# Flinders Emerging Companies Fund

Monthly Update: August 2019

FLINDERS
Investment Partners

| **Performance** *(after all fees and expenses)* | 1 Month (%) | 3 Months (%) | 1 Year (%) | 2 Years (% pa) | Since Inception^ (% pa) |
|---|---|---|---|---|---|
| Flinders Emerging Companies Fund | -2.1% | 4.6% | 3.9% | 16.4% | 13.4% |
| S&P/ASX Small Ords Accumulation Index | -3.9% | 1.4% | 0.9% | 11.1% | 13.1% |
| **Net Value Added** | **1.8%** | **3.2%** | **2.9%** | **5.3%** | **0.3%** |

^ Inception date is 30 September 2015. Past performance is no indicator of future performance. Information relates to the Flinders Emerging Companies Trust Class B.

**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
Zenith: Approved

**Platform Availability**

MLC Wrap, Navigator, Netwealth, Powerwrap, HUB24, Macquarie Wrap, uXchange, WealthO2, CFS FirstWrap, Xplore

**Further Information**

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- **Markets by Twitter ensures volatility**
- **Reporting season – not as bad as feared**
- **Small Company growth characteristics remain attractive**

## Market

The Small Ords Accumulation index gave back most of its July gains in August with a drop of 3.9%. Pleasingly the portfolio performed well, finishing 1.8% above the benchmark. It was a volatile month with macro and political events dominating – China/US trade issues in particular. Any tweet from the US president seemed to determine market direction as would responses from Chinese officials. Fortunately, by month end, the volume had come down a little. Not surprisingly, gold did well and global cyclicals didn't.

Reporting season was interesting. On a net basis, profits were a little lower than expectations (revisions of <5%) however, we would suggest not as poor as feared. That was clear in sectors such as discretionary retail where expectations were low. Companies such as Super Retail Group, Baby Bunting Group, Bapcor and Nick Scali all had solid jumps after posting their profit results. Other sectors showed similar signs of life which gives us some confidence that the modest improvement in conditions we've been expecting in this half may well be emerging.

As for the markets, they were generally weaker. The S&P500 eased 1.0% and the Nasdaq 1.8% over the month. European markets were weaker – especially the UK where the FTSE100 dropped 5.0%; unsurprising given the political backdrop. Asian markets suffered from a case of Hong Kong political flu with the Hang Seng down 6.7%, Singapore -5.6% and Japan -3.9%. Bond yields fell sharply with US 10 years down to 1.50% and local 10 year yields at 0.91%. Commodities also fell with the clear exception of gold which added 7.7% over the month to reach an all time high in Australian Dollars. Little wonder Kalgoorlie seems a touch more lively…

## Portfolio

**The Fund was down 2.1% over the month but meaningfully better than the benchmark that fell 3.9%.**

**Key Contributors:** Investment themes can come and go quickly in modern markets. Especially if they aren't based on fundamentals. Consequently, it is a good check to see that our investment performance comes from a wide range of industries, sectors and size of company. Buoyed by a good profit release and commentary about a better FY20, retailer **Baby Bunting Group (+26.8%)** was an outstanding contributor in August. Sentiment toward retailers had been particularly poor in the lead-up to reporting season but less competitor pressure and a focus on costs and customer needs, saw the company perform strongly in the June half. Electronics goods developer and manufacturer, **Codan (+18.6%)** has been a portfolio holding for over three years and performed very well over that time. It's FY19 profit result was stronger than both we and the market expected. Both Metal Detection and Communications segments were key drivers of the increase, while the development of several new products suggests further growth ahead as the business diversifies further.

Salary packaging and vehicle leasing company, **Smartgroup (+21.0%)** was also a company that performed well in a difficult industry environment. With vehicle sales particularly weak, the group did well to exhibit earnings growth given its skew to the more defensive segments of health and government. Gift card and digital payments operator, **EML Payments (+18.8%)** continued to add value to the portfolio. A strong profit result and a good pipeline of contracts in reloadable smart cards saw upgrades to earnings expectations over the next few years. The company operates on a global level, has excellent cashflows and is improving its market position in a number of growing financial services applications.

A stock that we have been patient with and is now beginning to get market recognition is litigation firm, **Shine Lawyers (+13.8%).** The company has obviously been tainted by the woes of competitor Slater & Gordon over the past few years, but CEO Simon Morrison and his team have done a good job setting the company on a path for solid growth in the future. It is an industry that requires capital, quality people and scale to succeed. Shine has all three, plus significant valuation upside. And it is rare that a professional services sector has such limited competition with those attributes.

**Key Detractors:** Despite a solid profit result in an industry that is suffering from subdued operating conditions, **Corporate Travel Management (-24.8%)** continued to slide. The stock still has its detractors and short selling has not abated. Political issues in key markets such as Hong Kong and the UK has also not helped perception. Despite that, the company is still winning market share, has good control on costs and still has enormous growth potential from its global position in the travel industry. The most disappointing profit announcement during the reporting season for us was clearly outdoor media operator, **oOh!media (-30.5%)**. While the interim 2019 profit was largely in line with expectations, management announced that a sharp drop in ad bookings in July and August meant that the full year profit would be around 17% below their previous expectation. The company pointed to weakness in automotive and banking ad spending on billboards being the notable areas of weakness. As has been typical in this market, the stock was savaged on open, down 43% at its lows (more than twice the quantum of the earnings downgrade) – the Fund was able to buy stock near the lows at $2.35/s, and the stock finished the month at $3.07/s.

Diversified mining and services company, **Mineral Resources (-17.7%)** suffered as both of its key commodity exposures, lithium and iron ore, saw price weakness. Coupled with further delays to its large Wodgina Lithium Project, the market sold the stock down to two-year lows. Unlike many competitors in the emerging Australian lithium industry, Mineral Resources is well capitalised, has excellent cashflows, and extremely long-life quality assets.

| Performance Attribution^ | | Top 5 Active Positions^ |
|---|---|---|
| Top 5 Contributors | Top 5 Detractors | |
| Baby Bunting Group | Appen | Codan |
| Codan | Corporate Travel Management | Credit Corp Group |
| EML Payments | Mineral Resources | Service Stream |
| Shine Corporate | oOh!media | Shine Corporate |
| Smartgroup Corporation | Silver Lake Resources | Smartgroup Corporation |

^ Alphabetical order. * Denotes stock not held.

## Portfolio and Market Statistics

Based on FY20 Factset consensus numbers, it's striking how mediocre the EPS growth for large caps currently is, with only 4.4% growth (table below). Small caps on the other hand are currently set to deliver 14.4%, without an excessive premium to access that exposure. The Fund continues to demonstrate favourable metrics with regards to growth and valuation.

| | Portfolio | Small Ords | ASX 100 |
|---|---|---|---|
| **EPS GROWTH** | 26.5% | 14.4% | 4.4% |
| **PE** | 14.0 | 17.0 | 16.2 |
| **EV / EBITDA** | 6.9 | 9.4 | 9.2 |
| **ROE** | 13.4% | 9.9% | 12.8% |

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