MEREWETHER CAPITAL

Merewether Capital Inception Fund Performance Summary (at 31 May 2023 net of fees and expenses)					
1 Month	3 Months	6 Months	1 Year	2 Years (p.a.)	Since Inception*
-3.83%	-3.32%	-7.46%	-12.03%		-35.00%

Indicative performance is reported net of all fees and assumes reinvestment of distributions. Past performance is not a reliable indicator of future returns. * Inception Date 26 November 2021

Dear Investor,

The Merewether Capital Inception Fund (the “Fund") began the month with a unit price of $0.6759 and ended the month with an indicative unit price of $0.6500 for a -3.83% return.

While May was a down month for markets globally, for Australia and the ASX it was the month where the first cracks began to appear in the consumer discretionary parts of the market. I have remarked numerous times that the earnings resiliency of retail, leisure and tourism exposed companies has been extremely surprising given the rapid rise of interest rates that began in early 2022.

However, in May we received trading updates from numerous companies in the consumer discretionary space, and while the headline numbers often weren’t too bad (especially relative to share price moves) what was alarming was the commentary from all the companies that there was a sharp deterioration in conditions that began in April.

Dusk Group announced to the market they have seen tough conditions since the start of the year, but it was a much weaker than expected run up to Mother’s Day which saw them give earnings guidance roughly 40% lower than last year. Fellow homewares retailer Adairs Limited noted a “subdued” April with lower traffic in-store and online which led to them downgrade their previous earnings guidance by over 15%.

It wasn’t just homewares retailers though as Best and Less Group noted “inconsistent” trading throughout March and April though they did claim that their Mother’s Day performance was strong. However, that didn’t stop them from downgrading their earnings guidance by 50% from its previous levels.

City Chic Collective also reported a sharp downturn in sales to start the year, however most of their issues are self-inflicted. January and February saw revenue down 17%, however a transition in their US logistics meant March was especially poor and through to mid-May revenues were down 26% in 2023 on the prior year.

Universal Store rounded out the month for retailers confirming what their peers had already communicated, stating that “trading conditions observed throughout April and May to date have further tightened indicating that some customers are reducing their spending”.

Turning to tourism exposed businesses, Alloggio Group (provider of short-term holiday rental accommodation) provided an update that also suggested a sharp deterioration of conditions in April. Despite a “solid booking foundation” through to Easter, gross booking value fell 37% for the month. While alarming, in the context of this year’s April having the contribution of an acquisition that should have roughly increased gross booking value by 50%, the update becomes ominous.

Tourism Holdings (a caravan manufacturer and rental provider) didn’t provide specific numbers, but in their commentary from their investor day noted that they expect a “reduction in domestic activity” through their high season in Australia and New Zealand.

Fortunately, we have very little exposure to these sectors in the Fund. However, it is worth watching these stocks closely as they will be the canaries in the coalmine for wider economic weakness. While it was inevitable that after several years of strong conditions for consumer discretionary spending that a slowdown was coming, the speed and severity that these businesses have reported since April is alarming and worth paying attention to.

Pleasingly, the updates we had from portfolio companies during May were positive, some of them exceptionally so.

Vysarn Limited (VYS) upgraded their earnings guidance from $5.1m profit before tax to $6-6.5m. With a first half result of $1.6m, it implies a second half profit before tax of $4.4-4.9m or a $9-10m run-rate into the new financial year. Trading at just a $50m market capitalisation, a ~7x earnings multiple (assuming standard tax rates) is very cheap for the current growth and potential to expand into higher margin water management services.

As one of the few businesses reporting strengthening operations and upgrading guidance VYS's share price saw a nice bounce during the month but the business remains wildly misunderstood by the market as its valuation sits below much lower quality cyclical mining services peers. With long term contracts with tier one miners, VYS's hydrogeological drilling segment is generating ~$15m in EBITDA but crucially is not re-investing back into growing their drill rig fleet meaning they are generating significant free cash flow.

A disciplined management team is taking that free cash and carefully deploying it into strategic acquisitions and building out new business segments in the water management space. So far, the early signs of expansion have been very successful with acquisitions of test pumping and aquifer recharge businesses performing well, with opportunities in the pipelines and water infrastructure space being assessed.

Austco Healthcare (AHC) had two pieces of news during the month. The first was a contract with a new Canadian aged care facility for $3.9m, a nearly 20% accretion to the last reported orderbook of $20.3m back in February. More importantly however, management confirmed the contract includes all of AHC's high margin upsells such as real time location, mobile alerts and enterprise workflow software and will contribute strongly to the bottom line.

Later in the month AHC announced the acquisition of Teknocorp, one of AHC's resellers in Australia (along with other nurse call/communication providers and some security monitoring hardware). While paying 3.5x earnings for the business is a good price, it offers far more strategic value as AHC does not have an in-house sales/support team in Australia (unlike other geographies) and this acquisition provides that immediately with a team familiar with AHC's products and extensive industry contacts.

The timing of the acquisition is potentially also strategic as news emerged during the month that Hills Limited (AHC's largest competitor for hospital customers in Australia) had entered administration. This potentially leaves a large hole in the market that AHC is best positioned to fill, and a dedicated Australian sales and support team will no doubt help.

Smart Parking (SPZ) provided a trading update after a very strong third quarter. Revenue grew 32% assuming constant currency and profits adjusting for losses in the nascent German segment, grew 140%. Importantly, those German losses are reducing as the business scales, only contributing a $300k loss in the third quarter, down from a $600k quarterly average in the first half.

Although management are generally conservative in their outlook and targets, they specifically commented that there was strong momentum into the fourth quarter, which is generally the seasonally best one. If the growth rates through the first three quarters continues, the business will likely earn $12-13m in EBITDA for the full year, a cheap 7x multiple on the current $85m market capitalisation.

Back in the February report which discussed the half year results from various portfolio companies, I said that **Compumedics** (CMP) was the most disappointing as the recovery in the Covid-affected operations failed to emerge as higher costs were put into sales and marketing and large impairments taken against one of their growth segments.

Pleasingly, an update during the month showed the business is back on track with $4.3m in sales orders from China that were delayed from the first half coming through as well as the first sales of Okti, CMP's next generation neurological monitoring system to the Royal Children's Hospital in Melbourne.

Most of the higher sales and marketing costs were put in place to drive initial sales of the next generation of products that CMP are looking to commercialise in 2023, particularly in the US where the business has only had a modest footprint in the past. Given this, it was positive to see initial sales for Okti already coming in and US FDA approval received to go after that market in earnest.

The second half recovery means the business is expecting to report $1m EBITDA for the year after a ~$1m loss in the first half. At the current $35m market capitalisation, the investment thesis remains intact that the business remains extremely cheap on it's pre-Covid earnings base (~$6m) as it continues to normalise back towards there.

As we enter the final weeks of the financial year, I am expecting significant volatility from tax loss selling, especially in the more illiquid pockets of the market where Merewether invests. This should hopefully create some opportunities where underlying businesses are performing well and irrational selling sees prices diverge from the fundamentals.

As always, if you ever have any questions about the Fund or its holdings, please call me on 0423 510 004 or email luke@merewethercapital.com.au

Thanks for your on-going support.

Luke Winchester (Portfolio Manager)