Selector High Conviction Equity Fund Quarterly Newsletter No.62

December 2018

In this quarterly edition, we review performance and attribution for the quarter. We visit Blackmores in China and Indonesia. We profile Nearmap, and we consider the importance of leadership and culture. Photo. Gough Whitlam is remembered as Australia's finest Labor Prime Minister. Can Bill Shorten walk in these shoes?

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selector

Selector is a boutique fund manager. Our team, combined, have over 150 years of experience in financial markets. We believe in long-term wealth creation and building lasting relationships with our investors.

We focus on stock selection, the funds are high conviction, concentrated and index unaware. As a result, the portfolios have low turnover and produce tax effective returns.

Selector has a 15-year track record of outperformance and we continue to seek businesses with leadership qualities, run by competent management teams, underpinned by strong balance sheets and with a focus on capital management.

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IN BRIEF – DECEMBER QUARTER

Dear Investor,

Markets endured a difficult fourth quarter, reflected by our main benchmark, the All Ordinaries Accumulation Index retracing 8.98% over the period and contributing to an overall negative return of 3.53% for the 2018 calendar year.

Despite Australia's robust economic backdrop, with a current annual GDP growth rate in excess of 3.0% and a 5.0% unemployment rate, concerns of a more muted outlook are rising. In an environment of heightened risk, investors are prone to react to impending trouble.

Our approach is somewhat more measured. Stealing a line from U.S. Federal Reserve Chairman Jerome Powell, given in a strategy update during December, *"You slow down and you maybe go a little bit less quickly, and you feel your way more."*

It is, in our opinion, a sensible way forward that neither rules things in or out. In the current market setting where a broad-based sell-off has unfolded, taking advantage of individual investment opportunities has merit.

When we find these businesses, we allocate funds in a concentrated manner, seeking to capture as much real earnings per share growth as possible over time. Our low turnover, long-term approach is tax efficient and harnesses the power of compounding investment returns.

To this point, a host of businesses held by Selector, either reported earnings, provided updates or held investor days during the quarter. These included Fisher & Paykel Healthcare, Technology One, OFX Group, Aristocrat Leisure, Jumbo Interactive, CSL, Flight Centre Travel Group, Altium and Nearmap.

As varied as this group is, and despite indifferent share price performances post these updates, each continues to execute to a long-term business plan, pursuing leadership in their respective fields through consistent reinvestment, often at the expense of short-term profitability.

The progress each company has made over an extended time frame is illustrative of this winning formula. Furthermore, it reinforces the importance of selecting investments purely on merit, undertaken on a case by case basis and away from the noise of the market.

Investors who look beyond current macroeconomic concerns and take advantage of the attractive opportunities now on offer are likely to be well rewarded in future years.

During the quarter we travelled with Blackmores to attend the inaugural China International Import Expo (CIIE), before heading to Indonesia where we reviewed the joint venture operations run with partner Kalbe Farma. In this newsletter we provide an overview of these country visits as well as profiling Australian aerial imagery specialist Nearmap, a business that has made its way into the portfolio.

We provide some commentary on aspects of our investment philosophy outlined in our articles titled, *"Where not to go"* and *"Corporate spin"*. We show how global markets performed during 2018 and also add a recent speech given by Alibaba Vice Chairman Joe Tsai on the values of teaching. Finally, we provide an insight to what defines Selector in a series of short stories.

For the December quarter, the Fund delivered a gross negative return of **13.63%** compared to the All Ordinaries Accumulation Index which posted a loss of **8.98%.** For the 2018 calendar year, the Fund delivered a gross positive return of **5.47%** compared to the Index which posted a loss of **3.53%.**

We trust you find the report informative.

Regards,

Selector Investment Team

"It is remarkable how much long-term advantage people like us have gotten by trying not to be consistently stupid, instead of trying to be very intelligent."

Charlie Munger
Investor and Vice Chairman of Berkshire Hathaway

PORTFOLIO OVERVIEW

Table 1: Performance as at 31 December 2018*

	FYTD	3 Month	6 Month	1 Year	3 Year	5 Year	10 Year	Since Inception
Fund (net of fees)	(9.82)	(13.95)	(9.82)	3.97	10.57	12.93	15.01	10.24
Fund (gross of fees)	(9.15)	(13.63)	(9.15)	5.47	12.17	14.70	17.01	12.28
All Ords. Acc. Index	(7.28)	(8.98)	(7.28)	(3.53)	6.60	5.71	9.14	7.37
Difference (gross of fees)	(1.87)	(4.65)	(1.87)	9.00	5.57	8.99	7.87	4.91

Inception Date: 30/10/2004
**Performance figures are historical percentages. Returns are annualised and assume the reinvestment of all distributions.*

Figure 1: Gross value of $100,000 invested since inception

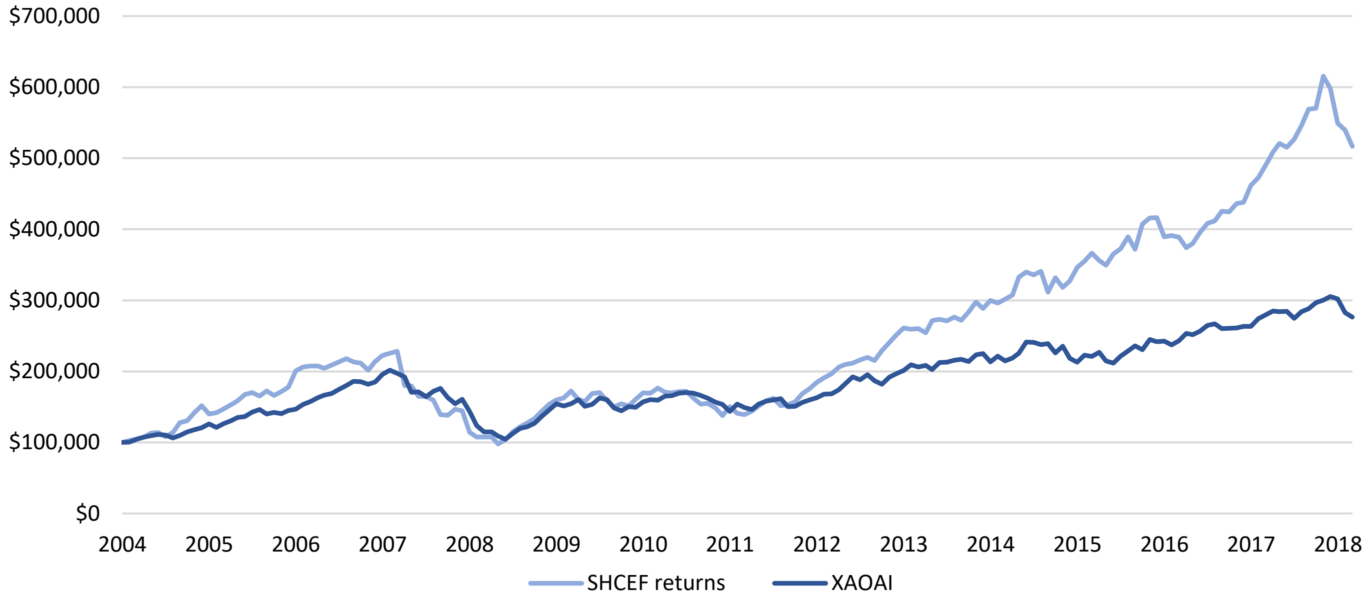


Table 2: Fund's Top 10 Holdings

Top 10 December 2018	%	Top 10 September 2018	%
ResMed	5.53	Aristocrat leisure	6.54
Aristocrat Leisure	5.44	Altium	5.82
Jumbo Interactive	5.00	Jumbo Interactive	5.17
Altium	5.00	ResMed	5.10
Reliance Worldwide Corporation	4.58	Reliance Worldwide Corporation	4.91
Oil Search	4.51	CSL	4.10
CSL	4.08	Seek	3.98
Infomedia	3.95	Reece	3.95
Flight Centre Travel Group	3.83	Oil Search	3.89
Technology One	3.78	Domino's Pizza Enterprises	3.50
Total	45.70	Total	46.96

Table 3: Unit prices as at 31 December 2018

Unit Prices	Entry Price	Mid Price	Exit Price
	$2.4456	$2.4395	$2.4334

Selector employs a high conviction, index unaware, stock selection investment strategy, which typically targets 15-25 stocks for the Fund. As shown above, the Fund's top 10 positions usually represent a high percentage of its equity exposure. Current and past portfolio composition has historically been very unlike that of your average "*run-of-the-mill index hugging*" fund manager. Our goal remains focused on truly differentiated broad-cap businesses rather than the closet index hugging portfolios offered by most large fund managers.

Table 4: ASX sector performance – December 2018 quarter

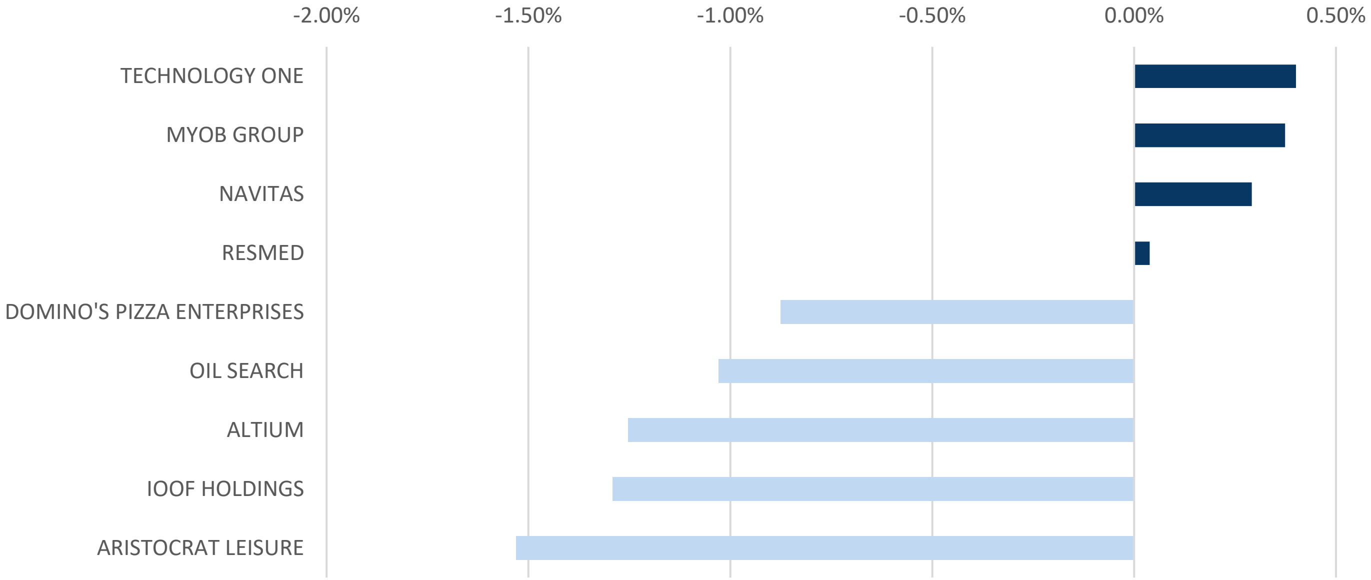
S&P ASX Industry Sectors	Quarter Performance (%)
Materials	(5.03)
Consumer Staples	(6.46)
Industrials	(6.76)
Health Care	(8.15)
Financials	(9.19)
Information Technology	(14.00)
Consumer Discretionary	(14.49)
Telecommunications	(14.74)
Energy	(21.34)

Table 5: Fund's industry weightings

Industry group	December 2018 (%)	September 2018 (%)
Consumer Services	21.42	22.78
Software & Services	21.29	20.49
Health Care Equipment & Services	12.77	12.90
Capital Goods	8.33	8.87
Diversified Financials	5.46	5.27
Materials	4.83	5.12
Commercial & Professional Services	4.68	4.45
Energy	4.51	3.89
Pharmaceuticals, Biotechnology & Life Sciences	4.08	4.10
Cash & Other	3.96	3.34
Household & Personal Products	3.30	3.31
Insurance	2.78	2.38
Media & Entertainment	1.94	2.36
Retailing	0.65	0.74

PORTFOLIO CONTRIBUTORS

Figure 2: Contributors and detractors – December 2018 quarter



Top contributors

1. Technology One (ASX:TNE)

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-a-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 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. Already 347 of its 1,200 customers have been successfully transferred 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 $2.05b and net cash of $104m.

2. MYOB Group (ASX:MYO)

Leveraged buyout specialist KKR returned following due diligence with a bid of $3.40 per share for accounting software provider MYOB Group. The offer is 37 cents lower than the original proposal supported by the board, that enabled access to the company's books.

While the revision is a disappointing turn of events, it is not altogether surprising. The collapse in equity markets during the due diligence process and the 17.6% holding KKR had earlier acquired, placed the MYOB board in a weak negotiating position. Ultimately the board and its advisors managed to extract some conditions from the KKR team, who agreed to allow MYOB to solicit for competing bids as well as agreeing to on sell their stake into a superior proposal, should one emerge.

The MYOB board have recommended shareholders accept the bid. The shares are now trading at a narrow discount to the $3.40 offer, suggesting merger arbitrage hedge funds are either confident the proposal will be successful or believe there is a chance of a superior bid emerging.

SFML wrote to the board of MYOB urging them to reject the bid. We noted,

We believe that the offer price is inadequate based on the information the company has provided in its outlook presentations.

- At the $3.40 offer price the valuation of 10x 2019 EBITDA is light.
- Should you achieve the numbers management have guided to for 2022 this multiple is circa 7x EBITDA.

MYOB has a market capitalisation of $1.98b and net debt of $406m.

3. *Navitas (ASX:NVT)*

Following the Navitas Board's rejection of the conditional, non-binding proposal from BGH Capital we have reviewed our position in Navitas.

Our opinion of the potential of the business and its long-term outlook is unchanged, however, the participation of Navitas founder Rod Jones in the proposal as well as cooperation from a number of other founding shareholders has exposed potential conflicts of interest in the management of the business. The risk this poses to the strategic direction is our primary cause for reviewing our position. We have had experience with dysfunctional boards in past investments. This is not something to be ignored. We have shared these views with both management and the board via the Chair Person.

Navitas has a market capitalisation of $1.77b and net debt of $200m.

4. *ResMed (ASX:RMD)*

Sleep apnea specialist ResMed reported strong first quarter results for 2019. The group is delivering solid top line growth and operating leverage is magnifying the impact at the bottom line. For the quarter, group revenue rose 12% to US$588m, while adjusted profit after tax rose 23% to US$116.3m, equivalent to EPS of US$0.81.

Selling into more than 120 countries, ResMed recorded an increase in quarterly device growth of 13% to US$324m, masks sales growth of 9% to US$217m and revenue from digital services of US$47.5m. Margins have risen from 20.6% to 23.6%, an illustration of the business's operating leverage.

The group continues to target sufferers of sleep apnea, of which there are estimated to be 936m as well as the Chronic Obstructive Pulmonary Disease (COPD) patient cohort of circa 400m. A key enabler has been the company's significant commitment to research and development expenditure that has resulted in market leading products and the rollout of digital health technologies. This has enabled patients and physicians to be better informed on the daily health outcomes of those affected, leading to higher levels of compliance and better treatment outcomes.

ResMed has a market capitalisation of US$16.1b and net debt of US$300m.

Bottom contributors

1. *Aristocrat Leisure (ASX:ALL)*

During November 2018, Aristocrat Leisure delivered results for the financial year. Earnings per share before goodwill amortisation rose 34% to $1.14, benefitting from both the inorganic growth from acquisitions in the digital division as well as a strong showing from the U.S. gaming operations division. Group revenue rose 47.7% and operating earnings grew 32.7%. In percentage terms, of the 34% gain for the year, organic operations delivered 17%, while acquisitions and tax benefits provided 12% and 5% growth respectively.

Consistent investment in design and development is generating high performing products and has led to market share gains. This is expected to moderate, although, management are confident they are still underrepresented in market ship-share given, the outperformance of Aristocrat games on casino floors.

The largest driver of growth came from the digital division, boosted by the acquisitions of online and social game developers, Big Fish and Plarium. Aristocrat is leveraging game development from their traditional businesses through digital channels, giving it a substantial competitive edge over smaller competitors. That said, margins surprised investors on the downside in the digital division.

Historically high performing games which are maturing have now entered the runoff stage of their life cycle and new games such as Lightning Link and FaFaFa Gold are early in their launch phases. As new games ramp up, margins will rise. In the future, the breadth of the digital business will allow Aristocrat to better manage the game portfolio's lifecycle mix.

Aristocrat has a market capitalisation of $14.7b and net debt of $2.45b, up from September's $0.7b level following the recent acquisitions.

2. *IOOF Holdings (ASX:IFL)*

See accompanying article.

3. *Altium (ASX:ALU)*

Altium released a strong result for FY18, growing revenues 26% to US$140.2m and net profit after tax 34% to US$37.5m. The provider of printed circuit board (PCB) design software is the beneficiary of macroeconomic and microeconomic tail winds. The strong demand for Altium's latest release, Altium Designer 18, was driven from electronic engineers who design and develop smart, internet connected devices. The cadence of the design cycle has also increased rapidly, forcing designers to turn to solutions that make the entire process faster, more efficient and flexible.

Altium's main competitors have neglected the increasingly important "*makers*" community. Although the revenue generated from this market is limited, this cohort of start-up designers eventually find their way into larger companies and their familiarity with Circuit Studio gives Altium a leg up on the incumbents including, Mentor, Cadence and Zuken. Unlike Altium, these competitors only focus on higher end customers with their premium offerings.

At Altium's November AGM, management presented their vision of the future of the PCB lifecycle and how the company is planning to shape its involvement in the industry. Specifically, the presentations focused on the lack of interoperability between systems up and down the supply chain and the difficulty with which participants communicate and translate design concepts. Demonstrations by the team illustrated how Altium's products are helping to overcome these challenges.

Altium CEO Aram Mirkazemi has an aspirational goal of delivering at least US$200m of revenue and EBITDA margins of 35% by 2020, making Altium the leader in the PCB software market. At the general meeting, Mirkazemi expanded on this view. He is confident the PCB design software market will become a winner takes all domain. Like Microsoft in desktop productivity tools, and Adobe in graphic design, the company that provides a solution for the issues that engineers face will end up with the lion's share of the market and the profit pool. Furthermore, management confirmed that the issues the industry face are significant and that Altium is best placed to provide the necessary solutions.

Altium has a market capitalisation of US$2.1b and net cash of US$52m.

4. *Oil Search (ASX:OSH)*

During the last quarter we visited Oil Search operations in both Alaska and Papua New Guinea. Recent drilling results in acreage adjacent to Oil Search's Pikka Unit in Alaska have been provided to Oil Search management, who clearly have confidence that the resource is substantially larger than the original 500m barrel base case. The expected increase in value, created since the acquisition, will be determined when Oil Search exercises its option and on-sells part of its increased interest in the project.

In PNG, Oil Search has progressed the brownfield expansion of its LNG export terminal by signing a Memorandum of Understanding with the Government setting out the key terms of the development of the Elk Antelope gas fields. Originally the joint venture partners had been targeting the execution of a gas agreement with the Government at the November APEC Economic Leaders' meeting, but this has been delayed and now faces a deadline of 31 March 2019. Front End Engineering Design studies are expected to begin in 2H 2019 and the Final Investment Decision is expected in Q4 2020, while first gas is expected to be exported around the end of 2024.

Oil Search has a market capitalisation of US$8.3b and net debt of US$2.9b.

5. *Domino's Pizza Enterprises (ASX:DMP)*

We attended the company's investor day held at their Brisbane headquarters during October 2018. CEO Don Meij provided an overview of the group's current service offering and key competitive advantages. ANZ CEO Nick Knight, Chief Marketing Officer Allan Collins and Chief Digital & Technology Officer Michael Gillespie all presented on their respective areas of focus.

A key message from the presentations was how much of an impact technology is having on the Domino's business. Delivering high quality food to customers quickly, is key to generating repeat sales and a consistent investment in technology is helping achieve this.

Technology will only cut delivery times so far and getting physically closer to customers is critical. To this end, splitting store territories is an important leg of the company's strategy. Questions have been asked of the approach, suggesting the strategy might lead to cannibalisation of store sales. Domino's findings to date have been the opposite. Split territories not only result in increased demand due to shorter delivery times, but the stores profitability improves as the labour and transportation costs per order fall substantially. Time will tell whether this is experienced consistently across the network, but the success so far has management confident they can execute.

Domino's has a market capitalisation of $3.5b and net debt of $522m.

BLACKMORES – SITE VISIT 2018

We attended a Blackmores led investor tour of Shanghai, China and Jakarta, Indonesia during November. Despite a difficult and complex registration process, we managed to secure our entry passes and joined thousands of international visitors at the inaugural China International Import Expo (CIIE).

Opened by Chinese President Xi Jinping on 5 November 2018, the CIIE is said to have brought together more than 3,000 foreign companies from 130 countries, in a major initiative to promote investment opportunities within China.

A host of well-known Australian businesses including Blackmores, Australia Post, Chemist Warehouse and Bellamy's were on show. Stretching over eight halls, the expo showcased businesses in the following industries:

1. High-end intelligent equipment
2. Consumer electronics and appliances
3. Automobile
4. Apparel, accessories and consumer goods
5. Food and agricultural products
6. Medical equipment and medical care products

Exhibit 6 was of specific interest to us.

In his Healthy China 2030 plan, President Xi Jinping placed health reform front and centre in the Chinese Government's overall agenda for the next decade.

Blackmores exhibit

The company's exhibit was placed in the Medical Equipment and Medical Care section. While not as well located as competitor Swiss Wellness, the booth was an excellent presentation of the company's brand, its history and importantly, Australia's reputation as a clean, green environment.

We were joined at the CIIE by Blackmores' senior management team which included Executive Director and major shareholder Marcus Blackmore, CEO Richard Henfrey, CFO Aaron Canning, Blackmores Institute Director Dr Lesley Braun, Financial Controller and Investor Relations Manager Dee Henz and the company's Deputy Head of China Raymond Chan.

Photo 1: CIIE China November 5-10

Source: SFML China trip.

Photo 2: Blackmores stand CIIE November 2018

Source: SFML China trip

The clear message from all involved was the company's commitment to the Chinese market and the long-term approach they favour in building a local business. This demands investment across all facets of the business, including registration of products, building out operations, establishing celebrity endorsements and implementing educational initiatives.

In crude market share terms, the Chinese Vitamins, Dietary and Supplements (VDS) market is estimated to be worth US$20b annually of which Blackmores represents less than 2%.

During 2018 the company grew sales in China (net of rebates) to $143m (including export and in country sales), which generated operating profits of $35m. This represented an increase of 22% over the previous year and compares to overall group sales of $601m. Additional sales through the daigou[1] channel from Australia are estimated to add around $60m to overall China bound sales, bringing the total to $200m, or 33% of total company wide sales.

The Blackmores Board travelled to China in June to meet with e-commerce retailers, developing a first-hand understanding of the in-country opportunity. As Marcus Blackmore highlighted, the China opportunity is significant, but the company must be respectful of the rules and regulations governing the Chinese market.

Regulatory settings are fluid and subject to frequent change. As recently as November this year, import restrictions have given way to more relaxed settings. Additional products have been added to the CBEC's positive import list and higher purchase limits have been granted for individual shoppers buying goods offshore.

These changes support both the continuing purchase of goods in offshore markets as well as the sale of products directly into China's e-commerce platforms such as Alibaba's TMall and Kaola.com. Post this expansion, over 1,300 products will receive preferential import treatment, with the scope of the policy earmarked for expansion from 15 Chinese cities to 22.

Since entering the Chinese market in 2012 with its own Wholly Foreign-Owned Enterprise (WFOE) accreditation, the company set about building a China based business. Considerable resources have been invested with the China based entity now employing 60 staff. Building a business from the ground up is never an easy undertaking, and in this case, made more difficult when the operation is in a foreign land and where high-quality staff are in short supply due to intense competition.

In our opinion, the recruitment of a high-quality country head for the China business is the group's highest priority. Currently operating without one, the goal of doubling staff over the coming year will be extremely challenging.

While the sales numbers point to positive operational progress, the company has also met several significant milestones including:

1. **March 2018** – Establishment of a partnership between the Blackmores Institute and Tsinghua University to build out further VDS accreditation programs.
2. **June 2018** – Signing a joint business plan with China's largest e-commerce operator Alibaba.
3. **August 2018** – Signing an exclusive New Product Development (NPD) partnership with China's largest digital Vitamins and Dietary Supplements (VDS) operator Kaola.com.

The company's aspirational goal is to become the number one VDS importer in China. Today, the company is the market leader in Australia, Thailand, Singapore and Malaysia.

[1] Daigous are personal shoppers for customers in mainland China, who purchase primarily luxury goods outside of China.

Photo 3: Display – Flying car automobile stand

Source: SFML China trip – Automobile exhibit

China Skinny

During our time in Shanghai we heard from industry speakers including Mark Tanner, the Managing Director of brand strategy agency China Skinny.

In his engagements with over 150 companies, Tanner has developed various insights on China and its consumers which he shared with us. We include a list below:

- Chinese consumers don't relate to Australia's flag, boomerangs or our map. They are more familiar with our furry animals the kangaroo and koala. They also see Australia as being green, with all its inherent environmental positives.
- Comparatively, the affluent Chinese consumer attains a level of wealth at a much younger age, circa 10 years younger than counterparts in Hong Kong and the U.S.
- The highest Chinese income earners sit within the 18-29 age bracket, a contrast to those in more traditional markets.
- Chinese youth have an overwhelmingly positive view (60%) on the U.S. way of life.
- 67% of Chinese people consume more products and services from the destination country following an overseas visit.
- Chinese born after 1990 have never experienced hardship. They are not seen as savers, they are prepared to spend their earnings and take on debt, underpinned by substantial intergenerational property holdings.
- China's GDP growth has declined over the past decade from more than 10% to around 6.5% per annum. Today the main driver is consumer spending, contributing 70% of GDP growth.
- The population of China is circa 1.4b. Cities in China can be categorised into four tiers according to their populations:
  1. Tier One – populations greater than 15m (includes Shanghai and Beijing).
  2. Tier Two – populations between 3m and 15m.
  3. Tier Three – populations between 150,000 and 3m.
  4. Tier Four – populations less than 150,000.
- E-commerce growth has been driven by rapid consumer adoption. More than 50% of consumers undertake detailed research before purchasing compared to 30% in the U.S.
- Within the e-commerce segment, cosmetics is the biggest category, 36% market share.
- Around 40% of products on cross border e-commerce sites are fake.
- A growing trend known as *"New Retail"* has emerged in China, where consumers purchase products in store with the option of free home delivery within 30 minutes. We visited the Alibaba Hema store where this format was on show.
- Chinese consumers pay for goods and services via smart phones, using either Alibaba's Alipay or Tencent's WeChat payment platform.
- Together, Alibaba and Tencent control 7 of the top 10 online retail sites.
- Celebrity endorsement is a proven method of building brand and consumer loyalty. Blackmores have utilised celebrities in the past and recently announced the appointment of well-known Chinese male actor Shawn Dou as its newest recruit.

Photo 4: Hema store – Shanghai

Source: SFML China trip

Photo 5: Shanghai Premium – Product Store

Source: SFML China trip

Photo 6: Shawn Dou – Blackmores Ambassador

Source: SFML China trip

AdMaster

Calvin Chan is the Chief Operating Officer at AdMaster, a data marketing company. He noted several market observations.

- Within China the new norm is lower GDP growth.
- Even as the economy slows, consumers are spending more.
- The most common method of communication is WeChat.
- DTC (Direct to Consumer) is the new normal business model.
- Consumer spending on premium and high-end goods and services such as travel is rising.
- Established brands need to deal with China's *"Walled Gardens"*, the companies that dominate e-commerce and who in-turn look to extract more from brand owners. Alibaba is seen as the most powerful and protective of its own eco-system.
- Over 30% of online traffic is fake, making data difficult to interpret.

Blackmores China

Blackmores Deputy Head of China Raymond Chan, presented on the region.

- As noted earlier, the group delivered net sales of $143m during 2018 from China bound and in country sales.
- Blackmores is a leading premium imported VDS brand.
- Across e-commerce and retail stores the group has over 100 stock keeping units (SKUs) across five key categories.
- Blackmores is the preferred brand across e-commerce channels.
- Blackmores heritage and history across the VDS category is unmatched amongst competitors.
- Blackmores Health Institute underpins a commitment to undertake research and invest in education, with 40 projects underway.
- The Chinese e-commerce market is valued at US$604b with 16% penetration of consumer spend compared to the U.S. at US$394b with 10% penetration.
- The dominant e-commerce players in the VDS market are:
  1. Kaola - 24%
  2. Tmall Global - 20% (Alibaba)
  3. VIP - 16%
  4. JD Worldwide - 13%
- New distribution agreements with Kaola and Alibaba have led to the DTC channel representing more than 50% of Blackmores sales.
- Overall e-commerce sales account for more than 90% of total sales with the balance coming from physical store sites.
- Offline sales are expected to grow strongly in the medium term as more product registrations are received.

- Staff numbers are set to double over the course of 2019, with a new head office required to accommodate the increase.
- Management and the Board are committed to driving growth and have stepped up marketing spend during the latter part of 2018 and into 2019.
- Gross margins are set to expand but the company has clearly articulated a desire to invest any additional benefits into the China business.
- Blackmores has launched a new marketing campaign message for China and Asia, *"Begin, Better, Everyday"*.

Site visit Indonesia

Following our China tour, we headed to Jakarta Indonesia where we reviewed the operations of Blackmores joint venture with Kalbe Farma. Known as PT Kalbe Blackmores Nutrition, the joint venture has been operational for three years.

Blackmores has a long history in Indonesia, having established market operations in 1995. The decision to exit some years later was an acknowledgement of the company's lack of operational firepower in the region. Re-entering in 2015, the company chose to team up with Kalbe Farma, opting to use the powerful resources of a successful Indonesian based healthcare group.

Kalbe Farma was established in 1966, listed on the Indonesian exchange in 1991 and has a current market capitalisation of $6.5b.

Today Kalbe, with an employee base of 17,000 and sales of $2b, is the largest healthcare provider in Indonesia covering four business segments including nutrition, consumer health, prescription pharmaceuticals and distribution and logistics.

We were joined on the tour by the Kalbe Blackmores team which included General Manager Dickson Susanto, Accounting Director Ratna Li, Director Diny Elvirani and Director and Chief Marketing Officer Ongkie Tedjasurja.

As noted earlier, the Kalbe Blackmores Joint Venture (JV) was established in 2015, and first products launched in 2016. Beginning with eight staff and 16 product lines, the business has expanded significantly over a relatively short period.

Currently, the business employs 42 staff and 328 Product Advisors, who are physically located across the various retail pharmacy channels assisting customers with product choice.

The JV partners have expanded the number of product units from 16 to 42, with Fish Oil and Pregnancy Gold the two flagship products.

The retail landscape is made up of four channels:

1. **Modern Pharmacies** – 378 outlets (35% market share).
2. **Modern Trade** – 258 outlets including supermarkets and baby shops (21% market share).
3. **Independent Pharmacies** – 26,600 stand-alone stores (26% market share).
4. **E-commerce** – Blibli Tokopedia, JD.ID (18% market share).

The most profitable and fastest growing channels are the independents and e-commerce sites.

The Vitamins and Dietary Supplements (VDS) market in Indonesia is valued at US$660m, with the premium VDS segment estimated to represent circa 15% or US$100m. This is an important market and one that the JV is aiming to dominate. Currently the JV is ranked third with less than 10% market share.

Indonesian market facts:

1. Indonesian population 264m.
2. 42% of population is younger than 25.
3. Jakarta is the largest city with a population of 10m.
4. Indonesian GDP sits at US$1.1b.
5. GDP growth has been consistently above 5% for some years.
6. Growth has been driven by consumption and government spending which are growing at 5.1% and 4.0% respectively.
7. Healthcare spend to GDP of 2.9% compares to 5.6% in Thailand and a global average of 9.2%.
8. The VDS market grew at 9% per annum between 2014 and 2017.
9. Across Asia compound annual growth in VDS has averaged 7% to 8%.
10. Imported products represent over 70% of the VDS market.
11. A survey of 1,500 consumers across seven cities, showed 60% consumed supplements continuously over 2 years.

12. Monthly spending averaged between US$10 and US$30.
13. The VDS market is highly fragmented with Bayer the largest player holdings a 6.1% market share.

Site visits

We visited a number of stores, located in shopping malls and off-street locations. The Blackmores marketing presence was clearly visible with Product Advisors located in each of the sites visited. Independent store feedback on the Blackmores brand was strong, with product acceptance reflected in continuing strong double-digit annual growth

Summary

The China market continues to evolve, and the company's long-term commitment is gaining traction among consumers and local partners. In Indonesia, which can be regarded as a more traditional consumer market, the company has made significant inroads in a short period of time.

Management are targeting profitability in all Asian markets in 2019, with China and Indonesia offering the greatest sales upside.

More specifically, while China continues to generate a lot of interest among investors, the few of us that took the time to visit Indonesia benefited from local management's presentation. Blackmores is positioned very well in Indonesia, where VDS demand is growing at a rapid clip.

Overall, the visit reinforced our positive view of the business. Both markets are in their infancy, allowing Blackmores to invest to gain longer term brand acceptance. The opportunities in China and Indonesia are multiples of their current sales and the results generated thus far support the significant opportunities that lie ahead in each region. ***SFM***

Photo 7: Indonesian pharmacy outlets – Jakarta

Source: SFML China trip

NEARMAP – CHANGING THE WAY PEOPLE VIEW THE WORLD

Nearmap CEO Rob Newman starts most of his presentations to investors by explaining the photomap provider's purpose, *"changing the way people view the world"*. As simple as it sounds, the offering is generating traction. Their browser based, high resolution aerial imagery offers a cost-effective solution for viewing and analysing the world, eliminating hours of wasted time and money spent travelling and surveying sites physically.

In July of 2008, Nearmap was acquired by ipernica, a listed intellectual property protection company, for $4m in cash, 60m ipernica shares (9 cents a share at the time) and 12.5m ipernica $0.40 strike price options.

Nearmap was described as a producer of high resolution aerial imagery with multiple view angles at a fraction of the cost of traditional solutions. Following the acquisition, the company announced plans to change the name of the listed vehicle from ipernica to Nearmap in February of 2012. This reflected aerial imagery's growing importance and the future strategic focus of the business. Plenty has changed since the acquisition but at its core the company is a low-cost aerial imagery specialist.

Aerial imagery

The use of aerial imagery in government and business is not a new phenomenon. A bird's eye view provides a unique perspective, allowing for a far more complete understanding of an area. Whether captured by drones, planes or satellites, aerial imagery is regularly used for surveillance, geographical surveys and planning the development of towns. Unsurprisingly, the cost of flight makes large scale capture an expensive endeavour. Consequently, aerial imagery has been used predominantly by well-resourced organisations such as the government and the military.

This dynamic shifted with the release of Google Maps. Suddenly, access to high quality photomaps became a commodity. Satellite imagery allowed companies such as Google to provide free access for non-commercial use. Google's service was ground breaking at the time, but it had and still has flaws. The ability for individuals to look down on their homes was neat, but astute users noticed the images were months and in some cases years out of date.

Google's services were incapable of providing images either current enough, or of the quality required for commercial use. Business and government users continued to rely on either expensive satellite imagery or bespoke photo surveys. Those surveys could only provide the users with a view of the environment at a single point in time and were often delivered as a collection of individual images. Rapidly changing urban areas quickly rendered these images ineffective.

Bespoke surveys were often conducted on the basis that the patron owed the image rights. Even in cases where the surveyor retained reuse rights, the absence of an efficient delivery medium prevented easy re-sale, hindering the improvement in the economics of the service.

High resolution aerial imagery

Enter Nearmap. The company's founder Stuart Nixon developed a system to capture images from far higher altitudes than aerial photo surveys were previously capable of. The basic logic being that from higher up, aircraft could capture the same survey area while flying a shorter distance.

Given such a large proportion of the cost of generating photomaps comes from aircraft charter fees, being able to conduct the survey in less flight time improves the overall cost.

However, flying at a higher altitude poses several problems. Anyone who has used a pair of binoculars to view something in the distance will know how hard it is to stay focused on a fixed point. The further away the point, the more difficult it is. Conducting photo surveys at altitude requires specialised hardware and software to compensate for the forward movement as well as turbulence. The higher the aircraft, the more precise the image capture needs to be.

Nearmap could have opted to compete with traditional aerial imagery providers by marginally undercutting their fees. Lower capture costs would have delivered the company superior margins and allowed them to capture market share. Instead, their strategy is to provide the imagery at a cost which makes it affordable for businesses small and large alike.

It's worth noting that when ipernica acquired Nearmap, their stated goal was to provide imagery covering 20% of the world's population (700 cities) updated on at least a monthly basis. A lofty goal to say the least.

The annual spend on aerial imagery in Australia is estimated to be roughly $250m-$300m. Nearmap has succeeded in selling to traditional users of aerial imagery such as local councils and planning authorities, but a large proportion of the company's revenue comes from businesses too small to pay for bespoke aerial surveys.

More than half of Nearmap's contract value of $66m is generated from customers paying less than $50,000 in subscription fees annually. This demonstrates the success the company has had growing a niche within small to medium enterprises (SMEs). Under Nearmap's model revenue can effectively be earned by providing an unlimited number of customers the same image over and over through its subscription model.

Nearmap users get access to the company's entire imagery library, via a web browser. A subscription also provides the user with a complete range of digital tools. This is a far broader offering than most providers. It is worth exploring some of the use cases of their subscription services to demonstrate how this broad offering at a lower price point has created demand which previously didn't exist.

Nearmap Solar and Roofing

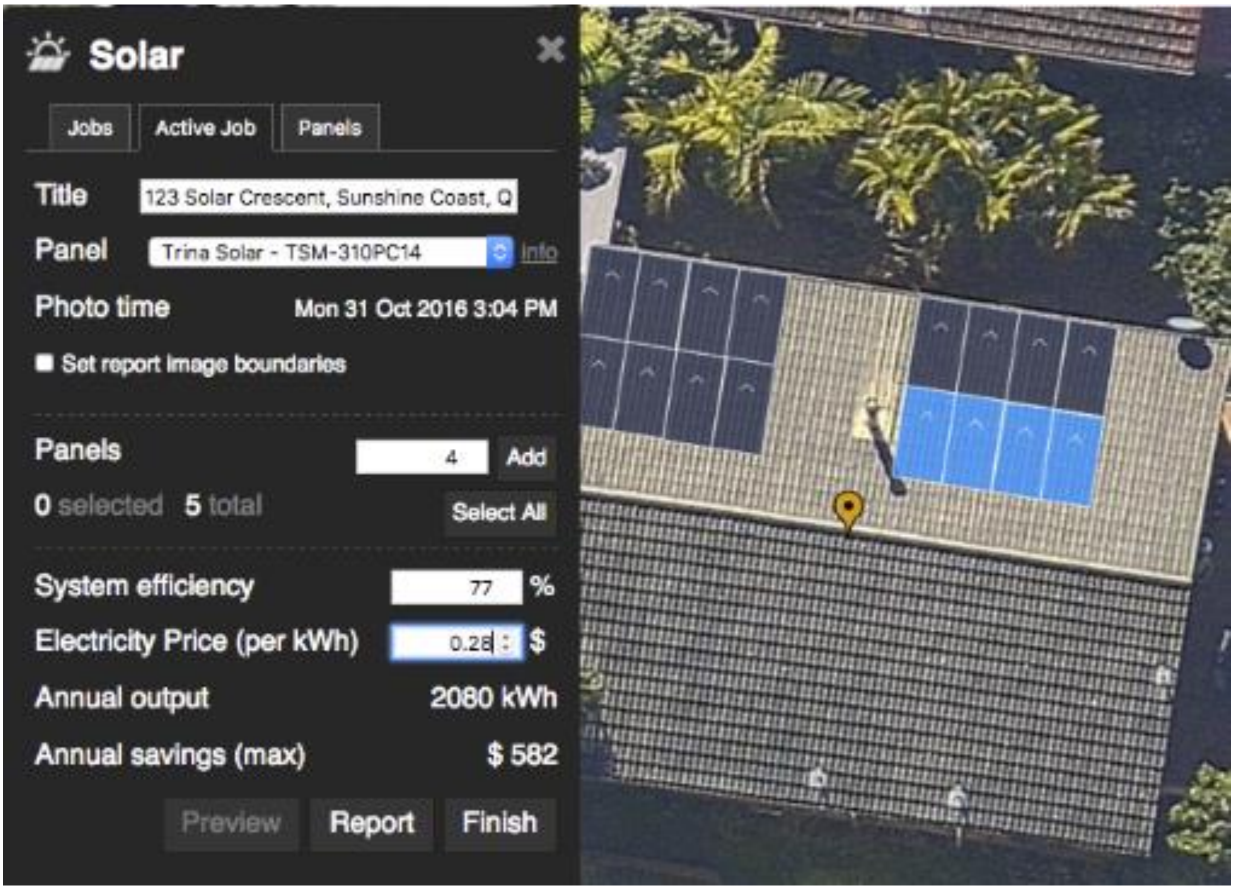
Onsite visits to conduct appraisals for solar panel and roofing jobs are time consuming and costly. High-resolution aerial imagery provides a viable alternative to site visits.

In-built tools in MapBrowser, Nearmap's photomap library, allow users to measure roof dimensions including pitch and area. Frequent updates ensure images are current and high resolution allows for precise measurement. Quotes can be provided far more efficiently, helping develop a strong sales pipeline. Without needing to step foot on a site, the installer saves on labour costs, insurance and petrol.

Photo 8: Nearmap Roofing analysis example

Source: Nearmap corporate disclosures

Photo 9: Nearmap Solar analysis example



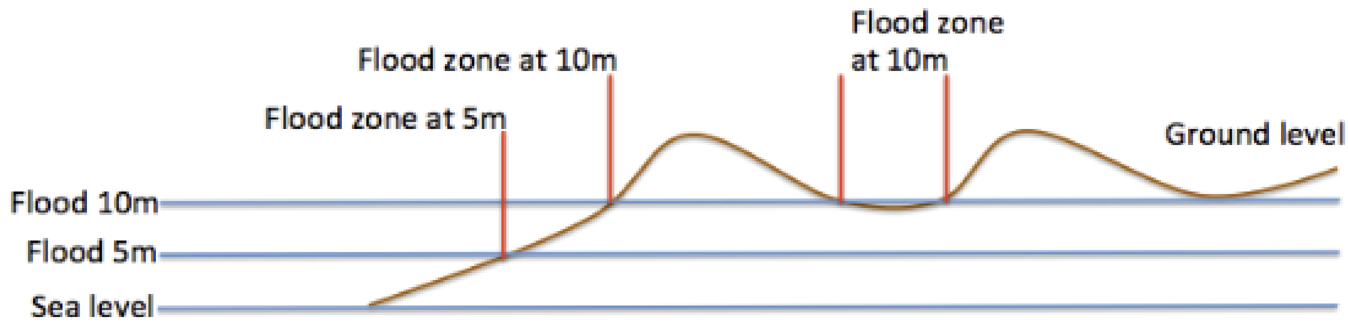
Source: Nearmap corporate disclosures

Nearmap Insurance

The insurance industry relies on the use of site visits to verify assets are authentic, assess risk and identify potential claims, all of which require an army of assessors. With the help of aerial imagery insurers have been able to reduce their reliance on assessments from employees in the field, instead relying on appraisals conducted with Nearmap's tools.

High risk assets can be identified during quoting by viewing property conditions over time and by using tools such as the Flooding Tool. As a part of its surveys, Nearmap collects elevation data which is integrated as a data layer in the MapBrowser allowing customers to conduct flood risk modelling.

Photo 10: Nearmap flood analysis example

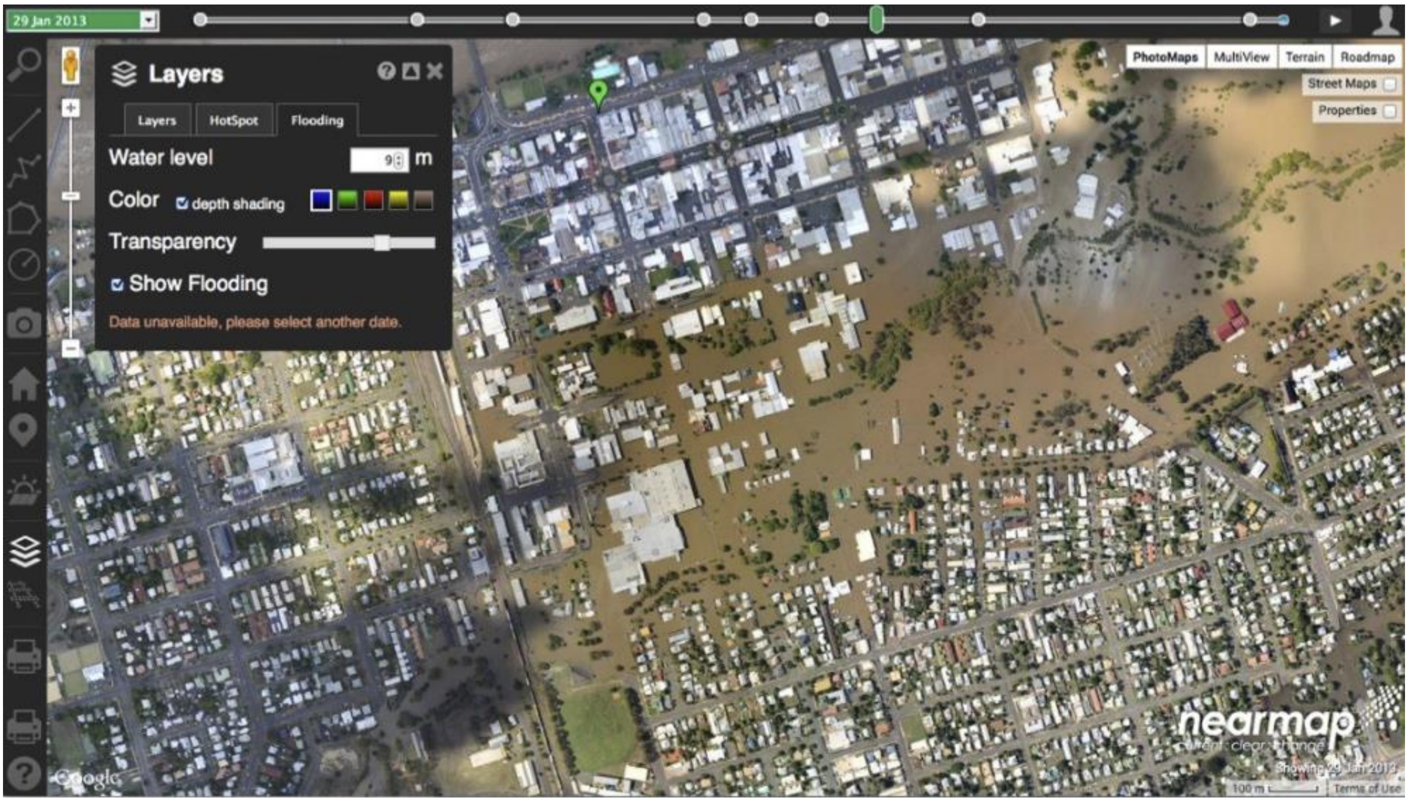


Source: Nearmap corporate disclosures

Photo 11: Nearmap Flood Tool analysis of Bundaberg

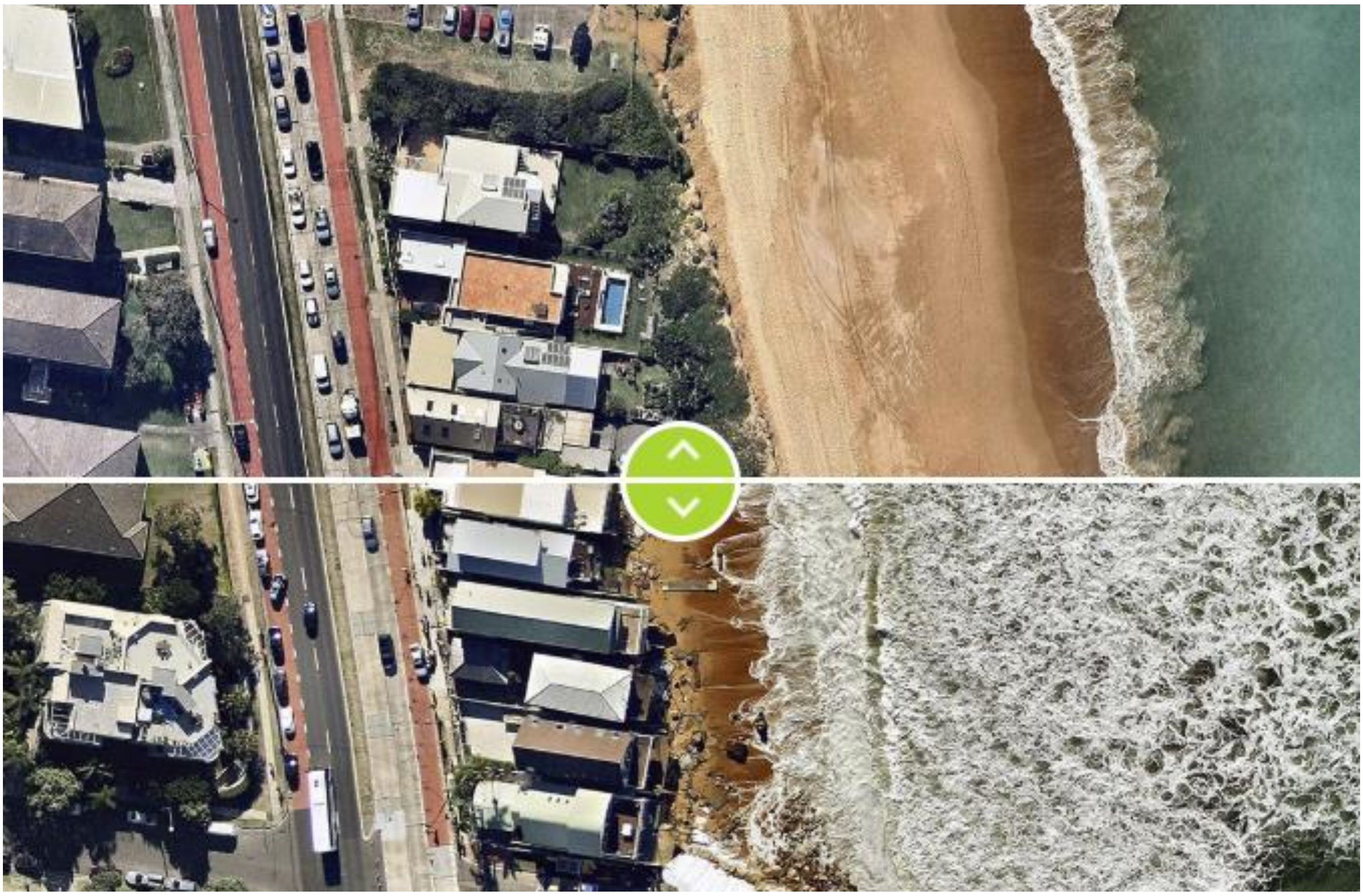
Source: Nearmap corporate disclosures

Photo 12: Actual impact of 2014 floods in Bundaberg, QLD



Source: Nearmap corporate disclosures

Photo 13: Before and after images of damage caused by storm surge at Collaroy Beach, Sydney, NSW



Source: Nearmap corporate disclosures

Frequent updates allow for fast damage assessments. Photo 13 shows before and after shots of the damage caused at Collaroy beach in Sydney by storm surges on 5 June 2016. The image illustrating the damage was captured three days later on 8 June 2016.

Nearmap Utilities

Maintenance and damage assessments are part and parcel of doing business as an owner of hard assets such as water mains, power lines, dams, large processing plants and mines. Traditionally these companies would hire hundreds of employees to conduct in person surveys of assets to identify damage, plan maintenance activity and respond to unexpected issues.

With up to date imagery, surveys can be done with a smaller workforce, inventories at mine sites can be tracked using built in volume calculation tools and environmental problems such as illegal dumping and leaks can be acted upon quickly.

Photo 14: Gorgon LNG Plant, Barrow Island, WA

Source: Nearmap corporate disclosures

Photo 15: Desalination plant at Kurnell, NSW

Source: Nearmap corporate disclosures

Business model

Nearmap's business model involves customers paying a subscription fee for access to the content. Different subscriptions afford the customers different data allowances. New products such as 3D layers utilise alternative pricing models to account for differing data densities but conceptually operate in the same manner. Customers are charged based on consumption, rather than a mark-up on the cost to capture the imagery, the model utilised by traditional aerial surveyors.

One of the most important performance indicators, like any other SaaS business is customer churn, which measures the proportion of the licenses that lapse annually. A healthy level of churn for SaaS businesses is determined by factors such as gross margins and the capital intensity of the business. Generally, churn of less than 20% provides a long enough customer life to generate an appropriate return on the capital invested acquiring customers and developing the product. At a 20% churn rate the average life of a customer is five years.

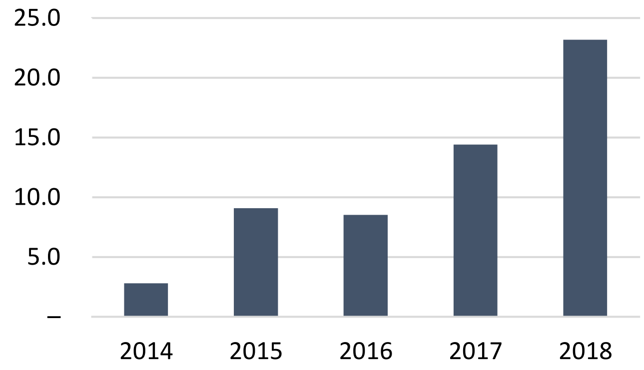
The approach taken to grow a SaaS business is somewhat different to other traditional endeavours. An intense focus on customer life time value (LTV) is a key driver of business strategy. LTV is calculated by multiplying the average annual contract value (ACV) per customer by the expected life of the account in years. If the ACV of the customer is $1,000 and the expected customer life five years, the LTV will be $5,000.

The economic value of a customer is a function of the LTV, the cost of acquiring the customer, the cost to service the customer, and the company's cost of capital. The larger the LTV, the higher the gross margins, and the lower the company's overheads, the more a business can afford to spend acquiring customers.

- **Churn** – Customer churn for Nearmap is particularly low and gives rise to an average customer life of around 13 years. The average ACV per subscription was running at $7,500 as at 30 June 2018 giving rise to an average customer LTV of $97,500.
- **Gross margins** – Nearmap earns gross margins of 94% in Australia, 27% in the U.S. and 80% at a group level. Gross margins in the U.S. will rise towards those earned in Australia as hosting costs remain stable and the customer base grows.
- **Operating margins** – Like server hosting costs, capture costs and company overheads are more or less fixed. As revenue grows and gross profits reach a level where they exceed the fixed costs, EBITDA margins and cash flow should grow rapidly.

Despite this, it is expected that cash flow will not grow as fast as it otherwise might, as Nearmap invests more in sales and marketing each year to acquire customers. Sales and marketing are the company's largest variable costs, other than discretionary spend. This strategy remains prudent, while customer LTV expectations hold true and the company can acquire customers for a sensible amount.

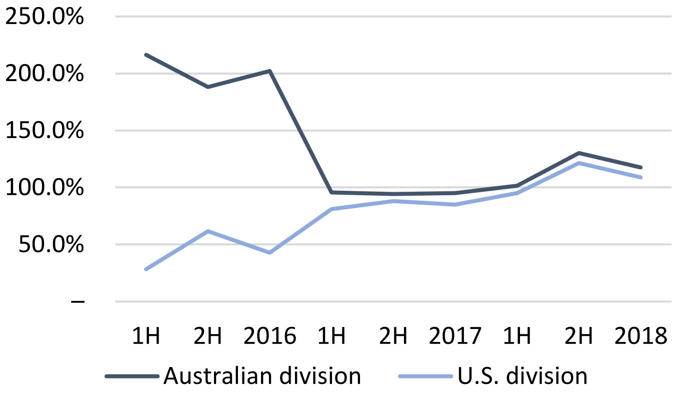
Figure 3: Group sales and marketing expense



Source: Nearmap company financials

The key performance metric for the customer acquisition strategy is the sales team contribution ratio (STCR), which compares the increase in the ACV over a 12-month period with the cost of the sales function. The company targets a STCR of greater than 100%, which means the team is paying back their own cost base in under a year. As revenue grows, Nearmap will continue to invest more to acquire new customers if they can achieve this at a sensible price.

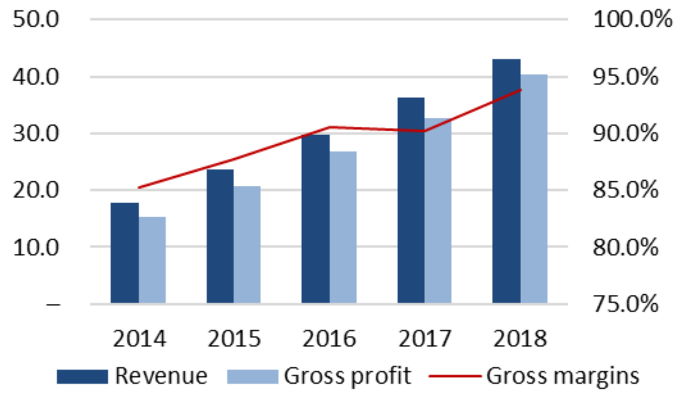
Figure 4: STCR per division



Source: Nearmap company financials

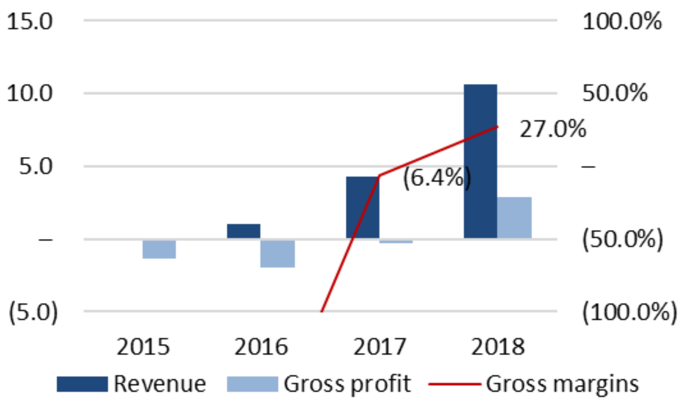
Perhaps most importantly, the business model has already been proven in Australia. Compare **Figure 5** and **Figure 6** below, which illustrate the strengthening of gross margins which occurs as the business units reach scale. The Australian business is highly profitable, earning operating profits of $22.9m on revenues of $43m, a margin of more than 50%. In comparison, the U.S. business lost $17.2m at the operating profit level on revenues of $10.6m.

Figure 5: Aus division revenue and gross profit



Source: Nearmap company financials

Figure 6: U.S. division revenue and gross profit



Source: Nearmap company financials

The profitability of the Australian business is a result of its maturity. It has been capturing images and selling the service for more than a decade. Annual capture costs are stable, growing in line with moderate increases in capture operations to expand the footprint. In Australia, the total cash capture costs amounted to $3m during 2018.

Announced in October of 2014, the expansion into the U.S. is relatively recent and only now beginning to scale. The first commercial sales to SME's and local government departments commenced in May of 2015. In FY18 the business generated revenues of $10.6m up 146% from the $4.3m earned in FY17. ACV also rose 145% from $7m to $17.2m. Clearly the U.S. business is still very small but the runway for growth is long.

Although the size of the U.S. aerial imagery market is far larger ($1.3b to $2.6b), the difference in geographic size and population density of the U.S., compared to Australia, means the capture program is far more expensive to fly than it is domestically, costing the company around $13m annually. In Australia, the five largest cities account for almost 65% of the nation's population. In contrast, the ten largest cities in the U.S. account for less than 10% of the population. As penetration in the U.S. increases, the ongoing investment in the capture program should remain relatively stable.

In September of 2018, the company launched an institutional equity raising, placing 43.75m new shares at a price of $1.60 to raise $70m. The strategic rationale for the raising was outlined as follows:

- **Increased sales and marketing investment** – As discussed, investment in sales and marketing to acquire customers makes sense, particularly given the low customer churn and high margins the company earns once the business begins to mature.
- **International expansion and partnerships** – Demand from larger customers and partners in areas outside of the current capture program has given the company confidence to expand operations into Canada. The United Kingdom is also an attractive market given its size and population density. With product demand underwritten by these large customers, expanding the operations beyond their current scope is a low risk, value accretive strategy.

- **Technology and product investment** – Investment in research and development is critical to maintain a competitive advantage over aerial imagery peers. Balance sheet strength provides the company with the firepower to more carefully consider make versus buy decisions.
- **Strategic flexibility** – Although the company has guided that they will be cash flow breakeven in FY19, the additional balance sheet optionality provides flexibility that the company previously lacked.

As the business is scalable and capital intensity low, returns on invested capital will be high if Nearmap maintains a competitive advantage over its peers.

Competition

Nearmap's value proposition is already well established and the sales and marketing strategy is based on demonstrating this proposition to customers. The biggest risk the company faces is competition that successfully emulates their offering.

Eagleview Technologies

The company's closest peer is the U.S. based Eagleview Technologies which operates an on-demand report-based model. Eagleview offers two main services:

- Providing bespoke photomap imagery (orthogonal[2] and oblique[3] imagery) to 1,700 municipal, country and state government customers (35% of revenue in 12 months to 31 March 2018). A fleet of around 115 aircraft carry out their capture program, with a claimed coverage of around 98% of the U.S. population. It is estimated that images are updated around once every two years.

- Sale of 3D wall and roof measurement reports to residential contractors (29% of revenue) and property and casualty insurers (28% of revenue). The reports are generated using photomap imagery collected during bespoke surveys for municipal, county and state governments. Unlike Nearmap, SME users of Eagleview's products do not get direct access to imagery and instead, request reports on specific properties. Although the report generation is partially automated, there are elements of manual intervention which are conducted by offshore outsourced business process providers.

Eagleview has a number of technological shortfalls which give Nearmap confidence they will be able to compete with Eagleview on their home turf. As discussed, refreshing Eagleview's entire capture area with new imagery takes approximately two years, using 115 aircraft. In comparison, Nearmap captures approximately 70% of the population but is able to update its coverage three times a year using a fleet of less than 20 planes, delivering similar or better resolution outcomes.

Until its recent acquisition of Spookfish, Eagleview's capture operations were limited to flying at around 2,000-3,000 feet, using off the shelf imaging technology, compared with the 12,000 to 14,000 feet that Nearmap flies at.

To help close the gap, Eagleview recently purchased the Perth based aerial imagery specialist Spookfish for $136m. Spookfish was started by a number of ex-Nearmap employees and while they were able to take their learnings with them, they have struggled to adapt them to the capture system they developed. Our understanding is that they have faced a series of problems with the capture of oblique imagery, which poses issues for Eagleview due to their reliance on this type of imagery for the generation of 3D reports.

Despite the problems Spookfish face, Eagleview's acquisition demonstrates how seriously they take Nearmap as a threat. Although the purchase price is small in the scheme of listed acquisitions, the alternative of spending $140m on systems development should give investors an indication of the financial resources the company is prepared to throw at research and development. Continued investment in research and development is therefore critical, an area we address below.

Satellite imagery

Satellites are often raised as a potential competitive threat to Nearmap’s operations. While images available through Google Maps lack the resolution users require, the prospect of falling launch costs has the potential to make satellites more affordable.

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[2] *Bird’s eye view.*

[3] *Imagery captured at a 40 – 45 degree angle from the horizonal.*

Cost effective satellite imagery is still some way off. Specialist DigitalGlobe plans to spend US$600m on its next generation Worldview Legion program which will launch earth imaging satellites aboard Elon Musk's Falcon9 SpaceX rockets. These next generation satellites will have around 30 cm resolution (30 cm on the earth's surface will be represented by a single pixel). In comparison, Nearmap photomaps have a resolution of between 5 cm and 10 cm.

Military surveillance satellites are capable of far higher resolution images than Nearmap generates, however, these are extremely expensive to build and launch.

Smaller satellites can be launched at a lower cost, however, there are limits to how small telescopes can be without compromising the image resolution.

The threat of competition from satellite imaging companies can't be entirely dismissed but for now, a viable competitor is a long way off.

Drone image capture

Recent improvements in drone technology have made flight and aerial image capture far more accessible. Although they give users the ability to capture imagery quickly, drone flight lacks the scalability of a service such as Nearmap’s. Current regulations largely ban the use of drones beyond line of site. A key driver of uptake is the ability to visualise buildings remotely, something drones are incapable of within current regulatory frameworks.

The importance of research and development

Although our assessment is that Nearmap has stronger technical capabilities than their peers, continued investment in research and development to maintain and grow their advantage is critical. The rate that Nearmap can acquire customers will be determined by the advantages of their product over competitors and margins will be determined by how efficiently capture programs are run.

Nearmap Chief Technology Officer Tom Celinski, who previously worked as the Director of Software at another of the portfolio’s investments Aristocrat Leisure, breaks down the technology into four functional streams.

Camera system

The camera system is one of the key elements of Nearmap's intellectual property. The research and development process has cycled through several generations of cameras from the original HyperPod, followed by the HyperCamera (capable of capture at 8,000 feet), the HyperCamera2 and now the second generation HyperCamera2 which is currently being rolled out and is capable of flying at altitudes of up to 14,000 feet.

The HyperCamera2 comprises a housing which sits inside a plane above a viewing hole. The system simultaneously captures photographs of varying size and at a variety of angles while the aircraft follows a pre-determined survey path.

The system sits on a stabilisation platform to minimise disturbances caused by turbulence. An articulating mirror mechanism enables the capture of images at a variety of angles, limiting the number of cameras required and eliminating the need for physical movement of the camera in between each successive shot.

The goal is to capture a large number of overlapping images while minimising blur. The higher the cruising altitude, the more difficult this becomes.

Currently the HyperCamera2 can be used to run surveys from an altitude of 12,000 to 14,000 feet. Celinski has established a development program to increase the survey altitudes to almost jet level capture (30,000 feet) which, if achieved, will result in a markedly more efficient capture program. In comparison, Eagleview surveys are conducted at between 2,000 and 3,000 feet. Spookfish can capture from around 8,000 feet but have struggled to accurately deliver oblique imagery at this altitude.

Image processing system

Following a photo survey, the imagery is downloaded to hard drives and couriered to Nearmap offices, where it is loaded to Amazon Web Services (AWS). Hundreds of AWS compute instances[4] sort through data, choosing the best images to splice together to create the continuous photomaps.

[4] Individual virtual servers in Amazon’s cloud designed for running applications on the AWS infrastructure which can be scaled up and down as operations require.

The system also re-constructs 3D models using the imagery and sensor data collected during the flight, publishing this in a variety of formats. Although the use cases for this data are prospective, there are strong justifications for its use in fields such as radio and microwave signal propagation modelling and development planning which require understanding of line of sight between discrete 3D points in space.

Client user interface design

The MapBrowser interface is the subscription user's main window into the imagery provided by Nearmap. Central to the value proposition, the MapBrowser gives users access to the entire photomap library and includes tools for measurement of roof pitch, distances, flood modelling etc.

Survey systems

Running survey flight operations isn't quite as simple as scheduling survey locations and flight times months in advance. Adverse weather, as well as seasonal changes determine where and when surveys are run. To optimise operations, a team of staff are tasked with monitoring weather and organising the flights to ensure Nearmap achieves appropriate frequency of coverage, while capturing images through different seasons to allow users to understand how the environment changes between spring, summer, autumn and winter.

The future of aerial imagery

The aerial imagery industry has now reached a tipping point where scale is driving substantial growth beyond the traditional use cases. Nearmap's approach to building their business has literally been to change the way businesses and government view and understand the world, delivering value that was previously not economically available to them.

The company is obviously not the first to recognise the size of the potential market that can be tapped with the right product and we expect them to face substantial competition over the foreseeable future. Despite this, we feel comfortable with the competitive position of the company, particularly given the head start they already have on their closest peers.

Nearmap has demonstrated the power of the business model in the Australian market, where the scalability and the attractiveness of the products are proven. Recent progress indicates similar success in the U.S. is achievable and the Nearmap management team's confidence in the model is evident from the recent capital raising and willingness to continue expanding operations beyond the U.S. into Canada.

Nearmap has a market capitalization of $740m and net cash of $17.5m at 30 June 2018, prior to the $70m raising conducted in September. ***SFM***

Table 6: Nearmap historical timeline 2008 – 2018

Date	Event
Jul 2008	Ipernica announces acquisition of geospatial imagery company Nearmap.
Feb 2010	Nearmap reports first sales to government agencies. City of Swan becomes the company's first Government client.
Aug 2010	Nearmap founder Stuart Nixon joins ipernica Board and Simon Crowther appointed as company CEO.
Feb 2012	Ipernica announces plans to change company name to Nearmap.
Feb 2014	Launch of Nearmap Rail – a tool to help rail operators with asset management.
Apr 2014	Launch of Nearmap Solar – delivers instant client quotes and location aware power calculations without having to leave the office.
Jul 2014	Nearmap launches new FAA approved aerial camera system. HyperCamera is designed to fit in the cabin of any aircraft fitted with a standard camera hole.
Jul 2014	Launch of Nearmap Insurance.
Oct 2014	U.S. expansion announced with initial plans to capture 30% of the population and more than 100m people during FY15.
May 2016	Peter James appointed Chairman of the Board. Ross Norgard steps down as Chair and remains on Board as Non-Executive Director.
Jul 2016	Nearmap announced first imagery generated by HyperCamera2. Allows company to capture, process and publish 3D models from an altitude of 14,000 feet.
May 2017	New Zealand pilot capture program announced and confirms first commercial sale of imagery.
Jul 2017	Nearmap delivers new 3D content and oblique imagery transforming location content for a range of industries in the U.S. and Australia.
Aug 2018	Expansion of business operations to New Zealand announced. Dedicated sales, marketing and product resources established in country.
Sep 2018	Company launches institutional placement of 43.75m shares to raise $70m at $1.60.

Source: Nearmap company announcements

WHERE NOT TO GO

The opening quote for this quarterly newsletter resonates with us. As a unit we openly acknowledge that we are not the smartest team in the room.

That said, we strongly believe in our investment philosophy. We see it as being a sensible, patient approach to delivering long-term performance. Our record to date, a period stretching over 15 years is perhaps an accurate reflection of that philosophy.

We openly discuss our ideas internally and publish our thoughts in our monthly updates and quarterly newsletters but avoid airing our views in the media. A practice that, we believe, has become all too common within our industry.

Obviously, all managers have their stated approach to investing and we are no different. There are, however, subtle variations that require further explanation. Below we expand on one, namely stock selection and where not to go.

Our bottom-up, business by business review process is not driven by a black box or a quantitative model selection outcome. Rather, it entails a deeper appreciation of what makes a specific business worth backing, including the very people entrusted to oversee shareholder's capital.

In our September 2017 Quarterly Newsletter, we touched on this approach in our article titled *"Culture – Essential"*. In that article we explained why we deem this so critical to our assessment of businesses. Below we include two extracts from that quarterly write-up.

"In business, we measure profits, cash flows, assets, liabilities and the equity that keep the wheels turning. We employ auditors to check the veracity of financial statements. Accounts need to balance, and ratios must be met but the picture that financial statements paint rarely tell the whole story. Not everything is measurable. In reality, financial statements are but a snapshot, capturing a simple point in time. The long-term wellbeing of a business is often determined by far more than just numbers."

and

"So, what makes an ideal leader? We would single out one attribute; the stewardship of a company's assets and its people, above all else. Shareholders expect their leaders to set the right example and deploy their capital in a sensible and disciplined manner. Leaders who approach the task as if it were their own capital are far more likely to make sensible decisions."

The first quote refers to the parts of a business that are far more difficult to measure than the pure financials. The industry terms them qualitative attributes, leading many to question the merits of apportioning too much weighting in any final analysis.

The second entails an assessment of the team, both as individuals and as a collective unit, all driving towards a common goal.

The two combined are important, if not critical, to a business's ultimate long-term performance. They also form the backbone of where we choose to go when selecting businesses.

We are firm believers that a united team, one where company management, employee culture and the shareholders have clear alignment is where the greatest long-term value can be generated.

It is also why we try to avoid those businesses where internal conflict, including shareholder activism and capital management programs are designed to deliver short-term gain but rob the company of long-term opportunities.

Below, we expand on these thoughts.

Emerging trend

In recent times we have seen an increase in shareholder activism. Led by proxy advisors who have muscled their way into the domain of shareholder decision making. Today, company boards are under constant pressure to conform.

This can have unintended negative consequences. Those who are elected to represent the best interests of the public company, have become hostage to a host of external demands.

This has led to some companies making changes that appease the critics but, in the process, impair the business over the long-term. While our philosophy on how we invest hasn't changed, our views on which areas to avoid have strengthened.

Where not to go

Investing is represented by a diverse range of styles. From passive to active, those that are index focused, others index agnostic, short, long, value or growth, the list is endless. Company boards that endeavour to satisfy the needs of so many groups end up tying themselves in knots.

In our pursuits, we seek businesses with leadership qualities, run by competent management teams, underpinned by strong balance sheets and with a focus on capital management.

Above all, we aim to get the management piece right. We see no point in going down a path where we have little confidence in management's ability or even worse, where they have demonstrated a track record of capital destruction.

To illustrate this point, it wouldn't surprise many that two stocks that have appeared in the press lately, AMP and BHP Billiton don't make the grade. To a lesser extent, a third stock that is caught in a bind is Caltex Australia, not knowing who to please.

AMP

AMP has consistently fallen short of investor expectations. They have a very long track record of delivering poor returns. The events of the recent Royal Commission further exposed their shortcomings.

Where some investors now see value in a weakened share price, we simply take the opposite view and avoid. The sale of AMP's Life Insurance business is a case in point. Agitated investors are questioning if fair value has been extracted and are now threatening to call an extraordinary general meeting to spill the board.

Shareholders who are calling the deal *"stupid"*, *"value destroying"*, *"terrible"*, and a *"brain explosion"* are all likely to be right in their assessment but what is even more puzzling is why they are there in the first place.

How many bad deals do you have to do and how bad a track record do you need before you realise the low share price is telling you all you need to know?

It doesn't require much analysis to understand that a business with a board that has overseen such poor capital management decisions while presiding over a culture that is so mis-aligned will continue to struggle into the future until it is broken up and sold off. Hoping to salvage value from this situation is drawing a long bow.

Unfortunately for AMP shareholders, the writing has been on the wall for some time, making the current situation almost consistent with past outcomes.

BHP Billiton

The clean-up at BHP Billiton following previously poor capital allocation decisions has seen a new management team determined to restore value. The most recent example being the Board's decision to return excess funds to shareholders post the company's exit from the U.S. shale oil operations.

This will see some US$10.8b of dividends and capital returned to shareholders. The decision to exit the U.S. shale market, follows its entry in 2011.

Many shareholders have responded favourably to the bounty of funds heading their way, but a little perspective is required. Since embarking on this ill-fated strategy, the company has ploughed some US$40b into building the U.S. shale business.

The subsequent drop in oil prices during 2016 and a reprioritisation by the newly elected management team, led to the decision to put the assets up for sale. BP, certainly not a new comer to the oil business, moved in and acquired the assets, leaving BHP Billiton nursing an overall loss of close to US$20b.

While the decision to return funds to shareholders may be viewed in a positive light, it probably speaks more to the pressure to return what little capital remains.

This is not the first time BHP have dropped significant capital on ill-conceived resource projects, an aspect that shareholders should readily consider before popping the champagne corks.

Caltex Australia

The company has done incredibly well over the years to reduce its exposure to the low performing oil refinery business.

While selling fuel has been the backbone of the company, the move into retail, via the Caltex outlets has been a winning formula. Management are now undertaking further analysis to understand the potential of expanding their presence in this space.

In the meantime, the decision to take back control from franchisee operators as well as analysing the effect electric vehicles may have on the business long-term, continues to demand management's attention.

This led to a change in strategy regarding dividends, with the board announcing in August 2018 the prospect of a lower pay-out ratio. All hell then broke loose, with prominent investors openly questioning the strategy, demanding a higher dividend pay-out and capital returns.

In late October the company changed tack and confirmed the pay-out ratio would be lifted from the intended 40%-60% range to the updated 50%-70% level and would consider returning excess capital through buybacks.

In making the switch CEO Julian Segal and CFO Simon Hepworth commented that the company had been listening to shareholders. We believe that is the problem.

Those pushing for higher a pay-out ratio might conclude that the business is sound with a highly sustainable earnings profile. Alternatively, it could be that they just don't trust management to invest their capital wisely.

In this instance it is clearly the latter, which begs the obvious question, why do these shareholders stay? Whatever your view on Caltex, it makes little sense why investors would remain in a business when there is a clear lack of trust on how the business is being managed.

Management's change of tack is not a good sign and is reflective of the pressures powerful voices can have on a company's direction.

Where we choose to go

For our part, we want to invest all our time and energy on businesses where the management of the company and the interest of shareholders are aligned.

We have no problem accepting less today for a greater reward down the track. And we openly encourage and support teams that acknowledge the importance of undertaking investments ahead of the curve and who are prepared to push back when circumstances dictate.

Investing is difficult enough without adding more layers of complexity. Learning where not to go is a lesson worth heeding and one we have looked to consistently apply in our investment decision making process. ***SFM***

CORPORATE SPIN

Coca Cola Amatil's investor briefing held in late November provided little comfort for investors looking for earnings clarity. We didn't attend the event, nor have we ever been an investor in the company, but a couple of points are worth noting.

Shareholders deserve a few basic truths from company management teams. One is financial transparency, the second is honest and frank discussion about the business, free of spin.

Having scrutinised the media release accompanying the financial results, it is little wonder the share price sank like a stone. Delivering sombre news to the market is never easy and we have sympathy for those making tough decisions, but the use of spin is a blight on Coca Cola Amatil.

In our March 2017 Quarterly Newsletter, we highlighted the difficulty the business was facing. A change in consumer trends and increased competition had crimped demand. This has impacted the group's flagship Beverages division, underpinned by its iconic brand Coca-Cola.

Despite this uncertainty, management led by CEO Alison Watkins saw fit to lift dividends and undertake a share buy-back program while sticking with their target of mid-single digit earnings per share growth over the medium term. Views can differ on what constitutes the medium term, but one to three years appears a fair period.

Fast forward to this year's investor briefing day which was accompanied by a 157-page presentation pack. There is no doubting the level of disclosure and preparedness to discuss business specifics.

Throughout the presentation the year 2014 was singled out, the year Watkins joined the company. Four years on and the business is still in transition. Management described the situation as follows, *"In Australian Beverages, we will progress our Accelerated Australian Growth Plan… In Indonesia, we will continue to deliver our Accelerate to Transform strategy."*

Unfortunately, the update provided little in the way of financial progress. Surely, a 157-page report could have allocated one slide outlining financial performance since 2014. Call it a progress report, one that gives shareholders some line of sight. In contrast, the financial focus remained on the company's 80% plus pay-out ratio and the strength of its balance sheet.

Management's summary provided little in terms of hard numbers, relying instead on its message, *"Overall, we remain committed to our Shareholder Value Proposition targeting a return to mid-single digit earnings growth in the medium term."*

The outlook for 2019 is for another transitional year and with no company guidance, analysts were left with no option but to cut future year forecasts. Table 7 below illustrates the summary financials since 2014 along with analyst consensus forecasts out to 2020.

Shareholders have been offered lots of positive words, but it would be preferable if, rather than relying on corporate spin, management stuck more to the facts. While management are sticking to their desire to deliver *"mid-single digit earnings growth in the medium term"* the real numbers suggest this is unlikely.

Running a publicly listed business isn't easy which is why we seek management teams who are prepared to speak honestly and openly.

In singling out Coca Cola we are simply highlighting the difficulty boards and management teams have in telling shareholders the truth when a business is under structural pressure.

You can only keep pushing the same message for so long. The company's languishing share price suggests shareholders agree. ***SFM***

Table 7: Coca Cola Amatil financials[5]

	2014	2015	2016	2017	2018HY	2018(e)	2019(e)	2020(e)
Revenue ($m)	4,953	5,094	5,078	4,933	2,417	4,979	5,083	5,173
EBIT pre-sig items ($m)	652	661	683	679	298	644	670	691
NPAT pre-sig items ($m)	376	393	418	416	179	388	400	413
EPS cents	49.2	51.5	54.7	55.9	24.7	53.7	55.3	57.2
DPS cents	42	43.5	46	47	21	45.3	45.9	47.3
Net Debt ($m)	1,871	1,146	992	1,337	1,453	1,494	1,455	1,404
Issued capital (m)	764	764	764	724	724	724	724	724
Share price ($)	9.32	9.30	10.12	8.51	9.20	8.19		

Source: Coca Cola Amatil company financials

[5] *Financial year ending 31 December*

REGULATORY UNREST

The decision by the Australian Prudential Regulation Authority (APRA) on 7 December to seek disqualification proceedings against financial services group IOOF, directors and executives, for failing to act in the best interest of superannuation members came with little warning.

The industry is undergoing a period of re-regulation, a direct result of the fallout from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. The media coverage surrounding the review process has been extensive, impacting all the major retail industry players, including the big four banks, life insurer AMP and now wealth manager IOOF.

Turning specifically to IOOF, it would appear on our reading that APRA and IOOF have disagreed on four matters that occurred in the treatment of superannuation members dating back to 2015. APRA deems that IOOF contravened the Superannuation Industry Supervision Act 2013 (SIS Act) by failing to act in the best interests of members regarding errors that occurred, referred to as breaches. It should be noted that the breaches are not the primary issue, instead APRA is not satisfied with how the breaches were handled.

IOOF remain confident they acted in accordance with their legal obligations in correcting the breaches.

This appears to sit at the heart of the matter along with APRA's desire to remove what it sees as an inherently conflicted structure that has resulted in IOOF undertaking a dual regulated role, in the capacity as the Responsible Entity (RE) for IOOF managed investment schemes and as the Registrable Superannuation Entity (RSE) for the respective superannuation funds in question.

In essence, APRA is arguing that wearing two hats, for different parties, being shareholders and superannuation members will lead to conflicted outcomes.

APRA's concerns have merit, while IOOF has vigorously defended its legal view that the company has acted in the interest of both parties. The total amounts involved in the breaches have not been outlined either by APRA or IOOF, but the media has noted that they are small in nature. Our understanding is that it is less than $2m. It is also clear that any shortcomings suffered by superannuation members since the breach was uncovered have been rectified or *"made whole."* Again, our understanding is that superannuants have subsequently been transferred to lower cost funds with substantially higher reserving. In contrast, across the four major Australian banks, the compensation and compliance bill related to wrongdoing has already topped $1.4b.

So why has APRA acted in such a heavy handled manner?

Deputy Chair of APRA Helen Rowell put the case forward in her public statement that, *"APRA's efforts to resolve its concerns with IOOF have been frustrated by a disappointing level of acceptance and responsiveness to the issues raised by APRA, which is not the behaviour we expect from an APRA-regulated entity."* She added, *"Furthermore, the individuals included in the proceedings have shown a lack of understanding of their personal and trustee obligations under the SIS Act and at law, and a lack of contrition in relation to the breaches of the SIS Act identified by APRA."*

At the company's recent annual general meeting held on 28 November, the Chairman George Venardos, put forward a case that the company was responding positively to the issues raised by the Royal Commission and APRA. In particular, the Chairman noted the concerns surrounding the dual regulated role and outlined that a raft of changes were already in train. Despite these reassuring comments, APRA saw things differently, resulting in their actions on 7 December.

Post these events, the IOOF Board moved swiftly to deal with the fallout. Chairman George Venardos and the company's long-tenured Managing Director Christopher Kelaher stepped aside pending resolution of the proceedings. Their roles have been filled by Acting Chairman Allan Griffiths and Acting CEO Renato Mota. Both individuals have been with IOOF in their capacity as a non-executive director and in wealth management executive roles for 4 years and 15 years respectively.

In their new capacity, both Griffiths and Mota have begun the process of mending the relationship with APRA. The company has laid out the issues at hand and is working to address the matters as set out by APRA in its Managed Action Plan (MAP). Elements of this plan have already been completed, with the company having begun the process back in September.

Further, in addressing one of the key concerns regarding the dual role structure, significant work is required in separating the Registrable Superannuation Entity (RSE) and Responsible Entity (RE) functions of both IOOF and Australian Executor Trustees into distinct legal entities.

The way forward now sits with IOOF and to an extent, APRA. As long-term shareholders in IOOF, stretching back over a decade, it is difficult to comprehend why things got to this stage. While some could accuse us of being biased in our view, it is surprising that of all the financial breaches that have been uncovered in recent years, including the significant fines that the major banks have already incurred, that IOOF should be singled out for disqualification proceedings and court action is difficult to swallow.

And it is a view shared by others with Australian Shareholders Association monitor Ian Curry criticising APRA's role for taking an *"overstated action"* that is *"being delivered to a wider audience. It seems APRA is looking for a soft target rather than taking on the banks, AMP or others."*

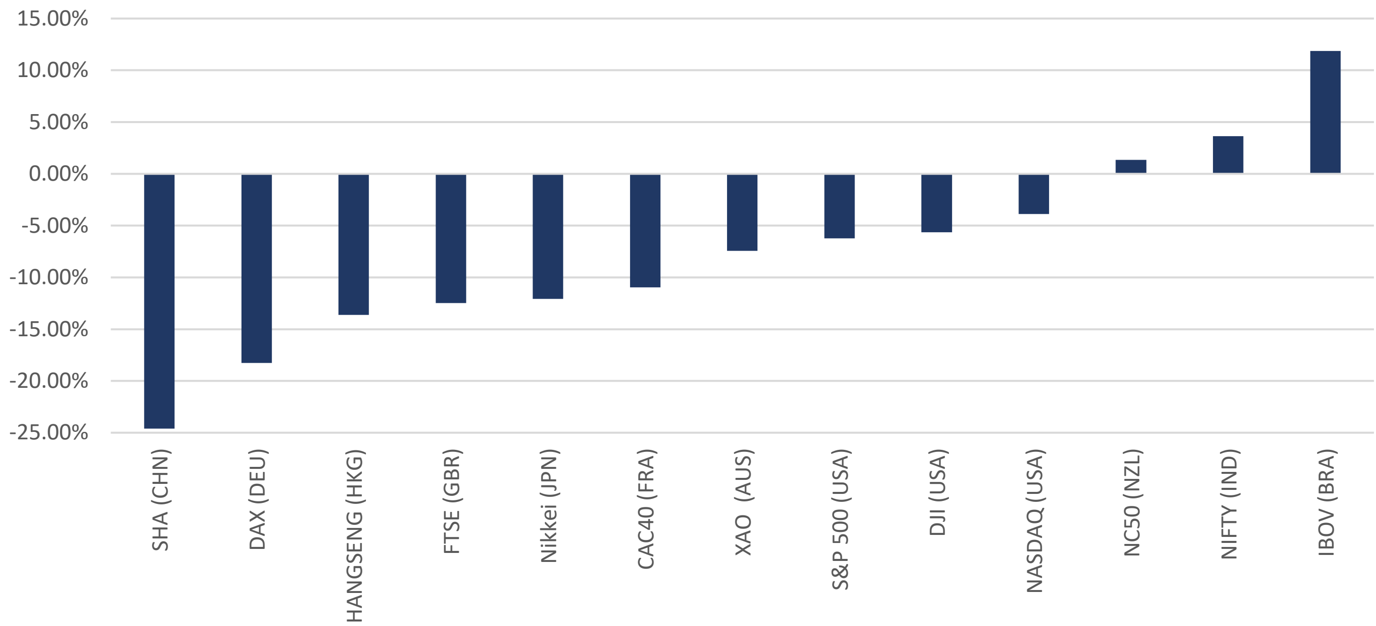
APRA's public stand against IOOF has impacted shareholders, leading to the company's market capitalisation dropping over $900m in the period that followed. Whether APRA took this into account or considered their action necessary is for the court and others to judge. There is no doubt that the findings from the Royal Commission have shone the light not only on the industry players but also on the regulators, who have been criticised for acting slowly on regulatory matters.

It is apparent that APRA, ASIC and the ACCC now feel compelled to act. Hopefully in their zeal to uphold the law they take into consideration the consequences of their actions. ***SFM***

2018 GLOBAL MARKET INDEX PERFORMANCE

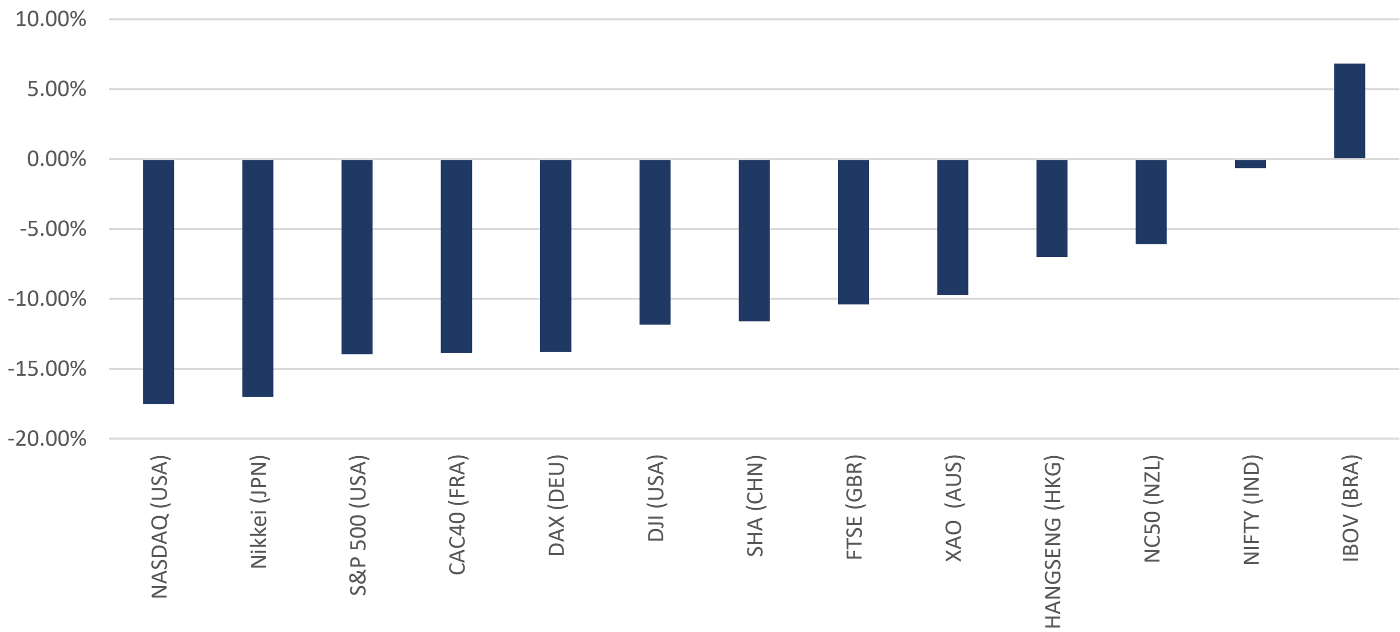
Overall, the global market delivered a negative performance for the 2018 calendar year, driven in large part by the significant losses in the final few months. Figure 7 and Figure 8 below compares the performance for the December 2018 quarter and the 2018 calendar year.

Figure 7: Global Market Index Performance for Calendar Year 2018



Source: IRESS Market Technology

Figure 8: Global Market Index Performance for December 2018 Quarter



Source: IRESS Market Technology

It is interesting to note that in the December quarter, the NASDAQ was the biggest detractor falling 17.54%, which compares with an overall fall of 3.53% for the 2018 calendar year. In contrast, the Chinese Shanghai Composite was one of the worst global performers for the calendar year falling 24.59% but fell in the mid-range of negative performers for the final quarter. ***SFM***

GOOD LEADERS TEACH

On November 15, 2018 Alibaba Group Vice Chairman Joe Tsai received an Honorary Doctorate of Social Science at the Education University of Hong Kong. Below is an excerpt of his acceptance speech, delivered on behalf of the Honorary Doctorate recipients to the congregation.

"Nineteen years ago, I walked into a modest second-floor apartment in Hangzhou, China, and that visit changed my life. I met a great teacher by the name of Jack Ma. I not only met him, but also his disciples – who were his students from university who followed him to start Alibaba. And later these students became great teachers in their own right.

Alibaba is a story of teachers. It is a story of teachers who became leaders. It is a story of leaders who begot more leaders.

You must be curious about how this happened, so here it is.

We went from humble beginnings in 1999 to being one of the largest technology companies in the world today. As our business became more complex, as we scale our operations from hundreds to thousands to tens of thousands of people, we began to realize that we couldn't just add more people to handle all of that growth. We must train them.

So, who was going to do that? All of that training and mentoring. The tendency was to delegate this work to our human resources department. But then we realized that people development was the job of the business leader, not the HR person. That was when we started to appreciate that the qualities of a teacher are common to sound leadership in business. That is, we began to realize that good teachers make great business leaders.

You say, "oh yes I get it, big bosses always evaluate their people, ranking them from best to worst, and as a teacher this is what I do to my students as well." Well, leadership is a lot more than grading and ranking your people.

Photo 16: Joe Tsai thank you speech after receiving honorary degree

Source: Alibaba

Three things about teachers stand out to me.

First, good teachers are good communicators. Through communication they connect with students, not only enrich their minds but also touch their hearts. As a business leader, if you want to lead a company, you have to clearly communicate – excuse me, not only communicate, but evangelize – the company's mission, vision and values to your employees. A company without clear direction and a strong moral compass from its leaders will be rudderless, with employees drifting off in different directions and ultimately failing in either execution or upholding ethical standards, or both.

Second, good teachers care about developing their students, and they are willing to spend the time and effort to make their students better. In a business, you are constantly looking to improve the capabilities of your talent base. The leaders who pay attention and invest personal time to develop their people will achieve more because with the support of a better team, you can scale your business to new heights.

Third, good teachers have that innate sense of humility in them. They are eager to see their student become more successful than they are – in Chinese we say "青出于蓝" (qing chu yu lan). The student has moved on to achieve career success, and the teacher is thrilled to see that, because they enjoy the fruits of what they sow. In a business, you want your leaders to have that sense of humility – what I call "胸怀" (xiong huai) – which is best translated into English by Jack Welch, the legendary chairman and CEO of General Electric. In his memoire, which is the bible of business management, Jack Welch said: "Grade A people hire other grade A people; grade B people hire grade C people."

In other words, you want your leaders to be able to hire people who are smarter and better than they are. Organizations improve only when you have leaders who possess the self-awareness and humility to identify and give young, smart people the opportunities to shine. Develop young people and then step aside. True leadership is about never taking credit for the success of your team. By the same token, when great teachers are asked to explain the secrets of their success in developing great students, they will say all they did was unlock the potential in their students.

We live in a very complex and challenging world. It is a world full of frustration and discontent. The trade war may last for a long time. As you walk out the gates of this institution, you will be faced with unprecedented challenges. But there are reasons to be optimistic. I am optimistic about your future because you possess the talent to lift up others, especially our younger generation which is so important to the future of our society.

I'd like you to remember, no matter what profession you end up in, your talents as a teacher – that is, your good communication skills, your eagerness to develop people, and your humility to let your students exceed you – will always be in great demand. So, my final word of advice is: don't forget to teach, whether it is to your students or your employees or your children. Always seize that teaching moment to make others better. By making others better you will make yourself better!"

Leadership

As Tsai emphases, leaders must lead, and they must teach. While not wishing to draw too long a bow, we aim to identify management teams and company cultures that allow the best to flourish. Successful businesses are invariably powered by the silent majority, the staff, who are entrusted to do the right thing. Importantly, they also represent the face of many organisations and as such they require a clear sense of direction and ethical standards from those chosen to lead. Our earlier article on Blackmores is illustrative of this direction, one wholly endorsed by the group's largest shareholder Marcus Blackmore. ***SFM***

TWELVE SHORT STORIES DEFINE OUR CULTURE

We are often asked, by new clients, what differentiates our firm? It is not an easy question to answer, because the answer is intertwined in 12 short stories that summarise our history. In today's time poor world few people have the inclination to read 12 stories, however, short. We do, however, believe we are different. So, to establish this point, we often emphasis one key aspect to our approach.

- We have owned and run our own businesses for decades. As a result, we think and act like long-term business owners.

Our 12 short stories unfold in four stages typical of many businesses,

- Start out small with some element of experience and passion.
- Struggle for a long time and grow sensibly for the right reason without reliance on debt.
- Associate with good people and try to maintain these relationships over the long term.
- Continuously invest to improve the business.

Since inception, 15 years ago, we have grown from two people to a team of nine. Culture was important initially, but it was a given, rather than something that was carefully laid out and followed, let alone communicated.

Back then our culture was based on our combined past experiences. From the start we were determined to be both open minded and prepared to explore new avenues, with a simple caveat to avoid doing things we were not comfortable with or didn't understand.

Today, there is a need to articulate and communicate the culture of the firm because our team is made up of different generations, who come from diverse backgrounds, with a variety of skill sets, views and personal experiences.

This piece was not originally intended for the newsletter, it was conceived as an internal discussion paper for our team. It is a collection of the 12 stories that we draw from when we articulate the history of the firm for potential institutional investors and external investment consultants carrying out due diligence or cultural analysis.

Over the last 15 years these anecdotes have been shared with many outsiders. Today, as a collection of short stories they have two new purposes.

Firstly, we thought it was important to share these stories with our insiders – our newer staff members, so we can both teach and refine the cultural elements that remain important to us while also building a better firm for the future.

Secondly, in days gone by our new investors invariably visited us. Today, with an established long-term track record, this is no longer the case. So, we thought it would also be informative to share our stories with the new clients that have not had the chance to meet with us.

Finally, for the clients who have been with us for years, we hope this adds another piece to the puzzle of understanding how we go about investing your capital for the long term.

Like our internal research pieces, our 12 stories are recorded in point form. Like a good old slide show, some dot points may be more relevant to the writer and hopefully, some points may resonate for you, the reader. The initial aim was to promote discussion, debate (even arguments) and to create some of the lighter moments that feed our firm's internal jokes.

Perpetual story

- 1983 – 88, Tony Scenna (TS) rose from ranks of Analyst to Portfolio Manager (PM) of the Perpetual Industrial Share Fund and Common Fund.
- A simple process was employed,
  - Reading annual reports and making sense of the published numbers,
  - This was aided by tools including butcher paper and lead pencils,
  - The HP 12c (circa 1981) remains a key tool for TS today,
  - Reece Limited was added to the portfolio in the mid 80's and remains in Perpetual funds today.
- Perpetual performed very well post the crash of 1987 creating the platform for the future.
- TS left Perpetual in 1988 with fellow PM Chris Bernays (to found Harper Bernays – HB) after Perpetual added procedural layers to the investment process.

- To put this into historical context, this was prior to a host of high-profile managers that followed at Perpetual, including Anton Tagliaferro, Peter Morgan, John Sevior and Matt Williams, all later becoming household names within the funds management industry.

The story behind PM's coming together

- TS and Corey Vincent (CHV) met in the early nineties and formed a working relationship, Fund Manager – Broker.
- Our separate businesses were located on the same floor in Spring Street Sydney for nearly 10 years.
- In that time, we jointly attended hundreds of company meetings, many we would today consider un-investable.
- After setting out alone in 2001 to emulate what he had seen at HB, CHV was joined by TS in 2003 and SFM was founded from scratch,
  - The 14% compound annual growth achieved over the 14 years by HB's long-term investors while TS was PM was a long-term goal,
  - This performance contrasted markedly with those of transactional broking models.

The story behind our name

- The name Selector reflected two ideals,

1. *Selecting clients*
   - With long-term investment horizons and realistic expectations,
   - Who understand the inherent risk of equity investment, where markets can halve at points in time.

2. *Selecting the right stocks*
   - Based on in-house research,
   - Holding high conviction concentrated positions,
   - Benefiting from real EPS growth over the long term.

- Three years after inception, with excellent performance, we entered the Global Financial Crisis
- Eight years after inception, two aligned equity partners joined SFM to augment the management team and grow the business for the right reasons,
  - John Maragiannis (JM) 25 years of institutional distribution experience.
  - George Giovas (GG) 25 years of Banking and Finance management experience.
- 10 years after inception IOOF acquired 15% of SFM through its boutique funds program.
- 15 years after establishment our compound annual return since inception is >12%.

The story of our staff

- We seek to employ candidates we know or are well known to our trusted associates.
- Staff are encouraged to invest in our funds over the long-term.
- Staff are encouraged to study, and approved education is funded by SFM.
- Senior staff receive base salary and bonus attached to performance achieved for clients.
- Staff are our biggest single investment (cost).
- Our staff solve our problems by building technology applications in house. We are proud of this.
- Our greatest success has come from long-term relationships with staff.
- We offer a real pathway to portfolio management for the right team members. This is a work in progress.
- A business needs to grow sensibly to retain talented staff.

A story of common sense investing

- Our investment style is based on our own experiences as business owners,
  1. People are the most important ingredient, so we focus on board, management and culture.
  2. A business requires leadership qualities to grow over the long-term.
  3. We wouldn't have debt in our business and we prefer that to be the case in our investments.
  4. Capital management is important, cash flow, earnings, business re-investment and dividends.
- We start with a premise that many listed businesses are not investment grade, based on the four points listed above, so we don't want to own them.
- Many of these (un-investable) businesses make up an index for which we have no interest. As a result, we are index agnostic.
- We do all our own research, so we understand what's happening when things go wrong. This is often our best opportunity.
- When things go right we want to be rewarded. We run a concentrated portfolio, so our winners make a big difference to client returns.

- This is a simple home truth – We can't time markets, so we don't try. We invest for real earnings growth which comes with time. Hence, we are long-term investors with very low turnover, which is tax effective.
- Our process is consistent and repeatable because we only do things we believe in and eliminate the rest.
- Our phones ring rarely and this helps eliminate most market noise.

The risk out story

- We try to take as much risk off the table before we invest.
- We can often watch a business for many years before we invest,
  1. The greatest risk is in the people.
  2. A business with unique industry leadership attributes is likely to be sustainable over the long-term.
  3. The balance sheet is our *"get out of jail card".* When things go wrong debt drives dilution.
  4. If we get the top three right, real earnings growth will enable re-investment and dividend growth.
- The last thing we assess is the business valuation. We use an all-in valuation (Buyout) of debt and equity as you would if you bought the whole business to own forever. We compare this to a risk-free rate, because with equity you take on risk that needs to be compensated for.
- We combine the Buyout with an 18-point Roadmap, made up of qualitative and quantitative attributes that experience has taught us are critical for long term business viability.
- The Buyout and Roadmap drives our entry and exit from investments.

Painting the Harbour Bridge Story

- Businesses are modelled in-house.
- No information dump is used.
- The source of our data is annual reports and 4E and 4D statements, like Perpetual back in 1983.
- This process starts with the commencement of reporting season.
- All company models in our universe are completed.
- When reporting season commences the process starts again. Just like painting the Harbour Bridge.

The boat story

- Investing is like getting into a little public boat with a bunch of misfits,
  - You do your homework then set off in uncharted waters confident in your own understanding and skill set.
  - What you can't prepare for are the actions of others in the public boat (your fellow shareholders).
  - Some know more, and many know far less.
  - Passengers will rock the boat, jump out at inopportune times and sometimes just panic for no real reason.
  - Rocks are thrown at you boat by outsiders (fake news, shorts, analyst views).
  - These actions impact your journey in the short term.
- It's often a very long journey at sea for you and your investment conviction, so we seek,
  - A good crew (capable management),
  - A good boat, (business with leadership qualities),
  - Sound fuel, (clean balance sheet),
  - Sensible navigation, (capital management).
- Our aim as always is a safe passage (real EPS growth).

The newsletter stories

- We have been writing the newsletter for 16 years.
- When we started we had low funds under management, very few clients and lots of time.
- We threw ourselves at our newsletter because it gave us purpose and was the mouthpiece of our convictions.
- Today, it's a reflection of who we are and our thoughts. It's not widely read but remains very important to us.

Worst investment story – the overvalued business vs the dud

The dud

- Imagine going to listen to a new investment listing roadshow and learning that the prospective investment target, a regulated educator no less, had just overseen the death of a student, and then continuing along the path to investing. We did that.
- The story got worse, modest debt was used to make acquisitions and this ended up killing the business.
- It cost us 200 basis points of performance and was a painful lesson we remember well.

The over-valued business

- We sold a high multiple business that had performed extremely well for the fund.
- We failed to understand the true pricing power of depth and premium offers.
- The upside left on the table in the ensuing years was well over 1000 basis points.

Running a business story

- TS has 29 years' experience running his own business. TS was a founder at HB and SFM.
- CHV has 24 years' experience running his own business. CHV was a founder of broking businesses and SFM.
- Four key learnings from being business owners drive our investing,
  - The importance of good people is paramount, and culture is king.
  - A business needs some unique attributes to be sustainable over the long-term.
  - A business with net cash rather than debt on the balance sheet has options and is more valuable.
  - Organic growth and free cashflow enables a business to invest and grow over the long-term.

The culture of our business today

- We remain a founder owned and led business.
- We invest in the funds alongside clients.
- Culture is at the forefront of how we invest, and we attempt to apply our collective learnings of *"best practise"* in our own business.
- We try to keep it simple and repeatable.
- Internally, on a cultural front, we are working towards three simple goals,
  1. Ethical conduct,
  2. Business excellence,
  3. Outperformance for clients and staff. ***SFM***

COMPANY VISIT DIARY – DECEMBER 2018 QUARTER

Date	Company	Description
3/10/2018	ALU	Altium US Management Meeting
8/10/2018	OSH	Oil Search Alaska Investor Tour
9/10/2018	OSH	Oil Search Alaska Investor Tour
10/10/2018	OSH	Oil Search Alaska Investor Tour
11/10/2018	OSH	Oil Search Alaska Investor Tour
15/10/2018	IFM	Infomedia Conference Call with Bart Vogel (Chairman)
15/10/2018	NVT	Navitas Conference Call re takeover proposal
16/10/2018	COH	Cochlear Annual General Meeting
16/10/2018	MP1	Megaport UBS Management Meeting
16/10/2018	MYO	MYOB Group Conference Call re takeover proposal
16/10/2018	NVT	Navitas Conference Call with Chairman
16/10/2018	NVT	Navitas Conference Call with Rod Jones
17/10/2018	IPD	Impedimed Annual General Meeting
18/10/2018	IPD	Impedimed SFML Management Meeting
19/10/2018	DMP	Domino Pizza Enterprise Investor Day - Brisbane
22/10/2018	SGM	Sims Metal Management SFML Management Meeting
23/10/2018	SnapOn	SnapOn UBS Conference Call
23/10/2018	PEXA	PEXA Macquarie Briefing
23/10/2018	PEXA	PEXA Macquarie Q&A Briefing
24/10/2018	FPH	Fisher & Paykel Healthcare SFML Management Meeting
24/10/2018	FDV	Frontier Digital Ventures SFML Management Meeting
24/10/2018	NEA	Nearmap SFML Management Meeting
25/10/2018	BKL	Blackmores Q1FY19 Results Conference Call
25/10/2018	BKL	Blackmores Annual General Meeting
25/10/2018	REH	Reece Annual General Meeting
26/10/2018	RMD	ResMed Q1FY19 Results Conference Call
26/10/2018	IFM	Infomedia Annual General Meeting
26/10/2018	CAR	Carsales.com Annual General Meeting
29/10/2018	SEK	SEEK SFML Management Meeting
25/10/2018	MP1	Megaport GS Tech Conference
25/10/2018	NEA	Nearmap GS Tech Conference
25/10/2018	WEB	Webjet GS Tech Conference
25/10/2018	WTC	Wisetech Global GS Tech Conference
25/10/2018	SLC	Superloop GS Tech Conference
25/10/2018	CAT	Catapult Group GS Tech Conference
29/10/2018	BAP	Bapcor Annual General Meeting
29/10/2018	DMP	Domino Pizza Enterprise SFML Management Meeting
31/10/2018	NHF	NIB Holdings Annual General Meeting
31/10/2018	NAN	Nanosonics SFML Meeting

Date	Company	Description
5/11/2018	BKL	Blackmores Blackmores Asia Investor Tour
6/11/2018	BKL	Blackmores Blackmores Asia Investor Tour
7/11/2018	BKL	Blackmores Blackmores Asia Investor Tour
7/11/2018	ALU	Altium MS Management Meeting
7/11/2018	CPU	Computershare SFML Conference Call with Chairman
8/11/2018	JHX	James Hardie Industries Q2FY19 Results Briefing
8/11/2018	PNV	Polynovo Macquarie Life Sciences Corporate Day
8/11/2018	PXS	Pharmaxis Macquarie Life Sciences Corporate Day
8/11/2018	IMM	Immutep Macquarie Life Sciences Corporate Day
8/11/2018	NAN	Nanosonics Macquarie Life Sciences Corporate Day
8/11/2018	TLX	Telix Pharmaceuticals Macquarie Life Sciences Corporate Day
8/11/2018	SPL	Starpharma Holdings Macquarie Life Sciences Corporate Day
8/11/2018	JHX	James Hardie Industries Macquarie Management Meeting
8/11/2018	SGM	Sims Metal Management JP Morgan Management Meeting
8/11/2018	JHX	James Hardie Industries Management Meeting
9/11/2018	RHP	Rhipe DB Management Meeting
9/11/2018	NAN	Nanosonics Annual General Meeting
12/11/2018	WTC	Wisetech Global UBS Australasia Conference
12/11/2018	MP1	Megaport UBS Australasia Conference
12/11/2018	NAN	Nanosonics UBS Australasia Conference
12/11/2018	NHF	NIB Holdings UBS Australasia Conference
12/11/2018	NXT	Nextdc UBS Australasia Conference
12/11/2018	BRG	Breville UBS Australasia Conference
13/11/2018	TNE	Technology One UBS Australasia Conference
13/11/2018	BRG	Breville Annual General Meeting
13/11/2018	NVT	Navitas Conference Call re rejection of proposal
13/11/2018	JIN	Jumbo Interactive MS Management Meeting
14/11/2018	JHX	James Hardie Industries SFML Management Meeting
15/11/2018	NEA	Nearmap Annual General Meeting
16/11/2018	RWC	Reliance Worldwide Morgans Industry Call
16/11/2018	ALU	Altium Investor Technology Day
16/11/2018	NEA	Nearmap MS Post AGM Management Briefing
16/11/2018	ALU	Altium Annual General Meeting
19/11/2018	OSH	Oil Search PNG Investor Tour
19/11/2018	COH	Cochlear SFML Conference Call with IR
19/11/2018	OFX	OFX Group SFML Management Meeting
20/11/2018	OSH	Oil Search PNG Investor Tour
20/11/2018	OFX	OFX Group HY19 Results Conference Call
20/11/2018	TNE	Technology One FY18 Results Conference Briefing
20/11/2018	OFX	OFX Group SFML Management Meeting
20/11/2018	OFX	OFX Group Macquarie Management Meeting

Date	Company	Description
21/11/2018	TNE	Technology One SFML Management Meeting
21/11/2018	VRT	Virtus Health Annual General Meeting
21/11/2018	OSH	Oil Search PNG Investor Tour
22/11/2018	OSH	Oil Search PNG Investor Tour
26/11/2018	FPH	Fisher & Paykel Healthcare HY19 Results Conference Call
26/11/2018	IFL	IOOF Holdings SFML Meeting with Chairman
27/11/2018	OFX	OFX Group SFML Meeting with Chairman
28/11/2018	COE	Cooper Energy GS Emerging Energy Conference
28/11/2018	OEL	Otto Energy GS Emerging Energy Conference
28/11/2018	ATS	Australis Oil & Gas GS Emerging Energy Conference
28/11/2018	SXY	Senex Energy GS Emerging Energy Conference
28/11/2018	NVT	Navitas SFML Meeting with Chairman
29/11/2018	ALL	Aristocrat Leisure FY18 Results Conference Call
30/11/2018	NEA	Nearmap SFML Management Meeting
30/11/2018	ALL	Aristocrat Leisure JP Morgan Management Meeting
30/11/2018	FPH	Fisher & Paykel Healthcare SFML Management Meeting
3/12/2018	N/A	InLoop Macquarie Tech Investor Day
3/12/2018	N/A	Lendi Macquarie Tech Investor Day
3/12/2018	N/A	ReadyTech Macquarie Tech Investor Day
3/12/2018	N/A	BizCover Macquarie Tech Investor Day
3/12/2018	N/A	Athena Macquarie Tech Investor Day
3/12/2018	N/A	Healthshare Macquarie Tech Investor Day
3/12/2018	N/A	:86 400 Macquarie Tech Investor Day
4/12/2018	IFL	IOOF Holdings Investor Briefing
5/12/2018	CSL	CSL Annual Research & Development Briefing
5/12/2018	ALL	Aristocrat Leisure SFML Management Meeting
6/12/2018	FLT	Flight Centre Travel Group Corporate Demonstration Meeting
6/12/2018	NVT	Navitas SFML Management Meeting
7/12/2018	SGM	Sims Metal Management SFML Management Meeting
10/12/2018	IFL	IOOF Holdings SFML Conference Call
11/12/2018	SLC	Superloop Morgans Management Meeting
11/12/2018	OFX	OFX Group UBS Management Meeting
13/12/2018	NHF	NIB Holdings SFML Management Meeting
19/12/2018	NAN	Nanosonics SFML Management Meeting