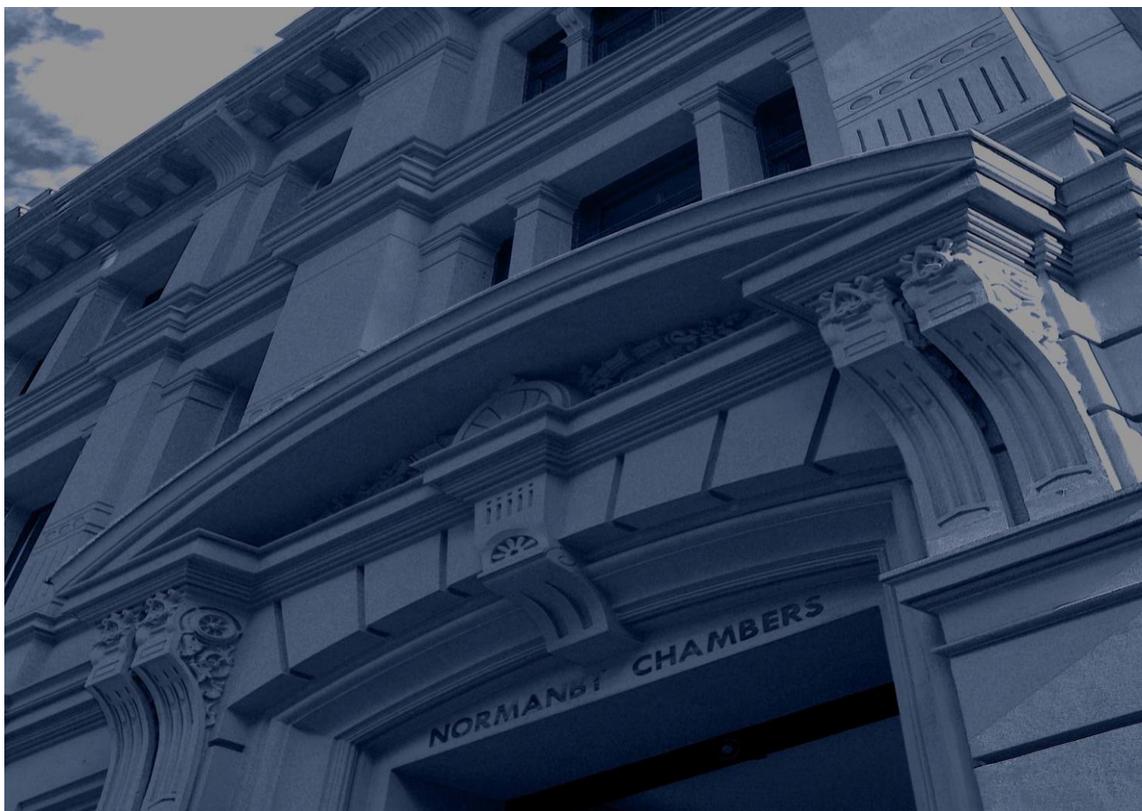


# COLLINS ST

— ASSET MANAGEMENT —

## ASX Listed Companies Research Process White Paper



Date: 1 January 2021

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## Executive Summary

Superior investment outcomes can be achieved consistently over the medium to long term. Pre-requisites for this to occur include:

- An efficient allocation of attention when scoping the universe of stocks for research;
- Extensive 360° research that encompasses both conventional and unconventional methodologies;
- Access to sources of information (such as company management, industry participants, customers and regulators) and an ability to extract and decipher both verbal and non-verbal responses;
- The ability to diminish the impact of personal biases and group think from investment decision making processes;
- Flexible timeframes for discussion, debate and implementation of investment ideas; and
- An appropriately structured and resourced review program for all investment positions.

The purpose of this White Paper is to provide an overview of the approach used by the Collins St Asset Management Investment Team within the Australian equities market.

This approach has delivered absolute returns well above market and peer group averages over most reported time periods, often seeing the flagship Collins St Value Fund ranking in the top decile of peers as measured by independent research surveys.

As at 31 December 2020 the Collins St Value Fund had achieved:

- 17.3% p.a. net of fee returns since inception in February 2016;
- A #1 performance ranking, out of all long only Australian equity funds as measured by Mercer for the 2020 calendar year;
- A #1 ranking out of 105 funds and a #1 ranking out of 103 funds within its Morningstar peer group category over 1 and 3 years respectively;
- Outperformance of the ASX 200 and Morningstar peer group average by 11.86% p.a. and 16.3% p.a. net of fees respectively over 3 years; and
- The only fund within its Morningstar peer group to deliver a positive, net return to investors in the COVID-19 impacted 2020 Financial Year and the #3 top performing Australian equities fund as measured by Mercer for the 2020 Financial Year.

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“Our contrarianism is more of a way of thinking than a goal in itself. Sometimes stocks are cheap for a reason. It is an investors job to find overstated pessimism and to test their view using primary evidence.”



Michael Goldberg

Vasilios Piperoglou

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Managing Director  
Portfolio Manager

Chief Investment Officer  
Portfolio Manager

## Introduction

Collins St Asset Management challenge the status quo, are relentlessly inquisitive and combine a bespoke combination of conviction and caution in the research of investment ideas – after all, to achieve what others don't, you have to be prepared to do what others won't!

This approach lends itself to:

- A concentrated portfolio of 8-20 positions.

Superior returns from great investments can't be generated where they are diluted by the inclusion of lesser ideas. As an investor, if you put in the effort you should be appropriately paid, with the best pay back profile generated by high conviction calls (2.5% - 10% absolute weightings) in thoroughly researched and understood businesses.

- Cash weightings of up to 100%.

In the absence of a compelling investment idea cash will be held at a significant level. Whilst it would be easy to simply invest in 'the market' and derive a relative (or index) like return, such an approach would be inconsistent with the research efforts that have been undertaken and, by default, lead to sub-optimal investments being made.

Why invest in everything if, after doing the research, you've found nothing?

- Careful capacity management.

Managing too much money, or owning too much of a company, can create increased disclosure obligations regarding 'substantial' positions. Flagging to others what you are buying, selling or participating in can attract others to your ideas before they have had the opportunity to reach their full potential.

'Flying under the radar' also enables positions to be taken, from time to time, in smaller companies that larger investors can't (or won't) get into and which aren't covered by many sell side analysts, thus expanding the pool from which potential, less 'crowded' ideas can be drawn.

Investment time frame is also critical in shaping the research effort. Collins St Asset Management focus on medium to long term returns and apply a strategic mindset to investment decisions consistent with that time frame.

This approach is naturally very different to the mindset and research approach one would take if seeking to generate short term returns through the active trade of stocks where 'noise' and emotion will drive stock prices more so than fundamentals.

## Efficient Allocation of Attention

Distilling the full breadth and depth of the ASX into a short list of investment ideas is complex. On one hand, it may be desirable to use quantitative measures to aggressively filter the market, however rigidly applying such measures without appropriate consideration of context can also potentially, and unduly, limit the pool of ideas.

For example, screening out stocks based purely on price to earnings multiples may overlook the quality of earnings for which an investor may be prepared to pay a premium (such as where the earnings are backed by contracts with high grade counter parties), the emergence of future earnings (such as near to production commodity businesses or pharmaceutical companies at an advanced stage of drug development) or where other 'non-consensus' events (such as capital management, corporate strategy or unexpected market conditions) have the potential to deliver strong returns to shareholders.



At Collins St Asset Management we do use quantitative filters as a guide and tend to focus on those companies that have:

- Low levels of debt (D/E <40%) which can be serviced easily (high ICR > 3X);
- Are attractively priced based on our view of earnings (P/E < 10X) or their underlying asset base (P/B preferably less than 1); and
- Have the ability to grow earnings over time and are priced accordingly (P/EG).

However, we do 'sense check' the numbers and any fringe cases against primary data (usually ASX announcements) on a daily basis to ensure we've narrowed our universe appropriately and are focusing our research effort on the best ideas available to us (usually only 5% - 6% of stocks within the All Ordinaries Index).

It is through researching a focused list of ideas that superior returns can be made. It is impossible to be 'all things to all people' and diseconomies of scale undoubtedly exist when researching stocks. After all, even with the resources to offer analyst coverage over several hundred different companies to varying degrees,

how, as a Portfolio Manager, would you then seek to decipher the 'noise' that inevitably arises from the sheer number of staff required to do the research, all competing for attention for their preferred ideas?

## Conventional and Unconventional Methodologies

When working out how to go from point A to point B on a map, you first need to locate where point A actually is. Investing is no different.

In order to derive a non-consensus view you have to either first understand what consensus actually is or be clear in your view that there is no consensus and that the investment idea hasn't actually been covered by mainstream analysts.

Conventional research can include:

- Meeting with company management;
- Reading ASX announcements;
- Participating in Annual General Meetings and other scheduled corporate presentations; and
- Review of industry and economic data from widely available sources (i.e. the RBA, IMF, OECD, Treasury and industry bodies / regulators).

Against this, opportunity exists for dedicated investors to gain a broader and potentially non-consensus view on a company through unconventional research.



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Specific things that the research effort may seek to uncover could include:

- Company culture and cohesion amongst senior management;
- Whether or not the innovations or services offered actually meet a consumer need in a positive way;
- How satisfied key staff, customers and suppliers are with their relationship with the company;
- Potential capital management initiatives;
- Industry trends.

Importantly, these activities should, wherever possible, be done individually – being part of a pre-arranged group of people all attending the same event has little merit as insights are shared widely and become less exclusive (and, as a consequence, less actionable).



Examples of things that can be done to source this information research include:

- Speaking with customers and competitors (listed and unlisted);
- Speaking with other institutional or significant shareholders;
- Testing the good or service yourself;
- Visit the physical premises of the business (or multiple premises depending on the business); and
- Speak with employees (either from the business or from related / competitor businesses).

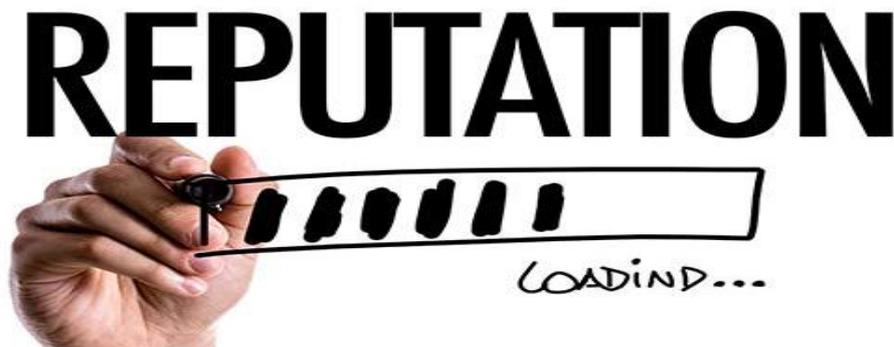
## Accessing Information

Transacting on inside information is illegal, however not all relevant (and legal) information is equally accessible to all.

Professional relationships with c-suite executives, directors (who often sit on multiple boards across different companies / industries), brokers, regulators and other relevant stakeholders take years to establish.

Reputation is key. Doors are also more readily opened where:

- You are a genuine investor with a flexible mandate and ready access to cash; and
- You are in a position to offer something of value back to the other person in the meeting.



As a professional fund manager with a proven track record of successful and comprehensive research there are often obvious benefits for key stakeholders to engage with us as part of a broader two-way dialogue on a particular issue.

Effective interview technique is also essential for getting insights into the 'bigger picture'. Some important strategies in this regard include:

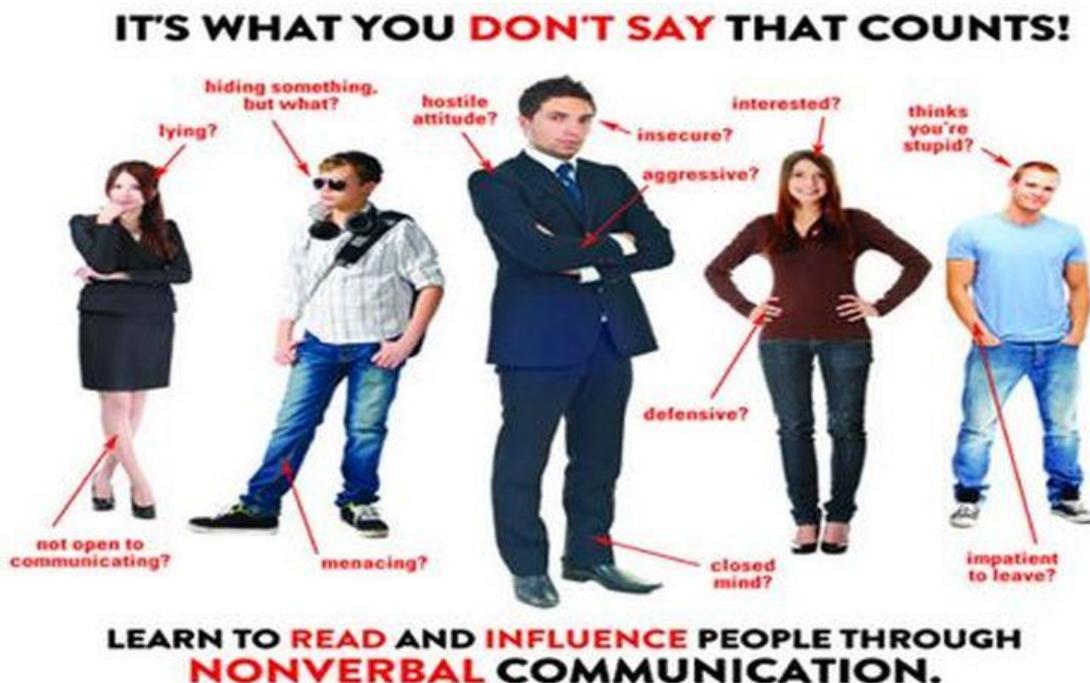
- Having at two people from your side in the meeting where one acts as the primary speaker and the other keeps notes and observes. This not only ensures accurate records of the meeting are kept (as talking, listening and writing all being done by the one person can lead to a disjointed discussion) but enables body language to be studied and considered. Body language and the way in which people

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relate and respond to the person asking the questions can give essential clues to the authenticity, conviction or deception of the person providing the answers.

Body language and the way in which people from the other side (where two or more people from your source organisation are attending) can also provide clues into team dynamics, team cohesion and team consensus on any given point.



## Personal Biases and Group Think

We are all human and need to counter our own emotional biases when researching stocks. To some degree this can be involved in sharing an investment decision with other qualified individuals. Doing this effectively, however, can be challenging as people who work together frequently and closely can start to develop a convergence of perspective known as group think.

One way of effectively debating and considering investment research within a group setting is to have a designated 'devils advocate' in any conversation and to have rules in place that force a rotation of that role at set intervals (even when it may be uncomfortable for that person to take on the role for one reason or another).

Robust debate that pushes people outside of their comfort zone can make all members of the group more aware of their own personal biases and better shape the research effort. For example, forcing someone to advocate against their stated view could lead to:

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- Additional research being undertaken on assumptions underpinning an investment thesis that were otherwise untested;
- Valuation and portfolio weighting considerations being adjusted or tempered should the original researcher be particularly enthusiastic or cautious about an idea; and
- Identify areas for personal development and improvement. After all, how often do people actually acknowledge their weaknesses in an informed way and set about improving themselves in some way?

Having a supportive, yet independently minded team around you to do this is important, however, the number of people involved is important. Where the size of the group is over 5 'diseconomies of scale' can occur and ideas can either become diluted by the inclusion of too many views or the decision making process itself can descend into more bureaucracy and hierarchy than that conducive to good investment outcomes.

## Flexible Timeframes

The window of opportunity for investment ideas to be actioned in a profitable way may not be open for all that long. Consequently, decision making processes need to be flexible and pragmatic, whilst remaining robust and accountable.

Governance should never be sacrificed for convenience.

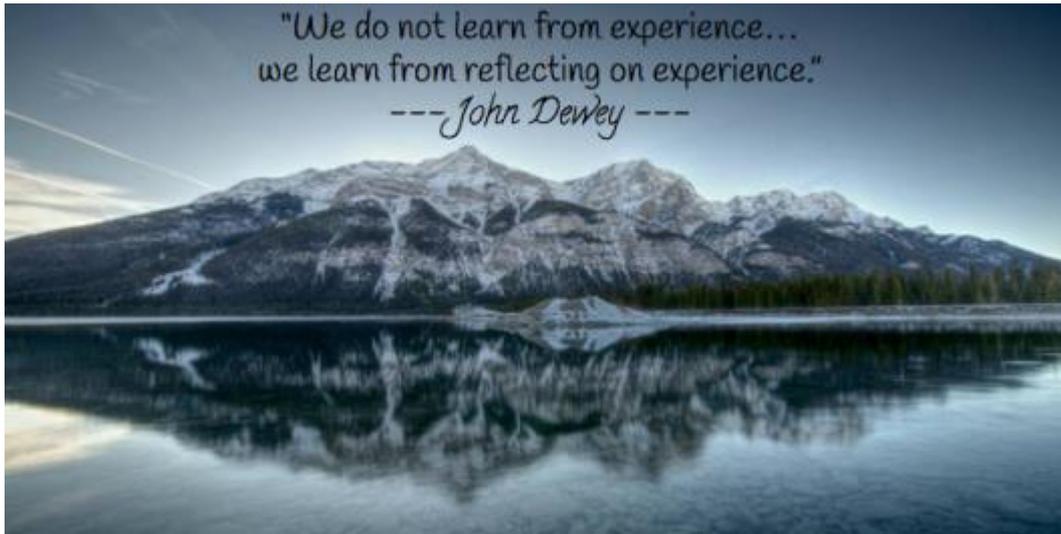
For this reason a discipline of daily forums for debating and approving investment decisions (mindful of the size of the group involved) is vital in making the most of the research undertaken. Investment ideas can go 'stale' or can go 'viral', both of which need to be avoided if money is to be made.

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## Reviewing Positions

Similar to the reasons for having a concentrated portfolio of ideas to select from upfront, structured ongoing and intensive review of portfolio positions is essential. Understanding when to increase an investment, redeem or even seek to negotiate directly with a company (for example via a convertible note) requires knowledge, insight and timing. Neither of which can truly be achieved with a large number of investments to stay abreast of.



## Conclusion

Collins St Asset Management, through their flagship Collins St Value Fund, have built a strong track record of researching and implementing high conviction stock ideas on behalf of their clients. This approach requires time, patience and the freedom to do what others won't so that their investors can have what others don't!

“One must follow a disciplined thought process to be a successful investor.  
This process may come in many different shapes and forms.”

Michael Goldberg and Vasilios Piperoglou.

## Further Information

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