

Dragonfly Fund

Issued: October 2024

A Path

"If you find a path with no obstacles, it probably doesn't lead anywhere." - Frank A. Clark, US lawyer & politician.

Performance to Sep 30, 2024	1 month	Sep Qtr	FY2025 to date	FY2024	FY2023	FY2022	FY2021	Inception
	+1.43%	+7.70%	+7.70%	+6.71	-34.04%	-23.53%	+74.34%	-6.99%

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	\$0.59819
Inception	Sep 1, 2017
Bloomberg	EQUINDF AU Equity
APIR code	EQB7664AU
ISIN	AU60EQB76649

Portfolio Key Metrics

Sep 30, 2024	% NAV [#]
Cash (incl. cash ETF)	2%
Unlisted	9%
Con Notes in Listed	7%
ETFs	0%
Listed Equities	82%
Market cap <\$100m	79%
Market cap \$100m-\$1b	21%
Market cap >\$1b	0%
Top 5 positions	48%
No. positions*	23

[#] 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	Adveritas (AV1), Intelligent Monitoring (IMB)
Negative	Spacetalk (SPA), Top Shelf (TSI)

Key Contributors | Quarter

Positive	De.mem (DEM), Intelligent Monitoring (IMB)
Negative	MedAdvisor (MDR), Top Shelf (TSI)

SUMMARY

- **THE MONTH** | A return of +1.43% for September with both Intelligent Monitoring (IMB) and Adveritas (AV1) rebounding from August dips.
- **THE QUARTER** | Over the quarter the Fund returned +7.70%, while the S&P/ASX Small Industrials Index advanced +6.4% and the Emerging Companies Index was up +8.82%. You can click on these links to read the [July](#) and [August](#) updates.
- **OUTLOOK** | While ASX indices have been quoted above for context, this Fund does not hold a portfolio that we expect will follow the path of "the market" over time, although it is helpful to now be in an environment where the decline in liquidity for small stocks appears to have been arrested and interest rates are not rising. Most of the Fund's listed investments are not index components and do not have deep liquidity. Some of its investments are held in a convertible note form and some are unlisted. We are looking for valuation catalysts like [IMB's ADT acquisition](#) and subsequent delivery on its financial forecasts; and [MDR's emergence](#) into full-year cashflow and net profit positivity. Occasionally there are negative catalysts as well - the [most painful](#) for the Fund was the unexpected collapse of Ellume in FY2023. We are actively engaged in seeking to deliver positive catalysts for portfolio companies.

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

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

PORTFOLIO REVIEW

We highlighted in the [latest edition](#) of *Small Talk* how capital raising activity among smaller companies has kicked off, albeit it often requiring discounts of 50%. We first set out the “recapitalisation opportunity” market conditions were creating for smaller stocks in [this presentation](#) in June 2022. It has been a slow-motion thematic since but the highs, lows and activity of the last month highlight how this is continuing to play out.

- Digital ad fraud identification company **Adveritas (AV1)**; ~\$62m market cap; +33% stock price change in [September](#)) released its annual report for FY24 and CEO Matthew Ratty met with investors during the period. AV1’s key message was that it has a “visible path to positive operating cashflow” as it increases prices, maintains cost discipline and takes up prepaid annual contracts from new customers as it tackles a record pipeline.
 - ◆ Trials of AV1’s TrafficGuard solution are underway with large advertising agencies and first revenues are expected by AV1 in the December (current) quarter.
 - ◆ The Fund has participated in a series of capital raisings AV1 has made over the past few years to keep it funded - these deals were priced well below 2022 market prices and also below a takeover offer made in late 2022 - and the message now is that we may have now seen the last of the funding rounds, given cash flow positivity is in sight.
 - ◆ We profiled AV1 in this edition of [Small Talk](#) from May 2024.
- In the [August 2024](#) report we commented that security monitoring company **Intelligent Monitoring (IMB)**; ~\$235m market cap; +23% stock price change in [September](#)) delivered FY24 numbers that bettered its guidance - but the market did not get the chance to react as the figures were announced on the last trading day of the month and IMB’s shares spent that day halted from trade. The market has had the opportunity to respond to those results in September and responded positively.
 - ◆ This business laboured under an unsustainably high level of debt when it was named “Threat Protect” and has had to undertake a series of capital raisings over the past three years that the Fund participated in - and bought scale through M&A.
 - ◆ IMB CEO Dennison Hambling’s F2024 results presentation to *Coffee Microcaps* can be viewed [here](#).
- MedTech **MedAdvisor (MDR)**; ~\$221m market cap; -4.5% stock price movement in [September](#)) had been falling late in August despite there being no surprises with its results and the drift lower was only arrested in the middle of September, at a time when fund manager Perennial Value moved to lift its stake in MDR to 10.4% from 8.7%.
 - ◆ We profiled MDR most recently in this edition of [Small Talk](#) from September 2024.
- Whisky and agave producer **Top Shelf (TSI)**; ~\$13m market cap; -45% stock price movement in [September](#)) conducted a \$13.9m recapitalisation several months earlier but market sentiment was damaged in September by the collapse of a peer, Billson’s (produces ready-to-drink vodka, craft beer and cordial), and an article suggesting TSI’s funding was tight and it was reviewing opportunities to sell assets, such as its whisky inventory. We are unimpressed with the lack of shareholder communication emanating from this company at this time. In the absence of information, investors are left to their imagination.

WHAT'S ON OUR MINDS

Liquidity in small stocks The last time we saw a year-on-year gain in the trailing twelve month value of trade in the S&P/ASX Emerging Companies Index was in August 2022. The year-on-year change in September 2024 was nearly flat at -0.96%, with six consecutive single months showing growth in trading value compared to the same month a year earlier. The 12-month trailing figure for August still remains ~40% below the peak of April 2022. The Emerging Companies Index has an average market cap of \$273m and we expect the deterioration in liquidity over the past few years has been even greater for sub-\$100m market cap companies.

Private Market Valuations Private markets continue to slowly adjust to reflect 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, PE and “real assets” - and despite marketeers labelling private assets as low volatility, there is underlying volatility in the pricing of private assets AND correlation with public markets.

- Private equity’s annualised IRR fell below 10% in the year to March 2024, according to PitchBook data cited by the [Financial Times](#), compared to a target of 25%. Meanwhile, the [Wall Street Journal](#) reported in June on how stakes in private equity funds were being traded at “big discounts to the official values”.
- In US secondary markets for VC investments, on average, the ZX Index Values for September 2024 showed a 12% discount compared to the last fund raising round’s price per share.
- Wilshire used an 11.9% decline in its Real Assets Benchmark for pension fund giant CalPERS in the year to June 2024 (covering real estate, infrastructure and forestland)

“Recap” risk and opportunity Australasian equity capital raising activity has continued to gain momentum and - as of October 15 - is up 27% year-to-date, compared to the same period a year earlier (as measured in USD by Dealogic). IPOs remain scarce. The ASX calendar currently features eight companies only - five in the minerals space and only one raising more than \$20m (a listed investment trust).

We analysed quarterly cash flow reports for the June quarter of 2024 and found over 262 companies with no more than four quarters of cash funding at hand based on their most recent burn rates - and also 95 companies in net debt positions that reported negative operating cash flow. With these companies competing for new capital, there is a funding risk for existing investments that are not self-funding at this stage. The situation is also an opportunity 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](#)). Our view through the first half of CY2024 had 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 has led the Federal Reserve to begin cutting rates in the US this month 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 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. “Electricity demands from AI data centres are outstripping the available power supply in many parts of the world” already, [reported](#) Bloomberg. In Ireland there has been a ban imposed on new data centres connecting to the grid until 2028. 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 industrial and technological angles.

Unlisted A key lesson for us from FY2023 is the importance 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.