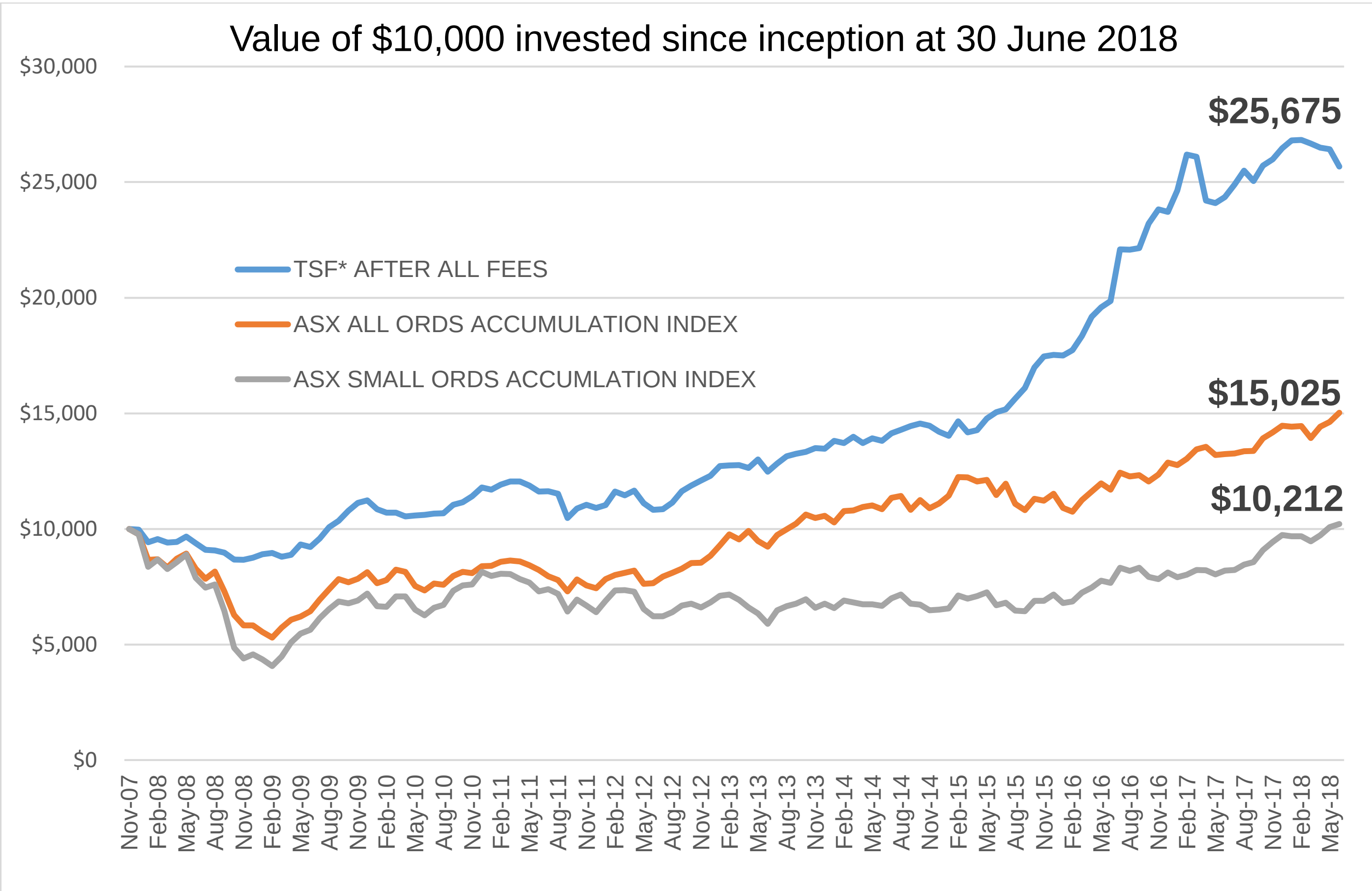
The Supervised Fund (TSF)

Monthly Report – June 2018

Performance Analysis (as at 30 June 2018)	TSF after all fees	All Ords Accumulation	Benchmark
1 month	**-2.8%**	2.8%	0.4%
1 year	**5.4%**	13.5%	5.0%
2 years p.a.	**13.7%**	13.3%	5.0%
3 years p.a.	**19.5%**	9.4%	5.0%
5 years p.a.	**15.5%**	10.2%	5.0%
7 years p.a.	**12.0%**	9.0%	5.0%
10 years p.a.	**10.6%**	6.1%	5.0%
Since inception p.a. (Dec. 2007)	**9.5%**	4.0%	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 30 June 2018

Top 10 Positions	% of NAV
Kangaroo Island Plantation Timbers Limited	26%
Cash and government bonds	13%
HGL Limited	14%
Hillgrove Resources Limited	12%
Po Valley Energy Limited (equity and convertible notes)	9%
Engenco Limited	7%
Bisalloy Steel Group Limited	5%
Physical Gold ETF	5%
Spicers Limited	3%
Coro Energy Limited	2%

- 0% of capital is invested in put and call options over stock market indices.
- 6% of capital is invested in non-ASX listed investments (excluding cash and bonds).
- 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.
- 74% of capital is invested in companies with market capitalisations of less than $150m.

Commentary

The Supervised Fund's June 2018 return of -2.8% was impacted by considerable selling in Po Valley Energy and Hillgrove Resources. Neither released negative news and we took the opportunity to add to the latter. Hillgrove was presumably weaker due to the copper price, which fell by 4% over the month, largely due to speculation about the consequences of a potential global trade war. Nevertheless, this was partially offset by the lower AUD, which fell by 2% against the USD over the same period. Further, as at the end of the 2018 March quarter, Hillgrove has hedged 41% of remaining production at 10% above current prices. We presume the company took further advantage of the high copper price in early June and increased its hedging position. However, if this were not the case, and the copper price fell a further 10% from its current level, Hillgrove would still generate about $62m of free cash to equity holders by September 2020. This compares with the company's current market capitalisation of $46m.

Winners in June 2018	Contribution to fund return	Gross return	Losers in June 2018	Contribution to fund return	Gross return
HGL Limited	0.4%	3.1%	Hillgrove Resources Limited	–2.1%	–14.6%
Kangaroo Island Plantation Limited	0.2%	0.9%	Po Valley Energy Limited	–1.0%	–13.5%

2018 Financial Year

FY18 was one of two distinct halves for TSF. In the six months to 31 December 2017, we returned 8.7% net of fees; in the six months to 30 June 2018, -3.0% net of fees. In the first half, KPT shares increased in value by 19% and Po Valley, 64%. The second half was considerably weaker, with our major holdings suffering largely due to a lack of news flow. KPT fell by 10% and Hillgrove, 5%.

KPT's environmental impact study for its proposed export facility has taken longer to prepare than originally advised. Whilst it was meant to be released in January 2018, it has been deferred to September 2018. This has been due to adverse weather and unforeseen additions to the study pertaining to road routes and potential pollution to a nearby abalone farm. The company is satisfied they are adequately addressing these issues and want to ensure the study is watertight before releasing it for public and government consultation. It is understandable the delay might be disconcerting for investors, especially ones who are less familiar with the company and participated in the April or December 2018 raisings with the prospect of a quick path to export facility approval.

On the other hand, Hillgrove's poor six-month performance was less understandable. The company has continued to meet guidance and in the March quarter of 2018 reported the highest quarterly production since the June quarter of 2014. Costs were in line with predictions and, as pointed out above, there is significant hedging in place. On this news, the share price appreciated by 19% before falling for no apparent reason.

Attribution for FY18

Winners	**Total return on capital employed**	**Contribution to TSF return**
Po Valley Energy Limited	64%	2.40%
Bisalloy Steel Group Limited	114%	2.21%
Engenco Limited	57%	1.58%
Kangaroo Island Plantation Timbers Limited	6%	1.12%
Selection of cannabis stocks	28%	0.92%
Bell Financial Group Limited	40%	0.83%
Base Resources Limited	22%	0.71%
Hillgrove Resources Limited	5%	0.38%
Losers		
Put and call options over the S&P	-78%	-1.14%
HGL Limited	-7%	-0.72%
HT&E Limited	-33%	-0.67%
Gale Pacific Limited	-12%	-0.55%
Sirtex Limited	-15%	-0.36%
Hexagon Resources Limited	-31%	-0.31%
NZME Limited	-8%	-0.16%
Ramelius Resources Limited	-15%	-0.16%

Outlook

Whilst we are disappointed by our FY18 performance, especially in light of the broader market's run, we note that our fund's holdings are largely uncorrelated to general market sentiment. We invest in "micro- cap" companies that are too small for most institutions and are either unknown or out of favour amongst retail investors. We find a large proportion of fellow shareholders in such companies are relatively unsophisticated investors and are often disgruntled, long term holders. They are sometimes forced sellers and are often indiscriminate as to their sale price; they simply need to raise money or want to exit. The underappreciation of such companies is what allows us to buy in cheaply, once we are confident of catalysts for growth in the short to medium term. Since the shares of these companies tend to trade infrequently and on low volume, periods in between catalysts can result in considerable share price declines, even if there has been no change in the health of the company. Whilst our strategy can be frustrating when market sentiment is at its peak and our particular stocks are in a lull, over the long term this has allowed us to outperform the All Ordinaries Accumulation Index by 5.5% p.a. since inception.

We believe the 2019 financial year will be one of considerable growth for The Supervised Fund, with a number of our holdings set for positive catalysts. Here are some of the highlights ahead:

Kangaroo Island Plantation:

After the completion of its environmental impact study in September 2018, the report will undergo a six-week consultation period. Following this, the company will prepare a response, which should take less than a month. An assessment report will then be made by the Minister for Planning, which should take 6 weeks. A final decision by the South Australian Cabinet should be made several weeks later. Accordingly, approval for KPT's export facility is likely to occur in early 2019. Whilst the delay has been frustrating, there is some silver lining, in that lumber prices have gone up by about 15% over the last six months. This increase has not been factored into the company's share price. Once KPT begins harvesting its trees in around 2021, we expect it to generate free cash flow of over $20m per year, representing an 18% yield on its current market capitalisation of $109m.

Hillgrove Resources:

By September 2018, Hillgrove will have returned the majority of its creditors to normal terms and paid all outstanding employee benefits, which had been frozen when the company fell into financial difficulties. Thus, from the December quarter of 2018, the company will begin to generate substantial free cash flow for equity holders, in the order of $8 to $11m per quarter (compared to Hillgrove's current market capitalisation of $46m). This should allow Hillgrove to pay its first fully franked dividend since 2009. Once it starts distributing cash to shareholders, the company should attract a market rerating.

Additionally, Hillgrove is currently marketing its proposed pumped hydroelectric energy storage system. If there are any interested parties, this could be worth up to $50m. We are also expecting the results of two exploration programs in late 2019, which could extend the company's mine life well beyond its current two years.

Po Valley Energy:

There are numerous milestones ahead for Po Valley. We envisage the award of a preliminary production concession for its onshore gas field, Selva, in September 2018. The company will then undertake 3D seismic evaluation of the field, which could triple resources, increasing its net present value from about $18m to over $50m (compared to Po Valley's current market capitalisation of $25m). We expect these results in early 2019.

Further, the company is anticipating environmental approval for its offshore gas field, Teodorico, which has a net present value of about $44m. Following this, Po Valley will be in a place to conduct a final investment decision, which would involve securing debt funding for the project, finding a JV partner, or wholly divesting the asset to one of the numerous major producers in the region.

David Constable

10 July 2018

The Supervised Fund's Historical Performance

	TSF after all fees	Small Ords Accumulation	All Ords Accumulation
Since inception p.a. (Dec 2007)	**9.5%**	0.2%	4.0%
Financial year to date	**5.4%**	24.6%	13.5%
Calendar year to date	**-3.0%**	4.9%	3.9%
FY17	**22.6%**	13.1%	7.0%
FY16	**32.0%**	2.0%	14.4%
FY15	**9.0%**	5.7%	0.4%
FY14	**10.6%**	17.6%	13.1%
FY13	**15.3%**	20.7%	-5.3%
FY12	**-6.8%**	-7.0%	-14.6%
FY11	**9.4%**	12.2%	16.4%
FY10	**15.1%**	13.8%	11.2%
FY09	**-1.7%**	-22.1%	-28.6%

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.