HARVEST LANE
ASSET MANAGEMENT

M & A STRATEGY

SEPTEMBER 2016

Objectives	Receive higher bid and/or hidden franking credits
Market Outlook	Bullish or Bearish
Risk Management	Active stop loss on purchase of the stock

Our Strategy

Harvest Lane employs a strategy that involves identifying stocks subject to different corporate actions and purchasing those stocks subject to them meeting our criteria. This is dependent on the view that the opportunity exhibits risk attributes that are positively skewed in our favour. In our experience, these recommendations carry a low risk profile and are usually of a medium term outlook.

The managers of the fund have spent a considerable amount of time and resources researching and refining the edge that they have within this space. Over the years they have found what works and what doesn't and continue to search for and investigate inefficiencies within the market. One part of their strategy involves identifying opportunities that result from a company becoming the subject of a takeover. These takeover bids come in two forms; an off-market or an on market bid and the terms of either deal can vary significantly including the form of consideration (or payment). Some of these deals can include stock in the new company, a cash payment or a combination of the two.

In our experience, once a takeover bid has been announced to the market one of the following can occur.

1. The board of the target company does not accept the offer price. The bidder then offers a higher bid or sometimes multiple bids at an increased premium so that the takeover is eventually accepted; or
2. Multiple companies enter with higher bids, potentially starting a bidding war between the parties, and resulting in a significant increase in the price offered; or
3. The takeover is unsuccessful and the price falls back to around the level it was trading pre bid. Obviously our preference is for outcome 1 or 2. Outcome 3 is a poor outcome but can be avoided by adhering to the following criteria.
4. The Board accepts (or does not accept) the initial bid and the deal completes. Returns or losses from our initial purchase price are therefore minimal.

Risk Management

The risks associated with this strategy vary from trade to trade and depend on the type of takeover and associated conditions. Usually they involve:

- Buying the stock at a large premium to the current offer expecting an increased bid and a higher bid not being announced. This may result in a small loss to your capital
- The board of the target company rejecting the initial offer and/or the bidder fails to secure the percentage of shareholders they are seeking resulting in the offer lapsing or
- A situation arises where other conditions of the offer cannot be met.

The risk therefore is typically limited to a fall in the share price to the level it was trading at before the takeover was announced. On the other hand, it is not guaranteed to fall back to this level and could fall further depending on how the market perceives the news. This is rare and we would like to think that our experience helps us identify the situations where this is likely and to therefore avoid investing in that opportunity.

Below are three case studies that detail the Harvest Lane strategy on a more granular level.

Case Study 1 - Warnambool Cheese and Butter Factory (WCB.ASX)

For the first of our case studies, we'll be examining a series of trades in WCB that we undertook on behalf of our investors, commencing in September 2013.

Followers of Harvest Lane may be familiar with our takeover/merger arbitrage and this particular trade illustrates exactly why we are so fond of it and why it comprises such a significant part of our trading/investment strategy.

By way of background, Warrnambool Cheese and Butter Factory Company (WCB) is an Australian company producing a range of dairy products for domestic and export markets. Its products includes cheese, butter and butter blends, cream and dairy ingredients. Exports comprise of 50% of sales volume, largely to Asian and Middle Eastern markets, plus sales to US, Europe and South America.

On 12 September 2013, WCB shares entered a trading halt (whereby its shares were temporarily halted from trading) pending the release of a market sensitive announcement. The company announced soon thereafter that it had received a binding takeover offer from Bega Cheese Limited (ASX Code: BGA) whereby BGA would offer WCB shareholders 1.2 BGA shares plus $2 cash for every 1 WCB share held.

Prior to the offer, WCB shares had last traded at $4.51. Based on BGA's last traded price of $3.15, the takeover offer implied a value for WCB shares of $5.78 per share - an overnight increase in the value of WCB shares of 28.16% - a nice windfall for existing WCB shareholders. Note however that we were not a shareholder in WCB at the time. We were however soon to become one.

To recap, we are primarily interested in buying shares in target companies (WCB in this instance) whereby the takeover offer is a binding offer, conditions attached to the offer are minimal (or nil) and whereby we are receiving cash (rather than scrip/shares) as part of the offer. We also prefer that the takeover bid not be pitched at too significant a premium to the last sale price of the target (leaving room for an improved bid on valuation grounds) and so too that the target is strategically attractive such that other potential bidders may be attracted to the target. A bid that meets all of these criteria would typically see us take a maximum risk position in the target company. To the extent that these criteria are not met we will either reduce our position size accordingly (such that we have a position that is less than maximum risk) or avoid buying shares in the target company altogether. If we decide to take a position, we are generally prepared to pay slightly more than the bid price (whilst preferring to pay as little as possible) simply because our experience tells us that the first bid is rarely the last and that in the event that one or more improved bids subsequently emerges we will be more than compensated for our initial outlay.

Reviewing the BGA bid for WCB based on the above criteria we found that some but not all of our criteria were met. On the plus side, the bid was binding and the conditions were relatively minimal (with one important exception - see below). It was our belief that WCB was strategically attractive to a number of potential bidders (in particular as it had attracted a takeover bid from another party previously) and the bid premium of 28.16% to the last sale price was within our acceptable range (with anything up to 30% being generally acceptable). On the negative side, the bid was only partly cash (with the balance in BGA shares) and one of the conditions of the bid was that it would require Australian Competition and Consumer Commission (ACCC) approval. In our experience bids requiring the approval of a government agency don't always proceed smoothly and therefore warrant caution.

Taking into account all of the relevant factors, we felt that on balance it was worth taking a less than maximum risk position in WCB and purchased shares at an average price of $5.85 when the stock resumed trading later that morning, noting that the price we paid was slightly above the implied value ($5.78) of BGA's bid.

Over the course of the next three weeks, there was little to be done. Generally, having taken a position in a target company, we determine the level at which we would exit our position if the price starts to move against us (hereafter referred to as a stop loss) and then we simply sit back and await further developments. As it turned out, a significant development wasn't too far away but before we get to that a further comment regarding the use of stop losses is in order.

Case Study 1 - Warnambool Cheese and Butter Factory (WCB.ASX)

The primary purpose of a stop loss is to protect against (additional) loss by determining in advance the point at which a trade should be closed because the investment thesis is broken. In the case of a takeover bid, it stands to reason that in the absence of the bid proceeding, the share price will fall back to its pre-bid levels. Sometimes the share price of the target company will fall to a level that is a little lower than its pre-bid price and sometimes it won't fall quite that far. It would be fair to say that we try to avoid any bid that we believe is likely to fail (and thereby result in the share price of the target company falling to its pre-bid level) however on occasion this is simply not possible. This may occur because we have underestimated or failed to identify a risk factor (thankfully this rarely happens) or because we are aware of the potential for a bid to fail but are of the belief that the potential upside from participating in the trade outweighs the risk we are incurring in taking the trade.

Returning to WCB, for the three or so weeks immediately following the announcement of the BGA bid, the price of WCB crept higher in line with the price of BGA which had also traded higher following the announcement of the bid. Whilst this was a welcome development it also highlights why we generally favour cash bids over scrip bids (i.e. where we will receive shares in lieu of cash for our shares in the target). Whilst in this particular instance the price of BGA had increased post bid announcement it could just as easily have decreased. As we are primarily concerned with protecting our downside in all instances, we would prefer not to be exposed to movements in the share price of the bidder (BGA) in addition to movements in the share price of the target company (WCB). On occasion we will make an exception and on the morning of 8 October 2013 our decision to do so was rewarded when our day started with the (good) news that WCB had received a rival bid from Saputo Inc. - a Canadian listed dairy company - whereby Saputo was proposing to acquire all of the shares in WCB for $7.00 cash per share. This equated to a profit on our initial purchase of 19.65% in just 3 weeks. Importantly though, Saputo's bid had made the opportunity considerably more attractive to us than it had been up until that point. Instead of considering taking some or all of our profits of the table, we were preparing to buy more.

Our rationale was simple. The emergence of Saputo meant that the bidding process was now contested. BGA had earlier shown their intent to acquire WCB and Saputo was now attempting to thwart their efforts with a bid of their own. Additionally, Saputo's bid was all cash (our preference) and as WCB was now clearly 'in play' the emergence of additional bids (or bidders) could not be ruled out. As the business media had been pointing out daily, WCB was strategically attractive given the growing demand within China for Australian sourced dairy products and additionally, WCB's size in relative terms meant that it would not be particularly expensive for a bidder with deep pockets to pay more than $7 per share (and potentially much higher) in order to acquire control of WCB.

Finally, the emergence of the competing bid meant that the likelihood of the WCB share price falling back to its pre-bid levels was much lower than it had been previously as the chance of both bids 'falling over' was very remote.

When the stock re-opened (for trading) we increased our position to 'maximum' risk by purchasing additional shares at $7.22 and then we waited. We didn't have to wait long.

Less than 2 weeks later, Murray Goulburn Co-Op Co. Limited announced that they too would be entering the race for control of WCB, with a $7.50 per share cash offer of their own which they announced on 18 October 2013. This represented an increase of 28.21% on the price we had paid to acquire our initial parcel of WCB shares and an increase of 3.88% on the price we had paid a mere 10 days ago for the remainder of our position. Once more, we couldn't wait to buy more WCB shares when trading resumed. There were now three bidders competing for one asset (i.e. WCB).

Students of economics will be aware that when demand exceeds supply the price of a good or service will generally increase. We were hoping that this theory would hold true. When trading resumed, we added to our position by acquiring further WCB shares at an average price of $7.80.

Eagle eyed readers will have noticed that we already had a 'maximum risk' position in WCB prior to the announcement of Murray Goulburn's $7.50 cash bid and may therefore question how it was possible that we were buying more shares at that time. In essence, our risk management is such that our stop loss level can be (and is) adjusted as new information emerges. The stop is only ever moved upwards thereby ensuring that we never stand to lose more on a trade than we

Case Study 1 - Warnambool Cheese and Butter Factory (WCB.ASX)

had initially intended. This adjustment process ensures that we have less capital at risk in the trade as it starts to work in our favour but so too that we can maximize our profits in the event that further bids emerge. Luckily for us, a new bid was just around the corner.

On the 25 October 2013, Saputo Inc. announced that they would be increasing their offer price to $8.00 per share in response to Murray Goulburn's recent bid. With BGA yet to respond to both Saputo and Murray Goulburn's bids, we were now showing gains of 36.75% on our initial parcel of shares, 10.8% on our second purchase and 2.56% on our most recent purchase. We were of course preparing to buy more at the first available opportunity. Our fourth parcel of WCB was purchased at an average price of $8.41 later that day.

Four days later, WCB shares spiked unexpectedly soon after the market opened. No further bid had been announced and yet a large buyer appeared in the market for WCB shares at a price of $9.25 per share. Whilst a large unexplained buyer is generally a sign of more action to follow, the opportunity to sell part of our holding for a price that was in excess of 10% higher than the price at which WCB shares had been trading just minutes earlier was too good to refuse. Our exit price for half of our holding was at a 57.86% premium to our initial purchase, a 27.91% premium to our second purchase, an 18.4% premium to our third purchase and a premium of 9.81% to our purchase of 4 days earlier.

Later that day, WCB announced that they were unaware of the reason for the sudden spike in the share price. We were able to buy back some of the shares we'd sold earlier for $8.84 (approximately 5% less than what we had just sold them for). It subsequently emerged that the buyer of the shares was Kirin owned Lion Nathan (Lion) who had just paid a significant premium for a seat at the table. Whether they were intending to bid for WCB was not immediately obvious, but the emergence of a fourth entity to the contest was very welcome.

To make things even more interesting, on the 31 October 2013, the ACCC announced that they would not oppose BGA acquiring control of WCB. At that stage, BGA was still yet to respond to the emergence of the additional two bidders so an update from the company (BGA) was keenly anticipated.

Readers will remember that when BGA's initial bid for WCB was announced in September that we had some concerns about the condition of the bid that required BGA to obtain ACCC clearance in order to proceed with their proposed acquisition of WCB shares. That hurdle had now been cleared thereby paving the way for BGA to improve their bid.

Amazingly, nothing much happened for the next 7 days. There were no new bids, no announcement from BGA and so we waited…

On 7 November 2013, BGA released a brief statement to the ASX confirming that the BGA Board of Directors had met to consider whether to revise their offer and that they had not as yet reached a decision. Again, we waited…

On 12 November 2013, the Foreign Investment Review Board (FIRB) announced that they would not oppose Saputo acquiring WCB shares in the event that it was the winning bidder. This condition had previously been of little concern to us as we felt it was largely a foregone conclusion. It was however the catalyst for Murray Goulburn to break the bidding stalemate and on 13 November they announced that they would be increasing their bid.

Their new $9.00 per share cash offer was once again the frontrunner in the race to acquire WCB. When the shares re-opened following the announcement of the revised offer we bought a further parcel of WCB shares at $9.06. At $9.00 per share we were showing a gain of 53.85% on our initial purchase, 26.58% on our second purchase, 12.82% on our third purchase, 7.02% on our fourth purchase and 1.81% on our most recent purchase (not to mention the gain we had already booked on our earlier sale at $9.25).

By this stage, WCB had become our best trade of the year thus far and would take some matching. The action however wasn't over just yet.

On 14 November 2013, BGA increased their offer to 1.5 BGA shares plus $2 cash per share for every 1 WCB share.

Case Study 1 - Warnambool Cheese and Butter Factory (WCB.ASX)

As BGA's own share price had increased substantially (to $4.60) since the time of its initial bid was announced, this increase in BGA's offer kept them in the running to eventually acquire control of WCB although it was looking increasingly likely that they would not be able to match the firepower of either Saputo or Murray Goulburn. For a change, we decided not to buy additional WCB shares. Our position was already such that it comprised a significant percentage of our portfolio and in our view the revised BGA offer didn't constitute much of an 'improvement' in the bigger scheme of things.

Perhaps not surprisingly, it took Saputo all of 24 hours to respond with an improved offer of their own. Not only were they matching Murray Goulburn's offer of $9.00 cash per share but the offer was being structured such that in certain circumstances the offer could become worth up to $9.56 thanks to part of the offer consideration being comprised of fully franked dividend. As the latest Saputo offer was not announced until after trading had finished for that day (rather late on Friday evening in fact) we had the weekend to consider our position. On the one hand we were encouraged by the emergence of yet another increase in the bid price but on the other hand the stock was now trading at a 100% premium to the price at which it had been trading before BGA's initial bid was announced. Both Saputo and Murray Goulburn had deep pockets but they would undoubtedly reach their limit at some stage.

Additionally, Lion had all but confirmed that they were not intending to launch a bid of their own and rather had purchased their stake to protect their commercial interests given that they had an ongoing production contract with WCB which they did not want to be affected when WCB was eventually sold to the highest bidder.

There were some twists and turns yet to play out including an application to the Takeovers Panel (who adjudicates on matters of fairness in takeover proceedings) and a further revision to Saputo's offer whereby shareholders in WCB could expect to receive either $9.20, $9.40 or $9.60 per share depending on the level of ownership Saputo was able to achieve by the offer close date.

Murray Goulburn was not yet content to bow out of proceedings and submitted a revised offer of their own - promising to pay shareholders $9.50 cash per share should their offer ultimately succeed.

During this time we were able to repurchase some shares at $9.06. Within a matter of days we became sellers once more, offloading what remained of our holding at prices ranging from $9.23 to as high as $9.40. The latter price was the level at which Saputo finally gained control of WCB on 13 February 2014 after one of the most intriguing (and exciting) takeover battles that we could remember.

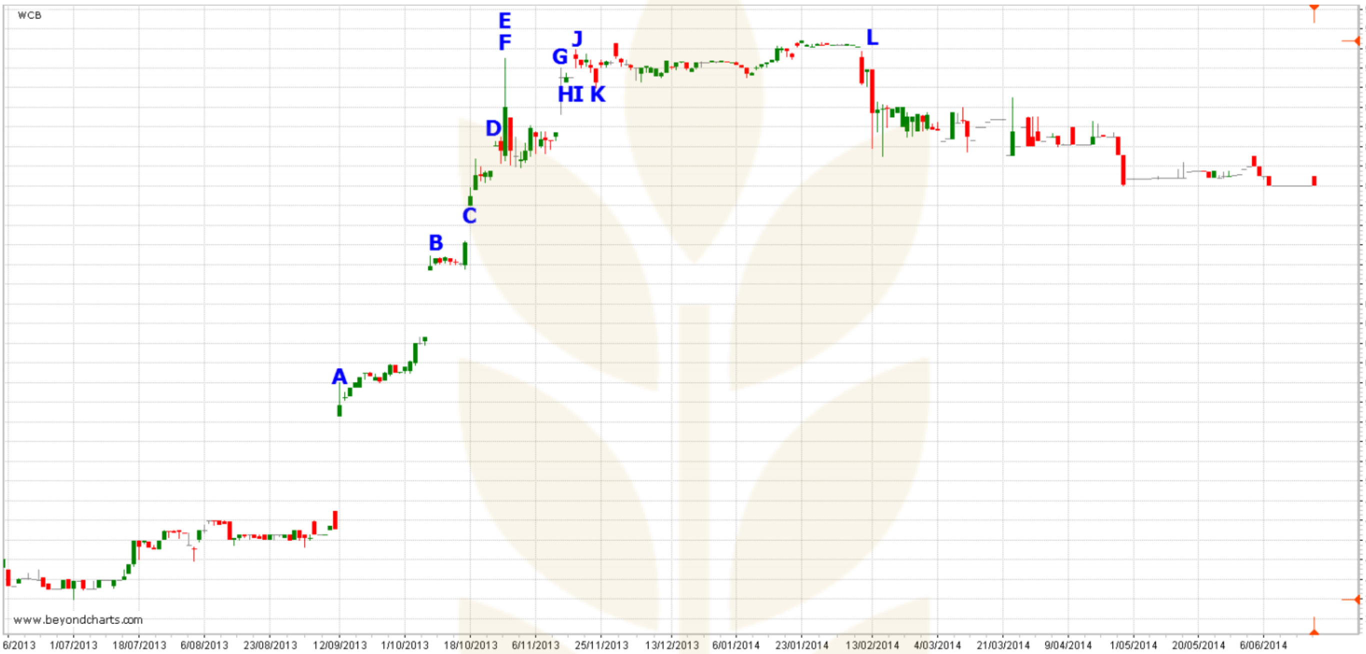
Importantly for our investors, the final sale price of $9.40 was some 60% higher than the price at which we had first purchased WCB shares just 5 month earlier. Lesser (albeit still spectacular) gains were also made on our subsequent purchases - 30.20% on our purchase at $7.22, 20.52% on our purchase at $7.80, 11.77% on our purchase at $8.41, 6.33% on our purchase at $8.84 and 2.65% on our (two) purchases at $9.06.

At this point it is worth making some general comments on why we are such unashamed fans of merger arbitrage. Our intent is never to buy potential takeover targets in advance of a bid because to attempt to do so is too 'hit and miss' for our liking. Instead, we are content to take positions in companies that have already received a bid in anticipation of a higher bid emerging. This does not always happen and in that instance, we will generally exit the position for a small gain or sometimes for a small loss (depending on whether we were able to obtain our initial parcel of shares at a discount to the bid or at a premium). However, as our WCB trade illustrated, more often than not the first bid is not the only bid that emerges and the gains that we stand to make in those situations more than make up for the trades that 'don't work'. Of course, not all of the trades that are 'successful' work out as spectacularly as WCB did but some of them do and there are many others that deliver us returns of 10%, 20% or 30% of our invested capital - compelling returns in anyone's view and particularly so when one considers the amount of capital that is actually 'at risk' in each trade.

Interestingly, at the time that we purchased WCB we had absolutely no idea how the trade would play out. Whilst we always hope that a bidding war will break out we never really know if it will. Sometimes the situations that we expect have the most chance of becoming competitive never play out that way and equally so, those situations where we think

Case Study 1 - Warnambool Cheese and Butter Factory (WCB.ASX)

a counterbid is unlikely frequently surprise us. The great news is that we don't need to know this in advance. All that we need to do is identify situations where this could happen and position ourselves accordingly.



A. Initial BGA bid for WCB announced. Shares purchased at $5.85.
B. First Saputo Inc. bid for WCB announced. Shares purchased at $7.22.
C. First Murray Goulburn bid for WCB announced. Shares purchased at $7.80.
D. Revised Saputo bid announced. Shares purchased at $8.41.
E. WCB shares sold to unknown buyer (later revealed to be Lion Group) at $9.25.
F. WCB shares repurchased at $8.84.
G. Revised Murray Goulburn bid announced. Shares purchased at $9.06.
H. Revised BGA bid announced.
I. Saputo second revised bid announced.
J. WCB shares sold at $9.31.
K. WCB shares purchased at $9.06
L. WCB offer closes. Remaining WCB shares sold at $9.40.

Case Study 2 - Clough Limited (CLO.ASX)

For the second of our case studies, we'll be examining a trade that we undertook in Clough Limited (CLO) in August 2013. Our trade in CLO was also undertaken as part of our takeover/merger arbitrage strategy but the outcome was somewhat different to that of WBC albeit successful.

CLO is an Australia based integrated engineering, procurement and Construction Company. CLO delivers oil and gas projects across Australia, South East Asia and the USA. CLO's services range from concept development through design, construction, installation, commissioning, operations and maintenance.

On 31 July 2013, CLO announced that it had received a conditional proposal from its major shareholder Murray & Roberts Holdings Limited, whereby Murray & Roberts would acquire all of the shares in CLO that it did not already own at a price of$1.46 per share paid in cash (a significant premium to the $1.115 per share that CLO had closed at the previous day).

Interestingly, the $1.46 would comprise of a capital payment of $1.32 per share and a fully franked dividend of $0.14 per share. Franking credits represent tax already paid by a company on behalf of their shareholders. Certain shareholders in income tax brackets lower than the corporate rate of 30% may be eligible to reclaim franking credits as a cash refund for the difference between the 30% corporate rate and their individual marginal rate. For an investor on a tax rate of 0%, for example, the 'grossed up' value of Murray & Roberts offer was in fact $1.52 (as opposed to $1.46) once the value of the franking credits were factored in.

In addition to buying shares in companies that have received an initial takeover bid because we expect that one or more improved bids may be forthcoming, we will on occasion also purchase shares in a target company not because we think that an improved bid will eventuate but because we have identified the trade as being of sufficiently low risk such that we would be willing to allocate capital to it in preference to holding cash. Essentially, we perceive that the risk involved is approaching that of 'cash in the bank' and yet taking the trade will allow us to achieve better than 'cash at bank' returns for the investment period in question.

The excess return available in these situations exists because there is one or more remaining hurdles for the bid to clear before the takeover can be completed. Sometimes this is merely a passing of time, sometimes it's because a shareholder vote is required and sometimes because government approval is required. Each situation must therefore be judged on its merits as sometimes the reward simply doesn't justify the risk involved.

In this particular instance, Murray & Roberts was already holding 61.6% of CLO shares, which in our opinion meant that shareholder approval for the deal to proceed was all but a foregone conclusion. The offer would also require approval from the Foreign Investment Review Board (FIRB). Once more we viewed this as a mere formality given that Murray & Roberts already had effective control of CLO via its existing shareholding in the company. The only other potential 'red flag' was that Murray & Roberts stated their intent to carry out due diligence before formalising their offer. Whilst we did not anticipate Murray & Roberts finding anything untoward as part of its investigative process, we remain wary of any bids that contain such clauses simply because they can provide a convenient 'out' for bidders should they no longer wish to proceed with their offer.

Having weighed all of these factors, we decided to take a less than 'maximum risk' position and purchased a parcel of CLO shares on 1 August 2013 at $1.43 per share. We effectively knew from the outset that a counter bid was unlikely for CLO, following our initial purchase there was little to be done other than wait for Murray & Roberts to confirm that they had completed due diligence and that the offer would either be proceeding or alternatively abandoned.

Thankfully, it was the former and on 29 August, CLO announced that Murray & Roberts had signed a binding Scheme implementation Agreement. With our only real concern now eliminated, we decided to add to our position and purchased additional CLO shares at $1.4375.

Thereafter, we waited a little more as the remaining hurdles (shareholder approval, FIRB clearance and some other regulatory matters) were cleared without incident. We received our $0.14 per share dividend payment and associated

Case Study 2 - Clough Limited (CLO.ASX)

franking credits on 3 December 2013 and the remaining payment of $1.32 in cash approximately one week later.

In total, our gross proceeds amounted to $1.52 including franking credits which equated to a return on investment of a little over 6% in approximately 4 months or approximately 18% annualised - slightly better than the rates currently available for cash held on deposit!. Admittedly, our trade in CLO was not quite as exciting as our other case study candidate - WCB. Nonetheless, as we are in the wealth management business and not the entertainment business we would be only too happy to be regularly presented with trades as 'unexciting' and profitable as CLO proved to be.

A. Murray & Roberts proposal to acquire CLO shares announced. Shares purchased at $1.43.
B. Murray & Roberts scheme becomes effective. Shares sold for $1.52 (including value of franking credits).

Case Study 3 - SAI Global (SAI.ASX)

For the final case study we will examine a trade that we undertook in SAI. Unlike the trades examined in our previous two case studies, our trade in SAI was not profitable. In fact, we lost half a 'risk unit' (a risk unit is the maximum amount that we are ever willing to lose on an individual trade in a 'worst case scenario'). So, why examine a losing trade?

The truth is that losing trades are unavoidable. The Harvest Lane strategy is successful in part because of trades similar to the previous case studies, but also because of a rigid framework that helps minimise the impact of one of these unavoidable losses. The good news is that losing trades need not be terminal; some trades are profitable and some aren't but with the right system there can be plenty of losing trades while significant returns are still made, and the results Harvest Lane has achieved since inception are testament to that. In fact, it would not be an exaggeration to say that we are largely indifferent to the results of our individual trades. We are not particularly upset by losing trades and nor are we particularly excited by profitable trades. Our real satisfaction lies in planning for all circumstances and acting accordingly. If we do that then the returns will take care of itself.

SAI Global Limited (SAI) provides information services and solutions for managing risk, achieving compliance and driving business improvement to organizations. SAI has three main divisions being Assurance, Compliance, and Information Services divisions.

On the 24 May 2014 SAI Global Limited received a conditional, non-binding proposal from Pacific Equity Partners Pty Limited (PEP) to acquire 100% of the shares in SAI for an indicative price of $5.10 to $5.25. The proposal in its current form did not meet enough of our criteria for establishing a position but we decided that we'd keep an eye on it as a possible future trade if the circumstances changed.

As it happened, the circumstances did change and on the 2nd of June the company announced that a number of other parties had approached SAI about a change of control transaction for some or all of its assets. The situation still did not meet all of our preferred criteria however the fact that the company now had multiple parties interested in its assets and the potential for contested bidding among those parties gave us sufficient cause to take a position albeit a smaller size than we otherwise would have had the approaches been more certain. As such, on 2 June 2014 we bought SAI shares at their opening price of $5.10. Recall (from above) that this was at the lower end of the indicative price range announced by PEP. We also placed a stop loss at $4.05 (the price at which the stock was trading immediately prior to the announced approach by PEP).

In purchasing the stock at $5.10, we weren't particularly interested in the prospect of the company receiving a bid in the range of $5.10 to $5.25 despite the fact that a bid at $5.25 would have represented a 3% return on our capital in a relatively short period of time. Rather, we were hoping for an improved bid from one of the other interested parties or PEP themselves. On balance, we felt that the chance of this happening was quite good given the strategic nature of SAI's assets however our reduced position size reflected our concern that not even PEP's approach was binding at that stage and hence we were willing to risk only half of the capital that we would otherwise risk on a trade that met more (or all) of our criteria.

Unfortunately, as time went by and we heard little from the company regarding the progress of its discussions with PEP and others it seemed unlikely that we were going to see an improved bid. In fact, we started to become concerned that we may not see a bid full stop (remembering that PEP's initial approach was non-binding and indicative only). It wasn't until 29 August that SAI announced that they had set a final deadline of 12 September 2014 by which time offers for the whole (or part) of the company must be submitted or else the company would simply continue in its current form and it would be 'business as usual'. This deadline was later extended to the 16 September but unfortunately didn't help secure any offers.

The very next day (17 September 2014) SAI announced to the market that while they did have multiple parties interested in acquiring the underlying business, no final offers had been received that the board considered satisfactory. This was obviously the news we didn't want to hear. The stock reopened at $4.05 (not coincidentally the price at which we had earlier placed our stop loss order) and triggered an exit from the position. This represented a loss of 20.58% on our invested capital for this particular trade but its impact was reduced by our decision to take a smaller position size on

Case Study 3 - SAI Global (SAI.ASX)

entry into the stock. In fact, despite losing 20.58% of the capital that we invested in the trade, we lost only 0.2% of the entire value of our portfolio thereby highlighting the importance of position size in managing risk. When the potential reward is sufficiently large and the odds of success are stacked heavily in our favour then we will generally risk more of our portfolio capital on the trade. When the potential reward is sufficiently large but the odds not as heavily in our favour then we will risk less of our portfolio capital.

We feel at this stage that it is once again worth pointing out the importance of having a plan and sticking with it irrespective of the outcome. Nobody likes losing money and when SAI announced that they had not received a satisfactory offer it can be tempting to justify holding the position in the hope that an offer for the company does eventually emerge and that the stock price recovers accordingly. Or worse still, despite having entered the trade only because of the company's potential imminent sale, then deciding to make it a long term hold on the basis that SAI is 'a good company'. 'Hope' is not a strategy and SAI may very well be a good company, but we didn't buy the stock initially because it was a good company. We bought it for a takeover that failed to eventuate. As such, we no longer have any basis for holding the stock. Interestingly (and it won't always be the case), 3 months after exiting the trade, SAI proceeded to trade at $3.70 i.e. a further 10% below our exit price, after reaching a low of $3.55. If we were still holding the stock we would be sitting on a an even larger loss than that which we sustained at the time and that doesn't take into account any other opportunities that we may since have missed as a result of having capital tied up in the trade thereby preventing us from taking other trades that fit our criteria and have a greater chance of success.

Losses are a part of trading. Being able to take a loss, move on and think about the bigger picture is of paramount importance. Consistently profitable trading happens when you find a strategy that works and stick to it.

A. Entered the original position after it was announced that multiple parties were involved at $5.10
B. Exited the position after our stop loss of $4.05 was hit.

Harvest Lane Asset Management Overview

Harvest Lane Asset Management Absolute Return Fund (Fund) is a high conviction absolute return fund which aims to produce high absolute returns using a conservative yet nimble investment approach. The Fund has a strong focus on preservation of capital and its trades have almost no dependence on traditional asset class returns.

The Fund invests very selectively in stocks subject to special circumstances, which the manager believes have limited risk of capital loss and a skew towards positive returns. In practice, the Fund takes advantage of merger arbitrage opportunities and capital raisings in a highly selective manner – and only when its assessment is that these represent a strong risk/return trade-off.

Given its low correlation with other investments and a focus on absolute returns, the Fund may be used in conjunction with other investments as part of a defensive portfolio allocation. Alternatively, it can be used as a standalone lower risk alternative to growth investments.

Considering the Funds strategy identifies a large number of opportunities that include fully franked dividends, the Fund may also suit self managed superfunds and other low tax paying entities depending on their investment objectives.

The manager only charges a performance fee on returns above cash and in the event that the Fund underperforms its benchmark, Harvest Lane Asset Management receives no other payment from investors in the Fund. Management fees go to pay costs and service providers such as Fundhost. The principals of the Fund, and their friends and family are also heavily invested in the Fund which further aligns the interests of its staff with that of its investors.

Disclaimer