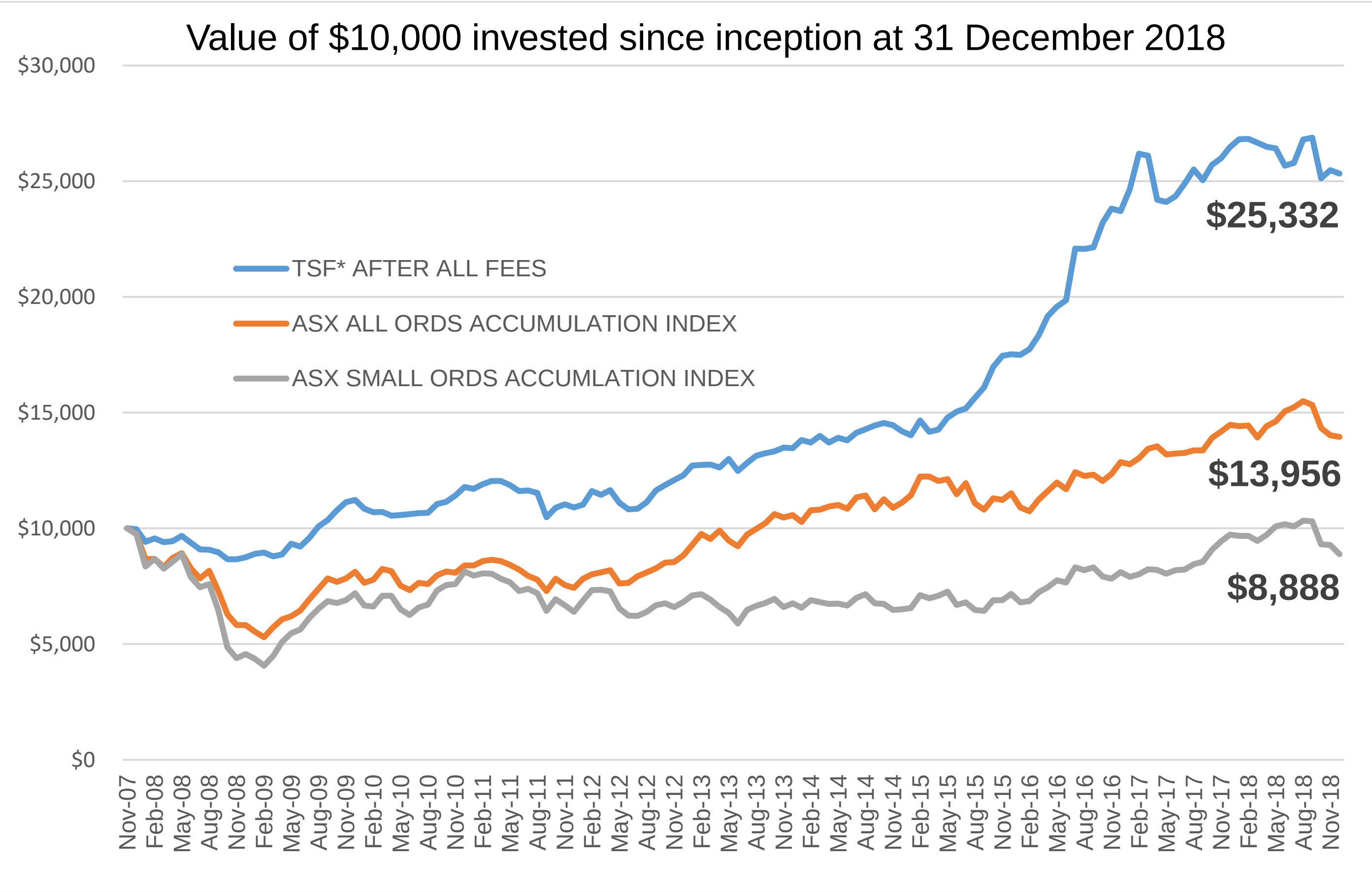
The Supervised Fund (TSF)

Monthly Report – December 2018

Performance Analysis (as at 31 December 2018)	TSF after all fees	Small Ords Accumulation	All Ords Accumulation	Benchmark
1 month	**-0.6%**	-4.2%	-0.4%	0.4%
1 quarter	**-5.8%**	-13.7%	-9.0%	1.2%
1 year	**-4.3%**	-8.7%	-3.5%	5.0%
2 years p.a.	**3.4%**	4.7%	4.2%	5.0%
3 years p.a.	**13.1%**	7.5%	6.6%	5.0%
5 years p.a.	**13.5%**	5.6%	5.7%	5.0%
7 years p.a.	**12.8%**	4.8%	9.4%	5.0%
10 years p.a.	**11.2%**	6.9%	9.1%	5.0%
Since inception p.a. (Dec. 2007)	**9.3%**	-1.1%	3.3%	5.0%

Past performance is no indication of future performance



*Please note TSF return assumes reinvestment of all distributions (as do the indices).

Portfolio at 31 December 2018

Top 10 Positions	% of NAV
Kangaroo Island Plantation Timbers Limited	25%
HGL Limited	14%
Po Valley Energy Limited (equity and convertible notes)	12%
Hillgrove Resources Limited	9%
Cash	9%
Engenco Limited	8%
Bisalloy Steel Group Limited	7%
Physical Gold ETF	6%
Avita Medical Limited	2%
Coro Energy Limited	2%

- 5% of capital is invested in non-ASX listed investments (excluding cash).
- 24% of capital is invested in oil, gas and resources companies (excluding gold).
- 6% of capital is invested in physical gold and gold mining companies.
- 84% of capital is invested in companies with market capitalisations of less than $150m.

Commentary

Winners in December 2018	Contribution to fund return	Gross return	Losers in December 2018	Contribution to fund return	Gross return
Bisalloy Steel Group Limited	0.8%	13.2%	Po Valley Energy Limited	–1.8%	–15.2%
Kangaroo Island Plantation Timbers Limited	0.8%	3.4%	Engenco Limited	–0.2%	–2.1%
Physical Gold ETF	0.4%	8.0%	HGL Limited	–0.1%	–1.0%

December 2018

The December return was largely driven by a significant fall in Po Valley Energy's share price. This occurred on no material news and seemed to accompany the general flightiness of retail investors. Throughout the month, Po Valley raised $1.2m from existing and new shareholders at 4.2c per share. This leaves the company with a sufficient amount of working capital to continue its application processes for Italian gas fields Selva and Teodorico.

Po Valley's negative return was partially offset by a rise in the price of Bisalloy shares. Although there was no news released during December, Bisalloy's appreciation was presumably the result of continued confidence in the company's prospects after a positive update in its AGM in late November 2018.

KPT shares appreciated on no news, whilst the physical gold price increased in line with macroeconomic uncertainty.

2018 calendar year

After a promising start, 2018 was a disappointing year for The Supervised Fund. We thought this report would be a useful forum to summarise the drivers of our performance over the year and outline the Fund's prospects for 2019. The table on the following page gives a useful overview.

2018 Performance Attribution:

Winners	Return on capital employed	Contribution to 2018 return
Bisalloy Steel Group Limited	30%	1.8%
Spicers Limited	55%	1.5%
Po Valley Energy Limited	10%	1.3%
Bell Financial Group Limited	13%	0.4%
Physical gold	8%	0.4%
Losers		
Kangaroo Island Plantation Timbers Limited	-17%	-4.9%
Put and call options over the S&P	-76%	-0.8%
OneMarket Limited	-29%	-0.5%
Avita Medical Limited	-18%	-0.3%
Engenco Limited	-3%	-0.3%

As evident from the above table, our negative return was largely concentrated in KPT. The shares suffered a sustained decline throughout the year as progress on the wharf approval was limited by delays in the completion of the environmental impact study (EIS). The company submitted a draft EIS in late September 2018 and is currently awaiting approval by the South Australian Minister for Planning of the release of a final document for a six-week public and agency consultation period. This is expected to commence early in 2019. Following the consultation period, KPT will respond to any formal submissions in a Response Document. This should take about a month. The EIS and Response Document will then be lodged with the South Australian Department of Planning Transport and Infrastructure (DPTI), which will write an Assessment Report on the proposed project. This report will be submitted to the Governor of South Australia and Commonwealth Department of The Environment and Energy for final approval.

We are disappointed with KPT's performance in 2018. However, we note its recent drag on the fund's return is a result of its appreciation over the last five years. Our initial book cost of $1.3m has increased to a market value of $4.5m, which represents 25% of our portfolio. This means any change in the KPT price has a material impact on the fund's overall performance. We hope this will be advantageous in 2019. If the wharf is approved, we estimate significant further upside in the value of our KPT shares. When the company begins full scale harvesting (by 2022), it could generate around $20m per year in net profit. At a multiple of 10x, this would imply a market capitalisation of $200m. This is equivalent to around $4 per share, 100% upside from the last traded price of $2 per share.

2019 and beyond

The Supervised Fund is a long–term investor which takes a multi–year view in its holdings. 80% of our portfolio comprises seven stocks that have been held for more than eighteen months. The majority of these have appreciated in value over several years and we believe they will continue to do so in the coming years.

Within our holding period the stock price is generally subject to fluctuations. We constantly reassess the prospects of our positions to determine our “target price”, the point at which we believe the company’s future earnings have been amply priced in by the market. Once the shares reach our target price we sell our position.

Due to our long–term outlook we only choose to invest meaningfully in a company when we believe it has the prospect of generating multiples on our initial capital over the course of several years. Our investment strategy is possible when a company’s stock is “cheap” measured against earnings or assets. Being cheap implies the business has been undervalued by the market despite having identifiable sound prospects. The undervaluation usually occurs because market sentiment is low and the company’s opportunities are not easily discernible.

Such companies have been difficult to find over the last eighteen months because the market had, up until recently, been in a major upswing. In particular, the latter stages of a bull run tend to be the strongest for our speciality, smaller companies, which have hitherto been outside of investors’ radars. This is because most blue–chip companies are trading at high multiples and low dividend yields, meaning investors have to look elsewhere for a good return. Accordingly, in the two years from 30 June 2016, the ASX Small Ords returned 37%. Thus, by 2018, the only stock that seemed “cheap” belonged to companies with clear problems such as poor management and those operating in uncertain industries or undergoing significant corporate strife. With the recent downturn in market sentiment, and the ASX Small Ords returning -13% over the six months to December 2018, we see the potential for undervalued stock to reappear. Subject to market conditions, we hope to capitalise on emerging opportunities and add two new long–term positions to our portfolio in 2019.

In the meantime, we are cautiously optimistic that our present portfolio has the potential to generate a good return for unitholders. KPT’s prospects have been outlined above. In addition, we hope to receive our first dividend from Hillgrove in 2019 and see Po Valley make progress in securing approval for its two major gas fields. Engenco and Bisalloy are also well positioned for continued growth. Finally, we intend to work with HGL’s board to help realise value for shareholders.

David Constable

22 January 2019

See the following page for historical returns

The Supervised Fund's Historical Performance

	TSF after all fees	Small Ords Accumulation	All Ords Accumulation
Since inception p.a. (Dec 2007)	**9.3%**	-1.1%	3.3%
Financial year to date	**-1.3%**	-12.7%	-7.3%
Calendar year to date	**-4.3%**	-8.7%	-3.5%
FY18	**5.4%**	24.2%	13.7%
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 Accumulation and All Ords Accumulation are included for the sake of comparison to the predominant Australian equity indices.