

Bennelong Emerging Companies Fund

Performance update

As at 31 December 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	-2.62%	2.87%	86.63%	na	na	na	35.97%
Benchmark ¹	0.49%	1.46%	6.35%	na	na	na	6.53%
Value added	-3.11%	+1.41%	+80.28%	na	na	na	+29.44%

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

¹Official 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, emerging companies can offer more exciting growth prospects, but can also present far greater investment risks. In this context, the BAEP team aims to be disciplined in focusing on higher quality and lower risk stocks within the universe of emerging companies. It seeks to avoid the higher risk - but potentially higher returning - investment propositions such as bio-techs, mineral explorers, fads, speculative stocks and unproven business models.

Key features

- The Fund offers investors exposure to micro and small-cap companies;
- It is a high conviction portfolio that has the ability to cash up to 30% of the portfolio;
- It utilises BAEP's large research budget, proven research capabilities, and extensive network of industry contacts;
- It leverages BAEP's historical success investing in emerging companies, including in pre-IPO opportunities; and
- It aims to leverage the size and reputation of BAEP within a micro and small-cap offering. This includes privileged access to attractive pre-IPOs, IPOs, placements, sub-underwriting & other similar opportunities.

Performance

The fund delivered a decent-enough return for clients in the December quarter, capping off a very nice 2019 for the fund.

The largest contributors to the quarterly performance were Viva Leisure and BWX, while the biggest detractor was Prospa. We wrote about these stocks in some detail in the September quarterly performance report.

Viva Leisure is a well-run gyms business that IPO'ed in June this year. Since then, it has successfully executed on its value-enhancing strategy of building out its business via new developments and acquisitions. The December quarter saw more of the same from Viva, and investors have started to take notice.

BWX is a personal care products company that owns brands such as Sukin skincare creams. The stock was a significant detractor last financial year, but has been recovering since. It guided to strong growth when it reported its financial results in August, and the December quarter saw it continue to enjoy quite decent momentum in its business. We like BWX for its popular consumer brands and longer term growth prospects.

Prospa is a fintech that is the leading online-only provider of small business loans in Australia that IPO'ed in June this year. The company has a growth strategy based on leading the penetration of lending products into the under-banked small business market. With the benefit of hindsight, we would have been better off if we hadn't invested in Prospa. The company downgraded its Prospectus forecasts in November. This downgrade raised serious questions on how the growth strategy was being executed. We quickly sold out and no longer hold it in the fund.

A wealth warning

Clients should be well aware that future returns are almost certainly not going to be as good as they were in 2019.

Micro and small-cap investing can deliver larger returns



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but comes with far greater risk. This greater risk means typically more volatility, larger drawdowns and a higher chance of loss.

Clients should appreciate the need to take a longer term perspective when investing in this fund. That includes through the highs and the lows, which inevitably come. It also means that fund returns should be judged over a longer timeframe. Focusing just on the recent good returns is a poor guide to the longer term performance. That all said, we manage the portfolio with a risk-conscious approach and we believe the fund can produce decent returns over the journey for those willing to stay on for the ride.

About emerging companies

There are a number of positives for clients about investing in emerging companies. These go beyond just the potential for outsized returns.

1. More diversity

Emerging companies offer a far more diverse range of investment propositions. This includes in relation to risk profiles, business models, stage of life cycle, business quality, managerial competence, corporate governance, etc.

This greater diversity naturally results in a greater variance of investor outcomes, including at the extremes of the good, the bad and the ugly. It also gives investors another opportunity to gain genuine diversification within their overall portfolio.

2. More growth potential

Emerging companies can offer more growth potential, particularly as they are usually starting from a lower starting base.

3. Direct exposure

Emerging companies can offer more direct leverage to a compelling investment trend or theme.

For example, Woolworths is essentially a play on the broader retail market in Australia. Alternatively, you can invest in category winners like Lovisa and Baby Bunting.

4. IPOs & other corporate activity

There is typically a lot more opportunity among emerging companies to take part in pre-IPO investments, IPOs, placements, and sub-underwriting opportunities.

One of the benefits of this particular fund is its privileged access to these types of opportunities, which access is gained through the firm's size and reputation and strong broker relationships.

The fund has benefited from a number of these opportunities since its inception. Examples include the IPOs of Netwealth, Viva Leisure and Sezzle, as well as placements in CML, Freedom Foods and Nearmap (we still own some of these stocks).

5. Less broker coverage & investor attention

There is less media, broker coverage and competing investor attention among the emerging companies.

Many perceive far greater risk in the lesser known micro and small-cap stocks which is then priced in.

Less investor attention also means there is significant value-add from one's own proprietary research and analysis, meaning greater rewards for superior skill and effort.

6. Idiosyncratic or stock-specific risk

Smaller cap stocks are typically easier to understand and risks and return drivers tend to be more stock-specific. Whereas Woolworths' prospects rely very much on the general retail environment in Australia, Lovisa and Baby Bunting can do well regardless. Smaller stocks tend to be less reliant on macro conditions and more reliant on executing their own company-specific growth strategy. This often makes it easier to analyse, but also means less influence from less predictable exogenous factors.

Positioning


The fund seeks to take advantage of these positives.

It is a concentrated portfolio of our best micro and small-cap stock ideas. True to our investment style, they are all high quality growth stocks. In our view, quality can reduce the risks, while growth allows you to capture some of the outsized returns available from emerging companies.

The portfolio includes stocks with a range of different value drivers and come from across a range of different industries. To that end, it is a reasonably diversified portfolio. 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 Holdings
Viva Leisure
Bwx
Mader

Whilst performance has been very strong this year, it is worth noting that we continue to find select opportunities among emerging companies that should position the fund for decent returns over time.



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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

AMP (Elements Investment, Elements Pension, iAccess, My North, North, Portfolio Care, Portfolio Care eWrap, PPS, Summit, Wealthview eWrap Inv)

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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