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

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

Markets

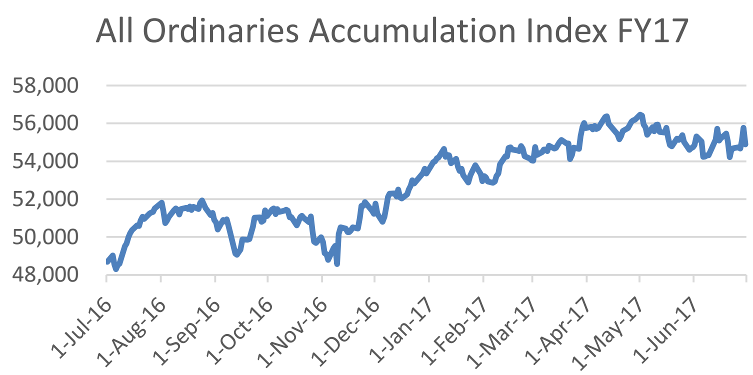
The past financial year has highlighted the importance of staying in the market, rather than attempting to time it any way. The graph below shows the path of the All Ordinaries Accumulation Index over the year, with the bulk of the years returns apparently generated in a short window following the election of President Trump at the end of 2016. For much of the rest of the year, the market whipped around quite a bit without doing too much. There is always something scary happening in the world, and it is easy as an investor to get frightened onto the sidelines by the most recent headline whether it be the election of Trump, Brexit, North Korean nuclear missile tests, rising interest rates or plunging oil prices. For the most part, these macro events are noise and their short-term impact on markets will subside and largely be forgotten by markets within several weeks or months.

Performance 30-June-17	Ganes	All Ord Index
1 Month	1.61%	0.28%
3 Month	3.88%	-1.54%
6 Month	4.39%	2.89%
1 Year	13.68%	13.12%
2 Year (p.a.)	10.17%	7.42%
3 Year (p.a.)	7.86%	6.83%
5 Year (p.a.)	10.49%	11.60%
10 Year (p.a.)	5.24%	3.46%
Since Inception (p.a.)*	7.60%	6.43%
NAV Unit Price ($)	1.5751	
Fund Assets ($ million)	26.32	

* Inception date of Fund 18/11/2005

Fund and Stock Performance

The Fund has reported its eighth year in a row of positive with a return of 13.7% representing a slight outperformance of the All Ordinaries Accumulation Index and very pleasing after several years of modest returns. 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.



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. In general, the picture is a positive one with six of the top ten holdings generating double digit returns and five of these circa 30%. Unfortunately, some of the weaker performances came from our largest five holdings with ARB Corporation recording a negative return and both Magellan Flagship Fund and Adelaide Brighton producing mid-single digit returns. Beacon Lighting generated a second consecutive year of negative returns. However, one year returns, good or bad are not something we should spend much time worrying about. For example, a poor one or two year return may simply follow several years of strong positive returns where the share price gets ahead of the good underlying business fundamentals.

Year	Fund Return	Market Return	Out-performance
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%

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Our focus in the following discussion, then, is much more on how the underlying business has progressed over the course of the year.

Top 10 Stocks as at June 2016			
	% of Portfolio (June 2016)	Total Return FY17	% of Portfolio (June 2017)
ARB Corporation	8.1%	-4.2%	7.8%
Smartgroup	7.6%	29.4%	9.7%
Magellan Flagship	6.7%	5.2%	7.1%
Clydesdale Bank	6.4%	12.9%	7.4%
Adelaide Brighton	5.2%	6.4%	4.9%
Cochlear	5.1%	30.6%	6.1%
Flight Centre*	4.8%	26.5%	1.9%
Austbrokers	4.4%	33.2%	5.8%
Nick Scali	4.3%	28.4%	5.4%
Beacon Lighting*	4.3%	-1.8%	4.2%

* No longer in the top ten holdings as at June 2017

ARB Corporation has been held by the Fund since 2006 and is the standard bearer for the type of company we like to see in the portfolio. It has an exceptional management with a long track record of delivering high quality products to a discerning customer base. Growth within the business is predominantly organic and underwritten by a commitment to new product development. High profit margins and returns on capital are made and the balance sheet is free of debt. The business continues to perform well but margins have compressed slightly following healthy expansion during the resources sector boom. The share price also appreciated greatly in 2015, and so it can take some time for the fundamentals to catch up with the share price, and our view is that this is worth waiting for. We are expecting single digit growth in revenue and profit for the 2017 financial year with further improvement in coming years.

Smartgroup has a December financial year end, and reported very strong growth 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 221,000 active packages and 53,000 active leases. Revenue was up 57% for the year and after tax profit (pre amortization of intangibles) up 68%. Debt levels are conservative despite the acquisitions and interest well covered by earnings. The strong share price performance during the year has lifted Smartgroup to the largest position in the portfolio at June 30.

Magellan Flagship Fund generated a second year of modest returns, despite a healthy improvement in pre-tax NTA from $1.914 at June 30, 2016 to $2.324 a year later. As is the nature of Listed Investment Companies (LICs), they can oscillate between premiums and discounts to NTA, and at year end it is trading at quite a discount. There is little change in the largest holdings in the Fund with Visa, Home Depot, Mastercard and Bank of America accounting for around 40% of the portfolio. We continue to believe MFF provides unitholders with access to a diversified portfolio of high quality international businesses.

Clydesdale Bank produced a healthy 12.9% return for the year despite a depreciation in the British Pound against the Australian Dollar. Clydesdale is a British bank spun off by the NAB and now under the stewardship of a new management team with a track record of getting a wayward ship back on course. A significant part of the bottom line improvement is expected to come from tackling a bloated cost base and the first half results released in May suggested management was on track in this area.

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After shooting the lights out with a 35% return in FY16, it is not surprising to see a much more modest 6.4% return for **Adelaide Brighton** over the last year. The company provides construction materials to a very cyclical building sector. The business is under-written by base level building activity but any given year can see various levels of upside or downside depending on a range of macro-economic forces beyond the control of Adelaide Brighton. For the full financial year ending December 2016, revenue slipped 1.2% and earnings (ex property) was up 3.1%. Cash flow is strong and balance sheet gearing is low. Management has a clear strategy for delivering improved earnings in the future, but shareholder returns may be muted in the near term as business fundamentals catch up with the share price.

Cochlear has backed up this year with a 30.6% return following a massive 53.9% last year. Much of this year's gain came from a very favourable market reaction to the FY16 result reported in August 2016. Revenue grew 23% with double digit implant unit growth and pre-tax profit was up 27%. Research and development is key to the future success of Cochlear and they reported spending $143m or 12% of sales revenue on R&D. This is a high quality business, but we should not be surprised to find near term share price gains to be well below that of the last couple of years.

After reporting a small negative return in FY16, **Flight Centre** produced a much stronger 26.5% in the last year. Over this period, we have come to the view that despite the track record of past growth and strong management, the future prospects of this business are not so bright. There are now many small, nimble, hungry competitors in the digital space who are having a growing impact on the economics of this largely bricks and mortar travel business. During the year, we continued to sell down this position and completed the sell down just recently. The Fund had held Flight Centre since 2006 when it was first purchased around $11, and so with dividends has produced good returns for unitholders over that period.

After several years of tough conditions in the insurance and insurance broking industry, with insurance premiums under pressure and stagnating earnings, the sun has started to shine for **Austbrokers** and others in this sector. The industry has started to report firming premiums and Austbrokers was able to generate an adjusted after tax profit up 12.7% for the half year ended December 2016. Analyst earnings forecasts for the next 3 years have ticked up nicely over the last twelve months. With this in mind, we initiated during the year, a position in **Steadfast Group**, another insurance broking business which will benefit from the improving industry conditions.

Nick Scali backed up a strong year in FY16 with a 28.4% total return in the current year. This came despite the pessimism which has recently beset the listed retail sector, around the entry of Amazon into the Australian market. In August last year, the company reported a 30% lift in sales for FY16, with 11.1% same store growth and a 53% increase in pre-tax profit. The company then backed up in February this year with a 16% increase in sales and 44% increase in profit for the first half of FY17. We would not be surprised to see these exceptional profit margins unwind somewhat going forward, but are happy to hold this well run family managed business as the store footprint continues to expand.

Beacon Lighting has found life as a listed retailer much tougher than Nick Scali in recent times. The company went into FY16 with a very strong FY15 under its belt, and so 7.7% sales growth and 6.3% profit growth for FY16 was not too shabby under the circumstances. For the first half of FY17 the business generated 10.9% in sales growth with a modest 1.2% same store growth but a reduction in gross profit margin due to competitive pressures and foreign

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exchange headwinds saw profit margins lower and pre-tax profit down 15.9%. Beacon is a relatively new listed company, with a manager who has built the business from the ground up and has a significant personal stake in the company. We like the company but will see how things play out over the next year or two. Beacon Lighting fell out of the top ten over the course of the year due to its relatively poor share price performance.

Top 10 stocks as at June 2017		
	% of Portfolio (June 2016)	% of Portfolio (June 2017)
Smartgroup	7.6%	9.7%
ARB Corporation	8.1%	7.8%
Clydesdale Bank	6.4%	7.5%
Magellan Flagship	6.7%	7.1%
Cochlear	5.1%	6.1%
Austbrokers	4.4%	5.8%
Nick Scali	4.3%	5.4%
Adelaide Brighton	5.2%	4.9%
Gentrack*	2.6%	4.8%
PM Capital Global* Opportunities	3.7%	4.7%
* Not in the top ten as at 30 June 2016		

There are two newcomers to the top ten holdings as at 30 June 2017, Gentrack and PM Capital Global Opportunities.

Gentrack was added to the portfolio in 2015, but a stellar 85.2% return for the year has launched it into the top ten holdings. Gentrack is a New Zealand based company that provides billing software for electricity, gas and water utilities and airport management software for airports. Much of this share price boost occurred in the last few months of the year following the announced acquisition of interests in two businesses allied to its airport management software, and the reporting of first half FY17 results. Reported revenue lifted 24% and earnings was up 31%.

PM Capital Global Opportunities (PGF) also lifted itself into the top ten on the back of a 33% return for the FY17 year. PGF is a listed investment company with an international focus across banking, service monopolies, pharmaceuticals and stocks which will benefit from housing recovery in the US and Europe. The share price return closely followed the change in Net Tangible Assets (pre-tax) from $0.96 at 30 June 2016 to $1.25 at 30 June 2017. However, the share price continues to trade at a discount to asset backing finishing the year at $1.105.

Other than the stocks mentioned above, significant positive contributions to performance came from **Fiducian Portfolio Services** and **Collins Foods**, while significant negative contributions were made by **GBST Holdings** and **Silver Chef** which were disposed of in full and **AP Eagers** which the Fund continues to hold.

Outlook

At the conclusion of this volatile financial year, the market has forged a respectable 13.1%, making it the best return for the past 3 years. The 3, 5, 10 and 20 year average annual returns for the All Ordinaries Accumulation Index are 6.8%, 11.6%, 3.5% and 8.2% respectively. The low ten year return reflects the fact that ten years ago the market was sitting around its pre-GFC peak, and was arguably somewhat inflated at those levels. The much longer 20 year return of 8.2% per annum is a better reflection of recent long run returns and is somewhat lower than the circa 10% per annum average return recorded over the last century. It seems fair to conclude at current levels, the overall market appears neither particularly cheap nor expensive at current levels suggesting reasonable future returns for the patient long term investor.

We remain optimistic about the future prospects of the portfolio of businesses held by the Fund and this continues to be reflected in the fully invested position of the Fund. 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.

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 2.3756 cents per unit has been paid to unitholders on the register at June 30.