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Intelligent Investor Australian Equity Growth Fund (Managed Fund) (ASX:IIGF)

"In 58 years of Berkshire management, most of my capital-allocation decisions have been no better than so-so. In some cases, also, bad moves by me have been rescued by very large doses of luck. Remember our escapes from near-disasters at USAir and Salomon? I certainly do.

Our satisfactory results have been the product of about a dozen truly good decisions – that would be about one every five years."

— **Warren Buffett**

The Fund lost 5.6% during February compared to the market's 2.4% loss, chiefly due to **Star Entertainment**, **Domino's Pizza Enterprises** and a general fall in small cap stocks at the end of the month as the yield on the six-month US Treasury bond eclipsed 5%, the highest since 2007.

Let's reverse the order of Sergio Leone's famous movie *The Good, the Bad and the Ugly* and deal with the ugly first.

New Star Entertainment CEO Robbie Cooke has cleared the decks with a painful $800m capital raising. We thought $500m would suffice at a price well above the $1.20 raising price, so the dilution of per share value is worse than we predicted.

Performance (after fees)

	1 mth	3 mths	6 mths	1 yr	S.I. p.a
II Australian Equity Growth Fund	−5.6%	−5.8%	−1.1%	6.2%	14.8%
S&P ASX 200 Accumulation Index	−2.4%	0.3%	6.4%	7.2%	12.9%
Excess to Benchmark	−3.2%	−6.1%	−7.5%	−1.0%	1.9%

Inception (S.I.): 5 October 2020

Fund overview

The Intelligent Investor Australian Equity Growth Fund 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.

5+ yrs
Suggested investment timeframe

10 - 35
Indicative number of securities

Risk profile: High
Expected loss in 4 to 6 years out of every 20 years

S&P/ASX 200 Accumulation Index
Benchmark

Investment fee
0.97% p.a.

Performance fee
Nil

Things are either worse on the inside than we know, we're underestimating the imminent pain from fines, taxes and other familiar problems or perhaps Cooke is just being conservative. We'd probably do the same if we were in his shoes.

The best we can say is that Star is on a much surer financial footing, and we'll still likely come out ahead after participating in the capital raising absent any new problems.

Soggy result

Our previously published fears about Domino's profit margins arguing for a smaller position were realised in its interim result. Despite sales falling 4% profit fell 21%, demonstrating the dangers we've previously highlighted of buying stocks trading on high multiples that rely on high volumes.

We lost all our recent gains after Domino's failed Warren Buffett's pricing power test.

'A couple of fast tests about how good a business is. First question is 'how long does the management have to think before they decide to raise prices?' You're looking at marvellous business when you look in the mirror and say 'mirror, mirror on the wall, how much should I charge for Coke this fall?' [And the mirror replies, 'More'.] That's a great business.'

'When you say, like we used to in the textile business, when you get down on your knees, call in all the priests, rabbis, and everyone else, [and say] 'just another half cent a yard'. Then you get up and they say 'We won't pay it'. It's just night and day. The ability to raise prices — the ability to differentiate yourself in a real way, and a real way means you can charge a different price — that makes a great business.'

Domino's increased prices to protect its franchisors' profits and, like the priests and rabbis, customers baulked. For a volume-based business facing increased pressure from a broad array of delivery options, this is deeply concerning.

CEO and major shareholder Don Meij said the remedy would be more discount offers but that will also undermine margins, especially as interest rates increase and people tighten their belts. Like Meij, many companies have based their full year expectations on a better second half, but that seems foolish with inflation and interest rates increasing.

We've kept our small position, as longer term the company should be able to grow profits, as recent store acquisitions mature. But we'll need a much lower price to buy more.

This is no longer – if it still was – a simple store rollout story. The next ten years will be much tougher than the past ten.

The Bad

It seems laughable to complain about an interim dividend that's a 30% fully franked yield on some of our purchases. But **Whitehaven Coal**'s interim dividend was well short of what we were expecting with management seemingly keener than us on a huge share buyback.

It was more of a bonus than the bonanza we'd predicted. We'd prefer the money in our hands as soon as possible lest management find something lousy to do with its expected $2bn cash hoard.

We sold **Omni Bridgeway** for a small loss following a lacklustre result filled with more promises than results. There's a possibility the new CEO may change that but our patience has worn out.

The Good

Though you wouldn't know it from the fund's performance, most of the results were good.

The recovery at **Auckland Airport** is happening quicker than expected with leisure travel bouncing back rapidly. The world is still opening from COVID and Auckland Airport should get back to paying decent dividends soon.

Woodside Energy declared a large dividend which prompted an increase in the share price, though the large capital gains are now behind the stock. The company's balance sheet is a thing of beauty but it has some large investments ahead of it to replace reserves like all resources companies.

The **Lottery Corporation** showed that recession or not people won't sacrifice their weekly $12 lotto ticket. The lotto is a relatively cheap source of excitement and my wife currently views winning the jackpot as our only hope of buying a house in Sydney any time soon.

Mineral Resources's massive lithium profits still couldn't meet sky high expectations and the share price fell.

MA Financial's result was good considering financial market activity in some divisions such as mergers and acquisitions has slowed rapidly. The credit and loan side of the business is performing well bolstered by inflows, which shows the business's long-term potential.

RPM Global's decent sales growth isn't falling to the bottom line as staff shortages means hiring expensive sub-contractors for software coding. Costs are also temporarily high as sales staff spread themselves far and wide to sit down with clients after nothing but zoom calls during Covid.

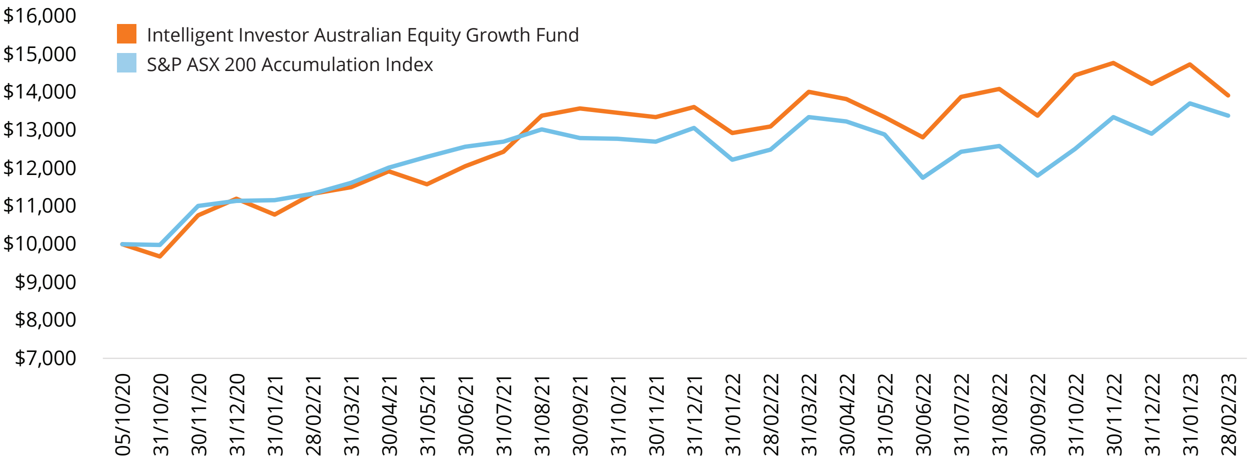
Frontier Digital Ventures' share price fell along with other small cap stocks despite Pakistan being close to agreeing a deal with the IMF that could add $200m or more of value back to the business that we'd written off. Frontier's total market value is currently only $280m.

In summary, reporting season was better for the fund than the underperformance suggests. The major indexes are being held up by the iron ore, bank and healthcare majors, but that's not where the current value is nor where we want to be for the next decade. At least not starting from current valuations in the case of healthcare stocks.

Our focus remains on capitalising on what we hope will be a fruitful period for value investors as the market ultimately adjusts to higher interest rates and slowing or falling profits.

Please get in touch if you have any questions on **1300 880 160** or at **info@intelligentinvestor.com.au**

Performance since inception



Inception (S.I.): 5 Oct 2020

Asset allocation

Cash	27.9%
Materials	14.5%
Information Technology	14.0%
Consumer Discretionary	11.7%
Financials	11.4%
Energy	6.9%
Industrials	6.1%
Real Estate	3.3%
Health Care	2.4%
Utilities	1.9%

Top 5 holdings

Auckland International Airport (AIA)	6.1%
RPMGlobal Holdings (RUL)	5.9%
New Hope Corporation (NHC)	5.0%
Alumina (AWC)	4.4%
Audinate (AD8)	4.3%

Fund Stats

Net asset value	$2.92

Important information

All tables and chart data is correct as at 28 February 2023