Flinders Emerging Companies Fund

Monthly Update: February 2018

FLINDERS
Investment Partners

Performance *(after all fees and expenses)*	1 Month (%)	3 Months (%)	FYTD (%)	1 Year (%)	Since Inception^ (% pa)
Flinders Emerging Companies Fund	1.3%	7.2%	26.5%	22.4%	16.9%
S&P/ASX Small Ords Accumulation Index	0.0%	2.7%	18.1%	20.8%	18.4%
Net Value Added	**1.3%**	**4.5%**	**8.4%**	**1.6%**	**-1.5%**

^ Inception date is 30 September 2015. Past performance is no indicator of future performance. Information relates to the Flinders Emerging Companies Trust Class B.

Investment Objective
Exceed S&P/ASX Small Ordinaries Accumulation Index by 3% pa (after-fees) over rolling 3 year periods

Investment Time Frame
5 years

Portfolio Managers
Andrew Mouchacca and Richard Macdougall

Risk Profile
High

Distribution Frequency
Half Yearly

Minimum Investment
$25,000

Inception Date
30 September 2015

APIR Code
ETL0449AU

M-Funds Availability
Code FEC01

Responsible Entity
Equity Trustees Ltd

Research Ratings
Lonsec: Investment Grade
IRR: Recommended
Zenith: Approved

Platform Availability
MLC, Netwealth, Powerwrap, HUB24, Macquarie Wrap

Further Information
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- **Aussie small caps resilient, despite global volatility**
- **Interim profit reporting period solid**
- **Growth continues to outperform**

Market

Despite the significant lift in market volatility during the month, the small ords index was unchanged over February. Resources (+0.4%) outperformed industrials (-0.1%) despite generally lower commodity prices.

The Australian equity market performed much better than its global peers (the S&P500 index in the US down 3.9% vs the ASX200 Index down 0.4%). The month was characterised by a sharp rise in volatility as markets sold off in the first week then partially recovered. The Australian dollar eased, finishing the month at US$0.7763. Commodities were weaker with gold falling 2%, WTI Oil down almost 5% and base metals softer.

Results from the interim profit reporting season were encouraging. A combination of cost control and a solid economic backdrop meant that profit forecasts remained intact. Although poorer results resulted in stocks dropping sharply, the market responded well to a positive growth outlook – a different dynamic to the same time last year.

Portfolio

The Fund had a positive month returning +1.3%, outperforming the benchmark by +1.3%.

Key Contributors: Telco and utilities engineer and service provider**, Service Stream (+22.1%)** released an excellent interim profit report but also outlined future growth opportunities and announced a share buyback. SSM has been one of our larger holdings for a couple of years, so its continued growth is very pleasing. After a period of consolidation following an acquisition and capital raising, **Webjet (+16.1%)** also released a strong profit result. It confirmed growth in almost all parts of its business and its international hotels bookings operation is going from strength to strength. Late last year we added **Corporate Travel Management (+25.7%)** to the Fund. The stock had fallen sharply following the CEO selling some of his stock. We used the weakness as an opportunity to buy at an attractive valuation and a strong profit announcement saw the stock bounce to new highs. Artificial Intelligence service company, **Appen (+18.1%)** rose after releasing a result that was better than expected but importantly, pointed to improving margins in both its speech and content businesses. The recent Leapforce acquisition also seems to be integrating well.

Key Detractors: It's not a reporting season without some disappointment. **EML Payments (-27.3%)** announced a profit that was in line with expectation but pointed to a softer second half as a number of gift card and betting card contracts won't be providing revenues until the 2019 financial year. The mood toward the stock wasn't helped by the fact that key directors had sold stock in December. **Catapult (-36.0%)** once again failed to impress investors after its interim release saw that good revenue growth wasn't being matched by profits. Investors are sensing rising risk with its lack of profitability. **TopBetta (-31.8%)** was sold off following news that the Northern Territory Racing Commission had delayed approval for corporate bookmakers, Ladbrokes and Neds to join Topbetta's Global Tote technology platform. While it is expected within the next few months, concerns about funding increased.

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Performance Attribution^		Top 5 Active Positions^
Top 5 Contributors	Top 5 Detractors	
Appen	Altium*	EQT Holdings
Corporate Travel Management	Catapult Group International	Mineral Resources
NRW Holdings	EML Payments	Service Stream
Service Stream	Nine Entertainment*	Smartgroup Corporation
Webjet	TopBetta Holdings	Webjet

^ Alphabetical order. * Denotes stock not held.

Post Reporting Season Changes to Earnings

Following the release of company results during reporting season, the Fund continues to demonstrate favourable metrics with regards to growth and valuation. Pleasingly, while the small ords index saw a slight downwards revision to EPS growth in FY18 and an upwards revision in FY19, the Fund saw upwards revisions to both years: +3.0% in FY18 and +2.5% in FY19 (based on Factset). For the Fund, this translates to EPS growth of +25.8% and +23.7% in FY18 and FY19 respectively, together with a PE multiple of 16.1x and 12.8x (again for FY18 and FY19). Please see table below.

Attributes	2018		2019	
	Portfolio	Index	Portfolio	Index
EPS GROWTH	25.8%	11.1%	23.7%	12.7%
SALES GROWTH	22.9%	10.6%	9.2%	4.9%
PE	16.1	18.6	12.8	16.3
EV / EBITDA	8.2	10.0	6.5	8.9
ROE	14.9%	10.1%	16.4%	11.2%

Growth vs Value in Australian Small Caps – February 2018 Update

When we originally undertook the analysis in April 2017 (link here), we observed that Growth stocks had dramatically underperformed Value stocks in Australian Small Caps in the preceding 18 month period, and that we were at 20 year extreme levels (circled in the chart below). There was no particularly good reason for this, so it was our expectation that a reversal would occur at some stage with Growth stocks to outperform strongly given compelling valuation and price signals. Pleasingly for our investors, this has occurred in the last 10 months.

As a reminder, Growth stocks in this part of the market have outperformed Value stocks ~60% of the time. While the chart suggests we are no longer at extreme levels, the current neutral level still bodes well for Growth stocks going forward.