Emerging Companies Fund

Monthly Update: December 2022

Dear Fellow Investors,

Our Emerging Companies Fund was down –6.7% in December vs -3.6% for the Emerging Companies Accumulation Index (XECAI) and -3.4% for the Small Industrials Accumulation Index (XSIAI). Since inception, the Fund has generated +10.9% p.a. and a total return of +84.4% vs +67.6% for the XECAI and +28.4% for the XSIAI.

December was yet another month of turbulence for markets and our Fund, largely driven by central bank commentary suggesting that interest rates would be going higher (and staying there for longer), which saw bond yields climb again albeit still failing to reach their highs of June and October. Whether the Fed commentary is merely tactical or an honest opinion on the interest rate outlook (we suspect the former), the short-term (and desired) outcome is to pressure the marginal consumer/investor to reduce spending/risk and increase savings/liquidity, thus relieving some of the persistent inflationary pressures that have arisen during the past 12 months. However, this concept of impacting the 'marginal' investor is an important one, as we must bear in mind that the vast majority of investors in the companies we currently own are not selling out at these depressed prices (in many cases, transaction volumes are negligible). An efficient market would imply that despite the marginal selling pressure, rational buyers would promptly respond and create sufficient balance such that these shares transact at a price that appropriately reflects the fair value of Company, but the growing (albeit temporary) financial and psychological pressures of the current investment environment, combined with insufficient liquidity levels for most institutional investors, unfortunately dictates otherwise.

Despite owning many stocks that were already down >50% from their 12-month highs, almost half of our portfolio declined by >10% during the month, despite no incremental negative news flow across the portfolio. Conversely, we had a few stocks that provided positive updates, which we will cover over the page. In order to highlight the ongoing short-term challenges we are facing to generate positive performance, a stock that we recently added to the Fund, Dropsuite (DSE, -16%), sharply declined during the month due to the emergence of a significant institutional seller. Yet in the two months prior when we were building our position, we couldn't find any significant sellers, forcing us to buy most of our stock via daily trading in the screen. The motives for selling significant volumes in a short space of time at declining prices are likely related to losses of FUM, as it is highly unlikely they are reacting to the operational performance or financial stability of the business given its most recent quarterly update (which exceeded broker forecasts) saw +63% growth in ARR, positive cash flow and a cash balance of $22.3m. Furthermore, the selling pressure only emerged this month, well after the update in October. As such, we continue to deal with highly unpredictable investor (and share price) behaviour, which we largely attribute to sustained negative market momentum (most acute in micro-cap industrials) that is feeding on itself, well after the initial cause of the market decline has passed. Looking forward, we are hopeful that the end of the year may provide a circuit breaker, with much of the more recent selling pressure likely to have targeted completion by 31 December. Also, January will provide plenty of news flow for our stocks, with many providing updates for the December quarter.

Performance summary

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total	3M	12M
2017		-3.2%	+2.6%	-0.6%	-1.0%	+7.6%	+6.4%	+2.7%	+4.0%	+13.2%	+9.5%	+8.1%	+60.1%		
2018	-1.6%	+4.2%	+1.6%	+1.1%	+4.1%	+1.6%	-3.1%	+0.7%	-0.8%	-3.2%	-4.8%	-5.2%	-5.9%		
2019	+6.0%	+4.8%	+3.1%	+4.7%	+10.8%	+0.6%	+17.6%	+1.4%	+6.1%	+4.6%	-0.8%	-1.3%	+73.2%		
2020	-0.6%	-11.7%	-28.4%	+23.3%	+18.4%	+14.1%	+16.0%	+20.7%	+3.1%	+1.0%	+2.3%	+4.0%	+62.3%		
2021	+1.9%	+2.1%	-0.1%	+5.0%	-4.4%	+5.5%	-8.0%	+4.3%	-5.5%	+1.0%	-4.5%	-9.6%	-13.0%		
2022	-7.9%	-9.6%	-3.0%	-5.8%	-17.6%	-15.5%	+10.1%	-0.3%	-6.1%	+2.0%	-3.8%	-6.7%	-49.9%	-8.4%	-49.9%

Returns are net of all base fees, performance fees and expenses of the Fund

Performance commentary

The only positive contributors during December were Imricor (IMR, +9%) and Bluechiip (BCT, +3%). The key negative contributors were Hydration Pharmaceuticals (HPC, -25%), Marley Spoon (MMM, -21%) and Shine Justice (SHJ, -16%).

IMR had a busy month in which it raised US$5m via a convertible note (interest rate of 10% pa, maturity in four years) from an existing US investor, K.A.H.R. Foundation, and obtained a further US$1.5m via a loan from the North Dakota Commerce Department's Innovation Technology Loan Fund. The loan attracts 0% interest and no required principal repayments for the first three years of the loan, with 2% interest and monthly repayments in the next two years. Given IMR's depressed share price relative to our view of its intrinsic value (and its average since listing in 2019), we fully support its endeavours to seek alternative sources of capital, rather than raise more money from the listed equity market. Finally, IMR received approval from the Leipzig Heart Centre Ethics Committee for its VT clinical trial. This is the first of two required approvals to commence the VT trial, with the second approval now being sought from the German Federal Institute for Drugs and Medical Devices.

HPC provided another sales update, highlighting that recent weekly sales growth is running at ~100% on pcp, driven by a combination of strong sales via Amazon USA and Amazon Canada, as well as bricks and mortar stores in Canada. December also saw the launch of a co-branded product alongside brand ambassador, Ms Shay Mitchell, including an immersive hydration event for 16 of America's top influencers, some with reaches of over 10m followers. The Company estimated the event was able to reach a cumulative audience of approximately 85m people. Over the medium-term, the Company expects to realise tangible benefits from the product marketing and brand awareness generated through Ms Mitchell's significant social media reach, which stands at more than 34m Instagram followers, ~3m Twitter followers, >4m YouTube subscribers and >7m followers on TikTok.

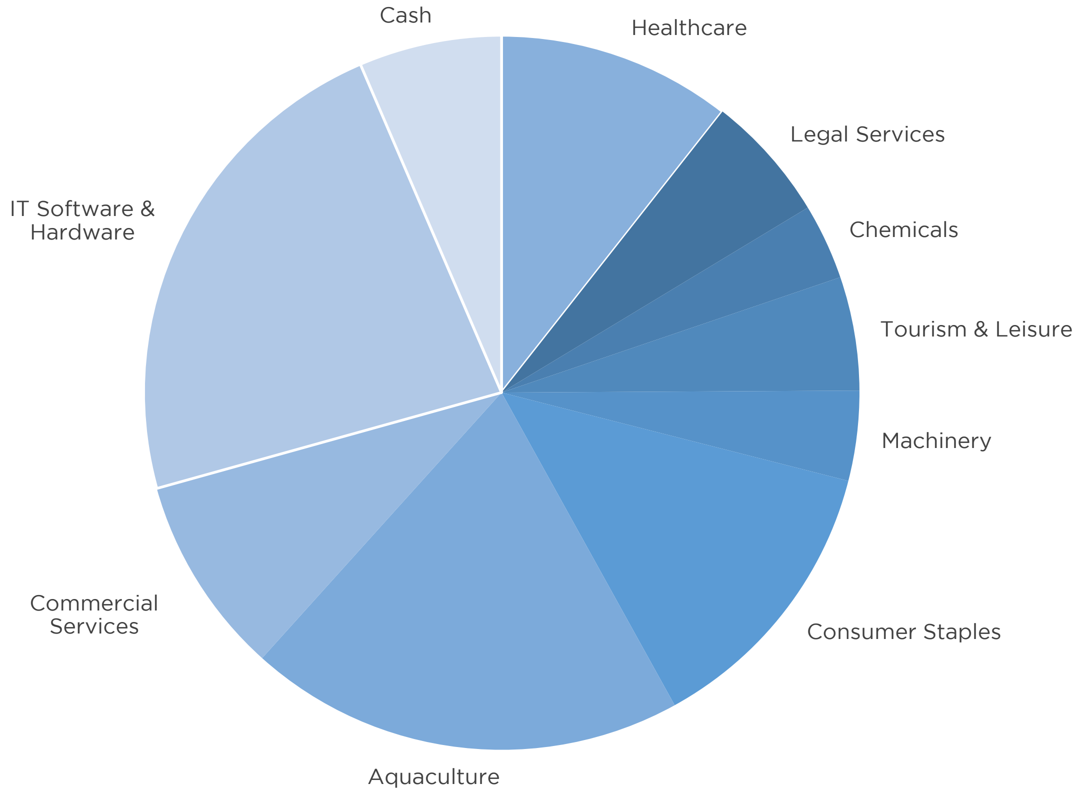
FBR Limited (FBR, -3%) announced that mechanical assembly of the first next-generation Hadrian X® has been completed. This is the latest iteration of FBR's bricklaying construction robot, designed to be able to lay at speeds of up to 500 blocks per hour (equating to up to ~120m^2 per hour), with the potential to complete both the external and internal walls of a standard double brick house in a single day. The next-generation Hadrian X® features a shuttle block delivery system designed to lay any existing commercially available blocks, as well as the ability to lay blocks not yet available on the market, including large blocks measuring up to 600mm x 400mm x 300mm and weighing up to 45kg. The shuttle delivery system is also designed to be adaptable to handle other products such as roof tiles subject to further future development. The lengthened 32 metre telescopic boom arm of the next-generation Hadrian X® provides further reach than its predecessor, enabling construction of walls three storeys high from the roadside as well as the ability to lay blocks within 50mm of existing walls. The improved design of the saw module of the next-generation Hadrian X® enables it to make height, mitre and gable cuts to blocks, further increasing the capability of the Hadrian X®.

Commissioning activities for the next-generation Hadrian X® continues with expected completion by 31 March 2023. Following completion of commissioning activities, the Hadrian X® will be calibrated and tested before being utilised for demonstration activities to potential partners, both domestically and internationally. This is a significant milestone for the Company (despite that its negative share price reaction would suggest otherwise) and continues its path towards either becoming a significant operator in the global housing construction landscape, or the target of an incumbent operator.

Finally, Birddog Technology (BDT, -3%) commenced an on-market share buyback of up to $2m (vs market cap of $31.7m) from mid-December, reflecting the confidence of the Board and Senior Management in BDT's sustainable future growth prospects. Given BDT has an NTA of >$0.21, including significant levels of unrestricted cash, the Board believes that a share buyback is an effective and flexible mechanism to enhance shareholder returns. Looking forward, BDT has now cycled through a very strong prior period (demand tailwinds from increased remote working) while dealing with its own supply chain disruptions, so we expect BDT to resume solid growth in 2H FY23, while continuing to generate positive EBITDA and operating cash flow.

Portfolio characteristics

We currently have ~94% of our capital invested in 16 stocks.



Please get in touch should you have any queries regarding the above. Thanks again for your interest and support and I look forward to providing another update in early February on our performance during January.

Kind regards,

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