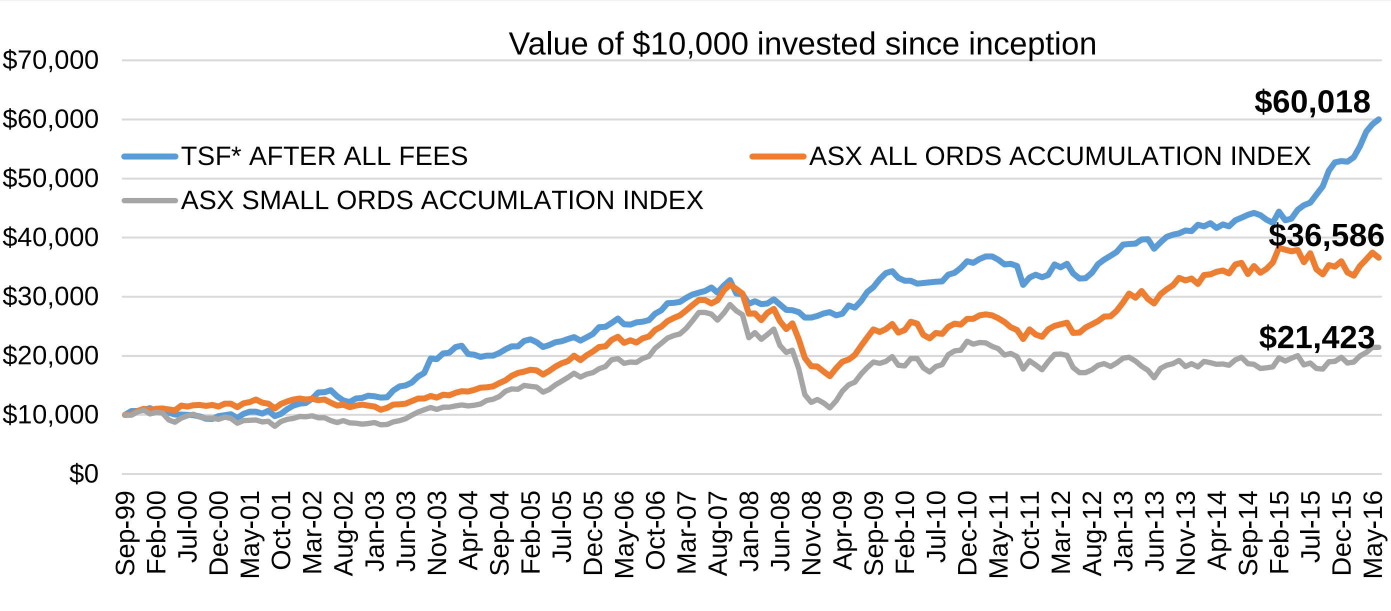
# The Supervised Fund (TSF)

## Monthly Report – June 2016

The Fund's performance compared with the All Ords Accumulation Index is set out as follows.

| | TSF AFTER ALL FEES | ALL ORDS ACCUM | TSF OUTPERFORMANCE |
|---|---|---|---|
| Month ending 30 June 2016 | 1.39% | -2.28% | 3.67% |
| 6 Months | 13.32% | 1.55% | 11.77% |
| 1 year | 31.93% | 2.01% | 29.92% |
| 3 years (p.a) | 16.33% | 8.24% | 8.09% |
| Since inception* (p.a) (16.75 years) | 11.29% | 8.05% | 3.24% |




*Please note the TSF returns include the previous USD denominated Supervised Investments Limited which merged with TSF in 2009.

At 30 June the portfolio was composed as follows[1]

| Top 15 Positions | % of NAV |
|---|---|
| Kangaroo Island Plantation Timbers Ltd | 29% |
| Cash | 8% |
| HGL Limited | 10% |
| Australian Vintage Limited | 7% |
| Gale Pacific Limited | 7% |
| Bell Financial Group Limited | 7% |
| Samuel Terry Absolute Return Fund | 5% |
| Hunter Hall International Limited | 4% |
| APN News and Media Limited | 3% |
| South 32 Limited | 3% |
| BHP Billiton Limited | 2% |
| Sirtex Medical Limited | 2% |
| IMF Bentham Limited | 2% |
| Base Resources Limited | 2% |
| Medusa Mining Limited | 1% |

- 0.5% of capital is invested in (put) options over stock market indices.
- 4% of capital is invested in non-ASX listed investments (excluding cash).
- 7% of capital is invested in ASX200 members.
- 9% of capital is invested in oil, gas and resources companies (excluding gold).
- 6% of capital is invested in gold mining companies.
- 76% of capital is invested in companies with a market capitalisation of less than $150m.

[1] Please note we treat our investment in the Samuel Terry Absolute Return Fund as an allocation to non-ASX200 equities.

## Commentary

The Fund returned 31.9% during the financial year ending 30 June 2016. We are pleased with this result in the context of historically low benchmark interest rates and negligible returns in equity market indices during the period. The Fund will not pay a distribution this year. We do not target a distribution yield when constructing the portfolio and are ever cognisant of the natural tendency of investors to prioritise after tax returns.

Unitholders will note we issued a new Information Memorandum on 1 July, the key changes were listed in last month's commentary. A digital copy of the IM is available here, please contact us if you would like to receive a hard copy.

Global markets were inherently volatile during June as many market participants were caught off guard by the UK's decision to leave the European Union. The Fund's positive return was driven by gains in Gale Pacific Limited (up 11%), HGL Limited (up 6%), Kangaroo Island Plantation Timbers Limited (up 4%) and Base Resources Limited (up 34%) which collectively contributed 2.8% to the gross return. The biggest detractors were Australian Vintage Limited (down 6%) and Sirtex Medical Limited (down 19%) which collectively cost 1% of capital.

**GAP, 7% weight.**

Gale Pacific Limited (**GAP**) rallied 11% in June on the back of improved earnings and debt guidance for FY2016. The stock has continued to rally in July. GAP manufactures outdoor knitted polymer fabric (shade cloth) in China and sells a range of building, horticultural, mining and industrial products to retail and commercial customers throughout the world. Approximately 60% of sales are derived in Australia, of which two thirds go to the 'all-powerful' Bunnings Warehouse.

We first investigated the stock in 2013, upon inspecting the Australian operations and meeting the then CEO we concluded the business was sound but the management was somewhat complacent. In 2014 a long term major shareholder nominated a corporate heavyweight as its representative on the Board – we viewed this as a positive development and invested accordingly. Soon after a highly competent and motivated management team was appointed. They immediately got to work taking costs out of the business, repairing tarnished customer relationships, improving the supply chain and exiting non-core product lines. The new CEO understood the business well having previously worked for the company 10 years ago. The stock was aggressively sold down to 17c when the new management team cleared the decks, taking impairment and restricting charges - we took the opportunity to increase to an aggressive weighting.

Management's recent guidance suggests 2016 will see a 47% uplift in profits. Today the stock is trading near 39c, implying a PE of 11x. We expect earnings to grow a further 20% in 2017 as the company experiences the full year contribution from recently acquired customers in the Australian wholesale segment. The management team is about to embark on a cost cutting initiative in the China manufacturing facility and could increase gross margins. Over the longer term there is scope for significant growth in the US division which has tail winds from growing awareness of the benefits of shade cloth and crop protection. Furthermore the earnings profile should benefit from a declining AUD against the USD.

Over time the risk of excessive exposure to Bunnings warehouse will be mitigated as other divisions continue to grow. We are comforted by the low level of debt (less than 1x EBITDA), significant tangible asset backing (the stock trades near the replacement value of its net assets) and expect the management team to continue to deliver. The market cap has recently increased above $100m which might draw attention from the institutional investment community.

**Gold stocks, 6% weight.**

During June we bought shares in 3 small cap gold producers and lifted our exposure to gold to 6%. In a stroke of luck the BREXIT fears late in the month spurred a gain in the price of gold. Investing in gold miners is controversial to some given the metal's useful value is a fraction of its market price and gold does not produce income. We think gold rises during times of uncertainty. While it seems there is a fair chance market participants will view the market environment as uncertain in the medium term, we did not invest purely on this basis. Each of our 3 new companies trade at cheap valuations if the gold price remains at present levels, fair valuations if gold drops 20% and operate a the low end of the cost curve. None of these companies have any debt or significant capital requirements and are run by reputable managers. Gold miners often carry elevated levels of sovereign risk, we have identified this as the most material risk for one of the positions. We cannot predict commodity prices but are comfortable having an allocation to gold miners at this point in the cycle.

## Outlook

The implications of the BREXIT vote continue to dominate news wires. We cannot quantify the impact of the vote on the UK, EU and global economies. It is comical that seemingly everyone we speak to has become an expert in the intricate details of international trade legislation over the last 30 days! We continue to consider the risks to global markets and contemplate how differing environments will impact the earnings capability and market perception of our holdings. Our goal is to create a portfolio which will perform under a multitude of market scenarios.

We continue to build several new positions and look forward to explaining these and existing investments in the coming months. The fund is open to new investors and we welcome any queries on the portfolio, investment strategy and outlook.

Mitch Taylor and David Constable – 20 July 2016.

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