



They're shining amid the gloom

Look beyond the blue chips and other bigger names and you will find a number of lesser lights among the ASX lists that are well worth closer examination. **Portfolio** examines some of the true performers in his bear market.

Ask any fund manager these days for a good small-cap pick and chances are they will point to a company that has the wherewithal to survive this financial crisis.

While this is highly predicated on the strength of the company's balance sheet and whether it needs to raise capital, high cash earnings and astute management are also essential.

The recent interim reporting season highlighted the importance of these factors. Indeed, solid earnings – and even some dividend lifts – came from companies that had displayed foresight and begun to manage their businesses more conservatively.

"I think what the reporting season did show is that those businesses on top of their game took precautions, were pre-emptive and had the good balance sheets and solid businesses, are the ones that can ride out the storm," Investors Mutual portfolio manager Simon Conn says.

"And there are other companies that are in denial and aren't acting as quickly." Souls Funds Management investment analyst Andreas Stephens agrees.

"It often comes back to management as to how well the company responds to the situation."

Nowhere was this more apparent than in areas such as consumer discretionary, where a number of companies shone over the half thanks to good management.

JB Hi-Fi was one of the reporting season's standouts, according to fund managers, delivery a hefty 41 per cent boost in profits thanks to its well-run, low-cost business model.

Further down the market capitalization scale, online travel booking group Wotif.com had a record first-half profit of \$20.6 million due to an increase in hotel room sales. Pharmaceutical group Probiotec also reported a stellar 74 per cent boost in first-half profits as management focused on its branded

products which deliver higher-quality revenues.

Super Cheap Auto is continuing to succeed, despite the macro-economic downturn. Its inventory management and strategy of rolling out concepts once they are tried and tested helped lift operating cash flows by 74 per cent.

For Perennial Value Management portfolio manager Grant Oshry, the Super Cheap result was a highlight given that cash flows are an important indicator of a company's health amid all the doom and gloom.

"It's a market where earnings and cash earnings count," he says.

Among companies to disappoint were those with high debt levels whose fortunes were strongly tied to the macro-economic outlook.

"The two no-nos in this market and leading into the results season were companies with a strong reliance on the economy, because it was obviously deteriorating and [any companies] with any query over the level of their indebtedness, the timing of refinancing and those sorts of things," Pengana Capital portfolio manager Ed Prendergast says. "And, pretty well, the stocks that were hit the hardest were typically due to those two factors."

Despite bleak expectations going into the results, Perennial's Oshry says the number of impairment charges and write-offs that occurred was "surprising". And dividend cuts were also common as companies tried to preserve cash.

No one expects things to get any easier in the second half.

"Companies aren't really sure where they are going to be... and so they are unwilling to give guidance because of that," Investors Mutual's Conn says.....

The MAC Services Group

The mining services sector didn't offer many highlights in the past reporting season, which



is one reason The MAC Services Group's performance stood out.

In the face of slowing mine development, the accommodation services company demonstrated its resilience by posting record half-year earnings of \$12.1 million, increasing its dividend by 0.75c and sticking to its forecast for stable second-half earnings.

The MAC is not expected to be completely immune from the downturn and the company has already had to curtail its growth plans, including putting the brakes on expansion into Western Australia's Pilbara region.

But it is unlikely to feel pain to the same degree as its peers. Indeed, in Goldman Sachs JBWere's books, it is the only mining services or contracting stock now worth buying.

The broker has a 12-month price target of \$1.14 on the group and says the key reason for its positive recommendation is that the company has "hard assets that it can sweat through the downturn and still generate good earnings and cash flow."

Those hard assets are the 3558 rooms it has under ownership and management in Nebo, Coppabella, Moranbah, Middlemount and Dysart, towns in the coalfields of Queensland's Bowen Basin.

Under existing contracts, the company has about another 500 rooms to build in the second half of the financial year.

It is reviewing how many rooms it adds beyond that as capital preservation has become a priority, but analysts still expect dividend payments to progressively increase over the next two years.

The MAC bolstered its balance sheet with a \$45 million capital-raising and does not have a lot of debt.

.....