SANDON CAPITAL

Lonsec Recommended

MONTHLY REPORT

Sandon Capital Activist Fund (SCAF)

Entry Price (Lead Units)	Exit Price (Lead Units)
$1.8599	$1.8487

FEBRUARY 2023

PERFORMANCE RESULTS

	1 month	1 year	3 years (p.a.)	5 years (p.a.)	Annualised since fund inception	Total Return since Fund inception
SCAF	-1.9%	-21.0%	5.0%	5.2%	9.3%	**232.1%**
S&P/ASX 200 Accum.	-2.4%	7.2%	7.9%	7.9%	8.2%	**188.3%**
Small Ordinaries Accum.	-3.7%	-8.0%	4.2%	3.6%	4.4%	**78.3%**
Cash	0.3%	1.4%	0.5%	1.0%	2.3%	**35.7%**

Note: Inception date is Sep 2009. Entry/Exit prices are for Lead Series Units. SCAF returns are net of all fees and expenses and are calculated for Lead Series units. Investors should refer to their personalized statements for performance of their investment.

FUND COMMENTARY

The Fund return for February 2023 was -1.9%, bringing total returns (net of all fees and expenses) since inception to the equivalent of 9.3% per annum. Cash levels ended the month at approximately 4%.

The largest contributors to performance were A2B Australia Ltd (A2B) (+1.4%) and Nuix Ltd (NXL) (+0.7%). Fleetwood Ltd (FWD) (-1.3%) was the largest detractor.

The end of February brought to a close the half year reporting season. The reports presented by most portfolio companies were either positive or where not, indicative that better times lie ahead. Only two companies disappointed, from both our expectations and in absolute terms.

Given the paucity of information we were able to communicate in December and January, and given the poor share price performance of many of our companies, we have provided more detailed commentary than usual regarding the half year results of the largest investment positions. We've sought to provide an overall view of each company, its prospects and our investment view, rather than a mechanical reporting of their half year results.

All commentary is for the six months ended 31 December 2022 and references to the prior period are for the six months to 31 December 2021, unless otherwise stated.

COG Financial Services Ltd (ASX:COG)

Share price	$1.43
Market Capitalisation	$276.5m
Net debt / (cash)[1]	($29.7m)
Dividend Yield	5.9%

Sources: Company reports, ASX announcements, Sandon Capital analysis

COG has two business segments – Finance Broking & Aggregation (FB&A) and Funds Management (FM). Put simply, it is a business that distributes financial products (FB&A), some of which it manufactures itself (FM). COG provides support services including technology, training, compliance and critically, product range, allowing brokers to focus on servicing clients and selling products. COG's growth over time has allowed it to become more attractive to brokers by offering a wider range of products at more attractive prices. FB&A distributes the financial products of other companies as well as COG's own financial products. The FM segment also allows it to provide funding to clients, thereby earning management fees on those funds, and brokerage on the products.

The overarching strategy is to grow both these segments organically and through acquisitions. Since 2015, it has acquired stakes in 21 businesses either directly or through subsidiaries and increased its stakes through 18 follow-on investments. COG estimates its network of finance brokers accounts for 21% market share of brokered asset finance lending to small- and medium-sized enterprises (SME) across the country. This market share represents a substantial distribution capacity, which becomes increasingly attractive to funders as it grows, the scale of which allows COG to obtain better terms and prices, which in turn benefit its clients. This in turn helps attract more brokers. We believe the "network effect" in COG's business is very powerful and the distribution footprint that it has built is almost impossible to replicate.

We think the value of this network can be seen in the financial performance since 2017, whence COG has grown revenues from $81 million to more than $320 million (or nearly 4 times). Profits after tax have grown from $3.6 million to $19.7 million (or nearly 5.5 times)[2]. Crucially, the share count has grown by less than 50%.

In our opinion, there remains considerable scope for COG to grow both its distribution and its product footprints. COG's underlying businesses are highly cash generative, allowing it to fund organic growth, make acquisitions and pay a large dividend. It also has a war chest of $38.8 million of unrestricted cash and a corporate acquisition facility with more than $20 million of funding available.

Fleetwood Ltd (ASX:FWD)

Share price	$1.23
Market Capitalisation	$116.0m
Net Debt/(Cash)	($39.9m)
Enterprise Value	$76.1m
Perth property value	$20.0m
EV adjusted for property	$62.1m

Sources: Company reports, ASX announcements, Sandon Capital analysis

FWD has three business units:

- Building Solutions is Australia's largest modular builder
- Community Solutions owns and manages accommodation facilities in Karratha and Port Hedland in WA
- RV Solutions supplies parts, accessories and services to the recreational vehicle market

FWD has been a poor performer for many years, and a new chairman and senior executive team have been overseeing a turnaround for the last 18 months. Turnarounds, like renovations, can deliver some unexpected problems and the

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[1] Proportionate share of unrestricted cash less drawn amount of corporate acquisition finance facility

[2] We've used figures full year figures to 30 June 2022 for purposes of comparison

Building Solutions business is no exception. Some of these problems were of the company's own doing, for example, former management taking on jobs outside of the company's core competencies, while others were outside of new management's control, for example, workforce shortages and raw material price increases.

Today, we believe the "unforced errors" (or own goals) are behind FWD. There have been widespread changes in the management team and a reorganisation of work processes. For example, a centralised tendering unit, which ensures consistency with corporate objectives, will ensure that projects won are focused on delivering profitability with acceptable risks rather than simply growing headline revenues. A more diverse pipeline of work, including more standardised, repeatable buildings, combined with a more disciplined approach to tendering should also yield more sustainable earnings. The half year report noted that while revenues will be lower as a result of applying such discipline, profitability is expected to improve.

Community Solutions, which includes the Searipple Accommodation Village in Karratha, reported subdued earnings in the December half, largely due to the timing of major client shutdowns – most were in the first half of last fiscal year and are expected to be in the second half of this fiscal year. The drivers of demand for accommodation at Searipple are twofold; (i) large scale maintenance, such as shutdowns of major resources projects and (ii) new projects, which require large numbers of contractors during construction. FWD has secured an important 5-year contract with Rio Tinto for maintenance workers, which we believe will help underpin positive earnings. Recent shorter-term contracts with Woodside and Yara Fertilisers will positively augment this baseload contract.

Construction of the Perdaman urea project, which has been beset with delays, remains a significant catalyst for Searipple. There are also other large scale solar and hydrogen projects slated within Searipple's catchment which will also require large blocks of worker accommodation during construction. Together, we think these augur well for Searipple's future occupancy and rates over the medium to longer term.

We believe FWD's turnaround is now well under way, although we don't expect a meaningful improvement in financial performance to be reflected until FY24. While we await these results, the company is well placed with net cash of nearly $40 million, excess land in Perth and an undemanding share price.

A2B Australia Ltd (ASX:A2B)

Share price	$1.32
Market Capitalisation	$160.0m
Net Debt/(Cash)	($14.6m)
Enterprise Value	$145.4m
Property value (after tax)	$65.0-73.0m
EV adjusted for property	$72.4-80.4m
FY23 EBITDA (company guidance)	~$18m
FY23 EV/EBITDA multiple	4.0x-4.5x

Sources: Company reports, ASX announcements, Sandon Capital analysis

A2B Australia Ltd (A2B) operates taxi networks and provides taxi payment services. Years of poor performance has seen major changes at Board and management level over the past 12 months. New executive chairman, Mr Mark Bayliss, announced a "Better before bigger" strategy in July 2022 leading to the closure of sub-scale "fintech" initiatives, a new property strategy and a focus on regaining taxi operators and drivers, which are the lifeblood of the business.

In our opinion, the December 2022 half year result showed the early signs of the successful implementation of the new strategy – taxi numbers and journeys are returning to pre-COVID levels, and taxi fares processed in December 2022 had reached the same level as December 2019. All these measures are important as they drive A2B's revenues. The business is once again profitable, generating cash and the outlook is bright due to the leveling of the playing field with ride share. A solid platform has been built for new Managing Director, Ms Daniela Fontana, and we look forward to her bringing to bear her demonstrated expertise in fleet management to A2B.

A2B property sales

In December 2022, A2B announced the sale of its smaller Sydney property, on Bourke Rd, for $19 million and the withdrawal from sale of the larger O'Riordan St property. The sale proceeds from Bourke Rd are expected to be used to pay down debt and provide cash for capital management initiatives expected to be announced at the full year result in August. While halting the sale process for O'Riordan St is disappointing, we support the decision as A2B is far from being a distressed vendor and we prefer a sale at fair value rather than transferring value to the purchaser. While A2B continues to own this property, its value should continue to compound over time.

We applaud the work undertaken by Mr Bayliss, the Board and all staff, as they have achieved an astounding turnaround in a short period of time. We believe the company is well on the way to achieving the "better" part of the "Better before bigger" strategy that was announced in July 2022.

Midway Ltd (ASX:MWY)

Share price	$0.95
Market Capitalisation	$83.0m
Net debt / (cash)	($7.1m)
Net (cash) due from plantation sale	($30.5m)
Enterprise Value	$45.4m

Sources: Company reports, ASX announcements, Sandon Capital analysis

MWY is one of Australia's largest wood fibre processors and exporters with mills in Geelong, Myamyn, Brisbane, Bell Bay and Melville Island. The company owns 19 hectares of land at Geelong Port and is developing an asset management business specialising in the management of forests and voluntary carbon offsets.

The turnaround strategy at MWY, implemented by MD/CEO Tony McKenna, has gained significant traction since his appointment in early 2022. The loss-making logistics business has been exited, the plantation assets and non-core parcels of land have been sold, and the Tasmanian wood fibre business has been expanded.

The fruits of the turnaround are yet to show in the financial accounts due to the adverse effects of currency hedges put in place by previous management. We estimate this has cost the company in excess of $30m over the last 18 months, including $10-11m in the December half alone. If not for the effects of the currency hedges, MWY would have generated EBITDA >$10m for the six months ended 31-Dec-22 (versus to the reported breakeven result). Importantly, the currency hedges have now rolled off, and Midway is receiving (approximately) spot currency for its US$ denominated woodchip exports. Other tailwinds that will significantly improve earnings in the short-to-medium term include increased woodchip volumes, higher woodchip yields and an 11% increase in woodchip prices from 1 January 2023.

Over the longer term, we believe the outlook is also bright given China's voracious appetite for virgin fibre and the inability of competitor woodchip suppliers such as Vietnam to meet this increasing demand. MWY also has a nascent asset management business which is cornerstoned by one of the world's largest insurers, Munich Re (MEAG). In addition to earning management fees for land/plantation services provided to MEAG, these plantations will also be valuable sources of timber for MWY's underutilised mill at Geelong. Furthermore, we expect an update on the company's grain strategy in the near future. Once implemented, this should assist in improving profitability at the Geelong operations by defraying a meaningful portion of the take-or-pay costs incurred at the port.

Following the recent initiatives put in place to close unprofitable operations, sell non-core assets and invest in growth initiatives, we believe MWY should sustainably generate annual free cash flow of $15-20m (vis-à-vis the current enterprise value of $45m). In addition to the proposed 19.5cps special dividend that MWY has flagged, we expect these strong cash flows to enable further capital management opportunities.

Global Data Centres (ASX:GDC)

Share price	$1.13
Market Capitalisation	$87.3m
Net debt / (cash)	$77.8m
Enterprise Value	$165.1m

Sources: Company reports, ASX announcements, Sandon Capital analysis

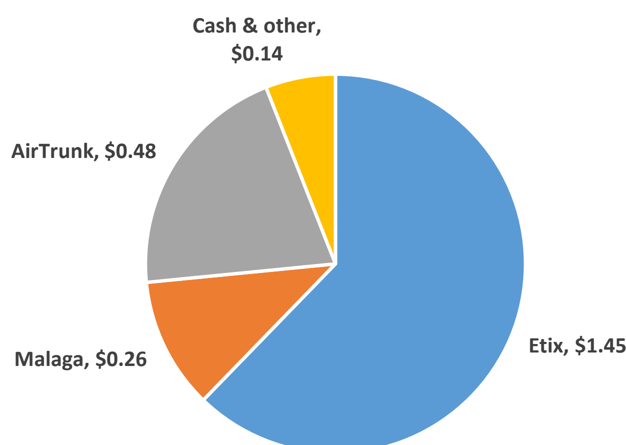
GDC owns a portfolio of data centres in Europe and the Asia Pacific region. The largest asset is a majority ownership stake in Etix Everywhere (Etix), an owner and operator of 10 edge (or regional) data centre businesses in France, Belgium, Colombia and Thailand. The company also owns the Malaga data centre in Perth which is contracted exclusively to Fujitsu, and has a stake of ~1% in AirTrunk, an owner and operator of hyperscale data centres in the Asia Pacific region.

Since listing in late 2019, GDC has actively grown the value of its portfolio through the judicious acquisition and disposal of assets. The last 6 months have been especially busy, with the company becoming the leading regional data centre player in France through the acquisition of two data centres in Lille for EUR56m. The growing value of Etix was validated by the recent investment in the business by Eurazeo Infrastructure Partners (Eurazeo), one of the largest private equity firms in Europe, with more than EUR32bn under management. Importantly, the investment by Eurazeo should allow Etix to expand its existing facilities and add greenfield capacity.

GDC reported fair value net asset value (NAV) of $2.32 per unit as at 31-Dec-22. The bulk of this value is made up by Etix, where the valuation was recently validated by the Eurazeo investment. We believe the investment in the Malaga data centre will be monetised at some point, freeing up capital to invest in higher growth and return opportunities in Etix. We also believe there is substantial upside in the AirTrunk valuation given the moderate increase in the carrying value since initial investment in September 2020.

In our opinion, a very strong foundation has been built at GDC and there are numerous organic and inorganic growth opportunities for the company to pursue, with the recent investment in Etix by Eurazeo providing the capital to take advantage of these opportunities.

Breakdown of GDC Fair Value NAV ($2.32/share)



Coventry Group Ltd (ASX:CYG)

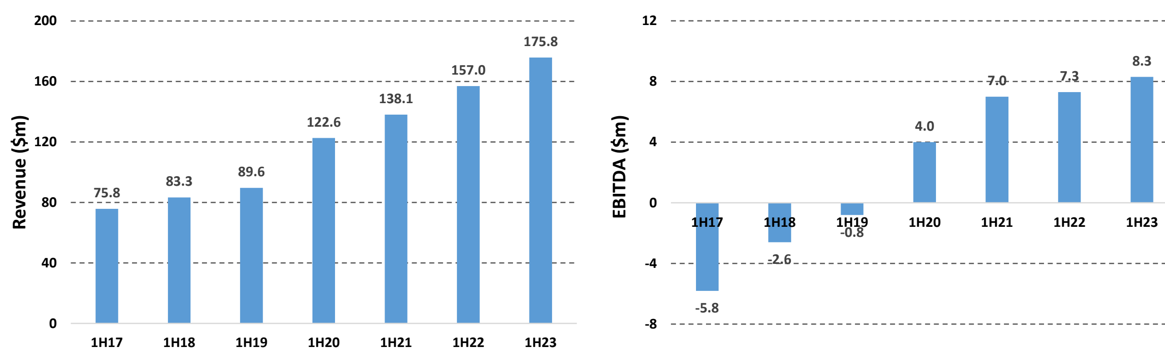
Share price	$1.05
Market Capitalisation	$96.0m
Net debt / (cash)	$34.8m
Enterprise Value	$130.8m

Sources: Company reports, ASX announcements, Sandon Capital analysis

CYG supplies industrial products and services to the mining, infrastructure, energy, manufacturing, construction, agriculture and defence industries through its 2 divisions:

- Trade Distribution, which distributes fasteners and other industrial products through a network of 48 branches in Australia and 17 branches in New Zealand
- Fluid Systems, which designs, manufactures, and supplies hydraulics, lubrication, fire suppression and refuelling systems and products through 15 branches in Australia

Following changes at Board and management level in 2017, CYG has successfully transitioned from operating losses to solid profitability. The management team have stemmed the market share losses that had been seen over the prior decade in Trade Distribution and the strong service mentality that has been pervasive in the New Zealand and Tasmanian (Nubco) businesses is now permeating the rest of the group. This has seen the company's revenues and earnings grow strongly, supported by its exposure to growing industrial sectors, with organic growth augmented by bolt-on acquisitions.



We believe that whilst the generation of free cash flow has lagged top line and profit growth, there has been significant improvement in this metric over the past 12 months. Through a sharp focus on managing working capital, CYG is now generating solid free cash flows, which we expect will be used to pay down debt over the next 12 months. As the company's gearing is currently above target levels, we expect acquisitions will be off the agenda for the foreseeable future. Despite this, organic growth remains strong, with the company pointing to continued double digit top line growth throughout the early part of CY23. With supply chain issues now starting to moderate, we expect this strong revenue growth will continue to translate to strong earnings growth.

Deterra Royalties Ltd (ASX:DRR)

Share price	$4.65
Market Capitalisation	$2,457.5m
Net debt / (cash)	($21.5m)
Enterprise Value	$2,436.1m
Dividend Yield	~6%

Sources: Company reports, ASX announcements, Sandon Capital analysis

DRR's main asset is a royalty over BHP's Mining Area C iron ore operations (MAC Royalty) in the Pilbara region of Western Australia. The company also has five smaller royalties.

In our opinion, the MAC Royalty is the best asset in the Australian mining sector. The royalty provides direct exposure to the revenues of iron ore production from Mining Area C without the typical risks that are inherent in mining assets. DRR does not have to concern itself with permitting, exploration, financing, capital expenditure, mine construction, operating costs, mine and equipment repair and maintenance, rehabilitation and all of the other risks that come with the ownership, development, operation and closure of mining operations. The company simply collects a royalty cheque from BHP Billiton each quarter that Mining Area C produces iron ore. The major risk for any royalty is counterparty risk, and in the case of BHP Billiton, the MAC royalty counterparty is the world's largest mining company and Mining Area C is one of the highest margin iron ore mines globally.

Since being demerged from Iluka (ASX:ILU) in late 2020, DRR has benefited from a robust iron ore price environment, enjoying strong payments from the MAC Royalty. In the last two years alone, DRR has received in excess of $450m in royalty and capacity payments from BHP, bringing total payments since inception of the royalty in 2003 to ~A$1.4bn. These royalty payments have been passed through to shareholders (after deduction of tax and corporate costs) as fully franked dividends on account of DRR's 100% dividend payout ratio. DRR shareholders have received ~60cps of dividends over the past two years, and strong dividends look set to continue as a result of a strong iron ore price and further capacity payments.

When the South Flank mine ramps up to full capacity in CY24, we expect total iron ore production in the MAC Royalty envelope to be ~145Mwmtpa. Assuming an iron ore price of US$80/t (vs ~US$125/t currently) and an A$/US$ rate of 0.70, DRR should receive annual royalty payments approaching $200m. After corporate costs and taxes, this will equate to annual fully franked dividends of ~25cps, equivalent to a yield of ~5.5% on the current share price. Whilst the company has stated it is ambitions to grow through acquiring additional royalties, we have little confidence that these ambitions will be fulfilled. In the meantime, we expect to continue to receive the strong cash flows and dividends from MAC Royalty.

BCI Minerals (ASX: BCI)

Share price	$0.265
Market Capitalisation	$319.6m
Net debt / (cash)	($101.0m)
Investments	($25.0m)
Enterprise Value	$193.6m

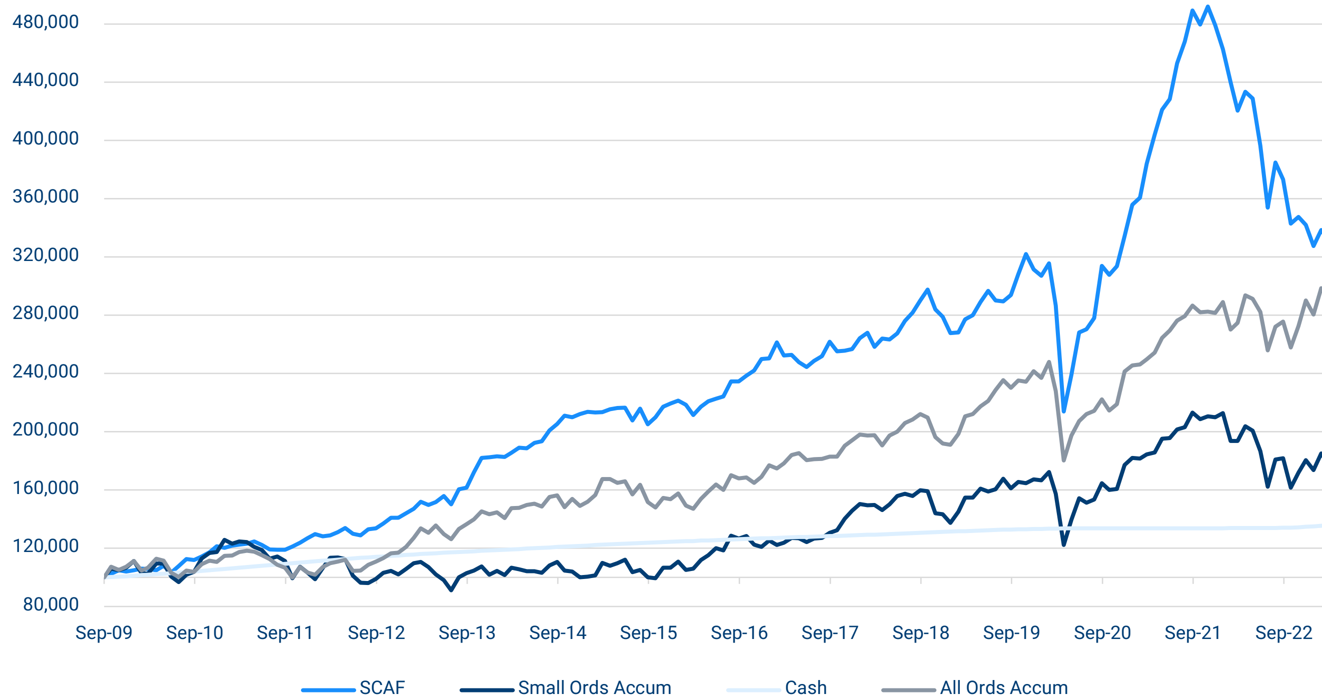
Sources: Company reports, ASX announcements, Sandon Capital analysis

BCI owns a royalty over the Iron Valley (IV) iron ore mine in Western Australia. The company is also developing the world class Mardi salt and potash project in Western Australia, having invested over $300m in the project to date. Mardi is a rare resources project that has an inexhaustible resource (seawater) and requires minimal capital expenditure once construction is complete and the project is in production.

The company has disclosed that the total cost of the Mardie Project is likely to materially exceed previous estimates and the construction schedule is likely to be extended. This did not come as a great surprise given the current inflationary environment for large project development in Western Australia. We expect an updated capital cost for Mardi to be detailed by April 2023, along with a funding solution for the increased expenditure, which may come from raising debt and/or equity and asset sales.

At steady state production (5.3Mtpa of salt and 140ktpa sulphate of potash), BCI estimates that the Mardi Project will generate ~$260m per annum of EBITDA. We believe this may be exceeded given the conservative salt and potash assumptions used in the feasibility study. We expect these commodity price assumptions and earnings potential to be refreshed with the upcoming capital cost update.

GROWTH OF INVESTMENT SINCE INCEPTION



PORTFOLIO EXPOSURES

Net Exposure	96%
Net Cash	4%
Long Positions	26
Short Positions	0

TOP 5 POSITIONS

COG Financial Services	19%
Fleetwood	11%
Coventry Group	8%
A2B	9%
BCI Minerals	7%

FUND DESCRIPTION

The objective of the Fund is to deliver returns to investors through a combination of capital growth and distributions. The Fund aims to achieve this objective by seeking to invest in opportunities that are considered by Sandon Capital to be trading below their intrinsic value and that offer the potential of being positively influenced by investors taking an active role in proposing changes in the areas of corporate governance, capital management, strategic and operational issues, management arrangements and other related activities. Neither returns nor capital are guaranteed.

FUND DETAILS

Structure	Wholesale unit trust
Trustee	One Fund Services Ltd
Custodian	One Investment Group
Fund Auditor	EY
Investment Manager	Sandon Capital Pty Ltd
Inception	4 Sep 2009
Minimum Investment	$250,000 (or as agreed with trustee)
Trustee/Admin Fees	0.21%
Management Fees	1.33%
Performance Fees	15.375% of returns above cash
High water Mark	Yes
Buy/Sell Spread	±0.30%
Applications/Withdrawals	Monthly/Quarterly

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