Flinders Emerging Companies Fund

Monthly Update: October 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 *	3.37%	-5.63%	-21.73%	1.19%	5.55%	8.24%
S&P/ASX Small Ords Accumulation Index	6.46%	-4.91%	-18.31%	1.46%	4.16%	8.02%
Net Value Added *	**-3.09%**	**-0.72%**	**-3.42%**	**0.27%**	**1.39%**	**0.22%**

^ 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

$144.8m

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

- **Markets bounce**
- **Inflation remains sticky despite falling input prices**
- **M&A activity picks up**

The Small Ords Accumulation Index recovered strongly in October with a rise of 6.46%. Industrials outperformed resources (7.4% vs 3.8%) with financials, energy and REITs leading the rise. Small caps marginally outperformed the S&P/ASX 100.

Global markets were generally stronger, led by the US. Despite the distinct weakness of major tech companies (Meta and Amazon in particular), the S&P500 managed a rise of 8.0% and the Dow Jones put on a robust 13.9% for the month. This was despite bond yields continuing to climb, warnings from the Fed that rates would increase further and US economic data clearly weakening.

European markets followed suit with solid rises and Asian markets were mixed – China and Hong Kong conspicuously weak with drops of 4.3% and 14.7% respectively. Covid lockdowns, a lack of economic stimulus and sluggish spending the main reasons. Commodities continued to fall, with the exception of oil - WTI rising 8.5%. Coal and iron ore reflected the Chinese weakness falling 17.8% and 16.3% respectively.

Features of the small cap market in October were the beginning of the AGM season providing an insight to current corporate trading conditions, increased merger and acquisition activity and a continued absence of IPOs.

Firstly, the AGM season. While there are plenty of companies yet to hold their AGM, there are some recurring themes. The most obvious being that trading conditions are still positive, especially for consumer facing companies. Weather interruptions have negatively impacted building and construction companies and exporters, or US dollar earners have had a tailwind from the weak AUD. Costs remain the key influence on profit margins. Some have managed better than others but, the familiar factors of labour, energy and logistics continue to be headwinds. Overall, profitability remains better than feared but a bit like sitting on a warm beach with clouds thickening; nervous about the near-term outlook…

M&A activity has certainly picked up in recent months in the small cap market. Most notably with an increase in private equity funds active in the tech and financial services sectors. Many of these stocks had been discounted over the past year but in most cases their businesses continued to thrive. Companies such as Nitro Software, Tyro, Pushpay Nearmap, Link, Elmo and more recently, one of our holdings, Readytech. Plus of course, Perpetual this month – on the back of its own bid for Pendal some months ago. A clear sign that if valuations for good companies do slip too far, there will always be buyers. This gives us confidence that the market recovery in October can be sustained in small caps. The S&P/ASX100 has outperformed the Small Ords (both accumulation) by 16.7% this calendar year but the higher profit growth in smalls has been maintained over that time. In four words, more growth lower price.

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Performance Review

The Fund returned 3.37% in October, against the benchmark which rose 6.46%.

Key Contributors: October was a particularly strong month for battery material stocks. While most commodity prices declined (and mining companies with them), the prices of lithium and graphite continued to firm, underpinning those stock prices. The best of which was graphite producer **Syrah Resources (+45.7%)**. As well as overcoming some labour issues at its Balama graphite mine in Mozambique, the company announced a grant from the US Dept. of Energy under the strategic minerals program for US$220m to expand and complete its battery grade graphite facility in Vidalia, Louisiana. This was the largest and most flexible grant under the program and along with offtake agreements with Tesla and LG, places the company as the preeminent natural graphite producer for batteries outside China.

Also benefitting was lithium developer, **Liontown Resources (+26.5%)**. While the company announced a final investment decision in June and two thirds of construction tenders have been issued, early in the month WA regulatory bodies approved all mine plans and construction of the project. This will see it well on the path to producing spodumene concentrate in 2024 from its very significant Kathleen Valley project.

Software developer, **Readytech Holdings (+13.3%)** provides services to businesses and Government with a focus on education and local government. The company has been growing market share and has also made a number of strategic acquisitions in recent years to now be a serious challenger to a number of incumbent operators. For some time, it has traded at a significant discount to its larger peers despite its superior growth, customer acceptance and good management team. We continue to see good upside in the stock. A better month for the property sector helped retirement village developer, **Lifestyle Communities (+15.7%)** in October. The company is still seeing healthy demand for its product and has an excellent pipeline of both developments and sales opportunities over the next five years. There is also a very different wealth demographic to its customer base that will insulate it from potential mortgage stress in other parts of the market over the next year.

Key Detractors: Negative surprises are a regular event amongst smaller companies but that doesn't make copping one that's held in the portfolio any less frustrating. Electronics and communications manufacturer **Codan (-31.7%)** did just that with a profit (or lack of it) update at their recent AGM. The mainstay of the company's earnings over the past few years has been the international sales of its industry leading metal detection units – especially semi-professional units into Africa. A combination of the residual impact of Covid and political instability in some markets has held back sales recovery and led to increased costs. The strong performance from the communications division has not been enough to rescue this year's profitability. A disappointing outcome.

Also disappointing was the profit warning from infant products retailer, **Baby Bunting (-25.9%)**. The company has faced cost pressures from staffing and logistics but so have many other retailers that have managed them better. These costs were exacerbated by the poor implementation of a new online customer loyalty system that led to higher than expected redemption volumes – further hurting margins. Nickel producer, **Panoramic Resources (-23.7%)** weakened despite nickel outperforming most metals in October. The company is still in the early stages of production and perhaps there was some worry about its shipment and cashflow profile. Pleasingly, the September quarterly report released towards the end of the month reaffirmed previous guidance supporting a recovery in the stock over the first few days of November. And in a similar vein, domestic gas producer, **Cooper Energy (-17.7%)** came under pressure during the month. Perhaps it was the politics around gas prices or a short-term dip in daily production but most of its gas is secured on long term contracts and the expected recovery in volumes this month give us confidence in our assessed upside in the stock.

Performance Attribution^		Key Portfolio Positions^
Top 5 Contributors	Top 5 Detractors	Top 5 Active Holdings
Lifestyle Communities	Baby Bunting	AUB Group
Liontown Resources	Codan	Johns Lyng
New Hope Corp. *	Cooper Energy	Peoplein
NIB Holdings *	Panoramic Resources	Shine Justice
Syrah Resources	Trajan Group	Syrah Resources

^ Alphabetical order. * Denotes stock not held. Attribution is for the 1 month ending 31st October 2022. Top 5 positions are effective 31st October 2022.