PARAGON FUNDS MANAGEMENT

THE PARAGON FUND // OCTOBER 2015

PERFORMANCE SUMMARY *(after fees)*

	1 month	3 month	6 month	1 year	Financial YTD	Net Return p.a.	Total Net Return
Paragon Fund	+2.5%	-0.2%	+2.7%	+9.4%	+4.2%	+18.1%	+56.0%
ASX All Ordinaries Acc.	+4.7%	-5.4%	-6.2%	+0.5%	-1.4%	+5.4%	+15.9%
RBA Cash Rate	+0.2%	+0.5%	+1.0%	+2.2%	+0.7%	+2.5%	+6.7%

RISK METRICS

Sharp Ratio	1.3
Sortino Ratio	2.7
Volatility p.a.	+11.8%
% Positive Months	+71.9%
Correlation	0.52

FUND DETAILS

NAV	$1.4682
Entry Price	$1.4704
Exit Price	$1.4660
Fund Size	$32.1m
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.

The objective of the Paragon Fund is to return in excess of 10% p.a. after fees over a 3-5yr investment horizon.

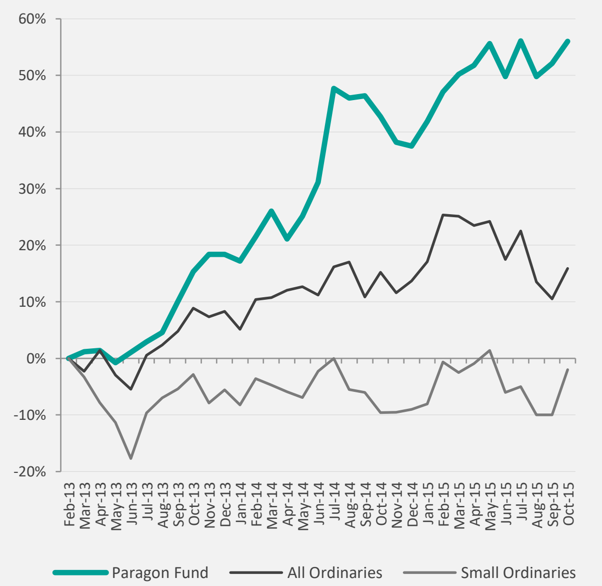
OVERVIEW & POSITIONING

The Paragon Fund returned +2.5% after fees for the month of October 2015. Since inception the Fund has returned +56.0% after fees vs. the market (All Ordinaries Accumulation Index) +15.9%.

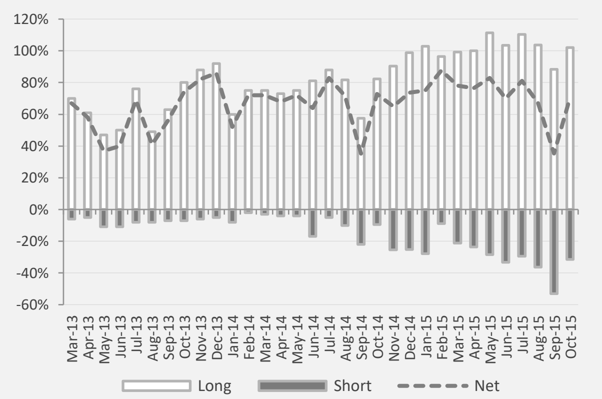
Key positive contributors for October included Longs in Macquarie Group, Henderson Group, NetComm Wireless, APN Outdoor, and Amaysim while detractors included our short positions in general given the strong market. At the end of the month the Fund had 30 long positions and 15 short positions.

INDUSTRY EXPOSURE	Long	Short	Net
Resources	21.8%	-10.2%	11.6%
Industrials	61.4%	-14.1%	47.4%
Financials	18.8%	-7.1%	11.7%
Total	**102.0%**	**-31.4%**	**70.6%**
Cash			**29.4%**

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%	2.5%			**13.4%**

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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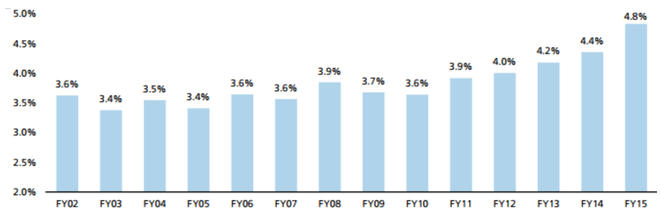
STOCK HIGHLIGHTS

APN Outdoor

APN Outdoor (APN) is Australia's largest outdoor advertising company with market leading positions across the four large verticals in which it operates (metro billboards, rail, transit, airports). Having started in 1995 through the acquisitions of Buspak and Cody, APN now has a 27% revenue share of the Australian (and New Zealand) outdoor advertising market which constitutes ~5% of the total advertising dollars spent across traditional and online mediums today.

Expenditure on outdoor advertising continues to outpace growth in traditional advertising, growing 50% faster per annum over the last 10 years. The overall outdoor advertising market spend year to date has grown at 17% over the prior year as both digital and traditional advertising continues to perform well in the context of a sluggish overall economy. The medium lends itself well to the growth in mobile/online campaigns and has proven relatively resilient to media fragmentation. The ability to accurately measure audience interaction for out of home campaigns via the industry standard MOVE introduced 4 years ago, has helped to highlight the cost effectiveness of outdoor advertising.

Outdoor industry share of total ad spend (%)



Source: CEASA

The development of digital outdoor advertising has further enhanced the sectors growth, bringing significant efficiencies to the advertiser (time segment advertising, speed to market, enhanced data collection, better engagement) and much better economics to APN (large format digital displays deliver 4x the revenue per panel). Digital outdoor advertisings share of total outdoor advertising spend has grown from 16% to 25% over the last year. As Australia's largest outdoor advertising company (2800 static billboards), APN will have over 150 large format static billboards which lend themselves to digital conversion. With 51 large format digital billboards by the end of 2015, there is significant growth to be gleaned from this conversion.

While we are not big fans of domestic orientated cyclicals, as discussed above we believed that digital outdoor advertising had structural drivers that would be able to outweigh any cyclical weakness in APN's traditional advertising business. Paragon bought APN at $3/sh in June 2015. At $3/sh the market was pricing the company in line with the average listed Australian company despite its structural growth drivers. These two factors provided us a margin of safety and a solid point at which to purchase shares in the business.

APN went on to deliver a solid result in August and then further upgraded their FY15 earnings guidance in October, highlighting the ongoing growth in the outdoor advertising market. While we continue to view the industry positively, with the shares trading at $5/sh the company's prospects are more appropriately reflected in the price and we have begun to reduce the position.

Nanosonics

Nanosonics is an Australian medical device company that designs and manufactures infection control and decontamination systems for the global healthcare industry. We first wrote about our investment in Nanosonics in our [Feb 2015 Monthly.](#) We outlined our positive stance on the long term outlook for the company, namely its patented ultrasound disinfection technology (trophon EPR) delivering recurring revenue streams with high barriers to entry that more effectively and efficiently replaces a 30 year old process.

As part of the company's original distribution strategy, they partnered with several global healthcare device companies (GE Healthcare, Miele, Toshiba) to help penetrate large western markets. In the US, their distribution partner was GE Healthcare who control ~35% of the ultrasound market. In February 2015 Nanosonics announced they would transition away from this strategy and instead look to build on their existing 6 man sales team in order to sell directly into the US market with the company raising $25m in March 2015 to expedite this process. The rationale for selling directly is that the gross margins received for each trophon unit would increase from ~$5000 to ~$8000, and the consumables margin would increase from $40 per bottle to $90 per bottle (each unit consumes around 27 bottle per annum). As the company progresses towards achieving their target of 40k installed units in the US alone (from 5000 today), there is clearly significant economic benefit to Nanosonics by selling directly.

While the company could be applauded for taking the hard road to greater profitability, much would rest on the quality of the product and indeed the sales team's ability to penetrate into hospitals without GE's reach. While Nanosonics had flagged that this changeover process would take some time, the release of the company's quarterly in late August showed a marked slowdown in second half FY15 sales. We maintained our view that the economic benefits of the trophon EPR on a bulging global healthcare system would be able to deliver the sales over time despite the short term fluctuations. This view was vindicated in October as Nanosonics delivered a quarterly increase in revenue of 60% as the transition away from GE progressed and the shares re-rated accordingly.

According to the World Health Organisation, the annual direct costs of hospital acquired infections exceed $13b in the US and Europe alone. Indeed in May 2015 it was shown that the trophon EPR was the only high level disinfection system capable of killing the human papilloma virus (HPV) that infects around 79 million Americans and is responsible for 5% of cancers worldwide. We continue to hold Nanosonics with the view that the company can deliver significant compounded returns to shareholders over time.