MEREWETHER CAPITAL

April 2024 Investor Update

Merewether Capital Inception Fund Performance Summary (at 30 April 2024 net of fees and expenses)					
1 Month	3 Months	6 Months	1 Year	2 Years (p.a.)	Since Inception*
5.82%	1.19%	12.13%	11.70%	-5.34%	-24.50%

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 $0.7135 and ended the month with an indicative unit price of $0.7550 for a 5.82% return.

April was a poor month for equity markets globally as stickier than expected inflation prints cemented the "higher for longer" view on interest rates. The intense focus on inflation continues and should come as no surprise as the market tends to want to "fight the last war".

Because it was the sharp rise of inflation through 2022 that sparked the last market rout it remains the big fear for many market participants despite the fact history tells us that outside of normal market fluctuations, large corrections usually come from a "black swan", the term for a risk that few in the market recognise or price correctly.

For all its flaws the wisdom of the crowd means the market is good at pricing known risks, and I would argue high inflation falls in that camp right now. I suspect the cause of the next downturn will be relatively mundane as some indicators of the classic economic cycle are starting to show cracks and may be pointing to economic weakness ahead.

The Australian employment and retail sales that were released for the March quarter are both showing signs of slowing, particularly when you adjust for higher than normal post-Covid immigration. On a per capita level there is cause for concern that the start of an economic downturn is beginning and may require fiscal and monetary support sooner rather than later.

Of course, knowing a downturn will come at some point is very different than predicting the exact timing, which is why my focus hasn't shifted from the operating businesses we own in the Fund. Being macroeconomic aware is important, being macroeconomic driven is dangerous.

On that note we had some positive updates across the Fund in April, pleasingly from some positions who had reported weaker than hoped financial numbers at the half year in February and it was good to see them back on track.

The best example of that was **Austco Healthcare** (AHC) who provided a great third quarter update generating $1.6m net profit for the quarter on a markedly improved gross margin. After a weak first half where AHC reported $1.2m net profit, it was good to see them eclipse that in the third quarter alone and be left in a strong position heading into the final quarter and new financial year.

Pleasingly, despite the strong third quarter for revenue generation, AHC continued to grow its order book with it now sitting at $45.7m after winning another $2.2m contract to deploy their clinical workflow solutions to an aged care facility in Canada.

On the back of the update AHC management took the opportunity to raise $10m to fund the purchase of the acquisition of Amentco, a systems integrator based in Queensland who is already a certified AHC reseller and gives AHC immediate sales and support capabilities in a new geography.

With the acquisition of Teknocorp (a similar systems integrator based in Victoria) performing very well it provides a platform for growth with both acquisitions set to contribute fully to the new financial year.

While profitability for AHC will be lumpy given the size and nature of the business, the recovery in gross margin, strong 3Q profitability and contributions from acquisitions should see the business earn around $7m in net profit next financial year. At the current market capitalisation of $67m it leaves the stock trading on a very reasonable multiple and AHC remaining a high conviction position within the Fund.

Aerometrex (AMX) management embarked on an investor roadshow in April with an updated slide deck that disclosed they had added an extra $500k in annualised recurring revenue for their key MetroMap product in the third quarter, taking the total to $9.2m. Later in the month they announced a partner agreement with the Australian arm of global engineering consultant giant WSP for a minimum of $300k per year in MetroMap licences as a bundled solution for one of WSP's public sector clients.

With ARR now over $9.5m and likely to exit this financial year over $10m it leaves AMX in a very healthy position as it is around that level that management has highlighted in the past when the subscription revenue will overtake the largely fixed cost base. While that cost base hurdle is larger than a pure software business, AMX should benefit from the same incremental revenue economics for each new customer as the aerial image capture and platform development is an already sunk cost.

Like AHC, the size and nature of AMX means profitability won't be a steady path, however the business is positioned to report a small profit in the second half of this financial year. With continued growth in the core subscription business and further contract wins in the dominant LiDAR segment they can hopefully build on that in the new financial year.

Shares in **Kip McGrath Education Centres** (KME) rallied during the month on news that long serving Chairman Ian Campbell would be replaced by Damian Banks, an experienced business leader.

Generally, share price movements for micro-cap companies are reserved for operational business updates, however the markets main criticism for KME over the last few years has been the lack of fiscal discipline with their multi-pronged growth initiatives. In that context the share price reacting to the appointment of a new Chairman with a proven listed history of driving value for shareholders makes sense.

Nonetheless in the short term KME needs to demonstrate resilience in its core business in the face of rising cost of living pressures for customers and tangible returns from its growth initiatives in the upcoming second half report.

XRF Scientific (XRF) continued its steady growth with a third quarter update with revenue growing 13% and profit before tax growing 15% on the third quarter a year ago. Mid-teen's growth across both metrics has become the norm for XRF over the last year or so as the business continues to steadily execute.

Despite trading on an elevated earnings multiple, XRF remains a high conviction holding in the Fund with steady growth able to be maintained into the new financial year with the release of new laboratory products and XRF able to acquire the remaining 50% of Orbis Mining which has performed well since being acquired in 2021.

For our Fund holdings that report quarterly cash results outcomes were mixed. **8Common** (8CO) reported revenue and user growth of 24% and 16% respectively for the third quarter, but the cash strain of having to incur upfront costs to onboard clients onto their expense management software before billing commences continued with a $700k outflow for the quarter.

The fourth quarter of the financial year is generally a strong one for the business however, with management forecasting a much improved result that will hopefully continue into the new financial year. With a market cap now beaten down below $10m, 8CO trades on barely over 1x it's recurring/transactional revenue with that revenue set to double as it continues to onboard users in the pipeline.

Climate technology business **Aeeris** (AER) had a weaker than expected quarter with cash receipts for the third quarter flat on last year and down from a strong second quarter. Management expects a recovery in the fourth quarter with some payments deferred.

Operationally AER continues to develop their innovative Climatics platform which allows for the assessment of climate risks for physical assets. While the monetisation of a new software will take time, management were upbeat on the size of sales pipeline that has been developed, largely from customers of AER's established severe weather alerting platform.

Global Health (GLH) continued its trajectory towards positive operating cashflow with a $200k loss in the third quarter much improved from a $660k loss in the third quarter last year. Like 8CO, GLH generally benefits from a stronger fourth quarter as Government clients rush to complete work before the end of financial year.

With that seasonality to their benefit GLH may report a small cash surplus in the fourth quarter and leave them well positioned into the new financial year. With rising labour costs impacting the health care industry, the longer term need for technology to drive productivity is only increasing and will benefit GLH.

Knosys (KNO) was the highlight from our quarterly cash reporters, generating $500k in operating cash for the quarter taking the year to date total to $1.2m. With a research and development tax refund due in the fourth quarter they are likely to be breakeven meaning they will generate over $1m in earnings for the financial year against the current enterprise value of $6m.

That is undoubtedly a cheap valuation for a software business, but the issue is that KNO has struggled for growth this financial year with annualised recurring revenue flat on last year. Nonetheless, the valuation is undemanding assuming maintainable earnings over $1m and management are confident of returning to modest growth driven by Libero, their library management software.

It was pleasing to report a strong result in April for the Fund in the context of weaker global markets and continues the trend I wrote about in the March report of green shoots of confidence emerging at the smaller end of the ASX. With valuations stretched and growth slowing for larger companies, investors are turning to smaller companies whose valuations sit well below larger peers while generally offer better growth outlooks.

Thanks for your on-going support.

Luke Winchester (Portfolio Manager)