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It takes two to Contango

Date: September 23 2011

Richard Hemming

Eyebrows were raised on a number of fronts after the bid by the listed investment company Contango Microcap (CTN) for its stable mate, Contango Capital Partners (CCQ).

Sitting in the middle of all this is the fund manager, David Stevens, and his team at Contango Asset Management (CAML) which he launched with Stephen Babidge in 1998. He is a director of both companies and is CCQ's chief investment officer. Not co-incidentally CCQ's biggest single investment is its 49.9 per cent holding in the unlisted CAML.

The bid does place the two high profile independent directors right in the firing line – investment banking veterans William “Bill” Beerworth (chairman) and former Merrill Lynch Australia boss Greg Bundy.

First up, there was CCQ's positive response to the bid, which occurred at 9.50am on Tuesday 20 September, only 14 minutes after CCQ's bid was announced at 9.36am on the same day.

In responding to the questions from Under the Radar, Bill Beerworth said that the bid wasn't accepted. But there is no doubt that he believes it will be accepted, as he stated in a written response:

“(Subject) to no higher bid being made and to the report by the Expert we will appoint, we propose to recommend the Offer.” And later he writes: “(It) presently seems unlikely that a third party will make a higher bid.”

Which brings us to the bid's price, which is all important for CCQ shareholders.

The bid values CCQ at \$17.8 million, or 90c a share. This is a 10 per cent discount to the net tangible Assets (NTA) which represent the Holy Grail for the listed investment company or LIC. The company's NTA was just over \$1.00 a share on 31 August 2011.

Shareholders might think they're being duded with other LICs like Hunter Hall, K2 Asset Management and Platinum Asset Management all trading at various premiums to their NTAs.

Investors in CCQ also complain that the takeover price doesn't take into account the accumulated losses of \$47 million, which generates tax credits, giving the company a post-tax NTA of \$1.77.

What all this means is that at least one key shareholder reckons this thing is being sold for a song, and its true worth is in the region of \$1.20 a share. This is based on the value of the tax credits, the NTA, and the company's \$745 million or so in funds under management.

Wilson Asset Management owns 19.9 per cent of the target CCQ. According to its principal, Geoff Wilson, the 90c a share bid benefits CTN shareholders at the expense of CCQ shareholders.

Wilson estimates that based on CAML's net profit, CTN will reduce its investment management costs by 0.75 percentage points a year. “Over time the saving to CTN shareholders will be significant,” says Wilson.

The market does not see it this way, however, and is not pricing in a higher bid. In reaction to the bid, the target CCQ's shares spiked from 70c prior to the announcement and now trade at 90c, in line with the bid. In contrast, the predator, CTN's shares also trade at 90c, but are down 15 per cent this month.

In the bag

Luxury leather goods retailer Oroton's 8 per cent growth in net profit after tax for the its last fiscal year might not look impressive, but that changes when you compare it to the 49 per cent decline in Premier Investments, the owner of brands including Just Jeans and Jay Jays, also announced this week.

Premier's (ASX code PMV) market cap is \$800 million and heading south, compared with Oroton's (ASX code ORL) of \$313 million, which is heading the other way.

A key to Oroton's growth is that it is successfully playing the online game, offering impressive discounts. While writing this column, your columnist is considering buying a "marais hobo" hand bag for \$300, which WAS \$500.

He is also hoping his wife isn't reading this, but more importantly, your columnist knows that if he does purchase the bag he would be supremely annoyed if he then went elsewhere online or to a shopping centre and saw the same bag being for say \$250.

The key is that Oroton is among a group of small cap retailers that can control their costs in marketing and pricing because they own the brand that they are selling direct to consumers. Other companies in this category include outdoor wear retailer Kathmandu (KMD), furniture retailer Fantastic (FAN) and automotive and camping gear retailer Super Group (SUL).

Right now all these companies look to be good value. Oroton is trading on a forecast PE of 12 times, Fantastic on 9 times, Kathmandu 7.5 times and Super Group 12 times. The average for the entire market is about 12 times, so take your pick.

*Richard Hemming (r.hemming@undertheradarreport.com.au) is an independent analyst who edits a fortnightly newsletter: **Under the Radar Report**. He has written columns on small caps for the Financial Times and for the Australian Financial Review.*

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