

# InvestSMART Australian Small Companies Fund

## Monthly Update - October 2018

| PERFORMANCE TO 31 OCT 2018                  | 1 mth  | 3 mths | 6 mths | 1 yr    | Since Inception (p.a.) |
|---|--------|--------|--------|---------|------------------------|
| InvestSMART Australian Small Companies Fund | -6.41% | -3.51% | -6.20% | -11.96% | 5.82%                  |
| S&P/ASX Small Ordinaries Accumulation Index | -9.60% | -7.67% | -4.22% | 2.59%   | 9.77%                  |

### Key points

- **The Fund's resilience amidst a tough month for equities**
- **Encouraging contract wins for Redflex**
- **Our new investment in Frontier Digital Ventures**

Equity markets experienced a sharp selloff in October with the Small Ordinaries Accumulation Index declining by 9.60%. The InvestSMART Small Companies Fund did not escape the carnage but it did show some resilience, with a smaller decline of 6.41%.

The investments that experienced the largest positive price movements were Academies Australasia (6.0%) and ALE Property (2.2%). Integrated Research (-22.3%), iCarAsia (-20.5%) and MSL Solutions (-18.2%) experience the largest declines.

Months like October can be frustrating or even frightening for investors. In truth, they catch most people by surprise, including us, as we make no attempt to predict their arrival nor do we have the ability to do so.

Instead, we simply focus on building a portfolio of undervalued securities that can provide an adequate return over the fullness of time, and to this aim, months like October provide tremendous assistance.

We're still cautious about the outlook for the Australian economy, so we continue to avoid sectors like retail and anything residential housing related for the time being. But following October's fall, our list of investment candidates has bloomed.

### A green light for Redflex

Many of our investments reported quarterly results in October in line with our expectations, including Audinate, Thorn Group, MSL Solutions, and iCarAsia. Another was Redflex (ASX:RDF), the enforcement camera operator, which we've been patiently holding since the fund's inception.

### **"FOLLOWING OCTOBER'S FALL, OUR LIST OF INVESTMENT CANDIDATES HAS BLOOMED."**

Redflex has many of the defensive properties we're drawn to, such as:

- a balance sheet flush with net cash
- revenue that is unrelated to the economic cycle, is predominantly recurring in nature with a large portion derived in US dollars
- Low shareholder expectations ("If I were asked to name just one way to figure out whether something's a bargain or not, it would be through assessing how much optimism is incorporated in its price." Howard Marks)
- And a multiple that is dramatically lower than its international competitors

But it also has the upside potential we require, through:

- An established presence in most major international markets

- A revamped product portfolio
- A new CEO with significant industry experience, who has set about reviving the company's sales culture
- The stabilisation of the US photo enforcement market, which had been in decline for years
- Takeover appeal, due to its low price, technology leadership, synergistic potential and the enduring benefits following industry consolidation

But despite valuing Redflex at considerably more than the current price (which the directors seem to agree with based on \$2.8m of recent on-market buying), owning its shares has been a fairly unrewarding experience to date with scant evidence of any improvement in the company's operations.

That is until the 1Q19 quarterly sales update, which highlighted growth in new orders of 302% over the prior corresponding period (or 55% over 4Q18). Could this be an inflection point in Redflex's fortunes? It's hard to say, as one quarter doesn't make a trend. So, we'll be watching future updates closely to see if Redflex is embarking on a more rewarding trajectory.

## A new Frontier

The recent selloff in equity markets has given us the opportunity to build a new position in Frontier Digital Ventures (ASX:FDV), a holding company that is seeking to replicate REA Group (ASX:REA) and iProperty's success in frontier markets. We like it as it has the right product, process, and people to be successful.

Frontier operates a portfolio approach through ownership of minority stakes in 15 online classifieds, with most being the clear leader in their respective markets. Places like Pakistan, The Philippines, and Honduras.

Frontier's portfolio is skewed to property classifieds which we prefer, as property has inherently higher monetisation potential compared to lower ticket items like cars, jobs or general items. If you've ever wondered why REA Group is three times the size of Carsales.com, this is the main reason why.

Frontier is led by Shaun Di Gregorio, who has previous senior executive experience at REA Group and iProperty as well as board experience at iCarAsia. He has a large investment in the business alongside renowned classified investors, Catcha Group.

Management's experience allows Frontier to adopt what has worked in the past while also learning from previous mistakes, vicarious or otherwise. Instead of acquiring an entire business and installing well-paid executives to run it – the model REA Group used with its failed foray into Italy – Frontier takes minority stakes and leaves the founders to run their businesses. An approach that retains local operational expertise and provides better alignment of interests.

Frontier's first investment shows the potential of its model. In 2014, it acquired a 30% stake in Zameen, the leading property portal in Pakistan, and it has appreciated in value by 55 times since then. When a classified becomes the only game in town, it's remarkable how valuable they can become, and Zameen shows no sign of stopping with revenue continuing to grow in the vicinity of 70-100% p.a.

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## **“MANAGEMENT’S EXPERIENCE ALLOWS FRONTIER TO ADOPT WHAT HAS WORKED IN THE PAST WHILE ALSO LEARNING FROM PREVIOUS MISTAKES.”**

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Frontier's stake in Zameen could be worth more than Frontier's entire market cap, which would gift Frontier's 14 other investments for free if so. When viewed as a group, investors are paying 8.2x Frontier's annualised sales (based on 3Q18), which is significantly less than REA Group (11.5x) even though Frontier can grow stronger for longer, with profitability around the corner.

Investing in frontier markets encounters a unique set of risks, but given the long-term potential on offer, we think we're being adequately compensated for taking them.

## PORTFOLIO ALLOCATION



|                            |        |
|----------------------------|--------|
| Information Technology     | 32.41% |
| Consumer Discretionary     | 24.23% |
| Cash                       | 10.61% |
| Health Care                | 9.32%  |
| Financials                 | 6.70%  |
| Real Estate                | 5.07%  |
| Materials                  | 4.23%  |
| Industrials                | 3.32%  |
| Energy                     | 3.25%  |
| Telecommunication Services | 0.86%  |

## TOP 5 HOLDINGS

| Security            | Weighting |
|---------------------|-----------|
| Trade Me            | 8.9%      |
| Thorn Group         | 7.0%      |
| RPMGlobal Holdings  | 5.7%      |
| MSL Solutions       | 5.5%      |
| Hansen Technologies | 5.0%      |

Performance numbers exclude franking, after investment and admin fees; excludes brokerage. All yield figures include franking. All performance figures, graphs and diagrams are as at 31 October 2018. Performance figures are based on the portfolio's previous investment structure, a Separately Managed Account (SMA). This portfolio is now offered as a Professionally Managed Account (PMA), as of 1 November 2018. The underlying securities remain the same between the SMA and PMA structures. The inception date refers to the SMA. Please see the Investment Menu for full PMA fee details.

## 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 STOCKS

10 - 25

### INVESTMENT FEE

0.97% p.a.

### 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).

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