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An evening with Jim Slater

Cover story

Investors should not be discouraged by the recent financial downturn, as many excellent opportunities remain amongst carefully chosen, dynamic growth companies. David Wash explains.

Any event at which Jim Slater is speaking is likely to attract keen interest. This was certainly so at the *Refs Evening with Jim Slater* held at the Royal College of Physicians, Regent's Park, last June.

The event was well attended, and capably hosted by Peter Webb, the current Chief Executive of Webb Capital, while presentations by Jim Slater, Mark Slater (of Slater Investments) and Tom Stevenson (original Editor of *IfG* and currently of Fidelity International) shed some valuable light on how to negotiate the current demanding conditions whilst still securing quality longer term returns.

The recommendations put forward remain extremely pertinent as we enter 2011 and ought to provide a useful source of inspiration for *IfG* readers amidst much of the doom and gloom to be found in both the mainstream and specialist press.

Mark Slater

Kicking off the event, Mark Slater argued that, while forced government spending cutbacks and high levels of personal debt amongst the general public have made for a challenging economic outlook, many companies look in much better fettle, boasting healthy balance sheets and strong cash generation.

He added that investors should be mindful that the last 10 years were a "lost decade" and that investing after such a period is usually profitable. He was encouraged to find plenty of value and niche growth businesses are the place to invest. Given that investment returns on alternative homes for money are very poor, he was convinced that investors will eventually pay a premium for quality growth.

Amongst those companies he recommended, two were *IfG* portfolio stalwarts: **Cape** and **Education Development International**. He favoured AIM Listed **Cape** (EPIC: CIU) as good value at 208p. This industrial services company is a highly predictable, cash-generative operation; attributes that are highly valued by investors. Having secured new business through 2010, and with a strong book of multi-year contracts from blue chip clients in place, last year represented a period of consolidation for the company. For Mr Slater, a PER of 5.5 was excellent

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against a peer group PER in the mid-teens, while a near 3% dividend yield was a further attraction. He also noted that Cape is soon to become fully listed following promotion from AIM, which could attract further institutional interest.

Meanwhile, **Education Development International** (EPIC: EDD), the provider of educational qualifications and assessment services, was singled out both as being cash rich (benefiting from cash reserves of £10m) and for having made continued inroads into its target market. At 118p, a PER of 8.5 and a PEG 0.5, he considered this to offer excellent long term investment potential.

A further recommendation was **Hutchison China Meditech** (EPIC: HCM), representing good value at 295p. The company is a Chinese healthcare and pharmaceuticals business, which benefits from a large distribution network and strong product patent protection. It has shown strong financial performance, with turnover compounded at 27% over the past five years, profits up 43% last year, and a prospective PER of 17.5. As a very niche, fast growing company, with a strong, high quality product, the company is also a low risk proposition, holding 15% of its market capitalization in cash (a reassuring factor in current market conditions). Furthermore, it owns a leading research and development business that is worth 30-50% of market capitalization.

Also in the pharmaceuticals space, **Alliance Pharma** (EPIC: APH) was tipped at 32p. With a portfolio of 56 off-patented, branded pharmaceutical drugs, the company has no promotional costs and little in the way of competition. Cash generative and with PER of 7.9, he predicts further earnings-enhancing deals are likely in the future.

Finally, Mr Slater presented two fully listed companies. The first, **Micro Focus** (EPIC: MCRO) is a growing niche business with a PER under 12 compared with a growth rate of 18%. With margins rising, he suggested it "ticked every box" at 476p. **British American Tobacco** (EPIC: BAT) at 2140p was also mentioned. This highly cash generative business generates half its turnover in emerging markets. It had a PER of 11.2 against a growth rate of 10.9% and PEG of 1. The dividend yield was attractive at 5.5%.

Tom Stevenson

Echoing Mark Slater's introductory remarks, Tom Stevenson also acknowledged that financial crises can take a considerable amount of time to resolve themselves, and that public sector debt will continue to rise in the meantime. The US has experienced inflation since 1871 and he suggested it would be wise to hold gold as a hedge against the inflation risk brought about by these conditions. China and Japan, for example, hold 1-2% of gold as reserves and could well increase their holdings.

He also observed that, while valuations are at their lowest since 1985, of the 90% of companies that had

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reported at the time of speaking, 80% had exceeded forecasts. He was also enthused by the growth potential presented by emerging markets. In 1950, for example, only one city in the world – New York – could boast a population over 10 million. By 2050, China alone will have fifteen cities of that size. He believes that emerging markets are a growth story in their own right.

Jim Slater

In the final presentation of the evening, Jim Slater bemoaned the process of easy credit and subsequent quantitative easing that has followed the crisis, describing it as "the same medicine that caused the problem". He warned that 1000 point falls are possible within current market conditions, as a climate of fear can quickly take hold. In common with the preceding speakers he remarked upon the poor performance of the past decade, noting that the total FTSE return between June 2000 and June 2010 was a miserable -21%, with a total dividend yield of 1.24% per annum, while the Dow Jones index was down -5% over the last 10 years and an overall total return of 0.66%. UK Small Caps have fared marginally better at 1.76% overall; 3.34% for the US equivalent.

Mr Slater noted that the key to exploiting current opportunities lies in the timing of entry. His advice for private investors is to divide your portfolio into three equal parts.

The first third should be held in cash, offering flexibility and liquidity.

The second third should be in carefully-selected shares with defensive characteristics, low PER, low PEG, strong cash flow and strong overseas potential. His current picks included *IfG* favourite **Education Development International** (EPIC: EDD), at 118p, with a prospective PER of 8.5, equivalent to an 11% yield after tax. Share buy-backs are in operation and he added that its Chief Executive Nigel Snook is one of the best he's come across.

Also recommended was **Advanced Medical Solutions** (EPIC: AMS), the advanced wound care and sealant company, at 41p. It has a tremendous overseas business, and a PER of 10.7, a growth rate of 22.5% and PEG of 0.48 were cited as being particularly attractive.

Elsewhere, high definition photography specialist **Andor Technology** (EPIC: AND) was highlighted as a good buy at 191p on a PER of 12 and a growth rate 9.5%, potentially rising to 18%. He added that it had made a couple of good acquisitions and has a particularly strong overseas business.

Finally, he mentioned **Marlborough Special Situations Fund**, a unit trust offering excellent exposure to AIM companies, which, over the last 10 years, has a returned 12.7% compound. He reminded the audience that holding unit trusts in an ISA avoids Capital Gains Tax.

He advised that investors should hold the final third of their portfolio in gold, and revealed that he had recently bought **Centamin** (EPIC: CEY) at 55p, **Medusa** (EPIC: MML) at 94p and **Norseman Gold** (EPIC: NGL) at 30p, and had also recently invested in the **Junior Mining Fund**. He was

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particularly attracted to **Norseman Gold**, at 56p, where output is due to increase from 65,000 ounces per annum to 105,000 ounces. The company's upgraded mill has a capacity of 140,000 ounces, which it hopes to hit next year, and with operating costs of A$600 per ounce (and gold at over A$1,200 per ounce) the margins are particularly attractive.

Mr Slater pointed out that growth potential in share price is provided by the upside growth in EPS together with a re-rating of the PER from a current 5 or 6 times earnings.

Sticking with gold, Mr Slater revealed that he has a 6-7% holding in the Canadian quoted exploration outfit **Spanish Mountain**, quoted at 50 cents (current price 64 cents). The company has 4 million ounces of gold in the ground and quotes operating costs of $800 per ounce, yielding $500 profit per ounce with gold at $1300 per ounce. The company expects to ramp up production to 200,000 ounces per annum in the next two years.

Finally he concluded that gold is the ultimate store of value when poor fiscal policies are in place, and in the current circumstances it is difficult to choose a better currency than gold.

NB: Share prices, statistics and recommendations featured in this article are based on those that evening. The investment stance of the speakers may have changed meantime.

Editor's Note. Although six months is a very short period in investing terms, we revisit the top performing share recommendations of that evening. **Cape** has more than doubled from 208p to 459p, for a rise of 118%. On a prospective PER of 10.3, it has a PER multiple less than its ongoing expected EPS growth rate over the next five years. Likewise **Andor Technology** has also more than doubled from 191p to 428p, up 124%. In September it announced that earnings were to exceed current market expectations. The prospective PER has expanded from 12 to 20, so is not offering such good value now. **Hutchison China Meditech** is up a very respectable 82% from 295p to 537p. Its healthcare and pharmaceuticals business is growing strongly and its research and development business may well float in the US later this year. **Advanced Medical Solutions** has been a favourite share of *IfG* over the years and has risen from 41p to 67p, up 63%. Currently it is on a PER of 15.5, EPS growth rate of 23% and PEG of 0.68. This is a world class company and is a classic zulu principle stock.

Norseman Gold looks attractive in *IfG's* view, despite the share price making little headway since last summer. At 58.5p we think this represents a good buy opportunity (see p4), and we feature it as a main recommendation this month. □

(Prices are from close of trading January 19th 2011)

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