Selector High Conviction Equity Fund

Monthly report – February 2021

Market insights

The February reporting season, in our opinion, was one of the strongest we have witnessed, given the remarkable circumstances of the COVID-19 driven recession. At its conclusion there were three specific points worth noting. Firstly, while companies were reporting half year numbers, for the great majority, the results spoke to two very distinct periods of performance; a very weak first quarter offset by a stronger second quarter. Secondly, the events that shaped the past year are having a permanent, structural impact on businesses and consumers alike. For this reason, we believe it is more important to consider the longer-term implications of such change, rather than extrapolate a company's financial performance under such abnormal conditions. Thirdly, the disruption caused by COVID-19 resulted in supply constraints amplified by surging demand. This bottleneck is lifting input costs and leading to price hikes on one hand but importantly, driving an even greater investment focus on improving operational efficiencies and reducing costs.

All this was swamped by financial markets digesting surging U.S. bond yields, triggered by concerns that interest rates will be lifted far sooner than Central Banks had indicated. Our own Reserve Bank confirmed in early February that they *"will not increase the cash rate until actual inflation is sustainably within the 2 to 3 per cent target range. For this to occur, wages growth will have to be materially higher than it is currently. This will require significant gains in employment and a return to a tight labour market. The Board does not expect these conditions to be met until 2024 at the earliest."*

In the short run it matters nought what is real but what investors fear. In the long run, however, what matters is what businesses do and ultimately deliver. The vast majority of our investment holdings have exited this period with strong operational momentum, amplified by excellent financial metrics and balance sheets with low debt or net cash balances. This underpins our confidence for the months and years ahead.

We expect that the sharp volatile moves we have seen in markets will continue for some time. As we wrote in our December 2020 Quarterly and repeat below, this should not come as a surprise or alarm investors.

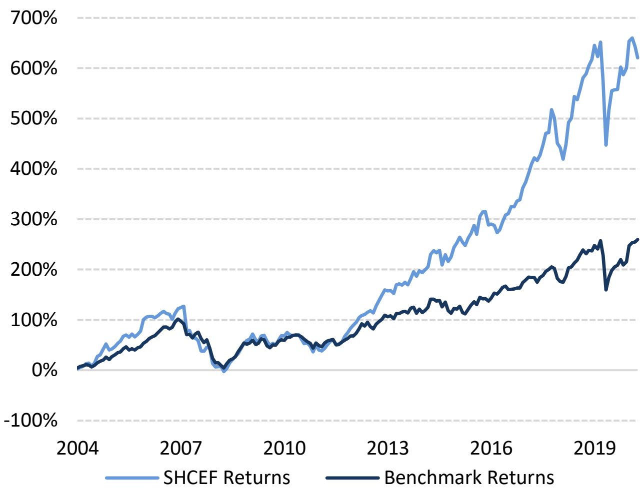
"The legacy of this new normal is one where interest rates are likely to stay low for longer. When global GDP comes roaring back, as is widely expected in 2021, it will naturally give rise to discussions around interest rates and inflation. It is highly possible both are set to rise, but whether either are sustainable longer term, under the massive weight of government or corporate debt, is another story altogether.

When this time comes, as sure as night follows day, investors would do well to stop reading the daily financial news preaching of impending doom and gloom, of interest rates roaring away and the risk of rising inflation. These scenarios are indeed possible, but the situation we now find ourselves in, the interdependency of managing record high debt levels while maintaining employment numbers and economic stability, makes this a tricky if not impossible path to transverse".

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 (%)
Domino's Pizza Enterprises	DMP	6.59
James Hardie Industries	JHX	6.18
Reece	REH	5.48
Aristocrat Leisure	ALL	5.12
Cochlear	COH	4.74
SEEK	SEK	4.46
ResMed	RMD	4.32
carsales.com	CAR	4.19
TechnologyOne	TNE	4.07
CSL	CSL	3.91

Unit prices as at 28 February 2021

Entry price	$3.0567
Mid price	$3.0491
Exit price	$3.0415

Performance as at 28 February 2021*

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	15 Years	Since Inception
Fund (net of fees)	(3.11)	(4.77)	1.93	4.74	9.27	13.57	13.50	8.63	10.74
Fund (gross of fees)	(2.98)	(4.39)	2.59	7.09	11.37	15.70	15.62	10.64	12.85
All Ords Accumulation Index	1.43	3.52	12.42	9.56	8.11	11.19	7.84	6.69	8.15
Difference (gross of fees)	(4.41)	(7.91)	(9.83)	(2.47)	3.26	4.51	7.78	3.95	4.70

*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

Flight Centre Travel Group (FLT:ASX)

With international borders facing hard lockdowns and domestic travel in a state of flux, it is no surprise that Flight Centre Travel Group's performance was significantly impaired over the half. The company generated $1.5b of total transaction value, only 12% of the number reported in the prior corresponding period (pcp). This resulted in an underlying loss before tax of $247m.

In response, the company has significantly reduced costs; almost 70% lower over the past twelve months. Importantly, the group has made significant efforts to shore up its balance sheet with a significant runway of over $1.2b in liquidity.

While the company has not provided guidance due to continued uncertainty, Flight Centre is targeting a return to breakeven in both corporate and leisure travel during the calendar year. Due to the cost reductions, this breakeven point would be at circa 40% of previously reported total transaction levels.

Flight Centre has a current market capitalisation of $3.3b.

Dominos Pizza Enterprises (DMP:ASX)

Domino's Pizza Enterprises has transitioned to the new COVID-19 world in better shape than most. As a digitally driven, home based food delivery business, the group's 2,795 global store footprint thrived under the restrictive lockdown conditions created by the pandemic. Executing under such fluid conditions is no easy feat especially while maintaining exacting health standards.

Domino's demonstrated strong operational performance as network sales increased 16.5% to $1,843m. The current climate gave rise to a notable uplift in online orders, which now represents 77% of sales compared to 65% in the pcp. Japan continues to be a growth engine for the company, responsible for over half of the 131 new stores opened in the period.

The company lifted operating profits (EBIT) by 32.3% to $153m, while underlying net profits rose 32.8% to $96m. Strong cash conversion of over 90% and lower capital expenditure saw the business cut net debt by $70m to $377m resulting in a healthy leverage ratio of 1.1x, down from 1.5x in June 2020.

Dominos has a current market capitalisation of $7.8b.

SEEK (SEK:ASX)

Leading online employment group, SEEK reported a better than expected first half performance considering the challenging operating environment. At a headline level, revenue decreased 6% to $819m with net profit after tax down 8% to $70m against the pcp. Despite this, the company has upgraded full year guidance, targeting revenue of $1.7b and net profit after tax of $100m.

SEEK also announced a partial sell down of Zhaopin, China's online employment business. While the $2.2b enterprise value struck was below market expectations, the new ownership structure is aimed at supporting Zhaopin's longer term growth aspirations. The sale will see SEEK's ownership reduce from 61.1% to 23.5%, with Primavera, a leading China-based investment firm, becoming Zhaopin's largest shareholder. The balance sheet will be strengthened as a result of the transaction. In addition, long standing CEO and co-founder Andrew Bassat is transitioning to CEO of SEEK investments and will be succeeded by Ian Narev.

SEEK has a current market capitalisation of $9.4b.

Performance contributors

Top five	Contribution (%)
Flight Centre Travel Group	0.41
Cochlear	0.29
Blackmores	0.24
FINEOS Corporation	0.19
IOOF Holdings	0.15

Bottom five	Contribution (%)
Altium	(0.63)
Infomedia	(0.60)
ResMed	(0.45)
Nanosonics	(0.40)
SEEK	(0.39)

Industry exposure

Industry group	Weight (%)
Software & Services	22.82
Consumer Services	17.83
Health Care Equipment & Services	14.87
Media & Entertainment	10.04
Capital Goods	8.70
Materials	6.18
Diversified Financials	4.66
Pharmaceuticals, Biotech & Life Sciences	4.40
Household & Personal Products	2.66
Insurance	2.39
Automobiles & Components	2.18
Cash & Other	1.71
Consumer Durables & Apparel	1.55

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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