MHOR AUSTRALIAN SMALL CAP

MONTHLY PERFORMANCE UPDATE

AS OF 31st MAY 2017

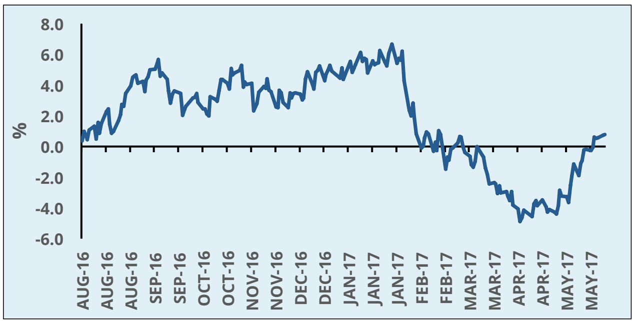
FUND RETURNED +3.24% (AFTER FEES)

NAV: 1.0431

PERFORMANCE TO BENCHMARK

	1 MONTH	3 MONTHS	SINCE INCEPTION
FUND	+3.24%	+2.72%	-2.56%
BENCHMARK	-2.05%	+0.31%	-3.36%
VALUE ADD	+5.29%	+2.42%	+0.80%

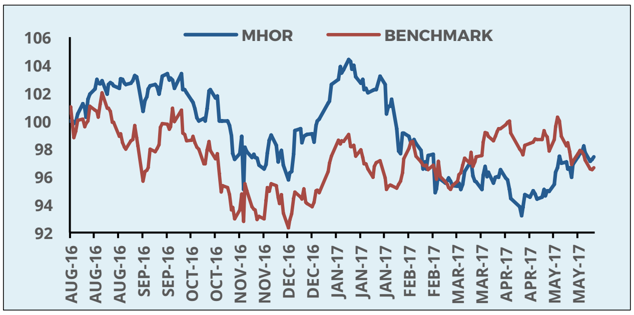
CUMULATIVE PERFORMANCE OVER BENCHMARK



HISTORICAL PERFORMANCE

2017	MARCH	APRIL	MAY
RETURN (%)	+1.57%	-2.03%	+3.24%

ABSOLUTE PERFORMANCE



MHOR TOP CONTRIBUTORS – MAY 2017

1	ALLIANCE AVIATION SERVICES	AQZ
2	SYRAH RESOURCES	SYR
3	NEXTDC	NXT

OVERVIEW AND WELCOME

JAMES SPENCELEY

GARY ROLLO

Welcome to the MHOR Small Cap Fund report for May 2017. We are pleased to report that The Fund outperformed its benchmark by +5.29% over the month, comprising an absolute return of +3.24% versus the benchmark index which was down -2.05%. Since inception in August 2016, the Fund has outperformed the benchmark by +0.80% (absolute return of -2.56% vs the market -3.36% over the same period).

Small Caps reversed recent trends, outperforming their larger counterparts in May (ASX100 -3.47% during the month), principally driven by the sharp selloff in bank stocks thanks to the surprise $6b bank tax unveiled in the May Budget. Smaller resources fared better than smaller industrials (XSR +1.6% vs XSI -3.5%), which we largely attribute to the high quantum of profit warnings issued by industrial companies throughout the month (MHOR navigated the 'mine field' particularly well this month). Investor sentiment in Small Caps is cautious with specific concern about stocks exposed to negative trends observed with the Australian Consumer and more specifically retail exposures.

Notwithstanding the cautious tone we see scope for positive returns forming as valuations have come back to more attractive levels, growth stocks are now discounting a lower expectation set than they were a few months ago. Consequently, we see a selective subset of small cap companies that offer good growth prospects at lower valuations against a diminishing expectation for growth in Large Caps. We see that combination as a good start for future outperformance. Our proprietary screening process and searching for industry tailwinds continues to identify a diverse pipeline of ideas which we are constantly and methodically narrowing down and then applying our bottom up fundamental research process to assess eligibility for investment. There are a number of themes that we continue to think look attractive and seek to leverage, including the impact of technology proliferation, ageing & changes in healthcare demands, demographic trends and industry consolidation, as well as seeking out overlooked classic value plays or using James' corporate experience to assess the many turnaround situations out there.

We entered April with 32 stocks and 4.4% cash, exiting the month with 31 stocks and 7.0% cash.

ABOUT THE MONTH

The benchmark Small Ordinaries index declined -2.05% over the course of May, giving up more than April's +0.25% gain. Small Industrials (XSI) were sold off -2.89% during the month (vs April +0.5%) as investors digested a high number of profit warnings while Small Resources (XSR) found some relief, rallying +1.63% after shedding -3.6% in the prior month. Small Caps outperformed the ASX100 which fell -3.47% (April +1.1%), largely driven by a sharp correction in domestic banks (bank index -10%) on the back of the Federal Government's surprise $6b bank tax revealed within the May Budget. The US market continued to reach new highs, up a further +1.2% in May (April +1.0% and +7.7% year to date), buoyed on by the broad-based economic recovery, Trump's promised stimulatory policies and ongoing investor enthusiasm for the 'FANG' stocks (Facebook, Amazon, Netflix & Google). Additionally, the future of the EU was somewhat brightened by the outcome of the French election, where the centrist Macron secured victory in early May. Chinese stocks continued their downward march, off another -1.2% in May (April -2.1%) as investors worried about the impact of tighter fiscal policy, property market curbs and a crack-down in off-balance sheet lending. May is an opportune time for domestic Small Cap industrials presenting at the numerous broker conferences to update the market on year to date trading and the outlook. This year, the volume of profit warnings far outweighed the number of upgrades issued; noteworthy warnings were issued by RCG Corp., Flexigroup, Pact Group, Murray River Organics (twice in one month!), Bulletproof, Salmat, Wellcom, Vita Group, Seymour White, Oroton, PAS Group, Redflex, Sigma, AP Eagers, QANTM IP, and Automotive Holdings Group (MHOR avoided all of these). Bucking the trend (with upgrades) were Lovisa, Nick Scali, Corporate Travel, Service Stream, Codan and Appen. A tough consumer environment was a common theme within the raft of disappointing trading updates issued during the month.

ABOUT THE PORTFOLIO

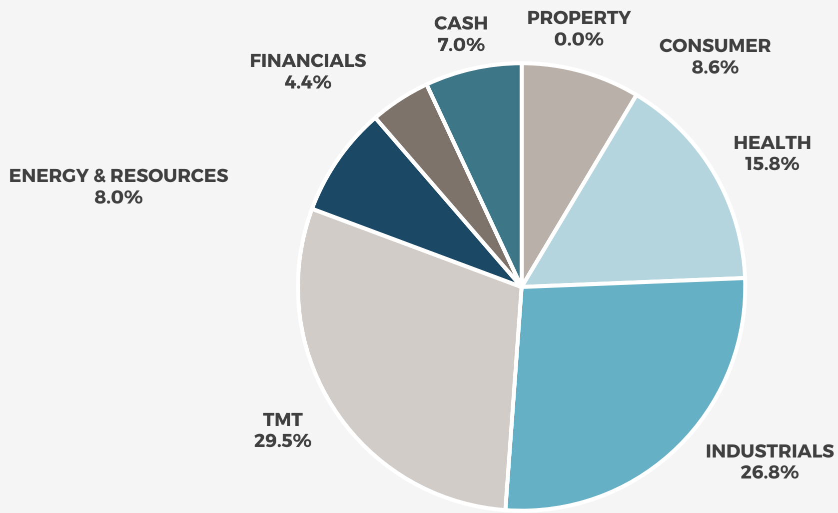
Three of the Fund's largest positive contributions came from Alliance Aviation Services (AQZ), Syrah Resources (SYR) and NextDC (NXT). The major detractor for the month was Zenitas Healthcare (ZNT). More on each of these in the 'What happened in the Portfolio' section. The portfolio continues to have growth bias, has considerable exposure to smaller "undiscovered", we believe, attractive undervalued growth stories. We continue to search and find interesting new 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	14.9X*	15.0X
1YR FORWARD DIV. YIELD	2.5%	3.0%
2YR EPS GROWTH CAGR**	C. 20%	5.3%

*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

Alliance Aviation Services (AQZ) +32%. AQZ is a provider of contract, charter and air services to the mining, energy, tourism and government sectors throughout Australia. The stock price rallied on the announcement of a deal with Virgin Australia (Virgin). Effective 17 July 2017, AQZ will expand its Regional Queensland operations to include four routes previously operated by Virgin, as well as operating flights for Virgin on three additional routes on a wet lease (assets plus crew) basis for one year. This deal will utilize three of AQZ's aircraft that the company recently acquired from Austrian Airlines, increasing AQZ's operating fleet by 11% and total flying activity by up to 45%. AQZ is an example of a classic deep value stock – it trades on a very cheap multiple, but the market has missed a significant de-risking of the business, the sustainability of its capital structure and the robust cashflows likely to translate to a rapid increase in dividends in our view. Key fundamental reasons why we continue to own AQZ despite its price performance include: (1) the business has substantially de-risked after restructuring initiatives which involved cutting fixed cost domestic maintenance to variable cost operations based in Slovakia; (2) the Austrian Airlines deal, whereby AQZ acquired 21 planes for US$15m, should represent a material value-creating event for the company, with some of the planes slated for breakup sale, some for consumable parts and some for fleet expansion, such as the case in the Virgin deal. Note that AQZ has already sold 3 of these planes – post some incremental capex deployed – for we estimate A$16m to Qantas. We think the aircraft purchased for US$15m should create value of A$80m+, material given AQZ market cap of just $110m; (3) AQZ's customer base is leveraged to improving commodity dynamics, with earnings arguably currently based off activity at a low point in the cycle, underlying commodity prices have improved which we think should on average drive higher fleet utilization; and (4) valuation remains compelling, (really really compelling), MHOR's forecasts suggests the stock trading on a year-forward PE of just 5.8x and a 17% free cash flow yield and growing based upon some undemanding assumptions, suggesting that rising dividend payments that use up $20m+ of surplus franking credits are likely in the near term, in our view.

Syrah Resources (SYR) +23%. Graphite player, Syrah Resources, was another positive contributor in May. Having fallen materially in the prior month, SYR shares bounced back in May as investor concerns were eased somewhat by the release of the AGM presentation which confirmed that the Balama graphite Project in Mozambique is approaching 80% complete and remains on track and on budget. The c.US$193m Balama Project is fully funded for production of graphite concentrate with production anticipated to commence in August 2017, ramping up from 140-160ktpa in year one to 250-300ktpa in year two (380ktpa nameplate capacity). Balama is a world-class graphite asset characterized by a huge, high-grade resource, positioned in the lowest quartile of the cost curve (60-year mine life, by 2020 SYR will be the largest natural flake graphite producer globally with c.40% share). Notwithstanding the quality of the assets and the recent rally, the stock remains heavily shorted. The bear case is largely built around fears that Balama's sheer size will ultimately drive down global graphite prices, much of the Project's future production remains uncontracted, and SYR's commercial downstream aspirations are not yet fully funded. Whilst we acknowledge the near-term development risks, we are attracted to the quality of the project and the underlying thematic of electric vehicles. SYR stands out to us as a clear take-out target at these prices.

NextDC (NXT) +9%. Our active investment in data centre operator, NextDC, continues to generate positive attribution to The Fund. NXT held a well-attended Investor Day in early May which showcased the company's broad depth of management talent across finance, engineering, sales and customer experience, and emphasized the robust industry fundamentals. Supporting a strong demand outlook, NXT cited industry forecasts for a 40% CAGR in public cloud workloads over the next five years, driven by higher enterprise penetration, the ongoing migration to SaaS for business applications and further momentum amongst hyperscale PaaS providers (Amazon Web Services, Microsoft etc) releasing the products that enterprise clients will adopt. On the supply side, management downplayed market fears about new competing DC capacity coming on stream, noting that anticipated growth in demand should outweigh supply which bodes well for industry pricing and returns. NXT also reiterated prior completion schedules for its data centre development pipeline (B2, M2 & S2). NXT also announced it had completed its third round of senior unsecured bonds issuance, raising A$300m in total at an all-in cost of funding of 6.625%. The funds will be used to redeem NXT's A$160m of existing bonds (bonds 1 & 2) which have an average cost of c.8.5% (implying interest costs reduced by c.190bps) with c.A$140m of additional debt capacity to fund growth initiatives. Note the material drop in the cost of debt funding. We believe NXT has reached an inflection point whereby institutional investors are beginning to better understand the fundamental drivers of the business and to view the stock more like a portfolio of long-life utility assets, as opposed to a speculative technology story. In our view NXT remains a key way for Australian investors to gain exposure to the generational shift in corporate computing to a cloud based services model – a genuine play on a global technology megatrend of a $1 trillion industry change – where else can you find that in Australia?

Zenitas Healthcare (ZNT) -10%. A detractor to May's performance was community-based healthcare service provider, Zenitas Healthcare. Despite no new news flow, we suspect the stock price weakness reflected market impatience with the pace of M&A activity (or lack thereof). The company, which listed on the ASX in January 2017, came to market armed with a substantial war chest to facilitate consolidation of the highly fragmented community-based healthcare sector. ZNT operates in the allied health, home care and primary care market segments, all of which are multi-billion dollar markets with solid medium-term growth profiles underpinned by Australia's ageing population, increased incidence of chronic disease and supportive government policy. The Federal Government is moving the burden of healthcare services from hospitals to primary care via the National Healthcare Reform and ZNT provides investors with a way to play this trend. We consider valuation to be attractive; the stock trading on 6x FY17E EV/EBITDA with c.$10m capacity for earnings accretive acquisitions. We believe the pipeline of acquisition opportunities remains intact and anticipate a re-rate on the back of deal execution.

OUTLOOK

From our standpoint, global equities should remain relatively well supported by the ongoing and broad-based US economic recovery, improving prospects for the EU (French election down, German election the next major pressure point) and valuation vs cash, bonds and property. Australia's fortunes remain highly correlated to China, which appears to be managing an orderly slowdown well so far, although the stock market has a healthy fear of China's heavily indebted shadow banking sector. Domestic Small Cap stocks remains an opportunity to find growth with less reliance on global macro forces.

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