Auscap Newsletter

JANUARY 2024

AUSCAP ASSET MANAGEMENT LIMITED

Auscap Asset Management

Not Middle Of The Pack: Why We Back Australian Mid Caps

Auscap's views discussed below are based on factual information available to us at the date of publication of this newsletter. Our views and market conditions as expressed below may change without notice. There is a risk that investments will not perform as expected, which could have an adverse impact on the performance of the Auscap funds. Past performance is not a reliable indicator of future performance. Any advice in the below is general only in nature and does not take into account a particular person's objectives, financial situation, needs or circumstances. Because of that, before making any investment decision, you should consider – with or without the assistance of a qualified adviser(s) – the appropriateness of any advice in the below to you, having regard to your objectives, financial situation, needs and circumstances. While all reasonable care has been taken to ensure that the information below is complete and correct, no representation or warranty is given as to the accuracy of any of the information provided.

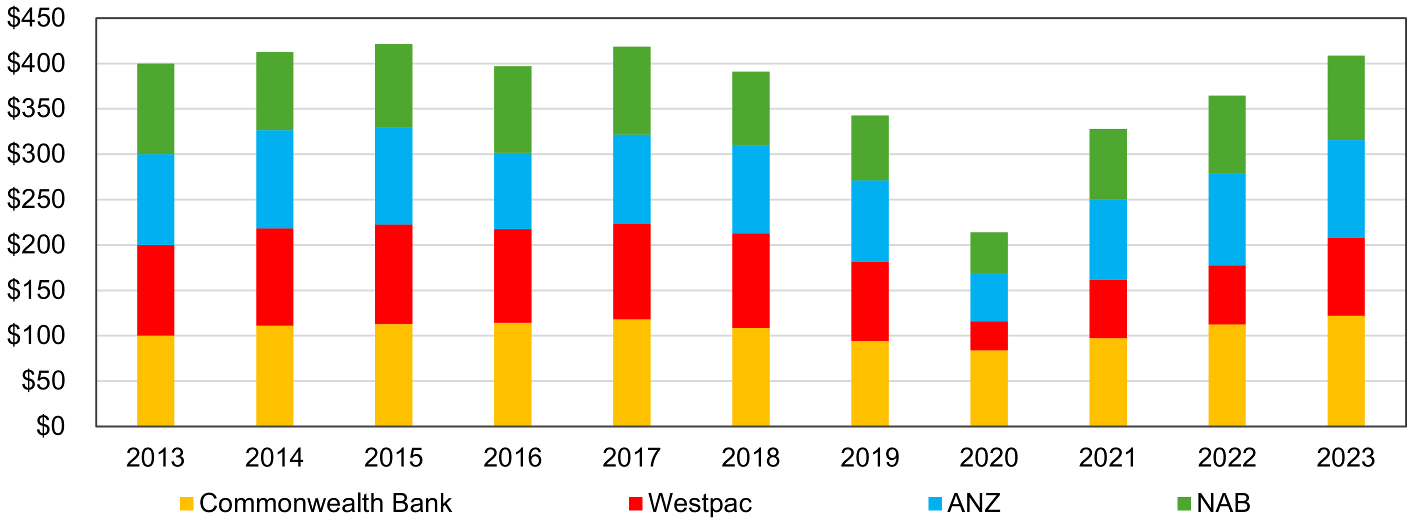
Calendar year 2023 was a good year for the Auscap Long Short Australian Equities Fund, delivering 18.5% net to investors compared to 13.0% for the All Ordinaries Accumulation Index.

Period	Auscap Long Short Australian Equities Fund	All Ordinaries Accumulation Index
1 Year	18.5%	13.0%
3 Years	14.1%	8.9%
5 Years	14.2%	10.7%
10 Years	12.2%	8.2%
Since Inception (Dec 12)	15.4%	9.4%

The performance of markets over November and December, a period in which the All Ordinaries Accumulation Index gained 13%, demonstrates the folly in trying to time markets. A change in expectations around the future path of interest rates led to a sudden response in markets, with equities gaining in two months what would be a reasonably solid full year performance. It reiterates to us the merit of investing in a range of excellent businesses that are reasonably priced and holding this portfolio for a long time.

Over the long term, we believe the most important factor determining a company's stock price is the level of earnings generated. This is not the level of earnings in an exceptional one-off year, but the level of sustainable and, preferably, growing earnings. A company with sustainable earnings at a fair valuation might be a reasonable investment, but unless the earnings are growing it is unlikely to be a strong one. The major domestic Australian banks are an example of this. Over the last decade, roughly representing the period since the Auscap Long Short Australian Equities Fund was launched, bank earnings have tracked sideways. The level of earnings has been broadly maintained, excluding the COVID-19 period, but has not grown. This can be seen in the chart below.

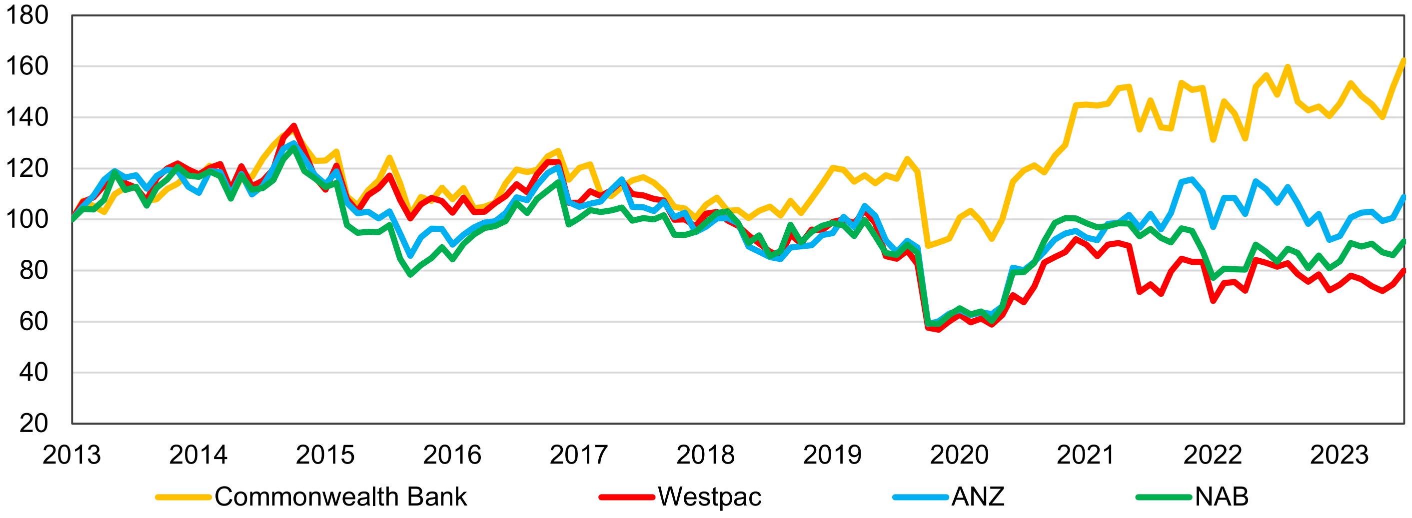
Big 4 Bank Combined Earnings Per Share (each rebased to 100 in 2013)



Source: FactSet, Auscap

The likely outcome and lived experience of this should be relatively obvious, that the companies' share prices are unlikely to have, and indeed have not, materially appreciated. Unsurprisingly, ceteris paribus, people are not willing to pay more for the same level of earnings than they were more than a decade ago. This can be seen from the share prices of the major domestic banks over this period.

Big 4 Bank Share Prices (Rebased to 100)

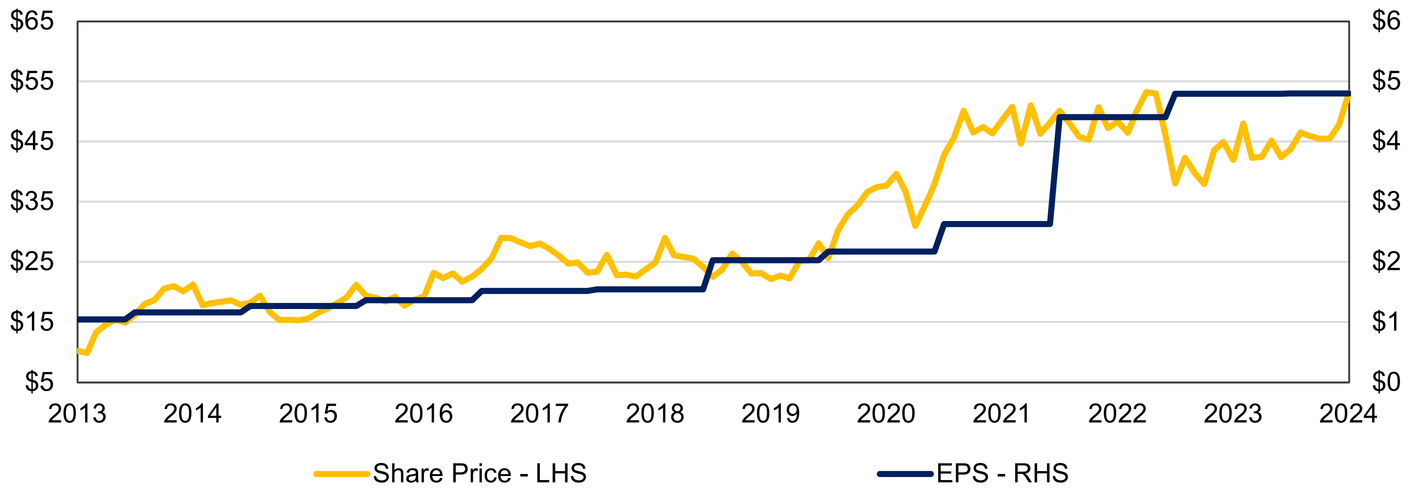


Source: IRESS, Auscap

In the short term, there are many factors that can influence share prices. Noise and shifts in sentiment can play a significant role. Investors worry about geopolitical events, movements in interest rates, currencies, global growth, market psychology, news headlines and plenty of other factors. Indeed some of these factors can and do have an impact on near term earnings. Over the long run however, what is going on inside a company is far more important than the short term impact of some of these factors. And over the long run, the most significant driver of the share price is the level of sustainable earnings a company generates. Earnings are what really matter to long term share price performance. And the total return one should expect from a security is the combination of the earnings growth delivered and the dividend yield received. This is the long term expected total return for an individual company bought at a fair price.

This can be seen in many of the businesses we have owned for a long time. It is hard to think of a company that moves more over the short term in response to changes in market sentiment than JB Hi-Fi. And the "short term" we refer to can sometimes be measured in years, not days or months. Its gyrations, as seen below, have historically been significant.

JB Hi-Fi Share Price and EPS

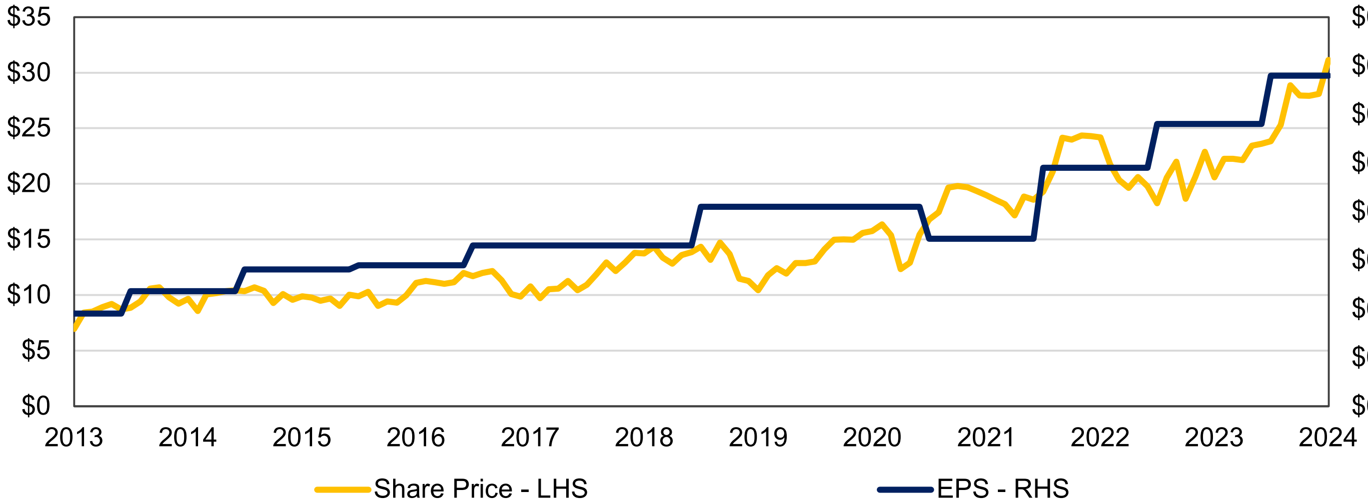


Source: IRESS, Auscap

Does this make it a risky investment proposition? While we acknowledge that JB Hi-Fi is unlikely to grow earnings in FY24 on FY23 as the company cycles heightened post COVID-19 expenditure in a rising cost environment, the company has grown earnings every year over the last decade. This is a better outcome than almost any of the 20 largest, and less price volatile, stocks listed on the ASX. Its share price suggests it is a very risky investment. Its earnings suggest the contrary. What is also obvious from the chart above is that earnings are the ultimate driver of the stock price over the long term.

Choose almost any stock and compare its share price with the earnings per share it generates and it becomes clear that over the long term earnings are the most important factor. To use a few examples of businesses we have held for a long time, this is true of CAR Group.

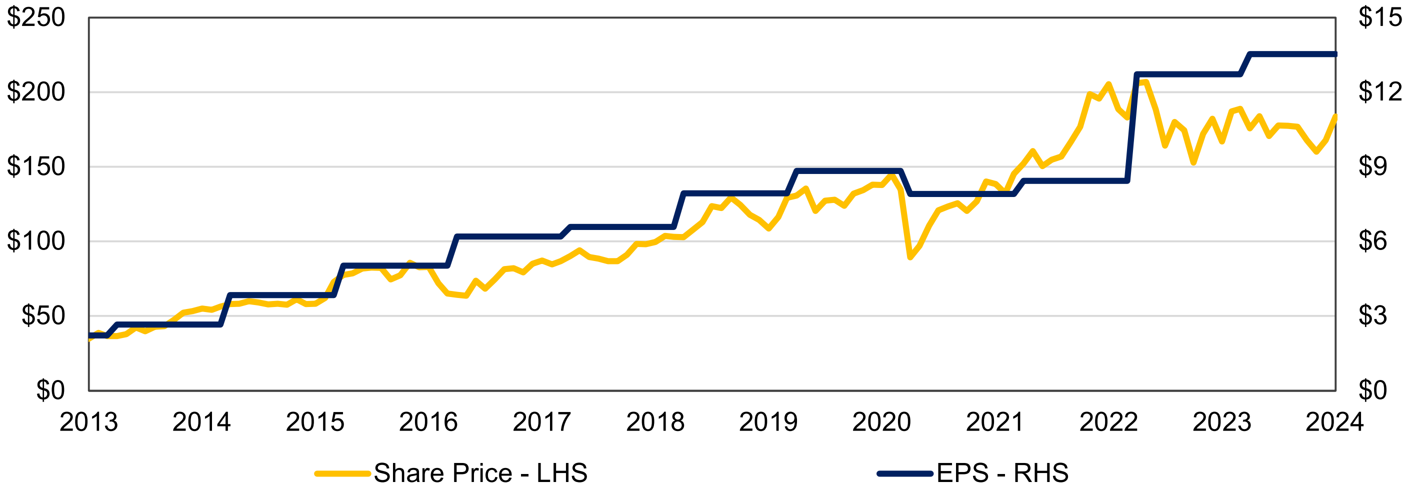
CAR Group Share Price and EPS



Source: IRESS, Auscap

It can be seen analysing Macquarie Group's share price performance against earnings.

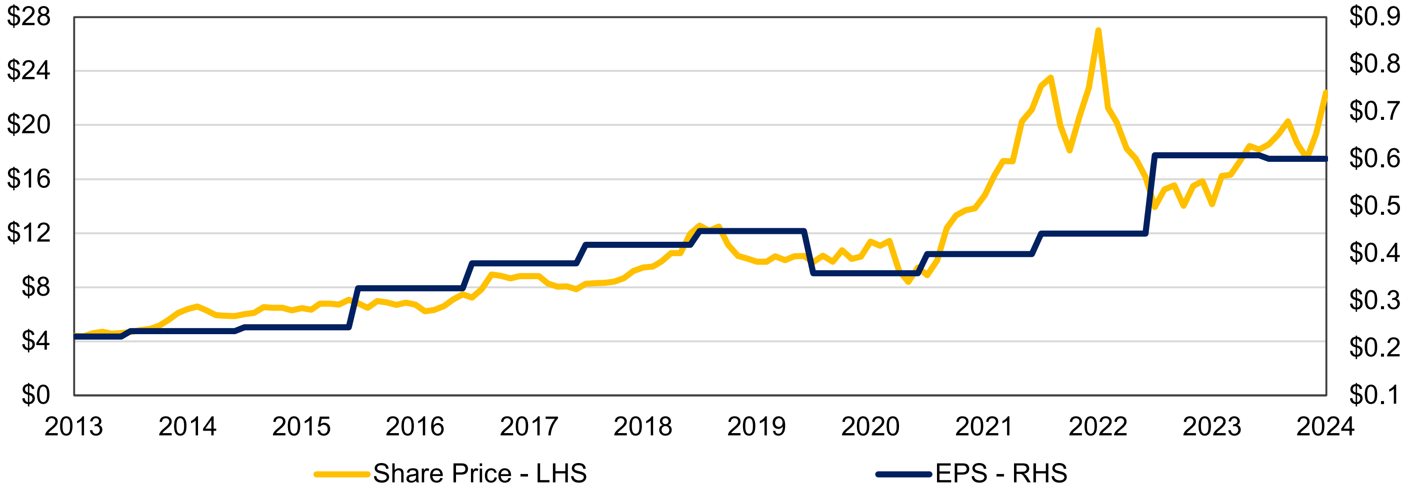
Macquarie Group Share Price and EPS



Source: IRESS, Auscap

Markets anticipate changes in earnings before they occur. Macquarie's earnings are expected to decline in FY24 and this has been reflected in the share price. However there are also times when share prices disconnect from their earnings, often driven by positive or negative sentiment towards a particular business. This can be seen below with Reece's unusually strong share price performance in 2021 and 2022, which greatly outstripped earnings growth. But in the lifecycle of a company these periods are typically short and self-correcting.

Reece Share Price and EPS



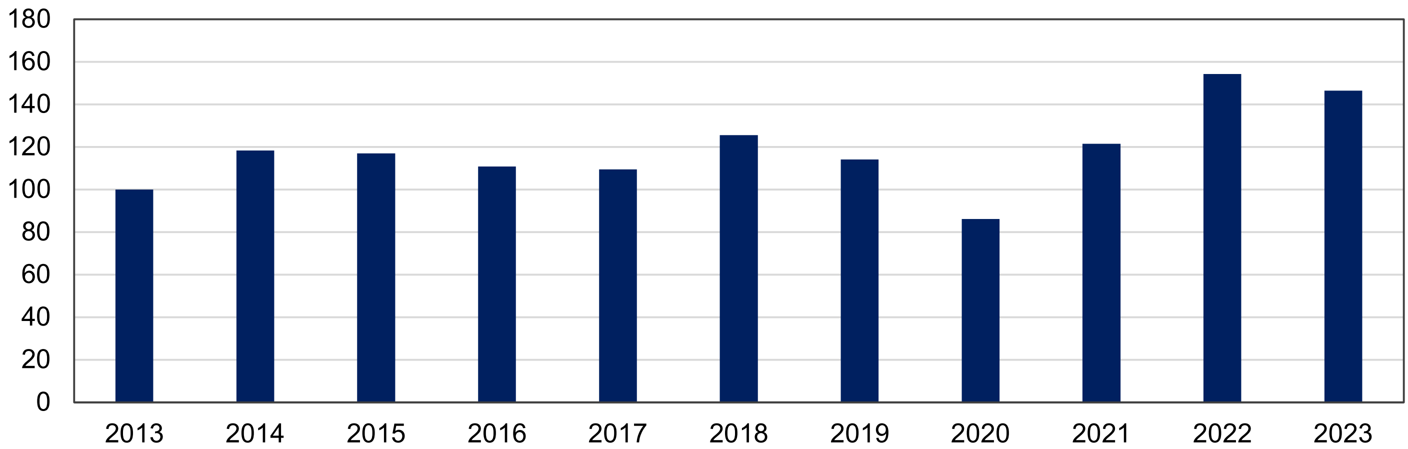
Source: FactSet, Auscap

So our primary focus is on finding businesses that can sustainably grow their earnings per share over time. The group of businesses that we are confident will achieve this reliably is not particularly large and tends not to change much over time. Then we invest more significantly in the businesses that demonstrate greater value at the current share price, less significantly in those businesses that are priced more aggressively, whilst continuing to closely monitor the businesses where we cannot justify the current valuation at all. There can also be very good businesses that we are not invested in because we have similar and preferred exposures in the portfolio already.

The end result of this process is that the Auscap Long Short Australian Equities Fund, which has now been managing investor capital for over 11 years, is a high conviction portfolio. Its highest weights are our highest conviction ideas, with very little consideration given to how the fund looks compared to the broader market. This means that the fund can at times act quite differently to the broader market. Because it is a concentrated portfolio, it may at times exhibit more volatility than the market, albeit we would stress that we do not believe higher volatility equates to the portfolio being riskier than the market. We define risk as the prospect of permanent loss of capital on an investment, not how much a share price fluctuates. Most of our holdings are leaders in their field with long financial track records, competitive advantages over their peers and conservative gearing, with many being in a net cash position. Whilst individual stock prices can be volatile, the earnings volatility for the majority of the businesses we own has historically been quite low.

Our focus on finding high quality businesses that are growing earnings over time has also led us to focus on businesses primarily outside of the largest listed businesses, where we see limited opportunity for growth. The S&P/ASX 20 has delivered less than 4% earnings growth per annum over the last decade.

S&P/ASX 20 - Diluted Earnings From Continued Operations (rebased)



Source: Bloomberg, Auscap

Therefore the Auscap Long Short Australian Equities Fund's portfolio tends to consist predominantly of companies that are in the ASX300 but outside of the ASX20, with our investment sweet spot frequently being the mid cap universe. These are often quite significant businesses, with profits typically in the hundreds of millions of dollars per annum. These businesses can be substantial enough to be leaders in their field and therefore enjoy the superior financial return profiles that come with great economies of scale, whilst still having plenty of opportunities for organic growth because they have not yet saturated their market. NIB Holdings is a good example of this. It is an ASX100 business with a market capitalisation of $3.6bn and net profit after tax of $198m in FY23. It has market leading metrics in the private health insurance industry, but it still only represents a 9.6% market share in its core Australian Residents Private Health Insurance market, with multiple attractive adjacencies to underpin many years of organic growth. Its earnings growth plus dividend yield will determine the long term returns it generates for our investors.

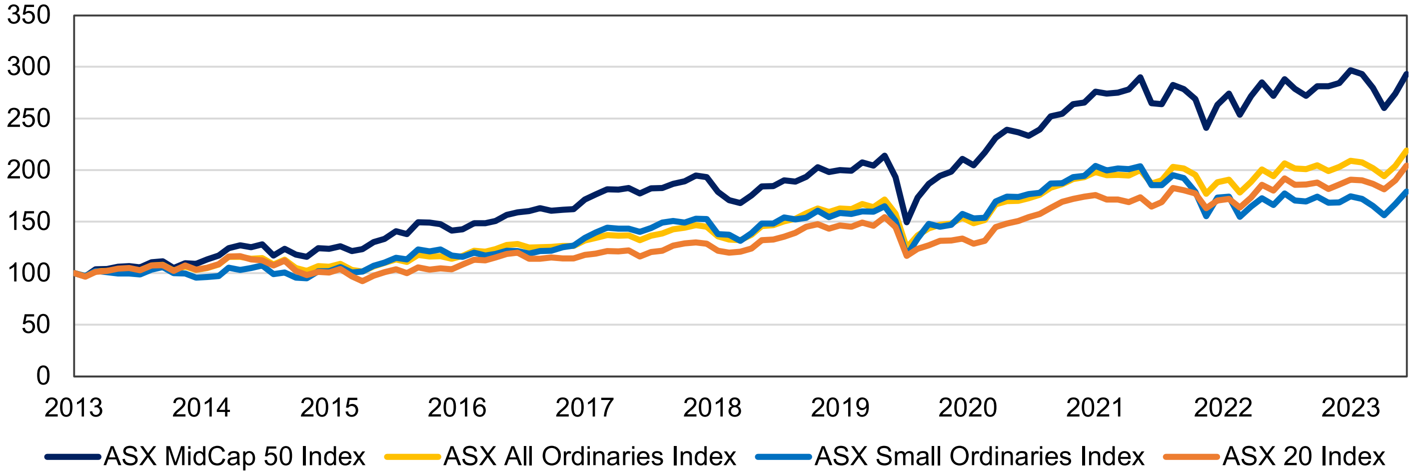
In fact, the performance of the mid capitalisation index over the last two decades has demonstrated why we find it a fertile hunting ground for great investments. Over the last decade the ASX Mid Cap Accumulation Index has seen 7.5% earnings growth per annum. This contrasts with the All Ordinaries Accumulation Index and the ASX20 Accumulation Index which have delivered earnings growth of 4.3% and 3.0% per annum. It also contrasts with the Small Ordinaries Accumulation Index which has delivered growth of just 2.5%. It should be of no surprise that these differing earnings growth profiles are strongly correlated with the total return delivered by the different indices, summarised in the table below.

Index	Earnings Growth p.a. (2013 to 2023 CAGR)	Annualised Return (2013 to 2023)
ASX Mid Cap 50 Accumulation Index	7.5%	11.3%
ASX All Ordinaries Accumulation Index	4.3%	8.2%
ASX20 Accumulation Index	3.0%	7.4%
ASX Small Ordinaries Accumulation Index	2.5%	6.0%

Source: Bloomberg, IRESS, Auscap

Many of the largest companies in the domestic market are so dominant in their sector it is difficult to grow significantly organically. Conversely, many smaller companies are at a competitive disadvantage relative to larger peers or are yet to achieve consistent profitability, which is reflected in their frequently lower earnings growth and poor total return performance over time on an aggregate basis. Over one year the difference in these annualised return figures might not appear significant. But over time the difference in the total return compounds to a very meaningful disparity in returns.

ASX Accumulation Index Long Term Performance (%) - Rebased to 100



Source: IRESS, Auscap

In fact, since 2013 the ASX Mid Cap Accumulation Index has risen 193%. This compares with the All Ordinaries Accumulation Index and the ASX20 Accumulation Index that have returned 119% and 104% respectively. The Small Ordinaries Index has been the poor performer, returning 79%. Yet there are very few mid cap focused funds in the domestic market looking to take advantage of the superior returns on offer.

Launch of the Auscap Ex-20 Australian Equities Fund

A high conviction fund, which typically concentrates capital in the fund manager's best ideas, is popular with many investors. It does mean that the fund can exhibit greater volatility than the market and can at times move differently to the market. A large part of this comes from the fund having quite different sector exposures to the All Ordinaries Accumulation Index against which it is measured.

Some prospective investors have expressed that they would prefer a less concentrated fund offering. In response to feedback, we are delighted to have launched the Auscap Ex-20 Australian Equities Fund in December. It is a long only mid cap focused fund, with a primary universe of stocks in the S&P/ASX300 Index and excluding stocks from the S&P/ASX20 Index. It is sector aware, meaning we expect the sector exposures of the fund to typically be within 5% of its benchmark. The concentration of fund holdings will be lower, with a greater number of companies in the portfolio. We expect the primary determinant of returns relative to the index will therefore be stock selection, rather than sector exposure. The response to the fund launch has been positive. We look forward to taking advantage of the compelling opportunities available in this universe of the Australian stockmarket to generate returns for our unitholders in the new fund. If you would like further information on either fund, please reach out to Lauren Murphy at distribution@auscapam.com.

Auscap Long Short Australian Equities Fund

Fund Performance*

Period	Auscap	All Ords
December 2023	9.9%	7.4%
Financial Year To Date	14.5%	8.0%
Since Inception (Dec 2012)	387.7%	171.2%
Annualised Returns	15.4%	9.4%

Fund Exposures

December 2023 Average	% NAV	Positions
Gross Long	97%	35
Gross Short	0%	0
Gross Total	97%	35
Net / Beta Adjusted Net+	97%	116%

Portfolio Commentary*

The Fund returned 9.9% net of fees during December 2023. This compares with the All Ordinaries Accumulation Index return of 7.4%.

All sectors contributed positively to returns. The Fund's exposures to the consumer discretionary, materials and real estate sectors contributed most significantly.

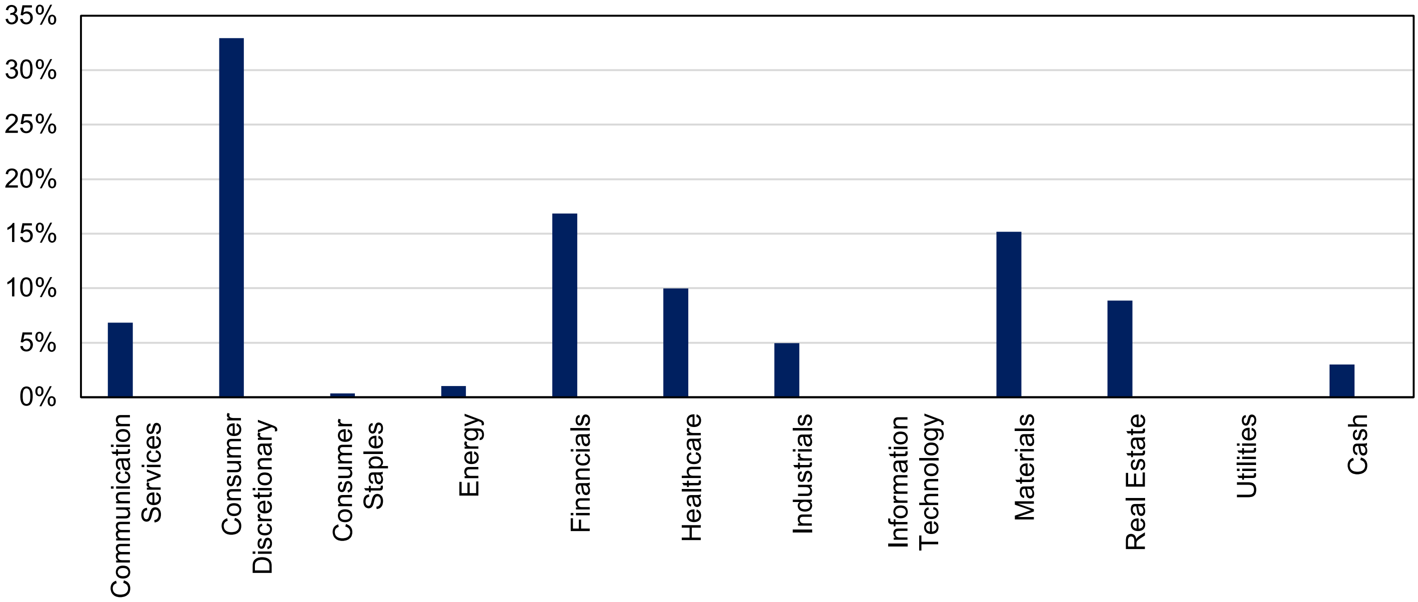
This was led by the Fund's exposures to Nick Scali, Lovisa, Eagers Automotive, ARB Corp, Breville, Mineral Resources, HMC Capital and HomeCo Daily Needs REIT. CAR Group, REA Group, Reece and Reliance Worldwide also performed strongly in the month.

NIB Holdings was the largest detractor from the Fund during the month.

Top 20 Investments^

ARB Corp	NIB Holdings
Breville Group	Nick Scali
CAR Group	Pilbara Minerals
Eagers Automotive	PSC Insurance
HMC Capital	PWR Holdings
HomeCo Daily Needs REIT	REA Group
HUB24	Reece
Lovisa	Reliance Worldwide
Macquarie Group	ResMed
Mineral Resources	Sonic Healthcare

Sector Exposure - December 2023#



Performance figures are calculated for the Monthly Class net of all fees and expenses and assuming the reinvestment of all distributions. Note, as at 1 January 2021, the Series Class was consolidated into the Monthly Class. Past performance is not a reliable indicator of future performance.

+ *Beta adjusted net adjusts the portfolio for the beta, or share price volatility, of the stocks relative to the All Ordinaries Accumulation Index.*

^ *Top 20 long investments in alphabetical order as at 31 December 2023.*

Average sector exposure during December 2023.

Auscap Ex-20 Australian Equities Fund

Fund Performance*

Period	Auscap	Index**
December 2023	8.6%	6.6%
Financial Year To Date	8.6%	6.6%
Since Inception (Dec 2023)	8.6%	6.6%
Annualised Returns	NA	NA

Fund Exposures

December 2023 Average	% NAV	Index
Equities	98%	100%
Cash	2%	0%
Beta Adjusted Exposure+	103%	102%
Positions	49	

Portfolio Commentary*

The Fund returned 8.6% net of fees during December 2023. This compares with the S&P/ASX 300 Ex S&P/ASX 20 Index return of 6.6%.

All sectors contributed positively to returns. The Fund's exposures to the materials, real estate, consumer discretionary and industrials sectors contributed most significantly.

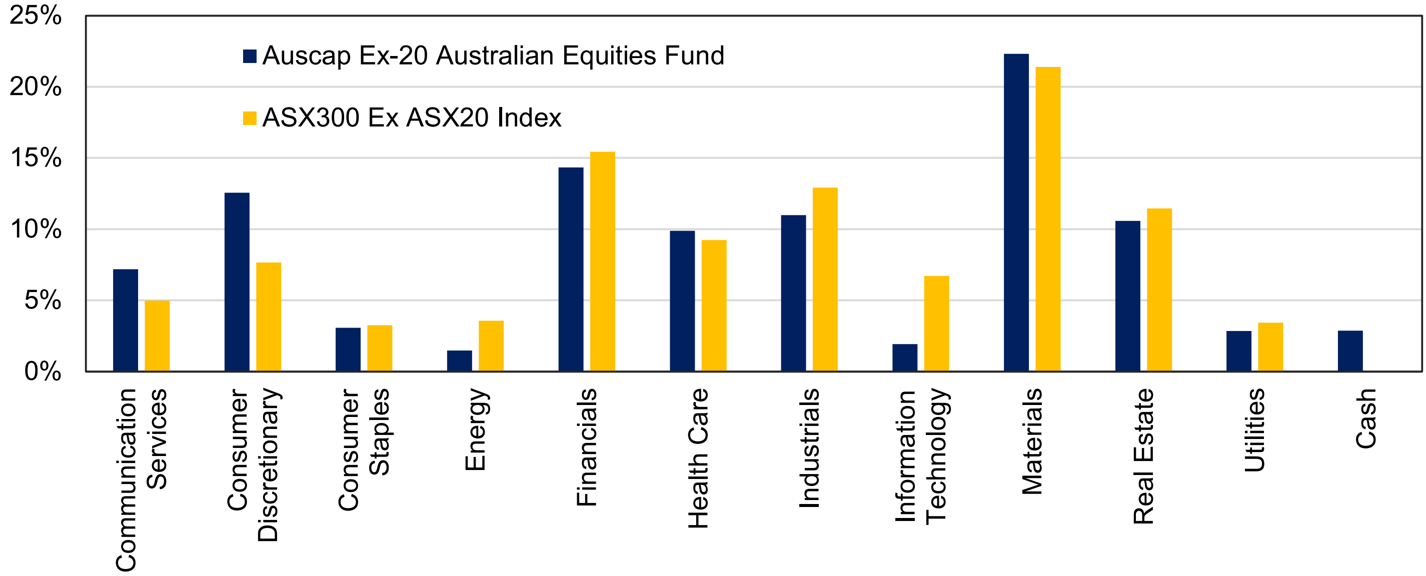
This was led by the Fund's exposure to Mineral Resources, HMC Capital, HomeCo Daily Needs REIT, Nick Scali, Reece, Lovisa and Reliance Worldwide. CAR Group and REA Group also performed strongly in the month.

NIB Holdings was the largest detractor from the Fund.

Top 20 Investments^

Amcor	NIB Holdings
APA Group	Nick Scali
CAR Group	Pilbara Minerals
Champion Iron	PSC Insurance
HMC Capital	Qube Holdings
HomeCo Daily Needs REIT	REA Group
HUB24	Reece
Independence Group	Reliance Worldwide
James Hardie	ResMed
Mineral Resources	Sonic Healthcare

Sector Exposure - December 2023#



* *Performance figures are calculated for the General Class net of all fees and expenses and assuming the reinvestment of all distributions. Past performance is not a reliable indicator of future performance.*

*** Index used is the Benchmark for the Ex-20 Fund, being the S&P/ASX 300 Ex S&P/ASX 20 Index.*

+ *Beta adjusted exposure adjusts the portfolios for the beta, or share price volatility, of the stocks relative to the All Ordinaries Accumulation Index.*

^ *Top 20 investments in alphabetical order as at 31 December 2023.*

\# *Average sector exposure during December 2023.*

Newsletter – January 2024

Auscap Asset Management

Disclaimer

The preceding pages in this newsletter contain performance figures and information in relation to the Auscap Long Short Australian Equities Fund ARSN 615 542 213 and the Auscap Ex-20 Australian Equities Fund ARSN 671 901 821 from their inception. The actual performance of an investor's account will be provided in their monthly statement. Actual performance may differ for investments made in different classes or at different times throughout the year. The preceding pages in this newsletter are intended to provide general background information only. They do not constitute investment, tax, legal or any other form of advice, recommendation or opinion to be relied upon when making an investment or other decision. Any advice in the balance of this newsletter is general only in nature and does not take into account a particular person's objectives, financial situation, needs or circumstances. Because of that, before making any investment decision, you should consider – with or without the assistance of a qualified adviser(s) – the appropriateness of any advice in this newsletter to you, having regard to your objectives, financial situation, needs and circumstances. This document is not a Product Disclosure Statement (PDS) under the Corporations Act 2001 (Cth). Any opinions and forecasts in this newsletter reflect the judgment and assumptions of Auscap Asset Management Limited ACN 158 929 143, AFSL 428014 (Auscap) and its representatives on the basis of information available as at the date of publication, and may later change without notice. The content of this document does not constitute an offer or solicitation to subscribe for units in an Auscap fund or an offer to buy or sell any financial product. Past performance is not a reliable indicator of future performance. While all reasonable care has been taken to ensure that the information in this document is complete and correct, no representation or warranty is given as to the accuracy of any of the information provided, including any forecasts. To the maximum extent permitted by law, Auscap, its related bodies corporate, directors, employees and representatives are not liable and take no responsibility for the accuracy or completeness of this document. Before deciding whether to acquire, or to continue to hold, units in an Auscap fund, a prospective or existing investor should fully review the information, the disclosures and the disclaimers contained in all relevant fund documents, including in particular the relevant fund's disclosure document, the PDS, or any supplement to that document, and consider obtaining investment, legal, tax and accounting advice appropriate to their circumstances. A copy of the PDS for the Auscap Long Short Australian Equities Fund is available on request or at www.auscapam.com/auscap-fund/pds/ and a copy of the PDS for the Auscap Ex-20 Australian Equities Fund is available on request or at www.auscapam.com/auscap-ex20-australian-equities-fund-product-disclosure-statement/. Copies of the Target Market Determinations for the Auscap Long Short Australian Equities Fund and the Auscap Ex-20 Australian Equities Fund, prepared by Auscap in connection with the Design and Distribution Obligations, are available on request or at www.auscapam.com/ddo/. You are receiving this newsletter because we hold personal information about you, namely your contact details. You should view Auscap's Privacy Policy, a copy of which is available on Auscap's website, to understand how your personal information will be used and processed. No part of this material may be reproduced or disclosed, in whole or in part, without the prior written consent of Auscap.

Hong Kong

This newsletter has not been reviewed or approved by any regulatory authority in Hong Kong. This newsletter does not constitute an offer or invitation to the public in Hong Kong to acquire the units in an Auscap fund. Accordingly, unless permitted by the securities laws of Hong Kong, no person may issue or have in its possession for the purposes of issue, this newsletter or any advertisement, invitation or document relating to the units in an Auscap fund, whether in Hong Kong or elsewhere, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong other than in relation to the units of an Auscap fund that are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" (as such term is defined in the Securities and Futures Ordinance of Hong Kong (Cap. 571) and the subsidiary legislation made thereunder).

Singapore

This newsletter is being furnished to you on the basis that you are an "institutional investor" (as defined in the Securities and Futures Act (Chapter 289) of Singapore) and on a confidential basis, solely for your information. This newsletter may not be reproduced, disclosed, or distributed to any other person in Singapore. Auscap Asset Management Limited, as the responsible entity and manager for the Auscap funds has not taken any steps to ensure that the capital markets products referred to in this newsletter are suitable for any particular investor, and will not treat recipients as its customers by virtue of their receiving this document.

This newsletter has not been, and will not be, registered as a prospectus with the Monetary Authority of Singapore and this newsletter is not intended to constitute an offering, and is not regulated by any financial supervisory authority pursuant to any legislation in Singapore. The investments or services referred to in this newsletter may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about such investments or investment services. Nothing in this document constitutes investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable or appropriate to your individual circumstances or otherwise constitutes a personal recommendation to you.

United Kingdom

This newsletter may be distributed in the United Kingdom only to persons who: (i) have professional experience in matters relating to investments in accordance with Article 19 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended) ("FPO"); or (ii) to whom this document may otherwise be lawfully distributed (all such persons together being referred to as "Relevant Persons"). This newsletter is only directed at, or available to, Relevant Persons and must not be acted on or relied on by persons who are not Relevant Persons. Any investment or investment activity to which this document relates is available only to, and will be engaged in only with, Relevant Persons.

United States

This newsletter may not be distributed in the United States and does not constitute an offer to sell, or a solicitation of an offer to buy, securities in the United States. Any securities described in this newsletter have not been, and will not be, registered under the US Securities Act of 1933 and may not be offered or sold in the United States except in transactions exempt from the registration of the US Securities Act, the US Investment Company Act of 1940 and applicable US state securities laws.

If you do not currently receive the Auscap Newsletter automatically, we invite you to register. To register, please go to the website www.auscapam.com and follow the registration link on the home page. A copy of the PDS for the Auscap Long Short Australian Equities Fund is available at www.auscapam.com/auscap-fund/pds/ and a copy of the PDS for the Auscap Ex-20 Australian Equities Fund is available on request or at www.auscapam.com/auscap-ex20-australian-equities-fund-product-disclosure-statement/. Copies of the Target Market Determinations for the Auscap Long Short Australian Equities Fund and the Auscap Ex-20 Australian Equities Fund, prepared by Auscap in connection with the Design and Distribution Obligations, can be downloaded at www.auscapam.com/ddo/. We welcome any feedback, comments or enquiries. Please direct them to info@auscapam.com.

Auscap Asset Management Limited

ACN 158 929 143 AFSL 428014
Lvl 30, 9 Castlereagh St, Sydney

Email: info@auscapam.com
Web: www.auscapam.com

Service Providers

Auscap Long Short Australian Equities Fund
Prime Brokerage: Citi Global Markets
Administration: Link Fund Services
Tax & Audit: EY

Auscap Ex-20 Australian Equities Fund
Administration: Apex Fund Services
Tax & Audit: EY