Switzer Super Report

Thursday 2 July 2015

Winner, winner chicken dinner

In the *Switzer Super Report* today, Roger Montgomery shares his outlook on IMF Bentham, Platypus Asset Management fund manager Jelena Stevanovic explains what's so great about Corporate Travel Management, and fund management guru Geoff Wilson writes about a new international listed investment company that supports a good cause as well.

I also want to announce the winner of our 400th issue competition on why you love the *Switzer Super Report*. Our winner – drum roll please – is Ray from NSW with the below entry.

Timely, relevant, with in-depth advice
Comes *Switzer Super Report* – weekly thrice.
Peter and team provide sound, insightful, financial analysis
Helping subscribers avoid financial paralysis.

Ray we will be in touch shortly to arrange the lunch.

Sincerely,

Peter Switzer

Inside this Issue

A first class company - Corporate Travel Management
by Jelena Stevanovic 02

switzersuperreport.com.au

Switzer Super Report is published by Switzer Financial Group Pty Ltd AFSL No. 286 531
36-40 Queen Street, Woollahra, 2025
T: 1300 SWITZER (1300 794 8937) F: (02) 9327 4366

A first class company - Corporate Travel Management

by Jelena Stevanovic

Key points

- *Corporate Travel Management recently embarked on its global strategy and still has ample opportunity to grow through further acquisitions.*
- *It participates in the corporate travel segment only, which is more resilient than the leisure segment.*
- *Platypus's short-term target price for Corporate Travel Management is $14.50 (currently around $10.74). There's upside risk to this valuation from potential further acquisitions.*

Jelena Stevanovic is a senior analyst at Platypus Asset Management.

How long have you held Corporate Travel Management?

We initiated our position in October 2014 as we started shifting our exposure to the global travel segment away from Flight Centre (FLT) to Corporate Travel Management (CTD) based on the view that a company exposed to the corporate travel segment only will have better growth opportunities than the one operating in both corporate and leisure segments.

Corporate Travel Management is a corporate travel management company with operations in Australia, New Zealand, North America, and Europe. The company was established in Brisbane in 1994 and since then has grown to 46 locations around the world through both acquired and organic growth.

Corporate Travel Management's acquisition in New Zealand in 2010 marked the beginning of its offshore expansion strategy and the company's global footprint grew very quickly after that. First by entering the US market in 2012 through the acquisition of R&A Travel, followed by their Asian acquisition in 2013, and a year later the acquisition of European based Chambers Travel.

What do you like about it?

Corporate Travel Management has only recently embarked on its global strategy and we believe the company still has ample opportunity to grow through further acquisitions in their current markets as well as by continuing to expand their global footprint. Both are expected to assist Corporate Travel Management in becoming more capable of servicing large clients with global travel needs.

Such clients have traditionally been serviced by large global providers like Amex and Carlson Wagonlit. Corporate Travel Management differentiates itself from its large competitors by providing travel solutions that are more flexible and through more personalised customer service.

We believe that Corporate Travel Management's organic growth will be supported by market share wins from such large competitors.

In addition, Corporate Travel Management participates in the corporate travel segment only which we believe is more resilient than the leisure segment and competitors in this space. Unlike its leisure counterparts, it is not forced to compete on price alone.

How is it better than its competitors?

Corporate Travel Management differentiates itself from other global corporate travel management providers by offering a tailored travel solution for each client based on their specific needs, whilst still promising to deliver a percentage of their total spend back in cost savings.

What do you like about its management?

Corporate Travel Management was founded by Jamie Pherous who is still involved in the day-to-day management of the company in his role as the managing director. Jamie is also the largest shareholder with over 20% of Corporate Travel Management shares.

His enthusiasm and commitment to growing the business has not changed in the two decades of the company's existence. The same passion for growing the business is evident throughout Corporate Travel Management's executive and senior management team as the team is made up of corporate tourism veterans and, just like Jamie, executives who founded businesses that have merged with Corporate Travel Management.

What is your target price on Corporate Travel Management?

Our short-term target price for Corporate Travel Management is $14.50 based on our 12-month forward EPS estimate. There's upside risk to our valuation from potential further acquisitions, which would result in a material upward revision of our EPS forecasts. We believe the stock can continue to trade in the 30 to 35 times 12-month forward PE range for the foreseeable future, as long as the corporate strategy and opportunities for further consolidation and growth remain intact.

At what point would you sell it?

We do not expect to sell Corporate Travel Management in the short-term as we believe the company is just starting its next phase of growth and as such will continue to deliver impressive earnings growth for the next few years.

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

Corporate Travel Management has contributed 15 basis points to our performance in the last nine months that we have owned it.

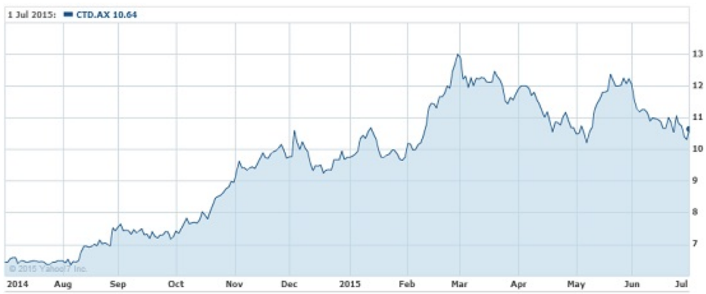
Is it a liquid stock?

Corporate Travel Management started its listed life with poor liquidity as Jamie Pherous, the founder and managing director, held a large portion of its shares. Jamie has not participated fully in the last few capital raisings in order to improve liquidity of the stock. We would argue the liquidity is reasonable with ~ $800m of free float.

Where do you see the value?

We believe Corporate Travel Management will continue to deliver value to shareholders through simply executing its strategy of continuing to grow the business through market share wins, further consolidation of the industry in their current geographies and expanding its global footprint. We believe that Corporate Travel Management has a passionate and committed management team that will continue to innovate and stay ahead of its competitors.

Corporate Travel Management (CTD)



***Source**: Yahoo!7 Finance, 2 July 2015*

***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.*

IMF Bentham – value trap or opportunity?

by Roger Montgomery

Key points

- *IMF Bentham (ASX: IMF) has fallen over 30% since its record high in March 2015.*
- *IMF has a very successful track record of funding class actions, generating an historical internal rate of return exceeding 40%.*
- *The company has recently announced the settlement of its sixth class action in the US and is funding four new cases in this market. Management is also pursuing a higher volume of smaller cases that may smooth the company's earnings profile. These initiatives should help grow the claims book above $2 billion.*

The share price of IMF Bentham (ASX: IMF) has fallen over 30% since its record high in March 2015, and shareholders (including Montgomery Funds) must inevitably ask – is this a value trap or an opportunity?

A temporary weakness

A value trap is when a company is perceived to be good value, though its share price continues to decline. We must assess if the company's fundamentals have deteriorated, or whether the weakness is temporary.

IMF has a very successful track record of funding class actions, generating an historical internal rate of return exceeding 40%. However, while management is very experienced at allocating resources to maximise payoffs for clients, it is difficult to accurately predict when a case will conclude.

A lumpy earning's profile makes it harder to determine IMF's 'normal' level of earnings and whether, for example, short term underperformance reflects longer term deterioration. For instance, after modest returns in fiscal 2013 and 2014, IMF was well on track for a bumper fiscal 2015. In the December 2014 half-year it settled $460 million of claims and recognised $23 million in earnings. But shortly after this impressive result, the company made a string of unfavourable announcements in quick succession.

First, there was the successful appeal of a case that IMF had initially fought and won in 2012. Then came the loss of a small case in the USA. And finally, the Full Court of Australia ruled in favour of ANZ in IMF's class action against the banks to recover credit card fees. While IMF will pursue the matter to the High Court of Australia for final resolution, the high-profile case did certain harm to the company's share price.

Finding intrinsic value

When you are holding an investment in a company with a falling share price, it is helpful to consider the wisdom of Howard Marks from Oaktree Capital. In order to profit in a declining market, you must have a view on intrinsic value and hold that view strongly enough to be able to hang in. Oh, and you must be right.

So let's first explore our view on IMF's intrinsic value. The company is in a very strong cash position, with $134 million in cash, $48 million in debt, and $65 million in current trade receivables, which are not subject to appeal at 31 December 2014.

IMF Bentham also had $79 million of intangible assets, which comprises the company's investment in current cases. This is a sunk cost, so provided that IMF Bentham maintains its historical returns we believe its liquidation value is similar to its current $280 million market capitalisation.

A company that is trading close to its liquidation value generally goes a long way in providing an attractive margin of safety for investment. Yet the conviction of our view must also consider the company's prospects – and IMF appears to have many growth opportunities on the horizon.

The company has recently announced the settlement of its sixth class action in the US and is funding four new cases in this market. IMF also reached agreement with its European joint venture partner to co-fund its first European case, which will attempt to recover damages from S&P and ABN Amro for investors who purchased Constant Proportion Debt Obligations.

Management is also pursuing a higher volume of smaller cases that may smooth the company's earnings profile. These initiatives should help grow the claims book above $2 billion.

Long-term hold

Our investment thesis depends on the company maintaining its rigorous risk assessment when funding cases, and despite the recent spate of unfavourable rulings, we consider that it is business as usual for IMF Bentham.

It's important to understand that the legal system is adversarial, which means there will always be a winner and a loser. While IMF's track record is impressive, it does not mitigate the risk of future losses. On balance though, we consider that a sufficient margin of safety exists and are comfortable with IMF's long-term prospects.

IMF Bentham

***Source**: Yahoo!7 Finance, 2 July 2015*

***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.*

A new global equity LIC with a feel-good factor

by Geoff Wilson

Access to global markets is often viewed as opaque and too difficult for Australian shareholders to tackle on their own. The opportunities are endless, but how do you know when to make the best investment decisions?

An Australian listed investment company that invests in global markets is an excellent investment opportunity. What's more, I am pleased to share an exciting investment opportunity and be part of the team delivering it – Future Generation Global Investment Company Limited (FGG).

The fund

FGG is a listed investment company offers investors the opportunity to gain access to Australia's most prominent global fund managers – a number of whom are closed or not accessible to retail investors – through a single ASX-listed investment vehicle.

Fund managers are managing the capital pro-bono so that 1.0% of net assets each year can be donated to Australian non-profits committed to young Australians affected by mental health issues. This is based on the Future Generation Investment Company (FGX) model launched last year.

The company offers diverse exposure to international equities through a range of different investment styles and strategies employed by its fund managers specialising in global markets.

FGG is seeking to raise up to $550 million for the fund, the largest float for an Australian LIC. If reached, the company would be on track to make an annual donation of approximately $5.5 million to Australian charities focused on youth mental health. This is a perpetual gift from fund managers and shareholders to young Australians suffering through mental illness.

The investment goal

FGG's investment objective is to provide shareholders with long-term capital growth. By investing in companies globally, the aim is to maximise total return with a combination of capital growth and income, thus allowing fully-franked dividends to be distributed to shareholders provided the company has sufficient profit reserves and franking credits available and it is within prudent business practices.

The fund managers involved with FGG are:

- Magellan Asset Management Limited
- Cooper Investors Pty Limited
- IronBridge Capital Management L.P.
- Paradice Investment Management Pty Ltd
- Nikko Asset Management
- Eastspring Investments (Singapore) Limited
- Insync Funds Management Pty Ltd
- Hunter Hall Investment Management Limited
- Ellerston Capital Limited
- Antipodes Partners Limited
- VGI Partners Pty Ltd
- Manikay Partners, LLC
- Avenir Capital Pty Ltd
- Morphic Asset Management Proprietary Limited
- Optimal Fund Management Pty Ltd
- Neuberger Berman Australia Pty Limited
- Tribeca Investment Partners Pty Ltd.

FGG has a highly experienced board that will act pro bono and is chaired by Australian business leader and University of Sydney Chancellor Belinda Hutchinson AM.

The philanthropic goal

FGG is determined to transform youth mental health by driving philanthropic investment in three core areas: helping the community understand the issue; investing in the most effective programs and services; and enabling investment in research and development.

Nearly half (45%) of all Australians will experience a mental health problem over the course of their lives, and one in five will do so in any given year.

Adolescence and young adulthood are an especially critical period, with 75% of mental health problems first appearing before the age of 25. Timely and appropriate help-seeking, especially during adolescence, can reduce the long-term health, personal, economic and social impact of many of these mental health problems.

We hope FGG will be the biggest funder in the youth mental health space, apart from government services.

The designated charities have been selected because of their potential to collectively transform youth mental health in Australia.

- *beyondblue*
- Black Dog Institute
- Brain and Mind Research Institute
- Butterfly Foundation
- headspace National Youth Mental Foundation Ltd
- MadCap Social Enterprise
- Orygen, The National Centre of Excellence in Youth Mental Health
- ReachOut Australia
- SANE Australia.

You can find out more about the fund here.

** Geoff Wilson is founder, director and on the investment committee of FGG.*

***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.*

Buy, Sell, Hold – what the brokers say

by Staff Reporter

In the good books

Macquarie upgraded Drillsearch Energy (DLS) to Outperform from Neutral. Buy/Hold/Sell 2/4/0 An update from Drillsearch indicates FY15 production at the low end of the guidance range but in line with the broker's forecast. Following recent discoveries, significant reserve upgrades are likely, which should support high margin production into FY17. This should help to offset the otherwise surprising increase in capex in a climate of energy company austerity.

UBS upgraded Bluescope (BSL) Steel to Buy from Neutral. Buy/Hold/Sell 6/2/0 Regional steelmaker spreads have fallen on continued oversupply from China. This is likely to push BlueScope's Australian business towards a loss in FY16. Hence, UBS suspects mothballing the remaining No 5 blast furnace could become a viable option. This scenario would mean a focus on downstream value-adding using imported steel. UBS upgrades on the potential upside seen in the stock.

Deutsche Bank upgraded South32 (S32) to Buy from Hold. Buy/Hold/Sell 6/0/0 Deutsche Bank has made changes to currency and commodity price forecasts. Commodities are largely downgraded. Base metal fundamentals remain more attractive than the bulks but the broker does not expect a recovery will get underway until 2016. Value is seen emerging in some stocks as the sector has been aggressively sold off. The major changes to forecasts are in iron ore, copper, aluminium, alumina and nickel.

In the not-so-good books

UBS downgraded Asciano (AIO) to Neutral from Buy. Buy/Hold/Sell 5/3/0 The company has received a cash and scrip takeover bid from Brookfield Infrastructure. The $9.05 per share offer represents a 36% premium to the stock's last traded price. UBS views Brookfield as a logical buyer, which already has a presence in the Australian rail industry. Asciano is a high cash generating business and an appealing target. Still, UBS believes there are some risks the bid may not progress, including the possibility of another bidder emerging.

UBS downgraded Slater & Gordon (SGH) to Neutral from Buy. Buy/Hold/Sell 3/1/0 Slater & Gordon has announced a significant accounting issue regarding the recognition of historical UK cash flows. Quindell plc shares have been suspended pending an investigation. The question for investors, in the broker's view, is whether there are any significant discrepancies with respect to due diligence in valuing the assets recently acquired from Quindell. As a consequence, UBS reduces its rating to Neutral from Buy pending clarification.

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.

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.*

Succession planning and super – not so simple anymore

by Tony Negline

Key points

- *A properly constructed business succession plan needs to address two key issues – disposal and funding.*
- *Sometimes business owners will want to have life insurance policies in a super fund so they can get tax concessions on the insurance premiums and the proceeds can often be paid out tax free when initially paid to the deceased's dependant.*
- *However a recent interpretive decision from the Tax Office didn't like an arrangement in which two brothers had arranged to execute a buy-sell agreement that said their SMSF would purchase a life insurance policy. The brother would then use the proceeds to pay out the spouse's interest in the business if her husband were to die.*

There are more than 1 million small businesses in Australia and all of them will have issues about succession.

What do I mean by this term? Basically ensuring a business survives when owners, key employees and managers can't work in the business because of death, permanent or temporary disablement, imprisonment and even bankruptcy.

Planning for these potential events can sometimes be a complicated affair. And to make matters slightly more difficult, the Tax Office may have made it harder to solve this issue using an SMSF. Fortunately solutions are at hand.

Make a succession plan

A properly constructed business succession plan involves establishing a written agreement between business owners that needs to address two key issues – disposal and funding.

In an ideal world a business succession plan will provide certainty but will also be flexible enough to take into account changes in business circumstances and dynamics. It also needs to be simple. Often achieving these competing objectives to high degree can be tough – sometimes too tough.

One option is to solve immediate critical issues and then agree on a timetable to consider other matters.

Important considerations when sorting out business succession are various taxes such as CGT, stamp duty and GST.

As an example, let's consider a business owned equally and run by two brothers who are both married. They agree that if the worst were to happen to one of them, it would be better if the surviving spouse didn't work in the business and her inherited ownership of the business would be compulsorily acquired by the living brother.

In many cases, owners don't have sufficient personal resources to buy out their unowned share of a business. The only way to effectively solve this problem for death and disablement is via various life insurance policies.

There are many ways to structure these arrangements. For example, one brother might take out a death insurance policy and nominate his other brother as the beneficiary of that insurance. A signed written agreement is executed which deals with a range of issues including how the business will be valued, how the proceeds from the insurance policy will be used as consideration for the business, which will then enable the surviving brother to compulsorily take ownership of the deceased's business interests.

Using super funds

Sometimes business owners will want to have the life insurance policies in a super fund so they can get tax concessions on the insurance premiums and the proceeds can often be paid out tax free when initially paid to the deceased's dependant.

The option of using super funds in this way has been around for years and some large retail super funds have regulatory approval, which they have used to market their offering. Often they have also provided pro-forma business succession agreements, which businesses have used as a handy template.

The ATO's interpretation

Recently the Tax Office issued an Interpretative Decision (ID) that looked at a specific business buy-sell agreement that used an SMSF.

The proposed arrangements had the following details: two brothers would execute a buy-sell agreement that said an SMSF which has two members – one of the brothers and his spouse – would purchase a life insurance policy with the sum insured based on an agreed market value of 50% of the business.

The business would pay for the insurance policy via super contributions that would be in addition to any Super Guarantee or salary sacrifice contributions that the business would make.

If any insurance policy claim proceeds were received, they would be paid to the super fund, which would then distribute this to the brother's spouse who, in turn, would agree that this would represent her interest in the business and would formally transfer ownership of her inherited portion of the business to the surviving brother.

The Tax Office said it didn't like this arrangement. In its view the SMSF would be part of an agreement but wasn't actually a party to it. The ATO concluded that such a proposal would be a breach of the sole purpose test (that is, a specific test which funds must satisfy at all times).

It also said the agreement indirectly provided financial assistance to the fund member's brother, which is prohibited. It argued that "the terms of the agreement allow the member's brother to obtain total ownership and control of the company upon the member's death without the need to pay any consideration either in the way of insurance premiums or as a direct sum to the member's widow for the expected inherited share of the company".

Can you use super for business succession?

Brian Hor, Special Counsel at Townsends Business and Corporate Lawyers says that it appears this arrangement provided too much detail and it could have been better structured. He added that businesses wanting to use super funds for buy-sell arrangements might be better utilising the insurances offered in retail or industry super funds rather than a SMSF and to be very careful in how they draft their agreement.

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.*

South 32 and Woolworths – buying opportunities?

by Questions of the Week

Question: What is your opinion on S32? I'm 75 and was thinking of having this in my portfolio.

Answer (By Paul Rickard): Tony Featherstone covered South32 a few weeks back. So far, he has been right on the money.

I am not rushing into buy South32 (yet,) as I think there will be more pressure on commodity prices (caused by a higher US dollar). Long term, there is probably some value.

The brokers are pretty positive on South32. According to FN Arena, the consensus target price is $2.54 (a premium 40.5% to its last closing price of $1.805). Sentiment is +1.0 (scale is -1.0 most negative, to +1.0 most positive).

Question 2: What are your thoughts on whether Woolworths (WOW) Shares as a buying opportunity for around the $26 – $27 range?

Answer 2 (By Paul Rickard): I think you will see Woolworths cheaper than $26 to $27. And, while the dividend for the second half of 14/15 will probably hold up, a cut to the dividend in 15/16 can't be ruled out.

Even if they don't fall in price from here, I think Woolworths shares will lag in any market rally (underperform). The supermarket wars are by no means over.

Have a look at my article on *Switzer Daily*.

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.*