

Companies & Markets

www.afr.com | Monday 16 July 2018

Inside

Health care Why Ramsay wants European rival p15

Banking UBS, Deutsche, Citi forced to navigate BEAR p16

Matthew Stevens BHP goes virtual for energy plans p27

Market snapshot

S&P/ASX 200 Index (points)



S&P/ASX 200 stocks Friday

Best	Close (\$)	Change (%)
Mineral Resources	16.04	+5.04
Wisetech Global	17.90	+4.74
Sigma Health	0.475	+3.26
Cochlear	205.32	+3.17
Appen	12.82	+3.14

Worst	Close (\$)	Change (%)
Sthn Cross Media	1.28	-4.12
GWA Group	3.35	-3.74
Pilbara Min	1.07	-3.17
Infigen Energy	0.68	-2.86
Orora	3.58	-2.72

Indices	Close (points)	Change
ASX 200	6268.4	+0.1
Nikkei	22,597.35	+409.39
Hang Seng (pm)	28525.44	+26.58
Shanghai A	2965.39	-7.1

Currency	Change
TWI	+0.2
SA/USc	+0.17
SA/¥	+0.46
SA/€	+0.003
SA/£	+0.0019

Rates	Close (%)	Change
Cash rate	1.50	steady
180-day bills	2.013	+0.021
10-yr bonds	2.630	-0.003

Commodities	Close (\$US)	Change
Gold (spot)	1241.00	-4.32
Iron ore	64.04	-0.02
Oil WTI	71.01	+0.03

+ Go to afr.com for live updates

Iron ore miners tipped to have record quarter

Peter Ker

The world's three biggest iron ore miners are expected to confirm the industry's strongest ever quarterly export figures this week, helping to explain recent weakness in prices for the bulk commodity.

Big miners have exercised restraint in both supply and rhetoric in recent years in a bid to calm fears the iron ore market could be flooded with supply, but port statistics suggest the miners' inexorable export growth reached new heights in the three months to June 30.

Brazilian miner Vale is expected to announce record quarterly production of 96.3 million tonnes when it kicks off reporting season early on Tuesday morning Australian time, and Rio Tinto is expected to report strong numbers of its own several hours later.

UBS believes Rio Tinto shipped 88.9 million tonnes from Western Australia in the quarter; a performance that would be its second best quarter ever and would put it on track to test the top end of its iron ore export guidance range for the 2018 calendar year.

The world's third biggest producer, BHP, will publish its production and export data on Wednesday, amid expectations it shipped record volumes of about 71.7 million tonnes during the quarter, including tonnes owned by joint venture partners such as Itochu.

"This quarter represents a record annualised rate of 288 million tonnes per year, noting that one day BHP hopes to ship at 290 million tonnes per year out of Port Hedland," said UBS analysts in a note.

UBS believes BHP shipped about 274 million tonnes from the port in fiscal 2018, which would see it fall just short of its original vow to ship between 275 million and 280 million tonnes in the year.

BHP shares Port Hedland with rival

iron ore producers Fortescue Metals Group, Atlas Iron, Mineral Resources and Gina Rinehart's Roy Hill.

Collectively those five miners grew output by 3 per cent in the year to June 30, with 508.9 million tonnes of iron ore shipped through the port.

That tally appears to have been bolstered by a late rush from Fortescue, which was estimated to have shipped a record 46.3 million tonnes during the June quarter.

If that estimate proves correct, it will mean Fortescue was shipping at an annualised rate of almost 186 million tonnes per year; far above the 170 million tonnes it expects to ship most years, and even further above the 155 million tonnes per year that was

This quarter represents a record annualised rate of 288 million tonnes per year.

UBS on BHP production

expected to be its full potential when it launched a \$US10 billion expansion plan in 2011.

While the strong finish to fiscal 2018 will provide encouragement for Fortescue's future, the late rush will only repair Fortescue's weak performance between October and March, which is expected to ensure it still falls marginally short of its 170 million tonne export target for the year.

Iron ore prices traded as high as \$76.88 per tonne in February 2018 when the world's five biggest producers were suffering disruptions, but the strong output in recent months appears to have weighed on prices, **Continued p18**



Preston Hamersley is backing the virtue of patience. PHOTO: JAMES ALCOCK

Hamersley's Indian Pacific riding market momentum

Monday fundie The sweat of a shearing shed was a good start.

Vesna Poljak

As momentum rips through the Australian sharemarket, one manager is seeing opportunities.

Preston Hamersley's Indian Pacific Funds Management is backing the virtue of patience as value gets left behind in the 2018 melt-up. "You hear quite a lot now of ten-baggers, one hundred-baggers, the bell's ringing I think we all know," the long-short manager says.

Hamersley has set up Indian Pacific in Perth, where he has returned to raise

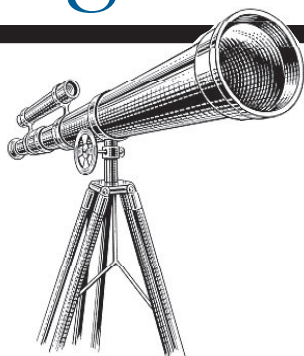
his family after a long stint in Sydney at Airlie Funds Management and, before that, JBWere. Having no cash limit and being able to invest widely within his strict parameters, he articulates the advantages of being small.

"In theory, good investors get maybe six or seven out of 10 right, having more breadth doesn't necessarily improve that hit rate." Indian Pacific's average net exposure has been 64 per cent since it started, and shorts have enabled it to make money in four out of five months on the short side – including two months when the market was up 3 per cent or more.

"The big momentum force in the market is throwing up some good value opportunities if you're willing to be patient, I think. There are a couple of **Continued p22**

Telstra's InfraCo a long-term bet but a distraction for now

Due Diligence



Anthony Macdonald

Andy Penn had just handed down his brand new vision for Telstra's future; a four-point plan dubbed Telstra2022, when he opened questions from the floor.

Anticipation was high. Telstra's under-fire chief executive had just announced 8000 job cuts, a huge reduction in the number of the company's mobile plans, a \$2 billion near-term asset sales target and guided to much weaker than expected earnings for 2019. Old heads reckon those elements alone made it the biggest news day for Telstra shareholders this decade.

But as he and six executives faced a packed amphitheatre at Telstra's offices on George Street in Sydney, it took only 20 seconds for the

temperature to drop. "Why bother with InfraCo?" Bank of America Merrill Lynch analyst Sameer Chopra asked of Penn's biggest and arguably most controversial move: separating most of the company's core fixed line infrastructure such as ducts, pipes and fibre, into a new standalone business unit.

"InfraCo", under the plan, would have \$11 billion in assets, a new dedicated boss, be run and report as a separate business unit and take a year to extract from the rest of Telstra. It would seek to increase capital efficiency inside Telstra and, ultimately, try and unlock value for shareholders.

Chopra argued Telstra's balance sheet was fine and the plan would only add another cost centre at a time when Penn was trying to make the company

lean and mean. Nearly four weeks on, it's the question that still lingers over Telstra and its CEO.

It also lingers in Telstra's boardroom, in the minds of some of its biggest investors, and across Australia's telecommunications industry at a time when the National Broadband Network has already rewritten the playbook.

In response, Penn told Chopra – and inadvertently Telstra's 1.4 million shareholders and much of the institutional investment community that had tuned in that day – it would drive efficiency and performance across the company. Commercial agreements between Telstra's operating businesses and InfraCo would make it easier to see which parts were performing and which were not. It stemmed from an unsuccessful

attempt to securitise some of its revenue last year and it would create "long-term optionality", he said.

Without that last bit it's hard to see how internally separating InfraCo makes a lot of sense.

Because if Telstra's board truly wanted to realise the value of its infrastructure, create full transparency and make underlying business units stand on their own two feet, it could have moved to demerge InfraCo rather than merely making it the newest child in the Telstra family.

If it wanted to create a world-class and highly valuable infrastructure company, it could have opened up Telstra's network to its rivals – for a suitable charge – and given away the competitive advantage of its own operating businesses to make more **Continued p18**

Apple exec exodus as India strategy falters

Saritha Rai

Apple has lost a trio of key executives in India as it struggles to boost iPhone sales in the world's fastest-growing major smartphone market.

Among the executives who have departed are its national sales and distribution chief, the head of its commercial channels and mid-market business, and the head of telecom carrier sales, said people familiar with the matter but who asked not to be identified discussing internal matters. Apple's Indian sales team is now undergoing a restructuring, one said.

The executive exodus is a symptom

of Apple's persistent malaise in India, where high tariffs inflate the price tags of imported gadgets such as the iPhone and consumers gravitate towards cheaper alternatives from the likes of Xiaomi and Samsung Electronics. Instead, the company resorts to marketing iPhones that are a few generations old and does not manufacture its latest models domestically, thereby incurring import levies.

Its inability to increase its business and single-digit market share stand in stark contrast to the publicly upbeat comments of chief executive Tim Cook, who has used phrases such as "very bullish" and "very optimistic" when

speaking about the country. Caught up in those challenges is Michel Coulomb, who took over as head of Indian operations in December 2017. While Mr Coulomb has rich experience in carrier-led sales, his team has been slow to cultivate business relationships in the market, the people said.

Apple also has had difficulties understanding the country, leaving the sales team direction-less, they said. The company's representatives in India did not respond to emailed questions.

Apple's failure to get going in India compounds its troubles elsewhere in Asia. The iPhone X, for instance, has been a disappointment in China. In

India, where it has a market share of about 2 per cent, Apple sold just 3.2 million iPhones in 2017, according to Counterpoint Research. In the first half of 2018, fewer than a million devices moved, it estimates.

"iPhone India sales were weak in the first half of 2018 and, even if they show a big jump in the traditionally strong second half, Apple will still fall short of last year," said Neil Shah, a research director with Counterpoint.

Mr Cook has suggested India could be the next China, which is now Apple's second largest market. While the iPhone's price tag puts it out of reach for most, the CEO has predicted young,

aspiring Indians moving up the socio-economic ladder would upgrade.

The world's most valuable company has stepped up its activity, setting up an app accelerator and a mapping development centre, while starting from mid-2017 to assemble some of its older models in the country. But it needed to do more, Mr Shah said.

"It has not put great focus or investments into India because the market is so minuscule," he said. The inattention could send more users to Android phones, making it difficult for Apple to build a user base and win loyalty. "It's a catch-22 situation for Apple in India."

BLOOMBERG

From page 13

Indian Pacific riding market momentum

stocks that have been sold down recently which represent really good long-term value."

Hamersley was raised on a sheep and wheat farm and that led to various sweaty jobs in shearing, fencing and driving a haul pack on a goldmine (four weeks on, one week off) in the middle of nowhere, before such work was lucrative. But the feast-to-famine pattern of life on the land was instructive in several ways: understanding cycles, getting on with people, and the impulse to go and do something else.

So he studied at UBC in Canada before returning to Australia and joining JBWere a week before the tech wreck, which underscored his mantra of capital preservation. He was there for almost 13 years before deciding to move to funds management with a view to starting his own business one day. John Sevier, who founded Airlie, used to be one of his clients.

"The sorts of things that John really taught me is to do your own work rather than listen to others. He put a big emphasis on the people running businesses not just numbers, and to have humility and realise you don't know more than the market a lot of the time," he says. Matt Williams, Geoff Wilson, Justin Braitling and Matthew Kidman are other fund managers whom he singles out, acknowledging that "everyone does things differently".

Indian Pacific's top two holdings are Wesfarmers and Macquarie Group, which are ahead handsomely since being added to the portfolio. He's also strongly backing the \$150 million Kina

Securities. "I think they've found their level for the time being," Hamersley says of Wesfarmers and Macquarie. "Macquarie is the best allocator of capital in Australia. A great custodian of your money within the financial sector, I believe, and even at today's level they're not unreasonably priced versus their peers."

As for Wesfarmers, "I just saw an opportunity there once they announced the spin-off. I just could not see Coles trading at a massive, massive discount to Woolies, which was trading on a very big multiple. I think today it's probably 21 or 22 times." At the time, Wesfarmers was trading on about 17 times earnings.

"You're about to then unleash one of the best businesses - if not the best business in Australia, Bunnings - which will be 55 per cent of earnings in the group that remains. So that will re-rate, not to mention I know within Wesfarmers they are very excited about the capital they have to invest going forward." He estimates 65 per cent of their capital is held within the Coles business even though it is only 35 per cent of earnings.

Hamersley emphasises that he's not a value manager in the textbook sense.

"It's a bit like Viva Energy; I would see that as being fairly priced, but I don't buy stocks that are fairly priced, especially at IPO. I would only buy at a 10 or 15 per cent discount. [At Airlie] if something went through our valuation, yes, we would sell some. And there's a lot of funds that don't do that - surprisingly - and they're winning, by the way."

"Who am I to say that my strategy's right? I run a wish list of stocks that I'd love to own and the fact is that wish list has performed really, really well because the market seems to be fairly price insensitive."

APN Outdoor has been a winner for Indian Pacific, being a stock that



APN Outdoor has been a winner for Indian Pacific. PHOTO: AAP

Hamersley identified in its "wilderness" period and acquired by JC Decaux in an agreed deal.

"You could just tell [CEO James Warburton] was going to pull the team together and take his share back of that outdoor segment. The stock was on 12 or 13 times and they had the best suite of assets in that outdoor sector, which I think structurally looks pretty good still long-term."

"The rest has played out: the industry turned, they won more than their share and then the bid came which, for what it's worth, I think the bid price from JC Decaux is underwhelming and I'm very surprised that they have sold it."

Two stocks he's eyeing with a view to

future gains are Graincorp and Event Hospitality & Entertainment.

Graincorp has fallen from \$9 to around \$7.50 for seasonal reasons. "You know the current result and possibly even next year's might be a challenge given the poor weather, but they have a fixed-asset base monopoly business in a lot of the areas they operate," the fund manager says.

"You almost know for a fact you are going to get above \$10 for that stock at some stage when a reasonable season is back. They will have a bad result, but they're unique assets. Let's not forget it was bid \$12.20 by Archer Daniels five years ago and mid-cycle earnings as I look at it are 35 to 40 per cent above

It's been weak ... with the World Cup; people are going to the movies less.

Preston Hamersley

current earnings, so looking at current multiples misses the point." On a mid-cycle basis Graincorp is trading at a discount to global peers.

Event is a means of capitalising on the tourism theme via its hotel portfolio under the Rydges and QT brands, but Hamersley is also keen on its development pipeline.

"Just their property and investment portfolio is worth about \$10 a share. They also own Event cinemas and Thredbo, which are not necessarily businesses that I love but if you value the property the right way then you're paying about 4.5 times EBITDA for the cinema business versus their international comps, which trade around seven times."

"It's been weak the past month or two with the World Cup; people are going to the movies less, but that's an example of the market being too focused on short-term numbers."

Hamersley declines to identify his shorts - although he will say they include two fund managers, a hospital operator, a telco "battling impossible short-term structural headwinds" and a discretionary retailer. Indian Pacific's prime broking relationship is with Morgan Stanley.

Asked if he is willing to short momentum, he says: "The problem with shorts is you can be wrong for long periods of time. Certainly there's a lot of high P/E momentum stocks where you're going to make a significant amount of money if you time it right."

Discover your next
commercial property
investment now

commercialrealestate.com.au

 Industrial

 Office

 Retail

 Leisure

 Rural

 Commercial Real Estate