PARAGON FUNDS MANAGEMENT

THE PARAGON FUND // MAY 2015

PROFILE		PERFORMANCE *(after fees)*		DETAILS	
Fund Managers	John Deniz & Nick Reddaway	**1 month**	+2.4%	**NAV**	$1.4975
Strategy	Australian absolute return	**3 month**	+5.8%	**Entry Price**	$1.4997
Inception Date	01/03/2013	**6 month**	+12.6%	**Exit Price**	$1.4952
Net Return p.a.	+21.7%	**1 year**	+24.3%	**Fund Size**	$30.8m
Total Net Return	+55.6%	**Financial YTD**	+18.5%	**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 managers' research process and active portfolio management is overlaid with strong risk management and a focus on capital preservation.

OVERVIEW & POSITIONING

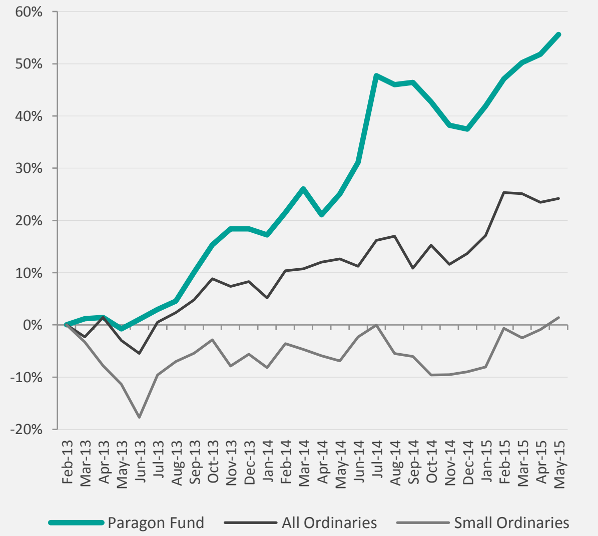
The Paragon Fund returned +2.4% after fees for the month of May 2015. Since inception the fund has returned +55.6% after fees vs. the market (All Ordinaries Accumulation Index) +24.2%.

The Australian equity market rose slightly in May, underperforming global equity markets. The major banks were marked lower again as investors weighed up their historically high valuations versus the outlook for capital requirements and growth. The 25 basis point cut to the cash rate by the RBA saw the AUD fall, boosting shares of Australian companies with international operations. Further stimulus in China saw their equity market continuing to rally while the price of iron ore rose +8%.

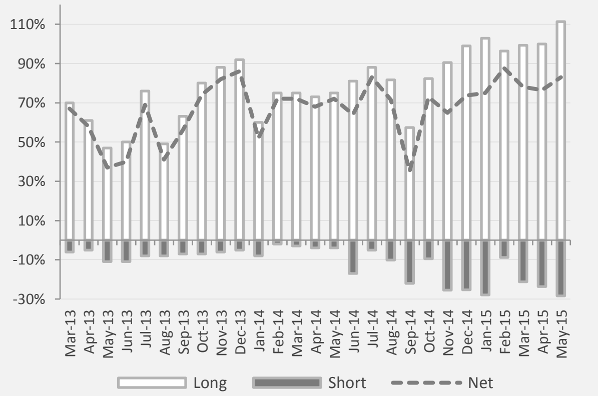
Key drivers of the Paragon Fund's performance for May included solid returns from Macquarie, Henderson Group, Orocobre, Nanosonics and Reward Minerals. Short positions in REA Group and 1-Page also contributed. At the end of the month the fund had 33 long positions and 14 short positions.

INDUSTRY EXPOSURE	Long	Short	Net
Resources	44.8%	-7.3%	37.5%
Industrials	45.8%	-17.4%	28.4%
Financials	20.6%	-3.7%	16.9%
Total	**111.3%**	**-28.4%**	**82.9%**
Cash			**17.1%**

HISTORICAL PERFORMANCE *(after fees)*



HISTORICAL EXPOSURE



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%	2.1%	1.1%	2.4%								**13.2%**

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

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STOCK HIGHLIGHTS

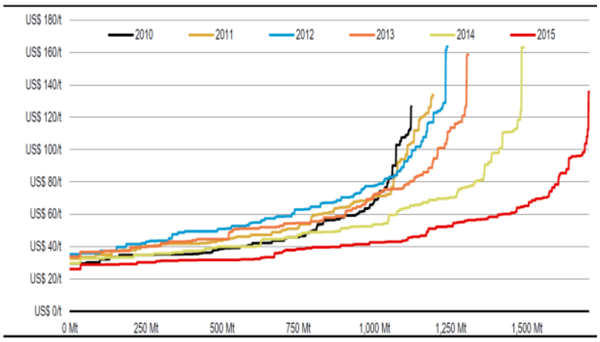
Fortescue Metals (FMG AU)

The street has become increasingly bearish on Iron Ore and FMG given its levered balance sheet, with sell side analysts now seemingly competing to downgrade their Iron Ore price forecasts after a 70% fall from its 2013 high. To top things off the Australian Treasurer has waged in on the debate as to how low the Iron Ore price may fall.

Indeed Iron Ore is an oversupplied market and now in surplus. The Seaborne Iron Ore market is ~1.5btpa, which only recently had annual deficits of ~50mt. As the lowest-cost majors Vale, RIO and BHP continue to materially expand production, and with new entrant Roy Hill, the Seaborne market is projected to swing into material surpluses of ~200mtpa+ by 2016/2017.

However if Iron Ore were to fall below recent lows of US$47/t (or hit US$35/t as some pundits were calling for), you would see significant supply curtailments and the industry correct itself given >1/3rd of the market will be loss making.

Iron Ore industry cost curve (62% Fe, CFR China equivalent):



Source: Metalytics, UBS estimates

Unless Steel demand comes off materially (Iron Ore is a key input), which is not our view, FMG will continue to be an important part of global Iron Ore supply. Even allowing for China's Steel demand nearing / having already peaked, in our view Iron Ore bottomed in early April (its price having since bounced ~38% off its lows) and FMG bottomed soon after, when it refinanced its near term maturity debt (no debt now due until 2019). FMG currently boasts a cash breakeven (62% Fe CFR China equivalent) of ~US$45/t and at current spot Fe prices and FX, is free cash flowing. We think that talk of a large dilutive raise remains just that. Founder and Chairman Andrew Forrest, who holds a 33% interest in FMG, did not want to do this at $6/sh, and so is highly unlikely he will want to do this now, given FMG still has the preferred option of selling a project level interest in its infrastructure assets.

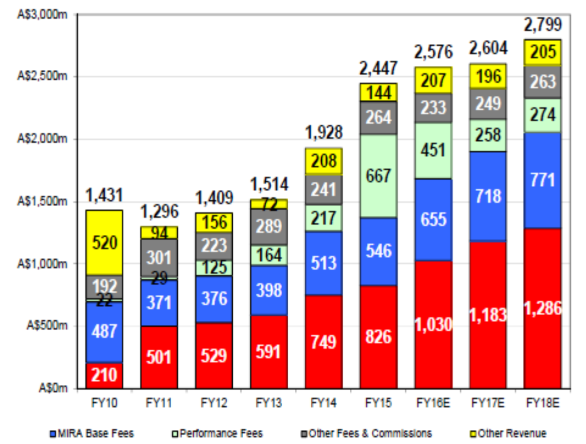
While we are not surprised FMG remains heavily shorted given it fell almost 70% since the beginning of 2014, we initiated a long position long at $2.11/sh in April. With a discernible shift from the "ongoing major expansion" mantra from the majors, ongoing cost reductions, falling China port inventories and China Steel Mill restocking underway, we think the lows have been seen for iron ore, and the stock. FMG is currently trading at $2.42/sh and we continue to be long the stock.

Macquarie Group Ltd (MQG AU)

Macquarie is a diversified financial services company, with business operations across 1) Asset Management, 2) Corporate and Asset Finance, 3) Banking and Financial Services, 4) Securities, 5) Capital Markets and 6) Commodities & Financial Markets. It is also globally diversified with 32% of revenue coming from Australia, 35% from the US, 20% from EMEA, and 13% from Asia.

Macquarie is taking advantage of buoyant conditions across its key segments - Asset Management (contributing ~42% of Macquarie's overall profit) and Corporate & Asset Finance (contributing ~25% of Macquarie's overall profit) - which are materially contributing to its growth. Asset Management - a leader in global Infrastructure – has grown significantly and offers annuity style earnings from its base management fees, and scope for material ongoing contributions from its performance fees.

Macquarie Asset Mgmt: Composition of Revenues



Note: MIML is Macquarie Investment Management (including Macquarie Specialised Investment Solutions). MIRA is Macquarie infrastructure and Real Assets.
Note: Other Revenue predominantly includes gains on sale of management rights and equity investments and impairment charges.
Source: Company Data, Morgan Stanley Research. E = Morgan Stanley Research estimates

Macquarie is well capitalised and in our view still in an earnings upgrade cycle. We expect solid yield + growth to continue as Macquarie's key segments drivers - low global interest rates, ongoing loose monetary policy across all of its keys global markets, strong net inflows, rising asset values, record North American M&A activity and AUD risk to the downside - remain in place.

Macquarie is currently yielding a 4.6% forward dividend (March year-end FY16F), and based on our estimates for FY16F earnings, is growing earnings at 30% CAGR for the three years to FY16F. MQG's operating mix has changed substantially from its pre-GFC highs, with substantially higher contributions from annuity style earning streams offering lower volatility and capital intensity – in turn justifying its higher rating.

We went long Macquarie at $56.58/sh in December 2014 and despite its near 50% increase, continue to like the stock's risk/reward.