SIGMA FUNDS MANAGEMENT®

Sigma Emerging Companies Fund

Monthly update as at 31 January 2017

	Month %	Quarter %	FYTD %	1 year %	3 years % p.a	Since Inception^ % p.a.
Sigma Emerging Companies Fund*	(1.6)	4.6	18.1	28.8	5.6	6.4
S&P/ASX Small Ord. Accumulation Index	(2.4)	(0.1)	3.3	16.4	6.4	3.6
Value added (detracted)	**0.8**	**4.7**	**14.8**	**12.4**	**(0.8)**	**2.8**

**Gross Performance. Past performance is not a reliable indicator of future performance. ^Since Inception: 10th October 2012*

Key points

- Small Cap "value opportunity" clearly evident as traditional metrics remain compelling
- Cyclical sectors expected to benefit as earnings bottom and risk appetite increases
- Fund positioned for cyclical re-rating and away from lower return defensives

Individual stock performance of note

The Sigma Emerging Companies Fund ("Fund") *outperformed* a falling small cap market in January. Value small cap stocks continue to regain favour over the last 7 months, reinforced by better than expected results during August's reporting. Stock selection rather than any key thematic was the key driver of alpha during the month.

Fund performance was impacted positively by:

- Pacific Energy (+19%) was stronger on the back of a contract win with Westgold resources for a new 5MW power plant;
- Sandfire Resources (+17%) was higher following a strong quarterly production report which highlight costs were well contained;
- Infigen Energy (+8%) rallied higher on the back of strong power prices following the heatwave conditions in South Australia and New South Wales, with the company upgrading profit guidance post month end;
- Peet Limited (+7%) pushed higher on little news;
- Contractor, RCR (+8%) was stronger following further contract wins, taking the order book to a record $1.1bn;
- The absence of Aconex (-40%) contributed in a relative sense following a disappointing sales update;

Fund performance was impacted negatively by:

- Chocolate and confectionary provider, Yowie (-20%) fell post a relatively sedate sales update which was less than market expectations;
- Village Roadshow (-18%) gave a disappointing theme park trading update following the fatalities at Dreamworld. This was below our expectations with both the Gold Coast and Sydney theme parks underperforming. Given the leveraged balance sheet the position was exited during the month;
- 3P Learning was weaker (-17%) on concerns over its UK based revenues post the Brexit vote and following on from Aconex comments regarding a slowdown in revenue growth;
- Sims Metal Management (-12%) was weaker despite an earnings upgrade, with the market focussed on the uncertainty around scrap metal markets in the second half of FY17;
- The absence of largest small cap by index weight, OZ Minerals (+14%), detracted in a relative sense;

Portfolio Changes

Stocks Added

Infigen Energy (IFN) is the owner and developer of Australian wind farm assets for renewable power generation. It is largely exposed to the South Australian and New South wales energy markets. Sigma believes that the company has benefitted from strong energy prices in South Australia during the December 2016 half, with hot weather and network outages

exacerbating the issue. The higher energy prices are expected to continue given the lack of investment in generation assets, either fossil fuel or renewables in Australia. Combined with high prices for LGCs during the period this suggests that the $130m EBITDA that the company has guided to is at risk of being upgraded. The company also has a pipeline of 1100 MW of wind projects that it could develop to help meet the 6000 MW of renewable energy projects required to meet the RET target by 2020. We currently value this pipeline at nil value. The company is also de-gearing rapidly given the strong FCF being generated at current prices which should lead to a potential refinancing event that will help reduce the cost of debt from 8%pa towards 4%pa. Stock is trading at a discount to our valuation.

Stocks Sold

Village Roadshow (VRL) was sold following a trading update that suggest its Gold Coast theme parks have not been able to capture market share on the back of the unfortunate events at its rival Dreamworld. This suggests that consumer sentiment has affected the whole industry rather than individual operators. Even the Sydney Wet and Wild posted its fourth straight disappointing performance since opening. This leaves the film exhibition business as the only division with earnings growth. Given the decline in earnings and the significant capex that the business has committed to, it puts its balance sheet under pressure with a capital raising likely.

Top 5 active positions

Stock	Active weight %
Overweights:	
Tox Free Solutions	4.7
IMF Australia	3.8
APN News & Media	3.4
Ingenia Communities Group	2.8
McMillan Shakespeare	2.3
Underweight:	
OZ Minerals	1.8
Evolution Mining	1.5
Macquarie Atlas Roads	1.5
WorleyParsons	1.5
Metcash	1.4

Note: Active weights refer to positions above benchmark only.

Asset allocation

Sector	Active weight %
Industrials	8.3
Utilities	4.5
Consumer Discretionary	1.9
Information Technology	1.1
Telecommunication Services	(0.7)
Financial-x-Real Estate	(0.7)
Healthcare	(2.4)
Financials-A-REIT	(3.5)
Energy	(5.0)
Consumer Staples	(6.1)
Materials	(10.5)
Cash & Other	13.1

Note: Active weights refer to positions above or below benchmark.

Strategy summary

Sigma Emerging Companies is a 'value based' investment approach that specifically focuses on avoiding "value traps", leading to:

- Superior performance potential,
- Lower risk, and
- Increased consistency.

What makes Emerging Companies unique?

- Value-biased portfolio of 40 to 60 stocks
- High conviction small cap positions: we back our ideas
- Focused on downside protection through *Sigma's Value: Risk: Adjust* investment approach

What makes Sigma's Emerging Companies Fund different?

Most investment management firms comprise distinct Large Cap and Small Cap teams with separate incentive structures and competing interests. In contrast, Sigma's Large Cap and Small Cap teams are equal partners and completely aligned to the success of two *interlinked* strategies: Sigma Select and Emerging Companies. As the best Small Cap ideas are also high conviction holdings in Select, the whole investment team is focused on delivering outperformance.

About Sigma Funds Management

- Value-style Australian equities manager which aims to outperform without the downside of "value traps" through an investment approach called *Value: Risk Adjust*
- Sigma is an investment partnership, 51% owned by Azimut, Italy's leading independent asset manager with the Executive founders owning the remaining 49%

Contact

For more information contact Pinnacle Investment Management, the Fund's distributor, on 1300 010 311.

See also www.sigmafunds.com.au