Caltex on cusp of a price rebound

A CHARTIST'S VIEW

MICHAEL GABLE

CALTEX operates as a near duopoly in the Australian fuel supply market.

With the imminent closure of the Kurnell refinery and its conversion to an import facility, the company is aiming to improve its competitive position.

Its business characteristics are not too dissimilar to that of Woolworths and Coles, which trade on a price-earnings multiple of about 17 times next year's earnings. Caltex is trading at 12.1 times and, as the company makes its transition to a fuel distribution business, we could see a re-rating in the share price. The overall market is trading on a multiple of about 15 times earnings, so if Caltex re-rates only to the market multiple, then we are looking at an appreciation of about 25 per cent in the share price. Turning to the charts, price action is starting to support our view on the stock's fundamentals.

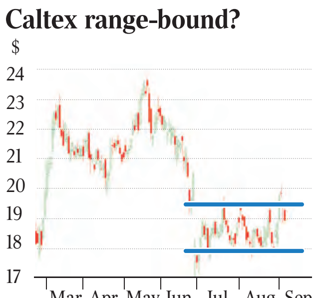
> Caltex is well placed to continue building up to higher levels

The stock was being sold off during May and June, along with the rest of the market. At the end of June, Caltex released its 2013 half-year profit outlook, which resulted in another drop in the share price. You will notice, however, that the volume more than doubled on that particular day and the share price finished well up from its lows. Often when volume comes in after a stock has already been heading in a particular direction, it can be the sign of a reversal in the trend.

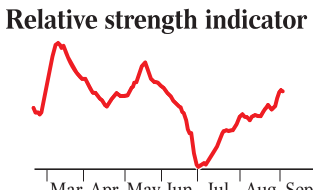
With Caltex being able to hold on to those lower levels, we most likely have a situation where the sellers have "exhausted" and fresh buying is ready to come in at those levels. Since then the share price has drifted in a sideways channel. We have started to see Caltex want to break out of that channel. If so, it will start trading in a new channel of equal depth. The new resistance level will then come in about the $21 mark. A break of that could see Caltex wanting to retest the $24 level, which would put it on a P/E multiple equal to that of the market.

So with what appears to be a valid low and the building of a solid base in the share price, Caltex is well placed to continue building up to higher levels across time.

Caltex range-bound?



Relative strength indicator



Source: Fairmont Equities

Pre-tax cap never enough for super savers playing catch-up

So what about rolling over half of any unused concessional contribution limit?

ANDREW MAIN

OUR next federal government should consider bringing in a multi-year averaging system on concessional super contributions that would allow savers to "roll up" unused concessions into the next year, says David Anderson of Mercer.

The group's local managing director and market leader for the Pacific says that most people younger than 40 in Australia "can probably not even contemplate sacrificing $25,000 a year", the current maximum level at which savers under the age of 60 can make pre-tax contributions to their super.

As of recently, savers aged over 60 on June 30 this year have a $35,000 ceiling for this financial year, which by the way is less than the $50,000 it used to be, and the $100,000 before that.

Mr Anderson said the current one-year-at-a-time concessional system wasn't allowing many savers to build up a significant retirement nest-egg because "by the time they've put their children through school, TAFE or university and got themselves that promotion, it's often too late to make a difference. When they want to play catch-up, they can't."

Mercer's proposal is that if an individual doesn't use their full $25,000 concessional contribution cap in any given year, half of what's unused should be rolled over until the next year, and so forth. It is understood to have had a good reception from the Coalition on the basis that any measure that can reduce the government's eventual age-pension liability without significantly blowing out current revenue has to be worth a look.

Mercer is a US-based multi-function financial services company in the superannuation and funds management space with a strong reputation for research.

Its proposal means, for instance, that if a saver made no concessional contribution in Year One they could add $12,500 to Year Two's concessional (pre-tax) contributions, so they could put away $37,500 on a pre-tax basis that year.

He said lifetime concessional caps "would create a fairer and far more equitable retirement savings system for all Australians" and would, for instance, "correct the unfair treatment of women and men who take career breaks".

RENEE NOWYTARGER

Mercer's David Anderson in Sydney this week. Most people younger than 40 'can probably not even contemplate sacrificing $25,000 a year'

Mr Anderson admits "there's a short-term burn to commonwealth government revenues if it provides the same level of concessions to higher income earners as it does to middle and lower income earners", but that the alternative, seeing big numbers of retirees falling on to the age pension, would be worse in the long run.

Referring to Treasury's notorious 2012 Tax Expenditures Statement, he says: "We've disputed Treasury's numbers that there is a $32 billion hole in commonwealth revenues caused by tax concessions to super, projected to rise to $45bn by 2015-16 — on two grounds.

"One is that if people weren't given a tax break to save money for their retirement, it was wrong to assume they'd pay full tax on the money and not seek to get a tax break elsewhere.

"The other is that it ignores the future burn to the budget caused by increased demand for the age pension."

Mr Anderson makes it clear that the government must make every effort to reduce retirees' dependency on the age pension, which is currently accessed sooner or later by 90 per cent of the population.

Mr Anderson's firm includes an actuarial service that has mapped a looming explosion in the number of older retirees, a matter of obvious concern to managers of defined benefit pension schemes paying lifetime pensions.

"For males working in the public sector, in the last 10 years there has been a four-year improvement in life expectancy, while for women the number is still relatively unchanged.

"Australian life expectancy tables do not yet reflect that recent reality."

He said more than half the baby girls born this year could expect to live past 95, although on the other side of the longevity paradigm Australian obesity numbers now rank "pretty high" by global standards.

"Not necessarily in terms of cardiac disease, but certainly in relation to ailments such as type-2 diabetes."

Caps for concessional contributions to a pension plan

Country	Cap (in local currency)	Cap (% of average earnings)
AUSTRALIA ($A)	**25,000**	**34.6%**
CANADA ($C)	24,270	43.8%
DENMARK	NO LIMIT	NO LIMIT
SWEDEN (Krona)	440,000	124.6%
SWITZERLAND (Franc)	210,600	255.2%
BRITAIN (£)	40,000	127.3%
US ($US)	51,000	93.7%

Source: Mercer

Take a big risk . . . it might pay handsome dividends

UNDER THE RADAR

RICHARD HEMMING

IN the Australian marketplace, hell hath no fury like an investor whose dividend hopes have been vanquished.

If you doubt this, just ask a shareholder in Vision Eye Institute who has watched the stock plummet more than 30 per cent since August 27, when management dashed investors' hopes of a dividend before June next year.

Vision Eye was the exception. One of the big themes of the results season was that companies, both big and small, resources and industrial, were touting their dividend appeal. Companies on average are paying out a record 70 per cent of their profits to shareholders, as they look to capitalise on Australia's love affair with income.

When it comes to dividend yields and whether to invest, it's important to look beyond the headline number. The average dividend yield on the top 100 stocks in the ASX is 4.6 per cent. But the top dividend yield-payers are at the small end. The top 20 dividend-paying companies on the ASX have an average forecast dividend yield of 9.4 per cent. Of these companies, all are small caps, which have market caps of $500 million or less, and all but one are industrials.

Smaller companies traditionally have to fight harder to attract investors, and all understand that Australia's love of dividends is something you don't fight.

Part of this love affair is attributable to the tax benefits domestic shareholders can get from franking credits. These benefits aren't available to offshore investors, so you could claim that fully franked dividends are underpriced because many foreign investors don't get the advantage.

For example, if you include franking credits, the average dividend yield paid by a bank of 5.6 per cent is pumped up to just over 8 per cent once an Australia-based shareholder gets his or her tax back. Many think this looks impressive compared with a one-year term deposit rate of 4 per cent.

The reality is, however, you can't compare equities and fixed interest securities such as term deposits.

There is far more risk in a bank, which for every $10 on its balance sheet has lent out more than $100. As an investor in a bank's stock, there is material price risk because of this leverage.

We believe that an investor should not look purely at dividends when deciding to invest in a stock. But dividends do provide valuable information on how much risk you are taking. The higher the dividend yield, the bigger the risk an investor is taking.

The key reason people invest in equities is for earnings growth, which can be achieved only when a company re-invests a good proportion of its profits. In the rush for investors' money, many listed companies have been throwing the rule book out the window and have been giving away a good portion of their future earnings potential.

When you see big dividend yields, they are somewhat analogous to junk bonds, which are bonds issued by companies where there is a prospect they might not be paid back.

If you do fundamental analysis, you can capture some of this return. We have tipped two of the top 20 dividend-payers in the past, Gale Pacific and Melbourne IT.

The latter has returned 60 per cent for shareholders, more than half of which came from dividends.

r.hemming@undertheradarreport.com.au
www.undertheradarreport.com.au

Richard Hemming is an independent analyst who edits a fortnightly newsletter.

Ainsworth has the numbers

Love them or hate them, there's money to be made in pokies

ROGER MONTGOMERY

I DON'T go to casinos. Never have. Investors live and breathe probability and the numbers just don't stack up. But I don't begrudge others who enjoy it as their entertainment.

I still cannot understand why so many people play poker machines. It seems utterly mindless to me, but that they do has been a boon for Len Ainsworth, founder and former head of poker machine manufacturer Aristocrat Leisure and now the major beneficiary of Ainsworth Game Technology's (AGI) success.

Recently, Ainsworth reported its FY13 results. Let's take a quick walk through the numbers. Revenue $198.1 million, up 32 per cent, and earnings before interest, tax, depreciation and amortisation $74.1m, up 39 per cent. Net profit after tax was down, but that's because last year the company didn't pay any tax and this year it did. On that basis, you are better off looking at the pre-tax or operating numbers for signs of change. And, remember, there are recession-like conditions out there.

When presenting the results, management noted: "Further revenue growth is expected within all international markets." That was stating the obvious.

Growth in South America was 77 per cent, but total revenue was just $19m. Think about that for a minute: the company's revenue from all of the South American continent was just $19m — and it has only relatively recently started selling its products there.

In the US, the biggest market for mind-numbingly boring poker machines, total revenue was just $49m. Ainsworth now has 602 gaming operations units installed at casinos across the US after the installed base grew 186 units from 416 at December 31 last year. And keep in mind the individuals at Ainsworth have plenty of experience managing much bigger operations in the US of A.

In Australia, the company enjoyed revenue growth of 21 per cent, the lowest annual growth since 2008.

Before you worry the company's growth is going to fall off a cliff, note there are still market share gains to be had. One of our brokers recounted a conversation with the company's chief financial officer: "In Victoria, at venues where they temporarily installed machines pending approval of a product called Players Paradise, the venues kept the temporary machines after the new product was installed."

Management went on to note that profit after-tax in the first half of FY14 is at least 15 per cent ahead of the $22m reported for the half year ended December 31 last year.

Total units sold in FY13 was 2021, compared with 1288 in FY12. The second half saw 1196 units sold, compared with 825 in 1H13 and 1052 in the previous corresponding period. In other words, it's ramping up. A key indicator of future orders — "units on trial" — looks healthy, with 354 on trial at the end of June, representing a significant increase on the 229 trial units at December last year and 142 on trial at June 30 last year.

Importantly, not only is the company selling more units but each unit is generating stronger returns. For other businesses, this is tantamount to selling more product at a higher price. After releasing its new range of games into the gaming operations market, Ainsworth saw a 39 per cent increase in its average revenue per machine per day during the year. Across the course of the year the company achieved a yield of about $39 a day, compared with $10 less a day in FY12. In some venues in the US this is as high as $60 a day.

OK, so the company is growing strongly and has enormous potential.

As you know, the remaining part of the puzzle is value. The company's shares are not a bargain at the moment and, while we own plenty in The Montgomery Funds, we'd want to buy more if the price fell towards $3. That may seem like a long way away, but in the stockmarket it's amazing how often the odds fall in your favour.

Roger Montgomery is founder of Montgomery Investment Management and author of Value.able: How to Value the Best Stocks and Buy Them for Less Than They're Worth, available at www.rogermontgomery.com.

Interest rates are plummeting.
But at 6.25%, bond yields are still flying.

Despite historically low interest rates, corporate bonds can still deliver high returns without the need to take unnecessary risks. In fact, FIIG is currently offering direct investment into Qantas corporate bonds with a fixed rate return of 6.25%*. As Australia's leading fixed income specialists, FIIG can provide you with a tailored, flexible corporate bond portfolio that is low risk and provides consistently strong returns. Visit **fiig.com.au** or call us today on **1800 01 01 81**.

FIIG

Fixed Income Specialists

*Senior corporate bond maturing 2020. To qualify, investors must be classified as wholesale. Contact FIIG for details of bonds available for non-wholesale investors.
FIIG Securities Limited ('FIIG') provides general financial product advice only. For a copy of our disclaimer please refer to fiig.com.au/disclaimer.

FIIG Securities Limited ABN 68 085 661 632 AFS Licence No. 224659