

K2 Australian Small Cap Fund

ARSN 166 480 584

Interim report

For the half-year ended 31 December 2015

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This interim report does not include all the notes of the type normally included in an annual financial report. Accordingly, this report should be read in conjunction with the annual report for the year ended 30 June 2015 and any public announcements made in respect of K2 Australian Small Cap Fund during the interim reporting period in accordance with the continuous disclosure requirements of the *Corporations Act 2001*.

Directors' report

The directors of K2 Asset Management Ltd (ABN 95 085 445 094), the Responsible Entity of K2 Australian Small Cap Fund, present their report together with the financial report of K2 Australian Small Cap Fund (the "Fund") for the half-year ended 31 December 2015 and the auditor's review report thereon.

Principal activities

The Fund continued to invest in accordance with target asset allocations as set out in the current Product Disclosure Statement and in accordance with the provisions of the Fund's Constitution.

The Fund did not have any employees during the half-year. During the half-year the Fund was admitted to trading status on the ASX under the AQUA Rules (ASX code: KSM). The units of the Fund commenced trading on the ASX on 15 December 2015.

There were no other significant changes in the nature of the Fund's activities during the half-year.

The Fund is a registered managed investment scheme domiciled in Australia.

Directors

The following persons held office as directors of K2 Asset Management Ltd during the half-year or since the end of the half-year and up to the date of this report:

Campbell W Neal
Mark S Newman
Robert C Hand
Hollie A Wight

Service providers

The Responsible Entity and Investment Manager of the Fund is K2 Asset Management Ltd.

The Custodians of the Fund are Morgan Stanley & Co International Plc and State Street Australia Limited.

The Administrator of the Fund is State Street Australia Limited.

The Unit Registry service provider of the Fund is Boardroom Pty Limited.

The registered office and principal place of business of the Responsible Entity and the Fund is level 32, 101 Collins Street, Melbourne, Victoria, 3000.

Review and results of operations

The Fund maintains its long/short investment strategy in Small Cap listed equities and other investment instruments in Australia and New Zealand permitted by the Fund's Constitution.

The investment policy of the Fund continues to be that detailed in the current Product Disclosure Statement and in accordance with the provisions of the constitution of the Fund.

Directors' report (continued)

Review and results of operations (continued)

Results

The performance of the Fund, as represented by the results of its operations, was as follows:

	Half-year ended	
	31 December 2015	31 December 2014
Operating profit/(loss) before finance costs attributable to unitholders (\$'000)	2,193	426

Distributions

Distributions paid and payable (\$'000)	-	-
Distribution (dollars per unit)	-	-

Net Asset Value (NAV) per unit

NAV per unit are shown as follows:

	2015	2014
	\$	\$
At 31 December	2.53	117.36

In preparation for the Fund being admitted to trading status on the ASX under the AQUA rules, effective 1 December 2015, a unit split transaction was processed to convert the unit price of the Fund from \$134.64 to \$2.50. For further information on this transaction, please refer to Note 3.

Significant changes in state of affairs

In the opinion of the directors, there were no significant changes in the state of affairs of the Fund that occurred during the financial half-year under review.

Likely developments and expected results of operations

The results of the Fund's operations will be affected by a number of factors, including the performance of investment markets in which the Fund invests. Investment performance is not guaranteed and future returns may differ from past returns. As investment conditions change over time, past returns should not be used to predict future returns.

Further information on likely developments in the operations of the Fund and the expected results of those operations have not been included in this report because the Responsible Entity believes it would be likely to result in unreasonable prejudice to the Fund.

Rounding of amounts to the nearest thousand dollars

The Fund is an entity of the kind referred to in Class Order 98/100 (as amended) issued by the Australian Securities and Investments Commission (ASIC) relating to the "rounding off" of amounts in the Directors' report and financial statements. Amounts in the Directors' report and financial statements have been rounded to the nearest thousand dollars in accordance with that Class Order, unless otherwise indicated.

Directors' report (continued)

Lead Auditor's Independence Declaration

A copy of the Lead Auditor's Independence Declaration as required under section 307C of the *Corporations Act 2001* is set out on page 5.

This report is made in accordance with a resolution of the directors of K2 Asset Management Ltd.



Hollie A Wight
Director

Melbourne
10 February 2016



Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To: the directors of K2 Asset Management Ltd, the Responsible Entity of K2 Australian Small Cap Fund

I declare that, to the best of my knowledge and belief, in relation to the review for the half-year ended 31 December 2015 there have been:

- (i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the review; and
- (ii) no contraventions of any applicable code of professional conduct in relation to the review.

KPMG

KPMG

A handwritten signature in blue ink, appearing to read 'Dean Waters', with a stylized flourish at the end.

Dean Waters
Partner

Melbourne

10 February 2016

Statement of comprehensive income

	Notes	Half-year ended	
		31 December 2015 \$'000	31 December 2014 \$'000
Investment income			
Interest income		4	76
Dividend and distribution income		311	145
Net gains/(losses) on financial instruments held at fair value through profit or loss		3,017	789
Net foreign exchange gains/(loss)		(155)	(84)
Other operating income		-	1
Total Investment income		<u>3,177</u>	<u>927</u>
Expenses			
Responsible Entity's fees	6	8	5
Management fees	6	241	178
Auditor's remuneration		4	17
Transaction costs		27	16
Performance fees	6	592	172
Administrative expenses		83	60
Other operating expenses		29	53
Operating expenses before finance costs		<u>984</u>	<u>501</u>
Profit/(loss) from operating activities		<u>2,193</u>	<u>426</u>
Finance costs attributable to unitholders			
Distributions to unitholders		-	-
Change in net assets attributable to unitholders (total comprehensive income)	3	<u>2,193</u>	<u>426</u>

The above statement of comprehensive income should be read in conjunction with the accompanying notes.

Statement of financial position

		As at	
	Notes	31 December 2015 \$'000	30 June 2015 \$'000
Assets			
Cash and cash equivalents	4	3,886	5,760
Receivables		435	64
Due from brokers - receivable for securities sold		-	603
Financial assets held at fair value through profit or loss	5	<u>24,729</u>	<u>15,501</u>
Total assets		<u>29,050</u>	<u>21,928</u>
Liabilities			
Bank overdrafts	4	2,188	2,358
Payables		141	105
Performance fee payable		567	340
Due to brokers - payable for securities purchased		-	118
Distributions payable		<u>-</u>	<u>668</u>
Total liabilities (excluding net assets attributable to unitholders)		<u>2,896</u>	<u>3,589</u>
Net assets attributable to unitholders - liability	3	<u>26,154</u>	<u>18,339</u>

The above statement of financial position should be read in conjunction with the accompanying notes.

Statement of changes in equity

The Fund's net assets attributable to unitholders are classified as a liability under AASB 132 *Financial Instruments: Presentation*. As the Fund has no equity, the Fund has not presented any items of changes in equity for the current or comparative period.

Statement of cash flows

	Half-year ended	
	31 December 2015	31 December 2014
Notes	\$'000	\$'000
<i>Cash flows from operating activities</i>		
Dividends and distributions received	327	135
Interest received	2	76
Other income received	4	1
Responsible Entity's fees paid	(7)	(5)
Management fees paid	(230)	(171)
Performance fees paid	(365)	(287)
Payment of other operating expenses	(112)	(147)
Net foreign exchange gain/(loss)	17	(5)
Net cash inflow/(outflow) from operating activities	(364)	(403)
<i>Cash flows from investing activities</i>		
Proceeds from sale of financial instruments held at fair value through profit or loss	7,390	7,466
Purchase of financial instruments held at fair value through profit or loss	(13,116)	(12,371)
Net cash inflow/(outflow) from investing activities	(5,726)	(4,905)
<i>Cash flows from financing activities</i>		
Proceeds from applications by unitholders	6,133	3,181
Payments for redemptions by unitholders	(1,245)	(477)
Distributions paid	(330)	(161)
Net cash inflow/(outflow) from financing activities	4,558	2,543
Net increase/(decrease) in cash and cash equivalents	(1,532)	(2,765)
Cash and cash equivalents at the beginning of the half-year	3,402	5,961
Effects of foreign currency exchange rate changes on cash and cash equivalents	(172)	(79)
Cash and cash equivalents at the end of the half-year	1,698	3,117
4		

The above statement of cash flows should be read in conjunction with the accompanying notes.

Contents of the notes to the interim financial statements

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1 Basis of preparation of interim report

This interim report covers K2 Australian Small Cap Fund (the "Fund") as an individual entity which is a registered managed investment scheme under the *Corporations Act 2001* and was admitted to trading status on the ASX under the AQUA Rules on 15 December 2015. The Fund was registered with ASIC as a registered managed investment scheme on 11 November 2013 and began operations on 2 December 2013. The Fund will terminate on 12 November 2093 unless terminated earlier in accordance with the provisions of the Fund's Constitution.

The Responsible Entity of the Fund is K2 Asset Management Ltd (the "Responsible Entity"). The Responsible Entity's registered office is Level 32, 101 Collins Street, Melbourne, VIC 3000. The financial statements are presented in Australian currency.

These general purpose financial statements for the half-year ended 31 December 2015 have been prepared in accordance with the *Corporations Act 2001* and Australian Accounting Standard AASB 134 *Interim Financial Reporting*.

This interim report does not include all the notes of the type normally included in an annual financial report. Accordingly, this report is to be read in conjunction with the annual report for the year ended 30 June 2015 and any public announcements made in respect of K2 Australian Small Cap Fund during the interim reporting period in accordance with the continuous disclosure requirements of the *Corporations Act 2001*.

This interim report was authorised for issue by the directors on 10 February 2016.

The accounting policies adopted are consistent with those of the previous financial year and corresponding interim reporting period. There have been no significant changes in the risk management policies and processes of the Fund since previous financial year end.

2 Fair value measurement

The Fund measures and recognises the following assets and liabilities at fair value on a recurring basis:

- Financial assets / liabilities at fair value through profit or loss (see note 5)
- Financial assets / liabilities held for trading (see note 5)

The Fund has no assets or liabilities measured at fair value on a non-recurring basis in the current reporting period.

AASB 13 requires disclosure of fair value measurements by level of the following fair value hierarchy:

- quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1);
- inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly (level 2); and
- inputs for the asset or liability that are not based on observable market data (unobservable inputs) (level 3).

(i) Fair value in an active market (level 1)

The fair value of financial assets and liabilities traded in active markets is based on their quoted market prices at the end of the reporting period without any deduction for estimated future selling costs.

The Fund values its investments in accordance with the accounting policies set out in note 2 to the annual report. For the majority of its investments, the Fund relies on information provided by independent pricing services for the valuation of its investments.

The quoted market price used for financial assets and financial liabilities is the last traded price. When the Fund holds derivatives with offsetting market risks, it uses last traded prices as a basis for establishing fair values for the offsetting risk positions and applies this last traded prices to the net open position, as appropriate.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

2 Fair value measurement (continued)

(ii) Fair value in an inactive or unquoted market (level 2 and level 3)

The fair value of financial assets and liabilities that are not traded in an active market is determined using valuation techniques. These include the use of recent arm's length market transactions, reference to the current fair value of a substantially similar other instrument, discounted cash flow techniques, option pricing models or any other valuation technique that provides a reliable estimate of prices obtained in actual market transactions.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate at the end of the reporting period applicable for an instrument with similar terms and conditions.

For other pricing models, inputs are based on market data at the reporting date. Fair values for unquoted equity investments are estimated, if possible, using applicable price/earnings ratios for similar listed companies adjusted to reflect the specific circumstances of the issuer.

The fair value of derivatives that are not exchange traded is estimated at the amount that the Fund would receive or pay to terminate the contract at the reporting date taking into account current market conditions (volatility and appropriate yield curve) and the current creditworthiness of the counterparties. The fair value of a forward contract is determined as a net present value of estimated future cash flows, discounted at appropriate market rates as at the valuation date. The fair value of an option contract is determined by applying the Black Scholes option valuation model.

The output of a model is always an estimate or approximation of a value that cannot be determined with certainty, and valuation techniques employed may not fully reflect all factors relevant to the positions the Fund holds. Valuations are therefore adjusted, where appropriate, to allow for additional factors including liquidity risk and counterparty risk.

Recognised fair value measurements

The following table presents the Fund's assets and liabilities measured and recognised at fair value as at 31 December 2015 and 30 June 2015.

As at 31 December 2015	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Financial assets				
Financial assets held for trading:				
Derivatives	55	-	-	55
Financial assets designated at fair value through profit or loss:				
Listed equities	<u>24,674</u>	<u>-</u>	<u>-</u>	<u>24,674</u>
Total	<u>24,729</u>	<u>-</u>	<u>-</u>	<u>24,729</u>

2 Fair value measurement (continued)

Recognised fair value measurements (continued)

As at 30 June 2015	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Financial assets				
Financial assets held for trading:				
Derivatives	174	-	-	174
Financial assets designated at fair value through profit or loss:				
Listed equities	<u>15,327</u>	<u>-</u>	<u>-</u>	<u>15,327</u>
Total	<u>15,501</u>	<u>-</u>	<u>-</u>	<u>15,501</u>

The Fund's policy is to recognise transfers into and transfers out of fair value hierarchy levels as at the end of the reporting period.

(i) Transfers between levels

There have been no transfers between levels in the fair value hierarchy for the half-year ended 31 December 2015. There were also no changes made to any of the valuation techniques applied as of 30 June 2015.

(ii) Fair value measurements using significant unobservable inputs (level 3)

The Fund did not hold any financial instruments with fair value measurements using significant unobservable inputs during the half-year ended 31 December 2015 or year ended 30 June 2015.

(iii) Valuation processes

Portfolio reviews are undertaken regularly by management to identify securities that potentially may not be actively traded or have stale security pricing. This process identifies securities which possibly could be regarded as being level 3 securities.

Further analysis, should it be required, is undertaken to determine the accounting significance of the identification. For certain security types, in selecting the most appropriate valuation model, management performs back testing and considers actual market transactions. Changes in allocation to or from level 3 are analysed at the end of each reporting period.

(iv) Fair values of other financial instruments

The Fund did not hold any financial instruments which were not measured at fair value in the statement of financial position. Due to their short-term nature, the carrying amounts of receivables and payables are assumed to approximate their fair value.

3 Net assets attributable to unitholders

Movements in number of units and net assets attributable to unitholders during the half-year/year were as follows:

	Half-year ended/year ended			
	31 December 2015	30 June 2015	31 December 2015	30 June 2015
	No. '000	No. '000	\$'000	\$'000
Opening balance	149	125	18,339	13,993
Applications - Pre ASX Quotation	72	41	5,839	4,988
Redemptions - Pre ASX Quotation	(40)	(18)	(1,245)	(2,285)
Unit Split - New Units Issued	9,894	-	-	-
Applications - Post ASX Quotation	274	-	690	-
Redemptions - Post ASX Quotation	-	-	-	-
Units issued upon reinvestment of distributions	3	1	338	130
Increase/(decrease) in net assets attributable to unitholders	-	-	2,193	1,513
Closing balance	10,352	149	26,154	18,339

In preparation for the quotation of the Fund on the ASX under the AQUA rules on 15 December 2015, effective 1 December 2015, a unit split transaction was processed to convert the unit price of the Fund from \$134.64 to \$2.50. This resulted in an additional 9,893,556 units being issued to investors.

As stipulated within the Fund's Constitution, each unit represents a right to an individual share in the Fund and does not extend to a right to the underlying assets of the Fund. There are no separate classes of units and each unit has the same rights attaching to it as all other units of the Fund.

4 Cash and cash equivalents

	As at	
	31 December 2015	30 June 2015
	\$'000	\$'000
Cash at bank	3,886	5,760
	<u>3,886</u>	<u>5,760</u>

Reconciliation to cash at the end of the half-year

The above figures are reconciled to cash at the end of the financial half-year as shown in the statement of cash flows as follows:

	As at	
	31 December 2015	30 June 2015
	\$'000	\$'000
Balances as above	3,886	5,760
Bank overdrafts	(2,188)	(2,358)
Balances per statement of cash flows	<u>1,698</u>	<u>3,402</u>

5 Financial assets held at fair value through profit or loss

	As at	
	31 December 2015	30 June 2015
	\$'000	\$'000
Held for trading		
Derivatives	55	174
Total held for trading	55	174
Designated at fair value through profit or loss		
Australian equity securities	22,330	13,074
New Zealand equity securities	2,344	2,253
Total designated at fair value through profit or loss	24,674	15,327
Total financial assets held at fair value through profit or loss	24,729	15,501

6 Related party transactions

Transactions and balances with related parties

Transactions with K2 Asset Management Ltd in its role as a Responsible Entity and Investment Manager have taken place at arm's length and in the ordinary course of business. The transactions during the half-year/year were as follows:

	31 December 2015	30 June 2015
	\$	\$
Management fees expense for the financial half-year/year	241,149	371,049
Performance fees expense for the financial half-year/year	592,078	557,492
Responsible Entity's fees expense for the financial half-year/year	7,515	11,939
Management fees payable at the end of each financial half-year/year	44,428	32,513
Performance fees payable at the end of each financial half-year/year	567,012	340,361
Responsible Entity's fees payable at the end of each financial half-year/year	1,280	1,142

For further information please refer to the Product Disclosure Statement.

There have been no significant changes to the related parties transactions disclosed in the annual report for the half-year ended 31 December 2015.

7 Events occurring after the reporting period

No significant events have occurred since the end of the reporting period which would impact on the financial position of the Fund disclosed in the statement of financial position as at 31 December 2015 or on the results and cash flows of the Fund for the half-year ended on that date.

8 Contingent assets and liabilities and commitments

There are no outstanding contingent assets, liabilities or commitments as at 31 December 2015 and 30 June 2015.

Directors' declaration

In the opinion of the directors of the Responsible Entity:

- (a) the financial statements and notes set out on pages 6 to 15 are in accordance with the *Corporations Act 2001*, including:
 - (i) complying with Australian Accounting Standards AASB 134 *Interim Financial Reporting*, the *Corporations Regulations 2001* and other mandatory professional reporting requirements;
 - (ii) giving a true and fair view of the Fund's financial position as at 31 December 2015 and of its performance for the financial half-year ended on that date; and
- (b) there are reasonable grounds to believe that the Fund will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the directors and on behalf of the Responsible Entity.



Hollie A Wight
Director

Melbourne
10 February 2016



Independent auditor's review report to the unit holders of K2 Australian Small Cap Fund

Report on the financial report

We have reviewed the accompanying interim financial report of K2 Australian Small Cap Fund, (the Scheme) which comprises the statement of financial position as at 31 December 2015, the statement of comprehensive income and statement of cash flows for the interim period ended on that date, notes 1 to 8 comprising a summary of significant accounting policies and other explanatory information and the directors' declaration of the Scheme.

Directors' responsibility for the interim financial report

The directors of the K2 Asset Management Limited (the Responsible Entity) are responsible for the preparation of the interim financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the interim financial report that is free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express a conclusion on the interim financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the interim financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the Scheme's financial position as at 31 December 2015 and its performance for the interim period ended on that date; and complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As auditor of K2 Australian Small Cap Fund, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of an interim financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Independence

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*.



Conclusion

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the interim financial report of K2 Australian Small Cap Fund is not in accordance with the *Corporations Act 2001*, including:

- (a) giving a true and fair view of the Scheme's financial position as at 31 December 2015 and of its performance for the interim period ended on that date; and
- (b) complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*.

KPMG

KPMG

A handwritten signature in blue ink, appearing to read 'Dean Waters', with a stylized flourish at the end.

Dean Waters
Partner

Melbourne

10 February 2016