Flinders Emerging Companies Fund

Monthly Update: February 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	-3.19%	-6.68%	0.82%	10.46%	11.43%	11.81%
S&P/ASX Small Ords Accumulation Index	-0.01%	-7.71%	5.02%	7.74%	9.35%	10.94%
Net Value Added	**-3.19%**	**1.03%**	**-4.20%**	**2.72%**	**2.08%**	**0.87%**

^ 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

$140.0m

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

- **Ukraine invasion**
- **Reporting season in a volatile market**
- **Commodities, commodities, commodities**

Market & Outlook

The Small Ords Accumulation Index was flat in February, but sectoral performance was extremely diverse. The small industrials fell 2.1% compared with a rise of 7.9% posted by the small resources index. Outside commodity exposed sectors, defensives such as REITs and consumer staples performed relatively well.

Global equity markets were generally weaker following the Russian invasion of Ukraine late in the month: Europe in particular, US indices were off 3-3.5%, Asian markets more resilient with modest gains. Moves in commodity prices on the back of the invasion were dramatic. Already strong over the past year, energy, base metals, gold and agricultural commodities all jumped. As has been well reported, Russia is a very significant exporter of oil and gas. But it is also a large producer in other key commodities including all base metals, gold (similar production to Australia), wheat and a number of strategic metals.

Oil rose over 10% during the month, nickel and aluminium over 10% each, gold was up 5%, the wheat price was up over 15% and coal over 20%. Since the end of February, and given the protracted nature of the conflict, all have kept rising. Little wonder there has been such a divergence between resource stocks and industrials. Such spikes are usually short-lived but with the scale of both the war and the consequent sanctions, high commodity prices are likely to persist.

Back home it was interim reporting season. Nothing like amping up a volatile market with corporate news flow. While not exactly pleased with some of the share price moves, on aggregate, small company profitability was slightly better than expected and while the outlook for the remainder of the year looks quite bright for earnings to improve, there still remains doubt toward some sectors that margins can be maintained or lifted with the expectation of better underlying demand.

Cost inflation continued to be a recurring theme in company announcements. Particularly freight and logistics but also labour and raw materials. Companies are now focussed on maintaining higher inventories, meaning higher working capital requirements which absorbs more cash. On the flip-side, many companies have managed price rises and cut costs in other areas to keep profitability at healthy levels as they emerged from lockdowns and managed through Omicron. This gives us confidence that the remainder of this year will see profitability in most sectors rise as consumer and business expenditure picks up and Government spending remains elevated.

The recent volatility in small caps due to reporting season, funds flow and global tensions is providing interesting opportunity. The fall in the market and a number of our own stocks has seen our portfolio become cheaper with no diminution in earnings growth. We expect coming months to see a number of our key positions re-rate.

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Portfolio

The Fund returned -3.19% in February, -3.19% behind of the benchmark which returned -0.01%. A challenging month in the small cap space with a number of stocks moving very sharply on profit results that were often only marginally above or below analyst expectations.

Key Contributors: Construction and engineering contractors had performed poorly over the past six months, largely on fears of higher costs and supply chain issues with materials, despite demand being high for their services. While this was true, some stocks seemed to have de-rated far too hard. We added mining and infrastructure contractor, **NRW Holdings (+36.3%)** into the portfolio in December on that basis, with added confidence post the company's AGM update in late November. It operates in key sectors that are seeing solid growth in expenditure. Management have addressed contract risk to better reflect underlying cost pressures and are winning new business. We expect the stock to continue to perform well into 2023 with their current book of business and to win more.

Utilities and telecommunications service provider, **Service Stream (+19.9%)** released a solid interim profit result and confirmed earnings guidance for the full 2022 financial year. Concerns that the company would struggle to contain costs and incur delays and staffing issues during lockdowns and Omicron has kept the stock subdued recently but the company is integrating the acquisition of Lend Lease Services well and successfully growing other parts of its business.

Gold companies **Silver Lake Resources (+25.9%)** and **Ramelius Resources (+13.9%)** both performed strongly with the move up in the gold price. Both are in the portfolio for their growth prospects, consistently good use of capital and excellent cash generation. The improving gold price is a bonus. Both remain undervalued.

Key Detractors: February saw an acceleration in the sell-off of unprofitable companies as risk aversion increased. Medical imaging software company, **4Dmedical (-36.4%)** was one we own in the portfolio. The company has exceptional technology which captures lung scans while a patient is breathing which greatly improves the ability to diagnose lung disease and infection. The company has FDA approval in the US where it is working with the Department of Veteran Affairs and TGA approval in Australia where it is currently introducing its technology into the national imaging group, iMed. The company has a solid cash balance and will sign more distribution deals throughout this year.

Electronics and communications company**, Codan (-17.4%)** sold off despite meeting analysts expectations for profitability with their interim result. The fact that metal detection was weaker (5% lower than pcp, primarily due to a coup in Sudan, a key sales geography) seemed to rattle the market despite a strong result from the US communications division. Given that the African issue happens from time to time and tends to recover quickly, we are surprised that this was an issue when the communications division is performing so well and addressing a far larger market. We feel that the stock is very oversold given growth prospects, returns, strong balance sheet and proven management team.

Specialist, plus size clothing retailer, **City Chic Collective (-20.4%)** also came under pressure despite meeting analyst expectations. The major concern seemed to be the high cash spend on an inventory build. The reason for this is that emerging from Covid lockdowns and the Omicron slowdown, the company didn't wish to be short of stock in its key markets. Demand for product is rising and margins are good. We see this as good retailing and good use of capital for shareholder return – that's what shareholders should want a company to do with its cash. The market saw it a different way. Also falling despite meeting analyst expectations was telco fibre network builder**, Uniti Group (-21.3%)**. It suffered after commentary about lower construction fees (recurring revenue is earned from new houses being connected to their network but also up-front one-off construction fee). We put little value on the construction fee as it is a diminishing part of their revenue base and one-off in nature, but again, it seemed to concern some investors. We are very comfortable with the earnings outlook for the company.

Performance Attribution^		Key Portfolio Positions^
Top 5 Contributors	Top 5 Detractors	Top 5 Active Holdings
Earlypay	City Chic Collective	Beach Energy
Novonix *	Codan	Codan
NRW Holdings	4Dmedical	Seven Group Holdings
Service Stream	Syrah Resources	Shine Justice
Silver Lake Resources	Uniti Group	Syrah Resources

^ Alphabetical order. * Denotes stock not held.