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Money

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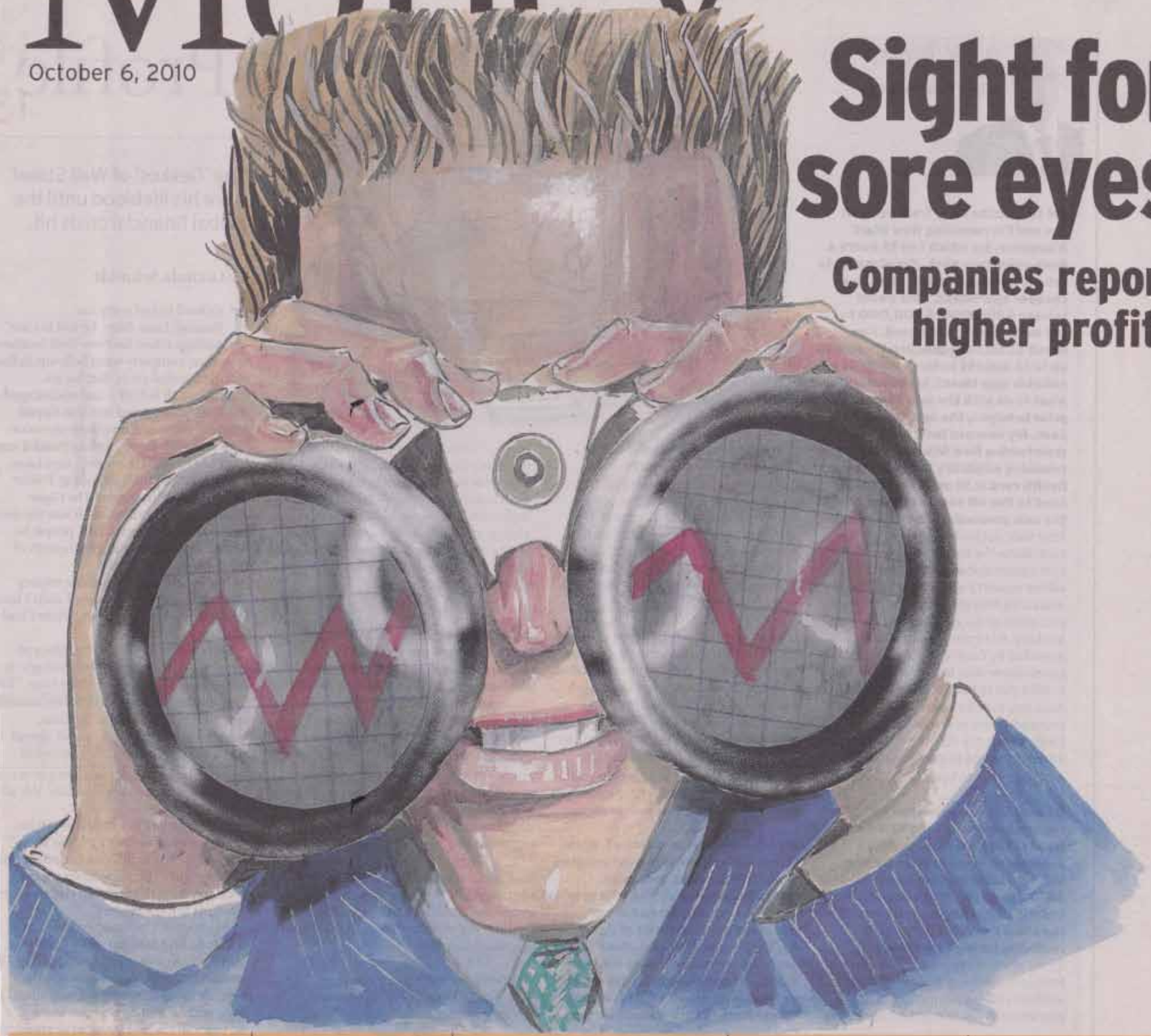
Sight for sore eyes

Companies report higher profits



Passengers sought for latest float

It may be the second-biggest sale of an Australian public asset but can investors count on QR National shares?

By Barbara Drury

The privatisation of Queensland Rail's freight business, QR National, is on track to become Australia's second-biggest sharemarket float, with a who's who of PR consultants, investment banks and stockbroking firms urging mum-and-dad investors to get on board.

The challenge is to work out if the investment returns will be worth the price of the ticket.

The chief executive of QR National, Lance Hockridge, is selling the float as a bet on the future of the Australian economy and a chance to take part in Asia's growing demand for Australian coal. The company also boasts an experienced management group led by the chairman John Prescott, a former chief executive of BHP. Hockridge joined as chief executive three years ago after 30 years with BHP and BlueScope Steel.

QR National is Australia's largest rail freight company, with 2300 kilometres of track, 700 locomotives and 16,000 wagons but the heart of its operation is its near monopoly over the central Queensland coal network.

Its supremacy has only recently been challenged by the entry of Asciano's Pacific National. QR owns the rails and trains that haul coal to coastal ports to be shipped to China, Japan and Korea. The Australian Bureau of Agricultural and Resource Economics (ABARE) forecasts 32 per cent growth in Australia's coal exports in the next five years but the longer-term political and economic future of coal is unclear. With climate change and the hunt for renewable sources of energy back on the political agenda, the coal industry is putting its faith in the development of carbon capture and storage technology but success is by no means assured. What's more, China is investing heavily in

All aboard ... Lance Hockridge (left) and John Prescott head QR National's management group. Photo: Paul Rovere

renewables and has stated it wants its demand for coal to peak before 2020.

A value investor and independent analyst, Roger Montgomery, says the prospectus for QR National, which is due for release on Sunday, will focus on growth in revenues and profits and improvements in efficiency – but that is only part of the story.

"Do you buy shares hoping things go well or do you want a demonstrated track record? One is speculating and one is investing," Montgomery says. He argues that the big issue for investors is the company's return on equity (ROE), which is a measure of the return shareholders receive for the equity they have invested in the business.

QR National expects to boost pre-tax profits from $204 million to $427 million this financial year. Montgomery points out that QR is a capital-intensive business, so investors need to focus on after-tax profits, which he estimates will be about $390 million. With an expected market capitalisation of $7 billion, this represents return on equity of just 5.5 per cent. Most long-term value investors look for a return on equity in double digits.

The challenge is to work out if the investment returns will be worth the price of the ticket.

The research manager at Lincoln Indicators, Dennis Ng, says that because QR is an established infrastructure business, its potential growth prospects are a less significant factor in determining the value of the business than the value of its tangible assets.

He suggests investors look to the prospectus to determine the value of QR's underlying assets, the amount of debt it expects to hold, how much of the cash raised in the float will go to the Queensland government and how much will be retained in the business.

There is an expectation that businesses perform better once they are out of government hands, although long-suffering investors in Telstra and Qantas will be aware that sharemarket success is not guaranteed.

Market volatility has also proved problematic for floats in the wake of the global financial crisis.

"A number of companies have pulled out of IPOs [initial public offerings] in recent times, which is not the best of signs," Ng says.

Shares in Myer have fallen 6 per cent since the company was floated with much hoopla by private equity interests last October. In the current market environment, it is unlikely QR will provide speculators with windfall profits but long-term investors also need to exercise caution.

Investors have until Friday to register interest in receiving offer documents for QR shares. Registration carries no obligation to buy but it does guarantee you will be allocated shares if you want them. The challenge will be to determine whether QR stacks up.

Key points

- The Queensland government is selling its rail freight business after 145 years of public ownership.
- QR National is Australia's second-largest float behind Telstra and is expected to raise more than $7 billion.
- The government will retain a 25 per cent to 40 per cent stake with plans to sell down over time.
- Offer details will be released on Sunday ahead of an expected December sharemarket listing.
- Queensland residents will have priority but all investors who pre-register are guaranteed a share allocation and incentives, including a discount to the price offered to institutions and loyalty bonus shares.