

Churchillian Resolve

November 2022 Update

"Success always demands a greater effort." - Winston Churchill cable to Robert Menzies (1940)

Performance to Nov 30, 2022	1 month	3 months	1 year	2 years	3 years	Inception
Dragonfly Fund	1.78%	-17.8%	-43.3%	-12.0% pa	-5.9% pa	-7.5% 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	\$0.6668
Inception	Sep 1, 2017
Bloomberg	EQUINDF AU Equity
APIR code	EQB7664AU
ISIN	AU60EQB76649

Portfolio Key Metrics

November 30, 2022	% NAV#
Cash (incl. cash ETF)	1.6%
Unlisted	11.2%
Notes in Listed	7.0%
Listed Equities	80.3%

Market cap <\$100m	86%

Market cap \$100m-\$1b	14%

Market cap >\$1b	0%
Top 5 positions	39%
No. positions*	33

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), Medadvisor (MDR)
Negative	DXN (DXN), Spectur (SP3)

SUMMARY

- **THE MONTH** | Despite the bleak outcome from the past 12 months, November was the fourth of the past six months to deliver a positive return - up 1.78%. **Intelligent Monitoring (IMB)** and **MedAdvisor (MDR)**, stocks that had been thorns in our side for most of CY2022 as investors just ignored them, were the strongest contributors to the Fund for the second consecutive month.
- **CY2022** | CY2022 has been the year of working the hardest for the least reward. The workload in 2022 included driving existing investments to ensure they have capital and appropriate cost structures, pushing for organisational changes, and corporate or strategic transactions - as well as sorting out which capital-needy companies are real opportunities under our "Recap" theme.

As co-investors we feel the poor outcome of CY2022 acutely. We remain fully committed and continue to look at ways to work harder and smarter to achieve the returns we seek in time. The Fund has experienced a larger draw down in the past and fully recovered.

- **OUTLOOK** | "What's on our minds" is set out inside this update. We expect to continue to keep our noses to the grindstone in early CY2023 as we position the Fund to capitalise on the opportunities a torrid 2022 has created. "Investors make short-term bets on long-term outcomes," we are reminded in the book *Expectations Investing*. The lower the market price of a security, the less the market is expecting and the more scope there is for a positive surprise in the future. Our "FIT" universe of micro-to-midcap industrials is down a third in 2022 and there is currently a huge spread in median earnings multiples between small and large stocks.

Top Nine Positions (alphabetical order, as of November 30, 2022; ASX-listed unless otherwise stated)

8Common (8CO)	Intelligent Monitoring (IMB)	Scout Security (SCT)
Cirrus Networks (CNW)	Geo (GEO:NZ)	Spectur (SP3)
Energy Technologies (EGY)	MedAdvisor (MDR)	Upsure (unlisted)

PORTFOLIO REVIEW

We focused on IMB and MDR in last month's update (you can read that [here](#)) when they were also top contributors to the monthly outcome. Since then we have had incrementally positive news from both investments. Both companies held their AGMs and delivered generally positive updates. IMB, a security monitoring company, announced its Monkey Vision security cameras would be stocked by Bunnings. MDR, the MedTech company, said it had increased digital access to patients by 50% in the US through additional pharmacy support of its inMotion digital communications solution - and revenue should increase in-line with usage.

It would not be a typical month of CY2022 if some things didn't go wrong. In this month data centre operator and modular data centre manufacturer **DXN (DXN)** had the sale of its modular manufacturing business to an offshore buyer blocked (the public announcement said the conditions precedent of the sale agreement could not be met - we expect that relates to Foreign Investment Review Board approval). DXN subsequently entered into a commercial agreement with the would-be-buyer that includes \$2m in fees for 10-years exclusivity and \$1.5m in consulting fees over three years. DXN retains ownership of its assets and we expect that the data centres in particular will be of value to other parties. DXN confirmed it has received non-binding indications of interest to acquire its data centres and that negotiations are being progressed.

Portfolio Changes

Among the Top Nine Positions (see above table), expense management software company **8Common (8CO)** crept in after we accumulated on weakness, while energy trading software company **Energy One (EOL)** slipped out on a modest opportunistic sale (above where it is now trading) to fund other purchases. 8CO was one of a number of small tech stocks that we felt were well oversold and were bought during the month.

We largely exited pine chemicals company **Leaf Resources (LER)** during the month. LER, previously a positive contributor to Fund performance, had been a drag on the Fund in October after it disclosed it was not as advanced with reestablishing its processing facility as expected. On the last day of October, LER announced that its "Apple Tree Creek construction likely to be deferred until Q1 CY23" and that the plant had not yet been shipped from New Zealand (NZ) - in fact it turns out LER's managing director "spent considerable time" in NZ in September and October looking at establishing the plant in Rotorua, NZ, instead of the existing site in Apple Creek, Queensland. The context is that back in July, LER had advised the market that "key components will commence being transported to Australia in the coming weeks, with plant construction to commence in the December 2022 quarter." Given the lack of transparency and execution risk, we have chosen to allocate our capital elsewhere.

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 49% year-on-year in the September quarter (and -41% in the first two months of the current quarter). Activity is now well below trend. For patient investors, such pull-backs in risk appetite tend to create opportunities. As an indicator, the median ASX-listed micro-to-mid cap with positive EBITDA is priced on an EV/EBITDA multiple that is 50% of the median for large caps (we excluded stocks on EV/EBITDA multiples >40x for this comparison). 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.

“Recap” risk and opportunity The other component of the current illiquidity issue is the scarcity of capital to fund growth. Australian equity capital raising activity has fallen 54% year-to-date, using dealogic data (in USD). In global venture capital markets, seed funding dropped by a third, early stage halved and late stage is down by 80% compared to November 2021, according to Crunchbase.

You can revisit our “Recap” video presentation from six months ago [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 view - indeed 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 have to walk back rate increases, the implication will be that the economy has deteriorated.

Energy The situation in the Ukraine and the broader geopolitical environment has really 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 have been 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 (how the administration of Ellume has been conducted is another whole line of discussion). 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.

OLIVIA₁₂₃
Apply Now

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.