



## Total returns

At 31 December 2021	3 mths %	6 mths %	1 yr %	2 yr % p.a	3 yr % p.a	Incep. % p.a. (27 Apr 2017)
Chester High Conviction Fund (after fees)	3.5	10.0	22.6	19.5	19.8	15.1
S&P/ASX 300 Accumulation Index	2.2	4.0	17.5	9.4	14.0	9.4
<b>Outperformance (after all fees)</b>	<b>+1.3</b>	<b>+6.0</b>	<b>+5.1</b>	<b>+10.1</b>	<b>+5.8</b>	<b>+5.7</b>

\* The inception date of the Chester High Conviction Fund was April 26th, 2017. The NAV at December 31st, 2021 was 1.5548

*"To succeed as a contrarian you must recognize what the crowd believes, have concrete justification for why the majority is wrong, and have the patience and conviction to stick with what is, by definition, an unpopular bet"*

## Whitney Tilson

### Quarter in review

We enjoyed playing club cricket in the early 2000s. It was both competitive enough, but very social at the same time. In late 2002, our new captain rallied the troops before the first game of the season. A lawyer by training, he was a very good orator, and left us feeling good about the season ahead. "Value your wicket", "make them bowl to you", "nothing silly early" were the well worn phrases of the day. As our new captain won the toss and elected to bat, we felt sure that he would, as the opening batsman, really show us the mindset in which to approach the game. By leaving the first ball of the season, we could see his intent. By skying a slog sweep to mid wicket on the second ball of the season leaving the team at 1/0 was a source of concern as a cricketer, but a source of great amusement ever since. Leadership comes in many forms.

Leadership is being challenged in many ways currently. We have (surprisingly enough) much empathy for politicians currently as they grapple with ever changing variants of the COVID-19 pandemic, while battling to keep supply lines open and the economy moving. Embedded cost pressure is everywhere. Fortunately as Australians we are a compliant nation, and vaccination rates appear to be working in managing a more significant health crisis. Geo-political leadership is being tested with Russia and China probing at the US/Western alliance's desire for global democracy. Are Ukraine and Taiwan susceptible to a change in control? Does the US still have the fortitude to be the world's policeman?

These issues may seem poles apart, but from an investment perspective, they form part of the same landscape in 2022. Risk appetite and investment leadership is changing. We have been consistent in our view that inflation is going to be a persistent problem in the 2020s. Absolutely the cyclical element of supply chains and logistic bottlenecks should theoretically unwind over the course of the next 12 months. The structural components of a willing workforce being incentivised to work (wage pressure), decarbonisation (cost of energy increases), localisation of supply chains (increased CO2B) and asset price inflation (cost of living increases through shelter costs going up) appear to be more embedded. Hence the most likely roadmap ahead is inflation remains stubbornly high (above 3-4%), but is likely to peak over the next 3-4 months (fall from 7%) as the rate of change starts decelerating. To reiterate though, this is the first time in 40 years that inflation has been considered a problem. The change in leadership from a growth friendly environment to a far more appealing backdrop for value based investments (focusing on near term cash flow delivery, dividend yields and asset backing) is now starting to play out. In our experience, this is not a 3-6 month trend, but is more likely to be a 2-3 year trend.

Of course this really only began in earnest as the Federal Reserve decided to change its approach to this inflation issue. Jay Powell, after being re-elected, went from a very sanguine monetary policy (slow tapering and no rate hikes in 2022) to a hawkish stance (accelerated tapering and 3-4 rate hikes in 2022, with the prospect of QT if inflation persists) in 8 weeks. Don't fight the Fed. This is a material change in thinking, and has driven a significant shift in sector leadership over the past 3-4 weeks. The underperformance of former market darlings and unprofitable technology names has (in our humble view) only just started, as interest rates rise, the demand for physical assets and actual cash flow will be highly sought after. We would hope the portfolio is very well placed to benefit from these more fundamental based investment outcomes, as opposed to the narrative based "hopetivism" that has driven the market over the past 3 years. With the prospect of financial conditions getting tighter in 2022, the focus will be very much led by stock specific earnings drivers, hence the most in demand stocks will be those that have earnings or cash flow tailwinds and valuation support.

**Our philosophy with the Chester High Conviction Fund is to strive to protect and then grow (what we hope to be) generational wealth. Under this framework, the least risky way to protect capital over the next 12 months is to not over pay for future cash flows, which means a rigorous focus on asymmetric investing. What is the downside vs what is the upside of an initial investment? We remain heavily focused on owning a portfolio of stocks that remain compelling on a bottom up cash flow basis, and by no means do we want to be overpaying for those cash flows. There remains significant risk around long duration valuations (the higher the bond yield goes, the lower the value attached to those cash flows). We think the backdrop is favourable for finding unloved and underappreciated assets, where the risk/reward trade off is far more compelling. This is how the fund initially invested in stocks such as MIN, ABB, NWS, LYC and ORG over the past 3-4 years. We believe we still have a significant number of stocks in the fund that fall into the category of unloved, underappreciated or undiscovered.**



## Portfolio changes over the past 3 months

From a bottom up basis, the quarter was relatively quiet in terms of activity. Over the quarter we took profits in several stocks that have performed very well for the fund, in Woolworths (WOW), Gold Road (GOR) and Westpac (WBC) while lightening Endeavour Group (EDV), Tabcorp (TAH), Lend Lease (LLC) and OceanaGold (OGC). We added to our existing positions in CSL, Mineral Resources (MIN), Origin Energy (ORG), Austal (ASB), News Corp (NWS) Aurelia Metals (AMI) and Synlait Milk (SM1), while adding to our Energy position early in the 1st quarter of 2022.

We see more reason to be very focused on the valuation margin of safety with the initial investment, with a strong emphasis on the assets on the balance sheet (asset backing) as well as favorable catalysts that hopefully provide reason for the intrinsic value of the company to be realised over the next 18 months.

## So what are we focusing on as we enter 2022?

Our thinking has been very consistent over the past 12 months and indeed as we start 2022. Financial conditions will get tighter with interest rates rising, which ties into our framework of desiring strong cash generation and asset backing. Broadly, we maintain our focus on four key areas of investing, while appropriately diversifying the fund from an industry stand point. These four key areas are listed below. There is still a wide range of outcomes possible from a macro perspective over the next 12 months, so we look to have a blend of stocks with significant valuation support, while also holding several stocks with strong pricing power and dominant industry positions.

**Real assets.** Inflation will drive real asset valuations significantly higher. We would highlight the multiples being paid for Sydney Airport, Ausnet, Spark Infrastructure and the Telstra Mobile Towers as providing us strong confidence in the way we value several of our holdings in the portfolio.

**Valuation margin of safety** - Not overpaying for concept stocks or long duration assets. Upward pressure on bond yields exacerbates this risk.

**Pricing power, or at a minimum pricing pass through.** With cost inflation evident, how likely is a company to be able to at a minimum hold margins, that is, pass through higher costs to their customers without impacting customer engagement? This remains the biggest risk to any portfolio holding currently, as while cost pass-through has been apparent in many cases over the past 12 months, as liquidity conditions dry up, only the very strong business models, or those with commodity linked tailwinds (energy/electricity) will see margins continue to improve.

**Gold.** We have been intellectually wrong with the gold position over the past year, as historically negative real yields (US 10 yr bond less inflation) have coincided with a period of gold price strength, but ultimately (and we have been using gold as a non-correlated equity exposure for over 17 years) gold does follow its own rhythm. Historically, more often than not, gold performs the best as a defensive asset class in times of inherent volatility, while on a cash flow basis, there is extreme value emerging in gold equities, as the most unloved sector across global equities right now. We see any significant volatility in 2022 as providing a favorable backdrop for gold, and hence we retain our 6% portfolio weight, albeit spread across several different holdings.

We see CSL as one of the highest quality businesses in Australia. The recent equity raising we felt was an appropriate time to increase our holding. Chairman Brian McNamee and CEO Paul Perreault have proven very fine stewards of capital over 30 years, with the Vifor acquisition providing a strong kidney and iron deficiency franchise as well as an exciting R&D portfolio. We are happy to back them. We believe Origin Energy (**ORG**) is experiencing trough earnings in FY21/FY22, with a strong recovery underway, while there are several catalysts ahead of it to see the stock trade closer to our valuation. Origin's 20% stake in Octopus, a fast growing energy retail platform in the UK, together with an FY23 earnings recovery and significant free cash generation from its APLNG stake make it a compelling investment at these levels. News Corp (**NWS**) also has a portfolio of assets that are without doubt, mispriced in the NWS conglomerate structure. This allows us an investment in a highly cash generative business, with high quality assets in property and media, with undeniable valuation support.

## The Portfolio

The CHCF posted a 3.5% gain in the December quarter, relative to the 2.2% increase in the ASX300 Accumulation Index. We believe there are several key holdings that are well positioned for strong periods over CY22. We remain genuinely excited by the valuation support within the portfolio, as well as a pre IPO position that will come to the market in May/June where we expect a significant valuation uplift. Mineral Resources (MIN) saw a strong recovery on both iron ore sentiment and the increasing understanding of the high quality lithium assets within the group. Our attraction to MIN over the past 4 years has been both the leadership of Chris Ellison and the enviable suite of assets across mining services, lithium and iron ore, providing a truly well balanced portfolio. Aurelia Metals (AMI) remains undervalued in our view as a strong cash generative company (<4x EV/EBITDA) with a company transforming discovery in Federation that the market (in our view) materially underappreciates.

Aurizon (AZJ) has been an extremely frustrating investment to this point, which has been discussed at length internally. The market has dismissed AZJ as an old economy stock exposed to coal movements (and a poorly executed transaction), while we have preferred to focus on the tightness in the end markets and the predictable cash generation. We continue to hold it. Betmakers was sold during the quarter.

Top 3 Holdings	Portfolio Breakdown		Top 3 Portfolio Attribution	Bottom 3 Portfolio Attribution
CSL Limited	Industrials	15.0%	Mineral Resources	Aurizon Holdings
Origin Energy	Materials	14.9%	Aurelia Metals	News Corp
News Corp	Consumer Disc	12.6%	Origin Energy	Betmakers Technology



## Accumulated Performance by Financial Year - Same Strategy

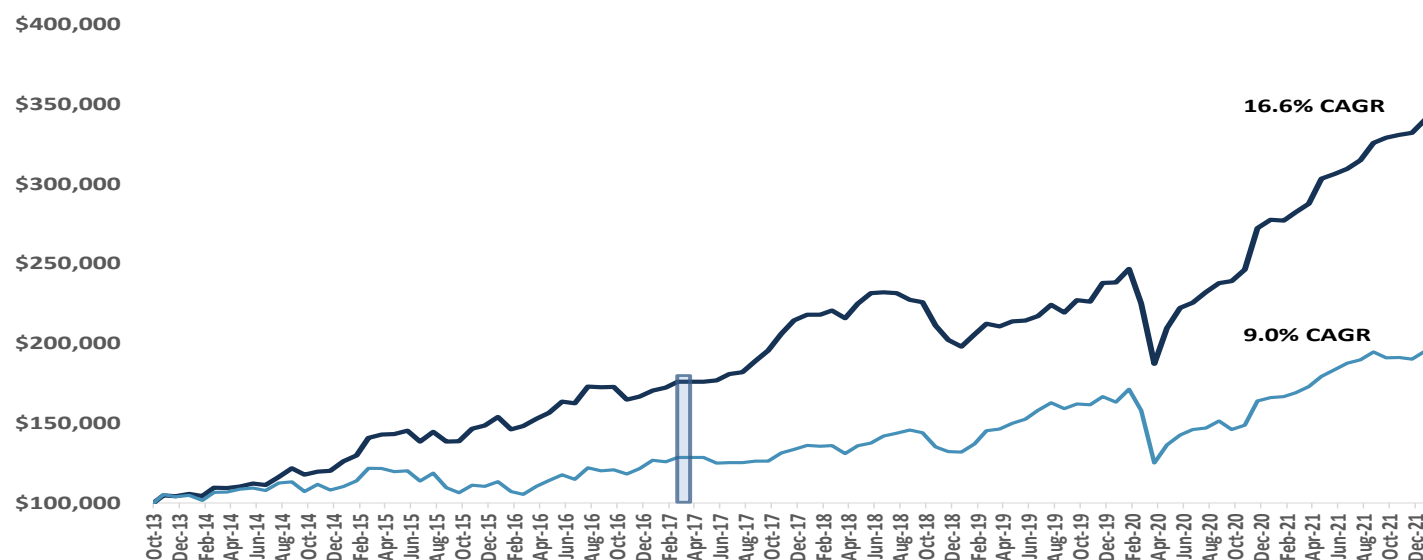
	FY14 (%)#	FY15 (%)	FY16 (%)	FY17 (%)*	FY18 (%)	FY19 (%)	FY20 (%)	FY21 (%)	FY22 (%)	Since Inception (%) p.a.
Same Strategy (after MER)	+11.2	+24.5	+17.4	+11.2	+28.3	-6.4	+3.9	+37.2	+10.0	+16.6
S&P/ASX 300 Accum Index	+7.8	+5.6	+0.9	+9.1	+13.2	+11.4	-7.7	+28.5	+4.0	+9.0
Value added (after MER)	+3.5	+18.9	+16.4	+2.1	+15.1	-17.8	+11.6	+8.7	+6.0	+7.6

# The inception date of SGH Australia Plus was the 8th of October, 2013, where Rob Tucker was the sole Portfolio Manager, until his departure on February 28th, 2017.

\* The inception date of the Chester High Conviction Fund was April 26th, 2017, hence FY17 reflects 8 months of SGH Australia Plus and 2 months of the CHCF.

We note this is a statement of fact of the performance achieved by the fund during the time which Rob Tucker was the sole Portfolio Manager making active decisions on the SGH Australia Plus portfolio. We note performance is the record of the firm not the individual however past performance has been constructed from publicly available unit price data. Past performance is not necessarily indicative of future performance and should not be relied upon in making investment decisions.

## Same Strategy - Accumulated performance



Note this graph is representative only of the combination of the same Portfolio Manager running the same strategy, and would only represent actual returns for unit holders that invested money at inception of SGH Australia Plus, withdrew those funds at the end of February 2017 and then invested all those initial funds again at inception of the Chester High Conviction Fund in April 2017. Note, this depicts returns after fees.

## The Chester High Conviction Fund philosophy - building a strong track record with these key principles

<b>High Active Share</b>	For active managers to outperform long term, the fund has to be truly different from the benchmark. This strategy has had an active share of over 80% since inception
<b>Mid Cap Bias</b>	Broadly speaking, we find more interesting growth opportunities outside the large cap universe. For funds to perform well over an extended period, exposure to mid caps and small caps is essential
<b>Back Owners of Capital</b>	Allocating capital to management teams that think like owners is more likely to ensure longer term success. Alignment of interests is crucial. Managers must take a long term view
<b>Concentration in Few Ideas</b>	While a portfolio can be appropriately diversified with approx 20 stocks, our mid cap bias has seen the strategy average around 33-35 stocks since inception
<b>Own Our Decisions</b>	As a team, Chester has worked together for over 10 years, we each know our role and the strengths and weaknesses of each employee. We are proud of the culture we have built
<b>Keep It Simple</b>	Ultimately, we allocate capital to sectors and companies that we understand
<b>Focus on Insights</b>	Do we have a different view than the prevailing wisdom of the market? Backing ourselves in unloved or undiscovered stories has been the most consistent alpha generation of this strategy
<b>Cash Flow Growth</b>	We seek to invest alongside companies that either generate predictable cash flows in high quality industry positions, or determine an appropriate margin of safety where valuation support is paramount



**These are the themes that have us contemplating the portfolio structure into 2022**

<p><b>WHEN DOES INFLATION PEAK?</b></p>	<p>Inflation remains the focus of the investment community as now it is being taken seriously. It has changed interest rate expectations and will erode profit margins. The current backdrop of chronic supply chain bottlenecks, persistently higher energy costs, used car prices, owners equivalent rent (OER) as a measure of house price inflation and pockets of significant labour shortages suggests to us that the cost pressures are currently intensifying. It is likely to peak in the coming months (but that depends on supply and wage bottlenecks being alleviated). The resumption of full international travel should be the key milestone to see these wages issues start to soften, as student/migrant workers fill much of the labour shortages in the developed world.</p>
<p><b>GROWTH VS VALUE</b></p>	<p>The direction and rate of change of the US 10 yr bond yield influences sector allocation, which is overly simplistic, but very true. The lower the bond yield, the higher valuations afforded to growth stocks, the higher the bond yield, the more value based assets and cyclical companies are supported. Simplistically, bond yields are going higher to start 2022. We would prefer the outcome of portfolio construction to be more stock specific than this simplistic framework. Given we err on the side of higher inflation, we also err on the side of being measured from a valuation perspective, and being very focused on asset backing within the portfolio position sizes. Our stocks mentioned through this quarterly reflect this focus.</p>
<p><b>ASYMMETRIC RISK IS CRITICAL AS THE INVESTMENT CLIMATE CHANGES</b></p>	<p>What is more stock specific, and at the core of how we think about allocating capital, is determining an appropriate margin of safety in an investment thesis. Margin of safety is a fund manager's way of saying, "what is the downside to this investment thesis vs what is the upside?". Or more simply, the risk vs the reward of an investment. With the stock market at record highs, how do we gain confidence that our capital allocation is appropriate to drive returns over the next 2-3 years, with many sectors seeing pockets of exuberance? Asymmetric risk is a fancy way of saying we are looking for more upside than downside in the investment case. We feel our top 3 holdings are perfect examples of this thesis on a 3 year view.</p>
<p><b>WAGE AND COST PRESSURE ACCELERATING</b></p>	<p>Anyone looking for a restaurant booking or walking into a supermarket will have seen the issues with managing the Omicron variant of COVID. Highly transmissible, the lost days from staff forced to isolate has wrecked havoc on fulfillment/distribution centres, wait staff at restaurants and bars, and nursing staff in hospitals, amongst others. The duplication of costs for businesses to cover shift workers has seen a couple of large blue chip profit warnings (Woolworths, Ramsay Healthcare) with a raft of others to come over the next 3-4 months. Any business heavy on human capital (including technology stocks) is facing business disruption issues. End market pricing has to be improving (either raising prices or selling products with significant short-ages) for profit margins to hold.</p>
<p><b>LEADERSHIP TESTS</b></p>	<p>Part of our investment framework has always been to focus on the governance aspect of "ESG". Strong leadership is core in promoting sustainable business practices. Strong corporate culture will focus on improving the business with which they operate – whether that be improving OH&amp;S, modern day slavery or supply chain concerns, achieving carbon neutrality or gender diversity. Given the prospect of the investing climate becoming more challenging in 2022, strong effective leadership we think becomes even more crucial to both sustainable business practices and shareholder returns. Leadership of both Australia and Victoria will be put to a vote in 2022, as will the US with mid-term elections in late 2022.</p>
<p><b>ENERGY PRICES</b></p>	<p>It appears to be an anomaly to us, but in a year (2021) where the major oil benchmark rose 55%, the ASX Energy Index fell 2%, lagging every other sector. This disconnect we see as a relatively (in market terms anyway) low risk/reward framework as the cash generation of current oil producers sees significant earnings upgrades on materially depressed prices. We don't actually forecast oil prices explicitly (we always refer to the forward curve when valuing oil stocks with a range of sensitivities). Both Woodside (WPL) and Santos (STO) have made transformational acquisitions over the past 12 months, which stands both of them in good stead for significant production growth over the next 3 years. Energy of course suffers from a lack of crowding, as the rise of ethical and sustainability investing screens out energy as an acceptable investment. Ongoing lack of capital investment will support oil prices for the foreseeable future. The outlook to us appears very favorable in 2022 as the perfect contrarian sector with strong operating leverage and 30%+ earnings upgrades.</p>
<p><b>A VERY TIMELY REMINDER</b></p>	<p><b><i>"Nobody can predict interest rates, the future direction of the economy or the stock market. Dismiss all such forecasts and concentrate on what's actually happening to the companies in which you've invested"</i></b> Peter Lynch</p>



## Stock selection - Origin Energy (ORG) Reviewing our highest conviction ideas as we start 2022

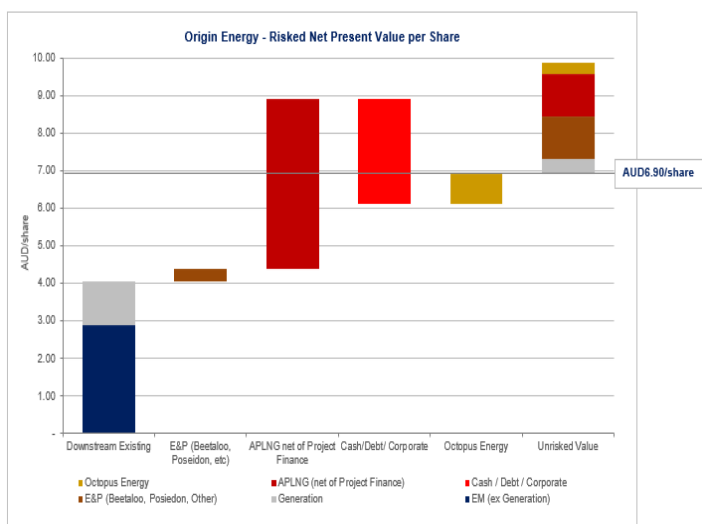
**Description** Origin Energy (ORG) is an integrated electricity generator sourced from both fossil fuels and renewable energy, while also operating a downstream retail business for gas, electricity, solar, LPG and broadband customers. It serves 4.2m customers across Australia. This combined business operates under the Energy markets division of ORG and is expected to generate approximately AUD500m of EBITDA in FY22. ORG also currently holds a 37.5% stake in APLNG (soon to be 27.5%), a LNG exporter whose largest customer is Sinopec (who is also a shareholder of APLNG along with Conoco Phillips). Most of the LNG is exported under contract, while around 15% is sold into the spot market. This JV is expected to contribute around AUD1.5bn in EBITDA to ORG in FY22. ORG also holds 20% of Octopus Energy, a UK based energy retailer that has developed a market leading user interface for consumers to understand electricity prices and consumption. This technology is named Kraken and has allowed Octopus to capture a 9.5% market share of UK electricity customers over the past 3 years. It is now licensed globally and ORG will roll it out in Australia. ORG invested approx AUD400m in 2020, which post a recent transaction sees the ORG 20% stake valued at AUD1.4bn.

**Quality** Clearly electricity is one of the most essential services there is, and (while transforming to cleaner fuel sources) is one of the key bedrocks of the economy. ORG is at the bottom of the cost curve with their integrated offering and ability to extract costs out of servicing their customers with Kraken. Sentiment has been so poor due to the weakness in the wholesale electricity price, which has largely been for two reasons. COVID related shutdowns of C&I (commercial and industrial) electricity usage in 2020 which caused significant oversupply - while electricity prices are contracted 12-18 months out the 2020 price weakness is now impacting FY22 energy markets EBITDA. The second reason clearly has been the push for cleaner energy and the phasing out of coal fired electricity. Coal generation is estimated to be less than 15% of ORG's EBITDA and is being phased out over the next 10 years, and most likely sooner. The consequences of this push for renewable energy and with AGL exiting Liddell in the next 18 months sees around 920MW of baseload electricity reduction in summer 2022/23, which actually tightens up the wholesale electricity market from a supply perspective. Hence we are of the view that FY22 (using the 2020 demand trough) will be the bottom of energy markets pricing and we expect ORG energy markets to recover from around AUD500m in FY22, to more than AUD900m in FY24 (FY20 was AUD1.46bn). With global LNG prices spiking in 2021 on shortages, APLNG is very well placed to sell their spot contracts into a buoyant market, providing a positive tailwind over the next 6-12 months. Having mentioned Octopus above, another component of the ORG investment thesis is their interest in the Beetaloo Basin, where they control 77.5% of a Northern Territory gas province that looks highly prospective. How ORG drills out and develops this province is still unclear, but it is an extremely gas rich holding, that is arguably not valued at all.

**Valuation** ORG is a good example of how we assess an asymmetric profile. Normalising Energy Markets for FY24 EBITDA, running an NPV through the APLNG project and adding AUD0.80 for the Octopus holding, we believe ORG is worth roughly AUD6.90/share. Clearly there is a wide range of outcomes dependent on the oil price assumption used for APLNG and the electricity price used for Energy Markets. Underpinning our entry point into ORG was a book value of circa AUD5.55/share, thus in the low AUD4.00 range, we saw little downside and potentially 50% upside. ORG is currently trading on 5.8x FY23 EV/EBITDA or 14x FY23 PER (using WTI at USD70.00/bbl). At spot prices for electricity and LNG, there would be significant eps upgrades to these numbers

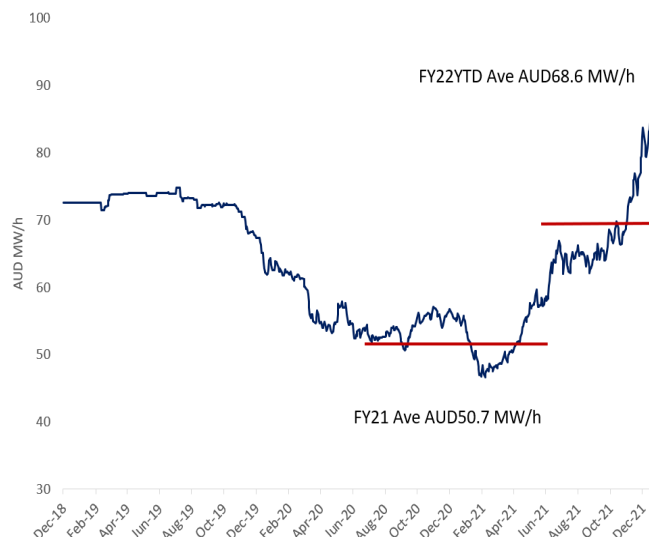
**Insight** ORG has several levers to improve share price performance over the coming 12-18 months. Clearly an improvement in electricity prices remains the most important variable, and to that end, we have seen a strong improvement in 2021 (NSW baseload currently AUD85/MWh) from the depths of 2020 (AUD45/MWh). A AUD10/MWh increase equates to an approximate AUD200m EBITDA uplift to the Energy Markets division. The roll out of the Kraken technology over the next 12 months is expected to save ORG around AUD150m p.a. in back office and processing costs, largely stemming from the integration of electricity and gas bills. The largest swing factor we believe will come from the strengthening of the ORG balance sheet, not that it is over leveraged currently (ND/ND + E = 24%), but the dividend payment can be significantly higher over the next 2 years as debt is paid down and electricity prices stabilise. It is the prospect of materially higher cash generation that has us excited by the ORG story. ORG also monetised 10% of the APLNG JV, by selling down from 37.5% to a 27.5% holding. This has alleviated any balance sheet issues and has paved the way for either further investment in green technologies, or higher returns to shareholders (dividend or capital). We published a detailed note on our ORG thesis in livewire which can be found here. <https://www.livewiremarkets.com/wires/not-a-sequel-but-an-origin-story>

Chart 2 The ORG NPV - still attractively priced



Source: Chester Asset Management

Chart 3 NSW Electricity prices are recovering



Source: Bloomberg



## Stock selection - News Corp (NWS) Reviewing our highest conviction ideas as we start 2022

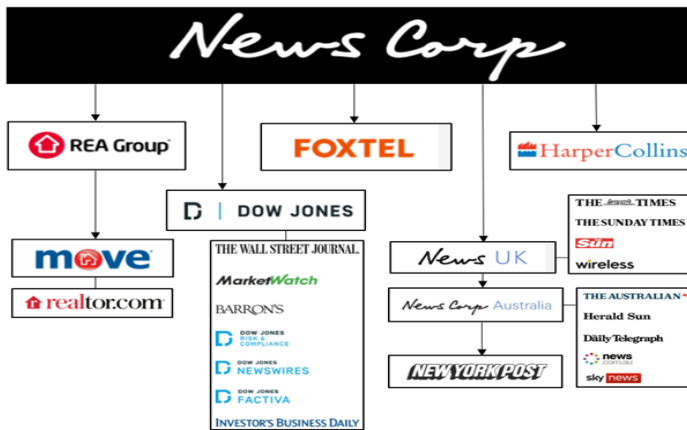
**Description** News Corp (NWS ASX/NWS US) is a global diversified media and information services company that operates primarily across the US, UK and Australia. The company's operating segments are: Dow Jones, News Media, Book Publishing, Digital Real Estate Services (comprising majority stakes in REA Group (61.4%) and Move Inc (80%) and Subscription Video Services (inc. 65% ownership of Foxtel). NWS's major brands include the Wall Street Journal, Dow Jones, Barron's, New York Post, The Sun, The Australian and Herald Sun. While Rupert Murdoch is a polarising figure, we note that the media assets that create so much public debate actually only account for less than 2% of the NWS valuation. Over the past 15 years, the NWS business model has pivoted successfully towards more subscription based revenues, with most of the value ascribed to the 61.4% stake in REA and 80% stake in Move, making NWS far more exposed to Australian and US property markets than traditional media.

**Quality** We consider REA to be one of the highest quality listed companies in Australia, with a dominant position in the Australian property search market, that has very strong pricing power. The exposure to REA through the NWS vehicle also provides diversification into the US market through Move and globally relevant media assets in Dow Jones and Harper Collins, both assets that generate a significant free cash flow profile.

**Valuation** AUD41.40/share using Sum of the Parts valuation method including recognising NWS's 61.4% REA ownership at Chester's DCF derived valuation. Comparable market multiples and/or transacted asset multiples are used as the basis for valuing the remaining group assets. Another way of looking at the discount is by back solving for the NWS value of their REA stake, which finds the rest of the business is trading at around 4.3x EV/EBITDA for some of the highest quality media assets globally.

**Insight** In addition to the price transparency NWS enjoys on its majority ownership in ASX listed REA Group, the value ascribed to comparable, and often inferior digital media assets in the listed and unlisted space supports the contention that NWS's current conglomerate discount is excessive and appropriate recognition of value should be achieved over time. We find that the 80% owned Move (US Real Estate website) is growing rapidly and widely underappreciated relative to peers. Chester recently published a deep dive into the NWS investment thesis which can be found here.  
<https://www.livewiremarkets.com/wires/news-corp-sufficiently-digital-sufficiently-sustainable>

Chart 4 A well diversified cash generating business



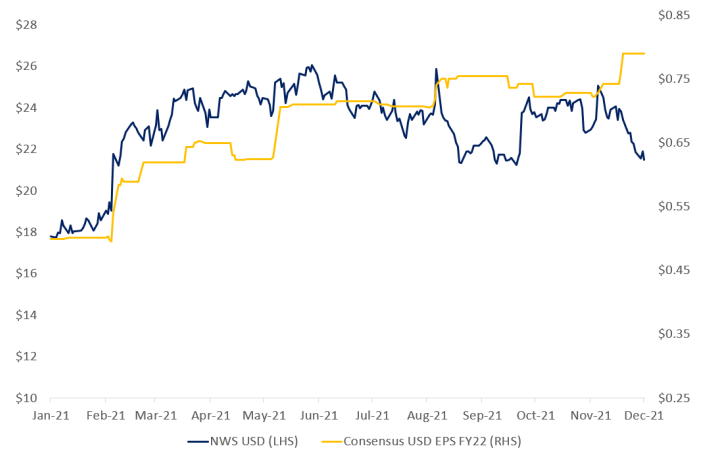
Source: Chester Asset Management

Chart 6 Ex REA The rest of the NWS assets are significantly cheap

NWS	NWS stake	2022F EBITDA	EBITDA Multiple
REA	61.40%		12,714
Dow Jones		586	0
News Media		107	0
Book Publishing		407	0
Subscription Video Services		470	0
Move		169	0
Corp costs		-304	0
Net Debt/(Cash)			260
NWS EV			\$31.75 18900.0
NWS EV ex REA stake			6186.0
NWS EBITDA ex REA			1435
<b>NWS EV/EBITDA</b>			<b>4.3</b>

Source: Chester Asset Management

Chart 5 That has lagged its eps momentum



Source: Chester Asset Management, Bloomberg

Chart 7 Or...there is significant upside if marked to market

NWS	NWS stake	2022F EBITDA	EBITDA Multiple
REA	61.40%		12,714
Dow Jones		586	20 11730
News Media		107	4 427
Book Publishing		407	8 3254
Subscription Video Services		470	6 2822
Move		169	25 4223
Corp costs		-304	8 -2432
Net Debt/(Cash)			260
NWS EV			\$32.88 32997.0
NWS EV ex REA stake			20283.0
NWS EBITDA ex REA			1435
<b>NWS EV/EBITDA</b>			<b>14.1</b>
No of shares			590
Share price			\$ 55.93

Source: Chester Asset Management



### Stock selection - Synlait Milk (SM1 AU or SML NZ) Reviewing our highest conviction ideas for 2022

**Description** Synlait (SM1 ASX or SML NZX) is a dairy processing company located in Canterbury New Zealand. SM1 controls the supply chain with farmer relationships and processing facilities while also controlling the SAMR (Chinese FDA) processing licences on behalf of its processing customers. The largest partner is currently A2 Milk (A2M), but that is expected to change over the coming 2-3 years. The SAMR license is significant as A2 Milk can't sell Chinese label A2 infant formula into China without the SM1 manufacturing licence. No new SAMR manufacturing licences has been issued globally for the past 3 years. Over the recent past SM1 has purchased Dairyworks and Talbot Cheese to offer retail brands for the first time and diversify their product offering. SM1 now offers products across 4 key product lines, the nutritional business (predominantly infant formula and lactoferrin), the ingredients business (whole and skim milk powder and milk fat products), beverages and creams (exciting opportunities in long life consumer packaged beverages and ready to feed infant formula) and consumer foods (manufacturing fresh milk, cheese, butter and yoghurt products) under their own or private label brands. The company is best known for its relationship with A2M where it is the exclusive supplier of Infant Milk formula (IMF) in Australia, NZ and China with a contracted minimum 5 year term, while A2M has also cemented the long term arrangement with SM1 by holding a 19.9% stake in SM1. The volatility in A2M inventory management and planning has been to the significant detriment of SM1 over the past 18 months, but the worst appears behind it, with SM1 having different growth levers over the next 2 years to diversify away from A2M as outlined by the 4 divisions listed above.

**Quality** SM1 has invested NZD860mn in plant and equipment over the past 5 years building world class facilities with the highest environmental standards globally. Whilst this capex has yet to generate an acceptable return on investment, the long term relationship with a global multinational FMCG customer (unnamed as yet, but believed to be Danone or Nestle) was believed to be bought about because of the environmental standards the facilities have been manufactured with. The capacity they have now built with SAMR registration is underappreciated by the market currently as there has been significant new demand inquiries from Chinese manufacturers, given their domestic market share growth exceeds their own manufacturing capacity. The key for us is that SM1 hold the licences for IMF brands (while A2 is the only brand currently registered at Synlait facilities, we expect this to change in FY22) and has direct relationships with the farmers. The founder of the business John Penno was called back into the CEO position in 2021, and has led a strong business reset. He is stepping back to be the Chairman, while bringing in highly regarded ex Miraka and Fonterra executive Grant Watson to the CEO position in CY22. SM1 has world class processing facilities, a very well regarded management team, and strong demand for its products.

**Valuation** Our assessed value of SM1 currently stands at AUD5.00/share DCF derived (WACC 10%, TGR 3%). Chester projected earnings implies 11x FY23 earnings, based on current share price (~AUD3.20/share). We see reason why SM1 can trade back towards 14-15x PER multiple as the organic cash flow de-gears the balance sheet and the market regains confidence in the SM1 story. AUD6.00 per share is achievable over the next 2 years based on our forecast FY24 NZD42c eps. As it currently trades below book value (0.9x P/B) we see a strong asymmetric risk profile over the next 2 years.

**Insight** SM1 has invested significant capital over the past 3 years preparing for the ongoing growth of its infant formula partners. We see a clear pathway towards SM1 generating an acceptable ROI on this capital already sunk. It has absolutely made a strategic decision to pivot away from A2 and focused on engaging with large potential customers that see the benefits of a vertically integrated supply chain. We have always been of the view that key customer wins have the potential to fill unutilised capacity and enable higher value end products rather than low margin ingredients products which are currently oversupplied. This is actually taking place over the coming 12 months. The long term supply agreement with the multinational customer will become SM1's biggest customer by FY24 by using Pokeno to supply a plant based protein consumer product into the Asian market. We see significant opportunities outside this as inbound inquiries for SM1's nutritional (infant formula) capacity could potentially accelerate the shift away from A2. Beyond that, we see strong growth levers in the consumer business and beverages and creams led by new CEO Grant Watson. From the Synlait AGM commentary in December 21 **"By the end of FY23, we expect the recovery plan will have seen Synlait return to similar levels of profitability, operating cash flows, and debt ratios as the years leading into FY21"**. While we share the sentiment, SM1 sits firmly in the unloved and underappreciated category as we start 2022.

Chart 8 The SM1 earnings recovery pathway is predictable

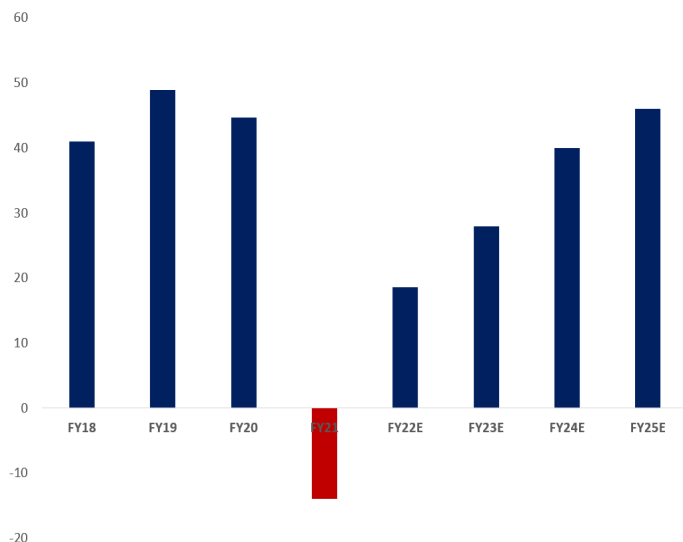
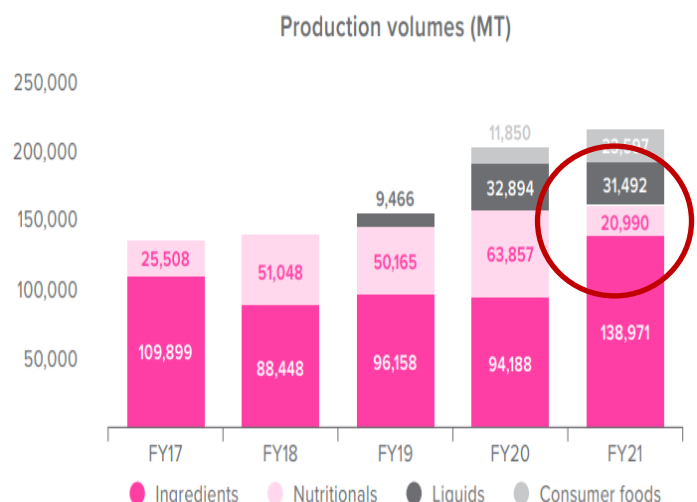


Chart 9 Synlait Infant formula volumes will recover



Source: Chester Asset Management

Source: Synlait Milk FY21 result presentation



## Stock selection - Austal (ASB) Reviewing our highest conviction ideas for 2022

**Description** Austal (ASB ASX) is the largest provider of aluminium ships in the world and has developed a long term successful partnership with the US Navy in providing Littoral Combat Ships (LCS) and Expeditionary Fast Transport Vessels (EPFs) over the past decade from its base in Mobile, Alabama. It also builds commercial vessels (fast ferries and vehicle passenger ferries) as well as Navy vessels out of its locations in Perth, Vietnam and the Philippines. It has a current order book of over AUD3.0bn or strong visibility for the next 2 years of operation. In Alabama, ASB is currently completing two key shipbuilding programs, the LCS in 2024 and the EPFs in 2023. The US defence contract for the delivery of these two programs currently accounts for around 70% of ASB's earnings. The US Government announced in 2020 a USD50m grant to ASB to upgrade the Alabama facility enabling steel vessels to be manufactured on site, which opens up an entirely new pipeline of opportunities for ASB to tender for. This grant is only for one reason, that ASB forms part of the industrial base that is an essential cog in the US Navy's ambitions to renew their naval fleet over the next decade.

**Quality** ASB has developed a strong reputation for delivering LCS vessels to the US Navy with increasing efficiency over the life of the contract, with labour hours per vessel decreasing more than 35% over the past 6 years, which has driven both a strong margin improvement, and a strong working relationship with the US Navy. The recent USD50m award from the US Government is testament of the desires of the US Government to maintain key strategic shipbuilding capacity operating and enhances ASB's total addressable market multiples (from just aluminum to aluminium and steel shipbuilding opportunities). With steel shipbuilding capability, ASB has numerous tender opportunities in front of it, which we discuss below. Combined with the Australian Navy recently awarding ASB a AUD350m contract in Perth (Cape Class Patrol Boats) and a pending deal to build several OPVs (Offshore Patrol Vessels) for the Philippine Government, ASB is well entrenched as a reliable supplier of shipbuilding services to national governments.

On top of this, ASB has developed a global network of support services to maintain the current fleet of LCSs and EPFs that they have already built. To this end, the US Navy has recently awarded ASB support contracts on both the East Coast and West Coast of the US which provides ASB predictable long term maintenance revenues.

**Valuation** Our assessed value for ASB is currently AUD3.00 per share, which assumes US shipbuilding earnings halve in FY24, from FY20 levels. ASB currently trades on 10.0x FY22 earnings which are largely already baked in given the long term agreements in place. ASB currently has

AUD150m in cash on the balance sheet, which is around 20% of its market cap, although much of this will pay for the dry dock they are building in San Diego to enhance their support service business. The support service business has ambitions to be a US\$500m p.a revenue business generating US\$40m in EBIT p.a., which goes along way to underpinning the ASB valuation, before any further large US Navy contracts are awarded.

**Insight** ASB has been a very poor performer over the past 2 years, but we see reason why that can change in CY22. After missing out on phase 1 (vessels 1-10) of the Future Frigate program FFG[x] we believe the market is underappreciating the longer term earnings potential and the US Government's desire to support the industrial manufacturing base in the region. The long list of potential contracts (some of which are outlined below) suggests that with ASB's track record, they will, be able to replace a large portion of lost revenue in FY24 onwards. Our base case assumes US earnings halve from FY24 but we see an upside case where earnings are maintained, if not expanded. With the current geopolitical focus on the South China Sea we see ASB as having the potential to become a key component of maritime strategy in the region. The long term investment in the Philippines and Vietnam (to a lesser extent) will assist ASB manage their work flow from the Australian operations and allow margin enhancement over time. We would classify ASB's shipbuilding capability as an essential service, and while tenders are large and lumpy, once awarded, offer a great deal of earnings visibility. While uncertainty remains over the timing of any new tenders, we believe the current market cap is not paying for any future contracts, while ASB has a steady predictable maintenance business (that is growing) to sustain the business until securing work for the next decade, an outcome that is far more likely (given the US Navy work program outlined below) than the current ASB share price reflects. Unloved and underappreciated? Absolutely.

Chart 10 ASB below book value, net cash and recurring revenue



Source: Chester Asset Management

Chart 11 ASB has a strong pipeline of tenders

Potential ASB tenders	No of vessels	Location	est USD value	est commencement
Next Generation Logistics Ships (NGLS)	6-10	Mobile, Alabama	US1.0-2.0bn	design phase awarded
Towing, Salvage and Rescue Ships (T-ATS)	3	Mobile, Alabama	US145m	awarded
Light Amphibious Warships (LAW)	28-30	Mobile, Alabama	US2.0-3.0bn	FY23
Large Unmanned Surface Vessels	30	Mobile, Alabama	US5.0bn	FY23
Offshore Patrol Cutters (OPC) Ships 5-25	6-21	Mobile, Alabama	US2.5-8.5bn	FY22
Tactical Auxillary General Ocean Surveillance (TAGOS)	4-6	Mobile, Alabama	US1.5-3.0bn	FY22
Emergency Medical Ships		Mobile, Alabama	US2.0bn	design phase
Future Frigate Program ships 11-20	5-10	Mobile, Alabama	US3.0-7.0bn	FY26
Autonomous Expeditionary Fast Transport Vessels	?	Mobile, Alabama	?	design phase awarded
Offshore Patrol Vessels (OPV)	6-18	Cebu, Philippines	US600m-2.0bn	FY22

Source: Chester Asset Management, Austal, Congressional Research Service



## Stock selection - Ridley Corp (RIC) Reviewing our highest conviction ideas for 2022

**Description** Ridley Corporation (RIC ASX) is Australia's largest provider of animal nutrition solutions across both bulk stockfeeds and packaged feeds and ingredients across a wide range of monogastric, ruminant, aqua and other species. RIC operates an extensive supply chain throughout eastern and southern Australia with a total capacity of ~1.7Mtpa across 14 feedmills, two rendering sites a packaging site and a supplements facility.

RIC also has a number of novel feed opportunities, of which Novacq is the most prominent. Novacq was originally developed by the CSIRO in the late 90s and is helping prawns grow bigger (~30%), more sustainably (with less nitrogen discharge), faster and cheaper (with reduced wild fish products in their diets). In FY21 RIC tripled production of Novacq from their Thailand farm and have the business on a pathway to break-even in FY22.

**Quality** We have seen a marked improvement in the quality of RIC since 2019 that led to us making our investment in the company. Management and Board: In August 2019 Quentin Hildebrand was appointed CEO and MD with Mick McMahon being appointed Chairman the following year. We were familiar with Quentin and Mick McMahon as the ex COO and CEO of Inghams (ING) a company we had previously invested in. Agribusiness contacts had referenced Quentin was very well regarded at ING and many believed he should've become MD when Mick departed. The RIC board has also been refreshed with Rhy Jones joining Mick in 2020.

Balance Sheet: When Quentin became MD of RIC it had a stretched balance sheet with Net Debt >AUD140m and leverage >2.5x (ND/EBITDA). With the proceeds from the sale of Westbury received in August 2021 we project RIC being almost net cash in FY22.

Cash Flows: The strength in the balance sheet has been assisted by improvements in working capital management and RIC enjoyed a cash conversion ratio of 119% in FY21

Return on Capital improving: Off the back of rationalising and optimising their supply chain footprint and staffing levels RIC has dramatically improved the returns on their invested capital.

**Valuation** Our assessed value of RIC currently stands at ~AUD2.20/share and is based on a DCF of the core business plus 10% of our unrisks Novacq case. Novacq, although a potential game changer for RIC, is still early into its commercial life and its book value was notably written down to zero by Management in 2020, hence we are reluctant to provide too much upside for Novacq in our reference valuation despite seeing the upside case ~ to the current share price. RIC currently trades on <12x FY23 eps with 50% eps growth with a PEG ratio of <1.0x.

**Insight** Our insight initially started from our views of management and the high regard we had held them. From an earnings perspective we have continuously been above the sell-side expectations while management is developing a track record in under promising and over delivering. The key for RIC has been in optimising the supply chain and asset base. Growth Strategy: Since 2019 Management has presented a "to scale" growth strategy slide in their presentation (chart 12), which on our ruler effort suggested an AUD82m run rate in FY22 plus AUD9m in Project Boost earnings i.e. >AUD90m in FY23 vs market at ~AUD83m. For 2 years this slide hasn't really changed hence we believe Management has been extremely transparent and granular and we believe we have witnessed continued outperformance vs target, a point we felt the market was underappreciating. The initial investment made in RIC was below book value with a strong pathway to pay down debt and see earnings materially increase on the successful execution of the strategy. LTIs: We noted 12 months ago that the LTIs per RIC's FY20 Remuneration report had an upper band ROFE target of >30% which we calculated would require >AUD80m earnings by FY2022 a number well north of consensus at the time. This along with our views on Management execution has led us to hold an above consensus view on earnings. Notably at the most recent AGM update RIC noted YTD EBITDA performance above the 16% growth experienced in FY21. Consensus remains unchanged at ~11% growth in FY22, hence we see a likelihood of ongoing upgrades through CY22, although with Omicron, variable costs are a source of near term volatility (for any business).

Chart 12 RIC has many growth levers despite its modest PER

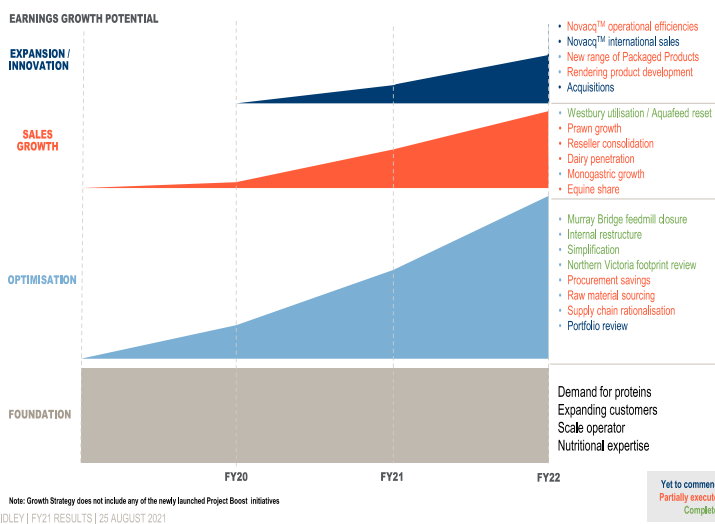


Chart 13 A strong likelihood of further eps upgrades



Source: RIC annual results presentation

Source: Chester Asset Management, Bloomberg



### Chester High Conviction Fund Portfolio top ten holdings

Chart 14

	FY22	FY23	FY22	FY23	FY22	FY23	FY 22 ROE	FY 23 ROE	FY22	FY23	FY22	FY23	FY22 PER	FY23 PER
	Sales GR	Sales GR	Div Yield	Div Yield	DPS GR	DPS GR			BOOK VALUE	EV/EBITDA	EPS GR	EPS GR		
Austral Ltd	-4.3%	3.7%	4.2	4.1	3.7%	-4.2%	8.54	7.90	0.9	3.9	-13.6%	-5.3%	10.6	11.2
Aurelia Metals	5.5%	1.3%	0.0	0.0	0.0%	0.0%	4.10	5.20	1.2	3.8	-70.8%	35.8%	32.1	23.7
CSL Limited	5.8%	18.6%	1.1	1.3	6.2%	17.1%	21.20	22.00	8.9	22.6	-4.7%	22.3%	40.8	33.4
Mineral Resources	-13.0%	17.9%	1.9	2.5	-59.5%	31.5%	14.90	20.13	3.7	9.2	-59.0%	14.6%	25.1	21.9
News Corp Ltd	11.4%	2.9%	0.8	0.9	-4.1%	4.3%	6.20	6.80	1.6	8.3	47.9%	30.3%	29.0	22.3
Nufarm	6.5%	1.3%	1.4	1.6	nm	18.5%	4.90	5.50	0.9	6.0	69.1%	9.1%	20.8	19.1
Origin Energy	-4.6%	3.5%	3.9	4.3	11.4%	11.1%	5.40	6.40	0.9	5.8	96.1%	27.8%	19.0	14.9
Ridley Corp	3.4%	2.5%	4.3	4.8	nm	15.2%	11.10	12.20	1.5	6.5	51.4%	14.2%	14.2	12.4
Synlait Milk	16.9%	4.4%	0.0	0.0	0.0%	0.0%	4.80	7.40	0.9	7.6	nm	50.0%	18.6	12.4
Tabcorp	1.7%	5.0%	2.4	3.3	-9.9%	34.6%	5.70	6.80	1.7	11.7	-3.3%	23.6%	29.8	24.1

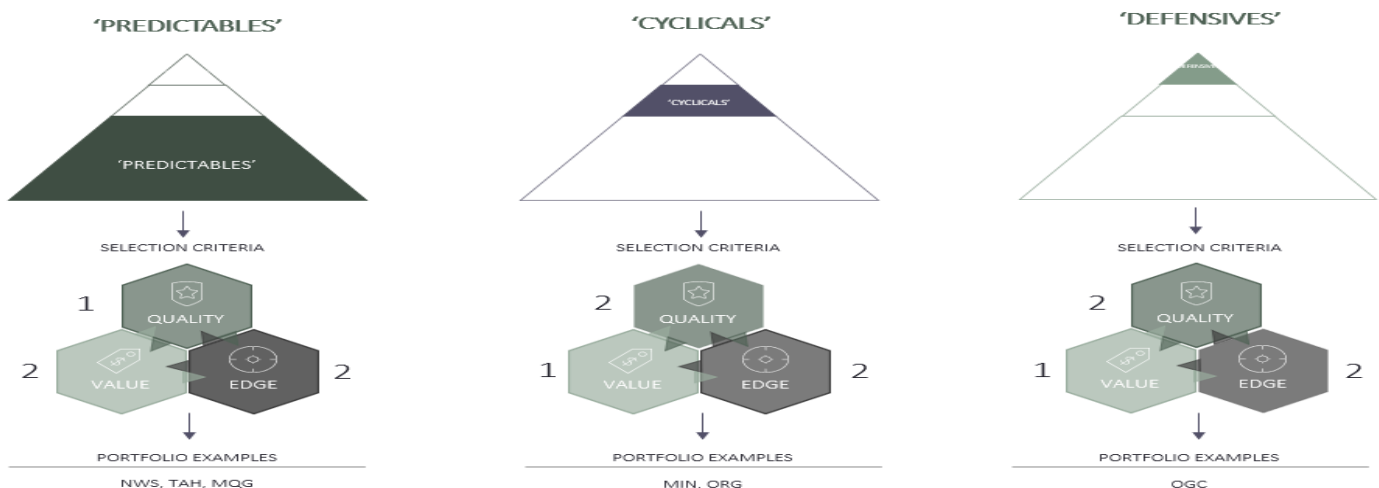
Source: Chester Asset Management, Bloomberg consensus data, stocks shown in alphabetical order

We have listed here our top ten holdings at the end of December, 2021. The CHCF is actively managed. Naturally we find that our stock weights can change over the course of a quarter or year. Our fund is actively managed and has no position that is simply there to lower the tracking error against the index. It is truly benchmark unaware investing. We broadly hold positions between 1% and 6% depending on our conviction level on the stock and the size of the company. Our conviction level is dictated by the broad art of combining 1/ the appropriate valuation of the stock, with 2/ our assessment of the quality of the assets and management team, overlaid by 3/ our expectation vs the market (or insight/edge) of the earnings direction. I.e. Do we think the market is mispricing earnings? For our thesis to hold, we require at least 2 of these 3 factors to be validated for the investment case.

To explain that in more detail we have used a slide from our presentation material (chart 5 below). The majority of the stocks currently held in the top ten holdings are classified as “Predictables” (Consumer Staples, Communication Services or Healthcare) while Origin Energy, Mineral Resources and Nufarm are classified as “Cyclicals”. Aurelia Metals is what we classify as a “Defensive”, where we view the non-correlated returns of the gold sector (which has historically been the case) as a way for the portfolio to lower the volatility of returns.

When we are allocating capital to those sectors that are more predictable in nature, our primary focus is the quality of the industry position they hold and relative cash flow certainty. We determine this by asking ourselves 7 questions around pricing power, barriers to entry, threat of disruption, etc. We also ask a range of questions around the management incentive structure and track record. Once we decide that a company is well positioned, we then seek at least one other “thesis” to hold true. For predictable companies, we need to be convinced around the quality first, and then valuation or edge. For cyclical or defensive (gold) companies, we need to have a high degree of confidence in the valuation support first (as by definition, we cannot be sure of how predictable the cash flows are). We then seek a degree of conviction around the management team and whether we have a unique insight (“edge”) to those particular assets. Thus for the cyclical or gold stocks, it is primarily a valuation driven decision first.

Chart 15





## Portfolio Construction

We have always broken down our portfolio construction into three categories as outlined on chart 16. We think of most sectors in the predictables bucket - Healthcare, Consumer Staples, Defence, Infrastructure, etc. as, in general, able to offer relatively predictable cash flow profiles from the industry structure they operate in. We are the first to admit this is a relatively primitive exercise given that many stocks have very different cash flow characteristics that may be categorised in several ways. For example, gaming or more specifically casinos have historically been relatively predictable cash flow generators, but COVID has derailed many of these formerly “predictable” sectors. We focus heavily on the industry structure and competitive advantages of each company when assessing the investment thesis for “predictable” stocks.

We use the word “relatively” predictable, as sectors that are genuinely cyclical in nature (energy, commodities, retail, etc) there is always less certainty over the longevity of a cash flow cycle and sustainability of margins, hence given the uncertainty, we tend to desire much better valuation support in cyclical sectors.

The “defensive” sleeve is comprised of positions that are historically uncorrelated to the ASX300. We classify gold equities with this lens, as a historical study of large equity market drawdowns highlights how well gold holds up in extremely volatile markets. Cash is often a residual position.

Chart 17 illustrates how these “buckets” have looked over the past 8 years. On average, the allocation to predictable has been 60-70%, while cyclicals have averaged around 15% (10-25%) and defensives have ranged from 10-25%. We have tended to hold an increased defensive position over the past 2 years, while in the last quarter have added incrementally to our cyclical position with the backdrop of an economic recovery that appears underwritten by central banks.

The history of the strategy has been successful in delivering alpha, outside FY19, in which the fund was (in hindsight) too cyclical leading into the end of 2018, and then far too defensive during the first part of 2019.

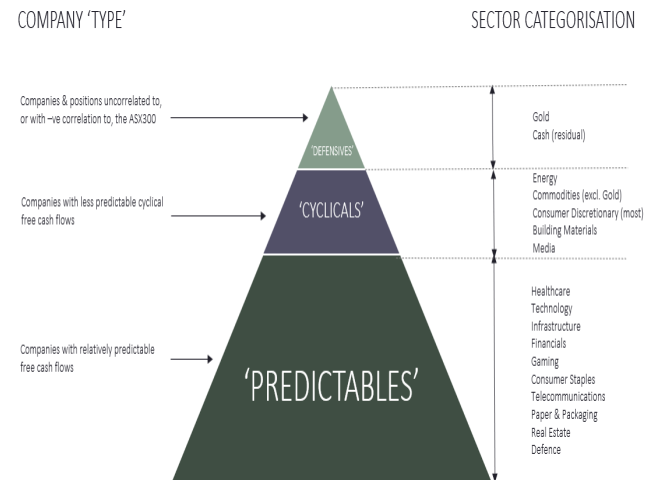
Chart 18 has been pulled directly from the Morningstar database of large cap Australian Equity strategies, whereby it highlights the strong track record relative to its peer group (ranked 27/304 funds over 1 year, and 9/281 over 3 years). While this is pleasing, the portfolio construction as described above, we think creates a differentiated product to our peer group. Largely because we use the defensive sleeve, our drawdown has been lower than the index and the peer group, which also shows in the beta of the strategy (0.89 vs peers at 0.98). This effectively means the fund demonstrates less volatility than the peer group, which is also shown by the standard deviation (16.1 vs 17.3).

What these tables also highlights is the lower level of correlation (R-squared) to the index, which shows this strategy is only 88.1% correlated to the index, relative to the peer group correlation of 93.3%. The portfolio is designed this way deliberately, which we think becomes even more important over the next 12 months with increasingly volatile markets, thus ensuring some focus on capital protection (although it is a long only product) is paramount to the way we invest.

Hence the fund, to this point (past performance is no guarantee of future performance), has been able to demonstrate higher alpha (returns) than many of its peers, for significantly lower beta (or volatility) and correlation. Thus, it has achieved its objective, while being a very different offering than most other Australian equity funds.

## How do we allocate capital?

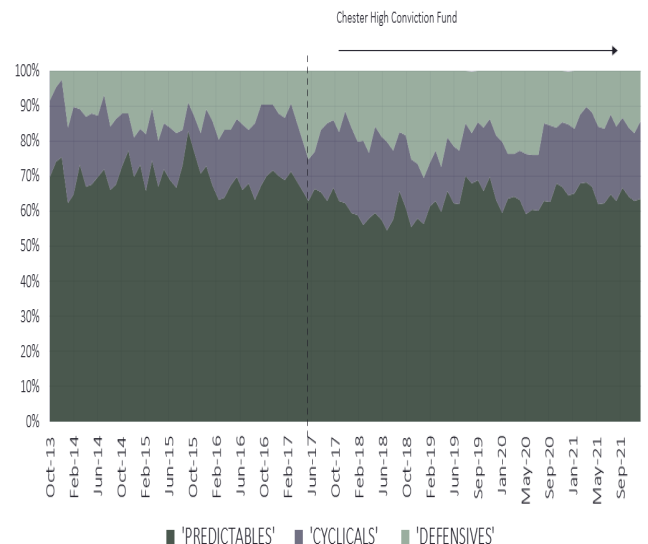
Chart 16



Source: Chester Asset Management

## Which has been done consistently over time

Chart 17



## Chester High Conviction Fund portfolio characteristics

Chart 18

	as at 31 Dec 2021			
	Total Return	+/- Cat	+/- Index	Cat Rank
<b>1 Month</b>	2.49	-0.14	-0.26	216 / 312
<b>3 Month</b>	3.46	1.32	1.37	39 / 310
<b>1 Year</b>	22.32	4.02	5.08	27 / 304
<b>3 Year</b>	19.79	6.08	6.17	9 / 281
<b>5 Year</b>	--	--	--	--

	as at 31 Dec 2021		
	Fund	Category	Index
<b>3-Year Risk Measures</b>			
<b>Standard Deviation</b>	16.08	17.26	17.06
<b>Sharpe Ratio</b>	1.18	0.81	0.81
<b>R-Squared</b>	88.08	93.32	--
<b>Beta</b>	0.89	0.98	--
<b>Alpha</b>	6.72	0.25	--

Source: Morningstar database, January 2021



## How we assess a sector in detail - the Healthcare universe

Chart 19

### Healthcare Valuation Summary

Date: 12/01/2022



#### Companies

Company	Model Link	Market Price	Modelled WACC	TGR Assumed	NPV (1x)	Price Diff.	Shares (m)	Mkt Cap (AUDm)	Net Debt (AUD)	22 NDA EBITDA	EV (AUDm)	EST 22 RDE	EST 22 Yld	Act 2021 PE	2022 PE	2023 PE	EV/EBIT DA	EV/EBIT DA	EV/EBIT DA	Financial Quality	Business Quality	Mgmt Quality	Insight Score
Australian Clinical Lab	ACL	5.61	10.0%	3.0%			201.8	1,172	21	-0.6	1,133	39.8%	2.8%	12.1	5.2	13.9	5.2	3.0	5.5	8	6	5	6
Ansell	ANN	34.12	9.0%	3.0%			127.8	4,361	190	0.4	4,551	13.1%	3.1%	12.9	14.3	14.6	8.2	8.8	8.9	8	6	5	5
Aroa Biosurgery	ABX	1.01	10.0%	4.0%			341.9	345	-53	N/A	292	-7.6%	0.0%	-72.8	-82.7	-535.7	-88.6	-63.4	122.8	9	8	7	6
Capitol Health	CAJ	0.37	10.0%	3.0%			1,028.1	380	8	0.2	388	11.2%	3.5%	25.5	22.7	18.1	8.1	8.6	7.6	7	6	5	6
Cochlear	CDH	207.73	8.5%	4.0%			65.7	13,648	-565	-14	13,083	19.2%	1.5%	53.1	45.4	39.7	31.9	27.4	23.7	9	8	8	5
CSL	CSL	283.13	7.5%	4.0%			455.1	128,852	5,363	3.3	134,215	15.1%	0.9%	40.7	47.6	36.3	36.1	38.6	27.9	8	9	9	6
EBOS Group	EBG	37.30	9.0%	3.0%			183.7	6,852	712	2.1	7,564	10.7%	2.6%	32.4	23.8	22.9	20.6	16.8	12.9	7	6	7	6
Fisher & Paykel	EPH	30.07	8.5%	4.0%			576.5	17,335	10	-0.1	17,345	23.0%	1.1%	33.0	42.4	41.5	21.8	26.0	25.2	9	9	8	7
Healthia	HIA	2.40	10.0%	3.0%			126.9	305	40	2.7	345	9.4%	1.4%	29.7	21.5	16.6	16.0	9.4	7.5	5	5	5	5
Healio	HLS	4.92	9.0%	3.0%			301.5	1,483	214	0.4	1,637	22.1%	3.0%	20.5	6.8	18.9	3.3	1.8	3.2	8	6	5	7
Integral Diagnostics	IDX	4.65	9.5%	3.5%			200.0	930	136	1.6	1,066	13.4%	2.5%	31.8	23.5	22.2	11.7	11.9	10.0	5	6	6	5
Mayne Pharma	MYX	0.29	10.0%	-1.0%			1,764.8	512	260	8.9	772	-0.2%	0%	60.4	-294.4	23.7	12.2	23.2	13.3	3	4	7	3
Monash IVF	MVF	1.00	10.0%	3.0%			389.6	390	-7	-0.3	383	10.0%	4.2%	16.7	14.1	13.5	8.0	7.5	7.2	5	6	6	5
Nanosonics	NAN	5.93	9.0%	3.0%			301.6	1,788	-116	-5.7	1,672	15.1%	0%	130.3	73.7	41.7	102.2	70.3	43.5	10	9	8	7
Polynovo	PNV	1.84	10.0%	4.0%			661.4	1,217	0	N/A	1,217	-14%	0%	-264.6	-4090.0	311.7	N/A	831.3	167.0	6	8	4	3
Ramsay Healthcare	RHC	67.77	9.0%	3.5%			228.9	15,513	3,545	3.8	19,058	8.3%	1.2%	35.1	49.0	24.4	3.3	3.9	7.7	6	8	7	4
Resmed	RMD	33.33	8.0%	4.0%			1,447.0	48,229	797	0.2	49,026	26.3%	0.5%	46.7	43.4	36.2	35.3	23.4	24.8	8	8	7	6
Silk Laser Australia	SLA	4.25	10.0%	3.0%			53.0	225	0	-0.4	225	9.7%	0.0%	29.8	26.3	17.2	13.0	10.3	7.3	9	7	5	6
Sonic Healthcare	SHL	43.72	9.0%	3.5%			477.9	20,894	1,005	0.3	21,899	25.6%	6.3%	15.9	12.0	27.2	8.6	7.0	12.4	7	7	5	7

Source: Chester Asset Management

We include this pack as a way of highlighting some of the detail that we undertake when selecting stocks. We have always started our search to narrow down our universe of stocks with a megatrend framework seeking strong thematic tailwinds. Clearly an ageing population and healthcare spending is a thematic that we are all aware of. With this in mind, we have illustrated here some of the work that we put into reviewing each sector, with this detail of the healthcare sector, which ties into the thematic of an ageing population. There are some of the highest quality companies in Australia listed here, and while we have valuation concerns over many of them, the tailwinds behind healthcare remain very strong. With less economic certainty this year, gaining exposure to economically insensitive stocks (at a reasonable price) may be very important throughout 2022. The level of detail that Chester covers is something we are very proud of. Here we have a summary sheet of 19 listed healthcare stocks in Australia (while removing our valuation). This is a front cover of 19 highly detailed models that provide us with conviction around how we assess the relative value across the strengths and weaknesses of each company. We may not always get it right, but it's always a very fundamental view that drives the decision making process. For illustrative purposes, we have also included an example of a summary page of our work on each company, which is how we communicate to each other internally, whereby we try to focus on the key elements of an investment thesis.

Chart 20

### Ramsay Healthcare



#### Key Drawcards & Insights

- **Demographic Trends:** Healthcare spending and Hospital visitation is underpinned by an ageing demographic, supporting Long term growth expected to remain between 4-5%
- **Organic Growth:** Brownfields capacity additions give rise to relatively predictable volume uplift, while margins are variable given fixed cost nature of staffing levels
- **Geographic Diversity:** RHC has operations in Australia, UK, Europe (France and Nordics) and Asia (Indonesia and Malaysia), providing it some diversity away from its historic heavy reliance on Australian PHI
- **Ancillary Services Opportunity:** Pharmacy (RHC owns 50 pharmacies) and mental health offerings provide opportunity for increased growth to RHC
- **French opportunity:** French assets are high quality but languishing with soft tariff growth & difficult labour agreements meaning margin pressure. Recent Capio acquisition provides scale...but synergies?
- **Sale and Leaseback:** We see valuation upside via a Sale and Leaseback to unlock property value. Potentially as much as AUD15/share.

#### Key Risks

- **Margin pressure:** Ramp up of brownfield capacity and French margins deteriorating
- **Private in Public Patients:** Public hospitals have been increasing number of privately insured patients
- **Wage pressures:** For nursing staff, which will be ongoing given structural shortages of nurses
- **PHI premiums moderating:** Increased Govt pressure to moderate premium increases
- **PHI Volumes:** Australia is seeing declining rates of Private Health Insurance
- **UK occupancy:** Risk of lower than optimal occupancy

#### Mitigant

Occupancy has to remain the key, which is dependent on doctors using OTs + cost out focus  
Recent attention from the private sector and Government could lead to resolution  
Less part time and casual nurses (higher cost per hour), better engagement with workforce  
Government actions to make PHI more affordable which feeds into the reimbursement rates of hospitals  
Government intervention and efforts to tackle affordability  
Spire takeover provides synergy opportunities

#### Key Catalysts

- **FY2022 Results:** Including the impacts of COVID and reduced elective surgeries
- **Capex Program:** Increased capex on organic growth particularly in Australia
- **Procurement savings:** To assist group margins in aggregate
- **Sale and Leaseback:** We believe opportunity exists to liberate property value

#### Timing

Feb-22 & Aug-22  
FY22-24  
FY2023  
FY2022?

#### Key Metrics

Metric	Measure	2020A	2021A	2022E	2023E	2024E	2025E
Revenue	(AUDm)	12,396	13,332	13,578	15,083	15,599	16,021
EBITDA	(AUDm)	1,844	2,054	1,922	2,470	2,704	2,822
Underlying NPAT	(AUDm)	337	449	324	642	774	867
Capex	(AUDm)	681	629	2,400	900	800	700
Operating Cash Flow	(AUDm)	1,681	1,481	1,188	1,992	1,884	1,962
Underlying EPS	(AUD)	1.62	1.93	1.38	2.78	3.36	3.77
P/E	(AUD)	41.86	35.08	49.03	24.38	20.18	17.99
EPS	(AUD)	8.08	8.37	5.07	8.82	8.18	8.53
DPS	(AUD)	0.63	1.52	0.93	1.67	2.01	2.28
ROE	(%)	9.6%	11.9%	8.3%	15.4%	17.3%	18.0%
[Net Debt / (Cash)] / EBITDA	(x)	2.00	2.60	3.76	2.41	1.90	1.49

Source: Chester Asset Management



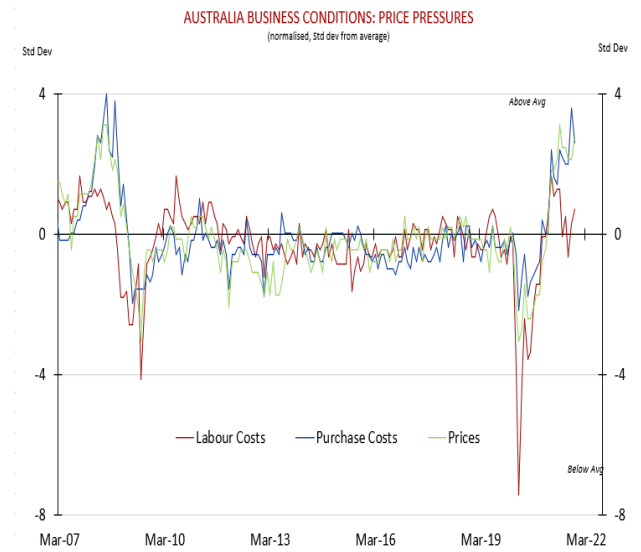
## Australian domestic trends

We're entering year 3 of living with the pandemic. It does feel further and further away from what life "pre-Covid" looked like. As this meanders on into the first half of 2022, grappling with what the new normal looks like is the challenge facing every decision maker. How much time in the office vs WFH? How much business travel vs Zoom fatigue? How many tracksuits do you need vs new suits because your old ones don't fit? Do we travel for recreation, or stay local? This challenges every business leader and politician to keep evolving and changing while bringing the workforce along with them. Continuing the theme, 2022 will take strong leadership to keep organisations evolving and real time assessments of how consumer trends are evolving. What we thought at the start of December looks very different in the middle of January. Having said that, it does feel the Omicron variant is so transmissible, the worst of the pandemic (and government responses) feels very much behind us.

If we can summarise the charts on this page into a couple of takeaways. Cost pressure is only going higher, at least in the first 6 months, hence the businesses that manage this the best either have strong pricing power, or are operating in products that have significant shortages (autos come to mind). Consumer confidence has taken a beating, so while consumers want to get out and about, they need a clear roadmap from governments to enable planning to occur. We do see reasons to remain somewhat optimistic, as the pent up household savings rate suggests that as mobility improves, so will consumer spending.

## Australian cost pressures will increase through 2022

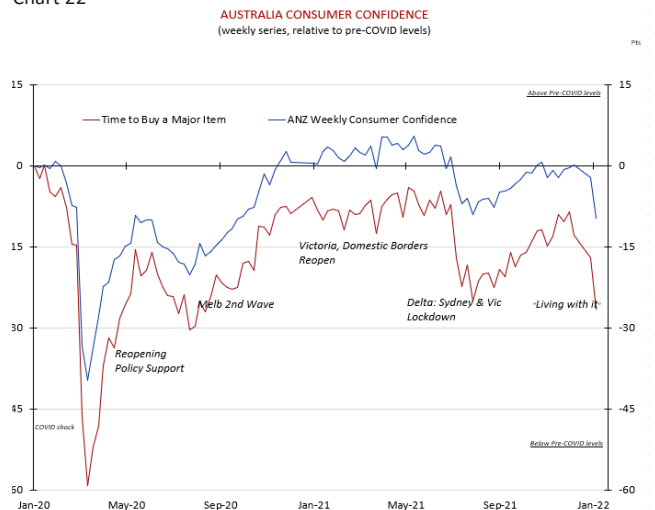
Chart 21



Source: EAP research

## Consumer confidence has taken a hit over summer

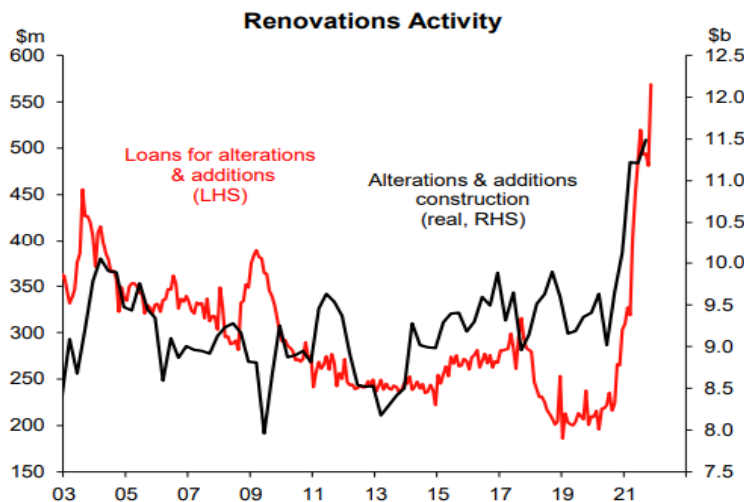
Chart 22



Source: EAP research

## Backlog of renovation work will keep cost pressure high

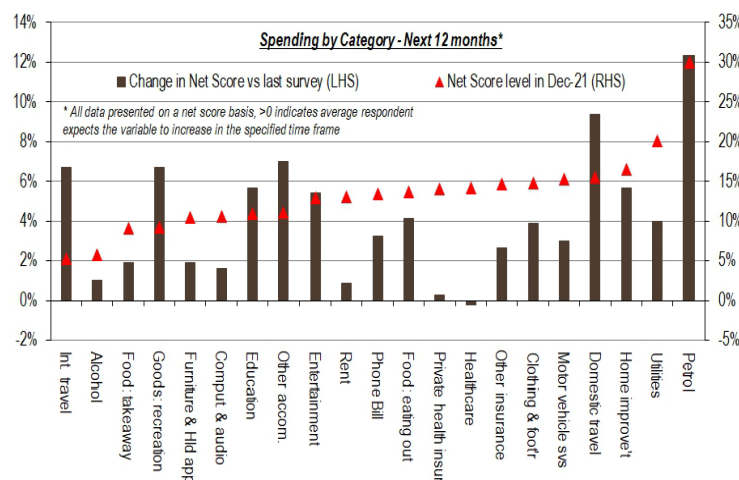
Chart 25



Source: Macquarie research

## Consumers see spend on petrol and travel as increasing

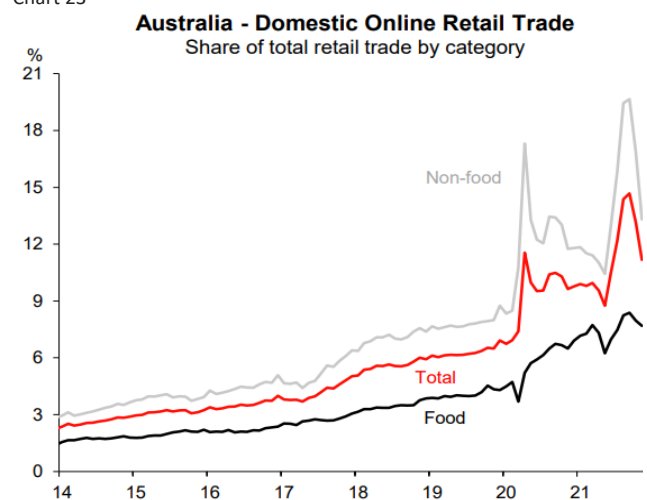
Chart 24



Source: UBS research

## Online purchases falling as stores reopen

Chart 23



Source: Macquarie research



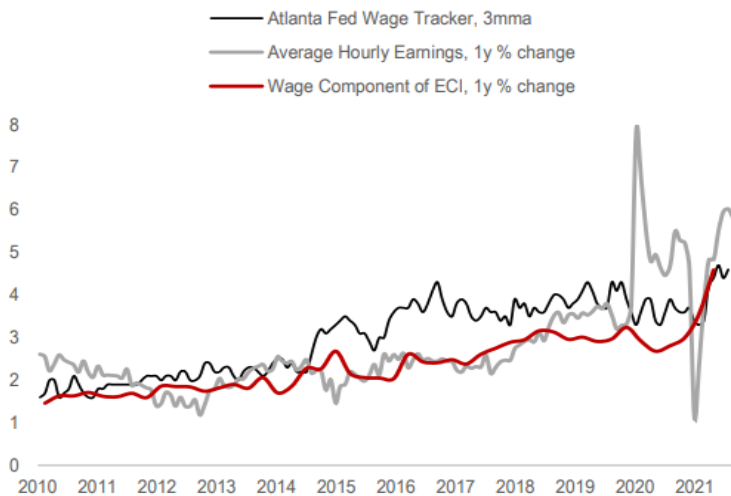
### US musings

Chart 26 illustrates just how easy monetary policy settings have been over the past 2 years. The Fed works on a dual mandate of managing inflation (not working) and full employment (arrived). Hence the switch in focus over the past 8 weeks. To us, it appears that the structural nature of inflationary pressures will accelerate over the first quarter, by assessing food and energy prices (still accelerating), owners equivalent rent (OER - just starting to accelerate) and wages (chart 30 below), just starting to become an issue. Historically, bull markets can continue until unemployment falls below full employment, which is theoretically below 4%, while we are currently sitting at 4.2%. The employment numbers and wage growth will be very significant numbers to watch this year, as they will feed directly into interest rate expectations.

One of the more staggering stats which highlights the extent of the supply chain issues is the auto inventories available at car dealers across the US. Averaging between 1.0m - 1.5m for 40 years, there is only 40k cars available across the US dealer network. It ties in to anecdotal feedback about wait times for new cars extending out to 6-9 months, which is wonderful for car dealer margins, but forces used car prices higher, exacerbating the inflation issue. We are intrigued with the strong pick-up in commercial lending, which normally is a leading indicator of strengthening economic growth. Our working assumption is here though is a significant amount of re-financing and drawdowns ahead of the inevitable interest rates rises in 2022.

### Wages are forcing the change in policy settings

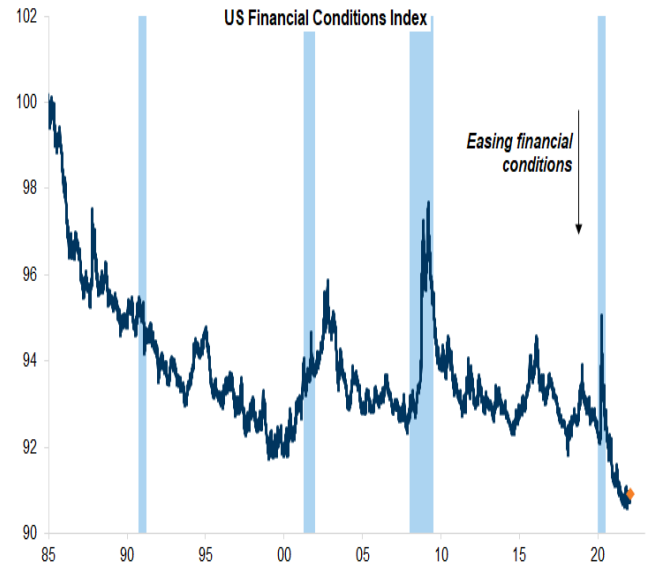
Chart 30



Source: Credit Suisse

### Financial conditions will get tighter in 2022

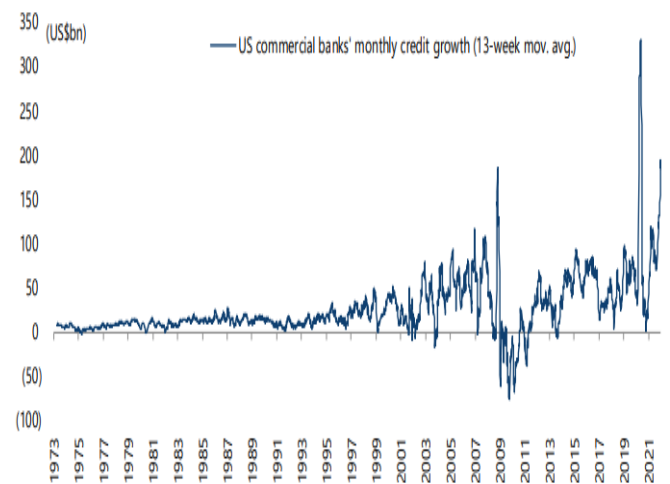
Chart 26



Source: Goldman Sachs

### US commercial bank monthly credit growth

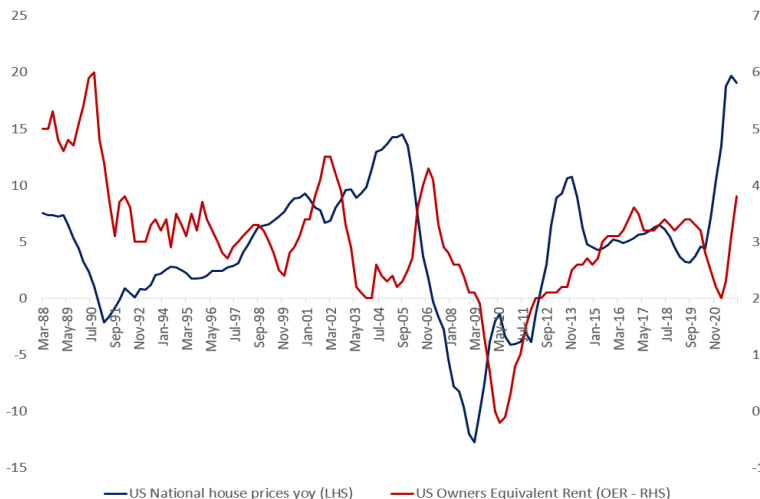
Chart 27



Source: Federal Reserve, Jefferies

### Rental growth (in the CPI basket) accelerating in 2022

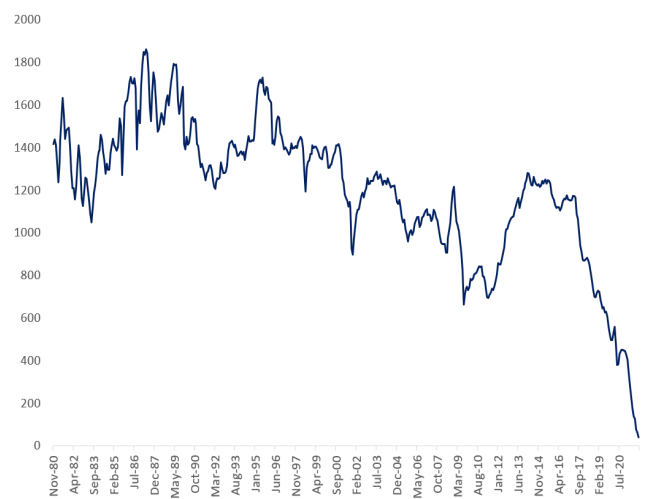
Chart 29



Source: Chester Asset Management, Bloomberg

### US car inventories over 40 years - there isn't any

Chart 28



Source: Chester Asset Management, Bloomberg



### More macro musings...

These charts frame our thinking in terms of where the risk/reward lies in portfolio construction. Clearly growth has been the major style beneficiary over the past 12 years as interest rates and bond yields kept falling. We do think that the dispersion of valuations (chart 35 below) highlights just how expensive high PE firms have become relative to the ASX200, while low PE firms (value stocks) are trading at near record lows. We don't think of ourselves as "growth" or "value" investors per se, but we are focused on the risk and reward dynamic with each individual stock decision. Hence these charts demonstrate to us, that we shouldn't be taking undue risk this year with high PE stocks, as there is very little margin of safety, as we are witnessing, the style rotation as the market starts pricing in higher interest rates. This really ties into the notion of asymmetric investing.

Chart 34 highlights that many of the uber growth investments have started rolling over, which we believe is the start of a longer term trend, if the current trajectory of interest rate rises holds into the second half of 2022. As discussed on the previous page, we think the inflationary forces do not abate quickly. What is interesting to consider is the fact that interest rate expectations are rising so sharply in the face of what appears to be a cyclical slowdown after the liquidity injections through 2020 and 2021. So in some respects, there could be a double whammy, of a cyclical slowdown and tighter financial conditions. In which case, chart 33 illustrates why gold and healthcare may have strong years.

### World value stocks vs world growth stocks

Chart 31

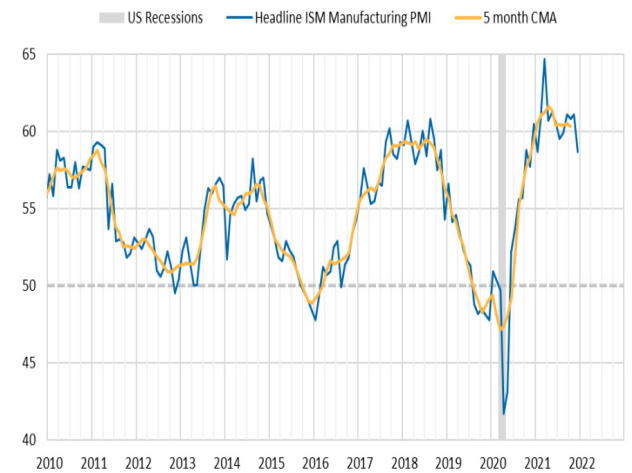


Source: Chester Asset Management, Bloomberg

### Risk of tightening as the economy rolls over?

Chart 32

#### ISM Manufacturing PMI vs US Recessions

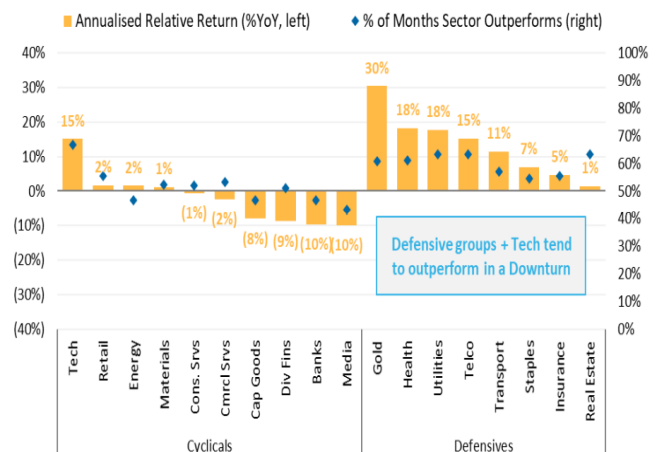


Source: Macquarie Research

### Something to bear in mind

Chart 33

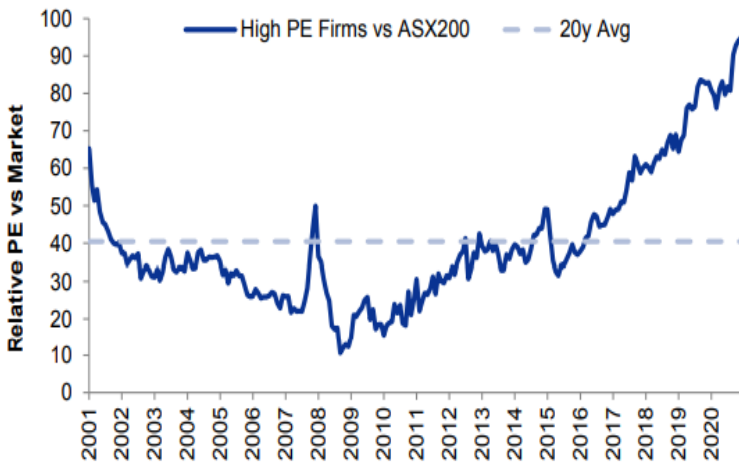
#### ASX 300 - Sector Rotation in a Downturn Phase



Source: Macquarie Research

### This changes as interest rates rise

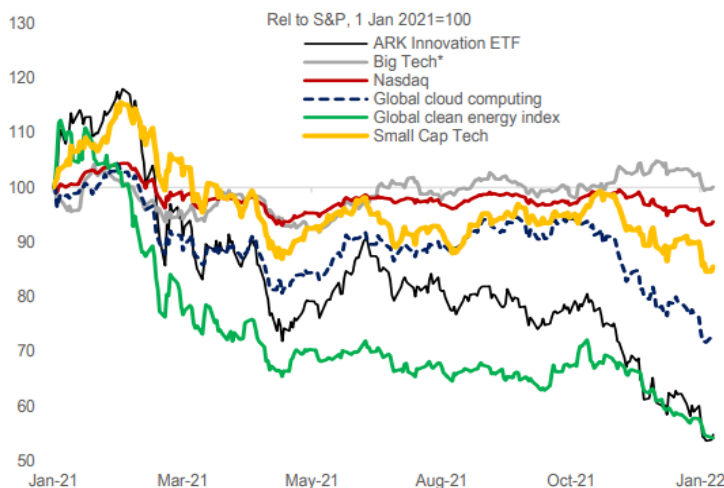
Chart 35



Source: Goldman Sachs

### Growth exposures rolling over

Chart 34



Source: Credit Suisse



## Leadership

We have run this before, but these skills are even more pertinent today.

Leadership has been a topical conversation over summer, given the struggle through the current wave of the pandemic. Like everyone, we hope the end is in sight.

That being said, we recently re-read one of our favorite books on leadership, “The Lombardi Rules” focusing on the traits and habits of Vince Lombardi, one of the iconic NFL Coaches, winning 5 NFL Championships with the Green Bay Packers in the 1960s. The NFL Superbowl Trophy is named after him, having died suddenly in 1970 at the age of 57.

- 1/ Ask yourself the tough questions** - Get to know yourself. By understanding your strengths and weaknesses, you are more likely to surround yourself with others that can compliment your own traits. Learn from failure. Failing can make you ask yourself the toughest questions of all. Being able to answer them honestly helps you learn more from failure than success.
- 2/ Look the truth head on** - Don't try to be something you're not. People have an unerring nose for dishonesty. To be successful, you must be honest with yourself and others. Don't compartmentalise. Your conduct matters at all times. If you compromise your principles in your private life, it may affect your professional life as well. This means authenticity is everything.
- 3/ Play to your strengths** - Choose your own path. It doesn't have to be the path less travelled, but it has to be the right one for you. It's not a failure if you've learnt something. Every experience can teach you something, and often the hardest lessons are the most important.
- 4/ Write your character** - Building character takes discipline, which takes daily renewal and practice. Living the principles everyday will ensure these principles stand you in good stead in times of crisis. As part of this, identify your heroes. Heroes embody qualities of character that are important to us, and compel us to examine more closely how we conduct our own lives.
- 5/ Think Big Picture** - Link your goals to vision. Goals must be anchored in conviction. Make sure your goals are closely linked to your mission, if they aren't, it will be too easy to throw them away at the first sign of adversity. Don't be swayed by minor setbacks - Don't confuse minor shifts with sea-changes. A bump in the road should be navigated without making major route changes.
- 6/ Be completely committed** - Everyone in the team (or organisation) must be completely aligned to the one goal. The commitment from everyone involved must be 100% towards that goal. There is no half measures or excuses.
- 7/ Work harder than everybody** - “The harder you work, the harder it is to surrender”. While this is sports orientated, it also resonates with business. Hard work is discipline, every day towards the end goal. Invest in your talent. All too often, our culture celebrates success without the effort. In any successful endeavor, over an extended period, there has been a lot of discipline, and hard work.
- 8/ Be prepared to sacrifice. Sacrifice leads to success. Pay the price - success is worth the cost.** Great achievements require courage, determination, drive and a willingness to pay the price. It hurts to fall short of a goal, use the pain to become a stepping stone on the way to the end goal.
- 9/ Be mentally tough - Never give in.** It's easy to do well when there's no pressure or stress, but how many of us can be poised when defeat is nipping at our heels. Mental toughness is stability and poise in the face of a career defining challenge. But you have to work at it. Its the singleness of purpose, the ability to stay motivated, no matter what obstacles are placed in your path.
- 10/ Balance humility and pride** - Pride is necessary, it's a determination to never do less than your best. It's critical to a successful culture. But beware of hubris. Never lose sight of the dark side of ego - the ego that gets in the way of truth and therefore interferes with leadership. Give credit where it is due, humility is about recognising all those that have contributed to the success.
- 11/ Lead with integrity** - Live what you teach. Great leaders (and coaches) win the hearts of their followers. They do so by being involved up to their necks, and making that commitment clear. Build accountability. Act your integrity. Take responsibility when you screw up, and take credit when you meet with success, and make sure this applies to everyone.
- 12/ Build team spirit** - Emphasise responsibility and loyalty. Teams depend on an extraordinary cohesiveness. Encouraging all members of an organisation to support and aid other members in the pursuit of shared goals will strengthen this bond. Focus on team success rather than personal glory. Strong team members place the interest of the team first. A good leader will exemplify this trait.
- 13/ Build confidence** - Project confidence. Confidence is catching, so is a lack of confidence. If a leader exudes confidence, his troops will follow his lead. A team that starts winning immediately increases its confidence, and immediately increases its chance of winning again.
- 14/ Know your stuff** - Demonstrate competence. When the time comes, show that you know it. Those under you will gain respect for and confidence in your leadership. Build your skills from the bottom up. Even if you don't feel you're getting the visibility you deserve, continue to hone your skills and demonstrate your competence.
- 15/ Act, don't react - Study the past, live in the present.** Find yesterdays lesson, but assume that today is new. Continue learning. The best way to be ready for the challenges of tomorrow is to keep learning today. Relying on the old skills that have worked in the past will backfire, as those skills become obsolete. Seize the moment. Seize the initiative by seeing things for what they are, and act without hesitation on what you see.

All these skills can be equally applied to the business environment, and many of them to funds management.



## Our Executive Summary

### Equities

All else being equal, equities remain attractively valued relative to bonds, albeit we do see risks around the potential for financial conditions (interest rates) to be considerably tighter in 2022 as central banks wind back the extremely easy monetary conditions from the past 2 years. Tighter financial conditions will most likely lead to higher volatility through 2022 than we have seen over the past 18 months.

By and large we prefer to be contrarian with our investments which has been remarkably difficult over the past 5 years. Our most successful ideas have either been somewhat unloved, underappreciated or undiscovered stories. We actually view the current environment to be more favourable for a more contrarian style bias to be rewarded over the course of 2022, as the bond market tries to reprice higher inflation expectations, leading to further sector rotations. This suggests a period ahead of value outperforming growth.

The inflation debate around “transitory” or “structural” is widely discussed as it is really something asset prices haven’t had to deal with since 1981. We are in the structural camp, but this is dependent on wage inflation, which we see as confirming our thoughts as we start 2022. As discussed through the quarterly, there are many other components of the inflation basket supportive of continued CPI prints higher than expectations. We have a view that real assets (property, agriculture, commodities, gold) will outperform capital light or long duration assets over the coming years, predominantly based on the view that inflation will be more persistent than current expectations, and that this is actually a desired policy response for governments burdened with insurmountable debt.

Our strategy is very focused on individual companies with appropriate diversification, given the wide range of outcomes possible over the next 12-18 months. Many of our positions are where we believe there is a strong margin of safety and the risk reward profile is favourable to generating positive returns over the next 12 months, regardless of the move in the ASX300.

By and large, our stock selection framework focuses on:

Real assets - AZJ, MIN, QUB, ORG, KAR

Valuation margin of safety - NWS, LLC, ASB, RIC, SM1

Pricing power - TAH, EGH, JHX, ALL

Gold - AMI, OGC

As we have demonstrated over the past 8 years with this strategy, the returns we generate do deviate significantly from the benchmark, where we are proud of the track record of the strategy, delivered with lower volatility than the ASX300.

### Gold

Gold effectively has a dual purpose. As a store of safety in uncertain times, which we saw through 2020, and as a store of value when inflation occurs, as real interest rates turn negative. To be honest, this didn’t turn out the way we envisaged in 2021, largely we suspect for two reasons. Firstly, the onset of crypto currencies as a competing alternate asset (not around in the 1970s) and secondly, the consensus thinking that because inflation is “transitory” the current negative real yields will inevitably turn positive again. Assisted by rising nominal yields and a strengthening USD, which act as headwinds for gold. We are less confident that real yields ever turn significantly positive again. We do see the prospect to a stronger USD as the biggest hindrance to gold’s price action this year, notwithstanding the gold equities (globally) remain out of favor and very cheap.

Gold has proven highly successful in outperforming when equity markets fall through the course of history and hence remains a valuable allocation to the portfolio construction.

We spend much of our time analysing gold equities which are selected primarily on valuation grounds first, and then an assessment of the quality of the resources and cost of extraction. Clearly management competency and a track record of delivery is also an important variable.

### Government spending and bond yields

The enormous increase in deficit spending across the globe to ensure the unemployed workforce can pay bills has left (and will leave) most central banks with an insurmountable debt burden. There is no longer any pretense of any political party anywhere to try to repay these debt burdens the future generations are faced with. Interest rates simply cannot rise with the amount of debt issuance by central banks, and it appears we are more likely to see negative real interest rates in the US, than positive real interest rates in the foreseeable future. Obviously the prospect of interest rate rises in 2022 will challenge this thesis, but inevitably there is an absolute structural ceiling on how high interest rates can go before bankrupting the US Government. Very simplistically if US interest rates were 3%, on USD30tn of debt, the US interest bill on that debt would be USD900bn, against 2022 revenues of USD4.2tn (and a deficit of USD1.9tn)

With this backdrop, the only way the debt burden to society gets repaid, is through asset reflation, or in some cases, debt forgiveness. Central banks (led by Japan) have had no other playbook since the GFC, and will continue to issue new bonds to finance the deficit spending of governments and the debt burden. Since Alan Greenspan, Fed governors have always issued a “put” on the stock market with new easing policies, which in the next downturn, eventually becomes yield curve control, and ultimately direct equity purchases, if needed. Is this possible in 2022? Absolutely.

### Risks

The outlook takes on a more cautious tone in the aggregate sense, given the easy financial conditions of the past 18 months are being wound back. The prospect for slower growth in the US combined with higher inflation really does signal a period of stagflation ahead. If 2020 has taught us anything, an ability to be nimble and change our assessment of the likely outcomes is critical to not only protecting capital, but identifying opportunities when they arise. Asymmetric investing or being contrarian in your investment framework we think will be rewarded over 2022.



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