DS Capital Growth Fund

December 2022 Half Year 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.

Performance as at 31 December 2022	
Financial YTD	2.3%
3 Years (pa)	4.5%
5 Years (pa)	6.9%
7 Years (pa)	8.0%
10 Years (pa)	12.1%
Since inception (pa)	12.1%

Notes: (1) Inception date is 1 January 2013. (2) Returns are after all fees and assuming reinvestment of net distributions. (3) Data does not include franking credits distributed to unitholders.

Top 10 Holdings (alphabetical order)
Breville
Dalrymple Bay
Intercontinental Exchange (US)
Lifestyle Communities
Macquarie Telecom
Mainfreight (NZ)
PSC Insurance
Resimac
Rightmove (UK)
Seven Group

Key Fund Information	
Manager	DS Capital
Strategy	Long only
Liquidity	Monthly
APIR Code	DSC001
Investors	Wholesale
Distribution	Annually
Inception	1 January 2013
Minimum	$250,000
AFSL	427283
Contact	dscapital.com.au

Portfolio Commentary

Investors continued to face a volatile environment, particularly in relation to elevated inflation and interest rates. In every central bank update, investors searched for signs of a 'pivot' from the hardline approach of battling inflation by using rates to slow demand, consumption and weaken asset prices to dampen the wealth effect and confidence. This did not eventuate with central banks seemingly determined to maintain the pressure. Our fund is particularly sensitive to interest rate movements given most of the businesses that we own have strong and growing cashflows.

During the quarter we visited London and met over twenty-five companies. The meetings covered companies we are invested in (such as **Rightmove**, **Boohoo** and **Grainger**), companies that we follow and due diligence meetings with selected industry experts. In most cases, the UK mood was cautious. In addition to issues common to the broader global economy, the UK continues to contend with post Brexit readjustments and leadership transition. These issues continue to be discounted in the share prices of many businesses including some very high quality ones that will provide opportunities.

Locally, share prices have been impacted by the valuation de-rating caused by rising interest rates. The November AGM season was scrutinised in detail and showed evidence of earnings being affected by inflation and weaker customer demand. There were more downgrades than upgrades with downgrades twice as impactful on share prices than upgrades.

Key portfolio holding, **Resimac,** remained under pressure. While loan performance has been fine so far, uncertainty remains as to the effect on borrowers that moving from the low introductory mortgage rates (set over 12 months ago) to today's higher market rates. In addition, the sector remains competitive with the major banks advantaged by huge deposit bases compared to lenders without a deposit base. By not passing on full rate rises to depositors, the major banks could aggressively price new loans and preserve margins compared to lenders like Resimac. Encouragingly, this appears to be normalising as bank deposit rates have been creeping up. We remain confident that Resimac will navigate this period.

The AGM update by **Breville** was encouraging with the company confirming that it was performing to expectations. Asia-Pacific and the Americas have continued to trade well but parts of Europe remain challenging. Management stated that retailers were leaning into trusted brands including Breville and Sage. The Christmas period will have been critical for Breville but the business should have benefited from improvements in supply chain conditions and inventory availability.

AGM guidance by core portfolio holding **Seven Group** was encouraging. While the recent Boral investment is likely to take longer to be proven, Seven's two main businesses are performing well. Demand is expected to remain strong for WesTrac's mining related products and services, and Coates' equipment hire business can benefit from inflation with its fleet of rental equipment offering customers an attractive alternative to the more capital intensive option of equipment ownership in the current environment. Both WesTrac and Coates are expected to deliver low-teens earnings growth.

Our biggest disappointment for the quarter was the first half result for **Collins Foods.** Higher costs (mainly chicken, oil and chips in Australia and labour and power in Europe) impacted management's margin guidance given in July. While the share price has fallen over 25% for the year to date, the bulk of Collins earnings comes from KFC Australia that should still deliver same store sales growth of 20% higher than prior to Covid at 15% EBITDA margins.

Outlook

The main influence on stock markets and asset prices will continue to be the central banks use of rates to treat and beat inflation. Possible outcomes from this strategy range from crushed economies needing new stimulus to persistently high rates and inflation. Whilst 2022 saw higher rates cause a valuation derating, the lag effect of these changes may yet be felt on company earnings leaving us cautious. We fear that significant wage growth has been embedded into Enterprise Bargaining Agreements across many industries meaning elevated inflation for longer. Consequently, we think businesses with pricing power will have an advantage.

This time last year, the consensus view did not discount these issues. Now, with many prices far lower now than twelve months ago, the consensus view is far more pessimistic regarding expectations of a recession in 2023. Should the consensus be wrong (again), stock markets could move sharply. We expect many opportunities will present over the next few months that could lay the foundation for the Fund over the next few years.

The Fund currently has 25% cash providing significant flexibility to make new investments or add to existing holdings. We have begun to selectively add to several holdings.

We are pleased to announce that Jay Shyam has joined us as a Senior Portfolio Analyst. Jay brings significant analytical and investment experience to our team. We are also pleased to announce that we have moved premises to Level 19, 627 Chapel Street, South Yarra and look forward to welcoming you to our new offices.

We wish all our investors a healthy and successful year ahead. As always, please feel free to contact us if you want to discuss the portfolio, the current conditions, or your investment with us.

Contact

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