

Flinders Emerging Companies Fund

Quarterly Update: September 2018

FLINDERS
Investment Partners



Performance (after all fees and expenses)	1 Month (%)	3 Months (%)	CYTD (%)	1 Year (%)	Since Inception [^] (% pa)
Flinders Emerging Companies Fund	-0.1	3.0	10.1	25.8	16.3
S&P/ASX Small Ords Accumulation Index	-0.4	1.1	5.8	20.3	17.0
Net Value Added	0.2	1.9	4.2	5.5	-0.6

[^] 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

MLC Wrap IDPS,
Netwealth, Powerwrap,
HUB24, Macquarie Wrap,
uXchange, WealthO2

Further Information

www.flindersinvest.com.au
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- **Flinders turns three!!!**
- **Small company profit growth on the rise**
- **Markets shrug off tariffs and politics – for now...**

The Flinders Emerging Companies Fund ('Fund') outperformed its benchmark in the September quarter returning -0.1% after expenses versus the Small Ords Index which returned -0.4%.

If you'll indulge us for a moment, three years running the fund is an important milestone, so we'd like to thank our early investors, service providers and our partner, Prodigy Investment Partners for the faith, support and help getting the business up and running. Markets have been both kind and savage in that time but with a consistent investment approach, one product focus and a tight-knit experienced team, our performance has been very pleasing. We look forward to continuing to reward our investors with great returns from this vibrant and growing asset class. So now, we'll get back to the report.

Despite a late rally in September, resource stocks were weak over the quarter (especially smaller ones) with the small resources index slipping 6.7% against industrials rising 3.4%. Overall, smalls slightly underperformed the Top 100 which rose 1.5%. Encouragingly, the August reporting season resulted in aggregate upgrades to small cap earnings forecasts. This gives us confidence that relative performance of the sector can continue to improve.

Compared with other developed markets, Australia's performance was pretty miserable. The US S&P500 was up 7.2% and the Nikkei 225 up 8.1% in the quarter. That contrasted with the MSCI Emerging Markets Index which fell 2.0%. EM investors would have seen significant currency deterioration as well.

Early in October, the RBA announced (is that the right word?) that the cash rate would stay unchanged at 1.5% for the 24th consecutive month. This was against a backdrop of weakening housing prices, ho-hum retail sales but still quite robust job growth – no surprise then. The dollar closed the quarter lower at US\$0.7224. Resources were remarkably mixed. Oil, iron ore and coal were all very strong (between +4-8%) but base metals very weak (-5-12%). Oh, and we shouldn't omit that we got a new Prime Minister, Treasurer and Foreign Minister during the quarter as well...

Performance Review

Positive Contributors: Utility service provider and engineer, **Service Stream (+19.2%)** performed very strongly following an excellent 2018 full year profit result. With a solid growth profile, no debt, experienced management team and excellent cash generation, the company continues to be undervalued by the market. Waste manager and recycler, **Bingo Industries (+21.1%)** posted an impressive profit result, made a substantial and accretive acquisition of a key competitor (Dial-A-Dump Industries) and

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raised capital during the quarter – all of which were viewed as positive developments by investors – and by us.

Online travel company, **Webjet (+14.7%)** often gets a run in this part of the report – and that's good, being one of our larger holdings. A good quality profit result, better than expected cash generation and confirmation of their strong growth profile all helped the stock move higher over the quarter. We took the opportunity to lock in some profits given the positive share price move in recent months. Also contributing to performance was another travel related company, **Helloworld Travel (+25.6%)**. Like Webjet, it posted a good profit result and the company is beginning to bed down the recent acquisitions of Magellan Travel, Flight Systems and Asia Escape Holidays. Cost control and growing market share from existing businesses are also helping profitability. Also worth mentioning is the continued recovery of infrastructure and resources contractor, **NRW Holdings (+23.3%)** which we feel has been under-rated by the market given it's experienced management team, much improved spread of industry contracts and strong balance sheet.

Negative Contributors: We were not alone in being disappointed by the interim result of satellite broadband provider, **Speedcast (-35.0%)**. A poor result from its energy communications division was unexpected but even more-so was yet another acquisition pushing the company's gearing level to significantly beyond its stated maximum target. While the company undoubtedly has a high growth profile in a consolidating industry, its risk profile has jumped considerably and unexpectedly – never good news for a share price. Despite a good full year profit release, **Sims Metal Management (-21.3%)** announced late in September that parts of the recycling business were suffering from the impact of tariffs and trade disruptions with China – especially in aluminium based products.

Not owning high-flying tech stocks **Afterpay Touch** and **Wisetech (+92.0%** and **+41.0%** respectively) certainly cost relative performance but we still consider both stocks overvalued on their current outlook despite the high growth forecast for each of them. And given the weakness in base metals over the period, it wasn't surprising that two of our pure-play metal stocks, **Red River Resources (-22.6%)** and **Western Areas (-25.3%)** were weak over the quarter.

Portfolio Activity

Additions: Among stocks added during the quarter was insurance broker and services company, **AUB Group**. Since releasing an excellent full year profit result and growth outlook, the share price has eased with many financial services companies associated with the Hayne Royal Commission. Given the limited relevance of the commission to AUB's businesses, we have seen a valuation gap open up and used the opportunity to add the stock to the portfolio. We also re-established a position in ferry and tourism operator, **Sealink Travel Group**. The company is coming off a disappointing 2018 FY that was characterised by increased cost establishing new ferry routes, restructuring new businesses and higher than usual maintenance spend. With much of this behind them, we feel Sealink is in for a better 2019 and took the opportunity to buy back in.

We added copper producer **Sandfire Resources** back into the portfolio. The stock had sold off sharply during July and August and with the development of the Monty resource helping future earnings, the valuation opportunity became compelling.

Exits: We exited our holding in **Sino Gas & Energy** during the quarter following the takeover by Lone Star. This was an excellent investment for us over the year and ended up being our top contributor for the 12 months to September. Less spectacular was our investment in **Nufarm** that we sold out of in the quarter. While the drought in Australia was cited amongst their difficulties, excess inventory in both Europe and Australia is impacting the company. The lower earnings profile in 2019 and 2020 significantly dropped our valuation and we exited. As mentioned above, with the downgrade to **Speedcast's** earnings, unless they can demonstrate a faster than expected debt reduction or surprise jump in profitability (preferably both), the increased investment risk impacted our valuation. Consequently, we exited the stock.

At the end of the quarter we had 41 stocks in the portfolio and were holding 3.7% cash.

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Performance Attribution [^]		Key Portfolio Positions [^]
Top 5 Contributors	Top 5 Detractors	Top 5 Active Holdings
Bingo Industries	Afterpay Touch*	Bingo Industries
Helloworld Travel	Red River Resources	Helloworld Travel
NRW Holdings	Sims Metal Management	Ooh! Media
Service Stream	Speedcast International	Reliance Worldwide Corp.
Webjet	Western Areas	Service Stream

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

Stock in Focus: Helloworld Travel (HLO)

Helloworld Travel is an Australian based travel company that engages in the sale of travel products and services. HLO operates three main segments: 1. its Retail business comprises the operation of a franchised network of retail travel agents; 2. its Wholesale business procures air, sea and land products for packaging and sale through retail travel agents (HLO's as well as others); and 3. its Travel Management business which provides travel management services to corporate and government customers.

Investment Case Key Questions

- Growth Opportunity:** we expect >20% EPS growth p.a. from the business over the next 3 years, largely driven by a continued improvement in margins as the business executes on synergies and operational efficiencies. The top line is also set to improve after a period of decline in the number of agents several years ago, as current management have stabilised and started to growth the network. Furthermore, declining international airfares have been a headwind to revenue growth in the recent period, however prices have stabilised and are likely to improve going forward. Continued acquisitions should also supplement growth.
- Management:** Andrew Burnes is the Managing Director. He was formerly the co-founder and Managing Director of the wholesale business AOT, which merged with HLO in early 2016. To date he has successfully extracted significant synergies from the merger, with further positive developments expected. Andrew, together with his wife and co-founder of AOT Cinzia Burnes (an Executive Director of HLO) have a 31% interest in HLO. Having founded the AOT business in 1987, the Burnes' have exceptional market knowledge and operational experience, making them extremely well suited to lead the business.
- Financial Strength:** the company is well capitalised and in a net cash position. The nature of the business is such that retail clients pay for their travel in advance, resulting in a substantial amount of 'client cash' held on HLO's balance sheet on behalf of clients.
- Risks:** several risks exist, including the ability to retain agents, loss of key contracts in the Travel Management division, acquisition and integration risk, and demand for corporate and leisure travel which in turn impacts the pricing of tickets. We are of the view that several of the risks above have been well managed by the company to date, while the main risk out of their control is the demand for travel.
- Valuation:** our Assessed Company Valuation is currently \$7.32/s, reflecting upside of over 20% from the current price.

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