Ironbark Karara Investment Funds

Quarterly Investment Report as at 31 March 2017

Market Review

Global equity markets continued to rally throughout the quarter as evidence clearly indicated an acceleration in global economic growth. The MSCI World Index exhibited a total return of 5.6% with cyclicals materially outperforming defensive exposures. Global markets largely ignored the chaos surrounding the new US Administration and focused on the underlying economic data.

Australian equity markets slightly underperformed the global index delivering a total return of 4.7% during the March quarter. The top performing sectors were health care (up 15%), utilities (up 10%) and consumer staples (up 11%).

During the quarter, the broader index saw slightly positive earnings revisions, however this was largely driven by resource earnings upgrades as iron ore prices remained elevated. Excluding that, the investment manager has seen small downgrades across industrials and marginally higher earnings for financials.

Domestic profit results for six months to December came in slightly stronger than expected. The underlying story is one of reasonable revenue growth, strong cost control, active capital management and conservative capital expenditure guidance. Relative to last year, companies are expressing more optimism around demand however are also expressing some emerging pressures on input costs.

The US Federal Reserve took advantage of the strong incoming economic data to raise rates in March. The outlook for further gradual rate increases was retained. Despite this, bond rates were relatively stable with US and Australian 10 year bond rates falling by 6 and 7 basis points respectively. The current US dollar 10 year real interest rate ended the quarter at 0.43% (down 7 basis points) with inflation expectations over that period increasing marginally from 1.95% to 1.97%.

Incoming domestic economic data continues to be mixed although clearly tells the story of the two-speed economy that currently exists. Leading indicators are supportive of an improving labour market, however the significant slack that exists is likely to prevent any near-term acceleration in wage growth. Whilst the Reserve Bank of Australia ('RBA') remains firmly on hold, there has been a concerted effort by regulators to address the strong credit growth within the housing sector through macroprudential measures.

Iron ore continued to outperform expectations, averaging $85 per tonne during the quarter. This strength resulted in substantial earnings upgrades for the major miners although longer term expectations of a fall in prices back to appromixately $60 per tonne remains the prevailing consensus view. These elevated commodity prices assisted in the appreciation of the Australian dollar by 6% versus the US dollar and by 4% on a trade weighted basis.

Oil prices retreated with Brent falling 7% to $52.83 as the anticipated fall in US inventories has been slow to materialise, despite the high level of compliance by the OPEC producers. The strong response from US shale producers exceeded all expectations although significant growth will be required to meet demand growth over the next 2 to 3 years.

Performance

Ironbark Karara Australian Share Fund

Fund size: $57.5 million **Exit Price: $1.5602** **Inception date: 30 June 2005**

	1 month (%)	3 months (%)	1 year (%)	3 years (pa) (%)	5 years (pa) (%)	7 years (pa) (%)	Since inception[3] (pa) (%)
Net Fund Return[1]	2.62	3.62	19.77	4.36	9.76	6.24	6.68
Benchmark[2]	3.28	4.71	20.24	7.51	10.83	7.23	7.37
Excess Return	-0.66	-1.09	-0.47	-3.15	-1.07	-0.99	-0.69

Ironbark Karara Australian Small Companies Fund

Fund size: $578.8 million **Exit Price: $3.3340** **Inception date: 30 June 2005**

	1 month (%)	3 months (%)	1 year (%)	3 years (pa) (%)	5 years (pa) (%)	7 years (pa) (%)	Since inception[3] (pa) (%)
Net Fund Return[1]	1.95	4.24	7.48	5.55	8.13	8.97	13.40
Benchmark	2.66	1.46	13.67	6.44	2.28	2.16	3.53
Excess Return	-0.71	2.78	-6.19	-0.89	5.85	6.81	9.87

Past performance is not an indicator of future performance. Net performance figures are calculated using exit prices, net of fees and reflect the annual reinvestment of distribution. Retail investors should refer to net returns. If investing through an IDPS Provider, the total after fees performance return of your investment in the Fund may be different from the information in this report.

[1]Karara Capital appointed investment manager on 1 May 2010, Fund performance prior to this date is not attributable to Karara Capital but the prior manager.

[2]The S&P/ASX 300 Accumulation Index was adopted as the Fund's performance benchmark on 1 July 2010. Benchmark calculations prior to this date are based on the S&P/ASX All Ordinaries Index.

[3]This figure represents the annualised performance of the Fund since inception.

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Portfolio Performance & Portfolio Activity

Ironbark Karara Australian Share Fund

The Fund rose 3.62% (net) during the March quarter. This constituted 1.09% of underperformance when compared with the S&P/ASX 300 Accumulation Index return of 4.71% (net) for the quarter.

AGL Energy (up 21%) benefitted from the decision by the government to subsidise the Portland Aluminium smelter. Combined with the closure of Hazelwood, there is now a shortage of low cost electricity generation with higher cost gas fired power generation now the marginal supplier. Consensus expectations have yet to reflect the new reality of longer term wholesale power prices of approximately $80 per megawatt hour, which more closely resembles the long run marginal cost. Given the strong performance in AGL, the strategy's large position was trimmed marginally at the end of the quarter to fund an increased exposure to Origin. Origin will also substantially benefit from the step change in the wholesale electricity market in addition to the associated tightness in the domestic gas market.

Qantas (up 19%) delivered a solid result with clear evidence of the domestic airline duopoly effectively managing the level of capacity enabling the yield environment to improve. Pleasingly, Qantas also committed to extending their pursuit of productivity gains with an anticipated $400 million per annum targeted. Overall, despite its strong performance since being added to the strategy, the strength of the domestic franchise along with their outstanding frequent flyer business is still not being reflected in its market value.

The Fund's underweight to Telstra (down 6%) added value as their result underwhelmed with increasing awareness of the difficult task they have ahead to defend their high margins given their infrastructure and network competitive advantage has materially reduced.

The REIT sector underperformed the broader index with the sector largely flat. Results were mixed with retail rent growth remaining below trend and revaluation gains slowing. However, the larger infrastructure companies, which are not held by the Fund,outperformed with Transurban and Sydney Airport both up 13%. Overall, the underweight to real estate and infrastructure was broadly neutral to the Fund's relative performance.

The investment in Worley Parsons was closed out towards the end of the quarter. Their half yearly results were weak and left the balance sheet precariously exposed to any further hold up in collecting accounts receivable. Whilst the raid by Dubai based Dar Group saw the stock close up 13% over the quarter, the balance sheet risk was considered too high versus the additional upside that may exist from a full takeover by Dar.

The largest detractor for the quarter was Brambles (down 23%). After years of solid growth, Brambles reported that its US pallet business saw a sharp revenue decline in December and slower new business wins. The new CEO used this soft trading to step back from long term return targets and indicated a new strategy around greater price competitiveness in the US pallet business and increased investment in growth markets. The investment manager views the challenges as largely cyclical with the underlying quality of the business intact.

Whilst exceeding expectations, JB Hi-Fi (down 10%) was impacted by speculation around the entry of Amazon into the Australian market. The concerns have reached fever pitch in the market despite the absence of any hard evidence of an imminent arrival. The underperformance of the stock seems to more than fully discount plausible long-term impacts, despite JB Hi-Fi being very well placed to compete and their ongoing capture of market share from traditional retailers.

The Fund increased its position to Navitas following a solid result. However, the subsequent loss of a material contract with the Federal Government resulted in Navitas falling by 9% during the quarter. Whilst the contract loss was disappointing, the underlying performance of their core university pathways has accelerated and the strong cashflow generation of the business is under appreciated.

James Hardie (down 6%) lowered guidance as manufacturing efficiencies constrained it ability to meet strong demand. Remediation will take some time (and expense) however seems well within the competencies management has historically exhibited. At this point the investment manager sees this as a temporary setback with the longer term potential as broadly unchanged.

CSL upgraded their earnings by 8% after competitors were hit by raw material shortages. The upgrade highlights CSL's operational flexibility and validates, in part, continued valuation expansion enjoyed over this period. However, competitor supply shortfall will be remedied and a variety of longer term challenges remain that are not reflected in the current share price.

Clean credit trends, good cost control, strong capital generation and some mortgage re-pricing benefits drove bank earning upgrades for the first time since August 2014. Regional bank margins came under pressure and they also saw higher credit losses, however these are not held. Following good recent relative performance, the overweight to the major banks has been trimmed.

Wesfarmers (up 10%) and Woolworths (up 11%) both benefitted from an improved outlook for the supermarket industry. Given the improved outlook and attractive valuation, the Fund reduced its underweight position to Wesfarmers during the quarter.

The Fund reduced its position in Downer early in the quarter following strong performance. Late in March, Downer undertook an equity raising to fund their unsolicited takeover of the Spotless Group. The Fund participated and whilst several uncertainties exist surrounding the acquisition, Downer management have a strong track record and the investment manager is prepared to give them the benefit of the doubt for now.

Portfolio Performance & Portfolio Activity (cont'd)

Ironbark Karara Australian Small Companies Fund

The Fund rose 4.24% (net) during the March quarter. This constituted 2.78% of outperformance when compared with the S&P/ASX Small Ordinaries Accumulation Index return of 1.46% (net) for the quarter.

The strongest contributors to Fund performance at a sector level were overweight positions in consumer staples, metals & mining and utilities, as well as underweight positions in consumer discretionary. The main sector to detract from performance was an underweight position in industrials.

At a stock level, positive contributors to quarterly performance included overweight positions in Bega Cheese, Costa Group, NIB, Steadfast and Westgold. A nil position in Fletcher Building also contributed. Bega Cheese shares rose 51% over the quarter after announcing it had agreed to buy most of Mondelez International's Australia and New Zealand grocery and cheese business, which includes the iconic Vegemite brand. Costa Group rose 27% after reporting earnings for the first half of the 2017 financial year that were ahead of guidance, as well as subsequently lifting guidance for the six months ahead. Similarly, NIB Holdings rose 27% after delivering a result ahead of market forecasts. Shares in Fletcher Building (not held in the Fund) fell 27% after providing downwardly revised guidance relating to the company's construction division.

The largest detractors to quarterly performance included overweight positions in Technology One, Eureka Group, Altium and Aveo Group. Shares in Technology One fell 9% on little news, the company has a September year end and does not report results in line with the majority of the market. Eureka Group fell 41% after it became clear recent acquisitions had fallen short of expectations. Altium fell 5% over the three months following the release of half-yearly results that included unanticipated additional one-off costs and slow first half sales growth in the US.

Top 5 Active Weights

Ironbark Karara Australian Share Fund

Security Name	Sector	% of Fund
AGL Energy	Utilities	3.77
CSL	Health Care	-3.59
Telstra Corporation	Telcom. Services	-2.30
James Hardie Industries	Materials	2.15
Brambles	Industrials	2.09

Ironbark Karara Australian Small Companies Fund

Security Name	Sector	% of Fund
Link Administration	Information Technology	3.15
Costa Group	Consumer Staples	3.03
Technology One	Information Technology	2.97
Altium	Information Technology	2.73
Bega Cheese	Consumer Staples	2.72

Key Contributors & Detractors over the Quarter

Ironbark Karara Australian Share Fund

Top 5 Contributors	Active Position
AGL Energy	Overweight
Telstra Corporation	Underweight
Qantas Airways	Overweight
Scentre Group	Underweight
Bega Cheese	Overweight

Top 5 Detractors	Active Position
Brambles	Overweight
CSL	Underweight
James Hardie Industries	Overweight
Navitas	Overweight
JB Hi-Fi	Overweight

Ironbark Karara Australian Small Companies Fund

Top 5 Contributors	Active Position
Bega Cheese	Overweight
Costa Group Holdings	Overweight
NIB Holdings	Overweight
Fletcher Building	Underweight
Steadfast Group	Overweight

Top 5 Detractors	Active Position
Technology One	Overweight
Eureka Group Holdings	Overweight
Charter Hall Group	Underweight
Seven Group Holdings	Underweight
Altium	Overweight

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Market Outlook

The recent surge in global growth indicators and inflationary expectations looks to be supported by the prospect of looser fiscal policy in developed markets. This should be supportive of demand and an upward trend in corporate earnings is already emerging in many countries, including Australia.

Investors have responded to this, although concerns around global economic activity and financial stability remain deep seated. Large pools of global capital remain sidelined in low or negative yielding assets and will take time to re-position as confidence over the durability of recovery builds. After strong gains, some cyclical sectors are vulnerable to any sign of moderation.

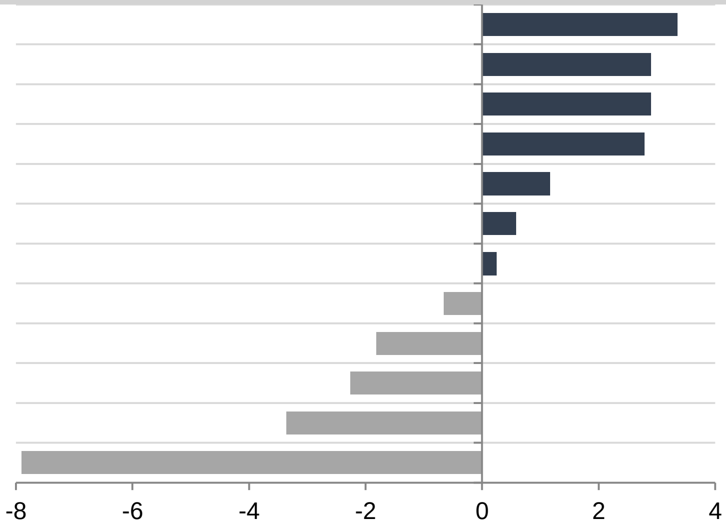
Slack in the US economy is steadily reducing and the investment manager expects that the Federal Reserve ('Fed') will slowly raise rates. However, their recognition of the structural pressures mean that they will have some tolerance for allowing inflation to exceed their target. The risk of the US implementing a suite of damaging tariffs seems to have materially reduced with the ineffectiveness of the new US administration.

Asset Allocation

Ironbark Karara Australian Share Fund

Sector Weights	Fund (%)	Bench (%)
Materials ex Metals & Mining	7.31	3.96
Energy	7.18	4.28
Utilities	5.57	2.68
Consumer Discretionary	7.69	4.90
Financial ex Property Trusts	39.37	38.20
Industrials	7.28	6.70
Information Technology	1.48	1.23
Healthcare	6.20	6.86
Telecommunications Services	2.13	3.95
Consumer Staples	4.97	7.23
Metals & Mining	8.30	11.66
Property Trusts	0.45	8.35
Cash	2.07	0.00

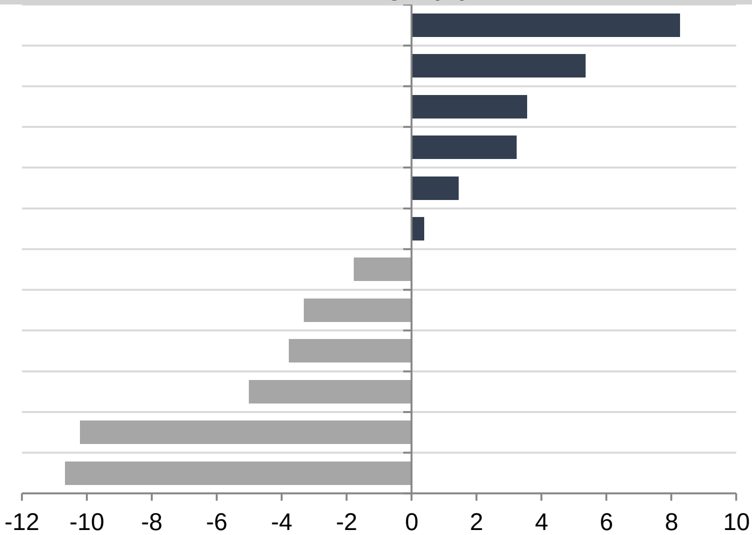
Active Weight (%)



Ironbark Karara Australian Small Companies Fund

Sector Weights	Fund (%)	Bench (%)
Information Technology	12.98	4.70
Utilities	6.03	0.67
Metals & Mining	17.28	13.71
Consumer Staples	11.78	8.54
Financial ex Property Trusts	11.50	10.05
Telecommunications Services	2.06	1.68
Health Care	5.97	7.76
Energy	2.73	6.05
Materials ex Metals & Mining	0.00	3.77
Industrials	3.70	8.71
Property Trusts	3.89	14.09
Consumer Discretionary	9.59	20.27
Cash	12.49	0.00

Active Weight (%)



Market Outlook (continued)

With the earnings outlook improving, and a decent gap between yields on bonds versus equities, there is scope for the stock market to weather somewhat higher interest rates. The prolonged bull market in bonds has inflated valuations and this will make it harder for developed market benchmarks to reach significant new highs. However, good opportunities should be available to stock pickers who remain conscious of value.

The keys macro risks remain twofold:

1. Chinese growth, the sustainability of debt driven growth? Given the success of their stimulatory efforts, the investment manager expects the Chinese Government's focus will be to judiciously move towards controlling credit growth and advancing structural reform (which will be less supportive for steel making materials). However, the leadership transition in 2017 means economic stability remains a high priority.
2. The structural challenges in Europe remain unresolved. Although growth is improving and polls show the electorate remains committed to the Euro, adverse political risks remain real.

While global growth improvement appears to be more synchronised, Australia has lagged. Rising terms of trade and now rising house prices suggest that the domestic outlook is improving.

The investment manager anticipates that Australian real gross domestic product ('GDP') growth will remain modest by historic standards at a sub-trend rate of around 2% to 3%, however the national income boost from the higher terms of trade will support the government and household financial position. Strong population growth is assisting headline growth numbers with growth on a per capita basis remaining low.

With high housing leverage, discretionary consumer spending is reliant on housing prices remaining stable. The oversupply of apartments in some markets is unlikely to result in a meaningful impact on the single dwelling market or the banking sector. Overall, the key risks to the domestic outlook are external macro shocks and the emergence of unintended consequences from regulators efforts to constrain credit to the housing sector.

Oil demand is at record levels. Evidence is emerging of global inventories reducing with the rundown expected to accelerate over the coming months. The ability of US shale producers to supply the increased volumes needed to balance the market will be firmly tested in late 2017 into 2018.

Moderate but improving growth and signs of increasing pricing power suggest a reasonable backdrop for stocks. After recent gains, further sustainable gains require better profit delivery.

The extremes in valuation dispersion seen through 2016 have largely dissipated, however there remains some pockets of the market at quite high valuation levels. The Fund remains positioned for a more reflationary environment than is currently priced by the market and the investment manager continues to believe there are good risk adjusted returns available in many sectors. Within this, the emphasis is on attractive quality companies whose prospects are unappreciated and mispriced by the market.

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