MARKET MATTERS

INVEST

MONTHLY REPORT | FEBRUARY 2024 | 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	5.48%*

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 Active Emerging Companies Portfolio gained +4.57% in February, outperforming the S&P/ASX Small Ords Accumulation Index which advanced +1.72%. The portfolio has returned +10.7% for the rolling 12 months against the benchmark return of +7.84% & 5.48% per annum since inception, outperforming the benchmark returns of 2.86%.

PERIOD	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA	INCEPTION
PORTFOLIO %	4.57	6.76	4.69	10.7	-1.52	-2.44	5.48
BENCHMARK %	1.72	10.05	6.88	7.84	-0.37	1.39	2.86
RELATIVE %	2.85	-3.29	-2.19	2.86	-1.15	-3.83	2.62

Benchmark: S&P/ASX Small Ords Accum Index

More broadly, the MSCI Developed Markets Index rose (+4.6%), while the S&P 500 also strengthened (+5.3%) in local currency terms highlighting the underperformance of Australian stocks.

Commodity prices were mixed in February. Brent Oil rose by US$1.97 to US$83.68/bbl, whilst Iron Ore prices fell by US$15.50 to US$117.50/Mt. Over the month, Gold fell by US$20.80 to US$2,032 as bullion markets recalibrated Fed expectations.

On a sector basis in Australia, IT (+19.5%) was a standout driven primarily by corporate activity, Consumer Discretionary (+9.1%), Real-Estate (+5.1%), Financials (+3.5%) and Industrials (+2.7%) all outperformed, more than offsetting the weakness seen in Energy (-5.9%), Materials (-5.0%) and Healthcare (-0.27%).

REPORTING - WHAT WE LEARNT

February results saw almost twice as many earnings beats versus misses, but this is somewhat misleading given analysts entered the period with unusually low profit expectations.

ASX200 FY24 earnings growth slipped by 0.6% overall and now sits at -5.5% year on year, although this is driven primarily by weakness in the energy sector. Cost-cutting was a dominant theme and the primary talking point, though most companies still highlighted sticky input prices. That said, the peak rate of upward momentum in cost growth looks to be over, with roughly 30% of reporting companies saying cost pressures have now passed peak intensity.

Profit margin improvements were the key to results, and the ability to pass costs onto the consumer remained robust. This is underpinned by a fully employed economy combined with significant investment from governments, meaning that for most companies, end demand remains solid. Combined with a focus on companies managing internal costs, this meant that around 75% of the companies that reported were able to expand or maintain profit margins, which is the main takeaway in our view.

Top-line growth does appear to be slowing though, with evidence of a decelerating sales trajectory coming through in forward guidance, with cost-of-living pressure and higher rates still to blame.

All in all, a solid results period, and when combined with easing pressure from a macro perspective, we came out the other side feeling more confident about the outlook from here.

PORTFOLIO POSITIONING

The portfolio held 19 positions at the end of February with cash finishing the month at ~13%. We made two changes to the portfolio during the period, slightly reducing the cash balance. We were particularly pleased with the relative performance given that we were overweight cash throughout the month, still managing to strongly outperform the Small Ords Accumulation Index.

We added **Paladin (PDN)** back into the Emerging Companies portfolio, buying into weakness which saw the stock dip below the average sale price over the staggered exit in January. We remain bullish on the Uranium outlook and Paladin remains our preferred pick as it nears production.

Our only other change in the portfolio was to trim **Aussie Broadband (ABB)** after the stock rallied ~50% in FY24. The telco announced a beat to expectations in the 1st half as well as upgraded guidance that was around 10% ahead of consensus. Revenue for the half of $445.9m was up 17% and ahead of the $451m expected with connections up 20.6% to 765,800 on strong growth across all segments. They now see FY24 EBITDA between $116-121m up from $100-110m. Consensus for the FY was already at the top end ($109.7m) so it was about a ~10% upgrade thanks largely to lower capex guidance, down from $47-52m to $40-45m.

The best-performing position last month was audio-visual software and hardware company **Audinate (AD8**), with the portfolio now sitting on more than a 100% profit - the stock traded to all-time highs at the end of the month. The first half results were impressive, Revenue grew 48% to $US30.4m with EBITDA $US10.1m being ~70% ahead of expectations. Growth of 78% in chips, cards & modules (CCM) drove the result, in part thanks to the improved supply of their Ultimo chip helping the company work through some of the demand backlog. Costs were up more than expected, however this was more than offset by strong revenues with margins improving ahead of consensus.

PORTFOLIO POSITIONING CONTINUED

While the first half was strong, the company left guidance unchanged, looking for growth in line with historical levels (~25% growth) and ~15% growth in headcount. They are looking at M&A opportunities with a strong cash balance of $117m to support those efforts. Audinate has cornered a significant portion of the market and is enjoying high levels of market interest given it is profitable at a time when there is a lack of quality tech stocks left on the ASX.

Mining & services contractor **SRG Global (SRG)** was another holding that reported well and is trading near long-term high. Revenue grew 34% to $510m, while earnings (EBITDA) were up 33% to $45m, around 10% ahead of expectations. Impressively, cash conversion swelled to 133%, a significant turnaround from the 68% at the FY23 result and one of the key areas of concern at the last update.

Investors were also expecting a drop in margins which didn't eventuate, contributing to the beat. Work In Hand (WIH) remains strong, up 27% from 1H23, while the company has a pipeline of $6.5b to bid on providing a solid runway for growth. Guidance was upgraded marginally at the midpoint for EBITDA, now expected to be $95-100m for FY24 which could still prove conservative given the strength seen in the first half. The stock remains cheap vs peers while improving execution is driving better earnings.

On the flip side, gold mining stock **Silver Lake Resources (SLR)** struggled after announcing a deal to merge with fellow ASX-listed midcap Red5 (RED).

The deal to create a ~450koz/year mid-tier Aussie gold producer and, strangely, the Silver Lake board agreed to a deal at what was a 10% discount to the prior close on 3.434 RED shares for each SLR. Silver Lake already owns 11.9% of RED shares but would end up with 48.3% of the new group. While the deal makes sense from the perspective of synergies and the balance sheet, combining SLR's strong cash balance with RED's long-term production profile, it seems a poor outcome for Silver Lake shareholders in the short term.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	18
ESTIMATED YIELD (%)	2.4
TOP 5 POSITIONS (% OF AUM)	30.85
TOP 10 POSITIONS (% OF AUM)	55.02

STOCK	CONTRIBUTION (%)
AUSSE BROADBAND (ABB)	1.42
AUDINATE (AD8)	1.25
SRG GLOBAL (SRG)	0.54
PEXA GROUP (PXA)	0.50
BAPCOR (BAP)	0.27

STOCK	DETRACTION (%)
SILVER LAKE RESOURCES (SLR)	-0.72
FINEOS CORP (FCL)	-0.55
NINE ENTERTAINMENT (NEC)	-0.43
CENTURIA CAPITAL (CNI)	-0.42
SILEX SYSTEMS (SLX)	-0.13

	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD
FY24	-1.16	6.67	1.08	-7.77	4.24	5.16	-1.64	4.57					**11.15**
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													**34.86**

PORTFOLIO POSITIONINGCONTINUED

Insurance software company **Fineos (FCL)** also struggled after reporting their FY23 results, the company is transitioning into a calendar year reporting period from 1 January 2024, hence the off cycle half year.

They have been pushing for more subscription-based revenue growth, a strategy that will yield value down the line (aka Altium). However, it has put pressure on near-term growth, with revenue for the half down marginally vs 1HCY23. Services revenue weighed on the top line; annualized recurring revenue (ARR) though grew 9.9% to €65.3m, and guidance suggests this is a growth run rate the market can expect to see going forward.

Costs have also been an issue for Fineos, recently raising money to transition and invest in cost reduction strategies, which supported an increase in Gross Profit Margins from 66.9% to 71.5%, alongside EBITDA margins improving to 8.1%. Despite this, the company posted EBITDA of €4.9m, short of the ~€7m expected. Overall, the result was a messy one, not only because of the new reporting period being implemented. Going forward though, we expect shares will see some support as they move into positive Free cashflow (FCF).