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## Isentia Shows That “Good” Businesses Can be Risky Too

**Isentia**’s shares were trading at \$3.50 this time last year. Yesterday the stock closed at \$1.05. There’s nothing unheard of about a 70% share price fall. Forager investors have experienced a few of those over the years. What’s interesting about this one is that Isentia was supposedly a “high quality” business – one with a competitive advantage that allows it to earn above average returns on capital.

You expect to lose your money every now and then buying highly leveraged mining services businesses. You don’t necessarily expect it buying at the quality end of the spectrum.

### **Lesson learned on competitive advantage**

Isentia’s business is media monitoring. Teams of people scan newspapers and television broadcasts every day and collate a report of relevant news and articles for their clients. It is a simple business but one that tends towards a market place with one dominant provider.

There is little economic sense in replicating the large team of people required to scan and dissect hundreds of newspapers, magazines and TV shows every day. Once a media monitoring business has the largest coverage and most clients, it becomes self-fulfilling.

Unfortunately for Isentia, the increasing prevalence of online content eroded that competitive advantage. Website content and social media has become far more important than print, and a computer can do the job.

Here is an example of how dramatically the media monitoring world has changed.

When Dick Smith entered receivership in January 2016, Forager’s website crashed under the weight of unprecedented traffic to our site. Numerous press articles mentioned Forager thanks to a blog post written in October 2015 titled [Dick Smith is the Greatest Private Equity Heist of all Time](#). A typical post on Forager’s blog gets about 1,500 unique views. In that first week of January, more than 200,000 saw the Dick Smith post.

Our PR agency at the time sent us a daily report – provided by Isentia owned Media Monitors – which highlighted newspaper articles that mentioned Forager. None of them featured prominently when we looked at the sources of traffic to our site. The most prominent source, by some multiple of its nearest competitor, was Reddit.

We pointed this out to the agency. They asked the same question some of you are asking now: what’s Reddit?

I will let you answer that for yourself. The point is that the most important reference to our business was coming from somewhere the PR company had never heard of and Media

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Monitors wasn't monitoring.

The world has changed. And the only thing keeping Isentia in business was that most of its clients are too slow to notice, or unaware of how to deal with it. Yesterday's announcement suggests they are slowly catching up.

Most "growth" investors think the world is going to change more than it is. At the other end of the spectrum, value investors can often get caught thinking the world will stay as it is forever (see our [September Quarterly Report](#) for more on this topic).

### **It is a long way down when the moat dries up**

The consequences of incorrectly analysing or overestimating competitive advantage can be severe.

As at 30 June 2017, Isentia's balance sheet showed \$5m worth property plant and equipment and another \$37m of working capital (cash and receivables less payables). For roughly \$40m you could replicate the physical assets of Isentia. Given it made \$35m of pre-tax income in the 2016 financial year, you can see why it was considered a wonderful business.

The \$3.50 share price a year ago implied a market capitalisation of \$700m. Throw in about \$60m of debt and the assumption was that the total business was worth \$760m (its "enterprise value"). The implied value of its moat – the gap between the value of its physical assets and the market valuation – was more than \$700m.

Businesses that don't need much capital can make for wonderful investments. We actively seek them out and are prepared to pay a premium for them. It is essential, however, to be confident that the moat is sustainable when buying these types of companies. When 90% of your company's value is moat, it is a long way down when the moat dries up.