

Fairview Equity Partners Monthly Combined Investment Report

31 December 2016



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 December 2016	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Since inception [#]
Fairview Emerging Companies Fund*	-0.10	-12.19	-2.91	7.36	13.11	14.99
S&P/ASX Small Ordinaries Accumulation Index	3.61	-2.45	13.19	6.25	4.87	4.30
Excess Return*	-3.71	-9.74	-16.10	1.11	8.24	10.69
Net Fund Return (after fees & expenses)	-0.19	-12.36	-4.06	5.03	9.68	11.45

* Returns shown are gross at a manager level (pre fees).

Returns over 1 year are annualised. Fund inception 8 October 2008.

Past performance is not a reliable indicator of future performance.

The small ordinaries Index ended up 3.61% for the month, driven by small industrial stocks as the small resources index was up only 1.03%, held back by that index' large gold weighting. Equity capital markets activity surged into December with 22 transactions announced. Typically this month is a quieter period leading into Christmas.

Market Commentary

Australia equity markets' performance in December continued to be positively focused upon the surprise US election result and the outcome of several Central Bank Policy meetings. Commodity prices pressed higher, supported by fiscal stimulus in China and the US FOMC rate hike. The Australian equity market bounced back from losses in early December to its highest levels since August 2015. In data released for the month, December began with the RBA keeping the cash rate at 1.5% as expected. This was followed by the unemployment rate coming in at 5.7%, a 0.1% increase from the previous month. Gold continued to decline during the first two weeks of December with the risk on trade in full swing while crude oil rallied on the back of proposed OPEC production cuts.

Covermore was the best performing name in the small ordinaries, rising 49% during December after catching a bid after a very poor calendar 2016. Programmed and Mesoblast also outperformed significantly although both were down 20% plus for the entire year. Aconex recorded a good bounce in December up 18%.

The worst performers in the small ordinaries index in December were milk and gold companies. Bellamy's was down 45% in the month, due to a very poorly received profit warning. The company stated it could not achieve the high revenue growth forecast by analysts and also revealed it had a large inventory build in spite of discounting. It then promptly went into trading halt for the rest of the month. A2 milk and Bega cheese went down in sympathy. Dacian gold struggled to get an equity issue away due to poor pricing and a rapidly slipping gold price, whilst Perseus suffered production missteps. Mayne Pharma had a tough month. It was caught in the slip stream of a price fixing racket by a competitor even though the potential financial penalties were not material.

We would categorise small cap performance in December as super harsh treatment of any perceived misstep. This was in part due to the wholesale retreat from the index by large cap investors, which started in October. A key early theme of calendar year 2016 was the indiscriminate flooding of the index by those seeking growth. Large cap forecast growth was anaemic, (in fact negative) and these investors screened much further down the market cap spectrum than normal. It appears this theme has now largely played out.

Performance Attribution

We highlight below the largest positive and negative relative performance contributors during December 2016.

Positive Contributors		Negative Contributors	
Bapcor	Overweight	Metal X	Nil Holding
Perseus	Nil Holding	Shine	Overweight
Costa	Overweight	Bellamy's	Overweight
Vita Group	Overweight	Mayne Pharma	Overweight
A2 Milk Company	Nil Holding	Sirtex	Overweight

Contributors

Bapcor was our best performer in December after it cleverly lifted its bid price for the New Zealand based Hellaby's and declared the offer final. **Costa** benefited from increased investor interest (although only one analyst covers the stock) on the back of its entry into Avocado growing and marketing in Australia. Avocados are a high value seasonal product and are an exquisite fit into the Costa fruit portfolio. **Vita Group** bounced as more information drifted in the public domain that perhaps the new Telstra deal could be quite beneficial for the company over the medium term. We benefited from not holding **Perseus**, a high cost gold miner that had grade issues at its Edikan mine. We also gained from not owning **A2 Milk** which was smacked down in sympathy with Bellamy's, this in spite of a very good AGM update.

Detractors

December was one of Fairview's worst months in eight years. Three key downgrades hit us very hard indeed. **Sirtex** surprised the market with an announcement that a new competitor oral product had taken share in the key US market for rescue dose liver cancer therapy. The MD being questioned by ASIC regarding selling a quarter of his personal holding in the days prior to this downgrade was a further drag. We exited **Bellamy's** the day that company announced they would not come anywhere close to the Chinese revenue growth forecast by broking analysts. Subsequently we only took cold comfort in the second downgrade of another 40% EPS drop after we had exited. **Mayne Pharma**, a stock that has been a wonderful investment over the past five years, had a torrid month. Trump's Twitter feeds regarding the US ethical (not generic) drug industry and investor focus on two US court actions involving price fixing sent the share price down sharply. Unlike the other two investments detailed in this paragraph, we still hold Mayne at a decent weight, as we think the share price fall is an overreaction in the extreme.

Top Ten Holdings

We highlight below our top ten holdings within the portfolio, in alphabetical order:

Bapcor	Link Administration Holdings Ltd
Charter Hall Group	Magellan Financial Group Ltd
Corporate Travel Management Ltd	Mayne Pharma Group Ltd
Costa Group Holdings Ltd	Regis Resources Ltd
IDP Education Ltd	Webjet Ltd

Number of stock holdings as of 31 December

59

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