WENTWORTH
WILLIAMSON

As you are aware, the objective of the Wentworth Williamson Fund (the Fund) is to generate superior returns to our competitors over the long term by acquiring a select portfolio of value-driven investments. We aim to protect our clients principal while growing capital well above the prevailing cash rate over the medium to long term.

A REMINDER - INVESTMENT APPROACH

The prices of shares tend to vary far more than the value of the underlying businesses. Some of the factors that contribute to this are:

- General market sentiment towards equity investments as a category
- Management changes
- Country-specific issues
- The market taking the view that the business model is broken (at least in the short term) or conversely over optimistic expectations and
- Lack of sell-side research due to size or free float in the shares of the company.

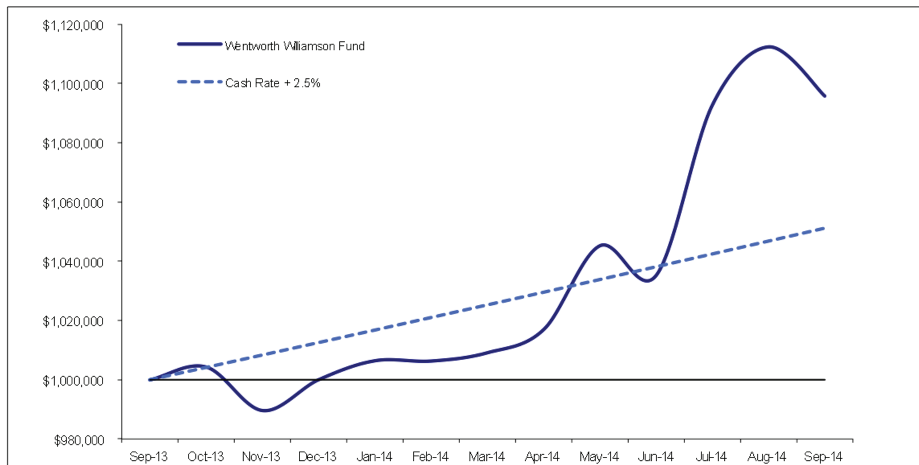
We aim to invest in companies that in our view fall below their underlying value (often for the reasons mentioned above) and sell when the price rises above our assessment of fair value.

The key aspect of our investment process is determining the underlying or intrinsic value of the businesses we evaluate. We therefore spend a great deal of time developing differentiated information that helps us determine the intrinsic value of a target company. This involves rigorous research and analysis of the industry and competitors, in order to construct a detailed picture of the dynamics of the market and investment being reviewed.

By not limiting ourselves to any market capitalisation size or sector and by allocating more time to research and investing (rather than trading) we believe this strategy gives us a structural competitive advantage to generate returns in excess of our benchmark.

The current composition of the portfolio is set out in the Appendix on page 5.

ONE YEAR LATER



Our fund increased 9.4% in its first year net of all fees. Arguably a reasonable outcome considering this return outperformed our benchmark (cash rate plus 2.5%), S&P/ASX 300 Accumulation Index and S&P/ASX Small Ords Accumulation Index by 4.0%, 5.1% and 9.4% respectively. The cash rate plus 2.5% proved to be a tougher hurdle than many other alternatives we considered at the inception of the Fund. At the end of the day, we are in the business of generating above average returns (net of all fees) at acceptable levels of risk for our clients and ourselves over the long term.

During the year approximately a third of the Fund remained in cash, this despite the fact we know we cannot exceed our hurdle by simply holding this low returning asset class. We have always maintained that if we cannot find suitable investments in the stock market we are more than happy to sit on the sidelines and wait for opportunities to emerge, capital preservation is very important to us. During periods of stock market weakness, cash offers us a tremendous level of optionality to deploy our capital in existing or new companies at lower prices.

During the month of September our Fund declined -1.7%, this was much less than the -5.4% decrease posted for the S&P/ASX 300 Accumulation Index. In addition, last month we initiated the purchase of a new investment for the Fund, that's a story for another day assuming we continue to increase our exposure. In this report we elaborate on our investment case for our largest equity investment, Australian Vintage Limited.

THIS IS THE TIME: AUSTRALIAN VINTAGE LIMITED

Supply responses in the wine industry are very long; there are lengthy periods of boom times and investor enthusiasm which eventually leads to a supply side response which drags the industry down into a prolonged period of oversupply and disillusioned investors (some characteristics shared with the resources industry). After many years of oversupply we believe we are finally entering the early stages of a new phase in the wine supply / demand dynamic both in Australia and abroad – bring on Australian Vintage Limited (AVG).

AVG is one of Australia's largest wine producers crushing approximately 8% of the total Australian wine crush, selling over 100m litres of wine into domestic and international wine markets. The business is mostly a product of a merger between Brian McGuigan Wines Limited and Simeon Wines Limited in 2002. During the previous 'good times' the Group bolted on the Miranda Wine Group in 2003 and the Nepenthe brand in 2006.

Source: ASX

The share price performance of AVG the past decade has been nothing short of truly terrible. In 2005 AVG traded above $5, today the stock price is ~40cps. The perfect storm for Australian Vintage the past decade included the following; 1) global wine oversupply; 2) domestic wine oversupply; 3) strong Australian currency; 4) consolidating retail channels; 5) high gearing levels and 5) onerous long term grape supply contracts.

It's interesting how tough times focus the mind! Today branded wine sales represent over 65% of profits (mostly from the McGuigan brand), up from ~30% in 2005. McGuigan is now the sixth largest wine brand in the UK and remains the number one brand in Ireland. To give you an idea of the leverage of AVG to a lower A$, ~90% of McGuigan sales volume is sold overseas. Current momentum remains strong (the brand grew 11% last fiscal year) and the long term prospects look very promising. A weaker $A will not only benefit profitability of the existing business platform but will open up new markets for the Group. We believe it is just a matter of time before we see the McGuigan brand distributed and sold in the United States. Furthermore, the recently signed distribution agreement with COFCO Wine and Spirits Co Ltd in China, a company with one of the strongest distribution networks, will significantly enhance McGuigan sales in that country. As added interest, McGuigan was selected as the Australian brand of choice for the COFCO international wine portfolio over a number of other iconic brands from the region.

The capital structure of AVG has been another beneficiary of management focus in recent times. Net debt has declined from $178m in 2005 to $112m in 2014. The recent $39.5 (net) capital raising put a healthy dent in debt levels and the Yaldara winery sale (47Ha of land plus1847 brand) for $15.5m will further reduce gearing and enhance earnings. Completion of the sale is expected before Calendar year-end. Current debt levels of ~$100m should be seen in context of gross tangible assets of $425m including another 962Ha of land and $191m of inventories at cost. AVG is trading on a price to net tangible assets (P/NTA) of only 0.4x.

An area that has been a significant drag on cash flow in recent years, but where we are likely to see significant benefits to shareholders in the future, relates to onerous grape supply contracts. AVG is currently contracted to buy in ~30,000 tonnes of grapes at prices way above market prices. During 2009 AVG raised a provision of $76.6m with the intention of bringing the contracts to break-even on the Income Statement for the duration of the agreements. The magnitude of the out-of-the-money contracts should be viewed in the context of the entire AVG market capitalisation of $92m. The good news is that we no longer have to wait so long for the contracts to expire, the bulk expire in vintage 2016 (V16). We are likely to see a significant cash benefit in FY16 with a lagged positive effect on the income statement in the following year.

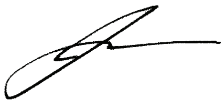
The AVG return on tangible equity (ROTE) of 4% and P / NTA of 0.4x are significantly below long term averages and suggest significant upside to normalised returns. Over 18 years the average ROTE is ~8%, which is a fair reflection of normal returns in our opinion. Over the next couple of years we believe AVG will improve returns from further growth in branded wine sales, a weaker A$ and the expiry of onerous grape supply contracts. At trough earnings AVG is trading on a FY15F Price/Sales, EV/EBITDA and PER multiples of 0.4x, 6.6x and 8.8x. In addition, AVG is due to pay a 2.2 cps fully franked dividend later this year, on every measure AVG looks like terrific value to us!

LOOKING FORWARD

It's highly unlikely you will find our investments in well-presented good news stories with a strong investor following that always seems to find a way to explain lofty valuation multiples. We are in the business of looking for mispriced assets in the share market that will make us money. Over the years Geoff and I have been successful investing in two areas of the market: Firstly, we have exploited opportunities in stocks that have been oversold as they have disappointed (or more ideally embarrassed) investors the most in recent years. Many of these companies attract the attention of short sellers; UGL and TSE are recent examples of ours. The second area we have invested in is small to mid-sized companies that are not actively followed by sell side researchers and institutional funds due to low free float or liquidity. AVG is a prime example of this investment strategy.

We will invariably have many challenges on this journey; it's the nature of the business. However, we intend to stick to our discipline and invest within our areas of expertise, which will likely lead to better performance than most over the long term.

Yours faithfully,



James Williamson
Fund Manager

APPENDIX

The Fund's Portfolio (unaudited)

As at 30 September 2014

Company Name	% of Fund
Beverages	7.4%
Real Estate Investment Trusts	7.2%
Industrial Services	6.7%
Food & Staple Retailing	6.6%
Industrial Services	6.3%
Consumer Discretionary	6.1%
Real Estate Services	5.8%
Consumer Apparel	5.7%
Consumer Discretionary	5.7%
Materials	5.3%
Other investments	7.3%
Total Equity Exposure	**70.1%**
Net Cash	29.9%
Total	**100**%

COMPANY NAMES ONLY AVAILABLE TO UNIT HOLDERS

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