# DS Capital Growth Fund

**September 2018 Quarterly Update**

**The DS Capital Growth Fund ('the Fund') seeks to deliver superior returns through a process designed to minimise the risk of a permanent loss of capital. The Fund comprises a concentrated portfolio of well researched listed businesses. The focus is on companies where we have a deep understanding of their business model and the industries in which they operate. The investment process combines traditional quantitative financial analysis with qualitative tools.**

| | 3 Months | 12 Months | Financial Year to Date | 3 Years (pa) | 5 Years (pa) | Since Inception (pa) | Since Inception |
|---|---|---|---|---|---|---|---|
| **DS Capital Growth Fund** | **2.1%** | **14.9%** | **2.1%** | **13.8%** | **16.3%** | **19.1%** | **169.3%** |
| All Ordinaries Accumulation Index | 1.9% | 14.7% | 1.9% | 12.4% | 8.4% | 10.2% | 73.6% |

**Notes**: (1) Data is after management fees and before performance fees. (2) Inception date is 1 January 2013. (3) Return since inception after all fees averaged 16.3% pa and totals 135% assuming reinvestment of net distributions.

During the quarter, we focused on the many earnings results. In general, it appeared that although business conditions were reasonable, it remained challenging to find organic growth and outlook commentary was cautious.

In the pursuit of strong organic growth, investors continued to favour a narrowing group of 'market darlings'. This resulted in even higher share prices that now build in very high expectations. We remind our investors that it is difficult for us to invest in businesses that require extraordinary earnings growth to justify today's price because of the risk that we may permanently lose our capital should this growth fail to materialise.

**NEXTDC** delivered a strong result but the lack of new contract wins in the second half disappointed some investors. This did not surprise us given that NEXTDC did not have the inventory to sell in the high demand market of Sydney. It does not change our long term view that NEXTDC remains a beneficiary of structural tailwinds and is firmly on track to significantly increase its size and earnings.

As foreshadowed in our June report, **Baby Bunting** was inexpensive and its share price recovered well after a strong result. The 60% recovery in the share price far exceeded our expectations and we exited our remaining holding.

We sold our holding in **Seek** early in the quarter on valuation grounds after the share price had risen 35% over the last year implying that investors were expecting strong earnings growth. Seek subsequently delivered flat earnings. We continue to like the business and will look to reinvest at an appropriate time.

Early in August, **Eclipx** announced a disappointing earnings update that caused a sharp fall in its share price. This drew an opportunistic takeover bid from SG Fleet which we feel is only a starting move in a sector that has been ripe for consolidation for some time.

Adventure tourism group, **Experience Co**, was the Fund's weakest performer as the business seemed to suffer growing pains. We were disappointed with the 2019 guidance commentary but understand management's cautious approach given a tough year that included an accident, poor weather and illness suffered by the founder who remains a driving force in the business.

During the quarter we progressed two new opportunities that we have been working on and have initiated investments in both. We hope to share more details on these investments next quarter.

The Fund's cash level ranged between 20% and 25% for the quarter.

## Outlook

Following reporting season, we have caught up with the senior management of many of the businesses in our universe to further analyse the reported results. As usual, these meetings were very helpful and add clarity to several opportunities that we hope to progress to new investments.

Internationally, the risk of a trade war continues to influence investors and will take some time to play out. Domestically, recent consumer and business surveys showed that July's political turmoil and the decision by some major banks to lift mortgage rates is affecting consumer and business confidence. We are monitoring any deterioration in business conditions.

We are watching for further signs of accelerating inflation that, together with the resulting higher interest rates, will have various implications for asset markets. Since the quarter ended, the main benchmark interest rate, the US 10 Year bond, significantly moved to its highest level since 2011. We have been cautious about the pace of change in interest rates for some time noting it regularly in these updates. The adverse effects are already being felt in equities markets, which will present opportunities to investors like us.

The Australian dollar is likely to remain under pressure as further rate rises are expected in the US while Australian rates remain flat. This is expected to benefit our investments in international businesses and offshore earners. We are continuing to assess our portfolio in light of the changing environment.

As always, feel free to contact us if you have any questions.



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