Intelligent Investor Equity Growth Portfolio

Monthly Update

PERFORMANCE TO 30 APR 2019	1 MTH	3 MTHS	6 MTHS	1 YR	2 YRS (P.A.)	3 YRS (P.A.)	S. I. (P.A.)
Intelligent Investor Equity Growth	5.15%	8.69%	7.20%	3.93%	6.09%	7.44%	9.14%
S&P/ASX 200 Accumulation Index	2.37%	9.29%	10.87%	10.41%	7.90%	11.10%	8.58%
Excess to Benchmark	2.78%	-0.60%	-3.67%	-6.48%	-1.81%	-3.66%	0.56%

'These [unicorn] losses are on a different scale from losses we've seen before. Pets.com, the poster child of the dot-com bubble, lost about $150 million from when it was founded in 1999 to when it collapsed in late 2000. Webvan, another infamous dot-com company, lost $610 million from 1998 through 2000. Let that sink in: The bubbliest companies of the dot-com bubble lost less over multiple years than Lyft lost in just 2018. Another fun fact: Amazon, the company that everyone loves to point to as an example of how losing money eventually makes money, lost a combined $2.8 billion over its first 17 quarters as a public company, significantly less than the $4.5 billion Uber lost in 2017.'
- Ali Griswold

'It's not given to human beings to have such talent that they can just know everything about everything all the time. But it is given to human beings who work hard at it—who look and sift the world for a mispriced bet that they can occasionally find one. And the wise ones bet heavily when the world offers them that opportunity. They bet big when they have the odds. And the rest of the time, they don't. It's just that simple.'
- Charlie Munger.

Technology Bubble 2.0

How do you spot a bubble in technology stocks? A good sign is when investors are paying many tens of billions of dollars for 'platforms' that lose billions of dollars while their private sponsors that get paid huge fees sell out.

Pinterest, WeWork, Uber and Lyft are just some of the US names that have listed recently or are about to. The common thread, aside from the fact that Uber and Lyft are rivals, is that they boast multi-billion-dollar market values and either measly profits (Pinterest) or large losses without a clear path to profitability, yet alone profits that justify a near US$100bn valuation in Uber's case.

Avoiding such stocks is easy, but other problems seem unavoidable. Author Martin Fridson, also known as the 'dean of high yield debt', says the percentage of corporate debt issuers blessed with the lowest rating handed out by Moody's was 20% in January of 1997. As the GFC grew teeth, it increased to 28% in January 2008, and now it's an eye-popping 43%. Today's debt levels could be a tinderbox for the next downturn.

As we've explained in past presentations, though, there are always opportunities even in expensive markets. This month we added three.

Fallen Star

The share price of casino operator **Star Entertainment** has fallen by almost a third from its peak. It now trades on an attractive EV/EBITDA (enterprise value to earnings before interest, tax, depreciation and amortisation) multiple of just over eight compared to a multiple of thirteen for **Crown Resorts** should James Packer get his price. Star also yields a handy 5.5% while we wait for the completion of its massive new Brisbane casino in 2022.

Although earnings could suffer in the short term along with the Australian and Chinese economies, the Star casino in Sydney has recently invested over $200m to attract VIPs in response to Crown's neighbouring Barangaroo VIP casino that opens next year on the city side of Darling Harbour. It's also laid out plans to expand its casino and accommodation on the Gold Coast, and the new Brisbane casino will be much larger than the Treasury Casino it will replace. Albeit it's still several years away from opening.

CEO Matt Bekier has done a good job turning around Star's fortunes since its low point in 2014 by investing heavily in existing assets and the new Brisbane casino. He also sensibly brought in two Asian developers as shareholders, Chow Tai Fook and Far East Consortium, to help finance the developments. This reduces Star's contribution, which keeps debt down, while opening new marketing avenues to entice Asian customers.

> **"MANAGING DIRECTOR DEVEN BILLIMORIA HAS BEEN WITH THE COMPANY FOR 18 YEARS AND OWNS $24M WORTH OF SHARES. THAT'S EXACTLY WHAT WE WANT IN OUR CEOS; A MEANINGFUL SHAREHOLDING AND LONG TRACK RECORD OF CREATING VALUE.**

Expectations for the company are relatively low as VIPs and regular customers are spending less in the current economic environment. While things might get worse in the short term, over the longer-term earnings should increase as the Queensland developments in Brisbane and on the Gold Coast are completed making today's valuation even more attractive. The Star may even be a takeover target if the Australian dollar stays low.

Smart choice?

Smartgroup is a salary packaging and novated lease company whose share price has recently fallen ~40% despite the company's excellent track record. Between 2014 and 2018, revenue has grown from $72m to $242m; profits from $17m to $78m; and packages from 118,000 to 330,000 for clients that mostly work in stable employment such as not-for-profit sectors and hospitals (they account for 83% of leases).

The company has an excellent balance sheet and doesn't have large residual liability risks associated with used car prices. Managing Director Deven Billimoria has been with the company for 18 years and owns $24m worth of shares. That's exactly what we want in our CEOs; a meaningful shareholding and long track record of creating value.

The share price has fallen in response to Billimoria selling a quarter of his shareholding recently around $8, and also due to falling new car sales. Following long service leave, Billimoria has disclosed that he is committed to the company despite his share sales, and Smartgroup's clients should be less impacted by a slowing economy with an average car purchase price below $40k.

Although the business will be more dependent on acquisitions to grow in future, given Billimoria's track record and the company's reputation for excellent customer service, a price-to-earnings ratio (PER) of 15 and dividend yield above 5% seems inexpensive.

Jumbo sized growth

Jumbo Interactive's earnings have recently taken a jumbo-sized step up due to the increase in the odds of winning Powerball. That's helped increase the size and frequency of jackpots above 40 per year, which should be sustainable. Too many jackpots create jackpot fatigue.

There have already been 14 in the first three months to March (the company's forecast was 17 for the six-month period to June), helped by the almost doubling in Powerball odds from one in 77m to one in 134m. The original version was just one in 3.8m. Six years is the rule of thumb for increasing the odds, but it can be shorter.

Based on this trend, and the increase in lottery tickets bought online from the current ~20% potentially toward 70% and above over the next decade, Jumbo is trading on an attractive PER of 20 net of cash based on 2021 forecasts provided the terms of its distribution license with **Tabcorp** remain similar and there's no major new competition. Lottoland, which is based in Gibraltar, exited the market recently, showing the strength of Jumbo's market position.

The new game Set for Life also kicks off next year, and should attract millennials with lower, but regular payments. It's expected to be a top six lottery game measured by revenue.

Jumbo also has outstanding economics. Current market darling **Nearmap** has a lifetime value to customer acquisition cost ratio over nine, which is much higher than the common benchmark of four. Jumbo's ratio is over 13.

In addition, there are three potential options that could increase earnings significantly - potentially doubling the current share price in the heady bull case - that aren't currently reflected in the company's valuation.

First, a recent software update has allowed the company to speak with potential clients in the US. Winning three state lotteries could add $100m in operating profit depending on 'the take'. We note Turkey recently awarded their national lottery on a take of just 2%.

“ WINNING THREE STATE LOTTERIES COULD ADD $100M IN OPERATING PROFIT DEPENDING ON 'THE TAKE'.

Second, the company has also won one Australian charity lottery client and is aiming for another half a dozen that could add $6m to the bottom line. And third, although 20% of Australian lottery tickets are sold in Queensland, Jumbo isn't currently permitted to sell there. That could change.

The biggest risk is negotiating poorer economic terms with Tabcorp in 2022. Jumbo accounts for 20% of Tabcorp's total lottery sales, earning a 9% commission from the lottery operator while charging a 10% premium to consumers. You can avoid the 10% charge buying tickets from Tabcorp's rival online lottery ticket business called Lott. We expect the 2022 negotiation to be largely business as usual, with Jumbo potentially being an acquisition target for Tabcorp later on.

Around the grounds

Frontier Digital Ventures provided an excellent update, with first quarter revenue from its key investment Zameen doubling from a year earlier. More importantly, Zameen reached breakeven, meaning the company can now sustain itself from internal cashflows. Good performances from other portfolio companies almost brought Frontier Digital Ventures to breakeven as well, which is a precursor to attracting more interest from large investors.

Flight Centre announced a larger than expected profit downgrade due to weakness in its Australian leisure business. While partly related to softness in the general economy, a raft of internal changes didn't help. We're giving founder and CEO Skroo Turner the benefit of the doubt as to whether the Australian leisure business is facing a more permanent decline in profitability. But Flight Centre's future is its US corporate small and medium sized business travel business, which is a huge opportunity and is performing well.

For more information on our Equity Growth Portfolio, **click here**.

Portfolio allocation

ASSET ALLOCATION

Sector	Weighting
Industrials	20.35%
Consumer Discretionary	18.95%
Information Technology	16.21%
Financials	10.86%
Real Estate	8.97%
Communication Services	7.53%
Health Care	6.00%
Cash	4.27%
Materials	4.10%
Consumer Staple	2.57%

TOP 5 HOLDINGS

Security	Weighting
Sydney Airport	4.87%
Frontier Digital Ventures	4.75%
Audinate	4.71%
Uniball-Rodamco-Westfield	4.59%
Seek	4.53%

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 30 April 2019. 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 Portfolio

The Intelligent Investor Equity Growth Portfolio is a concentrated portfolio of 10 - 35 Australian-listed stocks. The Portfolio invests in a mix of large, mid and small cap stocks, focusing on highly profitable industry leaders that have long-term opportunities to reinvest profits at high rates of return.

Investment objective

The Portfolio's investment objective is to achieve a return of 1% above the S&P/ASX 200 Accumulation Index per annum over five year rolling periods by investing in a diverse mix of Australian equities and cash.

Why the Intelligent Investor Equity Growth Portfolio?

Australia has one of the world's most stable and highest returning share markets and is often considered a safe-haven by investors. As contrarian value investors, producing safe and attractive returns in the stock market means sticking to a disciplined and repeatable process. We do this by patiently waiting for overreactions in share prices, so we can buy at a large discount to our estimate of intrinsic value.

Who manages the investment?

Nathan Bell, has over 20 years of experience in portfolio management and research and is supported by our Investment Committee, chaired by Paul Clitheroe. Before returning to InvestSMART in 2018 as Portfolio Manager, he was the Research Director at our sister company, Intelligent Investor for nine years which included over four years as Portfolio Manager and being a member of the Compliance Committee. Nathan has a Bachelor of Economics and subsequently completed a Graduate Diploma of Applied Investment and Management. Nathan is a CFA Charterholder.

Key Details

INVESTMENT CATEGORY
A portfolio of individually-selected Australian Equities

INVESTMENT STYLE
Active Stock Selection, Value Investing Approach

BENCHMARK
S&P/ASX 200 Accumulation Index

INCEPTION DATE
1 July 2015

SUGGESTED INVESTMENT TIMEFRAME
5+ years

NUMBER OF SECURITIES / STOCKS
10 - 35 stocks

INVESTMENT FEE
0.60% - 0.97% p.a.

PERFORMANCE FEE
N/A

MINIMUM INITIAL INVESTMENT
$25,000

STRUCTURE
Professionally Managed Account (PMA)

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

PORTFOLIO MANAGER
Nathan Bell, CFA

Important information

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InvestSMART Funds Management Limited
PO Box 744
Queen Victoria Building
NSW 1230 Australia

Phone: 1300 880 160
Email: invest@investsmart.com.au

www.investsmart.com.au