# SmartInvestor

*Everything you need to know about your money*

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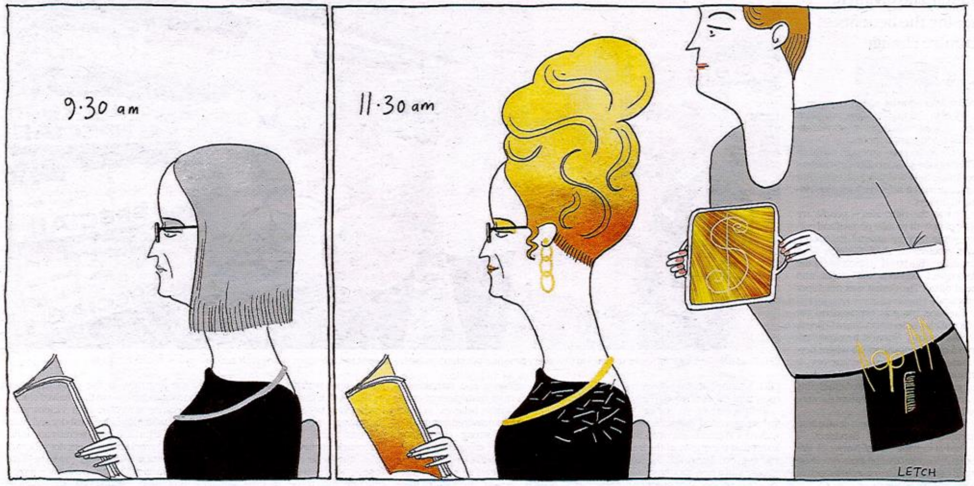

# BOOM TIMES

**Grey power** The Baby Boomers are poised to radically reshape retirement, presenting a golden opportunity for investors, writes **Duncan Hughes**.

Retiring Baby Boomers are using their $1 trillion in savings to challenge the status quo, shape industries and reshape society in ways that might turn grey into gold for savvy investors. Everything from sex to cemeteries is being challenged by "old money" that is demanding improved services, innovative products and more experiences.

Take the humble bicycle.

David Metzke, a former General Motors executive, has launched a company called Dyson Bikes, which makes custom-built bikes for older riders. Those who prefer talk to torque can have discreet engines installed to aid tiring muscles and crossbars can be lowered to ease access.

About 70 per cent of Dyson Bikes customers are aged 55 to 90.

"A lot of clients are former successful businesspeople who have sold up and are looking for a way to keep fit and have fun. Our bicycles allow for different levels of fitness," says Metzke.

Not only is the Boomer generation fitter and healthier than their parents' generation, but it is wealthier. The bulk of the nation's $2 trillion in superannuation assets – the world's fourth-largest pool of managed funds – is owned by Boomers, who have benefited hugely from the property boom.

Demand for products and services catering for Boomers is giving rise to a plethora of investment opportunities, as start-ups and established companies alike hunt for capital to launch, expand or push their ideas and businesses to the next level.

"We are going to see a lot more innovation and development," says David Bryant, chief executive of Australian Unity Investments, which has about $10 billion under management, including top-performing funds investing in hospital, aged care and retirement services and infrastructure.

Boomers are also expected to bequeath about $2.4 trillion during the next 20 years, creating unprecedented demand for advisory and trustee services to help them manage the windfall. It will also provide cash for travel and luxury services.

So what else could be in the pipeline?

## Think outside the casket

For the first time in history there will be two generations of retirees, increasing the need for smart monitoring devices.

Retired children in their 60s will be helping to look after parents in their 90s.

A "Carers Watch" for Boomers who need to keep track of their elderly parents – or ageing mates – is the first in an expected range of products using the latest technologies to ease carers' pressing responsibilities.

"There are 350,000 people with dementia in Australia alone," says Bruce Jeffers, director of Find-Me Technologies. "It impacts a staggering amount of people. This allows people to live in their homes longer, more safely and provides coverage anywhere there is 3G mobile phone service." The device incorporates a mobile phone, panic alert, tracking system and fall sensor.

Franchises predicted to boom in the coming years range from in-home healthcare services to fitness, say analysts.

The generation that pushed back the sexual boundaries with Viagra is rewriting the book on how to die, which is also creating new opportunities for entrepreneurs.

Franchises for university-qualified civil celebrants are being set up to conduct burial services that are more secular, individualistic and, in many cases, iconoclastic.

"Families are more likely to want a designer coffin," says Jacqui Weatherill, chief executive of Greater Metropolitan Cemeteries, which is responsible for about 19 cemeteries in Melbourne.

She points to growth in demand for bespoke coffins – designed as anything from phone boxes, to floral bouquets or skip bin.

**Franchises predicted to boom range from in-home healthcare services to fitness.**

This small segment of a big industry is spawning a vibrant sector, as evidenced by advertising on the internet.

Alternatively, there is growing demand for casket-free, eco-friendly funerals where the deceased is buried in a bush setting. Weatherill says a new generation of entrepreneurial undertakers is catering to the demand and developing other niche services.

Other high-tech start-ups looking for capital are targeting cashed-up Boomers with proposals for everything from medical and personal finance checks embedded in mobile phones.

The Australian Private Equity and Venture Capital Association can provide information on new technologies and ideas looking for funding. More-specialist groups include Melbourne Angels, which targets high growth, entrepreneurial companies, and Scale Investors, which backs women entrepreneurs.

In the case of Scale Investors, so-called Scale Angels are encouraged to build a diverse portfolio of at least six to eight companies and participate in two due diligence processes a year. There is a requirement to participate on one deal team a year, investing a minimum of $25,000.

One firm in the Scale Investors portfolio is Cognition Therapeutics, a clinical-stage pharmaceutical company that aims to improve the symptoms and halt the progression of neurodegenerative disorders, including Alzheimer's.

Experts note that would-be investors should seek independent expert advice about prospects, management, investment strategies, potential returns, access to invested capital, exit strategies, transparency and providers' track records.

## Care bonanza

At the other end of the scale, the big-ticket sectors for investors are retirement accommodation and aged care.

The number of Australians over 65 has more than doubled to 3.6 million since 1996, when Paul Keating was prime minister and a typical house in Sydney cost $211,000 and about $131,000 in Melbourne. Another 2 million are expected to turn 65 during the next 14 years.

"This is the boom that cannot go bust," says Australian Unity's Bryant.

ILLUSTRATION: SIMON LETCH

### Quick bites

After any short-term weakness, potentially caused by global political and interest rate uncertainty, AMP Capital expects share prices to rise over the next 12 months, propelled by "okay" valuations, easy global monetary conditions, moderate economic growth and rising company profits in the US and Australia.

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Big construction companies and newly listed boutique operators are developing a range of services from special-purpose facilities for aged residents to specialist housing estates where ground is leased for relocatable houses.

A recent round of listings by specialist aged-care companies and Australian Real Estate Investment Trusts (A-REITs) is evidence of the sector's growing sophistication and scale.

"Large numbers of affluent Baby Boomers are expected to bolster the sector's numbers over the next 10 to 20 years," says Adrian Harrington, head of funds management at Folkestone Funds Management.

'These customers will pay more for facilities and services but they will expect high standards. There will be greater emphasis on quality service, brand recognition and reputation of providers," he adds.

On the downside, the earnings of aged-care providers are heavily influenced by government funding, which is increasingly directing money away from aged-care facilities and towards home-care packages in an effort to keep more people in their homes.

For example, analysts are lowering expectations on immediate growth prospects of recently listed operators, such as Estia Health, Japara Healthcare and Regis Healthcare, because of government funding cuts stripping out $1.7 billion during the next four years.

Even so, the underlying case for long-term growth – and potential profits – is compelling because of the record numbers of retirees who will need more care and specialist accommodation.

More than 82,000 aged-care places will need to be supplied during the next 10 years, or more than double the number required in the previous decade, according to analysis by Aged Care Financing Authority.

The federal government reckons more than $33 billion will need to be invested in aged care during the next decade.

Replacing decaying hospital and aged-care facilities will be a priority, according to the authority.

Meanwhile, new developments will aim to provide integrated facilities, or a continuum of care from housing to aged-care facilities.

There are about 2300 retirement living communities and villages in Australia, comprising more than 140,000 dwellings and housing about 184,000 people, according to a recent report by the Property Council.

"If the penetration rate of retirement living communities and villages was to increase from about 6 to 7.5 per cent of the over-65s, then the population of retirement villages will more than double over the next 14 years to 419,000," says Folkestone's Harrington.

"If rates were to increase to 10 per cent – which would still have them under US growth rates – then more than 560,000 would be living in retirement living by 2030," he says.

Listed A-REITs focusing on the sector include Gateway Lifestyles, which has more than 40 residential communities centres for over-50s; Ingenia, which has more than 60 communities; and Lifestyle Communications, a provider of retirement homes and villages.

## Demand for hospitals

Managed funds are another option for investors looking to making a buck out of the Baby Boomers.

According to research company Morningstar, there are dozens of funds offering exposure to the health and property sectors. A handful specialise in aged care and retirement accommodation. It is an evolving sector with many funds including retirement, specialist medical and aged-care facilities in property portfolios with broad investment mandates.

Top performers during the past 12 months, such as Australian Unity's Healthcare Property Trust, which invests in hospitals, medical clinics, nursing homes and rehabilitation units, and funds from AMP targeting aged-care facilities, have posted gains of about 20 per cent.

Above: David Metzke has launched a company making custom-built bikes for older riders. PHOTO: PAT SCALA

Bryant says demand is strong from institutions and sophisticated investors for funds investing in quality facilities across the spectrum of retirement living and aged care.

Australian Unity has raised $60 million for three retirement village developments and has about $120 million of developments under construction. Folkestone is raising $25.6 million for its first fund in the sector, which is acquiring Watermark Retirement Living Community on Sydney's lower north shore as the fund's seed asset.

**Many funds are including specialist medical and aged-care facilities in portfolios.**

The S&P/ASX index is also a good hunting ground for investors hoping to turn grey into gold.

Investors are advised to look for individual good businesses, rather than invest in the theme. The best companies are those can defend themselves against the competition and have repeat customers, dominant market share and strong balance sheets.

Ramsay Health Care has emerged as one of the nation's elite risk takers and wealth creators.

The company, which specialises in brownfield hospital expansion and collaborates with governments in the construction of new hospitals and strategic acquisitions, has achieved compound annual earnings-per-share growth of nearly 17 per cent and compound annual dividend growth of about 17 per cent since listing on the ASX in 1998.

Its earnings have been underpinned by an ageing population and a rise in the rate of chronic disease.

Shares of hospital operator Healthscope had risen 17 per cent this year before crashing 19 per cent on Friday. Slower than expected revenue growth was largely blamed on bad publicity but before that Healthscope had benefited from a rise in admissions, increased rates charged to health funds and an improving case mix. It is bedding down a partnership with Icon Group, the country's largest cancer care provider, to establish radiation oncology centres at hospitals.

Bryant says fewer taxpayers and rising demands on public services will mean governments will no longer be able to afford to provide many of its traditional services, ranging from infrastructure to healthcare.

"The transfer of this role to the private sector will continue to gain pace," he says.

**560 thousand**
People predicted to be living in retirement communities by 2030.

# Stocks are 'the last honest market left': equity adviser

The cut-through

**Patrick Commins**

What if financial markets aren't as crazy as people say they are? How's that for a contrarian investment view: the world is not insane.

"There is a lot of talk about the distortion being imposed on capital markets by central bank policy," Citigroup global head of equity strategy Robert Buckland says.

He doesn't deny that this is happening. But: "I would argue that [stocks] are the last honest market left".

In recent years, listed companies have shown a powerful preference to paying out cash to shareholders over reinvesting in their own businesses.

This phenomenon has been decried by the many policymakers and politicians desperate to kick-start wallowing economic growth by getting bosses to start spending and hiring.

Analysts and pundits scoff at share prices puffed-up by buybacks and capital returns. Central bankers bemoan a lack of corporate "animal spirits".

Fifteen years ago, listed US companies reinvested twice as many dollars into their businesses as they distributed to shareholders. Today that ratio is more like one-to-one.

This marks a "profound change in the US away from capital investment to capital distribution," Buckland says. "Capital expenditure is falling and shareholder distributions are rising."

Buckland, who spoke this week at Citi's investment conference in Sydney, says what companies are doing may not be desirable, but it makes perfect sense.

And this is where his "last honest market" comment comes in.

"What the stockmarket has seen is a problem: excess capacity," he says. "We have been bitterly burnt by excess capital expenditure by all sorts of companies over the past 10 or 15 years."

"The last one that we endorsed and blew a lot of money on was of course the commodity sectors, but before that was emerging markets, and before that was tech and telecom of the late '90s."

"So I think that what's going on here: the last honest market left – the stockmarket – is trying to do an honest job of closing deflationary capacity in order to improve returns."

Japan provides a nice counterpoint to what happens when shareholders are unable to exert any pressure on management. Japanese companies invest four or five yen for every yen they pay out to shareholders.

"We all know that the return on that capex have been very poor, but that hasn't stopped Japanese companies spending lots," Buckland says. "Of course this is brutally deflationary."

This relates to a gripe Buckland has with central bankers. Policymakers are concerned about deflation and disinflation so they try to stimulate investment and hiring activity, and thereby economic growth, by making cheap money readily available to company bosses.

But, Buckland says, this is akin to asking businesses to expand productive capacity in an environment in which excess capacity is a key driver of the problem in the first place, and where there is no obvious growth in demand to meet any growth in supply.

In this way, policymakers are promoting a classic Catch 22: the proposed remedy would only make the problem worse.

This "capex cynical" trend is manifested in market prices by investors placing more value on a dollar returned to them than on a dollar reinvested. It's why global sectors such as consumer staples, healthcare and IT have traded at extremely high multiples.

They are cash cows, and shareholders love it. It's also why Australia, with its heavy emphasis on dividends, can also trade at a premium, Buckland says – our capex-to-distribution ratio is similar to America's.

Mining is the most obvious recent beneficiary of this trend. The big-spending CEOs of the past have gone, to be replaced with bosses focused on capital discipline and a preference for redistribution to shareholders over expansion of new mines.

Nobody would argue that Rio or BHP or Fortescue should be spending big on digging new pits. That has created a virtuous circle of recovering commodity prices as supply is curtailed, boosting cash flows.

And they have been rewarded with massive share price gains. A similar dynamic looks to be emerging in the Aussie energy sector, which is just at the end of a massive capital spending splurge.

Fitting perfectly into Buckland's narrative, Santos's new chief executive Kevin Gallagher this week promised investors "strong capital discipline" as he spruiked sharp cuts to the company's capex.

Buckland's analysis has big ramifications on how you might approach investing in the sharemarket, including our own.

*Free cash flow is a capex cynical valuation metric.*

Robert Buckland, global head of equity strategy, Citigroup

What has mattered the most in this cycle, is free cash flow – the difference between operating cash flow and cash reinvested.

"Free cash flow is a capex cynical valuation metric," Buckland explains; the easiest way to boost free cash flow is to cut capex.

And the key valuation metric that has "nailed" this cycle – and will continue to do so – Buckland says, is free cash flow yield.

Easy money that has been pushed into the sharemarket will continue to prioritise return of capital, the Citi strategist says, and there is no obvious fresh pulse of demand that would justify a rational hike in capex.

"It's a strategy that has worked here in Australia as well," Buckland reckons.

So where will this all end? Surely sharemarkets across the developed world are ripe for a fall. Buckland doesn't see it happening in the immediate future.

Bull markets classically "consume themselves" in an orgy of misplaced spending, he says. As we've seen, the current cycle shows little of that behaviour, which is also why it makes it so difficult for Buckland to say it is about to come to an end.

This is a bull market in companies, but a bear market in capital expenditure – a unique mix. So if you want to go long stocks, consider going short capex.