JUNE 2019 MONTHLY REPORT

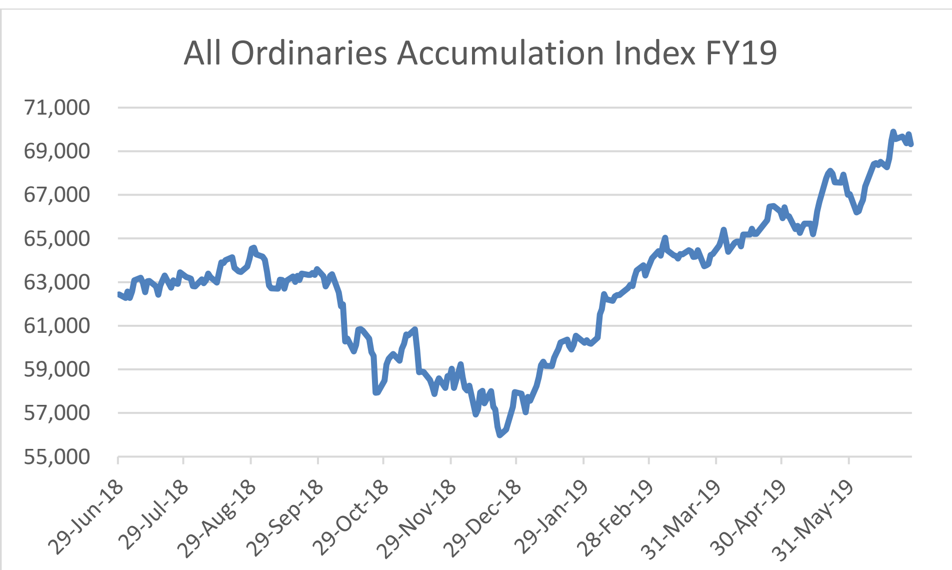
Market Returns and Portfolio Performance

Markets

The All Ordinaries accumulation index gained 11.0% for the 2019 financial year, an outcome that looked very unlikely six months ago after a global sell-off in the December quarter of 2018. Indeed, the 6 month return for the index at the end of June is a strong 19.8% illustrating the turn-around that has occurred and the risks of trying to predict markets. Leading the local market higher have been the larger capitalisation stocks assisted by the unexpected Coalition win at the May Federal Election. Falling interest rates have also provided a tailwind with record low treasury bond yields pushing up share markets. However, other than in the frothy tech stock space, small cap companies have had a more challenging 12 months recording a return of just 1.9% for the financial year.

Performance 30-Jun-2019	Ganes Value Growth Fund	All Ord Index (Accumulation)
1 month	-0.2%	3.4%
3 months	6.7%	7.8%
6 months	12.1%	19.8%
12 months	-3.8%	11.0%
2 years p.a.	10.8%	12.4%
3 years p.a.	11.8%	12.6%
5 years p.a.	9.0%	9.0%
10 years p.a.	11.8%	10.0%
Since Inception (p.a.)*	8.1%	7.3%
NAV Mid Unit Price ($)	$1.6651	
Fund Assets ($ million)	$17.29	

*Inception date of Fund is 18/11/2005



Fund and Stock Performance

The Fund has recorded a disappointing 1 year return of -3.8% breaking a nine year track record of positive financial year returns and the first negative year since the Global Financial Crisis. The underperformance almost exactly reverses the out-performance of the Fund over the previous financial year. Over 10 years the Fund has generated a return of 11.8% per annum, 1.8% ahead of the All Ordinaries Accumulation index return of 10.0% per annum. It is worth noting that the Fund return is net of all fees and expenses whereas the Index return does not suffer the burden of any fees or expenses.

Year	Fund Return	Market Return	Outperformance
2019	-3.8%	11.0%	-14.9%
2018	27.6%	13.7%	13.9%
2017	13.7%	13.1%	0.6%
2016	6.8%	2.0%	4.8%
2015	3.4%	5.7%	(2.3%)
2014	6.4%	17.6%	(11.2%)
2013	23.3%	20.7%	2.7%
2012	5.1%	-7.0%	12.1%
2011	17.0%	12.2%	4.8%
2010	23.2%	13.8%	9.4%
2009	-11.9%	-22.1%	10.2%

As we routinely do in this end of financial year update, we check back to the largest holdings of a year ago and assess how these performed and contributed to Fund performance over the past year. The return numbers in the table below for the 2019 financial year are in stark contrast to those of the prior financial year (FY18). As we said in the fund update at this time last year those returns were 'beyond our expectations' and in our commentary on several of the Fund holdings we noted the possibility that the market had brought forward returns from future years. For example, in the case of ARB we said '*The downside of a large single year return is that it can tend to pull forward future year returns which make the company look relatively expensive currently.*' We have no way of knowing when, or in what order, the market will deliver us these good and bad returns so we focus on achieving a satisfactory return over the longer term.

Top 10 stocks as at June 2018				
	Total Return FY18	% of portfolio (June 2018)	Total Return FY19	% of portfolio (June 2019)
Smartgroup	67.6%	13.1%	-23.3%	4.1%
MFF Capital Fund	38.6%	10.9%	9.7%	7.6%
ARB Corporation	47.6%	10.1%	-18.6%	5.8%
Cochlear	30.6%	6.9%	4.9%	4.8%
Reece Australia	54.7%	6.7%	-21.2%	5.6%
Gentrack	44.2%	6.2%	-5.9%	4.2%
PWR Holdings	17.8%	5.9%	54.9%	7.5%
AUB Group	7.9%	5.6%	-18.8%	4.8%
Nick Scali*	16.4%	5.2%	0.3%	1.4%
Adelaide Brighton*	27.8%	5.0%	-37.8%	1.1%

* No longer in the top ten holdings as at June 2019

After a stellar return of 67.6% in the prior financial year, salary packaging and fleet management company **Smartgroup** has given up some of that gain falling 23.3% over the last 12 months. As we noted in the March 2019 update, while the company reported strong growth in their December full year results, slowing organic growth has taken the gloss off the share price and that along with a couple of other red flags has seen us significantly reduce the weight of the company in the Fund.

MFF Capital Investments has delivered a sound 9.7% return for the year with its net tangible assets (NTA) rising 17.8% over the year assisted by a falling Australian dollar. The difference in these two returns is due to a larger share price discount to NTA at the end of the year compared to the start of the year. MFF is a patient investor and owns a high quality portfolio of mainly US listed assets with the largest holdings currently Visa, MasterCard, Home Depot, Bank of America and JP Morgan Chase.

In the update this time last year we noted the potential downside of the large single year return (47.6%) enjoyed by **ARB Corporation** in FY18. That downside has been realised in the form of a -18.6% return for the 2019 financial year. We wrote about the company in some detail in the March 2019 update and the challenges that it currently faces with a very weak new car market. High quality listed companies such as ARB are difficult to find and we are generally inclined to hold such companies in the portfolio throughout the challenges that they face from time to time.

Global hearing implant leader **Cochlear** reported an 11% lift in revenue and a 10% increase in pre-tax profit when it reported its half year results in February. While implant revenue was flat, services revenue grew strongly driven by strong demand for upgrades to the Nucleus 7 Sound Processor. The company continues to invest heavily in future products with 12% of revenue spent on research on development. This expenditure is expensed through the profit and loss statement as it is incurred rather than being capitalized over future years so there is an argument that the profits of the company are conservatively stated. The company maintains a strong balance sheet despite these ongoing investments. Cochlear generated a 4.9% return for the financial year following 30.6% in the prior year.

Plumbing and HVAC supplier, **Reece**, has been busy incorporating its large American acquisition (Morsco) into its business over the last year. The company announced the $1.9bn acquisition in May 2018 funded by a combination of debt and equity. The market's excitement over the acquisition helped delivered a strong 54.7% return in FY18 and as the excitement has subsided so has the share price contributing to the -21.2% return for the current year. While the company has said the acquisition is 'delivering to expectations' it will likely be several years to fully assess the success of the acquisition. However, with the Wilson family owning more than half of the company we are confident that management will be working hard to ensure that the $1.9bn was money well spent.

New Zealand based utility and airport software solutions company, **Gentrack,** recently reported a disappointing first half performance with profit down significantly on the prior period, driven by a write off of an investment in CA Plus an early stage business acquired in 2017. Despite this, the company made three new acquisitions during the period reflecting the importance of acquisition driven growth in the business model. With the UK as the company's largest market, there is some uncertainty in the near term with Brexit impacting on customer behavior. However, the company continues to be confident in its 15% long-term organic profit growth target.

Gentrack produced a -5.9% return for the year following a 44.2% return in the prior year.

A bright spot in the portfolio over the last year has been the performance of **PWR Holdings** with a return of 54.9% for the year. The company designs and manufactures cooling solutions for the automotive industry, including motorsports, with Formula One being its highest profile market. In the March update we noted the good progress the company has made over the last year investing in and growing its business and that has translated into good revenue and profit growth as well as plenty of investor interest. The company is now the second largest holding in the portfolio.

The last year has been a challenging one for **AUB Group** which operates a network of insurance brokers across Australia and New Zealand. The first half profit reported in February was negatively impacted by a fraud event at Austbrokers Canberra in October 2018 which carved $1.6m from the bottom line along with poor performance in the risk services part of the business. Consequently, management indicated that they expected full year profit growth to be at the lower end of the previously announced 7%-12%. In a recent trading update new CEO Mike Emmett cited continued underperformance in risk services as a primary driver of downgraded profit guidance now expected to be in the range of 3% to 5% growth. These difficulties have contributed to a poor return of -18.8% for the year.

Furniture retailer **Nick Scali** produced a flat return for the year despite a solid first half result with revenue up 10.3% and pre tax profit up 6.1%. With flat same store sales growth, the lift in revenue came courtesy of 10 new stores opened during the prior 18 months. We question the ability of the company to maintain its exceptional profit margins in the current environment and have significantly reduced the position as a consequence.

This time last year we noted the possibility of subdued future returns for concrete products manufacturer **Adelaide Brighton** given its strong return in FY18 and the cyclical nature of the industry that it operates in. In December 2018 the company warned the market that full year profit was expected to be below prior guidance and lower than the prior year. This saw the share price re-rate significantly downward and contributed to the -37.8% return for the last year. We have gradually trimmed this position since early 2017 and that along with the share price fall means it now sits well outside the top ten largest holdings.

<u>Outlook</u>
As is evident in the above narrative, share price performance has varied, sometimes widely, from the underlying business performance of the companies within the fund. Despite some large price falls there have been no disasters in the underlying performance of the businesses, in fact some such as PWR and Cochlear have produced quite decent results. But there have been a couple of disappointments as well such as Gentrack and AUB Group. This will happen from time to time and is a normal part of the running a portfolio of companies.

It appears with the benefit of hindsight that many of the share prices in the portfolio got ahead of the underlying businesses in the prior financial year and the subsequent readjustment has been necessary to bring value back into line with the business performance.

As we have said many times before, we have a strong preference for higher quality businesses and when we find them and add them to the portfolio we also have a preference for holding them for the medium to long term. Consequently by holding a relatively small number of businesses that bear no resemblance to the market index there will be periods of out-performance (e.g. FY18) and under-performance e.g. (FY19) over which we have no control. But we think over time patience will deliver appropriate rewards.

We look forward to reporting back to unitholders on the performance of the underlying businesses in the Fund at the conclusion of the upcoming reporting season in August. A distribution of 15 cents per unit has been paid to unitholders on the register at June 30.