Property investors hedge their bets

Home ownership is not the ultimate aim of many borrowers

JAMES KIRBY
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Australian investors are concentrating their risks ever deeper in the housing market according to new data this week with almost one in 10 existing home loans now interest-only.

The surge in property exposure comes as the concentration of power among the big four banks becomes ever greater with the Commonwealth Bank and its subsidiaries now controlling one in five home loans across Australia.

The Melbourne Institute's annual Household, Income and Labour Dynamics in Australia survey, which collected new data on home lending and home ownership, challenges many of our investment assumptions about what the financial landscape may look like in the future.

The survey author, Professor Roger Wilkins, has been widely quoted for his forecast that the majority of Australians will not own their homes in the near future.

For investors the survey shows us for the first time a full picture of what our neighbours might be doing in the residential property market and crucially how they are financing their ambitions.

The report also indicates foreign investors are dominating the boom in residential property investment. For investors the report offers two serious puzzles which at first glance stands in contrast to the consensus forming on the residential market among economists and stockbrokers.

1. The report indicates that only 48 per cent of the investment properties in Australia are negatively geared.

This is in serious contrast to the figures of about 62 per cent from the Australian Taxation Office.

Professor Wilkins, from the University of Melbourne, says "the gap is puzzling, it may have to do with specific tax matters such as the treatment of depreciation and other items".

However, the gap is so significant it could also be suggested that investors do their best to maximise the amount of negative gearing to get the best possible tax deductions from property.

2. The report suggests that the percentage of people in Australia who are active in the residential property market over the past eight years has barely changed from 5.6 per cent in 2006 to 5.7 per cent in 2014.

At first glance this flat line for the number of Australians who are active in the residential investment market is hard to fathom.

The Melbourne Institute's household survey indicates that many homeowners have no intention of paying off their loan

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1. One in ten homeowners now have interest free loans.
In taking this financing option - which has traditionally been associated with investors rather than owner-occupiers -the banks have unleashed another force pushing up house prices. The HILDA survey had not previously survey real estate finance patterns in Autstralia.

2. One in three mortgages are now either fixed rate or a combination.
The popularity of combination or 'split' loans (part-fixed and part variable) is now 12.4. Residential property investors who are not offer a 'split option' by banks or mortgage brokers should demand why such a choice has not been offered. It offers investors an each way bet on interest rates.

3. The portion of Australians with investment property is not changing.
The percentage of resident Australians active in the investment property market has remained unchanged for the last eight years. In 2006 the figure ws 5.6 per cent now it is 5.7 per cent: The flatline figure clearly indicates the investment property boom has been driven very heavily by overseas buyers.

4. Negative gearing may be less popular than we think.
If you are negatively geared, you should know that the Australian Tax Office figures suggest that 62 per cent of investment properties are negatively geared, but the HILDA survey suggests the figure is only 48 per cent.

Home loans – changing patterns

Households with primary loans	Proportion of households (%)	Proportion of (outstanding) loans funded (%)
Type of interest rate		
Fixed	17.9	18.1
Variable	69.7	65.1
Combination of fixed and variable	12.4	16.8
Total	**100**	**100**
Type of home loan		
Standard	84.4	81.3
Interest only	8.8	12.8

Source: HILDA report

However, the report, which is now running for more than a decade, takes its sample from 20,000 Australian residents — by definition it does not include overseas investors. The flat numbers suggest the growth within the investment property market is predominantly fuelled by overseas buyers.

Interest-only home loans surge

According to the survey 8.8 per cent of home loans are interest only.

The figure, which has not been released previously by HILDA, suggests that even homeowners — as opposed to investors — are hoping to ride a rising residential property market to make money.

To put it another away, one in 10 homeowners have no intention of paying back their mortgage.

What's more, the group is growing fast — some months ago a separate report showed the proportion of new home loans being written by the banks interest-only was 40 per cent.

HILDA also revealed the interest-only brigade were taking bigger bets: interest-only loans account for a much higher 12.8 per cent of outstanding funds loans — a clear sign that they are buying dearer houses.

At its worst this may mean that homeowners are choosing to maximise their deposits rather than seeking to pay off principal.

Until very recently it has been largely assumed that the dangers within the property market relating to interest-only home loans related to investors.

Fixed-rate mortgages rise to one in three

Two decades ago fixed-rate home loans were rare in the market with only a minority of buyers choosing to access the facility, which is most popular over a three-year time frame. However, with ever lower interest rates investors and consumers have clearly taken more confidence in their ability to repay in the future with a very large 17.9 per cent holding fixed-rate loans. The figure offers an insight into the endless question of whether investors should fix or not — almost one in five home buyers now fix their rates.

Moreover, a significant 12.4 per cent of home buyers use a combination of fixed and variable — indicating a cumulative 30 per cent of all home buyers have a fixed component in their home loans. This is a major find for the survey. Although banks are slow to suggest the combination solution for getting a property loan a significant number of people now use the facility to have a bet both ways on the future direction of interest rates.

Another pointed outcome from the new data is that fixed mortgage holders are missing out on the opportunity to get ahead on their mortgages — a trade-off which has only become apparent in recent years as interest rates have fallen to levels expected by very few observers. About 55 per cent of borrowers are ahead on payments choosing not to reduce their mortgage payments despite successive drops in the minimum amount the bank may ask them to repay each month.

How to pick a loser: sponsoring sport a kiss of death for small caps

TIM BOREHAM

Forget about quantitative analysis or top-down bottom-up investing strategies: the acid test of the worth of a small-cap stock is the sporting club it lends its name to.

As with the cruel dictum that investors should steer clear of any stocks with an ex-politician on the board, forking out dollars for a brand alignment with a footy team tends to be the kiss of death more potent than Lou Richards' infamous footy tips.

At least that's the view of one well-known active fund manager, which has studied the correlation between small cap underperformance and sponsorship (mainly of AFL teams). The work of the firm — which wisely wants to remain incognito — is light hearted.

Still, many a wise word is written in jest and it raises a salutary question as to why so many sponsors do so poorly after ploughing marketing dollars into seemingly unrelated endeavours.

Take MyATM, a former Port Adelaide sponsor which collapsed not long after listing in 2011. Or Linc Energy (liquidator appointed) and its backing of Brisbane Heat in the Big Bash cricket comp.

In the legal sector, the struggling **Shine Corporate (SHJ)** sponsors Geelong as well as the impecunious Parramatta Eels and North Queensland Cowboys in the NRL.

The uber-struggling **Slater & Gordon (SGH)** backs Greater Western Sydney and Western Bulldogs (as well as the Brisbane Broncos, Australian Olympic Committee and Newcastle Jets).

The fortunes of **Programmed (PRG)**, which adorns the Fremantle Dockers jerseys and also sponsors Western Bulldogs, haven't exactly soared since its merger with Skilled Group last year.

Investors took a dim view of another Bulldogs sponsor, **Beacon Lighting (BLX)**, after a shock profit downgrade in May.

Up north, **TechnologyOne's (TNE)** share price has gone south since lending its support to home town struggler Brisbane in 2014.

Perennial battler Richmond goes by the "misery loves company", with the support of listed retailers Dick Smith and Clive Peeters. Like the Tigers' finals fortunes, both went belly-up.

Australian Careers Network, which in March followed Vocation into administration, was not only Richmond's ball sponsor last year, but has also sponsored Melbourne Victory, Melbourne United (basketball) and the Penrith Panthers.

More justifiable is Four N' Twenty owner **Patties Foods (PFL)** support of the Brisbane Lions, or **Virgin Holdings (VAH)** bankrolling Carlton, Fremantle, GWS and Gold Coast. "Meat pie makers and footy seems fair enough, as do airlines in a national competition," the fundie says.

Health insurer **NIB Holdings (NHF)** has nicely aligned itself to Geelong's on-field success, while its sponsorship of the cellar-dwelling Newcastle Knights at least befits the group's Hunter Valley origins. On the same grounds we excuse the support of **Bendigo & Adelaide Bank (BEN)** for the Adelaide Crows.

Perth-based car dealer group **Automotive Holdings (AHG)** signed up as Melbourne's main sponsor in 2014, just in time to surf a revival in the Demons' on field performance.

Hawthorn sponsor iiNet (now owned by TPG Telecom, TPM) wouldn't be complaining about the cost of adorning the brown-and-gold conquerors' jumpers as they attempt to win a four successive premiership.

At the very least, **Blackmores' (BKL)** association with Collingwood hasn't done any harm, given the supplements giant's recent dalliance with dizzy $200 a share level. We'll avoid the predictable jibes about Magpies supporters.

The moral of the story for in-house marketers is that if the chairman insists on the body corporate sponsoring his favourite team, at least make sure it's a winning one.

IPOs Roar Ahead … and many make money

The initial public offering market continues to steam along, despite listings such as the hyped online retailer Kogan hitting a bum note.

This week's hero was **Oventus (OVN)**, which listed on Tuesday on the back of its bespoke mouthguards to combat sleep apnoea (chronic snoring).

The shares have almost doubled, with strong buying from exasperated spouses who figure the bespoke devices are much cheaper than divorce.

According to OnMarket Bookbuilds, the 34 listees so far this year had gained an average 23 per cent as of the end of June, blitzing the broader market.

In the second (June) quarter the trend strengthened, with 21 companies listed for an average first-day return of 24 per cent.

It's also not a case of wham-bam stag profits, because these stocks are now 33 per cent in the black.

In terms of size and type of the IPO, there's an ecumenical feel.

The bolter, plant seed play **Abundant Produce (ABT)**, still bears a $6 million market despite gaining 370 per cent since listing on April 24.

But plumbing supplies group **Reliance Worldwide (RWC)**, which raised a market-leading $918m, is also 23 per cent ahead.

With a 160 per cent gain for the quarter, **Graphex Mining (GPX)** showed there's still speculative appeal about an abundant carboniferous element hitherto more synonymous with HB pencils than new-age batteries.

There's been a fair smattering of duds, too: online market place **Redbubble (RBL)** and cloud-based tech plays **9 Spokes (9SP)** and **LiveHire (LVH)** are all well off the pace, while mobile payments play **ChimpChange's (CCA's)** 30 per cent swoon shouldn't be "aped" by anyone.

According to OnMarket, at least nine IPOs are slated over the next month.

While some IPOs evidently have been overpriced — typically those involving private equity vendors — the process should allow investors to pocket the benefit of the rerating.

We suggest that rather than risk exposure to one IPO dud, investors take a portfolio approach.

The best stocks have a habit of being available only to favoured parties, so keep your friends close and your brokers closer.

The Australian accepts no responsibility for stock recommendations. Readers should contact a licensed financial adviser. The author does not own any of the stocks mentioned.

Carsales, a disrupter, faces threat from a new model

ROGER MONTGOMERY

Driving along, content with your choice of vehicle, it may surprise you to know that the automotive industry that delivered your car is in an incredible state of flux.

At the halfway point for 2016, new vehicle sales have risen 3.4 per cent to 598,140 units, which means annuals sales could hit a record 1.2 million for the full year. Just two years ago Australian new car sales topped 1.1 million.

But despite total new vehicle sales exceeding population growth even amid a weakening Australian dollar, there is very little that is stable about the car industry.

One company that has typically enjoyed the benefits of selling cars, without having to buy the stock, or pay for mechanics or a showroom, has been **Carsales (CAR)**. Carsales is Australia's largest online list of cars with approximately 221,000 units available for sale at June this year.

In the first half of 2016 Carsales reported after tax profits of $76.9 million. Meanwhile the car dealership's **AP Eagers (APE)** and **Automotive Holdings (AHG)**, which includes a logistics business, reported first half 2016 profits of circa $50.1m and $48.2m, respectively.

The comparison is important because one car seller requires no physical property, plant and equipment, such as car lots and service centres, to conduct its businesses while the other does.

The heavy reliance on assets has a direct impact on profitability. In 2015, Carsales reported full year profit of $95m on total assets of $404m and equity of $186m.

Automotive Holdings reported a profit of $88m but required $2 billion of assets and $672m of equity to produce it. Similarly, AP Eagers 2015 full-year profit was $91.7m on $1.4bn of assets and $591m of equity.

Why Carsales stands out

While it's not strictly correct to compare after-tax profits to total assets, Automotive Holdings generated a return on assets of 4.44 per cent, and AP Eagers 6.55 per cent, while Carsales generated a 23.5 per cent return on assets. If they were your assets, which return would you prefer?

For every dollar of sales, Automotive Holdings generated earnings before interest, tax, depreciation and amortisation of 4.11c, AP Eagers 5c and Carsales generated EBITDA of 49.5c from every dollar of sales.

Which business would you prefer to own?

Carsales dominates Australia's online lists of cars with 222,000 listed vehicles. Its next nearest competitor is eBay's Gumtree with 176,017 vehicles, followed by the Carsguide (controlled by News Corp owner of *The Australian*) with 110,987 followed by the Trading Post with 20,252 vehicles.

Carsales's advantage has come from what is known as the network effect. The network effect is a strong source of competitive advantage and it is evident when the value of a service increases for both new and current users as more people use that good or service.

Think about it this way: as more people list cars on a website, more people visit that website because there is more to see. As the site attracts more eyeballs and unique visitors, it justifies more cars being listed and the virtuous circle continues to work in favour of the dominant site.

But the network effect may not be a permanent source of competitive advantage and there are many operators vying for some of the profits currently accruing to carsales.

New Car Inventories on carsales.com have declined considerably in recent months. While listings are seasonally weaker at the financial year end, the fall in the second half of 2016 was particularly strong.

Carzoos: a new threat in used cars

Many industry's evolutionary patterns are anything but a straight line. A piano accordion is a better analogy to describe the periods of consolidation of money and market power, followed by fragmentation, spin-offs and wind-ups.

Enquiries to dealers for used cars is far more lucrative for Carsales than new car listings.

> AP Eagers' Carzoos could disrupt the existing used car market

And while dealer used car inventories are softer than the start of 2016, the website still appears to play an important role in dealer sales. However, AP Eagers recently provided more detail about its apparent used car disrupter Carzoos at its AGM.

Over 2.2 million used cars change hands each year and AP Eagers will put small stores in shopping malls staffed with iPad-armed "buddies" who will purchase and sell customers' used cars in a streamlined, no-haggle environment.

Without the unregulated risks of the peer-to-peer used car market, and with a no-questions-asked seven-day return policy and a price based on the historical average negotiated sale price, the concept could disrupt the existing used car market.

AP Eager's trade-in inventory and buying power is a powerful barrier to entry for anyone other than an established dealership network. Of course not all second-hand cars will be available through one dealership network and presumably some brands will continue to dominate in the reselling of their own badges and models.

It is, however, it is possible that Carsales' network effect is beginning to be unstitched. And with the share price at 26 times next year's earnings, the development of alternative used car selling models is worth watching closely.

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