Integrity Transparency Conviction

Clime Smaller Companies Fund

Monthly Investment Report - February 2018

Clime Asset Management Pty Limited
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Investment Objective

The objective of the Fund is to generate sustainable long-term capital growth. The Fund seeks to achieve an annual total return of 8% above the Australian Consumer Price Index (CPI) over rolling five to seven year investment periods after management fees.

Investment Strategy

The Clime Smaller Companies Fund seeks to deliver strong risk-adjusted total returns by investing in a portfolio of high quality smaller Australian companies that are attractively priced.

Fund Profile (Wholesale^)

Investment Manager	Clime Asset Management Pty Limited
Investments	The Fund invests in those companies that are outside of the S&P/ASX200 Index and above $50m market capitalisation at the time of establishing a position.
Inception Date	24 April 2017
Income Distributions	Annual. Unless otherwise requested, distributions are automatically reinvested.
Management Fee	1.03% p.a.^^
Contribution Fee	Nil
Minimum initial investment	$100,000
Minimum additional investment	$10,000
Minimum balance	$100,000
Expenses	0.21% p.a.
Withdrawal Fee	Nil
Performance Fee	Performance Fee of 20% of Fund's total return above investment objective of CPI^^^ + 8% pa inc. GST.
Investment Horizon	Suggested minimum 5 years

^As defined by the Corporations Act
^^The Clime Smaller Companies Fund is currently in the incubation phase, during which time the manager will be charging reduced management fees. This will be reviewed on a (calendar) quarterly basis.
^^^Trimmed mean Consumer Price Index as measured by the Reserve Bank of Australia

Portfolio Total Return (28/02/18)

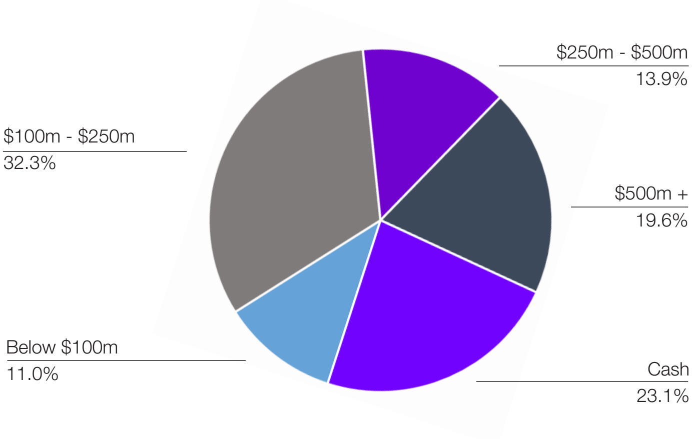
	Portfolio Return	Fund Objective^
1 month	-0.78%	0.76%
3 months	4.66%	2.47%
6 months	10.21%	5.04%
1 year	-	-
Inception*	19.56%	8.74%

* Inception: Wholesale Units: 24 April 2017. Performance figures for more than 1 year are annualised, calculated after all applicable fees and taxes. Returns have been calculated based on starting and ending unit prices after taking into account all ongoing fees, and assuming reinvestment of distributions. ^ CPI + 8% p.a. including GST.

Distributions

Period Ending	Wholesale Units (cents per unit)
30 June 2017	0.1564

Asset Allocation by Market Capitalisation



Prominent Fund Holdings *(alphabetical order)*

	Bravura Solutions Limited (ASX: BVS)
	Elanor Investors Group (ASX: ENN)
	Hansen Technologies Limited (ASX: HSN)
	Jumbo Interactive Limited (ASX: JIN)
	Navigator Global Investments Limited (ASX: NGI)

Summary

As is the case this time of year, we have received a broad range of updates from our investee companies over the past month's reporting season. A few updates were excellent, many were good, while some were disappointing. In turn, this has allowed us to further shape the portfolio towards what we believe is most appropriate given the new information received. Despite a broad range of portfolio constituent returns, the Clime Smaller Companies Fund delivered an aggregate return of -0.8% for the month.

The rush and tumble of reporting season does however belie the multi-year journey we believe we are on with many of our core positions. Ultimately, prominent fund positions are held at a meaningful weight because we have conviction in the long-term prospects of the company.

The reality in funds management is that as investors we will not get everything right. It's all part of the long-term journey, one where the learning and refinement never ends.

Starting with the disappointments, we believe it is important to provide a distinction between an investment thesis that has changed (adversely) and one that is perhaps challenged but not yet broken. An example of the former would be our investment in **Mitula Group (MUA)**, a business whose historical core focus has been on the aggregation of online classifieds on a global basis.

At the time of initial investment, we were of the view that MUA could successfully harness very high levels of visitation to drive a growing revenue stream from the sales of clicks and advertising, while also participating in transactions. With a strong net cash balance sheet and a talented management team, we saw the likelihood of successful execution as being reasonably high. Hindsight now suggests we overestimated the earnings power of MUA's core historical business, one which now appears to be challenged.

While MUA management have sensibly attempted to pivot the business towards other revenue streams, we believe the strategy (while necessary) increases the risk profile of future earnings. As such, after reducing our exposure in prior months, we decided to exit our position entirely during February.

Another aspect of maintaining a sell discipline within the Fund's investment process, is where an investment thesis plays out and a marked gain realised. We also completed the exit of one other position during the month, albeit for different reasons. For much of the Fund's life, we have held a moderate position in Australia's leading litigation funder **IMF Bentham (IMF)**. Over the past 12 months, IMF has rallied from a low of $1.74 to a high of $3.33 per share. This low (and high) represented a significant discount (and premium) to our intrinsic valuation range.

So, while we remain positive on the transition of IMF's funding model, which should prove to be less capital intensive, we took the opportunity to exit our holding at a substantial premium to our calculation of intrinsic value. IMF generated a total return of approximately 64% for the CSCF and now migrates to the Fund's 'watchlist' of interest.

Another investment thesis that continues to evolve is that of **Redflex Holdings (RDF)**, a company profiled in our November 2017 CSCF Monthly Report. RDF is one of the world's largest developer and operators of red light and speed enforcement systems. The somewhat messy first half result reflects the changing nature of the business, one that we believe now appears set to emerge from what has been years of difficulty.

With a refreshed management team, strengthened net cash balance sheet and a highly prospective sales pipeline, we are of the view that better times lie ahead for the business. Of course, time will be the ultimate judge on whether our investment thesis plays out as expected.

With the above noted, reporting season also provided ample reinforcement of our long-term theses in several core Fund holdings. Companies involved in the Software & Services sector particularly led the way, with businesses including **Bravura Solutions (BVS)**, **Hansen Technologies (HSN)** and **Macquarie Telecom (MAQ)** all delivering strong first half results.

As we have introduced previously, BVS is a market leading global provider of enterprise software and software-as-a-service to the wealth management and funds administration industries. Established in 2004 and first listed on the ASX in 2006, BVS has grown to become a world class supplier of software and professional services to some of the world's largest superannuation, pension, life insurance, investment, private wealth and funds administration entities.

BVS delivered an excellent first half FY2018 result, which culminated in an earnings upgrade for the full year. First half revenue was up 10% to $102.9m, with recurring revenue noted to be 68% of total group revenue at $70.2m. Implementation fees and licence fees were $27.7m and $5.0m respectively.

Underlying Net profit after tax was up 13% to $14.2m while operating cash flow was sound at $14.6m. Solid cash generation has again afforded management scope to reinvest in Research & Development (R&D) while concurrently declaring an interim dividend of 4.5c per share. The balance sheet remains in good shape, with net cash of $9.9m.

Given the strong operational momentum apparent within the business, BVS management upgraded full year earnings per share (EPS) from 'mid teen percentage growth' to EPS growth in the 'high teens'. This implies a full year NPAT forecast of between $26.3m to $26.7m, which in turn suggests BVS is trading on an FY2018 P/E of about 17x.

Looking further ahead, specific to (FY17 to FY20) earnings, we currently forecast a compound annual growth rate (CAGR) of 16.8%. On our forecasts, BVS is trading on a FY19 P/E of between 15x and 15.5x. While omnipresent risks relating to technological change and the broader economy remain, on balance, we believe BVS is well placed to continue to grow earnings and dividends over the coming years.

One of the significant bright spots of the small cap reporting season has been that of Hansen Technologies (ASX: HSN), whose result was ahead of investor expectations on all key metrics. For those unfamiliar with the company, HSN is a leader in mission critical billing software on a global basis. HSN's billing software is crucial to the operations of its customers, primarily those operating in the energy, water, telecommunications and Pay TV sectors. As a result, HSN's customer churn is extremely low while the degree of recurring revenue is high.

The first half result was sound; revenue was up 36% to $118.4m, EBITDA was up 41% to $33.8m while NPATA was up 47% to $22.7m. Given the recent acquisition of the market leading Nordic business Enoro was partially equity funded, earnings growth on a per share basis was comparatively lower, up 37% to 11.7cps.

As has so often been the case throughout HSN's history, operating cash flow was sound at $26.9m, which in turn led to the swift repayment of a reasonable amount of debt during the half. Net debt closed the period at just $17.2m, suggesting HSN may again be back in a net cash position within six to nine months.

Looking ahead, we believe the company is well placed to deliver double-digit growth in per share earnings and cash flow over the next two to three years. If achieved, this will build on the strong track record of growth, largely self-funded, delivered over the past decade.

The investment theses for **Navigator Global Investments (NGI)** and **Jumbo Interactive (JIN)** have both strengthened in recent months. There were no great surprises with the NGI first half result, with the business continuing purposefully on its growth path. Assets under management (AUM) grew by 10.5% during the half to US$10.5bn while both earnings and dividends for the full year are forecast to grow in the mid-teens (in percentage terms). After backing out cash and investments of about A$56m, NGI continues to trade on a modest forward multiple of about 11x earnings and cash flow and a dividend yield of about 7.0%.

Specific to NGI, what makes the above even more interesting is the acquisition of the 'Advanced Strategy' business unit of Mesirow Financial, which was announced post result. While terms and the amount of AUM to transition are yet to be finalised, we believe it is probable that this deal could be substantially accretive to per share earnings and perhaps more importantly, further strengthen NGI's foundation for future business growth. We look forward to providing further developments on this front in the coming months.

We remain equally constructive on the near to mid-term prospects for Jumbo Interactive (JIN). JIN is a leading digital retailer of official government and charitable lotteries that we believe has significant business operating momentum (as distinct from 'stock price momentum').

To summarise, we believe JIN is an attractive investment proposition for several reasons. Firstly, we believe JIN is an easily understood business with bright prospects. Over many years, JIN has built a substantial database of verified accounts, one that continues to grow.

Concurrently, the company has developed a high quality online platform. With much of that investment largely complete, we are only now starting to see significant operating leverage. As a result, each new incremental dollar of revenue is flowing through more potently to the bottom line. Put another way, we expect to see further margin expansion as the business grows.

JIN now presents as a capital light business whose profitability, as measured by normalised return on equity (NROE), should continue to trend higher in the coming years. As we have articulated previously, JIN is also in the healthy position of having substantial excess cash reserves, no debt and an abundance of franking credits.

Management have suggested that the core business only requires approximately $10m for the business to operate comfortably. We estimate that JIN's company cash balance will grow from the $34m noted as at 31 December 2017 to approximately $45m by 30 June 2018. This reflects not only the cash we expect the company to generate in the second half, but also, the expected cash injection from Tabcorp (ASX: TAH) exercising its remaining 3.7 million options by 12 May 2018.

In aggregate, we believe the above will provide significant impetus for management to declare a meaningful fully franked special dividend over the coming months. In our view, this could well equate to a further $0.20 to $0.30 of fully franked income to investors (in addition to the ordinary dividend income declared) before 30 June.

Two further portfolio holdings delivered notable earnings improvement during the February reporting season. **Axsess Today (AXL)**, a specialist provider of equipment funding solutions for SMEs, produced an excellent first half result, with profit up 95% to $3.2m. This was largely driven by a significant increase in receivables, which were up by 53% (vs 30 June 2017) to $256m.

Interestingly, if (hypothetically) this book was to 'run-off', the receivables balance would generate a total of approximately $400m of principal and interest repayments. The difference between the two figures ($144m) currently represents a significant premium to AXL's current market capitalisation.

Though such a finance business carries with it inherent risk, which we believe is currently being adequately managed, there remains significant potential for AXL to drive continued strong earnings growth over the next two to three years. In our view, key levers include continued market share growth in its core Australian hospitality and transport sectors, Canadian expansion and the execution of a securitisation program, which will provide a more efficient capital funding model as the business grows.

As a result of continued execution, albeit off a small base, management have (again) upgraded FY2018 earnings guidance to $7.0m. Given the velocity of growth in the receivables book, we believe AXL may exceed upgraded guidance for FY2018.

We were also pleasantly surprised by the execution by the management of **Lycopodium (LYL)**, an engineering and consultancy group that provides services primarily to the mining, infrastructure and manufacturing sectors. We believe LYL are among the best at what they do and are globally recognised in the specific niches in which they specialise.

After enduring a tougher period over the past five years, we believe the prospects for LYL continue to improve in what is an inherently cyclical industry. This view is reinforced by the effective upgrade for full year earnings, which LYL management expects to be in the range of $16.5m. If achieved, this will represent earnings growth of 60.0% on FY2017. Equally impressive is the strength of LYL's balance sheet. LYL's cash and receivables, net of all liabilities, stands at $50.6m or about 25% of the company's market capitalisation. On an ex cash basis, and despite a healthy share price rally, LYL still trades on a P/E of less than 9x and offers investors a forecast yield of between 5.5% and 6.0%, fully franked.

Finally, I believe it is important to acknowledge the strength of the management teams of the businesses we are invested in (and alongside). We will expand further on this line of thinking in subsequent commentaries but suffice to say it remains a privilege to not only interact with, but in many ways also learn from, some of Australia's best business managers. Finding alignment with some of our nation's most talented, devoted and focused minds continues to yield results.

We continue to believe that the portfolio remains well positioned with a reasonable amount of cash that will allow the Fund to take sensible advantage of volatility should it emerge further in coming months. We again thank you for your ongoing support, it is genuinely appreciated.