Emerging Companies Fund

Monthly Update: October 2018

Dear Fellow Investors,

Our Emerging Companies Fund was down -3.2% in October vs -10.9% for the Emerging Companies Accumulation Index (XECAI) and -10.6% for the Small Industrials Accumulation Index (XSIAI). Since inception the Fund is +66.8% (assuming distributions are reinvested) vs -3.7% for the XECAI, +13.0% for the XSIAI and +7.9% for our cash-based benchmark.

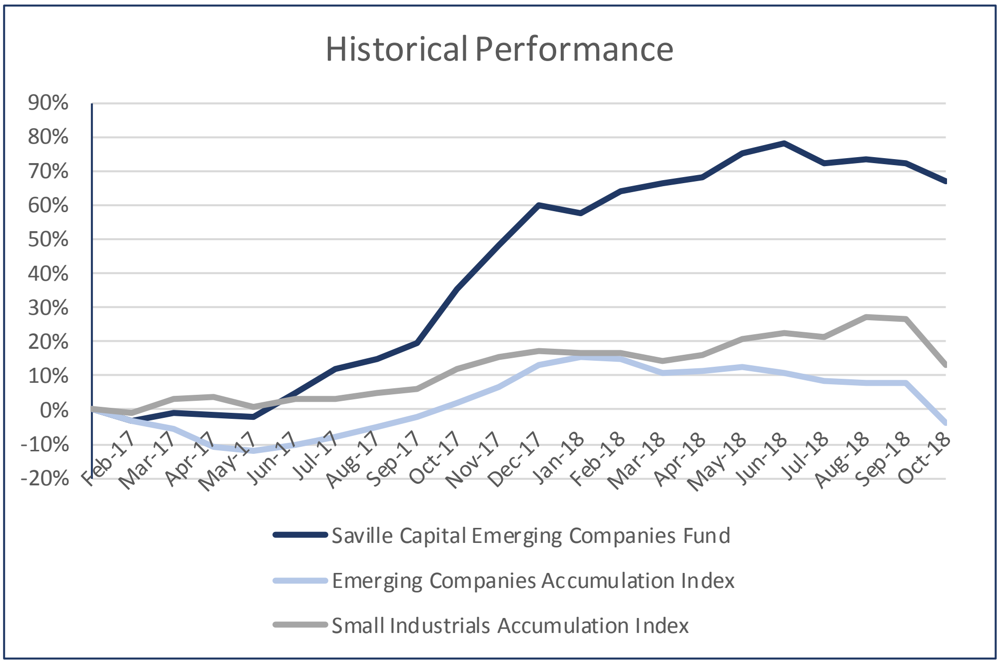
While it was the Fund's equal worst performing month since inception, the silver lining was that relative to the most relevant market indices (as highlighted above) it was actually one of our best performing months thus far. The Fund even outperformed the key large cap indices (S&P ASX200 and S&P ASX100 Accumulation Indices) which were down -6.1% and -5.7% respectively in October.

While we are certainly never happy with a negative absolute return, we think this highlights the quality of our portfolio (typically structural growth companies with conservative capital structures) combined with the benefits of a concentrated strategy. It was also a reward for having the discipline of previously selling out of stocks that had been very strong performers for the Fund and appeared overvalued. This was especially the case with a few stocks (e.g. Lovisa, LOV -26%) which suffered significant declines during the month due to a failure to meet grandiose market expectations and/or natural mean reversion on their capitalisation multiples as sentiment turned sharply negative.

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%	+1.6%	-3.1%	+0.7%	-0.8%	-3.2%			+4.2%

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



Performance commentary

The standout positive contributor to the Fund's performance in October was Volpara Health Technologies (VHT, +52%), which we discuss in more detail below. As is to be expected in such a significant market selloff, almost every other stock we own saw its share price decline during the month (albeit generally significantly less than the market).

Redbubble (RBL, -7%) reported another outstanding quarterly result with 1Q FY19 revenue growth of +40% on pcp, Gross Profit After Paid Acquisition up +42% on pcp and a +0.9% pts improvement in Gross Profit margin, all of which were ahead of our and consensus expectations. However, before it resumed trade on this positive news, RBL was placed into a trading halt while it raised $60m via an entitlement offer and institutional placement to fund the acquisition of TeePublic, a US-based competitor, for US$41.0m (A$57.7m).

Like RBL, TeePublic is a three-sided global online marketplace that enables artists to sell their designs on 45 different products (albeit largely t-shirts) that are fulfilled by a network of third-party suppliers. TeePublic currently generates US$25.5m (A$35.9m) of revenue and EBITDA of US$3.3m (A$4.6m), therefore adding significant scale and potential synergies to RBL, while being immediately EPS accretive. Furthermore, the capital raising will boost the size and liquidity of RBL, increasing its appeal to institutions.

Sealink (SLK, -2%) announced that the South Australian Government has decided that the use of port infrastructure and facilities at Cape Jervis (mainland) and Penneshaw (Kangaroo Island) will be subject to competitive tender to take effect from 1 July 2024, when SLK's current arrangements cease. We understand the tender process will take place in early CY19, thus delivering SLK a significant advantage (in addition to its incumbency) as it will be difficult to attract potential new entrants that are willing to place a competitively priced and conforming bid so far out from the new contract's inception date. SLK currently derives about 25% of its revenue and 33% of its EBITDA from its SA operations, which largely centre around its ferry services to and from Kangaroo Island.

National Veterinary Care (NVL, -3%) announced the acquisition of a further four clinics in Australia for total consideration of $7.0m. The new clinics are within NVL's existing geographic clusters along the eastern seaboard and are expected to deliver annual revenue of $6.5m and annual EBIT of $1.36m, implying an acquisition multiple of 5.2x EBIT. These clinics, combined with the recent Pet Doctors acquisition in NZ, will take the total number of integrated veterinary services businesses within NVL to 97. In other news, Longtable (LON, -14%) provided an update to shareholders in which it noted that in 1Q FY19 St David Dairy sales were up 33% on pcp, Maggie Beer generated positive EBITDA, and Paris Creek's brand relaunch had commenced with encouraging initial results.

Given there was no particular catalyst for VHT's share price strength during the month and its 1Q FY19 result was in line with our and consensus expectations, we decided to exit our position on that basis that it is now trading broadly in line with our DCF valuation and at very stretched capitalisation multiples into the foreseeable future. Having first bought into the stock in May 2018 at $0.60 and with a weighted average exit price of almost $1.25 in October, it was a stellar performer for the Fund over a relatively short holding period.

We also sold the last of our position in Clover (CLV, -7%) based on our view that it is fairly valued at current prices. While we had already substantially reduced our holding in the stock over the past six months, we retained a residual holding to see if its FY18 result gave rise to further upgrades to our earnings forecasts and valuation. When this didn't materialise, and our valuation remained unchanged at $1.50, we thought it was time to deploy the remainder of our invested capital elsewhere. CLV has been a standout contributor to the Fund's performance (in terms of both the large size of the position within the portfolio and its subsequent share price appreciation), having first accumulated our stake at an average price of just under $0.57 in October 2017, before selling our last remaining holding at a weighted average price of $1.50 over the past month.

Company in focus: Bluechiip Limited (BCT)

BCT owns and manufactures a suite of patented sensor chips used in the storage and recording of vials (test tubes). The various chips are miniscule and operate as a memory device and temperature tracker for vials used in blood/plasma, reproduction, pharmaceutical and clinical trials. The chips can either be embedded or manufactured into the storage product. Importantly, the Bluechiip device functions in extreme temperatures (between -196 °C and +100 °C) and can survive autoclaving, gamma irradiation sterilization, humidification, centrifuging, cryogenic storage and frosting. BCT owns seven families of patents and has 25 granted patents across the globe.

The global bio-preservation market is >US$2B, however BCT's initial target market is >US$200m which is the segment comprising vials stored at cryogenic temperatures. This market has not kept pace with the increasing value of those samples being stored, using outdated practices such as hand-written labels to identify samples. Even more recent technology such as the use of barcodes is both inefficient and risks damage to the sample as it often needs to be handled in order to wipe away frost from the barcode to enable a reading, thus altering the sample's temperature. Therefore, relative to existing practices, BCT's technology reduces human error, increases productivity and ensures sample integrity while not significantly adding to the cost of the storage product (i.e. only ~$1).

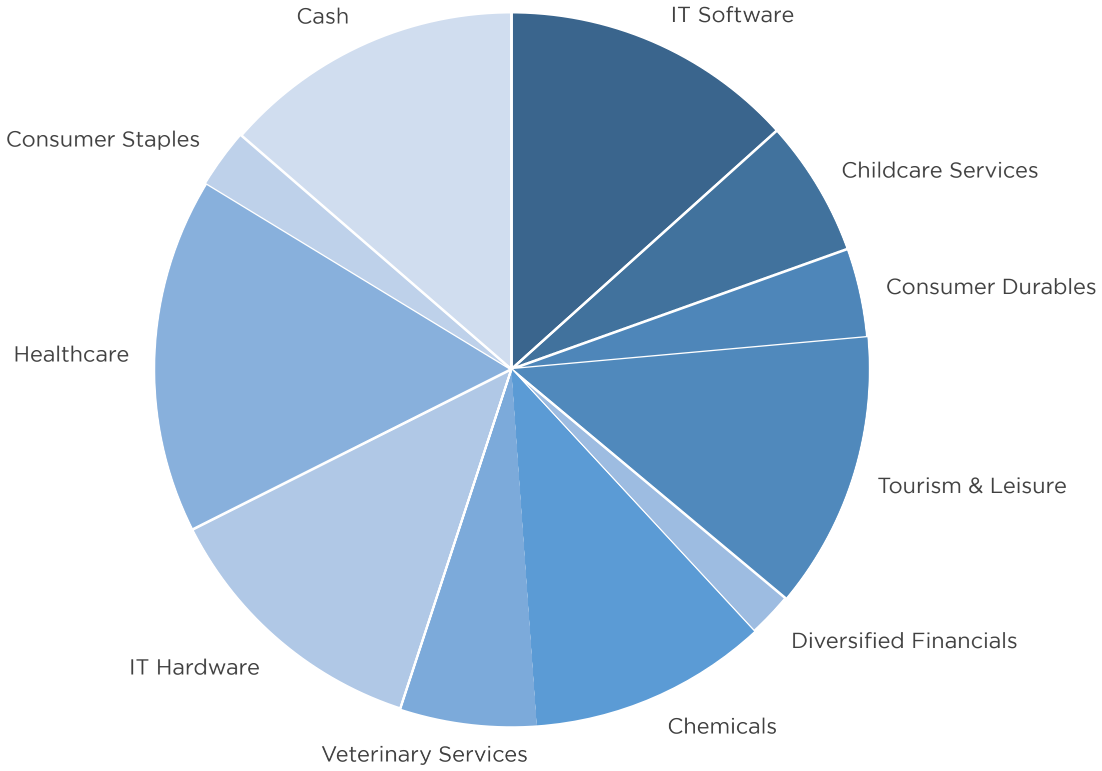
BCT's customer base is original equipment manufacturers (OEMs) who service the bio-preservation market with their own products. BCT recently announced the signing of a three-year US$11.6m (A$15.9m) deal to supply its chips and associated hardware and services to vial manufacturer, Labcon North America. This agreement underpins the production of Labcon's Coldpoint™ Bluechiip-enabled range for the global vial market, including cryovials, boxes, readers and software. Labcon was already an existing OEM partner of BCT and is the world's leading manufacturer of Earth Friendly laboratory consumables, last year moulding over 1.4 billion products. The agreement comprises of a US$4.2m two-year purchase order for chips, readers, software and engineering services as well as US$7.4m agreed minimum for a third year, with an additional two-year term to be negotiated as the supply agreement progresses. BCT also has OEM agreements with Genea Biomedx (IVF market) and Planet Innovation (healthcare technology company), as well as a further ~30 developer kits with other potential OEM partners.

In order to fund the working capital required to service the new Labcon contract, BCT recently raised $5.5m via a placement (in which we participated) and a further $1.95m via a share purchase plan, both completed at $0.059/share (vs current share price of $0.062). This capital ensures that BCT can now fully fund the next three years of its growth pipeline, at which point it should be cash flow positive and profitable. Importantly, our discussions with industry experts both within Australia and the US have delivered very favourable feedback on the BCT technology, its various potential applications and the potential benefits to industry participants. We have also visited BCT's operations in Scoresby and seen the technology in use. Furthermore, for such a small company, BCT has a very strong board and management team who collectively own ~15% of its shares.

Based on our detailed modelling, we have derived a DCF valuation of $0.25/share for BCT. This assumes that over the next decade it gains ~25% share of its initial target market, which could potentially be achieved via its OEM agreement with Labcon alone, albeit we do expect BCT to partner with other OEMs over time. We have not factored in any other adjacent markets or applications for its technology. Given the contract with Labcon takes BCT through to profitability by FY21, we see BCT as a much lower risk investment than many other early stage technology stocks that may have a unique (but commercially unproven) product technology. Yet, in our view, BCT still offers similar levels of long-term potential share price upside that investors are typically seeking from a company in its position. On that basis, we think the long-term investment proposition for BCT is as compelling as any company we currently own. However, we expect the share price re-rating to be gradual and somewhat aligned with the growth in revenue we will see generated from the Labcon agreement (as well as others), starting from CY19 onwards.

Portfolio characteristics

We currently have 87% of our capital invested in 14 stocks, with two removals and one addition since September.



Thanks again for your interest and support and I look forward to providing another update in early December on our performance during November.

Please don't hesitate to get in touch should you have any questions about the portfolio.

Kind regards,

Jonathan Collett

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Important Information