

# MICROCAPS RISE TO THE CHALLENGE



*Despite the challenges faced by consumers, microcap companies that can thrive irrespective of broader economic conditions offer exciting potential for outsized returns in the period ahead. By Joel Fleming, Microcaps Portfolio Manager*

## Recovery to opportunity: Microcaps to benefit from shifting economic winds

2024 saw a shift in performance for microcap companies after two consecutive years of challenging conditions. The S&P/ASX Emerging Companies Index has returned an impressive 27.88% (to 31 October). However, on a 3-year CAGR basis the index is still recovering, with a -2.40% p.a. return compared to +9.25% p.a. from the ASX 50.

Microcaps are inherently inefficient, with this inefficiency exacerbated by poor market sentiment and lack of interest under a backdrop of continued uncertainty. Nonetheless, we have remained focused on investing in companies capturing market share and demonstrating tangible progress in their fundamental business metrics. Often flying under the radar from the broader market, we have seen increased M&A interest return amongst these growing small and nimble businesses. In light of the more benign economic outlook, large cap peers have continued to use this space as a fertile hunting ground, with increased private equity activity reinforcing the inherent strategic and intrinsic value.

The recovery over the last 12 months has been driven by moderating inflation and the start of interest rate cutting cycles by major central banks globally. With a more supportive economic backdrop and subsiding uncertainty we have seen (and expect to continue to see) more interest in small and illiquid companies, with capital flowing back into the sector.

Looking forward into 2025, sentiment will no longer remain a hurdle as the risk-reward profile continues to strengthen, benefiting from long-term demand tailwinds. Those able to grow despite economic challenges are poised for continued success.

## The sectors to watch

**Resources:** With the US election now behind us, new policy settlements are going to have a global impact. While Trump's tariff proposal clearly has uncertain implications for Australia, the imposed China tariffs could see stimulus for housing and infrastructure projects, leading to bolstered demand for resources. While currently underweight resources in the portfolio, we are excited about a strong commodity price environment and the management teams that can take advantage. [Metals X \(MLX\)](#) is an Australian based Tin miner is well placed to capture attractive pricing in what remains a structurally undersupplied market. Similarly, base metal producer [Aurelia Metals \(AMI\)](#) will see new ore bodies unlocked and optimisation of their projects in the Cobar region of NSW.



the **2025**  
**outlook**  
microcaps

**Healthcare:** Dermatology business [Botanix Pharmaceuticals \(BOT\)](#) secured FDA approval for their novel drug to treat hyperhidrosis this year. The commercial launch earmarked for early 2025 will see first sales and prove out the product's attractive economics. [Dimerix \(DXB\)](#) is conducting phase 3 trials for a rare kidney disease, with results expected towards the end of the calendar year. With portfolio holdings radiology business [Capitol Health \(CAJ\)](#) and dentist franchise [Pacific Smiles \(PSQ\)](#) both receiving takeover offers in 2024, we expect the sector to remain heated as we move into 2025.

**Industrials:** We continue to find attractive opportunities in industrials that exhibit robust earnings growth. [XRF Scientific \(XRF\)](#), a scientific equipment and solutions business, continues to experience sustained demand and market share growth resulting from new product development. [Alliance Aviation \(AQZ\)](#), which supports blue-chip Australian miners with Fly-In-Fly-Out services, is well poised to benefit from an increased fleet size, while debt levels are falling as cash flow generation ramps. [Southern Cross Electrical \(SXE\)](#) continues to benefit from large infrastructure work in data centres and battery storage facilities as Australia continues to electrify and decarbonise.

### How we are positioning the portfolio

We position our portfolio through a long-term lens, seeking confidence in business models that can sustain growth and capture market share in all economic conditions. Diversification remains a critical part of our portfolio construction process, minimising the risks associated within each sector, gaining a broader spectrum of exposure to the end markets and customers in which their goods and services are sold.

Some current holdings that exemplify these traits include:

- [Eureka Group \(EGH\)](#) which provides critical housing for Australian pensioners that are unable to afford their own home.
- [Saunders International \(SND\)](#), a provider of advanced engineering services in mineral processing, energy markets and key infrastructure projects such as Western Sydney Airport.
- [Generation Development \(GDG\)](#), a diversified financial group with innovative tax efficient investment strategies.
- Software and consulting company [RPM Global \(RUL\)](#), a provider of solutions for tier-1 mining companies which is increasing the cadence of its sales pipeline through successful implementation of global agreements.

***The long-term capital growth potential in small and microcap companies is significant. We remain confident in our ability to identify these opportunities as market conditions change and new themes emerge. With an improving macro environment and a more supportive view on the microcap outlook we look forward to a successful 2025.***



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Microcaps set for a promising 2025

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