Six of the best

Roger Montgomery has a shortlist of star stocks that could rise even further

NOW THAT REPORTING SEASON is out of the way, I thought you might like to see what has risen to the top. Now, I don't want you to rush out and buy these stocks – we already own them from lower prices and you'd simply be rewarding us by pushing the share price up. I do think, however, you might appreciate the opportunity to focus your research on companies that someone else has already identified as worthy of a little effort.

Sirtex Medical (SRX)

The medical device company announced extremely encouraging growth of 18.7% in sales for the December quarter, causing its share price to jump more than 22% in a single day. The development comes atop a 25% growth in the dose sales rate in the previous period, providing confidence that its ongoing, phase-three SIRflox trial – a core study on the effectiveness of its medical device, SIR-Spheres – could show positive patient outcomes. The trial is scheduled to be completed in October and results are due in early 2015. A positive result has the potential to more than quadruple Sirtex's addressable market and such an event would be a step-change in the business, its earnings profile and valuation.

Ainsworth Game Technology (AGI)

The gaming machine manufacturer issued another positive trading update, guiding investors to expect a 50% increase in pre-tax profit for the first half of 2014. This is an impressive development and the second earnings upgrade for the 2014 financial year.

Credit Corp Group (CCP)

The debt ledger purchaser again raised its earnings guidance. While we can never be complacent, we are aware of and have previously described a pattern of upgrades throughout the year by which one could almost set a watch. Many analysts have noted a decline in margins, but this appears to be a function of funding an expansion into the US. Substantial cash also allows the company to retire debt to negligible levels, pay dividends, reinvest in growth and fund a micro-loans business in Australia, which is growing quickly and is now generating some of the benefits of scale.

JB Hi-Fi (JBH)

Amid a rash of downgrades from other retailers, including Super Retail Group and The Reject Shop, the share price of JB Hi-Fi declined materially. Local investor selling and US hedge fund shorting pushed the price down 18% in 10 trading days, from $22 to $18. A positive trading update by the company in response to the sharp share price declines polarised the market. JB Hi-Fi is now producing substantial levels of free cash flow and we expect it to be debt free by the end of financial year 2014.

SEEK (SEK)

SEEK has been The Montgomery [Private] Fund's largest shareholding for some time and it was arguably this reporting season's very best result. Its interim report detailed record across-the-board growth in revenue, EBITDA (earnings before interest, taxes, depreciation and amortisation), net profit after tax, earnings per share and dividend per share, as well as the company's strategic positioning in terms of global leadership in the online employment market. We have long believed SEEK's international divisions could prove to be, over the balance of this decade, many times larger than its domestic business, where it has 25% of the Australian and New Zealand job market.

Challenger (CGF)

Challenger also reported very strong results. The key fundamental to watch in any of its presentations is the growth in its long-dated (more than 10 years) lifetime annuities. Pleasingly, a resurgence appears to be currently under way at Challenger, which reported sales in the first half of 2014 that were greater than in all of 2013. This is the segment responsible for the bulk of its earnings and it's growing at a good clip.

Carsales.com (CRZ)

The latest website data shows that Carsales continues to grow by almost any measure – be that revenue, profitability, share of consumer browsing, share of total page views or page views per vehicle. Dealers might pay $40 per inquiry received, and there are typically five inquiries per car. It therefore costs a dealer about $200 in "advertising" to sell a car. With a gross profit of between $1500 and $4000 per car and about $6000 for luxury cars, there is clearly room for dealers to absorb the $200 and arguably scope for them to pay more.

So there you have it – a shortlist of companies about which you might like to dig a little deeper to uncover whether there's more potential growth for the stocks, given the already rather spectacular share price gains. As always, be sure to seek professional advice first!

Roger Montgomery is a portfolio manager at Montgomery Investment Management. For his book, Value.Able, *see www.rogermontgomery.com.*

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