Getting a handle on Ansell

by Roger Montgomery

Key points

- *Having aggressively pursued acquisitive growth in the past three years, Ansell is now beginning to see the benefit.*
- *The shift towards lean manufacturing resulted in $10 million of annual savings in FY11, but $20 million in annual savings in FY14.*
- *Ansell's share price and prospects offer a sufficient margin of safety to warrant a position.*

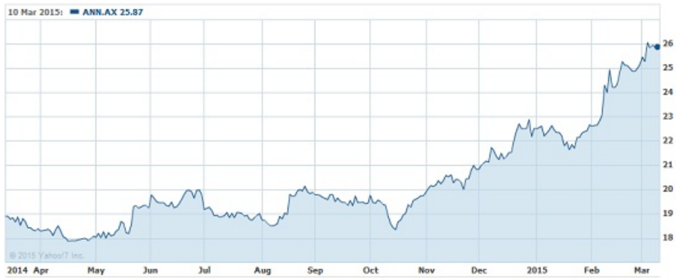
The share market has rallied sharply since the start of the calendar year, driven by investors demanding higher income. During this time however, we have maintained relatively high weightings to cash in The Montgomery Fund and The Montgomery [Private] Fund. One advantage of a higher cash weighting is the ability it affords to be an opportunist.

During reporting season, for example, we were quick to build a new position – that is already profitable – in one company after seeing a much stronger result than we had previously forecast.

Ansell develops intellectual property

The new addition is Ansell (ASX: ANN). Ansell is a global manufacturer of protection solutions, primarily gloves for customers in the industrial, automotive and life sciences sectors. Having aggressively pursued acquisitive growth in the past three years, the company is beginning to see the benefits that sometimes accrue to the largest player in a market.

Ansell



Source: Yahoo!7 Finance, 12 March 2015

Scale benefits are enormously important for manufacturers to remain competitive. With greater size comes greater bargaining power with suppliers, and higher volumes means greater economies of scale – leveraging a large fixed asset base.

Ansell is not a manufacturer of a generic commodity. While you may consider that one glove is like any other, Ansell has developed considerable intellectual property to set its products apart and that allows it to charge a premium. Gloves are not a material expense for most companies, yet hand injuries sustained by employees can be very costly. A few extra cents does not seem much to improve the safety of a company's workforce.

We are particularly attracted by Ansell's focus on its core brands. Companies are shifting away from niche applications, and are instead demanding products that are useful in any part of a plant. By rationalising non-core products, the company can better leverage its manufacturing facilities, while the sales force can deliver a stronger brand to the end user. Recall Henry Ford's iconic offer that you could buy the T-model Ford in any colour as long as it was black.

Strong leadership

And it's not just inorganic growth that is driving the company's improved performance. Since assuming

Arm's length dealings – the super law arm's length dealing rule says that when two parties are involved in a transaction, then the super fund must receive at least the same that someone dealing at arm's length would obtain.

Clearly unpaid rent means this isn't a normal commercial relationship. A larger arm's length dealing problem will occur if either or both of the following has occurred:

1. No bond has been paid.
2. The super fund trustee has done nothing to recover rent or apply penalties for non-payment as maybe provided for in the lease agreement.

In-house assets – this rule prohibits more than 5% of a super fund's assets, valued at prevailing market values, from being invested in related parties of the super fund. You as a fund member are a related party. Real estate that satisfies the business real property test is exempt from this test. Is this rule activated by the unpaid rent?

If there is a loan or some other financial assistance then this would be an in-house asset and a test would need to be run to see if the value of that assistance is greater than the 5% permitted limit.

How do you solve this problem?

Much depends on the time period for non-payment and the action the trustee has taken to recover the unpaid money.

If your super fund's auditor finds any super law breaches they will be reported to the ATO under the following circumstances:

- If your super fund is less than 15 months old, then any breaches valued at more than $2,000 must reported it to the ATO by your fund's auditor.
- If the same breach occurred in the current financial year and a previous financial year.
- If your fund had a breach in a previous financial year and you didn't fix it.
- If you breached a super law that has a statutory time limit (for example your auditor requested a document about your fund which you are expected to provide within 14 days) and you take more than 14 days, then your SMSF auditor will need to report that to the ATO.
- If the total value of all super law breaches is greater than 5% of a fund's total assets.
- If the total value of all breaches is over $30,000.

In my view, the best way to solve this problem is, ideally, not to let it happen in the first place. But if it has occurred, then the best bet is to fix it promptly and ideally before your auditor reviews your fund.

Alternatively, you will need to work with your fund's auditor and promptly implement any requirements they stipulate so that they can tell the ATO about the breach, but also say that it's under control.