Bramwell Brown Ltd

Investment Advisers – Brokers

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Bramwell Brown Limited – Newsletter – May 2018

Fletcher Building Rights Offer

Fletcher Building's troubles have been well-documented over the last few months. In February the company announced a half-year loss of $322 million following losses from the Building & Interiors Division (B&I) of over $600 million. These very significant losses come from a number of large construction projects undertaken by B&I, and include the International Convention Centre, the Christchurch Justice Precinct, Auckland's Commercial Bay development, the Novotel Hotel at Christchurch Airport, and development at Auckland and Wellington airports.

A combination of incompetence, prohibitive contracts and rising prices have been blamed for the losses, which led to the resignation of the chairman, Ralph Norris. New CEO, Ross Taylor has conducted a full review of the business and has announced that the B&I division will complete its existing projects but will not tender for any new contracts. Fletcher's other divisions remain profitable; however the scale of the B&I losses have led to the suspension of dividends until the company's finances are back on track.

The company has now announced an offer of new shares to existing shareholders in an effort to strengthen its financial position. The company is offering one new share for every 4.46 shares currently held at a price of $4.80 per share. The offer is fully underwritten and will raise $750 million. The offer is non-renounceable, which means you are unable to sell your entitlement for the new shares to another investor. If you do nothing your entitlement will be offered to institutional investors in a bookbuild run by the lead manager. Any premium realised from the bookbuild will be paid to eligible shareholders who do not take up their entitlements. I think even those shareholders who do not see a bright future for Fletcher Building should consider taking up their entitlement. The $4.80 offer price is at a significant discount to their current trading price at around $6.30.

The offer closes at 7pm on Friday May 11th. Offer documents were sent in the last week in April, and online applications can be made at www.fletcherbuildingshareoffer.co.nz

CALL THE OFFICE IF YOU WOULD LIKE TO DISCUSS YOUR OPTIONS

Australian Banking Royal Commission

Australian financial institutions are currently the subject of a Royal Commission of Enquiry into practices around inappropriate financial advice, fees and commissions. After initially denying the need for an enquiry the Government finally caved in to pressure and agreed to set up the Commission. Some appalling stories have been uncovered, highlighting significant deficiencies in the practices of some of the large financial planning firms. Clients' interests have not been put first, bank staff have been incentivised to sell inappropriate products, and in some cases advice has bordered on being fraudulent.

AMP has admitted to deliberately deceiving the corporate regulator (ASIC) over fees charged to thousands of customers who were not provided with the financial advice they were being charged for. More than 300,000 customers will receive refunds totalling over $200 million from AMP and the four big Australian trading banks after being charged for financial advice they never received. ASIC deputy chairman Peter Kell commented that "the financial planning firms' systems that underpinned the ability to collect revenue were better developed than the systems that ensured the client received the appropriate advice." I think this attitude is a hangover from the days when financial advisers largely sold insurance, and sound advice was secondary to selling product.

Other cases include alleged bribery involving NAB staff being paid cash to secure loans, as staff responded to an incentive programme to sign up new customers. Westpac has been criticised for its lax credit assessment processes, failing to verify customers' financial details before approving loans. Evidence has been heard that the Commonwealth Bank of Australia has been charging fees to clients who have died – in one case for more than ten years.

We are likely to see further scrutiny here in New Zealand around financial advice practices. I'm sure there are plenty of front-line bank staff who are uncomfortable offering products to customers in an effort to reach targets set by their employers. We have recently seen a move by the Financial Markets Authority to force KiwiSaver providers to disclose fees in dollar terms, rather than as a percentage. I'm sure in time the practice of paying commissions on financial products will be phased out, as is happening in Australia.

Bank Term Deposits

One particular bank practice I don't like is their default position around reinvesting term deposits. Far too often I see clients who have invested in a bank term deposit, and on maturity that deposit is rolled over for a similar term at the prevailing interest rate. More often than not the client is unaware that this will happen. My advice when taking out a term deposit is to insist that on maturity the funds are repaid to your own account. This way you are in a much stronger position to negotiate reinvestment terms acceptable to you.

Diversification

One of the most fundamental tenets of investment is diversification. Perhaps we don't give it as much attention as it deserves, because we take it for granted. However, recent events in financial markets serve to reinforce the importance of diversification. How many investors have held "blue chip" shares only to see them fall from grace after a period of poor performance. How many have only then realised they had too much money backing that one company. Fletcher Building is a good recent example of a company that many considered could not possibly fail due to the prevailing conditions in New Zealand. The company's shares were worth over $11 in 2016, and now trade at $6.30.

Sky TV is an example of a company that has not kept pace with the rapid changes in technology. The development of ultra-fast broadband has allowed other services such as Netflix to compete directly with Sky. Their shares were worth $6.50 in 2014, however the company now trades at $2.25. Recently we have seen Fonterra drop 15% following a poor investment in China. I would encourage investors to assess their exposure to individual companies and consider the implications of a significant drop in price. Well performing companies such as A2 Milk, Auckland Airport, Port of Tauranga and Ryman Healthcare may seem a sure bet, however none are immune to poor management decisions, Government regulation or natural disaster.

Investors should look to diversify across all sectors of the financial markets meaning they should spread their funds across cash, term deposits, bonds, property and shares. In 2007 many investors thought they were diversified by owning five or six different finance companies; however they were actually exposed to one sector. If you own shares you can further diversify by spreading your risk across different industries. For example instead of owning only property shares you can ensure you also hold retail, utilities, infrastructure and healthcare shares. Depending on the size of your portfolio you can also diversify into other countries to gain access to industries not represented in New Zealand. This is one aspect of diversification I think many investors don't take seriously enough. Overseas investments are your insurance policy against a significant shock to the New Zealand economy.

There is a counter-argument to diversification that suggests you can diversify your investments to the point of mediocrity. This is true if you took spreading your risk to the extreme and bought every company listed on the NZX. Your returns would match the market. We should be able to do better than that by buying companies we believe are going to outperform the market. Instead of diversifying, some argue they have benefitted greatly from backing a handful of winners, rather than spreading their funds across a number of different companies. For example, if you had put $100,000 of retirement savings into A2 Milk in 2015 it would have grown to over $2 million today. But what if you had chosen Sky TV or AMP? You may be one of the few to have backed one company and won, however I would suggest more often than not a well-diversified portfolio will best serve your interests.

Bank Term Deposit Rates

Here is a summary of some of the bank rates on offer at present.

	1 Year	2 Years	3 Years	4 Years	5 Years
ANZ*	3.55%	3.70%	3.85%	4.05%	4.15%
ASB	3.50%	3.70%	3.80%	4.00%	4.10%
BNZ	3.50%	3.65%	3.75%	3.95%	4.05%
Heartland	3.60%	3.80%	3.85%	4.00%	4.00%
Kiwibank	3.40%	3.60%	3.70%	3.80%	3.80%
Rabobank*	3.35%	3.81%	3.91%	4.06%	4.21%
Westpac	3.40%	3.65%	3.80%	4.00%	4.10%

* ANZ and Rabobank rates are available through an intermediary relationship with Bramwell Brown.

Reset Securities

Here are the current values of some of the resettable securities trading on the secondary market.

Security	Coupon	Benchmark	Margin	Next Reset	Price/100
ASB	3.42%	1 year swap rate	1.30%	15/11/18	90.50
ASB	3.03%	1 year swap rate	1.00%	15/05/18	89.40
ANZ	7.20%	5 year swap rate	3.50%	25/05/20	107.10
Fonterra	4.15%	1 year Govt stock	1.95%	10/07/18	97.00
Genesis Energy	6.19%	5 year swap rate	2.40%	15/07/18	102.00
Infratil	3.50%	1 year swap rate	1.50%	15/11/18	80.00
Kiwi Bank	7.25%	5 year swap rate	3.65%	27/05/20	107.40
Quayside Holdings	4.32%	3 year swap rate	1.70%	12/03/20	101.80
Rabobank	8.34%	5 year swap rate	3.75%	18/06/19	106.00
Works Finance	6.05%	1 year swap rate	4.05%	15/06/18	105.75

Portfolio Administration

Are you having trouble with the share registries sending your financial information via email rather than post? Are you spending hours searching for financial information for your accountant at the end of each financial year? If so Bramwell Brown can help. We offer a portfolio administration service where we handle all the mail associated with your portfolio and liaise with your accountant at the end of each year. Call the office if you would like to discuss this service.