

Ausbil MicroCap Fund

Monthly performance update

August 2022

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Returns¹ as at 31 August 2022

Period	1 month	3 months	6 months	1 year	2 years pa	3 years pa	5 years pa	7 years pa	10 years pa	Since Inception pa ⁶
Fund return %	2.61	-3.52	-6.92	-12.02	15.55	12.86	16.44	15.63	18.94	21.41
Benchmark² %	1.69	-5.35	-7.52	-2.29	18.32	16.10	13.83	14.55	6.88	5.45
Out/under performance %	0.91	1.83	0.60	-9.73	-2.77	-3.23	2.61	1.08	12.07	15.95
Reference Index³ %	0.58	-2.59	-6.08	-14.66	5.13	4.10	6.85	8.92	6.29	4.62
Out/under performance %	2.03	-0.93	-0.84	2.64	10.42	8.77	9.59	6.71	12.66	16.79

'We have witnessed stronger household and corporate balance sheets which suggests there is a level of resilience going into this slowdown that we have not seen in many years'

Performance Review

Fund performance for the month of August was +2.61% (net of fees) versus the benchmark return of +1.69%, as measured by the S&P/ASX Emerging Companies Accumulation Index, and the reference index return of +0.58% as measured by the S&P/ASX Small Ordinaries Accumulation Index.

Fund Review

Reporting season was reliably eventful, not least of which was **DGL Group** which fell -36% on the last day of the month. Despite this, the Fund outperformed due to the well-rounded portfolio positioning, and on balanced, superior stock selection with contributions from **Lovisa (+30%)**, **PSC Insurance (+18%)**, **PWR Holdings (+14%)** outweighing detractors. A bounce in **29Metals (+33%)** and continued strength in **Core Lithium (+21%)** also contributed.

As a reminder, the Fund is actively managed, adopting high conviction positions with appropriate diversification. **Uniti Group**, **Johns Lyng Group**, **Lovisa** and **Lifestyle Communities** are some of holdings held over recent years that have generated significant returns for investors, however the unfortunate reality is that some companies temporarily disappoint. Importantly, adopting a well-diversified portfolio of individual holdings, backed up by a consistent and proven investment process has generated superior investment returns for investors over the medium and long term.

This month, the largest positive contributors to performance were Lovisa, 29Metals and Syrah Resources. Negative contributors included DGL Group, City Chic and Aussie Broadband.

Key Contributors

Lovisa (LOV) rallied 29.6% in August following one of the standout report season results. LOV reported strong like-for-like sales growth of 19.9% for the full-year, and earnings well ahead of consensus expectations. New CEO, Victor Herrero, is in the early stages of a global rollout, with 43 net new stores opening in the second half of the year and entries into new markets, including Canada and Hong Kong, opening a plethora of growth opportunities. Targeting a consumer demographic shielded from most inflationary pressures, high returns on capital, a 'cookie cutter' store template and a global rollout in its early stages, LOV remains the most attractive growth name in our universe.

Materials positions in **29Metals (29M)** and **Syrah (SYR)** returned 33.1% and 26.9% respectively over the month. Resources rebounded in August, particularly battery materials on the back of several tailwinds, including purchase tax exemption extensions for new EV's in China and the US Climate Bill. 29M, an Australian based copper producer and SYR, owner of the world's largest producing graphite mine, are both well placed to capitalise as existing producers.

Key Detractors

DGL Group (DGL) fell 26.1% in August after a full-year result that produced weaker than expected cash conversion and an underwhelming outlook statement. The poor cash conversion partly reflected the need to build critical supply chain inventory in an environment of distorted supply chains to support DGL's tendering opportunities and long-term market position. What disappointed the market most was an underwhelming outlook statement that called out super-profits in FY22 that could not be forecasted to repeat in the year ahead. While incredibly disappointing and unexpected, DGL retains balance sheet strength, expectations are rebased and it is now trading on a compelling valuation. Following in-depth analysis and review, we have added to the position and look to the AGM for a trading update.

City Chic (CCX) fell 29.1% over the month. After a surprise inventory build in the first-half result, CCX surprised the market again, building additional inventory to mitigate uncertain supply chains. While calling peak inventory and a gradual reduction of inventory over the course of FY23, the market was uncomfortable with the additional risk added given the backdrop of a weakening consumer, the seasonal nature of retail inventory and the weaker capital position of the business in the face of a weakening consumer backdrop.

Aussie Broadband (ABB) fell 23.4%. ABB pre-released FY22 results, though its forward looking guidance fell short of market expectations. Increased promotional activity by competitors in residential NBN plans also detracted from the outlook for subscription growth. Despite the headwinds, ABB continues to take incremental share from incumbents and is well positioned to expand into higher margin business and enterprise markets following the acquisition and integration of Over The Wire.

Outlook

In Australia, we have witnessed stronger household and corporate balance sheets which suggests there is a level of resilience going into this slowdown that we have not seen in many years. The current economic settings could suggest higher-for-longer bond yields and interest rates. For now, we remain acutely aware of bond market signals, with the US 2/10 yield curve inverted and reflecting concerns of a potential recession given the pace of rate hikes. Against this backdrop, the Fund remains positioned for an elongated period of market volatility with an increased focus on quality companies that can grow irrespective of market conditions.

1. Fund returns are net of fees and before taxes.
2. S&P/ASX Emerging Companies Accumulation Index
3. S&P/ASX Small Ordinaries Accumulation Index
4. Top 10 stocks sorted alphabetically.
5. Date: February 2010.

Top 10 Stocks⁴

1. Boss Resources
2. Data#3
3. DGL Group
4. Imdex
5. Johns Lyng Group
6. Jumbo Interactive
7. Karoon Gas Australia
8. Lifestyle Communities
9. Lovisa
10. Macquarie Telecom Group

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