INVESTSMART

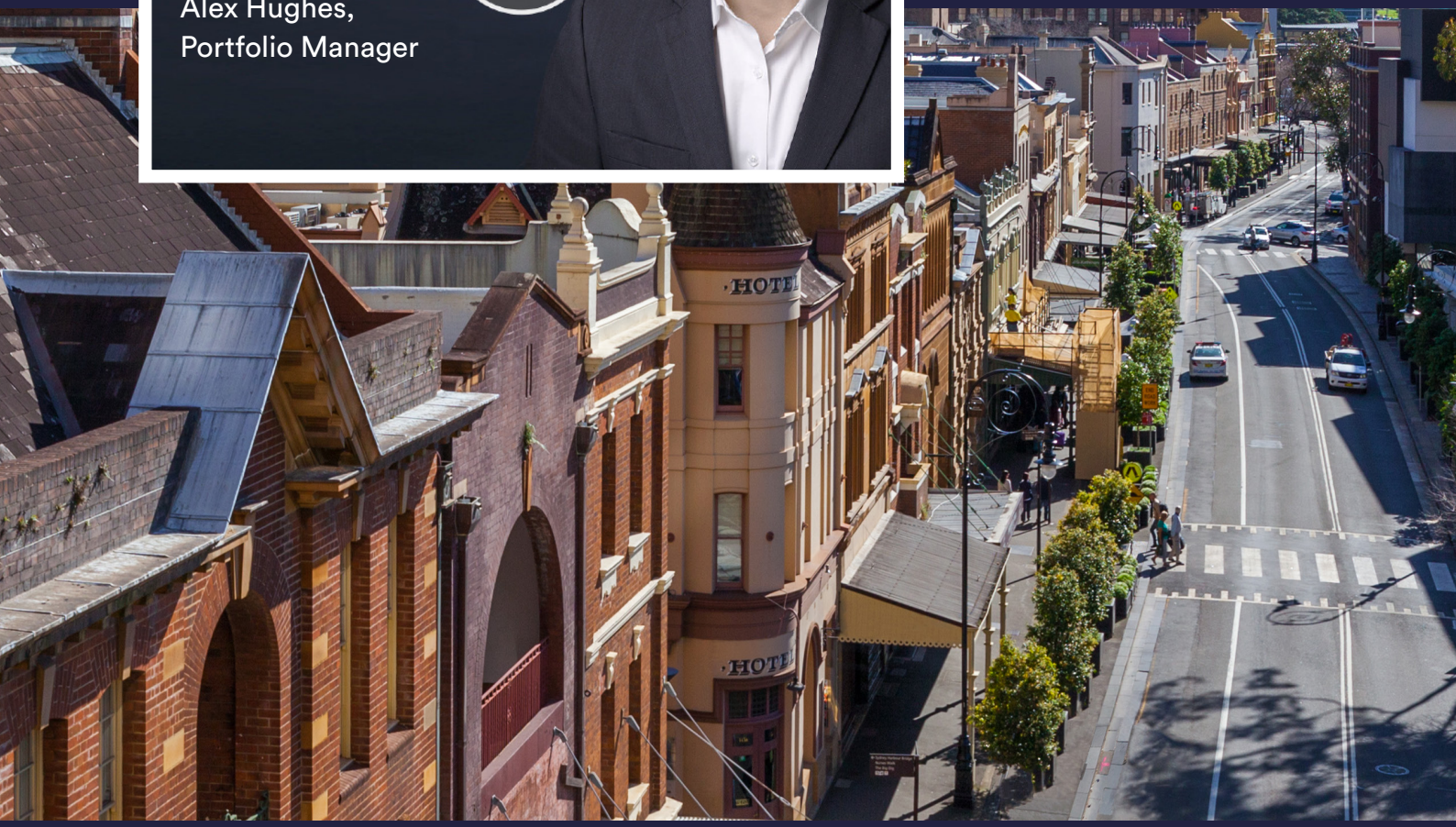
31 March 2018

InvestSMART Australian Small Companies Fund

QUARTERLY UPDATE

This quarter Alex discusses:

- Market favouring hyper-growth stocks
- Portfolio quality improving with recent trades
- Encouraging news from our companies



InvestSMART Australian Small Companies Fund

PERFORMANCE TO 31 MARCH 2019	1 mth	3 mths	6 mths	1 yr	Since Inception (p.a.)
InvestSMART Australian Small Companies Fund	0.01%	4.46%	-7.37%	-5.96%	4.19%
S&P/ASX Small Ordinaries Accumulation Index	-0.12%	12.59%	-2.83%	5.78%	11.52%

Key points

- **Market favouring hyper-growth stocks**
- **Portfolio quality improving with recent trades**
- **Encouraging news from our companies**

Lessons from tech boom 2.0

Stock markets are very good at taking sensible ideas and butchering them in the extreme. In a logical process of creative destruction, obsolete businesses are replaced by companies offering better or cheaper goods and services. The stock market becomes the butcher when valuations are pushed to extremes.

While the profitability of today's tech stars contrasts with 1999, when businesses were valued on the number of eyeballs they attracted, the stock market has his butcher's apron on and is reaching for the knife.

While a handful of local stocks deserve high valuations as they win more customers overseas, many imposters are riding on their coattails. Owning unexciting businesses with good prospects isn't enough to keep up with the market currently. Avoiding mining companies hasn't helped our returns, either, as they're a significant proportion of the index.

Portfolio

During March, we added to online job classifieds business **Seek**. Its price-to-earnings ratio (PER) of ~30 would be lower were it not investing heavily to grow its Asian business.

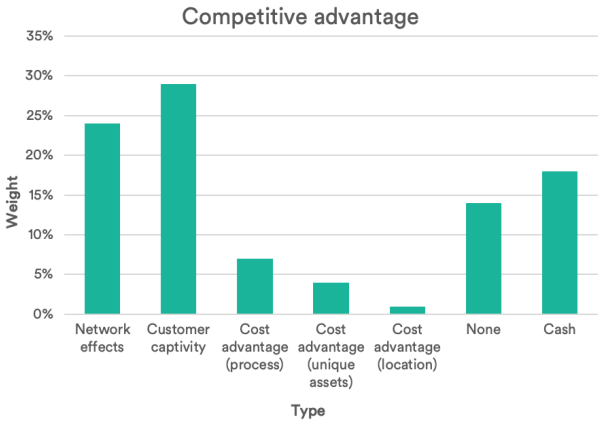
Success, particularly in China, will rapidly bring down the PER. The recent announcement that former **Commonwealth Bank** chief Ian Narev will join Seek as chief of Asia helps make Seek's large expansion more manageable for founder and CEO Andrew Bassat.

Seek strengthens our base of competitively advantaged businesses, joining **Audinate, Xero, Carsales**, and **Frontier Digital Ventures**, as businesses protected by network effects, which become more valuable as more people use their networks.

"WHILE THE PROFITABILITY OF TODAY'S TECH STARS CONTRASTS WITH 1999, WHEN BUSINESSES WERE VALUED ON THE NUMBER OF EYEBALLS THEY ATTRACTED, THE STOCK MARKET HAS HIS BUTCHER'S APRON ON AND IS REACHING FOR THE KNIFE"

Customer captivity is another well-known competitive advantage that features heavily in the portfolio, through holdings such as air traffic control provider **Adacel**, utility billing solutions provider **Hansen** and **Pushpay**, a digital payments business leading the US faith industry.

As the ability to earn high profits over long periods from durable competitive advantages is our guiding principal, in future we'll discuss the portfolio within this context more frequently.



Exiling Afterpay's ghost

We owned **Afterpay** long before it became a market darling. Unfortunately we sold it way, way too early, after our initial purchases were under $2.

Afterpay was initially an unprofitable start-up with a fledgling buy-now pay-later business in Australia. Clothing purchases were the initial target, long before root canals, flights and an overseas expansion caught the market's attention.

We clearly misinterpreted how it might evolve. We can justify that mistake, as we've never seen a business like Afterpay before. The future is always easier to predict in hindsight.

But the lesson not to sell a potential global juggernaut before its even conquered the local Ugg-boot market is useful today.

Audinate

Audinate has become our biggest position after its share price quickly doubled. It shares several similarities with Afterpay when we sold it. Rapid revenue growth, slim profits and a high valuation based on traditional measures. Yet, mainstream brokers and the financial press are still asleep to the opportunity.

Audinate's revenue could easily increase ten times as audio-visual technicians make the inevitable shift to digital systems. And due to Audinate's exceptional economics, including virtually zero customer acquisition costs (the don't need to reconvince Yamaha and co to use their technology), zero customer losses, high gross margins, and the company's big investments largely behind it, Audinate will gush cash as its customer base increases dramatically over time.

In summary, we'll be holding on for the ride despite the often higher volatility that comes with owning fledgling businesses that aren't well understood.

We've continued increasing the portfolio's quality by selling debt solutions provider **FSA Group** and online learning software company **3P Learning**, while trimming consumer loans company **Thorn Group**.

Thorn recently reached out to shareholders as part of a strategic rethink. We know exactly what we want the company to do and expect large shareholders will offer the same advice. Hopefully some good news for this cigar butt isn't far away.

Company news

RPMGlobal's transition to a software as a service (SaaS) business took another important step in March, when it began hosting its software in the cloud. With its development spending past its peak, RPMGlobal's earnings should grow nicely as confidence returns to the mining sector.

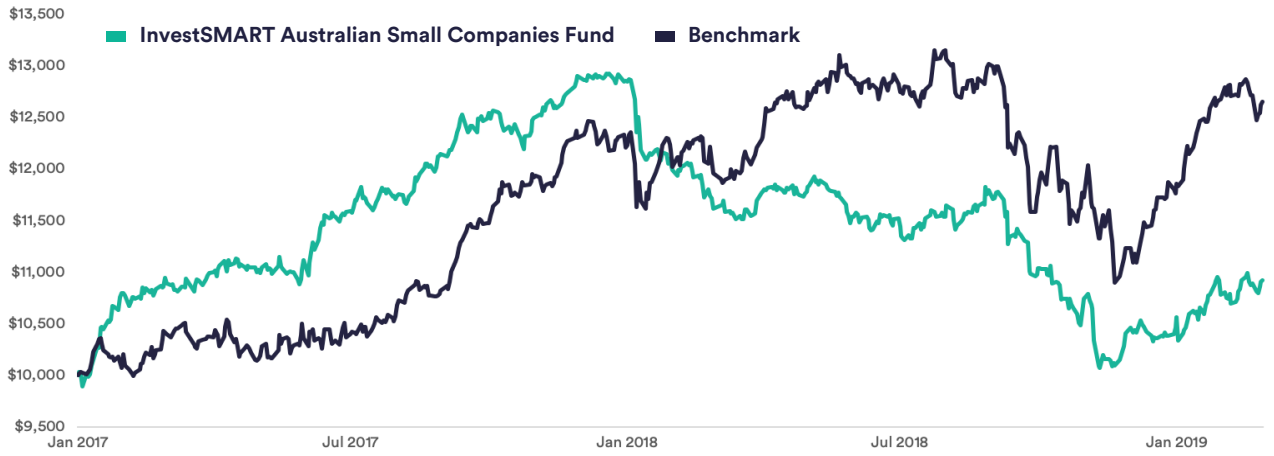
Adacel's CEO resigned in March, which wasn't surprising given the large share price fall under his watch. Adacel needs new leadership, though the transition could stall sales and lead to a rebasing of expectations.

MSL Solutions's share price rebounded strongly after winning its first contract to provide its world handicapping

solution to the Swiss Golf Federation. This increases its chances of attracting further European associations, as well as golf clubs, before the World Handicapping System launches in 2020.

Dicker Data forecast double-digit revenue and earnings growth for the coming year, continuing a long trend. The share price has increased quickly since our recent initial purchases, but we're holding for the long term given Dicker Data's impressive track record in a tough industry.

PERFORMANCE OF $10,000 SINCE INCEPTION



ASSET ALLOCATION

Sector	Weighting
Information Technology	43.78%
Cash	17.96%
Consumer Discretionary	16.60%
Financials	5.49%
Materials	4.08%
Industrials	3.83%
Real Estate	3.21%
Energy	2.95%
Communication Services	2.11%

TOP 5 HOLDINGS

Sector	Weighting
Audinate	7.44%
RPMGlobal Holdings	5.78%
Redflex Holdings	5.46%
Hansen Technologies	4.71%
Adacel Technologies	4.52%

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 INITAL 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; excludes brokerage. All yield figures include franking. All performance figures, graphs and diagrams are as at 31 March 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. Table 1 performance figures; after investment and admin fees, includes brokerage. Unit pricing taken at the end of each month.

Important information

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