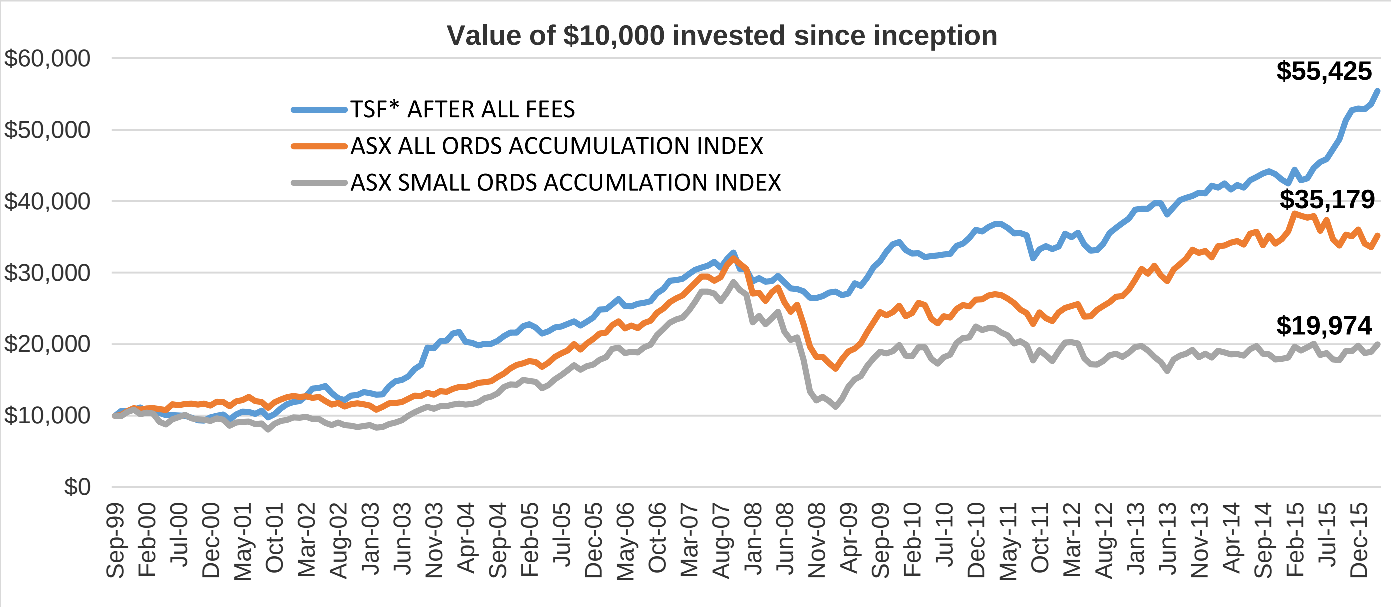
The Supervised Fund (TSF)

Monthly Report – March 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 31 March 2016	3.40%	4.74%	-1.34%
6 Months	13.92%	-3.09%	17.01%
1 year	29.08%	-7.32%	36.40%
3 years (p.a)	12.46%	5.63%	6.83%
Since inception* (p.a) (16.5 years)	10.99%	7.96%	3.03%



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

At 31 March the portfolio was composed as follows[1]

Top 15 Posotions	% NAV
Kangaroo Island Plantation Timbers Limited	26%
Cash	16%
Australian Vintage Limited	11%
HGL Limited	9%
Gale Pacific Limited	6%
Samuel Terry Absolute Return Fund	5%
Bell Financial Group Limited	5%
Hunter Hall International Limited	4%
APN News and Media Limited	4%
Sirtex Medical Limited	3%
South 32 Limited	3%
BHP Billiton Limited	2%
Co-Operative Bank PLC	2%
Molopo Energy Limited	1%
H&T Group PLC	1%

- 1% of capital is invested in options over Stock market indices.
- 5% of capital is invested in non-ASX listed investments.
- 12% of capital is invested in ASX200 members.
- 7% of capital is invested in oil, gas and resources (ex gold).
- 83% of capital (excluding cash) 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

During March global stock markets rallied apparently due to diminished fears of a recession in the US, better economic data out of China and recognition that US interest rates will remain low for some time. TSF's performance was driven by stock specific rather than market return. Australian Vintage Limited gained 19% and S32 Limited 17% and were the dominant drivers of our return. Please click here to read last month's report where we discuss these positions. Our largest holding, Kangaroo Island Plantation Timbers Limited (**KPT**), rose 1% in March. We remain comfortable with KPT and confident about its future.

BFG: 5% weight, up 0% during March.

During the month we bought more shares of Bell Financial Group (**BFG**) after digesting the full year accounts and meeting with management. BFG is the largest independent stockbroker in Australia with full capability across equity capital markets, institutional and retail broking. In addition the company owns 50% of a leading online stockbroking platform. The full year accounts showed a 130% profit improvement as the leverage of the company's fixed cost base was made evident. At current prices the stock trades on a price to earnings ratio of 8x and pays a 9% fully franked dividend. This is particularly attractive given the balance sheet has net cash and the company is led by reputable veteran operators who happen to be the largest shareholders. From our investigation it seems investors do not believe the company will be able to match 2015's result. The sentiment is BFG rode last year's capital raisings boom which seems to have fizzled. We disagree and believe earnings will grow at more than 10% for the next several years.

Global changes in financial institutional regulation are prompting many larger firms to exit the sometimes volatile Australian broking scene and make use of their increasingly expensive capital elsewhere. In the last 12 months CBA, Nomura and CIMB have closed doors. In addition, the increased complexity of stock markets is driving up technology costs meaning firms must have scale to cover remain profitable[2]. BFG is seeing this environment as an opportunity to grow the advisor base without having to pay for goodwill through acquisitions. Many established advisors are lining up to join BFG, with each adding incremental benefit to the bottom line as well as helping build market share which in turn helps win business in the equity capital markets division.

Over the longer term we expect the incumbent retail stockbroking business to be affected by the fast growing, cheaper online broking model. BFG's management has identified this secular trend and significantly invested in an online broking division. In fact, BFG has a much larger market share of the online broking market than its traditional business. This investment has incredible operating leverage; once the high fixed technology costs are covered, more than 70c of every dollar of revenue drops to profit. With this in mind we were excited to see the division record a modest profit for 2015 and expect it to be a driver of earnings growth in the future.

We think the risk to reward ratio is very attractive with Bell Financial and hope we can update you on its positive performance in the future.

BSE: 1% weight, 0% return during March.

During the month we invested less than 1% of unitholder capital into ASX listed Base Resources Limited (**BSE**). BSE mines mineral sands from its Kwale mine, situated in Kenya less than 50km from the principal port facility in East Africa. Between 2011 and 2014 the company raised more than $200m of equity capital and borrowed over $250m to finance the project. The project was commissioned 18 months ago and has been generating cash flow for over 12 months.

[2] The recent events surrounding local broker BBY solidify the need for adequate reporting and operating systems; the regulators would be acutely aware of this.

The confirmed mine life is over 12 years however this is likely to be extended. Today the market cap is approximately $40m with net debt near $250m, meaning the stock trades at 20% of its net tangible asset backing. Volatility in mineral sands prices and an impending debt refinance have spurred an 85% share price decline over the last 2 years. We are attracted to the high quality management team, and the fact the project heralds the second highest operating margin in the industry. At spot commodity prices the company is generating acceptable cash flow, if rutile and zircon prices remain stable or increase the stock could trade closer to tangible asset backing. However this investment entails significant sovereign and commodity market risk, which in conjunction with the unstable balance sheet halted us from risking more than 1% of unitholder capital. We are comforted in that more than 75% of the shares are owned by institutional investors.

HAT LN: 1% weight, up 22% during March.

During the month UK listed H&T Group PLC (**HAT**) released promising full year results which spurred a 22% rise in the share price. HAT is the UK's leading pawnbroker, providing a range of simple financial products tailored for customers who are excluded from the traditional banking sector. The company has been in operation for over 100 years and today operates over 190 stores which represents more than 15% of the national market. It has a remarkably strong balance sheet and a seasoned, incentivised management team. When tough times hit the UK economy HAT's gold buying division booms as clients scramble to raise funds. During 2009-2012 gold buying revenues spurred HAT's earnings to more than 3x their 2015 level. During the last gold buying boom a number of new players were enticed by the high margins and countercyclical earnings streams on offer, the number of UK pawn broking stores increased by over 300%. However when economic conditions settled and gold buying returned to more normal levels many of the new entrants defaulted on debt as the industry overcapacity was made evident. Since this time the industry has been undergoing a consolidation phase which we expect will boost HAT's market position. A recent regulatory probe is expected to cause many small operators to exit as the costs of adhering to new rules are excessive. Today HAT trades on 12x earnings; if underlying economic conditions remain stable we expect earnings will grow at 15-20% as the company takes advantage of industry consolidation. However, if underlying economic conditions deteriorate we would expect HAT to see a pickup in gold buying revenues and at least double annual profits. We like the natural hedge inherent in the stock.

Outlook

We are currently building several new positions and look forward to articulating our investment theses in 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 – 15 April 2016.

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