QUALITY COMPOUNDERS

December 2021 Quarterly Report – Q2 FY22

Quality Compounders Portfolio – Morgans Scone.
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*"Over the long term, it's hard for a stock to earn a much better return than the business that underlies it earns. If the business earns **6% on capital** over 40 years, you're not going to make much different than a 6% return even if you originally buy it at a huge discount. Conversely, if a **business earns 18%** on capital over 20 or 30 years, even if you pay an expensive looking price, you'll end up with a fine result."*

Charlie Munger, Vice Chairman, Berkshire Hathaway

Client Insights - Please let us know what you are using & consuming!

Some of the best opportunities are sitting right under our nose…consider these seven outstanding stocks that were sitting right in front of one of our team members when they had their first interaction with the product:

- 2006: First time logging onto **Realestate.com** …. stock was $3 … now $154.00 … 27% compound
- 2011: Purchased first couch from Nick Scali … stock was $1.6 …now $11 … 22.5% compound
- 2006: Looked on **SEEK.com** for career opportunities … stock was $5 … now $30.60 … 12% compound
- 2016: Family member started using **ResMed** Cpap machine … stock was $8 … now $33.4 … 26% compound
- 2009: Ordered first pizza via the **Dominos** ap … stock was $2 … now $107… 35.9% compound
- 2018: Hand surgeon used **Pro Medicus**' Visage imaging system to show hand x-ray on his computer … stock was $8 … now $45 … 54% compound

Note: the above returns do not include dividends

We are constantly on the look out of businesses that can put their prices up each year, need very little capital to run and provide a good service to their customers. If you come across any of these in your business or day to day lives - please let us know!

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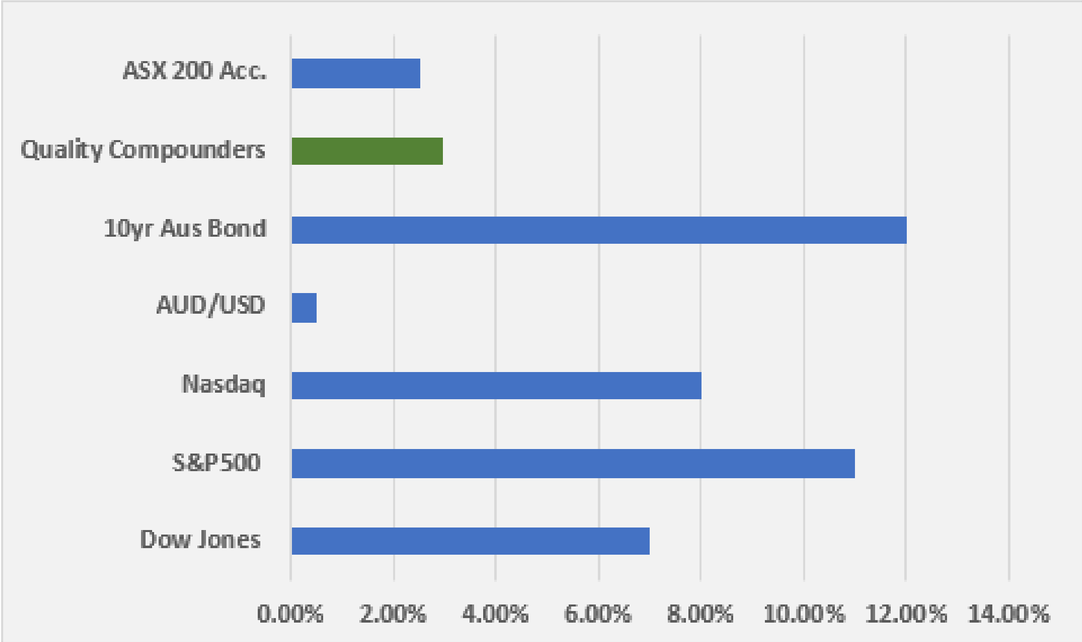
PERFORMANCE

Market Recap

The December 21 Quarter market movements again made big positive moves:

- The DOW Jones, +7%
- The S&P500, +11%
- The Nasdaq, +8%
- The AUD/USD, +0.5%
- The 10yr Aussie Gov Bonds: +12%
- Quality Compounders Stocks, +2.96%
- The ASX200 accumulation, +2.5%



Quality Compounders Portfolio since inception 1st March 2020: **123.2%**
S&P ASX200 Accumulation Index return since 1st March 2020: **22.7%**

Quality Compounders – Stock Performance Recap

- The Quality Compounders portfolio outperformed the ASX200 Accumulation by close to 20% for the December quarter 2021.

- The Key contributors were:
- TRJ which announced several acquisitions
- NWL which rebounded strongly due to strong FUA inflows again. This quarter performance number was artificial due to comparing September Qtr.

- Key Detractors were:
- CUV which had a sell research note produced, this sell view is solely based on Mitsubhishi Tanabes Phase 3 drug for EPP.

December Quarter 2021 Performance	
WiseTech Global	9%
Clinuvel Pharmaceuticals	-36%
Trajan Group	26%
Mainfreight	-3%
Lovisa Holdings	6%
Fineos Corporation	6%
Nanosonics	0%
Objective Corporation	8%
Xero	2%
Promedicus	14%
Netwealth	21%

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COMPANY UPDATES

Company	December Quarter 2021 UPDATE
Lovisa	Lovisa Founding CEO Shane Fallscheer resigned/retired from his position and was replaced by Victor Herrero who was a founding employee at Zara (Inditex). During the quarter we spoke with the Chairman, outgoing and incoming CEO's about the change. This replacement has been a multi year project with Victor attending several board meetings amongst other due diligence both parties did on each other. The emerging market countries appear to be more addressable in the shorter term with Victors experience but time will tell. We think the business still has enormous potential just in Europe and USA.
Mainfreight	Mainfreight paid their Half year dividend which was larger than the previous full year dividend due to increased earnings. The company reported earnings half year earnings of $131M which was an 80% increase on prior year. The company is also increasing development spend on its footprint committing $500M over the next to financial years. Global supply chains are presenting opportunities and challenges for the company but the quality can-do people in the business are making the most of it.
netwealth	Netwealth announced strong FUA growth for the September quarter with FUA net inflows +111% on the same quarter last year. The business is continuing to rapidly spend on development with new features and service continually added, as we have seen with other businesses that do this the small continual incremental changes eventually build up to an insurmountable advantage. Netwealth also announced the intention to acquire Praemium. This was a surprise to us; we will see the economics of this in time, but we are confidence the Heine family are deploying capital prudently.
Objective	During the quarter Objective had an investor day and AGM which outlined some more detail about the progress in developing new features of the software in the three key segments as well as some more customer insights. Tony Walls the founder also gave an FY22 outlook that was positive and highlighted a projected material increase in Revenue and profit. The company is clearly very customer focused and thinking long term.
TRAJAN	Trajan executed three transactions during this quarter. They ranged in sizes but broadly they strongly align with the message that Stephen Tomisich has presented us (Founder led businesses adjacent to TRJ), they are also being completed at very good valuations which is confirming our view that he is a capital allocator. The long-term opportunity is enormous in this specialist area. Trajan also had their AGM and released their Annual Report during the quarter, the communication from both Chairman and CEO are exceptional and we think they are building a high performance culture.
wisetech global	Wistech had their AGM during the quarter and reiterated guidance for the year ahead. Nothing too much to discuss from this quarter. Wisetechs key product Cargowise now accounts for 45% of manufactured trade flows with new products under development opening a much larger long term TAM.

Company	December quarter 2021 UPDATE
CLINUVEL	Clinuvel's entire fall in share price was due to a sell research note focusing on a competing drug that is in development. We believe this was the work of short sellers influencing sell side research. Our view is that CUV are building a competitive advantage by collecting the best dermatologists in the world to prescribe their treatment, this will be difficult to dislodge. As we have seen with other drugs such as Panhematin which despite being a very inconvenient treatment has broadly maintained market share against a new competitor. During this quarter CUV announced that it treated the first 2 patients in the DNA repair study to treat XP-C patients (A new treatment) with no adverse events. CUV also announced a record quarter of cashflows ($11.5M for the quarter). CUV also added a new compound to their portfolio ACTH which will be re-formulated into new treatments under the trade name Neuracthel. CUV also completed treatment for 6 patients in stroke study with no adverse events. Finally the FDA approved the Phase2 study to evaluate SCENESSE for treatment of Vitiligo. In a prior study SCENESSE with NB-UVB light successfully re-pigmented skin legions however the FDA didn't recognise NB-UVB as an approved therapy. Despite all of this progress the stock is trading at a $1.2B valuation, we think it is incredibly undervalued by the market.
FINEOS	FCL raised $70M from an equity placement in the quarter and we are very disappointed in this, we understand that the company is in a transition from its older consulting type business model to a pure SaaS product and this takes some patience. However, an increase of 17% in share capital is not a good trajectory to be on. We are monitoring this business and its capital allocation closely.
nanosonics Infection Prevention. For Life.	Nanosonics had their AGM during this quarter which re-iterated the earnings presentation made earlier in the year. To re-iterate the company increased the TAM for Trophon by 40%, announced AuditPro software for tracking ultrasound usage and de-contamination, and also announced the next big HLD product in Automated Endoscope Cleaning/re-processing. The effective cleaning of Flexible Endoscopes is a top 10 health technology hazard. To briefly unpack this long term opportunity, there are currently 60M annual endoscopy procedures completed per annum and the current manual 200 step process can take up to an hour to clean. We estimate that this is a market larger than Trophon.
xero	XRO announced half year results during this quarter. The results were in line with our estimates overall with stronger subscriber growth but lower ARPU growth. We are expected a material step up in ARPU as the ecosystem starts to contribute to total revenue. For example XRO ARPU of $31 is roughly 1/3 of Intuits ARPU and we believe there is a big opportunity for XRO to capture here. XRO has an incredible business and despite ebs and flows in expectations the opportunity is enormous and the customer base is very sticky, proven by a price rise in several markets with almost zero churn.
promedicus OUR SUPPORT YOUR SUCCESS.	ProMedicus signed a new contract with Novant Health which is equally the largest contract to date and because of cloud based solution this will be implemented in 2HFY22. It is our contrarian view that momentum for Visage is accelerating and will not revert to the mean over the next 3years, the consensus view is that PME will not continue to sign deals this big. We disagree. PME also completed a great presentation at the AGM outlining some new product development. Currently it is caught up in the washing machine of valuations but long term we are really excited by the companies prospects.

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ACTIVITY

Stocks we let go:

StepOne (STP:ASX): We were very interested in the strong founder leadership and apparent product market fit this business achieved in a short time however basic errors of financial management have resulted in this one not making it through our process.

Stocks we are still working on:

AfterPay (APT:ASX): We really like the Afterpay software and ecosystem that has been developed, this is the difference between other BNPL competitors. Its more than a BNPL company and we are beginning to understand the power of payments businesses. Currently APT is under consideration as a potential quality compounder. It will now become an ADI and stay trading on the ASX.

AFT Pharmaceuticals (AFP:ASX): We really admire the founder Hartley Atkinson who owns close to 70% of the business and has operated very prudently over the years re-formulating and in-licensing drugs to ANZ, this has resulted in very consistent revenue growth. We want to spend some more time to understand the pipeline of opportunities a bit more.

Company Meetings

We have been busy arranging conference calls with companies to discuss COVID-19 impacts and company updates. The meetings we conducted included:

COMPANY	CONTACT
Cettire x 4	Dean Mintz & Timothy Hulme
DGL Group x 2	Simon Henry
Clinuvel x 3	Malcolm Bull and Philippe Wolgen
ProMedicus x 2	Sam Huppert and Clayton Hatch
Trajan Group x 3	Stephen Tomisitch
EM Vision	Scott Kirkland and Ron Wienberger
Tiny Beans x 3	Eddie Geller
The Blue Space x 2	Les Patterson
StepOne x 2	Greg Taylor
Litigation Capital	Patrick Moloney
Lifestyle Communities	Darren Rowland
ImmVirX x 2	Malcolm McColl
Energy One x 2	Shaun Ankers, Andrew Bonwick & Guy Steel
Objective Corp	Tony Walls – Investor Day

COMPANY	CONTACT
Mainfreight	Don Braid
Vectus Biosystems	Maurie Stang and Karen Duggan
AFT Pharmaceuticals	Hartley Atkinson and Malcolm Tubby
MAAS Group	Investor Day
Joyce Corp	Dan Madden
Pinch Payments	Paul Allen
4D Medical	Andreas Fouras

What has the team been reading & listening to:

Whilst staying across the portfolio companies we are constantly trying to find new insights & opportunities through various books, news publications, journal articles & podcasts. We use these insights as both a source of new ideas and new learnings to continue to enhance our process.

The detail of the teams reading will now be released via the website Blog at www.qualitycompounders.com.au

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PORTFOLIO OVERVIEW

Company	WHY WE LIKE THE BUSINESS
Lovisa	**MANAGEMENT:** Hold 40% of the stock & are very experienced retailers **BUSINESS:** LOVs low basket size creates an almost habitual purchasing pattern from its core customers – who shop for regulator outings or dress-ups. LOVs low priced, high turnover products enables global leading store unit economics – generating ~$20,000 in sales per square metre which compares favourably with the likes of LuLu Lemon ($15,600); Tiffany ($27,900) & Apple ($55,460). It takes a management team with significant 'tactile knowledge' to execute a complex supply chain. This 'tactile knowledge' is incredibly difficult to replicate with both time & money **GROWTH:** We believe that LOV can grow their stores from ~450 today to ~2,000 over the next 10 years
MAINFREIGHT	**MANAGEMENT**: MFT have a very special culture that has been curated over the past 30yrs by the current management. Culture is a very difficult if not impossible competitive advantage to reverse engineer / replicate. One of MFTs core business lines is 'less-than-container-load' (LTL) services, the execution of an LTL service is highly differentiated to a full-container-load (FCT) given the multiple contact points involved with one truck servicing multiple customers. Conversely, FCT is a highly commoditized A to B transportation service. It is MFTs highly engaged & motivated staff that enable the execution on this higher margin, LTL service. **BUSINESS:** MFTs network of warehouses & branches would be both costly & difficult to replicate. Further, as branches are added to MFTs network they create a more compelling offering to their existing customer base in addition to another route they can be monetized **INDUSTRY:** The transport logistics industry is characterised by a number of large underperforming/slow moving participants who we believe MFT will take share from overtime. MFT currently sell all 3 of their products to just 31% of their 500 largest customers, we believe this is likely to increase overtime.

Company	WHY WE LIKE THE BUSINESS
FINEOS	**BUSINESS:** FCL provides a software service that is essential to the daily functioning for insurance companies. Errors in core claims processing software can lead to sever regulatory breaches and in some cases bankruptcy for an insurer. This critical function enables FCL to charge recurring revenues for their software and this fee is typically increased each year. Further, due to the deeply integrated nature of FCLs software, they experience very little customer churn, as highlighted by their top five customers having been with them for >8yrs. In addition, 50% of FCLs annual revenues are recurring **GROWTH:** The industry is still processing the majority of their claims through legacy systems that are > 30yrs old. These systems are now becoming increasingly costly to maintain. In addition, consumer lead demands for an ability to interact digitally, we believe, will see a number of insurers start to outsource their systems to providers, such as FCL. We expect this conversation process will see FCL on average, double their revenues per customer over a five-year period. **MANAGEMENT:** Founder, Michael Kelly is FLCs largest shareholder holding 60% of the business. Further, we also believe that Michael has instilled a high-quality culture at FCL, with 88% of FCLs senior executives having been in the business for > 15yrs
nanosonics Infection Prevention. For Life.	**INDUSTRY:** NAN is the world leader in the disinfection of ultra-sound probes through its product the Trophon. Management have stated that there is currently no competitive offering to the Trophon. This is a very niche market, one that is unlikely to attract significant competition given the small total addressable sales versus large barriers to entry. **BUSINESS:** NAN has 22,000 Trophon units installed across North America; EMEA & Asia Pacific. This installed base is highly valuable and difficult to replicate or penetrate as hospitals are unwilling to consider an alternative if the current product preventing the spread of inflection. Hospitals typically have to upgrade their Trophon every five years and NAN is able to sell a consumables product along with the Trophon unit – creating a 'razor blade' type model. Further, the hospitals sales cycle is typically very long, creating a barrier to entry into this very niche industry. **MANAGEMENT:** NAN is lead by Michael Kavanagh, who spent 10yrs a COH prior to joining NAN
TRAJAN	**MANAGEMENT:** The Tomisich Family own 60% of the business still, they founded it 11years ago and have never raised capital with the exception of the IPO. **BUSINESS:** TRJ is a developer and manufacturer of laboratory instrument consumables and sampling devices, they have ~90% recurring revenue contracts and are reallocating free cashflow to developing new devices and growing their share of niche markets. **GROWTH:** The wholesale addressable market is estimated at several billion USD that is made up of many small markets some of which TRJ owns 60% of. TRJ's growth will come from reallocating cash flow to acquiring similar businesses and developing new products. We estimate that Gross margins will expand from 40% - 50% as throughput grows, Revenue will grow organically at 5% plus free cash flow directed to acquisitions.

Company	WHY WE LIKE THE BUSINESS
xero	**BUSINESS**: XROs platform enables SMEs to manage the day-to-day accounting of their business. This central source of truth for an SME enables XRO to charge annual (recurring) fees for (on average) seven years (average customer life) and currently 98% of their revenue is recurring. XROs customers stickiness is a function of its two-sided network effect. Like Apple's 'ap store', XRO also earns revenue from SME application providers. The more applications on their platform, the more value XROs customers are likely to gain from being able to easily connect to their service providers. The more customers on the XRO platform, the more value they create for the application providers. Further, XRO has enable the accountant as a friendly middleman to both sell and educate their customer base on the software. **MARKET** opportunity: Currently, only 20% of the world's SEMs have adopted cloud accounting software (ex ANZ) – there are many millions of potential subscribers in UK and North America to convert. Further, XRO also processes billions of transactions across its platform which we believe it will be able to monetize **INDUSTRY STRUCTURE:** XRO has only really one major competitor – US based Intuit. Both players are highly profitable and in the best position to continue to penetrate cloud accounting systems into SMEs.
promedicus OUR SUPPORT YOUR SUCCESS.	**MANAGEMENT**: PME founders, Sam Huppert & Anthony Hall still own 55% of the business and are very experienced managers. They have allocated capital incredibly well since founding the business in 2000. Further, PME has a very stable management team with all senior executives having been in the business of over eight years **BUSINESS**: PMEs Visage Imaging Platform is a world leader in radiology imaging software – servicing a number of the world's leading hospitals including The Majo Clinic; Ohio Hospital; Cleveland Clinic; Duke University; German Government Hospital. These customers are contracted for typically 5 to 7yrs and are charged per scan. We estimate that >85% of PMEs revenue is recurring and PME is also able to increases their prices each year these factors combined, create a highly attractive & predictable revenue stream **MARKET OPPORTUNITY:** The North American PACS market is >$2B USD with PME growing the fastest with still only ~4% market share
CLINUVEL	**BUSINESS**: CUV is the only treatment for patients suffering for Erythropoietic protoporphyria (EPP – a rare blood disease which causes a severe reaction to sunlight) – making it a legal monopoly. This treatment needs to be administered by a clinical professional / friendly middleman at regular intervals, creating a lifetime patient value in excess of $1m. **INDUSTRY**: The FDA granted CUV market exclusivity for the distribution of SCENESSE. Legalized monopoly industry structures tend to create high long-term shareholder value **MANAGEMENT**: CUV achieved FDA approval through a total investment of ~$330m, this compares with most drug companies who would typically spend in excess of ~$1b. Wolgen's disciplined use of equity capital in addition to his very considered newsletters provides us with a lot of confidence in his ability to execute **GROWTH**: We believe that CUV will materially expand the market opportunity of SCENESSE overtime, with management identifying an additional five use cases.

Company	WHY WE LIKE THE BUSINESS
netwealth	**MANAGEMENT:** The Heine family still own 60%+ and have built a very good culture and long term orientated business model (not winning unprofitable business) **BUSINESS:** NWL is the market leader in wealth management software in Australia. 90% of NWLs earnings are recurring and they have very long-term customer relationships. NWL is a beneficiary of both rising equity markets (7% CAGR) & interest rates (NWL receives a margin on cash accounts). Due to NWLs customer focus & market leading functionality, they have created a 'friendly middleman' through the financial planner. **GROWTH:** The total industry is ~$1T in FUA size and grows at 10% CAGR due to super contributions & asset price growth. NWL currently only have 3% market share
Objective	**MANAGEMENT:** Tony Walls owns 66% of the company, has built a strong culture of integrity and can do attitude. **BUSINESS:** OCL product suite is very sticky with 99% customer retention and is a strong beneficiary of the growth in unstructured data management. The OCL business produces 95% gross margins and has grown revenue from $50M to $70M over the past 5 years while utilising no additional capital. Due to the core functionality being embedded in customer workflows and training the switching costs are very high and extremely painful to move from. **GROWTH:** The content management industry is forecast to be a $15B USD market growing at 14% CAGR (Fortune business insights).
wisetech global	**MANAGEMENT:** Richard White the founder owns 39% of the company and his Co-Founder Charles Gibbon own 11% of the issued capital, the business was founded on a innovation culture and both founders are business minds with a proven track record of capital allocation. **BUSINESS:** WTC has a very sticky customer base the rely on the core product CargoWise to move goods throughout the world on a daily basis. The software is embedded in the workflow of employees at the largest freight companies in the world and is charged per item of freight moved. WTC generates 81% Gross margins and is very capital light and highly scalable. **GROWTH:** WTC is currently ~10% penetrated in the global supply chain execution market, this market grows as ~5% per annum in addition to further product releases for new market applications.

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QUALITY COMPOUNDERS

We focus on finding and investing in capital light, price making businesses that are founder led with a growing competitive advantage. We are radically open minded and long term investors.

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