

Client: Chi Med
Source: Shares (Supplement)
Date: 28 November 2013
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Profit with Slater's growth picks

Market master is on a mission to unearth high-growth stars and the innovators of tomorrow

James Crux



Mark Slater, co-founder, chairman and chief investment officer (CIO) of Slater Investments, is one of the UK's top fund managers, lauded for his pedigree in delivering 'risk-adjusted alpha' and consistently outperforming benchmarks and both bull and bear markets. Slater, who runs the firm's flagship **MFM Slater Growth**, is a generalist who seeks out inexpensive growth shares offering a considerable margin of safety, believing this approach provides clients the best combination of long-term risk and reward.

His investment style is focused, disciplined and rooted in common sense, with a geographic slant to UK listed shares. Unlike many managers, Slater doesn't favour excessive diversification, preferring to build concentrated portfolios of his very best ideas. Those ideas frequently include picks from the stock market's small-cap recesses, where the manager has proved adept at finding the growth names of tomorrow. In particular he is keen to put money to work with technological innovators. Adhering to the small and mid-cap investing principles outlined by Jim Slater's book 'The Zulu Principle', which Slater helped research and edit for his father, the stock picker looks for Growth at a Reasonable Price (Garp).

IN SEARCH OF GARP

To isolate ideas for MFM Slater Growth the manager screens for a below-average price-to-earnings growth (PEG) ratio, with the PEG being a valuation tool for quantifying the price of forecast earnings

growth (see 'PEG down value', below).

A materially lower PEG than the market provides a margin of safety and also leaves scope for a rerating. A concentrated book of between 25 and 40 stocks, the fund looks for firms with sustainable and above-average earnings growth prospects, strong cashflow and a competitive advantage.

The £59 million unit trust delivered strong performances in 2009 as well as in 2010 and was ranked as the best-performing fund in the Investment Management Association's UK All Companies sector for the latter period. While 2011 was also a good year, 2012 and the opening five months of 2013 were tougher as cyclical surged ahead, leaving Slater's preferred high-quality growth picks behind. However, the portfolio's recent performance has been very good with the manager's preferred growth picks coming back into fashion and outperforming again.

At any one time Slater has a shortlist of 160-odd names under consideration which meet his Garp criteria. 'We're selecting really on the basis of quality and price from that shortlist,' he explains, 'and the sweet spot is normally where the PE is in the 10 to 15 sort of range and the growth rate is in the 15% to 20% range, when things are in a normal range, although you do get extremes.'

Target investments are typically 'profitable, growing and cash-generative today', doing things well in niche growth markets and often boasting international dimensions. 'We screen across the market-cap range and we

PEG DOWN VALUE

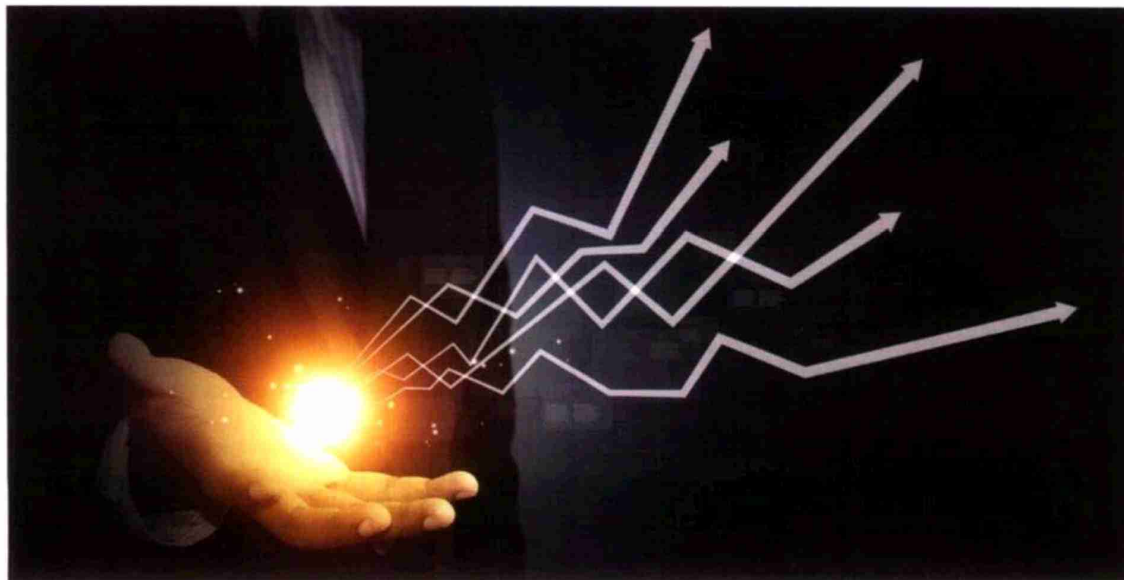
The price/earnings growth, or PEG, ratio is calculated as follows:

Prospective price/earnings ratio (PE)

Prospective EPS growth

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weight the portfolio according to conviction,' says Slater, adding that 'liquidity has a mitigating factor against conviction'. He need only point to past performance to justify his claims that 'compared with other strategies, it works pretty well most of the time. Over long-periods, it's a sleep-at-night approach'.

While there has been talk of value being hard to find in this market, Slater notes that 'quite a lot of companies have come off the top' of late, implying opportunities to pick up shares on a cheaper rating and still get their earnings per share growth.

Each and every month, the manager looks at the whole of Aim and while he thinks the

junior market is very interesting, he brings a healthy dose of realism to the table. 'The average company on Aim is stunningly low quality' he opines, while 'the choice is incredibly limited'. That said, by homing in on the 40 to 50 high-quality companies that are generating cash, turning a profit and offer real scope for share-price upside, he believes there's money to be made, particularly following August's change to the rules for Individual Savings Accounts allowing Aim stocks in.

INNOVATION AND GROWTH

Examination of the MFM Slater Growth portfolio demonstrates the degree »



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to which Slater is prepared to back innovation across an array of industry sectors, so long as the companies in question have a demonstrably successful business model, are generating cash and turning a profit. So long as the numbers and the valuation stack up, he is prepared to ride his winners for further upside.

Such names include **Advanced Medical Solutions (AMS:AIM)**, the £200 million cap wound care products play which is profitable, dividend paying and a driver of portfolio returns. Slater's fund has also profited thanks to the stellar share price surge at **Judges Scientific (JDG:AIM)**, the expansionist scientific instruments designer and producer. Originally bought by the manager at 150p, the stock rocketed past the £18 mark in September before settling at £16.98.

The manager has recently top-sliced his holding although he remains upbeat about the business. 'It is an acquisitions vehicle,' explains Slater of Judges, an acquirer of niche instrumentation firms that are very rich in intellectual property (IP). 'Each time they do a deal,' he explains, 'there is a very significant earnings enhancement.' Slater's portfolio is also invested in **Oxford Instruments (OXIG)**, the £722 million cap high-tech tools and systems provider to industry and the research sector which is making a bid for rival **Andor Technology (AND:AIM)**. Though it fell in September, Slater likes the fact Oxford is 'loaded with IP and has leading positions in all of the things it does'.

Headquartered in cost-effective Newry, Northern Ireland, **First Derivatives (FDP:AIM)** is another tech name that has helped power portfolio gains. 'It fits our criteria with its bread-and-butter business,' says the star manager of the capital markets software and consulting star turn, which this month (5 Nov) announced sales up 25% to £34.4 million for the half to end-August. According to the canny bottom-up stock picker: 'First Derivatives is in a lot of the banks, sells to

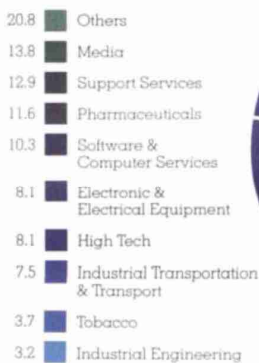
a lot of the exchanges and looks very well positioned.' He adds that by investing in the company, 'you've effectively got a big data play without paying the silly prices'.

The manager also likes the growth prognosis at another IP-rich venture, this time in the media sector. He has owned film and TV content specialist **Entertainment One (ETO)**, or 'E1' for a long time which has ascended from the small-cap ranks right into the FTSE 250. 'E1 is profitable and growing well into the double digits,' points out Slater, who still sees 'plenty of scope for the multiple to rise' from an undemanding 11-times earnings.

RUNNING WITH WINNERS

'The biggest drivers of the past year have been the biggest holdings,' says Slater, particularly bullish about **Hutchison China MediTech (HCM:AIM)** or 'Chi-Med'. The £325 million cap healthcare group have been propelled higher by excellent newsflow and a big tailwind in China. Less-well understood, according to the diligent Slater, are the rich property assets on the balance sheet and the progress being made by Chi-Med's majority-owned

TOP TEN SECTORS (% of fund)



Source: Slater Investments. Data as at 30 Sept.



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research & development (R&D) company, a biotechnology arm he describes as being 'years ahead of the next-best Chinese R&D business'.

Boasting a 'huge pipeline of products', the canny manager highlights Chi-Med's R&D arm with the likes of **AstraZeneca (AZN)**, **Nestlé (NESN:VX)**, **Eli Lilly (LLY:NYSE)** and **Johnson & Johnson (JNJ:NYSE)**-owned Janssen Biotech (see Skyepharma, page 10) as long-term value drivers. 'I think the shares could double from here quite easily,' says Slater of Chi-Med, 71-% owned by Hong Kong-quoted **Hutchison Whampoa (13:HK)**, the global conglomerate guided by Li Ka-shing or 'the Asian Warren Buffett'.

Other names contributing to strong returns are maritime services firm **James Fisher (FSJ)** which 'keeps delivering again and again and again' and **CML Microsystems (CML)**, a semiconductor maker servicing global communication and data-storage markets. 'They're in quite niche areas,' enthuses Slater of the £79.4 million cap, 'and they are very well positioned in those niches'.

SET FOR LIFT-OFF

Slater has recently opened new positions in the likes of support services group **Mears (MER)**, marketing services specialist **Communis (CMS)**, flexible workplace provider **Regus (RGU)** and a number of housebuilders, where he has taken small stakes. But he is keen to outline the attractions of one corporate gem in particular.

The company in question is aircraft leasing business **Avation (AVAP)**. 'It's trading at a big discount to asset value and on a single-digit earnings multiple,' says Slater, who topped up his position following the finals (27 Aug) which triggered massive earnings upgrades. 'Avation is a complicated business but it is a very good business,' explains Slater, who believes the £52 million cap, with enviable contracted fleet growth already locked in, will enjoy 'very rapid growth for the next few years'. ●●

FAST FUND FACTS

MFM SLATER GROWTH

Fund size:	£58.6 million
Fund type:	UK Unit Trust
Sector:	IMA UK All Companies
Inception date:	30 March 2005
Initial charge:	5.25%
Annual charge:	1.55%
Minimum initial investment:	£3,000

TOP TEN HOLDINGS (% OF PORTFOLIO)

Entertainment One	(ETO)	9.7
Hutchison China Meditech	(HCM:AIM)	8.4
Dialight	(DIA)	6.3
NCC	(NCC)	5.8
CML Microsystems	(CML)	4.8
James Fisher	(PRU)	4.2
First Derivatives	(FSJ)	3.4
Avation	(AVAP)	3.3
Alliance Pharma	(APH:AIM)	3.3
Restore	(RST:AIM)	3.0

Source: Slater Investments. Data as at 30 Sept.

