

# New values in a small market

[Christopher Webb](#)

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## Investor Dean Fergie feels the market fear but will stick to a basic strategy.

SMALL-COMPANY land is a scary place to be.

Professional investors in the sector are shell-shocked and even the people running companies can't believe the punishment their shares have copped.

Prices have been slaughtered even though underlying businesses remain sound, and in some cases, more profitable than ever.

Dean Fergie, 40, one of the founders of OPIS Capital, along with various members of the Baillieu clan, is a small capitalisation man through and through. He and his team look after about \$80 million of other people's money in four funds held largely by private client investors. They visit 500 companies a year, and own 25 to 30 stocks.

At the moment, though, Fergie is shocked at what he's seeing. "It's just extraordinary," he says. "I've never seen anything like it. It makes everyone's job incredibly difficult. Businesses don't change in value by 3 or 4 per cent, or 10 per cent, in an hour; that should happen over a few months, at least."

Fear abounds. "It's extreme, like I've never seen before, because it's so broad based. It's not just small caps being targeted, it's not just the miners, it's not just retailers, it's everything, it's the banks. There's almost nowhere to hide."

But, as bad as it is, Fergie is gritting his teeth and ploughing on; selling a few stocks here and adding to existing holdings there.

There is no thought that he might abandon the sector that previously served OPIS so well with a yearly return of 30 per cent-plus. Now it's something like minus 60 per cent over the past year.

"We've offered a product that says we'll basically concentrate on small to mid-cap industrial stocks and we won't do resources," he says. "There'll be times when that will be a great strategy and there will be times when that will be a terrible strategy."

"But we're not going to change our offering and we don't think they want us to change."

"Obviously people aren't expecting us to perform well at the moment and we're not, but it doesn't mean we're going to completely reinvent ourselves and do something different."

But share prices have come down so much that Fergie is looking at things slightly differently. He hasn't thrown his company valuations out the window, but he thinks the market is now running on something else.

"I've given up talking valuations because I think they've looked cheap for three months," he says.

"And they looked really cheap at the start of November, and they've got cheaper and cheaper. I've tended to move my thinking about the whole market from a fundamental perspective to almost a psychological perspective."

"It's easy to sit at your screen and watch all these prices falling by double-digit percentages and you intuitively think there must be something really wrong with the business.

"You'll pick up the phone and call (the company) and ask how is the business going and they say, 'not too bad, actually, we're still on track to meet our (earnings) guidance'.

"Two days later, the share price is off another 15 per cent. But if you can keep touching base with the businesses it does give you more confidence in being shareholders."

Fergie, who went to Brighton Grammar before doing engineering at Melbourne University, describes OPIS as a bottom-up fundamental investor that doesn't try to pick economic or commodity cycles.

"We look for businesses that are easy to understand and we judge them on their own characteristics. We stay away from biotechs and resources," he says.

"We try and get on small caps that become big caps. One of our early winners was ABC Learning Centres, which got into the top 100 and now isn't there any more."

OPIS sold the last of its ABC shares at \$2.50. "We didn't see it go to zero, which was a relief, but we left a lot of money on the table, unfortunately.

"Every now and then you will get an ABC where they don't seem to put a foot wrong and everything seems to be going along well, but they're just very good at hiding things."

He says it's not unusual for managing directors to mislead fund managers. "They're going to tell you the greatest story they can and I think it's just naive not to be cynical."

He is on the lookout for inconsistency, takes notes of what company managements tell him and refers to them later, sometimes much later.

So what does he look for in a person running a listed company? "I like genuineness. Some people come in and talk to us and they're real salesmen, and we know what we want to hear and they know what we want to hear.

"So they'll talk about increasing margins, increasing revenues and all that; stuff that sounds good, but anyone can say it.

"You look for people who will probably give a reasonably genuine view of their business, and will give an equal amount of time to the bad points as well as the good points."

One of Fergie's pet dislikes is company people who talk about their own share prices. "It's not their role to manage share prices, it's their role to manage the business and generate earnings, and the share price will look after itself."

He is also on the lookout for whiteboard syndrome, where a chief executive will draw a big J curve representing hoped-for sales. "You always take that with a big grain of salt."

So what sort of shares does OPIS hold?

"We own Service Stream, which is a business that does meter reading and works for Telstra, Optus and the like. We see that industry as being not as cyclical as some and we see it as a pretty strong business.

"We've got an investment in Hastie group, which installs air-conditioning for hospitals, prisons and commercial property, and they've expanded overseas and bought some businesses.

"Hastie was a classic. It was trading at a couple of bucks and they came out at the annual meeting and reaffirmed guidance and their stock fell 20 per cent in a couple of days. It was if they had issued a downgrade!"

So how far will the market fall?

"When everyone starts thinking that the world is never going to grow again, that companies will see negative earnings growth forever, and no one is going to company presentations — that is about when it's time to turn," Fergie says.

"When you've got all the fear in the market and all the sellers have sold everything they're going to, then that's the time."

So when? "We're getting close to it."