Switzer Super Report

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Charlie Charlie, quite contrary

Today, Charlie gives us the low down on a "trading idea" in Qantas. Now Charlie can be a little contrarian. *Switzer Super Report* expert, Paul Rickard, for example, is not a big fan of airlines at all, just like Warren Buffett, but Charlie walks us through why it might be worth considering Qantas as a "trading" stock rather than a buy-and-hold proposition.

Also in the *Switzer Super Report* today, we have Margaret Lomas explaining all the things you can, and can't, claim for when it comes to property in our EOFY special. Roger Montgomery describes why the cloud makes Amcom a good buy, Gary Stone tells us why he's very glad he started up an SMSF almost two decades ago and in *Buy, Sell, Hold - what the brokers say,* QBE and Tower get upgrades.

Sincerely,

Peter Switzer

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Qantas is not going broke – target $2

by Charlie Aitken

As you know, I am a *measured* contrarian. The biggest money you make is buying the nadir of pessimism and selling/shorting the peak of euphoria. Of course, this isn't a perfect science and is more about mass psychology, consensus analyst views, investor positioning, media/social commentary and momentum assessment.

In terms of contrarian buying opportunities, **the key is to the pick the turn.** Waiting for the knife to stick in the deep value floor is the key, then picking up that still vibrating knife.

The Qantas story

That brings me to QANTAS (QAN), where the stock has rallied 42% from its December 2013 low and 33% from its post-interim results lows in March 2014. I think that clearly shows you Qantas has found a deep value floor at $1.00 and the knife has finally stuck.

What interests me the most about Qantas is who has been buying the shares. **Two deep value US funds now own over 25% of Qantas** combined and the question then becomes what do they see that just about nobody else domestically sees?

They obviously see deep value in their modeling, but I suspect they see the US examples of how United Continental (UAL) and American Airlines (AAL) have traded out of bankruptcy protection/major loss making periods to be very strong performers on Wall St. The United Continental and American Airlines examples are relevant to Qantas, except I would suggest Qantas is two years behind the two big American carriers, which used bankruptcy protection/near death corporate experiences to accelerate the sustainable cost out program. Below is a chart of UAL, AAL, and QAN (blue line) on a common performance base over the last year.

Yes, I can hear you all saying *"airlines are terrible companies"* and *"Warren Buffett says never buy an airline"*, but Warren never said "never trade an airline stock". **Airline equities are GREAT trading stocks.** They will probably never be truly investment grade, but **they are GREAT trading stocks for multi-year periods.** The US example shows you the alpha that can be generated when they turn and that is why I remain focused on Qantas as a trading idea.

To me, Qantas has all the attributes of other Australian deep value turnaround situations we have made money in. It has a great brand, arguably one of the most recognisable in the world. It operates in a domestic duopoly, while Australians will always have some form of home bias towards its international offering. The Frequent Flyer/loyalty business locks in customers. The group should and will be more profitable (note well – Qantas group top line revenue has been very stable for many years).

Happy families

Earlier this week QAN announced they were ending the domestic capacity war with Virgin (VAH). This is another crucial step in the road to re-rating/ higher profitability. In fact, it's arguably the most important step in the process to date. Similarly, Virgin confirmed they had reduced domestic capacity for the third straight month.

Australia is the land of cozy duopolies. In my time, I can never remember a more futile battle in an Australian duopoly than what QAN/VAH have done over the last few years. It was possibly the dumbest thing I have ever seen in a domestic duopoly. There was no winner, both sets of shareholders were major losers, but now we are finally seeing economic rationality prevail and that is a major development in the domestic aviation market.

Market share means absolutely nothing unless it's profitable. What's wrong with having a highly profitable 51% share of a cozy duopoly? Nothing, and Qantas stepping back from defending the 65% market share line in the sand, in my view, confirms that shareholders can look forward to better returns from the group. If anything, Qantas and Virgin should reduce domestic capacity and put up premium ticket prices. There's an idea, none of us will be catching the Greyhound Bus to Melbourne no matter what you charge!

Just to remind you what Qantas domestic should earn, in the 1H of FY13 underlying EBIT was $218m versus the $57m reported at the February FY14 interim.

		1H14	1H13	VLY %
Revenue	$M	3,086	3,220	(4)
Underlying EBIT	$M	57	218	(74)
ASKs	M	19,227	19,187	0.2
Seat factor	%	74.9	76.9	(2.0)pts

So domestic industry structure is getting no worse and should improve in terms of rational competition. Yields and load factors should rise. This is a good backdrop for Qantas to then focus on itself and make the necessary adjustments to its overall business model.

The CEO view

I have to say I did like Alan Joyce's recent presentation at the Macquarie Group Conference. It was all focused on micro not macro, exactly like BHP Billiton now does. Focus on what you can control, run the business as hard as you can, drive better returns, be consistent in your message, then the share price will take care of itself.

Measuring Progress
Scorecard to FY17

ACHIEVING OUR TARGETS	Target: Metric	Target: Timeframe	PROGRESS TO DATE As at 1 May 2014
COST SAVINGS	$2b gross savings >10% ex-fuel expenditure reduction[1]	FY17	Initiatives in implementation phase = $800m
COST SAVINGS	5,000 FTE reduction	FY17	FTEs reduced by 2,200 by end FY14
DELEVERAGE BALANCE SHEET	>$1b debt reduction	FY15	Focus on cash generation in FY15
DELEVERAGE BALANCE SHEET	Gross Debt / Adj. EBITDA[2] <4.0x	FY17	Gross Debt / Adj. EBITDA[2] to peak FY14
CASH FLOW	Positive free cash flow	FY15 onwards	FY15 & FY16 net capex reduced by $1.2b since Aug-13
FLEET SIMPLIFICATION	11 fleet types to 7	FY16	1 x B747 retired since Dec-13 2 x B767 retired since Dec-13 All remaining B734s retired
CUSTOMER & BRAND	Customer satisfaction (6 month rolling average): Improving / Stable / Declining	Ongoing	Improving
CUSTOMER & BRAND	Most on-time domestic carrier: Qantas Domestic	Ongoing	9 out of 9 months (FY14)

- Guiding strategic principles remain consistent
- Immediate priority to strengthen core business
- Deleveraging balance sheet through earnings recovery, debt reduction
- Moving at pace towards delivering $2b cost savings
- Group capex aligned with financial performance
- Strict financial and customer targets in place
- Determined to deliver all milestones in scorecard

I like the line *"moving at pace"* and I think the key forecast in the scorecard is *"positive free cash flow from FY15 onwards"*. Well, FY15 is a month away and estimates are QAN could generate $1 billion of free cash post capex in FY15 that sees them retire the equivalent debt load.

The momentum in the core airline is heading the right way. Fleet age is falling sharply, fuel efficiency is rising, fleet complexity is falling, maintenance costs are falling, full time employee numbers are dropping sharply, and it's fair to say Qantas is now controlling its controllables. Better yields and load factors will follow.

Financial services play

But this is where I will now get a little controversial. Is Qantas a financial services company where you get an airline thrown in for free?

My view is that the US value funds which are moving up the Qantas register have focused on the stand alone value of the Qantas Frequent Flyer business and worked back from there to an assessment of what they are paying for the Qantas airline.

Yes, I realise Frequent Flyer needs the airline and the airline needs the Frequent Flyer business, but this is a valuation debate and I feel either the Qantas Frequent Flyer business is undervalued in the current Qantas share price, or the airline is, as it cycles earnings lows, or both.

Qantas Frequent Flyers/Loyalty is a high growth, high ROE, financial services company. It would arguably trade on 10x EBIT. In FY14, Qantas Frequent Flyer made $146 million of EBIT and will be on line to generate $300 million of EBIT this financial year. To my way of thinking, the stand alone listed value of that business is $3 billion.

Qantas Loyalty

- Record Underlying EBIT[1] $146m, up 7%
  - Up 10% excluding new business start up costs[2]
- Billings[3] up 9%, double digit credit card point sales
- 8 new QFF partners driving more ways to earn
- Sustained record customer advocacy levels
  - 9.8m[4] members and growing; FY14 target 10m
  - 3 million awards redeemed, up 11%
- Growth initiatives exceeding expectations
  - Qantas Cash – over 200,000 activations[4]
  - AQUIRE – ~25,000 SMEs pre-registered; more than 10 key partners in core categories; 31 March launch date

		1H14	1H13	VLY %
Underlying EBIT	$M	146	137	7
Billings	$M	662	607	9
Deferred Revenue Growth[3]	$M	59	45	31
Members	M	9.7	9.0	8

Is $3 billion an outrageous valuation for a debt free financial services business with 9.8 million customers? It works out at $306 per customer versus CBA's current market cap per customer of $23,000, and Qantas Frequent Flyer isn't risking its capital lending to customers. (Unfair comparison, but you can see my point).

The current market cap of Qantas is $2.6 billion. The enterprise value is closer to $6 billion when you add on net group debt (and subtract cash), but that net debt is coming down. By the end of FY15, the Qantas balance sheet should show $2.4 billion of cash and $4.3 billion of total debt obligations. EBITDA should be over $2 billion, meaning debt to EBITDA ratio headroom increases. Qantas is not going broke, far from it.

The value

I think the Qantas Frequent Flyer valuation underpins the Qantas share price at these levels and the airline business is effectively a call option. If I am right and international losses move to break even, the domestic business returns to appropriate duopoly profitability, and Frequent Flyer keeps growing, then value will be added to the Qantas share price for the airline business. It may be as simple as Qantas' reduction in group debt being replaced by equity value growth in the enterprise value of circa $6 billion.

So, I maintain my view that Qantas is a *"trading buy"* after this week's developments. Sure, it's not for *'widows and orphans'* (no dividends for the foreseeable future), but I can see a clear scenario where the stock trades up to $2.00 in the years ahead, generating significant portfolio alpha. Remember, it was around $2.00 in April 2013, so it's not like I am making a monster call here in a trading stock. It's also worth noting the two big US investors have tightened the Qantas register (top six shareholders own 52%) and the open short position is 58.2 million shares.

Qantas (QAN)

Go Australia, Charlie.

100% of Charlie Aitken's fees for writing for the Switzer Super Report are donated to The Sydney Children's Hospital Foundation.

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My SMSF – a blessing in disguise

by Super Report Subscriber

Name: Gary Stone
Age: 53
Other members of the SMSF: Heather Stone

How long have you had your SMSF?

It was established in May 1997, so 17 years now.

Why did you start it up?

I had started a small business in my mid 30's in 1995 and was transitioning from a successful career in the corporate world to the world of small business.

That small business, now Share Wealth Systems, operated in the financial services arena, which lead me to research all the entities through which to invest. An SMSF was one of those entities and given the vastly different capital gains tax advantages of using an SMSF vehicle compared to other entities, including in one's own name, I took the step of establishing an SMSF.

I thought that it was a no-brainer, despite most accountants and financial advisors at the time advising against it, using cost as the reason. It didn't take me long to work out that it was conflicted advice as the probability of that industry retaining trailing fees from managed funds would decrease enormously if SMSFs became a highly-accepted investment vehicle across society and private investors started DIY investing en masse.

To me, I had a long term plan that would take my SMSF to levels that it would be far more cost justifiable than it may have been at the time, and as such the sooner that I started that journey the better, even if it relatively cost me a bit more in establishment fees at the time and in ongoing accounting fees thereafter.

The idea of having my super investment managed by my then employer's super management company for relatively huge fees, and without any choice in what they invested in, didn't appeal to me. This was my future retirement capital and, at some stage, I would have to learn to manage it myself so I owed it to myself and my family to learn how to do that, and to take responsibility for that.

That realisation made, I started an SMSF immediately.

How big is it?

It started with $40,608 in June 1997.

It is now near the high hundreds of thousands. Growth has slowed in recent years after transferring some excellent stock market investing gains into commercial property some six years ago and with the Australian stock market basically moving sideways for the last four years since April 2010 to February 2014.

Is it more or less difficult to manage than you thought it would be?

It is not that much more difficult than keeping on top of how a super investment may be faring with an industry super fund or an employee scheme. I know this because I have had people ask me to decipher their super investments in these alternative super options and try to calculate their actual returns from the fees and the tax that they are paying.

Once you have established the regular processes with people that have the necessary skills, such as an accountant, it takes a relatively small amount of time and has a relatively low degree of difficulty.

Do you enjoy managing it?

I do, thoroughly.

It has motivated and inspired me to go through the learning curve of investing and gaining the necessary analytical and mental skills required to become a consistently successful active investor.

I have spoken directly to many hundreds of individuals, and indirectly to many more, around the time that they start the journey of managing their own investments. You see, at some stage, everybody gets to that point, only starting when they near or reach retirement makes it so much harder. To a person they all say: "I wish I had started sooner!"

How has it performed?

Over the last one, three, and five years my SMSF has slightly underperformed the equities market but over the last seven years, which includes the 2008 bear market, it has handsomely outperformed the equities market.

What is your asset allocation?

Via my SMSF, I have two main asset classes, rent-paying commercial property and equities. I use an active equities strategy across two stock exchanges, the ASX and the NASDAQ, which at times will be 100% in cash, so you might say I use three asset classes depending on what is happening in the equities markets at any given time.

I am also working on a strategy that uses ETFs, and inverse ETFs, to better use my cash during down equities market periods.

What are your favourite investments/stocks and why?

Of recent times, since January 2013, I have enjoyed actively investing on the NASDAQ. I managed a 54% return over 15 months to April this year but am currently in cash, according to the risk management rules of my strategy.

Why the NASDAQ? Over recent years, the USA equities markets have become so much more accessible and for very low cost. The benchmark rate from Fidelity, Schwab or Scottrade, huge brokerage houses, is around the US$7.95 – US$8.95 flat rate for each transaction, but you can pay far less that that.

However, the main reasons are the diversity and market breadth of stocks, much higher liquidity and better performance than the Australian equities market over many years.

The ASX relies on the materials and energy sectors to do well for the whole market to take on a positive sentiment, with around 55% of ASX stocks in these two sectors. The NASDAQ is spread far more evenly across, technology, health, financial, consumer discretionary, consumer stapled and materials.

What investments do you have outside of superannuation?

Residential property via an investment company, and a business that has been operating for 19 years in the financial service arena that devises DIY private investor strategies, which, incidentally, I use myself in my SMSF and in my business.

Do you use an advisor or any kind of service provider?

No to an advisor but I use an accountant. The right accountant is a blessing when it comes to SMSF and other investing entities. And obviously online execution platforms into the equities market, such as Saxo Capital Markets.

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Buy, Sell, Hold – what the brokers say

by Staff Reporter

Broker activity was dominated by actions on insurance and mining companies this week. Some of this was partly due to falls in the share price, which pushed stocks towards fair valuation but others – such as the Tower upgrade – were due to better than expected first half results. Regis Resources also disappointed with its FY15 guidance and scored four downgrades as a result.

In the good books

Macquarie upgraded QBE (QBE) to Neutral from Underperform. While there are plenty of issues facing QBE going forward – North American uncertainty, premium rate cycle pressure, moderating US reserve trends, macro headwinds and equity dilution drag – the broker has upgraded the stock to Neutral from Underperform as Macquarie believes the issues are now all, more than adequately, reflected in the share price.

Credit Suisse upgraded Tower (TWR) to Outperform from Neutral. The first half results were stronger than the broker expected, with higher catastrophe claims offset by higher investment income. Tower has a simpler and cleaner business now and is in a position to capitalise on growth opportunities in a consolidating market.

In the not-so-good books

UBS downgraded Envestra (ENV) to Neutral from Buy. At first glance, the CKI consortium's $1.32 indicative non-binding cash offer looks appealing to the broker, compared with APA's (APA) majority scrip offer. UBS does not doubt CKI's intent, but notes the requirement for approval from all the consortium directors could be a convenient way out. APA's scheme vote is adjourned until June 13 and it is unclear to UBS in whose court the ball really is. To avoid basing a recommendation on potential counter bids, the broker reflects current valuation and moves to Neutral from Buy.

JP Morgan downgraded Suncorp (SUN) to Neutral from Overweight. In a third quarter trading update, Suncorp signaled a $500 million non-cash write down in the life company and favourable claims trends in general insurance. The insurer downgraded growth targets to 4-6% from 7-9%. The positive aspect for JP Morgan was that capital management is still very much likely. But on balance, there were more negatives than positives.

JP Morgan downgraded National Australia Bank (NAB) to Underweight from Neutral. The broker notes NAB's margins have been flat since FY07, shifting from an average above peers of 20 basis points to an average of 20 basis points below. While this can, to some extent, be explained by a greater liquidity ratio than peers, the real problem lies in the bank's business mix and that needs fixing. This will take quite some time, and in the meantime the broker has downgraded NAB to Underweight on a sector basis.

Regis Resources (RRL) got four downgrades following a disappointing FY15 guidance. Credit Suisse downgraded to Neutral from Outperform, Deutsche Bank to Hold from Buy, JP Morgan to Neutral from Overweight and UBS to Neutral from Buy. For UBS, Regis' FY15 production and cost guidance led to a significant downgrade to forecasts, with production lowered and costs raised. The downgraded production guidance also fell well short of Deutsche Bank's forecasts with poor grades at Rosemont now reminiscent of the problems first reported at Garden Well. Given the company has had the same problem it now has at Rosemont at Garden Well, JP Morgan feels investor confidence will be further damaged. And Credit Suisse also found the FY15 guidance disappointing, with production revised down to well below the broker's projections.

Citi downgraded Woodside Petroleum (WPL) to Neutral from Buy following an investor briefing. Citi believes Woodside is delivering on a good strategy. That said, Citi considers there is a disconnect between the industry's confidence in FLNG technology and market sentiment. The broker envisages the potential upside from further acquisitions or additional special dividends, but will not include these in the target price until announced.

The above was compiled from reports on FNArena, 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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Amcom - reaching for the clouds

by Roger Montgomery

These days it seems near impossible to read about information technology without bumping into the word "cloud". Applications are now cloud-based; we store things in the cloud; and the cloud can even provide most of the IT infrastructure enterprises need to function.

In the clouds

So what does 'The Cloud' *actually* mean? Broadly speaking, a cloud is just a set of computer servers connected by a communications network. Picture a hub-and-spoke architecture: the cloud is the hub, while individual user machines connect into the hub like spokes. The cloud can be dedicated to just one enterprise, hosted internally or externally; or it can be shared across many client enterprises, hosted externally – such is the case with cloud behemoth Amazon Web Services. The idea is that applications and services can be performed and managed more efficiently by the centralized servers in the cloud rather than on the individual machines of each employee.

A cloud architecture also makes scaling up (or down) significantly easier for enterprises. Indeed, many cloud-based software applications – characterised by another buzzword: SaaS, or Software-as-a-Service – simply charge by usage-based subscriptions. This saves the enterprise from needing to make big and risky capital investments in IT. The cloud essentially transforms the cost of IT from one that is fixed to one that is variable.

The Amcom proposition

Amcom (AMM) is a niche cloud services provider in the Australian market. It specifically targets mid-sized enterprises, which are slowly transforming their internal IT architecture from the traditional model – internally hosted IT infrastructure and applications – to a cloud-based platform.

Initially, a client may only be comfortable with Amcom managing its internal network using its own internal IT infrastructure. Yet over time, the client will likely need additional infrastructure and will become comfortable with Amcom hosting its dedicated infrastructure externally – a dedicated cloud, so to speak.

Finally, many clients will become comfortable with using externally hosted shared cloud infrastructure – such as Amazon Web Services. With each step in the progression, significant efficiencies are captured by the client; and so too is incremental revenue captured by Amcom. This ability for Amcom to cross-sell new products to existing customers as they evolve is highly attractive.

Interestingly, this rapidly growing business accounted for less than 20% of Amcom's sales in its most recently reported half-yearly results. Its share of earnings was even less – though this will surely change very soon. The economics of this business are such that many of the costs are fixed – such as those associated with building an external data warehouse; and those associated with initially acquiring customers. So as revenues grow – which they have been at over 30% per annum – so too will profit margins. This effect is known as operating leverage.

Workplace change

There is another trend within the enterprise that is providing a secular tailwind for Amcom. This relates to the use of social media in the workplace, or 'unified communication' – as every trend needs a buzzword in this industry. Believe it or not, enterprises around the world – large and small – are using the tools of social media to enable their employees to collaborate and communicate more

efficiently. Mediums from instant messaging to video telephony and internal versions of Twitter and Facebook. And managers are using them across the spectrum: from interns all the way up to the senior executives. Whether it's Microsoft's Yammer, Google's Hangouts, or one of the many other cloud-based collaboration tools that are readily available.

The workplace is changing rapidly. How we collaborate and communicate is changing; and these changes require the applications that are highly suited for cloud-based architecture. How IT infrastructure is managed is also undergoing rapid change. For instance, installing new versions of software is much easier if it needs to only be installed on the cloud, rather than on every employee's individual machine. The efficiencies, and therefore cost-savings, that can be gained from Amazon hosting your cloud, for example, are enormous. These trends are highly favourable for Amcom, which appears to be a leader in servicing mid-sized clients in the Australian market.

Amcom (AMM)

Amcom's share price has increased by more than three times over the last three years – a truly stellar performance indeed. While one needs to always think of both business quality and valuation in their assessment of a particular stock, in this case, at least the quality can be said to be solid.

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Property and the end of financial year – a guide to your deductions in your SMSF

by Margaret Lomas

While owning business property has always been a popular strategy, with the changes to the rules around super loans (Limited Recourse Borrowing Arrangements), more trustees are choosing to own property directly through their SMSF. Potentially, the taxation benefits come from holding an investment asset in a lower or zero tax vehicle, rather than claiming tax deductions. However, it can still be important to optimise these deductions.

And of course, deductions are only available to those funds paying tax (ie those in accumulation mode). If your SMSF is in pension mode and the property is supporting the payment of the pension, then the SMSF won't be paying any tax – so there are no deductions that can be claimed.

Here's a quick guide to some of the more common property deductions your fund may have.

Capital costs

These are the purchasing costs, which you incurred when you bought the property. In addition, a capital cost includes capital improvements (such as extensions, pergolas, driveways, etc.) and also costs of selling. Careful distinction must be made between the replacement of an item of plant (such as replacing the hot water service) and an improvement (such as rendering the brickwork).

You cannot claim capital costs as a tax deduction against earned income. You can, however, offset them against a capital gain made at the point of sale. This is done by adding the cost of these items to the purchase price of the property – making the 'cost base' of the property higher.

While you, most likely, will not be making any claims for capital costs unless you have disposed of a property, if you are within the first five years of having purchased, you may still have borrowing costs which can be claimed.

Revenue costs

Revenue costs are all of those costs, which are incurred in the process of earning the rental income, and it's these costs, which make up part of your deductions.

They include, but are not limited to:

- Advertising for a tenant.
- Loan interest and bank fees.
- Body corporate fees, rates, energy and water bills.
- Land tax.
- Cleaning, mowing, gardening, repairs and maintenance.
- Building, contents, liability and landlord's insurance.
- Accountancy fees, property management fees, legal fees (not relating to the actual purchase).
- Lease costs.
- Pest control.
- Quantity surveyor's fees.
- Security patrol fees.
- Stationery, postage and telephone.
- Travel expenses when inspecting the property.

The list goes on, and your accountant will be able to tell you what's included as a viable property expense.

You cannot claim:

- Stamp duty on conveyancing.
- Expenses on the property not actually paid by you, such as water and electricity paid by the

tenant.
- Expenses that do not relate to the renting of the property.

In some cases, expenses must be apportioned between deductible and non-deductible. For example, where you combine a holiday with inspecting your fund's property, you must only claim a portion of the travel costs.

Depreciation

Depreciation can be divided into two sections – depreciation on plant and equipment (furniture, fixtures and fittings) and depreciation on the building (capital works deductions).

Depreciation on furniture, fixtures or fittings

Where an item of furniture, or a fixture or fitting not a part of the building, is used to produce an income, then the cost of its depreciation may be claimed against earned income.

The rate at which you can depreciate an item will depend on its effective life, and is anywhere between one and 20 years. The ATO has determined the average effective life on a long list of common items, however the taxpayer may make his or her own estimate of effective life, if it can be substantiated with evidence.

Capital works deductions

As a rule of thumb, if the item can be moved, then it is an item of plant and can be claimed as plant and equipment (fixtures, fittings and furniture) depreciation. If, on the other hand, it is part of the setting for a rent-producing activity, rather than a fixture, fitting or piece of furniture, then it would be claimed as a part of the capital works deductions.

These items may include things such as:

- In-ground swimming pools, saunas and spas.
- Plumbing and gas fittings.
- Garage doors, roller shutters and skylights.
- Sinks, tubs, baths, washbowls and toilets.

Capital works deductions include allowable deductions where you may claim the costs of construction of a building over a set period of time. The amount you can claim is limited (of course) to 100% of the cost of the construction.

Working out the amounts

There are two ways in which you can claim the capital works depreciation—the prime cost method or the diminishing value method. As each of these methods require quite a complicated formula to calculate, it is far better for you to ask your accountant which method would be most advantageous to your personal circumstances. The Australian Tax Office website allows you to download some great information on these—they also have available a guide to depreciation, which includes worksheets for calculating depreciation.

There are varying rules which apply depending upon when you acquired the property, and so checking with the Tax Office website, or your accountant, is the best way to know how your property will be treated.

If you do not know the original construction costs, or the value of any plant and equipment, now is the time to retain the services of a 'quantity surveyor'. The job of the surveyor is to provide for you what is known as a 'depreciation schedule'. This schedule will not only make an estimate of what the construction costs would have been, but it provides for you a list of all of the furniture, fixtures and fittings, and gives each of them a value at the time of your purchase.

A quantity surveyor will charge you a fee (usually around $600), but this fee is well worthwhile and tax deductible.

Records

You must keep all records and have them available in case the tax office does an audit.

With Paul Rickard

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Everything you need to know about the Seniors Health Card

by Tony Negline

This year's Federal Budget made four important changes to the Commonwealth Seniors Health Card (CSHC). These changes seem to be causing a bit of confusion.

The CSHC is a valuable benefit, especially if you're not entitled to the Aged Pension. It will remain valuable even with the proposed changes.

Here I'll explain those benefits and the proposed budgetary changes.

CSHC eligibility criteria

To get the CSHC, you need to satisfy all the following criteria:

- Not be receiving a Centrelink or Veteran's Affairs benefit.
- Be at least age pension age – that is, at least age 65.
- Live permanently in Australia (Australian citizen, permanent visa holder or New Zealand citizen who travelled with New Zealand passport); the CSHC will be cancelled after six weeks of a temporary absence from Australia.
- Have adjusted taxable income of less than $50,000 for singles or $80,000 for couples (combined). Special rules apply if a couple lives apart due to illness and/or have dependent children. Adjusted taxable income is a person's taxable income, reportable fringe benefits, salary sacrificed superannuation contributions and net investment losses.

The Commonwealth Seniors Health Care Card is only valid for a 12-month period and must be applied for each year. To successfully apply, you need to give Centrelink your Tax File Number (or be eligible for an exemption from this requirement).

2014 Budget changes to eligibility

- Adjusted taxable income thresholds will be indexed by CPI for 2014, 2015, 2016, 2017 and 2018 financial years (this is a positive!).
- Account based pensions and annuities that commence after December 2014 will be subject to deeming and the deemed income will be added to your adjusted taxable income, making it harder to qualify. Existing pensions that commence before January 2015 will be exempt.
- The Seniors Supplement will be abolished from 20 Sept 2014 (currently payable quarterly at a rate of $867.20 pa for a single, $1,320.80 pa for a couple).
- The Clean Energy Supplement will remain unchanged at a fixed payment (and will no longer be indexed to inflation).

What does the CSHC entitle you to?

Retirees are entitled to:

- Pharmaceuticals listed under the Pharmaceutical Benefits Scheme (PBS) at the concessional rate.
- Bulk-billed GP appointments, at the discretion of the GP (the Australian Government provides financial incentives for GPs to bulk-bill concession card holders).
- A reduction in the cost of out-of-hospital medical expenses above a concessional threshold, through the Medicare Safety Net.
- Discounted fares on Great Southern Railway services.
- In some instances, additional health, household, transport, education and recreation concessions that may be offered by

State or Territory and local governments and private providers. However, these providers offer these concessions at their own discretion, and the availability of them may vary between States and Territories (in addition some of these concessions were funded by the Commonwealth, which in this year's budget reduced the money it gives to the States and Territories for this specific purpose).
- Telephone supplement.
- Clean Energy Supplement – $356.20 (single) or $535.60 (couple combined) – payable twice per year in March and September.

Conclusion

CSHC remains a valuable benefit and the addition of deemed account-based pension income is an important change. I have discussed this issue before from a Centrelink perspective. If you don't receive the Aged Pension because of the income test but will be eligible for the CSHC, then you might want to look at this deeming issue before January.

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.*

Unlisted property trusts and pensions

by Questions of the Week

Question: What are your thoughts on unlisted property trusts? Are they better value than listed trusts trading above net present value (NPV)?

Answer (By Paul Rickard): Potentially – yes – but it will depend on the property. The major problem with unlisted trusts is the lack of liquidity and getting your money back. You need to understand the manager's plan to terminate the trust and assess how realistic this plan is.

In regard to buying listed trusts above their NPV, I would be fairly mindful of this, particularly in the current commercial property environment. While listed property trusts have done well this year due to the "thirst for yield", the commercial property market is arguably in oversupply and the outlook is mixed.

Question 2: Would you please tell me the SMSF rules for the percentage that you have to spend annually when in pension phase. I am 67 years old and as I am back working – running my consulting business – I wonder if I am allowed to make payments into my SMSF and what the annual limits are. Also, are there any benefits in doing that at my age?

Answer (By Paul Rickard): If you are taking a pension and were aged 65 years or over at the start of the year (and under 74), you must take out at least 5% of your super balance as a pension. For example, if your account balance was $500,000 on 1 July 2013, you would need (at age 67) to withdraw at least $25,000 as a pension during the year.

Provided you meet the work test (more than 40 hours over any one consecutive 30-day period during the year) you can continue to make contributions at age 67.

The concessional cap for a person aged 60 or over is $35,000 (compulsory 9.25%, salary sacrifice or if self employed, an amount you claim a tax deduction for); non-concessional cap (personal contributions) cap is $150,000.

Yes there are advantages at your age. It gets the money into a more tax effective environment – if you make contributions and then commence taking a pension, the investment earnings will be taxed at 0%.

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