Flinders Emerging Companies Fund

Quarterly Update: June 2020

FLINDERS
Investment Partners

Performance *(after all fees and expenses)*	1 Month (%)	3 Months (%)	1 Year (%)	3 Years (% pa)	Since Inception^ (% pa)
Flinders Emerging Companies Fund	-0.4	29.3	1.5	11.6	10.4
S&P/ASX Small Ords Accumulation Index	-2.0	23.9	-5.7	6.1	9.2
Net Value Added	**1.6**	**5.4**	**7.1**	**5.5**	**1.2**

^ 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: Recommended
Zenith: Recommended

Platform Availability

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

Further Information

www.flindersinvest.com.au

- **Now, that was a market recovery!**
- **Can economies really bounce back strongly?**
- **A new chapter as Flinders partners with Warakirri Asset Management**

It would be fair to say that if few expected the severity of the market fall in March, even fewer would have anticipated the extent of the recovery in the June quarter. The ASX Small Ordinaries Accumulation Index rose 23.9% for the quarter, dramatically outperforming its large-cap peer (the ASX100 Accumulation Index was up 16.0%).

Global markets were obviously strong over the quarter, none more than the Nasdaq index which rose 30.6% to an all-time high – a rise of 25.6% over a year that had most markets down! Domestically, it was the resources and technology sectors that led the market higher. One would have expected technology, but commodity prices (notably iron-ore, copper and gold) surprised as China recovered and supply bottlenecks continue.

It's hard to know if the COVID-19 pandemic is currently better or worse than experts anticipated three months ago. If one had said that by the end of June there would be over 11m global cases of which almost 3m were in the US, the reaction would have been negative. So, while the numbers might be worse, the level of fear has sharply declined, and that has certainly been a factor in the recovery. Living with the virus is now the challenge as economies have moved from lock-down to re-opening.

How that pans out for economic recovery is still unknown. Interest rates are effectively zero, all major economies have embarked on very significant fiscal stimulus, but governments are still trying to balance the medical and the economic. Some of the recent economic releases have been encouraging (consumer spending, clearance rates, auto sales), but renewed lockdowns, border closures and the risk of infection rates moving higher in other states might just slow the pace of recovery for a few months.

We feel that our current portfolio positioning of being underweight consumer facing sectors, healthy exposure to industrial and resource reliant companies plus quality technology based stocks is a good balance to provide continued growth and returns.

Lastly, and of significance, we are very pleased to have formalised a partnership agreement with Warakirri Asset Management. Warakirri have acquired a 50% stake in Flinders and will provide distribution, administration and client services on our behalf. The investment activities remain unchanged with the Flinders team continuing to run the portfolio with the same focus and enthusiasm as we always have. It is an exciting development for Flinders and partnering with the long standing, high quality Warakirri team will bring increased resources to benefit the future of both businesses. Please see the media release here for further information.

Performance Review

The Fund returned 29.3% in the quarter, 5.4% better than the benchmark return of 23.9%. For the 2020 financial year, the Fund returned 1.3%, 7.0% above the benchmark return of -5.7%.

Key Contributors: The quarterly contributors reflected a diverse and balanced portfolio. Online design and fulfilment provider, **Redbubble (+249.2%)** had an outstanding quarter as the company confirmed an acceleration in sales over the June quarter as more customers moved their buying habits online. Both sales and profitability were well above expectations. The business performance together with a positive cash balance of $56m continues to support our confidence in the future of the company. Gold mining company, **Saracen Mineral Holdings (+47.7%)** benefitted from the higher gold price, while confirmation that the company was on track to produce +500,000oz of gold this year as well as confirmation that the recently acquired 50% stake in the Kalgoorlie Super Pit was on track also helped performance. The company's inclusion into the ASX100 late in the quarter would have also supported the stock; Flinders first bought the stock in late 2015, so seeing the stock graduate into the top 100 has been a terrific outcome for investors.

In April we made the decision to add or increase positions in some select consumer finance companies; these stocks had been hit hard, yet the JobKeeper package would clearly help keep bad debts at bay. Online lender, **Wizr (+117.2%)** was one of those. The company continues to grow its book faster than expectations but with little compromise on the credit quality of its customers. Margins are also increasing, with the company now accessing cheaper funding facilities. Consequently, it had an exceptional quarter. As did machine learning and AI dataset provider, **Appen (+72.3%).** The business continues to perform well with the company confirming full year guidance at its AGM. This, together with the strength of the technology sector underpinned a strong share price performance from the lows of March.

Sometimes it's also what you don't own that can help relative performance in a volatile market and not owning NextDC or Metcash in the portfolio was beneficial to performance during the quarter.

Key Detractors:

Managed telecommunications provider, **Over the Wire Holdings (+18.9%)** was sold from the portfolio due to its exposure to the small business sector that we anticipated may have been struggling. So, whilst capital project activity has been impacted in the period, their customer base appears more resilient and hence we exited this position too early. Domestic gas producer, **Cooper Energy (-11.8%)** also struggled over the quarter. Delays to its Sole gas project in Victoria coming on stream due to problems commissioning the APA owned Orbost production plant has seen the stock retrace. While the delays are frustrating, the engineering is not frontier technology and the plant will perform soon (think we said that last month…) and the valuation of a long-term project such as this is not greatly impacted.

Telco and utilities engineer and service provider, **Service Stream (+4.7%)** proved that its earnings are resilient, but a 5% downgrade to 2020 profit expectations saw the stock badly underperform over the quarter. With NBN engineering work winding down and connection activity to be flat over the next couple of years, we believe this will be offset by a rise in 5G mobile expenditure and more work from the water and electricity divisions in the medium term.

Portfolio Activity

Additions: Compared with the March quarter, our trading activity was modest. We added a new gold miner and producer, **Ramelius Resources (RMS)** into the portfolio. Ramelius is the type of resource company we look for –well capitalised, good management with a history of executing, growing production, exploration upside and strong cashflow – plus it has its assets in a traditional domestic gold mining area with infrastructure.

We have held insurance broker, AUB Group in the portfolio for some time and it has performed well. The industry remains in good shape with brokers capturing market share from their direct competitors. During the quarter we added its larger competitor, **Steadfast Holdings (SDF)** to the portfolio. Industry volumes have only declined modestly but rates have improved over the past two quarters. The company is well capitalised and positioned well to make accretive acquisitions.

Exits: As mentioned earlier, we exited telecommunications company, **Over the Wire Holdings (OTW)** during the quarter and also **Viva Energy REIT (VVR)**. The latter had held up comparatively well during the sell-off in March and rebounded quickly, and as the stock approached valuation in early April, we sold out and reinvested the funds into a number of stocks with greater valuation upside.

At the end of the quarter we had 39 stocks in the portfolio and were holding 4.1% cash.

Performance Attribution^		Key Portfolio Positions^
Top 5 Contributors	Top 5 Detractors	Top 5 Active Holdings
Appen	Cooper Energy	Austal
Metcash*	Over the Wire Holdings	Codan
Redbubble	Shine Justice	Johns Lyng Group
Saracen Mineral Holdings	Service Stream	Service Stream
Wisr	Victory Offices	Shine Justice

^ Alphabetical order. * Denotes stock not held. Attribution is for the 3 months ending 30th June 2020. Top 5 positions are effective 30th June 2020.

Stock in Focus: Redbubble (RBL)

Redbubble (RBL) is an online marketplace that facilitates artists uploading their designs and creative works which can subsequently be printed onto various products including apparel, accessories, housewares, posters, and covers etc., and then sold to customers. The company owns and operates two distinct online marketplaces: Redbubble and TeePublic. Impressive and growing statistics across the group include: 27.7m active works, 350k selling artists, 3.7m unique customers. A 3rd party fulfiller network is in place which produces and ships the products to customers, thereby limiting RBL's inventory risk. The company was founded in 2006 and is headquartered in Melbourne, Australia.

Investment Case Key Questions

1. **Growth Opportunity:** as a global online marketplace, RBL has benefitted strongly from the structural migration to online shopping. Over the last five years to FY19, the company has grown its revenues by ~40% p.a., with organic growth accounting for >30% growth p.a. The company has delivered key profitability milestones of positive net operating cash flows in 2018 and positive operating EBITDA in 2019. NPAT profitability is on the horizon, with strong growth in both top line and earnings expected to continue over the next few years, as the structural shift to shopping online continues.

2. **Management:** RBL founder, former CEO and largest shareholder Martin Hosking is currently Interim CEO, as a search for a permanent CEO is underway. He knows the business intimately having started the business from scratch in 2006; we eagerly await the announcement of the upcoming CEO. Emma Clark is the CFO, having joined the company on 1 June 2019 from ANZ's Technology division where she was CFO. She has brought additional rigour to the business regarding investments and spend to support the best possible returns and future growth.

3. **Financial Strength:** the balance sheet is very strong with the company having maintained a net cash position since listing in 2016. The closing cash balance at 31 May 2020 was $56m. The business exhibits negative working capital which is very attractive as a funding mechanism as the company continues to grow. The company has grown almost entirely organically since inception, with the exception of the acquisition of TeePublic in October 2018 which was funded via an equity raising; the acquisition has exceeded expectations to date in all aspects, particularly regarding the rate of growth delivered.

4. **Risks:** competition from other online marketplaces; efficiency in their acquisition of customers (Google organic search traffic and paid marketing); overall consumer spending (offset to an extent by the structural shift to online spending); disruptions to supply chain particularly in a COVID-19 environment.

5. **Valuation:** our Assessed Company Valuation (ACV) is currently $3.20/s, reflecting upside of >50%. The stock remains attractively valued at ~1x EV/Sales, which is 3-4x cheaper than other global ecommerce peers, whilst our current DCF points to a valuation over $3/s.