Selector High Conviction Equity Fund

Monthly report – November 2018

Market insights

Australian markets sold off further during November, with the All Ordinaries Accumulation Index closing down 2.2%. Major European markets fell by a similar magnitude, while indices in the U.S. and Asia staged modest recoveries. The energy sector was hardest hit during November as Brent crude fell more than 20% to US$59 per barrel. Fears of an oil glut have taken hold as the global dominance of US crude oil production, led by booming shale oil output, have emerged. In June 2018, America accounted for 13% of global crude oil, nearly 2x that produced in June 2008. As America nears the status of net exporter, investment banks have laid heavy bets against the price of oil.

The Australian economy has shown no real signs of slowing despite the recent weakness in equity and property markets. In their statement on monetary policy, the RBA outlined expectations for GDP growth of 3.5% over 2018 and 2019 and for inflation to remain both low and stable. Should these conditions hold, the RBA expects the unemployment rate to trend down from its current level of 5.0% to 4.75% by 2020. The latest economic growth data would suggest these views now sit on the optimistic side

The RBA also commented on developments overseas, highlighting that growth in advanced economies has been exceeding growth in productive capacity. This has seen some small pockets of inflationary pressure emerge. Companies in the portfolio such as James Hardie and Reliance Worldwide Corporation have not been immune to these pressures. Raw materials and freight have been sources of cost inflation for both companies in recent results.

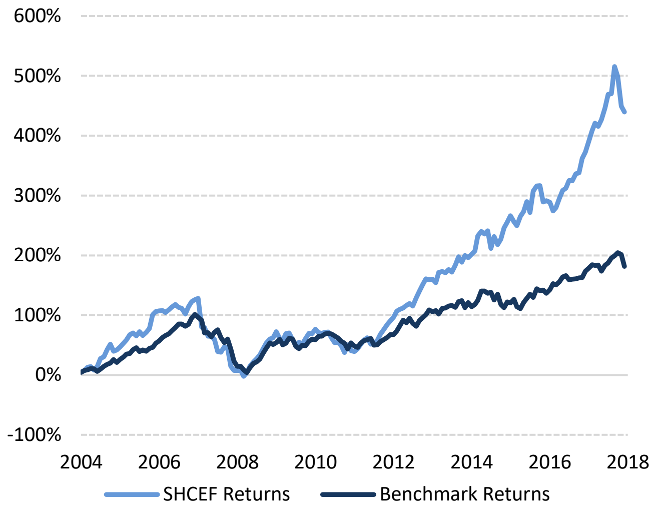
Comments made by Federal Reserve Chair Jerome Powell at the Economic Club of New York on 28 November appeared to suggest the Fed now believes they are near a neutral setting where rates neither contribute to, nor detract from economic growth. Although further increases in interest rates are expected, some investors believe the pace of rate rises in the medium term will be slower than previously anticipated. The unemployment rate is running at 3.7%, wages are growing at a modest rate, GDP is expanding at 2.5%-3.0% and inflation is around the Fed's target of 2.0%. These conditions have the Fed attempting to balance the risks of stifling economic growth and controlling allowing inflationary pressures.

Shortly after month's end, the U.S. postponed the imposition of further tariffs on imported Chinese goods for 90 days following preliminary discussions regarding a trade agreement. Although the announcement lacked substantial details, some hope it may resemble the deals the Trump Administration has recently signed with South Korea, Mexico and Canada.

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	5.65
Jumbo Interactive	JIN	5.45
Resmed	RMD	5.00
Altium	ALU	5.00
Reliance Worldwide Corporation	RWC	4.66
Oil Search	OSH	4.42
Flight Centre Travel Group	FLT	4.18
CSL	CSL	3.75
Reece	REH	3.69
Technology One	TNE	3.67

Unit prices as at 31 November 2018

Entry price	$2.5574
Mid price	$2.5510
Exit price	$2.5446

Performance as at 30 November 2018*

	FYTD	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	Since Inception
Fund (gross of fees)	(5.12)	(1.72)	(12.30)	(1.17)	14.17	14.96	15.80	17.52	12.71
Benchmark	(6.86)	(2.24)	(9.54)	(4.12)	(1.13)	7.69	6.00	9.18	7.45
Difference (gross of fees)	1.74	0.52	(2.76)	2.95	15.30	7.27	9.80	8.34	5.26
Fund (Net of fees)	(5.70)	(1.84)	(12.63)	(1.89)	12.55	13.32	14.01	15.52	10.66

*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. Performance can be volatile and future returns can vary from past returns.

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Portfolio commentary

OFX Group (OFX:ASX)

Money services bureau OFX Group delivered an operationally strong first half performance, growing turnover 18% to $12.1b. An 11% increase in customer transactions to 521,200 was the primary driver. This resulted in net operating income rising 12% to $65m and net profits rising 13% to $9.4m. Business with corporate clients rose 19%, consumer turnover rose 8% and importantly, the company has been successfully growing in all key regions. The Australian operations grew 11%, a welcome return to growth, while Europe rose 13%, North America by 18% and Asia up 29% during a period of relative calm in global FX markets.

Investors have been slow to recognise the positive transition under the new executive team led by CEO Skander Malcolm and CFO Selena Verth. Although OFX operates in a crowded and competitive space, barriers to entry are substantial and a net cash balance sheet should position the company well in driving long term performance.

Management confirmed revenue momentum had continued in early trading for the second half. Initiatives recently introduced are expected to improve conversion rates, which should help increase the active client count after a period of no growth. The company also highlighted their focus on delivering expanding operating income margins.

OFX has a market capitalisation of $435m.

Technology One (TNE:ASX)

Enterprise software vendor Technology One delivered full year results for 2018, unveiling revenues up 9% to $299m and net profits up 15% to $51m. The business is undergoing a transition as it shifts from a perpetual license model to a cloud powered, Software-as-as-Service (SaaS) model.

The adoption of new accounting standards means revenue is now recognised pro-rata over the life of the client's contract rather than booking license fees for contracts up front. Cash flow will be unaffected, the financial accounts will be simpler, and earnings will be more predictable. The company has also opted to capitalise costs associated with the development of new products, in contrast with the prior approach of expensing all R&D. Upwards of 50% of R&D will be capitalized then amortized over 3-5 years.

We are mindful that capitalisation of development costs is not the most conservative approach the company could have taken, but the shift to a SaaS model is overwhelmingly positive. The company has now successfully transferred 347 of its 1,200-strong customer book to its SaaS offering. As a result, annual recurring revenue has grown 22% from $139m to $169m (56% of total revenue). As the customer base continues to convert to the SaaS model, pre-tax profit margins will rise from 24% towards an expected 50% over the medium term. No profit guidance was provided for the 2019 year, but management noted strong momentum across the group's offerings.

Technology One has a market capitalisation of $2b and net cash of $104m.

Performance contributors

Top five	Contribution (%)
Jumbo Interactive	0.71
Technology One	0.53
Flight Centre Travel Group	0.22
Nearmap	0.19
Altium	0.18

Bottom five	Contribution (%)
Aristocrat Leisure	(0.70)
Domino's Pizza Enterprises	(0.56)
OFX Group	(0.45)
James Hardie Industries	(0.31)
Oil Search	(0.29)

Industry exposure

Industry group	Weight (%)
Consumer Services	22.69
Software & Services	20.08
Health Care Equipment & Services	11.70
Capital Goods	8.35
Cash & Other	6.86
Diversified Financials	5.02
Commercial & Professional Services	4.88
Energy	4.42
Materials	4.30
Pharmaceuticals, Biotechnology & Life Sciences	3.75
Household & Personal Products	3.21
Insurance	2.10
Media & Entertainment	2.01
Retailing	0.64

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. We offer the Selector High Conviction Equity Fund and the Selector Australian Equities Fund in addition to institutional mandates.

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