GANES

FOCUSED VALUE FUND

APIR GCM0001AU | ARSN 117 119 712

JUNE 2020 QUARTER REPORT

Portfolio Performance

The fund ended the financial year on a good note with the unit price up 22% to $3.02 (pre-distribution) for the quarter, outperforming the market by 5.4%. For the full year the fund reported a return of -4.4%, our first negative return for a full year since 2009. The fund has returned 8.7% per annum for the last 10 years and 10.6% per annum since inception.

The Fund performed well over the past quarter as prices rebounded for nearly all of our larger holdings. Some did so in spectacular fashion with Nearmap rising nearly 100% in just a matter of weeks and PWR Holdings also rose 30% as F1 races were announced to resume in July.

The unit price is still down ~10% from the February high but remaining fully invested and judicious buying has worked out well so far and cash remains at low single-digit levels.

As I wrote in March, I was confident that the crisis presented an excellent buying opportunity for investors and this has been borne out to date. Companies such as Carsales.com and Carindale Property Trust were added to the portfolio at attractive prices that should enhance portfolio returns over the coming years.

The rapid recovery in share prices has been surprising given that Covid-19 and its second order effects still have some way to play out. Fears of a second wave are not without merit as we are witnessing in Victoria and the Americas. In Australia, the economic hangover once Jobkeeper and Jobseeker payments are terminated or reduced, and the sugar hit from early access to super fund balances could also have unintended consequences.

Performance as at 30 June 2020:

	Fund (net of fees)	ASX 300 Accum. Index
3 months	22.2%	16.8%
1 year	-4.4%	-7.6%
3 years p.a.	6.5%	5.2%
5 years p.a.	7.3%	6.0%
10 years p.a.	8.7%	7.7%
Since Inception (p.a.)*	10.6%	8.5%
Value $10,000 invested since inception	$59,337	$42,417

*Inception date of Fund is 14/10/2002

Unit Prices as at 30 June 2020 (pre-distribution):

Entry Price	$3.0300
Unit Price	$3.0225
Exit Price	$3.0149

Top 10 Holdings:

Company	Code	Weight (%)
PWR Holdings	PWH	12.3
MFF Capital	MFF	9.4
Reece Australia	REH	6.3
Domino's Pizza Enterprises	DMP	6.2
Nearmap	NEA	5.9
ARB Corporation	ARB	5.8
Dicker Data	DDR	5.1
Cochlear	COH	5.0
Carindale Property Trust	CDP	4.2
Carsales.com	CAR	4.1

Top 5 Sector Exposure:

Sector	Weight (%)
Consumer Discretionary	29.5
Financials	21.5
Information Technology	17.6
Health Care	9.0
Industrials	8.0
Cash & Other	14.4

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Fund Performance

The largest contributor to fund performance over the past year has been Domino's Pizza by a clear margin. The decision to buy back into Domino's in 2017 and then add to the position last year has been rewarded with the price rising 80% during the year despite coronavirus causing the company to briefly close stores in Europe and New Zealand. Domino's is a global business and its overseas operations have produced good results recently and the company still has a long runway in front of it as it continues its store rollout in Europe. Domino's could emerge as one of the few businesses relatively unscathed by Covid-19.

Fun fact: Domino's Pizza USA (DPZ) floated on the New York Stock Exchange in 2004, almost the same time as Google. Google has provided investors with a return of 41 times their money since then. Domino's Pizza has risen from $14 to $790 (accounting for dividends) providing its shareholders with a return of more than 55 times their investment. Investors should not confuse the quality of the pizzas with the quality of the business.

Other positive contributions came from long term holdings PWR Holdings, Dicker Data and AUB Group. Newcomer to the fund, Carindale Property Trust, also provided a strong contribution as its price rose over the past quarter, and we enjoyed the benefit of not owning the shares prior to coronavirus.

On the negative side software provider Gentrack disappointed shareholders multiple times during the year, and I sold the shares earlier this year but not before it had fallen over 50% in just six months. It ended up falling nearly 80% for the year so there is some solace in that it could have been worse. The other large negative contributor was Nearmap as its price fell 40% during the year, but that was on the back of a strong run up in 2019. As noted earlier Nearmap nearly doubled over the past three months and remains a large holding in the fund.

Financial Year	Fund Return	ASX300 Return	Difference
2005	15.5%	26.0%	-10.5%
2006	34.8%	24.0%	10.8%
2007	45.0%	29.2%	15.8%
2008	-27.6%	-13.7%	-13.9%
2009	-14.1%	-20.3%	6.2%
2010	24.5%	13.1%	11.4%
2011	17.8%	11.9%	5.9%
2012	2.9%	-7.0%	9.9%
2013	23.7%	21.9%	1.8%
2014	5.6%	17.3%	-11.7%
2015	2.6%	5.6%	-3.0%
2016	4.8%	0.9%	3.9%
2017	12.5%	13.8%	-1.3%
2018	23.2%	13.2%	+10.0%
2019	2.5%	11.4%	-8.9%
2020	-4.4%	-7.6%	+3.2%

Nearmap is one of two businesses in the fund, (the other is Audinate), that is at or on the cusp of profitability. Investment markets have been very kind to shareholders in companies as they cross the threshold from losing money to making money. With strong growth in revenue and high profit margins they can ramp up profitability quickly providing wonderful investment results in the process.

The biggest surprise was the rapid rebound in the prices of many retailers, businesses that I thought would take a big hit as a result of the shutdown of the economy. I positioned the portfolio accordingly, selling our small holdings in Beacon Lighting and Nick Scali. They have both doubled since then.

The table on the previous page shows fund performance for each financial year since 2005. As readers can see, for the 10 years from 2010 to 2019 following the GFC, the fund enjoyed continuous positive returns. Some years were better than others, but they were all positive. What I find interesting in the table is that by zooming out to even just an annual view of the results the volatility and "noise" quickly dissipates. For all the drama and angst of the past year, and the major dislocation of markets in March, the fund is down a relatively modest 4% for the past year.

Being fully invested

Taking a long-term view has shaped another aspect of our investment approach quite profoundly over the past few years – remaining fully invested as much as possible. This was a lesson learnt in various stages and in various ways.

The returns in 2014 and the fund's underperformance against the market, was greatly affected by holding a large cash weighting. Like any year there were economic clouds on the horizon and we, wrongly as it turned out, thought markets could fall. However, sitting on a lot of cash creates its own problems. Firstly, believing that markets could fall led to gathering information that confirmed this opinion and justifying that prices for many companies were too high. And secondly, as prices rose, as they did during 2014, it became psychologically harder to buy at even higher prices than ones that we already thought were too high.

Finally, the other lesson learnt was holding cash also tends to lead to making small investments in companies that may not have otherwise made it into the portfolio. To that end 2015 returns were affected by losses on some smaller investments that were made but in hindsight were mistakes. Today, when a new investment is added to the portfolio it usually requires the sale of an existing investment creating two questions to be resolved. Is this prospective investment better than our existing portfolio and if so, which investment to sell?

Position Sizing

One of the other important lessons learnt from other successful investors in recent years is that of allowing investments to compound. The temptation to sell when a stock becomes a large holding, where there are large unrealised capital gains to protect, and fear any news could see those gains evaporate can be very tempting. But it is almost invariably wrong.

The largest holding in the fund currently is PWR Holdings which has increased to more than 10% of the fund as a result of price appreciation rather than additional purchases. Readers will note many holdings have around a 4% weighting which is considered a normal weighting for the fund for the type of businesses we like. Positions with larger weightings than this are almost invariably as a result of capital gains. It also means that companies at the lower end of the top 10 will tend to change each quarter as a result of price movements rather than additional purchases or sales. If a company no longer appears in the top 10 it should not be assumed it has been sold.

Quality is the strategy but sometimes asset plays will appear

Our investment approach has been to find good quality companies and hold them for the long term. That is, companies that are profitable, earn high returns on capital, and most importantly, can continue to grow profits by reinvesting capital into the business. These are our 'compounders' and include ARB Corporation, Domino's Pizza and Dicker Data as examples. I am confident that PWR Holdings will also join this list in the coming years.

The other approach is to buy assets at a significant discount to their appraised value and wait for that value to be recognised. I prefer owning compounders and watching them grow – much like a parent enjoys watching their children grow and realise their potential, however I will also add asset type plays when they present themselves. The recent addition of Carindale Property Trust falls into this category.

Carindale Property Trust

During March at the height of the Coronavirus panic many property trust prices fell around 70% as many retailers shut their shops and some were publicly refusing to pay their rent. In addition, the move to online sales led to questions being raised around the value of office buildings and shopping centres. Caught up in this, Carindale Property Trust saw its share price fall more than 50% in a matter of weeks.

Carindale Property Trust is a single asset property trust, owning 50% of the Carindale Shopping Centre in Brisbane. At 136,000 square metres, Carindale is one of the largest shopping centres in the country and one of four marquee shopping centres in Brisbane. Originally listed as the Suncorp Property Trust in the mid 1990's, the centre has expanded over the past 40 years as the surrounding suburbs have also expanded. Westfield made a takeover offer for the trust in 1999 at $2.63 per share, and I mention the price because we were able to buy the shares at the end of March for $2.70. So, an A-grade commercial property with 99% occupancy was selling for virtually the same price as 20 years ago.

The numbers are reasonably straight forward and quite compelling. There are 70 million shares on issue (the same as 20 years ago) providing a market capitalisation of $190 million. There is also $255 million in debt (fixed at 2.75%), for a total value of $445 million for 50% of the whole centre – this is the equivalent of $3,250 per square metre against its current book valuation of $6,250 per square metre.

The centre itself generates around $1 billion in sales or more than $13,000 per square metre, which means that most retailers within the centre are probably making money. This may become important if tenants start flexing their muscle over rent negotiations.

For the past 5 years the trust has paid between 35c and 40c per unit per year in distributions, a yield of 13% to 15% at our purchase price, although it is likely this will come under pressure in the short term.

Despite the potential for valuation reductions this should still work out okay. Assuming valuations are reduced by 25% to $4,500 per square metre, that still works out to a share price of $5.15 – 90% more than our purchase price. And if distributions also fall 25% to 30c per unit, where they were a decade ago, that's a yield of more than 10% per annum as well. Over the next few years if the price tracks back towards its book value Carindale should work out well as the shares should nearly double and we will receive 10% per annum in income as well.

I am fortunate that we have a group of investors that have taken the long view with the fund which I truly appreciate, and it allows me to take the long view when investing your funds. As always if you have any questions please feel free to contact me.

The fund will pay a final distribution of 9.67 cents per unit for the June half-year, which is expected to be paid shortly after the 13th July.

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