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Ganes Focused Value Fund *ARSN 117 119 712*
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GANES FOCUSED VALUE FUND – MARCH 2018

Unit Prices*

	31.03.18	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 ($)	$3.2263	$2.8741	$2.6379	$2.5890	$2.5716	$2.4721	$2.0377	$2.0438	$1.8024
Unit Price ($)	**$3.2150**	**$2.8641**	**$2.6287**	**$2.5800**	**$2.5626**	**$2.4635**	**$2.0306**	**$2.0366**	**$1.7961**
Exit Price ($)	$3.2038	$2.8541	$2.6195	$2.5709	$2.5537	$2.4549	$2.0235	$2.0295	$1.7898
Distribution (cents per unit)	**2.8620**	**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	-0.4%	-3.8%	+3.4%
6 months	9.7%	3.7%	+6.0%
1 Year	18.8%	2.9%	+15.9%
2 Years (p.a. compound)	14.9%	11.2%	+3.7%
3 Years (p.a. compound)	9.0%	3.9%	+5.1%
5 Years (p.a. compound)	8.5%	7.6%	+0.9%
10 Years (p.a. compound)	7.8%	5.2%	+2.6%
15 Years (p.a. compound)	12.2%	9.3%	+2.9%
Inception (p.a. compound)	11.9%	8.8%	+3.1%
Value of $10,000 invested at inception (14/10/2002)	$56,593	$38,026	

Largest Ten Holdings

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

Portfolio Allocation

Top ten	62.0%
Other shares	36.1%
Cash	1.9%

* 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.

For the twelve months ending 31st March the Fund return was 18.8% versus 2.9% for the benchmark S&P/ASX 300 accumulation index, representing a relative outperformance of 15.9%. We reiterate that outperformance over such a short period has as much to do with market sentiment as the investment manager's skills. Smaller companies have been back in favour and the Fund is a beneficiary of this market sentiment.

Over our preferred time frame of 5 years the Fund return was 8.5% per annum versus 7.6% per annum for the S&P/ASX 300. Investors should recognise that Fund returns are net of all fees, while the Index does not incur any fees. Since inception in October 2002 the Fund has returned 11.9% per annum versus 8.8% per annum for the ASX300 Accumulation Index representing an outperformance of 3.1%. While the outperformance may appear small as a percentage number, it is surprising how much this adds to an investment with the benefit of compound interest over long periods of time. $10,000 invested in October 2002 is now worth $56,593 compared to $38,026 invested in the market index, 49% higher.

We should also state that while the S&P/ASX 300 is presented as the benchmark for the Fund, the portfolio bears no resemblance to the Index as we generally seek out smaller companies for the portfolio and avoid resource companies. If we were to compare Fund performance against the Small Ordinaries Index instead, it has beaten this index by 2.0% per annum over the past 5 years and 6.4% per annum over the past decade.

As has been noted above, the Fund has enjoyed strong performance in recent times outperforming the broader market by a considerable margin. The portfolio is very concentrated by market standards with the top 10 holdings now representing 62% of the Fund. This is more concentrated than usual by our standards and has come about largely through price appreciation as many of our largest holdings delivered strong price appreciation over the past year.

In general terms our best ideas tend to be our biggest positions and as such our outperformance, or underperformance at times, will depend largely on the returns of these few select stocks. Below we highlight five of the largest ten portfolio positions.

Smartgroup has been the largest contributor to recent Fund performance. The Fund invested in the salary packaging provider in April 2015 between $1.61 and $1.84 and we have been pleased to watch the outstanding progress of the company since then. The company has grown from revenues of $72m, profits of $17m and managing packages for 118,000 clients in 2014 to recently reporting revenue of $205m, profits of $64m and managing 325,000 packages for customers mostly in the not-for-profit sectors and hospitals.

The company earns attractive returns on its capital and Managing Director, Deven Billimoria, has been with the company 18 years and has significant “skin in the game”, owning over $25 million of shares in the business. These are features that we look for in a business and all too rarely find.

MFF Capital is a listed investment company that holds a portfolio of international investments and has provided a 15% return over the past decade, making it one of our better performers in the portfolio. The share price has risen 24% in the past year largely in line with the asset backing (NTA) which has risen 20% from $2.12 to $2.55 during the same period.

The portfolio continues to consist of large holdings in Visa, Mastercard and Home Depot which are wonderful businesses that have no equivalent in Australia. At present the shares are selling in line with NTA and MFF remains a core holding in the Fund.

ARB, a core holding in the Fund since inception, also contributed strongly to Fund performance with the shares up 37% over the past year. ARB is a wonderful business, and this is reflected in the 22% return per annum delivered over the past decade despite the GFC. However, the underlying business itself has not improved by 30% in the past year, and hence ARB is very typical of why the Fund can produce returns very different to the market over the short term but provide returns consistent with underlying business performance over the longer term.

ARB has consistently grown sales and profits at 10% to 15% and consequently the underlying business has improved at something akin to its growth, however in any given year its share price has moved something in the nature of 40% either up, and sometimes down. As long-term term investors who wish to benefit from the underlying improvements in the business we need to have the temperament and patience to ignore the short-term volatility inherent in stockmarkets. We have some visibility over future business performance, but we have yet to find anyone that can predict share prices on a successful basis.

Looking at the first half results released in February, sales were up 12% to $208m and pre-tax profits rose nearly 11% to $35.7million. The company opened another three new stores and three more stores are expected to be opened in the second half bringing the store network to 64 stores, of which 25 are company owned. The business has confirmed that 2018 has continued strongly and we continue to like the company’s prospects over the medium to longer term and the company remains a core holding in the portfolio.

The healthcare sector has enjoyed a stellar year and **Cochlear** has done likewise with the share price up 36% for the past year and similar to our other good quality companies has delivered 16% per annum for the past decade despite the dramas of a product recall in 2011. The company recently released its half year results and while the company continued to achieve good results in developed markets, lack of growth in emerging markets took the gloss off the headline numbers. Sales revenue was up 6%, Earnings Before Interest and Tax increased 3% while profits were flat. These headline numbers mask a great underlying business as the company expenses $160million each year on Research & Development developing its products and still earns attractive profit margins of 25% at the operational level.

The company has invested $50m in China to develop production facilities and expand on its 20-year presence in the country and also continues to develop its Services division which targets existing customers and now accounts for approximately 25% of its revenues. On our estimates the share price has increased far more than the underlying business over the past year and doesn’t represent compelling value, but we are loath to sell and incur significant capital gains and miss out on the future growth in the business for a short-term perspective.

New Zealand based **Gentrack** bills itself as ‘essential software for essential services’. This means it provides business critical software for airports and the water utilities industries. The Arrivals and Destinations boards at the airport are an example of their software that unitholders might see, although billing systems for water utilities makes up most of the company’s business providing more than 80% of its revenue and profits. The company sources 65% of its revenue from Australia and New Zealand with the balance coming from overseas (mostly the UK). Business critical software can provide extremely good economics and build strong pricing power as the cost of switching providers is extremely costly in time, effort and money for often not much benefit. Shareholders in Hansen Technologies have also benefited from this type of business, which is what alerted us to Gentrack in 2015. The share price has risen 80% in the past year making Gentrack another large contributor to Fund.

We have constructed a portfolio that we believe constitute a range of good quality businesses providing good returns on capital with attractive growth opportunities. With the recent strong run up in price for some companies the value is not as compelling as last year but we are content to take a long-term approach and reap the benefits of being a patient investor despite unpredictable price fluctuations over the short term.