



21st January 2022

“Over the long term it’s hard for a stock to produce a much better return than the underlying return on capital the business produces. Over the long term your return will correlate even if you originally buy at a huge discount” – Charlie Munger

Quarterly Commentary

The portfolio return for Q3 FY22 ended March 2022 was -18.74% vs the index which was up 2.24%. The key detractors from the portfolio were **Clinuvel -35%, Nanosonics -39% and Fineos -48%**. This was an extra ordinary quarter with the equity market immediately pricing in a bond yield of 3% to the present value of future earnings. This interest rate view was further exacerbated by the European conflict which has throttled supply of soft commodities and energy further exacerbating inflation pressure. Our expectation for the long-term valuation of our businesses is that global interest rates would eventually make their way back to ~3% which is their 20year range. The top line of all our businesses are tracking in line with our expectations. To summarise the portfolios half yearly results in aggregate, the average revenue growth was 33%, average gross margin of 72% and is on average 39% owned by the founders running them.

Clinuvel’s continued share price weakness has been ongoing pressure from the institutional narrative around a potential new competitor to SCENESSE. Just as a reminder, CUUV has ~\$100M of net cash on their balance sheet and is producing \$30M of pretax profit per annum. They have five more treatments that are being developed and we are confident the market will reward them with a sensible valuation in time. For now they will continue to produce cash.

Nanosonics announced that they have revised their sales model in the USA with distribution partner GE Healthcare. This means that NAN will require a sales force on the ground to sell directly to their clients. We think this is short term pain for long term gain with a \$2,000 greater margin per unit and the ability to up-sell to Trophon 2, cross sell Audit Pro and eventually Coris, which GE never had an incentive to do. The global market opportunity for Trophon is estimated at 140,000 units. Currently NAN only have 28,000 units installed so have a long runway ahead. We met in person with Michael and McGregor to discuss the half year results and the GE change, and are confident in their capability and strategy to continue growing Nanosonics.

Fineos posted a half year loss for the first half with 40% of revenue expensed on Product Development and delivery. This increase was a shock to market expectations in the short term however management expect this to normalize to around 15%-20% as the business grows. The business has some very large clients and is providing mission critical software to an enormous worldwide market. We think that this crisis will force management to preserve capital and focus on compounding earnings faster over the next few years.

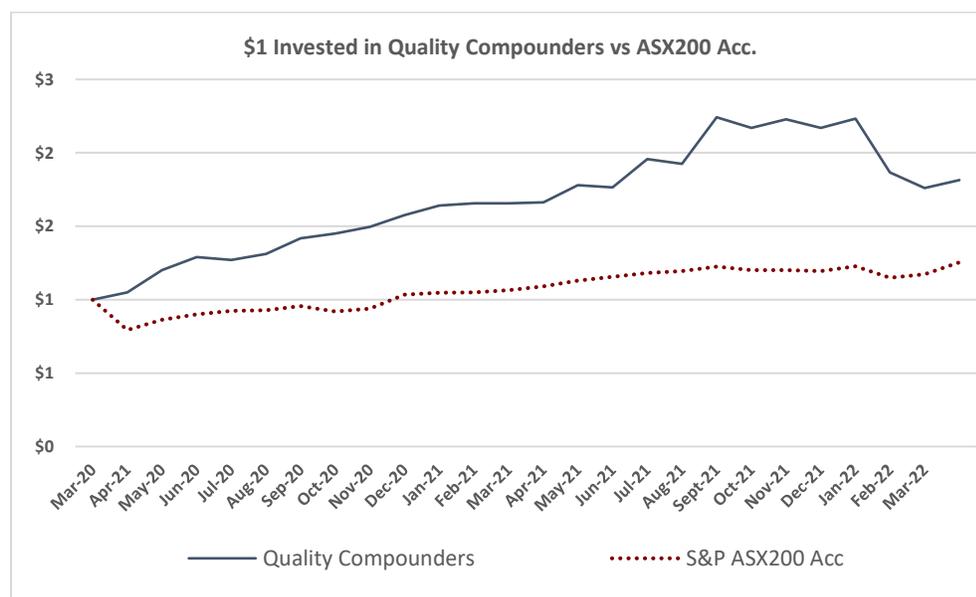
Things we have been working on During the March Quarter

The main project outside of covering the existing Quality Compounder stocks has been a long form study of the ASX and NZX market for founder led stocks that meet our criteria to potentially introduce to the portfolio. As part of this project, we have developed a universe of 61 companies that we need to meet with and study over the coming few years. We have completed a report to summarise our findings which we will send out in the coming weeks.

The team has been continuing to compound our learning during the quarter with over 20 meetings with Quality Compounder stocks management teams. We also conducted over 100 hours of company meetings with potential new companies.

We are preparing for our US trip to the Berkshire Hathaway Annual Meeting at the end of April. We are spending some time either side of this meeting to inspect the manufacturing and distribution facilities of Nanosonics, Trajan and PWR Automotive. We are also going to visit the ProMedicus R&D Hub and visit some other world class businesses - one of which is Cintas which we wrote about last year.

Quality Compounders Performance Q2 22



	Mar22 Qtr	2022 YTD	Since Inception (Feb 2020)
Quality Compounders:	-18.74%	-18.74%	+81%
ASX200 Accumulated:	+2.24%	+2.24%	+25%

Stocks we are working on

Our primary new stock focus for the quarter was **Macquarie Telecom - MAQ**. We met with this business some years ago when they were transitioning from a Telco business to Cloud Services and Data centers. They have passed that transition now and offer several attributes we look for in a quality compounder. We will outline this view in more detail in the coming weeks.

Reece was a focus of ours during the start of this quarter, it is another business we have admired for several years. We have been watching their large US acquisition of Morsco complete integration and start to show traction before committing to a long-term investment. Valuation has also been a limiting factor for REH.

DGL Group has also been a stock we are completing more analysis on. DGL is a specialty chemicals business that meets our founder led criteria. The business was founded by Simon Henry in 1984 however it has only just listed in 2021. This is also graduating up our list for investment.

PWR Automotive has been on our list for some years. We have met with them several times over the past 5 years including at their IPO where we saw their manufacturing facility. The business is founder led by Kees Weel and has been growing nicely over the past few years. We have always been interested in how they can scale beyond the F1 business.

Closing Commentary

This quarter has been a difficult time for the prices of several of our investments however they are all performing very well at an operational level and remain ungeared with substantial pricing flexibility. They are an exceptionally well managed group of businesses that will in time produce a pleasing investment outcome over the medium to long term.

Regards,

Quality Compounders Team

This presentation is provided for general information purposes only and is not intended as an offer to enter into any transaction. This information contained in it is not necessarily complete and its accuracy can not be guaranteed. We have prepared this presentation without consideration of the investment objectives, financial situation or particular needs of any individual investor. Before a client makes an investment decision, a client should, with or without Morgans' assistance, consider whether any advice contained in the presentation is appropriate in light of their particular investment needs, objectives and financial circumstances. It is unreasonable to rely on any recommendation without first having spoken to your adviser for a personal recommendation. The information contained in this presentation has been taken from sources believed to be reliable. Morgans Financial Limited does not represent that the information is accurate or complete and it should not be relied on as such. Any opinions expressed reflect Morgans' judgment at this date and are subject to change. Morgans and/or its affiliated companies may make markets in the securities discussed. Further Morgans and/or its affiliated companies and/or their employees from time to time may hold shares, options, rights and/or warrants on any issue included in this presentation and may, as principal or agent, sell such securities. The Directors of Morgans advise that they and persons associated with them may have an interest in the above securities and that they may earn brokerage, commissions, fees and other benefits and advantages, whether pecuniary or not and whether direct or indirect, in connection with the making of a recommendation or a dealing by a client in these securities, and which may reasonably be expected to be capable of having an influence in the making of any recommendation, and that some or all of our representatives may be remunerated wholly or partly by way of commission. The presentation is proprietary to Morgans Financial Limited and may not be disclosed to any third party or used for any other purpose without the prior written consent of Morgans. Morgans Financial Limited (ABN 49 010 669 726 AFSL 235410)
A Participant of ASX Group
Principal Office: Level 29, Riverside Centre, 123 Eagle Street, Brisbane QLD 4000
This document has been prepared by Morgans Financial Limited in accordance with its Australian Financial Services License (AFSL no. 235410). The views expressed herein are solely the views of Morgans Financial Limited.