

K2 Australian Small Cap Fund

ARSN 166 480 584

Condensed interim report

For the half-year ended 31 December 2019

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This condensed interim report does not include all the notes of the type normally included in an annual financial report. Accordingly, this report should be read in conjunction with the annual report for the year ended 30 June 2019 and any public announcements made in respect of K2 Australian Small Cap Fund during the condensed interim reporting period in accordance with the continuous disclosure requirements of the *Corporations Act 2001* and the current Product Disclosure Statement as per Note 2.

Directors' report

The Directors of K2 Asset Management Ltd (ABN 95 085 445 094), the Responsible Entity of K2 Australian Small Cap Fund, present their report together with the financial statements of K2 Australian Small Cap Fund (the "Fund") for the half-year ended 31 December 2019 and the auditor's review report thereon.

Principal activities

The Fund continued to invest in accordance with target asset allocations as set out in the current Product Disclosure Statement and in accordance with the provisions of the Fund's Constitution.

The Fund did not have any employees during the half-year.

There were no significant changes in the nature of the Fund's activities during the half-year.

The Fund is a registered managed investment scheme domiciled in Australia.

Directors

The following persons held office as Directors of K2 Asset Management Ltd during the half-year or since the end of the half-year and up to the date of this report:

Campbell W Neal

Mark S Newman

Hollie A Wight

Robert C Hand (Retired 26 November 2019)

Matthew W Lawler (Retired 26 November 2019)

Service providers

The Responsible Entity and Investment Manager of the Fund is K2 Asset Management Ltd.

The Custodians of the Fund are Morgan Stanley & Co International Plc and State Street Australia Limited.

The Administrator of the Fund is State Street Australia Limited.

The Unit Registry service provider of the Fund is Boardroom Pty Limited.

The registered office and principal place of business of the Responsible Entity and the Fund is Level 32, 101 Collins Street, Melbourne, Victoria, 3000.

Review and results of operations

The Fund maintains its long/short investment strategy in Small Cap listed equities and other investment instruments in Australia and New Zealand as permitted by the Fund's Constitution.

The investment policy of the Fund continues to be that detailed in the current Product Disclosure Statement and in accordance with the provisions of the Fund's Constitution.

Directors' report (continued)

Review and results of operations (continued)

Results

The performance of the Fund, as represented by the results of its operations, was as follows:

	Half-year ended	
	31 December 2019 \$	31 December 2018 \$
Operating profit/(loss) ('000)	1,830	(3,078)

Distributions

Distributions paid and payable ('000)	-	-
Distribution (dollars per unit)	-	-

Net Asset Value per unit

NAV per unit (quoted ex-distribution) are shown as follows:

	2019 \$	2018 \$
At 31 December	2.28	2.17

Significant changes in state of affairs

In the opinion of the Directors, there were no significant changes in the state of affairs of the Fund that occurred during the half-year.

Matters subsequent to the end of the half-year

No matter or circumstance has arisen since 31 December 2019 that has significantly affected, or may significantly affect:

- (i) the operations of the Fund in future financial years, or
- (ii) the results of those operations in future financial years, or
- (iii) the state of affairs of the Fund in future financial years.

Likely developments and expected results of operations

The results of the Fund's operations will be affected by a number of factors, including the performance of investment markets in which the Fund invests. Investment performance is not guaranteed and future returns may differ from past returns. As investment conditions change over time, past returns should not be used to predict future returns.

Further information on likely developments in the operations of the Fund and the expected results of those operations have not been included in this report because the Responsible Entity believes it would be likely to result in unreasonable prejudice to the Fund.

Indemnity and insurance of officers and auditors

No insurance premiums are paid for out of the assets of the Fund in regards to insurance cover provided to either the Officers of K2 Asset Management Ltd or the auditors of the Fund. So long as the Officers of K2 Asset Management Ltd act in accordance with the Fund's Constitution and the Law, the Officers remain indemnified out of the assets of the Fund against losses incurred while acting on behalf of the Fund. The auditors of the Fund are in no way indemnified out of the assets of the Fund.

Directors' report (continued)

Environmental regulation

The operations of the Fund are not subject to any particular or significant environmental regulations under a Commonwealth, State or Territory law.

Rounding of amounts to the nearest thousand dollars

The Fund is an entity of a kind referred to in ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191 issued by the Australian Securities and Investments Commission (ASIC) relating to the "rounding off" of amounts in the Directors' report and financial report. Amounts in the Directors' report and financial report have been rounded to the nearest thousand dollars in accordance with that ASIC Corporations Instrument, unless otherwise indicated.

Lead auditor's independence declaration

A copy of the lead auditor's independence declaration as required under section 307C of the *Corporations Act 2001* is set out on page 5 and forms part of the Directors' report.

This report is made in accordance with a resolution of the Directors of K2 Asset Management Ltd.



Hollie A Wight
Director

Melbourne
19 February 2020



Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To the Directors of K2 Asset Management Ltd

I declare that, to the best of my knowledge and belief, in relation to the review of K2 Australian Small Cap Fund for the half-year ended 31 December 2019 there have been:

- i. no contraventions of the auditor independence requirements as set out in the *Corporations Act 2001* in relation to the audit; and
- ii. no contraventions of any applicable code of professional conduct in relation to the audit.

KPMG

KPMG

Dean Waters

Partner

Melbourne

19 February 2020

Statement of condensed interim comprehensive income

		Half-year ended	
		31 December 2019	31 December 2018
		\$'000	\$'000
	Notes		
Investment income			
Interest income		13	33
Dividend and distribution income		261	308
Net gains/(losses) on financial instruments at fair value through profit or loss		1,799	(3,078)
Net foreign exchange gains/(losses)		<u>(20)</u>	<u>(24)</u>
Total net investment income/(loss)		<u>2,053</u>	<u>(2,761)</u>
Expenses			
Management fees	8	116	145
Transaction costs		48	89
Performance fees expense	8	11	-
Recoverable costs expense	8	15	19
Short dividend expense		17	53
Interest expense		2	4
Other operating expenses		<u>14</u>	<u>7</u>
Total operating expenses		<u>223</u>	<u>317</u>
Profit/(loss) for the half-year		<u>1,830</u>	<u>(3,078)</u>
Total comprehensive income/(loss) for the half-year		<u>1,830</u>	<u>(3,078)</u>

The above statement of condensed interim comprehensive income should be read in conjunction with the accompanying notes.

Statement of condensed interim financial position

		As at	
		31 December 2019	30 June 2019
		\$'000	\$'000
	Notes		
Assets			
Cash and cash equivalents	7	4,938	6,842
Receivables		34	48
Due from brokers - receivable for securities sold		686	312
Financial assets at fair value through profit or loss	4	<u>12,202</u>	<u>11,771</u>
Total assets		<u>17,860</u>	<u>18,973</u>
Liabilities			
Bank overdrafts	7	1,452	-
Payables		62	98
Performance fee payable	8	11	-
Due to brokers - payable for securities purchased		121	262
Distributions payable		-	847
Financial liabilities at fair value through profit or loss	5	<u>250</u>	<u>371</u>
Total liabilities		<u>1,896</u>	<u>1,578</u>
Net assets attributable to unitholders - equity	6	<u>15,964</u>	<u>17,395</u>

The above statement of condensed interim financial position should be read in conjunction with the accompanying notes.

Statement of condensed interim changes in equity

		Half-year ended	
		31 December 2019	31 December 2018
		\$'000	\$'000
Total equity at the beginning of the half-year	6	17,395	14,040
Comprehensive income for the half-year			
Profit/(loss) for the half-year		<u>1,830</u>	<u>(3,078)</u>
Total comprehensive income/(loss) for the half-year		<u>1,830</u>	<u>(3,078)</u>
Transactions with unitholders			
Applications		282	12,736
Redemptions		(3,783)	(312)
Units issued upon reinvestment of distributions		<u>240</u>	<u>574</u>
Total transactions with unitholders		<u>(3,261)</u>	<u>12,998</u>
Total equity at the end of the half-year	6	<u>15,964</u>	<u>23,960</u>

The above statement of condensed interim changes in equity should be read in conjunction with the accompanying notes.

Statement of interim cash flows

	Half-year ended	
	31 December 2019	31 December 2018
Notes	\$'000	\$'000
Cash flows from operating activities		
Proceeds from sale of financial instruments at fair value through profit or loss	11,776	15,646
Purchase of financial instruments at fair value through profit or loss	(11,044)	(14,535)
Dividends and distributions received	259	291
Interest received	15	28
Management fees paid	(117)	(133)
Payment of short dividend expense	(24)	(32)
Interest paid	(1)	(4)
Payment of other operating expenses	(56)	(140)
Proceeds from/(payments for) foreign exchange movements	(3)	(30)
Net cash inflow/(outflow) from operating activities	<u>805</u>	<u>1,091</u>
Cash flows from financing activities		
Proceeds from applications by unitholders	282	12,736
Payments for redemptions by unitholders	(3,819)	(312)
Distributions paid	(607)	(415)
Net cash inflow/(outflow) from financing activities	<u>(4,144)</u>	<u>12,009</u>
Net increase/(decrease) in cash and cash equivalents	(3,339)	13,100
Cash and cash equivalents at the beginning of the half-year	6,842	3,488
Effects of foreign currency exchange rate changes on cash and cash equivalents	(17)	6
Cash and cash equivalents at the end of the half-year	7 <u>3,486</u>	<u>16,594</u>

The above statement of interim cash flows should be read in conjunction with the accompanying notes.

Contents of the notes to the interim financial statements

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1 General Information

This condensed interim report covers the K2 Australian Small Cap Fund (the “Fund”) as an individual entity which is a registered managed investment scheme under the *Corporations Act 2001* and was admitted to trading status on the ASX under the AQUA Rules on 15 December 2015 (ASX code: KSM). The Fund was registered with ASIC as a registered managed investment scheme on 11 November 2013 and began operations on 2 December 2013. The Fund will terminate on 12 November 2093 unless terminated earlier in accordance with the provisions of the Fund’s Constitution.

The Responsible Entity of the Fund is K2 Asset Management Ltd (the “Responsible Entity”). The Responsible Entity’s registered office is Level 32, 101 Collins Street, Melbourne, VIC 3000. The financial statements are presented in Australian dollars.

2 Basis of preparation of interim financial statements

The condensed interim financial report for the half-year ended 31 December 2019 have been prepared in accordance with the *Corporations Act 2001* and Australian Accounting Standard AASB 134 *Interim Financial Reporting*.

This condensed interim report does not include all the notes of the type normally included in an annual financial report. Accordingly, this report is to be read in conjunction with the annual report for the year ended 30 June 2019, any public announcements made in respect of K2 Australian Small Cap Fund during the condensed interim reporting period in accordance with the continuous disclosure requirements of the *Corporations Act 2001* and the current Product Disclosure Statement.

This condensed interim report was authorised for issue by the directors on 19 February 2020.

(a) Significant accounting policies

Except as disclosed in the financial report for the year ended 30 June 2019, there were no new accounting standards, amendments and interpretations that are expected to have a material impact on the financial statements.

3 Fair value measurement

The Fund measures and recognises the following assets and liabilities at fair value on a recurring basis:

- Financial assets / liabilities at fair value through profit or loss (see Note 4 and 5)

The Fund has no assets or liabilities measured at fair value on a non-recurring basis in the current reporting period.

AASB 13 requires disclosure of fair value measurements by level of the following fair value hierarchy:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

(i) Fair value in an active market (Level 1)

The fair value of financial assets and liabilities traded in active markets is based on their quoted market prices at the end of the reporting period without any deduction for estimated future selling costs.

The Fund values its investments in accordance with the accounting policies set out in Note 2 to the annual report for the year ended 30 June 2019. For the majority of its investments, the Fund relies on information provided by independent pricing services for the valuation of its investments.

The quoted market price used for financial assets and financial liabilities is the last traded price. When the Fund holds derivatives with offsetting market risks, it uses last traded prices as a basis for establishing fair values for the offsetting risk positions and applies this last traded price to the net open position, as appropriate.

3 Fair value measurement (continued)

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

(ii) *Fair value in an inactive or unquoted market (Level 2 and Level 3)*

The fair value of financial assets and liabilities that are not traded in an active market is determined using valuation techniques. These include the use of recent arm's length market transactions, reference to the current fair value of a substantially similar other instrument, discounted cash flow techniques, option pricing models or any other valuation technique that provides a reliable estimate of prices obtained in actual market transactions.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate at the end of the reporting period applicable for an instrument with similar terms and conditions.

For other pricing models, inputs are based on market data at the reporting date. Fair values for unquoted equity investments are estimated, if possible, using applicable price/earnings ratios for similar listed companies adjusted to reflect the specific circumstances of the issuer.

The fair value of derivatives that are not exchange traded is estimated at the amount that the Fund would receive or pay to terminate the contract at the reporting date taking into account current market conditions (volatility and appropriate yield curve) and the current creditworthiness of the counterparties. The fair value of a forward contract is determined as a net present value of estimated future cash flows, discounted at appropriate market rates as at the valuation date. The fair value of an option contract is determined by applying the Black Scholes option valuation model.

The output of a model is always an estimate or approximation of a value that cannot be determined with certainty, and valuation techniques employed may not fully reflect all factors relevant to the positions the Fund holds. Valuations are therefore adjusted, where appropriate, to allow for additional factors including liquidity risk and counterparty risk.

Recognised fair value measurements

The following table presents the Fund's assets and liabilities measured and recognised at fair value as at 31 December 2019 and 30 June 2019.

As at 31 December 2019	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Financial assets at fair value through profit or loss				
Equity securities	11,590	-	-	11,590
Unit trusts	612	-	-	612
Total	<u>12,202</u>	<u>-</u>	<u>-</u>	<u>12,202</u>
Financial liabilities at fair value through profit or loss				
Equity securities - sold short	250	-	-	250
Total	<u>250</u>	<u>-</u>	<u>-</u>	<u>250</u>

3 Fair value measurement (continued)

Recognised fair value measurements (continued)

As at 30 June 2019	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Financial assets at fair value through profit or loss				
Equity securities	11,771	-	-	11,771
Total	<u>11,771</u>	<u>-</u>	<u>-</u>	<u>11,771</u>
Financial liabilities at fair value through profit or loss				
Equity securities - sold short	371	-	-	371
Total	<u>371</u>	<u>-</u>	<u>-</u>	<u>371</u>

(i) Transfers between levels

There were no transfers between levels in the fair value hierarchy for the half-year ended 31 December 2019. There were also no changes made to any of the valuation techniques applied as of 30 June 2019.

The Fund's policy is to recognise transfers into and transfers out of fair value hierarchy levels as at the end of the reporting period.

(ii) Fair value measurements using significant unobservable inputs (Level 3)

All financial instruments held by the Fund with fair value measurements using significant unobservable inputs at 31 December 2019 and 30 June 2019 have been valued \$0.

There were no transfers between levels in the fair value hierarchy for the half-year ended 31 December 2019.

The following table presents the movement in level 3 instruments for the year ended 30 June 2019:

As at 30 June 2019	Equity securities \$'000
Opening balance	-
Transfers	1,024
Gains/(losses) recognised in profit and loss	<u>(1,024)</u>
Closing balance	<u>-</u>

(iii) Valuation inputs and relationships to fair value

With the exception of financial instruments which have been valued at nil, the Fund has measured financial instruments with fair value measurements using significant unobservable inputs by applying a discount to the last traded price of securities which were suspended from trading status as at 31 December 2019 and 30 June 2019. In determining the discount applied, the Responsible Entity takes into consideration a number of qualitative and quantitative factors including, but not limited to, valuation multiples and industry and company specific information. The favourable and unfavourable effects of using reasonably possible alternative assumptions for the valuation of equity securities has been calculated by using unobservable inputs based on positive and negative outcomes. The most significant unobservable input is the discount for stale share prices. All financial instruments held by the Fund with fair value measurements using significant unobservable inputs at 31 December 2019 were valued at nil.

3 Fair value measurement (continued)

Recognised fair value measurements (continued)

(iv) Valuation processes

Portfolio reviews are undertaken regularly by management to identify securities that potentially may not be actively traded or have stale security pricing. This process identifies securities which possibly could be regarded as being Level 3 securities.

Further analysis, should it be required, is undertaken to determine the accounting significance of the identification. For certain security types, in selecting the most appropriate valuation model, management performs back testing and considers actual market transactions. Changes in allocation to or from Level 3 are analysed at the end of each reporting period.

(v) Financial instruments not measured at fair value

The Fund did not hold any financial instruments which were not measured at fair value in the statement of condensed interim financial position. Due to their short term nature, the carrying amounts of receivables and payables are assumed to approximate their fair value.

4 Financial assets at fair value through profit or loss

	As at	
	31 December 2019	30 June 2019
	\$'000	\$'000
Financial assets at fair value through profit or loss		
Australian equity securities	10,646	11,392
New Zealand equity securities	944	379
Real Estate Investment Trust	612	-
Total financial assets at fair value through profit or loss	<u>12,202</u>	<u>11,771</u>

5 Financial liabilities at fair value through profit or loss

	As at	
	31 December 2019	30 June 2019
	\$'000	\$'000
Financial liabilities at fair value through profit or loss		
Australian equity securities - sold short	<u>250</u>	371
Total financial liabilities at fair value through profit or loss	<u>250</u>	371

An overview of the risk exposures relating to financial liabilities at fair value through profit or loss is included in Note 3.

6 Net assets attributable to unitholders

Movements in the number of units and net assets attributable to unitholders during the half-year were as follows:

	Half-year ended			
	31 December 2019 No.'000	31 December 2018 No. '000	31 December 2019 \$'000	31 December 2018 \$'000
Net assets attributable to unitholders				
Opening balance	8,481	5,786	17,395	14,040
Applications	130	5,166	282	12,736
Redemptions	(1,734)	(133)	(3,783)	(312)
Units issued upon reinvestment of distributions	112	237	240	574
Profit/(loss) for the half-year	-	-	1,830	(3,078)
Closing balance	<u>6,989</u>	<u>11,056</u>	<u>15,964</u>	<u>23,960</u>

As stipulated within the Fund's Constitution, each unit represents a right to an individual share in the Fund and does not extend to a right to the underlying assets of the Fund. There are no separate classes of units and each unit has the same rights attaching to it as all other units of the Fund.

Capital risk management

The Fund considers its capital to be unitholders' funds. The Investment Manager manages its net assets attributable to unitholders as capital. The amount of net assets attributable to unitholders can change significantly on a daily basis as the Fund is subject to daily applications and redemptions at the discretion of unitholders.

The Fund monitors the level of daily applications and redemptions relative to the liquid assets in the Fund. The Fund strives to invest in securities that meet the Fund's investment objectives while maintaining sufficient liquidity to meet unitholders' redemptions.

7 Cash and cash equivalents

	As at	
	31 December 2019 \$'000	30 June 2019 \$'000
Cash at bank	<u>4,938</u>	<u>6,842</u>
	<u>4,938</u>	<u>6,842</u>

7 Cash and cash equivalents (continued)

Reconciliation to cash at the end of the period

The above figures are reconciled to cash at the end of the period as shown in the statement of interim cash flows as follows:

	As at	
	31 December 2019	30 June 2019
	\$'000	\$'000
Balances as above	4,938	6,842
Bank overdrafts	<u>(1,452)</u>	<u>-</u>
Balance per statement of interim cash flows	<u>3,486</u>	<u>6,842</u>

8 Related party transactions

Transactions and balances with related parties

Transactions with K2 Asset Management Ltd in its role as the Responsible Entity and Investment Manager have taken place at arm's length, in the ordinary course of business and are as follows:

	Half-year ended	
	31 December 2019	31 December 2018
	\$	\$
Management fees expense for the financial half-year	116,384	145,376
Performance fees expense for the financial half-year	11,248	-
Recoverable costs expense for the financial half-year	15,080	18,845

	As at	
	31 December 2019	30 June 2019
	\$	\$
Management fees payable at the end of each financial half-year/year	18,040	19,013
Performance fees payable at the end of each financial half-year/year	11,248	40
Recoverable costs payable at the end of each financial half-year/year	2,033	2,459

9 Events occurring after the reporting period

No significant events have occurred since the end of the reporting period and up to the date of this report which would impact on the financial position of the Fund disclosed in the statement of condensed interim financial position as at 31 December 2019 or on the results and cash flows of the Fund for the half-year ended on that date.

10 Contingent assets and liabilities and commitments

There are no outstanding contingent assets, liabilities or commitments as at 31 December 2019 and 30 June 2019.

Directors' declaration

In the opinion of the Directors of the Responsible Entity:

- (a) The financial statements and notes set out on pages 6 to 17 are in accordance with the *Corporations Act 2001*, including:
 - (i) complying with Australian Accounting Standards (including the Australian Accounting Interpretations), the Corporations Regulations 2001 and other mandatory professional reporting requirements; and
 - (ii) giving a true and fair view of the Fund's financial position as at 31 December 2019 and of its performance for the half-year ended on that date; and
- (b) the financial statements also comply with International Financial Reporting Standards as disclosed in Note 2; and
- (c) there are reasonable grounds to believe that the Fund will be able to pay its debts as and when they become due and payable.

Signed in accordance with a resolution of the Directors of K2 Asset Management Ltd.



Hollie A Wight
Director

Melbourne
19 February 2020



Independent Auditor's Review Report

To the unitholders of K2 Australian Small Cap Fund

Conclusion

We have reviewed the accompanying **Interim Financial Report** of K2 Australian Small Cap Fund (the Scheme).

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the Interim Financial Report of K2 Australian Small Cap Fund is not in accordance with the *Corporations Act 2001*, including:

- giving a true and fair view of the Scheme's financial position as at 31 December 2019 and of its performance for the half-year ended on that date; and
- complying with *Australian Accounting Standard AASB 134 Interim Financial Reporting* and the *Corporations Regulations 2001*.

The **Interim Financial Report** comprises:

- Statement of financial position as at 31 December 2019;
- Statement of comprehensive income, Statement of changes in equity and Statement of cash flows for the half-year ended on that date;
- Notes comprising a summary of significant accounting policies and other explanatory information; and
- The Directors' Declaration.

Responsibilities of the Directors for the Interim Financial Report

The Directors of the K2 Asset Management Limited (the Responsible Entity) are responsible for:

- the preparation of the Interim Financial Report that gives a true and fair view in accordance with *Australian Accounting Standards* and the *Corporations Act 2001*; and
- for such internal control as the Directors determine is necessary to enable the preparation of the Interim Financial Report that is free from material misstatement, whether due to fraud or error.

Auditor's responsibility for the review of the Interim Financial Report

Our responsibility is to express a conclusion on the Interim Financial Report based on our review. We conducted our review in accordance with *Auditing Standard on Review Engagements ASRE 2410 Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the Interim Financial Report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the Scheme's financial position as at 31 December 2019 and its performance for the half-year ended on that date; and complying with *Australian Accounting Standard AASB 134 Interim Financial Reporting* and the *Corporations Regulations 2001*. As auditor of K2 Australian Small Cap Fund, *ASRE 2410* requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of an Interim Period Financial Report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with *Australian Auditing Standards* and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*.



KPMG



Dean Waters

Partner

Melbourne

19 February 2020