INVESTSMART

31 May 2019

InvestSMART Australian Small Companies Fund

Monthly update

PERFORMANCE TO 31 MAY 2019	1 MTH	3 MTHS	6 MTHS	1 YR	2 YRS (P.A.)	S. I. (P.A.)
InvestSMART Australian Small Co. Fund	1.95%	5.47%	7.22%	-2.55%	2.24%	6.27%
S&P/ASX Small Ordinaries Accum. Index	-1.25%	2.69%	10.91%	2.06%	13.13%	11.95%

May Review

Faith sector payment provider **Pushpay** (down 1% in May) delivered its maiden operating profit through 40% higher processing volumes and tight cost control. New churches grew a relatively pedestrian 5%, but by targeting congregations with as many as 40,000 attendees, revenue per customer grew 33%. Focusing on larger churches is enhancing Pushpay's economics.

Traditional value investors may baulk at the high price ascribed to Pushpay's measly earnings, but that misses an accounting quirk that understates economic reality.

That's because Pushpay expenses 100% of its customer acquisition costs in the first year, even though customers are likely to stick around for many years. The customer retention rate has been 100% since listing, after all. This means Pushpay's income statement reflects a flood of marketing costs but only a trickle of revenue.

We support their growth strategy for several reasons. Firstly, Pushpay earns fantastic returns on its marketing, with each dollar spent adding several dollars in future gross profit. And it also allows earnings power to be built in a tax efficient manner.

To paint a clearer picture of economic reality, we recognise the customer acquisition costs over the customer's life. If we assume Pushpay retains its customers for 10 years, the PE ratio falls to 30x, which is attractive for a market leader with structural tailwinds.

The same thinking applies to accounting software juggernaut Xero (up 10% in May), which also invests heavily in marketing to grow quickly. Subscribers increased by 31% to 1.8m, with standout growth of 48% in the UK.

A sizeable userbase aids Xero's quest in becoming the de-facto marketplace for small business apps, similar to the App Store and Google Play's position with smartphones. Xero's app store boasts 700 apps from third party developers, which adds another layer of competitive strength and pricing power to its core accounting software business.

We're one step closer to realising value from Thorn Group (down 6% in May), after several suitors made proposals to buy some or all of the group's assets. Operating performance continues to deteriorate, with net tangible assets per share wilting to $1.06 from higher bad debts and legal expenses. But we're still hopeful of an acceptable return due to the large margin of safety that exists.

In unfortunate news, Republican lawmakers signed a bill to rid Texas' intersections of photo enforcement cameras, which will eventually strip away 13% of Redflex's (down 8% in May) revenue. The actual runoff could take years if governments complete existing contracts. This was partially offset by a $43m, 5-year contract to own and operate new speed cameras in Pennsylvania, backed by a $591k on-market purchase by the Chairman.

Our investment case centred on Redflex reigniting its sales engine after a lengthy legal hiatus, and with $75m of new work won in the last 12 months, they've certainly achieved that. But losing Texas is a painful body blow that will slow its recovery.

Audinate (up 28% in May) was introduced to more investors in May when two stockbrokers (Blue Ocean and UBS) initiated coverage with price targets between $9.45-10.0 (which is more than 3x our cost base).

Founder and Chief Technology Officer Aidan Williams will step into the chief executive role in September, replacing 11-year veteran Lee Ellison. Mr Williams' intimate understanding of the company's technology, processes and people make him our preferred successor, so we're expecting a smooth transition.

Dicker Data's (up 22% in May) good form continues with first quarter pre-tax profit up 47% over the prior period, which puts it on track to exceed its earnings guidance. Management displayed further confidence with more on-market buying.

Hansen (up 30% in May) acquired US based Sigma Systems for $166m from a private equity seller. Sigma's looks a decent business, with high margins and sticky customers that are likely to compliment Hansen's existing business. But a 100% debt funded acquisition adds risks.

We're inclined to give management the benefit of the doubt, as they have skin in the game and a history of careful acquisitions, but we'll be refining our view in the coming months.

Portfolio allocation

ASSET ALLOCATION	
Sector	**Weighting**
Information Technology	45.09%
Cash	20.18%
Consumer Discretionary	12.49%
Communication Services	9.03%
Financials	5.05%
Industrials	4.61%
Energy	2.51%
Health Care	1.04%

TOP 5 HOLDINGS	
Security	**Weighting**
Audinate Group Ltd (AD8)	10.01%
RPMGlobal Holdings Ltd (RUL)	6.39%
Hansen Technologies Limited (HSN)	6.39%
Lovisa Holdings Ltd (LOV)	4.90%
Frontier Digital Ventures Ltd (FDV)	4.77%

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.

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

Important information

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