

## Appliance maker will boil up in good time

### DIVIDEND DETECTIVE

#### Breville Group

ASX CODE: BRG  
SHARE PRICE: \$6.05  
INDUSTRY:  
Cyclic Consumer Products  
FORECAST FY2016 DIVIDEND:  
28.0c

#### DAMEN KLOECKNER

With a five-year compound annual dividend growth rate of 17 per cent Breville Group (ASX: BRG) is interesting to the dividend investor. The fiscal 2016 dividend yield of 4.6 per cent is also enough to attract attention. The interim result for 2016 is due on 25 February. Should income investors add the manufacturer and distributor of kitchen appliances to their portfolios?

Just at the moment we would say not. Breville will be compelling at the right time and price but we lack conviction now, about \$6.10, is the moment to pull the trigger. There is no point buying a good dividend record if the share price falls by more than the yield. We value the stock at \$6.40 but, given the risks, would require a 10 per cent margin of safety discount to our valuation before becoming more interested. A price below \$5.75 could be attractive. (It is trading about \$6.13.)

Investors might be surprised to know the maker of their juicer or blender sells in several countries: New Zealand, the US and European and South American markets. This global diversification adds growth potential but reduces earnings visibility by increasing complexity.

The key points are: sales of Breville's premium kitchen appliances are correlated with economic conditions, group earnings are affected by multiple currency exchange rates, and competition matters.

The interim result should reveal a strong result in the US and Hong Kong and UK earnings boosted by currency translation, but margin pressure

in Australia, a lower result in Russia due to economic pressures from the plunge in oil, and a mixed outcome in Brazil. A new distribution agreement in the Latin American nation will have its first full-year effect, but Brazil is in recession, so results could disappoint.

Australia and New Zealand should contribute about 40 per cent of revenue. The region faces the twin headwinds of currency depreciation, which increases the cost of imported inventory, and competition that is leading suppliers of kitchen appliances to defer price increases to retain market share.

Both these effects were present in rival brand Sunbeam's results, announced as part of GUD Holdings' group interim result in recent days. Sunbeam sales grew 1 per cent, but profit margins fell 7 per cent and the joint venture supplying the range made a loss. Management indicated an 8 per cent price rise in February should generate a better second half but also flagged cost cuts would be necessary. Breville will have faced the same tough conditions.

The inventory cost pressures faced by the two brands are a microcosm of what most Australian importers and retailers face in 2016. Breville raised its prices in June last year, and some of these hikes stuck, but we would like to gauge the brand's pricing power by hearing how confident management is about going further in February as Sunbeam plans.

The North American operations should be the standout in local currency terms with a further translation benefit from the Australian dollar's depreciation.

We also await the strategy outlook from recently appointed chief executive Jim Clayton.

We like the approach of partnering with prominent "food thinkers", baristas and chefs to guide research and product development.

Now this approach needs to extend into integrating the Breville brand with customers' culinary lives.

*Damen Kloeckner is an associate analyst at Cline Investment Management*

The wealth effect is benefiting some and leaving others behind

#### RICHARD HEMMING



In this market nothing can be taken for granted. Take the fortunes of two companies in the same industry: furniture manufacturers Fantastic and Nick Scali. Fantastic's shares have halved in the past three years, while Nick Scali's have more than doubled.

Oscar Wilde's observation on losing parents could easily be applied to Fantastic at the end of last month: to lose a CFO may be regarded as a misfortune. To lose a CFO and a CEO in the same week looks like carelessness. The company has clearly endured a boardroom meltdown, but this does not alter the fact that while sales growth has been impressive of late, it has been erratic. For instance, 18 months ago sales were hit by a poorly managed product mix and the discounting strategy that followed.

Nick Scali, on the other hand, which sells the bulk of its furniture at higher price points than Fantastic, has been a model of consistency.

Two things can be taken from this for the upcoming interim results reporting season for a small-caps sector that is suddenly awash with enthusiastic investors:

- First, it's not possible to say that in any one sector it's all good (although in resources there is a case to make that it's all bad). Put another way, the divergence between good and bad stock picking has become more dramatic.
- Second, it seems that the rich are doing just fine and the rest are struggling. The wealth effect from rising asset prices due to the low interest rate environment is benefiting some to the detriment of others.

Small-caps fund managers certainly echo these sentiments. "Retail, for example, is all over the shop," says Pengana Emerging



Baby Bunting chief executive Matt Spencer presses the flesh at the Hawthorn store in Melbourne

DAVID GERAGHTY

Companies Fund's Ed Prendergast. "One retailer has gone broke (Dick Smith); there has been a profit warning from the jewellery retailer Lavissa; at the same time stocks such as Baby Bunting, Domino's Pizza and (KFC franchise owner) Collins Foods are growing well through internally generated measures and store rollouts." Prendergast's fund owns

Baby Bunting, Domino's and Collins Foods and he expects big things from them this reporting season.

Sigma Funds Management's Issam Eid laments the wealth effect on the markets: "There is no rhyme or reason for what global equities markets are doing, but it's definitely benefiting some and not others because of low interest

rates." Eid tips Telstra store operator Vita Group to offer a positive surprise this reporting season because of its consistent earnings profile and its increased focus on the small business segment, as well as retail. He also likes an Under the Radar favourite, scaffolding and labour supply group Global Construction. Other beneficiaries from the wealth effect

this reporting season may include the fashion retailer Orotan and the salmon harvester Tassal. Orotan, like many of the stocks I've been reporting on in these pages, is going through a turnaround, having failed in its strategies of not discounting and of replacing its lost Ralph Lauren lines with Brooks Brothers and GAP.

Orotan has now abandoned

the no discounting strategy — it has also give up on Brooks Brothers — but it's still hanging onto its GAP business.

Meanwhile, Tassal is integrating the Costi seafood operations and is one of the increasing numbers of companies that are benefiting from Asia's demand for Australia's food products.

Across the reporting season our currency depreciation will benefit exporters and companies that compete with importers. One that has already reported and surprised because of currency related profits is technology group and metal detector manufacturer Codan. Other stocks that might benefit include the ship builder Austal and the liver cancer treatment specialist Sirtex. Both have big US dollar-based revenue streams.

The average forward PE multiple for industrial small caps is about 17 times, compared with their bigger counterparts, which is 17.4 times. Expectations are for 6 per cent earnings per share growth for industrials, which compares very favourable with expectations in the broader market of a decline in EPS between 4 per cent and 6 per cent. Nonetheless companies will need to do better than this. Certainly in our sweet spot of companies where market caps are below \$300 million, many trade on single-digit PEs and on dividend yields of between 6 and 10 per cent. Hence there is much more scope to deliver a positive surprise.

While dividends are important, the two crucial factors for an investor are a company's balance sheet and its return on equity. Plenty of cash and not too much debt means that if there are problems in this increasingly volatile world, the company can handle them. A good return on equity means that those profits that are reinvested into the company will ultimately deliver even bigger returns through the compound effect, which is where exceptional growth in small caps invariably comes from.

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## Super law stops an SMSF running a business

#### MONICA RULE SMART INCOME



I am occasionally asked by SMSF trustees if they can establish a self-managed superannuation fund and use the SMSF to run a business.

An SMSF can invest in anything as long as it complies with the superannuation law. One area of the law that covers investment is the "sole purpose test". This stipulates that the purpose of an SMSF must be to provide retirement income for members or death benefits for the members' dependants. Any investment that provides the members with an immediate benefit, to which they are

not entitled, contravenes the superannuation law.

So, would an SMSF running a business contravene the law?

Yes, it would. If an SMSF is operating a business to generate non-superannuation income (such as salary or wage income) it is funding the day-to-day financial needs of its members so it fails the sole purpose test. An SMSF cannot directly run a business.

On the other hand, the superannuation law does allow SMSFs to invest in entities that carry on a business. Obviously there is a fine line between investing in a business and using the SMSF to run a business.

For example, if an SMSF is generating employment income for members then it is operating a business. Whereas, if it purchased shares in a company, to generate investment income for its members' retirement, then the investment is acceptable as it is seen as a normal investment.

If an SMSF member operates a

business under either a company structure or a trust structure, their SMSF would be able to invest in the company or the trust entity. However, the superannuation law does restrict related-party investments to 5 per cent of the total value of assets in the SMSF. For example, if an SMSF's assets are valued at \$500,000, then the SMSF can invest up to \$25,000 in a member's company which carries on a business.

However, if the member's business is operated under an "unrelated" entity where the member and/or their Part 8 Associates owns 50 per cent or less of the entity, then their SMSF is not restricted in how much it can invest. The member and/or their Part 8 Associates will need to make sure that they do not have any control over the entity. This is because an entity that is controlled by the SMSF member and/or their Part 8 Associates is treated as a related entity. Part 8 Associates include other members of the SMSF, relatives

and people in a partnership relationship with the member.

I do have to warn you that if you are thinking of establishing an "unrelated" entity with other people, it needs to be genuine and you do not control the entity. An ATO audit in 2011-2012 on the R Ali Superannuation Fund found the SMSF member established an unrelated company with another person.

The ATO investigation found that the co-director was only appointed to create an appearance of independence and did not have any input into the management of the company. As a result, the investment by the SMSF was found to contravene the superannuation law.

SMSFs cannot run a business. While they may invest in a member's business, great care must be taken not to contravene the law.

*Monica Rule is an SMSF specialist and author — www.monicarule.com.au*

## Floats are a better bet than investors realise

#### BEN BUCKNELL EQUITIES

Investors are understandably feeling queasy about the sharemarket after a particularly rocky January. Unfortunately, the doom-and-gloom commentary about what are almost exclusively top 20 stocks has done its usual job of scaring people off the best performing asset class over the long term.

The focus on global issues such as the oil price and China has pushed confidence down and taken eyes away from the initial public offering market in Australia. It's a market introducing a raft of innovative small to mid-cap stocks that, despite the risks out there, are simply getting on with business. (It's also a market covered very well in the IPO Watch column on these pages each Tuesday).

IPOs have, for the most part, delivered returns significantly

better than anything available at the big end of the market.

To be specific, a report just issued by accountants HLB Mann Judd, tagged IPO Watch Australia, notes that while the ASX200 index fell by 2 per cent during calendar 2015, the 85 companies that listed during the year had an average price increase of 10 per cent.

The challenge for the retail investor remains getting access to IPOs.

Our own OnMarket organisation launched seven widely available IPOs in 2015 that ended the year up an average of 42 per cent.

It's no secret why IPOs have historically outperformed: managed fairly and priced sensibly, they create a liquidity event where an asset increases in value thanks to the simple fact that it becomes readily tradeable.

Investors are of course taking a risk because they're buying into a stock that, in many cases, doesn't have an established trading re-

cord, but that should, again, be reflected in the IPO subscription price.

Don't take my word for it: a recent global study by US academic Dr Jay Ritter from the University of Florida's Warrington College of Business noted that the weighted average initial return to investors of the 1562 IPOs launched in Aus-

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tralia between 1976 and 2011 was 21.8 per cent.

Of course the occasional IPO, such as Dick Smith, will fail.

When an IPO does fail investors it ends to get far more airtime and coverage than the successful ones, thus potentially discourag-

ing investment in an area that's actually got a very good record throughout the cycles, which now stretch out to a generation.

What's more, not all IPOs take off in a way that makes the category a "cert" for investors, but a spread of IPO investments takes much of the risk out and certainly looks a great deal more inviting, in return terms, than either blue-chip equities or fixed interest offerings. Bank deposits, meanwhile, only give you very slightly more than your original investment back.

I'm not suggesting that all investor portfolios should solely consist of IPOs. But it's a reasonable proposition that a percentage of any well-diversified portfolio should go into IPOs, either as a short or long-term holding.

*Ben Bucknell is the founder of OnMarket Bookbuilds, an online investment access portal that gives investors direct access to ASX IPOs and capital raisings*

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### JOIN OUR FILM WRITERS AT A STAR-STUDED SCREENING

Join The Australian's Michael Bodey and David Stratton for a member-only preview of *The Daughter*. After the credits, you'll hear a behind-the-scenes perspective into the film's production in a Q&A with director Simon Stone and lead actors Odessa Young and Ewen Leslie.

*The Daughter* is a beautiful and confronting Australian drama also starring Sam Neill, Miranda Otto and Geoffrey Rush.

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