SECTOR CONSTRUCTION

Get ready to pounce

It's tough out there, and any sell-off could give investors the chance to grab a bargain

Retail sales are starting to reflect the tougher employment and income conditions in the construction sector. The Reserve Bank's rate cuts, federal tax cuts and APRA's removal of the 7% floor on the mortgage serviceability test will now need to have an immediate impact on spending if it is to offset the 30%-50% decline in residential construction expected to occur over the next six to nine months.

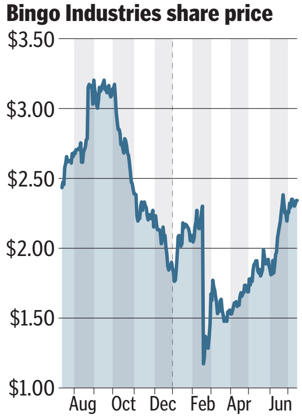
The early signs are positive, with auction clearance rates up significantly, compared with the same time last year, in the major capitals. But if a broader consumer response suffers any delay, it is likely the current optimism will reflect a post-election honeymoon rather than enduring improvement.

Sell-side analysts are broadly optimistic, as is common, which means the market might be negatively surprised by the extent of the slowdown and its impact on 2020 profits for many directly exposed companies. Negative surprises are followed by downgrades and the impact is seen in lower earnings forecasts and lower price-to-earnings multiples. It's the reason a 10% downgrade can result in a 50% fall in the share price.

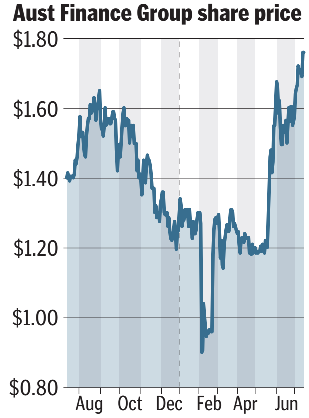
So where should investors be looking for possible downgrades and bargains over the next few months? The following group of companies are those where downgrades and lower prices might be an opportunity for much higher returns in the future. These aren't "buys" right now, so they have a "hold" attached to their names. However, a sell-off could render them much more attractive.

Roger Montgomery is the founder and CIO at the Montgomery Fund. For his book, Value.able, *see rogermontgomery.com.*

Bingo Industries share price



Aust Finance Group share price



Nick Scali share price

❶ Bingo Industries

In February, Bingo noted "a faster than anticipated softening in multi-dwelling residential construction activity across Bingo's key markets in NSW and Victoria", adding that "volumes in our building & demolition (B&D) collections business were above the previous corresponding period, but have not grown as much as initially forecast. In addition, competition in the collections market has put downward pressure on pricing, impacting our margins." That picture hasn't changed, but the share price has doubled since its February lows.

ASX code BIN
Price $2.35
52wk ▲ $3.27
52wk ▼ $1.17
Mkt cap $1.55bn
Dividend 3.72¢
Dividend yield 1.6%
PE ratio 31

HOLD

❷ Australian Finance Group

National clearance rates of almost 70% are up 50% on last year's numbers. Rate cuts, APRA changes and stability for the mortgage broking industry are all positive, as is AFG's strong balance sheet. If, however, post-election mortgage demand doesn't pick up quickly and sustainably, AFG's profit growth may be slower than the market's current expectations of 8%.

ASX code AFG
Price $1.77
52wk ▲ $1.77
52wk ▼ 84¢
Mkt cap $378m
Dividend 10.4¢
Dividend yield 6%
PE ratio 11

HOLD

❸ Nick Scali

The share price is up over 30% since its January lows and the company has confessed that it will prefer to maintain premium pricing, rather than volumes, in the event of a slowdown in activity. In May it told analysts it has not seen any slowdown, but given falling approvals that slowdown appears to be on its way.

ASX code NCK
Price $6.56
52wk ▲ $7.39
52wk ▼ $4.80
Mkt cap $529m
Dividend 49¢
Dividend yield 7.5%
PE ratio 12

HOLD

Prices as at ASX close of business, 12-July-19