Emerging Companies Fund

Monthly Update: June 2019

Dear Fellow Investors,

Our Emerging Companies Fund was up +0.6% in June vs -0.4% for the Emerging Companies Accumulation Index (XECAI) and +0.4% for the Small Industrials Accumulation Index (XSIAI). Since inception the Fund is +101.3% (assuming distributions are reinvested) vs +7.7% for the XECAI, +30.1% for the XSIAI and +10.8% for our cash-based benchmark.

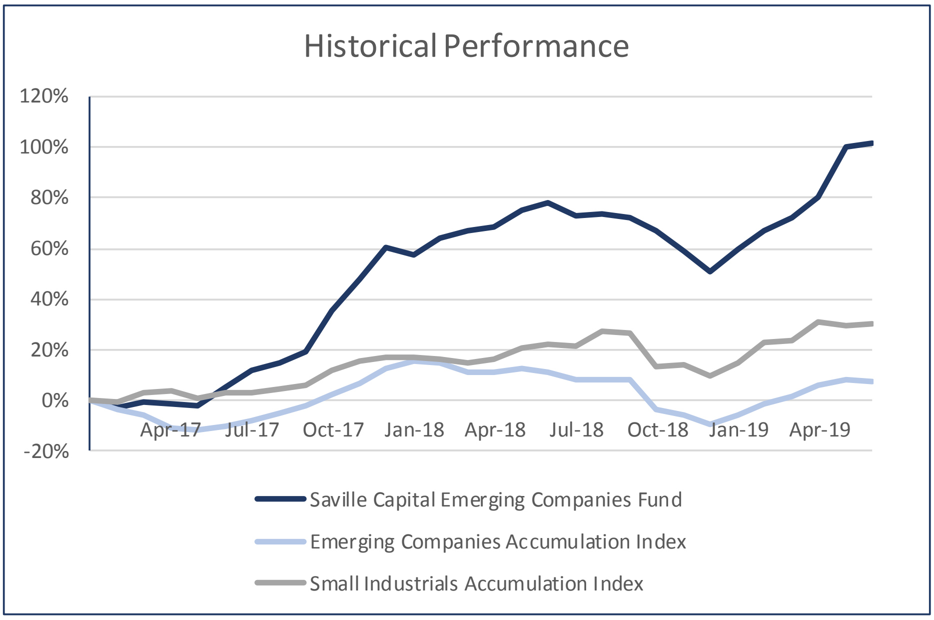
Before we move to a discussion on performance, please ensure you continue reading through to the last page of this update for some commentary on our recent decision to introduce a limit on the FUM for our Emerging Companies Fund.

While the headline numbers would suggest June was a relatively benign month, nothing could be further from the truth. We observed heightened levels of volatility during June due to a spate of fund closures and significant redemptions within the micro and small cap space, often fuelled by the growing trend of large industry super funds bringing more of their FUM in-house. This generally drives forced selling in any stocks held by the fund managers affected, which at the smaller and less liquid end of the market can create havoc (but also opportunity). There were also a lot of companies updating the market on how they are tracking towards earnings guidance (or broker forecasts) for FY19, with many falling short of expectations. Pleasingly, none of the companies we own delivered any significant downgrades to expectations, however it is difficult to ascertain whether they were impacted by forced selling. We suspect a few probably were given the significant and, in our view, irrational nature of some of the price moves during the month.

Performance summary

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total	3M	12M
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%	-4.8%	-5.2%	-5.9%		
2019	+6.0%	+4.8%	+3.1%	+4.7%	+10.8%	+0.6%							+33.6%	+16.7%	+13.0%

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



Performance commentary

The key positive contributors for the month were Polynovo (PNV, +28%), Pointsbet (PBH, +23%), Phoslock (PET, +16%), National Veterinary Care (NVL, +7%), and Sealink (SLK, +7%). The key negative contributors were Rhinomed (RNO, -18%), Redbubble (RBL, -15%), and Think Childcare (TNK, -15%).

PNV had another strong month of share price appreciation, however the only item of news flow was a presentation they made at the Macquarie Emerging Leaders Forum where it was highlighted that they are on track to reach breakeven in early 2020. Furthermore, it was the first time they discussed plans to enter the Chinese market (albeit still a few years away), and as such they have filed for all necessary IP and trademark protections. PET also continued its positive momentum, assisted by the first official research coverage by an institutional broker. Petra Capital initiated with a Buy rating and $1.05/share price target, noting however that there could be significant upside to its valuation given Phoslock's efficacy and the sheer size of PET's addressable market. As an aside, we should make the point that while both PET and PNV have been exceptional performers for the Fund, we are actively managing their portfolio weightings to ensure the appropriate level of risk exposure is maintained relative to our estimate of potential share price upside.

In other news, NVL announced that it has increased its debt facility with ANZ by a further $24m, taking it to a total of $85m, noting that the expanded facility provides NVL with significant capacity to support its forecast growth into FY20. In our view, NVL remains a very well managed business with solid growth potential through realised synergy benefits and improvements within its Pet Doctors acquisition in New Zealand, combined with ongoing organic and acquisition growth in Australia.

The market had a savage reaction to the news that TNK's main incubator partner (Edhod) was going into receivership. According to TNK, the Edhod subsidiaries (i.e. incubator centres) are not subject to the appointment of Receivers and Edhod is expected to be able to continue to execute on its development pipeline. While on face value the impact on TNK is likely to be minimal, the market didn't like the associated uncertainty. From our perspective, we own TNK for the current and future earnings potential of its existing asset base, not the development pipeline. Even in the highly unlikely event that the development pipeline was to completely disappear, TNK can still grow its footprint via the acquisition of other brownfield centres (as it has done in the past and continues to do).

SLK provided a trading and operations update during June, which fell modestly short of previous guidance and consensus expectations. However, given the stock finished the month 7% higher, we don't think this announcement came as any surprise to the market. The issues cited - ongoing soft tourism conditions in Sydney and Perth - were already well known and understood. Furthermore, given the stock is already trading on just ~14x FY20 and had its strategic long-term value validated by a takeover offer of $4.75/share only a year ago, we think the market is willing to look through any short-term earnings weakness. Meanwhile our other tourism exposure, Tourism Holdings (THL.NZ), announced a NZ$30m placement to HB Holdings (subsidiary of CITIC Capital International Tourism Fund) at NZ$4.02/share, as well as a NZ$50m rights issue at NZ$3.40 to underpin its global growth strategy (including entering the Chinese market) and strengthen its balance sheet.

In terms of the price weakness observed in RBL and RNO, in the absence of any news flow, we think this was largely driven by some of the issues highlighted earlier regarding forced selling. We remain strong believers in the valuation potential of both stocks.

Finally, we decided to exit our holding in Audinate (AD8). Having first acquired our stake in AD8 in August 2018 at $3.50 and sold the remainder of our holdings at an average price of $8.07 during June (implying a 130% return), it has been a stellar performer for the Fund. Our decision to sell was based purely on valuation. We think AD8 is an outstanding business with strong long-term growth potential, but above $8.00 we felt that a significant portion of this was already factored into the share price.

Company in focus: Pointsbet Limited (PBH)

PBH is an Australian corporate bookmaker that commenced operations in February 2017 that not only offers a full fixed odds product across racing and sports, but also its innovative PointsBetting form of spread betting within its target markets. While PBH has experienced early success with its offering in Australia, the May 2018 decision by the US Supreme Court to allow individual states to introduce legislation to permit both online wagering and sports betting (which was previously illegal outside of Nevada, Delaware, Oregon and Montana) is where the greatest opportunity lies for them (potential US market size is in excess of US$17 billion). However, to apply for an online sports betting licence in any given state, market participants are being required to be a licensed operator in the form of a casino or racetrack. Therefore, in order for a new operator to become established, like PBH, it typically must partner with an incumbent licence holder in exchange for an upfront fee and/or royalty arrangement.

In July 2018, PBH was awarded a commercial licence to partner with the Meadowlands Racetrack in New Jersey. Having launched on 17 January 2019, by March PBH already had 4.1% market share in online sports wagering within that state. New Jersey has a population of 9m and an estimated sports betting market size of US$550m, making it almost 20% of the size of the entire Australian wagering market. This agreement formed a foundation upon which PBH could then start building partnerships in other US states where legislation was pending. PBH now has partnerships with Hawthorne Racecourse Inc in Illinois (population 12.7m) and Catfish Bend Casinos in Iowa (3.2m) where legislative approval has been granted, and partnerships with American Racing & Entertainment in New York (19.5m) and an unnamed partner in Colorado (5.7m) pending legislative approval.

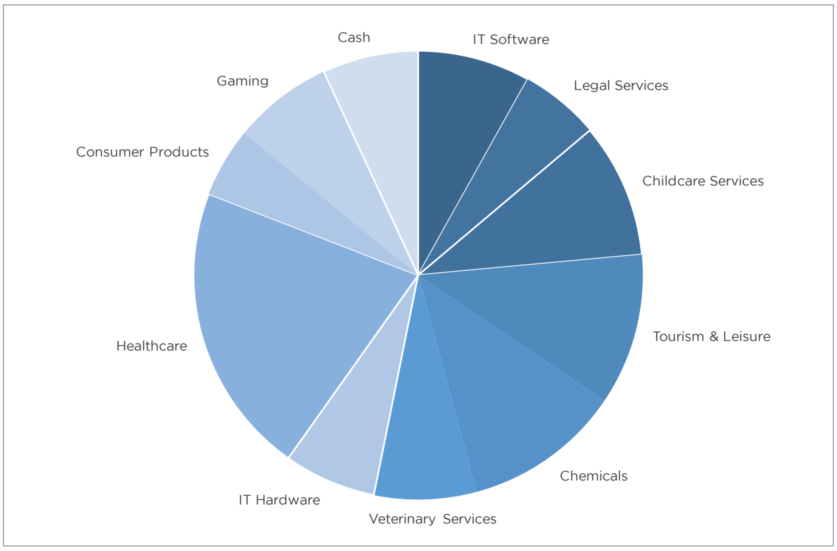
While there is little doubt that many more states in the US will follow with legalisation, this staggered approach is working in PBH's favour. Reason being is that its key competitors, such as the large UK corporate bookmakers, can't initially use their superior size to outmuscle smaller players like PBH through expensive national advertising campaigns (bearing in mind they have no brand equity in the US). Instead, every operator must treat each new state as a single market and allocate its capital accordingly, thus making it a more level playing field. Furthermore, incumbent US corporate bookmakers are relatively inexperienced when it comes to operating online sports betting services relative to corporate bookmakers in Australia and the UK. In competitive markets, these bookmakers need to be able to attract clients to join and frequently transact, as well as provide innovative betting products and efficiently price a wide range of markets on each sporting event. Therefore, despite its smaller size, we see PBH as very well positioned in this regard given the experience of its management team in building up the Tom Waterhouse bookmaking business in a market as mature and competitive as Australia.

PBH has developed its own scalable cloud-based technology platform, which has been designed to enhance the user experience across the website, mobile and apps, while back-end automation facilitates efficiency of operations. The platform provides both traditional fixed odds and in-play markets, as well as PointsBetting. PBH maintains detailed historical databases, containing box scores, play by play information, odds, player statistics and a range of other data. This is primarily sourced from a variety of third-party data feeds and stored in PBH's database, which is updated in real-time and used by PBH's team to model and analyse statistical relationships to produce automated and accurate pricing.

We acquired our stake in PBH as a cornerstone investor in its IPO at a price of $2.00/share. While it is still very early days, we are encouraged by the fact that PBH is already trading at ~$2.75, well above our entry price. We currently value PBH's potential at >$3.00/share, however with such a nascent (but enormous) opportunity the level of confidence one can have in an absolute figure is low. More importantly, we believe the board and management team is excellent and they are building a business of significant strategic value which appears likely to attract the attention of much larger corporate suitors if/when they reach scale in the US market. Ultimately, PBH is likely to be worth a lot more to a large incumbent gaming business than it is to Australian domestic investors.

Portfolio characteristics

We currently have ~93% of our capital invested in 13 stocks.



As mentioned on the first page, we have decided to introduce a limit on the amount of capital we will manage within our Emerging Companies Fund. The total cap will be $50m (vs current FUM of ~$32m), but we will be closing the Fund to any new investors at $40m, thereafter only accepting additional investments from existing investors until we reach our limit of $50m. At that point the Fund will be closed to all new and additional investment applications, other than reinvestment of up to 100% of our performance fee.

We will reserve the right to re-open the Fund to new investment should its FUM ever drop materially below $50m. The reasons behind limiting total FUM to $50m are to ensure we can maintain our current strategy in terms of the levels of concentration and our target investment size, while also retaining sufficient agility under that strategy. Our view is that beyond $50m the strategy may need to evolve somewhat, thus introducing the risk that we would not be able to maintain our ability to maximise performance for clients.

Please get in touch should you have any queries regarding the above. Thanks again for your interest and support and I look forward to providing another update in early August on our performance during July.

Kind regards,

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Important Information