



Paragon Fund Monthly Performance Report

October 2013

PARAGON FUND UPDATE – October 2013

KEY FUND FACTS

Fund Managers	John Deniz & Nick Reddaway
Strategy	Australian absolute return
Inception Date	01/03/2013
Total Net Return	15.4%

FUND PERFORMANCE (net of fees)

1 month	4.9%
3 month	12.2%
6 month	13.8%
1 yr	-

COMMENTARY

The Paragon Fund returned +4.9% net of fees for the month of October vs. the market (All Ordinaries Accumulation Index) +3.8%. Since inception the Paragon Fund has returned +15.4% net of fees vs. +8.7% for the market.

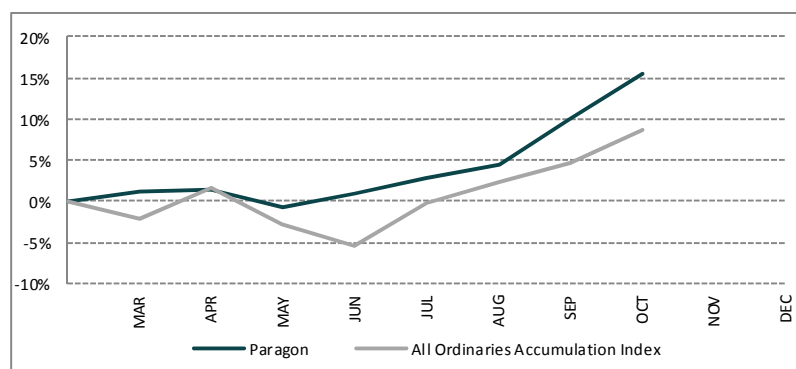
The ASX 20 Accumulation Leaders Index (which represents ~70% of the market) hit another record high in October driven by rallying bank shares into their dividend payments and relief over the debt ceiling debate. Global central banks remain supportive (maintaining loose monetary policies and in full quantitative easing mode), driving ongoing fund flows into equities and maintaining most developed world equity markets at the highs for the year.

Key drivers of the Paragon Fund performance for October included a combination of:

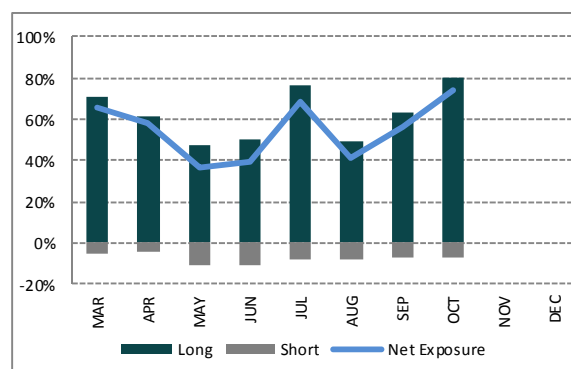
- Strong performance from core holdings in Crown Resorts, Xero, Tiger Resources, Donaco and our short position in Sirius Resources
- Maintaining net equity exposure ~70% on average for the month

In this month's update we discuss our holding in Xero (XRO). Xero is the global leader in cloud based accounting software which is disrupting the ageing desktop based accounting software industry dominated by MYOB, Intuit, and Sage.

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%	1.8%	1.6%	5.3%	4.9%			15.4%

PORTFOLIO BREAKDOWN

INDUSTRY EXPOSURE

	Long	Short	Net
Resources	21.7%	-5.2%	16.6%
Industrials	48.3%	-1.6%	46.6%
Financials	10.6%	-	10.6%
Total	80.5%	-6.8%	73.7%
Cash			26.3%

HOLDINGS

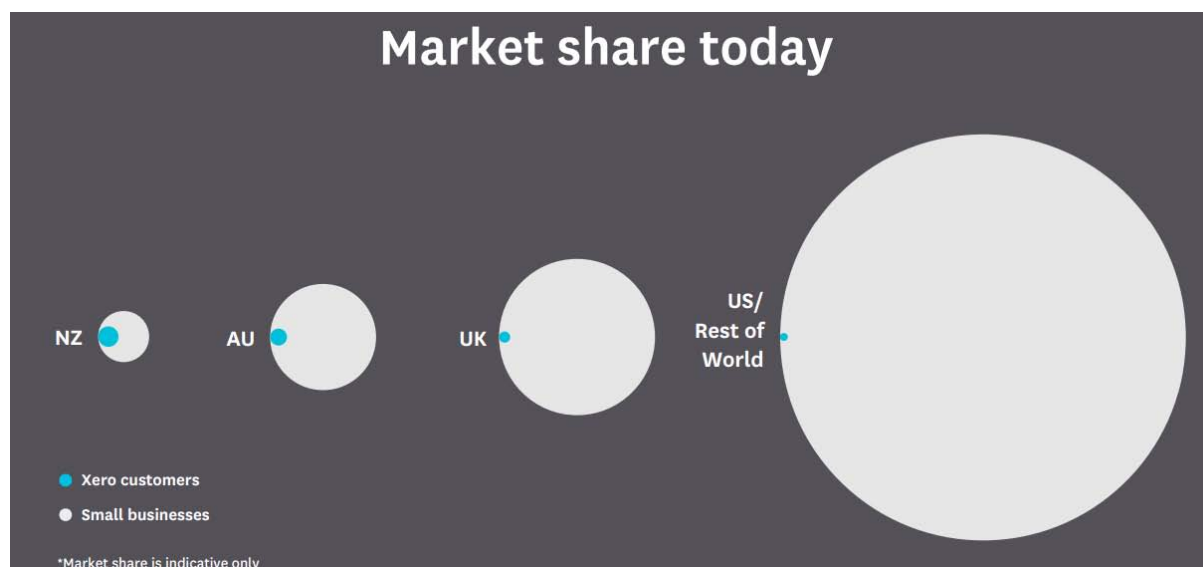
Long	22
Short	5
Total	27

CONCENTRATION

Top 5	32.2%
Top 10	53.8%



We first heard of Xero (global leader in cloud based accounting software) in early 2012 from a small business owner trialling the software when Xero's shares were priced at NZ\$4/sh and it had a market capitalisation of NZ\$470m. When we first met management in May 2013 (the Paragon Fund went live in March 2013) Xero had 157k customers and lost \$14m for the year as they accelerated their roll-out strategy targeting 36m small businesses globally. On a cursory glance with the stock price then at AU\$11/sh (now listed in Australia) one could be forgiven for thinking their bright future was already accounted for. The chart below from Xero highlights their potential growth runway.

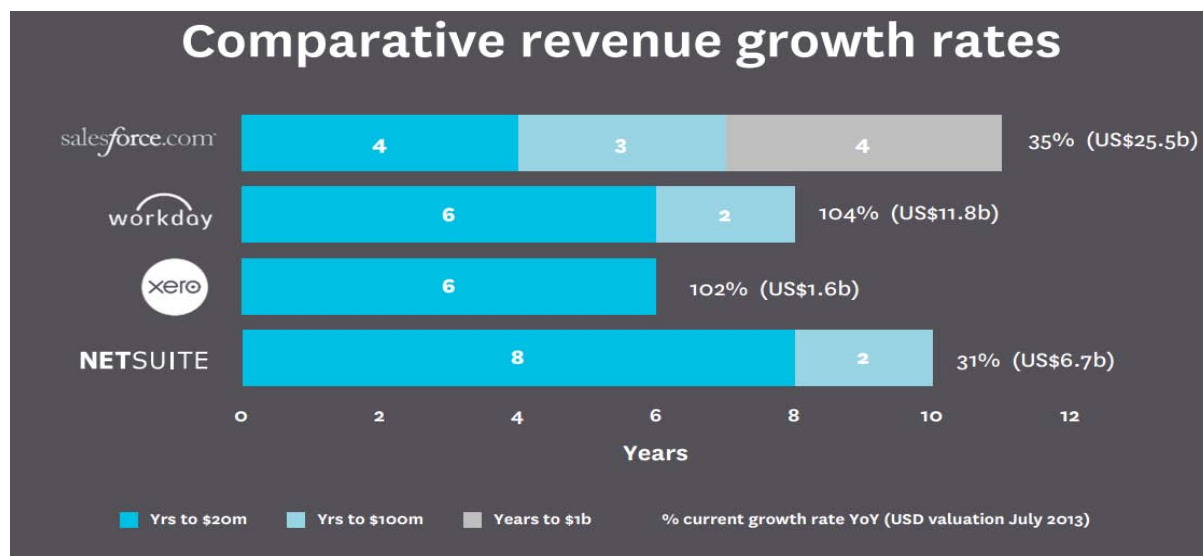


Having been a relatively early investor in several technology companies prior to starting Paragon (Apple, Google, Virgin Media, Success Factors), we instead found several compelling aspects to Xero's business.

- Cloud computing is a disruptive technology and Xero had first mover advantage targeting an industry controlled by dominant players (MYOB, Intuit, Sage) with ageing desktop based software offerings.
- Xero's competitors have only recently attempted to roll-out their own cloud based products with very mixed reviews from a technology and user perspective.
- Xero's CEO Rod Drury has an exceptional technology track record and has consistently been adding highly experienced management personnel from the world's best technology companies such as Microsoft and Google. Staff owned 47% of the listed shares.
- Xero's backers include Craig Winkler, the founder of Australia's leading desktop accounting company MYOB, and Peter Thiel who co-founded PayPal and was the first outside investor in Facebook.
- Despite a market cap of AU \$1.3bn in May, the company was not covered by any major broking houses nor had any local financial institutions of significant size on its register.

When considering the quality of the product and team behind it, we believed that Xero's target of 1m customers (<3% market share) by 2016 was conservative. When we first invested in Xero in May at AU\$11/sh we saw our downside in the medium term as being relatively small as they had only just begun to aggressively embark on entering their biggest target market (USA). Based on still conservative assumptions in terms of customer numbers and valuation of comparable companies listed globally, we calculated the medium term upside at the time was somewhere between AU\$25/sh - \$75/sh.

Today, Xero is priced at AU\$31/sh with a market capitalisation of AU\$4bn. To enable the company to fast track its expansion into the USA, Xero recently raised AU\$160m which was taken by existing long term investors. The fact that those with much longer investment history than ours used this opportunity to invest further in the business supported our stance that the company remains attractively priced compared to peers given its potential to continue to grow revenues at rates close to 100% p.a. for the next few years.



We took advantage of the near tripling in the shares since we bought them to trim our position yet we continue to view Xero as a unique investment in Australia. The quality and potential of the business is unparalleled as management continue to make their competitors appear flat footed. They are now fully funded to seek out their biggest market opportunity after ensuring the product and marketing strategy were tried and tested in Australia and New Zealand. While the shares have risen substantially, should Xero achieve success in the USA at rates close to their first market, New Zealand, the shares should be trading closer to AU\$60/sh today.