PARAGON FUNDS MANAGEMENT

THE PARAGON FUND // SEPTEMBER 2015

PROFILE		PERFORMANCE *(after fees)*		DETAILS	
Fund Managers	John Deniz & Nick Reddaway	**1 month**	+1.6%	**NAV**	$1.4320
Strategy	Australian equity absolute return	**3 month**	+1.6%	**Entry Price**	$1.4342
Inception Date	01/03/2013	**6 month**	+1.3%	**Exit Price**	$1.4299
Net Return p.a.	+17.6%	**1 year**	+3.9%	**Fund Size**	$31.5m
Total Net Return	+52.1%	**Financial YTD**	+1.6%	**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.

OVERVIEW & POSITIONING

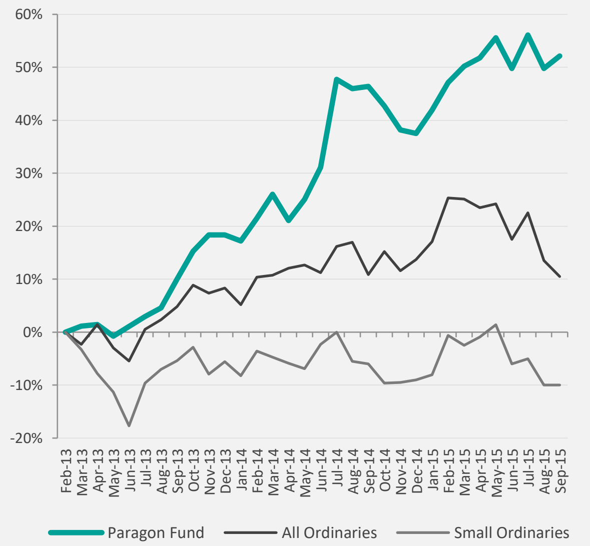
The Paragon Fund returned +1.6% after fees for the month of September 2015. Since inception the Fund has returned +52.1% after fees vs. the market (All Ordinaries Accumulation Index) +10.5%.

The Australian equity market fell -2.5% in September, reversing some of the late month rally in August. Markets initially stumbled after weaker than expected economic data was released in China signalling further contraction in manufacturing conditions. The move by the Federal Reserve to stay put on rate rises further unsettled markets given their signalling to the opposite for many months and the flow on assumptions around faltering growth. The Australian market weakness was led by resources and particularly energy as fears around Santos and Origin balance sheets escalated.

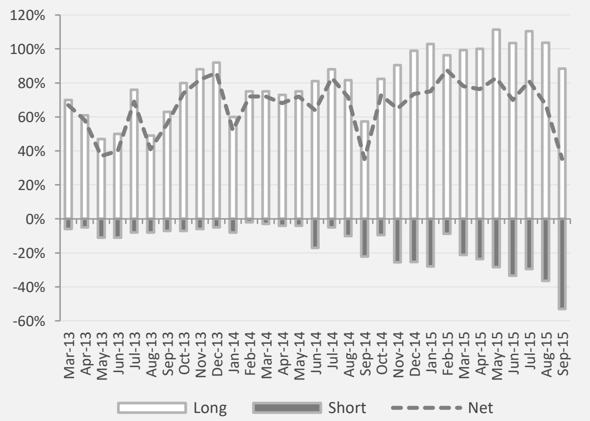
Key positive contributors for September included Longs in NetComm Wireless, Oil Search, Atherton and Blackham Resources, and Shorts in Origin, Alumina and Woodside. At the end of the month the Fund had 27 long positions and 18 short positions.

INDUSTRY EXPOSURE	Long	Short	Net
Resources	17.7%	-9.5%	8.3%
Industrials	55.9%	-13.8%	42.1%
Financials	14.8%	-11.8%	3.1%
Index Futures		-18.1%	-18.1%
Total	**88.4%**	**-53.1%**	**35.3%**
Cash			**64.7%**

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%	-3.8%	4.3%	-4.2%	1.6%				**10.6%**

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

NetComm Wireless

In our June Insight into our investment in the long term mobile internet thematic, we discussed NetComm Wireless, a company we first invested in back in Feb 2014 at $0.37/sh. We stated there were tangible catalysts to significantly build on existing M2M revenues including the potential to expand its NBN scope of works - customer penetration and technology refreshes - and the ability to utilise their established expertise in deploying rural broadband technologies on a global basis (22% of the world's population live in rural areas).

The approval of the merger between AT&T and DIRECTV on 24th July 2015 increased the probability that NetComm, 1 of 4 to tender for AT&T's rural broadband contract conditional on the DIRECTV deal, would be in the box seat to win the contract due this quarter. **NetComm remain the only company with proven experience in rural broadband deployment globally via the NBN.** With 13m AT&T customers requiring rural broadband, the contract is significant. Conservatively assuming 50% take up of the service at a lower price point, the present value of the cash flows of the contract would increase the value of the business by $1/sh today. Other NBN related opportunities including updating existing technologies to make the NBN rollout more economical (1.6m devices to enable the fibre to the distribution point rollout + 300k devices to convert existing HFC cable to VDSL) and longer term the natural replacement cycle for the NBN units currently being installed.

We stated in June that we thought the shares (then trading at $0.75/sh) were conservatively worth $1.00/sh based on the existing base business (we ascribed no growth) and NBN contract that was generating EPS CAGR of 66% from 2015-18. After raising guidance in June 2015 on the back of faster deployment of the NBN, the full year results showed that the base business was also capable of growth, helping the group deliver +15% in revenue and +40% in EBITDA growth for FY15. We were not factoring in the AT&T contract or NBN technology update / refresh opportunities nor any significant growth from their other M2M opportunities with 6 of the world's leading telecommunications carriers in our valuation.

Today the shares are trading for ~$1.50/sh or 18x next year's earnings. While we have taken some profits, we continue to hold the stock given the multiple near term catalysts still ahead.

Energy positions – Woodside, Oil Search & Origin Energy

We provided an update on oil markets including our view on Origin Energy in the August monthly report. Despite Origin's rhetoric of not needing to raise fresh capital, we discussed how the risks of a material ($2b+) dilutive equity raising and/or cutting its dividend were becoming increasingly likely. Origin has indeed done both of these – announcing a $2.5b materially dilutive equity raising (4-7 rights issue @ $4.00/sh – a 34% discount to its last close on 29Sep15) and cut its dividend from 50c to 20c. (It's hard to believe that Origin was once bid for by BG at $15.50/sh in an all-cash offer and that the company knocked it back!). Further, Origin has proposed $800m of asset sales and $1b of capex cuts. Origin has gone some way to finally addressing its over indebted balance sheet - aiming to get both its net debt to < $9b and net debt to EBITDA ~4x (was 6x!) by FY17 end - and maintain its BBB- investment grade credit rating. Our short thesis for Origin has essentially played out and so we covered our short position at $5.20/sh in the institutional component of the rights issue shortfall (we initiated our short position in May 2015 at $12.37/sh) and have actually gone long, also at $5.20/sh, as at this price we view the risk:reward to the upside.

Following on from our view discussed last month that oil prices were getting closer to a bottom, we put on a pairs trade Long-Oil Search & Short-Woodside at the start of the month. Oil Search in our view boasts a world class growth asset in its PNG LNG and the best operating LNG exposure of its ASX-listed peers – with outstanding margins (PNG LNG break even at US$16/barrel of oil equivalent) and economics. On the flip side Woodside we view as ex material growth, with its stable, but mature Pluto and NW Shelf LNG assets. Whilst we were delighted given our positioning, we were not surprised to see Woodside's takeover attempt of Oil Search – in an all-scrip bid of 1 WPL share for every 4 OSH shares. As expected OSH were quick to reject the bid as too low. We agree and are maintaining our long OSH and short WPL pair in anticipation of a higher bid. Woodside's recent commentary describing its bid as a 'full price' we view as rhetoric. We deem the likelihood of Woodside walking away as low as its own growth assets are long-dated and uncommitted due to their relatively unattractive economics.

Special situation / Event driven position – Atherton Resources

Denham Capital, a US$8b energy and resources global private equity firm, on 29/04/2015 announced its initial hostile bid for Atherton Resources at $0.135/sh. Atherton's King Vol high-grade zinc project in Northern Queensland boasts all the usual resource project investment attributes that we look for. King Vol is an advanced, low-capex, high-margin, long mine life zinc project with near term production and cashflows, backed by a high quality mineable resource with strong exploration upside. Management are solid and have a history of project delivery and execution. Further, the King Vol project is well placed to ramp up into a zinc market going into sustained medium-term deficits.

Atherton rejected Denham's opportunistic bid at $0.135/sh and instead proceeded to raise $5m to continue advancing its project. We participated in this capital raise at $0.14/sh in May 2015, as we had researched the sector previously and viewed King Vol as the standout emerging zinc project on the ASX. We valued Atherton at $0.30/sh at ~2x our entry price, and took the view that the initial $0.135/sh bid by Denham had set a firm floor price for the stock.

Denham Capital twice raised its bid with the final offer of $0.20/sh on 18/9/15 being on-market and unconditional, which Atherton's major shareholder has stated it will accept in the absence a superior offer. We have sold into the $0.20/sh Denham offer as we deem the risk of a competing higher bid as low and had an opportunity cost as were able to reallocate the capital into other attractive investments.

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