DIVIDEND DETECTIVE

More than the sum of its car parts

Automotive Holdings Group

ASX CODE: AHG
SHARE PRICE: $3.80
INDUSTRY: Retailing
CONSENSUS FORECAST FY2017 DIVIDEND: $0.24

STEPHEN WOOD

Automotive Holdings Group is one of the leading automotive retailing companies in Australia, with an industry-leading market share of about 7 per cent.

Listed on the ASX in 2005, AHG began as a Holden dealership in Perth called City Motors. Since then the business has expanded in WA and across the nation and currently represents nine of the 10 top-selling volume brands.

It has a small exposure to truck brands, as well as Mercedes-Benz in the luxury space.

While industry growth rates are low — about 2 per cent — compared to GDP growth, AHG is actively looking to grow market share via acquisitions, taking advantage of the current fragmented industry structure. These acquisitions are earnings-accretive due to the relatively lower acquisition multiples of target companies and availability of synergies.

The company also operates a refrigerated and cold storage businesses, contributing 13 per cent to overall group profits. This business has arguably underperformed over many years, with the operations requiring large levels of capital expenditure, while margins continue to be competed away, resulting in declining return on assets. Return on assets has fallen from 20 per cent back in 2009 to be sitting closer to 5 per cent this year.

But the recent change in management should a catalyst — some businesses may be sold, with available capital used within its core competency of expanding its automotive dealing business.

The key risk is the current ASIC inquiry into income derived by dealers via finance and insurance products, which is likely to be a near-term headwind to earnings.

Having said this, dealerships have multiple revenue streams available to them and can likely partially offset the potential headwinds to earnings.

Further to this, the recent sell-off in the share price from $5.00 in late August to a current prices around $3.80 suggests at least part of this risk is factored in to the share price already.

AHG currently trades well below our sum-of-the-parts valuation of $4.60 and offers an attractive fully franked annual yield of 6.3 per cent.

Stephen Wood is a senior analyst at Clime Investment Management. Clime Investment Management holds shares in AHG.

Coming up Trumps in the new world of investment

The president-elect's plans will affect stocks in many ways

DAVID WALKER

US president-elect Donald Trump's plan for his first 100 days in office is out and ASX investors will be wondering what it means for the precious share portfolios carefully accumulated to fund their retirements. After eight years of sharemarket volatility, many direct investors are feeling even more rattled by the sell-offs on the ASX before the election, the shocking election result and the violent movements over the two days afterwards. In a financial world where already nothing seemed certain, this stunning political development and the uncertainty it brings could make that world seem even more confronting.

The strong rallies in many ASX stocks since Trump's win are just speculation, as no one knows for sure how many of Trump's self-contradictory policy fragments will become implemented policy. The US president is relatively weak domestically, given the need for legislative approval of spending and tax measures, and the Republican Party, which controls congress and the Senate, contains philosophical wings opposed to Trumpism. These will be a moderating influence on Trump; we do not expect a full-blown trade war with China. We also point to the property developer's personal interests in a buoyant US economy. The most likely outcome now is a long period of uncertainty similar to post-

Brexit, with some of the Trump agenda delivered through next year.

The way forward is first not to feel shaken by shock events and market volatility (and I do appreciate this is not easy at times like last week) but to see them as welcome sources of opportunity. You pay a high price for waiting to buy stocks until there is confidence and calm in the sharemarket, as stocks are more highly priced then and therefore offer less upside. You'll make your most money in the panics, because traders and investors overreact in times of great unknowns, and this creates opportunity.

Here are the key sectors from a value investor's perspective:

Banks

The strong rallies last week benefited positions in ANZ, CBA and NAB. Banks were already pricing in higher long-term interest rates as world growth strengthened, central banks switched focus from quantitative easing to bond yield targeting, and wage pressures in the US labour market picked up. Bank interest margins suffered from the recent ultra-low interest rates. ANZ is worth around $29 in our view. We would look to lighten.

Insurers

At $11, QBE shares would price in most of the improvement in profitability we expect from management initiatives and higher bond yields. We would look to lighten.

Energy

The implications of Trump are mixed. Trump wants to lift restrictions on American fossil fuel output, which would be negative for oil prices, but has opposed the Iran nuclear deal. Cancelling the deal and returning to sanctions would support prices. Watch and wait on this sector.

Resources

The bullish scenario is infrastructure stimulus on both sides of the Pacific from China and Trump's US. The question is the timing of the inevitable supply response which would drag prices lower again. The surge in popularity makes these stocks riskier.

Building materials

Boral could benefit from US infrastructure spending but the US only contributes only about 10 per cent of earnings. James Hardie is mainly leveraged to housing, not civil infrastructure.

Retail and property

Trump's plan for middle-class tax cuts could unleash a wave of retail spending to benefit Westfield's shopping malls. There could be a switch from QBE to Westfield if bond yields and the Australian dollar overshoot on the upside.

Amcor and Brambles

Both would benefit from a stronger US economy but are already expensive, so they don't meet our return objectives at current prices.

David Walker is senior analyst at StocksInValue.

Investment winners and losers in the brave new world

JOHN KIMELMAN

Hours before the TV networks called Tuesday's election for Donald J. Trump, the stockmarket declared him the winner — and wasn't happy about it. At about 8pm that night, the Dow Jones Industrial Average went into a free-fall, plunging about 900 points, or 4 per cent in the futures market before bottoming at 17,500. The selling ended when the market's so-called circuit-breakers kicked in at midnight, halting the slide.

With the downward momentum stopped, stocks began to recover, kicking into overdrive around 3am when president-elect Trump began to deliver a measured victory speech, pledging to be "president for all Americans". Conciliatory talk is a good start, but what investors really seemed to like was the next president's pro-growth agenda, which ought to win rapid approval from his fellow Republicans, who retained control of Congress. The stockmarket thundered higher on Wednesday and Thursday, inched down Friday, and ended the week up 3.8 per cent, as measured by the Standard & Poor's 500 index. The big question for investors is whether Trump's pro-growth, tax-reform, and fiscal-stimulus policies will outweigh his protectionist views, says Matthew Peron, head of global equities at Northern Trust Asset Management. "This is the debate many on Wall Street will be having," he says. "Right now, the positive case for economic growth is strong."

Robert C Doll, the chief equity strategist at Nuveen Asset Management, puts it even more succinctly: "Which Trump will prevail, the one that will do tax reform or the one that stomps on (free) trade?"

Among money managers, there is hope that the realities of the presidency and pressure from congress will cause Trump to rein in his grandstanding against trading partners like China and Mexico, which he argues get an unfair deal at the expense of US-based manufacturers and their workers. During the campaign, Trump called for a 45 per cent tariff on Chinese goods coming into the US. "On trade, he may end up speaking loudly but carrying a small stick," says David Kelly, chief global strategist at JPMorgan Asset Management.

This time round policies will matter

As a rule, investment professionals are wary of politics. They're schooled in fundamental analysis, and earnings models don't easily accommodate uncertain political scenarios. "Bottom-up stockpickers are paid not to worry about politics," says Peron. "But as top-down strategists, you always need to take Washington policy into account. Since the global financial crisis, we are in a new world in which policy really does matter because of political intervention in the markets and a stringent regulatory regime."

Peron says that a Trump presidency, with a Republican-controlled congress, will usher in a "regime change" in Washington, as gridlock caused by divided government gives way to single-party rule. Trump's stated goals of corporate and individual tax cuts, a big infrastructure-stimulus package, and the repatriation of corporate profits from overseas could, he says, "release some animal spirits into the economy".

On the other hand, "protectionism is the one (issue) that we worry about the most," Peron says. "Free trade is good for global growth, but (Trump) has taken a stand against that."

More stocks, less bonds

We asked some top market professionals what they're investing in now to take advantage of the Trump victory. After all, biotech stocks, as measured by the iShares Nasdaq Biotechnology ETF, have already rallied 10 per cent since Tuesday's close, on the well-founded belief that Trump will go easier on these businesses than Hillary Clinton would have.

Arun Daniel, a fund manager at JO Hambro Capital Management Group, thinks there's still room to run, arguing that the benefits of a Trump administration to the bottom lines of biotech and drug companies aren't fully priced into the stocks yet. "The good news is not baked in the cake of biotech fully," he says. "You will see the effects over time."

Daniel is also bullish on stocks levered to fresh government-fuelled infrastructure spending. Among his favourites: Jacobs Engineering (JEC) and Martin Marietta Materials (MLM). He has also identified companies that will probably be allowed to bring home at a low tax rate billions of dollars of profits currently parked overseas, which they can put to work for shareholders. They include Nike (NKE), Procter & Gamble (PG), Caterpillar (CAT), and credit-card processors Visa (V) and Mastercard (MA).

Nuveen's Doll says that his firm hasn't made any changes yet to its asset-allocation models as a result of the election. But he suspects that Trump's plans to lower corporate taxes and increase infrastructure spending might lead to somewhat faster economic growth, "buttressing our existing allocation", which overweights stocks and underweights bonds.

Like others on Wall Street, he buys the view that long-term interest rates could creep higher in the coming years because of rising inflation and Trump's seeming lack of interest in reining in the federal deficit.

Joseph Amato, the equities chief investment officer at Neuberger Berman, also believes that a Trump administration will be better for stocks than bonds.

This feature first appeared in Barrons.com

Always pays to take a healthy look at future

ROGER MONTGOMERY

In the absence of broad value, and when everything is "going up", a great deal of self-restraint is required to avoid the temptation to buy something, anything. "Swing at something you mug," is an oft-heard instruction offered to professional fund managers by their investors. But as we have indicated many times in the past, we are not in the business of betting on the "ups" and "downs", which is tantamount to betting on black or red at the casino.

Unfortunately, when valuations are generally elevated due to low interest rates, as they are today, opportunities to deploy the cash tend to occur only as a result of a negative reaction to a company's news. The severity of the share price decline and the update that triggered it also tends to cloud the outlook for the company, requiring fortitude on the part of the fund manager investing at the new lower prices.

Take for example Healthscope — operator of 45 private hospitals and with 18,000 staff — which announced a weaker quarter of operations and projected a flat full-year result if conditions such as those experienced for the most recent quarter continued for the remaining nine months of the financial year.

In Australia there are few sectors with as clearly obvious bright prospects as healthcare. An ageing population, as well as a generation of baby boomers who took up aerobics and jogging for the first time, almost ensures a growing conga line of hospital visits.

Of course this growth is well understood and reflected in generally very high earnings multiples across stocks representing the healthcare sector. When a business then fails to meet the market's expectations, as HSO did recently, it tends to be reappraised harshly with many investors shooting first and asking questions later.

Healthy look

HSO's high price in 2016 was $3.17 compared with today's $2.25, a fall of almost 30 per cent and a price not far from the $2.10 the company listed at in July 2014.

The significant price reaction of a company whose shares are already held has a dual effect.

- In the first instance, it adversely impacts our short-term returns.
- But it simultaneously provides an opportunity to materially enhance our long-term returns.

A 30 per cent share price decline is nothing short of a crash, and when it comes to the highest quality prospects, rarely does the market offer value by treating that which is temporary as permanent.

The company stated: "Various data points across the industry tell us that the average rate of hospital volume growth generally has slowed. We have seen this impact a number of our hospitals resulting in increased variability in volumes and casemix month to month in the first quarter and particularly in September. Management focus continues to be on driving revenue growth and disciplined cost control."

Market misses

Given consensus analysis and therefore market expectations were for greater than 10 per cent growth, it is understandable the shares would be rerated. Even at the current price many investors might shy away from Healthscope, which is still trading on a historical P/E of 22 times (it would also be at 22 times next year's earnings if there was no growth).

But the company made little mention of the precise "data points" it was referring to, other than "orthopedics" and "ophthalmology", and we know the trends for elective surgeries — for which private hospitals dominate — coincide with the ageing population. When asked in a subsequent interview with *The Australian* about the share price reaction to the announcement, Healthscope boss Robert Cooke said: "That's an over-reaction. We have taken a really cautious view to our outlook statement and we are talking about a couple of per cent of volume." He also said: "The crazy thing about this is that you have waiting lists of nine months in the public sector, you then have the federal government getting billed for radiology, pathology and other things — so it's cost shifting by the states. Then they go and build extra beds for $2 million to $3m per bed — we can build them for $1m."

Clearly, in addition to the attractive prospects, the economics of private hospitals also make them a much more palatable option for governments which would otherwise need to take on the longevity risk associated with an ageing population.

As a long-term value investor I am not concerned with the monthly, quarterly or even one-year performance of our funds. However, I am extremely concerned with long-term performance and while you never know where the next opportunity will come from ... they always do.

Roger Montgomery is founder and chief investment officer of the Montgomery Fund. www.montinvest.com