

INVESTMENT

● SMALL CAPS

# FEATHERSTONE



Contact Tony Featherstone:  
tfeatherstone@brw.fairfax.com.au

## CHECK FIXED INTEREST

Choose carefully among well-positioned companies and take advantage of renewed opportunities for strong yields from listed hybrids and preference shares.

● Yield is back in vogue as growth investors chase higher-dividend stocks and juicy bank term deposits.

Good news has emerged on both fronts this year: average final dividends per share were 11 per cent higher in the latest profit-reporting period and intense bank competition for retail funding and higher interest rates earlier this year have boosted term deposit rates. But income-seeking investors who want yields above 6 or 7 per cent should look further than shares and cash.

A less-considered yield source is listed fixed interest. Several hybrid securities, such as preference shares, have running yields above 10 per cent. The main risk is the issuer not being able to pay promised distributions or the security's face value.

Unfavourable interest rate movements, changes in the issuer's share price and poor liquidity are other risks.

Always form a view on the company issuing the hybrid before falling for its yield. Poor-quality companies usually offer much higher returns to compensate for higher risk.

Chosen well, the best hybrids offer equity-like returns with bond-like risk in this market. Hybrids are further up the risk scale than term deposits and government bonds.

**Yield hunter: Look further than shares and cash for good returns**



Having a solid fixed interest allocation makes sense, especially for those in or near retirement. Too much equities exposure whacked many portfolios during the global financial crisis.

As to hybrids, the big banks offer some of the best floating coupon converting preference shares. Signs that interest rates will rise again this year or next are good news for bank hybrid holders because higher cash rates force up the bank bill swap rate and thus lift distributions of floating-rate hybrids. National Australia Bank's floating coupon hybrid (NABHA) is probably the pick, although it looks close to fair value.

Fixed income specialist FIIG Securities has a "hold" rating on nearly all income notes, reset preference securities and converting preference shares issued by banks and insurers. Most FIIG "buy" calls are for stepped-up preference shares. Some hybrid securities increase or step up their interest rate margin above a floating reference rate (for example, the 90-day bank bill swap rate) at a predetermined date under certain conditions. Stepped-up preference shares have already lifted this rate.

FIIG has a "buy" on Australand Assets

Trust, Gunns, Multiplex Sites Trust and Seven Group Holdings. The table shows their running yields, ranging from almost 11 per cent for Australand to 13.75 per cent for the riskier forestry group Gunns. FIIG also likes Elders (ELDPA) and Paperlinx SPS Trust (PXUPA) among floating coupon preference shares yet to step up their margins.

Multiplex Sites Trust is an interesting idea. Like several other Australian Real Estate Investment Trusts (A-REITs), Multiplex reported a steady result in the latest profit-reporting period amid a slightly improving property sector. Stabilising property values and signs of life in some parts of the commercial property sector were common themes. FIIG believes Multiplex has "an attractive running yield with potential for capital gain upon redemption". Multiplex appears in no hurry to redeem the Multiplex Sites Trust, but returns may be boosted when it happens.

Seven Group Holdings' 11.81 per cent running yield is also worth watching. The risk is higher, given Seven's exposure to the commodity price cycle after merging with WesTrac Group in April, and a more complex operational structure. In its profit result, Seven reported available cash reserves of \$455 million, a listed securities portfolio of \$393 million, significant stakes in Consolidated Media Holdings and West Australian Newspapers Holdings and \$268 million in undrawn debt facilities at June. Another \$498 million debt facility has been added since.

Seven's industrial equipment operations should benefit from more construction in Western Australia and China, and its media business is strongly leveraged to any sustained upturn in ad spending. The company looks in good shape, making its preference shares a solid idea, given their high yield. Its hybrid is reasonably expensive debt, so it might be redeemed in the next few years, creating further possible gains. **BRW**

### STEPPED-UP PREFERENCE SHARES

Entity	ASX code	Price (\$)	Franked	Running yield %	Risk	Advice	Comment
Australand Asset Trust	AAZPB	90.45	No	10.88	Med	Buy	High perpetual yield makes this de-risked property trust hybrid attractive. Potential for redemption at face value in the next few years as credit spreads contract.
Gunns	GNSPA	71.95	Yes	13.75	High	Buy	Possible class action against Gunns likely to be insignificant, yet risk difficult to quantify. Asset sales and possible capital raisings would significantly improve financial position.
Multiplex Sites Trust	MXUPA	78.50	No	11.37	Med	Buy	Attractive running yield with potential for capital gain on redemption.
Seven Group Holdings	SVWPA	84.00	Yes	11.81	Med	Buy	Security has now stepped up and offers attractive double-digit running yield.

Source: FIIG Securities