DMX ASSET MANAGEMENT

DMX Capital Partners Limited

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

DMX Capital Partners Limited

March 2019 – Shareholder Update

An investment company managed by:
DMX Asset Management Limited
ACN 169 381 908 AFSL 459 120
13/111 Elizabeth Street, Sydney, NSW 2000
PO Box 916, Milsons Point, NSW 1565

Opening NAV (1 March 2019) [1,2] **Closing NAV (31 March 2019)** [1,2]	**$1.5964** **$1.5705**	Fund size % cash held - month end [4]	$6m 30%
NAV Return (March)	-1.62%	Gearing	nil

*DMXCP Share price = Closing NAV ($**1.5705**), 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	**-1.624**										**-1.49**	**+9.12**

Dear Shareholder,

DMXCP's NAV decreased 1.62% after all accrued fees and expenses for March 2019. The NAV as at 31 March 2019 was **$1.5705**, down from **$1.5964** as at 28 February 2019. The ASX All Ordinaries Index increased 0.14% during the month. The performance of smaller companies was mixed, with the XSO Small Companies Index down 0.8% and the XEC Emerging Companies Index up 2.5%.

For the first nine months of the 2019 financial year, DMXCP's net asset value has decreased 3.13%. The XSO Small Companies Index has decreased 4.0 % over the same period, while the XEC (Emerging Companies Index) has fallen 9.9% during the financial year to date. The XEC remains 14.9% off its 2018 peak, highlighting the under-performance in the very small end of the market.

<u>Monthly summary</u>

The portfolio finished down for the month in what was a generally flat broader market. Portfolio weakness continued to reflect a general lack of interest in small cap and value stocks. In relation to monthly performance, small positive contributions came from **Joyce Corporation** (+5%), **Mainstream Group** (+6%), and **CV Check** (+6%).

The key detractor was **UCW Limited** (-22% - discussed below), while **CML Limited** and **People infrastructure** were down 11% and 10% respectively, on no news.

<u>Comments on the DMXCP portfolio and performance</u>

Given the challenging recent performance experienced by the portfolio and among micro-cap companies generally, we thought it useful to be transparent and set out how we see our portfolio today. We also highlight some initiatives that we are focussing on to ensure that the portfolio is in the best position to generate strong future returns, and in particular when interest returns to small nano and micro-cap companies. We set out below the key areas we are currently focused on:

1. **Investing in companies with good visibility around long term growth:** For the small companies that we invest in to attract greater market recognition, they need to be growing. We are absolutely focused on identifying and investing in companies that can deliver sustainable long-term revenue growth and expand their margins as they grow. During the month, we participated in a capital raising for education technology company Janison Education Limited (**ASX:JAN** – *market cap $57m*). The capital raise was to fund the purchase of Australia and NZ's largest examination services provider and is expected to be over 40% earnings accretive. Janison has aggressive growth plans, with a 2025 target of $120m revenue (at 25%-30% EBITDA margin), up from $20m in FY19. This uplift is expected to be driven by the increasing number of schools, higher education and government institutions transitioning their examinations from pen and paper to online assessments. We consider this to be a particularly attractive investment, given its growth opportunities, high barriers to entry, very sticky customers, and believe it has the potential to be valued at many times higher than its current value, if it can continue to execute.

   CV Check Limited (**ASX:CV1** – *market cap $21m*) is another portfolio holding that is well placed to continue to deliver strong revenue growth into the future. CV1 provides background screening (identity, credentials, employment history checks) on individuals which is particularly relevant for employers. It embeds its technology in its customer's HR software, enabling its corporate customers to conveniently undertake (at scale and from one source) many reference checks, identity checks, criminal checks, psychometric tests etc for new employees. This business-to-business revenue line is growing organically at ~30% annually. This organic growth is now expected to accelerate, as CV1 secure more corporate customers with significant new hiring requirements (i.e. childcare provider G8 Education, Optus, labour hire company Programmed Maintenance), and as these companies order increasing volumes of checks and tests. Importantly, with its technology now integrated into the client's HR software, CV1 can look to expand its product offering by offering additional tests/verifications and screenings and capture more customer spend. Again, this is a company that can scale revenue very quickly, with high gross margins (60%) and significant operating leverage and has the potential to be valued at many times higher than its current capitalisation.

2. **Investing in companies with offshore earnings:** With the Australian economy facing several headwinds, we are focussed on ensuring the portfolio has appropriate exposure to other geographies through investing in companies that generate much of their earnings outside of Australia. After a very strong first half result which saw its profit up 50%, we have added to our position in leading global tutoring company, Kip McGrath Education Centres (**ASX:KME** – *market cap $40m*). Kip McGrath generates over 60% of its revenues from England, Asia and the Middle East. We met with Management during the month and remain very excited about the opportunity for KME to thrive as a well-resourced large-scale player in a very fragmented market, with no organised competitor.

   Another position initiated recently which has approximately half its earnings generated from outside Australia is XRF Scientific Limited (**ASX: XRF** – *market cap $20m*). XRF is a manufacturer of consumables and equipment used to analyse the composition of metals and to assist in manufacturing processes. There are significant growth opportunities in Europe and in new geographies such as Russia and India, where XRF sees a large opportunity to sell its products to the over 600 cement plants in the country. The business is trading on less than 10x NPAT and, after a very strong first half (NPAT +105%), is on track to generate in excess of 100% increase in NPAT for FY19.

   Offshore earnings, and achieving further geographic diversification, is a key consideration when assessing new portfolio positions.

3. **Reducing exposure to small financials**: given the economic headwinds and the disruption in the lending space, we have reduced our exposure to this sector. While these companies tend to trade on cheap valuation metrics, in most cases we consider these stocks to be priced appropriately, given their exposure to a weakening economy and risks of a deteriorating lending book. During the month we sold down our holding in Pioneer Credit Limited (**ASX: PNC** – *market cap $132m*), and only have one open position in a small-cap financier - CML Limited (**ASX: CGR** - *market cap $97m*). Whilst PNC had been an important long-term position for us, its poor first half performance and in particular its cash collections, highlighted some operational concerns that will need to be overcome. We would prefer to wait to see evidence that collections are back on track. PNC also needs to maintain the confidence of its debt and equity holders to secure increased funding to grow, and given recent developments we have concerns around how it grows from here.

4. **Continuing to back our core portfolio holdings:** We continue to support our core positions such as Blackwall Limited (**ASX: BWF** – *market cap $51m*), Joyce Corporation Limited (**ASX: JYC** – *market cap $42m*), Easton Investments (**ASX: EAS** – *market cap $35m*), Gale Pacific (**ASX: GAP** – *market cap $90m*), Legend Corporation (**ASX: LGD** – *market cap $62m*), Elanor Investors (**ASX: ENN** – *market cap $165m*) and CML Limited (**ASX: CGR** - *market cap $97m)*. We have held most of these names for many years, and while the share prices have generally tracked sideways or downwards over recent years, they all generate good dividends, and the underlying businesses fundamentals have improved considerably since we first invested in these opportunities. These are some of the portfolio's core 'value' based opportunities, and their valuations have become even more attractive in recent times. While holding some of these companies has been detrimental to our performance, we are unashamedly long-term investors and offer patient capital to these companies as they continue to execute and grow the intrinsic value of their business. All these companies are trading on very undemanding multiples and offer significant valuation upside to the portfolio, in a market where valuations elsewhere look very full.

5. **Closely monitoring some 'problem' stocks:** Given small companies generally lack the diversification and robustness than larger companies, they are susceptible to earnings shocks. In recent times, some portfolio holdings have disappointed. We first acquired shares in Konekt (**ASX: KKT** – *market cap $20m*) at around current prices (20c), then saw the stock move up to close to 60c, before a series of poor news has seen its price decline markedly over the past 18 months. KKT has recently had its key Job Active contract renewed for another three years which should provide the business some stability. We will continue to closely monitor KKT's cash flow as its ADF contract comes to an end, but the renewal of its Job Active contract should mean that the bad news in relation to near-term contract risk is now out.

   Higher education provider UCW Limited (**ASX:UCW** – *market cap $13m*) delivered a disappointing half year result, driven primarily by the startup costs of ~$500k in relation to the opening of a new Melbourne campus. The campus was initially expected to be operating at break even by 31 December 2018, this has now been pushed back to 30 June 2019. As the Melbourne campus moves to break even and then into profit, UCW's profitability should be restored - we will continue to monitor progress here and look forward to news flow from the company indicating that this is on track.

6. **Continuing to provide growth capital to nano-caps and micro caps:** We continue to assess capital raisings, IPO's and back-door listings of nano-cap and micro-cap offerings. We remain selective in what we commit to but continue to see some interesting opportunities. In the current market environment where raising for small, illiquid companies can be challenging, we are pleased to be able to support and provide growth capital to small well-run Australian businesses.

<u>We believe the DMXCP portfolio is a unique offering that provides exposure to the most compelling opportunities on the ASX with market caps under $100m, from both a growth and value perspective.</u> The median market cap of our holdings is $47m, reflecting the portfolio's genuine micro/nano cap exposure. Despite their small size, these are not concept stocks, but small growing Australian businesses with good track records, committed management and significant valuation upside.

Being a value investor in small, illiquid, industrials has been challenging in recent times, whilst the broader market has been chasing and rewarding large caps, liquidity, resources, growth and momentum. As mentioned above, the XEC (Emerging Companies Index) is down 15% from its last year's high. The significant valuation gap that has emerged in the micro-cap end of the market (and even more so for industrials) should close over time as public and private investors are attracted to the compelling returns. Whilst we can't control the share prices of our portfolio companies, we can continue to work diligently to follow our processes and ensure the portfolio is well positioned for a return of interest to this part of the market.

Reflecting this confidence, DMX principals have this month committed further funds to DMXCP. There's certainly an element of frustration in the net positive developments within our portfolio holdings failing to transpire into stronger performance. However, we're cautiously confident that the continued positive operating momentum for our stocks will in time be recognised by the broader market.

Thank you for your trust, support, and patience as we continue to execute on our time-tested well-considered philosophy and process. In addition to your management team continuing to add to our holdings, we've had a number of long-term investors also seek to continue adding. If you would like to discuss either initiating an investment or topping up your holding at this prospective time, please do feel welcome to contact Steve McCarthy on 0403 869 632 or email steven.mccarthy@dmxcorporation.com.au at any time.

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

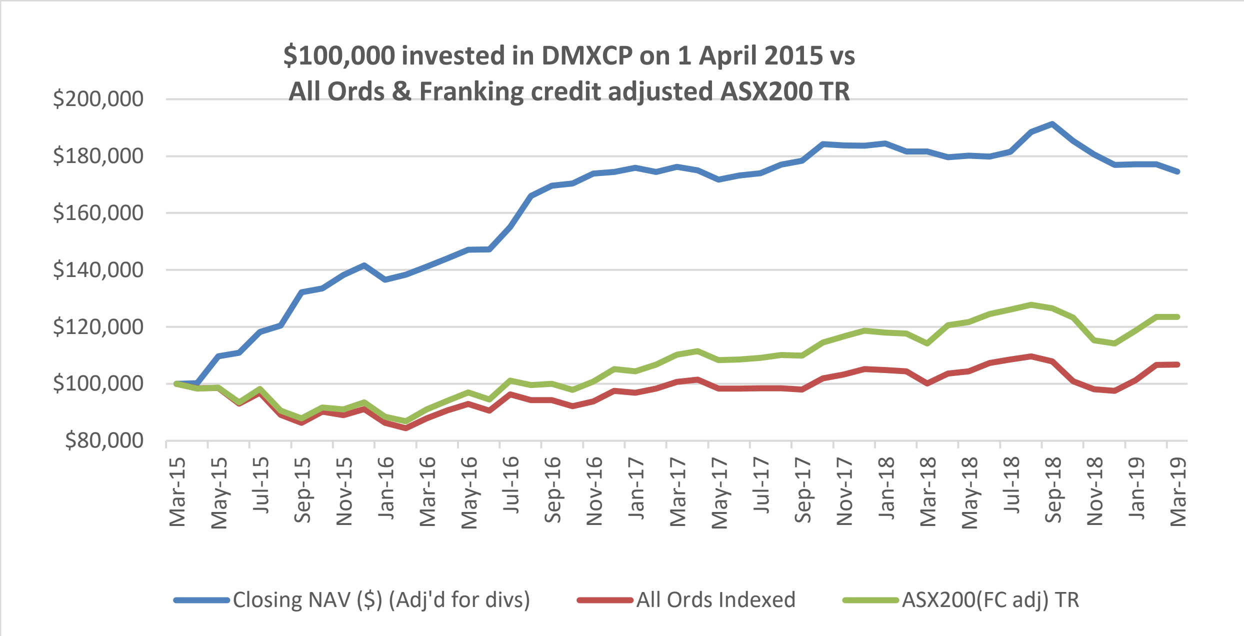
Kind regards

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

Appendix 1: 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.



Appendix 2: Portfolio Sector classification