Switzer Super Report

Issue 248 - 19 December 2013

Merry merry merry Christmas

The US decision to start tapering in January could bring a Santa Claus rally next week, but more importantly, it means next year will be a good year for stocks. If you want proof, just look at the almost 300-point gain by the Dow Jones overnight.

Today we have three large cap calls from Charlie Aitken, which he bets we will be partying on the proceeds of this time next year. We also have Margaret Lomas' property mythbusters for anyone considering an investment in the residential property market, and Tony Negline examines a court case that underlines how important proper estate planning is for your SMSF.

We'll be publishing a 'Best of Switzer 2014' on 2January 2 2014 and our first regular Monday report will resume on 6 January 2014. Here's wishing you a Merry Christmas and all the best for a profitable New Year.

Sincerely,

Peter Switzer

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Picks for 2014 part 2 – three large-cap calls

by Charlie Aitken

At this time of year, I tend to get a lot of questions about “what are your top picks for the year ahead?” More often than not, the answer is ‘same as this year’.

That’s not meant to be a smarty pants answer. History suggests your good ideas keep on giving and your bad ideas keep on taking. That is why in Part 1 of this series I encouraged you to cut losers, even some I may have recommended.

Today, I want to focus on three 2013 winners I think will keep winning in 2014. They should all offer strong total returns under the macro and micro scenarios I forecast for the year ahead.

Management is key

One thing I have learnt over the years, sometimes the hard way, is the no.1 variable in successful stock selection is management. The no.2 variable is management and the no.3 variable is management.

Bad management can wreck great companies, but good management can make great companies even greater.

At the end of the day, I am backing people running assets, not assets running people. This is a key point of differentiation in my approach, where I spend a disproportionate amount of time meeting company management and making a judgment on whether I want to back them, or not.

You can see in my notes that I often name CEOs I am backing. This is a deliberate decision so those CEOs know they are on the hook. They need to know there is a constant pressure to perform well for us, as custodians of our investment capital.

The other variable that has served me well is backing companies where management has a lot of personal “skin in the game”. To me, being co-invested alongside management teams with a large percentage of their personal wealth in the given stock reduces the probability of disastrous management decisions. It doesn’t eliminate risk, but, in my view, it reduces risk.

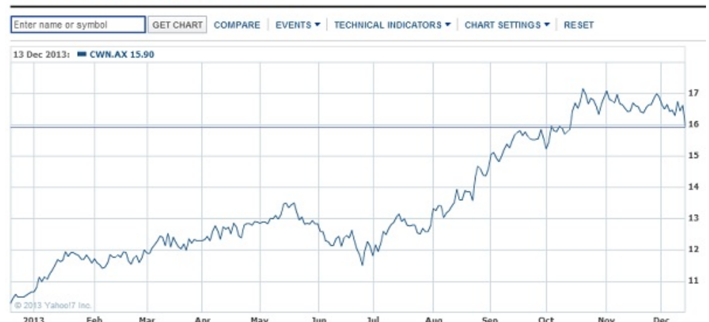
Industry position, barriers to entry, ROE and free cash generation are also measures I focus on in terms of stock selection.

In the case of all three stocks below, I feel I know management extremely well. They also all have very tight registers due to their billionaire majority owners.

Favourites for 2014

My three key picks for 2014 are Crown Resorts (CWN), Fortescue Metals Group (FMG) and Platinum Asset Management (PTM).

Crown Resorts (CWN)



Source: Bloomberg

All three are major beneficiaries of the falling Australian dollar and have leveraged to major macro themes I believe in.

Crown is leveraged to the rising Chinese consumer

class via Melco Crown Entertainment (MPEL.NAS) and inbound tourism. Fortescue is leveraged to a reaccelerating Chinese economy and market share gains in seaborne iron ore. Platinum is leveraged to "exporting Australian superannuation" and the outperformance of global equities.

James Packer is a winner, Andrew Forrest is a winner and Kerr Nelson is a winner. I want to be co-invested with those three as they experience macro and micro tailwinds.

Packer owns 50.1% of CWN, Forrest owns 34% of FMG and Nelson owns 57% of PTM.

All three stocks will experience consensus earnings upgrades in 2014 and concurrent P/E expansion.

In the case of Fortescue, a rapid balance sheet de-gearing will drive P/E expansion, as the stock becomes investable to all investors. This will be the year FMG truly "makes it" and the P/E ramifications will be large.

To me, the attraction of the three picks above is multi-faceted, but the key attraction is current price to growth multiples on consensus estimates, which I believe will be revised up as 2014 progresses.

CWN: FY14 P/E 18.2x, EPS Growth +36%

FMG: FY14 P/E 4.3x, EPS Growth +132%

PTM: FY14 P/E 19.5x, EPS Growth +44%

The year ahead

2013 was broadly about identifying the dividend yield compression theme. 2014 will be the year where the market focuses back on EPS growth. Cyclicals and growth stocks will lead global and local equity markets, while big dividend yield stocks will stay supported by those seeking income, in what will remain an ultra-low interest rate world.

I remain strongly of the view that the best total returning asset class in 2014 will be equities, but in an Australian equity context, we all now need more exposure to global growth equities.

US dollar earning global earners will lead the ASX200 in 2014 and that is why my three key picks for 2014 are exactly that.

That is the slight change to my equity strategy – more of a focus on global earners in 2014.

As Sam Chisolm famously said when he ran the Nine Network, "losers have meetings, winners have parties". Let's hope that in 12 months' time the selections above allow us to have a nice little party.

I hope you all have a safe and Merry Christmas, and a prosperous New Year.

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Six mythbusters for 2014

by Margaret Lomas

It has been a while since we have crashed into a new year in the midst of a property frenzy, and while it's not actually happening everywhere, there are certainly many parts of Australia that are either already too hot to handle, or where property is suddenly heating up beyond boiling point.

It always amuses me to see people who are too afraid to dip their toes in the water when the buying is great (that is, when no one else is doing it) suddenly joining the frenzied stampede, wanting to get in, at any price!

If you've ever had any interest in property at all, it's likely that interest has been piqued of late, and you're sitting eager for any tip to help you get the most out of 2014. So, as we close out 2013, here are some things to ponder – let's call them my annual myth busters!

1. Blue chip properties, in city CBDs, grow best

Those who insist that only Central Business District (CBD) properties qualify as blue chip property, and only blue chip property grows well, clearly do little real research and are overlooking the significant evidence that proves that it is not the location, per se, that impacts on how well a property grows. While location may play a small role in property choice, (which occurs last in the purchase process), initially there is an abundance of factors, which actually play a vital role in whether an area will grow well, or not.

I've purchased property in many areas, but only two within a CBD of a capital city. In our entire portfolio, these two have had the worst performance. Amongst the rest, some have been exceptional and some have been 'good', but these two CBD properties have had, overall, the lowest rates of growth and provided the lowest yields.

2. The 'regions' have good cash flow but lower growth

While the regions definitely do often show a better rental yield, most probably due to the lower buy-in prices and the relatively higher rent returns, it doesn't follow that they also perform less well in terms of their capacity to grow in value.

It's true that 'location, location' may be the key to good growth, it's not true that there is any link between that premise and the location being the seaside or the city. The characteristics that make property grow well have nothing to do with whether it is in the city or the country. Both the city and the country can grow well, and both can grow poorly.

3. You have to buy median priced property, or greater, to do well

When an area grows well, it's usually the result of what I call 'intrinsic' growth drivers. Intrinsic growth drivers are those qualities of an area that exist within an area – factors that are sustainable and ongoing, such as population growth, infrastructure planning, growing affluence and economic vibrancy.

When an area exhibits an abundance of such drivers, all property in that area will grow well, regardless of whether it is low-priced or median-priced. Sometimes, in such an area, the highest priced property grows less well and has a lower relative yield along the way, as there is less demand in higher priced property in any area.

4. You cannot have cash flow and growth in one property

Investors normally place themselves in one of two categories – those seeking value growth and those seeking good rent returns.

The whole point of buying property as an investment is to see an increase to the value of the asset, and the greatest possible income from that asset during the time that the investor owns it.

The belief that you cannot have both from the one property investment is simply not true. While some property has good growth with low yields, and others have good yields with low growth, the best property is one that has both! Further, buying property that has both is not only highly possible, but such property always exists somewhere, regardless of the present state of the economy.

The thing is, value growth and yield growth are often cyclical in nature, and, except in rare cases, hardly ever occur at the same time in one area. The trick becomes finding a property that has not yet had a significant increase in either, yet has all of the required drivers of growth in existence.

5. Market timing

You'll often hear property experts and those trying to sell investment property use the phrase, "It's not market timing, it's time in the market".

My theory is that this is said to help you deal with any short-term negative performance that the property they sell experiences! If you keep any property long enough, the sheer time that you remain in the market will most likely smooth out short-term negative growth and cash flow losses, and the property will be worth more than you paid.

Whether its future value is high enough to have made the overall performance strong or not is another thing, and often once you consider the holding costs, the overall returns can be dismal indeed.

In order to build the best possible property portfolio that you can – one which outperforms the average and contains properties that consistently deliver high returns, giving the greatest possible growth during the time you hold it – market timing is the key. You want to find an area on the verge of its boom, and have that boom occur during your period of ownership, and you want this to occur with every property you buy.

6. Knowing the area

Don't fall into the trap of believing that you should only buy in the area where you live because it's an area that you know well. What you know about your area includes information relevant to you as an owner occupier. The information most crucial when you are looking to invest in an area, is data that local residents are unlikely to know.

You don't have to live in an area to know it well. By the time I buy in any area, I can guarantee that I 'know' it better than the locals do. What I know about that area, though, relates to economics, and what the locals know is more likely to relate to lifestyle. Lifestyle features rarely create boomtowns, whereas economic vibrancy is the corner stone of a future hotspot.

And for 2014

The hotspots of 2014 most likely won't be where you live – so get out there, spread your search area, look interstate if you need to and let your fingers do the walking. Ask the right questions and you never even need to leave your own home to build a large diversified national portfolio!

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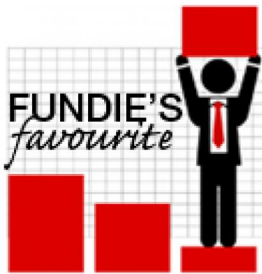

A new pharma to have faith in

by Fundie's Favourite

How long have you held Innate Immunotherapeutics?

We recently invested into the Innate Immunotherapeutics (ASX: ILL) initial public offering (the company's IPO is scheduled for tomorrow, Friday 20 December).

What does it do?

Innate is developing a drug called MIS416 for the treatment of Multiple Sclerosis ("MS"), specifically the secondary progressive stage of the disease. There are no approved drugs for the effective treatment of secondary progressive MS, so the drug has blockbuster (> $1,000 million) sales potential.

MIS416 looks to stimulate the body's immune system to reduce inflammation, protect and even repair some of the damage the disease causes to the central nervous system.

The company will commence a mid-stage clinical trial in 90-100 secondary progressive MS patients by mid 2014 and expects to report its clinical results in late 2015. We believe if the company is able to reproduce clinical results seen in both its earlier study and compassionate program, then investors can realistically expect a lucrative partnering or sales agreement with a big pharma in 2016.

What do you like about it?

We like the fact the data from an earlier clinical trial, as well as anecdotal evidence from the New Zealand compassionate patient program, indicated the drug actually reversed some recently acquired disabilities. The drug looked to be particularly effective at improving physical strength, energy levels and lessening pain.

These results are compelling, as drugs typically gain regulatory approval in MS by slowing the disease progression, not actually reversing some disabilities.

Another attraction is the company will have a fully diluted market capitalisation of just $45 million. This compares favourably with other neurologically focused ASX listed biotechs, which have performed very strongly in 2013. The Alzheimer's focused Prana Biotechnology (ASX : PBT) and Neuren Pharmaceutical (ASX: NEU) with its Rett Syndrome program, are broadly at similar stages of clinical development, yet capitalized much higher at $285 million and $150 million respectively.

We also like the fact that a high percentage of patients from an earlier New Zealand compassionate use program are still taking MIS416, with several patients having been on the drug for multiple years. We are encouraged to hear the New Zealand compassionate program has been extended and expect to be updated about patient experiences on the drug throughout 2014 and 2015.

How is it better than its competitors?

The treatment options for secondary progressive MS today are minimal and aimed at addressing individual symptoms, such as pain. We think MIS416 has disease-modifying qualities, as it appears to address a broader range of symptoms.

The company estimates the market for drugs in secondary progressive MS may be as large as US$3 billion per annum. There is a real gap in the global market for effective therapies for secondary progressive MS patients.

What do you like about its management?

Management is pragmatic and focused on doing a

deal around the results of the Phase II clinical study, due in late 2015. The technology was founded in New Zealand, but the attraction of the Australian R&D tax incentives and a broader MS patient pool has resulted in the company relocating to Sydney.

At what point would you sell it?

The stock is being listed at 20 cents tomorrow, Friday. This is a classical high-risk and high-return investment, albeit some clinical de-risking has already occurred from earlier studies and the anecdotal evidence from the New Zealand compassionate use program.

The upside is genuinely large (greater than 10 times investment) should the clinical data read positively. The upside will come through a partnering or a sales deal with a big pharma. In the meantime, there appears to be share price upside, as Innate Immunotherapeutics trades at an excessive discount to its listed peers. The catalyst for this discount to close may be news-flow from the enlarged New Zealand compassionate program.

Andy Gracey is portfolio manager of the Australian Ethical Smaller Companies Trust

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Measuring the shonks – or how to value a company

by Roger Montgomery

There are many skills that can help investors arrive at sound investment decisions. A good grasp of topics like strategy, finance, accounting and valuation is clearly high on the list, as is an ability to put together disparate pieces of information to form a cohesive picture of what is happening in an industry.

One skill that we think is highly relevant, but which doesn't get quite as much attention, is an understanding of how probability and statistics affect investment calculations. We humans have highly developed instincts that have helped us survive countless generations of natural selection, but when it comes to probability, we sometimes get the wrong end of the stick. In some cases, the answer that feels right may be very wide of the mark.

Lies and statistics

Let's look at an example. Suppose we have identified what we think is an excellent business, with an ability to raise prices year after year without impacting demand. What's more, let's suppose that we find this business trading in the market at a significant discount to our estimate of its intrinsic value. We think the company is worth $1.50 per share, but the share price is only $1.00.

There's just one problem: we have an idea that the CEO may be a shonk, and even though we think it's a good business, we clearly are reluctant to invest in a company where CEO shonkiness is likely.

Happily, we can go about our work on the basis that CEO shonkiness is a fairly uncommon problem – for argument, let's say that around 5% of CEOs fall into this category. However, our new company analyst has recently spent some time meeting with this particular CEO and, after reviewing the accounts, has a bad feeling about this one. Our analyst doesn't have decades of experience in the financial markets, but he studied Enron at university, and he knows a thing or two about accounting standards. We think he has an 80% success rate in spotting dodgy numbers, and in this case, he's satisfied that the books are being cooked. If he's right, we estimate that the value of the company will quickly halve to around $0.75 per share.

There are several dimensions to this problem, including questions of risk and ethics, but let's start with a relatively straightforward dimension – value. What do we now think this business is worth?

Finding a helpful valuation

Before we continue, think about how you would ascribe a valuation in this case. A helpful approach is to think in probability-weighted terms, but what probability-weighted value would you place on this company?

It's tempting to say that the business has an 80% chance of being worth $0.75 per share, and a 20% chance of being worth $1.50 per share, which gives a probability-weighted valuation of $0.90/share. At this level, we clearly would have no interest in paying $1.00 a share to own it.

However, this analysis is missing something. Even if our analyst has an 80% success rate at picking shonks, we need to keep in mind that CEO shonkiness is a rare problem, affecting only 5% of the corporate population.

If our analyst is right 80% of the time, then he's wrong 20% of the time. Think about what happens when he visits the 95% of companies where the CEO is entirely sound. If he calls "shonk" on 20% of these companies, then 19% of the total corporate population will be unfairly categorised in this way.

When he visits the 5% of companies where hornswoggling is rife, he will correctly raise the alarm for 4%, and incorrectly give a clean bill of health to 1%.

What this means is that across the population of companies, our analyst will call shonk 23% of the time.

He will get most of these wrong (19 out of the 23).

Conclusion

Taking into account the relative scarcity of shonky CEOs, we estimate that there is only a 17% likelihood that our particular CEO is a problem (four out of 23 such calls will be correct). On this basis, the valuation of the company can be estimated as 17% x $0.75 + 83% x $1.50 = $1.37.

This is not to say that we necessarily want to leap in and buy this particular company. The other dimensions of the problem require some careful thought. However, having thought about the analysis a bit more carefully, we now have a more accurate starting point in terms of value.

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Short 'n' Sweet – Aussie dollar and property

by Penny Pryor

Tapering will now start in January and it looks like the days of US dollar parity for the Aussie are over, at least for the immediate future. It might be bad news for your overseas holidays, but it's good news for US dollar earnings and anyone doing business in the States that has to swap currency back into local dollars.

CommSec chief economist, Craig James, in his annual "Big Issues 2014" report is forecasting the currency to hold from the low US80s to the mid US90s and he reminds us that the Reserve Bank Governor, Glenn Stevens thinks the Aussie battler should be closer to US85 cents. Something the Governor was reiterating yesterday.

AMP head of investment strategy and chief economist, Shane Oliver, also believes it is too high.

Charlie Aitken has been predicting 80c for a long time and his three favourite large caps today are all leveraged to this theme. "I have been bearish on the AUD/USD cross all of 2013 and I remain bearish for 2014. If I am right and the AUD/USD cross heads to 80 US cents in 2014, then we all need more exposure to US dollar earnings or direct US dollar assets," he said in Part 1 of his 2014 update.

And finally, the charts are also pointing to a much lower level. Gary Stone's analysis revealed that there is a high probability that the AUD/USD will continue to fall to around the US$0.79 – US$0.80 zone and on the way down, take a breather around the US$0.85 level.

Property

In his Big Issues 2014 report, Craig James also talks about a property "bubble" and echoes the views of Switzer Financial Group director, Paul Rickard, when he wrote back in September that: "There is no housing bubble in Australia".

James points out, that though values are increasing quickly in Sydney, this is from a very low base.

"Sydney is an 'outlier' with home prices growing at a slower rate than inflation for a long time. It was only 16 months ago that home prices were falling on an annual basis. Also, encouragingly, new home construction (supply) is lifting to meet the higher demand. And once that supply comes on to the market, then growth in home prices is likely to ease," he says.

Although there are plenty of SMSFs investing in residential property, for most that want a property exposure, the choice comes down to the decision between listed property trusts and unlisted commercial property funds. James Dunn's recent analysis revealed that the yields on unlisted commercial property are attractive and they are being made more accessible with smaller minimum investments.

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Buy, Sell, Hold – what the brokers say

by Penny Pryor

It was another slow week in analyst world as we creep into Christmas. The biggest news was the acquisition by IAG of Wesfarmers insurance underwriting business, which saw action from brokers on both parties, mostly on the positive side of the equation.

In the good books

CIMB Securities upgraded IAG to Hold from Reduce, following the announcement of the acquisition by IAG of Wesfarmers' (WES) underwriting business for $1.85 billion, strengthening its position in the Australian and NZ markets. CIMB notes the price is high but the deal looks accretive. The 10-year distribution agreement with Coles provides a new channel and also limits a competitive threat, although the broker thinks it could cannibalise existing business.

The recent decline in the share price means the valuation is less stretched and the broker thinks this acquisition will support earnings until Asian growth kicks in. BA Merrill Lynch, Credit Suisse, Deutsche Bank and Macquarie all left their ratings unchanged at Underperform, Neutral, Hold and Outperform respectively.

CIMB Securities also upgraded Wesfarmers (WES) to Hold from Reduce, following the announcement. CIMB asks whether the company will now look at buying a metallurgical coal asset at the bottom of the cycle or return cash. Given the negative franking balance, a dividend pay-out ratio above 100% is considered unlikely. The company may consider a capital return but CIMB notes this was not particularly popular last time with retail investors. The company has flagged the opportunity for counter cyclical investment in coal and a desire to evaluate acquisitions that offer economies of scale or downstream benefits.

Macquarie also upgraded Wesfarmers to Neutral from Underperform, following the deal. The price paid is significantly higher than Macquarie's valuation and the broker expects a capital return.

In the not-so-good books

Citi downgraded Amcor (AMC) to Neutral from Buy. As the company is about to be separated from spin-off Orora (ORA), Citi analysts have re-assessed. Bottom-line: while they ascribe a value of $1.10-1.20 to Orora, the price target for Amcor has only fallen by $0.56. The analysts think Amcor is already trading on a premium vis-a-vis international peers and a further widening of this premium cannot be justified.

Credit Suisse downgraded Gindalbie Metals to Underperform from Neutral. Credit Suisse is valuing Gindalbie on the assumption that Ansteel continues to assist with beneficial swapping of funding for Karara equity. Gindalbie has warned that a full solution to the problems may take all of 2014 and consume capex. Hence, the broker thinks Gindalbie's share will drop again, maybe to as little as 14%.

The above was compiled from reports on the FNArena database, which tabulates the views of eight major Australian and international stock brokers: BA-Merrill Lynch, CIMB, Citi, Credit Suisse, Deutsche Bank, JP Morgan, Macquarie and UBS.

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Get your succession planning right, or risk losing everything

by Tony Negline

Hopefully your Binding Death Benefit Nomination (BDBN) is robust and would survive any sort of challenge.

The outcome of a recent Victorian Supreme Court case provides an excellent example of how effective these documents can be, but also how your estate can be destroyed by warring heirs and successors.

Some background facts

Maxwell Morris died in late February 2010. At the time of his death, Morris was married to Patricia Morris, his second wife. They were the only trustees and members of the Morris Family Superannuation Fund, a self managed super fund, which had been established in August 2005. There were no other members or trustees of this fund.

At 30 June 2010, the fund had assets of over $1.3 million. Patricia's interest in these assets was about $450,000. The balance belonged to Mr Morris.

Since December 2005, they had both received super pensions.

In March 2008, Mr Morris completed a BDBN with all his super benefits to be paid to Susan Wooster and Kerry Smoel. Kerry was his first wife and Susan a daughter of that marriage.

In October 2010, Patricia Morris appointed Nathan Ashman to be co-trustee of the SMSF. (As the fund had individual trustees, at the date of death Mrs Morris was the only trustee and needed to appoint another person to act as co-trustee to remain as an SMSF. The super legislation gives you up to six months to appoint a replacement trustee but Patricia seems to have taken a bit longer to fix this problem.)

Between September 2010 and April 2011, Mrs Morris and the fund's newly appointed accountant prepared the fund's 2009 and 2010 financial year accounts and statutory returns.

Legal advice

In May 2011, the super fund's trustees received advice, which said that Maxwell's BDBN was invalid because it didn't meet all the requirements of the fund's trust deed. The trustee was also told that it would be better if the super fund's trustee was a corporation.

Not long after, Patricia and Nathan Ashman resigned as trustees and Upper Swan Pty Ltd was appointed as the fund's trustee. The sole director and shareholder of this company was Mrs Morris.

At this point, Upper Swan formally decided Maxwell's BDBN wasn't valid and therefore not binding on the trustee and transferred and divided his benefits between accounts held in Patricia's name.

In late June 2012, Maxwell's first wife and daughter commenced Victorian Supreme Court proceedings. They wanted a formal determination as to the validity of the BDBN and if it was valid, how much they were entitled to.

Special referee's determination

In September 2012, the parties agreed that a court-appointed Special Referee would determine the validity of the BDBN and how much should be paid to those nominated on it if valid. Later the court asked the Special Referee to award costs for the court action and his time.

In early March 2013, the Special Referee said the BDBN was valid and Maxwell's first wife and daughter from that marriage were entitled to his

account balance at the time of death (about $925,000) plus interest for late payment of the benefit.

The court case

The Supreme Court accepted the Special Referee's report and told the trustee to pay just over $600,000 of Maxwell's super benefit by 16 April 2013.

Upper Swan, now the SMSF's trustee, didn't pay this sum until early June.

In November 2013, the court decided that the remainder of the death benefit, plus interest for late payment, could be paid out of the super fund's assets (even if this meant that Patricia's own super account would be reduced). The Court ordered that this amount had to be paid by 14 November.

It also said that all costs for the case, including the costs of employing the Special Referee, would be paid by the super fund's trustee and Mrs Morris. In other words, Mrs Morris lost a substantial sum of money. No orders were made against Mr Ashman.

Key lessons

Almost four years after Mr Morris died, this matter is now almost closed. This is an extraordinarily long time. How many families could survive financially for this amount of time?

The case shows that SMSF BDBNs can bind a surviving trustee and also clearly shows how your wishes can be frustrated by that trustee, if they don't like the decision you made on that nomination. The case of blended families didn't help the situation.

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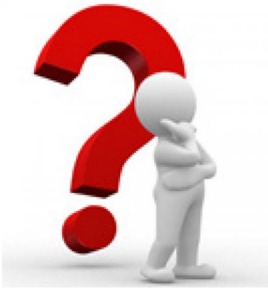

Currency risk and property trusts

by Questions of the Week

Question: *We hold a number of unhedged exchange traded funds (ETFs) – predominately China, Japan, Europe and, to a lesser degree, the US. Many expect the Aussie dollar to drop much closer to 80 cents. How would this event affect our SMSF?*

Answer (By Paul Rickard): Investment in China, Japan and Europe unhedged ETFs has two primary risks – the underlying stock markets (e.g. Nikkei for Japan), and the currency risk (back into Australian dollars – in the case of the Japanese ETF for example, the AUD/YEN cross rate).

In most cases, a fall in the AUD/USD to (say) 80 cents (1 AUD buys 0.80 USD) will be good for these ETFs, as the Aussie dollar should also weaken against these other currencies. It is probably not going to be 1:1, as the USD will tend to strengthen or weaken against all currencies. However, given the Aussie is widely considered to be over-valued, you would most likely expect it to fall in value as well against the YEN, Euro and Renminbi.

So, a fall in the Aussie dollar should, by and large, be a positive for these ETFs.

Question 2: *I've been sent a brochure for Charter Hall's Direct WorkZone Trust, an unlisted property syndicate investing in a newly-constructed A-grade office building located on the fringe of the Perth CBD. The major tenant is Leighton Contractors with a 12-year lease. The syndicate term is five years and aims to return around 9% per annum. My question concerns the long-term credit-worthiness of Leighton. Would you recommend investing in this syndicate?*

Answer 2 (By Paul Rickard): I don't know too much about the particular trust, however I would not be overly concerned about the tenancy risk.

The holding company (Leighton Holdings) is rated 'investment grade' by the major ratings companies (BBB for S&P, Baa2 for Moody's), with the current ratings one notch above the minimum for investment grade. The holding company is under a little bit of pressure at the moment, with the market worried that the current gearing level of 39% may deteriorate.

The major tenant of the proposed fund is a subsidiary – and you should check whether the holding company specifically guarantees its obligations in this case. That said, Leighton Contractors is a well-regarded company and I wouldn't be overly concerned.

Important: *This content has been prepared without taking account of the objectives, financial situation or needs of any particular individual. It does not constitute formal advice. Consider the appropriateness of the information in regards to your circumstances*