Flinders Emerging Companies Fund

Quarterly Update: September 2017

FLINDERS
Investment Partners

Performance (*after all fees and expenses*)	1 Month (%)	3 Months (%)	1 Year (%)	Since Inception^ (% pa)
Flinders Emerging Companies Fund	3.5	8.5	-6.5	11.9
S&P/ASX Small Ords Accumulation Index	1.3	4.4	3.0	15.3
Net Value Added	**2.2**	**4.1**	**-9.5**	**-3.4**

^ 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 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: 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 on the march...**
- **Resource companies have a very strong quarter**
- **Growth companies are still at a discount**

The Flinders Emerging Companies Fund ('Fund') performed well in the September quarter returning 8.5% after expenses versus the Small Ords Index which gained 4.4%. Resource stocks led the way with an impressive 12.8% rise, reversing their poor performance in the June quarter. Small Industrials gained a more modest 2.5%. The ASX100 gained only 0.4% in the period.

The August reporting period was a little disappointing as mentioned in our last monthly. However, it is worth pointing out that profit forecasts for the FY18 year were, on aggregate, actually upgraded around 3% - largely driven by resource companies. Not surprising they performed well in September.

We have been pointing out for a number of months that the Fund has excellent growth characteristics but a significantly lower valuation than the market. We started to see a number of our holdings begin to close that gap with good performances coming from a broad number of sectors.

Performance Review

Positive Contributors: New Century Resources (**+128%** since purchase during the quarter) performed strongly as details emerged on its plans for re-starting the Century zinc mine and plant in Northern Queensland. Given the underlying zinc price has doubled since early last year, potential growth in cashflows from the project are very significant. Fashion jewellery retailer**, Lovisa (+42%)** was a good contributor following a solid 2017 profit result and improved prospects from its global store expansion in 2018. **Mineral Resources (+50%)** benefitted from a higher iron ore price during the quarter and more recently, its position as one of the world's largest lithium miners. Its ore crushing operations, iron ore exposure and lithium business will generate over $500m in cash this financial year. Software developer, **Altium (+26%)** continues to be a long term holding that performs well. A solid 2017 profit result and upgrades to medium term growth expectations were the features during the quarter. **Beach Energy (+34%)** also performed well for the Fund, having only purchased the stock at the end of June 2017 at an extremely attractive valuation. The company announced better than expected production growth from its Cooper Basin assets and at the end of the quarter, the company announced the $1.5bn acquisition of Origin Energy's non-LNG production and exploration assets. This looks like a transformative deal for the company that will drive its valuation considerably higher over time.

Negative Contributors: Catapult (-44%) fell following a slightly lower than expected profit result and lower free cash generation despite good product sales. This un-nerved investors as confidence around its path to profitability waned. We exited the stock above current levels but it was still a disappointing outcome. Not owning **A2 Milk (+55%)** proved costly on a relative basis over the quarter. While we appreciate the terrific growth of its infant formula into China at the moment, we have difficulty justifying the current valuation for a company that is overwhelmingly one niche product into one market. **Webjet (-11%)** has been an excellent performer for the Fund over a long period of time. However, during the quarter they issued equity for a sizable acquisition (which we liked), but had a quarrel with their auditors about treatment of fee income. This put some pressure on the stock but given the accounting treatment makes no difference to cash earnings, it made little difference to our valuation. We continue to see the stock as having considerable upside.

Portfolio Activity

Additions: During the quarter we added emerging health and beauty products firm **McPherson's** to the portfolio. The company has been transitioning away from some of its traditional businesses for some time and now is growing strongly into a number of high margin consumer categories. We expect these to drive higher returns for shareholders. Engineer and constructor**, RCR Tomlinson** was purchased early in the quarter. With its exposure to East Coast infrastructure projects, we expect significant earnings growth over the next five years. Also added was **Seven Group Holdings** following their capital raising to fund the purchase of the outstanding 50% of Coates Hire. Similar to RCR, the company now has significant exposure to infrastructure spending with the NSW Caterpillar operations and now with 100% of a re-invigorated Coates. **Nick Scali** was another addition to the portfolio. The company is well managed, growing, and has better than peer returns. New housing and renovation spend is an important macro driver, but in furniture retailing there is plenty of scope for this company to increase market share.

Exits: As mentioned above, we exited **Catapult** during the quarter. We also sold out of **Mayne Pharma** due to the continued deterioration in the US generic drug market. While the company has an excellent pipeline of new products, we would need to see margin improvement in that market before buying back into the stock. **Monash IVF** has been caught in a situation where there is little growth in premium IVF service offerings and an increase in industry competition. Consequently our valuation was negatively impacted and we sold our position.

At the end of the quarter we had 41 stocks in the portfolio and were holding 3.0% cash.

Performance Attribution^		Key Portfolio Positions^
Top 5 Contributors	Top 5 Detractors	Top 5 Active Holdings
Altium	A2 Milk Company*	Altium
Beach Energy	Catapult Group International	G8 Education
Lovisa Holdings	Cooper Energy	SG Fleet Group
Mineral Holdings	iSelect	Speedcast International
New Century Resources	Webjet	Webjet

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

Stock in Focus: Smart Group (SIQ)

Smartgroup provides salary packaging, novated leasing, and fleet management services to governments and corporates in Australia. SIQ is a top two player in both salary packaging and novated leasing. The various addressable markets are substantial in size, and growing as more customers look to have their administration services outsourced to the likes of SIQ. Along with organic growth, we also expect the company to continue to consolidate the industry through acquisitions.

Investment Case Key Questions

1. **Growth Opportunity:** We expect ~10% organic revenue growth in outsourced administration as SIQ achieves greater penetration from existing customers, whilst also winning new customers. Earnings growth should be higher given margins have been expanding with additional scale. We also expect further acquisitions to be made.

2. **Management:** Deven Billimoria has been the MD since 2014 and has worked in the business since 2001. He has proved to be very capable in growing and managing the business, and gives us confidence that he can continue to execute on the company’s growth ambitions. His 3% ownership of SIQ aligns him well with other shareholders.

3. **Financial Strength:** SIQ has made several recent acquisitions that have been earnings accretive with substantial synergies. The company’s very strong cashflows have allowed debt to be paid down following acquisitions, and we expect a net debt/EBITDA level <1x at their CY17 end balance date. We particularly like the capital light nature of the business, which allows for very attractive margins and returns.

4. **Risks:** Regulatory change in regards to fringe benefits tax and novated leasing has come up periodically, but currently enjoys bipartisan government support for no change. Contract losses are an ongoing risk, however SIQ has long-standing relationships with their large clients given excellent service levels provided.

5. **Valuation:** Our Assessed Company Valuation is currently $11.14/s, reflecting upside of 21% from the current price.