DMX
ASSET MANAGEMENT

DMX Australian Shares Fund
Investing in the most compelling Australian smaller company opportunities

DMX Australian Shares Fund
November 2021 – 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 (31 Oct 2021)	**$1.2560**
Unit price (mid) based on NAV (30 Nov 2021)	**$1.2460**
Number of Stocks	44
% cash held - month end	2%

1-month return	-0.80%
3-month return	9.55%
Since inception (1 March 2021)	24.60%
Fund size (gross assets)	$10m

Dear Investor,

DMXASF's NAV declined 0.80% (after fees and expenses), slightly lagging the ASX 200 Total Return Index which fell 0.54% for the month. Having enjoyed some strong gains in prior months, many of our holdings declined by 10-20% each. These tended to be the higher-growth names that individually hold great potential, are priced attractively in the context of that potential and their operating momentum, but where valuations aren't as supported by strong *current* earnings. On the other hand, the more traditionally 'value' stocks in the portfolio held strong, and in some cases rose 10-20%, helping to mostly offset the decliners. Many of these are mentioned in Commentary, below.

With a rich assortment of potential portfolio additions which we diligently continue to assess, as well as opportunities to add to existing positions, we're as focused on working out what to trim or exit as we are on what to add to or initiate. We're happy to hold cash from time to time as a by-product of our process, and we'll never rush the process of deploying it. But we're equally happy to be as fully invested as we find ourselves now (with less than 2% cash at month-end) provided we own an economically and thematically diverse broad portfolio (as we do) and the prospects for each holding remains positive for the medium to long-term.

Portfolio Commentary

Laggards this month included a number of high-growth companies whose shares had previously performed very well and had perhaps gotten a little ahead of themselves in the short-term. Names include **8Common** which fell 15%, **Aeeris** which handed back some of its strong gains since its recent placement through which we established our position (down 20%), **Ansarada** down 10%, and **CV Check** handed back some gains, falling 14%. **Frontier Digital** reversed its prior month gains, declining 13% and Knosys handed back 11% as the market awaits an update on important software trials with a number of potential enterprise clients. In each case, as well as with a few others that declined, the thesis remains intact, and the lower prices are assisting us in adding to a small number of these.

On the other side of the ledger, **Kip McGrath** recovered 16%, having been an underperformer since the inception of this fund. Pleasingly, we had the opportunity to acquire a substantial line of stock in this otherwise illiquid company, which we did alongside DMX Capital Partners near the stock's low for the month. This brought the position from an inconsequential ~1% of the Fund to ~3%, a position size that better reflects the improving fundamentals and upside potential from these lower levels for this company. Kip McGrath is profiled in the DMX Capital Partners monthly report with that commentary attached to this report as an Appendix.

Education technology company, **Janison**, rose another 20%. During the month, the Janison made an acquisition of a local schools assessment business. Despite its share price performance, we believe Janison remains attractively priced in the context of its local and global opportunity, and excellent execution on that opportunity to date. **Swick Mining Services** rose 13% on confirmation of the demerger of its technology division, **Yellow Brick Road** gained 10% and **PTB Group** rose another 16% with a strong earnings update at the AGM.

Elsewhere, our core retail exposures assisted with **Michael Hill** rising another 21% and **Shaver Shop** up 18%. Both remain reasonably priced relative to normalised earnings, and especially considering their success and the expectations for continued success with their omni-channel model. While it's a fancy label, we believe *omni-channel* remains an underappreciated model in ecommerce, with a physical store network providing a strategic advantage versus online-only retail which must rely on expensive advertising (Google/Facebook) to drive traffic. Each of Michael Hill and Shaver Shop understand this and are building valuable online businesses alongside their bricks and mortar footprint.

The month was busy with many of our companies conducting their annual general meetings. This provided a good opportunity for us to hear from many of these management teams. One noteworthy meeting was for **FSA Group**, a company that has faced some difficulties with a core business during COVID, but, as we note below, has been pivoting its focus toward its successful finance division.

<u>FSA Group</u>

ASX-listed for nearly 20 years, **FSA Group** came to market providing services to assist clients wishing to enter into payment arrangements with their creditors. This *Services* segment is what the company has historically been known for but has declined in significance to the company and the stock's investment case. Back In 2011, 81% of profit came from Services with the bulk of the remainder from home loans. FSA has now built up its mortgage and vehicle finance business to a point where it is larger than Services, with the gap set to accelerate in the years ahead.

While diminishing in importance, the Services business does enjoy some powerful economic dynamics. FSA is by far the largest operator in the space in Australia. This gives the company significant scale advantage in terms of marketing, as well as a powerful position of trust in structuring and negotiating debt solutions for an individual with potential many creditors. The business is ordinarily powerful, but in the COVID environment of 2020 and 2021, FSA has essentially found itself redundant. The past two years have seen temporary legislation that restricts creditors' ability to chase debt, together with an unwillingness of many creditors to want to be seen to be chasing debt. Further, a flood of liquidity that has effectively bailed-out (for now) many marginal borrowers, thus reducing consumer demand for these services. When it structures a debt-repayment plan, FSA charges fees over the life of the repayment plan. In essence, it has a book of business that is constantly running-down, and it relies on replenishing that book with new business written. With new business written falling off a cliff since 2020, its book is shrinking. Costs have been managed down in the face of this, but the impact to the bottom line is yet to be felt. In our view, this has led to the opportunity with the shares, which trade at a low multiple of 'current' earnings, a figure that doesn't properly reflect the decline that is to come over the next 1-3 years from the Services division's decline. The variant perception here is that we believe the market is over-discounting this headwind to earnings, with growth elsewhere quite likely to plug most of that gap, and indeed, should the world for the Services business normalise over the next 2-3 years, and growth in its other business continue, the shares may prove to be very undervalued at current levels.

Services is only part of the FSA story, with its Finance business, carefully and successfully developed alongside the Services business over many years now, becoming the main focus for the company as it "reshapes its future". With Finance being its principal focus moving forward, management have set themselves ambitious goals as shown in the table below (from its AGM presentation). 2021 saw FSA enter the broker channel to accelerate lending growth and enter the asset finance business. Providing finance to the underserved self-employed will be the focus. Additionally, personal lending is being expanded from motor vehicles into unsecured personal loans using digital platforms. Management will leverage the experience they have from the Service business to make underwriting decisions.

Services	Regrow as demand returns
Home Loans	Increase origination from around $10m to $40m per month Grow loan pool from $382m to around $1.2b
Personal Loans	Increase origination from around $3m to $7m per month Grow loan pool from $65m to around $200m
Asset Finance	Increase origination from around $4m to $12m per month Grow loan pool from $40m to around $300m

An additional and interesting initiative the company is pursuing is to tweak its Services model to capture more margin. At present, debt repayment plans are structured and creditors receive repayments over a number of years with the process managed by FSA. FSA is looking to offer to purchase those debts from creditors, harnessing its deep experience and credit scoring capabilities to appropriate price debt purchase offers. For creditors, this simplifies the process and provides instant liquidity (at a price), whereas for FSA it provides an interesting opportunity to deploy some capital and capture additional margin from the work that goes into structuring and negotiating debt solutions.

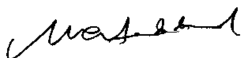
FSA is founder-led with over 44% of the company owned by its two executive directors, Tim Odillo Maher and Deborah Southon, who have a solid track record of stewardship and value-creation. In the last 10 years, profits have more than doubled, $81m has been returned to shareholders in buybacks and dividends, and the company has an impressive ROE of 31%. FSA is currently trading on PE of less than 7, and has a net dividend yield of 5.6%. The shares carry significant total return potential over the next few years if management delivers on its goals in lending, with that return being enhanced by the potential for its Services business to recover over that time-frame.

In Summary

It was a productive month with more capital being put to work across a range of highly prospective opportunities. Volatility within the portfolio is providing opportunity to continue to add to positions, while positive contributors have generally been so alongside positive fundamental developments, supporting their continued investment thesis.

Thank you for your trust and support.

Kind regards



Michael Haddad	Chris Steptoe
Co-Portfolio Manager	Co-Portfolio Manager

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Appendix – DMX Capital Partners' update on Kip McGrath

Kip McGrath Education Centres Limited (ASX:KME)

We attended the KME AGM in mid-November, which was an in-person event where the KME board, CEO and key management (CFO, CTO & COO) were all accessible to shareholders.

The KME share price has been weak over the past year, and, as illustrated below, has tracked sideways for the last three years. This lack of share price traction corresponds with three years of flat profit results, with COVID lockdown disruptions to face-to-face tutoring proving to be challenging for KME. KME has also undertaken a strategy shift towards a corporate delivery model (to complement KME's traditional franchise model) which is still in the early stages of being proven out.

We are confident that the company is well placed to resume earnings growth in the short term, and the KME story is starting to look particularly compelling for the medium term. Our confidence is supported by a number of positive earnings drivers and operational improvements that appear to be lining up nicely for the company:

- Post lockdown, there is strong demand globally for remedial learning, with parents concerned about the time children have spent out of school. KME lesson numbers have now returned to pre-COVID levels, with lesson numbers for Q1 of FY22 up 8%, notwithstanding the Australian and NZ lockdowns.

- The public education system is increasing its use of private tutors as governments devote more resources to lift children back to appropriate literacy and numeracy levels – KME's UK, US and Victorian businesses all have current tutoring contracts with schools, with KME expected to secure their first contracts with NSW Department of Education next year.

- KME's company owned tutoring centers are now operating at scale. In FY21 these corporate centres contributed a total of $3.7m revenue and generated a breakeven profit position. KME has guided for these revenues to increase more than 100% this year, with current run-rate suggesting corporate revenue in excess of $8m. At this level of revenue, corporate centres will contribute to group profit for the first time. KME group revenues for Q1 are up 21% driven by the growing corporate contribution.

- KME's new online US tutoring business (Tutorfly) is performing well and currently operating at breakeven, having benefitted from winning a material school tutoring contract. While we did have some initial concerns with this acquisition, revenues are ahead of expectations, and KME is planning for this operation in Houston to form the base of further expansion into the US.

- Over the last two years KME has invested in a stronger management team including a new CTO and COO. This has provided additional support to Storm McGrath, and has allowed more focused, management attention across all aspects of the KME business.

To attract investors back to the stock, KME needs to deliver earnings growth. Corporate-run centres should contribute to improved earnings this year. With further centre acquisitions planned, there is a clear pathway to double corporate revenues again to $15m over the next two years. At $15m revenue, the margins become material (30%+), and at this level, we expect that corporate centres would be delivering approximately half of group profits.

Another growth opportunity that KME has is to introduce Tutorfly (matching tutors with students for exam preparation primarily) into the Australian market, while taking the Kip McGrath brand (remedial tutoring) to the US to run a multi-brand go-to-market strategy in the medium term across various geographies.

In a post-lockdown world where there is increasing demand for remedial tutoring, we feel there are a number of growth opportunities for KME to take advantage of. We know families who have utilized the services of Kip McGrath and can vouch for the success of their methodologies. We are pleased to be long term supporters of a company that is making a meaningful difference to the outcomes of children, and look forward to the KME growth story playing out.