Leasing industry unfairly burdened

ANDREW MAIN
COMMENT

THERE hasn't been a lot of glory reflected in Chris Bowen's decision to crack down on the statutory method of claiming fringe benefits tax on novated car leases, which single-handedly took a 56 per cent axe to the price of Australia's biggest car leaser, McMillan Shakespeare.

"I'm not going to comment on individual companies," the Treasurer said yesterday, which was the technically correct response but not much consolation. "I stand by the changes" made to FBT, he said, adding that he was not surprised by the reaction.

"Is it going to be universally welcomed? Of course not," he said, noting also that "all businesses would like to have a very concessional tax rate".

The FBT change was "an important integrity measure . . . to ensure the fairness of the tax system," he said.

But John Abernethy, whose Clime Asset Management owns 1 per cent of McMillan, said yesterday that it was incorrect to assume the measure was a belated crackdown on a rort.

"Figures recently published by the salary packaging industry say that only 18 per cent of the last 100,000 leases on employer-provided cars in Australia had been taken up by private-sector companies," he said.

He said the balance was made up of state and federal government employees (33 per cent), charities and public health workers (28 per cent) and police and teachers (21 per cent).

"It's also worth pointing out that the average price of a leased car was $34,500, that only 5 per cent of the cars leased were BMW, Mercedes and Audi, and that over 35 per cent of the cars leased were made locally by Holden, Ford and Toyota."

Meaning, the measure will have a further negative impact on the local car industry and that a big group of workers in the sub-$100,000-a-year category, many of them shift workers, will have to make other transport arrangements.

His other beef is that he believes McMillan shares should have stayed suspended until the federal poll, as indeed the company had requested.

He made it clear that many investors were "margined out" of the stock when it re-listed at $7, meaning that indebted owners were forced to sell the stock because it had fallen so far that they were margin called. Since then, the stock has recovered to $9.80 but that is a world away from the $18 it was trading at before the FBT decision.

The ASX says that suspension should only continue "where there is a material risk that trading in a particular security might occur while the market as a whole is not reasonably informed".

The catch in all this is that the government announced a measure that hasn't been legislated and most likely won't be before the poll, which leaves a cloud over everything.

Hindsight suggests McMillan has now been tortured twice, once by the announcement and once by the stock's re-listing. That's yet another case of unintended consequences.

PREMIUM CONTENT
View an interview with John Abernethy
www.theaustralian.com.au

Merging of super balances may upset the insurance apple cart

Consolidation can have unintended consequences

ANDREW MAIN

THE federal government's long-running push to consolidate Australia's 30-odd-million superannuation accounts to a number more commensurate with our 11 million workers risks leaving those under-insured with even less insurance cover, according to Brad Fox and Phil Anderson.

They should know: the two are respectively chief executive and chief operating officer of the Association of Financial Advisers, which traces its origins back to the life-insurance industry.

The issue, as they see it, is that every pooled super account contains an element of life insurance and many also have total and permanent disablement (TDP) cover and, in some circumstances, a move to merge members' super balances may nullify the cover.

"It's very important that Australians are engaged with their super," Fox says. "In this insurance area it could be like holding on to old coins or stamps which could turn out to be very valuable."

He cites the example of a Melbourne woman in her early 50s who had done casual work at Melbourne's Spring Racing Carnival.

"She had about $400 put into a super account that had $20,000 worth of TPD cover," he says. "Three or four years later she contracted an illness that caused her to be classified as TPD and she got a payout of $20,000."

It didn't change her life totally but "she could have taken an overseas trip while she still had some memory", he says.

"An automatic consolidation of that account would have deprived her of that insurance."

So far the government has not pushed particularly hard for consolidation, so it's not a red-hot issue, but a recently passed bill called the Tax and Superannuation Laws Amendment (2013 Measures No 2) Bill of 2013 sets the process on the road.

It obliges trustees to consolidate accounts within the same fund where it is in the client's interest but they are not obliged to consult the client.

Anderson, who's forgotten more about these measures than most people will ever learn, says so far there's not much risk to a client's insurance cover, but that could change if the laws do.

NIKKI SHORT

Brad Fox and Phil Anderson, who are respectively the chief executive and chief operating officer of the Association of Financial Advisers

"The government has indicated an intention to extend this mandated consolidation to 'across fund' transfers in the future," he says, referring to the common situation where a worker has super accounts with more than one fund, rather than just two or more accounts with the same fund.

A lot of it comes down to so-called inactive accounts, he says, which may have been left inactive in order to preserve life and TPD insurance cover. "It's common for advisers to tell clients to hold on to an inactive account if they know the insurance cover is needed," he says.

Anderson is also concerned that another 2012 bill relating to unclaimed money will see small accounts with balances under $2000 consolidated automatically under certain circumstances, such as where the account hasn't received a contribution for five years, as happens with many of these preserved accounts.

"Inactive unidentifiable accounts that are classified as lost will be transferred into consolidated revenue after 12 months," he warns, adding that "the member will not have any cover when their funds are moved to consolidated revenue and it may be impossible to get the insurance back."

It's clearly a worst case, in which the government's taking money because it is classified as unclaimed, but the clear moral of that story is for members to identify all the accounts they own and make sure they are updated.

Anderson says the accounts are not classified as lost until mail to its owner has been "returned to sender" twice, so the member's address becomes a critical issue.

He notes that if a member chooses to increase their insurance cover later in life, the insurer is within its rights to put a loading on to the premium, which is another reason why advisers may tell clients to retain old accounts.

"The point we're trying to make here is not that consolidation is bad per se but that you have to be careful of unintended consequences," Anderson says.

The two men are unanimous that Australian workers are significantly under-insured with life and other related forms of insurance, which makes it particularly dangerous if insurance cover drops as a consequence of account consolidations.

The big one, they say, is the proposed automatic transfer of what is called "accrued default amounts" which must go across to a MySuper product by July 1, 2017 (but probably much earlier) for members who have never selected an investment option, or who are entirely in the default option.

Anderson says that definition fits the majority of super fund members in Australia and warns that "with many funds not electing to establish a MySuper fund, this means that ADAs will need to be transferred to other trustees".

"There is a very real risk that a number of people will unintentionally lose insurance as a consequence of this," he adds, noting that the risk lies in clients not being aware of the issue as the date looms.

"Clients will have the opportunity to refuse the transfer, but this is subject to the very high risk that they do not read, or react to, the information they are sent in the mail."

So what's the best solution for all of this? Fox sees a simple fix: "Keep all notifications of super balances then make a phone call and spend an hour with an adviser to see what these small accounts are worth.

"Even a $400 or $500 balance could be very valuable."

The risk lies in clients not being aware of the issue as the date looms

Small gems sparkling as dust from mining gloom settles

RICHARD HEMMING
UNDER THE RADAR

SMALL caps, or small listed companies, more than any other listed investment trade in an information vacuum, until reporting season comes around, which just happens to be next month for the vast majority of companies.

There are 2185 listed companies on the ASX and the median market cap of the 200 biggest as at June 30 was $1.8 billion.

But it's in the long tail where most action will be in the reporting season.

Almost 90 per cent of these companies, numbering just under 2000, have market caps below $300 million.

It's these companies that this column classes as small caps, and for these companies it is normal for there to be few announcements other than to report profit numbers.

For much of the past six months, many investors have based trading decisions of small caps often on assumptions of how they perceive the world.

This is mostly based on big macro-economic indicators such as the price of currencies, economic growth rates, general sentiment, and finally on the gamut of anecdotal evidence that each person picks up.

But sometimes major market-moving events can actually prove minor in the immediate fortunes of small caps.

Right now, we would say that this is the case for many mining services companies.

This year, the market sneezed when major mining projects were pulled, such as BHP Billiton's $20bn Olympic Dam project in South Australia, and Woodside's $36bn Browse gas project in Western Australia.

It is important to remember that these resources giants are simply managing their growth. They have a portfolio of assets and are working out how, in the current environment of high costs, they can maximise their returns.

The resources boom isn't over for the big boys, which is reflected in the fact that the prices for many commodities (particularly iron ore) have been so resilient.

But this sneeze meant that traders reacted with indiscriminate selling of anything with a whiff of mining about it.

What is also important to remember is that the big projects that have been mothballed don't affect many servicing the sector, because they don't represent anything in the way of current earnings streams for the vast majority.

For many companies in the mining services business it has been business as usual, particularly those that aren't of the size of the contracting giants such as Leighton Holdings, Downer EDI, United Group and Worley-Parsons.

This is why we believe some of the smaller mining services companies might surprise in the reporting season because they have been sold down off the back of big project delays, which don't actually affect the earnings of that many. Many of the smaller ones and those with high oil and gas services are still generating strong earnings, even if their outlooks have been tempered.

The market has started to factor this in.

Titan Energy Services' stock (ASX code TTN) has rocketed up more than 40 per cent in the past two weeks.

On Monday, the Queensland-based company said its net profit had more than quadrupled to $13.3m for the year to June 30 mainly due to the coal-seam gas projects it had been servicing with drilling rigs as well as portable accommodation.

It is no accident that two mining services stocks we have tipped in the past month, SCEE (the old Southern Cross Electricals & Engineering, ASX code SXE) and LogiCamms (LCM) are both in the black. SCEE is already up 20 per cent.

Richard Hemming is an independent analyst who edits a fortnightly newsletter: www.undertheradarreport.com.au

Gold producers worth a look

ROGER MONTGOMERY

GOLD is something that has piqued our interest in recent weeks. Since late last year we have seen some precipitous falls in the share prices of gold producers, largely driven by a declining gold price. In fact, looking at a sample of ASX-listed gold companies, the average share price fall since October is close to 60 per cent. It's beginning to feel like the market may have overreacted.

When we say "gold", we should add our focus for the moment is on producers, rather than the metal itself. Investing directly in the metal requires a confident view on where its price is going, and to have that confidence requires a self-delusion that for the moment is lacking. More on that later.

We need to acknowledge that further large changes to the gold price will affect the fortunes of gold producers, and so we can't put our head in the sand in respect of them, but if we can see good value in gold producers based on the gold price remaining broadly where it is, that can stack the odds in our favour, possibly enough to justify the risk.

Before you ask, we should also add that Newcrest Mining is not among the companies we are looking at. Newcrest has consistently dismal economics and we have never understood why our peers have been willing to pay the prices it has previously traded. Today, with the price having fallen by almost 60 per cent since its peak in September last year, Newcrest still looks expensive in our estimation and our interest in it remains firmly "un-piqued". What I find more interesting are some of the lower-profile gold producers. In particular, companies that may have healthy production growth profiles that the market has lost interest in.

Before we consider their merits, we should return to the gold price. Since October, when it traded at about $US1800 an ounce, the gold price has fallen by about 25 per cent to now be in the mid-$US1300s. During that decline, the Montgomery (Private) Fund has not held the shares of gold companies. In Australian dollar terms, however, the decline has been softened by the falling currency, which is about 17 per cent. This is still a meaningful change, but arguably small compared with the near 60 per cent share price decline for the typical ASX-listed gold company in the same period.

We can't exclude the possibility that the gold price will continue to fall. While it is considered a financial asset, gold earns no income, and we know of no reliable way of assessing its "value". All we can say with confidence is that the current price reflects the market's best judgment of what gold is worth (for now). There is a school of thought that says the gold price shouldn't fall much further, because many of the world's goldmines will start losing money at lower prices.

The logic says that a gold price below the cost of production would curtail supply, and the forces of supply and demand would drive the price back to a "profitable" level for gold producers.

We're sceptical about that argument for commodities generally, as we have seen many commodities trade below the cost of production throughout history. We are especially sceptical in the case of gold. Most of the gold that has ever been mined now sits in investors' vaults, and there is nothing preventing those investors from selling it.

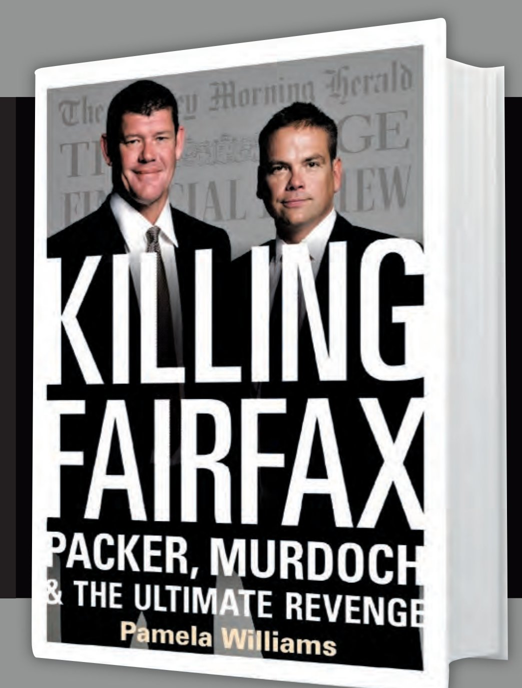
If they decide for whatever reason to sell, then it can become part of the supply equation, and the marginal cost to remove it from the vaults is close to zero. In fact, it may well be that the cause and effect relationship runs the opposite way for gold prices. It seems very plausible that a high price would prompt marginal goldmines to start operating and thereby raise average production costs, rather than the gold price being set by the level at which the world's gold producers can operate profitably.

So we are left with the current market price as our most reliable indication of what gold is worth, and the question we are interested in is: based on that gold price, are there gold companies whose share prices now look cheap based on our best estimate of the potential future profits, and having regard to the risk?

That debate still has some way to run at Montgomery, but we do have a good idea of where we are most likely to find a positive answer. Some of the companies that we will be running our analysis over include: Silver Lake Resources (SLR), Medusa Mining (MML) and Resolute (RSG).

Roger Montgomery is the founder of Montgomery Investment Management and author of Value.able: How to Value the Best Stocks and Buy Them for Less Than They're Worth, available at www.rogermontgomery.com.

THE BOOK THE WHOLE COUNTRY IS TALKING ABOUT



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