Paragon Fund Monthly Performance Report

April 2014

PARAGON FUNDS MANAGEMENT

PARAGON FUND UPDATE – April 2014

KEY FUND FACTS	
Fund Managers	John Deniz & Nick Reddaway
Strategy	Australian absolute return
Inception Date	01/03/2013
Net Return p.a.	18.0%
Total Net Return	21.3%

PERFORMANCE (after fees)	
1 month	-3.9%
3 month	+3.3%
6 month	+5.1%
Financial YTD	+20.1%
1 year	+19.6%

FUND DETAILS	
NAV	$1.213
Entry Price	$1.215
Exit Price	$1.211
Fund Size	$10.7m

COMMENTARY

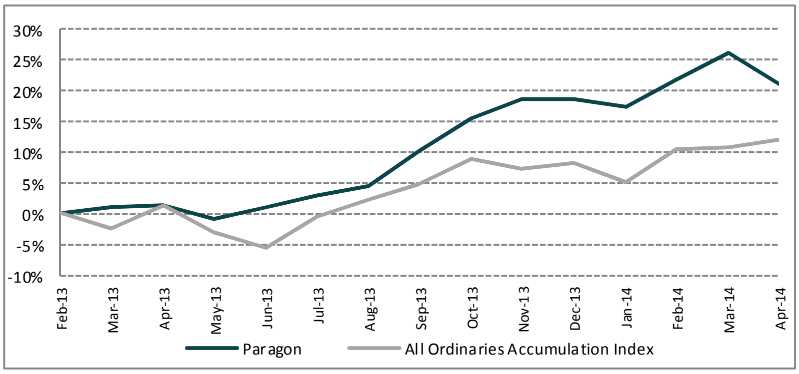
The Paragon Fund returned -3.9% after fees for the month of April 2014. Since inception the Paragon Fund has returned 21.3% after fees vs. the market (All Ordinaries Accumulation Index) +12.1%.

April saw heavy profit taking in growth stocks globally as investors shifted their economic growth assumptions higher and forecasts for Federal Reserve interest rate tightening sooner, creating a bid for value stocks and yield. M&A transactions also surged both in the US healthcare sector and in Australian REITS alongside a bid for David Jones and Goodman Fielder.

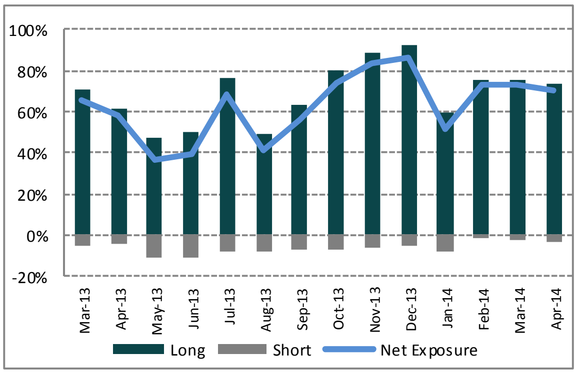
The key driver of the Paragon Fund performance for April 2014 was concurrent profit taking in several of our long held positions including core holdings in G8 Education (-9%), Donaco (-17%) and Xero (-21%). It is worth mentioning that these companies have been significant drivers of our 21% after fee total return since inception, and had risen 140%, 210%, and 220% through to March 2014 respectively from our initial purchase price. While managing their size in the portfolio, we continue to be attracted to their long term drivers and potential for outperformance and have indeed increased our position in 2 of them as their valuations have become more attractive.

This month we provide a brief update on two of our core positions, Orocobre and Xero.

HISTORICAL PERFORMANCE (after 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%	2.8%	0.0%	18.7%
2014	-1.1%	3.8%	3.6%	-3.9%									2.2%

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 main series using a monthly unit pricing methodology based on historical data.

PORTFOLIO BREAKDOWN

INDUSTRY EXPOSURE			
	Long	Short	Net
Resources	31.5%	0.5%	30.9%
Industrials	34.4%	2.7%	31.7%
Financials	8.1%	0.0%	8.1%
Total	**73.9%**	**3.2%**	**70.7%**
Cash			**29.3%**

HOLDINGS	
Long	23
Short	2
Total	25

CONCENTRATION	
Top 5	25.3%
Top 10	42.4%

Orocobre (ORE AU). We wrote about our Long position in ORE in August 2013 – "OROCOBRE (ORE) – world class supplier to the Lithium–ion battery revolution". Orocobre is developing its tier-1, World Class, Lithium brine-based Olaroz project, which we view as the best pure-play to the Lithium market.

- Construction of the Olaroz project is ~90% complete, on budget, with ~$200m spent to date. First production is due in Aug 2014, two months behind schedule, nevertheless impressive execution given most resource projects tend to materially blow out on both time and cost. Orocobre remains well funded with cash reserves of $28m, ample working capital cover to see it through to first cashflows.

- Market dynamics continue to strengthen. 1Q14 quarterly results by both Rockwood Holdings (NYSE: ROC US) and FMC Corp (NYSE: FMC US) – two of the world's biggest Lithium producers – illustrated solid demand growth in Lithium. ROC expects demand for battery-grade Lithium to continue to grow by 20% to 30% pa over the long term, driven by Lithium–ion batteries for Electrical vehicles. ROC re-iterated guidance for 50% earnings growth in CY15, noting that its Lithium segment generates >50% of its consolidated EBITDA. Lithium–ion battery production is the clear bottleneck to the Electrical Vehicle market. To tackle this, Tesla and Panasonic have announced that they are combining to build a Lithium-ion battery "gigafactory", required to support the high growth expected over the next decade. The net result is that Lithium Carbonate prices are expected to be well supported and likely to continue trending higher through to the end of the decade.

- Lithium is a highly concentrated industry, with the world's top four producers collectively producing more than half of the world's Lithium Carbonate. The world's 4th biggest supplier - Talison Lithium, a high-cost spodumene-based producer – was taken over by Tianqi Industry Group Co. (a Chinese battery maker) in Mar 2013 for US$765m, trumping ROC's initial offer for Talison by US$90m. Tianqi has since sold down 49% of Talison Lithium to ROC at an even higher price again, selling 49% for US$475m (implying US$970m on a 100% basis). ROC has $1.5b+ in cash reserves which they have stated will be deployed to their 49% interest acquired in Talison (US$475m), a US$500m stock buy-back and/or new M&A by the end of CY14 (Orocobre?). Separately, Tianqi has recently acquired Galaxy Resources (GXY AU) Chinese Lithium plant for US$230m. This is for a lithium carbonate plant only with no lithium resource asset included. These are very big prices and both transactions have positive implications for the Lithium industry and namely Orocobre. The Chinese, like ROC are credibly signalling where they think the Lithium market is headed, by buying up all the production capacity they can access.

Xero (XRO AU). We wrote about our holding in Xero in the October 2013 monthly update. 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.

- As part of their strategy to increase sales in markets where their brand is less established, Xero have in the last 2 months, released several partnerships with global firms to expedite the build out of their sales channel. Xero announced an agreement with the UK division of global accounting firm KPMG to provide cloud based accounting services to their small and medium enterprises via the cloud. Similarly, in the USA, Xero have announced an alliance with H&R Block, the world's largest consumer tax services provider, to become the preferred online accounting solution for H&R Block's small business customers. Xero also announced an alignment with fast growing online payments firm, Square, to integrate into their suite of online business tools for small businesses.

- Xero has appointed several key senior positions to its US division in order to help successfully drive their expansion into the US market. As the new CEO, North America, Xero have appointed Peter Karpas, who previously ran the North American small and medium business division of international online money payment and transfer business, PayPal. New Director, Bill Veghte, previously led the Hewlett Packard Enterprise Group, responsible for the delivery of IT infrastructure solutions prior to 20 years at Microsoft. Xero have also hired the ex CFO of both Microsoft and General Motors, Chris Liddell, to Chairman of the Board.

- Xero generated revenue growth exceeding 90% for FY2014 (excluding currency impacts) and reached 284k customers globally, an increase of over 80% for the year. Their penetration rate in the small business accounting software market has reached 43% in NZ and 15% in Australia with negligible share in the US or UK and as such we expect these growth rates will continue given their superior product and strong balance sheet.

- Management continue to expect a winner take all dynamic for the cloud based accounting software market. This market comprises an estimated 36m small businesses in Xero's initial target markets of New Zealand, Australia, United Kingdom, and the USA. Using conservative assumptions on both customer win, average revenue per customer, and potential valuation multiples, there remains substantial upside to today's price and we added to our position in the recent selloff after originally taking some profits above $36.

16th May 2014

Paragon Funds Management