Private equity floats disappoint on smaller scale, too

THE SHORT CUT

with ROGER MONTGOMERY

HAVING just completed the reporting season and while the big story is BHP's dividend drop and progressive dividend backflip, the rest of corporate Australia, it seems, is doing OK.

Some results have been sufficiently surprising that analysts following them have upgraded their outlooks including for annuity income security seller Challenger (owned by the Montgomery Funds), Cochlear, JB Hi-Fi and Sydney Airport.

Others have also beaten analysts' forecasts, including Qantas, Domino's Pizza, and Bendigo Bank.

But the real story this reporting season has been the results of smaller companies recently listed by private equity players.

Private equity has been getting a bad rap lately thanks to the collapse of electronics retailer Dick Smith, which was purchased by financiers from Woolworths in 2012 for about $90 million, sold to stock market investors in 2013 for $520 million and has since collapsed with no buyers.

While a Senate inquiry seeks to uncover what went wrong and what could be fixed, other smaller companies floated by private equity are also disappointing investors.

The Australian Private Equity and Venture Capital Association's annual study of floats says 67 private equity-backed initial public offerings since the start of 2013 that raised more than $100 million had delivered an average return totalling 40.9 per cent by last December.

Of course statistics can be massaged to reflect a myriad of views and it is also true the longer a bull market runs, the lower the quality of floats.

That would explain why the performance of companies listed by private equity (PE) in 2015 underperformed non-PE-backed floats.

According to the report, non-PE-backed IPOs in 2015 achieved an average return of 19.3 per cent and a weighted average return of 18.9 per cent up to the end of December, outperforming PE-backed IPOs by about 6 per cent and 9.5 per cent respectively.

During reporting season, travel insurer Covermore, Mathletics inventor 3P Learning and mobile phone services company Amaysim all disappointed investors.

Some companies — Spotless comes to mind — didn't surprise with poor results because they had already warned the market.

What is common, however, to all companies is they were floated relatively recently by private equity.

3P Learning reported on February 19, with adjusted earnings before interest, tax, depreciation and amortisation up 12 per cent to $7 million but this was about 10 per cent less than some analysts had been expecting. Because revenues grew, the implication was that margins have declined. In other words, in order to sell more they might have to charge less.

Sure enough, the lead indicator, invoiced billings, increased 11 per cent in the first half of the 2016 financial year compared to 26 per cent in the first half of 2015.

SIM-only phone and data plan provider Amaysim's share price plunged by more than one third after a disappointing half-year result — its first results announced since listing in July 2015.

With 65 per cent of smart phones purchased outside of a lock-in contract in 2015, Amaysim reported rising revenues, but the company also reported a 96 per cent fall in net profits to $681,000. Its shares lost 37 per cent, falling below their IPO price of $1.80.

Amaysim said increased competition placed pressure on revenue and earnings, which leaves one to wonder why it didn't draw attention to this at the time of the float just over six months ago.

Investors are not being well served by the disclosure regime surrounding floats. It seems companies, prospectuses and auditors can all comply with the law as well as the requirement to disclose, and yet many professional and private investors are none the wiser. Let's hope the Senate inquiry digs a little deeper this time.

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