

Some small players less risky

## MINNOWS

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A key consideration for any investor looking at small cap stocks is the strength of a company's earnings prospects.

But with the annual meeting season under way, the outlook is not so bright for local stocks, with companies facing a number of risks such as the stronger Australian dollar, higher interest rates and rising input costs.

And selecting junior stocks with good earnings is often harder as these players tend to have fewer diversified revenue streams than their larger counterparts. But despite a number of risks, there are still some minnow players with solid earnings outlooks.

Cadence Asset Management managing director Karl Siegling says investors just have to be very selective in terms of choosing stocks.

"Generally speaking, small caps have gone really well for the past three years," he says. "What you are going to see is that you are really going to have to differentiate on particular business models and particular stories to make sure you have got the story right."

In terms of those stocks with quality earnings, Siegling likes software group Reckon, saying the company's annuity-style revenue is increasing. "In terms of stocks that give us high degrees of comfort about what their cash flows are going to be, that would be definitely one that I would pick," he says.

Reckon posted a 16.2 per cent rise in net profit for the half year ended June 30 to \$5.01 million.

Reckon is positive it can repeat the strong performance in the second half, which it hopes will set a foundation for further performance enhancements in 2008 and beyond.

Another standout from a strategic earnings point of view is Photon Group, Siegling says, as the marketing services group's offshore expansion strategy looks promising.

Photon has steadily increased its presence in the UK, US and South-East Asian markets over the past few years and has a strong pipeline of acquisitions in UK, US and Australia.

It expects offshore earnings before interest, tax, depreciation and amortisation to be about 20 per cent of total fiscal 2008 EBITDA, with that expected to be about \$70 million.

Foresight Securities analyst Todd Guyot says there hasn't been a lot in the way of positive earnings surprise at annual meetings at the minnow end of the sector and notes there's a fair degree of expectation already built into share valuations.

With average sector earnings per share growth at 24 per cent for 2008, he also says there's a lot of room for general disappointment.

But Guyot is still confident about the earnings prospects for drilling services and products company Imdex, with a fiscal 2008 earnings per share growth forecast of 40 per cent, online travel group Webjet, with a 2008 EPS growth forecast of 45 per cent, and recruitment group Talent2 (2008 EPS growth forecast of 35 per cent).

Investors Mutual portfolio manager Simon Conn notes that Sydney Attractions Group has a strong earnings outlook after a period of company-specific issues.

"The outlook for their earnings is very strong with the new [Sydney] Wildlife World attraction ramping up and obviously Village [Roadshow] are using this opportunity to try and take them over but their outlook's pretty good," he says.

Sydney Attractions is forecasting net profit of \$6.5 million for fiscal 2008, excluding costs to defend Village's takeover bid.

Meanwhile, Warrnambool Butter & Cheese Factory's ability to supply goods amid a rising milk price environment means its earnings outlook is strong, says Armytage Private chairman Lee Iafrate.

Another positive is above-average rainfall in the south-east corner of Australia, while Kirin's takeover of National Foods should also highlight company value.

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