

Discounts give retailers little joy

Michael Bleby and
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Retailers face lower profits in the crucial post-Christmas period, with increased sales coming at the expense of heavy discounts required to shift unsold stock.

Bernie Brookes, chief executive of Australia's biggest department store, Myer, said trading conditions remained challenging as discounting by retailers, particularly in electrical products, continued.

"It has been a tough environment and will continue to be, so the Christmas period and [stock take] sale reflect that. We said things would be flat and we are in line with expectations," Mr Brookes told *The Australian Financial Review*. "It is getting to the stage where it will be dearer to buy a movie than a flat screen TV!"

Holiday season discounts are a double-edged sword for the retail industry. While reductions of 40 per cent on items such as suits at stores like Myer and other discounted items draw in shoppers, they also cut profit in a period that accounts for up to half of annual profit for department stores.

"Price competition is enhanced this year as retailers try to clear excess stock," David Jones spokeswoman Helen Karlis said.

Foot traffic jumped 4 per cent to a record 167,000 on Boxing Day at



Traffic may be up for larger stores, but severe price competition isn't helping earnings.

Photo: TOMIASZ MACHNIK

Chadstone Mall, the country's biggest, on Melbourne's outskirts. Numbers were up "beyond expectations", a spokeswoman for Westfield, Australia's largest shopping centre operator, said.

"What was going to happen in the post-Christmas sales was that there would be a much wider range of sizes and styles, simply because stores were going to have to clear inventory," said Margy Osmond, chief executive of the Australian National

Retailers Association. While it's too soon to know if consumers have been encouraged to spend by November's and December's interest rate cuts, indications of stronger large home-wares sales — sofas, fridges and the like — could indicate a change in sentiment, Ms Osmond said.

But smaller retailers are not so optimistic. Joe Richards, proprietor of menswear retailer Richards & Richards in Brisbane, says turnover is down 30 per cent on last year.

"No one has any confidence anymore. People who used to buy expensive clothes are buying cheaper stuff and men are just staying in their old clothes," Mr Richards said.

Grocery sales are strong. Richies Supa IGA chief executive Fred Harrison said sales at his 55 east coast supermarkets had been "significantly better than anticipated".

with Mathew Dunckley and
Matthew Cranston

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Juicy margins will attract Japan: Bouris

Mathew Drummond

The high margins banks make on mortgages leaves plenty of room for Japanese banks to push into Australia, according to Mark Bouris whose Wizard Home Loans business forced down mortgage rates in the 1990s.

But Mr Bouris and Aussie Home Loans founder John Symonds doubt that Japanese banks could sell mortgages much cheaper than major Australian banks. Mr Symonds said after factoring in foreign exchange costs a Japanese bank would be making a loss on Australian mortgages.

"There ain't going to be any Father Christmas coming from Japan or anywhere else who would have the capability or appetite to lose money on new home loans," Mr Symonds said.

Last week *The Australian Financial Review's* Chanticleer column reported that two of Japan's three largest banks are thinking of breaking into the Australian mortgage market which is dominated by ANZ Banking Group, Commonwealth Bank of Aus-

tralia, National Australia Bank and Westpac Banking Corp. One of those banks is understood to be preparing to launch operations this year.

Because the Japanese save more than they borrow Japanese banks have more deposits than they need to fund their loan books. Interest rates paid on deposits are close to zero in Japan,

would force them to buy insurance to protect them against unfavourable foreign exchange moves before lending that money out in Australian dollars.

"They won't take the currency risk. The cost of hedging will equate to the same landed cost of funds as borrowing anywhere else in the world. Otherwise we'd be borrowing from Japan as

would lose their comparative funding advantage once they insured themselves against currency risk but said they had an advantage due to the sheer amount of spare money available for lending.

In contrast Australian banks would need to fund loan growth in wholesale markets, which were currently very expensive.

He predicted Japanese banks might seek to tie up with a non-bank lender to give them access to customers.

"Japanese banks could be a wholesale facility for somebody. There's enough margin in a retail mortgage today to allow for a warehouse provider, a platform and a retailer.

"The margin allows for new forms of capital to come into this market and take advantage of Australian mortgages which still perform brilliantly."

The latest figures on the size of banks' operations collected by the Australian Prudential Regulation Authority show that Japanese banks have all increased lending to Australian businesses in 2011.

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Wizard Home Loans founder Mark Bouris

meaning high profits can in theory be achieved by taking excess deposits from that country and lending them to mortgage customers in Australia.

Mr Symonds, whose business is now one third owned by Commonwealth Bank of Australia, doubts the strategy would work. While Japanese banks had plenty of spare yen, prudent risk management procedures

were, he said. Mr Symonds described the current market for mortgages as "super competitive."

In contrast Mr Bouris said the level of competition for mortgages was ordinary. Margins on home loans were about 2.5 per cent — double that in the late 1990s when non-bank lenders could compete aggressively.

Mr Bouris agreed Japanese banks

Watchdog's auditor quits over ethics

Mathew Dunckley

The man responsible for checking the Victorian Auditor-General's books has quit his contract, citing a conflict of interest over millions of dollars worth of work his firm performed for the public sector watchdog.

Peter Sexton won a three-year contract in 2010 to audit the Victorian Auditor-General's office.

At the time, Mr Sexton was the audit principal at listed accountancy firm WHK Horwath, now known as Crowe Horwath. He conducted two audits of the Auditor-General's office, which has an annual budget of about \$36 million, covering the 2010 and 2011 financial years.

According to annual reports

issued by the Auditor-General, Mr Sexton's firm was paid \$1.85 million for service contracts in the 2011 financial year and \$1.61 million for similar services in 2010.

All up the Auditor-General paid \$10.2 million in the 2011 year to 26 audit firms for contract work.

Meanwhile Mr Sexton's fee for the auditing the watchdog was about \$30,000 a year.

In a letter to the Parliamentary Public Accounts and Estimates Committee (PAEC), Mr Sexton said that a change to the accounting profession's formal code of ethics that came into force on July 1 it was no longer possible for him to continue auditing the Auditor-General's office.

The Auditor-General's annual

report states that a condition of conducting that work was that Mr Sexton could not qualify for any of the other contracts offered by the office.

According to a Victorian Parliamentary committee report, Mr Sexton has declared he cannot fulfil the final year of the three-year contract because his firm had a commercial relationship with the state audit office.

In its report tabled in Parliament last year, the committee stressed it believed Mr Sexton had behaved appropriately.

"The PAEC, from the outset, make it clear that the financial auditor, Mr Sexton, properly alerted the PAEC and Parliament in a timely manner, of a potential conflict of interest, as

required in the contract for services and has not contravened any of those contractual obligations," the report says.

PAEC also found that WHK Horwath's work for the Auditor-General constitutes a "close business relationship" as described under the code of ethics.

The revised code "clearly places... Mr Sexton in a position that would be contrary to the public interest and community standards by virtue of the material and significant business relationships that his associated companies have with [the Auditor General's office]", the PAEC report says.

Crowe Horwath was unavailable for comment.

Falling ore price may cut into mining tax

Katie Walsh

Downwards pressure on iron ore prices mean the federal government may make little if any revenue from its pending minerals resource rent tax, an accounting firm that advises miners has warned.

In a submission to a Senate inquiry into the tax, BDO notes if prices experience a "double-dip drop" predicted by some, "no one will pay MRRT".

Even if prices fall to a lesser degree, big miners will pay nothing due to large deductions calculated on their stock of resources in May 2010 when the government first flagged the tax. It is not unreasonable to use an average iron ore price of \$US148 [per tonne] for an extended period of time," writes BDO director John Murray.

"We respectfully request Treasury advise what MRRT will be collected if iron ore prices remain at \$US120 [per tonne] for an extended period of time," writes BDO director John Murray.

Despite hitting highs of \$US190 last year, the iron ore price plummeted in October, losing almost a third of its value as it fell to a low of \$US117 in early November. Last month Rio Tinto chief executive Tom Albanese said he expected the floor price of the mineral to drop beneath \$US120 a tonne as world supply rose.

In a submission to a Senate inquiry into the mining tax, BDO notes if prices experience a "double-dip drop" predicted by some, "no one will pay MRRT".

Concerned that a drop in price would leave small and emerging miners, who do not have the massive starting base of resources to deduct from their revenues, to foot mining tax bills, Mr Murray repeated calls for safeguards — emerging miners should only pay the tax once "mature miners" (essentially BHP Billiton, Rio Tinto and Xstrata) pay, and at an effective rate that was no greater.

The tax is due to kick in from July at an effective rate of 22.5 per cent, applied to iron ore and coal production. While the big three miners succeeded in having the tax watered down, lobbying efforts by smaller miners who feel discriminated against have to date fallen flat.

The Association of Mining and Exploration Companies reiterated its opposition to the tax as an "ill conceived, punitive, discriminatory and irrefutably badly designed tax" that should be rescinded. It has called for an exemption for companies producing up to 10 million tonnes of resources a year and caps similar to those proposed by BDO to protect small miners.

However, the Minerals Council of Australia deems the tax a workable proposal and a "marked improvement" on the initially planned resources super profits tax.

In other submissions, the Construction, Forestry, Mining and Energy Union said the tax could go further to capture the industry's windfall profits and called for the revenue to be funnelled into a sovereign wealth fund.

with Peter Wells

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