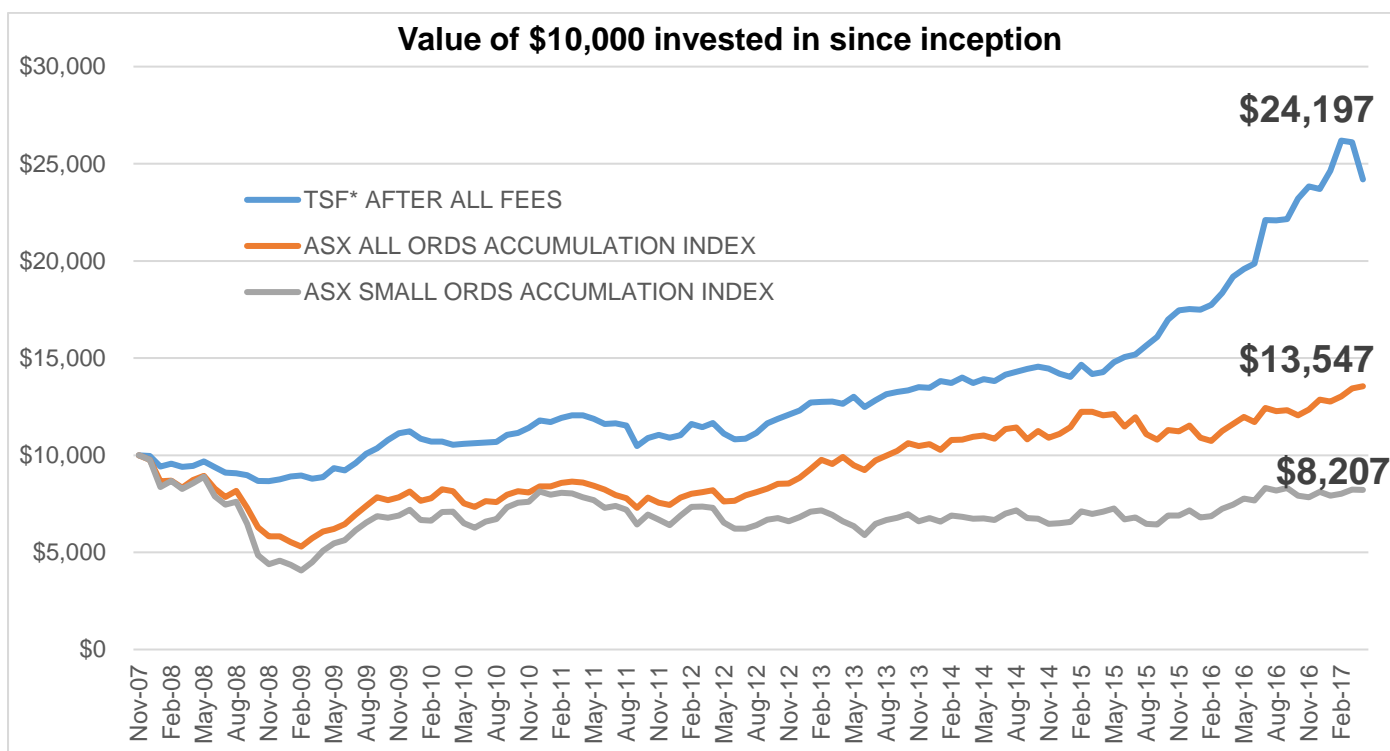


# The Supervised Fund (TSF)

## Monthly Report – April 2017



PERFORMANCE ANALYSIS	TSF AFTER FEES	ALL ORDS ACCUM	BENCHMARK
Month ending 30 April 2017	-7.3%	0.8%	0.4%
6 months	4.3%	12.4%	2.5%
12 months	26.2%	16.6%	5.0%
3 years p.a	20.8%	7.4%	5.0%
Since Inception p.a (Dec 2007)	9.8%	2.6%	5.0%



\*Please note TSF returns assume reinvestment of all distributions (as do the indices).

### Portfolio at 30 April 2017

Top 15 Positions	% of NAV
Kangaroo Island Plantation Timbers Ltd	25%
Cash	14%
HGL Limited	10%
Hillgrove Resources (equity, bonds and calls)	7%
Gale Pacific Limited	6%
Po Valley Energy Limited	4%
Base Resources Limited	4%
ETFS Physical Gold	4%
Nine Entertainment Co Limited	4%
Sirtex Medical Limited	4%
Bell Financial Group Limited	3%
NZME Limited	2%
Ariadne Australia Limited	2%
Ramelius Resources Limited	1%
APN News and Media Limited	1%

- 0.5% of capital is invested in (put) options over stock market indices.
- 2% of capital is invested in non-ASX listed investments (excluding cash).
- 8% of capital is invested in ASX200 members.
- 18% of capital is invested in oil, gas and resources companies (excluding gold).
- 7% of capital is invested in physical gold and gold mining companies.
- 68% of capital is invested in companies with a market capitalisation of less than \$150m.

## Commentary

April 2017 was the fund's second worst month since inception in December 2007. The majority of the decline was owing to a 21% fall in our largest holding Kangaroo Island Plantation Timbers Limited (**KPT**). The reason for this fall was the company conducted a major share issue, raising more than half of its market cap at \$2.00 per share (a 21% discount to the then market) to complete the acquisition of the largest timberland estate on Kangaroo Island (**KI**). We did not participate in this issue due to the size of our existing position.

While we share your disappointment with the price fall and corresponding fall in the fund's NAV<sup>1</sup>, we believe the capital raising and completion of the acquisition is a huge step forward and materially de-risks our investment in KPT. KPT has come a long way since an emergency recapitalisation issue in 2013 and over the past 12 months the company has:

- Consolidated the timberland ownership on KPT on commercially attractive terms.
- Sourced more than \$45m of new equity capital and up to \$57m of bank debt such that it is **now fully funded** for the foreseeable future.
- Announced its international deep water wharf proposal will be assessed as Major Project by the South Australian Government and conducted appropriate environmental, economic and social feasibility studies required to facilitate approval of such.
- Sourced an off-take partner and route to market for the standing timber on KI.
- Generated total shareholder return of more than 45%.

The completion is transformative for KPT and we believe the shares are undervalued. Today the company has a market cap of \$85m, an 'all in'<sup>2</sup> enterprise value of \$140m and owns 25,000 hectares of Land with almost 4 tonnes of standing timber. Over \$200m was invested in the estate (mostly MIS capital) with the vast majority deployed over a decade ago when no cash return was expected for many years. The timber is finally ready to be harvested.

KI is an excellent place to grow trees. Of all the timber planted during the MIS boom of the early 2000s, those schemes on KI were some of the only plantations to outperform their prospectus growth forecast. The relative short distance to the proposed international export wharf as well as cost savings from ownership of said wharf means KPT will be a low-cost producer, operating in the bottom quartile of the global timber industry. If and when KPT's wharf is constructed the company expects to perpetually export 500,000 green tonnes of timber each year. In this scenario and at current prices the stock trades on a:

- Price to sustainable earnings ratio of 7x
- Greater than 40% discount to tangible book value per share
- EV/EBIT multiple of 7x

These forecasts could prove conservative as they do not include incremental cost savings from making the wharf available to other industries. Furthermore, an impending shortfall of high quality timber available to be exported to Asian markets<sup>3</sup> may facilitate a higher AUD timber price and a corresponding increase in KPT's earnings.

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<sup>1</sup> The Directors and management of the trustee all have meaningful investments in the fund. In fact we collectively own more than 60% of the fund's units.

<sup>2</sup> Adjusting for debt which is not yet drawn but which is available to be drawn to fund the company's wharf development.

<sup>3</sup> According to specialist timber market consultants RISI International.

We believe it is fair to assume the stock would trade on a P/E of 12x or a slight premium to tangible book value if the wharf was operational. Accordingly, there is scope for the stock to almost double over the next 2 years **if the wharf is approved and constructed on time and on-budget**. The proposed wharf is not technically complicated, has an expected build time of less than 9 months and carries less construction risk than most large development projects. Long lead components and quotes for major inputs have already been secured. While there is risk of cost escalations we do not believe such would materially alter the economics. Thus, the key valuation catalyst is government approval for the company's wharf site at Smith Bay.

KI's timber plantations represent approximately 10% of available agricultural land on the island. All political and environmental stakeholders agree government needs to facilitate the construction of infrastructure capable of exploiting these vast assets – the question is how. In February South Australia's (SA) minister for planning declared the Smith Bay project will be assessed under the major development act of 1993. This designation fast-tracks the approval process by appointing a specialist panel of investigators and is reserved for major developments deemed important to SA for economic, social or environmental reasons. The project is now subject to a timeline which could facilitate approval this calendar year. It seems the government undertakes substantial due diligence on projects before awarding this declaration – of the 35 projects which have been assessed under this act 33 have been approved. The Smith Bay project offers compelling employment and economic benefits to KI and SA at a time of financial stress. Before progressing the application KPT has proactively undertaken vigorous environmental studies to ensure it is acceptable in the proposed form.

As with all infrastructure projects there are objectors. To date the only serious objection has predictably come from a neighbouring on-shore Abalone farm concerned the development will disrupt the supply of clean ocean water. KPT has conducted studies negating this accusation. In our view, it is not a question of if the Smith Bay wharf will be approved but rather when. There is a chance the approval is delayed up to 2 years and compliance costs cause the cost of construction to escalate 50%, such would not materially alter the economics. If we are wrong about Smith Bay the game is not over; the company has multiple back-up options which would further extend the time to first cash flow without materially altering the eventual economics. In any event the trees continue to grow! In fact, if the approval is delayed by 1 year the value of KPT's timber inventory would increase by approximately 6%. Furthermore, such increases the volume per tree and facilitates incremental margin expansion when a wharf is approved.

We do not know when the wharf will be approved and what strings will be attached however on balance we believe market participants are valuing KPT on an excessive discount to tangible assets and believe the risk/reward is desirable.

We understand unitholders may be disappointed by April's performance result – please feel free to call us to discuss the KPT position or any other holdings in more detail.

Mitch Taylor – 15 May 2017.

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