Ophir Asset Management
Level 2, 139 Macquarie Street
SYDNEY NSW 2000

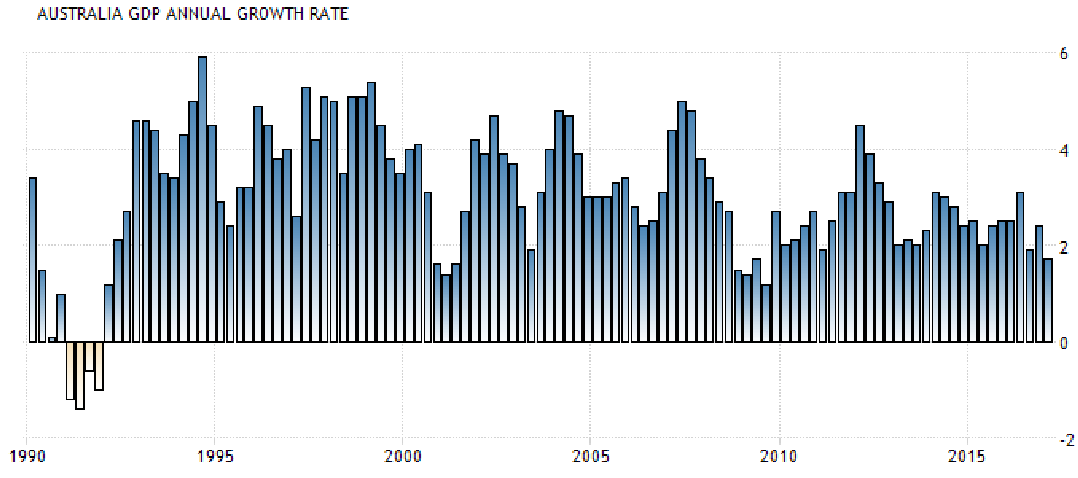
Dear Fellow Investors,

Welcome to the **May 2017** Ophir Letter to Investors – thank you for investing alongside us for the long term.

Month in Review

In a month where a number of the largest and most liquid developed world share markets again eclipsed all-time highs, Australian superannuants could be forgiven for some head-scratching on review of their May monthly performance reports. The ASX 200 instead delivered its worst monthly performance since January 2016, falling -3.4% for the month following an aggressive sell-off across the Australian banking sector in response to the Federal Governments' proposed Bank Levy.

While the Australian economy looks set to shortly eclipse the previous record held by the Netherlands of 103 successive quarters without recession, the 'Lucky Country' this month appeared to run short of some of its recent good fortune. While the banking sector caused the majority of the damage across large cap Australia (the sector falling -9.8% for the month), continued weakness across a number of the discretionary retail names and a -17.1% fall in the iron ore price collectively weighed on investor sentiment across the board.



The Australian economy continues to paint a mixed picture, with retail sales, consumer confidence, home construction and wage growth data all underwhelming through the month. While global growth data has remained broadly supportive, the 'great rotation' of capital away from growth-type businesses into more cyclical names through the second half of 2016 has begun to look somewhat premature.

Global markets, on the other hand have continued to climb to new heights in a now Herculean ability to circumnavigate a wide variety of extraneous shocks. The S&P 500, Dow Jones, Nasdaq, FTSE 100 and MSCI World all reached or surpassed their previous all-time highs – an effort all the more impressive given the impact from global terror campaigns, China's sovereign credit downgrade and calls for the impeachment of Donald Trump. In contrast to the Australian experience of a gravitation toward value-type businesses, it has been the growth names that have led markets higher, driven predominantly by the US Tech 5 (Apple, Amazon, Alphabet, Facebook and Microsoft). A recent observation from Bank of America noted the MSCI USA Growth Index is now outperforming global value stocks at a ratio not seen since the tech bubble of 2000.

Source: BofA / Merrill Lynch Global Investment Strategy

Looking further down the market cap curve, **small and mid-cap growth companies have continued in their recent trend of outperformance** versus their larger cap counterparts. The ASX Small Ordinaries outperformed the ASX 20 Leaders by 3.66%, while the MidCap 50 Index was the best performing index for the month, adding +0.7%. While a couple of months by no means marks a long term trend, this certainly marks a reversal of recent fortunes. With a banking sector looking under renewed earnings pressure and cyclical businesses yet to see any meaningful uptick from the economic cycle, companies delivering above market growth will continue to look an attractive destination for growth capital from here.

Small Ords Performance vs ASX 20 Leaders – Last 24 Months:

We mentioned in last month's letter the 'larger small caps' have provided the initial leadership of the recovery and the trend continued again this month, although it was pleasing to see a number of the smaller caps now also beginning to deliver. The ex-100 Ophir Opportunities Fund, for example, returned +2.5% this month, following a number of pleasing updates from smaller cap holdings that subsequently attracted renewed market support. There is still some ground to make up – on a rolling 12-month basis, the Small Industrials Index has added +1.6% in value, comfortably underperforming large cap industrials by some -7.4%.

That, however, looks the opportunity in our view and we continue to remain excited about the current portfolio's. A number of these businesses saw their share prices contract at a period of time when their operational performance was actually improving and this has provided an opportunity for investors that were able to withstand the short term pricing dislocations. In our Strategy Notes this month we'll have a look at couple of examples.

With inflation expectations continuing to remain low, the investment thesis for small and mid-cap growth businesses that deliver earnings growth independent of the cycle will continue to look favourable. We are, however, cognisant of the fact that the sector remains very much a stock pickers market - unlike an earnings recovery from a cyclical low-point, the current environment is obviously later cycle, meaning this isn't a 'rising tide lifting all boats' type scenario. While there remains excellent opportunities to deploy capital into businesses that have the ability to meaningfully grow earnings over the next 3-5 years, the broadly softer economic environment also means there will be increasingly more challenges for management teams to face. Investors will need to continue a rigorous assessment of their companies and the environments in which they operate – the 30 downgrades recorded in small caps just this month alone certainly has proved testament to that fact.

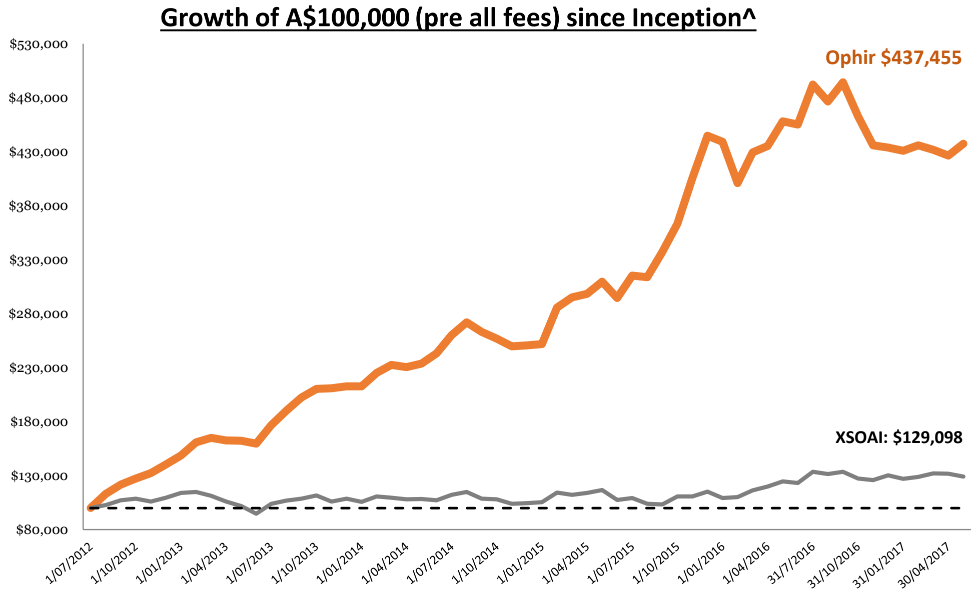
DATE	CODE	STOCK	NOTES
31-May	JIN	Jumbo Interactive	FY17 continuing operations NPAT of $7.1m vs $7.3m pcp; lower level of large jackpot activity in Australia (38% by number, 15% by Div 1 value)
30-May	PSQ	Pacific Smiles Group	FY17 EBITDA revised down to $20.4-21m (prev: $21.7-23.2m). April/May trading is soft, LFL patient fee growth 3.8% vs 5%+ expected.
29-May	GFY	Godfreys Limited	FY17 EBITDA to be at the bottom of the $14-15m range vs $17.5m pcp. Declining LFLs in the second half.
26-May	AHX	Apiam Animal Health	FY17 revenue in line but EBITDA of $7.2-8.5m vs consensus at $10m, increased investment in systems/resources, GM down due to mix
26-May	SHV	Select Harvests	Seasonal conditions have impacted crop volumes more than previously forecast and will have a 'material impact on full year earnings'
26-May	RCT	Reef Casino Trust	Second downgrade; rentals paid to the Trust are 17% below last year, "complete absence of flights from China into Cairns" impacted trading
25-May	AHG	Automotive Holdings Group	FY17 NOPAT of $87-89m vs $97m pcp. WA vehicle sales weak, Refrigerated Logistics turnaround behind schedule.
25-May	QIP	QANTM Intellectual Property	Will miss Prospectus; FY17 EBITDA of $22-24m vs $27.5m guidance. Legal, advisory and patent prosecution revenue all behind expectations.
24-May	APE	AP Eagers	1H17 NPAT will be down 7-9% on pcp; national vehicle sales are off 2.8% YTD with QLD and WA down 6%+
24-May	SIG	Sigma Healthcare	FY17 EBIT will be down 0-5% on pcp; dispute with Chemist Warehouse re purchasing ($5-10m EBIT impact) and subdued start to the year
22-May	SRF	SurfStitch	FY17 EBITDA loss of $10.5-11.5m vs $5-6.5m guidance; tough retail environment for apparel/footwear especially in the UK/Surfdome
22-May	MRG	Murray River Organics	FY17 EBITDA of $6.5-7.5m vs $15.9m Prospectus due to cold/wet weather affecting the Sunraysia crop volumes
19-May	RDF	Redflex	FY17 EBITDA of $10-12m vs 26m pcp and 7m in 1H17 implying conditions have worsened in 2H17
19-May	TCN	Techniche	FY17 NOPAT of $0.9m vs $1.2-1.4m guidance. Revenue from its JV business has been deferred into FY18.
19-May	PGR	PAS Group	FY17 EBITDA of $18.5-20m vs $24m pcp; retail sales for Black Pepper and Review impacted by highly elevated promotional environment
19-May	PNV	Polynovo Limited	FY17 NPAT loss of $5-5.5m vs $3m loss pcp; sales into the US occurring later than anticipated
18-May	ACG	AtCor Medical Holdings	FY17 revenue of $4.3-5m vs $6.2m guidance. Slower than anticipated uptake by clinicians, absence of major new hypertension drug trials.
16-May	KSL	Kina Securities	K10m impact in 1H17 from delays in establishing USD correspondent banking arrangements which will see forex income lower
15-May	FFT	Future Fibre Technologies	Will report FY17 EBITDA loss of $6-9m, delayed project starts in Americas & Europe, slower than expected increase in utilities sector demand
15-May	ORL	Oroton Group	FY17 EBITDA of $2-3m vs $13m pcp; Q3 is a key sales period at Oroton and was -11% on pcp, GAP lost $3.5m more at EBITDA line than pcp
12-May	SWL	Seymour White	FY17 NPAT will be flat on pcp and breakeven, Cyclone Debbie impact, postponement of contract awards, investment costs, loss making project
11-May	VTG	Vita Group	FY17 EBITDA of $63-66m vs consensus at $69m; flagged slower than expected 2H given remuneration reductions from Telstra
11-May	WLL	Wellcom Group	FY17 EBIT will be down 5% on pcp; subdued market conditions due to weak retail market, reductions in ad/marketing spend generally
11-May	CLH	Collection House	$2m in write offs associated with redundant capitalised computer software spend; auditors assessing the remaining carrying value at present
10-May	SLM	Salmat	Soft downgrade post cap raising. FY17 EBITDA of $20-22m vs 1H $13.4m and FY16 $19.6m. Lower catalogue/digital volumes from clients.
4-May	MRG	Murray River Organics	Will miss Prospectus revenue by $10m, half due to harvest delays from weather anomalies, half due to refurb delays at Sunraysia/lower sales
3-May	PGH	Pact Group Holdings	FY17 organic NPAT will be flat on pcp, demand remains subdued, April trading particularly weak in rigid packaging
3-May	ADA	Adacel	FY17 NPAT of $7-7.5m vs $9.2m pcp. Contract delays resulting in Systems segment revenue being down 35-40% on pcp.
2-May	FXL	FlexiGroup	FY17 Cash NPAT of $90-93m vs $90-97m prior guidance, $2m Ireland investment, Certegy behind expectations
1-May	RCG	RCG Corporation	EBITDA of $74-80m vs $85-88m provided in Feb, Accent/Hype LFLs below mgmt expectations, wholesale -5% YTD.

Source: Cannacord Genuity

If one were to pinpoint any specific trend in small caps for the 2017 financial year, it would be that the bulk of outperformance has come from avoiding the downgrades – **this has been a year more about what you don't own, rather than what you do**. On Macquarie Securities numbers, announced downgrades in the small cap space for FY17 now stands at 102.

We've been fortunate this year to have been able to avoid the bulk of these, with 6 total downgrades experienced across the Ophir portfolio's for the financial year to date. This is a metric we follow closely and we continue to remain confident that our investment process continues to deliver us a reasonable surety around the earnings outlook for our portfolio companies. While small caps as a sector has been a volatile ride of late, we remain very excited about the prospects for our current investments and look forward to keeping our investors updated on their progress.

The Ophir Opportunities Fund



The **Ophir Opportunities Fund** returned +2.6% for the month, outperforming the benchmark by 4.6%. Since inception, the Fund has returned +337.5%, outperforming the benchmark by +308.4%.

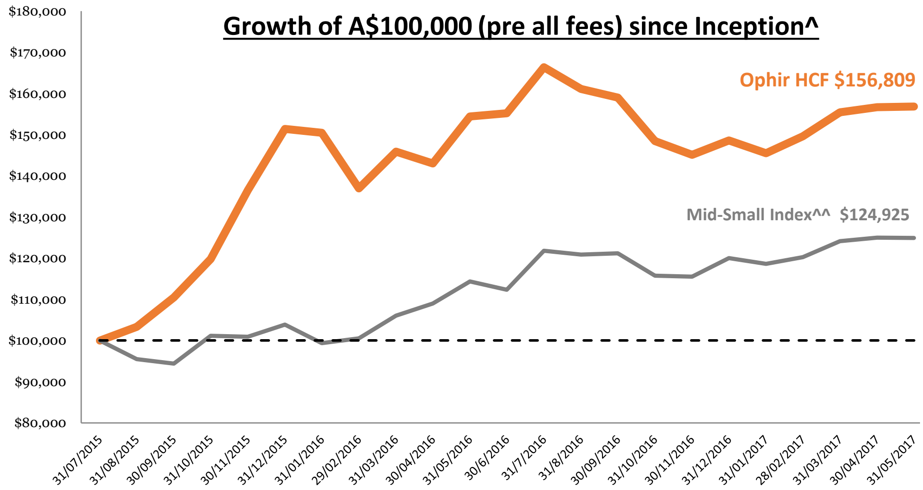
The May 2017 Unit Price is **$2.3784**

	1 Month	6 Months	1 Year	Inception (p.a)	Since Inception
Ophir Opportunities Fund (Gross)	2.6%	0.4%	-4.5%	36.5%	337.5%
Benchmark*	-2.0%	2.7%	3.6%	5.5%	29.1%
Value Added	4.6%	-2.4%	-8.0%	30.9%	308.4%

* S&P/ASX Small Ordinaries Accumulation Index (XSOAI)

Key contributors to the Opportunities Fund performance this month included **Netcomm Wireless (NTC), RCR Tomlinson (RCR)** and **Melbourne IT (MLB).** Key detractors included **Sundance Energy (SEA), Mount Gibson Iron (MGX)** and **Monash IVF (MVF).**

The Ophir High Conviction Fund



The **Ophir High Conviction Fund** returned 0.1% for the month, outperforming the benchmark by 0.7%. Since inception, the Fund has returned +56.8%, outperforming the benchmark by +32.6%.

The May 2017 Unit Price is **$1.4127**

	1 Month	6 Months	1 Year	Inception (p.a)	Since Inception
Ophir High Conviction Fund (Gross)	0.1%	8.0%	1.6%	29.4%	56.8%
Benchmark*	-0.6%	7.5%	8.7%	13.2%	24.2%
Value Added	0.7%	1.5%	-7.1%	16.2%	32.6%

* 50% S&P/ASX Small Ordinaries Accumulation Index (XSOAI), 50% S&P/ASX Midcap 50 Accumulation Index (XMDAI)

Key contributors to the High Conviction Fund performance this month included **Xero Ltd (XRO), Webjet (WEB)** and **Magellan Financial (MFG).** Key detractors included **Mineral Resources (MIN), SG Fleet (SGF)** and **CBL Corporation (CBL).**