Flinders Emerging Companies Fund

Monthly Update: August 2022

FLINDERS
Investment Partners

Performance *(after all fees and expenses)*	1 Month (%)	3 Months (%)	1 Year (%)	3 Years (% pa)	5 Years (% pa)	Since Inception^ (% pa)
Flinders Emerging Companies Fund *	1.19%	-2.92%	-18.48%	4.70%	9.23%	9.55%
S&P/ASX Small Ords Accumulation Index	0.58%	-2.59%	-14.66%	4.09%	6.85%	9.11%
Net Value Added *	**0.61%**	**-0.33%**	**-3.82%**	**0.61%**	**2.38%**	**0.44%**

^ 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: Citigroup

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

Fund Size

$148.5m

APIR Code

ETL0449AU

M-Funds Availability

Code FEC01

Responsible Entity

Warakirri Asset Management Ltd

Research Ratings

Lonsec: Recommended
Zenith: Recommended

Platform Availability

Macquarie Wrap, HUB24, Netwealth, uXchange, BT Wrap, BT Panorama, AMP, North, Xplore, MLC Wrap, CFS FirstWrap, Powerwrap, Navigator, IOOF, Praemium

Further Information

www.flindersinvest.com.au

- **Reporting Season: Solid profits but forecasts slip**
- **Commodities easing – tempering inflation**
- **When good news is bad news**

The Small Ords Accumulation Index rose a modest 0.58% in August, consolidating the strong rise in July. Resources strongly outperformed industrials despite commodities coming under pressure later in the month.

Global markets were generally weaker with the Nasdaq, Dow Jones and S&P500 all falling just over 4%, European markets posting similar declines and Asian markets holding up better with rises of around 1%. Commodities (with the usual exception of coal and gas) showed signs of cracking with oil (Brent) down 12.3%, base metals slightly lower and iron ore down 16%. The weakness was largely driven by continued soggy economic data out of China but also the expectation of slowing economic conditions in the US and Europe. All should help reduce the upward pressures on inflation, but Russia's disruptions to European gas supply continues to keep seaborne electricity fuel sources (LNG and thermal coal) at elevated levels in those countries.

August also saw bond yields head back toward the highs of mid-June with the US Fed reiterating its steely focus on lowering inflation whilst data pointed to strong employment, wages and retail spending. A case of the better the economic news, the further the Fed has to squeeze rates up to strangle inflation. The situation in Australia is similar; solid consumer spending and strong employment has been evident during the August profit reporting season, meaning the RBA won't pause its rate rises for some time yet.

So, onto reporting season. In a nutshell, better earnings than expected (off a lowered base) but with cautious commentary leading to downgraded profit forecasts for the 2023 and 2024 financial years. Consensus figures are now expecting a very modest 4.7% growth in Small Ordinaries EPS for the 2023 financial year sharply down from the 16.9% EPS growth posted in FY 2022. While the decline in growth is impacted by a sharp contraction in resource company earnings (down from 57.0% growth in FY22 to a forecast 8.0% growth in FY23), small industrials have seen a steady decline in FY23 EPS growth forecasts from 15.2% to just 3.2% over the past three months.

The decline has had more to do with costs than revenue. Energy, staff, transport and logistics costs are well documented but the need to hold higher levels of inventory because of disruptions has been a feature of this reporting season. This has come at a cost to free cashflow as working capital is deployed. Management teams must balance that capital against sales budgets or risk margin decline and debt blowout.

These factors will be closely monitored. We remain focussed on companies that have a healthy capital structure and can still provide earnings growth well above the market. Currently the EPS growth forecast for the Flinders portfolio is over 25% (consensus) for this financial year, a healthy buffer above the market. And importantly, this remains at a significant P/E discount to the Small Ordinaries index (13.4 times versus 15.8 times).

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Performance Review

The Fund returned 1.19% in August, 0.61% ahead of the benchmark which rose 0.58%.

Key Contributors: The key factor that supported the resources sector in August was the strength in battery material stocks. We hold two in the portfolio, lithium company **Liontown Resources (+31.4%)** and graphite producer **Syrah Resources (+26.9%)**. Both continued to perform strongly after being hit hard in May/June. Both companies have world class resources – long life, high grade and with downstream manufacturing opportunities and critically, both are well funded for their growth projects. While a number of commodities have sold off in recent months, global demand for electric vehicles continues to grow strongly and most battery inputs remain at elevated levels.

Mining and infrastructure contractor **NRW Holdings (+26.0%)** was also a standout performer in August. We re-entered the stock earlier in the year believing that they had been hit too hard on cost fears in their WA operations. That was the case late in 2021 but the company had addressed many of these issues with re-structured contracts, had won new work and were in a strong financial position to win more. The company pre-announced better than expected 2022 profit results in early August and announced new contract wins with their audited results later in the month.

Insurance Broker, **AUB Group (+14.7)** continued to re-rate following the large equity raise in May to fund the acquisition of UK based global insurance broker, Tysers. Despite the deal being accretive and providing a platform for future international growth, the stock struggled during the May/June market sell-off. A good management team, growth opportunities and rising insurance rates has seen the stock perform strongly over the past two months. As did domestic gas producer, **Cooper Energy (+20.0%)** – and for similar reasons. Cooper announced the transformational acquisition of the Orbost gas processing plant from APA in June. This was accompanied by a $244m capital raise. While the deal will create significant value for shareholders over many years and is strategically sound, the market struggled to absorb the new scrip and the stock traded under issue price through most of July before consolidating and moving higher this month. With east coast gas prices remaining at elevated levels, we feel the stock can continue to perform well.

Key Detractors: It is a rare reporting season that passes without something disappointing or unexpected. This season wasn't rare although the good and the bad seemed to balance themselves out. Utility engineering and service company, **Service Stream (-30.5%)** lobbed an unexpectedly poor result, mainly due to a one-off contract loss due to the QLD floods. Normally this would be partly forgiven by the market, but they then were particularly ambiguous about the prospects of reaching expected 2023 profitability. Uncertainty never sits well with investors and the stock was hammered. Following meetings with the company, we have no reason to believe current forecasts can't be reached (natural catastrophe aside) and have retained a position in the stock.

Apparel retailer**, City Chic Collective (-29.5%)** released a creditable result in a difficult market but fell victim to the 'high inventory, poor cashflow' syndrome. Inventory was high as at June 30th but the company has the advantage of having double seasonal sales periods because of its global exposure – and it is still growing, so a rise in inventory is normal. The doubters would suggest too much stock in a consumer downturn leads to heavy discounting. The company would counter with the fact that if you don't have stock, you can't make a profit. Management have successfully navigated good markets and poor in the past and the company is well capitalised and growing. We expect them to have a solid year.

Electronics equipment producer, **Codan (-14.3%)** also released a solid result but doubts about a rebound in its Minelab metal detection business this year seemed to un-nerve the market. This was despite a very strong result from its global communications business that is performing better than expectations. As the market comes to appreciate the opportunity and growth profile of its US communications division, we expect the stock to recover. And, also releasing a solid result but a cautious 2023 was **Credit Corp (-15.0%).** Lower earnings in Australia are expected, but their US collections business is doing particularly well and will be the basis of improving growth in 2023.

Performance Attribution^		Key Portfolio Positions^
Top 5 Contributors	Top 5 Detractors	Top 5 Active Holdings
AUB Group	City Chic Collective	AUB Group
Cooper Energy	Codan	Codan
Liontown Resources	Credit Corp	NRW Holdings
NRW Holdings	Sayona Mining *	Peoplein
Syrah Resources	Service Stream	Shine Justice

^ Alphabetical order. * Denotes stock not held. Attribution is for the 1 month ending 31st August 2022. Top 5 positions are effective 31st August 2022.