GANES

FOCUSED VALUE FUND

APIR GCM0001AU | ARSN 117 119 712

SEPTEMBER 2021 QUARTER REPORT

Quarter Commentary

The fund recorded another good quarter with the unit price up 8.1% to $4.53 at the end of September, while the market rose 1.8%. For the past year the fund has reported a return of 45.1%, outperforming the market by 14.2%.

Over the longer term the fund has provided a return of 12.7% per annum for the last 10 years and 12.7% per annum since inception. A $10,000 investment made at inception is now worth $95,882 against $55,476 for the ASX300 benchmark.

Our larger holdings continued to record strong price rises over the past few months, most also reporting record profits for the past year. This has continued our outperformance against the market over both the short and long term.

Concurrently, the portfolio weighting in some of our larger holding, particularly PWR and Domino's, has increased because of the price rises. As I wrote in the June update these companies are wonderful businesses and as recent profit results attest, we are benefitting from acting as owners. At this point I remain comfortable with the current level of concentration in these quality businesses.

There were again only modest changes to the portfolio during the quarter with some additional purchases to existing investments. There were no sales. PSC Insurance is a recent entry to the top 10 and I will explain the attractiveness of this business in the update.

The fund remains fully invested with less than 5% cash.

Performance as at 30 September 2021:

	Fund (net of fees)	ASX 300 Accum. Index
3 months	8.1%	1.8%
1 year	45.1%	30.9%
3 years p.a.	16.0%	9.9%
5 years p.a.	14.7%	10.5%
10 years p.a.	12.7%	10.8%
Since Inception (p.a.)*	12.7%	9.5%
Value $10,000 invested since inception	$95,882	$55,476

*Inception date of Fund is 14/10/2002

Unit Prices as at 30 September 2021:

Entry Price	$4.5457
Unit Price	$4.5344
Exit Price	$4.5230

Top 10 Holdings:

Company	Code	Weight (%)
PWR Holdings	PWH	15.5
Domino's Pizza Enterprises	DMP	12.5
ARB Corporation	ARB	8.6
Dicker Data	DDR	7.3
Reece Australia	REH	6.7
MFF Capital	MFF	5.7
Lovisa	LOV	5.7
PSC Insurance	PSI	4.8
AUB Group	AUB	4.4
Carsales.com	CAR	3.8

Top 5 Sector Exposure:

Sector	Weight (%)
Consumer Discretionary	42.8
Financials	22.5
Information Technology	15.5
Industrials	6.7
Healthcare	5.3
Other (including Cash)	7.8

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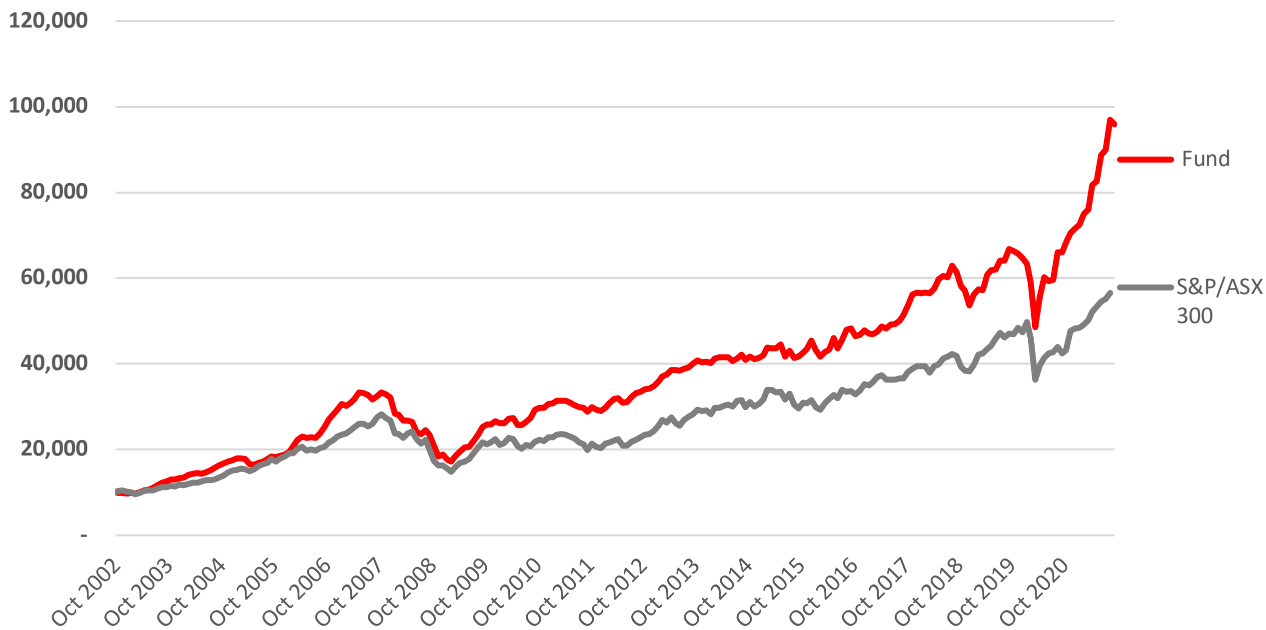
Fund Performance



While the table on the first page shows the performance of the fund over various time frames the graph above provides a visual representation of the fund against the ASX300 benchmark since inception. The benefits that accrue to compounding over the long term are becoming apparent.

Portfolio Performance

August was profit reporting season for most of the companies within the portfolio which led to some strong share price movements on the back of strong results. The biggest contributors to fund performance during the quarter were PWR Holdings, Domino's Pizza and Lovisa who also provided positive outlooks for the future.

The main detractors during the quarter were Reece, Magellan Financial Group and Cochlear.

PWR Holdings: We have enjoyed a nearly doubling of the PWR share price this year, and 33% in the last quarter, as the broader investment community has begun to understand the attractiveness of this business, which I have mentioned numerous times previously (March 2021 at length). It's fair to say the share price has probably outrun the underlying growth of the business recently and I won't be surprised if we experience a period of subdued returns at some point.

In the latest results sales were up more than 20% and profits were up 29% despite some currency headwinds during the year. However, it is more likely the comment by Management that emerging technologies will "dwarf" motorsports revenue in the coming years that has excited investors since the results were released.

Currently emerging technology is 11% of revenue and motorsports is five times larger at 54%, so there will be a major shift in the company's revenue base over the coming years as well as a near doubling of revenue if these forecasts eventuate.

Domino's Pizza: The Domino's share price has also nearly doubled this year and rose 24% for the quarter, also contributing strongly to fund performance. In the latest results sales were up 15%, profits were up nearly 30% and the dividend was increased by 45%. The company has recently purchased the Taiwan region to add to its Asian territories and is predicting record new store openings for next year. That's good news for shareholders.

For me, one of the tells of a business and its culture lies within its executive appointment announcements. With the acquisition of Taiwan and the retirement of the current Australian CEO, Nick Knight, a 30-year veteran of Domino's, the company has recently announced some management changes.

Internal promotions signal to me loyalty and development of managers, allowing the business to retain its culture. Don Meij, the current Managing Director, has been in the business for over 30 years starting as a pizza delivery driver in the late 1980's, as did Nick Knight. Knight's replacement is David Burness, another former award-winning franchisee who started with the company as a pizza delivery driver in 1991. Similarly, Martin Steeks who has been appointed to run Taiwan has worked for Domino's for 24 years.

Some of the most successful sporting teams are those that have a juniors' system that brings players through the lower grades rather than just buying players for first grade. Domino's would appear to have a very good "juniors" system that allows delivery drivers to become store managers, who can then become franchisees and often multiple franchise owners, which can lead on to executive roles.

Domino's has been one of our best investments in recent years but I will confess, it is one of those companies where I have been roughly right but precisely wrong in my predictions for the business. In 2017 as I was rebuilding our investment, I thought Europe would be the shining star for the company and growth was virtually unlimited. But for the past few years Japan has grown so strongly it is now the largest area by sales and profits within the group. Not what I had predicted, but **great companies often allow shareholders multiple ways to win in a way that poor quality businesses can't**.

The key metric for me is their store rollout, not only raw store numbers, but the willingness for existing franchisees to add to their ownership of stores. Unprofitable and disgruntled franchisees do not open or buy more stores. Watching store numbers and stores per franchisee is one of the first things I look at in any results announcement.

In the latest results the company opened 285 new stores, and 94% of these were opened by existing franchisees. Across the group 55% of franchisees own more than one store and 8% own more than 6 stores. But in Japan, 72% own more than one store and 12% of franchisees own more than 6 stores. These are trending in the right direction – up and to the right.

"Insurance policies are the most complex contract you will ever sign without the help of a lawyer"
Hyatt Brown, Brown & Brown

PSC Insurance

Insurance broking has provided some solid returns for the fund, in fact, it's the fund's largest industry exposure through PSC Insurance, AUB Group and Steadfast. PSC has only been added to the portfolio this year but with its share price rising more than 30% it has entered the list of top 10 holdings.

Insurance broking is quite separate from insurance underwriting. Broking clips the ticket, taking a percentage of the insurance premium – usually between 10% and 15% of the premium (which we like), while underwriting assumes all the risk in the transaction (not so keen on). It can be very profitable with high free cashflow and low capital requirements. And there are barriers to entry due to specialist knowledge and long-standing relationships which reduces competition. Overseas, insurance brokers such as Brown & Brown and AON have proven to be wonderful investments, and PSC has all the same qualities. We have also owned AUB Group and Steadfast for many years and they have each provided returns of more than 20% per annum for the past five years.

Insurance is a non-discretionary expense for business owners. In many industries it is a requirement just to be able to open the doors. These policies usually need to cover multiple, and often complex situations. As a result, a business may require a number of insurance policies so using a broker can be a very efficient method of obtaining coverage across different aspects of the business – property insurance, public liability and professional indemnity would not be uncommon for a professional services firm.

Therefore, it is not uncommon for brokers to specialise in certain industries and business owners to stick with those brokers for many years creating a stream of recurring revenue, and a business resilient to various economic conditions. This is a very different business model to householders shopping around for the best car insurance deal and dealing directly with the insurer.

After being founded in 2006, PSC listed on the ASX in 2016 at $1.00 with a market capitalisation of $220 million and revenues of $60 million. The founders retained 60% of the company, although that has been diluted in recent years due to various capital raisings to fund acquisitions. And they bring a good track record to the table, as former executives at OAMPS, which was very successful before being acquired by Wesfarmers. In recent years the company has expanded into the United Kingdom via several acquisitions and this region now makes up nearly 50% of their revenue and continues to grow.

In the latest results the company reported $207m of revenue and underlying profits of $45.8m which was up 17% and 22% respectively, and the dividend was increased by 17%. Management is forecasting growth of 20% or more for next year on the back of recent acquisitions and organic growth. Returns on capital are relatively consistent between 14% and 20%, and it's reasonable to expect our investment return should align with the business returns over the longer term.

As always, feel free to call or email me if you require any further information about the fund.

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The Fund(s) Target Market Determination can be found at https://fundhost.com.au/Ganes-Focused-Value-Fund-TMD.pdf

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