DIVIDEND DETECTIVE

Landlord opens up for yield seekers

INDUSTRIA REIT
ASX code: IDR
Security price: $2.35
FY1 value: $2.39
Industry: Industrial REITs
FY18 forecast distribution: 16.5c per share

DAMEN KLOECKNER

Industria REIT is a small-cap with an increasingly diversified and attractive industrial and fringe office property portfolio. IDR is a property pure play with no development activities, guided by an experienced external manager in APN Property (ASX: APD), making it ideal for yield-seeking investors.

Though IDR has been a solid and consistent performer since its 2013 listing, a very positive recent market update once again brought it to the forefront of our minds. Not only did IDR announce a move to quarterly distributions, it also confirmed funds from operations (FFO) would be at the top end of its guidance range. IDR also announced an 8 per cent uplift in net tangible assets (NTA) per unit to $2.26. As a result, gearing (total debt/assets) in FY17 is expected to be at the lower end of its targeted 30-40 per cent range.

The portfolio itself has also improved markedly in recent times. For one, it has significantly reduced its exposure to the Brisbane office market, which though much healthier now, remains potentially volatile.

In doing so, it has brought in attractive assets such as WesTrac Newcastle, diversifying IDR's geographical footprint and increasing its weighted average lease expiry (WALE). With occupancy of 96 per cent, a WALE of 7.8 years and conservative gearing, IDR's portfolio looks better than ever.

At current prices, it is trading at a modest premium to NTA, which is appropriate in this case. With an annualised yield in excess of 7 per cent and contracted rental increases of about 3 per cent per annum across its portfolio, IDR remains one of the most attractive income stocks in this space.

Going forward, manager APN Property remains highly aligned with IDR unit holders given it holds about 15 per cent of the REIT (plus an additional 7 per cent on behalf of its clients). For those with a nose for corporate intrigue, you may also notice 360 Capital, potentially a consolidator in this space, holds 18 per cent of the stock.

360 has recently been selling down property assets on its way to becoming a specialist property funds management group.

Damen Kloeckner is an analyst for the Clime Australian Income Fund. Clime Asset Management owns shares in Industria REIT.

www.clime.com.au/caif.

Standouts amid small caps

The stars are aligned for three stocks that offer good value

RICHARD HEMMING

Share investing in the new financial year is going to offer a new framework: we have rising interest rates around the world (there is even a chance of an RBA rate hike in the next few months).

As the game changes, investors could get more ruthless. If companies don't fit the growth tag, they get punished. On the other hand, if they present investors with genuine value, their shares receive a boost.

Looking at the next 12 months I see three standout opportunities in the market. But first every investor needs to get a grasp on the tempo of this market. Just look at the glamour "growth" stock Domino's Pizza Enterprises and its little brother Retail Food Group, which have both fallen about a third from their highs in the past 12 months.

Mind you, in the case of Domino's, this was preceded by a meteoric rise in its shares from $2.50 10 years ago to as high as $80. A lot of people made a lot of money. They're still making a lot of money in fact, at around $54 a share.

These companies both had an enviable track record of 20 per cent plus earnings growth, year in year out. They're both achieving 20 per cent-plus profit margins, 20 per cent-plus return on equity and strong dividend growth, underpinned by even stronger cash flow. These things are manna from heaven for your average fund manager.

So what's going wrong? People see this and extrapolate it out ad infinitum. When you're on a good thing, you want to believe that it will go forever. This is erroneous to say the least.

Both companies' business involves the franchise model, which is extremely efficient because it limits their capital outlays. Both businesses are also a form of roll-up where growth is achieved through increasing franchise numbers, which increases economies of scale. This works very well to a point ... until it doesn't, especially in a small market like Australia.

Domino's has more than 700 stores in Australia, most of which are franchises. When they had closer to 100 stores in Sydney it was a no-brainer going to 150, because the 150th store would have been much more profitable for them than the 100th.

The overheads don't change much (if at all). But at some point there are only so many outlets any particular market can sustain. It gets to the point where each new outlet runs the risk of cannibalising the sales of the pre-existing profitable stores. You get "diseconomies of scale".

Of the two businesses, the Domino's model is a superior because it's vertical whereas RFG's is horizontal. Domino's business is all in the same niche: pizzas. The same skills are replicated over and over again.

In contrast Retail Food Group owns different types of retail services businesses, albeit all involving food: Pizza Capers, Donut King, Michel's Patisserie and Gloria Jean's Coffees. There are some economies of scale, but there are different factors affecting pizzas (cheese and tomato prices) to those affecting the cost of a coffee.

Are these two worth buying after the fall? RFG looks much better value of the two, but it's notable that the franchise model in both cases is being closely scrutinised.

But here are three stocks offering demonstrable value:

• The Reject Shop:

The low-end retailer of household goods has a long track record in the local market. Although the stock has put on about 15 per cent already to trade at its current level of about $4.16, it remains on a price-to-earnings of less than 10 times earnings — a strong signal of value. Led since 2104 by Ross Sudano, it also pay a healthy dividend of about 5 per cent.

• Programmed Maintenance Services

The stock is priced at about $1.86 and a forward P/E ratio of 11 times. Programmed chief executive Chris Sutherland will have watched closely as rival Spotless Services was last week taken over by EDI Downer. Programmed pays a dividend of 4.5 per cent.

• Mayne Pharma

This health services stock had a very difficult few months, with issues in the US market, but it is now looking like a recovery story. Led by CEO Scott Richards, Mayne Pharma is trading at about $1.08 and a P/E of 14 times.

The last one is interesting because it is definitely a growth stock that has come back down to earth. It is a well-run company, which expanded too quickly a year ago when sentiment was too high, and brokers raised huge amounts of capital for the group.

Mayne Pharma shares have halved since then, which is why value is on the table now. Mayne's balance sheet is not stretched but it does have some 1.6 billion shares on issue.

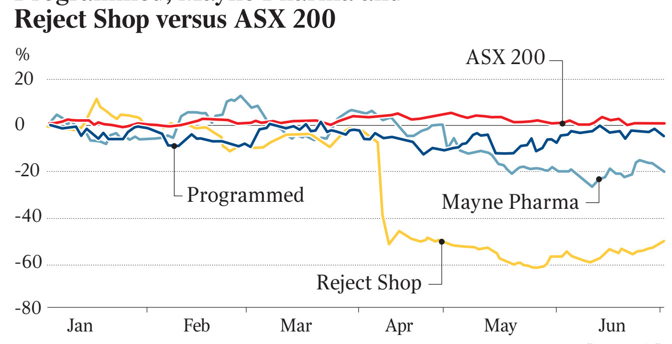
Of the three choices Mayne Pharma is perhaps most speculative but worth a punt at current prices.

Richard Hemming is an independent analyst who edits www.undertheradarreport.com.au, which provides investment opportunities in small caps.

DAVID GERAGHTY

Mayne Pharma chief executive Scott Richards in his Melbourne office

Programmed, Mayne Pharma and Reject Shop versus ASX 200



Source: ASX

Amazon threat: retail investors have choices

ELIZABETH MORAN

Disrupters are coming thick and fast and investors unaware of technological and social changes will be left taking stock of losses.

There is a long line of disrupters and technological advances that have put companies out of business — email and Google putting traditional post, yellow page directories and encyclopaedia out of a job, digital cameras leaving the inventor, Kodak in the dark, Uber, AirBnB, and now online US shopping colossus Amazon is coming to Australia.

The retail sector is perhaps the best case study of these changes. A generation of investors did very well out of Woolworths and Coles (through Wesfarmers) not to mention a string of related retail stocks at other times, such as Harvey Norman, JB Hi-Fi and others.

Now this paradigm is changing. The sheer might of Amazon, its online distribution model, cutting costs and delivering cheaper-end goods has Australian retailers shaking in their boots and with good reason. Last Christmas holiday season in the US, online shoppers spent $US91.7 billion ($119bn), with Amazon dominating sales with about 40 per cent of online purchases.

Survival v growth

Successful share investing is based on picking companies that will grow, but investing in bonds is more about survival as companies that survive will pay interest and return principal at maturity. Some successful bond issuers are companies that are in declining industries but are managing to downsize, consolidate and survive. Better to be a bond investor in that instance than a shareholder.

Best practice portfolio allocation suggests investors should always hold a mix of stocks and bonds, but the allocations should change depending on the market, the company's performance and individual circumstances.

If you are worried about the performance of your retail stocks you could look to exit and buy the bonds of retailers instead. We know there is a long list of Australian retailers thought to be affected by the arrival of Amazon — Woolworths, JB Hi Fi, Harvey Norman and Wesfarmers, to name a few.

Wesfarmers shares have done little over the last four years since February 2013 when they were priced around $40, where they traded again this week. Dividend yield is attractive at 4.89 per cent, but you would expect Target and Kmart to be hit hard by Amazon.

Woolworths has performed better than many expected after fierce competition from Aldi. Its shares have rebounded from about $20 to $25 over the last year, but the dividend yield is low at 2.63 per cent. It's hard to see how it can achieve significant growth in the face of such big competition.

Woolworths and Wesfarmers have bonds on issue and both are considered very good quality companies that are low risk, so the bonds pay low returns.

• Wesfarmers has a floating rate bond, maturing in November 2020 with a yield of 2.80 per cent a year.

• Woolworths has a shorter dated fixed rate bond maturing March 2019 with a yield of 2.42 per cent a year.

• Another retail bond paying greater returns is from health and beauty, consumable retailer, McPhersons. The listed company has a market capitalisation of $134m. While small, it has two high-yield bonds available, both with first call dates of March 2018 — a floating rate bond yielding 3.58 per cent per annum and a fixed rate bond with a yield of 4.65 per cent per annum to that first call date in nine months' time.

Real, monopoly infrastructure assets that are hard to replicate or be disrupted could be good additions to your diversified portfolio. Sydney Airport comes to mind, either the shares or the bonds. And there are a number of indexed annuity bonds with state government cashflows that appeal: Melbourne Convention Centre and NSW Schools. Neither are listed. But they are linked to inflation, real assets and they are great diversifiers.

* Note: Prices accurate as at June 30, but subject to change.

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

www.fiig.com.au

New financial year's rules for SMSFs should trigger a review of trustee duties

MONCIA RULE
SUPERANNUATION

According to the Australian Taxation Office's statistics, there are just under 600,000 self-managed superannuation funds in Australia. So what is an SMSF and what are the rules in establishing and managing an SMSF?

An SMSF is a small superannuation fund set up and run by people who are also its members. An SMSF can only have up to four members. An SMSF allows people to take control of their own retirement savings as members can choose what they want to invest in as well as control the fund's expenses. However, having this control comes with big responsibilities: whether a member is an individual trustee or a director of the SMSF's corporate trustee. Since SMSFs are regulated by the ATO trustees must carry out their responsibilities diligently or risk ATO compliance action.

An SMSF trustee, first and foremost, must comply with the rules of their SMSF's trust deed. A trust deed is a document that sets out the rules that govern the effective functioning of the SMSF. If a trustee fails to obey their SMSF's trust deed, other members of the SMSF have every right to take legal action against them!

Trustees must also comply with the taxation and superannuation laws. Failure to comply means risking their SMSF becoming a non-complying superannuation fund and losing its taxation concessions. Trustees can also face individual penalties. Depending on how serious the noncompliance is, trustees could be: disqualified, removed or suspended; subjected to civil and criminal prosecution; and risk financial penalties.

The superannuation law requires that an SMSF trustee must act honestly; exercise care, skill and diligence in managing their SMSF; act in the best interest of all SMSF beneficiaries; keep the money and assets of the SMSF separate from the assets they own personally; and, retain control over the SMSF and allow members access to information about the SMSF.

The purpose of superannuation is to provide death or retirement benefits for the members or the members' dependants. This also applies to SMSFs.

Therefore, an SMSF trustee must develop, implement and regularly review an investment strategy (including life insurance offerings) for their SMSF; determine members' eligibility to make contributions into their SMSF; understand the rules in paying superannuation benefits; and, ensure members do not access their superannuation savings if they are not legally entitled to do so.

Of course, money belonging to an SMSF cannot be used for personal or business purposes under any circumstances and it cannot be treated as an "emergency fund" when members face financial difficulties. Yet we know from the courts it is a regular occurrence: this is one of the biggest pitfalls of SMSFs — the temptation to access money when times are tough.

Managing an SMSF involves various administrative responsibilities and annual obligations. This includes keeping accurate tax and superannuation records; arranging an annual tax return for the SMSF; arranging valuations of the SMSF's assets; and, notifying the ATO if there are any changes in the SMSF's details. Trustees must organise annual audits of the SMSF by appointing an independent and approved SMSF auditor before lodging the SMSF's annual tax return.

As you can see, operating an SMSF involves much more work than just opening up a bank account. There can be consequences if you do disobey the relevant laws.

To maintain an SMSF successfully, you must have a good understanding of the trustee role as well as have the time and skills to manage your SMSF. Although a trustee can appoint other people, such as an accountant, fund administrator, or financial planner, to help manage the SMSF, the obligations ultimately fall on the trustee.

It is the trustee who has the responsibility and accountability for running the SMSF in a compliant, prudent, and honest manner. To be an effective trustee, you must be able to clearly make the distinction between yourself as a trustee of the SMSF, and as a member and beneficiary of the SMSF. Sometimes these roles might conflict so you must ensure you are wearing the "right hat" before taking any action.

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

www.monicarule.com.au