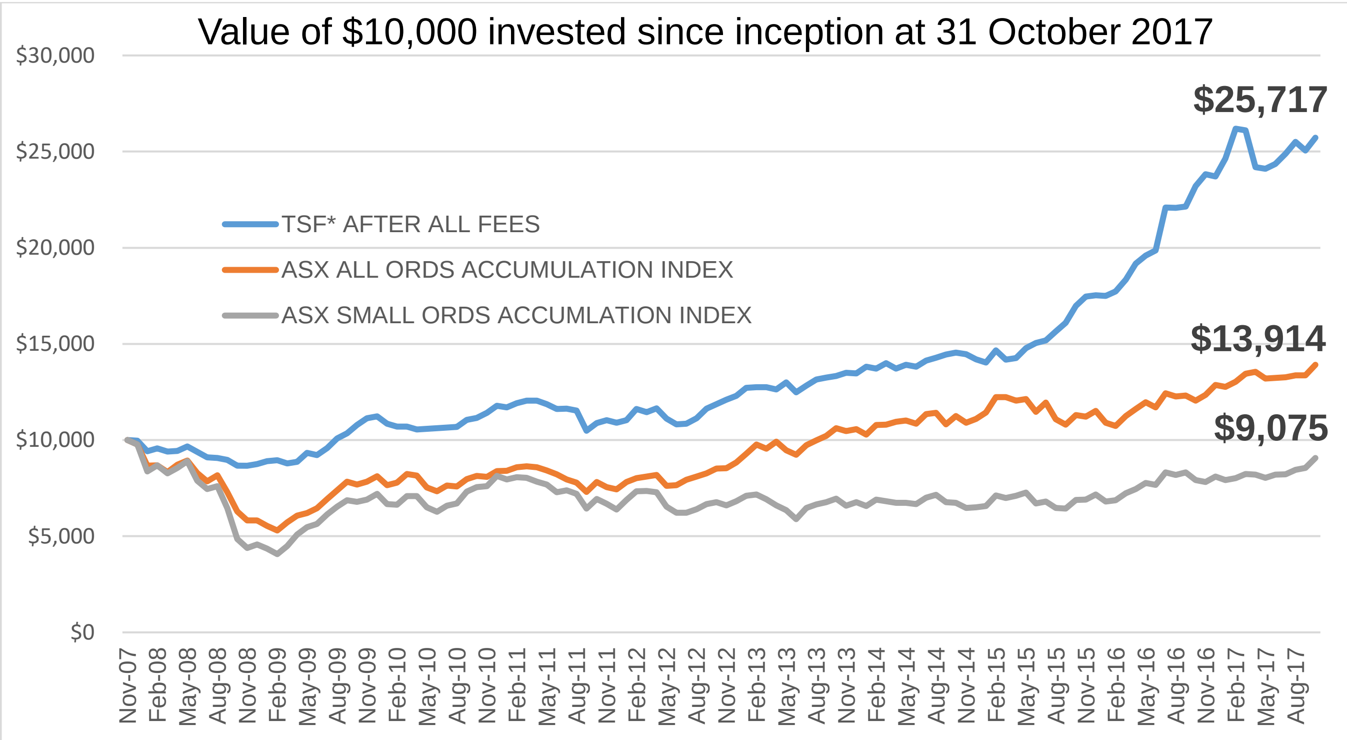
The Supervised Fund (TSF)

Monthly Report – October 2017

Performance Analysis (as at 31 October 2017)	TSF after all fees	Small Ords Accumulation	All Ords Accumulation
1 month	**2.7%**	6.0%	4.1%
12 months	**10.8%**	14.6%	15.5%
3 years p.a.	**20.9%**	10.5%	7.3%
5 years p.a.	**16.7%**	6.1%	6.1%
7 years p.a.	**12.7%**	2.7%	8.0%
Since inception p.a. (Dec. 2007)	**10.0%**	-1.0%	3.4%



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

Portfolio at 31 October 2017

Top 10 Positions	% of NAV
Kangaroo Island Plantation Timbers Ltd	25%
Cash	15%
Hillgrove Resources Limited (equity & notes)	10%
HGL Limited	9%
Po Valley Energy Limited	6%
Gale Pacific Limited	5%
Bisalloy Steel Group Limited	5%
ETFS Physical Gold	4%
Bell Financial Group Limited	3%
Engenco Limited	3%

- 0.2% of capital is invested in (put) options over stock market indices.
- 1% of capital is invested in non-ASX listed investments (excluding cash).
- 21% of capital is invested in oil, gas and resources companies (excluding gold).
- 5% of capital is invested in physical gold and gold mining companies.
- 71% of capital is invested in companies with a market capitalisation of less than $150m.

Commentary

The Supervised Fund's October return of 2.7% was driven by Namoi Cotton (up 43%), Po Valley Energy (up 27%), and Kangaroo Island Plantation Timbers (up 7%). The price of Namoi shares soared following the announcement of their half-year results, in which net profit after tax rose by 114% on the previous half-year. In addition, the company resolved to restructure from a co-operative with grower members and capital holders to a public listed company with a single class of ordinary shares. This is a welcome step and will enable the company to access appropriate funding when necessary. Our holding in Namoi is currently 1% of unitholder capital. Kangaroo Island Plantation's increase in share price followed positive updates from the company regarding their continued efforts in gaining wharf approval for exporting timber. An announcement detailing the economic impact of the proposed wharf reported that the forestry industry will create 234 jobs on Kangaroo Island, contributing more than $41m per year to its economy. The company is finalising its Environmental Impact Statement, which was slightly delayed by unfavourable weather in September.

The main detractors during the month were HT&E (down 15%) and HGL (down 8%). HT&E fell after the company announced that its subsidiary, Adshel, had lost the contract for Yarra Trams. We have since sold out of HT&E. HGL declined further after lowering earnings guidance for FY17, as discussed in the last quarterly. We remain sanguine holders of this stock.

The latest addition to our top 10 positions is Engenco Limited, which we acquired over the last eight months. We will discuss Engenco in detail in next month's performance report.

Po Valley Energy

Po Valley Energy (PVE), a $25m market cap oil and gas explorer and producer in Italy, has been a longstanding investment in the fund. We have held stock in PVE since 2009 and in June 2015 took a meaningful position when participating in a placement at around 2.5c per share (accounting for share dilution). At the time, PVE was finalising farm-out financing deals with major oil companies for several of its gas assets. While the deals passed technical due diligence and heads of agreement were drawn, they ultimately failed legal due diligence. PVE was forced to sell assets to repay debt. In addition to production set-backs, the misfortunes drove down the share price by 80% to 0.5c. At this level, the company conducted a 2.5 for 1 rights issue to raise $1.75m. We participated and underwrote some of the shortfall. Our rationale was that PVE was sitting on a portfolio of immensely valuable and underappreciated gas assets, and the main obstacle to unlocking their value was finding capital. Ultimately, it was a corporate play on securing funding. To this end, we had faith in the executive Chairman and largest shareholder (with 26% of issued shares), Michael Masterman, who has a proven track record in raising money for resources companies. Of further encouragement was the fact that all of the directors were investing their own money in the rights issue to take a 70% stake in the company.

In the ensuing sixteen months, the share price appreciated by four times as the company moved closer to realising the potential of its assets by refinancing debt, beginning operations at a new gas well, and spinning off its production assets into a new AIM-listed subsidiary called Saffron Energy (58%-owned by PVE). Over that period, we participated in another private placement of $900,000 at 2c per share. On 5 October, PVE took a major step forward in its endeavour to secure capital when it announced that Saffron was planning a merger with £550m market cap oil and gas producer Sound Energy (listed in London), which would include a reverse takeover of PVE. Sound Energy's assets in Italy are meagre but the company has an abundance of cash (£40m), whilst PVE's assets are optimum but they are lacking in cash (€800k). Thus, the merger is in both parties' interests. On this news, PVE's share price rose by 33% to 4c. We await the result of the proposed merger, which will likely be in February next year.

By sheer coincidence, on the day of the announcement I was in London and had organised a meeting with Po Valley's CEO, Sara Edmonson. I was impressed by her vision for the future of the company. Contemporaneously, Joseph had organised a site visit of one of PVE's two gas production wells, called Bezzecca, an hour's drive east of Milan. Production at Bezzecca began in April this year. He was shown around by Giorgio Bertuzzi, the exploration manager, and Enzo Vegliante, the production manager. Both worked for Eni, Italy's €53bn market cap oil and gas producer, for a combined 50 years. Giorgio became acquainted with Italy's oil and gas assets when he was head of Eni's Italian portfolio in the 1990s. During that time, the European Commission introduced anti–monopoly legislation, meaning Eni had to relinquish many of its Italian gas fields. PVE subsequently acquired these valuable assets at bargain prices.

Joseph at Bezzecca's processing plant with Giorgio and Enzo

It was useful to see the gas well and production facility and feel comfortable that operations are coming along. Giorgio and Enzo reiterated that the major hurdle faced by PVE is access to funding. Both are confident the company has the best assets available in Italy, in a country lacking in domestic production (only 8% of gas used there is locally sourced). However, PVE needs about €6m to expand their two current production operations, establish a new gas well, and commence exploration drilling at another site. If they can raise the necessary money, which has become increasingly possible due to the agreement with Sound Energy, they could be producing up to 180,000 cubic metres (cm) of gas per day by 2020, compared with the current 25,000cm per day. At a gas price of €0.21/cm and margins of around 60%, this equates to annual EBITDA of €5m (after minority payments to Saffron shareholders), compared to a loss of €1m in 2016.

David Constable, Portfolio Manager

14 November 2017.

See following page for historical returns.

	TSF after all fees	Small Ords Accumulation	All Ords Accumulation
Since inception p.a. (Dec 2007)	10.0%	-0.97%	3.4%
Financial year to date	5.6%	10.7%	5.1%
Year to date	8.5%	11.9%	8.2%
FY17	22.6%	7.0%	13.1%
FY16	32.0%	14.4%	2.0%
FY15	9.0%	0.4%	5.7%
FY14	10.6%	13.1%	17.6%
FY13	15.3%	-5.3%	20.7%
FY12	-6.8%	-14.6%	-7.0%
FY11	9.4%	16.4%	12.2%
FY10	15.1%	11.2%	13.8%
FY09	-1.7%	-28.6%	-22.1%

The fund's benchmark is 5% per annum. Small Ords and All Ords are included for the sake of comparison to the predominant Australian equity indices.

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