‘Buy and hold’ may be one thing, but ‘set and forget’ is absolutely not an option in this post-GFC epoch.
STIRLING LARKING



# Quality reading: latest crop of IPOs call for a sceptical eye

ROGER MONTGOMERY

Is it just me, or is there a discernible lack of quality in the companies seeking to come to market with an initial public offering?

In the past, when we have seen this — along with little value in evidence among incumbent listed quality companies — we have observed it is generally *not* a great time to be loading up on equities.

There has been enormous interest this week in the pending IPO of music streaming service Guvera. The negative commentary around this float has been so intense it has prompted the ASX to take the unusual step of extending its review of the offer, while the Australian Shareholders Association has put out a de facto warning note.

But there are many more IPOs deserving of a sceptical eye.

One reported forthcoming float is Booktopia. Presumably, like many companies before it, Booktopia — founded by “unassuming, middle-aged dads” Simon Nash and Steve Traurig — will be described along the lines of a leading Australian retailer of books and e-books.

Putting aside the question of whether a leading online book retailer can be Australian-based, it is worth considering the present economics of online book retailing, the competitive landscape in which this business resides, and its prospects. If the company has been loss-making recently it could possibly be due to reinvestment in the business. The problem is that when playing a competitive game, it is not relevant whether your reinvestment is large relative to the size of your business.

The investment required to be competitive has to be appropriate relative to the size of your rivals. And when they include Amazon, Apple’s iTunes, BBC Shop, the Amazon-owned The Book Depository and Google you need very deep pockets indeed.

According to the Smart Company Awards website, Booktopia generated revenue of $40 million in 2014 with 98 staff. In 2015, revenue grew nearly 30 per cent to $51.9m with 103 staff.

If growth continues at that pace, revenue will be $70m in 2016. So if the rumours of a $150m float are correct, the company will list on roughly two times revenue.

Predictably the promoters of the IPO will address the iTune, Amazon threat by pointing to the strong “growth” of revenue.

But shareholders cannot take revenue to the grocery store. As an old friend and restaurant owner once told me: “Revenue is vanity, profit is sanity.” Investors should also be cautious if an acquisition has been made recently.

Pre-float acquisitions are a warning sign to me that the business was unable to organically to be the dominant player in the industry, or alternatively to the scale that would permit an exit through an IPO. If an acquisition has occurred, be sure to adjust the numbers to exclude the revenue and profit of the acquisition.

> Shareholders cannot take revenue to the grocery store

And be cautious if debt was used to fund the acquisition because if funds raised through the IPO are being used to pay down that debt, you are effectively paying for the acquisition as well as any selldown by the owners, who otherwise may not have built the business to a scale in order to exit.

One has to wonder if the founders and their advisers considered or explored a trade sale. If they did but have chosen the IPO route to selling, it suggests that either trade buyers weren’t interested in the business or the price — or both.

Bookselling is a tough gig.

In 2011, Australia’s largest book retailer, REDgroup, went into voluntary administration with reported debts of $170m. By midyear, 2000 staff had lost their jobs as 114 Angus & Robertson and 26 Borders stores were shut down — and don’t forget these two chains represented more than 20 per cent of the nation’s retail book sales. That year, Australian Publishers Association chief executive Maree McCaskill reportedly warned “the book industry is in the midst of a prolonged, retail slump”.

Another prediction I will make is that analysts and promoters will put a rational-sounding “valuation” on the business by looking at the average multiple of much larger online operators such as Amazon and TradeMe, or even REA Group or Carsales.

They will then discount the multiple of these “winners” back somewhat because of size, lack of profit or short operating history to arrive at a multiple that seems rational and may allow investors to believe they’re getting a discount.

In truth, if you don’t believe a business has a future — it will be interesting to see if Booktopia’s founders are selling down at all — there is only one rational valuation: it is the same valuation you should attribute to any company not making a profit.

*Roger Montgomery is founder and chief investment officer of the Montgomery Fund.*

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# Illusion of sporting keepsakes

Memorabilia is a popularity contest and should be seen as a hobby, not an investment

CHRIS KOHLER

In 2012 a pair of Muhammad Ali’s fight-worn and signed boxing gloves was sold for $US1.1 million, which made it the eighth-most expensive piece of sporting history in the world.

The buyer, UFC co-owner Lorenzo Fertitta, might be thinking the value of his investment has just skyrocketed.

Sorry to disappoint, Mr Fertitta, but apparently it doesn’t work like that.

Ask pretty much anyone about sporting memorabilia and they’ll gleefully tell you the same thing, “it’ll be worth big money when they die!”

“I’ve been selling sports memorabilia for 25 years and I think that’s a fallacy,” Max Williamson of Melbourne-based auction house Mossgreen says, adding that he’s received calls from people this week asking if now is the time to sell their Ali memorabilia.

It’s apparently one of a few rampant misconceptions and misunderstandings about buying and selling sporting memorabilia.

Waiting for the grim reaper before selling a sporting hero’s gear might seem like a savvy, if insensitive, tactic, but according to the experts it doesn’t work … Although you can understand the theory when misty-eyed fans pay tribute to a once-great but recently forgotten champion. Time to strike!

It was clearly a contributing factor when a private seller put Richie Benaud’s baggy green Test cap on the market just five months after the cricket legend died in April last year. The cap brought in $42,700, which kept the vendor happy and compares with a whopping $400,000 in 2012 for the baggy green of another late, great batsman — Donald Bradman.

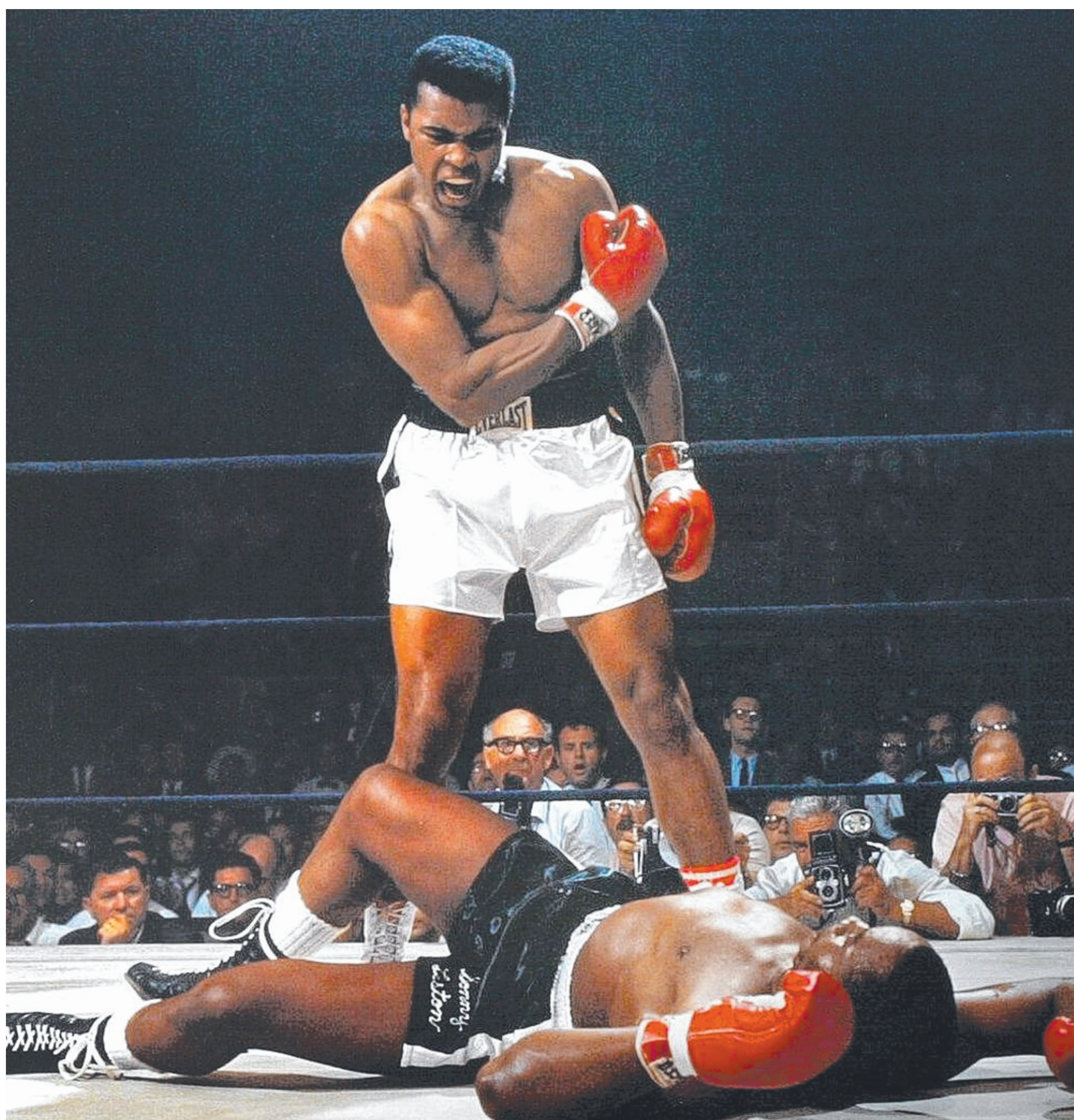
Meanwhile the baggy Test cap worn by Brian Lara, one of the game’s alive-and-well champions, was sold in 2014 for a measly $3660.

> ‘Most people who buy those things know it’s a donation, but some don’t. Some think it’s really worth that’
>
> MAX WILLIAMSON
> MOSSGREEN AUCTIONS

Here we have a key problem with trying to invest in sporting memorabilia: it’s a popularity contest, which means valuations are rooted in emotion: “It’s not generally considered an investment, it’s a hobby,” Williamson says.

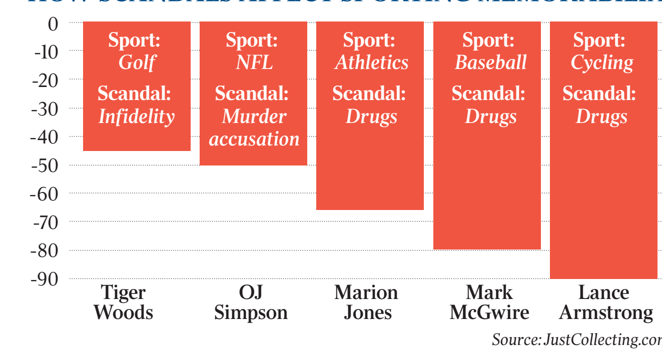
“When people go to a fundraising event and they or their company pay $10,000 for a signed Olympic flag or something and later bring it into us … We’d offer it at $500. Most people who buy those things know it’s a donation, but some don’t. Some will pay that sort of money and think it’s really worth that.”

That’ll unfortunately hit home for more than a few readers who have found themselves, usually after a wine or two, bidding for a signed football jumper or cricket bat at a fancy gala night and later stumbling home with it tucked proudly under their arm, usually mumbling something about it being worth a fortune one day.



With the death of The Greatest, selling a signed pair of Muhammad Ali’s gloves might seem shrewd but experts disagree

HOW SCANDALS AFFECT SPORTING MEMORABILIA




Source: JustCollecting.com

But here’s the biggest problem with “investing” in sporting memorabilia: the athletes have long and often controversial retirements.

Anything to do with cyclist Lance Armstrong’s career is worth around 90 per cent less today than it was before his spectacular fall from grace, according to JustCollecting.com, while golfer Tiger Woods’s memorabilia has dropped about 45 per cent in value since 2009 as a result of his infidelity and subsequent oncourse form slump.

Closer to home, 2012 Brownlow medallist Jobe Watson’s personal brand and, by extension, memorabilia, has taken a hit as a result of the 2012 Essendon doping scandal. Watson and 11 of his AFL teammates are serving a one-year suspension and the question of whether he will be stripped of his Brownlow hangs on a final appeal in a Swiss court.

Matt Moore, owner of Ultimate Sporting Memorabilia, says interest in memorabilia of Essendon stars such as James Hird and Watson remains but the market will have shrunk significantly.

“The Brownlow hasn’t been taken off him (Watson) yet and that’s still in limbo. If the AFL were to take it off him the memorabilia on the market may be affected. But you’re going to get the avid Essendon fans that aren’t going to care,” Moore says.

There’s the split. A mad Essendon fan will still be interested in a signed Jobe Watson Brownlow replica, whereas an investor would stay well clear, of the medal or indeed anything else a sport’s players might once have worn in the spotlight.

# ‘Bond ladder’ a sound bet as numbers swirl

STIRLING LARKIN
GLOBAL INVESTOR

As incipient as it may appear to many, now is the moment astute global investors begin to think ahead as to how and where they wish to trade and spread their investment allocations next year.

For those who did not make pre-emptive portfolio adjustments in February for the events about to unfold in Britain with the upcoming June 23 Brexit vote, scrambling to reposition at this point is indeed far too late.

After all, market cycles don’t die because of old age, they die because of macro imbalances or systemic geopolitical shocks — as would a Brexit “Leave” decision possibly trigger.

All being considered, after foreign exchange — the trading of any two currency pairings — equities are the second most unpredictable asset class to predicate with precision, at least when forecasting two quarters out. But, for Australian ultra-high-net-worth global investors, the more important portfolio consideration to tactically rebalance today is found within fixed income sub-allocations.

As capital preservation remains almost universally the number one priority for Australian UHNWs — with numerous holdings of $500 million in fixed income instruments — what is thought to be the best way to approach US, eurozone, emerging market and Australian domestic fixed income becomes a hot topic of conversation with their advisers around this time of year.

And beyond a linear prediction about the trajectory of US or domestic Australian interest rate policies, far more is reviewed and considered when balancing fixed income portfolios larger than “seven figures”.

Remembering that almost all global fixed income is benchmarked against US interest rate policy, it is important to know that the following is currently being discussed within sophisticated investor circles:

- US interest rate duration exposure, typically, one, three, five or 10 years, is at an highest high.
- This is due to a rapid expansion in the amount of debt outstanding post-GFC combined with a significant extension of maturities for US Treasuries and corporate bond debt, combined with a reduction in bond coupons.
- It is estimated that if a 1 per cent upward shock to interest rates surprised markets, that would translate into over $US1 trillion in capital losses to bond holders.
- If this did happen, this loss estimate would be large relative to the $US600bn in credit losses realised to date from non-agency mortgage-backed securities since 2006 and over twice the inflation-adjusted losses experienced in the tumultuous 1994 bond market sell-off.

So the logical question remains, approaching such tumultuous and volatile months ahead and then going further to think forward towards next year, why would UHNW, or any Australian investment community for that matter, continue to allocate so significantly towards fixed income markets and do so in effective ways?

The answer may be found in the fact that the hunt for income has been intensifying, globally, as the pool of international government bonds yielding below zero has reached a record high this month, driven in some large part by negative interest rate policies in Japan and Europe.

Global investors have been forced to pile into long-term debt in order to receive positive incomes while remaining mindful of a broader volatile conditions. In response to these concerns, one strategic approach being considered by many heading towards 2017 is referred to as a “Bond Ladder”.

Laddering refers to a portfolio of bonds whose maturities are spread out over a certain period of time, such that a portion of the portfolio will mature each year.

The ladder structure remains in place over time by reinvesting proceeds from maturing bonds into new bonds with maturities at the longer end of the specified range, which preserves the average duration and income stream of the portfolio.

> The RBA may well remain wedded to interest rates closer to current levels

Ladders can be implemented as a pure “buy and hold” but in practical terms, continue to require constant adviser supervision and should, in reality, only be implemented by those seeking fixed income consistency over the medium to longer term — not simply as a kneejerk response to the current suboptimal conditions.

However, even with the predictable cash flows, semi-annual coupon payments and transparent maturity schedules that laddering provides, global investors must remain vigilant to surprise hikes by US Federal Reserve chair Janet Yellen or indeed the inverse with unexpected cuts to Australia rates by our Reserve Bank.

One thing has become clear, though — during this period of unconventional global monetary policies, “buy and hold” may be one thing, but “set and forgetting” is absolutely not an option in this post-GFC epoch.

The good news for the Australian economy is that the national income shock that has plagued the nominal growth data is now tapering as commodity prices appear to have stabilised, and with this our RBA may well remain wedded to interest rates closer to current levels.

The savviest global investors are not only planning ahead for 2017, they are factoring in scenarios that will unfold closer to 2027 and one of the most practical ways to implement these views is to construct and commit to a bond ladder today.

*Larkin Group is an ultra high net worth wealth team focusing on high yielding global investments.*

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