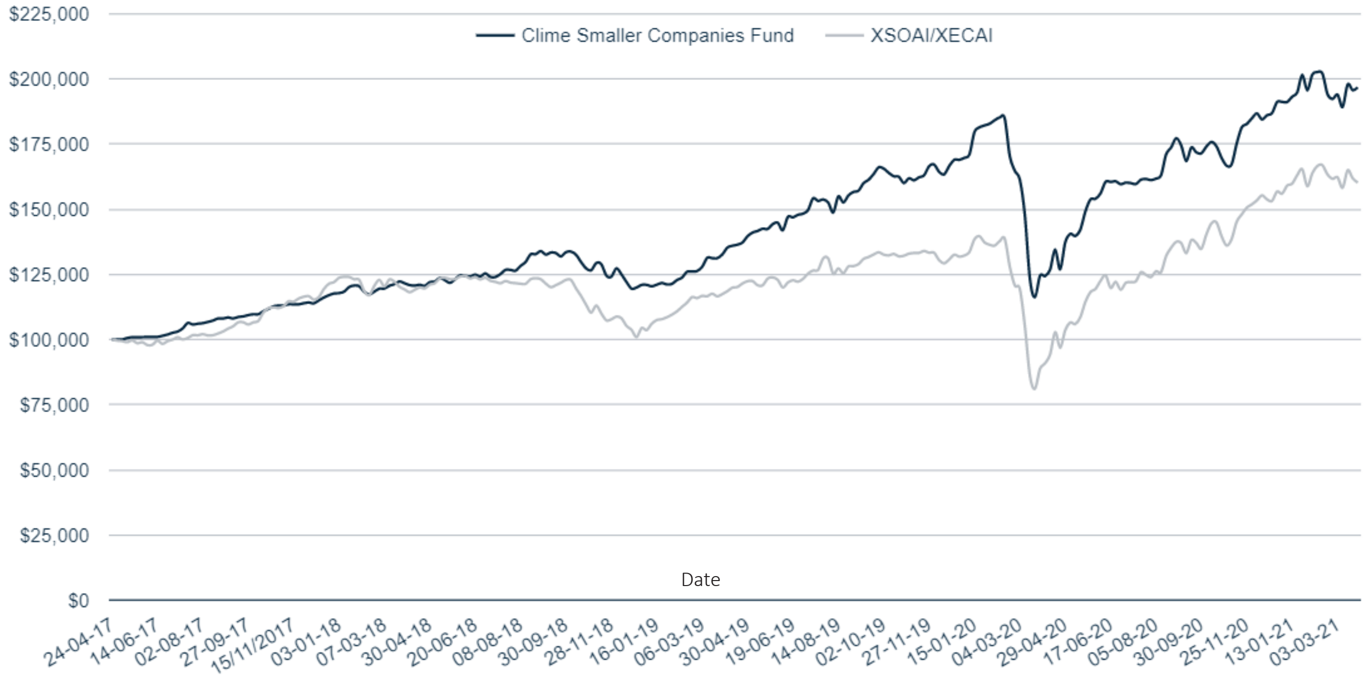
Clime Smaller Companies Fund (Wholesale)

Quarterly Report March 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.

Quarter Net Return (Wholesale)*	Inception p.a. Net Return (Wholesale)*	Inception Total Net Return (Wholesale)*	Total Fund Size
2.9%	18.8%	96.8%	$75.5m



	1 month	3 months	6 months	1 year	2 years	3 years	Inception p.a.	Inception Total
Fund Net Return (Wholesale)*	2.3%	2.9%	14.8%	58.1%	21.8%	17.4%	18.8%	96.8%
ASX Small Ords Accumulation	0.8%	2.1%	16.2%	52.1%	9.6%	8.3%	10.3%	47.0%
Benchmark	-0.9%	2.7%	18.8%	80.5%	15.3%	13.5%	12.6%	59.5%

*Net returns are after all fees, taxes, and costs

Fund Facts

Portfolio Managers	Jonathan Wilson & Adrian Ezquerro
Fund Inception	April 2017
Fund Size	$75.5m
Number of Stocks	15-40
Cash Distributions	Annually
Eligibility	Wholesale

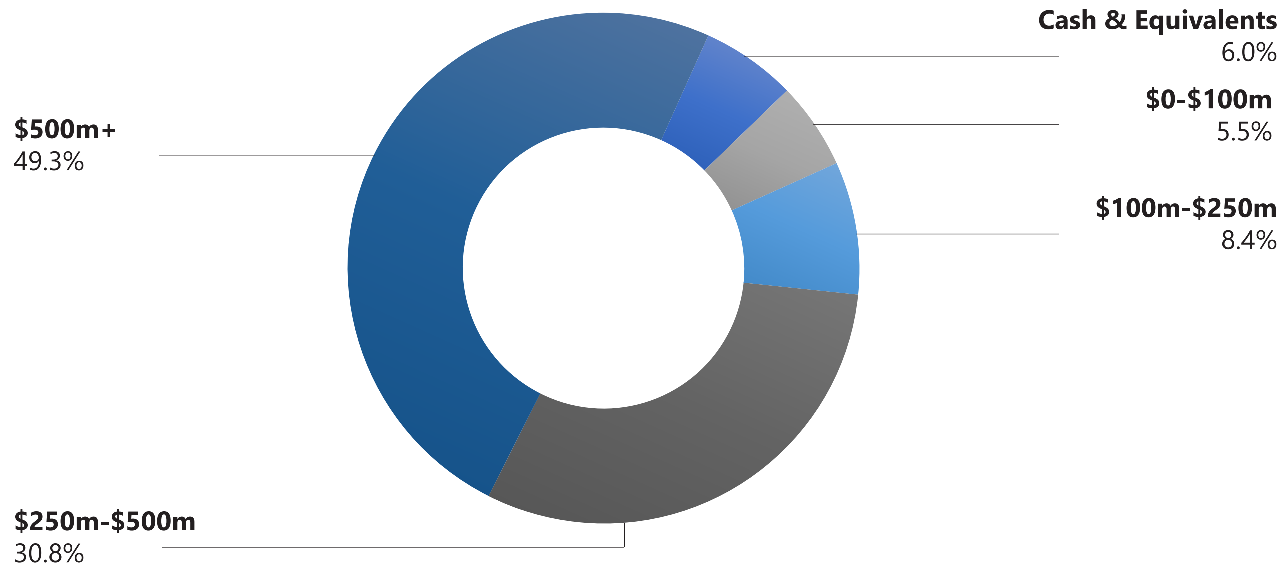
Top 5 Holdings (Alphabetical)

Company	ASX Code
City Chic Collective	CCX
Electro Optic Systems	EOS
Hansen Technologies	HSN
Mach7 Technologies	M7T
RPM Global	RUL

Unit Price

Date	Wholesale Unit (exit)
31/03/2021	$1.7822

Asset Allocation by Market Capitalisation



Asset Allocation by Sector

Industry	Weighting
Software & Services	21.9%
Retailing	13.9%
Health Care Equipment & Services	11.6%
Technology Hardware & Equipment	10.7%
Diversified Financials	10.1%
Capital Goods	9.3%
Media & Entertainment	6.4%
Consumer Services	6.0%
Communication Services	2.1%
Semiconductors & Semiconductor Equipment	1.9%
Cash	6.1%

Market Commentary

We have reported with growing confidence of a return to strong growth following the pandemic recession, supported by extraordinary fiscal and monetary programs on a global scale. This has been borne out by both economic data and the performance of financial markets over the first three months of the calendar year. A corollary of this reflation narrative has been the surge in yields of government bonds as economic growth accelerates and normalisation approaches.

Whether or not inflation is returning has been one of the most debated topics in financial markets over the last few months. As expected, we are seeing pricing pressures on food, energy, and commodities as economies re-open following lockdowns. Yet despite these trends, absolute core inflation levels remain generally subdued.

Some further inflationary pressures are expected in coming months (on base effects); however, the problem is less a short-term rebound of inflation, but the possibility of change in the inflation paradigm ahead. In other words, are we heading towards a prolonged period of higher inflation? The "return of inflation" narrative is gaining traction, propelled by the $1.9 trillion US fiscal package as well as anticipated multi-trillion dollar infrastructure programs and the recovery in demand expected as vaccination programs accelerate.

While there is a great deal of uncertainty, an important factor is the labour market, which we do not see fully recovering to pre-crisis levels for at least another year if not longer. There are divergences, in terms of unemployment in different sectors and industries and across markets, but our view is that the labour market recovery will be uneven and take some time, thereby dampening inflation pressures at least in 2021 and for most of 2022.

Markets are looking beyond the near-term headwinds of Covid-19 and a sluggish vaccine rollout across some countries in Europe and in Australia. Positive sentiment has been driven by hopes of continued policy support combined with an increasingly clear path to reopening. Substantial fiscal stimulus, progress on the vaccination front, and strong corporate earnings make economic rebound, profit recovery and reflation the main themes in the near term.

Portfolio Commentary

The Clime Smaller Companies Fund returned 2.3% and 2.9% for the month and March quarter respectively, ahead of the respective Benchmark returns of -0.9% and 2.7%. Since inception, the Clime Smaller Companies Fund has returned 18.8% per annum after all fees, ahead of the respective Small Ordinaries Accumulation Index and Benchmark returns of 10.3% and 12.6% per annum.

Whilst the Australian market delivered a solid return for the month, it again lagged major international indices. In local currency terms, the S&P 500, FTSE 100, and DJ Euro Stoxx 50 indices delivered returns of 4.4%, 4.2% and 7.9% respectively.

Domestically, we again observed material divergence in return outcomes by market cap segment and by sector. Large caps materially outperformed small caps during March, a contrast replicated in the US market. Utilities (+6.8%), Discretionary (+6.7%), Communications (+5.9%) and Real Estate (+5.6%) were all solid outperformers in March, while Materials (-3.1%) and Information Technology (-2.8%) lagged.

Key contributors to the portfolio return for the March quarter were Hansen Technologies (HSN), Codan (CDA), RPMGlobal (RUL), Adairs (ADH) and Pivotal Systems (PVS). Key detractors for the quarter were Rhipe (RHP), Omni Bridgeway (OBL) and Electro Optic Systems (EOS). We explore a number a number of these positions in the commentary to follow.

Hansen Technologies (HSN) was one of the highlights of the March quarter, delivering a total return of 47.0%. After announcing a strong 1H21 result and upbeat outlook in February, in March HSN upgraded FY21 guidance on the back of a material $25m 5-year contract with German telco Telefonica. HSN increased its FY21 revenue range from $295-305m to $316-326m, a 7% upgrade at the midpoint. The increase amounts to $21m incremental revenue, reflecting license revenue to be recognised in 2H21 (under IFRS accounting rules). As most of this revenue will fall straight to the bottom line, the underlying FY21 EBITDA margin range increased to 37-39%, above management's expected long-term margins of 32-35%.

We substantially added to our position in HSN last year at $2.80 per share or a $560m market capitalisation. Based on guidance, we expect HSN will generate $75m in free cash flow for FY21, representing a 13% free cash flow yield at the $2.80 share price. Although the stock has doubled since then, HSN still trades at a reasonable valuation. We remain positive on the stock given its strong track record of EPS growth (albeit via a highly successful M&A program), extremely high customer retention, high recurring revenues, balance sheet capacity and long-term growth afforded by a fragmented global market.

Codan (CDA) returned 39.1% during the quarter, reflecting a strong first half result, the announcement of two acquisitions and the effective upgrade to its full year earnings outlook. Coming into FY21, CDA had delivered compound annual growth in earnings of 32% over the past 5 years. Incredibly, this trajectory looks set to improve in FY21, with the company delivering profit growth of 36% in the first half.

CDA also announced the acquisition of both Domo Tactical Communications and Zetron during the quarter. Both are US based businesses that will materially build out CDA's Communications division, with each acquisition largely funded from existing cash reserves. As highlighted in recent reports, 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.

Adairs (ADH) was another solid contributor, returning 19.0% for the quarter. The home furnishings omni-channel retailer posted a pleasing half year result, beating the top end of December earnings guidance. The result was impressive on several fronts, with sales and underlying EBIT up 35% and 166%, respectively, and online share of sales hitting 37% of the total, up from 22%. Sales momentum carried through the month of January, signalling another strong half to finish FY21.

However, a share price below $4 reflects scepticism around the sustainability of recent performance. ADH is currently capitalised at $650m and is set to substantially add to its $22m net cash position by the end of the financial year. For further context, first half FY21 EBIT was $60m. ADH certainly rode strong COVID tailwinds in 1H21, but we believe conditions remain favourable in the near term, further supported by a surging housing market.

Household savings rates are elevated, and the Australian consumer remains largely landlocked with outbound travel down 97% in January, meaning $65bn of annual international travel spend continues to be diverted to sectors like household goods. ADH is well positioned having expanded its loyalty program to 900k Linen Lovers, up from 800k in June last year.

Rhipe (RHP) was a detractor for the March quarter, returning -14.5%. The SME cloud software wholesaler delivered sound 1H21 results with revenues and operating profit up 15% and 35% on the prior corresponding period. RHP guided to FY21 operating profit of $17.5m, reflecting 27% growth on FY20. Given solid execution and the maintenance of a positive outlook, we view the sell-off as unwarranted.

Post quarter-end, RHP announced the acquisition of cyber security software distributor, EMT for $11m cash with a $2m earnout. The acquisition was at a 5.5 times multiple of EMT's FY22 forecast operating profit of $2m. Including EMT, we expect RHP to generate approximately $22m EBITDA in FY22. RHP occupies a leading market position, has a long runway to grow recurring revenue from increasing cloud adoption in its markets across South East Asia, and over $55m net cash for further M&A. Shares are attractively priced at a FY22 an ex-cash free cash flow (FCF) yield of 8.0%.

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 7 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 14 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**	Wholesale
Structure	Managed Investment Scheme	**Minimum Investment**	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**	Wholesale: 1.03% p.a. management and 20% performance (against benchmark)
Stock Holdings	15-40	**Admin**	Mainstream Fund Services Pty Ltd
Stock Limit	15% at cost	**APIR Code**	Wholesale: CLA1557AU
Fund Size	$75.4m	**Platform Availablity**	Netwealth, HUB24

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