Pitching for strong returns: compounding wins each and every time

Adam Stanley — executive director of Pitcher Partners Investment Services

In today's Best Advice, a fortnightly series featuring leading financial advisers who have appeared on The List, we meet **Adam Stanley**, of Pitcher Partners Investment Services, who was ranked No 5

TIM BOREHAM
BEST ADVICE

Q: Anthony, tell us more about your role?

I have worked in the investment advisory practice area with Pitcher Partners since 2001, prior to which I spent six years as an accountant (also at Pitchers).

My role is to provide strategic asset allocation, portfolio construction and investment selection to our client base. My job also includes managing the investment advisory practice area.

Q: What sort of clients do you service?

A: Our clients consist of private clients and smaller institutional clients. Our private clients and larger family groups have typically accumulated wealth by operating successful businesses that have often spanned generations.

We also service institutional clients such as not-for-profits, charities, industry bodies and government institutions.

Q: What sort of issues do you solve for them?

Our clients are typically looking for advice on strategic and tactical asset allocation, structuring, asset protection, superannuation and investment advice.

In some cases I have been asked to step in as a family counsellor, mediator, psychologist, executor and have even been asked to cook. I am a better cook than I am a psychologist!

Q: What is your top tip for wealth creation?

Never underestimate the magic of compounding. While everyone likes the idea of getting rich quick, the time-proven method of wealth creation is combining regular saving together with compounding investment returns.

My role as an investment adviser is to help clients construct a portfolio which is consistent with their risk profile and to avoid making decisions based on emotion during periods of market volatility.

If this sounds too hard, then make sure you marry well!

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AUSTRALIA'S TOP 50 FINANCIAL ADVISERS
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Q: What's your current view on the local and global sharemarkets?

I have a more neutral view on Australian equity over the near term.

Falling cash rates have encouraged investors to seek higher returns from growth assets including equities and have led to stretched valuations by historical standards.

While the same can be said for international markets, particularly in the US, corporate profitability remains attractive.

I continue to allocate capital to alternative assets such as private equity, private debt and infrastructure and always recommend having a reasonable allocation to cash despite the low cash rates. Cash provides an option to take advantage of opportunities as they arise.

Q: What about our housing market: Are we looking at a recovery or a false dawn?

We are seeing a recovery in house prices. Clearance rates are improving and interest rates remain at historical lows. I believe people have delayed listing their property while house prices were correcting, but as the headlines become more positive listing activity should pick up.

Q: How can the advisory profession lift its game?

Post the banking royal commission, industry organisations and regulators have made progress on lifting the reputation and standing of our profession.

This has been achieved by raising the ethical and educational standards for advisers and taking action where appropriate (with more to come).

Financial advice is a large industry and further progress will be potentially slower than the general public would like, but it is important a new foundation is established to ensure the past events are not repeated. Having said that, improvements could include mandating fee-based services only, removing conflicted remuneration and trail commissions and introducing a general "best interest" duty for all financial professionals.

Q: What are you passionate about?

I have always had an interest in investment markets. I was gifted a modest amount of money from my grandfather when I was in grade three and my father made me buy ANZ shares.

That investment paid the deposit for my first house. That was my first lesson on compounding returns.

These days I have a small interest in a few race horses which are starting to show some promise. I would not recommend owning race horses as an investment strategy, but it can be great fun.

Peloton pedalling towards precipice

Let's face it, this fad will fade just like all the fitness crazes that came before it

ROGER MONTGOMERY

One of the biggest concerns I have about the current asset boom is that a significant concentration of money has flowed from ultra-high-net-worth private equity investors into the bank accounts of profitless technology companies. The issue arises because many of these "unicorns" — companies with billion dollar-plus valuations — have no clear or obvious path to increase revenue, or cut costs, enough to begin generating profits sufficient to justify their low-interest-rate-fuelled market values.

Is it a bubble? Without question! The only questions that remain are what will pop it and when will it pop?

This year I have highlighted the nonsense in Uber's prospectus such as its claimed Total Addressable Market being equivalent to 27 per cent of global GDP. That will never happen. I also used the company's raising of $US24.7bn over 10 years to question the implied promise that its current 2 per cent market share meant it still had a long runway of growth ahead. It looks like a mature business to me, and a profitless one at that, with mounting competition.

More recently, I examined WeWork as another profitless unicorn that will go down in history as another example of repeating investor stupidity. This time around, NYU professor Scott has dubbed it all as "consensual hallucination". Aside from WeWork paying its founder $US5.9m for the rights to use the name "We",

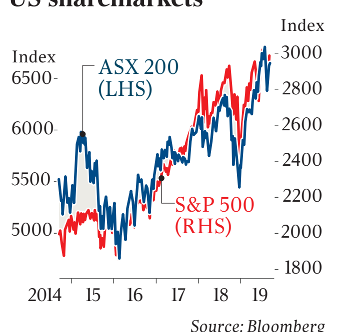
In the bubble of private equity, two weeks is a long time, and since my last column Peloton has registered to list on the Nasdaq under the ticker PTON, and with a near 200-page prospectus.

Peloton is variously described in its prospectus as a product design company, a media company, a direct-to-consumer retail company, a social connection company, an interactive software company and even an apparel and logistics company. Much as Uber sees itself potentially becoming almost a third of Earth, Peloton could be everything to everyone, too.

Let's be honest; Peloton is selling a grown-up version of Nintendo's Wii, the 2006 game console that introduced a handheld pointing device that detected movement in three dimensions. Peloton is selling an interactive exercise game. Bringing streamed and connected cardio workouts home is no more "game changing" than the 1980s fad of doing an aerobics workout with Richard Simmons in front of the TV.

While advocates see a business model that is less a traditional fitness-equipment manufacturer and more like an Apple or a Gillette, let's get real. Peloton is a fad just like the vibrating belt of the 1960s, Jane Fonda's aerobics videos of the 1980s, rollerblading in the 1990s, Nintendo's Wii Fit in the 2000s and, most recently, Soul Cycling/spin classes.

Peloton's products, apps and podcasts or watching TV or clips of waves on sand". He added: "I would implore you not to waste precious after-tax income on this latest attempt to encourage social strivers to show that they live at a more rarefied level than the proletariat."



in-room cycling fad will fade just as surely as all the fitness crazes that came before it. And I can assure you Simmons didn't spend $US324m to gain awareness like Peloton has in the last two years.

As one father's viral email response to his daughter's request for a Peloton stationary bicycle noted: "It is a ridiculous amount of money for such a basic concept as riding a stationary bike. You can ride a bike you own for as long as you want and cut the inevitable boredom factor by listening to

While Peloton has indeed grown its "subscriber" base fivefold since 2017 and consequently enjoyed revenue growth from $US218.6m in 2017 to $US915m in 2019, this is purely a function of the advertising spend. Once the promotion spend stops, or when popular instructors you have never heard of such as Jennifer Jacobs leave the "ecosystem", so will the fad. Meanwhile, losses are also growing. After losing $US71.1m in 2017, Peloton has lost $US195.6m in the last year ending June 30.

Ensuring nobody can sue the founders or its IPO "helpers", the prospectus usefully acknowledges that Peloton "may not achieve or maintain profitability in the future". And this is despite the prohibitively expensive $US2245, the company charges for its bicycles and the $US4295 for its treadmills along with a monthly subscription fee of $39 to connect with fellow riders/runners across the globe in live, streamed workout classes.

Remember, it's a fad.

So what is Peloton worth? Something much less than the $US8bn being touted or even the $US4.15bn valuation it achieved in private equity markets last year. In my opinion, Peloton is just the latest hula-hoop.

Peloton claims a high retention or renewal rate with 92 per cent of its fitness machines sold with a still-active monthly subscription. Of course, this may have something to do with the high investment its subscribers have made at the outset, which makes it much harder than the Ab Blaster or Thigh Master to throw out in the next council collection.

Roger Montgomery is founder and chief investment officer of the Montgomery Fund.

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HUGO DE VRIES

Infrastructure stocks are often regarded as "bond proxies" because of their defensive qualities when compared to other equity classes. Their stock prices tend to be inversely correlated to bond yield movements and, during the current period of heightened volatility in global markets, investors may want to consider the addition of these lower-risk assets into their portfolio.

As the largest energy infrastructure owner-operator in Victoria, AusNet Services has an asset base of about $12.8bn, comprising the Victorian electricity transmission network, an electricity distribution network in eastern Victoria and a gas distribution network in western Victoria, which collectively connects with more than 1.4 million customers.

AusNet also owns the Mondo brand, which has a portfolio currently valued at more than $1bn, providing a comprehensive range of services and technology for essential infrastructure in energy, water and transport sectors.

AST operates as a regulated natural monopoly with 86 per cent regulated revenues locked in until 2021 and growing contracted revenues.

AST has been able to maintain a stable and predictable yield, which is currently running at 5.8 per cent, with dividends 45 per cent franked.

The company has a history of issuing discounts for investors who elect to take up the dividend reinvestment plan. The last was offered at a 2 per cent discount, which resulted in a 36 per cent take-up rate and $59.3m reinvested into the business.

For AST, the greatest risk comes from government-imposed regulatory changes. An example of recent intervention was an enforced reduction in the regulated rate of return on capital. This was a result of the current low interest rate environment and the subsequent effect on the asset pricing model. In this case, the net effect was not significant since it has been offset by a reduction in the cost of debt for AusNet.

November will see the commencement of new managing director Tony Narvez, who leaves a similar position at NSW-based Endeavour Energy. Like the rest of the executive team, he is heavily incentivised to meet cost cutting targets, which should be accretive to the business's bottom line.

For those seeking a well-managed and high-quality business to dampen the effect of market drawdowns on their portfolio while earning a stable income, AST is well worth considering.

Hugo de Vries is an analyst at Clime Australian Income Fund. Clime owns AST across various mandates.

www.clime.com.au

Latest biotech to list has ResMed link

FLOAT WATCH

Osteopore Limited

ASX CODE: OSX
SHARES ON OFFER: 26.3 million
LISTING PRICE: 20c
MARKET CAP: $20.2m
LISTING DATE: September 19

SIMON HERRMANN

The Australian market has supported biotechnology floats in recent years as the thrill of exponential growth potential often outweighs the significant risks of emerging small caps.

Investors with a high appetite for risk may be interested in the coming initial public offer of Osteopore, as the Singapore-based company has chosen to tap Australian investors for funding to commercialise its bone regeneration technology.

Founded in 2003, Osteopore's technology is focused on 3D-printed implants to facilitate the natural healing process in bones. The 3D scaffolding is inserted into the bone and provides for infiltration of cells and blood vessels, which play a key role in healing and tissue repair.

The company received approval from the US Food and Drug Administration in 2006 and CE-Mark approval in 2009 and is generating close to $1m in revenues.

Customers are typically hospitals or doctors through the sale of standard products including Osteoplug or Osteomesh or customised bioscaffolds to fit different patient needs.

Timing of the IPO is curious as the company seeks funding from Australian investors after several years of commercialisation activities. Raising $5.3m by issuing 26.3 million shares at 20c each, Osteopore intends to use the IPO proceeds to invest in sales and marketing initiatives to enhance market penetration, research and development and for general working capital.

Management has strong credentials and a demonstrated track record in the industry, which elevates the quality of this IPO. ResMed CFO Brett Sandercock's will be chairman.

Osteopore has a head start as key products have received FDA clearance, generate revenues and are "market ready". Expansion and market acceptance in new jurisdictions could be a value driver and would validate the company's technology. However, Osteopore is currently loss-making and remains reliant on external capital to fund growth initiatives.

ASX-listed companies with a similar profile have performed mixed at best and investors will require a long-term outlook and, in particular, a speculative appetite for this IPO. The board has strong credentials through a mix of technical as well as ASX experience, which is why I will keep this stock on my watchlist post listing.

Simon Herrmann is an investment analyst at www.wise-owl.com

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