DMX Australian Shares Fund
July 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 June 2022) (ex-dist.)	**$0.9228**
Unit price (mid) based on NAV (31 July 2022) (ex-dist.)	**$1.0087**
Number of Stocks	47
% cash held - month end	0%
Fund size (gross assets)	$10m

1-month return	9.3%
3-month return#	-7.0%
12-month return#	-4.2%
Since inception (1 March 2021, p.a.) #	3.9%
Since inception (cumulative)	5.8%

 # Returns assume reinvestment of distributions.

Dear Investor,

DMXASF's NAV increased 9.3% (after fees and expenses) for the month of July, as markets staged a rebound following a strong sell-off into 30th June financial year-end. The broad-based ASX 200 Total Return Index rose 5.7% for the month, while the ASX Small Ordinaries recovered strongly, up 11.4%.

With markets stabilising, and recovering to some degree, we're experiencing the mixed sensation of being wary and mindful that the worst may not be behind us (is this the eye of the storm?); while also being very enthusiastic about the prospects for our portfolio constituents despite some of the bounce-backs. The latter really on account of a range of positive and reassuring updates we've enjoyed since 1st July. As we set out last month, and in a separate email to investors in June, we don't have any strong conviction that a bottom is in and it's all rosy from now on. Instead, we are focused on ensuring we own appropriately diversified portfolios of a range of quality smaller-company opportunities. If we own good businesses, ably-managed by well-incentivised people, and we own those at attractive prices, we're confident in the potential to generate respectable returns over the medium to long-term.

Portfolio Commentary

We didn't have any meaningful detractors this month, and the portfolio benefitted from a number of partial recoveries. Among them are companies that we believe were sold-off for tax loss harvesting reasons, and have gone on to report positively in July. Examples are **Ansarada** (up 10%), **AVA** (up 47%), **Knosys** (up 69%), **ELMO Software** (up 24%), **CV Check** (up 32%), **Frontier Digital Ventures** (up 33%), and **PropTech** (up 21%). Despite the recoveries, many of these still trade well below their recent highs and our initial entry points. Each of these companies has reported positively in July, and consequently our confidence is maintained at these higher levels. This basket of names is probably a good example of how we've responded on a case by case basis to the indiscriminate sell-off: ELMO, Frontier and PropTech were all added to in June (and July, in the case of ELMO), reflecting our confidence and the value on offer. Others were maintained as revenue wins and progress in general are more lumpy and risky. AVA and Knosys are good examples where the potential over time is significant, but our conviction isn't as strong as for other holdings. To add in the face of that uncertainty would carry undue risk, and irrespective, we'd deployed all our available liquidity into opportunities we were more comfortable with.

Other holdings that had also been weak and have enjoyed a good bounce in July include **Academies Australia**, **Credit Clear**, and **DDH1** (each up 24%), while **Diverger** and **Smartpay** were up 11-13% each. Each of these companies has reported positively, though Diverger – we believe – is a bit of a mixed bag with the company announcing an offer to effectively merge with Centerpoint Alliance in a transaction we believe to be very much in the latter's favour. Diverger is discussed in detail in the DMX Capital Partners' commentary, in the Appendix, below.

Relationship-Driven Deal Flow

One of the key value-adds we believe we bring to investors in the smaller company space is the relationships we've fostered with a network of brokers and broker-analysts. These relationships, developed over many years, have certainly been very helpful with accessing capital raisings, and significant lines of stock. This has certainly been the case of late as we participated in a line sale of ELMO shares at a handsome discount to the then market price, bringing this back to a meaningful position at a very attractive price point. We've been able to add to holdings recently in PropTech and 8Common by purchasing significant lines – again, at discounts to the prevailing market price.

We're also pleased to have been included as a sub-underwriter for a capital raise currently being conducted by **MedAdvisor**. MedAdvisor is a med-tech business with proprietary software technology that helps patients manage their medication, including adherence and re-ordering. The software connects patients and their pharmacists. The company has a significant business across Australia, and is growing into the US market (through the prior acquisition of Adheris). During July, the company announced the strategic acquisition of GuildLink from the Pharmacy Guild of Australia in an all-equity deal which sees the Guild becoming a substantial shareholder in the overall business. Concurrent with this, a rights issue is being conducted to raise growth capital and position the group for the years ahead. This is an underwritten rights issue, with sub-underwriters including the Guild, other institutional investors, as well as DMX funds. We have taken our share under the rights issue, and we're hopeful of acquiring additional stock via the sub-underwrite toward the end of the capital raise process, later this month.

So far, this batch of activity has added value, as we've increased positions at distressed prices. Funding for this activity has been achieved mainly from the ~5% of new capital inflow at 30th June (thank you again to those who have added to investments in June, and now July), together with the sale proceeds from reducing still-attractive but not-as-attractive other names. It's challenging and interesting to be working out where to harvest capital to take advantage of the rich pipeline of opportunities we face.

Positive Updates

The DMXCP report this month highlights our focus on cashflows, including companies that have strong current cash-flows, as well as a range of interesting opportunities in companies that are on track to become strongly cashflow positive in the short to medium-term. We're particularly interested in companies that are attractively priced relative to strong current cashflows, and where there are clear opportunities for growth. Within the DMXASF portfolio, companies like **FSA Group** and **Michael Hill** are good examples. These businesses trade for modest multiples of current earnings/cashflows, and each has the potential to reinvest some of those earnings into high-return growth. And while we wait for that growth to come through, and for the shares to re-rate, we enjoy dividend yields of ~5-6% each.

Among companies commonly-held with DMXCP, Diverger and DDH1 are good examples. The DMXCP report includes detailed commentary on each of these which we've included as an Appendix to this report. Additional brief commentary on a number of other commonly-held names is also included in the Appendix for your easy reference.

In Summary

After the declines of the previous few months, it's pleasing to report a strong July. While the macro-economic environment remains uncertain and carries an unusual degree of risk, the fundamentals for our businesses remain strong and the medium to long-term potential very positive. We don't have any sense as to short-term direction, and do feel what we can be increasingly confident in is a degree of volatility we've not had for some time. But volatility can be our friend, as we seek to take advantage at the stock-by-stock level within the portfolio: rotating out of the least prospective holdings, and into the most. We believe patience will continue to be required, but for those who are patient and disciplined in their allocation to investments such as these, the rewards over time can be meaningful.

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

Thanks for your trust and support.

Kind regards

Michael Haddad
Portfolio Manager

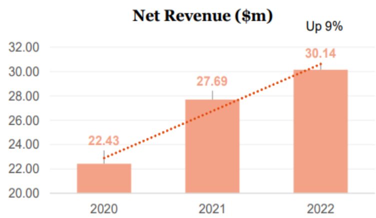
Chris Steptoe
Research Analyst

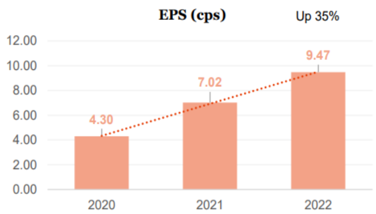
Appendix – DMXCP Positive Stock Updates

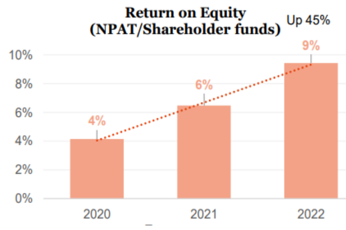
The DMXCP report contained updates on a number of commonly-held positions. These are:

Diverger Limited (ASX:**DVR**):

- Diverger provides products and services (licensing, training, back-office) to financial planners and accountants. In FY22, it generated $8.2m in operating cash flows (before tax), as well as 35% growth in EPS. With a capital light business model and predominantly recurring revenue (license and subscription fees) both DVR and our other holding in this space, Sequoia (ASX:**SEQ**) have been able to capitalise on some recent favourable industry structural changes. While SEQ hasn't yet provided its full year accounts, in its most recent update, it noted it was generating $1m+ operating cash a month. On current pricing, both DVR and SEQ are yielding **free cash returns (pre-tax) in excess of 20% on their enterprise values**.







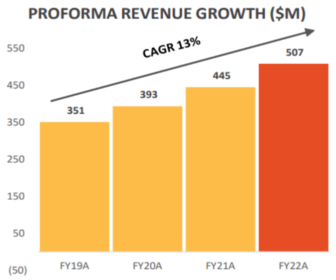
- Emerging industry tailwinds: There are strong tailwinds supporting DVR's growth - an aging population at the same time there has been a substantial reduction in the number of licensed advisors (due to increased regulation and education requirements, and banks vacating the space) has created a <u>rather unique supply/demand imbalance</u> and pricing power in favour of advisors. An upcoming intergenerational transfer of wealth of $3.5trillion from baby boomers to millennials will require significant professional support, increasing the importance of a robust wealth management industry and access to financial advisors. To position itself for this industry growth, DVR and its technology partner (and major shareholder) HUB, are working together on technology-led advice solutions around analytics, AI and automation, to improve the customer experience and importantly, lower the cost of financial advice, to make advice more accessible to an even wider audience.

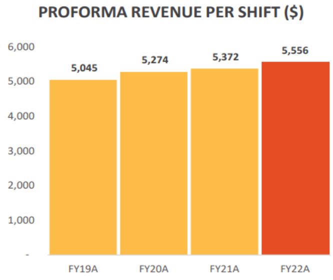
- Compelling valuation: In its update, DVR noted a "*Positive FY23 outlook - ongoing growth with higher returns for shareholders. We have started FY23 well, and look forward to delivering further growth and returns for shareholders*". DVR reported operating EBITA of $7.1m in FY22. According to broker estimates, this is expected to grow ~15% to $8.1m (NPATA of $5.8m) in FY23. With a market cap of $36m, **DVR trades on <7x FY23 PE**.

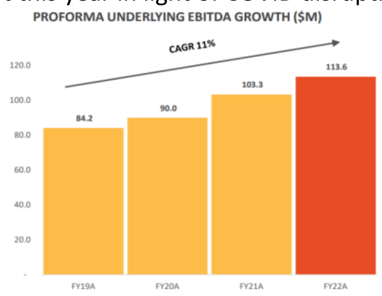
- There is a catch though: In June, DVR announced an unsolicited takeover of ASX listed competitor Centrepoint Alliance (ASX:**CAF**), with the intention to capitalise on these industry opportunities by creating a clear market leading player with greater operational scale (servicing more than 1,400 advisors). The problem we have with this proposed transaction is that DVR is paying a significant premium to acquire CAF (at a multiple well above that what DVR is trading on), which will need to be satisfied through issuing DVR shares (which we believe are undervalued) and taking on debt. While the merger of these two ASX listed players makes sense, in our view (from the perspective of a long-term DVR holder) the current deal terms do not. We have expressed these concerns to the DVR board and management. At this point, there is uncertainty as to whether the deal proceeds, but we would like to see a resolution to this, one way or the other, shortly.

DDH1 Limited (ASX:**DDH**):

- DDH is the largest mining drilling company in Australia and the third largest globally (by revenue). We acquired our position here when we received DDH shares after DDH took over our holding in Swick Mining earlier this year. While we are typically cautious on mining services companies, DDH has consistently delivered double digit revenue and earnings growth – a particularly commendable effort this year in light of COVID disruptions.







- Positive industry dynamics: The Australian drilling industry rig fleet numbers have surprisingly declined since peaking in 2012. Here we have similar industry dynamics to the wealth management industry (as mentioned above) – <u>supply has actually been dropping at the same time there has been increasing demand</u> for drilling services. DDH has the capacity to organically grow its fleet to leverage this industry fleet shortfall, to meet increased demand and maintain high rig 4utilization. These positive industry fundamentals are reflected in DDH's margins and cash flows – the company itself saying that, even in light of COVID issues, "*Our EBITDA margins are still remarkable*".

- Valuation and cash flows are compelling: DDH is expected to grow its EBITDA by ~10% in FY23 to over $120m, making it one of the most profitable sub-$500m market cap companies on the ASX. From this profit, it should generate before tax free cash flow (after all growth and maintenance capex) of ~$65m. DDH noted "*The business is well set to pursue its growth aspiration **<u>and</u>** deliver significant free cash flows for capital management purposes*". We have underlined 'and' in this statement: DDH continues to invest in growth initiatives (new rigs) to meet the industry demand. It's is on track this year to pay a 6% dividend yield, <u>as well as</u> conduct a share buy-back (forecast at ~$10m of shares by house broker Canaccord who is undertaking the buy-back) while still growing its cash balance year on year. In addition, if not for this capex 'growth' investment, on a steady state basis, free cash flows (pre tax) would be closer to $100m, or a **free cash yield in excess of 25%.** On an after-tax basis, we estimate DDH is currently trading on an **FY23 PE of ~6x**.

- Is the negative sentiment towards DDH justified? The low valuation here (relative to DDH's market position, growth outlook and strong balance sheet and cash flows) presumably reflects investor concerns about declining commodity prices on future demand, and the cyclical nature of the business more generally. The company believes otherwise, stating "*The outlook for FY23 is positive. Despite the macroeconomic factors that are currently impacting market sentiment, the fundamentals driving demand for DDH1's services remain compelling*." In support of this, ~90% of DDH's revenue is generated from production and resource definition drilling programs, rather than the more cyclical exploration drilling. From this low valuation, with a buy-back now in place and comparable companies (ie MACA Ltd, ASX:**MLD**) being acquired at much higher multiples, we see upside from here.

<u>Other notable FY22 cash results</u>

July also saw many of our emerging companies report their fourth quarter and full year cash flows, and for the most part, these were positive with most of our companies continuing encouraging trajectories. We run through a number of these below.

- Ansarada (ASX:**AND**) delivered another strong year of cash flows with annual operating cashflows of $12.2m (and development capex of $5.9m). As a great example of the power of free cash flows, AND was able to **self-fund out of its free cash the $6m** acquisition of a highly synergistic, earnings accretive acquisition (Triline GRC), without any reduction to AND's net cash balance through the year.

- Digital reference checking company Xref (ASX:**XF1**) reported positive net cashflows (after product development capex) for FY22 of ~$3m (up from ~$900k in FY21). This reflects the positive recent trends across the business, where revenue growth of 100% over the past two years has seen XF1 move from a $10m loss in FY20, to a breakeven profit position in FY21 to a forecast $2m profit in FY22. With momentum increasing in offshore markets, we back management to continue executing on the number of growth opportunities they are working on.

- Yellow Brick Road (ASX:**YBR**) generated free cash of ~$3m in FY22. While working capital movements can swing this number from period to period, on the face of it, it is a solid return for a company with an enterprise value of less than $20m. Almost half of YBR's market cap is now either in cash or high yielding notes – with the value of net cash and notes on its balance sheet now $12.4m, over $3m higher than the $9.2m net cash position 12 months ago – reflecting the strong cash generated through the year. Further, on an asset basis, the ~$20m enterprise value implies a 50% margin of safety to the ~$40m NPV of trailing commissions receivable by YBR, that underpins YBR's asset valuation.

  Trading at a **discount of ~30% to its net tangible assets** (cash, notes and commissions receivable), and therefore with **no value being ascribed to YBR's intangible assets** (i.e. the inherent value in YBR's leading 1,400+ broker network, its significant mortgage aggregation business, its digital lending platform and digital assets, and its $200m+ wholesale lending business JV), we remain of the view that YBR is one of the cheapest companies on the ASX.

- Smaller technology companies, CV Check (ASX:**CV1**), Knosys (ASX:**KNO**), Aeeris (ASX:**AER**) and Proptech (ASX:**PTG**) all reported broadly neutral free cashflows for FY22. These companies have all been investing in sales and marketing and product development, and continue to have strong balance sheets and have no need to raise capital. The growth trajectory in these businesses is positive, and we would expect these four companies to all start generating free cash in FY23 as operating leverage emerges.

- Another company making great progress in relation to its cashflows is payroll software provider ELMO Software (ASX:**ELO**). ELO advised that it is expecting to reach cash flow break even this year, a significant achievement and improvement on its $16.4m outflow in FY22. This improvement is being driven by exceptionally strong revenue growth of ~30%, which will see **EBITDA increase from ~$7m to ~$22m in FY23** – an outstanding growth profile.

- The one negative cash result came from Raiz Investments (ASX:**RZI**) which after many quarterlies of prudent cash management, has decided to invest heavily in marketing and branding in hindsight at what has proved to be an inopportune time. Negative operating cashflow for the quarter of $2.2m and for the full year of $2.7m appears to be a disappointing result, and we will see if there is an uptick in customer numbers over the next few months to provide evidence of a return on this marketing spend. With $15m in recurring account maintenance fee revenue, a significant customer base and $1b in funds under management, RZI intuitively seems good value at these levels ($40m EV), but we do remain concerned about its cashflows.