AURORA FUNDS MANAGEMENT

THE ALTERNATIVE VIEW

By Hugh Dive | 30th October 2015

Victors and Vanquished

In Ancient Rome victorious generals returning to the capital were given a triumph where they paraded through the city with their army, musicians and strange animals from conquered territories, together with carts laden with treasure and captured armaments. If everything goes well in the early hours of Sunday morning the Wallabies should be enjoying a triumph down George Street in Sydney, though sadly unlike in Roman times we are unlikely to see Richie McCaw and Chris Robshaw being dragged along in chains at the foot of the Wallabies chariots.

In this World Cup themed piece, we are going to turn the clock back four years to 23rd October 2011 (the date of the previous World Cup Final) and look at the top five outperforming stocks and the bottom five performing stocks along with the investment theses that were being applied at the time.

Top and Bottom Performing Stocks since France vs New Zealand October 2011

Security	Description	Sector	Price	Return	Security	Description	Sector	Price	Return
MFG	Magellan Fin Grp Ltd	Asset Management	$ 21.61	1760%	PDN	Paladin Energy Ltd	Uranium Miner	$ 0.24	-83%
SRX	Sirtex Medical	Biotechnology	$ 37.29	727%	WHC	Whitehaven Coal	Coal	$ 1.03	-80%
TPM	TPG Telecom Limited	Telecommunication Services	$ 10.80	726%	ARI	Arrium Ltd	Steel	$ 0.10	-74%
DMP	Domino Pizza Enterpr	Restaurants	$ 46.41	686%	TEN	Ten Network Holdings	Broadcasting	$ 0.17	-67%
SHV	Select Harvests	Agricultural Products	$ 10.25	666%	MSB	Mesoblast Limited	Biotechnology	$ 3.41	-65%
GEM	G8 Education Limited	Education Services	$ 2.97	653%	WOR	WorleyParsons Ltd	Oil & Gas Equipment & Services	$ 6.50	-64%
BTT	BT Investment Mngmnt	Asset Management	$ 11.29	514%	NCM	Newcrest Mining	Gold	$12.53	-60%
BKL	Blackmores Limited	Vitamins	$174.00	505%	SWM	Seven West Media Ltd	Broadcasting	$ 0.67	-60%
GXL	Greencross Limited	Pet Healthcare	$ 6.19	501%	KAR	Karoon Gas Australia	Oil & Gas Exploration & Production	$ 1.81	-52%
ALL	Aristocrat Leisure	Casinos & Gaming	$ 9.08	342%	MTS	Metcash Limited	Food Distributors	$ 1.18	-52%

Victorious Roman Generals

Magellan Financial Group (MFG) has been the top performing stock over the past four years, significantly outperforming the ASX200 total return of +52%. Four years ago global fund manager MFG had $2.7bn under management, which delivered $5.7m in profits to shareholders, but over the past four years the funds under management has expanded to $37.7 bn. Courtesy of the operating leverage inherent to asset managers this stellar 1,300% increase in assets translated to a 3,000% increase in net profits. Looking back at research notes from brokers four years ago, there was a large degree of skepticism that global equity funds could be successfully managed out of Sydney and based on that assumption MFG was overvalued.

In 2011 the market had a positive view on ***Dominos Pizza*** (DMP) to consolidate their position in their newly acquired assets in France, Netherlands and Belgium, there was concerns about increased competition and commodity prices posing a risk for franchises margins. Over the past four years DMP has added to its stores in Europe and now owns the rights to Dominos in Japan, increasing the number of stores from 518 to 1,570, whilst simultaneously expanding profit margins from 12% to 15.45%.

Yesterday vitamin maker ***Blackmores*** (BKL) hit $200 – when the French came close to beating the All Blacks, the stock was trading at $30. BKL was always viewed as a high quality stock with healthy profit margins, but in 2011 it was viewed as fully valued trading at 20 times earnings. Unlike many stocks with high expectations, BKL actually delivered on these expectations, increasing sales by 120% over the past four years and expanding into direct vitamin sales in Asia.

Vanquished Barbarian Kings

For every group of companies that had positive prospects and significantly outperformed expectations, there is a group of companies that have underperformed expectations or faced unforced challenges. Uranium miner ***Paladin*** (PDN) was well liked by analysts and was trading at $1.40 per share, however there were clearly some risks to investing in the company. The company had a shaky balance sheet, but analysts though that it could be a takeover target given it had fallen from $5 earlier in the year. PDN over the past four years faced collapsing uranium prices, operational issues at its mines and four years of losses.

In October 2011 ***Arrium*** née Onesteel (ARI) was riding high at $1.20; the rising iron ore price courtesy of Hu Jintao's 2008 stimulus plan had delivered higher profits from ARI's iron ore mines in South Australia. This was utilized to buy Anglo American's mining consumable assets in South America. Whilst the author of this piece enjoyed the analyst trip to look at the new assets in Chile and Peru in early 2011 (Malbec, steak and guinea pig served deep fried paws up), at the time it seemed like a pretty risky strategy. As with many offshore expansion strategies ARI had invested $1 billion outside their home market in a different corner of the steel business, which increased their debt and reduced their options when the iron ore price fell. Ultimately ARI were forced to conduct a 1:1 jumbo rights issue this time last year at $0.48 to repair their balance sheet. Despite these measures and a new competent and smart CEO, the company is in a challenging position with a market cap of $293 million and a net debt load of $1.7 bn.

Ten Network (TEN) and ***Seven West Media*** (SWM) are two of the most recognizable media brands in Australia. In 2011 these iconic brands looked pretty cheap to the analysts trading on PEs of 13x with attractive ~7% dividend yields. The market recognized the weaker macroeconomic background, and the problems that the magazine division faced with the rise of internet browsing for lifestyle news, what was underestimated was the decline in the value of the television franchises. TEN and SWM have both faced the twin hydras of declining advertising spend in television due to the impact of companies segmenting their advertising spend onto various internet platforms and the rising cost of content particularly for flagship sports. For example, SWM recently spent $2.5bn to retain the rights to the AFL and TEN spent $40M per annum on rugby, both of which can now be accessed through mediums outside of sitting in front a television set. This has resulted in the media companies having negative jaws, in that their costs are increasing but their revenues are flat to declining.

Our View

It is easy for investors to bask in the success of picks that have done well, but arguably greater lessons can be learnt in the stock picks that haven't fared well. Looking across the vanquished barbarian kings that populate the right hand side of the above table the common factor is that in 2011, the business was experiencing difficulties due to wider macroeconomic factors. Whilst the management was attempting to reassure investors, tough market factors ended up overwhelming the efforts of management to remediate the business.

Hugh Dive
Senior Portfolio Manager

Aurora is the issuer of the:

- **Aurora Dividend Income Trust (Managed Fund) (ASX code: AOD)**
- **Aurora Absolute Return Fund (ASX code: ABW)**
- **Aurora Fortitude Absolute Return Fund**
- **Aurora Global Income Trust (ASX code: AIB)**
- **Aurora Property Buy-Write Income Trust (ASX code: AUP)**
- **HHY Fund (ASX code: HHY)**

AURORA
FUNDS MANAGEMENT

Level 4, 1 Alfred Street, Sydney NSW 2000
PO Box R1695, Royal Exchange NSW 1225
Telephone: +61 2 9080 2377
Visit: www.aurorafunds.com.au
Email: enquiries@aurorafunds.com.au