DMX Capital Partners Limited

Investing in the most compelling small and micro-cap value opportunities

DMX ASSET MANAGEMENT

DMX Capital Partners Limited

February 2019 – Shareholder Update

An investment company managed by:
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Opening NAV (1 February 2019) [1,2] **Closing NAV (28 February 2019)** [1,2]	**$1.5965** **$1.5964**	Fund size % cash held - month end [4]	$6m 25%
NAV Return (February)	-0.01%	Gearing	nil

*DMXCP Share price = Closing NAV ($**1.5964**), being: Share portfolio value + cash – fees payable – tax payable + franking credits*
**References to All Ords are for illustrative purposes only*

Monthly DMXCP Net asset value (share-price) returns (after fees) since inception (April 2015) [3] (%):

Month	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	All Ords
2015	n/a	n/a	n/a	+0.201	+9.448	+1.104	+6.524	+1.971	+9.711	+0.958	+3.568	+2.470	**+41.62**	**-8.83**
2016	-3.590	+1.323	+2.049	+2.045	+2.143	+0.020	+5.389	+7.056	+2.156	+1.058	+1.520	+0.321	**+23.10**	**+7.01**
2017	+0.885	-0.816	+1.790	-0.741	-1.990	+0.210	+1.071	+1.208	+0.822	+3.494	-0.267	-0.055	**+5.54**	**+7.83**
2018	+0.445	-1.625	+0.008	-1.173	+0.310	-0.211	+1.017	+4.112	+1.604	-3.438	-2.827	-2.257	**-3.66**	**-7.24**
2019	+0.122	**-0.010**											**+0.101**	**+9.12**

Dear Shareholder,

DMXCP's NAV decreased 0.01% after all accrued fees and expenses for February 2019. The NAV as at 28 February 2019 was **$1.5964**, down from **$1.5965** as at 31 January 2019. The ASX All Ordinaries Index increased 5.30% during the month, while the XEC (Emerging Companies Index) was up 4.41%.

For the first eight months of the 2019 financial year, DMXCP's net asset value has decreased 1.60%.

Monthly summary

While the monthly performance was impacted by a surprisingly weak first half result from Pioneer Credit, the majority of our portfolio companies reported pleasing half year results that were in line with or ahead of our expectations.

In particular, strong half year reports were delivered by **Kip McGrath** (EBITDA up 50% from last year's profit, EPS up 41% - discussed below), **Legend Corporation** (EBITDA up 41%, EPS up 45%), **Easton Investments** (EBITA up 33%, EPS up 65%, and a maiden interim dividend) and **Blackwall** (with its Wotso business delivering EBITDA up 46%). These holdings are all meaningful positions for the fund, and while the market generally responded positively to these pleasing results, we believe the results justify stronger share price increases, which we look forward to see playing out over the coming weeks and months.

In relation to monthly performance, strong share price performances and contributions came from **Fiducian** (share price +35%), **People Infrastructure** (+33%), **CV Check** (+33%), and **Janison Education** (+22%).

The key detractor was **Pioneer Credit** (-24% - discussed below), while **Apollo Tourism** and **Konekt** were down 16% and 17% respectively, notwithstanding both reporting results in line with expectations.

We acknowledge the portfolio's slow start to 2019, in an environment where larger, liquid, high growth stocks have rebounded strongly. Our portfolio, with its micro-cap value-based opportunities, has yet to benefit from this rebound. Larger liquid stocks are generally the first to recover from a market correction, so we would expect broader interest in micro-cap stocks to follow, as investors start to look for value outside of the larger liquid names where valuations continue to look very full.

We are working hard to, and are committed to, improving performance.

We are focused on adding new positions and adding to compelling existing positions. For example, we have been purchasing **Primero Group** (ASX:PGX) which delivered a 66% increase in revenues. With a market cap of $60m and net cash of $22m, PGX is trading on 3.5x the midpoint of its forecast EBITDA ($11.25m). Despite media takeover speculation at the start of the month (from NRW Holdings), and its strong result and outlook, its share price remained flat for the month.

Whilst illiquid micro and nano-caps are generally currently somewhat out of favour (there are some success stories), we are looking to take advantage of opportunities in this part of the market in stocks with short term catalysts that are fundamentally good value. This may also involve participating in capital raises. For example, **CV Check** (ASX: CV1) had been sold off heavily in anticipation of a raising, and following the raising late last year (which we participated in) it has risen strongly (+40%). We are keen to capture the large upside potential from attractive stocks currently trading on low market caps, so as to benefit from this current opportunity when interest returns.

Stock reports:

<u>Kip McGrath Education Centres (KME) – A well-executed birdie</u>

At its 2018 AGM, Kip McGrath, Chairman of KME, a leading tutoring company, noted that its FY18 result (41% increase in profit) was the seventh consecutive year of increased profits. Further, based on results to date, FY19 would likely continue that trend. At the time, we suggested EPS should increase by around 20%. Well, it looks like that initial assessment will prove to be far too conservative.

In H1, revenues were up 18% driven by an increase in marketing spend. A key feature of the result was the fall in royalties after KME bought back a number of master franchises and are now servicing the franchisees directly. This trend should continue over the next year. Online tutoring rose 50% off a low base. Overall, KME reported a 50% increase in EBITDA and a 41.3% increase in NPAT. The dividend is also up 50% on last year.

KME results are seasonal and we expect a stronger second half. Kip McGrath stated in the outlook statement "we expect this increase in EBITDA and Net Profit to continue in the second half".

With a strong balance sheet and proven IP and systems, KME is very well positioned to continue to take market share as the leading national player in what is very much a cottage industry.

<u>CML Group Limited (CGR) – a solid par</u>

CGR provides invoice and equipment finance to Australian SMEs through its brand Cashflow Finance. It is the number two player in invoice factoring after Scottish Pacific. In last month's report, we outlined what we would be looking for in the report:

- *That invoices purchased are tracking to full year guidance ($1.7b);*

The invoice purchases for the half year came in at $838m. It looks as the company should come in close to that target.

- *The margin on invoices purchased reverts to Pre-Thorn book levels;*

Gross Margins fell. The company stated…"anticipates an opportunity over time to improve on current Gross Margin of 2.3%". We will keep a close eye on this metric in future reporting periods

- *The company announced the entry into invoice discounting at the AGM. While we expect this to be initially loss-making, we will be monitoring how this new business is tracking;*

As predicted, the division was loss-making, but is expected to break even during 2H19.

- *Growth in the Equipment Finance division*;

Receivables increased from $14m as at 30 June 2019 to $21m as at 31 Dec 18.

- *The level of arrears has not deteriorated.*

Bad and doubtful debts did increase broadly in proportion with the invoices purchased. Aging analysis was not provided.

The company presented new charts that highlight the growth potential of the company. With new business segments and digital transformation of its business, CGR are able to widen the size and type of lending they perform. This will allow for a 300% increase in the total addressable market.

Given the nature of the business activities (lending), growth usually comes with the prospect of a capital raise. However, in this case, the company has sufficient headroom to expand its invoice volumes by more than 30%.

Pleasingly, CGR reaffirmed its forecast of an Underlying NPATA in FY19 of $9m+, which will be up 38%+ on FY18. This leaves the company trading on a PE of around 11x with plenty of scope for growth.

Overall, this was a par result with a couple of items to monitor. We will be catching up with management in March where we will discuss progress, and we remain excited about the growth prospects of the business.

Pioneer Credit Limited (PNC) – a double bogey

Following a positive AGM, we were expecting financial services company Pioneer Credit to report, as it historically has, a strong report ahead of expectations. Unfortunately, the market reacted negatively to the PNC report, where there was two key issues:

1) Despite cash collections being up 10% to $50.5m, an undisclosed issue with ‘operational strategies’ resulted in collections being $4.5m short of PNC’s $55m H1 target. It has been suggested that this may relate to an unsuccessful technology-based collection strategy. PNC has advised that these liquidations are not ’lost’ and will be recovered in subsequent periods. However, this shortfall in revenue had a flow on impact on H1 EBITDA (flat) and NPAT (down 37%). PNC reiterated its full year guidance (i.e. no FY19 downgrade) but will likely require a heroic second half effort to meet this guidance.

2) PNC is also working through a potential accounting policy change. PNC has historically accounted for its portfolios at fair value, having used this method (which has been signed off by its auditors) since it listed on the ASX in 2014. The alternative position now being considered is for portfolios to be accounted for at cost and then amortised. Whilst we remain comfortable with fair value accounting, and ultimately this is a non-cash issue, this uncertainty will continue to impact PNC until a resolution is reached.

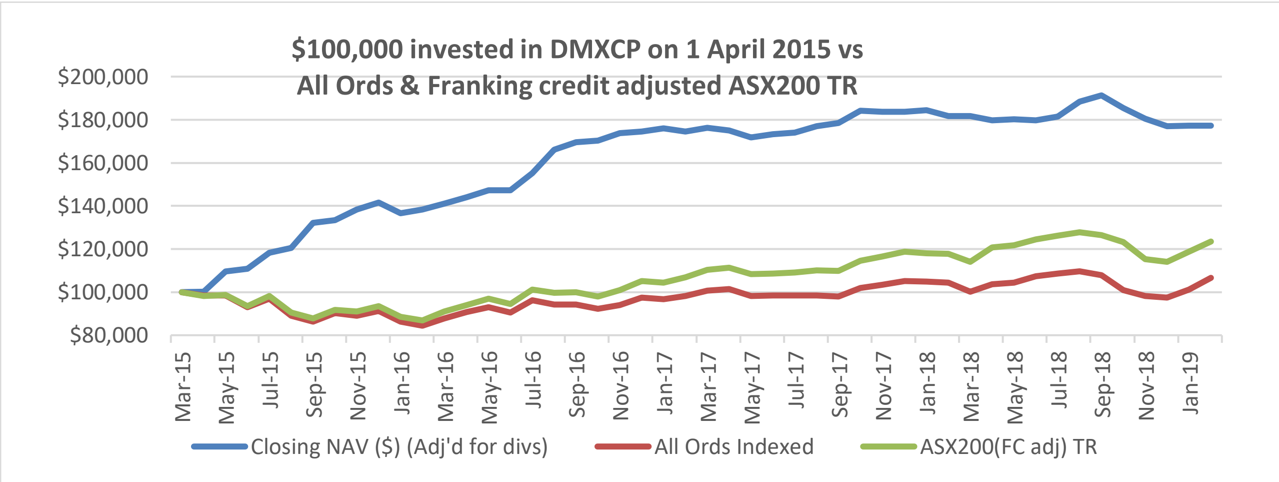
Our position in PNC is under review, and we are meeting Management next week to better understand a number of outstanding concerns, and we will report back to investors next month on items of significance coming from this meeting.

Portfolio Sector classification

We invite you to follow us on twitter to keep up to date with our articles and commentary: https://twitter.com/DMXAsset

Performance

The following chart illustrates the return from investing $100,000 in the fund (including dividends and attached franking credits) since inception (April 2015). DMXCP is an absolute return fund, focused on generating positive absolute returns over the medium to long term.



We'd like to take this opportunity to formally introduce and welcome Chris Steptoe to the team. Chris joined us as a research analyst on a part time basis in June 2017. With a strong focus on identifying and researching under the radar micro-cap opportunities, Chris has made a valuable contribution to the firm and our investment process. We're glad to have Chris on the team and look forward to working together in the periods ahead.

We look forward to reporting to you again in early April.

Kind regards

Roger Collison	Steven McCarthy	Chris Steptoe
Chairman	*Portfolio Manager*	*Research Analyst*

Note 1: Net asset value (NAV) is after all tax accruals but includes an estimate of franking credits available. Refer note 5, unaudited
Note 2: Unaudited result
Note 3: All DMXCP disclosed returns include the payment of dividends and franking credits
Note 4: Includes cash received during the month for the application of new DMXCP shares to be issued
Note 5: Franking credits per share are franking credits arising from dividends received and for tax paid or payable on realised portfolio gains