

# Selector High Conviction Equity Fund

Monthly report – May 2019

## Market insights

World politics dominated events during May. Locally, the Scott Morrison Liberal led government defied the bookies, returning to office with an elected majority. For Labor, the loss saw Bill Shorten step down. The share market's response was immediate, with the main All Ordinaries Index closing near 11-year highs up 1.1% to 6492. This contrasted to greater than 6% falls in world markets including the Dow Jones, Nasdaq, Hang Seng and Euro Stoxx indexes.

Labor's loss has put to rest the contentious policy issues that dominated the election debate, including cuts to franking credit rebates as well as changes to negative gearing and the capital gains tax discount. The re-elected government will now look to implement the first part of its proposed three stage income tax cut program beginning in 2019. Adding further positive sentiment to the banking sector was the announcement that APRA will lower the mortgage serviceability test for new loans, by scrapping the minimum mortgage rate of 7% to one that is based on a mortgage buffer of 2.5% above the actual loan interest rate. In theory this will provide home buyers with increased borrowing capacity. The third important development involved the Reserve Bank's indication that the current softness in the economy would underscore the need for interest rate cuts.

These factors and the government's more accommodating attitude towards business, infrastructure spend and addressing the growing impost of bracket creep on taxpayers is a welcome first step towards driving a more long-term, structurally aligned approach to encouraging investment and employment growth.

Trade tensions between the U.S. and China escalated during the month. Rather than settling disagreements, U.S. President Donald Trump confirmed a shift from 10% to 25% tariffs on US\$200b of goods. China retaliated with increased tariffs on U.S. based goods. All in all, Trump has shown no desire to take a backward step, a position shared by China's President Xi Jinping. And not to be outdone, the Brexit saga appears to be reaching a critical juncture, following British Prime Minister Theresa May's announcement of her resignation effective 7 June.

A raft of businesses held by the Fund reported earnings during the month, including Technology One, OFX Group, Fisher & Paykel Healthcare, James Hardie Industries and Aristocrat Leisure. In addition, we attended the investor day presentations held by registry group, Computershare and complementary medicines business, Blackmores. Overall, the earnings performance (Blackmores aside) and strategic business direction reinforced our positive long-term view towards each situation. Ultimately, success will be judged on the ability of these businesses to deliver real earnings per share growth over the long-term.

We continue to seek businesses with:

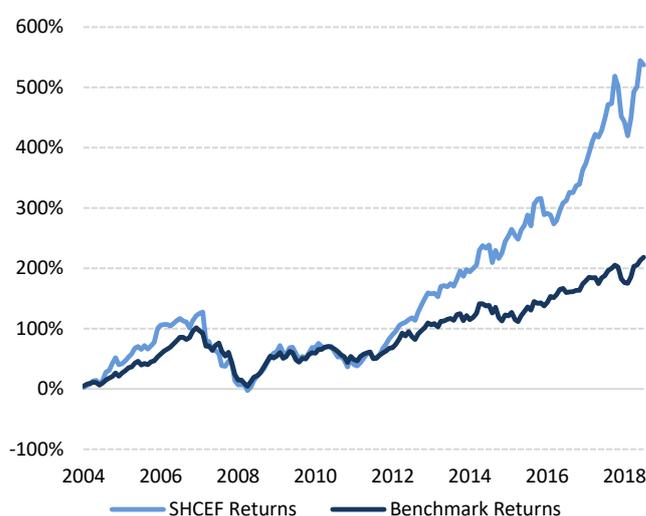
1. Competent management teams
2. Business leadership qualities
3. Strong balance sheets
4. A focus on capital management

## Performance as at 31 May 2019\*

	FYTD	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	Since Inception
Fund (Net of fees)	9.91	(0.79)	7.06	16.55	14.37	15.95	16.28	15.93	11.44
Fund (gross of fees)	11.51	(1.12)	7.49	17.42	16.21	17.96	18.32	18.04	13.54
All Ords Accumulation Index	7.36	1.67	4.99	15.27	10.52	10.51	7.98	10.05	8.26
Difference (gross of fees)	4.15	(2.79)	2.50	2.15	5.69	7.45	10.34	7.99	5.28

\*Performance figures are historical percentages, calculated using end of month redemption prices, and do not allow for the effects of income tax or inflation. Returns assume the reinvestment of all distributions. Performance can be volatile and future returns can vary from past returns.

## Cumulative returns since inception



Inception Date: 30/10/2004

Before fees, costs and tax, and assuming reinvestment of distributions

## Top holdings

Company name	Code	Weight (%)
Aristocrat Leisure	ALL	6.16
Jumbo Interactive	JIN	5.87
Seek	SEK	5.21
Altium	ALU	5.12
Flight Centre Travel Group	FLT	4.94
Cochlear	COH	4.60
IRESS	IRE	4.46
Infomedia	IFM	4.28
ResMed	RMD	4.07
NIB Holdings	NHF	3.58

## Unit prices as at 31 May 2019

Entry price	\$2.9806
Mid price	\$2.9732
Exit price	\$2.9658

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## Portfolio commentary

### Aristocrat Leisure (ALL:ASX)

Global gaming leader Aristocrat Leisure delivered a strong first half result, lifting revenues 30% to a record \$2.1b. Operating profits and net profits adjusted for goodwill amortisation both rose 17% to \$644m and \$422m respectively. To appreciate the significant progress the company has made over a relatively short period of time, it's worth reflecting that the group generated revenues of \$847m and net profits of \$120m in FY14. In the intervening years, strong organic growth and several important acquisitions have propelled the business forward. The group's issued capital has remained unchanged at \$638m, leaving the use of debt and internal cash flows as the means of funding this growth.

While net debt has risen to the current level of \$2.4b, the strong and recurring nature of income earned has provided the business with ample manoeuvrability, with debt cover sitting at 1.6x of operating profits. If we assumed that participation gaming operations and digital revenues generate relatively "sticky" and recurring income streams, more than 75% of revenues and a higher percentage of profits would be predictable. While this doesn't diminish the need for games to remain relevant and popular, it provides the company with higher levels of earnings predictability and the confidence to invest over the medium to long term. The company is currently enjoying strong market share growth in an otherwise flat and competitive market. This success is a direct by-product of the investments made in earlier years and the conservatism that prevails within the management team. Importantly, under the leadership of CEO Trevor Croker, the investment thesis continues to support a long-term approach.

### Technology One (TNE:ASX)

Leading enterprise software as a service (SaaS) provider Technology One reported first half profit numbers under the new accounting standards AASB15 during May. For the half, the group recorded total revenues of \$129m up 5% on a comparable basis. The main components of this were SaaS revenues of \$37m and annual licence fees totalling \$51m. Over 389 large scale customers have now converted to the group's SaaS model compared to the 280 reported in the last comparable period, leaving the company well on track to convert the majority of its existing 1,200 customers.

While SaaS revenues are rising strongly, up 42% for the half, the group's traditional on-premise license revenue model is turning down. As such the company is in a transition period which will extend over the next few years. Whilst first half operating profits of \$25m are expected to make up 33% of full year earnings, in time this will shift towards a 45%-55% split.

The company is not only successfully converting existing customers to the SaaS model, but winning a host of new enterprise relationships. Chief Operating Officer Stuart MacDonald noted that in terms of its enterprise offering, covering the key industries of Education and Local Government, Technology One's SaaS and cloud enabled offering is without a peer globally. For the full year the company is forecasting pre-tax profits within the range of \$71m - \$76m.

## About Selector

Selector Funds Management ("Selector") specialises in high conviction, index agnostic, concentrated portfolio management (AFSL 225316). The investment team have a high level of experience, are owners of the business and invest in the funds alongside clients. Selector has a long-term track record of performance.

## Performance contributors

Top five	Contribution (%)
Aristocrat Leisure	0.71
Seek	0.61
NIB Holdings	0.59
Flight Centre Travel Group	0.58
ResMed	0.43
Bottom five	Contribution (%)
Reliance Worldwide Corporation	(0.96)
Technology One	(0.72)
IOOF Holdings	(0.59)
Altium	(0.48)
Nanosonics	(0.34)

## Industry exposure

Industry group	Weight (%)
Consumer Services	22.66
Software & Services	18.78
Health Care Equipment & Services	13.40
Commercial & Professional Services	8.14
Capital Goods	6.33
Materials	5.87
Diversified Financials	5.49
Insurance	3.58
Pharmaceuticals, Biotechnology & Life Sciences	3.25
Cash & Other	3.22
Energy	3.19
Household & Personal Products	3.14
Media & Entertainment	2.20
Retailing	0.74

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