Fairview Equity Partners
Monthly Net Investment Report

31 July 2017

Emerging Companies Fund

Fairview Equity Partners is a smaller company Australian equities manager. The Fairview Equity Partners Emerging Companies Fund seeks to provide capital growth and some income by outperforming the S&P/ASX Small Ordinaries Accumulation Index over the medium to long term.

Performance Return

Period ending 31 July 2017	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Since inception#
Fairview Emerging Companies Fund*	-1.37	-0.84	-12.04	3.27	8.03	10.70
S&P/ASX Small Ordinaries Accumulation Index	0.34	0.24	-1.08	5.56	5.77	4.18
Excess Return*	**-1.71**	**-1.08**	**-10.96**	**-2.29**	**2.26**	**6.52**

** Returns shown are net of fees at a manager level (pre tax).*
 # Returns over 1 year are annualised. Fund inception 8 October 2008.
Past performance is not a reliable indicator of future performance.

Performance and Market Outlook

Global equity markets were again mixed during the month of July, with US markets continuing to move higher (S&P500 +1.9%), most European markets trading slightly lower (FTSE100 0.8%, STOXX 50 +0.2%, DAX -1.7%), whilst Asian markets were primarily stronger (China Shanghai +2.5%, Hang Seng +6.1%, Nikkei 225 -0.5%). Domestically, the S&P/ASX 200 closed the month flat.

There have been several drivers of a continued buoyant US market. Investors digested a July FOMC statement which brought little in the way of surprise, reinforcing expectations of a modest and progressive lift in official rates. There was a surprising rebound in US consumer confidence, the July Index of 121.1 significantly exceeding median forecasts of 116.5. The other key catalyst within the US currently is the Q.2 earnings season. As at the end of June, 57% of US companies had reported Q.2 earnings, with 73% reporting EPS estimates above market expectations (17% reporting results below the mean estimate). In aggregate, reported earnings have come in approximately 6% above expectations. Pleasingly, sales/revenue growth has also come in above expectations, reinforcing views of an improving growth environment. Interestingly, the only sector reporting a p.c.p. decline in earnings is the consumer discretionary sector.

Interestingly, market reactions to both results exceeding and missing market expectations (share price move from 2 days prior to results to 2 days post results) have to date been below 5 year averages, seemingly either indicating some anticipation on the part of the market, or that the market is looking somewhat beyond the immediate Q.2 earnings print. Nonetheless, positive earnings revisions, and positive absolute earnings momentum (Q.2 aggregate earnings growth relative to p.c.p. now exceeds 9% and continues to rise) are both important precursors for continued market strength. This is particularly important following a ~19% S&P500 rally since Nov-16, a good portion of this resulting from an expansion in the earnings multiple to ~18x next 12 months earnings.

Closer to home, the S&P/ASX Small Ordinaries Accumulation Index rose modestly during the month of July (+0.3%), and continued the recent outperformance relative to the large cap segment of the market (S&P/ASX 100 flat). Small Resources (+2.9%) outperformed Small Industrials (-0.2%) during the period. Official cash rates remained on hold at 1.5%, whilst the Australian dollar rallied a further 4% relative to the US dollar to briefly touch 80c, levels not reached for more than 2 years.

Stronger performing stocks within the S&P/ASX Small Ordinaries during the month included Programmed (PRG), +59.8% after catching an agreed bid from Japanese company PERSOL at a significant premium, Lynas (LYC), +28.6% after a Q.4 result highlighting stronger operating performance and improving conditions within the rare earths market, Metals X (MLX) +21.6% following several positive announcements during the month, and Beach Energy (BPT) +18.3%. Weaker stocks during the month included Doray Minerals (DRM) -36.1% after announcing that mining at its Andy Well underground mine will be suspended latest in c.17, Mesoblast (MSB) -16.1%, OceanaGold (OGC) -15.9% and WestGold Resources (WGX) -14.4%, the latter two both trading lower on the back of June quarter results which missed market expectations.

Market attention domestically will now turn to the full year reporting season, this providing the next set of stock specific catalysts. At a broader level, expectations have been moderated in recent months with a slew of earnings downgrades, which should ensure that negative surprises are limited. As well as assessing earnings delivery relative to expectations, and the quality of reported earnings including in such areas as cashflow conversion, the market will intently focus upon outlook comments. At a broader level the environment remains mixed – interest rates are low but rising, unemployment is low, minimum wages have recently risen, however under employment remains a feature, energy costs are rising, and consumer and business sentiment indicators have been mixed. Whilst not impacting the reporting period to 30 June, the recent rise in the AUD may also factor into the outlook comments of some companies.

The Small Ordinaries Index currently trades on approximately 14.8x F.18 earnings based on estimated EPS growth of 15.9% (15.7x with 10.9% EPS growth for Small Industrials). Provided we see relatively stable earnings revisions trends through the upcoming reporting season, relative to the estimated 5.0% EPS for the S&P/ASX 100 constituents (at 15.5x F.18 PER), we continue to expect further outperformance from the smaller companies segment over the coming period.

It has become clear in the past month or so that, save for a few exceptions, the IPO market has now likely paused here in Australia for companies of size. Investors have become increasingly jaded with ex private equity owned businesses extracting costs, and stripping the company of assets, before releasing businesses back into the listed environment at lofty multiples and with challenging prospectus period forecasts (and possibly sustainability issues in the years beyond). Indeed, with several of these private equity funds more recently undertaking further funding rounds, we would expect them to feature more prominently on the buy rather than the sell side over the next 12 months. In an environment of modest earnings growth, low interest rates, strong balance sheet capacity, and reasonably buoyant capital markets, we would expect larger listed companies to compete with private equity on the M&A front, with several companies within the Small Ordinaries potential targets for such activity.

Performance Attribution

We highlight below the largest positive and negative relative performance contributors during the month of July 2017.

Positive Contributors		Negative Contributors	
Kogan	Overweight	Mayne Pharma	Overweight
Nearmap	Overweight	BWX	Overweight
Nufarm	Not Held	Webjet	Overweight
Ausdrill	Overweight	Magellan	Overweight
Aveo Group	Not Held	Australis Oil & Gas	Overweight

Contributors

Kogan (KGN) rallied strongly throughout the month, first again exceeding its July 2016 IPO price and then going on with the job. As part of its quarterly cashflow statement KGN highlighted that its Q.4 trading momentum was strong, and exceeded revised management expectations. It also separately announced it would market a range of insurance products, adding a new line of business to its growing portfolio of products distributed to its large and growing customer base.

Nearmap (NEA) provided a preliminary update on its F.17 results, highlighting continued strong growth in its core Australian market and accelerating momentum within the earlier stage US operations. It also talked to the release of oblique imagery and related 3D products in both markets, providing an avenue for continued strong growth.

Nufarm (NUF) shares continued to re trace in July, following a sharp rally in the share price since late calendar 2016. This earlier strength had mainly been around expectations regarding the impact of the internal performance improvement program on profitability, with industry fundamentals still challenging. We do not hold NUF.

Ausdrill (ASL) continued to rally during the month. Whilst there was no specific newsflow during the period, the market is increasingly refocussing upon both an improving domestic environment but also the growth opportunities in front of the African operations. Current contracts in place underwrite continued solid growth into 2018, whilst there is a promising tender pipeline in front of the company.

Aveo (AOG) continued to come under share price pressure during July, following the late June ABC Four Corners story, which put a spotlight on the industry but more specifically the business practices of AOG, including a focus upon the deferred management fee model (DMF) which is a key feature of the AOG investment case. The potential for brand damage, and heightened regulatory focus, raise the risk profile for the stock. We do not hold shares in AOG.

Detractors

Mayne Pharma (MYX): MYX continued to underperform during this last month. The market continued to debate whether the price deflation highlighted by the company across its generic portfolio, resulting from buy side consolidation, has continued. In recent months, the rising AUD has become an additional headwind to translated earnings for the company. Post month end, MYX highlighted likely F.17 profit levels, acknowledging continued pricing pressure in this generics division, with consensus expectations for F.17 consequently requiring downward revision.

BWX (BWX) traded lower during the month, largely giving back the gains of the prior month. BWX announced that it has acquired the owner of number one US natural cosmetics brand Mineral Fusion for up to US$43m including potential earn outs, providing a beach head for BWX into this sizeable market, as well as the opportunity to leverage this additional brand internationally through the BWX network.

Webjet (WEB) fell on news that it is in dispute with its auditor around the accounting treatment associated with the Thomas Cook agreement entered into in August 2016. This change in stance runs contrary to the advice of two Big 4 accounting firms, seemingly in contrast to the nature of the agreement, and has no impact upon the cashflows or other economics surrounding a transaction which provides substantial upside for WEB over time. Post month end, WEB announced a materially accretive transaction, partly funded via a 1:6 entitlement issue, to acquire UK based B2B player JacTravel for GBP200m, creating the number 2 B2B player globally with pro forma TTV in excess of A$1.1b.

Magellan Financial Group (MGF) gave back some of the gains of recent months. Performance fees of $18m for the 6 months to the end of June were modestly lower than some analyst expectations which, combined with recent fund performance, saw some modest downward revision of nearer term earnings expectations.

Australis Oil & Gas (ATS): The share price for ATS has drifted lower in recent months, on no specific newsflow. The April US$80m Encana Tuscaloosa Marine Shale (TMS) acquisition positions ATS with a significant inventory of oil across 141k net acres, both developed and undeveloped, with operatorship allowing flexibility and control, and with a break even oil price well below current levels. Select drilling aimed at demonstrating value will commence in early 2018.

Top Ten Holdings

We highlight below our top ten holdings within the portfolio, in alphabetical order, as at 31 July 2017

Bapcor Ltd	Link Administration Holdings Ltd
Corporate Travel Management Ltd	Mayne Pharma Group Ltd
Costa Group Holding Ltd	Regis Resources Ltd
Credit Corp Group Ltd	Sandfire Resources NL
IDP Education Ltd	Webjet Ltd

Number of stock holdings as of 31 July 2017	**52**

Contacts

Website
www.fairviewequity.com.au

Email
info@nabam.com.au

Client Services
1300 738 355