



Total Returns

As at 29 February 2020	1 mth	3 mths	1 year	3 years (p.a.)	5 years (p.a.)	Since Incept (p.a.)	Since Incept (cum)	Volatility
Cyan C3G Fund	-11.9%	-15.8%	0.3%	5.9%	13.7%	14.8%	116.3%	12.7%
S&P/ASX All Ords Accum	-8.1%	-5.6%	8.2%	8.5%	6.4%	7.3%	48.1%	12.0%
S&P/ASX Small Ind Accum	-8.4%	-6.0%	5.7%	9.5%	7.7%	8.6%	58.4%	13.8%
S&P/ASX Emerging Accum	-14.1%	-12.9%	6.6%	2.9%	7.9%	5.0%	31.6%	13.7%

Given the extensive market coverage of COVID-19 and the associated market rout, investors may not necessarily be surprised, but will still be disappointed, with the Fund's fall of 11.9% in the month. This was worse than the fall in S&P/ASX All Ords Index but not as severe as the 14.1% dive in the S&P/ASX Emerging Companies Index.

For some context, this was the worst monthly performance in the Australian stock market since the height of the GFC panic in October 2008 and, not surprisingly, the most disappointing month in the 5yr+ history of the Cyan C3G Fund.

We will go into some detail about where the Fund's losses occurred, but will also focus on the underlying performances of the companies in which we have invested which, paradoxically, reported impressive results almost across the board.

Month in Review

As might be expected from the growing fear and volatility during the month, we were particularly active in February.

Mid-month we cut positions in three companies that we considered would be directly impacted by COVID-19: **Atomos (AMS)**, **McPhersons (MCP)** and **Webjet (WEB)**. AMS is likely to suffer supply issues sourcing electronic components from China; MCP enjoys large sales of its beauty products into China; and Webjet subsequently downgraded full year earnings expectations due to a massive drop off in travel bookings.

In the latter days of February and early March after further share price weakness we took the opportunity to add slightly to existing positions in **Alicidion (ALC)**, **Kelly Partners (KPG)**, **Quickstep (QHL)**, **Schrole (SCL)** and **Vita Group (VTG)**. All of these businesses are well funded, enjoy growing revenue streams and in the case of KPG and VTG, enjoy dividend yields above 6%.

Rather than concentrating wholly on market gyrations and virus fears, it's worthwhile focusing on the underlying metrics of a number of our core holdings, which continue to prove themselves as promising investments:

Kelly Partners (KPG): KPG owns a network of accounting practices, predominantly in NSW, but has a clear 5-year plan to expand the business, both organically and through acquisition. It delivered a strong interim result with both revenue and bottom-line profit ahead of expectations, which has given us confidence that management is delivering on its growth strategy. KPG has been a long-standing Fund investment, but we have been adding to our position through the current market weakness in light of strong forecast growth and an attractive earnings multiple.

Victory Offices (VOL): This co-working and office space provider suffered price pressure after its AGM late last year when it reported lower than expected occupancy rates due to the loss of a client at 3 suburban locations. However, at the time, management stated that the situation would improve by February 2020 and that is exactly what has happened. The interim result was strong, but the current market weakness has suppressed what we believe would have otherwise resulted in a strong share price rally. VOL is currently priced on a low single-digit PE ratio, has no debt, return on equity (ROE) exceeding 15% and forecast compound growth rate of 40% p.a. over the next 2 years. Again, we are opportunistically increasing our position.

Vita Group (VTG): Another company that delivered a strong earnings result, well ahead of forecasts. VTG has two key businesses: their telecommunications division which is more mature and generates strong cashflow; and their newer health and wellness division which is growing strongly as new clinics are rolled out. At current prices, maintainable ROE exceeds 20%, the PER is less than 10 times and the dividend yield is 7%. We can see a strong rebound as the market recovers.

In terms of market movement and contributions to the fall in the value of the Fund over the month, of our 30 odd holdings we had just 4 positions in positive territory - **Vita Group (VTG)**, **Oventus (OVN)**, **Big River (BRI)** and **PSC Insurance (PSI)** - and almost half our positions suffered falls of more than 20%. Similar falls have been suffered by many other 'smaller' companies and it must be remembered that in many cases this is no reflection of the underlying quality of the businesses.

The biggest negative contributors were those we have been most convinced with as fundamental investments and have been held at higher weightings (typically 2.5%-6%) including **Quickstep (QHL)**, **Alcidion (ALC)**, **Schrole (SCL)** and **Raiz (RZI)**. Two other companies that severely underperformed were **Jaxsta (JXT)** and **Murray River Organics (MRG)**. In both cases we stuck to our philosophy of not adding to stocks that were significantly moving against us thus limited the overall impact on the Fund.

Outlook

Clearly macroeconomic factors are influencing, indeed overriding, any stock specific fundamentals. As we write this the markets are in a state of sheer panic and we have no doubt that the current uncertainty will have a material impact for the near-term earnings of companies in the current half and potentially into the calendar year. Australian smaller companies indices are presently trading at close to 4 year lows.

Whilst the Fund is continuing to be impacted by the continued weakness in global markets, it has been holding reasonable amounts of cash for some time - to its detriment in a galloping market - but to a huge benefit in the current conditions.

We have been patiently waiting for the opportunity to deploy some of this cash and are currently taking the opportunity to do so. We are increasing some of our existing positions and finding appropriate entry points for a number of new companies we have been closely following but we have previously found too stretched on valuation metrics.

We're doing this in a controlled and prudent manner knowing full well that we're never going to be able to pick the bottom but confident that at the right prices, the current market is presenting some excellent long-term investment opportunities. At the same time we are actively avoiding tourism facing businesses, companies that have near-term funding requirements or those still trading on high growth multiples. As always, we have no exposure to resources companies or biotechnology.

We expect that even before the current uncertainty clears, the markets will look past the short-term economic virus impacts and into FY21 and beyond when valuing equities. And particularly in the increasingly likely background of government stimulus and sustained "lower for longer" interest rates (10yr Aust Govt Bonds are yielding just 0.60% p.a.), higher returning asset classes such as equities will appear attractive.

Whilst this view might seem pre-emptive, from our experience through the likes of the 90s bond crash, the tech crash and the GFC, markets rebound well before there is light at the end of the tunnel. When this occurs we expect the markets could see a swift and considerable upturn. The saying, "It is always darkest before the dawn." may appear quite apt in the coming weeks.

As always, we are contactable in person and encourage you to do so if you have any questions for us.

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