Growth With Value
Your investment can make the difference

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Growth With Value Investment Fund – 30 June 2020 Full Year Report

The Growth With Value Investment Fund focuses mainly on investing in Australian listed businesses. Our concentrated portfolio will consist primarily of businesses which are able to generate strong Returns on Capital, provide solid Profit Margins, carry little or no Debt and present long-term growth prospects. We also apply an ethical perspective when investing in a business. We look for a business which respects our environment, including both flora and fauna, and cares for its people and customers. We also avoid businesses which produce or provide a service that is considered an addictive substance. Our investment decisions are based on fundamental analysis with a long-term mind set, paying little regard to short term fluctuations in the market. We choose to invest only when the business presents us with an opportunity to buy below its Intrinsic Value. You can expect, over the long term, this portfolio to outperform our benchmark, the ASX 200 Accumulation Index (XJOA).

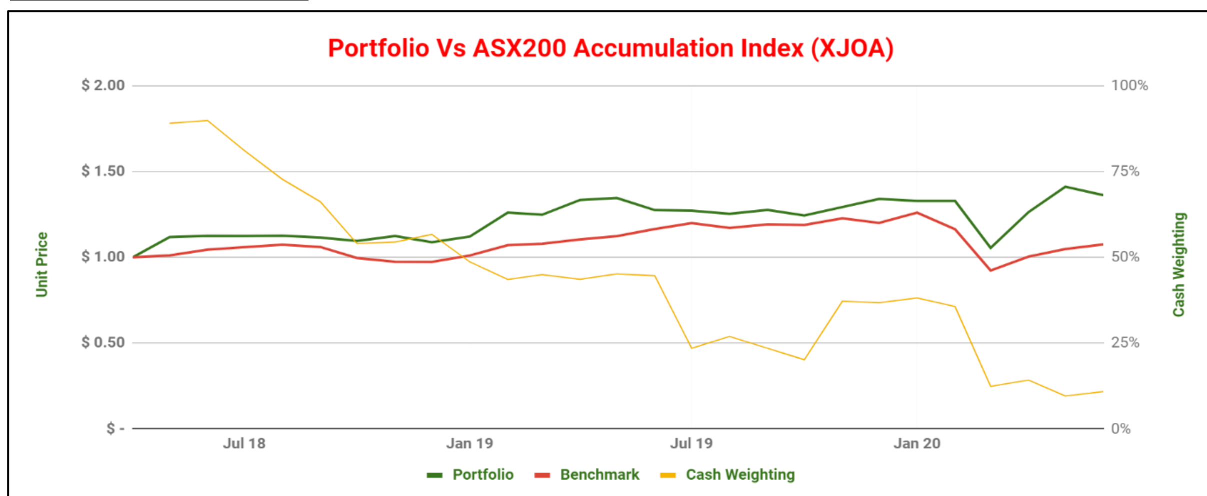
Fund Performance Since Inception (May 2018):

GWV Investment Fund versus ASX 200 Accumulation Index – Total and Annualised Returns			
Annualised Return		**Total Return**	
GWV Fund Annualised Return	15.3%	**GWV Fund Annualised Return**	36.2%
Benchmark Annualised Return (XJOA)	3.4%	**Benchmark Annualised Return (XJOA)**	7.5%
Outperformance / (Underperformance)	11.9%	**Outperformance / (Underperformance)**	28.7%

Fund Month by Month Performance Since Inception (May 2018):

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
GWV FY18	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	11.8%	0.6%	**12.5%**
XJOA FY18	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	1.1%	3.3%	**3.3%**
GWV FY19	(0.1%)	0.2%	(1.0%)	(1.8%)	2.7%	(3.2%)	3.0%	12.5%	(1.0%)	6.9%	0.9%	(5.3%)	**13.3%**
XJOA FY19	1.4%	1.4%	(1.3%)	(6.1%)	(2.2%)	(0.1%)	3.9%	6.0%	0.7%	2.4%	1.7%	3.7%	**11.6%**
GWV FY20	(0.2%)	(1.5%)	1.8%	(2.6%)	4.0%	3.6%	(0.9%)	(0.0%)	(20.6%)	19.8%	11.7%	3.5%	**6.9%**
XJOA FY20	2.9%	(2.4%)	1.8%	(0.4%)	3.3%	(2.2%)	5.0%	(7.7%)	(20.7%)	8.8%	4.4%	2.6%	**(7.7%)**

Fund versus Benchmark:



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Portfolio:

Company	Initial Purchase Date	Ave. Purchase Price	Annualised Return*	Portfolio Weighting
Nick Scali	05/07/2018	$ 4.48	32.0%	25.0%
Cash			3.6%	10.9%
Smart Group	20/02/2020	$ 5.90	(4.4%)	10.6%
InvoCare	02/05/2018	$ 10.88	3.1%	10.0%
Flight Centre	16/03/2020	$ 13.48	(27.8%)	7.3%
Lovisa	25/03/2020	$ 2.86	108.2%	7.2%
SG Fleet	27/07/2019	$ 2.43	(41.0%)	6.8%
Vita Group	31/08/2018	$ 1.09	0.9%	6.6%
Citadel Group	23/07/2019	$ 3.93	(23.9%)	5.6%
Pendal Group	28/09/2018	$ 7.94	(14.8%)	5.2%
Shine Corporate	25/07/2019	$ 0.73	11.3%	3.7%
Collection House	04/07/2019	$ 1.24	(66.1%)	1.1%

Note: For companies held for less than 12 months, the Annualised Return has been substituted with Total Return.

Performance:

For the Financial Year ended June 2020, the Growth With Value Investment Fund returned 6.9% versus negative 7.7% for our Benchmark, the ASX 200 Accumulation Index (XJOA). This is an outperformance of 14.6%. At the end of this period we held 10.9% in cash and had eleven open positions. We did not make any sales during the period.

Since its inception, the Fund has provided an annualised return of 15.3%, resulting in a total return of 36.2%. Our Benchmark has an annualised returned of 3.4%, resulting in a total return of 7.5% over the same period.

Portfolio Activity:

Over the last 12 months we added another seven companies to our portfolio; Collection House (CLH), Citadel Group (CGL), Shine Corporate (SHJ), SG Fleet (SGF), Smart Group (SIQ), Flight Centre (FLT) and Lovisa (LOV). We also increased our holdings in InvoCare and Nick Scali over this period.

Collection House provides credit management services including receivables management, debt collection, finance brokerage and legal and insolvency services. The business appeared to generate high levels of free cash flow on a consistent basis, which turned out not to be the case as I discuss further below under the heading “Mistakes”. The business was also suspended from trading on the 14th of February 2020, Valentine’s Day of all days, after stating it was conducting a strategic review of its operations. Basically, they were flagged in the Banking Royal Commission because of their questionable debt collection strategies which resulted in over 500 bankruptcy filings in just 12 months compared to zero for its competitor in Credit Corp. As a result, they now are looking to improve their debt collection strategy. Again, I will go into further detail below.

Citadel Group operate throughout Australian and the United Kingdom, providing software and services primarily to the government, health, education and defence industries. The main objective of the business is to ensure the data and operating systems of their clients function correctly with all information kept safe and secure. The has many long-term contracts providing an integral service to their clients. Citadel intends to become an emerging global software company.

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Shine Justice provide legal services specialising in personal injury compensation law with a no win no fee service. The Company has been practicing for over 40 years and has over 50 branches across Australia and New Zealand. This is an important industry, providing victims with an opportunity to seek justice and will most likely continue being an important service for many years to come.

Smart Group and SG Fleet both provide fleet management and leasing and salary packaging services, with Smart Group having a stronger focus on salary packaging and SG Fleet seeing more business from fleet management and leasing. SG Fleet operates across Australia, New Zealand and the United Kingdom, Smart Group operate across Australia.

Flight Centre is a globally recognised travel agency across both leisure and corporate travel sectors. It also has in-destination travel experiences businesses including tour operators, hotel management, destination management companies (which organise local events, tours, activities and logistics) and wholesaling.

Flight Centre has been directly impacted by the COVID-19 pandemic and subsequent global shut down, particularly in the form of travel restrictions, resulting in limited opportunity for both leisure and corporate travel. As a result, flight centre has seen revenue drop by almost 40% and profit decreased by 350%, 240% if we exclude the one-off impacts of COVID-19. Flight Centre has secured $1.1 billion via a mix of capital raisings and increased debt facilities. Currently, the business is experiencing net operating cash outflows of about $53m a month indicating the business can continue to operate “as is” for the next 20 months before facing further liquidity issues. I believe Flight Centre will most likely see sales increase over this period, primarily through local travel, which has already seen improvements as certain regions begin to open up. Flight Centre have stated this will be an area of focus, believing it will likely provide the highest area of growth over the short term.

Provided Flight Centre can get through these extremely tough trading conditions, which are likely to continue for some time, it will be well positioned to rapidly increase its market share. I believe the demand for travel is still very strong and once restrictions begin to lift people will begin to make travel arrangements, cautiously at first as there will still be a high level of uncertainty as to whether further restrictions will be re-introduced. Flight Centre will be well positioned to capitalise on a likely reduction on the supply side.

Lovisa is a multinational company with 435 stores across 15 countries, about 150 of which are in Australia. Lovisa has become the largest retailer of fashionable jewellery in Australia since the first store launched in April 2010. Lovisa controls about 19.5% of the Australian Fashion Jewellery market, with its nearest competitor having less than 5%. Chairman Brett Blundy and Managing Director Shane Fallscheer founded the business, setting out to create a jewellery store that provides quick, fashionable, and affordable jewellery for fun occasions like a night out on town. They achieve this by providing more than 100 new lines each week at very affordable prices, usually less than $40. Lovisa can fulfill inventory orders to any of its stores across the globe within 48 hours, supplied from their two centrally located warehouses in Melbourne and China. Lovisa also offers delivery to its customers within 2–4 days of an online purchase.

The Company has yet to experience any prolonged decline in retail spending, although the current conditions will likely provide a good test to see how the business can handle poor trading conditions. Lovisa saw its global network of stores closed from mid to late March and remain closed for about 1-2 months, depending on location. It is possible we could witness further rolling store closures over the

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next 12 months as regions continue to face increased COVID-19 cases. Lovisa has been able to continue to operate through its online store, which is available across most of its markets. Online sales grew by 256% in the fourth quarter to June 2020, but comparable store sales were down 32.5% for the period since stores began to reopen. I believe if we were to experience a prolonged downturn in the economy, Lovisa, due to the low price point, would likely fair better than its counterparts in higher end jewellery and retail stores.

Mistakes:

Our investment in Collection House is likely to prove to be costly, albeit one that was avoidable. After making the investment, I found that the Company had questionable reporting techniques in relation to its financials, in particular its Cash Flow Statement. Part of the businesses operations involves the purchase of Debt Ledgers from other companies, usually at large discounts, and then attempts to reclaim the debt ultimately making a profit. It turns out the reason the business appeared to generate high and consistent levels of Operating Cash Flow (and subsequently Free Cash Flow) was because it would record the purchase of these Debt Ledgers as an Investing Expense (which happens to be reported elsewhere on the Cash Flow Statement) and not as an Operating Expense, but conversely was happy to record the sale of these ledgers as Operating Profit. Basically, if we look at the Debt Ledgers as being the same as inventory, when a business buys and sells inventory, it is recorded under Cash Flow from Operations and the money left over is considered the Operating Profit (or Loss) produced by the business. So, a business which buys a pair of shoes for $10 and then sells them for $20, has made a profit of $10. In the case of Collection House, it would record $20 profit as the $10 cost to buy the shoes was recorded elsewhere on the Cash Flow Statement. After looking at how its main competitor Credit Corp record the purchase of debt ledgers, I found that they treat it as the purchase of inventory and subsequently record it as an Operating Expense. This results in a volatile, but honest, Cash Flow Statement, and is one that I suspect Collection House would likely closely resemble.

On reflection, it turns out this was an obvious mistake, one that is easily noticed if you know where to look. I have been able to learn from this mistake and have since applied my learnings to all subsequent investments in an attempt not to be fooled again. Although, the biggest mistake resulted when I failed to sell the investment after this discovery. After purchasing Collection House in July, I had ample opportunity to sell the shares at a small loss since in late 2019. My failure to do so will likely result in even greater losses if/when the business comes out of suspension in September, as it has stated. I have subsequently written down the holding each month since April.

I also failed to discover, in a timely manner, the reported “unethical” practices Collection House applied when collecting debt. This discovery would have prevented me from purchasing Collection House in the first place (although it would have meant missing out on the valuable accounting lesson I learnt). Collection House has a subsidiary business in Lion Finance, a law firm which specialises in bankruptcy matters, and it would use this business to its advantage when collecting outstanding Debt Ledgers. Legally debt collectors are allowed to take a person or business to court for outstanding debts totalling as little as $5,000. This resulted in over 500 bankruptcies in 12 months for Collection House debtors versus zero at Credit Corp and low single to double digits at some other smaller Debt Collection Agencies. So, Collection House was not only being over aggressive when it came to its debt collection activities, but the practice could also be seen as a means of providing additional business for its subsidiary, Lion Finance. This may have been a smart move from a business sense, but has

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resulted in many unnecessary bankruptcies, which can have significant negative effects on a person's ability to re-establish themselves.

Our investment in Pendal Group has not been a total disappointment in terms of lost capital and is one that, given time, could still play out to be a positive investment. Since first investing in Pendal Group in September 2018, I have since changed my views on the business and the way it generates revenue through providing actively managed funds to its investors. Pendal provides and astounding number of funds, with the last count at around 50 different funds. Of the approximately 50 funds offered by Pendal, about two thirds have underperformed their respective benchmarks and charge, on average, about 0.85% in management fees.

In February 2020 I had the opportunity to sell out at a price which I believed to be in line with fair value but failed to do so. I was probably too greedy, wanting a better return than the 8% to 9.5% annualised return we would have received at that time. Since then the shares halved in price and have only recovered slightly. I have still chosen to hold on with the anticipation that they will eventually recover.

If this were a situation where we were talking about a wonderful business, such as Nick Scali, Lovisa or InvoCare, I would not be overly concerned by the run up in price in February and the subsequent 50% decline through March. In fact, I would have taken the opportunity and acquired more shares at the lower price (which I did with Nick Scali and InvoCare).