# Investor Report


STRATEGIC GLOBAL FUND
ARSN 613 886 392 APIR OMF0027AU

# 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.*

*This report is divided into: (1) market commentary and an explanation of how and why the portfolio is currently positioned as it is; (2) updates on our largest holdings; and (3) summaries of newly established positions.*

# STRATEGIC GLOBAL FUND

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HALF YEAR REPORT    December 2020

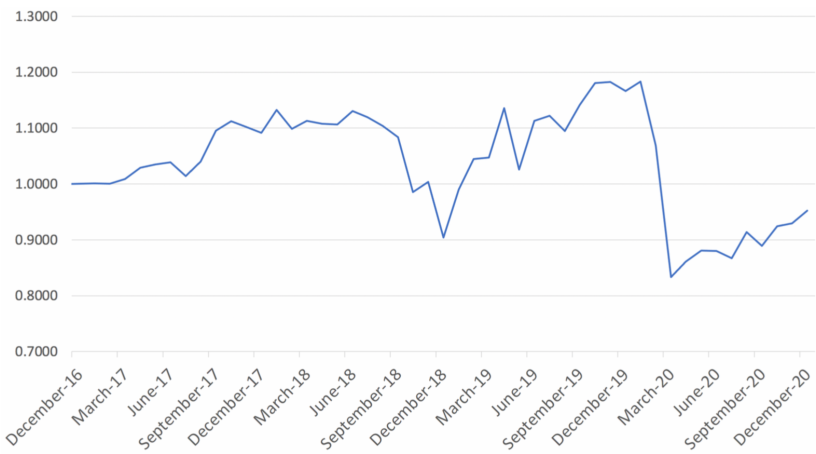
## FUND FACTS

| | |
|---|---|
| **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



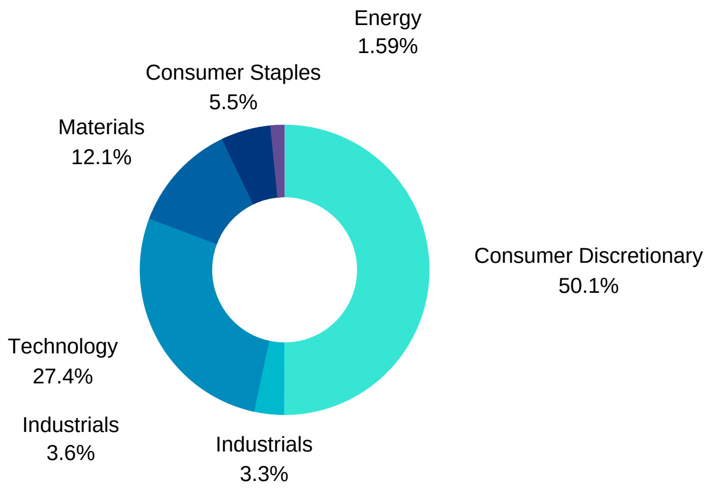

## NET PERFORMANCE

| | |
|---|---|
| **1 Month** | 2.46% |
| **3 Months** | 7.12% |
| **6 Months** | 8.21% |
| **1 year** | -18.34% |

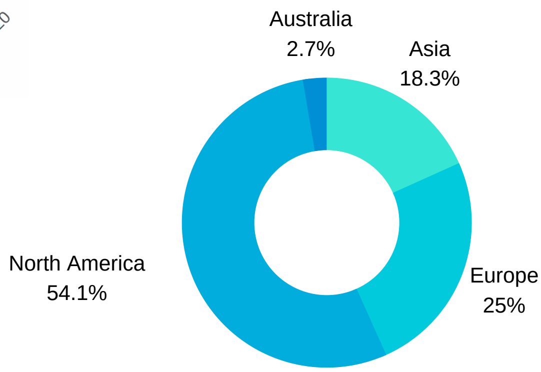
## TOP TEN HOLDINGS

| Company | Sector |
|---|---|
| **Betterware** | Consumer Discretionary |
| **BHG Group** | Consumer Discretionary |
| **CDON Group** | Consumer Discretionary |
| **Enlabs** | Consumer Discretionary |
| **Nautilus Group** | Consumer Discretionary |
| **Tuesday Morning** | Consumer Staples |
| **Sandstorm Gold** | Materials |
| **Bragg Gaming Group** | Technology |
| **Endor** | Technology |
| **Haier Smart Home** | Technology |

## INDUSTRY EXPOSURE




## GEOGRAPHICAL EXPOSURE



# Market commentary

This has been a devastating year in terms of human cost, both in terms of victims of the pandemic and their families as well as the mental cost of lockdowns and disruption to people's lives. Additionally, tens of trillions of dollars in economic damage have resulted. Vast increases to Government debt inevitably means that there will be a long term cost of paying off large stimulus programs.

The turbulence of 2020 brought with it seemingly contradictory market events as the worst economic contraction in nearly 90 years also featured huge rallies, speculative mania in some companies and assets, large numbers of new listings, negative oil prices, the first $2 trillion dollar company and relatively few corporate collapses. The overall stock market more or less ended as it began - valuations were stretched at the start of the year and finished with a similar amount of euphoria priced into most securities.

Usually in investing, doing the most obvious thing is not the best course. That was not the case this year. Doing what the herd did would have been the most rewarding strategy as many people did, as illustrated by the following quote:

> *"It's been nearly 21 years since the dotcom bust, 12 years since the Global Financial Crisis, and a whole new generation of traders locked down in their pyjamas with unspent disposable income now think they have an innate ability to pick stocks and time markets. The groupthink around certain stocks has driven them to insane this-time-it's-different levels, and index funds (a much larger share of the market now than in 2000) have no choice but to follow. In the S&P 500, the top 10 companies (11 stocks) make up 28% of the index and the top 41 account for 50%. Never have so many people put so much money into so few stocks."*
>
> ***- David Webb***

We felt like we were playing catch-up for much of the year and have worked hard to readjust the Portfolio as some of our initial expectations proved wrong. We initially underestimated the extent of Government stimulus coming into the market as well as the tailwind to equities helped in no small part by retail investors, many of whom were investing for the first time, often with leveraged products (which will not end well). Retail investors were a force in the market like never before in 2020, accounting for as much as 25% share of daily trading activity on peak days. Some contrast: the prior year, that figure was closer to 10%. Many of the market favourites from Afterpay to Tesla will eventually crash back to earth and some harsh lessons will be learned.

# Amazon FOMO and fallacies

## The wrong lessons

We have long thought that Amazon is a fantastic business as avid consumers using its services. Take these thoughts with a grain of salt as we never owned the stock. Not that long ago, Amazon was a battleground stock similar to Tesla today, with investors split into camps of those who unconditionally loved the stock and those who hated it as overpriced and overhyped. We were a fan as we could see that it was investing heavily in assets to grow the business in the future so that free cash flow in the years to come would be a lot greater than it would be otherwise. We saw online selling as a scale business characterized by high fixed costs and relatively low variable costs. We once debated the Amazon investment case with a well known investor who was in the "hater" camp and our thinking was that the company had pricing power so that in the future it could raise prices and consumers would tolerate it. Once the days of 20% per annum growth were past it, Amazon could rein in its capital expenditure and cash flow generation would increase dramatically. However, we had missed the key point; as explained by the Amazon founder himself:

> *"As our shareholders know, we have made a decision to continuously and significantly lower prices for customers year after year as our efficiency and scale make it possible. This is an example of a very important decision that cannot be made in a math-based way. In fact, when we lower prices, we go against the math that we can do, which always says that the smart move is to raise prices. We have significant data related to price elasticity. With fair accuracy, we can predict that a price reduction of a certain percentage will result in an increase in units sold of a certain percentage. With rare exceptions, the volume increase in the short-term is never enough to pay for the price decrease. However, our quantitative understanding of elasticity is short-term. We can estimate what a price reduction will do this week and this quarter. But we cannot numerically estimate the effect that consistently lowering prices will have on our business over five years or ten years. Our judgment is that relentlessly returning efficiency improvements and scale economies to customers in the form of lower prices creates a virtuous cycle that leads over the long-term to a much larger dollar amount of free cash flow, and thereby to a much more valuable Amazon.com. We have made similar judgments around Free Super Saver Shipping and Amazon Prime, both of which are expensive in the short term and – we believe –important and valuable in the long term."*
>
> ***- Jeff Bezos***

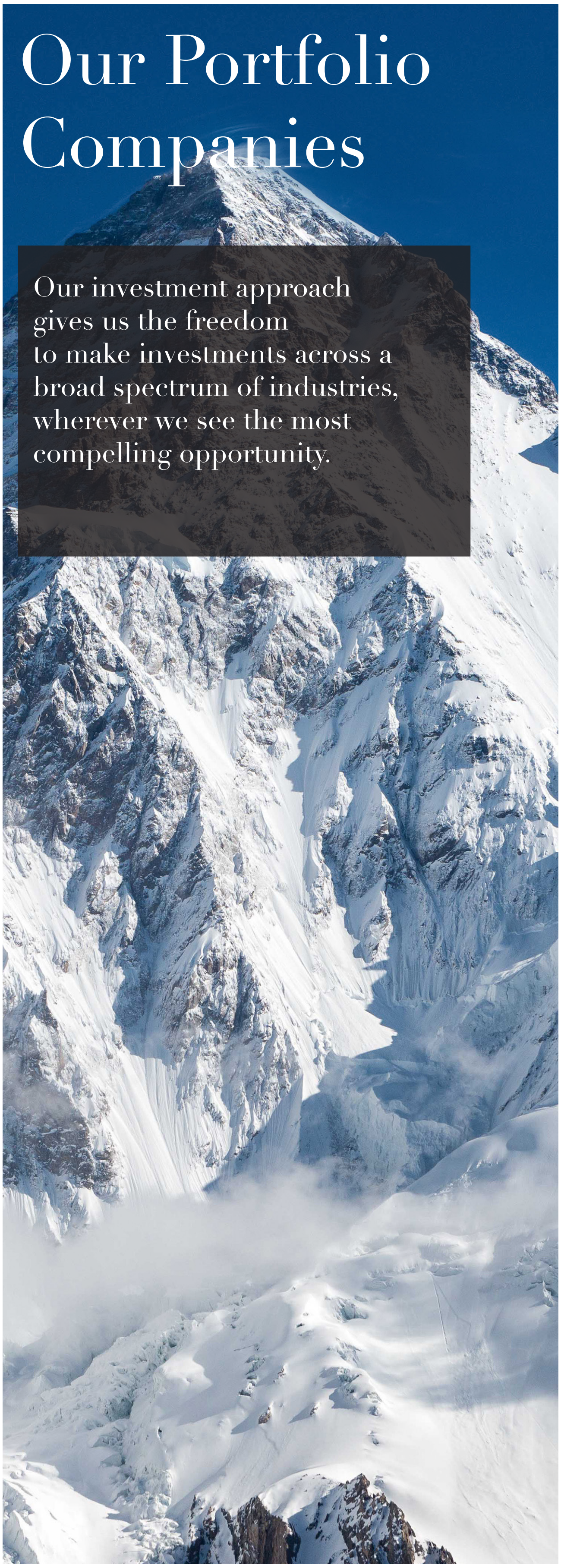
# Amazon FOMO and fallacies cont.

As a large company with very small margins, by sharing the efficiency benefits that increased scale brings with its customers, Amazon turns size, usually a headwind to business performance, into a significant competitive advantage. In other words, the moat surrounding the firm deepens as the firm grows. This concept is now well known as the Amazon flywheel or virtuous cycle.

Having failed to genuinely grasp this long term competitive advantage, we never owned Amazon. This brings us to "next-Amazon" fallacies and FOMO. Looking through the rear view mirror, investors are looking for the next Amazon. Many investors missed Amazon on the way up (as we did) but are perhaps taking some very wrong lessons from it. Ignoring traditional valuation metrics, such as price to book and price to earnings, is well and good if the other core parts of an Amazon-like business are there: scale efficiencies allowing savings to be passed on to the customer creating an ever widening competitive moat.

This model doesn't work when the business can be competed with easily. And we see clear excesses in the form of businesses that trade at >10x sales but lack any meaningful moat. There are simple insurance businesses with an online theme, transport apps that are unsustainably subsidising the customer. Many other loss making businesses have little more than a story to support a high valuation. And with Amazon FOMO, many investors are prepared to overlook serious red flags with no price too high to pay for topline growth. There are many examples, but perhaps the worst of the bunch is Nikola, at one time sporting a market capitalisation of US$30 billion and a business consisting of little more than a snazzy powerpoint presentation and a mockup of a truck with zero sales. When it was pointed out that footage showing the company's flagship truck driving down a highway was in fact faked by rolling an engineless truck down a hill, the company claimed that the truck was "in motion" and therefore it was not misleading! Even after such a revelation, the company still sports a market capitalisation today of close to US$7 billion. And expect a lot more start-up, money-losing electric vehicle companies to follow Nikola's lead and list in the near term. Yikes.

As the famed investor Benjamin Graham said, "In the short term, the stock market is a voting machine; in the long term, it's a weighing machine." Right now there is a record amount of voting going on and very little weighing. Our core investing skill set of balance sheet analysis, understanding the capital structure and cash flow analysis seems less relevant right now. Ultimately, however, over the long term, all companies will be weighed by their fundamental performance.



# Our Portfolio Companies

Our investment approach gives us the freedom to make investments across a broad spectrum of industries, wherever we see the most compelling opportunity.

## Position categorisations

You have to take the world as you find it and be pragmatic. Our focus has been on the following investment categories:

- Special businesses held for the long term
- Recovery stocks
- Catalyst situations where performance is driven by an upcoming event
- Mispriced growth
- Online champions at reasonable prices
- Low risk turnarounds

This has worked well in the past quarter as gains were driven by recently established positions.

The table overleaf sets out the performance and investment thesis underlying each of our core positions.

| Company | Investment thesis | Entry price | Price | Perf. to date | Target price | Upside target |
|---|---|---|---|---|---|---|
| Betterware | Betterware is a family run direct-to-consumer homeware company. The competitive advantage of the company stems from its geographic reach and distribution: products are delivered to customers within one to two days with a 99% on-time delivery record. Currently growing revenues at more than 80%, this debt free company pays out the bulk of its net income as dividends. We have established a meaningful position at an average entry price of $15 and see fair value in the mid-$50s. | 20.27 | 37.65 | 85.74% | 50 | 32.80% |
| Nautilus | Nautilus is an American manufacturer of fitness equipment founded in 1986 best known for its Bowflex brand of fitness of cardio and strength-training fitness equipment. After being caught napping by connected fitness company Peloton, Nautilus is now a low risk turnaround. New management re-invigorated the product line-up and the new bikes have resonated with customers for their clear cut value proposition as the lowest-cost connected bike available. Many of Nautilus's products are currently sold out which suggests very strong near term demand. Prior to the pandemic the turnaround was already taking shope and the crisis has accelerated the company's recovery. The current price places no value on the potential of Nautilus's own streaming app platform. | 19.56 | 19.93 | 1.89% | 40 | 100.70% |
| Haier Smart Home | New position: a cross border arbitrage position. Haier Smart Home is the Chinese white goods champion with shares listed on no less than three exchanges following a recent listing in Hong Kong. The recent listing highlighted a remarkable valuation discrepancy between the three share classes that is unlikely to stick around. | 1.35 | 2.07 | 53.33% | 3 | 44.93% |
| Sandstorm Gold | Sandstorm is a mining royalty company that funds mine expansion projects in return or a long term share of profits. Our long term thesis is that the company will rerate higher as new projects come online in the next two years which we expect would triple the share price. | 5.99 | 6.75 | 12.69% | 25 | 270.37% |
| Enlabs | Enlabs is an online gaming operator based in Eastern Europe. We were drawn to its dominant local market position and opportunity to expand to new markets. Others have spotted the attraction and Enlabs recently received a takeover bid. We are hopeful of the takeover price being increased. | 35.35 | 44.00 | 24.47% | 50 | 13.64% |
| BHG | BHG Group, one the largest and most successful e-commerce companies in Nordic region which has been growing revenue at +54% with earnings growing at an amazing +119% year on year. | 129.2 | 167.2 | 29.41% | 250 | 49.52% |
| CDON | CDON is the largest online marketplace in Northern Europe. Online e-commerce marketplaces are one of the best businesses given that it takes a cut similar to a tollroad on the growth of the underlying business. Despite its incredible growth ahead of it, we acquired shares at an attractive price. | 202 | 275 | 36.14% | 400 | 45.45% |

| Company | Investment thesis | Entry price | Price | Perf. to date | Target price | Upside target |
|---|---|---|---|---|---|---|
| Franchi Umberto Marmi | We believe this is a rock solid idea! The company is an international player in the marble stone industry. It sells premium marble at up to 10x the price of cheaper stone with profit margins to match. | 8.72 | 8.50 | -2.52% | 14 | 64.71% |
| Endor | Endor makes high end accessories for the video game industry, most notably Fanatec branded steering wheels. Endor has been booming in the pandemic as gamers spend up. Results for the year were earnings growth of 370%! Due to results only being reported in German, the shares only trade at a P/E of 12x, a third of what they would in the US market. | 115 | 111 | -3.48% | 150 | 35.14% |

# Position update: Nautilus

Nautilus had a blowout quarter, beating estimates by over 100%. The numbers were great across the board:

- $155 million revenue, +152% year on year (YoY) growth
- 40% improvement in gross margin (43.7% vs. 30.9%) YoY
- $33.8 million net income vs. $8.3 million loss in Q3 2019
- Order backlog exiting Q3 grew to $68 million (vs. $34 million in Q2 and $14 million in Q1)
- $59 million in net cash
- $540 million to $565 million revenue guidance for FY2020 and $90 million to $100 million in EBITDA

The day Nautilus reported results coincided with Pfizer's vaccine announcement and a market rotation away from stocks perceived as pandemic beneficiaries. Nautilus shares retreated more than 20% from its pre-earnings level. While vaccine-related pessimism has pushed down the shares in the short-term (and likely pushed out most of the short-term "stay-at-home" speculators), our long-term thesis as detailed in last quarter's report remains on track for a few reasons:

- **Working (out) from home is here to stay** - We expect that it will take at least a year for the vaccine to be administered to a large portion of the American population due to challenges ranging from logistics to skepticism. The net effect is that the pandemic has significantly increased the size of the addressable market for home fitness companies, regardless of how successful or widespread the vaccine becomes.

- **Substantial demand** - Demand continues to be extremely high and more importantly, stable. We have not seen evidence of saturation. Nautilus continues to release award-winning connected fitness equipment. The new flagship bike, the Bowflex Velocore, sold out in a few days, despite "bold expectations" (and matching inventory levels) from management. Nautilus management has stated that they don't expect for production to catch up with demand until Q2 2021 at the earliest.

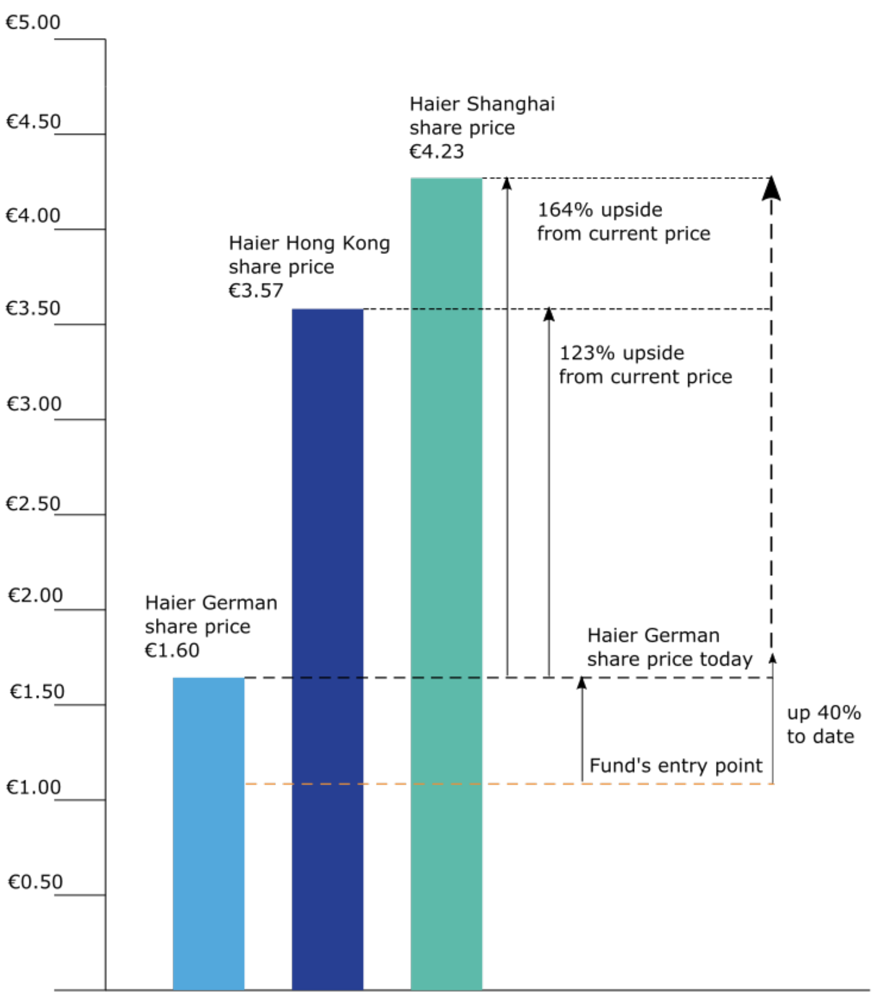
- **Free option on digital subscriptions** - The company's top priority now is to devote substantial resources towards its subscription app as part of the company's digital transformation. This is reflected in job listings on the company's website for app developers, software analytics, and more. More details surrounding the game plan for its digital subscription division will be announced shortly.

- **Valuation reflects low expectations** - The shares are cheap. If the company can execute and gain traction on the software side, the stock should re-rate upward heavily. At 1x sales, Nautilus is severely undervalued compared to both private (2.5x to 7x sales) and public comps (14x sales). On profitability metrics like free cash flow or EV/EBITDA, Nautilus is even cheaper. At that valuation and with roughly 15% of the market cap in net cash, there is a lot of downside protection. Any meaningful progress on the digital subscription side would make this a home run.

# New position: Haier Smart Home

'Twas the night before Christmas (well, two nights before) and a large Chinese national champion listed in Hong Kong, highlighting the huge valuation disparity between its newly listed shares and its equally ranking but long forgotten German listed shares. We are always interested in a listing that exists almost by accident and that is a decent description of Haier's German shares. Originally conceived as more diplomatic relations exercise than capital markets transaction, Haier's German listing (the only Chinese listing in Germany we are aware of) had a lukewarm reception. Since then, the shares have languished with no catalyst in sight. This changed when Haier listed shares in Hong Kong at a reasonable valuation which suddenly and starkly highlighted how cheaply the German shares were trading. We established a position at around €1.35. The diagram below shows the return to date and the potential upside.

**Haier Smart Home Valuation** *€ per share*



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