Flinders Emerging Companies Fund

Monthly Update: August 2021

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	2.33%	7.06%	30.15%	13.50%	12.35%	15.15%
S&P/ASX Small Ords Accumulation Index	4.98%	8.95%	29.51%	10.08%	10.99%	13.73%
Net Value Added	**-2.64%**	**-1.89%**	**0.64%**	**3.41%**	**1.36%**	**1.42%**

^ 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: RBC Investors Services

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

$121.3m

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, Xplore, CFS FirstWrap, MLC Wrap, Powerwrap, Navigator, IOOF, Praemium

Further Information

www.flindersinvest.com.au

- **Delta Blues**
- **Profit results positive, outlook statements not so**
- **The Ununited States of Australia**

Market & Outlook

The Small Ords Accumulation Index rose 4.98%% in August with industrial stocks strongly outperforming resources – a reversal of July. The Fund underperformed over the month as a number of our larger positions drifted lower and certain sectors we are underweight, did well – but more on that over the page.

Global equity markets continued to rally with new highs being reached in the US and most European markets (the UK still an exception). Asian markets were also stronger, led by China which for now, seems to have dealt with its Covid Delta variant outbreak. Bond yields rose slightly over the month and economic releases were largely benign in the US and weak in China (lockdown impacted). Commodities took a breather with gold flat, oil and base metals down modestly but iron ore falling 18%. Bucking the trend was thermal coal with a rise of 14.5% in August – and over 200% for the 12 months with tight supply of low sulphur quality product driving prices.

So, onto reporting season. In summary, the results were above expectations, driven by the strong recovery in the June half. Most states had opened up, consumer demand was high and the housing market buoyant. Corporate revenue growth was impressive and outside some supply chain and cost issues, operating margins were good. Resource companies had the benefit of ripping commodity prices over the year (except gold) and a stable currency – leading to strong cash generation. Some observations worth noting:

- Labour shortages and wage pressure will persist – in all states, particularly WA.
- Elevated freight costs and supply chain disruptions continue to be an issue for some sectors. Many corporates are increasing inventory levels as a precaution.
- Companies are dealing with the current lockdowns in a more 'managed' way than in 2020. Processes and procedures to deal with lockdowns are helping maintain activity.
- Corporate balance sheets are very healthy – M&A activity won't slow with lockdowns
- While lockdowns are clearly impacting this half, companies are now setting themselves up for both NSW and Victoria to begin opening up toward the end of this year.

Without getting ahead of ourselves, interest rates are likely to remain low, the consumer is still liquid and wanting to spend, companies have rebased expectations, and both the mining and agricultural export sectors are enjoying rare profitability. It would seem that investors are willing to look through the next few months until vaccination targets are reached. The onus is on the politicians to deliver. It won't be easy or pretty but the momentum to move on will be difficult to stop.

Portfolio

The Fund returned 2.33% in August, 2.64% behind the benchmark which returned 4.98%. The bulk of the holdings in the Fund met or exceeded expectations during reporting season, however two temporary factors impacted relative performance: 1. The resource companies in our portfolio (as part of the sector generally) took a breather on the back of weaker commodity prices; and 2. uncertainty around the impact of lockdowns on near term earnings forecasts for some of our stocks resulted in share price weakness. In our view, these are transitionary events and hence we have selectively added to our positions where we believe a mispricing opportunity exists.

Key Contributors: Fund manager umbrella group, **Pinnacle Investment Management Group (+32.4%)** continued to perform well for the Fund as markets moved higher but most importantly, many of their fund affiliates saw strong fund inflow and generated performance fees. This is expected to continue in the current half. With a broadening number of asset classes in the group and many with significant capacity, we see continued strong growth from the company. Also continuing recent strong performance was telco infrastructure company, **Uniti Group (+24.4%)**. Their full year profit result exceeded expectations and the outlook for the 2022 year (and certainly beyond) is strong with a pipeline of new dwelling and commercial developments, plus market share gains from NBN with a number of property groups. The attraction of their long-term assets (optic fibre direct to premises) with minimal forward capital expenditure has seen the market re-rate the company in line with more traditional fixed infrastructure valuations.

Electronic payments and card company**, EML Payments (+16.3%)** did the unexpected during reporting season, releasing a satisfactory profit result but sharply downgrading expectations for 2022. Then the stock went up. The stock was originally sold off dramatically in May on the revelation that the Central Bank of Ireland had raised some significant regulatory concerns; the subsequent update last month crucially highlighted that EML was working constructively with the bank and that a remediation plan was being implemented, alleviating some of the market's concern that ~25% of their revenues were at risk. The company also pointed to a recovering US card business and new contract wins.

One sector that performed exceptionally strongly over the month was property. Generally, we have minimal exposure to REITs due to their low growth nature, but we do hold two companies in the sector with good growth attributes that performed particularly well – retirement village developer, **Lifestyle Communities (+14.9%)** and funds management company, **Centuria Capital (+17.5%)**. Both companies benefitted from the sectoral shift but more significant was the fact that both released solid profit results with confirmation of improved growth prospects over the next few years.

Key Detractors: Trans-Tasman childcare operator, **Evolve Education Group (-17.8%)** released their interim profit result which was in line with expectations, however the company unsurprisingly withdrew CY21 guidance given recent lockdowns in New Zealand, Sydney and Melbourne. Given last years' experience, we can reasonably say that governments will support what is considered an imperative industry, yet the stock came under pressure, nonetheless. Importantly, the company is well capitalised and we expect acquisitions to continue. The previous CY22 earnings guidance was retained, highlighting the earnings power of the current asset base. Another holding that is suffering from the lockdowns is radiology and imaging company, **Integral Diagnostics (-12.8%)**, due to lower patient numbers as people defer scans for elective surgery. That combined with a level of fixed costs that are difficult to reduce and higher radiologist costs have crimped margins. That said, the company will certainly benefit from opening up next year, is well run, and has the capacity to make further acquisitions if market opportunities arise.

Diversified industrial group, **Seven Group (-8.6%)** drifted lower when the company pointed to slightly lower than expected revenue growth from its Westrac Caterpillar dealerships in WA and NSW for 2022. The company's Coates Hire business continues to perform well and the transformational acquisition of ~70% of Boral was completed during the month. The Boral purchase has led to significant upgrades to the stock and in our view will be hugely profitable for Seven over the next few years, something we think the market is yet to appreciate. It remains one of our top holdings in the portfolio.

Another large position is our holding in diversified electronics developer and manufacturer, **Codan (-9.8%).** Again, the company reported a solid profit performance, but investors had been used to the company exceeding expectations in recent years, so perhaps that led to some short-term selling. Likely of more significance was the announcement that long-term CEO, Donald McGurk would retire in mid-2022 after 11 years as CEO and 22 years with the company. He and his management team have done an excellent job building the company from a modest IPO in 2003 to the $2.7bn market cap it is today. New product releases and a couple of recent acquisitions support continued growth over the medium term.

Performance Attribution^		Key Portfolio Positions^
Top 5 Contributors	**Top 5 Detractors**	**Top 5 Active Holdings**
Champion Iron *	Codan	Codan
EML Payments	Evolve Education Group	Elders
Lifestyle Communities	Integral Diagnostics	EQT Holdings
Pinnacle Investment Management Group	Pilbara Minerals *	Liberty Financial Group
Uniti Group	Seven Group Holdings	Pinnacle Investment Management Group

^ Alphabetical order. * Denotes stock not held.

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