



DMX Australian Shares Fund

October 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 (30 September 2023)	\$1.0102	1-month return	-4.5%
Unit price (mid) based on NAV (31 October 2023)	\$0.9651	3-month return [#]	-2.7%
Number of Stocks	43	12-month return [#]	0.2%
% cash held - month end	1%	Since inception (1 March 2021, p.a.) [#]	2.9%
Fund size (gross assets)	\$10m	Since inception (cumulative) [#]	7.9%

[#] Returns assume reinvestment of distributions.

Dear Investor,

DMXASF's NAV decreased 4.5% for the month of October, broadly in-line with the market with the ASX 200 Total Return Index declining 3.8% and the ASX Emerging Companies Index down 4.6%. We'd been propped up in prior months by takeover activity within the portfolio. October wasn't as eventful in that respect, with (pleasingly) the **Energy One** takeover falling over and its stock falling 18% for the month, while **Diverger** (also pleasingly) rose 11% on the back of a competing acquisition proposal at a higher price.

Commentary

Along with a declining broad market, we suffered declines of 10% in **Academies Australia**, 14% in **Earlypay**, and 17% in **Smartpay**, all for no company specific reason, but perhaps on readthrough from listed comparables' negative updates. **SOCO Corp** declined 16% following a softer-than-expected profit result and outlook, while **Kip McGrath** backslid, reversing its previous recovery with a 27% decline. None of these have led to any portfolio changes, and we remain comfortable with the prospects and value for each. Some bright spots helped mitigate some of the damage with some large gains in smaller holdings helping: Findi up 52%, DataDot up 33% and Schrole up 32% for the month. **Frontier Digital** has finally caught a bid on the back of reasonable quarterly numbers. The stock was up 7% for the month and has maintained that momentum into November. Finally, as mentioned above, **Diverger** was up 11% on encouraging developments on the corporate activity front.

The DMX Capital Partners report includes our updated thoughts on the Diverger corporate activity, with the emergence of a counter-bidder. It also includes an update on **Sequoia** which remains a key holding across both funds. This commentary is included in an Appendix to this report.

New Stock: Fiducian

A new holding for the fund is **Fiducian Group**. Fiducian is an Australian financial services provider with an integrated model including financial planning, funds management, and platform development & administration. The company was established in 1996 by its founder-CEO, Indy Singh, who retains a 35% ownership stake in the business and has led the business through its long and steady growth journey. The company has an excellent culture and Indy is supported by a long-serving executive bench. The company has grown both organically and through strategic bite-size acquisition. Acquisitions have expanded either its product offer and/or geographic reach, and these have been augmented by cross-sell and organic growth. Indy's substantial shareholding which has been virtually unchanged for many years speaks to the effectiveness of its growth strategy which has been funded by earnings, despite paying a healthy dividend along the way.

Fiducian's core revenue sources are 1) funds management fees; 2) financial advisory fees; and 3) platform administration fees. Philosophically, the funds management division employs a multi-manager approach whereby they seek to outperform over time through selection of superior individual managers, but ultimately they wish to spread underlying investments to minimise risk of material underperformance. This business being integrated with its financial advisory and third party platform business provides a strong and natural source of distribution for their diverse fund offerings. The upshot from this is we've seen steady and consistent performance for the business over many years despite volatility that may occur in markets from time to time.

This is in contrast to purer-play funds management businesses which don't own their own distribution and tend to suffer material outflows following periods of underperformance.

Over time, Fiducian has gone through both golden periods and times of softer conditions in line with major market movements. Its earnings power has moved around modestly over time, but a core level of profitability has been consistently maintained through the cycle. With modest volatility in business performance, the market – we believe – has swung from being too bullish to too bearish at various times. The company had a good run operationally with a step-change to its earnings profile in the mid-2010's which saw its shares re-rated to fuller (and we'd argue, fairer) multiples. But recent results have been softer, with June 2023 financial year's earnings being impacted by higher costs, the impact of a fee reduction, a small misstep with a recent acquisition (which has since come good), and lower average FUM for the year. Prior enthusiasm has turned to neglect, with the shares falling some 30-35% over the past two years despite revenue and earnings growth over that medium-term time frame. At our purchase price in the \$5.55 to \$5.70 zone, Fiducian trades for less than 12 times last year earnings, and less than 11 times current year expected earnings. Its dividend yield is over 5%, and the company enjoys a debt-free balance sheet with cash at hand to help underpin its next leg of growth. It is well-positioned with strong industry tail-winds. Its dividend yield together with base-line earnings growth expectations in the 5-8% pa range should underwrite a long-term (10 year plus) return in the 10% pa+ zone. Any further step-change to earnings through capital allocation initiatives, and any eventual re-rate to a more normal multiple (in the 15-17 times zone) could enhance that total return profile to the 15% pa zone on a forward 10-year basis from these levels.

The main risks include key man risk around its charismatic CEO, Indy, though the bench is wide and deep and the company has been built very much for the long-term and with long-serving executives. Market risk is a factor as the company is exposed as a fund manager and financial advisor. But this risk is mitigated by its value-conscious multi-manager approach and a multi-sector approach to its business. It has capability across equities, property, fixed interest and cash, and any market dislocations have generally been absorbed comfortably in a broader asset allocation context.

Summary

While down in sympathy with the declining market this month, we remain enthused about the medium to long-term prospects for our portfolio companies. In what's becoming a significant bear market for the smaller company sector, there's no shortage of attractive opportunities. This is reflected in our cash weighting which is close to nil, and in the steady flow of new names and top-ups in the portfolio. We continue to look to trim less prospective holdings to fund purchases, and proceeds from takeovers (Cirrus Networks being the most likely to inject some cash in the next month or so) and investor flows are further assisting.

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.



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Appendix – DMXCP Diverger & Sequoia Updates

Diverger Update

Last month we discussed the proposed takeover offer for DVR from Count (ASX:CUP) and noted that, as long term shareholders in DVR, we could not see sense in DVR transacting at CUP's offer price of \$1.14 per share, given the quality of the DVR assets and when DVR is currently earning 13c EPS. Notwithstanding the DVR board's unanimous recommendation of the CUP offer, we did not believe that this transaction appropriately reflected the fair value of the DVR business. We viewed the 25%+ accretion to CUP's earnings as a result of acquiring DVR as excessive, and believed it highlighted the significant value that DVR was bringing to the transaction, and which we felt DVR shareholders were not being appropriately compensated for.

During October, DVR revealed that it had been approached by ASX listed financial services business COG Financial Services (ASX:COG) in relation to a proposal to acquire DVR for **\$1.41** – representing a **24%** premium to the \$1.14 offered by CUP. In addition, for the cash component of the offer, COG was offering \$27m cash, versus CUP's \$14m. We believe that this bid by COG at \$1.41 validates our view (that we had articulated to the DVR board) that the CUP offer at \$1.14 materially undervalues DVR and should not be accepted.

While COG had notified DVR of its proposal on 13 October 2023, it was only released to the market by DVR on 30 October 2023, after the offer terms had been leaked to the financial press. With the DVR board having "*unanimously recommended*" the CUP offer at \$1.14, and then only belatedly disclosing a superior potential offer at the materially higher \$1.41, the spotlight is now very much on how the DVR board drives an outcome that secures a more appropriate valuation for DVR. We expect that the DVR board will be exploring and progressing all viable options here to ensure a fairer outcome for DVR shareholders, as well as a logical and value-adding merger for its ultimate suitor.

During November we have also seen DVR's major shareholder HUB, acquire DVR shares on market at \$1.26. We now struggle to see how the Independent Expert appointed to assess the fairness of the CUP Scheme can recommend that CUP offer at \$1.14 as being fair to DVR shareholders, given DVR's major shareholder is happy to pay an amount ~10% higher to acquire more DVR shares on market.

Sequoia

During October, SEQ released an update confirming its strong operational progress.

In the second half of FY22, and through FY23, SEQ faced industry headwinds (margin pressure and declining advisor numbers) and was dealing with a number of internal distractions (the sale of Morrisons, issues with its Share Café purchase, and some legacy claims issues). With these distractions now behind them, and those industry headwinds easing (margins have improved on the back of price increases, and SEQ's advisor base has increased 10%), SEQ should start to see its profits improve from here, and we look forward to a positive trading update at SEQ's upcoming AGM.

In FY21, SEQ, after initially guiding for \$6m EBITDA, after several upgrades, delivered an actual result for FY21 of \$11.5m EBITDA. The SEQ share price increased from 20c to 70c over this period, following the improved trajectory in earnings. Given its capital light model, SEQ has the potential to, and has demonstrated the ability to, scale and generate significant cash (\$1m+ free cash per month).

As it stands today, we think SEQ represents a pretty compelling opportunity in this market:

- \$35m of its ~\$70m market cap is cash;
- Targeting 25% annual revenue growth;
- Forecasting a 5c (~10%) fully franked dividend;
- With forecast EBITDA of ~\$10m it is trading on ~3.5x EBITDA;
- With forecast NPATA of ~\$7m it is trading on ~10x PER (notwithstanding its large cash balance – adjusting for the cash held would it put it on a 5x PER); and

- Strong medium term growth aspirations: \$24m EBITDA by FY26 (with a target \$20m cash balance, implying (if achieved) a 2x EBITDA valuation).

SEQ's current pricing reflects concerns around how Management will deploy its large cash balance, together with scepticism around execution given disappointments over the last 18 months or so, but also more broadly reflects the lack of investor interest in small illiquid companies. With consistent recent director buying and SEQ's use of its buyback at current levels, its substantial cash balance (\$35m) relative to its \$70m market cap, and improved confidence that earnings growth is back on track and industry conditions improving, we think it now makes for an attractive set-up.

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