Quarterly Update

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Intelligent Investor Ethical Share Fund (Managed Fund) (ASX:INES)

"The desire for more, the fear of missing out, the tendency to compare against others, the influence of the crowd and the dream of the sure thing – these factors are near universal. Thus they have a profound impact on most investors and most markets. The result is mistakes, and those mistakes are frequent, widespread and recurring. Rather than trying to figure out the future, try to figure out where we are in the market cycle, make adjustments if necessary when close to the extremes, and prepare mentally to avoid behavioral mistakes that plague investors throughout. The key is to watch for investor behavior that typically emerges, especially at the extremes of the cycle."

— Howard Marks

The Fund increased 4.3% for the year trailing well behind the market's 14.8% return. A lack of resources exposure will always penalise an ethical fund like ours from time to time in a resources heavy market like Australia's, as it has over the past year.

But that's only temporary if we do our job right, as higher quality industrial businesses eventually prove their superiority. Virtually by default this fund forces us to buy the market's best businesses, which is what works best over the long term in our experience.

Performance (after fees)

	3 mth	1 yr	2 yrs	3 yrs	S.I. (p.a)
II Ethical Share Fund	0.5%	4.3%	0.8%	10.2%	8.9%
S&P ASX 200 Accumulation Index	1.0%	14.8%	3.6%	11.1%	6.3%
Excess to Benchmark	–0.5%	–10.5%	–2.8%	–0.9%	2.6%

Inception (S.I.): 11 Jun 2019

RIAA's RI Certification Symbol signifies that a product or service offers an investment style that takes into account environmental, social, governance or ethical considerations. The Symbol also signifies that Intelligent Investor Australian Ethical Share Fund (ASX: INES) adheres to the strict operational and disclosure practices required under the Responsible Investment Certification Program for the category of Product. The Certification Symbol is a Registered Trademark of the Responsible Investment Association Australasia (RIAA). Detailed information about RIAA, the Symbol and Intelligent Investor Australian Ethical Share Fund (ASX: INES) methodology, performance and stock holdings can be found at www.responsiblereturns.com.au, together with details about other responsible investment products certified by RIAA.

Fund overview

The Intelligent Investor Australian Ethical Share Fund is an Active ETF designed for investors seeking a diversified selection of Australian companies that produce growing, sustainable profits at low risk of interruption from the increasing threats associated with Environmental, Social and Governance (ESG) factors.

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

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The iron ore miners, for example, also seem highly priced in our view, along with many other resource companies that are spending a lot of money without making much, if any.

Incredibly, despite the economic rise of China, the biggest global asset and credit bubble in history created by zero interest rates, and an epic housing boom, many of Australia's largest businesses have produced virtually no capital gains in 15-20 years or more. That's set to continue given current valuations suggest you can get similar returns from fixed income investments.

The two other factors impacting the fund's performance were the savage treatment of many small cap stocks, which will reverse when fear subsides, and the general fall in price-to-earnings ratios due to higher interest rates.

The silver lining is that we've increased our positions in some great businesses, such as **ResMed** and **CSL**, at valuations that we haven't seen in years.

Portfolio

ResMed's share price initially bounced over 15% after reporting that every line on its quarterly income statement increased 30%. Competitor Philips Respironics, which is still suffering from product recalls, will eventually get its act back together. But, along with CSL, ResMed is one of the few companies on the ASX that can justify its high statistical valuation.

Every customer ResMed nabs from Philips potentially adds value for many years. All the while, the company's markets continue to grow as does the number of people treated and untreated for sleep apnoea.

A growing world population where average incomes are growing rapidly in the biggest countries also bodes well for ResMed provided it maintains its market leadership.

MA Financial continues to launch new funds and there has been some more positive commentary around the government's view of special investment visas, though a final decision could go either way.

The company also acquired a group of marinas for $225m that will seed a new fund. This is exactly the sort of niche deal we expect from the company but over time the deals will need to get bigger to move the needle on profits.

Audinate's share price has been riding the wave of enthusiasm for tech stocks despite the CEO and co-founder Aiden Williams selling 10% of his shares. We expect to be long-term shareholders, but it will take time for the earnings to catch up to its current valuation.

After proving its audio capabilities, the company is firmly pushing its video credentials, which we've explained in the Appendix.

Dicker Data's share price staged a relief rally after a weaker than expected final quarter gave way to stronger growth in the March quarter helped by acquisitions, but renewed its fall as recession fears increased.

The long-term story hasn't changed, and we expect to increase our position if the share price falls further on short-term, temporary concerns.

Telstra's share price has reached levels not seen since 2017. It's been a solid performer for the fund but is no longer cheap unless it can sell some assets at higher-than-expected prices. Mobile price hikes and less competitive markets are helping profits, but we look forward to replacing it with a new opportunity.

REA Group's share price has increased 15% in our very short period of ownership after announcing large price increases. Few, if any companies have the pricing power of REA Group, given advertising is still a small cost compared to the value of a home that isn't worth skimping on. Strong demand for property as prices stabilise or increase is also helping sentiment.

Sonic Healthcare is increasing its scale in Germany and Switzerland after announcing a couple of tuck-in acquisitions. This is the company's bread and butter and we expect more as its earnings grow steadily over time.

Pain on the frontier

Like Star Entertainment, **Frontier Digital Ventures**'s (small) capital raising smashed its share price. But a provisional funding deal between Pakistan and the IMF suggests there is still potentially $300m or more of value in Zameen and Pakwheels, twice Frontier Digital's current market value, which obviously isn't factored into its share price given the high risk Pakistan eventually defaults.

Throw in the Latin American (Latam) business that's cashflow positive and could be five times more valuable to Frontier than the Pakistan businesses and you're getting a lot of potential for 40c per share.

The better Latam performs, the less likely there will be another capital raising unless it's for an acquisition. Though it'd be tough to find an acquisition offering better value than Frontier itself at current prices.

The current valuation is particularly pessimistic given its run by a guy who sold his previous business, iProperty, to his former employer, **REA Group**, for over 27x revenue, and has an incredible track record.

In contrast, Frontier currently trades for around three times the revenue of Latam alone, or nearly half what Latam's new management recently struck their company shares at. Regardless, a bad outcome won't materially hurt the fund while a good one could help drive the fund's performance for many years.

Lastly, **Mineral Resources**' share price fell after announcing lower production estimates from its mining services division as contracts expire, and production expansion delays and higher costs at its key Mount Marion lithium project.

In such a complicated business with numerous divisions, earnings will jump around in the short-term. But, most importantly, we remain comfortable with the company's long-term plans. Hopefully increasing lithium supply will soon give us another buying opportunity.

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

Audinate's big picture

So far this networking company has mostly been about audio, but that will increasingly be intertwined with video.

Key Points

- **Needs video for AV platform**
- **Video market fragmented**
- **Big advantages from audio dominance**

Over the last ten years Audinate has taken the audio networking industry by storm. While competing technologies have stagnated, it has taken a market share of almost 90% of networked audio products. Its share of new products is much higher.

Lately, though, the buzz has been about the baby steps it's taking in video, and the company has highlighted those efforts in a couple of **recent presentations**.

To understand where video fits in the Audinate jigsaw, though, we need to take a step back and consider its primary market of real-time audio networking.

All in the timing

Through its Dante technology, Audinate's main purpose has been to get analogue audio signals onto a digital network (ie a bunch of computers linked by ethernet cable), where they can be managed and sent where they need to go – in real time.

Real-time audio presents different problems to recordings, largely because of timing issues. You want the sound data packets to arrive as close to instantaneously as possible, and you need them all to arrive with the correct order and timing.

This is different from recorded sound, where instead of sending individual data packets, you send entire files (or discrete parts of them), which get reassembled in their entirety before being played back (and which will keep you waiting if they're not ready, as the 'buffering' process catches up). You can't successfully manage the signals from ten microphones if they're all buffering at different rates.

So Audinate's Dante technology has established a set of protocols for turning live sound into individual data packets, sending them across a digital network, and then reassembling them and turning them back into sound with exactly the right timing and with no (or very, very little) waiting around. It works beautifully, which is why it has become the industry standard.

Video killed the radio star

But here's the thing. When a **conference centre** is sending audio to a break-out room, or a **theatre** is relaying audio to the green room round the back, or a **lecture hall** is sending audio to a classroom on another campus, they're typically going to want to send some video as well.

This is the V in the AV (Audio Visual) industry, and it's going to become increasingly important as technology makes it easier to manage and opens up new opportunities. To do that, though, people need to get the video onto their network alongside the audio. Due to its dominant position in audio, Audinate is in the prime position to do this.

This offers an extra leg of growth for the company – we'd estimate at least doubling its potential market. But because of the close connection of audio with video, it runs deeper than that. What the market needs is an integrated solution for both – and if

Audinate doesn't add video to its audio technology, then it might eventually find that someone else adds audio to their video.

Dante AV 4K-T and 4K-R from AJA Video Systems on Vimeo.

As chief executive Aidan Williams put it at last week's technology day, Audinate is aiming to provide an 'operating system for the AV industry'. This should enable it to replace existing hardware installations run over analogue cables with plug-and-play software installations connected by a standard ethernet network. This will be cheaper, quicker, simpler and much easier to scale. Moreover, it will enable all the bits of hardware from different manufacturers to be compatible with each other, and permit them to be connected over much greater distances.

Data squeeze

So video isn't just another growth market, it's essential to Audinate's future. It does, however, present its own challenges, chief among which are the much higher data rates. That's not too much of a problem when you're watching a movie on Netflix, because you can sit around for a few seconds while your TV downloads enough of it to get you started. But it's a huge problem where you've got real-time video signals being brought together on a network (alongside the audio of course).

This means that on their way onto a network the video signals need to be compressed, and on their way off they need to be decompressed again. This is done by a 'codec' (as in en**CO**der-**DEC**oder) – and the Belgian video technology company Silex Insight that Audinate bought in January last year came with several, notably the high-end Colibri codec.

Unless it's done right, the compression process will slow down the signals and add what the techies call 'latency' to a system – small delays in a signal's arrival. This leads to the other key problem with adding video to your audio: you need to get the two to be perfectly synchronised – most particularly the lip movements, which can be very jarring when they're off by even tiny amounts.

Tearing down the walled gardens

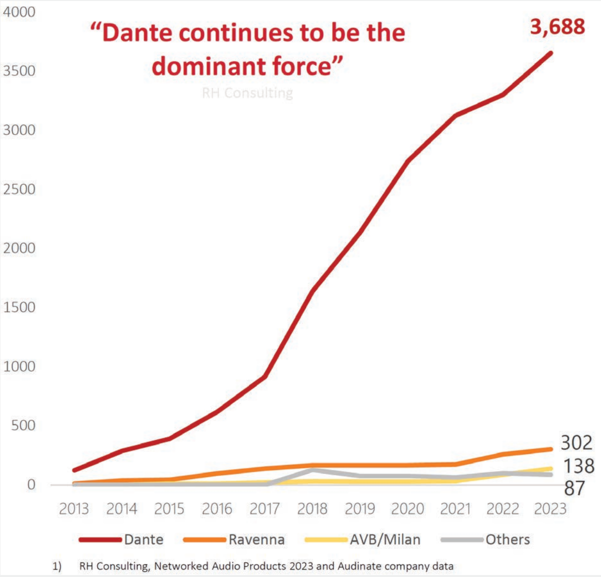
So it makes sense for the same technology to be handling both the audio and the video. This is how the industry has mostly developed, with vertically integrated manufacturers operating 'walled gardens' – closed ecosystems in which only their products work. It's an obvious solution where everything has to work seamlessly together, but it's also very limiting.

This is where Audinate has a huge advantage because it already has almost 4,000 audio products in the market working on its Dante technology (see chart), as well as the software to manage them. This gives it brand recognition and familiarity. AV engineers are comfortable with the technology and over 200,000 of them have been trained on it.

Video products fit seamlessly into this ecosystem. With a simple software upgrade, **Dante AV-H** can bring any video equipment based on the widely used **H.264** (and H.265) compression standard onto a Dante network.

For high-end applications, users can opt for the more expensive **Dante AV-Ultra**, a hardware solution using the Colibri codec that can manage **4k video** at 60 frames a second with latencies of less than one of those frames.

Total audio products per protocol



It has already been incorporated into AJA's **Dante AV 4K box**, which can connect existing video infrastructure to a Dante network, making it easier and cheaper to manage – with a laptop and the existing Dante Controller software (see video). AJA's Eric Guysen was interviewed at Audinate's investor day last week and gave the technology a glowing endorsement.

Then there's **Dante Studio**, which is a piece of software that enables PCs to send and receive Dante video signals and use them in applications – such as Zoom or Microsoft Teams (a Mac version will be released soon). It's the video equivalent of the existing **Dante Virtual Soundcard**, which enables a PC or Mac to send, receive and use audio signals (and with which Dante Studio integrates seamlessly).

The other significant video product at the moment is the **Viper board**, which came with the Silex Insight acquisition and enables AV signals to be sent over a network. It does this in a non-Dante fashion, however, and the plan is to migrate customers over to Dante-based products over time.

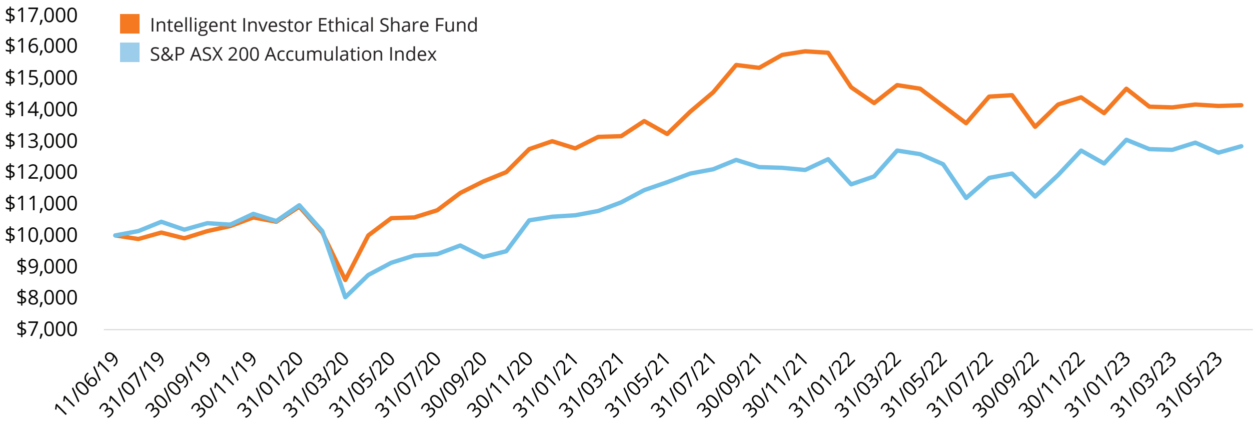
Strong pipeline

The video side of the AV market is highly fragmented and Audinate is starting out on the bottom rung of the ladder. It has some important advantages over the incumbents, though, due to its dominance in audio, its brand strength, and the interoperability that should be enabled by its AV platform approach.

From next to nothing in 2022, video revenues came to US$2m in the six months to December – well on their way to management's target of at least US$3m for the full year. With a strong pipeline of products in development, they're also well on their way to the ~$US9m for 2026 (and the ~$23m for 2031) we pencilled in for our neutral scenario when we had a **stab at valuing** Audinate a couple of years ago.

The exact level of sales over the next few years will depend on how quickly manufacturers turn the pipeline into products, and on the levels of investment made by the AV industry as it continues to rebound after the pandemic. More important for Audinate's long-term value, though, will be to see evidence of continued adoption of the Dante AV platform across the industry.

Performance since inception



Inception (S.I.): 11 Jun 2019

Asset allocation

Health Care	19.5%
Cash	17.7%
Information Technology	16.3%
Communication Services	15.8%
Financials	8.5%
Industrials	7.5%
Consumer Discretionary	6.0%
Materials	6.0%
Real Estate	2.7%

Top 5 holdings

Auckland Internationaal Airport (AIA)	7.5%
RPMGlobal Holdings (RUL)	5.7%
Telstra Corporation (TLS)	4.9%
Pinnacle Investment Mgmt Group (PNI)	4.6%
Audinate (AD8)	4.5%

Fund Stats

Distribution yield	0.91%
Net asset value	$3.03