

Flinders Emerging Companies Fund

Quarterly Update: June 2024



Performance (after all fees and expenses)	1 Month (%)	3 Months (%)	1 Year (%)	3 Years (% pa)	5 Years (% pa)	7 Years (% pa)	Since Inception [^] (% pa)
Flinders Emerging Companies Fund *	-0.29	-1.69	8.19	-3.96	4.37	7.83	7.96
S&P/ASX Small Ords Accum Index	-1.39	-4.46	9.34	-1.54	3.70	6.15	7.83
Net Value Added	1.11	2.77	-1.16	-2.41	0.67	1.68	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

\$112.0m

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



- **Hey Jim, we're not in step...**
- **What would an August rate rise do?**
- **No politics**

The S&P/ASX Small Ordinaries Accumulation Index finished 4.5% lower in the June quarter giving back some of the gains of the previous three periods. For the year, the index returned 9.3%. Industrials and resources performed in line over the quarter but were markedly different over the year with industrials outperforming by almost 12%. The ASX100 outperformed Smalls, largely driven by the banking sector.

Global markets were mixed in the June quarter. US indices were kept afloat by the continued performance of major tech stocks, Nvidia in particular. As a contrast, there was a 10% difference between the Nasdaq (up 8.3%) and the Dow Jones (down 1.7%). European markets were also mixed, with the UK FTSE up 2.7% but politics unsettled the French market, with the CAC falling 8.9%. Asian markets were also driven by tech, none more than Taiwan which rose 13.5% for the quarter and is up 36.2% for the year. Semiconductor manufacturer TSMC has doubled over the year and now makes up close to 50% of the Taiwanese index. Hong Kong rallied 7.1% and China lost 2.4%.

While commodities eased in June, over the quarter they were strong. Copper was up 7.9%, gold 4.2%, iron ore 4.4% and zinc 20.3%. The oil price recovered late but still eased 2.3%. A turning point for markets were the lower inflation figures in the US posted early in May. Bond yields had reached a year high of 4.70% and equity markets were looking nervous. The inflation surprise and some slightly weaker economic releases saw the prospect of rate cuts back on the agenda this year. After an April hiatus, big tech stocks took off again – leaving all other sectors (and small caps) languishing.

Which brings us to the domestic market. Australian inflation remains stubborn. Most OECD economies are seeing encouraging inflation falls. We are not. We mentioned in the May report that the Budget was a missed opportunity to squirrel away a rare surplus and with wages growth, tax cuts and State Governments still spending heavily, the chance of rate cuts this year were reduced. With the consumer clinging on, business still investing, and a rolling maul of wage rises coming through, there is now a growing expectation of a rise in August. This would not be good news.

Currently, confidence is brittle. A 25-basis point rise in rates by itself won't do the damage. What it does, is make it clear that without a more significant slowdown, rates are not coming down soon. That does little for confidence, risks putting expenditure and investment on pause and curtails employment growth. It certainly doesn't entice someone to buy some land and build a house. Well, that's *if* the RBA lifts rates.

The US cutting rates will be good for markets; ours too. We still find it hard to be too positive on consumer facing stocks right now but fortunately in small caps there are plenty of other stocks in industries with brighter prospects.

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Performance Review

The Fund returned **-1.69%** in the March quarter, **2.77%** above the benchmark return of **-4.46%**.

Key Contributors: The first six weeks of the quarter saw resources perform strongly then industrials take the running in the last six weeks. The diversification of the fund held it in good stead and performance was generated from a wide group of industries. Radiopharma company, **Telix Pharmaceuticals (+44.7%)** was a standout after a number of developments. Positive results from their prostate cancer therapy (drug known as TLX-591) phase 2 trial, increased market conviction in the therapy's commercial potential. Pleasingly, the statistical result around safety (primary objective) were positive and progression free survival (basically the period for which the tumour is contained) at 8.8 months is significant and augurs well for future results.

Multi affiliate funds management group, **Pinnacle Investment Management Group (+21.9%)** also had a strong quarter. The main catalyst was the announcement of a new affiliate global equities team that were the previous managers for UK based financial services firm, Royal London. The highlight of the deal with the managers is that a significant amount of funds under management will be moving across with them. Their investment performance is strong which should lead to new client opportunities, particularly in the US where Royal London had not pursued opportunities. We also expect a strong period of performance fees to be reported amongst a number of other group affiliates at the August profit result.

Utilities billing software developer, **Gentrack (+11.5%)** continued to receive investor support as its client base both in Australia, NZ and the UK continues to grow. As we've mentioned before with Gentrack, it's involved in an industry that is changing dramatically. Legacy billing systems for both large and small utilities in electricity, gas and water are being replaced as the needs of both operators and customers become more complex, opening the industry for new technology such as that provided by Gentrack and others. We expect more customer gains throughout the rest of 2024. International insurance broker, **AUB Group (+6.6%)** had a strong finish to the quarter after a period of flat performance following a \$200m raising to fund the acquisition of 70% of underwriting agency, Pacific Indemnity. The insurance of professional risk is growing, and it expands AUB's areas of capability at an attractive price that will provide growth opportunities over many years. We continue to expect further acquisitions with the company's strong financial position.

Key Detractors: The market is still pretty savage on profit downgrades, especially if unexpected. Global RV and camper rental and sales operator, **Tourism Holdings (-39.5%)**, did just that. As mentioned in the May monthly, the company downgraded the outlook for both FY 2024 and 2025. While rental revenues and yields are holding up well, the company hit an air-pocket in sales of used vehicles in both NZ and Australia (the US was already quite weak). Given this coincided with further weakness in consumer confidence and a drop off in retail sales in both countries, we are now assuming that the weakness may be prolonged. We exited the stock.

Following a strong March quarter, debt collector and consumer lender, **Credit Corp Group (-19.2%)** gave back much of its gain in the June quarter. This was a disappointing outcome given that the company is now in a position to take advantage of better pricing of debt ledgers in the US, good availability and better collection efficiencies. The Australian lending book has grown strongly and profitably, and while the local debt ledger market is quiet, it will likely improve in 2025.

In April, retirement accommodation developer, **Lifestyle Communities (-20.7%)** announced a lower number of property settlements for the 2024 financial year than previously expected. While the number of contracted properties were in line with previous forecasts, the time to settlement had increased and pushed into the 2025 financial year. Given the nervousness in the property market about residential builders going bust, buyers are reticent to fully settle until their new home is complete. Importantly, demand for their product is still high and they are well capitalised to deal with the issues.

It is worth calling out two companies that we don't hold in the portfolio that performed strongly and impacted relative performance against the benchmark in the June quarter. **Alumina (+19.4%)** was subject to a takeover bid from its parent company, Alcoa, in May and received FIRB approval in June. Tracking technology developer, **Life360 (+25.1%)** continued its strong performance with growing subscription revenue and new advertising revenues announced.

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Portfolio Activity

Exits: As mentioned above, we exited **Tourism Holdings (THL)** following their downgrade in May. This reflected our lack of conviction in the rebound in sales for recreational vehicles in Australia and New Zealand. Consumer confidence is poor in both markets – especially for large ticket items, and rate cuts that may reverse that spending caution seem a little further out than previously thought. We only added marine services company **MMA Offshore (MRM)** in the March quarter and private equity (Cyan) bid for the company soon after. We can't profess more than lucky timing. We are still of the view that there was more upside to the share price given the strong earnings momentum in the company, but with no other bidders and the board recommending the bid, we exited the stock.

We'd held insurance broker, **PSC Insurance (PSI)** for considerably longer. The company had a strong market position in Australia and a successful and growing retail broking business in the UK. With the founders controlling much of the stock, there was always likely to be an exit strategy. The bid from UK based insurer, The Ardonagh Group has been recommended by the board and we felt it a price that fully reflected the value of the company and consequently sold.

Additions: During the quarter we added stocks from a diverse range of industries to the portfolio. Utilities and telco billing software provider, **Hansen Technologies (HSN)** was added after a period of stock price weakness saw its valuation become very attractive. As mentioned above, in the comments on Gentrack, the industry is undergoing significant change and providing opportunity for new and more agile existing players. Hansen is one of the latter. A more detailed note on our investment thesis is in this report under Stock in Focus.

Australian based international vessel builder, **Austal (ASB)** was added to the portfolio during the quarter. The company has grown its pipeline of forward work impressively over the past two years. It has increased its spread of vessel types contracted to the US Navy, significantly increased its forward order book to the Australian Navy and Border Force and expanded its repair and maintenance facilities in Australia and Asia. The current forward contract book stands at \$12.7 billion, stretching beyond 10 years, an increase of 55% in the past year. The company is well capitalised, is being managed well and with increasing work and rising returns. Little wonder that Korean marine defence company, Hanwha Ocean made a conditional takeover bid for the company at more than 10% above its current share price.

Botanix Pharmaceuticals (BOT) is a company that specialises in the development of dermatology products for the treatment of skin condition and infection treatments. We added the stock to the portfolio after the company was granted US FDA approval after successful phase 3 clinical trials of its Sofdra treatment for hyperhidrosis (excessive sweating). With over 10m people suffering from the condition in the US, the opportunity for the company is large and we expect revenues to be generated quickly as current treatments are either poor, expensive, or invasive. The capital raising to start the sales process was an opportunity to buy into the stock.

We took profits in uranium producer, **Paladin Energy (PDN)** and added another uranium company, **Peninsular Energy (PEN)** into the portfolio. This was also on the back of a capital raising to commission their Lance project in Wyoming. The resource is large and the area has multiple prospects for expansion and growth. The raising puts the company in a position to fully fund the project to positive free cashflow.

At the end of the quarter, we held 42 stocks in the portfolio and were holding 3.6% cash.

Performance Attribution [^]		Key Portfolio Positions [^]
Top 5 Contributors	Top 5 Detractors	Top 5 Active Holdings
AUB Group	Alumina *	AUB Group
Austin Engineering	Credit Corp Group	Credit Corp Group
Gentrack Group	Life360 *	Johns Lyng Group
Pinnacle Investment Mgt Group	Lifestyle Communities	Neuren Pharmaceuticals
Telix Pharmaceuticals	Tourism Holdings	Service Stream

[^] Alphabetical order. * Denotes stock not held during this period. Attribution is for the 3 months ending 30th June 2024. Top 5 positions are effective 30th June 2024.

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Stock in Focus: Hansen Technologies (HSN)

Hansen Technologies (HSN) is a software company that engages in the development, integration and support of billing systems for the energy, water and communications sectors. Functionality includes billing and customer relationship management software. The company operates globally, with the following geographic segments: APAC, Americas, and EMEA. The company has a long history, dating back to 1971.

One of the key strengths of the business is on the acquisition front, with over 25 companies acquired over its history. The company has typically acquired well (good businesses at attractive prices), and then 'Hansen-ised' the target where revenue and cost synergies are identified and delivered on, driving better margins and returns. Significant value has been created through this process over time.

Aside from the ongoing opportunity to acquire well, the industry backdrop for the energy sector in particular is favourable. Currently, legacy systems (Oracle and SAP) are predominantly servicing a rapidly changing and dynamic industry (eg. rooftop solar generation by households). The opportunity for HSN is enormous, with research firm Gartner expecting 100% of utilities needing to replace their billing systems over the next decade, and 20% expected to transfer by 2026. HSN is in a good position to service existing customers further, as well as gain market share from legacy incumbents.

Investment Case Key Questions

- Growth Opportunity:** HSN has had a long history of growth; EPS has grown 21% CAGR in the 10 years to FY23. The growth profile has been dented in the near-term given their most recent acquisition of powercloud which is currently loss-making. powercloud is a modern, cloud native billing system which is taking market share aggressively in Germany. While we expect EPS to drop ~15% in FY24 due to the acquisition, HSN has acquired the business very cheaply, and the share price retracement has provided the opportunity to buy into the stock. On our forecasts, we expect EPS to grow ~18% CAGR over the next three years from FY24, as the company 'Hansenises' powercloud and transforms it into a profitable business over the next 18 months. The favourable industry structure described above should also support accelerating growth.
- Management:** Andrew Hansen has been the MD of HSN since it listed in 2000, having joined the company in 1990. As mentioned, a lot of the value has been generated through the acquisitions made, which Andrew has been instrumental in. Andrew and his family own ~14% of the business. Richard English was appointed CFO in February 2023, having been with the company for four years prior. Given acquisitions has been such an integral part of HSN's success, it's also worth mentioning Niv Fernando who recently returned to HSN as Chief Strategy Officer. He was previously very active in M&A for HSN over several years, and returns with that remit.
- Financial Strength:** the company has a strong balance sheet, with \$8.2m net cash at their 1H24 result (and now a very small net debt position following the acquisition of powercloud earlier this year). Cash collections are strong, with high cash conversion. The company has historically used debt to pay for acquisitions, but then paid down the borrowings relatively quickly eg. since FY19, the company paid down \$131.5m to effectively zero in FY23. HSN has \$100m of debt available to them in accordion facilities. We expect acquisitions to remain a feature of the business.
- Risks:** large customer losses (top 10 customers make up ~33% of revenue; largest customer is ~7%). Regulatory changes – HSN's customers are include regulated utilities. Competition – looking to take share in an industry where major platform changes are expected.
- Valuation:** our Assessed Company Valuation (ACV) is currently \$6.20/s, reflecting upside of 38%. The stock should trade at a premium to the market given that HSN is a strongly growing and profitable software company with a clear pathway to growth, has high recurring revenues and improving margins.

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