MARKET MATTERS
INVEST

MONTHLY REPORT | AUGUST 2023 | EMERGING COMPANIES

PORTFOLIO DETAILS

Portfolio Name	Emerging Companies
Structure	Separately Managed Account
Benchmark	S&P/ASX Small Ords Index
Management Fee	0.85% incl GST
Platform	OpenInvest
Included Assets	Equities
Portfolio Managers	James Gerrish & Harrison Watt
Annual Performance	3.95%*

OBJECTIVE

The objective of the Market Matters Emerging Companies Portfolio is to provide an active exposure to Australian emerging companies defined as all listed stocks outside the S&P/ASX 100. Returns will primarily be achieved through capital appreciation rather than income with an overall objective of outperformance of the S&P/ASX Small Ordinaries Index over 5 years.

**Inception Date 31.01.2020*

MARKETS & PERFORMANCE

The Market Matters Emerging Companies Portfolio gained +6.67% in August, strongly outperforming the S&P/ASX Small Ordinaries Accumulation Index which fell -1.31%. The portfolio has returned +0.87% for the rolling 12 months (against the benchmark return of -1.12%) and +3.95% per annum since inception, +2.59% per annum above the benchmark.

PERIOD	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA
PORTFOLIO %	6.67	6.95	2.01	0.87	-8.14	-5.83
BENCHMARK %	-1.31	2.22	0.90	-1.12	-8.15	3.00
RELATIVE %	7.98	4.73	1.11	1.99	0.01	-8.83

Benchmark: S&P/ASX Small Ords Accum Index

More broadly, the MSCI Developed Markets Index fell over August (-1.7%), while the S&P 500 also declined (-1.6%) in local currency terms. Australian 10-year bond yields were at 4.03%, trading relatively flat as the RBA kept rates unchanged but still retained a tightening bias. That said, we believe the current 4.1% cash rate will be the peak of this RBA cycle.

In the US however, there remains a distinct possibility of one more hike, and this evolving belief pushed up US 10-year yields by 0.14% over the month, to 4.09%, as the Fed continued their hawkish tone.

Commodity prices were mixed across the board in August. Brent Oil rose by US$0.30 to US$85.86/bbl, Iron Ore showed resilient strength to rise by US$6.50 to US$117.50/Mt, while Gold prices fell on a strengthening dollar coupled with higher yields, falling by US$23.10 to US$1,948.

From a sector perspective, Consumer Discretionary (+5.7%) and Property / REITs (+2.3%) were the highlights while Energy +0.5% was the other sector that finished in the black.

Utilities (-3.8%) struggled most while Consumer Staples (-3.2%), IT (-2.1%), Industrials & Materials (-2%), Healthcare (-1%), Financials & Communication Services (-0.8%) all dipped more than the index.

REPORTING WRAP UP

FY23 results were solid, with earnings (Net Profit After Tax)) beats outnumbering misses by a ratio of 5:3, illustrating the underlying strength of the domestic economy, however, underwhelming guidance for FY24 into a strong market leading into August weighed on confidence and ultimately led to weaker share prices collectively.

Materials (ex-mining) and Communication Services saw the strongest beat rate, while the Consumer Staples and Information Technology stocks saw the biggest skew towards earnings misses. Post results, analysts revised their expectations on FY24 profits at a ratio of 2 downgrades for each upgrade, and now expect ASX200 FY24 profits to decline -5.7% in the year ahead. For comparison, this number was -0.8% just prior to results and +0.7% six months ago, showing downside momentum.

While the index itself was weak, it was also an unusually volatile reporting period with a high proportion of outsized share price moves on company results (+ or - 10% on the day). This is indicative of crowded trades at a time of unpredictability from an economic standpoint, while another observable outcome has been the continuance of trends, on the upside or downside.

A major surprise was the contrasting performance in consumer sectors pre- vs. post-results. In the months leading up to reporting investors had been buying staples, on expectations that the discretionary names would suffer as householders struggled against cost-of-living pressures and higher interest rates. Instead, discretionary retailers saw that consumer spending was slowing (but not collapsing), whilst staples suffered under cost and operational challenges.

PORTFOLIO POSITIONING

The portfolio held 22 positions at the end of August with cash sitting ~4%. We started the month with elevated cash levels and used some of the volatility in individual shares to put money to work, a strategy that helped drive much of the outperformance alongside a number of positions beating expectations.

We made 8 changes to the portfolio in the month, buying 5 new names including **PEXA Group (PXA)**, **Fineos (FCL)**, **Sandfire (SFR)** and **Cenutria Capital (CNI)**. We reduced two positions, taking some profits in **Bapcor (BAP)** and **Audinate (AD8)** after both reported well, and we cut **Capitol Health (CAJ)** from the portfolio altogether.

Reporting season was the main driver of the outperformance in the period with a number of positions beating expectations. One of the key winners was **EML Payments (EML)**, a technology company that has struggled over recent years on the back of compliance issues. The company beat earnings expectations by ~20% in FY23, leading to a strong move by the stock which was helped by the short sellers holing ~6% of the register heading into the announcement. Shares rallied 50% higher in August on the back of the result.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	22
ESTIMATED YIELD (%)	1.89
TOP 5 POSITIONS (% OF AUM)	32.84
TOP 10 POSITIONS (% OF AUM)	52.87

STOCK	CONTRIBUTION (%)
AUDINATE (AD8)	2.88
AUSSIE BROADBAND (ABB)	1.71
PALADIN ENERGY (PDN)	1.22
PRAEMIUM (PPS)	0.76
EML PAYMENTS (EML)	0.68

STOCK	DETRACTION (%)
FINEOS (FCL)	-0.77
GLOBAL LITHIUM (GL1)	-0.51
SILEX SYSTEMS (SLX)	-0.40
CALIX (CXL)	-0.39
CENTURIA CAPITAL (CNI)	-0.35

	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD
FY24	-1.16	6.67											**5.51**
FY23	14.48	3.07	-9.21	0.87	5.76	-6.42	8.36	-4.24	-2.29	2.33	-5.22	1.47	**8.96**
FY22	2.97	1.17	5.91	1.13	2.19	-2.47	-10.29	-5.93	6.68	-5.19	-7.80	-15.25	**-26.88**
FY21	10.92	17.19	-10.89	0.63	0.58	0.57	-0.86	5.91	-7.10	4.38	-3.81	2.37	**19.89**
FY20								-16.09	-27.07	37.98	21.26	5.66	**21.74**
CUMULATIVE													**29.22**

PORTFOLIO POSITIONING CONTINUED

EML is undertaking a strategic review to look at various aspects of the business with a further ~$10m expected to come out of costs. We see a restructure and potential subsequent asset sales as the key drivers underpinning the value in EML near term, a company that remains exceptionally cheap if they can get it right.

AV technology business **Audinate (AD8)** saw its shares rally to all-time highs after a stellar FY23 report. With a 50% increase in revenue, earnings were up 143% which was ~35% ahead of expectations. They continue to see strong growth across the business with demand at record levels while margins remained strong on the back of a growing software contribution. While we continue to like the business, we reduced exposure to AD8 into prevailing strength.

Telco **Aussie Broadband (ABB)** hit 12-month highs with a solid FY23 resilt backed up by strong FY24 guidance getting the market excited. The company expects a further ~15% increase in earnings this financial year, backed up by a strong pipeline and improving cost control. Importantly, there were several comments made during the presentations that suggested the guidance was a baseline leaving the door open for upgrades as the year progresses. There was also a ~4% short position heading into the update which also supported the rally.

On the flip side, insurance software business **Fineos (FCL)** struggled in August after a capital raise surprised some. We recently bought the stock following a big contract win. Insurance companies have been hanging on to ageing, clunky software that supports customer details, billing and claims management with the current systems quickly becoming clunky and obsolete. Fineos is filling this gap with their cloud-based offering and with recent contract wins and strong margins we saw a pathway to cashflow breakeven without the need to raise capital.

Unfortunately, Fineos took the conservative approach and raised $35m in a placement weighing on shares in the short term. While the raise was frustrating from a holder's point of view, we can't argue that it sets the company up well to grow considerably and turn profitable.

Recent purchase **PEXA Group (PXA)** disappointed at their FY results sending shares down 6% on the day. The two main issues fell on lower-than-expected mortgage refinancing and some downbeat commentary for FY24. The digital property settlements platform has an exciting future in our view with regulatory tailwinds set to support growth, however, in the shorter term they are beholden to the property market where volumes have been soft, though there are some signs that the seasonally strong spring period is setting up better than expected. Despite the soft result, we like PEXA and it's a position that we may look to increase.

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