DMX Australian Shares Fund

February 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 (31 January 2023)	**$1.1101**
Unit price (mid) based on NAV (28 February 2023)	**$1.0416**
Number of Stocks	45
% cash held - month end	6%
Fund size (gross assets)	$11m

1-month return	-6.2%
3-month return#	-3.7%
12-month return#	-7.5%
Since inception (1 March 2021, p.a.) #	4.4%
Since inception (cumulative)	9.0%

 # Returns assume reinvestment of distributions.

Dear Investor,

DMXASF's NAV declined 6.2% (after fees and expenses) for the month of February, in what was a generally weak market environment with the ASX 200 Total Return Index declining 2.5%. We fared worse than the market through what turned out to be a very rough reporting season with companies suffering for higher costs, lower margins, and deteriorating outlooks for the periods ahead. With investor sentiment much more cautious, any good news received fairly muted responses, while bad news carried punishment that was seemingly disproportionate to the crime.

Commentary

Most of our companies reported in February, and some with disappointing results or guiding toward continued challenges ahead. The common theme being ongoing cost inflation, weaker economic conditions, and deteriorating margins. The expectation of worse to come has certainly been very broadly discounted into share prices, with 2/3rd of our 45 companies falling over the month, the average decline for that group was 12% while the five largest decliners fell 20-34% each. Among the big decliners were some of our larger holdings, including **Academies Australia** (down 27%), **Kip McGrath** (down 34%), and **Pureprofile** (down 20%).

Bright spots on the other side of the ledger enjoyed only very muted positive share price performances, with the likes of **Laserbond** up 8% on a very solid result, and **Sky-Fii** being the only 'double-digit' return at up 17% though on an inconsequential position size. With bad news dominating, and little to mitigate the damage, our NAV declined over 6% on a net basis for the month.

We don't feel too strongly one way or the other in terms of short-term *price* action, but we do feel the *fundamentals* for *some* of our companies have deteriorated. With that, we are being particularly cautious with how we manage through this environment, including where and how we add to increasingly attractive opportunities, and where and how we should recognise the adverse outcomes and potentially cut losses.

On the whole though, we do believe price declines reflect an overreaction, and the broadly negative market sentiment of the day. We're enthusiastic about the medium to long-term prospects, with an eye to capitalising on perceived mispricing in favoured individual names.

For further discussion on a number of our positions, we highlight the detailed commentary from the DMX Capital Partners report on its Top 10 holdings, included in the Appendix, below. These companies are all owned by the DMX Australian Shares Fund, with many also among our Top 10. The updates give a good sense for the value, growth and opportunity in front of us across our diverse portfolio.

Kind regards

Michael Haddad
Portfolio Manager

Chris Steptoe
Research Analyst

Appendix – DMXCP Top 10 Positions: Half Year Updates

Portfolio company	Industry / market cap	Commentary on half year reporting
Laserbond (ASX:**LBL**)	Laser engineering technology company with global customer base Market cap: $99m	**How it reported:** Solid report with strong growth metrics Revenue **+39%** NPAT **+32%** EPS **+18%** **Outlook**: Despite these strong numbers, LBL still hasn't fully hit its straps post COVID. The second half is expected to be even stronger than the first, on the back of technology license revenue being recognized, and improved margins from its products. LBL noted that by providing products and services that reduce the total cost of ownership of equipment in capital intensive industries, as well as contributing to reductions in their carbon footprint, it expects strong demand for its products and service to continue. **Upside/growth thesis**: LBL continues to target $60m revenue over the next two years, which will see NPAT exceeding $10m. This provides solid upside, for an innovative engineering technology company with a global opportunity supported by strong ESG tailwinds.
Kip McGrath Education Centres (ASX:**KME**)	Global tutoring company Market cap: $25m	**How it reported:** Below expectations Revenue **+9%** (organic) EBITDA**+5%** NPAT **-27%** **Outlook**:We had expected FY23 to be a break-out year for KME, on the back of its corporate centres becoming profitable, and a recovery in lessons post COVID. However, EBITDA growth was, disappointingly, lower than expected with the contribution from KME's corporate centres below expectations, and lower revenues from its US business. Management have guided for a stronger second half. A more diversified US business is expected to lead to improved revenue (currently contracted revenue for the year of $1.1m versus $0.3m recognized in 1H) and profit contribution from Tutorfly in the US. The contribution from KME's corporate centres is also expected to improve in the second half. With those two uplifts, we think a full year NPAT of $2m to $2.5m is achievable, which would represent 10-25% EPS growth from FY22. This will be important to show that the KME growth thesis is back on track, albeit at a lower rate than we had expected. The market will remain sceptical until this full year result is delivered and there is more confidence in the company's earnings and cash profile. **Upside/growth thesis**: KME has been a very frustrating hold for us, and very testing of our patience, as well as being a material detractor to performance. While the business has a track record of many, many years of revenue growth and profitability, margins have been declining in recent years. We find it particularly frustrating that a leading global business generating annual tuition fees of $100m + across its network provides such poor profit returns to its shareholders. But therein lies the opportunity. KME is a resilient and growing profitable business, and a leading global brand in the tutoring sector with a large international footprint, now with a market cap of less than $30m. The business continues to generate good levels of cash and is in a net cash position. If current management are unable to properly monetise this significant fee base (and capitalise on its growth opportunities) then we would expect private equity to make a bid for the company.

SOCO Corporation (ASX:**SOC**)	IT services Market cap: $59m	**How it reported:** In line with expectations Revenue **+61%** (organic) EBIT**+35%** NPBT**+36%** **Outlook**: Positive – SOC noted its sales pipeline continues to show strong performance while there are signs that the IT employment market is beginning to loosen. Together with price increases and enhanced staff utilisation, this will continue to uplift SOC's future margin. SOC's expanded team sets a strong footing for future reporting periods (with revenue increasing in line with head count). **Upside/growth thesis**: Notwithstanding its recent IPO, SOC retains very high insider ownership, with more than 80% of the company held by founders, management, board / employees, and aligned to continued successful execution. An impressive 74% of employees are shareholders today. Current valuation at 10x EBIT is not demanding, and the growth profile (both organic and inorganic) remains very strong, and tailwinds very supportive.
DDH Group (ASX:**DDH**)	Mining services - drilling Market cap: $147m	**How it reported:** Above expectations Revenue **+17%** NPAT**+31%** EPS**+13%** **Outlook:** While January and February are expected to see some revenue weakness, primarily due to adverse weather, the outlook for FY23 is positive. The fundamentals and macro trends driving long-term demand for DDH's services remain compelling with 85% of DDH1's revenue derived from production and resource definition drilling programs. **Upside/growth thesis:** DDH's fleet of 190 rigs is the largest in the Australian market and fifth largest in the world. DDH continues to trade on a very low multiple (7x PE), at a significant discount to its international peers, and with a strong balance sheet is generating large amount of free cash, allowing it to pay a 7% fully franked dividend, as well as undertake an on-market buy back. With a strong trend of operating EBITDA growth (5 year 12.8% CAGR), and a market leading position, we are confident that DDH will continue to grow and benefit from a multiple re-rate and growing earnings.
Smartpay (ASX:**SMP**)	Independent EFTPOS provider Market cap: $136m	**How it reported:** SMP has a March balance date, so was one of the few portfolio companies that didn't report. Based on its half year results released in November it reported: Revenue **+68% (all organic)** NPAT**+637%** EPS**+637%** **Outlook**: SMP expects a strong second half performance, based on the continuing momentum it has seen in the first half of FY23. Growth is underpinned by an acceleration in the number of new terminals being onboarded, and an increasing acceptance by consumers and businesses of SMP's surcharging model. **Upside/growth thesis**: SMP will deliver a very strong profit performance in FY23 notwithstanding a significant investment in its sales and marketing resources. There is an opportunity for further leverage in SMP's earnings base as sales and marketing costs stabilise. EBIT margins are forecast to grow from 7% in FY22 to high teens in FY25, highlighting the operating leverage and rapid scaling of profits in coming years.

Cirrus Networks (ASX:**CNW**)	Enterprise / government focused IT services Market cap: $30m	**How it reported:** Above expectations Revenue **+27% (all organic)** EBITDA >100% $2.2m (up from a loss of $379k) PBT >100% $1.3m (up from a loss of $2.2m) **Outlook**: Very positive - CNW noted it is well placed for continued strong growth through the remainder of FY23, with growth underpinned by 2H23 contributions from new managed service contracts along with its record backlog, positive pipeline of opportunities, disciplined overhead cost controls and strategic focus on higher margin services revenue. **Upside/growth thesis**: Based on consensus EBIT for FY23 ($3.8m), CNW trades on an EV/EBIT of 6X, a significant discount to closest peers Data3 (DTL) and Attuara (ATA) which are trading on FY23 EV/EBIT of 20X and 13X respectively. CNW remains very much under-the-radar and unloved, and, as a result, trades on very attractive earnings multiples and at a significant discount to its larger peers. This compelling valuation and growth outlook means there are multiple ways to win from current pricing: 1) a multiple re-rate closer to its peers 2) additional managed services contract wins increasing the quality and the level of CNW's earnings 3) an accretive internally funded acquisition improving the range and/or reach of CNW's services and 4) attractive takeover candidate.
Cryosite (ASX:**CTE**)	Clinical trial logistics (specialised storage and transport). Market cap: $40m	**How it reported:** In line with AGM outlook Revenue **-2%** NPAT **– 13%** EPS **-13%** **Outlook**: CTE noted that the demand for its depot capabilities remains strong, with distribution and other services replacing the record spike in demand for storage services experienced during Covid. CTE is well positioned to take advantage of the expected growth in clinical trials, biological services and complex logistics that is emerging and will continue over the remainder of the decade, particularly with the backdrop of strong onshoring tailwinds. **Upside/growth thesis**: After four years of consistently strong growth CTE reported a marginal drop in revenue this half. CTE's revenue and profits would have been materially higher if there had been no delay in regulatory approval for a new commercial product that CTE is contracted to store and distribute. With approval of this product expected this half, we would expect CTE to continue its strong growth trajectory in future periods.
Medadvisor (ASX:**MDR**)	Global medical adherence Market cap: $130m	**How it reported:** A quite remarkable result highlighting a significant turnaround Revenue +66% EBITDA of $8.6m, **up $13.1m** on 1H FY22 loss of $4.5m NPAT of $4.7m, **up $11.4m** on 1HFY22 loss of $6.7m **Outlook**: MDR is historically a seasonal business, and has guided for a moderation in revenue growth in the second half. However this maiden profit provides us with increased confidence in relation to the future of MDR: • It highlights that the digitialisation of MDR's large US pharmacy network is attracting increasing business from large pharmaceutical companies looking to access MDR's pharmacy distribution platform (which now provides digital access to 60 million people). Pharma companies are looking to increase spend on digital messaging, as a higher ROI alternative to other advertising mediums. .

		• After many years of making losses, this result demonstrates MDR's ability to derive strong profit margins from its products when it operates at scale. • It is pleasing validation of the efforts of MDR's new management team and restructured board. **Upside/growth thesis**: As mentioned in our update last month, MDR is currently tracking towards $100m revenue for the year, which is essentially a break even position (gross margins are at 60%, while OPEX is ~$60m). In FY24 and FY25 it has a unique opportunity to significantly further its revenue growth as it utilises its distribution base to undertake large digital campaigns in the US. As it grows its revenue line past $100m we expect MDR to be generating sustainable NPAT results.
Sequoia Financial Group (ASX:**SEQ**)	Service provider to Australian wealth management industry Market cap: $65m	**How it reported:** Well below expectations (but in line with its January update) Revenue **-20%** EBITA **– 13%** **Outlook**: SEQ noted that ~$2m of abnormals impacted the first half, and that the second half would see it return to its $1m EBITDA/month earnings run-rate that it had been generating in FY22. Guidance for the second half of $6m EBITDA compared to $3.2m in the first half. The market is in no mood for 'second half stories' at the moment, so will remain highly skeptical until evidence of this level of earnings can be achieved. **Upside/growth thesis**: Like KME, SEQ has been a particularly disappointing investment over the past 12 months. However, it is fundamentally a very strong business, currently sitting on $15m cash. Assuming it does indeed return to its $12m EBITDA runrate (with ~$1m in lease costs), it will be generating $11m annualized pre-tax cash, so is clearly cheap relative to its $50m enterprise value. SEQ is open to divesting non-core assets while it also retains an ambitious FY26 revenue target of $300m. We would expect SEQ to return to growth this half, which should drive a share price recovery.
Diverger (ASX:**DVR**)	Australian wealth and accounting services provider Market cap: $37m	**How it reported:** In line with AGM guidance Revenue **+7%** EBITA **– 13%** **Outlook**: Management have stated they expect a second half skew to earnings and relatively flat profit result for the full year. An investment in resources, in particular the addition of more business development staff to support growth in training and membership services, has held back profit growth for the year. **Upside/growth thesis**: Management have presented a three year strategy to grow DVR's net revenue to $45m in FY25, through growing scale, service expansion across its network (training, IT services, self licensee services) and technology driven transformation. If successful, this is expected to see EPS increase from its current 12c to between 18c – 22c. With a share price of <$1, this highlights the potential value on offer here for what continues to be an attractive (90+% of its revenue is now recurring in nature), under the radar, business.

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