

Intelligent Investor Australian Equity Growth Fund

(Managed Fund) (ASX:IIGF)

"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 finished the year up 6.3%, well behind the market's 14.8% return. Not owning the iron ore miners didn't help – a decision we're very comfortable with given we expect higher supply to reduce iron ore prices – but there were many factors.

The dumping of small cap stocks in favour of the perceived safety offered by the market's biggest companies. The general fall in valuations for some highly rated businesses due to higher interest rates and/or growth concerns, such as **CSL** and **Lovisa**.

And mistakes such as **Star Entertainment**, where we drastically underestimated the size, discount and dilution of its capital raising. And, to a much smaller extent, **Domino's Pizza Enterprises**, which is grappling with pricing strategies to protect franchisee margins and its own.

Performance (after fees)

	1 mth	3 mths	6 mths	1 yr	S.I. p.a
II Australian Equity Growth Fund	0.7%	-0.8%	-4.2%	6.3%	12.0%
S&P ASX 200 Accumulation Index	1.8%	1.0%	4.5%	14.8%	11.6%
Excess to Benchmark	-1.1%	-1.8%	-8.7%	-8.5%	0.4%


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

There haven't been many changes to the portfolio over the past 18 months. We recently swapped **The Lottery Corporation** on valuation grounds for CSL, which trades at the most attractive valuation in years due to the share price treading water for nearly the past four.

Showing our inability to time markets has never improved, CSL obliged with its first profit downgrade in over a decade. Albeit mainly due to currency movements.

CSL has been an incredible growth and income stock over a long period of time and we're delighted to add it to the fund to complement some of the slower growing and more cyclical high yielders, such as **Woodside Petroleum** and **Newhope Coal**.

Portfolio

Newhope recently paid a final fully franked dividend of 40 cents for an annual fully franked yield of 20%. It followed an excellent quarterly production and financial result, though with commodity prices falling heavily the large capital gains are likely behind us.

MA Financial's share price has bounced on improving market sentiment and the \$225m acquisition of a group of marinas 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.

James Hardie Industries' share price increased after recent results met expectations and signs the drop in US housing starts has bottomed. Not enough new homes are being built in the US so, recession or not, this should fuel the company's profits for decades to come.

Tabcorp's share price also rallied as it remains in the box seat to retain its Victorian wagering license, but it still isn't factoring in favourable tax changes that we expect in the years ahead.

Star supernova

We reduced our position in **Star Entertainment** after the company announced things are getting even worse. So bad, in fact, that CEO Robbie Cooke announced 500 job cuts and called in the bankers and everyone else with an interest in the company to pull together to save what's left of the Star Sydney casino lest it be sold for its land and building value alone.

Management should've divulged more about Star's rapidly deteriorating operating performance when it recently raised money instead of offering feeble excuses a month later.

It can be a fine line between patiently backing your analysis, and stubbornly hanging on despite a fluid and deteriorating situation. But to borrow a line from Bud Fox in my favourite movie, *Wall Street*, 'the break-up value is higher'.

Though Star isn't at the point of being broken up and sold off in pieces yet, we're managing any ownership bias on our part with a smaller position.

The current situation feels reminiscent of when we upgraded **Aristocrat Leisure** in 2009 at \$6.96. I castigated myself for years after it fell below \$2 before increasing seven-fold from my initial upgrade and 25 times from the bottom.

It was a similar story for **Fisher and Paykel Healthcare**. Both of which we foolishly sold so early in their recovery that it's comical.

The difference is that Star doesn't have that sort of potential and various government agencies will soon determine Star Sydney's value. Star's destiny isn't entirely in its own hands, which warrants a smaller position.

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.

ResMed

We repurchased ResMed after every line on its quarterly income statement increased 30% in an incredible result. 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.

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.

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 provide another buying opportunity.

Though this is a growth fund, there are still several stocks that aren't paying dividends anywhere near what they're capable of due to the lingering effects of Covid and other issues.

As dividends are gradually restored, we expect stocks such as **Auckland Airport**, **Alumina** and **Star Entertainment**, to provide respectable if not very large capital gains as well.

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-**DE**coder) – 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

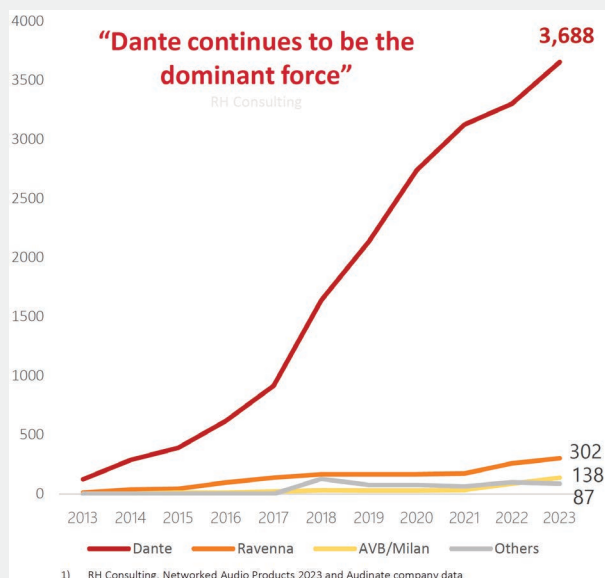
So it makes sense for the same technology to be handling both the audio and the video. This is how the industry has mostly developed, with vertically integrated manufacturers operating 'walled gardens' – closed ecosystems in which only their products work. It's an obvious solution where everything has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

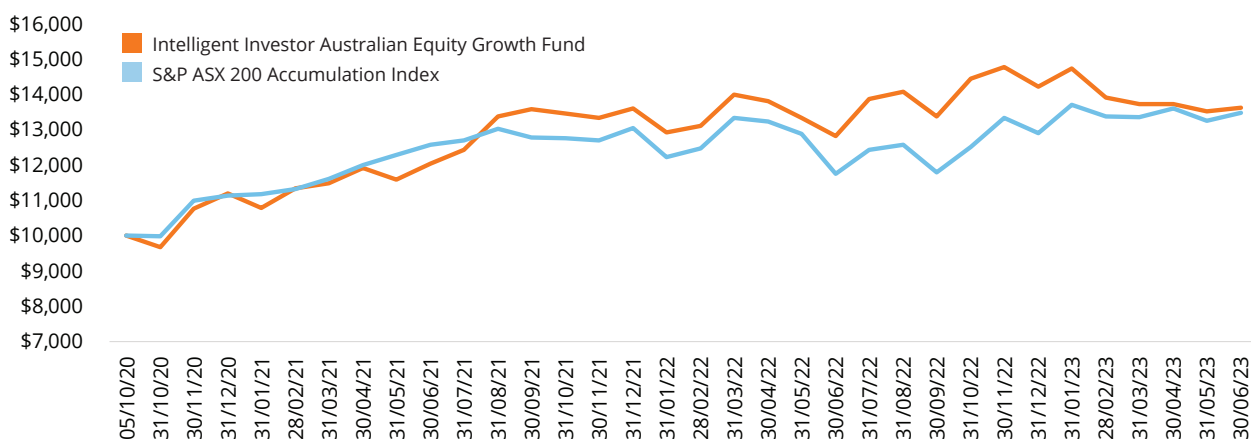
Strong pipeline

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.): 5 Oct 2020

Asset allocation

Consumer Discretionary	16.4%
Materials	14.8%
Information Technology	13.1%
Financials	12.2%
Cash	11.4%
Health Care	10.5%
Energy	6.6%
Industrials	6.2%
Real Estate	3.3%
Communication Services	3.1%
Utilities	2.3%

Top 5 holdings

Auckland International Airport (AIA)	6.2%
RPMGlobal Holdings (RUL)	6.2%
New Hope Corporation (NHC)	4.6%
Tabcorp Holdings (TAH)	4.4%
Audinate (AD8)	4.3%

Fund Stats

Distribution yield	6.30%
Net asset value	<u>\$2.73</u>

Important information

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All tables and chart data is correct as at 30 June 2023