FORAGER

DECEMBER 2022 QUARTERLY REPORT

The case for small companies in 2023

FORAGER

CHIEF INVESTMENT OFFICER LETTER

QUARTERLY LETTER DECEMBER 2022

FORAGER FUNDS PERFORMANCE SUMMARY (as at 31 December 2022. Net of all fees and expenses)

	1 month return	3 month return	6 month return	1 year return	3 year return (p.a.)	5 year return (p.a.)	10 year return (p.a.)	Since inception* (p.a.)
Forager Australian Shares Fund	-3.87%	9.36%	16.69%	-24.54%	6.42%	0.07%	9.96%	9.19%
Forager International Shares Fund	-5.13%	2.47%	1.52%	-28.23%	4.48%	5.31%	-	10.62%

Past performance is not indicative of future performance and the value of your investments can rise or fall. Performance in FASF is calculated using Net Asset Value (NAV), not the market price.

*8 February 2013 for FISF and 30 October 2009 for FASF

THE CONSUMER, INFLATION AND SMALL CAPS: THREE BIG "WHAT IFS" FOR 2023

"But" is a dangerous word for investors. I know you can't pick the bottom of markets, Forager investors tell me, but I still don't want to invest until I am "sure" the worst is behind us. I know you can't predict markets, many fund managers say, but here are my prognostications anyway. Most forecasts are wrong, and the ones that are right are usually a result of the inevitable tail actually getting pinned on the donkey through random chance.

That doesn't mean the future isn't worth thinking about. If ever there was a year where macroeconomics mattered, it was 2022.

The S&P 500 index of US stocks had its seventh worst year on record, falling 18%. More unusually, bonds also performed horribly, with 10-year US government bonds suffering double-digit losses for only the second time since the 1920s. That made it one of the worst years on record for a diversified portfolio of stocks and bonds.

That was all thanks to inflation spiralling out of control and central banks around the world rapidly raising interest rates to contain the inflation threat. More specifically, we started 2022 with asset prices that assumed near-zero interest rates forever—an assumption that proved disastrously wrong.

That's the way I like to contemplate the future. Less trying to forecast with certainty. More trying to understand what current asset prices assume, and looking for risks and opportunities should those opportunities be wrong.

Frankly, as you can see in Forager's Fund returns for 2022, we have not turned the contemplation into appropriate portfolio settings. Despite giving some serious thought to Why Inflation Might Return in January of 2020, both portfolios have suffered as interest rates rose throughout 2022.

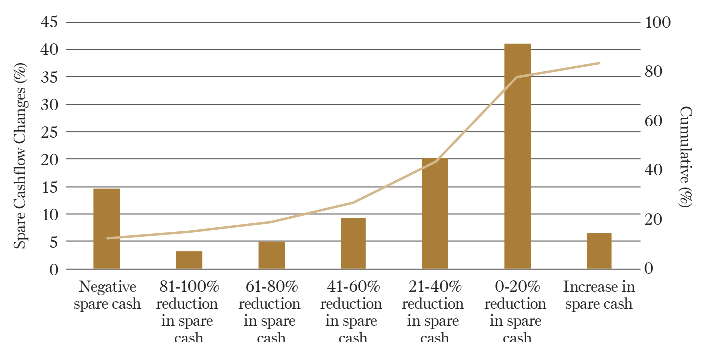
With the aim of doing better this time around, here are some thoughts on the key questions facing investors for 2023.

HOW BAD DOES IT GET FOR THE AUSTRALIAN CONSUMER?

Let's start with the Australian consumer. You don't get any points for pinning the tail on this donkey—2023 is clearly going to be tough. The Reserve Bank of Australia has raised interest rates by 3% since March this year and is expected to add another 0.5-1% to that by March 2023. Thanks to a proliferation of fixed-rate loans, significant amounts of prepayment through the pandemic and a lag for rates to be passed on to borrowers, most of the pain of these rate rises is yet to be felt. It will, though, through 2023 and 2024.

The RBA estimates that some 15% of variable rate mortgage holders do not have enough spare cash flow to absorb the hit. At an aggregate level, Australia's debt service ratio (the percentage of disposable income dedicated to servicing loans) will rise from approximately 13% to 18%, the highest level since 2008. On the flip side, the savings rate has already fallen from almost 20% of income during Covid lockdowns to 7% in September 2022. The day of reckoning can be delayed as those Covid savings get used up, but at some point the Australian consumer needs to curtail their spending.

SPARE CASHFLOW CHANGES FOR VARIABLE RATE OWNER OCCUPIERS



*Cash flow is estimated as income net of mortgage payments and essential living expenses; assumes interest rates rise by 350 basis points relative to April 2022 levels; wages and inflation evolve in line with August 2022 SMP forecasts.

Source: Reserve Bank of Australia

Share prices have fallen a long way for most companies selling to the Australian consumer. For the most part, though, I still look at the expectations and question whether they are low enough. Especially for the beneficiaries of the pandemic. JB Hi-Fi, for example, saw its profit margins (earnings before interest and taxes) jump from an average of 5.3% pre-COVID to 8.6% last financial year, mostly thanks to dramatically higher throughput. It trades at just nine times last year's earnings and is a wonderful business. That nine can become 15 fairly easily, though, as sales and margins contract.

It's a fair price, rather than a bargain. And that's true across most of the discretionary sector. There will (hopefully) come a time when investors are far more pessimistic.

WHAT IF INFLATION FALLS HARD?

Inflation is clearly going to be a big factor again in 2023. Despite the falls of 2022, asset prices today are consistent with interest rates of about 4% in Australia and the US. If they need to rise much further than that (roughly 1% of further increases), there is more downside for both equities and bonds. While it remains a debate with well-founded arguments on both sides, there are good opportunities for investors prepared to take the risk.

The Manheim Used Vehicle Value Index which tracks used car prices - the single most significant contributor to US consumer price inflation over the past year—has now fallen 16% from its peak in January. Oil and gasoline prices are down more than 30% since June, shipping costs have more than halved and lumber prices—after quadrupling through 2021—are now back to historical levels. Moreover, global food prices look like they are about to turn negative, a stark difference from the 20-40% year-on-year rises witnessed through 2021 and the first half of 2022. The price of wheat is now below where it was prior to Russia's invasion of Ukraine.

When the 2022 highs for these items are used as the base for inflation calculations in 2023, they will be meaningful negative contributors and headline inflation numbers will fall dramatically (and possibly be negative).

I, for one, hope zero rates are a thing of the past. It makes my job—finding cheap stocks—nigh on impossible and causes serious distortions in asset prices and misallocation of capital in the real economy.

And this could be a temporary reprieve, of course. Job markets remain extremely tight and wage inflation is a more intransient issue.

But it is worth thinking about a scenario where inflation becomes less of a problem. Maybe it was transient after all, just a much longer transit period than economists first thought. That would allow the RBA to nurse the consumer through a difficult adjustment period with a lot more care. More importantly for our portfolios, the share prices of many growing companies have been smashed on the prospect of higher and higher rates. If there are only a couple more rate rises to come, investor focus should shift to the resilient nature of these companies' revenues through what will be an inevitably difficult economic environment.

WHAT IF 2023 IS A GREAT YEAR FOR SMALL CAPS?

They say you should never ask a barber whether you need a hair cut. Well never ask a person who has a massive portfolio skew to small companies whether small company share prices are going to have a good year.

At least I am on the record making the opposite argument a few years ago. But let me make the argument anyway: what if 2023 is a great year for small caps?

That might seem counterintuitive. Everyone is telling you to buy defensive, resilient businesses, right?

Well, in and of itself, what everyone is telling you is often a good contrarian indicator. But global small-cap fund manager Global Alpha recently released research suggesting there is more to my question than a simple contrarian viewpoint.

First, dramatic underperformance during 2022 has led to starting relative valuations for US small companies that are the lowest since 1992. Here in Australia, the ASX Small Ordinaries Index was down 21% for 2022, versus an All Ordinaries Index that was down just 7%. For non-mining companies, the performance was even worse.

RELATIVE PERFORMANCE OF THE ASX SMALL ORDINARIES INDEX VS ASX ALL ORDINARIES INDEX

Source: Bloomberg

That leaves us with some undemanding valuations. And starting prices matter more than anything else.

Second, small companies tend to perform better in a recession than most investors anticipate. They can be nimble and agile and are often run by a founder or significant shareholder who has a strong incentive to make tough decisions early.

Third, acquisitions become far more attractively priced in an economic downturn and can be far more important for small companies than large ones. That is both for companies that are doing the acquiring and those that get bought. Our Forager Australian Shares Fund received takeover offers for five different companies in the second half of 2022, out of a portfolio of just 30 stocks.

The combination of low expectations embedded in share prices and companies performing much better than anticipated through recessions has, surprisingly, led to small cap outperformance through recessions.

Global Alpha's research was US-centric but showed that, historically, small caps have started outperforming large caps from the time a recession hits, not just once it is over.

In the US, small caps were the best-performing asset class for the five years post the 1973/4 market meltdown, through a recession and a decade of high inflation.

LOWER PRICES EQUAL BETTER RETURNS

It has been a wild start to the 2020s and 2023 can deliver plenty more unexpected twists and turns. My grandmother always tells me the secret to happiness is low expectations, though. The good news is that expectations are a lot lower today than they were just 12 months ago.

Kind regards,

Steven Johnson
Chief Investment Officer

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FORAGER

INTERNATIONAL SHARES FUND

MONTHLY REPORT DECEMBER 2022

FORAGER INTERNATIONAL SHARES FUND PERFORMANCE SUMMARY (as at 31 December 2022. Net of all fees and expenses)

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International Shares Fund	-5.13%	2.47%	1.52%	-28.23%	4.48%	5.31%	10.62%
MSCI AC World Net Index in $A	-5.04%	4.14%	3.99%	-12.52%	5.15%	8.00%	12.15%

MSCI AC World Net Index in $A is an abbreviation of MSCI All Country World Investable Market Index (Net) in Australian dollars. Past performance is not indicative of future performance and the value of your investments can rise or fall.

*8 February 2013

The 2022 calendar year was a shocker for financial markets, and worse for the Forager International Shares Fund. The Fund's net asset value fell 28% for the year, only the second negative year in its 10-year history and the largest loss by some margin. That was with some help from a depreciating Australian dollar.

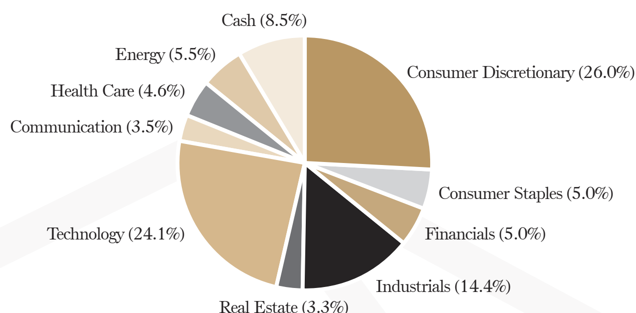
As explained in recent monthly and quarterly reports, we have been concentrating the portfolio on those businesses performing well and reducing the overall number of investments. Recent months have also seen the addition of two new investments to the portfolio, both of which are introduced below.

YETI—NOT SO ABOMINABLE

Yeti Holdings (NYSE:YETI) is a smaller cap business that had a tough 2022. But fortunately we didn't own it until November when it became a new addition to the portfolio.

US-listed outdoor lifestyle brand Yeti specialises in designing and distributing premium coolers and insulated drinkware, with opportunities to expand into other adjacent product categories. Yeti products were originally designed for rugged outdoorsmen and have a reputation for being "nearly indestructible". Brand recognition has expanded to reach the masses in the United States (Yeti's major market) and key international markets like Australia and Canada.

STOCK EXPOSURE BY SECTOR



Source: S&P Capital IQ

Consumers rave about the utility and quality of products and they've become a status symbol, in the US especially. It's not unheard of for people to own four or five products from Yeti's drinkware category. Yeti distributes its products direct-to-consumer, through its branded website, 12 retail stores and via wholesale partners. Your local MacPac or BCF store likely stocks its products.

Yeti's share price is down 50% this year as investors are (rightly) concerned about consumer discretionary spending and a potential COVID unwind. But there is a secular story here that should overwhelm it. The company's third-quarter results showed that demand for Yeti products remains strong, easing investor concerns that COVID pulled forward demand excessively. Less than 10% of its sales are currently generated from consumers outside the US. Other premium brands like **Lululemon** (NASDAQ:LULU) and **Nike** (NYSE:NKE) generate 30-60% of revenue from international consumers. This provides a long runway of growth for Yeti ahead.

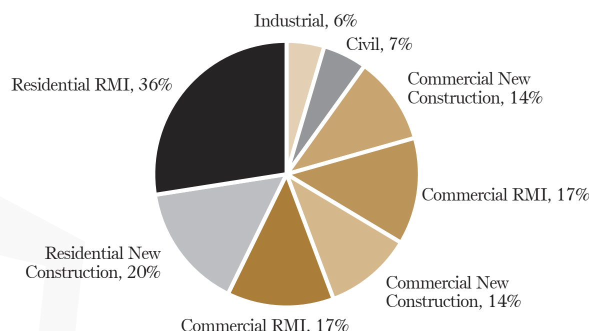
The stock is currently trading at less than 15 times 2023's expected earnings, a very reasonable price for a high-quality business that has compounded revenues at 40% per year over the past eight years. We expect growth to continue, though at a lower rate, for some time.

TOO MUCH WORRY ABOUT FERGUSON

While small cap stocks remain a focus, we've also made an investment in a much larger business recently. **Ferguson** (NYSE:FERG) is a distributor of products to trade customers in the US. **Reece** (ASX:REH) is probably the closest Australian equivalent. But such analogy doesn't capture the scope of products and breadth of customers served by Ferguson, in the building, plumbing, heating, ventilation and air-conditioning (HVAC), non-residential construction and water infrastructure businesses, among others.

Middleman businesses are most entrenched when they allow a large number of suppliers (Ferguson has more than 30 thousand) to offer an immense range of individual stock keeping units (more than a million) to an even more diffuse group of customers (also more than 1 million). They're most profitable when the customer is focused not just on price competitiveness but other factors. In this case speed, availability and delivery (nearly 80% of product is delivered straight to construction sites rather than collected in store) are all crucial to making customers' lives easier and more efficient.

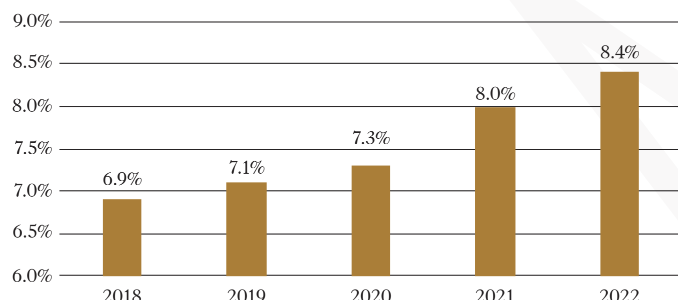
FERGUSON 2021 REVENUE SPLIT



Source: Company Data, Barclays Research

It is the US market leader in four important segments, including residential repair, maintenance and improvement (RMI) and waterworks (water and sewerage infrastructure). It's the number two or three player in a few more categories, such as residential trade (just behind **Home Depot** (NYSE:HD)) and HVAC. Each of these segments has 2-4 large players that collectively control a surprisingly small chunk of the overall pie, with what Americans call mom-and-pop shops still dominant. That's slowly shifting. Ferguson has been a beneficiary via organic market share gains and highly accretive acquisitions.

ESTIMATE OF FERGUSON'S BLENDED MARKET SHARE



Source: Company Data, Barclays Research

Ferguson is clearly a good business that generates high return on equity. But why is the stock undervalued, trading at around 14 times forecast earnings? Anything with a link to the US housing market has come under scrutiny over 2022. We have a retort, of course. While 56% of sales is residential housing-related, only 20% of total sales is linked to newbuild with the remainder focused on repair, remodelling and improvement (which historically holds up better in downturns). The rest of the business is non-residential, which moves in different cycles.

Another likely explanation for why Ferguson has traded at a discount to peers is that the stock is something of a geographic orphan. Its roots are in the UK and Europe, but it's divested all of its businesses there over the past decade. Listed in both the UK and US, until recently the UK was its main exchange. That's changing and the stock is in the process of clearing various hurdles for inclusion in important US indices including, ultimately, the S&P 500. Many US investors, passive and active, have until recently been unable to invest. That won't be the case much longer. In the meantime, we own a high quality business acquired at a sensible price.

THE CASE FOR CONTRARIAN IN 2023

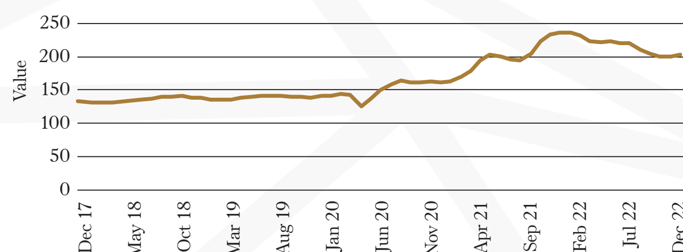
While many investors are seeking the safety of "quality" companies, it is clear to us the potential rewards for investing in small and cyclical companies is currently excellent. Our CIO letter outlined the potential for small cap outperformance as a result.

The Forager International Shares Fund owns numerous smaller businesses navigating difficult external demand environments. We're leaning into the wind and waiting for the turn.

Open Lending (NASDAQ:LPRO) is one such investment. This company helps facilitate loans between its lender partners (largely credit unions, which continue to take share in the auto financing industry) and so-called "near-prime" consumers that are purchasing vehicles. The company matches the lenders with insurance providers during a transaction and Open Lending itself takes no direct balance sheet risk. This is a very high margin business with great free cash flow generation and a strong balance sheet. The company announced a $75m buyback in November, which represents almost 10% of its current market capitalisation.

But its share price is down 70% over the past year, driven by investor concerns surrounding the potential for used car prices to fall from unprecedented recent highs, a tougher consumer backdrop and rising interest rates.

MANHEIM USED VEHICLE VALUE INDEX



Source: Bloomberg

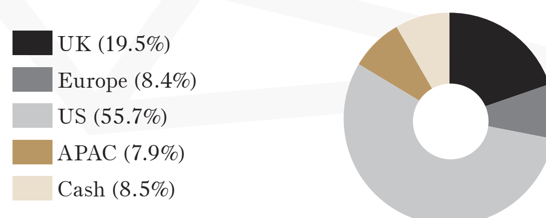
Approximately two-thirds of the customers that source their loans via Open Lending have FICO credit scores of 600 and above, a category that has so far held up well when it comes to auto loan defaults and tends to be more resilient through tougher economic environments. That loan book quality makes it quite different from other subprime focused lenders, where FICO scores are typically less than 550.

Although Open Lending was much smaller during the 2008/9 financial crisis, when overall auto loan defaults ended up at extremely high levels, the business remained profitable throughout that period.

We feel the company is a structural grower facing cyclical headwinds, while being priced like it will never grow. As production volumes of new cars normalise and used-car prices settle down, some of the headwinds Open Lending has been facing should abate. Obviously, high interest rates will continue to pressure end customers for some time. But the long term story here remains attractive relative to the company's current valuation.

It's not just small caps where sentiment is extreme. In our October report, you could probably sense our frustration with the Fund's **Meta** (NASDAQ:META) investment. We weren't alone. In the days after its third quarter result (and our report), selling of the shares became indiscriminate.

STOCK EXPOSURE BY GEOGRAPHY



Our original investment was a mistake. We don't have an edge analysing this global giant, and it failed to provide the thing we need most from large cap investments—resilience. Add Mark Zuckerberg doubling down on his speculative metaverse bets, our inclination was to move on.

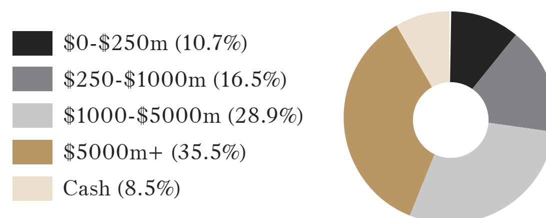
One thing we do have an edge in is going against the herd. And one thing we know how to recognise is investor capitulation and indiscriminate selling. The signs here were obvious.

The company's market capitalisation fell more than $100bn in just a few days. It was trading at just nine times earnings, and that's after the expenses from Zuck's big bets. The narrative—he's going to waste all of the company's profits—is impossible to refute. No Fund manager wants to admit they own it. But nine times earnings for the owner of Facebook and Instagram?

After some late night soul searching, the whole Forager International team turned up to the office having reached the same conclusion: this is not the time to be selling. Instead we added—at $92 a share.

We weren't contrarian enough at the market highs of 2021. We won't be making the same mistake amidst the pessimism of 2023.

PORTFOLIO DISTRIBUTION ACCORDING TO MARKET CAPITALISATION



TOP 5 HOLDINGS (as % of NAV)

Flutter Entertainment Plc	**(LSE:FLTR)**	4.9%
Blancco Technology Group Plc	**(LON:BLTG)**	4.2%
Linamar Corp	**(TSE:LNR)**	3.9%
Meta Platforms Inc	**(NASDAQ:META)**	3.5%
Janus International Group Inc	**(NYSE:JBI)**	3.4%
Cash		8.5%

FUND OBJECTIVE

The Fund is an international equities fund, targeting undervalued securities on the world's stock markets. The Fund's investment objective is to outperform the MSCI All Country World Investable Market Index (Net) in Australian Dollars (MSCI AC World Net Index in $A) over a rolling 5-year period. The Fund's goal is to produce superior long-term returns from a portfolio of 20–40 businesses, irrespective of short-term share price movements^.

FUND PERFORMANCE BY MONTH AND FINANCIAL YEAR

FY	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Total Return
2013								-0.26%	-0.62%	2.88%	8.74%	3.47%	**14.73%**
2014	3.61%	1.11%	-1.26%	4.59%	6.58%	2.82%	1.40%	1.92%	-4.64%	1.85%	1.46%	-0.16%	**20.54%**
2015	-1.81%	-0.82%	1.47%	-2.93%	2.43%	3.63%	1.33%	3.59%	1.47%	2.84%	4.54%	-2.17%	**14.06%**
2016	5.61%	-0.29%	-2.07%	2.55%	-3.19%	-2.74%	-5.08%	3.36%	0.09%	3.64%	5.84%	-6.36%	**0.44%**
2017	4.55%	3.84%	1.91%	0.52%	4.65%	5.55%	-0.63%	-0.13%	2.25%	4.97%	1.69%	-4.25%	**27.42%**
2018	-0.76%	-0.43%	3.99%	2.31%	1.62%	-2.76%	0.97%	-1.78%	-1.22%	4.64%	0.97%	1.21%	**8.81%**
2019	-0.55%	1.50%	2.22%	-6.62%	-5.49%	-3.66%	5.11%	5.19%	-4.03%	4.79%	-2.68%	1.85%	**-3.31%**
2020	0.07%	-1.92%	3.09%	0.95%	4.83%	4.73%	3.62%	-6.03%	-15.53%	9.78%	12.60%	-0.22%	**13.74%**
2021	1.36%	10.05%	1.63%	2.36%	10.85%	5.98%	2.07%	6.56%	2.20%	8.05%	1.41%	7.75%	**78.88%**
2022	-4.25%	-0.03%	-3.57%	-1.79%	1.27%	-4.61%	-6.24%	-6.32%	-7.29%	-6.24%	-1.50%	-5.98%	**-38.09%**
2023	4.46%	0.80%	-5.91%	8.57%	-0.52%	-5.13%							**1.52%**

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FACTS

Fund inception	8 February 2013
Minimum investment	$20,000
Monthly investment	Min. $200/mth
Distribution	Annual, 30 June
Applications/Redemption	Weekly

UNIT PRICE SUMMARY

As at	31 December 2022
Buy Price	$1.3285
Redemption Price	$1.3231
Mid Price	$1.3258
Portfolio Value	$175.7 million

The Fund is forward-priced; you will receive the price struck subsequent to the receipt of your application/redemption.

ABOUT FORAGER

With approximately $330 million of funds under management and a focus on long-term investing, Forager Funds is a unique Australian asset management company.

Following a strong ten-year track record, Forager is a sustainable business but is nimble enough to invest in smaller listed companies not accessible to many investment managers.

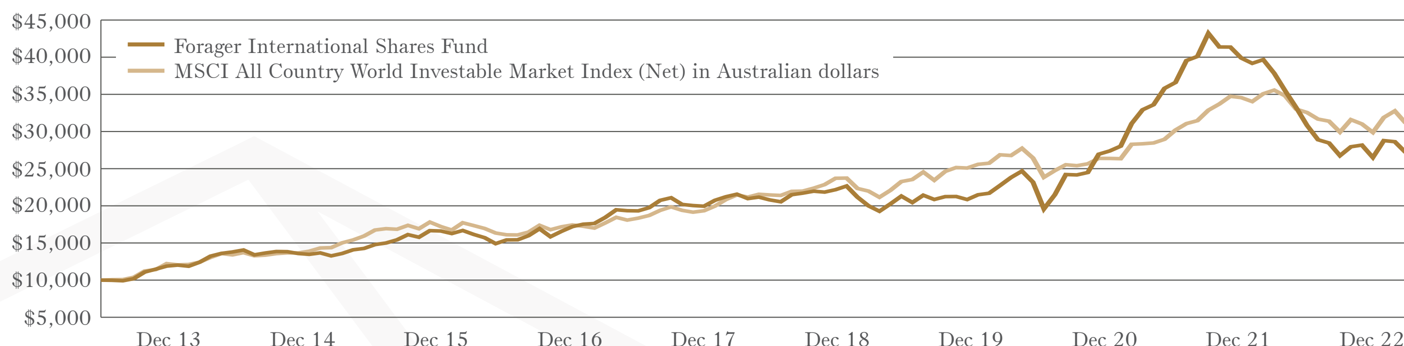
The company is majority owned by staff. Forager's shareholders support the desire to place performance before revenue. That means capping the size of funds before too much money becomes an impediment to performance.

Key investment staff are strongly aligned with investors through co-investment and / or equity in the Forager business.

FUND CHARACTERISTICS

- Concentrated portfolio of global equities
- A combination of large liquid resilient businesses with smaller value based opportunities
- Flexible mandate allows for a wide range of markets
- Investment team with deep pockets of expertise
- Strong focus on managing portfolio risks
- Weekly applications and redemptions

COMPARISON OF $10,000 INVESTMENT OVER TIME



Source (MSCI AC World Net Index in $A): S&P Capital IQ. The above figures assume that all distributions have been reinvested. Past performance is not indicative of future performance.

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AUSTRALIAN SHARES FUND

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	1 month return	3 month return	6 month return	1 year return	3 year return (p.a.)	5 year return (p.a.)	10 year return (p.a.)	Since inception* (p.a.)
Australian Shares Fund (ASX:FOR)	-3.87%	9.36%	16.69%	-24.54%	6.42%	0.07%	9.96%	9.19%
All Ordinaries Accumulation Index	-3.30%	8.77%	9.65%	-2.96%	5.79%	7.22%	9.15%	7.73%

The value of your investments can rise or fall. Performance is calculated using Net Asset Value (NAV), not the market price. Past performance is not indicative of future performance.

*30 October 2009

In December the Forager Australian Shares Fund net asset value declined 3.9%, against a fall of 3.3% for the All Ordinaries Accumulation Index. Since the June nadir, the market has bounced 9.7%, while the Fund has recovered 16.7%. While 2022 was still a horrible year for overall fund performance, the second-half recovery was thanks to takeovers and profit upgrades rather than any market-wide factors. Small caps continued to underperform.

As outlined in our CIO letter, there are reasons to expect better relative performance from the smaller end of the market in 2023. Either way, low valuations and good operational performance are a recipe for strong returns. There was some of both in December.

TAKEOVER TIME

The Fund's performance was buoyed by takeover activity over the past six months. In total six businesses were either acquired, have a high likelihood of being acquired, or have been dealing with takeover bids. The long-running saga of comparison site **iSelect** (ISU) ended in December with a takeover by its largest shareholder and competitor approved by shareholders, and its shares delisted from the ASX.

The battle for PDF software and e-signing company **Nitro** (NTO) heated up, with two private equity groups competing to acquire the business. The current highest bid of $2.15 per share is due to be put to shareholders in February, but more and higher bids are possible.

FORAGER AUSTRALIAN SHARES FUND TAKEOVER ACTION

COMPANY	LATEST BID	STATUS
iSelect	$0.30	Closed
MSL Solutions	$0.30	Shareholder vote early 2023
Nitro Software	$2.15	Shareholder vote February 2023
Readytech	$4.60	Bid withdrawn
Bigtincan	$0.80	Highly conditional bid
Apollo Tourism and Leisure	One THL share for every 3.21 ATL shares	Closed

Two other investments have found themselves in more complicated bidding situations. A bid for education, payroll and government software provider **Readytech** (RDY) was unpopular with the company's second-largest shareholder. In December, the approach was withdrawn. Readytech confirmed recent guidance of strong organic growth for the current financial year and management can get on with running this very prospective business.

Sales enablement software company **Bigtincan** (BTH) announced an approach from its largest shareholder, US hedge fund SQN, in December at $0.80 per share. While contemplating the conditional bid, Bigtincan proceeded with a capital raising of its own at $0.60 per share to fund acquisitions.

SQN's bid doesn't look particularly compelling—its leaked communication with the board seemed to suggest it is as interested in buying the company as selling it. And we think this business would be particularly attractive to a corporate acquirer in 12-18 months' time.

But raising money at $0.60 per share is a horrible look with or without an $0.80 bid on the table. We have made our dissatisfaction known and will be watching the acquisitions closely. They need to be good to justify such a bizarre sequence of events.

A GLOBAL TOURISM BUSINESS

The merger between **Tourism Holdings** (THL) and Apollo Tourism and Leisure completed in December and the combined entity is now trading on both the ASX and NZX. Having exchanged our Apollo shares for THL shares, THL is now the largest investment in the Fund.

The combined recreational vehicle business now stretches across the globe, with operations in Australia, New Zealand, the US, Canada, the UK and continental Europe. The group has NZ$1.1bn of assets on its balance sheet and now has a market capitalisation of NZ$745m. It dominates in the antipodes and has strong positions in North American markets.

THL can now take advantage of scale across the three components of the RV ecosystem: build/buy, rent and sell. Factories in Australia and NZ will produce RVs for rental operations while the combined entity has greater scale when buying from suppliers. The more streamlined network of rental depots allows for more efficient rentals and returns. And selling ex-rental RVs through owned dealerships improves sales margins. In total, the synergies from the transaction are estimated at between NZ$27 and NZ$31m, to be realised by the 2025 financial year.

Before COVID decimated tourism, THL had sensible aspirations for NZ$50m of net profit. Apollo's most recent guidance was for at least $20m of net profit, similar to undisrupted pre-COVID levels. And synergies, after tax, are due to contribute an extra NZ$20m. Upside exists through recent small acquisitions, higher yields and more

synergies out of the North American operations.

By the time international travel fully recovers and the scale benefits are fully realised in 2025, THL should earn upwards of NZ$90m of net profit. At the current market price, that would be an attractive nine times after-tax earnings. With more investors becoming aware of the business, it shouldn't stay that cheap for long.

GENTRACK TURNS THE CORNER

That wasn't the only world-beating New Zealand-based business to provide some positive news. **Gentrack** (GTK), a provider of software to utilities and airports, reported earnings for the 2022 financial year and saw its share price rocket more than 52% between late November and the end of the year.

Gentrack's airport segment has had to contend with the COVID-induced passenger slump over the last few years. But, as with Tourism Holdings, things are looking brighter. Traffic in key geographies is already at more than 85% of 2019 levels. And airports have started spending again with new customers and expansions of existing customers secured during 2022. The company forecasts its airports business to grow a solid 15% p.a. for the next five years at healthy margins. The airport software business is relatively small and unrelated to the utilities business. It should fetch a healthy price should the company decide to sell it and focus on the main game.

The main game is looking particularly prospective. Gentrack has suffered from the collapse of several of its UK utilities clients over the past few years. The last of those, Bulb, will wind down its contribution in the 2023 financial year. Gentrack, though, has been winning plenty of work elsewhere. The recurring component of those new wins will more than offset $13m of lost revenue from collapsed UK energy clients in 2023. In total, the company's utilities segment should grow modestly over the next two years, but growth outside of collapsed clients could top 20%. This sets the business up well to deliver on its "high teens" percentage growth rates in the longer term.

GENTRACK SHARE PRICE

Source: Bloomberg

While the utilities industry is notoriously slow to embrace change, a transition from legacy systems to cloud-based software is underway and accelerating. Our industry research indicates Gentrack's software is industry-leading, which explains the recent client wins and suggests it should win more than its fair share of work in future too.

This business has been around for a long time and was once an investor favourite. The past few years have been difficult, with large clients going bust and the significant investment required in its software offering. Recent results and the outlook suggest it is on the path to becoming a favourite again.

UPGRADES IN UNLIKELY PLACES

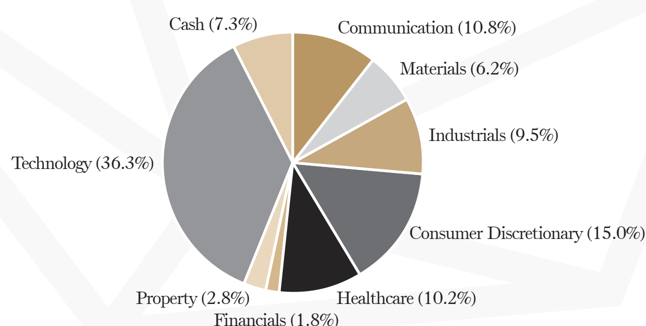
One of the rarer things to see is a profit upgrade from a mining services company. So it was to the market's great surprise that **Perenti** (PRN) produced two upgrades in the space of just five weeks. The first 14% profit upgrade was partly attributed to better contract performance and partly to a weaker Australian dollar. The second 8% upgrade stemmed from retrospective rate adjustments and new contract wins.

The company has painted a rosy long-term picture. By the 2025 financial year, management plans to increase profit margins to 10% and return on capital to 20%. While last year ended with margins of 7.2%, new 2023 guidance has that closer to 8.6% on higher revenue. The market's confidence in longer-term targets has increased and the stock has more than doubled from a low of $0.56 in July to $1.32. The business still trades on eight times next year's earnings.

This sharply contrasts with the Fund's long-term investment in **Macmahon** (MAH), which continues to trade at its July lows. The company gave a surprisingly wide range of profit guidance for this year. It needs to deliver closer to the top end to justify the amount of capital invested in recent years and, just prior to Christmas, announced a dispute with a client that might explain the difference.

While that's more like the mining services we know, the gap with Perenti looks unjustified. Macmahon is making good progress on recruiting staff for secured projects, won a 7-year $1.1bn contract with a major lithium producer and continues working on an extension to its largest project. Macmahon now trades at just four times next year's expected earnings but there is little investor tolerance for a slip-up.

STOCK EXPOSURE BY SECTOR



Source: S&P Capital IQ

DISTRIBUTION AND REINVESTMENT

Forager Australian Shares Fund units now trade ex the entitlement to the interim distribution. The cash will be paid on 17 January and investors are encouraged to ensure your bank account details are up to date.

In conjunction with the Responsible Entity, we made the difficult decision to suspend the Distribution Reinvestment Plan due to FOR units trading at a large discount to the net asset value in recent months. We know many investors want to compound their wealth by reinvesting distributions and would prefer to make that as simple as possible. However, issuing new units at a large discount to NAV is anathema to our philosophy.

A decision will be made about the July distribution in June 2023. For those who want to reinvest their interim distribution themselves, you can always buy units on market and achieve exactly the same outcome. Units are, in our opinion, available at a particularly attractive price.

PORTFOLIO DISTRIBUTION ACCORDING TO MARKET CAPITALISATION

TOP 5 HOLDINGS (as % of NAV)		
Tourism Holdings Ltd	**(NZE:THL)**	7.7%
RPMGlobal Holdings Limited	**(ASX:RUL)**	7.0%
Bigtincan Holdings Limited	**(ASX:BTH)**	5.7%
Readytech Holdings	**(ASX:RDY)**	5.3%
Gentrack Group Limited	**(ASX:GTK)**	5.0%
Cash		7.3%

FUND OBJECTIVE

The Fund targets securities that Forager believes are undervalued and invests predominately in securities listed on the ASX. Its investment objective is to outperform the All Ordinaries Accumulation Index over a rolling 5-year period and its goal is to produce superior long-term returns from a select number of underlying investments, irrespective of short-term price movements^.

The portfolio has historically generally held 15 to 25 securities but in recent times the number of investments has increased to around 35 securities. This has reflected the fact that the Fund has grown, the investment team has grown and the Manager has enhanced the portfolio liquidity requirements as a result. We expect that the portfolio will remain relatively concentrated and the number of portfolio investments will generally be in the 15 to 50 range.

FUND PERFORMANCE BY MONTH AND FINANCIAL YEAR

FY	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Total Return
2010					-0.69%	2.52%	-1.66%	0.08%	-0.34%	4.60%	-4.27%	-4.40%	**-4.41%**
2011	4.97%	-2.40%	-2.80%	-1.54%	3.12%	6.59%	1.58%	0.47%	-1.49%	3.40%	-5.39%	-0.82%	**5.12%**
2012	-1.00%	-2.61%	-7.20%	9.89%	-0.02%	-4.62%	1.53%	8.90%	5.02%	2.17%	-0.51%	-2.64%	**7.76%**
2013	8.70%	0.44%	2.83%	-3.07%	4.57%	0.33%	5.83%	4.86%	4.51%	1.41%	2.65%	-0.69%	**36.87%**
2014	10.45%	1.13%	4.77%	2.50%	-0.11%	0.38%	1.05%	0.48%	-1.28%	-3.44%	1.28%	-0.15%	**17.73%**
2015	6.70%	2.56%	-1.23%	-2.06%	-0.21%	-1.15%	0.94%	3.38%	4.87%	-2.42%	3.13%	-2.34%	**12.31%**
2016	7.94%	-4.46%	-1.38%	12.87%	-2.97%	0.22%	-1.33%	2.70%	4.40%	2.48%	1.51%	-3.91%	**18.06%**
2017	6.99%	3.25%	4.50%	-1.99%	-4.65%	1.76%	7.20%	1.29%	1.60%	1.16%	1.16%	1.00%	**25.16%**
2018	2.32%	-0.95%	2.69%	0.95%	0.21%	4.06%	-0.57%	-3.18%	-2.64%	2.77%	-0.97%	1.91%	**6.50%**
2019	-0.62%	-1.90%	-2.19%	-6.16%	-3.78%	-3.68%	0.98%	4.46%	-0.95%	-2.02%	-3.97%	-1.46%	**-19.66%**
2020	6.67%	-1.09%	4.38%	1.54%	-3.22%	-1.50%	2.46%	-10.97%	-39.71%	20.57%	18.04%	-2.16%	**-18.36%**
2021	3.70%	18.80%	2.00%	7.79%	13.22%	3.56%	-3.05%	4.07%	1.21%	13.23%	0.26%	1.62%	**87.09%**
2022	5.01%	2.58%	0.45%	1.57%	-1.35%	2.81%	-7.55%	-7.48%	2.86%	-7.29%	-9.60%	-12.30%	**-27.91%**
2023	12.28%	1.67%	-6.53%	7.58%	5.75%	-3.87%							**16.69%**

Past performance is not indicative of future performance and the value of your investments can rise or fall. Performance is calculated using Net Asset Value (NAV), not the market price.

FACTS

Fund inception	30 October 2009
ASX Code	FOR
Distribution	Annual, 30 June

UNIT PRICE SUMMARY

As at	31 December 2022
NAV (ex price)	$1.45
Distribution	$0.03
Market Price	$1.36
Portfolio Value	$152.5 million

ABOUT FORAGER

With approximately $330 million of funds under management and a focus on long-term investing, Forager Funds is a unique Australian asset management company.

Following a strong ten-year track record, Forager is a sustainable business but is nimble enough to invest in smaller listed companies not accessible to many investment managers.

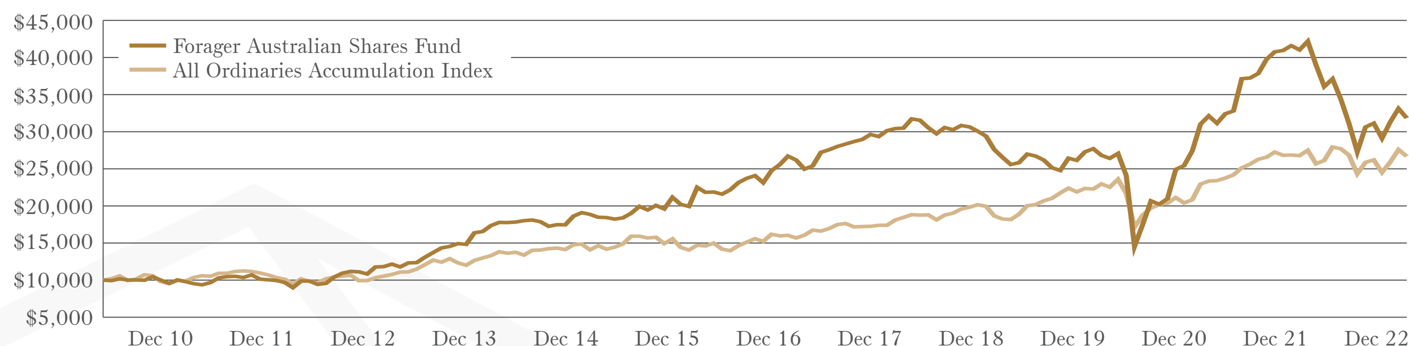
The company is majority owned by staff. Forager's shareholders support the desire to place performance before revenue. That means capping the size of funds before too much money becomes an impediment to performance.

Key investment staff are strongly aligned with investors through co-investment and / or equity in the Forager business.

FUND CHARACTERISTICS

- Concentrated portfolio of ASX-listed stocks
- Long track record in identifying unloved gems
- Restricted fund size allows investment in smaller businesses
- Strong focus on managing portfolio risks
- Listed on ASX as a Listed Investment Trust (LIT)
- Structure offers Forager flexibility in distressed markets

COMPARISON OF $10,000 INVESTMENT OVER TIME



Source (All Ords): S&P Capital IQ. The above figures assume that all distributions have been reinvested. Performance is calculated using Net Asset Value (NAV), not the market price. Past performance is not indicative of future performance.

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