DMX Capital Partners Limited
July 2022 – Investor Update

An investment company managed by:
DMX Asset Management Limited
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DMXCP directors: Roger Collison
Dean Morel
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Opening NAV (30 June 2022) [1,2]	**$2.4132**
Closing NAV (31 July 2022) [1,2]	**$2.6237**
Fund size (gross assets)	$23m
% cash held - month end	3%
Gearing	Nil

1-month return	8.7%
3-month return	-8.2%
12-month return	-5.4%
3-year return (CAGR p.a.)	19.8%
Since inception (*7 years 4 month*) (CAGR p.a.)	18.2%
Since inception (*7 years 4 month*) (cumulative)	241%

*DMXCP Share price = Closing NAV (**$2.6237**), being: Share portfolio value + cash – fees payable – tax payable + franking credits*
Returns include dividends reinvested and franking credits paid. Since inception 81c of dividends & franking credits have been paid

Dear Shareholder,

DMXCP's NAV increased 8.7% (after all accrued management fees and expenses) for July 2022. The NAV as at 31 July 2022 was **$2.6237** compared to $2.4132 as at 30 June 2022. Following the large falls in June, the market saw a recovery in July with the All Ordinaries up 6.6% during June while the Small Ordinaries recovered strongly to be up 11.4%.

July portfolio developments

July saw a number of holdings rebound off their 30 June 2022 lows, including Konsys (ASX:**KNO**) which was up 69% while AVA Group (ASX:**AVA**) was up 47%. There were only two detractors during the month: Datadot (ASX:**DDT**) which advised of further delays in licensing income from Europe/Russia, and Sequioa (ASX:**SEQ**) which was down slightly on no news.

Importantly, after a quiet couple of months in relation to news flow, July saw many of our portfolio companies release quarterly and full year updates, enabling us to assess the progress they have made during FY22.

A focus on cash-flows

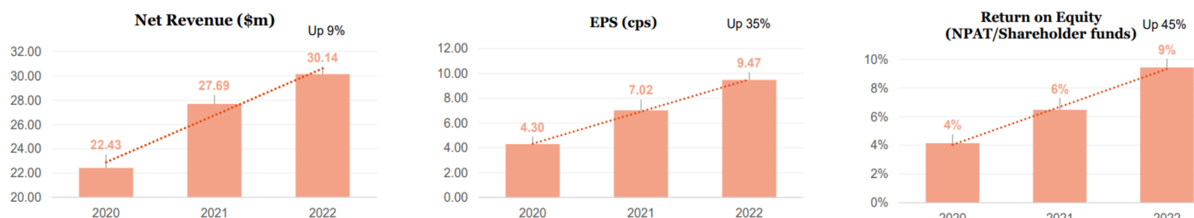
In building our portfolio, we are focused on those businesses that are currently generating strong free cash flows and that have solid future growth prospects, complemented by exposures to emerging, predominantly technology focused businesses that have attractive business models and growth outlooks, but typically have a longer dated free cash flow profile. As macro conditions deteriorate and growth outlooks become more uncertain, highly cash generative businesses become increasingly attractive. Free cash flows provide a business with security and optionality - giving them the capacity to pay good dividends, buy-back shares and/or reinvest for growth without having to rely on capital markets. They enable us (and at some point, the market!) to make a reasonably confident assessment of value (based on cash flow visibility) without having to rely on too many subjective valuation assumptions.

During July, several portfolio holdings released preliminary full year updates ahead of reporting season, while a number of others provided the market with their 4C cash flow statements – giving us a great opportunity to assess progress of our holding's operations and cash flows for the financial year. Across the portfolio we were pleased with the progress.

Two larger holdings, Diverger (ASX:**DVR**) and DDH1 (ASX:**DDH**), were particularly impressive in terms of the free cash they are producing. Both these companies have also been able to continue their long track record of delivering double digit earnings growth and maintain ongoing positive outlooks, supported by some very encouraging industry dynamics. Both continue to trade on very low (mid-single digits) PE multiples, and for reasons we touch on below, remain quite unloved by the market.

Diverger Limited (ASX:**DVR**)

- Diverger provides products and services (licensing, training, back-office) to financial planners and accountants. In FY22, it generated $8.2m in operating cash flows (before tax), as well as 35% growth in EPS. With a capital light business model and predominantly recurring revenue (license and subscription fees) both DVR and our other holding in this space, Sequoia (ASX:**SEQ**) have been able to capitalise on some recent favourable industry structural changes. While SEQ hasn't yet provided its full year accounts, in its most recent update, it noted it was generating $1m+ operating cash a month. On current pricing, both DVR and SEQ are yielding **free cash returns (pre-tax) in excess of 20% on their enterprise values**.



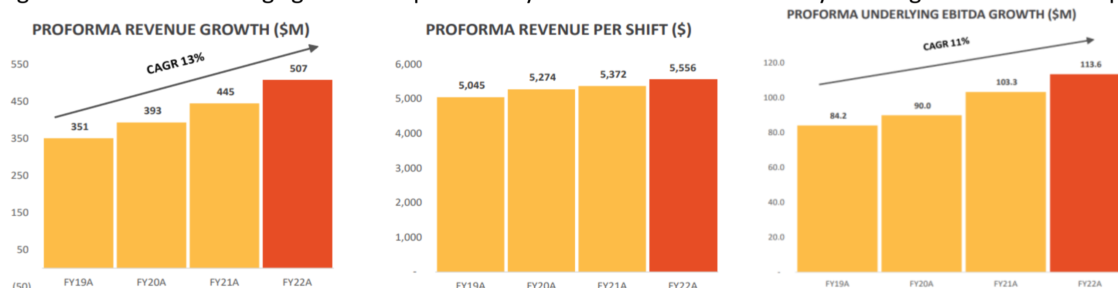
- Emerging industry tailwinds: There are strong tailwinds supporting DVR's growth - an aging population at the same time there has been a substantial reduction in the number of licensed advisors (due to increased regulation and education requirements, and banks vacating the space) has created a rather unique supply/demand imbalance and pricing power in favour of advisors. An upcoming intergenerational transfer of wealth of $3.5trillion from baby boomers to millennials will require significant professional support, increasing the importance of a robust wealth management industry and access to financial advisors. To position itself for this industry growth, DVR and its technology partner (and major shareholder) HUB, are working together on technology-led advice solutions around analytics, AI and automation, to improve the customer experience and importantly, lower the cost of financial advice, to make advice more accessible to an even wider audience.

- Compelling valuation: In its update, DVR noted a "*Positive FY23 outlook - ongoing growth with higher returns for shareholders. We have started FY23 well, and look forward to delivering further growth and returns for shareholders*". DVR reported operating EBITA of $7.1m in FY22. According to broker estimates, this is expected to grow ~15% to $8.1m (NPATA of $5.8m) in FY23. With a market cap of $36m, **DVR trades on <7x FY23 PE**.

- There is a catch though: In June, DVR announced an unsolicited takeover of ASX listed competitor Centrepoint Alliance (ASX:**CAF**), with the intention to capitalise on these industry opportunities by creating a clear market leading player with greater operational scale (servicing more than 1,400 advisors). The problem we have with this proposed transaction is that DVR is paying a significant premium to acquire CAF (at a multiple well above that what DVR is trading on), which will need to be satisfied through issuing DVR shares (which we believe are undervalued) and taking on debt. While the merger of these two ASX listed players makes sense, in our view (from the perspective of a long-term DVR holder) the current deal terms do not. We have expressed these concerns to the DVR board and management. At this point, there is uncertainty as to whether the deal proceeds, but we would like to see a resolution to this, one way or the other, shortly.

DDH1 Limited (ASX:**DDH**)

- DDH is the largest mining drilling company in Australia and the third largest globally (by revenue). We acquired our position here when we received DDH shares after DDH took over our holding in Swick Mining earlier this year. While we are typically cautious on mining services companies, DDH has consistently delivered double digit revenue and earnings growth – a particularly commendable effort this year in light of COVID disruptions.



- Positive industry dynamics: The Australian drilling industry rig fleet numbers have surprisingly declined since peaking in 2012. Here we have similar industry dynamics to the wealth management industry (as mentioned above) – supply has actually been dropping at the same time there has been increasing demand for drilling services. DDH has the capacity to organically grow its fleet to leverage this industry fleet shortfall, to meet increased demand and maintain high rig utilization. These positive industry fundamentals are reflected in DDH's margins and cash flows – the company itself saying that, even in light of COVID issues, "*Our EBITDA margins are still remarkable*".

- Valuation and cash flows are compelling: DDH is expected to grow its EBITDA by ~10% in FY23 to over $120m, making it one of the most profitable sub-$500m market cap companies on the ASX. From this profit, it should generate before tax free cash flow (after all growth and maintenance capex) of ~$65m. DDH noted "*The business is well set to pursue its growth aspiration* ***and*** *deliver significant free cash flows for capital management purposes*". We have underlined 'and' in this statement: DDH continues to invest in growth initiatives (new rigs) to meet the industry demand. In addition, it's on track this year to pay a 6% dividend yield, as well as conduct a share buy-back (forecast at ~$10m of shares by house broker Canaccord who is undertaking the buy-back) while still growing its cash balance year on year. If not for this capex 'growth' investment, on a steady state basis, free cash flows (pre tax) would be closer to $100m, or a **free cash yield in excess of 25%.** On an after-tax basis, we estimate DDH is currently trading on an **FY23 PE of ~6x**.

- Is the negative sentiment towards DDH justified? The low valuation here (relative to DDH's market position, growth outlook and strong balance sheet and cash flows) presumably reflects investor concerns about the impact of declining commodity prices on future demand, and the cyclical nature of the business more generally. The company believes otherwise, stating "*The outlook for FY23 is positive. Despite the macroeconomic factors that are currently impacting market sentiment, the fundamentals driving demand for DDH1's services remain compelling*." In support of this, ~90% of DDH's revenue is generated from production and resource definition drilling programs, rather than the more cyclical exploration drilling. From this low valuation, with a buy-back now in place and comparable companies (ie MACA Ltd, ASX:**MLD**) being acquired at much higher multiples, we see upside from here.

Other notable FY22 cash results

July also saw many of our emerging companies report their fourth quarter and full year cash flows, and for the most part, these were positive with most of our companies continuing encouraging trajectories. We run through a number of these below.

- Ansarada (ASX:**AND**) delivered another strong year of cash flows with annual operating cashflows of $12.2m (and development capex of $5.9m). As a great example of the power of free cash flows, AND was able to **self fund out of its free cash the $6m** acquisition of a highly synergistic, earnings accretive acquisition (Triline GRC), without any reduction to AND's net cash balance through the year.

- Digital reference checking company Xref (ASX:**XF1**) reported positive net cashflows (after product development capex) for FY22 of ~$3m (up from ~$900k in FY21). This reflects the positive recent trends across the business, where revenue growth of 100% over the past two years has seen XF1 move from a $10m loss in FY20, to a breakeven profit position in FY21 to a forecast $2m profit in FY22. With momentum increasing in offshore markets, we back management to continue executing on the number of growth opportunities they are working on.

- Yellow Brick Road (ASX:**YBR**) generated free cash of ~$3m in FY22. While working capital movements can swing this number from period to period, on the face of it, it is a solid return for a company with an enterprise value of less than $20m. Almost half of YBR's market cap is now either in cash or high yielding notes – with the value of net cash and notes on its balance sheet now $12.4m, over $3m higher than the $9.2m net cash position 12 months ago – reflecting the strong cash generated through the year. Further, on an asset basis, the ~$20m enterprise value implies a 50% margin of safety to the ~$40m NPV of trailing commissions receivable by YBR, that underpins YBR's asset valuation.

Trading at a **discount of ~30% to its net tangible assets** (cash, notes and commissions receivable), and therefore with **no value being ascribed to YBR's intangible business assets** (i.e. the inherent value in YBR's leading 1,400+ broker network, its significant mortgage aggregation business, its digital lending platform and digital assets, and its $200m+ wholesale lending business JV), we remain of the view that YBR is one of the cheapest companies on the ASX.

- Smaller technology companies, CV Check (ASX:**CV1**), Knosys (ASX:**KNO**), Aeeris (ASX:**AER**) and Proptech (ASX:**PTG**) all reported broadly neutral free cashflows for FY22. These companies have all been investing in sales and marketing and product development, and continue to have strong balance sheets and have no need to raise capital. The growth trajectory in these businesses is positive, and we would expect these four companies to all start generating free cash in FY23 as operating leverage emerges.

- Another company making great progress in relation to its cashflows is payroll software provider ELMO Software (ASX:**ELO**). ELO advised that it is expecting to reach cash flow break even this year, a significant achievement and improvement on its $16.4m outflow in FY22. This improvement is being driven by exceptionally strong revenue growth of ~30%, which will see **EBITDA increase from ~$7m to ~$22m in FY23** – an outstanding growth profile.

- The one negative cash result came from Raiz Investments (ASX:**RZI**) which after many quarterlies of prudent cash management, has decided to invest heavily in marketing and branding in hindsight at what has proved to be an inopportune time. Negative operating cashflow for the quarter of $2.2m and for the full year of $2.7m appears to be a disappointing result, and we will see if there is an uptick in customer numbers over the next few months to provide evidence of a return on this marketing spend. With $15m in recurring account maintenance fee revenue, a significant customer base and $1b in funds under management, RZI intuitively seems good value at these levels ($40m EV), but we do remain concerned about its cashflows.

As investors, we want to own companies that grow and become more valuable. Value is ultimately, quite simply, a function of the free cash a company generates, with $1 of free cash generated by a company today increasing its intrinsic value by $1. All our key holdings continue to generate healthy levels of free cash, increasing their value (irrespective of what direction their share prices may be moving in each month or year). In many cases, the market is ascribing very low market valuations to these cash profiles (i.e. 20%+ cash yields). As mentioned above, we also own a number of emerging businesses that we expect to be generating free cash this year, and that will generate significantly higher levels in future years.

While more challenging economic conditions may impact the rate of growth of this cash generation, we are confident that these cash flows, on the whole, will remain strong. While share prices will generally do their own thing in a volatile market as sentiment ebbs and flows, the power of free cash flow generation from growing companies on low valuations with strong market positions, will continue to increase the value of our portfolio over time.

We look forward to updating you again in September.

Kind regards

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

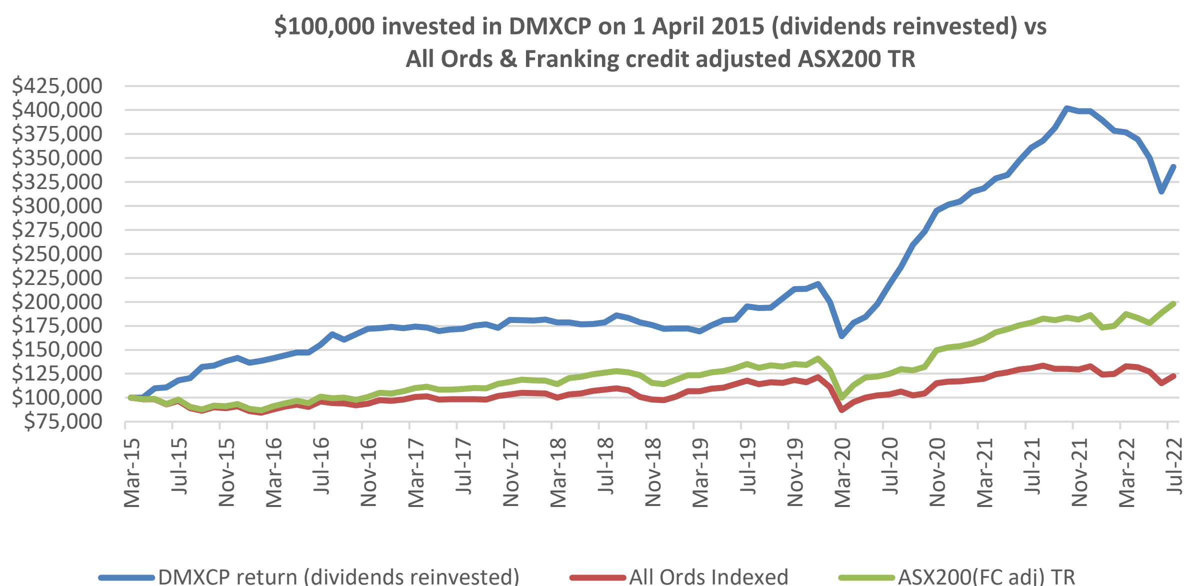
Note 1: Net asset value (NAV) is after income tax payable but includes an estimate of franking credits available. Refer note 4, unaudited
Note 2: Unaudited result
Note 3: All DMXCP disclosed returns include the payment of dividends and franking credits
Note 4: Franking credits per share are franking credits arising from dividends received and for tax paid or payable on realised portfolio gain

Appendix 1: Performance

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	+2.997	+0.140	**+25.10**	**+19.02**
2020	+2.33	-8.42	-17.91	+8.521	+4.525	+6.213	+10.09	+8.669	+6.518	+11.10	+7.86	+2.24	**+42.47**	**+0.72**
2021	+1.02	+3.31	+1.17	+3.20	+1.10	+0.70	+3.96	+2.12	+3.80	+5.51	-0.84	+0.04	**+28.06**	**+13.55**
2022	-2.48	-2.93	-0.51	-2.04	-5.50	-10.64	**+8.72**						**-12.8%**	**-7.8%**

The following chart illustrates the return from investing $100,000 in the fund (including dividends and attached franking credits) since inception (1 April 2015). DMXCP is an absolute return fund, focused on generating positive absolute returns over the medium to long term.



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