Lifespan
FINANCIAL PLANNING

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A few ideas ahead of the Reporting Season

AGL Ltd

Most market analysts and commentators viewed gas as the energy source to back up renewables and batteries. It was this logic that saw AGL and the SA Government commit $645m to new gas-fired power plants. The question is whether these will pay their way…
The Australian Energy Markets Commission (AEMC) stated that "power companies Origin Energy, AGL Energy and Energy Australia enjoy excessive margins in Victoria" so there may be pressure on the prices that the majors are charging.

Recommendation: AGL is a defensive stock that provides a dividend yield of 3.2% plus franking credits. Watch for discussion regarding the power companies' margins as the Federal Government could take action. Hold.

Amcor Ltd (AMC)

Is a global packaging company that produces bottles and specialized packaging for the food, health, pharmaceutical and tobacco industries. Exposure to the consumer market means that the businesses are largely defensive in nature. It is slightly more expensive than Orora on a Price/Earnings basis and the dividend is unfranked.

Recommendation: Switch to ORA for growth and franking credits.

AMP Ltd (AMP) $5.35

AMP has the elements for success with a large distribution base, improving investment performance and a good track-record. However, the insurance policy lapses and reductions have been problematic for the past year or so. Management has yet to deliver results from the AXA acquisition. The update delivered in May, provided details of AMP's strategy provided goals but little detail on how it plans to deliver them. The new goal is to "shift from a product and distribution business to a customer-led organization focused on helping our customers achieve their personal goals."

Recommendation: I don't believe that AMP will deliver any major improvement in the forthcoming report. The dividend yield of 5.2% remains attractive.

ANZ Bank (ANZ) $29.81

CEO Shayne Elliot intends to create a "more agile" workplace and there are fears that there will be significant job losses. Part of the restructure has seen ANZ exit the wealth management business, Restructure usually deliver write-offs. A Trading Update is due to be released on 15/08/17.

Recommendation: Avoid or take profits on the expectations of write-offs.

AREITS

AREITS measure returns using capitalisation rates. These rates have hit cyclical highs and are like to re-trace over the coming years. Valuations of properties have also peaked. Therefore, the recent acquisitions within the AREIT sector are cause for concern. Deutsche Bank has cut target prices on both Mirvac and Stockland by 4%. Another negative for the sector was the rise in bond yields which results in asset price falls. AREITS follow the bond market so unit prices fell too.

- **Dexus (DXS)** **$9.57**
  DXS paid $720m for 50% of the MLC Centre which was on a 4.5% cap rate.
  Recommendation: Hold for income generation. Buying on-market is cheaper than participating in the SPP.
  SPP: Closes on: 08/08/17
  Purpose: purchase of 25% interest in MLC Centre, Martin Place, Sydney
  Purchase of 100 Harris St, Pyrmont
  Price: $9.96, lower than the institutional price of $10.20
  To accept: Pay using BPay facility

- **Mirvac (MGR)** **$2.91**
  MGR sold a 50% stake in their 477 Collins Street (MLB) property for $414m on a cap rate of 4.4%. This is a good move considering that commercial property is peaking.
  Recommendation: Hold for continued income stream.

- **Stockland (SGP)** **$4.30**
  SGP has a high-quality investment portfolio. The group strategy has been to expand the industrial and retail businesses but gradually exit the office segment. Greater focus is now on residential and, more particularly, retirement living which I believe is an important growth point. Whilst earnings and distributions can be volatile due to the development activities, sales and the resulting settlements will increase through 2017 to 2018 and augur well.
  Recommendation: Hold for the attractive distribution yield which is currently 5.8%.

- **Scentre (SCP)** **$2.20**
  SCP posted a large price fall (12%) but I do not like its exposure to development risk.
  Holders may participate in the DRP at $2.13
  Recommendation: Avoid.

- **Vicinity (VCX)** **$2.71**
  VCX fell about 13% and may be worth buying if retail sales remain strong… VCX revalued their properties with a lift of $850m in the last year. The buy-back worth approximately $1.5bn implies that there is nothing else that offers similar value. It is likely that Angus Mc Naughton will step down in December 2017 and there are several contenders to replace him. If VCX managed to secure ex Bunnings CEO, John Gillam, the market would view the appointment positively.
  NTA is $2.82 and gearing is approximately 24.7%.
  Recommendation: The units are trading at a discount to the NTA which implies value. Watch for retail sales details.

- **Westfield Corp (WFD)** **$7.64**
  In May, WFD released a 1Q Update that showed the 'Flagship' properties posted a 8.9% year-on-year rental growth with Leisure sales leading the other specialty sectors. There are 4 development projects underway that should be completed in between now and 2019, plus 3 other future development prospects. The growth is sales augurs well for distributions, however the development projects tends to cause volatile earnings which may affect distributions.

Recommendation: The distribution yield is only 4.4% and may be affected by currency conversions. I prefer AREITS that are rental income focused because they generate a regular stable income streams for investors.

Bellamy's Australia (BAL) $7.39

BAL fell from its high of $15.07 due to troubles with exporting to China and the renewal of licenses. The battle in the boardroom was further disincentive for shareholders. BAL raised funds by way of a Retail Entitlement offer to Shareholders (5 new shares for every 38 at $4.75). The company also provided a trading update stating that it had been cash flow positive since March 2017 and indicated that 2H17 revenue should be $121m with a FY17 revenue of $239m and EBIT should be at the upper range of $9.5m to $14m.The company resumed trading at $5.90 on 20/07/17.
Further bad news was that the Camperdown Powder Pty Ltd certification registration in China was suspended. However, it does NOT impact current production or sale of Bellamy's Australian or Chinese label products. Therefore, the Chinese label product will manufactured elsewhere and the facility will be upgraded.

Recommendation: If BAL hits the guidance provided when it reports on 18/08/17 it will improve investor confidence. Watch for information on the Chinese certification issues. Hold.

BHP Billiton $26.23

BHP has responded to the iron ore price and the Chinese Iron Ore futures. Given the new "One Belt, One Road" policy, China will be developing infrastructure to cope with imports and exports at the chosen hubs. Therefore, it will continue to require iron ore, particularly if it reduces trade with North Korea as a penalty for continued missile launches. BHP will continue to offload onshore US oil acreage and the oil and gas prices received may impact that division's performance. Copper production will be lower on industrial action at Escondida and a power outage plus unplanned maintenance at Olympic Dam. Production of iron ore, metallurgical coal and energy coal should all be high.
There is likely to be some discussion regarding US Shale oil impairments following an admission that it had found "material deficiencies" in the controls and processes that BHP use. Therefore, some write-downs are possible.

Recommendation: Hold or buy below $19 as production growth in the short-to-medium term is likely.

Blackmores (BKL) $87.00

The share price has fallen from a high of $166.80 but is off the 52-week low of $86.27. Given that Blackmores has been the market leader of complementary medicines in Australia since 2003 as a result of product innovation and expansion as well as improved distribution, there is no reason why the company should not bounce back. Whilst the Australian market is generally viewed as mature, complementary medicines are still gaining traction and there is the potential for strong growth in the Asian markets. It's a brand that has a trustworthy reputation. The loss of CEO & MD, Christine Holgate, is problematic but Marcus Blackmore will fill in until a replacement can be appointed. If the appointee is viewed as competent, the share price should rebound.

Recommendation: Buy a parcel with a view to buying another parcel if the appointee is favoured by the market.

Cimic Group (CIM) $42.31

CIM has weathered the slowing resources and mining services factors as well as problems with their Middle East businesses, including corruption and boardroom altercations. However, a strong balance sheet coupled with ongoing projects in infrastructure and construction has seen the company deliver to its potential. CIM delivers strong cash flows; $520m in 2Q17, up 55% or $184m YOY. 2Q17 NPAT of 163m, up 21% YOY.

Recommendation: CIM is involved in WestConnex and has been a successful bidder for government transport projects. At the current price and on a yield of 2.8% (fully-franked), CIM is fully priced. CIM goes ex-dividend of 60cps on 12/09/17 so consider taking profits thereafter.

Coca-Cola Amatil $8.48

The soft-drink market has matured and is now saturated. Neither of the major retailers will stock the new Coca-Cola No Sugar product. IT is also rumoured that several of the Mount Franklin varieties of bottled water will not be stocked on Woolworths shelves. Further, Domino's has decided not to renew their product supply arrangement. Rationalisation of product and brands must follow.

Recommendation: Avoid due to lack of strategy

Cochlear Limited $140.22

The company announced that it will expand its global capacity by building a manufacturing centre in Chengu, China. This follows the opening of the new centre at Macquarie University earlier this year. China is one of the top 5 markets for Cochlear and has significant potential for growth in the future.

Today, CEO, Chris Smith, resigned and COH announced that Dig Howitt will become the new CEO and President. Dig Howitt has been the Chief Operating Officer since July 2016, so he is relatively new to the company.

The FY17 results should be released on 17/08/17 and guidance was for NPAT of $210 - $225m.

Recommendation: A capital raising may be announced to build the Chinese facility Buy on the dip if it appears, preferably below $120.

Commonwealth Bank $84.35

CBA remains one of my preferred banks due to its conservative management style and exposure to Wealth Management via Colonial. CBA has said that it is capable of meeting the new capital adequacy requirement of 10.5% of CET1. Annual results are scheduled for 9/08/2017. The money laundering saga using CBA automatic tellers sent CBA shares tumbling. Ian Narev may be close to stepping down and this may be the catalyst. Both issues will continue to lead to price weakness and provide a buying opportunity.

Recommendation: On a Price/Earnings basis CBA (15.48) still commands a premium. Hold and participate in the Dividend Reinvestment or Share Purchase Plan depending on the price. Watch for announcements…

CSL limited (CSL) $127.00

Price movement indicates that the market believes that there is little growth available. CSL has fallen from $145 to $127. The company is a key player in the vaccines and blood product market. The recent joint acquisition with Humanwell Healthcare Group of Shanghai of Ruide, establishes an operational base for CSL. The only concern is that the Chinese market does not operate with the same level of corporate governance and intellectual property may be compromised.

Recommendation: Buy for long-term growth

Insurance Australia Group (IAG) $6.57

Former Chief Operating Officer, Mark Milliner, has been appointed head of the Australian Division by CEO, Peter Harmer. IAG will be restructuring operations in order to deliver $250m in cost savings by the end of 2019. The aim is to become more customer focused. Watch for write-offs in the coming report due to Cyclone Debbie and the restructure.

Recommendation: IAG is close to its 52-week high of $7, so it may be worthwhile locking in capital gains if you are not dependant on dividends.

JB HiFi (JBH) $26.43

Sales have been driven by new store openings and may be as high as 75% for JBH which denounces the fear on Amazon entering the Australian market. JBH will report the JB HiFi stores as well as 'The Good Guys'. There seems to be some joint merchandising which is, in my opinion, unfortunate. I would prefer to see JB HiFi remain a specialist technology retailer and The Good Guys concentrate on home entertainment, white goods and small electrical appliances. However, both chains appear to have solid support and sales should continue to be strong.

Recommendation: Hold. I hope to see a clearer store and product distinction which will provide confidence in the management.

Orora Ltd (ORA) $2.75

ORA is the Australian-based paper and packaging company that spun out of Amcor (AMC). It is a well-established business and generates strong cash flow which should ensure good dividends for shareholders. In May, the company presented at the Macquarie Conference. ORA has operations in Australia, New Zealand, USA, Mexico, UK, Canada and China and management state that it is a "diversified and defensive business with a healthy track record of improving earnings and cash flow generation."

Recommendation: ORA is close to its 52-week low of $2.65 and offers a 3.6% dividend yield, franked to 30%. Over time franking should move to 100%. The packaging division accounts for 45% of revenue which implies good defensive qualities. Switch from Amcor (AMC) which trades on a higher PE and the dividend has no attached franking credits.

Retail Food Group (RFG) $5.03

RFG is a food distributor and franchisee trading as Donut King, Michel's Patisserie and Brumby's Bakery, Pizza Capers, bb´s café, Big Dad´s Pies and Esquires Coffee Houses. RFG also owns Evolution Coffee Roasters Group. Growth has been through acquisition but the company has started to enter markets overseas, including the Gulf region of the Middle East.

RFG has fallen from its high of $7.37 partially on short-selling. Part of this fall may be attributed to the UBS report valuing RFG at $4.70 due to the incoming accounting standard for companies (IFRS 16 Leases). RFG and its lenders are aware of the changes and no concerns have been expressed. Interestingly, UBS, despite their earlier downgrade, posted a substantial shareholder notice on 6/07/17.

The June trading update states that RFG anticipates an FY17 underlying NPAT growth of approximately 15% above FY16, with an EPS growth of 8% and an increase in the fully-franked dividend.

Recommendation: If the results are in line or better than the guidance, RFG may be re-rated upwards which will pressure the short-sellers. Depending on the initial purchase price, it might be worth buying additional shares…

Super Retail (SUL) $8.26

SUL rationalised BCF and Rays outdoors previously and I am pleased that they are now rationalising their sports outlets by rebranding the 65 Amart Sports stores as Rebel. Having a recognisable brand and stores in shopping centres will shore-up support and is likely to reduce the impact of Amazon, JD Sports and Decathalon who intend entering the Australian market. At present SUL believes that they have 25% market share. The synergies resulting from the rebranding are worth approximately $15m over 2 years but transformation will cost $34m and be expensed in FY18. Capex for fitouts will be approximately $9m. The FY report should see Revenue of $2.5m, NPAT of $280,000.

Recommendation: Buy based on a yield of 5% fully franked and the fact that the share price has fallen from a 52-week high of $11.19 on short-selling and a reaction to Amazon entering the market. I believe that the stock is oversold and will have strong results.

Santos Ltd (STO)

The 2Q Report provided evidence of the company's focus on cutting costs and reducing debt. Debt fell US$600m to US$2.9bn. Production costs are now between US$8 and US$8.25 per barrel of oil equivalent (boe). STO breaks even on a cashflow basis on US$33per barrel down from US$36.50. It also announced that it upgraded production to between 57m and 60m boe. STO has emerged as a low-cost producer that should generate strong cash flows in a low oil price environment.

Recommendation: Buy for improved yield and potential capital gain

Sydney Airport (SYD) $6.82

Market talk suggests that SYD is interested in acquiring the Ibis Hotel at Mascot which could be worth $50m. SYS's performance is dependent on passenger numbers and will respond to economic cycles. IT is viewed as a 'bond proxy' due to its structure and reliance on debt funding. In a rising interest-rate cycle there will be some negative price pressure.

Recommendation: On a distribution of 4.7% without any franking credits, I believe that there are better opportunities. A rights offer could eventuate…

Transurban Group (TCL) $11.80

TCL is likely to be one of the bidders for the WestConnex motorway worth approximately $16.8bn. TCL operates the majority of toll roads in Australia and therefore has great local experience. TCL also has toll roads overseas. TCL is also a 'bond proxy' but is structured as a stapled security where a considerable portion of cash flows are distributed to investors on a pre-tax basis. Distributions should increase overtime but the unit price may weaken.

Recommendation: The distribution yield is only 4.2% and offers only 15% franking. I do not believe that this is the correct time to be investing in bond proxies.

Woolworths Ltd (WOW) $27.00

WOW is a strong business, with competitive advantages stemming from its leading store network, low cost of doing business, and buying efficiencies. Therefore, stores should be able to regain sales momentum and protect its market share in the long term. 3Q Sales details were released in May with Australian Food up 5.6%, NZ Food up 4.4% and Endeavour Drinks up 3.9%. Hotels posted a marginal 1.9% improvement. Big W detracted with a 6.1% fall in sales and Ezibuy (mail order) dropped 10.3% and has been sold.

The home improvement joint venture with Lowes (Masters) is being unwound with valuations being obtained by independent experts.

Recommendation: WOW still has a few hurdles to navigate but I believe that it is back on track. Hold.

Please note that the information above should be considered **GENERAL ADVICE** because there is no consideration for your financial situation or goals. Further, the recommendations are based on my experience and from assessing information that is publically available. I hold shares in many of the companies discussed above.

Kind regards

Gail

Gail Gadd
Specialist Financial Planner
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Lifespan Financial Planning Pty Ltd