SGF

Half Year Investor Report

31 December 2019

STRATEGIC GLOBAL FUND
ARSN 613 886 392   APIR OMF0027AU

STRATEGIC GLOBAL FUND

ARSN 613 886 392   APIR OMF0027AU

HALF YEAR REPORT — December 2019

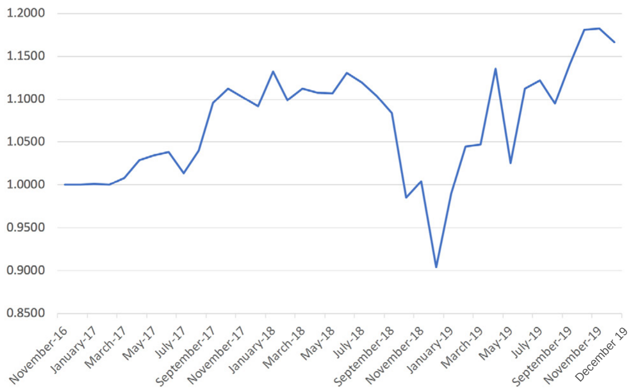
FUND FACTS

Structure	Global Equity Fund
Fund Manager	JBS Investments
Currency	AUD, Unhedged
Unit Valuation	Monthly
Minimum Investment	$20,000
Investment Strategy	Event Driven Global Value
Distribution Frequency	Annually at 30 June

FUND FEATURES

- Specialised Global Equity Fund
- Invests Globally in Strong, Dominant Businesses with Sustainable Competitive Advantages
- Benchmark Unaware
- Relatively Concentrated Portfolio
- Maintains Long-Term Investment Horizon

PERFORMANCE CHART



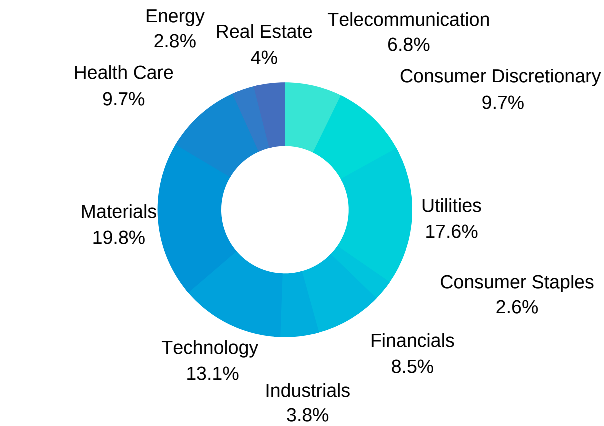
NET PERFORMANCE

1 Month	-1.37%
3 Months	2.21%
6 Months	4.83%
Calendar Year to Date	29.20%

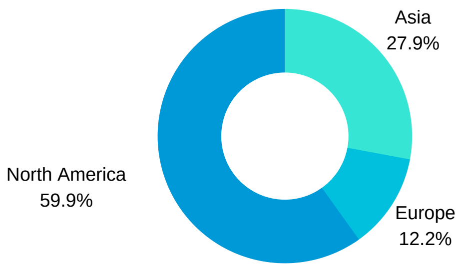
TOP TEN HOLDINGS

Company	Sector
LKQ	Consumer Discretionary
Sberbank	Financials
3SBIO	Health Care
Bausch Health	Health Care
Sea Limited	Information Technology
Crown Holdings	Materials
Graphic Packaging	Materials
Magnachip	Technology
Nexstar Media Group	Telecommunication
Vistra Energy	Utilities

INDUSTRY EXPOSURE



GEOGRAPHICAL EXPOSURE



To Our Unitholders

The core proposition of SGF is very simple: it makes long term investments in strong companies at as low a price as possible. The cornerstone of our investment approach is rigorous in-house research and creative insight combined with an opportunistic investment style.

We look at the economy through the eyes of the underlying companies in which we invest. Our on-the-ground research indicates that a recession is unlikely to be imminent. Although companies in certain sectors are saying that business is slowing, as we survey our holdings we see strong growth or attractive valuations. We believe that we are in the middle of a slow-growth economy. In such an environment we expect that interest rates will remain relatively low and that inflation won't be a major concern in the near term.

Although much of the financial press is taken up with speculating on wider economic circumstances, our focus is on companies and industries whose financial results and returns will ultimately be specific to their own circumstances rather than tied to general economic factors.

Market Observations

An important question to consider is how our portfolio companies are placed in the current economic environment. There is less wind at the back of companies in the US as compared to a few years ago when a decrease in interest rates and massive corporate tax cuts boosted corporate earnings. The sugar rush from those measures has now passed and we are back to a situation of slow growth, low inflation and little prospect of meaningful increase rate increases. The trade tensions between the US and China continue to threaten unpredictable outcomes with the prospect of short-term market sell-offs.

We do not feel directly exposed to fall out from the trade wars. Many of the businesses directly impacted by trade sanctions are commodity exposed companies such as steel and aluminium companies. These are not areas in which SGF invests. We prefer more sophisticated companies that possess higher barriers to entry and better economic characteristics. Our companies are typically marked by strong balance sheets, reliable profitability and very high free cash flow.

Equity markets remain at high levels and valuations in certain sectors are particularly over-extended. As a result, we believe over the next five years it will be very difficult to generate higher returns from simply relying on the overall equity market. We believe it will become more and more a stockpickers' market where it matters which individual companies you own. Particularly, in a slow growth environment, we feel that the investment case for owning high-quality businesses that generate strong cash flow remains more relevant than ever.

The Advantage of a Long Term View

Investment Philosophy

To recap, our investment philosophy is simple, straightforward and consistent. We select shares for the SGF portfolio based on three core principles. The first is to search for areas where we expect to find misunderstood and out-of-favour companies. We believe that this is where the best investment opportunities are often found. The second critical step is to ensure that the quality of the business is high. That is, the company must be profitable and earn a decent return on the capital employed in its business and be a dominant business. Thirdly, we must insure that we pay a cheap price for the company. This final step is perhaps the most crucial factor in determining what rate of return we will earn on the investment.

Once we have identified a company or situation that is in transition and possibly misunderstood, our investment process begins with a research effort that seeks to value the target company. Although share prices often react to emotion in the short term, they generally trade toward fair value over the long term. Therefore, if we do a good job at identifying mispriced businesses, the market will agree with us in due course. For an individual position, the typical waiting period for the market to revalue a business on the basis of the underlying fundamentals is up to 2 or 3 years. Sometimes, the average waiting period can be much shorter. In recent times, we feel that the waiting period for markets to catch up to company fundamentals is taking longer.

When it comes to the share market, if we are correct in our analytical and valuation work in relation to companies, our effort will be well rewarded - eventually. A crucial point is that no sustainable investment strategy, regardless of how logical, works all the time. The important thing for us is to stick to our strategy even when it is not working over shorter time periods. And that is what we do in the management of your funds.

Key Points

“The big money is not in the buying and the selling but in the waiting.”

Charlie Munger

Notable from the half-year

- The Fund delivered strong returns over the half-year and year
- Broad contribution to performance from nearly all core holdings of the Fund; Nexstar, NCSP and MagnaChip particularly strong performers
- Vistra Energy was the meaningful laggard with a decline in price over the quarter despite solid fundamentals
- Short-term caution is required given buoyant market conditions
- Having said that, we remain comfortable with our portfolio positioning. The current portfolio is attractive in comparison with market averages, with low starting valuation levels and resilient business fundamentals
- Accordingly, we are optimistic about future returns for the portfolio

Portfolio Summary

The table below sets out the top ten holdings of SGF in no particular order:

Company	Ticker	Entry price	Current price	Gain/ loss %	Observations
Crown Holdings Inc	CCK	44.53	73.25	64.50%	Strong financial results and a low starting valuation have driven the increase in the value of this investment. Despite the increase, there remains a meaningful gap between the current valuation and a market multiple providing further upside.
Graphic Packaging Holding Company	GPK	11.82	16.47	39.34%	The other packaging holding of SGF shows that a mundane industry doesn't mean a mundane business. GPK continues to generate solid free cash flow and is now seeing the benefits of previous business improvements.
MagnaChip Semiconductor Corp	MX	9.64	15.33	59.02%	A story of two separate divisions. MagnaChip has steadily increased its earnings in its crown jewel OLED chip business. Its weaker foundry division has picked up its results meaning that the company may not choose to sell this division as had been speculated previously.
Vistra Energy Inc	VST	22.81	22.71	-0.44%	Mispriced power company recently retreated in price back to our entry price despite no noticeable change in its business. Our conviction on the position remains strong. See comments below.
LKQ Corporation	LKQ	30.05	34.23	13.91%	Leading provider of alternative and specialty parts to repair cars. Valuation understates the long term prospects of its European business which is rapidly improving its results up to the levels of its US division.
Nexstar Media Group Inc	NXST	82.98	129.84	56.47%	Leading US free to air television company. See extended commentary below.
Sberbank	SBER	12.44	17.36	39.55%	Sberbank is the largest bank in Russia and a leading international financial institution. See extended commentary below.

Portfolio Summary cont.

The table below sets out the top ten holdings of SGF in no particular order:

Company	Ticker	Entry price	Current price	Gain/ loss %	Observations
3SBIO	1530. HK	11.39	11.48	0.79%	Reflecting its position as a leading biotechnology company from China, 3SBio has been growing at circa 25% p.a. Given valuation prices in a large part of the near term prospects for the company, we have reduced the position to free up capital for more compelling ideas.
Bausch Health Companies Inc	BHC	25.04	29.73	18.73%	Bausch Health Companies Inc was formerly known as Valeant and is one of the most despised companies in the US. Its origins are as a formerly high-flying roll-up of pharmaceutical companies fueled by debt. There is even a Netflix documentary about the behaviour of former management! The name of the company has now changed and gone are the formerly suspect accounting adjustments. The company owns leading brands such as eye care company Bausch + Lomb, Salix among others with no one product representing over 5% of revenue. It operates in over 100 countries. The legacy of its prior acquisition spree is too much debt. However, it has restructured this and pushed out the timing for repayment. Fortunately, the company generates strong free cash flow which it is using to pay down debt which should cause the value of the equity should appreciate significantly.
Sea Ltd	SE	31.15	41.31	32.62%	Singapore based business comprising of a gaming division, e-commerce division and payments platform. The company does not screen well due to the very different financial profiles of its respective businesses. The gaming business is particularly profitable and this cash flow has been used to finance the growth of its Amazon.com-like e-commerce business called Shopee. Shopee has had remarkable growth, with a long growth pathway ahead.

Portfolio Highlights

SGF's portfolio contains a mix of businesses which serve a broader range of customer bases across a range of different geographies.

Nexstar

Nexstar Media Group (NXST) is the second largest broadcast group in terms of U.S. television household reach. As of the end of 2017, the company owned, operated, programmed, or provided services to 170 full power television stations in approximately 100 domestic markets across 40 states. The company's broadcast properties reach 26% of American households. 82% of the company's stations affiliate with major networks such as CBS, NBC, ABC, and FOX. These agreements give NXST the exclusive rights to primetime content within the markets they serve. Nexstar produces and delivers nearly 4,000 hours of weekly local news and content, with top-two revenue share in a majority of their markets.

We have owned Nexstar no less than three times over the course of our Firm's history (in our sister wholesale fund) and we know the business well. We have witnessed the industry consolidate which has allowed reduction in costs as well as an increase in pricing power to the remaining industry players.

An interesting aspect of the business is that US election years tend to dramatically increase Nexstar's earnings as well-funded political candidates compete at the various stages of the US presidential election. Political advertising spend in the upcoming election is set to reach record levels. This is perhaps not surprising in a field of candidates which features a bitter fight between numerous billionaire candidates. We have reviewed estimates that total political advertising could come close to A$15 billion in 2020! Nexstar Media Group is more exposed than its peers to presidential spending which gives us confidence that it will exceed market expectations over the next year.

Our average entry price is $82.98 and at the time of writing Nexstar trades for $129.84 for a gain of 56%.

Portfolio Highlights cont.

Sberbank

Sberbank has continued to report excellent results. The bank generated a net profit of over US$14 billion for 2019 with its return on equity exceeding 20%. Management recently confirmed its confidence in achieving its profit target for 2020. From a business quality point of view, Sberbank continues to set the standard across the 100 largest banks in the world on nearly all profitability and capital adequacy levels:

Return on Equity (ROE)	%
Sberbank of Russia PJSC	**23.1**
FirstRand Ltd	23.1
Qatar National Bank QPSC	19.6
Bank of Ningbo Co Ltd	19.1
Itau Unibanco Holding SA	18.6
Bank Rakyat Indonesia	18.5
Bank Central Asia Tbk PT	18.3
Emirates NBD PJSC	18.1
National Commercial Bank	18.1

Return on Assets (ROA)	%
Bank Central Asia Tbk PT	3.3
Sberbank of Russia PJSC	**2.9**
Bank Rakyat Indonesia	2.7
Samba Financial Group	2.4
National Commercial Bank	2.4
Credicorp Ltd	2.3
Bank Mandiri Persero	2.2
Riyad Bank	2.1
Emirates NBD PJSC	2.1

Cost to income (CIR)*	%
Qatar National Bank QPSC	27.1
First Abu Dhabi Bank PJSC	27.4
Samba Financial Group	30.3
National Bank of Kuwait	31.3
Emirates NBD PJSC	32.3
Public Bank Bhd	33.0
Abu Dhabi Commercial Bank	33.6
Sberbank of Russia PJSC	**34.2**
National Commercial Bank	34.2

Despite this, Sberbank remains the cheapest large bank in the world across a wide range of valuation metrics:

P/BV 1YF	times
Sberbank of Russia PJSC	**1.1**
State Bank of India	1.2
Banco do Brasil SA	1.4
Malayan Banking Bhd	1.4
Samba Financial Group	1.7
First Abu Dhabi Bank PJSC	1.7
Standard Bank Group Ltd	1.8
Bank Mandiri Persero Tbk PT	1.9
Public Bank Bhd	2.4
National Commercial Bank	2.4

P/E 1YF	times
Sberbank of Russia PJSC	**5.0**
Banco do Brasil SA	10.6
Standard Bank Group Ltd	11.0
Qatar National Bank QPSC	13.2
Samba Financial Group	13.3
FirstRand Ltd	13.3
Malayan Banking Bhd	13.4
National Commercial Bank	13.4
First Abu Dhabi Bank PJSC	13.6
Banco Bradesco SA	13.6

Dividend yield 1YF	%
Sberbank of Russia PJSC	**10.0**
China CITIC Bank Corp Ltd	6.2
Bank of China Ltd	6.2
Malayan Banking Bhd	5.8
Agricultural Bank of China Ltd	5.7
China Construction Bank Corp	5.4
Bank of Communications Co Ltd	5.3
Standard Bank Group Ltd	5.2
First Abu Dhabi Bank PJSC	5.1
Samba Financial Group	5.0

Portfolio Highlights cont.

Even after the increase in its share price of 33% over the year, Sberbank continues to trade at a meaningful discount to its peers as can be seen above. On our likely conservative numbers, Sberbank trades at a P/E of around 5.7x forward earnings at the present time. The Russian government has made it very clear in recent years that it will require State owned companies such as Sberbank to pay out at least 50% of earnings as dividends driven by government funding pressure. We are reminded of a historical case study of an investment made by the great Warren Buffett when Berkshire Hathaway, Inc made over six times its money on Chinese energy company PetroChina in 2002. Warren Buffett explained the investment rationale as follows: "It was bought because it was very, very cheap by any metric – far cheaper than Exxon, BP, Shell... You could say it should be cheaper, given that it's 90% owned by the government of China, which is a factor, yes, but not so big for me. If you read the annual report of PetroChina, you'll have as good an understanding of the company as reading the annual report of any other oil company." Warren Buffett went on to mention that the company wrote that it will "pay out 45% of their earnings, barring the unexpected. I like knowing that that cash will come to Berkshire".

Case studies, of course, have natural limitations given that every investment situation is different. However, we feel that our investment in Sberbank has some similarities. The company is certainly cheap on an absolute and relative basis and is difficult to critique from a quality point of view. It is difficult to argue that country risk is not higher than China but we do take comfort from Sberbank's forward dividend yield of 10%.

Our average entry price of $12 compares favourably to the current price of $17.43. The larger picture remains positive with Russia remaining underbanked with a long runway for growth. There are anecdotal indications that the recent credit boom has led to some extensions of credit at the retail level that appear to indicate some loosening of lending standards. Accordingly, we continue to carefully monitor for signs of deterioration in credit quality.

Portfolio Highlights cont.

Recro Pharma

One of our favourite investment opportunities are situations where companies comprise of two divisions that have very different economics. Our recent investment in Sea Limited fits this model; the substantial cash flow generated by its gaming platform is obscured by losses incurred building out its Amazon-like online retail business. As a result, the stock does not screen well and presents a long term structural growth opportunity.

In a similar vein, we established a modest sized position in Recro Pharma during the quarter which is in the midst of a meaningful corporate transformation. Recro comprises two divisions:

- CDMO division - which is a contract manufacturer of controlled drugs for third-party pharmaceutical customers; and
- Acute Care division - which is focused on the development and commercialisation of an intravenous version of Meloxicam (IVM), a non-opioid pain medication.

In recent years Recro has focused on the development of IVM and has funded the associated costs with cash flow generated by the CDMO division. The company has spent over $100m to fund the development of this drug. Recro's investors have too focused on the potential market for IVM given the expectation that the widespread opioid crisis would provide strong support for the commercial launch of IVM. However, investors were met with disappointment when IVM was rejected by the FDA sending the shares plummeting.

The Company responded with a plan to spin-off the acute care segment to shareholders which will leave a pure play CDMO. Even according zero value to the value of IVM, we are left with a CDMO business that trades at a discount to the value of competitors. Unfortunately, our investment was hampered by the fact that the FDA reversed its decision whilst we were accumulating a position sending the price meaningfully upward. We were at first tempted to pack up the tent and close the position. However, we reworked our valuation work and concluded that the standalone CDMO business trades at a discount to peer companies and at a large discount to acquisition multiples. We believe the spin-off transaction is meaningfully transformative for the company. It both simplifies the story making the company easier to analyse as well as increasing the likelihood of a takeover.

Conclusion

We thank you, our unitholders, for your support and trust. As we look toward the future, we affirm our commitment to staying focused on long-term value creation to repay your trust.

Further Updates

We will write to you following the end of the next month and in more depth following the end of the March quarter.

We leave you with the following quote:

"There is no better teacher than history in determining the future... There are answers worth billions of dollars in a $30 history book."

Charles T. Munger

STRATEGIC GLOBAL FUND

Level 34, Waterfront Place
1 Eagle Street
Brisbane, QLD 4000 Australia

Postal Address (applications and redemptions)
PO Box R1479, Royal Exchange
NSW 1225 Australia