

## PARAGON FUND UPDATE – JUNE 2013

### KEY FUND FACTS

Fund Managers	John Deniz & Nick Reddaway
Strategy	Australian absolute return
Inception Date	01/03/2013
Total Net Return	1.0%

### FUND PERFORMANCE (net of fees)

1 month	1.8%
3 month	-0.1%
6 month	
1 year	

### COMMENTARY

The Paragon Fund returned +1.8% net of fees for the month of June vs. -2.6% for the market (All Ordinaries Accumulation Index). Since inception the Paragon Fund has returned +1.0% net of fees vs. -5.5% for the market.

Despite a sharp late month rally, the equity market fell again in June as the trifecta of ongoing issues – weak domestic growth, health of the Chinese economy, and the threat by the Federal Reserve to remove its liquidity punchbowl – weighed on investors' confidence. Resources continued to bear the brunt of the selling as illustrated below:

	June 2013	Total Return*
All Ordinaries Index	-2.6%	-5.5%
ASX 300 Financials Index	0.2%	0.5%
ASX 300 Industrials Index	-2.8%	-8.8%
ASX 300 Resources Index	-10.1%	-19.4%
<b>PARAGON FUND</b>	<b>1.8%</b>	<b>1.0%</b>

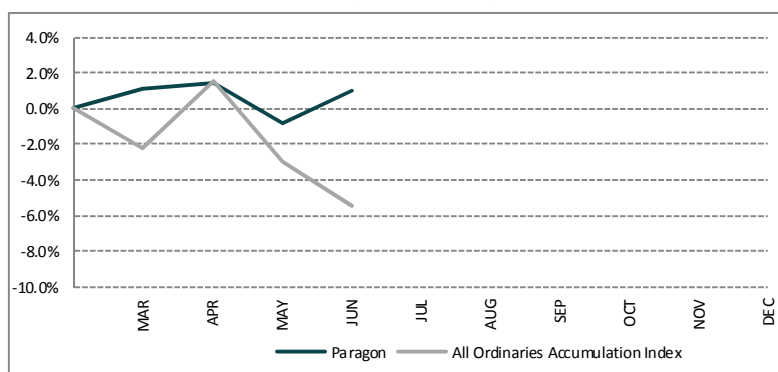
\* Total Return since inception (01 Mar 2013), indices are Accumulation indexes

Key drivers of performance for June included a combination of:

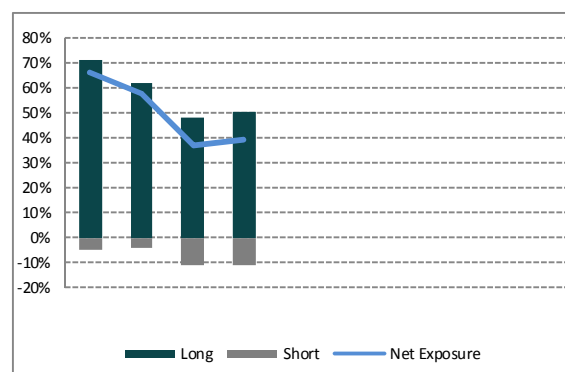
- Keeping overall equity market exposure low through the month (below 30% net exposure)
- Select shorts in the resource sector

To highlight how we were able to produce a positive return despite the falling market, this month we discuss below one of our short positions, Sirius Resource (SIR) – the falling angel.

### HISTORICAL PERFORMANCE (net of fees)



### HISTORICAL EXPOSURE



	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YTD
2013			1.1%	0.3%	-2.2%	1.8%							1.0%

Performance results are presented net of all transaction costs, investment management and performance fees and all other costs incurred by the Fund.

### PORTFOLIO BREAKDOWN

#### INDUSTRY EXPOSURE

	Long	Short	Net
Resources	4.0%	-11.0%	-7.0%
Industrials	29.6%	0.0%	29.6%
Financials	16.4%	0.0%	16.4%
<b>Total</b>	<b>50.0%</b>	<b>-11.0%</b>	<b>39.0%</b>
<b>Cash</b>			<b>61.0%</b>

#### HOLDINGS

Long	16
Short	5
<b>Total</b>	<b>21</b>

#### CONCENTRATION

Top 5	25.3%
Top 10	40.2%



## Sirius Resources (SIR) – the falling angel

### Summary

We initiated our short position in SIR at \$3.30/sh having valued the company at \$1.40/sh. We view SIR as a compelling short given 1) the poor industry dynamics in Nickel, 2) a market capitalisation well in excess of its fundamentals and its tier 1 producing peers, and 3) SIR's early stage, material funding and development risks. SIR is currently trading \$2.00/sh and we continue to be short the stock.

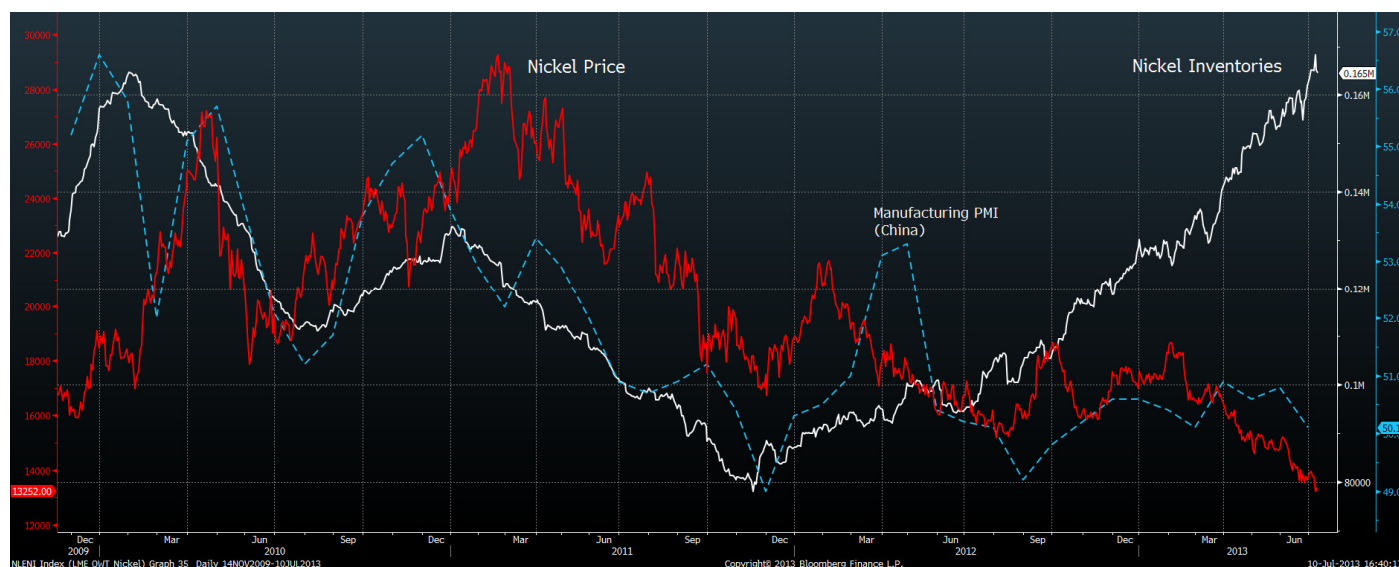
### SIR background

SIR, a nickel-sulphide base metals exploration stock, was recently crowned “stock of the year”, after rising 3,547% in FY13 on the back of its Nova-Bollinger discovery. SIR has a 70% interest in the Fraser range project in Western Australia (WA) which is touted as the best resource discovery of its kind in the last decade.

### Nickel

By way of background, nickel is used primarily for the alloys it forms - it is predominantly used for making stainless steel (typically ~10% nickel content), and many other corrosion resistant alloys and plating applications, all of which are used in most industrial end markets.

Nickel has arguably the worst industry fundamentals of all the metals. This is largely due to the substantial supply growth from low-cost nickel pig iron output, and tempered demand from a slowing Chinese economy (China represents ~43% of primary nickel demand). We believe this dynamic, captured in the chart below, will continue to keep the nickel market in a material surplus and maintain pressure on the nickel spot price.

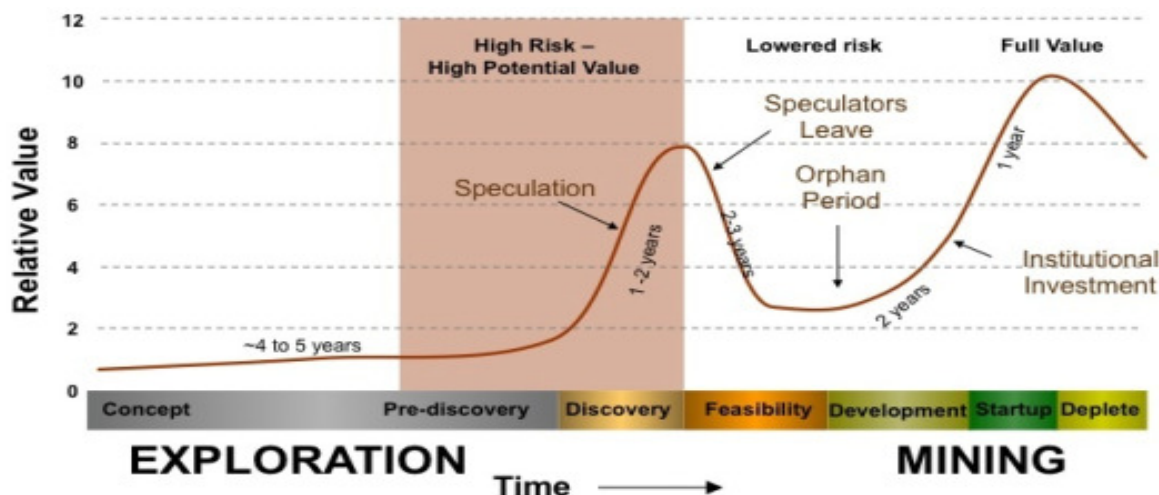


### A great discovery

SIR's Nova-Bollinger resource is a great discovery. On our high-case estimates, we expect an economic resource of ~15mt at ~2.3% Nickel (Ni) & ~1% Copper (for ~350kt of contained nickel), comprising of a homogenous, high grade core surrounded by a lower grade halo. The attributes of the resource (it boasts scale, grade, a shallow dip and orebody continuity, with up to 100m of vertical thickness) would place SIR's Nova-Bollinger project at the lower end of the nickel industry cost curve. However we view comparisons to the world class Voisey Bay discovery as overly optimistic given Voisey Bay, at 35mt at 3.5% Ni, is more than 3x the size of SIR's Nova-Bollinger.

### The classic resource price S-Curve

As is common with resource discovery plays, initial excitement gets replaced with the reality of the resource limitations and the long and costly exercise of actually getting the metals out of the ground. The chart below highlights the typical path exploration stocks take as they move through the S-Curve.



We believe SIR is moving from its Discovery phase through to Feasibility, Funding and Development.

### The catalyst to short SIR

Further exploration drilling results released from Bollinger (shown in green arrows below) were largely infill (not step out), moderate grade and were starting to close out the scale potential. With other key targets largely drilled out, we felt material exploration upside was unlikely and more than captured in SIR's price. We are cognisant that the highly experienced geologist, Mark Creasy, could continue to unearth further discoveries, but the markets negative reaction to the drill results reaffirmed our belief that the core fundamentals were winning the debate.



### Market price materially stretched

At \$3.30/sh, SIR's market capitalisation was \$900m fully diluted for its 70% project interest. On a 100% project ownership basis, the market was paying \$1.3b for Nova-Bollinger. This implies the market was paying an EV/Resource of \$3,700/t (or \$5,000/t if grossed up to include \$450m of development capital). This metric is well above both current top-tier Nickel producers (WSA at \$3,000/t) and historical top-tier producer takeover multiples paid at the peak of the previous nickel boom, when nickel was ~4x the current spot price.

Allowing for SIR's Nova-Bollinger economic orebody attributes and exploration upside, we believe SIR should trade on a maximum EV/Resource of \$1,500/t, or \$1.60/sh fully diluted.

We note that EV/Resource is a quick and crude pricing metric, which does not allow for the high-margin potential of an orebody if monetised. If you instead consider SIR's Nova-Bollinger discovery from a development perspective, assuming capex of ~\$450m and a 50/50 debt to equity financing, the valuation is \$1.20/sh fully diluted.

With SIR commencing feasibility works, we value SIR at a blend of these approaches of \$1.40/sh fully diluted, where we expect the stock price will revert to in time.