Flinders Emerging Companies Fund

Quarterly Update: June 2018

FLINDERS
Investment Partners

Performance ***(after all fees and expenses)***	**1 Month** (%)	**3 Months** (%)	**CYTD** (%)	**1 Year** (%)	**Since Inception^** (% pa)
Flinders Emerging Companies Fund	1.0	8.6	6.8	32.6	16.7
S&P/ASX Small Ords Accumulation Index	1.1	7.7	4.7	24.2	18.2
Net Value Added	**-0.1**	**0.9**	**2.2**	**8.3**	**-1.5**

^ 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 round off a great financial year**
- **Equity investors continue to reward growth**
- **Trade war fears still lurk…**

The Flinders Emerging Companies Fund ('Fund') outperformed its benchmark in the June quarter returning 8.6% after expenses versus the Small Ords Index which rose 7.7%. For the year, it was an excellent result for our investors with The Fund returning 32.6%, 8.3% above the Small Ords Index. Significantly, The Fund returned an excess of 20.5% above the S&P ASX100 Index for the year; the market clearly rewarding the better growth characteristics of smaller companies and certainly, the companies Flinders invest in.

For the quarter, small resources returned 10.4% while small industrials rose 6.8%. Returns have been reflecting the short term growth profiles of the two sectors with better profits expected out of resources than industrials over the next year.

Global equity markets were mixed with the US Dow Jones up less than 1% (although the Nasdaq was up 6% for the quarter). European markets were slightly weaker but Asian markets were hit particularly hard on tariff concerns and fears of lower Chinese growth figures. Commodities were mixed with oil strong, gold weak, and base metals (except nickel) also weak. The Aussie Dollar finished just off its 12 month low at US$0.7407 which is good news for exporters and USD earning companies.

While the spectre of trade wars has been worrying the market for a number of months, it is now certainly coming to the forefront. No matter the developments, there will be implications for Australian companies – both positive and negative. For instance, small moves in Chinese tariffs on US food products can make a big difference to the demand for these products from Australia. There are many potential outcomes and we will be closely focussing on what they might mean to our investments. It will be challenging but also a potentially rewarding period.

Performance Review

Positive Contributors: Voice and language technology company, **Appen (+50%)** had a terrific quarter as investors began to recognise its growth potential supplying its services to major US technology companies. The company refined guidance to the top end of its range at its May AGM, while a lower Australian dollar will also help support profits. Contractor**, NRW Holdings (+28%)** recovered after a poor first quarter on fears of lower margins on certain projects. However, management announced a number of new contract wins and extensions, as well as a sizable order book that has restored confidence in the outlook over the next few years. **Sino Gas & Energy (+50%)** was the recipient of a cash takeover bid from Bermuda based private equity firm, Lone Star. The bid has been recommended by the board and we intend to exit the stock. **Webjet (+22%)** continued to recover from its February lows with confirmation that the expected profit result of at least $80m EBITDA was still intact. Webjet is another company that will benefit from the lower currency in this half year.

The quarter was also notable for profit downgrades that heavily impacted a number of stocks that we had chosen *not* to invest in. This also helped our relative performance. This was also a feature of the yearly return. Avoiding problem stocks is almost as important as picking the good ones.

Negative Contributors: Telco and utilities service provider **Service Stream (-7%)** underperformed a strong market despite an ongoing buyback, extending its maintenance contract with NBN and reiterating 2018 FY profit guidance. We continue to like the outlook for the company in all its operating divisions and see significant valuation upside. Mining services and lithium ore producer, **Mineral Resources (-6%)** eased on a lower production report and weakness across all lithium producers during the quarter. While the production report was disappointing, the fact that the company is fielding approaches to invest in its lithium division gives us confidence that its true valuation can be reflected. Online design company, **Redbubble (-16%)** eased on a slightly disappointing first quarter result released in April. While the company mentioned that the lower margins experienced in January had not continued, the market has taken a cautious approach to the stock. We expect the interim result to show an improvement.

Portfolio Activity

Additions: Among the stocks added during the quarter were two that we reinvested in following recent price declines. Retirement living operator, **Lifestyle Communities** was added back into the portfolio as a solid valuation opportunity re-emerged. Sales of properties continues at a good clip, with the new Bittern development commencing settlements earlier than expected and overall group settlements running ahead of previous guidance. After selling out of recreational vehicle company, **Apollo Tourism & Leisure** in the previous quarter as it reached our valuation, the stock fell back quite sharply (over 20%) in a matter of weeks. We like the growth attributes of the company and recent acquisitions look like adding considerable value. Consequently, we used the weakness to buy back in.

Also added to the portfolio was remote site power generation provider**, Zenith Energy**. The company has won a number of significant new contracts to provide both gas and diesel powered generation to mining sites over the past year and has an excellent pipeline of future opportunities. Returns are improving and with contract tenure improving, we see significant upside in the share price over the next few years.

Exits: We exited our holding in **Beach Petroleum** in the quarter. It has been a terrific investment for us, rising three-fold since we purchased the stock only a year ago. While we still are attracted to the growth attributes of the company and its quality assets, it reached full valuation and we couldn't justify holding the stock at current levels. We also sold out of enterprise software developer, **TechnologyOne**. Although a fairly recent addition to the fund where a sustained de-rating and share price pullback provided the initial opportunity, the half year result in May signalled a deterioration in the company's growth profile which led us to pull back our valuation and consequently signalled a move to exit the stock.

At the end of the quarter we had 41 stocks in the portfolio and were holding 2.6% cash.

Performance Attribution^		Key Portfolio Positions^
Top 5 Contributors	Top 5 Detractors	Top 5 Active Holdings
Appen	EQT Holdings	Mineral Resources
Beach Energy	Mineral Resources	oOh!media
NRW Holdings	Redbubble	Smartgroup Corporation
Sino Gas & Energy	Service Stream	Service Stream
Webjet	WiseTech Global*	Webjet

^ Alphabetical order. * Denotes stock not held. Attribution is for the 3 months ending 30 June 2018. Top 5 positions are effective 30 June 2018.

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Stock in Focus: Mineral Resources (MIN)

MIN is an Australian based service business, primarily through the provisioning of crushing services to resource companies. In addition, the company owns and operates resources projects in iron ore and lithium. The latter commodity is providing the company with material growth options.

Investment Case Key Questions

1. **Growth Opportunity**
   Key drivers of growth include: 1) Crushing volumes increasing from 126mtpa in FY17 to 145mtpa in FY19; 2) Lithium ore production set to increase from 0.2mtpa to ~1mtpa; and 3) Innovation to drive costs reductions in the iron ore business. Earnings are expected to grow ~25% pa over the next 3 years.

2. **Management**
   Chris Ellison, co-founder and MD together with Peter Wade, co-founder and Chairman, as well as Bruce Goulds as CFO, have been in place since the company listed in 2006 at $0.90/share. Since that time the team has grown shareholder value 31% pa. They understand their market well, and are material shareholders themselves in the business.

3. **Financial Strength**
   The balance sheet has been in a net cash position for some time, and we forecast ~$100m of net cash at the end of FY18. This places the company in an excellent position to deliver on its growth initiatives.

4. **Risks**
   Cyclicality of earnings is the key risk; commodity prices dictate demand for its services.

5. **Valuation**
   Target price is $21.90/s based on a sub-market target multiple (given cyclicality). Assessed Company Valuation return of 37%.