Slowdown in house price growth 'to crimp construction'

HOUSING

THE pace of housing construction will gradually ease from its recent highs in the months ahead as home price growth softens, economists believe.

Approvals for the construction of new homes rose by 4.2 per cent in July compared to a 5.2 per cent drop in June, official figures reveal. The rise was driven by a double-digit increase in the volatile category covering flats, offsetting a dip in approvals for houses.

JP Morgan economist Tom Kennedy said: "In our view, building approvals is tracking at pretty good levels. Activity this year has continued the upbeat trend from 2014."

CoreLogic RP Data head of research, Tim Lawless, said if house prices continued to ease, construction could begin to slow as there would be less incentive for people to invest in housing and become landlords.

The firm's housing report, also released yesterday, found capital city home prices rose just 0.3 per cent in August following an almost three per cent gain in July. On average, rental growth slowed, falling to a record 0.7 per cent for the past year.

Mr Lawless said it was too early to tell if the slowdown would be sustained: "The spring season will provide a timely litmus test for the housing market given it's a time when listing numbers normally increase."

Wine chief's bottler

Penfolds boss reaps $4.5m pay

DREW CRATCHLEY

EXECUTIVE PAY

THE head of Treasury Wine Estates, the company behind the Penfolds wine brand, earned almost $4.5 million in his first full year in the job, company accounts show.

Michael Clarke's base salary of $1.7 million was topped up with a $1.5 million cash bonus, according to the group's annual report.

And he could earn another $1 million in shares as part of long-term bonuses, the report reveals.

Mr Clarke was appointed chief executive in March last year and has been cutting costs, streamlining the company's operations and brands and increasing its focus on Asia. That contributed to Treasury Wine's return to profitability in the past financial year.

The group chalked up a net profit of $78 million for the year to June, up from the previous year's $101 million loss.

Asia was the company's strongest market in the year, where earnings rose 55 per cent.

Robert Foye, the head of Treasury Wine's operations in Asia, the Middle East and Europe since August 2014, earned $1.8 million in cash and shares for the year.

Treasury Wine brands also include Wolf Blass, Lindeman's and Rosemount Estate.

Despite receiving a bumper pay packet, Mr Clarke falls a long way short of some counterparts at bigger listed companies on the executive pay league table.

Qantas last week revealed chief executive Alan Joyce had received a pay and perks package worth $11.9 million for the year to June as the airline, buoyed by falling oil prices, soared back into the black.

Mr Joyce's package included $2 million in base pay, a $1.9 million cash bonus, shares worth $6.9 million and another bonus package of shares worth almost $1 million that hinges on Qantas' future performance.

Among other prominent companies, the Commonwealth Bank last month revealed chief executive Ian Narev received a pay and perks package worth $8.3 million for the year to June.

Shares in the winemaker closed 2.2 per cent lower yesterday — a fall roughly in line with the slide in the market — at $5.83.

AAP

Treasury Wine Estates chief Michael Clarke earned almost $4.5 million in his first year in the role.

ACTIVITY ON THE IMPROVE

MANUFACTURING

A PICK UP in housing construction and strong demand for food and beverages continue to benefit the manufacturing sector, with activity expanding for a second month.

The Australian Industry Group's performance of manufacturing index has climbed 1.3 points to 51.7 for August, with the result above the 50-point level implying activity in the sector has grown.

Three of the eight manufacturing sub-sectors expanded — food, beverages and tobacco; wood and paper; and textiles, clothing, footwear and furniture.

Ai Group chief Innes Willox said the expansion was driven by greater production, employment and new orders.

He said manufacturers were hopeful the results would be built upon to overcome continued headwinds from reduced orders for materials and equipment from the mining sector and car producers.

Victoria, NSW lead the way

THE ECONOMY

ECONOMIC growth has dipped across most of Australia, with Victoria and New South Wales the only states powering ahead, new research suggests.

ANZ economists say growth in the other states was below average in the year to June. NSW was the strongest performer followed by Victoria with economic activity growing faster than their long-term average rates. The findings were part of ANZ's inaugural Stateometer, which measures the economic performance of the nation, state by state.

It's tricky to figure out the worth of a legal conundrum

THE SHORT CUT with ANDREW MACKEN

OVERALL, the underlying business is performing well.

So said the brave-faced Andrew Grech, group managing director of ASX-listed law firm Slater & Gordon, following the release of the company's FY15 results.

It has certainly been a tough period for Grech.

Many market participants have raised concerns over the company's accounting practices. A prior-period accounting "error" has already been found, disclosed and restated.

The stock has halved since the beginning of the year; and ASIC is conducting an ongoing investigation into the company's practices.

So what to make of the most recent set of financial data disclosed to the market by Slater & Gordon?

Well, putting aside that the accounts are still "in the process of being audited" and a number of new changes to accounting classifications, the quality of this business will remain the subject of considerable debate for some time to come.

For starters, despite a tripling of the size of this business since FY14, the amount of cash generated by operating activities declined 25 per cent over the year to just $41 million.

Yet the market value of Slater & Gordon's enterprise is somewhere around $1.7 billion — 42 times this level of cash flow generation.

Upon deducting the cash used to fund capital investments and acquisitions, this figure was materially negative — as it has been for quite some time.

Net debt increased sixfold in FY15 to over $600 million. Receivables — a measure of cash that is owed to the company but has not yet been collected — more than tripled in FY15 to over $600 million.

These equate to more than one full year of sales revenue.

Looking at Slater & Gordon's income statement, we observed a $42 million "gain on bargain purchase" which accounted for nearly 40 per cent of the company's total earnings for the year.

This is accounting speak for saying that Slater & Gordon was able to acquire net business assets for less than they were actually worth.

Quite a feat, wouldn't you say, particularly in the current low interest rate environment in which many assets are arguably overpriced.

At the very least, we can conclude that bargain purchase gains do not represent a persistent source of earnings going forward.

Upon stripping out this gain, Slater & Gordon would have made only about $51 million in net profits — equating to return on equity of less than 6 per cent and an implied price-to-earnings multiple of a lofty 22 times.

Throw in a near 70 per cent jump in expenses related to bad and doubtful debts, and we have a set of accounts that hardly scream high quality.

Investors will also be asking why the company paid only $6 million in taxes despite reporting $110 million in pre-tax profits.

Are the earnings being reported to the tax authorities materially less than those being reported to investors?

Stepping back, the growth model of this law firm has been acquisition led.

There is nothing wrong with effectively buying future revenues, assuming the acquirer does not overpay and the revenues acquired are recurring into the future.

Investors in this business need to be confident that both of these conditions are being met at Slater & Gordon.

And they need to be confident that the recent run-up in the company's debt level is sustainable. Remember, creditors' claims are prioritised over shareholders' claims.

Investors will now turn their attention to the impending release of the company's audited accounts and the conclusion of ASIC's investigation.

Andrew Macken is portfolio manager with Montgomery Global Fund