

# Bears Take a Beating

Short selling has been a happy hunting ground for bears in recent years, with bumper performances in 2010 and 2011. Highlights include identifying such implosions as: **JB HI-FI (JBH)**, **Fairfax Media (FXJ)**, **David Jones (DJS)**, **Gunns (GNS)** and **Billabong (BBG)**. But, a rallying market in the latter half of 2012 has made replicating the outperformance a difficult task. In saying that, we still have a murky six months to play out!

Following our July 2012 report, *A short warning!*, and October 2012's *Shorts betting on another wardrobe malfunction for retailers*, we have chosen to focus our attention on short selling performance. On a backward looking basis starting in June 2010 and June 2011, the top five shorted stocks fell by an average 9.8% pa and 50.1% pa respectively (Table 1). However, when analysing the December half, the top five shorted stocks rallied an average 24% – with **Flight Centre**

(**FLT**) up 44.1%! Obviously a consequence of a rising market, but the magnitude of the top five returns is significant. Noticeably, four of the five stocks (JBH, FXJ, FLT and MYR) still reside in the top five shorted stocks. As we have seen with the short position in **carsales.com (CRZ)** (Figure 1), a rallying stock price generally raises the probability of a capitulation, which can be more profound with smaller-cap stocks with relatively tight free floats. So as these heavily shorted companies keep rising, the probability of a short squeeze grows. During a short squeeze, investors holding short positions are typically forced to purchase shares in a rising market, magnifying price increases in order to cover the position.

## Company Analysis

In early 2012, some of the more high-profile profit downgrades belonged to **Boral (BLD)**, **Fairfax (FXJ)**, **Iluka Resources (ILU)** and **Billabong (BBG)**. Interestingly, all stocks displayed mounting short interest leading into the announcement. We now analyse selective heavily short companies leading into the upcoming reporting season – some we agree with, and some we don't. We will revisit later in the year to see how they are faring.



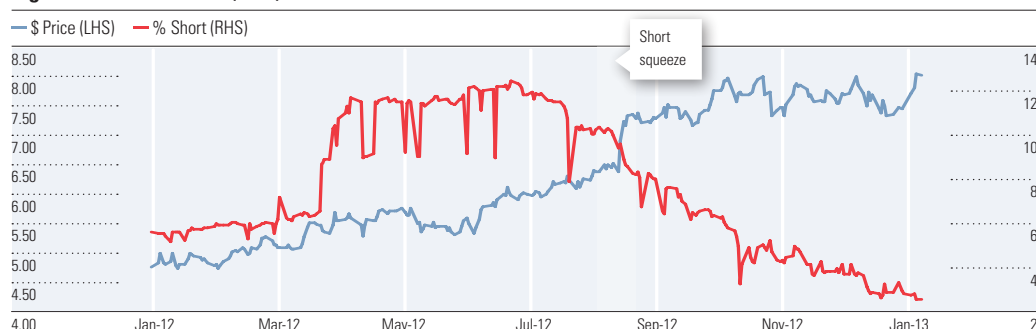
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**Table 1: Top five shorts in June 2010, 2011 and 2012 with performance**

Top 5	30/06/2010	Return FY11	Top 5	30/06/2011	Return FY12	Top 5	30/06/2012	Return 1H13
FXJ	12.1	-25.5%	JBH	15.7	-48.1%	JBH	21.0	16.8%
PPT	5.3	-11.8%	FXJ	12.1	-43.4%	FXJ	13.5	-6.3%
NCM	5.3	7.4%	DJS	7.2	-36.2%	FLT	12.3	44.1%
BLD	4.2	-8.7%	GNS	7.1	-40.7%	CRZ	11.8	28.3%
JBH	4.0	-10.5%	BBG	6.1	-82.1%	MYR	10.3	36.8%

Source: ASIC/Morningstar

**Figure 1: Carsales.com (CRZ)**



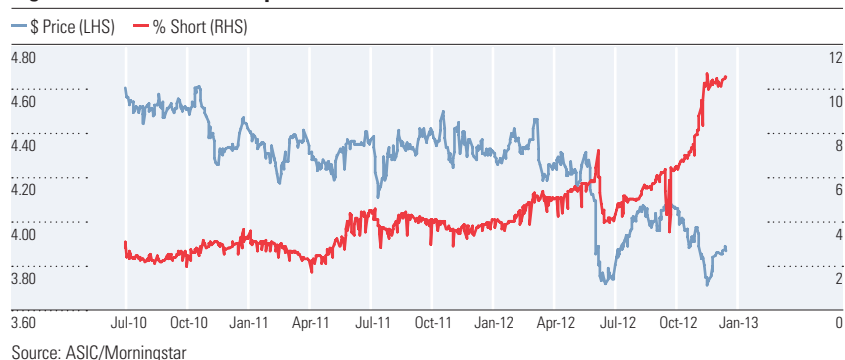
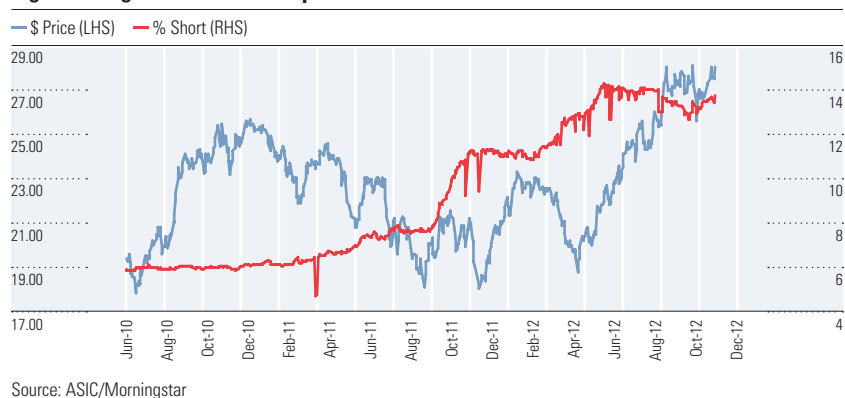
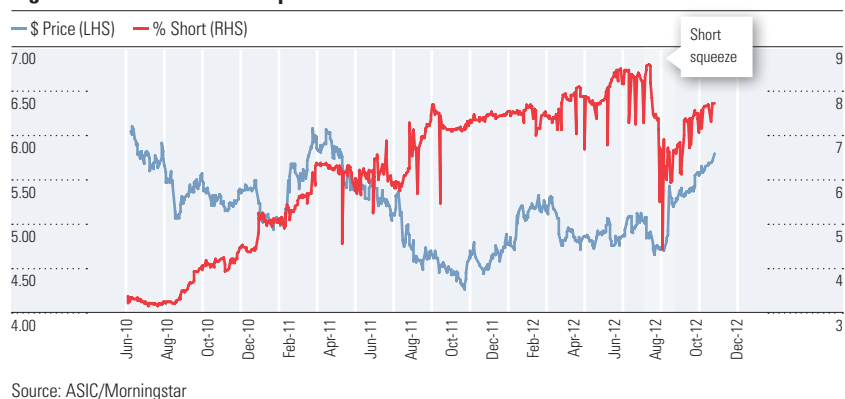
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**Figure 2: Metcash vs short position****Figure 3: Flight Centre vs short position****Figure 4: Wotif.com vs short position****Metcash (MTS)**

Metcash is a marketing and distribution company that operates four business units: IGA Food Distribution, Campbells Wholesale, Australian Liquor Marketers (ALM), Mitre 10 Hardware and Automotive Brands Group.

Short interest in Metcash rose dramatically from around 4% in July to a peak above 10% (Figure 2). The high short position suggests some investors view Metcash's Franklins acquisition as expensive and the increased price competition between Woolworths and Coles will lead to downgrades in FY13 earnings. Despite the rising short position, Morningstar still considers Metcash slightly undervalued, with a P/FV of 0.8 and Accumulate recommendation.

**Flight Centre (FLT)**

Flight Centre is Australia's largest traditional high street travel agent. It differentiates its brand into market segments including retail, wholesale, corporate and online. Discount airlines intensify price competition, driving down the cost of air travel and lowering commissions to travel agents.

The short interest in Flight Centre has been mounting since September 2011. Even in the face of significant share price appreciation, shorting has risen with equal conviction. Shorts are betting Flight Centre's growth potential is exhausted, with outperformance less likely in FY13. With considerable short positions in place prior to the rally, shorts are bleeding. If there is any capitulation, expect a short squeeze. Morningstar also considers Flight Centre overvalued, with a P/FV of 1.2 and Reduce recommendation.

**Table 2: Top 5 percentage change in Short Position – Increases and decreases (absolute)**

Weekly	Δ	Monthly	Δ	Quarterly	Δ	Half-Yearly	Δ	Yearly	Δ
FXJ	1.3	FXJ	3.1	ILU	4.4	SLR	7.7	ILU	13.5
PDN	1.3	PDN	2.6	MTS	4.4	MTS	6.2	PDN	9.0
ARI	1.0	MBS	2.4	ACR	3.6	ILU	6.1	SLR	7.5
VAH	0.9	FKP	2.2	BKN	3.5	ACR	6.1	MTS	7.2
TOL	0.4	ILU	1.5	PDN	3.4	BKN	5.7	ACR	6.9
Weekly	Δ	Monthly	Δ	Quarterly	Δ	Half-Yearly	Δ	Yearly	Δ
SGT	-0.8	TEN	-2.4	LYC	-7.2	CRZ	-9.0	BBG	-8.1
JBH	-0.7	LYC	-2.1	APA	-6.0	BBG	-7.6	RIO	-3.7
CSR	-0.3	GBG	-1.4	SGT	-5.3	LYC	-4.1	CRZ	-3.0
DOW	-0.3	CRZ	-1.2	IGO	-3.1	SGT	-3.5	BOQ	-2.3
PNA	-0.3	BLD	-1.1	CRZ	-3.1	EGP	-3.1	GFF	-2.2

**Wotif.com (WTF)**

WTF offers customers a portal to access accommodation bookings. There are numerous accommodation offers, the market is fragmented and this explains why consumers seek companies such as WTF to aggregate all the information into a single, searchable internet site. Fragmented supply also gives hotels minimal bargaining power.

The short interest in Wotif.com peaked around 8% in September 2012 before a short covering eased interest back to 3% over a two-week period (Figure 4). It's hard to know exactly what triggered the substantial change,

but it appears to be a fund manager correctly pre-empting a rallying share price. Shorts were betting deteriorating economic conditions would transform into declines in travel expenditure. Under such conditions, WTF would find it far more difficult to grow in line with high market expectations. We consider WTF fairly valued, with a P/FV of 1.11 and a Hold recommendation.

**Boral (BLD)**

The market reaction to Boral's cost-cutting initiatives smacks of short covering – abnormally high volume associated with sharply higher share prices. ■■■