Flinders Emerging Companies Fund

Quarterly Update: June 2017

FLINDERS Investment Partners

Performance *(after all fees and expenses)*	1 Month (%)	3 Months (%)	1 Year (%)	Since Inception^ (% pa)
Flinders Emerging Companies Fund	1.0	-4.4	-4.3	8.5
S&P/ASX Small Ords Accumulation Index	2.0	-0.3	7.0	14.8
Net Value Added	**-1.0**	**-4.1**	**-11.3**	**-6.3**

^ Inception date is 30 September 2015. Past performance is no indicator of future performance.

Investment Objective

Exceed S&P/ASX Small Ordinaries Accumulation Index by 5%pa (pre-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: Recommended
IRR: Recommended
Zenith: Approved

Platform Availability

CFS, MLC, Netwealth, Powerwrap, HUB24, Macquarie Wrap

Further Information

www.flindersinvest.com.au or
+61 3 9909 2690

- **Small caps showing signs of life...**
- **Growth stocks remain undervalued and at extreme levels**

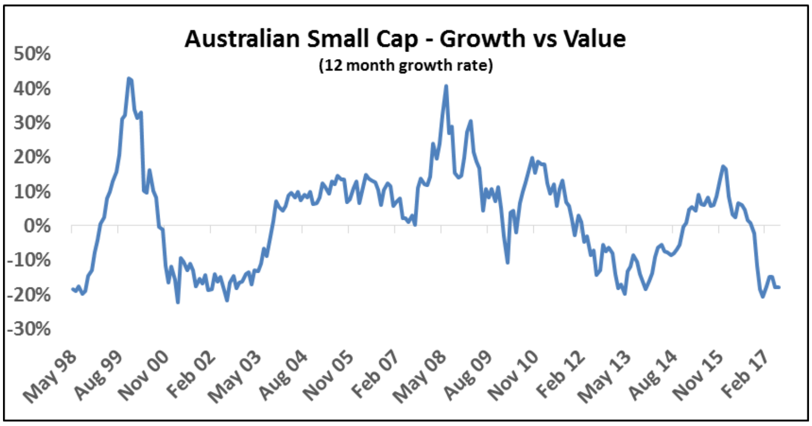
The Flinders Emerging Companies Fund ('Fund') lost some ground in the June quarter returning negative 4.4% after expenses versus the Small Ords Index which slipped 0.3%. Industrials outperformed resource stocks again reflecting weakness in oil and gold prices.

Over the quarter small companies outperformed the top 100 for the first time since the September quarter last year, with most of the strength coming in the back half of the quarter. We still see a very significant valuation gap between our current portfolio and the broader market – certainly wider than at any stage since launching our fund, giving us confidence going into the new financial year. The table below highlights two key takeaways: 1. the Flinders portfolio currently continues to demonstrate superior growth characteristics at a cheaper valuation to its Small Cap benchmark; and 2. the growth/valuation characteristics of Small Caps seems superior on balance to Large and especially Mid caps.

Attributes	Large Cap	Mid Cap	Small Cap	Flinders
EPS GROWTH	1.6%	9.2%	8.8%	19.0%
SALES GROWTH	2.6%	5.1%	4.9%	10.8%
PE	15.4	17.4	15.7	13.8
DIVIDEND YIELD	4.6%	3.8%	4.0%	3.0%
EV / EBITDA	8.9	9.8	8.9	6.5
ROE	12.1%	11.4%	10.5%	14.6%

Source: Factset, Flinders Investment Partners. Based on FY18 consensus estimates

Within Small Caps, the relative performance of Growth stocks vs Value stocks remains at extreme levels (chart below) – we continue to see risks to the upside for our Fund and Growth stocks in general. NB in the series below since inception, Growth as a style has outperformed Value over 60% of the time.



Source: Thomson Reuters Datastream

Flinders Investment Partners Pty Ltd ABN 19 604 121 271
Level 15, 385 Bourke Street, Melbourne, Victoria 3000
www.flindersinvest.com.au

Performance Review

Global equity markets continued to rise over the quarter with the US S&P500 up 2.5%, European markets firm and Asian markets generally strong (HK up 6.9% and despite regional politics, Korea up 10.7%). Iron ore and base metals were flat over the quarter but that masked a strong finish in June. As mentioned, oil was weak with WTI down 8.8% in the period.

The Australian dollar was slightly stronger, finishing the quarter on its highs at US$0.7687 after hitting a low of US$0.7350 in May. The Government managed to pass a slightly expansionary budget during the period but outside a retail and export recovery following the weather impacted March quarter, economic releases were largely subdued.

Positive Contributors: Our best performing stocks for the quarter came from a good spread of industries. **BT Investment Management (+13%)** rallied after announcing better than expected fund inflows, particularly into its UK based JO Hambro business in the UK. Lithium producer, **Orocobre (+23%)** rebounded from its poor March quarter as the lithium price firmed. The growth in electric vehicle production is gaining momentum and the supply of lithium for batteries, while also growing, has seen production delays. Software engineer, **Altium (+13%)** found support as confidence in the company reaching sales and profit margins lifted. **Service Stream (+14%)** continued to perform well as the company confirmed that revenues and profit growth would be strong for the 2017 year and its backlog of work for NBN and mobile telecommunication providers was growing into the 2018 and 2019 years.

Negative Contributors: Sundance Energy (-48%) fell following the news of another weak production report expected in the second quarter. This coincided with a significant capital expenditure program and a weak oil price. This combination lifted the risk profile to an unacceptable level and we exited our position in the stock. **Blackham Resources (-48%)** continues to have issues in ramping up its gold production. However, unlike the first quarter where there were mechanical issues with the crushing plant, the second quarter has been hit by the impact of very wet weather. Regardless of the temporary nature, the market sold the stock down aggressively. Also impacting performance was the fall in **Mayne Pharma (-24%).** The company had an investor day in May where it alluded to revenues being below expectation and confirmed price pressures in the US generic drug market where it has significant exposure. While only a modest impact on overall group profitability (around 5-7%), the stock has de-rated significantly.

Portfolio Activity

Additions: Accommodation provider, **Mantra Group** was added to the portfolio during the quarter. The company continues to grow its portfolio and with tightness in the Melbourne and Sydney markets offsetting weaker areas we expect solid revenue growth. The stock has fallen considerably over the past year providing an attractive entry point. Also added was international payments and card services company, **EML Payments**. The company has contracts with major international gaming companies and a large spread of gift card businesses in Europe, the US and Australia; we expect a strong growth trajectory over coming years. Financial services technology and advice provider, **HUB24** was brought into the portfolio during the quarter. With its rapidly growing platform business and the momentum of independent advisor groups in the market, the company still has considerable valuation upside. We bought back into **iSentia** in the quarter after its share price fell to a compelling level. While the company has had difficulty with the acquisition of King Content, its core business of media data seems back on track and its Asian businesses are providing terrific growth opportunities.

Exits: Despite being a good performer for the portfolio, we sold out of **BT Investment Management** after it reached our valuation. Similarly with **Lifestyle Communities**, the stock has done particularly well in recent times but we couldn't justify the price it reached. Also sold on valuation grounds was cattle and beef producer **Australian Agricultural Co**. Both **Amaysim** and **Eureka Holdings** exited the portfolio on the grounds of diminished growth profiles and the consequent negative impact on valuation.

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At the end of the quarter we had 41 stocks in the portfolio and were holding 3.5% cash.

Performance Attribution^		Key Portfolio Positions^
Top 5 Contributors	**Top 5 Detractors**	**Top 5 Active Holdings**
BT Investment Management	Apiam Animal Health	Catapult Group International
iSentia	Aveo Group	G8 Education
Orocobre	Blackham Resources	Service Stream
Service Stream	Mayne Pharma Group	Speedcast International
Sigma Health*	Sundance Energy	Webjet

^ Alphabetical order. * Denotes stock not held. Attribution is for the 3 months ending 30 June 2017. Top 5 positions are effective 30 June 2017.

Stock in Focus: Service Stream (SSM)

Service Stream is a provider of engineering, technical and maintenance services to the telecommunication, water and power sectors. It provides installation and support services to the NBN and the large mobile telephony providers. It is also a significant installer of domestic solar panels and electrical smart meters for large energy providers. The Fund has held the stock since late 2015 and we continue to see good growth prospects in the name.

Investment Case Key Questions

1. **Growth Opportunity:** SSM is participating as a contractor in the NBN rollout. It provides activation then ongoing maintenance services. We expect a good profile of growth as activations gain momentum over the next 2-3 years. The company will also benefit from the adoption of electricity smart metres in NSW, the adoption of 5G mobile services from 2018 and synergies from the $20m acquisition of utility services company TechSafe early this year.
2. **Management:** CEO Leigh Mackender and CFO Bob Grant have taken the company from overgeared and underperforming to its current state of low debt, good margins and growth prospects. The recent record of winning and successfully executing on large contracts gives us confidence that the company can deliver on its opportunities.
3. **Financial Strength:** After the acquisition of TechSafe, the company still has over $20m in net cash providing opportunity for further modest acquisitions and providing working capital for new contracts. It a conservative user of capital and return on capital has been improving.
4. **Risks:** The company needs to execute on its NBN obligations or its contracts can be reduced in scale. Management is vital in these industries and losing key personnel can be disruptive and damaging to returns. Also, if there is a sudden change in the scope or scale of the NBN roll-out there may be potential for disruption to revenues.
5. **Valuation:** Our Assessed Company Valuation is currently $1.58/s, reflecting upside of 20% from the current price.