

### Celeste Australian Small Companies Fund

Monthly update 31 August 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	+2.4	+12.5	+15.9	+6.6	+7.9
Performance (relative to Index)	-0.1	-9.8	-1.0	-2.6	+4.8
S&P/ASX Small Ords Acc Index	+2.5	+22.3	+16.9	+9.2	+3.1
S&P/ASX Small Inds Acc Index	+4.4	+21.1	+14.6	+10.7	+6.7
S&P/ASX Small Res Acc Index	-4.1	+26.3	+27.8	+2.7	-5.7

Past performance is not necessarily indicative of future returns.

The Fund rose 2.4% in August, with its benchmark, the S&P/ASX Small Ordinaries Accumulation Index increasing by 2.5%. Since inception (May 1998) the Fund's return is 13.8% pa, net of all fees, against the Index's 6.2% pa.

#### Portfolio Commentary

Retailers **Baby Bunting** (BBN) +47.9% and **Specialty Fashion Group** (SFH) +37.7% were strong August performers. BBN's result was as expected, however the market responded positively to the strong outlook of like for like (LFL) sales growth of 9.8% so far in 1H19. We have been steadily building a position in BBN since the 1H18 result in February with the view that the market was capitalising an unusually difficult year. Post the closure of Baby Bounce and Babies R Us, BBN is now by far the largest baby goods retailer in the Australian market. We expect BBN will see increased sales from market share gains and store roll-outs which should translate into growing margins.

**Breville Group** (BRG) increased 26.4% after reporting a strong FY18 result with sales growth of 13.4% in constant currency terms. Increased investments saw EBIT growth of only 10%. Most of these costs are increased R&D, marketing spend and expansion into new countries which incurred an initial cost in the start-up phase. We believe BRG is getting closer to the point at which some of these investments will start to deliver incremental returns and ultimately, over the medium term, positive operating leverage.

**HT&E** (HT1) rose 19.7% for the month. Despite the ATO seeking to apply a significant amount of penalties against HT&E in an outstanding NZ tax matter, the share price rallied on a combination of: 1) a solid 1H18 result, which saw both major operating divisions, ARN and Adshel, perform ahead of expectations; and 2) the ACCC's decision not to oppose the sale of Adshel to oOH!media. Post the sale of Adshel, we remain attracted to the cash generative nature of HT&E's radio division, ARN, which we believe is undervalued at the current share price.

**RCR Tomlinson** (RCR) & **Gascoyne Resources** (GCY) declined by 47.2% & 31.5% respectively in August. GCY raised money to fund slower than anticipated ramp up at their newly commissioned gold mine. RCR raised money to fund working capital and also cover a one-off solar contract impairment. We think that both issues were substantially one off in nature and while the two stocks are only small weights in the portfolio we subscribed for our entitlement.

#### Portfolio Top 5 Holdings

Stock	% of Fund
1 REECE	6.1
2 AMA GROUP	5.1
3 IMF BENTHAM	4.9
4 WPP AUNZ	4.8
5 INVOCARE	4.3

#### Global Index Performance (Accumulation)

	1 month %	1 year %	3 years % pa
Australia – S&P/ASX All Ordinaries	+1.7	+16.0	+11.8
USA – S&P 500	+3.0	+17.4	+13.7
USA – NASDAQ Composite	+5.7	+26.1	+19.3
Europe – FTSE (UK)	-4.1	0.0	+6.0
Europe – DAX (Germany)	-3.4	+2.6	+6.4
Asia – Nikkei (Japan)	+1.4	+16.4	+6.6
Asia – Shanghai Composite (China)	-5.3	-18.9	-5.3

#### Monthly Commentary

There was much action in the market over the month of August. The market opened and closed 23 times, trade war rhetoric raged between China and the US, the sitting Australian Government committed the almost annual process of regicide and the country swore in its 30<sup>th</sup> Prime Minister. August was also FY18 reporting season for the vast bulk of Australian listed stocks. Reporting season is traditionally a period where the market hands you the report card on your portfolio and lets you know what it thinks of the stocks you own, their current performance, their growth prospects and the future cash flow streams they are likely to generate.

The Small Ordinaries Accumulation Index was strong, rising 2.5%; the Celeste portfolio almost mirrored this move, up +2.4%. Whilst a performance that was in line with such a strong market was pleasing, we were still slightly disappointed. We had broadly seen performance emerge from the portfolio as stocks we own had reported stronger than expected profit and cash flow generation. Most of the logic behind the positions rang true in reported financial numbers and outlook statements. We did see one drag that was unexpected in the RCR Tomlinson contract impairment and subsequent capital raising. Whilst we had significantly de-weighted our position above \$4/share it was frustrating to be caught by what looks like a contracting error and poor risk management oversight. But by and large, the portfolio did what a diversified portfolio should do and delivered robust and balanced performance.

Relative performance was however impacted by the strong move in some of the stocks that we didn't own. In particular, two IT stocks cost the fund around 80bp of relative performance. WiseTech Global (WTC) and Altium (ALU) are stocks that we have analysed in the context of our investment process. We have looked at the business model, Management & Board, reported accounts and ESG performance. We valued the stocks in multiple ways to assess if there was significant upside to justify a position in the portfolio. Alas, the valuation was always tough to make stack up. In August both reported FY18 earnings and their stock prices rose 40% and 37% respectfully. In the short term we have been wrong.

Eventually all stocks, even tech stocks have to operate and sell their product into a total addressable market (TAM). Aconex, recently acquired by Oracle for A\$1.5b operated in an estimated TAM of \$6b, so a multiple of 0.25x. Based on the recent share prices, Altium capitalised at \$3.6b with a TAM of \$1b, trades on 3.6x TAM. Similarly WTC capitalised at \$6.5b with a TAM of \$5.2b, trades on 1.25x TAM. Whilst it is possible that markets grow over time, the current valuations imply that both stocks are worth more than the total revenues of their entire addressable markets. We thought the risk/reward skew for the stocks was to the downside before the share price moves. We think it is even more so now. We continue to follow our investment process seeking to find stocks that have an upside skew to valuation with less lofty implied growth rates.

# CELESTE

Funds Management

## Fund at a Glance

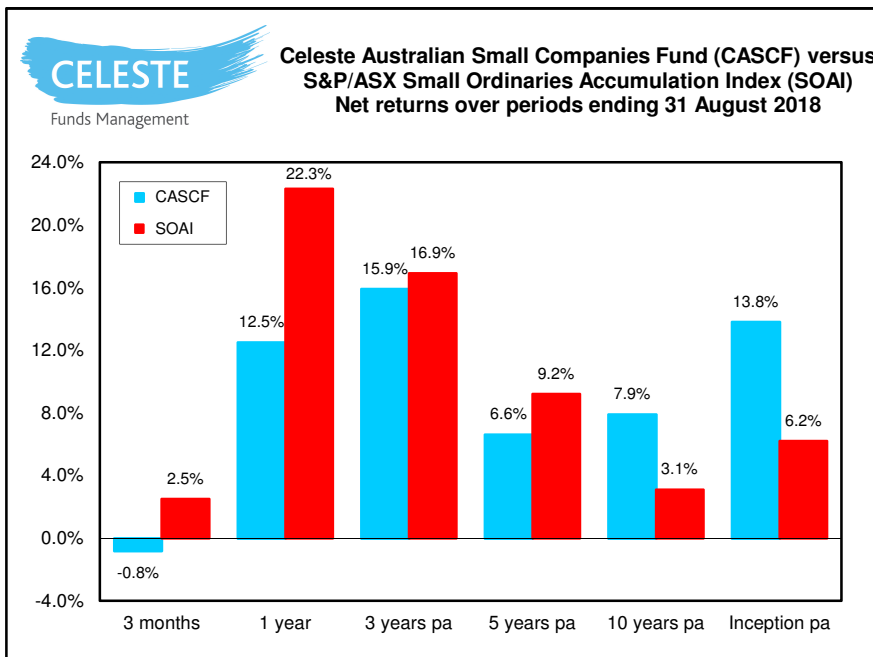
### Fund Information

<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 31.08.2018</b>	\$3.6517
<b>Unit price (application) as at 31.08.2018</b>	\$3.6736
<b>Fund Size as at 31.08.2018</b>	\$65m
<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

\* 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.

### Fund Returns



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### Distribution History

Total distribution year ended	Cents Per Unit	Annual Yield %*
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
June 18	7.01	2.2

\* CPU / unit price at beginning of period

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The issuer of units in Celeste Australian Small Companies Fund (ARSN: 093 539 416) is the Fund's responsible entity The Trust Company (RE Services) Limited ABN 45 003 278 831 (AFSL 235150). You should read the Product Disclosure Statement (PDS) before deciding to acquire the product. Copies of the PDS are available from Celeste Funds Management Limited (02) 9216 1800 or at [www.celestefunds.com.au](http://www.celestefunds.com.au).

Before making any decision to make or hold any investment in the Fund you should consider the PDS in full. The information provided does not consider your investment objectives, financial situation or particular needs. You should consider your own investment objectives, financial situation and particular needs before acting upon any information provided and consider seeking advice from a financial advisor if necessary.

You should not base an investment decision simply on past performance. Past performance is not an indicator of future performance. Returns are not guaranteed and so the value of an investment may rise or fall.

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