Emerging Companies Fund

Monthly Update: March 2023

Dear Fellow Investors,

Our Emerging Companies Fund was down -6.1% in March vs -0.3% for the Emerging Companies Accumulation Index (XECAI) and -3.0% for the Small Industrials Accumulation Index (XSIAI). Since inception, the Fund has generated +7.8% p.a. and a total return of +59.2% vs +71.5% for the XECAI and +30.2% for the XSIAI.

Following on from a couple of notable banking collapses during the month, and further evidence that inflation has peaked, bond yields across the spectrum declined sharply. The market is now implying that central banks are at the end of the rate hiking cycle, with cuts likely to follow within the next 6 to 12 months as the effects of such a rapid and substantial rise in rates filters through the economy. Unsurprisingly, the move in bond yields was supportive for the share prices of many growth/duration stocks (e.g. the NASDAQ has now officially entered a new bull market) but this was largely confined to the largest companies in the index. Unfortunately, the buying did not (at least, not yet) cascade down to small and micro-cap stocks which fit within that category. In fact, paradoxically, the share prices of most of our stocks continued on their same negative trajectory, seemingly oblivious to the changing macro-economic backdrop and any improvement in the underlying businesses. While it is still early in the month, we are at least seeing signs of stabilisation/improvement during April.

In yet another bizarre and deflating example of the perverse outcomes we are still observing within micro-cap industrials, Pentanet (5GG, -13%) made two significant positive announcements early in the month, driving the share price up by +50% (with an intra-day peak of +133%) on large volumes. Yet by the end of March, not only had the stock given back all of those gains, but it ended down –13% for the month. Rest assured, there will again come a time when micro-cap stocks can hold onto significant gains following positive news flow, but first we need investors to start to gain confidence that a more rational mindset has finally returned to the entire segment.

When comparing the Fund’s recent performance to the XECAI, it is important to note that the index was again significantly boosted by resources, most notably lithium stocks. With only one week to go, the XEC was down over -5% for the month, in line with our Fund’s performance. This was before Liontown Resources received a bid, with the stock surging ~80% (other lithium stocks followed it up), helping to push the small resources index up ~10%. Finally, we again increased our personal investment in the Fund at the end of March, trying to capitalise on the capitulation of others in the market (quite appropriately, another fund manager in the press recently described micro-caps as a “killing field”). We obviously don’t know if we have reached the bottom, but we are very confident that the value of the Fund will not be sustained at these depressed levels. As Warren Buffet wrote in October 2008 when buying into persistent weakness during the GFC, “if you wait for the robins, spring will be over”. A year later, the S&P ASX200 was up ~25% and the XECAI was up ~75%.

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%		
2023	-0.2%	-8.1%	-6.1%										-13.9%	-13.9%	-46.7%

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

Performance commentary

The key positive contributors during March were Imricor (IMR, +26%), Marley Spoon (MMM, +7%) and Dropsuite (DSE, +7%). The key negative contributors were Ansarada (AND, -18%), Terragen (TGH, -42%) and Hydration Pharmaceuticals (HPC, -36%).

As mentioned on the previous page, Pentanet (5GG) announced a couple of positive developments during the month. Firstly, it executed an MOU with Cambium Networks (NASDAQ-listed with A$700m market cap) to enter into a Network-as-a-Service (NaaS) agreement. The proposal will allow Pentanet to purchase 5G fixed hardware as a fixed monthly subscription instead of via higher upfront payments, which will assist Pentanet in spreading its capex profile over future years. Under the proposal, Cambium will provide a variable financing facility over a four-year term worth up to $5.95m for Pentanet's 5G rollout plan, at an annual interest rate of 13.3%. Pentanet will be required to make a proportionate down payment as they add equipment to the NaaS model. Putting aside the funding benefits, we see this partnership as further validation of Pentanet's ability to deliver on its ambition to deliver Fixed 5G based high speed services in WA. Secondly, Pentanet announced the signing of a Collaboration Agreement with Optus to deliver the NVIDIA GeForce NOW cloud gaming service to Optus customers. While Pentanet remains the exclusive distributor of the NVIDIA cloud gaming service in Australia, this agreement introduces Pentanet's first large-scale wholesale partner. GeForce NOW will be integrated into the Optus SubHub subscription management platform, enabling access for Optus customers in Australia, offering the potential to accelerate growth for both parties.

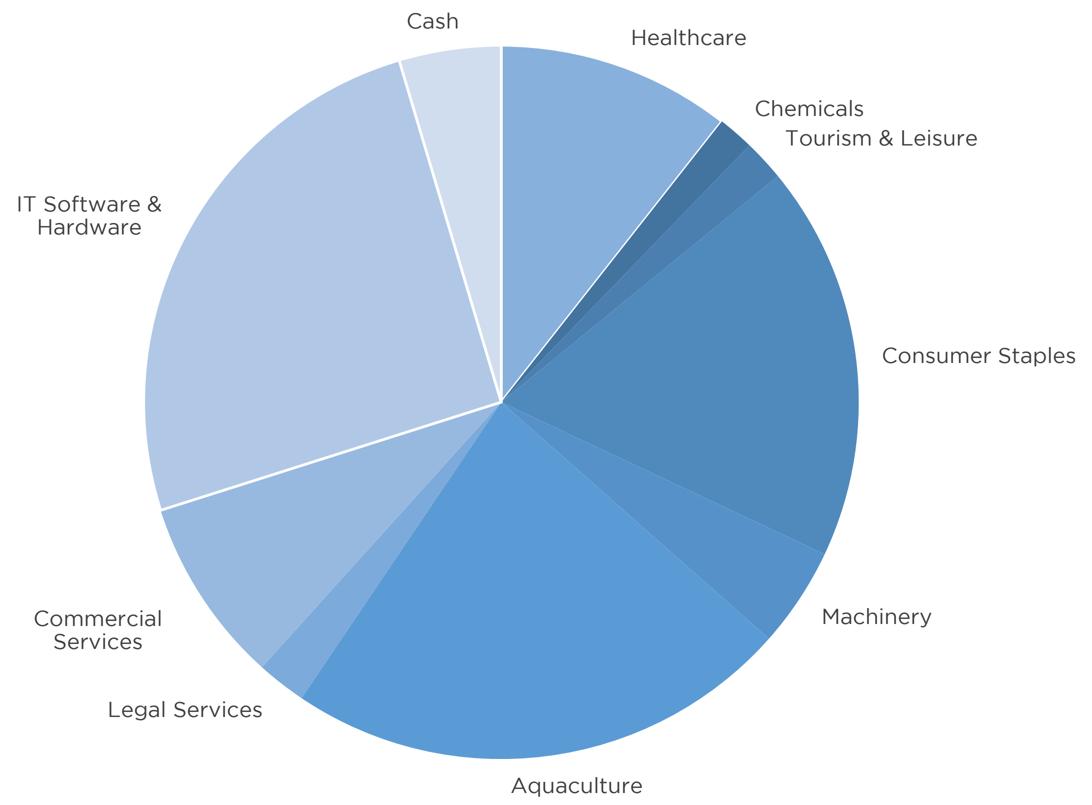
Mighty Craft (MCL, -16%) noted that Better Beer Co is undertaking a capital raising of up to $20m from external sources to accelerate its growth plans. While MCL has elected not to participate in the raise given the large position Better Beer already occupies in its portfolio, it did decide to raise $5m of its own (in which we participated) via a placement to accelerate the Company's spirits portfolio, support the ongoing rapid growth of Better Beer from a sales and distribution perspective and strengthen its balance sheet. We think the Better Beer capital raising has the potential to be a significant positive catalyst for MCL as it will not only provide a look-through value for its stake in the business (which will be brought to account via the P&L and Balance Sheet, as MCL will now equity account for its investment as a 33% holder), but may also provide the opportunity for MCL to sell part of its stake to the new investors, depending on who they are. Given MCL's depressed share price (implying an enterprise value of ~$65m), there is a reasonable chance that the valuation ascribed to Better Beer as part of its capital raise (market sources suggest it could be up to $200m) would mean that MCL's stake in that business is worth as much as its entire EV, effectively implying that the remainder of MCL's beer and spirits portfolio is being (erroneously) valued at zero.

IDT Australia (IDT, +1.5%) announced that the TGA has expanded the licensing conditions covering the Company's Aseptic Sterile Processing (ASP) facility. The updated license enables IDT to manufacture and supply Good Manufacturing Practice (GMP) injectable drugs for use in clinical trials in Australia and overseas. This is an important milestone for IDT as the upgraded license allows the Company to expand its offering to the clinical trial industry to include injectable medicines. IDT is already licensed to produce GMP Specialised Orals and Active Pharmaceutical Ingredients (APIs) to the sector. The upgraded license further positions the Company to be a key partner for companies developing new therapies, particularly given the local and international shortage of ASP facilities that can manufacture advanced therapies. IDT's sales pipeline for the ASP (advanced injectable therapies) business alone currently stands at over $6 million and growing (bearing in mind IDT only needs ~$20m of revenue to be profitable again). Having recently undertaken another visit to the IDT manufacturing facility for a site tour with senior management, we are very confident that strong momentum is building within the business following the distractions of its pursuit of vaccine-related work that ultimately only led to disappointment, with those funding decisions mired in bureaucracy.

Finally, we attended the AND investor day held at its offices in Sydney during the month where management outlined its ambitions to reach an ARR of $100m (currently $10m, albeit its total revenue is $50m) within the next five years. When coupled with a target gross margin of >90%, EBITDA margin of 20-30% and FCF margin of ~20%, it will become a highly profitable (and valuable) business over time. AND already has clear and detailed plans on how it will achieve these targets, with 50% of its revenue target to come from its Deals and Procure software solutions and the other 50% from its GRC and ESG solutions, both via an identified global TAM that is currently over $6bn (and growing).

Portfolio characteristics

We currently have ~95% 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 May on our performance during April.

Kind regards,

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