FORAGER

SEPTEMBER 2019 QUARTERLY REPORT

VALUE BOUNCES BACK
When shareholders expect little, it doesn't take a lot to please.

ZEBRA'S RIGHT BARCODE
Asset intelligence is a growing industry and one company is a primary beneficiary.

MACMAHON PAYS DIVIDENDS
The annual result from Macmahon was one of the better results this reporting season.

GETTING MORE AGGRESSIVE
The Fund has been getting more involved in board appointments, pay, strategy and capital allocation.

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GROWTH BUBBLE BURSTS

A failed IPO for office sharing company WeWork might herald the end of a boom for businesses with lots of revenue growth but even bigger losses.

Every era has an event that defines it. The audacious Elders IXL bid for BHP marked the end of Australia's leveraged buyout craze of the 1980s. Time Warner's disastrous merger with AOL marked the end of the tech bubble of 1997-2000. The Lehman Brothers collapse was the defining moment of the 2008-9 financial crisis. Will WeWork's failed attempt at a stockmarket float in September mark the end of the latest era of financial excess?

The office sharing company is certainly emblematic of the current hurbis. Forager's Gareth Brown was blogging about WeWork way back in 2015, calling it the Uber of dumb investments. Fund manager Fidelity had invested US$400m back then at a valuation of US$10bn. A year later, Chinese investors tipped in $430m valuing it at $US15bn (Gareth doubled down with WeWork: Dumb and Dumber).

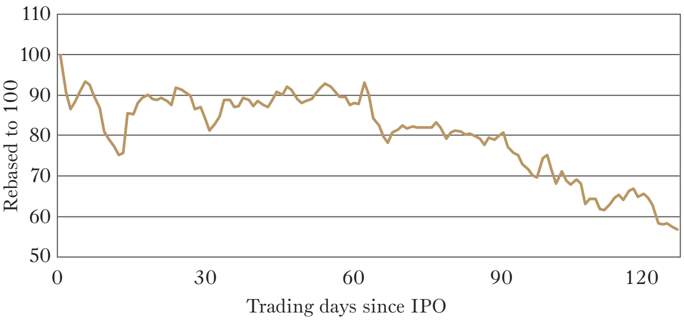
The most recent funding round, a US$2bn commitment by Softbank and its Vision Fund, valued WeWork at some US$47bn. Were Gareth betting against the stock, he would be living back with his parents in Toongabbie.

When it came time to raise serious money through a stockmarket float, though, investors weren't interested. Not at the US$60bn valuation being touted by investment bankers. Not at the US$47bn Softbank's investment suggested. Not at US$15bn. Not even after the company's founder, Adam Neumann, agreed to hand back the US$5.9m paid to him to transfer the name "We Company" and reduce his voting power (the original proposition was that one of Neumann's shares should get 20 times the votes of anyone else's).

Eventually Softbank, fearful of the consequences of dramatically lower prices on the value of its own investments, pressured WeWork to withdraw its IPO and fire Neumann and his wife and "strategic thought partner" Rebekah Neumann.

WeWork joins Uber (down 26.1% from its float price) and Lyft (down 47.8%) on a rapidly growing list of hyped companies that investors are growing wary of. The bubble in rapidly growing but loss making "disruptors" has burst, at least for now.

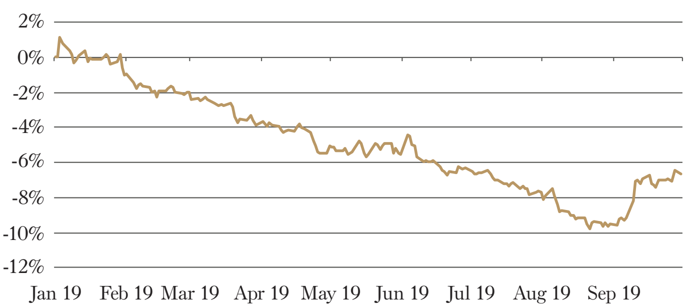
Chart 1: Average Share Price Performance of Large US IPOs (2019)



Source: S&P Capital IQ
*Average share price performance of Lyft, Uber, Peloton and Smile Direct since IPO

In a three month period where wider indexes hardly budged, the reversal of exuberance in the growth space was pronounced. After relentless outperformance by growth stocks, the trend reversed sharply in September (see chart below) and our International Fund's relative performance took a positive turn at the same time. Some of our worst performing stocks, like **Babcock International** and **Just Group**, bounced sharply off their lows. Babcock's share price is up 33.9% since 23 May, and it's paid 5.5% in dividends, and Just Group is up 46.9% from its £0.36 low.

Chart 2: Performance of MSCI ACWI IMI Value compared to Growth



Source: MSCI

THE MAIN FOCUS IS PROFITS AND DIVIDENDS

While a change in sentiment would be welcome, we're not relying on it to rectify our recent poor performance. We're focused on making sure existing and new investments make profits and pay dividends commensurate with our valuation. And on that front, it was also a mostly pleasing quarter.

Here at home, **Macmahon** announced an 80% increase in underlying profit and its first dividend since 2012. While small, it's a start. **Enero's** profit was up substantially and the final dividend made a total of 5.5 cents for the financial year. Relative to the $0.80 share price a few years back, that's a healthy return. It's also why the share price has increased substantially. **National Tyre & Wheel**, a small investment for the Australian Fund, paid 10% of our purchase price back in fully-franked dividends.

Internationally, the period saw excellent results from long-held investments **Blancco**, **Alphabet**, **Flughafen Wien**, **Hallenstein Glassons** and **Auto Trader**. With the exception of Blancco, which remains in growth mode, all are generating copious amounts of cash and returning a good amount of that cash to shareholders.

On those that aren't delivering to expectations, it was also a period of progress. We promised you a more active role in realising value from under-performing investments this year, and the September quarter showed the first meaningful tangible results from our efforts.

Logicamms finalised its merger with fellow engineering company OSD and is forecasting a healthy year. Three new

"WEWORK JOINS UBER (DOWN 26.1% FROM ITS FLOAT PRICE) AND LYFT (DOWN 47.8%) ON A RAPIDLY GROWING LIST OF HYPED COMPANIES THAT INVESTORS ARE GROWING WARY OF."

directors were appointed to the **Thorn** board, all of whom bring substantial commercial experience to the table. Three **MSL Solutions** directors resigned and Tony Toohey, an experienced listed company CEO, joined its board as executive chair.

On the friendlier side of the ledger, our prodding probably played a part in the dividend at Macmahon and the special dividend at National Tyre.

There remains plenty of work to be done in both portfolios. But it is nice to see some green shoots.

BEWARE "CHEAP" DEBT IN A DEFLATIONARY WORLD

Our roadshow around Australia took place in July and August. If you couldn't make it, a recording of the event is available on our YouTube channel. Despite the funds' poor performance, I wasn't investors' number one villain. Dr Phillip Lowe, governor of the Reserve Bank of Australia, was even less popular than me.

The RBA board had just cut the official interest rate to 1%. It has since been cut again to 0.75% and Lowe is openly talking about Australia's own version of quantitative easing. We're soon to join Japan and Europe in the zero club. The US might not be far behind us.

Many investors assume that "what goes down must go up". Many of our clients lived through the inflation of the 70s and 80s and and see its return around every corner. But what if that period was the anomaly rather than the rule? We all thought the stimulus and growth in money supply after the financial crisis was certain to kick start an inflationary spiral. It hasn't. In fact, inflation has been worryingly low. Best prepare, I would suggest, for a sustained period of zero rates.

More importantly, what do these zero rates imply about the future of the economy? What if, rather than rates going up, we are headed for a long period of low growth and deflation?

Low nominal rates are not necessarily a panacea for borrowers. It feels like it, because the interest payments today are so low. But, if we are headed for a deflationary world, it's repayments later in life that you need to worry about.

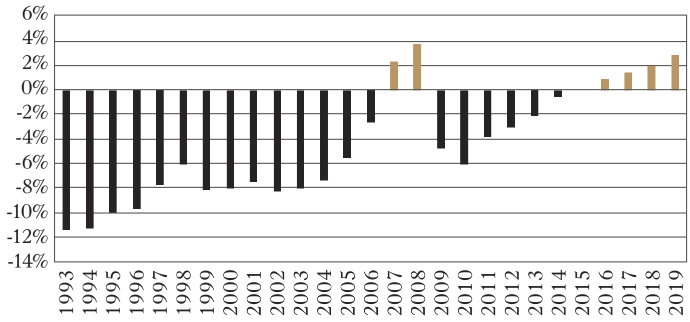
TURNING JAPANESE

Back in 2011 and 2012 I spent a significant amount of time looking at two Japanese property trusts listed on the ASX. Both had been created prior to the financial crisis and were trading at significant discounts to their net asset value in its aftermath.

Even prior to the discount, Japanese commercial property looked attractive. You could buy an office building in the mid 2000s on a cap rate, or net rental yield, of between 5% and 6%. Debt was freely available at interest rates of less than 1%. A purchaser funding a building with half debt and half equity could earn a 10% return on their investment. Not bad in a land where you get nothing on your bank deposits.

The catch became clear the more I investigated the history of Japanese office property. In 18 of the previous 20 years, property prices had fallen (see chart 3). Almost every year wages fell, rents fell and property values went down in tandem. Within a decade, that investor who thought they were earning 10% per annum found themselves the proud owner of property that was worth less than the outstanding debt.

Chart 3: Japan Nationwide Commercial Property (YOY change %)



Source: Bloomberg

Today's borrowers need to give that scenario some thought. Yes, it might look like you can safely borrow millions of dollars at today's extremely low rates. But what if your wage and the value of your property march steadily down over the next 20 years? Back in 1953, my grandparents borrowed £2,000 to buy their home in Sydney. The initial mortgage payments were a significant proportion of their combined incomes at the time. By 1978, when they made the last payment, the payments were barely noticeable. Today's borrowers could have the opposite experience.

There are important differences between Australia and Japan. Our population is growing. Our central bankers have the benefit of observing Japan's experience and attempting to avoid the same mistakes. But today's low rates are sending a very important signal. The world is turning more and more Japanese.

If that is the world we are headed for, be very wary of debt.

Thanks again to those who attended the roadshow. We know it hasn't been an easy year to be a Forager investor and appreciate the support and loyalty.

Our next webinar will be in the first week of December. Details will be sent via email soon, but keep lunch on the 4th of December free.

Kind regards,

STEVEN JOHNSON
Chief Investment Officer

INTERNATIONAL SHARES FUND

FACTS

Inception date	8 February 2013
Minimum investment	$20,000
Monthly investment	Min. $200/mth
Income distribution	Annual, 30 June
Applications/redemptions	Weekly

UNIT PRICE SUMMARY

Date	30 September 2019
Buy price	$1.5566
Redemption price	$1.5504
Mid price	$1.5535
Portfolio value	$157.8m

NEW AND OLD IN FORAGER INTERNATIONAL SHARES FUND

Plenty of new investments have been added during the first nine months of 2019. A few of the older underperformers, though, have been making something of a recovery.

Table 1: Summary of Returns as at 30 September 2019

	International Fund (Net of fees)	MSCI ACWI IMI
1 month return	3.09%	1.99%
3 month return	1.18%	3.86%
6 month return	5.09%	8.68%
1 year return	-5.19%	7.79%
3 year return (p.a.)	7.02%	14.06%
5 year return (p.a.)	9.47%	12.30%
Since inception* (p.a.)	12.20%	15.19%

*Inception 8 February 2013
The value of your investments can rise or fall. Past performance is not necessarily indicative of future performance.

New investments have been plentiful of late in the Forager International Shares Fund. A number of those, in Hong Kong and the US, are featured in this quarterly report. It was a number of our older investments, however, that benefited from renewed investor focus during the September quarter. As the rampant enthusiasm for much-hyped growth stocks waned, attention returned to those with assets and profits.

Two beneficiaries were **Babcock International** (LSE:BAB) and **Just Group** (LSE:JUST). As Steve noted in his cover letter, Babcock's shares have returned 39.4% since the middle of May (including its dividend). Its results have not been fancy. Management guided to a fall in profits this year but a Bloomberg headline in September summed up expectations about the stock: "Babcock up most in more than four months after confirming outlook". When expectations get so low that your shares are priced at just six times earnings, it doesn't take much to exceed them.

Unlike Babcock, Just Group won't be paying dividends any time soon. At their nadir, though, the shares were trading at less than one third of their asset backing. Recent announcements suggest the company may have a path out of a regulatory quagmire that is swallowing shareholder capital. Much remains to be done, but the shares have bounced some 46.9% on news that the future might not be quite as bad as feared.

There need to be many more better-than-feared results before high fives will be seen in the Forager offices. But there might be hope for value yet.

HONG KONG IN TURMOIL

When Hong Kong citizens took to the streets in March this year, most observers expected a short disruption to life in the city.

After four months, police have fired off more than 2,000 rounds of tear gas and made almost as many arrests. Recently, even the city's beloved Wednesday night horse races were cancelled. Other than for severe typhoons or the outbreak of influenza, that has never happened before. While races did resume the following week, there are still concerns that any further disruptions will be catastrophic for the local economy. Four percent of Hong Kong's tax revenues came from horse racing last year.

A bill that would have allowed the extradition of suspected criminals from Hong Kong to China sparked the protests, but its withdrawal has done nothing to end them. The protestors' demands, including more democratic representation, are things China is unlikely to acquiesce to. It is hard to see a logical solution to the standoff. And, in the meantime, Hong Kong's economy is suffering.

Tourism, retail and leisure are the worst affected. Tourist arrivals were down 40% in August, sharply deteriorating from the 5% decline in July. Health and beauty retailer **Sa Sa** (HK:178), the Hong Kong equivalent of Australia's Priceline, reported that sales dropped by a third in August. Such is the desperation of some hotels that room rates have fallen to the point where it is now cheaper to stay in a hotel than to lease an apartment. The Hong Kong stock market is one of the world's worst performing markets this year.

Table 2: Price to Earnings and 2019 Year to Date Performance of Market Indices

	Price Earnings	Total return YTD
China	13.8x	30%
Australia	19.5x	24%
France	19.5x	24%
Switzerland	22.1x	24%
United States	19.6x	21%
Canada	16.9x	19%
MSCI	18.6x	18%
Germany	20.2x	18%
Taiwan	17.2x	16%
United Kingdom	18.0x	14%
India	24.6x	7%
Hong Kong	10.2x	4%
South Korea	13.4x	2%

Source: Bloomberg

The Fund has made several 'bite sized' investments in Hong Kong in 2019, focusing on companies run by seasoned management teams who have a track record of paying shareholders a growing amount of cash every year.

Oriental Watch (SEHK:0398) is an example of one such company. This 58-year-old luxury watch retailer has endured the Hong Kong handover anxieties of 1997, the Asian and Global Financial Crisis, previous social unrest like the Umbrella Movement of 2014 and the outbreak of various epidemics.

“WHEN EXPECTATIONS GET SO LOW THAT YOUR SHARES ARE PRICED AT JUST SIX TIMES EARNINGS, IT DOESN’T TAKE MUCH TO EXCEED THEM.”

Its resiliency has helped cement its position as a key authorised dealer for Rolex in Asia. The current environment is hurting its sales and management is bracing for more uncertainty.

Oriental Watch’s balance sheet should allow the company to ride through this comfortably. It has $200m of net cash and $150m in inventory. It also owns some of its shops, bought decades ago, which could be sold for significantly more than their balance sheet value.

Chart 4: Oriental Watch—Trading Below Cash

Source: Company filings, Forager analysis

As an indication of how much pessimism there is in the company’s future, the company’s market capitalisation is less than its cash holdings. This is not a typical Hong Kong value trap, though. The company paid more than 100% of earnings as dividends last year, equating to a 16% yield. Its cash balance and retained profits should continue to build (the company is not expanding its store footprint and has no desire to buy other companies). In short, with the track record of returning capital, there is much more value to be unlocked here even before contemplating a ‘recovery’ scenario in Hong Kong.

Kerry Logistics (SEHK:0636) is another recent investment that has a clear intention of returning surplus capital. As an integrated logistics provider and freight forwarder, large companies call Kerry Logistics when they require seamless assistance in the storage and movement of goods. Having entered the business in 1981, Kerry aims to become entrenched with the customer for the long-term. It has a strong backing, being a key part of the Kuok empire of companies which are involved in property, hospitality, food, agribusiness and maritime.

Trade tariffs and recent events in Hong Kong have weighed on Kerry’s share price, creating an investment opportunity. The half year report highlighted business resilience and growth, with earnings excluding revaluations up 24%. Strong growth in the rest of Asia offset the weaker regions of Hong Kong and China. Deliveries by Kerry’s Thailand business have grown to more than one million parcels a day, doubling in the last two years. In Taiwan, Kerry is the only certified logistics provider in the pharmaceutical sector.

On the capital management side, Kerry has actively been slimming down its portfolio of valuable but low-yielding warehouse assets. The Fund has already received a special dividend arising from the sale of the first two warehouses. There are seven more to go.

The path to resolution in Hong Kong remains clouded, as the underlying causes of discontent are deep rooted and involve political, cultural and economic considerations. Both of these investments are small for the Fund. Both management teams, however, have dealt with plenty of turmoil before. We’re backing them to do it again.

CHANGING HORSES

In the last quarterly report we wrote about another recent Hong Kong investment, infant milk formula company **Ausnutria** (SEHK:1717).

After the company reported its results for the half year ended 30 June, we became increasingly concerned. While revenue and profit grew in line with our lofty expectations, none of that profit turned up in the company’s bank account. Instead, Ausnutria’s inventories have been increasing alarmingly. From an already-high 176 days’ worth of sales at the end of December 2018, inventory levels jumped to 212 days by the end of June. That is a lot of tins of baby formula.

Just days after the results were released, investment firm Blue Orca published a detailed short report accusing Ausnutria of improprieties ranging from overstating its sales to undisclosed related party transactions. After an initial tumble following the report’s release, the share price recovered thanks to a vehement defence from the management team. Combined with our concerns about the quality of the recent result, though, there was enough in the short-seller’s allegations to cause us concern. Rather than lose sleep at night, the investment has been sold.

ZEBRA’S GOT THE RIGHT BARCODE

Why would you want to own a company with a third of its sales exposed to the retail sector? Many traditional retailers have fallen by the wayside in recent years, including well-known names like Diesel, Sears, Radio Shack, Quiksilver, Toys R Us, Esprit and Oroton. As Amazon and its thousands of online competitors further upend the industry, many more will suffer the same fate.

There are success stories, though. And the ingredients for success are universal. Nimble retailers like **Hallenstein Glasson Holdings** (see page 9), Zara and Uniqlo are thriving. They have efficient supply chains that get products to market quickly and keep inventories low. And they serve their customers however they want to be served; online, in store or a combination of the two.

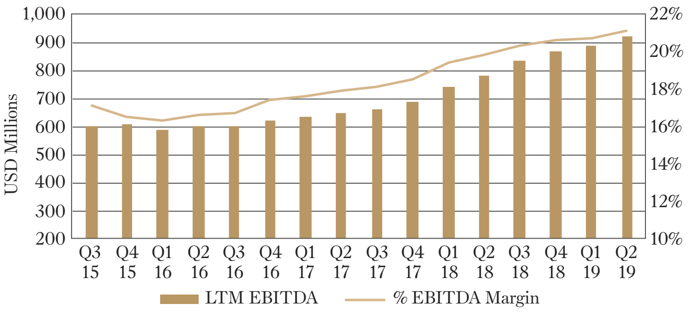
To do those things well, you need **Zebra Technologies** (NASDAQ:ZBRA), a leader in asset intelligence.

Zebra helps companies optimise their operations and adapt to a rapidly changing world where information, such as inventory levels and locations, needs to be immediately accessible. That makes it an essential partner for the likes of Target or Woolworths, companies that need to offer multiple delivery strategies such as online ordering or click and collect.

Its products include barcode printers and scanners, handheld mobile computers, data capture services, and RFID (the same technology in credit cards that allows tap and pay).

> "ZEBRA'S MOBILE DEVICES AND NEW APPLICATIONS ENABLE A SALESPERSON TO BETTER ENGAGE WITH CUSTOMERS IN THE STORE."

Chart 5: Zebra—EBITDA Growth and Margin Expansion



Source: Company filings

KEY TRENDS BENEFITTING ZEBRA TECHNOLOGIES

Numerous trends are benefiting the company at the moment, the first of which is the proliferation in the number of things connected to the internet (the so called Internet-Of-Things, or "IoT").

Connected devices capture a much broader range of information versus traditional tracking systems. Information is now communicated instantaneously, often through the cloud, allowing customers to know exactly where their inventory is at any moment instead of having to manually count it each week. It also helps logistics customers pack cargo on a truck more efficiently and monitor its movement in real time, leading to efficiency savings and on-time deliveries.

Zebra's mobile devices and new applications enable a salesperson to better engage with customers in the store (for example, help find exactly what a customer is looking for, check inventory, order from neighbouring stores, etc). They are proliferating. Next time you ask a friendly shop assistant a product's location, keep an eye out for their handheld Zebra device.

Finally, the "on-demand economy" and e-commerce growth is resulting in more packages than ever being delivered. Each one must have an identification label on it for tracking purposes. This has created more demand for Zebra's labels and printers in recent years as customers adapt to these new trends and require higher tracking capability.

Traditional companies in mature markets such as retail and logistics are increasing investment in asset intelligence to take advantage of these trends. A recent Zebra survey suggests 77% of decision makers plan to enable partial automation or supplement their labour force with technology while more than 80% are in the process of expanding the size and number of their warehouses by 2024.

And new areas like manufacturing and healthcare, where component or patient medication tracking is becoming more important, offer further growth opportunities for Zebra. According to John Hopkins hospital, medical errors such as giving the wrong medicine to a patient are the third most common cause of death in the United States.

MARKET SHARE GAINS

Zebra already has more than 40% market share across its main businesses. In the mobile computing space, the company estimates that it has captured an additional 13% in market share over recent years. This has come at the expense of its main competitor **Honeywell International** (NYSE:HON) and now commands more than half of the market.

Customers are shifting away from legacy Windows devices that are being phased out to the Android operating system where Zebra has a dominant position. Transitioning to 4G/5G technologies is also resulting in customer upgrades as older device functionality starts to deteriorate.

It has captured specialty printer market share every year and further gains are likely given high spend on research and development. At more than 10% of sales, Zebra spends two times that of its nearest competitor.

The past year saw Zebra launch a record number of new products, evidence that the spend is not going to waste.

Table 3: Zebra—Estimated Global Market Shares and Key Competitors by Core Application

Segment	Barcode & Card Printing	Mobile Computing	Data Capture & RFID
Mkt. Size	**~$3bn**	**~$4bn**	**~$2bn**
	Zebra (~40%)	Zebra (~50%)	Zebra (~30%)
	Sato	Honeywell	Honeywell
	Honeywell	Datalogic (LSD)	Datalogic
	Toshiba TEC	Panasonic (LSD)	Newland (SD)
	TSC	Denso (LSD)	

Source: Company filings, Atlantic Equities

ATTRACTIVE VALUATION AND SHAREHOLDER RETURNS

Zebra generates a lot of free cash flow thanks to its lean cost structure and low capital investment requirements. Although the capital allocation priority over the past few years has been repayment of debt (post a large acquisition in 2014) the company is now focusing on investing in areas that would help bolster its value propositions and on share repurchases. Over the past 12 months, Zebra has added almost 3% to revenue through small acquisitions and has committed to buying back approximately 2% of its shares every year.

Yet for all this, the company trades at an attractive valuation.

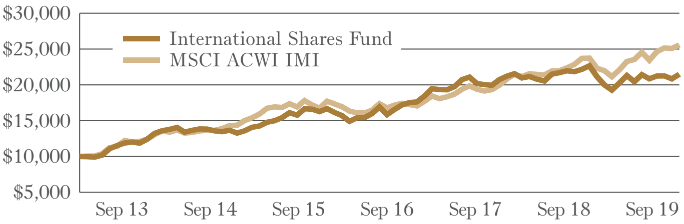
The bear case is that some of Zebra's technology, particularly mobile computing devices, could become commoditised. There is also a view that barcodes are becoming obsolete.

Neither are concerns that worry us unduly. Many of their products are purpose-built to address the specific needs of its customers, making generic competition an inferior option for clients focused on return on investment. And barcodes remain the most cost effective and prevalent means of asset tracking and tracing. The number of use cases are proliferating, not shrinking.

Today's price represents just 15 times our estimate of 2020 earnings, despite the growth runway ahead of it.

It is certain that more retailers and old economy companies will struggle or go bust over the next decade. The ones that survive and thrive, however, will be using products and solutions from companies such as Zebra Technologies.

Chart 6: Comparison of $10,000 Invested in the Forager International Shares Fund and MSCI ACWI IMI



Source: S&P Capital IQ
The value of your investments can rise or fall. Past performance is not necessarily indicative of future performance. Assumes distributions are reinvested.

Chart 7: Portfolio Distribution According to Market Capitalisation

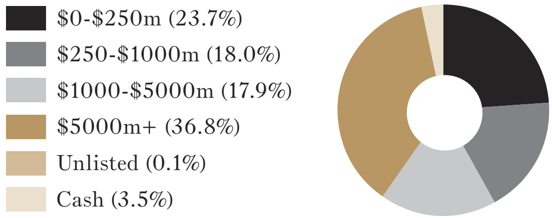


Chart 8: Stock Exposure by Geography

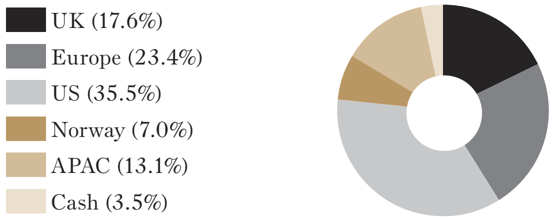


Table 4: Top 5 Investments

Blancco Technology Group Plc	10.2%
Flughafen Wien AG	5.9%
Babcock International Group Plc	5.8%
Alphabet Inc	5.4%
Linamar Corp	5.1%
Cash	3.5%

PORTFOLIO NEWS

Hallenstein Glasson Holdings Ltd (NZSE:HLG) continues to perform well in a challenging environment. Sales were up almost 5.5% for the year, while profits increased 6.1%. Growth came from the Glassons brand, both in New Zealand (sales increased 3.9%) and Australia (up 13.9%), while growth at Hallenstein Brothers stagnated despite adding a new store in the period. Operating costs were kept low, offsetting the negative impact of a stronger US dollar on its gross profits.

Consistent with HLG's strategy, online sales are accelerating growth. eCommerce sales increased 24% this year and now represent 15% of sales. The group is in the process of expanding their network of fulfillment centres to support the transition.

Growth has continued into this financial year, with sales for the first eight weeks of 2020 up 7.2%. Including the final dividend of NZ$0.24, the stock yields 7.5%.

Erasure software and mobile diagnostics leader **Blancco** (AIM:BLTG) grew revenue 13% to £30.5m for the year just ended, with a stronger increase in the first half than the second. In past years Blancco did numerous multi year deals with clients in exchange for discounts, reporting all revenue upfront. Current management has largely stamped out the practice, so underlying growth was better again.

The Enterprise segment grew revenue 20% and has a long runway ahead of it. The IT Asset Disposition market increased revenue 18%, that growth rate will slow sharply. Mobile was up 4%—growth here, if it comes, will be in step changes. Management's outlook implies 15% growth for 2020, including help from two smaller acquisitions (see July 2019 Monthly Report). We think that's very achievable.

Oil services provider **Gulf Marine Services** (LSE:GMS) had another eventful month. The UK-listed company's banks signed a waiver to relieve it of complying with covenants in the short term. A long-term solution to Gulf Marine's capital structure issues should be announced by the end of the year.

The company also released its half yearly results this month. Revenue for the six months to June 2019 was a touch lower at US$55m. Utilisation reached 69% compared to 62% last year, but this was more than offset by a dramatic reduction in vessel day rates. The average day rate for the period was almost 20% lower at US$30,000. This had a significant impact on profits, and the company made a loss including writedowns of US$16.9m in the period. Gulf Marine remains a small investment at less than 1% of the Fund.

AUSTRALIAN SHARES FUND

FACTS

Inception date	30 October 2009
ASX Code	FOR
Income distribution	Annual, 30 June

UNIT PRICE SUMMARY

Date	30 September 2019
NAV	$1.41
Market price	$1.20
Portfolio value	$160.0m

BUILDING FOR A LOW RATE WORLD

Reserve Bank interest rates were cut again during the quarter (and further in the first week of October). As much as we might wish it were different, there's no use in pretending low rates aren't here to stay. Throughout 2019 we have been actively reducing the Fund's cash weighting and increasing exposure to some high quality, dividend paying stocks (albeit out of favour for a variety of reasons at the time of purchase).

Table 5: Summary of Returns as at 30 September 2019

	Australian Fund (Net of fees)	S&P All Ords. Accum. Index
1 month return	4.38%	2.13%
3 month return	10.13%	2.82%
6 month return	2.11%	10.87%
1 year return	-7.21%	12.08%
3 year return (p.a.)	0.72%	11.73%
5 year return (p.a.)	7.66%	9.69%
Since inception* (p.a.)	10.65%	8.45%

*Inception 30 October 2009
The value of your investments can rise or fall. Past performance is not necessarily indicative of future performance. Returns are calculated using NTA, not market price.

After last financial year's fund underperformance, the September quarter provided some welcome respite for the Forager Australian Shares Fund. The net asset value increased by 10.1% during the period, versus a 2.8% increase for the All Ordinaries Accumulation Index.

Part of the increase was a simple rebound for a number of stocks sold off heavily into the end of June. Adding to that were some good portfolio results through reporting season.

Reserve Bank interest rates were cut again during the quarter (and further in the first week of October). As we discussed in the last quarterly report, as much as we might wish it were different, there's no use in pretending low rates aren't here to stay. Throughout 2019 we have been actively reducing the Fund's cash weighting and increasing exposure to some high quality, dividend paying stocks (albeit out of favour for a variety of reasons at the time of purchase). **Carsales** (CAR) and **Smartgroup** (SIQ) both saw significant share price jumps after reporting resilient results in line with our expectations. **SG Fleet** (SGF), too, performed well in a tough year for new car sales. Its share price, though, went south.

In SG Fleet's consumer-facing division, new leased vehicle deliveries fell by 3% in a market where new car sales fell 10%. The business-facing fleet management division maintained its fleet size. Overall revenue was down just 1%, with better uptake in complementary products like vehicle accessories and monitoring technology partly offsetting lower funding commissions.

What scared investors, however, was a change in product structure that will hurt near-term profits. Profit of $15m to $20m, which would have been earned as an upfront payment, will now be earned over the three years of a vehicle lease. The company will also fund more leases itself. Earnings and dividends will be lower this year, but the change creates more stable earnings in future years.

It's not easy for management teams of public companies to make long-term decisions at the expense of short term earnings. SG Fleet's majority owner, listed South African logistics and mobility group **Super Group Limited** (JSE:SPG), may be less concerned about share price fluctuations than your typical fund manager. The $16m of shares owned by CEO Robert Blau also gives us peace of mind that decisions are aligned with long term shareholder interests.

The company remains attractively priced, trading at 11 times this year's expected earnings. And the amount lost this year will be regained over the next few years, making growth aspirations easier to achieve.

CONTRACTING A STRONG RESULT

Profit up 80%. Revenue up 55%. A strong growth outlook. The annual financial result from mining services business **Macmahon** (MAH) was one of the better results this reporting season. But the share price is down 20% over the past year as a series of missteps have dented confidence in the company.

The first issue arose at the half-year result in February. An employee bonus scheme meant most of the earnings above the low end of management's previously guided range was to go to staff. The second came when two directors unexpectedly resigned. The third when the company entered a formal dispute with a client over a large contract.

None of these issues are individually significant and they are being addressed.

The profits for last year were in the middle of the forecast earnings range, after the payment of $3m for the employee bonus scheme. A smaller bonus pool, with more stringent conditions, is in place for this year.

Resigning directors have been replaced with board members who will bring plenty of experience and independence to their roles. The first is Vyril Vella, a former Macmahon director who, despite being a **CIMIC** (CIM) appointee to the board, joined with the rest of the board in resisting a lowball bid from the construction giant 2017.

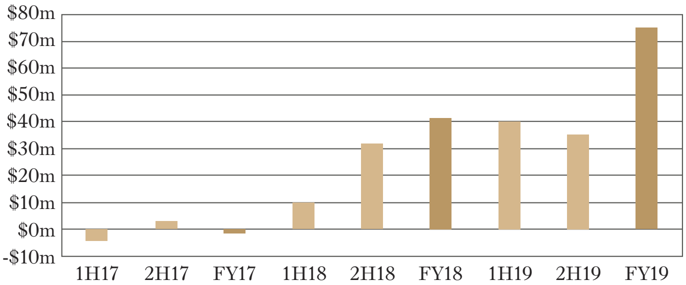
> “IT’S NOT EASY FOR MANAGEMENT TEAMS OF PUBLIC COMPANIES TO MAKE LONG TERM DECISIONS AT THE EXPENSE OF SHORT TERM EARNINGS.”

Two other experienced industry participants, both formerly employed by CIMIC subsidiaries, have also joined the board. CEO Mick Finnegan will also step up to the board table. With seven members and four independent non-executives the board will be able to keep AMNT, Macmahon’s largest shareholder and a major client, in check.

The dispute over Newcrest’s Telfer mine also looks to have been put behind the company, though a formal agreement is still to be signed off. It has been problematic and loss-making for years. Macmahon management now expect the project to be cash flow positive after negotiating for increased contract rates. If management didn’t push hard to achieve fair rates the company could have been facing a loss of $25m to $35m over four years.

Mostly forgotten as these corporate issues gripped investor attention is the company’s strong operational performance.

Chart 9: Macmahon—Underlying Earnings Before Interest and Tax by Half



Source: Company filings

Tropicana and Batu Hijau, Macmahon’s largest contracts, continue to perform well. These reached record volumes, as did new coal and gold projects at Byerwen and Mt Morgans. The company is pushing into underground mining with the purchase of GBF, an underground specialist contractor. It is contracted to perform work worth $4.7bn and has the potential to win $7bn more over the next few years.

Earnings forecasts for this year are well supported by contracted work and a contribution from the GBF acquisition. At the middle of the new guided earnings range, Macmahon shares trade at just eight times this year’s net profit.

Management has had a year of working hard to put out fires. Now, with some issues being resolved, they can finally get on with the job delivering for clients and shareholders.

GET AGGRESSIVE TO REALISE VALUE

Realising the value in the Fund’s investments more aggressively has been an area of focus for the past year. In a handful of underperforming investments we have been getting more involved in board appointments, management pay, strategy and capital allocation. The fight continues, but progress has been made.

Equipment finance and consumer leasing provider **Thorn** (TGA) has been a horror investment for the Fund and is one of the worst performers on the ASX in recent years. Changes were badly needed.

Three new directors were appointed to the Thorn board at its recent annual general meeting and the other board members have announced that they intend to move on once appropriate replacements have been found. The CEO is also leaving the business. Two of the new board members represent a major shareholder. Another is well known to Forager. We’re confident this new board will renew focus on realising value at Thorn.

The company then settled a long-running class action. The transgressions of the past have meant that Thorn needed to find $25m to put the issue behind it. A rights issue to raise $38.7m was announced last month, funding the settlement and giving the company some breathing room. The Fund took up its entitlement in the rights issue and agreed to contribute more if other investors didn’t want to increase their investment. When the rights issue is complete, Forager will control 15% of Thorn.

A drawn out strategic review has attracted a buyer for Thorn’s smaller equipment finance business, with listed company **Consolidated Holdings** (COG) putting forward an $82m bid for the business unit. With a bid for the business Thorn now has options after the completion of the rights issue.

With a new board, the class action behind it and good strategic options ahead, Thorn’s future should be brighter. After the rights issue the company has the cash to move on with these opportunities and finally realise some value for long-suffering shareholders.

There has also been a shakeup in two other investments: **MSL Solutions**, a provider of software to clubs and sporting venues, and engineering company **Logicamms** (LCM).

MSL has disappointed investors since listing in 2017. Recurring revenue from software products has grown slower than expected and one-off product sales have declined faster. Costs have risen rapidly. The business was left in a tenuous cash position and relied on asset sales to fund its operations.

In August, significant leadership changes were announced after investors, including Forager, put pressure on the board. Tony Toohey, who led a successful turnaround at gaming systems provider INTECQ (formerly eBet), was appointed Executive Director and Chairman. Two non-executive directors including the Chairman, John Down, stepped down. New executives were appointed to the CEO and CFO positions.

"MSL HAS DISAPPOINTED INVESTORS SINCE LISTING IN 2017. RECURRING REVENUE FROM SOFTWARE PRODUCTS HAS GROWN SLOWER THAN EXPECTED AND ONE-OFF PRODUCT SALES HAVE DECLINED FASTER."

Major cost reductions are underway to return the business to profitability. Dubious initiatives, such as retirement living software and a United Arab Emirates office have been closed. Other products are being considered for closure or sale. Staff costs have been reduced.

This is a good start but the cash position remains delicate. We continue to work with the company to achieve a shareholder friendly resolution.

Logicamms was another underperforming position now showing some signs of improvement. In June the company announced the completion of its merger with OSD Group, a strongly performing privately held engineering services firm. This brought scale, an aligned owner-manager, complementary capabilities and much needed balance sheet stability. The combination of the two businesses appears to be on track, with over $3m in annualised cost savings already achieved.

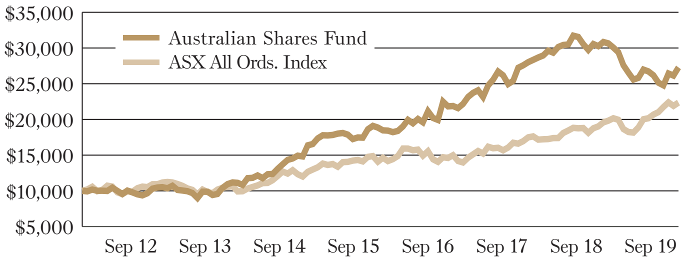
Chart 10: Logicamms—Share Price

Source: S&P Capital IQ

CEO Chris O'Neil, appointed in November 2018, continues to focus on improving business development and bid processes while also keeping a close eye on overheads. Combined with better balance sheet strength, the business should now be in a stronger position to bid for larger contracts. A search for two new non-executive directors is progressing.

Engaging in this type of more aggressive activism isn't always a smooth process, soaking up plenty of the team's attention and time. But there has been some headway, giving confidence that meaningful changes are possible. We will continue pushing hard to realise value in these and other investments.

Chart 11: Comparison of $10,000 Invested in the Forager Australian Shares Fund and ASX All Ords. Index



Source: S&P Capital IQ
The value of your investments can rise or fall. Past performance is not necessarily indicative of future performance. Values are at NAV, not market price. Assumes distributions are reinvested.

Chart 12: Portfolio Distribution According to Market Capitalisation

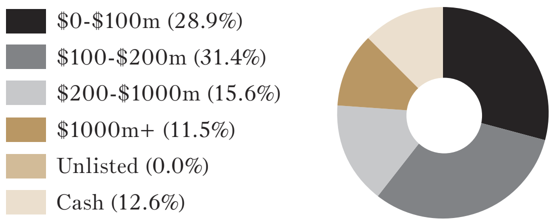


Table 6: Top 5 Investments

Enero Group Limited	9.9%
Macmahon Holdings Limited	7.1%
iSelect Limited	7.0%
Smartgroup Corporation Limited	6.2%
MMA Offshore Limited	6.0%
Cash	12.6%

PORTFOLIO NEWS

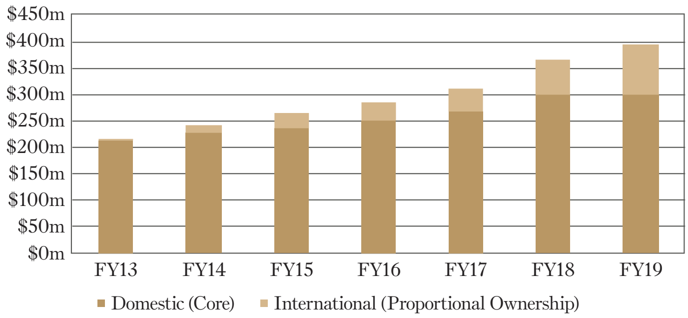
Marketing services business **Enero** (EGG), the Fund's largest investment, delivered another strong result. Revenue was up 25% and profit was 53% higher. Strong results in the US businesses helped the company grow revenue by 14% excluding acquisitions. Hotwire, Enero's star technology public relations business, continues to perform well as technology companies grow and face plenty of public scrutiny.

As the businesses under Enero's umbrella have grown the company's corporate costs, for a long time a significant burden, have risen less quickly. The resulting operating leverage saw profit growth substantially above revenue growth. The Fund has sold some shares in Enero over the past few months, but as the price has increased the weighting has remained high, finishing last month at 10% of the portfolio.

Carsales (CAR), the online car classifieds portal, has also performed strongly. Revenues in the largest segment, online advertising for dealerships, grew 7% over the past year. The number of leads passed to dealers rose, price was increased, and clients paid for more premium products. The company's products are mostly oriented towards used car sales rather than the more volatile new car sales. Revenue and profit in Australia rose a more modest 1%, but the company confirmed its resilience amidst tough conditions in the auto sector.

The performance of the company's international operations was a highlight. Korea's SK Encar grew revenue by 17% and profit by 16%. Brazilian subsidiary Webmotors performed even better, growing profit by 44%. The international businesses have large market shares in markets that are early in their online auto classifieds development. They continue to hold significant potential for Carsales.

Chart 13: Carsales Revenues—Domestic (Core) and International (Proportional Ownership)



Source: Company filings

Logistics provider **CTI Logistics** (CLX) had a tough year. A slow Western Australian economy continued to impact the business: the second half of last financial year was barely profitable. Management attributed this to significant reductions in customer activity, increased margin pressure and elevated costs from consolidating recent acquisitions. A full year dividend was not declared for only the second time in fifteen years. A turnaround in WA activity continues to be elusive but the company's property portfolio underpins net tangible asset backing of $0.88 per share. The business is well positioned for an eventual return in WA activity.

Skydiving and adventure business **Experience Co** (EXP) had mixed results across its two business segments. The skydiving business returned to growth and showed early signs of restored customer confidence after some recent incidents. The number of jumpers grew 1.3% across Australia despite Far North Queensland declining by 13% due to lower Cairns tourist visitations. The adventure businesses, based in Cairns, suffered for the same reason but look to have retained market share.

An impressive management team also met investors for the first time. John O'Sullivan, former head of Tourism Australia, started his new role as CEO in July. He will be leading a strategic review to cut costs and exit some of the badly performing adventure acquisitions made by previous management. A renewed focus on the company's core skydiving business will be a welcome change.

Tyre distributor **National Tyre & Wheel Limited** (NTD) faced a challenging environment. Profit fell by a quarter despite revenue rising 10%. A lower Australian dollar and higher tyre purchase prices were difficult to pass onto customers. Lower consumer confidence hurt purchases of the company's premium tyres. The difficulties of last year will persist into this year and earnings may fall again.

But National Tyre continues to have more cash than debt and trades on five times last year's net profit. Importantly, profit is being paid out to shareholders as fully franked dividends. For the last financial year investors received $0.048 per share of fully franked dividends, a yield of 12%. As competitive pressure and consumer confidence improves margins should return to higher levels over time.

Fund administrator **Mainstream Group** (MAI) continued with consistent growth in funds under administration. Another record level of $173bn was reported in June, growing 24% from last year. Revenues of $50m and earnings before interest, taxes, depreciation and amortisation of $7.4m were achieved. This was at the low end of earnings forecasts: margins fell as costs rose faster than revenue. Revenue growth remains the priority this year with the company planning to add sales staff to all offices. Growing the company's mostly recurring revenue will increase the value to both shareholders and potential acquirers over the long term.

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Forage
verb, for·aged, for·ag·ing.
to search about; seek; rummage; hunt (for what one wants).