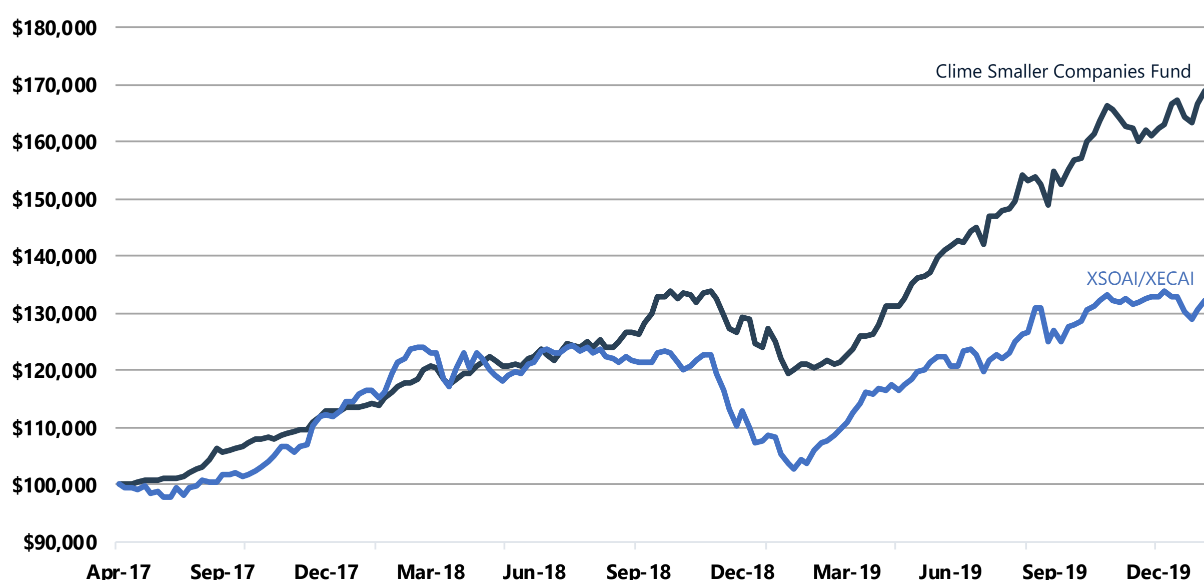
Clime Smaller Companies Fund

Quarterly Report December 2019

The Clime Smaller Companies Fund is a concentrated portfolio of high-quality businesses that are outside the ASX200 at the time of initial investment. The Fund invests in niche leaders that have superior business economics, strong balance sheets and significant growth prospects, provided they are attractively priced relative to assessed value. The Fund is designed to take advantage of the structurally inefficient and under-researched market segment of small capitalisation stocks.

Quarter Net Return (Wholesale)*	1 - Year Net Return (Wholesale)*	Inception p.a. Net Return (Wholesale)*	Total Fund Size
1.7%	39.7%	21.6%	$43.7m



	1 month	3 months	6 months	FYTD	1 year	Inception p.a.	Inception Total
Fund Net Return (Wholesale)*	1.1%	1.7%	13.9%	13.9%	39.7%	21.6%	69.0%
Benchmark^	-1.1%	-1.3%	6.9%	6.9%	12.0%	10.6%	31.2%

*Net returns are after all fees, taxes, and costs
^ CPI Trimmed Mean + 8% p.a. from 24th April 2017 and then 50% of the ASX Small Ordinaries Accumulation Index (XSOAI) and 50% of the ASX Emerging Companies Accumulation Index (XECAI) from the 30th June 2019

Fund Facts

Portfolio Managers	Jonathan Wilson & Adrian Ezquerro
Fund Inception	April 2017
Fund Size	$43.7m
Number of Stocks	15-40
Cash Distributions	Annually
Eligibility	Wholesale & Retail

Top 5 Holdings (Alphabetical)

Company	ASX Code
Afterpay	APT
Audinate	AD8
Electro Optic Systems	EOS
Macquarie Telecom	MAQ
RPMGlobal	RUL

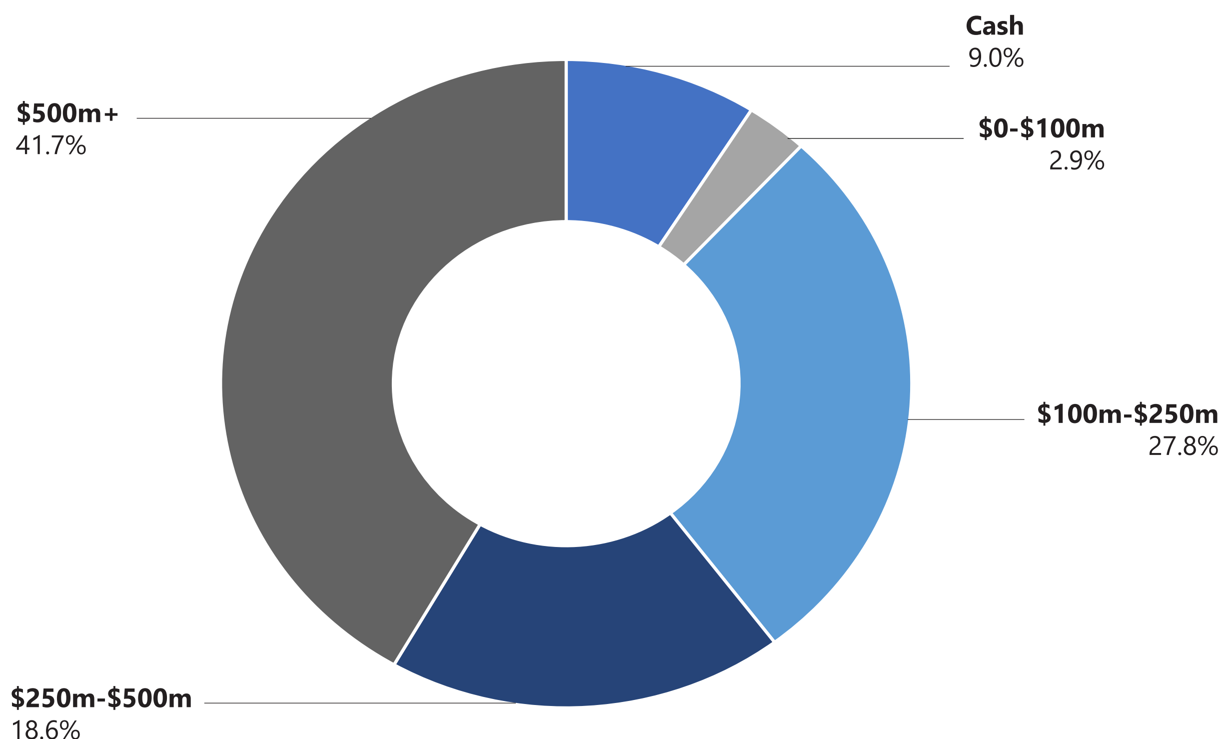
Unit Price

Date	Wholesale Unit (exit)
31 December 2019	1.5302

Distributions

Period Ended	Wholesale Units (cents)
30 June 2019	8.2837

Asset Allocation by Market Capitalisation



Asset Allocation by Sector

Industry	Weighting
Software & Services	30.0%
Healthcare Equipment & Services	10.5%
Technology Hardware & Equipment	8.8%
Diversified Financials	7.5%
Capital Goods	7.0%
Consumer Services	6.3%
Real Estate	6.2%
Telecommunication Services	5.5%
Retail	5.3%
Commercial & Professional Services	3.9%
Cash	9.0%

Portfolio Commentary

The Clime Smaller Companies Fund (CSCF) returned +1.7% (Wholesale Class, net of fees) for the December quarter, ahead of the Benchmark return of -1.3%.

The CSCF fund made a sound start to FY2020. At the half-way point of the financial year the Fund has delivered a net return of +13.9% versus Benchmark at +6.9%.

The market conditions that defined 2019 will likely persist through 2020: with low interest rates supporting asset prices, and geopolitical friction as China and the US come to terms with the former's increasing influence.

These issues factored into elevated market volatility over the last 18 months. However the Portfolio weathered this without too much worry. The Fund is constructed to capture structural growth from individual businesses, somewhat insulated from the broader macroeconomic themes. Niche leadership, net cash balance sheets, and large opportunity sets are the defining characteristics of Fund holdings. We believe they drive long term results. Since inception in May 2017 the Fund has delivered a total net return of +69.0% (+21.6% p.a.) versus Benchmark of +31.2% (+10.6% p.a.).

We enter 2020 optimistic about the prospects of a number of companies in the Fund.

Mach7 Technologies

Healthcare imaging data management software provider Mach7 Technologies (M7T) remains on an inflection, with a raft of initiatives since our June update.

Early in 2019 management committed to delivering a maiden 12 months of positive cash flow. True to its word, M7T had strong start to FY20 with operating cash flow of $1.7million for the September quarter. Positively, this result was delivered without any contribution from the A$15 million Enterprise Imaging contract with the Hospital Authority of Hong Kong (HAHK) signed in December 2018, M7T's largest deal to date. With HAHK to contribute from 2H20, cash generation should stay strong from here.

On the contracting front, M7T started FY20 by adding a top 10 US public health system, Aurora Healthcare (A$5.7 million over 5 years), and a leading Hong Kong private hospital, St. Teresa's (A$0.95 million over 5 years).

Typically contracts are split evenly between upfront licence and implementation fees and recurring maintenance revenues. Contracts are typically renewed at the end of the initial term. M7T hasn't lost a customer to date and Contracted Annualised Recurring Revenue has increased by 70% to $8.5 million over the last 18 months.

The main event of 1H20 was M7T's $20 million placement in December, which was well-oversubscribed. Management highlighted that the funds were "not raised for working capital purposes", implying no change to its cash flow positive outlook. Rather, the funds were raised to "provide financial security well into the future". The Fund participated in the raise at the placement price of $0.62 per share.

This is notable because hospital customers are anxious to ensure providers of mission-critical systems will be partners over long periods. The placement signals there are potentially large contracts in the near-term pipeline. For context, there are several hospital systems in the US that outsize HAHK's network of 43 hospitals.

In the new year, the Imaging Innovations Lab at key client Sentara Healthcare will be ready to receive visitors, allowing potential hospital customers to review a fully functional demonstration of M7T's novel PACS and Enterprise Imaging systems.

With $24 million in cash, no debt, an advanced reference site in Sentara, and a healthy contract pipeline, we believe the future is bright for this emerging leader.

APN Property Group

One of the first positions added to the portfolio upon its April 2017 launch was property focused asset manager, APN Property Group (APD). As articulated in the June 2017 monthly report, at that time APD attracted for numerous reasons. We considered these to be significant scope for growth, a strong net cash balance sheet, aligned management and an enticing entry price.

In retrospect, our initial position was built at a price that only reflected net tangible asset backing, with a profitable funds management business encompassing $2.5 billion of Funds Under Management (FUM) priced at next to nothing. While outsized returns can be generated by a focus on emerging quality, they are often augmented by a sharp entry price.

Since that time, APD management have executed well. Group FUM has continued to grow at a steady rate and now approximates $3.0b, with APD's listed funds leading the way. Both APN Industria REIT (ASX: ADI) and the APN Convenience Retail REIT (ASX: AQR) have delivered strong investment outcomes for their investor bases and remain well capitalised with attractive future growth pipelines. Concurrently, APD's property securities funds, the APN AREIT Fund and Asian AREIT Fund, have continued on their respective growth paths.

While APD has since rerated, having delivered a total shareholder return of 28.2% p.a. since April 2017, we still see several positive attributes. The strong net cash balance sheet remains, as does the significant opportunity set for long term growth. Management continue to demonstrate execution, albeit in a measured, thoughtful way. All of this is still available for a sensible price, while the yield of 5.0% also remains attractive in this low interest rate environment.

<u>New Additions</u>

City Chic Collective

Over the December quarter we initiated a position in plus-size fashion leader City Chic Collective (CCX). This was partly triggered by the October acquisition of the ecommerce business of CCX's US peer, Avenue. Consideration was US$16.5 million. Avenue has the potential to substantially grow CCX's presence in the US.

Founded by CEO Phil Ryan, CCX was the leading brand in Specialty Fashion's portfolio until mid-2018 when Specialty divested the other brands. Now running as a standalone operation, the business is now free of previous capital-constraints and free to reinvest cash flows into an ambitious global expansion program.

In Australia and New Zealand (ANZ) CCX has 10% market share of the plus-size category. Plus-size is an under-served segment in several developed markets, accounting for only 10 – 20% of spend despite encompassing over 50% of consumers.

CCX is optimised for the online channel, where one in every two sales occurs. Its 110 stores in ANZ are designed for online lead generation and staff are incentivised to convert customers to online. CCX is driving an inventory-light 'fast-fashion' business with an efficient supply chain capable of delivering garments in 6-8 weeks on repeat order.

Leveraging profitable operations in Australia, the global online expansion provides a long growth runway, and carries a significant payoff on successful execution.

Over the last four years in the US, CCX has successfully established profitable wholesale operations, including Macy's, Nordstrom and Bloomingdales, which has converted to a growing online presence. Solid offshore execution in FY19 saw offshore revenues grow by 41% to $30 million or 20% of total revenues.

The business model centres around brand control and online sales is interesting because online sales have much lower costs of doing business and online customers tend to be repeat buyers. This translates to increasing margins and likely higher revenues as the proportion of online sales increases.

Avenue is an interesting proposition because the ecommerce business purchased for US$16.5 million generated US$70 million in annualised sales prior to the company filing for Chapter 11 bankruptcy. Although bankruptcy doesn't inspire confidence, Avenue's downfall largely related to a migration of customers away from its large physical store network to online.

To put the opportunity into context, Avenue's 1.3 million online monthly visits is 50% more than CCX's 0.8 million monthly visits. If CCX manages to stabilise Avenue's sales at similar margins as the existing business (~20%), Avenue could lift pre-tax earnings by over $15 million or 50%. Although this is a medium-term story, we would back what is a high-quality management team to deliver.

EML Payments

We increased our initial position in global B2B pre-paid card program provider and payments processor EML Payments (EML) during the quarter. EML has significant offshore growth potential.

EML's core proprietary software enables its business clients to tailor 'open-loop' and 'closed-loop' card programs, by codifying controls on how loaded money is spent – by merchant type, store, transaction value, frequency, amongst many other features. These programs enhance loyalty and manage transactions across large customer bases. EML is thus entrenched in the user experience for customers of EML's clients. The risks of switching customer bases to alternate providers is high, which is partly why EML has retained all its clients to date.

EML typically targets specific industry verticals that are undergoing regulatory or structural change, and this has resulted in EML becoming the global leading card program provider across local gaming, salary packaging, gift and incentive verticals. Over the near to medium term EML is seeking to expand gift card operations in Europe and reloadable gaming cards in the US.

In Europe, regulatory uncertainty around the treatment of gift cards is increasing demand for third party card program management services. The US gaming industry is also experiencing regulatory change. In May 2018 a US Supreme Court ruling enabled US States to legalise sports betting. Federal regulation in the US prohibits direct transfers between banks and gaming accounts, however EML's reloadable cards can fill the gap by facilitating transfers and payouts.

EML has established strong positions in these niche verticals, putting the business in a position to capitalise on the change in market structure.

In November 2019 EML made a $423 million acquisition of Ireland-based Banking-as-a-Service software provider Prepaid Financial Services (PFS). PFS positions EML to participate in the growth of digital neobanks in Europe and US. EML partially funded the acquisition via a $67 million placement, in which the Fund partook at $3.55 per share.

EML was subsequently included in the ASX200 index in early December.

A key attraction of EML is its operating leverage. The business is able to add new business clients with little extra investment in its operations. Gross margins are over 75%. Organic annual revenue growth over last two financial years was 20%. With successful execution offshore we forecast strong earnings growth over the medium term.

Other Portfolio News

Citadel Group

Information management solutions provider Citadel Group (CGL) had a busy December quarter, with a positive AGM update in October, a new CEO announced in November, and a 10-year contract extension with Queensland Health in December.

CGL had a tough calendar year 2019 for a couple of reasons. The first is that the business is pivoting from Managed Services to Software. Software is growing but still only contributes a third of revenues. There's a lot of potential with its cloud software products, particularly Citadel IX, however it's not yet showing in the financials.

The second was that contracting with CGL's Managed Services segment during the June quarter was disrupted by the Federal Election. This dented FY19 revenues and earnings and triggered a heavy sell-off. Despite CGL reporting at its AGM that these contracts had been finalised, confidence is yet to fully return.

CGL has pedigree in information management in highly sensitive environments, and they've never lost a managed services contract. We increased to our position during the sell-off.

Software is the growth engine, and our channel checks found that early adopters of Citadel-IX are very happy with the product. Citadel-IX is a global opportunity. The new management team led by co-founder and now CEO Mark McConnell have solid experience in enterprise software.

IMF Bentham

As outlined in our September 2019 Quarterly Report, our investment thesis for IMF Bentham (IMF) centres on the company's multi-year transition from investing in legal disputes via its own balance sheet to investing as manager of partly owned (generally 20%) fund structures with much larger capacity.

The transition should facilitate global expansion and increase the breadth and potential value of case investments. As a future player of global scale, IMF should also enjoy reduced competition for very large case investments, and therefore protect healthy unit economics – historically IMF has averaged Returns on Invested Capital of about 140%.

However, most of its $1.5 billion of fund vehicle capacity was added in the last 12 months or so with the launch of two US$500 million funds, each respectively focused on the US and Rest of World markets. This capital will be fully deployed in coming years, and both vehicles include an option to increase capacity to US$1 billion.

We believe successful execution on this strategy will result in IMF becoming a much larger business. The $141 million October acquisition of European litigation funder Omni Bridgeway will help accelerate the process. The Fund participated in the associated equity raising at $3.40 per share.

In the near-term IMF is benefiting from a series of financial windfalls as balance sheet investments roll-off. Most notably, in December the Supreme Court of NSW ruled in favour of the plaintiff in the Brisbane Floods Class Action. As funder, IMF expects to generate $100 - $130 million in revenue.

Total expected income for 1H20 of $304 million already dwarfs the $35 million generated for the whole of FY19.

Bravura Solutions

Earlier in 2019 wealth and funds management administration software provider Bravura Solutions (BVS) raised $165 million for acquisitions, initially as part of a bid for competitor GBST. However GBST was lost to a competing bid, and BVS finished FY19 with a balance sheet laden with net cash of $195 million.

Some of this went to acquisitions during 1H20. In August BVS completed a $50 million acquisition of Australian financial planning back office software provider MidWinter.

MidWinter's offering sits adjacent to BVS. It followed this in October with a $25m purchase of FinoComp, a Wealth reporting and regulatory compliance software provider with some leading UK Wealth institutions as clients. This business will add functionality to Bravura's existing software.

At the November AGM BVS reiterated previous guidance of mid-teens NPAT growth, but clarified that guidance excludes the impact of acquisitions of about $3 million to NPAT. This was effectively an upgrade.

The AGM update was a nice surprise, however our focus remains on the long term opportunity. Within the wealth and funds administration software market BVS is a key beneficiary of increased out-sourcing by financial institutions in highly regulated financial markets across Australasia and Europe. BVS is well positioned to soak up what is a multi-year pipeline of demand from new and existing customers.

Electro Optic Systems

In November defence and space technologies developer, Electro Optic Systems (EOS), announced upgraded guidance alongside a capital raising to fund growth and working capital. FY20 EBIT guidance was increased to 70% growth (previously 45%). Including a $68 million placement and a $17 million share purchase plan (increased from $10 million due to investor demand), EOS increased equity by $85 million and remains debt-free. The Fund participated in the placement at $6.66 per share.

Demand for EOS's leading remote weapon system technology is reflected in a $680 million order backlog. Additional demand from 2020 will be met in by new plants in USA, the UAE and Singapore, to complement Australian operations. The technology has applications in the emergent counter drone market, which as per the guidance update, EOS expects to exceed the $12 billion weapon systems market by 2022.

EOS is a niche leader in remote defence systems, supplying to Australian defence allies. Whilst we're very pleased with progress in this field, we look forward to potential opportunities in the Space sector, where EOS has leading and highly coveted Space object monitoring technology. We believe potential value of the Space business is not reflected in the current market valuation.

Manager Alignment

We take the opportunity to reiterate a philosophical cornerstone of our investment process: alignment. We seek to invest in companies that have products and/or services that we believe in, backed by highly capable and aligned management teams. Furthermore, we hold ourselves to account when considering the core value of alignment. We invest alongside our clients, and upon the same terms as clients. Accordingly, several members of the Clime investment and executive team are meaningfully invested in the Fund.

Thank you for your ongoing support.

Jonathan Wilson
Portfolio Manager

Adrian Ezquerro
Head of Investments

Fund Information

Investment Objective

The Clime Smaller Companies Fund is a concentrated portfolio of high-quality businesses that are outside the ASX200 at the time of initial investment.

The Fund invests in niche leaders that have superior business economics, strong balance sheets, and significant growth prospects, provided they are attractively priced relative to assessed value. The Fund is designed to take advantage of the structurally inefficient and under-researched market segment of small capitalisation stocks.

Its objective is to outperform a blended benchmark comprising 50% of the Small Ordinaries Accumulation Index and 50% of the Emerging Companies Accumulation Index.

Investment Methodology

The Clime Smaller Companies Fund has a quality focus with a valuation discipline. Fund holdings are characterised by:

- A competitive advantage, leadership within a specific niche
- High levels of profitability and margin
- Low financial leverage
- Capital-efficient growth and cash generation
- Capable management aligned with shareholders
- Sustainable long-term growth
- Attractive share prices relative to assessed value

Position sizing reflects not only our assessment of valuation and quality, but also the degree of strategy execution.

Portfolio Managers

Jonathan Wilson

Jonathan has 6 years of investment experience, specialising in growth strategies. He was the founding Co-Portfolio Manager of the Clime Smaller Companies Fund. Jonathan holds a Bachelor of Engineering, Bachelor of Commerce from the Australian National University and is a CFA Charterholder.

Adrian Ezquerro

Adrian, Clime's Head of Investments, has 13 years of investment experience. Adrian was the founding Portfolio Manager of the Clime Smaller Companies Fund. Adrian holds a Bachelor of Science from the University of Wollongong, and a Graduate Diploma of Applied Finance from Kaplan Professional.

Fund Information

Name	Clime Smaller Companies Fund	**Investor Eligibility**	Retail & Wholesale
Structure	Managed Investment Scheme	**Minimum Investment**	Retail: $10,000 Wholesale: $100,000
Investment Universe	Ex-ASX 200 at initial investment	**Liquidity**	Weekly Unit Pricing Applications and Redemptions
Benchmark	50% of the ASX Small Ordanairies Accumulation Index & 50% of the ASX Emerging Companies Accumulation Index	**Fees**	Retail: 1.23% management and 20% performance Wholesale: 1.03% management and 20% performance
Stock Holdings	15-40	**Admin**	Mainstream Fund Services Pty Ltd
Stock Limit	15% at cost	**APIR Code**	Retail: SLT5667AU Wholesale: CLA1557AU
Fund Size	$43.7m	**Platform Availablity**	Netwealth, HUB24

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