

### Celeste Australian Small Companies Fund

Monthly update 28 February 2018

#### Performance Statistics (Net of fees)

	1 mth %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	10 yrs % p.a.
Celeste Aust. Small Co. Fund	+1.4	+15.3	+13.2	+5.5	+6.6
Performance (relative to Index)	+1.4	-5.5	+2.4	-0.7	+5.5
S&P/ASX Small Ords Acc Index	+0.0	+20.8	+10.8	+6.2	+1.1
S&P/ASX Small Inds Acc Index	-0.1	+17.7	+9.1	+9.0	+4.5
S&P/ASX Small Res Acc Index	+0.4	+33.5	+17.4	-3.5	-7.2

Past performance is not necessarily indicative of future returns.

The Fund rose 1.4% in February, with its benchmark, the S&P/ASX Small Ordinaries Accumulation Index flat. Since inception (May 1998) the Fund's return is 14.1% pa, net of all fees, against the Index's 6.0% pa.

#### Portfolio Commentary

**The Reject Shop** (TRS) increased 13.5% after announcing 1H18 NPAT of \$17.7m, exceeding guidance of \$16-\$17m. While this is marginally better than the \$17.5m 1H17 result, guidance for FY18 is significantly higher than pessimistic market expectations. Given the improved trend in trading performance, TRS is likely to deliver a 2H18 that is close to break-even and a meaningful improvement on the ~\$5m loss in 2H17. We believe TRS has made meaningful progress on strategic initiatives over the past few years that have been overshadowed by volatility in the merchandise performance. Direct sourcing is likely to be a \$1.5m drag on earnings in FY18 but will improve both the cost and quality of goods sourced from Asia.

**Hansen Technologies** (HSN) rose 16.6% on the back of a 36% increase in revenue and a 33% increase in net profit. Performance of Enoro, the FY17 acquired Nordic energy metering company, is exceeding expectations. The strong cash flow conversion will allow for ongoing investment in core billing systems and should deliver no net debt by year end. HSN has significant growth opportunities as it seeks to assist companies to measure, monitor and bill for their services.

WA based engineering consultancy firm, **Lycopodium** (LYL) had a strong H1 in FY18 with net profit up 36%, and FY18 guidance moving from expectations of a flat year on year performance, to a 50%+ lift. Whilst LYL note that their end market remains competitive the company continues to execute well and deliver to a global client base in the minerals sector. We remain attracted to the investment case for LYL and are confident that the company will continue to grow revenues, and profits, in the medium term.

The **WPP AUNZ** (WPP) FY17 result delivered further balance sheet deleveraging, with Net Debt / EBITDA reducing from 1.9x to 1.6x. This was driven by strong operating cash conversion (82% of EBITDA) in an anaemic environment where net sales grew 0.6%. With the industry outlook stabilising, we expect earnings growth to improve in FY18 augmented by delivery of STW merger synergies.

#### Portfolio Top 5 Holdings

Stock	% of Fund
1 CLEANAWAY WASTE MANAGEMENT	5.9
2 AMA GROUP	5.7
3 REECE	5.5
4 IMF BENTHAM	5.2
5 STEADFAST GROUP	4.6

#### Global Index Performance (Accumulation)

	1 month %	1 year %	3 years % pa
Australia – S&P/ASX All Ordinaries	+0.2	+10.9	+5.7
USA – S&P 500	-3.9	+14.8	+8.8
USA – NASDAQ Composite	-1.9	+24.8	+13.6
Europe – FTSE (UK)	-4.0	-0.4	+1.4
Europe – DAX (Germany)	-5.7	+5.0	+2.9
Asia – Nikkei (Japan)	-4.5	+15.4	+5.5
Asia – Shanghai Composite (China)	-6.4	+0.5	-0.5

#### Monthly Commentary

Equity markets were volatile in February with the major indices down by as much as 8% in the first 2 weeks of the month. Global markets rallied to halve these losses in the back half of the month. Ongoing strong US jobs data and rising hourly wage rates caused concerns around the rate of inflation. The yield on US 10 year bonds rose 20bp in February to a high of 2.9% on the back of a 30bp increase in January. Since the beginning of the year the 10 year bond rate has backed up by near on 50bp and reflects fixed income markets factoring in higher US inflation over the medium term. Stocks were sold off on tempered earnings growth expectations, not helped by already stretched valuations. The US congress passed the Tax Cut & Jobs Act legislation placing in train \$1.5 trillion in unfunded tax reduction over the next 10 years. These cuts together with Federal Government spending on healthcare and social security has seen the Congressional Budget Office review the US Federal forward deficit estimates post 2019 to over \$1 trillion per annum. The anticipated 0.7-1.0% GDP growth boost from the cuts has caused further upward pressure on bond yields as markets anticipate ongoing Federal Reserve interest rate tightening.

The EU recorded growth of 2.7% in 2017, the fastest growth in 10 years. The powerhouse economies of Germany and France recorded 2.2% and 2.5% respectively, their strongest since 2010. Industrial production across member states rose 5.2% with capital and consumer durable goods the growth standouts. Europe continues to see strengthening corporate profitability, rising wages and low inflation. Focus remains on the UK EU transition arrangements and any political uncertainty in Italy post the March general election.

China recorded GDP growth of 6.9% for 2017, up on 6.7% in 2016. This was the first acceleration in growth since 2011. Retail sales were 10.2% maintaining a 14 year run of double digit growth rates. Smart phone shipments slipped 4% in 2017 to 459m units. After several years of very strong growth the handset market appears to have plateaued at higher penetration levels with growth now driven by new model releases and a standard replacement cycle.

In Australia, Q4 CPI was +0.6%, +1.9% year on year and below the 2%-3% RBA target for the 5<sup>th</sup> quarter in a row. While employment rose 35,000 in December, the unemployment rate was up slightly to 5.5% with the participation rate at 65.7%. While February reporting season produced some individual stock volatility, the period ended quite balanced with around 34% of companies beating expectations and 29% missing expectations.

We believe investors should retain a cautious stance in 2018 as lofty valuations and yield curve adjustment weigh on investors' minds. At Celeste we continue to focus on our investment process, and acknowledge that periods of equity market volatility provide attractive opportunities to add to our portfolio positions.

# CELESTE

Funds Management

## Fund at a Glance

### Fund Information

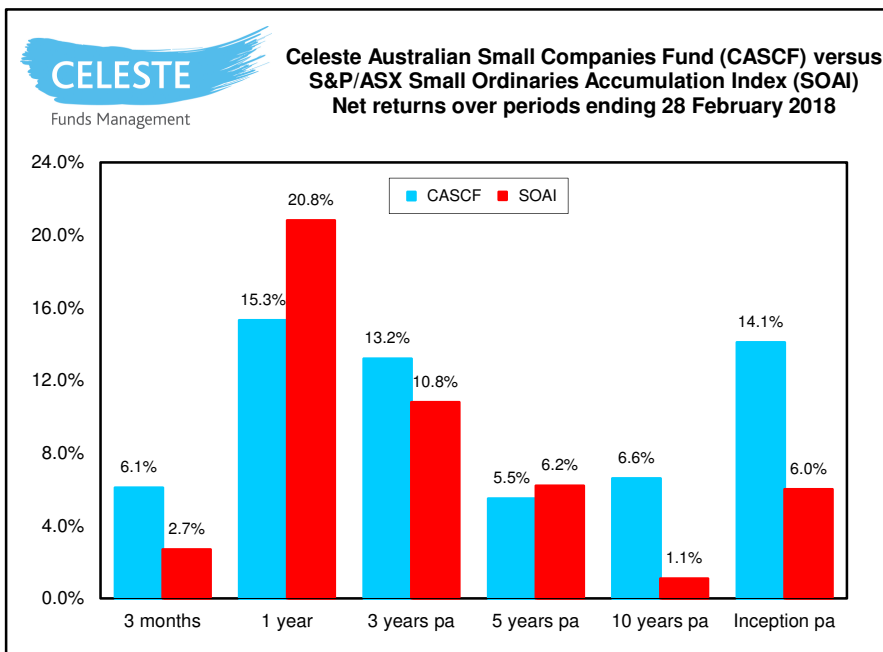
<b>Primary Investments</b>	Shares in listed Australian smaller companies
<b>Investment objective</b>	Small Ordinaries Accumulation Index + 5% p.a. over rolling 3 years
<b>Unit price (redemption) as at 28.02.2018</b>	\$3.6200
<b>Unit price (application) as at 28.02.2018</b>	\$3.6417
<b>Fund Size as at 28.02.2018</b>	\$62m
<b>Minimum investment</b>	\$25,000
<b>Minimum additional investment</b>	\$1,000
<b>Minimum balance</b>	\$15,000
<b>Redemption will generally be available in</b>	7 days
<b>Distributions</b>	30 June and 31 December
<b>Entry fee*</b>	0%
<b>Exit fee*</b>	0%
<b>Buy/Sell differential*</b>	0.30%
<b>Management fee*</b>	1.20% p.a.
<b>Performance fee**</b>	20% of return above benchmark
<b>OGFM***</b>	1.20% p.a.

\* These fees and charges apply for the duration of the Product Disclosure Statement (PDS) and are inclusive of the Goods and Services Tax.

\*\* A fee charged on performance of the investments of the Fund above the nominated benchmark performance. The benchmark is the S&P/ASX Small Ordinaries Accumulation Index.

\*\*\* The Ongoing Fee Measure (OGFM) is the total amount of the ongoing Manager and Custodian Fees and aggregate Fund expenses in a Financial Year (but excluding the performance fee), divided by the average Net Asset Value of the Fund for the Financial Year expressed as a percentage. Transactional costs, such as bank charges, brokerage and stamp duties are not included in the ratio. The OGFM for the Fund will not exceed 1.20% p.a. for the duration of the PDS.

### Fund Returns



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### Distribution History

Total distribution year ended	Cents Per Unit	Annual Yield %*
June 08	38.82	9.9
June 09	10.06	4.2
June 10	18.70	8.9
June 11	11.89	4.6
June 12	4.07	1.4
June 13	15.81	5.5
June 14	14.56	5.4
June 15	12.67	4.5
June 16	9.95	4.0
June 17	6.87	2.6

\* CPU / unit price at beginning of period

This report is intended to provide only general securities advice. Celeste Funds Management Limited does not purport to make any recommendation that any securities transaction is appropriate to your particular investment objectives, financial situation or particular needs. Prior to making any investment decision, you should assess, or seek advice from your adviser, on whether any relevant part of this report is appropriate to your individual circumstances. Celeste Funds Management Limited believes that the information contained in this report has been obtained from sources that are accurate, but it has not checked or verified that information. Except to the extent that liability cannot be excluded, Celeste Funds Management Limited accepts no liability for any losses or damage caused by any error in or omission from this report

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