Emerging Companies Fund

Monthly Update: February 2024

Dear Fellow Investors,

Our Emerging Companies Fund was down –4.8% in February vs +5.1% for the Emerging Companies Accumulation Index (XECAI) and +3.9% for the Small Industrials Accumulation Index (XSIAI). Since inception, the Fund has generated +7.0% p.a. and a total return of +60.3% vs +66.4% for the XECAI and +51.2% for the XSIAI.

While the headline number would suggest otherwise, it was actually a "successful" month for the Fund in that a long-held (top 3) position in the portfolio, Ansarada (AND, +36%), received a takeover offer of $2.50/share in cash. To put this into context, we first started buying AND at ~$1.50/share in October 2021 and in late May 2023 the stock hit a low of $0.86. Despite the material positive uplift from AND (it had a ~12% weighting), the Fund suffered from another monthly decline as we continue to battle against the persistently negative market perception towards stocks below ~$250m (and particularly <$100m), noting that the weighted average market cap of stocks within our portfolio is ~$100m.

Interestingly, and importantly, when we look behind the headline of the XEC monthly performance, it reveals an absurd divergence. If we split the index by market cap, we see that during February the median performance of stocks with a market cap of >$500m was +21.2%, meanwhile the median performance of stocks <$250m and <$100m was -3.4% and -6.1% respectively. This is merely a continuation of the trend we observed in CY23 when the median performance of those stocks currently >$500m was +44.2%, meanwhile the median performance of stocks currently <$250m and <$100m was -32.9% and -58.8% respectively. Consequently, the overall performance of the XECAI for CY23 was a relatively benign -0.4% (our Fund was -8.1%), yet the composition was completely chaotic.

The sharp rise in bond yields which set this micro-cap bear market in motion in mid-2021 effectively concluded by mid-2022, and yet almost two years later many of our stocks are trading significantly below where they were then, despite delivering some key milestones and demonstrating ongoing access to capital (if required). In the meantime, corporate activity is rapidly accelerating as larger companies with more rational market valuations are capitalising on the significant disconnect between the intrinsic value of micro-caps and their current market value. This trend will continue until the listed market recalibrates its mindset towards micro-cap investments, most likely when central banks commence rate cuts, which is forecast to occur in 2H CY24. We also take comfort from the fact that less than 12 months ago, we could have barely given away our significant holding in AND ("cheap, but no catalysts", we were told), and yet now it is almost three-times that price.

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%	-3.7%	-5.6%	-1.8%	+3.9%	+2.6%	-8.1%		
2024	-0.9%	-4.8%											-5.7%	-3.2%	-5.5%

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

Performance commentary

The key positive contributors during February were Ansarada (AND, +36%), FBR Limited (FBR, +8%) and Fleetwood (FWD, +6%). The key negative contributors were Imricor (IMR, -19%), Murray Cod Australia (MCA, -13%) and Bluechiip (BCT, -46%).

Both BCT and IMR undertook equity capital raises during February to help fund ongoing operations as they continue to expand their customer base and build out their sources of recurring revenue. While we acknowledge that both companies are taking longer than we would like to grow their revenue to a point where they become self-funding, the customer engagement and industry feedback on their respective technologies remains very positive. The issue is one of time (patience is required when transitioning customers and industry to a new technology) and tight funding (which impedes sales and marketing activities), as opposed to commercial viability. But as a symptom of persistent weak micro-cap markets, both raises were done at significant discounts to the prevailing share price (46% and 27% respectively). Furthermore, in the current market, micro-cap stocks that raise capital are typically trading straight down to the (often heavily) discounted issue price. Both stocks complied with this current trend and unfortunately, in the short term, negatively impacted our Fund's performance (much like FBR in January). In a normal market, a stock that raises capital should trade at its theoretical ex-rights (or placement) price, with a net neutral impact on investors who participate on a pro-rata basis. However, we are currently operating in different times and those rules don't apply.

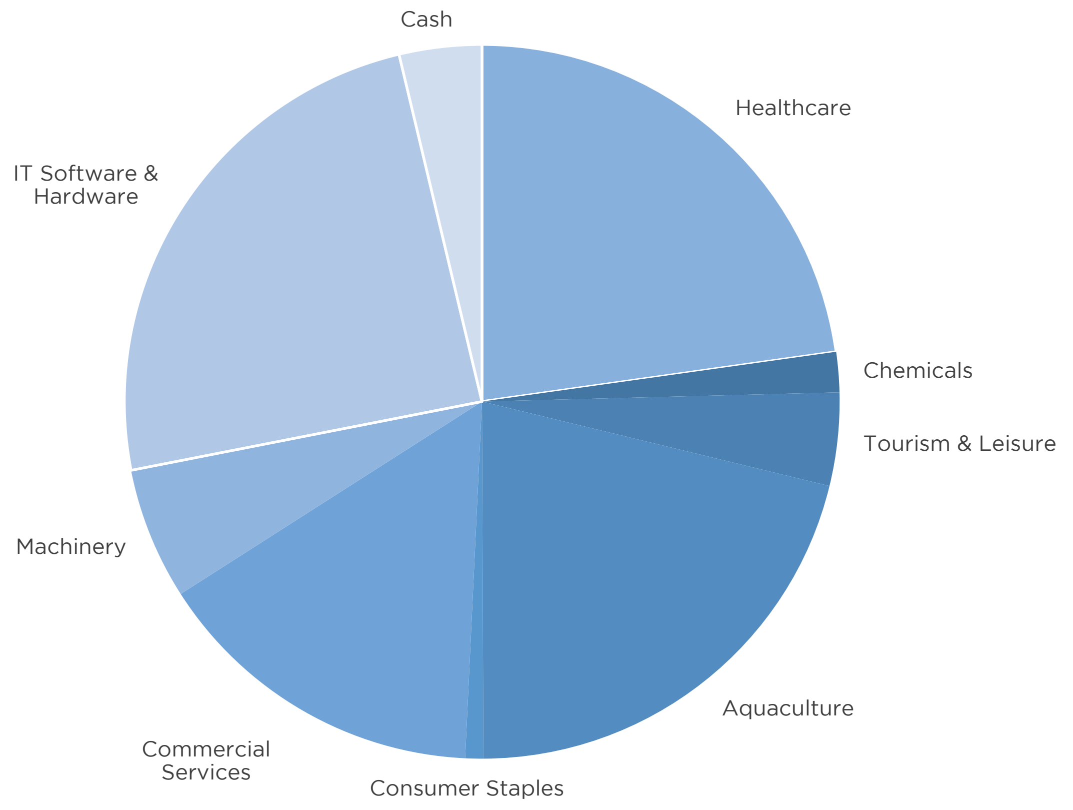
Camplify (CHL, 0%) reported 1H FY24 GTV and revenue growth of +93.6% and +95.4% respectively, while gross margins increased from 58.1% to 61.4%. Total bookings increased by +59.0% on pcp and the total number of RVs on the platform increased by +19.7% to 29,388. CHL still posted a modest EBITDA loss of -$1.4m, but this is influenced by seasonal factors, with 1H being the weaker period for revenue. CHL has completed the integration of the PaulCamper business into its global OnePlatform with all customers now using the same platform across all markets. This will allow CHL to begin managing the PaulCamper countries (i.e. Europe) using standardised technology, centralised resources, and roll out products such as Premium Membership and AER into these markets. Through this CHL will be able to increase take rates, booking volumes, and accelerate growth in these markets. A key focus for CHL remains the global rollout of its MGA Myway, with all active Northern Hemisphere markets to be completed in FY24 and Southern Hemisphere markets completed in 1Q FY25. This new division will not only grow CHL's core marketplace, it will also allow for the retailing of insurance products outside of CHL's customer base in the future. Finally, CHL recently acquired the "Rent a Tent" business, placing it in a leading position for festival and event accommodation solutions within Australia, with potential to expand operations globally. Despite delivering a solid result, CHL's share price initially declined -25% vs its previous close (before finishing the month flat), providing yet another example of the unusual trading activity we continue to observe in micro-cap markets.

Speaking of inexplicable outcomes, FBR continues to trade well below its recent capital raise price despite having now successfully completed the Factory Acceptance Test for CRH, triggering its second milestone payment of US$800k. The test structure was completed at an effective lay rate of 330 blocks/hour, exceeding the required rate of 285. Preparations are now underway to ship the Hadrian X® to Florida (USA) to undertake the Site Acceptance Test ahead of the commencement of a 5 – 10 house Demonstration Program. In a further piece of validation, subsequent to month-end it was announced that FBR's Hadrian X® will be serviced and maintained at Liebherr's facilities in Florida, and the parties will engage in knowledge transfer of the mechanical and electrical systems and service requirements with a view to accelerating the manufacturing ramp up upon execution of a long-term Manufacturing and Commercialisation Agreement.

Finally, we continue to hold AND on the basis that there is a reasonable chance of a counter bid. We value AND at $3.50/share, so we think there is certainly scope for other bidders (and indeed the current bidder) to justify a higher offer. But in the absence of that occurring, the liquidity from the transaction will provide other opportunities for the Fund.

Portfolio characteristics

We currently have ~96% of our capital invested in 13 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 April on our performance during March.

Kind regards,

Jonathan Collett

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Important Information