

Quick Brown Fox Asset Management



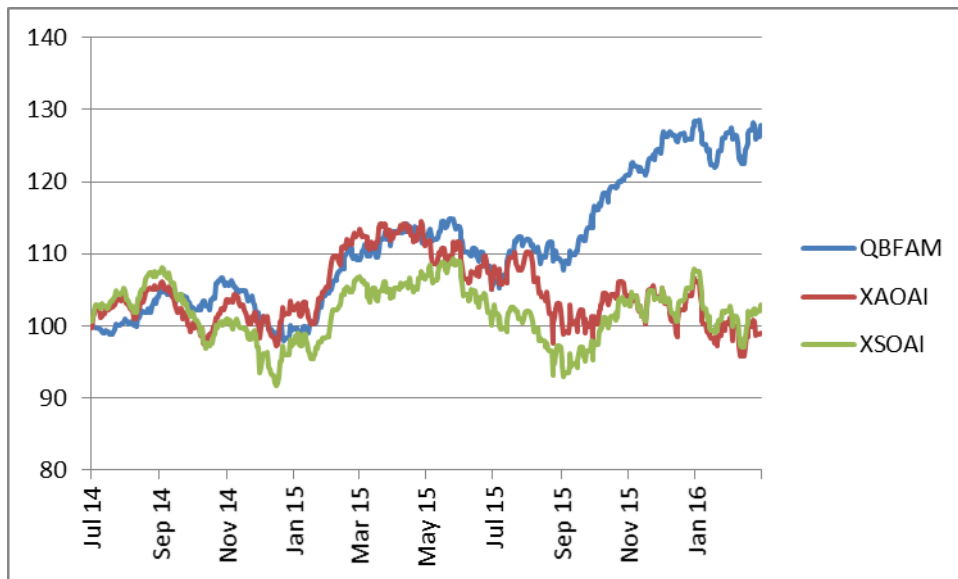
Monthly Report – February 2016

February is all about reporting season in Australia. This is an opportunity for investors to analyse and review how the companies in their portfolio are performing. It also gives an opportunity to review the broader and seek out new opportunities.

The fund through the month held up in a volatile market, returning +0.84%.

	1 month	3 months	6 months	1 year	Since Inception
QBFAM	0.84%	3.08%	17.36%	17.96%	28.05%
XAOAI	-1.47%	-4.31%	-3.09%	-12.24%	-1.05%
XSOAI	0.95%	-0.46%	6.07%	-3.56%	2.94%

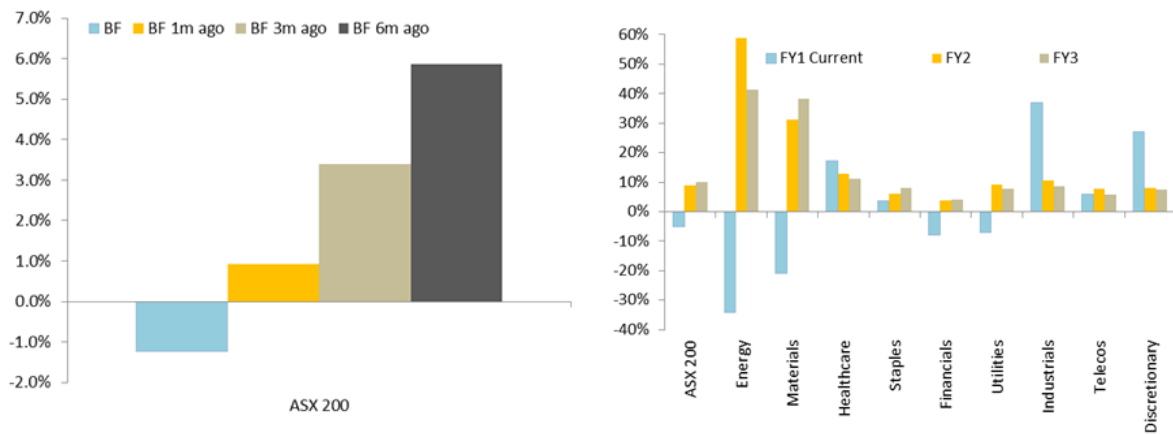
The fund has held onto its gains over the last year.



Reporting Season

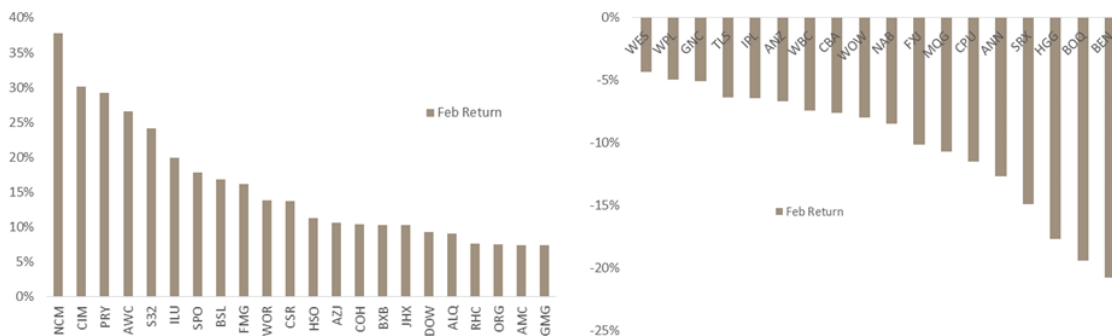
Heading into reporting season the market had low expectations for earnings. Since the end of the 2014-15 financial year analysts have broadly been in downgrade mode. Blended forward earnings (i.e. looking at the next 12 calendar months from today) over that time period have fallen from expected growth of 6% to an expected fall of 1%.

In fact, FY16 earnings per share are now expected to fall in the order of 4%. We can see from the chart below that the primary reasons for the expected fall in earnings is the resources sector (Materials and Energy) and the Financials where increased capital bases, lower asset growth and higher funding costs are putting pressure on earnings (more on this later). On the other side we note strong growth in Healthcare, Industrials and Discretionary.



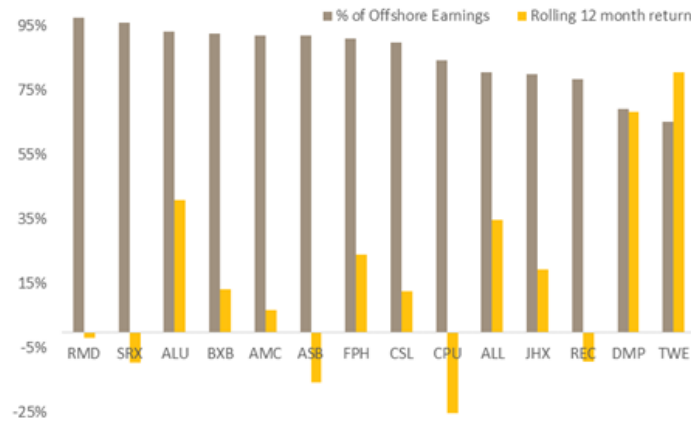
This brings us to reporting season and like the chart above we have a real contrast in the performance of companies in different sectors. The chart below looks at the top performers over February to date in the ASX100. Two themes stand out. Firstly, resource companies have rebounded on the back of commodity prices, despite the fact their results were poor (NCM, AWC, S32, FMG, ORG). Secondly, industrials with offshore earnings have done well (COH, BXB, JHX, RHC, AMC, GMG). In the fund we remain exposed to this offshore industrial thematic with our positions in ALU, TME, GTK, IMF, RMD and HSN.

On the other end of the spectrum the most notable disappointments were the second tier banks (BEN, BOQ and MQG). Funding pressures have led to an inability to compete in a sector where top line growth has slowed substantially in the last six months.



Offshore Industrials

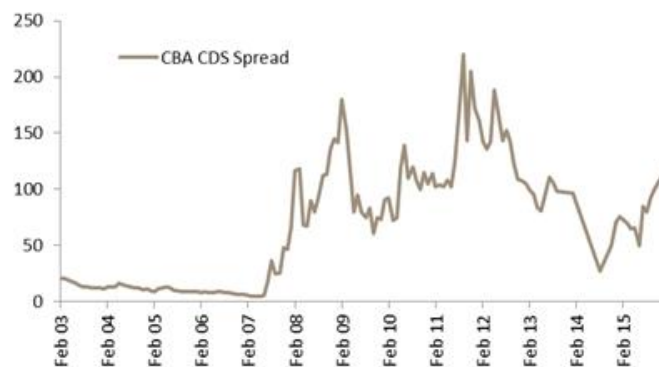
The main standout across reporting season were Industrial companies with offshore earnings. This has been a consistent theme over the last few years as the Australian dollar has fallen from north of parity with the US dollar to around 70 cents. The below chart looks at a selection of companies (excluding Financials and Resources) with a significant majority of their earnings offshore. Whilst buying them en masse is not a foolproof strategy we do note most of the companies have given strong returns and all bar CPU and ASB have outperformed the broader market, which has fallen nearly 14%.



Whilst we don't actively chase companies purely for their offshore earnings we do see it as an additional benefit when we find high quality companies that are global leaders in what they do. We continue to believe the Australian dollar will fall further and have positioned portfolios accordingly, however the fundamentals of a company need to warrant its inclusion first and foremost.

Second Tier Banks

During reporting season we saw Bendigo and Adelaide Bank report that they are struggling to compete with the majors in both loans and deposits, we had a dividend cut from Suncorp and profit warnings from Bank of Queensland and Macquarie. The major problems facing the sector are a lack of lending growth (evident in the Commonwealth Bank result where its asset book was broadly flat over the six months) and offshore funding costs which have increased notably in recent times as can be seen by the CBA CDS spread (Credit Default Swaps, representing the market cost of insurance against the bank defaulting on its debt, a proxy for the funding cost of CBA, chart below) that has hit its highest level since the European crisis in 2012.

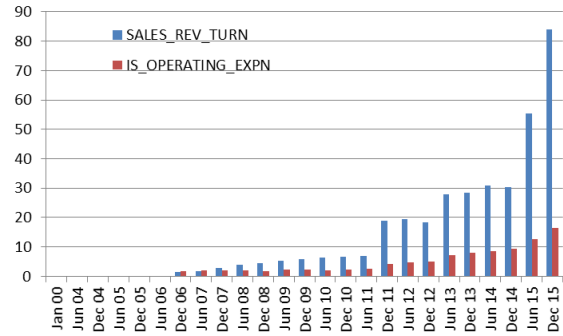
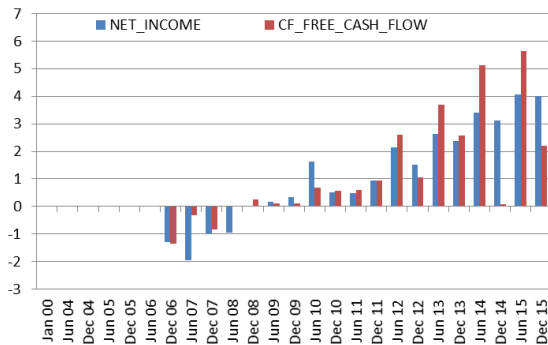


New Position

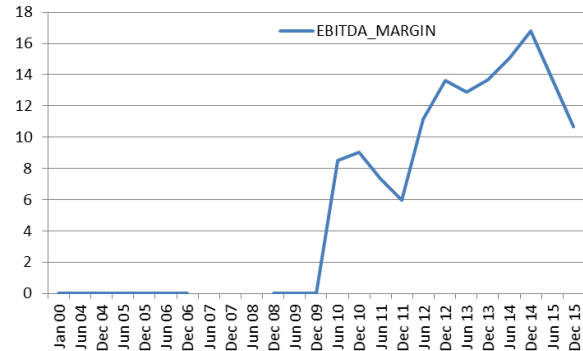
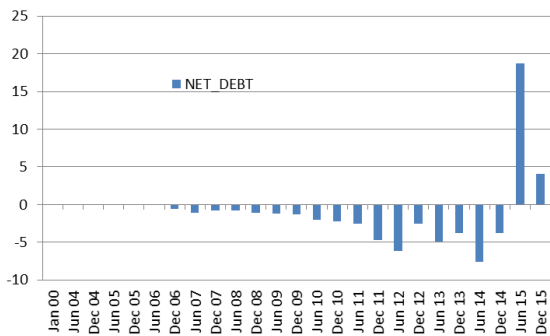
MNF Group

MNF Group is an Internet Protocol based Telco provider. The business has built its own independent VoIP network which serves private residences, businesses and public sector organisations. Given it has its own network the incremental addition of clients almost entirely flows through to the bottom line. More recently it bought the global wholesale voice business of Spark, formerly Telecom New Zealand, for \$NZ22.4 million. The Spark business has operations in six countries, carries more than 2.8 billion minutes of voice a year and has 220 wholesale voice customers.

Sales have risen strongly and as a result profits and cashflow have followed suit:



The balance sheet was utilised for the Spark acquisition but this has been paid back in a hurry. Margins have increased over time before falling on the acquisition. Given the sunk cost of the network we can see margins continuing to improve into the future.



The Portfolio

The fund is currently invested in 14 positions and retains a cash balance of 31%. The cash balance is up from 27% at the end of December after exiting positions in HFA and LHC after reviewing their results. We also reduced our positions in MTU (now VOC) and HSN. In addition to adding MNF, we topped up on IMF which announced a substantial profit from a settled case that will boost full year earnings.

