Integrity Transparency Conviction

# Clime Smaller Companies Fund

## Monthly Investment Report - December 2017

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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 (31/12/17)

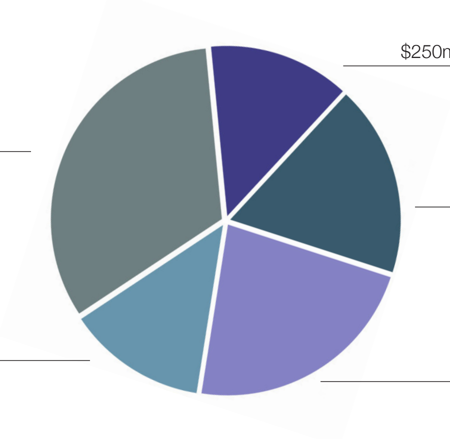
| | Portfolio Return |
|---|---|
| 1 month | 3.03% |
| 3 months | 7.26% |
| 6 months | 14.53% |
| 1 year | - |
| Inception* | 17.70% |

* 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) |
| 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) performed strongly in December, returning 3.0% for the month (Wholesale Units, after fees). The Financial Year to Date 2018 return (Wholesale Units, after fees) is +14.5%. Reflecting continuing steady inflows, the Fund finished the period with 23% held in cash, providing the ability to exploit sensibly priced, high quality opportunities. Returns for the month were pleasing and reflected contributions from a wide range of portfolio constituents.

### Kangaroo Island Plantation Timbers Introduced

Recent portfolio activity within the CSCF has seen a meaningful position established in forestry business Kangaroo Island Plantation Timbers (ASX:KPT). We've been interested in KPT for some time, and the company's $20m institutional placement in early December provided the opportunity to establish the position in the Fund.

KPT owns 16,000 ha of mainly eucalypt plantation assets on Kangaroo Island. Situated a little over 100km from Adelaide, Kangaroo Island is Australia's third largest with an area of 4,400 square kilometres (approximately twice the size of the Australian Capital Territory). Pending approval and construction of a deep water wharf at Smith Bay on Kangaroo Island (decision expected mid- 2018 - subject to approval - construction commencing shortly thereafter), KPT will export substantial woodchip quantities to Japan (from 2019).

Of KPT's plantation assets, approximately 14,000 ha is planted with mostly eucalypt (hardwood chip) and some pines (logs), with the remaining 2,000 ha of land holdings earmarked for future planting. There is also potential for consolidation of the remaining plantations on Kangaroo Island held by a small number of private operators, which could add a further 25% to plantation assets.

In time, the company plans to solely produce hardwood chip, which is used in the production of nappies, rayon and viscose.

We believe KPT is an interesting opportunity due to it currently trading close to net assets per share of $2.26 (including the December raising), which reflects a conservative valuation of its timberland assets. We thought the December placement at $2.00 per share was attractively priced at a discount to net asset per share. Based on company production forecasts of approximately 500,000 tonnes of woodchip per annum, at current prices KPT would generate free cash flow (pre-financing costs) of around $20m. This compares well to its market valuation (at the time of writing) of $119m.

A key reason why we believe estimates of KPT's timberland assets and annual cash flows may prove conservative is that they don't include the potential positive impact of a looming supply shortfall on hardwood chip prices. According to global forestry industry research house, RISI, a shortfall of approximately 4 million tonnes per annum will emerge in Asian markets by 2030. Based on forecast production, KPT will be capable of supplying over 10% of this expected shortfall, which is somewhat structural in nature due to lengthy harvest cycles of around 12 years.

KPT has taken a number of key steps in creating a path to market during 2017. These include the $55m acquisition of FIT Estate, which added close to 11,000 ha of eucalypt assets, appointing Kangaroo Island-based PF Olsen for forestry management, reaching an exclusive five-year offtake MoU with Japanese conglomerate Mitsui & Co Ltd, as well as securing capital resources required to build the proposed wharf at Smith Bay.

We see the perceived uncertainty around this final and crucial step as being the key factor behind KPT's discounted share price.

The addition of a deep water wharf on Kangaroo Island has been debated for a long time, however the decision process is now in its final stages. In January KPT will submit an Environmental Impact Statement (EIS) to South Australia's Department of Planning Transport and Infrastructure (DPTI). Following a review and consultation process a final decision is expected to be made by the SA Governor in July of this year.

Although this decision is ultimately a binary outcome, we view a favourable decision as probable for the following reasons:

Firstly, Smith Bay is not home to any endangered species, and most of the scientific studies to meet the EIS requirements have been completed. As of November 2017 KPT had only offshore geotechnical studies to finalise. Thus, we believe the proposal is unlikely to be rejected on environmental grounds.

Secondly, the wharf development offers compelling economic benefits to the state of South Australia. KPT is fully funding the ~$30m development, and upon completion it will add around 170 permanent jobs and boost SA economic activity by $109m.

Lastly, the proposal will be assessed as a Major Project by the independent Development Assessment Commission, rather than at a local government level. Projects with Major Development status have historically seen high approval rates, as this pathway removes any right of appeal by objectors against development consent (and thus any future uncertainty around the outcome).

With the financial and operational pieces now in place, and the outcome of the wharf proposal seemingly weighted in KPT's favour, we see potential for the company to realise its intrinsic value, which we estimate as being beyond $3 per share.

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