# FORAGER

# CHIEF INVESTMENT OFFICER LETTER

QUARTERLY LETTER SEPTEMBER 2022

**FORAGER FUNDS PERFORMANCE SUMMARY** (as at 30 September 2022. Net of all fees and expenses)

| | 1 month return | 3 month return | 6 month return | 1 year return | 3 year return (p.a.) | 5 year return (p.a.) | 10 year return (p.a.) | Since inception* (p.a.) |
|---|---|---|---|---|---|---|---|---|
| **Forager Australian Shares Fund** | -6.53% | 6.70% | -21.57% | -28.92% | 2.18% | -0.69% | 9.12% | 8.62% |
| **Forager International Shares Fund** | -5.91% | -0.93% | -13.98% | -33.55% | 7.24% | 5.03% | - | 10.63% |

Past performance is not indicative of future performance and the value of your investments can rise or fall. Performance in FASF is calculated using Net Asset Value (NAV), not the market price.

*8 February 2013 for FISF and 30 October 2009 for FASF

The new financial year began the way the previous one ended, with global stock markets dancing to the tune of the world's central bankers. Stock prices surged for the first six weeks of the quarter on optimism that rate rises were coming to an end, only to collapse again when Federal Reserve Chairman Jerome Powell put paid to that assumption in a speech from Jackson Hole.

As I said at our annual roadshow events in July and August, I have never seen financial markets this momentum-driven or correlated. Whether interest rates need to go 1% or 2% higher doesn't significantly change our stock valuations. We are buying businesses that we expect to provide returns well north of 10% per annum over the long term.

The news on that front has generally been good. The largest investment in the Forager International Shares Fund, **Flutter**, has been announcing some thesis-confirming news (see the August monthly report). You can also read about some excellent recent news at Australian Fund investments **Motorcycle Holdings**, **Apollo Tourism and Leisure** and **Tourism Holdings** in this month's Forager Australian Shares Fund report.

More of this is what we are hoping for over the coming years. A world of higher interest rates and cheaper stocks is one in which there are more opportunities to find businesses like these, buy them at attractive prices and let the businesses deliver us outstanding returns. So don't be hoping for a big market rally. If wider markets rise significantly and everything gets expensive again, that only makes our job more difficult.

Speaking of Flutter, it is a business we are confident will grow (a lot) over the coming decades. It is also an investment the likes of which risk getting me kicked out of the value investor's club.

## BUYING GROWING BUSINESSES IN A VALUE FUND

Is it fair to say that there is a style change occurring at Forager? It's a question we received off the back of our recent roadshow after disclosing that about one-third of our Forager Australian Shares Fund is currently invested in tech stocks. Plenty of people want to know if we can still call ourselves value investors.

Value investing has always, to me, meant investing in shares of a company at a significant discount to the underlying value of the business. That has often incorporated businesses with significant growth prospects, as long as those growth prospects aren't reflected in the share price.

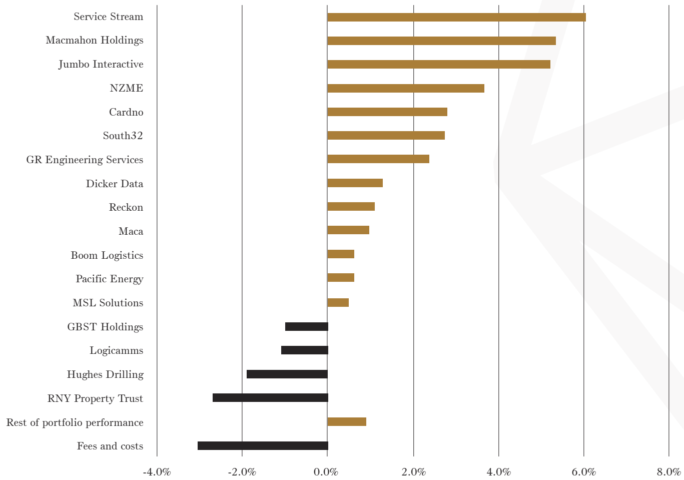
Wind back five years to our 2017 Performance Report and many of the best performers that year were growing businesses and tech companies.

**Jumbo Interactive**, **GBST** and **Reckon** were all tech stocks. Jumbo and GBST were barely profitable at the time we bought them. Dicker Data was a growth stock (albeit one trading on a low earnings multiple at acquisition).

Most of our historically successful investments were businesses that grew, even if they weren't priced to grow at the time of our first investment.

This is not unique to Forager. Most famous value investors are perfectly capable of valuing growing businesses. One of Warren Buffett's most successful investments, the Coca-Cola Company, was one of the 20th century's greatest growth stocks. Seth Klarman's publicly disclosed holdings currently include Amazon and semi-conductor company Qorvo.

### FASF CONTRIBUTION FOR THE 12 MONTHS ENDING 30 JUNE 2017




### HANGING ON TO THE VALUE MONIKER

The challenge is that the understanding of what constitutes a value investor has changed with the rise and rise of index funds. By categorising the market as either "value", for stocks with high dividend yields and low price-to-earnings ratios, or "growth" for those with the opposite characteristics, index providers could offer factor funds. Seth Klarman without the fees.

But I'm not yet ready to give up the moniker. Value investors have appreciated growing companies since before the index fund existed, and the distinction between us and the rest is still important.

Quality and growth are not criteria for our portfolios, simply inputs into our valuations. We want to own quality when it is unloved or underappreciated, not quality for quality's sake. Forager's Australian Fund also has investments in **Seven West Media**, mining services and **Qantas**. None of those would meet a "quality" filter. We simply invest on estimates of future cash returns to shareholders. That is equally true of Seven West Media, where we think the earnings will probably shrink slowly, as it is of **RPMGlobal**, where the earnings are fairly obviously going to grow.

### MORE NOW, BECAUSE THE TIME IS RIGHT

Forager has certainly "drifted" towards a higher allocation to growing companies over the past few years. There are two good reasons for that.

First, look back at that 2017 list and you will also see **Boom Logistics**, **Hughes Drilling** and **RNY Property Trust**, a cluster of asset-heavy businesses that we invested in at substantial discounts to the "value" of their tangible assets. These did not work out well and were subsequently joined by the likes of **Thorn Group** and **iSelect**, similarly "cheap" stocks that never generated the profits we expected. Every business has a price. But the gap between the right price for a shrinking business and a growing one is a chasm. We learned that more than once.

Second, investors should expect us to "drift" a lot.

We have a particularly high weighting to tech stocks at the moment. They are all established businesses with predictable and growing revenue streams.

Investors didn't give a hoot about profits 18 months ago and tech stocks traded on revenue multiples. Today, the share prices have been absolutely hammered, and all anyone cares about is profitability.

Yes, some of them are currently reporting losses. But that is largely a function of significant investment in attracting new customers rather than any reflection on the profitability of the existing customers. Twenty years ago the accounting standards allowed companies to capitalise customer acquisition costs and spread the expense over the life of the expected revenue stream. That, predictably, led to a proliferation of aggressive and unrealistic assumptions and overstated profitability.

Today's accounting standards, where all customer acquisition costs get expensed upfront, lead to an understatement of economic reality.

For the value investor, therein lies the opportunity. These businesses are no more difficult to value than most, and our estimates have not changed meaningfully over the past 18 months. Yet some share prices are 70% lower, taking them from premiums to our valuation estimates to significant discounts. We buy them when they are cheap.

If those share prices rise a lot and everyone else becomes optimistic, you should expect us to be moving on to the next sector that is out of favour.

If that gets us kicked out of the value investors' club, then so be it.

Kind regards,

**Steven Johnson**
Chief Investment Officer

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