Flinders Emerging Companies Fund

Monthly Update: October 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	-0.94%	-0.61%	27.51%	16.29%	12.04%	14.16%
S&P/ASX Small Ords Accumulation Index	0.92%	3.86%	31.01%	13.51%	11.44%	13.10%
Net Value Added	**-1.86%**	**-4.29%**	**-3.51%**	**2.78%**	**0.59%**	**1.06%**

^ 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

$128.3m

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

Further Information

www.flindersinvest.com.au

- **Jailbreak – lockdowns ease**
- **Australian Bond yields take wing**
- **Flinders portfolio – strong growth; significantly undervalued**

Market & Outlook

The Small Ords Accumulation Index rose 0.92% in October with resource stocks strong and industrials declining. Global equity markets were led by the US where strong gains were made on the back of better than expected September quarter corporate profits. Technology stocks led, with the Nasdaq rising 7.3% to record levels. European markets were also firm while Asian markets struggled with soft Chinese economic data during the month. Japan, China and Korea all posted modest declines in October.

Energy prices continued their upward march with oil (WTI) up 11.4%. Global coal and gas prices were also strong. Base metals were up between 7-15%, the exception being Aluminium which declined 5%. Gold rose modestly and iron-ore seems to have found a base around the $100-110 per tonne mark after falling over 40% in the past quarter.

Domestically, the most significant development (if one could get past submarines and Glasgow) has been the end of lockdowns in NSW and Victoria plus the rapid improvement in vaccination rates throughout the whole country. The early signs of rising consumer spending are encouraging, and we would expect an acceleration as travel restrictions ease further. There will continue to be distortions over the next quarter or two as we are already seeing, with logistics and supply chain issues, labour shortages in many sectors and, surprise, surprise, an increase in industrial action in key industries.

We expect a very strong rebound in the domestic economy in the next two quarters and corporate profits will also recover strongly – especially in businesses with enough pricing power to offset rising costs – but margin pressure is likely to emerge in the back half of 2022 – something to watch closely. The domestic recovery and inflation expectations led to a sharp rise in domestic bond yields with the 10-year yield climbing from 1.48% to 2.01% at the end of the month. It took soothing words from the RBA to bring them back on Cup Day but certainly gives a flavour of what to expect in terms of inflation.

Lastly to the usual end of year rush to list companies. Once again, we have been cautious. The large IPO issuance this time last year didn't provide too many winners and this quarter looks similar. Some good companies coming to market but not much in the way of compelling pricing – quite different to the first half of this year when we were more active.

Portfolio

The Fund returned -0.94% in October, 1.86% behind the benchmark which returned 0.92%. October was a frustrating month for the Fund as a small number of our stocks had business updates leading to some hefty share price falls. Frustrating in that most of the portfolio performed solidly. Switching the usual format, we will start with the key detractors as they are at the core of the underperformance for the month and need explaining.

Key Detractors: Electronic product developer and manufacturer, **Codan Ltd (-21.3%)** has been one of our better performers over the years but has de-rated considerably this half. The company is coming off a stellar 2021 financial year and its growth rate will moderate in 2022, plus its long serving CEO, Donald McGurk is retiring in the near future. The point of more moderate growth in FY 2022 was re-iterated at the company's recent AGM and the stock was aggressively sold. The share price weakness in recent months has been surprising, given consensus earnings estimates in that time are virtually unchanged. The company has above market growth, exceptional return on assets, no debt and an experienced management team. We added to our position, and it is now the largest active holding in the portfolio.

Pre-prepared meal provider, **Marley Spoon (-31.7%)** lowered its growth outlook during the month. While still adding customers at a solid rate in Australia, the US and Europe, spending patterns had become more irregular – especially in the US. While we believe there is a massive market opportunity, Marley Spoon is a fraction of the size of major competitor, US based HelloFresh. It needs to keep spending on marketing and facilities in order to have the scale to compete, keep growing and importantly, generate positive cashflow. Our fear was that reaching sustainable cash generation had been pushed out and consequently its financial risk had jumped. While painful, we exited the stock.

Gift & loyalty card and payments technology company, **EML Payments (-24.2%)** updated the market that its investigation by EU regulator, the Central Bank of Ireland, would crimp growth of its Prepaid Financial Services (PFS) division until the investigation into its regulatory practices has been resolved. That the review has not yet been finalised, and with little information as to when it will, the stock has been under pressure. We expect greater disclosure at the AGM this month and have held our position in the stock. The market has almost written off the value of the PFS business which is unwarranted when we expect a resolution over the next few months.

And to the last of the four stocks that caused the majority of the issues in October, transport and tourism company, **Sealink Travel Group (-17.5%)**. Sealink commuter subsidiary, Transit Services missed winning the tender for a sizable piece of the Melbourne bus network and was surprisingly sold down close to 20%. With tenders in place for an inner Sydney bus contract and all of Darwin, there are still opportunities domestically. However, none are factored in the company's future profit expectations and with the opening of domestic travel, its ferry and tourism businesses are poised to perform well in 2022. The company is in excellent financial shape and we maintained our position.

Key Contributors: Recently we outlined why trans-Tasman childcare operator **Evolve Education (+18.1%)** had fallen and why we continued to be confident in its future. This month it bounced following NSW and Victoria emerging out of lockdown and fewer restrictions on childcare places. And given the company's significant number of centres in New Zealand (especially Auckland), the increasing vaccination rate means that childcare restrictions are likely to ease over the next few weeks. We expect the stock to recover further over the next few months as attendance numbers normalise.

Graphite producer and soon to be battery anode producer, **Syrah Resources (+17.8%)** moved up with a greater focus on battery materials companies following further rises in the price of lithium. Syrah has restarted production at the world's largest high-grade graphite mine situated in Mozambique. It is also close to announcing final investment decision (FID) on its US based battery anode grade graphite project. This will be the lowest cost and lowest energy consuming production of the material outside China. We assume an FID would be accompanied with off-take agreements with key customers.

We added employment placement company, **People Infrastructure (+15.4%)** to the portfolio in September following a period of weakness, and it performed well in October. It specialises in the IT, healthcare and industrial services industries and while IT has continued to be very strong during lockdowns, its other two divisions will improve over the next quarter as business conditions normalise. Importantly, the company benefits from tight labour conditions and rising wage levels.

Performance Attribution^		Key Portfolio Positions^
Top 5 Contributors	Top 5 Detractors	Top 5 Active Holdings
Evolve Education	Codan	Baby Bunting
Pendal Group *	EML Payments	Codan
People Infrastructure	Liontown Resources *	Elders
Syrah Resources	Marley Spoon	Pinnacle Investment Management
Whitehaven Coal *	Sealink Travel Group	Seven Group Holdings

^ Alphabetical order. * Denotes stock not held.

Portfolio Valuation

On the back of a challenging month, it is important to remain vigilant in relation to all stock holdings as well as the portfolio itself. As part of this ongoing process, it is important to note that the fundamental characteristics of the Fund compare favourably to both the small ordinaries index as well as large caps. As can be seen from the table below, the Fund has significantly higher earnings growth characteristics, but critically, is now trading at a discount not seen since 2017. This is important as the Fund delivered material alpha in both 2018 and 2019. Ultimately, surprises often occur (as discussed in the detractors above) however, our fundamental approach to selecting companies with strong growth characteristics and that are attractively valued remains the hallmark of the Flinders investment process.

	2023		
Attributes	Large Companies	Small Companies	Flinders Portfolio
Earnings Growth	-4.8%	9.4%	18.4%
Price to Earnings ratio	18.0	18.4	15.4
Dividend Yield	3.9%	3.0%	2.5%

Source: Factset, Flinders Investment Partners

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