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Ganes Focused Value Fund *ARSN 117 119 712*
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GANES CAPITAL MANAGEMENT LTD

GANES FOCUSED VALUE FUND – SEPTEMBER 2014

Unit Prices*

	30.09.14	30.06.14	30.06.13	30.06.12	30.06.11	30.06.10	30.06.09	30.06.08	30.06.07
Entry Price ($)	$2.5766	$2.5716	$2.4721	$2.0377	$2.0438	$1.8024	$1.5322	$1.8130	$2.6617
Unit Price ($)	**$2.5676**	**$2.5626**	**$2.4635**	**$2.0306**	**$2.0366**	**$1.7961**	**$1.5268**	**$1.8067**	**$2.6525**
Exit Price ($)	$2.5586	$2.5537	$2.4549	$2.0235	$2.0295	$1.7898	$1.5215	$1.8003	$2.6432
Distribution (cents per unit)		**4.0178**	**4.5014**	**4.8340**	**6.7378**	**5.8396**	**6.6702**	**11.6800**	**18.1078**

* Unit prices are quoted pre-distribution. The *total* distribution paid during the financial year is shown.

Past Performance*

	Ganes Focused Value Fund	ASX300 Accumulation Index	Margin
3 months	**0.9%**	**-0.6%**	**1.4%**
6 months	-1.3%	0.3%	-1.6%
1 Year	**2.4%**	**5.7%**	**-3.4%**
2 Years (p.a. compound)	10.7%	14.3%	-3.7%
3 Years (p.a. compound)	**12.5%**	**14.4%**	**-1.9%**
5 Years (p.a. compound)	10.3%	6.6%	3.7%
10 Years (p.a. compound)	**9.7%**	**8.2%**	**1.5%**
Inception (p.a. compound)	12.6%	9.3%	3.3%
Value of $10,000 invested at inception (14/10/2002)	**$41,063**	**$29,842**	

Portfolio Allocation

Top ten	43.9%
Other shares	18.2%
Cash	37.9%

Largest Five Holdings

Flight Centre (FLT)
Woolworths (WOW)
Treasury Group (TRG)
Austbrokers (AUB)
Spark Infrastructure (SKI)

* Fund performance is net of all fees and expenses, and assumes reinvestment of distributions. Investments can rise and fall in value. Past performance is not necessarily indicative of future performance. The fund currently invests substantially in smaller companies that may involve unique risks. The Product Disclosure Statement details the risks associated with an investment in the fund and is essential reading for investors.

The market recorded a small negative return (-0.6%) for the September quarter, marked by a company reporting season which didn't produce any nasty surprises but saw earnings growth driven more by margin improvement than revenue increases, and was followed by analysts trimming their earnings forecasts on a raft of companies. Dominating the market news during the quarter was the slide in the Australian dollar down around 6c to the US dollar. This is good news for our local exporters including companies in the portfolio with global operations (eg. Sonic Healthcare, Flight Centre, ARB Corporation), but bad news for Australian travelers and overseas investors who own Australian shares.

The Fund has out-performed the market by 1.4% over the quarter (up 0.9% vs down 0.6%). It is worth noting that the Fund has a solid track record of out-performing in down markets. Of the 50 down-market months since the Fund's inception the Fund has outperformed the market in 39 of those months, that is 78% of the time, at an average outperformance of 1.45% per month. Countering this however, the Fund has under-performed the market in up-markets 65% of the time, with an average under-performance of 0.42% per month. This out-performance in down markets and under-performance in up markets results in much lower price volatility in the Fund unit price than the market (the All Ordinaries Index in this case).

However, there is another point that should be made here, because beating the market by taking a lot more risk than is inherent in the market is not necessarily any great achievement. Over the past five years, for example, the annualised volatility of monthly Fund returns was 7.7% versus 12.1% for the Index. Over that five-year period the Fund has generated a total return of 3.7% per annum more than the Index. So investors have enjoyed higher returns and with less volatility. We believe this is a result of investing in high quality businesses with stable, predictable earnings along with our philosophy of holding cash when we can't find investment opportunities rather than "chasing" the market. While we don't know if this will continue into the future this is a characteristic of past returns that we are pleased to see.

Reporting Season Wrap

The majority of companies in the Fund reported either full year results or half-year results in the September quarter. The reporting season was very much a mixed bag. Notable on the plus side were companies that generate revenue from the equity markets; namely **Treasury Group**, **Platinum Asset Management**, **Fiducian Portfolio Services** and **Euroz,** with each delivering strong growth driven by improved market conditions. We will discuss Treasury Group in more detail below. Notable on the minus side of the performance ledger were **Cochlear** and **Coca Cola Amatil**, although these are smaller holdings in the portfolio and had less impact. Let's take a closer look at the Fund's largest 5 holdings which account for 30% of the portfolio:

Flight Centre is a significant business, as well as a significant holding in the portfolio. For the full year ended June, it produced $16bn of transactions, and from that generated $2.2bn in revenue and an underlying after tax profit of $264m. All these values represented record results for the business and all 10 countries in its portfolio were profitable. Australia remains the mainstay

Please turn over....

of the business, generating 56% of TTV and an even larger share of profits. It is evident that management is focused on continuously improving the value-add proposition for its customers, which indeed it must to thrive in a very competitive industry. Management has provided guidance of 5-8% profit growth for the coming year, disappointing some in the market, but we prefer management who under-promise and over-deliver. The company maintains a strong balance sheet with just $45m in debt and cash of $476m. Dividends rose 11% for the year to $1.52 per share.

Woolworths is one of Australia's largest listed companies, and as a result one where it is difficult to significantly move the dial in terms of revenue and earnings. Particularly challenging in the last year has been price deflation (3%) and the poorer than expected sales and losses within the Home Improvement (ie. Masters hardware) division. Despite these challenges, the business managed underlying sales and profit growth of around 6%. The Australian Food and Liquor division is the engine room of the business and while Coles is now a much more worthy competitor, Woolworths is still the stand-out operator in the supermarket and liquor business and holds a position which is difficult to assail. However, it is disappointing to observe the poor progress of the Master's hardware business, but a reminder of how difficult it can be to enter the territory of an entrenched, dominant player (ie. Bunnings). Masters aside, the company continues to invest profitably in new stores and refurbishments, with $2.2bn expected to be spent on capex in the current year. Management has provided guidance of profit growth to be in the range of 4-7% this year. Improvements in profit growth in future years are very much dependent on solving the problems at Masters and getting it to at least a break-even position.

Insurance broking group, **Austbrokers**, produced a solid result for the year with adjusted profit up 10.5%. Austbrokers provides a range of support services to insurance broking businesses where the group holds an equity interest in these businesses but importantly the individuals who run the business day to day retain a significant equity interest. The insurance broking network comprises 48 brokerages with around 320,000 clients and $2bn in gross written premium. The company was listed in November 2005 at $2.00 and has experienced consistent growth in revenues, profits and dividends since then and now trades around $10. The fund made its first purchase around the GFC market low in March 2009 at $3.61 and has an average purchase price of $4.99.

Fund manager, **Treasury Group**, has benefited from an improvement in equity markets during the past year which saw funds under management (FUM) grow 48.5% to $25.4bn including the acquisition of ROC partners ($5.3bn), and 17.6% excluding that acquisition. A return to favour by retail fund manager Investors Mutual (IML) saw an improved revenue mix (retail vs institutional) and an 18.4% lift in boutique management fees. Welcome cost control at the boutiques and at head office produced a 40% lift in pre-tax profit. The full year franked dividend was up 25%. Subsequent to the end of the financial year, the company announced a merger with Northern Lights Capital, a privately owned US based asset management business with $24.2bn in FUM across 13 boutiques. Management has highlighted the earnings accretive nature of the acquisition along with several other merger benefits. However, major corporate transactions like this are high risk and will need to be very well managed if shareholders are going to see the espoused benefits.

Spark Infrastructure has a 49% interest in two electricity distribution networks in Victoria and South Australia. These networks are monopolies, and as such, must adhere to the decisions of the Australian Energy Regulator in setting the prices that it charges its customers. These prices are derived from a formula which effectively allows for an appropriate level of return on the assets employed. Central to this calculation is the weighted average cost of capital (WACC) which has been set at 9.49%-9.76% for the current regulatory period. We think this is an attractive return given the stable cashflows that the business generates. For the first half which ended June, Spark reported only a slight increase in revenue and profit impacted by reduced residential demand for electricity. For the full year, the company has provided guidance of 4.5% growth in the distribution and 3-5% for next year.

Two Retailers Added to the Portfolio

During the quarter we initiated 2 new positions in retail stocks. The first is somewhat illiquid and we will hold back on divulging its identity until we have established our position. The second is in electronics retailer **Dick Smith Holdings** which was listed on the ASX late last year after being sold by Woolworths to private equity in 2012 pocketing just $20m cash in the initial payment. To the credit of the private equity owners and management, and to the discredit of its previous owners (Woolworths), the business has been returned to robust health in not much more than one year.

Dick Smith owns and operates a chain of 379 stores across Australia and New Zealand and the company is expecting to open a further 20 stores in FY15 and has a 3 year target of 450 stores. Like for like growth is difficult given industry competition and price deflation so growth is expected mainly through store roll-out at around 5-6% of existing store count. The company is currently debt free. We think the stock is attractively priced at current levels.

The market has certainly turned bearish in the last several weeks, and we are hoping that this will throw up more opportunities amongst the existing portfolio and within our watch-list, as there is ample cash in the Fund to take advantage of these.