Weekly Review

RESEARCH

3 PMP: RESULT 2016 | 5 AUCKLAND AIRPORT: RESULT 2016 | 7 AUTOMOTIVE HOLDINGS: RESULT 2016 | 9 SCENTRE GROUP: INTERIM RESULT 2016

– Issue – 9 Sep. 2016

With a more detailed special report on the way, John Addis asks the team for their immediate thoughts.

BY JOHN ADDIS • INTELLIGENT INVESTOR • 6 SEPTEMBER 2016

Reporting season wrap

Behind the themes expressed in the recently completed reporting season, one stood out: the incredible influence the bond market is having on share prices. The impact of lower rates touched almost every sector, impacting the behavior of investors and company managers alike.

Key Points

- ***Low rates driving markets in different ways.***
- ***Valuations beginning to look stretched.***
- ***It's risky when there is no sign of risk.***

Take listed property trusts (A-REITs), for example. They continue to benefit from cap rate compression as low long-term interest rates raise the attractiveness of commercial property on long term leases. Smart owners are taking advantage of this. Witness **Crown's** proposal to spin off 49% ownership in most of its Australian hotels, the **Viva Energy REIT** float and Charter Hall's Long WALE partnership listing.

If and when long term interest rates rise, this sector will be the first to show it in the form of lower share prices. Long average lease terms make them highly attractive in the current low interest rate environment but much less so if and when long term bond rates rise. But if and when that might happen is anyone's guess.

General insurers **QBE Insurance** and **IAG** had a rough year, facing pricing pressure, increasing competition and low returns from their investment portfolios (QBE didn't even manage a 2% return). According to senior analyst Graham Witcomb – and no-one I imagine would disagree with him – there's no value here.

Retail

In retail, **Woolworths** and **Wesfarmers** took the opportunity to wipe the slate on poorly-performing businesses with multi-billion dollar writedowns, signalling an end to the sector's margin expansion and profit growth. In fact, many companies are trading on premium prices and have been downgraded, or are closer to being so. In the aftermath of the Woolies result, a stock only just removed from our Buy List, the share price surged 4% because the news wasn't as bad as expected. It makes the point: there's a general air of positivity factored into share prices that is not always matched by reality.

The big retailers have also let their dividends creep up at the same time as their debt levels. Realising they've been too complacent, both have cut dividends, as did **Flight Centre**. By contrast, **JB Hi-Fi** has been a beneficiary of the collapse of competition from **Dick Smith** and department stores vacating the consumer electronics space.

Resources

In resources, cost improvements were a big theme, although top line profits were hit by impairments and high depreciation charges from the boom years. Cash flows are much better and the top end miners (**South32**, **BHP Billiton** and **Rio Tinto**) are repairing balance sheets and even talking about spending cash again. Two were already on our Buy List but price rises put paid to that. It would be nice to get another opportunity in this sector. Mining services generally reported good results with higher cash flows and lower debt and the gold sector has been on a tear, not that that is in any way predictable.

Continued on page 2 ...

CONTENTS

FEATURE ARTICLES PAGE

Reporting season wrap 1

STOCK ARTICLES

	RECO.	PAGE
Auckland International Airport	Hold	5
Automotive Holdings Group	Sell	7
iCar Asia	Hold	11
Platinum Asset Management	Hold	13
PMP	Hold	3
Scentre Group	Hold	9

STOCK ALERTS

	RECO.	PAGE
Amaysim	Buy	16
ASX	Hold	16
Commonwealth Bank	Hold	16
Trade Me	Hold	16
Virtus Health	Hold	16
Westpac	Hold	16

EXTRAS

Insights: Do Something Syndrome 15

Q&A 17

RECO. CHANGES

	FROM	TO
Automotive Holdings Grp	Ceased coverage	Sell
PMP	Speculative Buy	Hold

IMPORTANT INFO

DISCLAIMER This publication is general in nature and does not take your personal situation into consideration. You should seek financial advice specific to your situation before making any financial decision. Past performance is not a reliable indicator of future performance. We encourage you to think of investing as a long-term pursuit.

DISCLOSURE Staff own many of the securities mentioned within this publication.

PORTFOLIO CHANGES

PORTFOLIO	COMPANY	BUY/ SELL	DATE	NO. OF SHARES	PRICE ($)	VALUE ($)
Income	ASX	Sell	2 Sep 16	5	51.51	258
Income	Commonwealth Bank	Buy	2 Sep 16	10	71.6	716
Income	Trade Me	Sell	2 Sep 16	83	5.32	442
Income	Virtus Health	Sell	2 Sep 16	26	7.92	206
Income	Westpac	Buy	2 Sep 16	12	29.55	355
Growth	Amaysim	Buy	2 Sep 16	122	2.04	249
Growth	Trade Me	Sell	2 Sep 16	41	5.32	218

Continued from page 1 ...

It was a year of consolidation in the telecommunications sector where three giants – **Telstra**, **TPG** and **Vocus** – have emerged. None reported outstanding results and industry growth is slowing. Once a hot part of the market, it looks as though maturity is catching up. But after a 8% price fall since July, Telstra is looking more attractive (see below).

Large caps underperformed

There were a few standout results – **Computershare**'s prompted a 17% share price rise in a few weeks and **Bellamy** tripled profits and boosted margins and revenue – but large caps generally underperformed. With stretched valuations a few large fund managers are moving into small caps, pushing up the prices as a result. We're hopeful of opportunities here when the inevitable disappointments force them out of their new found loves.

With growth stocks outperforming over the past year perhaps the 'rush to yield' has gone into reverse. With interest rates falling the market has been happy to pay up for stocks with good and growing cash flow, dismissing big yielding stocks like Telstra, the big four banks and **IOOF** where growth seems limited. But as James Carlisle says, with fully franked yields of 6% plus you don't need much growth in this environment.

The banks will start growing again – eventually – and ironically the lack of growth (and the lower discount rate that results) means valuations are less dependent on near-term performance. Even more than ever, what matters is the long term and we expect the big banks to retain their privileged positions in our economy. That's why they're closer to an upgrade than other blue chips.

Perhaps more than usual, there were also some sharp price movements as some relatively unloved stocks came in better than expected, while others failed to match higher expectations. **Ansell** and Computershare rose 13% and 9% respectively, after reporting falls in earnings per share of 14% and 8%. The response to Woolworths and Flight Centre's results were also a mark of the times. With valuations high at the quality end of the market, investors are, unsurprisingly, nervous and are prepared to pay up for the appearance of certainty.

There has also been a rise in the number of companies buying back stock – **James Hardie**, **CSL**, IAG, Computershare, Ansell, **Qantas** (shudder), Telstra, Rio, **Caltex** to name just a few. Historically, this is a trend that increases as a bull market progresses but ends abruptly when share prices collapse (as counterproductive as that is).

That buybacks are becoming more popular could be a sign of complacency among managements and investors. As Howard Marks once said, 'The riskiest thing in the world is the belief that there is no risk'.

Note: Our detailed Reporting Season Wrap Special Report is now in production and will be available to members this week (fingers crossed).

Note: The Intelligent Investor ***Growth Portfolio*** *and* ***Equity Income*** *portfolios own shares in many of the stocks mentioned. You can find out about investing directly in Intelligent Investor and InvestSMART portfolios by* ***clicking here****.*

Disclosure: The author owns shares in Computershare and South32. Staff members may own securities mentioned in this article.

PMP's result wasn't great but, with cash flow still strong, our investment case is on track.

BY GAURAV SODHI • INTELLIGENT INVESTOR • 7 SEPTEMBER 2016

PMP: Result 2016

Five years ago PMP carried net debt of almost $150m and the business was struggling. PMP's transformation from a debt-ridden disaster to profitable, stable printer of catalogues is now largely complete and is perfectly illustrated by its balance sheet today.

Key Points

- ***Poor profit result***
- ***FCF remains strong***
- ***Now debt free***

PMP (PMP) / HOLD

Price at review	Max. portfolio wght.	Business risk	Share price risk
$0.64	**3%**	**Medium**	**Medium**

BUY Below **$0.60** — **HOLD** — **SELL** Above **$1.00**

$0.64

Mountainous debt has been repaid and the business now carries a small net cash position, the first time it has been debt free in living memory.

The improved balance sheet doesn't only reduce risk; it also highlights the sheer volume of cash being generated even as statutory profits appear feeble. That was again the case in PMP's full-year result where the business reported net profit of just $185,000.

That low number includes more than $14m in significant items, including restructuring charges of $8m, impairments related to the collapse of Dick Smith worth $4m and a $1.5m break fee for repaying debt too quickly.

On an underlying basis, net profit was more respectable at $12m although this was 2% lower than last year due a contract loss.

Competition remains intense and print volumes were lower across the board, including falls of 11% in catalogue volumes and a 10% in magazine volumes. New distribution contracts and lower costs helped offset the decline but this was still a poor result.

Case on track

The core of our investment case – that PMP is depreciating far more than it is spending in capital expenditure and hence under-reporting earnings – was again evident.

Depreciation and amortisation came to $28m but the business spent just $4m on capital expenditure. Maintenance on the existing asset base was expensed so underlying net profit of $12m was far below cash flow.

As we explained in ***PMP: Pressing on*** last November, PMP is depreciating an asset base that will not be replaced so we expect profits to remain undercooked for some time. Cash flow is the best way to value the business and, on this score, operating cash flow fell marginally to $32m while free cash flow was stable at $28m.

Even after rising 26% this year, PMP still trades on a free cash flow yield of 14% and well below net tangible asset backing of 73 cents per share.

Table 1: PMP results

YEAR TO JUNE	2016	2015	+/(–) (%)
REVENUE ($M)	816	812	0
UNDERLYING EBITDA ($M)	51.2	58.1	(7)
UNDERLYING EBIT ($M)	23.3	26.4	(12)
UNDERLYING NPAT ($M)	11.8	12.1	(2)
POST-TAX SIG. ITEMS ($M)	11.6	4.1	–
OP. CASH FLOW ($M)	32	33.2	(1)
CAPEX ($M)	4.2	5.5	(24)
FCF ($M)	27.8	27.7	0

Management did reveal that they were looking for an acquisition opportunity which is important for our investment case. Buying a competitor would lower industry capacity, lift utilisation rates and generate higher margins but, so far, peers have been reluctant to sell.

Free cash flows have also been used to buy back $4m of stock over the year and the business paid almost $12m in dividends. At current prices the full year dividend of 3 cents represents a sustainable yield of 4.7%.

> **"This is still an average business albeit one operating well and performing nicely.**

Due to liquidity concerns, the buyback has been cancelled and dividends could climb again but are tied to net profits. PMP has pledged to pay 100% of underlying net profits in dividends, which still leaves ample cash to build an acquisition war chest.

Average result

PMP hasn't had a great year with losses from Dick Smith and an additional contract loss detracting from profits but, with cash flow still strong and a mismatch between accounting and economic depreciation expected to continue, the investment case is on track.

Our base valuation is about 70 cents per share but acquisitions could lift it considerably over $1 if done well.

While catalogues are an attractive part of the print business, the industry itself remains competitive and tough.

This is still an average business albeit one operating well and performing nicely. We don't wish to chase the stock price. With the share price now above our buy price, we're downgrading to **HOLD**.

*Note: The Intelligent Investor **Equity Income** portfolio owns shares in PMP. You can find out about investing directly in Intelligent Investor and InvestSMART portfolios by **clicking here**.*

Disclosure: The author owns shares in PMP.

Tourists are flooding into the land of the long white cloud, and they're mostly coming from the land of the Red Dragon.

BY GRAHAM WITCOMB • INTELLIGENT INVESTOR • 7 SEPTEMBER 2016

Auckland Airport: Result 2016

This is what a tourist flood looks like: The local population of Auckland, New Zealand is around 1.5 million people yet, over the past year, the number of passengers moving through its main airport increased by that same amount to 17.3 million. Side by side, those extra 1.5 million seats would stretch from Sydney to Melbourne.

Key Points

- ***Chinese growth continues***
- ***Retail sales strong; large landholding***
- ***Lofty valuation; Hold***

AUCKLAND INTERNATIONAL AIRPORT (AIA) / HOLD

Price at review	Max. portfolio wght.	Business risk	Share price risk
$7.40	6%	Low–Med	Medium

BUY Below $4.00 — HOLD — SELL Above $8.00

$7.40

As with most big numbers, China has something to do with it. The number of passengers arriving from the country in 2016 was just under 360,000 compared to 292,000 in 2015. To put it in perspective, that one-year increase almost matched the total arrivals from Germany, the airport's sixth largest market.

The international market has always been Auckland Airport's bread and butter. International passengers account for around 54% of total passengers, compared to around 33% for **Sydney Airport**.

So far, that extra exposure to foreign travellers has been a blessing. International passengers grew 9% in 2016. What's more, traffic to and from New Zealand is growing faster than passenger traffic globally. The International Air Transport Association (IATA) estimates total global traffic has grown at 5.5% a year over the past decade and increased 7% in 2016.

Cost curve

All this extra traffic comes down to one surprising factor – New Zealand is pretty much in the middle of nowhere. Its remoteness means that tickets from major markets are expensive, so – to borrow a mining term – Auckland Airport sits high on the 'cost curve'.

As incomes rise, particularly in Asia, holidaymakers have more disposable income, which puts New Zealand within financial reach. Where once the scenic islands were reserved for rich western tourists, low-cost airlines and high-capacity aircraft have made long-haul travel cheap enough for Asia's rising middle class.

Nonetheless, we aren't banking on 9% international passenger growth over the long term. The airport's own long-term projection for growth of 3% a year **as part of its 30-year masterplan** seems more realistic.

Retail bonus

Passenger growth helped the airport achieve a 13% increase in revenue to NZ$574m for the year, but the benefits of international passenger growth don't stop at extra aeronautical fees. Retail sales get a kick too because international passengers have longer wait times for their flights and so tend to linger in the retail stores.

Table 1: AIA result

YEAR TO JUNE	2016	2015	+/– (%)
AERO. REV. (NZ$M)	258	234	10
RETAIL REV. (NZ$M)	157	132	19
PROPERTY REV. (NZ$M)	75	65	16
PARKING REV. (NZ$M)	52	47	12
TOTAL REV. (NZ$M)	574	509	13
UNDERLYING EBITDA (NZ$M)	430	380	13
NET PROFIT (NZ$M)	262	224	17
FINAL DIVIDEND	9.0 + 1.6 NZ cents (up 23%), unfranked, ex date 28 Sept		

Sydney Airport's management has said that international passengers are around seven times more valuable to the airport than domestic passengers. We don't have a similar figure for Auckland airport, but this explains how a 9% increase in Auckland Airport's total passenger numbers led to a 19% increase in retail sales.

Unfortunately, being a tourist hotspot is a double-edged sword as it exposes the airport to volatile exchange rates, oil prices and tourism trends. If the world slipped into a recession, there's little doubt that Auckland Airport would have a rougher time compared to Sydney Airport.

> **But it's important to be mindful that every 1% rise in interest rates would now shave around 6% from net profit.**

Interest rates

As a vital piece of Auckland's infrastructure, with reliable, growing earnings, the airport can handle a lot of debt, which it uses to fund its capital expenditure needs, such as upgrading runways or terminals.

However, with more volatile earnings than Sydney Airport, Auckland Airport's management take a more conservative approach to borrowings. The company currently has NZ$1.9bn of net debt, which is roughly 4.4 times underlying earnings before interest, tax, depreciation and amortisation (EBITDA). The equivalent figure for Sydney Airport is 7.2.

What the airports have in common is that these debt piles have been a huge tailwind for earnings as interest rates have declined over the past few years.

Despite Auckland Airport's net debt almost doubling since 2008, interest expense has actually fallen slightly. Relative to 2008, the decline in funding costs saved the airport around $74m this year. Pre-tax profit has risen from NZ$160m to NZ$337m over that period, so, put another way, lower interest expense has contributed almost half the airport's pre-tax profit growth.

If interest rates stay low or fall further, Auckland Airport and other highly leveraged infrastructure assets will be among the biggest beneficiaries. But it's important to be mindful that every 1% rise in interest rates would now shave around 6% from net profit.

What's more, with a weighted average debt maturity of just 4 years – compared to 7 years for Sydney Airport – refinancing risk can't be ignored. Creditors may be clamouring to lend to Auckland Airport today, but plenty of airports and infrastructure assets had difficulty rolling over debt during the financial crisis, which led to a rush of desperate capital raisings. We don't expect trouble but this is one reason that, all things being equal, we still prefer Sydney Airport.

Highly valued

Of course, all things never are equal, and valuation is always the trump card. Here too Auckland Airport plays second fiddle with an enterprise value to EBITDA ratio of 26 (see ***The case for essential infrastructure*** for why we use this metric).

Make no mistake, an EV/EBITDA ratio of 26 is a hefty sum, even for a high-quality asset. Few airports are listed and they rarely change hands privately but we can get an idea of relative valuations by looking at two recent European transactions: Bristol and Toulouse airports were sold in 2014 and 2015, respectively, on EV/EBITDA ratios of 18.

Auckland Airport earns higher margins than both these airports thanks to its international exposure and undoubtedly has better growth prospects and less competition. It's a bit of an apples and oranges comparison, but it's still a sizeable gap.

Even Sydney Airport trades on an EV/EBITDA ratio of 22. Sydney Airport shareholders don't own the underlying land, though, which is held on a 99-year lease. Auckland Airport shareholders, on the other hand, have 443 hectares of freehold land available for development, which roughly matches the size of Auckland's CBD. As we've explained previously, ***Auckland Airport is a property developer's dream***, and that option means a higher earnings multiple is probably justified.

Management expects underlying earnings per share growth of 8–13% in 2017. The board declared a final dividend of 9.0 NZ cents, with Australian shareholders receiving a supplementary 1.6 NZ cents in lieu of franking credits, for a yield of 2.1%.

We're a long way from buying, but Auckland Airport is still a high-quality, stable business with excellent growth prospects. We're raising the price guide and continue to recommend you **HOLD**.

Staff members may own securities mentioned in this article.

AHG's result showed it should ditch its refrigerated logistics business. But will the new managing director's hands be tied?

BY JAMES GREENHALGH • INTELLIGENT INVESTOR • 8 SEPTEMBER 2016

Automotive Holdings: Result 2016

Most car dealerships lose money on the sale of each vehicle. They make it all up – and more – by selling you finance, insurance, servicing and parts. But there's a problem – ASIC wants to crack down on what it sees as usurious interest rates charged to some car buyers.

Key Points

- ***Decent result from Automotive business***
- ***Dragged down by Refrigerated Logistics***
- ***Downgrading to Sell***

AUTOMOTIVE HOLDINGS GROUP (AHG) / SELL

Price at review	Max. portfolio wght.	Business risk	Share price risk
$4.64	4%	Med–High	Med–High

BUY Below $3.00 | HOLD | SELL Above $4.00

$4.64

This is just one of the risks faced by Automotive Holdings Group (AHG), Australia's largest car dealership company. Indeed, ASIC's potential prohibition on flex commissions – whereby dealers earn greater commissions for charging higher interest rates to car buyers – occupied a good chunk of time on the 2016 results conference call.

Who knows where ASIC will draw the line? Our bet is that the reforms will be watered down. But AHG seems to be counting on a sizeable increase in the number of loans it sells to offset any potential downside, something that seems unlikely.

If you were conspiracy-minded, you might think this risk was at least partly behind the decision of long-serving managing director Bronte Howson to sell some AHG shares in March this year (see **this review** from April 2016). You might even think it was behind his decision to step down from the managing director role this coming December.

Watch for pedestrians

The truth is it was probably time for Howson to move on. AHG has been the also-ran of the sector, with earnings per share increasing by a pedestrian 29% over the past five years.

AP Eagers, AHG's smaller but more expensive competitor (and a 20% shareholder in AHG), shows that car dealerships can be a good business. AP Eagers has been one of the best-performing stocks on the ASX over the past five years, helped by earnings per share growing 85% over the period.

As AP Eagers' performance shows, the car dealership business is better than its low margin, high asset intensity and indebtedness might indicate. High volume, low margin businesses like car dealerships can produce excellent cash flow, but return figures tend to be depressed by high property and inventory holdings, while floorplan financing (the non-recourse financing used to fund the vehicle inventory) inflates the net debt-to-equity ratio.

Table 1: Cars v. trucks

YEAR TO 30 JUNE	2016	2015	+/(–) (%)
AUTOMOTIVE			
REVENUE ($M)	4,725	4,271	11
EBIT ($M)	159	143	11
REFRIGERATED LOGISTICS			
REVENUE ($M)	580	609	(5)
EBIT ($M)	16	24	(34)

AHG's 2016 results show why it takes the sector's wooden spoon award. The company's Refrigerated Logistics business is a significant drain on its Automotive (car dealership) division. Whereas Automotive's operating profit rose 11% in 2016, Refrigerated Logistics' operating profit fell 34% (see Table 1). Despite a 7% lift in overall revenue, AHG's underlying net profit rose just 3% in 2016 (see Table 2).

Gone cold

Despite all the capital allocated to Refrigerated Logistics over the years, it is, to put it bluntly, a dud business. Heavy ongoing capital spending is required, with management having made significant investments in technology, warehouses and fleet in recent years.

Unfortunately, customers are also big and powerful. Management explained that the poor result from Refrigerated Logistics in 2016 was partly due to 'competitive market conditions with significant pricing pressure from customers impacting margins'.

Despite years of acquisitions and investment, the return on assets in the Refrigerated Logistics division has deteriorated

> **"Poor businesses have a habit of continuing to siphon off capital from good ones, which is exactly what's happening at AHG.**

to just 5%. Management has belatedly recognised the problems and revealed on the 2016 conference call that it is 'certainly ... not wedded to this asset'. But the board also appears unwilling to cut Refrigerated Logistics loose after having invested so much time and capital into it.

Table 2: AHG result 2016

YEAR TO JUNE ($M)	2016	2015	+/(–) (%)
REVENUE	5,626	5,246	7
EBIT	182	175	4
NPAT	97	94	3
EPS (C)	31.7	30.7	3
DPS (C)	22.5	22.0	2
FRANKING (%)	100	100	N/A

*** Interim dividend 13 cents, ex date 15 Sep**
Note: Figures are underlying results

Poor businesses have a habit of continuing to siphon off capital from good ones, which is exactly what's happening at AHG. While 2016 operating cash flow was $140m, a big turnaround from the weak performance in the first half (see ***Moving AHG to Hold***), the combined business continues to produce weaker free cash flow than it should. In 2016 AHG produced $80m of free cash flow, but $55m of that came from the sale of property, plant and equipment.

Over the past five years, AHG has produced average free cash flow of less than $40m a year (see Table 3). This is an inferior performance to AP Eagers and suggests that AHG's capital allocation has been sub-optimal. Much of the blame lies with the Refrigerated Logistics division in our view.

Weak free cash flow – combined with a too-high dividend – also explains why AHG keeps raising money from shareholders. It raised $83m in 2011, $145m in 2014 and following the 2016 result it has launched yet another $110m raising.

Without the free cash flow to support its acquisition strategy – this year it has bought Hyundai, Mitsubishi, Jaguar, Audi and Mazda dealerships – AHG must fund them through capital raisings.

While acquisition-based strategies rarely delight us, the ongoing consolidation of the car dealership market makes some sense. Generally earnings multiples are low and efficiencies can be obtained by standardising systems. Operating margins in AHG's Automotive business have expanded from 2.9% to 3.4% over the past five years, which makes a big difference on $4.7bn of revenue.

I'll tumble for ya

The question now is whether any skeletons will tumble out of AHG's closet after Howson departs. At least new chief executive John McConnell looks like a good choice. As the former finance director for Inchcape PLC, one of the world's largest automotive retailers, he should bring greater financial discipline to the company. With any luck he'll sell AHG's logistics businesses.

At this point, though, the poor performance of Refrigerated Logistics, combined with management change and regulatory risk mean it is time to return to the sidelines. If there's evidence that the new managing director is taking steps to improve AHG's performance then we'll revisit the company.

Table 3: AHG free cash flow

	2012	2013	2014	2015	2016	AVG.
OPERATING CASH FLOW ($M)	86.9	91.8	102.2	113.3	139.8	
CAPITAL EXPENDITURE ($M)	(42.1)	(67.0)	(111.4)	(98.4)	(113.9)	
SALE OF PROPERTY ETC. ($M)	6.1	9.0	9.2	17.1	54.5	
FREE CASH FLOW ($M)	50.9	33.8	0	32.0	80.4	**39.4**

Source: Capital IQ

As part of AHG's recent capital raising, shareholders were given the opportunity to participate in a Share Purchase Plan at a price of $4.52 a share. If you've already participated, you will shortly receive shares at a small discount to the current price. If you haven't though, we recommend ignoring the offer (which is due to close tomorrow, 9 September).

AHG's share price is up 6% since ***AHG stronger than ever*** from August 2015, and you will have received dividends totalling 22.5 cents over the past year as well. But with more risks on the horizon, we recommend that you **SELL**.

Note: AHG goes ex a 13 cent fully franked dividend on 15 September.

Staff members may own securities mentioned in this article.

The shopping centre landlord is continuing to build on its strong foundations.

BY ANDREW LEGGET • INTELLIGENT INVESTOR • 6 SEPTEMBER 2016

Scentre Group: Interim result 2016

The collapse of Dick Smith left a number of victims in its wake. However, unlike the shareholders or bankers who are desperately fighting to get some of their money back, it barely left a dent in Scentre Group — who leased 40 sites to the former electronics retailer. Although it took a few months, all 40 sites have now been successfully re-leased to other retailers at higher rents than before. Dick who?

Key Points

- ***Still close to fully occupied***
- ***Strong development pipeline***
- ***Increasing price guide***

SCENTRE GROUP (SCG) / HOLD

Price at review	Max. portfolio wght.	Business risk	Share price risk
$4.87	5%	Medium	Medium

BUY Below $4.00 — **HOLD** — **SELL** Above $7.00

$4.87

It's a testament to the quality of Scentre's properties that the collapse of a company that leased 1% of its total lettable area was so easily overcome.

In the first half of 2016 — Scentre's financial year ends on 31 December — Scentre's occupancy was still above 99.5% leased, and total specialty sales hit a record high with shoppers now spending around $11,000 annually per square metre.

It is not just the shopping activity that has been getting bigger, many of the actual properties are as well. The company completed $855m of development activity in the six months to June (Scentre's share was $170m) and commenced another $855m (Scentre's share $480m). The second half of the year will see the completion of two more projects, including the new wing to Sydney's Westfield Warringah Mall which will include **Myer**'s first department store opened under its new concept.

Development continues to be a key source of growth for Scentre and the company expects its development pipeline of over $3bn to generate a yield of between 7% and 7.5%.

It isn't just developments, however, that will help boost future performance for Scentre. The company won the auction for the 78-year-old David Jones building on Sydney's market street (currently connected to the existing Westfield Sydney on Pitt Street). David Jones will continue to lease this building until 2019, but will eventually make way for 10,000sqm of new luxury retail space.

Best yet to come?

Scentre remains one of the best listed property companies on the ASX with well-located properties in many of Australia's busiest trading regions. Its great locations and the highest sales per square metre in the industry mean it should have no problem maintaining its high occupancy and continue to attract the most popular names in retail.

Table 1: Scentre interim result 2016

SIX MONTHS TO JUNE ($M)	2016	2015	+/(–) (%)
RENTAL INCOME	1,014	1,091	(7)
BORROWING EXP.	(90)	(400)	(77)
DISTRIBUTABLE PROFIT	617	604	2
DPS (C)*	10.65	10.45	2
GEARING (%)**	34.5	34.7	(1)
NTA PER SHARE ($)	3.49	3.37	3

***10.65 cents unfranked, ex-date already past**

**** Net debt / (total tangible assets – cash)**

With specialty leases mandating rental increases of either 2% or 3% above inflation (5% fixed in Victoria) over at least five years and strong development pipeline, we expect the company to be able to grow distributable profit over the long term between 3–5% per year. Combined with an unfranked distribution yield of 4.4%, that would imply total long-term returns of 7.4–9.4% before tax.

> **Scentre remains one of the best listed property companies on the ASX with well-located properties in many of Australia's busiest trading regions.**

Note, however, that you'll only get that return if our assumptions are right and you hold forever. If you sell before then, then the sooner that is the more your total return will be determined by changes in the price the market puts on Scentre's returns. If long-term interest rates start to rise, the market will doubtless put a lower value on the stock.

The current returns on offer aren't sufficient for us to recommend Scentre as a Buy for most members, but it may make sense for people who particularly value a high quality source of income, particularly if you take a long-term view and expect interest rates to remain low. We're moving our Buy price up to $4.00 and our Sell price up to $7.00. The wide range is despite a relatively narrow range of expected returns, but reflects the fact that the desirability of those returns will be highly dependent on personal circumstances and attitudes to risk. **HOLD**.

Staff members may own securities mentioned in this article.

As expected, the company is raising capital. Just not from you.

BY JAMES GREENHALGH • INTELLIGENT INVESTOR • 2 SEPTEMBER 2016

iCar Asia finds the funds

Start-ups can be capital hungry – as shareholders of iCar Asia will no doubt attest. Since listing in 2012, the company has raised capital every year. This morning iCar Asia announced another raising, as expected (see ***iCar Asia: Interim result 2016***). But there were two things this raising wasn't.

Key Points

- ***Capital raising as expected***
- ***No chance to participate***
- ***Operating metrics still acceptable***

ICAR ASIA (ICQ) / HOLD

Price at review	Max. portfolio wght.	Business risk	Share price risk
$0.355	2%	Very High	Very High

First, it wasn't an entitlement issue, which is the **fairest way to raise capital**. Instead it was a $23m placement to related and institutional investors at a price of 32 cents a share. Participants in the placement included 29% shareholder Catcha Group and an iCar Asia director (for $5.0m and $0.5m respectively, subject to shareholder approval). There was no word on whether **Carsales** will subscribe for additional shares, but it has a 'top-up' right and last year took a few weeks to make a decision.

Given iCar Asia's weakened position, we suspected the Board **might not opt for an entitlement issue** this time – and it didn't. But today we alerted management to the unfairness of not allowing small shareholders to participate, and requested that a share purchase plan be considered. We'll let you know if there's a change of heart here.

There's a second thing this capital raising wasn't: enough. While $23m, combined with the estimated $10m of cash the company has remaining, should get the company through the next two years, it probably won't be sufficient to see it through to profitability (originally forecast as the 2018 calendar year but now unlikely before 2020 in our view). (Of course, this could be at least partly solved by a share purchase plan.)

Bungle in the jungle

iCar Asia has now bungled the past two capital raisings. In 2015 the company waited too long, it didn't raise enough (as is now patently clear) and it was forced to follow up its placement with an entitlement issue. There's a chance iCar Asia has done exactly the same thing this year. It could get a reputation.

Now we've given the company a rap over the knuckles, is there any good news?

Yes. The dilution from the capital raising is minimal – about 2.5%. This is a function of both the raising and the discount being smaller than expected. Today's share price decline was actually less than the dilution. If you think the stock is cheap – and there is a case for it – today's 35.5 cent market price isn't much different from the 32.0 cent raising price.

Last week's investor presentation didn't give us much cause for concern either. Despite an economic slowdown and the additional competition management has mentioned, it's not showing up in the operating metrics at this stage.

Audience figures for all three countries in which it operates – Malaysia, Thailand and Indonesia – are near record highs. This is important, because it shows that car buyers are heading to iCar Asia's sites. Listings of vehicles also continue to grow in Malaysia and Indonesia (the company's most advanced and least advanced markets respectively).

Thailand is a little more concerning. Listing volumes have consistently declined since iCar Asia acquired leading site One2Car in 2014. Thailand is iCar's market with the strongest direct competition and it also accounts for most of the goodwill on the balance sheet. Any significant deterioration in expectations for that business could require a writedown (although the balance sheet could cope with that).

So what now?

Uncertainty resolved

Well, the immediate uncertainty surrounding the capital raising has obviously been resolved. And the operating metrics for the business remain acceptable – despite competition, iCar Asia appears to be generally growing its audience and listings.

> **New management combined with a capital raising can sometimes signal the point of 'maximum pessimism' for the share price.**

Nevertheless, the 'path to profitability' that we envisaged in ***iCar Asia's road to riches*** was too optimistic. This implies that the Speculative Buy price of $0.965 back in April 2015 was too high. The share price has fallen 63% since then and, with iCar likely to report losses into the foreseeable future, we are no longer comfortable with a positive view.

All that said, this has always been a speculative situation. The stock could still be worth zero, but it might also be worth $1.00 or more if iCar Asia makes itself invaluable to car dealers, as Carsales has done in Australia. There also remains the potential for iCar to be taken over.

With the stock price having fallen substantially, you might be well below our 2% maximum portfolio weighting. If so, there's a case to be made for buying more (to 'average down'). Just be aware that the stock remains highly speculative. You need to be sure you could tolerate a complete wipe-out of your capital here.

New management combined with a capital raising can sometimes signal the point of 'maximum pessimism' for the share price. In some ways this situation reminds us of **Myer**, where we upgraded because new management's strategy and the associated capital raising made sense. But iCar Asia is no Myer – it is a long way from producing positive operating cash flow, let alone the $200m a year that Myer generates.

Whilst acknowledging there is a reasonable chance of a share price recovery from here, we now believe iCar Asia is too speculative to recommend. There is however enough reason to **HOLD**.

*Note: The Intelligent Investor **Growth Portfolio** owns shares in iCar Asia. You can find out about investing directly in Intelligent Investor and InvestSMART portfolios by **clicking here**.*

Staff members may own securities mentioned in this article.

Platinum's result shows how quickly things can change in funds management.

BY ANDREW LEGGET • INTELLIGENT INVESTOR • 2 SEPTEMBER 2016

Platinum Asset Mgmt: Result 2016

What a difference six months can make. When Platinum's first half closed at the end of December, funds under management (FUM) were around $27bn and net profit was up almost 19% against the first half of 2015. Everything seemed positive.

Key Points

- ***Difficult second half***
- ***Funds underperforming***
- ***Not cheap enough***

PLATINUM ASSET MANAGEMENT (PTM) / HOLD

Price at review	Max. portfolio wght.	Business risk	Share price risk
$5.17	6%	Med–High	High

BUY Below $5.00 — HOLD — SELL Above $8.00

$5.17

Then things started to go wrong. In January, China's Shanghai Composite index fell around 25% compared to its level at 31 December 2015. Whilst it has improved since then, it's still down around 18% since the calendar ticked over to 2016. Then in June, the United Kingdom shocked the world by voting to leave the European Union.

Funds flow out

With this as a backdrop, Platinum ended the 2016 financial year with FUM of around $23bn, a fall of 15% since December as a big institutional client waved goodbye. The impact of the lower FUM was cushioned by the timing, with the biggest fall occuring in June. This meant that average FUM only fell 1% over the year, to $26bn. Fee revenue also fell by 1% to $338m, representing a flat margin of 1.31%, but other revenue fell by $13m to $7m due to lower currency gains on cash held in US dollars, so total revenue therefore fell 4% to $338m.

Combined with a 5% increase in expenses (largely driven by an 11% rise in staff costs), this meant that profit before tax fell 6% and earnings per share fell 7% to 34.2 cents – a long way short of consensus forecasts for a flat result.

With FUM already 10% below its average for 2016, 2017 is likely to see another fall in profits. It's early days, though, and July began on a positive note, with FUM increasing by $700m or 3% – but with the MSCI World Index falling 2% since the start of July the market isn't making it easy.

Platinum has also not been helped by the performance of its funds. The flagship Platinum International Fund, which accounts for almost half of FUM, has underperformed the market over the past 1 and 5 years – by 6% and 2% a year respectively – although it remains well ahead over 10 years and since inception.

Betting on Asia

Platinum's performance has suffered from its large bet on the Asian region and away from the US market. More than 30% of Platinum's funds are invested in Asia (excluding Japan) and North America represents just over 20%, compared to the MSCI World Index which has less than 10% in Asia (ex Japan) and more than 50% in North America. Unfortunately for Platinum, the Asia (ex Japan) region ended down 9% in 2016 compared to the 6% growth of the United States.

Table 1: Platinum 2016 result

YEAR TO JUNE ($M)	2016	2015	+/(-) (%)
FUM ($BN)	25.8	26.1	(1)
MGMT FEES	319.6	322.1	(1)
PERF. FEES	2.6	2.3	12
ADMIN. FEES	15.6	16.4	(5)
OTHER REVENUE	6.8	19.5	(7)
TOTAL REVENUE	344.7	360.4	(4)
EXPENSES	62.5	58.9	6
NET PROFIT	199.9	213.5	(6)
EPS (C)	34.2	36.7	(7)
DPS (C)	32.0	37.0*	(14)

***Excludes 10c special dividend**

Compare this to **Magellan Financial Group**, whose Global Fund, dominated by North America, was flat against the MSCI index over one year and has outperformed over five years and longer. A bet on Platinum is still a bet on Asia.

> **For one thing it's not clear that an improvement in fund flows would necessarily follow an improvement in performance.**

Ironically, the one thing that might help most in improving Platinum's relative performance would be a downturn in global markets, particularly the US – but investors in fund managers need to be careful what they wish for.

For one thing it's not clear that an improvement in fund flows would necessarily follow an improvement in performance. Managing director Kerr Neilson observes that 'performance can change remarkably quickly and within several months positive flows tend to follow', but fund flows were patchy in the five years following the global financial crisis, despite excellent five-year performance. Investors are also increasingly cost-conscious – particularly with lower returns forecast for most asset classes – and Platinum's margins stick out like something of a sore thumb.

Rocky markets

The other point, of course, is that rocky markets tend to hit the share prices of all fund managers – even the ones that tend to perform relatively well in those conditions – so there might be better opportunities to buy the stock.

The share price is now down 43% since **we recommended selling the stock** eighteen months ago and 10% since we reduced our Buy price to $5.50 and declined to upgrade in ***Brexit Buy List***. However, given the weak FUM performance, earnings are likely to fall again in 2017, so the stock doesn't look obviously cheap on a price-earnings ratio of about 17. Our preference is for **Perpetual**, which is on a similar PER, but has more reliable distribution and much less key man risk (although recent performance has also been poor).

We still admire Platinum Asset Management as a fund manager and are hopeful of an opportunity to buy the stock – but it will need to be at a lower price. We're shifting our Buy price down to $5 and will be watching closely. **HOLD**.

Staff members may own securities mentioned in this article.

Investors often choose action when inaction may be the better option.

BY PHILIP BISH • INTELLIGENT INVESTOR • 5 SEPTEMBER 2016

Do Something Syndrome

Have you ever sold a stock only to watch it go up – and up? I certainly have, and I've missed out on some big gains as a result.

On many occasions my best course of action would have been to sit on my hands, but instead I have succumbed to the 'action bias', also known as 'do something syndrome'.

It's a common mistake for novice and experienced investors alike, with the frequent buying and selling of shares often delivering nothing more than an increased brokerage bill.

The idea that humans like to be active is not new. In 1654, for example, French mathematician Blaise Pascal suggested that 'all of humanity's problems stem from man's inability to sit quietly in a room alone'. That's probably a stretch, but you only need to glance at the media circus that is modern politics to see that there's something in what Pascal said.

In 2007 Michael Bar Eli studied 286 penalty kicks faced by elite soccer goalkeepers. He found that the optimal strategy was to stay in the centre of the goal, but goalkeepers almost always dived one way or the other. It just looks and feels better to be doing something, rather than risk the humiliation of standing there flatfooted, while the ball sails past.

But activity does not always mean good results and in some cases can be counterproductive. For good results, we need to pause, think, and ensure that our facts and reasoning are right.

Ventures and Acquisitions

Company executives and boards also fall for the do something syndrome. Acquisitions are an obvious trap, with many chief executives giving in to their overactive animal instinct to take action and buy other companies, rather than risk being picked off themselves.

It's also easier for a CEO to explain what they are doing, rather than having to explain why they are doing nothing, and acquisitions and other new ventures are obvious focal points for activity.

In the early days of its disastrous Masters venture, **Woolworths** (ASX: WOW) had a great story to tell. But it's now painfully clear that it would have been better to stick to its knitting and focus on the threat to its core business from Aldi and a revitalised Coles (owned by **Wesfarmers** (ASX:WES)). All the activity with Masters ended up having a negative value for shareholders.

BHP Billiton's (ASX: BHP) $US37bn venture into shale gas was another enormous quantum of activity that has resulted in nothing but huge asset writedowns and losses for shareholders.

In both these situations, shareholders would have been much better off if management had simply done nothing and held on to the capital.

Despite many chief executives falling for the adrenaline rush of The Big Deal, statistically acquisitions fail more times than they succeed – as James Greenhalgh explained last year in ***Protect yourself from M&A disaster***.

Commenting on **Berkshire Hathaway**'s (NYSE:BRK.A) approach, vice chairman Charlie Munger explains: 'We've got great flexibility and a certain discipline in terms of not doing some foolish thing just to be active'.

In other words, they are willing to wait until the right opportunity comes along.

Time for action

There is of course a time for action, and you don't want to be watching from the sidelines when a great opportunity presents itself.

To be ready for opportunities requires a lot of patience and discipline. 'Temperament is more important than IQ,' explains Munger's partner and chairman of Berkshire Hathaway, Warren Buffett. 'You need reasonable intelligence, but you absolutely have to have the right temperament'.

The best opportunities don't need more than a reasonable level of intelligence to pick out, but you have to have a cool temperament to carry it through. By staying calm, thinking clearly and avoiding action just for the sake of it, you'll put yourself in the best position to take decisive action where it is warranted.

Equity Income Portfolio trades

BY JAMES CARLISLE • INTELLIGENT INVESTOR • 2 SEP 2016

The *Intelligent Investor* **Equity Income Portfolio** has reduced its holding in **Trade Me** by about two percentage points to 6.6% (at $5.32) and its holdings in **ASX** (at $51.51) and **Virtus Health** (at $7.92) each by one percentage point, to 6.3% and 4.3% respectively.

It has used the money (and some cash) to increase its holding in **Commonwealth Bank** by three percentage points to 5.2% (at $71.60) and its holding in **Westpac** by 1.5 percentage points to 3.8% (at $29.55).

Trade Me remains a Buy and we're very comfortable with it. However, its weighting (at 8.6%) was well above our 6% recommended maximum. Commonwealth Bank and Westpac are both Holds, but close to their Buy prices and they're well suited to an income-focused portfolio due to their high fully franked dividend yields.

See our article ***What we mean by Buy Hold and Sell*** for a fuller explanation of what our recommendations mean.

*Find out how you can invest in this and other InvestSMART portfolios by **clicking here**.*

Staff members may own securities mentioned in this article.

Growth Portfolio trades

BY JAMES CARLISLE • INTELLIGENT INVESTOR • 2 SEP 2016

The *Intelligent Investor* **Growth Portfolio** has reduced its holding in **Trade Me** by about one percentage point – at a price of $5.32 – and increased its holding in **Amaysim** by the same amount, at $2.04.

Trade Me remains a Buy and we're very comfortable with it. However, its weighting (at 8.5%) was well above our 6% recommended maximum and we were keen to increase our investment in Amaysim, which is also a Buy.

See our article ***What we mean by Buy Hold and Sell*** for a fuller explanation of what our recommendations mean.

*Find out how you can invest in this and other InvestSMART portfolios by **clicking here**.*

Staff members may own securities mentioned in this article.

Trade Me downgraded

BY JAMES GREENHALGH • INTELLIGENT INVESTOR • 8 SEP 2016

TRADE ME (TME) / HOLD

Price at review **$5.55** | Max. portfolio wght. **6%**

BUY Below **$5.25** | **HOLD** | **SELL** Above **$7.50**

$5.55

Trade Me's share price has continued to jump after we upgraded the stock again to Buy in Trade Me: Result 2016. With it now well above our $5.25 suggested Buy limit, we're downgrading again to **HOLD**.

Note: Trade Me went ex a dividend of NZ$0.09 today (or NZ$0.10588235 for Australian shareholders).

*Note: The Intelligent Investor **Growth** and **Equity Income** portfolios own shares in Trade Me. You can find out about investing directly in Intelligent Investor and InvestSMART portfolios by **clicking here**.*

Disclosure: The author owns shares in Trade Me.

Cleanaway

CWY was one stock on your Buy List quiet a while ago. I have noticed the price has started to move up. Is it worth a revisit , waste is expensive to remove . Has the company finally turned the corner? After a basing pattern for 6 years , maybe this time its time to turn waste into money. I like most investors forget about stocks, revisit them years later. Just to find they have had a huge movement to the upside.

2 Sep 2016 – **Gaurav Sodhi**: The Cleanaway result was better than expected but our investment case of a few years ago remains broken and we have no plans to upgrade again. We will try to cover it again soon.

Mining services

As the mining sector is picking up I had a good look at the companies that service them. I picked out Ausdrill, MND and Worley Parsons, as three companies that had been to hell and back but whose charts certainly showed that they had bottomed and were on the way up, and I bought them all. I was making 50% on MND before its poor result. Ausdrill had a wonderful result but not so the other two, and their share prices plunged back to nearly where they started. I sold WOR which seems to be past praying for but what about MND? It is paying a decent dividend and it seems to still have a chance. Do you agree?

3 Sep 2016 – **Gaurav Sodhi**: We will have updates for Ausdrill, Bradken and Macmahon coming up early next week but no plans for new content on Worley or Monadelphous. These pure services businesses are hard to value in stable conditions, about impossible to do so in volatile conditions. While they may well be cheap, it's impossible to make the case convincingly and reccos based on gut feel or intuition arent good enough for members. We concentrate on areas where we can make a convincing case for value. We may well be wrong but it will always be a case based in facts and logic rather than a gut feel which is all I have for the mining service providers.

Gage Roads Brewing (GRB)

I know GRB is too small to officially cover, but I was wondering if anyone personally (or Greg) is still tracking the business? They announced a highly dilutionary capital raising today which while I appreciate the pivot in strategy to extract themselves from Woolworths, the structure of the raising combined with issuing even more options is frankly a joke and I'm trying to decide if this is the final straw on their appalling governance and to just move on or not. Appreciate any general comments you may have on the outlook for their business. I might go have a beer to think it over, though not one of Gage's!

1 Sep 2016 – **Jon Mills**: Governance of **Gage Roads** has been terrible as you note. Interestingly, after selling down their stakes in the mid-20s (see Greg Hoffman's comments **here** for more), CEO John Hoedemaker, Chairman Ian Olson and director Robert Gould (or their related parties) are sub-underwriting the entitlement offer as well as being given 55m shares in long-term incentives.

The incentive shares are priced at $0.05 (ie twice the entitlement offer price), vest in equal installments over the next five years and are subject to tenure requirements and the company satisfying minimum earnings targets. That's the good part. Of course, they don't have to fork over any cash for these shares despite making a bundle from selling their previous holdings as noted above. Moreover, if the company doesn't meet the minimum earnings threshold in each year, the shares aren't necessarily forfeited - if GRB's share price subsequently reaches certain levels, they still vest. This isn't necessarily a bad thing although the required share prices aren't high enough in my view.

The raising substantially de-risks the business – it will now have net cash and minimal capital expenditure requirements after the $25m spent on its brewery in recent years. However, support from Woolworths will gradually wind down under the latest contract brewing agreement and GRB will be cranking up spending on marketing and branding to expand the sale and distribution of its proprietary range. The question is whether it can successfully do so and offset declines in contract brewing volumes (both for Woolworths and third parties).

Notably, these changes allow GRB to pursue distribution through Woolworths' competitors (ie Coles). The proprietary brands are higher margin than contract brewing so if the company is successful, profits will likely rise. Unlike the overall beer market which is slowly declining, the craft beer segment is growing fast (at around 15% per year) and so now that Woolworths' 23% stake has been bought back, it's possible that a big brewer might see it as an opportunity to expand its craft beer business (like Lion Nathan did with Byron Bay Brewing and Little Creatures). Production could be easily ramped up as GRB is only producing at about 60% of capacity and its proprietary range represents just under 15% of capacity.

Of course, if you don't participate in the rights issue, you'll be diluted. All in all, despite the governance concerns and highly dilutionary nature of the raising, the company is probably in a better shape than previously and, while we don't officially cover it, it may be a speculative opportunity for those aware of the risks. If GRB fails to increase sales of its proprietary range, however, things could deteriorate quickly.

Disclosure: I am a shareholder and will probably take up my rights.

INTELLIGENT
INVESTOR