Top 3 stocks for 3 years

Special Report | December 2017

Contents

Part competition, part education and always lots of fun, here's the round-up from our fourth 'Top 3 for 3' contest and our selections for the fifth.

And the winner is...

What if you had to choose only three stocks to hold for three years – with no averaging down, no profit taking and no switching?

This is the question posed to your analyst team every three years in our *Top 3 for 3* competition.

The fourth iteration of the contest began three years ago, so it's time to unveil the winner and extract some lessons from the results. We'll also kick off the fifth contest, with your current team of analysts revealing what they hope will be the winning picks over the next three years.

The contest was originally conceived as an antidote to all the new year stock pick articles in the media at this time of year. We're uncomfortable picking just one stock and we're very uncomfortable dealing in single years – but we didn't want to miss out on all the festive fun – so we decided to stretch it to three stocks for three years.

Of course three years is still too short a time period – and three stocks is too small a portfolio – to illustrate any stock-picking prowess. We wouldn't ever suggest having such a concentrated portfolio in real life. Indeed our highest maximum recommended portfolio weightings are 10% (for **CBA**, **Westpac**, **NAB**) and most are closer to 5% or less.

Table 1: Previous Contests

YEAR	DESCRIPTION OF ANALYST PICKS	RESULTS
2005	First Contest	First Contest Results
2008	Second Contest	Second Contest Results
2011	Third Contest	Third Contest Results
2014	Fourth Contest	

In the real world, you also have the opportunity to follow an investment case and move on to greener pastures if things aren't going to plan. If one (or more) of your stocks blows up early in this contest, it can be a painful couple of years watching it play out.

As you'll see, that concern doesn't seem to stop your analysts from chancing their arm with some risky stocks – but it's worth stressing again that we wouldn't be putting 33% of our real-life portfolios into this kind (or in fact any kind) of stock.

Despite these limitations, though, the contest does provide an opportunity for your analysts to express their investing characters with some stocks that we may not be able to cover in the publications – and to explain the thinking behind these selections. It also enables us to add colour around some of our more prominent recommendations – it's notable, for example, that Trade Me has been chosen by four out of six of the analyst team.

Previous contests

As previous competitions have showed, the level of the market at the time the picks are made – and its performance throughout the contest – has a major impact on the selections and their performance.

In the **first contest**, starting in 2005, your analysts had to pick stocks in an elevated market, then watch the market continue to soar before almost halving in the final year. In the end, the average of our picks was down 4% compared to the All Ords' fall of 8%, and the winning selections – **ARB**, **Cochlear** and **Westfield** – showed how quality can triumph in tough conditions.

In the **second contest**, between 2008 and 2011, as the market recovered from the depths of the global financial crisis, we managed an average total return of 69%, compared to the All Ords' 39%, with the best-performing stock being the beaten-down debt security **BBI EPS**.

In the **third contest**, from 2011 to 2014, the All Ords made steady progress with a total return of 43%, while we managed 58%, with the winner, Tony Scenna, doubling his money on **Flight Centre** and getting a five-bagger out of **Sirtex Medical** (good thing the contest ran for three years not six).

During the **latest contest**, from 2014 to 2017, the market went sideways for a year and a half before embarking on the recent bull run, which has put it 25% ahead for the three years. Against that, we've managed a respectable return of 55%.

Table 2: Stock Performance

HANSEN (HSN)	136%
NONI B (NBL) *	111%
NRW HOLDINGS (NWH)	109%
RESMED (RMD)	89%
CLEANAWAY (CWY)	82%
FSA (FSA)	76%
II AVG	**55%**
COMPUTERSHARE (CPU) *	44%
PERPETUAL (PPT)	26%
ALL ORDS ACCUM	**25%**
TRADE ME (TME)	23%
AINSWORTH GAME TECH (AGI)	–16%
TECHNICHE (TCN) **	–38%

*** Performance is only for two years**
**** Performance is only for one year**

As you can see, though, there was a wide range of performances for individual stocks. **Hansen** led the way, rising 136% including dividends (and franking credits), followed by **Noni B** (111%). The latter is particularly impressive as it was picked by James Greenhalgh, who only joined the competition at the start of the second year.

On the downside, cigar butt **Techniche** fell 38%, although this performance was over the even shorter period of one year, as Alex Hughes only joined the competition in its latter stages. For those stocks that were held for the full three years, **Ainsworth Game Technology** was the biggest dud, falling 16%.

And the winner is...

After admitting not having a great performance in the previous competition, Gaurav Sodhi just pipped Graham Witcomb to take out the latest version. Gaurav's three stocks returned 81% over the past three years compared to 79% for Graham's. Both had Hansen, but Gaurav backed it up with **Cleanaway**, which returned 83%, while Graham's number two was **FSA**, with a return of 76%. Congratulations Gaurav.

Before we get into their picks for the next three years, you can see the analyst rankings for the 2014–2017 *Top 3 for 3* competition below. Note that the returns are gross returns and so don't take into account the annualised returns for those such as James Greenhalgh who joined after year one or Alex Hughes, who only joined the competition after year two. (In fact, on an annualised basis James Greenhalgh would actually be the winner – but don't tell Gaurav!)

Table 3: The winner's mini-portfolio
Sodhi's Stockpile

STOCK (ASX CODE)	PRICE AT 7 NOV 2014	PRICE AT 7 NOV 2017	2015 DIVS	2016 DIVS	2017 DIVS	TOTAL DIVS	TOTAL VALUE	TOTAL RETURN
CLEANAWAY (CWY)	$0.91	$1.585	$0.0214	$0.0243	$0.0300	$0.0757	$1.6607	82.5%
TRADE ME (TME)	$3.60	$3.88	$0.1764	$0.1841	$0.1980	$0.5584	$4.4384	23.3%
HANSEN (HSN)	$1.56	$3.41	$0.0813	$0.0978	$0.09	$0.2649	$3.6749	135.6%
AVERAGE								**80.5%**

Table 4: Analyst Rankings

ANALYST	TOTAL RETURN
GAURAV SODHI	81%
GRAHAM WITCOMB	79%
JON MILLS	59%
JAMES GREENHALGH*	54%
JAMES CARLISLE	32%
ALEX HUGHES**	-38%

*** Only in the competition for two years**
**** Only in the competition for one year and only picked one stock**

James Carlisle

Head of Research

Carlisle's Crackers – New Picks

PRICES AS AT 23 NOV 2017	
TRADE ME (TME)	$4.23
TPG (TPM)	$5.71
ICAR ASIA (ICQ)	$0.18

It's crucial to remember that in the sharemarket more risk doesn't necessarily equal more return. It's a lesson that's been demonstrated by this contest over the years, where the tortoise has often beaten the hare. My selections this time around have emphasised the point again.

It's crucial to remember that in the sharemarket more risk doesn't necessarily equal more return.

After picking a couple of quality stocks three years ago, in **ResMed** and Trade Me, it seemed like a good idea to pep things up with something a little more racy and I'd been drawn to Ainsworth Game Technology following Jon Mills's **analysis** a few weeks before the contest began.

I still think it was a good investment – but not all good investments work out and that's been the case here. Although the international operations have grown as we'd hoped, the company has been crunched by **Aristocrat** at home. Still a 16% loss is hardly a disaster, and steady performances from Trade Me and ResMed have more than made up for it.

ResMed has done particularly well, with new products outperforming expectations and a tailwind from a lower Australian dollar.

After that experience, you'd think I might have learnt my lesson. But it'd be a dull contest if we only picked plodders, so I'm going to follow the same approach again, with two of those and one to pep things up.

Pick #1: Trade Me

For the first of my plodders I'll pick Trade Me again, although 'plodder' perhaps doesn't do it justice. In the contest just finished it fell 25% before rising to a 60% gain and then settling back to a return of just 23%.

Over the past three years the company has invested heavily in its technology and that process continues. While that's held back profit growth, it has increased the barriers to entry and should support future revenue growth.

Concerns have crept in lately over the threat to its General Items business from **Amazon** and Facebook, but the division is now down to 30% of revenue and less of the valuation, which is dominated by the classifieds businesses for Motors, Jobs and Property.

The recent fall puts the stock on a forward price-earnings ratio of 19, which is attractive given the long-term growth prospects, particularly as most of the earnings translate into free cash flow. That's why we have a Buy on the stock, it's in our **Equity Growth** and **Equity Income** portfolios and **Small Companies Fund**, and it's my own second-largest holding.

Pick #2: TPG Telecom

For the second of my 'plodders', I'll go for **TPG Telecom** – although again it hardly fits the bill, with its share price rising five times over the past five years before tumbling 60%.

The telecoms sector is certainly on the nose, with the NBN levelling the playing field and forcing providers to fight it out on price. TPG, though, has proven adept at this in the past. It also has some protection in the form of its own fibre network, and gets almost 40% of its profit from its corporate business, which we expect to be less disrupted by the NBN than the consumer business.

The main reason for recent share price falls, though, is the company's move into mobile. Investors fear that setting

Carlisle's Crackers

STOCK (ASX CODE)	PRICE AT 7 NOV 2014	PRICE AT 7 NOV 2017	2015 DIVS	2016 DIVS	2017 DIVS	TOTAL DIVS	TOTAL VALUE	TOTAL RETURN
TRADE ME (TME)	$3.60	$3.88	$0.1764	$0.1841	$0.1980	$0.5584	$4.4384	23.3%
RESMED (RMD)	$6.03	$10.89	$0.1543	$0.1699	$0.1777	$0.5019	$11.3919	88.9%
AINSWORTH GAME TECH (AGI)	$3.10	$2.32	$0.1429	$0.1429		$0.2857	$2.6057	–15.9%
AVERAGE								**32.1%**

up the mobile business will cost more than the company expects, and that it will earn less than anticipated when it's mobile business is up and running. However, we think the company will have significant advantages in focusing on metropolitan areas and being unburdened by legacy networks.

Chief executive David Teoh has proved himself to be a master strategist and allocator of capital in the past. He owns 35% of the stock and we're very happy to follow along.

Pick #3: iCar Asia

If any stock can make those two look like plodders, it's probably my final selection, **iCar Asia**. The sharemarket can be brutal if you miss your targets, and the more so if you're loss-making and need to raise capital, as iCar has done pretty much every year since listing. However, its websites have stretched their lead as the top 'vertical' auto classifieds sites in three large Asian markets – Malaysia, Thailand and Indonesia.

While they still face significant competition from 'horizontals' (ie sites selling a wide range of goods as well as cars), they have advantages over these sites because they're better optimised for selling cars, particularly new ones.

The challenge for iCar (and its competitors) is to encourage people to pay more for its services. I think they will eventually, although the timing remains uncertain. If it happens in the next three years and the company can keep a lid on costs – two very big ifs – then the share price could see big gains. If not ... then next time I might pick three steadier stocks – but probably not.

Disclosure: James Carlisle owns shares in Trade Me and iCar Asia

Gaurav Sodhi

Deputy Head of Research

Sodhi's Stockpile – New Picks

PRICES AS AT 23 NOV 2017	
REDFLEX (RDF)	$0.505
MMA OFFSHORE (MRM)	$0.235
AMAYSIM (AYS)	$1.95

I'm a little sheepish at winning the latest *Top 3 for 3* competition because I'm **on record** as saying that I would have sold Cleanaway – my best-performing stock – a long way back. We tend to complain about the restrictive rules of this game but they can be advantageous too. They also show that inertia can often be a good thing.

Cleanaway itself has been surprising. Performance has improved but the gains have come mostly from multiple expansion – the market's willingness to pay more for the stock. I'm not sure the investment case has really been realised, but I'll take the gains.

My other picks, Trade Me and Hansen, probably didn't do as well as I expected. Trade Me now looks to be on the nose and it looks like a decent pick for the next three years. Hansen is an excellent business that also seems reasonably priced today and I would be happy to continue holding both.

I generally prefer owning bigger safer stocks for this competition but valuations across the market are high and opportunities few. We've been turning over stones in the small cap space of late and a few of our finds have found their way into the new round.

Sodhi's Stockpile

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HANSEN (HSN)	$1.56	$3.41	$0.0813	$0.0978	$0.09	$0.2649	$3.6749	135.6%
AVERAGE								**80.5%**

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Pick #1: Redflex

One such find is **Redflex**.

There are so many reasons to stay away from Redflex: revenue from its largest market is shrinking; it's due to pay heavy fines for past misdeeds; and it's currently raising capital at low prices. Here is a business convicted by the courts and maligned by investors.

The share price has sunk 85% over the past decade and few want to look at it let alone own it. Yet look closer and there are things to like.

Much of its revenue is sticky and backed by assets that are hard to replicate. The replacement cost of Redflex's traffic enforcement systems exceeds the current market capitalisation by some margin and, with its legal troubles over, it can now focus on an underlying business that can be lucrative and sticky. Few appreciate this business yet but that will likely change as focus returns to the core business.

Pick #2: MMA Offshore

This is a contentious inclusion. As Cleanaway showed, being forced to own a stock for three years also forces you to abandon your psychological baggage and that could be a good thing.

Enter **MMA Offshore**, a vessel leasing business that is mired in the worst cyclical downturn in oil prices in living memory. Worse still, it entered the downturn with too much debt and now faces extinction.

MMA has reacted furiously to its plight: it has aggressively sold assets, cut costs and is currently raising capital to plug away at its enormous debt pile. The structure of that debt is interesting: MMA has a four-year window to repay the debt and is left with an asset base that is new and requires only minor capital expenditure. An improvement in industry conditions might deliver a windfall – but the status quo would sink this business.

Yet the business is so cheap that it merely needs to survive for investors to do very well from here. I'll repeat, though, that going bust is still a high probability.

It sits in this competition because within these rules I can't be scared into selling it or be impacted by swings in sentiment. This is a hairy situation but the upside is too interesting to ignore.

Pick #3: amaysim

There has always been scepticism among investors about **amaysim** and, despite a series of good results, that scepticism remains. Most investors think of amaysim as just a reseller that's hostage to host network Optus.

Yet among the hundreds of mobile resellers that have come and gone, amaysim is the only one to reach scale. It has built an IT stack that's fully automated and enables the company to be exceptionally low cost in terms of acquiring and servicing customers.

amaysim has now reached a size that helps generate economies of scale and makes it hard to compete with in its chosen markets. Moreover, its million plus customer base is a potential prize for rival telcos. Its move into electricity and broadband was one we thought long and hard about before concluding that it makes sense to introduce new products on a single platform.

The market is quick to dismiss the reseller model but I think it exhibits better economics than peers. It isn't cheap on PE terms but it is on a cash flow basis. amaysim is a risky inclusion; it's a competitive market and being forced to hold for three years may not be wise. But it isn't the wisest who wins the *Top 3 for 3* competition. Heck, I won last time!

Disclosure: Gaurav Sodhi owns shares in Redflex, MMA Offshore and amaysim.

James Greenhalgh
Senior Analyst

Greenhalgh's Gems – New Picks

PRICES AS AT 23 NOV 2017	
TRADE ME (TME)	$4.23
NEWS CORP (NWS)	$21.09
WESFARMERS (WES)	$42.890

As a man of my word, I hereby repudiate my results for the fourth series of the Top 3 for 3 competition (even though I also feel honour-bound to note that, on an annualised return basis, I won!).

I rejoined *Intelligent Investor* a year into the competition, **explaining then** that I would never actually select just three stocks for only two years.

Even so, each of **Computershare**, Trade Me and Noni B looked underpriced two years ago. While Computershare's business hasn't improved significantly, market sentiment has. Trade Me's business has plodded along nicely but, with market concerns about competition, the stock lost all its 2016 gains in 2017.

Womenswear retailer Noni B was an unusual pick for me. I don't usually select small companies for this competition because of their volatility and the enormous portfolio weighting of individual stocks. In this case, though, Noni B performed well partly because of an acquisition, but I personally sold out of the stock earlier this year. I stress that I'm usually much more 'slow and steady wins the race' than the Noni B selection would suggest.

For me this fifth series is more about risk management than high returns. With the high-quality businesses I prefer looking expensive, finding value is the hardest it's been in this competition.

While we don't try to time markets, the relative ease or difficulty in which we can find ideas is an indication of how cheap or expensive the market may be. With only 10 stocks on our **Buy list**, my three picks are aimed at minimising downside so this could be a low-returning series.

Pick #1: Trade Me

Like James Carlisle, I'm giving **Trade Me** a re-run this series. It's still primarily a high-quality New Zealand online classifieds business that should grow earnings over time.

Its crown jewel is the Classifieds division, where there's still plenty of potential to sell premium advertising and take advantage of its three classified businesses' pricing power. While investors are worried that Facebook and Amazon will take market share from its Marketplace division, this should be manageable over time.

That said, Trade Me is probably the pick I'm most worried about. There's significant downside in a number of scenarios and I'm wary of being forced to hold the stock for the full three years (as this competition requires). But the fact Trade Me is a wonderful business at a reasonable price gets it across the line.

Pick #2: News Corporation

News Corp's digital real estate business has been going from strength to strength, even as its legacy media assets are coming under attack. It owns 62% of REA Group, one of Australia's best businesses and the US-based Move looks to have been a sensible buy. Over time the performance of these businesses should drive News Corp's own value.

News Corp also has what you might call 'option value'. The company has been pretty savvy when it comes to recent acquisitions and it still has US$1.9bn of cash available. With former stablemate 21 st Century Fox looking to sell various assets, the Murdoch family may also restructure the company to release value at some point.

However, it's worth noting that the stock is no longer cheap, and that fact is reflected in our recent downgrade to Hold. Despite the structural weaknesses in some divisions, though, News Corp's portfolio is likely to be stronger in three years' time.

Greenhalgh's Gems

STOCK (ASX CODE)	PRICE AT 7 NOV 2014	PRICE AT 7 NOV 2017	2015 DIVS	2016 DIVS	2017 DIVS	TOTAL DIVS	TOTAL VALUE	TOTAL RETURN
COMPUTERSHARE (CPU)	$11.36	$15.62		$0.41	$0.38	$0.7950	$16.4150	44.5%
TRADE ME (TME)	$3.98	$3.88		$0.1841	$0.1980	$0.3821	$4.2621	7.1%
NONI B (NBL)	$0.950	$1.95			$0.0571	$0.0571	$2.0071	111.3%
AVERAGE								**54.3%**

Pick #3: Wesfarmers

Perhaps I should call my picks the anti-Amazon battlers because, like Trade Me, **Wesfarmers** is also at risk from Amazon, particularly its retailers Kmart, Target and Officeworks. Coles's weakening profitability in comparison to Woolworths' recovery and Bunnings woes in the UK are also weighing on the stock.

Rob Scott's recent commencement as Wesfarmers' new managing director should also bring a fresh perspective to the company's portfolio. He's likely to make a fairly significant acquisition over the next three years.

With total sales continuing to march upward, Wesfarmers should be a bigger business in three years' time despite current uncertainty. It doesn't look particularly expensive at present and, while we have a Hold on the stock, it's a diversified, low-risk addition to a three-stock portfolio.

Disclosure: James Greenhalgh owns shares in Computershare and Trade Me.

Graham Witcomb

Senior Analyst

Witcomb's Winners – New Picks

PRICES AS AT 23 NOV 2017	
FSA (FSA)	$1.48
VIRTUS HEALTH (VRT)	$5.23
TRADE ME (TME)	$4.23

As poet John Greenleaf Whittier put it, 'For all sad words of tongue and pen, the saddest are these, "It might have been".' Still, despite now owing Gaurav a coffee, I was happy with the performance of my top three stocks during the competition (and over-performance in one case).

Hansen was the standout, beating my initial expectations by a lot, and it's a reminder that good things tend to happen to good companies. Its expansion has been well executed and the company continues to build its European presence, while benefiting from locked-in customers, strong free cash flow and a deregulation of utility providers.

Perpetual also performed admirably, though fund flows have been poor in recent years so the company's lagging Investments division offset the strong growth from the other major divisions.

My third pick for the previous edition, FSA, is a curious case. I added it last time despite it not being on our **Buy list**, but figured the potential growth was worth paying a slight premium for. That strategy seems to have worked, with the stock returning 76% despite the initially high valuation.

Pick #1: FSA

Despite the sharp rise in its share price over the past three years, it has been below the growth rate of the company's intrinsic value. So trading on an undemanding forward PER of 12, FSA is in my view an even better bargain now than three years ago.

FSA is Australia's largest supplier of bankruptcy services and subprime mortgages. The company offers loans to clients that don't meet the big banks' lending standards – 'non-conforming' loans in the jargon – so that they can consolidate their debts and pay off credit cards at a lower interest rate.

It has a dominant market share, operating leverage, juicy profit margins and the opportunity to reinvest capital at high rates of return.

Witcomb's Winners

STOCK (ASX CODE)	PRICE AT 7 NOV 2014	PRICE AT 7 NOV 2017	2015 DIVS	2016 DIVS	2017 DIVS	TOTAL DIVS	TOTAL VALUE	TOTAL RETURN
HANSEN (HSN)	$1.56	$3.41	$0.0813	$0.0978	$0.09	$0.2649	$3.6749	135.6%
PERPETUAL (PPT)	$48.15	$49.88	$3.4286	$3.6429	$3.7857	$10.8571	$60.7371	26.1%
FSA (FSA)	$1.025	$1.51	$0.0929	$0.1000	$0.1000	$0.2929	$1.8029	75.9%
AVERAGE								**79.2%**

The company is also well positioned to benefit from any slowdown in the Australian economy – which provides some diversification benefits – but, in the meantime, it should be able to grow earnings from its lending business.

Pick #2: Virtus

Virtus also deserves a place on the list. The IVF provider has many things going for it, including a dominant market share, high returns on capital, excellent free cash flow generation, and a long-term tailwind of rising infertility in the Australian population.

The trouble is that the high price and discretionary nature of IVF make sales highly volatile from one quarter to the next, so Mr Market seems to perpetually hate it. Right now, we seem to be in a bit of a funk, with the sluggish Australian economy and pressures on discretionary income from slow wages growth affecting cycle growth and, hence, all the full-service IVF providers including listed competitor **Monash IVF** and unlisted Genea.

By contrast, low-cost competitor **Primary Health Care** continues to gain market share and is helping to spook investors in the full-service providers. But in IVF you get what you pay for. Australia's continued strong population growth, women continuing to postpone childbirth to concentrate on their careers and rising incidences of obesity and other diseases (which reduce the chances of getting pregnant the old-fashioned way) mean Virtus is well placed over the longer term.

Hopefully three years is long enough to even out some of the bumpiness in profitability and let the company's underlying qualities shine through.

Pick #3: Trade Me

Finally, I'll add **Trade Me**.

Given the small size of the New Zealand market and rising competition from Amazon and Facebook on different fronts, it has its share of risks but these are more likely to affect its smaller, less profitable Marketplace division.

By contrast, its three classified businesses – jobs, cars and real estate – are high-quality, cash-generative classifieds businesses, all with dominant market shares. Benefitting from network effects, they are less vulnerable to competition, and are also behind their Australian counterparts such as Seek, Carsales and REA Group in using their dominant market position and pricing power to raise prices.

Add in a modest valuation and strong growth potential from cost-cutting and investment in its website and products and it's no surprise I'm not the only one with Trade Me as one of my picks for the new competition.

I'm also happy to add a little international diversification to this highly undiversified three stock portfolio in case the Australian economy hits a snag in the next few years (which, incidentally, would undoubtedly clobber Virtus).

Disclosure: Graham Witcomb owns shares in Hansen, Perpetual, FSA, Virtus and Trade Me.

Alex Hughes
Senior Analyst

Hughesy's Hits – New Picks

PRICES AS AT 23 NOV 2017	
ACADEMIES AUST (AKG)	$0.325
THORN GROUP (TGA)	$0.600
TRADE ME (TME)	$4.23

Entering the competition only in its final year, **I was asked to pick a single stock** and went with Techniche, the software cigar butt.

I wish I hadn't now, because I got smoke in my eyes instead of a good puff. Techniche's business performance was lacklustre and things were made worse when it turned down an attractive offer for a subsidiary. A sample size of one is always going to be inappropriately small, but it does highlight how you shouldn't put all your eggs in one basket.

So even though having one third of my portfolio in each of three stocks is still far too high a weighting, I'm excited about having three picks and a full three years this time. To that end, we've found a number of interesting opportunities for our **InvestSMART Australian Small Companies Fund**, and I contemplated 'swinging for the fences' with our best three.

But the fund can hold 25 positions whereas we can only hold three under the rules of this competition. So I've decided to play it safer with one high quality larger company alongside two cheap small caps.

Pick #1: Academies Australasia

The first of the small caps is **Academies Australasia**, Australia's oldest listed education business.

Hundreds of its competitors entered administration during the recent vocational education crisis, including listed operators Vocation Limited, Australian Careers Network and Intueri Group. This leaves immense opportunity for survivors like Academies Australasia.

The company mostly educates international students and they continue to come to our shores in droves, while insiders have shown their conviction by buying its shares heavily.

Academies Australasia made a poor acquisition a few years back, but those issues have been addressed and management has learned from the experience.

The company now oozes cash once again, with a free cash flow yield in the high teens, and most of that will be paid to shareholders in the coming years. Even after having nearly tripled since a recent rights issue, the company still appears good value.

Pick #2: Thorn Group

Everything is going wrong for **Thorn Group** at the moment: an ASIC investigation, a class action, a CEO departure, an earnings downgrade, a goodwill impairment and a covenant breach. It's enough to make most investors run for the hills.

But with its share price less than half net tangible assets, very little needs to go right for Thorn to be an exceptional investment.

My main concern is a big increase in bad debts brought about by an economic contraction or a slip in underwriting standards. Bankruptcy and a total wipeout for shareholders is possible given Thorn's high debt load.

But if things pan out slightly better, then Thorn could easily 'multibag'.

With a sick feeling in the pit of my stomach (which often precedes great investments) I'm choosing Thorn as my second pick.

Pick #3: Trade Me

With a risky holding like Thorn Group my mini portfolio is screaming for balance, which is why like many of my colleagues I've opted for the lower risk **Trade Me** for pick number three.

It's hard to buy anything online in New Zealand without using Trade Me. And it's even more difficult to find fantastic businesses trading cheaply like Trade Me is.

The threat of Facebook is front of mind for investors today but I expect that to wane with time. By contrast, its classified businesses are much more defensible.

I'm particularly attracted to Trade Me's defensive qualities and how they round out my mini portfolio, adding some geographic and business diversity to my other two picks.

Disclosure: Alex Hughes directly owns shares in Techniche, Academies Australasia and Thorn Group and also indirectly in Academies Australasia and Thorn Group via units in the InvestSMART Australian Small Companies Fund.

Hughesy's Hits

STOCK (ASX CODE)	PRICE AT 8 DEC 2016	PRICE AT 7 NOV 2017	2015 DIVS	2016 DIVS	2017 DIVS	TOTAL DIVS	TOTAL VALUE	TOTAL RETURN
TECHNICHE (TCN)	$0.076	$0.042			$0.01	$0.0050	$0.0470	–38.2%
AVERAGE								–38.2%

Jon Mills

Senior Analyst

Millsy's Monsters – New Picks

PRICES AS AT 23 NOV 2017	
REDFLEX (RDF)	$0.505
ACADEMIES AUST (AKG)	$0.33
TEMPO AUSTRALIA (TPP)	$0.20

To say the performance of my previous three picks Cleanaway, Ainsworth Game Technology and **NRW Holdings** was 'interesting' would be an understatement.

To recap, I chose these three cyclicals believing they were near the bottom of their respective cycles and hence would benefit from cyclical recoveries.

James Carlisle and Gaurav have covered off Ainsworth Game Technology and Cleanaway.

As for NRW Holdings, after nearly being sent bankrupt by some questionable actions on the part of Samsung over work at Roy Hill, it somehow managed to survive and has 32-bagged since hitting a low of 4.5c (which was a mere 93% fall from the price at which it entered this *Top 3 for 3* competition).

This shows that good – or bad – luck can often be the dominant reason for the performance of an individual stock, particularly when it comes to such low-quality businesses as mining services stocks.

Overall, after losing a cool 46% one year into the competition, finishing up with a gain of 59% at the end of the competition is a decent enough performance. Unfortunately, I did gain my first grey hairs in the process but as Gaurav shrewdly notes, grey hair is still hair.

Pick #1: Redflex

As Gaurav has also explained, there are many reasons not to own **Redflex**. But with 2017 underlying earnings before interest, tax, depreciation and amortisation of $17m, it's selling on an enterprise value to EBITDA multiple of four. This is low for a business whose underlying earnings are recurring in nature.

Moreover, having finally settled its US-based legal problems, the board and new chief executive can finally concentrate on growing the business, particularly outside the United States, and releasing new products such as Halo, its latest camera system, and Alcyon, a cloud-based back office management system. A recent restructure should also lead to material cost cuts.

And while it shouldn't be your only reason to hold a stock, there is also a chance that it could be taken over by private-equity owned competitor American Traffic Solutions. Merging the two companies would create a more diversified combined business along with material cost savings from removing duplicated functions.

Pick #2: Academies Australasia

The shenanigans and dare I say, fraud, in areas of the vocational training market in Australian in recent years are well known.

Yet with the dodgier operators now out of the business and events in the United States and United Kingdom meaning Australia's higher education system is even more attractive to foreign students, **Academies Australasia** is well placed to benefit.

High insider ownership, a recent capital raising and the disposal of its holding in competitor Redhill Education also mean shareholders should start to see more cash returned to them.

Millsy's Monsters

STOCK (ASX CODE)	PRICE AT 7 NOV 2014	PRICE AT 7 NOV 2017	2015 DIVS	2016 DIVS	2017 DIVS	TOTAL DIVS	TOTAL VALUE	TOTAL RETURN
AINSWORTH GAME TECH (AGI)	$3.10	$2.32	$0.1429	$0.1429		$0.2857	$2.6057	–15.9%
NRW HOLDINGS (NWH)	$0.68	$1.42				$0.0000	$1.4200	108.8%
CLEANAWAY (CWY)	$0.91	$1.585	$0.0214	$0.0243	$0.0300	$0.0757	$1.6607	82.5%
AVERAGE								58.5%

Pick #3: Tempo Australia

With my first two picks being small caps, I considered following Alex's lead and adding a 'plodder' to reduce the risk of looking like a fool in three years' time.

But part of the fun of this competition is trying to win it and with this in mind I've thrown caution to the wind and chosen **Tempo Australia** as my final pick.

Previously a Western Australian engineering services company focussed on energy and resources, this mini Monadelphous has recently expanded onto the east coast and into the electrical and communications services markets.

Guido Belgiorno-Nettis, formerly of engineering and construction company Transfield Services, took a cornerstone 16% stake at $0.25 in late calendar 2016, while the chief executive owns a further 18%.

Tempo concentrates on winning contracts that are too small for its largest competitors to service profitably, and is prepared to wait for the right contracts.

As such, revenue is likely to be lumpy, but with $15m in net cash and a $900m pipeline, the company remains well placed to scale up quickly and benefit from the east coast construction and infrastructure boom as well as from the cyclical upturn in resources and energy. Additional M&A activity is also a possibility.

So with three small caps, my performance in three years' time could be very satisfactory –or things could go horribly wrong and leave me with many more grey hairs. Time will tell.

Disclosure: Jon Mills directly owns shares in Ainsworth Game Technology, NRW Holdings, Redflex, Academies Australasia and Tempo Australia and also indirectly owns shares in Redflex and Academies Australasia via units in the InvestSMART Australia Small Companies Fund.

Here we summarise the analysts' picks and note the popular favourites.

The popular favourites

While each of our recommendations here at *Intelligent Investor* are associated with an individual analyst, in reality picking stocks is a group exercise.

Before they are added to our **Buy list**, our Buy recommendations first go through a rigorous 'Dragon's Den' process, where analysts present their ideas and subject them to scrutiny from the group.

So it's no surprise that there are a number of duplicate picks across this fifth version of the *Top 3 for 3* competition.

Trade Me is by far the most popular pick, followed by micro caps Redflex and Academies Australasia.

The two most popular stocks in the previous competition, Hansen and Cleanaway, were the top performing and fifth-best performing stocks respectively after three years. However, **QBE**, the most popular pick in the second competition, ended up being the fourth-worst performer.

Table 5: Popular Favourites Stock

(ASX CODE)	PICK TOTALS	ANALYST
TRADE ME (TME)	4	JC, JG, GW, AH
ACADEMIES AUST (AKG)	2	AH, JM
REDFLEX (RDF)	2	GS, JM
AMAYSIM (AYS)	1	GS
FSA (FSA)	1	GW
ICAR ASIA (ICQ)	1	JC
MMA OFFSHORE (MRM)	1	GS
NEWS CORP (NWS)	1	JG
TEMPO AUSTRALIA (TPP)	1	JM
THORN GROUP (TGA)	1	AH
TPG (TPM)	1	JC
VIRTUS HEALTH (VRT)	1	GW
WESFARMERS (WES)	1	JG

Here we reveal the results of those participants to have moved on since the contest began.

To absent friends

Nathan Bell – Bellseye

STOCK (ASX CODE)	PRICE AT 7 NOV 2014	PRICE AT 7 NOV 2017	2015 DIVS	2016 DIVS	2017 DIVS	TOTAL DIVS	TOTAL VALUE	TOTAL RETURN
RESMED (RMD)	$6.03	$10.89	$0.1543	$0.1699	$0.1777	$0.5019	$11.3919	88.9%
CLEANAWAY (CWY)	$0.91	$1.585	$0.0214	$0.0243	$0.0300	$0.0757	$1.6607	82.5%
VIRTUS HEALTH (VRT)	$7.670	$5.37	$0.39	$0.4143	$0.3571	$1.1571	$6.5271	–14.9%
AVERAGE								**52.2%**

Andrew Legget – Legget's Legends

STOCK (ASX CODE)	PRICE AT 15 DEC 2015	PRICE AT 7 NOV 2017	2015 DIVS	2016 DIVS	2017 DIVS	TOTAL DIVS	TOTAL VALUE	TOTAL RETURN
MYER (MYR)	$1.13	$0.745		$0.07	$0.07	$0.1429	$0.8879	–21.4%
WOOLWORTHS (WOW)	$22.49	$26.11		$1.1000	$1.2000	$2.3000	$28.4100	26.3%
BHP (BHP)	$16.270	$28.75		$0.5699	$1.5161	$2.0860	$30.8360	89.5%
AVERAGE								**31.5%**

Note: AL joined after 1 year

Greg Hoffman – Hoffman's Heroes

STOCK (ASX CODE)	PRICE AT 7 NOV 2014	PRICE AT 7 NOV 2017	2015 DIVS	2016 DIVS	2017 DIVS	TOTAL DIVS	TOTAL VALUE	TOTAL RETURN
NRW HOLDINGS (NWH)	$0.68	$1.42				$0.0000	$1.4200	108.8%
FLEETWOOD (FWD)	$1.66	$2.76			$0.0714	$0.0714	$2.8314	70.6%
MACMAHON (MAH)	$0.092	$0.24				$0.0000	$0.2400	160.9%
AVERAGE								**113.4%**

Steve Johnson – Steve's Stars

STOCK (ASX CODE)	PRICE AT 7 NOV 2014	PRICE AT 7 NOV 2017	2015 DIVS	2016 DIVS	2017 DIVS	TOTAL DIVS	TOTAL VALUE	TOTAL RETURN
RNY (RNY)	$0.285	$0.016				$0.0000	$0.0160	–94.4%
HANSEN (HSN)	$1.56	$3.41	$0.0813	$0.0978	$0.09	$0.2649	$3.6749	135.6%
SERVICE STREAM (SSM)	$0.18	$1.43	$0.0214	$0.0857	$0.0643	$0.1714	$1.6014	789.7%
AVERAGE								**277.0%**

So that's a wrap for the latest version of what is always a fun competition. We'll update members on a yearly basis and in three years' time with the final result of the competition along with the next version. May the best picks win!

Staff members may own securities mentioned in this report.