



MHOR
ASSET MANAGEMENT

MHOR AUSTRALIAN SMALL CAP

MONTHLY PERFORMANCE UPDATE

AS OF 31ST AUGUST 2017

FUND RETURNED +1.30% (AFTER FEES)

NAV: 1.1342

PERFORMANCE TO BENCHMARK

	1 MONTH	3 MONTHS	12 MONTHS	SINCE INCEPTION
FUND	+1.30%	+8.73%	+2.91%	+5.95%
BENCHMARK	+2.71%	+5.12%	+3.20%	+1.59%
VALUE ADD	-1.42%	+3.62%	-0.29%	+4.36%

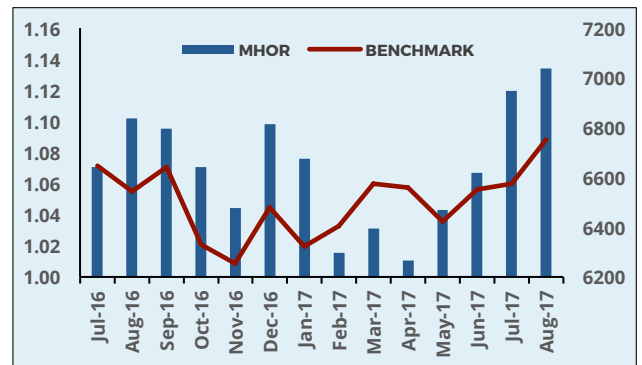
RECENT PERFORMANCE

2017	JUNE	JULY	AUGUST
RETURN (%)	+2.28%	+4.95%	+1.30%

MHOR TOP CONTRIBUTORS - AUGUST 2017

1	IMDEX	IMD
2	NEXTDC	NXT
3	ALLIANCE AVIATION SERVICES	AQZ

MHOR NAV VERSUS BENCHMARK



OVERVIEW AND WELCOME

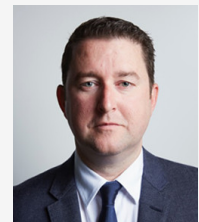
Welcome to the MHOR Small Cap Fund report for August 2017. The Fund returned +1.30% for the month, underperforming the benchmark index which was up +2.71%. Since inception in August 2016, the Fund has returned an absolute +5.95%, beating the benchmark by +4.36% (Small Ords +1.59% over the same period).

August was dominated by earnings releases which were heavily concentrated towards the last two weeks of the month. Our take on this results season was that earnings expectations were broadly met (having been reset lower in May) while outlook commentary was typically mixed. The share market continues to punish any crowded 'market darlings' that disappoint and reward those oversold value names which present better than feared prospects. In general, we saw earnings upgrades delivered across the resources, resource services, industrials and food sectors and downgrades from health and auto. Having delivered 7% EPS growth in FY17 (Vs 10% forecast a year ago), small industrials are now forecast to generate c.7.5% earnings growth in FY18 which we view as relatively healthy.

Small Cap equities outperformed Large Caps yet again during August (XSAOI +2.71% vs ASX100 -0.31%), underpinned by particularly strong gains in smaller resources (XSR +6.85%) and a solid uplift in smaller industrials (XSI +1.42%).

Result season provides us with a great opportunity to get out and meet face-to-face with a high volume of management teams to discuss the threats and opportunities for their businesses and to build our pipeline of ideas. This season proved no different and we came away with a good number of interesting investment prospects, some of which we have already prosecuted, some of which we are working up. The next major scheduled period for company new flow will be the October/November AGM season where companies often provide a quarterly update. In the meantime, we will be busy screening the investable universe for new winners. We remain of the view that The Fund is well positioned to outperform the benchmark index with a diverse portfolio of stocks leveraged to multiple structural growth themes and trends, as well as a number of overlooked classic value plays.

We entered August with 31 stocks and 9.2% cash, exiting the month with 33 stocks and 14.6% cash.



JAMES SPENCELEY



GARY ROLLO

ABOUT THE MONTH

The benchmark Small Ordinaries index rallied +2.71% during August, outperforming the ASX100 which declined -0.31%. Strengthening commodity prices, buoyed on by growing global demand expectations, higher risk appetite amongst investors and a weaker USD, drove the Small Resources Index (XSR) up 6.85% over the month, further extending July's +2.88% gain. Smaller Industrials (XSI) advanced +1.43%, having eased -0.33% in July. US equities were broadly flat during August (S&P500 +0.05%), consolidating recent positive momentum against a backdrop of rising geopolitical tensions with North Korea. Domestically, the market's focus turned towards corporate earnings releases which were heavily concentrated towards the back end of the month. Our take was that earnings expectations were broadly met, while outlook commentary was typically mixed but in aggregate looking for healthy earnings growth. In general, we saw earnings upgrades delivered across the resources, resource services, industrials and food sectors and downgrades from health and auto. A review of domestic consumption exposed stocks suggests that the Aussie consumer still has a pulse, however retailers have a lot of work to do to convince consumers (and investors) that they can thrive in an Amazon world – there is significant, long overdue, investment required by Australian retailers in systems and product offering as they attempt to improve their competitive positioning. The high AUD is also presently benefiting many retailers whilst causing a headwind for exporters and overseas earners.

ABOUT THE PORTFOLIO

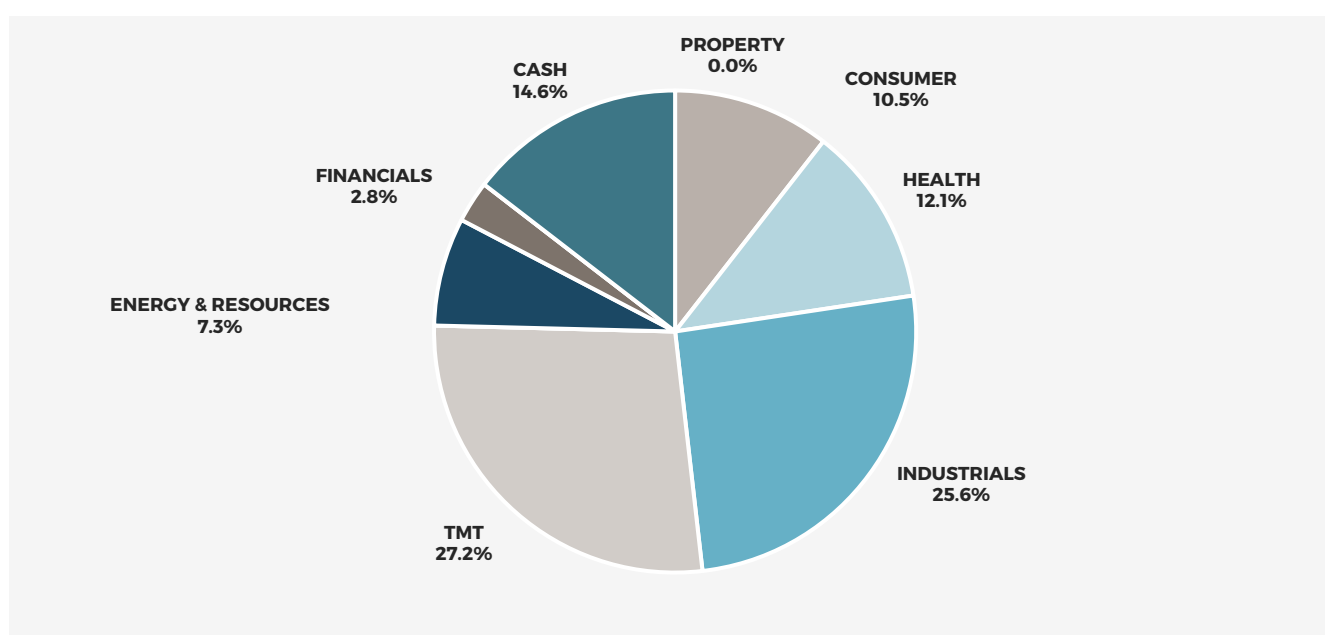
Three of the Fund's largest positive contributions came from Imdex (IMD), Alliance Aviation Services (AQZ) and NextDC (NXT). The major detractor for the month was TopBeta Holdings (TBH). More on each of these in the 'What happened in the Portfolio' section. The portfolio continues to exhibit a growth bias and has considerable exposure to smaller "undiscovered", we believe, attractive undervalued growth stories. We continue to search and find interesting new and emerging Small Cap equity stories, picking those that have the scope to be discovered by larger Small Cap funds.

PORTFOLIO EXPOSURE AND METRICS

CHARACTERISTIC	PORTFOLIO	MARKET***
1YR FORWARD PE	14.1X*	18.9X
1YR FORWARD DIV. YIELD	3.5%*	3.5%
2YR EPS GROWTH CAGR**	C. 20%	C. 7.5%

*Ex Select early stage companies, ** MHOR and FactSet Consensus data, *** FactSet Consensus for Small Ordinaries Forward P/E

PORTFOLIO SECTOR EXPOSURES



WHAT HAPPENED IN THE PORTFOLIO

Imdex (IMD) +23%. A key positive contributor to the Fund during August was drilling fluids and downhole instruments provider Imdex, a business clearly benefitting from the early stages of the cyclical recovery occurring across all the major mining regions. Pleasingly, the company delivered a better than expected FY17 operating result and positive outlook commentary which led to consensus earnings upgrades. Increased minerals drilling activity is driving solid demand for Imdex's AMC consumable fluids products as well as its REFLEX downhole navigation instruments, lifting overall FY17 sales revenues up 23% and REFLEX instruments on hire up 42%. The business' high level of operational gearing was on display with FY17 EBITDA growing 55% and margins expanding from 14% to almost 18%. Further, this was achieved while the company continued to invest in both people and technology to sustain its market leading positioning. The balance sheet has been restored to a net cash position, strengthened during the year by the divestment of the non-core oil and gas business, raising \$45m of new equity and securing a new \$30m debt facility with Bankwest to replace the high-cost Bain facility. Management did not provide quantitative earnings guidance for FY18, only noting their expectations for an improved financial performance. We believe the outlook remains favourable, underpinned by robust commodity prices, well-capitalized resource companies and the ongoing need for exploration considering the rate at which existing mining reserves are depleting. Although the stock has performed particularly well, we view valuation as undemanding at 7.0-8.0x EBITDA with upside risk to consensus estimates.

NextDC (NXT) +11%. NextDC also generated positive attribution for The Fund during August. The data centre operator produced a strong FY17 result, showcasing the attractive attributes of the business model as its scales. Sales revenue increased 33% on the back of burgeoning customer demand, driving 21% growth in contracted utilization and 27% growth in billing utilization. Higher sales volumes delivered on the relatively fixed cost base cut through to 77% EBITDA growth (margins expanded 11% to 42%) with operating earnings coming in at the upper end of the guidance range and bang in-line with market forecasts. Management provided a typically bullish outlook for the business and anticipate FY18 EBITDA to grow 14-25% (broadly consistent with consensus), underpinned by growth in contracted recurring revenue, growth in connectivity and cross connects, new customer wins, partially offset by investments being made into new facility operational capacity plus higher energy costs. However, the FY17 result was largely overshadowed by the announced planned capacity upgrades for the M2 (from 25MW to 40MW) and B2 (6MW to 12MW) second generation development assets. In our opinion, these material capacity upgrades send strong signals to the stock market that global megatrends are driving accelerating demand for cloud computing and connectivity and this secular trend remains in its infancy. NextDC is the pure play way to invest in this thematic in Australia and we expect this stock to become a core holding within large institutional portfolios over the coming years.

Alliance Aviation Services (AQZ) +9%. Another major positive contributor to the Fund during August was national air charter operator, Alliance Aviation Services. The FY17 result, which represented a modest beat to market forecasts, demonstrated that the earnings recovery story remains firmly on track with total flying hours increasing 11% over the year, driving 11% revenue growth and 14% EBITDA growth. The key positive surprise within the result was the 3.0 cents per share final dividend (up 50% on pcp), reflecting the improved operating conditions and stronger balance sheet position (net debt was reduced 8% in FY17 to 1.4x EBITDA). Having successfully navigated through the resources sector downturn by rationalizing operating costs and paying down debt, the business now appears in particularly good shape and well positioned as aircraft utilization improves on the back of increased FIFO charter activity (as evidenced by recent contract announcements) and the ramping up of the Virgin Australia services agreement (which also diversifies earnings risk). Additionally, the Austrian Airlines transaction (November 2015) whereby Alliance will progressively acquire 21 Fokker aircraft for US\$15m provides significant optionality and potential value creation. The stock remains way too cheaply priced in our opinion, trading on a FY18 PE of just 6x with a 3.5% dividend yield. These are exactly the kind of investment opportunities that we constantly screening for; strong management teams, a solid balance sheet, and improving earnings and cash flow momentum that has been completely mispriced by the market. As the catalysts payout, the share price will catch up. This stock has doubled since we first bought it yet it is still on 6x earnings!

TopBetta Holdings (TBH) -7%. The major detractor to August's performance was disruptive gaming company, TopBetta. Having rallied quite hard during the months of June and July in response to a raft of positive new flow and a general de-risking of the equity story, the shares consolidated in August. The principal cause of August's retracement, in our view, was the market digesting the \$9m equity placement. The funds were raised to accelerate the roll-out of The Global Tote towards full race coverage and wagering product offering, onboarding local and international B2B bookmakers, launching The Global Tote into the UK and European markets, additional development and technology staff, and expansion of the wholesale business into the US market. Operationally, TopBetta continues to demonstrate strong positive momentum and we see numerous catalysts ahead which should drive the stock price higher. With a market cap of sub \$60m, we see the risk-reward proposition as highly attractive, particularly when considering the significant size of the prize on offer.

OUTLOOK

We believe the fundamentals remain in place to support a positive medium-term outlook for global equities. Notwithstanding geopolitical risks associated with the North Korean regime, the global macro backdrop appears sound. The synchronized global economic recovery continues to drive positive corporate earnings momentum, validating prevailing equity valuations. This firmer foundation will allow central banks to progressively normalize monetary policies, although we anticipate only a gradual tightening

cycle considering wage inflation remains stubbornly low throughout the developed world while household debt is high thanks to asset price appreciation. The EU's prospects have improved somewhat and China is managing its economic slowdown well. Domestically, recent data suggests that the Australian economy is holding up better than previously feared with solid employment growth figures (albeit with low wage inflation and high household debt), consumers are showing a pulse and the capital city housing market hasn't collapsed as predicted. East coast construction and infrastructure activity has provided a solid buffer to the resources sector downturn while recent commodity price strength has been welcomed by the sector. We still think Small Caps are the place to be, offering investors superior earnings growth at more attractive valuations, and with less reliance on global macro forces.

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