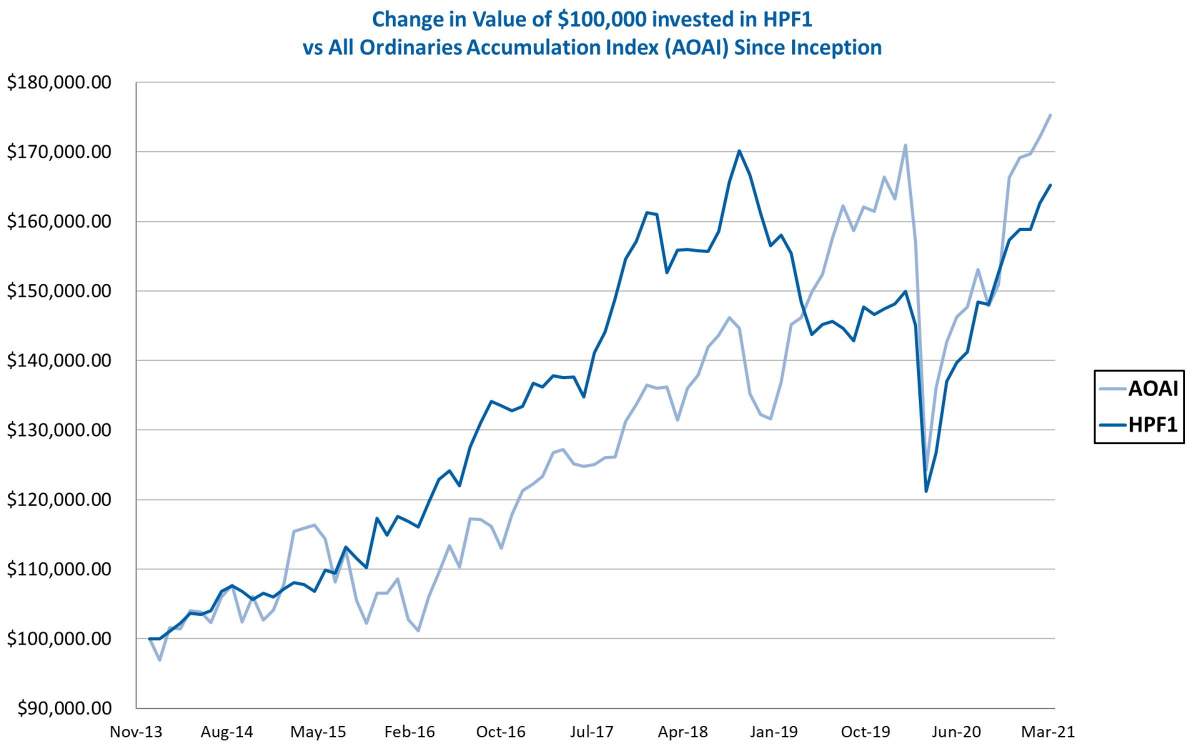
HARRINGTON PARTNERS
Investment Management

Harrington Partners Fund 1 (HPF1) – 31 March 2021

Harrington Partners goal is to compound capital over the long term through concentrated investments in undervalued high-quality companies. The Fund managers have the majority of their investable assets in the Fund, this creates a very strong alignment of interests between the managers and investors.

	HPF1 Net Return	AOAI Return	Relative Performance
6 Months to 30/06/2014	**3.71%**	2.36%	1.35%
30/06/2015	**5.51%**	5.67%	-0.16%
30/06/2016	**11.50%**	2.01%	9.49%
30/06/2017	**10.48%**	13.12%	-2.64%
30/06/2018	**15.49%**	13.73%	1.76%
30/06/2019	**-6.45%**	11.04%	-17.49%
30/06/2020	**-4.06%**	-7.20%	3.14%
9 Months to 31/03/2021	**18.34%**	19.86%	-1.52%
Annualised Performance	**7.18%**	8.05%	**-0.87%**
Cumulative Performance	**65.35%**	75.32%	-9.98%

*Net Return to investors which is less fees and charges but includes reinvested distributions.



The Fund returned **18.34%** net of all fees over the first 9 months of Financial Year 2021, this compares to a return of **19.86%** for the All Ordinaries Accumulation Index over the same period. Although the return is reported net of fees, fees are only payable on the return at June 30.

The Fund has performed well over the past 3 months rising by 5.39% over the period. The main driver of this increase came from a single business in the portfolio, Field Solutions Group (ASX:FSG) which was our previously undisclosed 10th largest holding at December 30. We also added to our second largest position in Kelly Partners Group (ASX:KPG). Please see below for a brief qualitative outline of these businesses, we have refrained from including any specific valuation detail as we are still potentially active buyers in both companies.

Portfolio

The portfolio is in a strong position. Most businesses we own are quite defensive in nature, with low debt levels, high insider ownership and the potential for compound growth of 10-12% per annum (pa). We are actively searching for higher growth opportunities that can compound at 15%+ but these are harder to find at prices below intrinsic value, especially in well established businesses.

The intention for the portfolio is to have 80-90% invested in 7-10 high quality and well-established companies that can compound between 10-15%pa, these businesses will create the ballast for Fund whilst still providing attractive long-term returns. The remaining 10-20% will be allocated to companies that have a higher probability of compounding at over 15%pa. These companies generally have less developed business models and hence we will only take smaller positions (1-2.5% of the portfolio) until we become more comfortable that our thesis and the business model is sound. We will generally look to hold around 5-10% cash, but ideally, we would like to be fully invested. These figures are meant as an allocation at the time of purchase, so actual allocations may vary widely.

The top 10 holdings as at March 31, 2021 were:

Rank	Holding	Total Equity Weighting	Total Portfolio Weighting
1	Field Solutions Group (ASX:FSG)	12.47%	10.42%
2	Kelly Partners Group (ASX:KPG)	8.99%	7.50%
3	Servcorp Limited (ASX:SRV)	8.83%	7.38%
4	Dicker Data (ASX:DDR)	7.68%	6.41%
5	United Overseas Australia (ASX:UOS)	6.66%	5.56%
6	Ryman Healthcare (NSX:RYM)	6.38%	5.33%
7	1300 Smiles (ASX:ONT)	6.18%	5.16%
8	360 Capital Group (ASX:TGP)	6.18%	5.16%
9	Wotso Property (ASX:WOT)	6.06%	5.06%
10	Gowing Brothers Limited (ASX:GOW)	5.88%	4.91%

The top ten holdings made up **62.9%** of the total portfolio and cash allocation was **16.5%** at the end of the period.

Field Solutions Group (ASX: FSG)

FSG owns and operates Australia's largest national footprint of non-nbn fixed wireless networks with a current coverage of 81,000km^2 and 69,000km^2 of recently announced expansion. The company focuses on building infrastructure across underserviced rural, regional, and remote (RR&R) areas as a means to close the persistent 'digital divide' that exists between these locations and their metropolitan counterparts. Telecommunications providers have traditionally viewed infrastructure investment in these areas as non-feasible, however FSG has overcome many of the inherent economic barriers through leveraging unique public/private partnerships.

Under these partnerships, FSG commits to building and operating carrier grade infrastructure, and in return receives substantial co-investment for initial construction, combined with long-term connectivity contracts with relevant local, state, and federal government entities. This upfront funding and recurrent contract commitments underpin minimum network viability, and as the infrastructure owner FSG is also able to utilise surplus capacity to provide connectivity solutions for residential and business customers. In many of these RR&R areas, the performance of FSG's symmetrical broadband offering is on-par with metropolitan standards and has no close substitute, providing long awaited digital transformation opportunities for these communities.

FSG currently has a pipeline of committed projects that will support strong growth for several years whilst management contends that the available funding pool of government grants for additional RR&R connectivity projects is many multiples of previously awarded contracts. The company is fortunate to find itself in a competitive sweet spot whereby the large telecommunications companies are seemingly disinterested in many of these projects, given they are intensely focused on rolling out 5G across their more densely populated networks. Whilst at the same time, many smaller competitors do not have the capacity to tackle this type of broadscale infrastructure deployment. In addition, the winding down of the nbn construction phase is freeing up the skilled labour FSG requires to expand its operations. All in all, the momentum FSG has built thus far points to a high probability that they will continue to be a major beneficiary of future government co-investment.

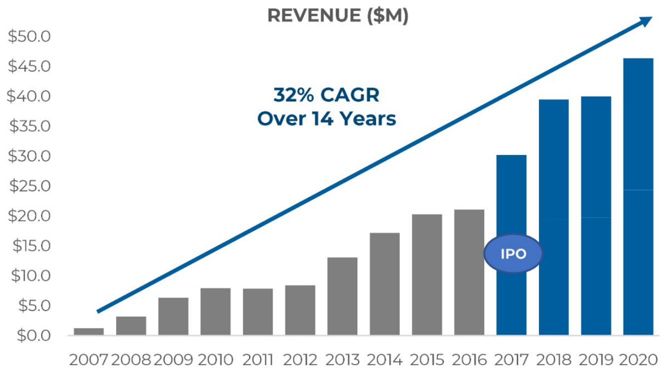
We are firm believers that FSGs' continued growth will play a crucial role in unlocking the social and economic potential of RR&R areas, which currently produce 93% of domestic food supply and 2/3 of Australia's exports[1]. The initial opportunities enabled by high performance connectivity are likely to pale in comparison to the longer-term emergent possibilities in areas such as the more efficient management of natural resources, agricultural technology, and the remote delivery of healthcare and professional services. FSG has a substantial growth runway ahead as it increasingly becomes the pre-eminent provider of mission critical digital connectivity solutions to RR&R Australia.

FSG is a great example of what we described above in that it is a company we took a 2% position in late 2019 when the market cap was around $10M and has subsequently grown to a market cap of closer to $50M. When we first looked at FSG we thought it had a good management team and the potential to establish a unique competitive advantage in owning the 'last mile' of telecommunications infrastructure across large parts of RR&R Australia. This was combined with the potential to get access to meaningful amounts of government funding to build this infrastructure. At the time of initial purchase this had not been proven and hence we began with a small position to which we progressively added at higher prices as the strength of the business model became more apparent.

[1] https://acola.org/wp-content/uploads/2020/09/hs6_agricultural-technologies_acola_report.pdf

Kelly Partners Group Holdings (ASX:KPG)

Kelly Partners primarily provides chartered accounting and professional services to small and medium private enterprises (SME) and high net worth individuals (HNWI). KPG was founded in 2006 by current CEO Brett Kelly and was listed on the ASX in 2017. Brett started with only two offices in North Sydney and the Central Coast and has grown KPG into 22 operating businesses over 16 different locations with 14 in NSW, 1 in Melbourne and 1 in Hong Kong. The business has grown revenues at 32% compound since 2007 and 15.4% compound since listing.



We became interested in Kelly Partners after hearing Brett present at a microcaps conference in early 2019, although we were sceptical at first glance at what appeared to be another professional services roll-up. These types of roll-ups are usually characterised by undisciplined debt fuelled acquisitions where the acquiree managers have little incentive to stick around and promised synergies that prove to be elusive. After further research and watching the business for the next 12 months we started to realise that KPG's acquisition strategy was quite different to the regular roll-up model.

Kelly Partners calls their system the 'Partner Owner Driver' model and is based around a 51-49% split where the owner/partner of the acquiree firm maintains a 49% ownership. This ownership structure is especially important in keeping the acquiree partner engaged as they will continue to receive a profit share of their business. However, the main difference in Brett's approach is his focus on instilling a culture of high productivity, principle centred leadership, and values-based decisions and only adding partners to the group who align with this. Brett is very disciplined in his acquisition strategy and is not trying to grow the business as fast as possible. Instead, he concentrates on creating sustainable long-term growth whilst delivering increasing value for clients, partners, employees, and society as a whole[2].

At Harrington Partners we believe that businesses that are willing to forego short-term growth and/or profits if it is in the best interests of their clients and stakeholders have the highest probability of generating sustainable growth over long periods. To achieve this there needs to be a decentralised management approach combined with a strong culture throughout the company of putting the client outcomes and the long-term success of the business first. The more we investigate Kelly Partners the more we believe they possess these highly valuable characteristics. Brett personally owns 50% of the shares in Kelly Partners, and as can be seen from the 'KPG Owner Principles' below, he takes the long-term growth in per share intrinsic value seriously.

[2] As an example, Kelly Partners is a B-Corp certified corporation. - https://www.kellypartners.com.au/about/b-corp-certified

KPG OWNERS' PRINCIPLES

	K+P
1	Our attitude is partnership in everything we do.
2	Our founder and Partner Owner Drivers™ have their majority net worth invested in the business.
3	Our long term goal is to maximise KPG's intrinsic value on a per share basis.
4	Our intention is to grow by continuing to acquire accounting firms using our proprietary Partner Owner Driver™ model
5	We will make decisions to maximise KPG's intrinsic value, even when such decisions may result in unfavourable treatments under current accounting standards.
6	We use debt prudently and structure our loans to be aggressively repaid.
7	We measure our performance using Earnings Per Share (EPS) growth and owner earnings.
8	We intend to seldom, if ever, issue shares to acquire a business.
9	It is not our intention to sell a business that we have acquired.
10	We will be completely transparent in our reporting to our shareholders, treating them as genuine partners in our business. We would call a spade a spade rather than under emphasise difficult situations.

This all sounds very comforting but obviously it must be backed up through real world value creation. Thankfully, business owners who join Kelly Partners realise significant benefits because even though they are selling 51% of their business, they generally gain back 40% of their time whilst also gaining increased growth and profitability in their remaining 49% stake. These benefits are generated from centralised management and back-office services and gaining access to Kelly Partners brand, marketing, and Intellectual Property. KPG's highly systemised intellectual property has proven to be exceptionally valuable with the business generating EBITDA margins of 33% against an industry average of 19%. Other benefits include succession planning and employee career development.

Although it can be hard to fully measure the benefit to clients, KPG have a fixed-fee engagement model so there are never any nasty surprises and a low annual client churn rate of ~2%.

Kelly Partners acquires firms in two different ways, the first and most common is what they call a 'tuck-in' in which smaller firms ($1-$2M revenue) are integrated into one of the existing network offices.

> *"We are building a focussed strategy of building each of our locations to a size that dominates their local region and would have them qualify in their own right as a top 100 firm by size. We believe this scale in each location makes our businesses more competitive and sustainable, and more attractive to clients as well as talent." - Brett Kelly, KPG Market Announcement February 22, 2021.*

The second type of acquisition is what KPG call a 'marquee' acquisition in which they rebrand the acquired premises, these are usually firms with $2M+ in revenue. Marquee acquisitions are generally larger and take up to two years to fully integrate into the business with KPG looking to purchase one marquee acquisition each year on average.

What we believe is least understood by the wider market is that these acquisitions are structured like miniature leveraged buy-outs, whereby KPG creates a subsidiary company to purchase the operating entity with the vendor partner (51/49% split respectively) and the purchase is funded through debt in the acquired operating entity. This means that the Parent entities attributable debt is only ~25.3%[3] of Group Debt, greatly reducing debt risk of the parent.

[3] Slide 24, KPG Owners manual- https://kellypartnersgroup.com.au/assets/downloads/KPG-Owners-Manual.pdf

Kelly Partners will also open greenfield sites when opportunities arise and has recently launched new services under Kelly Partners Investment Office, Kelly Partners Alternative Investments, along with a partnership with Austbrokers insurance brokers. KPG is not a company we would like to see grow too quickly because maintaining the current culture is paramount to remaining successful, but as the team grows, and the culture is instilled, an acceleration in growth should be possible.

"In this world nothing can be said to be certain, except death and taxes" – Ben Franklin

KPG has three industry tailwinds at their back:

1. Governments with record indebtedness who are unlikely to reduce nor simplify tax collection.
2. An addressable SME accounting market of around $7 billion across Sydney and Melbourne.
3. A highly fragmented industry facing mass generational succession challenges.

Kelly Partners helps business owners get control of their financial universe and grow their business, they view this service as being greatly beneficial to society and we tend to agree. If you are business owner and in the need for accounting services we recommend you get in touch with them www.kellypartners.com.au

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We are privileged that you have chosen to partner with us on this journey. As always, we welcome any feedback and if you have any questions, comments or investment ideas please do not hesitate to contact us.

Yours Sincerely,

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