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March Quarterly Report

MACRO CAPITAL LIMITED
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GANES INVESTMENT MANAGEMENT PTY LTD
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Markets

The local market was flat in March but this didn't prevent the first quarter of the calendar year producing an exceptionally strong 10.21% return to the All Ordinaries Index. This performance was driven by the larger companies, as the table below indicates. The top 100 companies put on 10.58% for the quarter with the 50 mid cap stocks producing 12.17%.

		Annualised Returns			
Accumulation Index	**3mth**	**1yr**	**3yr**	**5yr**	**10yr**
S&P/ASX 20	10.48%	14.00%	18.25%	9.46%	10.20%
S&P/ASX 50	10.38%	14.15%	17.18%	9.20%	8.91%
S&P/ASX 100	10.58%	14.96%	16.93%	9.10%	8.69%
S&P/ASX 200	10.33%	14.13%	15.82%	8.59%	8.33%
S&P/ASX 300	10.31%	13.90%	15.31%	8.32%	8.16%
All Ordinaries Index	10.21%	13.25%	14.72%	8.22%	8.13%
S&P/ASX Mid Cap 50	12.17%	21.91%	14.70%	8.22%	7.02%
S&P/ASX Small Ordinaries Index	7.30%	2.30%	-1.72%	-0.30%	2.72%

Source: au.spindices.com

Performance 31-Mar-15	Ganes	All Ord Index
1 Month	-0.50%	-0.03%
3 Month	6.57%	10.21%
6 Month	8.32%	13.04%
1 Year	7.04%	13.25%
2 Year (p.a.)	8.81%	13.22%
3 Year (p.a.)	12.35%	14.72%
5 Year (p.a.)	10.82%	8.22%
Since Inception (p.a.)*	7.90%	7.13%
NAV Unit Price ($)	1.5389	
Fund Assets ($ million)	36.14	

* Inception date of Fund 18/11/2005

The **four major banks** which comprise roughly 28% of the All Ordinaries Index had a stellar quarter lead by Westpac (18.8%), NAB (14.7%), ANZ (14.2%) and Commonwealth Bank (11.4%). There is little doubt that record low interest rates have driven the appetite for the relatively high yielding bank stocks exemplified by the strong bank share price reaction to the 25bp cut in the cash rate by the RBA on the 3rd of February. With at call bank deposit rates now below 2%, the hunt for yield is keen, and the banks are prime targets given their 4 to 5 percent fully franked yields. The table also shows that the top 20 companies have produced a 10.2% annualised ten-year return, no mean feat given it spans the GFC, and well ahead of the high single digit returns of the other indices. Not surprisingly, the banks have led the charge with double digit ten year returns from ANZ, Commonwealth Bank and Westpac. Our major banks now rank amongst the most expensive in the world, and as attractive as our financial system is, it is hard not to conclude that investors have grown complacent about business risk and valuation risk in this sector.

Beyond the top 100, the story for the last quarter and longer periods is much more sobering. The Small Ordinaries Index, covering companies ranked 101-300 generated 7.3% for the quarter but just look at those longer term returns. Investors in this index have gone backwards, with an investment made five years ago, are ahead just 2.7% per annum over the last decade. The lower returns across time of the All Ordinaries Index against the S&P/ASX300 indicate that companies smaller than those in the Small Ordinaries Index have fared even worse. Ten year returns point to a starting point of March 2005 some two years before the market peaked in 2007. Investors in small stocks who bought at the top of the market in 2007 when the Small Ordinaries price index topped out at 4,177 points are looking at some sizeable losses with the index currently at 2179.

Portfolio Performance

The Fund reported a return of 6.57% for the quarter, lagging the All Ordinaries index which generated a 10.21% return. It is difficult for us, as managers of the Fund, to not be disappointed by these sub-market returns which now stretch over periods of up to 3 years. However, our disappointment needs to be tempered by insights from the analysis above, which suggest that the space in which we have primarily hunted over the life of the Fund, beyond the top 100 stocks, has produced poor share price returns. This under-performance has been tempered in recent years by a growing allocation in the portfolio toward larger companies, as we saw opportunities for superior returns there. Nevertheless, our preference remains to find growing businesses in the smaller company universe. To that end, we have identified several interesting smaller companies where we have established new positions during the last quarter including Centuria Capital, Isentia, Silver Chef and GBST.

Top 10 Portfolio Holdings	
Cash	12.86%
Flight Centre	9.75%
Treasury Group Limited	7.25%
Woolworths Limited	6.69%
Spark Infrastructure Group	5.27%
Austbrokers Holdings Limited	5.24%
ARP Corporation Limited	4.16%
Magellan Flagship Fund Ltd	4.01%
Sonic Healthcare Limited	3.98%
Computershare Limited	3.65%
Other Holdings	37.14%
Total	100.00%

Centuria Capital (CNI) - $80m market capitalisation

Centuria Capital is the renamed OFM Group, which has fallen from grace since the heady pre-GFC days when it listed. We had owned the company during this period but some poor capital management decisions caused us to lose confidence in the business and we sold our holding. Since that time, the company made some further ventures into fields outside its core competencies of insurance bonds (Over 50's Friendly Society) and unlisted property trust management with less than stellar success.

However, the company has come back onto our radar as it has managed to exit these businesses and move essentially back to its core businesses, which are quite profitable. In its recent profit results, it reported an 87% increase in underlying profits to $5.4m, however substantial property performance fees earned during the period distort the result. The company stated it expected "desirable conditions to continue which bodes well for expansion", and given the yields in the commercial property sector, we agree. To be conservative, we are estimating the company can earn $7m - $10m on an ongoing basis which places the company on a PE multiple of 8 to 11.4 times. In addition, the company offers a dividend yield of 4% and a very conservatively financed balance sheet, providing some downside protection to our investment.

Isentia (ISD) - $738m market capitalisation

Founded in 1982, Isentia was listed in June 2014 with 139m shares offered at $2.04. The company provides media intelligence services to a large number of corporate and government departments. It runs a software-as-a-service (SaaS) business which uses in-house software and systems to capture and analyse data from thousands of media outlets, online news and social media to tell clients what is being said about them. Clients number more than 5,000 in the Asia Pacific region and it has 92% of world leading brands, 28% revenue share and is 5 times bigger than its nearest competitor. The media intelligence industry in the Asia Pacific has grown at nearly 19% CAGR for 2009-2012, a much higher rate than in the Americas and Europe/Middle East, reflecting a less developed market. Asia Pacific forecast growth for 2013 to 2016 is 13.7% and the company estimates that they only have 25% of their target businesses currently as clients. This is a high quality business, with a dominant market position and strong growth

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prospects reflected by strong revenue and profit growth reported for the first half of the year.

Silver Chef (SIV) - $243m market capitalisation

Silver Chef is primarily a small-scale financier for business equipment such as coffee machines and fridges in the hospitality industry. In recent years, the company has expanded further afield through its Go-Getta business. Founded by the Chairman and major shareholder, Allan English, the company listed in 2005 and since then has performed well with profits growing from less than $1m in 2005 to $12.7m last year. And along with the solid business performance, the share price rose from less than $2.00 to nearly $9.00 in mid 2013. However, the share price then gradually fell 25% and that's when we became interested, providing an entry point for the portfolio.

The company introduced new funding models which we thought looked attractive from the business' perspective and the company upgraded its profit forecasts in tandem. Profits have grown at more than 20% per annum for the past five years and the $12.7m profit made last year was a 19% return on shareholders' funds. Due to the nature of the business of financing and the demand for the equipment, the company has borrowed to fund its expansion which means the company has more debt than others in the portfolio. So far, this has meant that the company has been able to grow profits at a rate much greater than many others since GFC and shows no sign of slowing at this stage.

GBST Holdings (GBT) - $405m market capitalisation

GBST was founded in 1984 and was listed on the ASX in 2005. The company provides software and services to the financial services industry. Its two main divisions are Capital Markets and Wealth Management. The Capital Markets business provides software to institutional and retail stock brokers for the processing of transactions. The Wealth Management business provides software to the wealth management industry for fund and registry administration. Wealth management now provides the larger share of both revenue and earnings. The company has clients in Australia, Asia, the UK and North America and recently, for the first time, international sales exceeded local sales. The company is now enjoying significant operating leverage, driven by corporate expenses becoming an increasingly smaller portion of revenue. EBIT margin has grown rapidly and now sits at around 15% and ROE is also strong approaching 20%. Driving the current and future growth in the business is structural change in the UK pension industry driven by new regulatory requirements, which have forced the industry to look to products like GBST Composer to provide better value to its customers. GBST says that the UK business is in early growth stage given the size of the market. Key risks for the business are exposure of the Capital Markets division to large equity market moves and to regulatory changes in the markets in which it operates. GBST has come through a long period of product investment and is now reaping the benefits of strong revenue and profit growth driving healthy cashflow and delivering an ungeared balance sheet. This growth appears in place for the foreseeable future.

Over the last quarter, the main drivers of portfolio performance in dollar terms came from positive contributions by Flight Centre, Treasury Group, Beacon Lighting, while the largest negative contributor was Austbrokers.

Flight Centre (FLT)

Flight Centre produced a return of 22% over the quarter courtesy of a rebounding share price that had previously slumped in December following a profit warning. The February profit result was ahead of subdued market expectations, benchmarked to the December profit warning and management outlook was notably positive. Despite first half profit going backwards by around 7%, the fact remains that Flight Centre continues to grow its underlying business to record levels generating nearly 9% growth in total transaction value to $8.1bn and nearly 5% growth in revenue to $1.1bn in the first half.

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Few listed companies have been able to match the genuine business growth achieved by Flight Centre over the last decade, and for all that its shares sell at a discount to much of the market. Accordingly, Flight Centre remains the largest holding in the portfolio. It should be noted that, as the largest holding, Flight Centre has been the largest contributor of Fund under-performance over the last twelve months with the share price trading comfortably above $50 just one year ago.

Austbrokers (AUB)

Austbrokers pre-empted its formal release of first half results with a market update in January, which was effectively a profit warning. Austbrokers has a range of business interests in the insurance industry but its focus is on taking significant equity stakes in insurance brokers and providing them with a range of back office services. In January, management reported insurance premium reductions of up to 30% in its commercial lines which it expected to push profits for the first half down up to 18%, though it expected a stronger second half to actually allow it to avoid a loss for the full year. This announcement drove a 20% fall in the share price though it has recovered a little since then. We have trimmed our position in Austbrokers at higher levels over the last two years, following the appointment of the current CEO and remain cautious with accelerated acquisition activity and expense growth. However, the stock remains a top ten holding, and this has hurt Fund performance over the year.

Treasury Group (TRG)

Treasury Group is similar in a number of ways to Austbrokers in that it owns meaningful equity stakes in other operating businesses, in this case, funds management businesses, and it provides a range of services to these businesses. Dominating news flow from Treasury Group over the last few months has been the merger with US based Northern Lights, announced in early August last year. Northern lights held investments in 13 boutiques totalling A$24.2bn with offices in the US and Europe. The combined group has FUM of around $50bn with Treasury Group shareholders holding a 61% economic interest in the new structure. We are mindful that large acquisitions and particularly off-shore acquisitions, are high risk and many don't work out so well for the shareholders of acquirers. For now however, the merger appears to be progressing smoothly, first half results were good and the market has embraced the new look business with strong recent returns.

Beacon Lighting (BLX)

Beacon Lighting listed on the ASX in April 2014 and was added to the portfolio in August last year. The 40 year old business is a lighting retailer but differentiates itself through in-house product design and development, allowing it to offer customers a range of exclusive products. The industry and business is currently in the midst of significant technological change with growing demand for energy efficient products such as LED lighting, which is an important part of the growth driver at Beacon. The company produced an excellent first half result with revenue up 22% and like for like sales up 11.7%. Operating profit was up 32.9%.

Outlook

At this juncture, the world is a challenging place for Australian investors. Interest rates across the developed world, including Australia, are at historic lows which have seen income starved investors scramble for yield, driving up prices across the share market, in particular stocks with high dividend yields. Few would have predicted current interest rate levels and equally, few will successfully execute an investment strategy based on their forecast of future interest rates. Rather than be diverted by uncontrollable and unpredictable macroeconomic variables, we continue to focus on finding businesses that can grow and prosper in a range of economic seasons, and that we think will deliver sound longer term returns to unitholders.

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