GANES
VALUE GROWTH FUND
APIR WPC004AU | ARSN 115 121 527

SEPTEMBER 2019 MONTHLY REPORT

Portfolio Performance

The fund has enjoyed a strong period with the unit price gaining 3.3% for the month and 7.4% for the quarter. The fund has delivered a return of 2.9% for the past year and 8.5% per annum since inception.

The highlights for the month were the continuing strong run of Dicker Data following a good profit result – the shares were up 22% in September, Beacon Lighting bouncing back 17% after the release of their flat results and Smartgroup also rising a further 9% on the back of a 19% rise in August.

Changes to the portfolio included additional purchases of Domino's Pizza, and also adding to our Nearmap investment as its price fell following the profit results in August.

A new layout

Regular readers will note the different layout of the fund update. In trying to tell you how the fund is performing, and so you may better understand the portfolio, along with portfolio weightings we are now sharing sector exposure with unitholders as well.

Classifying companies can sometimes be quite simple such as Cochlear within the Healthcare sector but sometimes the sector description can also cover a wide range of territory. For example, PWR Holdings is included in Consumer Discretionary when very little, if any, of their business comes directly from consumers. However, the sector exposure does give you a flavour of where the portfolio is invested in broad terms. Our holdings in PWR and ARB make up more than half of the Consumer Discretionary weighting, our largest exposure.

Cash currently sits at 7.8% of the fund.

Performance as at 30 September 2019

	Fund (net of fees)	All Ord Accum. Index
1 month	3.3%	2.1%
3 months	7.4%	2.8%
1 year	2.9%	12.1%
3 years p.a.	10.9%	11.7%
5 years p.a.	10.4%	9.7%
10 years p.a.	10.6%	8.2%
Since Inception (p.a.)*	8.5%	7.4%

*Inception date of Fund is 18/11/2005

Top 10 Holdings:

Company	Code	Weight (%)
PWR Holdings	PWH	11.0
MFF Capital	MFF	10.6
Reece Australia	REH	7.9
ARB Corporation	ARB	7.7
Smartgroup	SIQ	7.7
AUB Group	AUB	6.8
Cochlear	COH	6.2
Nearmap	NEA	5.0
Gentrack	GTK	4.4
Steadfast	SDF	4.3

Unit Prices as at 30 September (cum Distribution):

Entry Price	$1.6307
Mid-Unit Price	$1.6266
Exit Price	$1.6225

Sector Exposure:

Sector	Weight (%)
Consumer Discretionary	34.3
Financials	24.0
Industrials	15.6
Information Technology	10.6
Health Care	6.7
Materials	1.0
Cash & Other	7.8

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PWR Holdings

PWR remains our largest holding and while the shares were flat in September the market appears to now recognise the underlying quality of this business and its growth prospects. The shares continue to reach new highs but rather than focus on the positives which we have written about in previous updates, there are two issues to contemplate currently.

Firstly, while October 31 will be taken up with headlines about Brexit, just as importantly for the fund the Formula 1 governing body, FIA, will be announcing some rule changes that day with the aim of standardising some parts on the cars and reducing overall costs for the teams. FIA boss, Ross Brawn, has hinted that things like fire extinguishers, pit gear and fuel pumps could be standardised. There has been no mention that cooling systems will be included but if they are there is no doubt that PWR will take a hit to its bottom line. How much is hard to say, and the company is stating that it's confident that cooling systems will be excluded from the rule changes. These sorts of scares have been around F1 for many years and reminds us somewhat of the intermittent scares about banning bullbars with ARB last decade (which never came to anything). But the price has risen strongly, it's our largest investment, and these changes could have an impact on the business, so we are not complacent about them.

And secondly, there has been some further Director selling in recent times. MD, Kees Weel owns most of his shares jointly with his son so it's hard to tell whether it's Kees, his son Paul, or a combination of both that are selling, but the reality is that after recent profit results they have taken the opportunity to reduce their holding. And in recent months Non-Exec Director Roland Dane also sold all his shares except for those held by his Superannuation fund.

The AGM will be held at their factory later this month and Kees will be presenting at an investment conference in mid-October and no doubt he will be quizzed at these events on this as it will be top of mind for other investors too.

Nearmap

Nearmap was the largest detractor on fund performance for the quarter with the price down 33% since June. We added to our position after its profit results were released and added more during the month. We wrote about the result last month but it's worth adding some further commentary given the price fall.

Accounting principles don't always neatly explain economic value in a business and in the case of Nearmap it can be seen quite clearly. By opening a new sales office in the USA, the company has added to its cost base and reduced profitability over the short term. But when sales staff are adding at least $1 of revenue for every $1 of expense and profit margins are high then this is the right thing to do. Our expression for this is 'investing in the P&L'.

The easiest way for Nearmap, or any other growth company, to generate higher profits is to slow down spending on growth that must be immediately expensed. Of course, there is a big distinction between "investing" and wasting money unnecessarily and we rely on management to know the difference. We have other companies in the portfolio that fall into the same boat. Whether its store rollouts by retailers, adding engineers at PWR, or R&D spend by Cochlear for examples it's clear that increasing economic value is not always reflected by accounting results.

Nearmap is gaining new clients, they are spending more each year (average revenue per subscription increased by 23% for the year shown in the chart below), and they are staying longer (indicated by the churn rate falling to 5.3%), leading to very strong growth in revenue. And the sales staff are doing a good job with the Sales Team Contribution Ratio nearly three times higher than usual SaaS business model indicators. If they can continue to do that our investment should work out well.

Lovisa – a new addition to the portfolio

Lovisa was a new addition to the portfolio during the quarter**.** For investors with teenage daughters this company needs little introduction, but for the rest of us Lovisa is a retailer that sells fast fashion accessory items at very affordable prices.

From its original beginning with a shop at Chermside in 2010, Lovisa has now grown to have 390 stores in 11 countries and sales of $250 million. Overseas stores now comprise more than 60% of the business and the company has just started its rollout in the USA where the early signs indicate it could be a big success. The company now has 21 stores in the USA, mostly on the West Coast, but it will eventually have multiples of this as it builds out its store network. The USA market is a significant opportunity for the business although costs could be higher, and therefore margins lower than in Australia.

What has attracted us to the business are its big profit margins. With a gross profit margin of 80% Lovisa is no ordinary retailer. To put that number into context, it is higher than Inditex, the owner of Zara, considered one of the best retail businesses in the world. To buy something for $1 and sell it for $5 suggests this is more than a transaction of goods, the business is adding value to its customers in other ways.

An investment case is not built around personal anecdotes but this concept of adding value was highlighted to by two stories we heard while researching the business. One was a friend with two young daughters on an outing, and rather than buy them a meal at a fast food outlet he took his daughters to Lovisa where they spent the same amount of money but received something far more tangible and longer lasting than a meal that is soon forgotten. For both Dad and the daughters this was a win-win. The other is that of a daughter of a friend entering the workforce and her daughter regularly buys pieces of jewellery, as often as weekly, that she finds very affordable and can wear to work and keep her wardrobe updated. It's this type of customer that provides the business with the ability to turn over their inventory at much higher levels than other fashion retailers.

From an operational perspective the stores have a small footprint, they don't cost a lot to fitout, and they appear to have sales per square metre that easily exceed that of other fashion retailers.

Execution of its overseas rollout is the obvious risk for investors as well as managing their supply chain as they become a truly global business, but the founder CEO, Shane Fallscher, and Chairman and Rich Lister, Brett Blundy have successfully grown the business thus far and both have big stakes in the business and are closely aligned to its success.

Retailing is a hard business to build any competitive advantage and more often than not investors can fare poorly, so we are very mindful of this when sizing our position.

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