selector

Selector High Conviction Equity Fund

Monthly report – April 2020

Market insights

The fiscal impact of COVID-19 continues to be felt as businesses grapple with an unprecedented downturn in demand. With earnings under pressure, it has been no surprise to see a host of companies seek an injection of new capital over the month. Despite the growth in cases of COVID-19, with the global tally nearing 3.2m infections and over 220,000 reported deaths, measures taken in Australia may have reduced the spread of the virus. That said this has come at a high economic cost to society, and future generations who are set to be saddled with debt. Buoyed by talk of possibly rolling back lockdown restrictions over the coming weeks and returning to some level of normality, our local All Ordinaries Index closed up 9.53% to 5,598 points.

National Australia Bank's (NAB) mammoth $3.5b capital raise has highlighted the inherent leverage that sits within our banking sector. To that end we question the rationale of banks paying out a significant portion of reported profits in dividends. Considerable leverage coupled with unsustainably high payout ratios has required more capital top ups to navigate market downturns. While NAB cut its interim dividend to 30 cents per share, down 64% from last year, this will still consume $800m of their total raise.

Even pre-COVID, banks have had an unsustainable habit of borrowing from one hand to pay the other. We observed this when Westpac raised $2.5b in November 2019 at a price discount of 6%, only to pay out their usual December half year dividend costing $2.8b. Raising money from investors at a discount, to fund unsustainable dividend policies destroys value and introduces unnecessary dilution.

Since mid-March, there have been over 35 deals to raise in excess of $15b in fresh capital for listed companies attempting to improve liquidity or shore up balance sheets. Interestingly, technology companies including Megaport and Infomedia have raised new capital to leverage the recent market dislocation to pursue growth investments and M&A opportunities. We appreciate the difficulty of navigating current market dynamics and have participated in a number of these new capital raisings.

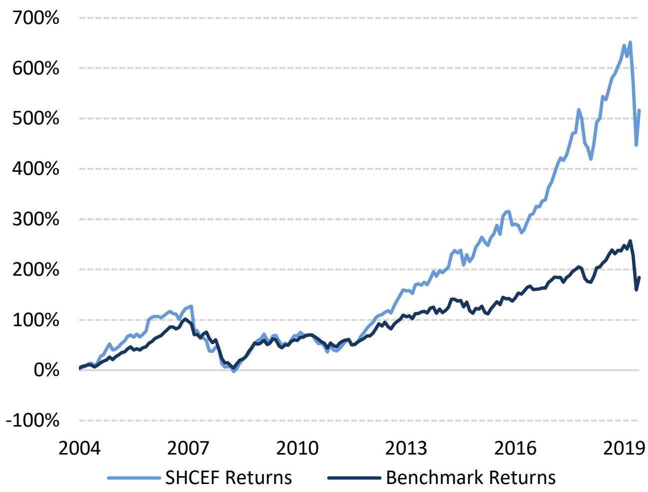
As the global economy has stalled, oil consumption has collapsed creating significant pressure on international storage capacity. For the first time, the futures price of West Texas International (WTI) crude fell below zero to negative US$37.63 per barrel. For oil producers, this is equivalent to paying someone to take product off your hands. While WTI crude has since rebounded to just under US$20 per barrel, this is still significantly below the US$57 per barrel price averaged over 2019. In response to this vast oversupply, OPEC and other oil-producing countries have agreed to cut production by 10m barrels a day, reducing oil production to roughly 23% of the levels seen over May and June. Time will tell if this is enough to curb the global oil glut.

In this unprecedented and fast-moving environment, we continue to invest with a long-term perspective.

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 (%)
Altium	ALU	5.82
Iress	IRE	5.40
ResMed	RMD	5.29
Domino's Pizza Enterprises	DMP	5.23
Aristocrat Leisure	ALL	4.99
TechnologyOne	TNE	4.84
Nanosonics	NAN	4.79
Cochlear	COH	4.77
CSL	CSL	4.71
James Hardie Industries	JHX	4.51

Unit prices as at 30 April 2020

Entry price	$2.6540
Mid price	$2.6474
Exit price	$2.6408

Performance as at 30 April 2020*

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	15 Years	Since Inception
Fund (net of fees)	12.10	(18.58)	(14.87)	(6.25)	12.49	10.95	11.67	10.22	10.32
Fund (gross of fees)	12.66	(18.01)	(14.10)	(4.31)	14.75	13.09	13.80	12.30	12.44
All Ords Accumulation Index	9.54	(20.39)	(15.73)	(9.22)	2.12	3.66	5.88	6.79	6.97
Difference (gross of fees)	3.12	2.38	1.63	4.91	12.63	9.43	7.92	5.51	5.47

*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

Infomedia (IFM:ASX)

This month Infomedia, a leading automotive electronic parts catalogue (EPC) software provider, raised $70m in fresh capital through an institutional placement. In addition, a complementary Share Purchase Plan (SPP) seeking to raise an additional $15m is currently underway. This new injection of capital is expected to enhance the financial flexibility of the company, allowing them to emerge from the recent market volatility in a position of strength.

CEO and Managing Director, Jonathan Rubinsztein explained the timing of the raise, *"We believe COVID-19 provides a unique opportunity to fast-track our growth strategy towards acquiring quality assets that leverage our global parts, service and data insights platform with enhanced technology, access to new customers and entry to new geographies. This Capital Raising puts us in a strong position to take advantage of value attractive and operationally accretive opportunities that will emerge in the current environment, and strengthen our position as one of few market-leading software service providers in the automotive industry globally".*

Infomedia has reaffirmed its FY20 outlook of delivering low double-digit growth in revenue and earnings. The company expects their revenue to be between $93m to $95m, an increase of 10% to 12% on FY19, with net profit after tax to be in the range of $18m to $19m, an increase of 12% to 18%. Trading to the end of March has met internal expectations with the company ending the quarter holding $15.2m in cash (prior to the capital raising).

Infomedia has a current market capitalisation of $580m.

Aristocrat Leisure (ALL:ASX)

Due to continued uncertainty as to the duration and extent of the impacts of COVID-19, Aristocrat has withdrawn its FY20 guidance provided in February. Digital games, which contributed approximately 40% of total group revenue last year, have performed strongly over this period. Land-based operations, which accounted for the remaining 60% of revenue last year, have been significantly impacted by temporary venue closures around the globe.

As such, Aristocrat has enacted cost reduction measures including standing down 1,000 staff until the end of June 2020, removing a further 200 roles permanently, and reducing base salaries for staff and the Board by between 10%- 20%. The cost reduction initiatives are expected to deliver circa $100m in cost savings until September 2020.

The company continues to have a conservatively geared balance sheet, especially when compared to global peers, with a net debt to EBITDA ratio of 1.4x (as at September 2019 when the company last reported). In addition, the company is well positioned with headroom in existing credit facilities and will therefore be unlikely to require additional funding in the near-term.

Aristocrat Leisure has a market capitalisation of $15.4b and a net debt position of $2.2b.

Performance contributors

Top five	Contribution (%)
Altium	1.08
Nanosonics	1.02
Jumbo Interactive	0.93
Aristocrat Leisure	0.89
James Hardie Industries	0.88

Bottom five	Contribution (%)
ResMed	(0.28)
Fisher & Paykel Healthcare Corporation	(0.12)
NIB Holdings	(0.11)
Cochlear	(0.05)
OFX Group	(0.03)

Industry exposure

Industry group	Weight (%)
Software & Services	27.18
Consumer Services	18.33
Health Care Equipment & Services	17.16
Media & Entertainment	8.75
Capital Goods	6.42
Diversified Financials	4.88
Pharmaceuticals, Biotech & Life Sciences	4.71
Materials	4.51
Household & Personal Products	3.02
Insurance	2.74
Automobiles & Components	1.26
Consumer Durables & Apparel	0.70
Cash & Other	0.35

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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