

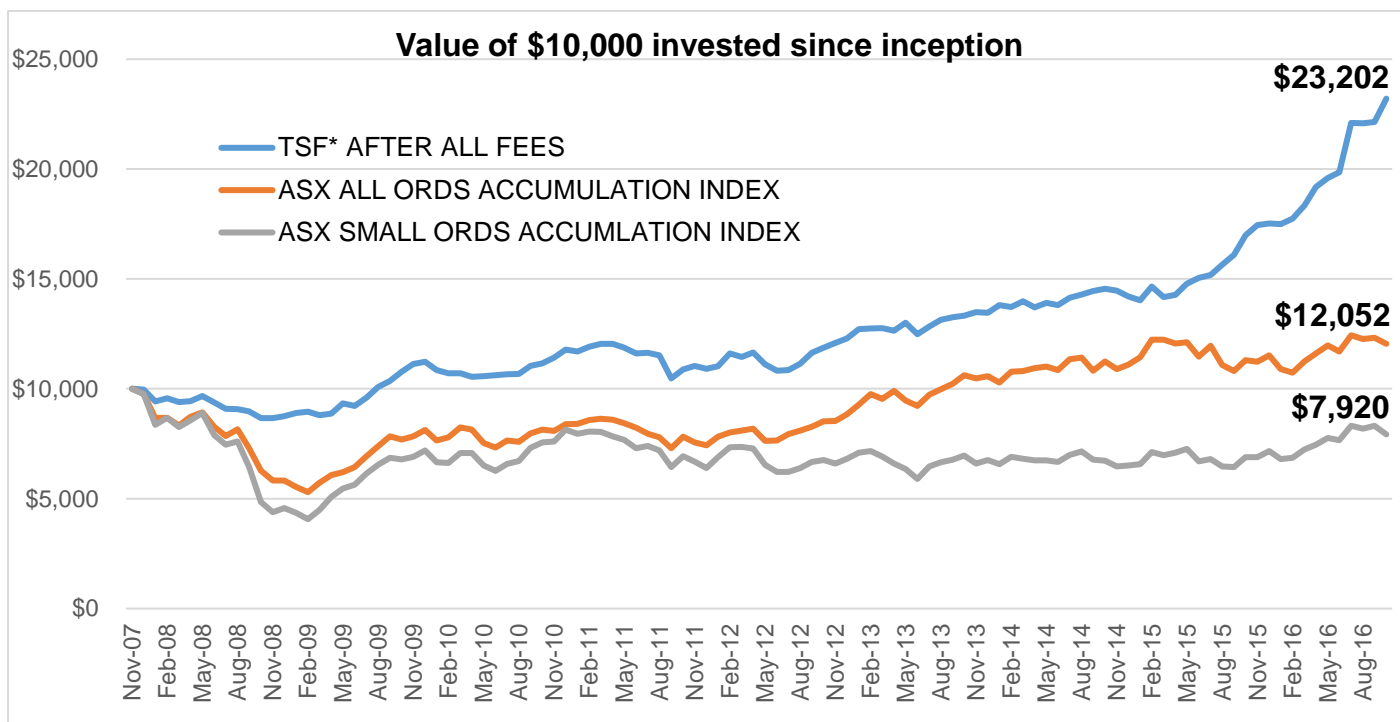
The Supervised Fund (TSF)

Monthly Report – October 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 October 2016	4.77%	-2.18%	6.94%
6 months	20.98%	3.77%	17.21%
1 year	36.62%	6.63%	29.99%
3 years p.a	20.29%	4.30%	15.99%
Since inception p.a (since 1 Dec 2007)	9.90%	2.11%	7.78%



*Please note TSF returns assume reinvestment of all distributions.

At 31 October the portfolio was composed as follows:¹

Top 15 Positions	% of NAV
Kangaroo Island Plantation Timbers Ltd	35%
Cash	12%
HGL Limited	8%
Bell Financial Group Limited	6%
Gale Pacific Limited	6%
Samuel Terry Absolute Return Fund	4%
Base Resources Limited	3%
Osprey Medical Inc CDI	3%
Hunter Hall International Limited	2%
Australian Vintage Limited	2%
IMF Bentham Limited	2%
Po Valley Energy Limited	2%
Sirtex Medical Limited	2%
Beadell Resources Limited	2%
Ramelius Resources Limited	2%

- 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).
- 2% of capital is invested in ASX200 companies.
- 6% of capital is invested in oil, gas and resources companies (excluding gold).
- 7% of capital is invested in gold mining companies.
- 66% 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.

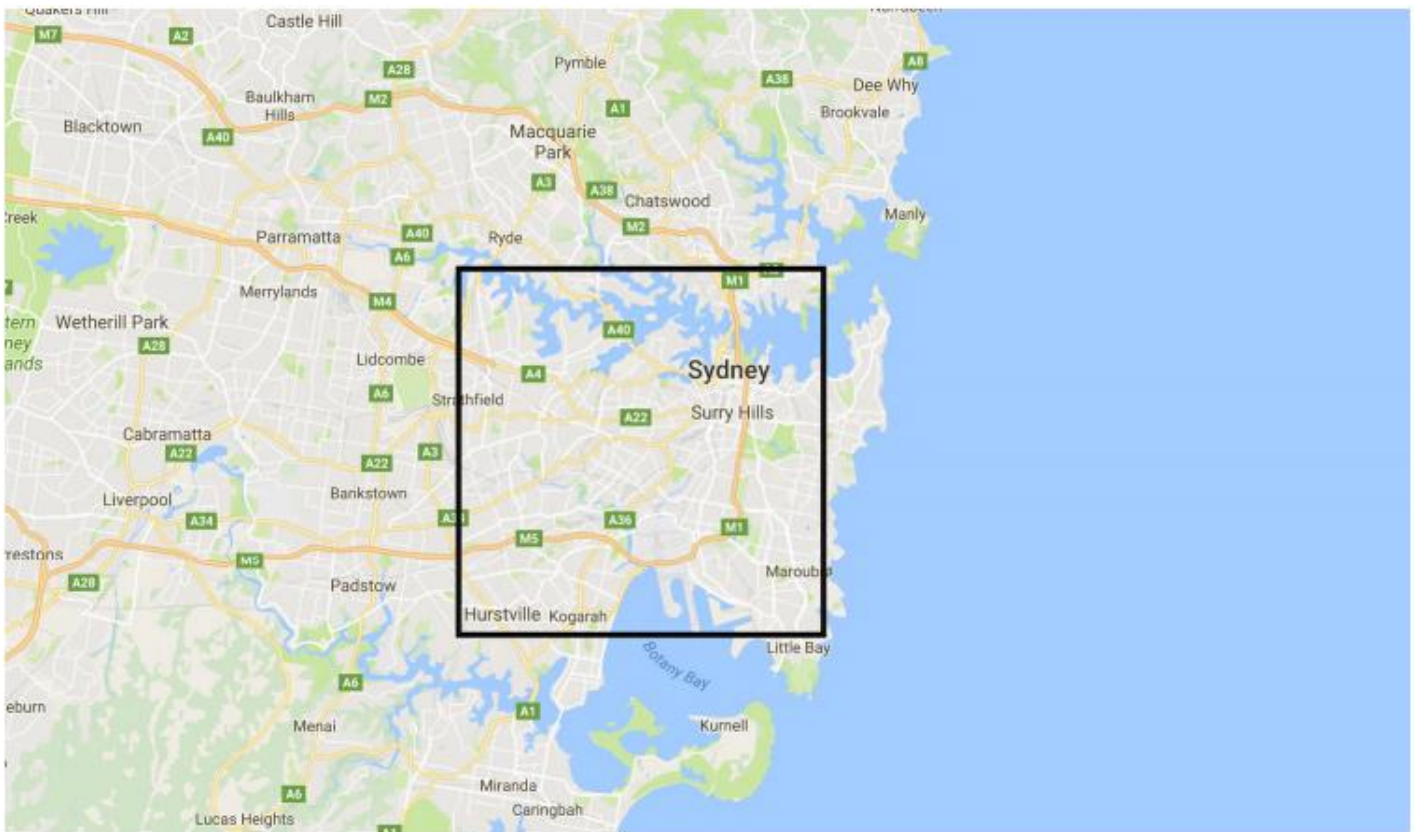
Commentary

The Fund’s positive performance during October was mostly owing to a 30% rise in the carrying value of Kangaroo Island Plantation Timbers Limited (**KPT**)². Given the size of our position we deemed it appropriate to dedicate this month’s report to detailing our KPT investment thesis in full.

During the month KPT announced a purchase of the largest timber estate on Kangaroo Island from New Forests for \$55m. This is a transformative transaction which will:

- Quadruple KPT’s land holding to near 25,000 Ha.
- Triple the volume of KPT’s standing timber so the company will own over 90% of all standing timber on Kangaroo Island.
- All but guarantee ownership of any wharf necessary for the timber to be harvested and ensure the company will have access to such on economically desirable terms.

The below to-scale map illustrates the size of the company’s land holding, superimposed over a map of Sydney.



Source: KPT Investor Presentation.

We believe KPT’s timber will be worth at least triple its land holdings once there is a commercial wharf on the Island. KPT’s enterprise value is currently near \$60m³.

² We moved our carrying value back to a level 1 valuation of \$25 per share, referenced from the last bid on 31 October 2016. We took the view the ASX market for KPT stock was again ‘Active’. This also represents the price at which a \$12.8m (underwritten) capital raising is being conducted.

³ After the rights issue.

The acquisition settles in April next year with extensions available at cost to KPT. To fund an initial deposit and working capital, KPT has undertaken a \$12.8m (underwritten) rights issue at \$25 per share – we did not participate due to the size of our existing position. The objective between now and April is to obtain approval to construct a wharf capable of exporting KPT's timber directly to end users in Asia. Doing so will materially de-risk the project. In approximately 6 months KPT plans to raise \$37m of equity and \$50m of debt to fund settlement and wharf construction. If KPT can achieve wharf approval and the capital markets remain open to small Australian companies we think the stock's stellar rise will continue.

On the same day the transaction was announced KPT lodged an application for Major Development Status with the South Australian (SA) Government to develop the wharf. Importantly, KPT has not sought government aid in its application. The commissioner for Kangaroo Island has publicly supported the application, noting the expected boost to local employment and economic benefit for other industries on the island. SA's economy is undergoing significant hardship as a result of downturns in the mining, steelmaking and car-making sectors – the problem is expected worsen as Holden closes its doors next year. The SA government is desperately trying to secure jobs for its constituents. It has even resorted to paying companies to relocate their headquarters to SA⁴. KPT's project will generate *Jobs and Growth*. Specifically it will generate \$60m+ per annum in export revenue for SA and ongoing direct on-island employment of 118 people. The MD has been pro-active in managing any environmental concerns; the wharf has been designed as minimally invasive to the local eco-system and community. We believe it is highly likely the wharf will be approved for development within 6 months. The cost of the wharf has been quoted at \$25m with 9 months lead-time. We don't know what the true cost will be but acknowledge there are many contractors looking for work in South Australia.

It takes 12-14 years for timber to mature. More than \$200m has been invested in Kangaroo Island forestry to date – this is now ready to be harvested. Once the wharf is constructed KPT will:

- Operate in the bottom 25% of the global timber cost curve.
- Have net tangible assets consisting of land, trees and a commercial wharf exceeding \$200m.
- Generate sustainable EBIT from forestry in excess of \$20m per annum (at current timber prices).
- Have a long term opportunity to generate complementary income streams from alternative industries on the island.
- Become an integral cog in the Kangaroo Island community and economy.

The Australian timber market is facing a shortage of supply as increasing land prices have made timber plantations uneconomic in many regions. The low cost of land on Kangaroo Island in conjunction with expected proximity to an international export facility and favourable climate mean KPT's timber plantations are capable of generating a sustainable economic return in the current environment. Some commentators are suggesting Australia's planted timber volume will cut in half over the next 5 years. KPT will be leveraged to any upward movement in timber prices – our thesis does not rely on this.

Our position in KPT has been very rewarding for unitholders since an emergency recapitalisation issue at \$1.50 per share in early 2013. The Board has continually exceeded our expectations and we believe they are capable of executing their plan – they own 25% of the stock and seemingly share our optimism. We think KPT's future is bright and while there are many hurdles to jump, we remain comfortable having over 60% of our investment backed by arable land in one of the most favourable sovereign jurisdictions in the world.

The fund is open to new investors, please contact us if you wish to discuss our strategy and outlook.

Mitch Taylor – 17 November 2016.

⁴ The most notable initiative saw SA grant \$2.5m to engineering support company Babcock to relocate from Brisbane. The government justified this expense by the move of 48 high-skilled jobs to the state. (<http://www.abc.net.au/news/2016-07-14/babcock-moves-headquarters-to-adelaide/7628120>).

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