Where we took profits and losses in 2015

In comparison to 2014, there were a lower number of sales in the Australasian portfolio in 2015. This was partly a function of profits having been taken at higher average levels in 2014, and also with the overall market's value being unduly discounted in 2015.

While the ASX 200 appears set to finish the year below where it started, it did not always look like this would be the case, and was essentially a game of two halves. Below we provide a brief review of the stocks that we recommended either an outright exit (Sell) or a partial exit (Sell Half) from over the course of the year.

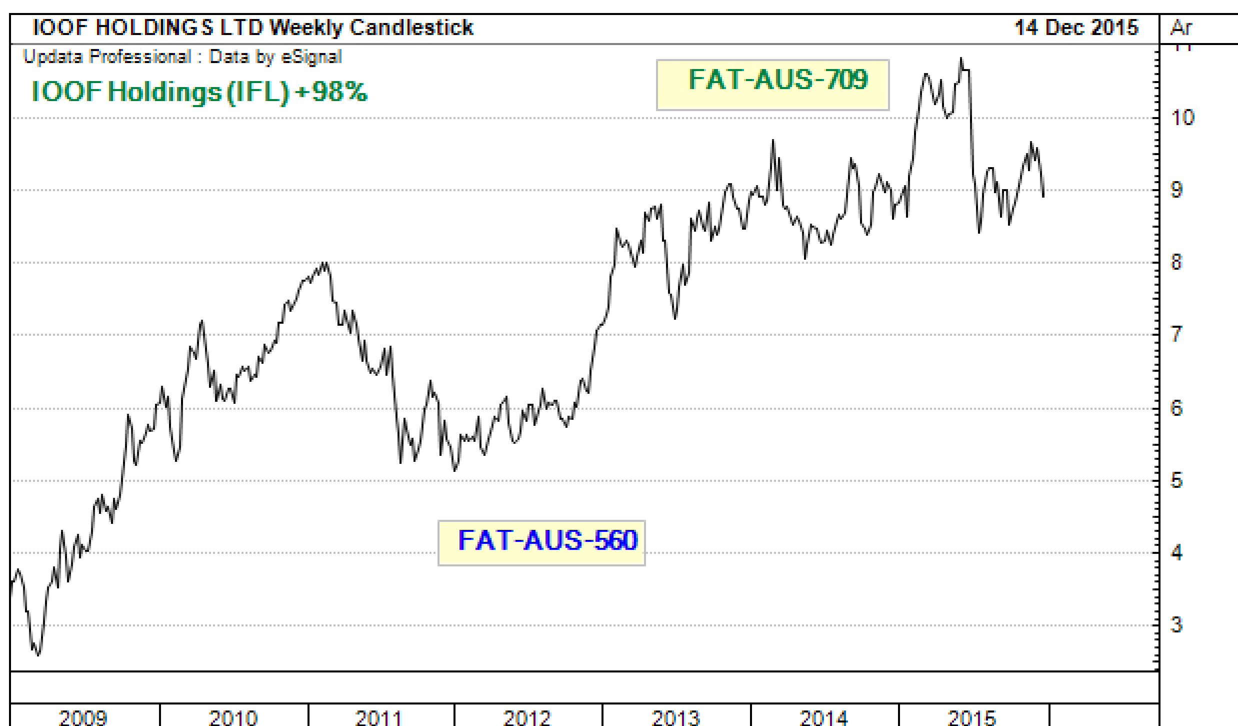
For the 12 months ending 31 December 2015, we published eight sell and sell-half recommendations, with all bar one resulting in positive gains, while the only loss on sale was limited to an absolute loss of 2.4 percent and an annualised loss of 1.1 percent. While the majority of these stocks are currently trading at prices higher than our recommended exit price, it is worth noting that the average annualised gain (including the one loss on sale) for these eight trades was 59 percent, with four of the eight limited to sell-half recommendations.

Our calls by stock are provided below in reverse chronological order.

IOOF Holdings

As we outlined at the time of our sell-half recommendation on IOOF Holdings (IFL.ASX) in FAT-AUS-709, while we remain favourably disposed to the company given its scalable business model and leverage to an attractive medium-term thematic (i.e. ageing population and legislation), the company's rising valuation (at the time) was putting some handsome gains on the table. With the benefit of hindsight, taking some profits proved to be a good move, with IOOF Holdings having since become the subject of some damaging claims from an ex-employee that featured in a Fairfax newspaper in mid-June.

Having taken the view that IOOF Holdings fundamentals remained intact despite the unfortunate publicity and that the subsequent sell-off in the company's share price was overdone, **we took the opportunity to buy back in at a much lower price.** This, in our view, reflects Fat Prophets disciplined investment process that is governed primarily by the principles of value investing - that is buying shares at a price below their assessed intrinsic value, and selling the shares when an appropriate risk buffer (i.e. the gap between the share price and our assessed intrinsic value per share) no longer exists.

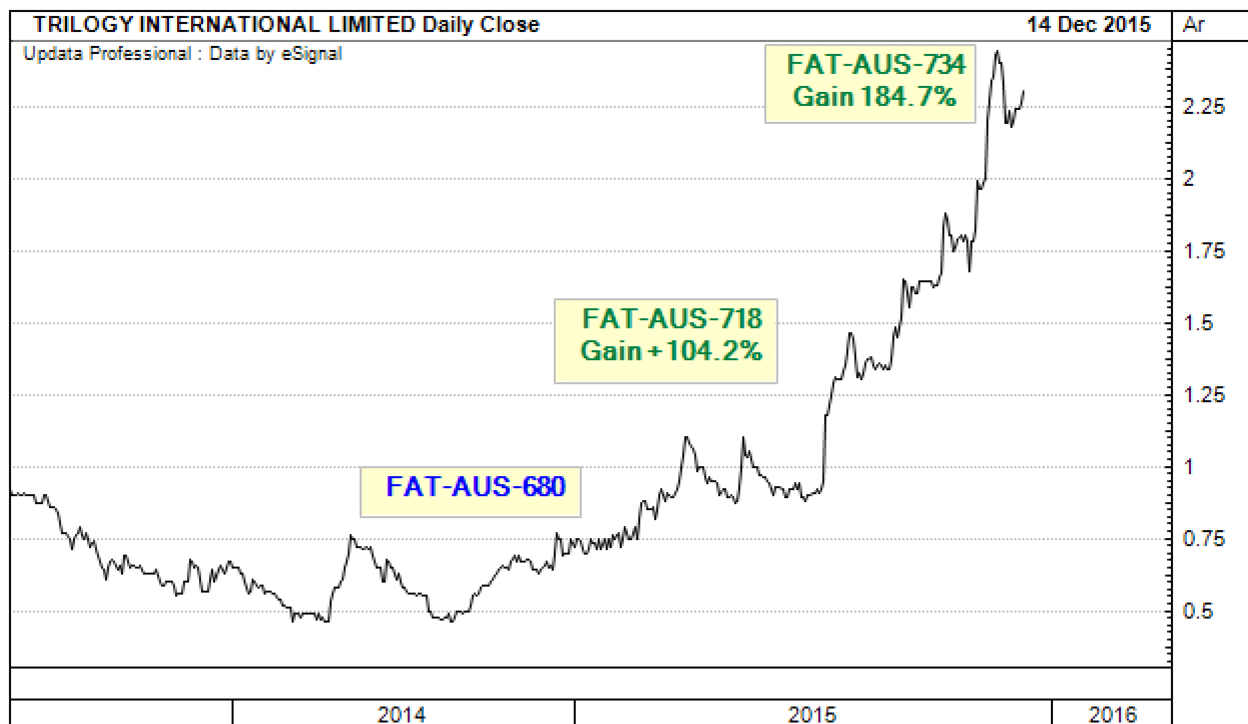


Trilogy

We published two separate sell-half recommendations on Trilogy (TIL.NZX) in 2015. With reference to the initial sell-half recommendation in FAT-AUS-718, we noted that with Trilogy's share price having doubled since our initial recommendation less than a year ago, we considered it an **opportune time to lock in some of the gains to date, while at the same time maintaining a holding for medium to longer term outperformance.**

We did not consider Trilogy's valuation metrics at the time of the sell-half recommendation as being overly expensive, particularly if the company was able to reach its full year targets of a profit in excess of NZ$4m. While this would have implied Trilogy was trading at a price earnings multiple of approximately 16.3x, this was lower than the company's peer group average of 18.7 times earnings for the comparable period. However, given the speed at which Trilogy's relative valuation was closing the gap (i.e. the price to earnings discount to peers), and the potential for earnings risks, we considered it an appropriate time to lock in some of the early gains.

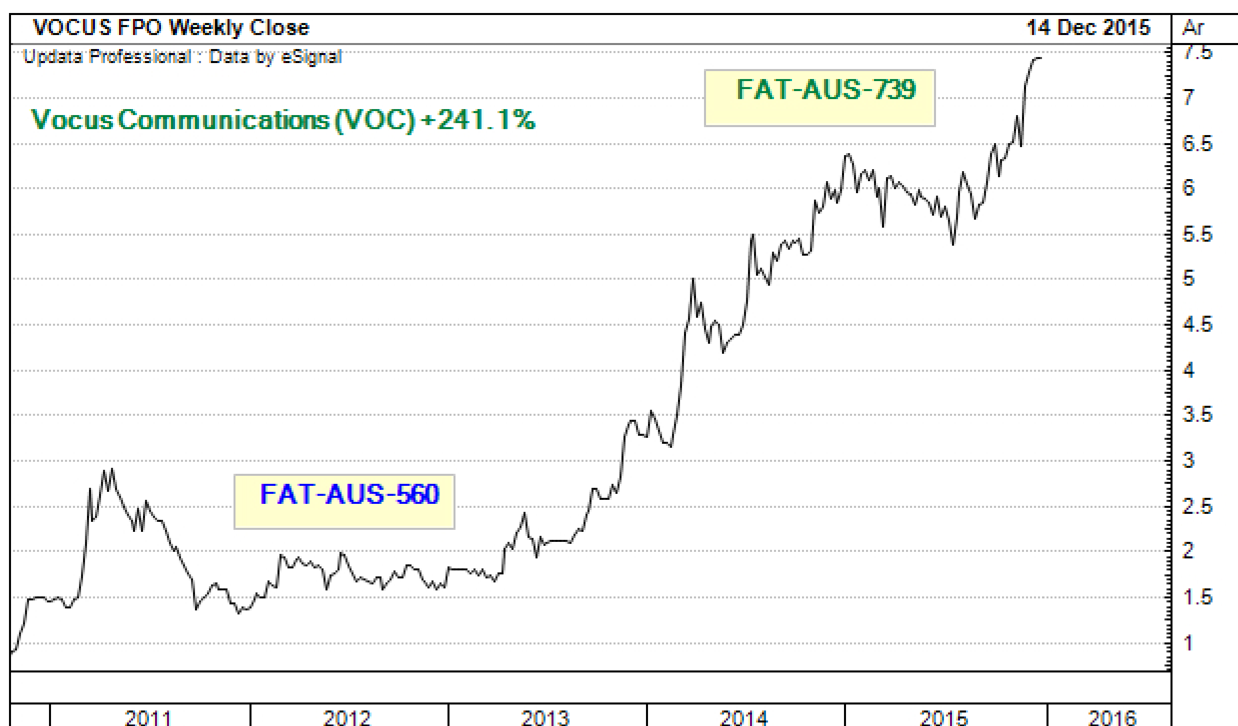
In publishing our second sell-half recommendation in FAT-AUS-734, the rationale was unchanged from our prior sell-half trade in April 2015. In essence, with Trilogy's share price having jumped 170 percent since the initial buy recommendation and around 70 percent since our initial sell-half report, we considered it appropriate to some take further profits on the name. While management did deliver a strong 1H15 result and was guiding towards a full-year profit in excess of NZ$3.5 million, which is comfortably ahead of the $1.1 million reported in FY14, we remained cognisant of some execution risks relating to the company's rapid growth trajectory.



Vocus Communications

In what was our first sell-all report for 2015, our decision to cash in all of our chips on Vocus Communications (VOC.ASX) was based on three key factors. **That is, given a modest yield, the expansion in the premium of the company's earnings multiple to the broader market, and a general increase in volatility in equities, we took the view that there were ample opportunities elsewhere with better risk to reward metrics** than those offered at the time by Vocus Communications. While Vocus Communications has a solid track record as a high growth and low yielding company, and arguably has the management team to undertake a seamless merger of equals with Amcom Communications, we believed this had already factored into the company's share price, particularly on a relative basis.

As history attests, our decision to publish a sell-all recommendation on Vocus Communications in FAT-AUS-739 was premature, with the company's subsequent announced merger with M2 Group having pushed the company's share price to around $7.50. While there are obviously some material risks associated with undertaking two major mergers or acquisitions in such a short period of time, investors appear to have reacted positively to the deals on the basis that the combined entity will become the fourth largest player in the Australian market, and therefore much better placed to compete in what is a dynamic and competitive market place. At any rate, we were nonetheless happy to report an annualised gain of 40.5 percent on the sale of our shareholding in Vocus Communications.



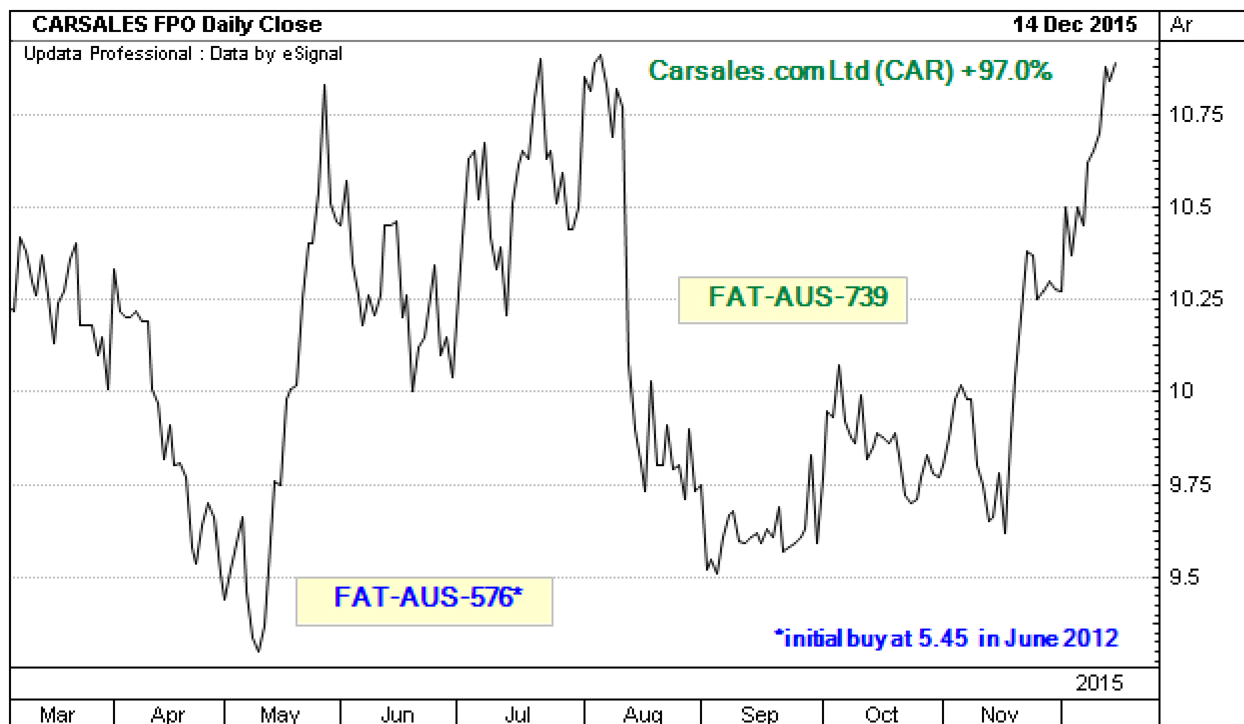
Carsales

Carsales' (CAR.ASX) share price performance through 2015 is indicative of a company at a crossroad. While a number of investors clearly remain comfortable with Carsales' ability to protect its competitive position in its core domestic market while at the same time looking to replicate its domestic success in offshore markets, not everyone is convinced. As evidenced by our decision to publish a sell-all report in FAT-AUS-739, after reviewing Carsales' FY15 results, we concluded that the trend, while far from alarming, was tipping the balance between investment risks and rewards towards the former.

While it was hard, in our view, to fault Carsales' reported revenue growth for FY15, the key question was why this momentum was not filtering through to a commensurate increase in earnings. As we noted at the time in our sell-half report, there appeared to be two reasons for this. First, the need to invest additional capital into the core business to protect its market position, and second, the change in sales mix stemming from recent investments in new businesses, with this comprising a combination of ramp up/integration costs and lower margins.

As evidenced by the fact that Carsales' share price has recently enjoyed a rally of sorts and is now trading at around $10.89 per share, it is interesting to note that the bulk of these gains have been made since mid-November, with the company's share price having outperformed the broader market by around 15 percent over this period.

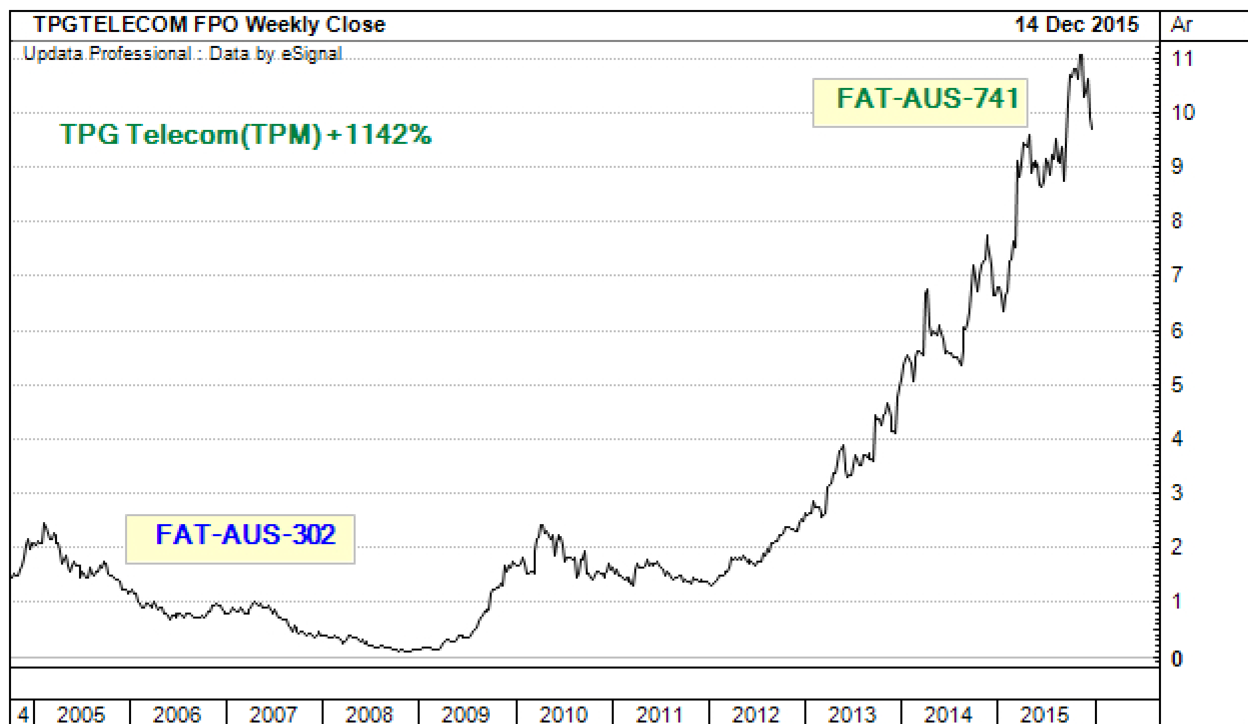
While there appears to be no clear catalyst for this, it is worth noting that management did provide a positive, albeit vague, trading update as part of its Annual General Meeting on 23 October. It is, of course, also possible that investors are punting on a favourable outcome to the government's recent efforts to make a decision regarding the proposal deregulation of Australia's car imports, both with respect to second-hand and new.



TPG Telecom

In one of two (the other IOOF Holdings) being instances (including sell-half recommendations) this year where we have sold shares at a higher price than the current share price, **it is pleasing to note that we exited TPG Telecom (TPM.ASX) at $10.32 per share, which is just shy of the company's 52-week high of $11.25 per share. In essence, having seen TPG Telecom's share price rise more than tenfold since our initial Buy recommendation, we concluded that it was now an appropriate time to take profits.**

Having noted at the time that TPG Telecom's FY15 result was solid, with the key drivers being an impressive performance from the company's consumer segment and the successful acquisition of AAPT, and that the outlook appeared positive given the more recent acquisition of iiNet and management's focus on further market share gains, we had two key concerns. First, TPG Telecom's share price was trading at 33.7 times next year's earnings (i.e. including iiNet), with a dividend yield of 1.1 percent. Second, debt had ballooned to $1.96 billion. Add to this the likelihood that the proposed merger between Vocus Communications and M2 Group will create stiffer competition, and this was enough of a reason for us to recommend taking profits on TPG Telecom.



Hub24

If there is one takeaway from our trade in Hub24 (HUB.ASX), it is that while there are potentially high rewards on offer for those investors willing to invest time and money uncovering hidden gems at the smaller end of the market (i.e. microcaps and smallcaps), there are usually risks attached. First and foremost is the challenge of managing liquidity risks, both in terms of getting in (i.e. buying) and out (i.e. selling) of a stock at the desired levels. Another challenge can be the stock's limited operating track record, particularly as a listed entity.

Having formed the view that the fundamentals underpinning Australia's financial services market make it an attractive investment destination, this provided to be the basis for our subsequent buy recommendations on a number of the market's participants, including Hub 24, Praemium (PPS.ASX), OneVue (OVH.ASX), and IOOF Holdings (IFL.ASX). However, unlike IOOF Holdings, but not unlike Praemium and OneVue, Hub24 is relatively illiquid, has a limited rack record as a listed entity, and was, at the time, not profitable.

Within this context, we viewed the meteoric rise of Hub24's share price from $0.80 per share to $3.83 per share within the space of 12 months as being too great an opportunity to ignore taking profits. While we believed that Hub24's recent operating performance would continue and that the company would transition to profitability in FY16, we were also cognisant of the fact that the timing and magnitude of the inflection point in earnings remained uncertain. Add to this the fact that IOOF Holdings' takeover offer of $2.75 per Hub24 share was at that stage indicative, non-binding and conditional, we took the opportunity to lock in some of profits.

While Hub24's share price has continued to soar to around $3.90 per share despite IOOF Holdings having withdrawn its offer for Hub24, this appears to be based on a combination of Hub24's continued operational momentum and speculation regarding Hub24's potential involvement in future M&A. While we believe that some of Hub24's recent share price performance can be attributed to the former, a lot of the recent uplift in the company's share price is likely due to M&A speculation, meaning that there is every chance the share price could fall if a bid fails to emerge over the near-term.

Trade Me

In what stands as the only blemish on Fat Prophets' sell calls in relation to the Australasian Equities portfolio in 2015, we reported an annualised loss of 1.1 percent on Trade Me's (TME.ASX) shares that we had held for just over two years. However, as is often the case, timing counts for a lot in investment markets. With Trade Me's share price having recovered from what we considered to be oversold levels at the time we published our sell-all note in FAT-AUS-744, the stock has recently jumped higher.

While we initially thought the All Blacks winning the Rugby World Cup may have been the catalyst for the recent rally in Trade Me, it looks as though the trading update provided by the CEO at the company's Annual General Meeting is to blame. This, of course, does not mean that the rationale for our sell-all recommendation was flawed, which was based on concerns that the New Zealand economy (and thus job ads) was slowing. As per Trade Me's recent trading update, management noted that FY16 was trading in line with the company's previous guidance, with similar revenue growth to FY15 expected to combine favourably with lower costs. Time will tell.

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