Auscap Long Short Australian Equities Fund Newsletter – September 2015

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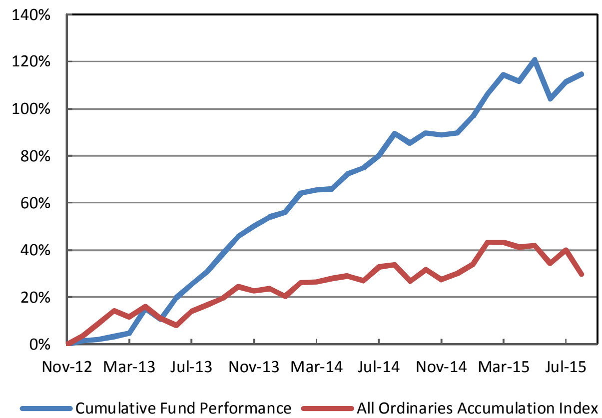
Welcome

Welcome to the Auscap newsletter, an opportunity for us to report the performance of the Auscap Long Short Australian Equities Fund (“Fund”) to current and prospective investors. In each publication we will also discuss a subject that we have found interesting in our research and analysis of the market. We hope that you enjoy reading these snippets and encourage any feedback. In this edition we analyse the returns delivered by the Fund in FY15 in terms of single stock and sector contributions.

Fund Performance

The Fund returned 1.64% net of fees during August 2015. This compares with the All Ordinaries Accumulation Index return of negative 7.3%. Average gross capital employed by the Fund was 112.7% long and 33.1% short. Average net exposure over the month was 79.6%. At the end of the month the Fund had 33 long positions and 7 short positions. The Fund’s biggest stock exposures at month end were spread across the financials, consumer discretionary, healthcare, materials and energy sectors.



Fund Returns

Period	Auscap	All Ords
August 2015	1.64%	(7.30%)
Financial Year to date	5.16%	(3.38%)
Calendar Year to date	13.23%	(0.17%)
Since inception	114.72%	29.74%

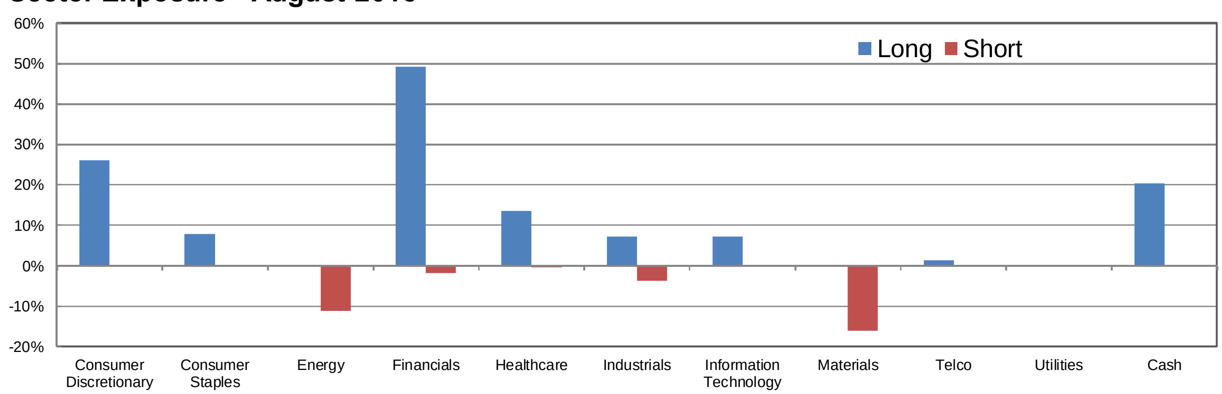
Fund Exposure

August 2015 Average	% NAV	Positions
Gross Long	112.7%	35
Gross Short	33.1%	11
Gross Total	145.8%	46
Net / Beta Adjusted Net	79.6%	50.2%

Fund Monthly Returns

Year	Jul %	Aug %	Sep %	Oct %	Nov %	Dec %	Jan %	Feb %	Mar %	Apr %	May %	Jun %	YTD
FY13						1.35	0.74	1.23	1.46	9.83	(4.05)	8.32	19.72
FY14	4.70	4.28	5.84	5.46	2.86	2.57	1.32	5.32	0.70	0.29	3.82	1.48	46.01
FY15	2.95	5.24	(2.09)	2.25	(0.43)	0.44	3.65	4.90	3.98	(1.36)	4.43	(7.55)	16.81
FY16	3.46	1.64											5.16

Sector Exposure - August 2015

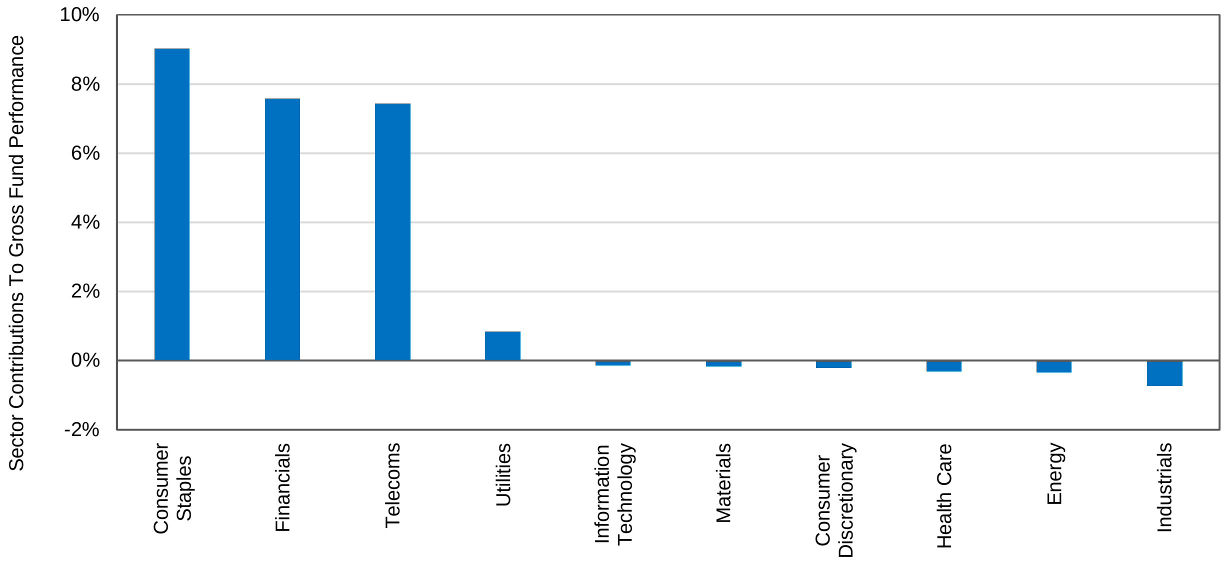


Analysing FY15 Fund Returns

FY15 was a good year for the Auscap Fund, delivering a 16.8% net return to investors, substantially above the All Ordinaries Accumulation Index return of 5.7%. In order to consistently provide transparency to our investors, we have dedicated the September newsletter to an analysis of the Fundôs returns in the prior fiscal year. We spend a great deal of time explaining our investment philosophy, this is a chance to look at the return profile.

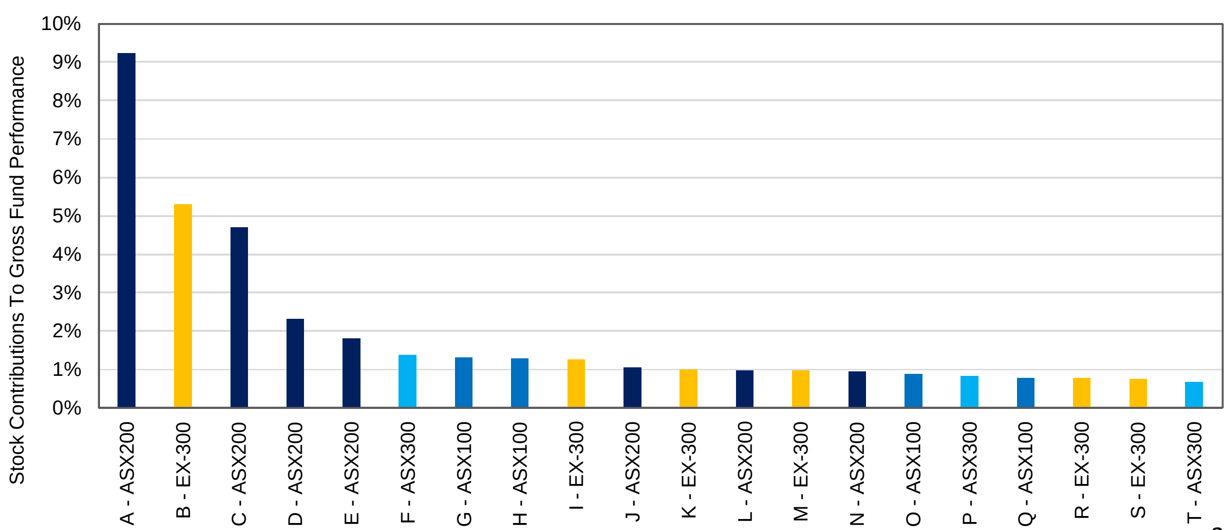
From a sector contribution perspective, almost all of the Fundôs performance in FY15 was driven by investments in the consumer staples, financials and telecommunications industries.

Gross Fund Returns by Sector



From a single stock perspective, there was some dispersion in terms of stocks that meaningfully affected the overall return for the Fund. If we start with the positives, there were three stocks that delivered outsized returns to the Fund, each returning over 4% gross to the Fund.

Best 20 Single Stock Contributions to Gross Fund Performance



Overall, a very large part of the Fund's FY15 return came from stocks within the ASX200. This is demonstrated in the chart below (right). The mid and large cap universe is typically our preferred hunting ground, and we are not surprised that such a large portion of the Fund's returns were generated from these stocks. It is a reminder that, in our opinion, these stocks typically display better risk and return characteristics.

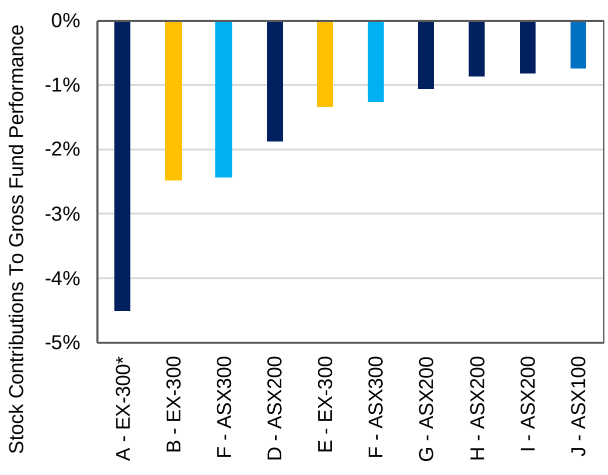
We view these companies favourably for a number of reasons, including:

- The companies have a track record of return on invested capital that can be analysed (we find consistent historical performance to be the best indicator for future performance and a demonstration of sustainable competitive advantage);
- The companies are often dealing in products or services with which we are personally familiar;
- The companies are typically not reliant on any single CEO or manager;
- The companies are already generating substantial cashflows; and
- The stocks have reasonable liquidity (so that if we are wrong in our analysis, we have the ability to exit the position in a timely manner).

We invest across the full spectrum of the market, but the return opportunity in smaller companies needs to be substantially greater, in our view, to justify the position. We classify it as an illiquidity premium, because if your thesis turns out to be incorrect, it can be more difficult to exit the position.

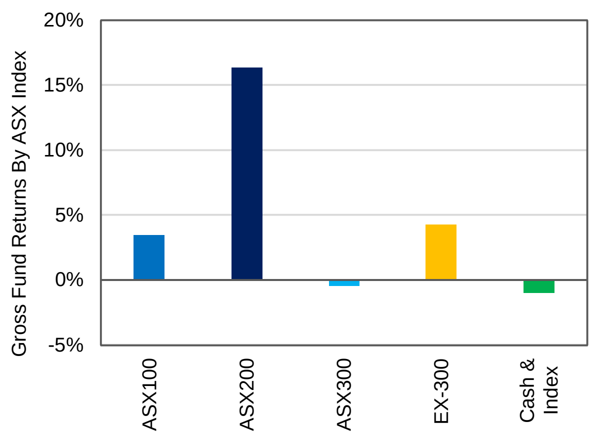
At the other end of the performance attribution were the stocks that cost the Fund money and impeded returns.

Worst 10 Single Stock Contributions



* In ASX200 at time of holding

Gross Fund Returns By Index



While it should be expected that we will make mistakes, we are disappointed with the errors that cost the Fund returns in FY15. Ideally, these mistakes should not have been allowed to contribute as negatively as they did to the performance of the Fund. We have relearnt a few lessons from these mistakes that we thought we would share with our readers.

- The golden rule: the best way to generate returns is to focus first and foremost on not losing money.
- Poor management has the ability to ruin any business. If management appear not to be operating in the best interests of shareholders, or if ego and personal reward seem to be a focus, it's best to avoid the company. If you don't trust the team running the business, don't invest in the business.

- Companies with structural headwinds are best left alone until the headwinds subside. It is better to invest in a business after its earnings have resumed an upward march than it is to attempt to anticipate when a company's decline in earnings will stabilise.
- A company that is conducting an initial public offer needs to be incredibly compelling to warrant participation, and a justifiable reason for why the stock is being sold cheaply. A stock being sold by informed, intelligent and knowledgeable owners to uninformed, inexperienced and undemanding shareholders is rarely a recipe for success if you are part of the latter group.
- If you don't like the business, don't buy the stock, irrespective of how cheap it looks on paper.
- When you realise you're wrong with an investment, cut it immediately (and enjoy the feeling of relief!). Holding onto bad investments can cost investors more than the money they end up losing on them, because they often cause investors to miss great buying opportunities in great companies because they are so focused on the energy-sapping mistakes that haven't been cut from the investor's portfolio.

Certainly we constantly remind ourselves of our process and are focused on being disciplined with each investment decision we make. We endeavour to continue to learn from our mistakes.

We also take this opportunity to remind our investors that we are focused on investments in high quality, cash producing businesses that have strong return on capital characteristics. We aim to purchase said businesses when they occasionally transact at prices that we consider attractive. We continue to hold a number of short positions, with the aim of protecting the portfolio from broad market downdrafts and adding to the overall return of the Fund. We look forward to continuing to work hard for our investor base in the years ahead.

If you do not currently receive the Auscap Newsletter automatically, we invite you to register. To register please go to the website and follow the registration link on the home page. Interested wholesale investors can download a copy of the Auscap Long Short Australian Equities Fund Information Memorandum at www.auscapam.com/information-memorandum. We welcome any feedback, comments or enquiries. Please direct them to info@auscapam.com.

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