Ganes Capital Management Ltd *ACN 102 319 675 AFSL 291 363*
Ganes Focused Value Fund *ARSN 117 119 712*
PO Box 3512 Newmarket Qld 4051
Phone: 1300 766 916 ● Fax 1300 766 917 ● admin@ganescapital.com.au ● www.ganescapital.com.au

GANES CAPITAL MANAGEMENT LTD

GANES FOCUSED VALUE FUND – SEPTEMBER 2018

Unit Prices*

	30.09.18	30.06.18	30.06.17	30.06.16	30.06.15	30.06.14	30.06.13	30.06.12	30.06.11
Entry Price ($)	$3.3209	$3.4596	$2.8741	$2.6379	$2.5890	$2.5716	$2.4721	$2.0377	$2.0438
Unit Price ($)	**$3.3093**	**$3.4476**	**$2.8641**	**$2.6287**	**$2.5800**	**$2.5626**	**$2.4635**	**$2.0306**	**$2.0366**
Exit Price ($)	$3.2978	$3.4355	$2.8541	$2.6195	$2.5709	$2.5537	$2.4549	$2.0235	$2.0295
Distribution (cents per unit)	**-**	**21.2855**	**6.3040**	**8.8129**	**8.0993**	**4.0178**	**4.5014**	**4.8340**	**6.7378**

* 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	1.4%	1.5%	-0.1%
6 months	8.7%	10.0%	-1.2%
1 Year	19.3%	14.0%	5.3%
2 Years (p.a. compound)	12.8%	11.5%	1.3%
3 Years (p.a. compound)	13.8%	12.2%	1.6%
5 Years (p.a. compound)	8.9%	8.2%	0.8%
7 Years (p.a. compound)	11.4%	11.2%	0.3%
10 Years (p.a. compound)	10.1%	7.7%	2.5%
Inception (p.a. compound)	12.0%	9.2%	2.8%
Value of $10,000 invested at inception (14/10/2002)	**$61,528**	**$41,826**	

Portfolio Allocation

Top ten	68.0%
Other shares	30.0%
Cash	2.0%

Largest Ten Holdings

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

* 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 Fund has continued to perform well, outperforming the market by 5.3% over the last year, but more importantly outperforming the market over much longer periods. An investment in the Fund of $10,000 at inception in 2002, and with distributions reinvested, is now worth $61,528 compared with $41,826 if invested in the S&P/ASX300. It is important to note that the index is a hypothetical portfolio and does not have to bear any of the fees and expenses that the Fund must bear.

After many months, and years, of good performance we tend to ignore the short-term price volatility present in the current market, where this is unaccompanied by any Fundamental change to the business. For example, despite the 10% fall for **Reece** in September it has still delivered a return of nearly 30% for the past year and 15% per annum for the past decade – almost double that of the general market. It is a similar story for **Smartgroup,** and hence we only report these movements to explain performance rather than act upon them.

In the current market there are many smaller companies that have reported stellar returns for shareholders including companies such as Afterpay, A2 milk and Appen. We have not owned any of these businesses and hence have missed out on these outsized returns, but as we have written previously, a lot of investment success is about not making mistakes rather than hitting big winners. In this instance we looked at each of the companies and felt that we did not understand the business and its prospects well enough to invest yours and our money in the company. We invest in businesses we think we understand, and we think will offer attractive returns in the future. This means that we will miss some of these opportunities but that does not worry us one bit, nor should it worry unitholders. Fear of missing out and investing in companies that are outside the investor's circle of competence increases risks significantly while not necessarily increasing the returns for investors.

We have written many times that we invest in good quality businesses and this has not changed one iota since we started. We have long advocated buying quality companies rather than any other path – that is not to say it's the most successful, but that it more closely matches our temperament as investors – and it has shown in our investment results, particularly over the longer term as the economics of the business becomes more important than short term share price movements.

We have found that good quality companies provide the least headaches to their shareholders, a more predictable future, and the ability to remain as long-term shareholders – as examples the Fund has owned shares in **Reece**, **ARB Corporation** and **MFF Capital** for more than a decade.

Quality businesses have generally created a competitive advantage in their market over many years and this competitive advantage is usually hard to destroy quickly, providing attractive returns for shareholders. However, companies with little or no competitive advantage and no pricing power tend to provide poor long-term results for shareholders and management become adept at providing a never-ending array of excuses as to why the current results are poor but next year's will be better. At various times these types of companies will become so cheap, or market conditions will temporarily change creating some short-term favourable trading conditions, that they offer attractive returns.

However, investors need to have both the temperament and the skill to recognise these turning points before they can expect to achieve good investment results. For many, however, they can also be what are known as 'value traps' where the business always looks cheap and eventually the poor underlying economics of the business come to the fore again and investors earn poor returns in tandem with the business. We have long recognised that this style of investing does not suit us and hence why the portfolio consists of what we believe are 'quality' companies. While they can sometimes appear expensive in the short-term we have usually found that the business value catches up to the share price and will often provide a favourable surprise along the way.

The August profit reporting season was generally good for the portfolio and below we highlight some salient points from the larger holdings in the Fund.

Smartgroup has enjoyed another good year and has been the strongest performer in the portfolio since its purchase in mid 2015 and is the second largest holding in the Fund. The company reported another strong half year result with revenue increasing by 26%, profits by a similar amount and the dividend increasing by 24%. The company continues to execute well on its acquisition and growth strategies and now manages more than 330,000 salary packages, doubling in the past few years.

MFF Capital Investments had a strong year with the pre-tax NTA for the company increasing by more than 30%, partly as a result of the weaker Australian dollar, and has increased a further 10% in the latest quarter as its exposure to the US market provides a strong tailwind. MFF is one of the best performers in the Fund with a 40% return over the past year and an 18% per annum return over the past decade, well ahead of local markets. Its portfolio remains largely unchanged with large positions in Visa, Mastercard and Home Depot.

ARB Corporation reported a solid year with revenue climbing 11% to $426m and pre-tax profits up a similar amount. Dividends increased by 9%. Pleasingly, export sales were up 15% and comprise 28% of total revenue. This is a key component for the growth of the business in markets such as the USA and the United Arab Emirates where 4WD vehicles are becoming increasingly popular. Growth for the company has slowed since the heady days of the mining boom but nevertheless it still is reporting record results as it continues to expand. The share price has pulled back slightly from its record highs but remains a core holding in the Fund.

PWR Holdings also reported a solid result for 2018 with revenues rising 8% to $52m and net profit up 30% to $12m. Perhaps more importantly for the business, their major competitor has announced it is withdrawing from the F1 business which should provide big opportunities for the company in FY19 and beyond. Led by founder Kees Weel, the main part of the business remains cooling systems for autosports, with an emphasis on Formula 1. However, in the future other areas such as niche contracts for car manufacturers and emerging technologies such as cooling systems for electric cars will also add to the bottom line for shareholders. We like the business, management is strong and growth prospects are good. The share price has risen strongly in recent months and has contributed to Fund performance due to its high portfolio weighting.

We remain optimistic about the future prospects of the portfolio of businesses held by the Fund and this continues to be reflected in the fully invested position of the Fund. However the recent strong performance has outpaced the underlying performance of many of the businesses so future short-term returns could be muted without specific news to support the higher share prices. The portfolio comprises a mixture of companies with motivated and innovative managers, good revenue and profit growth potential, as well as strong balance sheets and healthy cash flow.