DMX Australian Shares Fund
May 2022 – 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 April 2022)	**$1.1357**
Unit price (mid) based on NAV (31 May 2022)	**$1.0741**
Number of Stocks	44
% cash held - month end	1%
Fund size (gross assets)	$10m

1-month return	-5.4%
3-month return	-8.9%
12-month return	3.3%
Since inception (1 March 2021, p.a.)	5.9%
Since inception (cumulative)	7.4%

Dear Investor,

DMXASF's NAV declined 5.4% (after fees and expenses) against the ASX 200 Total Return Index which declined 2.6% for the month. As has been the case for several months now, the broader index has held up well, propped by large and resource companies, while smaller industrial companies continue to fall significantly.

Brief Performance Commentary

While over the past few months our NAV has declined by more than that of the broad-based but very top heavy ASX 200 Total Return Index, we believe it's important to note what's been going on 'under the surface'. When reporting results, we emphasise the ASX 200 as a benchmark as it's a value-weighted index that best reflects the typical/average experience of most investors. Our decision to focus on smaller companies, and on industrials (rather than resources), is an active one and reflects our analytical capability as well as where we believe the best opportunities lie for creating value over the long term. To the extent we deviate from the ASX 200's larger and resource company composition we expect our performance outcomes to also deviate. That can be in either direction, and potentially significantly so. We're totally comfortable with that, accept it as an outcome of having a unique & highly differentiated portfolio, and believe the exposure adds value from a diversification perspective for investors while carrying the prospect of strong returns over time.

To illustrate the dispersion that's occurring across the market, we note that the ASX Small Industrials index is down 7.5% for the month of May, and is down 21% from its month-end peak of September 2021. At the same time, DMXASF is down 14% from its October peak. Meanwhile, the ASX 200 Total Return Index is down just 1% from its December 2021 peak. This clear dispersion in particular between large and small companies, we believe, helps put into context the current decline, while also reinforcing the compelling value on offer with the smaller companies in which we're invested.

Portfolio Commentary

As outlined above, the portfolio continues to be impacted by the very broad sell-off in smaller and industrial companies. Declines were recorded with **Ansarada** (down 16%), **DDH** (down 22%), **Frontier Digital Ventures** (down 20%), **Kip McGrath** (down 15%), **Medadvisor** (down 18%), and **PTB Group** (down 8%). With nearly half the portfolio's constituents being down 5-20% for the month, a few bright spots again helped mitigate the broader portfolio decline. **FSA Group** rose 8% as it continues to aggressively scoop up shares via its buy-back programme; and thematically similar **EarlyPay** rose 7% as a previous suitor paid a premium price on-market to boost its ownership stake to 20%. **Pureprofile** recaptured some of its prior month losses, bouncing back 6%; while **AFT Pharmaceuticals** rose 12% as it posted results meeting guidance and reaffirming a strong profit outlook.

As usual, May was a generally quiet month in terms of news-flow. As noted in the DMXCP report, **Laserbond** has downgraded on account of supply chain issues impacting timing on key licensing deals. And **Shriro**, too, reported being impacted by supply chain issues including freight costs. Shriro's updated *full-year* EBITDA guidance of $20-25m implies a very substantial contraction for the second half. Its shares are down 15% for the month, and while the company clearly has a large earnings gap in the short-term, its fundamentals remain intact and at these prices we see the shares on a 6-7 times earnings multiple, little implied goodwill considering tangible asset backing, a robust balance sheet with 15-20% surplus capital, and a fully-franked double-digit dividend yield. We've taken the opportunity to add to our holding in Shriro this month following its downgrade.

While many companies are ratcheting down earnings expectations, a few of our holdings reported very pleasing results which confirm our thesis, and reinforce the long-term value on offer with some of these share prices in this environment:

- **AFT Pharmaceuticals**. As mentioned above, AFT reported strong results for the 31st March financial year, and is guiding to strong continued growth. The New Zealand-based company focuses on developing over-the-counter drugs and has a valuable portfolio of products which it sells directly to re-sellers in Australia & New Zealand, and licenses around the world. The company has a long track record of success, has been consistently growing its revenues by 15% pa, and all indications are that this momentum will continue for some time to come. Despite investing heavily to support product development and its global growth aspirations, the company is solidly profitable and expectations for this are to now increase significantly. A meeting with management at their Auckland head office post-result reaffirmed our conviction in the business and opportunity.
- **Smartpay**. It's pleasing to report that Smartpay has reported its first profitable year since entering the Australian payments market. The company has a steady and profitable core EFTPOS terminal business in New Zealand and has for several years been using that cashflow (and then some) to build out a valuable, high-growth, payments operation in the substantial Australian market. As a disruptor, alongside Tyro and other emerging payment technologies, Smartpay has been winning business away from the Big 4 banks who generally are focused elsewhere and have been seemingly content to cede – in particular – the smaller independent merchant business. With the company now solidly profitable, an overall expected growth profile of 20-30% for at least the next few years, and that NPAT likely to grow even faster as it benefits from operating leverage, the outlook is very positive. Considering the ~$160m market value for the business, roughly half of which we assess is supported by its bread & butter NZ operation, the implied ~$80m valuation for its Australian business we believe is far too cheap.

Portfolio Strategy & Execution

Given the recent weakness in markets and across both our portfolios, we've spent time in the DMXCP monthly report reviewing our investment strategy, why we believe in it, what we're seeing in the portfolio today, and commenting on our execution. Included within this is commentary on nano-cap companies **Aeeris**, **Datadot**, **EDU Holdings**, **Knosys** and **8Common** – all of which are also owned by DMXASF.

The DMXCP report comments are broad, comprehensive, and we believe of utility to DMXASF investors as well. We include these comments as an Appendix to this report, and we encourage you to review them, if you haven't already read the DMXCP report.

In Summary

Again, markets are going through a challenging period, and we're not immune to this. While it's never pleasant reporting consecutive NAV declines, we emphasise that we believe the portfolio is in very good shape with a diverse group of good businesses at increasingly attractive prices. The corollary of lower pricing – all things equal – is better value and higher expected future returns. Of course, things aren't always equal, and clearly the economic environment and some negative newsflow has impaired the prospects and valuations for certain holdings. But on the whole, our assessment is that the portfolio has considerable embedded value and upside potential that we believe will help drive meaningful returns over the medium to long-term. We're enthused about the potential to generate value in the years ahead, from this base, and with the process of continuing to execute on our time-tested investment strategy.

If you'd like to discuss the portfolio or the potential to invest or add to an existing investment, please contact Michael at any time on michael.haddad@dmxam.com.au or 02 80697965.

Thanks for your trust and support.

Kind regards

Michael Haddad	Chris Steptoe
Portfolio Manager	*Research Analyst*

Appendix – DMXCP Commentary on Strategy

Strategy

Given the challenging market conditions and decline in our NAV over the past few months, we see this as a timely opportunity to discuss the thinking behind our strategy, and why we so strongly believe in it. Consistent with how we have been investing since the inception of DMXCP in 2015, we are focused on owning a portfolio of small, under the radar, growing companies with sound businesses that are cash flow positive (or very close to it), have solid balance sheets and low market capitalisations and which we are happy to hold for the long term. We believe a portfolio constructed on this basis offers strong potential for attractive returns over time, and multiple ways to win due to the following:

- Growing companies with low market caps/enterprise values with limited liquidity offer plenty of upside as they grow and attract broader investor interest;
- Operating leverage in small companies can drive strong earnings growth from a low and disciplined cost base;
- Strong cash flows generating cash surpluses will make the operating business (ex-cash component) much cheaper over time; and
- Smaller companies typically trade on lower multiples, which allows for significant multiple expansion, and make companies attractive takeover targets.

We consider there is substantial optionality inherent in a portfolio of small companies. And the longer one holds these types of investments, the greater the chance of the "option" paying off, whether that be through earnings growth from operating leverage, from a takeover or from other types of corporate activity.

Why we believe in this strategy

Simply, we believe in this strategy because we know it works. A great illustration of the powerful, long term, multi-bagger upside from a portfolio of interesting, under-the-radar companies with small capitalisations was well documented by fellow fund manager, Andrew Brown in two interesting articles in 2020. We have previously made mention of these powerful articles, and believe it's timely to revisit them.

https://arichlife.com.au/for-want-of-a-coffee-can-we-left-7million-on-the-table/

https://arichlife.com.au/coffee-can-number-2-the-25-million-sequel/

Andrew discussed two portfolios (Tidewater (ASX:**TDI**) and Equities and Freeholds (ASX:**EQF**)) constructed coming out of the GFC in 2009, to showcase the benefits of taking a coffee-can approach to investing in a portfolio of illiquid, low profile, small companies very much beaten up during the GFC. Andrew's portfolios comprised a collection of 'quirky' asset plays, together with some sound, but small, emerging, under-the-radar businesses. With a couple of exceptions, all these portfolio companies had very low market capitalisations.

Highlighting the power of patience and persistence, if held for 10 years from the GFC in 2009, the value of the EQF portfolio would have increased from \$1.1m to \$8.1m, while the value of the TDI portfolio would have increased from \$3.9m to \$26.2m. These outcomes were driven by a combination of strong business success, takeovers and corporate reorganisations.

We knew some of the portfolio companies owned by TDI and EQF very well. Like TDI, DMXCP also benefited from owning Konekt (ASX**:KKT**) through to its takeover at 70c in 2019 (although our initial entry price at ~20c in 2016 was higher than the 5c KKT share price at the starting point of Andrew's analysis (when KKT had a market cap of less than \$4m)). Interestingly, Diverger (ASX:**DVR**), which emerged out of Andrew's EQF, continues to be an interesting portfolio holding of DMXCP.

Over the years, we have had numerous other positions deliver very powerful returns, from low market valuations, when they were profitable, and relatively low profile, including the likes of Sequioa (ASX:**SEQ**), Secos (ASX:**SES**) and AVA Group (ASX:**AVA**). Just over 12 months ago, we became a substantial shareholder in Cryosite (ASX:**CTE)** when it had a market cap of ~\$7m and a share price of 17c. Recently, CTE's share price has traded at levels 200% to 300% above our entry price – highlighting the upside from buying an under the radar, profitable, growing, illiquid, low market cap stock, even in a challenging market environment.

What we are seeing today

We don't consider market conditions to be as dire as they were at the time of the GFC when Andrew Brown constructed his small company portfolios. Indeed, some of our larger positions have held up reasonably well. These include stocks like Earlypay (ASX:**EPY**), PTB, DVR and SEQ where there has been a strong track record of profit and dividend growth, and importantly, there had been little hype or growth expectations priced into their share price.

However, we do think the current market is presenting opportunities where the risk reward is starting to look very attractive. Our basket of very low capitalisation illiquid stocks (nano-caps) has been particularly impacted with the share prices of many of these companies trading on 12 – 24 month lows. While we are not currently seeing the number of asset-backed opportunities that we did during the GFC, we are seeing many beaten up technology opportunities, which in many respects, offer higher quality long term prospects. We highlight the following low market cap positions within our portfolio:

Company	**Market cap**	**Cash**	**Profit/loss**
Aeeris (ASX:**AER**)	$8m	$3m	Break even – first half profit before tax of $5k
Datadot (ASX:**DDT**)	$10m	$3m	Yes - first half profit before tax of $506k
EDU Holdings (ASX:**EDU**)	$14m	$3m	Previously profitable, but COVID impacted
Knosys (ASX:**KNO**)	$18m	$3m	Cash flow positive, running at a small EBIT loss
8 Common (ASX:**8CO**)	$20m	$4m	No – first half loss of $950k ahead of new contracts

We consider these all to be interesting, unique, under the radar opportunities on very low market valuations, and importantly, <u>have very little hype or any degree of growth factored into their share prices</u>. Therefore, if they can deliver the growth that we suspect, and surprise the market, they offer real possibilities of multi-bagger outcomes from their low current valuations:

- 8CO (which provides software to manage employee expenses for governments and large corporates), AER (environmental/climate monitoring and reporting) and KNO (enterprise grade knowledge and information management software) are all companies with low market capitalisations on the cusp of profitability. 8CO and AER in particular have strong revenue growth outlooks for FY23 and both have historically maintained a very disciplined low cost base and have had very low customer churn which should support their moves into profit. Indeed, the broker covering 8CO has it moving from loss making in FY22, to delivering a profit before tax of $2.3m in FY23 ($1.7m NPAT - which may be a tad optimistic, though FY23 is certainly shaping up to be a strong year for 8CO, as it begins to benefit from its recent win to provide the expense management system to over 90 organisations within the Australian government covering ~150k employees, and which is expected to generate ~$7m in high margin, annual annuity revenue). KNO has a bit more work to do to drive strong revenue growth, but three encouraging federal and state government wins in recent months suggest momentum is building post Covid.

  All three are interesting small businesses, punching well above their weight in terms of the customers and contracts they are winning. While inevitably progress takes longer than one expects, all three could be profitable next year: three high quality (all have impressive, long term federal and state government and corporate customers, high gross margins and very low churn) and growing businesses with market capitalisations of less than $20m. And once they turn profitable, continued customer growth, high margins, low churn and a low cost base, mean these companies are well placed to deliver strong growing future profits. In our experience, these represent some very attractive opportunities for re-rates.

- EDU is building a high quality, higher education business focused on providing career-focused qualifications and training in the high job growth health and community services sectors. EDU was making encouraging progress prior to COVID, but has since suffered due to a drop in international students. With those headwinds becoming tailwinds, substantial operating leverage within the business and an attractive new acquisition (a nurse training business) the business now has a strong profit profile as it exits CY22. Post month end, we participated in a capital raise to add to our existing position here, as we look to support sensible initiatives in long term positions that we know well.

- DDT is delivering strong profits. Whilst it has a small exposure to the automotive industry in Russia, it is seeing growth opportunities in other markets. A strong balance sheet, continued cash flow growth, multiple expansion, and the possibility of an inaugural dividend, ensure that there are multiple ways to win here. We think DDT continues to represent good value and an interesting low enterprise value opportunity.

Executing on our strategy

These smaller companies mentioned above (which are smaller weighted positions) complement our larger weighted portfolio positions that are typically more advanced, and which we have discussed in detail in recent monthly updates (Top 10 – March 2022 Report). These include the likes of PTB, KME, SEQ, DVR and EPY which are all profitable, dividend paying, attractively valued stocks with great growth prospects. We continue to be very excited about their future.

We believe we have a nice blend of these smaller nano-cap opportunities, and slightly larger micro-cap opportunities, all with significant upside potential. These are often difficult to access positions, in a portfolio that has been constructed over many years that we consider to be unique and difficult to replicate. We are long term substantial shareholders in several companies. We accept that not all will succeed in their journey to become much larger companies (as was highlighted in Andrew Brown's examples). It is one of the reasons why we invest in a *diverse* collection of these sorts of opportunities, each of which may have a certain risk profile individually, but which carries the potential to become multi-baggers over time.

In summary, we would like to emphasise:

- We remain focused on our strategy, because we absolutely believe it works over the long term. While the share prices may not reflect it, the portfolio companies that we own are stronger, more valuable businesses than they were 12 months ago, and we believe they will continue to grow and become more valuable over time;

- The recent weakness in smaller companies and our own portfolio are par for the course in investing. We seek to capitalise on volatility and mis-pricing on an individual stock level within the portfolio, and as investors ourselves, we expect to continue to add to our holdings, averaging in over time and accordingly are enthused about the potential to get more bang for our buck in these softer times;

- We are proud of the portfolio we have constructed and are keen to be transparent with our investors as to where we are invested and what we are doing, and why we are doing it (just as we expect similar transparency as investors from the managers of companies that we invest in). By being transparent, we hope we can illustrate why we are enthused about our portfolio and the value and opportunities on offer; and

We think we can add real value to our investors in this part of the market by offering exposure to interesting positions with attractive upsides, that are very much under the radar and often difficult to access.