INVESTSMART

31 May 2019

Intelligent Investor Equity Growth Portfolio

Monthly Update

PERFORMANCE TO 31 MAY 2019 (AFTER FEES)	1 MTH	3 MTHS	6 MTHS	1 YR	2 YRS (P.A.)	3 YRS (P.A.)	S. I. (P.A.)
Intelligent Investor Equity Growth	1.05%	4.56%	9.11%	4.38%	6.12%	6.49%	9.22%
S&P ASX 200 Accumulation Index	1.71%	4.88%	15.32%	11.08%	10.35%	10.60%	8.86%
Excess to Benchmark	-0.66%	-0.32%	-6.21%	-6.70%	-4.23%	-4.12%	0.37%

'If you played golf and you hit a hole in one on every hole, nobody would play golf, it's no fun. You've got to hit a few in the rough and then get out of the rough. That makes it interesting.' **– Warren Buffett.**

'The market is quickly becoming less about finding good businesses and more about managing the day's headlines.' Sports talk radio host Mike Francesa.

'The conventional view serves to protect us from the painful job of thinking.' John Kenneth Galbraith.

Premature election relief?

It wasn't just the sound of corks popping that you could hear after Scott Morrison was voted back in as Prime Minister. With changes to franking credits, negative gearing and a host of other taxes proposed by Labor largely nixed, share prices of companies that had dodged a bullet popped as the market celebrated a return to business as normal. But what is normal?

Although Australian property prices appear to be stabilising in the major markets of Sydney and Melbourne, high debt levels will continue to weigh on economic activity. Earnings estimates are mostly falling, so we're hunting sensibly priced businesses that can add value without relying on strong credit growth.

As you'll read below, our preference for entrepreneurial, founder-led businesses shows our CEOs are energetically planting the seeds of future success even though it often doesn't show up instantly as higher earnings. Failure to sacrifice short-term earnings growth to invest in the long-term health of your business in today's competitive markets is a sure path to ruin.

The surprise Coalition victory didn't have a material impact on the portfolio's returns. In the spirit of Jesse Livermore, who said 'It never was my thinking that made the big money for me. It always was my sitting.', there were no transactions this month. But there were some important company announcements.

Portfolio

We recently interviewed **Audinate** CEO Lee Ellison not knowing that just a month later he would announce that he was handing over the management reins to chief technology officer and co-founder Aidan Williams.

Although it doesn't guarantee success, we're delighted that an internal successor with skin in the game and expert knowledge of the industry and Audinate's customers has been appointed. With little in the way of competition, Williams has every opportunity to create the value needed to justify today's valuation.

Hansen Technologies' share price jumped 30% in response to its debt-funded acquisition of Canadian software catalogue business Sigma Systems. While the EV/EBITDA (enterprise value to earnings before interest, tax, depreciation and amortisation) multiple of 8.3 is only half Hansen's valuation, Canadian software businesses don't change hands this cheaply unless there are issues.

While the jury's out regarding Hansen's ability to sell Sigma's products to new and existing customers, Hansen needs acquisitions to grow. As the debt it's used to buy Sigma will rule out further material deals for a while, management needs to deliver.

Shareholders might have to be patient, though, as the deal increases Hansen's exposure to the telecommunications market from 17% to 38%. The telco sector often moves glacially, as providers can't afford technology issues. Only around 20% of the sector has moved its systems to the cloud, for example, despite huge cost savings.

The bad

Reliance Worldwide Corporation's share price initially dropped over 20% after announcing a fairly small and well-flagged profit warning. The announcement was very messy, reflecting numerous changes in the business. But it was management's suggestion that its innovative products were already mature despite only accounting for ~10% of total market sales that likely shocked investors.

At least the recent acquisition of John Guest in the UK is on track. Management currently has a lot of balls in the air, and we'd very much like to see the company's free cashflow improve.

Like Buffett's quote above, **Link Administration** is squarely in the rough. It blamed a profit downgrade on Brexit delaying IPOs where Link was the administrator. Indeed, UK financial activity has recently collapsed. Higher costs have also lingered to deal with regulatory changes affecting Australia's superannuation sector.

Our long-term case for owning Link includes further acquisitions in an industry that requires scale (i.e. large size) to relentlessly reduce costs. Link also owns a 44% share of PEXA (a fledgling monopolistic digital property lodgement and settlement business in Australia) that should eventually earn material profits when it reaches scale.

The company's investor day is 18 June and we'd like to see its major contract with REST signed, sealed and delivered. Negotiations have been 'advanced' for well over a year. Link also needs to renew agreements with all its major Australian superannuation clients over the next couple of years.

Brexit is also affecting our holdings in **Clydesdale Bank** and Reliance Worldwide, but eventually we expect to look back at this tumultuous time as a wonderful buying opportunity.

The king surrenders his crown

James Packer announced that he's ceding control of **Crown Resorts** by selling a 20% stake in the company at $13 per share to his friend and ex-business partner Lawrence Ho of Chinese gaming company Melco Resorts and Entertainment. That's nearly half Packer's shareholding at a price well below the prior offer of $14.75 per share from US gaming company Wynn that's now likely permanently off the table.

> **“WE'RE FINDING VALUE IN HIGH QUALITY BUSINESSES THAT HAVE BEEN BATTLE TESTED THROUGH MANY ECONOMIC ENVIRONMENTS AND THAT TRADE AT SAFER VALUATIONS.**

Crown remains a small holding due to valuation, and we expect to find better ideas like 360 Capital over time. **360 Capital**'s share price hasn't budged despite announcing a 50/50 joint venture named 360 Capital Global Digital Infrastructure Partners with telecommunications entrepreneur David Yuile.

Initially a US$250m fund will target data centres, dark fibre, and cell towers and sites both in Australia and abroad. We're delighted that 360 Capital founder Tony Pitt has partnered with Yuile and bemused that 360's share price reflects no value for recently proposed fund raisings or Pitt's track record of success.

Summary

While the market is currently infatuated with a small group of technology companies and large dividend payers, we're finding value in high quality businesses that have been battle tested through many economic environments and that trade at safer valuations.

We also continue to invest in undiscovered emerging leaders. As Audinate's success shows, the returns for uncovering tomorrow's heroes and holding patiently until the market catches on are huge. Backing founder-led businesses that can compound your money at high rates for a very long time is what continually excites us about helping you grow your wealth.

Portfolio allocation

ASSET ALLOCATION	
Sector	**Weighting**
Consumer Discretionary	19.56%
Industrials	19.18%
Information Technology	15.84%
Financials	10.21%
Communication Services	8.86%
Real Estate	8.69%
Health Care	6.69%
Cash	4.23%
Other	4.02%
Consumer Staple	2.71%

TOP 5 HOLDINGS	
Security	**Weighting**
Audinate Group Ltd (AD8)	5.99%
Hansen Technologies Limited (HSN)	5.18%
Seek Limited (SEK)	5.15%
Frontier Digital Ventures Ltd (FDV)	5.12%
Lovisa Holdings Ltd (LOV)	4.93%

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 May 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.

Skin In The Game podcast

Join portfolio managers Nathan Bell and Alex Hughes weekly as they discuss stocks, economics, their respective portfolios and much more.

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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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