Merewether Capital

31 July 2023 Investor Update

Merewether Capital Inception Fund Performance Summary (at 31 July 2023 net of fees and expenses)					
1 Month	3 Months	6 Months	1 Year	2 Years (p.a.)	Since Inception*
0.36%	8.49%	4.28%	1.72%		-26.67%

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 $0.7307 and ended the month with an indicative unit price of $0.7333 for a 0.36% return.

July saw buoyant returns across global markets, especially for ASX small and micro caps who had quick recoveries from the impact of tax loss selling in June. The fundamental performance from several of our larger Fund holdings has seen us uncorrelated over the last two months with a very strong June in the face of tax loss selling, and now consolidating in July as we enter reporting season.

July was a busy month for portfolio news, our smaller companies reported their quarterly cash flow statements as required and several others provided unaudited updates to their end of financial year numbers ahead of formal reporting in August.

Integrated water services business **Vysarn** (VYS) was the standout, upgrading their guidance for the second time to $7m profit before tax (up from $6.5m previously). Operationally the business is performing very well, with the core hydrogeological drilling segment seeing excess demand from tier one iron ore miners allowing for double shifting of rigs and driving higher utilisation. I look forward to the full audited accounts in August and expect the strong second half has likely left the business in a net cash position and with plenty of liquidity to further pursue their acquisition strategy to drive penetration deeper into various water verticals.

Given the first half result was a profit before tax of $1.6m, that means the second half has generated $5.4m of the $7m total and leaves the business entering the new financial year on a run-rate of ~$11m. Assuming a normal 30% tax rate the current run-rate valuation of 9x earnings looks more than reasonable for the growth and the potential for further organic or acquisitive growth funded from debt and free cash flow.

Prophecy International (PRO) had two pieces of news during the month. The first was the announcement that the Australian Tax Office had signed a contract for the company's eMite software. The contract adds ~$750k to eMite's recurring revenue base and provides a solid foothold into Australian Government departments and represents the first win under the distribution agreement signed with Optus last year.

Later in the month the company provided an unaudited trading update, with annualised recurring revenue growing to $23m (up 26% on last year) and the business hovering around the profit/cashflow breakeven inflection point. I wrote a blog post outlining my investment thesis for PRO last month and it is pleasing to see the business performing up to that thesis so far.

Compumedics (CMP) also released two pieces of news through the month, first announcing a supply agreement with a leading home sleep testing business to provide their novel Somfit Pro device for their testing services. That same customer also signed an agreement to provide Somfit Pro through their retail network which sells sleep apnoea devices. The amount of both deals is $1.5m with half of that being high margin recurring software revenue with the potential to expand over time.

CMP also released an unaudited trading update, beating their previous revenue guidance ($41m+ vs $40m) and meeting their earnings guidance of $2m EBITDA. However, given the weak first half result where the business lost $1m EBITDA, it implies a strong second half and provides confidence the business can return to the guidance of $4m+ EBITDA provided at last year's AGM which provides a reasonable valuation against the current $33m enterprise value.

Enterprise human resources software provider **Xref** (XF1) was the only disappointing update during the month as the business is struggling to generate growth and higher costs bite into the profits seen last year.

At a group level revenue growth of 11% seems acceptable but is boosted by an acquisition that fully contributed to the second half of the year. Excluding the Voice Project acquisition, revenue was essentially flat. Given the business did $1.3m in operating profit last year, a flat result would not have been terrible if costs could have been contained but unfortunately that wasn't the case.

Expenses grew 27%, partly due to the cost base from Voice Project, but mainly due to higher employee costs from an increase in headcount from 72 to 114 (including 15 employees Voice Project). The higher cost base means the business will move from a tidy profit last year to a small loss this year.

In the update management provided granular detail on the increased headcount and cost base, with the majority aimed at bringing forward the development of several modules for the new enterprise software suite. With the bulk of that development behind them and the suite now in market and being sold aggressively to new and existing clients, there is genuine reason to be optimistic strong revenue growth will return.

With a focus on containing costs moving forward it is likely the business returns to profits in FY24 and we continue to hold our shares for now.

Global Health (GLH) announced during the month that they won a five-year contract for their Mastercare patient administration software/electronic medical record at the new Weststate Private Hospital in Townsville. The value of the contract is $400k a year, a nice incremental addition to the company's ~$6m in annual recurring revenue.

GLH also reported their cashflow for the quarter and showed their cash outflow had slowed dramatically to just $400k for the quarter. Staff shortages within their hospital and community health customers has seen delays with onboarding and recognising revenue, but these headwinds are easing and the company is confident of bringing on ~$1m of recurring revenue that is currently contracted and awaiting execution and would swing the company into profitability.

For our companies who still provide quarterly cash reports, all looked quite positive. **8Common** (8CO) recorded their first free cash flow positive quarter on the back of large Federal Government contract implementation revenue with a large pipeline remaining and increased recurring revenue from new users brought onboard.

Electrical/audio visual contractor **SKS Technologies** (SKS) admitted they would fall slightly short of their ambitious $90m revenue target set at the start of the financial year, but nonetheless had a strong quarter generating roughly $1m in free cash. They enter the new financial year with an elevated work on hand backlog and solid traction achieved into their expansion into work with data centres and the defence sector.

Looking to August, we have reporting season for most ASX companies, and I am optimistic portfolio holdings will report well.

Thanks for your on-going support.

Luke Winchester (Portfolio Manager)