

Intelligent Investor Select Value Share Fund

Active ETF (ASX:IISV)

“I wonder why we think faster than we can speak. Probably so we can think twice.” — Bill Watterson

“Stupidity is an enduring feature of human existence but inherently not modelable.” — Flaubert

“CEO’s feel this tremendous pressure to grow. The problem is that sometimes you can’t grow. Many times, you don’t want to grow because growth can force you to take on bad customers/clients, excess risk, or excess leverage.” — Jamie Dimon

Mineral Resources was again the largest contributor. The iron ore price has remained steady and short covering has fuelled lithium stocks with the lithium price doubling from its low.

MinRes also announced a string of good news, including the Mt Onslow project running at capacity, a favourable debt rollover and selling a stake in its lithium business at a good price.

We sold **Allfunds** after the share price increased 27% due to a takeover offer from Deutsche Börse. We’ve been frustrated that the market hasn’t rewarded solid earnings growth and operational progress, and at the bid price of €8.80 per share

Performance (after fees)						
	1 mth	3 mths	6 mths	1 yr	2 yrs p.a	S.I. p.a
II Select Value Share Fund	0.1%	0.0%	4.9%	12.3%	15.8%	18.0%
S&P ASX 200 Accumulation Index	1.3%	-1.0%	3.6%	10.3%	10.9%	11.1%
Excess to Benchmark	-1.2%	1.0%	1.3%	2.0%	4.9%	6.9%

Note: The benchmark is the ASX200 Accumulation Index. It’s one of the world’s highest performing indexes, which sets the bar high for the performance fee, and we need to beat our home index to justify investing abroad.


Inception (S.I.): 28 Mar 2023





Fund overview


The Intelligent Investor Select Value Share Fund is an Active ETF designed for investors seeking a diversified selection of International and Australian companies with superior financial metrics and competitive advantages to outperform the S&P/ASX 200 Accumulation Index over five year rolling periods.

 **5+ yrs**
Suggested investment timeframe

 **Risk profile: High**
Expected loss in 4 to 6 years out of every 20 years

 **S&P/ASX 200 Accumulation Index**
Benchmark

 **Investment fee**
0.97% p.a.

 **Performance fee**
15% p.a.

it still looks cheap. But the deal is complex, faces a lengthy European approval process and prior bids have fallen through.

MA Financial benefited from various capital raisings and we're expecting a step change in profits over the next two years as large investments scale.

Coupang's stock price fell 27% following a data breach that exposed customer details. No bank accounts or passwords were compromised and those affected will receive free coupons, but management's response has been underwhelming for a business that prides itself on customer experience.

Despite this, Koreans are unlikely to abandon the fastest, broadest ecommerce platform, and Coupang continues to replicate Amazon's playbook by expanding into higher-margin services like advertising and third-party fulfilment. These initiatives should boost profit margins and revenue for many years, even if this year includes some one-offs.

AI takes on online classifieds

Fears that AI will replace online classifieds businesses has hammered these former market darlings across the globe. Rightmove announced earnings growth will slow materially due to investment needed to defend itself, while Auto Trader's share price also fell around 25%.

While we don't expect the rapid earnings growth of the past and we should've sold our position when REA Group made several takeover bids, the share price is now factoring in some of the lowest expectations in the company's history.

We believe it will be more difficult to dislodge the online property portals than AI's current enthusiasm suggests, and that double digit returns should be achievable due to a mix of modest earnings growth, dividends, share buybacks and potentially a higher price-to-earnings ratio as growth accelerates. An improvement in the UK economy would also help, though we're not holding our breath.

The major risk is that if more property and auto searches shift to large language models like ChatGPT or specialised house-hunting AI agents, portals could lose control over discovery.

A personalised AI agent could scrape listings from anywhere, merge them into its own feed and bypass the portal. It could also message agents, organise inspections, offer comparisons and even negotiate. Time-poor users might prefer this over the current model, which places paid vendor ads towards the top.

Several start-ups are building these tools but the eyeballs haven't moved yet and changing user behaviour is hard. The leading marketplaces have spent decades building trust and direct customer relationships. Around 80% of Rightmove and Auto Trader's traffic comes directly.

Plenty of us also jump on a portal to check prices around us or to see what a mate's place fetched. This casual browsing further entrenches the moats surrounding these businesses.

Rightmove will invest £60m over three years to enhance AI-driven search and introduce features such as renovation ideas, cost estimates and other personalised insights. Backend systems will be upgraded as well. This will cap short-term earnings growth while strengthening its moat.

Auto Trader is also rolling out AI capabilities but expects to do so within its existing R&D budget. With both stocks trading below 18 times earnings, we think the fears are overblown.

Amazon's share price bounced at the end of October after releasing a good result. The share price has been weak as many feared the company would be an AI loser. But at the very least its warehouse costs should fall as automation replaces menial roles helping increase margins in what is a highly competitive, low margin business where incremental margin increases can have a large impact on profits.

Lastly, we added serial Canadian software acquirer Constellation Software. Constellation has been an investor favourite for many years due to its consistently high growth. But the share price dropped 40% recently after founder Mark Leonard held an investor day explaining the company's response to the growing threat of AI before announcing his retirement the following day.

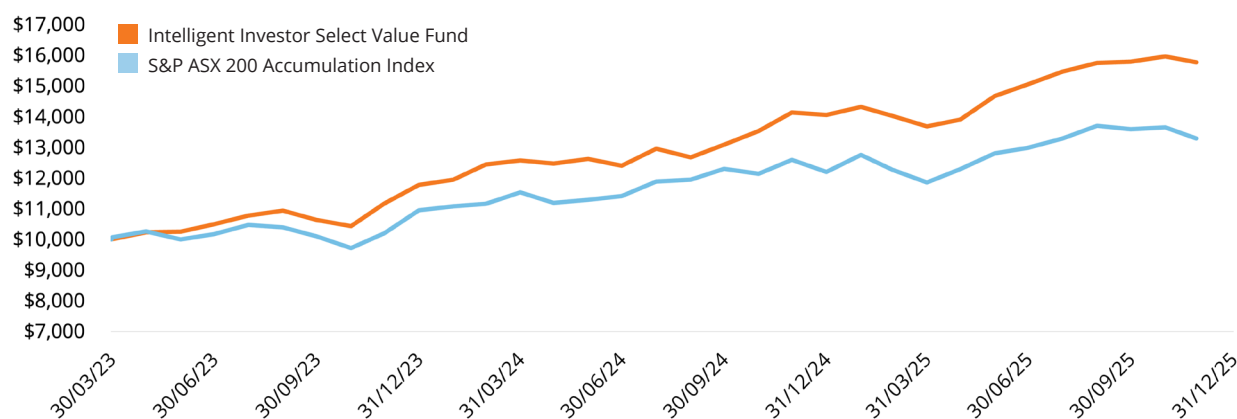
Like the online classified's businesses, we believe the best software businesses will be hard to displace, though cheaper AI options could impact pricing power. As a \$100bn business Constellation won't grow as fast as it used to, but on a multiple in the mid-twenties it doesn't need to to achieve double-digit returns. The appointment of company veteran Mark Miller to CEO is also a no brainer. The Appendix provides a deeper look.

Please get in touch if you have any questions

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Performance since inception



Inception (S.I.): 28 Mar 2023

Asset allocation

Financials	30.9%
Information Technology	21.1%
Cash	14.6%
Communication Services	11.5%
Health Care	5.8%
Materials	5.8%
Consumer Discretionary	4.1%
Real Estate	3.7%
Industrials	2.5%

Top 5 holdings

Australian High Interest Cash ETF (AAA.AXW)	7.9%
Fairfax Financial Holdings (FFH.TSX)	6.8%
Visa (V.NYS)	6.0%
Mineral Resources (MIN.ASX)	5.8%
Amazon (AMZN.NAS)	5.3%

Fund Stats

Distribution yield	7.22%
Net asset value	\$3.65

Important information

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All tables and chart data is correct as at 31 December 2025

Appendix

During the mid-90s dot-com boom, Mark Leonard was mining for cheap golden software nuggets while a mania was unfolding to find the next **Microsoft**. Leonard's value approach led him to niche vertical market software (VMS) businesses, as their focus on specific industries means sticky customers and predictable, recurring revenues.

He then founded **Constellation Software**. After three decades and over a thousand small acquisitions, Leonard created a US\$50bn juggernaut that's expected to make almost US\$2bn in free cash flow this year. Including dividends, since 2006 the stock has increased 250-fold.

Often acquisition-led or 'roll-up' strategies are fuelled with debt and share issuance ending in misery, but some have made it an art form. Leonard has done it without raising any additional equity and focusing on return on capital. The discipline not to overpay for acquisitions has been remarkable.

The consistent growth means the stock normally trades on a huge multiple of earnings, but the price has recently dropped by a third due to fears of AI disruption and Leonard stepping down for medical reasons. At 25 times free cash flow with an incredible track record and a seamless CEO handover, it finally looks cheap.

VMS advantages

VMS targets niche, industry-specific applications that can range from global airline booking software to local cemetery management tools. Horizontal software instead serves broad markets across industries, think Microsoft Office or Salesforce.

Both can be lucrative, but VMS has some advantages. The big one is less competition. The profit pools in niches like library software are tiny, organic revenue growth is low and trust takes

years to build. These conditions make competing relatively unattractive.

Incumbents, as a result, enjoy strong pricing power and very low customer churn. Exactly the kind of features that make rolling up an industry attractive.

Constellation skews the odds further in its favour by targeting businesses that are #1 or 2 in a vertical, have at least US\$5m of revenue and a diversified customer base. Acquisition size ranges from about US\$5m to almost US\$1bn, though most sit at the lower end.

Over the last three decades, Constellation has acquired over 1,000 businesses at an average valuation of one times revenue. This shotgun approach means one bad deal doesn't blow you up.

Acquisition targets aren't always great businesses. Constellation will happily buy cigar butts if the price is right, with group organic revenue growth typically around 2-3%. Some examples include Coris, which helps the ACT government manage offenders in custody, and My PT Hub, a platform for physical therapy training plans.

Acquisitions typically target a 25% return on capital for mid-sized businesses and 15-20% for those above US\$100m, with little room for discretion. Once acquired, Constellation aims to hold them forever, which often gives it an edge over competing private equity bidders.

All free cash flow is invested in these deals apart from a tiny dividend. But as Constellation has grown, so has the number of acquisitions it must complete to maintain growth.

Constellation structure

This is where management has been extraordinary. Most roll-up strategies hit a wall early on. Either a

large deal backfires, too much leverage is used or management overpays. Constellation has avoided these snags through decentralisation, alignment and a massive universe of potential acquisitions to choose from.

The company is split into six business units: Volaris, Harris, Jonas, Vela, Perseus and Topicus. Each act as a mini-Constellation, focusing on a subset of over 150 different verticals and often housing hundreds of individual companies.

Division leaders are granted the autonomy to make acquisitions up to US\$20m and are free to run their unit as they see fit. They are expected to source their own deals through networking and direct, long-term relationships. Any oversight from head office is shunned.

Acquired companies get the same treatment. Once a deal is made, there's almost no integration or synergy expectations. Doing so risks destroying cultures that have worked for decades. Aside from updating financial reporting to public-company standards, Constellation leaves them alone.

The head office's role is to approve large deals, train future leaders and share best practices across the group. It's that simple.

Beautiful alignment

The real magic is alignment. Compensation is tied to return on invested capital metrics to ensure everyone buys in. Employees who earn a salary of over US\$75,000 with bonuses above US\$10,000 must invest 25% of their incentive pay in Constellation stock. Executives must invest 75% of their bonuses into shares, with the option to take cash only once every five years. Board members face similar requirements.

The goal is to have universal alignment. Ten current or former insiders now own over US\$25m in stock each. It's rare to see alignment this good.

This shows in the results. Despite its many acquisitions, impairments are rare and return on invested capital still hovers around 30%, though calculations can differ. Management's preferred metric of profitability—free cash flow available to shareholders—has grown five-fold over the last decade to nearly US\$2bn.

Constellation seems to have cracked the code. By aligning people with the economics of the business, it has avoided the classic roll-up traps and made shareholders rich.

The bear case

The market's concern is whether this formula survives the arrival of AI. This risk isn't unique to Constellation, and software valuations across the board have already been hit.

The bear case goes something like this: most vertical market software (VMS) is clunky and outdated. With AI, current customers could build an improved, cheaper replacement in-house. At the same time, AI will supposedly make software development so easy that someone using an AI model to code could create a competing product, undercut incumbents and disrupt entire verticals. There's more nuance but that's the idea.

We think it's more complicated than that, or, at the very least, it's years away. Constellation's first defence is diversification. Cash flows come from over a thousand businesses across unrelated verticals. If one niche gets disrupted, it doesn't automatically mean they all will.

No customer accounts for more than 2% of revenue, operations are geographically diverse and a little over half the customer base is government.

These relationships are sticky. Public-sector clients rarely change mission-critical systems and have little incentive to build software from scratch. Most VMS is also only a sliver of a customer's cost base,

which further reduces the urge, and many lack the in-house expertise to do this themselves.

The second defence is the nature of B2B software. Unlike consumer apps, where user experience changes and customers churn regularly, VMS prioritises consistency, reliability and compliance in each niche. They handle sensitive and often regulated data, where stability matters more than having the latest gizmo. Insourcing this seems unlikely.

The other worry is whether someone could undercut it. Again, we think it's unlikely. Mark Leonard originally targeted VMS because most niches had tiny profit pools and slow growth. That logic still applies today.

Sales cycles are long, relationships matter a lot and winning business requires knocking on doors rather than an interest-based sales model. These just aren't attractive hunting grounds for would-be disruptors.

It's not as if Constellation is sitting still, either. It has access to the same AI tools as everyone else and can use them to improve its products before any competition gets off the ground. Vibe coding could actually save it money.

Ways to grow

Ironically, Constellation could also benefit from AI disruption. If perceived AI risks push more founders to sell, Constellation suddenly has a richer hunting ground for deals.

The company tracks an estimated 40,000 VMS businesses, with an employee assigned to stay in touch with each one. When industry conditions shift, Constellation tends to know who's ready to talk.

Private equity is another potential supplier. If higher rates or investor pressures force these groups to offload assets, Constellation would be a natural buyer.

Then there's the larger deals. The company has quietly done several almost US\$1bn deals in recent years,

including Allscripts, after lowering its return hurdle for deals of this size back in 2019. To feed the pipeline, it has relied on business brokers, and we think Constellation now gets a look at most industry deals.

It's also toyed with buying horizontal software businesses or even taking small stakes in public companies.

This introduces the risk of style drift, but given management's incentives and insider ownership, we trust they'll do the right thing.

Valuation

Valuing Constellation requires some flexibility. Statutory profit is a mess thanks to acquisition amortisation and other accounting quirks, which is why free cash flow available to shareholders is management's preferred measure of profitability.

If Constellation continues to pay roughly one times revenue and reinvests all free cash flow into acquisitions, it can potentially sustain around 15% annual revenue growth from deals alone. Organic growth could chip in another 1-2% on top.

Free cash flow margins have remained in the mid-to-high teens for years, and we don't see that changing. Revenue growth will likely drive returns.

If this plays out, Constellation could make US\$4bn in free cash flow by 2030, and the stock price might double. This scenario relies on the cash-flow multiple holding and the acquisition machine staying disciplined.

What to watch

Return on invested capital (ROIC) is the key metric to watch. This has been Constellation's north star and dictates how executives are paid. On our numbers, ROIC has hovered around 30% recently, but has previously been much higher. Mark Leonard has warned it will drift lower over time, especially with bigger deals or moves into horizontal software, but thinks excellent acquisitions and returns can still be made.

A sharp drop in ROIC would be a big red flag. It could signal either weakening discipline or a shrinking pool of reinvestment opportunities. Neither outcome is attractive.

To keep mid-teens growth going a decade from now, Constellation would need to deploy just under US\$10bn a year in free cash flow. The law of large numbers eventually catches up. It's this, rather than AI, that worries us most.

Mark Leonard stepping down is another unknown. The fear is that without Canada's Warren Buffett in charge, Constellation loses its mojo. The new CEO, Mark Miller, insists nothing has changed and is well-incentivised with over US\$500m in stock. He joined Constellation in 1995 when his business was acquired, and most recently ran the business unit Volaris while serving as the group's chief operating officer. He looks like the ideal replacement but only time will tell.

Fears about disruption and new leadership mean Constellation is finally available at a sensible price. And while the 30% yearly returns aren't coming back, we expect a good result from here.