



## THE PARAGON FUND // FEBRUARY 2016

### PERFORMANCE SUMMARY *(after fees)*

	1 month	3 month	6 month	Financial YTD	1 year	2 year p.a.	3 year p.a.	Net Return p.a.	Total Net Return
<b>Paragon Fund</b>	-5.2%	-5.3%	+1.2%	+1.2%	+3.0%	11.5%	14.9%	+14.9%	+51.6%
<b>ASX All Ordinaries Acc.</b>	-1.5%	-4.3%	-3.1%	-5.0%	-12.2%	-0.2%	+3.2%	+3.2%	+10.0%
<b>RBA Cash Rate</b>	+0.2%	+0.5%	+1.0%	+1.2%	+2.1%	+2.3%	+2.4%	+2.4%	+7.4%

### RISK METRICS

Sharp Ratio	1.3
Sortino Ratio	2.8
Volatility p.a.	+11.5%
% Positive Months	+69.8%
Up/Down Capture	76% / -11%

### FUND DETAILS

NAV	\$1.4268
Entry Price	\$1.4283
Exit Price	\$1.4246
Fund Size	\$35.9m
APIR Code	PGF0001AU

### FUND STRATEGY

The Paragon Fund is an Australian equities long/short fund established in March 2013. The Fund's strategy is fundamentally driven, concentrated and transparent for investors. The manager's research process and active portfolio management is overlaid with strong risk management and a focus on capital preservation.

The objective of the Paragon Fund is to return in excess of 10% p.a. after fees over a 3-5yr investment horizon.

### OVERVIEW & POSITIONING

The Paragon Fund returned -5.2% after fees for the month of February 2016. Since inception the Fund has returned +51.6% after fees vs. the market (All Ordinaries Accumulation Index) +10.0%.

Key positive contributors for February included longs in Blackham Resources, Troy Resources and IDP Education, offset by declines in Amaysim (surprise profit downgrade) and our shorts as the market rallied into month end. At the end of the month the Fund had 34 long positions and 14 short positions.

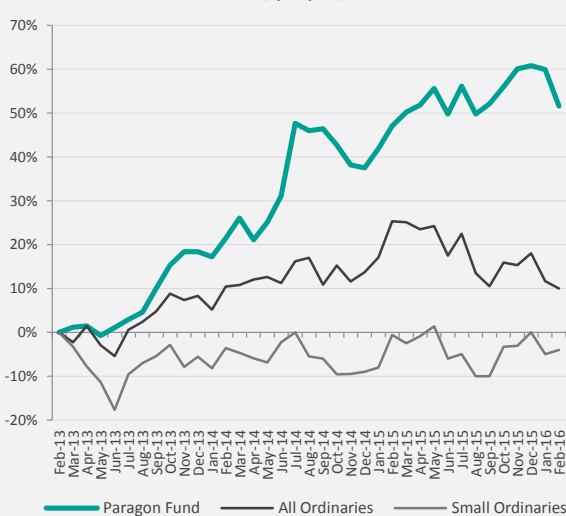
INDUSTRY EXPOSURE	Long	Short	Net
Resources	+37.3%	-2.8%	34.5%
Industrials	+59.6%	-17.2%	42.3%
Financials	+9.5%	-5.4%	4.1%
Index Futures		-10.4%	-10.4%
<b>Total</b>	<b>+106.4%</b>	<b>-35.9%</b>	<b>70.5%</b>
Cash			29.5%

### MONTHLY PERFORMANCE BY YEAR

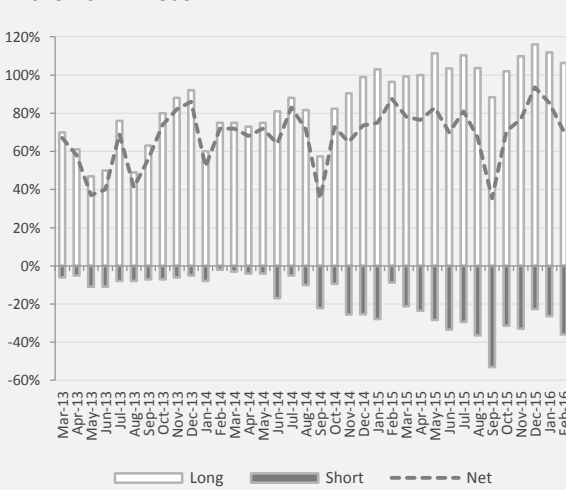
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YTD
<b>2013</b>			1.1%	0.3%	-2.2%	1.8%	1.8%	1.6%	5.3%	4.9%	2.8%	0.0%	<b>18.7%</b>
<b>2014</b>	-1.1%	3.8%	3.6%	-3.9%	3.2%	4.9%	12.5%	-1.1%	0.3%	-2.5%	-3.1%	-0.5%	<b>15.9%</b>
<b>2015</b>	3.2%	3.6%	2.1%	1.1%	2.4%	-3.8%	4.3%	-4.2%	1.6%	2.5%	2.6%	0.3%	<b>16.8%</b>
<b>2016</b>	-0.5%	-5.2%											<b>-5.6%</b>

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.

### HISTORICAL PERFORMANCE *(after fees)*



### HISTORICAL EXPOSURE





## 3 YEAR ANNIVERSARY

We are excited to report that the Paragon Fund turned 3 this month, delivering 15% after fees p.a., exceeding our performance objective and growing the fund from \$4m to \$36m through a combination of inflows and performance. John and Nick remain focused on performance and are committed to the strategy of the fund (active, fundamental & concentrated, long/short approach with an ASX all-cap mandate) whilst maintaining a culture of investment excellence. We thank our investors for their ongoing support and interest in the Fund.

## STOCK HIGHLIGHTS

Investors generally have polar opposite views to the gold sector. Some see neither utility in gold nor its investment merit, whilst others see it as a hedge against a myriad of negative market forces and in turn an essential part of every portfolio. Quite simply we see gold as a currency. We see its investment merit given the unprecedented level of global QE and currency debasement, and have become increasingly constructive on gold given the return of negative real interest rates across the globe. Finally we like gold as a hedge to global market volatility - when gold tends to do very well.

After 4 years of decline, US\$gold has had a strong start to 2016 while A\$gold is now 5% from all-time highs and in-turn offering exceptional margins to various Australian gold producers. We have maintained particular interest in the Australian gold space leveraged to A\$gold, particularly strong free cashflowing mid-to-large-cap producers and emerging producers boasting high-margin, low capital-intensity assets with solid mine life and/or exploration upside. In this environment high-quality turnarounds, brownfield-restarts and discovery-delineation stocks, tend to do very well.

### Blackham Resources (BLK)

Blackham Resources quite simply is a turnaround story. Blackham was a hidden gem when we entered the stock in its capital raise in late January 2015. The stock was dismissed by the market due to its previously complex WA-based Wiluna asset history.

Over the last 5 years, Blackham has patiently and cheaply (<\$7m in total!) brought their 780km<sup>2</sup> Wiluna mining district - centred on the Wiluna gold plant - back into single ownership. In 2011, Blackham purchased its Matilda and Williamson mines, and surrounding tenements from Kimba Resources for a mere \$1.4m, where Blackham has since discovered more high-margin gold resources. Apex Minerals had sunk ~\$100m on Wiluna before going belly up on a poor execution strategy. Then in 2014, Blackham acquired Wiluna (both 1.3mtpa plant and its multi-million ounce gold resources) for <\$5m from Apex's liquidators. Existing processing plant and infrastructure unlocks Blackham's 100koz pa high-margin Matilda gold project. Blackham is a unique, fully-funded near-term (3Q16) emerging producer, boasting low capital intensity with a short payback (<1yr) - both in absolute terms and relative to its peers.

We were excited by its investment prospects given its asymmetric risk-reward profile. Indeed Blackham was very cheap when we first purchased it, and despite rerating to now boast a proforma \$130m EV, we still view it as cheap on every relevant metric. Blackham's average annual EBITDA is \$65m+ @ spot gold (>A\$1700/oz), implying it is trading at a proforma FY17F EV/EBITDA multiple of 2x.

We see Blackham derisking to be the next mid cap gold stock, like one of its leading peers, Saracen Resources (SAR). Saracen too was unknown \$50m gold company that has rerated materially to now boast a market cap of ~\$1b.

### Troy Resources (TRY)

Troy is a high-quality turnaround gold stock that was forgotten by investors due to chequered production performances from its Brazilian-based Andorinhas and Argentinean-based Casposo gold production assets. These depleting assets have been problematic (namely Casposo) which led the company to pursue a replacement production source - acquiring Azimuth Resources in July 2013 for its Karouni high-grade resource in Guyana. Troy acquired Azimuth for ~\$190m (in a full Troy scrip takeover when Troy was ~\$1.50/sh), and funded its ~\$175m development via \$100m of debt & \$75m in cumulative equity.

Karouni, an exciting gold discovery of 2011 made by its previous owners Azimuth, was arguably the highest-grade and highest-margin open-pit undeveloped gold resource globally. We had successfully invested in Azimuth, and visited the Karouni project in Guyana in 2012 and have always held the view that it would become a strong cashflowing gold mine given its highly economic resource orebody attributes.

Whilst we have always been attracted to the Karouni asset, we have patiently watched and waited, choosing not to own Troy shares through Karouni's risky funding and development phase, and not until Troy's other two assets were adequately ring-fenced. Recently we became comfortable that Andorinhas (being wound down) and Casposo (now cashflow breakeven and to be sold for up to US\$11m) were no longer a drain on Troy's cash reserves. Once Karouni production ramped up towards commercial production rates, Paragon entered Troy at ~30c/sh - a market cap of ~\$100m, EV ~\$130m.

Karouni is very well placed to produce 120koz in CY16 at a margin >US\$750/oz based on spot gold. These margins translate into >A\$1000/oz, easily the strongest margin of any ASX-listed gold stock. These strong margins imply Troy's Karouni will generate the company A\$100m+ of free cash in CY16. On our price entry point, this placed the stock on an EV/CY16F free cash multiple of 1.5x which is remarkably cheap.

We forecast Troy will be debt free by mid-2016. Troy's Karouni is experiencing both positive grade and tonnage reconciliation, which will lead to production upside, higher margins and will likely increase its mine life to a solid 5 years. None of these positive attributes were priced in the stock when we acquired our position. Troy's rerating has started on the back of the company confirming the above along with production guidance upgrades, and we expect to see the stock at \$1/sh (~\$300m market cap) by CY16 end.

### High likelihood of ongoing corporate activity in the ASX-listed gold sector

We believe both Blackham and Troy will have strong corporate interest from larger mid and large cap peers that are short quality growth assets and/or have depleting gold production assets. Larger peers who are trading on FY17F EV/EBITDA multiple of >6x will find acquiring Blackham or Troy highly accretive.

In our view the catalyst for a takeover attempt for Blackham will be as soon as it achieves a nameplate production run-rate of 100koz (~4Q16). We also think that the first company that makes a move will put Blackham in play and instigate competing interest, as with the bidding war for NT-based Tanami Gold between Northern Star Resources and Metals X.

We also note with interest Troy's geographical neighbour Beadell Resource's (operating in NE of Brazil) and its recent \$50m capital raise and question its operational necessity, which leaves only corporate flexibility. Beadell's recently appointed Simon Jackson is well known for his empire building skills in his prior role at Redback Mining, and would be well aware of Troy's strong cashflows and very attractive metrics.