MEREWETHER CAPITAL

31 July 2022 Investor Update

Merewether Capital Inception Fund Performance Summary (at 31 July 2022 net of fees and expenses)					
1 Month	3 Months	6 Months	1 Year	2 Years (p.a.)	Since Inception* (p.a.)
7.13%	-14.71%	-25.00%	-	-	-27.91%

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 $0.6729 and ended the month with an indicative unit price of $0.7209 for a 7.13% return.

July finally brought a reprieve from the market sell-off we have been experiencing since the start of the year, and while the Fund has only roughly picked up the losses sustained in June, we will take our first positive month and look to build on it into financial year 2023.

Despite the rebound, the overwhelming consensus among market participants is that this is a bear market rally providing us with only a short-lived relief before we resume further pain in the months ahead. While I generally agree that a large part of July's strong bounce was simply due to a return of liquidity post tax loss selling in June, it is fair to say some of the factors driving the negativity seem like they have started to abate.

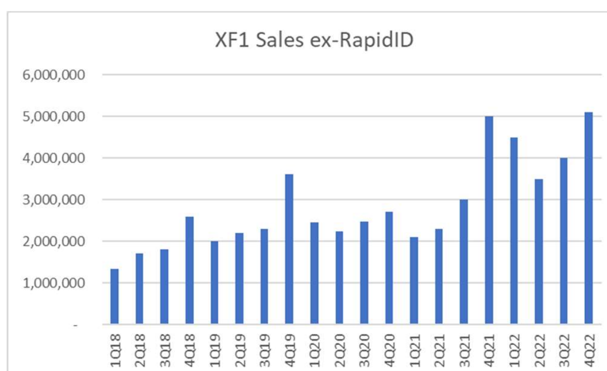
Central banks seem more circumspect on the pace of interest rate rises after bringing rates much closer to neutral levels. Moving forward, lagging data from the recent rises seem likely to dictate future movements with the market expecting a slowdown (and perhaps a reversal) in the future.

Many inflation indicators have also rolled over, particularly with commodities and shipping costs. In broad terms, retailers have also been caught with excess inventory which could lead to discounting and further price reductions in durable goods. That said, spiking energy prices and stubbornly low unemployment will no doubt keep inflation in the front of minds both for investors and consumers.

Overall, my thoughts on the market haven't shifted a great deal despite the rally. Large pockets of the market remain overvalued or face earnings headwinds in the months ahead. I struggle to get enthused about the market at an index level, however there is more than enough value in other areas to put together a portfolio of businesses that are both cheap and growing which is what we are aiming to do.

Turning to portfolio holdings, **Xref** (XF1) reported their quarterly report which disappointed the market after headline numbers showed a year-on-year decline in sales. The disappointment was mitigated somewhat due to the fact the biggest reason for the weak result was a decline in their smaller RapidID segment which was acquired in 2019. This subsequently benefited from a crypto boom in the previous period through their key customer Coinspot.

Adjusting for the 62% fall in RapidID revenue, the result was satisfactory while not being stellar:



Source: Merewether Capital, Xref

Moving forward I expect Xref to slowly replace RapidID's reliance on crypto revenue, underpinned by an enterprise-wide agreement with Coles and the exclusive distribution rights to a new Graduate Verification Service with Higher Education Services.

Even with a weaker than expected quarter, Xref still generated $1m free cash flow in the quarter and $3m for the full financial year. Management have shown fantastic cost control in an environment where not many tech peers can say the same and with further revenue growth expected in financial year 2023, I would expect that operating leverage to continue into strong profit growth.

During the month I presented on Coffee Microcaps Manager Interview series (https://www.youtube.com/watch?v=2r2MMHnQ5nI) and discussed two small software holdings; **Global Health** (GLH) and **Knosys** (KNO).

Last month I mentioned Global Health had seen some recent momentum in contract wins which extended into July winning another $360k annualised recurring revenue (ARR) contract with Latrobe Community Health in Victoria. Making the contract even sweeter was a large chunk of implementation revenue ($1.2m) to be recognised over the next two years. Recent contracts now lock in 25% ARR growth moving forward with CEO Michael Davies confident of further contract wins soon.

Meanwhile the implementation revenue will provide a strong boost to the headline numbers and may be enough to pivot the company back towards profitability after dipping into a small loss this year to spend more fleshing out sales, development, and executive teams.

Knosys reported their quarterly results and was cash flow positive for the fourth quarter and trading roughly at breakeven for the full financial year. They also tacked on $500k in ARR largely from the continued expansion in their GreenOrbit segment as they upsell existing customers to the higher value cloud-based product.

Further growth is expected as recent contract wins with Government departments Services Tasmania, Services South Australia and Healthdirect Australia are implemented. Like Global Health, the additional ARR being added is likely to tip Knosys back into profitability this year.

We also had the quarterly report from **intelliHR** (IHR), one of the worst performers in the portfolio so far. As I have written in the past, intelliHR is a 2021 stock that is stuck in 2022. A cloud based human resources software as a service product experiencing rapid revenue growth (~100% year on year) with all the operating metrics you love to see; high net revenue retention, low customer churn and best in class customer reviews/feedback.

The problem of course is the rapid growth and the investment in the platform to provide those wonderful operating metrics means heavy cash burn. Last year the market was more than willing to provide the capital to fund growth. However, in 2022 the taps have been turned off.

After signalling last quarter that a focus on capital discipline would be coming, it was pleasing to see intelliHR management follow through on that promise. Quarter on quarter cash receipts grew $400k while operating costs fell $300k meaning the cash burn fell from $2.9m to $2.2m. At a headline level with $5.5m cash in the bank and still a $2.2m quarterly burn, the market wasn't too enthused, so the share price stayed relatively stable.

While a capital raise is still likely I think the size and dilution of that could be much smaller than the market expects. The company is still growing extremely fast, adding $1.1m ARR in the quarter and can grow in a more capital light manner moving forward through Partner agreements. If intelliHR can pivot into cash flow positivity only needing a small capital injection ($2-3m) I expect the stock to re-rate strongly as the positives discussed earlier outweighs the spectre of dilution.

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)