K2 Australian Small Cap Fund (Hedge Fund)
30 November 2024

The K2 Australian Small Cap Fund is an Absolute Return equities fund. The fund is index-unaware, aiming to produce positive absolute returns over the long term with a capital preservation mindset. The Fund's mandate allows it to actively manage its net market exposure – utilising both cash and shorts to help protect clients' capital.

	1 Month	Unit Price	Inception (%pa)
Performance (Net of Fees)	0.43%	2.39	5.00%

Refer below detailed performance data matrix

Top 5 Stock Holdings	Current	Monthly Move
SGH Ltd	8.9%	+1.3%
Summerset Group Holdings Ltd	5.7%	+0.1%
Judo Capital Holdings Ltd	5.1%	+0.2%
Lifestyle Communities Ltd	4.5%	+0.2%
Bendigo And Adelaide Bank	4.5%	+0.3%

Market Capitalisation Coverage	Current	Monthly Move
Large Caps>=AUD$7.5b	13.4%	+8.2%
Mid Caps>=AUD$2b<AUD$7.5b	29.6%	-5.5%
Small Caps<AUD$2b	47.5%	+2.5%

Month End Exposures	Current	Monthly Move
Communication Services	2.3%	+0.3%
Consumer	3.2%	+2.9%
Energy	2.7%	+0.3%
Financials/Real Estate	36.2%	-2.0%
Health Care	5.7%	+0.1%
Industrials	28.2%	+6.8%
Information Technology	8.5%	+3.9%
Materials	3.9%	-14.7%
SHORTS	-2.9%	+1.5%
Number of Positions	**33**	**-6**
Gross Equity Exposure	**93.7%**	**-3.9%**
Cash Weighting	**12.2%**	**+1.0%**
Net Equity Exposure	**87.8%**	**-1.0%**

Fund Characteristics	
Portfolio Managers	Campbell Neal, David Poppenbeek and Bill Laister
Strategy	Australian and New Zealand Small Cap Equities
Objectives	To deliver consistent returns over the investment cycle with a focus on capital protection during periods of market declines
Return Target	+10% pa over the long term
Number of Stocks	25 to 50
Cash	Up to 100% of portfolio
Distributions	Annually
Management Fee	1.31%
Buy/Sell	Bought and Sold on the ASX market (ASX: KSM)
Performance Fee	15.38% pa of the amount by which the NAV per unit exceeds the High Water Mark once the fund achieves its hurdle
Investment Horizon	5 Years
Style Bias	Growth At a Reasonable Price
Market Capitalisation Bias	>$1billion

Commentary

The K2 Small Cap Fund returned 0.43% for the month.

The broad outlook for Australian equities is becoming complicated and the Reserve Bank of Australia (RBA) is in somewhat of a bind. Excessive spending by government bodies has created labour related bottlenecks. Hours worked are rising but economic outcomes are fading. As a result, productivity measures are declining, and inflationary implications are persisting. Given the magnitude of the slowdown in Australia's economic activity, the RBA arguably should have already cut rates. Australian mortgages have rolled off the COVID low-cost fixed rate loans and today most mortgages have a variable interest rate. Hence, the thirteen rate hikes over the past few years has had a meaningful impact on the costs of running a household and pockets of stress are appearing. By way of example, over the past year, the aggregated value of loans for ANZ, NAB and WBC that were 90 days in arrears rose by 34%. Outside of COVID, this is the largest rise since the GFC. Despite this, the RBA is holding steadfast to its view that the underlying rate of inflation in Australia remains too high and therefore its restrictive stance on monetary policy needs to be maintained. Accordingly, the majority of listed companies continue to sail into economic headwinds. The few companies that have tailwinds, are now being priced exuberantly.

During the month, there were six companies in the Small Ordinaries Index that accounted for the majority of the performance. The share prices of Life360 (360), Zip Co (ZIP), Pinnacle Investment Management (PNI), Sigma Healthcare (SIG), Netwealth Group (NWL) and HMC Capital (HMC) rose on average by +20% during the month. Today, these companies are on average trading on 53x next years' expected earnings and offer a PE-to-Growth ratio of 1.4x. This is too rich for us. We have found a comparable subset of companies that offer strong growth but are trading on just 17x next years' expected earnings or a PE-to-Growth ratio of just 0.9x. We have opted to invest in companies like a2 Milk (A2M), Judo Capital (JDO), Australian Ethical Investment (AEF), NIB Holdings (NHF), EQT Holdings (EQT) and MA Financial (MAF). We are more comfortable making a meaningful investment in a quality fallen angel like A2M as opposed to riding the momentum of a shooting star like 360.

The bull case for 360 is that it follows the pathway forged by "freemium" pioneers like Spotify and Pinterest and revenue per user escalates higher. Spotify and Pinterest are seen as platforms that cater for users that are looking to be entertained and inspired. These attributes are highly attractive to advertisers and explain why Spotify and Pinterest deliver premium levels of revenue outcomes. Platforms like 360, Match and Nextdoor are more aligned to users who have a specific need in mind. As a result, the advertising pull-through is more bespoke and ultimately the revenue per user metrics is substantially lower than Spotify and Pinterest. Match and Nextdoor trade on Enterprise Value-to-revenue (N12M) multiples that are sub-3x which seems more sensible than the 7x metric that 360 currently trades on.

A2M is a fallen angel that had seen its share price decline by 65% over the past five years. Despite this, A2M has the potential to delivering 20%+ growth in revenue over the next two years and evolve into a dividend aristocrat. We believe that ATM has the capacity to sustain a return on equity of 15%+ which supports the Boards' decision to establish a dividend payout policy of 60-80% of earnings. As a result, we would expect an investment in a2MC to deliver shareholders a total return of 10%+pa for many years to come. We shouldn't lose sight of the fact that peer companies like Nestle, Danone, Unilever and Hershey have all been around for more than one hundred years.

George Boubouras
Managing Director (MD)
Research, Investments & Advisory
research@k2am.com.au

Marcela Tirado
Head of Relationship Management
& Corporate Services
invest@k2am.com.au

K2 Australian Small Cap Fund Net Monthly Returns in AUD

Year	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Fin YTD	Fin YTD Index (1)	Average Cash	Average Short
2013/14						2.86	3.19	3.06	4.44	0.36	1.15	-1.26	**14.52**	1.12	*41.95%*	*0.00%*
2014/15	3.64	2.57	-0.68	0.50	-1.04	-0.37	2.60	4.48	1.37	-0.22	2.23	-2.11	**13.51**	0.44	*22.50%*	*0.00%*
2015/16	5.71	-2.77	3.61	1.57	1.31	1.20	-3.95	-5.76	4.80	3.33	1.21	-0.40	**9.58**	14.40	*12.48%*	*-0.20%*
2016/17	4.80	3.05	0.00	-1.48	-3.76	-0.39	1.57	-1.54	3.14	-2.28	0.78	2.80	**6.50**	7.01	*15.90%*	*-0.54%*
2017/18	2.08	3.58	0.05	2.86	-0.23	5.91	-0.28	-3.36	0.04	-2.06	1.65	-1.87	**8.29**	24.25	*21.35%*	*-2.04%*
2018/19	1.82	-0.96	2.06	-6.33	-4.24	-3.25	-0.36	1.48	-1.08	1.04	0.31	-0.08	**-9.53**	1.92	*44.79%*	*-3.92%*
2019/20	5.21	-3.19	3.27	-0.11	2.71	1.01	2.56	-8.00	-28.03	11.37	6.81	-0.18	**-12.11**	-5.67	*26.94%*	*-1.30%*
2020/21	4.81	11.25	1.40	3.21	12.13	1.58	0.80	-1.11	2.75	6.18	1.08	3.57	**58.25**	33.23	*6.13%*	*-0.24%*
2021/22	-1.03	4.78	0.19	0.75	-2.02	2.31	-8.61	-1.08	2.50	-0.86	-9.08	-13.71	**-24.36**	-19.52	*8.30%*	*-0.01%*
2022/23	9.20	1.14	-9.78	2.28	3.94	-4.45	8.43	-2.17	-4.84	2.21	-3.10	-3.33	**-2.16**	8.45	*7.70%*	*-0.21%*
2023/24	5.12	-2.13	-1.49	-4.25	3.80	5.92	1.15	0.18	3.34	-3.49	-0.63	-1.88	**5.13**	9.35	*7.51%*	*-0.11%*
2024/25	4.56	-2.59	3.53	0.39	0.43								**6.32**	8.80	*8.76%*	*-1.55%*
												Incept.	**70.99**	105.47		
												Incept.	**5.00%pa**	6.77%pa	***18.69%***	***-0.84%***

(1) S&P/ASX Small Ordinaries Accumulation Index