Switzer Super Report

Issue 319, 4 September 2014

Drink and be merry

As the market takes a breather following reporting season, today we have Charlie Aitken, or Champagne Charlie as I like to call him now, start us off with a view on his new favourite Woolworths. It's a contrarian position, as most analysts are concerned by the Masters underperformance, but Charlie explains why he believes that is almost irrelevant.

Also in the *Switzer Super Report* today, Tony Featherstone walks us through the reasons why frequent flyer programs are so important, Tony Negline gets fired up about the constant criticism of SMSFs – and also suggests a few thing you can do, and Paul Kasian of Equity Trustees tells us why he loves Oil Search.

In *Buy, Sell, Hold – what the brokers say,* Billabong and Harvey Norman get upgrades and in *Short n' Sweet* we give you a refresher on the Telstra buyback and review our calls on NAB and Ramsay versus Healthscope.

Sincerely,

Peter Switzer

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Champagne Charlie toasts WOW

by Charlie Aitken

In recent times there has been plenty of financial press and broker debate about Woolworths (WOW). The debate is mostly coming from the negative side, focusing on Masters start-up losses, increased competition from Aldi and the UK experience, which saw incumbents J Sainsbury and Tesco de-rated.

Tesco had another profit warning last week and fell 6%. There have even been questions raised about WOW CEO Grant O'Brien's overall strategy. This is reflected in the fact that WOW actually has a reasonable open short position of 13.7 million shares ($495 million). That is the first time I can ever remember a short position of any scale in WOW.

Drink and be merry

However, what hadn't been focused on was WOW's core Food & Liquor business, which extended its market leadership and expanded operating margins. On every measure, the F&L result for FY14 – the only result that really matters for WOW – was again excellent and confirms what a strong business this is with very high technology, logistics and product sourcing barriers to entry.

I am going to start with some *Peter Lynch theory* (the best investment ideas you see with our own eyes in everyday life). Woolworths recently opened a brand new supermarket and Dan Murphy's in Double Bay NSW. The new facility is absolutely superb and also offers two hours free parking for customers, providing relief from over-zealous Woollahra Council parking meter inspectors, who operate in the vicinity.

Let me give you an example why WOW's F&L revenues and margins are expanding. On Saturday night I popped down to Dan Murphy's to buy a bottle of champagne. Dan Murphy's must have known I was coming as smack in my face as I walked in the door was a display of chilled Bollinger for the very low price of $57.00 (exhibit 1.)

If you bought 6 bottles of Bollinger, the price per bottle dropped to $54.00. Of course, as a value investor I took up the offer and bought six. The very attentive/knowledgeable salesman knew a soft target when he saw one and guided me around the shop to other areas I may be interested (i.e. everywhere). Exhibit 2 shows how this ended.

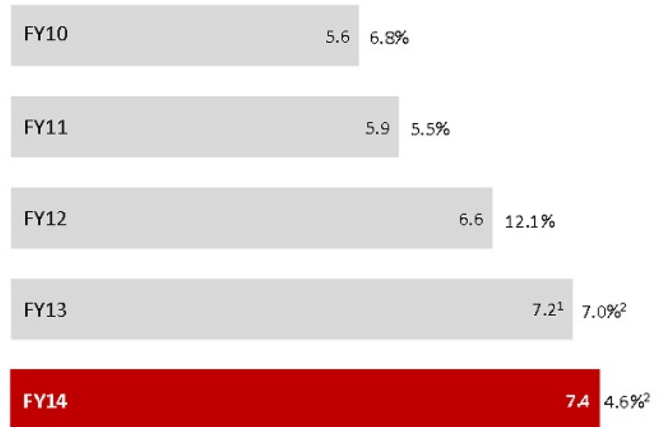
Yes, a quick trip to buy a bottle of champagne ended up with a case of champagne, a case of “low carb” beer, three cases of wine and a bottle of tequila. I don’t even like tequila.

Why did this happen? No, not because I am an alcoholic, but because the range, prices and service at Dan Murphy’s new format store in Double Bay were so damn good. Yes, I spent more money than I intended to, but I left feeling I got a great deal. Isn’t that the goal of retailers? Remember it wasn’t that long ago analysts were sceptical on WOW’s Dan Murphy’s strategy as it rolled out.

WOW liquor group sales growth over the last five years is below.

WOOLWORTHS LIQUOR GROUP SALES

Leading the market both in-store and online



Masters – borderline irrelevant

So for all the criticism of Masters and concerns about pending supermarket competition, my view is they are missing the point about the dominance and growth options embedded in the WOW F&L offering. These guys are absolutely superb F&L retailers, yet I think there’s more to come in terms of margin enhancement as technology enhances the supply chain.

At the headline level, WOW FY14 group results were rock solid.

	Total Group			Continuing Operations Before Significant Items[1]		
	FY14	Change	Change Normalised[2]	FY14	Change	Change Normalised[2]
Sales	$60.8b	↑2.7%	↑4.7%	$60.8b	↑3.9%	↑5.9%
EBIT	$3,775.2m	↑4.7%		$3,775.2m	↑3.3%	↑5.3%
NPAT	$2,451.7m	↑8.5%		$2,451.7m	↑4.2%	↑6.1%
EPS	196.5¢	↑7.6%		196.5¢	↑3.3%	↑5.2%
DPS	137¢	↑3.0%				

But here’s where it gets interesting. Masters start-up losses are a pimple in the scheme of group EBIT. The “home improvement” loss of $169 million is just 4.4% of group EBIT ($3.775 billion). It’s borderline irrelevant.

$ million	FY14	FY13	Change	Change Normalised[1]
Australian Food, Liquor and Petrol[2]	**3,368.0**	**3,199.3**	**5.3%**	**7.2%**
New Zealand Supermarkets (NZD)	*309.8*	*302.7*	*2.3%*	*4.2%*
New Zealand Supermarkets	**271.4**	**236.2**	**14.9%**	**17.1%**
General Merchandise	**152.9**	**191.3**	**(20.1)%**	**(18.8)%**
Hotels	**275.4**	**263.7**	**4.4%**	**6.5%**
Home Improvement	**(169.0)**	**(138.9)**	**21.7%**	**24.1%**
Central Overheads	**(123.5)**	**(98.4)**	**25.5%**	**28.0%**
Group EBIT – Continuing Operations	**3,775.2**	**3,653.2**	**3.3%**	**5.3%**
Group EBIT – Discontinued Operations	-	**2.5**	**n.c**	
Total Group EBIT (before significant items)	**3,775.2**	**3,655.7**	**3.3%**	
Significant Items (before tax)				
One-off loss on SCA Property Group transaction	-	(32.8)	n.c	
Gain on disposal of Consumer Electronics businesses	-	9.9	n.c	
Victorian transport fleet redundancies	-	(25.8)	n.c	
Total Group EBIT (after significant items)	**3,775.2**	**3,607.0**	**4.7%**	

Click here to view larger image

Now let's look at that $169 million loss from "home improvement" in terms of group cash flow. Group Operating cash flow was almost $5 billion, while free cash flow was $1.6 billion. Note well at the cash flow level, Masters JV partner Lowes injected $183 million into the business.

$ million	FY14	FY13	Change
Total EBITDA	**4,771.5**	**4,572.5**	**4.4%**
Gain on disposal of Consumer Electronics businesses	-	(9.9)	
Change in net investment in inventory	103.2	(490.6)	
Net change in other working capital and non-cash	98.7	79.7	
Cash from Operating Activities before interest and tax	**4,973.4**	**4,151.7**	**19.8%**
Net interest paid	(338.2)	(454.5)	
Tax paid	(1,162.5)	(977.3)	
Total cash provided by Operating Activities	**3,472.7**	**2,719.9**	**27.7%**
Proceeds from the sale of property to the SCA Property Group	12.2	802.8	
Proceeds from the sale of subsidiaries and property, plant and equipment	218.7	206.1	
Payments for the purchase of businesses	(371.5)	(263.4)	
Payments for property, plant and equipment	(1,856.4)	(1,888.6)	
Payments for intangible assets	(42.3)	(66.7)	
Dividends received	7.9	8.1	
Total cash used in Investing Activities	**(2,031.4)**	**(1,201.7)**	**69.0%**
Lowe's cash contributions (Home Improvement)	183.0	230.0	
Free Cash Flow	**1,624.3**	**1,748.2**	
Proceeds from share issues / other	35.5	193.7	
Dividends paid (including to non-controlling interests)	(1,523.1)	(1,416.8)	
Free Cash Flow after equity related Financing Activities	**136.7**	**525.1**	

Click here to view larger image

Food & Liquor

Now let's focus on what really matters, the F&L business.

What I focus on here is gross margin up 9 basis points, cost of doing business down 6 basis points, and EBIT to sales margin +15 basis points to nearly 7.00%.

WOW confirmed increases in market share, customer numbers, basket size, items sold and sales per average sqm. They served on average 21.2 million customers a week, up +3.7% on FY13. EBIT grew faster than sales, reflecting improved margins and cost control.

This is where it gets clever and I believe most people don't understand the long-term margin enhancement power of data mining in the WOW F&L business. WOW now has 7.9 million Everyday Rewards cards on issue, (+10% vs previous corresponding period). WOW is using customer data to refine store layouts and ranges to meet customers evolving needs. This is why the new WOW Double Bay has a cheese room, sushi bar and barista.

WOW is increasingly using customer data to identify new store sites and provide greater access for its customers. For all the hoopla about Aldi's plans, WOW opened 34 new stores in FY14 and completed 23 refurbishments. WOW now has 931 supermarkets and a monstrous supply chain to match. It also upgraded 67 petrol canopies and forecourts to expand access to diesel, premium fuels and fast flow fuel pumps.

The winners

Customers were the winners, with average price deflation of -3.1%. Promotional campaigns provided another $750 million in savings to customers.

This is all about supply chain management and getting the right fresh products to the right customers in the right location "just in time". It is not beyond the realms of possibility that with the technology available today that the individual supermarkets can order replenishment in real time (from POS data) from an automated DC that fills a truck and routes it back the most efficient way. In theory, it could all be automated in real time.

I believe WOW can further dial up the efficiencies of supply chain management in project Mercury 2 and through time that will lead to higher operating margins, higher sales growth and better working capital terms and higher profitability.

In terms of guidance WOW guided to FY15 NPAT growth of +4% to 7%. My view is that will prove conservative and another year of +8.5% NPAT growth will be delivered. Aggregate ASX200 NPAT growth is only forecast at +5% in FY15.

Over the next 12 months I think WOW can see a P/E re-rating to within sight of a WES multiple of 19.7x FY15. 19x equates to a WOW share price target of $39.42.

Part of that re-rating will be capital management driven (similar to the WES re-rating this year). WOW has $1.8 billion of franking credits on its balance sheet and with the potential $800 million sale of the hotel properties, the ability to return a good proportion of those excess franking credits to shareholders tax effectively in the year ahead.

WOW is also cum the 72 cents fully franked final dividend, offering a 13-month yield of 6.00% fully franked for anyone who buys the shares in the next three days.

I realise it's a bit lonely nowadays being a Woolworths believer and a supporter of Grant O'Brien's strategy, but in retailing terminology, ultra-high quality, long duration cash flow is rarely on sale and I think that is the situation in WOW's shares today.

WOW is a core portfolio holding for private investors and should be accumulated on dips. I forecast a +15% total return from WOW over the next 13 months, with the added potential off an off-market buyback/franking credit return.

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Qantas finds value in frequent flyer loyalty

by Tony Featherstone

Qantas Airways' $2.8 billion statutory loss, one of the biggest in aviation history, made front-page news. But beneath the massive loss for 2013-14 was some excellent news: the full retention of the Qantas Loyalty frequent flyer points business.

Speculation was rife that Qantas would sell 30-40% of its loyalty business to free up cash and pay down debt. Analysts estimate the business is worth $2.5-$3 billion, based on multiples for sales of similar loyalty programs here and overseas.

More airlines are unlocking the value of their frequent flyer programs. Virgin Australia Holdings in August announced it was selling 35% of Velocity Frequent Flyer to the private equity fund, Affinity Equity Partners, valuing the loyalty program at $960 million.

Several overseas airlines have also sold, or partially sold, their loyalty programs to free up cash. As the global airline industry faces unrelenting pressure, selling keenly sought assets such as points programs has become a quick fix for embattled CEOs.

The value

These programs have huge strategic value. Virgin's Velocity Frequent Flyer program has doubled its membership to 4.5 million in four years. Qantas Loyalty has doubled membership to 10.1 million since 2008, with its points program the envy of the global aviation industry.

Think about that for a moment. Qantas Loyalty gives the airline a touch point with almost one in two Australians. The program sells points to Qantas, a host of retailers, including Woolworths, and is used extensively in data mining and through Qantas consulting services.

Some frequent business travellers I know view Qantas points as Australia's de-facto currency and a critical tool to buy their next overseas air trip, accommodation or other goods and services.

It is no surprise that the market applauded Qantas' decision to keep the program. In an August 28 research note, Macquarie Equities Research described Qantas Loyalty as a star performer in the airline's recent full-year profit result. It has a $1.84 share price target over 12 months for Qantas, and an outperform recommendation.

Bank of America Merrill Lynch said of the decision to retain Qantas Loyalty: "We regard it as a significant positive that even a minority stake of Qantas Frequent Flyers will not be sold. The division remains a strong cash generator, with FY14 earnings before interest and tax (EBIT) up 10%. Qantas has said there is no justification for a sale; long-term investors agree." Bank of America has a hold recommendation on Qantas.

Analysts mostly believed any decision to sell the frequent flyer program would be a "short-term fix" at the expense of the asset's long-term potential. The market agreed, driving Qantas from a $1.30 in late August to $1.56, and signalling that the worst is behind the airline.

The decision

Did Qantas make the right decision? If the Qantas Frequent Flyer program is worth more than $2.5 billion, a reasonable valuation given the much smaller Velocity Frequent Flyer program was valued at $960 million, what is the rest of Qantas worth? The airline is capitalised at about $3.2 billion.

Qantas has a lousy annualised shareholder return (capital growth and dividends) of minus 12% over five years, and minus 5% over 10 years. Long-suffering

shareholders might have seen the divestment of Qantas Loyalty as unlocking considerable latent value in the Qantas Airways valuation, and giving the program even more momentum as a stand-alone entity. It's always a problem when great businesses are dragged down by other underperforming divisions.

I like the decision to retain Qantas Loyalty for two reasons. The first is short term. The business is performing strongly: its underlying earnings rose 10% to a record $286 million in the latest Qantas result, underpinned by 8% growth in customer numbers and billings. Selling all or part of Qantas Loyalty would have stripped a significant growth engine out of the airline.

It could have led to significant disruption in other parts of the business. Concerns about the points program might have encouraged more travellers to cash in their points, switch programs, or even use other airlines. There were also questions about how Qantas would have used the points program to fill unused seats on its planes, had it divested the asset.

The points program will become even more popular in the next few years as consumers, who are struggling with the worst wages growth in 17 years, pay more attention to the value in their points program, and use the points to pay for travel and other treats.

Longer term, Qantas Loyalty is the airline's best asset and arguably the main reason to buy the stock. I always avoid airline stocks: their earnings have low visibility, they have huge upfront and ongoing capital expenditure, and are subject to myriad risks such as weather, security, oil prices, currency, and safety. Airlines have few hallmarks of exceptional companies.

Big data, big opportunities

But the rapidly expanding points program gives Qantas a shot at something different and much bigger: the potential to leverage the brand and customer relationships, and find uncontested market spaces, or so-called "radical adjacencies", as Qantas moves well beyond transport into new industries.

Growth in data mining, where companies process huge amounts of real-time customer information, is a big tailwind for Qantas Loyalty.

In fact, the most valuable hub for Qantas will have nothing to do with airlines in coming years. The big upside is becoming the hub in a giant network of retailers, using points and customer information through data mining to help other retailers grow their business.

Unlike the cost-intensive airlines, this is a virtual, technology-based business with recurring income and high barriers to entry. It is also a business where Qantas has a genuine, sustainable competitive advantage through its size, scale and brand. With that comes higher switching costs for customers who leave the program, and latent pricing power for Qantas Loyalty.

But it is still not enough to buy Qantas at the current price. Upside from Qantas Loyalty is dampened by the poor economics of aviation and lingering uncertainty in the global airline industry. On a risk-adjusted basis, there are better stocks to own in the long run.

- *Tony Featherstone is a former managing editor of BRW and Shares magazines. All prices and analysis at 3 September 2014.*

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Buy, Sell, Hold – what the brokers say

by Staff Reporter

Broker activity is quietening down now reporting season is over but results, and positive results, dominate the moves on the positive side of the ledger. Some former laggards, like Billabong and Harvey Norman, got upgrades as Woolworths failed to inspire JP Morgan.

In the good books

Deutsche Bank upgraded Billabong (BBG) to Hold from Sell. The return to like-for-like sales growth in Asia Pacific and Europe pleased the broker. The Americas remain tough and gross margins weakened considerably in the second half. At current levels, the broker believes a turnaround is being priced in.

UBS upgraded Harvey Norman (HVN) to Buy from Neutral. FY14 results were well ahead of UBS estimates. Australian franchises stood out but New Zealand was also strong. UBS had made material upgrades to earnings forecasts, raising FY15 estimates by 11% and FY16 by 13%. Still, only a modest recovery is assumed in franchisee margins. The lift in the second half dividend was a signal for the broker that the board is more confident about returning cash, as well as franking, to shareholders.

Deutsche Bank upgraded Transfield Services (TSE) to Buy from Hold. Finally, the company's transformation program is starting to deliver, according to analysts at Deutsche Bank. They point at improving margins for the company's core operations. Despite the positive reception of Transfield's FY14 report by investors, the stockbroker continues to see value.

In the not-so-good books

BA Merrill Lynch downgraded Duet Group (DUE) to Neutral from Buy. The broker has concluded that the existing capital and distribution structure looks tight, albeit sustainable. Merrills is downgrading to Neutral from Buy because of the heavy reliance on the distribution profile and the fact that two of the three assets do not generate enough cash to fund maintenance capex requirements.

UBS downgraded Tiger Resources (TGS) to Neutral from Buy. The company will acquire the remaining 40% interest in the Kipoi mine in the DRC for US$111 million. To fund the deal, the company needs to conduct a placement, an underwritten entitlement offer and enter a bridging finance facility. This means a material amount of high cost, short-term debt. The stock remains cheap, relative to the broker's valuation, but UBS is downgrading to Neutral from Buy, based on the increased risks.

JP Morgan downgraded Woolworths (WOW) to Underperform from Outperform, while six other brokers kept their ratings unchanged following FY14 results. Woolworths' FY14 report was in line with guidance but JP Morgan analysts found it less than inspiring. The analysts express their concern about the slowdown in Food & Liquor LFL sales growth and about the risk that strong EBIT margin expansion may not be sustainable.

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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Short n' sweet – Telstra buyback, NAB and Ramsay

by Penny Pryor

Reporting season may have dominated the past few weeks but it wasn't the only event in the markets. There is also the Telstra buyback on the cards and for SMSF trustees, who are considering whether to sell, or not to sell, Paul Rickard has written a thorough investigation of all the pros and cons, which you can read here.

Paul says: "Deciding whether to accept an off market buyback is a pretty straightforward decision. If you are paying tax at a high marginal rate (30% or higher), don't even bother to open the offer document – throw it in the bin."

"If you are paying tax at 0% (such as an SMSF in pension, income under tax free threshold), you are mad if you don't accept – and if you are somewhere in between, such as an SMSF in accumulation, it will depend on the tender discount."

Back in June, Peter Switzer also called out NAB as a potential outperformer, despite some commentary that its US operations were still a bit of a drag. He had been listening to business strategist Gary Hamel, who made him think the bank had the potential to surprise the doubters.

He believed that the bank's focus on business banking could be worth more in the next two to three years.

"I do think they might be a surprise package," he said then.

As the share price chart below shows, it's still having its ups and downs but it is heading slowly northward. Its new chief executive, Andrew Thorburn, is showing that he is serious about turning things around with offloading its US operations and changes at the top. It's still the laggard of the banks but has the potential to surprise.

National Australia Bank Limited (NAB)

Source: *Yahoo!7 Finance, 4 September, 2014*

Other *SSR* calls we'd like to highlight include Ardent Leisure (AAD), one of Peter's favourites, which has also shot up in recent weeks. It started the month around $2.50 and is now trading well over $3.10.

And Paul Rickard's darling Ramsay Health Care (RHC), which has managed to outperform the newly floated Healthscope (HSO). Healthscope listed at $2.10 and closed on its first day of trading in late July at $2.21 but has only now got above $2.28. Ramsay, on the other hand, has simply powered through August and added almost $5 to be now trading at around $53.

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It's time to do something about the SMSF attacks

by Tony Negline

Well here we go again.

Hardly a day goes by when self managed super funds aren't being attacked. In the vast majority of cases, those leading the charge are opposed to SMSFs for commercial reasons.

Let there be no mistake: the forces attacking SMSFs are powerful.

But as a group, SMSF members and trustees are powerful in their own way. (At the bottom of this article I give you some ideas on how you can protect your wealth from adverse Government policy caused by the negative politicking of SMSFs' enemies.)

Power in numbers

There are enough SMSF trustees to change the outcome of elections at all levels of government in Australia.

Furthermore, SMSFs, as a group, have effective control over many of the top Australian listed companies, including the big financial institutions that have publically attacked SMSFs.

However, this authority is only useful if SMSF trustees actively defend themselves against the nonsense that is often spoken about.

Let's take some examples of recent criticism.

1) SMSFs don't pay tax

The latest ATO Statistics (for the 2012 financial year) cover about 425,000 SMSFs.

At the end of June 2012, SMSFs had about $419 billion and APRA funds about $860 billion. The ATO stats show that APRA funds pay about 0.9% tax on their assets, whereas SMSFs only pay 0.3% tax on their assets.

Why do SMSFs overall pay less tax than APRA funds? Because APRA funds receive the vast bulk of employer contributions (that is taxable contributions) each year. Extract employer and personal deductible contributions from APRA funds and they pay a similar rate of tax as SMSFs.

Two interesting points to note about the ATO statistics:

- 60% of APRA funds have $63 billion of capital losses (7% of total fund assets) and 47% of SMSFs have $18 billion of capital losses (4.2% of fund assets) that can be offset against future capital gains. This difference says a lot about how quickly APRA funds traded assets during the GFC.
- 44% of SMSFs and 60% of APRA funds pay pensions.

2) Franking credits reduce tax payable

Franking credits are a simple mechanism to ensure dividends are taxed at the owner's applicable tax rate. That is, they neutralise the impact of company tax.

The biggest misconception about franking credits is that they reduce tax. If a company's directors distribute profit to its shareholders via dividends, those shareholders must include the dividend paid plus the attached franking credit in their taxable income.

A super fund pays less tax itself when it has franking credits because some of its tax liabilities have been pre-paid by the company. Between the payment of that company tax and the effective refund to the

super fund, the Tax Office has had free use of your money.

Excess franking credits are refunded to super funds (and charities and potentially individual taxpayers) and some claim this is a problem. Any mischief here – if this really is a malignancy – is created by the tax system. Compared to APRA funds, SMSFs have more money in the pension phase, and therefore more franking credit refunds.

What you can do

- Are you a shareholder in any financial services business operating in Australia? Write to the chairman and the company's board. Express your displeasure on any attack they make on SMSFs. Let them now that unless it ceases forthwith, you'll have to seriously consider asking questions at the next AGM about their views, vote against all of the board sponsored resolutions (especially the remuneration report!) and possibly even sell your shareholdings. You can be sure your views will rapidly trickle down to senior management.
- Are you an industry fund member? Write to the trustees and suggest their time would be better spent running their fund properly rather than commenting on or criticising another segment of the superannuation sector.
- Finally, write to your state/territory and federal politicians and tell them that you want them to publicly back SMSFs. If they're not prepared to look after your interests, then they can hardly expect your vote at the next election. All politicians become and remain politicians by counting votes. You have to use this to your advantage.

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Oil Search - an energy company with plenty of oomph

by Paul Kasian

How long have you held Oil Search Limited OSH (market cap $14.7 billion)?

We've held an overweight position vs benchmark since August 2011.

What do you like about it?

We like the strong production growth potential that Oil Search offers investors in the energy sector. They have a 29% interest in the ExxonMobil operated PNG LNG Project. The project is now operating at full capacity, following the early completion of the project, which will underpin strong cash flows for the company going forward. In addition, the company has extensive interests in two major gas hubs, the PNG Highlands and the Papuan Basin. The company is pursuing a gas aggregation strategy in the PNG to drive the next phase of LNG development. We believe that a brownfield expansion to the PNG LNG project will provide further strong economic returns for investors given the ability to leverage existing infrastructure.

Oil Search Limited (OSH)

Source: *Yahoo!7 Finance, 4 September 2014*

How is it better than its competitors?

The company has extensive experience in Papua New Guinea, having been operating in the country since 1929. In addition, with ExxonMobil as the project operator of the PNG LNG project, Oil Search can also leverage the super major's capabilities.

What do you like about its management?

Experienced senior management and a supportive board have ensured the early completion of the PNG LNG project slightly under budget.

What is your target price?

Around $11 in the next 12 months.

At what point would you sell it?

We will look to review our position once a Final Investment Decision (FID) has been made on some of the company's growth options.

How much has it added (subtracted) to your overall portfolio over the last 12 months?

Oil Search is up around 15.5% over the past year and not surprisingly has outperformed the broader ASX 200 benchmark, which is up around 14.3% (total return) over the same time period.

Is it a liquid stock?

Yes. It is a very liquid energy stock for both global and domestic investors.

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Investment properties and market outlook

by Questions of the Week

Question: We have an investment property outside of our SMSF. We still have a mortgage on it. Can you please explain the options available to transfer the property into our SMSF? We can pay off the balance on the loan from funds outside of super. Can we withdraw a lump sum from our SMSF to pay off the mortgage as our fund is in pension mode? Would it create a tax liability?

Answer (By Paul Rickard): You can't transfer your investment property to your SMSF. There are no exceptions for residential property.

If your SMSF Trust deed allows it, you can usually commute an account based pension and withdraw it as a lump sum. The lump sum can then be used to pay off the mortgage.

Question 2: Do you think now is the time to be fully invested? If not, what percentage would you recommend? I mainly look at dividends with some capital appreciation.

Answer 2 (By Paul Rickard): Peter and I feel that the domestic share market is heading towards 6000 – a position we have held now for more than a couple of years, based on the view that the "easy money" policy of the Central Banks would lead to higher asset prices.

That said, I have never been fully invested in shares – I invest across all the asset classes – and as we move higher, my inclination will be to take some money off the table.

Unfortunately, I cannot legally even attempt to answer your question because I have no insight into your financial objectives, investment horizon, particular needs or risk appetite. An adviser may be able to help you in this regard.

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.*