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GANES CAPITAL MANAGEMENT LTD

GANES FOCUSED VALUE FUND – SEPTEMBER 2017

Unit Prices*

	30.09.17	30.06.17	30.06.16	30.06.15	30.06.14	30.06.13	30.06.12	30.06.11	30.06.10
Entry Price ($)	$2.9658	$2.8741	$2.6379	$2.5890	$2.5716	$2.4721	$2.0377	$2.0438	$1.8024
Unit Price ($)	**$2.9554**	**$2.8641**	**$2.6287**	**$2.5800**	**$2.5626**	**$2.4635**	**$2.0306**	**$2.0366**	**$1.7961**
Exit Price ($)	$2.9451	$2.8541	$2.6195	$2.5709	$2.5537	$2.4549	$2.0235	$2.0295	$1.7898
Distribution (cents per unit)	**-**	**6.3040**	**8.8129**	**8.0993**	**4.0178**	**4.5014**	**4.8340**	**6.7378**	**5.8396**

* 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	4.7%	0.8%	3.9%
6 months	8.3%	-0.8%	9.0%
1 Year	6.7%	9.0%	-2.3%
2 Years (p.a. compound)	11.1%	11.2%	-0.1%
3 Years (p.a. compound)	7.9%	7.1%	0.8%
5 Years (p.a. compound)	9.0%	9.9%	-0.9%
7 Years (p.a. compound)	8.4%	7.7%	0.7%
10 Years (p.a. compound)	4.7%	2.9%	1.8%
Inception (p.a. compound)	11.6%	8.9%	2.7%
Value of $10,000 invested at inception (14/10/2002)	$51,574	$36,679	

Largest Ten Holdings

Reece Australia (REH)
Smartgroup (SIQ)
Clydesdale Bank (CYB)
Gentrack (GTK)
PWR Holdings (PWH)
Nick Scali (NCK)
Beacon Lighting (BLX)
MFF Capital Fund (MFF)
PM Capital Global Opportunities (PGF)
ARB Corporation (ARB)

Portfolio Allocation

Top ten	58.5%
Other shares	38.6%
Cash	2.9%

* 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.

15 Year Anniversary for the Fund

When we began the Fund in October 2002 with $100,000 of our own money we were (and remain) fans of the Buffett style of investing – buy quality, buy at a reasonable price and hold for as long as possible. With that approach we believed we could succeed in producing good returns for ourselves and other investors. It appears that we were fortunate to begin the Fund when we did, as we and the market enjoyed a good tailwind for the first few years through to 2007. The market recorded 20%+ returns in Financial Years 2004 to 2007 and, with the exception of 2005, we handily beat those lofty numbers. In the 2007 financial year the Fund was up 45% after all fees and costs against the fee-free ASX300 return of 29.2%.

In hindsight it was all a bit too easy and we along with many other investors, professional and otherwise, were about to find out that the business of investing in public markets is much more difficult that it may first look. The Global Financial Crisis (GFC) that began on Wall Street with its sub-prime origins spread throughout international financial markets. The 2008 financial year saw the ASX300 down 13.7% while the Fund fell 27.6%, and the pain continued into 2009 when the market fell 20.3% and the Fund was down a further 14.1%.

However, the US sub-prime crisis was really more a catalyst than a cause for the grief in the Australian market. The reality was that by the middle of 2007 the local market was very expensive. This was painfully obvious, when viewed through the prism of the market median price-to-book ratio. This is a ratio which much of the time tends to hover between 1 and 2 times but had worked itself up to above 3 times shortly before the market crashed, in other words the market was between 50% and 100% higher by this value than in most years. There is an argument that with the trend towards technology and service businesses this ratio may have cause to be higher than in the past but to our minds it remains a good reality check on the current market and hence we now review it on a regular basis.

One of the hazards of running a concentrated portfolio of higher quality businesses, with a desire to hold for the long-term, is that this desire can involve maintaining some investments even when the shares rise above the inherent value of the underlying business. This was certainly an issue in mid 2007 after a 45% return year. Equally holding good quality businesses with strong Balance Sheets meant that despite underperforming the market through the GFC we subsequently recovered quicker with a 24.5% return in 2010 against 13.1% for the benchmark, and again in 2011 with 17.8% return versus 11.9% for the market. Our large holding in Flight Centre was a major reason for outperforming during this period.

Following this strong period, as share prices rose within the portfolio, we sold down and raised our cash levels to unprecedented levels which led to a period of underperformance that you now see in our current 5 year returns. We like to think that we learned a great deal about markets and investor behavior (including our own) over the last 15 years and are better placed to deal with a range of market conditions in the future. We now tend to remain far more highly invested than previously as holding high levels of cash has hurt our investment returns over the long term.

Our investment approach remains the same even after 15 years. A desire to own great businesses, benefitting from the superior long-term returns that these businesses run by owner-managers with the opportunity to reinvest capital at above average rates of return, can deliver.

It is pleasing to note, as we write this update in early October, that the unit price has risen above $3.00 for the first time. With distributions reinvested, an initial $10,000 invested 15 years ago is now worth $51,574 (at the end of September), and that is after all fees and costs. The same $10,000 invested in the ASX300 is worth $36,679 and this would be even smaller if fees had to be paid. A 2.7% per annum outperformance has led to an investment worth 40% more, highlighting that even small outperformance can lead to materially higher outcomes given a long-term timeframe.

Finally, on the subject of fees, as of July 1, 2017 we have decided that Ganes will absorb the administration costs of the Fund and will not seek to be reimbursed for these. These costs previously ran at 0.27% per annum.

Reporting Season Wrap

The out-performance of the Fund in August (+1.6% vs the market +0.7%) and September (+2.8% vs the market 0.0%) reflects the generally positive news flow during reporting season for portfolio holdings.

Amongst the Funds largest positions, **Reece** produced a solid result with revenue up 6.7%, pre-tax profit up 8.0% and continued investments in their branch network and technology. The Reece share price slipped from $44.97 to $42.87 over the last 12 months serving up some good current value for the portfolio. The **Smartgroup** share price rose from $7.19 to $9.22 over the last 12 months driven on by another strong half-year result with revenue up 57% to $95m and earnings per share up 42%. No guidance was provided by management but there appears to be no reason why the company won't continue to perform well. **Clydesdale Bank** reported its third quarter trading update at the start of August with results in line with expectations. A large part of the Clydesdale turnaround strategy is improved efficiency and lower costs, so it was pleasing to see that operating expenses are now expected to be below GBP680 million and ahead of prior guidance of GBP690-700 million. The market has welcomed the trading update and the share price finished September at $5.14 up from $4.39 a year ago. Software provider **Gentrack** will not report until later in the year due to its September year-end, but has provided an update to the market with underlying profit (EBITDA) for the full year now expected to be NZ$24m up from prior guidance of $20m. The Gentrack share price has increased from $3.08 to $4.80 over the last year. Rounding out the top five holdings is **PWR Holdings** which has seen its share price slump from $3.13 to $2.42 since last September. Despite the share price fall, we believe the growth story is still intact and have increased the Fund's position following the result and meeting with management. While reported revenue was up just 1.6% and profit fell 13.8% over the prior year, these numbers were significantly impacted by a weak British currency being the currency that much of its Formula 1 income is contracted in. The business earns high profit margins, high return on equity and good opportunities ahead for reinvestment.

Current Activity

The Fund continues to be effectively fully invested with 97.1% of capital deployed across 30 companies of varying sizes. One of these 30 companies is **Domino's Pizza** which we have owned previously. We have taken a small initial position, following a large share price fall accompanying the full year results in August which did not meet previous company guidance. However, the reported results were still very impressive. The growth engine for the business over the next decade will be Europe following its recent addition of Germany, and we think Domino's experienced management team can deliver on the European store roll-out aspirations and lift profitability closer to that achieved in Australia.