



PARAGON AUSTRALIAN LONG SHORT FUND // October 2019

PERFORMANCE SUMMARY (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	-1.6%	-2.1%	+19.3%	+7.1%	+18.0%	-5.1%	+0.9%	+5.9%	+10.1%	+89.8%
ASX All Ordinaries Accum. Index	-0.7%	-0.9%	+7.8%	+2.5%	+20.0%	+11.0%	+12.4%	+8.8%	+8.8%	+75.5%
ASX Small Ords. Accum. Index	-0.4%	-1.7%	+2.3%	+2.7%	+14.9%	+8.4%	+10.4%	+9.6%	+6.2%	+48.9%

\*Since inception 1 March 2013

RISK METRICS

Sharpe Ratio	0.5
Sortino Ratio	1.0
Correlation	0.4
% Positive Months	60%
Up/Down Capture	77%/41%

UNIT PRICE & FUM

NAV	\$1.7624
Entry Price	\$1.7650
Exit Price	\$1.7597
Fund Size	\$35.9m
APIR Code	PGF0001AU

FUND STRATEGY AND OBJECTIVE

An Australian equities long/short fund, with a long-bias, fundamentally driven with a concentrated portfolio of high conviction stocks. The objective of the Fund is to return in excess of 10% p.a. after fees over a 3-5yr investment horizon.

OVERVIEW AND POSITIONING

The Fund returned -1.6% after fees for October, down for the month as were all Australian Indices. October was a challenging month as we saw a continuing rotation of value to growth stocks. Positive contributors were Alacer Gold (another production upgrade), Xero and PointsBet. These were more than offset by declines in Jumbo, Prospa and our other gold holdings. The Fed cut the cash-rate for the third time in 3 consecutive meetings by 25bps to 1.625% (average), US 10yr yields held ~1.7% and US\$ & A\$ gold also held for the month +1%. Zinc prices continued their bounce on US-China trade optimism, up ~17% from September lows. Adriatic and PointsBet both conducted successful capital raisings to fund growth initiatives. Xero delivered another solid interim result and Alacer released another excellent quarterly result, both continuing to break multi-year highs, and remain key long positions for the Fund, discussed overleaf.

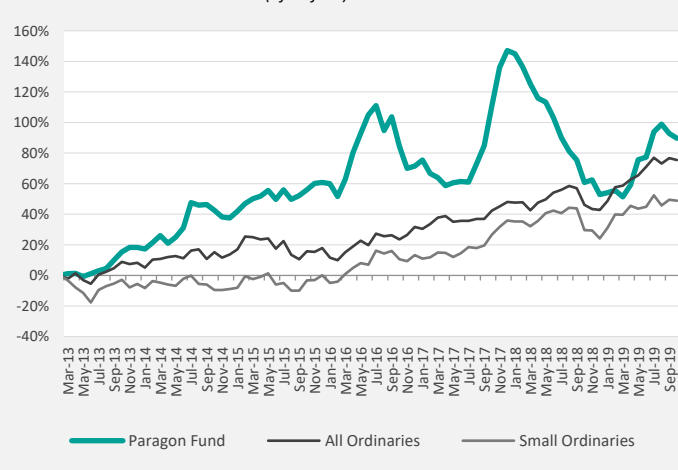
FUND POSITIONING

Number of Longs	24
Number of Shorts	3
Net exposure	111%
Gross exposure	127%
Index futures	0%
Cash	-11%
Beta-adj net exposure	53%

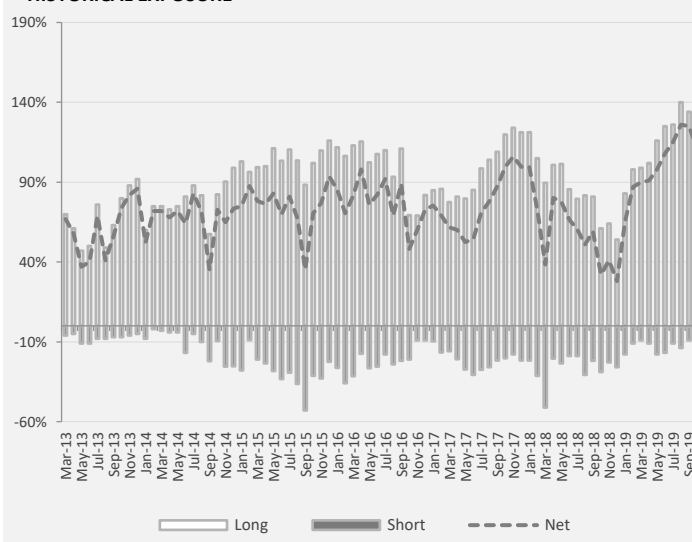
FUND FACTS

Structure	Unit trust
Domicile	Australia
Applications & Redemptions	Daily
Minimum investment	\$25,000
Min. addition/redemptions	\$5,000/\$10,000
Administrator	Link Fund Solutions
Prime Broker/Custodian	UBS

HISTORICAL PERFORMANCE (after fees)



HISTORICAL EXPOSURE



MONTHLY PERFORMANCE BY CALENDAR 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%	2.6%	0.3%	16.8%
2016	-0.5%	-5.2%	7.4%	10.8%	7.0%	6.3%	2.9%	-7.8%	4.3%	-9.0%	-7.9%	0.8%	6.8%
2017	2.3%	-5.0%	-1.6%	-3.2%	1.3%	0.4%	-0.2%	7.3%	7.0%	14.0%	11.9%	4.7%	44.1%
2018	-1.3%	-3.0%	-4.7%	-4.2%	-1.2%	-4.7%	-6.5%	-4.6%	-3.2%	-8.4%	0.9%	-5.8%	-38.1%
2019	0.8%	1.0%	-2.7%	5.1%	10.4%	0.9%	9.4%	2.6%	-3.1%	-1.6%			24.2%

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 daily unit pricing methodology based on historical data.



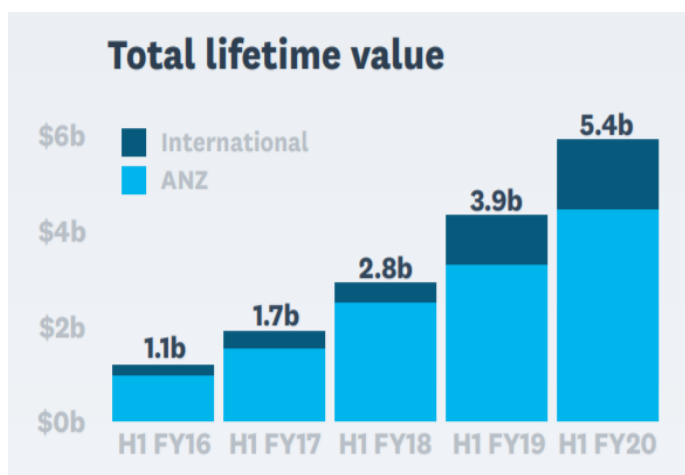
## Portfolio insights

### Xero keeps on delivering; Subscriber growth of +30% beats expectations

As one of the Fund's key long positions, Xero was previously discussed in [May](#). Xero is a best-in-class cloud-based accounting software business with a proven track record of disrupting the ageing desktop-based accounting software industry dominated by MYOB, Intuit and Sage. With a dominant position in Australia & New Zealand (ANZ), Xero is continuing to rapidly expand in the UK and in turn pursuing a substantially larger total addressable market (TAM). Digitisation of small business tax compliance continues to be a great tailwind for Xero (including single touch payroll in Australia and making tax digital in the UK) and should see the ongoing shift from desktop-based accounting software to cloud-based systems.

Xero's 1H20 results released in the first week of November showed strong growth rates across ANZ and the UK, for both total subscribers and average revenue per user (ARPU) growth. ANZ subscribers grew to 840k, +130k on 2H19, and UK subscribers grew to 536k, +73k on 2H19. Total subscribers were 2,057k, +237k on 2H19 and revenue was ~NZ\$340m, +32% on 1H19. Annualised recurring revenue and lifetime value (LTV) growth continues to be strong.

Figure 1: Xero's total lifetime value has almost doubled in 2 years



Source: Xero

Xero continues to be free cashflow positive, and has ample liquidity to self-fund its large growth opportunities with net cash of ~\$100m.

Xero boasts a long runway of growth, noting UK cloud-based accounting Software-as-a-Service (SaaS) penetration is ~25%, less than half that of ANZ, and an estimated ~\$2.5b TAM, twice that of ANZ. Whilst market penetration in the US remains elusive at this stage, being an under-penetrated market at 10x the TAM of ANZ, it still remains the largest opportunity. Roll out in Canada is modest, however it is still early days for Xero in this market pursuit. Xero's platform strategy of 'add-on services' continues to build on its large adjacent revenue opportunity.

Xero boasts strong revenue momentum in its cloud-based accounting SaaS and a substantial growth runway. We expect Xero to more than grow into its growth multiple over the medium term.

### Alacer surprises to the upside yet again; Standout free-cashflow generation

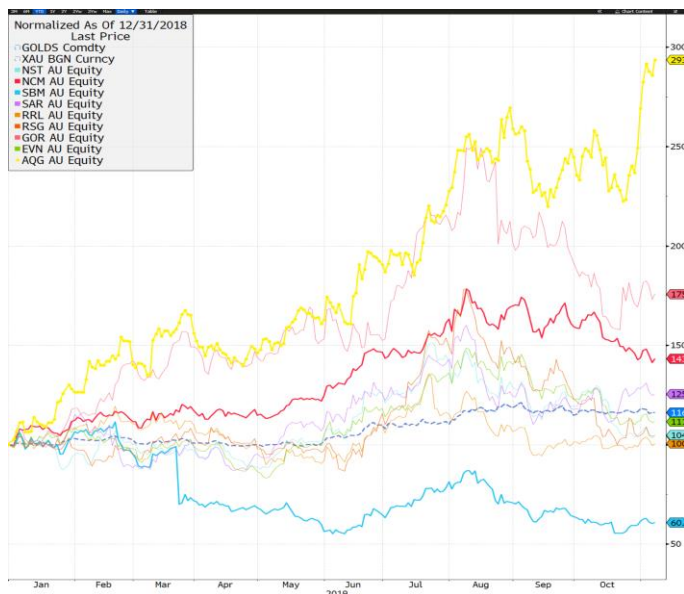
As one of our key gold positions, Alacer Gold (AQG) has already been discussed in our June and [July monthly](#) updates. Alacer's Copley mine in Turkey is world class, with large-scale production (~400ktpa on 100% basis), low cost and ~20yr mine life (2-4x its peers bar Newcrest). A strong 3Q19 result was released in

October, surprising to the upside on its key metrics. Alacer continues to be the cheapest ASX-listed gold large-cap by some margin, with an enviable growth profile, offering solid share price upside, despite gold's current correction.

Alacer's recently commissioned US\$650m sulphide project has ramped up very well over 2019 and its oxide operation continues to surprise to the upside - driving a tripling in its share price since our initial entry into the stock in January near its lows. Management are doing an outstanding job and we expect further upgrades to continue across both the sulphide and oxide operations. Given ample scope in Copley's sulphide resource, mine plan and plant optimisation, management are now moving towards additional production capacity beyond design rates. Oxide's growth opportunity is arguably even better, where market expectations continue to be low. In pit exploration success, positive grade reconciliation and the continued success in discovering and delineating local resources (Ardich and others), is likely to see oxide production upside over the medium to long term at modest capital intensity.

Alacer is really starting to print money. It is unhedged to the strong gold price (unlike its ASX-listed peers, all realising lower gold prices due to out of the money hedges) and is rapidly paying down its debt. We expect Alacer to be net cash in 2Q20 and to resume paying dividends in 2020. It is worth noting that Alacer has substantial carry-forward tax losses to utilise, resulting in an effective corporate tax rate at ~5%, implying free-cashflow at ~\$285m p.a. at spot gold. As the market becomes more comfortable with Alacer's outlook, including 1) sulphide capacity expansion and optimisations; and 2) oxide longevity and scale additions, we expect Alacer will continue to re-rate, via expansion of its free-cashflow multiple and ongoing production upgrades.

Figure 2: ASX-listed large-cap peers 2019 relative performance - Alacer the standout



Source: Bloomberg, Paragon

Alacer is an attractively priced strong free-cashflow stock, which happens to be in gold. As previously stated, any further rises in the gold price will simply be a bonus for Alacer. On the flipside, modest to moderate corrections in the gold price should not impact Alacer, as over time, its strong free-cashflow generation, debt unwind and ongoing multiple expansion should see the stock perform well. Classic case studies for this include large-cap resource stocks Fortescue (Iron Ore), St Barbara (Gold) and Whitehaven (Coal), which all performed very well over time, through their debt unwind/strong free-cashflow phases, despite periods of underlying commodity price volatility. Given gold's current volatility, we have partially hedged Alacer by shorting a couple of challenged and expensive large-cap gold stocks.

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