


Australian fund managers reveal best long and short ideas for 2018



Fund managers are looking to beat the market this year. The tastiest long and short investment ideas suggest the longs have the edge in 2018. Antonio Heredia

by [Jonathan Shapiro](#) [Vesna Poljak](#)

A pyjamas retailer, two Australian media icons, and a Polish mobile disrupter are the unlikely sources of inspiration for intrepid fund managers looking to beat the market this year.

Those long ideas are the counterpoint to a handful of battleground stocks in the hot areas of technology and resources that investors nominate as the stocks to short, or avoid, in the longest bull market in a generation.

AFR Weekend's survey of the best long-short ideas for 2018 saw longs outnumber shorts and Australian fund managers, for the most part, shy away from calling out stocks that they are betting will head south. But a handful of strongly hyped technology names have elicited concerns about overly stretched valuations and invite counter-consensus thinking.

Karen Towle of Tribeca identified **Updater (UPD:ASX)**, which tripled in value during 2017, as a short candidate. The business partners with real estate agents in the United States to help people moving house. While Updater has been successful in generating demand for its service, Towle says the company has battled to monetise its offering.



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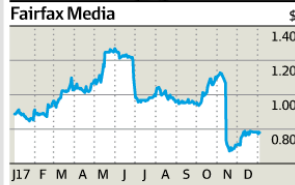
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Five stocks fund managers are tipping to run hard this year...



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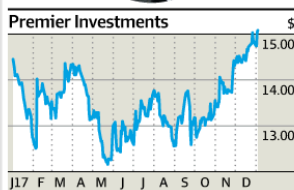
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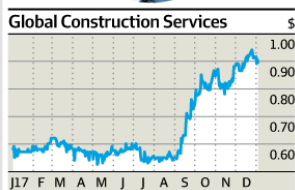
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That's led them to explore other areas like insurance, which she says are more competitive and uncertain.

"With little in the way of revenue, no earnings in sight and a market capitalisation of over \$700 million, we believe the share price has run too hard," the Tribeca portfolio manager says.

[Ben McGarry and Sam Granger of Totus](#) make the case for betting against **GetSwift (GSW:ASX)**, the delivery software stock, which surged after announcing a deal with Amazon, which it promptly followed with a capital raising. They regard the \$670 million valuation as "ridiculous" for a company with \$300,000 of revenue and claim "industry feedback on the product is lukewarm at best".

The Totus pair believe GetSwift's promotional partnership announcements are reminiscent of [the tech shocker I-Page](#).

And just to show value is in the eye of the beholder, investors would recall that digital upstarts Afterpay and WiseTech Global were both tipped as shorts for 2017, only to make their backers richer and detractors poorer.

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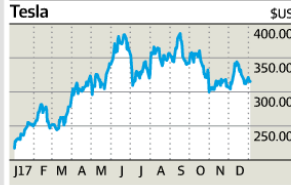
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... and the stocks they're betting against



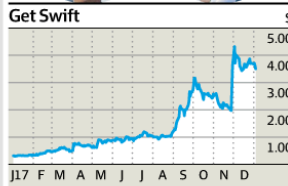
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Karen Towle, Tribeca



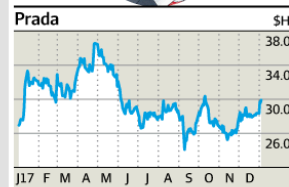
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In funds management, Totus sees turbulence for the \$1 billion high-flying funds management outfit **Blue Sky Alternative Investments (BLA:ASX)**.

McGarry and Granger are uncomfortable with what they say are complicated financial statements, an aggressive exposure to the Brisbane property market, and a large accounts receivable balance "as a result of accruing performance fees before cash realisation".

Totus also called out "delays in investment timeframes" at several Blue Sky funds that were scheduled to return funds to investors some time ago, but were still operating.

Australian hedge funds bounced back in style in 2017, clocking double-digit returns after a difficult 2016.

Long-short manager Paragon – [which shrewdly selected Magnis Resources as a short and Kidman Resources as a long last year](#) – finished notably strong. John Deniz of Paragon is tipping small potash play **Agrimim (AMN:ASX)** for success. He describes its sulphate of potash (SOP) project in Western Australia as a world class, strategic asset.

"SOP is a premium and essential fertiliser for the fastest growing segment of the global food market, being fruits and vegetables," he says. "In the face of a strong demand outlook, we are seeing supply shutdowns at highly polluting secondary production facilities around the world."

Paragon's short idea is the \$2 billion **Pilbara Minerals (PLS:ASX)**, a hard-rallying lithium interest. Deniz does not share the market's confidence in the "highly promoted story" where management has aggressively guided for stage-one first concentrate production by June 2018.

"We view this as a stretch target and cost overruns in addition to the recent capex increase of \$40 million are likely," he says. "Whilst direct shipping ore sales will help, any delays will see a funding shortfall before first cash flows."

Sebastian Evans of NAOS is looking to [the local real estate investment trust sector](#) for stocks that could come unstuck as bond yields rise. Investors have piled into REITs as an alternative to low-yielding bonds, pushing up valuations, but Evans believes there are subtle changes in the global economy which could reverse these flows.

"If inflation continues to climb, then the Fed Reserve will likely move faster on their interest rate rise program, and if they do so, then eventually Australia will have to follow," Evans says. "The entire REIT sector is trading well above the stated value of their assets and we don't see this lasting in a rate rise environment."

Global equities manager Antipodes Partners agrees there is an opportunity betting against interest rate sensitive stocks.

"The extreme thirst for yield has pushed the US high yield corporate debt cycle into uncharted territory with the average leverage ratio expanding significantly beyond the previous 2007 profit cycle peak," says Jacob Mitchell, Andrew Baud and Sunny Bangia of Antipodes.

Antipodes is shorting two types of stocks that have benefited from the high-yield boom: "over-hyped, thematic disrupters such as **Tesla (TLSA:NASDAQ)** that are increasingly vulnerable to a fight-back from strong incumbent competitors such as Toyota and Hyundai"; and, "bond proxies favoured by passive strategies that confuse momentum with value and low volatility with quality".

Mitchell points to the mobile tower operators as the kind of equity that is "priced for the illusion of duration".

Last year, any business that came within Amazon's radius was aggressively sold. But Andrew Macken and Chris Demasi of Montgomery Global believe the market has missed some Amazon-sensitive shorts. He's pitched \$US3 billion battery maker **Energizer Holdings (ENR:NYSE)** as vulnerable to a correction.

Not only is single-use battery demand in structural decline, over 90 per cent of sales are occurring on Amazon which has its own private label battery line. "Amazon is simply giving Energizer's 50 per cent gross margin back to consumers!" Demasi says.

Chad Slater of Morphic is shorting fashion house **Prada (1913:HK)** which has "consistently failed to deliver on earnings expectations over the last three years". At first this was put down to slowing Chinese demand, but as China has stabilised and accelerated, the story lacks merit he says, citing soaring sales at Louis Vuitton.

"It seems something is wrong with the brand. Something is also wrong with the treatment of shareholders: the co-CEOs paid themselves €24.8 million in 2016 for this poor performance. Consultancy and directors fees for the co-CEOs total more than €240 million since the IPO."

Slater is dark on the storied Italian **fashion label** but he is happily buying rubbish in China: Morphic's long pick is **China Everbright International (257:HK)**. The waste disposal and incineration business looks cheap as value stocks lag more "sexy" tech plays.

"With growing cities, large scale landfill is not a viable long-term option for the country. A recent plant to trip to China by one of our team confirmed that the targets set out by the central government in their current five-year plan are being implemented," Slater says.

David Prescott of Lanyon is willing to back cinema chain **AMC Entertainment (AMC:NYSE)** which halved in value last year.

"The cinema industry has experienced robust attendance and reliable pricing power over the last decade – a period which includes substantial disruption from the likes of Netflix." Prescott believes that as AMC's refurbishment plans wind down, capital expenditure will decline and leverage will fall.

"The shares today are offering more than a 15 per cent normalised free cash flow yield. With the company planning to eventually list its European cinema business and the 2018 box office outlook looking strong, we think AMC is a compelling opportunity in an already unloved sector."

[Justin Braitling of Watermark](#) is cool on the UK's **Metro Bank (MTRO:LN)**, a play on founder Vernon Hill's success in the US with "fast-food banking" Commerce Bancorp. "Our sense is that Metro's branch-banking model will be far less successful in the UK than Commerce was in the US," because retail banking and the role of branches have changed since Commerce swooped.

"The company has a lot of wood to chop to get from 2017's 3 per cent return on equity to 2022's 18 per cent, and on 3 times tangible book the stock has a long way to fall if anything goes wrong."

Braitling is bullish on **Play Communications (PLY:WSE)** which he calls "the most successful mobile disrupter anywhere in the world".

"Play is the most capital-efficient mobile network in the world with a 7 per cent capex/sales budget. Its network design is unencumbered by legacy systems, and attention is paid to every element of the network to be as efficient as possible." Incredibly, it is also cheap, trading at a 30 per cent discount to the telco sector average and a higher yield than Telstra.

Turning to healthcare, Antipodes favours **Gilead Sciences (GILD:NASDAQ)**, which at a price-earnings multiple of 11 times is also one of its top 10 investments by virtue of its dominant and growing share in HIV treatments.

[Lev Margolin of LI Capital](#) favours \$US10 billion aluminium producer **Alcoa Corp (AA:NYSE)** which boasts an "attractive" portfolio of assets that would be impossible to replicate even with unlimited capital. In fact, "its replacement cost would be over \$US100 per share, or double the current share price."

[Harry Cator of DMP](#) took a meta approach, shorting Australia's "tall poppy syndrome" by going long poppy stock **TPI Enterprises (TPE:ASX)** and challenging consensus short **Syrah Resources (SYR:ASX)**, the most-shorted stock on the ASX.

Syrah has an "ultra high grade product" in natural graphite which is vital to the expansion of electric vehicles, a 40-year-plus production lifespan, downstream production capability, a project in production and fully funded for all current development plans. ("Note to the shorts – stop hiding behind your "For Education Purposes Only" reports that are factually incorrect", he says.)

TPI "may just be on the brink of becoming a very tall poppy, through its lowest cost, licit production of narcotic raw material, to convert into an active pharmaceutical ingredient, for input into a fixed dose tablet format." It is only one of a small number of companies worldwide with the capability and capacity to supply all markets, outside of the US, for codeine phosphate finished dosage product.

For value-oriented small cap hunters, Tribeca's Towle nominates **Southern Cross Electrical (SXE:ASX)** as a long idea. The supplier of electrical contracting services has historically been exposed to the mining industry in Western Australia but their acquisition of Heydey brings exposure to the East coast infrastructure boom.

[Chris Prunty and Tony Waters of QVG](#) picks **Somnomed (SOM:ASX)**, the manufacturer of an appliance that treats sleep apnea. The company has had success in Europe but Prunty says the "real kicker" in 2018 will be roll-out of their own direct to-patient centres in the US.

QVG is also backing New Zealand thermal and coking coal producer **Bathurst Resources (BRL:ASX)** which has a 65 per cent interest in Stockton, an asset that produces high quality export coal. "With the current hard coking coal price over \$US200 per tonne and guidance set assuming a \$NZ185 price, we see scope for meaningful earnings upgrades."

Lanyon's Prescott is bullish on **Global Construction Services (GCS:ASX)** which owns one of Australia's leading cladding businesses and is "well placed to benefit from the mountain of industry work". "The market is only just now slowly starting to appreciate the significance of the problems," referring to highly combustible, non-compliant aluminium building cladding.

Evans of NAOS believes 2018 will be the year the market finally appreciates the "enviable" position of finance broker **Consolidated Operations Group (COG:ASX)**.

Steve Black and Ed Prendergast of Pengana like **Hub24 (HUB:ASX)**, the investment platform that is winning around 11 per cent share of net investment inflows, or around \$200 million a month. Planners [prefer its functionality over the traditional bank-owned platforms](#), with the benefit of independence from the maligned banks.

Just by growing its share of industry funds under administration from less than 1 per cent to 5 per cent over the next seven years, the Pengana pair expect profitability to climb above \$100 million annually due to the scalability of the business.

Black and Prendergast also favour **Lifestyle Communities (LIC:ASX)** retirement villages where homeowners own their home but lease the land for a weekly fee. They're encouraged by the growth from 150 homes under management to almost 2000 and a high referral rate validating claims of high customer satisfaction.

"We rate management very highly, having grown the business at rates above 20 per cent per annum for over a decade without raising capital," they conclude.

While hedge funds have preferred (and succeeded) betting against old media, two top performing managers advocate long positions in **News Corp (NWS:ASX)** and **Fairfax Media (FXJ:ASX)**, the publisher of *AFR Weekend*.

LI Capital's Margolin believes [News could be at least 50 per cent undervalued](#), even after ascribing modest multiples on what he regards as "free assets" including the *Wall Street Journal*, *Barron's*, *The Sun*, *The Times*, *The Herald Sun* and *Daily Telegraph*.

News' combined stakes in its two largest assets – online real estate portals REA Group and Move – plus the \$US2.5 billion of cash on balance sheet is almost equal to its market cap, implying cheap publishing assets which "have a look through consolidated EBITDA of \$1.2 billion".

[And Tim Carleton and Matt Parker of Auscap](#), a high-performing long-short fund, argues the spin-off of Fairfax's Domain has "highlighted the undervalued nature of the remaining parts of the business" being radio, digital and publishing assets.

Fairfax's residual stake in Domain is worth \$1.2 billion, which implies that the rest of the business is worth less than \$600 million at current prices, with Fairfax in a net cash position, he says. Last year, Carleton adds, these assets collectively generated over \$190 million of earnings.

Auscap also favours **Macquarie Group (MQG:ASX)**, "a high quality, cash generating, strong return on capital business with significant cyclical and structural tailwinds trading at a modest valuation".

In a twist on the Amazon effect, Matthew Ryland of Greencape's picks appear to play both sides of the trade.

He cites packaging stock **Ancor (AMC:ASX)** as a dependable investment that will benefit from the rise of e-commerce with a track record of allocating capital skilfully. "It's a liquid blue chip global leader that's very well run that trades in line with average industrial Aussie listed stocks, whilst growing faster, with less risk. It's too cheap."

The other is **Premier Investments (PMV:ASX)** because of the "hidden value" in [the Smiggle](#) and Peter Alexander brands.

Premier, Ryland says, is a cheap, high-growth global retail rollout story with the market ascribing a near-zero valuation to its legacy brands Portmans and Just Jeans, even though they are turning a profit.

"Management have been very disciplined targeting rent savings, closing stores and managing risk, which is what investors should expect from good retailers in challenging times." The stock is trading at 16 times forward earnings, forecast to grow by 15 per cent.

Five top short ideas

Karen Towle, Tribeca – Updater (UPD)

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