30 September 2018

InvestSMART Australian Small Companies Fund

QUARTERLY UPDATE

This quarter Alex discusses:

- The quarter's performance
- Our strategy for improving performance
- Why we continue to like Thorn Group

InvestSMART Australian Small Companies Fund

PERFORMANCE TO 30 SEPT 2018	1 mth	3 mths	6 mths	1 yr	Since Inception (p.a.)
InvestSMART Australian Small Companies Fund (%)	1.25	2.26	1.53	-2.90	10.48
S&P/ASX Small Ordinaries Accumulation Index (%)	-0.35	1.10	8.86	20.32	17.26

Key points

- **Portfolio slightly outperforms its index over the quarter**
- **Portfolio stalwarts Trade Me and Hansen performing well**
- **We discuss why we like 'cheap optionality'**

The portfolio gained 2.3% during the quarter ending 30 September, compared to a 1.1% gain by the ASX Small Ordinaries Accumulation Index. A small step in the right direction following a disappointing twelve months, in which the portfolio slightly declined while the index surged ahead.

The biggest positive share price moves during the month of September were Academies Australasia (27%), RPMGlobal (13%), and Redflex (13%). The biggest decliners were Thorn Group (-12%), iCarAsia (-10%) and Audinate (-9%).

We don't read much into monthly share price movements, especially for smaller companies that tend to be more volatile anyway, as they're often a function of short-term supply and demand for shares rather than a change in the company's intrinsic value. Academies Australasia, the vocational education business, is case in point.

If you recall from last month's update, **Academies Australasia** was the biggest negative mover as sellers became more eager, but it rebounded strongly this month as director buying intensified (Redflex has also had particularly strong director buying recently too, another encouraging sign). Despite this month to month volatility, Academies Australasia's business remains largely unchanged, and its long-term growth profile remains attractive.

In fact, there's reason to believe its growth is accelerating. A recent presentation highlighted that international student growth was an impressive 22% for the year (or a compound annual growth rate of 14% over the last 5 years), which isn't immediately obvious in the headline numbers due to the underperformance of its domestic business. But now that the international business represents 80% of total enrollments, and the domestic business has stabilised, the group result is likely to more closely reflect its superior international operation.

"DESPITE THIS MONTH TO MONTH VOLATILITY, ACADEMIES AUSTRALASIA'S BUSINESS REMAINS LARGELY UNCHANGED, AND ITS LONG-TERM GROWTH PROFILE REMAINS ATTRACTIVE. "

And for a business with predominantly fixed costs, made up of teaching staff and leased premises, this is encouraging news, as higher revenue growth converts to even higher growth in free cash flow.

Heads I win, tails I don't lose much.

In a perfect world, our portfolio would be packed full of attractively priced 'compounders', which we describe as companies that have a competitive edge that allows them to deliver high returns on capital and consistent growth over the long term. We've compiled more than a few already, such as **Hansen Technologies** and **Trade Me**, that are endowed with competitive advantages and attractive growth paths, and they're likely to form the bedrock of our portfolio for the foreseeable future.

When such investments can be found, holding for long term is the best course of action, as it minimises pesky costs like tax and brokerage, and allows the magic of compounding to take effect.

But as these types of businesses are hotly sought after, and especially so in the current market, they're rarely mispriced. So, we use other strategies, such as buying 'cheap options' for a smaller portion of the portfolio, to put capital to work when we can't find any sensibly priced 'compounders'. With cheap options, we're looking for downside protection, which is often in the form of tangible assets, and some form of upside potential that isn't factored into the valuation.

Matrix Composites and Engineering is an example of a cheap option in the portfolio. It enjoys lots of downside protection due to its plentiful tangible assets, comprised of mostly working capital and a large freehold property in the Western Australian industrial precinct of Henderson. Its shares trade at 40% of its net tangible assets.

But it also has lots of upside potential too, as if conditions improve in the offshore oil and gas industry, which is looking increasingly likely with the oil price trending higher, its manufacturing business will kick into life and be worth substantially more than investors currently give it credit for.

But if that doesn't happen for whatever reason, Matrix' net tangible assets provide an important layer of protection. Either way, we see this as a '*heads I win, tails I don't lose very much' situation*.

Another is **Universal Biosensors** (UBI), which derives downside protection from a lump sum cash payment that is worth its market cap and upside potential from sales of its high margin testing strips to Siemens for its Xprecia Stride blood coagulation device (along with new products in its pipeline).

" WITH CHEAP OPTIONS, WE'RE LOOKING FOR DOWNSIDE PROTECTION, WHICH IS OFTEN IN THE FORM OF TANGIBLE ASSETS, AND SOME FORM OF UPSIDE POTENTIAL THAT ISN'T FACTORED INTO THE VALUATION. "

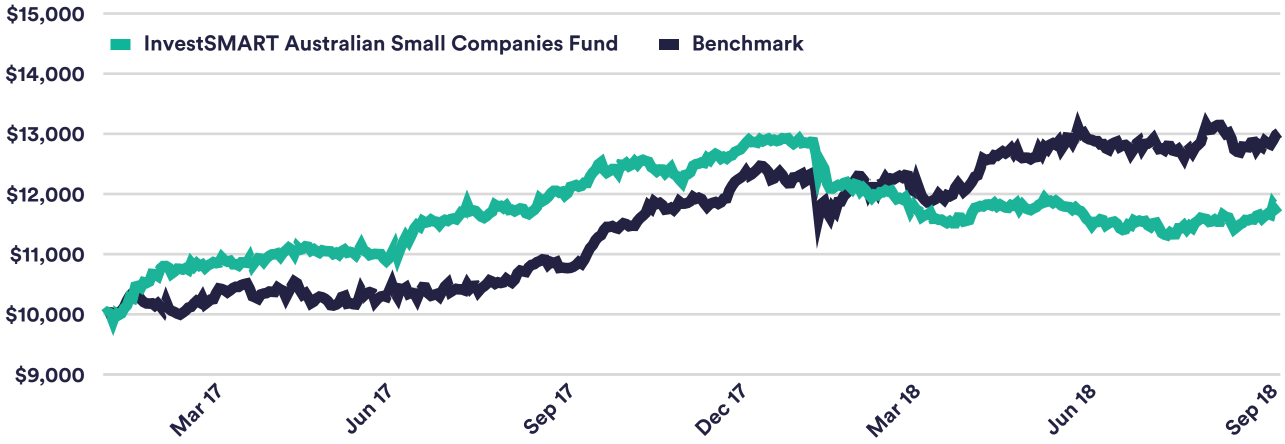
UBI received bittersweet news during September when it announced it will be receiving the lump sum payment early, which means they'll miss out on the extra year of royalties we were hoping for. On the plus side, UBI will be awash in cash by the time the $44m expected payment is received this coming February, which underpins its valuation and opens the door for capital management.

This takes away some of our option value but the protection remains, which highlights the thinking behind the strategy. Heads I win, tails I don't lose much.

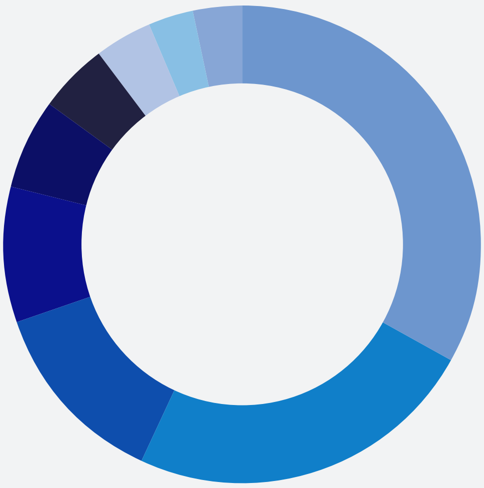
New investments

After a busy reporting season, we spent the quieter September month following up on a number of investment opportunities. We visited 13 companies during the month, and came away with two new investments that meet our criteria. We look forward to outlining our investment cases once we've finished buying.

PERFORMANCE OF $10,000 SINCE INCEPTION



Portfolio breakdown



Information Technology	33%
Consumer Discretionary	24%
Cash	13%
Health Care	9%
Financials	6%
Real Estate	5%
Materials	4%
Industrials	3%
Energy	3%
Telecommunication Services	0%

TOP 5 HOLDINGS

SECURITY	WEIGHTINGS (%)
Trade Me	8.9
Thorn Group	7.0
RPMGlobal Holdings	5.7
MSL Solutions	5.5
Hansen Technologies	5.0

InvestSMART Group Limited (INV) was founded in 1999 and is a leading Australian digital wealth advisor which has over 32,000 clients and over $1.4B in assets under advice. InvestSMART's goal is to provide quality advice and low cost investment products, free from the jargon and complexities so commonly found in the finance industry, to help you meet your financial aspirations.

The Fund

The InvestSMART Australian Small Companies Fund is a concentrated portfolio of 10 - 25 Australian listed small companies and cash, that seeks to deliver moderate to high total portfolio returns over the long-term.

Investment Objective

The Fund's investment objective is to deliver long-term capital growth by investing in small Australian companies.

Why the InvestSMART Australian Small Companies Fund?

Suitable for those looking to diversify their Australian equity exposure, take advantage of the potential missed opportunities that are often overlooked and not well-researched by larger fund managers.

Actively managed by our investment team, the InvestSMART Australian Small Companies Fund allows investors access to these opportunities at a lower fee structure than most fund managers.

Who manages the investment?

Alex joined the team in July 2016 to provide dedicated research on small capitalisation companies (small caps) and is supported by our Investment Committee, chaired by Paul Clitheroe. Alex has over 8 years successfully managing private portfolios, and prior to joining the team, held various roles in funds management and international research. Alex is a Chartered Financial Analyst (CFA) charterholder and holds a degree in Finance and International Business from Griffith University.

Key Details

INVESTMENT CATEGORY
A portfolio of individually selected Australian Equities

INVESTMENT STYLE
Active Stock Selection, Value Investing Approach

BENCHMARK
S&P/ASX Small Ordinaries Accumulation Index

INCEPTION DATE
1 February 2017

SUGGESTED INVESTMENT TIMEFRAME
7+ years

NUMBER OF SECURITIES / STOCKS
10 - 25

MANAGEMENT FEE
0.97% per annum

PERFORMANCE FEE
10.25% of the excess of the Fund's performance above the benchmark^

MINIMUM INITIAL INVESTMENT
$25,000

STRUCTURE
Managed Fund

SUITABILITY
Suitable for investors who are seeking domestic equity exposure with a growing stream of dividends to offset inflation.

PORTFOLIO MANAGER
Alex Hughes, CFA

^Benchmark is the greater of the S&P/ASX Small Ordinaries Accumulation Index and the RBA Cash Rate in each 12 months to June 30. Performance fees are only accrued if the Fund Net Asset Value (NAV) is higher than the NAV when last performance fee was paid (high watermark).

Performance numbers exclude franking, after investment and admin fees, including franking. Excludes brokerage. Unit Price taken at the end of each month to calculate the figure. All performance figures, graphs and diagrams are as at 30 September 2018.

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