Is Telstra about to turn the corner?

After a torrid first half there are signs things are improving

ROGER MONTGOMERY

DAVID GERAGHTY

Telstra CEO Andy Penn will give investors a better view on the telco's dividend policy and strategy next week

Back in February 2015, I warned investors buying Telstra shares that the 6 per cent dividend yield they were pursuing would be gobbled up by the inevitable decline in the share price, given it was trading at such a significant premium to a reasonable estimate of value.

As I said: "An investor buying Telstra today needs to consider that instead of that average 6 per cent per annum capital growth, they might experience something closer to zero. Or less than zero and a negative number that wipes out the positive return from dividends." Back then the share price was $6.59; today it's about $2.74.

The reason we couldn't establish a valuation anywhere near the price in 2013 was more than partly due to the fact that 100 per cent of the company's earnings were being distributed as a dividend, leaving little retained for growth. Investors at the time appeared to be so enamoured with the fully franked dividend that they were unable to see they were chasing the shares towards a cliff edge.

Three-and-a-half years later — it takes that long for the most widely held stock in Australia to react, with the share price down about 60 per cent, and the dividend policy adjusted to 70-90 per cent — it is worth asking whether Telstra now represents a more attractive investment opportunity?

It is fair to say that at the height of its popularity Telstra investors were thinking short term and focused almost entirely on the relative attractiveness of the dividend. At the same time, the long-term drivers of value — the retention of profits and redeployment at attractive rates of return — were probably being ignored.

Today we could argue that the same is happening again. Investors are focused on the short term without a view to the longer-term potential.

Telstra recently updated its full-year guidance. The problem for investors was that while the company guided to the lower end of its range, it noted that the one-off payments it receives from the NBN, for migrating its customers off the copper network and on to the NBN, would be at the higher end of the range. In other words, Telstra's core mobile telephony business was deteriorating more rapidly than many had expected.

Telstra is already operating in a competitive space. While it was paying all of its earnings out as a dividend for several years, it left the door open for competitors to catch up. Optus is just completing its billion-dollar spend upgrading 3G sites to 4G, buying regional spectrum, along with the 114 towers built with funding from the Mobile Black Spots Program.

TPG announced last year that it would pay the government $1.3bn for 4G spectrum and spend another $600m building a network.

Unsurprisingly, Telstra CEO Andy Penn is trying to make life difficult for competitors by cutting prices and winning customers. The impact is evident in declining average revenue per user. And all of that is on top of the clear hole in earnings that will be created when the NBN one-off payments cease.

A new Telstra?

The problem with all of the above, is that it is all well known. It is therefore likely to have been factored into the price. It is important to remember that telecoms is a scale business and margins and returns are highest for the largest players. The relationship exists globally. Telstra's leading position is difficult to replicate and all else being equal it should earn the large majority of industry profits.

Keeping that in mind, it's worth noting that neither the government nor the opposition wants to own NBN Co at the end of the next term. But how on earth can they sell it if NBN wholesale pricing for access remains uncertain?

NBN Co's new permanent pricing sets the wholesale cost of a basic internet service at $45 a month. For that $45, retailers can put internet users on a service capable of speeds up to 50Mbps and it comes with 2Mbps of bundled connectivity virtual circuit capacity to help users see those speeds during the evening peak.

But raising prices beyond that level will make the NBN unattractive to many and it would incentivise players like Telstra to invest more determinedly in the 5G network. That puts buyers of the NBN in a difficult position — charge less, attract more customers but don't make an attractive return, or charge more and push the competition to roll out the 5G network and lose revenue to a potentially superior offering.

This means that while fixed broadband profitability will never be as attractive as before, it is unlikely to remain as it is. One possibility is lower wholesale charges. Another is bypassing the NBN altogether for 5G and bring back home revenues that have been lost to the NBN. It has been reported that Telstra has a first and last right of refusal to buy parts of the NBN, especially the valuable hybrid fibre-coax network. That would put Telstra in the box seat and give investors a catalyst for a share price rerating.

It is also true that while investors have been focused on the short term, they have also focused on the negatives. They have chosen not to give much merit to the Telstra's announcements that the $1 billion cost-cutting program is not only on track but going so well that the target has been upgraded to $1.5bn. Longer term, the market appears to be giving little or no value to the possibility of higher margins and revenues from the Internet of Things.

Next week, Telstra's strategy day will give investors a better view on dividend policy and strategic intent. There's the possibility of a further dividend cut with more profits being reinvested. But there is also the possibility of the dividend being reaffirmed. One thing is for sure, the share price is much more interesting today than it has been at any time since 2010.

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

www.montinvest.com

Dream run: oil junior calls Rocky Mountain asset 'buy of the decade'

TIM BOREHAM

Elk Petroleum
(ELK) 7.2c

A year ago, the oil price was around $US45 a barrel and Elk chief Brad Lingo would have given the "Darryl Kerrigan" response to anyone predicting the commodity would rebound to $US60.

The oil bulls weren't dreaming after all. By January 1 this year oil indeed had hit $US60 and, thanks to Donald Trump's Iranian sanctions, the price hit $US72 in May and is now hovering around $US66 a barrel.

For Elk, this has made backing a horse called Aneth — its asset in the Rocky Mountains — a providential bet. Aptly, the $137 million deal was sealed on Cup Day.

"With oil prices where they are you might call it one of the buys of the decade," says Lingo.

Strictly speaking Elk acquired 63 per cent of Aneth, an oilfield in the wilds of Utah. Elk also has a smaller oilfield called Grieve and a gas project called Madden/Lost Cabin, both in neighbouring Wyoming cowboy country.

Elk's point of difference is that it is applying enhanced oil recovery techniques to what it dubs the "oiliest" of US oilfields. First deployed by Shell in the 1960s, EOR involves injecting carbon dioxide down the well to make the hydrocarbons flow to the surface. Rather like WD40, it loosens the whole thing up.

In Aneth's case, the field produced close to 500 million barrels over its lifetime, but only a third of its reserves base. Because the oil is pretty much known to be there, EOR is 90 per cent successful, which can't exactly be said for your typical wildcat well.

On Elk's sensitivities, a $US1-a-barrel rise in the oil price adds $US20m ($26.8m) to Aneth's net present value of about $400m. Last month Elk raised $13.5m in a placement and up to $7m more in a share purchase plan, partly to fund a $US16.4m expansion at Aneth. This will increase Aneth's reserves from 30 million barrels to 50 million and boost attributable output by 30 per cent, to 7500 barrels of oil per day.

Overall, Elk expects to chug out 10,000 barrels per day, with "potential" to increase this to 14,000 by 2022. In the meantime, Elk strips CO_2 from its Wyoming gas facility and sells it to other EOR producers. In fact, it's a bigger earner than the gas itself.

The former head of Drillsearch, Lingo says Australian investors have been focused on US shale production, which can look deceptively productive. The shale fields go gangbusters initially, but in some cases production falls by 90 per cent within three months.

In contrast, Aneth has a 3 per cent annual decline rate. "When I started I was determined to build a different company to what Australian were familiar with — production and engineering rather than exploration," he says.

"We're talking about long-life, low-risk, profitable oil-producing assets that are almost like annuities."

Leigh Creek Energy
(LCK) 19.5c (trading halt)

Leigh Creek management must be feeling like Fortescue Metals founder Andrew Forrest on opening his Cloudbreak mine, after an analyst earlier opined he would safely lie on the railway track to the site because the mine would never be built.

A South Australian underground coal gasification developer, Leigh Creek faced similar scepticism because of the misadventures of Peter Bond's now-defunct Linc Energy at its Chinchilla UCG site in Queensland. The market had been betting the SA government, which changed hands on March 17, would not approve the company's environmental permit. Yet the paperwork was signed on April 8, around the time Linc was found guilty of causing environmental harm at Chinchilla (the defunct company was later fined $4.5m).

Now, the company has started drilling the first holes to demonstrate first gas in the September quarter, while building a 30MW pilot power plant.

The first stage will be supported by a capital raising of $9m-$11m, announced on Thursday, by way of a placement and share purchase plan (at 16c a share, an 18 per cent discount). The second stage envisages full-scale base load power plants, or other options such as urea (fertiliser), methanol, diesel or ammonia production.

Having had its Twiggy Forrest moment, Leigh Creek needs to prove the project is not only environmentally safe and viable, but a commercial goer as well. Until it does, the company's reserves will be valued at a lowly 2c per gigajoule compared with an average valuation for its peers of 73c GJ.

Tim Boreham edits The New Criterion.

Tim.boreham@independentresearch.com.au

I retired in 2001 and rely on the age pension and dividends from a small share portfolio to meet my living expenses. I have previously lodged an income tax return via a tax agent to access my refund on the franking credits from my share portfolio. Do I have to lodge a tax return as I don't receive enough income to pay tax? Is there a simpler way?

Retirees who are eligible for the Seniors and Age Pensioners Tax offset (SAPTO) and have rebatable income of less than $32,279 as a single (or $28,974 each if a member of a couple) are not obliged to lodge an annual tax return provided they meet an extensive list of criteria. I have been asked this question regularly and certainly the only way to answer it is writing.

The way it works is that you would be obliged to continue to submit annual tax returns if any of the following 13 circumstances apply:

1. You receive income as a pay-as-you-go employee where tax was withheld.

2. Reportable fringe benefits were received by you in the financial year.

3. You carried on a business as a self-employed person.

4. You received a distribution from a trust.

5. Money came in from elsewhere: For example, you received income from foreign employment, investments or pensions.

6. You have not claimed your private health insurance rebate and wish to do so.

7. You wish to claim tax deductions for donations or eligible expenses.

8. Capital gains were made in the current year (losses) or earlier years that you wish to claim.

9. You own foreign assets worth more than $50,000.

10. You wish to claim tax deductions for donations or eligible expenses.

11. There are foreign assets in your name worth more than $50,000.

12. You made a personal contribution to superannuation and you are entitled to claim a tax deduction or receive the government co-contribution (for those under 71).

13. You have received an Australian superannuation lump sum where there was an untaxed component or you received a lump sum death benefit paid to you as a non-dependent.

Now, assuming that you do not fall into the above category and your income falls within the SAPTO limits, then you would not need to lodge a tax return.

It's also worth pointing out that dividends paid to shareholders by Australian resident companies are taxed under a system known as imputation. This is where the tax the company pays is imputed to the shareholders.

The tax paid by the company is allocated to shareholders as franking credits attached to the dividends they receive, typically the tax credit is 30 per cent.

If you are not required to lodge a tax return, you can claim a refund of the franking credits by lodging an "Application for a refund of franking credits for individuals" with the ATO.

You can lodge the form online, via www.my.gov.au, complete a paper form and submit the records over the phone or via post direct to the ATO in your capital city. Application forms for the 2018 tax year are already available on the ATO website. Processing of the refund typically takes two weeks for online or telephone claims.

Paper-based applications will take up to 50 days to process.

To order an application for refund of Franking Credits contact the ATO on 1300 720 092 or download the form www.ato.gov.au.

For further information, contact the ATO on 132 865 or visit their website.

Andrew Heaven is an AMP financial planner at WealthPartners Financial Solutions.

Andrew@wealthpartners.net.au

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