

Bennelong Emerging Companies Fund

Performance update

As at 30 September 2019

Net client returns (after fees and expenses)

	1 mth	3 mths	1 Year	3 years pa	5 years pa	10 years pa	Since Inception** pa
Fund	9.92%	28.63%	39.75%	na	na	na	39.50%
Benchmark*	0.49%	1.52%	6.55%	na	na	na	6.61%
Value added	+9.42%	+27.11%	+33.20%	na	na	na	+32.89%

Performance figures are net of fees and expenses. 'Value added' calculation does not use rounded performance figures.

*Official RBA Cash Rate + 5%

**Inception date is 1 November 2017

About the Emerging Companies Fund

The Bennelong Emerging Companies Fund invests predominantly in micro and small-cap stocks listed on the ASX. It is managed by the BAEP team based on the same investment approach that is behind the success of BAEP's other long established Australian equity funds. This is a research-intensive and predominantly bottom-up investment approach.

Compared to larger companies, micro and small-cap stocks can offer more exciting growth prospects, but on the other hand, also present far greater investment risks. In this context, the BAEP team aims to be disciplined in focusing on high quality stocks. It will seek to avoid the higher risk, but potentially higher returning, propositions such as minerals explorers, speculative stocks, fads, and unproven business models.

Key features

- The Fund offers investors exposure to micro and small-cap companies. Compared to larger caps, these stocks are often less well known and less well researched;
- The Fund utilises BAEP's existing knowledge of micro and small-cap stocks, gained as part of its sector-targeted research and analysis;
- The Fund leverages BAEP's historical success investing in emerging companies, including in pre-IPO opportunities; and
- The Fund aims to leverage the size and reputation of BAEP within a micro and small-cap offering. This includes by taking advantage of IPOs, placements and other similar opportunities.

Portfolio performance

Micro and small-cap stocks can be volatile. It means one should take a longer term approach to investing in them than normal. It also means one should assess the returns over a longer timeframe. On this front, the Fund has performed strongly in the almost two years since its inception.

By way of a more recent update, the Fund performed very well in the September quarter, with a return of over 28% for the three months. In investing towards good long term returns, it is usually uncertain when those returns will appear over the journey. Investors should be aware things do not always work out as well as they did in the quarter. The smaller end of the stockmarket seems to provide higher highs and lower lows.

The largest contributors to performance over the quarter were:

- Viva Leisure
- BWX
- Sezzle
- EML Payments
- Prospa

One of the benefits of this fund is the access it offers to corporate activity. Viva Leisure, Sezzle and Prospa – all in the list above – are examples of recent IPOs. The IPO market itself is quite cyclical, with attractive opportunities tending to come in ebb's and flow's. The current IPO market is rich in opportunities, and indeed, we have committed to adding a number of new ones into the portfolio in coming months.

Another benefit of the fund is that it invests in micro- and small cap-stocks that tend to have their destiny in their own hands. That is, their operating performance will depend largely on management executing



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successfully on the company's stated strategy. This means the risks are more idiosyncratic than one generally finds with larger cap stocks.

The August reporting season was a positive one for the Fund. In general, portfolio holdings reported strong financial results in line with what we were expecting. These companies are showing good business momentum, strong near-term earnings growth and bright long term outlooks.

A number of positions rose very strongly in price on the back of their result or other positive news. In some cases, this has detracted from the risk-reward they offer as an investment, and in some cases, we took the opportunity to trim or even sell out. Nearmap is an example of a stock we have sold out of, and Jumbo Interactive and Zip are examples of some whose weight we have trimmed considerably in recent months.

On the other hand, we continue to find new stock ideas. One recent example is Audinate. We have actually previously owned this but more recently bought back in. Audinate is a high quality growth stock that is the clear global leader in its niche market of audio networking and it has a very large market in which to grow.

Portfolio positioning

The portfolio comprises our best micro and small-cap stock ideas. As indicated before, it is important for us in selecting these stocks to balance out both potential downside risks and upside return potential.

In managing the risk-reward equation, the portfolio comprises a number of high quality growth stocks. A focus on quality is particularly important in mitigating the significantly elevated business risks involved in micro and small-cap stocks.

The portfolio comprises stocks with a range of different value drivers and across a range of different industries. That said, there is a heavy exposure to the consumer, technology and finance sectors, which is where we most readily can identify quality and growth attributes among micro and smaller-cap stocks. The following table shows the largest holdings.

Top Five Holdings
Viva Leisure
Bwx
Prospa
Eml Payments
Zip Co

Viva Leisure runs a very profitable gyms business.

Currently, it has around 40 gyms mostly in the ACT but also in NSW and Victoria. It is able to leverage a number of different formats to suit local demand, from big-box gyms under its Club Lime brand to trendy new concepts such as its HIIT Republic brand ("HIIT" stands for high-intensity interval training). The company's strategy is to grow the number of gyms it operates via new developments as well as acquisitions.

The company started out in 2004 and came to the ASX via an IPO in June of this year. We participated in the IPO and added to our position post-listing, ultimately disclosing to the ASX a substantial shareholding in the company.

Viva has so far impressed investors. At its maiden financial result reported in August it was able to better its prospectus forecasts. Operations are showing good underlying growth and it has been able to announce it is expanding to 50-plus gyms over the next six months, with good growth prospects thereafter. Its IPO price was \$1 per share, and its shares now trade above \$2. We see a strong management team continuing to execute well on its growth strategy, and continue to hold it as the largest position in the Fund.

Helping our investment in Viva Leisure was the experience and contacts we built up when looking at the gym business of Ardent Leisure when we were invested in Ardent some years ago.

BWX is a stock that BAEP invested in for its other funds prior to its IPO. This pre-IPO opportunity has been a very successful investment for these funds since then. BWX was also added to the Fund's portfolio on its inception in November 2017.

The company has had a difficult time of it over the last financial year. During this time, it faced a number of distractions, including a failed management buy-out takeover bid, the upheaval that comes with replacing management, and the difficulties of bedding down recent acquisitions.

The company owns a number of personal care brands including Sukin, the number one selling skincare brand in pharmacy and beauty channels. Despite the distractions of last year, Sukin and other brands continued to sell through well.

In the September quarter, the company reported revenue and earnings in line with guidance, and guided strongly to revenue growth of 20%-25% and EBITDA growth of 25%-35% for the upcoming financial year. This implies building momentum in profitability.



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After performing poorly last financial year, the company was one of the best performing stocks on the market this quarter, returning 114% (it was the second best performer on the S&P/ASX 300 index after Dacian Gold).

Prospa Group is a fintech that is the leading online provider of small business loans in Australia. Since starting out, it has arranged approximately \$1 billion in loans to over 20,000 SME customers. It is currently seeing accelerating growth in loan originations. The longer term growth opportunity is in fulfilling unmet demand for loans in the large and under-banked SME market. The company came to the ASX via an IPO in June of this year, and its shares have performed modestly since.

EML Payments is another fintech that provides client-tailored gift cards and reloadable payment cards in the US, Europe and Australia. In simple terms, it is effectively a payments technology platform that last financial year processed approximately \$9 billion of payments. Its financial results reported in August were very pleasing, showing strong earnings momentum and near-term growth prospects. One of the big opportunities for it right now is in leveraging its technology into online sports betting markets in the US.

Zip Co is a buy-now-pay-later firm that is a rival to Afterpay. Afterpay is the clear leader in this market, while Zip Co is the number two player with a slightly differentiated customer proposition. Both are expanding aggressively offshore. Afterpay is currently a position in our larger cap funds. Our research of Afterpay assists in our research of Zip Co, and vice versa. It goes to the benefit of managing a micro and smaller cap fund within a larger funds management operation, with an 8-person investment team that has coverage right across the broader stockmarket.

For some time now, we have been sitting with a relatively high cash position. It has been over 10% since May of this year, and it currently sits at nearly 20%. Holding as much cash as we have has meant less risk and the ability to be opportunistic.

We have observed the flow of money into and out of micro and small-caps can exaggerate returns both on the way up and down. The ability to hold up to 30% of the portfolio in cash provides an opportunity to manage at least some of the risk that comes with this volatility.



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About BAEP

Bennelong Australian Equity Partners (BAEP) is a boutique fund manager focused on Australian equities. It was founded in 2008 in partnership with Bennelong Funds Management. BAEP is a genuinely active fund manager with a consistent, disciplined and proven investment approach.

BAEP's investment philosophy is to selectively invest in:

- high quality companies;
- with strong growth outlooks; and
- underestimated earnings momentum and prospects.

BAEP's investment process is research-intensive with a focus on proprietary field research and is supported by macro-economic and quantitative insights.

About the Fund

The Bennelong Emerging Companies Fund typically holds approximately 20-30 predominantly micro and small-cap stocks listed on the ASX.

Benefits of the Fund

- The Fund offers investors exposure to micro and small-cap companies. Compared to larger caps, these stocks are often less well known and less well researched;
- The Fund utilises BAEP's existing knowledge of micro and small-cap stocks, gained as part of its sector-specific research and analysis;
- The Fund leverages BAEP's historical success investing in emerging companies, including in pre-IPO companies; and
- The Fund aims to leverage the size and reputation of BAEP within a micro and small-cap offering. This includes by taking advantage of IPOs, placements and other similar opportunities.

The Fund at a glance

Feature	Fund facts
APIR code	BFL3779AU
Benchmark	Official RBA Cash Rate + 5%
Investment objective	To beat the benchmark over the medium to long term
Investment manager	Bennelong Australian Equity Partners (BAEP)
Cash limit	0-30%
Inception date	1 November 2017
Recommended investment period	Long term (seven years plus)
Minimum investment	\$10,000
Buy/sell spread	+/-0.25%
Entry/exit fees	Nil
Management Fee	1.20% p.a. of Net Asset Value of the Fund
Performance Fee	20% of the extent to which the Fund's gross performance is 1.20% per annum greater than the benchmark

How to invest

The Fund is open to investors directly via the PDS, available on our [website](#), or the following platforms.

Platforms

Hub24 (IDPS, Super)
Netwealth (IDPS)

Contact details

For more information, call 1800 895 388 (AU) or 0800 442 304 (NZ) or visit baep.com.au.

The Fund is managed by Bennelong Australian Equity Partners, a Bennelong Funds Management boutique.

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