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

GANES FOCUSED VALUE FUND – DECEMBER 2016

Unit Prices*

	31.12.16	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 ($)	**$2.8148**	$2.6379	$2.5890	$2.5716	$2.4721	$2.0377	$2.0438	$1.8024	$1.5322
Unit Price ($)	**$2.8050**	**$2.6287**	**$2.5800**	**$2.5626**	**$2.4635**	**$2.0306**	**$2.0366**	**$1.7961**	**$1.5268**
Exit Price ($)	**$2.7952**	$2.6195	$2.5709	$2.5537	$2.4549	$2.0235	$2.0295	$1.7898	$1.5215
Distribution (cents per unit)	**2.1121**	**8.8129**	**8.0993**	**4.0178**	**4.5014**	**4.8340**	**6.7378**	**5.8396**	**6.6702**

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

Past Performance*

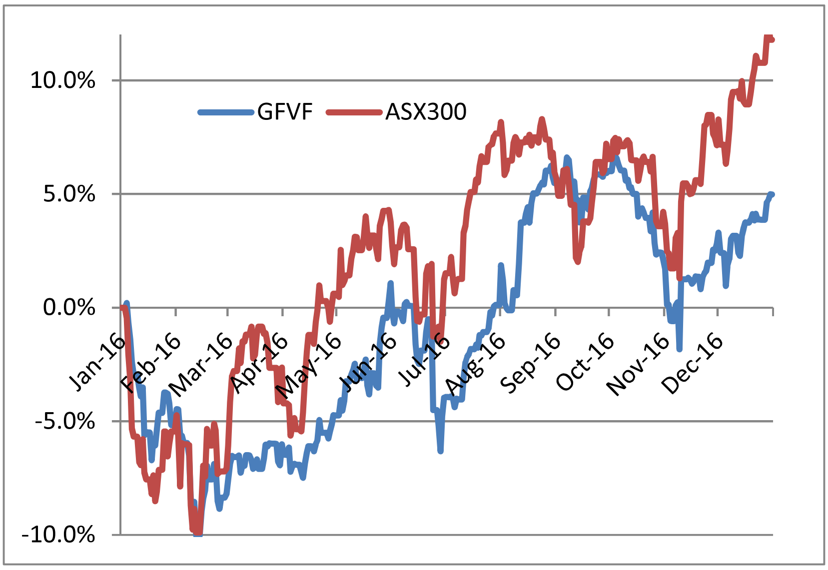
	Ganes Focused Value Fund	ASX300 Accumulation Index	Margin
3 months	-0.97%	4.9%	-5.9%
6 months	9.31%	10.4%	-1.1%
1 Year	4.98%	11.8%	-6.8%
2 Years (p.a. compound)	7.48%	7.2%	+0.3%
3 Years (p.a. compound)	5.59%	6.6%	-1.0%
5 Years (p.a. compound)	10.52%	11.6%	-1.1%
7 Years (p.a. compound)	8.75%	6.7%	+2.1%
10 Years (p.a. compound)	5.02%	4.4%	+0.6%
14 Years (p.a. compound)	11.9%	9.2%	+2.7%
Inception	11.6%	9.1%	+2.5%
Value of $10,000 invested at inception (14/10/2002)	**$47,869**	**$35,305**	

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

Portfolio Allocation

Top ten	53.4%
Other shares	39.5%
Cash	7.1%

* 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.



As the chart to the right shows, 2016 has been a roller-coaster ride for the Fund and the broader market. The big slump in January and February, driven by worries for global growth on the back of slumping commodity prices, was largely forgotten by May. Then came Brexit in June with the Fund suffering collateral damage through several UK exposures including **Clydesdale Bank**, **GBST** and **Flight Centre**. The Fund then enjoyed a good reporting season in August out-performing the market by 6.9% for the month. The big surprise for the last quarter of the year was the election of Donald Trump and the subsequent market reaction. The expert consensus expectation was a Clinton win, and in the unlikely event of a Trump win for the market to fall sharply. Well, the experts were wrong on both counts and the large cap stocks lead by financials have pushed the broader market higher over the last quarter. Smaller companies, to which the Fund has a significant exposure were left behind in this rally as illustrated by the fall of 2.5% in Small Ordinaries Index over the final three months of the year against a rise of 7.9% in the largest 20 companies.

The end product of the full year then is a gain of 5% for the Fund against 11.8% for the S&P/ASX300 index. A glance at the top ten holdings of the Fund reveals a portfolio quite different from the underlying Index, with Flight Centre the only top ten Fund holding also in the S&P/ASX100 Index. Therefore, it is not surprising that fund performance will be quite different from the index in any given period, exemplified by the 6.8% under-performance this year following the 7.2% out-performance last year (see table on next page). It is also important to note that the Fund performance numbers are after all fees and transactions costs, whereas the index bears no such burden as it is a hypothetical portfolio with no costs.

Portfolio review

Currently, the largest ten holdings in the Fund account for 53.4% of the portfolio, which is at the higher end of the historical range. Naturally, these tend to represent our best current ideas. However, we also tend to incubate other attractive prospects outside the top ten and let them grow into larger positions through additional purchases as their management teams prove themselves and, hopefully, as the share price increases through business performance. Let's have a look through these top ten holdings.

CY	GFVF	ASX300
2003	34.6%	15.0%
2004	31.6%	27.9%
2005	7.6%	22.5%
2006	55.8%	24.5%
2007	9.7%	16.2%
2008	-41.6%	-38.9%
2009	41.5%	37.6%
2010	15.2%	1.9%
2011	-5.3%	-11.0%
2012	20.3%	19.7%
2013	16.4%	19.7%
2014	1.9%	5.3%
2015	10.0%	2.8%
2016	5.0%	11.8%

Reece is one of the original holdings of the Fund, added first in October 2002 at $6.18 per share. A year ago the share price was $34.19 and it has finished 2016 at $44.85, a rise of 31% for the year. The improvement in price and some additional purchases of the stock in the early part of the year combined to push Reece to being the largest holding in the portfolio. Largely unknown as a listed company, Reece has been listed for more than 60 years and our analysis finds it is one of only a handful of companies to have increased the value of $1 invested to more than $1,000 since 1980. The company operates bathroom fitting and plumbing supply outlets across Australia and New Zealand, and in 2014 added Actrol, Australia's largest wholesaler of refrigeration and air conditioning parts. After several years of low growth, a pickup in building activity and the acquisition of Actrol saw revenue up 9.2% to $2.28 billion and pre-tax profit up 23.2% to $281m in FY2016. Reece has one of the most outstanding track records as capital allocators. This means that over a long period of time, capital deployed by management to grow the business has generated significant incremental profits and returns. We also like the long-term involvement of the Wilson family as managers, directors, and major shareholders.

Clydesdale Bank was added to the portfolio early in 2016 following its spin-off from the NAB. We outlined our thesis for the stock in the March 2016 fund update, so won't repeat that here but the thesis remains. We purchased the current position at an average of $3.92 in February and March, and a little bit more in July following the Brexit rout. The share price finished the year at $4.82, but has been held back by the sharp appreciation of the Australian dollar to around 60 British pence currently from around 52 pence in March.

It has been a more difficult year for the Fund's holding in **Beacon Lighting**. Starting the year at $2.09 the share price fell sharply in May to around $1.20 when the company released a trading update with a forecast for sales and profit well below market expectations. The company cited a range of drivers for this outcome and was a reminder to all investors in retail enterprises, that it is a very competitive industry with limited visibility around futures sales activity. However, we were also aware that it was always going to be tough for management to produce strong growth in 2016 following a very strong 2015 when sales grew 19% and pre-tax profit grew 38.6%. Given this, and our confidence in management, we added to our position in May at $1.26 and by year end the share price had recovered to $1.56.

Another retailer in the portfolio, **Nick Scali,** was a stand-out performer in 2016 generating a return of 50%. In August, the company reported sales up 30% for FY16 with like for like growth of 11.1% and after tax profit up 53%. We like businesses where management have significant shareholdings in their companies, and Managing Director Anthony Scali now has a 27.3% stake in the company. In late November, the company announced profit for the first half of FY17 is expected to be 30%-35% above the first half of FY16, which will be a remarkable achievement.

While salary packaging company **SmartGroup** had a strong 2016 with a total return of 26%, it was one of the main contributors to the weak final quarter for the Fund, down 12.7% over that period. The underlying business reported a strong first half result in August with revenue up 36% and profit up 45%, with much of this growth coming from its recent acquisitions. The business remains highly profitable with an EBIT profit margin of 41% and this could improve further as economies of scale from recent acquisitions are bedded down.

PM Capital Global Opportunities Fund is an ASX listed investment company currently with a heavy exposure to US and European banks and financials. The Sydney based manager, led by Paul Moore has a good long term track record in taking positions in out of favour industries and profiting from their eventual recovery. We are attracted to the international exposure that this investment provides, and the opportunity to purchase at a significant discount to net asset backing. However, banks, financials and Euro or Pound denominated assets have been a tough place to be in 2016, and so the pre-tax NTA finished 2016 virtually unchanged at $1.147 and the share price finished 2016 at 98c, 3c lower than a year prior, although there was 3c paid in dividends during the year.

ARB has been in the portfolio since the early days of the Fund, being added first in March 2003 at $2.07 per share. We talked in detail about the merits of this company in the update a year ago, and we are clearly admirers of the management of this business. Over time, many other investors too have become admirers of ARB and the consequent rising share price and associated valuation metrics challenged our comfort around value for several years. Consequently, we did sell a sizable portion of our holding a few years ago below current levels although it should be said some of these sales were motivated by reducing the large exposure that the Fund had to ARB at the time. In our experience, the sell decision is one of the most challenging tasks for an investor, and our philosophy now is to generally let stocks that have experienced a strong rise in the share price remain in the portfolio, even if we find the current valuation a little challenging. As we have seen with ARB, quality businesses, given time, are able to grow into their elevated share price. ARB generated a total return of 11.3% for the year.

New Zealand based software company, **Gentrack**, started the year at $2.33 and finished at $3.43 and we doubled the holding in the Fund in early 2016, so the combination of purchases and share price rise catapulted the stock into the top ten holdings. Gentrack develops software for electricity, gas and water utilities as well as airports with its customer base mainly in NZ, Australia and the UK. This software is mission critical for Gentrack customer so is not easily replaced with a competitor product. The business boasts high profit margins, is debt free and produced revenue growth of 25% and pre-tax profit growth of 18% for the most recent full year.

Another New Zealand company moving into the top ten is **Trade Me Group**. This company is essentially the Realestate.com.au, carsales.com.au, Seek and Ebay of New Zealand. These are prime internet assets to own but fat margins attract strong competition, and the company has been forced to aggressively invest in the business in the last few years to protect its turf, which has flat-lined profits even though revenue has continued to grow. Management has indicated this period of high investment has now finished and so the expectation is for several years of profit growth ahead. The Trade Me share price started the year at $3.92 and finished at $4.85 for a 28.4% total return with some contribution from a slightly weaker Australian dollar.

Rounding out the top ten is the Fund's long-standing investment in **Flight Centre**. We first purchased the stock in early 2005 around $16 and held it through the depths of the GFC when the price went under $3.50 briefly. For many years now, there have been a number of vocal critics of the bricks and mortar retail travel business model that is at the core of this company, as online travel services continue to grow. Despite that, the value of travel products and services that the company sells has continued to grow, benefiting from the relentless fall in the cost of travel and the extra demand that this stimulates. However, there is growing evidence of the business's margins succumbing to competitive pressure and much of that competition is online. We significantly reduced the weighting of the stock in the portfolio in 2015 and while we admire what Graham Turner has achieved building this business, we think the time has come to further reduce this position, and look for more attractive opportunities elsewhere. The share price slid from $39.89 at the start of the year to $31.30 at the end resulting in a negative return of -17.7% for the year.

In the update a year ago we reflected on what worked in the portfolio, what didn't work, and what lessons were learned. The top ten company reviews above highlight a lot of what worked, that is, being invested in dynamic smaller companies that sell products and services that their customers want and value, and that have motivated, invested, capable managers. These are the sort of companies that we like and continue to search for – though, as Flight Centre demonstrates, the underlying economics of a business can change and investors need to remain vigilant to identify this.

In a reversal of what worked last year, the exposure to overseas businesses through three listed investment companies hurt Fund performance this year. We have already noted PM Capital Global Opportunities which flat-lined for the year. Other LICs in the top ten at the start of the year were **Templeton Global Growth** and **Magellan Flagship Fund**. Templeton managed a 3.3% total return for the year but Magellan lost 7.6% as the share price lost some of its premium to net tangible assets.

While only a small overall loss was realised on the Fund's terminated investment in **Isentia**, it made a significant negative contribution to the 2016 Fund performance. The position in Isentia was sold when we lost confidence in management following a trading update where the company announced that the King Content business purchased for $46.8m just over a year prior would make a shock loss in the first half.

We continue to hold a positive view on the prospects for the businesses we own in the portfolio, and look forward to reporting back to you on their progress. We thank you for your continued support and would like to wish you a prosperous 2017.

A 2.11 cent per unit distribution has been paid for the first half of the year.