MHOR AUSTRALIAN SMALL CAP

MONTHLY PERFORMANCE UPDATE

AS OF 31ST AUGUST 2018

FUND RETURNED 3.43% (AFTER FEES)

NAV: 1.3861

PERIOD	FUND	BENCH	RELATIVE
1 MONTH	3.43%	2.49%	0.93%
3 MONTHS	5.14%	2.53%	2.61%
6 MONTHS	4.32%	6.75%	-2.43%
12 MONTHS	22.21%	22.32%	-0.11%
INCEPTION*	29.48%	24.26%	5.22%

*Inception: 1/8/16

AUGUST 2018 PERFORMANCE

Fund performance for the month of August 2018 was +3.43% (net of all fees) versus the benchmark of +2.49%. Since inception (August 2016) the fund has delivered returns of 29.5%.

DRIVERS OF FUND PERFORMANCE

August is reporting season, so portfolio performance was driven by earnings releases and outlook statements – we cover off our view of reporting season later in the report. Portfolio wise, notable positives included AQZ, BIN, IPH, NWH & WEB and detractors were SDA & AXL. The fund exited the month with 46 investments, and 16% cash.

AUGUST WINNERS

AQZ (+18% for month), a longstanding fund investment, delivered strong earnings, cashflow and a good growth outlook leading to 20% upgrades to consensus EBITDA forecasts for F19. AQZ's balance sheet is strong, its asset base fully invested, primed to take advantage of good industry conditions and we expect strong cash generation to drive a material capital management/dividend event, likely announced at its upcoming AGM.

BIN (+16%) announced a strategic transaction, acquiring a Sydney landfill site – we think it's a game changer on the group's risk profile. BIN's growth for its valuation looks compelling. We see a key catalyst from the proposed introduction of a landfill levy in QLD, driving volumes and rising prices for landfill assets in NSW which we expect will have a positive impact on BIN's future earnings power.

IPH (+16%) rose as investors regained confidence in its ability to grow earnings following a recent history of weaker results. Organic growth rates normalised and IPH benefitted from a weaker AUD as it's a leveraged offshore earner – more revenue exposure in USD on an AUD cost base – AUD weakness turns prior currency earnings headwinds to tailwinds crystallising 12% F19 EBITDA upgrades to consensus forecasts.

WEB (27%) delivered a good earnings report and outlook driven by strong organic growth on top of significant strategic M&A that's yet to fully bear fruit. Of the 20%+ structural growers out there, WEB remains one of the "cheapest" in the market in our view.

NWH (+24%), delivered a good report, the highlight for us being the return of the drill & blast business back to normal profitability. However it's the outlook here that gets the market excited, with the prospect of significant volume growth from capital spend by WA Iron Ore majors on replacement tonnes driven by mine depletion – all are expected to be in the market over the next two years with significant multi-billion $ capex programs – NWH has a strong capability in this market and we expect it to win its fair share, likely crystallising a strong order book and material earnings increases.

AUGUST LOSERS

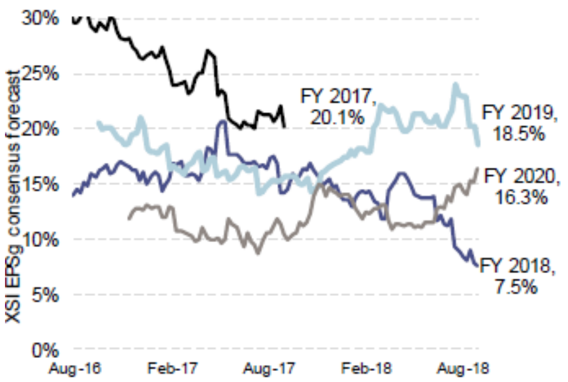
Individual stock losers didn't play a material role in defining fund performance in the month, however we did have some losers worth calling out.

SDA (-32%) delivered weak earnings driven by poor revenue performance in its Energy business, but it underperformed in almost all its divisions – management blamed temporary factors behind most of the weakness, however they have form in this regard. Thankfully we had sold 2/3rds of our exposure ahead of results as our portfolio risk review pre-results season had identified significant investor crowding in this stock – its PE multiple had expanded 20% faster than the market since its last results release. At the current SDA valuation, we are more inclined to look positively on the investment again.

AXL (-20%), a profitable fintech SME lender, shook investor confidence with its disclosure of higher than expected arrears deep in its accounts. Management attribute the shift in arrears volume to a change in accounting policy, but have no doubt lost some investors with the lack of transparency on this issue.

REPORTING SEASON REVIEW-SOLID

We'd characterise the reporting season as good, not an unusual spread of beats and misses, and outlook statements signalling a continuation of growth. F19 earnings expectations have dropped by a few percentage points in aggregate, that's no more than normal as analysts (natural optimistic bias) faced with the reality of new information reign in near term forecasts. According to broker Wilson, consensus expects 18% earnings growth for F19 for the Small Ords. It's not likely to be that high, but its shaping up to be a double-digit growth year for small caps.



Source: Wilson Advisory – Nathan Szeitli

RISING COSTS, A POSITIVE FOR MINING SERVICES

In terms of fundamental themes and trends we observed we'd highlight more commentary on rising costs, labour expenses generally and in resource exposed sectors most acutely. We welcome rising costs in resources as a positive for our mining services related exposures, which should benefit from a tightening labour and gear market and the theory goes should see margin expansion alongside revenue growth. Mining services was the sector area where outlook commentary was the most robust and in our view above market expectations.

CONSUMER REMAINS CHALLENGED

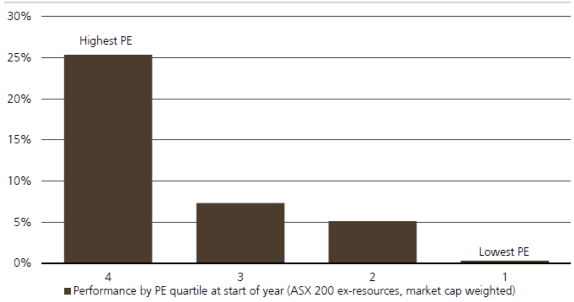
Consumer related companies showed mixed performance. It's been clear for some time that weakening house prices is impacting consumption, this impact is apparent in those companies exposed to larger ticket consumer items (Autos, furniture, childcare), and the weaker retailers (of which there are plenty in Australia) are still doing it tough. The recent decline in the AUD will likely add gross margin pressures to the risk profile of the general retailers in the coming year, as does the inevitable political uncertainty ahead in an election year and adds to our sense of caution for consumer exposed names. We sold the last of our retail exposure – NBL – during the month. Our view is you need to be a very good retailer to do well in the coming retail environment and we will pass on that sector opportunity for now.

PREFERENCE FOR OVERSEAS EARNERS

Overseas earners remain a preference for us, with activity levels more robust than domestic markets. We aren't currency strategists, but reporting season provided plenty of anecdotal evidence that consumption activity remains brittle, with corporates exposed there more cautious in their planning, investments and outlook. There seems little reason to question the prevailing wisdom that the AUD will remain weak as the economic conditions here in Australia suggest our RBA has limited scope to lift rates in step with the anticipated rate rises in the US.

MARKET PERFORMANCE DRIVERS

Momentum, particularly in high-PE valuation stocks, drove index performance in small caps through reporting season, it's been a trend for a while as observed in the chart below (courtesy of Paul Winter at UBS) of YTD performance by valuation quartile.



Source: UBS – Paul Winter

Stocks that occupy this cohort are the structural growers, including the "disrupters" with large market opportunity and scalable business models. They appear expensive based on short term earnings multiples measured against their profit today, as those profits aren't representative of the potential investors see these businesses can make in the future. We understand that and are usually happy to pay a more expensive price for access to this better growth opportunity, however valuations here appear high, very high, and we believe recent share price performance has been driven in part by self-fulfilling momentum and by those that today are acting as if valuation agnostic. We don't like the risk reward profile if the momentum or the perception of valuation changes (which history suggests that at some point it will), so we remain cautious and very selective of high valuation growth stories right now.

ACTIVITY

We added 6 new stocks to the portfolio, sold 5, added to others but net trimmed the aggregate equity exposure moving some 400bps to cash. New stocks included buying;

- BAL - gently adding some growth at much cheaper than recent valuations. Small nibble as there remains risk.
- EHL (again) – rotating out of some other mining services to fund.
- MGX - small cap high grade iron ore miner, that's got yield (no typo!)

Sells included;

- NBL - great execution so far but heavy integration and re-structuring lifting ahead. We are cautious on retail.
- PVS – great story but forecasts depend on volatile Semi-conductor capital equipment spend and, having covered tech for a decade during the tech boom and bust, we know that's volatile of the very variety!
- TNE - the valuation dis-continuity we spotted has now closed.

CYCLICAL GROWTH? BALANCED

The portfolio continues to have a balanced exposure to cyclical growth names. Our preferred expression is mining services. We have re-ordered the stock selection here, to take advantage of better value, lower risk or earnings scenarios, but have maintained our aggregate exposure. The fund achieves its balance by holding limited direct resource exposures. The benchmark has around 18% resources, the fund holds 8%, with over half of that exposure in Energy. We have done due diligence on enough resource names that we feel we can dial-up the resource exposure quite quickly should the macro mood change (Trump tariffs and emerging market risk appetite).

POSITIONING

With macro-economic and market valuation settings where they are our tactic is to buy quality growth with the lowest risk at the cheapest price. Whilst our skew away from the high valuation area of the market didn't help the portfolio through reporting season, it didn't hurt either. The aggregate positioning of the portfolio towards sectors with cyclical tailwinds and toward GARP – that next tier down of growth but at materially better value per unit of growth than those high growth names – continues to appear sensible to us now post the earnings season information deluge. We also prefer overseas earners, and don't like domestic discretionary consumer exposure as we see that sector facing headwinds, preferring consumer staples instead. As always, we are ready to change should conditions determine we should.

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FACT SHEET

MHOR ASSET MANAGEMENT

MHOR is an independent boutique investment manager and was established in 2016 by Gary Rollo and James Spenceley, based in Sydney.

MHOR's investment team is a combination of successful entrepreneur with real world business building experience and fund manager with a proven investment process and performance track record. MHOR holds its own AFSL licence and today manages the MHOR Australian Small Cap Fund. MHOR is 100% owned by its employees.

MHOR AUSTRALIAN SMALL CAP FUND

The fund's investment universe are stocks listed in Australia and New Zealand outside of the S&P ASX 100 stocks. We believe Smaller Companies are the growth and innovation engine of Australia, with many established to specifically commercialise a single product or service, often in industries where change is badly needed. Investing alongside talented founders and managers, unencumbered by the legacy of an industry status quo, can create significant value.

We believe that with the right investment process, team, skills and experience that this value can be un-locked for investors, crystallising the potential in the under-researched asset class. The fund's objective is to outperform its benchmark – the S&P/ASX Small Ordinaries Accumulation Index - over a rolling five year period and aims to deliver strong absolute positive returns. The fund has an independent trustee (Equity Trustees), is priced daily, has a low minimum investment of $20,000, and is Audited by Deloitte.

OUR APPROACH

Real world business experience + proven investment process:
We have built our investment team with the specific objective of being able understand management's challenges and opportunities from an operator's perspective, believing that combining this understanding with a disciplined and proven investment process helps unlock the value creation potential in Small Caps for our investors.

Philosophy & Process:
Our investment philosophy is theme led, we aim to benefit from direct positive exposure to the tailwinds of change. Investment opportunities are researched on a bottom up basis, we aim to have portfolio risk and return driven by stock specific factors that we can research, not hard to call macro factors.
We seek an advantaged edge, investing where we believe we know more than the market, aiming to find stocks before their potential is fully discovered by others. Our portfolio construction process aggregates and selects from these investment candidates, building a balanced portfolio of under-valued companies with absolute upside.

Performance driven:
The Investment team believe that fund size is a factor in delivering investment performance. Fund size will be limited to that which does not restrict the ability to perform.

Alignment:
The employees of the manager have made significant personal investments in the fund, providing strong alignment between the Investment Team and our investors.

JAMES SPENCELEY

The company's CEO **James Spenceley** is one of Australia's most successful entrepreneurs, founding and growing his previous business, Vocus Communications into one of the best small cap growth stories in recent years, now a multiple billion-dollar business.

GARY ROLLO

Chief Investment Officer, **Gary Rollo** has a proven track record as a successful small cap portfolio manager. Gary spent six years as a Portfolio Manager at Renaissance Asset Management, a dedicated Australian small cap investment firm. During those six years the fund outperformed the Small Ordinaries Index by over 13% p.a.

FUND INFORMATION	
APIR CODE	ETL0030AU
ARSN	105 436 753
MINIMUM INVESTMENT	$20,000
APPLICATIONS & REDEMPTIONS	Daily
BENCHMARK	S&P ASX Small Ordinaries Index (Acc)
PORTFOLIO MANAGERS	Gary Rollo and James Spenceley
STOCK HOLDINGS	25-75
INDIVIDUAL STOCK LIMIT	10%
AUTHORISED STOCKS	Stocks listed on the ASX or NZX and unlisted companies expected to list within 12 months
UNLISTED STOCK LIMIT	20%
CASH LIMIT	0-50%
INVESTMENT STYLE	Long only
INVESTMENT TEAM	MHOR Asset Managment
RESPONSIBLE ENTITY	Equity Trustees Limited
RECOMMENDED INVESTMENT PERIOD	Medium to long term
INCEPTION DATE	1 August 2016