Emerging Companies Fund

Monthly Update: July 2023

Dear Fellow Investors,

Our Emerging Companies Fund was up +21.2% in July vs +4.6% for the Emerging Companies Accumulation Index (XECAI) and +4.8% for the Small Industrials Accumulation Index (XSIAI). Since inception, the Fund has generated +9.3% p.a. and a total return of +78.4% vs +74.0% for the XECAI and +39.7% for the XSIAI.

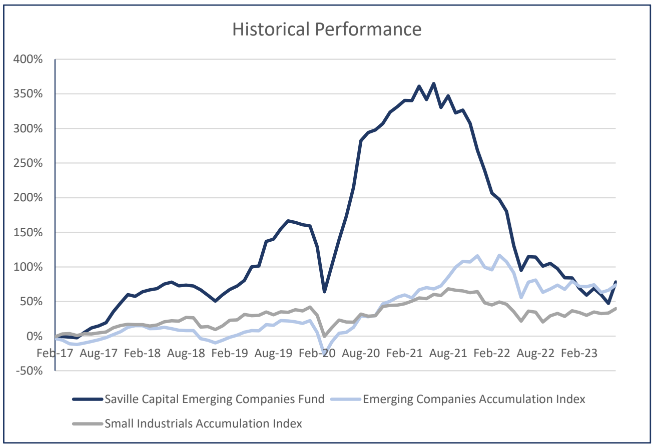
While we had anticipated a rebound in July given the artificial nature of much of the share price declines seen during June caused by significant tax-loss selling, the quantum of the rebound was a pleasant (and welcome) surprise. As such, we think there was more to our strong performance in July than just an unwind of selling pressure. Firstly, we are seeing evidence that the market is willing to adopt a slightly longer investment horizon, including the acceptance of negative operating cash flow (in the short term) in micro-caps that have high quality business models and reasonable market cap size (>$50m)/liquidity. Secondly, some of our key stocks delivered quarterly results/commentary that would indicate they are rapidly approaching an inflection point, which should bring with it a powerful combination of accelerating revenue growth and significant operating leverage.

On the macro front, while further unexpected moves higher in rates/yields cannot be discounted as a persistent headwind, it is increasingly feeling like we are a lot closer to the end of that cycle, than the beginning. In fact, we view this period of lingering uncertainty as the opportunity to still gain exposure to some heavily oversold stocks in the micro-cap sector that, while having recovered off their lows, are nowhere near back at levels that we would consider to be fair value. Especially in the context of bond yields that, while much higher than two or three years ago, are still only at ~4% (vs our own DCF input of 5%).

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%	+6.1%	-5.4%	-7.8%	+21.2%						-3.5%	+5.6%	-17.2%

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



Performance commentary

The key positive contributors during July were Murray Cod Australia (MCA, +57%), Ansarada (AND, +48%) and Imricor (IMR, +45%). The key negative contributors were Dropsuite (DSE, -18%), Mighty Craft (MCL, -33%) and FBR Limited (FBR, -23%).

While AND only delivered +3% revenue growth in 4Q FY23 (+10% QoQ), this was against the backdrop of persistent weak conditions for deal activity, particularly IPO's. Yet despite the very soft operating environment, AND delivered its third consecutive quarter of positive operating cash flow ($3.0m), highlighting the latent operating leverage that now sits within the business. Furthermore, it continues to add significant numbers of new customers (+81% on pcp) via its freemium offering, leaving it ideally positioned to capitalise on the inevitable rebound in deal volumes, in terms of both revenue and cash flow. Finally, its push to diversify its revenue continues to succeed, with Non-Deal revenue increasing by +31% on pcp during 4Q, now comprising over 20% of AND's revenue base.

Consistent with the last two quarters and guidance, MCA delivered 4Q FY23 cash receipts below pcp (-32%) as it seeks to grow its supply of larger fish in response to customer feedback. Pleasingly, the Company is now forecasting a significant improvement in supply of fish (particularly larger size grades) from 2Q FY24 onwards, which should underpin very strong growth in cash receipts thereafter. In other news, MCA had a 'soft launch' of its Aquna Gold Murray Cod Caviar, initially targeting chefs in the wholesale market. Importantly, harvesting the caviar can increase the gross dollar return per female fish by as much as 50-100%, depending on the yield achieved from each fish. This is another example of the potential within the business to use innovation to create earnings growth and shareholder value, as opposed to simply growing capacity/supply over time. Finally, it's also pleasing to hear that supermarkets continue to exhibit very positive demand for Aquna Murray Cod, requesting that more stores be included to provide greater access for consumers to the product. Unfortunately supply constraints are yet to make this possible, but in the meantime MCA is negotiating material price rises with Woolworths and Coles.

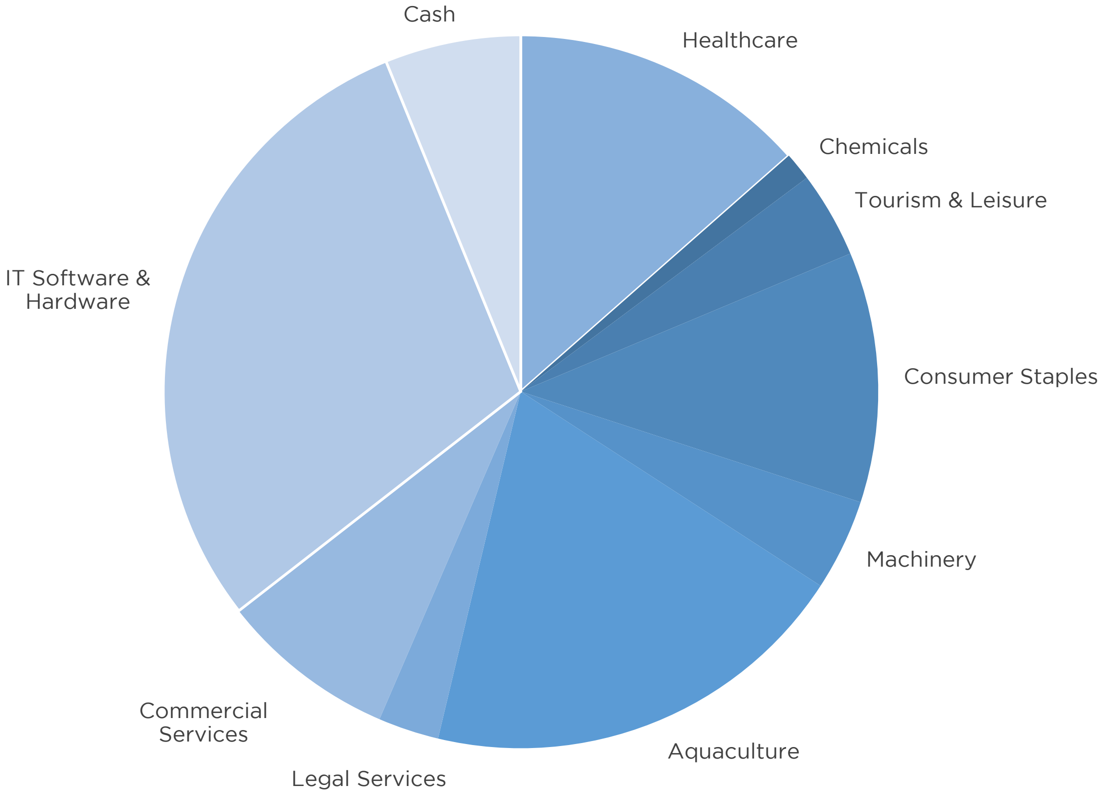
5GG reported +10% growth on pcp in cash receipts for 4Q FY23, which remains below trend while it continues the rollout of its 5G network (four towers are now enabled with another four to come in 1H FY24). However, the key positive from the update was that through prudent cost control the business achieved an EBITDA breakeven exit run rate during June 2023, including both its telecommunications and cloud gaming divisions. This is particularly promising in the context of a likely acceleration in revenue growth from 1H FY24 onwards, underpinned by 5G deployment delivering a strong rebound in telco subscriber growth and ongoing growth in cloud gaming revenue (was +125% in FY23).

IMR made several positive announcements during the month including the signing of a five-year distribution agreement with Faisaliah Medical Systems, based in Saudi Arabia. This will make Saudi Arabia the first country in the Middle East to offer iCMR ablation products (it performs nearly 50,000 cardiac ablation procedures annually) and should form a base from which IMR can expand its presence throughout the region. Separately, IMR secured a A$30m Security Subscription Facility from GEM Global that can be progressively drawn down over the next three years, at IMR's discretion. In other funding news, IMR raised US$1m from an existing US investor at a 36% premium to the prevailing share price, while also receiving approval from the North Dakota Development Fund for a US$1m term loan. These funds help give IMR the runway required to advance its clinical trials to obtain approval for atrial flutter in the US and ventricular tachycardia in Europe.

Finally, DSE delivered another strong quarter of revenue growth (ARR +51% on pcp) and positive operating cash flow. However, the stock took an unexpected dive following news that Microsoft is launching a back-up solution for its suite of products. Having spoken with the Company and industry participants, we are very comfortable that this is not going to pose a threat to DSE given it won't offer independence from the product administrator (required for disaster recovery), isn't product agnostic (unlike DSE) and will be far more expensive. In any case, DSE's share of this large/rapidly growing market is very modest.

Portfolio characteristics

We currently have ~98% of our capital invested in 17 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 September on our performance during August.

Kind regards,

Jonathan Collett

Principal

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