The Contact Australian Ex-50 Fund

Annual Letter – June 2023

Dear Investor,

Given the barrage of negative commentary over the past twelve months, some readers will be surprised by the returns generated by equities markets over fiscal 2023. Notwithstanding an environment of high inflation, a war in Ukraine, wage pressures, slowing earnings growth and unprecedented pace of interest rate rises, the market pushed higher. Quite a bit higher. The S&P/ASX 300 Accumulation Index increased by 14.4% but was well outpaced by the NASDAQ (+26%), the Indian market (+24%), Eurostoxx (+21%) and the S&P500 (+20%). Only the Chinese / Hong Kong market closed lower in FY23 as the region continues to recover from the pandemic. This could reverse quickly on evidence of Chinese Government stimulus.

The market does not always act rationally in the short-term, which is a fundamental reason why we believe in long-term investing. We also believe in a better tomorrow and take little notice of the pessimists. Author Morgan Housel summed it up well recently, when he noted that, *"In investing, a bull sounds like a reckless cheerleader, while a bear sounds like a sharp mind who has dug past the headlines – despite the record of the S&P 500 rising 18,000-fold over the last century."* At Contact Asset Management, we simply say *"Bears sound intelligent. Bulls make money."*

Closer to home, we witnessed a continuation of an interesting theme over the past two years, whereby large ASX stocks have outperformed their smaller counterparts. In FY23, the S&P/ASX Top 100 Accumulation Index increased by 15.1%, whereas the S&P/ASX Small Ordinaries Accumulation Index increased 8.4%. We anticipate some mean reversion in the performance of small caps.

We were pleased with the Fund's performance given the volatile investing environment and the underperformance of small stocks. The Fund return was 9.4%. The past six months was particularly solid, with a 5.5% return against the S&P/ASX Small Ordinaries (+1.3%) and the S&P/ASX Midcap 50 Index (+4.6%). We put this down to a focus on Quality and Valuation.

Investments that contributed in a positive way to annual performance included Smartgoup Corporation (SIQ), IGO Limited (IGO) and OZ Minerals (OZL). Detractors from performance included Alliance Aviation (AQZ), TPG Telecom (TPG) and Service Stream Limited (SIQ).

Quality Matters

FY23 has reminded us that Quality matters. In mid-to-late 2020, as the world was inundated with cash from a combination of Government stimulus and cheap money (low interest rates). Everything went up! However, sooner or later the market rewards profitability and earnings growth. We take a long-term view and the longer one plans to hold, the more important quality becomes.

Several years ago, we travelled to the US and met successful investor Chuck Akre. Chuck is renowned for his "three-legged stool" approach, comprising (1) extraordinary business, (2) talented management and (3) great reinvestment opportunities and histories. This resonates with us. Importantly, Chuck reminded us that *"the quality companies continue to surprise you on the upside"*.

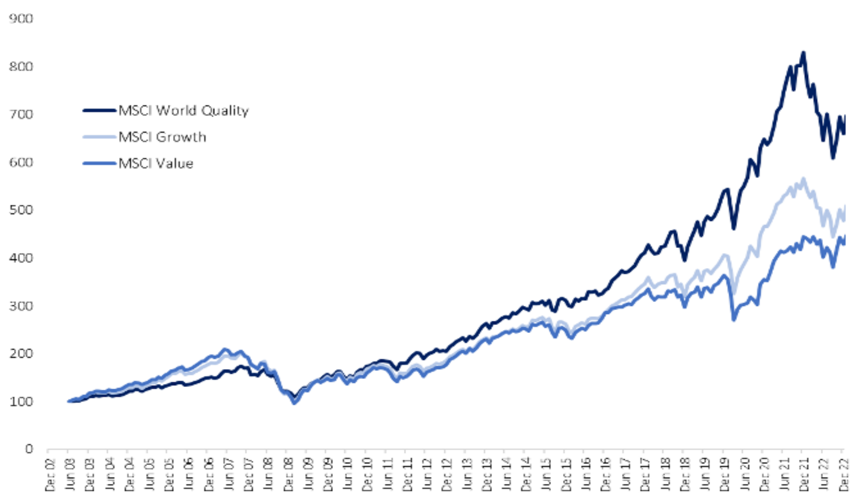
Quality means different things to different people. At Contact, we define "Quality" as:

- Companies that have an identifiable competitive advantage and are growing.
- The business is profitable and generates cash, allowing it to pay us a sustainable dividend stream.
- The business generates attractive returns on its invested capital.
- The Balance Sheet is strong or, at least, appropriately geared for its stage of growth.

- Companies that are conscious of ESG and score favourably with MSCI ESG Ratings.
- The business is run by capable, dedicated and trustworthy people. Ultimately, they are founders of the business or have significant "skin in the game".

We believe that in the end, Quality wins. Our beliefs have been tested for generations. The proof is in the pudding.

Chart 1: Over the long-term, Quality wins



Source: Factset, MSCI, Contact Asset Management

Portfolio Developments

Our portfolio turnover is generally lower than our peer group. Experience has taught us that only over the long run can a company truly benefit from a company's superior fundamentals. The challenge is trying to balance long-term investing with constantly seeking superior investment returns from reinvestment opportunities.

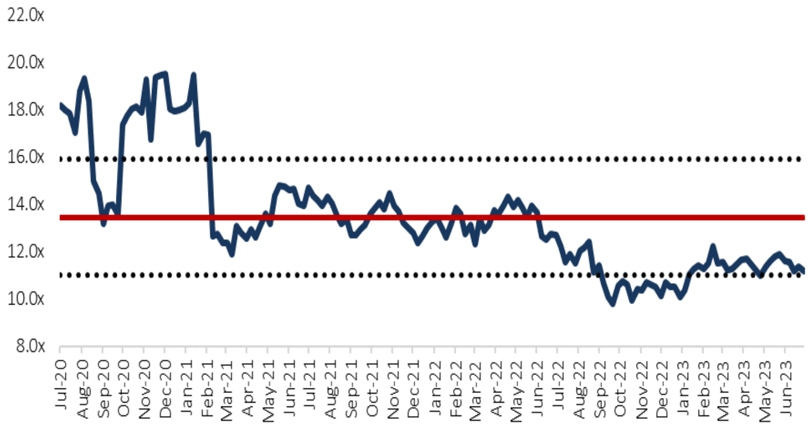
The Fund has increased in size over the past year. Each inflow of cash provides an opportunity to reweight, and we have been active with this in FY23. Notable new additions include lithium companies (Allkem and IGO Limited), Industrials (Orora Limited and Reliance Worldwide), Financials (Hub24 Limited and PSC Insurance), IT company Hansen Technologies and travel company Flight Centre. We exited five positions for different reasons including AV Jennings and Cedar Woods Property (deteriorating industry outlook), OZ Minerals (takeover) and Monadelphous and Reece Limited (solid businesses but we couldn't justify the valuation). We have discussed the rationale for the majority of these portfolio decisions in our prior Monthly Reports or *Contact Insights* notes.

At the end of June, the three largest Fund positions were Ampol Limited (ALD), Metcash Limited (MTS) and IPH Limited (IPH). A brief summary of our investment case on each is covered below.

We continued to build our position in Ampol Limited (ALD) throughout the year and the stock is now our largest position. ALD boasts several strategic assets dominated by the Lytton Refinery, 6 pipelines and 24 terminals. The company also has 2,350 retail sites, which further highlights the significant barriers to entry. While we believe that demand for fuel will continue for some time yet, ALD is already investing ahead of the curve into Electric Vehicle (EV) fast charging to future-proof the business. Our thesis sees continued growth in the convenience store business alongside fuel demand, which generates significant cash. We are also being rewarded by an attractive fully franked dividend yield of 6%.

The often-underappreciated change in the ALD investment case is the improved sustainability of earnings. Historically, ALD earnings could be volatile, due to the fluctuations in refining margins. During COVID, there was a lot of refinery capacity taken out, strengthening ALD's competitive position. Indeed, the refinery is considered so strategic that the Government was willing to provide downside protection with unlimited upside. This gives us increased confidence in the outlook for earnings, dividends and an improving ROE. Our DCF valuation suggests at least 25% upside to the shares. As depicted in Chart 2, the stock looks cheap relative to its historical P/E multiple.

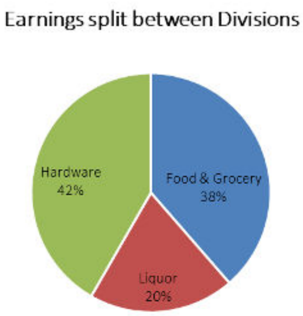
Chart 2: Ampol Limited (ALD): Valuation appears compelling on a P/E basis

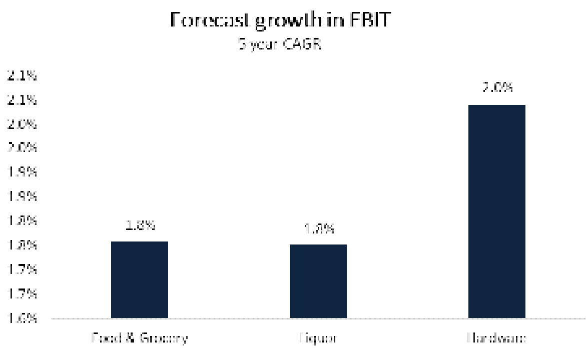


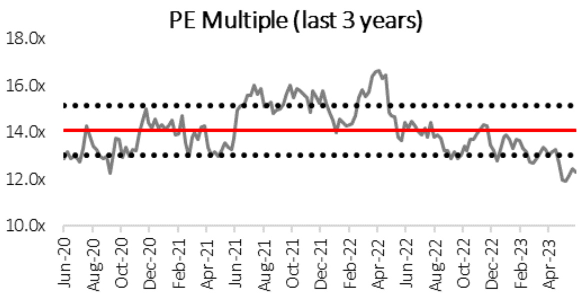
Source: Factset, Contact Asset Management

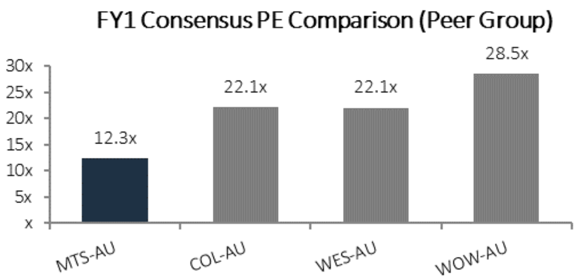
Metcash Limited (MTS) delivered a solid full year result that was ahead of expectations. All pillars (Food, Liquor and Hardware) continued to perform well, with a notably strong performance from the Total Tools business. The Result Presentation and subsequent management meeting highlighted the gains that have been made by MTS over the past three years. MTS is now a larger, more diversified and stronger business, which has grown EBIT by 50% (aided by Hardware M&A). Underlying EPS has increased by >40% and Group ROFE exceeds 30%. We struggle to comprehend why MTS continues to trade at such a stark PE multiple discount to Coles, Woolworths and Wesfarmers. Our forecasts are not heroic, yet our DCF valuation suggests 30% upside. The following charts provide an overview of some key metrics in the MTS investment proposition.

Charts 3-7: Key charts on Metcash Investment Case





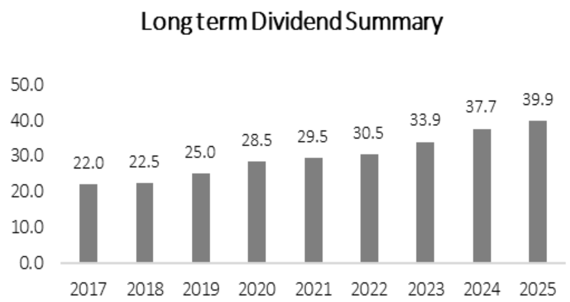


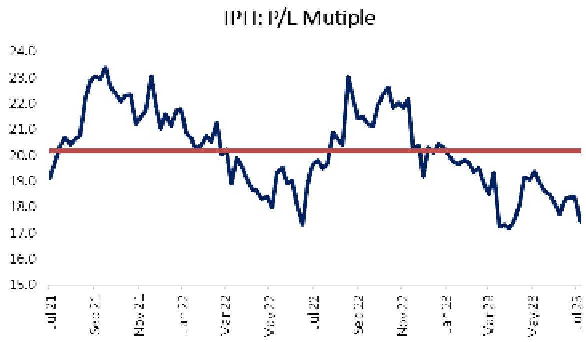


Source: Factset, Contact Asset Management

IPH Limited (IPH) was hit by a cyber incident in March 2023. Despite management assurances that the damage to financials or customer relationships was immaterial, the stock has struggled to recover. We think that this presents an opportunity for the long-term investor, and we have selectively added to our position in the Fund. IPH is the leading intellectual property services group in the Asia-Pacific. The majority of revenue is derived from patent filings, and the long length of a patent lifecycle means that IPH benefits from a high proportion of recurring revenue. This is another stock, where we see 30% upside to the current price. IPH generates excellent levels of free cash flow, it boasts a growing dividend (and a grossed-up yield of approximately 6%), margins are over 30% and the Balance Sheet is robust. We remain optimistic on the prospects for the business.

Charts 8-9: IPH offers a robust dividend history and attractive valuation

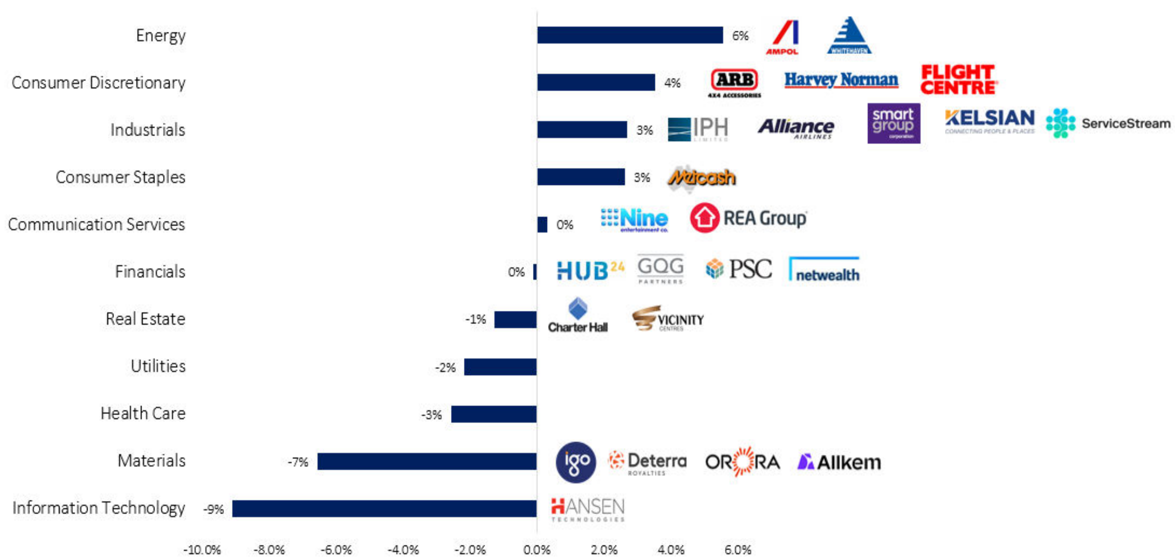




Source: Factset, Contact Asset Management

On the whole, we believe that the Portfolio is well positioned with a cross section of high-quality businesses across a range of sectors. We aim to own the best companies, and this may result in us having no exposure to a sector at all. For example, while the ASX boasts some outstanding Healthcare businesses amongst the mega-caps, we currently find it difficult to find outstanding investment opportunities in the healthcare sector among the small and mid-caps. The following chart provides some insight into portfolio exposure by sector, highlighting some of our higher conviction investments.

Chart 10: Fund sector exposure (vs S&P/ASX Midcap Index) and key investments per sector

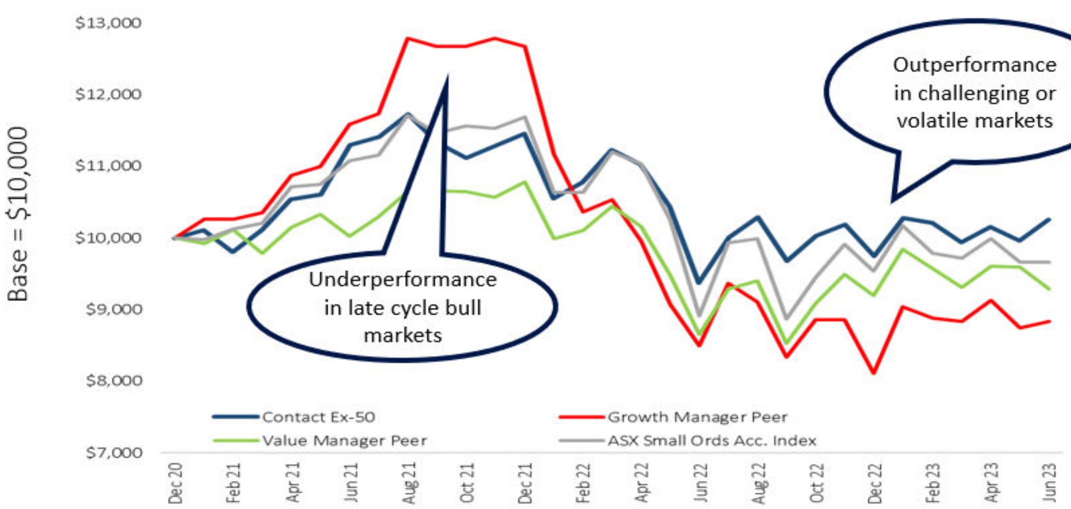


Source: Factset, Contact Asset Management

The Contact Australian Ex-50 Fund: Points of difference

(i) Sensible and consistent investment process: The volatile markets of recent years have reinforced the importance of a sensible and consistent investment approach. The Contact Australian Ex-50 Fund has delivered solid performance over the last two years which has seen very different market dynamics. As the Fund seeks to invest in quality companies, we will typically underperform in late cycle bull markets, but outperform in challenging or volatile markets. This is in line with our expectations.

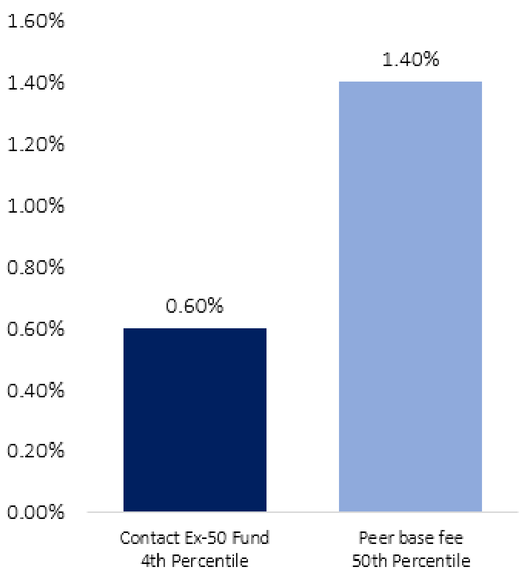
Chart 11: a Proven track record across different market dynamics



Source: Company websites, Contact AM. These numbers include distributions. The figures above are unaudited. Past performance is not an indicator of future returns. Data to 30 June 2023

(ii) Industry low fees: Contact has an investor-focused approach. Low fees boost the ability to effectively compound capital over time. Our fees are at industry low rates, and we do not believe in performance fees. Our headline rate of 0.60% is among the lowest in the Australian Funds Management Industry.

Chart 12: Industry low fees



Source: Fee information from Morningstar. Contact Asset Management.

Closing

A patient, cost-effective, long -term approach is where we believe we have an edge as investors. We are not chasing a short-term performance fee against some arbitrary index. Instead, we target a 10% p.a. total return over the long-term. We think that this is an admirable return target and one that is likely to outperform the broader equities market in any case.

In challenging markets, we are fortunate to rely on an investment philosophy that has been honed for generations. We believe that:

- **Patience pays off:** time in the market beats timing the market. We invest for the long-term and minimise portfolio turnover.
- **Dividends don't lie:** companies need to have strong financials and prospects to pay a sustainable dividend stream. They must be profitable and generate cash. The market often underappreciates the high proportion of returns that are generated by dividends.
- **Fees dilute returns:** low fees boost the ability to effectively compound capital over time. Our fees are at industry low rates, and we do not believe in performance fees.
- **Alignment is crucial:** we seek to invest in founder-led businesses. We invest alongside our shareholders and unitholders in all products that we manage. History has taught us that the success of a business comes down to its people.
- **Invest in good companies:** if we get the research into the company right, the share price will take care of itself.

At the end of June, the Portfolio characteristics of the Fund remain robust. From a valuation perspective, the Fund was trading on a P/E of 12.7 times (based on 2023 earnings estimates). This is attractive by historical standards. We aim to buy businesses at above average rates of return and the ROIC (return on invested capital) of the Portfolio was 29.3%. By comparison, the ROIC on the S&P/ASX Mid-cap 50 index was 15.6%. We believe this is a high-quality portfolio and the companies within it also deliver greater cash flow generation and stronger balance sheets than the broader market.

We will soon pay a semi-annual cash distribution, which is being finalised. Our goal is to provides investors with a reasonable yield which is complemented by capital growth over the long-term.

Please let us know if you have any questions or require additional information. In the meantime, we encourage you to visit the Insights section of our website at https://contactam.com.au/insights/ where we collate interesting thought pieces.

We appreciate the opportunity to manage your assets and we look forward to reporting to you in the quarters ahead.

Yours sincerely,

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Appendix 1: Full portfolio disclosure as at 30 June 2023

Ampol Limited	ALD	**5.5%**
Metcash Limited	MTS	**5.4%**
IPH Limited	IPH	**5.3%**
Deterra Royalties	DRR	**5.3%**
Whitehaven Coal	WHC	**4.8%**
IGO Limited	IGO	**4.6%**
HUB24 Ltd	HUB	**4.1%**
GQG Partners	GQG	**4.1%**
Alliance Aviation	AQZ	**3.7%**
Nine Entertainment	NEC	**3.7%**
Vicinity Centres	VCX	**3.6%**
Smartgroup Corporation	SIQ	**3.4%**
Service Stream	SSM	**3.4%**
Harvey Norman	HVN	**3.4%**
Flight Centre Travel	FLT	**3.3%**
Charter Hall Group	CHC	**3.2%**
Reliance Worldwide	RWC	**3.1%**
Kelsian Group Ltd	KLS	**3.0%**
Allkem Limited	AKE	**2.8%**
REA Group	REA	**2.6%**
Netwealth Group	NWL	**2.5%**
ARB Corporation.	ARB	**2.4%**
Orora Limited	ORA	**2.1%**
Hansen Technologies	HSN	**2.0%**
Bank of Queensland	BOQ	**1.8%**
PSC Insurance Ltd	PSI	**1.7%**
TPG Telecom Limited	TPG	**1.2%**
E&P Financial Group	EP1	**1.0%**
Cash	AUD	**7.0%**
Total		100.0%