DMX Capital Partners Limited
May 2022 – Investor Update

An investment company managed by:
DMX Asset Management Limited
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DMXCP directors: Roger Collison
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Opening NAV (30 April 2022) [1,2]	**$2.8592**
Closing NAV (31 May 2022) [1,2]	**$2.7008**
Fund size (gross assets)	$23m
% cash held - month end	5%
Gearing	Nil

1-month return	-5.5%
3-month return	-7.9%
12-month return	2.1%
3-year return (CAGR p.a.)	24.0%
Since inception (*7 years 2 month*) (CAGR p.a.)	19.1%
Since inception (*7 years 2 month*) (cumulative)	250.0%

*DMXCP Share price = Closing NAV (**$2.7008**), being: Share portfolio value + cash – fees payable – tax payable + franking credits*
Returns include dividends reinvested and franking credits paid. Since inception 81c of dividends & franking credits have been paid

Dear Shareholder,

DMXCP's NAV declined 5.5% (after all accrued performance and management fees and expenses) for May 2022. The NAV as at 31 May 2022 was **$2.7008** compared to $2.8592 as at 30 April 2022. The ASX Small Industrials was down 7.5% for the month and the All Ordinaries declined 3.5%.

May portfolio developments

May saw the continuation of the broad selling of smaller industrial companies we have seen since the start of the year, with the Small Industrials Index now having fallen 19.3% during 2022. Whereas in previous months, the largest negative contributors came from technology names, this month we saw the selling of some of our industrial holdings weighing materially on performance, including Kip McGrath (ASX:**KME**), PTB Group (ASX:**PTB**), DDH1 (ASX:**DDH** – which we have owned since it acquired our position in Swick Mining), Shriro (ASX:**SHM**) and AFL Group (ASX:**AFL**).

While there wasn't a lot of news during the month, companies that did release updates highlighted the challenging operating conditions many businesses are facing: Laserbond (ASX:**LBL**) noted supply chain issues that impacted its ability to deliver two technology licensing deals by 30 June, while SHM advised of increased container, freight and fuel costs. Notwithstanding these challenges and COVID impacts during FY22, LBL has had a strong year, guiding for a ~15% increase in organic revenue growth (and ~40% EPS growth), while SHM has guided for FY22 EBITDA of $20-$25m (and has a current Enterprise Value of ~$70m).

In terms of portfolio management initiatives, we have been focused on selling some lower conviction, smaller sized positions. This is helping to consolidate the number of names in the portfolio, while we also have been adding to certain existing positions at attractive valuations. Examples include DDH, which owns the largest drilling fleet in Australia, and is trading on a mid-single digit PE, and in the case of EDU Holdings (ASX:**EDU** – discussed below) participating in a well-priced capital raising opportunity.

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 would like, 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.

<u>Executing on our strategy</u>

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 (<u>Top 10 – March 2022 Report</u>). 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 prospects.

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.

As we have previously highlighted, we are patient investors and are happy to sit comfortably through this bout of market weakness, confident it will eventually pass and market interest will return, as it inevitably does. Unfortunately, no one rings a bell at the bottom, but long-term success in investing is correlated with patience, discipline, and consistency – not picking short-term tops and bottoms. To all our investors, we thank you for your support - we are absolutely focused on adding value over time through our unique portfolio of compelling small company opportunities.

We look forward to updating you again in July.

Kind regards

Roger Collison	Steven McCarthy	Chris Steptoe
Chairman	*Portfolio Manager*	*Research Analyst*

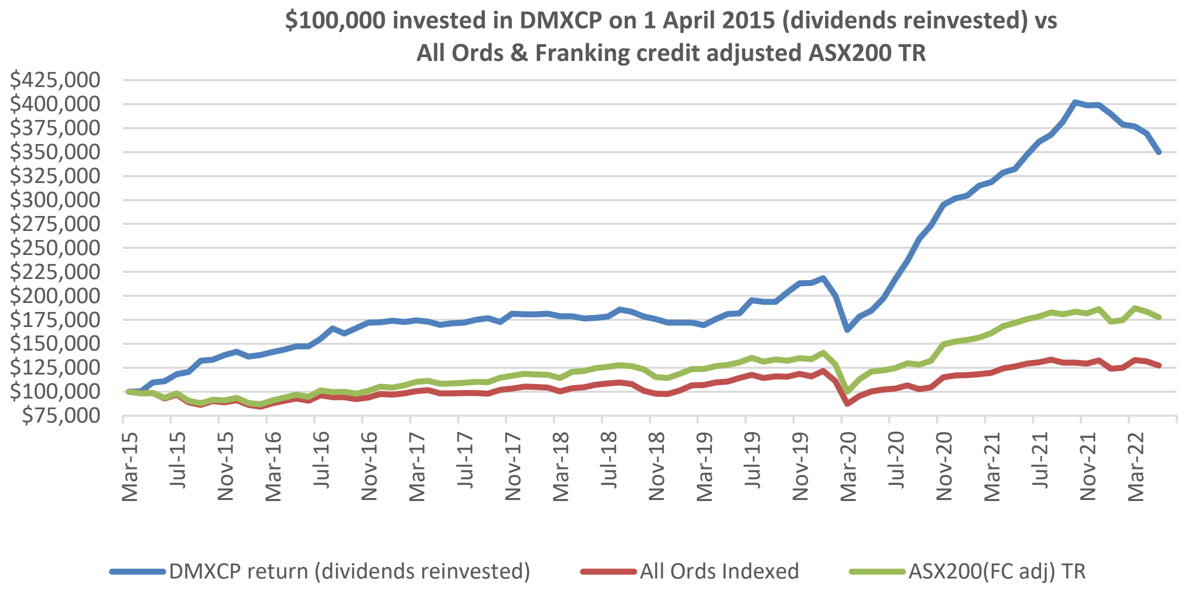
Note 1: Net asset value (NAV) is after income tax payable but includes an estimate of franking credits available. Refer note 4, unaudited
Note 2: Unaudited result
Note 3: All DMXCP disclosed returns include the payment of dividends and franking credits
Note 4: Franking credits per share are franking credits arising from dividends received and for tax paid or payable on realised portfolio gain

Appendix 1: Performance

Monthly DMXCP Net asset value (share-price) returns (after fees) since inception (April 2015) [3] (%):

Month	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	All Ords
2015	n/a	n/a	n/a	+0.201	+9.448	+1.104	+6.524	+1.971	+9.711	+0.958	+3.568	+2.470	**+41.62**	**-8.83**
2016	-3.590	+1.323	+2.049	+2.045	+2.143	+0.020	+5.389	+7.056	+2.156	+1.058	+1.520	+0.321	**+23.10**	**+7.01**
2017	+0.885	-0.816	+1.790	-0.741	-1.990	+0.210	+1.071	+1.208	+0.822	+3.494	-0.267	-0.055	**+5.54**	**+7.83**
2018	+0.445	-1.625	+0.008	-1.173	+0.310	-0.211	+1.017	+4.112	+1.604	-3.438	-2.827	-2.257	**-3.66**	**-7.24**
2019	+0.122	-0.010	-1.624	+3.754	+3.014	+0.418	+7.482	-0.889	+3.279	+4.567	+2.997	+0.140	**+25.10**	**+19.02**
2020	+2.33	-8.42	-17.91	+8.521	+4.525	+6.213	+10.09	+8.669	+6.518	+11.10	+7.86	+2.24	**+42.47**	**+0.72**
2021	+1.02	+3.31	+1.17	+3.20	+1.10	+0.70	+3.96	+2.12	+3.80	+5.51	-0.84	+0.04	**+28.06**	**+13.55**
2022	-2.48	-2.93	-0.51	-2.04	**-5.50**								**-12.9%**	**-4.21%**

The following chart illustrates the return from investing $100,000 in the fund (including dividends and attached franking credits) since inception (1 April 2015). DMXCP is an absolute return fund, focused on generating positive absolute returns over the medium to long term.



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