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June Quarterly Report

MACRO CAPITAL LIMITED
ABN 14 145 321 928 | AFSL: 392401

GANES INVESTMENT MANAGEMENT PTY LTD
ABN 86 113 032 741 | AFSL 287598

Markets

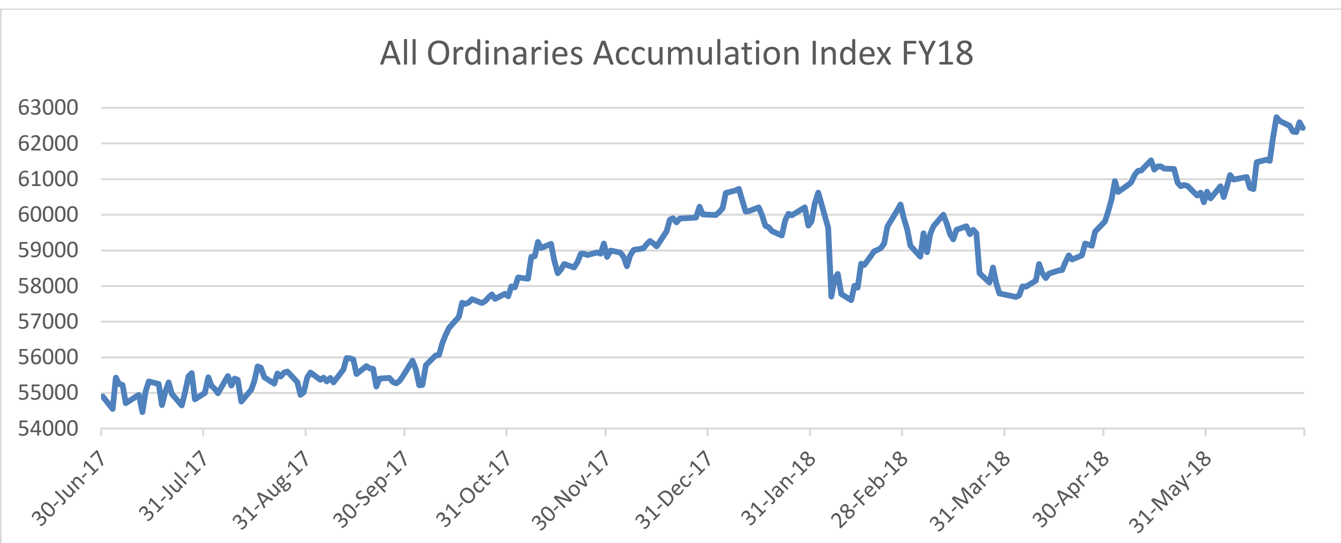
Performance 30-Jun-18	Ganes	All Ord Index
1 Month	2.78%	2.95%
3 Month	8.23%	8.03%
6 Month	8.46%	4.04%
1 Year	27.65%	13.73%
2 Year (p.a.)	20.46%	13.42%
3 Year (p.a.)	15.71%	9.48%
5 Year (p.a.)	11.25%	10.28%
10 Year (p.a.)	10.86%	6.16%
Since Inception (p.a.)*	9.07%	6.99%
NAV Unit Price ($)	1.8655	
Fund Assets ($ million)	27.55	

* Inception date of Fund 18/11/2005

The Australian sharemarket has enjoyed a second consecutive year of double-digit returns, producing a 13.7% return following a 13.1% return last year, all despite worrying developments in geo-politics. The global economy is doing well led by the USA which is benefiting from tax cuts, strong job growth and healthy corporate profits and a buoyant housing market. The S&P500 also had a good year, outdoing the local market with a 14.4% return despite a rising chorus of value-oriented investors and commentators claiming that the US market appears to be too expensive.

On the other hand, the Australian market in aggregate appears reasonably priced with the ASX200 price/book ratio sitting at 2 times, which is around its long-term average. Part of the value comes from the relative under-performance of large companies lately and in particular, the big four banks and Telstra, though this was somewhat offset by the good performance of the larger mining companies.

By contrast, it has been a stellar year for Australian small cap companies, and while some companies appear excessively expensive, in general the small cap index is still lagging the large cap index over the past ten years.



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Fund and Stock Performance

The Fund has reported its ninth year in a row of positive returns with a gratifying return of 27.6% representing a significant outperformance of the All Ordinaries Accumulation Index. Over 10 years the Fund has generated a return of 10.9% per annum, 4.7% ahead of the All Ordinaries Accumulation index return of 6.2% 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
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 are of a magnitude that could not have been anticipated a year ago, and beyond our expectations. As we have said before, with a concentrated portfolio approach we expect our top ten holdings to do the heavy lifting for the Fund and they certainly have delivered over the last year with all delivering positive returns and all but one delivering solid double-digit returns.

Top 10 stocks as at June 2017	% of portfolio (June 2017)	Total Return FY18	% of portfolio (June 2018)
Smartgroup	9.7%	67.6%	13.1%
ARB Corporation	7.8%	47.6%	10.1%
Clydesdale Bank*	7.5%	19.9%	0.0%
MFF Capital Investments	7.1%	38.6%	10.9%
Cochlear	6.1%	30.6%	6.9%
AUB Group	5.8%	7.9%	5.6%
Nick Scali	5.4%	16.4%	5.2%
Adelaide Brighton	4.9%	27.8%	5.0%
Gentrack	4.8%	44.2%	6.2%
PM Capital Global*	4.7%	23.6%	1.6%

*No longer in the top ten holdings as at June 2018

Smartgroup reported another strong year of growth in February principally from acquisitions but organic growth was also a meaningful contributor. The bulk of the company's business comes from salary packaging and novated leasing and by year end it had 325,000 active packages (up 47%) and 62,500 active leases (up 18%). Revenue was up 40% for the year and after-tax profit (pre-amortization of intangibles) up 46%. Net debt increased but the interest expense remains well covered by cashflows. Smartgroup remains the largest position in the portfolio at June 30 and produced a 67% return for the year.

ARB Corporation reported a solid half year result earlier in the year with sales up 12.4% and adjusted net profit up 13.4%. Importantly, the company continues to invest in research and development of new products and expand its distribution capability both here and internationally. This time last year we noted that ARB had produced a small negative return for FY17 but as long term shareholders, we remained confident in the business and its management. Our confidence has paid off in FY18 with a 47% return. 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.

Clydesdale Bank had a solid year up 19.9% with the new management team continuing to make progress in restoring profitability. However, we exited the position over the course of the financial year having achieved our targeted return ahead of time. The average purchase price was $4.04 with purchases made in early 2016. Our average sale price was $5.18 over the course of FY18 generating a return of 28% in less than 2 years.

After two years of modest returns, **Magellan Flagship Fund** produced a healthy 38.6% return for the year. Pre-tax NTA per share rose 18% to $2.761 from $2.324 a year earlier. Again, there was little change in the list of largest holdings over the year with Visa and Mastercard now 27.4% of the MFF portfolio.

Cochlear reported a solid result for the December half year in February with sales up 7% and NPAT up 1% with profit impacted by higher marketing, R&D and taxation expense. The Americas was a strong performer for the company with unit sales and dollar sales up 15%. Cochlear notes that 360 million people have disabling hearing loss and that this market is penetrated less than 5%, so there remains a significant runway for the company. We noted last year that after two years of strong share price gains, that we expected more subdued share price performance. However, in line with our lack of ability to predict share prices or markets, the shares rose another 30.6% this year which, while gratifying in the short term, has arguably brought forward future returns.

AUB Group operates a large network of insurance brokers across Australia and New Zealand representing $2.6B in Gross Written Premium across more than 1 million client policies. For the first half of the year underlying revenue lifted 7.2% and adjusted after tax profit was up 15.1% with management noting that the results were ahead of their expectations and that they expected full year results to be at the top end of their 5-10% guidance. Despite the positive results and outlook the shares produced the lowest, but still positive return amongst the top ten holdings, of 7.9% for FY18.

In February **Nick Scali** reported solid like for like sales growth of 2.6%, total sales growth of 8.1% and an impressive increase in after tax profit of 15%. We mentioned last year that we would not be surprised to see the exceptional profit margins unwind in the future, but they continued to expand in the first half. The company opened six new stores in the first half of the year and were targeting two new stores in the second half with the long-term target of 75 stores compared to the current 52 store network. The shares have produced a respectable 16.4% return for the year but the market was under-whelmed by full year guidance and by the announcement that the Managing Director, Anthony Scali, had sold half (11m shares) of his shares in the company to a Chinese based company that is also a supplier to Nick Scali.

Adelaide Brighton reported its full year (December 2017) results in February with revenue up 11.7% and underlying after tax profit up 5.3%. The company is the number one concrete products manufacturer in Australia and holds number one or two industry positions in other parts of its business. Its business is tied closely to the fortunes of the engineering, construction and mining sectors but its dominant position provides some protection against those cyclical forces. The shares rose 27.8% over the year, well ahead of the underlying business, so we should expect more subdued returns going forward.

New Zealand based software developer **Gentrack** has had an eventful and productive year signing new customers, opening new offices, and making acquisitions. In its recently reported half year results (to 31 March 2018) revenue was up 80% and profit up 50% benefiting from acquisitions made in early 2017, and management restated their long term target of 15% compound annual growth in earnings. The market has reacted positively to these developments marking the stock up 44% over the last 12 months.

The **PM Capital Global Opportunities Fund** owns a portfolio of international listed shares domiciled mainly in North America and Europe with a large exposure to the banking sector. In a recent update, the investment manager noted the negative impact of political uncertainty in Italy and Spain, on the banks owned in the portfolio. Despite this, pre-tax NTA rose around 13% over the year in line with global markets, but total return was 23.6% as the discount to NTA closed.

Top 10 stocks as at June 2018

	% of portfolio (June 2017)	% of portfolio (June 2018)
Smartgroup	9.7%	13.1%
MFF Capital Investments	7.1%	10.9%
ARB Corporation	7.8%	10.1%
Cochlear	6.1%	6.9%
Reece Australia*	3.8%	6.7%
Gentrack	4.8%	6.2%
PWR Holdings*	4.5%	5.9%
AUB Group	5.8%	5.6%
Nick Scali	5.4%	5.2%
Adelaide Brighton	4.9%	5.0%

*Not in the top ten as at 30 June 2017

There are two newcomers to the top ten holdings as at 30 June 2018, Reece and PWR Holdings.

We have owned **Reece** in the portfolio since 2006 when we first purchased it at a split adjusted price of around $3.50 compared with the current price of $12.65. Reece made its way into the top ten this year on the back of a 54.7% return for the year and additional purchases for the Fund when we participated in a rights issue by the company to raise capital for the acquisition of Morsco.

The acquired business is a US distributor of plumbing, waterworks and heating and cooling equipment (HVAC) products with $2.3bn in sales in CY17. Reece paid $1.91B for the business and the company raised $560m from shareholders to help fund the purchase which we participated in. This is the first issue of any new shares by Reece in at least the 12 years we have owned the shares, underlying the importance of the business being acquired. The Wilson family, who own 75% of the company, have said the acquisition provides a strategic platform into the US market, though we are ever mindful of the difficulties many Australian companies have had following promising US acquisitions.

PWR Holdings listed on the ASX in late 2015 at $1.50 and currently trades at $2.71. The company has grown out of a small Gold Coast radiator factory started by Kees Weel in 1987. Today they specialize in customized cooling solutions for the automotive industry and motorsports in particular, highlighted by their supply of cooling systems to several Formula One teams which constitutes about one third of revenue. We have visited the business including their manufacturing facility located between Brisbane and the Gold Coast and were impressed with the management team, the workplace culture, the technology and pursuit of excellence, as well as their focus on profitability. As a result, we have continued to purchase shares in PWR over the last year pushing the company into the top ten holdings of the portfolio.

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Outlook

Our focus as managers of the Fund is to identify, buy and hold a portfolio of superior businesses characterised by owner-managers with a track record of allocating shareholder capital wisely, a product or service that is sought after and highly valued by its customers and not easily replicated by competitors, as well as above average profit margins and returns on capital.

It's a long list but we believe that this results in a portfolio with good growth prospects, strong cashflows and minimal need for additional capital diluting returns for investors.

We believe we have built a portfolio with these attractive features and prefer to hold these positions in spite of share price movements which might prompt others to sell and move on elsewhere. Selling incurs transactions costs, brings forward tax payments, and requires us to find replacements for hard to replace businesses. Consequently, given the high returns of the last year, we believe parts of the portfolio are currently priced at levels which we would not find attractive as an entry point but we are content to hold given their quality and future prospects and our long term approach.

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 12.01 cents per unit has been paid to unitholders on the register at June 30.

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