SIGMA FUNDS MANAGEMENT®

Sigma Emerging Companies Fund

Monthly update as at 30 June 2016

	Month %	Quarter %	FYTD %	1 year %	3 years % p.a	Since Inception^ % p.a.
Sigma Emerging Companies Fund*	(0.8)	2.8	3.1	3.1	6.4	2.6
S&P/ASX Small Ord. Accumulation Index	(1.3)	5.9	14.4	14.4	9.1	3.5
Value added (detracted)	**0.5**	**(3.1)**	**(11.3)**	**(11.3)**	**(2.7)**	**(0.9)**

**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 Fund *outperformed* a falling small cap market in June with decent underlying contributions across a range of stocks being held back by the downgrade to F17 earnings by ERM Power. Prior to the Brexit event, the market was dominated by more stock specific news rather than any style thematic, however gold stocks and defensives were back in the spotlight after Britain's shock decision to exit the EU towards the end of the month.

Fund performance was impacted positively by:

- Thermal coal producer, Whitehaven Coal (+27%) and Gold and Nickel miner, Independence Group (+14%) on firmer commodity prices;
- Mining contractor, MACA (+19%) was stronger post announcing a contract win, while fast fashion jewellery retailer, Lovisa Holdings (+12%) was firmer after the company reaffirmed FY16 guidance.
- Electronic and Metal detection product provider, Codan (+16%) was stronger following investor site visits during the month;
- IMF Bentham (+12%) continued to recover as the news flow continues to improve with new cases being pursued and case settlements highlighting the profitability of the business, reversing recent negative sentiment towards the stock;
- Pacific Energy (+17%) rallied following a management roadshow and earnings update, while Ingenia Communities (+9%) was stronger following speculation of corporate activity within the retirement sector, with Gateway Lifestyle supposedly an acquirer.

Fund performance was impacted negatively by:

- The downgrade from ERM Power (-46%) due to margin pressure from recently won contracts in the Australian business. The positive surprise was the substantially improved profitability of the new US operations, highlighting the ability to export intellectual property. The position was reduced to a 1% overweight given the margin pressure expected in the Australian business through to FY18, and the belief management should have been more forthcoming on the existing in-force energy book in previous announcements. Consequently the management score has been downgraded. Nevertheless, a smaller position is warranted given the valuation upside and the balance sheet strength;
- Nine Entertainment (-14%) was weaker on little news, while Ardent (-14%) drifted lower on concerns that comparable store sales in the Main Event business in the United States might have been weak in the March quarter;
- The absence of Mayne Pharma Group (+26%) impacted negatively following the acquisition of a portfolio of generic drugs from Teva Pharmaceutical Industries.
- Being underweight gold stocks also impacted with, Northern Star (+15%) and Evolution Mining (+15%) rallying post the gold price spike driven by the political uncertainty of Brexit.

Portfolio Changes

Stocks Added

3P Learning (3PL) has a strong Australian franchise in online learning built around Mathletics. Management have identified a number of steps to revitalise the brand and positioning of Mathletics. It also has a 40% interest in Learnosity, an on line testing tool business that is growing at 100%+, to which the market places no value. We expect management to articulate their strategy with the core business at FY16 results and improved visibility with Learnosity which should re-rate the stock.

ASG Group (ASZ) is an IT provider that is gaining good momentum in its New World platform cloud business having established credible reference sites and is seeing increasing take up. It will generate strong cash flow and is likely to be debt free by end of FY17. Sigma also expects some form of capital management in FY17.

Gale Pacific (GAP) is involved in the marketing and manufacturing of shade cloth globally under the Coolaroo and Gale Pacific brands. The company has been rationalising back to its core brands under a new management team which has also refocused on product innovation, improved execution and getting back to basics. They have improved delivery times and also are looking to improve their Chinese manufacturing. The company is gaining traction in Australia and the US and is seeing the results with 2 upgrades within the last 6 months. The company is trading on a FY17 PE of 9.2x, with earnings growth opportunities from both sales and improved efficiency.

Range International (RAN) is a manufacturer of plastic pallets that has a process of converting plastic waste into plastic pallets at a price comparable to wooden pallets but a significantly higher gross margin. The technology is a potential disrupter to the existing pallet market that is worth $50bnpa globally. The environmental benefits of recycling plastic waste versus wooden pallets are substantial. The company is raising capital through an IPO to expand manufacturing capacity through additional lines in Indonesia. It expects to be profitable in FY17.

Shaver Shop Group (SSG) is a small format specialty retailer focusing on personal care appliances. The business has been growing strongly with strong comp store growth and store rollout contributing to revenue CAGR of 54% between FY13 to FY17. The company is the largest player in the space with exclusive product arrangements with suppliers. Management has been stable and the CEO, who has been being in place for the last 8 years, will not be selling down any equity in the IPO. Growth to continue via store roll out, as well as capturing more of the wet shave market, of which, they only have 3% market share. The stock is priced on 13.4x FY17 PE.

Stocks Sold

Galileo Japan Trust (GJT) was sold on valuation grounds.

Top 5 active positions

Stock	Active weight %
Overweights:	
Ingenia Communities Group	4.6
G8 Education	4.5
Seven West Media	4.1
Tox Free Solutions	4.0
APN News & Media	3.9
Underweight:	
Northern Star Resources	2.1
Evolution Mining	1.7
Macquarie Atlas Roads	1.5
NIB Holdings	1.4
Link Administration Services	1.4

Note: Active weights refer to positions above benchmark only.

Asset allocation

Sector	Active weight %
Consumer Discretionary	11.0
Industrials	6.0
Utilities	4.3
Financials-A-REIT	1.3
Information Technology	(0.7)
Energy	(1.8)
Telecommunication Services	(1.9)
Financial-x-Real Estate	(2.2)
Healthcare	(2.9)
Consumer Staples	(6.1)
Materials	(12.4)
Cash & Other	5.4

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 Aziumt, 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