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S&P/ASX 200	AUD/USD	TOP GAINER ILU	TOP LOSER ARI	
+1.29%	+0.11%	+8.48%	-4.55%	
5489.9000	\$0.80	\$7.16	\$0.21	

Bouncing back from adversity to increase profits

ROGER MONTGOMERY THE AUSTRALIAN SEPTEMBER 27, 2014 12:00AM

LISTED company outlook statements for 2015 have provided fresh information to allow our analysts to re-evaluate previous valuations and estimations for future prospects. Where greater clarification was required, we have met with or spoken to management, other analysts who have written reports about the 2014 results or, in some cases, even competitors. We spoke with one who was driving his car to a meeting ... in Reno, Nevada.

What I am interested in, and what I think you should be interested in, is simply whether there were any companies that emerged from reporting season presenting not only great results, but also still offering reasonable prices for a serious value investor. There were several that produced surprisingly robust results and here I'll discuss two.

The first company worthy of note is a company called Sirtex Medical (SRX). At the outset, let me say this is a "riskier" proposition than some of our other large positions such as Woolworths or Challenger Financial. The reason for the greater risk is that despite the companies' very strong revenue and earnings growth over the last 10 years, the outcome of clinical trials, to be released next year, are binary. They'll either be very, very good for the company and its prospects or they won't be. It's as simple as that.

Having provided that caveat, what struck the team at The Montgomery Fund was the very large increase in marketing spend. The company also flagged that another \$10 million would be spent ahead of the result of the aforementioned trial, Sirflox. A successful trial would demonstrate that the company's SIR-Spheres microspheres medical device has efficacy, not only in the salvage phase of the treatment for liver cancer, but in the early stages (first-line setting) of the diagnosis and treatment. A successful result could see dosage sales increase from about 8000 per annum to over 30,000.

In the meantime, and in advance of the trial results, dosage sales to oncologists have enjoyed over 40 quarters of consistent double-digit growth. The combination of marketing spend and existing oncologist support does suggest some confidence is warranted in the outcome of the trial, but as I mentioned, the outcome will be binary for the share price. If — and it's a big if — the results are positive, a much larger potential market opens up for Sirtex and its intrinsic value per share is estimated by Montgomery to be above \$45.

Another surprising result for us was from salary packaging company McMillan Shakespeare (MMS). The former Labor government's proposed changes to the Fringe Benefits Tax treatment of novated leases, amid claims of rorting, caused the salary packaging industry to virtually shut down for the first six months of FY2014. Even Ford blamed Kevin Rudd's \$1.8 billion FBT overhaul for halting production, which forced at least 750 workers to be stood down.

We never believed Rudd's plan would proceed and always believed McMillan would quickly return to "business as usual". We even believed the negative press would work in the company's favour — raising awareness about salary packaging.

We doubled our position in the business, buying shares at approximately \$7.25 on the day they relisted at a near-50 per cent discount to the hitherto highs.

Not only did the business fully recover, but it has already returned to growth.

McMillan enjoyed a very strong recovery in the second half of FY14, delivering 10 per cent revenue growth from \$167.7m to \$183.8m over the previous corresponding half in FY13.

Profits, which had grown from \$29.7m to \$32.95m in the half immediately prior to Kevin Rudd's "proposal", slumped to \$20.3m during the six months after the announcement was made. Since then, however, profits have not simply grown incrementally, but they have surged beyond even the record-high level achieved before Rudd's proposal was mooted.

The tearaway speed of the company's recovery has surprised even us. Importantly, MMS also grew NPAT by 12 per cent over the previous corresponding half in FY13 from \$32.9m to \$37m, after normalising for one-off expenses.

Roger Montgomery is the founder of Montgomery Investment Management.

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