

Selector High Conviction Equity Fund

Monthly report – July 2020

Market insights

As investors ready themselves for what is expected to be an eventful August reporting season, markets maintained their positive stance despite the continuing global fallout from COVID-19. While still trading behind pre COVID-19 levels, the local All Ordinaries Index closed up 0.95% to 6,058 points. Geopolitical relationships remain at the fore with recent escalations, primarily involving China, culminating in sanctions and consulate closures. Domestically, we remain cognisant of the ramifications of mounting debt levels as the Government considers the most prudent and necessary steps required to stimulate economic activity.

The Australian Federal Government has revealed that the recent fiscal response to COVID-19 has created a budget deficit of circa \$86b for the financial year just closed. This is an outsized shift from the 'return to surplus' of \$5b that was widely expected when the budget was first set. This deficit is forecast to expand significantly to circa \$185b in the new fiscal year in view of an expected decrease in tax collection revenues and the ongoing economic response to COVID-19. This will be the largest deficit the country has faced since World War II with Treasurer Josh Frydenberg describing the figure as "eye-watering".

James Gorman, who sits on the board of the Federal Reserve Bank of New York and serves as CEO of Morgan Stanley, warned that the increased deficit may have implications for Australia's credit rating. He commented, "The AAA rating is not something to be messed around with. That's a massive sovereign risk advantage for Australia. It is very important. I would not give that up. Having a very stable sovereign risk and stable banking system is essential to the economic balance in the country."

More broadly, the Australian Prudential Regulation Authority (APRA), in a measured response, guided bank boards to cap dividend pay-out ratios at 50%. This represents a significant step down from the usual 75-95% pay-out range shareholders have been accustomed to. Prime Minister Scott Morrison welcomed the decision explaining that "it will ensure banks will have continued flexibility to be able to deal with the commitments that their clients have on their mortgages and business loans and things of that nature."

With question marks over the fragility of global monetary systems, demand for alternative investments has been strong. Gold, which is viewed as an inflation hedge and a safe haven asset, reached an all-time high of US\$1,981 per ounce, trumping the previous high set in 2011.

Offshore, Google has confirmed that its 200,000 North American employees and contractors will not return to office until July 2021, pushing past its original January timeline. While this is only a small example, COVID-19 has been a significant accelerant of change across many industries and the greatest beneficiaries will be organisations that are able to adapt effectively.

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 July 2020*

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	15 Years	Since Inception
Fund (net of fees)	(0.09)	6.45	(13.32)	(5.57)	13.51	12.71	13.52	9.34	10.58
Fund (gross of fees)	0.06	6.70	(12.52)	(3.40)	15.70	14.83	15.65	11.37	12.70
All Ords Accumulation Index	0.95	8.51	(13.62)	(9.02)	5.70	5.54	7.43	6.62	7.41
Difference (gross of fees)	(0.89)	(1.81)	1.10	5.62	10.00	9.29	8.22	4.75	5.29

*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.

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 (%)
Domino's Pizza Enterprises	DMP	6.16
ResMed	RMD	5.91
James Hardie Industries	JHX	5.38
Altium	ALU	5.18
Cochlear	COH	5.02
Iress	IRE	4.88
Carsales.com	CAR	4.87
Aristocrat Leisure	ALL	4.73
Seek	SEK	4.52
TechnologyOne	TNE	4.34

Unit prices as at 31 July 2020

Entry price	\$2.8167
Mid price	\$2.8097
Exit price	\$2.8027

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Portfolio commentary

Megaport (MP1:ASX)

Global cloud enabler Megaport released their fourth quarter results in July, with the company continuing to track well towards its target of growing ports, services and data centres. For the year, ports increased 42% from 4,069 to 5,767, services rose 45% from 11,561 to 16,712 and installed data centres grew by 63 to 363. Importantly, the company advanced its key metric of revenue per port from \$887 to \$980, representing an increase of 10.5%. Megaport exited the year with monthly recurring revenue at \$5.7m, up 57% from the \$3.6m in the prior comparative period.

Megaport remains intent on enhancing its competitive moat, by broadening their vast global network ecosystem. During the quarter, the company extended its platform reach to 23 countries and 128 cities, while connected cloud on-ramps increased by a record 26 to 197. Management have indicated their ecosystem has reached sufficient scale to commercialise further by catering for the different needs of customers in the cloud.

CEO English iterates this through his comments, *“Profitability remains a company-wide priority. We will focus on achieving EBITDA breakeven by the close of Fiscal Year 2021 by driving further customer growth across all regions. With our SDN reaching over 700 enabled data centres across 23 countries, we are well positioned to capture the demand for elastic interconnection to support the ever-increasing surge of data powered by the digital economy.”*

The company also raised \$72.5m in April from investors to accelerate sales, product development and platform expansion opportunities.

Megaport has a market capitalisation of \$2b and net cash of \$167m.

Altium (ALU:ASX)

Electronic Printed Circuit board (PCB) designer Altium updated the market with their unaudited sales and revenue to the end of FY20. While the trading environment created by COVID-19 prevented the company from reaching their aspirational revenue target of US\$200m, their decision to extend payment terms and provide attractive pricing drove solid volume growth over the year.

CEO Aram Mirkazemi explained that *“conditions surrounding COVID-19 have dramatically accelerated our movement towards market dominance and the implementation of our transformative agenda for the industry”*. This is most notably seen through the strong growth in new Altium Designer seats and record growth in the subscription base, now totalling well above 50,000 seats. Despite adjusted payment terms, the company achieved revenue growth of 10% to US\$189m, up from US\$172m.

With companies across the globe moving quickly to enable employees to work from home, Altium accelerated the roll-out of their new cloud platform Altium 365. This development allows for enhanced collaborative functions as well enabling customers to work remotely. Since release, over 2,500 companies and 5,000 users have adopted the recurring Software-as-a-Service (SaaS) platform.

Altium has a market capitalisation of \$4.3b and cash of over US\$90m.

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 (%)
Domino's Pizza Enterprises	0.43
Jumbo Interactive	0.35
Reece	0.30
Infomedia	0.30
James Hardie Industries	0.27
Bottom five	Contribution (%)
Nanosonics	(0.40)
Iress	(0.32)
Blackmores	(0.29)
CSL	(0.23)
OFX Group	(0.23)

Industry exposure

Industry group	Weight (%)
Software & Services	26.58
Consumer Services	17.28
Health Care Equipment & Services	17.27
Media & Entertainment	10.23
Capital Goods	6.35
Materials	5.38
Diversified Financials	4.69
Pharmaceuticals, Biotech & Life Sciences	3.80
Household & Personal Products	2.77
Insurance	2.27
Automobiles & Components	1.47
Consumer Durables & Apparel	1.12
Cash & Other	0.78

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