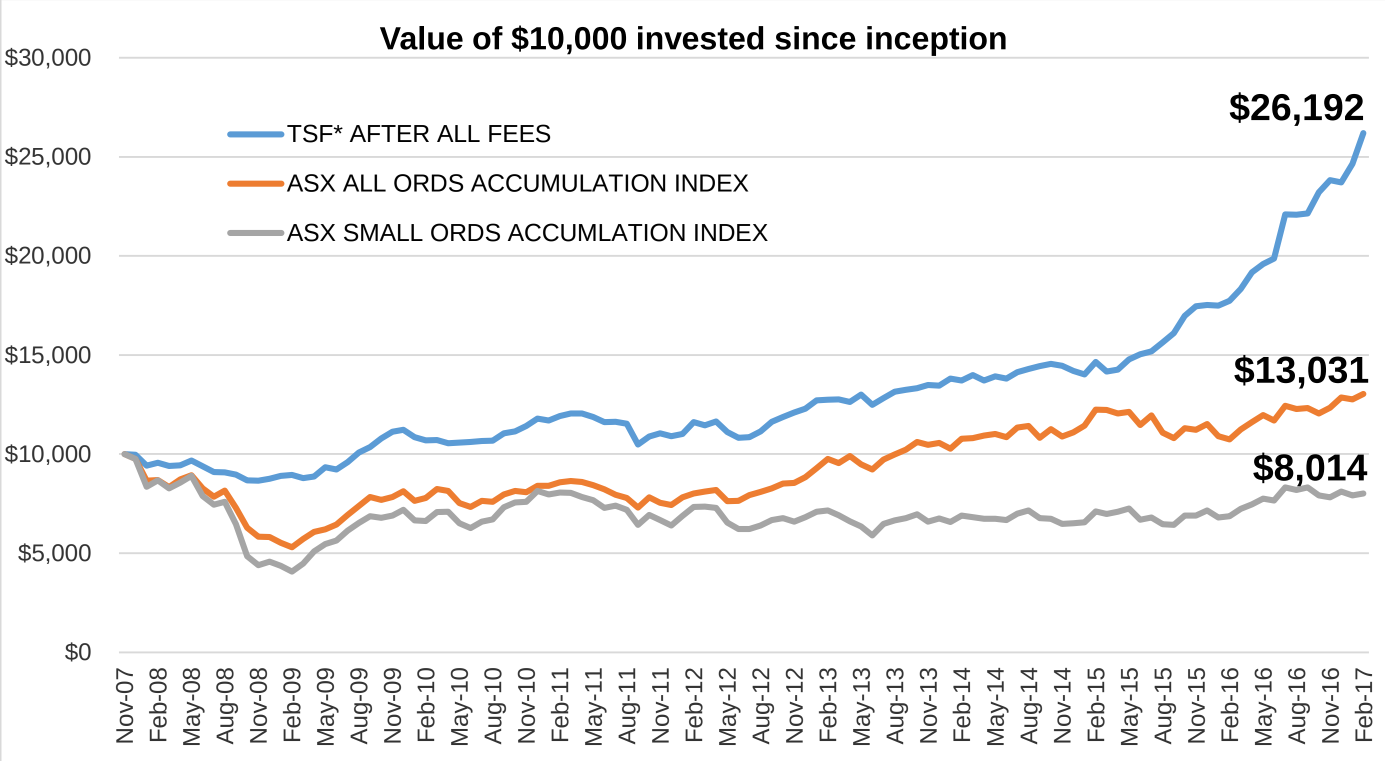
The Supervised Fund (TSF)

Monthly Report – February 2017

	TSF AFTER FEES	ALL ORDS ACCUM	BENCHMARK
Month ending 28 Feb 2017	**6.3%**	2.1%	0.4%
6 months	**18.6%**	6.2%	2.5%
12 months	**47.7%**	21.3%	5.0%
3 years p.a	**24.1%**	6.5%	5.0%
Since Inception p.a (Dec 2007)	**11.0%**	2.7%	5.0%



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

Portfolio as at 28 February 2017

Top 15 Positions	% of NAV
Kangaroo Island Plantation Timbers Ltd	32.0%
Cash	11.5%
HGL Limited	11.0%
Hillgrove Resources Limited (notes, shares and options)	7.1%
Gale Pacific Limited	6.3%
Bell Financial Group Limited	4.5%
Po Valley Energy Limited	4.3%
Base Resources Limited	3.7%
NZME Limited	3.5%
ETFS Physical Gold (AUD)	2.6%
Ariadne Australia Limited	2.1%
Sirtex Medical Limited	1.8%
Ramelius Resources Limited	1.8%
Beadell Resources Limited	1.4%
APN News and Media Limited	1.4%

- 0.6% of capital is invested in 6 month at the money put options over the S&P500. This effectively gives us the option to invest 17% of the fund in a short position in the S&P500 at current prices for the next 6 months.
- 1.9% of capital is invested in non-ASX listed investments (excluding cash).
- 17.2% of capital is invested in oil, gas and resources companies (excluding gold).
- 6.6% of capital is invested in gold mining companies. A further 2.6% of capital is invested in physical gold.
- 71% of capital is invested in companies with a market capitalisation of less than $150m.

Commentary

During February, most of our holdings released financial results. On the whole we were satisfied with their progress. During the month, our largest position Kangaroo Island Plantation Timbers Limited (**KPT**) increased 8% as the company's wharf development was declared a 'Major Development' by the South Australian Government, and the company positively revalued its timber inventory.

Po Valley Energy Limited (**PVE**) gained 32% as the company spun out a 40% interest in its on-shore gas assets into AIM listed Saffron Energy Limited (**SRON**) by way of an IPO. SRON has returned 68% since its IPO last month. In fact, the market value of PVE's SRON shares is now $12.5m vs its enterprise value of approximately $15m. We think PVE's other assets are worth substantially more than its SRON shares and hope the management will continue to unlock their value.

Other gains came from our investment in Hillgrove Resources Limited's (**HGO**) notes, options and shares, which increased 18%, and our second largest position, HGL Limited (**HNG**), which increased 17%. During the month, we sold out of Osprey Medical Inc – CDI (**OSP**), realising a 58% gain in the 8 months we owned it. We still think Osprey is a great company with a great product and excellent management. However, there seems to be renewed optimism in the stock and we see some short-term risks to continued growth in the US due to the uncertain healthcare regulatory environment. Because the company is yet to reach break-even cash-flow and we don't fully understand this risk, we decided it was prudent to avoid it and move on. Also during the month, we redeemed our units in the Samuel Terry Absolute Return Fund, which has been an excellent investment for the fund.

HGL Limited (HNG)

HGL is our second largest position. The company is a mini-conglomerate, which owns several domestically focused import and distribution businesses operating in the school uniform, headwear, commercial lighting, fabrics, beauty care and collector model cars industries. Four years ago, a new management team was appointed. They have significantly changed the structure of operations to focus on cash generation and client acquisition. There has been head count reduction and products with high sales volatility and low margins have been discontinued.

The company's commercial lighting division, JSB lighting, is the powerhouse of the group generating 80% of earnings. JSB has excellent growth prospects. Its services are rendered in the final stages of a property development. Accordingly, JSB is only now starting to experience the positive influence of our recent building boom. JSB's market and earnings should continue to grow for at least the next two years.

The remainder of HGL's earnings are generated from a 50% interest in school uniform and headwear business manufacturer and supplier, Mountcastle. Mountcastle is seeing double digit earnings growth as the management continues to sign new clients in the schools sector. These contracts are very sticky and generate attractive levels of recurring revenue. A recent tie-up with Harvey Norman is expected to contribute to continued growth.

The other business units represent almost half of the group's ~$70m revenue but are running at a loss. Their return to break-even alone would result in a 20% uplift in group earnings. We have spent a great deal of time and effort gauging an understanding of these business units. HGL's management team seem to have done an enviable job repositioning these divisions and we expect several to return to profitability in the short to medium term.

HGL currently trades on a trailing P/E of 10x, offers a 6% fully franked yield, and has net cash on the balance sheet. The company's market cap of only $34m sees it below the radar of most institutional investors. While we are confident in double digit earnings growth over the medium term, we are more comforted by our belief that JSB and Mountcastle could be sold to a trade buyer in a somewhat stressed liquidation scenario and still generate cash proceeds sufficient to cover the current market cap.

Ariadne Australia Limited (ARA)

During February, we invested 2% of unitholder capital in diversified investment company Ariadne. In December last year, the company announced a binding sale of its 50% interest in car park operator Secure Parking for approximately $75m. This represented a 582% premium to Secure's $11m book value and dramatically increased Ariadne's cash reserves. The share price rose by 30c to the mid–60s. This piqued our interest because the prevailing price still represented a material discount to book value after adjusting for gain on the sale. Our research suggests the book value of Ariadne's remaining holdings is conservative, if not understated. The below illustrates a comparison of the company's book value compared to its market value (referenced from listed security prices) as well as a bull case value based on our investigation into each of the assets.

Ariadne Net Asset Value	**Book**	**Market**	**Upside**		**Comment on upside case**
50% share of Orams Marine village	$14.1	$14.1	$28		Assume re-zoning of leased property
Clearview (at market value)	$38.2	$33.6	$0.00		Assume sale and corresponding increase in cash
Freshxtend	$11.8	$11.8	$11.8		We don't have enough information to make an informed decision
DTA	$3.0	$3.0	$12.0		**ARA has in excess of $200m unrecognised capital and income losses**
Foundation Life	$4.6	$6.0	$6		Assuming a capitalisation rate similar to peers
Mercantile	$2.4	$2.4	$2.64		Assuming Mercantile trades at NTA not a 10% discount
Other investments	$4.7	$4.7	$4.70		We don't have enough information to make an informed decision
Hillgrove	$3.7	$9.3	$24.0		Based on our assessment of Hillgrove's value
Prepayments and receivables	$1.1	$1.1	$1.1		
Other net Liabilities (including minority interests for Fxtend and other)	$7.20	$7.20	$7.20		
Cash	**$92**	**$92**	**$127**		ARA received ~$75m early January - for simplicity we assume this was booked at 31 Dec.
Net asset value	$168.20	$170.55	$210.24		
Shares on issue	201	201	201		
Net asset per share	$0.84	$0.85	$1.05		
Our entry price	**$0.66**	**$0.66**	**$0.66**		
Purchase price discount to NAV	**21%**	**22%**	**37%**		
% of investment backed by cash	**70%**	**70%**	**97%**		
Paid for net assets ex cash	**$39.45**	**$39.45**	**$3.71**		
Value of assets ex cash	**$76.40**	**$78.75**	**$83.24**		
Discount to Net Assets excluding cash	**48%**	**50%**	**96%**		

Somewhat key to our investment thesis is Ariadne's position in ASX listed Clearview Wealth Limited (CVW). CVW is subject to a takeover option by Sony Life at a premium to the current price. It seems likely Sony will exercise this option and enable Ariadne to realise a further ~$40m in cash. If it does not complete, we expect other parties would likely bid for the assets or in an alternative scenario Ariadne continues to hold this highly liquid ASX listed investment on balance sheet.

At our entry price of 66c we effectively paid cash backing plus the market value of Clearview and received the other assets for free. The other assets have a book value of approximately 23c per share and we believe an upside value of 41c per share. The shares have since rallied to the low 70s and we think they are still very cheap.

Contrary to our view on some other ASX listed diversified investment companies, we believe a dollar in the bank with Ariadne is certainly worth a dollar. The company's CEO is a highly regarded veteran investor who holds 39% of the issued capital. The Board consists of reputable, experienced company directors who all have a meaningful personal investment in the company. Neither the CEO nor board members receive exorbitant remuneration, which is encouraging from a corporate governance perspective. The company itself does not burn NTA in operating costs and has capital and income losses in excess of $200m.

We recently invested alongside Ariadne in Hillgrove Resources Limited. We were extremely impressed by their stringent approach to risk and due diligence. We believe ARA offers an attractive risk/reward.

The Supervised Fund is open to new investors and we welcome queries on our strategy and outlook.

Mitch Taylor – 16 March 2017.