

# BRAMWELL BROWN LTD

## INVESTMENT ADVISERS – BROKERS

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### **Bramwell Brown Limited – Newsletter – September 2012**

#### **Mighty River Power**

Unfortunately this newsletter is being distributed just before the Government is due to make an announcement regarding the float of Mighty River Power. Normally I would wait for the information, and put the newsletter out a bit later, however I am out of the office in the first week of this month. My prediction is that the Government will want to push ahead with the float immediately, and will offer some sort of compromise to appease Maori. The Waitangi Tribunal has found that Maori have proprietary rights in water and that failing to accommodate those rights would be a breach of the Treaty of Waitangi. Whatever compromise the Government comes up with needs to be full and final in my view if investors are to be enticed into buying shares. Threats of future litigation do not offer a good basis on which to make investment decisions. I don't understand what rights are being taken away from Maori due to a change in Mighty River's shareholders; however this is probably not the forum to debate that issue.

Mighty River Power has just released its earnings for the year to June 30<sup>th</sup> 2012.

- Earnings \$461 million
- Profit \$67.7 million
- Dividend to Government \$119.8 million

The Government has announced its intention to offer a minimum application for shares of \$1,000 and they have guaranteed applications up to \$2,000 will not be scaled back. A loyalty bonus has been agreed to in principle and will likely be awarded if shares are held for three years. Details of the loyalty bonus will be confirmed closer to the time the shares are offered. Scaling is an issue investors need to be aware of as they decide what sum of money they want to invest. Popular share issues in the past have been heavily scaled and investors are left disappointed with what they have been allocated. Strategies to ensure you get what you want include applying for shares under several different entities and then combining the shares once they are issued. Of course you run the risk of the float not being scaled and you have to come up with twice as much money as you had bargained on. If you are buying through a broker who has been allocated shares you are less likely to have your application scaled (unless the broker has had their bid scaled back). Closer to the time I will be seeking firm dollar values from clients interested in purchasing shares through the float. We will do our best to satisfy that demand fully, but can't guarantee we can get all the stock we demand if the issue proves extremely popular.

## Stock and Share

Stock and Share are at it again with their lowball offers, recently offering \$1.00 for Tower shares when they were trading at \$1.76. How anyone can fall for these scams is a mystery to me, but unfortunately plenty of people do. They have now become more devious in that they are targeting fixed interest securities. I would imagine they see greater potential in duping investors who may not understand how the secondary market in fixed interest works. Their offer is for Fletcher Building Industries 8.50% capital notes maturing in March 2015. Stock and Share are offering 80 cents for every \$1.00 of notes, a twenty percent discount to their face value. This discount alone should alert holders to the fact their offer is a rip-off, but what many holders of the notes may not realise is that the notes are worth more than \$1.00 on the secondary market. They are currently trading at yields around 5.85%, which gives them a value of \$1.10. For those who find the secondary bond market a mystery here is another explanation of how it works.

First of all a quick look at the terms that are important when looking at a bond in the secondary market.

- Coupon – the interest rate received for the term of the bond. The coupon is set at the time of issue and does not change. In the case of Fletcher Building’s capital notes the coupon is 8.50%.
- Price – how much you pay for the bond. For example if you buy 1,000 bonds at issue the price you pay would be \$1,000. If you buy 1,000 bonds on the secondary market half way through their term, the price you pay will be determined by supply and demand. This is where “yield” comes in.
- Yield – the return the new buyer will receive, from the time they buy the bond in the secondary market, until maturity.

Fletcher Building issued their capital note in 2009. It was a six-year note paying 8.50% semi-annually until maturity in 2015. They had no idea interest rates were going to continue falling when they issued their capital note. They have an obligation to honour their commitment to pay 8.50% until maturity, regardless of how far interest rates drop in the interim. It is this change in interest rates during the term of the bond that causes the difference in prices of fixed interest securities when traded on the secondary market.

Anyone looking at fixed interest today would consider 8.50% to be a high return due to the decrease in underlying interest rates over the last few years. Let’s assume you own some Fletcher Building Capital notes that are paying you 8.50% through until 2015. You need to sell them to raise some money. Would you sell them at their face value of \$1.00 each? Of course not – they have become more valuable as interest rates have dropped. Buyers of these notes are prepared to accept a return under 6.00% in the current environment. Because the coupon (8.50%) doesn’t change throughout the term of the note, the only way you can achieve a sale at a yield under 6.00% is to demand more money for it. That is why they are trading at \$1.10 instead of \$1.00. At a price of \$1.10 the new buyer will yield 5.85% until maturity in 2015.

## Fixed Interest

Now that you are reacquainted with the intricacies of bond pricing, here are the current yields on some of the more popular bonds trading in the secondary market at present. Their February prices are included in order to draw some comparisons over time.

<b>Bond</b>	<b>Rate</b>	<b>Maturity</b>	<b>Yield</b>	<b>February Price/\$100</b>	<b>Current Price/\$100</b>
Telecom	8.20%	June 2013	4.30%	104.18	103.01
Marac	10.50%	July 2013	6.00%	103.68	103.81
Wellington Airport	7.50%	November 2013	5.00%	103.78	102.89
Tauranga City Council	7.05%	December 2013	3.33%	106.27	104.58
Auckland City Council	6.42%	March 2014	3.43%	105.41	104.53
Tower	8.50%	April 2014	6.05%	103.97	103.77
Contact Energy	8.00%	May 2014	4.00%	106.57	106.59
Fletcher Building	9.00%	May 2014	5.80%	104.36	105.13
Vector	7.80%	October 2014	4.35%	107.65	106.93
Auckland Airport	7.00%	November 2014	4.00%	107.09	106.37
Kiwi Income Property Trust	8.95%	December 2014	4.63%	107.00	109.50
Trustpower	7.60%	December 2014	5.25%	104.46	105.05
Auckland City Council	6.28%	March 2015	3.55%	106.67	106.65
Fonterra	7.75%	March 2015	4.00%	109.59	108.99
Meridian Energy	7.15%	March 2015	4.12%	107.48	107.26
Goodman Property Trust	7.75%	June 2015	5.05%	107.49	106.97
Warehouse	7.37%	June 2015	5.55%	103.50	104.64
Telecom	8.35%	June 2015	4.83%	109.46	109.09
Trustpower	8.40%	December 2015	5.80%	105.05	107.75
APN News & Media	7.86%	March 2016	10.25%	89.70	92.96
Fletcher Building	9.00%	May 2016	5.78%	107.28	110.60
Goodman Fielder	7.54%	May 2016	7.45%	96.47	100.29
Infratil	8.50%	June 2016	6.50%	101.82	106.68
Z Energy	7.35%	October 2016	6.35%	103.38	103.57
Air New Zealand	6.90%	November 2016	5.70%	101.00	104.43
Auckland Airport	8.00%	November 2016	4.50%	112.44	113.28
Trustpower	8.00%	December 2016	5.70%	107.08	108.71
Meridian Energy	7.55%	March 2017	4.60%	110.44	111.98
Infratil	8.50%	June 2017	6.80%	100.00	106.91

<b>Bond</b>	<b>Rate</b>	<b>Maturity</b>	<b>Yield</b>	<b>August Price/\$100</b>	<b>Current Price/\$100</b>
Manukau City Council	6.52%	September 2017	4.10%	107.40	111.00
Infratil	8.00%	November 2017	7.10%	100.00	103.89
Trustpower	7.10%	December 2017	5.75%	103.40	106.12
Z Energy Limited	7.25%	August 2018	6.05%	101.83	105.97
ANZ Bank	6.25%	March 2019	5.32%		105.08
AMP	9.80%	April 2019	5.50%	108.01	106.65
IAG	7.50%	December 2036	6.92%	102.40	106.70
NZ Post Group Finance	7.50%	November 2039	5.65%	101.99	103.78
Genesis Energy	8.50%	July 2041	7.84%	103.20	107.50
Contact Energy	8.00%	February 2042	7.50%	100.00	105.90
BNZ Perpetual	9.10%	No maturity date		106.00	107.25
Kiwibank Perpetual	8.15%	No maturity date		102.00	104.50
Rabobank Perpetual	8.78%	No maturity date		104.80	107.20

## **Portfolios**

I have spent a good deal of time reviewing clients' investment portfolios over the last two months. Common mistakes I see people making include:

- Investing predominantly in “favourite” sectors – be it property, shares or bonds
- Having large exposures to individual securities
- Not retaining a spread of maturities within a fixed interest portfolio
- Being led by emotion in investment decision-making

I will expand on these findings in next month's newsletter.

## **Hockey**

I am taking a week's leave in the first week of September to support Rathkeale College at the Mayhill Cup Secondary School hockey tournament in Stratford. Sue will be in the office while I'm away, although she has a wedding to attend on Friday September 7<sup>th</sup>. The office will be closed on that Friday and the phone will be diverted to my mobile. As I've said previously if at any time the office is unattended and you need to reach me don't hesitate to phone me either at home (3703911) or on my mobile (0274523980).