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Sohn Hearts and Minds 2018: Top investment tips from leading fund managers

Wilson Asset Management chairman Geoff Wilson says mobile gaming company Bandai Namco has the potential to rise by more than 50 per cent. Daniel Munoz

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Leading fund managers have gathered in Melbourne's Hamer Hall for the third Australian Sohn Hearts and Minds investment leaders conference. Here are their best ideas:

Peter Cooper, Cooper Investors: Liberty Sirius XM (LSXMA: NASDAQ)

Mr Cooper is a long-term backer of businesses that John Malone has run and owned. "What I really love about John Malone is he brings a culture of owner management," he says. "He has a ferocious focus on costs, return on investments and returns." Cooper expects a 68 per cent return over three years for a tracking stock of one of Malone's companies, Sirius XM which is a satellite radio group.

The company has 34 million subscribers paying $US15 a month and is growing strongly. Sirius XM, which was formed when two satellite radio competitors merged, is now taking over Pandora, which Cooper says may be temporarily depressing the valuation but has great opportunity.


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Usually, tracking stocks where voters have no voting power typically trade at between 5 and 15 per cent discounts, but Liberty Sirius XM is trading at a 30 per cent discount. The combined company will have 100 million active customers. In particular, he noted how Sirius XM has 25 million people take up free trials, and of those only one-third take up services, with the potential to channel the others to Pandora.

Craig Collie, Regal Funds Management: (short) Celltrion (068270:KRX)

Regal Funds Management's Craig Collie says Celltrion, a Korean-based copycat pharma company with a $US35 billion market cap, has only got to where it is through a combination of deceptive accounting and the exuberance of Korean retail investors.

The fund manager expects this is about to come to a stop. "We envisage a long and steep share price correction," he said, forecasting 80 per cent downside to the stock. Celltrion has reported sales of $US1 billion, but Regal says the company is overstating its earnings five-fold. In particular, Collie says the company is using a swag of accounting tricks, including hiding debt off-balance sheet, capitalising R&D and most significantly, using subsidiaries to inflate sales and earnings.

Regal says Celltrion uses intermediary Healthcare Celltrion to stuff product into, estimating it has 3.5 years worth of inventory. But he says this way of moving stock is likely to be coming to an end: minority shareholders in the subsidiary are getting nervous, and the channel stuffing is fading. He believes a similar trend has been taking place with distributors, and this is also slowing.

Life in the canned soup business is difficult. AP

Another factor that will prompt a drop in company sales and profits, Collie says, is that it is facing greater competition. When it launched its first two products, there were only a few competitors. For upcoming products, it's likely to be more than 10, though it varies from product to product. Collie says management is another red flag.

Chris Demasi, Montaka: (short) Campbell Soup Company (CPB: NYSE)

We all know that we're shopping differently now for food, and that's making life in the canned soup business difficult.

Fresh food and nutrition leads consumers to smaller brands. All the while the very large supermarkets are taking back their shelf space and promoting private label products.


Jun Bei Liu selected New Oriental Education & Technology Group as a long idea. Janie Barrett

Canned soup sales are down a third in the last decade. They've been cutting costs for so long, that the company needs to reinvest in marketing and innovation to have any chance of growing the top line. Campbell is attracting too high a multiple for inflated earnings and investors have used the stock as a yield substitute. "Equity risk for bond like returns," the fund manager said.

For the last six years it has gone on an acquisition spree and it is potentially headed for financial distress. Even an activist investor has failed to reinvigorate the strategy. The iconic business is "in trouble" and could halve from here.

Jun Bei Liu, Tribeca: New Oriental Education & Technology Group (EDU:NYSE)

The insatiable demand for after-school tutoring is best played through New Oriental, the fund manager said. The structure of Chinese families, the staggering growth of its middle class and its commitment to spending on education could propel the Chinese education group's shares higher by as much as 40 per cent in the next 12 months.

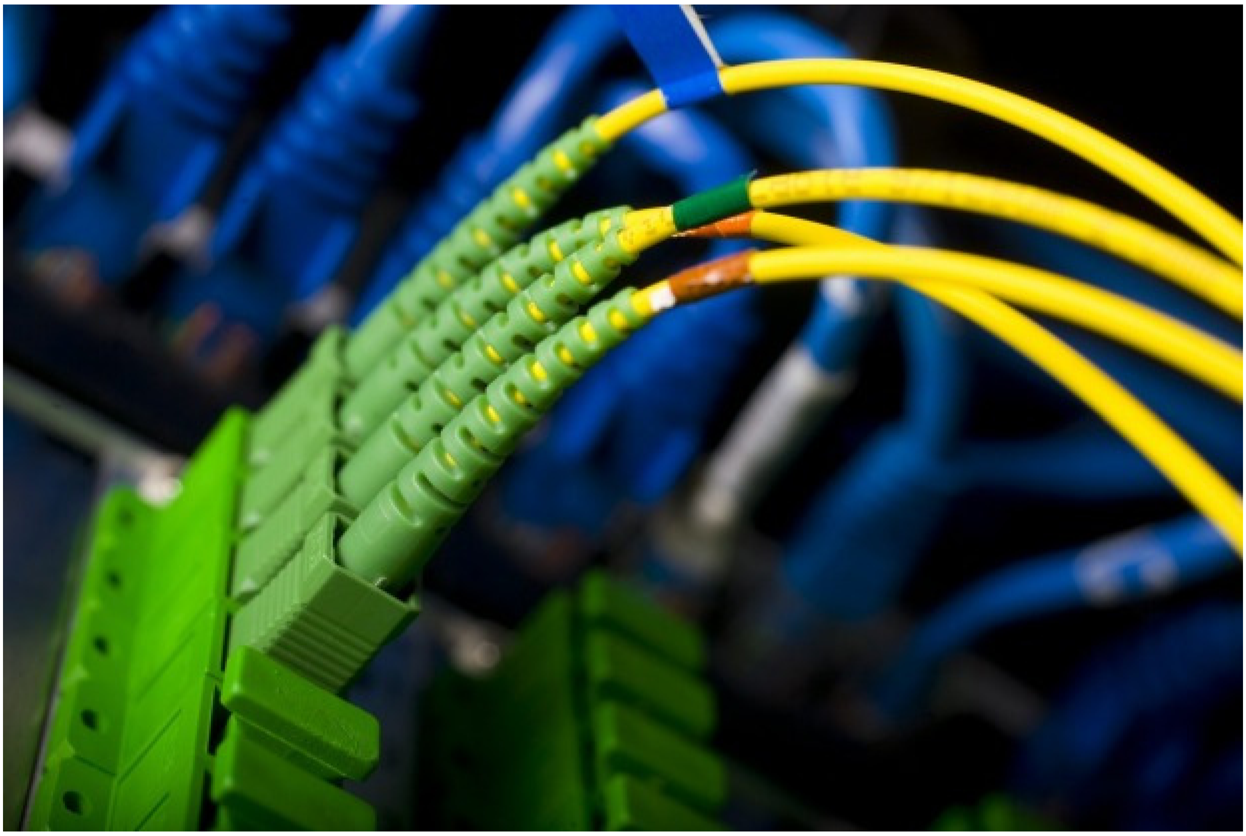
Alex Waislitz pitched Austin - an Australian small cap mining company that is well managed, well capitalised

Ms Liu says the China's middle class will grow so large that by 2030, about 25 per cent of the world's middle class will live in the nation. The consumption of this cohort will hit $11 trillion by that point; by comparison, Australia's gross domestic product will be $2 trillion.

A big chunk of that spending will be on education, which Liu says "has always been the number one shopping item for any Asian family". This has much to do with China's one child policy; each child has two parents and four grandparents doting on them.

Private education spending is tipped to climb three-fold by $US692 billion by 2030, and around 34 per cent that is likely to go towards after school tutoring – which is where New Oriental specialises. The company, which was founded in 1993, has 88 schools, 1,100 learning centres and employs 30,000 teachers in 76 students.

The company has been growing at 20 per cent per annum in recent years, and has delivered return on invested capital in excess of 20 per cent since 2006.



The major structural growth story of our time is data and the increasing importance of connectivity, Elephant Asset's Christina McGuire said. Nic Walker

But Tribeca sees room for more growth. The after-school tutoring market is very fragmented (the top two players have less than 6 per cent of the company) and New Oriental is well placed to drive consolidation and win market share.

Tribeca says the stock is cheap, trading on an enterprise value to EBITDA multiple of 17 times, compared to the multiple of 40 times its peers are trading on. The stock, listed on the New York Stock Exchange via American Depository Receipts, is currently worth $US58.82. Tribeca thinks it can hit $US90.30 in 12 months.

Paul Mason, Paradice Investment Management: Lear Corporation (LEA:NYSE)

Paradice Investment Management's Paul Mason describes Lear, which makes car seats and car e-systems, as a "deeply misunderstood business". He says it is well positioned to take advantage of mega trends, including the shift to e-vehicles and driverless cars, as well as more immediate automotive trends to SUVs in favour of sedans.

Mason says Lear, the biggest player in the luxury market, generates between 30 per cent and 40 per cent revenue from manufacturing seats for SUVs rather than sedans because they are larger, with more features. In addition, the customer base is very loyal because while they are a critical part of car safety features, they only make up 2 per cent of the cost which makes it a low priority to shift manufacturers.

But it is the so-called "e-systems" part of the business Mason is most excited about. Lear is the only supplier with full electronic architecture from the design, implementation and manufacturing, to installation. In addition to giving the company insight into trends between five and seven years out, Mason forecasts that most of its profits will come from tech by 2023 from 34 per cent at the moment.

That's partly underwritten by about half of vehicles expected to be electric or hybrid by 2028, which means market growth is five times. "Lear could conceivably increase content per vehicle by 500 per cent," he said. Mason said the company's allocation of capital in the past five years has been "nearly perfect". And he says the company is cheap at seven time earnings, even accounting for the slowdown in China and the sell-off following Volkswagon's Dieselgate.

Alex Waislitz, Thorney Investments: Austin Engineering

There are an estimated 2.3 billion gamers globally, and some millennials game to reduce stress, said Geoff Wilson. Peter Braig

Mr Waislitz of Thorney pitched Austin - an Australian small cap mining company that is well managed, well capitalised and well placed to deliver significant share price gains. Thorney has a 22 per cent stake in the mining services company with a market capitalisation of $120 million.

The company rejected a takeover from Bradken of $350 million, but then the mining boom ended and the downturn left the business saddled with debt.

The company has since been recapitalised and Thorney is betting that the large coal, copper and iron ore miners that have delayed maintenance spend will turn to Austin which manufactures dump truck bodies and mining equipment.

"When prices are lower they deferred maintenance and pushed their equipment to the limit," Waislitz said. "But the equipment must be replaced. It is happening now and Austin is in the box seat."

The share price, currently at 23¢, could move "north of 30" thanks to an added sweetener: the dividend could be reinstated.

Christina McGuire, Elephant Asset Management: Yangtze Optical Fibre and Cable (6869:HK)

The major structural growth story of our time is data and the increasing importance of connectivity, Ms McGuire begins. Not only human to human or human to machine, or indeed machine to machine, but even cows to farm. "The information we create with all of these connections is huge," she says. "We're not even looking at new technologies we're developing over the next five or ten years."

Data and connectivity has become increasingly politicised. Made in China 2025 identifies 10 sectors they would like to become self-sufficient in, the majority of which are linked to higher data and connectivity growth. This is enabled by infrastructure and means the network needs to be denser, easily 10 times as many base stations and optical fibre.

Mr Wilson said it was with a "heavy heart" that he selected an offshore company, but it was because of his concerns about Labor's proposal to make franking credits non-refundable. JOEL CARRETT

A telco however is not overly keen to spend a lot of money on a 5G upgrade.

But the Chinese government might take a different view, and can direct capex in any way desired. Enter Yangtze, a supplier to the sector: from 2014 to 2018 revenue doubled and profit quadrupled. We are now at the absolute trough between 4G and 5G capex, the fund manager says. It's a great time to consider going long, as the stock is trading at a bit over 6 times forecast earnings, and the only real risk is a delay attached to 5G capex. "We are looking at a fantastic structural story here," the fund manager concludes.

Geoff Wilson, Wilson Asset Management: Bandai Namco (7832:TYO)

The Wilson Asset Management chairman says mobile gaming company Bandai Namco has the potential to rise by more than 50 per cent in the next "little while", based on a low valuation, strong sector dynamics and strong intellectual property.

Global gaming top line growth is 10 per cent per annum, and in the mobile segment it's even greater: 20 per cent per annum. There are an estimated 2.3 billion gamers globally, and some

50 per cent of millennials game to reduce stress, improve mental health and feel confident, he said.

The company, created in 2005 with a merger of a toy company and gaming business, has good management, strong cash flow and is well positioned, he said. It's also cheap, growing at a similar rate to the industry with a multiple of nearly half of the market at 13.4 times cash adjusted earnings.

Wilson said it was with a "heavy heart" that he selected an offshore company, but it was because of his concerns about Labor's proposal to make franking credits non-refundable. Spotting Solomon Lew in the audience, Wilson told his fellow Myer shareholder that at least WAM's entry price was lower than Mr Lew's.

Beeneet Kothari, Tekne Capital Management: PagSeguro (PAGS:NYSE)

Firetrail's Blake Henricks was the first fund manager to present at the Sohn Hearts & Minds event in Melbourne on Friday. Daniel Munoz

Payments companies are incredible businesses that are growing and profitable, Mr Kothari says, and there's an undervalued gem in Brazil in the form of PagSeguro. The stock is cheap because of global investor aversion to emerging markets. While the company's growth did slow during the 2016 recession in Brazil, from 100 per cent to 40 per cent, it has since resumed triple-digit growth.

PagSeguro services small merchants in Brazil of which there are around 12 million. They account for a third of the GDP of Brazil. "You have the chance to own the dominant market leader in an enormous market," the fund manager says. "Just with earnings growth, you can get a stock that doubles in a few years," but the real gains will be made if the multiple expands from its current valuation of 10 times earnings.

"Why would it expand? Because the company does one tenth of what it could do in a few years." PagSeguro transacts $38 billion a year in payments – which is just 2 per cent of the total market size. "It can grow for a long time before running into market sizing problems and it is very profitable."

Kothari says investors are also concerned that Brazilian regulators will crack down on instalment payments, but this form of credit is a "way of life in Brazil". "Half of all transactions in Brazil have been payments on instalment and they allow the merchant to get immediate liquidity." Brazil is a country without a lot of household debt, so access to credit is achieved by purchasing goods on instalment.

Blake Henricks, Firetrail Investments: Nufarm

Why buy Nufarm? Industry consolidation and Omega 3. Nufarm has become undervalued because of the Australian drought and their distribution of a specific weed killer commonly used in crops. The company has had two stumbles, but Mr Henricks believes it presents great value at today's prices. The industry is now more consolidated than the Australian banking market. That means Nufarm can take organic market share as competitors are distracted doing M&A, in short, Nufarm is a beneficiary of industry consolidation.

Nufarm has a technology which earns nothing today but is worth $1 billion according to Firetrail. Humans rely on small fish as a source of Omega 3, growing around 6 per cent per annum. Henricks expects no increase in ocean based supply of Omega 3 because of over-fishing. But it can now be grown from plant-based canola and Nufarm can take 20 per cent market share of that supply gap.

Most of the regulatory approvals have come through, and it is trading on less than seven times EV to EBITDA today because the market has over-reacted to the drought and glyphosate concerns. One of the great strategies is to buy in drought and sell in rain, Mr Henricks said. He strongly believes Nufarm is well placed around all reasonable scenarios related to glyphosate outcomes. Valuation of $10.40.


Airlie's Emma Goodsell was second to present on Friday with Reece.

Emma Goodsell, Airlie Funds Management: Reece

In May, Ms Goodsell says she woke up to the ten most terrifying words an Australian investor can read - equity raise to fund large offshore acquisition from private equity. "I had visions of half-eaten Bunnings sausages lying on the floor in the UK rain," she said, in reference to Bunnings' doomed purchase of UK home improvement chain Homebase.

But she says there is sound logic to Reece Ltd's $1.9 billion purchase of wholesale plumbing chain MORSCO. One of the reasons is that Reece is a owner-managed company – a subset that has delivered twice the returns to shareholders compared to the broader index.

The Wilson family, which still has a substantial stake in the $6 billion company, have managed to handily outperform their main rival Tradelink. Over the past 20-years, Reece's sales are are up 6 times and profits are up 18 times, while Tradelink has traded flat. "They have maintained fantastic returns by investing in the business," Goodsell said. She says increased margins and store roll outs in the United States can add up to $4 to its current $10.77 share price.

Nick Griffin, Munro Partners: Amazon

Mr Griffin says Amazon may have been the second company to hit a $US1 trillion valuation, but he expects it to be the first to hit $US2 trillion.

"That's a fairly bull market statement," he told the conference, but while the fund has owned the e-commerce and world's largest cloud computing stock for years, it is still its best stock idea.

Griffin says the big problem for investors has always been Amazon's valuation. But he says its valuation has been relatively stable around 20 times earnings before interest tax depreciation and amortisation (EBITDA), which is just a 40 per cent premium to a standard consumer company.

Nick Griffin from Munro Partners sees Amazon hitting a market cap of $US2 trillion. Jessica Hromas

He also questions the commonly-held view that the stock is overvalued because it doesn't make any money: he points out Amazon hasn't undertaken a capital raising since it listed, and is able to entirely fund its growth.

Griffin says Amazon sits at the start of two "growth runways" and notes it has about a 10 per cent share in two rapidly growing sectors: cloud computing and e-commerce. "Amazon's growth is being driven by two structural trends and they are both in their infancy," he said.

He noted that Amazon has 109 data centres around the world, and 50 per cent share of the public cloud market. As well as growing its market share, Griffin expects Amazon will increase its margins, noting that it only generates 5 per cent margins in its e-commerce division at the moment.

Griffin predicts Amazon's EBITDA is going to grow more than three fold in the next seven years, and ascribing a 17.5 times multiple he forecasts it will have a $US2.3 trillion enterprise value by 2025.

Scott Bessent, Key Square: macro views

Three forces driving macro investing: Bessent won the crowd over by saying if you could be long on any asset in the world he would be long Melbourne. His presentation, 'the divorce, the disruptors and the divergence', was macro in theme. The former professor said when the candidacy of Donald Trump was announced, he was sure of a Trump victory – "The hardest part of macro investing is distinguishing between what you want to happen and what's likely to happen". The divorce refers to China and US relations, a theme which will drive 2019 and maybe the next decade.

As it is, he tells anyone who comes into his office with a European idea to "get the hell out". But the new government in Italy is a wake-up call, he says. The bull case for Europe relies on cracking open fiscal spending, as Europe is the only place not doing a fiscal spend. In the US, "we have blown the doors off".

The divergence refers to the "orange swan" a rare creature who likes to hiss, has good instincts and many characteristics of a black or white swan. President Trump has also, however, overseen a drop in regulation, creating a perception the government is on the side of business. The White House is trying to entice the Democrats into an infrastructure program.

Griffin says the big problem for investors has always been Amazon's valuation. MARK LENNIHAN

"An alternative outcome is the Democrats become a confidence killer in the economy."

Trying to assess the Australian dollar, he starts with, 'where is the currency relative to its long-run real exchange rate, its purchasing power?' "Aussie dollar is not cheap, not expensive now". He spends a lot of time on plumbing, meaning the financial sector and economy – GDP has remained remarkably resilient, he said. "This is the first time in my career that US rates have been higher than Australian rates," the 56 year old said. Finally, "when you're sure, do twice as much."

Tim Carleton, Auscap Asset Management: JB Hi-Fi

"How do we get comfortable buying a retailer, even a high quality retailer like JB Hi-Fi when it's facing these issues?" the fund manager began, referring to house prices and Amazon. He is long JB Hi-Fi, taking the other side of sizeable shorts against the stock.

Mr Carleton says fears about the rise of Amazon and falling prices make JB Hi-Fi, the retailer that is the most shorted stock on the market, a screaming bargain. The retailer is well-run, highly cash generative and most importantly cheap at 11 times forward earnings.

JB Hi-Fi was pitched as a short idea at the 2017 conference by Regal's Phil King, partly because he anticipated Amazon would disrupt its bricks and mortar model. But Carleton says the retailer is out-competing Amazon on headphones, games and laptops and is attracting more eyeballs to its website.

He also strongly believes that the strength of the Australian economy is being understated. The correction in house prices has been triggered by a tightening of credit – "a sensible long-term objective."

"We are forgetting about a number of economic positives – household wealth is at all-time highs and a 20 per cent drop in house prices would only take us back to 2016 levels.

Crucially, Australia's population growth is healthy and there is still positive inflation – which provides a positive medium-term forecast for retail sales. "We are in a technology super cycle and this is the company that is going to sell us our gadgets we are going to need for the next twenty years."

Kok Hoi Wong, APS Asset Management: Venustech (002439:CH)

China's dominant cyber security firm Venustech is Kok Hoi Wong's pick, and he says it's better than just a strong growth stock: it's also recession proof and undervalued. The fund first got interested in the sector after the Edward Snowden affair, and since 2014, has visited Venustech 15 times and talked to the company more than 50 times. Venustech is the largest cyber security company in China, with an 8 per cent market share.

At a broad level, APS argues the Chinese are massively under-invested in cyber security, noting cyber security capital expenditure to IT was just 1 per cent, compared to 6 per cent in the US.

The fund is also impressed with the talent at Venustech, with about 30 per cent of 4000 staff having doctorates or masters degrees, including the founder. Venustech has a broad customer base, it services 80 per cent of government institutions, banks and 60 per cent of the top 500 Chinese companies. As well as taking market share, another source of growing earnings is the SME sector, where the adoption of cyber security is only 35 per cent compared to 80 per cent in the US, and winning contracts for cities.

"This is a strong buy... paradoxically, the more Sino-US relations worsen the higher the earnings visibility of this company," he says. The valuation is compelling at 23 times next year's earnings. "While some people speak of building walls, China built one 2000 years ago... today

China is building a new wall in cyber space, a wall you can't see and touch, but very possibly profit from."

APS, which manages more than $US2 billion mainly for institutional investors, was founded in Singapore in 1995 and was among the first foreign investors in China. At Sohn's Hong Kong conference in May, the stock pick was going short JD.Com, on the basis of an overhyped share price and a CEO that made "reckless and silly" acquisitions.

"There's almost no prospect of JD making any profits for the next few years... yet the stock is still selling at five time NAV. Why so many institutional investors still hold the stock is very puzzling to me."

Steven Glass, Pengana: Kar Auction Services (KAR:NYSE)

Kar is mainly an auctioneer for commercial customers in North America. Its Adesa unit is an auctioneer of whole vehicles with 30 per cent market share, and the two largest players have 70 per cent share in that market. Another business, IAA, has 40 per cent market share and handles the category of salvage vehicles. Kar operates in essentially duopoly markets and is a major player in all. That being so, it will spin-off IAA in 2019.

Finally, its AFC unit supplies car financing: "this business is not as risky as you might think," the fund manager says. To give you a sense, AFC was profitable in 2008 and 2009, so "don't let this business distract you from Kar," Mr Glass urged.

"I love network effects," he continued, and "Kar clearly has network effects." Namely scale, owing to the need to operate numerous large facilities to provide vehicle repair services and inspections. "The key message is Kar has sustainable competitive advantages." Its market multiple is just 18 times earnings, and 6 per cent free cashflow yield.

However, there are two structural bear arguments: vehicles are becoming safer, and there will be a decline in vehicle ownership owing to car sharing services. The problem with this argument is miles driven is actually the key driver of Kar's volumes.

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JB Hi-Fi is Tim Carleton from Auscap's long idea