Flinders Emerging Companies Fund

Monthly Update: May 2023

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 *	-4.40%	-0.74%	-7.83%	3.54%	3.35%	7.85%
S&P/ASX Small Ords Accumulation Index	-3.26%	-1.29%	-5.77%	4.46%	2.46%	7.72%
Net Value Added *	**-1.14%**	**0.54%**	**-2.06%**	**-0.92%**	**0.89%**	**0.13%**

^ 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

$153.5m

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

- **Debt ceiling negotiations dent equities**
- **Interest rates starting to bite at home; retailers hurting**
- **Earnings expectations little changed. Small Cap bargains aplenty**

Markets sold off in May, in what was a 'risk-off' month given weak market sentiment. Debt ceiling negotiations in the US weighed, as did further interest rate increases by central banks, particularly given robust employment data and stickier inflation prints.

The Small Ords Accumulation Index declined 3.3% in May, underperforming large caps which were down 2.4%. There was even more weakness further down the market cap spectrum; to illustrate, the Emerging Companies Accumulation Index was down 6.3%. Risk sentiment has clearly been weighing on smaller stocks. Industrials (-1.7%) performed far better than Resources (-7.1%), reflecting continued weakness across most commodities.

The US market was curious in that the S&P500 was reasonably flat (+0.2%), and while the Dow Jones was down 3.5%, the Nasdaq was *up* a strong 5.8%. Strength in the megacap tech companies was the key reason for this divergence, with investor interest and enthusiasm for all things related to artificial intelligence (AI). European markets were weak with the UK FTSE -5.4%, Germany -1.6% and France -5.2%. Asian markets were also negative with Hong Kong down a hefty -8.3%, China -3.6%, and Singapore -3.4%; Japan bucked the trend however, with the Nikkei up 7.0%.

As mentioned, commodities were broadly weak, with the biggest moves seen in coal (-27.3%), base metals (zinc -16.9%, nickel -14.0%) and WTI crude (-11.8%). Elsewhere, copper was -6.5%, and iron ore was -4.8%. The only relatively resilient commodity of note was gold (-0.9%). The China reopening trade has faltered in recent weeks which has weighed on the sector. On the reopening trade, it's important to note that the consumer still has plenty of dry powder to spend, and policy makers could stimulate meaningfully.

Despite the risk-off sentiment seen in the moves above, bonds were *not* bid up as a safe-haven. Rather, both US and Australian 10-year yields were up 20bp and 26bp respectively. Rising interest rates over the last 12 months are clearly starting to bite, with several updates from domestic retailers highlighting that trading conditions had softened over the last couple of months. Yet, there are pockets of spending with travel companies reporting strong demand. Unemployment rates continue to track around record low levels and the resilience of several indicators meant that the RBA delivered a surprise rate hike.

Despite 'confession season', profitability for most companies and the broader market remains on track. Consensus forecasts show little change in EPS for both FY23 and FY24 from what was expected in the prior month. Currently, EPS growth for the Small Ords in FY24 is 16.4% (vs 16.6% expected the previous month). Despite this, the Small Ords index has de-rated nearly a full PE point to 14.6x in April. Similarly, the Flinders Emerging Companies Fund showed little change in earnings expectations, with 38.3% growth expected in FY24; amazingly, the PE has de-rated even further to 11.2x. Like a coiled spring, the portfolio is inherently filled with strong re-rating opportunities.

Performance Review

The Fund returned -4.4% in May, -1.1% below the benchmark return of -3.3%.

Key Contributors: Billing software company **Gentrack Group (+29.5%)** announced their 1H23 result, which exceeded expectations, while both FY23 and FY24 revenue guidance was upgraded. A relatively new holding to the Fund, Gentrack has undergone a significant turnaround and investment phase, which is now seeing the company win new utilities customers globally, many of whom operate on archaic systems in critical need of upgrade. The addressable market for the company globally is substantial, and currently serviced mostly by SAP and Oracle who have legacy solutions ill-fit for the modern needs of utilities customers. A partnership with Salesforce is helping win new business. Bus and tourism operator **Kelsian Group (+11.5%)** rallied without specific new news but rather a reminder to investors (via a conference presentation) that they have a number of favourable attributes, particularly in this environment; namely that costs are well hedged through their contracts, that a rebound in tourism is benefitting their Marine and Tourism businesses, and that a strong tender pipeline of bus contract opportunities exists. The recent major acquisition of All Aboard America! was also due to settle imminently, with early indications suggesting that the acquisition should at least deliver to expectations.

Private health insurer **NIB Holdings (+9.5%)** also presented at a conference revealing net policyholder growth and net margins remained robust. The company also acquired its fourth National Disability Insurance Scheme (NDIS) plan manager, Port Macquarie based All Disability Plan Management. NIB made its first acquisition in the NDIS space only in November 2022, and has been focused on growing this capability under its Thrive brand. Several other acquisitions are under consideration, which if successful, would see Thrive become a top three plan manager in the NDIS. Similarly, fund incubator **Pinnacle Investment Management (+8.8%)** presented at a couple of conferences and provided updated FUM and flow data to 31 March 2023. Despite a cautious stance across their institutional, financial adviser and individual investor base, net inflows were seen. Markets were positive over the March quarter as well, helping increase FUM levels.

Key Detractors: The key disappointment for the Fund over May was engineering and manufacturing group **Austin Engineering (-25.6%)**. The company materially downgraded its FY23 earnings guidance, primarily due to their largest customer delaying orders of truck trays. While the contract is signed, actual purchase orders have been delayed; a separate announcement later in the month suggested that 85% of the purchase orders had been received, however the lead times mean that these orders will benefit revenue in the 2024 financial year. Hence, not lost earnings but deferred. Invoice financing firm **Earlypay (-24.1%)** gave up the gains from the previous month on no news. Earlypay is emblematic of many microcap stocks currently, where perceived risk and illiquidity has resulted in a lack of investor appetite. For stocks tracking near 12-month lows, tax-loss selling has exacerbated poor performance further.

The three remaining key detractors are similar in that they are resources companies (which as mentioned had a tough month). This is despite some positive stock developments. Emerging mineral sands producer **Strandline Resources (-15.3%)** has been in the process of ramping up production at its Coburn Project in WA, with its sixth shipment of Heavy Mineral Concentrate (HMC) being completed. ~$60m of revenue has been generated from these shipments to date, with a steady rate of one shipment per month being expected going forward. Remarkably, product is being sold at 40% more than what their feasibility study was based on, given prevailing market prices, a terrific outcome for revenues.

Domestic gas producer **Cooper Energy (-17.6%)** announced that operatorship of its problematic Orbost Gas Processing Plant would transfer from APA Group to Cooper Energy on 22 May 2023. The plant has not been running to expected performance levels under APA Group's operatorship, who frankly haven't paid attention to running the asset to its full potential. We're of the view that several 'low hanging fruit' initiatives exist to meaningfully improve the performance over the short to medium term. Nickel miner **Panoramic Resources (-30.0%)** had some positive drilling and exploration updates, however this was overwhelmed by the steep sell-off in the nickel price, to which Panoramic is leveraged to.

Performance Attribution^		Key Portfolio Positions^
Top 5 Contributors	Top 5 Detractors	Top 5 Active Holdings
Gentrack Group	Austin Engineering	AUB Group
Kelsian Group	Cooper Energy	Credit Corp Group
NIB Holdings	Earlypay	Johns Lyng Group
Perseus Mining *	Panoramic Resources	Kelsian Group
Pinnacle Investment Mgmt Group	Strandline Resources	Pinnacle Investment Mgmt Group

^ Alphabetical order. * Denotes stock not held. Attribution is for the 1 month ending 31st May 2023. Top 5 positions are effective 31st May 2023.