DMX
ASSET MANAGEMENT

DMX Capital Partners Limited
Investing in the most compelling small and micro-cap value opportunities

DMX Capital Partners Limited
October 2019 – Shareholder Update

An investment company managed by:
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Opening NAV (1 October 2019) (1,2) **Closing NAV (31 October 2019)** (1,2)	**$1.7858** **$1.8674**	Fund size % cash held - month end (4)	$8m 21%
NAV Return (October)	+4.567%	Gearing	nil

*DMXCP Share price = Closing NAV (**$1.8674**), 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	+3.754	+3.014	+0.418	+7.482	-0.889	+3.279	**+4.567**			**+21.25**	**+18.51**

Dear Shareholder,

DMXCP's NAV increased 4.57% (after all accrued fees and expenses) for October 2019. The NAV as at 31 October 2019 was **$1.8674**, compared to **$1.7858** (ex-dividend) as at 30 September 2019.

For the first four months of the FY20 financial year, DMXCP's NAV has increased 14.72%.

The ASX experienced modest losses during October, with all key indices finishing down. The All Ordinaries finished down 0.40%, the ASX Small Ordinaries Index decreased 0.66% during the month, while the XEC Emerging Companies Index decreased 0.40%.

<u>Private Equity takeovers and portfolio management</u>

October commenced with a takeover offer from Quadrant Private Equity for Konekt Limited (**ASX: KKT**). After a challenging 2018, KKT in recent times had been demonstrating an improving operating performance, highlighted by a profit upgrade in June. Notwithstanding the improving performance, the offer at 49c was very attractive, and the CEO Damian Banks and the KKT Directors are to be congratulated on steering KKT through its challenges and securing this outcome. Subsequent to month end, pleasingly, the offer has been revised to 64c. We continue to hold our KKT shares.

The KKT takeover represented the fourth Private Equity led takeover bid for a portfolio company in the last 12 months, following Zenitas Healthcare (**ASX:ZNT** - completed December 2018), Legend Corporation (**ASX:LGD** - completed September 2019) and Dreamscape (**ASX:DN8** - completed October 2019).

All four companies prior to their takeover had been trading on low PE multiples, had strong cashflows and in the case of KKT, LGD and DN8, were run by very aligned and experienced management teams. However, ultimately they were stories that failed to excite the public market, and struggled to compete for attention against the hyper-growth stories that ASX small-cap investors have become increasingly focused on. Private equity investors, with a more cash flow focus and longer term outlook, it appears can better appreciate the value opportunity, and the ASX is worse off for having these types of companies depart the bourse.

As each of these companies left the portfolio, we endeavored to find replacements that shared similar fundamental characteristics. However, we have found this exercise of identifying like-for-like replacements increasingly difficult.

Small companies in our universe that have previously traded on low PE multiples and strong cash flows (such as XRF Scientific (**ASX:XRF** – held) and Academies Australasia (**ASX:AKG** - held)) have now been bid up to levels where they no longer represent obvious value. Other stocks in our universe that are NPAT profitable but still remain cheap such as National Tyre (**ASX: NTD** - not held) and Apollo Tourism (**ASX: ATL** - not held) generally remain cheap for a reason (challenging industry conditions, debt issues).

So what does that mean from a portfolio management perspective?

As discussed by Chris Steptoe in his recent article "Our Portfolio has evolved – are we still value investors?", we are finding interesting opportunities among unloved, illiquid, nano-cap stocks, some of which are not yet profitable.

The core (majority) of our portfolio continues to comprise profitable, cash flow positive, dividend paying stocks. However for a smaller part of the portfolio, we have focused on companies with strong business models and product offerings, that may not be currently profitable but where we feel we can model their cash flows with a reasonable level of confidence. We are looking to identify opportunities that trade at meaningful discounts to our intrinsic value, and that do not require heroic assumptions to support their valuations.

In assessing these opportunities, we are very conscious that the further away expected profitability, then the higher the risk that profit is never reached, and our investment case becomes broken. We are therefore focused on opportunities where companies expect to be reaching break-even within 12 months. As an investment team, we are inherently risk adverse - we seek to further manage risk in these situations through the following:

1) Buying companies cheaply (low market capitalization) *before* any hype or expectations has been built into the share price, when sentiment is poor and the stock is under the radar and not currently 'fashionable'. This provides us with the most opportunity for asymmetric returns. For example, Tiny beans (**ASX:TNY**) was purchased earlier this year when it was an unloved, ignored, illiquid, beaten-up $10m market cap company. Six months later it reached a $100m market cap.
2) When buying a loss-making company, it needs to be purchased on a low multiple of revenue / recurring revenue. This is critical for us in order for our modeling to generate an appropriate margin of safety on our entry price. The higher the multiple of revenue, the more aggressive the assumptions that are required for our modelling to arrive at a sufficient margin of safety, and therefore the less comfortable we are.
3) Sizing positions appropriately. We ensure we don't take oversized positions, and that we take profits as appropriate.
4) Ultimately, we want to own businesses that have a compelling product or service offering, and that will continue to grow their customer base over the long term, irrespective of broader macro-economic conditions. Simply put, for our smaller companies to become bigger companies, they need a strong and sustainable growth profile.

Through turning over a lot of stones, we continue to identify very interesting under the radar, out of favour, asymmetric opportunities that meet these criteria. For example, during October, we added a global brand owner to the portfolio which has been generating sales growth in excess of 25%, and is on track for its maiden operating profit this year, and is trading at less than $20m market cap.

Portfolio news

Aside from KKT (+88%), October saw plenty of portfolio news flow with AGM updates, and first quarter updates being reported. Strong contributions came from TNY (+91%) and Urbanise (**ASX: UBN** +70%). We discuss some notable trading updates below. Towards the end of the month, we received the takeover proceeds from our DN8 position, meaning we finished the month holding 21% cash. While we are comfortable with this level of cash, we do expect to deploy some of this cash given our large pipeline of potential opportunities that we are currently assessing.

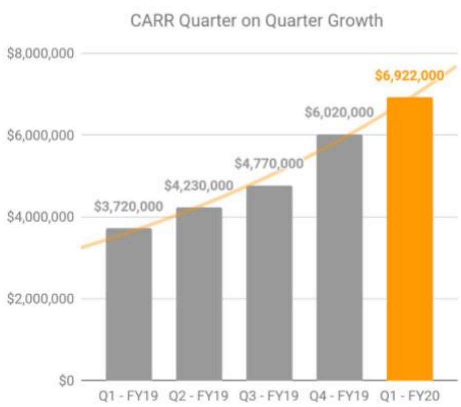
Vault Intelligence Limited (ASX: VLT) – market cap $41m

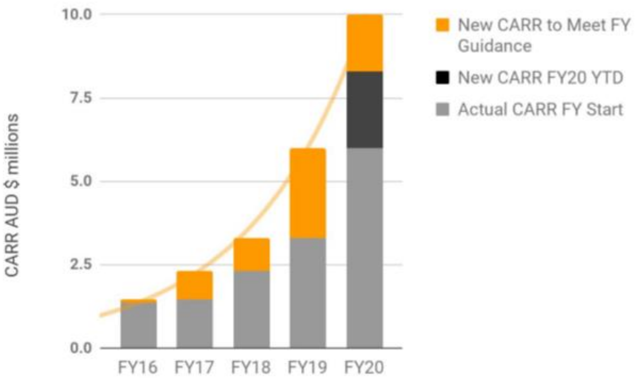
In our [last newsletter] we mentioned our position in VLT which develops workforce performance technology solutions. VLT is looking to land grab the large addressable market for its wearable and mobile people monitoring technology. During October, VLT reported that its year to date Annual Recurring Revenue (ARR) was up to $8.3m, which suggests they are well placed to achieve its FY20 target of $10m ARR.

Following a $3m deal in August with M1, a leading Singapore telecommunications provider (generating ~$500k ARR), VLT announced a $7m deal ($1.36m per year) with ADT Security – one of NZ's largest security companies. The VLT Solo product (a Samsung Galaxy smart watch fitted with VLT software) will help monitor, protect and manage the large ADT mobile workforce. This is another large deal with a reputable counter-party suggesting that the addressable market for VLT is large (estimated at ~$25b). VLT noted that it continues to have a number of significant global opportunities in its pipeline.

The thematic at play here is employers increasingly turning to wearable technology (smartwatches) to:

- protect their workforce (i.e. identify if workers have become injured / incapacitated / loss of pulse);
- monitor their workforce (i.e. ensure workers are where they should be & for the right length of time)
- provide better quality administration and reporting (i.e. location/travelling time information obtained can be used to support and provide more accurate billing to customers)
- obtain insights around employee efficiencies and productivity.





AVA Risk Group (ASX:AVA) – market cap $28m

We profiled AVA in our [May 2019 update]. After an underwhelming FY19, AVA has commenced FY20 strongly, with both its divisions reporting profits. Pleasingly, it represents an example of an opportunity that we supported pre-profit, and that is now generating profits.

AUD$M#	Q1FY2019	Q1FY2018	% change YoY
Sales Revenue	9.8	8.4	18%
COGS	4.8	4.8	3%
Gross Profit	5.0	3.6	37%
GP margin (%)	51%	43%	
Operating Expenses	3.7	4.2	-12%
EBITDA*	**1.2**	**(0.5)**	**335%**

- **Growing Revenues**
- **Increasing Margins**
- **Reducing Costs**
- **Producing Profits**
- **Increasing cashflow**

AVA's technology division improved its gross margins from 66% in FY19 to 72% in Q120. Meanwhile its service division, which it has built up from scratch, continued its growth trend, expanding its gross margins from 21% in FY19 to 25% in Q120.

We have recently met with the AVA management team. The company appears re-focused and re-energised under new management, and with a large number of potential large-scale global opportunities to execute on. It is on track to deliver FY20 EBITDA of around $5m, meaning it is trading on approximately 5x EBITDA. Whilst we are still cautious here, we believe that the valuation is on the low side for a fast growing, profitable, sizeable ($40m+ revenues), global business operating in fast growing markets, with some unique, market leading IP and a Tier 1 customer base.

Primero Group (ASX: PGX) – market cap $59m

Engineering services group PGX delivered a strong update during the quarter. New contract awards, coupled with existing contract extensions and general client repeat works, has increased PGX's contracted order book for FY20 to approximately $120m. Committed work for FY21 was also building strongly. This effectively means that less than a third of the way through FY20, PGX has secured around 80% of their targeted $150m revenue for the year.

Encouragingly, PGX also noted that tendering activities continue to increase with current activity levels strong across all three of the its core service sectors (Energy, Non-Process Infrastructure (NPI) and Minerals). In particular, the NPI market in Western Australia is providing potential large-scale opportunities within which PGX is currently participating in advanced delivery discussions. PGX has recently been awarded a contract by Rio Tinto for the design, procurement, construction and commissioning of the heavy vehicle refueling and diesel pipeline infrastructure at Rio's West Angelas Iron Ore Project.

With net cash of $22m, and trading on less than 3x consensus EBITDA, PGX is an example of a more traditional 'value' stock. It highlights that the portfolio has exposure to a wide variety of different styles of investments across a broad range of sectors, with opportunities that we consider to be extremely compelling and provide the potential for strong asymmetric returns.

For further updates and news on portfolio holdings, please visit us on twitter or go to our blog. Our Annual Report can be found here, while our current Investor Presentation can be accessed here.

Again, thank you for your trust, support, and patience as we continue to execute on our time-tested well-considered philosophy and process. 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 December.

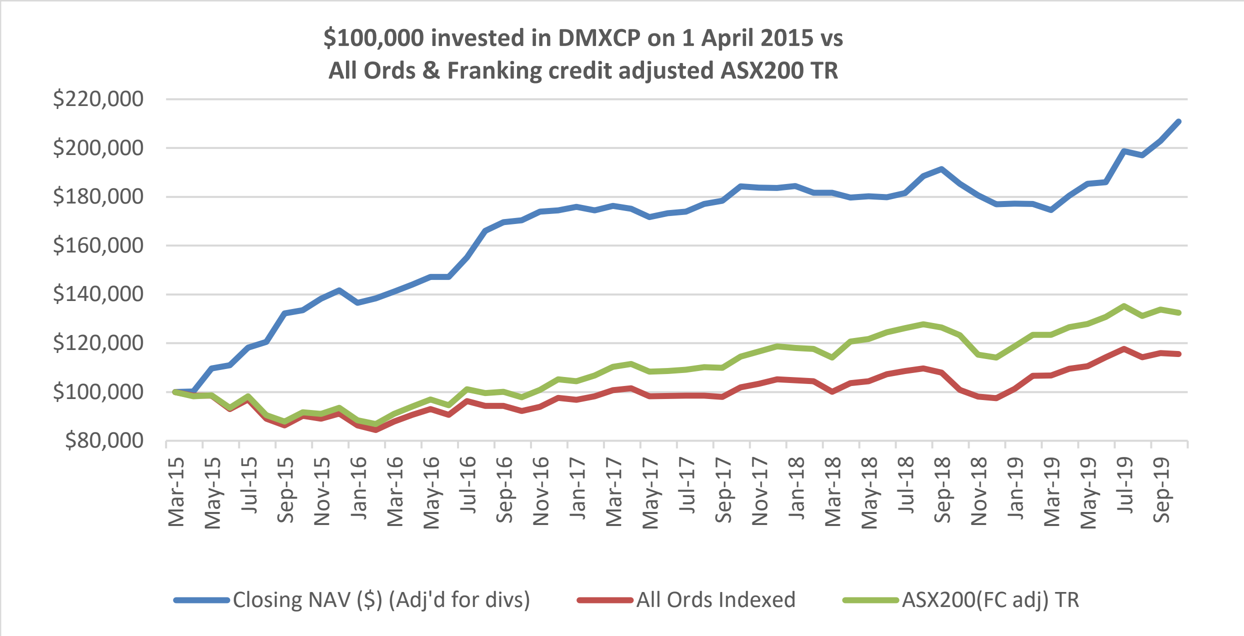
Kind regards

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: Excludes 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