Downturn may produce upside to aged care costs

JOHN RAWLING

As the aged care royal commission rolls on across the country, the troubled sector has received a rare positive signal. The unmistakeable trend of falling property prices, which are down 10-20 per cent Australia-wide, is set to affect costs in aged care.

Many people have to sell their family home to pay the infamous Refundable Accommodation Deposits, so it stands to reason that if the family home is worth 20 per cent less than it was last year, RADs become commensurately more expensive.

The range of RADs is enormous, varying between different facilities, aged-care providers, locations, even between different rooms within the same facility. So far, RADs have not changed to reflect falling house prices, but we can expect changes soon.

Since July 2014, the Minister for Aged Care has had the power to set the RAD threshold under the Aged Care Act. That threshold is currently $550,000. When an aged-care provider wishes to set the RAD above this threshold, it must apply to the Aged Care Pricing Commissioner for approval. (No approval is required if the proposed RAD is less than $550,000).

Once a higher RAD has been approved by the commissioner, it remains valid and can't be changed (except for annual CPI increases) for four years, after which it lapses. The aged-care provider must then reapply for a further approval.

A wide range of factors determine how much an aged-care facility wishes to charge as a RAD.

In their application to the commissioner, providers are required to include details such as quality, condition, size, and amenity of rooms and common areas, business case supporting the proposed pricing, and the cost and value of the facility. Part of the calculation is assessing median house prices and historical bond levels by locality and comparing the proposed RADs to historical bond levels.

In theory at least, the commissioner has the power to demand a lowering of RADs in times of falling house prices.

Perhaps the most encouraging sign came from listed retirement accommodation provider Aveo, whose business includes mainly retirement villages but an increasing proportion of aged-care services.

Aveo management recently acknowledged that the residential property market is posing challenges for its business, including a longer gap between clients signing for rooms, selling their homes and moving in.

Aveo is one of the smaller listed aged care operators. When the royal commission was announced last September, shares in the three largest listed companies — Regis, Estia and Japara — were smashed. All fell at least 20 per cent.

All have recovered a little since these lows, but they are still well below the performance of the All Ordinaries index. All reported their interim results last month and all were largely uninspiring.

The drop in share prices does not mean that the companies are now cheap. Regis and Japara shares are now on 18 times earnings while Estia's shares are on 15 times earnings.

Of course there are two sides to the story. Retirees looking to enter a retirement village must now factor in lower expected proceeds from the sale of a house and possibly longer times to sell those houses.

Hopefully, the Aged Care Pricing Commissioner will do the right thing and lower RADs.

While the process for entering residential aged care is different to entering a retirement village, the property market downgrades will put pressure on both types of aged-care providers, as well as those entering both types of facility.

One effect of lower house prices will be that families will look at lower-priced rooms or different quality facilities.

In addition, people are delaying their entry into aged care for as long as possible, and more of them are opting for home care as an alternative to aged care. The government is happy about the latter trend, as it means a smaller funding requirement. Regis recently offered to waive the basic daily care fee for anyone moving into its facilities before June 30.

One thing's for sure, people and their families looking at aged care should negotiate very hard with the aged-care providers on the RAD, which is, after all, a maximum advertised price that can be negotiated down. If the facility is keen to fill beds, they are often willing to come to the party and agree to a reduction in the RAD.

Sooner or later, falling property prices will affect RADs, whether aged-care providers like it or not.

John Rawling is an aged care expert at Joseph Palmer & Sons.

The path to aged care may become cheaper

Shades of dotcom bust in tech boom

Eighty-three per cent of IPOs were unprofitable last year

ROGER MONTGOMERY

I'm watching the enthusiasm in technology stocks and thinking of two enduring investment quotes: "Is this time different?" and should we continue to "be greedy when others are fearful and fearful when others are greedy"?

Much of the rally in markets since the global financial crisis can be attributed to widely defined technology stocks. When short-term rates were set to zero after 2009, saving money became unappealing. Then, as quantitative easing pushed long-term rates toward zero, investing also became unattractive. The only thing left was speculation.

Sure enough, speculative assets soared ... even among profitless technology hopefuls.

Consequently, technology stocks have risen to the vaunted peaks of both public and private capital markets.

Many of the new band of technology companies have enabled changed consumer behaviour and business operations, if not a wave of fast growth across all aspects of life on Earth. Amazon continues to grow its earnings at more than 40 per cent per year, while Facebook has completely unhinged traditional advertising businesses and models. These companies are generating vast revenues and profits and must be separated from the band of up-and-comers that can lay no claim to profit or even revenue. Some don't even have a product yet.

These profitless businesses are little different from those that lost their investors billions in the tech bust of 2000.

Then there are the cases in between. Companies such as Tesla, Uber and Netflix, have a business, a product and generate revenue, but are collectively burning millions per minute. In the case of Tesla, it trades at a multiple that simply cannot be sustained as the market realises that the economics of the business must look very similar to its car manufacturing peers. If GM trades at market capitalisation equivalent to $US5000 ($7000) per car sold and Mercedes at $US29,000 per car sold, Tesla will not be able to justify a multiple of $US360,000 per car sold as it ramps up production from 160,000 units towards a Mercedes-like 1.7 million units or Ford's 6.6 million units ... if it ever gets there.

I was at Merrill Lynch during the dotcom boom of 1999 and ultra-high valuations fuelled by even higher hopes were considered normal. Indeed, a research report at the time noted that "almost any price should be paid for these businesses".

But history is replete with examples of technology that changed the world and while consumers were better off, investors weren't. There have been more than 1500 car manufacturers in the US. Yet, despite the undeniable benefit this invention brought to humanity, investors have not done so well. Indeed today only one profitable car manufacturer exists in the US that was not bailed out by the government during the GFC. That company is Ford.

Similarly, since the invention of the television, from more than 1000 US manufacturers, none exist today. Again, consumers benefited, but not investors.

In 1999, Warren Buffett gave a prescient speech at the Allen & Co annual conference at Sun Valley and revealed a list of US airlines that emerged following the Wright brothers' flight at Kitty Hawk — an event that inspired a world until then undreamed of. He then observed: "As of a couple of years ago, there had been zero money made from the aggregate of all stock investments in the airline industry in history."

When a company is losing money today, but promises to make lots in the future, the value is all tied up in uncertainty, and the sky is truly the limit. Emotions replace logic and traditional or conventional metrics are replaced with unconventional and untested ones. Looking at companies such as Afterpay, Pushpay, Appen, WiseTech Global and Splitit, while it may be true that they are operating genuine businesses, possibly with long-term prospects that are bright, it is not equally true that their current prices can be sensibly justified by anything other than the hope they will be spectacularly successful.

A "unicorn" is a start-up with a market valuation of more than a billion dollars. And a tidal wave of unicorns are preparing to go public this year. Companies including ride-sharing competitors Lyft and Uber are readying IPOs and it is expected that Postmates, Pinterest, Airbnb, Peleton, Zoom and Slack will follow.

Goldman Sachs estimated that $US80bn of funds will be raised through IPOs this year and Renaissance Capital believes a record $US104bn in IPO raisings is more likely.

Either number for a group of businesses that in aggregate lose money is simply evidence of another bubble. Lyft lost $US254m in the third quarter of 2018, while Uber hasn't made a profit in the nine years since being founded. Uber has lost $US6bn in the past two years and in the fourth quarter of 2018 it lost $US865m. The bubble began last year when, despite the apparent maturity of these businesses and their multi-billion market valuations, 83 per cent of IPOs were unprofitable. It was the highest on record since 1980.

But investors should be particularly concerned about the increase in supply of such companies this year, especially when valuations are stretched and global growth is being revised lower.

For now, the capital is flowing and the confidence is building again. Towards the end of a cycle investors almost always favour momentum rather than valuation, and they ignore the longer-term truth of investing; that returns are highest when capital is scarce, not when it is abundant.

While the timing and the magnitude of a return to normality cannot be accurately predicted, its eventuality is much more certain.

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

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ZUMA PRESS

Ride-sharing operator Lyft lost $US254 million in the third quarter of 2018 yet is preparing an IPO

> Emotions replace logic and traditional or conventional metrics are replaced with unconventional and untested ones

Emerging markets ready to run on back of brighter political outlook

China's stimulus gets benefit of the doubt from investors

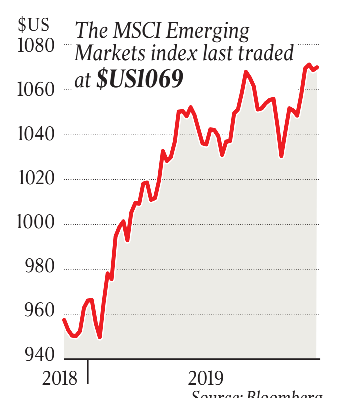
CRAIG MELLOW

Emerging markets are rebounding. The iShares MSCI Emerging Markets exchange-traded fund is up about 10 per cent for year to date. But conditions remain ripe for a further rally in emerging markets, investors say.

The macro risks that have been frightening investors — from a Chinese hard landing to an escalating Washington-Beijing trade war — seem to be lessening. The US economy is slowing to a "Goldilocks" pace from the standpoint of emerging markets: vigorous enough to support global growth, but measured enough to keep the Federal Reserve dovish. And valuations remain cheap by historical standards.

"Our central position is for positive outcomes on the big issues," says Jorge Mariscal, chief investment officer for emerging markets at UBS Global Wealth Management. "We are overweight in global emerging market equities."

China, whose economic growth rate has slowed to about 6.5 per cent from double digits over the past decade, is the question mark at the heart of emerging markets. It accounts for a third of the global index itself and sets the stage for other big players, from Brazil to Taiwan. But investors are giving Beijing's latest stimulus moves, and longer-term shift from export reliance to consumption, the benefit of the doubt at current prices



"China recovery is the most vulnerable part of the EM story, but the balance of data is going in the right direction," says David Hauner, an emerging markets strategist with Bank of America Merrill Lynch.

The US environment is more favourable towards emerging markets now than it was in 2018, and not only because President Trump is talking up trade peace. Gross domestic product growth should cool closer to 2 per cent from near 3 per cent as the steroids from Washington's late-2017 tax cut dissipate. That could put further Fed rate increases, which vacuum capital from the rest of the world, on hold, without calamitously weakening global demand. "About 2 per cent US growth is perfect for EM," Mr Hauner says.

With the Fed on pause, the dollar should eventually fall from near-historic highs on a trade-weighted basis, translating to strength in other currencies and their assets.

"Our view is to buy when FX is cheap," says Justin Thomson, chief investment officer for international equity at T. Rowe Price. "You can make a lot of money in a short space of time when that dollar tear ends."

The best profit may be found among countries most beaten up by last year's flight from emerging markets, such as Mexico, Turkey, South Africa, and Russia, says Aaron Hurd, portfolio manager at State Street Global Advisors.

"The market tends to overreact in countries with specific issues," he says. "We're happy to go collect some of that excess risk."

The political forecast elsewhere is brightening, too. Investors are expecting Jair Bolsonaro's government to push a critical pension reform through Brazil's fractious congress this year, and that Prime Minister Narendra Modi of India will retain power, keeping the No 4 emerging market on its world-beating growth path.

All these green shoots are sprouting in the soil of attractive valuations. Emerging market stocks are trading at a 25 per cent discount to global indexes, compared with a 16 per cent average since 2001, based on a blend of price/earnings and price-to-book value, says Kostya Etus, at ETF adviser CLS Investments. Plenty could go wrong. But staying in the game is likely worth it.

BARRONS

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