



# Katana Capital Limited

## 30 June 2016 Investment Report

### Overview

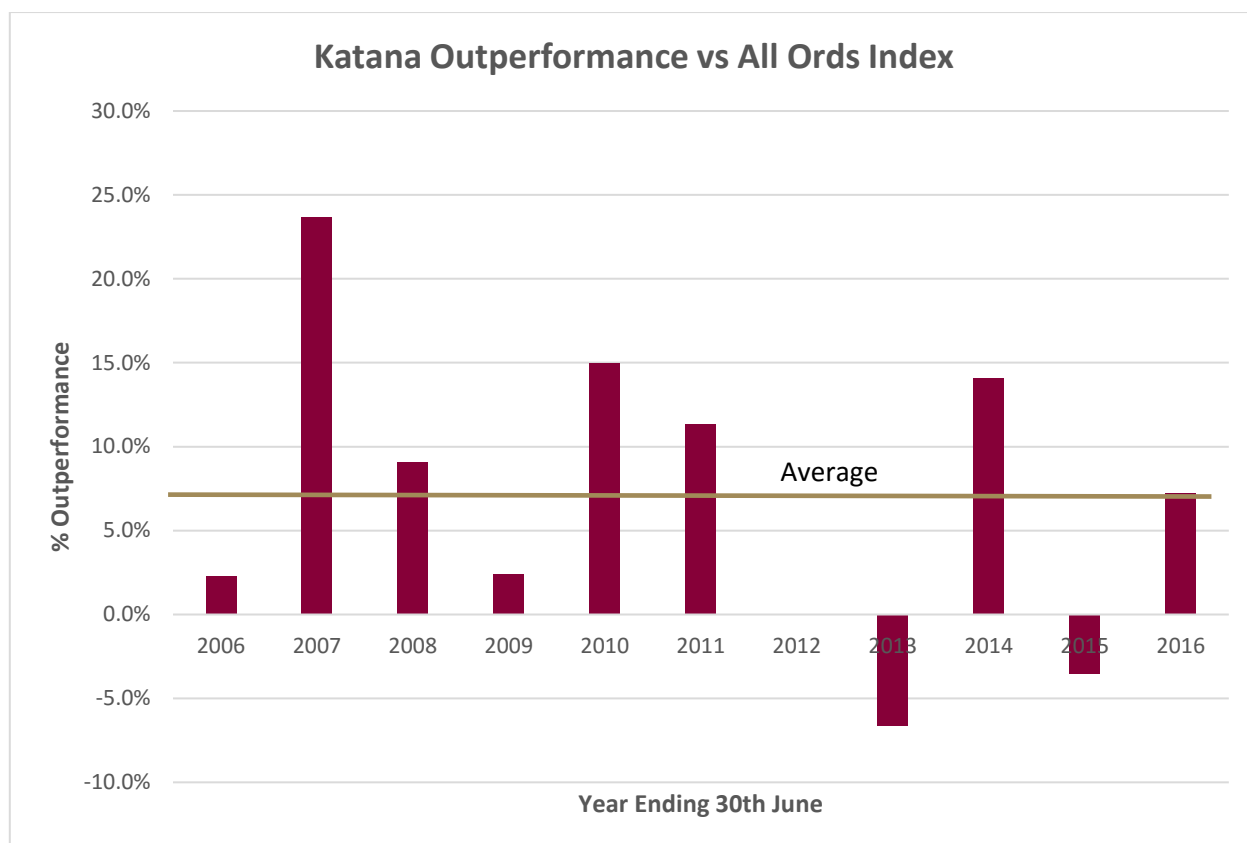
Katana Asset Management Ltd ('The Manager') has completed a report on the performance of Katana Capital Limited's portfolio for the 12 months to 30 June 2016.

### FY16 Financial Year Review

The All Ordinaries Index started FY16 at 5,451.2 points and fell by 2.58% during the course of the year to close at 5,310.4 points on 30 June 2016. FY16 was characterised as another year of low global growth during which the US Federal Reserve commenced its interest rate hiking cycle and concern about the level of bad debts in the Chinese and Italian banking systems increased. Subsequent to the financial year end, the UK voted to leave the European Union ('Brexit') in July 2016. Katana outperformed its benchmark by 7.21% with a positive (gross) return of 4.63%. This extended its track record of outperformance to nine out of the past eleven years since the Fund's inception (before fees and taxes). A summary of the Fund's returns compared to the All Ords Index is shown in the table below.

Year Ending	Katana Gross Investment Return	All Ords Index	Outperformance
2006	9.20%	6.90%	2.30%
2007	49.03%	25.36%	23.67%
2008	-6.41%	-15.49%	9.08%
2009	-23.57%	-25.97%	2.40%
2010	24.54%	9.55%	14.99%
2011	19.10%	7.75%	11.35%
2012	-11.19%	-11.25%	0.06%
2013	8.84%	15.47%	-6.63%
2014	26.79%	12.70%	14.09%
2015	-2.28%	1.29%	-3.57%
2016	4.63%	-2.58%	7.21%
<b>Average</b>	<b>8.97%</b>	<b>2.16%</b>	<b>6.81%</b>

The Manager continued to hold between 50-60 individual stock positions and a high level of cash over FY16. The Manager is committed to maintaining a diversified portfolio, which it believes, provides better risk adjusted returns compared to achieving that same outcome with a concentrated portfolio.



The bar chart above illustrates the Manager's track record of outperformance in each of the past eleven years together with its average level of outperformance over this period. The Manager increased the Fund's holdings in large energy and mining stocks in FY16 and reduced its overweight tilt to financials. These changes are represented in the top 10 stocks, which now also include two consumer stocks. All of the top 10 companies have strong balance sheets and produce robust cash flows. The top 10 holdings as at 30 June 2016 are shown below.



## Outlook

The world remains in a low global growth environment despite significant monetary stimulus being injected by many of the world's central banks. Growth in the US economy does appear to be recovering slowly and interest rates should continue to normalise over the next several years. Europe and Japan have implemented very accommodative monetary policy, which has resulted in bond yields trading at negative rates. Despite this, growth in these geographies remains tepid; unemployment is only declining slowly; and inflation remains well below central bank targets. China is trying to rebalance its economy away from fixed asset investment and more towards consumer expenditure and despite it having some success, there is concern over the high level of bad debts in its financial system.

Australia continues to grow at a sub-trend pace with the lower Australian dollar assisting non-mining sectors such as tourism, education and agricultural production as it transitions away from mining investment. Demand is being driven by the emerging middle classes in China and other Asian countries. This region contains some 40% of the world's population and should continue to increase demand for a broad range of products and services for many years to come. As an example, seven of the top 10 sources of Australian inbound tourism are from Asia and there is a similar theme occurring in education. Low interest rates have facilitated strong growth in housing demand although new home approvals are currently peaking. Healthcare services are also growing strongly aided by an ageing population. Volume growth in liquefied natural gas (LNG) and iron ore exports are also partly offsetting the decline in commodity prices.

The low growth environment is providing a tailwind to companies in the form of lower interest rates and lower input costs, which is being partly offset by reduced consumption growth due to an ageing population and lower immigration. In addition, technological change is disrupting traditional business models and in many cases, reducing operating margins. This issue and the associated uncertain outlook has resulted in many companies cutting back on investment and instead simply using any excess funds to pay higher dividends and/or to buy back shares. While this is exactly what shareholders are looking for in the short term, profitability will inevitably decline if this continues over the longer term.

## Strategy

Overall, the Manager believes the stock market will move slightly higher and provide modest total shareholder returns in FY17, boosted by low interest rates; a more reasonably priced Australian dollar; and a gradual improvement in global economic growth.

The Manager has added a few large resource stocks to the portfolio as it believes we have now seen the low in the oil price and potentially other commodity prices, too. It has also increased the Fund's holdings of quality small and mid-cap companies that are able to grow earnings and dividends despite being in a low growth environment and trimmed some of its previous financial positions. The Manager believes that dividends will continue to form a greater part of total shareholder returns in this low growth environment. Although the Manager has recently deployed some of its cash holdings into the stock market, it is likely to maintain higher average cash balances in FY17 as it will only invest valuable shareholder funds when it considers the risk/return equation to be favourable. The Manager believes the share market will continue to experience periods of volatility and will use any weak periods to add to its holdings.

## Corporate

Katana Capital Ltd finished FY16 with 44.7m shares on issue. During the period from 1 July 2015 to 30 June 2016, 753,968 shares were bought back on market and were subsequently cancelled. The shares were acquired at an average price of \$0.80 with the price ranging from \$0.76 to \$0.835 per share. The buyback also provided liquidity and increased the underlying net asset backing for all existing shareholders.

Katana paid four quarterly 1.5 cent dividends, totalling six cents (\$0.06) during FY16. Three of the dividends totalling 4.5c were fully franked and one of 1.5c was 50% franked.

Despite the uncertain environment, the Manager remains committed to outperforming its benchmark and rewarding shareholders with solid dividends.

On behalf of all of the staff at Katana Asset Management, we take this opportunity to once again thank Katana Capital's valued shareholders for your support.

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Investment Managers  
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