MEREWETHER CAPITAL


| Merewether Capital Inception Fund Performance Summary (at 31 July 2024 net of fees and expenses) | | | | | |
|---|---|---|---|---|---|
| 1 Month | 3 Months | 6 Months | 1 Year | 2 Years (p.a.) | Since Inception* |
| 12.37% | 16.61% | 18.00% | 20.06% | 11.06% | -11.96% |

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 $0.7835 and ended the month with an indicative unit price of $0.8804 for a 12.37% return.

In line with their seasonal history, global markets were stronger in July backed by muted inflation data which cemented the market’s view that the next move for interest rates in most economies will be down. With inflation seemingly tamed, I suspect attention will now move to traditional economic metrics to determine whether a “soft landing” can be achieved, where central banks realise their inflation goals without driving their economies into recessions.

After two months of little fundamental news across the Fund, we had a wave of updates from portfolio companies in July with most providing positive updates and outlooks for the future.

**Austco Healthcare** (AHC) provided a very strong trading update, expecting to report $58m revenue and $8m EBITDA for the financial year, 38% and 122% increases on last year respectively. While impressive numbers overall, it is the growth through the year and the subsequent momentum of the business into the new financial year which was the most pleasing aspect of the update.

After reporting $2.1m EBITDA in the first half of the financial year, AHC achieved $5.9m in the second half, and $3.4m in the fourth quarter alone. Given the lumpiness of their project-based business model it can be dangerous extrapolating any one period but given the momentum and the full impact of the recent Amentco acquisition it is feasible to see AHC report $12m+ EBITDA in FY25.

Importantly, despite the strong second half result the company continues to grow its order book, increasing from $44.4m to $46.2m over the last six months, supported by a $5m contract announced early in July for a Canadian hospital installing their best-in-class nurse call and clinical workflow solutions.

With modest capital and development expenses and a chunk of tax losses to be used, AHC should convert most of their EBITDA to net profit. At the current $75m market capitalisation with no debt, the business likely trades on less than 10x forward earnings, a clear example of the value still on offer at the smaller end of the ASX.

**Compumedics** (CMP) also clarified their financial year guidance with record revenue of $49m (compared to >$46m originally guided in May). Despite the higher revenue management re-iterated they would not hit their $5m EBITDA guidance as they were investing heavily into the USA opportunity for their next generation sleep testing product Somfit.

When I wrote a blog post on CMP over a year ago (which can be found here) I commented that a direct to consumer business model is notoriously difficult to achieve, but a memorandum of understanding with a pharmacy based home sleep testing provider was a potential path to market for Somfit.

Fast forward to today and CMP believes they have captured 75% of the fast-growing pharmacy-based home sleep testing market in Australia and New Zealand and are looking to replicate that success in the USA. On the back of a small $1.9m capital raise early in the month (which we participated in), CMP is looking to hire up to six sales staff and rapidly drive the penetration of Somfit into the established USA home sleep testing market.


**Prophecy International** (PRO) guided to full year revenue of $23.2m and a breakeven cashflow result, slightly below my expectation for $24m revenue. However, a strong last quarter for contracted recurring revenue provides a positive outlook into the new financial year.

The contracted recurring revenue was boosted by a contract with Services Australia won early in the month which added $1.1m per year and took the total to $28.4m. While management expects an EBITDA loss for the recently concluded financial year, they are guiding to positive EBITDA this year which should result in $1-2m in free cashflow given the negative working capital model of the business (customers pay cash upfront before revenue is recognised).

With a current market capitalisation of less than $60m, PRO is trading on roughly 2x recurring revenue with $12m cash in the bank, no debt and roughly 20% organic revenue growth. Given those characteristics I expect the inflection into statutory EBITDA profitability in FY25 will be well received by the market if PRO management can execute.

**SDI Limited** (SDI) announced they expect revenue of $111.4m and operating net profit of $11m when they release their results in late August. The profit result came in at the higher end of my forecasts, and while not a surprise given the strong first half result it is pleasing to see the growth drivers for the business continue into the second half.

An $11m operating net profit looks very reasonable in the context of the current $107m market capitalisation with SDI expecting to double their manufacturing capacity in the coming years and continue the double-digit growth in their core Aesthetics and Whitening dental product segments. The size of the capital project to construct a new manufacturing facility in Melbourne will likely continue to weigh on the share price, but in the meantime it is pleasing to see SDI continue to grow their revenue and margins.

It was a busy July for electrical contractor **SKS Technologies** (SKS). They began the month upgrading their FY24 revenue guidance from $120m to $130m with some very bullish commentary on their outlook and pipeline with management stating the "opportunities for new work shows no sign of abating."

One of those opportunities was converted shortly after when the company announced a $90m contract for a hyperscale data centre in Melbourne. On the back of the large contract management provided their preliminary revenue guidance for FY25 of $200m. In the context that just five years ago the business reported $27m revenue, the growth of the business (and subsequently the share price) has been remarkable. We took some (premature) profits in May but continue to hold a large weighting in the Fund.

**Vysarn** (VYS) announced they had been granted licenses to conduct drilling and test pumping programs at two remote stations within the Kariyarra native title land to further progress their emerging Vysarn Asset Management (VAM) segment.

While it is still early days in the VAM strategy, VYS continues to steadily progress through the required regulatory approvals. As the potential of VAM becomes more defined and tangible, I expect the VYS share price to significantly re-rate. The problem of usable water in the Pilbara is not easily solved, but with their vertical integration across the water industry VYS is well placed to benefit.

**XRF Scientific** (XRF) advised the market they had exercised the option to acquire the remaining 50% of Orbis Mining they originally purchased in 2021. Orbis has grown substantially within XRF's broader product suite, growing profit before tax from $340k in 2021 to $1.7m last year.

The notoriously conservative XRF management commented that the fourth quarter results were "positive as expected" with specific numbers to follow in late August.

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Unfortunately, it wasn't all good news from our portfolio holdings with geospatial imaging company **Aerometrex** (AMX) providing a weaker than expected outlook based on "general market softness" in the second half of the financial year. While no consolation, this industry view was supported by peer **Veris** (VRS) who also cited "sub-optimal macro and industry-wide conditions" in an update through the month.

AMX is expecting to report revenue down 2-3%, but an outsized hit to EBITDA with profitability falling 25-30%. This is a disappointing result after a strong first half report, and while I still have faith in the long-term potential of the business, we reduced our holding after the update in line with the philosophy I outlined last month of trying to *"find and own businesses with improving earnings outlooks"*.

I am optimistic for an on-going recovery in micro and small cap stocks, but in that market dynamic it is important to ensure we are positioned to take maximum advantage with our highest conviction positions being those with strong operational execution in the short term. We will look to add back to our AMX position on signs of management guiding the business through this period of industry weakness and returning to earnings growth.

Finally, it was largely positive updates all around from our portfolio companies who still report quarterly cashflow updates. **8Common** (8CO), **Change Financial** (CCA), **Knosys** (KNO) and **Global Health** (GLH) all reported positive cashflow quarters, with only **Aeeris** (AER) having negative cashflow as they invest in product development of their Climatics climate reporting platform ahead of new Government mandated reporting requirements later this year.

CCA management also provided preliminary revenue guidance for the new financial year of more than 30%. As per my recent blog post (which can be found here), I suspect management is being conservative, and estimate revenue growth of ~50% if customer on-boarding goes smoothly.

With July in the books, attention turns to reporting season in August which is always a hectic time of year as analysts frantically try to keep up with the barrage of reports coming in at the same time, particularly towards the end of the month.

Given the plethora of updates we had this month I am not expecting too many surprises in the Fund, though as always I look forward to adjusting my numbers and hearing from our various management teams on the business outlooks for the future.

Thanks for your on-going support.

Luke Winchester (Portfolio Manager)