Selector High Conviction Equity Fund

Monthly report – February 2020

Market insights

Company reporting season is always a good barometer on the health of a business and the general economy. This year has proven to be no exception. We entered this reporting season with the backdrop of a weakening global outlook, driven in large part by the long running trade wars between the U.S. and China and complicated by the aggressive spread of the coronavirus officially known as COVID-19. Businesses have responded, working to contain the potential fallout and preparing for a multitude of eventual outcomes in an increasing volatile market. Off the back of this uncertainty, the All Ordinaries Index closed down 8.56% to 6,511.5 points.

Not all companies report during this period, but for those that did, our general assessment has been positive. Standout results from the likes of global plasma manufacturer CSL, building materials group James Hardie Industries, printed circuit board global leader Altium, sleep disordered breathing leader ResMed, plumbing operator Reece and global pizza franchisor operator Domino's Pizza Enterprises were countered by weaker performances from the likes of complementary medicines supplier Blackmores, push-to-connect plumbing operator Reliance Worldwide Corporation, and health insurer NIB.

In determining the health of any business, we consider how well management are traversing the economic landscape. This is a long-term pursuit, rather than a short-term sprint. The need to reinvest to meet longer term business aspirations often runs counter to hitting current earnings expectations. This season, matters were further complicated with the outbreak of COVID-19 which originated in Wuhan, China. Such has been the speed in which the virus has spread that Chinese authorities have taken the unprecedented steps of shutting down daily activity, significantly impacting manufacturing and restricting travel.

Reporting season has been dominated by reference to the impacts of COVID-19 making general comparisons on performance harder to measure. Matters are made worse by having little visibility over the duration of the virus spread or its potential longer-term impact. Market reactions to these events are therefore not unexpected and while company valuations will be directly hit, we caution investors to consider each situation on its individual merits. We do not profess to have any skill in determining the severity or fallout from such left field events but add that, in our experience, they eventually lose intensity with the passage of time.

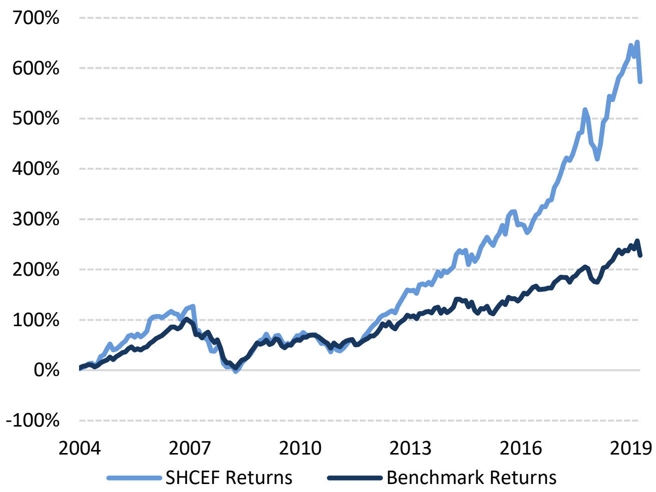
The situation is certainly fluid and under the extreme circumstances that currently exist, investors will do well to offer company management teams some latitude in navigating through these times.

With the increased market uncertainty created by COVID-19, many investors are exiting assets with higher perceived risk. This has seen U.S. 10-year Treasury Bonds, traditionally considered risk-free by investors, plunge below a yield of 1.1% for the first time in history.

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	6.05
Iress	IRE	5.38
ResMed	RMD	5.27
James Hardie Industries	JHX	5.13
Altium	ALU	4.82
Domino's Pizza Enterprises	DMP	4.78
CSL	CSL	4.49
Seek	SEK	4.45
Nanosonics	NAN	4.42
Infomedia	IFM	4.40

Unit prices as at 29 February 2020

Entry price	$2.9272
Mid price	$2.9199
Exit price	$2.9126

Performance as at 29 February 2020*

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	15 Years	Since Inception
Fund (net of fees)	(10.20)	(9.41)	(2.77)	11.59	18.99	13.30	13.63	10.59	11.15
Fund (gross of fees)	(10.48)	(9.72)	(2.34)	13.58	21.09	15.32	15.71	12.63	13.23
All Ords Accumulation Index	(8.08)	(5.59)	(0.99)	8.24	8.54	6.37	7.90	7.48	8.06
Difference (gross of fees)	(2.40)	(4.13)	(1.35)	5.34	12.55	8.95	7.81	5.15	5.17

*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. For periods greater than one year, returns are annualised. Performance can be volatile and future returns can vary from past returns.

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Portfolio commentary

Domino's Pizza Enterprises (DMP:ASX)

Global pizza operator Domino's Pizza Enterprises delivered a much improved performance for the December 2019 half year. Following a difficult past twelve months, the group's domestic and international performance improved markedly, benefiting from solid organic sales growth.

Operating in three geographic regions and with a network of over 2,600 stores, Domino's recorded a 10.6% lift in global food sales to $1.6b, with same store sales (SSS) growth of 4.1%, while operating profits rose 10% to $151m, giving rise to an operating margin of 9.6%. Group performance was solid across all regions, led by an improving local performance that saw SSS growth of 3% and operating profits up 1.7% to $71.4m.

Fortressing, a term used to reflect the group's aim to reduce the delivery times to customers by increasing store numbers within a defined area, remains a key focus. The financial wellbeing of franchisees remains a key metric and having endured a difficult backdrop over recent times, management is committed to ensuring that the quality of franchisees improves to ensure operational and customer excellence.

The company ended the half with strong sales momentum and the current period has begun in an equally positive note. For the full year, the group is expected to report global food sales of over $3b, while SSS is expected to sit within the long-term guidance range of 3% to 5%. Store numbers are forecast to increase by 7% to 9% over the foreseeable future, with the company indicating a target in excess of 5,000 by 2025-2028.

Domino's has a market capitalisation of $4.8b and net debt of $476.9m.

Reliance Worldwide Corporation (RWC:ASX)

Reliance Worldwide (RWC) manufacturers and distributes push-to-connect (PTC) plumbing systems, fittings, PEX pipes, valves and related specialty products under an array of brands including Reliance, SharkBite and John Guest.

The first half result was impacted by a raft of global headwinds across Reliance's key markets. These included slowing new house construction in Australia, continued uncertainty around Brexit in the U.K., alongside the well-publicised tariff and trade issues combined with the loss of Fergusons, a wholesale customer in the U.S. The culmination of these challenges placed the company under significantly increased pressure over the period.

Reliance downgraded their EBITDA guidance for the full year to a range of $265m-$280m and NPAT to $140m-$150m. This was an 8% downgrade at the midpoint from the previously reported NPAT guidance range of $150m-$165m. As is customary with skittish investors, second downgrades are treated harshly, and a rotation of the share register is currently underway. Impatient investors smash and run with scant regard for business fundamentals.

Operationally this was a sound result with strong inventory control driving cash flow conversion of over 100%. Net debt reduced slightly from 1.67 to 1.57 times net debt to EBITDA. Surprisingly, the interim dividend was increased from 4.0 to 4.5 cents per share which appeared somewhat at odds to the reported result.

Reliance has a market capitalisation of $2.7b and net debt of $394.7m.

Performance contributors

Top five	Contribution (%)
FINEOS Corporation Holdings	0.21
Infomedia	0.13
Reece	0.08
Fisher & Paykel Healthcare Corporation	0.06
Breville Group	0.03
Bottom five	**Contribution (%)**
Altium	(1.17)
IOOF Holdings	(1.15)
Reliance Worldwide Corporation	(0.87)
Blackmores	(0.79)
Oil Search	(0.63)

Industry exposure

Industry group	Weight (%)
Software & Services	23.19
Consumer Services	19.48
Health Care Equipment & Services	16.08
Materials	6.81
Capital Goods	5.77
Diversified Financials	5.60
Pharmaceuticals, Biotech & Life Sciences	4.49
Commercial & Professional Services	4.45
Media & Entertainment	4.21
Insurance	2.45
Household & Personal Products	2.44
Energy	2.15
Automobiles & Components	1.13
Cash & Other	1.01
Consumer Durables & Apparel	0.74

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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