Quality and Value Stocks in Focus

Investors Mutual Australian Share Fund

September 2020

Investors Mutual Limited (IML) was established in 1998 as an Australian equities fund manager focused on building portfolios of companies that represent both 'quality and value'. IML's highly-awarded, prudent investment style has a long-term focus and aims to deliver consistent returns for clients.

IML uses an active, 'bottom-up' approach to identifying, researching and valuing companies. Our approach is systematic, disciplined and focuses on finding companies that meet our investment quality criteria and then determining an appropriate valuation for those companies.

We select companies for our portfolio which, following extensive research, are found to be reasonably valued and which are assessed to have strong competitive advantage and that are run by experienced, capable management teams which have a sound plan to grow each company's long term earnings. In our view, a portfolio of these types of companies will do well for investors over the long term.

Active selection of quality and value investments is key

IML's active approach involves the following:

- **Long-term:** we invest with a view to holding companies for at least 3 - 5 years
- **Valuation-driven:** we buy or sell shares after extensive research which allows us to assess the appropriate fundamental long-term value of a company
- **Risk-aware:** we avoid the hype often associated with speculative or highly cyclical companies
- **Investor-focused:** we never forget what our investors tell us they want from their investments – which is capital preservation, reasonable capital growth over time, and consistent income
- **Benchmark-unaware:** we take active positions away from the index to deliver a better long-term risk-return outcome

On the following pages, IML's analyst team provides an update on IML's view of the Australian Share Fund's key holdings.

The Investors Mutual Australian Share Fund aims to generate long-term returns which:

Are ***less volatile*** than the overall sharemarket

Can provide reasonable ***capital growth*** over time

Can provide sustainable, ***tax-effective income*** to the Fund's investors

Amcor ASX: AMC

Amcor is one of the world's largest packaging suppliers with operations diversified globally. Amcor's operations are highly cash-generative and have produced steady earnings and dividend growth over time thanks to organic growth as well as through accretive bolt-on acquisitions.

IML believes Amcor has sound downside protection characteristics as over 90 percent of its sales are to fast-moving consumer goods companies such as Nestle, Unilever and Pepsi which reduces any credit risk to Amcor. Amcor's revenues and earnings have proven to be relatively steady and predictable even at times time of economic uncertainty.

AusNet Services ASX: AST

AusNet is a regulated utility which owns monopoly infrastructure assets used for electricity and gas distribution and electricity transmission in Victoria and South Australia. AusNet's earnings and cash flows are highly predictable and recurring, given the majority of the company's revenues are contracted or regulated.

The growth in new gas and electricity connections continue to be driven by the increased generation from renewable energy facilities as part of Australia's transition to a lower carbon economy as well as by long term population growth. In IML's view AusNet also offers downside protection qualities as its electricity assets operate under a revenue cap and hence do not take volume risk and with customer credit risk borne mostly by the large integrated energy retailers, which have very strong balance sheets.

Brambles ASX: BXB

Brambles is a global leader in the pallets industry which is an essential component of the distribution of fast-moving consumer goods between manufacturers and supermarket chains. Brambles is the number one or two player in all the markets in which it operates.

IML has a very favourable view of the firm's management team and their focus on capital efficiency which has improved Brambles cashflows and lowered the risk of excess pallet storage costs in the future. Brambles is utilising its excess cashflows to invest in the future with R&D projects focused on pallet tracking technology and data solutions that add value to the company and its customers.

Coles ASX: COL

As the second-largest supermarket player in Australia, **Coles** is quite a simple business with earnings made up 90% from supermarkets and 10% from liquor sales. Coles generates very reliable, consistent cashflows and the company has a very strong balance sheet.

Coles was listed on the ASX in late 2018 after being demerged from Wesfarmers. Coles new management team have reinvigorated the company and Coles offers a defensive business model with earnings growth and margin improvement to come in the next few years from management's focus on extracting efficiencies from the company's existing business as well as from the extraction of efficiency gains thanks to management's focus on rationalising and improving Coles' existing distribution centre footprint.

CSL ASX: CSL

CSL is the clear global leader in plasma/blood products. The plasma industry is attractive as it has few players of scale, significant barriers to entry and strong growth in demand for existing and newly developed plasma products. CSL is a fully integrated player in the plasma industry - collecting the plasma and processing it into high value products.

CSL has also made some very astute and sensible acquisitions over its history. As a result, CSL has been able to generate consistently higher returns than many of its competitors.

CSL's future earnings growth will continue to be driven by strong demand for their plasma products as well the company's substantial investment in R&D, which we expect to yield a number of material new products over the next 3-5 years adding to CSL's long term growth outlook.

Metcash ASX: MTS

Metcash is Australia's largest food, hardware and liquor wholesaler, supplying well-known neighbourhood retailers including IGA, Mitre 10 and Cellarbrations. In the last few years, the company has invested heavily in efficiency programmes to ensure that its retailers can compete effectively with their larger competitors.

Metcash received an unexpected boost during the COVID-19 lockdown as more shoppers switched to the convenience of neighbourhood stores. This has led to the company gaining market share from competitors – some of which we believe will stick even when things normalise. IML likes Metcash because of its attractive valuation and the company's ability to produce sustainable earnings and dividends.

Orica ASX: ORI

Orica is the largest explosives player in the world with operations in every major mining region globally. The company manufactures and distributes ammonia nitrate, detonators and provides services to almost all the major mining companies in the world.

The business has strong recurring earnings as Orica typically sells its products on 3-5 year contracts, where demand is linked to mining volumes. We believe the outlook is strong for Orica in the medium term as the company has a number of internal growth drivers which will generate earnings growth in the years ahead. Growth drivers include launching new products (wireless detonators), cost out programs and acquisition synergies from Orica's recent acquisition of Exca - Peru's leading manufacturer and distributor of industrial explosives. Once Exca is fully integrated it will establish Orica as the number one player in Latin America. Orica has an experienced management team and board and a strong balance sheet.

Sonic Healthcare ASX: SHL

Sonic Healthcare is a global pathology company, holding market leadership positions in most of its geographies (Australia, Germany, the UK and Switzerland). Sonic is also the number 3 player in the US market.

Despite significant weakness in pathology volumes during the global lockdown, these volumes have recovered to pre-COVID levels for most of Sonic's businesses. This combined with continued elevated levels of COVID testing - which Sonic has been contracted by various Health authorities around the world to perform - provides a level of confidence in Sonic's earnings outlook in these uncertain times.

Sonic has a highly capable and experienced management team. The company generates very strong cash flow and it has strong balance sheet. This positions the company to emerge from the economic downturn in a much better position than many of its smaller or more leveraged competitors.

Tabcorp ASX: TAH

Tabcorp owns valuable gaming licences across lotteries and wagering. We view Tabcorp's lotteries division as one of the best businesses in the Australian market as it is a monopoly business which holds long term licences and with earnings growth to be driven by increased digital penetration and new and enhanced games. The segment now accounts for more than half of the company's earnings.

We welcomed the recent announcement of a new incoming Chairman and CEO and we see potential for good upside for the company with substantial cost savings expected from Tabcorp's current cost review and better focus and execution in its wagering division.

Telstra ASX: TLS

As Australia's largest telco, **Telstra** has around a 50% market share of both the fixed internet and mobile markets. Owing to economies of scale, and network quality advantages, Telstra is the only player able to earn meaningful margins from the mobile market due to highly competitive mobile pricing in recent years.

We believe at some stage industry mobile pricing and margins will lift as Optus and Vodafone are in an unsustainable position. Looking forward, Telstra is extending its network advantage with the roll out of 5G to cover 75% of the population by the end of FY21 which puts Telstra in a good position to win high value customers.

Telstra is a well-run company which generates strong cashflow and which has a strong balance sheet. We believe Telstra's earnings will grow when industry mobile pricing improves, which we believe will happen given Optus and Vodafone's unsustainable situation.

About the Portfolio Managers

Anton Tagliaferro

Anton is the Investment Director for Investors Mutual Limited (IML), which he founded in 1998 as a boutique, value-style Australian equities fund manager. Anton is a Co-Portfolio Manager for the IML's Australian Share, All Industrials Share and Equity Income Funds. He is also co-Portfolio manager for QV Equities, an ASX-listed investment company. After completing an Accountancy degree in London, Anton trained as a Chartered Accountant joining the funds management industry 35 years ago.

Hugh Giddy

Hugh is IML's Head of Research, Co-Portfolio Manager of the Investors Mutual Australian Share Fund and Portfolio Manager of the Investors Mutual Concentrated Australian Share Fund. Hugh has almost 30 years' investment experience in equities. He founded Cannae Capital Partners in 2007, and he joined IML in early 2010. Hugh has an M.Phil. (Economics) from Cambridge University, and B.Com. (Hons.) and B.Sc. degrees.

Daniel Moore

Daniel joined IML in 2010 and has been managing a growing portion of the Investors Mutual Australian Share Fund since 2013. Daniel also co-manages the large-cap research team. Daniel commenced his investment career in 2005, as an equities analyst. Daniel holds a B.Com. from the University of Sydney and is a CFA charterholder.

Further Information

For more information about Investors Mutual Limited, please contact your financial adviser, or call us on 1300 551 132 or visit iml.com.au.