Bramwell Brown Ltd

INVESTMENT ADVISERS – BROKERS

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Bramwell Brown Limited – Newsletter – November 2012

Portfolios

I commented in the September newsletter about the common mistakes I see clients making in their investment portfolios including:

- 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

Too often I see investors heavily exposed to a favourite sector. Residential housing is the obvious example, with others being the listed property trusts, bonds in isolation, and previously the finance company sector. Diversification is not simply choosing five property trusts or ten different bonds – you need to ensure your diversification goes further than that. Generally if something affects one company in a sector, it's likely to affect other companies in the same sector.

Large exposures to individual companies are fine when things are going in your favour – ask anyone who bought Apple shares between 2000 and 2004. However when things go against you large exposures can have a devastating effect on your wealth. In 2000, Telecom was trading at $9.50. They now trade at $2.40, which is a 75% reduction in value. Serial offenders I see in some portfolios include BHP, GPG, Telecom, ANZ, and Fletcher Building. I recommend you limit your exposure to individual companies to a maximum of 5% of your investment portfolio.

Having all of your fixed interest maturing at the same time exposes you more to changes in interest rates than would be the case if you spread your maturities out over a five to seven year period. Anyone with a wide range of fixed interest maturities will still be enjoying some of the pre-financial crisis returns of 8% to 9%. You can't stop rates falling but you can smooth out the impact of those changes by staggering your maturities.

One of the more common emotional responses I hear is "I couldn't possibly sell it for $2 – I paid $3 for it. Unfortunately what has happened in the past is largely irrelevant. The question must be "what is the best use for this money from now on."

Fonterra – Trading Among Farmers

The much-anticipated Trading Among Farmers (TAF) is finally a reality, and investors will now be able to gain exposure to New Zealand's dairy industry. Fonterra is raising $500 million to support a fund that will be used as a mechanism for dairy farmers exiting the dairy industry. Up until now when a Fonterra supplier sought to exit the industry the company was obliged to redeem their shares for cash. This can pose cash-flow problems for Fonterra, especially if a large number of suppliers decide to exit the industry at the same time.

The fund will be of sufficient size to provide the liquidity needed to cope with dairy farmers exiting the co-operative. Of course in the future, as with any supply and demand situation, if there are more people seeking to sell than buy, the price will reflect this accordingly. Unit holders will now be the ones carrying the redemption risk Fonterra is trying to avoid. So if a large number of dairy farmers decide to exit the industry at the same time, the inevitable consequence is a drop in the price of the units. The opposite will apply when the next wave of dairy conversions occurs, and farmers have to buy shares in order to fulfil their obligations to be able to supply Fonterra.

Your return on the units in the fund will be based on the dividend Fonterra pays to its supplier shareholders. The dividend is paid over and above the money paid to suppliers for their milk. A raw milk price is set each year by Fonterra and is intended to reflect the price that would be expected to be paid in a competitive market. The Commerce Commission has an overseeing role in the setting of this price. The profits Fonterra makes after it has paid for the milk, paid to operate its business, and paid for capital development is available to be returned to shareholders as dividends. The more milk Fonterra can turn into niche products (as opposed to milk powder for example) the more money should be available as dividends. Fonterra paid 32 cents per share in dividends last year and expects to do the same in 2013. The final price of the units is predicted to be in a range between $4.60 and $5.50, which gives an indicative gross yield of 5.80% to 6.95%. My prediction is that due to the popularity of the issue the price will be at the upper end of that range.

One point to be aware of is that you will not be a shareholder of Fonterra and your units will not carry the same rights as a holder of shares in the company. For example you will have no voting rights. One of the sticking points in the ongoing negotiations to bring this fund to the market was the desire for dairy farmers to retain control of Fonterra in its co-operative structure. The argument against listing Fonterra fully is that farmers fear their milk payout will be cut in order to satisfy shareholders desire for higher returns. The conflicting argument is that Fonterra needs access to a stable source of capital to allow it to grow, without the risk of large capital outflows at unpredictable times. I'm firmly in the camp of the dairy farmers, believing a full listing would eventually lead to lower prices paid for their milk. Hopefully this fund will satisfy the needs of the company in relation to a stable source of capital, without compromising the ability to return the proceeds of the sale of milk fully to dairy farmers.

Here are some statistics on Fonterra:

- 17 billion litres of milk collected annually
- 10,500 suppliers throughout New Zealand
- 31 manufacturing sites throughout New Zealand
- Fonterra is responsible for 25% of New Zealand's merchandise export receipts
- Revenue of $19.8 billion (2012)

	2013 (Prospective)	**2012**	**2011**	**2010**
Revenue ($millions)	18,627	19,769	19,871	16,726
Profit ($millions)	690	624	771	685
Earnings per share (cents)	43	42	55	51
Dividends per share (cents)	32	32	30	27

The offer is for $500 million of units with the ability to accept oversubscriptions of $25 million. The offer is **not open to the general public**, instead being offered to Fonterra stakeholders, institutions and then NZX brokers. Whether we can receive an allocation through our relationships with NZX broking firms is yet to be seen, however my feeling at this stage is that will be unlikely. I believe the broker allocation is in the vicinity of $150 million, which is likely to be oversubscribed heavily. We will, however, do our best to source stock for our clients.

- Closing date November 21st
- Pricing announced November 27th
- Trading on the NZX commences November 30th
- Expected first distribution paid April 2013

PLEASE CALL THE OFFICE AS SOON AS POSSIBLE IF THIS IS OF INTEREST TO YOU

Stock & Share

Stock & Share are at it again with their low-ball offers – this time trying to tempt Trustpower shareholders into selling their shares at a heavy discount. Their offer of $6.00 per share came at a time the shares were trading on the NZX at $8.16. They now trade at $8.46. They cleverly show the full amount payable to you under the offer in bold print in the hope you don't take note of the fact they are offering you 26% less than the shares are worth at the time. Please ignore these offers. Send the reply envelope back without a stamp and with nothing inside (if you think you might like to put something else in the envelope that's entirely over to you).

Infratil

Infratil has announced an offer of up to $25 million of unsubordinated, unsecured, fixed rate bonds, with the ability to accept oversubscriptions of $50 million. Holders of the Infratil bond maturing this month are being offered the opportunity to roll that investment over into the new bond.

- Interest rate – 6.85%
- Maturity Date – November 15th 2018
- Interest paid quarterly (February, May, August and November)
- Minimum investment - $5,000

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GPG Capital Notes

GPG Finance will be repaying their capital notes in full on November 15th. The Infratil bond may be a good replacement, however for those seeking other opportunities please call the office to discuss what is available.

Fraud

I've written previously about investors being defrauded by advisors they thought they could trust, and it's disturbing to see the trend continuing. An Auckland foreign currency trader recently duped investors (mainly friends and family) out of $1.50 million and has pleaded guilty to fraud. I have no idea what causes a professional person to become greedy and deceitful; however there are certain steps investors can take to limit the possibility of being cheated out of their savings. One big mistake investors make is entrusting an adviser with a large sum of money. Handing over a large sum and giving an adviser discretion to invest as they see fit is something I would only recommend in very limited circumstances.

Any investment made through Bramwell Brown Limited is registered in the client's own name. Shares, debentures, fixed interest, KiwiSaver accounts and Kiwi Bonds are all held by the individual investor. Any security you buy should be traceable by it having a certificate issued, appearing on a registry statement, or a simple letter acknowledging your holding. In some cases overseas shares might be held by a nominee rather than in your own name in order to reduce the costs associated with buying them. I don't think you can completely eliminate the possibility of dishonesty in your dealings with money; however I think you can minimise the potential by ensuring you own any investments you make in your own name. You need to be able to trust your financial adviser, but don't give an adviser a large sum of money that disappears into a pool of investments that lack some sort of accountability.

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