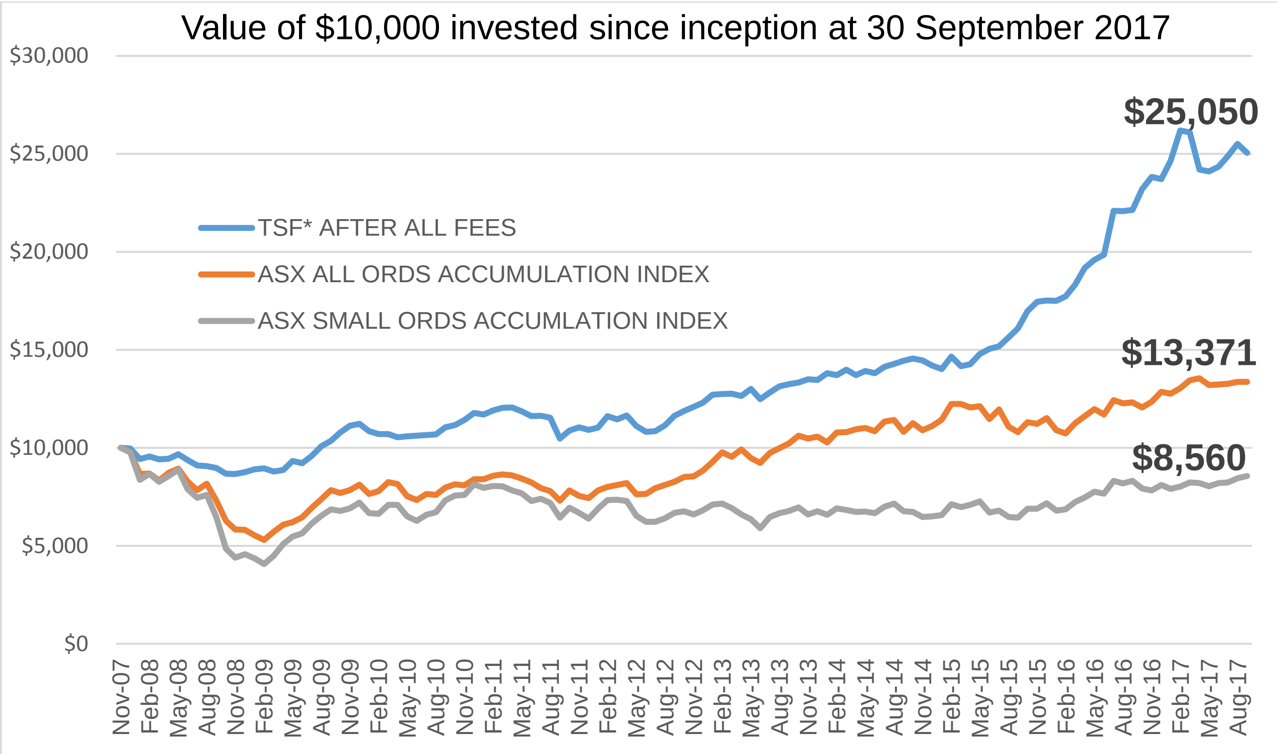
The Supervised Fund (TSF)

Monthly Report – September 2017

Performance Analysis (as at 30 September 2017)	TSF after all fees	All Ords Accumulation	Benchmark
1 month	**-1.8%**	0.1%	0.4%
12 months	**13.1%**	8.5%	5.0%
3 years p.a.	**19.9%**	5.4%	5.0%
5 years p.a.	**16.7%**	10.5%	5.0%
Since inception p.a. (Dec. 2007)	**9.9%**	3.0%	5.0%



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

Portfolio at 30 September 2017

Top 15 Positions	% of NAV
Kangaroo Island Plantation Timbers Ltd	24%
Cash	15%
Hillgrove Resources Limited (equity and notes)	11%
HGL Limited	10%
Gale Pacific Limited	6%
Po Valley Energy Limited	5%
Bisalloy Steel Group Limited	5%
ETFS Physical Gold	4%
Bell Financial Group Limited	3%
Ariadne Australia Limited	3%
NZME Limited	2%
Base Resources Limited	2%
HT&E Limited	2%
Nine Entertainment Co Limited	2%
Undisclosed**	2%

**We are still buying shares in this company.

- 0.5% of capital is invested in (put) options over stock market indices.
- 1% of capital is invested in non-ASX listed investments (excluding cash).
- 4% of capital is invested in ASX200 members.
- 18% of capital is invested in oil, gas and resources companies (excluding gold).
- 5% 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

The Fund’s result in September was driven by losses in HGL Limited (down 14%), Hillgrove Resources Limited (down 6%) and Kangaroo Island Plantation Timbers Limited (down 3%), which were slightly offset by gains in Bisalloy Steel Group Limited (up 21%) and Bell Financial Group Limited (up 7%). Whilst it was disappointing that the share prices of our three largest holdings declined during the month, we remain confident in these companies’ prospects. KPT still trades at a discount to its tangible book value per share of $2.32 (last price $2.25 as at the day of writing) and continues to await news of its proposed export facility at Smith Bay. Hillgrove was negatively impacted by the expiry on 20 September of 188m options, convertible at 3c. It was evident that numerous option–holders were forced to sell ordinary shares to raise money to convert their options, putting short–term downward pressure on the price of ordinary shares. The conversion of options between their issuance in December 2016 and September 2017 raised around $5.5m, contributing positively to the company’s balance sheet.

HGL declined due to a trading update reporting that while the majority of its businesses had achieved solid growth during FY17, fine crafts wholesaler Leutenegger and model car supplier Biante had suffered considerable declines in revenue and profit, eroding the company’s earnings. Consequently, underlying net profit for FY17 (reporting at 30 September) is forecast to be between $2 and $2.5m, compared with $3m in FY16. The company also stated it was undertaking a strategic review of Leutenegger. In addition, the company announced the acquisition of Intralux, a high–end commercial lighting business, which will be complementary to HGL’s existing JSB lighting business. Despite the decrease in earnings for FY17, we believe HGL remains cheap. At the lower end of guidance, its trailing twelve–month p/e ratio is 13x; at the upper end, 11x. Its dividend yield remains high, at 7.8%. The company has considerable room for growth, with its recent acquisition and strategic review of Leutenegger.

Murray River Organics Group Limited (MRG)

During the month, we participated as a sub–underwriter of Murray River Organic’s capital raising. MRG is a producer and distributor of organic fruit, specialising in grapes and raisins. The group controls 12,253 acres of farmland in the Sunraysia region of Victoria. This is double the size of the City of Sydney council area. The company listed in December 2016 at $1.30/share and saw its share price plummet to 30c in May 2017 after lowering earnings guidance twice in the space of three weeks. This was due to a poor harvest resulting from heavy frosts, which led to the company forecasting a breach of their debt covenants. To pay off debt, the company was forced to raise $12m through an institutional placement and entitlement offer to existing shareholders at 30c/share. The net tangible book value per share is 64c; accordingly, we felt we were buying land in the fertile Sunraysia region at half–price. We sub–underwrote $250,000 in the entitlement offer, for which we received a fee of $2,500 and $230,000 worth of shares at 30c. Since receiving the stock on 20 September, the share price has rallied by 40% to 42c as at the day of writing.

Joseph Constable

19 October 2017.

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