

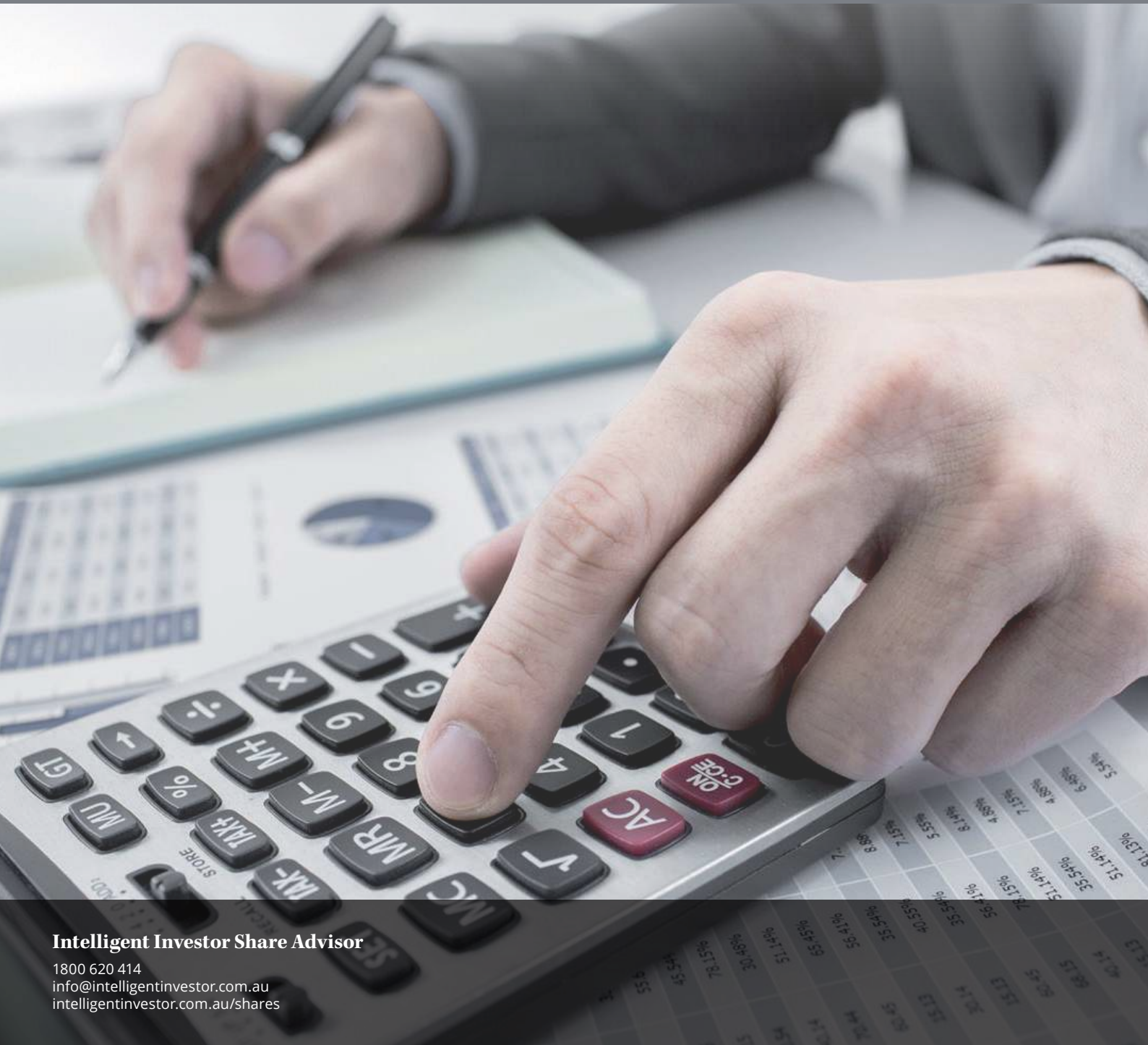


INTELLIGENT INVESTOR  
SHARE ADVISOR

# Top Stock Picks

## From Australia's best fund managers

■ EFY 2015 Special Report



**Intelligent Investor Share Advisor**

1800 620 414  
info@intelligentinvestor.com.au  
intelligentinvestor.com.au/shares

# Contents

## Stock Articles

---

COMPANY	PAGE
Antipodes Global Investment Partners (Nippon Electric Glass, Cisco, KB Financial Group)	4
Ausbil Investment Management (Surfstitch Group, Altium, GBST Holdings)	6
Cadence Capital (Gilead Sciences, Fortescue Metals)	8
Ganes Capital (Templeton Global Growth Fund, Lifehealthcare)	10
Lanyon (PMP, BSA Limited)	12
Leyland Private Asset Management (Challenger Limited, Smartgroup Corporation)	14
Maple-Brown Abbott (Atmos Energy Corp, Crown Castle International)	16
Perpetual Global Share Fund (BBVA, Lloyds Bank)	18
Peters MacGregor (Michael Hill International, Nicholas Financial)	20
Platinum Asset Management (The People's Insurance Company of China)	22
Wilson Asset Management (Blackmores Limited, Eclipx Group)	24
Appendix: <b>Applus Services</b>	26

*Note: The fund managers in this report and their funds own many of the stocks mentioned.*



# Cadence Capital

## Simon Bonouvrie & Chris Garrard

**Simon picks out a cheap US anti-viral pharmaceutical company from his buy list while Chris nominates one of Australia's biggest miners as a short sell.**

“As the world's leading anti-viral company Gilead holds strong market positions in some very lucrative markets.”

About 12 months ago, Cadence Capital began investing in non-ASX listed stocks. Our rationale wasn't solely due to the limited nature of local stocks, heavily weighted as they are to banks and resources, although that was part of it. We also thought the Australian dollar was overvalued and that the end of the mining boom meant more challenging economic circumstances. We moved away from stocks exposed to the local economy and toward countries emerging from recession.

### Profile

#### BACKGROUND

Chris joined Cadence Capital in 2007 as a Portfolio Manager and has over 10 years finance and financial services experience, first as a financial analyst at IBM and as Portfolio Manager for the Garrard Geared Australian Share Fund. Simon joined Cadence in 2013 as a Portfolio Manager, prior to which he was a Portfolio Manager at Platypus Asset Management. Simon started his career in banking and has over 15 years of financial services experience including 10 years in funds management.

#### PERFORMANCE

Since inception in October 2005 to 30 April 2015, Cadence Capital (ASX:CDM), a listed investment company, has returned an annualised gross performance of 18.52%, compared to an increase in the All Ordinaries Accum. Index of 6.8%. Over the last five years CDM has paid an annualised historical distribution yield of 6.9%.

#### MORE INFORMATION

Website: [cadencecapital.com.au](http://cadencecapital.com.au)  
Phone: 02 8298 2444

Excluding our picks from last year – **Macquarie Group** (ASX:MQG) and **Henderson Group** (ASX:HGG) – both of which have substantial offshore revenues, about 28% of our portfolio is now allocated to non-ASX listed companies, mostly in the United States. In fact, of the 40-plus stocks in our portfolio, 12 are listed in the US and I'm choosing one of them as my first pick.

### Gilead Sciences

**Gilead Sciences** (NASDAQ:GILD) is a US biotech specialising in antiviral drugs to treat patients suffering from HIV, hepatitis C, influenza and other conditions. In Australia 'biotech' has a poor reputation. Don't let it put you off; Gilead is more like a conventional pharmaceutical company than a speculative Australian biotech. In 2014 it generated about US\$25bn in revenue and currently has a market capitalisation of US\$165 billion. As the world's leading anti-viral company Gilead holds strong market positions in some very lucrative markets.

Take Harvoni and Sovaldi, new drugs developed by Gilead used for the treatment and cure of hepatitis C (Harvoni being the newer version of Sovaldi). In the company's latest quarterly report (for the period ending 31 March 2015), company product sales totaled US\$7.4 billion. That compares very favourably with the previous year's corresponding quarter sales of \$4.9 billion. Harvoni and Sovaldi explain much of that revenue growth.

Globally, up to 200 million people are living with chronic hepatitis C, including 4 million in the United States. Gilead owns the best-in-class drug in this market, launched in October last year with very promising results. Harvoni is a one-pill anti-viral combination taken daily for 8–12 weeks. With almost no side effects it has a cure rate of over 90%. Of the four million people in the US with hepatitis C only 260,000 have been treated with either Harvoni or Sovaldi, which shows the extent of the opportunity.

Through partnerships with health insurers and government agencies, Harvoni and Sovaldi have established a high market share in the United States. Although the headline treatment costs about \$80,000, the total cost of treatment is far cheaper than former maintenance therapies, which had

lower cure rates and left many patients eventually facing a liver transplant. The actual cost for the treatment is much less than the headline rate suggests as health insurers have negotiated better cost outcomes with Gilead.

Gilead also has the world's leading position in HIV treatment which generates a third of company revenues. Of US HIV patients, 81% use a Gilead drug. The company also develops treatments for diseases in the areas of oncology, cardiovascular and respiratory illnesses.

For investors, the real attraction is the valuation. Thanks to the revenue from its hepatitis C and HIV treatments, Gilead currently trades on a PER of 11 times forward earnings. Given the huge market opportunity for treatment of these two diseases, company revenue and profits are forecast to grow strongly over the next several years.

So why is it apparently cheap? First, Harvoni is a new drug and it appears the market hasn't fully factored in the extent of the global opportunity. Many investors are worried about what might be called 'peak sales' from its hepatitis C drugs. From a financial point of view, a product that cures patients after only eight weeks of treatment isn't as good as one that keeps the virus at bay for years through a daily maintenance pill.

Second, competing products already exist (one from **AbbVie** (NYSE:ABBV), for example) and more are on the way. Third, investors are concerned about the negative reaction from politicians and health insurers over the cost of treatment with Gilead's hepatitis C drugs, and the subsequent potential for downward pressure on pricing. Gilead's hepatitis C drugs currently make up more than 50% of company revenue so any effect on the outlook for these products will influence the stock valuation.

My view is that these concerns are overdone. Harvoni has already established a very strong foothold in this huge and growing market. This is a best-in-class anti-viral drug that lowers the cost of treatment to health insurers and agencies, which is why it has maintained a very high market share and is the leading choice for physicians.

The company also has a full and growing suite of treatments in influenza, HIV and other areas. The company has very strong free cash flow and is in a position to extend its foothold in oncology treatments through acquisitions. On 11 times forward earnings with solid earnings growth combined with a strong balance sheet, Gilead is an excellent opportunity. For Cadence Capital's second pick – a short no less – I'll hand over to fellow analyst Chris Garrard.

### **Fortescue Metals**

**Fortescue Metals** (ASX:FMG) is the third-largest producer of iron ore in Australia and a stock we're currently shorting, having first established a position in September last year at a price of \$3.84. There are two main reasons for our belief that Fortescue's share price will fall further.

Until 2005, the iron ore price traded below US\$20 a tonne, then peaked at around US\$190 in early 2011 before falling to about US\$60 now. In commodity cycles, this pattern tends to repeat. As the ore price has fallen we have seen a small drop in iron ore production by some mining companies but the price needs to fall further to cause a meaningful decrease in iron ore supply.

The second reason is that of the world's four biggest producers, Fortescue has the highest cash costs and the lowest grade ore. Without reducing costs, Fortescue would currently be making a pre-tax loss of around US\$14.5 per tonne of ore. The company recently claimed cost reductions would take it from a breakeven price of US\$76.50 in the first half of this financial year to a breakeven price of US\$45.50 in 2016. That would be an amazing achievement. However, it's only beneficial if other iron ore miners cannot reduce costs in the same way.

We believe the strong downtrend in iron ore prices will continue until we see significant mine closures, which we expect to occur at a price between US\$30 and US\$40 per tonne. We expect Fortescue to make a loss in the short to medium term and are comfortable with our current short position.

*Editor's note: Shorting is a practice best left to the professionals and is not recommended to Share Advisor members. For our reasons why, please see our recent special report [Jim Chanos Masterclass: The fundamental short seller](#).*

“*Of the world's four biggest producers, Fortescue has the highest cash costs and the lowest grade ore.*”