Selector High Conviction Equity Fund

Monthly report – June 2020

Market insights

The 2020 financial year has proven to be a watershed twelve months. As a nation we have faced drought, bushfires, floods and more recently the ongoing economic and health impacts of the COVID-19 pandemic. Taking all of this into account, our local market has been surprisingly resilient with the All Ordinaries Index closing up 2.2% to 6,001 at the June month end, while recording a negative 10.42% return for the financial year, the first down year since 2016.

On the international front, COVID-19 has brought into question the suitability of global supply chains. As boards grapple with the implications of continuing to source from a single region or channel, the reality of economies effectively shutting down overnight exposed many businesses. Supply chain contingency may now carry equal or more importance than margin benefits alone. Coming out of this pandemic, we expect companies to reconsider the sustainability of their supply chains, this may include introducing significant backup redundancies or potentially exploiting new emerging market manufacturing opportunities, amongst other solutions.

In addition, COVID-19 has brought geopolitical tensions to the fore. Mid-month, Indian and Chinese soldiers were involved in a bloody clash along their disputed Himalayan border. India has reacted by banning 59 software applications created by Chinese developers, including popular video sharing platform TikTok, citing privacy and security concerns.

This escalation may have implications in aligning India and the U.S. interests in opposing Chinese political subjugation. This is particularly evident after a bill unanimously passed the U.S. House of Representatives seeking to impose sanctions on banks that transact with Chinese officials responsible for cracking down on pro-democracy protestors in Hong Kong. The move comes as a response to China overstepping its promise to honour the former British colony's autonomy with the enactment of national security laws in Hong Kong.

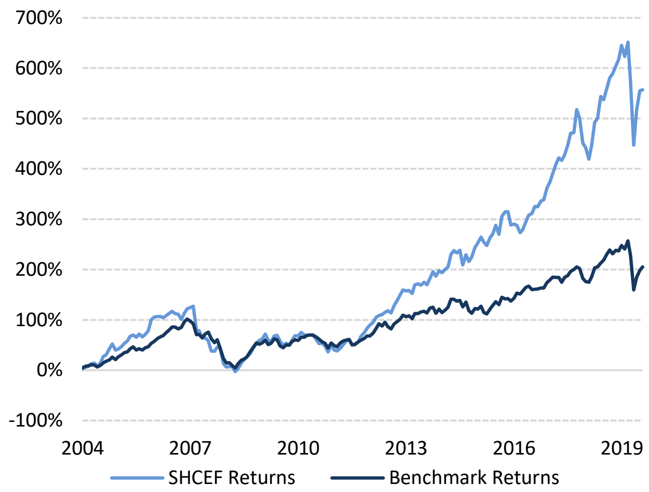
Back home, Prime Minister Scott Morrison announced a fresh wave of cyber-attacks orchestrated by a foreign state-sponsored actor. These attacks have been widespread, targeting government institutions, businesses, critical infrastructure, as well as other organisations. While first calling for personal vigilance, the Prime Minister has unveiled a 10-year funding commitment totalling $1.35b to protect Australia's data and computer networks. Despite the orchestrator not yet being named, speculation has pointed to China following the recent escalation in trade tension caused by new restrictions on Australian exports imposed last month.

With so many industries fundamentally impacted by COVID-19, we remain cognisant of governments continuing to amass debt to financially engineer economic outcomes that are becoming increasingly out of reach. This has resulted in the public sector, the government, being the primary allocator of capital in its drive to stabilise the very same global economies that they closed. With limited viable options for repaying this debt we expect that, while the road ahead is not totally unchartered, it will certainly be bumpy as the market climbs a wall of worry.

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 (%)
ResMed	RMD	5.80
Domino's Pizza Enterprises	DMP	5.77
Iress	IRE	5.25
Altium	ALU	5.16
James Hardie Industries	JHX	5.15
Carsales.com	CAR	4.73
Aristocrat Leisure	ALL	4.65
Seek	SEK	4.60
TechnologyOne	TNE	4.58
Cochlear	COH	4.55

Unit prices as at 30 June 2020

Entry price	$2.8191
Exit price	$2.8051
Mid price	$2.8121
Mid price – Cum Distribution ($0.0086 per unit)	$2.8206

Performance as at 30 June 2020*

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	15 Years	Since Inception
Fund (net of fees)	0.50	19.43	(9.80)	(2.37)	13.44	14.12	13.85	9.50	10.65
Fund (gross of fees)	0.33	20.13	(9.09)	(0.08)	15.62	16.27	15.98	11.54	12.76
All Ords Accumulation Index	2.34	17.75	(10.42)	(7.21)	5.43	6.22	7.78	6.75	7.39
Difference (gross of fees)	(2.01)	2.38	1.33	7.13	10.19	10.05	8.20	4.79	5.37

*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

Fisher & Paykel Healthcare Corporation (FPH:ASX)

In June, leading respiratory care group Fisher & Paykel Healthcare reported their 2020 financial year result a month later than expected, with the company choosing to pivot internal resources towards meeting significant demand for hospital products resulting from COVID-19. A response team was set up in January, with the group effectively adding more manufacturing shifts and staff to double and, in some cases, triple the output of hardware products.

Fisher & Paykel operates two product groups, being Hospital and Homecare. Within these two groups hardware sales totalled NZ$185m, while consumables being recurring in nature, hit NZ$1,073m.

For the full year, Fisher & Paykel delivered total revenues of NZ$1.3b, up 18% along with a 37% increase in net profits to NZ$287.3m. Despite the increase in profits, management remain focused on long-term sustainable growth. This is most evident in research and development spend of NZ$119m or 9.4% of sales and capital expenditure up 28% to NZ$170.7m.

The company has provided FY21 guidance, on the basis that COVID hospitalisations peak in the first quarter, with full year revenue of NZ$1.48b and net profits within the range of NZ$325m and NZ$340m. This would represent growth rates of 17% and 16% respectively, with the long-term target of doubling revenues every five to six years firmly in place.

In order to maintain low gearing levels and cash for future growth, the company has decided to pay a final dividend of 15.5c per share, representing a full year payout ratio of 55%, lower than the 65% in the pcp. Fisher & Paykel has a market capitalisation of NZ$19.6b and net cash of NZ$42.2m.

Jumbo Interactive (JIN:ASX)

Leading internet lottery business, Jumbo Interactive extended its long-term relationship with gambling entertainment group Tabcorp by way of a 10-year reseller agreement until July 2030. While the new costs to the business are substantial, the certainty provided by the length of the agreement offers significant value.

Under the new arrangement, Jumbo has agreed to pay an upfront extension fee of $15m for the full term and a per ticket service fee phasing in at 1.50% in FY21 progressively ramping up to 4.65% in FY23. This fee is based on the net buy price at which Jumbo purchases their tickets from Tabcorp and excludes any premium they charge. This is expected to reduce the groups revenue margin from circa 20% to 16%. The commercial arrangements took into consideration Jumbo's scale and the value that Tabcorp's lottery licenses provide to the company.

Jumbo's CEO and Founder, Mike Veverka commented, *"The next 10 years will see a lot of advances in the lottery industry both in Australia and abroad. The new 10-year reseller agreements are the longest ever term in Jumbo's history and provide a basis for continuing expansion. Having a long-term distribution arrangement with Tabcorp with its world class operational capabilities and significant commercial relationships will support our future growth aspirations."*

Jumbo has a market capitalisation of $674m and reported a cash balance of $71m in February.

Performance contributors

Top five	Contribution (%)
ResMed	0.79
Domino's Pizza Enterprises	0.52
Carsales.com	0.42
Seek	0.37
James Hardie Industries	0.29

Bottom five	Contribution (%)
Altium	(0.75)
Jumbo Interactive	(0.62)
Flight Centre Travel Group	(0.42)
Nanosonics	(0.26)
Megaport	(0.25)

Industry exposure

Industry group	Weight (%)
Software & Services	26.62
Health Care Equipment & Services	17.37
Consumer Services	16.76
Media & Entertainment	10.19
Capital Goods	6.31
Diversified Financials	5.20
Materials	5.15
Pharmaceuticals, Biotech & Life Sciences	4.07
Household & Personal Products	3.09
Insurance	2.39
Automobiles & Components	1.39
Consumer Durables & Apparel	0.99
Cash & Other	0.48

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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