Fairview Equity Partners
Quarterly Net Investment Report

30 June 2017

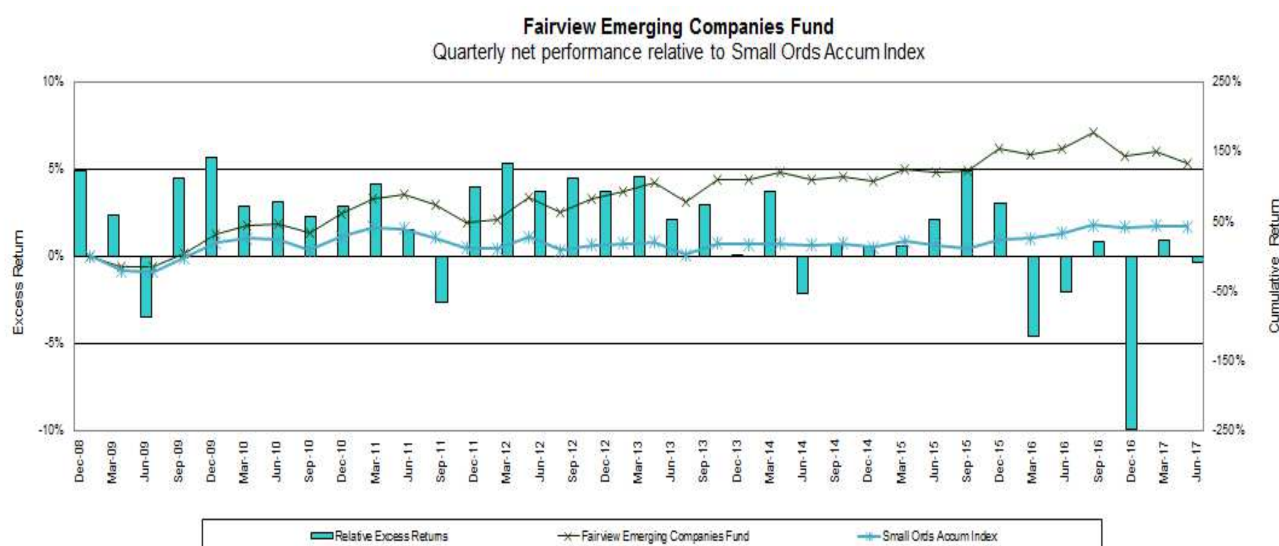
Emerging Companies Fund

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 30 June 2017	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Since inception#
Fairview Emerging Companies Fund*	3.10%	-0.66%	-2.51%	5.63%	8.70%	10.98%
S&P/ASX Small Ordinaries Accumulation Index	1.99%	-0.35%	7.03%	7.14%	5.66%	4.18%
Excess Return*	**1.11%**	**-0.31%**	**-9.54%**	**-1.51%**	**3.04%**	**6.80%**

** 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.



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Performance and Market Outlook

Global equity markets were mixed during the June quarter, with US markets continuing to move higher (S&P500 +2.6%), European markets generally flat to slightly lower (FTSE100 -0.1%, DAX +0.1%), whilst Asian markets were mixed (China Shanghai -0.9%, Hang Seng +6.9%, Nikkei 225 +6.0%). Domestically, the S&P/ASX 200 closed the quarter -1.6%.

The S&P/ASX Small Ordinaries Accumulation Index declined a modest -0.4% during the quarter, out performing the large cap segment of the market (S&P/ASX 100 -1.7%), with Small Industrials +0.1% relative to Small Resources -2.0%. The returns over the quarter somewhat belied the intra period volatility, with the June month Small Ordinaries gain of +2.0% largely offsetting weakness in May as well as a modest decline for April.

There was little in the May Federal budget to alter perceptions around the immediate outlook for the domestic economy, and indeed the consumer environment has arguably further weakened as highlighted by a number of negative earnings revisions in the space during the period. Indeed, the negative earnings revision trend has continued at a broad level, with a number of companies needing to adjust earnings expectations as they approach the close of the financial year.

Whilst the last two months retail sales data have suggested some improvement, it remains difficult to mount a compelling case around the discretionary retail space over the coming 12 months. Whilst unemployment has remained broadly consistent, low wages growth, rising energy prices, out of cycle rate rises from the banks (given low absolute rates represents a reasonable proportionate rise), and a general level of negativity out of the media, sees consumer sentiment and activity unlikely to materially improve in the shorter term. When you add into the mix the shadow of Amazon entering the domestic market (and we do highlight that offshore experiences should not be directly translated into the domestic market), we have a cautious view around the discretionary retail / consumer space and have reduced our sector exposure.

Earnings revisions trends remained negative during the June quarter across the Small Ordinaries universe, with 51 companies seeing F.17 consensus EPS estimates revised downward by more than 5% (36 small industrials, 15 small resources). This compares to just 25 with upward revisions of more than 5% (small industrials 13). This negative earnings revisions bias has been a headwind to absolute performance for the small cap segment, but also in a relative sense with small caps under performing large caps since September 2016. Over the course of the F.17 year we have seen forward estimates across the Small Industrials universe progressively wound back from initial expectations of +9% F.17 EPS growth (as at Sep-16) to +2 to 3% growth currently. By way of comparison, consensus for the S&P/ASX100 has trended from +4 to 5% to now +11 to 12% for F.17 (aided by material revisions for several of the large miners).

With the Small Industrials currently trading on approximately ~15x F.18 earnings (assuming ~12% EPS growth) we likely need to see some stabilisation in this EPS revision trend to see a major leg up in broader markets. Further to this, increasing confidence of delivery upon current expectations for F.18 EPS growth of ~12% for the Small Industrials (versus ~6% for the S&P/ASX100) should aid in reversing recent small cap under performance.

However, we again reiterate that we are not investing in 'the market', we are investing in stock specific ideas within a segment of the market containing less mature companies, companies growing market shares or benefiting from niche markets and those which have other growth options, enabling growth rates which bear a less direct relationship to the broader economy. Particularly following a period in which the smaller cap part of the market has under performed, we continue to view that this stronger earnings growth will be rewarded by the market.

It has been a hectic quarter for the Fairview team in terms of company visitation, with a number of investment conferences offering opportunities to again get in front of management teams, combined with numerous proprietary visitations around the country, and other discussions with both listed and unlisted companies. This ongoing and intensive company visitation program continues to be the key source of insight and understanding, and critical to both remaining on top of existing positions but also uncovering new opportunities.

Performance Attribution

We highlight below the largest positive and negative relative performance contributors during the June quarter 2017.

Positive Contributors		Negative Contributors	
Magellan Financial (MFG)	Overweight	Vita Group (VTG)	Overweight
Ausdrill (ASL)	Overweight	Mayne Pharma (MYX)	Overweight
BWX Ltd (BWX)	Overweight	A2 Milk Company (A2M)	Nil holding
Corporate Travel (CTD)	Overweight	Sims Metal (SMG)	Nil holding
Regis Resources (RRL)	Overweight	Nanosonics (NAN)	Overweight

Contributors

Magellan Financial Group (MFG): Magellan continued to benefit from solid fund flows and improved Fund performance. Post 30 June the company updated the market with respect to estimated performance fees for the 6 months to June, alongside its monthly update on FUM and net fund flows. In today's terms capacity around the combined strategies of the Group equates to in excess of AUD$110b versus current FUM of approximately AUD$50b, with shareholders significantly leveraged to both FUM growth and fund performance.

Ausdrill (ASL): Ausdrill rose strongly during the June quarter as sentiment toward the stock and the broader sector further improved. In terms of specific newsflow it's 50% African Underground Mining Services (AUMS) JV announced the award of a US$280m 5 year contract to supply underground mining services for the Subika Underground Mine, with an expected commencement in the June quarter.

BWX Limited (BWX): BWX benefitted earlier in the quarter from the indefinite deferral of proposed regulatory changes in China that would have required animal testing on products sold through off line channels. Whilst China sales are currently small at present it obviously represents a significant medium term opportunity. Post 30 June BWX acquired the owner of number one US natural cosmetics brand Mineral Fusion, providing a beach head for BWX into this sizeable market, as well as leveraging this brand internationally through the BWX network.

Corporate Travel (CTD): Corporate travel is one of our larger positions within the fund and rose solidly during the quarter on the back of a trading update confirming that full year underlying EBITDA is likely to be 'minimum' at the top end of previous guidance. The company also spoke positively about recent contract wins, boding well for the F.18 year.

Regis Resources (RRL): Regis was again a stronger performer for the Fund during the period, despite the gold price tracking modestly lower. During the period RRL provided its March quarterly update on production and exploration, which contained net positive news, a maiden reserve for Tooheys Well, whilst also highlighted continued progress with respect to the McPhillamy's project. Subsequent to June, Regis announced that it had progressed two water supply options for the McPhillamys Project, previously seen as a key hurdle for this project which represents strong upside for the Group.

Detractors

Vita Group (VTG): This stock continued to disappoint during the period, resulting in us exiting our position. It is now clear that in addition to the changes effective earlier this year, Telstra intends to implement a succession of further reductions to remuneration arrangements with VTG over the coming years, whilst likely changes to the network of TLS branded stores provides further uncertainty around future profitability and returns.

Mayne Pharma (MYX): MYX under performed after highlighting price deflation across its generic portfolio, this a consequence of consolidation amongst the generic buying groups within the US. Despite these price declines the gross margin on the Teva portfolio remains ahead of the guidance provided at the time of the acquisition. More positively, volumes of leading generic product Dofetilide continue to grow unimpeded whilst the company announced FDA approval and commercial launch of a generic competitor to existing acne drug Acticlate, which has US sales of around US$250m.

A2 Milk (A2M): A2M rose strongly during the period, with the company providing two positive trading updates to the market. The April update highlighted that infant formula demand had exceeded expectations during H.2, both domestically and through cross border e-commerce channels into China, and upgraded full year sales forecasts to NZ$525m. In early June A2M further updated the market that given continued strong demand and improved production levels, sales for the full year are now expected to be NZ$545m, representing growth of 54% on p.c.p.

Sims Metal (SGM): Sims re rated strongly during the June quarter. The company hosted an investor day in the US during the period, during which it provided guidance for H.2 FY17 underlying EBIT to be above H.1 levels, and reiterated its target of delivering a FY18 return on capital of at least 10% (H.1 FY17 6.8%). We retain some caution that nearer term scrap market conditions remain somewhat uncertain given recent volatility in the iron ore price, with a very strong historical correlation between the two.

Nanosonics (NAN): NAN largely reversed its prior quarter gains and underperformed during the period. There was some broker research during the period highlighting concerns that the sales cycle in the US might have lengthened more recently, with a corresponding impact upon nearer term revenue growth.

Major Stock Additions

HUB 24 Limited (HUB): We recently initiated a position in HUB. Following several years of development HUB has now built sufficient scale to reach sustainable profitability, with strong incremental returns as it continues to grow is FUA base. Relative to a very modest current market share it is currently delivering in excess of 10% of industry net flows as it adds advisers to its platform. HUB is well positioned as one of the few independent platform providers to benefit from the migration of advisors from aligned platforms.

ISelect Limited (ISU): We are attracted to the ability of ISU to leverage its existing technology and customer base into additional verticals, such as NBN/telco and insurance, having been initially very successful in the health insurance space. The business model continues to demonstrate strong value add to corporate clients seeking distribution, which is seeing ISU continue to add further choice to its platform. We also view the current economic environment is one where consumers will be increasingly seeking out ways to save money, benefitting comparison sites such as ISelect.

McMillan Shakespeare Limited (MMS): We re-entered MMS during the quarter, viewing that the market is under estimating the resilience of the remuneration services business to recent changes to the QLD government contract. We understand MMS continues to dominate share in this market. Strong customer growth, further penetration of existing customers and productivity improvements auger well for earnings growth relative to current market expectations.

Opthea (OPT): We participated in a capital raising undertaken for further clinical development post the release of very strong Phase 1/2A clinical trials. These trials highlighted significant 'letter gain' relative to existing treatments, including for heavily prior treated patients. Through its OPT-302 program, OPT is attractively positioned within this significant market for eye disease. Whilst a small position for the fund, we see the potential upside as significant.

Major Stock Disposals

Aconex (ACX): We exited our position in Aconex during the quarter. We remain attracted to the long term growth opportunity available to the company, and expect it to continue to grow its revenue base solidly. However, we are concerned that the market is under estimating the required reinvestment into sales and marketing, and product development, and therefore over estimating the nearer term margin leverage of the business.

Adairs (ADH): We exited our residual position in Adairs on the back of elevated concerns around heightened competition within an already difficult discretionary consumer spending environment. Combined with potential for store rollout to moderate to reflect the difficult current environment, this sees risk that a turnaround in fortunes is somewhat protracted.

APN Outdoor Group Ltd (APO): Following the decision to abandon the merger proposal with Ooh Media (OML), in the face of likely challenges in overcoming ACCC concerns, we consolidated our exposure in the outdoor media sector and exited APO in favour of OML.

RCG Corporation (RCG): We exited this position early in the quarter, ahead of the most recent downgrade to earnings. We had grown concerned that assumptions underlying already revised company guidance were optimistic given the difficult state of the discretionary consumer environment.

Scottish Pacific (SCO): With the share price having improved from its lows, and with SCO providing comfort that it would indeed deliver upon its revised earnings guidance for its Prospectus Year, we took the opportunity to exit.

Vita Group (VTG): We sold our position in VTG during the period. It became all too apparent that there has been a seismic shift in the approach of Telstra in dealing with its independent service providers and that there is likely to be ongoing degradation of the margins and returns available to VTG within this competitive telecommunications retail space.

Top Ten Holdings

We highlight below our top ten holdings within the portfolio, in alphabetical order, as at 30 June 2017

Bapcor Ltd	IDP Education Ltd
BWX Ltd	Magellan Financial Group
Corporate Travel Management Ltd	Mayne Pharma Group Ltd
Costa Group Holding Ltd	Regis Resources Ltd
Credit Corp Group Ltd	Webjet Ltd

Number of stock holdings as of 30 June 2017	**51**

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