Integrity Transparency Conviction

Clime Smaller Companies Fund

Monthly Investment Report - May 2018

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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
^^Trimmed mean Consumer Price Index as measured by the Reserve Bank of Australia

Portfolio Total Return (31/05/18)

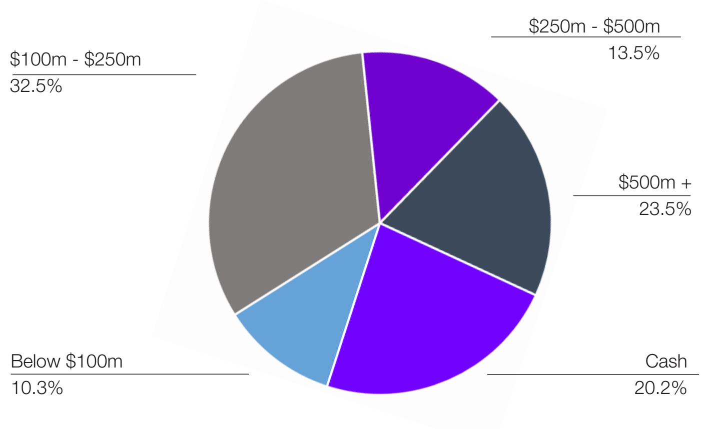
	Portfolio Return	Fund Objective^
1 month	2.14%	0.81%
3 months	4.26%	2.41%
6 months	9.12%	4.83%
1 year	23.42%	9.88%
Inception*	22.17%	9.87%

* 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)*

Axsesstoday	Axsesstoday Limited (ASX: AXL)
bravura solutions	Bravura Solutions Limited (ASX: BVS)
Elanor Investors Group	Elanor Investors Group (ASX: ENN)
HANSEN TECHNOLOGIES	Hansen Technologies Limited (ASX: HSN)
JUMBO	Jumbo Interactive Limited (ASX: JIN)
NAVIGATOR GLOBAL INVESTMENTS	Navigator Global Investments Limited (ASX: NGI)

Summary

The Clime Smaller Companies Fund (CSCF) delivered a solid return of 2.1% (net of all fees) for the month. The CSCF has delivered a return of 21.3% (net of all fees) for the financial year to date.

Specific to research, the month of May proved to be a particularly constructive period, with Clime's Smaller Companies analysts meeting with dozens of company management teams. This covered off a range of both existing and prospective investments that generally left us comfortable with our existing positioning, while also progressing our research on several companies of interest not currently held. We expect that this significant groundwork will position us well to selectively deploy capital in the coming months, as and when attractively priced opportunities become apparent.

One topic permeating investment circles at present is the recent outperformance of small caps over their larger counterparts. Indeed, the previous 12 months has seen smaller companies garner greater support, which we see as reflecting two key factors.

Before we delve more specifically into these thoughts, it is important to reiterate our belief that the delivery of meaningful earnings growth, preferably self-funded, over the medium to long-term is the core driver of investment performance. We have far less confidence in predicting short term price movements and as such, retain our significant focus on understanding the drivers of future earnings growth, concurrent with a solid understanding of intrinsic value.

A high quality smaller company whose earnings march upwards over time will almost inevitably be rewarded with higher pricing. Often, equity holders will also be rewarded with a growing income stream that typically matches earnings growth. Ultimately, price follows value creation.

The first driver of recent small cap performance relates to the mining cycle. Small cap resource companies have collectively enjoyed a spectacular recovery off post mining boom lows, in turn reflecting the improving commodity cycle and the associated increased allocation of capital to the resources sector. While small cap industrials have in aggregate delivered solid results, gains in this sub-sector have not come close to matching their more cyclical resource small cap peers.

Having noted the above, we still see solid pockets of underappreciated growth opportunities within the industrials space and remain encouraged by the start made to the CSCF investing journey. We retain conviction in our investing framework and process; one that generally screens out investments more acutely associated with commodity-focused, price taker dynamics.

Secondly, when reflecting on the diverging fortunes of small and large caps, it is important to recognize (and then effectively price) the differing growth profiles of each cohort. Many established 'old world' large cap businesses are under attack from emerging competition at a time when regulators are increasingly scrutinizing business practices.

One doesn't have to look too far to see the challenges being faced by some of Australia's largest listed institutions, many of which have been exposed in recent times by the Royal Commission. This in turn has delivered investors in the likes of AMP, Telstra and the big banks some underwhelming returns recently. As a result, many investors are now looking beyond the traditional blue chips for a sound mix of sustainable growth and income.

One such opportunity is AxsessToday (ASX: AXL), a specialist provider of equipment funding solutions for SMEs across Australia. AXL provides its equipment finance products to SMEs at the retail point-of-sale, with most loans originated through trusted, accredited equipment retailers in real-time through a streamlined online portal. In effect, AXL allows its customers, who operate primarily in the hospitality and transport sectors, to purchase business critical equipment without needing to outlay 100 per cent of the capital upfront.

As introduced above, the Royal Commission has become quite the headwind for many established businesses operating across the Australian financial sector. As is often the case, industry disruption often brings with it opportunity. With the big banks particularly pulling back from directly engaging in the funding of SMEs in Australia, nimbler operators such as AXL are provided with substantial opportunity to drive market share growth. While cognizant of the risks involved, we have taken the opportunity to add to our AXL position on weakness and remain generally positive on the company's medium-term prospects.

One of the more significant contributors to performance since inception has been Navigator Global Investments (ASX: NGI), a company discussed several times in prior monthly reports. The key driver of recent performance has been the finalization of the acquisition of Mesirow Advanced Strategies (MAS), the multi-manager hedge fund division of Mesirow Financial. As expected, the transaction will deliver a step-change in NGI's Assets Under Management (AUM) and future earnings power, adding US$5.2 billion to its pre-acquisition AUM of US$10.5 billion, a 50 per cent increase.

NGI appreciated steadily following the March announcement of a definitive agreement reached with Mesirow, however in the days prior to the May 31st update shares were still trading on relatively modest pre-acquisition multiples of 15 times our estimate of fiscal year 2019 free cash flow, or 13 times adjusted for cash and investments on the balance sheet. Therefore, little value was attributed to the potentially significant value accretion to be realised from the transaction.

For background, NGI is the parent of Lighthouse Partners, a multi-manager hedge funds business based in the US. Lighthouse's 'managed accounts' platform distinguishes itself within the notoriously opaque hedge funds and alternative investments space.

Essentially Lighthouse owns the underlying assets and appoints specialist investment managers to trade them within certain guidelines. This allows Lighthouse to collect real-time data on portfolios to track managers and assess adherence to mandates, providing more transparency, protection and stronger investment governance compared to traditional Fund of Hedge Funds.

Lighthouse and MAS are highly complementary in our view. MAS will benefit from Lighthouse's managed accounts platform whilst adding expertise in less liquid strategies such as credit and other lending strategies to the existing offering. Financially, MAS should increase underlying cash earnings by at least 20% in fiscal year 2019. At today's share price this should drive a healthy yield of approximately 6 per cent.

Consideration for the acquisition is on a deferred earnout basis (details of which are yet to be released) and linked to the US$5.2 billion AUM to be transferred to NGI. Management clearly structured this acquisition to minimise risk while preserving substantial long-term upside.

Beyond MAS, we see opportunities from further institutional mandate wins, as well as sales of its Management Accounts Platform as a product to other investors, which could make up a larger part of the business in 5 years time.

In aggregate, the above update has in turn driven an increase in forecast value, which was revised up to a range of $5.10 to $5.30 per share (FY2019). We continue to view NGI as an attractive investment proposition that, like many other portfolio constituents, offers a solid mix of growth and income.

As we approach the end of the CSCF's first complete financial year, we remain pleased with the portfolio's positioning. While we have taken some opportunity to reduce exposure to companies whose prices have rallied towards value, much of the recent increase in cash holdings has been driven by investment inflows. As highlighted above, we still see significant opportunity to selectively deploy capital into sensibly priced, high quality smaller companies.