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SE portfolio

HD Wise choices reap firm yields

BY Trevor Hoey - Trevor Hoey uses socioeconomic trends to identify stocks with the best potential for growth.
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HOEY'S TOP TEN - shares

Wise choices reap firm yields

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Allure of foreign markets lends bullish outlook across IT, food, health, leisure and aged care sectors, writes Trevor Hoey.

1

Ingenia Communities Group

Ingenia is a leading operator, owner and developer of affordable housing for senior Australians. It has 58 villages across Australia comprising about 3800 homes. The share price fell more than 10 per cent towards the end of May when management advised of temporary supply delays in relation to new manufactured homes for its retirement village business.

There has also been a nominal impact from the government's decision to discontinue the National Rental Affordability Scheme incentive funding. While the company only has 17 residents at one rental village in Queensland affected by this change, when combined with supply chain issues this news may have contributed to negative investor sentiment. Those issues aside, there were positive factors. Management noted demand for its Lifestyle Parks had remained strong, resulting in margins being maintained at historically robust levels.

The company has a market-leading position in NSW where it has 15 Lifestyle Parks, comprising 166 permanent and short-term sites. There is also a pipeline of about 930 sites, many of which have development approvals.

Chief executive Simon Owen said demand and margins were exceeding expectations.

Owen said the group had significant deal flow in place in the NSW market and anticipated announcing further acquisitions in the coming months. The company had also started a detailed assessment of the South East Queensland market, with several opportunities under exclusivity or due diligence.

Ingenia's Garden Villages portfolio focuses on the provision of independent living options for seniors. Owen said this area of the business continued to perform to expectations, with occupancy now at 81.5 per cent.

The Ingenia Care Assist program now has 142 participants – a credible platform to build on given it was only launched in October last year.

Current numbers will equate to approximately $1.3 million in annualised gross income in 2013-14, and that project is already cash flow-positive.

Si view: While recent news caused some short-term share price downside, it could be offset over the year by positive developments in acquisitions and a return to satisfactory supply chain performance.

2

Virtus Health

Virtus Health's acquisition of a 70 per cent stake in SIMS IVF, a leader in the provision of IVF (in-vitro fertilisation) services in Ireland, represented an important development for the company. The SIMS transaction is a substantial boost for Virtus by size, given that it generated earnings before interest, tax, depreciation and amortisation of €2.8 million ($4 million) from revenue of €12.4 million for the year to December 31, 2013. The company will fund the acquisition from cash and existing bank facilities, resulting in no earnings-per-share dilution. SIMS's maintainable earnings would have increased Virtus's earnings per share by about 2¢ in 2013 based on existing exchange rates.

From an operational perspective, the addition of SIMS is in keeping with the company's ¬¬long-term goal of expanding into international markets, as well as growing its core business.

Virtus chief executive Sue Channon said Ireland is an attractive market with a number of operational and regulatory similarities to Australia. She confirmed the company would continue to seek value-accretive opportunities to expand its network with leading IVF businesses in its targeted regions of Europe and Asia.

Channon said such additions would complement the organic growth the company is seeking through its fertility clinics, day hospitals and diagnostic services. Management said in February the company was on track to meet 2013-14 prospectus forecasts.

Virtus has snared what appears to be a good acquisition; the terms of the SIMS purchase offer Virtus the option to acquire the remaining shares in the company in two tranches in 2017 and 2019.

Si view: A player in a niche market with high barriers to entry, Virtus has defensive characteristics. It expects to enter the Singapore market in November: a platform for expansion in the Asia region.

3

Adelaide Brighton

Building materials company Adelaide Brighton took a hit in May after the company provided profit guidance 6 per cent below consensus estimates. Some brokers responded harshly, but there could be value in a company that has traditionally recovered quickly from the sort of setbacks recently encountered.

In lowering its earnings estimates, Bell Potter noted the $5 million negative effect on cement margins of a strong Australian dollar compared with the Japanese yen, as well as the loss of about 5 per cent of lime volumes from reduced gold production in Western Australia and the shutdown of a Northern Territory customer.

A significant positive is the decision to rationalise clinker production at the Munster site in WA: by 2016 all 400,000 tonnes of clinker produced there will be replaced by imported clinker, which will be milled into cement at Kwinana and Munster.

This decision is expected to boost annualised earnings before interest and tax by $5 million.

Si view: Adelaide Brighton's underlying fundamentals remain strong and it stands to gain from recent and coming capital investment, the benefits of which should be apparent in 2014-15, moving into 2015-16.

4

Technology One

IT software and services provider Technology One delivered a mixed performance for the six months to March 31, 2013, with revenue exceeding broker estimates but profit falling slightly short. Management declared an interim dividend of 1.95¢, in line with the expectations of analysts at Bell Potter.

Executive chairman Adrian Di Marco said profit growth of between 10 per cent and 15 per cent is expected.

Technology One's shares rallied about 7 per cent on the day its results were released, hitting a new high of $2.66. This implied a price-earnings multiple of 26.6 relative to Bell Potter's 2013-14 pre-result forecasts which remained virtually unchanged.

One of the highlights of the result was a 24 per cent increase in initial licence fees, a strong indicator of the success of its product and an important **lead** in relation to the future performance of its other segments, particularly recurring revenue growth from licence fees.

Si view: Given Technology One has traditionally been a medium-term stock, the licence fee data may provide enough confidence in the longer-term outlook to provide share price support around current levels.

5

Domino's Pizza Enterprises

Analysts at Moelis have taken a bullish stance on Domino's Pizza Enterprises, tipping more upside from the high-flyer after a strong performance over the past 12 months.

Domino's interim result, released in February, shows the **company** is reaping the benefits of its entry into Japan, but it is worth noting from a sales perspective that its Australian, New Zealand and European **operations** all delivered year-on-year gains, resulting in overall sales growth of nearly 40 per cent. With underlying net profit up 38.8 per cent and earnings-per-share growth of 20.3 per cent, a premium multiple appears justified. Determining the extent of the premium is the challenge.

Moelis slightly upgraded earnings forecasts in May, and its 12-month share price target of $23 implies a fairly heady price-earnings multiple of 36.4 relative to its 2014-15 forecasts. The broker is factoring in earnings-per-share growth of 25.9 per cent in 2013-14, followed by growth of about 18 per cent in both 2014-15 and 2015-16.

Si view: From an operational perspective, Japan is the real growth engine, with Domino's now the number-two pizza brand in Japan and likely to be market leader within two years by Moelis' estimates.

6

Aristocrat Leisure

Analysts at Citi responded favourably to Aristocrat Leisure's result for the six months to March 31, 2014. The broker maintained its buy recommendation and increased the 12-month price target from $5.80 to $6, noting the provider of gaming products and services is poised for strong earnings growth in the second half of 2013-14 and 2014-15.

Citi forecasts an underlying net profit of $168 **million** in 2014-15. This compares with $123.2 **million** in 2013-14, implying year-on-year earnings per share growth of 36.2 per cent.

Aristocrat's expansion into overseas markets is one of the key drivers and while first-half revenue from North America was flat, Citi highlighted it masked underlying market share gains. In participation games, Aristocrat was the only major supplier to grow its installation base. Not only did it achieve 645 new additions, but daily fee growth of 6.1 per cent was realised.

Outright sales in North America rose 3.9 per cent, however, its three major peers had falls.

Si view: Recent successful game releases will add to the second half of 2013-14 and go on to have a major impact in 2014-15. Aristocrat's social gaming has almost doubled to over 500,000 active daily users.

7

Cover-More Group

Analysts at Bell Potter initiated coverage of Cover-More Group with a buy recommendation and a 12 month price target of $2.62. This came five months after the **company** listed on the ASX in December 2013 with an IPO price of $2 and shortly after its shares hit $2.49.

Despite being Australia's largest travel insurance **company** it hasn't all been plain sailing for Cover-More with its shares trading below the IPO price in its first two month as a listed entity. The **company**'s inclusion in the S&P/ASX 200 on March 21 prompted a 20 per cent re-rating.

In assessing the group's overall outlook Bell Potter's confidence is buoyed by the **company**'s strong industry position and the expectation of sustained robust levels of international travel.

The broker views recent volatility in the Australian economy that could affect spending as short-term. Low airfares, favourable currency movements and increased capacity from low-cost airlines are expected to well outweigh a potential lull in consumer activity.

Si view: Cover-More is in the early stage of developing travel insurance capabilities in India, **China** and Malaysia with high upside potential. Its dominant market position justifies its premium price-earnings ratio.

8

Pacific Brands

Analysts at Citi have posed the question whether Pacific Brands is worth more to someone else compared with its implied valuation as an ASX listed **company**. After disclosing earnings before interest and tax for 2013-14 were likely to be in a range between $90 **million** and $93 **million** as opposed to guidance of $105 **million** its shares plummeted.

Having revised its forecasts, Citi determined earnings before interest and tax would fall 25 per cent despite sales growth. It is of the view margin pressure is unlikely to ease in 2014-15. Given this backdrop the broker downgraded earnings per share forecasts between 2013-14 and 2015-16 inclusive by 15.8 per cent, 19.1 per cent and 13.4 per cent. Analysts at Moelis downgraded earnings by a similar proportion and have a sell recommendation on the stock.

By contrast, Citi downgraded its target price from 67¢ to 60¢ but upgraded its recommendation from neutral to buy. The price target is based on the probability of a takeover.

Si view: Citi expects clarity about a break-up by the end of 2014. It notes Pacific has five high-profile labels and thinks these alone are worth more than its current market capitalisation of $465 **million**.

9

Super Retail Group

Trevor Hoey

In May, analysts at Bell Potter downgraded earnings per share forecasts for Super Retail Group for 2013-14 and 2014-15 by 5 per cent, anticipating it would be affected by unseasonably warm weather. The broker also downgraded its recommendation from buy to hold and slashed the 12-month price target from $12.22 to $9.03.

Bell Potter expects Ray's Outdoor, AMart and Rebel to be hardest hit by the unseasonable weather. However, while camping goods should feel the pinch, the sporting goods sold by Rebel and AMart could negotiate the headwinds related to depressed consumer spending.

There is also evidence to suggest the **company**'s Boating Camping and Fishing (BCF) business could hold its ground given its strong like-for-like sales performances in past years when consumer confidence was at low levels. There is already evidence more conservative spending could be directed to stay at home activities rather than travel.

Si view: Over the past five years Super Retail Group's average price-earnings multiple is 15.2. With its recent trading range implying a much lower multiple, further weakness may present an opportunity to buy.

10

Viento Group

Viento Group provided upbeat 2013-14 guidance in June, representing a substantial improvement on its 2012-13 result which featured an earnings before interest, tax, depreciation and amortisation (EBITDA) loss of $1.7 **million** from revenues of $24 **million**.

Following the acquisitions of HVLV and Power Infrastructure Services, the **company** expects EBITDA between $10 **million** and $12 **million** from revenues of about $100 **million** in 2013-14.

Executive chairman, Ray Munro, said the result demonstrated early success in the board's decision to create a diversified earnings base for the **company** which it expects will continue to produce further growth in 2014-15.

Viento provides a broad range of services to the **mining**, **oil** and gas industries.

While only small, the **company** has won contracts from big players such as Rio Tinto. The most likely share price catalyst will be new work. As a junior, regular news will be required to achieve a substantial share price recovery.

Si view: Viento's strength is its diversification and if it can secure further work in the more resilient **oil** and gas industry, reducing its reliance on revenues from **mining**, it could come back into favour.

CO villif : Ingenia Communities Group

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