MONTGOMERY SMALL COMPANIES FUND

INVESTMENT REPORT & FACT SHEET

FUND OVERVIEW

Montgomery Lucent's investment philosophy is guided by fundamental research and analysis. Small market capitalisation companies are relatively under-researched and when markets misprice securities, this creates investment opportunities.

The Montgomery Small Companies Fund (The Fund) typically invests in a portfolio of 30 to 50 high quality, undervalued small and emerging companies with strong growth potential. The Fund will focus on investing in companies outside of the ASX 100 and across the New Zealand stock market, while being able to invest up to 10% of the portfolio in pre-IPO opportunities.

We are searching for companies likely to benefit from secular trends, industry change and with substantial competitive advantages. With a "lifecycle approach" to sizing the portfolio positions depending on whether they are an early stage, emerging, developed or a core investment, The Fund is designed to be as agile as the remarkable small companies that it invests in. This is a long-only portfolio.

FUND FACTS

INVESTMENT MANAGER
Montgomery Lucent Investment Management Pty Limited

OBJECTIVE
The Fund aims to outperform the S&P/ASX Small Ordinaries Accumulation Index over a rolling 5 year period.

BENCHMARK
S&P/ASX Small Ordinaries Accumulation Index

FUND CONSTRUCTION
The Fund's Small Cap portfolio will typically comprise 30-50 high quality stocks listed on the ASX and/or NZSX. Cash typically ranges around 10%.

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FHT3726AU

RECOMMENDED INVESTMENT TIMEFRAME
5 years

MINIMUM INITIAL INVESTMENT
$25,000

INCEPTION DATE
20 SEPTEMBER 2019

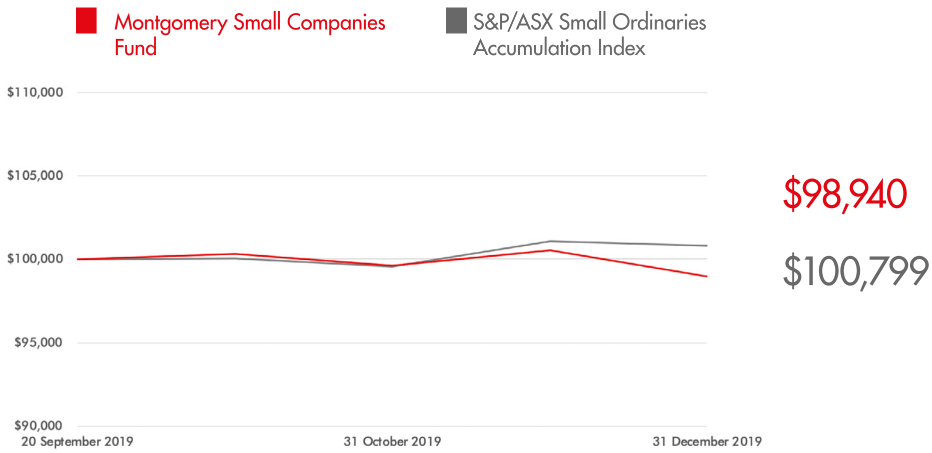
FUND SIZE
$27.2M

MANAGEMENT FEE
1.23% per annum, which includes a management fee of 1.03% per annum. Both figures are GST inclusive and net of RITC.

PERFORMANCE FEES
17.94% of the amount by which The Fund outperforms its Benchmark, after other fees and expenses have been deducted and achieves positive performance.

APPLICATION & REDEMPTION PRICES
www.montinvest.com/our-funds/montgomery-small-companies-fund/

PERFORMANCE GRAPH



CONTACT DETAILS

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PORTFOLIO PERFORMANCE

(to 31 December 2019, after all fees)

	INCOME	CAPITAL GROWTH	MONTGOMERY SMALL COMPANIES FUND	S&P/ASX SMALL ORDINARIES ACCUM. INDEX	OUT/UNDER PERFORMANCE
1 month	0.00%	-1.58%	-1.58%	-0.29%	-1.29%
3 months	0.00%	-1.37%	-1.37%	0.76%	-2.13%
6 months	N/A	N/A	N/A	N/A	N/A
Since inception#	0.00%	-1.06%	-1.06%	0.80%	-1.86%

Inception: 20 September 2019

FUND COMMENTARY

Fund Performance and Drivers

December was a volatile month for small caps, impacted by several large institutional portfolio mandate transitions as well as some disappointing trading updates. A number of recent IPOs came to market and generally traded well including MoneyMe (ASX:MME) which the Fund participated in.

The Montgomery Small Companies Fund (the Fund) returned negative 1.58 per cent, net of fees in December versus the benchmark, the S&P/ASX Small Ordinaries Accumulation index which declined by 0.29 per cent. Since inception (20 September 2019), the Fund has fallen 1.06 per cent, underperforming the benchmark by 1.86 per cent.

The largest positive contributors to performance included Adairs (ASX:ADH), Cooper Energy (ASX:COE) and Megaport (ASX:MP1).

Adairs rallied strongly on news that it had utilised its balance sheet strength and acquired Mocka, a pure-play online furniture retailer, in a deal expected to be 10 per cent earnings accretive. We think this deal potentially represents a step-change for Adairs, adding a large adjacent market with low online penetration that should accelerate earnings growth and improve perceived quality (see our recent blog, "A step change for Adairs").

Cooper Energy shares gained on a positive Sole Gas Project update. In an important milestone, the Project has now progressed from the construction stage with the first phase of gas commissioning planned to begin in early January 2020.

Megaport rose following a well-received capital raising with the $62 million equity injection earmarked for accelerating growth and future innovation; we expect that this to be the last fund-raising round before Megaport's growth becomes self-sustaining.

The largest detractors from performance included AMA Group (ASX:AMA), Jumbo Interactive (ASX:JIN) and Smartgroup (ASX:SIQ).

AMA Group provided a disappointing trading update with FY20 EBITDA now expected to be materially below prior market forecasts (which were only recently reconfirmed). Management cited depressed new car sales volumes reducing demand for aftermarket products, prolonged dry weather on the east coast impacting smash repair activity, as well as fewer acquisitions while the recent Capital Smart deal is being bedded down. Whilst these events are likely transitory, the impact they have on AMA's balance sheet flexibility, and consequently its ability to fund its M&A led growth strategy means we decided to exit our position. In AMA's case limited funding = limited growth rate.

Jumbo Interactive's trading update revealed strong first half sales growth, however profits fell short of expectations due to higher costs (marketing, new business and one-off transaction costs). Jumbo Interactive's outlook commentary around future investment levels surprised the market and led to material broker forecast downgrades. Notwithstanding this disappointing setback in earnings estimates, the stock continues to offer a multi-year earnings growth story with considerable leverage and scale.

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TOP COMPLETED HOLDINGS* (TCH)

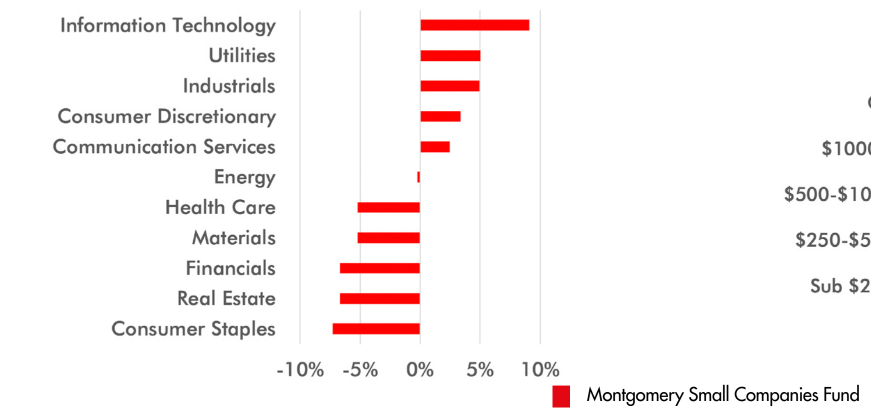
(as at 31 December 2019 showing top 5 of 45 holdings, in alphabetical order)

COMPANY NAME	TICKER	COMPANY WEBSITE
EML Payments	ASX:EML	https://www.emlpayments.com/
IDP Education	ASX:IEL	https://www.idp.com/australia/
Infigen Energy	ASX:IFN	https://www.infigenenergy.com/
NEXTDC	ASX:NXT	https://www.nextdc.com/
Seven Group Holdings	ASX:SVW	https://sevengroup.com.au/

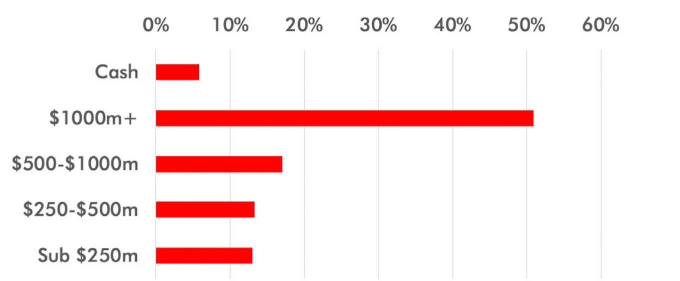
**Top Completed Holdings are businesses we own but are not actively buying or selling at the time of writing.*

Total equity weighting	94.23%
Total cash weighting	5.77%

GICS SECTOR WEIGHTS RELATIVE TO THE BENCHMARK



MARKET CAPITALISATION EXPOSURE



PLATFORMS WE ARE ON: N/A

Smartgroup warned that profits would be lower than planned due to weaker expected future economics from the sale of insurance products due to revised terms with its underwriting partner. The quantum of the financial impact was a surprise ($8 million post-tax, per annum) while the timing of the downgrade was unfortunate (25 per cent shareholder sold out in October and their well-regarded CEO announced his retirement in November). Smartgroup shares have paid a heavy price and remain in the 'sin bin' until investor confidence is restored.

Current themes and investments

The portfolio is currently positioned to benefit from three key themes which we expect to play out over the coming years. These are: 'Digital & Cloud 2.0'; 'Global Growth'; and 'Decarbonisation'; whilst taking advantage of the best cyclical opportunities that become available from time to time.

'Digital & Cloud 2.0' relates to global megatrends like the rapid rise of e-commerce and mobile, technology infrastructure and enterprise computing migrating to the cloud. These multi-year trends have important implications for small caps considering digital and cloud technology advances are effectively breaking down the barriers that large companies used to enjoy, allowing smaller companies to innovate and disrupt. Stocks the Fund currently owns that are leveraged to this theme include: NextDC (ASX:NXT), MP1 (ASX:MP1), Kogan (ASX:KGN), MoneyMe (ASX:MME), Dubber (ASX:DUB) and Bigtincan (ASX:BTH), amongst others. Having been on our watch radar over the last year, we recently participated in the IPO of MoneyMe. Founded in 2013 MoneyMe has offered more than $340 million in loans up to $25,000 to more than 80,000 customers across Australia. The company describes itself as an "agile fintech" that uses a cloud-based platform with artificial intelligence to assess credit risk, and boasts that its loan applications can be completed within five minutes. We monitored its progress prior to the IPO and we think the business has a genuinely scaleable platform, using technology and data to make advantaged credit decision making with significant automation. We see the business as nimble and positioned to take advantage of a growing marketplace of customers looking for alternatives to the big banks. MoneyMe is a platform story and we expect good growth from their existing products whilst the business has the ability to launch more to fuel future growth. A stock that passed our IPO filters.

Our 'Global Growth' exposure looks to take advantage of a select group of Australian small caps' ability to successfully export their leading products or services into large and growing overseas markets. International expansion strategies provide opportunity for a long runway for growth, but come with added execution risk that has led to plenty of failures in the past. Here we curate carefully based on product differentiation, sustainable competitive advantage, business model scalability and management capability to rapidly gain sales traction. Stocks we own which are global growers include: IDP Education (ASX:IEL); EML Payments (ASX:EML); City Chic (ASX:CCX); Nanosonics (ASX:NAN); and Premier Investments (ASX:PMV), amongst others.

Our 'Decarbonisation' theme seeks to position the portfolio to benefit from the gradual shift by consumers, government & corporates to reduce the carbon intensity of economic activity. The best and earliest expression of opportunity here appears within electricity generation taking advantage of the growth in renewable energy generation capacity, and so today the portfolio exposures include Infigen (ASX:IFN); Contact Energy (NZX:CEN); and Genesis Energy (NZX:GNE). We expect to add more 'Decarbonisation' themed exposures over time, as companies exposed to this trend develop, come to market and build their business models.

Our current cyclical exposures look to take advantage of companies that have substantially improved their competitive positioning during the downcycle, poised to disproportionately benefit from an improvement in cyclical conditions in their vertical – these are 'survivors to thrivers.' One cycle where we continue to see positive catalysts and good value is mining services; here we own Imdex (ASX:IMD); Seven Group Holdings (ASX:SVW); and NRW Holdings (ASX:NWH).

Outlook

The Fund is currently positioned with an overweight exposure to attractive growth stocks and underweight in cyclical and defensive stocks relative to its benchmark. As at the end of December, the Fund was reasonably fully invested holding 5.8 per cent in cash.

We think the growth available in the small cap market continues to look attractive, consensus data suggests the Industrials stocks in the Small Ordinaries index are expected to grow earnings at 11 per cent in FY20, which compares to expectations for the Industrials (ex-Financials) in the ASX 100 to grow at 6 per cent. We think this 'growth gap' is attractive in the low growth world we live in, and our aim is to pick the best of these small cap growers. The valuation of the small industrials relative to the bigger index is consistent with the recent past, and does not in our view reflect this 'growth gap'. See the chart below, courtesy of our friends at UBS.

Figure 11: The PE discount of the small industrials to the large industrials ex-financials remains larger than average...

Source: FactSet, UBS