

AUSTRALIAN

RESEARCH

INDEPENDENT INVESTMENT RESEARCH

Contango MicroCap Ltd (CTN)

Listed Managed Investments

June 2017 Quarterly Review

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Rating

Rating Under Review

LMI Type

Listed investment company

Investment Area

Australia

Investment Assets

Listed companies and other

Investment Sectors

Diversified

Key Investment Information

| | |
|---------------------------------|------------|
| Price (\$) as at 15 August 2017 | 0.93 |
| Market cap (\$M) | 156.3 |
| Shares on issue (M) | 168.1 |
| Shares traded (\$M p.a) | 56.0 |
| 12-month L/H (\$) | 0.88/1.20 |
| Listing date | March 2004 |

Fees

| | |
|----------------------------|-----------|
| Management Fee (% p.a) | 1.0-1.25* |
| Performance incentives (%) | na |

*The management fee is 1.25% for the first \$200m managed and 1% thereafter. There is no performance fee.

Premium/Discount to Pre-tax NTA

| | |
|----------------|--------|
| 30 June 2017 | -11.4% |
| 3 year average | -10.8% |

Dividend Yield

| | % |
|------|--------|
| FY15 | 8.00pf |
| FY16 | 6.30pf |
| FY17 | 7.11pf |

Largest Shareholders

| | % |
|---|-----|
| RBC Investor Services (Australia) Nominees Pty Ltd | 4.5 |
| Victor Plummer | 2.4 |

As at 30 June 2017

COMPANY OVERVIEW

CTN is a listed investment company focusing on small/micro cap stocks. The portfolio is managed by Contango Asset Management Ltd (ASX:CGA), an ASX listed fund manager partly owned by management and staff. CTN aims to pay annual dividends amounting to a minimum 6% p.a. yield on the Net Tangible Asset value per share prevailing at the beginning of the financial year.

INVESTMENT OBJECTIVE

CTN aims to achieve a return above the benchmark index (All Ordinaries Accumulation Index) and pay regular dividends to investors through investment in a portfolio of ASX listed small/micro cap stocks. There tends to be increased risk levels when investing in small/micro cap stocks, however, the upside potential can be considerable.

STYLE AND PROCESS

CTN uses a combination of top down and bottom up fundamental analysis to identify attractive investment opportunities in the small/micro cap universe. CGA focuses on stocks that have a market cap of between \$10M and \$350M at the time of acquisition. There is often a lack of research on small/micro cap stocks. CTN endeavours to take advantage of this situation to identify market inefficiencies. When the economy is growing strongly, the fund focuses on companies that can grow their businesses rapidly, while in more difficult times, it focuses on companies with more stable earnings.

PORTFOLIO CHARACTERISTICS

CTN holds a diversified portfolio of small/micro cap stocks with the company aiming to have between 40 to 100 stocks in the portfolio. Given the risk associated with the investment universe, the manager does not tend to take large positions in companies and reduces risk through portfolio diversification. During the March quarter the company increased its exposure to Materials which is now the largest sector exposure. Compared to the market, the portfolio is significantly underweight the Consumer Staples and Financials sectors.

INDEPENDENT INVESTMENT RESEARCH COMMENTS

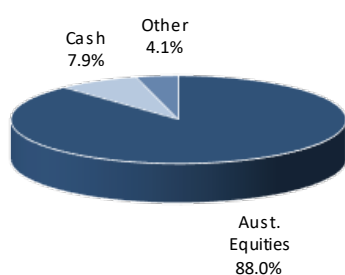
We placed our CTN rating under review in December 2016 following the announcement that it would add an additional manager and change the LIC name. We saw this as a highly unusual step that would add new risks for shareholders. CTN has since returned to being a one manager listed investment company with OC Funds Management (OCFM) ceasing to provide investment management services to the company. Management of the entire CTN investment portfolio has reverted back to Contango Asset Management (ASX:CGA). In our view, and without making any judgement about OCFM's portfolio management capabilities, we see the reversion to a single manager as a good outcome for CTN shareholders. It removes much of the uncertainty that has surrounded the LIC since the December announcement and removes the risks and administrative complications of the two manager arrangement. Whilst we are familiar with the single manager, CGA, there have been changes at the Board level since we suspended our rating. We are currently undertaking a detailed review of CTN and will publish a full report and new investment rating in coming weeks.

During the June 2017 quarter, the portfolio (pre-tax NTA plus dividends) significantly underperformed the market with a negative return of 8.0% versus the ASX Small Ordinaries Accumulation Index return of minus 0.4%. This dragged down the 12 month and medium term performance returns, with underperformance over 1, 3 and five-year periods. Over the long-term, the portfolio has outperformed with an average rolling annual return for the portfolio over the ten years to 30 June 2017 of 7.1%, compared to the ASX Small Ordinaries Accumulation Index average rolling annual return of 2.8%. CTN announced a final FY2017 dividend of 3.9 cents per share, 50% franked, taking full year dividends to 6.6 cents per share, 50% franked compared to 6.3 cents per share, 50% franked, in FY2016. Given the recent portfolio underperformance, we have some concerns that the dividend may not be sustainable at these levels. In our view, CTN shares are likely to remain at a discount to pre-tax NTA until performance improves.

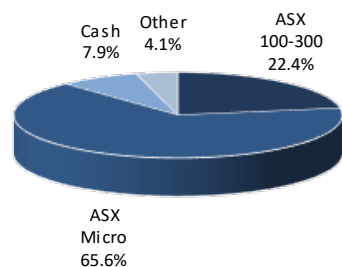
SECTOR BREAKDOWN

| Sector | 31 Mar (%) | 30 Jun (%) |
|----------------------------|------------|------------|
| Energy | 2.5 | 4.0 |
| Materials | 26.3 | 21.4 |
| Industrials | 9.5 | 9.9 |
| Consumer Discretionary | 10.4 | 10.5 |
| Consumer Staples | 1.9 | 0.5 |
| Health Care | 8.7 | 8.9 |
| Financials & REITS | 17.3 | 10.8 |
| Information Technology | 9.0 | 7.4 |
| Telecommunication Services | 1.9 | 9.9 |
| Utilities | 2.2 | 2.0 |
| SPI Futures | 6.8 | 2.7 |
| Cash | 3.5 | 4.1 |

Asset Weighting



Size Weighting



Board of Directors

| | |
|-------------------|---------------------------------|
| Mark Kerr | Chairman & Independent Director |
| Alistair Drummond | Executive Director |
| Trevor Carroll | Non-Executive Director |
| Ken Poutakidis | Non-Executive Director |

Note: IIR classifies Directors that are employed by the appointed Investment Manager as Executive Directors.

PERFORMANCE ANALYTICS

| Performance | June Quarter | 1 year | 3 year p.a | 5 year p.a |
|--|--------------|--------|------------|------------|
| Pre-tax NTA + Dividends (%) | -7.97 | -11.20 | 0.79 | 3.07 |
| Peer Group Median (pre-tax NTA plus dividends), %* | -2.17 | -2.07 | 4.68 | 3.07 |
| ASX Small Ords Acc Index (%) | -0.35 | 7.01 | 7.13 | 5.66 |
| Out/Under performance of index (%) | -7.62 | -18.21 | -6.34 | -2.59 |
| Share Price + Dividends (%) | -9.55 | -4.55 | 2.59 | 5.53 |
| Tracking Error (%) | 12.24 | 13.15 | 9.71 | 9.20 |

*LICs that invest in Small and Micro cap equities.

OTHER DATA

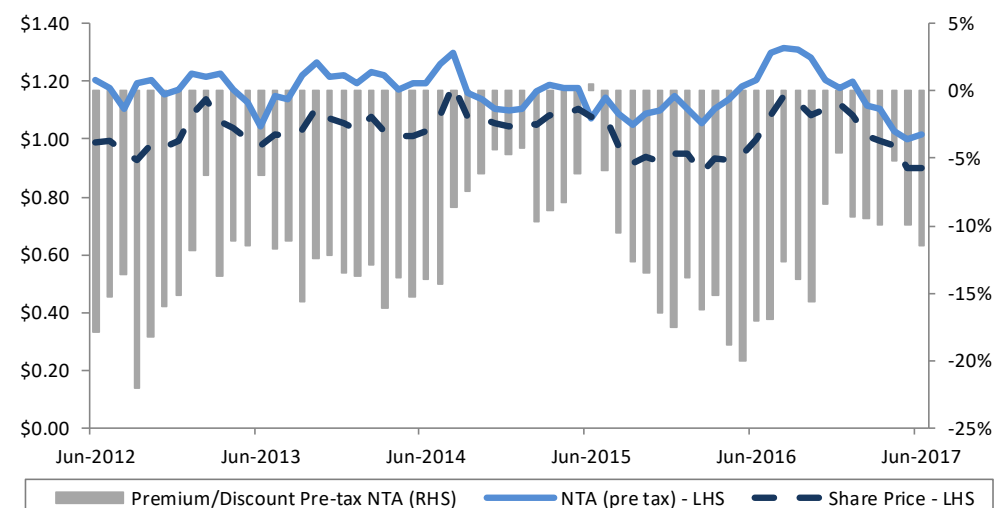
- ◆ **Dividend policy** – CTN aims to pay annual dividends amounting to a minimum 6%pa yield on net tangible asset value per share prevailing at the start of the financial year.
- ◆ **Capital management policy** – CTN announced an on-market share buy-back program of up to \$5m of its ordinary shares, approximately 3.35% of its issued capital. The buy-back started on 19 June 2017 and will remain in place for a period up to 12 months.
- ◆ **LIC tax concessions** – No
- ◆ **DRP available** – Yes at a 3% discount.

CTN's Portfolio (Top 10) Weighting

| Code | Portfolio (%) | All Ords (%) |
|------|---------------|--------------|
| EML | 3.1 | 0.0 |
| ASL | 2.8 | 0.0 |
| ENN | 2.8 | 0.0 |
| ASB | 2.2 | 0.0 |
| VLW | 2.2 | 0.0 |
| RVR | 2.1 | na |
| CAT | 2.1 | 0.0 |
| PEA | 2.1 | 0.0 |
| HPI | 2.0 | 0.0 |
| HUB | 1.9 | 0.0 |
| | 23.3 | 0.2 |

Source all figures: CTN/Independent Investment Research/IRESS. All data as at 30 June 2017 unless otherwise specified.

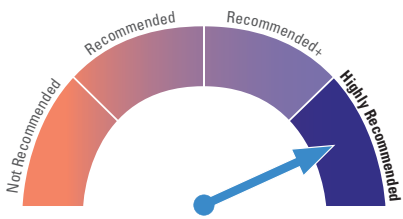
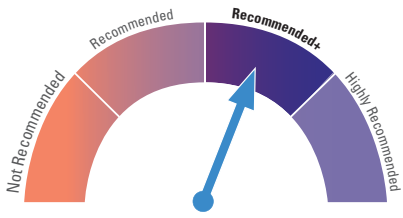

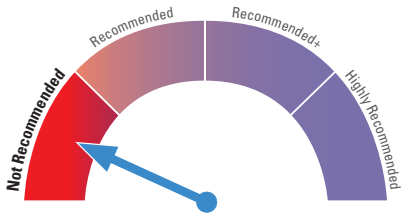
NTA & Share Price Performance



APPENDIX A – RATINGS PROCESS

Independent Investment Research Pty Ltd “IIR” rating system.

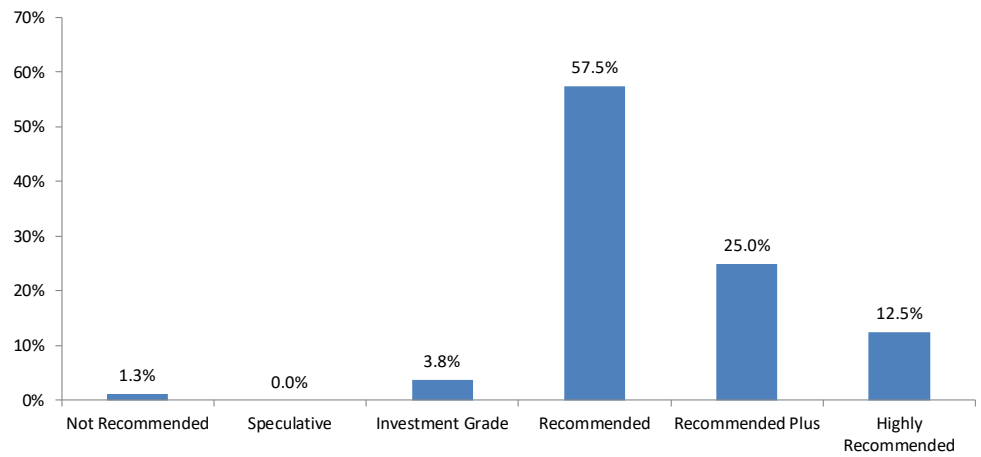
IIR has developed a framework for rating investment product offerings in Australia. Our review process gives consideration to a broad number of qualitative and quantitative factors. Essentially, the evaluation process includes the following key factors: management and underlying portfolio construction; investment management, product structure, risk management, experience and performance; fees, risks and likely outcomes.

| LMI Ratings | SCORE |
|--|---|
| <p>Highly Recommended</p>  | <p>83 and above</p> <p>This is the highest rating provided by IIR, indicating this is a best of breed product that has exceeded the requirements of our review process across a number of key evaluation parameters and achieved exceptionally high scores in a number of categories. The product provides a highly attractive risk/return trade-off. The Fund is likely effectively to apply industry best practice to manage endogenous risk factors, and, to the extent that it can, exogenous risk factors.</p> |
| <p>Recommended +</p>  | <p>79–82</p> <p>This rating indicates that IIR believes this is a superior grade product that has exceeded the requirements of our review process across a number of key evaluation parameters and achieved high scores in a number of categories. In addition, the product rates highly on one or two attributes in our key criteria. It has an above-average risk/return trade-off and should be able consistently to generate above average risk-adjusted returns in line with stated investment objectives. The Fund should be in a position effectively to manage endogenous risk factors, and, to the extent that it can, exogenous risk factors. This should result in returns that reflect the expected level of risk.</p> |
| <p>Recommended</p>  | <p>60–78</p> <p>This rating indicates that IIR believes this is an above-average grade product that has exceeded the minimum requirements of our review process across a number of key evaluation parameters. It has an above-average risk/return trade-off and should be able to consistently generate above-average risk adjusted returns in line with stated investment objectives.</p> |
| <p>Not Recommended</p>  | <p><60</p> <p>This rating indicates that IIR believes this is a suitable product that has met the aggregate requirements of our review process across a number of key evaluation criteria. The product provides some unique diversification opportunities, but may not stand apart from its peers. It has an acceptable risk/return trade-off and should generate risk adjusted returns in line with stated investment objectives. However, concerns over one or more features mean that it may not be suitable for most investors.</p> |

APPENDIX B – MANAGED INVESTMENTS COVERAGE

The below graphic details the spread of ratings for managed investments rated by Independent Investment Research (IIR). The managed investments represented below include listed and unlisted managed funds, fund of funds, exchange traded funds and model portfolios.

Spread of Managed Investment Ratings



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