

Navigating Markets

May 2022 Update

"A very significant part of my philosophy has to do with managing your psychology. Markets are about the psychology of others. When are they panicking? When are they greedy? But you have those same flaws or those same potential flaws... if you can rule those extremes out, you'll navigate the markets well" - Seth Klarman, 2022

Performance to May 31, 2022	1 month	3 months	Fiscal YTD	Last 12 months	3 years	Inception pa
Dragonfly Fund	-8.69%	-14.56%	-16.04%	-19.76%	-0.02% pa	-2.97%

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	\$0.8664
Inception	Sep 1, 2017
Bloomberg	EQUINDF AU Equity
APIR code	EQB7664AU
ISIN	AU60EQB76649

Portfolio Key Metrics

May 31, 2022	% NAV#
Cash (incl. cash ETF)	2%
Unlisted	34%
ETF	0%
Listed Equities	64%

Market cap <\$100m	73%

Market cap \$100m-\$1b	27%

Market cap >\$1b	0%
Top 5 positions	50%
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

Best	Reckon (RKN), Earlypay (EPY)
Worst	Intelligent Monitoring (IMB), Scout Security (SCT)

SUMMARY

- **THE MONTH** | Nothing about CY2022 has been easy for listed equities and the month of May brought on another round of share price declines as interest rates rose and investors who have not operated in such an environment since 2010 grappled with the implications. Software company **Reckon (RKN)** provided a highlight for the Fund as the company struck a deal to sell a business unit, in-keeping with our view on value and demonstrating our approach to "bottom-up" investing focused on the opportunities presenting in individual companies. But in the absence of catalysts elsewhere, the smaller and less liquid listed investments faced broad selling pressure as sentiment was compounded by tax loss selling.
- **STOCK PROFILES** | Fund investors recently received profiles on **Audinate (AD8)** and data centre owner **Global Data Centre Group (GDC)** via weekly *Small Talk* updates.
- **PUTTING NEW CAPITAL TO WORK** | We will be entering the new financial year with a firm focus on the recapitalisation opportunity presented by the market and you can view our presentation on that opportunity [here](#). We are keen to start FY23 with a strong cash position to take advantage of these opportunities and we invite investors to **consider putting capital to work with Dragonfly Fund**. While cash is at a 2% weighting as of May 31, we have been holding back new inflows while awaiting the outcome of a pending transaction by an unlisted investment, in order to ensure we did not disadvantage existing investors. Our expectation is that we should be in a position to take on that new cash at the end of the month.

Top Nine Positions (alphabetical order, as of May 31, 2022; ASX-listed unless otherwise stated)

Earlypay	Energy World Corp	MedAdvisor
Ellume (unlisted)	Geo (NZX-listed)	Scout Security
Energy Technologies	Mad Paws	Upsure

PORTFOLIO REVIEW

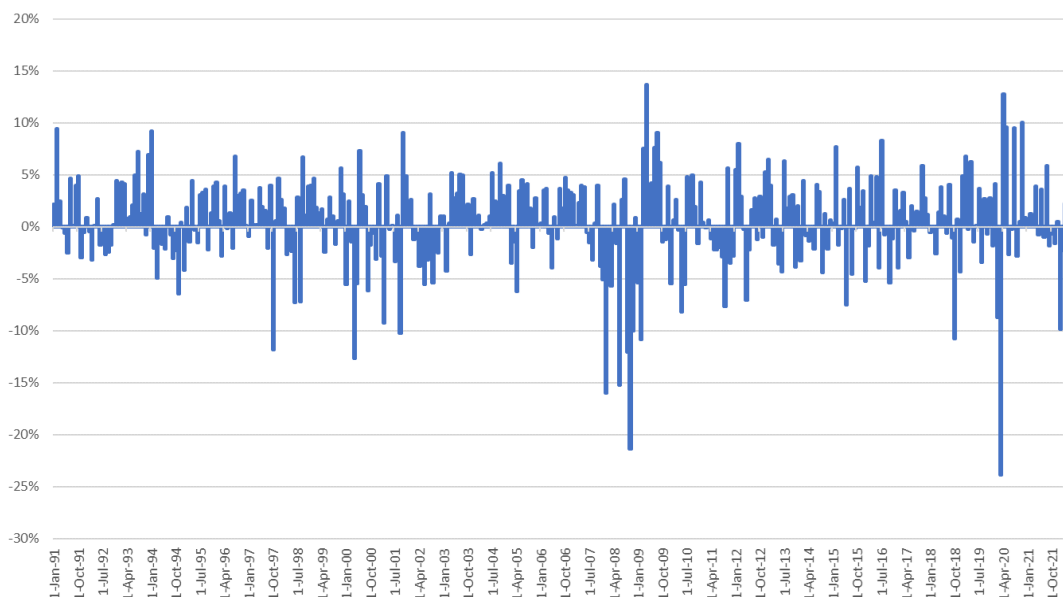
May wasn't pretty for small listed industrials. The S&P/ASX Small Industrials Index dropped 7.5% - a monthly decline of at least that size has only occurred once every 22 months, looking at data stretching back to December 1990. Equitable Investors "FIT" micro-to-mid cap industrials universe of over 600 ASX listings averaged a decline of 8.7%, with the smallest third of these stocks averaging a 10.9% decline. See Figures 1 & 2.

Software company **Reckon (RKN)** is one of the longest held positions in the Fund. You can [read our investment thesis](#) for RKN way back in 2017 on livewire - the alignment of board and management; the company's proven ability to endure; and its track record of pursuing the maximisation of shareholder value.

The part of that 2017 thesis that did change was the composition of the sum-of-parts. Back then, RKN had agreed to sell its Accounting Practice Management business, often considered its jewel, for \$180m to MYOB. But the ACCC got involved and MYOB eventually walked. Now in May 2022, RKN agreed to sell the same business unit to Access Group for \$100m cash. As summarised by research house MST Access, this business unit now represents ~1/3 of RKN's activities and is being sold on 8.4x historical EBITDA when the whole company had been priced on 4.2x by the market.

The greatest drag on the portfolio, security monitoring company **Intelligent Monitoring (IMB)**, made an acquisition and launched a capital raising that weighed on market pricing. IMB said its run-rate EBITDA is \$6.25m, prior to the inclusion of loss-making (-\$0.3m EBITDA) acquisition Mammoth Technology. Its capital raising, via an underwritten rights issue, is supposed to reduce net debt to \$19.2m from \$22.3m at December 31, 2022. IMB priced its rights issue at \$0.15, compared to a closing price of \$0.31 at the end of April, and its market price fell accordingly.

Figure 1: S&P/ASX Small Industrials monthly % change



Source: Iress, Equitable Investors

Figure 2: Equitable Investors “FIT” Universe - factor performance for May 2022

Size	Market cap bands	
Small 3rd		-10.9%
Middle 3rd		-9.2%
Big 3rd		-6.3%
Small Minus Big	SMB	-4.6%

Value	EV / EBITDA bands	
Low 3rd		-7.7%
Middle 3rd		-7.1%
High 3rd		-9.4%
High Minus Low	HML	-1.7%

Momentum	Price returns 12m trailing less most recent	
Losers		-12.4%
Middle 3rd		-6.3%
Winners		-7.3%
Up Minus Down	UMD	5.1%

Source: Sentieo Equitable Investors

OUTLOOK

News headlines on inflation and central bank interest rate actions have had an impact as illustrated by the charts on Australian consumer confidence declining and web searches for “inflation” and “interest rates” surging that you can view on our [blog](#). ANZ noted from its consumer survey with Roy Morgan that “retailers may get caught with higher inventories” as 30% of households think it is a very bad time to buy a major household item - much lower than in the recession following the Global Financial Crisis!

Last month we said that we see fundamentals being more compelling now than they have been for some time and that remains the case. But we also said that this did not mean equity markets would snap back upwards. Our view remains consistent with last month that there will be ongoing sentiment swings as the world adjusts to higher interest rates, central banks juggle inflation and employment targets and geopolitical instability looms.

We see the period ahead as one for opportunism, bottom-up fundamental research and constructive engagement with companies to deliver the best outcomes for shareholders.

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.

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Applications to invest in Equitable Investors Dragonfly Fund can now be made online with Olivia123 - click [here](#).

**STOCK
SWAP**

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](#).

Past performance is not a reliable indicator of future performance. Fund returns are quoted net of all fees, expenses and accrued performance fees. Delivery of this report to a recipient should not be relied on as a representation that there has been no change since the preparation date in the affairs or financial condition of the Fund or the Trustee; or that the information contained in this report remains accurate or complete at any time after the preparation date. Equitable Investors Pty Ltd (EI) does not guarantee or make any representation or warranty as to the accuracy or completeness of the information in this report. To the extent permitted by law, EI disclaims all liability that may otherwise arise due to any information in this report being inaccurate or information being omitted. This report does not take into account the particular investment objectives, financial situation and needs of potential investors. Before making a decision to invest in the Fund the recipient should obtain professional advice. This report does not purport to contain all the information that the recipient may require to evaluate a possible investment in the Fund. The recipient should conduct their own independent analysis of the Fund and refer to the current Information Memorandum, which is available from EI.