Next Big Thing

Name: Simon Burge

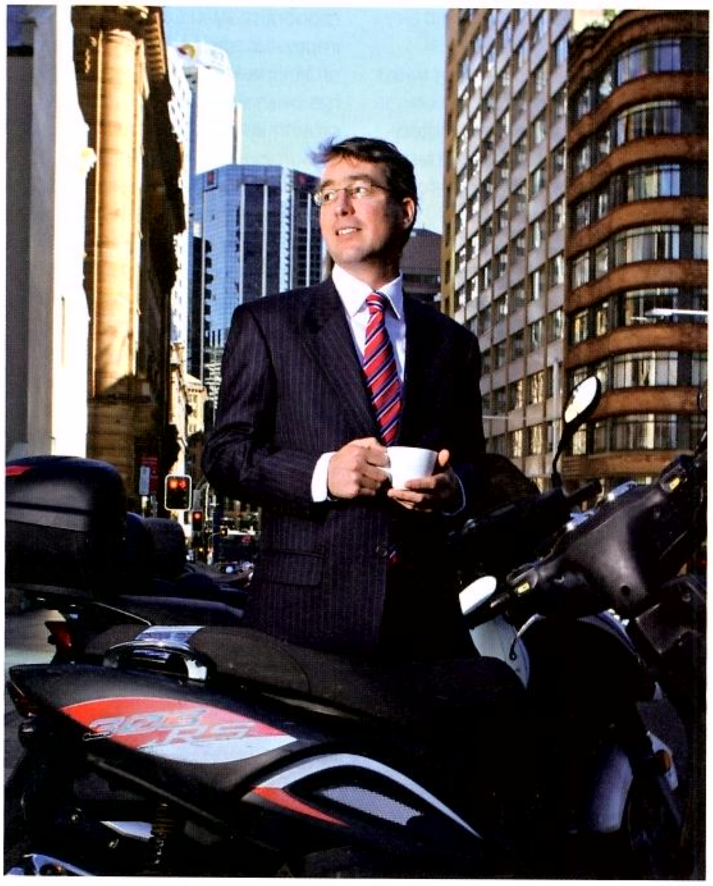
Title: Chief investment officer, Above the Index Asset Management

Flagship fund: ATI Australian Equity Portfolio

Performance: 2.2pc net of fees since inception (Dec 2005)

Value hunters

Chasing underpriced stocks is tempting, but investors should keep an eye on debt and intangibles, ATIAM's Simon Burge tells **Patrick Commins.**



TAMARA VONINSKI

Describe your approach to investing.

Our approach is termed "relative value". The two main determinants of how we look at stocks are earnings and the price that you pay for those earnings. So if we have an earnings forecast for a stock, and the stock is trading at a price-earnings ratio below what we think it might trade at in the future, that would generally seem to be an attractive investment for us.

Are you looking for great companies or mispriced ones?

Purely mispriced: we try to take the emotional element out. We're looking for things that are mispriced by the market and in sustainable industries. It's not whether we think it's the greatest company, per se, it's whether they'll survive and are they mispriced.

Many shares, especially with our process of relative value, certainly popped up as looking cheap: Babcock & Brown, Allco Finance Group (AFG), ABC Learning (ABS), [but] the debt was too much for us to stomach. We avoided those types of companies because debt is one of the main things we try to understand before we invest.

For companies you've never heard of, what do you look at?

The first two things we look at are its level of debt and serviceability, and the level of intangibles. There are a lot of companies now where there are requirements to start writing down goodwill. When we see a large component of intangibles as part of net equity, that's often something we'd be concerned about.

The profit and loss is obviously important. But before we're worried about the next three years of earnings, the balance sheet gives you a guide to capacity to grow the business, or whether it'll still be around. They're the value traps we try to avoid.

Often there's a large portion of active funds in blue chips – why?

Part of diversification and risk management means we'll still hold some of the larger stocks, even if they're not the cheapest. It's about risk management rather than pure return, in that sense.

We use tracking error as the main guide for risk. So to run a portfolio with quite a low tracking error we need to have holdings in those larger benchmark shares, [but] we might be overweight or underweight those stocks. We certainly don't just hold them at index weight. The top 20 accounts for over 70 per cent of the Australian market, so to not be holding any of those shares would [make it] impossible to maintain a tracking error as low as we do.

Do you see anything fantastically undervalued now?

These markets have led to clear-outs and balance sheet intervention. I think there are plenty of opportunities in the industrial space, because companies have repaired themselves.

What's the next big thing?

Credit rationing. Will the spreads on loans revert to a more normalised level, or will this rationing continue? [It's] reducing the opportunities for people to get money. People are really focused on viability and I think it's another 12 months or so before credit rationing will end. I think it's another year of consolidation, that's why our outlook is relatively sanguine.

I don't expect it to be a double-digit return year. However, the strength of Australian balance sheets puts us in pretty good stead. **Si**

SHOOT FROM THE HIP

Property or shares?
Shares

Value or growth?
Value

Australian or international shares?
Australian

Small-cap or large-cap stocks?
A mixture

Diversification or concentration?
Both

TO WATCH OUR FULL INTERVIEW WITH SIMON BURGE, GO TO WWW.TV.AFR.COM