Retail investors left to sink as big institutions lap up floats

Private briefings to the big end of town are unfair, argues Clime's John Abernethy

ANDREW MAIN

FUND manager John Abernethy has been running equities for longer than he's prepared to admit and is frustrated at how retail investors are far less informed about the imminent crop of listings than institutional investors.

"We've been told in the press that the Dick Smith selldown has 'two cornerstone investors' but we don't know who they are," Abernethy says, noting that, clearly, the big investors have had private briefings that are legal, but which he believes are unfair to retail investors.

The prospectus was lodged late on Thursday, after the institutional bookbuild had locked in buyers for about 85 per cent of the available stock.

"I was a fund manager back when private briefings on listed stocks were legal so I know what goes on, and retail investors are at a disadvantage when big issues are pre-sold because the big investors have a great deal more information about the company after it lists than do the small investors," Abernethy says.

He says the present rush of new issues, which includes $1.83 billion worth of raisings with firm listing dates and a further $1.38bn aiming to get dates as soon as possible, is one in which vendors have "seen a window opening".

"It's worth noting that most of them aren't capital raisings, they are sellouts in existing businesses," he says. "The average person in the street doesn't really know the difference between a sellout and a capital raising, even though the latter creates companies that have more scope to grow."

Of the 10 industrial issues with certain dates yet to list this year, half are capital raisings and half are sellouts. But of the big issues in the wings, all bar Yuma Energy are sellouts.

"The market's opened up because of quantitative easing in the US, and PE ratios have expanded accordingly, from the 11-12 times we had a year ago to 13-14 times without any commensurate increase in earnings," he says.

"The appetite for equities has been driven by the search for yield among retail investors who have been effectively driven out of their bank deposits because of the low interest rates created by quantitative easing.

"This market is starting to smack in some ways of 1999 (the start of the tech boom) and 2007 (pre-GFC), not least because a lot of fund managers have to keep investing, and with low rates they have to invest even more. I'm not saying that we're heading for a bust, but the end of quantitative easing will see price-earnings ratios come down. You'll only see a loss of value when the market comes back to reality."

He admits that Clime Asset Management, the closed-end Licensed Investment Company that he runs, doesn't have to invest in any new floats because it has a different model.

"When Clime gets a call about a new issue we know they're in trouble," he jokes.

More seriously, he says that "if you are a retail investor looking at one of these IPOs you may well be at a disadvantage because ASIC hasn't regulated the issue of pre-float briefings".

The answer, he says, may be to escrow the cornerstone investors' shareholdings to protect the aftermarket.

"You're in a situation where if the issue's been underpriced, the institutions with the extra knowledge will be able to buy stock in the aftermarket from retail investors who don't have that information, and in the converse case where it's been overpriced and the institution has taken some because it wants a good allocation from the same promoter when a better issue comes along, the institution can sell into the demand from retail investors."

SAM MOOY

The Dick Smith prospectus was lodged on Thursday, after the institutional bookbuild had locked in buyers for about 85 per cent of available stock

John Abernethy

Companies aiming to list in 2013

Company	Code	Seeking ($m)	Sector	Planned date
AFFINITY EDUCATION GROUP	AFJ	77.5	CHILDCARE	DEC 11
DICK SMITH HOLDINGS	DSH	400	RETAIL	DEC 4
DORSAVI	DVL	14.5	MEDICAL	DEC 11
INDUSTRIA REIT FUND	IDR	212	PROPERTY	DEC 3
NINE ENTERTAINMENT	NEC	697.3	TV AND MEDIA	DEC 6
ORORA	ORA	(demerger)	PACKAGING	DEC 18
PM CAPITAL GLOBAL OPPS FUND	PGF	300	LIC	DEC 12
PS&C	PSZ	25	IT SYSTEMS	DEC 2
REAL ENERGY CORP	RLE	10	OIL AND GAS	DEC 5
RECALL HOLDINGS	REC	(demerger)	IT	DEC 10
SANDON CAPITAL INVESTMENTS	SNC	$100	LIC	DEC 27
SUBTOTAL		**$1836.3**		

Major listings pipeline

Company	Code	Seeking ($m)	Sector	Planned date
PACT GROUP		500	PACKAGING	
BIS INDUSTRIES		300	EQUIPMENT HIRE	
HOTEL PROPERTY INVESTMENTS		285	PUBS	
YUMA ENERGY		300	US SHALE EXPLORATION	
QUEENSLAND MOTORWAYS		?	BRISBANE ROAD TUNNELS	
TOTAL		**$3221m**		

Source: ASX

Low-end lenders offer rich pickings

UNDER THE RADAR

RICHARD HEMMING

EARLIER this month, official data showed the Australian economy shed the highest number of full-time jobs in 16 months, and if you think things are going to get tougher you should consider buying into consumer lenders who benefit from tough times.

The lenders that provide financing at the "low quality" end of the spectrum are the ones that benefit most. Thorn, Cash Converters and Money3 engage in so-called payday lending, which is the business with the highest profit margins. An example is someone on $600 a week who needs $200 to pay a bill and gets paid in three days. He borrows the $200 and then pays back about $240.

There have already been some big gains made from listed consumer finance companies. Shares in kitchen financing specialist Silver Chef have almost trebled in the past two years, while FlexiGroup and Money3's shares have more than doubled.

Portfolio manager Andrew Hills is adamant the gains will continue. "The entire market for lending is growing," he says. "Banks don't play in the area because there is not the quality, and it is growing because there is a lot of hardship out there."

Hills says that because of loose monetary policies around the world, meaning low interest rates and effective printing of money, there is increasing disparity between those who have access to finance from the big banks and those who don't.

"Money printing causes asset price inflation and higher unemployment means that people will require these lenders more than ever."

These companies are part of the "shadow banking" industry that has grown exponentially in the past four years in the wake of the financial crisis. Banks have largely exited the specialised consumer lending segment, leaving the field open to the GFC survivors.

The question is: how much more money can be made in this sector?

The stocks listed above have gone from trading at steep discounts to the industrial average PE two years ago, to trading at or near the average of 16 times the current year's earnings.

Hills says there is still good money to be made in the sector and prefers those on the "low quality" lending side like Thorn, Money3 and Cash Converters.

New Zealand fund manager Mike Taylor of Pie Funds agrees. He has recently taken profits in Silver Chef and invested in Money3.

He used to work for a bank. "We still like the sector thematic because banks provide personal loans but only to people with history with the bank or have a house. At the end of the day they love the security of the house."

There is regulatory risk in the sector. Taylor and Hills agree this has diminished following legislation implemented in March. The changes include capping loan charges at 48 per cent a year.

Richard Hemming edits www.undertheradarreport.com.au. He does not own shares in any of the stocks mentioned.

Investors in annuities bonds take on role of bank

LIZ MORAN

SMART INCOME

IMAGINE for a moment that you are in retirement (if you're not already there). Your investments need to generate an income to pay for those non-stop bills. The difference being that you no longer have the safety net of an income, so you really need to reconsider the risks you are taking with your investments. Any loss, however small, will have ongoing repercussions on your income.

The resurgence of annuities has been encouraging in the past few years as investors acknowledge the risks of only investing in growth assets such as shares and property. Annuities offer known payments over a fixed term but can also be "lifetime" investments. That is, once you've invested in the annuity, regular payments continue until your death, no matter what age you live to. They are great investments for retirees and can provide comfort that you won't outlive your savings.

The companies that issue annuities are regulated by APRA and conform to strict guidelines.

However, annuity returns can be low and it can be difficult to access your invested capital if you need it. However, there are bonds available that have annuity-like characteristics that provide an alternative. Indexed annuities bonds return both principal and interest at each preset payment date until maturity. IABs are tradeable investments and would constitute part of your estate should you die, but there isn't the regulatory oversight by APRA, nor the opportunity for lifetime investment. Just like paying a mortgage loan back to a bank, IAB investors take on the role of the bank and loan money to the issuer of the bond, the borrower. Investors can then expect interest and principal repayments from the IAB issuer over the life of the bond. In the absence of any indexation (inflation), each payment would be equal, consisting of part principal and part interest. This amount is also referred to as the base payment or base annuity. The base payments are indexed (by inflation) over the life of the bond. Assuming inflation remains positive, there is a steady increase in the payments until maturity.

IABs offer investors a cash stream that will increase with inflation, so are perfect for investors in retirement as well as investors seeking a known cashflow over time. The table shows some of the IABs available in the over-the-counter market.

Annuity bonds

Issuer	Maturity date	Yield to maturity	Current value*	Forecast cashflow 2014
Praeco	15/08/2020	5.65%	$65,192	$10,918
JEM (CCV) (County Court of Victoria)	15/06/2022	5.66%	$83,792	$11,121
MPC Funding (Melbourne Convention Centre)	31/12/2025	6.16%	$84,666	$8,664
Australian National University	07/10/2029	5.91%	$92,940	$7,617
Novacare Solutions	15/04/2033	6.76%	$92,453	$7,058
JEM NSW Schools II	28/11/2035	6.58%	$94,668	$6,844

**Note: Assumes a 2.5 per cent inflation rate (RBA target mid-point)*
Prices accurate as at November 13

All of the bonds make quarterly payments and the estimated returns are based on an assumption of 2.5 per cent per annum inflation rate (the Reserve Bank target mid-point). The bonds have different maturity dates and expected cashflows in coming years given the term to maturity and the return. One of our favoured bonds is the Australian National University IAB. The final payment is due in October 2029. If you were to invest $92,940 in this bond, estimated principal and interest payments to you in 2014 would be $7617. The estimated payments in the final year would be $11,071, but could be higher or lower depending on inflation over the 16 years. Based on 2.5 per cent inflation per annum the total cashflows would be $147,901, providing a yield to maturity of 5.91 per cent. The ANU IAB is the lowest risk investment shown in the table, but offers a high relative value return.

While the table shows high investment amounts, these bonds are available from $10,000 each with a minimum initial investment of $50,000.

On Monday, November 25, I will be presenting a webinar, "Fundamentals of Fixed Income", at 12.30pm AEDT. I will run through all the key components of the fixed income asset class and it's free for anyone who would like to register.

See www.fiig.com.au/seminars

Elizabeth Moran is a director of education and research at FIIG Fixed Income Specialists.

Business model fit for a king

Retail Food Group has got the franchise system all worked out

ROGER MONTGOMERY

FROM time to time, a national dialogue is raised about Australia's position in the commonwealth. For a period, the public questions the role of the British monarchy in Australia, before ultimately deciding that if the system isn't broken, don't fix it.

Monarchs have historically served a very real purpose within society by maintaining order while expanding the empire.

Of course, they would demand payment for providing these services. While history is scattered with fallen kingdoms, the fact that many are still functioning today is a sign of the long-term potential of such arrangements.

Comparisons can be drawn with the franchise model in business. The franchisor packages a chain of stores with established suppliers, controls the marketing of the brand, and co-ordinates the expansion of the portfolio. To participate in this arrangement, the franchisee will pay a royalty on sales, and will be required to pay for the majority of the costs associated with the store fit-out.

This arrangement removes a lot of the expenses and capital from the franchisor's financial statements, while providing the franchisee with favourable operating metrics.

Much like a monarch, this model is very attractive as long as the franchisees are happy (i.e. profitable). So how do franchisors successfully grow their empires?

The crown jewel of RFG's wholesale network is its coffee-roasting

The (Donut) King of all franchises in Australia is the Retail Food Group (RFG). Along with the deep-fried treats, the company also controls the following well-known brands: Michel's Patisserie, Brumby's Bakeries, Esquires Coffees, Crust Pizzas and Pizza Capers. While the company has over 1300 outlets in Australia and New Zealand, only in recent years has management been able to capitalise on this scale.

RFG has experienced prolonged issues with its supply chain, considerably reducing the range of products sold by its brands.

The company is putting the final touches on a distribution model that it hopes will be attractive to a national supplier.

The crown jewel of RFG's wholesale network is its coffee-roasting facilities, which distribute 1.35 million kilograms of beans annually to its network.

It is unlikely the company will release this asset while it continues to clip the ticket twice on every cup of coffee sold — once for the beans, and once for the beverage. A robust supply chain will allow management to focus more attention on invigorating its existing brands.

The company has expanded the Donut King menu to be more appealing to parents, and is introducing freshly made sandwiches in Brumby's stores. Michel's Patisserie is also being rebranded with a European flair. Such endeavours are important to improve foot traffic and keep existing franchisees happy, while significant growth to the empire will likely be achieved via acquisitions.

The core driver of RFG's recent growth has been the acquisitions of Pizza Capers and Crust Pizzas, which added 228 stores to its network. The divisions contributed meaningfully to earnings in the 2013 financial year, and management is hoping to capitalise on this success by rolling out a further 130 outlets in the next two years.

RFG has historically funded expansions and acquisitions with debt, which resulted in a high level of gearing. While current debt facilities provide $40 million for an acquisition, the company has used its rising share price to conduct a $55m capital raising. It now has a war chest to acquire a food chain of similar scale to Pizza Capers and Crust.

Much like the British monarchy, RFG's share price has experienced a surge in popularity in recent times, as positive sentiment abounds in the market. This popularity is certainly warranted with RFG, appeasing both franchisees and investors.

Roger Montgomery is the founder of Montgomery Investment Management.