

Portfolio Super revolution

Inflow speculation causes ritzy valuation

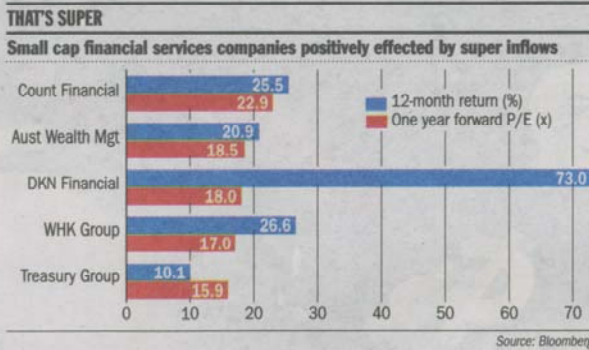
Small financials
 Richard Hemming

There is no doubt some small-cap financial companies are gaining from bigger than usual superannuation inflows, but the benefits might be less than their multiples suggest.

The funds are coming from individuals taking advantage of a one-off entitlement to make up to \$1 million in post-tax super contributions before July 1. And super inflows are forecast to grow after that date as a result of the new tax-free status of most payouts to the over-60s.

The average one-year forward price-earnings multiple for financial services companies that benefit directly from superannuation inflows is 18.5 times, which is above the historical average P/E for small caps of about 18 times.

This implies investors believe their earnings will rise by more than 18 per cent a year for the next three to five years. This may very well happen for these companies, which include Count Financial, Australian



Wealth Management, DKN Financial, WHK Group and Treasury Group. But it won't be solely the result of a heavy inflow of superannuation.

"We look beyond the short term in terms of positive developments," says Pengana Emerging Companies portfolio manager Steve Black. "This tax-preferred situation could bring forward superannuation inflows."

An example he uses is business owners selling their businesses now

instead of in the next three years.

But Black's fund has invested in all these companies, with the exception of Count Financial, on the basis of the "leverage effect" inherent in financial services companies. This refers to the low cost base of these companies, which means that once revenue exceeds outlays, most of the money goes straight to the bottom line. Hence, above-average profit growth is achievable.

The effect on earnings of the

superannuation contributions is evened out by the business model used by these companies, which involves management fees based on the funds under management, or the amount of funds the company is in charge of advising in the case of financial planning.

Previously, financial services companies received most of their fees "up-front" when a client signed up but the most common model now, says Black, provides more consistency over time, which is a better outcome for listed companies.

But if ever there has been a red flag run up about investing in financial services companies it was in the past week, with markets at their most volatile. The benchmark S&P/ASX 200 Index fell about 6 per cent in four trading days, reacting to sell-offs in sharemarkets around the world concerned that consumer demand is slowing in the United States.

Shares in financial planner Count Financial, the most expensive of the financial services juniors, have fallen almost 11 per cent since mid-February.

Australian Wealth Management, another financial services provider, has declined more than 16 per cent in this period. Shares in Treasury Group, which is a part-owner of several boutique fund managers, have been marked down 12.5 per cent.

Smallco Investment Manager managing director Rob Hopkins says these companies are vulnerable to sharemarket weakness because of the "ritzy valuations" investors are placing on these companies at current share prices.

He says other financial services companies provide the same leverage effect, but aren't trading on the same multiples. Coincidentally, they don't benefit as directly from the superannuation explosion.

Record Realty is one of the financial services companies in his fund. Hopkins says the company intends to maintain its dividends at current levels, giving the stock an income yield of almost 13 per cent.

"They're not cowboys," Hopkins says. "Allico Finance Group's management team is behind the company, so we have confidence they will maintain their dividend."