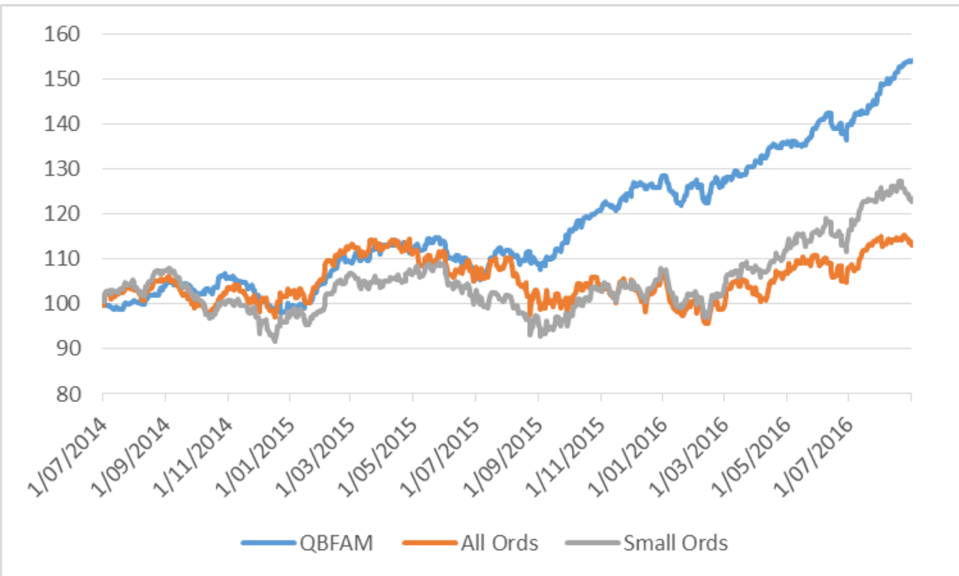
Quick Brown Fox Asset Management

Monthly Report – August 2016

August brings reporting season for Australian companies. It's one of two times during the year that investors get an insight into how companies are performing. Overall expectations for the market were low heading into the month and those expectations were met. Earnings for the major sectors (Financials ex REITs and Commodity based companies) saw significant falls for the year. Thankfully the fund remains completely unexposed to those sectors and as a result saw significant outperformance. Performance during the month was helped by a takeover offer for Intecq, plus strong results from the likes of Altium and SDI.

	1 month	3 months	6 months	1 year	Inception
					1-Jul-14
QBFAM	5.21%	10.42%	20.69%	41.64%	54.54%
All Ords	-1.33%	2.49%	14.25%	10.72%	13.04%
Small Ords	-1.56%	5.47%	19.30%	26.55%	22.81%

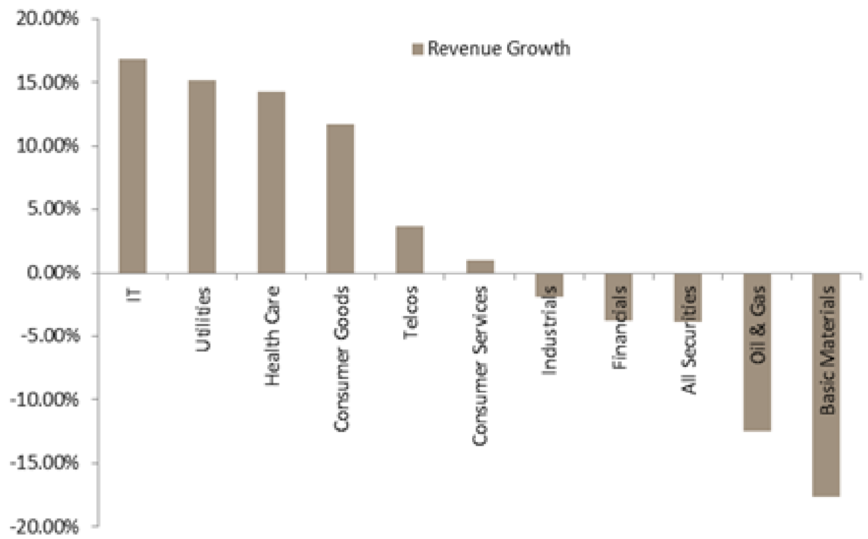
The fund continues to trend upwards and maintain a strong lead over the market.



Reporting season

Reporting season is now in the books and the overall results were weak with earnings down 16.5% on the previous year. This earnings fall was dominated by large scale impairments centred in the top 50 companies. The main sectors which have been affected are Mining (BHP Billiton, Rio Tinto) and Energy (Origin Energy, Santos) on the back of commodity prices, as well as Consumer Staples (Woolworths, Wesfarmers) due to poor expansions and declining margins.

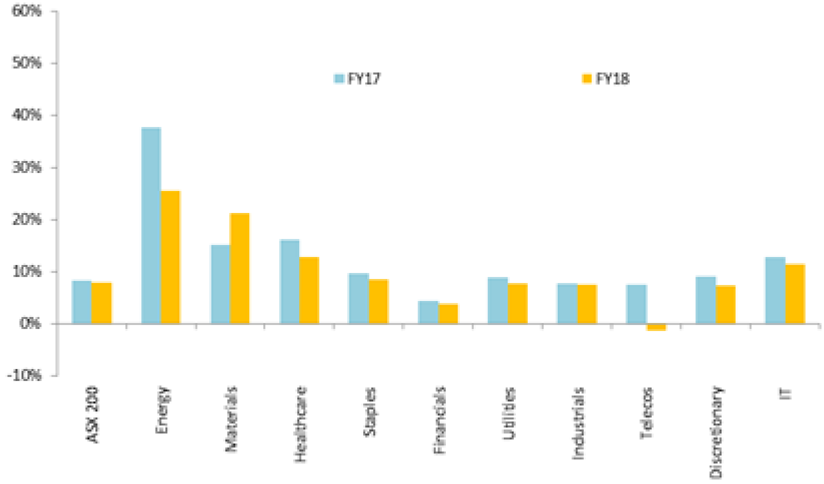
Because of these impairments, the underlying earnings trends are a little unclear from the overall data. For a cleaner look at how sectors and companies are performing in this instance, we turn to the revenue line. The below chart looks at revenue growth by sector over the six month period to 30 June 2016.



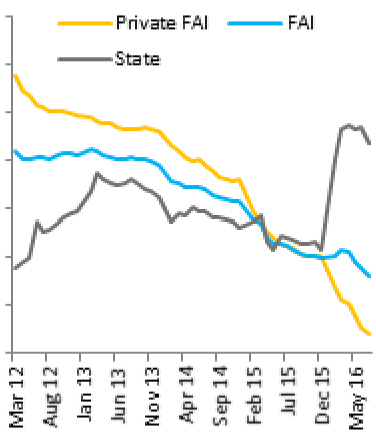
Overall, revenues for ASX200 companies fell around 4%. The primary drivers of these falls were the commodity related sectors (Materials and Oil & Gas) and financials. These two sectors comprise a majority of the index (Financials are 45%, Materials and Energy combined are 19%).

Where we have strength over the last year have been IT (driven by technological change with particularly strong growth from Aconex, Isentia and Altium), Healthcare (driven by demographics and world-leading companies) and Consumer Goods (driven by companies leveraging the Chinese consumer, with Bellamy's and Blackmores seeing strong growth). The question for investors is whether the growth of these themes is sustainable.

Looking at consensus earnings expectations for the next two years, there is a significant rebound factored in for both the Energy and Materials sector. The below chart shows earnings growth expectations over the next two years by sector.

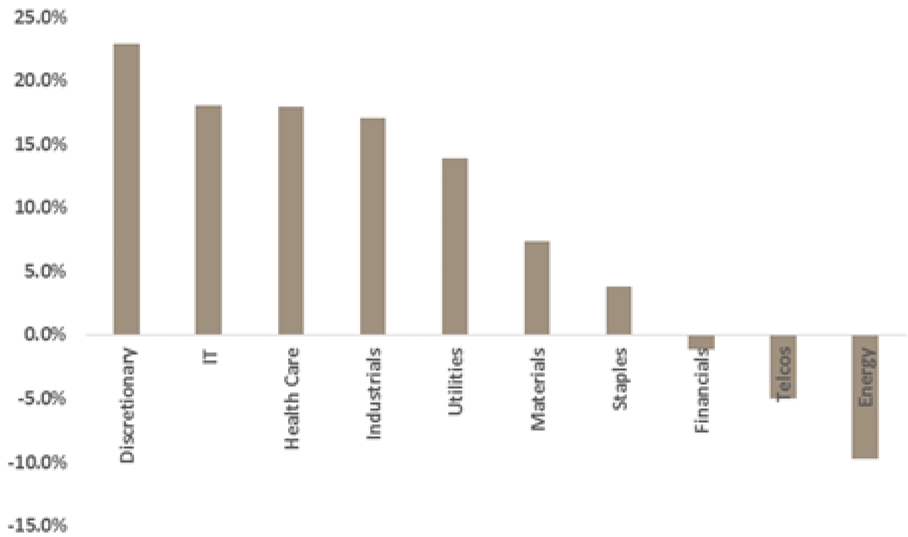


To us, the risks to consensus earnings remain firmly to the downside. The oil price appears capped by US shale marginal production whilst OPEC continues to struggle to come together on a production agreement. To add to that the evolving LNG market is starting to question the oil linked pricing currently in place. The other major commodity from an Australian perspective is Iron Ore which has had a strong run from sub $40 in December last year to around $60 today. This run was started by a mini-fiscal stimulus in January from the Chinese government, the effects of which are now starting to run off. At the same time Chinese Private Fixed Asset Investment continues to plunge as can be seen in the chart below. As a result we expect the risks to Iron Ore to be to the downside.



Where to invest

When we look at the first chart above and compare it to the returns from each sector over the last 12 months, it is not surprising to see the top performing sectors are Discretionary, IT and Health Care.



Over time, share prices will follow earnings. We have significant exposure to two of the top performing sectors being IT and Healthcare.

Technological change has been a key driver of economics and markets in recent years. The problem for most fund managers in Australia is that they see the listed IT sector as somewhat anaemic, currently making up just 1.2% of the index and represented by nine companies. However, when you look beyond the headlines, you can find fast growing companies with recurring earnings, strong cashflow, high returns on capital and good balance sheets. A real standout to us in reporting season was Altium, a company that listed back in 1999 but has really come into its own over the last five years. Altium is a leader in designing software for the production of Printed Circuit Boards. The most recent 12 months has seen them grow their global market share from 10% to 16% and the company has announced a revenue target for 2020 of $200m, up from $93m today.

Ageing populations provide support for the earnings of healthcare companies. In addition to this, the healthcare sector is probably the only sector where we can find multiple world leaders in what they do listed here in Australia, whether its medical technology (Cochlear, Resmed), biopharmaceuticals (CSL) or medical facilities (Sonic Healthcare, Ramsay Health Care). All of these companies have a strong track record of growing earnings through multiple cycles, have high margins, high returns on capital, and good balance sheets. Of course finding great investment opportunities requires not only a great company but also an attractive share price. Currently the fund has exposure to RMD and SDI, both of which saw solid rallies on the back of their results.

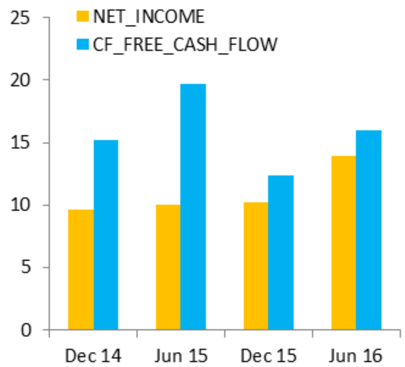
New Position

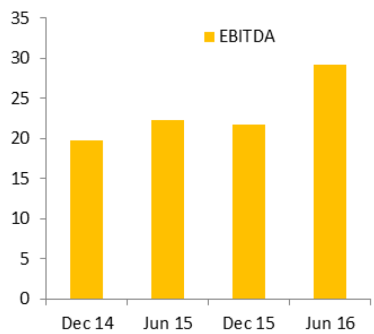
isentia

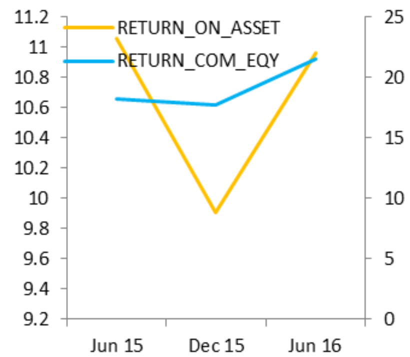
We added an exposure to isentia during the month. Founded as a small Australian family business called Media Monitors in 1982, and rebranded to iSentia in 2012, the company has become an Asian-Pacific leader in real-time media intelligence serving over 6,000 clients around the region. It offers clients a proprietary cloud-based media monitoring tool that captures and interprets content from over 5,500 mainstream media outlets – including TV and radio; 50,000 online news sources; and 3.4 million user generated content sources, such as Facebook, Twitter and China’s Weibo. The company collects and interprets around 8.5m news stories per day, informing its clients in near real time how news on their company is evolving.

With a 90% market share, growth has started to slow for the core Australia and New Zealand business. However, the cashflow from the business supports growth in other areas being content marketing (through the King Content acquisition which is ahead of expectations), and through expansion into Asia.

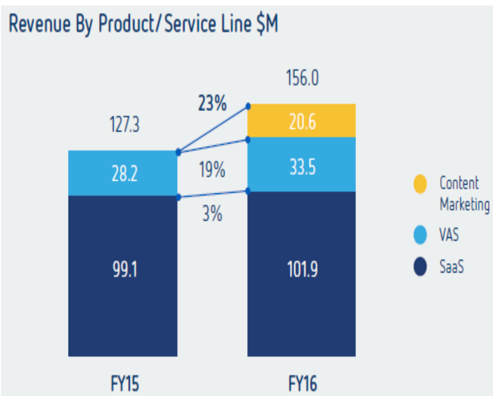
Profit and cashflow have grown since listing whilst returns on capital have remained high.

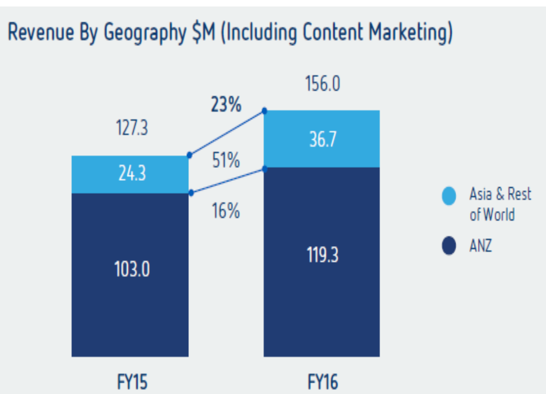






Growth is coming from Content marketing and Value added Services as well as the company's expansion into Asia.





The Portfolio

The fund is currently invested in 15 positions and retains a cash balance of 29.5% (up from 27.5% last month). We sold out of ITQ during the month after the takeover offer from Tabcorp. We introduced ISD and increased our position in IRI.