DIVIDEND DETECTIVE

Telstra fades for dividend hunters

Telstra
ASX CODE: TLS
SHARE PRICE: $4.50
INDUSTRY:
Telecommunications services
FORECAST FY2017 DIVIDEND:
31c fully franked

DAVID WALKER

Telstra has been one of the market’s most popular dividend stocks. But the telco recently held its dividend flat at 15.5c after a lacklustre result.

Telstra’s bottom-line result disappointed market expectations and the company guided towards the lower end of its full-year earnings range.

Telstra, led by Andy Penn, faces a complex, evolving competitive landscape. Rivals large and small are all focused on stealing from its legacy margins and market shares. There is widespread irrational price discounting to take share of the new NBN resale market in what the whole industry recognises is a once-in-a-generation opportunity to take marginally profitable share now ahead of hoped-for profitable cross-selling and upgrading later.

While data usage is growing rapidly it costs billions in capital spending to provide ever more capacity to meet this demand and the rapid pace of technological change adds further to the capex and depreciation bill.

Telstra is steadily losing its highly profitable fixed voice and ADSL revenue streams as customers switch to the NBN.

Compensation payments from the NBN are ramping up with the NBN’s rollout but Telstra still faces a $2 billion-$3bn earnings gap after the rollout completes in 2020. The best case is only that Telstra fills this gap and there are plenty of reasons why it might not. At the same time Telstra is struggling to increase profitably in mobile in the manner it used to. Interim mobile earnings dipped 3 per cent, the first fall in six years, because customer churn ticked up and average revenue fell sharply.

For many investors Telstra stands in the market very much like another leader of another sector, Commonwealth Bank. Unfortunately though it looks like these two titans of the market are going their separate ways.

While Telstra is down 13 per cent post-result; Commonwealth Bank increased its dividend by 1c to $1.99 and the stock is up 6 per cent.

Prolonged low bad debts expense in the banking sector and the different competitive structures of the banking and telco industries explain the different share price outcomes. The major banks compete on price but still price rationally and are lifting borrower interest rates together.

Also, upgrading digital customer interfaces is expensive, but not sufficiently large to overwhelm the banks’ ability to find offsetting cost savings and productivity gains elsewhere.

David Walker is senior analyst at Clime.com.au

Support a worthy cause (and make some money)

Impact investing need not be limited to the wealthy

ANDREW ZBIK

Michael Traill from Social Ventures Australia
DAVID GERAGHTY

One of the biggest investment themes in the US in recent times has been “impact investing”. In Australia it is clear investors are also looking to “do some good with money”. But one of the first issues encountered in this area is scepticism: what does impact investing mean exactly?

Put simply, impact investing is an investment approach that intentionally seeks to create both financial return and positive social or environmental impact that is actively measured.

For advisers working with Australian clients, opportunities in this area might include the ability to co-invest with the Australian Clean Energy Finance Corporation or the opportunity to invest in a Social Impact Bond.

SIBs such as the Newpin SIB in NSW, which deals with family restoration, or Aspire SIB, which has just been launched in South Australia to address homelessness, align private and public funds to fund programs that address social problems.

In an era of low rates there is considerable interest in these SIBs. However, the issue just now is not investor demand but rather the provision of product.

Despite the best efforts of pioneers in this area, including former Macquarie Bank executive Michael Traill, Rob Koczkar and Ian Learmonth at Social Ventures Australia, the sector remains very limited at this time.

In essence an SIB works through a return being paid on a program being successful.

However, to participate in opportunities like this, you may need to be classified as a “sophisticated investor”.

A sophisticated investor has more than $2,500,000 in net wealth or earns over $250,000 per annum. Of course, not every investor who wants to be an “impact investor” meets this criteria.

So how can common investors (ie, not “sophisticated investors”) deliberately invest in assets that make a social impact? Here are two ideas:

Finding right stocks

This is the most common way investors are currently trying to make a social impact. An investor can apply their own ‘’filters” to avoid assets that are involved with mining, minerals, gambling, tobacco and armaments.

For some of my clients, this has meant not holding companies like Woolworths, which owns ALH Group, which is one of the largest poker machine operators in Australia. At the same time investors are including companies such as Cochlear, a global leader in hearing implants, or companies such as Tesla, which is leading battery development technology and the manufacture of electric cars.

There are limitations to this option: filtering through the stockmarket is a time-consuming process, while using fund managers to pick shares also has its issues. New research from the likes of Standard & Poor’s is showing that active share managers are underperforming the general sharemarket over three and five-year periods.

Using ethical ETFs

Exchange-traded funds provide a great way for investors to purchase a basket of companies in a particular sector or index. An ETF significantly reduces specific company exposure. They can also be traded on the securities exchange daily like an ordinary share, they can be cheaper than managed funds and they are very transparent (you can discover the underlying holdings). Here are three ETFs worth considering.

- BetaShares Global Sustainability Leaders ETF (ASX ticker code: ETHI).

Provides simple, cost-effective and transparent exposure to a portfolio of sustainable, ethical companies from a broad range of global locations.

The fund owns stocks that have been identified as “Climate Leaders” that have also passed other eligibility screens designed to exclude companies with direct or significant exposure to the fossil-fuel industry or engaged in other activities deemed inconsistent with responsible investment considerations.

- iShares Global Healthcare ETF (ASX: IXJ)

The fund seeks to track the investment results of an index composed of global equities in the healthcare sector.

The index, the S&P Global 1200 Healthcare Sector Index, may include large, mid or small capitalisation companies, primarily in biotechnology, healthcare, medical equipment and pharmaceuticals companies.

- iShares Global Clean Energy ETF (Nasdaq ticker code: ICLN)

This ETF is currently not available on the Australian Securities Exchange but can be purchased on the Nasdaq if you have an international share broking account.

This ETF seeks to track the investment results of an index composed of global equities in the clean energy sector.

So as you can see, it remains early days in the impact investing space but with some careful selection, it is possible for Australian investors to start directing their investment to assets that satisfy the impact investing criteria.

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Calling SMSF operators: don’t put your head in the sand

MONICA RULE

Looming changes to superannuation laws to begin on July 1 create a range of challenges for almost everyone in the SMSF sector.

If you are an SMSF member who is aged 65 or is turning 65 before July 1 there several particular adjustments you need to be aware of to take full advantage of the current and the new superannuation laws.

If you haven’t made any superannuation contributions into your SMSF this financial year (2016-17), and have not made any in the past two financial years then it could be time to consider using the full two year bring-forward non-concessional contributions cap and make a $540,000 non-concessional contribution into your SMSF by June 30.

The transitional two-year bring-forward cap will be reduced to $380,000 from July 1 due to the new annual non-concessional contribution cap of $100,000.

This is because the annual cap for the current financial year is $180,000. When combined with the new annual cap for the next two financial years, the transitional bring forward cap will be $380,000.

If you have already contributed more than $380,000 non-concessional contributions but did not use the full $540,000 bring-forward cap, you do not have to remove the amount above $380,000 from your SMSF.

But if you have used only, for example, $200,000 of the current bring-forward cap by June 30, it means you can only put in a further $180,000 in the next two financial years due to the reduced bring-forward limit of $380,000. Separately, keep in mind that from July 1 the new law also requires your superannuation balance to be below $1.6 million in order to make further contributions.

Also remember that once a member is aged 65 they can access their superannuation savings in their SMSF, regardless of whether they are working or not. Also, members that are aged 60or over do not pay any tax on their superannuation benefits received from their SMSF.

So, for example: if an SMSF member (aged 65) has a spouse (aged 62) whose superannuation balance is much lower than theirs, they could consider withdrawing a lump sum and giving it to their spouse so that their spouse could take advantage of the $540,000 bring forward-cap before July 1. This is provided their spouse has not already used up the entire bring-forward cap. This is one way for you and your spouse to ensure your pension accounts do not exceed the $1.6m cap.

You could also consider splitting your superannuation with your spouse, where 85 per cent of your concessional contributions made in the last financial year are put into your spouse’s superannuation account. Of course the most you will be able to split is $29,750 (i.e. $35,000 x 85 per cent) which might not be enough to reduce your pension balance to below the $1. 6m cap.

Another thing SMSF members, who are currently in receipt of a transition to retirement income stream (TRIS), may not realise is that their TRIS will turn into an account-based pension once they turn 65 or retire from work. This means the new $1.6m transfer balance cap, limits the amount they can have in their pension account where investment earnings are exempt from tax. Therefore, they would need to consider either transferring the excess to their accumulation account or pay the excess out as a lump sum superannuation benefit. They also need to consider if they are going to apply for the transitional CGT relief to reset any of their TRIS assets that have been moved into the accumulation phase.

Please do not stick your head in the sand and think that the changes to the superannuation law will not affect you ... or that they are all too difficult.

As I said, it affects every SMSF member in one way or another.

By having basic understanding of the law, you can ensure you will have more money in your SMSF where investment earnings are either exempt from tax or taxed concessionally at a maximum of 15 per cent.

Monica Rule is an SMSF specialist and author of The Self Managed Super Handbook: Superannuation Law for SMSFs in plain English.

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Ridiculously valued Snapchat stock should be shunned

ANDREW BARY

Snap investors better be more patient than Snapchat users. The company’s shares look ridiculously valued after surging 59 per cent to $US27 from an initial public offering price of $US17 just last Wednesday, giving the company a market value of $US37.8 billion ($50bn). That’s a stunning 93 times its 2016 revenue of $US405 million. The parent of Snapchat, a popular instant-messaging service, isn’t expected to be profitable until 2019 or 2020.

Even assuming strong growth, it’s hard to justify more than half the current stock price. Snapchat looks more like Twitter, which fizzled, than Facebook which sizzled. Bears argue Snap will be constrained by a large but limited user base, which skews toward those 24 years or younger in North America and Western Europe.

Snap lost $US515m last year and its red ink deepened quarter by quarter. A flurry of cautious analyst notes did appear in the wake of the Snap IPO, but they did little to damp investor enthusiasm for what bulls view as the next Facebook.

Anthony DiClemente of stockbroker Nomura began coverage of Snap with a “Reduce” rating and a $US16 target.

He cited four negatives:
1. Slowing user growth
2. Slowing growth in monetisation of users
3. Fierce competition from Facebook
4. A rich valuation relative to current and future growth.

The bull case for Snap is that it offers a unique advertising platform targeting a young demographic that’s difficult to reach through television and other traditional media and that brand advertisers will pay to get it. However, huge advertising growth is already reflected in Snap’s stock price.

The company is valued at 34 times projected 2017 revenue of $US1bn based on its enterprise value (market value less net cash). Facebook fetches 10 times sales. Bulls are betting that Snap’s revenue can top $US2bn in 2018, but DiClemente is sceptical. “Snap has a niche audience. It doesn’t have the targeting tools of Facebook. It can’t customise advertising as well as Facebook,” he says.

Where’s the revenue?

Probably the most important financial measure to watch in coming quarters is revenue, followed by active daily users, which totalled 158 million in the fourth quarter.

If Snap can’t hit $US1bn this year in revenue and $US2bn-next year, the stock could get crunched. Continued slow user growth also is a risk.

“Without meaningful re-acceleration in user growth, which stood at just 3.3 per cent in the fourth quarter (relative to the third quarter), we do not believe Snap will be able to reach an audience large enough to justify an aggressive valuation,” DiClemente wrote.

Other issues for Snap include the challenge of reaching out beyond top-100 brand advertisers to the small and midsize businesses that use Facebook and Alphabet’s Google services.

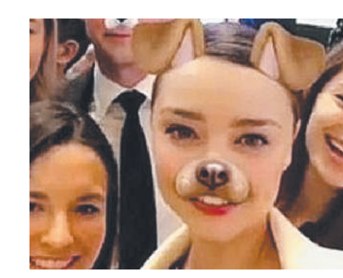
Then there is the potentially faddish nature of the Snapchat service and the difficulty in developing a large audience over 25. Snap users are believed to skew female, another possible limiting factor.

“Snap has a promising and innovative advertising offering, but so far it is still mostly unproven and difficult to quantify its ultimate scale,” wrote Brian Wieser of Pivotal Research Group, which began coverage of Snap with a Sell rating and a $US10 price target.

“Investors will also be exposed to what appears to be a suboptimal corporate structure operated by a senior management team lacking experience transforming a successful new product into a successful company.”

IPO investors received non-voting stock, giving them no say in the company controlled by chief executive Evan Spiegel and chief technology officer Robert Murphy.

The IPO was skilfully handled by underwriters led by Morgan Stanley, which appeared to put shares in the hands of long-term holders and minimised the number of flippers who got IPO allocations, then quickly sold the shares. Flippers usually are big institutional investors who, by virtue of their relationship with Wall Street underwriters, are rewarded with allocations of hot IPOs they have no intention of keeping.



Model Miranda Kerr celebrates Snap’s listing

Cable giant Comcast invested $US500m in the $US3.9bn deal (this assumes the full 230 million shares were offered). Buyers of a quarter of the IPO are expected to agree to a one-year lockup.

Bulls point to a huge opportunity, since Snap’s North America recent quarterly revenues of about $US2 per user are just 10 per cent of that of Facebook. But Snap’s current valuation assumes it can substantially close that gap. Snap had 69 million daily active North American users at the end of the fourth quarter.

If Snap does get 100 million users and hits $US20 per quarter of revenues per user ($US80 per year), it would generate $US8bn in North American revenue. Assume a 40 per cent operating margin and 35 per cent tax rate, and Snap would generate $US1.50 a share of net income based on the current share count of 1.4 billion.

Snap could continue to rally as institutions seek to build holdings, but recall that Twitter went public at $US26 in 2013, and soon hit $US74, before crashing to a current $US16.

Stay away from Snap. It’s priced for perfection.

BARRON’S