



February 2020

The Manager
ASX Market Announcements
ASX Limited
Exchange Centre
Level 4, 20 Bridge Street
Sydney NSW 2000

Dear Shareholders,

Please find attached Hearts and Minds Investments Limited February Investment Update.

If you would like to receive these monthly investment updates via email please [click here](#).

For and on behalf of the board,

A handwritten signature in blue ink, appearing to read "T. Bloomfield", is positioned above the name of the signatory.

Tom Bloomfield
Company Secretary

Investment objective

Provide a concentrated portfolio of long-only positions in 25-35 Australian and globally listed securities based on the highest conviction ideas from leading fund managers. The Company will forego any investment fees and instead donate to leading Australian medical research institutes.

Portfolio Commentary

During February, the portfolio delivered an investment loss of 1%, compared to a loss of 5% in the MSCI World Net Total Return Index (AUD). Developed Market (DM) indices were all down 8-9% over the month (S&P 500 -8.2%; ASX200 -7.7%; FTSE -9%). The 2.6% decline in the Australian dollar against the US dollar helped our portfolio, and our benchmark outperform the DM indices, as we hold roughly 75% of our portfolio in offshore companies. Since inception (November 2018), the investment portfolio is up 36.5% compared to 21.8% for the benchmark. Our post tax Net Tangible Asset value decreased by 0.7% during February and is now up 26% since inception. The share price at the end of February was \$2.95, up 18% since inception.

Markets in February were volatile with the Volatility Index (VIX) increasing from 13 to almost 50. The NASDAQ and the ASX-200 reached all-time highs earlier in the month, before ending the month down 6-8%. The number of confirmed cases of COVID-19 (coronavirus) increased from about 10,000 at the start of the month to nearly 90,000. This has left many companies facing clear disruptions (flight cancellations, global supply chain breakdowns, production halts, etc) and some have subsequently issued profit warnings. The flight to safety was evidenced by the decline in the US 10 year bond yield from 1.5% to 1.14% in February. China also released their first data prints post coronavirus, with the Purchasing Managers Index (PMI) dropping to a record low of 35.7, down from 50.0 in January. The Non-Manufacturing PMI (a gauge of sentiment in the services and construction sectors) dropped to 29.6 from 54.1, which was the lowest number since November 2011.

The conference portfolio delivered a small overall gain for the month, which was pleasing given the turmoil in markets. Five of the twelve stocks had positive returns in their local currency, of which four (GDS Holdings, Tesla, The Trade Desk, and Floor and Decor) also benefited from the stronger US dollar. A2 Milk also delivered excellent numbers when it reported at the end of the month and was up 6.3% for the month. Of the detractors, the three worst performers were also our three smallest holdings. Wizz Air Holdings, which provides short-haul and medium-haul passenger transportation across Europe and the Middle East, was affected by coronavirus fears.

The core portfolio had a more difficult month, with many stocks falling in line with global indices (8-9%) and two having more significant declines. Our best performing stock for the entire portfolio also came from the Core portfolio. Pleasingly, all of our Core fund managers have made respectable contributions to the overall core portfolio return of 30% since inception.

Severe market gyrations have happened before, and they will happen again. Equities are a riskier asset class than cash, and therefore investors demand a higher return in order to take on this added risk. The HM1 portfolio will not be immune to such moves in the short term. This month we have seen an asset reallocation event out of equities and into the safer havens of cash and bonds, as seen by the fall in global bond yields.

Our share price fell heavily in the last week of the month, as some investors decided to hold more cash and less equities in their portfolio. No one knows the end game of the coronavirus and the impact it will have on companies around the world. Expect volatility to continue. Expect to see more headlines in the media. Expect to see some hedge funds close. Expect central banks to intervene. We have just seen the Fed and the RBA lower interest rates once again.

Our portfolio continues to be invested in only the highest conviction ideas of our fund managers, and we remain in regular contact with them, so that we can manage the risk of the portfolio. We are pleased with the performance of our portfolio which has outperformed the benchmark in all the periods reported.

Financial results for the half year ended 31 December 2019

We recently reported our financial results for the half year to 31 December 2019. HM1 reported total comprehensive income after tax of \$37,792,917 for the half year. The result for the period reflects the investment portfolio's performance over the six months to 31 December 2019 after providing for all taxes.

The result for the half year includes net realised gains from the disposal of our 2018 Conference Portfolio and the movement in the market value over the period of our Core Portfolio and new 2019 Conference Portfolio. The full financial report for the half year ended 31 December 2019 is [available here](#).

Dividends

HM1 provides shareholders with exposure to a concentrated portfolio of Australian and international securities. As such, returns to shareholders are predominantly delivered through capital growth. The Board is committed to paying fully franked dividends to shareholders provided HM1 has sufficient profit reserves and franking credits and it is within prudent business practice. The Board has not declared a dividend in respect to the half year to 31 December 2019. The Board will consider a dividend payment for the full financial year ending 30 June 2020.

HM1 has also announced a dividend reinvestment plan (DRP). The DRP allows shareholders to buy additional HM1 shares when HM1 makes dividend payments to its shareholders. If HM1's dividend payments are franked participants in the DRP will receive franking credits for their use, as well as receiving additional shares in HM1 to the extent of the dividend paid. Full details of the DRP are [here](#).

Medical Research

In line with its philanthropic objective, HM1 provides financial support to leading Australian medical research organisations in order to help the development of new medicines and treatments and drive a new generation of medical research in Australia. HM1 and its participating fund managers and service providers forego any fees and instead an amount equivalent to 1.5% of net tangible assets per annum is donated to designated charities. The current designated charities are set out on the last page.

In the half year to 31 December 2019 the Company accrued \$4.1m in donations based on 1.5% of the Company's net tangible assets over the period. This amount will be paid to the designated charities during March 2020 to fund leading medical research initiatives.

We would like to thank our participating fund managers and service providers for their outstanding and continued generosity since listing.

Investment Performance	1 month	6 months	12 months	Since Fund Inception
Investment Performance	-1.0%	12.9%	19.6%	36.5%
MSCI World Net TR Index (AUD)	-5.0%	5.4%	15.5%	21.8%

Investment Performance is calculated on a before tax basis. Index returns are before expenses and taxes. Source: Citco Fund Services and www.msci.com. Fund inception 14 Nov 2018.

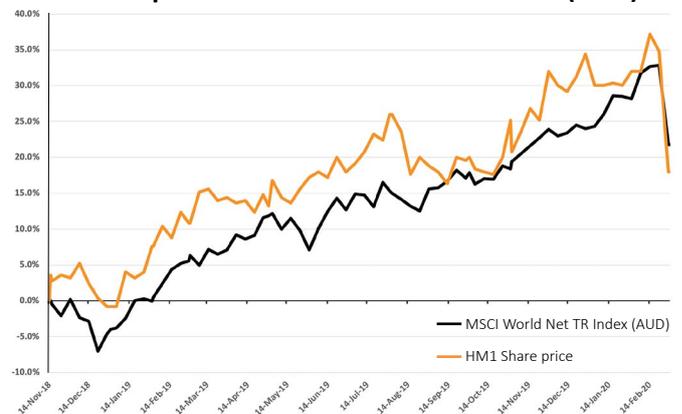
Net Tangible Asset (NTA) Performance	1 month	6 months	12 months	Since Fund Inception
Post Tax NTA Performance*	-0.7%	9.7%	14.6%	26.0%

Source: Hearts and Minds Investments Limited and Citco Fund Services. Fund inception 14 Nov 2018.

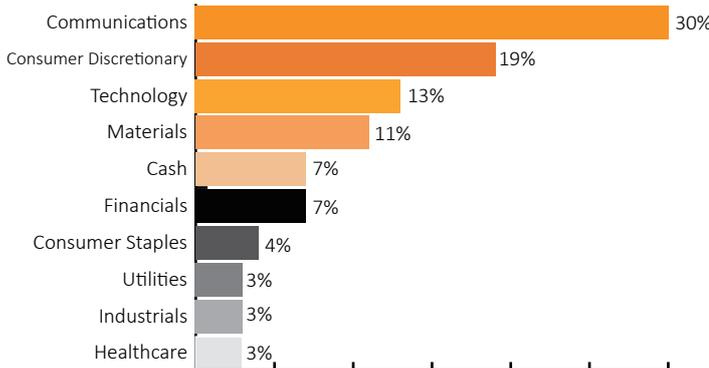
HM1 share price vs pre tax NTA backing



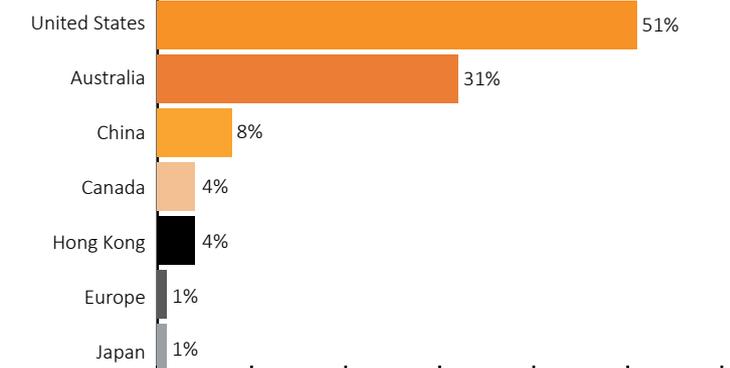
HM1 share price vs MSCI World Net TR Index (AUD)



Sector allocation



Business domicile⁴

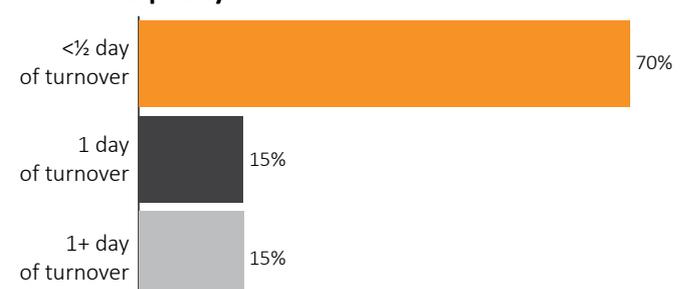


Key details

Pre Tax NTA ¹	\$3.32
Post current tax NTA ²	\$3.18
Post tax NTA ³	\$3.08
ASX code	HM1
Share price	\$2.95
Percent invested	93%
Listing date	14 Nov 2018

All numbers as at 28 February 2020 unless otherwise stated.

Portfolio liquidity⁵



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¹Pre tax NTA is the NTA of the company before the provision for current or deferred tax. ²Post current tax NTA includes a provision for tax on operating profits, a provision for tax on realised gains and losses on the Total investment portfolio and a provision for tax on unrealised gains and losses on the Conference investment portfolio. ³Post tax NTA includes the provision for tax on operating profits, and a provision for tax on both realised and unrealised gains and losses on the Total investment portfolio. ⁴Determined by location where primary business takes place. ⁵Based on 20 day average daily turnover. ^{*}The performance figures quoted are historical, calculated using end of month prices. Performance can be volatile and future returns can vary from past returns. ^{**}All NTA figures are unaudited and prepared by Citco Fund Services. [†]All numbers as at 28 February 2020 unless otherwise stated.

Stock of the Month: Spotify Technology

Hamish Corlett, from our newest Core Fund Manager, TDM Growth Partners, presented Spotify at the 2019 Sohn Hearts & Minds Investment conference.

As with Tesla, the Spotify brand is instantly recognisable to most people. It is an international media services provider, whose primary business is its audio streaming platform. Founded by Daniel Ek and Martin Lorentzon in 2006, a year before Steve Jobs released the first iPhone, it provides music, videos and podcasts to its 271 million monthly active users in 79 countries, including most parts of Europe, the Americas, Australia, New Zealand, and parts of Africa and Asia.

The company went public on 3 April 2018, via an Initial Public Offering, where Spotify did not actually issue any new shares to the public, but rather the existing shares were taken directly to market. The market capitalisation immediately following the IPO was \$26B.

Spotify operates under a 'freemium' business model, whereby the basic services are free (with advertising), and additional services with an ad free experience are offered via paid subscriptions. There are currently 124 million paying subscribers to the platform. Revenue is generated by premium streaming subscriptions, and advertising placements to third parties. Spotify offers advertisers ten different types of advertising formats, described in 2016 as: Branded Moments, Sponsored Playlists, Sponsored Sessions, Video Takeovers, Audio, Display, Overlay, Homepage Takeovers, Branded Playlists, and Advertiser Pages. These advertisements vary in size, type and user engagement.

So why did Hamish recommend the stock to the audience?

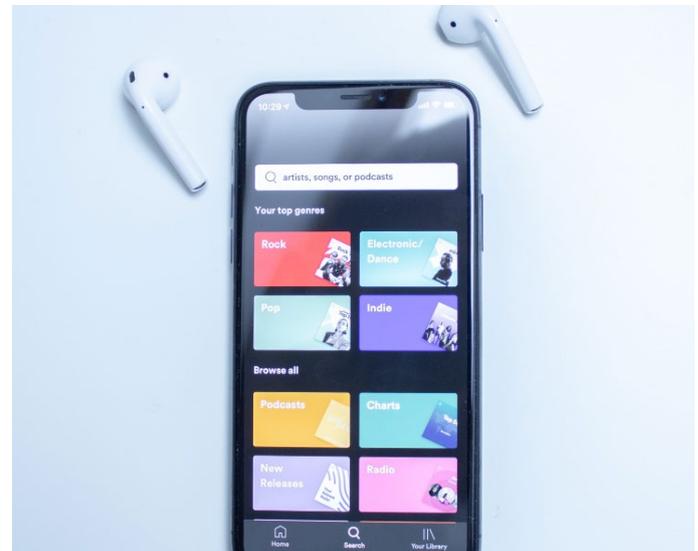
To give everyone an idea of the scale Spotify has already achieved, Hamish came onto the stage with AC/DC's "Back in Black" playing. This is the second highest selling album of all time, having sold **50 million** copies from 1980-2015. *Back in Black* has already been played **1.5 billion** times on Spotify, and every time it is played, the musicians are paid. He firmly believes Spotify saved the music industry from the internet piracy threat of the early 2000's that very nearly destroyed it.

Spotify earns revenues of \$7.5B, which is increasing at 30% per annum. Hamish believes Spotify can compound its capital at 25-40% from here.

How?

Hamish said that to be the leader in audio streaming, you need to dominate the 'free' market. At the moment, 55% of Spotify subscribers use their free version, while 45% are paying subscribers. 90% of Spotify's current revenue comes from paid subscriptions, while the remaining 10% comes from advertising revenue.

The two biggest competitors to Spotify's free offering, Apple and Amazon, are seemingly not challenging Spotify in this space. Apple currently does not have a free offering, while Amazon has just 2 million songs compared to Spotify's library of 50 million songs. He estimates that the audio market will be a \$60B market, with ⅓ of that coming from the free/ad supported market. Currently, the vast majority of that free market is in commercial radio.



With the advent of podcasts, Hamish believes this will be a game changer, and Spotify are at the forefront, with over 25 million podcasts already available on their platform. He told us that brand advertising on podcasts should increase the free user monetisation from about 50c/month per user currently to \$2-3/month per user. This in turn will increase the ability to deliver more product to the free users, which will bring more new free users to the platform (some who will convert to paying).

Hamish ended his pitch by telling us that he believes the FAANG stocks, the five clear market leading consumer internet companies, comprising Facebook (the leader in social media), Apple (devices), Amazon (e-commerce), Netflix (video streaming), and Google (search) will shortly become the FAANGS suite, with Spotify being the clear market leader in audio.

Company information

Ticker code	SPOT US
Market capitalisation	USD \$25bn
Average daily volume	1.6 million shares / day
52-week range	USD \$110.57- \$161.38
Bloomberg consensus	19 Buys, 9 Holds, 4 Sells
Average price target	USD \$169.63

SPOT US: Share price history



Core fund managers



Conference fund managers



Designated charities



Pro-bono service providers

