Time and Ignorance

April 2023 Update

"The social object of skilled investment should be to defeat the dark forces of time and ignorance which envelope our future." - John Maynard Keynes

Performance to Apr 30, 2023	1 month	CY to date	FY to date	FY2022	FY2021	3 years	Inception
	-4.31%	**-4.85%**	**-25.1%**	**-23.53%**	**74.34%**	**-0.46%** pa	**-8.86%** pa

Performance Hurdle: a total return greater than the five year government bond rate + 5% pa over the medium-to-long term.
Fund return is calculated net of all management fees, expenses and accrued performance fees.

Fund Facts

NAV	$0.6180
Inception	Sep 1, 2017
Bloomberg	EQUINDF AU Equity
APIR code	EQB7664AU
ISIN	AU60EQB76649

Portfolio Key Metrics

April 30, 2023	% NAV#
Cash (incl. cash ETF)	0.1%
Unlisted	10.3%
Notes in Listed	11.7%
ETFs	0.8%
Listed Equities	77.2%
Market cap <$100m	*89%*
Market cap $100m-$1b	*11%*
Market cap >$1b	*0%*
Top 5 positions	46%
No. positions*	28

May not add up to 100% due to rounding
* excludes positions <0.1%; counts multiple security types in one company as one position
Note: In-the-money convertible notes treated as equity

Key Contributors to Monthly Performance

Positive	Intelligent Monitoring (IMB), Locality Planning (LPE)
Negative	Energy Technologies (EGY), Spectur (SP3)

SUMMARY

➔ **THE MONTH |** There is very little we can write about the recent mark-to-market share price performance of our investments that is positive. On the flip-side, there has not been many recent negative developments within the businesses we are invested in. “The market” is not showing any interest in the smallest stocks. The value of trade in stocks in the S&P/ASX Emerging Companies index was down 38% year-on-year in the month of April to a monthly tally last seen three years ago. We think the decline in liquidity has been worse for companies not in the index.

➔ **SMALL TALK |** Over the past month our weekly *SmallTalk* updates for investors (accessible here) profiled digital ad fraud mitigation company **Adveritas (AV1)**, **Intelligent Monitoring (IMB)** and **Medadvisor (MDR)**. You can also listen to our recent “Resilience” presentation here (or see the slides here).

➔ **OUTLOOK |** “*... just in the last couple of years, I've had the realisation that with some of these stocks, nobody's ever going to care. Nobody is paying attention, nobody is doing the work, nobody cares what the company says. There's just nobody home.*” - Greenlight Capital founder David Einhorn. We have cited Einhorn on this theme before and his comments ring true in the part of the market we focus on. As we said last month, our “True North” remains our understanding of the opportunities, capabilities and catalysts among our investments. With liquidity down, this looks like “private equity in public markets”. On the following pages we set out some charts that show not only where things are at now but also the strength with which small stocks in general have come out of past downturns.

Top Nine Positions (alphabetical order, as of April 30, 2023; ASX-listed unless otherwise stated)

Cirrus Networks (CNW)	Mad Paws (MPA)	Spacetalk (SPA)
Energy Technologies (EGY)	MedAdvisor (MDR)	Spectur (SP3)
Intelligent Monitoring (IMB)	Scout Security (SCT)	Upsure (unlisted)

PORTFOLIO REVIEW

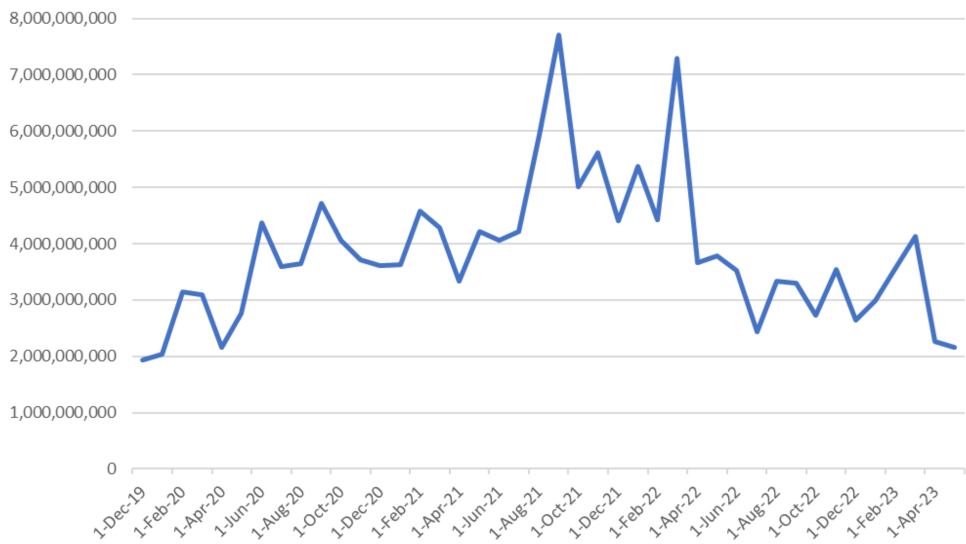
Roughly one stock in the portfolio made share price gains for the month for every two that declined. The state of the market for the smallest listings is set out starkly in Figure 1, below. We do not have broad liquidity stats on hand for the “nano” and “micro” stocks that are not in any S&P/ASX indices but even the S&P/ASX Emerging Companies Index tells a story on liquidity, as set out in Figure 2.

Figure 1: The median performance of ASX stocks by size and industry over the past year (as of publication)

Industry	Nano	Micro	Small	Mid	Large	Mega	All
Utilities	-26.79%	+9.26%	+9.36%	+9.44%	-8.84%	-	-5.06%
Financial Services	-19.21%	-8.45%	+1.33%	-2.5%	-2.19%	-	-7.98%
Industrials	-20.52%	+2.23%	+1.37%	+14.53%	+18.45%	-	-9.16%
Real Estate	-20.5%	-9.77%	-6.43%	-10.32%	+2.76%	-	-9.79%
Consumer Cyclical	-46.05%	-23.77%	+2.22%	+3.65%	+8.77%	-	-12.81%
Energy	-36.82%	-22.2%	-9.03%	+22.42%	+14.23%	-	-21.1%
Communication Se...	-43.75%	-17.84%	-15.83%	+10.4%	+19.34%	-	-21.24%
Overall Median	-42.41%	-12.65%	-2.45%	+6.97%	+5.85%	+7.63%	-25.53%
Consumer Defensive	-51.22%	-14.58%	-18.65%	+4.33%	+8.47%	-	-26.2%
Healthcare	-48.39%	-10.58%	+2.78%	+23.16%	+13.56%	-	-31.18%
Technology	-42.71%	-7.14%	+5.48%	+39.49%	+27.22%	-	-34.52%
Basic Materials	-44.44%	-19.3%	-3.05%	+9.72%	+2.25%	+7.63%	-37.5%

Source: GuruFocus

Figure 2: The monthly value of trade in the S&P/ASX Emerging Companies Index



Source: Iress

We continue to believe that ultimately we can distinguish our investments from "the market" through our bottom-up approach to investing in businesses where we see an opportunity to grow their valuation. But we also take solace at the macro level that historically small stocks have bounced back very strongly as set out in Figure 3, taken from our recent "Resilience" slide deck.

Figure 3: Smaller Stocks in Downturns

US small caps v large caps during & after the "dot-com bubble"

	Russell 2000	S&P 500
Mar 10, 2000 – Oct 9, 2002	-44%	-43%
Subsequent 1-year	62%	36%
Subsequent 3-years	104%	62%

Source: abrdn

US small caps v large caps during & after the GFC

	Russell 2000	S&P 500
Jun 6, 2008 – Mar 9, 2009	-54%	-51%
Subsequent 1-year	98%	72%
Subsequent 3-years	148%	116%

Source: abrdn

S&P/ASX small v large during & after the "dot-com bubble"

	Small Industrials	Top 100
Mar-10-2000 - Oct-09-2002	-33.00%	-7.12%
Subsequent 1-year	21.05%	11.07%
Subsequent 3-years	60.32%	51.13%

Source: Equitable Investors, Iress

S&P/ASX small v large during & after the GFC

	Emerging Companies	Small Industrials	Top 100
Jun-06-2008 - Mar-09-2009	-58.24%	-54.41%	-42.35%
Subsequent 1-year	90.77%	73.40%	65.85%
Subsequent 3-years	119.96%	62.39%	43.87%

Source: Equitable Investors, Iress

Monthly Movers

Intelligent Monitoring (IMB; +27% in April), Australia's largest independent security monitoring company, oversees more than 70,000 wholesale and direct connections. The most recent news from IMB was its quarterly cash flow update for the three months to the end of March: Positive operating cash flow of $181k in the quarter and $530k for the first nine months of FY23; $0.6m EBITDA in the month of March alone; guidance maintained for >$5.9m EBITDA for FY23. The elephant in the room with IMB is its debt position, created when it was named "Threat Protect": Its net debt peaked at over $52m at the end of FY21. Capital raisings were undertaken after reaching that dire point, with $29m raised in 1H22 and another $8m in 2H22. At the end of the March quarter, IMB had $2.6m cash at hand and $28.4m debt drawn, mostly due September 30. IMB said it planned to refinance the debt with a new three-year facility by June 30, 2023. A "preferred debt partner" has been selected.

Embedded networks operator **Locality Planning Energy (LPE; +24% in April)** reported $2.5m operating cash flow for the March quarter. Its contracted customer base of 28,200 was unchanged but LPE said it had a further 3,200 customers at various stages in the contracting process. LPE said it is looking for complimentary acquisition targets. It expects a $5m loan it provided to Bundaberg Biohub to be repaid in the June quarter. LPE had $2.4m cash and $8m in unused financing facilities ($11.3m drawn, of which $9.2m is covered by the unwinding of LPE's electricity hedge positions).

The most negative contributors to monthly fund performance were led by specialist cable maker **Energy Technologies (EGY; -19% in April)**. While there was only $16k worth of EGY shares traded in April, the specialist cable maker had booked $4.4m in cash receipts for the March quarter, up 57% year-on-year. Its order book was "in excess" of $3m. EGY also reported that construction of the second factory at its Rosedale site has now completed and is awaiting the final concrete pour and permits associated with making it operational. EGY still burned $2m on operations, including a $0.7m increase in work-in-progress. It held $309k cash at the end of March with $2.7m in financing facilities available and a $375k grant payment pending.

Remote monitoring technology company **Spectur (SP3; -20.5% in April)** reported revenue of $5.3m over the nine months to March 31, 2023, excluding the contribution from recent acquisitions, up 20% year-on-year. Its annualised recurring revenue run rate also hit $5.3m. SP3 had $1.6m cash remaining, following the acquisition of 3CT and

Spectur NZ, with $636k cash used in operating activities for the quarter. SP3 said its unweighted sales pipeline was $11.5m, or $5.2m weighted, “underpinning expectations of continuing growth into FY24”.

Portfolio Changes and the Recap Theme

The one change in the Top Nine was simply a result for a second consecutive month of cybersecurity company Archtis (AR9) and IMB swapping places based on share price movements rather than material trading activity. As mentioned in the last update, we participated in a capital raising for field services app maker **Geo (NZX; GEO)**.

Since the end of April we have participated in a $9m capital raising for digital ad fraud protection software company **Adveritas (AV1)**, which we profiled in SmallTalk here. With a strong group of cornerstone shareholders behind it, AV1 has until now managed its capital tightly and conducted small capital raisings anchored by its key backers - but having $3m cash in the bank at the end of the March quarter (plus $0.8m from non-executive director Mark McConnell that was approved by shareholders in April) wasn’t providing the market with confidence when it had burned $3.7m in the March quarter. AV1 has addressed this with the $9m capital raising, which it says allows it “to focus on its key objective of achieving cashflow breakeven.”

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WHAT'S ON OUR MINDS

Liquidity in small stocks	The value of trade among stocks in the S&P/ASX Emerging Companies Index was down 37% year-on-year in the March quarter of calendar 2023 - and 39% in the month of April. For patient investors, such pull-backs in risk appetite tend to create opportunities. As an indicator, we estimate the median ASX-listed micro-to-mid cap with positive historical EBITDA is priced on an EV/EBITDA multiple that is ~30% below the median for large caps. As we have said in the past, if the market does not re-rate some of these forgotten smaller companies, we expect strategic buyers will ultimately step in.
Private Market Valuations	We see evidence that private (unlisted) markets have only just begun the process of adjusting valuations to reflect the change in the cost of capital that has occurred over the past 12 months. “Cap rates” applied to property assets appear low. VC funded entities are not marked-to-market even though we expect in many cases they would be unable to raise substantial capital at the same prices they did in the past. There is potential for future revaluations of unlisted assets to trigger volatility in broader markets.
“Recap” risk and opportunity	Australian equity capital raising activity was down 78% year-on-year in the December quarter of calendar 2022, using dealogic data (in USD). There has been an improvement in the March quarter of 2023 compared to the prior year but that prior year figure was the lowest quarterly tally in years. In global venture capital markets, funding fell 53% year-on-year, according to Crunchbase, with that figure looking even worse if Microsoft’s $US10 billion investment in OpenAI is excluded. You can revisit our “Recap” video presentation from 2022 here. Everything said then is just as applicable now: hundreds of ASX listings either have less than a year of cash on hand or do not generate enough earnings to cover their interest expense. Businesses are increasingly desperate for funding. This is a risk for existing investments that may require capital. It is also an opportunity and an exciting time for investors to apply bottom-up, fundamental research and engage constructively with companies to provide them with capital on attractive terms.
Interest rates & inflation	We see logic in the market expectation that inflation should moderate in CY2023. But we see less sense in the view that this will result in central banks conducting an about-face and reducing interest rates - and that this will be simultaneously a good thing for equities. Interest rates remain low by historical standards and central banks should be keen to get back to something like the Taylor Rule estimate that an equilibrium policy rate is 2% above inflation. If central banks do walk back rates, the implication will be that the economy has deteriorated.
Energy	The situation in the Ukraine and the broader geopolitical environment has brought energy to the forefront. We now see energy as a quasi-currency - if you have energy you hold something valuable and exchangeable. The world is going to need all forms of energy to sustain or further advance standards of living. Dragonfly Fund does not invest in the resources sector directly but we do own and seek out opportunities to participate in the energy economy - through engineering, manufacturing and software or other industrial and technological angles.
Unlisted	The Fund’s returns in CY2022 were undermined by the implosion of an unlisted investment, digital diagnostics company Ellume. When we invested in the equity of Ellume it was on the basis that it was a pre-IPO round and it was valued at ~$80m pre-money. We were one of many investors and had no board influence or advisory role. Nor did we have any special rights as ordinary equity owners. The Board of Ellume failed to follow through on its representation that it would pursue an IPO and chased higher valuations - mooted by its advisors to have snowballed to $1.3 billion-$1.5 billion in 2021. Instead of an IPO in a reasonable time period or even raising more equity in private markets, the Board chose to finance the company with debt, which left the company at greater risk when a series of events knocked it off course. We would have very happily accepted an IPO valuation less than half the numbers mentioned above. One of the lessons for us is that it is important when investing in unlisted entities to have some form of influence.

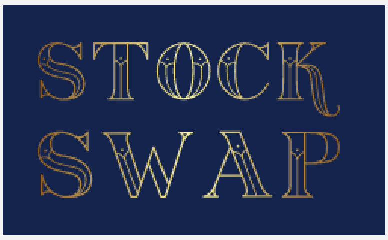
Fund Details

Strategy	Long only. Seeking growth or strategic value at an attractive price.
Management fee	1.5% pa
Expenses	Capped at 0.5% pa
Benchmark	5 Year Australian Government Bond Yield + 5% pa
Performance fee	20% (above benchmark)
High watermark	3 year rolling
Minimum initial investment	$50,000, wholesale only
Investment Manager & Trustee	Equitable Investors Pty Ltd
Custodian	Sandhurst Trustees
Administrator	William Buck Managed Funds Administration (SA) Pty Ltd

Key Characteristics

Unique Opportunities	Invests in businesses that often lack widespread investor awareness.
Proprietary Research	Continually updating investment views, meeting companies, researching, evaluating.
Constructive Approach	Open dialogue with companies assists in maximising value.
Expertise	Equitable's directors have over 50 years of experience.
Alignment of Interests	Seeded by the Manager & all our best ideas go into the Fund.

Applications to invest in Equitable Investors Dragonfly Fund can now be made online with Olivia123 - click here.



Dragonfly Fund has the capability to "swap" shares in a company or companies for Fund units where Equitable Investors finds them attractive and suitable investments. To date we have used this capability sparingly, rejecting all but a very small number of proposals, but we continue to seek favourable opportunities. Further info is available here.