Flinders Emerging Companies Fund

Monthly Update: February 2020

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	-10.1%	-5.4%	7.8%	5.9%	11.8%
S&P/ASX Small Ords Accumulation Index	-8.7%	-5.9%	1.6%	2.6%	10.9%
Net Value Added	**-1.4%**	**0.5%**	**6.2%**	**3.4%**	**0.9%**

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

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: Recommended

Platform Availability

MLC Wrap, Navigator, Netwealth, Powerwrap, HUB24, Macquarie Wrap, IOOF Pursuit/Expand, CFS FirstWrap, Praemium

Further Information

www.flindersinvest.com.au
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- **Market panic on coronavirus suggests no one is ever going to have an MRI, eat fish, or cook with gas ever again…**
- **Reporting season reasonable with only slight revisions to consensus**
- **Indiscriminate selling provides excellent opportunities**

Market

The Small Ords Accumulation index declined 8.7% in February, as panic selling set in all markets globally due to fears of the coronavirus spreading outside of China. The steep selloff occurred almost entirely in the last week of the month, making it the worse week since the GFC. Large caps fared only slightly better, down 7.7% for the month.

Interestingly, many Asian markets outperformed, with Shanghai down only 3.2%, Hong Kong down 0.7%, and Taiwan down 1.8%. Developed markets bore the brunt of the selling, with the US, Europe and Japan down high single digits.

With concerns that global growth will slow as a result of the coronavirus, most commodity prices were down, including WTI crude oil -12.2%, Zinc -9.0%, and Nickel -4.1%. Copper bucked the trend to be up 0.1%, while gold was resilient at -0.1%. The Australian dollar was weaker again, down 2.7% to finish the month at US$0.651.

The interim reporting season was mostly to expectations. EPS growth for small caps was revised down ~1.3% for FY20, and increased ~1.3% for FY21 (compared to consensus expectations a month prior). This currently translates to expected EPS growth of ~11% in FY20 and ~14% in FY21. While the move in aggregate has been minimal, certain sectors that clearly have a higher exposure to the impacts of coronavirus saw more meaningful downgrades and issued more cautious outlook comments. These sectors included travel and leisure, and sectors such as retail that have their supply chain exposed to China. The bias to further earnings revisions is clearly to the downside for many companies. Consequently, we remain focussed on identifying potential earnings issues for industries and individual companies, while also trying to take advantage of opportunities.

Portfolio

The Fund returned -10.1% in February, versus the benchmark return of -8.7%.

As a general comment, we were satisfied with the interim results of our companies held in the Fund. The weak share price moves in many of our stocks was due primarily to the indiscriminate panic selling in the last week of the month. In response, we are using this unique opportunity to selectively add to our holdings given that the solid underlying fundamentals of our investments remain intact.

Importantly, all of the 38 companies held in the Fund are well capitalised, and have a track record of growth. Our companies are generating cash, and overall, the Fund continues to trade at a discount (15x FY20 PE, a ~3x discount to the market), providing a fundamental basis for support (and in a world where US 10-year treasury yields have dropped to 1%!). Furthermore, the Fund continues to exhibit superior growth (24% EPS growth in FY20 vs 11% for the market). We remain comfortable with positioning of the portfolio which continues to be well diversified and expect a solid recovery when volatility subsides.

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Key Contributors: Insurance broker **AUB Group (+7.2%)** delivered an upgrade to their FY20 guidance at their interim result, with acquisitions and a favourable premium pricing environment helping deliver growth. The company also announced two larger accretive acquisitions earlier in the month. The defensive nature of the company's earnings has clearly found favour in this market. Property fund manager **Centuria Capital Group (+3.3%)** reported a strong result with operating earnings up 25% on the prior period. Assets Under Management (AUM) continues to grow meaningfully, up $1.2bn organically to take AUM to $7.3bn at the end of the period. We feel that the company is well placed to grow their business over the medium term as the funds that they manage offer investors yields that are several percent above term deposits, an attractive return in this low interest rate environment.

Building and restorations services company **Johns Lyng Group (+6.6%)** reported a 78% increase in earnings and upgraded their guidance for FY20. The company is currently in a sweet spot as they are exposed to work from damages inflicted by insurable events like floods, hailstorms, and fires. They are currently facing record demand for their 'business as usual' services, and with six catastrophe events having been declared in Australia these past few months, record job registrations provide a good lead for more work going forward.

The Fund bought funds management group **Pinnacle Investment Management Group (+9.2%)** in January, ahead of its interim result, following a large de-rating of the stock. The previous weakness was seemingly due to a couple of their larger and higher profile fund managers underperforming over the last 12-18 months. With this factored into the price, we felt there was value on offer and a positive outlook to earnings growing with newer managers in the stable looking very prospective regarding growing their funds under management. The result itself ended up being slightly better than expected, and the outlook for 2H20 suggests they are on-track to exceed consensus expectations for FY20.

Key Detractors: Payment solutions provider **EML Payments (-31.2%)** and utilities services company **Service Stream (-20.2%)** were key examples of companies that delivered to expectations and provided a positive outlook, yet their share prices were savagely sold off in the month. EML has been a tremendous performer over the last year, however being a well held stock, trading at a premium to the market, and not printing 'a beat' perhaps explains the profit taking. Service Stream remains a robust small cap industrial company, growing its defensive earnings under the leadership of top-tier management, at a cheap valuation; a compelling investment in any market.

Telco provider **Over the Wire Holdings (-27.9%)** was one of the few disappointing results for the Fund. The interim release highlighted higher costs relating to investments made in the period together with a softer revenue return which led to downward revisions to the 2020 full year. After meeting with management and despite the miss, we have come away with the belief that the business strategy remains intact and together with the investment made in the period, the profit growth will return to ~15%pa on the back of more stable recurring revenue growth.

Consumer lending company **Wisr (-35.8%)** was sold off aggressively despite the release of its interim result which indicates that the company continues to deliver against expectation and grow its loan book at a rapid rate. It's the one company held in the Fund that is not currently profitable at the group level (albeit capitalised well with over $30m of cash in the bank), and the sell-off in markets has been particularly ruthless on companies with this profile – specifically microcaps without earnings. A recent $200m debt facility provided by NAB allows the company to continue to grow its loan book at a rate of 10-20% quarter on quarter and at a much more profitable level.

Performance Attribution^		Top 5 Active Positions^
Top 5 Contributors	**Top 5 Detractors**	
AUB Group	EML Payments	AUB Group
Centuria Capital Group	IDP Education *	Codan
IOOF Holdings *	Over the Wire Holdings	Johns Lyng Group
Johns Lyng Group	Service Stream	Service Stream
Pinnacle Investment Management Group	Wisr	Shine Corporate

^ Alphabetical order. * Denotes stock not held.

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