22 August 2023

ARC Funds Limited 2023 Annual Report

Chairman's Review

The Financial Results

The company recorded an after-tax loss of $964,971 for the full year to June 30, 2023. This result did include a number of non-cash items. The main contributors to the loss, apart from our operating costs, were the two unsuccessful projects of Magnum and Lanyon. These have now been fully expensed. We also undertook a series of business development initiatives and progressed two potential acquisitions which also incurred incremental legal expenses beyond our operating costs, which have also been expensed.

Business Development and Investments

In the first half of this year, we completed the exit from the Magnum and Lanyon projects, we then have been pursuing an acquisition in the financial services sector, in businesses associated with funds management or in providing services to fund managers, wealth managers and advisors. Our objective here is to acquire a business that will enable ARC to be cashflow positive. We have conducted due diligence on two good opportunities, however, were unable to complete due to ASX listing rules and compliance reasons.

This process was time consuming and costly, however our subsequent learnings have placed us in a better position to consider and evaluate potential opportunities. Further to this, we are seeing several attractive opportunities available to acquire. We have developed five initial screens to help us evaluate any potential acquisitions or investments, as per below.

1. The opportunity must create value for ARC shareholders.
2. It generates positive operating cashflow.
3. Have an established management team aligned to the outcomes of the business
4. The business has the potential to scale in size, without large capital expenditure.
5. The vendors are willing to accept all or part ARC stock as consideration.

An update on our investment in Merewether Capital will be covered in Harleys CEO Report.

AMP Investment (ASX: AMP)

Further to our direct business development and fund launch activities we have also made an initial investment of $100,000 in this diversified financial services company. Our reasoning here is ARC invests in diversified financial services companies. AMP operates in banking, funds management (also called wealth management), financial products distribution (called Platforms), Master Trust operations and financial advice.

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Based upon our analysis of the businesses it owns, we estimate AMP shares to have a combined value of more than $2 per share on a sum of parts valuation. We purchased our shares at $1.16. A discount to valuation is a good start. The company also has a new CEO with a track record in creating value for, and returning capital, to shareholders. This is a fundamental of any investment, and this process is now in action with dividends resumed and a share buyback in place and operating. The benefit of a share buyback when the underlying value of the company is less than 60 % of a sum of parts valuation, is that the company is buying shares at a large discount to our valuation and cancelling those shares. We believe the remaining shares in AMP represent an exceptional value opportunity in the diversified financial services sector.

Summary and Thanks

I again thank my fellow directors, Harley, Darren and Wayne for their continued work, support, and input during the year. I thank Harley for his relentless executive drive and continued pursuit of our goals to build the business. Your board remains focussed on creating value for our shareholders whilst also preserving our capital.

I also want to thank our company secretaries at Acclime Australia for their efforts and our various advisers with whom we have worked with over the past year for your help.

Finally, the Board thanks all our shareholders for your patience, support, and interest, and we look forward to updating you on our future progress.

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Managing Director's Letter

In FY23, in response to the changing market conditions, we adjusted our strategy.

As James explained in the Chairman's report, rather than make further investments in start-up fund managers, we instead focused on acquiring established, profitable fund and wealth management businesses, including service providers to the wealth management and financial services industries.

Despite the change in strategy, our end goal remains the same, which is to build out our wealth management platform by continuing to back talented fund managers and provide them with the services and support they need to be successful.

As we acquire profitable, cash flow positive businesses we will be in a stronger position to utilise that cash flow to further build out our funds management platform. The potential acquisition of service providers to our core funds management businesses is also highly strategic and would add value to businesses like Merewether, as well as those managers we back in the future.

To this end we continue to review several attractive opportunities that align with the acquisition criteria James listed above. We want businesses that are profitable, in line with our strategic objectives and, most importantly, come with aligned and talented people that see the value and potential in partnering with ARC. And then we aim to structure deals that are accretive both to ARC shareholders and to the vendors joining our group.

During the year we varied our AFSL to expand our authorities and allow for the potential launch of ARC Emerging Managers, though we note we have prioritised the acquisition of established companies for now.

We continue to support Merewether and have not waivered in our optimism for both the investment talent of Luke Winchester and the potential for the business once at scale. We note emerging green shoots for ASX listed small and microcap equities, which if they continue should be supportive for Merewether's investment performance.

Earlier this calendar year we had agreed commercial terms for the acquisition of a long established, highly profitable funds management business, only for that deal to be declined by ASX due to a change of scale issue.

While frustrating, we emerged from this process with a refined criteria and clearer M&A strategy, as well as a pipeline of several deals (and talent) that we are currently working on bringing under the ARC banner. It is a priority of mine to not only acquire good businesses, but to also acquire good people, ideally in the same deal, as building out the ARC team is critical to achieving our vision.

We are progressing the above as quicky as possible, but these things do take time, so I wish to extend my gratitude to our shareholders for their support and patience over the last 12 months. If we can execute on the strategy and pipeline we have in front of us, the wait will be worth it, and I hope to have updates for you prior to the company's AGM later this year.

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Harley Grosser
Managing Director
August 22, 2023

ENDS.

By order of the Board of Directors.

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