SE portfolio

HD **Celebrate the performers**

BY Trevor Hoey - Trevor Hoey uses socio-economic trends to identify stocks with the best potential for growth.

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HOEY'S TOP TEN

With earnings season now over, the market has had time to sort the wheat from the chaff, writes Trevor Hoey, and there are plenty of opportunities among well-run companies.

TD

1 AV Jennings

REAL ESTATE

As a national property development company with nearly 10,000 lots under management, with a gross value of more than $2.5 billion, it is hard to understand how AVJennings flies under the radar. In part it could be attributed to the sector being out of favour until recently, or its smaller market capitalisation of about $250 million.

But the company is punching above its weight financially, with pre-tax profit up 216 per cent in 2013-14 to $27 million and Bell Potter forecasting net profit after tax to increase from $15.2 million to $17.2 million in 2014-15. This represents year-on-year earnings per share growth of 13.7 per cent, but the real kick is expected to come in 2015-16 when the broker is forecasting growth of 33 per cent, implying earnings per share of 6¢. This would see AVJennings trading on a price-earnings multiple of about 14 relative to Bell Potter's 12-month price target of 82¢, upgraded from 78¢ after the company delivered its 30 per cent higher than expected full-year result.

The price target is supported by AVJennings' net tangible asset backing of 81.4¢ per security, as at June 30, 2014. This is likely to increase substantially in the near to medium term as the company enters a growth phase, developing its large land bank into residential housing projects.

Bell Potter highlighted that detached dwelling activity on the east coast looks to have recovered substantially, with approvals up 48 per cent from their post-GFC slump. AVJennings built up its land bank when prices were low so now has a strong balance sheet, with a debt to total asset ratio of 17 per cent.

Despite the low interest rate environment, affordability for first home owners remains a challenge. But AVJennings' house prices are mainly in reach of entry-level buyers.

Management said there is a significant housing shortage, notably in Auckland, Brisbane and Sydney. AVJennings recently acquired 400 lots in Auckland, potentially extending its success in the Catalina Precinct project.

Si view: AVJennings forecasts between 1500 and 1700 contract signings in 2014-15. Its metrics look strong, with the group having its highest levels of lots under development in seven years.

2 Pioneer Credit

DIVERSIFIED FINANCIALS

Pioneer Credit defied the market rout in September, its shares gaining more than 10 per cent. It benefited from a strong 2013-14 result and from an agreement struck with one of its major banking partners.

The provider of consumer debt management services listed on the ASX in May, but its share price flatlined until August, trading below its IPO price of $1.60. However, the quality of its annual result couldn't be denied. Customer payments were up about 60 per cent compared with the previous corresponding period, helping to generate net revenues of $25.8 million.

Operating profit after tax of $4.6 million was slightly ahead of prospectus forecasts, and management provided guidance which implied a sharp uptick in earnings in 2014-15. The group forecasts customer payments of $57.4 million, underpinning an after-tax profit of $6.6 million, representing earnings per share of 14.6¢.

Pioneer's announcement in late September that it had expanded its forward flow investment program through a new agreement with one of its major banking partners was viewed favourably by Bell Potter. The broker highlighted this was the first such agreement with this bank, and was an important step in further diversifying its vendor base.

Bell Potter sees Pioneer as well positioned for long-term sustainable earnings growth, assisted by debt portfolio purchases and the demonstrated ability of its customer-focused model to maximise payments, essential in transforming debt repayment clients into users of its broader financial services product offering.

Si view: Bell Potter has a buy recommendation, with a 12-month target of $1.95. It believes recent developments have added credibility to the company's ability to secure business partnerships, as well as increasing its industry profile, providing a platform for further banking relationships.

3 Nick Scali

RETAILING

Furniture retailer Nick Scali lived up to its reputation of underpromising and outperforming, with a net profit of $14.2 million for the year to June 30. This was ahead of the expectations of Moelis analysts, who forecast a $14 million net profit, in line with management's June guidance.

The broker said the result underlined Nick Scali's qualitative strengths and its ability to negotiate challenging conditions. Like-for-like sales growth of 6.3 per cent speaks for itself as many retailers are struggling to sustain previous year's sales levels while maintaining margins.

Though gross margins were slightly lower than last year they remained solid, evidenced by the underlying net profit growth of 16.3 per cent being ahead of sales growth of 11 per cent.

Providing further positive sentiment were management's comments about a solid pipeline of orders, which should see the company deliver a strong result in the first quarter. The company will provide earnings guidance later in the year.

Si view: Moelis's 12-month price target of $3.30 appears easily within reach given it implies a forward price-earnings multiple of 16.6. This is supported by the current growth profile, but accelerating the store roll-out would bring higher earnings momentum.

4 Tassal Group

FOOD, BEVERAGE & TOBACCO

Shares in salmon farmer Tassal Group rallied after it delivered a solid 2013-14 result featuring lower revenues than the previous corresponding period, but a 13.9 per cent increase in EBITDA.

A warm summer in 2012-13 contributed to reduced supply, driving down revenue. But EBITDA of $78.6 million was achieved due to improved pricing and operational efficiencies, generating more dollars per kilo of fish.

Net profit of $30.5 million was lower than CIMB estimates of $31.3 million, but the full-year dividend of 11.5¢ compared well with brokers' expectations of an 11¢ return.

Management said it had agreements with major customers for fresh and smoked salmon for two to three years, an important factor when supermarkets are squeezing suppliers.

Strong cash flows helped Tassal improve its balance sheet, and net debt to equity is 15.4 per cent. Management is targeting a statutory return on assets of 15 per cent in 2014-15.

Si view: Tassal is trading in line with its 12-month price target, and any upside in 2014-15 appears to be factored in. The stock has merits for long-term investors comfortable with the risks linked to crop production.

5 Tandou

FOOD, BEVERAGE & TOBACCO

Agricultural group Tandou isn't easy to understand, particularly its financial performance. In 2013-14 profit fell from about $6 million in the previous corresponding period to a break-even result. Despite this, Tandou's shares barely moved. It all comes back to accounting treatment and even from this perspective there are anomalies, including the company's inability to recognise fair value for its water entitlements.

This has been a growth area, with valuation gains of $8.7 million pre-tax. But management provided some indication of the value of its assets. Tandou had a net asset backing of 59¢ a share as at June 30. This represented a rise from 57¢ a share in 2013. Based on independent valuations, the net asset value per share including water entitlements is 64¢ a share, a substantial premium to its current trading range. Water entitlements holdings rose 148 per cent in 2013-14 to $78 million.

Si view: With core debt of $12.1 million and the potential for better growing conditions, Tandou looks reasonable value given its shares are trading at a substantial discount to net tangible asset value.

6 NIB Holdings

INSURANCE

Shares in NIB Holdings pushed up to their all-time high of $3.38, struck in mid-June, when it delivered its 2013-14 result in August. Top-line growth was 15.6 per cent and revenue increased to $1.5 billion. Though operating profit was up 4.3 per cent to $72.3 million and was below guidance of between $73 million and $78 million, the result was generally well received by analysts.

Bell Potter highlighted the combination of increased competition and a loss of $8.8 million associated with one product contributed to a modest result for the core health insurance division. The broker expects the average 8 per cent premium rise, which began in April, will lead to a big improvement in margins in 2014-15.

NIB declared a special dividend of 9¢ a share as part of its capital management plan, and Bell Potter anticipates this strategy will continue in 2014-15. The broker made nominal increases in earnings per share estimates in 2014-15 and 2015-16, but increased the 12-month target from $3.04 to $3.21.

Si view: NIB seems robust with cash and investments of nearly $560 million at year-end, up from about $500 million in the previous corresponding period . Net cash inflow of $93.7million is a better indicator of performance than net profit and perhaps caused the positive share price response.

7 Sedgman

CAPITAL GOODS

Engineering and construction group Sedgman's break-even 2013-14 result wouldn't normally be well received by investors, but with consensus estimates indicating a loss of $2.3 million it wasn't surprising to see the company's share price bounce.

From closing at 50.5¢ on August 27, its shares spiked more than 20 per cent over the next three days. Moelis said a strong second-half performance in projects provided momentum into 2014-15 but assumptions shouldn't be made about the renewal of three contracts.

Aside from this potential upside, the 10 per cent increase in the order book to $385 million is important when put into perspective. This represents income in excess of the $355.9 million generated in 2013-14.

Even though revenue will be spread over more than 12 months, it is robust work in hand. Benefits are starting to materialise from diversification beyond the coal industry.

Si view: Moelis is forecasting 2014-15 EBITDA to increase from $17.1 million to $30 million. It expects Sedgman to pay dividends totalling 5¢, implying a substantial yield relative to its current trading range.

8 Collins Foods

CONSUMER SERVICES

Collins Foods provided a positive update at its annual general meeting in September, indicating it had achieved a net profit of $4.5 **million** in the 2014-15 first quarter, representing an increase of 21 per cent on the previous corresponding period. This was driven by good sales figures, with revenue up 28 per cent to $124.3 **million**.

First quarter same-store sales growth was 3 per cent. The **company** should go on to harness additional growth from store rollouts. It plans to open five KFC restaurants in Queensland and two in Western Australia, and remodel 16 outlets. While Collins tries to rejuvenate its Sizzler **operations** in Australia, it's a different story overseas where it has 60 restaurants across **China**, Japan and Thailand.

Moelis' analysts expect the March **acquisition** of Competitive Foods will provide earnings per share accretion of 15 per cent in 2014-15, a significant proportion of overall forecast growth of 20.4 per cent.

Si view: Moelis has a 12-month target of $2.75 on Collins Foods. The **company** should maintain earnings per share growth of 11 per cent in 2015-16 and 2016-17 after the sharp uptick in 2014-15.

9 SMS Management & Technology

SOFTWARE & SERVICES

While shares in SMS Management & Technology plunged from the previous day's close of $4.22 to hit an intraday low of $3.72 on the day it delivered its 2013-14 result, some analysts believe it could be poised to rebound.

The IT services provider had a stellar run after the global financial crisis as its shares increased from about $1.70 at the start of 2009 to a high of $7.20 in early 2010, an increase of more than 300 per cent. It remains to be seen whether the **company** can produce a similar rally when **business** investment in the IT sector recovers.

Certainly, the 2013-14 net profit of $12.7 **million**, down 40 per cent on the previous corresponding period, was uninspiring. But new contracts worth $348 **million** were signed during the year, representing an increase of 10 per cent.

Another encouraging sign was an improved fourth-quarter performance, reflecting more traditional patterns with a seasonal uplift in utilisation and client activity.

Si view: CIMB analysts believe SMS is set to recover. It upgraded its recommendation to add, forecasting earnings per share growth of 25.6 per cent in 2014-15 and 13.2 per cent in 2015-16.

10 Australian Vintage

FOOD, BEVERAGE & TOBACCO

Shares in Australian Vintage rallied 30 per cent in the two months leading up to the winemaker announcing its 2013-14 result. With net profit up 49 per cent to $10.5 **million**, despite nominal revenue growth, it was an impressive performance, demonstrating management has been successful in focusing on more profitable areas of its **business** while driving down costs.

These should continue to drop, with the **group** announcing it won't renew above market-priced grower contracts that expire in 2016. Chief executive Neil McGuigan said they would be replaced with fair market-priced grape contracts which would immediately yield cash benefits.

Exports to North America and Asia were up by 25 per cent and 15 per cent respectively and, with strong sales of its McGuigan **brand**, helped boost profits in a low sales growth environment.

Australian Vintage also had to deal with the challenges of a low vintage which negatively affects processing margins.

Si view: Bell Potter noted AVG continues to transition from a bulk **wine** operation to a branded **wine** play. Its growing presence in Australia is likely to be complemented by an emergence in **China**.

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