



# Paragon Australian Long Short Fund

OCTOBER 2020

www.paragonfunds.com.au

\*Since inception - 1 March 2013

| PERFORMANCE DATA<br>(after fees)    | 1 month | 3 months | 6 months | Financial YTD | 1 year | 2 year p.a. | 3 year p.a. | 5 year p.a. | Net Return p.a. | Total Net Return* |
|-------------------------------------|---------|----------|----------|---------------|--------|-------------|-------------|-------------|-----------------|-------------------|
| Paragon Aust. Long Short Fund (est) | -5.2%   | -5.4%    | +37.7%   | +7.1%         | +16.0% | +17.0%      | +1.5%       | +7.1%       | +10.9%          | +120.3%           |
| ASX All Ordinaries Accum. Index     | +2.1%   | +2.2%    | +11.0%   | +3.3%         | -6.5%  | +5.7%       | +4.8%       | +7.2%       | +6.7%           | +64.0%            |
| ASX Small Ords. Accum. Index        | +0.5%   | +4.7%    | +15.1%   | +6.2%         | -2.4%  | +5.9%       | +4.7%       | +8.6%       | +5.0%           | +45.3%            |

## OVERVIEW

The Fund returned an estimated -5.2% after fees in October, impacted by a sharp market sell-off in the last week of the month - the worst-ever loss in the week leading up to a US presidential election. Global Indices were down, -2.3% (Nasdaq) to -2.7% (S&P500), gold equities -4.6% (GDX), with the VIX jumping 44% to 38. This was driven by anxiety around the election outcome and it being contested, the next US fiscal stimulus bill delayed until after the election, and further COVID-19 lockdowns in Europe and potentially the USA. Local Indices performed better, +0.5% (Small Ords AI) and +2.1% (All Ords AI), the latter driven by a bounce in the banks. Positive contributors for the Fund were Tesserent and shorts in AGL and Atlas Arteria, which were more than offset by declines across the remainder of our portfolio.

Safe-haven assets fell slightly, with both US\$ gold and the US Treasury Index down -0.4% and -0.9% respectively. Silver was marginally up +1.8% to US\$23.66/oz. The US\$ Index rose +0.2% to 94.0c and US real rates rose slightly to -0.84%, impacting gold. We continue to view gold as being in a correction since its Aug 2020 highs - as it was in Feb-May 2019 and Aug-Nov 2019 before it broke out strongly. Regardless of the US presidential outcome, more stimulus is coming and it will continue to be monetised by the Fed, a.k.a 'monetary-fiscal co-ordination' as coined by US Fed Chair Jerome Powell.

## PORTFOLIO INSIGHTS: Adriatic trifecta - share price re-rate is underway

As anticipated, **Adriatic**, first written about in [November 2018](#), released a strong pre-feasibility study (PFS) in October for its Vares project. The PFS was a high-quality 'third-party' study conducted by Ausenco and backed by Reserves only. Based on spot commodity prices the PFS boasts outstanding metrics - including an NPV of ~\$1.5b (>3x Adriatic's market cap), an IRR of 113%, NPV/Capex of ~6x and a project payback of a mere 1.2yrs. Whilst Vares is a polymetallic project, a significant portion of project revenues (~45%) are derived from silver and gold. Production in yrs 1-5 average ~200koz p.a. gold-equivalent at lowest quartile opex of <US\$600/oz, generating free cashflow (FCF) of ~\$340m p.a. Producers like this are commanding market caps of \$2b+.

Soon after the PFS release Adriatic secured a \$39m capital raise completed at a premium from tier 1 financiers, including \$11m equity (at \$2.14/sh) from the European Bank for Reconstruction (EBRD) and a \$28m convertible (at \$2.79/sh) from Queen Road Capital (QRC). QRC is majority owned by billionaires including Andrew Forrest and Jack Cowin. This overall financing is a big endorsement from a well-respected institution and investors. Adriatic's net cash position rises to ~\$50m and should be the last equity raise required, as the balance of capex funding will likely be covered by project debt and offtake financing. Note that Resources companies interested in taking over Adriatic will not want to see it deal away its 'strategic' offtake (hence Wesfarmers' timely Kidman takeover). Importantly, QRC are forced to convert if Adriatic's share price hits \$3.50/sh under a takeover scenario.

Finally, Adriatic released its first exploration results from its newly acquired Tethyan Serbian base metals asset. We can already see a 10mt+ mineable resource underwriting a second economic project generating \$80m+ p.a. FCF at modest capital intensity.

Adriatic's 2yr-forward EV/FCF is ~2x, compared to its producing peers at >8x. Adriatic's un-risked valuation is \$5/sh and is currently trading at \$2.30/sh. With Adriatic's project technicals and funding de-risked, we expect its big discount to NPV and its peers to close in the near-term. Upside risk in both exploration and commodity prices are bonuses to our investment case. Near-term catalysts include Vares' bankable feasibility study, environmental and mining permits. Strongly-aligned management continue to do an excellent job and remain very well placed to execute.

## FUND POSITIONING & RISK METRICS

|   |          |
|---|----------|
| Fund Size   | \$34.9m  |
| Longs   | 27       |
| Shorts  | 6        |
| Net exposure                                      | 113%     |
| Beta-adj net exposure/<br>Average since inception | 61%/71%  |
| Gross exposure                                    | 146%     |
| Cash  | -13%     |
| Index Futures                                     | 0%       |
| Correlation                                       | 0.57     |
| % Positive Months                                 | 61%      |
| Up/Down Capture                                   | 102%/67% |

## UNIT PRICING\*

|                 |          |
|-----------------|----------|
| NAV (Mid-Price) | \$1.9203 |
| Entry Price     | \$1.9231 |
| Exit Price      | \$1.9174 |

\* Based on our estimated return.

Official UP to be issued ~BD7 by the Fund's Administrator.

## FUND FACTS

|   |  |
|---|--|
| APIR Code                                     | PGF0001AU  |
| Responsible Entity &<br>Investment Manager    | Paragon Funds<br>Management Ltd  |
| <b>Strategy*</b>                              | Aust Equities L/S (long-bias),<br>Fundamental, Concentrated.<br>Global and unlisted permitted. |
| Objective                                     | >10%p.a. over 5yrs   |
| Structure                                     | Unit trust   |
| Domicile                                      | Australia  |
| <b>Pricing/Applications/<br/>Redemptions*</b> | Monthly  |
| Min. Investment                               | \$25,000   |
| Min. Additions                                | \$5,000  |
| Min. Redemptions                              | \$10,000   |
| Administrator                                 | Link Fund Solutions  |
| Prime Broker/Custodian                        | UBS  |

\* Changed from 1 July 2020