Switzer Super Report

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Finding yield

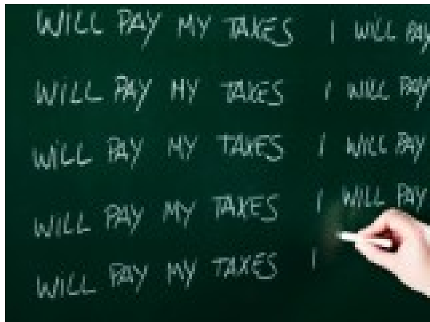
We've got some green on the screens for a second day in a row, setting a much happier mood for investors. But the temperamental slumps likes the one earlier this week are causing increased competition for high-yielding dividend paying stocks, and that's no surprise given low fixed interest rates. To help you out, I name some alternative income-paying stocks in my column today.

Also in the *Switzer Super Report*, Charlie Aitken believes the resources slump is hitting a bottom and there's one stock he expects to lead the turnaround. Plus, we look at how you can ride the US housing recovery, and we also explain what to do if you break your contributions caps. Happy reading!

Sincerely,

Peter Switzer

Inside this Issue



What to do if you break your contributions caps
by Andrew Bloore
08

02 **Six alternative income-paying stocks**
by Peter Switzer
Don't limit yourself to the big players.

04 **Time to shut your eyes and buy this stock**
by Charlie Aitken
A stock to lead resources higher.

06 **How to ride the US housing recovery**
by JP Goldman
This industry ETF is up 75% in the past year.

08 **What to do if you break your contributions caps**
by Andrew Bloore
The tax penalties are harsh.

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36-40 Queen Street, Woollahra, 2025
T: 1300 SWITZER (1300 794 8937) F: (02) 9327 4366

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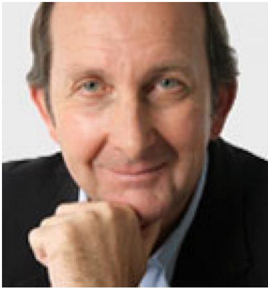

Six alternative income-paying stocks

by Peter Switzer

The hunt for income-paying stocks has intensified in recent weeks. Regular readers know this has been my recommended strategy for a couple of years as great companies paying good dividends looked like a safe approach while we waited for the inevitable big bounce that ends all secular bear markets.

The experts say our bear market started in 2007 while the Yanks kicked off theirs in the early 2000s. That said, history shows when the forces creating domineering bears dissipate, stock market bulls go mad and big rises happen.

Bounces in Aussie shares

In case you need reminding about how markets can ricochet, have a look at these local stock market spikes since 1980:

- 1980 48.8%
- 1983 66.8%
- 1985 44.1%
- 1986 52.2%
- 1988 17.9%
- 1989 17.4%
- 1991 34.2%
- 1993 45.4%
- 1995 20.2%
- 1996-2001 10% on average
- 2003 15%
- 2004 27.9%
- 2005 22.5%
- 2006 24.5%
- 2007 16.5%
- 2009 37.6%

Now my point is proven, let me return to income stocks that not only pay good dividends but also have potential for good capital gain prospects.

I asked Gary Stone from Share Wealth Systems to look for some income stocks other than the Big Four banks, Telstra and Coca-Cola Amatil.

Gary Stone's stock picks

Using his reading of market movements and the inherent potential for capital gain for a stock, he came up with the following companies:

- Tatts Group (TTS) with a yield around 8%
- Oroton Group (ORL) with a yield of 6.75%
- Retail Food Group (RTL) with a yield of 6.15%
- Amalgamated Holdings (HLD) with a yield of 5.56%
- NIB Holding (NHF) with a yield 5.2%
- Automotive Holdings (AHE) with a yield of 6.75% (but its P/E is in the 20s and might have less capital growth potential, but technical signs point to more upside, according to Stone).

Following my brief, Stone found 68 companies paying dividends over 5%. However, he said some, such as Tabcorp, could be a value trap. This is where the dividend yield is high percentage-wise because the share price is depressed. David Jones (DJS) could fall into this category.

Of course, some investors could be buying DJs because they believe the stock has been oversold, it has potential to nail the internet world or it is a takeover target, and they're all good reasons to make a play for the retailer. However, don't buy it because it has a current yield of 11.04% because that won't last!

DJs is still a good company and might pay a 5% dividend, but it has become a more speculative play until management gets its act together.

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Time to shut your eyes and buy this stock

by Charlie Aitken

In broking you do encounter many episodes of déjà vu. Right here, right now the capitulation in leading and wannabe Australian resource stocks is identical to what occurred at the peak of the US banking crisis in 2008. The difference is the underlying commodities haven't collapsed.

I remember back in 2008 getting hundreds of emails about the end of the commodity cycle, the end of Chinese demand, the end of commodity equities as we knew them, mass outflows/redemptions from commodity funds, Fortescue (FMG) going broke etc etc. BHP Billiton (BHP) bottomed at $21.90 then subsequently rallied to a high of $48.00 within 18 months. The gains in smaller, riskier Australian resource stocks were even more dramatic.

Déjà vu, but this is not 2008

However, this 2012 European sovereign debt and associated banking crisis has been far less dramatic in terms of commodity price falls than the 2008 experience. The difference between 2012 and 2008 is that the Lehman collapse and subsequent trade finance/credit collapse was sudden and caught EVERYONE unaware. The European sovereign/banking crisis has been a three-year slow burn, which in turn has dragged down Chinese economic growth. It can hardly be described as a 'surprise' and that is why corporations and individuals are holding record cash hoards.

Yet what the market underestimated back in 2008 was the twin power of trade finance being re-established and the commodity supply response becoming non-existent. As global growth reaccelerated, the world was again caught under-supplied in key commodities, which led to aggressive commodity price rises and aggressive share price rises in those who controlled large, low cost production bases.

This time around will be no different in my view.

The bottom

In 2008, the bottom was China Inc's attempt to buy Rio Tinto. That was the signal and I can't help but think China Inc's twin pieces of merger and acquisition (M&A) action in the global resource sector this week was that signal. Of course, when everyone is bearish/capitulating, the natural response is to dismiss these signals, but with the benefit of hindsight, it will prove to be one. Only time will prove me right on that.

BHP Billiton

The stock that bottomed first in 2008 was BHP Billiton. That was because it became ridiculously cheap, had a pristine balance sheet, and was still profitable even at the low point of the commodities rout due to its place at the bottom of every cost curve.

This time around, BHP is fractionally more indebted than in 2008 due to the US Gas purchases, yet where commodity prices are today (plus their production growth since), the company is dramatically more profitable.

They are making money every day the sun shines, but from the share price performance you could be tricked into thinking their earnings had collapsed. Believe it or not, consensus full-year 2012 forecasts for BHP actually rose after the solid fourth quarter production report, yet the stock went into free-fall because Spanish bond yields rose.

Today I wanted to simply look at BHP consensus forecasts for fiscal 2012 and 2013. My view remains that BHP's full-year 2012 result in August will be a 'buy the fact/short cover the fact' event as the company tones down capex intentions and steps up

the final 'progressive' dividend.

Instead of writing some 'what if' downside scenario to justify the current BHP share price, I want you to consider 'what if' BHP's full-year 2013 consensus forecasts prove right?

I don't believe there is any value at all generated by running 'downside scenario' analysis AFTER a $20 correction in BHP shares. Just look how solid the numbers are for 2013 in the table below.

The consensus view is that earnings per share (EPS) grow as production growth kicks in. The stock drops to trading on 6.1-times operating cashflow, generated from 48% earnings before interest, tax, depreciation and amortisation (EBITDA) margins. On current consensus forecasts, the payout ratio is 35%, which generates a 4% dividend yield. If the payout ratio was lifted to 50%, the stock would yield a prospective 5.5%, which is highly competitive with leading industrials that command up to double the EV/EBITDA multiples. BHP on 5.2-times enterprise value/EBITDA will prove grossly cheap, particularly if they lower the capex intentions.

Think of it this way. If BHP was simply to rally to its historic average price to earnings (P/E) ratio of 11-times its FY2013 consensus earnings, the share price target would be $36.74. If they concurrently lifted the payout ratio to 50%, the yield would be 5.5%, driving a total return of 26%.

As I have been saying, I believe the BHP Board and management are listening to the feedback about getting the balance between capex and dividends right. This should be confirmed when they report a $17 billion annual profit in August.

On that basis and considering the deep value in BHP shares, it is time to be a complete contrarian, shut your eyes, and buy some BHP into this capitulation stage, which will prove no different to 2008.

This is the bottom in Australian metals and mining equities. Right here, right now is my view. Straw hats in winter.

BHP Billiton (BHP)

Factors	*Concensus Data*	
	FY12	FY13
Sales ($m)	70228.70	74495.38
EBITDA ($m)	33130.05	35594.44
EBIT ($m)	26855.95	28335.04
Net Profit ($)	17343.23	18077.43
EPS (c)	322.45	334.72
DPS (c)	110.03	118.32
BVPS ($)	12.59	15.14
Operating Cashflow ($m)	24285.18	26881.96
Capex ($m)	16183.17	17816.56
OCFPS (c)	451.52	497.74
FCFPS (c)	150.64	167.85
EPS Growth %	-0.15	0.04
DPS Growth %	0.12	0.08
ROE %	0.28	0.24
ROA %	0.21	0.20
PE	9.47	9.13
PB	2.43	2.02
POCF	6.77	6.14
PFCF	20.28	18.20
EV/EBIT	7.03	6.66
EV/EBITDA	5.69	5.30
Div Yield %	0.04	0.04
Pay Out %	0.34	0.35
Profit Margin %	0.25	0.24
EBIT Margin %	0.38	0.38
EBITDA Margin %	0.47	0.48

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How to ride the US housing recovery

by JP Goldman

Although there are understandable concerns in the global economy – ranging from Europe's financial woes to China's economic slowdown – one bright spot is the steady improvement in America's housing sector. The fundamentals in this once stricken industry are turning around, providing opportunities for investors that don't mind dabbling in foreign markets.

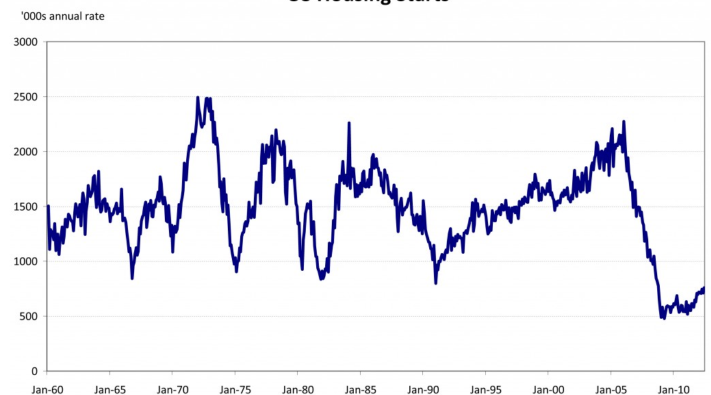
Many local brokers now offer relatively easy access to international markets – especially Wall Street – and with the advent of exchange-traded funds (ETFs), it has never been easier to gain exposure to favoured sectors without having to worry about which individual companies to buy.

An investment option

The SPDR S&P homebuilders ETF, for example (code XHB), provides exposure to just under 40 home building companies within the US S&P total market index. Among its top ten holdings is Home Depot, one of America's leading home improvement retail chains. Lowes, the hardware and home improvement retailer, is another large holding. There's also a collection of actual home building companies, such as Lennar and Toll Brothers.

Along with the US market overall, this ETF bottomed in early March 2009 at a mere US$8 compared with a peak of US$46 at the height of America's housing boom in early 2006. It has since enjoyed steady though not spectacular improvement, in line with the very sluggish improvement in the US housing sector.

Indeed, despite record low interest rates and the biggest downturn in US home building on record – with new home construction touching 50 year lows – the housing recovery has been held back by high unemployment, tight credit conditions, and excess stock of housing from the previous building boom.



Changing tide

Slowly, but surely, however, the sector's outlook is improving. After years of low construction, the backlog of excess new homes has been reduced. Falling home prices have also boosted affordability. An influx of former homeowners into the rental market has pushed up rental yields, making construction of new apartments more attractive. The early pickup in housing starts over the past year has been mainly in multi-unit construction, but even construction of single-family homes now also appears to be picking up.

US housing starts are already up 23% over the past year, but remain around half their average level of the past half-century.

More recently, there have been signs of a levelling out and even tentative increases in house prices. With greater confidence that house prices have stopped falling, sale of new and existing houses are also rising.

Strong stock price recovery

These improvements have naturally been reflected in the home building sector of the share market. The SPDR S&P homebuilders ETF, XHB, has been outperforming the S&P 500 index since around

October last year. While the S&P 500 has risen by around 25% since its lows of late last year, the homebuilding ETF has increase by 75% from US$12 to US$21.

As might also be expected, more analysts are jumping on the homebuilder bandwagon. Citing an improving outlook for the sector, Goldman Sachs analysts this past week upgraded their rating on homebuilders from 'neutral' to 'attractive'.

Of course, America's housing recovery is unlikely to become robust for a while yet. Indeed, the sector still faces strong headwinds from high unemployment, low consumer confidence, tight lending conditions given fragile bank balance sheets and ongoing European/China-related global concerns.

Interest rates are also at rock bottom levels and can't really go much lower. Last but not least, America faces a possible sharp lift in taxes and cuts in spending by the Federal Government early next year unless Washington can reach a speedy compromise after the November Presidential election.

All that said, interest rates are likely to remain low and supportive for several more years. And there is one thing investors can be sure about – America will need to eventually build houses again and in much greater numbers than it is doing at present.

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What to do if you break your contributions caps

by Andrew Bloore

Superannuation is a tax effective means of saving for retirement, so attractive that the Government imposes caps on how much you can put into super in any given year to make sure you don't reduce your taxes too much.

If you break these caps, a nasty tax penalty applies.

How much can you contribute?

Excess contributions are contributions made to your super fund that exceed your concessional or non-concessional contributions cap. The general concessional cap is currently $25,000 and the non-concessional cap is $150,000. You can read more about these different caps on our website.

These amounts are subject to excess contributions tax, with the amount of tax dependent upon which cap has been breached.

Excess concessional contributions are taxed at 31.5% in addition to the 15% already paid by the super fund when the contribution was received. This brings the total tax on the excess to 46.5%.

Excess non-concessional contributions are taxed at 46.5%. If an excess concessional contribution causes the non-concessional cap to be breached as well, the total tax on that amount equates to 93%. It becomes an expensive exercise for those who are not aware of their caps and contributions.

How excess contributions are determined

The Australian Taxation Office (ATO) will assess whether excess contributions tax is payable from information provided to them by the individual's super fund as well as their tax return. They will then issue an excess contributions tax assessment to the individual in writing. A release authority will then be given stating the date and the amount of tax payable.

The individual may pay the tax liability personally (for excess concessional contributions tax), or have their super fund release the amount of tax (for both excess concessional and non-concessional contributions tax).

Concessional Contributions

From 1 July 2011, eligible individuals who breach the concessional contribution cap by up to $10,000 will have a one-off option to request that these excess contributions be refunded to them rather than attracting the excess tax.

Conditions of this refund require the individual to lodge an income tax return for the relevant year, that it is the first time the individual has had excess concessional contributions from 2011-12 or later years, and only the first eligible breach is refundable. Once an individual has received a notice of offer, whether or not exercised, they are no longer eligible for the refund option in subsequent years, unless the contribution amount is amended and it removes the person from having excess concessional contributions in the financial year. This also applies to individuals who make excess concessional contributions of greater than $10,000.

The refund will become assessable income for the individual at their marginal tax rate.

Non-concessional contributions

Note: the following information has not yet been legislated

As indicated in a Superannuation Consultative Committee (SCC) meeting, tax payers will not incur excess contributions tax when an excess

non-concessional contribution occurs by inadvertently triggering the 'bring forward' rule. This concession will only apply where the contribution in question is of a small value.

Avenues of appeal

Amend the assessment: For incorrectly reported contributions, the super fund will need to provide amended contributions information so the ATO can amend the existing contributions tax assessment.

Object to the assessment: On the belief that the ATO has applied the law incorrectly.

Special circumstances: Applying to have your contributions disregarded or reallocated will be based on unusual, exceptional, abnormal or uncommon circumstances where applying the law would result in an unjust, unfair or otherwise inappropriate outcome. Consideration may be applied where the contributions would be more appropriately allocated to another financial year, whether it was reasonably foreseeable that the individual would have excess contributions when a contribution was made, and any other relevant factors involved.

Generally, the following factors in isolation are not considered special circumstances:

- financial hardship from having to pay excess contributions tax
- unintentionally going over the cap
- misunderstanding the law
- incorrect professional advice
- making a mistake.

It is extremely important that all contributions are tracked and monitored to ensure the caps are not breached. Whilst it may be possible to apply to the ATO for leniency, special circumstances are not granted frequently. Prudent management will be the best way to avoid excess contributions tax.

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Don't miss this!

Economists will be closely watching the housing data due early next week to gauge the health of the Australian housing market. Activity has been weak. Will the latest figures show signs of a turn around, or are the soft conditions set to continue? The new home sales data will be released on Monday, while the latest building approvals figures will be released on Tuesday.

You can find the results on the Switzer Super Report website.

Did you know?

Property is an attractive investment for your SMSF, but there are a lot of regulations you need to make sure you don't break. I had Kate Anderson from SuperIQ on my *SWITZER* show to talk about some of the most common problems SMSFs run into when investing in real estate. Hear what she had to say on SuperTV on the Switzer Super Report website.