Flinders Emerging Companies Fund

Quarterly Update: March 2018

Performance *(after all fees and expenses)*	1 Month (%)	3 Months (%)	FYTD (%)	1 Year (%)	Since Inception^ (% pa)
Flinders Emerging Companies Fund	-3.5	-1.6	22.1	16.7	14.7
S&P/ASX Small Ords Accumulation Index	-2.3	-2.8	15.4	15.0	16.7
Net Value Added	**-1.2**	**1.2**	**6.7**	**1.7**	**-2.0**

^ 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: Investment Grade
IRR: Recommended
Zenith: Approved

Platform Availability

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

Further Information

www.flindersinvest.com.au
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- **Small caps still outperforming large stocks**
- **Resource sector takes a breather**
- **Equity market volatility continues**

The Flinders Emerging Companies Fund ('Fund') outperformed its benchmark in the March quarter returning -1.6% after expenses versus the Small Ords Index which slipped 2.8%. While both down, industrial stocks fared better than their resource counterparts, easing 2.2% versus 4.6%. And in a stark reminder of the degree that large companies have struggled in Australia, for the 12 months to March, the Top 100 accumulation index is up a modest 1.6% against a 15.0% gain for the Small Ords accumulation index.

Global markets have been riding a roller-coaster this quarter with increased volatility in the US driven by higher interest rates, issues with high profile tech stocks such as Facebook and most significantly, the spectre of trade and tariff barriers rising. This is particularly worrying – especially if the Chinese look at any currency related retaliation.

Equity markets were generally weaker with the S&P500 down 1.2% over the quarter and European markets weaker again. Asian markets were mixed with Japan down almost 6%, the Shanghai Comp down 4.2% but HK and Singapore marginally higher. Commodities were mixed with oil the standout, WTI Crude rising 7.5%. Gold put on 1.7% but base metals were weaker – copper in particular, falling 7.5%.

Bond markets continued to deteriorate in the US with 10 year yields rising 33bp to 2.74% which resulted in the unusual situation of local 10 year yields being below those of the US – 14bp at the end of the month. Despite that, the Australian dollar has been remarkably resilient and finished the quarter at $US0.7679.

Performance Review

Positive Contributors: Service Stream (+24%) reported a strong interim profit result that pointed to good prospects for long term work for NBN, and solid pipelines of work in their commercial solar installation business and smart meter business. They also announced an increased dividend and a stock buy-back that helped investor sentiment. Legal firm, **Shine Corporate (+24%)** enjoyed a good quarter with their interim profit meeting expectations and commentary which reflected confidence for a solid second half. The company also has a good chance of benefitting from the class action against US corporate Johnson & Johnson over the Mesh contraceptive device used in Australia.

Industrial conglomerate, **Seven Group (+17%)** also reported a better than expected interim profit result on the back of improving conditions in its Westrac Caterpillar dealerships and Coates Hire equipment rental divisions. The company is now well diversified to benefit from recovering mining volumes on both the East and West coasts of

Australia and infrastructure projects throughout the country. Waste management and recycling company, **Bingo Industries (+10%)** saw support after some timely acquisitions has given the company access to the Queensland waste market and valuable landfill access in NSW. The industry is consolidating and subject to greater regulation which we expect to benefit larger participants such as Bingo and Cleanaway.

Negative Contributors: Payment systems and loyalty card provider **EML Payments (-38%)** fell following a downgraded profit outlook for FY 2018. While the company has significant scope for growth following the signing of new customers in all of its operating divisions, integrating these new contracts has taken longer than expected. Consequently, some revenues have been pushed into the 2019 year. **Mineral Resources (-18%)** gave back some of its strong gains of the previous quarter as the iron ore price eased through March and global lithium stocks also saw profit taking. Wagering platform company **Topbetta Holdings (-44%)** announced that its expected licence to run tote operations for Ladbrokes and Neds had been delayed by Northern Territory authorities. While likely only a delay, the company will likely face working capital issues if the delay runs to later this year. We exited the stock shortly after this announcement.

Portfolio Activity

Additions: Among the stocks added during the quarter was online marketplace **Redbubble**. The company provides a platform for consumers to get access to a large universe of artists and designers for clothing and other consumer items. Redbubble enables the printing, delivery and billing to the consumer and a “royalty” to the designer, with a healthy margin for themselves. User growth is rising substantially and the company is starting to generate meaningful cashflow. Also added was travel agency, **Helloworld Travel**. The company has been expanding through acquisition and has reached a critical mass where its buying power is leading to better deals from airlines and accommodation providers. It has also been in the process of lowering operating costs and implementing new operating systems that should also lead to improved operating systems – this has been significant as the previous management team ran the business inefficiently.

We’ve been attracted to the business of **Technology One** for some time but had not owned the stock due to its lofty valuation (on our assessment). The enterprise and government software provider has been providing software to a growing array of industries and generated consistently high returns. Early in the quarter the stock sold off on concerns about its ongoing growth profile. We are of the view that the de-rating of the company was overdone and provided an excellent buying opportunity with valuation upside of over 30%.

Exits: As mentioned above, we exited **Topbetta** during the quarter. We also sold out of resource companies **Sandfire Resources** and **Red River Resources** (copper and zinc producers respectively), both on the grounds that they had reached our valuation targets. Similarly, RV motorhome rental company **Apollo Tourism & Leisure** was sold prior to their result having reached our valuation. All three had been good contributors to performance while we held them. Another stock we sold after being in the portfolio for some time was **Sealink Travel Group**. The company has some excellent ferry transport assets but its profit growth profile has been pared back in recent times as it establishes new commuter and tourist routes in Sydney and Perth.

At the end of the quarter we had 40 stocks in the portfolio and were holding 3.1% cash.

Performance Attribution^		Key Portfolio Positions^
Top 5 Contributors	Top 5 Detractors	Top 5 Active Holdings
Bingo Industries	Altium*	EQT Holdings
Sandfire Resources	Bellamy’s Australia*	NRW Holdings
Service Stream	EML Payments	Service Stream
Seven Group Holdings	Mineral Resources	Smartgroup Corporation
Shine Corporate	Topbetta Holdings	Webjet

^ Alphabetical order. * Denotes stock not held. Attribution is for the 3 months ending 31 March 2018. Top 5 positions are effective 31 March 2018.

Stock in Focus: EQT Holdings (EQT)

EQT Holdings is one of Australia's oldest listed companies and is the holding company for independent trustee services business, Equity Trustees. The company has two main operating divisions, Trustee and Wealth Services (TWS) that includes its executor, funds management and philanthropic services, and Corporate Trustee Services (CTS) that provides responsible entity trustee services to the funds management and superannuation industry.

Investment Case Key Questions

1. **Growth Opportunity:** As the only independent trustee company of scale, the CTS division has been able to grow its customer base considerably in recent years. Funds management companies are under increasing regulatory and compliance pressure and outsourcing responsible entity function is increasing. EQT is now offering international services for this function as well. The other area of growth is the company's maturing base of wills where it has been appointed executor. While longer term, it provides the company with an increasing annuity over many years to come.

2. **Management:** The current management team has only been in place for a couple of years but are already making a difference. CEO Mick O'Brien and CFO Phillip Gentry have put in place a more focussed management structure, improved systems and taken out significant costs. Importantly, improving the customer and revenue culture is another focus of the management team that was badly needed. We have faith that these developments will lead to the company starting to capitalise on the industry dynamics that are already working in their favour.

3. **Financial Strength:** While EQT has to hold regulatory capital for a number of its businesses, the company is in solid financial state with modest gearing and good cashflow. It has the capacity to make add-on acquisitions but is not reliant on buying competitors to fuel growth. The company can also comfortably maintain a dividend payout ratio of over 50%.

4. **Risks:** As a trustee, there is always risk. However, with better systems, a tight focus on compliance and a leadership team that understands the industry well, internal risk is well managed. Regulatory risk is always a possibility however, regulation seems to be trending in favour of trustee companies as financial service companies are moving to outsource for compliance reasons. Financial market risk is also a potential issue. EQT does have leverage to equity markets as many of its services are charged on a funds under management basis. Lower markets mean lower FUM for their clients. However, improving markets results in higher revenues.

5. **Valuation:** Our Assessed Company Valuation is currently $24.88 per share, reflecting upside of over 18% from the current price.