Integrity Transparency Conviction

Clime Smaller Companies Fund

Monthly Investment Report - October 2017

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 and is expected to be in place until the fund size reaches A$10 million.

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

Portfolio Total Return (31/10/17)

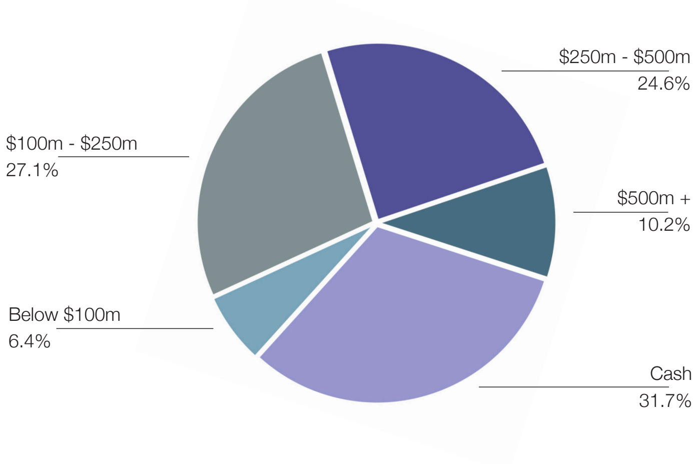
	Portfolio Return
1 month	3.00%
3 months	6.54%
6 months	12.97%
1 year	-
Inception*	13.04%

* 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.

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	Bravura Solutions Limited (ASX: BVS)
Elanor Investors Group	Elanor Investors Group (ASX: ENN)
HFA holdings	HFA Holdings Limited (ASX: HFA)
INDUSTRIAREIT	Industria REIT (ASX: IDR)
1300 SMILES Dentists	1300 Smiles Limited (ASX: ONT)

Summary

The Clime Smaller Companies Fund delivered a sound return of 3.0% for the month, though this was achieved in the context of a surging broader market. While our optimism specific to the longer-term prosperity of Australia and its economy remains, we balance this with an appropriately measured view on equity valuations.

As much of the commentary emanating from the broader Clime Group has suggested for some time, we are of the view that the excessive stimulatory monetary policy settings that remain in place across the globe continue to distort markets. The strong hands of central banks, acting to manage / manipulate bond yields have effectively encouraged speculation in all risk assets, including equities. We believe valuation – the price paid for future growth, future earnings and future distributions – matters and must continue to be considered in the current market environment.

Nonetheless and though the opportunity set is somewhat less compelling, we continue to see pockets of value in the less efficient segment of the market in which we operate. As you would expect, we remain focused on achieving strong risk-adjusted returns by investing in a portfolio of high quality smaller Australian companies that are attractively priced. Though still early in the investment journey, this mantra and focus will endure.

As highlighted in the 'Prominent Fund Holdings' disclosure included in this report, one of the more meaningful positions held (since inception) has been that of HFA Holdings (ASX: HFA). Though we have averaged up and maintained the position as the fund size has grown, at the time of initial purchase we saw this as a company that was incorrectly priced for no growth.

HFA is the parent company of Lighthouse Investment Partners, a US-based global absolute return hedge fund manager. Lighthouse manages US$10.0bn across commingled funds and customised accounts for endowments, foundations, institutions, pension funds and large individual investors.

At the time of initially establishing the position (late April 2017), assets under management (AUM) totalled US$9.5bn, the business was showing signs of growth, was debt free, had cash and investments of around A$50m, offered a yield of just under 10% and was priced at circa A$380m. In our view, this compared favourably with a company that was generating free cash flow of nearly A$40m, a figure we expected to grow in future years. We were also impressed by management, led by a high quality, long serving and aligned CEO in Sean McGould.

Since this time, HFA delivered a sound FY2017 result before providing a positive September quarter AUM update. Highlights included respective AUM growth of 13% (FY2017) and 5% (1Q FY2018). Pleasingly, this growth was driven by strong net inflows and solid performance across both Commingled Funds and Customised Solutions. To provide some context, the growth seen in the first quarter of FY2018 was close to consensus estimates for the full year. The positive surprise exceeded expectations and led several analysts to increase their respective AUM, fee revenue and earnings forecasts.

Now trading slightly beyond $3 per share (~$500m market capitalisation), and having paid a healthy dividend along the way, HFA has been a solid contributor to the Fund's performance thus far. After a solid run, the question of course is whether it's time to assess our portfolio weighting. In our view, although HFA is no longer extremely cheap, it is certainly not expensive. Given the company still trades on an attractive and growing free cash flow yield of around 8.0% (9.2% on a forecast ex-cash basis), which supports a 7%+ dividend yield, we remain positive on the company's near-term outlook. Perhaps more importantly, we also remain positive on the company's longer-term prospects.

Based on discussions with management, HFA looks to have a strong pipeline for more customised mandate wins in new distribution markets in the Middle East, Japan and Europe. HFA will soon be renamed Navigator Global Investments as part of the company's gradual shift away from its historical exclusive core of fund of hedge funds operations. The business is still likely to retain its heritage in hedge funds; however, we expect that Navigator will grow to become a broader asset management business in three to five years' time.

Looking more broadly at the portfolio, we are comfortable with its existing positioning, which balances concentration with diversity. As at October month end, we own a part share of 21 high quality businesses, held just under 32% in cash and remain well positioned to take advantage of further opportunities as and when they arise. While still early in its investment journey, the Fund has grown encouragingly in its incubation stage. The Fund size now stands at just under $10m AUD.