Investing overseas without leaving home

SPECIAL REPORT

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INTELLIGENT INVESTOR

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Understand the benefits of investing overseas but find the expense and hassle off-putting? Then this report is for you. John Addis uncovers a low cost, hassle-free way of lifting your returns whilst reducing your exposure to the Australian economy.

Investing overseas without leaving home

By John Addis • 11 February 2016

There are three reasons to allocate a portion of your portfolio to overseas investments. Two are permanent and long-standing, one temporary and opportunistic.

In June last year in ***Going with the flows***, we wrote that, 'In October 2009 the Australian dollar was buying 88 US cents. The Aussie peso had miraculously transformed into a safe-haven currency, bolstered by a China-driven mining boom, low government debt and a Houdini-like ability to escape recession. The currency was charging, eventually hitting a high of US$1.10 in August 2011.

If ever there was a time to diversify one's portfolio overseas, this was it. High quality businesses were cheap in their local currency but buying them with Aussie dollars made them potentially more so.'

This was an early invitation to the party, a chance to buy cheap stocks with a strong currency. That party is now largely over. The curtains are closing and the cleaners are moving in. The Australian dollar may yet fall further but it's a fair bet most of those falls have already occurred.

What, then, is the point of this special report? We like to buy cheap stocks; if punting on currency movements was our game we'd be recommending you buy currencies themselves, with much lower transaction costs than international funds or listed stocks. Clearly, we're not. Predicting anything is a mug's game; predicting currency movements is only for the King of Fools.

Whilst getting in early on the international theme has juiced up our returns over the past few years, even a 30%-plus fall in the local currency doesn't subtract from the two remaining reasons for allocating a portion of your portfolio to overseas investments; if you're obsessed with cheap stocks, as are we, markets like the US, Europe and Japan usually offer more of them. And secondly, as explained in ***Welcome volatility, harbinger of opportunity***, our local index is heavily concentrated in a few big stocks, confined to a handful of sectors.

Going offshore not only offers you more opportunities to find cheap stocks, it also means you can get exposure to sectors the ASX simply does not offer. Plus you get geographic diversification benefits. If you don't want to be over-exposed to the Australian economy, itself over-exposed, at least in an investing sense, to a huge banking sector, this strategy has great appeal.

The argument is made stronger if your income is dependent on an Australian employer, if you have a mortgage with an Australian bank and if your investments are Australian-based. In a broad sense, you may be far more exposed to the Australian economy than your portfolio indicates.

No need to leave the ASX

For these reasons, we're big proponents of at least considering the merits of investing overseas. A strong currency may strengthen the argument but a weak one does not eradicate it. Diversification and the prospect of more cheap stocks are reason enough to put some of your money to work overseas.

But if the argument is that strong, why do so few investors actually do it? According to the **2015 ASX Australian Share Ownership Study**, in 2014 just 13% of investors owned shares listed on an overseas stock exchange. Now, that figure is almost twice the percentage in 2002 and it doesn't include those investing in managed funds and locally-listed overseas companies, but it's still not much. Why the apparent disinterest?

Most people are more comfortable investing in stocks they're familiar with, that they see and read about every day. In investing, familiarity breeds a misplaced sense of security rather than contempt. Then there's the Kafkaesque nightmare one enters when establishing positions in foreign-listed companies. Even reading the instructions to complete the **IRS W8-BEN** form is enough to put you off living, let alone investing overseas, to say nothing of the horrors of opening a broking account specialising in overseas markets.

There is a better way; to seek out attractively priced ASX-listed stocks that give you all the geographic and sector-based diversification benefits that investing directly overseas offers,

> **“Whether it’s exposed to the European, US or New Zealand economies is less important than the fact that each offers an opportunity to diversify away from Australia.**

but without the hassle. That’s what this report is all about; a low-cost, uncomplicated way to get international exposure in your portfolio without actually leaving home.

So, how do we do it? It really was quite simple. We scoured the stocks on our Buy List. By definition, this means we believe them to be cheap. Then we identified seven ASX-listed stocks that generated a large proportion of their revenues overseas (see Table 1). Over the next few pages you’re going to read all about them.

But first, a few comments on how to use this research. You’ll notice in the table the incorporation of our recommended maximum portfolio weighting. This limit is there for a reason; to preserve a well-diversified portfolio by ensuring you’re not over-exposed to one particular stock. For whatever reason you might purchase these stocks, please do not exceed this limit.

Second, you need to make your own decisions about what percentage of your overall portfolio you want to allocate to these stocks. Whilst I have the larger part of my portfolio in stocks exposed to overseas markets, other analysts have a heavy weighting to the local index. This is a personal choice and one only you can make.

Thirdly, we don’t have a clear preference for particular markets. Again, our primary consideration is the quality of the businesses we’re purchasing and the price we have to pay for them. Whether it’s exposed to the European, US or New Zealand economies is less important than the fact that each offers an opportunity to diversify away from Australia. It is more important that you’re reducing your portfolio exposure to Australia than the countries in which it is being increased.

Finally, please take a careful approach to building your position. Study the research we have published on each stock and take note of our Buy, Sell and Hold prices. The largest factor in your future investing success won’t be where the stocks you purchase generate their income but how much you pay for them. Please do not chase stock prices up and be patient, accumulating a position over time. That may mean missing out on the occasional opportunity but it will save you plenty in the long run.

Table 1: Your ASX-listed international portfolio

COMPANY (ASX CODE)	LATEST RECOMMENDATION	PRICE (AS AT 15/2/16)	MAXIMUM PORTFOLIO WEIGHTING	GEOGRAPHIC EXPOSURE
ANSELL (ANN)	9 Feb 16 (Buy – $16.14)	$17.00	7%	United States, Europe
BHP BILLITON (BHP)	9 Dec 15 (Buy – $17.28)	$15.09	8%	Global
COMPUTERSHARE (CPU)	19 Aug 15 (Buy – $10.12)	$9.28	7%	US, UK, Australia
GBST (GBT)	23 Oct 15 (Buy – $4.27)	$4.36	6%	UK, Asia, Australia
NEWS CORP (NWS)	8 Feb 16 (Buy – $17.34)	$15.42	4%	US, Europe
PM CAPITAL GLOBAL (PGF)	19 Jan 16 (Buy – $0.91)	$0.85	5%	US, UK
TRADE ME (TME)	19 Oct 15 (Buy – $3.53)	$3.60	6%	New Zealand

There's a lot more to this glove and condom maker than meets the eye. The latest result wasn't great but the price fall it produced was.

Ansell: Global presence, leading position

By any measure, Ansell is in a league of its own when it comes to protective wear. This is a company of premier standing and global presence. Take the industrial gloves division, where the company has a market share twice that of its nearest rival. Or the disposable gloves market, where it is three times larger than the No. 2. Ansell is the largest or second largest player in all of its core divisions, with dozens of popular brands in its stable. The mere suggestion that this globally recognised and positioned business might be undervalued seems outlandish.

Key Points

- ***Brands and scale advantage***
- ***High margins and return on capital***
- ***Well managed, attractively priced***

Ansell (ANN)

COMANY INFO	
PRICE AT REVIEW	$17.00
MARKET CAP.	$2.6bn
12 MTH RANGE	$14.76–$30.40
BUSINESS RISK	Low–Medium
SHARE PRICE RISK	Medium
PORTFOLIO WEIGHTING	7%
OUR VIEW	**BUY**

RECOMMENDATION GUIDE

SELL Above **$25.00**

HOLD

$17.00

BUY Below **$16.50**

And yet there it is. Share prices don't quite behave the way people assume they do. In early February, Ansell said January sales were poor. The company reduced its forecast for full-year earnings per share by 9% from US$1.05–1.20 to US$0.95–1.10, implying net profit will come in around US$15m short of expectations.

The response? One broker cut its target price by 34% – implying that Ansell was worth, in its opinion, $1.1 *billion* less on Thursday than it was on Wednesday. The stock has now halved since its April 2015 high. And therein lies the opportunity.

Ansell manufactures medical, industrial and single-use gloves as well as condoms and a few other latex products. It sells these products around the globe. If you've ever washed the dishes, you're probably familiar with some of its brands.

Ansell sensibly focuses on highly tailored products that fill hundreds of obscure niches; gloves impervious to a particular chemical or with a textured grip for use on oil rigs. The company has released more than 100 new products over the past three years and the 'innovation cycle' seems to be speeding up – 50 new products were released in 2015. In an industry largely dominated by commodity, price-driven products, this is essential, and profitable.

Specialisation means Ansell can often charge a little more than competitors that sell generic merchandise. That supports the company's margins. Ansell had an earnings before interest and tax (EBIT) margin of 14.8% in 2015 – its highest in more than a decade. The company gets more ticks, too. Return on tangible assets is over 20% due to its **economies of scale**. And because Ansell is the largest operator in almost all its markets, it can be profitable at a price that leaves smaller competitors, with higher average costs, losing money. Higher profitability means it can then reinvest more into R&D and reinforce its market-leading position. It's a nice model.

Table 1: Sales, margins and market position*

	INDUSTRIAL	MEDICAL	SINGLE-USE	SEXUAL WELLNESS
SALES ($M)	$669m	$447m	$312m	$217m
SHARE OF TOTAL SALES	41%	27%	19%	13%
EBIT MARGIN	14%	16%	19%	12%
GLOBAL MARKET POSITION	#1 (2X No. 2 player)	#1 (1.1X No. 2 player)	#1 (3X No. 2 player)	#2 (share unknown)

*** From review published 24/11/15**

Ansell's stock plunged 20% following the full-year announcement and management responded exactly as we had hoped. Three weeks later the company announced a US$100m share buy-back over the next 12 months, which should reduce the share count by around 4%. It's a good use of cash flow given the company's limited growth opportunities.

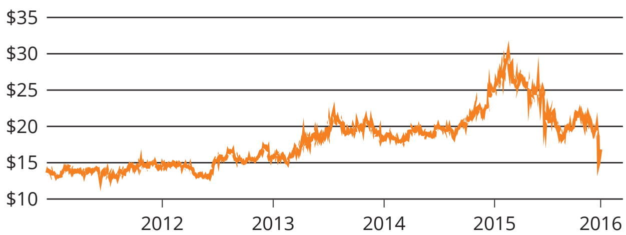
Management has also shown its skill on the acquisition front. In 2013, the company bought BarrierSafe Solutions, the largest maker of single-use gloves in the US (see ***Ansell buys US market leader***). Whilst growth in Ansell's industrial and medical glove divisions has flat-lined in recent years, the US single-use market has been growing at about 4%. BarrierSafe has done even better and is increasing market share with organic revenue growth

> “ **The latest result was disappointing but the share price reaction seems overdone.**

of 6%. Management wasn't willing to overpay, either, paying just 10 times EBITDA.

The company's strategy also stacks up, consolidating its core brands. 'It improves the impact in the marketplace, so that we build the Ansell brand, the Hyflex, Gammex and SKYN brands to be demanded by the end customer by name ... in a few years, we expect to have 80% of our sales from core brands,' up from around 50% today. The added recognition should flow through as increased pricing power and, hopefully, wider margins. In any case, it's Ansell's branded products that are contributing all the growth, with core brand sales overall increasing by 10% a year since 2010.

Chart 1: ANN 5-year share price (to Feb 2016)



Source: S&P Capital IQ

The latest result was disappointing but the share price reaction seems overdone. Despite net profit falling 10% in constant currency terms to $70m, free cash flow fell only 2% to $66m. The Single Use and Sexual Wellness divisions, which together account for nearly a third of sales, are performing admirably. And, while the Industrial division had a modest result this time around, new product releases from the Intercept range in the coming six months should improve things.

What's more, a big part of the Medical division's woes were, as management put it, 'self inflicted' due to the supply constraints. That issue should correct itself over time. Even the lower oil price – so damaging to Russian and energy industry glove sales – has a silver lining: Ansell is highly leveraged to industrial demand and the lower cost of energy should encourage growth.

Ansell operates in a highly cyclical industry but the company has a formidable distribution network and the broadest product line of any competitor. Its brand recognition and economies of scale make for wider margins, which would cushion the impact of increasing competition or a weakening economy. With strong brands, a dominant and increasing market share, able management and economies of scale, there's every reason to believe Ansell will be bigger and stronger 10 years from now.

Table 2: Ansell Latest research

DATE	TITLE
9 FEB 16	Interim result 2016
4 FEB 16	Bad news, good news
24 NOV 15	A fresh look

Using the midpoint of management's forecast range for full-year earnings and a US dollar exchange rate of 0.71, Ansell sports a price-earnings ratio of just 11 and a yield of 3.6%. That's attractive for a global company of this quality.

Note: Our ***Growth*** *and* ***Equity Income*** *portfolios own shares in Ansell. You can find out how to invest directly in these and other InvestSMART portfolios by clicking the* ***recommendations tab on our website****.*

Disclosure: Staff members may own securities mentioned in this article.

Commodity price falls have caused further carnage in the resources sector. BHP looks set to ride out the troubles rather well.

For the first time in a decade, BHP is cheap

The commodities boom is over. From gold, iron ore and oil, to graphite, lithium, and lime, commodity prices of every description have suffered calamitous falls. Reason enough, you might think, to avoid buying the world's largest miner. Yet that is just what we are recommending you do.

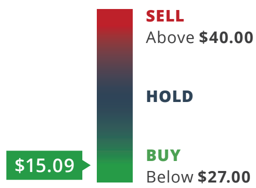
Key Points

- ***Asset base is high quality***
- ***Free cash flow rising***
- ***Strong balance sheet***

BHP Billiton (BHP)

COMANY INFO	
PRICE AT REVIEW	$15.09
MARKET CAP.	$80.3bn
12 MTH RANGE	$15.72–$16.14
BUSINESS RISK	Low–Medium
SHARE PRICE RISK	Medium
PORTFOLIO WEIGHTING	8%
OUR VIEW	BUY

RECOMMENDATION GUIDE



This is not the business it appears to be. Falling prices, so often the death of miners, will not doom BHP. Mostly, this is because the Big Fella holds the best mining assets in the world – an unmatched collection of the lowest-cost, largest, irreplaceable mines. Less obvious, but just as important, is the change BHP is undergoing. An aggressive, acquisitive miner, intent on domination through relentless expansion, is being replaced by a more humble beast interested in the dull virtues of prudence, profitability and shareholder returns.

Although miners are thought to be captives of the commodity price cycle, BHP shows few scars from cyclicality. Over the past 25 years, a time that covers a variety of manias, panics and crashes, BHP has not made a single operating loss. When incurred, losses have come from errors in capital allocation rather than as a consequence of low prices.

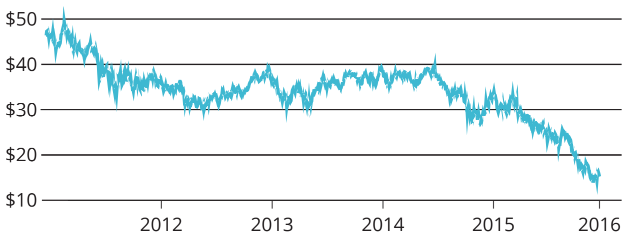
The resilience of the business comes from the quality of its assets. BHP boasts the second most profitable iron ore business in the world; its Bowen Basin coal mines have no equal; the petroleum business is among the world's top dozen oil producers; it operates the world's largest copper mine, the largest uranium deposit.

BHP's weakness has always been management, not mines. After wasting the greatest resources boom in history, management now shows signs of penance.

Iron ore and petroleum accounted for 30% of BHP's asset base in 2004; in 2014 it was 55%. BHP's past capital expenditure – as well as its future spending plans – are concentrated in these two commodities. It is here where the case for the Big Fella will be made or unmade. Price weakness in these commodities is also why an opportunity exists today.

Even though iron ore prices have crashed, BHP should still generate a return on assets of more than 20%. It has never generated a return of less than 25%. With or without a resources boom, this is a wonderful business. At US$40 a tonne, prices are back to where they were in 2004. In that year, BHP produced 100m tonnes of iron ore and generated a return on assets of over 30%. This year it will produce 240m tonnes of iron ore. Even though prices have fallen, profits will remains strong.

Chart 1: BHP 5-year share price (to Feb 2016)



Source: S&P Capital IQ

Moreover, costs that had risen over the decade are now falling again. By spreading infrastructure costs over more output, BHP can reduce unit costs while tweaks to logistics – de-bottlenecking in the parlance – will lower them again. Iron ore is a logistics business where small cost savings accumulate over time. BHP suggests it can lower costs from about $40 a tonne to $25 a tonne over the long term. We believe that figure is within reach. The enlarged iron ore business should continue to generate stunning returns even if prices never recover to boom levels. Only BHP and Rio can make this claim, which is why the pessimism surrounding iron ore returns is unjustified.

> **“Historically, BHP has never generated an operating loss. All losses have been mistakes of management rather than the fault of mines.**

No commodity has attracted more pessimism of late than oil. Posting one of the swiftest declines on record, the oil price collapse has stunned producers and will be painful, even for BHP. The legacy assets are hugely profitable, able to produce oil for less than US$10 a barrel. They continue to generate stunning returns. The shale business, however, which now accounts for the bulk of capital expenditure and output, faces lower returns.

With iron ore and oil prices joining coal, copper and aluminium in the dumps, now is the time to start building a position in the world's largest miner. To examine the three valuation scenarios for the company, **please see here**.

Historically, BHP has never generated an operating loss. All losses have been mistakes of management rather than the fault of mines. The BHP empire remains a high quality asset base that will continue to generate generous cash. Free cash flow is better now than during the boom and, with the exception of shales, where we expect further writedowns, the asset base is performing splendidly.

Profits will be down and returns will fall with prices, but peers will be bust long before BHP suffers a similar fate. As custodian of the lowest cost output, the business can withstand the downturn and is now attractively priced.

Table 1: BHP Billiton Latest research

DATE	TITLE
9 DEC 15	*Resource sector price falls*
10 NOV 15	*Cracks in the Buy case?*
26 AUG 15	*Result 2015*
30 JAN 15	*Biting into BHP – Pt 2*
27 JAN 15	*Biting into BHP – Pt 1*

We have been rather cautious about BHP in previous upgrades, suggesting members take bites as prices fell. We repeat that call again with one difference; BHP is, for the first time in more than a decade, cheap. We don't expect the cycle to turn or for profits to soar but these assets are performing as well as we had thought and there is a genuine change in management's approach to capital allocation. **BUY** for up to 8% of your portfolio.

*Note: Our **Growth** and **Equity Income** portfolios own shares in BHP Billiton. You can find out how to invest directly in these and other InvestSMART portfolios by clicking the **recommendations tab on our website**.*

Disclosure: Staff members may own securities mentioned in this article.

This global share registry business has been helped out by merger synergies and the lower $A, but real organic growth remains elusive, for now.

Computershare's glass half full

Industries dominated by a single firm are easy to spot. The winner has the highest margins, even when charging a similar or lower price; it enjoys a dominant market share, often over 50%; and it has higher returns on capital.

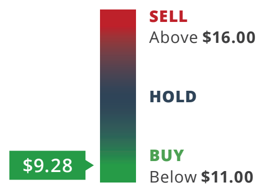
Key Points

- ***World's dominant share registry***
- ***Business hit by low interest rates***
- ***Expanding into mortgage servicing***

Computershare (CPU)

COMANY INFO	
PRICE AT REVIEW	$9.28
MARKET CAP.	$5.1bn
12 MTH RANGE	$9.05–$13.56
BUSINESS RISK	Medium
SHARE PRICE RISK	Medium
PORTFOLIO WEIGHTING	7%
OUR VIEW	BUY

RECOMMENDATION GUIDE



That dominance frequently creates a virtuous circle. A large market share delivers the cash flow that can be used to further strengthen the company's competitive advantage. The Coca-Cola Company and Gillette are famous US examples, as is **Cochlear** closer to home. **Computershare**, the world's largest share registry business, can be added to this illustrious list.

Since opening its doors in 1978 in Melbourne, Computershare now operates in 20 countries. In most major markets it's the biggest player. This dominance shows up in the figures. Computershare earns operating margins around 25% and a return on equity close to 30%, all from an operation that appears to be a commodity-like business but in reality is anything but.

Computershare manages the share registers of listed companies across the globe, managing records, legal titles and dividend payments on behalf of its clients' shareholders. It also takes queries and phone calls from shareholders and manages complex employee equity plans. At key points in the stockmarket cycle, other lucrative but irregular revenue kicks in; the back-end processing of capital raisings, mergers and takeovers, stock splits and other one-offs, for example.

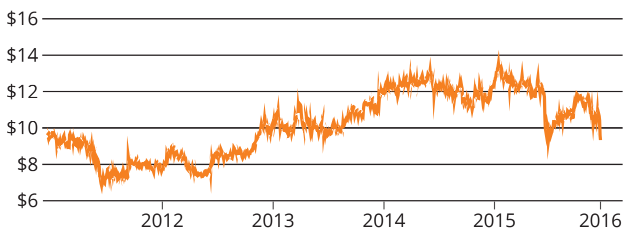
With sharemarkets struggling and interest rates low (Computershare earns much of its revenue from interest on money waiting to be paid as dividends), growth has been absent from this business in recent years. However, much of the revenues are recurring in nature and operating margins remain at a healthy 25%.

There could be a sharp improvement if and when corporate activity increases and interest rates eventually rise. The futures market, explained management at the recent interim results announcement, points to an increase of 1% in interest rates over the next five years, from 0.5% to 1.5%. If this increase flowed through to Computershare's yield on client balances, boosting it from 1% to about 2%, all things being equal it would add about $150m, or almost 30%, to underlying earnings before interest, tax, depreciation and amortisation (EBITDA).

At the moment, though, the market sees half-empty glasses everywhere, and they're not seeing much scope for improved confidence and higher rates.

In the absence of rising interest rates, the great hope for growth is the group's mortgage servicing businesses in the UK and US. These are included in the group's Business Services revenues, alongside the management of class actions and the declining deposit protection scheme and voucher services businesses.

Chart 1: CPU 5-year share price (to Feb 2016)



Source: S&P Capital IQ

In all, Business Services revenues have more than doubled over the past five years and now contribute 31% of the group total, up from 16% five years ago. This will increase further following the acquisition of US-based mortgage servicing agent Capital Markets Cooperative earlier this month and – potentially – from the contract to supply mortgage servicing to the UK Asset Resolution (UKAR) business (which supervises the closed mortgage books of the Bradford and Bingley and Northern Rock) for which Computershare was recently named preferred bidder.

It makes sense for Computershare to grow into 'adjacencies' where it can use its skills at data management and communication. However, servicing mortgages is not as good a

> **“ Investors took this to mean that downgrades are now more likely than upgrades and sent the stock down around 11% over two days.**

business as maintaining share registries, as reflected in slightly lower EBITDA margins of around 23%. So as the mortgage servicing grows, it dilutes the quality of Computershare as a whole.

Table 1: Latest half-year result

SIX MTHS TO 31 DEC	2015	2014	+/(–) (%)
UNDERLYING REVENUE (US$M)	939	960	(2)
UNDERLYING EBITDA (US$M)	242	259	(7)
UNDERLYING NET PROFIT (US$M)	144	161	(10)
EPS (US CENTS)	25.6	28.9	(10)
FINAL DIVIDEND (AUST CENTS)	16c (up from 15c), 100% franked, ex date 18 Feb		

Investors were also somewhat alarmed recently by management's comments on the outlook in the company's interim results. Although guidance was officially maintained for the year to June, at around 55.3 US cents, management suggested that it was 'seeing some softening in the operating environment' and added that it was 'working hard to meet the guidance'. Investors took this to mean that downgrades are now more likely than upgrades and sent the stock down around 11% over two days.

The results were a little ugly in other places too. Costs rose 7% following acquisitions as well as 'the combined effect of investment in product development and innovation, regulatory cost and efficiency initiatives'.

New cost saving plans have been launched in the UK and the US, including the relocation of services to Louisville, which is expected to cost US$85m–90m but to save $25m–30m a year when completed in about four years' time.

The company also absorbed cash, after accounting for SLS loan servicing advances. These are a working capital requirement of the group's SLS mortgage servicing business, which benefitted from an effective investment of $87m in the first half. The company expects to sell a large chunk of these advances in the second half, which should therefore deliver a decent cash outflow. At an underlying level, the cash flow performance was solid.

The company has been using the cash to buy back shares – a total of 7.2m in the half and about 1.3% of the company's shares on issue – at an average price of $10.88. There probably won't be too much more to come, though, since the plan is to keep net debt between 1.75 and 2.25 times management EBITDA, and it's currently at about 2.1.

Table 2: Computershare Latest research

DATE	TITLE
12 FEB 16	*Interim result 2016*
18 AUG 15	*Computershare launches buyback*
11 MAR 15	*Downgraded to Hold*
12 FEB 15	*Interim result 2015*
19 NOV 14	*Struggling for growth*

Management's somewhat underwhelmingly endorsed guidance for 2016 earnings per share translates to about 78 Aussie cents at current exchange rates, slightly below the 82 Aussie cents recorded for 2015, but enough to put the stock on a forward multiple of just 12. That looks cheap even for a company struggling for growth and diluting its quality. We recommend the company as a **BUY**, with a recommended maximum portfolio weighting of 7%.

*Note: Our **Growth** and **Equity Income** portfolios own shares in Computershare. You can find out how to invest directly in these and other InvestSMART portfolios by clicking the **recommendations tab on our website**.*

Disclosure: Staff members may own securities mentioned in this article.

This financial software company has a rapidly growing international business and a new CEO getting to grips with its growing pains.

GBST a platform of riches?

GBST has a very attractive business, with leading market positions supplying software that automates the back-end processing of transactions in securities and wealth management. As such, it adds a lot of value, is protected by high barriers to entry, and has a large proportion of recurring revenue. These are the building blocks of an attractive business.

Key Points

- ***High barriers to entry and recurring revenue***
- ***Prospects for rapid growth in the UK & Asia***
- ***New CEO dealing with growing pains***

GBST Holdings (GBT)

COMANY INFO	
PRICE AT REVIEW	$4.36
MARKET CAP.	$294m
12 MTH RANGE	$3.55–$6.84
BUSINESS RISK	Med–High
SHARE PRICE RISK	High
PORTFOLIO WEIGHTING	6%
OUR VIEW	**BUY**

RECOMMENDATION GUIDE

SELL Above **$8.00**

HOLD

BUY Below **$5.00**

$4.36

But let's start at the beginning. In 1996 the company's **Shares** product was the first software to be aligned with the ASX's new CHESS clearing and settlement system. Shares now handles around 60% of all ASX trades and is supplemented by a global capital markets product called '**Syn~**'. Unlike Shares, Syn~ can handle all kinds of securities in all kinds of currency, which is why it forms GBST's spearhead for international growth.

Its customers are big banks and brokers that sign up for multi-year contracts, but typically stick around for much longer because of the difficulties involved in switching. GBST earns revenues on the initial installation and then a licence fee for using the software, with maintenance and upgrades thrown in. Overall, these licence fees contribute about 80% of capital markets revenues. Over time GBST aims to migrate its Australian clients to Syn, which is now enjoying some success overseas.

The real excitement, though, relates to its wealth management business, which provides the software for financial institutions to create and manage investment platforms. Australia and New Zealand are widely credited with inventing the platform market in the 1990s, with the goal of reducing costs and making life easier for investors (although a cynic might add that it enabled the wealth management industry to squeeze in another layer of fees).

In 2013, the UK went live with its own version of FoFA, known as the Retail Distribution Review (RDR). RDR outlaws commissions, requires advisers to declare whether their advice is 'independent' or 'restricted' and mandates the 'auto-enrolment' of employees into workplace pension schemes.

The new rules are expected to make life much harder for the UK's independent financial advisers (IFAs), leaving the UK's financial institutions looking for new means of distribution to retail customers. The favoured option appears to be – you guessed it - investment platforms.

The UK may be late to the party but it's making up for lost time. In its 2014 annual report, GBST notes that its UK sales have risen six-fold in the past five years, but that the 'market is still in its early stages' with the wrap and platform market 'expected to quadruple by 2020'.

The Australian and New Zealand specialist developers of platform software – notably GBST through its Composer product, Bravura and FNZ – have found themselves right at the heart of this sweet spot. With a multi-channel capability and a 'gating' facility, which enables the system to close off certain features to different categories of user, GBST is at the front of the pack. GBST Composer now supports three of the top six UK investment platforms.

Table 1: GBST full-year result

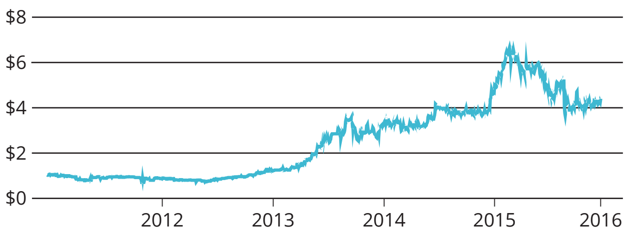
YEAR TO 30 JUN	2015	2014	+/(–) (%)
REVENUE ($M)	114.3	98.5	16
EBITDA ($M)	24.5	20.5	20
UNDERLYING NET PROFIT ($M)	19.2	14.3	34
UNDERLYING EPS (C)	28.9	21.5	34
DPS (C)	10.5	8.5	24
FINAL DIVIDEND	5.5 cents, fully franked, ex date 28 Sep		

If the UK platform market does indeed quadruple by 2020, and GBST takes its existing share of that, then it could propel the international wealth management division to revenues of around $140m (from $36m in 2014) and a six-fold increase in operating profit to about $43m (assuming the margin expands

> **Despite the great products and explicit growth path, recent months have been tumultuous.**

to 30%, compared to the 38% achieved in Australia in 2014). Combined with the pedestrian growth expected from the other divisions, that might mean underlying earnings per share of around 78 cents in 2020 (before the amortisation of acquired intangibles) – getting on for four times the 21.5 cents achieved in 2014.

Chart 1: GBT 5-year share price (to Feb 2016)



Source: S&P Capital IQ

If we plug in more conservative assumptions, including a mere doubling of international wealth management revenues and a margin of only 25%, underlying group earnings per share would still double by 2020, implying earnings growth of 11% a year on top of the stock's current free cash flow yield of around 6% (the company needs to invest hardly any capital to grow, so almost all its profits appear as free cash).

Of course, more bearish scenarios exist including: the potential for reputational damage if there's a security problem on one of its platforms; a rise in the Australian dollar (compared to sterling in particular); and the possibility of consolidation among its client base. But unless you actually expect earnings to suffer permanent impairment – which is hard given the company's sticky revenues, strong market positions and net cash – then that 4% free cash flow yield provides considerable protection.

Despite the great products and explicit growth path, recent months have been tumultuous. Project delays have hit earnings, the company's chief has retired and GBST has announced plans to move away from more speculative projects to focus on 'low hanging fruit'. We put this down to growing pains. Dealing with them is a necessary part of growing up and in that regard, new CEO Rob De Dominicis appears to be handling things well.

Table 2: GBST Latest research

DATE	TITLE
23 OCT 15	*Targeting low hanging fruit*
10 NOV 15	*Project delays hit earnings*
26 AUG 15	*Result 2015*
23 APRIL 15	*Upgraded back to Buy*
30 MAR 15	*Platform for growth*

Nevertheless, GBST is a high risk, high return proposition with a volatile share price. We rate the stock a **BUY** below $5 for up to 6% of your portfolio.

*Note: Our **Growth** and **Equity Income** portfolios own shares in GBST Holdings. You can find out how to invest directly in these and other InvestSMART portfolios by clicking the **recommendations tab on our website**.*

Disclosure: Staff members may own securities mentioned in this article.

News Corporation has shown shareholders the future: digital real estate with a hint of romance.

News Corp on the Move

Is the 'bad News' coming good? When News Corporation split from 21st Century Fox in 2013, it was considered an ugly duckling (or pond slime, depending on one's sympathies). News Corp's ragbag collection of assets, including newspapers, Australian pay TV, book publishing and online real estate listings weren't foxy enough.

Key Points

- ***Foxtel penetration improving slowly***
- ***Move's performance exceeding expectations***
- ***Diversification and Aussie dollar helping***

News Corp (NWS)

COMANY INFO	
PRICE AT REVIEW	$15.42
MARKET CAP.	$9.2bn
12 MTH RANGE	$15.35–$21.98
BUSINESS RISK	High
SHARE PRICE RISK	High
PORTFOLIO WEIGHTING	4%
OUR VIEW	**BUY**

RECOMMENDATION GUIDE

SELL Above **$36.00**

HOLD

BUY Below **$22.00**

$15.42

While the 'bad News' has indeed produced some bad news over the past few years, the company's story has improved. Several of News Corp's divisions are performing better than expected, the decline in the Australian dollar has helped, and management's acquisition strategy is taking shape.

Moreover, Rupert Murdoch is not in the habit of losing money. (Except when it's necessary to run his treasured but loss-making newspaper The Australian, but that's another story.) Witness News Corporation's decision to pull the plug on digital education business Amplify a few months ago.

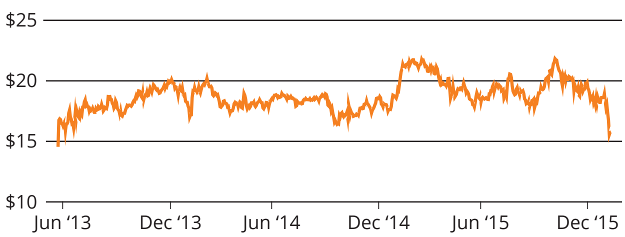
So what does Murdoch's loss aversion mean for News Corp's two most important businesses: pay television and digital real estate? Pay television provider Foxtel – of which News owns 50% - faces structural challenges. Netflix and other subscription television services – with plans from around $10 a month – have forced Foxtel to unbundle its packages. Foxtel's average revenue per user was $93 a month in 2015 but that figure looks destined to fall.

Foxtel's management also needs household penetration to rise. At around 30%, pay TV penetration is much lower in Australia than the US, where it stands at 83%. Foxtel grew subscribers from 2.7m to 2.9m over the nine months to 30 September 2015 by unbundling its packages, which now start at $25 a month (plus installation).

Where Foxtel has a significant competitive advantage over other subscription television services is in sport broadcasting, which is why Fox Sports – News Corp's 'Cable Network Programming' division – recently bid a combined $2.2bn for the AFL and NRL pay TV rights until the end of the 2022 seasons. The AFL called the deal 'colossal'. If sport fans want to watch sport it will cost them, whether it's through watching advertising or paying subscription fees.

News Corp isn't infallible, of course. Fox Sports recently lost the broadcasting rights to the English Premier League to Optus. While News Corp management downplayed the loss, Foxtel will probably lose subscribers from the 2016/17 season because of it. In the first quarter of 2016, Foxtel's Australian dollar EBITDA fell 21% (38% in US dollars). News Corp's management attributed most of this to one-off factors and is still (a little too?) confident that Foxtel's earnings will rise this financial year.

Chart 1: NSW share price (to Feb 2016)



Source: S&P Capital IQ

To reflect the structural challenges and rising cost of broadcasting rights, we've decided to reduce the low, medium and high multiples for Foxtel and Fox Sports in our sum-of-the-parts valuation (see Table 1) in The not so bad News. One over-riding fact remains, though: dedicated sport fans will need a Foxtel subscription for the foreseeable future.

While News Corporation's pay television businesses are arguably weakening, its digital real estate businesses are doing the opposite. The 62%-owned REA Group is the jewel in News Corp's crown. REA's share price surge to around $50 reflects the quality of the business but takes it further away from an upgrade.

> **In time, though, Move – which operates realtor.com in the US – could be even more important to News Corp's valuation.**

Table 1: News Corp sum-of-the-parts valuation

DIVISION	2015 EBITDA FOR VALUATION (US$M)	MULTIPLES: LOW /MEDIUM /HIGH	LOW VALUE (US$M)	MEDIUM VALUE (US$M)	HIGH VALUE (US$M)
NEWS AND INFORMATION SERVICES	603	3/5/7	1,809	3,015	4,221
FOXTEL (50% SHARE)	380	4/6/8	1,520	2,280	3,040
CABLE NETWORK PROG. (FOX SPORTS)	135	4/6/8	540	810	1,080
BOOK PUBLISHING	221	6/8/10	1,326	1,768	2,210
DIGITAL REAL ESTATE SERVICES					
REA GROUP STAKE		$A36/$50/$60	2,045	2,840	3,408
MOVE/REALTOR.COM			0	762	1,400
BUSINESS VALUE			7,240	11,475	15,359
CORPORATE	(215)	10	(2,150)	(2,150)	(2,150)
BUSINESS VALUE AFTER CORP. COSTS			**5,090**	**9,325**	**13,209**
CASH			1,857	1,857	1,857
OTHER INVESTMENTS			342	342	342
LESS SHARE OF FOXTEL DEBT			(813)	(813)	(813)
LESS OTHER LIABILITIES			(357)	(357)	(357)
TOTAL VALUE			**6,119**	**10,354**	**14,238**
AVERAGE PER NWS SHARE ($US)			10.53	17.82	24.51
AVERAGE PER NWS SHARE ($A)			**15.05**	**25.46**	**35.01**

In time, though, Move – which operates realtor.com in the US – could be even more important to News Corp's valuation. Management is extremely pleased with the performance of Move since its 2014 acquisition, with 2016 first quarter revenue rising 33%. Compare that to Zillow, the US number one real estate website, where revenue rose 13% in the same period. The realtor.com home page has been revamped and there's a new focus on editorial content. Importantly, the company is driving traffic to the website from its collection of premium media sites.

Table 2: Divisional performance 1Q16 (US$m)

DIVISION	1Q16	1Q15	+/(–) (%)
NEWS AND INFORMATION SERVICES	83	105	(20)
FOXTEL (50% SHARE)	140	225	(38)
CABLE NETWORK PROG. (FOX SPORTS)	28	32	(13)
BOOK PUBLISHING	42	55	(24)
DIGITAL REAL ESTATE SERVICES	57	57	N/a

Move's ultimate business model isn't yet clear but realtors in the US are generally unhappy with market leader Zillow so Move's relationship with the National Association of Realtors could be a source of competitive advantage. Management expects Move to become EBITDA positive in 2016, with further improvement in 2017. There's certainly long-term upside here.

Table 3: News Corp Latest research

DATE	TITLE
8 FEB 16	*Interim result 2016*
11 JAN 16	*On the Move*
3 NOV 15	*REA Group bids for iProperty*
13 AUG 15	*Result 2015*
27 JUL 15	*The not-so-bad News*

> **“The market remains concerned about how the structural issues in pay television will play out while, in the book publishing division, there seems to have been an industry-wide downturn in e-book sales.**

As for the other divisions, we've converted everything to US dollars, News Corp's reporting currency, before converting back to a per-share Australian dollar valuation at the end. We've maintained the same multiples for the News and Information Services division as before, although we reiterate that revenues and earnings from this division are likely to continue declining over time. We have however reduced the medium and high multiples for the Book Publishing division, primarily to reflect the strong year that was 2015.

The net effect is that the valuations per share are largely unchanged. In fact, the low valuation has increased slightly because Amplify has been sold. So why has News Corporation's share price fallen 7% since The not-so-bad News from 27 Jul 15 (Buy – $19.84)?

It's probably because the market expects earnings to fall in 2016. All divisions except digital real estate reported lower first quarter earnings (see Table 2). The market remains concerned about how the structural issues in pay television will play out while, in the book publishing division, there seems to have been an industry-wide downturn in e-book sales.

Some divisions are facing structural challenges, it's true, but News Corporation is a very diversified business. Don't underestimate management's ability to use the company's media properties to increase – or at least protect – the value of its other businesses. Management for one thinks the stock is underpriced, with the company buying back more than three million shares since the buyback commenced in May last year.

We agree with that implied view. And the fact the share price has fallen 21% since News Corp: Result 2015 from 13 Aug 15 (Buy – 19.59) at the same time as the Aussie dollar has fallen improves the value on offer. **BUY** for up to 4% of your portfolio.

Disclosure: Staff members may own securities mentioned in this article.

This internationally focused listed investment company is available at a significant discount to NTA, despite an exemplary track record.

PM Capital Global Opportunities Fund backs foreign banks

One way to get a portfolio of international stocks without purchasing more than one is to do it through internationally-focused **listed investment companies** (LICs) such as **Magellan Flagship Fund**, **Hunter Hall Global Value Fund**, **Platinum Capital** and **Templeton Global Growth Fund**.

Key Points

- ***LICs a good way to obtain international exposure***
- ***Heavy exposure to foreign banks***
- ***Trading 20% below NTA***

PM Capital Global Opportunities (PGF)

COMANY INFO	
PRICE AT REVIEW	$0.85
MARKET CAP.	$295m
12 MTH RANGE	$0.8–$1.12
BUSINESS RISK	Low–Medium
SHARE PRICE RISK	Medium
PORTFOLIO WEIGHTING	5%
OUR VIEW	**BUY**

RECOMMENDATION GUIDE

SELL
Above **$1.50**

HOLD

BUY
Below **$0.95**

Despite recent market falls, however, none of these LICs yet offer a sufficient discount to their asset values to warrant an upgrade (although Templeton Global Growth Fund is close). But one more is.

After 14 successful years at Bankers Trust Australia, Paul Moore founded PM Capital in 1998. His original fund – the Global Companies Fund – has beaten its benchmark (the MSCI World Index in Australian dollars) by 5.1% a year since then. Three more managed funds have followed – the Australian Companies Fund, the Asian Companies Fund and the Enhanced Yield Fund. They too have comfortably beaten their benchmarks. PM Capital now boasts $2.2bn in funds under management.

Like many other fund managers, PM Capital recently extended its offering to LICs, launching PM Capital Global Opportunities Fund (PGF), an internationally-focused LIC, in December 2013 (see Table 1).

PGF follows PM Capital's value investing philosophy that 'the best way to preserve and enhance your wealth is to buy a good business at a good price'. Its strategy is to invest in a concentrated portfolio of global shares (including Australian shares) and other securities, aiming to hold a total of about 40 stocks, with no one position exceeding 10% of the portfolio.

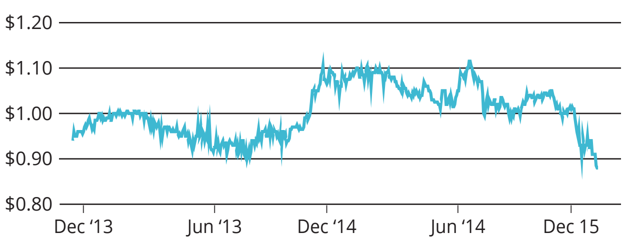
This concentrated strategy differs from the more diversified portfolios of many LICs, which is one of its attractions. If you're backing a manager to look after your money you want them to back themselves. The caveat is that this increases the risks, particularly since much of the portfolio's current makeup is in financials, as we'll see.

Table 1: PGF details

SHARE PRICE	$0.85
PRE-TAX NTA (AT 31 JAN 16)	$1.09
POST-TAX NTA (AT 31 JAN 16)	$1.06
DISCOUNT TO POST-TAX NTA	20%
MANAGEMENT FEE	1% per year
PERFORMANCE FEE	15% of return above MSCI World Index (AUD)

The LIC can also use borrowings, short sales or derivatives to leverage the portfolio, up to a limit of 30% of its net asset value. 84% of PGF's currency exposure is to the US dollar and it will hedge against increases in the Australian dollar should it believe it necessary.

Chart 1: PGF share price (to Feb 2016)



Source: S&P Capital IQ

As we've noted before, we suggest you buy LICs at a discount to their post-tax NTA, which reduces pre-tax NTA for tax payable on both realised and unrealised gains. This is to compensate investors for the ongoing costs of managing the LIC, which mean investors' returns over time will be less than those of the LIC's portfolio.

> **The LIC's portfolio itself doesn't look expensive, although it is heavily weighted to financials.**

At current prices, investors can purchase PGF at a 20% discount to its most recently released post-tax NTA, which more than compensates for the 1% management fee and other ongoing costs. The consistent discount in recent months is no doubt a major reason why Paul Moore has been buying more shares. He now owns 7.3% of the LIC himself.

The LIC's portfolio itself doesn't look expensive, although it is heavily weighted to financials. Table 2 details PGF's top 10 positions at 31 December, along with some simple valuation metrics.

Table 2: PGF top ten positions at 31 Dec 15

POSITION	FWD PER	P/TBV*	FCF YIELD*
ALPHABET (FKA GOOGLE)	23	nm	3%
LLOYDS BANKING GROUP	9	0.9	n/a
INTERCONTINENTAL EXCHANGE	19	nm	4%
ING GROEP	10	1.0	n/a
BANK OF AMERICA	11	1.0	n/a
JP MORGAN CHASE	10	1.3	n/a
BANK OF IRELAND	12	1.1	n/a
PFIZER	13	nm	7%
BARCLAYS	8	0.7	n/a
REALOGY	18	nm	10%

***P/TBV – Price divided by tangible book value**
***FCF yield – Free cash flow divided by market cap**
Source: S&P Capital IQ

Financials made up 49% of the portfolio at that year end date. This is based on the manager's view that interest rates will rise in coming years and that this, along with credit growth, should help banks in the US, UK and Europe improve their earnings, book value and dividends. Even better, these banks are currently much more reasonably priced than their Australian equivalents such as **Commonwealth Bank**.

Services – which includes Alphabet (FKA Google) and ICE – the owner of the New York Stock Exchange – make up 22% of the portfolio, while 19% is invested in companies exposed to anticipated improvements in American residential property and European commercial property.

As a result of this concentrated portfolio and its emphasis on long-term capital growth rather than dividends, PM Capital recommends investors have a minimum timeframe of seven years. PGF intends to announce its inaugural dividend along with its upcoming 2016 first half result and, while it's unlikely to become a yield stock any time soon, dividends will be franked 'to the greatest extent possible'.

This may help close the discount between PGF's post-tax NTA and its share price, although there is no guarantee this will occur. To help, PM Capital is attempting to increase investors' familiarity with PGF and, if the substantial discount persists, it will also consider share buybacks.

More important, though, will be whether PM Capital can continue to buy undervalued stocks and help PGF outperform its benchmark, as it has in the past. We think it can and, with the margin of safety provided by the substantial discount, we're upgrading PGF to Buy, with a maximum recommended portfolio weighting of 5%. Note, though, that with LICs the level of the discount matters. We wouldn't advise chasing it below a 10% discount to NTA, which amounts to a Buy price of about $0.95. **BUY**.

Disclosure: Staff members may own securities mentioned in this article.

In a country of 4.5m people, this business has 3.4m of them as active members. With attractive margins, growth potential and a cheap price, this stock offers much more than a 4.3% yield.

Trade Me, Trade Me not?

Internet stocks have been on a tear over the past few years, although the love hasn't been shared around. Classified advertising businesses including **REA Group** and **Carsales** have been leading the way.

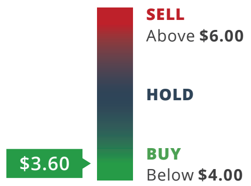
Key Points

- ***Cheap compared to other online classifieds***
- ***Investments are future-proofing business***
- ***Market under-estimating long-term growth potential***

Trade Me (TME)

COMANY INFO	
PRICE AT REVIEW	$3.60
MARKET CAP.	$1.4bn
12 MTH RANGE	$2.68–$4.00
BUSINESS RISK	Medium
SHARE PRICE RISK	Medium
PORTFOLIO WEIGHTING	6%
OUR VIEW	**BUY**

RECOMMENDATION GUIDE



The trouble is that these stocks now trade on high multiples – of 33 and 25 respectively. But what if you could buy a portfolio of them for a multiple of just 19? You can do just that – well almost – by investing in New Zealand's Trade Me. As well as a cheaper price, by combining these businesses Trade Me benefits from additional economies of scale and network effects.

Recently, the company moved into new offices in Auckland and Wellington, increasing its total employee numbers by 31%. While the market has a tendency to see hiring in terms of costs, for Trade Me it's something far more important. The business has grown from a small website built in founder Sam Morgan's flat back in 1999 to the dominant classifieds site in New Zealand. This once-tiny business needed to grow up – and hundreds more staff were needed to secure its future. Without them, it risked becoming complacent. It was a smart move.

The most recent result showed a flat profit because the company is investing in its future but revenue grew 11% last year, driven by the Classifieds division. Motors revenue was up 24% thanks to selling premium products to dealers and the acquisition of Motorweb. And Jobs revenue rose 14% as the company continued to close the gap with market leader Seek New Zealand.

Table 1: Trade Me result 2015

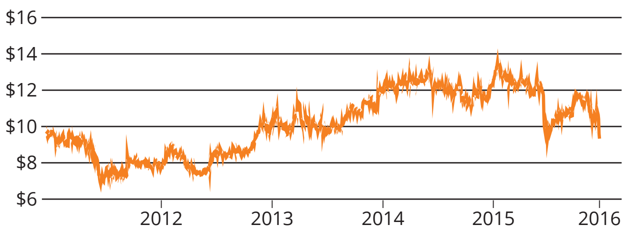
YEAR TO 30 JUN	2015	2014	+/(–) (%)
REVENUE (NZ$M)	200	180	+11
EBITDA (NZ$M)	134	129	+4
NPAT (NZ$M)	82	80	+3
EPS (NZ C)	20.7	20.1	+3
DPS (NZ C)	16.2*	16.0	+1
FRANKING (%)	100	100	N/a

*** 8.5 NZ cent final dividend, 100% franked, ex date 9 Sep. Note non-NZ residents also receive a top up 1.5 NZ cent dividend as they are not entitled to franking credits.**

Note: Figures are underlying results

For investors, the sleeper is Trade Me's 'Other' division. Revenues here grew 23% as it expands into financial services and makes acquisitions in adjacent areas. With the recent launch of Trade Me insurance, we expect further revenue growth. Even the company's General Items division (the New Zealand equivalent of eBay) is showing turnaround potential. While revenue here declined 2%, the company highlighted an improvement in the fourth quarter.

Chart 1: TME share price (to Feb 2016)



Source: S&P Capital IQ

All of this indicates that the market is significantly under-estimating Trade Me's medium to long-term potential. Recent investment in new staff and product improvement initiatives mean the company's products are now much more competitive.

> **"This leads to a virtuous circle where they can lift prices as more value is delivered.**

Moreover, the history of online classified companies is that, once dominant, they keep investing to drive greater value for customers. This leads to a virtuous circle where they can lift prices as more value is delivered. Of course, Trade Me is at a much earlier stage in this process compared with its Australian online classified peers. Despite past problems in the Property division, for example, there is likely to come a time when Trade Me can charge significantly more than the current NZ$159 per property listing (on premium properties).

Table 2: Trade Me Latest research

DATE	TITLE
19 OCT 15	AGM 2015
20 AUG 15	Result 2015
14 AUG 15	Insurance foray
19 FEB 15	Interim result 2015

That said, Trade Me is riskier and could be prone to disruption in some market segments if well-financed competitors decided to compete in the New Zealand market. Whilst unlikely – Trade Me's dominance would make it an expensive proposition for the new entrant – it can't be ruled out.

The company expects to produce another year of double digit revenue growth in 2016, which clearly shows it's not ex-growth. But additional investment in staff as well as higher depreciation and amortisation will again limit profit growth this year. Expect much stronger growth in 2017 and beyond.

With Trade Me on a forecast 2016 PER of 19, the stock is one of our better buying opportunities because there's significant latent value for which you are not yet paying. It's also a more resilient business than when we first upgraded 18 months ago in ***Trade Me: Interim result 2014***. **BUY** for up to 6% of your portfolio.

*Note: Our **Growth** and **Equity Income** portfolios own shares in Trade Me. You can find out how to invest directly in these and other InvestSMART portfolios by clicking the **recommendations tab on our website**.*

Disclosure: Staff members may own securities mentioned in this article.

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