

K2 Asset Management

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KSM - K2 Australian Small Cap Fund (Hedge Fund) Monthly Report - 30 November 2016

Australian Small Cap Market Review

The K2 Australian Small Cap Fund returned -3.76% for the month of November.

The election of Donald Trump was the catalyst for a major shift to the post-crisis economic regime. Fiscal policy is set to take centre stage from monetary policy and inflation expectations have ratcheted up accordingly. This repricing of risk sent shockwaves across all corners of asset markets. Bonds sold off aggressively and possibly signalled the end of a 35-year bull market. "Bond-like equities" suffered the same fate and investors who have been employing the "Growth at Any Price" strategy discovered that value is important. Australian Small Caps were also in the thick of the action with both valuation and trading conditions commanding investor attention.

The Fund's holdings in Adairs and Medical Developments were the major detractors from performance for the month. Adairs shocked investors with a downgrade to full year earnings expectations, stemming from underperforming product lines. Given the company had presented an upbeat outlook during their post results roadshow only 2 months ago, the share price reaction was savage (-40%). We no longer hold a position in the company. Medical Developments has been a core holding for the Fund for over 3 years and despite positive news flow suffered a bout of profit taking. We recently met with management and remain comfortable that the company is in a strong position to deliver on a multi-year growth strategy, focused on taking their "green whistle" global.

Portfolio Insight: Think Childcare Limited

Think Childcare is a company the Fund has owned since listing in 2014 and it has delivered strong shareholder returns. The company owns, manages and operates 35 premium childcare facilities with a clear focus on centres located within 100km of the Melbourne CBD. The company recently delivered a strong set of results for the 2016 half-year with revenue up +19% and profit after tax up +45%. The key growth drivers come from their successful strategy execution, targeted at improving occupancy and efficiency in its current portfolio, complemented by further acquisitions. With favourable industry dynamics and a proven strategy, management have the opportunity to grow the business substantially. The company trades on a 1 year forward PE of 14x and a fully franked dividend yield of approximately 4.5%. This still represents compelling value and the ongoing delivery of earnings growth will prove to be the catalyst for a re-rating.

Outlook

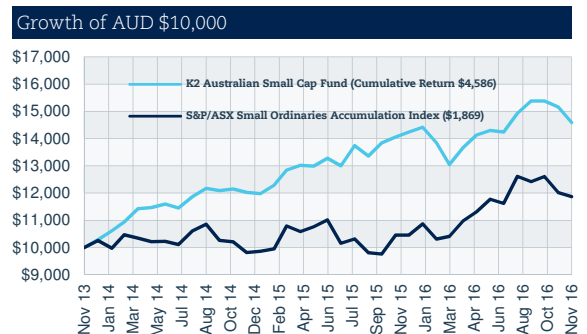
The Australian Small Cap Index has suffered a near -10% pullback from its high over the past 3 months, driven by a combination of valuation de-rating and earnings disappointments. The sell-off over this period has been broad based and while not uncommon for this to occur over the small cap cycle, the speed and magnitude has certainly surprised investors. Specifically, companies operating in the Telco, Healthcare and IT sectors have been hardest hit.

The Fund ended the month with 87.9% net equity exposure and we remain optimistic about the prospects for the companies we hold in our portfolio. However we are also aware that, given liquidity, these sell-offs can run longer than investors envisage. We will continue to closely monitor our current holdings and will look to take advantage of any opportunities that arise during this sell-off.

Top 5 Stock Contributions - November

Largest	Apollo Tourism & Leisure Ltd, Cedar Woods Properties Ltd, Ellex Medical Lasers Ltd, Smart Parking Ltd, Think Childcare Ltd
Smallest	Adairs Ltd, Baby Bunting Group Ltd, Medical Developments International, Money3 Corp Ltd, Updater Inc

Performance to 30 November 2016 (net of fees)	
1 Month	-3.76%
3 Months	-5.19%
6 Months	1.99%
1 Year	2.40%
Since Inception (pa)	13.41%



Returns are based on NAV per unit plus distributions reinvested net of management fee and performance fee accruals. The method for calculating the NAV is set out in the Fund's PDS.

Fund Details (Unaudited)	
NAV Per Unit:	A\$2.56
Fund Size:	A\$21.8m
Start Date:	1-Dec-13

Top 5 Holdings	Sector	%
Medical Developments International	Cons. Non-Cyc	4.2
Updater Inc	Technology	3.7
Baby Bunting Group Ltd	Cons. Cyclical	3.7
Think Childcare Ltd	Cons. Non-Cyc	3.6
Motorcycle Holdings Ltd	Cons. Cyclical	3.5

Sector Exposure %			
	Long	Short	Net Equity
Basic Materials	1.2	-	1.2
Communication	6.9	-	6.9
Cons. Cyclical	18.5	-	18.5
Cons. Non-Cyc	24.1	-	24.1
Energy	0.4	-	0.4
Financial	21.0	-	21.0
Industrial	7.0	-	7.0
Technology	8.8	-	8.8
Total Equity	87.9	-	87.9
Total Cash			12.1
Total Equity and Cash Exposure			100.0

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