State of play

A behind-the-scenes look at what the experts are thinking

NEXT BIG THING

Name: Leanne Pan

Title: Joint chief investment officer

Flagship fund: Prime Value Growth Fund

Performance: 14.3 per cent net of fees annually since inception (April 1998)

Being conservative by nature, but flexible in strategy, lays the foundations for long-term success in the market. Prime's Leanne Pan tells **Patrick Commins** about keeping it steady.

What's your investment philosophy?
Minimisation of mistakes is our motto. We are a pretty conservative bunch and we try to keep things simple, easy to understand and transparent. If I were to use an analogy of a golfer, quite often people are aiming for just the best shots, trying to do a hole in one. But in fact, you will get to the end much faster if you play slow and steady and minimise the bad shots.

How is that approach reflected in your investment process?
[First, we have] a thematic approach – what the macro environment is, and what is driving the economy. For the past 10 years or so, we've been running with the China theme. We prefer companies that supply what China needs rather than compete with China.

The other [approach] is a "bottom-up" process, [when] all the company fundamental details are analysed. We look for things that we understand and avoid the companies with very complicated structures.

In terms of portfolios, we look for companies that fit into both approaches.

So does it start with the macro trend and then you'll go on to finding companies that fit into that theme?
It can go both ways, [but] quite often that's the case. For example, the China thematic led us into more resources-oriented companies. And being a conservative group of people, we go for the mining services companies instead of the miners themselves.

Why are mining services safer than miners?
Because, as in anything, you always need people to do the work: the production and construction.

Isn't relying on winning contracts a risky business model?
I think you need to pick and choose within that sector. One company that we've had for a long, long time is Monadelphous. It's a relatively small company, and most people can't even pronounce its name, but it's been one of those steady-as-she-goes businesses for more than 10 years. They've been growing organically, [they have] no debt on their balance sheet and ROE [return on equity] in excess of 50 per cent.

It's one of those very unassuming companies. No big egos, but knowing that it's hard out there and you've just got to do the work. And they keep delivering the goods.

You talked about organic growth, low debt, and high return on equity. Are these the kinds of attributes that you look for in a company?
Pretty much. One thing I always eyeball is how much in intangible [assets] there is [on the balance sheet].

One of the mistakes that I made earlier in my career was [getting caught out by] companies that – before IPO – amalgamate a number of businesses together because they want to take advantage of the IPO market.

But inevitably [the merger] is very hard culturally. They were just there for an IPO, for somebody to cash in on their business or whatever.

In mining services, there are a lot of examples like that and I have fallen into that trap.

So it's important to have a look at the story leading up to the IPO, is that right?
Yes. [In the case of] Monadelphous, [they] have worked as a team for 20 to 30 years; the culture of the place is very important.

So if you were limited to three financial ratios from a company's accounts, which would you choose?
We always look at the balance sheet strength; debt-to-equity gearing ratio, that sort of thing.

TAMARA VONINSKI

Return on equity is always important. And potentially the dividend: that's real cash, real profit, coming back to you.

Has dividend yield become more important in your portfolio?
Yeah, I suppose in the past few months. Our portfolio is very much [geared towards] the China thematic, but given the macro environment in Europe and the US, we've become a little bit more conservative from the whole portfolio's perspective.

So the new [stocks] we have been adding to the portfolio have got a bit more emphasis on dividend yield. It's a balanced portfolio. We have 50 per cent or thereabouts towards the China story, and not just mining; it [also] includes energy and agriculture stocks, [such as] Incitec Pivot and Maryborough Sugar, which is a consolidation story. The other 50 per cent is a bit more conservative, focusing more on dividend yield.

What companies look good for income?
We have recently added Transurban. Pre-GFC [the company was] not our pick because there were all these [complex] financial instrument structures and it didn't pay dividends out of cash flow.

But lately, with a change of CEO, the dividend is being paid out of free cash flow, which is always a big tick for us. That's what has attracted [the stock] to us. The yield is about 5 or 6 per cent – it's not huge – but there's room for that to grow because their revenue is basically "CPI [or inflation]-plus". And if they can control their costs, the traffic volume is typically higher than GDP.

CURRICULUM VITAE

Experience
Leanne Pan has over 20 years' experience in the investment industry. Before joining Prime Value in 2004, she was portfolio manager for the Orica Superannuation Fund, responsible for the active management of the $400 million Australian equity portfolio. In the 1990s, she and Han K. Lee – who co-founded Prime Value – managed the successful and sizeable Australian equity component of the Shell Australia Superannuation Fund. At Prime Value, she is responsible for the formulation of investment policy and process, portfolio strategy and construction, as well as fundamental research.

Qualifications
Leanne Pan holds a bachelor of economics and an MBA. She is a certified practising accountant (CPA) and chartered financial analyst (CFA).

SHOOT FROM THE HIP

Value or growth?
Neither – style "neutral"

Fundamental or technical?
Fundamental

Diversified or concentrated?
Both

Small or large cap?
Both

Australian or international?
Australian

It might sound a bit boring, but some of the well-known names look quite attractive.

In this environment, banks are still relatively OK, compared with some of the cyclical industrials.

Telstra is still paying its dividend out of debt, is it not?
In these last results, their cash flow has improved a lot. So I think 28¢ is pretty sustainable. That's one company, I think, that's pretty interesting at the moment.

If something did go badly wrong in Europe – and it seems it probably will – what would that effect have on the Australian sharemarket?
Sharemarkets quite often anticipate [events], but they can overshoot, both on the upside and downside. In this case, are we saying that they're overshooting on the downside or is there more to come? I'm not sure.

Can you give us some examples of companies that are looking particularly attractive from a valuation point of view?
It might sound a bit boring, but some of the well-known names look quite attractive.

If you see how much growth is being imputed at the current share prices in terms of the valuation, some companies, like Wesfarmers and Woolworths, those strong franchise names, you're talking about growth of 2 per cent or 3 per cent [being factored in] into perpetuity. So that's not expensive.

What are the big lessons from your career as an investor?
Try to understand the business, that's number one. Know where the drivers are coming from – just keep things simple, I think that's really my message.

Of course, management is very important. So you just want to keep things simple and delivery of results is the game. You can have the most beautiful picture and system, or whatever, but if the result is not there, the result is not there.

What's the next big thing?
Gee, I might sound very negative. I think the de-leveraging story that's going on at the moment [will continue for] quite a number of years, both from the public and private side.

Corporations' balance sheets look good, but they don't seem to be willing to invest. On the household front, the savings rate has gone up.

So with all this happening, I'm a bit concerned about growth for the next few years.

For companies, what sorts of returns on investment are to be expected? What sort of price-earnings multiple is appropriate in the so-called post-GFC environment? Are we in a sort of different paradigm? I'm not sure.

We still believe the China thematic will continue, even though it faces a roller-coaster [ride]. **Si**