Annual Review: 2015

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Introduction

We regard the fund's results as being pedestrian over the year, returning -3.7%. The contributors to the return were as follows:

- Weakness in the Australian dollar contributed 2.35%;
- Long equity investments (in local currencies) cost 1.0%;
- Yen options cost 2.0%;
- Currency hedges cost 0.8%; and
- Equity derivatives and short positions cost 1.0%.

The fund is 45% gross long and invested in eleven businesses. In addition we continue to spend approximately 2% annually on options shorting the Yen against the USD.

We expect the businesses the fund owns to be longer term holdings. Internally we often discuss an investment idea around "tolls on the real economy". The common traits of these businesses are they have some pricing power, reasonable balance sheets, scale in the context of their individual markets and, importantly, they each have genuine and meaningful internal re-investment opportunities. The businesses we are attracted to and that the fund owns generally have these traits.

Our preference is to own businesses ahead of cash. We view cash as a depreciating asset over time and our sense is the influence or interference of central banks is accelerating this depreciation. We view businesses with the traits described above as having the characteristics we want in this environment.

We are content to be patient investing the fund's available cash. We think volatility in equity markets is likely to increase and divergence of returns across sectors will continue, which may provide some opportunities. Our mindset is the available cash provides the fund flexibility to invest where we perceive there to be suitable opportunities, when and as they arise.

The fund increased its energy / oil related investments over the year and it also made an initial investment in Deere & Company, the agricultural equipment manufacturer. We regard these investments as high quality and well managed businesses. They are obviously cyclical, current earnings are down and short term earnings risks are high. The cyclicality and immediate earnings risk do not concern us; rather, we think it creates entry points for the fund to invest. Maybe, more importantly, the cyclicality also creates opportunities for the underlying businesses to aggressively reinvest both internally and also externally. We are tending towards steadily increasing these investments as we get ongoing confirmation of them successfully managing their activities in the context of the negative macro headwinds.

Corporate activity in Australia over the year also perked our interest. Brookfield Infrastructure Partners bid for Asciano Limited, Japan Post Co Ltd's acquisition of Toll Holdings Limited and Berkshire Hathaway Inc acquiring a minority equity interest and executing an insurance quota sharing agreement with Insurance Australia Group Limited. These are three large and significant transactions and each initiated by non-AUD investors which implicitly appear content to own the AUD at current levels. This view combined with the divergence of returns across the Australian listed assets since early 2010 suggests there may be some interesting opportunities locally.

Our positioning through 2015 really only changed at the margin. We would welcome more broad based weakness in equity markets enabling the fund to increase its capital invested in some existing positions and also providing an opportunity to broaden and increase the fund's invested position.

Please do not hesitate to contact us if you would like to discuss the fund or our mandate offering in detail.

During the year we welcomed Toby Deloughery to the team as Chief Executive Officer. Toby is responsible for all business functions outside of the investment management area.

Thank you for your interest and support over the year and best wishes for the holiday period and the year ahead.

Miles Webster & Nigel Trewartha

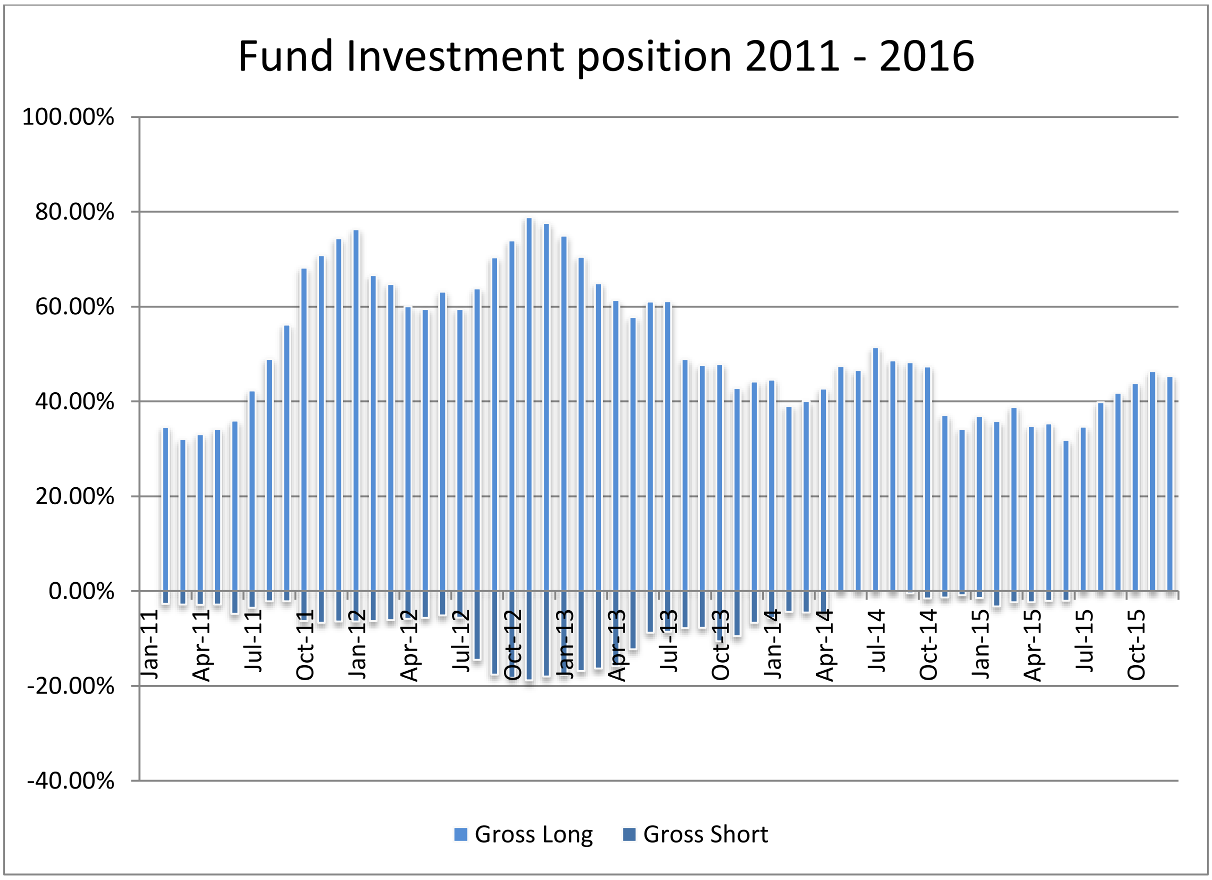
Fund Positioning

The following tables summarise the fund's investment position at 31 December 2015.

	Australia		United States		UK/Europe		Total	
	%	no/.	%	no/.	%	no/.	%	no/.
Tenet 1: Energy Related			13	2			13	2
Tenet 2:			13	2			13	2
Whole Foods Market			5	1			5	1
Deere & Company			3	1			3	1
Saft Groupe					3	1	3	1
Dover Downs Gaming			3	1			3	1
Other					6	3	6	3
Gross long			36	7	9	4	45	11
Gross short								
Gross invested position			36	7	9	4	45	11
Derivatives (annual cost)							3	3

Note: Totals may vary due to rounding.

	31 December 2015
Large capitalisation ($3 billion plus)	34%
Mid / Small capitalisation ($100 million to $3 billion)	7%
Micro capitalisation (less than $100 million)	4%
Total	45%



Investments sold

During the year the fund exited investments in European airport owners and operators; Aeroports de Paris (ADP) and Flughafen Wien (Vienna Airport):

- The fund began accumulating ADP in July 2010 and Vienna Airport in March 2012; and
- The annualised realised IRRs from these investments were 19.9% and 53.0% respectively.

The fund also exited its investment in Praemium Limited, an ASX listed small cap financial services provider with operations in Australia, UK and a developing "international business". The fund began accumulating this position in October 2011 and completed exiting in April 2015. The fund's annualised realised IRR from this investment was 61.6%.

New and existing investments

Energy / Oil related

During 2015 the fund increased its capital invested in the energy / oil sector from one investment and 7% of the fund's capital, to two investments and 13%. We believe that the oil extraction process is becoming progressively more technically difficult and increasingly capital intensive. The fund's investments in this area are levered to this idea rather than being an investment based on rising oil prices.

The energy / oil related businesses the fund owns have the ability to essentially "lean into" the cycle at current oil prices and invest reasonably aggressively, a trait we find desirable given the recent adjustment. This is an important and different dynamic to owning an investment whose success is reliant on higher oil prices.

To date, the valuations and share prices of the better quality energy related businesses have held up well despite the negative move in the oil price. We see this as rational; the market seems to be recognising the opportunity that these businesses have to deploy capital. We are hopeful that oil prices will continue to languish and a prolonged decline in the underlying commodity price will enable the fund to increase its capital invested around this idea.

Deere & Company

In August 2015 the fund acquired an initial 3.5% position in Deere & Company at US$80.93.

We are attracted to Deere's global brand, the importance of its product to its owners and their locally engrained third party dealer / distribution network. We have been impressed by Deere's cash generation over time and more recently the manner that their cashflow and margins have held into a declining macro environment. We regard Deere as a very high quality well managed business operating in highly cyclical industries. The current valuation strikes us as reasonable.

Saft Groupe S.A.

Last year we detailed our rationale behind the fund's investment in Saft. That rationale has not changed. Saft's share price appreciated over the year from E25.15 to close at E28.09. Point to point the outcome was okay but the volatility in between was high. Early in the year it appreciated towards E40 but in October 2015 the share price fell by 24% in one day. The fund was fortunate enough to be generally on the right side of these moves which limited the harm. We are encouraged by the approach and direction that the new management team are taking towards the business as detailed in their November 2015 strategy update. We expect Saft's earnings will continue to be lumpy and the share price volatile. We think they are well positioned and have a high level of existing activity and engagement with leading customers for high end niche battery applications. We think there is an interesting longer term investment opportunity, despite the volatility in the share price.

Whole Foods Market

In May 2014 we invested 4% of the fund's capital into Whole Foods Market at US$38.75 per share. Currently the shares are trading at US$33.50. Over the calendar year the Whole Foods share price fell from US$50, costing the fund 1% in 2015.

We continue to believe that there are enduring assets within Whole Foods that will enable management to eventually stabilise the business and that these assets will provide a base to build from. We do not expect there to be any quick fixes. The success of the investment will come down to confirmation of these enduring assets and then management's ability (and desire) to drive steady and methodical retail execution.

We continue to regard the Whole Foods retail offering as unique and highly desirable. We also continue to perceive they are trusted by their customers and other stakeholders in regard to food sourcing, supply chain activities, labelling and transparency. We think these traits are difficult to replicate and our sense is they are enduring assets of the business.

We consider the risks as very high and suspect that the operating momentum in the business may well continue to deteriorate further in the near term.

Whole Foods continues to be highly profitable and cash generative. When we think about the returns Whole Foods generates on its existing store base and the incremental return they generate on an additional store, they continue to be an effective retailer.

So, what is going on? What is causing the deceleration in activity?

While increased competition has been a contributing factor, we regard many of the issues as self inflicted. Some are the result of sloppy retail execution, others we regard as part of a natural evolution of the business.

It is clear their competitors have improved their offerings. This improvement was evident in the financial results Whole Foods delivered over the year (progressive deceleration in comparative sales to -2.1% as of the first five weeks Q1 2016). The deceleration is more concerning in the context of the US retail environment which was reasonable over this period. The changed competitive dynamic was also evident to us from a number of store visits we did in November 2015 in Texas, the Mid-West and Florida. Our impressions from these visits were that the Whole Foods stores were consistently good but they seemed to have lost the buzz we had become accustomed to. The competition had also improved; this was our consistent observation across regional competitors, national super market chains and smaller listed entities rolling out stores focussed on natural and organic offerings.

The declining performance has triggered considerable introspection and adjustment within Whole Foods. We see this as constructive. In November 2015, management detailed a strategy around:

- Reducing costs;
- Increasing focus on exclusive brands, prepared foods and amplifying these differences;
- Refining their pricing strategy, particularly around non-perishable homogenous items;
- Developing and launching a national affinity (rewards) program. We suspect this may prove a highly productive tool in engaging with their customers; and
- Focussing on backend systems alignment to assist with point of sale information, pricing, inventory management and business control.

We expect it will take some time to really know if these initiatives successfully re-engage Whole Foods' customers and drive increased activity in their stores. The risks are high if they fail. We think the risks are worth taking as there are a lot of interesting and positive aspects with regard to this business and very considerable upside for owners should they prove successful. We have not added to the Whole Foods position since the initial purchase in May 2014. We regard a 4% position as being an appropriate amount of capital weighing up the risks and issues around the business.

<u>Japanese Yen put options</u>

The fund continues to short the Japanese Yen against the USD. Over the year this position cost the fund 2% (we limit the amount the fund spends on Yen options to approximately 2% annually). The current face value of the position is in excess of two times the fund's size. The contracts are intended to profit should there be a run on the Yen as a result of Japanese solvency concerns. Day to day the Yen seems to be trading around perceptions regarding US and Japanese monetary policy. Our view is the solvency position of the Japanese government continues to progressively and relentlessly deteriorate. We view the Yen's weakness over the last three years as a result of quantitative easing; in some regards this is a sideshow to the solvency issue that we perceive to exist.

Investment Results

The fund provided a return of -3.7% for calendar year 2015.

The contributors to the return were as follows:

- Weakness in the Australian dollar contributed 2.35%;
- Long equity investments (in local currencies) cost 1.0%;
- Yen options cost 2.0%;
- Currency hedges cost 0.8%; and
- Equity derivatives and short positions cost 1.0%.

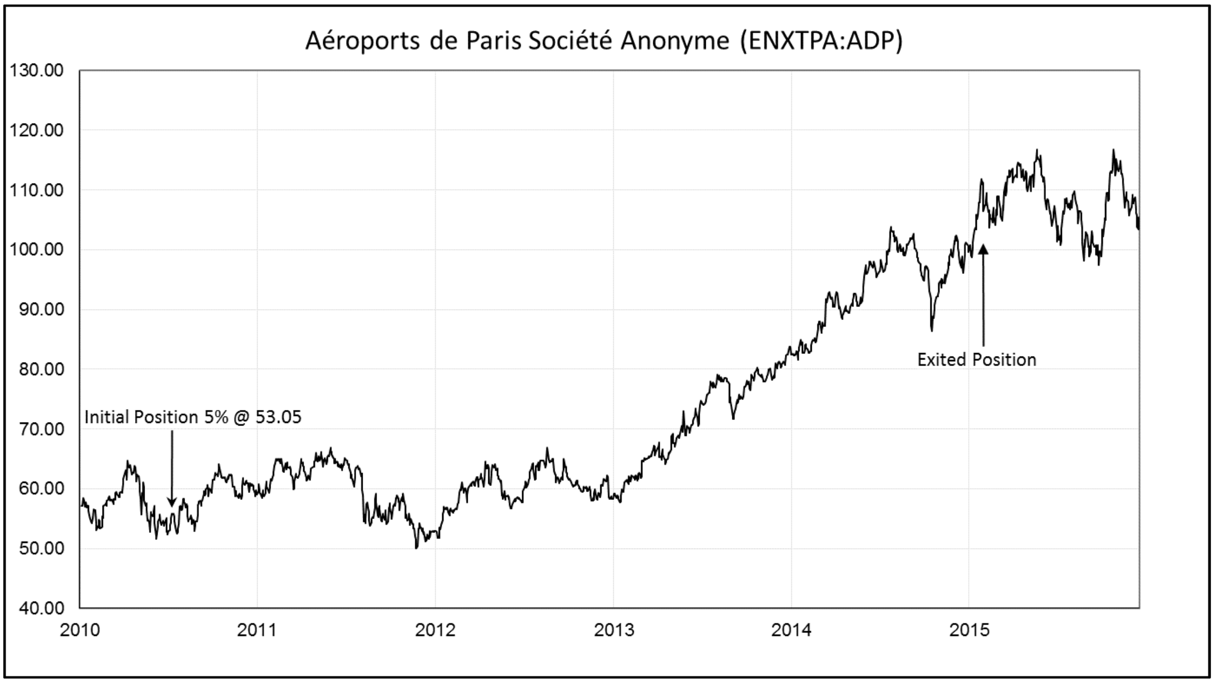
Returns (to 31/12/2015)	Fund
Since inception* (annualised)	11.3%
Since inception* (cumulative)	85.1%
Rolling 5 year (annualised)	12.6%
Rolling 3 year (annualised)	19.3%
Rolling 1 year	-3.7%
Standard deviation	9.4%

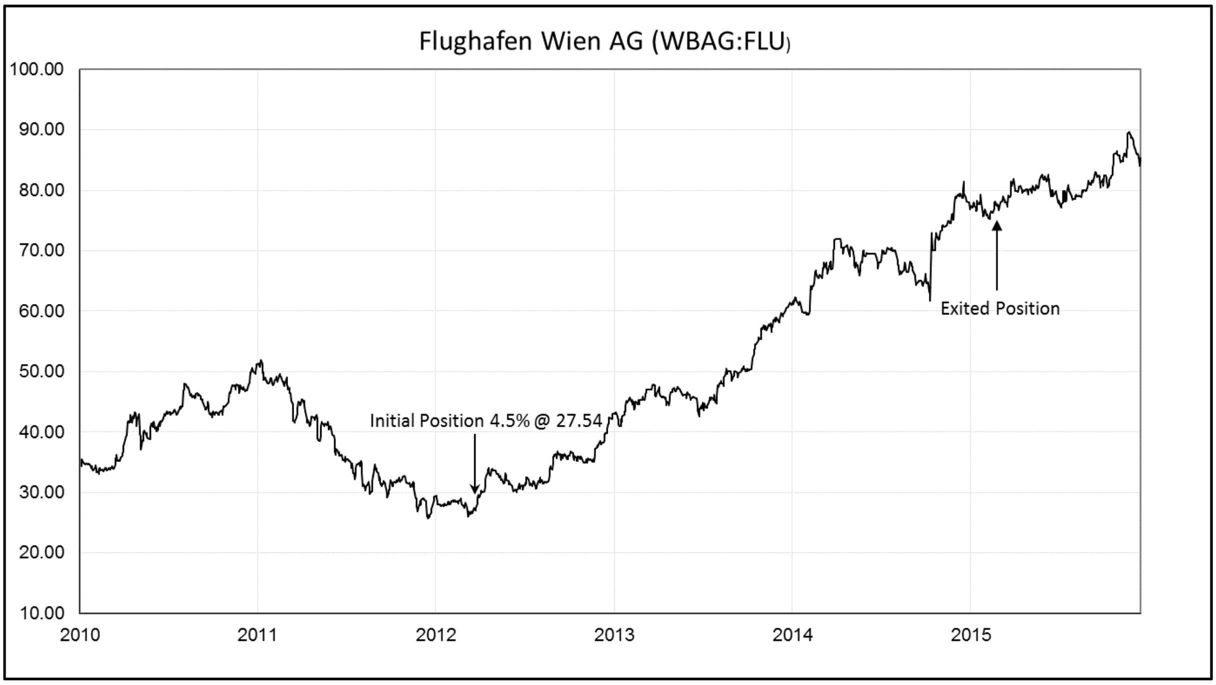
Financial Year	2010	2011	2012	2013	2014	2015	2016
July		1.14%	-1.95%	-3.06%	2.03%	1.98%	0.45%
August		-0.33%	-0.32%	0.45%	1.42%	-0.39%	-1.39%
September		0.60%	-2.18%	1.89%	0.52%	4.18%	-1.19%
October		2.12%	0.83%	1.30%	1.43%	2.53%	0.27%
November		0.47%	-1.22%	-2.46%	3.97%	11.10%	0.60%
December		-0.24%	0.27%	6.93%	1.13%	3.00%	-3.07%
January		0.31%	0.84%	9.92%	-0.54%	0.97%	
February		1.78%	0.02%	2.69%	-0.81%	1.57%	
March		1.06%	5.59%	-0.44%	-1.45%	-0.04%	
April	*0.04%	-1.94%	1.62%	4.45%	0.08%	0.32%	
May	-0.78%	1.01%	-0.37%	8.63%	1.29%	0.47%	
June	-0.76%	-0.70%	-2.58%	1.68%	0.02%	-2.61%	
Financial Year	-1.49%	5.33%	0.29%	36.06%	9.33%	24.95%	
Calendar Year		-3.10%	10.12%	43.95%	22.40%	-3.70%	

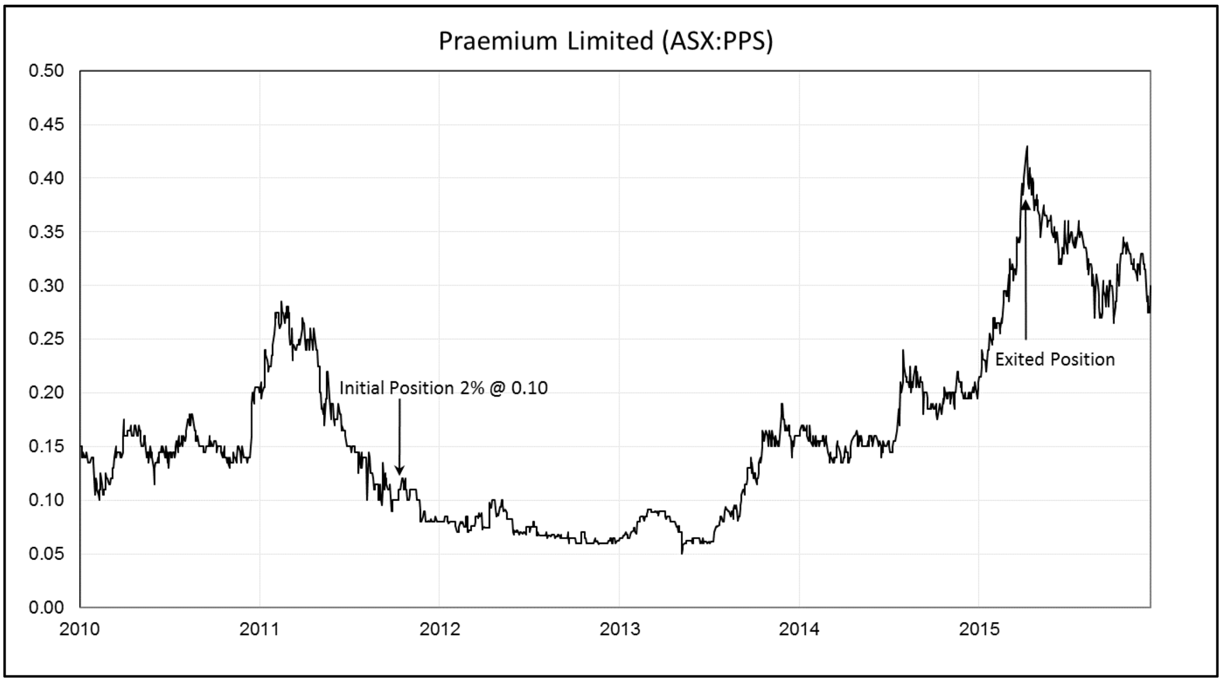
* Inception date: 15/04/2010

Appendix A: Chart Pack

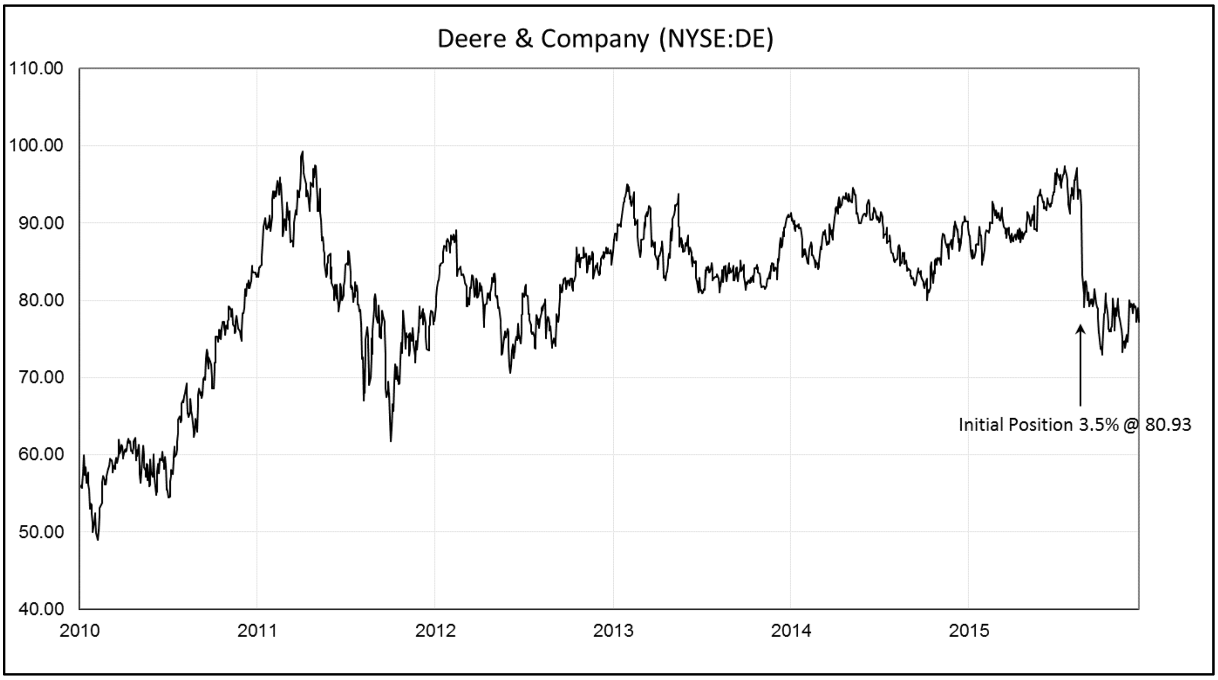
Investments Realised

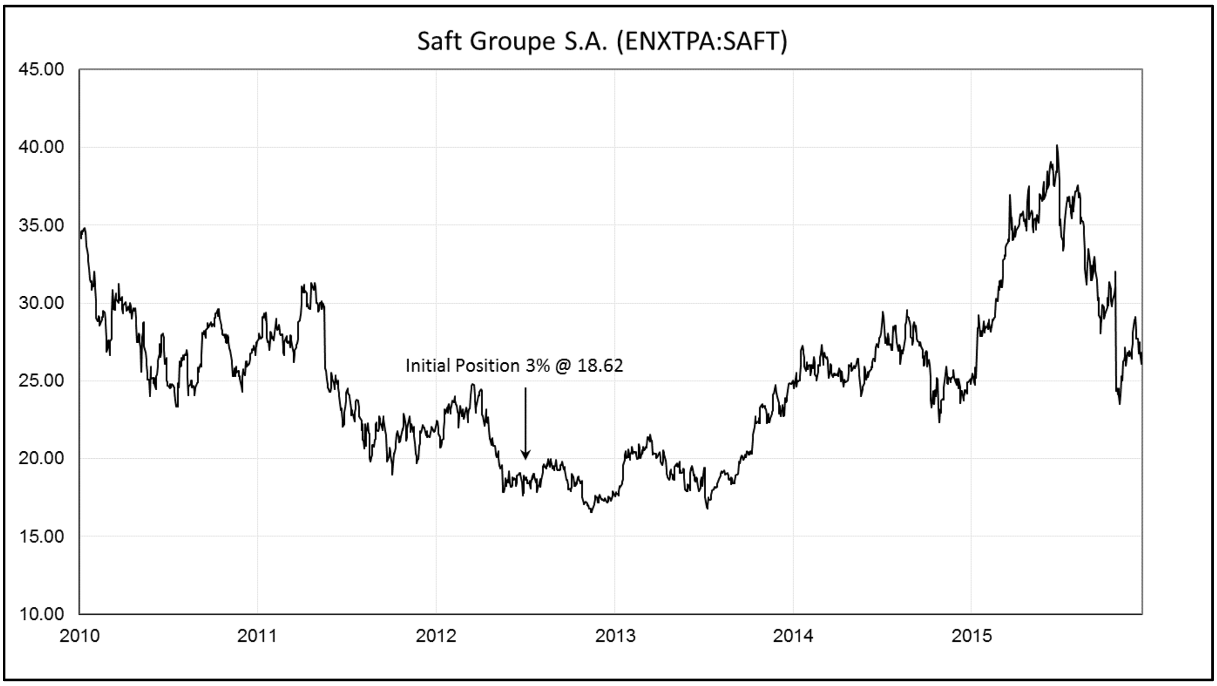


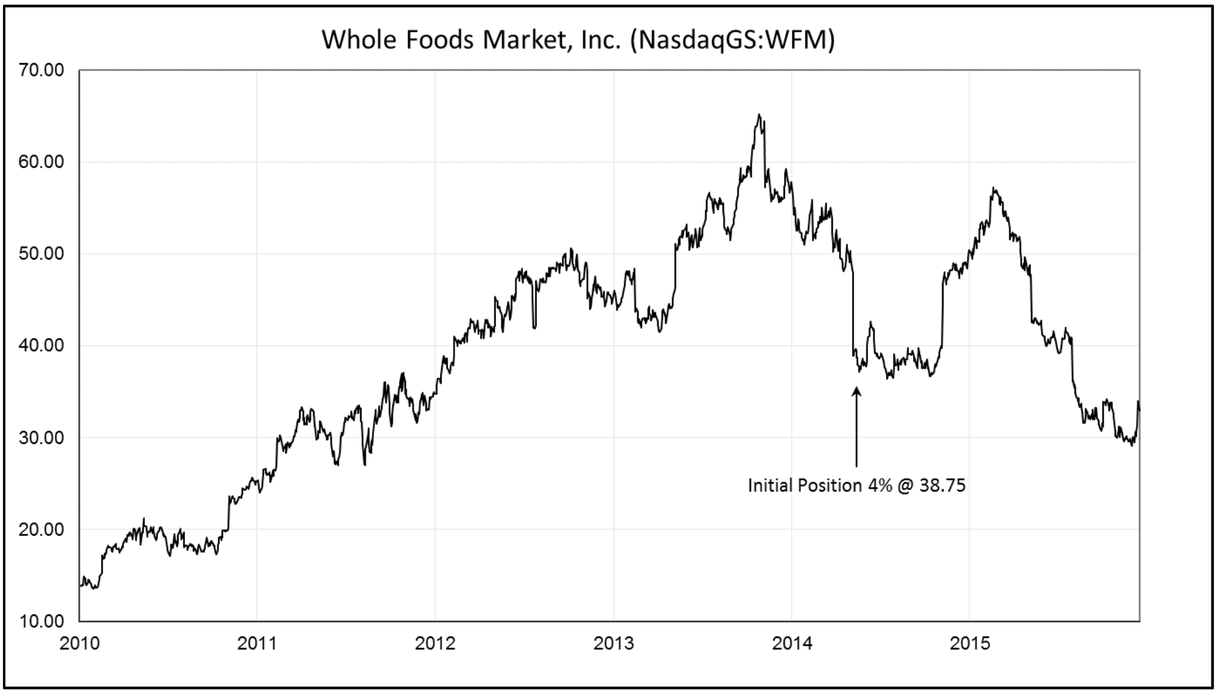




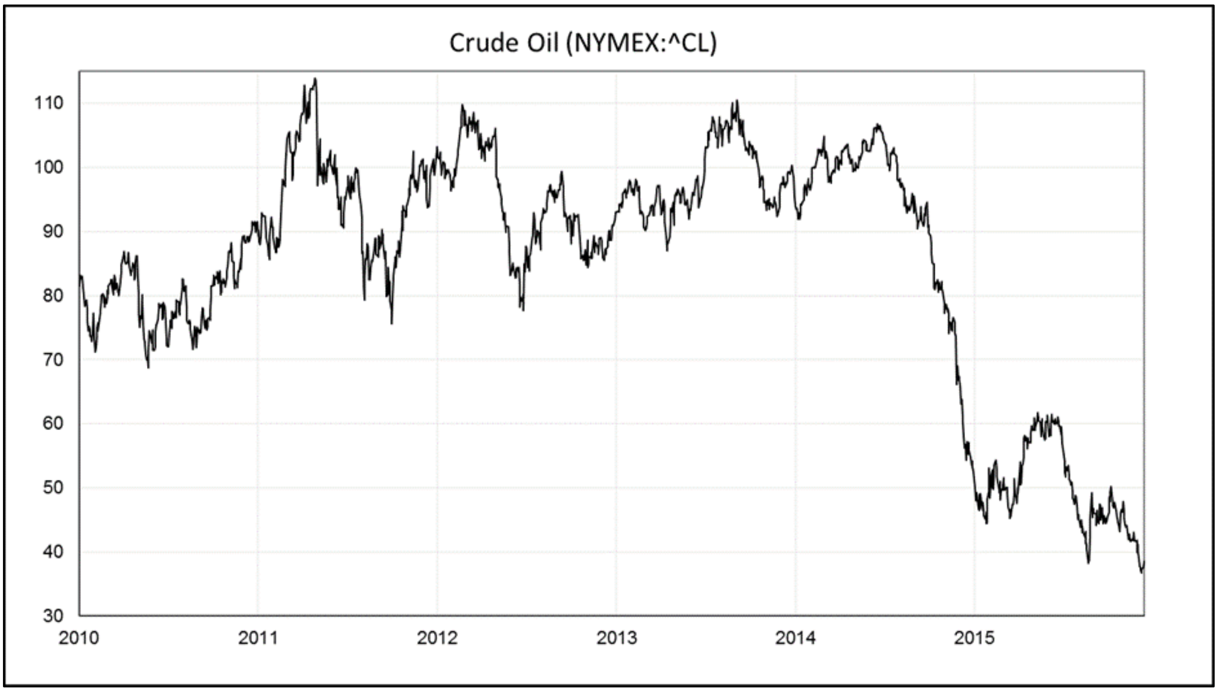
New and Existing Investments

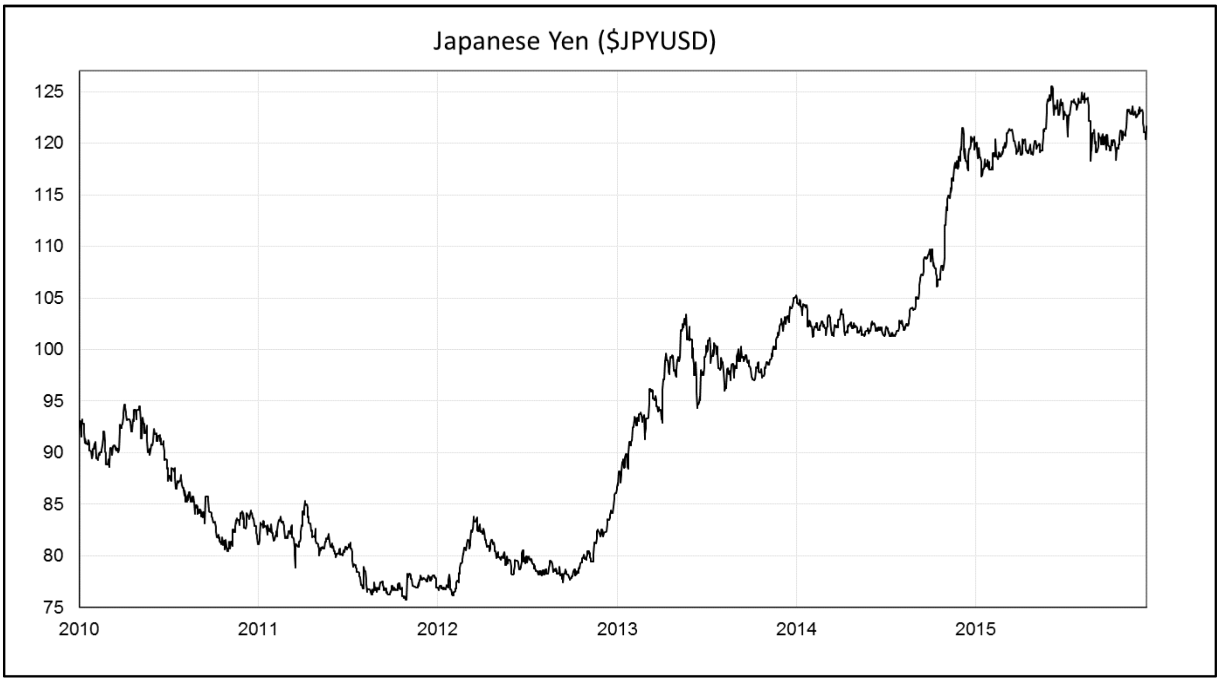


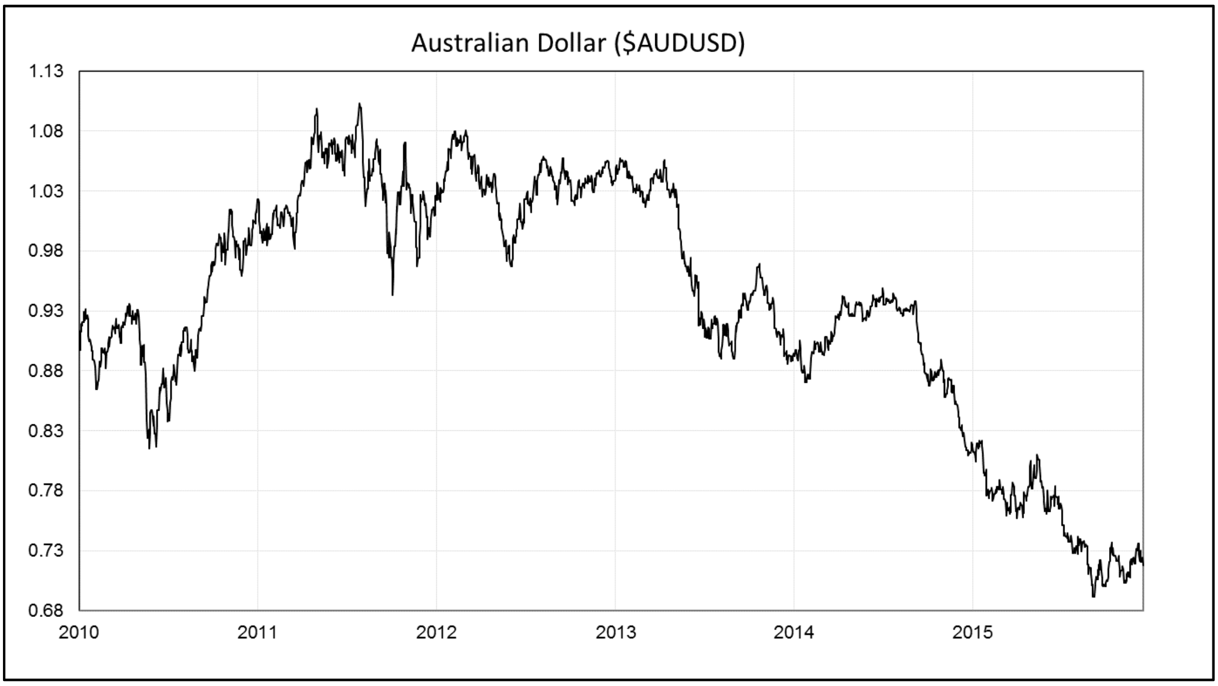

Saft Groupe S.A. (ENXTPA:SAFT)
45.00
40.00
35.00
30.00
25.00
20.00
15.00
10.00
2010
2011
2012
2013
2014
2015
Initial Position 3% @ 18.62


Whole Foods Market, Inc. (NasdaqGS:WFM)
70.00
60.00
50.00
40.00
30.00
20.00
10.00
2010
2011
2012
2013
2014
2015
Initial Position 4% @ 38.75

Macro


Crude Oil (NYMEX:^CL)
110
100
90
80
70
60
50
40
30
2010
2011
2012
2013
2014
2015


Japanese Yen ($JPYUSD)
125
120
115
110
105
100
95
90
85
80
75
2010
2011
2012
2013
2014
2015


Australian Dollar ($AUDUSD)
1.13
1.08
1.03
0.98
0.93
0.88
0.83
0.78
0.73
0.68
2010
2011
2012
2013
2014
2015

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