

Merewether Capital Inception Fund Performance Summary (at 30 November 2023 net of fees and expenses)

1 Month	3 Months	6 Months	1 Year	2 Years (p.a.)	Since Inception*
1.86%	-7.65%	5.51%	-2.36%	-15.71%	-31.42%

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 an indicative unit price of \$0.6733 and ended the month with an indicative unit price of \$0.6858 for a 1.83% return.

There is some nuance to this month's indicative unit price which I will shortly explain.

November saw a raft of AGMs across the ASX, most bringing with them trading updates for the start of the 2024 financial year. Overall, the updates across our portfolio were very strong barring one notable exception.

I attended the AGM for **Rectifier Technologies (RFT)** in Melbourne, though it quickly devolved from a shareholders meeting to an environment of utter confusion. While the exact details are still being determined, what is known is a voting bloc of approximately 37% of the business led by the Chairman voted against the election of the three directors that were up for nomination.

In response to this (and the fact they knew the votes were going against them), those three directors stood down and did not proceed with the AGM resolutions. However, what really threw the meeting into disarray and has created further issues was the two remaining directors also resigned, leaving the Chairman as the sole director on the board.

This is a breach of the Corporations Act and ASX listing rules, and the stock was placed into a suspension until two new Australian based directors could be appointed to reach the minimum three director threshold.

From a compliance point of view, this should be able to be sorted out relatively quickly and would allow the stock to re-list and trade again, but the much deeper problem is uncovering the motives involved and understanding why the Chairman would seek to take such a radical action to gain control of the board.

Given the Chinese background of the voting bloc led by the Chairman, the market discourse has been suspicious. Legitimate questions are being asked about whether the Chairman could get operational control of the business given the history of some Chinese businesses previously listed on the ASX.

However, I think those worst fears are unfounded. It is important to note that RFT is an Australian business. It was founded by Australians, the business remains headquartered in Melbourne with a sales office in Singapore and manufacturing in Malaysia, and despite a global customer footprint, it has no Chinese customers or revenues.

This is very different to previous examples where a Chinese business was listed on the ASX and Australian shareholders had very little recourse under Chinese law when controlling shareholders acted against the interests of minority shareholders.

Further to that point, the Chairman previously had little role in the day-to-day operations of the business and in that context it is hard to understand his motive to try and seize control of the board. I am hopeful that cooler heads can prevail quickly, and although I am sure the short term will still see a sharply lower share price, the long-term value potential of the operational business may still be intact.

Noting the fact that I expect the share price to trade substantially lower when trading resumes, I have priced the indicative unit price of the Fund assuming an RFT share price of 2c, compared to a 3.6c share price that is currently in suspension (roughly a 3% performance impact).

Given re-listing from a compliance point of view should not cause a lengthy delay I hope that this temporary solution will only apply for this month end, and we will have proper market pricing moving forward. Whether 2c is an appropriate price is difficult to say, but it is my best effort with the information available.

These events with RFT have caused me to think deeply about risk. Environmental, social and governance risks (colloquially “ESG”) have become a leading issue in investing over the last decade or so, however most of the mainstream attention goes to the “E” in the acronym as investors shun fossil fuel, tobacco or weapon manufacturers. However, the incident with RFT has left me very focused on the “G”. Governance risk is not only often overlooked by investors, it is sometimes celebrated.

While not something I seek out specifically in the Fund, it is true that if an investment ticks the other boxes I look for, I do prefer to see a management and board with significant “skin in the game”, and even better if there is a founder involved.

However, while the winners are celebrated (business such as **Wisetech (WTC)**, **Objective Corp (OCL)**, **Dicker Data (DDR)** or **Reece (REH)** come to mind), there are examples where minority shareholders have not benefited from having controlling shareholders.

In recent times, minority shareholders of **Advance Nanotek (ANO)** or **Yellow Brick Road (YBR)** would definitely not be celebrating the fact they had large controlling shareholders in place as they have launched takeover bids at extremely depressed share prices or delisted the business to be removed the scrutiny of the public eye.

We wait and see how RFT will play out, but moving forward I am much more aware of the key risk of a controlling shareholder and will try to make a deeper assessment of whether their long-term incentives align with minority shareholders.

Despite the drama with RFT dampening our month, we did have some fantastic updates from other portfolio companies.

Vysarn (VYS) was the highlight, updating the market on their financial performance through the first four months of the financial year with profit before tax of \$4.5m compared to \$7.1m for the entire financial year 2023. A stronger profit result was certainly expected given a weak first half last year, but the results so far are ahead of expectations and the commentary remained exceptionally bullish moving forward.

The core de-watering drilling segment currently has one rig double shifted but there are plans to increase that to three before the end of the financial year. A second rig was commissioned and in the field for the test pumping segment in September and the managed aquifer recharge product manufacturing capacity will be doubled with a new facility being constructed.

Further detail about the new asset management segment was also provided, with the savvy hire of Richard Lourey who launched Australia’s first water investment fund many years ago.

After a strong run in the share price and growing to be the largest position in the Fund by far we took some profits in the month but maintain a large position and remain highly convicted in the outlook for the business.

Smart Parking (SPZ) is another business that has performed very well over the last few months and the operational momentum continued in the first quarter of the new financial year with revenue up 25% and EBITDA up 52%. Management also brought forward their long-term target of 1500 parking sites under management by six months to December 2024.



In a previous blog post

[\(https://www.merewethercapital.com.au/blog/a-smart-way-to-play-the-uk-re-opening/\)](https://www.merewethercapital.com.au/blog/a-smart-way-to-play-the-uk-re-opening/)

I provided back of the envelope calculations to show the business could earn \$21m EBITDA when they hit that site target. With a current market capitalisation of \$120m, it leaves SPZ trading extremely cheaply on that outlook however it should be noted that an outcome on the UK parliamentary enquiry into private parking operators is due early next year and could impact the business if maximum breach fines are reduced.

My trip to Melbourne wasn't entirely fruitless as I was able to catch up with the CEO of **SKS Technologies** (SKS) Matthew Jinks. Unfortunately, I couldn't attend the actual AGM due to a timing conflict, but I remarked to Matt that I thought his address provided to shareholders was the best update I had read from a CEO or Chair in the whole AGM season.

The detailed address went in-depth on the strides the business has made in the last few years, but rather than talk in generalities Matt highlighted the specific goals that began at the 2021 AGM and benchmarked where the company is today to those goals. Even further, he quantified the investment that had been made in real dollar terms and highlighted that now that those investments were bearing fruit the business had achieved \$1m profit before tax through the first four months of the year.

What also certainly would have boosted the mood at the AGM was the announcement of a large contract for the electrical fit out of new data centre worth over \$30m. Given the forward order book sat at \$55m prior, it is clearly a very material contract and sign that the expansion into the data centre space has been successful.

With on a small market capitalisation of \$25m, SKS trades on less than 10x this current year's earnings run rate, with earnings set to increase dramatically as the business begins to eat into its large forward order book.

Kip McGrath Education Centres (KME) AGM update was mixed, with management reporting 20% revenue growth in the first quarter and guiding to a similar growth rate for the full year. That level of growth is solid and ahead of expectations, however despite commentary that profitability will increase over the full year, more franchisee buybacks than expected will impact the half year results as it takes time to bring new corporate centres up to full efficiency.

Given KME's poor track record of having revenue growth filter down to profits over the last few years the market was rightfully wary of the commentary for a stronger second half, though it is positive to see strong revenue growth which provides a good base to scale from.

Mitigating the risk that profit growth doesn't eventuate as planned is a cheap valuation with a market capitalisation of \$27m and KME generating \$2.5m in free cashflow last year.

Prophecy International (PRO) also had a mixed AGM. The negative was the headline annualised recurring revenue falling slightly on the previous quarter as some legacy revenue and licence contracts rolled off. The core subscription products revenue grew slightly at 4%, though still below trend. Ultimately, growth quarter to quarter can be lumpy and the outlook for long-term growth remained solid driven by new channel and re-seller partnerships established.

It wasn't all bad news however as management guided to the business returning to positive cash flow generation for both the half and the full year. After a year where costs escalated and revenue growth was outweighed by cost growth, it is pleasing to see they seem to be contained now and the business is back to generating cash again.

Like KME, an undemanding valuation provides the margin of safety for PRO, with a \$39m market capitalisation backed by \$10m in cash, \$20m in recurring revenue and sustainable positive cash flow.

Aerometrex (AMX) didn't provide a detailed trading update, though they did highlight they had seen an acceleration in the annualised recurring revenue of their MetroMap product which had previously suffered because of price discounting from peers. After a strong second half last year the business seems well placed to grow revenues strongly this year and should be well on the path to profitability.

Despite also providing no formal trading update, **Xref** (XF1) disappointed the market, myself included, when they guided to further cash burn this year that would likely result in them needing to extend and increase their debt facility. Fortunately, our position in the Fund remains small as the large balance sheet risk remains in place. I still believe the product and customer base that XF1 has built is worth multiples of their current \$22m market capitalisation, but it is not unlikely that shareholders could see significant dilution on the path to that value being realised.

While the outcome with RFT has been disappointing so far, it is pleasing to see most of our portfolio performing well into the new financial year, and more importantly seeing the market reward that performance. Being mindful of the risk of "cutting the flowers and watering the weeds", we have taken modest profits on some of those positions that have been rewarded by the market and are looking to allocate to those who are performing well but haven't received the same response yet.

As this will likely be my last correspondence before the new year, I would like to wish investors the best over the holidays. In many ways 2023 continued with the tough investing conditions of 2022, but the green shoots presenting themselves leave me optimistic for better times in 2024.

Thanks for your on-going support.

Luke Winchester (Portfolio Manager)

