

 INTELLIGENT INVESTOR

Nathan Bell • Portfolio Manager
28 June 2022

How to make friends with a bear

INIF • IIGF • INES



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Past performance is not a reliable indicator of future results. Our performance figures are hypothetical and based on recommendations from Intelligent Investor using stock prices at date of publication. Brokerage costs have not been included. As stocks rise and fall, returns may be negative. We encourage you to think of investing as a long-term pursuit.

**“You can always count on the
Americans to do the right thing after
they have tried everything else.”**

– Winston Churchill



“It isn’t going to be immediate that we see 2 per cent inflation ... It will take a couple of years. But it’ll be moving down.”

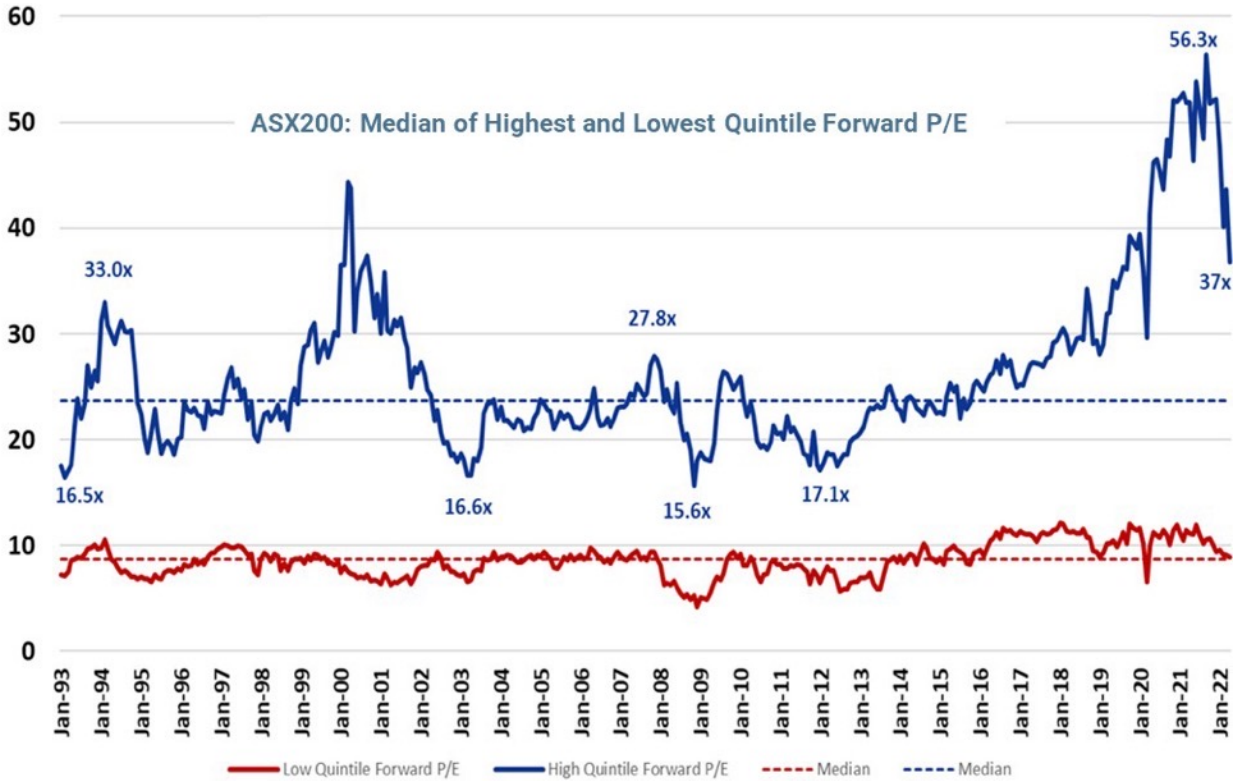
– Loretta Mester, President of the Federal Reserve Bank of Cleveland



Where are we?

- Contrarian resources picks have performed well
- Good stock picking; few mistakes
- Maintaining valuation discipline has protected portfolios
- Profit taking, outright sales and several takeovers realised lots of value that's now patiently sitting in cash
- Cash is the reward for good stock picking and is perfectly timed
- Own numerous owner-led stocks that will emerge bigger and better
- Compounders starting to get cheaper

Back down to dot-com bubble high



Source: livewire via Lazard

How far to go?

- “Disruptive innovation in the public equity markets today is valued at about \$US7 trillion globally, which is maybe 8 per cent of total global market cap. We believe that \$US7 trillion will go to \$US210 trillion by 2030.”
- “We’re ready for prime time.”

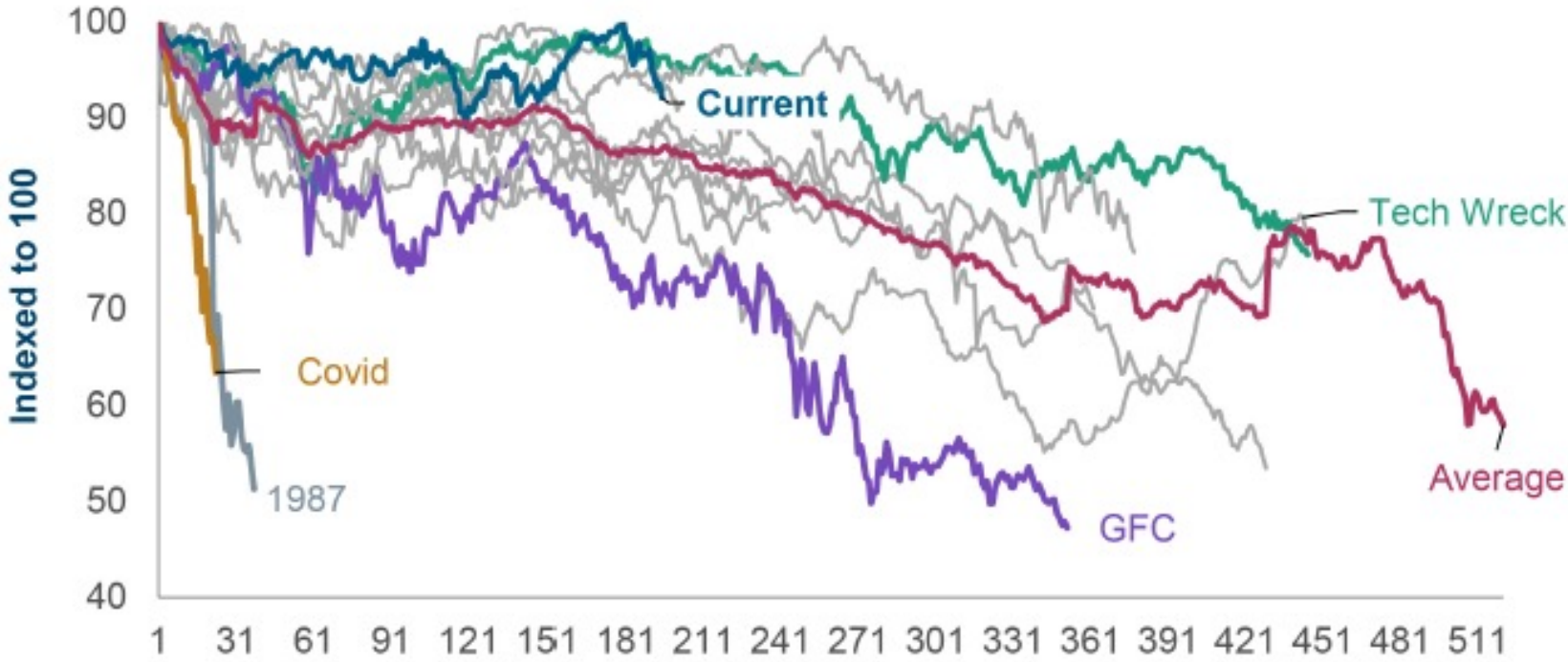


How far to go?



How far to go?

MSCI Australia bear market comparisons



Source: livewire via Factset, as at 17 May 2022

A classic bear market?

Tech Wreck Bear Market



Source: stockmarket cycles via stockcharts.com

What shoes have dropped

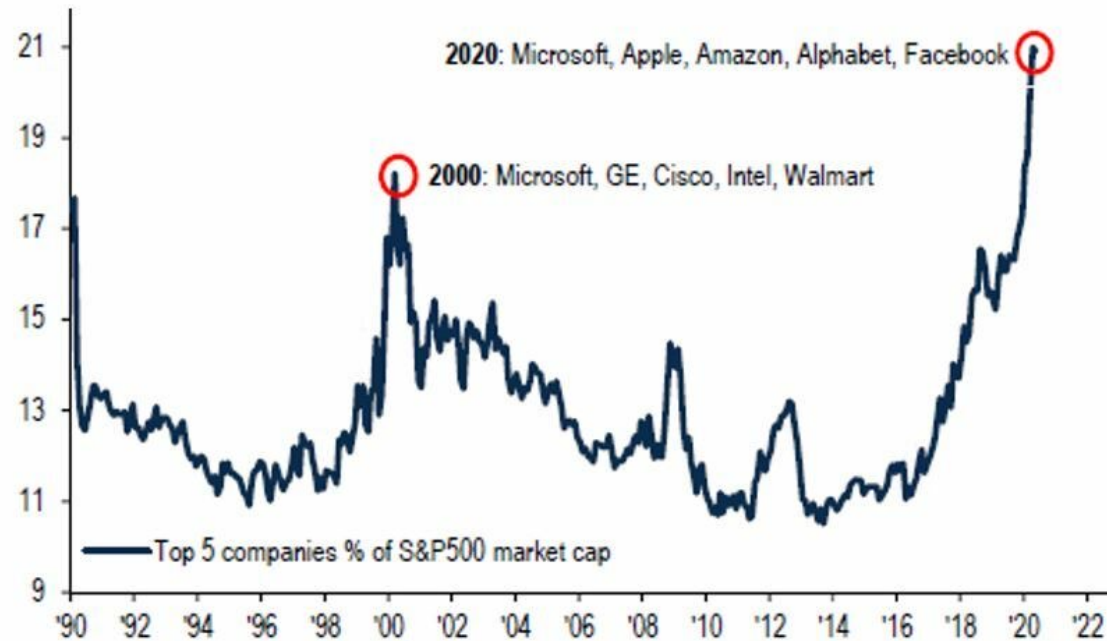
- Crypto
- Unprofitable companies
- US Technology sector
- Venture Capital funding door has slammed shut
- Narrow market leaders starting to crack
- ???
- ???

What shoes will drop

- Markets rational so far
- Credit markets still liquid though covenants and yields adjusting
- Record merger and acquisition activity
- Valuations of Australia's best businesses still way above average (herding)
- Individual investors (margin loans)
- Fund manager redemptions
- Housing market – Builder bankruptcies
- Massive pool of fixed rate mortgages expire next year

Reliable sign of a bull market peak

S&P 500 5 largest stocks as a % of market cap

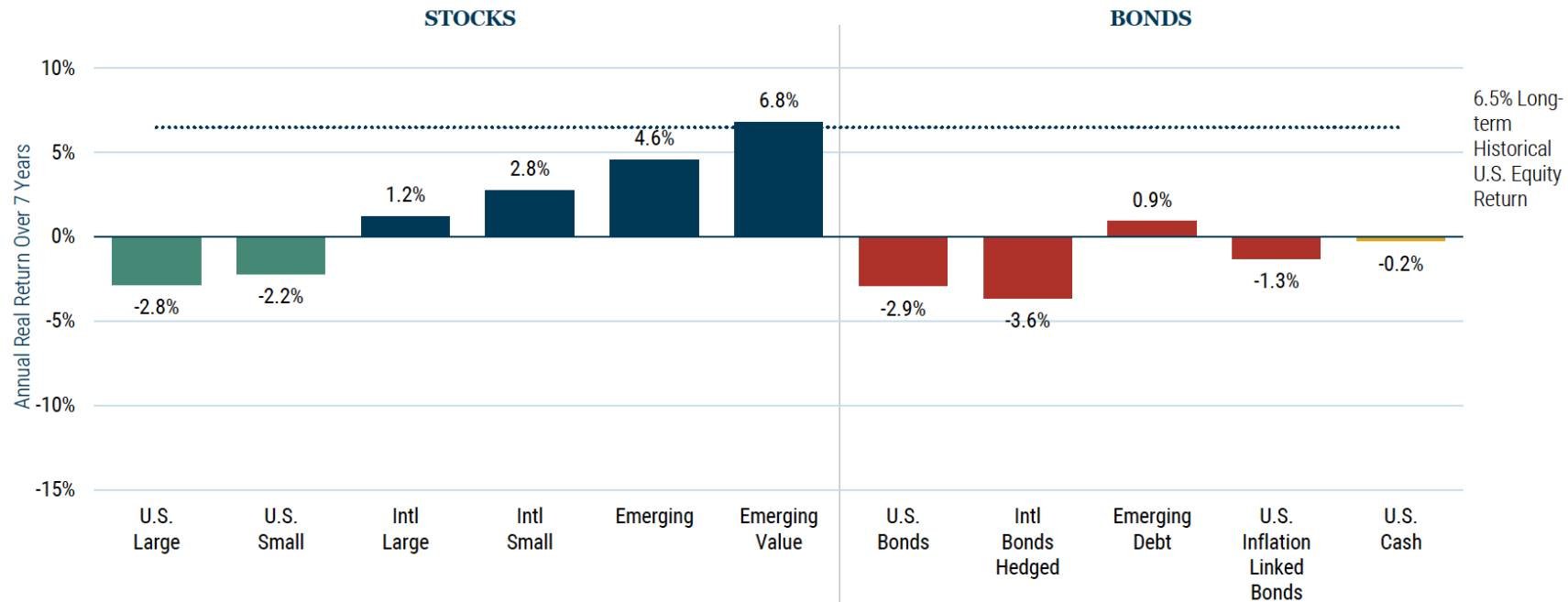


Source: PM Capital via Bernstein, BofA Merrill Lynch Global Investment Strategy, Bloomberg, Datastream, Global Financial Data.

Future returns??

7-year asset class real return forecasts

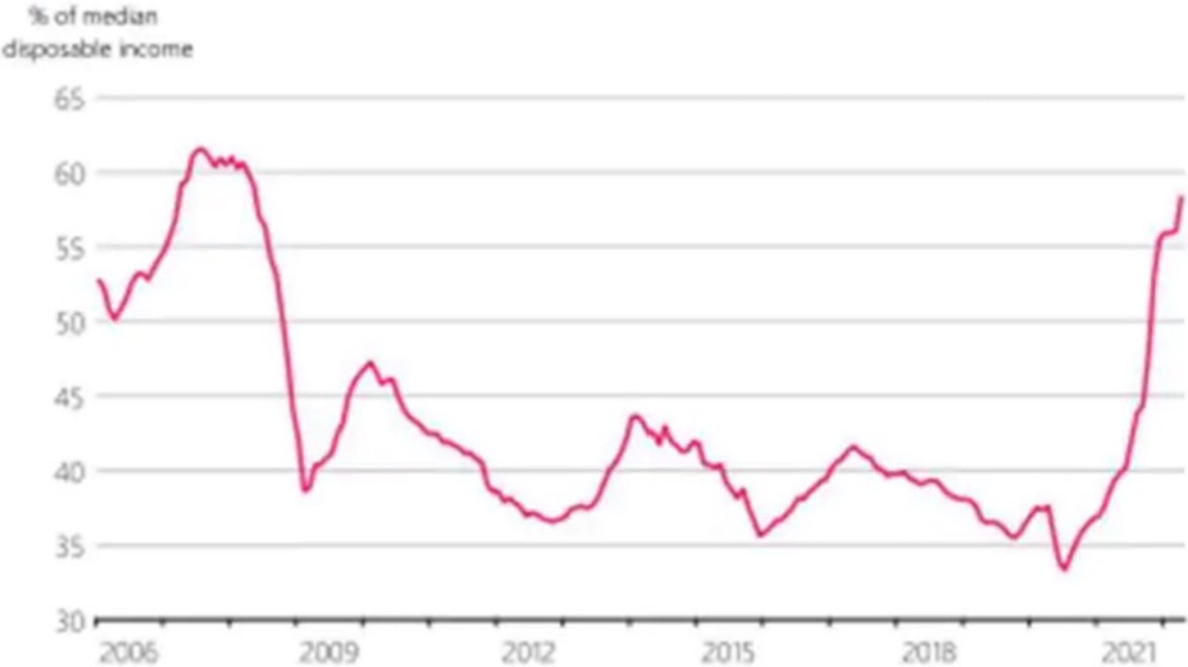
As of May 31, 2022



Source: GMO LLC

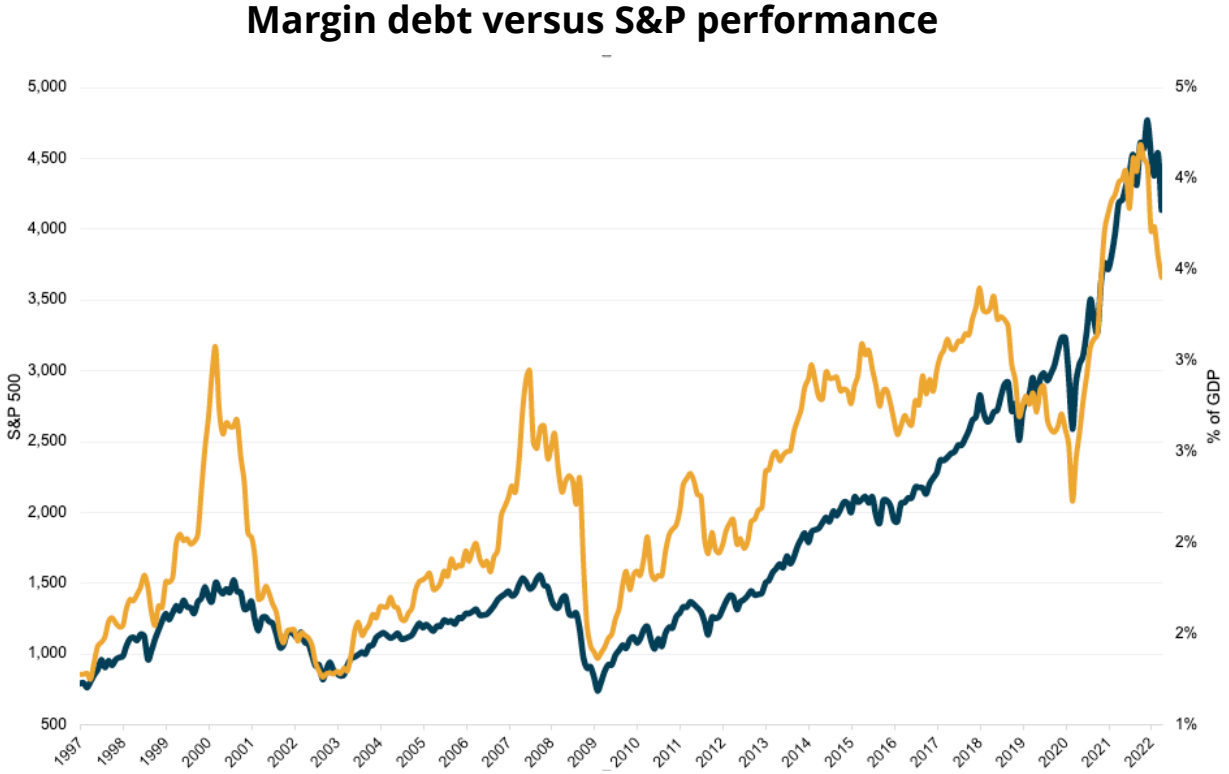
Peak profit margins (ever)

Indicative mortgage payments for a new buyer



Source: Citi Velocity via RBNZ MPS May 2022

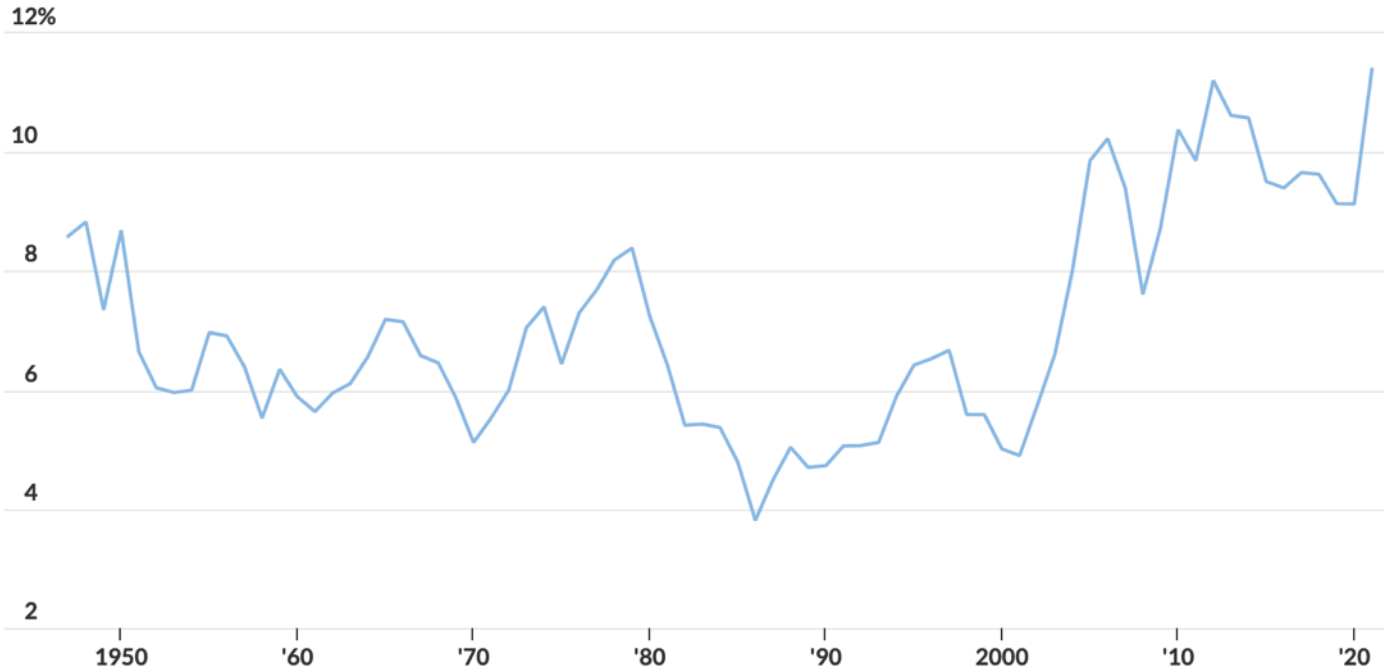
Margin debt chart vs S&P500



Source: Livewire via Bloomberg, Finra, BIS, as at 30 April 2022.

Peak profit margins (ever)

US Corporate profits after tax as a % of GDP



Source: MarketWatch via US Bureau of Economic Analysis via FRED

Peak profit margin trends

- Globalisation of manufacturing and supply chains
- Falling wages as a percentage of GDP
- Low and falling interest rates
- Huge global technology companies with incredible margins
- Cheap and plentiful commodities
- Accommodative monetary and fiscal policies
- Bull market in everything – Global housing boom

The great reset

- Slower revenue growth for most companies
- Costs increasing almost everywhere – energy; wages; fuel;
- Deglobalisation to secure supply (national security)
- Interest rates increasing
- Slower credit growth
- Less funding for unprofitable businesses = staff cuts
- Advertising budgets being slashed – digital more immune?
- First downturn for many companies – how recurring are their recurring revenues?



What if I'm wrong

- Bubbles rarely hit the same group of stocks twice
- Earnings still under pressure even if inflation starts to fall
- Government budgets need to be balanced
- Interest rates can't go much lower than zero
- Deglobalisation not short term
- Geopolitical tensions unlikely to diminish

How to make friends with a bear



How to make friends with a bear

- COVID-recovery stocks with increasing margins (AIA, LLC, RUL)
- Hidden gems (RUL, AD8, FDV)
- ESG has helped create cheap, irreplaceable resources companies (WPL, AWC, WHC)
- Don't give up on tech, but choose wisely (AD8,FDV)
- Irreplaceable infrastructure (AIA)
- M&A will slow, but takeovers may continue as growth slows
- Hold some cash; Buy in stages
- Do the work; be patient!



Appendix

Proven II approach



High quality businesses

- High insider-ownership – FDV, RUL, TGP, AD8, PNI, IFT
- Long growth runways – All the above
- A large discount to intrinsic value – LLC, AIA, VGL, UMG

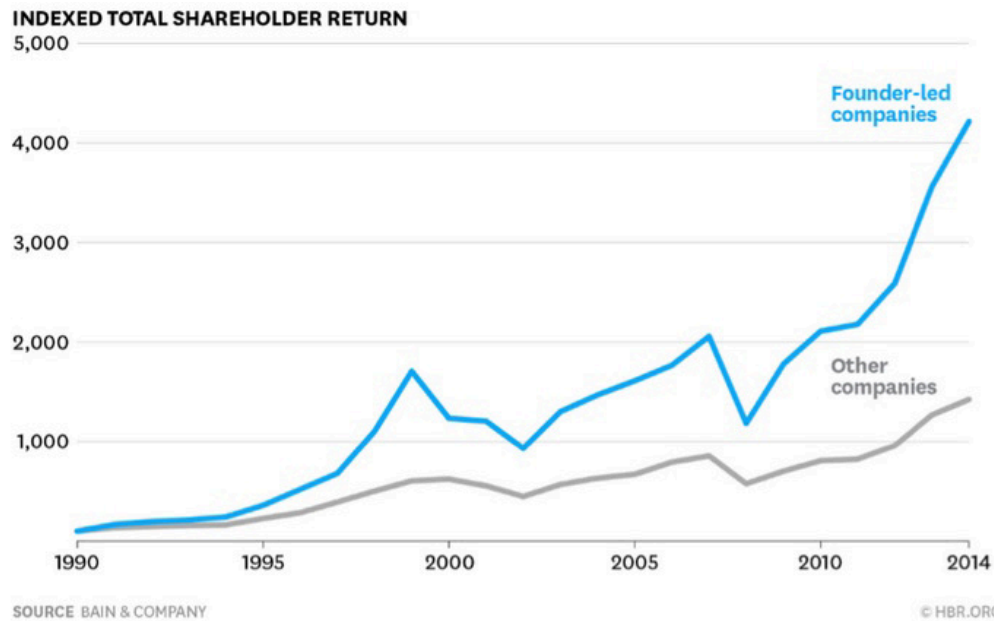
Special situations

- New CEO – LLC
- Busted IPOs
- Re-capitalisations
- Spin-offs – FDV
- Hidden assets – TGP

Best corporate governance: Skin in the game!

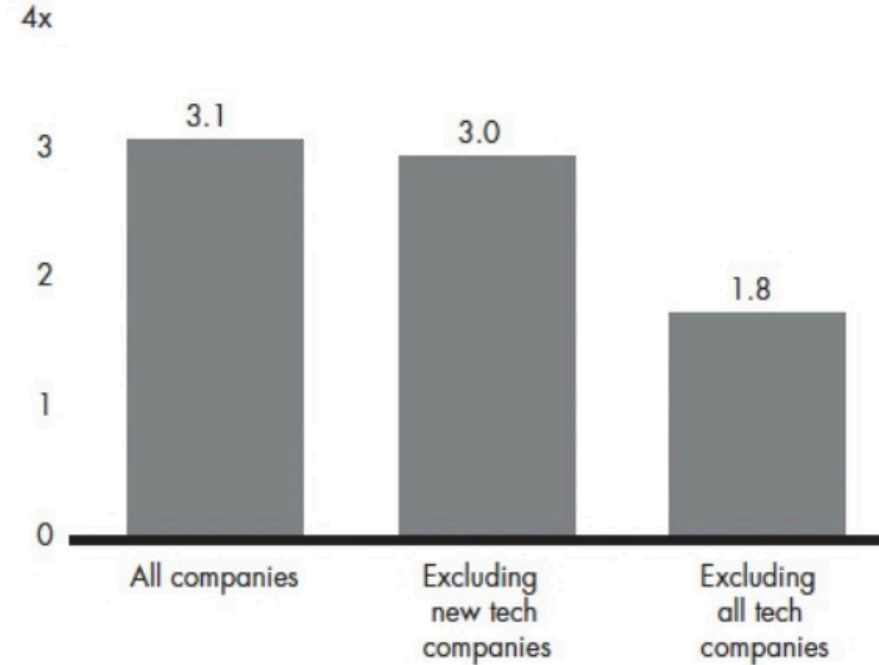
Founder-led companies vs S&P 500

Founder-led companies outperform the rest
Based on an analysis of S&P 500 firms in 2014

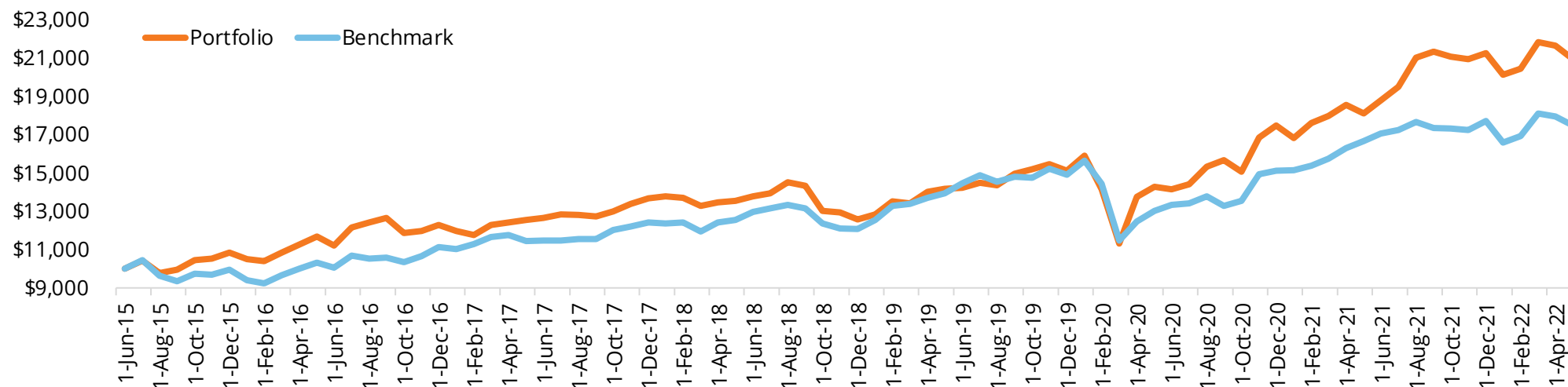


True even with tech companies excluded

Founder's Index vs other S&P 500



Growth Portfolio Performance



	1 yr	2 yrs	3 yrs	5 yrs	Since Inception
Growth Portfolio	15.7%	21.1%	13.9%	10.8%	11.3%
Benchmark	4.8%	15.9%	7.8%	8.8%	8.4%
Difference	10.8%	5.2%	6.1%	2.0%	2.9%

Why has the fund performed so well?

- Contrarian resources picks have performed very well
- Good stock picking; few mistakes
- Maintaining valuation discipline has recently protected portfolio
- Numerous undiscovered owner-led stocks
- Profit taking, outright sales and several takeovers realised lots of value that's now patiently sitting in cash
- The high cash balance is the reward for good stock picking and is perfectly timed



BALANCE SHEET

ASSETS	3,476,700.00
Current Assets	1,238,700.00
Non-Current Assets	2,238,000.00
Liability	3,576,767.00
Current Liability	2,558,568.00
Non-Current Liability	1,018,199.00
EQUITY	2,571,212.00
Current EQUITY	3,354,312.00
Non-Current EQUITY	5,332.00

CASHFLOW STATEMENT

OPERATIONS	6,554,224.00
NOT SALES	3,120,563.00
Investment	6,764,984.00
EXPENSES	9,550,452.00
Development	8,337,886.00
Operating expenses	2,899,500.00
Marketing	500,799.00
NET INCOME	59,877,892.80

How will the fund keep performing?

- What performs in increasing interest rate environments?
Value; Cyclical; Hidden gems; Resources; Pricing Power; cash = optionality.
Ten current holdings could double.
- Market potentially priced for losses for many years
= Active management!
- More M&A activity? RUL; AIA; UMG; TAH; EML
- Invest aggressively when higher interest rates and profit downgrades create opportunities. But don't expect a GFC scenario.
- The biggest mistake = buying too early and locking in mediocre returns as interest rates increase.

**“Software is eating
the world.”**

– Marc Andreessen



Frontier Digital Ventures (ASX:FDV)

- Owns (stakes) in 18 online property classifieds businesses
- Increasingly attaining 100% ownership
- Market Cap = \$430m; Potentially worth \$3.5bn-\$5bn
- Insider ownership 20%; Founder/CEO is ex REA and iProperty
- Internet giant Naspers (via OLX) likely acquirer
- Property transactional market dwarfs advertising
- Battle for market share over; time to pull the price levers;
- Reputable fund managers buying shares

Audinate (ASX:AD8)

- Created at the CSIRO
- Market size \$1bn
- 13x the volume of next largest competitor
- 6% insider ownership
- Brokerage coverage increasing
- COVID recovery appearing in higher sales

RPM Global Mining (ASX:RUL)

- Mining software
- Trades at 7x revenue (Xero trades at ~19x)
- Switching to SaaS model
- Insider ownership 11%
- CEO Richard Mathews has done this before
- Lets results do the talking
- Likely takeover candidate
- Sales recovering post-COVID

Pinnacle Investment Management (ASX:PNI)

- Founder/CEO Ian Macoun doing a terrific job
- Insider ownership 46%
- FUM recently reached \$90bn across 20 strategies
- One stop shop for managers with skin in the game
- Investors want independent managers
- Plenty of ways FUM can grow
- Stock was a gift at \$2.50 during the downturn

LendLease (ASX:LLC)

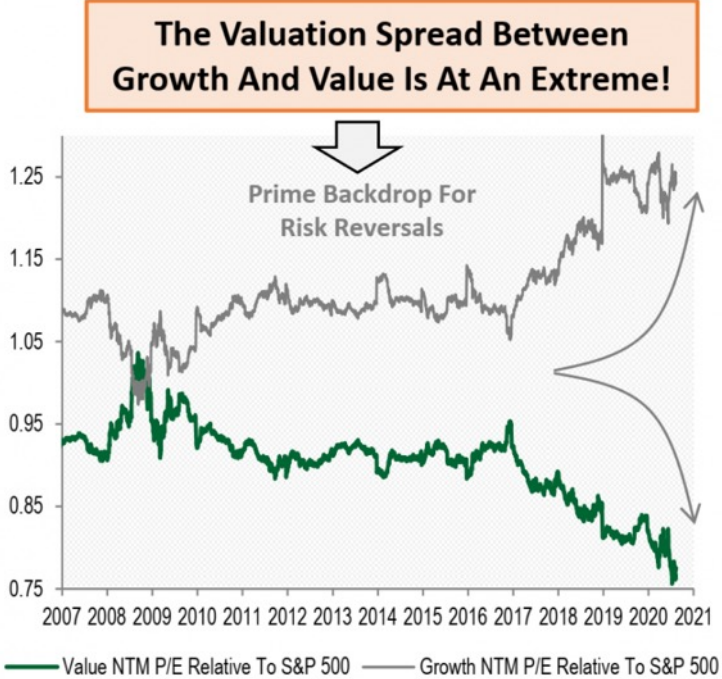
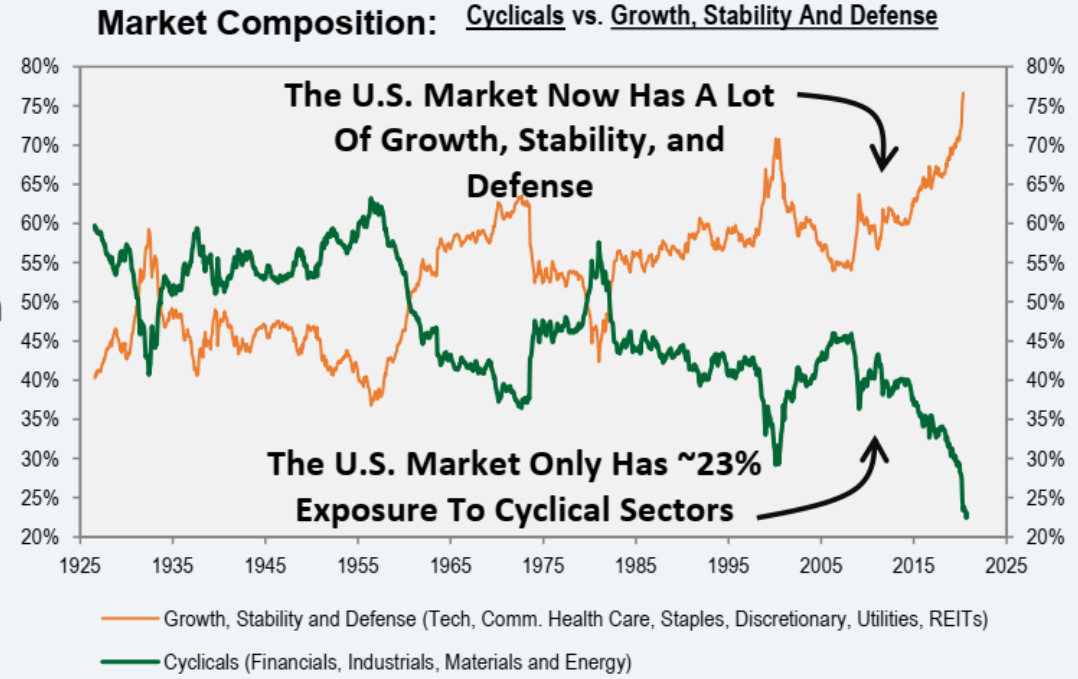
- New CEO: Tony Lombardo
- Sold problematic engineering business
- Development profits have crumbled due to COVID
- World's major cities now reopening
- Lombardo focused on more completions with fewer resources i.e. doing more with less
- Plenty of ways FUM can grow
- Stock was ~\$20 pre-COVID; recent activist pitched \$25

**“There is always
something to buy.”**

– Chris Cuffe



Value investing still works



It's easy (ASX:IIGF)

- Buy and sell at net asset value (NAV) just like a regular stock
- Ready-made portfolio
- Same Intelligent Investor long-term approach
- Focus on high quality businesses
- Long-term holdings help minimize tax
- Semi-annual distributions
- Regular reporting and candid communication
- Management fee of 0.97%; no performance fee





 INTELLIGENT INVESTOR

Gaurav Sodhi • Deputy Head of Research
28 June 2022

Just so stories

Investing is about stories

- Stories are everywhere
- Understand the narrative
- The task is to compare the stories you hear with reality

You must find reality

Two stories



NEW HOPE
GROUP

MAQ: the story by numbers

- Persistently lower profit
- Lower NPAT than 10 years ago
- PER of 132x
- Debt rising
- Looks like a high PE tech stock that deserves to fall

MAQ: the *real* story

- Building a data centre business
- Build, fill, then service
- The business is getting better
- Profit growth is coming

MAQ: how stories meet

- Large capex is being depreciated
- Debt is being used as funding
- Costs counted upfront
- New capacity will generate about \$4m/MW in revenue
- That will double over time as services are added
- Current price counts cost of expansion but not the benefit

NHC: One story

- NHC is up 190% over the year
- Coal price already reflected in the equity price
- Coal still in permanent decline
- Prices will fall swiftly
- There was an opportunity, but it's gone

NHC: Another story

- Move in coal is partly structural
- No supply response
- Quality matters
- Currently generating \$200m a month in EBITDA
- Paying out everything in divs
- Every month coal prices persist, equity value grows

The coda

- Understand narrative
- Listen to stories
- Recognise reality
- Compare stories against reality

The logo for 'i INTELLIGENT INVESTOR' is located in the top left corner. It features a small, stylized 'i' icon with a circular pattern of dots above it, followed by the words 'INTELLIGENT INVESTOR' in a clean, sans-serif font.

Nick Cummings · Analyst
28 June 2022

An undiscovered microcap



Energy One (ASX:EOL)

A software business facilitating
the renewable transition.

5-year share price



Source: Capital IQ

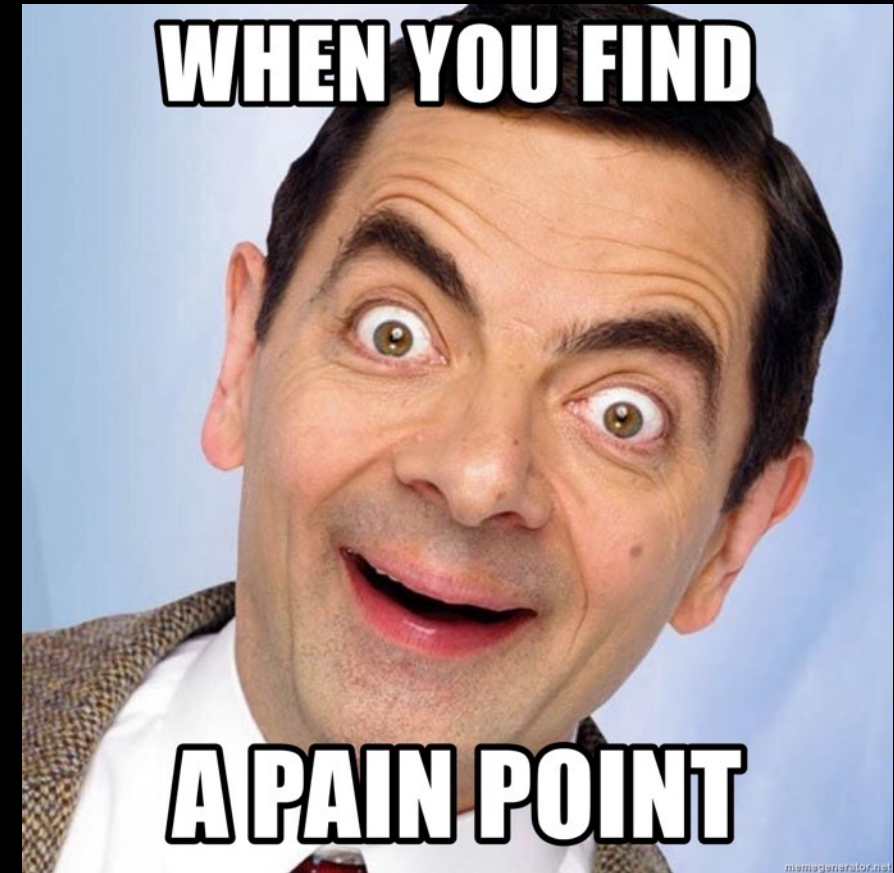
Who is Energy One?

- Provides software and services
- Australia and UK/Europe
- CEO Shaun Ankers
- Board and management own 52%



Industry headaches

- Settlement times
- Transition
- Outsourcing
- Grid management



Business model

- No price risk
- Mission critical with low churn
- Out of the box
- Modules sold per user
- 80% recurring revenues

Energy One's offering



Software

Physical bidding
Energy trading and risk management
Market analytics
Business process automation



Service

24/7 trading room offering
Manages outages

Customers



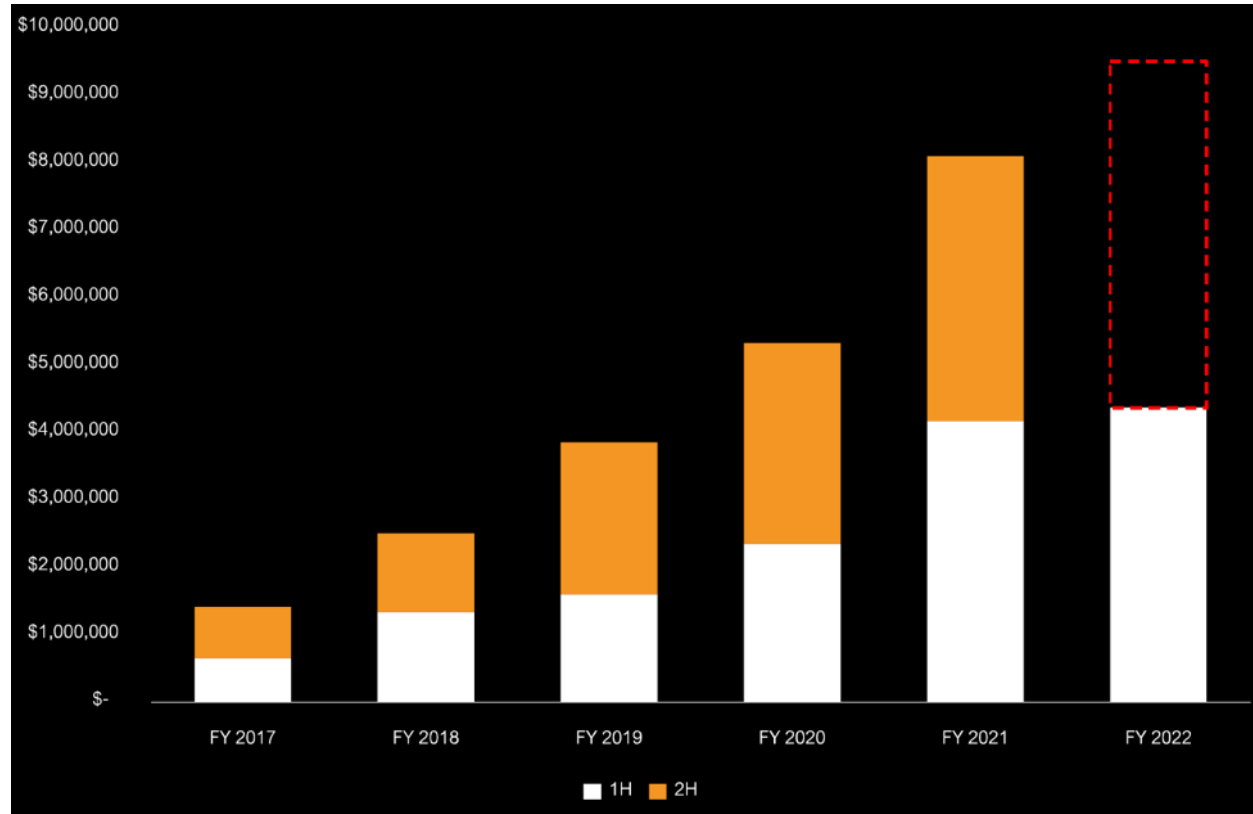
Source: Energy One First Half Results FY22

Growth

- Transition
- Modules per customer
- Cross-sell
- Market share



EBITDA growth



Source: Energy One First Half Results FY22

Consistent profitable growth

Net debt/ EBITDA of 1.5x

Profits convert to cash



- FY23 – Earnings will rise
- European market share
- E world

Note: Stock is illiquid

Q&A



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