
ThinkSmart Torpedoes Efficient Markets

Efficient Market Theory is the idea that asset prices accurately reflect all available information and thus it's impossible to beat the market on a risk-adjusted basis without luck, and lots of it.

This is not another pointless rant against a theory nobody believes in literally, at least in its hard form.

But anyone who has ever invested in the sharemarket recognises the usefulness of the idea. Markets are mostly efficient, most of the time. When it's time to make any investment, we better have a good theory as to why we're right and "the market" is wrong.

Seamless information flow, more analysts, more computer power. These are but a few reasons why markets are also getting more efficient over time. Although their periodical insanities may also be getting more extreme too.

Still, markets can be surprisingly ignorant from time to time. Especially at the smaller end of the market.

Afterpay's little cousin

Afterpay (ASX:APT) and **ThinkSmart** (AIM:TSL) are joined at the hip. Afterpay needs no introduction for Australian investors. The Buy Now, Pay Later (BNPL) giant took the Antipodes by storm. It is now doing the same in the US and UK. Early investors have made 20 times their money and it is now one of Australia's largest companies by market capitalisation.

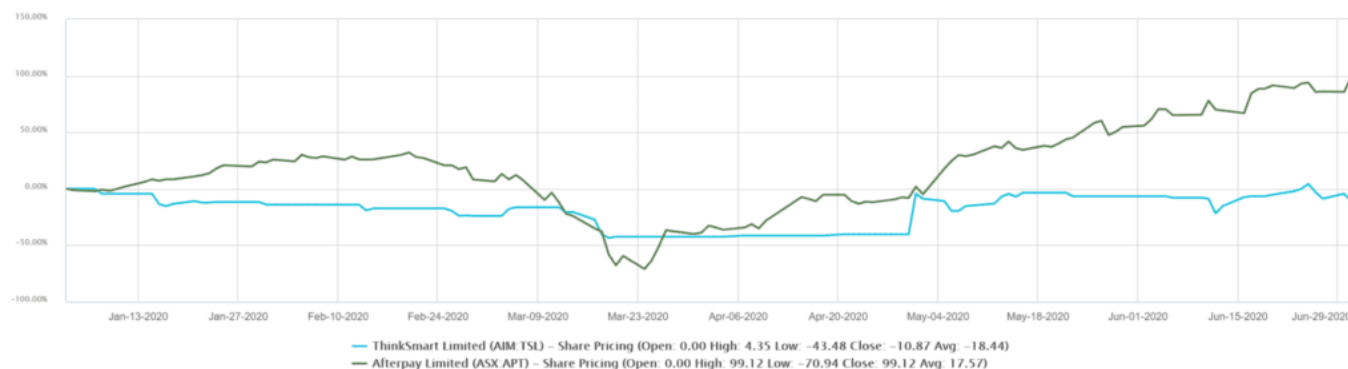
Thinksmart won't be so familiar, unless you are an investor in our Forager International Shares Fund (which has made a lot of money out of the stock over the past few years).

A few years ago when Afterpay was focused on Australia, tiddler ThinkSmart started a copycat business in the UK called Clearpay. When Afterpay decided to take on the UK, they deemed it wiser to acquire the fledgling Clearpay than start from scratch.

That's how ThinkSmart ended up with a 6.5% stake in Afterpay's UK operation, which is overwhelmingly ThinkSmart's main asset. Afterpay has the option to buy this 6.5% stake in Clearpay from mid-2023, and ThinkSmart has the right to force Afterpay to buy it from mid-2024. The sale price will be based on "agreed valuation principles" which link to Afterpay's market capitalisation at the time of purchase and the size of the UK business relative to Afterpay's other markets come that date.

For a few years now, it's been pretty easy to calculate fair value for Thinksmart shares. The two stocks should walk largely in lockstep (adjusted for any moves in the UK pound against the Australian dollar). Even if you think ThinkSmart should trade at a large discount to fair value, which it has, the shares should still dance in tandem.

And yet, here's what happened over the first 6 months of 2020.



Afterpay shares rose 99%. And ThinkSmart shares *fell* 11%.

It was enough to perplex some folk:

https://twitter.com/forager_gareth/status/1278557128689504257

Buy Now, Rally Later

And what about the almost 9 months since 1 July 2020?



Afterpay rose a further 73%, ThinkSmart ? 271%.

Efficient markets?

As you might have guessed, we've been selling ThinkSmart shares aggressively over the past few months and have been putting the proceeds into more certain bargains. We sold the last of our shares a few weeks ago. The stock is still cheap enough to make sense to a long/short fund. But for us, the Afterpay exposure is unhedgeable, and we don't want to own it at anything other than a gaping discount.

What about that all-seeing, all-knowing market? Well there's still plenty a diligent investor can do to gain an edge over it. Look hard and think smart.

