September Quarterly Report

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

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

In this update, we expand on our usual monthly update to provide investors with a broader view of Fund performance, the portfolio and our view of the current market.

Markets and Investment Principles

September produced a third positive month in a row for the local market and the Fund, both up approximately 2.4% and roughly tracking the US market. The Reserve Bank of Australia kept the cash rate on hold at a record low of 2.5% during the month, though the consensus still appear to be for further easing over the next several months. The record low interest rate environment both locally and around the globe is driving many asset class prices higher. Interest rates act as a pricing mechanism for assets in something like a see-saw; the lower they fall, the higher asset prices will rise.

Performance 30-Sep-13	Ganes	All Ord Index
1 Month	2.41%	2.39%
3 Month	4.28%	10.78%
6 Month	6.27%	7.08%
1 Year	20.68%	23.55%
2 Year (p.a.)	18.27%	18.34%
3 Year (p.a.)	12.12%	8.65%
5 Year (p.a.)	11.80%	6.98%
Since Inception (p.a.)*	7.98%	6.09%
NAV Unit Price ($)	1.4431	
Fund Assets ($ million)	47.08	

* Inception date of Fund 18/11/2005

With interest rates so low, we are cautious to use these benchmarks as a new valuation hurdle rate when we assess company intrinsic value as the see-saw is likely to move again at some point. As a result, we have sat on the sidelines and missed a few opportunities as the market has run hard. We are ever conscious that investors' funds are hard-earned and investment principles (they are called principles for a reason), should not be abandoned as our conservative valuation methods prevent us from buying and participating in a hot market.

Rationality and investment temperament play a big role in investment performance in these types of markets, not remodeling valuation tools and spreadsheets to suit the current environment. As we stated earlier, principles are principles for a reason and we are not tempted to change ours to suit a frothy market which in all likelihood, would lead to poor investment performance over the longer term.

Top 10 Portfolio Holdings	%
Cash	44.92%
Flight Centre Limited	9.12%
Austbrokers Holdings Limited	6.65%
Woolworths Limited	5.28%
ARB Corporation Limited	3.76%
Treasury Group Limited	3.53%
Spark Infrastructure Group	3.36%
Sonic Healthcare Limited	2.42%
Computershare Limited	2.40%
Magellan Flagship Fund	2.37%
Other Holdings	16.19%
Total	100.00%

Results Season Scorecard

Reporting season concluded during the quarter with most companies in the portfolio reporting full or half year results. Overall, companies in the portfolio reported good results with only a couple of disappointments. When we review company results each reporting season, we also score the company on various metrics we consider important as a business owner including profitability, balance sheet, cashflows, business risks, quality, growth and value. The score is out of 60 and the table shows the scores for our largest holdings from this reporting season. Our highest score for this season was 50 and the lowest 29, prompting us to consider selling the investment that scored 29, as the business economics of that particular company have deteriorated.

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Flight Centre Limited

The largest holding in the Fund, Flight Centre, produced a record result with total transaction volume growing 7.7% to $14.3bn, revenue up 8.7% to $2bn and after tax profit up 20% to $240m. All ten countries operated by the business were profitable during the year and management continues to seek out growth opportunities. The balance sheet is strong with net company cash of nearly $400m. The price is higher than we would like and has run strongly but the company continues to impress us with its execution on organic growth and profitability.

By contrast, less favourable results were reported by Cochlear and Coca-Cola Amatil.

Company	Score
Flight Centre Limited	42
Austbrokers Holdings Limited	46
Woolworths Limited	45
ARB Corporation Limited	43
Treasury Group Limited	43

Cochlear Limited

Sales at Cochlear stalled as the clinical market awaited the release of its Nucleus 6 device which should revive growth in FY14 and beyond. While competitive pricing pressures are more evident, Cochlear's dominant market share, large unmet clinical demand and new products should see the company continue to grow for the foreseeable future.

Coca-Cola Amatil Limited

Coca-Cola continues to feel the brunt of trading conditions in the supermarket channel and competition from other suppliers, which saw revenue down 3.2% and EBIT down 6.9%. This is a good quality business and we remain confident that Australian and Indonesians will be drinking more Coca-Cola products in the next 10 years. In the short-term however, profit margins will remain under pressure particularly in the SPC Ardmona business. Against the trend of the market, the share price has fallen in recent times. We would look to add to our position, should it fall further and meet our target buy price.

Retailers Run Hot

The consumer discretionary sector has traditionally been a sector where we have found quite a few companies for the Fund which had produced strong returns. The past year offered another one of those years with the accompanying table highlighting some of the incredible returns recorded by companies in the sector. Even some of the laggards in the sector, such as Myer and David Jones have produced returns that defy and far outstrip their business performance. All of the companies as shown in the table are on our watchlist or have been in the portfolio at various times but Flight Centre is the only company currently owned by the Fund.

Company	1 Year Return
JB Hi-Fi Limited	138%
Nick Scali Limited	122%
Flight Centre Limited	110%
Super Cheap	71%
Harvey Norman Holdings	68%
The Reject Shop Limited	45%
Domino's Pizza Enterprises	43%

The results across the sector were uneven with some outstanding results (Nick Scali) tempered by some relatively poor results (Fantastic) so we are at a loss to explain the widespread enthusiasm shown by investors. What is clear is that value is scarce among the companies we follow in this sector.

Domino's Pizza Enterprises Limited

Domino's is one that we have previously owned and would be happy to own again at the right price. In 2013, the company reported a net profit of 43.4 cents per share. At the current price of $13.88, the business trades on a nose-bleed multiple of 32 times earnings, 9.5 times book value and a skinny 2.2% dividend yield.

The current price assumes strong growth a long way into the future. With the announcement of expansion into Japan and the existing European operations still in its early stages of development, it is possible that this growth will be achieved. However, history has been littered with disappointed shareholders of formerly fast growing companies brought to heal by inexorable competitive forces.

Nick Scali Limited

Nick Scali produced strong results with revenue up 16.5% and profits increasing 35% to $12.2m or 15.1c per share. The company continues to grow and will open 3 more stores this year to add to its network of 38 stores but at 17 times earnings and nearly 6 times book value, it is priced for much better growth prospects than we are prepared to believe will occur.

Cash

Unitholders may have noticed that our cash holding continues to rise and now sits at record levels in the nearly eight years since the Fund's inception. Our cash position is not a market prediction; it is purely a by-product of the lack of value on offer in the current market.

It has not been uncommon for the Fund to hold a 20% cash weighting. While the current level of 45% is more than double that level, it does not concern us. Ideally, we would prefer to be more fully invested with plenty of opportunities to put the funds to work in owning businesses we like and think will provide attractive returns. For the moment, those opportunities are not around. Nevertheless, we know they will return and when they do, we will be in a position to act.

Rather than altering the investment strategy to one of closet indexing or using 'relative value' as a valuation method, we prefer to allow cash to accumulate rather than invest in companies at unattractive prices.

If circumstances change and company earnings grow more rapidly than we are expecting, or if share prices were to fall, the cash level would drop quickly and significantly.

Outlook

Readers will have picked up the general theme that we are struggling to find value in the current market and we remain cautious on current valuations being applied to even the best companies – the ones we would like to own. We continue to scour the markets using various search tools and several small opportunities often present themselves as worthy of further analysis. In recent times, this has seen the addition of two small positions in the Fund and a number of other companies added to our watchlist.

The Fund is relatively small enough that we can take advantage of most investment opportunities that we find. We are prepared to take meaningful positions and would only require a handful of good ideas to be fully invested again.

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Distribution

The Fund will pay a distribution of 0.9008 cents per unit for the quarter. We are conscious of providing income for investors and continue to seek companies that pay dividends (usually fully franked) as well as companies with the ability to increase their dividends over time as profits grow.

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