DMX Australian Shares Fund
December 2023 – Investor Update

A wholesale unit trust managed by:
DMX Asset Management Limited
AFSL 459 120
13/111 Elizabeth Street, Sydney, NSW 2000
Trustee & Administrator:
Fundhost Limited AFSL 233 045

Unit price (mid) based on NAV (30 November 2023)	**$0.9993**
Unit price (mid) based on NAV (31 December 2023)	**$1.0132**
Number of Stocks	43
% cash held - month end	5%
Fund size (gross assets)	$11m

1-month return	1.4%
3-month return#	0.3%
12-month return#	-1.3%
Since inception (1 March 2021, p.a.) #	4.5%
Since inception (cumulative) #	13.3%

 # Returns assume reinvestment of distributions.

Dear Investor,

DMXASF's NAV increased 1.4% for the month of December, building on November's recovery but lagging a very strong broad market with the ASX 200 Total Return Index up 7.3% and the ASX Emerging Companies Index up 6.3%.

Commentary

The portfolio was impacted both positively and negatively by some material movements in what is usually a generally quiet month as the year winds down. Detractors included **EML Payments** which continued to deflate following its prior negative AGM update, down 8%. **Pureprofile** was down 10% with market chatter around insiders selling – as usual, for "tax reasons" – impacting its shares. **Schrole** fell 22% – a big decline on a small position, while **SOCO Corp** and **Field Solutions** fell 13% & 16% respectively – smaller declines but on larger positions.

Each of SOCO Corp and Field Solutions had negative updates, with SOCO guiding toward much reduced earnings as revenue delays crunch its bottom line. Field Solutions on the other hand finally repaired its balance sheet albeit on terms that appear unfavourable to the company. In short, the company faces a near-term cashflow issue as it funds capital investment ahead of receiving government grants upon completion. The risk was that an equity raise would be conducted to fund this, but the hope (and company guidance) was that a debt line with a Tier 1 lender would be negotiated. Instead, an expensive Tier 2 debt arrangement was reached with Regal Funds Management who are providing a loan on a high interest rate and with attached out-of-the-money equity warrants. We believe the market is overly focused on this as a bad debt deal, but we'd highlight it's most likely superior to a straight equity raise.

Offsetting some of this was strong moves of 21% & 25% on smaller positions, **Careteq** & **Kinatico**. A recent acquisition by Careteq together with our thesis for the company is discussed in a recently-published blog article here.

Some larger holdings enjoyed positive momentum in this broadly strong market, including **Smartpay** up 9%, **Michael Hill** up 10%, **Shriro** returning 17% (including its 18.5c capital return), and **RPMGlobal** up 15%. Recently added **Fiducian Group**, to which we added during the quarter, was up 13%, as was **Earlypay** on the back of receipt of recovery proceeds from RevRoof, as well as entering a favourable new debt facility. Finally of note, **Frontier Digital Ventures** rose 28%, recovering some of our prior losses.

Portfolio Structure

We continue to target a >50% overlap with DMX Capital Partners which itself is explicitly focused on the highly prospective nano and micro-cap segment of the market ($5m to $200m). At present, the overlapping portion of the portfolio is in the 70%-zone, reflecting just how attractive the smaller segment of the market has become over the past few years. The DMXCP monthly report includes commentary on how the micro-cap segment has lagged considerably, and references an interesting recent AFR article highlighting many significantly undervalued micro-caps. We encourage you to review the DMXCP report alongside this one.

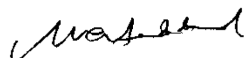
The main point of difference between DMXASF and DMXCP at present is with a few companies that happen to be slightly larger in the ~$200m-$400m market capitalisation zone. These companies too – in our estimation – are undervalued and carry the potential to perform handsomely in the years ahead. Importantly, they're a source of differentiation within our portfolio, each having diverse economic models that should lead to different performance within the portfolio. A key tenet of our portfolio construction approach is that in addition to seeking *quality assets* at *attractive prices*, we also value *differentiation* among positions so as to effectively manage portfolio risk. The five key stocks in this basket, and a brief outline for each are:

- **EML Payments**. (~$300m market cap.) EML has been an investment mistake for us, having been initially added around $3 per share (versus ~80c now). The company has run into regulatory trouble together with internal operational issues. Despite these, at its core is a valuable payments business, and we believe the company is on a path to resolving its issues and potentially selling itself. Its shares are discounting plenty of bad news and pessimism, but from these levels we're hopeful of a strong return over the next couple years.
- **Fiducian Group**. (~$200m market cap.) Detailed commentary was included on this recent portfolio addition in our October report. This founder-led serial acquirer operates an integrated financial planning, funds management & investment platform administration business. A multi-bagger investment over the past 20 years, the company's shares had fallen along with the broad smaller-cap market segment over the past year or so, coming back to an earnings multiple of just 11 times. For this quality company with continued high-return growth runway ahead, these sorts of multiples have preceded strong medium and long-term returns.
- **Frontier Digital Ventures**. (~$230m market cap.) Another poor investment for us, Frontier Digital owns a portfolio of valuable digital marketplace assets across Asia, Africa and Latin America. We initially invested in 2021 in the mid-$1 range when the company had been enjoying strong growth, and apparently very good operational execution. The past couple years have been challenging though, with issues with various of its assets, and in particular its Pakistani key asset – Zameen – amplifying what turned out to be an underfunding balance sheet, with prior acquisition earn-outs needing to be paid. This caused a major price correction, ahead something of a forced capital raise in early 2023. Still believing in the long-term prospects and value within its portfolio, we've cautiously added to our holding in 2023. With no real bad news since that last cap-raise, investors appear to be forgiving the balance sheet misstep and are perhaps again starting to focus on its underlying value, with its shares bumping up from the 30c range to north of 50c.
- **Michael Hill International**. (~$350m market cap.) Our principal retail exposure is this long-established and mature jewellery retailer, Michael Hill. The company performed very well with a strong post-COVID recovery, but results over the past year or so have been weaker in a now-challenging retail environment. We invested in 2021, early in what turned out to be a COVID-recovery cycle, and held through its highs of late 2021/early 2022. The company has a strong dividend yield at around 8% pa, and is trading around 9 times earnings. We have mixed feelings about its recent acquisition of Bevilles, and it's clear growth is hard to come by for a brand of Michael Hill's maturity. We're attracted to its long-term track record, its strong current execution, highly cash generative nature, and low valuation.
- **RPMGlobal**. (~$400m market cap.) RPMGlobal is a high-quality Software-as-a-Service business serving the mining industry globally. Having gone through a long period of transitioning its customers to a recurring revenue model, as well as integrating a number of complementary acquisitions, the company has past a financial inflection point is now enjoying significant operating leverage which is coming through with very strong profit growth. These results have been augmented by a full and effective boots on the ground sales approach which wasn't possible during COVID. With high sales lead times, the fruit of these renewed efforts over the past year or two are starting to be enjoyed. Despite strong numbers coming through over the past while, its shares have been slow to follow. From these levels in the $1.70-range, we expect a strong long-term return, or for the company to be eventually be bought by a strategic acquirer at much higher levels.

Summary

Across the micro-cap and small-cap segments we've experienced a substantial de-rating over the past couple years with valuations now compressed to levels from which we expect to enjoy strong returns over the medium to long-term. Getting here hasn't been without pain, with a number of our companies experiencing material declines and fundamental problems. But the benefit of a properly diversified portfolio has been that losses have usually been fairly contained, and we've been able to grind through what's been a very challenging market characterised by declining valuations.

With considerable media attention now on the smaller market cap segment, together with the value on offer, we believe patient long-term oriented investors will be rewarded with strong returns from here.



Michael Haddad
Portfolio Manager

Chris Steptoe
Research Analyst

This document is issued by DMX Asset Management Limited (DMXAM - AFSL 459 120) in relation to the DMX Australian Shares Fund (DMXASF). The information provided in this document is general information only and does not constitute investment or other advice. The content of this document does not constitute an offer or solicitation to invest in DMXASF. DMXAM accepts no liability for any inaccurate incomplete or omitted information of any kind, or any losses caused by this information. Any investment decision in connection with DMXASF should only be made based on the information contained in the relevant disclosure document.