

Ausbil MicroCap Fund

Quarterly performance update

June 2022

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Returns¹ as at 30 June 2022

Period	1 month	3 months	6 months	FYTD	CYTD	1 year	2 years pa	3 years pa	5 years pa	7 years pa	10 years pa	Since Inception pa ²
Fund return %	-15.47	-24.67	-28.82	-12.07	-28.82	-12.07	17.05	9.65	14.49	13.70	18.09	20.44
Benchmark ² %	-18.58	-28.09	-27.92	-7.34	-27.92	-7.34	21.47	13.12	11.61	11.81	5.39	4.26
Out/under performance %	3.11	3.43	-0.90	-4.74	-0.90	-4.74	-4.42	-3.47	2.88	1.88	12.70	16.18
Reference Index ³ %	-13.09	-20.39	-23.74	-19.52	-23.74	-19.52	3.55	0.38	5.07	6.64	5.37	3.73
Out/under performance %	-2.38	-4.28	-5.08	7.45	-5.08	7.45	13.50	9.27	9.42	7.06	12.73	16.71

'Whilst we acknowledge recent conditions have been volatile and somewhat challenging, we are encouraged about some of the opportunities the recent sell-off has presented'

Performance Review

Fund performance for the June quarter was -24.67% (net of fees) versus the benchmark return of -28.09%, as measured by the S&P/ASX Emerging Companies Accumulation Index and the reference index return of -20.39%³ as measured by the S&P/ASX Small Ordinaries Accumulation Index.

Fund Review

The downdraft in equity markets accelerated in June as central banks displayed a willingness to front-load rate hikes in order to negate inflationary pressures. The US 2/10 yield curve inverted and the market became increasingly concerned about a potential recession and subsequent earnings downgrades. A flight to safety featured throughout the broader market sell-off, which was exacerbated by the Small Resources index falling over 22% in the month of June. This capped off a tough year of Australian Small and Micro Cap stocks, with both benchmarks materially underperforming the ASX100.

The Fund outperformed +3.43% (net of fees) over the quarter to June, despite being down -24.43% in absolute terms. Whilst we acknowledge recent conditions have been volatile and somewhat challenging, we are encouraged about some of the opportunities the recent sell-off has presented.

The bulk of positive absolute performance came from positions which are currently under takeover, such as **Uniti Group** and **Ardent Leisure**, while the Fund's positioning in defensive industrials, such as **Propel Funeral Partners** also contributed to performance. Throughout June, our company visitation program included a research trip to the USA seeing over a dozen companies, providing a timely update on the pulse of the USA economy as well as many current and prospective holdings offshore operations.

Turning to the financial year, the Fund returned -12.07% (net of fees), behind the more speculative Emerging Companies Benchmark return of -7.34%, which has started unwinding, but ahead of the Small Ordinaries reference index return of -19.52%, which includes more profitable and liquid small and micro-cap companies comparable to the Fund. Contributors for the financial year included long-term industrial holdings **Uniti Group**, **Johns Lyng** and **DGL Group** as well as Australian lithium developer **Core Lithium**. Detractors included discretionary retailers **City Chic** and **Universal Stores** with the recent shift in consumer sentiment and technology providers **Life360** and **Betmakers Technology**.

Since inception in 2010, the Fund has returned 20.44% p.a. (net of fees), generated through a consistent process focus on high-quality businesses with strong free cash flow generation and positive earnings revisions. While there may be further market volatility ahead, we believe the recent drawdown in share prices offers compelling opportunities to acquire quality businesses at more attractive valuations. The Fund has selectively been adding to high-conviction positions over the quarter. As of 30 June, the Fund held 37 holdings, with high conviction in the top-20 holdings, accounting for 73.8% of the portfolio, with cash levels at 7.7%.

This month, the largest positive contributors to performance were **Uniti Group**, **Ardent Leisure** and **Propel Funeral Partners**. Negative contributors included **City Chic**, **29Metals** and **Johns Lyng Group**.

Key Contributors

Uniti Group (UWL) returned 4.0% over the quarter, with the share price acting as a cash proxy during the market pullback ahead of the scheme vote in July.

Ardent Leisure (ALG) returned 4.9%. In June, the sale of ALG's Main Event Division in the US to Dave & Busters was confirmed by shareholders, with a significant capital return anticipated to be completed in July.

Propel Funeral Partners (PFP) returned 1.9% over the quarter. On a morbid note, provisional data from the Australian Bureau of Statistics highlighted that death rates increased 17.5% for the first quarter of the year above the historical average. A normalisation of mortality rates and total spending per funeral following easing of restrictions supports the outlook for earnings in a high-fixed cost business where volume is key. PFP offers highly defensive characteristics with non-cyclical earnings, a renewed management structure following internalisation of key senior management functions and a refreshed balance sheet to support M&A growth.

Key Detractors

City Chic (CCX) fell 46.2% over the June quarter. Discretionary retailers succumbed to growing concerns of a slowdown in consumer spending. The build-up of inventory by CCX to meet strong demand in the first half of the year, while mitigating supply chain risk, comes at a potential inflection point of slowing consumer demand which increases the risk of having to discount inventory in response to increased competition. Acknowledging the risks to the outlook, while unquantifiable at this stage they have clearly increased.

29Metals (29M) retraced 36.7%. Concerns of slowing global economic demand from tighter monetary settings and Chinese lockdowns resulted in a significant pullback in commodity prices over the quarter. Copper, typically a barometer of economic growth, fell sharply, alongside other base metals, such as zinc.

Johns Lyng Group (JLG) fell 34.0% over the quarter, after holding up incredibly well CYTD. Weakness in JLG was exacerbated by the likely expectation for a May earnings upgrade, whereas JLG only reaffirmed full-year guidance, and a minor sell-down of stock by management, who still retain significant holdings. Fundamentally, we see the strength in JLG's business as only improving, with fresh flooding in NSW a reminder of the need for at-scale building remediation, which is on-top of an already large backlog of CAT work following previous floods across the East-Coast. We increased JLG on weakness during the quarter and it remains one of the highest conviction holdings for the Fund.

Top 10 Stocks³

- | | |
|----------------------|----------------------------|
| 1. 29 Metals | 6. Johns Lyng Group |
| 2. DGL Group | 7. Lovisa |
| 3. Data#3 | 8. Macquarie Telecom Group |
| 4. Imdex | 9. Sandfire Resources |
| 5. Jumbo Interactive | 10. Uniti Group |

Outlook

Continued Fed hawkishness, including an expeditious normalisation of rates and ongoing focus on QT, have led to the 2/10 yield curve inverting as concerns about a weakening economic backdrop begin to materialise. A potential US recession and resultant earnings downgrades are firmly on the table and add to equity market uncertainty. In Australia, the RBA's commitment to remove "extraordinary monetary support" is a major shift from past rhetoric that rates were unlikely to increase until 2024. This has caught many off guard and has the potential to place enormous pressure on the consumer, in addition to general inflationary pressures such as energy, food and the cost of living. We continue to monitor the pulse of the consumer, discretionary consumption and the adverse implications of falling house prices and the wealth effect. Against this backdrop, the Fund remains positioned for an elongated period of market volatility with an increased focus on stocks higher in the market-cap spectrum with ample liquidity.

1. Fund returns are net of fees and before taxes.
2. Date: February 2010.
3. Top 10 stocks sorted alphabetically.

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