Clime Smaller Companies Fund

Quarterly Report June 2020

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
28.2%	7.6%	15.8%	$46.8m

	1 month	3 months	6 months	FYTD	1 year	3 years	Inception p.a.	Inception Total
Fund Net Return (Wholesale)*	3.6%	28.2%	-5.5%	7.6%	7.6%	15.8%	15.8%	59.6%
Benchmark^	-0.3%	34.1%	-9.7%	-3.4%	-3.4%	5.2%	5.5%	18.6%

*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	$46.8m
Number of Stocks	15-40
Cash Distributions	Annually
Eligibility	Wholesale & Retail

Top 5 Holdings (Alphabetical)

Company	ASX Code
Bravura Solutions	BVS
Hansen Technologies	HSN
Mach7 Technologies	M7T
Macquarie Telecom Group	MAQ
RPM Global Holdings	RUL

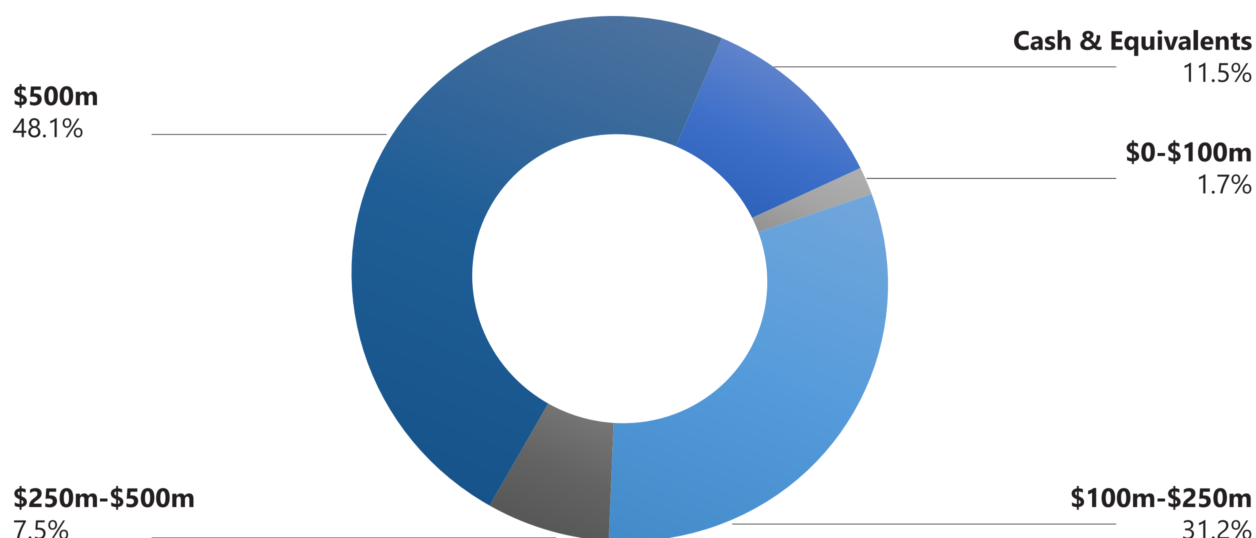
Unit Price

Date	Wholesale Unit (exit)
30 June 2020	$1.4454

Distributions

Period Ended	Wholesale Units (cents)
30 June 2019	8.2837

Asset Allocation by Market Capitalisation



Asset Allocation by Sector

Industry	Weighting
Software & Services	27.6%
Healthcare Equipment & Services	14.5%
Diversified Financials	11.3%
Communication Services	10.6%
Capital Goods	7.6%
Retailing	5.6%
Technology Hardware & Equipment	5.4%
Consumer Services	4.2%
Media & Entertainment	1.7%
Cash & Equivalents	11.5%

Portfolio Commentary

The Clime Smaller Companies Fund returned 28.2% for the June quarter, behind the Benchmark return of 34.1%. Since inception the Clime Smaller Companies Fund has returned 15.8% per annum after fees, ahead of the Benchmark return of 5.5% per annum.

The Fund invests in quality companies using strong valuation discipline. Portfolio holdings are each characterised by niche leadership, strong balance sheets and significant growth prospects. In our experience, these types of businesses are resilient in the face of economic stress and tend to power out of downturns.

From the onset of the pandemic we have emphasised the digital leaders in various sectors as a way to access growth through the period. Most of the holdings in the Clime Smaller Companies Fund have well developed digital strategies, and so they are well positioned to capture shifts in demand as businesses and consumers turn further toward digital channels for products and services.

The portfolio has delivered solidly in recent months, albeit more quickly than we expected and in the context of a rapid and broad market recovery. The recovery in equity markets from March lows was enabled by massive synchronised monetary and fiscal support. Government bond yields have reduced to near zero and will remain so for some time. The flow-on effect is reduced discount rates used to value equities, which results in higher stock prices, all else being equal.

The unintended consequence of this new liquidity is increased speculative activity. Lower quality businesses with serious demand risks have also rallied off lows and face a second reckoning as the pandemic persists into FY21, in our view. As this plays out, we will likely see a widening dispersion of returns across the market.

Mach7 Technologies

In June US-based medical imaging software company, Mach7 Technologies (M7T) announced a $40.8 million acquisition of Canadian peer Client Outlook. We took part in both the Institutional Entitlement Offer and Placement at $0.68 per share.

We view the acquisition as a transformational merger of best of breed solutions to form the strongest end-to-end healthcare imaging system on the market.

The medical imaging market is ripe for structural change. For healthcare systems globally, effective patient data management has the potential to significantly improve system efficiency and patient outcomes. In the US, the Electronic Medical Record (EMR) was mandated in 2009, requiring hospital systems to invest in patient data management software.

Within the imaging space, Picture Archiving and Communication Systems (PACS) need to be modernised to enable imaging data to be consolidated and included in the EMR, and to be shared across healthcare enterprises which, in the US, range from single entities to hundreds of hospitals. Well over half the PACS space is dominated by equipment vendors, including GE Healthcare, Lexmark, Agfa, Fuji, and Philips, which traditionally packaged software as add-ons with their equipment. The problem is, the vendor-specific software systems don't talk to each other, resulting in data silos within departments (eg radiology, cardiology) and individual hospitals.

Both M7T (formed in 2007) and Client Outlook (2002) were founded as 'software pureplay' businesses to address the need for vendor neutrality and provide 'data liquidity' across the healthcare enterprise. M7T specialises in Vendor Neutral Archive (VNA) and data routing (the back end), while Client Outlook's focuses on viewing technology (the front end) for both Enterprise Imaging as well as departmental (radiology, cardiology etc) PACS.

Both are leaders in their respective domains, with industry research house IDC rating M7T as the best-in-class VNA (2016) and KLAS rating Client Outlook's eUnity product as the best-in-class viewer for enterprise (2019).

This merger is particularly good because, from a technology standpoint, the two are already tightly integrated. M7T and Client Outlook are resellers of each other's products and have partnered for several years. Their products work together seamlessly.

The merger should also enhance contract win-rates and improve pricing power. Based our discussions with management, although M7T and Client Outlook previously bid for deals under a single contract arrangement, buyers had a clear preference for single vendors (all else being equal) to reduce supply-chain risk. This is supported by industry research by Reaction Data (2018), which found 67% of buyers preferred a single vendor over a best-of-breed modular approach. M7T is now a single vendor of an end-to-end system combining best of breed components.

In terms of the total addressable market (TAM), M7T can now compete for departmental PACS business, which increases its TAM from US$750m to US$2.75bn.

Live tenders have also increased from ~$30m to $40m over the next 6 to 12 months and the pipeline of opportunity has increased from $100m to $150m. Notably, two contracts each valued at over $13m are to be decided in the near term. For context, M7T's largest deal yet was its 5-year $15m Enterprise Imaging contract with Hospital Authority of Hong Kong (HAHK), covering 43 hospitals. Beyond cross-sell opportunities across M7T's and Client Outlook's customer bases, winning large US tenders in the near term should enhance M7T's standing as a vendor of choice among leading hospital networks in its home market.

Financially, M7T comes out of the merger with Contracted Annualised Recurring Revenue (CARR) of $14.75m, up from $9.2m, and net cash of $15m. CY21 revenues are forecast be $27m and EBITDA $5m-$7m.

M7T and Client Outlook are only now transitioning to profitability and the combined entity is set to benefit from structural tailwinds for many years to come.

Jumbo Interactive

Digital lotteries retailer and software provider Jumbo Interactive (ASX:JIN) kept shareholders in suspense during the final week of the financial year with regards to its ticket reseller agreements with Australia's two official lottery operators, Tabcorp (ASX:TAH) and WA Lotteries.

On 29 June JIN announced an updated reseller agreement with TAH. Negotiations are still in progress with WA Lotteries at the time of writing.

The new TAH agreement was mixed, but in the context of JIN's depressed share price, it was good news. JIN will remain a licensed reseller through to 2030, providing long-term certainty, but will pay Tabcorp annual service fees starting from FY21. The service fee, calculated as a percentage of the underlying ticket value, reduces JIN's revenue margin on its Total Transaction Volume (TTV). In effect, JIN's TTV margin falls from 20% to approximately 16% when the service fee is fully implemented from 2024.

This is good news because JIN should still deliver revenue growth driven by increasing digital share of ticket sales from approximately 30% now. Digital sales have increased more than 6-fold over the last decade, and likely will continue this trajectory.

On this basis JIN should deliver solid double-digit earnings growth even after accounting for the service fee. This is interesting because JIN trades at healthy free cash flow yield of 7% and has a balance sheet with net cash of $60m.

In the near term, JIN will redeploy Australian reseller cash flows to ramp up international growth of its new lotteries management Software-as-a-Service (SaaS) business, Powered by Jumbo. This is a multi-billion dollar opportunity across the UK, Canadian and US markets. We expect the SaaS strategy accelerate in FY21, when early reference sites (Australian charity lotteries) demonstrate improved performance.

Macquarie Telecom

Cloud and telco services provider Macquarie Telecom (MAQ) is a beneficiary of surging data consumption, which is driving demand for its hybrid-cloud, cyber-security and data centre offering. MAQ has an industry leading Net Promoter Score of +71.

In June MAQ announced increased capacity to its data centre portfolio via a new 4MW facility in Canberra to expand its government business. It is also bringing forward capacity at the Macquarie Park campus to service accelerating demand.

As per recent announcements, improving cyber-security is a top priority for the federal government. With 43% of government agencies as customers, and with the Canberra facility expansion underway, MAQ should capture future demand in this area in particular.

In total, MAQ plans to increase capacity from 13MW to 50MW across the Sydney and Canberra portfolio, representing growth of more than 300%. The capacity expansion will be reflected in a similar revenue growth over the coming years, and even higher earnings growth due to operating leverage.

Although shares doubled over the June quarter, MAQ remains Clime's preferred data centre exposure, and still trades at a discount to larger listed peers despite offering a superior growth profile.

In what we believe will be the exception rather than the norm heading into reporting season, MAQ reiterated pre-COVID guidance of $63-$66 million EBITDA ($55-$58 million pre-application of AASB16), representing approximately 10 percent growth. Future earnings growth will accelerate as new capacity comes online.

Rhipe (new addition)

We initiated a position in cloud software licensing and subscription management company Rhipe (ASX:RHP) during the half, after it was sold-off despite an improving demand profile in the COVID-19 environment. We participated in April's $35 million institutional placement at $1.60.

RHP provides cloud-based software licensing, subscription management tools and cloud services to various service providers such as Data Centres, Telcos, and MSPs. Its software vendors include Microsoft, Citrix, Datacore, McAfee, Red Hat, Trend Micro, Veeam Zimbra and VMware. Typically, RHP earns a fee of 10% - 20% of each subscription.

RHP's internally developed PRISM platform gives software resellers access to SaaS products from these vendors on a pay-as-you-go basis. Resellers essentially outsource billing, marketing and support to RHP so that they can focus on managing customer relationships.

The business is differentiated by its cloud-only business model, which positions the company for increasing adoption and complexity within the cloud market. Considering there are hundreds of products sold through PRISM, and over 450 from Microsoft alone, billing management becomes very complex, especially when combining multiple vendors.

Microsoft, which contributes three-quarters of RHP's revenues, is strategically well positioned among the public cloud providers due to its business productivity suite, its large

datacentre footprint (2x AWS), and Azure platform. Around 95% of Microsoft revenue comes via wholesalers and resellers. RHP is a preferred partner driving adoption in the APAC region.

Testament to their good standing in the market, in October 2019 Rhipe Japan was established after Microsoft Japan appointed RHP as an Indirect Cloud Solutions Provider. Rhipe Japan is an 80% owned JV with Japan Business Systems (JBS), which has over 2,000 staff and was appointed Microsoft Japan partner of the year for the last six years. Japan is one of Microsoft's largest markets but has been slow to adopt pay-as-you-go cloud business subscriptions. RHP's execution to date and PRISM platform were key reasons for the appointment and JV with JBS.

With 80% recurring revenues and $65m net cash RHP is in good financial shape. We believe the free cash flow yield of 4% (at the time of writing) is attractive given structural demand from increasing cloud adoption, which is set to drive 30%+ earnings growth for RHP in the near term.

Hansen Technologies

Utilities billing software provider Hansen Technologies (ASX:HSN) is among the minority of companies set to deliver a strong result for FY20.

In May HSN announced EBITDA guidance at the top end of the pre-COVID range. EBITDA for the full year is set to come in at between $75m and $76m. Surprisingly, the stock is down over from the time of the announcement and trades at about 14 times next year's earnings.

We like the business because it provides mission-critical billing and customer care software to essential telco and utilities customers. There is low demand risk and there's low counter-party risk. About two thirds of revenues are recurring.

Organic growth is modest within the billing product suite however Hansen's recently acquired business, Sigma Systems, should provide good cross-sell opportunities and drive mid-single digit revenue growth over the medium term. Sigma provides catalogue-driven software that sits more at the front end and helps telcos and utilities quickly bring new offers to market.

With the US Federal Reserve guiding to near-zero interest rates for the next couple of years, Hansen's free cash flow yield of about 6% looks very attractive.

City Chic Collective

A theme across the board during the crisis so far has been the rapid shift to the online retail channel from bricks and mortar. Ladies' fashion retailer City Chic Collective (ASX:CCX) is a key beneficiary with a leading brand and 65 percent of pre-COVID sales already online.

In May CCX provided a positive trading update, with Australia and New Zealand online sales up 57% versus the same time last year, which helped offset the impact of store closures in its home markets.

Importantly the international growth strategy appears to be well on track. The US ecommerce business, Avenue, which was acquired last year, is 'exceeding expectations' according to management. Successful offshore execution could yield a very strong payoff from current prices, in our view.

In the update, management also said the business has traded profitably during the period. The balance sheet remains well-resourced with minimal debt and significant headroom within its $40m facility. The team has done an excellent job in the circumstances.

Despite retail being under significant pressure City Chic is doing well and remains track to deliver on its global ambitions.

Omni Bridgeway

Litigation funder Omni Bridgeway (ASX:OBL) is a niche leader in it's field and a source of uncorrelated returns in the current environment.

The June quarter saw increasing debate around regulation of Australia's litigation funding industry, which is in relative infancy.

On 5 March the government launched a parliamentary inquiry into litigation funding and its impact on outcomes for plaintiffs. A report is due on 9 November 2020, which will provide the basis for new legislation.

There are many aspects to the inquiry, however, the central issues are the amount of class actions as well as claimants' (i.e. 'ordinary Australians') share of case recoveries (judgements and settlements).

We believe increasing regulation will be manifestly to OBL's advantage, although there are some risks. Given its low exposure to Australian Class Actions (15% of its case book) and global strategy, OBL is well-placed to re-enter the Australian Class Actions market, should regulations increase barriers to entry. It also has limited downside in the event of unfavourable legislation.

The business is in the final stages of a 5-year strategy commenced in 2015 to reduce idiosyncratic case risk and improve earnings quality by moving investments from the balance sheet to fund vehicles with much larger capacity. OBL typically invests 20% of the capital in these funds and acts as manager. Effectively, the funds provide OBL with 5 times the capacity as it previously had from investing via its balance sheet while adding additional management fee income. Already strong unit economics should therefore improve, and we'll also see a much smoother income profile in the future.

As it stands, OBL is the second largest litigation funder globally, behind UK-based Burford (LON:BUR), and one of the few litigation funders with local offices in every jurisdiction in which it operates.

Financially, OBL is in a strong position to invest in the global opportunity with total cash and receivables of $254m and a further $277m expected from settlements and potential completions.

Closing Commentary

While FY2020 delivered its own set of challenges, as is always the case with business and markets, a range of opportunities also presented themselves. Bushfires and the global Covid-19 pandemic tested both economies and markets in what has been an extraordinary period.

The above is the context for what was another productive year for our Smaller Companies Fund. Despite the volatility of the past 12 months, we managed to deliver a return of +7.6% for the FY20 period. This compares to -5.7% for the Small Ords Accumulation Index and -7.7% for the ASX200 Accumulation Index. Since inception, the Fund has now delivered a return of 15.8% per annum, in excess of the benchmark return of +5.5% per annum.

These positive outcomes to date reflect a process that focuses on investing in high quality emerging Australian companies, while maintaining strong valuation discipline. It's the significant efforts of a number of management teams and the thousands of collective employees of our investee companies that have allowed us to deliver for our co-investors. Executing well on their respective strategies creates the value, and as the old saying goes, price follows value.

We now welcome in a new financial year, one that will undoubtedly bring with it further challenges and opportunities. Thanks to our co-investors for your continued support, and best wishes to all in FY2021.

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	$46.8m	**Platform Availablity**	Netwealth, HUB24

Contact Information

Investor information
Clime Asset Management
Ph: 1300 788 568
Email: info@clime.com.au

Administrator
Mainstream Fund Services
Ph: 1300 133 451
Email: registry@mainstreamgroup.com

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