Flinders Emerging Companies Fund

Quarterly Update: June 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	1.27	-0.60	7.24	4.11	3.41	7.94
S&P/ASX Small Ords Accumulation Index	0.03	-0.54	8.45	5.16	2.25	7.64
Net Value Added	**1.24**	**-0.06**	**-1.21**	**-1.05**	**1.15**	**0.30**

^ 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

$149.1m

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

- **Rates beginning to bite, or just nibble?**
- **China still in post Covid paralysis**
- **Once again, good news isn't…**

The S&P/ASX Small Ordinaries Accumulation Index finished 0.54% lower in the June quarter with industrials outperforming resources by almost 10%.

US tech stocks once again took the lead with the 12.8% rise in the Nasdaq driven by a small number of large companies. In contrast, the Dow Jones posted a more modest 3.4% rise as cyclicals struggled. This was despite most US economic releases being stronger than expected leading to the assumption of more aggressive interest rate rises by the Fed. US June quarter profit releases will be fascinating.

Other global markets were generally positive with the Japanese Nikkei jumping a massive 18.4% in the quarter. Taiwan and Korea were also strong but in contrast, China and Hong Kong were down 2.2% and 7.3% respectively. European markets were little changed. In contrast to equity markets, commodity markets were a sea of misery. Gold was the best of them with a fall of 2.9%. Oil (WTI) fell 6.9%, Copper 8.1% and other base metals down over 10%. Thermal coal fell 27.8%, iron ore 10.6% and it's time to fatten the animals, corn is now 24.8% cheaper…

It is clear that this year's economic performance from China has been disappointing. Consumer spending post Covid lockdowns has been more modest than expected and savings rates are exceptionally high. Stimulus from the Government has been insipid and exports sluggish. And now there is talk of deflation. All grim. We expect stimulus measures and an improvement in economic conditions over the remainder of this year but are aware that social cohesion is as much a focus as economic growth. Any fall in employment and wages will focus authorities on kick starting growth.

The Australian economy remains a balancing act. While the RBA paused, they still pointed to further rises being likely. There is clear evidence from companies we speak to that consumer demand in some areas is beginning to slow, whereas others remain surprisingly buoyant. A number of discretionary retailers (many that are ex-ASX 100 stocks) have downgraded profit expectations on both lower demand and higher costs. Media companies have seen lower ad spending from certain sectors and the challenges in the home building industry are well known. That's the bad stuff.

The flip side is that the certain industries are doing well. Travel & tourism, healthcare and aged care are still recovering from the Covid period, infrastructure is still strong and with the energy transition taking place, will continue to be. Certain financial services are also in good health as is mining capital expenditure, transport, automotive and agriculture. Sentiment will be whipped around by short term economic releases, but we continue to be focussed on companies that have good growth prospects, well managed and have low debt and low capital needs. That's reflected in the 38 investments in our portfolio.

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Performance Review

The Fund returned -0.60% in the June quarter, -0.06% below the benchmark return of -0.54%.

Key Contributors: Better performers came from a variety of industries over the quarter. Outside the poor performance of resources after a very strong March quarter, sectoral themes were few.

Bus and ferry operator, **Kelsian Group (+24.1%)** had a solid re-rate over the quarter after a weak period which followed their capital raising in March to fund the US$325m acquisition of US bus business, All Aboard America! The business will give Kelsian a profitable and growing position in the US market which will put them into a position to bid for Government contracts in the states that All Aboard America! operates. Recent confirmation that the new business is performing well and the imminent (August) start of the Sydney bus contracts won in December have helped investor sentiment.

Also performing well was telco and utility services company, **Service Stream (+25.6%).** The company has been on the nose with investors over the past year after revealing an underperforming (and expensive) construction contract with a water utility last August. While the loss had been well provided for and other divisions are performing well, the company continued to de-rate. An unexpected $50m tax refund from the ATO last month seems to have prompted a revisit by investors. Another stock that had struggled earlier in the year then found support was debt collection and consumer credit company, **Credit Corp (+16.9%)**. The company reported a soft first half profit as its rapidly growing US collection business added costs to deal with a greater influx of work. This has now largely been addressed and we expect a stronger second half driven by expanding US margins and a considerably stronger result from the domestic lending business. Australian collections remain subdued due to lower credit card balances and still high credit quality – both are likely to reverse over the next 6-12 months driving better business opportunity. Don't be fooled by the name, this company is a beneficiary of deteriorating consumer credit conditions.

Diversified funds management group, **Pinnacle Investment Management (+27.1%)** had a very strong quarter (again, following a poor March quarter). The company reported lower than expected performance fees from its affiliates in its interim result but provided updated details on funds under management and performance metrics of its affiliates in May. While not all of its stable are performing well, there has been a distinct improvement from some of its larger funds and global equity markets (with the exception of property trusts) have risen strongly over the past six months. At the smaller end, it is worth mentioning billing system software provider **Gentrack Group (+49.2%).** We bought into the stock right at the start of the quarter so captured nearly all of the market move. We make comment in Stock in Focus.

Key Detractors: Graphite producer and battery material developer, **Syrah Resources (-50.7%)** released a surprisingly poor March quarterly result in April on the back of lower graphite pricing and lower production. Having overcome labour issues at its Balama mine late last year, an over-stocked supply chain (in many battery materials at that time) saw buyers suspend orders and prices fall. Both the drop in production and prices were far greater than expected. It remains unclear as to when these issues will reverse but, in the meantime the company is chewing through cash which is much needed to support the development of its Vidalia battery material plant in the US. We exited the stock on the announcement so didn't cop all the price fall, but it was still costly during the quarter.

Another stock that struggled in the June quarter was mining consumables manufacturer, **Austin Engineering (-31.2%)**. The company downgraded this year's earnings expectations on the back of delayed orders from a significant domestic client. Given the high margin, low volume nature of most of their products (mining buckets, excavator tools, dumper trays), delays can have a meaningful impact on quarterly profits. Fortunately, this was not lost business, with all purchase orders received in recent weeks (ie. the revenues to fall in FY24, rather than FY23). Their other business units (Latin America, North America and Indonesia) are doing well. Mineral Sands miner, **Strandline Resources (-27.6%)** drifted back after short term commissioning delays at its Coburn mineral sands project. Given the size of the project, it's mine life of over 22 years and low costs, we remain confident that production will steadily build towards capacity throughout the rest of the year. Zircon and Titanium prices have come off recent peaks, however remain well above project assumptions.

Remediation builder and insurance contractor, **Johns Lyng Group (-16.7%)** performed well until June when the company saw some profit taking on the view that the company was likely to raise capital for an acquisition (an accurate prediction

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helped by management comments). This was followed by a trading update that upgraded its catastrophe division earnings but not its business-as-usual divisions. On writing, the company has announced the acquisition of two businesses in Australia (Smoke Alarms Australia and Link Fire Holdings) with an associated equity raising. The deals add value, slot neatly into the JLG core business and the market has responded in a positive manner to the deals.

Portfolio Activity

Exits: There was more activity within the portfolio this quarter than last. As mentioned above, **Syrah Resources (SYR)** was sold, as was lithium project developer, **Liontown Resources (LTR)**. The lithium price stabilised over the quarter after falling early in the year. This led to renewed interest from investors and also M&A activity. Liontown announced that US based Albemarle had approached the company with an indicative conditional bid for the company. Higher subsequent bids were made and eventually, the stock price reached our valuation and we sold. It had been a terrific performer for the Fund but we saw better upside opportunity elsewhere.

Gold miner, **Ramelius Resources (RMS)** performed well over the course of the year and opened up a large valuation gap with another gold producer, **Silver Lake Resources (SLR),** a company we know well and have previously owned. SLR's share price was also weighed down given its unsuccessful bid for St Barbara. We took the opportunity to switch out of RMS and into SLR. SLR has completed a heavy capex period, and we expect substantial cashflows to come.

Property fund manager, **Centuria Capital (CNI)** was also sold from the portfolio. While managing a broad asset base with good tenancy rates, the office sector will continue to be under pressure for some time as cap rates continue to rise. The stock performed well toward the end of the quarter and we took the opportunity to exit.

Additions: International travel company, **Corporate Travel Management (CTD)** was added to the portfolio early in the quarter following the announcement that they had won a material UK Government contract that will add significantly to earnings over the next three years. The corporate sector is still well behind the leisure sector in travel bookings compared with pre-Covid levels and we expect a longer period of catch-up. The addition was part funded by reducing our position in Webjet which has performed very strongly.

Building remediation contractor, **Duratec (DUR)** was another inclusion in the June quarter. The company provides protection and refurbishment services for infrastructure assets, buildings and other facilities, largely in the mining and defence industries. Over the past year the company has won a number of contracts that increased its pipeline of work which generally has low capital needs and are higher margin than basic construction contracting. The company is well capitalised with over $60m of net cash, growing strongly in industries that have a good outlook and a proven team.

Insurance broker, AUB Group has been a very strong performer for the Fund over the past few years and the industry remains healthy. During the quarter, we added smaller competitor, **PSC Insurance Group (PSI)** to the portfolio. PSI is growing strongly, has experienced management that has built the business both in Australia and the UK and is attractively valued. Given the scale of both larger listed competitors, Steadfast and AUB, PSI is well placed to acquire at the smaller end of the market and we see that the business insurance market should continue to perform well.

As mentioned above, we also added **Silver Lake Resources (SLR)** and **Gentrack (GTK – featured in Stock in Focus)** to the portfolio over the quarter. At the end of the quarter, we held 38 stocks in the portfolio and were holding 4.3% cash.

Performance Attribution^		Key Portfolio Positions^
Top 5 Contributors	Top 5 Detractors	Top 5 Active Holdings
AUB Group	Austin Engineering	AUB Group
Credit Corp Group	Johns Lyng Group	Credit Corp Group
Kelsian Group	Strandline Resources	Johns Lyng Group
Pinnacle Investment Mgmt Group	Syrah Resources	Kelsian Group
Service Stream	Telix Pharmaceuticals	Pinnacle Investment Mgmt Group

^ Alphabetical order. * Denotes stock not held. Attribution is for the 3 months ending 30th June 2023. Top 5 positions are effective 30th June 2023.

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Stock in Focus: Gentrack Group (GTK)

Gentrack Group (GTK) is a software as a service (SaaS) company supporting electricity, gas and water utilities, as well as airports. Functionality includes billing and customer relationship management software for utilities, as well as airport management software. Customers are predominantly located in Australia, New Zealand, and the UK, while we expect several other countries to become meaningful in time with presences recently established in Singapore, Fiji and PNG. While the company has a long history, the last few years were problematic with failed changes in strategy, underinvestment in product, customers entering administration etc. New management from late 2020 have overseen a turnaround, with a substantial investment being made in R&D. Importantly, this has seen financial momentum return with business wins and upgrades to earnings.

There's a unique situation in the global utilities industry currently, where legacy systems (primarily Oracle and SAP) are predominantly servicing a rapidly changing and dynamic industry (eg. rooftop solar generation by households). The opportunity for GTK is enormous, with research firm Gartner expecting 100% of utilities needing to replace their billing systems over the next decade, and 20% expected to transfer by 2026. GTK has somewhat of a first mover advantage in capturing share, given their investment in recent years, with some early signs of success. The business was founded in 1989 in New Zealand.

Investment Case Key Questions

1. **Growth Opportunity:** following several earnings upgrades already, GTK has a substantial and growing pipeline of opportunities, which should see the company grow its top line by 15-20% p.a. over the next several years. The company has explicitly guided to improving EBITDA margins over the next two years to reach 15-20% in FY25 onwards. While margins are currently low for a typical software business, all R&D is expensed, and the large amount of new work won requires an element of implementation work which is lower margin. Through the company's turnaround and investment period, earnings declined to trough at their March 2022 half year result (the company has a September YE) – revenues and earnings have grown substantially in the two sequential halves since.

2. **Management:** current CEO Gary Miles was appointed in October 2020. He has successfully overseen the turnaround of GTK to date. He has a long history in senior positions in software businesses, most recently serving on the leadership team of Amdocs (NASDAX listed), a provider of cloud business software and services to the communications industry. Notably, Amdocs has a history of consistent growth, meeting or exceeding guidance for +48 quarters. Gary has appointed a number of capable ex-colleagues from Amdocs into the GTK business. CFO John Priggen commenced at GTK in February 2022, and has held CFO roles in several software and fintech businesses.

3. **Financial Strength:** the company has a very strong balance sheet, with NZ$41.9m net cash at their recent 1H23 result. This is up from NZ$27.4m net cash at the FY22 result. Cash collections are strong, with high cash conversion from EBITDA with no R&D capitalisation. GTK also have a NZ$25m debt facility available to them, currently undrawn. The company has not made any acquisitions in recent years, however have capacity now. We don't expect any acquisitions in the near-term, however could expecting something in the medium term to open up a new geography.

4. **Risks:** large customer losses (top 10 customers make up ~58% of revenue; largest customer is ~12%). Regulatory changes – GTK's customers are largely regulated utilities. Competition – looking to take share in an industry where major platform changes are expected over the next several years.

5. **Valuation:** our Assessed Company Valuation (ACV) is currently $4.64/s, reflecting upside of 19%. The stock should trade at a premium to the market given that GTK is a strongly growing and profitable SaaS company with a clear pathway to growth, has high recurring revenues, and improving margins and high ROIC.

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