CV Capital Pty Ltd

24 November 2022

SHAREHOLDER REPORT AS AT 31 October 2022

To my fellow shareholders & partners,

First, let me get some housekeeping matters out of the way. We like to thank everyone for reinvesting their FY22 dividend. Our dividend statements have been emailed out to you and our official ASIC shareholder register has been updated for the new shares issued under the dividend reinvestment. If you did not received your dividend statement or would like to view the ASIC shareholder register, please reach out to me.

The biggest economic event in 2022 has been runaway inflation which is driving higher interest rates. The RBA has raised the cash rate every month since May, resulting in the cash rate going from 0.1% in April 2022 to 2.85% today. The favourite sport amongst the tea leaf readers (economic analysts) these days is making their predictions on peak cash rate and when will inflation start to fall back to the RBA's target inflation rate of 2-3%.

Investing is a relative game, higher cash rates will lift yields of other fixed income securities such as bonds and as the yield of these fixed income securities get more attractive, it will entice many equity investors to switch from equities to "safer" fixed income securities. High interest rates make equities relatively less attractive as an asset class. In addition, as interest rates move up, it should theoretically lower the value of equities. The value of a stock is the sum of the present value of its future cash flows. Higher interest rate lowers a stock value by increasing the discount rate used to present value the future cash flows.

High interest rates are a bane for equity values. The unknown for me at least is how high does interest rate need to reach before triggering big moves out of equities.

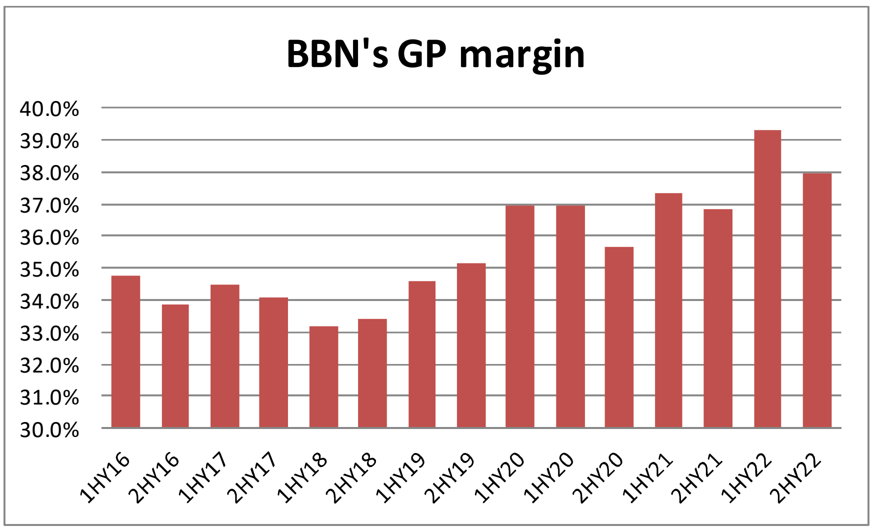
On these macroeconomic issues, I adopt the view of Buffet who says "For a piece of information to be desirable, it has to satisfy two criteria: It has to be important and it has to be knowable". Of course interest rates are important, if I had a crystal ball which told me that the cash rate would be 10% this time next year, I would sell all our positions (and probably go short) and wait for the market to crash to buy back-in. However, I do not think the outlook for interest rates is knowable. Our modern economy is just too complex and is driven by collective human behaviors which is simply too difficult to model and forecast with any degree of accuracy. Forget the analyst, even the RBA governor got it embarrassingly wrong when he said in 2021 that interest rates would not rise until 2024.

While the interest rate outlook makes for interesting reading, it has zero impact on our investing decisions.

Fund Activity

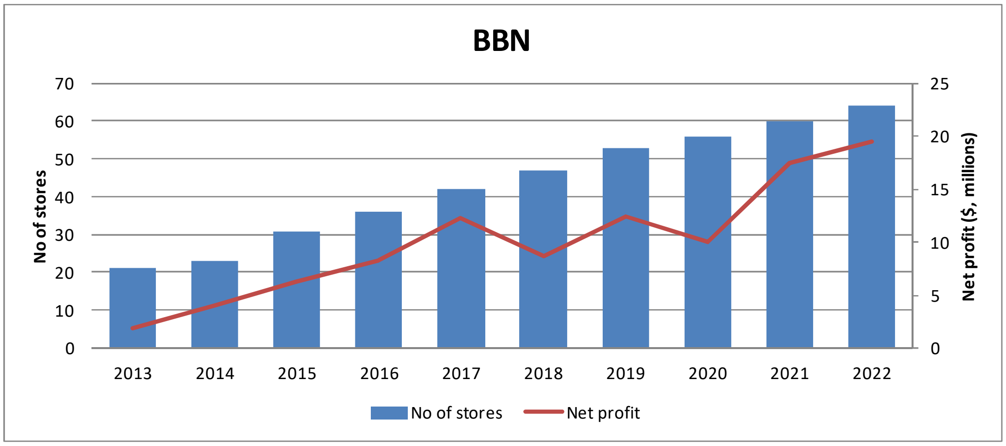
We continued purchasing more Baby Bunting (BBN) as the market sold off BBN heavily after the latest trading update during the 2022 AGM. BBN announced that their gross profit margin (**GP Margin**) for 1Q23 was 2.3% below 1Q22 due to a variety of factors and the market reacted negatively by selling off BBN from around the $4 mark before the AGM to $2.60 today (35% decline).

I believe this is an overreaction by the market because 1) its unrealistic for even a great business to not have fluctuations in its GP margins and 2) BBN's GP margins has been trending upwards since its 2015 IPO (see chart below). I consider a 2.3% fall in GP margins to be a normal trading for a retailer.



Note: 1HY is period from Jul to Dec and 2HY is period from Jan to Jul

Over the past 9 years, management has increased their store network by 205% and net profits by 962%. While it would be impossible to grow their footprint and net profits by the same token over the next decade, management has set a target for 100+ stores for Australia which implies BBN can still expand its store footprint by at least another 40%. Couple this by economies of scale as it grows larger (better margins), lack of any major competitors and the growing population of Australia and you can see strong tailwinds for earnings growth over the next 5-10 years.



I read a comment in one of the forums where someone said he couldn't understand why BBN was grouped under the consumer discretionary sector as he didn't think prams, cots and car seats were discretionary purchases for parents of a newborn. I totally agree.

Fund Performance

CV Capital's return for FY2023 (1 July 22 – 30 October 22) is 4.2% (including FY22 dividends and after FY22 performance fees). Since inception our returns are 12.1% (before performance fees) and 11.3% (after performance fees) on an annual compounded basis.

In my last report, I said I didn't like taking a performance fee when we beat the benchmark by reporting a smaller loss compared to the benchmark and I said I would withhold the performance fee payment until we register a positive return measured from 1 July 2021. We have now achieved that and the performance fee for FY21 has been paid. As with the dividend, I reinvested the performance fees.

The share price as at 31 October 2022 is $1.32. Details as follows:

	Per share
Securities portfolio value	$1.17
Cash	$0.15
Franking credits	$0.00
Share price	**$1.32**
Less: Estimated tax liabilities on realised gains	($0.01)
Subscription price	**$1.31**

YOURS SINCERELY,
DARRELL CHEAH