selector

Selector High Conviction Equity Fund

Monthly report – November 2019

Market insights

Despite the backdrop of global unrest, the market moved into record territory, as it continues to climb the proverbial *'wall of worry'*. For November, the All Ordinaries Index closed up 2.6% to 6,948 points. The banking industry fallout and a heightened level of corporate activity dominated domestic markets while internationally, the U.S.-China trade war remains the focus of attention.

Westpac's failure to report roughly 29 million international money transfers highlights the enormity of meeting regulatory compliance standards. In normal circumstances, details of these transactions would have been passed to the anti-money laundering authority AUSTRAC, to ensure that international standards are not breached. However, due to technical issues associated with a software system update in 2011, automatic reporting alerts were not activated and passed on as required. While most of these transactions are assumed not to be nefarious, AUSTRAC alleges a series of low value transactions can be linked to child exploitation in high risks jurisdictions. The bank's failure to address this matter going back as far as 2017, is now the subject of intense public and political debate. Chairman Lindsay Maxsted agreed to step down in 2020 while CEO Brain Hartzer has resigned, alongside the chair of the Bank's risk and compliance committee. As Westpac scrambles to address a number of regulatory compliance matters, one thing is clear, that the complexity and cost of meeting ongoing compliance requirements will remain elevated.

A renewed bout of corporate activity is continuing to underpin the local market. In recent months, organic baby formula group Bellamy's Australia accepted, with the Foreign Investment Review Board's (FIRB) approval, a $1.5b takeover offer. Further, chemical group Nufarm sold its Latin America business for $1.2b while the share price of oil refiner Caltex Australia jumped following a full takeover offer valuing the company at close to $10b.

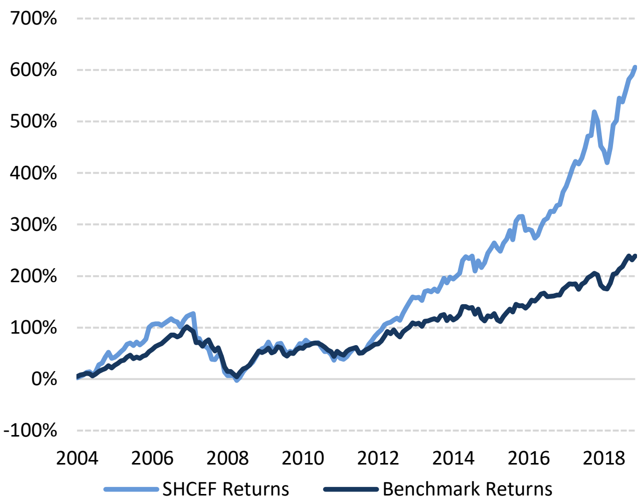
The protracted U.S.-China trade war continues unresolved with the U.S. further destabilising the relationship through domestic policy. This month, Trump signed bills backing pro-democratic Hong Kong protestors. The measures, approved unanimously by the US Senate, threaten sanctions on Chinese and Hong Kong officials who are deemed responsible for human rights abuses in Hong Kong. The legislation also requires that the autonomy of Hong Kong is tested annually to justify favourable U.S. trading terms. This development has angered Beijing, condemning the legislation as *"full of prejudice and arrogance*".

Notably, each year the Harvard Business Review (HBR) compiles a list of the best-performing CEOs in the world. The review considers CEOs from companies in the S&P Global 1200 Index and considers financial metrics and non-financial metrics including environmental, social and governance (ESG). One point garnering interest is the significance of experience, "*The CEO's of the S&P 500 have an average tenure of 7.2 years; in comparison, HBR's best performing CEO's have been in the job 15 years, on average*."

We continue to seek businesses with:

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

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	6.20
James Hardie Industries	JHX	5.28
Altium	ALU	5.04
Seek	SEK	5.00
ResMed	RMD	4.79
Jumbo Interactive	JIN	4.69
Cochlear	COH	4.65
Nanosonics	NAN	4.41
Infomedia	IFM	4.41
Flight Centre Travel Group	FLT	4.32

Unit prices as at 30 November 2019

Entry price	$3.2179
Mid price	$3.2099
Exit price	$3.2019

Performance as at 30 November 2019*

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	15 Years	Since Inception
Fund (net of fees)	3.37	6.90	14.60	33.57	21.44	18.08	14.31	11.97	12.05
Fund (gross of fees)	3.90	8.19	17.01	37.59	24.09	20.47	16.55	14.16	14.25
All Ords Accumulation Index	3.07	4.88	9.21	25.89	12.64	10.13	8.46	8.33	8.61
Difference (gross of fees)	0.83	3.31	7.80	11.70	11.45	10.34	8.09	5.83	5.64

*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.

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Portfolio commentary

TechnologyOne (TNE:ASX)

Leading enterprise software as a service (SaaS) provider TechnologyOne reported its full year 2019 result in November. For the year, the group recorded total revenues of $286m, up 13% and operating profit before tax of $76m, up 50% on a comparable basis. Net profit rose 15% from $51.0m to $58.5m.

TechnologyOne continues to transition its business from an on-premise license model to a subscription-based SaaS offering. The company now has 435 enterprise customers adopting the SaaS platform which has seen the SaaS Annual Recurring Revenue (ARR) increase to $102m up 44% from the prior year. The company continues to target a goal of migrating over 1,000 existing enterprise customers to its SaaS offering by 2022, giving rise to an ARR in 2024 of over $500m. As the SaaS business scales, strong operational efficiencies are being realised with profit before tax margins increasing from 20% to 27%. Over the medium term the company is pointing to profit margins lifting to 35%.

The company continues to invest over 20% of revenues into new product development. One such investment, termed DXP, is currently being piloted with university partners as a student engagement tool. While further work is required, the opportunity for TechnologyOne to provide a front-end digital solution that integrates with the university's existing back-end administration platform is illustrative of the opportunity set available.

The group maintains a conservative approach to capital management with a prudent dividend payout ratio of 65% giving rise to an increasing cash balance. TechnologyOne has a current market capitalisation of $2.9b, cash of $105m and no debt.

Aristocrat Leisure (ALL:ASX)

Leading global gaming operator Aristocrat Leisure maintained its impressive financial performance, delivering a high quality 2019 full year result. The company reported a strong result with revenues up 23% to $4.4b, while net profits before amortisation lifted 23% to $894m. With over 65% of earnings recurring, management has the capacity to invest over a longer time horizon.

Now into his second year as group CEO, Trevor Croker continues to shape the company’s strategic direction, encompassing both land-based and digital gaming operations. The company’s attention is clearly focused on the U.S. operations which have lifted to a higher level following significant operational expansion and acquisition activities. In the land-based sale and placement of gaming machines, Aristocrat is the leading player in a number of key market segments. In digital, management continues to bed down recent acquisitions, comprising Big Fish and Plarium. As such, the 2019 year has been described as a transition year.

The business is in a strong position, with clearly defined growth opportunities and operating with scale. While no formal outlook was provided, the key U.S. market segment is set for stronger growth during 2020, underpinned by operational efficiency benefits and a materially lower corporate tax rate.

Aristocrat Leisure has a current market capitalisation of $21.6b, with net debt of $2.2b.

Performance contributors

Top five	Contribution (%)
TechnologyOne	0.85
James Hardie Industries	0.78
Altium	0.53
Aristocrat Leisure	0.49
Cochlear	0.46
Bottom five	**Contribution (%)**
Jumbo Interactive	(0.40)
Infomedia	(0.36)
PolyNovo	(0.32)
Blackmores	(0.14)
NIB Holdings	(0.12)

Industry exposure

Industry group	Weight (%)
Software & Services	21.82
Consumer Services	21.23
Health Care Equipment & Services	16.17
Materials	7.16
Capital Goods	5.81
Diversified Financials	5.70
Commercial & Professional Services	5.00
Pharmaceuticals, Biotechnology & Life Sciences	3.88
Insurance	2.97
Energy	2.91
Household & Personal Products	2.73
Media & Entertainment	2.30
Automobiles & Components	1.25
Consumer Durables & Apparel	0.65
Cash & Other	0.42

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.

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