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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

The broader market (All Ordinaries Accumulation Index) generated a modest 2% total return for the 2016 financial year but this masked a very volatile year with the Index moving in a 20% range from a high above 5,700 in August 2015, to below 4,800 in February 2016.

Performance 30-June-16	Ganes	All Ord Index
1 Month	-4.82%	-2.28%
3 Month	3.51%	4.00%
6 Month	-3.92%	1.55%
1 Year	6.77%	2.01%
2 Year (p.a.)	5.05%	3.82%
3 Year (p.a.)	5.51%	8.24%
5 Year (p.a.)	8.77%	7.30%
10 Year (p.a.)	6.74%	4.93%
Since Inception (p.a.)*	7.04%	5.82%
NAV Unit Price ($)	1.4263	
Fund Assets ($ million)	26.72	

* Inception date of Fund 18/11/2005

There have been three notable sell-offs in the past year. The first came in August 2015, in the midst of company reporting season on the ASX, driven by significant falls in overseas markets and concerns around higher capital requirements for the major banks. Not helping things was a poor reporting season, where many companies disappointed the market, either with their results or their outlook statements. The market recovered around half of those losses before another sizable sell-off in January 2016 and continuing into February 2016, pushing the market below the August 2015 lows.

Again, our market followed the weak lead from overseas markets with Chinese growth and falling commodity prices signaling perhaps a slowdown in global growth. The major banks were again at the centre of the poor market performance. By the end of May, all of the early year losses had been recovered before the market was clobbered by the Brexit fall-out in the last few days of June. However, the market has bounced back quickly to recover those losses as at the time of writing in early July.

Top 10 Portfolio Holdings	
ARB Corporation Limited	8.08%
Smart Group Corporation	7.57%
Magellan Flagship Fund Ltd	6.67%
CYBG PLC	6.44%
Adelaide Brighton Limited	5.16%
Cochlear Limited	5.10%
Flight Centre Travel Group	4.79%
AUB Group Limited	4.43%
Nick Scali Limited	4.34%
Beacon Lighting Group	4.31%
Other holdings	43.11%
Total	100.00%

It is very challenging for investors to keep their heads and stick to their long-term plan in periods like this. The relentless noise from the market and from commentators can be hard to ignore and some investors will find themselves doing long term damage to their future wealth by reacting to this noise. As professional investors, we are closely connected to the markets each and every day, and are even more exposed to the noise than most. However, over the years we have learnt to see this noise for what is, as a distraction to a sound long-term plan.

Our plan centres on managing a portfolio of better than average businesses with good long term growth prospects for revenue and profits, and monitoring their achievement from year to year.

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Fund and Stock Performance

The Fund has reported its seventh year in a row of positive returns, though again this year that return was a modest 6.8%. On a positive note, the Fund outperformed the market by 4.8%.

Year	Fund Return	Market Return	Outperformance
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 is our regular practice in this end of financial year update, we glance back to the ten largest holdings, which are suggestive of our best ideas one year ago, and see how these contributed to Fund performance over the year. The accompanying table indicates quite a mixed bag with strong double-digit returns from Austbrokers, ARB Corporation, Adelaide Brighton and Cochlear, but large negative returns from Computershare and Beacon Lighting.

Top 10 Stocks (June 2015)	% of portfolio (June 2015)	Total Return FY16	% of portfolio (June 2016)
Flight Centre	9.8%	-2.8%	4.8%
Austbrokers	6.0%	16.6%	4.4%
Sonic Healthcare	5.6%	4.2%	0.0%
Magellan Flagship Fund	5.3%	6.8%	6.7%
ARB Corporation	4.8%	30.8%	8.1%
Templeton Global Growth	3.5%	-8.4%	2.2%
Computershare	3.4%	-19.0%	0.0%
Adelaide Brighton	3.3%	35.5%	5.2%
Cochlear	3.2%	53.9%	5.1%
Beacon Lighting	2.8%	-29.7%	4.3%

The insurance broking sector has been a difficult place to be over the last two or three years, with premiums under pressure which has been reflected in stagnant earnings at **Austbrokers**. While premium declines have stabilised, the outlook for the business is still subdued. Though the stock remains in the top ten today, we have gradually trimmed the portfolio holding in Austbrokers since 2013.

ARB Corporation has also experienced a subdued two or three years, with profit margins compressing slightly after expanding appreciably over several years, assisted by the resource sector boom. However, management at ARB are singularly focused on the long term and have invested heavily in new products and overseas infrastructure, with this investment expected to bear fruit over the coming years and the market driving ARB shares higher in expectation of this. ARB is now the largest holding in the portfolio.

The **Adelaide Brighton** share price has benefited from increased residential and commercial construction activity but also from a higher multiple being awarded the stock by the market currently. The company remains in the top ten holdings today.

Cochlear delivered at 30% increase in EBIT at its half year result in February, with recent new product launches driving demand and pushing the product recall difficulties into the past. Reported revenue and profitability has also benefited from the depreciating Australian dollar. In response, the market has pushed the share price of Cochlear sharply higher and the stock is currently firmly entrenched in the top ten holding of the portfolio.

We have sold out of **Computershare**, following the disappointing full year results in August last year at prices well above where they are today.

The **Beacon Lighting** share price was hit hard in May this year, when the company released a trading update which downgraded sales and profit expectations for the full year due to a raft of causes including the timing of the Easter break, weak consumer confidence, an increase in clearance activity by competitors (eg. Masters hardware) and reduced advertising. While we don't like to see such a lengthy list of 'excuses' we note it was always going to be difficult for the company to back up after strong growth in FY15. We are also reassured by the ongoing management role of the founders and their significant personal stake in the company, and took the share price weakness as an opportunity to increase the Fund's holding.

Flight Centre remains a top ten holding but we significantly reduced the exposure of the portfolio to the stock in August and September last year, mainly due to its high weight in the portfolio, which is the main reason why the distribution this year is higher than in previous years. The company released a trading update in May this year, indicating that record sales for the year were expected but that profit would be below prior guidance, affected by macro-economic uncertainty, airfare price wars and higher than expected spending on improvement strategies. The consequent share price fall, saw the stock produce a small negative return for the year but we are happy to hold, given our confidence in management's ability to tackle the challenges ahead and the modest multiples that it trades on.

Sonic Healthcare generated a small positive return for the year but was sold out of the portfolio earlier this year mainly to make way for better ideas, given the modest longer term growth outlook.

Magellan Flagship Fund generated a modest return for the year, despite the pre-tax NTA per share falling from $1.998 to $1.914 over the course of the year, though we should recognise two cents in fully franked dividends were also paid during the year. The main holdings in the Fund have been fairly stable over the year headed by Visa, Lowe's, Home Depot, Mastercard and Wells Fargo. We continue to see this holding as a means of accessing a portfolio of high quality international businesses, and it remains a top ten holding in the Fund.

Templeton Global Growth found itself on the wrong side of the Brexit vote in June with its large exposure to European stocks. Pre-tax NTA was $1.50 at 30 June 2015 but finished the 2016 year at $1.279, with a 4.1 cent dividend paid. The share price moved from $1.305 a year ago to $1.155 at year end for a -8.4% return. Over the last few months, we have reduced the holding in Templeton and it now sits outside the top ten holdings.

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The table (to the right), highlights three new additions to the top ten holdings in the portfolio: Smartgroup; Clydesdale Bank and Nick Scali.

Top 10 Stocks (June 2016)	% of portfolio (June 2015)	% of portfolio (June 2016)
ARB Corporation	4.8%	8.1%
Smartgroup	**2.2%**	**7.6%**
Magellan Flagship Fund	5.3%	6.7%
Clydesdale Bank (CYBG PLC)	**0.0%**	**6.4%**
Adelaide Brighton	3.3%	5.2%
Cochlear	3.2%	5.1%
Flight Centre	9.8%	4.8%
Austbrokers	6.0%	4.4%
Nick Scali	**0.9%**	**4.3%**
Beacon Lighting	2.8%	4.3%

By far, the biggest winner for the portfolio over the year was the salary packaging and novated leasing business **Smartgroup**, which started the year with a share price of $2.20 and finished at $5.75. The share price has benefited from strong revenue and profit growth driven by both organic initiatives and acquisitions. Stocks like Smartgroup have also benefited during the year from a reduction in regulatory risk, as both major parties publicly committed to maintaining the current favourable salary packaging and Fringe Benefits Tax measures. However, as we are well aware, politicians are apt to change their minds so this remains a longer term risk.

Clydesdale Bank was added to the portfolio earlier in the year following its divestiture by the National Australia Bank (NAB). Clydesdale is a British bank focused on the retail and SME markets in Northern England, the Midlands and Scotland. CEO David Duffy was installed in June 2015 to manage the demerger from NAB and having orchestrated a major turnaround at Allied Irish Bank, is being relied on to achieve something similar at Clydesdale. At listing, Clydesdale traded on just 0.6 times book value, reflecting the low level of profitability and high cost to income ratio in the business. Our view is that Duffy will be able to achieve this and see the shares re-rate back towards book value. After taking an initial position around $4 per share on average, the shares rallied prematurely hard to above $5.80 following the release of half year results in May, before being smacked down by the shock Brexit vote at the end of June.

We have topped up the Fund's holding in **Nick Scali** over the course of the year pushing it into the top ten list. In February, the company reported a 32% increase in revenue on the back of an 11.6% growth in same store sales, a key metric for retailing businesses. The company presently has 48 stores but has plans to expand to 75 stores suggesting that earnings should increase substantially from present levels. In May, the company confirmed the favourable trading conditions it was experiencing when it announced a lift in the expected after tax profit range from $24 to $26 million. We are also attracted by the continued involvement of the founding family. The business was founded by Nick Scali Snr. more than 50 years ago. The company listed in 2004 and is now managed by Anthony Scali, who in a recent restructure of family holdings, lifted his economic interest in the company from 16.7% to 27.3%.

Other than the stocks mentioned above, significant positive contributions to performance came from Trade Me Group and A.P. Eagers while significant negative contributions were made by Life Healthcare, Dick Smith which were disposed of in full and PM Capital Global Opportunities Fund which the Fund continues to hold.

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Outlook

A glance at the Performance Returns table in this report portrays very subdued equity market returns for the last two years, and while high single digit returns have been achieved over three, five and seven years, the ten year return for the All Ordinaries index is just 4.93% per annum. The future of stock market returns is unknowable but a glance through the history books would suggest that periods of poor prior ten year returns are often followed by periods of good ten year returns. There is a lot for the markets to worry about in the world right now and these recent returns reflect that, but worrying times can be a precursor to better future long term returns.

We are optimistic about the future prospects of the portfolio of businesses held by the Fund and this is reflected in the fully invested position we have moved to in the past twelve months. The portfolio comprises a mixture of small and mid-cap companies with motivated and innovative managers, good revenue and profit growth potential, as well as strong balance sheets and healthy cash flow.

A good example of this is **PWR Holdings**, a recent addition to the portfolio. PWR listed on the ASX in November 2015 and designs and manufactures customised cooling systems for high performance automotive applications globally from its purpose built facility at Ormeau just south of Brisbane. The business has grown its revenue from $16.6m in FY13 to $32.5m in FY15 and expects revenue of nearly $50m in FY16. The business boasts high profit margins with pre-tax profit in FY13 of $3.9m growing to $11.9m in FY15 and expected to hit $14.9m this year. The business was established by CEO Kees Weel and production manager Paul Weel in 1987 and between them, they now own 38.4% of the listed company. PWR is a major provider of cooling systems for motorsports including an estimated 48% share of 2015 season Formulae One cooling products. The company also supplies products to automotive OEMs and the automotive aftermarket, with future opportunities in emerging cooling technologies such as battery powered vehicles and energy capture and storage. We are optimistic about the prospects for PWR and have established an initial 2.5% position in the portfolio which will increase as we obtain more confidence in the management and business.

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 3.2874 cents per unit has been paid to unitholders on the register at June 30. As noted earlier in the report, the realised capital gains flowing from a reduction in the Flight Centre holding, and to a lesser extent Austbrokers, were the main factors in our larger than usual June distribution this year.

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