Flinders Emerging Companies Fund

Monthly Update: January 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 *	5.54%	5.94%	-12.16%	0.66%	5.22%	8.80%
S&P/ASX Small Ords Accumulation Index	6.56%	7.64%	-4.44%	2.41%	4.35%	8.83%
Net Value Added *	**-1.02%**	**-1.69%**	**-7.73%**	**-1.74%**	**0.87%**	**-0.03%**

^ 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

$160.9m

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

- **Up, up, and now what?**
- **Macro jelly wrestling**
- **Is the de-rating of small caps about to reverse?**

The Small Ords Accumulation Index opened the year with a strong rise of 6.56%. Large and small caps performed in lockstep and small resources outperformed industrials by a modest 1.2% in the month.

Bond markets saw yields fall back to September levels which resulted in a strong recovery in technology and other growth stocks, REITs and interest rate sensitive sectors. The bounce in large US tech stocks resulted in the Nasdaq adding 10.7%, well and truly eclipsing the 2.8% rise in the Dow Jones. European markets continued their recovery with the French and German indices up 9.4% and 8.6% respectively. Asian markets were also strong with Japan and China up 5% each, Korea and Taiwan both up 8%.

Commodities had a good month with the US Dollar weaker on relative yields. Gold was 6.5% higher, base metals rose strongly, iron ore was up almost 10% on Chinese re-stocking but energy was the opposite. WTI and Brent oil fell around 2% each but big falls were recorded in coal (down 35%) largely on the mild US winter. The most striking (and with broad implications) fall has come in both US and European gas prices. In the US, gas prices are not far off 25 year lows and down 72% from their 2022 peak. In Europe, gas prices have fallen 86% from their peak following the Russian invasion of Ukraine. This has obvious economic benefits and will lead to lower prices across all petrochemicals, fertilisers, broad energy intensive manufacturers and electricity prices. Good news.

The market continues to wrestle with the rates conundrum: is the rate rise path too low for fighting inflation or too high to avoid a nasty recession? Consequently, we get months of market exuberance (such as January or October) that can quickly slip into maudlin nervousness (such as September or December).

The Australian economy has been resilient in the face of the very sharp rises in rates – full employment will do that. And while there are still some inflationary forces in the system, fortunately, there are an increasing number of forces working to bring inflation down – not least the energy costs mentioned above. So, if the consumer and small business isn't killed off by the RBA going Rambo (there does remain some risk), it would lead to a supportive environment for equities in 2023.

What does that mean for smaller companies? Simply, reversal of the underperformance against large caps that occurred in 2022. Being a small cap manager, we would be expected to say that. However, small caps underperformed large caps by 20% in 2022, small industrials by 18% and small resources by 27%. There is some index composition influence on these figures but it's worth pointing out that there was no diminution of earnings growth between large and small industrials – it was a simple de-rating of the asset class. Looking into 2024 FY, the growth/price trade-off for small caps looks compelling. Oh, and the Flinders Emerging Companies portfolio even more-so.

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Performance Review

The Fund returned 5.54% in January, 1.02% below the benchmark which rose 6.56%.

Key Contributors: Multi affiliate funds management group, **Pinnacle Investment Management Group (+19.1%)** bounced strongly in January after a lacklustre couple of months. While higher equity markets helped funds under management, the company has a much broader suite of asset classes and revenue diversity than it did a number of years ago. Despite this, the Pinnacle share price does seem to trade as a global growth stock proxy due to its holding in Hyperion Asset Management which is a growth focussed equity manager, but only 12% of group FUM.

Mining equipment manufacturer, **Austin Engineering (+22.8%)** performed well in January in line with a number of other mining contractors that continue to see strong demand for product and better pricing. The company is focused on better utilising its presence in the Americas and Indonesia, keeping costs under control and integrating the recent Mainetec excavation bucket acquisition. Late in the month the company announced an increased manufacturing deal to supply RIO which doubles its order pipeline from a year ago out to late 2024. Debt collector and unsecured lender, **Credit Corp Group (+15.1%)** also had a strong month. The company has a growing collection business in the US where the credit cycle is much more advanced than Australia, debt books are readily available from credit card lenders and at attractive yields. This is offsetting the domestic business where credit quality remains sound and credit card balances are exceptionally low. Interestingly, demand for loans from the low credit score part of the market has picked up in Australia which would suggest that inflationary pressures are belatedly starting to bite that sector.

As mentioned, most resource companies performed well in January. Copper producer, **Sandfire Resources (+14.9%)** continued to outperform. The company is progressing well towards early production from its Motheo project in Botswana. First production is still expected before the end of June, a good outcome in an industry environment of cost blowouts and delays. Lithium developer, **Liontown Resources (+18.9%)** recovered after a rocky December despite announcing significant cost over-runs expected at its large Kathleen Valley project in WA. While the capacity of the project has risen from 2.5 million tonnes per annum to 3 million tonnes under the new specifications, the cost has ballooned from $593m to $895m which results in a funding shortfall of close to $200m that has to be covered over the next year – modest in the project context but the company will have to reassure the market that the revised costs are realistic and conservative.

Key Detractors: Services and engineering provider to the utility sector, **Service Stream (-9.5%)** drifted over the month on concerns that its interim profit would be negatively impacted by poor weather and a troublesome construction contract in Queensland. While both issues are largely behind them, they have added a level of uncertainty as to the company's full year profit prospects. The company's telco division has been performing strongly and synergies integrating the Lend Lease Services acquisition are being realised. Also underperforming was diversified building services provider, **Johns Lyng Group (-5.3%)**. There were no announcements during the month – nor any industry dynamics that might have changed earnings expectations. The company remains on track to meet their profit guidance and any extreme weather events usually add to their maintenance and repair workload. Not that we factor those outcomes into our valuation.

Trustee company **EQT Holdings (-1.4%)** was largely static over the month – as it has been over the past quarter and year. This is despite the accretive acquisition of Australian Executor Trustees in August last year for $135m. It is rare that an acquisition fits as neatly as this one with complimentary business exposures and regional presence. It gives EQT a more solid national spread of customers and improves their exposure to areas such as health and personal injury, community trusts and testamentary trusts. The synergies between the two businesses are significant. Also detracting value was Canadian iron ore producer, **Champion Iron (-2.2%)**. Given the stock has risen 55% over the past quarter, we shouldn't be surprised that there was some profit taking. The company did produce a quarterly report that pointed to costs being higher than expectations, but that was offset by price and a number of the costs were one-off in nature.

Performance Attribution^		Key Portfolio Positions^
Top 5 Contributors	Top 5 Detractors	Top 5 Active Holdings
Austin Engineering	Champion Iron	AUB Group
Credit Corp Group	EQT Holdings	Credit Corp Group
New Hope Corporation *	Johns Lyng Group	Johns Lyng Group
Pinnacle Investment Management	Pro Medicus *	ReadyTech Holdings
Sandfire Resources	Service Stream	Shine Justice

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

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