Clime Smaller Companies Fund

Monthly Report February 2021

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.

1 Month Net Return (Wholesale)*	Inception p.a. Net Return (Wholesale)	Inception Total Return	Total Fund Size
-1.7%	18.5%	92.3%	$65.2m

	1 month	3 months	6 months	1 year	2 years	3 years	Inception p.a.	Inception Total
Fund Net Return (Wholesale)*	-1.7%	4.0%	8.5%	16.7%	23.4%	17.2%	18.5%	92.3%
ASX Small Ords Accumulation	1.5%	4.1%	12.1%	17.2%	9.1%	7.2%	10.3%	45.8%
Benchmark^	1.8%	6.5%	17.6%	33.8%	16.3%	14.1%	13.1%	60.9%

*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	$65.2m
Number of Stocks	15-40
Cash Distributions	Annually
Eligibility	Wholesale & Retail

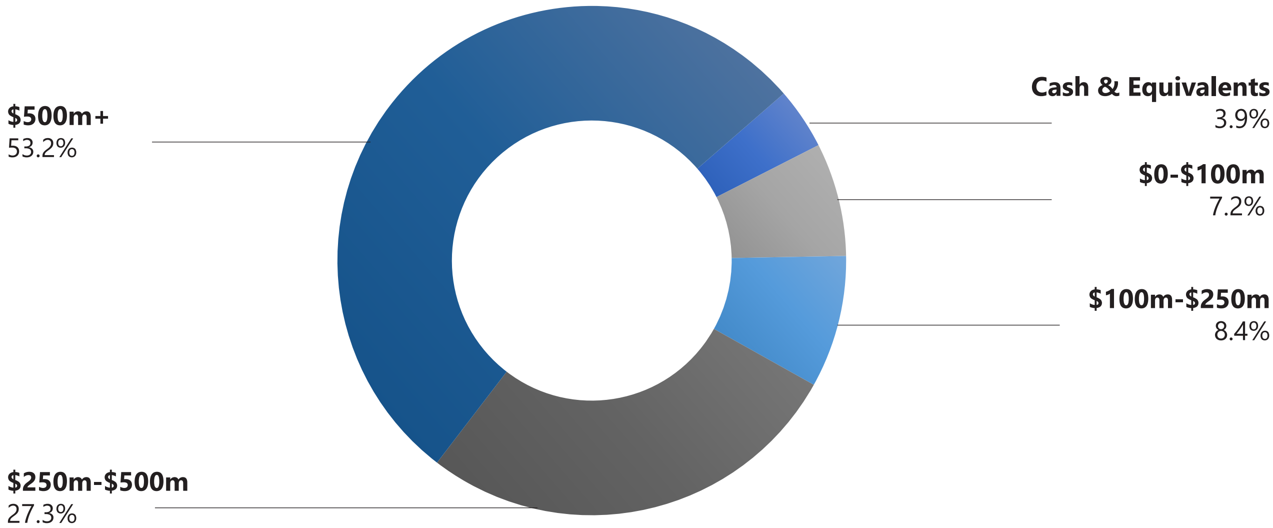
Top 5 Holdings (Alphabetical)

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)
26/02/2021	$1.7416

Asset Allocation by Market Capitalisation



Asset Allocation by Sector

Industry	Weighting
Software & Services	19.6%
Retailing	15.2%
Healthcare Equipment & Services	12.9%
Technology Hardware & Equipment	12.5%
Diversified Financials	10.9%
Capital Goods	7.7%
Consumer Services	6.4%
Media & Entertainment	5.6%
Communication Services	3.7%
Semiconductors & Semiconductor Equipment	1.6%
Cash & Equivalents	3.9%

Portfolio Commentary

The Clime Smaller Companies Fund (CSCF) portfolio returned -1.7% in February, versus the Benchmark return of +1.8%. The Fund has delivered +18.5% per annum after fees since inception, above the Benchmark and Small Ordinaries Accumulation returns of +13.2% per annum and +10.3% per annum, respectively.

The so-called "reflation trade" accelerated in February as COVID-19 infections receded and vaccination campaigns gathered pace in most major economies, including (a somewhat slow start) in Australia. Greater optimism about economic growth is evident in the sell-off in government bond yields, which experienced a large and sharp price reversal during February.

Even though the underlying force behind bond market moves is an improvement in the economic outlook, higher yields are raising fears that equity market valuations could be compromised. Given that expensive and "longer duration stocks" such as high growth tech are more vulnerable to higher discount rates, sector rotation to cyclical and value stocks continued during the month; thus while resources and financials did well, tech and utilities performed poorly.

Rising bond yields did cause some market ructions towards month end. But stock prices need not suffer from rising bond yields as long as the yield increase reflects favourable economic conditions (which also push up earnings and dividends), rather than a perception that inflation is about to break out in a sustained manner. Evidence from history suggests that the relationship between bond yields and equity prices shifts with changes in inflationary expectations.

The question being asked by market participants is whether a structural rise in inflation will occur that will cause inflation expectations to become uncontained. Our thoughts are that this is still unlikely; with significant excess capacity still available in most economies, and with unemployment levels still high and minimal signs of wages growth, inflation is unlikely to rise above central bank targets in a sustained way. However, we recognise that a durable increase in prices on the back of very loose policy settings is a risk to this view.

Attribution & Outlook

Before turning our attention to monthly attribution, we feel it is worthwhile reiterating the focal points of our fundamental investing philosophy. Ultimately we seek to acquire shares in businesses that have niche leadership, strong balance sheets and long term growth opportunities.

Shorter term macro dynamics may currently favour the traditional 'deep value' category, but in small caps particularly, such exposure often goes hand in hand with structurally challenged businesses and clouded outlooks. This is not our game and does not represent a dynamic that we will compromise our process to chase.

Ostensibly, market allocations to higher growth companies have been used as funding sources for allocations towards the more value oriented, cyclical parts of the Australian market. There may well be a period of rebalancing that ensues. However, we maintain that a focus on high quality businesses that offer long term growth remains critical to delivering long term outperformance.

Key contributors for the month included Codan (CDA), Audinate (AD8), Hansen Technologies (HSN) and City Chic Collective (CCX), key detractors were RPM Global (RUL), Electro Optic Systems (EOS), Rhipe (RHP) and EROAD (ERD).

Codan (CDA) delivered another impressive result, with first half revenue up 14% to $194m and profit up 36% to $41.3m. CDA continues to build on its market leadership position within the global metal detection market, driven by an R & D program that exceeds the annual spend of all of its competitors combined. CDA also announced the acquisition of Domo Tactical Communications (DTC) for $114m, funded from existing cash reserves, and is a deal that is immediately earnings per share accretive. We remain upbeat about the future prospects for the business. Record levels of metal detection sales have continued, while communications will have a materially stronger second half.

Hansen Technologies (HSN) was one of the standout results from the February reporting season. Led by irrepressible CEO Andrew Hansen, HSN's first half revenue edged higher while profit surged 65% to $29.6m. Despite a positive outlook and wonderful long term track record, which has seen earnings per share grow at a compound annual growth rate of 31.4% since 2006 (to FY21e), HSN currently trades on 12.6x forward earnings and a free cash flow yield of 8%. We remain of the view that the business represents excellent value at current prices.

The impact of Covid-19 on the progress of **RPM Global (RUL)** has been material, with the closure of international offices and travel bans impairing RUL's ability to get on site with clients and convert its significant pipeline of opportunity. Despite the challenges, RUL managed to grow its annual recurring revenue (ARR) during the half to $15.8m from $12.7m as at 30 June 2020.

Positively, sales are again accelerating, with management noting total contracted value of new software subscriptions sold year to date to be $14.5m, of which only $0.8m was recognised in the accounts for H12021. While the stock sold off during February, we emerged from reporting season with even greater confidence around the long term opportunity for RUL.

In December, **Electro Optic Systems (EOS)** pulled guidance of $20-30m EBIT for the full year due to delivery delays of approximately two weeks of is Defence Systems units to an offshore customer. As a result, EOS reported a loss for the 2020 year.

Inventories increased over the year from $53m to $68m, and EOS recognised contract assets (shipped units to be monetised) of $124m, up from $40m, reflecting the COVID-related disruptions to final product delivery. EOS expects these contract assets to mostly unwind over the next 6 months, adding significantly to the company's current net cash position of $66m.

Although EOS had preannounced these issues, shares were sold off. In our view, the weakness represents a solid opportunity for long term investors, as the issues relate to timing for a single contact within a single division, being Defence.

Looking ahead, the opportunities across the Defence, Communications and Space divisions of EOS encompass a total addressable market in the tens of billions over the coming decade. The market is clearly heavily discounting the potential realisation of these opportunities. We believe recent issues are transitory and see the business exiting 1H21 in a fundamentally stronger position.

With reporting season now behind us, and despite the re-emergence of market volatility, we remain positive on both current portfolio positioning and the outlook for portfolio companies.

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**	Daily 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	$65.2m	**Platform Availablity**	Netwealth, HUB24, BT Panorama

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