EQUITABLE INVESTORS®

Fund Update

Dec 2024

Dragonfly Fund

Issued: January 2025

The Participant

"*The participants' perceptions influence the market in which they participate, but the market action also influences the participants' perceptions.'*" - George Soros

Performance to Nov 30, 2024	1 month	FY25 to-date	FY2024	FY2023	FY2022	FY2021	Inception
	-6.18%	**-2.61%**	**+6.71**	**-34.04%**	**-23.53%**	**+74.34%**	**-8.03%**

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	$0.54096
Inception	Sep 1, 2017
Bloomberg	EQUINDF AU Equity
APIR code	EQB7664AU
ISIN	AU60EQB76649

Portfolio Key Metrics

Dec 31 2024	% NAV#
Cash (incl. cash ETF)	4%
Unlisted	8%
Con Notes in Listed	8%
ETFs	0%
Listed Equities	80%
Market cap <$100m	*82%*
Market cap $100m-$1b	*18%*
Market cap >$1b	*0%*
Top 5 positions	45%
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	Intelligent Monitoring (IMB), Ixup (IXU)
Negative	MedAdvisor (MDR), DXN (DXN)

Key Contributors | Quarter

Positive	Adveritas (AV1), Gratifii (GTI)
Negative	MedAdvisor (MDR), Spacetalk (SPA)

SUMMARY

➔ **THE MONTH |** December brought no Christmas cheer - as foreshadowed in the prior update - with both the top 100 stocks and small industrials declining more than 3%. The Fund fell 6.18% as MedAdvisor (MDR; -27% price change) gave up all gains from the prior month, alongside Spacetalk (SPA; -11%) and DXN (DXN; -19% from its issue price).

➔ **THE QUARTER |** The last three months of CY2024 were challenging. The "double-edged sword" of tightness in the availability of capital was a key factor, with a stock like Gratifii (GTI) advancing following its recapitalisation, while companies perceived to still be in need of further capital found it difficult to attract on-market buying - even as it became evident that the recession in small stock trading volume on the ASX had come to an end.

➔ **OUTLOOK |** We remain focused on the businesses the Fund has invested in and their valuation propositions. We do not have the scale of capital to lead funding of these companies and that means, while our investment strategy is to invest in the unknown and under-appreciated, we do need other investors or corporate buyers to come to the party at some point. The process of building market interest in a small company has proven far more difficult in the past few years than has historically been our experience. Investor George Soros' "theory of reflexivity" says that…

Top Nine Positions (alphabetical order, as of December 31, 2024; ASX-listed unless otherwise stated)

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

… what happens in the market impacts on the real economy and creates a feedback loop. This is certainly the case for small stocks that require access to capital markets. Eventually the trend reverses, once it is recognised as having become detached from reality. But in the meantime, companies need to survive.

This is not a recent realisation. The Fund has always avoided investments where it was apparent that vast amounts of capital were required in the years ahead and there was no obvious funding source. A classic example would be computer memory technology company Weebit (WBT). We felt we understood the computer memory market and had engaged with WBT management. What WBT was developing (“ReRAM”) was very exciting as the next logical advancement in RAM. But we could not see revenue coming in any material form for many years and expected the costs to be material. WBT’s retained losses have surpassed $150m - of which only $15m were attributable to the mining shell it was backed into in 2016 - and there has been virtually zero revenue generated over the eight years since it listed.

But in the current environment even very small amounts of funding for revenue-generating businesses have been difficult to access on reasonable terms - in fact we think it is true to say that smaller amounts of capital have been more difficult to raise than large amounts. As we discussed recently on ausbiz, companies are getting creative with convertible notes and other funding structures in order to survive and fund their ambitions. That’s an opportunity for investors with capital to deploy to secure better terms than ordinary equity holders - and represents increased risk to equity holders who can’t or choose not to provide further funding to their existing investments..

One company in the Fund’s portfolio that requires funding to meet its objectives is security technology company Scout Security (SCT - *Equitable’s Martin Pretty is a non-executive director*), as noted last month. SCT has announced a non-cash acquisition of a similar business, Roo Inc, with the combined entity benefiting from synergies that take the $6.5m pro-forma revenue and are expected to deliver positive EBITDA and neutral-to-positive cash flow. That places SCT in a self-sufficient position to pursue its organic growth opportunities: a partnership with Origin Wireless AI on the latest security technology, WiFi sensing, and a partnership with a “mega tech” company to pursue enterprise sales opportunities in the US. But SCT requires working capital to execute the deal and deliver the synergies. It is currently in discussions with strategic, current and new investors. We believe the company has a great opportunity ahead of it - including further industry consolidation in a “smart home” sector where billions of dollars have been spent too early but consumer take-up is now taking off. But the funding risk is real.

MONTHLY PORTFOLIO REVIEW

MedAdvisor (MDR) is the roller-coaster in the portfolio - in October it suffered a dramatic fall on the last trading day; in November it recovered as it flagged a strategic review; in December it dropped away again as it advised the market that the December half-year would not be as strong as analysts expected. The reason the strategic review is so important to us is because we do see a compelling case for a split that is underlined by the December news - MDR has a near-monopolistic Australasian business that is built around recurring subscription revenue from pharmacies that should demand a high valuation, in keeping with other software businesses with similar market positions. MDR’s US business is more volatile - it needs to keep winning new business from Big Pharma - and while the trends are very strong for MDR’s digital and omni-marketing offering to Big Pharma, there will always be volatility in their period-to-period spend. So we do not expect MDR’s US segment to be valued on as high a revenue multiple as we think the original Australasian business should be. But the US segment should be valuable - and possibly a target for private equity.

MONTHLY PORTFOLIO CHANGES

The lack of buyers for small companies can create opportunity. We took advantage of selling in health monitoring tech company Talius Group (TAL) and participated in the purchase of a line of stock that appeared to be scaring off buyers. TAL rallied almost as soon as the line of stock was dealt and we sold down in December. Similarly, we participated in a capital raising for Compumedics (CMP) in early December that seemed attractively priced - and that stock also advanced once the transaction was completed.

A purchase that hurt Fund performance in December was the Fund's participation in the second tranche of a capital raising by modular data centre company DXN (DXN) that was launched and priced in October. DXN had traded as high as 9.1c in that month and priced its raising at 7c. During November the stock slipped below the issue price and it remained stuck there in December. We look forward to positive updates from DXN in relation to its guidance for FY25, with the company facing strong demand and having both recapitalised and exited loss-making activities during CY2024. A better result came from the Fund's participation in a capital raising for RegTech company Ixup ("eyes up" - IXU), which is advancing its Australian-developed platform for tracking problem gamblers (known in Australia as BetStop National Self-Exclusion Register).

QUARTERLY PORTFOLIO REVIEW

You can check on on what happened earlier in the quarter here:

➔ Is This Different? | November 2024 Update
Digital ad fraud protector Adveritas (AV1) continued to re-rate while MedTech MedAdvisor (MDR) recovered part of the 33% plunge it suffered on the final day of the prior month. Family connectivity and safety tech company Spacetalk (SPA) drifted while it completed a 1:10 consolidation The Fund returned +1.4% against a backdrop where the S&P/ASX Emerging Companies Index fell 0.9%.

➔ Know what you own | October 2024 Update
Strong gains came from technology businesses Adveritas (AV1) and Gratifii (GTI), both companies that the Fund has invested in through capital raisings. The month was largely undone for the Fund by a 33% final-day plunge in Top Nine holding MedAdvisor (MDR). Volatility like that is never enjoyable but MDR remains a business we see great value in, while also remaining a long-term positive contributor to the Fund.

WHAT'S ON OUR MINDS

M&A	There was a 34% increase in Australasian M&A spend in CY2024, in USD, according to dealogic. The December quarter of CY2024 was the strongest quarter since September CY2022. What is of most interest to us is increased bidding activity for smaller ASX listings and the strong trend in premiums being offered. Our study of 30 ASX (ex-resources) deals over the past year features a median takeover premium of 53%. Where the marginal buyer on the ASX is not recognising value, industry and financial buyers are taking advantage.
Liquidity	December's trading activity was consistent with our view last month that the multi-year recession in trading activity in the S&P/ASX Emerging Companies Index has come to an end. The year-on-year change in the trailing 12 month tally of the value of trade in stocks in the index was +17%. Still, trading over the past 12 months was 36% lower than the peak figure recorded in the 12 months to April 2022. We use trading data from the Emerging Companies Index as a proxy for micro and small caps but the Index has an average market cap of $277m and we expect the deterioration in liquidity over the past few years was greater for sub-$100m market cap companies than was evident via the Index data.
Private market valuations	Private markets continue to slowly adjust to changes in the cost of capital that have occurred over the past few years. Despite marketeers labelling private assets as low volatility, there is underlying volatility in the pricing of private assets AND correlation with public markets. ➔ Companies valued at >$US500m experienced "down rounds" when IPOing (Reddit and ServiceTitan), noted PitchBook, ➔ The *Wall Street Journal* reported in June 2024 on how stakes in private equity funds were being traded at "big discounts to the official values"; with subsequent signs of improvement as the Financial Times reported in October 2024 that sales of buyout fund stakes were now being priced between 93% and 98% of a fund's reported value - but including deferred payment worth up to four percentage points. ➔ In US secondary markets for VC investments, on average, the ZX Index Values for December 2024 were 4% lower than last round price per share, the narrowest margin in the last 24 months; with an average bid-ask spread of 11%.
Our private Investments	A key lesson for us when investing in unlisted entities has been the importance of having adequate influence with the investee. When problems arise, exiting private investments is often not an option. But if we can influence the actions taken in response, we can push for the best possible outcome.
"Recap" risk and opportunity	Australasian equity capital raising activity has continued to gain momentum - up 44% in CY2024 (as measured in USD by Dealogic). IPOs remain scarce and have struggled to trade above issue price once listed. 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). Increasing signs of softness in the economy has led the Federal Reserve to begin cutting rates in the US in September 2024. 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	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. Dragonfly Fund does not invest in the resources sector directly but we do seek opportunities to participate in the energy economy.

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 founder has well over 20 years of experience.
Alignment of Interests	Seeded by the Manager & all our best ideas go into the Fund.

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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.

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