

Hearts & Minds Investments (HM1)

Unique “Best Ideas” listed investment company - Initiation

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Wayne Sanderson
wsanderson@phillipcapital.com.au
+61 3 8633 9930

Summary

Hearts and Minds Investments Limited (HM1) is a unique listed investment company focused on international equities. It provides a concentrated portfolio of long-only positions in 25-35 listed stocks based on the highest conviction ideas from leading fund managers.

These fund managers provide their services for free. There are no performance fees, and instead of a base fee, HM1 makes half-yearly donations to certain medical research charitable organisations of 1.5% annualised of the net asset value of the company. Operating costs are low as a number of service providers also provide their services for free, to help maximise the performance of the company and therefore the charitable donations.

HM1 was listed on the ASX on 14/11/18 after raising \$500m at \$2.50 per share. 60% of the initial portfolio was invested in 15 stocks being 3 high conviction stock ideas nominated by each of 5 “Core Portfolio” managers – Caledonia, Cooper Investors, Magellan, Paradise and Regal.

The other 40% of the portfolio (13 stocks) were selected by “Conference Fund Managers” presenting at the November 2018 Sohn Hearts & Minds investment conference.

Performance to Date

HM1 has just reached its one year anniversary. Performance to end October (11.5 months) has been strong:

- Share price return +25.2% from IPO to 31 October (11.5 mths) ranked equal second of the 17 internationally focussed LICs and LITs we follow.
- NTA return +21.2% from IPO to 31 October.
- HM1’s shares currently trade close to pre-tax NTA and do not appear to have been impacted by the “NTA discount malaise” affecting many other LICs.
- Dividends - None yet, however a maiden dividend is likely to be declared after the 1H20 result. We forecast a 1.5% dividend yield paid from realised gains.
- Strategic / altruistic benefits to shareholders – The donation to medical research for FY19 was \$4.9m (Victor Chang Cardiac Research Institute) being reimbursement of IPO costs. Future donations will be spread across a wider group of 10 designated medical research organisations.
- A 1 for 8 rights issue at \$2.50 has been proposed to raise an additional \$62.5m, and allow a new Core Manager to be included – TDM Growth Partners.

Accumulate – 12mth Price Target \$3.43

We initiate coverage with an Accumulate recommendation.

The S&P 500 TR index has delivered a total shareholder return of 9.9% pa over the last 30 years. We assume a 10% capital return (pre-tax) for FY20 and 8% for FY21.

We are particularly attracted to HM1 for its unique structure, of “Best ideas” from leading fund managers and low costs.

Recommendation

Accumulate

Risk Rating	Medium
12-mth Target Price (AUD)	\$3.43
Share Price (AUD)	\$3.07
NTA (pre tax / post tax) (October)	\$3.03 / \$2.88
Share price to NTA – Premium (Discount)	1.3% / 6.6%
12-mth Price Range	\$2.35 - \$3.18
Forecast 12-mth Capital Growth	11.7%
Forecast 12-mth Dividend Yield	1.5%
12-mth Total Shareholder Return	13.2%
Market cap (\$m)	614.0
Net debt (net cash) (\$m)(Jun 19)	(7.1)
Enterprise Value (\$m)	606.9
Gearing (Net Debt/ Equity)	N/a (Net cash)
Shares on Issue (m)	200.0
Average Daily Value Traded (\$)	\$592,000

Financial Forecasts & Valuation Metrics

Years ending June \$m	Inception	19(A)	20(e)	21(e)
Net Assets	500.0	570.5	604.4	632.9
NTA per share (Pre tax)(\$)	2.50	3.00	3.25	3.43
NTA per share (Post tax)(\$)	2.50	2.85	3.02	3.16
NTA growth (post tax) plus dividends		14.1%	7.5%	6.4%
NPAT (reported)(excludes investment gains)	-0.7	1.4	1.9	
Realised investment gains (net of tax)	4.2	20.8	18.3	
Unrealised investment gains (net)	67.0	20.8	18.3	
NPAT (adjusted)		70.5	43.0	38.5
EPS (adjusted)		35.2	21.5	19.2
DPS		0.0	4.5	5.0
P/E		8.7	14.3	16.0
Yield		0.0%	1.5%	1.6%
Franking		0%	100%	100%

Source: Phillip Capital estimates

HM1 SHARE PRICE PERFORMANCE



Reasons to Buy

- 1. Unique Structure – High Conviction / Best Ideas portfolio** – HM1 provides investors with a concentrated “best ideas” portfolio from a group of ~16 leading Australian and international fund managers in one simple investment vehicle. Some of these manager’s products are closed to new investors, or not normally available to retail investors, or have high minimum investment requirements. Further, these managers are putting their stock-picking abilities and reputations on the line for a good cause.
- 2. Low Management Expense Ratio (MER)** – As there are no base fees (usually 1.0%-1.5% pa plus GST for international fund managers) and no performance fees (usually 10-20% plus GST of any out-performance) an investment in HM1 is an attractive option. Further, the HM1 directors and investment Committee members have waived their rights to director fees and committee fees. And a number of Service Providers are not charging for their services, which again brings the costs down and maximises the 1.5% per annum donation to medical research organisations. The MER in FY19 was 0.2% or 1.7% including the donation (based on 7.5 months annualised).
- 3. Year 1 investment performance has been excellent.** HM1 has achieved a 25.2% total shareholder return (TSR) for the 11.5 months from IPO (14/11/18) to 31 October 2019. HM1’s total managed return (“TMR” i.e. Pre-tax NTA return plus dividends) was also strong at 21.2% for the same period. Both figures comfortably outperformed the benchmark MSCI All World TR (AUD) return of 18.4%.
- 4. Predominantly International exposure** – HM1’s portfolio at June 2019 comprised 72% international stocks, 25% domestic Australian stocks and 3% cash. We believe that HM1 is an attractive stock for investors looking to increase their international exposure in a simple way via a professionally managed listed investment company structure.
- 5. Rights Issue proposed** – HM1 has proposed a 1 for 8 renounceable rights issue to raise an additional \$62.5m at the original IPO price of \$2.50 per share. This will enable a sixth “Core Fund Manager” (TDM Growth Partners) to be added, without the need to sell down any of the existing core portfolio which is performing well.

For shareholders we regard the proposed rights issue as an attractive opportunity to acquire further stock at a 19% discount to the current share price, without brokerage. NTA will be diluted by 1.5%-1.9% on our estimates, but all shareholders will be treated equally as the issue will be fully renounceable (see further discussion on page 10).

HM1: Estimated impact of rights issue	30/10/19 \$m	Post Rights \$m	Change \$m	Change %
Estimated Net Assets (pre tax)	606.0	668.5	62.5	10.3%
Estimated Net Assets (post tax)	576.0	638.5	62.5	10.9%
Shares on Issue (m)	200.0	225.0	25.0	12.5%
NTA (pre tax)	\$ 3.03	\$ 2.97		-1.9%
NTA (post tax)	\$ 2.88	\$ 2.84		-1.5%

Source: October NTA report; Phillip capital estimates

- 6. Dividends expected** – HM1 has stated that it will consider paying a dividend after the December half year, dependent on the quantum of realised profits from the disposal of the first year’s stocks recommended by Conference Fund Managers. We expect a small dividend of 1-2% of the portfolio value. Because HM1 will pay tax in Australia on realised gains made, there should be at least some franking available.
- 7. Altruistic benefits to shareholders** – We think that many investors would be pleased to support HM1’s dual objectives – of supporting medical research charities in a material and on-going way, and high conviction global investing.
- 8. Strong Board** – In our opinion HM1 has a very strong and well credentialed board and investment committee. All board members have meaningful shareholdings in the company. All board members have waived their rights to directors’ fees.
- 9. Strong shareholder base** - We note that the company already has a strong and supportive shareholder base including over \$150m of cornerstone investors and well

known family investors. And given the unique structure of “Best ideas”, “Low costs” plus Societal benefits we expect buying demand for HM1 shares to grow. We would not be surprised to see the shares trade at a significant premium to NTA as the company and its dual purpose gets better known.

Risk Factors / Possible Negatives

1. **Market risk** - Global stock markets are close to record highs, reflecting unusually low global interest rates. HM1 is a “long-only” fund with a minimal allocation to cash. It is a high conviction portfolio. There are no stock short positions or use of futures to protect the portfolio in the event of a market sell-off. The defence is the quality of the individual chosen stocks in the portfolio, and the diversification by company, sector and geography. The intention is for the company to be close to fully invested at all times.
2. **FX risk** – The current portfolio weighting is 69% international and 31% Australia (per the October monthly report). The current strategy is to leave the portfolio unhedged. This has been beneficial since inception but may not always be the case.
3. HM1’s “Conference Manager” portfolio (~ 40% of the total current portfolio) is effectively based on static stock selections made at the annual conference in November. This is different to other fund managers making decisions on a monthly, weekly or more frequent basis. However HM1’s investment manager watches the portfolio closely and is in regular contact with the fund managers should anything change materially. The Chief Investment Officer provides a weekly report to the board. In addition the Investment Committee has further oversight. Changes can and have been made during the year. Proceeds from disposals are reallocated across continuing positions, or if within 3 months of the next conference are held in cash.
The “Core Managers portfolio” (~60% of the total portfolio value) is intended to comprise the 3 best ideas from each of the 5 managers and the selections are intended to be held long term. Each manager can change their selections if required and nominate a different stock(s). At least one manager made a change during the year, and part profits were also taken and some stocks to lock in some gains.
4. **No IPO’s** - Further HM1’s structure means it is unlikely to participate in new IPO’s or opportunistic placements as a regular fund manager might do. We don’t think this would make a material difference given this is not a trading portfolio.
5. **Donation will be made regardless of investment performance** – The half yearly donations would continue to be made even if the investment performance was a loss. We see this as no different to traditional LICs which have the fixed costs of an in-house management team, or a base fee payable if externally managed LIC. With low costs, no base fees and no performance fees, HM1 has an attractive low MER (management expense ratio) even including the donation.
6. **Premium or Discount to NTA** – Listed investment companies can trade on the stock market at a premium or discount to the underlying net tangible assets of the company. At end October HM1’s share price was a modest 3% premium to NTA, but this could change in either direction. Factors that contribute to LIC’s trading below NTA typically include size and liquidity, investment performance, dividend yield, complexity and the level of information flow and marketing done by the LIC and its managers. We think that HM1 scores well on all these points apart from dividend yield, which we expect to be addressed in the near future. We believe that HM1’s unique structure is likely to see it continue to trade at a small premium to NTA.
7. **Discounted peers may offer better value short term** - A number of HM1’s peers trade at significant discounts to NTA and so may offer better value to investors in the short term. HM1’s closest peer is probably Future Generation Global Investments Limited (FGG), market cap \$498m, historic yield 1.2%, which currently trades at a 9% discount to NTA. We discuss possible reasons for this in our Valuation section on page 11.

Brief History of Company

Hearts & Minds Investments Limited (HM1) was incorporated on 12/9/18 and raised the maximum \$500m in the November 2018 IPO (200 million shares at \$2.50 per share). It was listed on the ASX on 14/11/18.

The company was established with the combined objective of providing a concentrated securities of the highest conviction ideas from leading Fund Managers, while also supporting Australian medical research institutes.

Cornerstone family investors contributed over \$150m, demonstrating strong support for HM1 and the dual purpose initiative.

HM1: List of Cornerstone Investors & Families (> \$150m committed in IPO)

Ainsworth family	Joseph family
Benari family	Karedis family
Carapiet family	Lew family
Cannon-Brookes family / Grok Ventures	Lewin family
Craig family	Lowy family
Chris Cuffe family	Mason family
Hamish Douglass family	Myer Family Investments
Gonski family	Packer family
Gresham Partners Capital Limited	Brett Paton Family
Gurry family	Paul Ramsay Foundation
Gwinnett family	Ross family
Gyngell family	Stokes family
Hadley family	The University of New South Wales
Hutchinson family	The University of Sydney
Ivany family	Gary Weiss family
Jackson and Farquhar family	Judy & Sam Weiss family
Johns family	Geoff Wilson family
Johnson family	Woods family

Source: Prospectus

Members of the Board of Directors and Investment Committee also contributed over \$25m.

The expenses of the IPO (\$5.3m) were paid by The Victor Chang Cardiac Research Institute (Victor Chang Institute) to be reimbursed by subsequent donations, so that the company commenced operations on day one with net tangible assets of \$2.50, equal to the offer price. HM1 made its first payment of \$4.9m to Victor Chang Institute in June 2019 with \$0.3m remaining to be reimbursed from the December 2019 half yearly donation. Donations to the 10 designated charities will commence during FY20.

The Company's Charitable Goal

The company's charitable goal is to provide financial funding to leading Australian medical research organisations in order to support the development of new medicine and drive a new generation of medical research in Australia. The company will seek to support medical research across a broad spectrum of human health conditions, from heart disease to neurological disease and mental health issues.

In order to support its Charitable Goal, the company will forego any investment fees and instead make a donation to the Designated Charities every six months. The donation amount is 1.5% per annum of the average monthly net assets of the company (plus GST).

The list of designated charities is shown below:

HM1: List of Designated Charities

The Victor Chang Cardiac Research Institute
The Black Dog Institute
The Brain and Mind Centre, Sydney University
The Charlie Teo Foundation
The Children's Hospital at Westmead – Pediatric Intensive Care Unit, Research
The Florey Institute of Neuroscience & Mental Health
Swinburne University - The Centre of Human Psychopharmacology
Multiple Sclerosis Research Australia Limited
Orygen
Royal Prince Alfred Hospital, research

Source: Prospectus

Low Operating Costs

The Company, its Fund Managers and a number of key Service Providers have agreed to forego fees that they would normally charge in relation to services provided to the company.

The members of the Board and the Investment Committee have also agreed to waive any right to be paid director fees and committee fees.

This results in very low operating costs and management expense ratio (MER), which in turn helps to maximise the on-going donation to medical research charities.

In FY19 we calculate the management expense ratio was 0.2% or 1.7% including the donation (7.5 months annualised).

Board of Directors

HM1 has a board of eight non-executive directors (all considered independent), and an Investment Committee of 5 (one external member). A brief summary is shown below. Full details are available in the company's annual report.

All directors have meaningful investments in the company.

HM1 - Directors & Key management Shareholdings		HM1 Shareholding	% of Coy
Chris Cuffe AO, Chairman, NED	Founder Third Link Growth Fund, ex Chairman of UniSuper, ex CEO of Colonial First State & Challenger	1,300,000	0.65%
Lorraine Berends, NED	Ex Chair of IMCA Aust (Investment Mgt Consultants Assoc) & ASFA (Association of Super Funds Aust)	40,000	0.02%
Guy Fowler, NED	Ex Head of Capital Markets and Corporate Advisory, UBS Australia	1,000,000	0.50%
Matthew Grounds, NED	Ex CEO and Country Head, UBS Australia	1,000,000	0.50%
Michael Traill AM, NED	Founder Social Ventures Australia; ex co-founder & director of Macquarie's private equity arm	3,264,250	1.63%
Gary Weiss AO, NED	Chairman Ardent Leisure, Ridley & Estia Health. Numerous previous directorships incl Guinness Peat Group	440,000	0.22%
Geoff Wilson AO, NED	Founder Wilson Asset Management, WAM Capital and Future Generation Investments	1,500,000	0.75%
David Wright, NED	Managing Partner & co-founder of Zenith Investment Partners	40,000	0.02%
Key Management personnel:			
Paul Rayson, CEO	Former MD of CommSec and Colonial Mutual Life Assurance Society	133,250	0.07%
Rory Lucas, CIO	Former senior roles at CBA, UBS Australia and Rothschild Australia Asset Mgt	80,694	0.04%
Total		4,564,250	2.28%
Investment Committee:			
Brett Paton	Chairman Escala Partners; former Vice Chairman UBS Australia		
Chris Cuffe AO	As above	As above	
Lorraine Berends	As above	As above	
David Wright	As above	As above	
Paul Rayson	As above	As above	

Source: FY19 Annual Report

HM1 has just three paid employees – Paul Rayson (CEO), Rory Lucas (Chief Investment Officer) and Maggie O'Neill (Marketing Manager).

HM1 operates out of a small office in the Sydney CBD provided at no cost by one of the service providers.

The first Sohn Hearts & Minds investment conference was held in Sydney in 2016, followed by Sydney again in 2017 and Melbourne in 2018. HM1 was actively involved in the 2018 conference and will be again at this week's 2019 conference, but it does not bear any of the direct costs of this event, which we understand is funded independently.

The CIO told us that there was over \$750 billion of funds under management by the HM1 fund managers in the room at last year's conference. A very powerful statistic. The HM1 fund managers are putting their stock-picking abilities and reputations on the line for a good cause.

Core Portfolio Managers

60% of the initial portfolio was allocated to a group of 5 leading “Core” portfolio managers (ie. 12% each). These fund managers nominated three stocks each, being their highest conviction ideas, and their recommended weighting per stock.

CALEDONIA

Caledonia is a global investment management firm with offices in Sydney and New York. With over 25 years’ investment experience, Caledonia’s goal is to achieve high absolute returns for their clients over a long-term time horizon. The firm manages a long short equity strategy with a focus on deep fundamental research and high conviction long-term investing.

COOPER INVESTORS

Cooper Investors Pty Limited is a specialist equities fund manager with funds under management of approximately \$14 billion. Cooper Investors commenced operations in 2001 and manages money for a range of clients, including large pension and superannuation funds, religious institutions, Australian State Government agencies, school endowments, charities, high net worth families and retail clients. Cooper Investors is 100% owned by its employees. Cooper Investors seeks to invest in quality companies with a strong value proposition.

MAGELLAN EXPERTS IN GLOBAL INVESTING

Magellan Asset Management Limited (Magellan) is an Australian-based asset manager that is a wholly-owned subsidiary of Magellan Financial Group Limited, an ASX top-100 company that was formed by Hamish Douglass and Chris Mackay in Sydney in 2006. Magellan manages approximately \$75 billion of funds under management as at 31 August 2018 across its global equities, global listed infrastructure and Australian equities strategies for retail, high net worth and institutional investors and employs over 120 staff globally.

PARADICE INVESTMENT MANAGEMENT

Paradise Investment Management Pty Limited (Paradise) is a privately-owned Australian boutique funds management business established in 1999 by David Paradise. Paradise currently manages over \$15 billion in assets across five distinct investment strategies including Australian small cap, mid cap and large cap equities, global small cap equities and emerging market equities. Paradise has offices in Sydney, Denver and San Francisco.

REGAL FUNDS MANAGEMENT

Regal Funds Management is a specialist alternatives investment manager. It was founded in early 2004 and is one of Australia’s leading investment managers servicing a wide range of institutional investors and high net worth individuals. The investment team has extensive investment experience through many market cycles and a long track record of delivering superior returns for investors. Regal offers a range of products to suit different investment objectives.

A sixth Core Fund manager will be added for 2020 – **TDM Growth Partners**. TDM is a global investment firm with offices in Sydney and New York. It invests in fast growing companies run by passionate management teams. TDM operates on long-term time horizons, and has a highly focused approach to investing with a portfolio of no more than 15 investments globally. Over the last 14 years, TDM has delivered returns for its clients well in excess of the market. It has only 20 clients and will only manage funds for other like-minded, long-term investors.

Conference Fund Managers

40% of the initial portfolio was allocated to the “Conference Fund Managers” portfolio, being the high conviction, large cap nominations from the November 2018 conference in Melbourne. (I.e. approximately 3% each).

Over half of these firms or individuals will be returning for the 2019 conference, plus a few new firms and individuals, which should deliver another group of fresh and interesting stock nominations.

All stock ideas at the conference were vetted for market cap and liquidity requirements to suit the HM1 portfolio objectives.

HM1 - 2018/19 Conference Fund Managers

Babak Poushanchi	Cota Capital	Jun Bei Lu	Tribeca Investment Partners
Christina McQuire	Elephant Asset Management	Peter Cooper	Cooper Investors
Geoff Wilson AO	Wilson Asset Management	Blake Henricks	Firetrail Investments
Paul Mason	Paradise Asset Management	Emma Fisher	Airtie Funds Management
Tim Carleton	Auscapp Asset Management	Nick Griffin	Munro Partners
Beeneet Kothari	Tekne Capital Management	Steven Glass	Pengana Capital Group
Christopher Demasi	Montaka Global Investments		

Source: FY19 Annual Report

Investment Portfolio

The FY19 Annual Report for HM1 provided a full listing of all stocks held in the two investment portfolios at 30 June 2019. The stocks in the “Conference Portfolio” (stocks nominated at the November 2018 Sohn conference) were well publicised previously, but the composition of the “Core Managers portfolio” was generally kept confidential to preserve the intellectual property of the managers.

There were 25 stocks held at June 2019, down from the initial 28 stocks purchased at inception with 3 stocks being sold during the year. The intention is that the Conference portfolio stocks from last year (~40% of the total portfolio) will be sold and be replaced with new ideas from this year’s conference unless a conference manager nominates the same stock for a second year. (HM1 has proposed to reduce this weighting to 35%).

It is expected that the Core Managers portfolio will continue to be held for 3-5 years unless the manager’s investment thesis changes, or the stock becomes over-valued in the opinion of that manager. In that case, the manager would nominate a replacement stock. At least one manager made such a change during the year, and part-profits were also taken in some instances.

We have provided for interest a brief summary of the key metrics of the stocks in the portfolio, as listed at 30 June 2019. Some of these positions may have changed since the disclosure as at June 30.

Stock Code	Company	Sector	% of HM1 Portfolio	Market Cap US\$m	Price Local Curr	Performance TSR -12 mths (to 15/11/19)	P/E		EPS Growth		Revenue Growth		Dividend Yield
							FY1	FY2	FY1	FY2	FY1	FY2	
PAGS.N	PagSeguro Digital Ltd	Information Technology	5.89%	11,997	36.54	55.0%	33.1x	24.7x	60.9%	34.1%	34.8%	26.7%	
Z.O	Zillow Group Inc	Communication Services	5.77%	8,221	39.68	37.3%	NaN	NaN	2.1%	85.0%	95.8%	84.0%	
APX.AX	Appen Ltd	Information Technology	5.43%	1,914	23.31	80.2%	48.7x	36.6x	21.9%	33.0%	46.0%	25.1%	0.4%
1299.HK	AIA Group Ltd	Financials	4.53%	118,928	77.00	21.2%	18.8x	17.2x	142.7%	9.6%	7.3%	16.6%	1.5%
FB.O	Facebook Inc	Communication Services	4.50%	556,376	195.10	39.8%	30.1x	21.3x	-14.4%	41.5%	26.2%	21.7%	
SVW.AX	Seven Group Holdings Ltd	Industrials	4.36%	4,394	19.08	14.2%	13.6x	12.3x	116.6%	10.1%	7.5%	6.5%	3.1%
GOOG.O	Alphabet Inc	Communication Services	4.31%	920,183	1334.87	25.8%	28.8x	24.7x	6.0%	16.9%	18.9%	17.7%	
TEL.N	TE Connectivity Ltd	Information Technology	4.26%	31,140	93.10	22.5%	18.1x	16.0x	-10.1%	13.2%	-3.0%	4.6%	2.0%
AMZN.O	Amazon.com Inc	Consumer Discretionary	4.21%	862,434	1739.49	9.2%	84.2x	63.8x	4.1%	32.0%	19.8%	18.4%	
BXB.AX	Brambles Ltd	Industrials	4.13%	13,160	12.41	27.6%	24.8x	21.1x	20.2%	17.6%	3.4%	5.8%	2.8%
DOCU.OQ	DocuSign Inc	Information Technology	4.09%	11,929	67.78	73.8%	414.3x	168.7x	NaN	145.6%	35.6%	25.5%	
AIR.PA	Airbus SE	Industrials	4.03%	116,968	136.40	48.9%	22.8x	18.7x	52.7%	22.0%	9.0%	7.2%	1.2%
BABA.K	Alibaba Group Holding Ltd	Consumer Discretionary	3.95%	484,286	185.49	20.4%	25.5x	20.6x	NaN	24.0%	37.7%	29.2%	
ITT	ITT Inc	Industrials	3.93%	6,077	69.29	24.6%	18.5x	17.3x	9.5%	7.0%	3.5%	3.4%	0.8%
7832.T	Bandai Namco Holdings Inc	Consumer Discretionary	3.85%	13,337	6532.00	39.8%	21.2x	19.2x	6.7%	10.7%	2.4%	6.1%	2.3%
4502.T	Takeda Pharmaceutical Co Ltd	Health Care	3.83%	64,603	4456.00	8.3%	NaN	47.4x	NaN	NaN	58.4%	0.7%	4.0%
JBH.AX	JB Hi-Fi Ltd	Consumer Discretionary	3.64%	2,854	36.61	63.9%	16.5x	16.2x	3.1%	2.1%	2.8%	2.7%	5.5%
LEA	Lear Corp	Consumer Discretionary	3.51%	7,374	121.94	-7.4%	9.1x	7.9x	-22.2%	14.4%	-8.3%	4.3%	2.5%
TSGI.TO	Stars Group Inc	Consumer Discretionary	3.50%	6,481	29.77	27.6%	12.7x	11.8x	NaN	7.4%	24.2%	9.5%	
ORG.AX	Origin Energy Ltd	Energy	3.43%	9,896	8.28	23.2%	14.2x	13.6x	-15.2%	4.5%	-2.8%	-0.7%	4.3%
LSXMA.O	Liberty Media Corp	Communication Services	3.41%	26,260	47.01	16.7%	25.5x	19.5x	-9.4%	30.8%	35.2%	6.2%	
REH.AX	Reece Ltd	Industrials	2.37%	3,958	10.40	-0.7%	22.9x	21.1x	25.8%	8.7%	4.2%	4.0%	2.8%
GRUB.K	GrubHub Inc	Consumer Discretionary	2.25%	3,639	39.79	-54.5%	50.3x	182.0x	-7.0%	-72.3%	28.7%	12.8%	
MSFT.O	Microsoft Corp	Information Technology	2.00%	1,144,092	149.97	40.1%	27.8x	24.7x	13.6%	12.5%	11.5%	11.3%	1.4%
NUF.AX	Nufarm Ltd	Materials	1.88%	1,659	6.41	8.5%	21.8x	16.0x	NaN	36.2%	4.4%	4.4%	1.7%
AAA.AX	Betashares High Interest	Cash ETF	2.96%										1.8%
	Mean Average			184,173		25.5%	44.1x	35.5x	18.2%	22.3%	19.5%	13.6%	2.4%
	Median			13,248		23.9%	22.9x	20.0x	6.7%	14.4%	10.3%	6.9%	2.3%

Source: Refinitiv consensus estimates for all stocks; FY1 means forecast year 1 (FY19 in most cases); FY2 means forecast year 2. NaN means no available number, or no meaningful number.

Shire plc taken over by Takeda Pharmaceuticals for cash and scrip in Takeda. Performance of Shire plc prior to the takeover is not shown.

The portfolio at June 2019 consisted of 25 stocks, being 17 international stocks and 8 local Australian stocks. The average performance (total shareholder return including dividends - TSR) for these stocks over the 12 months to 15 November was 25%.

There were 7 stocks in the Consumer Discretionary sector, 5 in the IT sector, 5 in Industrials, 4 in Communication Services, and 1 each in Energy, Financials, Healthcare and the Materials sector. There were no mining stocks.

Most stocks (but not all e.g. JB HiFi) had good earnings or revenue growth.

The median P/E of the portfolio was 23x based on consensus forecasts (Refinitiv), for 7% growth this year and 14% growth next year. The average forecast yield was 2.4%, with several stocks not paying any dividends.

Performance

We show below the performance of HM1 since its IPO date (14/11/18) to end October (approx. 11.5 months), and also that of its peer group of listed investment companies and listed investment trusts.

HM1 was the equal second best performer of our selected comparables with a total shareholder return (TSR) of 25.2% for this period. This was well ahead of the MSCI World Net TR index (AUD) return of 18.4%.

Listed Investment Companies & Trusts - International focus											
Code	Stock	Corporate Structure	Market Capitalisation A\$m	Share price 14/11/18 \$	Share price 31/10/19 \$	Capital Growth %	Dividends (11.5 months) %	Dividend Yield %	TSR (11.5 months) %	PreTax NTA 31/10/19 \$	Premium (Discount) to NTA
MFF.AX	MFF Capital Investments Ltd	Company	1,848.5	\$ 2.610	\$ 3.380	29.5%	\$ 0.035	1.3%	30.8%	\$ 3.505	-3.6%
HM1.AX	Hearts and Minds Investments Ltd	Company	612.0	\$ 2.500	\$ 3.130	25.2%	\$ -	0.0%	25.2%	\$ 3.030	3.3%
EAF.AX	Evans & Partners Asia Fund	Trust	163.3	\$ 1.080	\$ 1.300	20.4%	\$ 0.052	4.8%	25.2%	\$ 1.340	-3.0%
EGF.AX	Evans & Partners Global Flagship Fund	Trust	202.7	\$ 1.530	\$ 1.700	11.1%	\$ 0.116	7.6%	18.7%	\$ 1.720	-1.2%
MGG.AX	Magellan Global Trust	Trust	2,262.3	\$ 1.630	\$ 1.805	10.7%	\$ 0.060	3.7%	14.4%	\$ 1.867	-3.3%
WQG.AX	WCM Global Growth Ltd	Company	189.0	\$ 1.030	\$ 1.095	6.3%	\$ 0.020	1.9%	8.3%	\$ 1.279	-14.4%
PIA.AX	Pengana International Equities Ltd	Company	274.0	\$ 1.080	\$ 1.125	4.2%	\$ 0.035	3.2%	7.4%	\$ 1.270	-11.4%
EAI.AX	Ellerston Asian Investments Ltd	Company	139.4	\$ 0.950	\$ 0.980	3.2%	\$ 0.025	2.6%	5.8%	\$ 1.136	-13.7%
EGI.AX	Ellerston Global Investments Ltd	Company	118.2	\$ 1.000	\$ 1.010	1.0%	\$ 0.030	3.0%	4.0%	\$ 1.191	-15.2%
WGB.AX	WAM Global Ltd	Company	453.4	\$ 2.060	\$ 2.110	2.4%	\$ 0.020	1.0%	3.4%	\$ 2.390	-11.7%
TGG.AX	Templeton Global Growth Fund Ltd	Company	261.2	\$ 1.270	\$ 1.235	-2.8%	\$ 0.070	5.5%	2.8%	\$ 1.444	-14.5%
PGF.AX	PM Capital Global Opportunities Fund Ltd	Company	411.2	\$ 1.180	\$ 1.145	-3.0%	\$ 0.038	3.2%	0.3%	\$ 1.373	-16.6%
FGG.AX	Future Generation Global Investment Company Ltd	Company	500.4	\$ 1.295	\$ 1.275	-1.5%	\$ 0.015	1.2%	-0.4%	\$ 1.405	-9.2%
VG1.AX	VGI Partners Global Investments Ltd	Company	923.7	\$ 2.351	\$ 2.270	-3.4%	\$ -	0.0%	-3.4%	\$ 2.390	-5.0%
PMC.AX	Platinum Capital Ltd	Company	459.0	\$ 1.813	\$ 1.555	-14.2%	\$ 0.100	5.5%	-8.7%	\$ 1.573	-1.2%
APL.AX	Antipodes Global Investment Company Ltd	Company	540.5	\$ 1.095	\$ 0.940	-14.2%	\$ 0.045	4.1%	-10.0%	\$ 1.127	-16.6%
PAI.AX	Platinum Asia Investments Ltd	Company	364.8	\$ 1.180	\$ 0.985	-16.5%	\$ 0.040	3.4%	-13.1%	\$ 1.092	-9.8%
Average						3.4%		3.1%	6.5%		-8.6%

Source: Refinitiv, Iress; Phillip Capital.

Note: MGG NTA's are weekly NTA's closest to 31/10/19.

Below we show the Total Managed Return (TMR) which we define as NTA growth plus dividends. This ignores whether the stock is trading at a premium or discount to NTA and shows the performance achieved by the manager. HM1 was ranked third on this basis for the 11.5 months (NB. Performance for all other companies calculated for 12 months).

Listed Investment Companies & Trusts - International focus										
Total Managed Return (NTA return)		Corporate Structure	Market Capitalisation A\$m	PreTax NTA 31/10/18 \$	PreTax NTA 31/10/19 \$	NTA Growth %	Dividends (11.5 months) %	Dividend Yield %	TMR (12 months) %	
MFF.AX	MFF Capital Investments Ltd	Company	1,848.5	\$ 2.837	\$ 3.505	23.5%	\$ 0.035	1.2%	24.8%	
EAF.AX	Evans & Partners Asia Fund	Trust	163.3	\$ 1.100	\$ 1.340	21.8%	\$ 0.052	4.7%	26.5%	
HM1.AX	Hearts and Minds Investments Ltd (11.5 mths)	Company	612.0	\$ 2.500	\$ 3.030	21.2%	\$ -	0.0%	21.2%	
EGF.AX	Evans & Partners Global Flagship Fund	Trust	202.7	\$ 1.550	\$ 1.720	11.0%	\$ 0.116	7.5%	18.5%	
MGG.AX	Magellan Global Trust	Trust	2,262.3	\$ 1.665	\$ 1.867	12.1%	\$ 0.060	3.6%	15.7%	
EGI.AX	Ellerston Global Investments Ltd	Company	118.2	\$ 1.072	\$ 1.191	11.1%	\$ 0.030	2.8%	13.9%	
WGB.AX	WAM Global Ltd	Company	453.4	\$ 2.130	\$ 2.390	12.2%	\$ 0.020	0.9%	13.1%	
PIA.AX	Pengana International Equities Ltd	Company	274.0	\$ 1.165	\$ 1.270	9.1%	\$ 0.035	3.0%	12.1%	
EAI.AX	Ellerston Asian Investments Ltd	Company	139.4	\$ 1.038	\$ 1.136	9.4%	\$ 0.025	2.4%	11.9%	
PAI.AX	Platinum Asia Investments Ltd	Company	364.8	\$ 1.012	\$ 1.092	7.8%	\$ 0.040	4.0%	11.8%	
PGF.AX	PM Capital Global Opportunities Fund Ltd	Company	411.2	\$ 1.287	\$ 1.373	6.6%	\$ 0.038	3.0%	9.6%	
FGG.AX	Future Generation Global Investment Company Ltd	Company	500.4	\$ 1.314	\$ 1.405	6.9%	\$ 0.015	1.1%	8.1%	
WQG.AX	WCM Global Growth Ltd	Company	189.0	\$ 1.204	\$ 1.279	6.2%	\$ 0.020	1.7%	7.9%	
PMC.AX	Platinum Capital Ltd	Company	459.0	\$ 1.569	\$ 1.573	0.3%	\$ 0.100	6.4%	6.6%	
VG1.AX	VGI Partners Global Investments Ltd	Company	923.7	\$ 2.260	\$ 2.390	5.8%	\$ -	0.0%	5.8%	
TGG.AX	Templeton Global Growth Fund Ltd	Company	261.2	\$ 1.434	\$ 1.444	0.7%	\$ 0.070	4.9%	5.6%	
APL.AX	Antipodes Global Investment Company Ltd	Company	540.5	\$ 1.145	\$ 1.127	-1.6%	\$ 0.045	3.9%	2.4%	
Average						9.7%		3.0%	12.7%	

Source: Refinitiv, Iress; Phillip Capital.

Note: MGG NTA's are weekly NTA's closest to 31/10/19.

FY19 Results

HM1 reported a Net loss after tax of -\$0.7m for the period 12/9/18 to 30/6/19. However this excluded realised and unrealised investment gains of \$70.5m after tax which were taken directly to reserves on the balance sheet as Comprehensive Income. We have added these back to derive our Adjusted NPAT and Adjusted EPS.

These gains represent an impressive 14.1% after tax return on the initial \$500m portfolio investment, for a period of approximately 7.5 months (IPO funds raised were due by 6/11/18 and were invested shortly after the conference on 16/11/18).

The Reported Net Loss includes \$5.3m of IPO costs paid by Victor Chang Institute which HM1 will reimburse as part of its donation framework agreement. \$4.9m was reimbursed in June 2019 and the remainder of \$0.3m is expected to be reimbursed as part of the December 2019 half yearly donation. Once the IPO costs have been reimbursed, normal donations to the 10 designated medical research charities will begin.

EPS (adjusted) was 35.2c (based on 200m shares). There was no dividend at this stage.

Phillip Capital Forecasts

We have prepared forecasts for HM1, a listed investment company, as if it was a normal operating company. Our key assumptions are as follows:

- We assume an annual performance on the investment portfolio of 10% capital growth (before tax) in FY20 and 8% in FY21 plus 2.0% dividends received. The 8% is in line with the 30 year average TSR of the S&P 500. We assume a return of 1.0% on cash held.
- We assume a 50% portfolio turnover each year. We assume that the entire "Conference Portfolio" is turned over each year (~40% of current total portfolio value), plus a further 10% for possible sales from the "Core Portfolio" (currently ~60% of total).
- We assume that operating costs in FY19 were for 9 months and have annualised these for FY20. We assume a 5% increase for FY21.
- Donation expense calculated at 1.5% of average net assets for the year.
- We assume an annual dividend of 1.5% of asset value, paid out of realised gains. We note that HM1's dividend policy is to be decided after the 1H20 result.
- We have not yet factored in the proposed 1 for 8 renounceable rights issue, but will do so if the relevant resolution is passed at the forthcoming AGM.

HM1 - FY19 Results & Phillip Capital Forecasts					
	1H19	2H19	FY19	FY20e	FY21e
Years ended June \$m	(1.5 mths)	(6 mths)	(7.5 mths)		
Dividend & Interest received	0.5	3.2	3.7	11.9	13.2
Other income (FX gains)	0.3	0.1	0.4	0.0	0.0
Total Income	0.8	3.3	4.1	11.9	13.2
Staff costs & other	(0.4)	(0.2)	(0.6)	(0.8)	(0.9)
Donations / Reimbursement of listing costs	(1.0)	(4.3)	(5.3)	(9.0)	(9.6)
Total Operating Expenses	(1.4)	(4.5)	(5.9)	(9.9)	(10.5)
Management Expense Ratio (MER)(FY19 annualised)			-1.7%	-1.6%	-1.7%
Interest Expense	0.0	(0.1)	(0.1)	0.0	0.0
Pre-tax profit	(0.6)	(1.3)	(1.9)	2.1	2.7
Income Tax Credit (Expense)	0.2	0.9	1.1	(0.6)	(0.8)
Tax Rate	-37.5%	-71.3%	-60.4%	-30.0%	-30.0%
NPAT (reported)	-0.4	-0.4	-0.7	1.4	1.9
Adjustments:					
Realised gains taken to equity (net of tax)	0.0	4.2	4.2	20.8	18.3
Unrealised gains taken to equity (net of tax)	-11.9	78.9	67.0	20.8	18.3
NPAT (adjusted)(Comprehensive Income)	-12.3	82.8	70.5	43.0	38.5
EPS (adjusted)(cents)	-6.2	41.4	35.2	21.5	19.2
DPS (cents)	0.0	0.0	0.0	4.5	5.0
NTA (pre-tax) per share (\$)	2.41		3.00	3.25	3.43
NTA (post-tax) per share (\$)	2.44		2.85	3.02	3.16

Source: Company actuals; Phillip Capital forecasts

Rights Issue Proposed

HM1 has proposed a 1 for 8 renounceable rights issue to raise an additional \$62.5m at the original IPO price of \$2.50 per share. This will enable a sixth “Core Fund Manager” (TDM Growth Partners) to be added, without the need to sell down any of the existing Core Portfolio which is performing well, and without triggering a tax liability.

HM1 had stressed in the IPO marketing that HM1 was a “limited availability” product, and that no further capital raisings were intended. HM1 was approached by TDM, a global investment firm with a strong investment track record over 14 years and a deep belief that it has a responsibility to give back to the community. After considering TDM’s skills and expertise, performance, investment style and willingness to provide investment recommendations without any charge, the Board concluded that engaging TDM would be beneficial to HM1 investment strategy and dual purpose.

In addition the board is proposing to increase the weighting to the Core Fund Managers (from 60% to 65%), and reduce the allocation to Conference Fund Managers (the short-term portfolio) from 40% to 35%. Given these circumstances, and in the interests of good corporate governance the HM1 board decided to put this proposal before shareholders at the forthcoming AGM.

For shareholders we regard the proposed rights issue as an attractive opportunity to acquire further stock at a 19% discount to the current share price, without brokerage. NTA will be diluted by 1.5%-1.9% on our estimates.

HM1: Estimated impact of rights issue	30/10/19 \$m	Post Rights \$m	Change \$m	Change %
Estimated Net Assets (pre tax)	606.0	668.5	62.5	10.3%
Estimated Net Assets (post tax)	576.0	638.5	62.5	10.9%
Shares on Issue (m)	200.0	225.0	25.0	12.5%
NTA (pre tax)	\$ 3.03	\$ 2.97		-1.9%
NTA (post tax)	\$ 2.88	\$ 2.84		-1.5%

Source: October NTA report; Phillip capital estimates

The issue will be fully renounceable, so all shareholders will be treated equally. Shareholders can take up their rights, sell the rights on market, or do nothing and the company will place out any shortfall to other investors and distribute the proceeds to shareholders who do not take up or sell their rights.

We have not yet adjusted our forecasts for the rights issue, as it is dependent on shareholders approving the proposed increase in the investment allocation to the Core Fund Manager portfolio from 60% to 65%.

Valuation & Recommendation

Listed Investment Companies & Trusts - International focus											
In order of Total Managed Return (NTA return)		A	B	C	D	E	F	G	H	I	J
Code	Stock	Corporate Structure	Market Capitalisation A\$m	Dividend Yield %	TMR (12 months) %	TSR (11.5 months) %	Share Price 31-10-19	PreTax NTA 31/10/19	Premium (Discount) to NTA Pre tax	PostTax NTA 31/10/19	Premium (Discount) to NTA Post tax
MFF.AX	MFF Capital Investments Ltd	Company	1,848.5	1.2%	24.8%	30.8%	\$ 3.380	\$ 3.505	-3.6%	\$ 2.863	18.1%
EAF.AX	Evans & Partners Asia Fund	Trust	163.3	4.7%	26.5%	25.2%	\$ 1.300	\$ 1.340	-3.0%	\$ 1.340	-3.0%
HM1.AX	Hearts and Minds Investments Ltd (11.5 mth)	Company	612.0	0.0%	21.2%	25.2%	\$ 3.130	\$ 3.030	3.3%	\$ 2.880	8.7%
EGF.AX	Evans & Partners Global Flagship Fund	Trust	202.7	7.5%	18.5%	18.7%	\$ 1.700	\$ 1.720	-1.2%	\$ 1.720	-1.2%
MGG.AX	Magellan Global Trust	Trust	2,262.3	3.6%	15.7%	14.4%	\$ 1.805	\$ 1.867	-3.3%	\$ 1.867	-3.3%
EGI.AX	Ellerston Global Investments Ltd	Company	118.2	2.8%	13.9%	4.0%	\$ 1.010	\$ 1.191	-15.2%	\$ 1.158	-12.8%
WGB.AX	WAM Global Ltd	Company	453.4	0.9%	13.1%	3.4%	\$ 2.110	\$ 2.390	-11.7%	\$ 2.326	-9.3%
PIA.AX	Pengana International Equities Ltd	Company	274.0	3.0%	12.1%	7.4%	\$ 1.125	\$ 1.270	-11.4%	\$ 1.237	-9.1%
EAI.AX	Ellerston Asian Investments Ltd	Company	139.4	2.4%	11.9%	5.8%	\$ 0.980	\$ 1.136	-13.7%	\$ 1.118	-12.3%
PAI.AX	Platinum Asia Investments Ltd	Company	364.8	4.0%	11.8%	-13.1%	\$ 0.985	\$ 1.092	-9.8%	\$ 1.081	-8.9%
PGF.AX	PM Capital Global Opportunities Fund Ltd	Company	411.2	3.0%	9.6%	3.0%	\$ 1.145	\$ 1.373	-16.6%	\$ 1.291	-11.3%
FGG.AX	Future Generation Global Investment Company	Company	500.4	1.1%	8.1%	-0.4%	\$ 1.275	\$ 1.405	-9.2%	\$ 1.336	-4.6%
WQG.AX	WCM Global Growth Ltd	Company	189.0	1.7%	7.9%	8.3%	\$ 1.095	\$ 1.279	-14.4%	\$ 1.218	-10.1%
PMC.AX	Platinum Capital Ltd	Company	459.0	6.4%	6.6%	-8.7%	\$ 1.555	\$ 1.573	-1.2%	\$ 1.529	1.7%
VG1.AX	VGI Partners Global Investments Ltd	Company	923.7	0.0%	5.8%	-3.5%	\$ 2.270	\$ 2.390	-5.0%	\$ 2.390	-5.0%
TGG.AX	Templeton Global Growth Fund Ltd	Company	261.2	4.9%	5.6%	2.8%	\$ 1.235	\$ 1.444	-14.5%	\$ 1.412	-12.5%
APL.AX	Antipodes Global Investment Company Ltd	Company	540.5	3.9%	2.4%	-10.1%	\$ 0.940	\$ 1.127	-16.6%	\$ 1.119	-16.0%
Average				3.0%	12.7%	6.5%			-8.6%		-5.3%

Source: Refinitiv, Iress; Phillip Capital. TMR is for the 12 months to end October (HM1 11.5 months). TSR is for 11.5 mths since the HM1 IPO date.
Note: MGG NTA's are weekly NTA's closest to 31/10/18 & 19.

We show above the key data for 17 LICs and LITs we follow. This has been sorted in order of TMR (Total Managed Return which we define as the NTA growth achieved by the manager, plus dividend yield) for the 12-mths ended October. Refer column D. We regard this as one of the most important measures when looking at the LIC sector. This is slightly different to TSR (Total Shareholder Return which is the share price return plus dividend yield). We have calculated the TSRs for the 11.5 months from the HM1 IPO date (14/11/18) to 31/10/19.

At end-October, HM1 shares at \$3.13 were trading at a 3% premium to the pre-tax NTA at end October of \$3.03. It was the only internationally traded Listed Investment Company (LIC) we follow that wasn't trading at a discount to pre-tax NTA. (Refer column H above). It was also one of only 3 stocks trading at a premium to post tax NTA (along with MFF and PMC).

At end-October, HM1's closest peer, Future Generation Global Investments (FGG) was trading at a 9% discount to NTA. FGG also uses the services of a group of approximately 13 local and international fund managers, has no base fees or performance fees and makes a 1.0% annualised donation to youth charities (another very admirable cause). But it is not a concentrated "best ideas" portfolio. FGG invests directly in the main funds (trusts) of each of its chosen managers and so would be much more diversified than HM1. Also approximately 35% of FGG's portfolio is in long / short funds which seek to provide protection and also benefit in down-markets. We consider FGG a lower risk/ lower reward proposition than HM1. FGG performance has been reasonable (9.2% pa since inception in September 2015). We note that FGG has its own AGM and Investment Forum (presentations by participating fund managers) coming up later this month which might help close the current discount.

During this month, HM1's pre-tax NTA has improved from \$3.03 to \$3.17, whilst the share price has fallen to \$3.07, so it currently stands at a small discount of 3.2%.

Possible Share Price Catalysts / Important dates

- Sohn Hearts & Minds 2019 Conference, and new Conference Manager stock nominations – Friday 22/11/19
- HM1 AGM – Tuesday 26/11/19
- Rights issue record date – to be announced soon after the AGM
- Details of realised profit from the sale of the FY18 Conference Manager portfolio
- Monthly NTA reports
- Interim results and possible maiden dividend – February 2020

Conclusion

Provided the strong investment performance can be maintained, we think that the unique structure of HM1 could see the shares move to premium to NTA, particularly once dividend payments commence. The forthcoming conference (this Friday 22/11/19) and the attractive discounted rights issue may also be positive catalysts for the share price.

We set our 12-month price target at \$3.43 in line with our projected June 2021 pre-tax NTA forecast.

We initiate coverage with an Accumulate recommendation.

We recommend that existing HM1 shareholders should take up their rights if they have the funds available.

Appendix 1: Comparison of Listed Investment Companies Vs Managed Funds

Similarities

1. **Active and Professional Portfolio Management** - Both LICs and Managed Funds provide investors with access to actively managed portfolios run by investment professionals. The number of stocks held would typically range from 20+ stocks in a concentrated, high conviction portfolio to 40-100 stocks in more diversified portfolios. Managing and administering this number of stocks would be difficult for most retail investors.
2. **Wide Range of Offerings** - There is an increasingly wide range of LICs and Managed Funds to choose from, with some specialising in large capitalisation stocks, small cap stocks, overseas stocks or certain sectors or thematics such as resources, technology, high income and funds that do shorting (selling stocks they don't own in order to profit from an expected fall in the share price).
3. **Management Costs & Fees** – Most LICs and Managed funds have a cost of providing the investment service with either their own internal staff, or using external fund managers. Traditional LICs were created to provide low cost, transparent management cost structures. New style LIC's and Managed Funds have emerged in the last 20 years which also charge performance fees if they achieve a performance above a nominated benchmark or index. This has encouraged the growth of “boutique” fund managers in both the listed and unlisted space. Performance fees are not necessarily a bad thing, if the manager has delivered the out-performance.

Differences – Advantages of LICs

1. **Easy Access to LICs** – Shares in LICs can be purchased or sold on the ASX in minimal parcels of just over \$500 with settlement to your nominated bank account in in two trading days. Provided an investor has an existing account set up with a broker, there is no up-front ID or other paperwork required.

Managed Funds require completion of a detailed application form and certified ID. There is no set time period to process applications or redemptions. This is dependent on the efficiency of the administrator and the rules of each fund, but typically varies between a few days and a month. Some specialist funds only process applications and redemptions at the end of each month. (Some managed funds are available through the ASX M funds platform, but this is only supported by some brokers).

2. **Price limits** – Investors can set price limits with their broker when buying or selling LICs on the ASX, to take advantage of daily and intra-day variations of stock prices.

Investors in Managed funds do not have this option, and the buy or sell price is usually done at the overnight price on whatever day the application is processed.

3. **Visibility of prices** – LIC share prices and volume traded are readily available to investors on-line (e.g. ASX.com.au or broker websites).

For managed funds, the availability of pricing depends on the administrator. Volume data is not normally available.

4. **Taxation of dividends / distributions.** LICs are companies and dividends are usually taxable in the hands of investors when the payment is received. Many traditional LICs are actively managed on an “after tax basis” to ensure stable or growing dividends to shareholders, and a pass through of attaching franking credits.

Managed Funds are trust structures and are not typically managed with taxation or franking in mind. Distributions are usually paid after financial year end (typically June), but for Australian personal tax purposes are retrospectively included in the financial year the income was earned, not when the distributions were paid. Distributions typically comprise a pass through of dividend income derived by the fund, plus a share of the net realised gains in the fund for the year. For this reasons, distributions are not very predictable and can vary significantly from one year to the next depending on the level of realised gains made by the fund. A further complication is that an investor buying into a managed fund during or towards the end of the financial year typically would receive a distribution covering the whole financial year (or half year if an interim distribution has been made). This can lead to some unpleasant tax bills. Investors should seek their own tax advice for their own particular circumstances.

5. **Trading Opportunities with Franking Credits** – Some low or nil tax payer investors may seek to maximise their level of franking credits and potential tax refunds by buying shares ahead of dividend ex-dates, holding the shares the requisite 45 + days to retain the franking credit benefit. Many LICs have high fully franked dividends and predictable dividend ex and payment dates.
6. **Dividend Reinvestment Plans (DRPs)** – Many LICs offer dividend re-investment plans, some with an added benefit of being priced at a discount to the current market price (adjusted for the dividend going ex). For investors who do not require cash dividends, this can provide an attractive compounding effect.

Managed Funds also usually offer re-investment of distributions, though not typically with discounts.

7. **Continuous disclosure** – LIC's listed on the ASX are subject to the same disclosure obligations as regular listed companies. This means audited financial accounts must be provided half yearly, within 2 months of the financial year-end or half year-end. Directors' holdings and remuneration must be included in the Annual Report, and changes in director's shareholdings must be notified within 2 days. Substantial shareholdings above 5.0% must also be declared and changes of over 1.0% above that level must be disclosed. In addition, the ASX requires Monthly net tangible asset details to be advised by the 14th of each month. Most LICs also include a useful commentary at the same time on their portfolios and their largest positions or sector weights.

This detailed level of reporting to the ASX means that LICs are open to effective public scrutiny and analysis by market participants.

Managed funds are not subject to these ASX rules and so have considerably less visibility and transparency.

8. **AGMs** – LICs must also hold an Annual General Meeting open to all shareholders. In the case of many of the large and popular LICs, these have become important events with valuable and comprehensive discussions on investment markets and economic conditions, stock and sector holdings, and investment strategy, and the ability for shareholders to meet the directors and some of the portfolio managers either formally, or informally afterwards, to ask their questions. Some LICs also have webcasts and national roadshows to meet shareholders and other investors in other states.

Managed Funds do not have this requirement. However some of the larger management funds do hold information meetings and events, or webinars, but it is not the norm and is highly variable.

9. **Permanent Capital** - LICs do not have to worry about holding cash reserves to meet redemption requests, or being forced to sell stocks they own as their capital base is considered “permanent capital”.

For Managed Funds, applications and redemptions are generally processed at overnight net asset value per trust unit, plus or minus a small buy / sell price spread. In normal market conditions, the fund manager will hold sufficient cash reserves to meet the normal level of redemption requests. But in times of extreme market turbulence such as during the global financial crisis, the manager may be forced to sell stock positions, or sometimes freeze redemption requests.

Differences – Disadvantages of LICs Vs Managed Funds

Premiums & Discounts to NTA - The main disadvantage of LICs is that the share price can trade above or below the underlying net tangible assets (NTA) or net asset value (NAV) of the company, depending on the buying and selling demand for the stock.

Buying an LIC at a discount to net assets is obviously good for buyers, but not for sellers who would be receiving less than fair value for their shares. And it might take a long time, or possibly never for the shares to get back to trading at or near NTA. Similarly buying an LIC at a premium to NTA means the buyer is getting less value. Like buying a house, this matters less for long term investors.

Factors that contribute to LICs trading below NTA typically include size and liquidity, investment performance, dividend yield, complexity and the level of information flow and marketing done by the LIC and its managers. The LIC sector as a whole has generally de-rated in the last 12 months or so we think due to uncertainty in the run up to the May 2019 federal election particularly regarding the Labor party policy on franking credits. The growth and rising popularity of Exchange Traded Funds (ETFs) has also been a factor.

Hearts and Minds Investments Ltd (HM1) \$ 3.070

Profit & Loss

Year end June	FY19	FY20e	FY21e
	A\$m	A\$m	A\$m
Dividend & Interest received	3.7	11.9	13.2
Other income (FX gains)	0.4	0.0	0.0
Total Income	4.1	11.9	13.2
Staff costs & other	(0.6)	(0.8)	(0.9)
Donations / Reimbursement of listing costs	(5.3)	(9.0)	(9.6)
Total Operating Expenses	(5.9)	(9.9)	(10.5)
EBITDA	-1.8	2.1	2.7
Depreciation & Amort	0.0	0.0	0.0
EBIT	-1.8	2.1	2.7
Interest Expense	(0.1)	0.0	0.0
Pre-tax profit	(1.9)	2.1	2.7
Income Tax Credit (Expense)	1.1	(0.6)	(0.8)
Tax Rate	-60.4%	-30.0%	-30.0%
Minorities (share of loss)	0.0	0.0	0.0
Abnormals	0.0	0.0	0.0
NPAT (reported)	-0.7	1.4	1.9
Adjustments:			
Realised gains taken to equity (net of tax)	4.2	20.8	18.3
Unrealised gains taken to equity (net of tax)	67.0	20.8	18.3
NPAT (normalised)(Comprehensive Income)	70.5	43.0	38.5

Balance Sheet

Cash	7.1	14.4	22.4
Receivables	0.1	0.1	0.1
Inventories	0.0	0.0	0.0
Other	0.0	0.0	0.0
Total current assets	7.1	14.4	22.5
PP&E	0.0	0.0	0.0
Investments	593.1	652.4	704.6
Intangibles	0.0	0.0	0.0
Deferred tax assets	1.3	1.3	1.3
Other	0.0	0.0	0.0
Total non-current assets	594.4	653.7	705.9
Total Assets	601.5	668.1	728.3
Payables	0.0	0.0	0.0
Interest bearing liabilities - Current	0.0	0.0	0.0
Provisions	0.0	0.0	0.0
Other	-2.3	-9.9	-9.0
Total Current Liabilities	-2.3	-9.9	-9.0
Interest-bearing liabilities - Non-curr	0.0	0.0	0.0
Provisions	0.0	0.0	0.0
Deferred tax liability & Other	-28.7	-53.8	-86.5
Total Non-current Liabilities	-28.7	-53.8	-86.5
Total Liabilities	-31.0	-63.7	-95.5
Total Shareholders' Equity	570.5	604.4	632.9

Portfolio Composition by Business Domicile

	FY19	Oct
United States	46.0%	45.0%
Other international	26.0%	24.0%
Australia	28.0%	31.0%

Portfolio Composition by Sector

	FY19	Oct
Consumer Discretionary	24.9%	21.0%
Information Technology	21.7%	14.0%
Industrials	18.8%	12.0%
Communication Services	18.0%	18.0%
Financials	4.5%	10.0%
Health Care	3.8%	4.0%
Energy	3.4%	0.0%
Materials	1.9%	8.0%
Utilities	0.0%	3.0%
Cash ETF	3.0%	10.0%
Total	100.0%	100.0%

Source: Company data & Phillip Capital estimates

Per share & Ratio data

Year end June	FY19	FY20e	FY21e
Shares on Issue - Wavge (f/d)	160.3	200.0	200.0
Shares on Issue - at year-end	200.0	200.0	200.0
Reported EPS (cents)	(0.5)	0.7	1.0
Growth	n/a	-254.8%	33.0%
P/E ratio (x)	-659.3x	425.9x	320.2x
EPS (normalised)(cents)	35.2	21.5	19.2
Growth	n/a	-39.0%	-10.5%
P/E ratio (x)	8.7x	14.3x	16.0x
DPS (cents)	0.0	4.5	5.0
Franking	0%	100%	100%
Yield	0.0%	1.5%	1.6%
NTA per share (Pre tax)(\$)	3.00	3.25	3.43
Price / NTA Premium (Discount) %	2.4%	-5.6%	-10.5%
NTA per share (Post tax)(\$)	2.85	3.02	3.16
Price / NTA Premium (Discount) %	7.6%	1.6%	-3.0%

Liquidity & Leverage

Net Cash (Debt) \$m	7.1	14.4	22.4
Net Debt / Equity %	-1%	-2%	-4%
Net Debt / EBITDA	n/a	n/a	n/a
ROE (Adj NPAT / T.Equity) %	12.4%	7.1%	6.1%
Mgt Expense ratio (MER) incl Donations	-1.7%	-1.6%	-1.6%

Cash Flow

Operating expenses	-0.5	-0.8	-0.9
Chge in Working Capital	0.1	0.1	0.1
Dividends & Interest Received	3.5	11.9	13.2
Income taxes paid	0.0	-1.2	-9.5
Donations / Reimbursement of Listing costs	-5.0	-9.0	-9.6
Other	-0.1	-0.1	-0.1
Operating cash flows	-2.0	0.8	-6.8
Sale of Investments	90.6	296.5	326.2
Purchase of Investments	-582.0	-296.5	-326.2
Other	0.0	0.0	0.0
Net investing cash flows	-491.4	0.0	0.0
Equity raised (bought back)	500.0	0.0	0.0
Dividends paid	0.0	-9.0	-10.0
Change in Debt	0.0	0.0	0.0
Other	0.0	9.0	10.0
Financing cash flow	500.0	0.0	0.0
Change in Cash	6.6	7.3	8.0

Top 10 Shareholders

	No. (m)	%
HSBC Custody Nominees (Australia) Limited	41.8	20.90%
National Nominees Limited	13.6	6.80%
Netwealth Investments Limited	5.1	2.53%
Koll Pty Limited	4.0	1.98%
Associated World Investments Pty Ltd	2.0	1.00%
Wroxby Pty Limited	2.0	1.00%
Jane Hansen Super Pty Limited	2.0	1.00%
Skip Enterprises Pty Limited	2.0	1.00%
Paul Ramsay Foundation	2.0	1.00%
Tandom Pty Limited	2.0	1.00%

Directors Shareholdings

	No. (m)	%
Chris Cuffe AO, Chairman, NED	1.300	0.65%
Lorraine Berends, NED	0.040	0.02%
Guy Fowler, NED	1.000	0.50%
Matthew Grounds, NED	1.000	0.50%
Michael Traill AM, NED	3.264	1.63%
Gary Weiss AO, NED	0.440	0.22%
Geoff Wilson AO, NED	1.500	0.75%
David Wright, NED	0.040	0.02%
Total	8.584	4.29%

CONTACT INFORMATION

CEO

John Miles +61 3 8633 9838 jmiles@phillipcapital.com.au

Research

Wayne Sanderson +61 3 8633 9930 wsanderson@phillipcapital.com.au

Corporate Finance

Sharon Cardy +61 2 9233 9611 scardy@phillipcapital.com.au

Institutional Sales

Enzo Salvatore +61 3 8633 9924 esalvatore@phillipcapital.com.au Chris Walker +61 3 8633 9928 cwalker@phillipcapital.com.au

Institutional Execution

Craig Stephens +61 3 8633 9881 cstephens@phillipcapital.com.au

Private Wealth

Enzo Salvatore	+61 3 8633 9924	esalvatore@phillipcapital.com.au	Luke Pitrone	+61 3 9618 8236	lpitrone@phillipcapital.com.au
Ben Roper	+61 7 3338 3835	broper@phillipcapital.com.au	Mark Wiseman	+61 3 9618 8228	mwiseman@phillipcapital.com.au
Bo Xin	+61 7 3338 3840	bxin@phillipcapital.com.au	Michael Cori	+61 2 9233 9648	mcori@phillipcapital.com.au
Chris Forte	+61 3 8633 9841	cforte@phillipcapital.com.au	Nick Katiforis	+61 3 8633 9847	nkatiforis@phillipcapital.com.au
Chris Walker	+61 3 8633 9928	cwalker@phillipcapital.com.au	Nigel Ormiston	+61 7 3149 8630	normiston@phillipcapital.com.au
Daniel McFarlane	+61 3 8633 9917	dmcfarlane@phillipcapital.com.au	Patricia Harrison	+61 2 9994 5505	pharrison@phillipcapital.com.au
Dinesh Magesan	+61 7 3338 3831	dmagesan@phillipcapital.com.au	Patrick Trindade	+61 3 8633 9926	ptrindade@phillipcapital.com.au
David Dwyer	+61 2 9233 9643	ddwyer@phillipcapital.com.au	Prasanna Wickramatunge	+61 3 9618 8270	pwickramatunge@phillipcapital.com.au
David Thang	+61 3 8633 9923	dthang@phillipcapital.com.au	Reg Keene	+61 2 9233 9603	rkeene@phillipcapital.com.au
Howard Elton	+61 3 9618 8233	helton@phillipcapital.com.au	Rob Hughes	+61 3 8633 9846	rhughes@phillipcapital.com.au
Jim Yong	+61 7 3338 3839	iyong@phillipcapital.com.au	Sam Sheffield	+61 7 3338 3837	ssheffield@phillipcapital.com.au
Joel Christie	+61 7 3338 3834	jchristie@phillipcapital.com.au	Shane Langham	+61 7 3338 3838	slangham@phillipcapital.com.au
Josh Graham	+61 3 92339645	jgraham@phillipcapital.com.au	Sue McDonald	+61 3 9618 8211	smcdonald@phillipcapital.com.au
Kate Hanrahan	+61 3 8633 9909	khanrahan@phillipcapital.com.au	Xiaoming Huang	+61 3 8633 9912	xhuang@phillipcapital.com.au
Lachlan Owen	+61 3 8633 9842	lowen@phillipcapital.com.au			

Funds Management

Glenn Tan	+61 3 8633 9905	gtan@phillipcapital.com.au	Monica (Mengnu) Yu	+61 3 8633 9810	my@phillipcapital.com.au
Jessica Bell	+61 3 8633 9998	jbell@phillipcapital.com.au	Zane (Zheng) Song	+61 2 9233 9640	zsong@phillipcapital.com.au

CONTACT INFORMATION (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd

Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel +65 6533 6001
Fax +65 6535 6631
www.phillip.com.sg

HONG KONG

Phillip Securities (HK) Ltd

11/F United Centre 95 Queensway
Hong Kong
Tel +852 2277 6600
Fax +852 2868 5307
www.phillip.com.hk

INDONESIA

PT Phillip Securities Indonesia

ANZ Tower Level 23B,
JI Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel +62-21 5790 0800
Fax +62-21 5790 0809
www.phillip.co.id

THAILAND

Phillip Securities (Thailand) Public Co. Ltd

15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel +66-2 6351700 / 22680999
Fax +66-2 22680921
www.phillip.co.th

UNITED KINGDOM

King & Shaxson Capital Limited

6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel +44-20 7426 5950
Fax +44-20 7626 1757
www.kingandshaxson.com

MALAYSIA

Phillip Capital Management Sdn Bhd

B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel +603 2162 8841
Fax +603 2166 5099
www.poems.com.my

JAPAN

Phillip Securities Japan, Ltd.

4-2 Nihonbashi Kabuto-cho Chuo-ku,
Tokyo 103-0026
Tel +81-3 3666 2101
Fax +81-3 3666 6090
www.phillip.co.jp

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd

No 550 Yan An East Road,
Ocean Tower Unit 2318,
Postal code 200001
Tel +86-21 5169 9200
Fax +86-21 6351 2940
www.phillip.com.cn

FRANCE

King & Shaxson Capital Limited

3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel +33-1 45633100
Fax +33-1 45636017
www.kingandshaxson.com

UNITED STATES

Phillip Futures Inc

141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1-312 356 9000
Fax +1-312 356 9005

INDIA

PhillipCapital (India) Private Limited

No. 1, C - Block, 2nd Floor, Modern Center,
Jacob Circle, K. K. Marg, Mahalaxmi
Mumbai 400011
Tel: (9122) 2300 2999
Fax: (9122) 6667 9955
www.phillipcapital.in

TURKEY

PhillipCapital Menkul Degerler

Dr. Cemil Bengü Cad. Hak Is Merkezi
No. 2 Kat. 6A Caglayan
34403 Istanbul, Turkey
Tel: 0212 296 84 84
Fax: 0212 233 69 29
www.phillipcapital.com.tr

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Buy	Accumulate	Hold	Reduce	Sell
>20%	10% – 20%	0% – 10%	0% to -10%	>-10%

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