

DIVIDEND  
DETECTIVE

## Seven's offering a good number

ASX CODE: SVWPA  
SECURITY PRICE: \$71  
INDUSTRY: Diversified  
FORECAST DISTRIBUTION: \$4.886 a share

DAMEN KLOECKNER

In 2010, the Seven Network and WesTrac merged to form Seven Group Holdings, a conglomerate with exposure to industrial services, media and energy.

The group, led by Kerry Stokes, later rolled over its original preference shares to a new structure now represented by the SVWPA preference shares. These securities are redeemable, convertible preference shares entitling holders to a preferred, non-cumulative, floating rate dividend.

SVWPA's "floating" dividend yield is calculated based on a gross margin of 4.75 per cent a year above the 180-day bank bill swap rate (BBSW), which sits at 2.2 per cent. The effective gross dividend rate for SVWPA is, therefore, 6.95 per cent on a face value of \$100, but calculated on market price of \$71 is approaching double figures at 9.8 per cent.

This steep discount to face value reflects underlying volatility of Seven Group earnings, but the market has undervalued one particular aspect. SVWPA carries a dividend stopper that precludes payment of ordinary dividends for 12 months if a preference share dividend is not paid.

We think of it this way. In FY15, SVW generated underlying profit of \$204 million and operating cashflow of \$287m, and was able to comfortably pay dividends to ordinary shareholders. In FY16, despite guidance to a 10 per cent earnings fall, the likelihood of a dividend is equally high and, due to the dividend stopper, SVWPA's near-10 per cent gross yield is protected.

Of course, the payment of dividends is at the board's discretion and subject to sufficient funds. But, in our view, SVW presents as a solid business with a more moderate level of gearing. As a consequence, and coupled with the dividend stopper in place, the perceived risk of non-payment is relatively low.

Better still, as SVWPA's yield is not tied to SVW's ordinary distribution rate, forecast flatness will not affect the yield for preference shareholders. Although an investment in SVWPA brings with it more risk, the grossed-up yield of almost 10 per cent compares favourably to returns offered by term deposits.

In our view, it would take a significant decline in SVW's outlook for Stokes and the board to consider forsaking the preference dividend, particularly given SVW's ongoing share buyback, totalling more than \$46m to date, and demonstrates the board's capital management flexibility. SVWPA should be on the radar of all income-focused investors.

*Damen Kloeckner is an associate analyst at Clime Investment Management.*

# Home truths: using an SMSF to purchase foreign property

Overseas investments may be tempting but they're also risky

MONICA RULE



The lure of overseas property and the relatively low prices available — compared at least to our own metropolitan prices — continually tempts Australian investors.

It is hardly a surprise when we constantly read how you can buy a rural chateau or a quaint farmhouse for the price of a Sydney apartment that SMSF fund operators want to investigate what might be possible.

But all too often when self-managed superannuation fund trustees invest in overseas real estate, they ensure they do everything correctly in accordance with the foreign country's law but fail to ensure that their action complies with the Australian superannuation law. As a result their investment often results in a costly mistake.

The hard facts are that using an SMSF to buy overseas properties is very restrictive: obviously you must first satisfy the legal obligations of the region along with the variable currency and investment risks. But crucially, you must obey the rules of your fund and for many people that means you can only invest a maximum of 5 per cent of your total fund value in some regions, such as the US.

Whether an SMSF invests in properties situated in Australia or overseas, the legal requirements are the same. For example:

- The Sole Purpose Test: the property investment must be made solely to provide retirement benefits for members and cannot



An SMSF trustee should also consider the risks associated with forex fluctuations

be for private uses such as holiday accommodation in the foreign country.

- The Trust Deed and Investment Strategy: the property acquisition must be allowed by the SMSF's Trust Deed and be consistent with the SMSF's investment strategy.

- Arm's Length Transactions: the purchase price and rental income must be at the market rate.

Related party acquisitions: the property should not be acquired from members or related parties unless it meets the legal definition of a "business real property".

- In-house asset rules: the purchase of the property and leasing of the property must comply with the in-house asset rules under the superannuation law.

- Borrowing: any borrowing must legally comply with the "Limited Recourse Borrowing Arrangement".

What SMSF trustees often fail to consider before investing over-

seas is how their SMSF can own land in that country. The laws and customs of the country must be satisfied. If the country allows foreign investors to invest in real properties, without a local entity intermediary, then the SMSF will have no problem as long as it satisfies all the requirements of the superannuation law. The SMSF trustee will need documentary evidence as proof that the SMSF owns the overseas property and that the ownership is recognised in the foreign country.

In many countries, such as the US and Malaysia, a foreign entity cannot hold property directly. Therefore, an SMSF may need to establish a local entity that buys the property for the SMSF, with the SMSF owning all the interest in the local entity. The local entity may also need to be a taxpayer in the foreign country and pay tax. Because of this, an indirect investment in overseas real property can be a problem for SMSFs.

ised deposit taking institution which falls within the auspices of the Banking Act 1999. Unfortunately, overseas bank accounts do not comply with our banking law and therefore the SMSF investment in the LLC would be considered an in-house asset. This means the SMSF is restricted to an investment in the LLC of 5 per cent of the total value of its assets.

Therefore, an SMSF would not be able to invest in US real estate unless the total value of assets in the SMSF is more than 5 per cent of the property. If the property in the US is valued at \$500,000, the SMSF must have at least \$10 million worth of assets.

Another strategy commonly used is where some SMSF investors ask relatives who are resident in a foreign country (i.e. the local foreign entity) to be the property buyer when investing in the foreign real estate. In so doing, the SMSF's money has been provided to a relative to acquire a personal asset. This action contravenes the superannuation law as the transaction would amount to providing a loan to a relative of an SMSF, which is prohibited.

As for the specific currency risk, an SMSF trustee should also consider the risks associated with fluctuations in foreign currency and exchange rates. All superannuation assets must be converted into Australian dollars for financial statements. The dollar variations could affect other calculations in SMSFs such as member balances and minimum pension payment requirements.

Overseas investing is not easy, and trying to do it through an SMSF can be particularly difficult depending on local rules; it almost certainly means you must have a large and successful fund to even try this exercise. Overseas investments can be complex and also come with higher risk due to foreign laws and customs.

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## Why I'm not worried about houses, banks

DON STAMMER



What would you say are the key features of investment markets in 2015?

I'll mention my top five; interestingly, they have a common cause.

1. For many investors, returns over 2015 are looking paltry. On Australian shares, the average gain since early January is 3.4 per cent; on a 10-year government bond the return has been about 2.7 per cent; and a cash trust has paid around 2.2 per cent.

2. But two major asset classes have provided double-digit returns. Thanks to the Aussie dollar's 12 per cent fall against the greenback, Australians holding assets denominated in US dollars, and with their currency exposure unhedged, are well ahead for the 10 months. And median house prices in Melbourne and Sydney have risen by 12 per cent.

3. In August and September, sharemarket volatility heightened; bond markets stayed unusually calm.

4. In each of the major asset classes, investors are putting more effort into stock selection.

5. There's a lively debate going on as to whether investors should hang on to, or toss, their shares in Australian banks.

The common cause of these themes? It's the combination of the extremely accommodative monetary policies around the world and of the prevailing view of investors that these policies cannot generate the economic growth that governments and the monetary authorities have hoped for.

Easy money has done too little to boost global growth, but a lot to impact on investment markets.

As a result, share investors, who usually focus on the prospective earnings and on price-to-earnings valuations, are also having to decide how much to pay for shares while interest rates are negligible — especially shares with modest growth in earnings. As a result, small changes in sentiment can bring about big swings in share prices. The dominant sentiment of bond investors is closing in: a view the world is suffering secular stagnation — that is, rates of economic growth will be slow and inflation won't be a problem for a decade or so. Hence the strong demand for bonds, even though yields are at or about the lowest levels they have ever been. Housing markets differ a lot from country to country. In

Australia, easy credit and low interest rates have pushed house prices in the biggest cities well into boom-time levels.

Prospects are that monetary policy in the big four economies (and in Australia) will remain accommodative.

The US central bank says increases in its cash rate will be "gradual". China, which has reduced interest rates five times this year, hints at further reductions. The European Central Bank, which has the cash rate set at a negative 0.2 per cent and a heavy program of bond purchases, is willing to ease further, too. Japan is continuing to print money on an unprecedented scale.

What sharemarkets need, to move higher, are signs that the recent slowdown in world growth has about run its course.

Easy money has done too little to boost global growth, but a lot to impact on investment markets

I've been putting the case in this column that expectations for a hard landing for the Chinese economy seem overdone. In the US, too, growth forecasts seem currently to be unduly pessimistic.

Yields on government bonds — which on 10-year maturities have recently been 2 per cent in the US and 2.6 per cent here — seem unsustainably low.

When the Fed delivers its long-foreshadowed increase in the cash rate, or there are signs of global growth strengthening or of inflation returning, bond yields could move sharply higher, and at short notice.

The strong upward moves in average house prices in Melbourne and Sydney seem now to be running out of puff; and momentum could slow further as the cutbacks in lending for investment housing, the new requirements on banks to boost their capital, and declines in rental yields take effect.

But I can't see median house prices falling very much. In Australia, when house prices rise too strongly, the usual correction is to move sideways for an extended time. And that's one of the reasons I'm less pessimistic than a good number of other investors on the outlook for bank shares.

*Don Stammer chairs QV Equities, is a director of IPE, and is an adviser to the Third Link Growth Fund and to Altius Asset Management. The views expressed are his alone.*

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## Offshore focus shines light on semiconductor scene

CLAY CARTER



The semiconductor industry has been and will remain a key "enabler" for technological progress.

The fact is "computer chips" are no longer just found in computers; a typical car now uses an estimated \$US520 (\$730) in semiconductors, according to research firm IC Insights.

Advanced driver assistance systems, semi-autonomous and eventually autonomous vehicles will increase this exponentially.

Semiconductors are also used extensively in wearable tech, in the fast-growing, sensor embedded internet-of-things products and, of course, smartphones, which are constantly upgraded and so require smaller and more complicated chip designs.

According to analysts Gartner and Price Waterhouse Coopers, global semiconductors are a huge market, with sales expected to grow 28 per cent from \$US336 billion in 2014 to \$US432bn by 2019.

US-based Lam Research supplies essential wafer fabrication equipment and services to the semiconductor industry. It supplies the machines and processes that allow the world's semiconductor companies to make semiconductors.

I find it one of the most interesting companies in the technology industry just now, as it has created a powerful presence at the core of computing, chip fabrication.

Lam's customers include semiconductor manufacturers that make memory, microprocessors, and other logic-integrated circuits for a range of electronics, including cell phones, computers, tablets, storage devices and networking equipment.

The big names are on its order books: Intel, Samsung Electronics, Texas Instruments, Nvidia, and Qualcomm are among the

world's largest manufacturers of semiconductors.

Semiconductor manufacturing is a complex process and involves the fabrication of multiple die or integrated circuits (ICs) on a so-called wafer.

Lam also has products for "back-end" wafer-level packaging (WLP), an alternative to traditional wire bonding.

In addition, its products are for related markets that rely on semiconductor processes and require production-proven manufacturing capability, such as micro electromechanical systems (MEMS).

Lam is also exposed to opportunities afforded by significant advances in the architecture of NAND flash memory, now augmenting and even replacing hard disk drives.

These chips have shrunk over the years, taking up less surface area. Where chips were once flat, these new chips are built in layers to pack more data.

Lam has won the vast majority of the "etch" fabrication business at four of the major NAND flash

manufacturers: Samsung Electronics, SK Hynix, Micron Technology, and Toshiba.

For its key divisions the company is forecasting a 32 per cent share of the wafer fab equipment (WFE) spend in 2018, up from 29 per cent this year and just 26.5 per cent in 2013.

Lam estimates it had a high-30s share of the deposition equipment market, a low-mid 50s share of the etch equipment market and a high-teens share of the clean equipment market coming into 2015.

Wall Street analysts are well disposed to Lam Research, with 18 analysts having a buy rating and only two with a hold. Lam Research has a market capitalisation of \$US11.9bn and trades at an undemanding multiple of 12.9 times 2016 earnings a share.

Of course, it carries some risks.

- Semiconductor equipment stocks have traditionally been highly correlated to the expectations and volatility of the semiconductor cycle, in terms of pricing, unit levels, and demand patterns.

- Lam competes in the most

competitive and price-fierce segment of the semiconductor equipment markets, deposition and etch.

- Failure to develop new products and processes that address rapid technological change could risk market position. The semiconductor equipment industry is constantly developing.

- Lam Research drives a substantial percentage of its revenues from a limited number of products. This concentration may be subject to risks relating to a weak demand environment, competitive threats and technological changes.

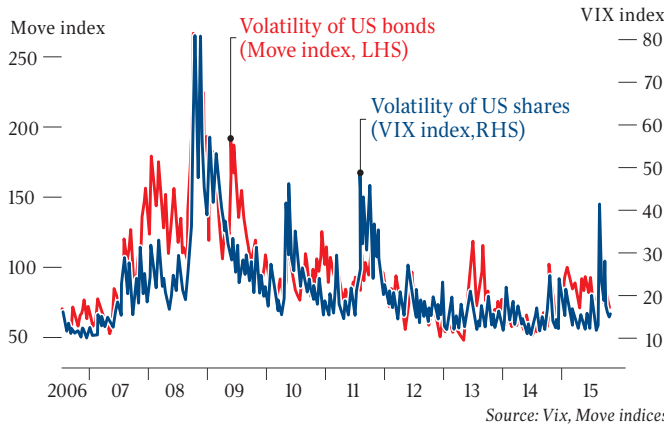
- The company relies heavily on international sales (80 per cent of total FY13 sales were non-US).

In many ways, Lam is a typical example of the sort of stock we simply don't have on the ASX — and we are unlikely to have anything like it in the near future.

On that basis alone, for the offshore focused local investor Lam is worth further investigation.

*Clay Carter writes on global equities for Eureka Report.*

Volatile times for shares while bonds stay calm



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