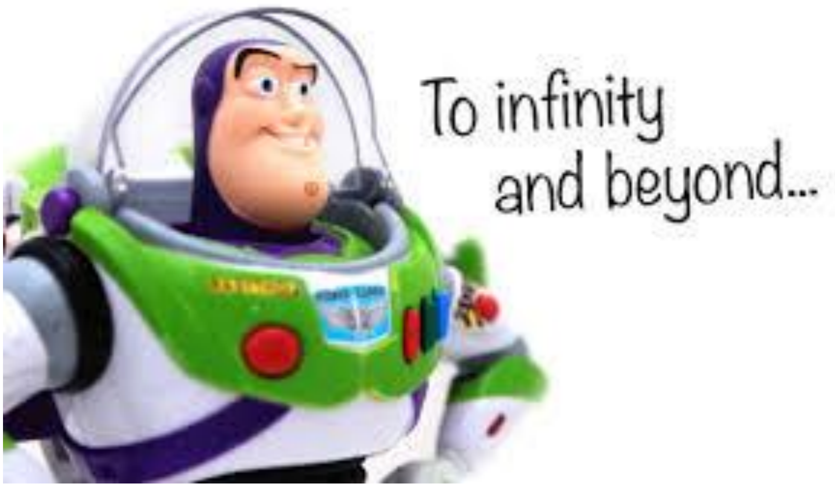
Selector High Conviction Equity Fund Quarterly Newsletter No.67

March 2020



In this quarterly edition, we review performance and attribution. We examine a reporting season whose relevance was lost to market chaos. Our lead article chronicles the performance of a long only, low turnover fund that started in 1935.

We review Central bank policy and we highlight the new rounds of global stimulus in Infinity and Beyond. We also highlight the risk of over relying on supply chains in China. Finally, we share some links to some reading material we have found interesting during the period. Photo. Toy Story's Buzz Light Year coined the phrase "To Infinity and Beyond".

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Selector is a Sydney based fund manager. Our team combines deep experience in financial markets with diversity of background and thought. 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 – MARCH QUARTER

Dear Investor,

As we go to print, the setting for the current global environment is beyond normal comprehension. The extraordinary events that have ushered in 2020 are having a dramatic impact on all social and economic endeavours. For the first time in living memory, the virtual shutdown of cities and countries in response to a health outbreak is unprecedented, leading to an economic fallout impacting all aspects of human activity.

SARS-CoV-2, which causes *"Coronavirus disease 2019"* (COVID-19), originated in China yet the human transmission of this disease has since reached all corners of the globe. Being highly contagious and potentially deadlier than the common flu, health authorities and global leaders have taken draconian steps to limit its advance. The difficulty in preparing for the events that are currently unfolding, is in appreciating business life is not set up to stop midstream.

While containment of the virus is of paramount importance, the decisions enforcing a halt to daily activities carries enormous economic consequences. When businesses stop functioning normally, the ramifications are wide and deep and, in many quarters, not truly known or understood until the damage is done. It is important to appreciate here, there is no historical precedent to draw upon and all authorities, be they government leaders or medical experts, are flying blind at this point.

So, in that context we will resist the urge to compare this period to previous historical market events but suffice to note that extraordinary political decisions are leading to similarly extraordinary daily market moves and extreme share price actions. Many company valuations, having collapsed over the quarter, are being priced for failure.

Certainly, the impacts to daily cash flows, being the lifeblood of any business, is without precedence. However, as uncertain as conditions currently are, we would also venture to suggest that the great bulk of companies will take the necessary steps to deal with whatever hand they are dealt. In many instances this is likely to require emergency capital raisings. No doubt shareholders will be tapped on the shoulder for support.

Although the broader question remains, what role should the government play in all this?

No one expects a handout or a bailout, but the government has in its actions and directives, effectively shut businesses down by restricting daily movements, activities and gatherings. It is as draconian as one can imagine and no matter how hard management teams cut costs, the shortfall to revenues is unprecedented. In short, businesses are looking to the Federal Government for debt funded assistance to address this shortfall. Anything less would be abandoning the industry in their hour of need.

The time for swift action is upon us all, as businesses start to lay off scores of staff. Unemployment is on the rise and increasing numbers of bankruptcies are now likely. This period is not for the faint hearted, a brutal lesson that all investors have had to learn. The level of fear and panic among the general community is very real and, in this setting, share markets act as a pressure release mechanism.

It is important to appreciate there are many elements currently at play and to draw any meaningful long-term conclusions from such dramatic daily moves is unwise. To that end, while the immediate economic outlook remains unclear, company valuations are now offering compelling value.

However, to suggest that we can protect against further downside loss would be foolhardy of us and misleading to our clients. The companies we own are based on our assessment that good long-term returns can be generated. This encompasses not only owning businesses that possess attractive financial metrics, but more importantly the right cultural setting that fosters and encourages business ownership, transparency and accountability throughout the organisation. In this unprecedented and fast-moving environment, we will continue to act as required and always with a long-term perspective.

In this quarterly, we comment on the latest reporting period from a host of businesses held within the Fund. COVID-19 has completely upended the corporate landscape since these results were first posted and few have escaped without financial pain. We continue to monitor the business health of all our portfolio holdings and the broader market for potential new opportunities.

We'll also cover several other topics, including the current economic predicament, monetary policy, supply chain consequences and long-term investing with a twist.

This has been a very difficult period, carrying both health and financial consequences. We do not have the answers to many of the big questions at hand, reproduction rates, mortality rates, underlying business and structural damage and most importantly duration. For these reasons, you will not read any hero calls within this letter nor will we be swayed from our long-term investment philosophy and process. To date our actions have been at the margins and will likely continue that way as we progress through this global crisis.

With that said we wanted to reassure our investors that the Selector team is working to ensure the Fund is well positioned to exit this period in the best possible shape, notwithstanding the current extreme circumstances.

For the March quarter, the Portfolio delivered a gross negative return of **24.33%** compared to the S&P ASX All Ordinaries Accumulation Index, which posted a loss of **23.92%.** For the financial year to date, the Fund has delivered a gross negative return of **16.83%** compared to the Index which has posted a loss of **21.19%.**

We trust you find the report informative.

Regards,

Selector Investment Team

SELECTOR FUNDS MANAGEMENT RESPONSE TO COVID-19

With the rapidly evolving nature of COVID-19 and its relatively unknown impact on our team, our business partners and our communities, the leadership team of Selector Funds Management Limited (SFML) would like to keep our stakeholders informed of the decisions and actions we are taking as a Firm.

Below are the actions we have taken to ensure that SFML is operating at a full capacity, while addressing the impact of COVID-19, and mitigating its risks.

- Our team adopted SFML's work from home protocol on Monday, 16 March 2020. This protocol will remain in place until it is deemed safe for our team to return to our Sydney CBD offices. We will evaluate the situation each week to determine the correct course of action.
- Our Portfolio Managers (PM's) Tony Scenna and Corey Vincent, adopted SFML's work from home protocol for the first time on Thursday, 26 March 2020. SFML is fully functional under this operating environment.
- Selector has in place the proper IT infrastructure and technology platforms to ensure our team remains connected and can collaborate in order to continue to operate at full capacity.
- Selector has cancelled all business and personal travel abroad and domestic. We have also restricted office access and face-to-face meetings. All communication is being conducted via pre-existing conference lines and video conferencing technology.
- The building management company, responsible for our tenancy, has provided us with their tenant communication policy, including updated information, which addresses building procedures and preventative measures in common areas. They have also provided us with specific procedures if a COVID -19 incident is reported.

Our team conducts morning and evening conference calls each business day. We discuss the events of the day, prioritise tasks that need to be completed and assign business items to the appropriate team members. These calls also allow us to communicate about our health, wellbeing and any other issues we are facing.

These measures have been implemented to support the wellbeing of our staff, ensure our continued business operations and to reduce community transmission of COVID-19. Health, safety and business protocols are being reviewed and updated, as needed, on a daily and weekly basis.

Our team is fully available to support our business and to continue to operate efficiently during these continuously changing times.

We appreciate that some of you may have queries about these arrangements. In this regard we encourage you to reach out to me personally to discuss any questions or concerns that you may have.

Kind regards,

Head of Operations & Compliance

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"The thing about the flu, it's an evil that we know and the biggest problem with this new coronavirus epidemic is the fear of the unknown."

Professor Isaiah Arkin
Structural Biochemistry
Hebrew University of Jerusalem

PORTFOLIO OVERVIEW

Table 1: Performance as at 31 March 2020*

	3 Month	6 Month	1 Year	3 Year	5 Year	10 Year	15 year	Since Inception
Fund (net of fees)	(24.48)	(22.96)	(10.87)	9.38	8.14	10.47	8.98	9.56
Fund (gross of fees)	(24.33)	(22.32)	(8.95)	11.45	10.15	12.53	11.02	11.65
All Ords. Acc. Index	(23.92)	(23.36)	(15.02)	(0.68)	1.49	4.80	5.87	6.38
Difference (gross of fees)	(0.41)	1.04	6.07	12.13	8.66	7.73	5.15	5.27

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

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

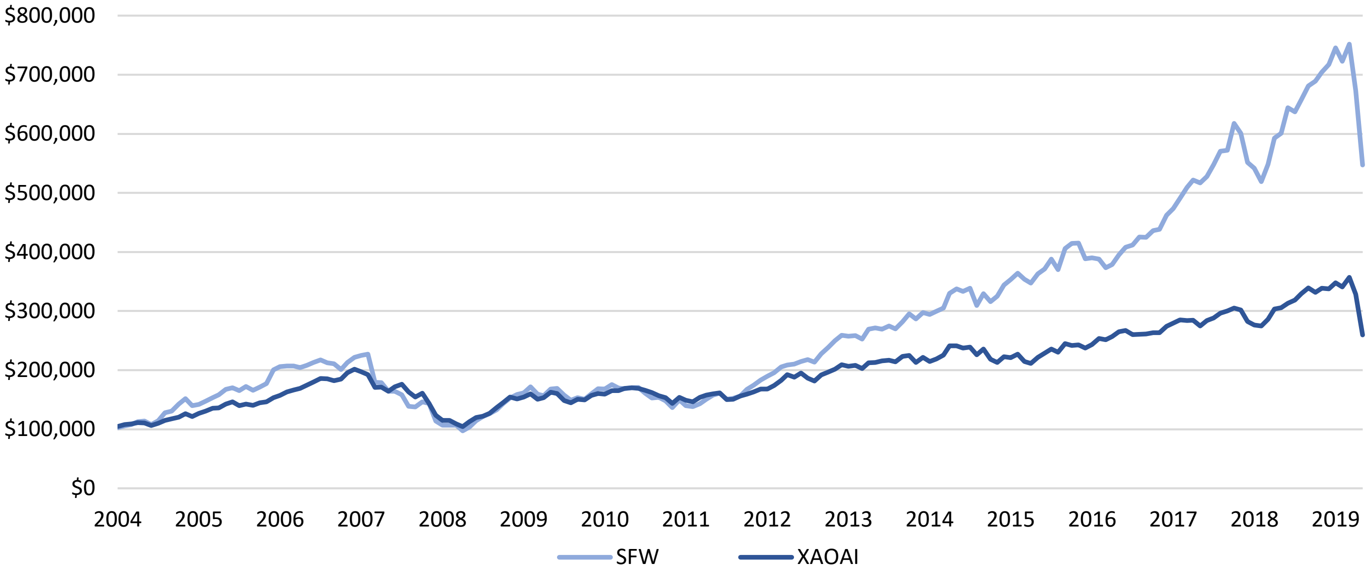


Table 2: Fund's Top 10 Holdings

Top 10 March 2020	%	Top 10 December 2019	%
ResMed	6.28	Aristocrat Leisure	6.33
Iress	5.57	James Hardie Industries	5.22
Altium	5.48	Altium	5.01
Cochlear	5.45	Seek	4.99
Domino's Pizza Enterprises	5.18	ResMed	4.86
CSL	5.08	Cochlear	4.59
Aristocrat Leisure	4.60	Infomedia	4.47
TechnologyOne	4.58	Flight Centre Travel Group	4.44
Nanosonics	4.36	Nanosonics	4.32
James Hardie Industries	4.07	CSL	3.88
Total	**50.65**	**Total**	**48.11**

Table 3: Unit prices as at 31 March 2020

Unit Prices	Entry Price	Mid Price	Exit Price
	$2.3676	$2.3617	$2.3558

Selector employs a high conviction, index unaware, stock selection investment strategy. 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 – March 2020 quarter

S&P ASX Industry Sectors	Quarter Performance (%)
Healthcare	1.50
Consumer Staples	(4.34)
Utilities	(10.31)
Telecommunications	(17.27)
Materials	(23.66)
Information Technology	(24.90)
Industrials	(28.33)
Financials	(28.66)
Consumer Discretionary	(30.13)
A-REITS	(34.82)
Energy	(48.88)

Table 5: Fund's industry weightings

Industry group	March 2020 (%)	December 2019 (%)
Software & Services	25.44	21.52
Health Care Equipment & Services	18.36	16.26
Consumer Services	15.68	20.34
Capital Goods	6.37	6.20
Pharmaceuticals, Biotech & Life Sciences	5.08	3.88
Materials	5.04	7.13
Diversified Financials	4.97	5.93
Media & Entertainment	4.52	2.39
Commercial & Professional Services	3.76	4.99
Household & Personal Products	3.27	2.88
Insurance	3.21	2.84
Cash & Other	2.23	0.77
Automobiles & Components	1.33	1.27
Consumer Durables & Apparel	0.76	0.68
Energy	N/A	2.92

Investment Transactions

Purchases

During the quarter, we increased our holdings in:

- Altium
- ARB Corporation
- Blackmores
- Carsales.com
- Cochlear
- Computershare
- CSL
- Domino’s Pizza Enterprises
- FINEOS Corporation Holdings
- IOOF Holdings
- Iress
- James Hardie Industries
- Jumbo Interactive
- NIB Holdings
- Reece
- Reliance Worldwide Corporation
- TechnologyOne
- The Star Entertainment Group

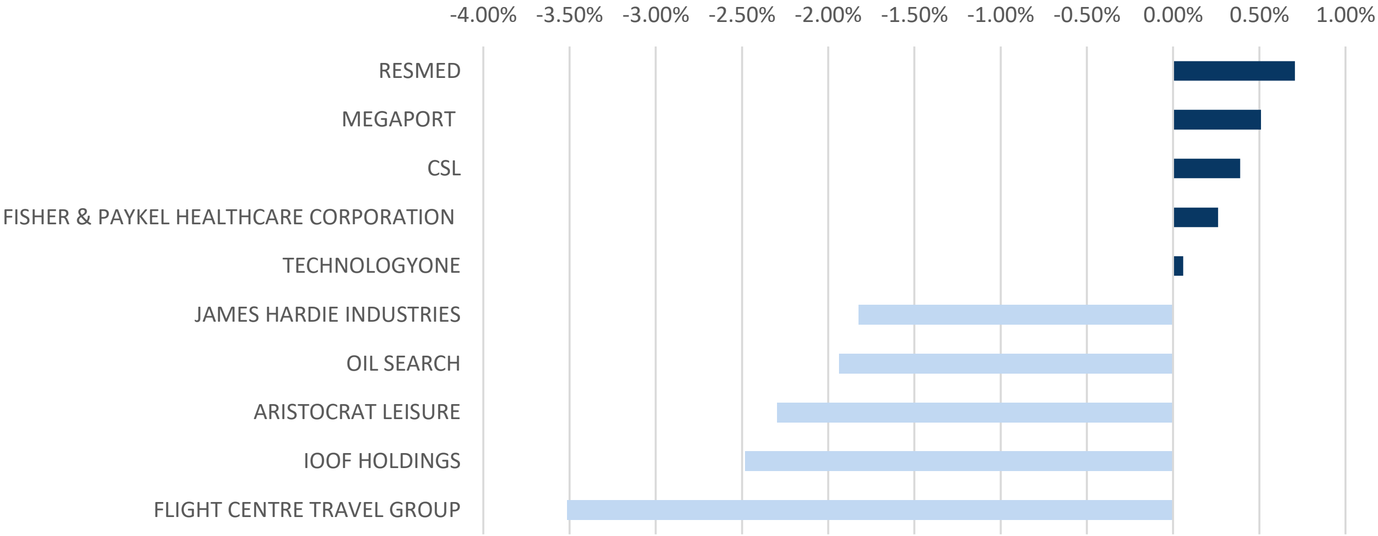
We also initiated positions in **Megaport** and **REA Group**.

Sales

During the quarter, we reduced our holding in **Sims** and exited our positions in **ImpediMed** and **Oil Search.**

PORTFOLIO CONTRIBUTORS

Graph 2: Contributors and Detractors – March 2020 quarter



Top quarterly contributors

1. *ResMed (ASX:RMD)*

Refer to Reporting Season Commentary below.

2. *Megaport (ASX:MP1)*

During the period we initiated a position in Megaport, a global leader in cloud connected networking. Operational in Asia Pacific, the U.S., and Europe, the business is on a clear path to profitability, with a substantial cash buffer in place. The company provides connectivity between its customers and any other network service provider across the *"Megaport Fabric"*. With no lock in contracts, Megaport allows for flexible, dedicated connections to cloud service providers including Amazon, Microsoft, Google, IBM, Salesforce.com and many others.

The company has established a growing physical network of 601 enabled locations servicing 1,777 customers. Once a customer physically connects to Megaport in one of their connected data centres, they can access any cloud services on the Megaport network. This avoids the need for customers to establish their own point-to-point connections with each individual service provider which may be located in different data centres. As many companies rely on services from multiple cloud providers, Megaport enables its customers to establish virtual connections to these providers, in real time, without the need for them to co-exist within the same data centre.

The economics are appealing, with the company charging for each service that the customer connects to, with the cost depending on the required speed and the distance between the point-to-point connection facilitated. Overtime, Megaport has observed customers progressively expanding the quantum of services thereby increasing their lifetime value.

The traditional means of connecting to ports across data centres requires an enterprise to purchase a fixed cost cross-connection, usually facilitated by a telco. These provide limited flexibility in relation to actual use and require customers to sign up for extended contracts. The flexibility provided by Megaport and the small cost of connections in total IT budgets has created a sticky customer base.

Recognising that not all companies have a physical presence in a data centre, the company launched the Megaport Cloud Router (MCR) in 2018. This enables cloud-to-cloud networking and the ability to deploy Virtual Points of Presence without the need to purchase or maintain physical routing equipment. Given the inherent cost savings that can be obtained through avoiding capital expenditure on physical networking equipment and upkeep, MCR has seen a significant uptick of users increasing 102% year-on-year to March 2020.

CEO Vincent English said, *"Megaport's path towards profitability remains in focus and firmly on track as we* *continue to execute our network expansion and operational goals. Continued accelerated growth in the face of unprecedented global market conditions shows the strengths of our platform and partnerships."*

Megaport has a market capitalisation of $1.5b and cash of $108.7m.

3. CSL (ASX:CSL)

Refer to Reporting Season Commentary below.

4. Fisher & Paykel Healthcare Corporation (ASX:FPH)

Leading respiratory care group Fisher & Paykel Healthcare delivered a strong first half result for 2020, as it continues to deliver on its long-term business plan. At its core the company's respiratory heritage, reflected in global leadership in humidification technologies, spans multiple applications that are utilised across hospital settings, which are now extending to the home.

Having recently celebrated its 50th anniversary, the focus remains on meeting the unmet needs of a growing patient cohort, underpinned by a long-term commitment to ongoing product innovation.

For the half year, the business reported total revenues of NZ$571m, up 12%, while net profits lifted 24% to NZ$121m. Part of the reason behind the sharper percentage rise in profits compared to the prior year is the significant costs incurred in patent litigation.

The two business segments include the Hospital product group which accounted for 62% of group revenues or NZ$353m and the Homecare product group with NZ$215m.

Within each business segment management points to different levels of product maturity. In Hospital, the core humidification technology is benefiting from the latest product release, the F&P 950 system. This is being rolled out globally and leading to a spike in hardware replacement sales of the existing F&P 850 system. Within this segment, new applications consumables, as defined by management, continues to enjoy robust growth. For the half, sales rose 25%, underpinned by the company's Optiflow nasal high flow technology. The uptake of this product suite remains in its infancy across the hospital settings of the Intensive Care Unit (ICU,) general wards and emergency departments.

CEO Lewis Gradon noted that across Europe and the U.S., the adoption of Optiflow sits at approximately 70% of all ICU's but with penetration remaining low at only 5%-10% of all patients that could be treated. This reflects a significant unmet need and provides management with confidence that ongoing education and independent studies supporting the use of Optiflow will drive ongoing adoption.

The same technology is now being extended to use in the home, with an increasing number of patients being treated in a setting that is more comfortable and familiar to the patient and significantly less expensive for the hospital. While management are reluctant to spell out the growth trajectory of this demand, the Homecare division which captures this revenue stream, is set to benefit from this increasingly important trend.

Significant capital investment in new facilities both in Mexico and New Zealand are nearing completion, with some NZ$170m of expenditure earmarked for the year. In addition, the company has maintained its research and development investment commitment, which for the half amounted to NZ$54m, along with a full year run rate of circa 9% of revenue expected.

Dividends were lifted 23% to NZ12.0 cents per share, with net debt of NZ$5m, underscoring the group's commitment to a sustainable, conservative business approach.

The outbreak of COVID-19 has created a significant tailwind for Fisher & Paykel with a surge in demand for respiratory humidifiers and homecare products. Managing Director and CEO Lewis Gradon explained, *"Our respiratory humidifiers and consumables are directly involved in treating patients with coronavirus. We have seen an increase in demand globally and have ramped up our manufacturing output. At the same time, we have benefited from stronger sales in our Homecare product group and a weakening of the NZ dollar."*

As such, the company has increased their FY20 guidance with revenues now expected to be NZ$1.24b from NZ$1.2b and net profit after expected to be within the range of NZ$275m to NZ$280m, from NZ$260m to NZ$270m.

Fisher & Paykel has a market capitalisation of $16.7b, along with a net debt position of $119m.

5. TechnologyOne (ASX:TNE)

Leading enterprise software as a service (SaaS) provider TechnologyOne reported its full year 2019 result in November. For the year, the group recorded total revenues of $286m, up 13% and operating profit before tax of $76m, up 50% on a comparable basis. Net profit rose 15% from $51.0m to $58.5m.

TechnologyOne continues to transition its business from an on-premise license model to a subscription-based SaaS offering. The company now has 435 enterprise customers adopting the SaaS platform which has seen the SaaS Annual Recurring Revenue (ARR) increase to $102m up 44% from the prior year. The company continues to target a goal of migrating over 1,000 existing enterprise customers to its SaaS offering by 2022, giving rise to an ARR in 2024 of over $500m. As the SaaS business scales, strong operational efficiencies are being realised with profit before tax margins increasing from 20% to 27%. Over the medium term the company is pointing to profit margins lifting to 35%.

The company continues to invest over 20% of revenues into new product development. One such investment, termed DXP, is currently being piloted with university partners as a student engagement tool. While further work is required, the opportunity for TechnologyOne to provide a front-end digital solution that integrates with the university's existing back-end administration platform is illustrative of the opportunity set available.

The group maintains a conservative approach to capital management with a prudent dividend payout ratio of 65% giving rise to an increasing cash balance.

The company has not provided an update post its FY19 results or in relation to COVID-19.

TechnologyOne has a market capitalisation of $2.6b and a net cash position of $105m.

Bottom quarterly contributors

1. Flight Centre Travel Group (ASX:FLT)

Refer to Reporting Season Commentary below.

2. IOOF Holdings (ASX:IFL)

Refer to Reporting Season Commentary below.

3. Aristocrat Leisure (ASX:ALL)

Due to continued uncertainty as to the duration and extent of the impacts of COVID-19, Aristocrat withdrew its FY20 guidance provided in February. While digital games remain unaffected, at this time, land-based operations and outright sales have been significantly impacted by temporary venue closures.

The company continues to have a conservatively geared balance sheet, especially when compared to global peers, with a net debt to EBITDA ratio of 1.4x (as at September 2019 when the company last reported).

Aristocrat Leisure has a market capitalisation of $14.0b and a net debt position of $2.2b.

4. Oil Search (ASX:OSH)

After reviewing the business operations, the increasing need for capital, and to take advantage of other opportunities including the Cochlear placement, we took the decision to exit this position.

5. James Hardie Industries (ASX:JHX)

Refer to Reporting Season Commentary below.

REPORTING SEASON COMMENTARY

Considering the events that have transpired during the latter part of the quarter we apologise upfront if the following commentary on businesses held within the portfolio appear out of date.

We have endeavoured to maintain transparency in the ownership of companies and their respective financial performances during the first half of 2020.

As we have all witnessed, the economic and operational shutdown of communities and countries has halted demand. Governments have taken the action to freeze business activity, depriving companies of vital cash flow, which is now cascading down the line to suppliers and of course staff.

Supplying credit to the market and offering financial assistance is what governments are geared to do in times of crisis, but ultimately shutting down demand is without precedence.

As we have outlined on numerous occasions, our investment philosophy is predicated on identifying businesses underpinned by four key principles:

1. Competent management teams
2. Business with leadership qualities
3. Strong balance sheets
4. Focus on capital management

Today, for many business leaders, the central issue is one of cash flow survival. Having a balance sheet that is net cash is not what the financial industry or many investors support, the argument being that borrowing costs are so low that it warrants a business having higher gearing.

This might have merit when things are going swimmingly well but we have consistently argued that cash provides a safety net, or what we term *"a get out of jail card"*, when extreme events occur.

Many of our business investments have retained net cash positions over long periods and include the likes of TechnologyOne, Altium, Infomedia, Flight Centre Travel Group, Nanasonics, Jumbo Interactive and OFX Group to name a few. Many more have very moderate levels of debt, highly recurring revenue models and operate with strong financial metrics. This place the majority of these businesses in a good position to weather the destructive force now blowing through the global economy. Enormous damage has been done in this very fluid scenario and unfortunately with governments and medical experts continuing to enforce outcomes, getting any real clarity is limited.

What has resulted are a multitude of companies providing trading updates to the Australian Stock Exchange that are for the most part rather meaningless. Revoking earnings guidance or delaying or omitting the payment of dividends is simply reflective of an environment where the immediate future is unknown.

Our correspondence with management teams over the past month, provides us with a high degree of confidence that the great majority will emerge from this enforced economic slump in a stronger competitive position.

Altium

Online Electronic Printed Circuit board (PCB) designer Altium, delivered a solid first half 2020 result with revenue increasing 19% to $92.8m and net operating profit increasing 22% to $36.8m. All core business segments delivered double-digit revenue growth as the company confidently advances towards its medium-term target of 100,000 subscribers, delivering US$500m in revenue by 2025.

The Boards and Systems segment, consisting of Altium Designer and Altium Nexus, continues to drive significant growth for the company. For the half, this segment delivered revenue of US$74.9m and net operating profit of US$39.2m, an increase of 28% and 27% respectively. New licenses for Altium Designer increased 19%, with a total of 4,205 seats sold in the first half. This brings the total subscription pool to 46,693 subscribers, well in reach of the company's financial year target of 50,000. Whilst the revenue growth in all regions was significant, China outshone, recording a rise of 27% to US$12.5m. Altium Nexus, the company's agile enterprise PCB design tool, delivered an exceptional performance with a revenue increase of 197% to US$7m. The significant improvement was driven by contracts with Bosch (generating over US$1m for the half) and Texas Instruments.

While the company continues to invest in its sales teams, product innovation remains central to its goal of market dominance. This is evident through the recently released Altium Designer 20 (AD20), proclaimed as a *"game changer"* within the PCB user community. Based on its features, AD20 has been described as the best product while retaining the best value available on the market and is already enjoying strong reviews. Management remains confident that adoption will be significant.

The company has been simultaneously developing its new cloud-based offering, Altium 365, which is undergoing the early stages of release. The group is currently onboarding clients onto the Pro version of the software, with over 90 companies already adopting the solution. This product is set to transform how PCBs are designed, providing greater collaboration across organisations and clearer insights from inception at the PCB design level, all the way through to manufacturing outcomes. This reflects the company's vision to deliver an end-to-end solution for the electronics industry, connecting PCB design to the product assembly, with the ultimate goal of transforming and dominating the global PCB industry. Collectively, this is a US$2t industry opportunity.

With both the release of AD20 and Altium 365 Cloud, the level of annual recurring earnings now sits at 58%. This is set to rise further with management pointing to annual churn rates below 10%, driving greater ongoing adoption.

At their annual technology presentation in December 2019, Altium unveiled their growth strategy. The company has made a commitment to achieve the Rule of 50, whereby the annual percentage revenue growth and net operating (EBITDA) margin combined is greater than 50%. CEO Aram Mirkazemi explained that *"consistently outperforming the Rule of 50 is the domain of elite companies"*, with only Altium and Ansys[1] being able to regularly perform at this level. For the period, Altium achieved a Rule of 50 result of 58.7% with an expectation that the full year result will be at a similar level. In light of this target, the company continues to invest prudently in product innovation, their brand and the Dassault Systèmes *"3DExperience".*

Altium has been working in partnership with Dassault for over three years to deliver a native integration of Altium's software onto the Dassault *"3DExperience"* platform. This joint product will see the world's first model-based systems engineering that includes electronics, which is targeted at high-end use customers, such as passenger aircraft manufacturers and automotive industries.

Altium remains steadfast in the view that this important relationship will only sensibly progress once a commercially fair, revenue generating agreement can be reached.

Octopart, the leading electronic parts search engine acquired by Altium in 2015, faced significant headwinds over the period leading to a muted performance with revenue marginally increasing to US$9.0m.

COVID-19

By balancing both operating profits and growth, Altium is targeting aggressive but sustainable expansion. While the company withdrew its full year guidance in early April, it remains confident of achieving its long stated revenue target of US$200m and EBITDA margins of 39% to 41% in 2020.

The dividend was lifted to 20 cents per share, up 25% with management expecting company cash levels of US$100m by year end.

Altium has cash of US$80.7m, no debt and a market capitalisation of $3.7b.

ARB Corporation

Four-wheel drive equipment manufacturer ARB released their results for the first half of 2020, reporting a 7.3% increase in sales and a 7.4% decrease in profit after tax. The pressure on the company's profit was primarily driven by increased manufacturing costs in ARB's Thai factories, as a result of the significant strength in the Thai baht against the Australian dollar.

Aftermarket sales in Australia contributed $144.7m of sales over the period, an increase of 2.8%. This is reflective of challenging market conditions with new motor vehicle sales continuing to decline. Despite the stagnant domestic market, export sales grew significantly, increasing 21.9% to $72.2m.

Sales to original equipment manufacturers (OEMs) declined by 6.1% to $16.6m over the half. As we've previously noted, this type of business does tend to be

[1] *Engineering simulation software company listed on the NASDAQ*

more lumpy than direct sales to consumers. Thus, the decline is unsurprising as the company cycles off the strong growth of 21.5% in the corresponding period last year.

The group recently opened its latest ARB store for the Australian aftermarket distribution, bringing the total to 66, of which 27 are company owned. This is supplemented by a new global warehousing facility in a free-trade zone in Thailand, which will increase the efficiency of the company's global distribution network.

While management is cognisant of the continued economic and currency headwinds expected in the short-term, new product releases and geographic expansion underpins long-term confidence in the group's product offering.

COVID-19

While confirming that trading has been in line with internal expectations, full year earnings guidance has been withdrawn considering increased economic uncertainty.

Importantly, ARB provides essential services to many critical industries around the world including emergency vehicle services, government law and order, and health organisations.

ARB has a market capitalisation of $1.1b and net cash of $36.4m. The company has deferred payment of the interim dividend.

Blackmores

Global complementary medicines business Blackmores, delivered an underwhelming first half result, citing adverse costs and challenges from the coronavirus as reasons for a weaker full year 2020 guidance.

Presenting at their first results call together, CEO Alastair Symington and CFO Gunther Burghardt released the group's half year performance. Here they reported revenues of $303m and underlying net profit after tax (NPAT) of $18m, a decrease of 48% from the $34.3m recorded in the previous comparable period.

Although these results met the half year guidance set at the annual general meeting in October, CEO Alastair Symington emphasised, *"the quality of earnings and underlying NPAT has not met expectations."*

In conjunction with the first half results, management presented a strategic update where the breadth of change proposed across the business is significant. A few notable call outs include a focus to rejuvenate Australia by targeting the Bioceuticals and PAW brands, delivering new growth in South East Asia through innovation and product customisation, and a goal to target the modern career woman in China.

As Blackmores enters this volatile period, it's imperative the new executive team and the refreshed board continue to work together to implement the revised strategic objectives, while rebuilding the balance sheet and earnings potential of the company.

COVID-19

At the first half results, management provided a full year 2020 outlook for NPAT to be within the range of $17m-$21m, indicating group second half profitability will be close to zero. No further guidance has since been provided.

With a differentiated set of immunity products, Bioceutical's Armaforce in particular, the company is expected to benefit from increased demand across the group's health and wellness product offering.

Blackmores has a market capitalisation of $1.3b and a net debt position of $119m. Prudently, the company has chosen not to pay an interim dividend to conserve cash for operations.

Breville

Global kitchen appliance maker Breville, delivered a high quality first half 2020 result. Group revenue increased 25.4%, compared to the previous corresponding period, to $552m while earnings before interest and tax (EBIT) lifted 15.6% to $72m. The strong performance can be attributed to Breville's innovation-led strategy, that has seen the business invest in research and development (R&D) ahead of profits.

CEO Jim Clayton commented, *"in the last 3 years, we have added 21 new products to the portfolio. These products have accounted for over 30% of the revenue from the local Breville branded products over this 3-year period."*

From a geographical perspective, the European market rollout is driven by the group's Sage brand and represents the company's most significant growth opportunity.

Breville's decision to transition from a distributor to direct selling model in Germany, Austria, Benelux, Switzerland and Spain, has been vindicated by the strong segment growth, with first half revenue increasing 63% to $83.7m.

Despite this success, the company's products remain underpenetrated across a range of categories, with CEO Clayton commenting that, *"Both North America and ANZ have a fairly diversified portfolio across beverage, cooking and food prep. Europe, however, given its youth, has had to pick its shot to build our initial brand position, and that has been coffee."*

The opportunity lies in the company's ability to build its brand, broaden its array of products across Europe and expand directly into new countries. We remain confident in this strategy and in management's proven ability to execute across this vast region.

In North America, Breville delivered first half revenue of $258.1m up 20.1%, driven by a series of new product launches. The strong growth is particularly impressive as it was achieved against a backdrop of higher selling prices resulting from the U.S. and China trade war.

COVID-19

The company has chosen to withdraw earnings guidance despite year-to-date sales performance being consistent with expectations.

Breville has a market capitalisation of $2.2b, with modest net debt of $52m, equivalent to a net debt/EBITDA ratio of 0.6 times.

Carsales.com

Leading online automotive listings business Carsales.com, delivered a solid first half 2020 result. Revenue increased 5% and net profits were up 6%, to $214m and $63m respectively. This result is especially commendable considering the challenging market conditions encountered.

Carsales has three primary business segments including the traditional domestic Online Advertising Services, the Data, Research and Services business and International markets. Under the leadership of CEO Cameron McIntyre, management continues to innovate and refine each offering.

The core Online Advertising Services business posted 4% revenue growth and 4% net operating profit growth, to $152.6m and $78.5m respectively. This result was buoyed by the Dealer and Private business division, posting sales up 6% to $79.4m along with profits up 7% to $44.3m.

This is reflective of the breadth of the product offering and resilience of the used car market. The Display division, however, faced continued headwinds over the period reporting revenues down 5% to $28.8m, impacted by the challenging advertising market due to a subdued new car market.

The Data, Research and Services result was flat, with revenues of $21.8m as the business transitioned out of low margin contracts, offset by resilience in the RedBook data business. This shift in the margin mix has improved the net operating profit by 3% to $13.4m.

International operations include the wholly owned SK Encar (South Korea), Demotores (Argentina and Chile), Carsales Mexico (Mexico) and Chileautos (Chile), along with part owned WebMotors (Brazil, 30%) and iCar Asia (Indonesia, Malaysia and Thailand, 11.8%).

Importantly, on a *"look-through"* basis, the International segment contributed revenues of $51.9m and operating profits of $20.4m. While the majority of these operations are market leaders, online adoption remains in its infancy, providing a long runway for growth.

Carsales' ability to succeed is also heavily dependent on the group's capacity to modify its offering to satisfy local conditions. At present, the wholly owned SK Encar Korean operations is the main driver of performance, contributing revenue of $33.1m and net operating profit of $16.3m, an increase of 13% and 16% respectively.

A key revenue growth driver for this business has been the uptake of the Guarantee vehicle inspection service. Unique to South Korea, this service provides peace of mind for consumers when purchasing a car from a dealership.

The company continues to focus on developing value add services to help improve the potential revenue extracted from the sale of each car. The purchasing model in South Korea, with customers unlikely to test drive a car before purchase and with the option of home delivery, has meant the business has remained resilient to date.

COVID-19

Since releasing the half-yearly result, the company has confirmed the escalating impact of COVID-19 in Australia has made it impossible to accurately predict activity on the Carsales platform for the foreseeable future.

CEO Cameron McIntyre commented, *"As a business, we had good momentum prior to the impact of COVID-19 and we are confident in the underlying performance and resilience of our business model. We have a strong balance sheet and prudent gearing, which positions us well to deal with this challenging environment."* Given the increased uncertainty, the company withdrew their previously advised guidance for the full year.

Carsales has a market capitalisation of $3b and carries net debt of $398.2m.

Cochlear

Leading global hearing implant specialist Cochlear delivered a solid first half 2020 result, underpinned by implant unit growth up 13% to 18,894. The rise was supported by the group's newest Nucleus Profile Plus Series, with developed markets recording unit growth of 7% and developing countries up over 20%.

These varying growth rates reflect the difficulty in assessing the business on a short-term basis, with reimbursement and specific country issues surrounding product awareness, playing a key role in greater implant adoption.

That said, the North American region, which is the largest global market opportunity, grew strongly with implant units rising over 10%, as the group recaptured market share lost in the preceding period. Sales for the region rose 9% to $382m, representing 49% of group sales.

In Western Europe unit growth of 5% was recorded, while revenues rose a 6% to $252m, representing 34% of total group sales.

Asia Pacific was a standout, however, delivering 18% revenue growth to $133m, assisted by strong growth in the key markets of China, Japan and Korea.

COVID-19

Following the half year results, Cochlear has encountered two significant headwinds with a global slowdown in elective surgeries due to COVID-19 and an adverse court appeal decision in the long running U.S. patent infringement case.

Most notably, the company announced its appeal against a U.S. District Court's decision, to award US$268m in patent infringement damages to the Alfred E. Mann Foundation for Scientific Research and Advanced Bionics had been lost. The company will seek a review for a rehearing and are also disputing the counterparty's application for prejudgement interest costs of US$123m and attorney fees of US$15m.

Management had initially expected COVID-19 to only impact full year sales in China, with implant surgeries on hold. With the continuing spread of the virus, Cochlear have withdrawn their full year guidance, citing a material deferral of elective surgeries.

With the duration and severity of COVID-19 an unknown, forecasting a recovery is difficult, if not impossible. In response, the Cochlear board elected to initiate a capital raising of up to $880m to shore up the balance sheet.

We are fully supportive of management's actions and have participated in the raising.

Cochlear has a market capitalisation of $12b and will be net cash to the tune of $700m, prior to any patent settlement taking place. At the interim results an interim dividend of $1.60 was declared although any future dividend decision will be suspended until further notice.

Computershare

Global registry service provider Computershare announced its first half 2020 result delivering revenue of US$1.14b, up 1.2% over the prior corresponding period, and net operating profit of US$338.7m, up 2.2%. Management earnings per share (EPS) fell 16.7% to US29.1c, with the company facing significant headwinds from weaker margin income, subdued corporate actions activity and a higher than expected effective tax rate. As this was largely outside management's control, the company confirmed their confidence in the operating performance of the underlying business.

The group's largest operation, the Issuer Services division delivered revenue of US$431m over the period, a decrease of 8.8%, while net operating profit declined 19.2% to US$130m.

Post the acquisition of Equatex, the Employee Share Plans division continues to perform strongly. For the half it delivered revenue of US$144.1m, an increase of 23.5% and net operating profit of US$27.5m, up 24.4%. This result was buoyed by positive equity markets driving higher transactional activity and was achieved despite reduced average holdings for U.K. *'save as you earn'* plans, which saw margin income revenue decline 7% to US$6.5m.

In relation to Mortgage Services, the group experienced strong growth in the U.S. market with revenue of US$227.3m, an increase of 42.6%. This was dampened by the performance in the U.K., as the business experienced a delayed migration of their secondary platform. Post migration, expected for completion in May, expenses are set to fall US$35m. In total, Mortgage Services delivered revenues of US$332.7m and a net operating profit of US$75.5m, an increase of 15.8% and 27.5% respectively.

Computershare continues to extend its ancillary service offering with the acquisition of Corporate Creations, a business providing Registered Agent and related filing services with a national network across the U.S. Here, companies are required to register their entities in every state where they operate. Each of these entities requires a Registered Agent, a third-party appointed to be a company's official representative to receive lawsuits, subpoenas and Government documents. Management continues to look for opportunities, such as this, to extend their product offering and enhance the value offered to customers, as well as their ability to cross-sell.

COVID-19

With the flow-on impacts from COVID-19, global interest rates yields have collapsed as governments attempt to stimulate economic activity. As a significant proportion of Computershare's earnings relate to margin income on cash balances held, the reductions to interest rates have had a substantial impact.

As a result, Computershare has downgraded full year 2020 guidance for margin income to be US$180m, compared to US$245m in 2019. Term deposits currently held are helping protect the company from the full impact of the recent interest rate changes. As these roll off however, further margin income erosion is expected with 2021 margin income estimated to be around $100m.

Management remains focused on improving the underlying, recurring revenue of the business noting that in time, this could constitute up to 85% from current levels of 75%. This should improve the predictability of earnings with a lower reliance on event-based revenue.

Computershare has a market capitalisation of $5.3b and net debt of US$1.3b.

CSL

Leading global biotechnology company CSL, presented another record set of financial results. Both first half revenue and net profit after tax increased 11% to US$4.9b and US$1.25b respectively. The CSL Behring division, which houses the key therapy products of Immunoglobulins, Albumin, Haemophilia and Specialty, grew collective sales by 10% to US$3.8b, while generating operating profits of US$1.3b.

CSL continues to benefit from the global supply shortage of immunoglobulin (IG) therapies for treating individuals with immunodeficiency disorders. For the first half, IG sales grew by 26% to US$1,985. This was primarily driven by increased IG production from investments made in previous periods on donor collection sites, fractionation centres and research and development (R&D). The company is now the global leader in supplying IG therapies through consistent investment and product innovation.

In contrast, CSL's albumin sales declined 33% to US$279m, as the company transitioned its distribution model in China. For the half, CSL recorded a US$170m impact from reduced sales into China, partially offset by a greater allocation of albumin into Europe, Emerging markets and the U.S. Underlying sales, excluding this one-off effect, grew in the high single digits, highlighting the positive contribution albumin can still make going forward. Management expects an annualised impact of US$340-US$370m in 2020, while fiscal year 2021 sales are set to slowly normalise, as China resumes from the COVID-19 shutdown.

CSL's flu vaccine division Seqirus, delivered a solid performance with total revenue up 9% to US$1,018m. This is consistent with earlier guidance, as the company transitions to higher valued quadrivalent influenza vaccines, with trivalent vaccines now representing only 8.6% of seasonal vaccine revenue. The company remains focused on R&D in order to improve patient outcomes and reduce annual global flu infections.

COVID-19

The potential impacts of the virus remain unknown given the fluidity of the situation. Management have announced a few targeted initiatives to assist in the development of a vaccine to prevent the disease and treatments for patients already infected.

Demand for CSL's products should continue to be strong, as they remain essential for use in hospitals or for patients at home. The real risk is in the company's ability to source blood at current levels. During the half, U.S. collection centres were running at capacity, seven days a week for 15 hours a day. As cities shutdown and social distancing is encouraged, CSL may experience a slowdown in donations, which would impact supply for financial year 2022.

CSL operates a conservative and highly cash generative business, providing essential therapeutic products for the global population. Although growth may slow, the company is in a strong financial position to overcome any challenges.

CSL has a current market capitalisation of $135b and net debt of US$4.9b.

Domino's Pizza Enterprises

Global pizza operator Domino's Pizza Enterprises delivered a much improved performance for the December 2019 half year. Following a difficult twelve months, the group's domestic and international performance improved markedly, benefiting from solid organic sales growth.

Operating in three geographic regions and with a network of over 2,600 stores, Domino's recorded a 10.6% lift in global food sales to $1.6b. Same store sales (SSS) grew 4.1%, while operating profits rose 10% to $151m, giving rise to an operating margin of 9.6%. Group performance was solid across all regions, led by an improving local performance, which saw SSS growth of 3% and operating profits up 1.7% to $71.4m.

Offshore, Japan continues to impress, lifting its store count by 42 to 642. SSS growth was also solid at 6.1%, contributing to a 11% lift in operating profits to $38.4m.

In Europe, both France and Germany are benefiting from a significant period of investment. Along with the Benelux region, European SSS grew a solid 5%, while operating profits lifted 18% to $48m and is well on track to exceed $100m for the full year.

Management remain committed to driving operational improvement, with a focus on lifting total online sales from the current 70% level and improving carry out sales, with the reintroduction of the $5 pizza offering.

Management led by CEO Don Meij, have a clear desire to lead on all aspects of business, including issues surrounding environmental, social and governance matters (ESG). This will see the appointment of a new executive in the near term to reflect the importance of this role. Further, the company announced the resignation of Europe CEO Andrew Rennie following a career spanning 26 years. His role will be taken over by another Domino's veteran Andre Ten Wolde, who will lead an experienced European executive team.

COVID-19

The company ended the half with strong sales momentum, which has continued in the first six weeks of the new calendar. That said, COVID-19 has brought short-term uncertainty to the company's trading operations, especially across Europe.

In France, Domino's voluntarily closed all stores for a period of 15 days during March, in response to a government requested shutdown. In New Zealand, stores closed for a period of four weeks. All other markets remain open, providing communities with much needed food support, while traditional restaurants and cafes closed.

Management is also working closely with governments and are receiving positive recognition for their efforts in providing zero contact delivery and zero contact carry out.

Financially, the company is in good shape, having lifted dividends by 6% to 66.7 cents per share for the half, while net debt remains at a modest level of $514m. Importantly, the financial wellbeing of franchisees remains a key metric and having endured a difficult backdrop over recent years, management is committed to ensuring the quality of franchisees improves to ensure operational and customer excellence. This is even more important during times like these, where other franchisors may be struggling to provide ample support for their franchisees.

Domino's Pizza Enterprises has a market capitalisation of $4.4b and as noted, ended the half with net debt of $514m.

FINEOS Holdings Corporation

Life, Accident and Health (LA&H) insurance software vendor, FINEOS released its 1H20 result, the first financial update since listing in August 2019. The company outperformed its guidance, reporting revenues of €40.4m, an increase of 37.7% from the prior corresponding period and a net profit after tax of €2.4m, an increase of 318.2%.

FINEOS is benefiting from significant tailwinds as the LA&H industry shifts from in-house developed systems to outsourced, contemporary, cloud-based modules to meet growing regulatory requirements. Headquartered in Dublin, Ireland, the company employs 740 staff and invests extensively in research and development, totalling over 30% of group revenues.

In 2003, FINEOS identified the need to redesign the core system software that LA&H clients were reliant upon. This led to the development of the group's flagship Claims module, which manages insurance claims from intake to closure, offering an end-to-end software solution.

Since 2013 the company has invested heavily, to the tune of €100m, in developing the software modules used within the LA&H industry. The company estimates the total annual spend on external core systems software, by LA&H insurers applicable is circa US$10b.

The company's service platform is offered over the cloud, with the company transitioning clients from the legacy on-premise solution to the more contemporary Software-as-a-Solution (SaaS) offering. Claims is also just one of six modules in the group's broader FINEOS AdminSuite, and sits alongside newer additional service modules, FINEOS Engage and FINEOS Insight.

With increasing complexity resulting from continually shifting federal, state and municipal regulations in the U.S., FINEOS' Absence module has proved to be a significant drawcard for customers onboarding onto the AdminSuite. This was most evident with the company recently signing up The Prudential Insurance Company of America, one of the top ten group life and health carriers in the U.S., to support integrated disability and absence management (IDAM) for their Employee Benefits division.

CEO Michael Kelly commented, *"The Employee Benefits industry is experiencing enormous change in support of the modern and flexible benefits employers want for their employees today. The FINEOS Platform is designed specifically to support the group and voluntary benefits insurance industry, with absence management being a fully integrated part of our overall core solution. We are uniquely positioned to support insurance carriers in this industry to deliver great digital customer experience and overall operational efficiency. By implementing the FINEOS Platform in support of their IDAM needs, our new customer will be strongly positioned to serve employers and employees and we will help to ensure they can keep pace with future advances in technology and regulatory changes."*

FINEOS is a global market leader, evident by the fact that seven of the top 10 U.S. LA&H insurers and six of the top 10 Australian LA&H insurers use FINEOS, and 100% of Accident Claims in New Zealand are processed through the platform.

In total, the company supports over 50 clients with the largest customer providing 22% of total revenue, down from 27%, showing a healthy diversification of earnings as the business continues to mature.

Financial metrics are healthy and improving, with management forecasting revenues of between €84m-€86m for 2020. To date, the subscription style recurring nature of the SaaS offering has the company well on track to hit this target, with a significant portion of forecast revenues already committed.

FINEOS is a standout when considering management's alignment to shareholders, with CEO Michael Kelly who founded the business in 1993, retaining circa 60% of the issued capital.

COVID-19

The company has not provided an update in relation to COVID-19.

FINEOS has €34.7m in cash, no debt, and a market capitalisation of $740m.

Flight Centre Travel Group

Financial year 2020 has been an extremely turbulent year for Flight Centre Travel Group. The company posted a record first half total transaction value (TTV) of $12.4b, up 11.2% over the prior corresponding period, and profit before tax of $102.7m. However, as we outline below, the outbreak of COVID-19 has fundamentally impacted the company.

COVID-19

COVID-19 has completely changed the landscape for Flight Centre. Restrictions Implemented by most world governments have temporarily halted air travel to stem the spread of COVID-19. This has led to an immediate stop to revenues generated from the provision of air travel services. In response, the company has outlined a three-pronged plan focused on costs, cash, and liquidity, to curtail a prolonged downturn in demand.

In relation to costs, the company has temporarily, or in some instances permanently, suspended 6,000 support and sales roles out of its 20,000-person global workforce. Flight Centre is expecting to maintain close relations with all affected individuals, including weekly contact, with the intention to bring them back to work as soon as global travel normalises.

In addition, the company is bringing forward their previously announced intention to close underperforming stores and downsize its leisure networks in North America. Further cost savings have been secured through renegotiated rental agreements with landlords. Flight Centre has reduced pay for senior executives and Board members by 50% and announced a cancelation of all short-term incentive payments for the year.

In order to preserve cash, Flight Centre has also paused several major expenses including its monthly sales and marketing spend of $15m and various non-essential projects. The previously announced interim dividend has been cancelled, preserving $40m of cash on the balance sheet. The group is currently engaging with state and federal governments to discuss various support mechanisms, which could help preserve jobs into the future if this downturn is protracted.

Finally, in relation to liquidity, the group has taken steps to ensure it retains a robust balance sheet throughout the current crisis. This has included a $700m equity raising as well as a $200m increase to the group's existing bank debt facilities.

Managing Director Graham Turner commented *"We are dealing with unprecedented restrictions and extraordinary circumstances that are having a significant impact on our customers, people, suppliers and all other stakeholders... As a result, we have been forced to make extremely difficult decisions, including temporarily standing down some of our people and cancelling our interim dividend, with a view to preserving more jobs for the future... We will also be conscience of the need to make changes that allow us to successfully overcome this short-term challenge, but do not harm our culture or prevent us from thriving into the future."*

Flight Centre Travel Group has a current market capitalisation of $2.1b and post the capital raising available liquidity in excess of $1.0b.

IOOF Holdings

Fund platform and financial advice provider, IOOF has undergone a period of significant change as it works towards restoring trust and rebuilding the culture within the advice-led business. Financially, the group delivered a lower first half underlying net profit after tax (UNPAT) of $61.4m, in contrast to the $90.8m in the previous comparable period. These two sets of results are difficult to compare, as new CEO Renato Mota explains, *"The impact of the step down in the ANZ P&I coupon interest and additional months' ownership of ex-ANZ Advice Licensees were in line with our expectations. During the period we also experienced some gross margin re-set from both regulatory and competitive dynamics, in addition to a greater investment in governance."*

During the period, the group also completed the acquisition of the ANZ Pensions & Investments (P&I) business for a total consideration of $825m, following a $125m reduction in the sale price announced in October 2019. Along with the loss-making Aligned Dealer Group (ADG) also acquired from ANZ, the total consideration paid was $850m.

Management have confirmed the acquired P&I business delivered UNPAT of $42.3m for the period ending December 2019. On a full year run rate this would translate to $84.6m of UNPAT that will begin to flow to IOOF from 31 January 2020. In addition, management revised pre-tax P&I cost synergies to $68m from $65m, of which $13m has already been realised. These synergies are expected to be fully delivered by July 2023.

IOOF is competing in a dynamic wealth management industry, where advisers are now subject to greater governance and compliance requirements. Financially, the group's financial advice division recorded a resilient result, delivering revenues of $193.1m and UNPAT of $26.4m, down 13%. Unlike the big banks, IOOF remains committed to servicing their 1,433 advisers by providing governance support and investing in a *"ClientFirst"* strategy. This approach is reflective of their endeavours to reinvent their advice model into a sustainable and economically viable business.

From a Platforms perspective, the industry is experiencing greater pricing pressure and an exodus of funds from the large banks to independent specialty platforms such as NetWealth and Hub24. Despite this, IOOF's Platforms business recorded $756m of positive net inflows for the six months to 31 December 2019. Further, the company is expected to realise $10m of synergy benefits, by consolidating their technology onto one platform through Project Evolve. We remain confident in the company's platform solution, providing leading edge technology in combination with a superior service proposition.

Importantly, IOOF has met all of APRA's licence conditions. In addition, they have been informed by ASIC no further action is being considered in relation to referrals from the Royal Commission. Management can now focus on growing earnings and ensuring synergy benefits are realised from the ANZ acquisition, with funds under management and advice (FUMA), including P&I, totalling $221b.

The company has a conservative balance sheet, with net debt/EBITDA of circa 1.3 times.

COVID-19

The company has not provided an update in relation to COVID-19.

Since the half year results, IOOF's market capitalisation has fallen from $3b to current levels of $1.3b. Group net debt stands at circa $320m.

Infomedia

Infomedia, a leading automotive electronic parts catalogue (EPC) software provider, reported a strong first half 2020 result with revenues increasing 19% to $47.9m and net profit after tax improving 24% to $9.0m. These positive metrics illustrate the company's ability to successfully grow the top-line, while investing ahead of the curve to drive future earnings growth.

Infomedia has traditionally offered three services:

1. The Microcat EPC, which provides automotive dealers with an up to date electronic catalogues of vehicle parts.
2. The Superservice Platform, which provides aftermarket car service departments with a suite of products aimed at optimising price transparency, increased customer trust and improved dealer service productivity; and
3. Data insights and analytics.

While each solution has had success historically, the group is moving beyond siloed applications with the release of its *"Next Gen"* platform.

The company has positioned their *"Next Gen"* platform as a market leader with improved functionality and a customer-centric design that ensures it remains intuitive to use. By moving to a single technology stack, Infomedia can deliver a scalable solution in which new modules and features can be rolled out quickly with reduced development complexity. While still in its early stages, customer feedback to date has been positive.

Infomedia recently completed the acquisition and successful integration of Nidasu, the leading provider of critical automotive data analytics to automakers and dealerships throughout Australia and Asia Pacific. The group notes that while initially small scale, the potential opportunities presented within the expanding data offering will be a significant contributor to the business in the coming years.

By geography, most growth was observed in the Asia Pacific region, contributing a 49% increase in revenue to $14.5m. This was off the back of the Nidasu contribution and several mandated contract wins across the product range.

Mandated contract wins in the EMEA region also lifted revenues by 6% to $11.2m. Growth in the U.S. was subdued, recording a 2% revenue increase to $10.4m. The appointment of a new regional head with extensive front line sales experience is expected to drive significant growth.

While the company has not provided a formal guidance range, they expect to deliver low double-digit revenue growth and earnings above FY20. With over 95% of revenue considered recurring and 80% generated internationally, we remain confident in the company's ability to sustainably drive growth.

COVID-19

The company has not provided an update in relation to COVID-19.

Infomedia has a current market capitalisation of $450m with cash of $15m and no debt.

IRESS

Financial services software provider IRESS, reported a resilient financial year 2019 result, with operating revenue and segment profit both increasing 10% to $508.9m and $152.1m respectively. Underlying net profit after tax rose 11%, a significant milestone for management as earnings growth has been absent from previous results.

The share market reacted negatively to what seems to be a weaker earnings outlook, with CEO Andrew Walsh noting, *"the execution of medium-term growth opportunities, particularly in super, trading and data and further scalability across our business will bring 2020 investment ahead of revenue from these objectives."*

Management faces the challenge of balancing shareholder expectations, while investing in future business opportunities. This is particularly evident in superannuation, which the company recognises as a segment ideal for technological disruption while also having a total addressable market larger than the current Australian wealth management division.

With current processes undertaken manually, IRESS is confident in its ability to automate back office functions such as end-to-end transaction processing, potentially reducing member administrative costs by up to 50%. The near-term challenge is in the company's ability to successfully implement its technology across larger organisations, currently underway at ESS Super, Australia's largest open defined benefit fund.

IRESS have acknowledged the time and refinement required for their technology to displace current solutions. However, management are confident the large unmet need and regulatory dynamics will drive change.

IRESS' data and analytics solution, Lumen, is equally well placed well to service the growing compliance requirements of advisers following the Royal Commission.

From an acquisition perspective, IRESS has remained opportunistic in expanding business capabilities beyond the short-term. The acquisition of blockchain communication platform provider BC Gateways, an EPS dilutive and non-revenue generating business, is highly reflective of this.

COVID-19

The company has decided to withdraw FY20 guidance, despite early results performing in line with expectations.

IRESS provides business critical technological and financials service solutions, that is over 90% recurring in nature.

IRESS has articulated a clear and consistent strategy, investing ahead of revenues to attain market leadership in new and existing verticals. With a strong management team and proven technological leadership in current markets, we remain confident in the company's ability to deliver long-term shareholder value.

IRESS has a market capitalisation of $1.8b, with net debt of $191m.

James Hardie Industries

Leading global fibre cement producer James Hardie Industries, delivered a strong third quarter 2020 financial result, led by its U.S. operations. Under the leadership of CEO Jack Truong, the company has set out a *"transformational"* agenda to deliver on multiple business fronts.

At its core, the group's ambitions are to lead in all markets in which it operates, by running world class manufacturing operations, underpinned by a customer centric and product innovative approach.

The early results indicate the company is well on track across several areas, most specifically in the US., the group's largest and most important market. Volumes in this region grew 11% for the quarter, driven by exterior products up 13% and interior volumes, returning to growth, up 3%. Together this lifted net sales 12% on a comparative basis to US$430m, while operating profits rose 30% to US$112m.

Combined with the introduction of *"Lean"* operational and efficiency improvements across the group's 10 manufacturing sites, operating margins exceeded management's long-term guidance range of 20%-25%, coming in at 26.1%.

Elsewhere, Asia Pacific (APAC) operations have maintained their performance levels despite contracting market conditions, while the newly combined European segment reported a softer result, partly driven by weaker housing conditions.

Overall, the group ended the quarter in a strong position. Adjusted operating profits (EBIT) are up 20% for the nine months to the end of December 2019 at US$366m, while adjusted net profits increased 17% to US$266m.

Management confirmed a tighter net profit range for the full year of US$350-US$370m. Importantly, CEO Truong confirmed the group's commercial transformation has continued to gain momentum and the 2022 US$139m *"Lean"* program was trending ahead of plan.

COVID-19

Despite this growth, James Hardie is susceptible to global macroeconomic slowdowns and the impact of COVID-19 will be no different. Lockdown periods across Europe and across the U.S., is expected to impact building activity across James Hardie's markets.

The company has a strong balance sheet and through *"Lean"*, has demonstrated an ability to reduce costs across the business. We remain confident James Hardie can overcome the impacts from the global pandemic and are willing to back management in creating efficiencies and growing market share once building activity stabilises.

James Hardie's market capitalisation has declined from AUD$14.5b to AUD$8.2b with net debt of US$1.2b, sitting just outside the company's targeted range of 1-2 times leverage.

Jumbo Interactive

Leading internet lottery operator Jumbo Interactive, reported its first half 2020 result, off the back of earlier guidance released in January. The growth of online lottery play, now accounting for 26.7% of Australian ticket sales, continues to present a significant opportunity for the company's digital offering. This is particularly true for younger demographics.

Over the period, Jumbo successfully grew total transaction value (TTV) by 25.3% to $158.3m. This resulted in revenues of $37.6m and net profit after tax of $14.4m, up 23.1% and 14% respectively.

The company's active customer base grew 47% to 848,621 over the prior corresponding period, with each active user spending on average $389. While large Jackpot activity provides significant tailwinds for attracting customers in the short-term, Jumbo is increasingly investing in artificial intelligence and machine learning to further improve personalisation and in turn driving loyalty.

Jumbo's *"Lotto Party"* feature and access to Super Combos, Public Syndicates and Charity Games are providing increased optionality, helping to reduce dormancy despite the growing customer base.

Moving beyond its traditional ticket reselling business, Jumbo's SaaS platform *"Powered by Jumbo",* enables lottery operators around the world the opportunity to adopt the company's digital offering to manage ticket sales.

Having secured three leading lottery operators as customers, with estimated aggregate ticket sales of $135m and estimated net profit before tax of $3.3m per annum, the company is forecasting substantial growth over the forward years.

Since the interim result, Jumbo has announced their fourth SaaS agreement, this time with Multiple Sclerosis Queensland.

The market opportunity for the Charity market segment is significant, with the company initially targeting charity lotteries in Australia, the U.K. and Canada, representing a total addressable market of $3.5b.

While *"Powered by Jumbo"* is an appropriate offering for mid to large lottery operators, it is not well suited for smaller organisations. The strategic acquisition of Gatherwell in the U.K. is expected to fill this gap.

Gatherwell currently services around 80 local authorities and 1,000 schools, facilitating the sale of roughly 130,000 tickets per week. Since acquisition, Gatherwell has contributed TTV of $0.96m, revenue of $0.2m and net profit of $0.05m.

Management remains confident in its ability to grow TTV to $1b by FY22.

COVID-19

In response to COVID-19, popular sports across the globe have been cancelled, leaving players with fewer options.

At the same time, social distancing is impacting retail store foot traffic. Prior to the onset of COVID-19, almost 75% of all Australian lottery tickets were sold via retail channels. Jumbo is lifting marketing activity to leverage this dynamic and help drive more sales online.

Given increased restrictions on person-to-person meetings, management is expecting some minor delays in progressing current *"Powered by Jumbo"* initiatives.

Jumbo has a current market capitalisation of $590m, with net cash of $65.5m.

Nanosonics

Under the leadership of CEO Michael Kavanagh, global leader in infection control solutions Nanosonics is laying the foundations of a long duration business. The company continues the rollout of Trophon2, an automated high-level disinfection (HLD) unit for ultrasound probes. The installed base now sits at 22,500 globally, an increase of 17% since the prior corresponding period. With adoption expanding, roughly 75,000 patients per day are protected from the risk of cross contamination.

Nanosonics derives revenue from selling Trophon machines and the consumables required to operate a disinfecting cycle. Over the period, consumables contributed $34.1m of revenue, an increase of 40%. This is reflective of the growing installed base and offset by a temporary reduction in capital equipment sales, down 12% to $14.4m.

Despite record revenues of $48.5m, an increase of 19%, the group delivered a profit before tax of $6.7m, down 39%. This was not surprising with management guiding towards a significant increase in staff headcount globally, as the company enters new markets and focuses on establishing Trophon as the global standard of care. This is in addition to continued investment in a new technology platform, with the company targeting a commercial launch in FY21.

Nanosonic's strategy to go *"wide and deep"* refers to its efforts of not only extending the company's geographic footprint, but also further penetrating each hospital or institution where units are already in place. Over the second half of the year, the company is expecting the installed base in North America, currently 19,930, to grow strongly. Alongside this, expanded geographical reach and increasing regulatory guidelines are expected to drive product penetration across Europe.

The appointment of five distributors in Japan has delivered the first unit sales for the region, with significant investment expected to drive further growth. An expansion strategy into China is currently being explored.

COVID-19

While management has observed strong growth over Q3 FY20, the recent limited direct access to hospitals is expected to delay the planned adoption of some trophon units over the final quarter of 2020. This is expected to have a smaller impact on consumables which continue to perform in line with expectations.

Outbreaks of this nature serve to highlight the importance of infection control, which lays at the heart of the Nanosonic's offering. Internally, the view remains that as hospitals progress past the management of the current COVID-19 outbreak, focus will be redirected to the importance of overall infection prevention, with increasing global customer enquiries serving to validate this hypothesis.

Nanosonics has a strong balance sheet with negligible levels of debt, cash reserves of $82m and a current market capitalisation of $1.8b.

Nearmap

Aerial imagery leader Nearmap, released their first half result off the back of a revised guidance in January. While Annualised Contract Value (ACV) for the 1H20 grew by 23% to $96.6m, the ACV guidance for the full year has been reduced to a range of $102m-$110m, down from $116m-$120m. From an earnings perspective, the business generated revenue of $46.3m for the half, an increase of 31%, and a net loss after tax of $18.9m. This loss was unsurprising as the company flagged their intention to heavily invest in scaling and expanding their offering over the year.

The North American business has experienced significant growth over the half, with revenue increasing 62% to US$11.4m. The recently opened New York office is showing success in some market verticals, however, the added costs associated in scaling up in this region resulted in a segment loss before tax of US$11.0m. A slowdown in mapping for the automotive industry also saw significant churn events in North America, with two enterprise customers not renewing their subscriptions. While we are cognisant of the impact large customers will continue to have in this segment in the short to medium term, accelerating growth in small to medium clients should help offset the potential lumpiness of enterprise agreements into the future.

The focus on upscaling the North American opportunity left management stretched and as a result, the Australian and New Zealand geography saw an increase in client churn from 5.3% to 7.2%. While this remains within management's targeted range of 5%-10%, the company has re-organised the sales leadership team to drive renewed focus on the ANZ segment.

Despite the lift in churn, ACV in ANZ grew 14% to $61m and revenue increased 15% to $29.6m. With pre-capitalisation gross margins of 92%, ANZ contributed operating profits of $12.6m for the half.

Having raised $70m in 2018, the company's current cash balance sits at $50m. Further investment is expected over the course of 2020, including the rollout of AI capabilities in beta mode, the strategic acquisition of capabilities in the roofing geometry market, and the continued improvement of camera performance.

Commenting on the first half performance, CEO and Managing Director, Dr Rob Newman noted *"we reiterate that we remain confident in our outlook for the company. Our North American core business continues to build momentum, with the returns on our investments beginning to show through strong ACV growth in the second quarter. The ANZ business continues to build on its market leadership position, outgrowing the competition significantly, and with the execution issues outlined previously within our control to rectify. The churn and downgrade events experienced show our susceptibility to large deals but, just as these can go against you, they can just as easily go in your favour, as they have previously. With all of this in mind we remain confident that we will return to delivering year-on-year ACV growth of 20-40% in the medium to long-term."*

COVID-19

For the most part, operations to date have remained largely unaffected considering COVID-19. All Australian and U.S. employees are working remotely with the online service offering remaining available. Capture flights are scheduled to continue as normal, with new content types still expected for delivery during the second half of FY20.

At the end of calendar year 2019, Nearmap had a cash balance of $50m. If trading conditions materially worsen, the company has the necessary levers to maintain capital flexibility and a strong balance sheet.

Nearmap has a current market capitalisation of $550m with net cash of $50m.

NIB Holdings

For the half year to December 2019, private health insurer NIB Holdings reported revenues increasing 6.4% to $1,279.1m, offset by higher than expected costs. This led to a 27.2% decrease in group underlying operating profit (UOP) to $83.2m.

The company also downgraded earnings guidance for the 2020 financial year with group UOP likely to be at least $170m, a decrease from the $200m expected at the time of the 2019 full year result release.

The Australian Residents Health Insurance (ARHI) business was the primary driver for the weaker performance, delivering first half UOP of $62.6m compared to $88.3m in the previous comparable period.

Despite promising trends with premium revenue rising 3.8% and industry leading net policyholder growth of 1.4%, the division succumbed to industry wide claims expense and risk equalisation levy increases (explained in further detail below).

From an industry perspective, rising claims inflation has been an ongoing issue, impacting health insurer profitability as they struggle to balance government pressure to keep premium rate increases down. NIB reported higher claims expense across their Australian, New Zealand and International health insurance businesses, as a result of prosthetic price increases and greater mental health utilisation, with CEO Fitzgibbon noting, *"it's been more widespread across a number of business lines than we previously anticipated."*

Private health insurers are party to a risk equalisation scheme, a fund for insurers, where those who have paid lower hospital and chronic disease management program benefits, are required to subsidise insurers who have paid more. Since NIB is the largest contributor to risk equalisation, they are effectively subsidising the growing claims utilisation and cost of other health insurers, which has resulted in a 10.3% increase in net risk equalisation expense half-on-half.

COVID-19

With the profound uncertainty relating to the effects of COVID-19, NIB has withdrawn financial year guidance for 2020.

In the company's recent update to shareholders, NIB confirmed net group policyholder membership growth for ARHI, and international students were ahead of budget, as consumers express more health risk concerns.

Further, NIB expects a slowdown in claims expense, including risk equalisation, as elective surgeries, hospitalisations and ancillary services are delayed allowing hospitals and staff to focus their attention on treating the virus.

Offsetting this positive trend, is the group's NIB's travel business which is being impacted due to the range of travel restrictions being enforced by the government. The group is expecting lower sales and higher claims expense for the travel business.

NIB Holdings has a current market capitalisation of $2.3b and net debt of $88m

PolyNovo

PolyNovo is a medical device company that develops and manufactures dermal regenerative solutions. Its lead product, the NovoSorb BTM, is used to promote normal healing for patients who have suffered a partial or complete thickness skin injury. BTM is approved for sale in Australia under the regulatory authority TGA, the U.S. under the FDA, and now in Europe having received its CE mark during the latter months of 2019.

As the company is still in the early stages of commercialising Novosorb BTM, PolyNovo is investing significantly in expanding the sales network, primarily in Australia and the U.S., resulting in a significant increase in revenue and deeper account penetration. The business has also built a small presence in the UK/Ireland and Singapore markets, which is driving some early success.

For the period, PolyNovo reported BTM sales of $8.6m, an increase of 129% from the prior corresponding period. However, increased investment in manufacturing facilities and new product research and development resulted in a net loss of $2.4m, an increase of 26%.

Utilising the NovoSorb base polymer, PolyNovo has developed a solution to aid recovery post hernia operations. Considering the risks associated with the mesh-based solutions currently on the market, this product presents a significant opportunity for the company.

While the group is currently building a factory to house the manufacturing of the hernia product, they intend to commence commercial validation at an alternative site for the remainder of the calendar year. Pending regulatory approvals, this should allow for entry into the U.S. market by mid-2021. The company has also commenced the development of a breast reconstruction solution in collaboration with Establishment Labs.

COVID-19

The company is expecting to see minimal direct impact from COVID-19. PolyNovo has secured its supply chain with multiple backup redundancies in place. In addition, the major markets to which NovoSorb BTM are supplied have adequate stocks to meet anticipated sales for a significant period.

PolyNovo has a current market capitalisation of $1.1b, with net cash of $8.1m.

Reece

Leading plumbing group Reece released a strong first half result for 2020, delivering record sales revenue of $2,962m, up 9% and profit after tax increasing 37% to $105m. The result was particularly pleasing considering the significant economic headwinds the company faced across Australia and New Zealand over the period.

In 2018, Reece unveiled a strategically significant entry into the U.S. market through the acquisition of MORSCO, a plumbing, waterworks, heating and cooling equipment distributor. At the time of purchase, MORSCO's operations included 171 branches spread over 16 states across the U.S. sun belt region. The acquisition cost totalled $1,910m, of which $560m was funded through an equity raise and the remainder through debt.

The purchase of Todd Pipe & Supply, a Southern Californian plumbing supply wholesaler, in September 2019, further extended the company's long-term organic and acquisition strategy in the fragmented U.S. market.

Todd Pipe's management team has joined with MORSCO to help direct and shape growth across Southern California. This latest acquisition complements MORSCO's existing presence, providing an additional six branches across the region, increasing the total number of locations to 23.

At present, Reece is maintaining the acquired branding across the U.S., while integrating the learnings from domestic store layouts to improve walk-in retail sales.

Three updated stores have now been rolled out and whilst it is still early days, initial feedback has been positive. In total, the combined U.S. segment delivered revenue of $1.5b and profit after tax of $21.2m, an increase of 19% and 59% respectively.

The ANZ segment delivered a strong performance despite a downturn in the dwelling approvals, completions and alterations market. For the period, this region reported flat revenues of $1.5b and a profit after tax of $83.7m. The company successfully added five new stores over the period, bringing the total to 639.

CEO and Managing Director of the Reece Group, Peter Wilson summarised the result, *"In Reece's 100th year, we're proud to share another record result as we write our next chapter as a global business. We're laying the foundations for the next century through our US expansion. We're also maintaining our competitive advantage in Australia and New Zealand through investment in technology and innovation."*

COVID-19

Management believes the potential fallout of COVID-19 will be muted in the short-term with all factories currently fully operational. A prolonged economic downturn that affects dwelling approvals, completions and alterations will undoubtedly have earnings implications for the group.

Due to current uncertainly the company has chosen to raise an additional $600m in equity via an Entitlement Offer and Placement to ensure that the balance sheet remains robust.

Reece has a market capitalisation of $5.1b and net debt of $1.6b.

Reliance Worldwide Corporation

Reliance Worldwide's (RWC) offering is vast; manufacturing and distributing brass and plastic push-to-connect (PTC) plumbing systems, fittings, Pex pipe, valves and related specialty products, under the Reliance, SharkBite John Guest, Speedfit Pro Lock, FluidTech, Cash-acme and Holdrite brands, to name a few.

Approximately half of Reliance's revenue comes from a combination of brass PTC (34%), plastic PTC (11%), and fitting (9%). This is a US$1b global opportunity, which Reliance believes can grow at above market rates of high single digits. The balance of the company's revenue is dominated by non-PTC plumbing products, including valves, pipe, and plumbing accessories. The group expects this to grow at market rates of low single digits. The strategy is to augment this growth with a combination of point of sale basket expansion and volume layers, delivered through new product development or targeted acquisition.

The first half result was impacted by a raft of global headwinds across the company's key markets. These included a slowing of new housing construction in Australia and continued uncertainty around Brexit in the U.K. In the U.S. it was a host of challenges; The loss of a key wholesale customer combined with changing promotional periods, amidst a backdrop of well-publicised tariffs and trade issues. The culmination of these placed the company under significant pressure over the period.

Underlying growth of 4% in the U.S. was below expectations. The performance of the U.K. and Australian operations, while above market sales growth of 3% and flat respectively, was creditable under the circumstances. The highly touted FluidTech and new product launches were a disappointment as execution and expectations were weak, which also led to missed budget targets.

In response to lower global demand, Reliance reduced manufacturing volumes, ultimately decreasing inventory levels that impacted margins.

The group downgraded EBITDA guidance for the full year to a range of $265-$280m and NPAT to $140-$150m. This was an 8% downgrade at the midpoint from the previously reported NPAT guidance range of $150-$165m.

Operationally this was a sound result with strong inventory control driving cash flow conversion of over

100%. Net debt to EBITDA reduced slightly from 1.67 to 1.57 times. Surprisingly, the interim dividend was increased from 4.0 to 4.5 cents per share, which in our view, appeared somewhat at odds to the reported result.

A closer look at the business regions reveals a mix of positives and negatives as any real business owner might expect.

In the U.K., John Guest synergies are being extracted but it's still early days. Headcount remains high and efficiency is not optimal. The rollout of a global ERP system will give management access to data for the first time in decades to make informed decisions. This has been a key gap and is considered the top priority by management.

In Europe, management changes have followed the poor operational results and a restructuring will occur. Manufacturing in Spain, which is proving to be a difficult location, is also under review. Combined, this is management's second priority.

In the U.S., manufacturing is being consolidated in Alabama and new product development is being reconsidered, as market penetration timeframes and investment commitment are reviewed. Following disappointing results from EvoPEX in new construction and StreamLabs' unsuccessful attempt to establish a position in the market, management are now reconsidering the direction of both products.

COVID-19

The company has withdrawn formal earnings guidance for the full year, as considerable uncertainty exists around COVID-19. Although sales were in line to March, the company is experiencing supply constraints in the U.K., New Zealand and Canada.

In the U.K., the company has seen some distributors close and others modify purchasing activity, resulting in more than 40% of the region's workforce being placed on furlough due to this uncertainty.

Financially, Reliance remains in a strong position with net debt of $395m, and $750m of additional funding lines available. However, the company has decided to defer their interim dividend payment to preserve cash during these fluid times.

There is obviously a substantial body of work remaining and we continue to be supportive of management and the business.

Reliance Worldwide has a market capitalisation of $2.1b and, as already noted, net debt of $395m.

ResMed

Leading out-of-hospital medical device and software provider ResMed, delivered a strong second quarter result. Global group revenues rose 13% to US$736m and net profits adjusted for amortisation increased 22% to US$176m. Robust masks growth has again been the driver for the operating leverage, evident in the result, as the investments made in prior periods on cloud connectivity, software and product innovation continues to increase patient awareness.

For the quarter, group device revenue lifted 8% in constant currency (cc) terms to US$366m, while global masks and other sales grew 16% in cc to US$284m. Management remain focused on utilising digital end-to-end solutions to improve sleep apnea patient engagement, as noted by CEO Farrell, *"when we're achieving 87% adherence, with the doctors using AirView and the patients using myAir and all the digital techs in play, that drives up our mask growth."*

In addition, ResMed continues to innovate within their mask portfolio, while also automating and improving the mask reordering process by connecting Durable Medical Equipment (DME) providers directly on the cloud.

ResMed are also committed to better managing the respiratory disease known as Chronic Obstructive Pulmonary Disease (COPD). In the call, CEO Farrell noted *"We believe that the future of health care is outside the hospital. That's where ResMed competes today, and that's where we are winning today. We have the right elements in place to achieve our strategy and to drive financial success as we provide market-leading value to customers."*

To that end, with an estimated 400m global COPD sufferers, the current course of treatment is ineffective and costly with patients regularly revisiting hospital emergency rooms. The company has endeavoured to formulate a complete portfolio of solutions, as outlined below:

- Stage 1-2 patients: Concentrating on inhaled therapy adherence using Propeller's software
- Stage 2-3 patients: Providing portable oxygen therapy
- Stage 4 patients: Supplying hospitals with non-invasive ventilation therapy

By following the progression of COPD patients, the group can assist doctors and patients with a targeted response, thereby lowering costs and improving clinical outcomes for this large market segment.

COVID-19

ResMed are experiencing greater demand for ventilators and masks to treat seriously ill coronavirus patients. The company is working hard to triple the output of ventilators and scale up mask production more than tenfold.

While a positive, CEO Farrell also noted the possibility of a slowdown in new sleep apnea patient diagnosis and testing at hospitals. ResMed is in a very strong financial position and has a business model that enjoys recurring sales through the resupply of masks and accessories.

ResMed has a current market capitalisation of US$16.5b and net debt of US$1.1b.

Seek

In February, employment specialist Seek released results for the first half of FY20. Despite difficult macroeconomic conditions across key markets in Australia, China and Hong Kong, the company revealed strong revenue growth.

Overall, Seek delivered a revenue increase of 16% to $876m and operating earnings of $247m up 4%. This lower level of earnings growth is consistent with management's long-term focus on reinvesting surplus funds to drive long-term performance, in pursuit of its aspirational FY25 revenue target of $5b.

In Australia and New Zealand (ANZ), considered as mature market, the company's sustained investment in developing new depth (higher value) products is gaining traction. This is illustrated through depth revenue growing 17%, offset by lower job ad volumes in the half.

During the period, the company continued the realignment of its pricing model to better reflect what management considers a *"compelling value"* offering for clients. Seek will now actively align price to value, lifting prices where the value delivered is justified and adjusting downwards where required. The company will adopt a considered approach with customers when addressing the current imbalance, with management stating early feedback has been positive.

In China, the company operates the leading online employment site Zhaopin (61% economic interest), with two times more online hirers and over one times the number of candidate traffic visiting the site than its nearest rival, 51job. These two leading metrics have the business well placed to deliver significant long-term growth.

For the half, Zhaopin contributed revenues of $418m, an increase of 31%. This was largely driven by the lower margin market adjacent business, including training, assessment of job candidates and business process outsourcing. With online recruitment services expecting weaker demand due to macroeconomic uncertainties, adjacent revenue provides an opportunity to attract customers initially through offline channels, before eventually transitioning them online.

The third area of investment involves the group's early stage business ventures portfolio. The segment was one of the highlights of the financial result, delivering first half look-through revenue growth of 30%. While currently loss making, Seek has a clear line of sight regarding the progress of each investment and continues to provide additional capital, commensurate with its equity positions where warranted.

COVID-19

At the first half results, management acknowledged significant uncertainty surrounding the business impact of COVID-19. Management provided a high-level assumption that a recovery by May in China could lower guidance for revenue by $110-120m and operating earnings by $40-45m.

The company has provided a further update, noting an improved China performance, offset by weaker domestic conditions.

Seek has a market capitalisation of $5.2b and net debt of $1.3b.

Sims

Sims, a global leader in metal and electronics recycling and an emerging leader in municipal and renewable energy, released a poor first half result. As the company flagged in December, challenging trading conditions created by volatility in ferrous prices, lower automobile sales and disruptions from the continuing China-U.S. trade war, presented significant headwinds over the period.

These pressures have significantly decreased the demand and price for steel and zorba (scrap metal created from shredded cars) related products. Revenues fell 18.7% to $2,710m, with an underlying net loss of $23m compared to a net profit of $110m in the prior period.

The market volatility and pricing pressure had the greatest impact on the North America Metals business, returning an underlying profit before tax of $0.1m, down from $55m previously. The margin pressure experienced becomes obvious compared to volumes down only 9.6% over the same period.

Margin pressure was felt to a lesser extent in the Australia & New Zealand Metals business, which returned an underlying profit before tax of $22m down 56.9%, off the back of 7% lower volumes. The positive earnings observed, were supported by continued healthy demand for ferrous scrap metal from Australian steel mills and cost reduction efforts.

The U.K. metal market proved to be challenging over the half with the major incumbents cutting costs to prevent any market share erosion. U.K. Metals returned an underlying loss before tax of $28m, down from a net profit of $7m. The U.K. operation is currently being rationalised to reduce sites and costs.

Sims Lifecycle Services, the division responsible for processing *"new world"* scrap, is focusing heavily on recycling data storage centres. As the company has outlined, Sims aims to recycle 20,000 tonnes of data centre material by FY20 and 200,000 tonnes by FY25. This will be sourced from the growing use and obsolescence of hardware electronics with Sims providing customised recycling solutions to several of the world's leading electronic manufacturers. Over the period, this segment delivered a profit before tax increase of 48% to $15m.

COVID-19

While management originally guided towards second half profit before tax for the group of between $40m-$60m, this was withdrawn considering the unprecedented world-wide response to COVID-19.

Despite the downturn, the company has observed a progressive resumption of business activity across China with demand for non-ferrous metal now evident.

Group CEO & Managing Director, Alistair Field commented, *"We've entered this environment with a strong balance sheet. While our focus has always been on disciplined capital expenditure and cost management, we will be particularly cautious during this period. This will put us in a strong strategic position when the market normalises."*

Sims finished the period with $151m in cash. In addition, the company has completed the divestment of the compliance scheme-oriented recycling operations and has since received cash of €83.5 million (~A$149 million) as payment. The company paid an interim dividend of 6c.

Sims has a current market capitalisation of $1.2b.

The Star Entertainment Group

Casino and entertainment operator The Star Entertainment Group, presented a solid first half result. Normalised net revenue increased 1.9% to $1,131m and normalised earnings were up 3.5% to $307m, reaching the upper end of guidance set at the annual general meeting.

Importantly, the $45m cost out program has successfully been delivered in full for the half, with approximately 350 business roles now removed, creating a more agile and efficient operation.

Operationally, The Star Gold Coast reported a strong normalised result, with revenue up 16.8% and earnings before interest and tax up 28%. The group remains committed to the city and has proposed a further $2b investment, to build four towers with 3,000 hotel rooms, conditional on an alternative second casino licence not proceeding.

Competitively, Crown Sydney is expected to open from December 2020, targeting overseas and domestic VIP gamblers with 125 premium gaming tables. In anticipation, the group has upgraded and expanded the current premium offerings, including the Sovereign and Oasis rooms, with both scheduled to open prior to Crown's entrance. Along with non-gaming upgrades, a luxurious hotel base and an improved loyalty program, the group remains well positioned to compete for VIPs, with a vision towards expanding the gaming market in Sydney.

COVID-19

Since the half year results, the Government's directive to stop all non-essential activities has led to the closure of The Star's three casinos.

The Star has since provided a COVID-19 update outlining a significant reduction in monthly costs and a reduced capital expenditure profile. This has resulted in the standing down of over 90% of the 9,000-employee workforce, while the board and senior management have chosen to forego a significant percentage of their fees and salaries.

Management has also made the decision to defer payment of its recently announced interim dividend and revoke its dividend payment policy of paying out a minimum of 70% of normalised profit after tax.

The Star Entertainment Group has a current market capitalisation of $2.0b and net debt of $1.3b. ***SFM***

1935

We don’t intend to write about COVID-19, since much has already been written and even more remains unknown. And if we are to be honest with ourselves, as generalist fund managers, COVID-19 information more than a few hours old is not worth much to anyone. As we write this, business is at the mercy of government policy, something which we are following closely.

So as an alternative to COVID-19, we will provide some observations of these times, alongside some of our macro views. We can then tie this into our philosophy by including some history.

Observations from a bike ride

I am late for work, as I ride my bike along a Sydney beach front, on Friday 20 March 2020. My 10-year-old daughter is staying home from school and planning to surf with a friend. It’s 8.30am, and a crystal-clear blue sky is joined at the hip by a fantastic east swell hitting some well-formed banks.

The only problem for the surfers is the crowd. It’s packed with the new *“work from home crew”.* No social distancing is practiced in the line-up. The bike path is jammed with newfound exercise devotees. Some brunch type picnics are underway and a children’s birthday party is in full swing, tears and all.

As I approach Manly, the volleyball courts are full. Even the outdoor beach ping pong table is being used, which I have never seen before. How many times have I said those last five words this week?

Things change as I approach Manly wharf. Bike spots are plentiful and there is no queue at the *“Cartel”* coffee cart. The Manly fast ferry, which runs every 10 minutes, is running at circa 10%-25% capacity.

Two worlds apart, the city is not eerie. Yet one can’t help imagining what the arrival of the *“real”* pandemic, along with its associated health and economic outcomes, might do to both worlds.

For us the logical comparison period is the global financial crisis (GFC), but even this is rapidly becoming less relevant.

With the GFC as a base, we observe the following:

1. Governments today can’t deliver a meaningful monetary response.
2. Business balance sheets are generally better positioned, for some even this is not enough.
3. Households have more debt.
4. As a business, Selector has a strong cash balance sheet.

The first three points are not contentious, in fact they are generally accepted. The fourth is relevant only to us and our clients.

We add one final simple observation; no business has ever been designed to close its doors, indefinitely, while maintaining its fixed costs. Yet this is where we are right now. Could a managed fund close its doors to investing and survive? More on that later.

It’s little wonder there are articles emerging comparing the global macro outlook to something resembling the times of the Great Depression, a period we have only read about. Like the Great Depression the prospect of a future with massive job losses, i.e. double-digit unemployment, is very real and very concerning.

Yet we remain more optimistic. Governments may have less room to adjust monetary policy but be assured they will leave no stone unturned in order to prevent a reoccurrence of the late 1920s. This may well include unprecedented intervention, including going *“to infinity and beyond”,* whatever that means? Time will tell.

It’s fitting then to delve into the history books. In 1935 a fund emerged from the financial wreckage of the time, and the story is a fascinating one at that.

Figure 1: John Bogle quote

Source: John Bogle

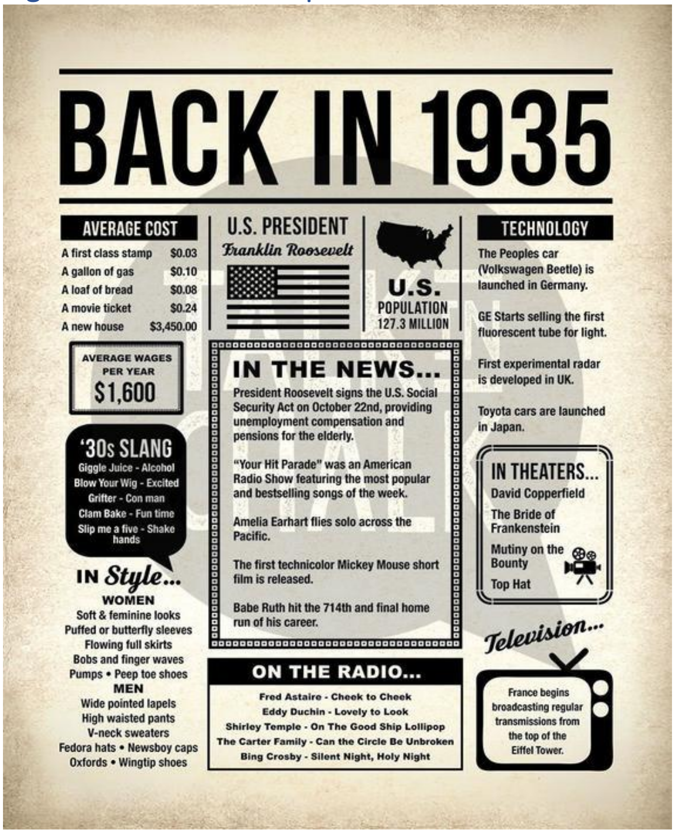
Should investing be a spectator sport?

John C. Bogle, the late founder of the Vanguard Group, said individual investors should buy an equal amount of two or three dozen high-quality stocks and store them away for a lifetime. He believed many would go to zero, but if only a few turned out to be big winners they would carry the whole portfolio to an outstanding return — without any burden of fees.

Mr. Bogle always cautioned that this approach could work its maximum magic only for investors who never traded.

The history of the Voya Corporate Leaders (VCL) fund, which emerged in 1935, suggests he may have been right.

Figure 2: Back in 1935 poster



Source: Pinterest

The fund was launched on November 18, 1935, with its hands tied. It would hold an identical number of shares in each of its 30 stocks. It could never buy new holdings or sell out of its existing ones unless a company went bankrupt, underwent a merger or became *"inadvisable"* to keep. Voya Corporate Leaders became a portfolio frozen in time.

Corporate Leaders is so old that nobody seems to know that its performance dates to 1935. Between the beginning of 1970 and November 30, 2019, the fund gained an average of 11.1% annually, according to Morningstar Inc.; the S&P 500 returned 10.5% annually over the same period. Corporate Leaders ranks 16th among the 62 U.S. stock funds that have been around since 1970. That's a stellar result for a fund that doesn't even have a portfolio manager.

What has kept it going strong all these years?

In some of the earliest records known, as of December 31, 1940, Corporate Leaders held 139 shares apiece in American Radiator & Standard Sanitary Corp., American Tobacco Co., Socony-Vacuum Oil Co., Union Carbide and Carbon Corp., Westinghouse Electric and Manufacturing Co., F.W. Woolworth Co., and 24 other giants of the time.

Some of those holdings, like the Pennsylvania Railroad Co. and what is now Sears Holdings Corp., ended up essentially worthless. Others, such as General Electric Co., are fallen titans.

On the flip side, the fund benefited from becoming a major shareholder in Berkshire Hathaway Inc., after Warren Buffett bought Burlington Northern Santa Fe Corp in 2010, an offspring of one of the fund's earlier holdings (Atchison, Topeka & Santa Fe Railway).

Union Carbide, another one of the fund's original 1935 holdings, has morphed into Linde PLC, which is up 1,200% over the past 20 years, a period when the S&P 500 gained 230%, according to FactSet.

Without ever adding anything from scratch, Voya Corporate Leaders still has 22 stocks, a mix of its holdings in 1935 and their descendants through mergers and other restructurings. When investors add money, the fund buys more shares in the stocks it already holds; when they withdraw money, the fund sells some of its shares proportionately.

Its annual turnover rate of 7%— implying that it holds onto its typical share of stock for more than 14 years—is one of the lowest of any mutual fund.

Morningstar believes the fund was set up to counteract some of the hazards that led to the crash of 1929. As risk-loving portfolio managers had inflamed the mania that triggered the crash, the fund was put on permanent autopilot. It would buy, hold and do nothing for 80 years. In 2015, its charter was extended to the year 2100.

The founders built in a degree of diversification, with the requirement to hold 30 stocks across the energy, industrial, railroad and utility sectors. Hot stocks of the day, like Nash Motors Co. and Radio Corp. of America, found no home in the portfolio.

The initial list had no financial stocks, presumably because so many depositors had pulled their money out during the bank runs of the Depression. The fund's designers *"wanted to avoid companies that they believed had the potential for bankruptcy,"* says a client portfolio manager at Voya Investment Management in New York.

As you'd expect of a portfolio that was set in concrete during the Great Depression, Voya Corporate Leaders owns no technology or health care stocks. The $800m fund has almost all its assets in four sectors: Industrials, energy, basic materials and financial services. Its only financial stock being Berkshire Hathaway. And nearly two-thirds of the fund is in only four stocks: Union Pacific Corp., Berkshire Hathaway, Linde and Exxon Mobil Corp.

Why pay any fees on a frozen portfolio when you could freeze one of your own for free? We wonder how many investors possess the courage of their convictions, to remain on strategy after 25% of their portfolio has not just experienced an unforeseen downgrade but has been bankrupted.

It's interesting to contrast our own style to that of Voya Corporate Leaders (VCL).

Where we differ from VCL is in our evaluation of people and culture. We look to back high-quality people across the spectrum of leadership roles that encompasses the board and management team, and the staff that support them.

As we highlighted in our December 2019 Quarterly Newsletter, a premium can be placed on a business with managers who have a long-term outlook and are prepared to forgo a portion of profits today, to invest for the future.

The Harvard Business Review article, which we referenced in that quarterly, notes the best performing managers are well into their second decade of experience. With this we would concur.

VCL on the other hand, did not set out to evaluate management, people or culture as far as we are aware.

We would draw the following parallels between our own investment approach and that of VCL.

1. *Business*
   We seek businesses that have leadership qualities. With business leadership, the scale required for sustainable profit growth can be achieved. This manifests in a balance between the need for future investment and a sensible dividend payout ratio. In 1935, VCL purchased common stock shares of leading U.S. companies at the time.

2. *Balance Sheet*
   We seek to own businesses that are conservatively managed. We prefer a net cash balance sheet but are mindful of the fact that these are relatively rare. In normal circumstances, debt can be used alongside long duration assets if it is combined with a sensible payout ratio. In 1935, VCL set out to avoid businesses that could be beset by bankruptcy.

3. *Capital management*
   We seek to maximise real earnings per share growth over time. Essentially this means owning a business over the long-term and benefiting from organic growth that drives higher profitability. This is the determinant for higher dividends and share prices to follow. Capital management encompasses management stewardship of the issued capital of the business. VCL set an aggressive agenda that followed this path. By enshrining a policy of not buying any additional stock and selling nothing, they became the ultimate long-term long only investor.

Our process, like that of VCL, results in a low portfolio turnover. A secondary advantage from this approach is the tax adjusted return benefits one derives.

On average, through our in-house research and travel (under normal circumstances), we are trying to add one or two new ideas to the portfolio each year that we believe make the grade.

Regular readers of the newsletter will see these show up, from time to time, as our business profile stories. So, in answer to the question we posed earlier, we don't think investing should be a spectator sport. We spend a significant amount of our time researching and understanding the structural drivers that impact the businesses we own. Here we aim to exit quickly when we identify external drivers that are insurmountable for a business we own.

A crisis event speeds up this process, as opportunities can emerge very quickly. It's not about hero calls or timing. We are not trying to do either of these. Rather it's about small adjustments to increase the overall quality of the portfolio. We only need to be partially right.

We have long believed that possibly the most important attribute we can offer our investors is *"staying true to label".* In other words, our approach is consistent with what we say, we will do. When we enter a stock (we like to think of it as buying a business) we don't know what the ultimate outcome will be. We simply don't have those answers, but what we do know is that over time some will fail, where others will succeed. The portfolio is structured to cope with this outcome.

We have a high degree of faith in our process, and we do know that we can stick to it, even when it's painful. Each crisis we navigate reinforces our belief.

Perhaps this is why the article that appeared in the Wall Street Journal on the Voya Corporate Leaders Fund appeals to us.

A frozen fund is not only unique, it truly represents the funds management core quality of being *"true to label".*
SFM

TIMELINE OF KEY COVID-19 RELATED EVENTS

Date	Description
17-Nov	The first confirmed case of the novel coronavirus emerges.
8-18 Dec	Seven cases diagnosed with novel coronavirus were documented; two of them were linked with the Huanan Seafood Wholesale Market; five were not.
29-Dec	A hospital in Wuhan admits four individuals with pneumonia, all having worked in the Huanan Seafood Wholesale Market.
31-Dec	Chinese Health officials inform the World Health Organisation (WHO) regarding a cluster of 41 patients with a mysterious pneumonia. Most are connected to the Huanan Seafood Wholesale Market.
1-Jan	Huanan Seafood Wholesale Market closes.
8-Jan	Scientists in China announce the discovery of a novel coronavirus.
11-Jan	China records its first death.
13-Jan	Thailand witnesses a confirmed case of coronavirus, the first outside China.
20-Jan	Chinese premier Li Keqiang urges decisive and effective efforts to prevent and control the epidemic. Confirmation that the coronavirus could be transmitted between humans.
23-Jan	Wuhan is placed under lockdown and Hubei province follows thereafter. Beijing cancels events for the Lunar New Year, while officials report the first death outside Hubei.
25-Jan	Australia confirms its first four cases, one in Victoria and three in New South Wales.
26-Jan	New cases confirmed in the U.S., Taiwan, Thailand, Japan and South Korea.
30-Jan	WHO declares a global public-health emergency.
31-Jan	U.S. President Donald Trump bans foreign nationals who had traveled to China within the prior two weeks from entering the U.S.
2-Feb	First death outside China recorded in the Philippines.
9-Feb	Death toll in China surpasses that of the 2002-2003 SARS epidemic, with 811 deaths recorded.
11-Feb	WHO announces the novel coronavirus would be referred to as *"COVID-19"*.
12-Feb	COVID-19 cases start to spike in South Korea.
19-Feb	Iran reports two deaths from the coronavirus, hours after confirming its first case.
21-Feb	In Italy, the region of Lombardy reports the first local transmission of the virus with three cases.
1-Mar	Australia reports its first death from COVID-19.
3-Mar	U.S. Federal Reserve cuts the benchmark interest rate by 0.50%, leaving rates within a range of 0.50% and 0.75%. South Korea announces a US$9.8b stimulus package to cushion the impact of the virus. Part of which is allocated to small and medium businesses to assist companies pay workers, provide child-care subsidies and job retraining.
6-Mar	U.S. signs a *"Phase One"* US$8.3b spending bill to fund efforts to fight the pandemic.
7-Mar	Official data shows China's exports plunging 17.2 percent in the first two months of the year.
8-Mar	In Italy, the government imposes a strict quarantine in the state of Lombardy and 14 other areas in the north, affecting a total of 16m people.
11-Mar	WHO declares the outbreak a pandemic. President Trump bans all travel from 26 European countries. Italy declare a US$28b plan to provide loans for small and medium businesses and help workers who are facing layoffs.
12-Mar	Australia's Prime Minister Scott Morrison unveils a $17.6b stimulus package to *"protect Australians' health, secure jobs and set the economy to bounce back"* from the crisis.

Date	Description
13-Mar	A U.S. national emergency is declared over the novel COVID-19 outbreak.
14-Mar	Spain imposes a nationwide lockdown for at least 15 days.
16-Mar	New York City Mayor Bill de Blasio orders the city's bars, theatres and cinemas to close, as the number of cases continues to rise in the U.S. European Union bans all non-essential travel in the region for at least 30 days. U.S. Federal Reserve drops the benchmark interest rates by a further 0.50% in the same month, leading to a near zero rate setting.
17-Mar	Bank of Japan doubles equity purchases and raises targets for corporate bond and commercial paper holdings. U.K. unveils a significant stimulus package, which includes US$379b in business loan guarantees and US$23b in business tax cuts. France announces a US$49b stimulus package, entailing social security tax cuts, unemployment benefits and a fund to help shopkeepers and the unemployed.
18-Mar	Scott Morrison declares for the first time ever a *"human biosecurity emergency"* in the country.
19-Mar	Nearly all U.S. states declare a state of emergency. Italy overtakes China as the country with the most coronavirus-related deaths, registering 3,405. Reserve Bank of Australia drops interest rates to 0.25%, the second decrease for the month. Bank of England cuts interest rates drastically from 0.25% to 0.10%, returning borrowing costs to their lowest level in history.
20-Mar	The U.K. announces more fiscal measures. The most significant being grants covering up to 80% of worker's salaries if companies keep them on the payroll.
22-Mar	Prime Minister Scott Morrison announces a second stimulus package of $66b. This includes several new measures, including doubling income support for individuals on Jobseeker allowance, granting $100,000 to small and medium-sized businesses and $715m to Australian airports and airlines.
23-Mar	U.K. enters stage 3 coronavirus lockdown, with all non-essential businesses shut, schools closed, and gatherings of two or more people banned. Australia enters stage 2 restrictions, with social distancing of 1.5m required and a range of non-essential businesses to close, such as gyms and cinemas.
25-Mar	New Zealand enters a level 4 four-week lockdown, with all businesses closed except for essential services and lifeline utilities. U.S. Senate strikes US$2t deal on the coronavirus stimulus, representing 10% of GDP. The deal includes US$500b government lending, US$367b in small business loans, US$250b to expand unemployment insurance and US$301b in direct cash payments. Germany authorises funding of US$610b to virus-hit companies with loans and guarantees, as well as equity stakes in stricken businesses. Further, a promised US$172b of increased spending was announced.
27-Mar	Prime Minister Scott Morrison announces all travelers arriving in Australia will be required to undertake a mandatory 14-days of self-isolation at designated facilities, such as hotels.
29-Mar	Australian National Cabinet agreed to limit both indoor and outdoor gatherings to two persons. Further restrictions on activities and venues, such as parks, were also discussed.
30-Mar	The Morrison Government announces a historic employer wage subsidy for around 6m workers, in the form of a flat pretax payment of $1,500 per fortnight. The named, 'JobKeeper' payment aims to keep Australians employed during the coronavirus imposed shutdown.

Source: SFML Research

INFINITY AND BEYOND

Table 6: COVID-19 Fiscal Stimulus Response by Country

Country	Stimulus	Stimulus inc Loans & Guarantees	Total Stimulus % of GDP	Key Benefits
Germany	€156b	€756b	20.5%	• Stabilisation fund worth €600b for loans to struggling businesses and direct stakes in companies. • Assistance to small businesses and the self-employed threatened with bankruptcy, with direct payments of up to €15,000.
U.K.	£110b	£440b	16.6%	• Grants covering up to 80% of worker's salaries if companies keep them on their payrolls. • Bailout fund worth £330b to provide business loan guarantees.
Australia	A$214b	A$319b	16.4%	• Wage subsidy to around 6m workers, with flat payment of $1,500 per fortnight through their employer. • Expanding eligibility and increasing payments for income support. • Cash payments equal to payroll withholding tax for small businesses.
Spain	€100b	€200b	15.6%	• Support for workers temporarily laid off and suspension of mortgage payments. • €100m of guaranteed liquidity for Spanish businesses.
U.S.	US$1,350b	US$2,200b	9.8%	• $US500b in loans to help harder hit industries. • Direct cash payments, totalling US$1,200 for those earning up to US$75,000 and US$500 per child. • Federally guaranteed small business loans.

Source: SFML Research, The World Bank

The current economic climate is one like no other. Here, all bets are off, as governments across the globe implement fiscal stimulus and monetary policy measures going deep and wide.

Table 6 provides an overview of the grants, loans, subsidies and tax cuts currently being promised by governments at an unprecedented scale. The figures being thrown around are extraordinary to say the least.

By way of example, the U.S. Treasury contributed US$700b, under the Troubled Asset Relief Program to essentially save the country's financial system during the Global Financial Crisis. Fast forward 12 years and this has now been surpassed three-fold, as the U.S. Government undertakes a US$2.2t relief package to aid the country in overcoming the COVID-19 impacts.

Some interesting methods have been introduced by countries to support businesses, individuals and communities. Germany, which is Europe's largest economy, has set up a €600b Economic Stabilisation Fund, providing loan guarantees and funding for struggling companies, with the objective to protect firms from insolvency as well as unwanted takeovers. Germany's total fiscal stimulus represents approximately 20% of the country's GDP.

Time will tell whether these significant measures are appropriate. What is clear though, is the preparedness of all governments to go to *"infinity and beyond"* to stem the economic impacts of lockdowns and restrictions, as a result of COVID-19. ***SFM***

THE FED LISTENS

Central banks have long influenced the direction of financial markets and the business cycle. Primarily concerned with economic stability, unemployment and inflation, central banks have traditionally regulated growth by adjusting interest rates by influencing the availability of credit.

With interest rates now close to zero, central banks are left without their principal lever over the business cycle. Thus, when external shocks like COVID-19 present, central bank actions are reduced in their ability to stimulate economic activity.

The eurozone economy is all but stalling, but the European Central Bank, having cut rates below zero, can't do much more. The central bank said it would spend €750b buying government debt and private securities before the end of 2020. This is a process known as quantitative easing, which aims to provide liquidity in the financial system when many investors are rushing out.

Since 2008, Japan has had three recessions while the Bank of Japan, having set rates around zero, largely confined to the side lines.

The U.S. might not be far behind. *"We are one recession away from joining Europe and Japan in the monetary black hole of zero rates and no prospect of escape,"* said Harvard University economist Larry Summers. The Fed typically cuts short-term interest rates by 5% in a recession, he said, yet that is impossible now with rates at 0%-0.25%.

Workers, companies, investors and politicians might need to prepare for a world where the business cycle rises and falls largely without the influence of central banks.

The Role of Central Banks

In determining monetary policy, the Reserve Bank of Australia (RBA), Australia's central bank, has a duty to *"contribute to the stability of the currency, full employment, and the economic prosperity and welfare of the Australian people. To achieve these statutory objectives, the Bank has an 'inflation target' and seeks to keep consumer price inflation in the economy to 2–3 percent, on average, over the medium term. Controlling inflation preserves the value of money and encourages strong and sustainable growth in the economy over the longer term."*

This echoes the U.S. Federal Reserve (Fed), *"Monetary policy in the United States comprises the Federal Reserve's actions and communications to promote maximum employment, stable prices, and moderate long-term interest rates--the three economic goals the Congress has instructed the Federal Reserve to pursue."*

Central Banks in Operation

Central banks implement monetary policy by controlling short-term interest rates and influencing the availability and cost of credit in the economy. In Australia, each domestic bank has a settlement account with the RBA.

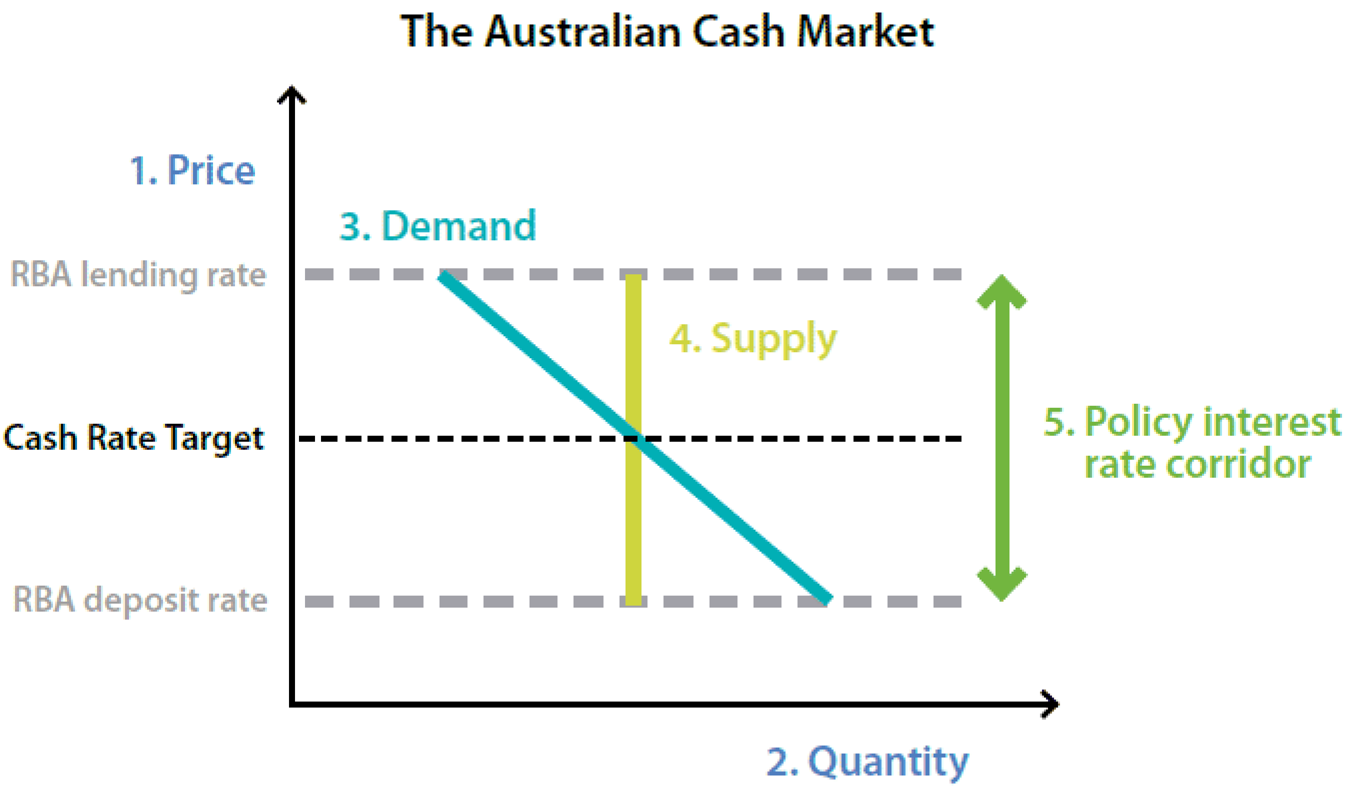
After a cash rate target has been determined (currently at a historic low of 0.25%), the RBA adjusts the interest rates available in these settlement accounts. The interest paid on balances held by the RBA is at a lower rate than the target cash rate (0.25% below).

The RBA also charges interest on borrowings at a higher rate than the target cash rate (0.25% above). This incentivises banks to hold as little as possible with the RBA and instead borrow or lend their balances to other banks at a more attractive rate.

To control the supply of money available in the overnight cash market, the RBA can also purchase or sell bonds and repurchase agreements (repos), a process referred to as open market operations.

Repos, the more frequently used instrument, consist of two separate transactions; the RBA buys or sells a bond with a predetermined reversal. For example, the RBA could lend funds to a bank in exchange for a bond, in order to cover a shortfall in their settlement account. At a pre-determined time, the bond is then returned to the bank and the funds are repaid to the RBA.

Graph 3: The Australian Cash Market



Source: Reserve Bank of Australia

As a result, the supply of money available within the exchange account decreases. More generally, by issuing bonds the RBA are essentially removing funds from exchange accounts and reducing the amount of money in circulation.

By nature of supply and demand economics, the RBA controls the overnight lending rate and money supply between banks to maintain the target cash rate, as shown in Graph 3. The cash rate is an important determinant of the savings and lending interest rates banks can offer their clients. This has flow on implications for household spending, business investment, production, employment, and inflation.

In the latter part of the Great Depression, World War II, the post-war expansion, and throughout the Global Financial Crisis, central banks used monetary policy and government spending (fiscal policy)[2] to counteract excessive economic contraction or growth beyond sustainable levels.

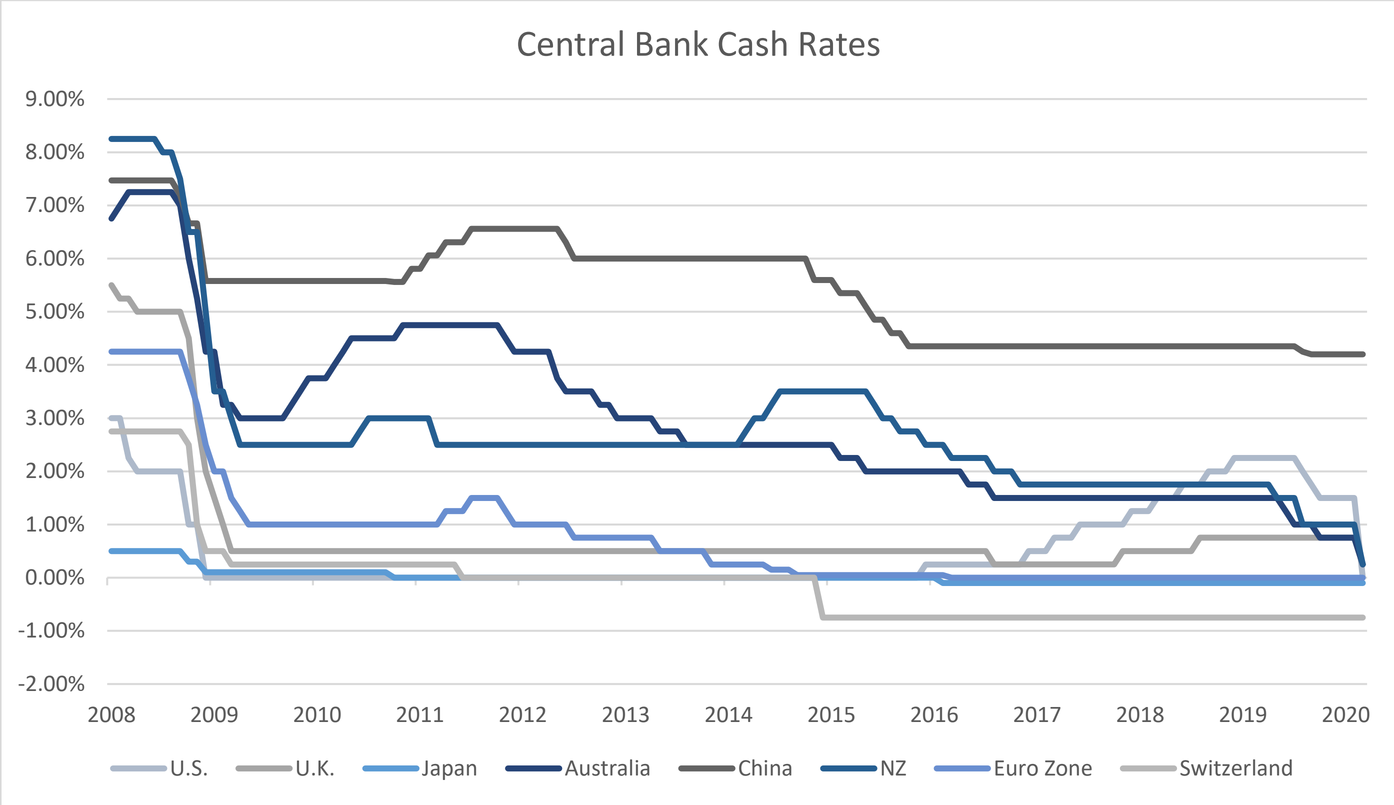
If an economy begins to grow at a rapid pace, central banks can lift interest rates to slow down economic activity. This makes borrowed money more expensive to obtain, which discourages investment and encourages savings. Conversely, when the level of growth within an economy starts to decline, central banks can encourage growth by reducing interest rates, as observed in many major economies recently.

Taking this a step further, growth is an important determinant of whether people can find suitable work. As an economy expands, production and the labour required to meet demand simultaneously increase.

Prices are subsequently impacted by these changes to demand, which has a flow-on effect on prices (inflation). While extreme levels of inflation are unsustainable, small increases in prices help manage economic activity, as people are discouraged from delaying purchases too far into the future.

[2] Most developed nations have separated the roles and responsibilities of their central banks and government. This means that the central bank should be unable to exert any control over fiscal policy in the same way that the government should be unable to control monetary policy.

Graph 4: Central Bank Cash Rates



Source: Compiled using data from Global-Rates.com

However, with interest rates for many advanced economies at their current low levels, as shown in Graph 4, monetary policy has become less effective in managing the business cycle.

RBA governor Phillip Lowe explained, *"monetary policy has become less effective at the margin… once upon a time, when we lowered interest rates, people would run off to the bank to borrow to go on a holiday or buy furniture or kind of do some spending, they don't do that anymore."* The inability to manage the economic cycle through changes to the cash rate is leading central banks around the world to reconsider the future role of monetary policy.

The Fed Listens

Despite President Donald Trump's open disdain for the Fed's resistance to aggressively dropping rates, the Reserve has been taking a fairly considered approach to rate moves. In November, Fed Chairman Jerome Powell warned Congress that *"the new normal now is lower interest rates, lower inflation, probably lower growth…all over the world."* As a result, he said, the Fed is studying ways to alter its strategy and develop tools that can work when interest rates approach zero.

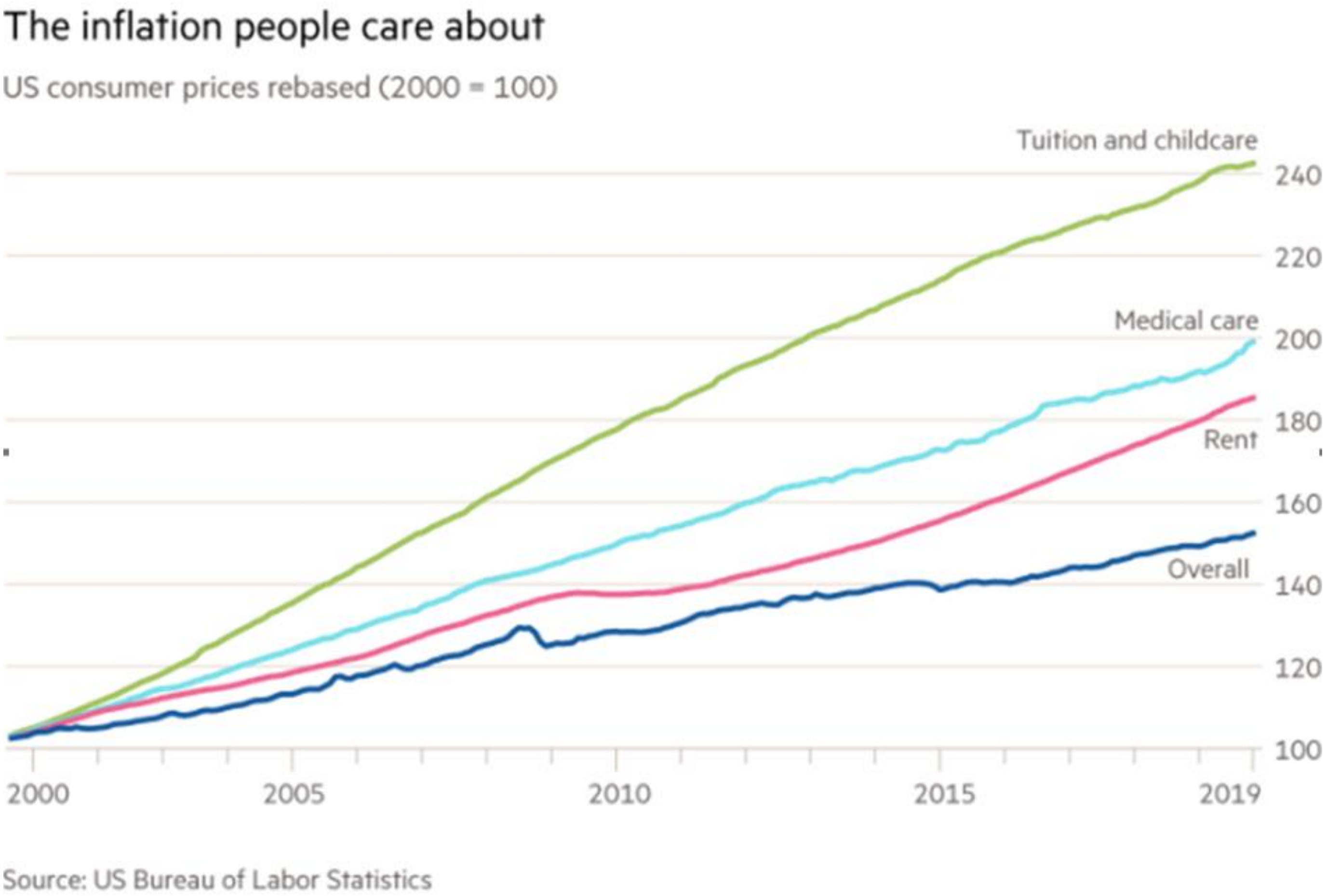
In the middle of the year, the Fed will release the results of an 18-month review of how it approaches and discusses monetary policy. As part of this review, 14 *"Fed Listens"* events were organised, with representatives presenting their perspective on the effects of interest rates on their communities. Prominent members of the Fed attended these events, including Powell who appeared at several.

Central banks consider an array of economic data to try and forecast the implications of changes to monetary policy. Unemployment rates and inflation play heavily in determining whether changes in interest rates are appropriate.

As the Fed has discovered, however, while economic indicators have their place, they cannot paint a complete picture of what is happening at the ground level.

The *"Fed Listens"* events have allowed the Reserve to peek behind the curtain, with two clear messages coming through. Firstly, despite the official level of unemployment declining across the country, there are more people available to come into the workforce, particularly in poorer areas. Secondly, targeting low overall inflation is not nearly as important to most

Graph 5: Inflation People Care About



Source: Australian Financial Review (This is what happens when the Fed Listens to Main Street USA, 15/01/2020)

Americans as is controlling the increasing costs of housing, schooling and medical care.

As shown in Graph 5, these costs have increased faster than the general inflation index. Prior to the significant cuts in response to COVID-19, these two messages are believed to have been influential in the Fed's decisions to cut the cash rate.

Summary

As central banks continue to grapple with the implications of the current low interest rate environment and its impact on monetary policy settings, we remain focused on the businesses navigating this complicated market. While not immune to the actions of government authorities, companies with competent management teams, strong balance sheets and a focus on capital management are better placed to deliver sustainable growth. ***SFM***

ALL ROADS LEAD TO…HOME

The phrase, *'All roads lead to Rome'* refers to the road system of the Roman Empire, with Rome positioned in the centre and every road leading to it. While China isn't Rome, it wouldn't be out of place to say that in modern times a large chuck of the world's manufacturing capacity has been centred in this country. Many point to the period post 1990 as China's entry onto the world stage. The combination of western industrial know-how and Asian manufacturing muscle has fuelled the globalisation of supply chains.

The Organisation for Economic Co-operation and Development (OECD) notes that some 70% of global trade now involves global value chains (GVCs). GVCs are described as the mechanism by which raw materials, parts and components are exchanged across multiple national boundaries before being assembled into finished goods.

The rise of GVCs can be linked to several thematic trends that took hold as world trade surged. The two principles, just-in-time inventory and lean production illustrate how multinational corporations (MNCs) have needed to adapt and respond to global competition and changing consumer demands.

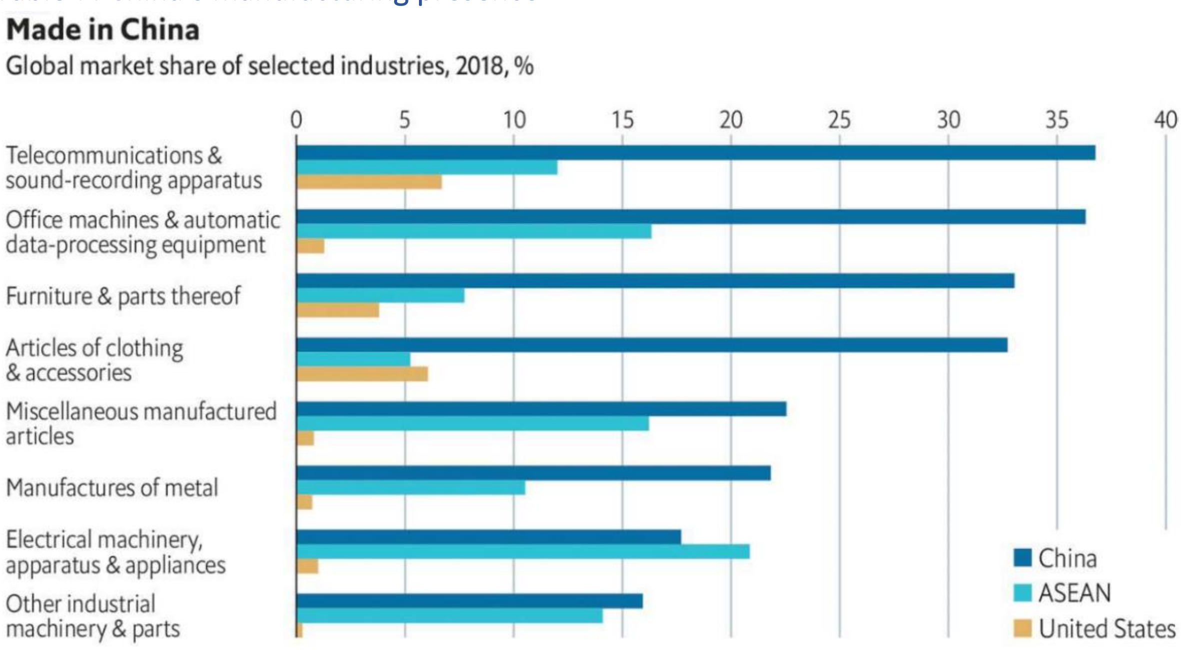
To sustain *'everyday low prices'*, MNCs have increasingly shifted manufacturing operations offshore. Stretched home based supply chains gave way to territories offering cheap labour and manufacturing scale with all roads leading to China, bountiful in both labour and scale. The question now being posed is whether MNCs, in their pursuit of globalisation, have gone too far.

Having hooked their train to China, MNCs appear to have left themselves seemingly exposed to the same risks they sought to avoid, that of rising costs and supply disruption.

In a world that is more demanding of privacy protection and environmental issues, the notion that *'cheap'* will win out is no longer a given. Soaring wages in developing nations and a concerted effort by specific nations to push for in-country manufacturing, most notably the U.S., is now posing a direct hit to current trade flow arrangements.

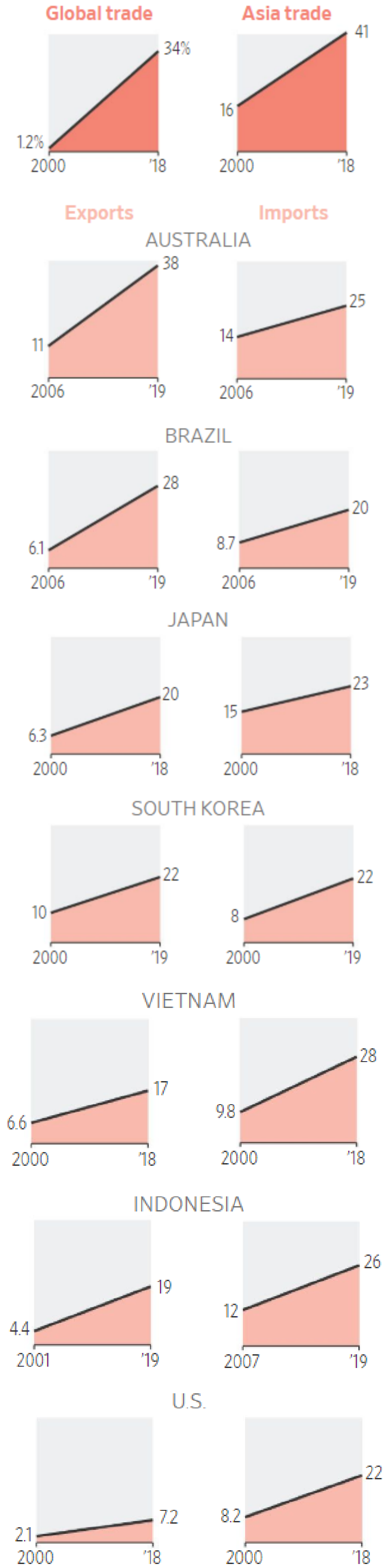
Enter the *'trade wars'*. The imposition of tariffs by the U.S. President Donald Trump and renegotiations of existing free-trade agreements is disrupting long-standing supply chains in various regions, including North America and Asia. Table 7 illustrates China's manufacturing role in a number of industries, while Figure 3 highlights China's trading position on a global basis and with respective countries.

Table 7: China's manufacturing presence



Source: The Economist

Figure 3: China's position in global trade



Source: World Bank

In its July 2019 edition, The Economist wrote, *"China's role as the world's workshop is starting to fade, but surprisingly this may not sound the death knell for mainland manufacturing. Thanks to its skilled labour force and excellent infrastructure, China remains an outstanding place to make things, hence its continued strength in numerous sectors. Also, the rise of the Chinese middle class has led many firms to redirect production to serve the local market."*

However, a 2019 survey that was conducted among 600 MNCs around Asia found that *"nearly half of them are considering major changes to their supply chains, and over a tenth a complete overhaul. In many sectors this will mean a rethink of the role that China plays in sourcing."*

The trade war between the U.S. and China exposed the frailties that exist between the two largest economic powers. Caught in the middle are the MNCs that are having to deal with government interference, whilst keeping pace with advancing innovations and evolving consumer preferences.

A temporary truce in trade tensions took effect during January 2020, when the U.S. entered into a signed phase-one agreement with China, which at its heart aimed to reduce the trade imbalance between the two regions.

Average U.S. tariffs on imports from China currently sit at 21%, a marked increase from the 3% level before the trade war began in 2018. Under the new brokered phase-one deal between the U.S. and China, tariffs remain elevated but will reduce to 19.3%, underlining Trump's determination to hold the line.

Unfortunately, the market's cheery response to a trade truce has been short lived. The outbreak of COVID-19, in reference to the coronavirus that was first reported in December 2019 in the city of Wuhan, China, has underscored how exposed and interlinked the MNCs are to global events. In this instance, the outbreak of a highly contagious respiratory virus, now been declared as a pandemic, has resulted in extraordinary actions to contain its spread. Government response has included shutting down cities, with manufacturing on hold and restricted travel in and out of affected regions.

The long-lasting consequences of these astonishing responses is to pile further pressure on MNCs to reconsider the current status. A trade war is one thing, but a total derailment of trade flow is quite another.

"America will never be a supplicant nation. We will be a proud, prosperous, independent, and self-reliant nation. We will embrace commerce with all, but we will be dependent on none."

Donald Trump
U.S. President

"We need to have smart sovereignty. We can't be completely independent of global supply chains. But 90 per cent dependence on imported fuels and imported medicines is not acceptable in the world we live in today."

John Blackburn
Chairman Australian Institute for Integrated Economic Research

The economic and social shock of the pandemic, *"has done more to close borders, reverse globalisation, decouple supply chains and marginalise multinational institutions than the most fervent efforts of the world's populist nationalists."*

Allan Gyngell,
President, Australian Institute of International Affairs

When global iPhone manufacturer Apple updated investors during February, they warned quarterly revenue guidance was unlikely to be met.

Of the production facilities operated by Apple's top 200 suppliers, more than 80% were in China, with just 15% in the U.S.

Apple is among the growing number of corporations in this predicament, with The Economist reporting, *"More than half of the world's mobile phones are made in China, along with almost all of the printed circuit boards, the guts of any device. Chinese factories install two-fifths of the world's semiconductors."*

It's reflective of a much bigger problem; the world's overreliance on China's manufacturing infrastructure and the vulnerability of those companies who long depend on them as a supplier.

While the trade wars can be contained, COVID-19 has exposed MNCs to the failure of not taking seriously the risk of disruption. It is perhaps too early for clear heads and a rational response to this shortcoming but in the fullness of time the threat of future supply disruption can no longer be shuffled to one side.

A case in point is the automotive industry. According to Ford's supply-chain Executive Hau Thai-Tang, as reported in The Economist in July 2019, *"He sees a trend towards greater rationalisation coming with three hub-and-spoke networks: Mexico as the low cost spoke for America; Eastern Europe and Morocco for Western Europe; and South-East Asia and China for Asia."*

What works for one industry, however, doesn't necessarily carry across to others. The electronics segment, for example, is dominated by China. In fact, half of the world's electronics-manufacturing capacity is based on the Chinese mainland. Scale, diversity and sophistication of product places the region in a unique position but that was before Huawei and now COVID-19. Both events, one addressing security risk and the other supply chain disruption, are too big for company boards and executives to ignore.

While leaving China may be technically difficult for many, due to the supply chain linkages, countries including the U.S., Mexico, parts of Europe and Asia are very much open for business. In some respects, while the U.S.-China trade war indirectly opened the discussion around board tables of where too next, COVID-19 will in all probability accelerate a necessary response.

In the U.S., some have questioned Trump's economic reform policies. He is pro U.S. jobs, local manufacturing, and has backed this up with tax reform and the resetting of international trade agreements. Quite ironically, the outbreak of COVID-19 has given Trump the upper hand and given businesses even greater reason to slowly disengage from China.

The traditional approach for building supply chain resilience assumed that the threat would originate from a natural disaster, forcing capacity offline for a while. Virus and cyber security issues are now forcing a total rethink, which will undoubtedly lead to some uncomfortable outcomes.

Most notably, the importance of GVCs will be elevated within company organisations. Manufacturing supply risk will force alternative arrangements and whether we like it or not, a more robust and safer supply chain will come at a cost. Providing alternative supply backup is certainly one aspect, but businesses also need to elevate the importance of holding greater stock as inventory.

Higher levels of working capital will result, along with less reliance on sub-contractors. In short, the importance of supply will be a core competency that can no longer be decided on cost alone.

As this transformational mix shift begins, manufacturing regions that have lost out to China in recent decades are likely to benefit. Safe to say that the likes of Vietnam, Korea, Mexico, India, the U.S. and parts of Europe will be under active consideration.

In some ways, COVID-19 was the wake-up call that the industry required. For consumers, it is hard not to imagine prices going up for many items. If we expect companies to take greater control of supply, increases are inevitable.

All in all, what began as the trade war and continued with COVID-19 is reflective of a world adjusting to rapid change and uncertainty. Boards have a lot on their plate, covering all matter of issues, stretching from environmental, social and governance (ESG) matters, to cyber security risks, climate considerations and now supply chain disruptions.

This next period will test many firms and countries alike but, in the end, management teams will be forced to take ownership on all these matters. To do otherwise will leave many businesses stranded. ***SFM***

PUBLICATIONS OF INTEREST

During the past couple of months, we as a firm have endeavoured to stay informed amid the everchanging global epidemic, known as COVID-19. Some recent articles have caught our interest and resonate well with us. For those interested, these include:

- Stevenson, R., 2020. *Michael Burry Of 'The Big Short' Slams Virus Lockdowns In Tweetstorm*. [online] Bloomberg.com. Available at: https://www.bloomberg.com/news/articles/2020-04-07/michael-burry-slams-virus-lockdowns-in-controversial-tweetstorm

- Australian Financial Review. 2020. *COVID-19's Intergenerational Wealth Transfer*. [online] Available at: https://www.afr.com/policy/economy/low-interest-rates-forever-will-be-the-legacy-of-this-virus-20200406-p54he6.

- Gottliebsen, R., 2020. *Coronavirus: Morgan Stanley Sees COVID-19 Bear Market As Part Of Longer-Term Bull Run*. [online] Theaustralian.com.au. Available at: https://www.theaustralian.com.au/business/markets/coronavirus-morgan-stanley-sees-covid19-bear-market-as-part-of-longerterm-bull-run/news-story/b02209b87735572b94ea09e8fba425bf.

COMPANY VISIT DIARY – MARCH 2020 QUARTER

Date	Company	Description
13-Feb	ASX	ASX HY20 Results Conference Call
13-Feb	BRG	Breville HY20 Results Conference Call
13-Feb	CAR	Carsales.com SFML Management Meeting
13-Feb	CAR	Carsales.com Macquarie Management Meeting
13-Feb	CSL	CSL UBS Management Meeting
13-Feb	BRG	Breville UBS Management Meeting
13-Feb	BRG	Breville Macquarie Management Meeting
14-Feb	MP1	Megaport UBS Management Meeting
14-Feb	CAR	Carsales.com GS Management Meeting
14-Feb	MP1	Megaport GS Management Meeting
17-Feb	CSL	CSL UBS Management Meeting
17-Feb	ALU	Altium HY20 Results Conference Call
18-Feb	SGM	Sims Metal Management HY20 Results Conference Call
18-Feb	NWL	Netwealth Group HY20 Results Conference Call
18-Feb	COH	Cochlear HY20 Results Conference Call
18-Feb	IFL	IOOF Holdings HY20 Results Conference Call
18-Feb	ALU	Altium UBS Management Meeting
18-Feb	NWL	Netwealth Group UBS Management Meeting
18-Feb	ALU	Altium SFML Management Meeting
19-Feb	IFL	IOOF Holdings SFML Management Meeting
19-Feb	NEA	Nearmap HY20 Results Conference Call
19-Feb	SHL	Sonic Healthcare HY20 Results Conference Call
19-Feb	DMP	Domino's Pizza Enterprises HY20 Results Conference Call
19-Feb	COH	Cochlear results Management Meeting
19-Feb	DMP	Domino's Pizza Enterprises MS Management Meeting
19-Feb	SGM	Sims Metal Management BAML Management Meeting
19-Feb	SOM	SomnoMed Taylor Collison Management Meeting
19-Feb	COH	Cochlear SFML Management Meeting
19-Feb	NEA	Nearmap Investor Management Meeting
20-Feb	SGM	Sims Metal Management SFML Management Meeting
20-Feb	IRE	IRESS FY19 Results Conference Call
20-Feb	TRO	Tyro Payments HY20 Results Conference Call
20-Feb	SGR	The Star Entertainment Group HY20 Results Conference Call
20-Feb	ALL	Aristocrat Leisure Annual General Meeting
20-Feb	DMP	Domino's Pizza Enterprises SFML Management Meeting
20-Feb	NEA	Nearmap SFML Management Meeting
20-Feb	DMP	Domino's Pizza Enterprises UBS Management Meeting
21-Feb	SGR	The Star Entertainment Group UBS Management Meeting
21-Feb	IRE	IRESS SFML Management Meeting
21-Feb	SGR	The Star Entertainment Group SFML Management Meeting
21-Feb	BVS	Bravura Solution UBS Management Meeting

Date	Company	Description
21-Feb	DTL	Data#3 UBS Management Meeting
24-Feb	RWC	Reliance Worldwide HY20 Results Conference Call
24-Feb	AD8	Audinate HY20 Results Conference Call
24-Feb	NHF	NIB Holdings HY20 Results Conference Call
24-Feb	JIN	Jumbo Interactive HY20 Results Conference Call
25-Feb	AD8	Audinate UBS Management Meeting
25-Feb	BKL	Blackmores HY20 Results Conference Call
25-Feb	SEK	SEEK HY20 Results Conference Call
25-Feb	APX	Appen HY20 Results Conference Call
25-Feb	OSH	Oil Search FY19 Results Conference Call
25-Feb	TNE	TechnologyOne Annual General Meeting
25-Feb	JIN	Jumbo Interactive SFML Management Meeting
25-Feb	BKL	Blackmores SFML Management Meeting
26-Feb	RWC	Reliance Worldwide SFML Management Meeting
26-Feb	BUB	Bubs Australia HY20 Results Conference Call
26-Feb	PNV	PolyNovo HY20 Results Conference Call
26-Feb	NAN	Nanosonics HY20 Results Conference Call
26-Feb	RWC	Reliance Worldwide Macquarie Management Meeting
26-Feb	SEK	SEEK UBS Management Meeting
26-Feb	NAN	Nanosonics UBS Management Meeting
26-Feb	SEK	SEEK SFML Management Meeting
26-Feb	FCL	FINEOS HY20 Results Conference Call
27-Feb	FLT	Flight Centre Travel Group HY20 Results Conference Call
27-Feb	IFM	Infomedia HY20 Results Conference Call
27-Feb	IFM	Infomedia UBS Management Meeting
27-Feb	FLT	Flight Centre Travel Group UBS Management Meeting
27-Feb	NAN	Nanosonics SFML Management Meeting
28-Feb	RWC	Reliance Worldwide Macquarie Management Meeting
28-Feb	TLX	Telix Pharmaceuticals Taylor Collison Management Meeting
28-Feb	REH	Reece HY20 Results Conference Call
28-Feb	FLT	Flight Centre Travel Group SFML Management Meeting
28-Feb	CSL	CSL SFML Call with CFO and IR
28-Feb	REH	Reece SFML Call with CFO
2-Mar	IFM	Infomedia SFML Management Meeting
2-Mar	PWH	PWR Holdings HY20 Results Conference Call
2-Mar	OSH	Oil Search SFML Management Meeting
2-Mar	FCL	FINEOS Macquarie Management Meeting
2-Mar	A2M	The A2 Milk Company GS Management Meeting
2-Mar	NHF	NIB Holdings SFML Management Meeting
2-Mar	FCL	FINEOS SFML Management Meeting
3-Mar	DMP	Domino's Pizza Enterprises GS Management Meeting
3-Mar	APX	Appen UBS Management Meeting
3-Mar	PWH	PWR Holdings UBS Management Meeting
4-Mar	PNV	PolyNovo SFML Management Meeting

Date	Company	Description
5-Mar	FCL	FINEOS SFML Management Meeting
6-Mar	FCL	FINEOS GS Management Meeting
9-Mar	AMX	Aerometrex Morgans Management Meeting
11-Mar	CPU	Computershare Revised Earnings Guidance Conference Call
16-Mar	MP1	Megaport SFML Meeting with Investor Relations
16-Mar	COH	Cochlear Guidance update Conference Call
16-Mar	COH	Cochlear SFML Call with Management
17-Mar	COH	Cochlear Update call on US Patent court case
17-Mar	SGR	The Star Entertainment Group SFML COVID-19 update with Management
17-Mar	JOBS.NASDAQ	51job FY19 Results Conference Call
18-Mar	OFX	OFX Group SFML COVID-19 update with Management
18-Mar	JIN	Jumbo Interactive SFML COVID-19 update with Management
18-Mar	SEK	SEEK SFML COVID-19 update with Management
18-Mar	CAR	Carsales.com SFML COVID-19 update with Management
19-Mar	DMP	Domino's Pizza Enterprises SFML COVID-19 update with Management
19-Mar	ALU	Altium SFML COVID-19 update with Management
19-Mar	IFL	IOOF Holdings SFML COVID-19 update with Management
19-Mar	CAR	Carsales.com SFML Call with Management
19-Mar	BKL	Blackmores SFML COVID-19 update with Management
19-Mar	CSL	CSL SFML COVID-19 update with Investor Relations
20-Mar	CPU	Computershare SFML COVID-19 update with Investor Relations
20-Mar	NHF	NIB Holdings SFML COVID-19 update with Investor Relations
24-Mar	IRE	IRESS SFML COVID-19 update with Management
24-Mar	ALL	Aristocrat Leisure SFML COVID-19 update with Investor Relations
25-Mar	COH	Cochlear Capital Raising Conference Call
25-Mar	IRE	IRESS UBS Conference Call with Management
25-Mar	SGR	The Star Entertainment Group SFML COVID-19 update with Investor Relations
26-Mar	IFM	Infomedia SFML COVID-19 update with Management
26-Mar	NXT	NEXTDC UBS Conference Call with Management
26-Mar	NEA	Nearmap SFML COVID-19 update with Investor Relations
27-Mar	IEL	IDP Education SFML COVID-19 update with Management
27-Mar	CLV	Clover UBS Conference Call with Management
27-Mar	NHF	NIB Holdings SFML COVID-19 update with Management
30-Mar	NHF	NIB Holdings COVID-19 Investor Update Call
30-Mar	MP1	Megaport Morgans Conference Call with Management
30-Mar	RWC	Reliance Worldwide SFML COVID-19 update with Investor Relations
31-Mar	BRG	Breville UBS Conference Call with Management

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