

LUGARNO FUND

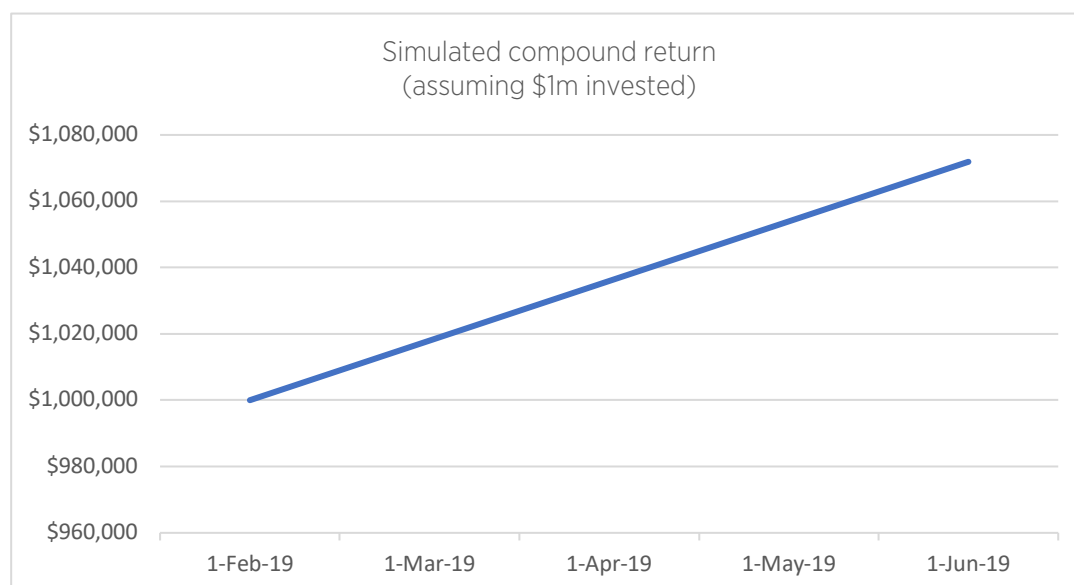
14 September 2019

Dear Partners,

I'm pleased to be providing you the inaugural investor update for the Lugarno Fund.

Returns (after all fees and costs)	Annual Return	Since Inception
FY2019 (4.5mths)	+7.19%	+7.19%
FY2020 (estimate at 20 August)	+1.3%	+8.29%

The fund began on Feb 15, 2019 and since inception we have achieved a return of 7.19%. In other words, if you had invested \$1m in our fund at inception, it would now be worth \$1,071,900.



"Investing isn't about beating others at their game. It's about controlling yourself at your own game."
– Benjamin Graham, The Intelligent Investor

THE FUND

We strongly believe in the concept of skin in the game – we eat our own cooking.

This fund serves as the primary investment entity for my family's wealth so you can be confident we are treating your investment like it's our own.

This fund exists to generate solid returns and if we fail to do so we don't deserve to be in business. We do not charge a management fee and only earn performance fees if we achieve returns of greater than 6%. This fee structure is a clone of Warren Buffett's early partnership.

We believe that the easiest way to grow capital is to avoid losing it. In practice this means that investments require a large margin of safety between what we pay and the value we believe we are receiving. We also prefer companies with substantial tangible assets to protect us should things not go to plan.

Good investment opportunities are rare so when they come along we are willing to invest significant amounts of the funds capital to maximise the investors benefit. Conversely, we are content holding substantial cash in the absence of valuable opportunities.

In order to consistently make good decisions, we cultivate a sceptical & contrarian mindset. It is statistically impossible to generate great returns by investing with the same lens and conventional wisdom of 'Mr Market'.

Our investment strategy looks to capitalise on two main elements of the investment market place.

Inefficient distribution of information: This is where under-researched companies are much less understood by the broader market.

Over-reaction tendency: This where investors act in herd like behaviour by over-reacting to negative news on otherwise quality investments.

Well known opinions are usually priced into stocks and so we find that ideas are only valuable if they are contrary to consensus.

In practice, none of our investment ideas are found by reading the newspaper or research reports by the major stockbrokers and banks. All of our investments are in unloved companies or overlooked business.

Internally, we judge our performance over periods of at least 3 years and we ask you do the same. While we strive to identify near term catalysts for our investments, 'Mr Market' rarely agrees with our perspectives as fast we would like.

We believe wealth gives people the freedom to live their best life and we are immensely proud to get to work every day helping you with that.



POOR RETURNS

We will always prioritise the bad news before the good when updating you.

To date, there have been no mistakes or significant drawdowns in the fund.

BETTER RETURNS

The following positions accounted for most of the achieved return in the period.

VGI PARTNERS [VGI]

VGI traded significantly above its attractively priced IPO.

VGI Partners is an Australian based hedged fund who we have invested alongside since 2009. VGI have a single flagship fund which invests globally on a long & short basis. They have a large and very loyal pool of very high-quality investors. The strategy is conservative and we back that the managers are unlikely to 'screw up'.

The current share price is high-ish based on current AUM levels. However, we are confident the revenues are sufficiently defensive and back the management team to continue to deliver great returns. We also note their announcement about a new Asian strategy which will come close to doubling their AUM by the end of the year.

CSG LTD [CSV]

This investment formed part of the seed capital for the fund and was originally purchased prior to 15Feb2019 at a higher price than today.

The stock increased in the period after the company confirmed guidance that they will deliver an attractive profit in FY19.

CSG provide print sales, service, and managed IT services to SMEs in Australian & New Zealand. The share price has fallen over 90% due to the slowing demand for printers, some poor capital allocation decisions by management, and a series of downgrades in their (now closed) enterprise business.

Big management and board changes has resulted in a refocussing of the business, significantly reduced debt, and a return to growth. Despite the good news, Mr Market is slow to catch on.

Should CSG continue its current growth trajectory it is selling for ~5x EV/FY20 EBITDA which we consider to be extremely cheap.

Should CSG's current trajectory stall or fail, we believe that parts of CSGs business have plenty of value to protect our investment. The run-off in the lease book alone is worth half of the company's enterprise value.



ACRUX LTD [ACR]

This investment formed part of the seed capital for the fund and was originally purchased prior to 15Feb2019 at a higher price than today.

The stock rose mildly in the quarter for no apparent reason.

Melbourne based pharmaceuticals company developing a portfolio of generic medicines for sale in the US. Acrux are specialists in producing drugs for topical and transdermal application. We purchased most of our holding in this company when it traded at a substantial discount to its cash balance.

Five years ago the company was an extremely profitable market darling having commercialised a blockbuster FDA approved drug (Axiron). However, following a challenge the patent was lost and after a fortunate period of residual royalties, the company was left with (almost) zero revenue.

This made Mr Market very disappointed, so he sold off the share price by 95% and has refused to see any merit in how management have been investing the company's capital since.

Since 2016, the company has been investing in a portfolio of generic medicines focussing on their niche capability of topical and transdermal medicines. The investment cycle for each product is 3-4 years, this year will see the first product commercialise.

Led by a highly capable and experienced CEO, the management team have been extremely consistent in their articulation of the strategy. Furthermore, the early results have been in line with their guidance.

We believe management have invested rationally and we expect that the new generic portfolio's royalties will exceed the Acrux's current enterprise value by 2022.

Acrux still have a healthy cash balance (no debt), some valuable equipment, and a legacy royalty stream which protects our investment should things not turn out as expected.



FUND PARTICULARS

Trustee	DDH Graham Limited
Investment Manager	Lugarno Partners Pty Limited
Administrator	DDH Graham Limited
Auditor	PWC
Min Investment	\$ 250,000 (negotiable)
Additional Investment	\$ 50,000
Redemptions	Minimum 90days notice
Fees	Zero Management Fee
Performance Fee	Performance Fee of 25% above a hurdle of 6% subject to a high watermark
Buy/Sell Spread	0.5% of applications and redemptions
Fund Costs	Capped as the higher of \$50k or 0.5%

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This update contains information concerning about the Lugarno Fund (Fund), an unregistered managed investment scheme, and has been prepared by Lugarno Partners Pty Ltd ACN 607 035 138 AFSL no. 508934 (Investment Manager) as investment manager of the Fund. DDH Graham Limited ACN 010 639 219 AFSL no. 226319 (Trustee) is the trustee of the Fund. This update is for distribution only to wholesale clients as defined in section 761G of the Corporations Act and to sophisticated investors under section 761GA of the Corporations Act. It contains general information only and is not intended to provide advice to any particular investor, nor take into account an individual's investment objectives, circumstances or needs.

Returns shown are net of all fees and costs. Past performance is not indicative of future performance. This update also contains statements about the estimated future performance of the Fund, which are based on a number of assumptions that may not prove to be correct or appropriate. Actual performance may vary from estimated or forecast performance. Neither the Investment Manager nor the Trustee give any representation, assurance, guarantee or warranty that the estimated return or any projection, forecast or assumption contained in this document will actually occur.

