selector

Selector High Conviction Equity Fund

Monthly report – June 2022

Market insights

Equities continued to fall in June as global markets got wind of the argument that the Fed needs to damage demand and employment to slow the U.S. economy, and that super-sized rate rises might be the best way to do this. JP Morgan strategists noted, *"small cap stocks in the U.S. currently trade near the lowest valuations ever. Many equity market segments are down 60-80%. Positioning and sentiment of investors is at multi-decade lows."* The month ended with the All-Ordinaries Index down 9.5% to 6,746.

Fears that longer dated consumer inflation expectations are becoming entrenched, saw the Federal Reserve (Fed) lift the Fed funds rate by 75 basis points (bps) to a range of 1.50%-1.75%, the largest increase in nearly 30 years. Chairman Powell reiterated his objective is to tame inflation at all costs, *"we really need to restore price stability... need to, …must do."*

With the U.K. likely in recession, sentiment in Germany plunging, G4 money supply negative and G4 fiscal & monetary stimuli down US$5-6t, U.S. Bond yields have taken a fall, with yield curves flattening and some inversions occurring. The Atlanta Feds Q2 GDP data suggests a reading of -1% annualised following on from -1.6% in Q1, all but indicating a looming recession.

Today markets are pricing in a Fed funds rate that continues to rise in 2022 to 3.5%, while growth has turned negative, before central bank policy pivots with rate cuts starting in 2023. The risk of policy error is high, as is normal.

Locally, the RBA lifted its cash rate by 50bps to 0.85% citing rising inflation as well as record low interest rates and unemployment removing the need for the extraordinary monetary support provided during COVID. With cash rates expected to return to neutral levels of 2%-2.5%, Governor Lowe points to record low unemployment rates, high household savings and reasonable borrowing levels as reasons the economy should remain resilient.

The macro environment continues to drive bearish sentiment as traders and "investors" flee. Business fundamentals continue to be ignored providing stellar opportunity for those with a long-term mindset who understand the power of compound earnings. In this instance we refer to businesses that are performing well. The recent May reporting season is illustrative of this, with Aristocrat, James Hardie, TechnologyOne, OFX and carsales.com's June update all recording strong operational numbers and positive outlook statements.

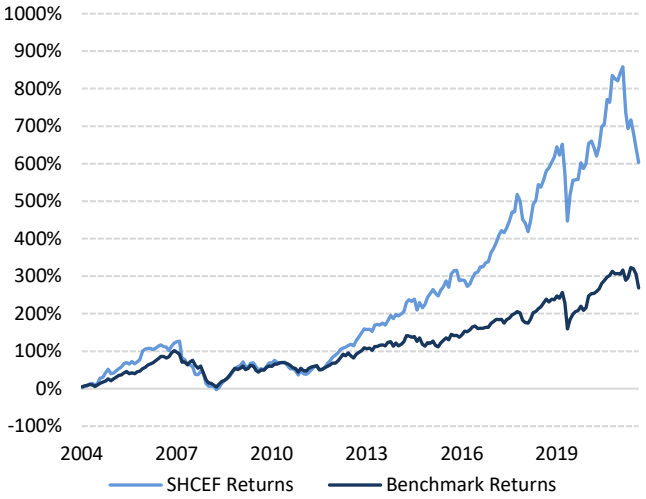
We remain of the view that we will pass peak inflation, return to a period of relatively low rates, and subdued global growth due to high levels of government debt, and the removal of emergency rate settings and fiscal stimulus.

Our internal metrics present a portfolio that is 97% profitable, 86% dividend paying with 47% net cash balance sheet. A common thread of recurring earnings and sustainable cashflows enable high levels of reinvestment that drive significant latency across the businesses we own. Our risk out process provides confidence, that runs contrary to the chorus of concerns.

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 (%)
carsales.com	CAR	5.82
TechnologyOne	TNE	5.37
CSL	CSL	5.34
Aristocrat Leisure	ALL	5.15
ResMed	RMD	4.95
Cochlear	COH	4.85
Altium	ALU	4.80
James Hardie Industries	JHX	4.36
Computershare	CPU	4.36
Domino's Pizza Enterprises	DMP	4.16

Unit prices as at 30 June 2022

Entry price	$2.8549
Mid price	$2.8478
Exit price	$2.8407
Mid price – Cum Distribution ($0.0663 per unit)	$2.9112

Performance as at 30 June 2022*

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	15 Years	Since Inception
Fund (Net of fees)	(5.53)	(14.22)	(26.85)	(20.57)	0.39	8.63	14.47	6.36	9.61
Fund (gross of fees)	(5.41)	(13.87)	(26.60)	(19.31)	2.26	10.59	16.54	8.30	11.67
All Ords Accumulation Index	(9.36)	(12.91)	(11.50)	(7.44)	3.81	7.15	9.35	4.68	7.66
Difference (gross of fees)	3.95	(0.96)	(15.10)	(11.87)	(1.55)	3.44	7.19	3.62	4.01

*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

carsales.com (CAR:ASX)

In June, carsales.com exercised its call option to acquire the remaining 51% interest in Trader Interactive (TI) for US$809m or 21x EV/EBITDA vs 26x paid for the first 49%. TI's market leading positions in the U.S. non-automotive industries, RV, powersports, trucks & equipment, have a TAM 16 times carsales' Australian non-automotive business. TI Q4 annualised revenue is US$151m, 84% recurring, with a Q4 annualised EBITDA of US$89m. This business has momentum.

Twelve months on carsales knows what it is buying, a solid management team, strong cultural alignment and economic opportunities from increased penetration, higher take rates, new product offerings such as dynamic pricing and digital trade-ins, and enhanced capabilities of Dealer systems. After adjusting for tax and interest benefits, the acquisition is double digit accretive. The company also released a solid estimated FY22 result with adjusted revenue of $508m up 16.0%, EBITDA of $271m up 6.7% and NPAT of $195m up 27.5%.

The acquisition will be funded by a $1.2b non-renounceable entitlement offer, via a fully underwritten 1 for 4.16 pro-rata offer ratio at a price of $17.75 per new share. Carsales has a market capitalisation of $5.7b and will have a net debt to EBITDA ratio of 2.7x post-acquisition, falling to 2x within 2 years.

Infomedia (IFM:ASX)

This month, Infomedia received an additional non-binding proposal from Solera Holdings to acquire the business at $1.70 per share. This follows the two indicative proposals from TA Associates and Battery Ventures, with the latter offering the higher price of $1.75. With three separate offers on the table, the Board will seek to engage further and grant due diligence to all parties. Infomedia has a market capitalisation of $643m.

ResMed (RMD:ASX)

In June, leading medical device, mask, and software provider, ResMed announced the acquisition of MEDIFOX DAN, a software operator for out-of-hospital patients in Germany. MEDIFOX provides mission-critical solutions in major care settings for home health, nursing homes and outpatient therapy.

The acquisition complements ResMed's 2025 strategy of improving 250m lives in out-of-hospital care and becoming the world's best software provider in this space. It also extends ResMed's position into one of Europe's largest markets, while broadening the SaaS portfolio into new care settings such as outpatient therapy. ResMed SaaS President Bobby Ghoshal further notes, *"we're seeing greater adoption of digital solutions across Germany as its population continues to age and severe staffing shortages continue to challenge German care providers. MEDIFOX DAN and ResMed are well positioned to help providers across major out-of-hospital care settings meet rising demands and ultimately help improve patient outcomes."*

ResMed is expected to acquire MEDIFOX for a total cash consideration of US$1b, to be financed via existing cash and debt facilities. In calendar year 2021, MEDIXFOX delivered pro-forma revenue of US$83m and adjusted EBITDA of US$35m, representing margins of 42%. The company has over 8,000 customers and around 600 employees. ResMed has a market capitalisation of US$31.2b and net debt of US$479m pre-acquisition.

Performance contributors

Top five	Contribution (%)
Iress	0.35
Computershare	0.26
ResMed	0.25
TechnologyOne	0.13
Aristocrat Leisure	0.09
Bottom five	**Contribution (%)**
Cochlear	(0.59)
James Hardie Industries	(0.58)
Reece	(0.58)
Insignia Financial	(0.50)
carsales.com	(0.50)

Industry exposure

Industry group	Weight (%)
Software & Services	26.80
Health Care Equipment & Services	15.03
Consumer Services	14.92
Media & Entertainment	9.49
Capital Goods	6.32
Pharmaceuticals, Biotech & Life Sciences	5.59
Diversified Financials	5.07
Cash & Other	4.99
Materials	4.36
Insurance	2.64
Household & Personal Products	2.02
Automobiles & Components	1.71
Consumer Durables & Apparel	1.07

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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