Martin Bros Monitor

www.martinbros.com.au

June Quarter 2010 Edition

Paul & Jarrod Martin are Authorised Representatives (259367 & 259249) of RBS Morgans Ltd.

Our New Look

Now in its eighth year, the Martin Bros Monitor will take on a new look from the September edition.

We hope you like it and feel free to pass on any feedback or suggestions you may have.

Stock Review - Paperlinx Step Up

Paperlinx is a paper merchanting company that have a step up preference share on issue and trade under the code PXUPA. As with most step up preference shares they have a face value of $100 per security (the price they were issued at).

Paperlinx, the underlying company, was crunched during the GFC with crippling debt and falling revenues. They have slowly turned their fate around though and reduced debt from $1.52B as at 31st December 2008 to approximately $400M by the end of June this year.

In the last couple of weeks they have completed the re-financing of all of their debt facilities into regional based finance facilities. This is to align each geographic region's debt with the area in which it operates. The three key areas of operation for Paperlinx are the US, Aust. and Europe.

In April of this year the company announced the closure of its final manufacturing plant. It stated it could no longer compete in the manufacturing space with cheap imports from Asian countries. It is now purely a paper merchanting company. Ongoing operations are noticeably improving.

The company stopped the bi-annual distribution payments on the PXUPA's at the start of the 2009 year at the requirement of its lenders. As a result of the recent re-financing into regional based facilities, this restriction no longer applies. As such, the company has announced that distributions on the PXUPA's will re-commence.

The PXUPA's have a reset date of November 2011. On this date one of three things will happen. One, the security will be converted into ordinary shares of the company and holders will receive $102.50 worth of shares for every PXUPA security they own. Two, the security will be redeemed for its face value of $100 by the company, or three, the security will step up and continue indefinitely (at the option of the company to redeem on any distribution date), paying a floating rate yield of 4.40% plus the 180 day BBSW rate. Based on a current price of $67, this would equate to a current (stepped up) yield of circa 13.75% per annum.

In our view, any of the three options is a good outcome for security holders and will result in a healthy investment outcome.

RSPT - Bad Timing

Since the last Martin Bros Monitor (MBM) in March the markets have returned to a level of volatility that we had not seen in over a year. On the 15th April the market peaked at 5,025 points. By the 21st May the market had fallen to an intra day low of 4,175 points, representing a 16.9% decline. This fall has been larger than any of the other pullbacks since the ultimate market lows (of the most recent Bear market) in March of 2009. Corrections along the way to recovery are commonplace. The extent of the most recent correction is larger than "normal" however. But it is important to distinguish between larger than normal and a new Bear market.

In May, there were several factors that collectively helped to swing the fickle short term sentiment of the markets negative. These include, but are not limited to, the Greece debt crisis, Gulf of Mexico oil spill, potential hung parliament in England, US private sector jobs growth, Chinese slowdown fear, Australian retail sales figures, Hungarian debt concerns, falling $A and the big one (for us) - Resources Super Profits Tax (RSPT) announcement.

Without the RSPT our market should have outperformed the rest of the world. Our banks are strong, interest rates high (relative to the rest of the world which is a good sign) and we have almost full employment. The RSPT has not only affected mining companies but the rest of the (investment) world's perception of Australia as a "safe" place to invest. Safe does not just refer to political instability or the potential for terrorism. Unsafe, in terms of investment decisions, also includes the potential for a government to change the tax landscape without warning or consultation (and make it apply retrospectively).

Please don't take these comments as political in nature, they're not. We are looking at the RSPT purely from an investment perspective. Let us provide an example of what the RSPT has done in terms of an overseas investor's perception of Australia. Let's assume you take out a gym membership and you entered into a contract to pay for ten years membership upfront. Then, two years into this contract the gym announces that the annual cost is increasing by 30%. Although you made the investment decision to commit two years ago, they advise you that you must now pay this annual increase, on top of your original investment.

> **"Australia just fell a lot lower down the expected return table since the announcement of the RSPT.**

How happy would you be with this situation? If someone else was considering joining a gym and they knew about this change, do you think they would join that gym, or look around for other similar gyms without the track record of forcing additional costs onto people, after you had already committed your funds to a long term contract?

So now replace gym with resource projects and persons with company. Resource companies make large investment decisions based on total expected returns over the life of the project. Australia just fell a lot lower down the expected return table since the announcement of the RSPT.

We can understand the idea behind the RSPT and the benefit of distributing some of Australia's natural resources wealth to more closely benefit all Australians. However, the way in which it has been announced (without warning or consultation), the far reaching impact it has across all resources and the retrospective nature of the tax, it has damaged more than just our resources industry in the short term.

We will make our way through this "sovereign" risk. We suspect the RSPT will change quite substantially in its nature, if it survives at all. Markets will overcome this impost if it does prevail and international investors will once again return to Australia, especially if our economy remains this strong. Likewise, markets will, and have begun to already, overcome many of the issues thrown at them in May. There are no indicators pointing to another Global Financial (credit) Crisis at this point in time.

Our view is the market will have traded over the 5,000 point level again by Christmas.

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Last Chance To Qualify For Super Co-Contribution

What is the Government Co-Contribution?

The Government Co-contribution for low income employees, which applies from 2003/04, is provided by the *Superannuation (Government Co-contribution for Low Income Earners) Act 2003* and associated regulations.

The co-contribution effectively replaces the tax rebate to which a low income employee may have been entitled before 2003/04.

The Scheme was introduced to allow low income earners the opportunity to increase their superannuation savings for retirement.

How the scheme works

The co-contribution works in the following way:

1. If you earn $31,920 or less in the 2009/10 financial year as assessable income (including reportable fringe benefits), the Government will contribute one dollar for every dollar you personally contribute into your superannuation, up to a maximum of $1,000 in that year.
2. Where your income is more than $31,920 but less than $61,920 in the 2009/10 financial year, your co-contribution payment will be adjusted based on your income and how much you personally contribute. For example, if you are eligible and your income is $42,000 and you make a personal super contribution of $1,000 during the year, you will be entitled to a co-contribution payment of $664 (this equates to a reduction of $33.33 for every $1,000 of assessable income above the minimum threshold).

Eligibility for the payment

The criteria for eligibility is:

- a tax deduction cannot be claimed on the personal contributions; and
- the personal, after tax contribution must be made to a complying superannuation fund in the same year; and
- a person's assessable income for the financial year in which the personal contribution is made must meet the required income thresholds for either a full co-contribution payment, or a pro-rata co-contribution payment; and
- 10% or more of your total income is derived from eligible employment (from 01/07/2007 this includes self-employed people where at least 10% of total income is earned carrying on a business, eligible employment or combination of both); and
- You do not hold an eligible temporary resident visa at any time during the year and you lodge an income tax return for the year of income; and
- You are under age 71 at the end of the financial year.
- the Australian Tax Office will automatically determine who is eligible to receive the co-contribution and payments will be made to your superannuation fund.

Reminder - Concessional (employer, salary sacrifice, deductible) Contributions

In the 2009 Federal Budget, Treasurer Wayne Swan outlined changes to the concessional contributions limits to apply from the 2009/10 financial year. From this income year, the total concessional contribution (**including the 9% superannuation guarantee**) limits are:

- $50,000 for persons aged 50 or over
- $25,000 for those less than 50

At a time when the government is trying to encourage people to self fund their retirement, they have halved the tax effective contribution limits to super from this year. Let's hope common sense takes over and they re-instate the prior (double current rates) thresholds.

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