NOT ALL GROWTH IS EQUAL, EVEN IF IT'S ORGANIC

SHORT CUT

ANDREW MACKEN

AS happens four times a year across global equity markets, publicly-listed companies are reporting their quarterly results.

This is not only an enormous undertaking for the disclosing businesses, it is also a busy time for equity analysts and fundamental investors who carefully dissect the updates looking for new insights.

When multinational businesses report their revenue growth, many also report their rate of "organic" revenue growth which is often a different number.

The organic number typically eliminates the distortions of acquisitions and divestitures, as well as any changes due to currency translations which are often volatile.

Why report this organic growth rate? Generally, it is a helpful data point for fundamental investors.

You see, not all sources of growth are created equal.

There are instances when even good-looking organic revenue growth can be deceiving

If I grow my revenue line by $100 as a result of investing $2000 in new capital equipment or an acquired business, this is actually low-quality growth and likely value-destructive.

I might also own a business in the US which is not growing.

But it may appear to be when the results are translated into Aussie dollar terms given the recent deterioration of our currency against the greenback.

This again is a low-quality and non-persistent source of growth.

In contrast, if I can grow my revenue line organically — by increasing prices for example — then this is a wonderful source of growth.

In the case of a price rise, the incremental revenue translates into pure incremental profit and no capital investment was required to achieve it.

It is organic forms of revenue growth which translate into higher returns on invested capital.

And ultimately, it is high returns on invested capital that increase the value of a business over time.

But as is the case with most accounting metrics, there are instances when even good-looking organic revenue growth can be deceiving.

One such instance was observed in recent weeks when Kimberly-Clark (NYSE: KMB), owner of Kleenex tissues and Huggies brands, reported their quarterly results.

Kimberly-Clark is a true multinational. Headquartered in Dallas and listed in New York, the company generates roughly half of its revenue outside the US.

Much of Kimberly-Clark's international revenue stems from markets including Eastern Europe, the Middle East, Africa, Latin America and Asia Pacific.

During the third quarter, Kimberly-Clark delivered organic sales growth of 1 per cent. This was in line with forecasts and was likely the bare minimum rate of organic growth deemed acceptable by the market.

But scratching beneath the surface, even this positive 1 per cent may be a little misleading.

On the company's conference call, management referred to very high rates of organic sales growth in segments based in Brazil, Argentina and Eastern Europe.

Growth in these regions were a meaningful contributor to the company's overall reported organic sales growth.

But these countries are experiencing significant inflation and associated currency depreciation.

Australians know something about currency depreciation with the Aussie dollar falling from around US80c to around US71c over the past year or so.

Well, in the case of Brazil, the depreciation in the currency is like the Aussie falling to around US60c, or as low as US40c in the case of Argentina.

Reporting high rates of organic sales growth in high-inflation regions is misleading.

While it is true that the rate of growth is high in local currency terms, it is also true that local currency costs are also inflating and any profits generated will be worth a lot less given the currency devaluation.

Organic sales growth is typically a high-quality source of growth.

For Kimberly-Clark last quarter, their reported positive rate of organic sales growth was anything but.

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Optimism central

Analysts query upbeat RBA

STUART CONDIE
THE ECONOMY

THE Reserve Bank has lifted its forecast for growth in the Australian economy as it adopts an increasingly rosy outlook.

And the central bank says the jobless rate is now likely to fall further than it previously expected in coming years.

But the upbeat outlook has been received with scepticism by some economists, who caution lacklustre wage growth and a tepid housing market threaten the RBA's updated forecasts.

The RBA board, which kept the cash rate on hold at 1.5 per cent at its monthly meeting yesterday, now expects Australia's economy — measured by gross domestic product — to grow 3.5 per cent this year and next before moderating in 2020. That compares with its previous forecasts of 3 per cent both this year and next.

It has lowered its forecast for the unemployment rate in 2020 from 5 per cent to 4.75 per cent.

In his statement announcing the cash rate would stay on hold for a 27th consecutive month, governor Philip Lowe acknowledged the property market had weakened in Melbourne and Sydney and there were concerns about the level of household consumption.

BIS Oxford Economics chief economist Sarah Hunter said the economy was only likely to expand by about 3.3 per cent this year and growth could fall below 3 per cent next year. "We are not as optimistic on the outlook for the economy," she said.

"Like the RBA, we see consumer spending as the biggest drag on growth momentum next year."

Marcel Thieliant, an economist with Capital Economics, agreed the RBA was being overly optimistic and said the cash rate would remain on hold throughout 2019.

In his statement on monetary policy, Dr Lowe said the RBA saw inflation at 2.25 per cent in 2019 and "a bit" higher the following year. The Australian dollar ticked up from US72.05c just before the RBA decision was announced to US72.14c shortly after.

AAP

Toy titan Lego has secured another court victory against copycat Chinese manufacturers.

LEGO BLOCKS CHINA FAKES

LEGAL

LEGO has won another case against imitators in China, where copies of its colourful plastic toy bricks and figures have been a recurring issue.

The famous toymaker announced yesterday that the Guangzhou Yuexiu District Court had ruled four companies had "infringed multiple copyrights of the Lego Group by producing and distributing Lepin building sets".

"We believe these decisions are well-founded in the facts and the law, and clearly demonstrate the continued efforts of Chinese authorities to protect intellectual property," Lego chief Niels Christiansen said.

The court ordered the companies immediately ceased "producing, selling, exhibiting or in any way promoting the infringing products", Lego said.

It will receive around 4.5 million Chinese yuan ($901,568) in damages.

Web cash not green

ENERGY

EXTRACTING a dollar's worth of cryptocurrency such as bitcoin from the web consumes three times more energy than digging up a dollar's worth of gold, researchers say.

There are hundreds of virtual currencies and an unknown number of server farms working to unearth them — more than half in China — according to research by the University of Cambridge.

In other words, mining virtual currencies with a real-world value carries a hidden environmental cost that is rarely measured.

"We have an entirely new industry that is consuming more energy a year than many countries," said Max Krause, a researcher at the Oak Ridge Institute for Science and Education and lead author of a study in *Nature Sustainability*.

Mining cryptocurrencies requires hundreds, even tens of thousands of linked computers running intensive calculations in search of the internet equivalent of precious metals.

MARKET WRAP

BANKS, ENERGY HOLD FORT AS EYES WANDER

THE Australian share market closed almost 1 per cent higher yesterday, fuelled by strong gains from banking, energy and resources stocks.

The benchmark ASX 200 index added 57.1 points, or 1 per cent, to close at 5875.2 while the broader All Ordinaries climbed 53.9 points, or 0.9 per cent, to 5958.7.

CommSec market analyst James Tao said that on a day when the nation stopped for a horse race, the Melbourne Cup public holiday in the Victorian capital, combined with the looming US midterm election, made for a light day of trading on the local bourse.

"A lot of peoples' attention is certainly not on the markets today so the light volume has seen a pick-up for the financials and resources," Mr Tao said.

"There's a bit of a holding pattern here and globally." Investors were also likely holding out for the US rates decision coming later this week followed by the RBA's statement on monetary policy, Mr Tao said.

Local energy stocks were higher reacting to rising crude oil prices, with **Woodside Petroleum** climbing 1.7 per cent to $33.98, **Oil Search** up 2.2 per cent to $7.71, **Santos** gaining 2 per cent to $6.50 and **Origin Energy** rising 0.8 per cent to $7.23.

DOLLARS & SENSE by ROY

Major miner **BHP Billiton** gained 1.3 per cent to $33.55 and **Rio Tinto** rose 2.1 per cent to $81.25.

South32 added 1.4 per cent to $3.69.

Gold prices edged slightly lower but this had little impact on its mining stocks, with **Newcrest Mining** rising 1.6 per cent to $21.06 and **Northern Star Resources** adding 2.1 per cent to $8.63.

The big four banks were stronger with the **Commonwealth Bank** leading the gains, up 1.4 per cent to $68.95 after agreed to buy Property Exchange Australia.

Bucking the trend, **Macquarie Group** was down 0.2 per cent to $121.50.

Biotech **CSL** dropped 0.3 per cent to $187.01 while sleep apnoea device specialist **ResMed** lost 0.6 per cent to $14.54.