Weekly Review

RESEARCH

– Issue – 2 Dec. 2016

One of Seek's businesses may have hit a brick wall, but the others are more than making up for it.

BY JAMES GREENHALGH • INTELLIGENT INVESTOR • 29 NOVEMBER 2016

Seek's Learning difficulties

Well, that's $300m we're never getting back. When we upgraded Seek in ***Seek finds success overseas*** last year, we put a 'high' value on Seek Learning, which funnelled students into third-party education courses, of almost $300m.

Key Points

- ***Seek Learning has fallen over***
- ***Emerging markets risks higher***
- ***Australian business resilient***

SEEK (SEK) / HOLD

Price at review	Max. portfolio wght.	Business risk	Share price risk
$14.73	6%	Medium	Medium

BUY Below $14.00 | HOLD | SELL Above $22.00

$14.73

Even that high value seemed reasonably conservative, given that Seek Learning had earned a record $47m in earnings before interest, tax, depreciation and amortisation (EBITDA) in 2014. Had Seek Learning been listed on the ASX, we suspect the business would have been valued by the market at close to $700m at its peak.

Last week, at the company's 2016 annual general meeting, Seek effectively announced the division was worth something between zip and not much. Government legislation has been proposed that will ban brokers – Seek Learning meets the definition – that push students into vocational education courses.

While Seek maintains it acted ethically, it certainly benefited from the mad scramble of educational providers to sign up students following the government's ill-advised deregulation of the vocational education sector in 2012.

Derailed

The gravy train has come off the tracks and, while Seek Learning looked like a wonderful business, it was in fact an illusion. At the annual meeting, Seek announced it will incur one-off post-tax charges of $16m for Seek Learning in 2017 as it scales back operations. It's a reminder of the benefits of diversification.

Thankfully, as we've indicated in previous reviews, Seek's domestic employment classifieds business and Seek Asia both look like they're worth considerably more than we outlined in September last year. We've updated our sum-of-the-parts valuation to reflect changes in value, as well as the sale of the company's stake in **IDP Education** last year (see Table 1).

Zhaopin, the company's American-listed Chinese operation, also continues to grow nicely. For the first quarter of 2017, management announced revenue and earnings growth of 21% and 14% respectively. Zhaopin continues to invest in product, sales and marketing, so earnings growth remains lower than sales growth. There's still no news on whether Seek will permit Zhaopin to be taken over; we continue to think it will remain a shareholder if so.

Continued on page 2 ...

CONTENTS

Continued from page 1 ...

Day of the dread

With the elevation of US President-elect Donald Trump on 8 November, we're a little more wary of Seek's emerging markets exposure. Perhaps the most obvious risk is to the company's OCC employment and education business in Mexico although, with a net profit contribution of $3m in 2016, it's the company's smallest international division.

OCC has, however, been growing fast. OCC's fledgling education business is something of a star, having produced revenue growth of 72% in 2016. It remains to be seen whether Trump's posturing has any effect on the Mexican economy in the years ahead but it's something to keep in mind.

More worrying is Seek's much larger exposure to Asia. Seek Asia and Zhaopin together contributed $67m in net profit to Seek's 2016 results, so any Asian economic downturn – Trump-inspired or not – would hurt. While these businesses continue to have fantastic potential, they do come with above average risk.

These concerns – emerging markets risk, and Seek Learning's disappearing act – have contributed to the 10% slump in the share price since ***Seek: Result 2016***. But any Asian economic downturn – or fear thereof – might provide the opportunity to upgrade our Seek recommendation again. At this stage we'll stick with Buy below $14 although the potential for a profit crunch in Asia means we reserve the right to lower it.

Table 1: Seek sum-of-the-parts

DIVISION	EBITDA 2015 ($M)	EBITDA 2016 ($M)	LOW MULT.	MID MULT.	HIGH MULT.	LOW VALUE	MID VALUE	HIGH VALUE
SEEK DOMESTIC								
ANZ EMPLOYMENT (100%)	154.2	177.8	12	16	20	2,134	2,845	3,556
SEEK INTERNATIONAL								
ZHAOPIN (CHINA) (61.5%)	67.0	79.7				500	676	900
SEEK ASIA (86.3%)	49.1	75.8	12	16	20	785	1,047	1,308
BRASIL ONLINE (BRAZIL) (100%)	43.7	34.0	6	8	10	204	272	340
OCC (MEXICO) (98.2%)	7.8	9.3	12	16	20	110	146	183
SEEK EDUCATION								
SEEK LEARNING (100%)	32.5	5.0	0	0	5	0	0	25
ONLINE EDUCATION (50%)	28.9	34.4	10	12	15	172	206	258
EARLY STAGE INVESTMENTS								
VARIOUS						0	0	100
TOTAL						***3,904***	***5,192***	***6,670***
ADD SEEK SHARE OF CASH						456	456	456
LESS SEEK SHARE OF DEBT						(786)	(786)	(786)
LESS CORPORATE COSTS						(200)	(200)	(200)
TOTAL EQUITY VALUE						3,374	4,662	6,140
VALUE PER SEEK SHARE						***9.74***	***13.45***	***17.72***

> **The revenue model Seek will adopt is unclear but establishing this new venture will be costly in the short term.**

New venture

Seek continues to invest in new projects which, as **previously noted**, will slice $25m off the bottom line in 2017. One of these 'early stage ventures', as Seek calls them, was announced at the annual general meeting.

Seek anticipates this new education venture will have two services. One will be like 'Tripadvisor' (the travel review site) but for education courses, while the other will offer free phone-based careers counselling.

The revenue model Seek will adopt is unclear but establishing this new venture will be costly in the short term. Seek anticipates it will incur losses of $6m in 2017, which will be included in the $25m of early stage venture losses already forecast. That suggests Seek will redirect funds from elsewhere, so presumably management considers the venture promising.

In the end, though, Seek still depends largely on its Australian and New Zealand employment classifieds business, which accounts for around half of the company's value. The story here is promising, with the business having lifted earnings by 15% in 2016. Revenue has almost doubled since 2010 and we expect the company's pipeline of new products to continue driving growth (if not at quite the same rate).

It's testament to management's abilities that the failure of the Seek Learning business has put barely a dent in Seek's growth profile. It's another reason why we think this is one of the Australian market's best businesses, even if it's not quite cheap enough to buy. **HOLD**.

*Note: The Intelligent Investor **Growth** and **Equity Income** portfolios own shares in Seek. You can find out about investing directly in Intelligent Investor and InvestSMART portfolios by **clicking here**.*

Disclosure: The author owns shares in Seek.

For the first time, Sirtex's lone money-spinner wasn't centre stage at its annual R&D meeting. Here we look at the next generation of products.

BY GRAHAM WITCOMB • INTELLIGENT INVESTOR • 30 NOVEMBER 2016

Is Sirtex's $20,000 teaspoon enough?

Talk about scary statistics: in 2015, a **financial literacy survey** asked 4,000 Australians about 'diversification' as an investing principle – and just under two-thirds of respondents ticked 'I haven't heard of this' or 'I have heard of this but don't really understand it'. Yikes.

Key Points

- ***New sepsis product close to trials***
- ***Early stage; significant existing competition***
- ***Main opportunity still SIR-Spheres***

SIRTEX MEDICAL (SRX) / HOLD

Price at review	Max. portfolio wght.	Business risk	Share price risk
$27.70	3%	Very High	Very High

Sirtex Medical's management falls squarely in the other third of the population. Earlier this week, the company held its annual research & development (R&D) investor briefing and diversification was the big theme.

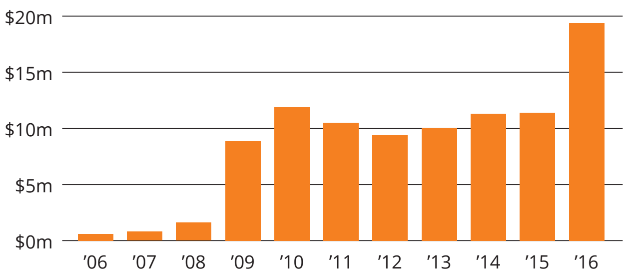
Historically, these meetings have been focused on the company's lone commercial product: a radiotherapy for liver cancer, catchily named SIR-Spheres microspheres. This time, though, the product was only mentioned three times during the 100-page slideshow presentation.

If you baulk at the cost of cough medicine these days, hold your breath: a single teaspoonful of SIR-Spheres – the typical dose size – has a price tag of close to $20,000. Sirtex may be a one-product company but, with a product like that, diversification was the last thing on most investors' minds.

That was, at least, until the stock plummeted 60% last year when a poorer-than-expected clinical trial suggested **SIR-Spheres might never become a first line treatment for liver cancer**, and instead remain as a last resort. Since then, diversifying the company's product line-up and revenue streams – or at least giving investors that impression – has been a priority.

The company is spending close to 9% of revenue on research and clinical trials to expand its product pipeline, with $19.4m spent in the year to June (see Chart 1). The bulk of this was for trials that will hopefully improve acceptance of SIR-Spheres among doctors, but around $8.7m went on early-stage research into novel therapies.

Chart 1: R&D investment



Source: Company reports

How many syllables?

Of this early-stage research, the company has four primary projects: a special antioxidant that makes healthy tissue less sensitive to radiation; two separate programs researching nanoparticles, one to enhance medical imaging and another to deliver drugs more effectively; and the 'Histone Inhibition Program'.

All four projects are in their infancy, so we'll focus on the Histone Inhibition Program in this article as it's the closest to commercialisation – which, it must be said, still resides somewhere between the far horizon and the moon.

The Histone Inhibition Program is developing a compound – dubbed STC314 – to treat sepsis, a medical condition that causes more than 200,000 deaths in the US each year.

Sepsis is essentially where everyday inflammation to fight an infection gets out of hand and the inflammation spreads throughout the body. This can damage healthy organs and cause them to stop working. Sepsis is the most expensive condition to treat in hospitals and costs the system something in the order of US$20bn a year in the US, which will almost certainly be the product's major market.

> **A final concern is that management doesn't have much of a track record with drug discovery and development.**

Sirtex's compound inhibits toxic proteins ('extracellular histones') that are released into the fluid around dying cells and can trigger the excess inflammation and damage tissue. It removes an important domino before the inflammation cascade gets underway.

Big potential

Sirtex's STC314 is exciting for a few reasons. Firstly, it already has a US patent out to 2030 and Sirtex has the commercial rights, though the product is being developed in partnership with the Australian National University.

Secondly, if it ever does reach commercialisation, the therapy may qualify for 'orphan drug status' with the US Food & Drug Administration because it meets a largely unmet medical need. This special designation comes with accelerated regulatory approval and more generous marketing and pricing guidelines, so it would enjoy very high margins.

What's more, management expects that clinical trials will be much shorter than those for cancer drugs, which can stretch over several years, and it believes the potential market for the drug is around US$1–2bn in yearly sales.

But it's important we don't get ahead of ourselves. The drug in question is still in early research, with Phase 1 clinical trials expected to begin early next year. Only around 7% of drugs that begin Phase 1 trials ultimately get regulatory approval, and unless you're an expert in inflammatory proteins you probably can't judge the odds of success (it's a stab in the dark for us too).

Then there's the inconvenient fact that STC314 already has its share of competition, including a drug called Selepressin and a device that removes toxins from the blood called Toraymixin.

Though each works in a different way to Sirtex's histone inhibitor, the therapies still treat sepsis and so can be considered substitute products. Worse, they are already in Phase 3 clinical trials, so much closer to reaching the market. Not only will Sirtex need to show STC314 works, it will need to show it works better.

No track record

A final concern is that management doesn't have much of a track record with drug discovery and development. Chief executive Gilman Wong joined the company in 2005, three years after SIR-Spheres had already gained regulatory approval. Management has a strong sales and marketing background, and has certainly shown its worth at commercialising an approved product – but whether it can navigate the delicate risk-reward balance of funding early-stage research and clinical trials is yet to be seen.

The bottom line is that, at this stage of the game, the Histone Inhibition Program adds no more than a rounding error in our valuation of Sirtex. It may work out but we won't know for years whether the $8m spent each year on these long-shot programs will bear any fruit.

Diversification is an important investing principle, but so too is the cost of distraction. Given management's expertise and the success of SIR-Spheres, we'd prefer management to stay focused on Sirtex's real opportunity: the potential market for SIR-Spheres – patients with inoperable liver cancer – is around 500,000 people a year, yet the product is only used in around 2% of cases. Every 1% increase in that penetration rate by improving awareness and acceptance among doctors would add well over $100m to revenue. Management expects 'double-digit sales growth' of SIR-Spheres in 2017.

Sirtex's share price has fallen 30% since late last year but has still nearly quintupled since we first upgraded the stock on **8 Nov 10** (Speculative Buy – $5.90). With a price-earnings ratio of 30, Sirtex looks expensive on traditional valuation metrics, but we think it deserves a premium price.

The company has a huge untapped market for SIR-Spheres, profitable sales growth and more than $100m of net cash to fund its clinical trial and research programs. Having a single product adds significant risk, but you can manage that by locking in profits as the share price rises and adhering to our recommended portfolio limit of 3%. **HOLD**.

Staff members may own securities mentioned in this article.

The stock price has halved and key executives have left. All is not well at Vocus.

BY GAURAV SODHI • INTELLIGENT INVESTOR • 29 NOVEMBER 2016

Vocus: AGM 2016

Vocus began with a very specific idea: to build fibre for corporate customers. That business is no more. A hastily assembled combination of four companies – Vocus, Amcom, M2 and NextGen – constitutes the large telco today.

Key Points

- ***Earnings downgraded at AGM***
- ***Clear internal conflict a red flag***
- ***It is now cheap***

VOCUS COMMUNICATIONS (VOC) / HOLD

Price at review	Max. portfolio wght.	Business risk	Share price risk
$4.35	4%	Med–High	Med–High

BUY	HOLD	SELL
Below $4.00	$4.35	Above $7.00

It uses the Vocus name but bares little resemblance to the original business.

This kind of rapid growth story needs to be treated cautiously. Vocus has suffered integration issues, a clash of personalities and management discord as it has completed 7 acquisitions in 20 months.

Perhaps this is just a distraction from the main business? If this were a boring, stable industry we might agree. Instead, this is an industry rapidly changing with the NBN comprising the largest churn event in its history. Management doesn't always matter but it does in this case.

The big fall

That said, the 25% share price plunge following today's annual meeting was a surprise.

There was a mild earnings downgrade with management forecasting EBITDA of between $430-450m in 2017 and the NextGen business reported a dramatic fall in profitability with earnings falling from $60m to $40m.

Yet that misses the point. NextGen was purchased not for its earnings but as a piece of infrastructure with low utilisation rates. Vocus will presumably utilise capacity for its own customers so earnings from this business is largely irrelevant.

With the share price much cheaper, there are two temptations at Vocus.

The most attractive part of the Vocus business is fibre which earns high incremental margins and is currently lightly utilised. Fibre utilisation rates are currently under 20% and growth here will attract stunning gross margins.

The other attraction is price. Vocus trades on a forward EV/EBITDA multiple of about 8 times and it shouldn't face the same savage margin decline as **TPG** because margins were never as high to start with.

We might even see margin expansion as fibre assets are better utilised and acquisitions finally integrated.

Not quite there

The main argument against buying now is that we don't have a high level of confidence regarding earnings power in this business.

The extent of savings, synergies, customer growth and margin changes makes it difficult to estimate earnings, which is perhaps why the premium multiple has vanished. We admit this may be a source of opportunity but the best opportunities exist when the market is uncertain and our own analysis adamant. That's not the case here.

More tangibly, Vocus earns most of its revenue from its voice division, a business that will almost certainly face decline. The business also reports churn rates twice as high as TPG and returns on capital are poor considering the extent to which it leases assets.

Vocus owns a strong fibre business, an asset-light broadband business, a strong but declining voice business as well as data centres, energy plans and a mobile business. It's a lot of balls to be juggling, especially for a management team with evident internal conflicts and no obvious solutions.

The price is now cheap and we're tempted to dip a toe in but the risks have risen even as the price has fallen. The departure of several senior executives, internal selling of stock and several downgrades are enough to scare us off. We look down before we look up. **HOLD**.

*Note: Our current recommendation is **AVOID**, please see latest update on* page 1**2**.

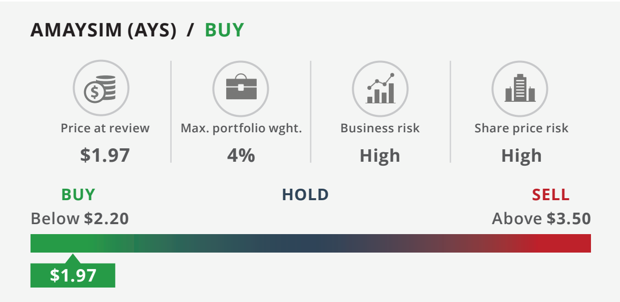
Staff members may own securities mentioned in this article.

The share price tanked following an update. Was it really so bad?

BY GAURAV SODHI • INTELLIGENT INVESTOR • 30 NOVEMBER 2016

Amaysim investor day

It's been a tough week for telcos. **Vocus**, of course collapsed earlier this week and **TPG** fell in sympathy. It seems a similar fate has befallen Amaysim whose share price crashed 12% following an investor day.



The update itself didn't contain any bombs. Amaysim confirmed it would add between 58-60,000 new customers in the first half, a run rate of over 100K new additions per year. As we've noted in ***Unlocking value in Amaysim*** incremental margins are higher than average margins so adding customers strengthens the economics of the business.

Average revenue per user (ARPU) fell for the second consecutive half but that should not surprise as Amaysim counts lower priced vaya customers into its aggregate numbers for the first time.

There is one lingering concern: that Vaya customers, who typically have higher churn rates and lower ARPUs are cannibalising Amaysim growth. It's hard to see if that's the case so far but it is something to watch. The direction of ARPU will be key.

The trigger for today's fall may well be lower gross margins which fell from the mountainous 36% in the second half last year to a more reasonable 32%. That should not be any cause for alarm.

There are seasonal reasons why second half margins are higher (for example, Amaysim counts unused phone card credit as revenue at that time) but that gross margin was unusually high because it coincided with a favourable wholesale agreement with Optus which temporarily elevated margins.

That impact has now subsided and we expect a long term gross margin around current levels.

On a forward multiple of just 12 times and prospective yield of around 5%, Amaysim is cheap. The business should generate double digit revenue growth, slowly expand margins and grow free cash flow. With operating metrics looking sound and an undemanding valuation, it's hard to see what spooked the market. We were within whiskers of downgrading as the price bumped up against our recommendation guide. The fall today puts it squarely back on the radar. **BUY**.

*Note: The Intelligent Investor **Growth Portfolio** owns shares in Amaysim. You can find out about investing directly in Intelligent Investor and InvestSMART portfolios by **clicking here**.*

Disclosure: The author owns shares in Amaysim.

GBST is already on our Buy list. Will its main competitor join it?

BY ALEX HUGHES • INTELLIGENT INVESTOR • 1 DECEMBER 2016

Enter Bravura: GBST's biggest competitor

After a quick vacation in the private equity health spa, where figures are buffed and excess fat slashed, Bravura Solutions is back on the ASX. When it left the boards in 2013, it did so nursing a hangover. Bravura returns refreshed and rejuvenated, as shown in table 1.

Key Points

- ***Private equity float***
- ***Good business***
- ***On to the watchlist, BUY GBST***

BRAVURA SOLUTIONS (BVS) / NO VIEW

Price at review	Max. portfolio wght.	Business risk	Share price risk
$1.40	N/A	N/A	N/A

Take these headline figures at face value, as Ironbridge Capital would have us believe, and the turnaround has been masterful. All three of the components have increased since 2013 – the margin by a factor of eight – and the result is a much better-looking business, at least financially. But why then did the stock trade more than 20% below its starting price on its first day back? And why is it still below its listing price?

Investors burnt by private equity may have something to do with it. After the float of **Myer** (down 66% since listing and now back on our Buy List), **Spotless**, down 46%, and the total wipeout of **Dick Smith**, investors are wary of the next private equity lemon. We don't think Bravura is it, as we explained in ***No, Bravura is not the next Dick Smith***.

In fact, Bravura is a great business. That, however, is quite different from being a great investment. It's possible that the company will join our Buy List at some stage, to accompany **GBST**, its main competitor, in the way that we have recommended a number of IVF providers rather than just one.

For now, we're bringing the business to your attention before any formal coverage and recommendation. If you already own GBST, this will be a useful insight into its main competitor.

If you don't, you'll get some background on an industry rich with opportunity. With current Buy recommendations on **IOOF**, GBST and **Perpetual**, we see wealth management as an area of rich opportunity. At the right price, we'd love to add Bravura to the list.

Bravura, with 76% more revenue, is bigger than GBST. But the companies square off in wealth management software, mostly provided to investment platforms. Here, Bravura is bigger (by 60%) and growing faster. Since 2013, its wealth management division has grown at 24% p.a., twice the rate of GBST.

Table 1: Dupont comparison*

	MARGINS	ASSET TURNOVER	LEVERAGE
2013			
GBST	7.3%	0.9x	2.0x
BRAVURA	1.4%	0.7x	1.6x
2016			
GBST	8.6%	1.1x	1.4x
BRAVURA	11.2%	1.2x	1.7x

Dupont analysis breaks down return on equity into three components: the margin earned on revenues, the revenue earned on the asset base and the 'leverage' (the amount of total assets relative to equity).

Driving this success is Sonata, Bravura's flagship wealth management software. In five years, Sonata has gone from a standing start to $92m in revenue. Meanwhile, its funds administration business has declined over the same period, reducing total company growth to a shade over 8%, dead even with GBST.

Sonata sizzle

Sonata is Bravura's latest release of backend software for investment wraps and platforms, although its addressable market is broader than that. Superannuation, pension and life insurance providers can also find a use for it. Targeting growth in Europe and Asia, Sonata is much less UK-centric than GBST.

> **"The best software doesn't necessarily win, as Apple found during Microsoft's heyday in the 1990s.**

It took Bravura 10 years and $100m to complete Sonata, which will unify and replace many of Bravura's legacy platforms. That investment has transformed customers' digital experience. Sonata can be used on any device and is configurable by the client.

Bravura will tell you its software is the best, as will GSBT. How much that matters is up for debate. The best software doesn't necessarily win, as Apple found during Microsoft's heyday in the 1990s.

Just consider the battle to win CoFunds as a client, the UK's largest platform. When it needed to update its legacy technology, CoFunds selected Bravura's Sonata for the job, a great endorsement. But Legal & General, CoFunds's owner at the time, was unnerved by the £40m–60m needed for the transition. Instead, it opted to sell CoFunds altogether.

This is where it gets interesting. Aegon then stepped in and bought CoFunds, consolidating it with its existing technology, which happens to be from GBST. **Steven Bradbury** would have been proud.

Inflating earnings

With an attractive product, sticky long-term clients and a debt-free balance sheet, the biggest risk appears to be paying more than Bravura is intrinsically worth. Granted, the multiples are undemanding after the recent price fall (at 9x times EV/EBITDA and 14 times PER), but these numbers are based on estimates made by private equity, and who would want to trust those?

Table 2: Research and development

	2014	2015	2016	TOTAL
GBST	10.8	11.7	18.1	40.7
BRAVURA	5.0	10.9	6.2	22.1

Ironbridge's most recent floats made money for IPO investors (Eclipx and Monash IVF), so it may not be as ruthless as others. But despite good intent, the incentives are to maximise profits, often at retail investors' expense. You won't find any clues in the headline numbers, but they sometimes appear in the footnotes. So, let's have a look at those.

Before it was taken over by Ironbridge, Bravura amortised its intellectual property (IP is its biggest asset) over 8–10 years. The prospectus informs us that this period has been stretched to 5–15 years. With this policy change, amortisation could theoretically be reduced by up to 47%. Intangibles were also impaired by $81m in 2015.

What does this change signify? Expanding the useful life of IP is a more aggressive accounting practice. The question is whether this is an indication of similar behaviour across the business. When dealing with large, multi-year contracts, many levers exist to pull earnings forward. We won't know what levers, if any, have been pulled for a few years. GBST, on the other hand, has been operating in the public eye for years, which makes nasty surprises less likely. Further, Bravura's R&D has been low in recent years, as table 2 shows, which could be another indication of unsustainably low expenses.

Lighthouse contracts

Another contentious issue is the treatment of Bravura's lighthouse contracts – those it signs to get a new product off the ground. After spending $100m building Sonata, Bravura was keen to secure new clients. The trouble is, shifting to an untested product is a risk for the guinea pig clients. So Bravura discounted the price for early adopters to entice them onto its platform, a common industry practice.

As it turned out, the low price was too low and the contracts lost money. Bravura regards these as exceptional items, excluding the losses from the calculation of profits. We'd argue this is a normal business decision, and therefore should be included in profits, having the effect of reducing them.

Bravura is a good business but, for the reasons given, we're less convinced it's a good investment – yet. It's going on the watchlist, while GBST remains a Buy.

*Note: The Intelligent Investor **Growth** and **Equity Income** portfolios own shares in GBST. You can find out about investing directly in Intelligent Investor and InvestSMART portfolios by **clicking here**.*

Staff members may own securities mentioned in this article.

There is as much hot air in HotCopper's share price as there is in its forums.

BY ALEX HUGHES • INTELLIGENT INVESTOR • 28 NOVEMBER 2016

HotCopper is too hot

I'm just going to come out and say it. I think HotCopper (ASX:HOT) is a decent little business.

My trepidation to share this view stems from the stigma that surrounds the site. The stock market forum is better known for spruiking and rampant speculation, rather than detailed research and considered views.

But say what you will about the quality of the discussion. It's irrelevant. All that matters is that people continue to visit and post on the site. Like Facebook and Twitter, you must admire a business whose members are the content.

The value of HotCopper is in its 235,000 strong ecosystem, that boasts more online traffic than Flight Centre. Here, network effects apply. People visit because it has more comments, and people comment because it has more visitors, and after two decades of existence, the principles of **Lindy's law** suggest this is likely to continue. HotCopper's $24m market cap is based on its ability to monetise this activity through advertising and emails.

But a good business and a good investment are not the same thing. Again, I'm just going to come out and say it. Am I the only one that thinks HotCopper is grossly overpriced?

Before the thought of an ASX listing entered management's minds, revenue was stagnant, as was profit around $240k each year. But the desire to list, and the need for some "sizzle", changed that.

HotCopper users could see the float coming. New ads started appearing everywhere. In the thread topic lists and even in the threads themselves. With a fixed cost structure, this additional advertising revenue fell powerfully to the bottom line, pushing profits to $498k in 2016.

But is the current trailing PER of 48 times justified? It implies enduring growth at a rapid clip. Shareholders must think HotCopper has a lot more untapped earnings potential up its sleeve.

I'm skeptical. I suspect recent growth is merely a one-off event. Still a no-growth business, just one that has reached a new earnings plateau. With a finite amount of online real estate in which to advertise, there are limited bullets and risk in using them. More ads and less content inevitably threatens user experience. And seeking to monetize the database also has its limits.

In saying that, I could be wrong and I have been before. What I can be certain of is that when earnings don't follow an expected stairway to heaven, the share price falls like an elevator.

So, I'm giving HotCopper a wide berth. Remind me to check back in if it ever has a $10m market cap.

Ardent confirms Dreamworld reopening

BY ANDREW LEGGET • INTELLIGENT INVESTOR • 30 NOV 2016

ARDENT LEISURE (AAD) / HOLD

Price at review: $2.15
Max. portfolio wght.: 4%
BUY Below $1.10 | HOLD | SELL Above $2.20 | $2.15

Ardent Leisure has confirmed that its Gold Coast theme parks — Dreamworld and WhiteWater World — will reopen on December 10. This is following the accident in late October that led to the deaths of four people on one of its rides in Dreamworld.

After the accident, both parks were closed pending a 'thorough safety check'. While this safety check uncovered other issues to date, most were minor and have been fixed.

As expected, the month-long closure of the parks had a financial impact. The company said that along with lost revenue (November generated revenue of $7.6m in 2015), the company also incurred operating costs of between $4.0m and $4.2m, as well as a one-off cost of $1.6m due to costs associated with the accident.

To put those figures in perspective, all things remaining equal, the hit of about $5.6m would have reduced the theme park division's operating profit in 2016 by almost 20% had it occurred last year.

As explained in **our recent article**, we expect earnings in 2017 to be significantly lower as a result of the accident. How much lower will depend less on what happened during the parks' closure, though, and more on how many people turn up when they reopen. With the reopening date set we will be able to get a better understanding of how much this division is actually worth.

Ardent has promised to keep the markets fully informed and provide regular updates on the performance of its theme parks. **HOLD**.

Staff members may own securities mentioned in this article.

Ceasing coverage of Intecq

BY ALEX HUGHES • INTELLIGENT INVESTOR • 28 NOV 2016

INTECQ (ITQ) / COVERAGE CEASED

Price at review: $7.14
Max. portfolio wght.: N/A
BUY | HOLD | SELL

Tabcorp's takeover of Intecq is all but complete.

Intecq shareholders have approved the deal, as have the ACCC. All that remains is the second court date this Friday, which is the final formality in a done deal.

Intecq will cease trading on the ASX this Friday. For those who still hold, that want their money back before December 16th, we recommend you **SELL** this week. Otherwise, you could wait for the takeover proceeds, but you will only receive another cent for your troubles (the total acquisition price is $7.15, to be paid on December 16th).

With this, we say goodbye to Intecq. We are now **CEASING COVERAGE**.

Staff members may own securities mentioned in this article.

Flight Centre downgraded

BY JAMES GREENHALGH • INTELLIGENT INVESTOR • 30 NOV 2016

FLIGHT CENTRE (FLT) / HOLD

Price at review: $33.05
Max. portfolio wght.: 6%
BUY Below $32.00 | HOLD | SELL Above $50.00 | $33.05

Having already increased our price guide to be sure we didn't miss the stock at the time of ***Flight Centre's ticket to ride*** earlier this month, we're not inclined to give the price more room to run. We're downgrading back to **HOLD**.

Staff members may own securities mentioned in this article.

Rio rises with iron ore

BY GAURAV SODHI • INTELLIGENT INVESTOR • 29 NOV 2016

RIO TINTO (RIO) / HOLD

Price at review $60.58 | Max. portfolio wght. 6% | BUY Below $45.00 | HOLD | SELL Above $75.00 | $60.58

It's fair to say your analyst has been absolutely gobsmacked by the iron ore price. We've been negative on iron ore for years and, as John Addis's splendidly timed article (see ***5 from 15: The myth of stronger for longer***) pointed out, we were right on the way down.

As the iron ore price today suggests, however, we've been completely caught out on the way up.

When we examined **Rio** in Is ***Rio Tinto a steel?*** we assumed iron ore prices around US$40 per tonne would persist for years. Today, prices are at US$80 a tonne.

That is despite enormous new supply from the Pilbara and the Carajas, the two dominant iron ore producing basins, flooding markets and a global oversupply of steel. What we couldn't foresee was that a bureaucrat would wake up one morning in China and decide to instantly slash Chinese production while providing an artificial boost to demand. As a result of these measures, ore prices have rocketed and equity values with them.

We were hoping to pick up Rio below $40 but that looks unlikely now. Our previous sell price also looks conservative considering where iron ore prices sit today. We've bumped up both buy and sell prices.

Yet we caution not to chase the new boom. Prices have risen because the Chinese government is managing supply and demand. A decision that caused prices to spike could easily reverse and have the opposite impact. We would love to buy Rio but only at the right price. **HOLD**.

Staff members may own securities mentioned in this article.

Vocus downgraded

BY GAURAV SODHI • INTELLIGENT INVESTOR • 30 NOV 2016

VOCUS COMMUNICATIONS (VOC) / AVOID

Price at review $4.17 | Max. portfolio wght. N/A | BUY | HOLD | SELL

Well that was fast. Within two days, Vocus's share price has collapsed and it now sits close to our new buy price. The huge price fall could signal capitulation among investors who are tired of losing money and are now, belatedly, selling.

With the stock coming into range, our internal discussions about it have heated up. While there is a consensus that this is a fair business that looks cheap, it is also clear that the red flags are waving too vigorously to ignore.

The integration of four large businesses isn't going well and customer growth has halted; key managers have left and have sold shares. We find it difficult to articulate a strategy or a competitive advantage for the business, and the issues of governance overwhelm the case to buy which rests mostly on valuation and the potential for lifting utilisation rates.

While that valuation might make an intriguing speculation, we don't have the necessary conviction to act. **TPG Telecom** is the better business and the better investment. For Vocus, given the red flags and the difficulty we're having pinning down a price at which we'd be happy to buy, we're switching to **AVOID**.

Staff members may own securities mentioned in this article.

Boral has been a chronic underperformer

Do you have any information on Boral (BLD)?

30 Nov 2016 – **James Greenhalgh**: We ceased coverage on Boral some time ago. The reason is that Boral has a very poor long-term record. Over the past ten years the company has produced an average annual return to shareholders of just 0.5% a year.

Boral – like a lot of building materials companies – has been very capital intensive. This means it has tended to produce poor free cash flows for shareholders. Management has also tended to allocate capital poorly when it has made acquisitions. Having ceased coverage on the company, it's hard to make a definitive comment about the recent takeover of Headwaters, but it looks expensive on the face of it and it's hard to understand strategically. If it is a cyclical play on the US housing recovery, we would consider that an insufficient strategic rationale.

We've no plans to re-commence coverage on Boral. We think there are far better companies in general, as well as better ones within the sector. We already cover Brickworks for example and have plans to cover Adelaide Brighton in the coming months. I hope that helps.

Short-term impact of commodity prices

Despite its impeccable considered value investing approach, II's recommendations on certain stocks are often let down by the fluctuations in commodity prices. Recent experiences include Origin and Santos (gas), Rio (iron ore) and Qantas (oil) come to mind. Given the short to medium term success of many of these recommendations is beholden to the price commanded for commodities, I challenge II to develop an in-article mechanism that : a) dynamically factors in the current commodity price as a "floating variable" on the buy/sell price and/or b) allows subscribers to edit assumptions around current and future prices to "auto-update" the buy/sell values.

29 Nov 2016 – **Gaurav Sodhi**: Uncertainty is a bit like death: it is better to learn to accept it rather than to try to conquer it. By their very nature, commodity businesses are cyclical and risky. They are almost always poor quality and they only make sense if we have a specific insight into commodity prices or prices are extremely attractive. In the absence of those conditions, it's not a place we must be invested. I'm not a believer in plugging in spot prices and getting to value as prices change so much. Spot prices are a rough guide but they aren't a map and I fear this would cause more harm than good. Appreciate the suggestion but it's not something we would consider.

Margin loans

I'm relatively new to investing, in my early 30's and am in the highest income tax bracket. I have sufficient cash to build a portfolio of stocks, but I am wondering if a margin loan of a similar value would be a better option to start a portfolio while minimizing tax at the same time. Considering my age and my goal to grow wealth, is this too risky?

28 Nov 2016 – **Andrew Legget**: Before I start I have to state that we are unable to provide personal advice so you will need to decide for yourself what is and is not the best investment strategy to follow, perhaps in partnership with a person who is licensed to give personal advice.

The general topic of margin loans is something, however, that we can talk about. We published a blog back in 2004 **explaining margin loans** that you might find interesting as it cuts through a lot of the 'benefits' claimed by the financial companies who offer them. If you type 'margin loan' into our search box you will also see a number of previous Q&A's on the subject. In short, our opinion on them have always been quite negative.

Vita Group

I am a shareholder in Vita Group. I am concerned as their share price has recently taken a hammering. They have not reported any negative news that I am aware of, am I missing something?

24 Nov 2016 – **Alex Hughes**: This is the challenging part of investing. Vita Group has not made any announcements which spell their challenges out in black and white, but the actions of the company and management have provided a number of clues.

In ***Vita Group: Result 2016*** (Sell above $5.20), which we released on September 9th, we had concerns that the core business was mature, as store numbers were stagnant and it appeared that profit maximising opportunities were close to being exhausted. This was supported by management's decision to expand into IT services. You will rarely find a business expand beyond its core area of expertise when the future looks bright for its core business. We were concerned about this, and with Vita Group trading at lofty multiples at the time, it made it easier to downgrade to SELL.

Since then we have seen significant selling by insiders, and have learned that Telstra is seeking to renegotiate its supply agreement (which likely means lower profits). Compounding the problems is the company's decision to expand into men's apparel retailing. After that, we decided to cease coverage in ***Trouble at Vita (Cease coverage)***.

However, there is nothing wrong with a mature business per se, or even one making speculative bets in unchartered waters, if, and only if, it is priced appropriately. Vita was once priced for growth, but it since adjusted to a more gloomy outlook, with a further discount for the added risks. It looks about right to me here.

INTELLIGENT
INVESTOR