Emerging Companies Fund

Monthly Update: October 2019

Dear Fellow Investors,

Our Emerging Companies Fund was up +4.6% in October vs -0.3% for the Emerging Companies Accumulation Index (XECAI) and -0.5% for the Small Industrials Accumulation Index (XSIAI). Since inception the Fund is +166.5% (assuming distributions are reinvested) vs +22.0% for the XECAI, +34.5% for the XSIAI and +12.2% for our cash-based benchmark.

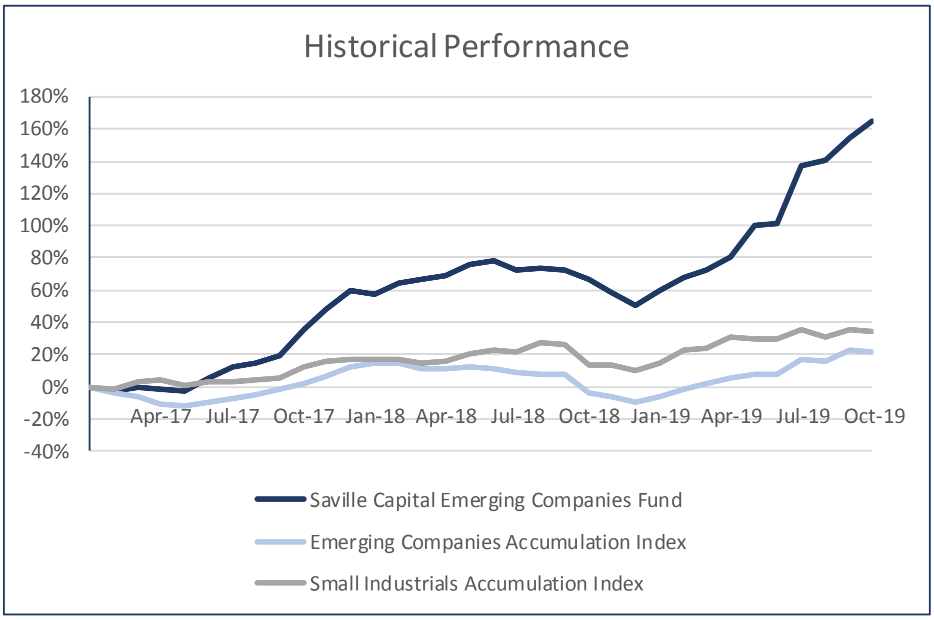
October was a very rewarding month for the Fund, in both absolute and relative terms, after two of our largest positions, Redbubble (RBL, +30%) and Sealink (SLK, +38%), were both re-rated significantly higher by the market. We discuss the reasons behind these large share price moves over the page. We were particularly pleased to generate a strong positive return when over half of the stocks within our portfolio recorded share price declines during the month (consistent with a softer market), which we think demonstrates the importance of actively managing the position sizes within our portfolio, commensurate with the prevailing level of conviction/risk and perceived upside.

October was also a busy month of research activity as we added two IPOs to the Fund, the details and investment merits of which we will discuss in upcoming monthly updates. Suffice to say that we are excited about the medium to long term prospects of both businesses and look forward to seeing them list on the ASX in the next month or so. Once officially added into the Fund, they will also help to decrease our elevated cash position, which is currently 21.5%.

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%	+17.6%	+1.4%	+6.1%	+4.6%			+76.9%	+12.5%	+59.7%

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



Performance commentary

Apart from RBL and SLK, the other key positive contributors for October were PointsBet (PBH, +17%), Think Childcare (TNK, +10%), Polnovo (PNV, +6%) and Shine Corporate (SHJ, +5%). Conversely, the key negative contributors were Phoslock (PET, -22%), Tourism Holdings (THL, -16%), McPhersons (MCP, -8%), Bluechiip (BCT, -6%), National Veterinary Care (NVL, -6%) and IDT Australia (IDT, -6%).

RBL's strong share price performance came in response to an outstanding 1Q FY20 result in which it delivered operating EBITDA and free cash flow that were both similar to the entire FY19 annual result (and significantly ahead of 1Q FY19). All of RBL's core metrics were excellent, with Revenue from Members up 133% (now 46% of total), Revenue from Mobile App up 146% (now 12% of total), Gross Margin up 1.5pp to 37.9% and marketing spend at 9.4% of revenue (down from 10.9% in pcp). These results, combined with strict control of operating expenses (again flat QoQ), is seeing significant operating leverage emerge within the business. This is particularly exciting given the top line growth should accelerate now that it is cycling the negative impact of the Google algorithm changes of late year, as well as benefitting from further content partnerships (5 more added during 1Q, now 53 in total) and new products (7 added during 1Q, now ~100). Despite its recent share price re-rating, we still see RBL's valuation metrics as very undemanding and expect it to move substantially higher throughout FY20 and beyond.

SLK announced a transformative acquisition during October, buying Transit Systems Group (TSG) for $635m plus an earn-out component of up to $63m. TSG is Australia's largest private operator of metropolitan bus services and an established international bus operator in London and Singapore, with its revenue underpinned by typically long-term, low-risk, CPI indexed government service contracts. SLK has paid 8.2x FY19A EV/EBITDA, with forecast synergies reducing this to 7.8x. Importantly, the risk around such a large acquisition is significantly mitigated by the fact that TSG's shareholders are receiving more than 60% of their consideration in SLK scrip, and TSG's CEO, Clint Feuerherdt, will replace the retiring Jeff Ellison as CEO of SLK. Furthermore, SLK bought its QLD transit ferry business from TSG several years ago, which has already proven to be a very solid acquisition. While SLK expects the deal to be ~20% EPS accretive, it also has the benefit of adding significant size and liquidity to the stock, making it far more relevant and accessible to the institutional investment community, while offering a lower risk cash flow stream given this pivots the business further towards commuter, as opposed to tourism, traffic. As an existing shareholder, we actively participated in the $154m equity raising at $3.50/share and were very pleased to see it finish the month at $5.12/share.

TNK agreed to acquire 11 childcare services from its distressed incubator, Edhod, for $16m at a CY20F EV/EBITDA multiple of 4x. As previously mentioned, Edhod was placed into receivership by its secured creditor in June, so this acquisition resolves any uncertainty regarding the impact that process might have had on TNK's ability to secure its preferred services from that incubator, whilst also ending their call and put option agreement.

PBH provided a very strong 1Q FY20 update in which it reported substantial increases in turnover, net win and active clients on both the pcp and 4Q FY19, largely driven by increasing online market share in Australia and New Jersey (now 6.7%, up from 5.4% in 4Q FY19). Given the recent agreement with Penn National Gaming has now given PBH potential access to 10 states in the US (with expectations of more to come), it elected to raise a further $122m via an institutional placement and entitlement offer (in which we participated) so it is sufficiently funded to capitalise on the opportunities before it.

BCT also undertook a capital raising, securing $4.6m via an institutional placement at $0.15/share (in which we participated), with the proceeds being used to continue to scale operations (particularly chip production) to meet growing demand from existing OEM partners as well as expected demand from potential new OEM partners.

THL provided an update on its vehicle sales performance in the US at its AGM, noting that conditions remain difficult and that if recent trends continue throughout FY20, then it is likely to have a material impact on THL's FY20 net profit, such that NPAT could decline on FY19. While peak buying season doesn't commence until the North American spring, the average vehicle sales margin in 1Q FY20 has been down 40% on pcp, while vehicle sales by units are in line. This margin pressure is being driven by some large volume discounts in the wholesale market, and general retail price pressure, which is affecting all market participants. While the weak sales in US vehicles is material in an earnings sense, we think it will likely prove to be transitory and they are arguably low-quality earnings anyway. More importantly, rental forward bookings in all businesses are up on pcp into CY20, and it is this sustainable earnings stream which underpins our investment thesis for THL. As such, we have been using its recent share price weakness as a buying opportunity.

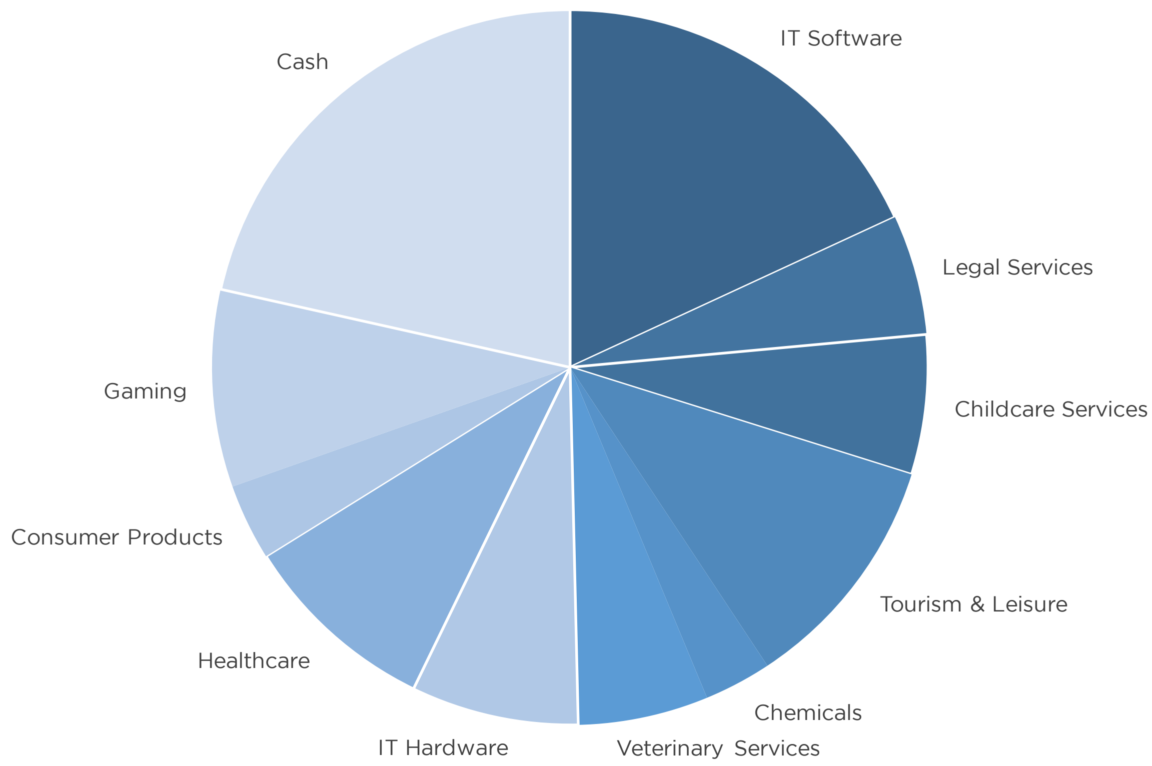
PET's share price struggled during October despite ongoing positive news flow, including a new large lake project in Wuhan, China, and an initial (modest) order for the Florida Wetland and Lake Remediation Projects. PET also provided CY20 production guidance of 25,000 to 30,000 tonnes which, if converted to sales, would imply revenue of $75m to $90m (note that PET already has forecast CY20 sales of $30m to $45m on 'known' projects). Nonetheless, the market remains sceptical due to a combination of recent director selling and a 3Q CY19 result which implied that 4Q CY19 would need to see a significant acceleration in revenue to meet its guidance, let alone exceed it which was probably the expectation of those who were buying the stock at much higher levels. Our view is that the story remains on track as these new projects were never going to provide an immediate significant boost to earnings (it takes time to scale up operations). But we do accept that the Company will need to deliver significantly stronger financial results in 4Q CY19 and 1H CY20 before we will see its share price re-rate back to $1.50 and beyond, which brings execution risk and was a catalyst for us to reduce its weighting in the Fund.

IDT was surprisingly weaker despite announcing that it is now focussed on building scalable high margin revenues from a vertically integrated portfolio of proprietary/partnered GMP medicinal cannabis products. Importantly, following the sterilisation and conversion of parts of its existing facility, IDT now has the facilities, licensure and capabilities in place to execute on its medicinal cannabis plans. Given that cannabis biomass is increasingly becoming commoditised, IDT is somewhat uniquely positioned to expand its business into differentiated and value-added products within the medicinal cannabis supply chain, without the associated risks of production. Thus, we continue to think that the opportunity in front of IDT is being overlooked by the market.

Finally, RNO had another solid (albeit not spectacular) quarter of sales, with similar revenue to 4Q FY19. While the Mute product continues to perform reasonably well, in our view it needs more significant investment in marketing and promotion to build upon its current platform of loyal customers. In the meantime, we await with interest the initial sales data to come from its recent new product launches, most notably Pronto Sleep (which is now stocked in ~1,000 Walgreens stores) and Pronto Clear.

Portfolio characteristics

We currently have ~78% of our capital invested in 13 stocks.



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 December on our performance during November.

Kind regards,

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Important Information