

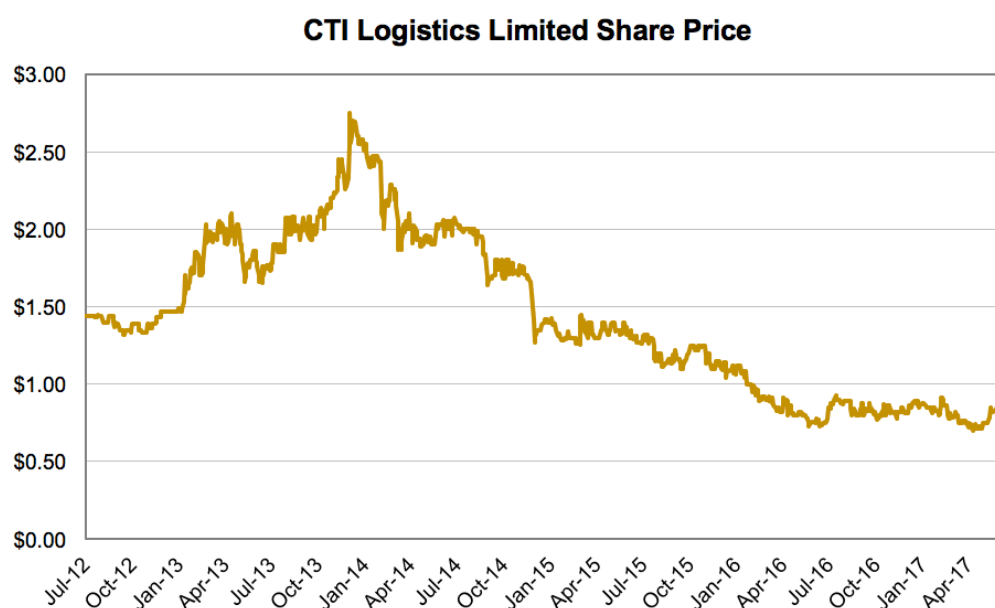
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## Australian Fund Stocks up on CTI Shares

Forager has recently become a substantial shareholder in **CTI Logistics** (CLX), a courier and warehousing services company. CTI has a strong competitive position within the Perth delivery market where it carries out 30% of on-demand taxi-truck deliveries, 35% of courier deliveries, and 40% of same-day parcel deliveries. CTI also provides third party contract warehousing and it's the national market leader in storage and distribution of floor coverings such as vinyl and carpet.

### Cooling WA Economy Creates Opportunity

The end of the mining boom is hurting the company's businesses. In 2016, CTI generated \$150m in revenue but only \$2m in net profits. As you can see in the chart below, the company's share price has plummeted from as high as \$2.75 in 2013 to \$0.84 cents today – a 69% drop. CTI's current market capitalisation is only \$62m.



While last year's sales reached the highest level on record due to an acquisition, profitability was well below what CTI has earned in the past. In 2014 and 2015 net profits were \$10m and \$6m respectively on a much lower revenue base.

Since then, competition has increased and demand for the company's services fallen, but CTI should be able to adjust its cost structure to the new market conditions. CTI only owns a small fraction of the vehicles it uses and most of its workers are contractors.

Once the economy recovers CTI should bounce back. Its 30-year old delivery network is a hard asset to replicate. Furthermore, the flooring business should continue to grow as it benefits from

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a new bigger warehouse.

Based on the 2017 half-year result, CTI should be able to earn net profits of about \$6m for the full year. This implies it's trading at a multiple of about 10 times these 'depressed' earnings. Importantly, the company has net tangible assets of \$63m and \$20m worth of franking credits. These provide today's investor downside protection.

### **Strong Management Team**

While we don't spend much time talking to management we strive to understand whether their interests are aligned to those of shareholders. We also look at their past capital allocation decisions to gauge how capable they are in their line of business.

Insider ownership is usually one of the first things we look at when assessing management – there is no bigger incentive than 'having skin in the game'. Management turnover is also an important factor. CTI's three main directors own nearly 60% of the company and have at least 30 years of history with the business – each.

While a long tenure and significant insider ownership are big positives, they can mean little without good financial performance. On this score, CTI's directors have done an outstanding job over the years. Book value per share has grown from 18 cents in 2004 to \$1.25 today, a compound annual growth rate of 17%. This is even more impressive when considering the company paid 58 cents in dividends per share over the period.

Given the attractive valuation and management's great track record, Forager bought shares in the company in late May. This has mostly happened through a small [placement](#) of new shares. About 2.4% of the [Forager Australian Shares Fund](#) is invested in CTI Logistics.

### **LIT Structure Serving its Purpose**

While it is a promising investment, CTI's shares are extremely illiquid with only a few thousand shares trading a day. Investing in illiquid securities is not a problem per se. In fact, it's often one of the reasons why a stock might be mispriced. But, it presents some challenges for fund managers, especially those who manage open-ended funds.

The Australian Fund has historically held many stocks that have low trading liquidity. This required the Fund to keep a high cash balance at all times in order to protect the Fund from an unusually large number of investors deciding to redeem their units at once. Trying to sell illiquid stocks on the market in a hurry can obviously be costly.

Since the Fund closed to new investors and converted to a Listed Investment Trust (LIT), Fund liquidity is not a concern. CTI is exactly the sort of business we had in mind when making the change.

**This is an extract from the upcoming June 2017 Quarterly Report. Please click [here](#) if you wish to sign up to receive the Quarterly Report.**