



## Quarterly Report September 2020

The objective of the Fund is to provide consistent capital growth and a growing level of income over the medium term (3 - 5 years) by investing in securities listed on the Australian Securities Exchange.

Quarter Net Return (Retail)	1 - Year Net Return (Retail)		Inception p.a. Net Return (Retail)		Total Fund Size	
<b>3.5%</b>	<b>-5.9%</b>		<b>6.3%</b>		<b>\$8.2m</b>	
	1 month	3 months	1-year	3-years*	5-years*	Inception*
<b>Retail (AUD Portfolio Return)</b>	-2.8%	3.5%	-5.9%	7.2%	6.1%	6.3%
<b>Wholesale (AUD Portfolio Return)</b>	-2.7%	3.5%	-5.7%	7.4%	6.2%	4.8%

Inception: Retail Units: 28 August 2006; Wholesale Units: 15 April 2011.

\*Performance figures for more than 1 year are annualised, calculated after all applicable fees and taxes. Performance figures compare unit price to unit price for the given period. The returns exclude the impact of imputation.

### Top 5 Holdings (Alphabetical)

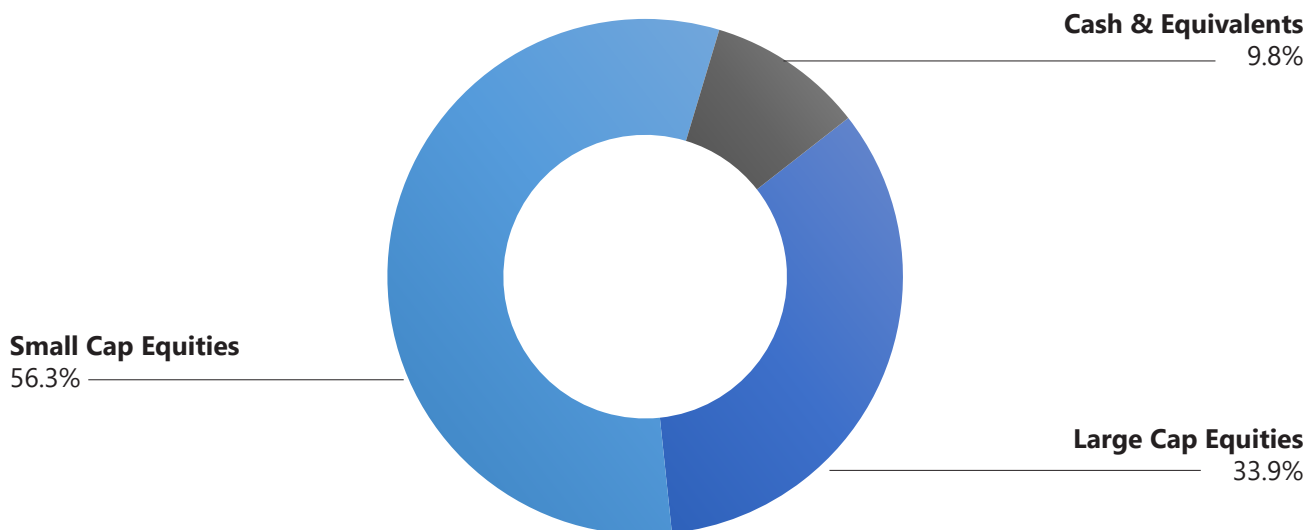
Company	ASX Code
<b>BHP Group</b>	BHP
<b>CSL</b>	CSL
<b>Hansen Technologies</b>	HSN
<b>Jumbo Interactive</b>	JIN
<b>Mach7 Technologies</b>	M7T

### Fund Facts

<b>Portfolio Managers</b>	Adrian Ezquerro, Ronni Chalmers, Jonathan Wilson & Vincent Cook
<b>Fund Inception</b>	August 2006
<b>Fund Size</b>	\$8.2m
<b>Cash Distributions</b>	Semi-annually
<b>Eligibility</b>	Wholesale & Retail



## Asset Allocation



## Asset Allocation by Sector

Industry	Weighting
Information Technology	20.6%
Health Care	15.3%
Financials	13.5%
Consumer Discretionary	12.4%
Materials	9.6%
Industrials	8.2%
Communication Services	4.5%
Real Estate	4.2%
Consumer Staples	1.9%
Cash & Equivalents	9.8%



## Portfolio Commentary

The portfolio returned -2.8% in the month of September, compared to a -3.7% return for the S&P/ASX200 Accumulation Index. For the quarter, the portfolio delivered a return of 3.5%, compared to a -0.4% return for the S&P/ASX200 Accumulation Index. The ongoing theme of volatility continued during the quarter, with a strong August month giving way to a particularly weak month of returns in September.

Weak monthly returns domestically were largely mirrored offshore, with the S&P 500 returning -3.9% for the month. Specific to the ASX, Consumer services (+0.8%) and Healthcare (+0.4%) were the only sectors to deliver positive returns for the month, while Energy (-10.7%), Consumer Staples (-6.6%) and Technology (-6.4%) were the key detractors.

Key contributors and detractors to the portfolio return for the September quarter were:

- **Australian Equity Large Cap Sub-Portfolio:** Key contributors included Goodman Group (GMG), Sonic Healthcare (SHL) and Fortescue Metals Group (FMG), key detractor a2 Milk (A2M).
- **Australian Equity Small Cap Sub-Portfolio:** Key contributors included Hansen Technologies (HSN), Jumbo Interactive (JIN), Mach7 Technologies (M7T) and Navigator Global Investments (NGI), key detractor Bravura Solutions (BVS).

We explore many of these positions, while also introducing new positions, in the commentary to follow.

### Large Cap Sub-Portfolio

**Goodman Group (GMG)** delivered a strong return for the quarter after reporting 9.8% funds from operations growth for the financial year. Positively, this was in line with expectations prior to the advent of Covid-19. Further, guidance was provided for earnings per share growth of 9.0% in the 2021 financial year.

Distributions per share are to be maintained at \$0.30, given a step up in development and co-investment activity. This investment is a positive reflection of growing demand and future earnings growth for the business. GMG is a globally diversified business that is leveraged to the growth of e-commerce, which is a strong long-term thematic that has only been strengthened by the Covid-19 pandemic.

**Sonic Healthcare (SHL)** contributed positively to quarterly returns and delivered a solid 2020 financial year result, with earnings per share 4% ahead of consensus. Earnings were in fact down 4% on the prior year, given the significant impact of Covid related disruptions to normal testing activity, offset by the provision of lower margin Covid testing, cost reductions and a seven months contribution from the Aurora acquisition. Cash generation was characteristically strong, and the final dividend was maintained at \$0.51 per share, marking 28 years that this company has either increased or maintained its dividend.

Looking forward to the 2021 financial year, normal testing activity has resumed in most geographies, although lagging in the US. Positively for SHL, significant Covid testing is also ongoing, positioning the business for a strong year overall. Management indicated that July and August revenue growth has been "substantially higher than historic growth rates". 2021 consensus earnings expectations have been upgraded by 8% post the result and now sit above the pre-pandemic estimate.

**A2 Milk Company (A2M)** detracted during the quarter, after announcing a disruption to the corporate daigou sales channel following the renewed lockdown in Victoria. The stock price performance was also adversely impacted by insider selling following the result and prior to the negative trading update. While the timing of this selling and the trading update are unfortunate, indications are that demand for A2 infant formula in China remains very strong and sales channels are likely to be largely restored over time. There is significant further opportunity for market share growth in China over the medium and long term.

In the 2020 financial year, the company reported revenue growth of 33% to NZ\$1.7 billion and net profit growth of 34%. This makes A2M a stand out in the ASX100 in terms of the rate of growth for a large company. During the quarter, the group entered exclusive due diligence to acquire Matura Valley Milk, which will expand production capacity for infant formula. This is a reflection of the expectation for strong growth over the medium term.



**Magellan Financial Group (MFG)** was a new addition to the portfolio during the quarter. This followed a 14% retracement in the stock price as a result of a modest pull back in domestic and global equities. Often the best time to buy funds management businesses is when there is a period of negative market sentiment like this. Positively, in Australian dollar terms the global equities market was actually relatively unchanged over this period as the US dollar appreciated against our local currency by 3% in the month of September.

Importantly, from an operational perspective Magellan is tracking very well. Despite the size of the business, now at over \$100 billion dollars in funds under management, Magellan continues to grow strongly through consistent inflows. Over the past six months MFG reported retail inflows of \$1.4bn, which equates to 10% annualised growth in retail funds under management and institutional inflows of \$2.9bn, equating to 8% annualised growth. In terms of fund performance, Magellan's Global Equities strategy and the Infrastructure strategy both have 4-5% per annum annualised outperformance over the key three-year time period, so that is likely to continue to support inflows. Further, Magellan has a strong track record at preserving capital in down markets, so it is well placed given the continued economic uncertainty stemming from the pandemic.

In late September, the company purchased a 40% stake in start-up investment bank Barrenjoey Capital Partners. That equity investment was funded by the issue of 1.2 million Magellan shares and \$90 million in cash, valuing the stake at \$160 million. This is very small in the scale of Magellan but is indicative of a drive for some diversification over the long term which will help to sustain earnings growth.

**Amcor (AMC)** was another new addition to the portfolio during the quarter. The company produced a solid 2020 financial year result, with 13% earnings per share growth. This reflected 4% organic growth combined with the benefit of Bemis acquisition synergies and the ongoing buyback of shares. Positively, management has guided to 5-10% earnings per share growth in the current financial year.

Earnings expectations for last financial year and the current financial year have been well maintained over the past 12 months despite the pandemic. This is a key attraction of the stock, with almost all sales related to staple consumer goods or healthcare. Roughly half the forecast growth in the current financial year will be generated from acquisition synergies, which is a driver within the control of the company. Moreover, synergy capture is currently tracking ahead of expectations, with an \$80m run rate as at balance date versus prior management expectations for \$65m.

### **Small Cap Sub-Portfolio**

**Hansen Technologies (HSN)** was a standout of the FY20 reporting season, comfortably exceeding pre-COVID guidance and expectations. Heading into the result HSN was trading at a free cash flow yield of approximately 8%, and represented an excellent buying opportunity, in our view. HSN boasts 99% customer retention, 70% recurring revenue, and has a solid M&A pipeline to build its earnings base in coming years. Although the stock rallied 36% over the quarter, we remain happy holders.

**Mach7 Technologies (M7T)** also delivered a strong full-year result, though key details were largely pre-announced. The outlook for M7T has never been better following the acquisition of Client Outlook in June. Mach7 and Client Outlook are complementary best-in-class solutions in the North American US\$3 billion medical imaging software market. As indicated in the presentation accompanying the Client Outlook acquisition, M7T has an active tender pipeline totalling A\$40m over the next 12 to 18 months, including two 80+ US hospital systems. One of these is expected to be awarded before the end of the calendar year.

There were no surprises in the result of **Jumbo Interactive (JIN)**, however the strategic outlook was the highlight. Firstly, only 28% of lottery tickets are sold online in Australia, which underwrites long term growth for Jumbo's core Australian lotteries business. Secondly, JIN's new lottery management SaaS business, Powered by Jumbo, was boosted by the announcement of a term sheet signed with LotteryWest, the Western Australia lottery operator. Lotterywest represents a high-quality government reference site to aid its international growth strategy, particularly in the \$21 billion US State Lotteries market. Shares sold off sharply on the announcement, perhaps due to the absence of financial details that are yet to be agreed and finalised. Directors bought stock, however, and so did we.

During the quarter and ahead of respective results, we initiated positions in two high quality Australian small caps: **Nick Scali (NCK) and Codan (CDA)**. NCK is a leading retailer of premium furniture, with a store network that spans Australia and New Zealand. Founded in 1962 by Nick Scali and listed on the ASX in 2004, NCK has an excellent track record of delivering consistent earnings growth and a steadily increasing stream of fully franked income to shareholders.



Over many years, NCK has proven itself to be a best in class Australian retailer, exhibiting a strong and growing position of leadership within the premium furniture market. Recent written order sales growth rates of 70% compares to industry growth rates of 20% to 30%. NCK is thus strongly taking market share and we anticipate near term results to be exceptional. Taking a longer term view, we believe NCK is well placed to continue creating value for shareholders in the years to come.

CDA was established in Adelaide in 1959 and listed on the ASX in 2003. Initially focused on electronics engineering and communications, the company subsequently acquired Minelab Electronics in 2008, which had developed advanced handheld metal detection technology. This acquisition was followed by the additions of Minetec and Daniels Electronics in 2012, resulting in three segments focussed on servicing an international customer base across Metal Detection, Radio Communications and Mining Tracking Solutions (Minetec).

CDA's recent result was outstanding, with the company delivering revenue and profit growth of 29% and 40% respectively for FY20. With a strong industry position reinforced by a focused R&D program, global footprint, strong balance sheet and high quality management team, the outlook for the company looks equally positive.

### Closing Commentary

The portfolio has come through a volatile reporting period in sound shape. While we expect volatility to continue, as domestic and global economies edge out of the pandemic inspired recession, the support of low interest rates and enormous levels of fiscal stimulus lead us to believe risk assets will retain a reasonable degree of support in the near to mid-term. In turn, this adds support to our constructive portfolio positioning that retains its focus on high quality Australian equities.

**Adrian Ezquerro**  
Head of Investments

**Ronni Chalmers**  
Portfolio Manager - All Cap Australian Equities

**Jonathan Wilson**  
Portfolio Manager - Small Caps

**Vincent Cook**  
Portfolio Manager - ASX 100



## Market Commentary

Following the severe COVID-19 global pandemic which commenced in the first months of the year, leading to shut-downs and recessions across the world, the global economy has begun a patchy yet vigorous recovery. This is evidenced by strength in consumer spending, housing activity and surveys of business conditions. In August, the JPMorgan Global Composite purchasing managers index (PMI) rose to 52.4 from 51.0, its highest since the pandemic began (and above its 51.7 average during 2019). Recent Chinese activity data, as well as exports from Japan and Taiwan, suggest global activity has picked up strongly during the third quarter.

The true shape and durability of the recovery in the months remaining until the end of 2020 and beyond, however, remains uncertain. We do not know the path which the pandemic will follow, although prospects for a vaccine and other treatments appear promising. Therefore, it remains unclear the pace at which consumers and businesses will be able to return to near-normal activity, amid the social impacts of the crisis and ongoing requirements for physical distancing and restricted business. Renewed lockdowns in the UK and other parts of Europe will likely weigh on near-term demand.

Equity markets sold off in September as rising virus numbers, the US presidential election and the stalled US fiscal stimulus gained attention. Despite these risks, the prospects for recovery remain positive.

We expect markets to remain volatile as the COVID-19 picture evolves, the earnings outlook becomes clearer, and we approach the end-game for the presidential election in the US. At present, polls suggest a Joe Biden victory over President Trump. We do not expect that this will be a cause for a market correction: whereas Biden may raise corporate taxes, his support for broad social security spending and a higher minimum wage would be a boost for income and consumption, both critical ingredients to the US domestic economy.

Within Australia, the containment of the second wave in Victoria has offered great relief, and the hope is for all lockdown measures and restrictions to be gradually lifted. Economic growth in Australia in the second quarter fell by 7.0%, confirming our first recession in almost 3 decades. This was better than many other countries, with the exception of China, which has staged a quite remarkable recovery. Within the domestic economy, retail sales have been predictably volatile, rising 6.0% over June and July, before falling 4.0% in August, as Victoria's lockdown intensified. But strong home loans data point to a stabilising housing sector, and consumer and business confidence has recently improved. Jobs market data continue to positively surprise, with unemployment dropping back to 6.8% from 7.5%, though renewed weakness may lie ahead.

The strong recovery in China and demand and prices for commodity exports such as iron ore have underpinned an improvement in Australia's outlook. The OECD has lifted its forecast for 2020 from -5.0% to -4.1%. In September, the Reserve Bank of Australia added further stimulus through its bank lending facility, and there has been recent speculation that rates could be cut in November from 0.25% to 0.10%. The federal budget to be brought down on 6 October is expected to provide further stimulus to the economy.

While the global recovery is most welcome, risks remain and volatility in investment markets in coming months would not surprise us. The US Presidential election (and including many Congressional seats and Governorships) remains a fierce battle, and the potential for a contested result creates great uncertainty. Many other risks abound, including further periodic outbreaks of the virus, geopolitical and international trade tensions, record levels of unemployment, disruption of manufacturing supply lines, and relatively high valuations in many markets.

Yet, on balance, unprecedented monetary and fiscal stimulus, a capex pick-up and broad progress in containing the virus suggest the world is still on track for a broad economic recovery. Central banks have been emphatic that they will err on the side of supporting the nascent recovery rather than allow the threat of incipient inflation to curtail their cheap money policies. After a 4.5% decline in 2020, the OECD expects global growth to rebound to 5.1% in 2021. Global interest rates are likely to stay low for an extended period, measured in years rather than months.

As always, we continue to recommend diversification across both securities and asset classes. Increased volatility in the face of the risks and uncertainties alluded to above should be seen as opportunities for asset allocation reviews, and if appropriate, for additional investment in high quality long term themes, such as technology, healthcare, automation, artificial intelligence, and care for the ageing population. We particularly favour securities able to generate growing revenue and profitability streams, and which have the potential to distribute rising levels of dividends over the long term.



## Fund Information

### Investment Objective

The objective of the Fund is to provide consistent capital growth and a growing level of income over the medium term (3 - 5 years) by investing in securities listed on the Australian Securities Exchange. The Fund may not achieve its investment objective. Returns are not guaranteed.

### Investment Methodology

Clime seeks to identify high quality securities issued by businesses which contain most if not all of the following characteristics:

- A competitive advantage, leadership within a specific niche and a sound track record
- Financial strength, high levels of profitability and margin
- Low financial leverage
- Relatively low capital requirements allowing a business to generate cash while growing
- Highly capable management team aligned with creating shareholder value
- Companies that can deliver genuine sustainable long-term growth
- Investments that can be purchased at appropriate prices

## Portfolio Managers



**Adrian Ezquerro**  
Head of Investments



**Ronni Chalmers**  
Portfolio Manager - All Cap Australian Equities



**Jonathan Wilson**  
Portfolio Manager - Small Caps



**Vincent Cook**  
Portfolio Manager - ASX 100

### Fund Information

<b>Name</b>	Clime Australian Value Fund	<b>Investor Eligibility</b>	Retail & Wholesale
<b>Structure</b>	Managed Investment Scheme	<b>Minimum Investment</b>	Retail: \$10,000 Wholesale: \$100,000
<b>Investment Universe</b>	ASX Listed Securities	<b>Liquidity</b>	Daily Unit Pricing Applications and Redemptions
<b>Benchmark</b>	12% pa return after Investment Management Fees and usual expenses but before any Performance Related Fee.	<b>Fees</b>	Retail: 1.03% management and 15.38% performance Wholesale: 0.87% management and 15.38% performance
<b>Stock Holdings</b>	25-40	<b>Admin</b>	Mainstream Fund Services Pty Ltd
<b>Fund Size</b>	\$8.2m	<b>APIR Code</b>	Retail: CRE0001AU Wholesale: CRE0005AU

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