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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 2016

Unit Prices*

	30.09.16	30.06.16	30.06.15	30.06.14	30.06.13	30.06.12	30.06.11	30.06.10	30.06.09
Entry Price ($)	$2.8424	$2.6379	$2.5890	$2.5716	$2.4721	$2.0377	$2.0438	$1.8024	$1.5322
Unit Price ($)	**$2.8325**	**$2.6287**	**$2.5800**	**$2.5626**	**$2.4635**	**$2.0306**	**$2.0366**	**$1.7961**	**$1.5268**
Exit Price ($)	$2.8226	$2.6195	$2.5709	$2.5537	$2.4549	$2.0235	$2.0295	$1.7898	$1.5215
Distribution (cents per unit)	**-**	**8.8129**	**8.0993**	**4.0178**	**4.5014**	**4.8340**	**6.7378**	**5.8396**	**6.6702**

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

Past Performance*

	Ganes Focused Value Fund	ASX300 Accumulation Index	Margin
3 months	10.4%	5.2%	+5.2%
6 months	12.8%	9.4%	+3.4%
1 Year	15.7%	13.5%	+2.2%
2 Years (p.a. compound)	8.5%	6.2%	+2.3%
3 Years (p.a. compound)	6.4%	6.0%	+0.4%
5 Years (p.a. compound)	10.9%	11.0%	-0.1%
7 Years (p.a. compound)	9.8%	6.5%	+3.3%
10 Years (p.a. compound)	6.7%	5.0%	+1.7%
Inception (p.a. compound)	11.9%	8.9%	+3.0%
Value of $10,000 invested at inception (14/10/2002)	**$48,339**	**$33,646**	

Largest Ten Holdings

Reece Australia (REH)
Smartgroup (SIQ)
Clydesdale Bank (CYB)
Beacon Lighting (BLX)
ARB Corporation (ARB)
Nick Scali (NCK)
Trade Me Group (TME)
Flight Centre (FLT)
PWR Holdings (PWH)
PM Capital Global Opportunities (PGF)

Portfolio Allocation

Top ten	53.7%
Other shares (17)	43.7%
Cash	2.6%

* 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.

Portfolio Performance

After the volatility of the June quarter following the Brexit fallout, the September quarter has provided a reasonably sanguine experience for local investors with the local currency remaining strong, commodity prices rising in some sectors and interest rates remaining low. As always, though, we encourage investors to adopt a longer term timeframe than this when considering their investment returns and strategies, especially as much of the recent market performance has come from strong returns in the resources sector, which is both volatile and mostly unpredictable.

We are pleased that despite our lack of exposure to this recent resurgence of resources, the Fund has reported a one year return of 15.7%, outperforming the ASX300 by 2.2% over the past year. However, as we are prone to often repeating; short term results are as much as about good luck as good management. To illustrate this point, our second largest holding Smartgroup has more than quadrupled since our purchase less than 18 months ago. While we believed at the time we were buying this business at a very attractive price our expectations for such an outsized return over the short term were not predicted by us, or anyone else that we are aware of.

Since inception nearly 14 years ago the Fund return of 11.9% per annum has materially outperformed the market (ASX300) return of 8.9% per annum, converting an initial $10,000 investment into $48,339 compared to $33,646 for a hypothetical investment in the market. It is important to note that the Fund returns are net of all fees and transaction costs, whereas the market returns are based on a hypothetical portfolio and does not bear any fees or transaction costs.

Confusing portfolio activity and productivity

Turnover in the Fund has always been very low by industry standards. Indeed some months we may not even buy or sell any shares. By contrast, industry statistics indicates that the average manager fails to hold most of their investments for even 12 months. Some investors may be tempted to believe that these managers are doing a better job, or at least are more erstwhile in their endeavours, but we believe in this industry investors shouldn't confuse the busyness of trading activity for being productive.

We like to take a long term perspective, indeed some of our investments like ARB Corporation have been held for more than a decade and delivered a return of 23% per annum for shareholders during that time, despite the GFC. In this case, allowing the outstanding performance of the business to deliver results to shareholders as patient shareholders has proven the best strategy. Hence our thoughts are that if an investment manager can't find a business that they are happy to own for at least a few years (especially as their financial models probably make predictions for 10 years, and sometimes 20 years) then the person most likely benefitting in that relationship is the broker, rather than the investor.

Reading constitutes a large portion of our time, along with critical thinking and talking with others about companies and prospective investments. We endeavour to not confuse the activity of buying and selling with being productive. This 'slow' style investing is well suited to our temperament and investment of goal of finding of good quality businesses that can grow over time and reinvest capital at attractive rates of return. The best thing we can do in these circumstances as investment managers is remain patient shareholders and benefit from the growth of the business and in the process save unitholders the transaction costs and the taxes.

<u>Reporting Season Wrap</u>

It is pleasing to again report that the portfolio had a good reporting season with many companies continuing to grow both their top-line sales and profits, and this has been reflected in the strong relative performance of the Fund return over the last quarter. Three of the largest holdings in the portfolio are Reece, Smartgroup and ARB Corporation.

Reece delivered a strong result with revenue up 9% and profits up 23% following the acquisition of Actrol in 2014, and the opening of another six stores this year. Management usually give little away in their comments but after a few flat years, early signs are that Actrol provides a platform for future growth, though management have indicated they expect construction activity to be down in 2017 on the current year. Reece has been held by the Fund for nearly 14 years and remains a core holding for the Fund.

Smartgroup delivered another strong result for the latest half-year which has underwritten the share price performance in recent months. Revenue was up 36% to $61m and NPAT up 45% on the prior year to $18m. The business remains incredibly profitable with an EBIT profit margin of 41% and this could improve further as economies of scale from recent acquisitions are bedded down. With such strong profit growth the company also announced a 24% increase in the dividend over the prior year.

The company expects to report a full year profit of between $41m and $43m for the full year, or 38c per share, placing the company on 16.5 times full-year earnings, and with the prospects of growth of more than 20% per annum for next year or two the price still remains reasonable despite the strong rise over the past year. In fact, a director with an already significant shareholding has been a buyer of the shares on multiple occasions over the past few weeks, another positive for sign for shareholders.

ARB Corporation produced yet another record result with net profit after tax up 7.6% to $47.4m. Sales increased by 8.2% to $356.9m with exports up 12.6% continuing the trend of the past decade which follows the deliberate strategy in recent years of increasing its distribution capacity in overseas markets, notably the Middle East and northern Europe. Export sales now make up almost a quarter of company sales.

After many years of double-digit growth, and excellent returns for investors, this year's results have been impacted by an unusually high number of new vehicle releases which made it impractical to supply a full range of accessories in a timely manner, as well as constraints on after-market fitting capacity limits. This was flagged in the half-year result in May and management have stated they are addressing the issue. Given their track record and their significant ownership stake in the business we are prepared to accept this.

The total return of 34% for investors over the last year was well ahead of profit growth and the stock looks expensive on any metric, but profit growth from its investments in distribution and manufacturing capacity over the next 2-3 years should see the underlying business catch-up with the share price.

We have held ARB in the portfolio for more than a decade, during which time it has delivered a return of 23% per annum to shareholders, and continue to see it as a core holding into the future.

<u>Current Activity and Outlook</u>

With the Fund fully invested across a wide variety of industries, and the companies within the portfolio generally performing quite well, we remain confident about the future prospects for the portfolio over the medium to long term.