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September Quarterly Report

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Markets

The September quarter has produced a roller coaster ride for Australian investors with high volatility and more downs than ups. The 3, 6 and 12 month returns for the market are now all negative and the 2 year return is just 2.8% per annum. Local concerns around the capital needs of the banks, the impact of falling commodity prices on the big miners, signs of slowing growth and a weak profit reporting season have contributed to the volatility and the large negative returns to Australian equities. In addition, the Australian market has tracked global markets in terms of volatility and direction. Concerns around slowing Chinese and global economic growth have been pinned as the culprits along with continuing uncertainty around when the US Federal Reserve will move up from its current zero Fed funds rate.

In the middle of the market turmoil, the majority of ASX listed companies reported either their full year or half year financial results during the quarter. Across the broader market, companies tended to disappoint either with their results or their outlook statements, and analysts have since been busy trimming their 2016 and 2017 forecasts for large sections of the market.

Fund Performance

It is pleasing to report that the Fund portfolio had a good and more positive reporting season than the broader market and this has been reflected in the strong relative performance of the Fund return compared to the market over the last quarter. While the All Ordinaries accumulation index (the Fund benchmark) is down 5.8% for the quarter, the Fund has fallen just 0.2% producing an outperformance of 5.6%.

However, the most important performance numbers from an investor's viewpoint are the longer term ones, that is 5 years and beyond, as this is where a fund manager demonstrates their worth (or lack of it) to unitholders. Over 5 years, 7 years and since inception (nearing 10 years), the Fund has outperformed the benchmark by 1.9%, 3.3% and 1.4% per annum. It is important to note that these Fund returns are after all fees, whereas the benchmark returns have no fees associated with them so the pre-fee outperformance is significantly greater.

Performance 30-September-15	Ganes	All Ord Index
1 Month	0.55%	-2.50%
3 Month	-0.23%	-5.79%
6 Month	-5.54%	-11.68%
1 Year	2.31%	-0.16%
2 Year (p.a.)	2.59%	2.82%
3 Year (p.a.)	8.29%	9.31%
5 Year (p.a.)	8.20%	6.28%
Since Inception (p.a.)*	6.86%	5.42%
NAV Unit Price ($)	1.3798	
Fund Assets ($ million)	28.62	

* Inception date of Fund 18/11/2005

Reporting Season Wrap

The majority of companies in the Fund reported either full year results or half-year results in the September quarter. We were generally pleased with the majority of companies in the portfolio reporting a good lift in operating revenue, along with improved profits. While rising profits are important, top line (revenue) growth is also a compelling attribute of businesses that we like to have in the portfolio, as it reflects a real and growing demand for the products or services offered by the business. However, we recognise that businesses don't grow in a straight line and from time to time, even good businesses will experience a pull back in revenue and/or profits and this needs to be accommodated in a patient portfolio.

Top 5 Portfolio Holdings

Taking a closer look at the results announced by the Fund's largest 5 holdings (as at the end of August) which accounted for 28% of the portfolio weight:

Top 10 Portfolio Holdings	
Cash	8.22%
Magellan Flagship Fund Ltd	6.34%
ARB Corporation Limited	6.28%
Austbrokers Holding Limited	5.25%
Flight Centre Limited	5.20%
PM Capital Global Opportunities	4.36%
Templeton Global Growth Fund	3.95%
Smart Group Corporation	3.90%
Adelaide Brighton Limited	3.83%
Isentia Group Limited	3.73%
Other holdings	48.94%
Total	100.00%

Flight Centre generated Total Transaction Value (TTV) of $17.6bn up 9.7% and revenue growth of 6.8% to $2.4bn. However, underlying pre-tax profit was down 3.4% to $363.7m as was previously flagged in the surprise June 2015 market announcement. The profit margin was impacted by increased rent due to network growth and higher wage costs, but the profit margin still sits above the long term average. The Australian business produced record TTV despite soft trading conditions and record TTV was recorded in all ten countries with nine making positive pre-tax profits. The company has a strong balance sheet with a net cash position of $530m and token debt. The company estimates it will make $380m-$395m in pre-tax profit next year, a 4-8% growth on FY15 and management continues to appear optimistic in its outlook and investments. We continue to be positive on the company, but have actively reduced the weight of the stock in the portfolio to a more comfortable level (currently just over 5%).

Magellan Flagship Fund is a listed investment company that holds a portfolio of international stocks, rather than an operating business. Accordingly, the financial results of the company are not particularly worthy of comment. However, it is worthwhile noting the 40% increase in per share net tangible assets over the year from $1.43 to $2.00, with around two-thirds of that coming from portfolio appreciation and the remainder from the falling Australian dollar. The portfolio has a significant weighting toward large US based financial institutions with the three biggest being Visa, Wells Fargo and Mastercard. Magellan tends to run a concentrated portfolio with the top five holdings accounting for around 50% of the portfolio. The portfolio is unhedged and so investors in MFF are also fully exposed to changes in the Australian dollar relative to the currency of the stocks in the portfolio.

ARB Corporation produced a record revenue and profit result with revenue up 10.7% to $330m and pre-tax profit up 4.8% to $60m. The revenue growth was pleasing particularly in the context of the continued mining slowdown and overall, this was a solid result in a challenging environment. The aftermarket business makes up the lion's share of sales via the 52 ARB retail stores across Australia and management says that 3 new stores are expected to be opened in FY16. The weak Australian dollar assisted export earnings which were up 18% for the year. ARB continues to invest in new product development and has an ongoing R&D commitment. Margins were impacted by higher input costs due to the falling dollar, as well as increased resourcing expenses. The company had a large capex spend this year of around $50m, driven by increased warehousing capacity suggesting management confidence in the future of the business. The company has minimal debt and a net cash position. The business remains highly profitable, with a strong balance sheet and management investing for the future. We have held ARB in the portfolio for nearly ten years and continue to see it as a core holding into the future.

Austbrokers owns stakes in insurance broking businesses that earn commissions on the policies they write. Broker operations generated growth in revenue of 3.1% which was negatively impacted by declining insurance rates, but boosted by acquisitions. Expenses grew faster than revenue at 4.9%, delivering a 1.1% fall in profit from the broking operations. The company's balance sheet is robust with $66m debt and $51m cash. The FY16 outlook is for premiums to remain soft but management is targeting adjusted profit growth of 5% driven by organic growth and acquisitions. The Fund has earned a good return on its investment in Austbrokers since first purchasing the stock in 2009 at $3.61. However, we have been reducing the Fund's exposure to Austbrokers over the last two years as it became evident that historic growth rates inside the business are unlikely to continue. We are likely to continue to reduce the weight of the stock in the portfolio as opportunities arise.

Sonic Healthcare reported a somewhat lacklustre result, though this had been previously flagged to the market. Revenue of $4.2bn represented solid growth of 5% across most areas of the business with Australia and Europe leading the way, while the US market only achieved 2% growth. However margins were impacted by various costs that saw profits slide 5.6%. The deregulation of collection centres in Australia appears to be the main culprit for the decline in margin although this was not quantified. In addition, lower levels of Medicare rebates also hurt. The main take away from the result, is the continued growth of the overseas business such that international operations should comprise approximately 70% of the pathology business next year. The market has high growth expectations for the coming year following the profit fall this year. We are content to hold the stock in the portfolio but may seek to trim the position if the price moves higher given the relatively modest growth prospects for the company.

Current Activity and Outlook

Fear and volatility bring opportunity and we have used the fearful and volatile markets of the last quarter to top up several holdings and initiate new positions. These acquisitions have brought the Fund cash weight down into the single digit range. The Fund holds stakes in a range of growing businesses and we are optimistic about their prospects over the next year or two.

The Fund will pay a distribution of 0.738 cents for the quarter.