Truffle Hound

"Like a 'Truffle Hound' you kinda keep looking for good ideas… That's what we do every day. We come to work, and the more we look the harder we work – we find interesting things." – Mario Gabelli

Performance to June 30, 2024	1 month	3m rolling	FY2024	FY2023	FY2022	FY2021	Inception
	-0.34%	**+0.20%**	**+6.71%**	**-34.04%**	**-23.53%**	**+74.34%**	**-8.24%** 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	$0.55544
Inception	Sep 1, 2017
Bloomberg	EQUINDF AU Equity
APIR code	EQB7664AU
ISIN	AU60EQB76649

Portfolio Key Metrics

Jun 30, 2024	% NAV#
Cash (incl. cash ETF)	1%
Unlisted	10%
Con Notes in Listed	12%
ETFs	0%
Listed Equities	77%
Market cap <$100m	*75%*
Market cap $100m-$1b	*25%*
Market cap >$1b	*0%*
Top 5 positions	47%
No. positions*	25

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 | Month

Positive	Intelligent Monitoring (IMB), MedAdvisor (MDR)
Negative	MadPaws (MPA), Top Shelf (TSI)

Key Contributors | Quarter

Positive	Adveritas (AV1)), MedAdvisor (MDR)
Negative	De.Mem (DEM), MadPaws (MPA)

Key Contributors | FY2024

Positive	Intelligent Monitoring (IMB), MedAdvisor (MDR)
Negative	Redflow (RFX), Scout Security (SCT)

SUMMARY

→ **THE MONTH |** For the second consecutive month some impressive gains by a few holdings were offset by general weakness, featuring the impact of tax loss selling pre-June 30, across the broader portfolio. The Fund was nudged down 0.3% while the S&P/ASX Emerging Companies Index shed 3.8%. It was a month in which it was fortunate not to be exposed to the resources sector, with the S&P/ASX Small Resources Index sliding 8%.

→ **FY2024 |** A frustrating second half to the financial year after a 10% gain in the first half was eroded for a +6.7% annual return.

→ **SECURITY TECH |** Since the last update, Equitable has presented at the NWR Security Technology conference. You can watch here and investors can read the post-conference *Small Talk* for a summary.

→ **INSIDE THIS UPDATE |** Portfolio Review (the month & FY2024); 'FIT" Universe FY2024 review; Outlook commentary; and 'What's on our Minds".

Top Nine Positions (alphabetical order, as of June 30, 2024; ASX-listed unless otherwise stated)

Adveritas (AV1)	Intelligent Monitoring (IMB)	Spacetalk (SPA)
De.Mem (DEM)	MedAdvisor (MDR)	Spectur (SP3)
Energy Technologies (EGY)	Scout Security (SCT)	Upsure (unlisted)

PORTFOLIO REVIEW

THE MONTH | JUNE 2024

It seems almost inevitable that smaller ASX listings will struggle each year in June as tax-loss selling undermines this end of the market. Our number-crunching on the S&P/ASX Emerging Companies Index showed that the month of June has averaged a -1.9% return, while July has averaged a +5.8% gain, dating back to 2016. If we exclude the impact of the COVID-19 market plunge in 2020, June has been clearly the worst month.

Underlining the view that these declines in June are not linked to fundamentals is the fact that July is typically the best month for small stocks. In our ""FIT" (Financials, Industrials & Technology) universe of micro-cap-to-mids-caps, $10m-to-$50m market cap stocks averaged a 4.65% gain for the first week of July (following the close of June 2024); and $50m-to-$100m averaged a 3.6% gain.

➔ Security monitoring company **Intelligent Monitoring (IMB)** and MedTech company **MedAdvisor (MDR)** were the strongest performers in the portfolio again, as they were in the month of May.

➔ While we saw MDR finally getting some of the market attention we think it deserves and IMB continuing its progressive re-rating; two portfolio positions fell for every one position that made gains in the month. Thus, overall, NAV didn't really move much.

Portfolio Changes

➔ Water treatment systems company **De.mem (DEM)** raised $2.1m in a placement to finance the acquisition of Auswater Systems, which services WA mining clients. DEM is seeking to emerge with material market share in a fragmented Australian industry through organic growth and acquisition. Dragonfly Fund participated in this placement, priced at $0.10 a share (compared to $0.12 at the end of the month of May and $0.115 post-raise, at the end of June). DEM now has a ~$36m market cap and has been tracking progressively towards positive EBITDA - moving from -$3.1m in CY20 to -$0.8m in CY23, with Auswater adding +$0.5m EBITDA. We profiled DEM in Small Talk (before this deal) here.

➔ We also quietly added to some existing positions during June where we thought tax loss selling had created an opportunity. Purchases were funded by selling down some positions where our conviction was not as high or material gains had been achieved and the risk/reward scenario was less attractive.

THE FINANCIAL YEAR | FY2024

➔ On one hand it is a relief to report a positive return for FY24 after two consecutive years of negative returns. On the other hand, we expected better.

➔ The story of the financial year was consistent with that of recent months: IMB and MDR led the way. In fact, they were the strongest contributors in FY23 as well. A year ago, in our FY2023 review, IMB was highlighted as a "good case of sticking to valuation discipline" as "if the equity doubled again from here, the multiple [EV/EBITDA] would remain less than 6x". It more than doubled and still remained below 6x. That same FY2023 review also discussed MDR emerging into positive EBITDA territory - exceeding the FY24 expectation set at that time has attracted more investor interest.

➔ The takeover of IT consulting firm **Cirrus Networks (CNW)** by larger listed peer Alturra (ATA) also delivered a gain of similar magnitude (it was bought out at a ~54% premium to its "undisturbed" pre-bid price). A bid for **Locality Planning Energy (LPE)** also aided overall returns.

➔ The worst performed investments were those that found it most difficult to navigate very tight capital markets. Investing in flow battery technology company **Redflow (RFX)** during the year was a mistake that we exited. Our expectation had been that RFX was at a turning point, having tracked its commercial development for a number of years and being led to believe that material revenue was to flow in FY2024. None of the expected revenue arrived in the first nine months of FY24 as $690k in cash receipts was reported, 24% less than $907k received a year earlier. At the end of January the company told the market that it had been having "ongoing production issues". Ultimately, RFX needed to raise more capital at a material discount to its previous capital raising.

➔ Security technology company **Scout Security (SCT)** (*Equitable's Martin Pretty is a non-executive director*) also faced the need to improve its capital position as large enterprise customers/partners advanced slowly. SCT has arranged a recapitalisation that is pending shareholder approval later this month. SCT was one of a number of security technology companies to present at this conference on July 11, along with a presentation from Martin (all viewable at the provided link).

"FIT" Universe | FY2024 Review

Equitable Investors is more interested in the actual performance of stocks than of market-cap weighted S&P/ASX indices that do not reflect what happens across the 2,000-odd underlying ASX listings. We track our "FIT" (Financials, Industrials & Technology) universe by measuring the share price performance of >550 companies that meet the following criteria: ASX-listed; Market caps of between $10 million and $5 billion; at least $5m annual revenue in the previous financial year; and ex- mining and energy sectors.

Here are some key data points from the financial year just ended for this "FIT" universe:

➔ The median price change of all "FIT" stocks was -2.0%
➔ There was clear discrimination by size once again - the smallest third of "FIT" companies averaged a -19% decline while the largest third averaged a +33% gain
➔ The worst performed sector was Utilities
➔ In terms of valuation, high multiple stocks materially outperformed those trading on lower multiples
➔ Plant-based food company Wide Open Agriculture (WOA) was the worst performed "FIT" stock as excitement over the theme petered out (Nasdaq-listed thematic leader Beyond Meat nearly halved in FY24) and cash ran out as well, leading to a capital raising in July 2024.
➔ Indian digital banking and ATM network operator Findi (FND) gained over 1000% in FY24. Its EBITDA is estimated by MST to have grown to $42.4m in FY25 from $16.8m in FY2022 (its year ends March 31)

OUTLOOK

Once again we enter a new financial year with early gains in the first weeks of July - in-part due to the release of tax-loss selling pressure but this year also with a noticeable positive sentiment shift towards smaller stocks as signs that central banks around the world will not be increasing interest rates further and are more likely to cut rates from here - a key signal for those who allocate funds from a macro or "top down" perspective.

Small and micro cap stocks with solid fundamentals and growth opportunities remain ripe for a broad re-rating after being unloved for a prolonged period. We said the same thing a year ago - acknowledging that timing is never obvious.

Australia's large caps trade on a market cap weighted average EV/EBITDA multiple of 12.9x trailing earnings and 10.3x consensus expectations, at the time of writing. This compares with our "FIT" universe of micro-to-mid caps, where the median multiples are 10.2x trailing and 9.5x patchy consensus expectations (only 56% of these "FIT" companies have consensus estimates, generally the larger ones). Historically smaller stocks have often traded on higher multiples than large caps due to greater growth potential - this has not been the case in recent times.

Maybe the shift in sentiment in the first weeks of July is the beginning of this re-rating but we will have to wait and see.

Several times over the past year or so we have cited a quote from hedge fund manager David Einhorn, of Greenlight Capital:

> "*... 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.*"

The quote was focused on the identification of fundamental value rather than on a specific market cap segment but we think it is a very accurate description of the hollowing out of the nano/micro/small cap space. We hold the view that if the marginal investor won't identify and recognise value, strategic and financial acquirers ultimately will.

Historically takeover premiums on the ASX have a median of ~35%. But in a market that is often not valuing companies fairly, in CY2024 we are seeing premiums of ~70% - as set out in the table below.

Figure 1: Recent M&A activity on the ASX

Target	Acquiror	Announced	Offer price / share	Premium to undisturbed share price	Cash / Scrip
Mermaid Marine (MRM)	Cyan	Jun 20, 2024 (revised bid)	$2.700	15%	All cash
K2Fly (K2F)		Jun 21, 2024	$0.190	90%	All cash
Locality Planning Energy (LPE	River Capital	Jun 19, 2024 (revised bid)	$0.105	94%	All cash
Capitol Health (CAJ)	Integral Diagnosti	Jun 17, 2024	$0.326	33%	All scrip
Namoi Cotton (NAM)	Louis Dreyfus	Apr 29, 2024	$0.600	69%	All cash
Pacific Smiles Group (PSQ)	National Dental Ca	April 29, 2024	$1.900	98%	All cash
Genex Power (GNX)	J-POWER	April 12, 2024	$0.275	49%	All cash
Decmil (DCG)	Macmahon Holdir	April 16, 2024	$0.300	76.50%	All cash
Task Group Holdings (TSK)	PAR Technology	March 11, 2024	$0.810	103%	All cash
Qantm Intellectual Property	Adamentum	May 10, 2024	$1.817	58%	All cash
Vonex (VN8)	MaxoTel	June 25, 2024	$0.0375	108%	All cash
APM Human Services (APM)	Madison Dearborn	May 31, 2024	$1.45	74.70%	All cash
PSC Insurance (PSI)	Ardonagh	May 8, 2024	$6.19	16.14%	All cash
Eureka Group (EGH)	Aspen Group (APZ	May 2, 2024	$0.48	-11.89%	All scrip
Median				72%	
Average				62%	

Sources: Equitable Investors, companies, TIKR

WHAT'S ON OUR MINDS

Liquidity in small stocks	The value of trade in the S&P/ASX Emerging Companies Index was down 9% in FY24, following a 39% decline in FY23. However, the last three months of FY24 each experienced stronger trading than the same month 12 months earlier. We use trade in the Emerging Companies Index components as a benchmark but expect smaller stocks that are not in S&P/ASX indices suffered an even greater decline in the value of trade over the past two years.
Private Market Valuations	We continue to watch private markets slowly adjust to reflect the change in the cost of capital that has occurred over the past two years. Clearly not all is rosy in the world of unlisted VC and PE investments. Despite marketeers labelling private assets as low volatility, there is underlying volatility in the pricing of private assets and there is correlation with public markets. The *Wall Street Journal* reported recently on how stakes in private equity funds were being traded at "big discounts to the official values set by the private-equity funds' manager" with "buyers quickly mark[ing] up the stakes they acquire to the official value, no matter how little they paid for them". March quarter data from PitchBook shows that "median Q1 early-stage and late-stage valuation step-ups were either flat or down" and in the secondary market shares were trading at median and average discounts of 37% and 28%, respectively. "The number of flat and down rounds as a proportion of all VC deals expanded consistently since Q1 2022 on a QoQ basis, notching 27.4% in Q1 2024—the highest level in a decade", said PitchBook. "Common stockholders and early-stage investors face the challenge of highly dilutive terms."
"Recap" risk and opportunity	Australasian equity capital raising activity has been improving. The dollar value raised in CY2024-to-date is up 16% year-on-year, following a 6% decline in CY2023 (using Dealogic data in USD). We analysed quarterly cash flow reports for the December quarter of 2023 and found over 230 companies with no more than four quarters of cash funding at hand based on their most recent burn rates (and backing out the R&D tax rebates many received in the quarter). Thus it continues to be the case that businesses are 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	Interest rates remain low by historical standards (see 700 years of declining rates charted here) 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. Our view through the first half of CY2024 has been that there was not a strong case for reducing interest rates in the near-term and that if central banks do walk back rates materially, the implication will be that the economy has deteriorated. Increasing signs of softness in the economy now suggest the Federal Reserve and other central banks may make some rate reductions. In Australia there remains more uncertainty regarding central bank policy. Shifting market sentiment regarding the extent to which interest rates could decline from here will influence the market in the short term.
Energy	We 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. Bloomberg reported recently that "electricity demands from AI data centres are outstripping the available power supply in many parts of the world" already. 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	A key lesson for us from FY2023 is that it is important when investing in unlisted entities to have some form of influence. During FY2024 we realised one unlisted investment, in data centre cooling tech company Firmus, for a return equating to just under 20% a year.

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.