



THE PARAGON FUND // FEBRUARY 2015

PROFILE		PERFORMANCE (after fees)		DETAILS	
Fund Managers	John Deniz & Nick Reddaway	1 month	+3.6%	NAV	\$1.4158
Strategy	Australian absolute return	3 month	+6.4%	Entry Price	\$1.4180
Inception Date	01/03/2013	6 month	+0.8%	Exit Price	\$1.4137
Net Return p.a.	+21.3%	1 year	+20.7%	Fund Size	\$26.4m
Total Net Return	+47.1%	Financial YTD	+12.0%	APIR Code	PGF0001AU

OVERVIEW & POSITIONING

The Paragon Fund returned +3.6% after fees for the month of February 2015. Since inception the fund has returned +47.1% after fees vs. the market (All Ordinaries Accumulation Index) +25.3%. The fund reached a significant milestone in February by turning two years old and pleasingly has achieved compounded returns of 21.3% pa after fees, above our long term targets.

The Australian equity market had its best month for over three years in February as the Reserve Bank of Australia cut the cash rate by 25bps to 2.25%. Global equity markets were also stronger in the wake of the ECB's implementation of quantitative easing. Australia's major resource companies led the local market higher while Brent oil had its first monthly gain (+18%) after 7 months of consecutive declines.

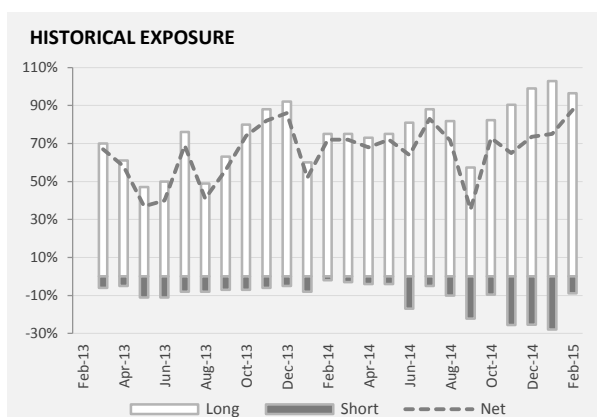
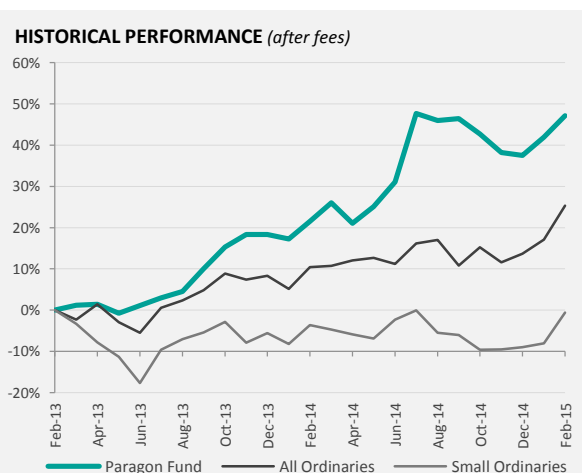
Key drivers of the Paragon Fund's performance for February included solid returns from industrial firms Regis Healthcare, Qantas and Orora, from diversified financials Macquarie Bank and Henderson Group, and Nanosonics. At the end of the month the fund had 29 long positions and 7 short positions.

INDUSTRY EXPOSURE	Long	Short	Net
Resources	22.2%	-1.6%	20.6%
Industrials	45.7%	-6.2%	39.5%
Financials	28.5%	-1.0%	27.5%
Total	96.4%	-8.8%	87.6%
Cash			12.4%

STOCK HIGHLIGHTS

Nanosonics (NAN AU)

Nanosonics designs and manufactures infection control and decontamination systems for the healthcare industry, employing 110 people globally. Their maiden product, the trophon EPR, is a disinfection device for ultrasound probes. Paragon invested in Nanosonics in August 2014 at \$0.92/sh.



The trophon EPR device has been created by Nanosonics in order to combat healthcare acquired infections (HAI) that are contracted while receiving medical care, with a focus on obstetrics and gynaecology. Almost 2 million Americans are estimated to contract HAI's annually, resulting in ~100,000 deaths and exceeding fatalities caused by breast and prostate cancers combined.



With the trophon EPR, Nanosonics is removing the level of human error involved in the typical 25 minute process for disinfecting ultrasound probes which involves manual chemical processes like soaking / spraying / wiping, and replacing it with a safe and effective 7 minute automated process. Validating the success of the product so far is the take up in 44 out of 50 of the USA's largest hospitals and the non-exclusive distribution partnerships signed with Toshiba in the UK, Miele in Germany, and GE Healthcare in the US. The technology is patent protected, has little competition, and the work done to validate the trophon EPR with over 600 types of probes serves as a strong barrier to entry.

The company estimates that there is an addressable installed base of 120k trophon EPR units globally from ~5k in 2015. While this represents significant revenue opportunity, only ~60% of total revenues will be derived from selling the actual unit. The attraction of the business lies in the recurring revenue stream derived from selling the consumables that get used in the disinfection cycle (4 cycles per trophon EPR per day), other accessories as well as replacement and servicing of the units.

Nanosonics is led by a management team borne from the likes of device powerhouses Cochlear and Resmed and has recently further enhanced its balance sheet having raised \$25m to fund their global expansion. The company can achieve a 10 fold rise in revenues over the next decade from the trophon EPR, with further potential from additional product verticals. Despite the shares almost doubling since we acquired them, the company should continue to deliver substantial compounded returns for shareholders.

Orocobre (ORE AU)

Since we last wrote about our investment in Orocobre in April 2014, the company has constructed and commissioned its world-class, Lithium brine-based Olaroz project. In our opinion, Orocobre is the best pure-play to the Lithium market and the Lithium-ion battery revolution. Paragon invested in Orocobre in May 2013 at \$1.45/sh.

The fundamentals for the Lithium sector continue to strengthen, and Lithium continues to be one of our favoured Resource sub-sectors. The Lithium market grew to 175ktpa

in CY14 (~US\$1b pa market) and demand is likely to grow at >10% cagr to the end of the decade to 300ktpa+, driven by Electric Vehicles and the Lithium-ion battery revolution.

The Lithium market is currently balanced with supply meeting demand and approaching effective full capacity utilisation. This is evidenced by Lithium price increases of 10% announced from the major Lithium producers for all Lithium products for CY15. (Note since 2002, Lithium Carbonate prices have risen >3x to \$6000/t). Existing suppliers are encountering constraints in their ability to expand production with issues ranging from declining Lithium supply volumes from existing operations, high-capex and high-opex hard rock Greenfield lithium extraction projects and environmental permitting issues preventing Albemarle Corp's (acquirer of Rockwood) Salar de Atacama 20ktpa Brownfield expansion project.

Orocobre is now ramping up Lithium Carbonate production from Olaroz towards nameplate capacity and we expect the company will be operating cashflow positive by June/July 2015. Orocobre has recently raised \$50m at \$2.55/sh and remains well funded with ample cash reserves, working capital and interest coverage.

Significant re-rating potential exists as the company achieves 17.5ktpa nameplate production and then looks towards expansion of production to 40ktpa. Orocobre's Olaroz is the only Lithium-brine project that has capacity to meet rising demand over the long-term in a timely manner and with modest capital intensity. The company is led by a highly competent and well-aligned management team.

Our current base case valuation for ORE is \$3.53/sh and our high (expansion) case valuation for ORE is \$5.12/sh. We note that recent M&A implied multiples suggest both of these valuations are conservative.

MONTHLY PERFORMANCE BY YEAR

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YTD
2013			1.1%	0.3%	-2.2%	1.8%	1.8%	1.6%	5.3%	4.9%	2.8%	0.0%	18.7%
2014	-1.1%	3.8%	3.6%	-3.9%	3.2%	4.9%	12.5%	-1.1%	0.3%	-2.5%	-3.1%	-0.5%	15.9%
2015	3.2%	3.6%											7.0%

Performance results are presented net of all transaction costs, investment management and performance fees incurred by the Fund. Monthly performance figures are calculated based on the lead series using a monthly unit pricing methodology based on historical data.

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