

Flinders Emerging Companies Fund

Monthly Update: August 2023



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 *	-1.35%	3.52%	-1.72%	1.40%	3.22%	8.06%
S&P/ASX Small Ords Accumulation Index	-1.31%	2.22%	-1.12%	3.00%	2.40%	7.76%
Net Value Added *	-0.04%	1.30%	-0.60%	-1.60%	0.82%	0.30%

[^] 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

\$148.6m

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: Noisy, Volatile and Insightful**
- **Corporates managing the slowdown well**
- **Small-caps remain the place to find growth**

Equity markets retraced slightly in August after a strong month in July. Bond markets remained under pressure with the US 10-year treasury yield reaching its highest level since the GFC. The AUD was also under significant pressure dropping under US\$0.65. Large caps (-0.7%) outperformed smaller companies (-1.3%) which partially reflects the more volatile price moves during reporting season – but we will come to that shortly.

Global markets all retraced with the US S&P500 down 1.8% and the Nasdaq down 2.2%. European markets were weaker again with falls between 2.5-3.5% and flowing from continuing weak economic data, Chinese equities were down 5.2% and the Hong Kong market 8.5% lower. Commodities were mixed with oil (WTI) up 2.2%, iron ore up 5.9% and thermal coal up 13.6%. Base metals were weak, gold off 1.3% and in bad news for some farmers, the ABARE 2024 wheat crop forecast was significantly reduced and the global wheat price fell 9.8% in August.

Reporting season confirmed the different state of many industries, the impact of higher rates, cost pressures and the varied abilities of management teams to deal with the current challenges. As a snapshot, the results were better than feared for 2023 but resulted (in aggregate) in minor downgrades for the 2024 financial year's profit expectations. Like the interim results in February, the most noticeable headwind was the increase in interest costs. Other relevant observations included:

- Company forecast revenues were little changed but margins modestly reduced.
- Earnings per share growth forecast in small-caps came back by 4.2% over the month. This included a slight drop of 3.2% for Industrials with higher interest costs and depreciation and amortisation charges noticeable.
- Small resources were downgraded by 5.7% with higher operating costs a feature.
- The Australian household is clearly spending less on some discretionary items (homewares & household goods both noticeable), but other areas (services and entertainment for example) have held up.
- Housing remains weak with builder stress, higher costs and rates impacting.
- REITs remain under pressure, particularly office.
- The employment market has loosened somewhat, and supply chain issues have almost normalised, but energy costs, insurance and Government charges remain issues.
- Smaller companies are still investing to grow.
- Dividends came in lower than expected – reflecting a level of caution. Sensible.

Overall, we felt the August reporting season was encouraging for small cap equities. While there were modest downgrades to the outlook, the Small-Ords is still forecast to grow at 10.0% in FY 2024. A contrast to the negative 1.5% for the ASX100. Small caps remain an asset class that provides the opportunity for good capital gains and compelling valuations.

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Performance Review

The Fund returned **-1.35%** in August, marginally below the benchmark return of **-1.31%**.

Key Contributors: Reporting season always throws up surprises and often larger than expected stock moves – this year was no exception. Insurance building and restoration services company, **Johns Lyng Group (+21.4%)** recovered strongly after lagging the market over the previous few months. A strong performance from its core insurance-based business, growth prospects in the US and opportunities in strata management services all boosted confidence in the 2024 outlook. In particular, the market liked the +20% earnings growth guidance in their Business as Usual (BaU) divisions. Its catastrophe repairs business is inherently lumpier but is seeing greater opportunity with agreements with State Governments and expansion into the US.

Building protection and remediation provider, **Duratec (+19.1%)** posted another strong profit result that also led to upgraded profit expectations for the next two financial years. Particularly strong growth came from its contracts with defence facilities but also in the mining and industrial divisions. Good cost control led to improved operating margins which sets the company up for another good year given their increased pipeline of potential work with major customers. Emerging gold producer, **Bellevue Gold (+16.6%)** is on the cusp of production (first gold within months) and will be a low cost, high grade producer with a project that is (unusually for WA) on track. The company has clear expansion opportunities, is well funded and will be generating significant cashflows in 2024. While the gold price was slightly down in August, the weaker AUD saw the price in local currency creep back toward the record levels reached in early May this year.

While mentioned a number of times in recent reports, insurance broker **AUB Group (+7.5%)** continues to post strong profit results both from its domestic operations and from the newly acquired Tysers broking and distribution business in the UK. The August profit release led to modest upgrades for the 2024 FY but with the rate cycle remaining strong and volumes solid, we can see scope for even stronger outcomes. With large stock moves in both directions, not owning stocks that are sold down heavily can help performance relative to the benchmark, and in the case of **Chalice Mining (-39.6%)** and **IRESS (-38.3%)** we benefitted from not owning either company.

Key Detractors: Compensation lawyers, **Shine Justice (-23.7%)** have had a number of issues surrounding the final settlement of the Mesh implant class action win against Johnson & Johnson. The case had run for a number of years and the legal costs were very high and funding costs also significant. While the settlement total of \$300m is clear, the revenue to Shine is yet to be determined and is facing legal challenge. The ultimate impact is reduced cashflow and perhaps a reduced level of expected return on what has been a torturous process for both the claimants and Shine.

Mineral sands developer, **Strandline Resources (-20.5%)** drifted lower following its capital raising in July. There was no new news out on the company but since that time, mineral sands prices have eased and the extra stock issued is clearly causing indigestion. Importantly, the company now has sufficient working capital to start shipments of concentrated product. Medical consumables manufacturer, **Trajan Group (-18.4%)** slipped after its profit result, while healthy at an EBITDA level, missed net profit expectations due to higher depreciation and interest costs over the year. The company continues to grow revenues and importantly, margin and returns. Given its global growth opportunities and customer base, we see the stock as significantly oversold.

Debt collector and unsecured lender, **Credit Corp (-9.3%)** fell in August after being a strong performer over the past few months. Profit guidance for 2024 was a little more cautious than had been expected due to slightly slower debtor recoveries in the US during June and July. This should be temporary given the still strong employment conditions in that market.

Performance Attribution [^]		Key Portfolio Positions [^]
Top 5 Contributors	Top 5 Detractors	Top 5 Active Holdings
Bellevue Gold	Cooper Energy	AUB Group
Chalice Mining *	Credit Corp Group	Karoon Energy
Duratec	Shine Justice	Kelsian Group
IRESS *	Strandline Resources	Johns Lyng Group
Johns Lyng Group	Trajan Group Holdings	Seven Group Holdings

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

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