31 March 2021

Quarterly Report

Intelligent Investor Australian Equity Growth Fund

(Managed Fund) (ASX:IIGF)

Quarter Highlights

- **Fund returned 2.7% for the quarter**
- **The index benefited from much higher exposure to cyclical stocks**
- **Reporting season was mostly very good for the portfolio**

About Us

With a 20-year track record of beating the market, clear and straightforward language, and an 'open book' approach to stock research and analysis, *Intelligent Investor* offers actionable, reliable recommendations on ASX-listed stocks.

In 2014, *Intelligent Investor* became a part of the InvestSMART family, extending our expertise to even more Australian investors seeking quality analysis and advice.

Portfolio overview

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.

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.

Investment objective

The portfolio aims to achieve a return of 2% above the S&P/ASX 200 Accumulation Index p.a. over five year rolling periods with minimal turnover to allow returns to compound in a favourable tax environment.

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. Nathan returned to *Intelligent Investor* in 2018 as Portfolio Manager, having previously been with *Intelligent Investor* for nine years, spending five of those as Research Director. Nathan has a Bachelor of Economics and subsequently completed a Graduate Diploma of Applied Investment and Management. Nathan is a CFA Charterholder.

Key Fund 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

6 October 2020

SUGGESTED INVESTMENT TIMEFRAME

5+ years

NUMBER OF STOCKS

10 - 35

INVESTMENT FEE

0.97% p.a.

PERFORMANCE FEE

N/A

MINIMUM INITIAL INVESTMENT

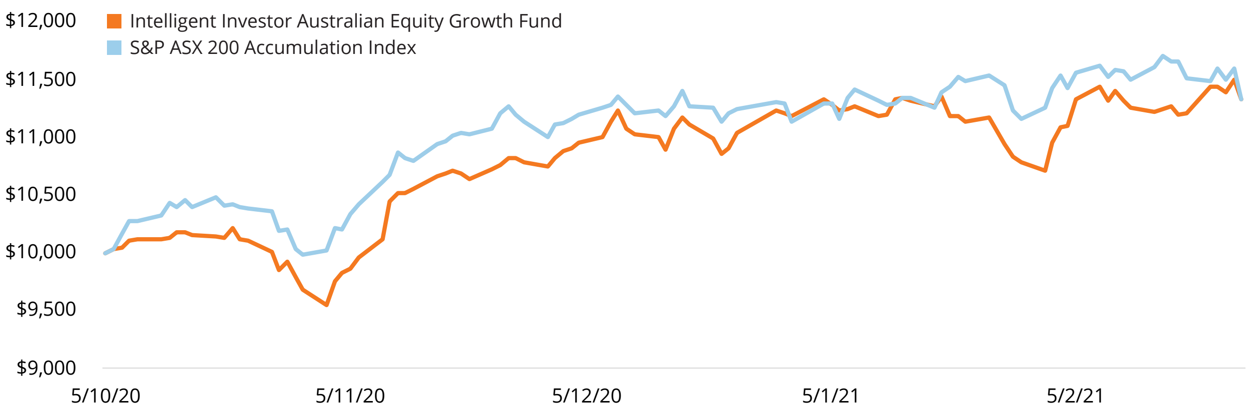
N/A

SUITABILITY

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

As at 31 March 2021

Performance of $10,000 since inception



Performance (after fees)

	1 mth	3 mths	6 mths	1 yr	S.I. (p.a)
II Australian Equity Growth Fund	1.4%	2.7%	N/A	N/A	14.9%
S&P ASX 200 Accumulation Index	2.4%	4.3%	N/A	N/A	16.0%
Excess to Benchmark	–1.0%	–1.6%	N/A	N/A	–1.1%

Asset allocation

Information Technology	29.1%
Consumer Discretionary	16.7%
Cash	15.5%
Financials	13.3%
Industrials	8.2%
Materials	5.8%
Energy	5.3%
Communication Services	3.7%
Utilities	2.5%

Top 5 holdings

Frontier Digital Ventures (FDV)	8.8%
RPMGlobal Holdings (RUL)	7.2%
Star Entertainment Group (SGR)	6.7%
360 Capital Group (TGP)	5.8%
Pinnacle Investment Mgmt Group (PNI)	4.9%

Intelligent Investor Australian Equity Growth Fund

Quarterly Update

'I absolutely think it's a bubble, to be quite honest. I go back to the analogy of the beginning of the internet. There was a bubble. And the bubble burst.' — Digital artist Mike Winkelmann (a.k.a. Beeple) on the non-fungible tokens market where he recently sold a piece for US$69m.

Two thoughts from Nikola Tesla: 'All that was great in the past was ridiculed, condemned, combated, suppressed — only to emerge all the more powerfully, all the more triumphantly from the struggle.' 'We are all one. Only egos, beliefs, and fears separate us.'

'I never have an opinion about the market because it wouldn't be any good and it might interfere with the opinions we have that are good. If we're right about a business, if we think a business is attractive, it would be very foolish for us to not take action on that because we thought something about what the market was going to do.'

– Warren Buffett

The Growth Fund's 2.7% return this quarter trailed the market's 4.3% return.

Cornerstone investor Catcha sold half its shareholding in **Frontier Digital Ventures**, allowing value investor Perennial to become the company's latest major shareholder. We're not perturbed by the sale, as Catcha has likely been waiting for an opportunity to reduce its stake to fund larger investments, such as the Asian version of Netflix.

While the share price has fallen below Catcha's selling price of $1.50, Frontier's latest quarterly results included its maiden annual profit. All the underlying numbers are heading in the right direction and Perennial won't be the last major fund manager buying a material stake in the stock as management is angling for the stock to be included in the ASX300 index.

AMA Group

At the end of January, **AMA Group**'s board released a cryptic announcement suggesting impropriety from CEO Andy Hopkins. Soon after, the company had employed lawyers to chase Hopkins for $1m, while Hopkins sold his 5.6% shareholding and was replaced by board member Carl Bizon.

Bizon seems to be a safe pair of hands and is focused on improving the company's governance by tightening operating controls. Several senior managers have followed Hopkins out the door, but that may make it easier for Bizon to change the company culture once he has the right people in the right roles.

AMA's results are still showing the severe impact of lockdowns in Victoria, which has reduced the number of vehicle accidents. While that's good news for all of us, unfortunately as traffic is rebounding the number of car accidents will get back to normal, as will the number of repairs handled by AMA.

The key question beyond the cyclical recovery will be whether Bizon can deliver on a bigger vision like former CEO Andy Hopkins, which will be based on tuck in acquisitions. Either way, we believe the company is worth much more than its trading at today.

We sold our remaining shares in **Seek** to help make way for **Uniti Wireless**, an aggressive telco minnow that's been growing rapidly by acquisition under the guidance of well-known telco entrepreneur Vaughan Bowen.

The company now has an excellent collection of fibre assets, showing that being small can be very profitable even in such a slow-moving industry dominated by a handful of very large players.

Pinnacle Investment

The standout result was **Pinnacle Investment Management**, whose share price increased 30% during the quarter. It's hard to imagine that just twelve months ago, Pinnacle's stable of fund managers would've been thinking it would be years before they enjoyed performance fees again.

Yet, the company could report earnings per share of over 40c for the full year in August, which means it was trading on a price-to-earnings ratio of just 6.5 during the COVID-induced panic last year.

The company's funds under management (FUM) has reached $70bn. But with its growing stable of high performing fund managers offering 18 investment strategies, the company trying to tap overseas investors, and more Australians searching for funds where the owners have skin in the game and aren't being flogged to them by a large financial institution biased towards its own funds, FUM could continue to grow for a long time yet.

Lastly, **Crown Resorts** received a non-binding takeover offer from 10% shareholder and US private equity firm Blackstone pitched at $11.85 per share. While this undervalues the company, Blackstone's offer is only the first move in what could be a lengthy process given the company's current governance and regulatory issues, which we believe are manageable despite their seriousness and the impact COVID lockdowns have had on the company's casinos.

If you have any questions, as always, please call us on ***1300 880 160*** *or email us at* ***info@intelligentinvestor.com.au***.

Aussie Broadband's head start

How is this little NBN reseller taking so much market share?

Aussie Broadband's shares doubled the day they listed. We expected a rise on listing day – we telegraphed that much when we covered the business in Aussie Broadband's perfect pitch – but the soaring price was a turn off.

A business we had expected to list at just over $200m was suddenly worth $350m and we decided not to pursue it further. New information, however, challenges that view.

Initial public offerings (IPOs) aren't our natural hunting ground. Over the past decade, I can't recall a single instance of us purchasing an IPO. That's because they are usually associated with insiders cashing out by telling a hot story in a hot market.

Promising IPO

This one, as we noted earlier, was different. Not a single existing shareholder was selling stock at the IPO. The founders were being diluted, but they kept their monetary interests in the business. That's unusual.

Aussie also ticked another important box by raising money for a specific, defined purpose. The business currently sells NBN broadband plans by leasing fibre to access the NBN at wholesale rates. It proposed to use cash from the listing to build its own fibre network to replace leased fibre to access the NBN.

Doing so would, at a stroke, lower lease costs by about $15m and allow the business to scale more successfully. By controlling its own fibre, Aussie could also offer new products and services while raising margins. It's a logical next step.

A quiet conquest

Customer growth has been tremendous. Connections have grown from 60,000 in 2018 to 240,000 at listing time. Data from the ACCC shows that, since listing, Aussie has been busy accumulating even more customers.

It appears to have almost 310,000 customers on its books now, almost 90% higher than a year ago. That means Aussie's share of the entire market has grown to about 4%.

That is extraordinary when we consider the humble origins of the business. Started as a reseller from regional Victoria, Aussie has grown to become the fifth-largest broadband provider in the country, outfoxing over 100 competitors and the largest telcos in the land.

Aussie did this without any obvious competitive advantage other than its own operating nous.

It built its own software systems for billing and customer management; onboarding with Aussie is among the quickest in the industry and completely automated. Interactions with the NBN for purchasing wholesale bandwidth is monitored by internally developed software. It's only a small exaggeration to say that Aussie is actually a software business that sells broadband rather than a mere reseller.

Customer satisfaction ratings are industry-leading and the clamour from customers to become shareholders – the customer stock allocation during the IPO sold out within an hour – says plenty about customer love for the brand (your analyst is now a customer, too).

Running faster

ACCC data shows that customer love is translating to real dollars. Of all NBN connections over the last quarter, one in ten went to Aussie. Its market share is growing quickly.

Even more impressively, its share of high-end broadband plans is growing quickest of all. More than

40% of all Aussie customers choose ultra-fast plans (defined as more than 100mbs) compared to 12% of the market and an incredible 86% of new ultra-fast connections to the NBN came from Aussie.

This suggests that Aussie is growing rapidly but, more significantly, it is collecting the most profitable customers. All this is being achieved with a marketing budget that is probably less than Telstra's executive lunch bill.

In our initial analysis, we suggested that Aussie could grow to about 6% market share by 2025, generating average revenue per user of $80. We now think those numbers are too conservative.

With so much growth coming from high-value plans, ARPU is likely to approach $90 and market share should comfortably get to 6%, perhaps earlier than expected.

That means that Aussie is on track to generate about $860m in revenue and, assuming 5% EBIT margins, perhaps over $40m of EBIT. The business isn't profitable today but that will change.

If it meets our expectations, Aussie could be trading on an EV/EBIT of less than 9.0 times. That's not screamingly cheap for a telco, especially considering that value will take a few years to appear.

We are yet to consider, however, new products and services likely to be introduced. The business has already built an enterprise portal to sell direct to businesses and could easily add new services to its offering.

A different case

The investment case for Aussie as a reseller of NBN alone is reasonable, but weak because it's hard to identify a moat. It is only when we consider what the business has overcome that we can appreciate its true competitive advantage.

Aussie fought over 100 competitors and industry giants; built an industry-leading software platform and is collecting an outrageous share of high-end broadband users because its management and culture are superior. This advantage is intangible and hence hard to replicate. It's also hard for investors to see and adequately price.

To some, this might look like a $350m business that makes no money in a competitive industry. In our view, this is a fine example of a business with a deep cultural moat. Those are the hardest to breach.

INTELLIGENT INVESTOR

Important information

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