Emerging Companies Fund

Monthly Update: May 2018

Dear Fellow Investors,

Our Emerging Companies Fund had a very strong May, up +4.1% vs +1.4% for the Emerging Companies Accumulation Index (XECAI) and +3.8% for the Small Industrials Accumulation Index (XSIAI). Since inception the Fund's return is +75.4% (assuming distributions are reinvested) vs +12.8% for the XECAI, +20.7% for the XSIAI and +6.0% for our cash-based benchmark.

Performance summary

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
2017		-3.2%	+2.6%	-0.6%	-1.0%	+7.6%	+6.4%	+2.7%	+4.0%	+13.2%	+9.5%	+8.1%	+60.1%
2018	-1.6%	+4.2%	+1.6%	+1.1%	+4.1%								+9.6%

Returns are net of all base fees, performance fees and expenses of the Fund

Performance commentary

We had several strong contributors to the Fund's performance in May, most notably Polynovo (PNV, +17%), Lovisa (LOV, +19%), Phoslock (PHK, +16%), Clover (CLV, +13%) and Axsesstoday (AXL, +12%). Furthermore, a stock which we added to the Fund in early May via an institutional placement at $0.60, Volpara Health Technologies (VHT), finished the month at $0.82, generating a gain of 37% in just four weeks. We will discuss the thesis behind our investment in VHT in a subsequent monthly update.

The key negative contributor continues to be Think Childcare (TNK, -14%), which remains under pressure due to short term concerns around occupancy trends across the childcare industry as a result of supply increases that haven't been matched with demand. The market seems to be taking a very myopic view when it comes to TNK (and other childcare stocks) given that on 2 July an additional $1.1 billion in Government funding will be made available to parents that qualify for childcare subsidies, with the new scheme providing a materially higher subsidy for well over 90% of families. While the full impact on occupancy will not be immediate as it will take time for some parents to adjust their work hours to capitalise on the additional funding available, we are already hearing of increased waiting lists at childcare centres from 2 July when the funding changes take effect.

Ironically, while we are likely observing a cyclical trough in the earnings of TNK, this is also being matched by a trough in its forward earnings multiple. While counterintuitive, this is not uncommon in markets and creates the classic 'value' opportunity, where very short term concerns about earnings momentum translates into an irrationally low multiple, completely ignoring what lays just beyond the horizon. Based on our (and consensus) estimates, TNK is trading on a CY19 P/E of <10x and a fully franked yield of >6%, despite solid growth prospects thereafter driven by a combination of higher occupancy and fees (underpinned by the increased Government funding) as well as further acquisitions via its incubator pipeline and greenfield developments.

In other news, National Veterinary Care (NVL, +7%) reiterated its FY18 earnings guidance and announced the acquisition of a further three clinics, taking its total to 67. Confirmation that the business remains on track to meet its guidance came as welcome news given that Greencross (GXL) had recently downgraded its earnings guidance, citing weakness in its independent veterinary clinics business. While our own channel checks at the time suggested that the issues at GXL were not representative of the broader industry, it was nonetheless pleasing to have this publicly confirmed by NVL.

In addition, Phoslock (PHK, +16%) announced a major upgrade to its Beijing Wetland projects, increasing the contract size by 50% to $15m. Nonetheless, revenue guidance for FY18 was lowered from $21-23m to a range of $15-17m due to timing issues around weather and project logistics. Importantly, PHK still expects to record FY18 Net Profit (before tax) of c.$3m (implying very strong gross margins) and will enter FY19 with at least $10-12m of work in hand solely from the Beijing Canal and Wetlands projects, with the expectation of substantial additional projects in China to be forthcoming. As such, we remain very positive on PHK's growth outlook.

Company in focus: SeaLink Travel Group Limited (SLK)

SLK is a diversified tourism and transport company with 78 vessels, 60 touring vehicles and three resorts servicing some of Australia's most iconic destinations including Kangaroo Island, Sydney Harbour, Fraser Island, Magnetic Island, North Stradbroke Island, the Murray River, the Swan River in Perth, and Rottnest Island. A significant portion of its earnings is underpinned by long term concessions or other significant barriers to entry that help preserve its competitive position and sustain an attractive return on capital.

SLK is an ongoing beneficiary of the structural growth trends driving tourism within Australia, particularly inbound from Asia. With a portfolio of assets that service destinations that possess unique qualities and enduring appeal, yet to many markets remain relatively undiscovered, it is well positioned to sustain above trend growth, particularly as airport/airline capacity servicing these regions continues to expand. Furthermore, SLK's organic growth has been augmented by an acquisition strategy which has enabled it to assemble a unique and very attractive portfolio of tourism assets that have the potential to generate ongoing synergies. SLK's scale and experience also places it at a strategic advantage when assessing the potential value to its business of acquiring other tourism assets that might come up for sale in Australia or in neighbouring countries.

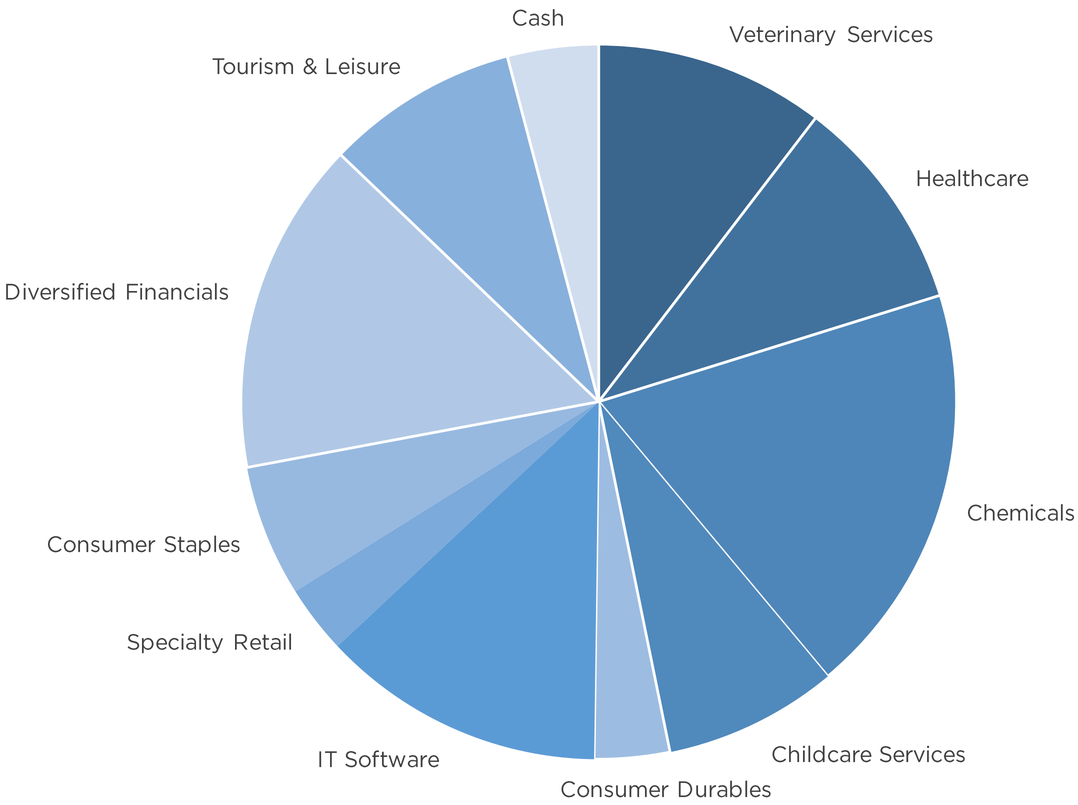
Having spent a couple of days last week with SLK's senior management team, we think the Company's growth strategy is both considered and conservative. It has a clearly defined acquisition strategy that has been successfully deployed to date, including its recent acquisition of Kingfisher Bay Resort Group on Fraser Island. We think this is a great example of SLK capitalising on an opportunity to bring its operational knowledge, distribution capabilities, balance sheet and capital discipline to an asset that, while already well managed, still has significant unlocked potential.

Interestingly, SLK recently disclosed that it had received an unsolicited takeover offer of $4.75 (its share price was c.$3.80 at the time) from an undisclosed suitor. While SLK's decision to reject it based on valuation grounds has seen the suitor withdraw its offer, we think this highlights that other industry participants can see the strategic value of SLK and the potential to continue to enhance that value over time. While we have not invested in SLK with a view to selling out to a financial or corporate suitor, the fact this offer was made arguably places a floor under SLK's share price into the foreseeable future.

Based on our own modelling, we have derived a DCF valuation of $5.25 for SLK (vs current share price of $4.30) which is based on consistent future revenue growth (c.5%) driven by improving both yield and volume in its core business, combined with modest margin expansion from FY20 onwards. We have ascribed no amount to the value it can create through further accretive and synergistic acquisitions, which shouldn't be underestimated given its strategic and scale advantage over many other potential acquirers. Importantly, while the stock has rallied since the bid was disclosed, on consensus forecasts it is still only trading on an FY19 P/E of c.16x. This remains relatively undemanding compared with most other domestic tourism companies, especially when you consider the strong competitive position occupied by most of SLK's key assets.

Portfolio characteristics

We currently have c.96% of our capital invested in 14 stocks, having added two stocks to the portfolio during the month.



Thanks again for your interest and support and I look forward to providing another update in early July on our performance during June. As always, please don't hesitate to get in touch should you have any specific questions about the portfolio.

Kind regards,

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Important Information