Emerging Companies Fund

Monthly Update: December 2019

Dear Fellow Investors,

Our Emerging Companies Fund was down -1.3% in December vs -2.0% for the Emerging Companies Accumulation Index (XECAI) and -1.4% for the Small Industrials Accumulation Index (XSIAI). Since inception the Fund is +161.0% (assuming distributions are reinvested) vs +18.4% for the XECAI, +36.4% for the XSIAI and +12.8% for our cash-based benchmark.

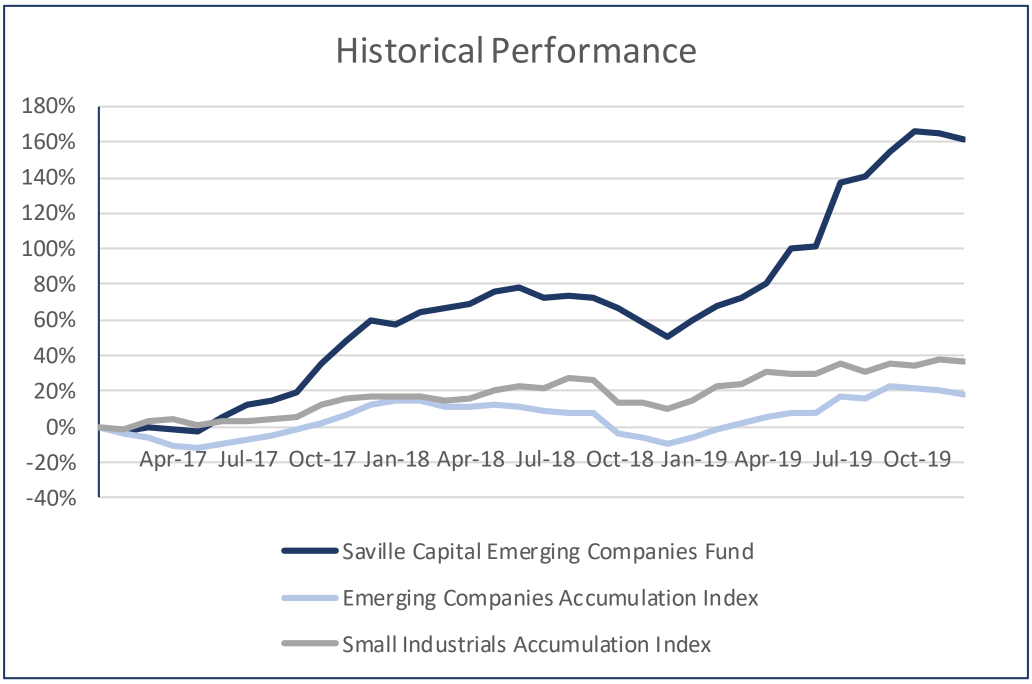
December was another month of significant volatility across the market and certainly within our Fund. Despite ongoing buoyant US markets, the Australian microcap market continued its recent decline, which we again somewhat attribute to the impact of transition flows driven by large super funds withdrawing money from external microcap fund managers. Exacerbating this volatility within our portfolio was the performance of two key stocks, Redbubble (RBL, -38%) and National Veterinary Care (NVL, +54%). The former was driven by an untimely and somewhat disappointing sales update, while the latter was due to a takeover offer at a 57% premium to its last closing price.

While the RBL decline had a larger impact on Fund performance than the NVL increase (due to relative portfolio weightings), the most pleasing aspect is that the impact of the NVL increase is permanent. In fact, we used the liquidity to exit the stock at just below the bid price, as opposed to waiting for approval and payment in March. Conversely, we expect the RBL pullback to again prove to be temporary, albeit incredibly frustrating. We will provide more discussion on both events over the page.

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%	-0.8%	-1.3%	+73.2%	+2.4%	+73.2%

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



Performance commentary

The key positive contributors for December were NVL (+54%), Carbon Revolution (CBR, +13%), Think Childcare (TNK, +7%), Tourism Holdings (THL, +6%), Polynovo (PNV, +10%), IDT Australia (IDT, +8%). The other positive contributor to the Fund was a new addition to the portfolio (via placement), Murray Cod Australia (MCA, +7%). Conversely, the key negative contributors were RBL (-38%), Bluechiip (BCT, -6%) and another new addition to the portfolio (via IPO), Terragen Limited (TGH, -20%).

As already mentioned, the highlight of the month was the takeover offer made by VetPartners for NVL at $3.70/share (vs last close of $2.36 and our average entry price over time of $2.34). Given the offer was made by way of a Scheme Implementation Deed, with the NVL Board's recommendation, the stock immediately re-rated to ~$3.60 (reflecting the high likelihood of completion), which we took as an opportunity to exit so that we might be able to redirect that capital towards more attractive opportunities in the imminent future. For those who have followed our Fund from inception, you may recall that NVL was one of the first businesses we invested in and wrote about (valuing it in excess of $3.00/share), subsequently accumulating a >2% stake in the Company as our Fund grew in size. As such, this outcome was a great reward for the faith and patience we showed in the Company's management team and strategy. We first entered NVL at $2.18/share in March 2017 and since then NVL's share price had been as high as $3.14 (January 2018) and as low as $1.74 (January 2019), a 45% decline, thus highlighting the potential share price volatility of even a relatively stable business in a listed environment.

The clear lowlight was yet another untimely sales update from RBL in which it noted that revenue growth in the December quarter to date (noting this announcement was made for the period ending 9 December, prior to peak Xmas trading) was +20%, comprised of +2% for the Redbubble marketplace and +59% for the TeePublic marketplace. The Redbubble marketplace growth was below their, our and market expectations (which were more like +10%), however the TeePublic growth was well above. Hence on a net basis the figures for RBL Group were only modestly below expectations and as such RBL maintained guidance for EBITDA growth and positive FCF in FY20. Nonetheless, the market slammed the stock once again, initially sending it tumbling ~43% from its last close. RBL cited increased competition in its stickers market (largely from one Amazon reseller, which is likely to prove transient given their unsustainably low pricing) and ongoing softness in US apparel sales due to its more vigilant approach to removing content that potentially breaches copyright. Neither of these issues are terminal, but yet again the share price reaction was staggeringly negative, as it has been to disappointments in the past. Despite another setback, we maintain our belief in RBL's value and long-term upside potential and, like NVL, look forward to seeing our patience being rewarded in the future.

TNK announced that it had received security approval to implement a stapled security structure to finance its own (modest) greenfield development pipeline. We expect that as the market observes the structure in operation it will become increasingly comfortable with its (positive) impact on the Group. Separately, PNV's NovoSorb BTM finally received CE Mark approval for sale through the UK/Ireland and European Union.

Meanwhile, the two stocks we added to the portfolio during the month (MCA and TGH) had divergent initial impacts on the Fund's performance. After a significant amount of research (and patience), we were finally able to orchestrate a substantial investment in MCA for the Fund. We see this as an outstanding long-term investment opportunity and look forward to discussing it in more detail in a subsequent monthly update. The opportunity to invest in TGH came via an IPO, which after detailed due diligence, we decided to help cornerstone. Similar to MCA, we think TGH has great long-term potential and exhibits many of the key characteristics we seek in a target company. Unfortunately, the IPO failed to facilitate an exit for some stale long-term holders and they have been actively selling into a thin market. Nothing has changed since IPO (other than an encouraging business update and director buying), so we remain very comfortable despite its soft debut. In fact, we have used the weakness to accumulate more stock.

Company in focus: Carbon Revolution Limited (CBR)

CBR designs, manufactures and markets single piece carbon fibre wheels, largely targeted at the global (premium) automotive market. Its wheels are significantly lighter than traditional wheel technologies which provide numerous efficiency and performance benefits, being critical points of differentiation in the highly competitive automotive industry. The weight saving is estimated to be in excess of 40% for some wheels and can deliver between 2% and 6% in fuel cost savings. CBR has protected its IP via patents, with 41 patents granted over seven families, and a further 12 pending. It already has nine contracts with five OEMs including globally recognised brands such as Ferrari, Ford and Renault, and is in active negotiations with several others.

CBR's foundation customer was Ford, for the supply of wheels for the Mustang GT350R. This was subsequently expanded to provide wheels for the Ford GT and Mustang GT500 programs. Additional contracts have been signed with Ferrari to provide wheels for the 488 Pista and the SF90 Stradale, alongside Renault for the Megane Trophy RS. The Company has also recently signed a contract to supply wheels to an SUV manufacturer, which we understand to be Land Rover. The annualised production run-rate for August 2019 was ~12,000 wheels, and the Company is forecasting annualised production to increase to almost 32,000 wheels by June 2020.

We expect that CBR will sign further OEM contracts to absorb the existing capacity of their factory – achieving 80,000 wheels in 2022. Having toured its factory in Geelong, located at Deakin University's campus at Waurn Ponds, it was difficult not to be impressed by the scale of its operations, but also its potential in terms of further production automation and streamlining. The ongoing industrialisation program positions CBR at a significant inflection point. Successful execution can significantly increase manufacturing capacity, lower production unit costs and increase the scalability of production; providing the platform for much broader adoption of carbon wheels in a global premium automotive wheel market that is constantly seeking new innovation.

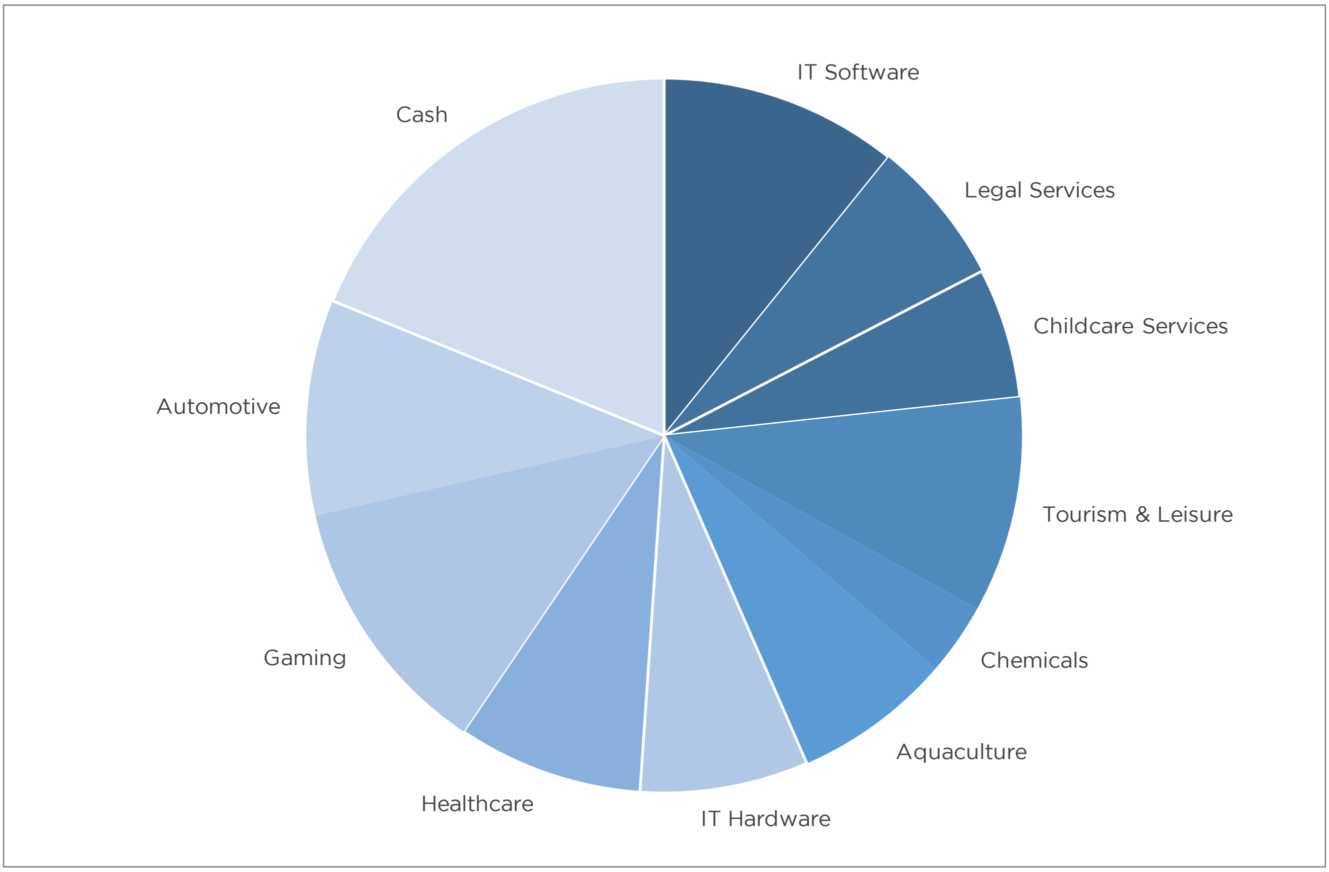
Our positive view on CBR is underpinned by: (1) first-mover advantage as a Tier 1 supplier of single piece carbon fibre automotive wheels to OEM's; (2) comparative advantages supported by intellectual property and proprietary manufacturing processes, (3) a very large addressable market comprising the high-performance and luxury segments of the new vehicle automotive wheel market, which equates to ~36-56m wheels pa, and (4) an industrialisation program that is expected to increase manufacturing capacity and lower production unit costs of each wheel, thus expanding its gross margin and level of profitability (noting that CBR expects to be EBITDA positive by 4Q FY20).

To put the size and value of the medium-term opportunity into perspective, we understand that the CBR is targeting annualised production of 600,000 wheels per year within the next 5 to 7 years, noting that each additional production line of 80,000 wheels requires $20m of capex (can be self-funded). At a forecast gross profit of $800/wheel, this implies a Company generating ~$480m of gross profit (vs a current Enterprise Value of just ~$500m), with significant fixed cost leverage given its OEM sales model. While certainly not without execution or competitive risks, this would still represent only ~1% of the addressable market for a Company with existing programs across some of the world's largest manufacturers of high-performance and luxury vehicles.

We acquired our stake in CBR in its IPO at a price of $2.60/share and subsequently accumulated further stock in the mid-3s such that our average entry price is now $3.29, vs its $3.91 closing price at the end of December. While there is a long way to go and many execution challenges still to overcome, if the management team (who we rate highly) can execute on the Company's expansion plans over the next decade (we are confident the OEM demand will match their capacity growth), then we believe CBR could easily be worth at least three times where it is currently trading. With so much scope to grow into our (upside) valuation, combined with an outstanding product and management team, we have made CBR one of the larger positions within the Fund.

Portfolio characteristics

We currently have ~81% 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 February on our performance during January.

Kind regards,

Jonathan Collett

Principal

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