

21 October 2019

QV Equities 2019 AGM Chairman's Address

The total return to shareholders for the year ended 30 June 2019 was a negative 0.4% compared to the ex-20 benchmark's return of 7.7%. Technology stocks, Real Estate Investment Trusts and certain Resources companies were the main drivers of overall Australian sharemarket gains for the year. Some technology stocks more than doubled over the year, while Real Estate Investment Trusts rose as investors sought higher yields given record low interest rates on savings. Higher commodity prices, especially iron ore and gold, were responsible for gains to many Resources stocks.

Investors Mutual Limited, our Investment Manager, considers many stocks in these sectors to be, not only overvalued, but have higher risk in the event of an economic downturn. For these reasons, they were excluded from the investment portfolio. Also, certain stocks in the Company's portfolio that had been performing well suffered setbacks to their earnings forecasts over the financial year.

The Board of your Company and the Manager remain steadfast in our view that the best strategy for growing wealth over the longer term is identifying companies which are undervalued, well-managed, with strong competitive advantages, and provide both earnings and dividend growth.

Financial Year 2019 was an eventful year for sharemarkets. Global and domestic sharemarkets declined sharply towards the end of 2018, only to rebound strongly in the second half of the financial year.

The market was affected by both economic and political factors. These included:

- The Coalition's surprise victory at the May 2019 Federal election was well received by investors who welcomed no changes to the treatment of franking credits and negative gearing.
- Australian economic growth, as measured by Gross Domestic Product slowed to just 1.9% for the year.
- While unemployment is stable at 5.3%, continued low wage growth, low inflation, falling house prices and slowing housing investment has raised concerns about future growth of the Australian economy.
- These concerns saw fiscal stimulus by way of tax cuts and increased infrastructure investment announced in the 2019 Federal Budget.
- Furthermore, having left interest rates unchanged since August 2016, the RBA took action by cutting the official cash rate by 0.25% in June to 1.25%. This was followed with additional interest rate cuts at the RBA's July and October meetings to take the Australian cash rate down to a record low level of 0.75%.
- Major Central Banks including the Federal Reserve of the United States and the European Central Bank reversed their positions during the year and have lowered rates and signaled further quantitative easing to support flagging economic growth.
- And finally geo-political risks continue for investors with US-China trade wars continuing to flare up and Brexit remaining unresolved.

I will now report on the Company's financial performance.

The net after-tax profit was \$9.4 million, down 15.8% compared to the prior financial year. There were two main reasons for this:

1. The result for financial year 2018 included a special dividend of \$2.3 million, resulting from the takeover of Tox Free Solutions by Cleanaway, while the result for the year ended 30 June 2019 included a special dividend of \$1.3 million, resulting from the Caltex off market buy-back.
2. In August 2018, the Government increased the corporate tax rate from 27.5% to 30% for listed investment companies, including QV Equities. The Government backdated the 30% tax rate to apply to the financial year ended 30 June 2018.

However, your Board had already announced the dividend and financial results for the year ended 30 June 2018 after applying the corporate tax rate of 27.5%. Accordingly, an additional income tax charge of \$0.4 million was included in the financial results for the year ended 30 June 2019.

Therefore, excluding these factors, the Company delivered a net after-tax profit of \$8.5 million, in line with the result for the financial year 2018.

The net asset value of the Company at 30 June 2019, after dividend payments of \$14.6 million, was \$312 million compared to \$326 million at 30 June 2018.

The management expense ratio (MER) rose modestly, however management expenses were maintained at \$3.3 million, the same level as last year.

Turning to the first quarter of the 2020 Financial Year: Pre-tax, the portfolio returned 0.1% compared to the benchmark's return of 4.6%.

This underperformance was mainly due to continued strength in the Resources sector over the quarter. Our investment manager remains comfortable with this positioning, especially given the sector's total reliance on global economic growth to sustain current commodity prices.

One of our objectives is to deliver income to our shareholders. Your Board remains mindful of the importance of income through regular, consistent dividends to you, our shareholders.

Including the final dividend payment for Financial Year 2019, shareholders who subscribed to the IPO in August 2014 will now have received a total of 18.9 cents per share in fully franked dividends since the Company's listing.

Our stated investment timeframe for shareholders continues to be 5 or more years. After approximately 5 years the Company's pre-tax return was 7.1 percent per annum compared to 11.4 percent for the benchmark.

As most of you would be aware when looking at benchmark returns, the sharemarket has been strong in the last few years with the US market hitting new record highs and Australia closing in on new record highs. With many economies around the world - including Australia's - struggling to grow and with competition in many industries intensifying, central banks have tried to counter these headwinds by cutting interest rates to record low levels - as anyone who recently put money in a term deposit would know.

In the past few years this has led to many investors taking more risk creating a momentum type of market where investors chase short-term returns often without regard to the value of the asset that they are buying. We are seeing this in the shares and in property.

In the opinion of Investors Mutual, the Company's Investment Manager with over 20 years of experience, it is times like these when it pays to take a cautious approach. The market conditions of recent years - in particular the last two years have been a challenging time for value-style investors, like Investors Mutual as market returns are being driven upwards often by themes and market momentum and not by the underlying long-term fundamentals of many of the stocks or sectors.

While the QVE portfolio has delivered a reasonable return to shareholders since inception, the Board is fully aware that the QVE portfolio managed by Investors Mutual has lagged the benchmark - especially in the last 18 months.

As a Board we are regularly updated about QVE's portfolio holdings and positioning and we continue to be satisfied with the job that Investors Mutual is doing.

The Board continues to believe that a carefully selected holding of ex20 stocks, managed by Investors Mutual Limited, will provide good opportunities for shareholders going forward. Now is the time to remain disciplined and true to label which is why the Company's investment portfolio remains defensively positioned. The Manager continues to look for good, quality companies, underpinned by reasonable valuations. The Manager has cash available to take advantage of any market volatility.

In addition, your Board is mindful that the Company's market share price is currently trading at discount to net tangible assets per share.

As a proactive measure to address this discount, in August your Board announced the establishment of an on-market buy-back. Under this facility the Company can purchase up to 10% of its shares over a 12-month period. This commenced on 9th September 2019. The Board expects any buyback of shares undertaken to be accretive to net tangible assets (NTA).

Also in September, with the intention of providing more timely information the Company commenced advising the market of its net tangible assets per share on a weekly basis.

About QV Equities: QV Equities Limited (QVE) is a Listed Investment Company established with the primary objective of providing both long term capital growth and income, through a diversified portfolio of ASX listed entities outside of the S&P/ASX 20 Index. The portfolio is managed by Investors Mutual Limited (IML), a multi award-winning and experienced investment management company, with an excellent track record of successfully managing Australian equities since 1998.