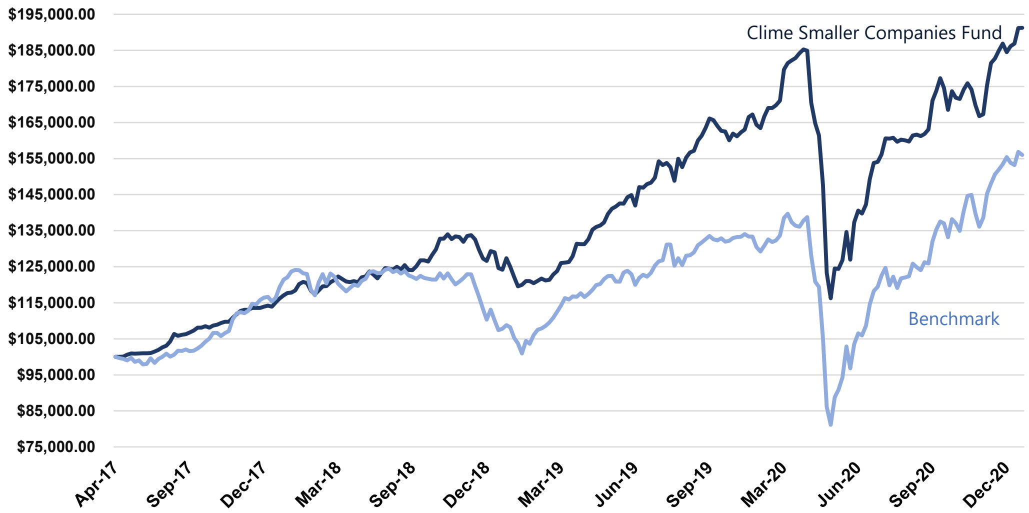
Clime Smaller Companies Fund

Quarterly Report December 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)*	Inception p.a. Net Return (Wholesale)	Inception Total Return	Total Fund Size
11.5%	19.2%	91.2%	$59.0m



	1 month	3 months	6 months	1 year	2 years	3 years	Inception p.a.	Inception Total
Fund Net Return (Wholesale)*	3.4%	11.5%	19.8%	13.2%	25.7%	17.6%	19.2%	91.2%
ASX Small Ords Accumulation	2.8%	13.8%	20.3%	9.2%	15.1%	6.6%	10.4%	44.0%
Benchmark^	2.7%	15.6%	31.0%	18.3%	15.1%	13.3%	12.7%	55.3%

*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	$59.0m
Number of Stocks	15-40
Cash Distributions	Annually
Eligibility	Wholesale & Retail

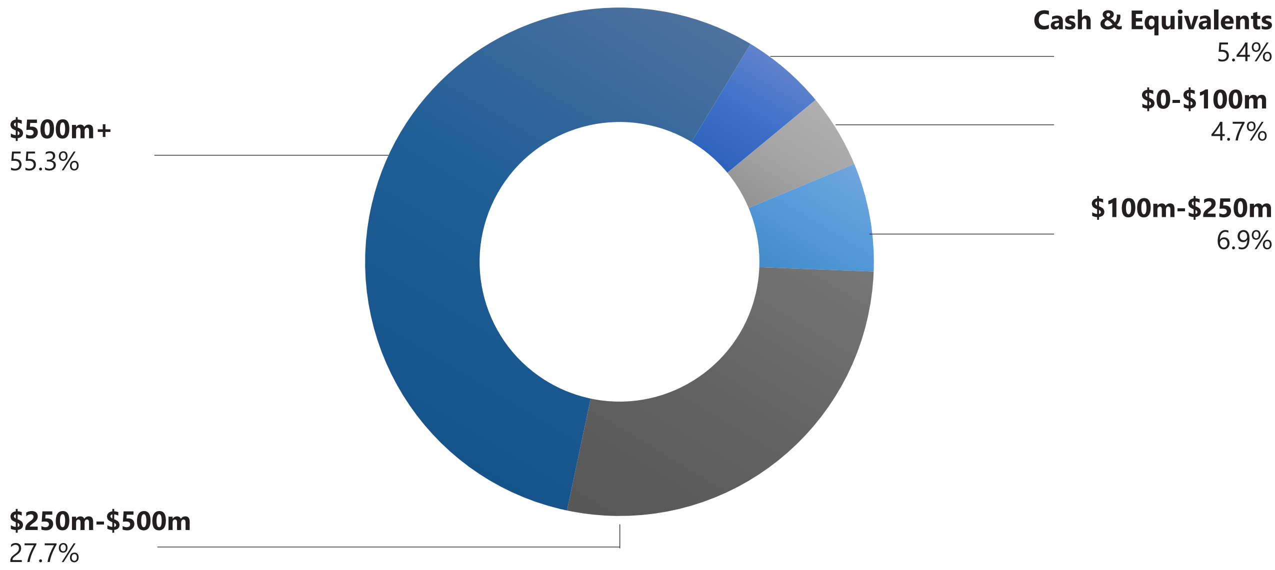
Top 5 Holdings (Alphabetical)

Company	ASX Code
City Chic Collective	CCX
Hansen Technologies	HSN
Jumbo Interactive	JIN
Mach7 Technologies	M7T
RPM Global Holdings	RUL

Unit Price

Date	Wholesale Unit (exit)
31/12/2020	$ 1.7315

Asset Allocation by Market Capitalisation



Asset Allocation by Sector

Industry	Weighting
Software & Services	26.2%
Retailing	15.0%
Healthcare Equipment & Services	11.4%
Diversified Financials	9.6%
Capital Goods	8.0%
Technology Hardware & Equipment	7.6%
Consumer Services	7.3%
Communication Services	4.4%
Media & Entertainment	3.8%
Semiconductors & Semiconductor Equipment	1.3%
Cash & Equivalents	5.4%

Portfolio Commentary

The Clime Smaller Companies Fund returned 11.5% for the December quarter versus the Benchmark return of 15.6%. Since inception, the Clime Smaller Companies Fund has returned 19.2% per annum after fees, ahead of the benchmark return of 12.7% per annum.

Markets continued to rally through the December quarter, fuelled by the massive monetary response to the pandemic in March and in conjunction with positive vaccine news in November. What was mainly a tech rally has turned into an 'everything rally' with the prospect of general economic recovery in sight.

Although the market looks expensive - the ASX200 is at an elevated Price Earnings ratio of 20x (forecast earnings), well above the long term average of 15x - it is arguable that equities remain attractive relative to bonds, with 10 year government bonds yielding less than 1%. Equity markets should therefore remain well supported, absent a surprise inflation spike.

The issue for market participants is that lower quality 'junk' assets have been brought along for the ride, which can lead to complacency. In our corner of the market, we have witnessed this in the particularly strong recent performance of micro-cap companies. The S&P/ASX Emerging Companies Accumulation Index (XEC), which is the resources-heavy, micro-cap half of our benchmark, returned a whopping 42% in 1HFY21. The other half, the S&P/ASX Small Ordinaries Accumulation Index (XSO), which includes larger and more established businesses, returned 20%.

It is our view that the XEC's recent performance cannot be sustained for much longer. Therefore we are retaining our focus on cash flow yields, efficient growth, and balance sheet strength, thereby ensuring the portfolio is robust and resilient should a reversal in risk appetite occur.

Adairs (ADH) was an addition to the portfolio during the quarter, providing attractively priced exposure to the booming eCommerce sector.

ADH is a leading homewares and home furnishings retailer in Australia and New Zealand. It is a genuine omni-channel operator, with around 40% of sales from the online channel in 1H21.

Per ADH's 8 December trading update, total sales rose 23% in the first 23 weeks of FY21, with Like-for-Like sales across its 167 stores up 17% (5.2% including a 12 week closure of 43 stores in Victoria), and Adairs online sales up 99%. Mocka, the pure online nursery furniture business ADH acquired in December 2019, saw sales increase by 45%.

Online retailers were clear COVID beneficiaries as a result of rapid (and potentially permanent) shifts in consumer behaviour. Social distancing pulled-forward new online shoppers by several years, stimulus has supported discretionary spending, and travel restrictions diverted spend to fashion and home categories.

Occasionally, themes can herd the market towards the purest fundamental beneficiaries, leading to wide valuation disparities within certain sectors. We found that, in the COVID environment, omni-channel retailers were left behind in preference for the online pure plays, creating some interesting opportunities.

Take, for example, pure online home furniture retailer Temple and Webster (TPW). TPW is a leader in its niche and has enjoyed a jump in demand with expectations of 80%+ sales growth for FY21.

After appreciating 5-fold off March lows, TPW is capitalised at $1.4 billion. By comparison, ADH is capitalised at $575 million. One would think TPW is 2-3x larger than ADH, but the opposite is the case. In FY21 ADH will generate more gross profit from its online operation than the whole of TPW.

In terms of valuation, ADH was attractive because it was trading on a 10% FY21 free cash flow yield for much of the quarter, despite a robust growth outlook and healthy balance sheet. We see further online growth, but as an omni-channel operator, ADH will also capture demand returning to physical stores as conditions normalise.

City Chic Collective (CCX) is another omni-channel beneficiary, and returned 40% for the quarter.

CCX is a specialist in extended-size ladies fashion and has a strategy to acquire plus size customers online globally. CCX is generating 70% of sales online, up from 44% in FY19, with online exposure to much larger offshore markets including North America and the UK. The remaining 30% of sales comes from CCX's Australia and New Zealand (ANZ) network of 92 stores.

To date, CCX has acquired customers both organically and via opportunistic acquisitions. The COVID environment has benefited players with well-developed digital businesses, largely at the expense of those dependent on bricks and mortar networks. In the virus-stricken US and UK especially, CCX is targeting acquisitions of high quality digital assets of competitors that have been bankrupted under the weight of their under-performing physical store networks.

After its unsuccessful September bid for the eCommerce assets of Catherines (US), on 21 December CCX announced it had acquired the eCommerce assets of leading UK plus-size brand Evans, marking CCX's entry into the $9 billion UK market.

Consideration for Evans was $41 million, funded from existing cash, and representing approximately 1x Evans's $46m FY20 online revenue, or about 5x EBIT on our estimates.

The acquisition follows a positive AGM update in November. For the first 20 weeks of FY21, CCX reported comparable sales growth of 18.7% excluding temporary Victorian store closures (7.9% including store closures), and a significant improvement in gross margins since the peak of COVID disruption in April and June. Gross margins are now above 50%. Like ADH, CCX commands superior margins due to its vertically integrated structure.

With a proforma cash balance of $73 million and no debt, CCX is well positioned to execute on its strategy. Despite the recent share price rally, we still see opportunity in the stock.

EROAD (ERD), a recent addition, returned 16% for the December quarter following the launch of a potentially lucrative Dashcam product in October and a 1H21 result beat in November.

ERD is a NZ-based regulatory telematics company that provides hardware and software to vehicle fleet operators. ERD's offering typically involves an in-cab 'eHubo' device and SaaS platform that collects and processes relevant data. Use-cases for this offering include regulatory compliance, fleet management, driver management, and road safety.

ERD is interesting because it currently trades at about 12x its New Zealand division operating earnings of $37m (annualised), and has strong growth prospects in the US and Australia.

ERD implemented the world's first national electronic road user charging 'eRUC' system in New Zealand around 10 years ago. It also offers the USA's number 1-rated Electronic Logging Device (ELD), according to eldratings.com.
Fundamentals are equally impressive. Recurring revenues are 95% of total, gross margins are 90% and revenues have compounded at 46% per annum over the last 6 years.

A key structural tailwind comes from electric vehicle penetration, which is expected to increase from less than 5% now to 40% by 2030. This presents a significant road funding challenge for governments globally. For example, approximately 40% of road user revenues in Australia come from fuel excise taxes and this will decrease in proportion to Electric Vehicle use. Governments will need to explore eRUC systems to address the looming funding gap.

ERD is a leading technology provider in the regulatory telematics industry with potential to be a much larger business in the future, given three-quarters of its earnings are currently sourced from the relatively small NZ market. CEO Steve Newman owns 21% of the company, and no doubt will want to ensure growth is pursued in a capital efficient manner.

There were several other positive contributors to Fund performance over the quarter, the two most topical of which were:

Mach7 Technologies (M7T) returned 13% for the quarter on the back of a 7-year contract with Trinity Health, a top 5 health system participant in the US encompassing 92 hospitals. The contract, valued at $5.3 million, was for M7T's Enterprise Viewer called 'eUnity', with potential contracts in 2021 for M7T's other software including archiving, diagnostic viewer, and worklist products. Winning the remaining contracts represents a potential step change for the business.

Electro Optic Systems (EOS) returned 8% on mixed news. More details about EOS SpaceLink, a potentially enormously valuable business line, were provided via webinar in November, which was followed by a $34 million contract awarded by the Australian Government for the "C4 Edge" program as Prime Contractor. However, in late December, EOS withdrew previous guidance of $20-$30 million EBIT, citing shipment delays (12 days) of its Remote Defence Systems to offshore customers.

Jonathan Wilson	**Adrian Ezquerro**
Portfolio Manager	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	$59.0m	**Platform Availablity**	Netwealth, HUB24

Contact Information

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