Switzer Super Report

Issue 267, 6 March 2014

All in the family

We like to think of the *Switzer Super Report* as a family and indeed we run the business as a family concern, with both my sons involved. Today Charlie Aitken explains why family interests make Seven Group Holdings an attractive business, and the only stock with mining services exposure he likes.

Also in the *Switzer Super Report* today, we have Ben Griffiths of small cap manager Eley Griffiths talking about one of their new favourites - Cover-More Group Limited. Tony Negline walks you through how you can ask the ATO directly for advice and in *Buy, Sell, Hold - what the brokers say*, Beach Energy gets an upgrade, as Woolworths is downgraded.

Penny Pryor explains why we're not a member of the bank-bashing movement in *Short 'n' Sweet*, Tony Featherstone examines how, and why, you might consider infrastructure and in *Questions of the Week* we answer queries about annuities and SuperStream responsibilities.

Sincerely,

Peter Switzer

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Seven Group Holdings on the way to $10

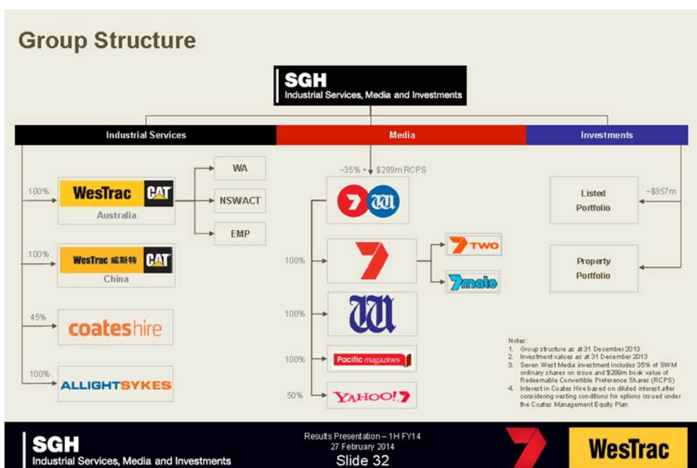
by Charlie Aitken

Seven Group Holdings (SVW) remains the only stock with any form of mining services exposure I recommend.

However, while Seven Group Holdings does generate a large percentage of earnings from the WA, NSW and ACT Caterpillar (WesTrac) franchises, that earnings weighting is falling, and unlike all other mining services related companies, comes into the downturn with the strongest balance sheet and highest liquidity ratios in its listed history.

Invest in the family

I see Seven Group Holdings more like a listed Family Office vehicle. With Australian Capital Equity (the Kerry Stokes Family) controlling 67% of the register, you are basically co-investing in a vehicle that replicates the sector and asset allocation, plus gearing levels, they are satisfied with. This is a good thing. The company structure is below.



The company describes one of its objectives as "*ensure an efficient capital structure and maintain prudent levels of gearing".*

"Retain sufficient balance sheet flexibility to fund the working capital needs of operating businesses through the cycle and to pursue growth and investment opportunities".

It would be fair to say the first half FY14 result confirms that objective has been met.

Gearing is not a problem

In recommending Seven Group Holdings over the years, the common pushback from potential investors has been "*it's too highly geared*". Fast forward to today and that is an inaccurate statement. In fact, I would argue that Seven Group Holdings is under-geared.

As at December 30, net debt to debt plus equity (gearing) was down to 15.6%, from 19.7% at June 30. Net debt fell from $764 million to $615 million. Cash and cash equivalents rose from $431 million to $524 million.

If you assume the $857 million listed equity portfolio is liquid, which I am assured it is, then adding that to cash and undrawn facilities of $1.078 billion, means Seven Group Holdings has $2.46 billion of available liquidity at its disposal. That is quite a war chest for acquisition or further diversification.

What I do like, is the first move the Seven Group Holdings board has made with that large war chest is to announce an 11.9 million ($100 million) on market share buyback. That tells me that the Seven Group Holdings Board feels that SVW shares are undervalued (we agree). While some might say 11.9 million ($100 million) is not a huge buyback, when you take into account that it is extremely unlikely (see also zero chance) that the Stokes Family (ACE) will sell any shares into the buyback, the buyback is actually 11.7% of the remaining free float of the company. That is a VERY significant buyback.

Increase in dividend

The other shareholder friendly move from the SVW Board is the lifting of the dividend payout ratio. The 1H FY14 payout ratio was lifted to 53%, which puts Seven Group Holdings on a 5.00% fully-franked annual yield, or 7.2% grossed up. Seven Group Holdings is underpinned by its attractive yield ("*the board aims to maintain and grow the dividend over time*") and, from March, an active on market buyback program.

What is also important for Seven Group Holdings sentiment is that there are signs that capital sales trends in Australia's for Caterpillar equipment have bottomed and product support revenue growth (maintenance & parts) is returning. Combined with a 25% reduction in headcount, suggests FY14 will be the earnings trough for WesTrac.

It's worth remembering that Caterpillar equipment is absolutely essential in the bulk minerals production process. For every one million tonnes of annual bulk commodity production, a given mine needs one CAT 250t dump truck. Produce 50mtpa and you need 50 of them, working 24/7.

CAT is a production growth and efficiency play. It is quite different to other mining services companies. They are helping the big miners in their productivity drive.

Driverless caterpillars

I caught up with Seven Group Holdings Don Voelte (CEO), Richard Richards (CFO) and Ryan Stokes (COO) last week and the most interesting aspect of the meeting was a discussion on autonomous trucks (driverless trucks). Yes, it sounds like a science fiction movie, but hear me out…

An autonomous 250t CAT truck saves a mining company $1 million per year in driver costs (5 drivers, full-time rotation). You also get greater truck productivity and less wear and tear. Safety is also better with automation.

BUT the big saving for the miners is all the fly-in-fly-out costs (FIFO) and ancillary services that mine workers expect (accommodation, food, pay TV, etc.).

Seven Group Holdings reckons the bigger savings for the miners are in these areas and that is why there is such a push to autonomous trucks and shovels.

The productivity gains autonomous gear brings to their customers (+ maintenance/parts) is not widely understood, nor is the just-in-time parts deliver service WesTrac has commissioned from a new state of the art warehouse in Perth.

The other point is the big miners can't put equipment maintenance off forever. You are starting to see the maintenance cycle pick up again and Seven Group Holdings make good margins in this area.

I am bullish on the WesTrac business, particularly now that I understand the broader mining customer benefits Caterpillar equipment automation brings.

Realising our Strategy: Mining Technology

- WesTrac's strategy is to deliver solutions that contribute to our customers' success
  - In Mining Technology we do this through deploying the Cat MineStar System
  - This delivers value for our customers by improving their safety and productivity, and provides actionable insight from automated machine data
- WesTrac is also working with Cat to lead the way in Autonomous Haulage Solutions (AHS)
  - WesTrac plays a key role in AHS deployment, project managing on site execution and process integration with customers such as FMG and BHP
  - We are also exploring further ways to strengthen our AHS proposition, piloting complimentary technology which supports AHS roll out

Other exposure

In the other Seven Group Holdings businesses, I am looking for an East Coast pick up in the 45% owned Coates Hire investment. Residential construction and infrastructure upgrades should drive demand for Coates equipment and I suspect you have also seen the EBITDA bottom in the Coates JV.

Seven West Media (SWM), 35% owned by Seven Group Holdings, has also bottomed and is entering an earnings upgrade cycle. I think Seven West Media looks extremely cheap (10.1x, 7.7% grossed up yield) and I wouldn't be against Seven Group Holdings creeping in on another 3% of SWM. In fact, there would be worse things that Seven Group Holdings could do with its war chest than buying out the

minorities in Seven West Media.

The 100% owned investment portfolio, run by Ryan Stokes, has done very well, beating all relevant benchmarks and adding value to the group. While the investment portfolio could be liquidated to fund a bigger acquisition, the point is, as a stand alone earnings and asset price stream, it is more than carrying its cost of capital.

Basically, I have come to the conclusion that FY14 is the trough EPS year for Seven Group Holdings and FY15 and beyond will see EPS growth, both organic and potentially acquired. Our estimates below show you are being paid 5.00% fully-franked at the bottom of the EPS cycle.

Earnings Forecast

Year end June	2013	2014e	2015e	2016e
Sales (A$m)	4934.2	3446.1	3609.6	3817.5
EBITDA (A$m)	686.0	415.2	445.1	510.1
NPAT (reported) (A$m)	486.4	225.7	237.7	283.8
NPAT (adjusted) (A$m)	396.7	225.7	237.7	283.8
EPS (adjusted) (cps)	124.8	71.0	74.8	89.3
EPS growth (%)	18.9	-43.1	5.4	19.4
PER (x)	6.4	11.3	10.7	9.0
FCF Yield (%)	2.0	0.5	0.0	0.1
EV/EBITDA (x)	5.2	8.6	8.0	7.0
Dividend (cps)	40.0	40.0	40.0	40.0
Yield (%)	5.0	5.0	5.0	5.0
Franking (%)	100.0	100.0	100.0	100.0
ROE (%)	13.1	7.3	7.5	8.6

SOURCE: BELL POTTER SECURITIES ESTIMATES

The people in charge

My final, but not least important attraction, to Seven Group Holdings is the board and management. The CEO used to run Woodside Petroleum, while the board includes individuals who have run Coca Cola Amatil, JB Hi-Fi, Nine Network, Seven Network and UBS Investment Bank. It's a strong and diverse board.

I continue to recommend buying SVW, collecting the 20-cent fully-franked interim dividend and being on the register before the significant on-market buyback commences.

My 12-month price target on Seven Group Holdings is $10.00 and the stock remains a high conviction buy. I note Seven Group Holdings has recently underperformed Caterpillar (CAT.NYS). I expect this gap to now close in favour of Seven Group Holdings.

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Why you need to consider infrastructure

by Tony Featherstone

A potential multi-billion-dollar privatisation of the Port of Melbourne could unleash a wave of public infrastructure sales and provide an opportunity for self-managed superannuation funds (SMSF) to invest in an asset class that deserves higher portfolio allocations.

The opportunity

In February, Federal Treasurer Joe Hockey flagged up to $130 billion of public asset sales, much of which would come from State and Federal ports and utilities.

Politics aside, infrastructure sales are an obvious strategy. Cash-strapped governments desperately need to fund new transport projects, to cope with population growth on city fringes. Selling assets to a cashed-up private sector, or attracting superannuation investment, makes sense. Superannuants have a useful self-interest in funding infrastructure that makes their life easier.

Industry and commercial super funds have long been attracted to infrastructure. AustralianSuper, for example, allocates billions of dollars to local and global infrastructure projects, and was an early, successful investor in various Australian airports, motorways and train stations.

The logic is simple: high-quality unlisted infrastructure assets sit on the risk/return curve between fixed interest and equities. Chosen well, these assets provide similar yield to blue-chip income shares, with less volatility and risk. That makes them ideal for long-term investors, such as SMSFs.

But accessing infrastructure investment, at least for retail investors, is not as clearcut as it seems. Much of the action takes place through wholesale funds that specialise in unlisted infrastructure assets, and are supported by giant industry or commercial super funds.

The SMSF strategy

SMSFs need a different strategy. Key options include investing in retail infrastructure managed funds, holding ASX-listed infrastructure funds, or buying global infrastructure funds that are unhedged for currency moves, and will benefit as the Australian dollar falls.

Funds are a good place to start, especially for SMSFs with lower risk tolerance. Morningstar lists 15 retail global infrastructure funds, although several have tiny net assets. The Magellan Infrastructure Fund, RARE Infrastructure Value Fund and Macquarie International Infrastructure Securities Fund stand out.

Magellan's fund had a four-star Morningstar rating and $555 million net assets at 31 January 2014. Almost 80% of the fund is invested in international tollroads, airports, energy and telecommunication infrastructure. Just over a quarter in the US, and a third is in Europe.

The fund has a five-year average annualised return of 18.3% to 31 January 2014. The management fee is 1.05% and a performance fee applies. That is a consistently good return in a lower-risk asset class, from one of the market's current star fund managers. Gaining infrastructure equities exposure through a fund, rather than buying shares directly, also improves diversification.

SMSFs seeking unhedged currency exposure can choose the smaller Magellan Infastructure Fund (unhedged). Those with at least $500,000 to invest might opt for the fund's wholesale version.

The RARE Infastructure Value Fund (unhedged) is

another option. It typically holds 30-60 global infrastructure euqities, giving exposure to assets in developing and emerging markets. It returned 26.1% over one year to 31 January 2014, and 14.1 per annum since inception.

The direct option

SMSFs that prefer direct investing have 15 ASX-listed infrastructure funds to choose. Although several are a good match with SMSFs, two stand out: Sydney Airport and APA Group. I favour infrastructure assets that have a monopoly-like position, in lower-regulated markets, meaning returns depend less on governments that decide price rises and the like.

Sydney Airport (SYD) is a good example. Politicians have talked about a new airport in the city's west – a risk for Sydney Airport – for decades. It is still all talk and no action. Sydney Airport's dominant position is unlikely to change for years, leading to continued growth for its investors.

The well-run Sydney Airport is not cheap, has plenty of debt, and the airline industry has a history of volatility. But Sydney Airport continues to tick higher as it attaches more airlines, and secures higher retail and car-parking fees.

Continued strong growth in Chinese tourism is another plus. Sydney remains the first destination for many international travellers, and Chinese tourists, in particular, have a habit of spending more time – and dollars – in airports. Growth in discount airlines is another long-term positive, and airport infrastructure has proven to be a far better investment than airline stocks over the years.

Like Sydney Airport, APA Group (APA) has an irreplaceable asset. It delivers about half of the nation's gas usage through its transmission pipelines, and has a consistent record of steady revenue, profit and distribution growth.

Rising population growth will underpin higher long-term demand for gas, although softer gas prices in the short-term could be an issue. With a 6.3% trailing distribution yield, APA looks the pick of Australia's energy utilities. SP AusNet also has a good record, but faces more regulatory challenges.

One important point to note – distributions from SYD and APA are not franked. There is a tax-deferred element for APA (which means that an SMSF in accumulation mode won't pay tax on that component), however it is only relatively small.

On balance, SMSFs seeking to construct and maintain a strongly diversified portfolio should consider three things: the weighting of infrastructure within their portfolio, and within that, the split between global and local infrastructure exposure, and currency exposure (for the offshore component).

Global infrastructure exposure through one or two well-performed managed funds, and holding a few key infrastructure stocks directly, such as those mentioned above, could improve the risk/return trade-off within the equities component of SMSF portfolios.

Tony Featherstone is a former managing editor of BRW and Shares magazines.

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A travel insurance company to unpack into your portfolio

by Fundie's Favourite

How long have we held the stock?

We have held the stock since its initial public offering in December 2013. Its somewhat disappointing debut on the ASX (-11% on day one of trade) has allowed our funds to significantly add to their holdings.

Source: Bloomberg, Data as at 6 March, 2014

What do you like about it?

We are always impressed with growth franchises that have seasoned, high energy but disciplined management teams. Cover-More is a specialist travel insurance and medical assistance provider, with operations anchored in Australia but spread through Asia and the UK. Significantly for investors, Cover-More commands a 40% market share and is twice the size of its next nearest competitor. The company is well positioned to participate in the continuing growth of outbound Australian tourism, as well as developing markets, such as China and India, where the company has nascent operations.

How is it better than its competitors?

Cover-More chiefly markets travel insurance and medical assistance products for travellers, whereas its competitors' travel insurance offerings are only one component in a suite of insurance products, as seen with Allianz, NRMA or One Path. It is probable that its after sales service, such as call centres and concierge services, are best of breed. We like the fact that the underwriting risk is borne by someone else (Munich Reinsurance) so the company is able to operate as a global service company, rather than having to carry much of the risk associated with claims management.

What do you like about its management?

We became comfortable rather quickly with group chief executive officer Peter Edwards. He has 10 years' experience in the travel insurance sector, which includes a senior management role with competitor, Allianz Global. He and his team have articulated a lucid growth strategy for both domestic and offshore markets. He is *au fait* with balance sheet optimisation, with the business able to operate a negative working capital model (suppliers effectively funding debtors) and healthy profit-cash flow conversion.

What is your target price?

We don't set share price targets for our investee companies, preferring a relative valuation methodology. Simply, as long as the companies underlying prospective earnings per share stream is appropriately rated by the market (PE Ratio) and the business maintains its superior qualitative features, then we will maintain our investment. Right now, the stock is trading on around 21 times for near term growth of circa 16%. We view the prospectus numbers to be on the conservative side.

At what point would you sell it?

We would have reason to consider a position if our investment process indicated the 'price-for-earnings-growth' was excessive and uncomfortably above market in the first instance. We would be alarmed if there was any meaningful change to senior management or any shift in the very supportive industry dynamics the company presently

enjoys. The travel insurance market has grown at a compound annual growth rate (CAGR) of 8.5% since 2008 and Cover-More's core markets of Australia, China and India are forecast to grow at rates well in excess of this pace. The company has a number of significant distribution agreements in place, with Flight Centre representing around 25% of Cover-More's FY14 forecast. This contract is not due for renewal until 2019, so for now, the only risk here is performance of that retail franchise.

How much as it added/subtracted to your portfolio?

The stock is up 6% from its December listing, following a very forgettable early trading experience. We expect good share price performance over the next 12 months.

Is it a liquid stock?

Very much so. The stock has found favour with a number of specialist small cap investors who have taken advantage of the liquidity bulge normally associated with a new listing to position themselves.

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Buy, Sell, Hold – what the brokers say

by Staff Reporter

As earnings season draws to a close, analysts seem already to be on holidays, with just a handful of actions so far this week. Downgrades outnumber upgrades but, as ever, analysts are conflicted, with at least one company, James Hardie, getting both.

In the good books

Credit Suisse upgraded Beach Energy (BPT) to Outperform from Neutral.

Beach has leverage to the rising prices for east coast gas, without the exposure to the downside of the export LNG projects. The company also has a quality oil business in the Western Flank.

Macquarie upgraded James Hardie (JHX) to Outperform from Neutral following its quarterly result, which beat the broker's expectations. The company also gave its shareholders a 125-year anniversary present in the form of a US28 cent special dividend. The company delivered an upbeat commentary and suggested more capital will be returned to investors. With Australia and New Zealand and the US showing positive trends in residential construction, the broker upgrades to Outperform. (See downgrade below)

In the not-so-good books

JP Morgan downgraded Aurora Oil and Gas (AUT) to Neutral from Overweight. The broker was waiting for Aurora's result before reassessing its view in light of the bid by Canadian company Baytex Energy in early Feb, just in case there were any potential deal breakers therein. There aren't, so with the bid highly likely to succeed, the broker has downgraded to Neutral, given the stock is trading in line with the bid price.

JP Morgan downgraded Ausdrill (ASL) to Underweight from Neutral. Although the first half results were broadly in line with JP Morgan's estimates, management is now forecasting no improvement in trading conditions in the second half. Gearing is a concern too for the broker, reducing the buffer against risks. The results also show the company has lost its strong link to mine production volumes in WA iron ore and Australian/West African gold.

Credit Suisse downgraded James Hardie (JHX) to Neutral from Outperform.

While capital management provides yield support, Credit Suisse has reduced the rating following the relative share price outperformance over the quarter. The broker is looking for a more attractive entry point.

Macquarie double downgraded Woolworths to Underperform from Outperform. Following Woolworths' first half result, management has tightened its FY14 guidance range to 5-7% growth from 4-7% growth, and the broker has downgraded its forecast to 7%. Macquarie suggests that while the outlook for food and liquor remains positive, as was evident in quarterly sales numbers, sales at Masters are still declining and the losses are growing.

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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Short 'n' sweet – bank bashers

by Penny Pryor

Regular readers of the *Switzer Super Report* will know our view on the banks, and in *Short 'n' Sweet* today we'll revisit that and look at how the banks have faired so far this year. The below chart shows the Big Four, compared to the ASX over the past year.

Source: Yahoo, Data as at 4 March, 2014

In response to the bank bashers, Peter first wrote about why it's ok to still hold banks in early February. He explained then that even if the banks have a sub-index year and rise just 3% from their lows, that's still 7-8% performance with dividends plus grossing up.

"I know there will be better buys this year, but they might not be stocks you will want to have in a crash, because not only will the share price fall by more than the banks, so will the dividends," he said.

Paul Rickard then followed up after some very strong earnings results and updates from three of the Big Four.

He pointed out then that the banks were in minor "cost-cutting" mode.

"Expense growth is being held, some jobs are going, and productivity and other automation benefits are helping to drive improvements in the bottom line," he said.

The biggest risk for the banks would be an increase in loan impairment losses (bad debts), which could be caused by sharply higher unemployment or a bursting of the housing "bubble". But neither of these things is likely in the short term.

Paul reiterated Peter's assertion that even if banks lag the market, bank dividends will always provide support and cushion any downward price movement.

His preferred pick is CBA over NAB.

Dividend daze

This bank bashing is all part of a theme about the days of dividend payers being over. But as Peter was almost tempted to say a few weeks ago – that's a load of crap.

"For lots of SMSF trustees, creating a portfolio, which has a great correlation with the index, for example Paul Rickard's dividend portfolio, which returned over 24% last year, makes a lot of logical sense," he said.

While that means it might be unlikely you will beat the index, it does mean you should be pretty relaxed about your fund under-performing, as it will have been built in for reliable returns in good times.

We know that the primary concern for SMSFs is income and we continue to like companies and stocks that can deliver that.

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How to ask the ATO for advice

by Tony Negline

Here's a motto for SMSF trustees – before doing anything, if you're unsure – check.

The obvious question, however, is who do you get information from and can they be relied upon? What happens if you later find out they were wrong?

Great questions which we will seek to answer here.

First, let's look at the two most common sources of information for SMSF trustees.

1. **Media** – research has constantly shown that SMSF trustees rely on various media for information, knowledge and ideas. On the whole journalists are skilled at communicating but aren't superannuation subject matter experts. They often turn expert information into something more digestible. But there are no guarantees the information is accurate or encompasses all relevant information. Super and tax laws aren't without their twists and turns and I have seen some journalists ignore important caveats on the basis that the material would be too boring or complex.

The Courts and the ATO are mostly reluctant to let you off the hook if you've done something wrong because of a newspaper or journal article or what you heard on the radio. In some rare cases, superannuation investors have successfully pleaded for leniency from the Courts because their primary information had come from newspapers.

1. **Professionals** i.e. financial advisers, SMSF administrators, lawyers and accountants – when given the wrong information you can always sue for negligence but you need deep pockets and oodles of patience. In many cases, your ability to get compensation will depend on the nature of a mistake and whether or not it's covered by an organisation's Professional Indemnity insurance policy. Sometimes you can complain to professional bodies (for free) and seek redress.

The ATO

So what's another strategy you can employ? The ATO offers you an avenue to get its views about your super fund or a proposed transaction. It allows you to apply for a Private Binding Ruling (PBR) for tax matters and for SMSF Specific Advice in relation to your SMSF.

These two documents serve similar purposes but deliver very different results.

1) Private Binding Rulings

These can only involve taxation matters – for example, taxation of super contributions, Capital Gains Tax, GST, super fund income tax issues, tax on super payouts and pensions.

You, or your advisers, apply for a ruling about anything in the tax laws. For example, you might want to know if you can claim your personal super contributions as a tax deduction. So, you apply for a PBR and provide details of your age, income etc.

Your question can be about something you have done or something you are thinking of doing.

The ATO has to respond within 60 days. If you don't get a response, then they're deemed to have answered your question in the negative.

The best thing about any ATO response you receive is that it legally binds the ATO. This means that they must abide by the document they sent you even if

they later change their mind on how the tax laws operate. For example, suppose the ATO initially told you that you can claim your super contributions as a tax deduction but it later decides that people in your circumstances can't claim this deduction. Because you have a PBR, your deduction would be locked in and can't be undone.

In most cases, their document also continues to apply even when a Court or Tribunal decides that the ATO's interpretation of the law is incorrect.

Your PBR could be overturned if the Parliament passed a retrospective law that outlawed something the ATO had specifically permitted. Fortunately, this doesn't happen very often.

If you don't like what the ATO says in a PBR, you can object. Within the required time frame, you firstly ask the ATO to review their work. They then have the same time to come back to you with their reconsidered views. If you're still unhappy, you can object either in the Administrative Appeals Tribunal or Federal Court.

A specific Commonwealth law demands that the ATO publishes PBRs. It does this on its website – http://www.ato.gov.au/rba/search/

Prior to publishing, they remove all relevant information about the specific taxpayer. I find these rulings a valuable source of information and give an excellent insight into what some taxpayers are planning on doing.

2) SMSF Specific Advice

These are very similar to PBRs except they involve superannuation legislation – for example, Limited Recourse Borrowing Arrangements, the types of pensions your fund can pay, super fund investments and so on.

The key difference between these documents and PBRs is that SMSF Specific Advice documents aren't binding on the ATO. That is, you can rely on these documents, but the ATO is free to change its mind later on.

If they change their mind, then they can seek any unpaid tax (if relevant) from you. In these cases, they probably would not apply any severe penalties as you acted on their initial information.

Because these documents aren't binding on the ATO, it doesn't publish them on its website.

A potential downside

It has been said to me that one reason not to ask the ATO questions via PBRs or SMSF Specific Advice is that it draws attention to you and might encourage them to have a closer look at your circumstances. This is one point to be mindful of.

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The pros and cons of annuities and SuperStream

by Questions of the Week

Question: I have been retired for several years with a couple of large term deposits. What do you think of Challenger annuities?

Answer (By Paul Rickard): Challenger is one of a number of life insurance companies providing annuities, including the Commonwealth Bank Group via CommInsure.

The product serves a purpose (for the very risk averse investor who wants relative peace of mind), and Challenger is certainly the market leader.

I am not a huge fan of annuities in this climate of very low interest rates because the returns are so low, and I think that over the long term, you can do better in a portfolio of tax-advantaged dividend-paying blue chip companies, with some other assets for diversification.

The provider of the annuity (Challenger) is largely investing your monies in the bond market – so after they take out any distribution costs, their product costs and their profit margin, you can see why the returns are so low.

If you are planning to invest with Challenger in an annuity, ask these questions:

a) What is the effective rate of return/interest rate on your initial lump sum?; and

b) Are there any commissions being paid to my financial planner or adviser? If so, you may wish to ask for the product option that doesn't pay commissions.

Question 2: With regard to SuperStream, I have briefly checked out the information on the ATO website and the service providers on the ATO register. We are very wary of the need to provide substantial information to a provider. Being sceptical, one can only assume that some time soon the ATO intends to require SMSFs to start paying the 15% entry tax at the time contributions are made. Is your team able to recommend a service provider that we can trust with so much of our personal and financial details?

Answer 2 (By Tony Negline): I've put together a few points that should help answer your first question:

- If your SMSF is large enough to be a "large business" taxpayer, then you would have to submit Income Activity Statements every month, like most large APRA regulated funds, and submit super fund tax every month.
- But as most SMSFs are small business taxpayers, they get a concession on how often they have to submit paperwork and tax payments.
- I can't foresee a time when this will change.
- Politicians and public servants are often greedy for cash flow (i.e. tax collections) and so anything is possible, especially if the Federal Budget continues to be in bad shape.

Your second question involves a service provider for SuperStream. There are a number of providers who have registered, and I haven't yet seen their proposed pricing. Your SMSF administrator may have developed a solution, and I note Australia Post is one of the providers. In any case, you only need one before May 2014 if your SMSF is taking employer contributions from a large employer that has more than 19 employees.

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.*

Switzer Super TV

Earlier this week, Paul Rickard and I sat down to talk about the last month in markets and what SMSF trustees should be doing with their portfolios, given our outlook for the next few months. You can find out all here.