Flinders Emerging Companies Fund

Monthly Update: February 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 *	-3.18%	-3.61%	-12.15%	3.18%	4.28%	8.23%
S&P/ASX Small Ords Accumulation Index	-3.70%	-1.21%	-7.97%	4.24%	3.56%	8.18%
Net Value Added *	**0.52%**	**-2.40%**	**-4.19%**	**-1.05%**	**0.72%**	**0.05%**

^ 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
$161.2m

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

- **I used to be indecisive, not so sure anymore…**
- **Interim reporting season**
- **Domestic observations**

The Small Ords Accumulation Index gave back almost half of January's rise with a drop of 3.70% in February. Resources dragged the index down with the sector 9.1% lower, compared with small industrials falling a much more modest 1.7%. Stronger sectors included IT, Communications and Financials while Consumer Discretionary (retail especially) and Energy lagged the index.

The month saw a reversal of most of the market trends of January. Bond market yields jumped (US 10-year bonds rose almost 50bp to 4.0%) on modestly better (stronger) economic data. This saw the US Dollar stronger and commodities weaker. Equity markets were generally soft but held up better than other asset classes. The Dow Jones lost 4.2% for the month and was outperformed by the Nasdaq which fell only 1.1% on continued support for tech stocks. European markets were better; the UK, France and Germany all posting modest gains. Asian markets were flat, with the exception of Hong Kong, which lost 9.4% on a weak technology sector.

Commodity moves were quite severe. Thermal coal dropped 25% in February and is now down over 50% for the first two months of the year. Zinc and Aluminium both fell close to 10% and Nickel 15%. Gold came back 5.6% and soft commodities also fell. Oil, copper and iron ore held up a little better, losing around 2% each. A big flip from January.

Interim reporting season can often be volatile and with an uneven economy, inflation, rates, labour shortages and supply chain issues, there was always likely to be surprises. Fortunately, there weren't too many to hit the portfolio. Below are some observations that will likely impact small companies over the next 6-12 months:

- Employee costs have risen but the labour market is beginning to free up.
- Supply chain constraints are easing as are transport and logistics costs.
- Increased interest costs are clearly hitting the bottom line.
- Sales have remained strong in most industries but consumer facing companies are sounding a more cautious tone for the current half.
- Companies put through price rises – but often not enough to offset rising costs.
- Small cap industrial earnings per share growth for FY 2023 was downgraded by ~5.0% – and are now negative. Much of this related to increased interest costs.
- Small cap resources earnings forecasts for FY 2023 remained steady.
- FY 2024 EPS growth forecasts for small caps stands at 12.9% steady on January.

The 37 stocks we hold in the portfolio have an average growth rate for FY 2023 of 32.0% versus the index of -0.4% (consensus figures, not ours) and a further 25.5% in FY 2024. Importantly, the portfolio is at a significant valuation discount to the benchmark. Of course, these figures will move but with those differences, we are confident of the year ahead.

Performance Review

The Fund returned -3.18% in February, 0.52% above the benchmark which fell 3.70%.

Key Contributors: Insurance broker, **AUB Holdings (+17.4%)** continues to perform well. The company released a strong half yearly profit report driven by improving insurance rates in Australia and a solid contribution from its newly acquired Tysers insurance business in the UK. We expect further improvement in the current half from both the domestic business and Tysers as the insurance rate cycle continues to be supportive.

After a poor month in January following a profit update that included a costly contract write-down, utilities services group, **Service Stream (+12.9%)** released an interim result that provided evidence that the underlying businesses are performing well. This was highlighted by the growth in its telecommunications division that is seeing increased spending by NBN and mobile operators now beginning to roll out their 5G services beyond inner urban areas. While the utilities business dragged on first half margins, fewer weather interruptions this half will see profitability improve. Bus, ferry and tourism operator, **Kelsian (+12.5%)** released a solid interim profit result with an exceptional performance from its marine and tourism businesses. It also announced it had been awarded two more Sydney bus concessions that will make it the largest operator in the Sydney metro area for the next seven years. While the stock has been a strong performer for the Fund over the quarter, it's improving outlook and further contract opportunities gives us confidence of more upside this year.

Building services provider, **Johns Lyng Group (+7.3%)** also released a solid interim. The stronger than expected result was driven by a large lift in profitability from its catastrophe division with increased work from floods in NSW and Victoria and a contribution from the US following Hurricane Ian. The US based Reconstruction Experts business also performed well with its business pipeline up 20% in the half.

Key Detractors: Compensation lawyers, **Shine Justice (-26.7%)** fell after a poor interim profit report. The company has had delays in case settlements and up-front costs as new cases are in discovery mode. This also led to a poor half for cash generation. Many of these issues will reverse in the second half of the year and the company has maintained it full year profit guidance but the poor first half was a surprise to the market – as was the reduced dividend to preserve cash.

In line with the selling down of resource stocks, junior nickel producer, **Panoramic Resources (-25.0%)** also performed poorly. While the company's Savannah project is ramping up production and exporting concentrate shipments on schedule, it does have debt and consequently, leveraged exposure to the Nickel price which was off 15% in the month. This leads to price volatility despite Nickel still trading at a high (and profitable) price. After being one of our better performers over the past year, resources and infrastructure engineering contractor, **NRW Holdings (-16.8%)** came in for some profit taking. Their profit result was in line with expectations and their pipeline of work remains solid. Costs have clearly been an issue for contractors across the country, but the NRW management team seem to be managing this well and we don't expect margins to slip meaningfully over the next year.

Graphite producer, **Syrah Resources (-14.3%)** also eased over the month. The company released a production report that reflected some of the logistics issues with shipping and labour over the December quarter but pointed to much improved conditions early this year. Production from its Balama graphite project will rise significantly this half, cost will be lower and cashflow much improved. Added to that, construction progress at its US based battery anode facility is on track. With offtake agreements with Tesla, LG and Ford in place and funding packages locked in, we remain confident about Syrah being the leading non-Chinese supplier of natural graphite material for lithium-ion battery production.

Performance Attribution^		Key Portfolio Positions^
Top 5 Contributors	Top 5 Detractors	Top 5 Active Holdings
AUB Group	Flight Centre *	AUB Group
Johns Lyng Group	NRW Holdings	Credit Corp Group
Kelsian Group	Panoramic Resources	Johns Lyng Group
Service Stream	Shine Justice	Kelsian Group
Seven Group Holdings	Syrah Resources	Seven Group Holdings

^ Alphabetical order. * Denotes stock not held. Attribution is for the 1 month ending 28th February 2023. Top 5 positions are effective 28th February 2023.