

Example of assignment that scored 'High' marks. **Note: Marks were lost due to summary exceeding the 100 word maximum.**

Article: John McGrath: Horror Week for Mr Real Estate four months after float

The Sydney Morning Herald, Patrick Begley, April 29, 2016

Summary:

McGrath's share price plummeted after an unexpected earnings downgrade which real estate mogul John McGrath claims is due to a significant reduction in the sales of the acquired Smollen group of 30%. The shares in McGrath floated in December 2015 at \$2.10 but haven't traded at that height since; dropping as low as 85c after the decreased earnings for the 2016 year to date were announced. This downturn has not only been experienced by McGrath but by a multitude of other firms in the real estate industry, due to a low and decreasing volume of listings and sales coupled with a skittish market, low affordability and dwindling availability of funds.

Word Count: 110

Accounting Theory:

The **EFFICIENT MARKETS HYPOTHESIS** states that securities markets will reflect information in individual stocks and in the stock market as a whole in three forms, the most pertinent of which is semi-strong form efficiency (Fama, 1970). Semi-strong form is when markets impound all publicly available information into the stock price rapidly and without bias (Fama, 1970). Publicly available information in this case includes not only financial statements but other publicly available information relevant to firm value, such as industry health reports (King, 1966). The market will interpret the available information and respond to negative information with a decrease in share price and vice versa for positive information. If the market is unresponsive to the release of information, then such information is said to lack information content (Beaver, 1968). Ball and Brown (1968) evidenced this in their study of earnings announcements. Whereby, only announcements of unexpected earnings were seen to have an effect on the share price in a way that the efficient markets hypothesis suggests.

Word Count: 153

Analysis:

The article "*John McGrath: Horror week for Mr Real Estate four months after float*", illustrates the efficient markets hypothesis of accounting with respect to the responsive nature of capital markets in particular to earnings announcements. It is important to note however that capital markets will react to a variety of information, not just financial information in order to

evaluate potential future cash flows and make investment decisions (King, 1966). The article states that industry wide change with regard to sales and listing volumes and median house prices is occurring, these changes have the potential to affect share price for McGrath in the future (King, 1966).

McGrath's share price experienced a drastic plunge to only 85c per share as a result of a downgraded earnings forecast being released (Ball & Brown, 1968). The earnings forecast for 2016 was downgraded as a result of a rapid decline in the first quarter sales of the acquired Smollen group, by approximately 30 per cent and an overall reduction in activity in the housing market . The reaction of the market to the information provided in the earnings forecast suggests that it was unexpected and materially relevant to future cash flows and thus had information content (Beaver, 1968).

A variety of stakeholders will utilise accounting information and earnings forecasts when making investment decisions as it is widely regarded as reliable information. However, stakeholders may also analyse a variety of other publicly available information with respect to making an investment decision (King, 1966). One example of such information would be industry reports regarding overall industry health. In this case, such reports would show a significant decrease median house prices, as well as a low and decreasing volume of sales and listings given the information in the article. This industry wide change could also be responsible for some of the movement in McGrath's share price (King, 1966). This is because the market would impound the impact of these industry wide changes on expected future cash flows for McGrath into the share price as soon as the information became publicly available (Fama, 1970).

Word Count: 329

Conclusion:

Efficient markets hypothesis suggests that publicly available, unexpected information will be immediately impounded into the share price in an unbiased manor. In the case of McGrath Ltd information available included an earnings downgrade announcement, and warnings of overall industry poor health which negatively affected the share price of McGrath Ltd to trade at less than half of the original float value.

Word Count: 61

Total Word Count: 543

John McGrath: Horror Week for Mr Real Estate Four Months After Float

The Sydney Morning Herald

John McGrath: Horror Week for Mr Real Estate Four Months After Float

Patrick Begley

Published: April 29, 2016 - 2:14PM

- McGrath Limited advisor JPMorgan cuts share price value
- John McGrath backs his business with share buy

By all accounts, HSC failure John McGrath is a smart man. It was through his own nous that the author of *You Don't Need To Be Born Brilliant* created a property empire worth hundreds of millions of dollars.

But was the Sydney mogul wise to float his real estate company on the stock exchange in December?

Terrible timing, some say, pointing to a glummer property market and a share price that has halved in four months.

Excellent timing, say others, noting the \$37 million McGrath pocketed selling a third of his stake at what many have called the top of the market.

Depending on whom you ask, the teetotaller son of an alcoholic is naive, calculated or unlucky, either a victim of circumstances or a deft manipulator of them.

Share Slump

A skittish Sydney has an eye on his fortunes.

For a week, McGrath Ltd shares have traded at about half their \$2.10 float price, finishing at \$1.10 on Friday after a trading halt the week before and a crash to 85¢ on Monday.

The company, valued at \$215 million, downgraded its projected revenue by \$4 million the same day. Float brokers JPMorgan and Bell Potter then slashed their share price outlooks by 23 to 28 per cent.

Housing affordability fears, tighter bank borrowing rules, slowing Chinese demand, increased apartment supply, election-year uncertainty and bad press have all been blamed for the share slump.

As a full-page McGrath advertisement said on Wednesday: "The difference between a good price and a great price isn't one thing, it's everything."

Ideas Man

McGrath himself has kept quiet this week, refusing interview requests.

"I imagine he must be finding it very challenging and very disappointing," said entrepreneur Wendy McCarthy, a founding chair of McGrath Operations who left in June. "You've got people telling you everything is going to be fabulous and the float is oversubscribed and you believe it."

McCarthy, who praised McGrath's imagination and generosity, said he had dreamt of floating for at least 15 years. "I think it's a sort of validation."

McGrath was pleased with his school leaving score of 95 before he discovered it was out of 500. Having wanted to become a rugby league player, he suffered two collapsed lungs and went into real estate instead in 1988.

"He took the industry to another level," Debbie Donnelley, a former employee, said. "He was an ideas man."

McGrath produced marketing materials of unprecedented quality and expanded to become a force in Sydney's inner and eastern suburbs as well as south-east Queensland.

At his side for more than two decades was business partner James Dack, who concentrated on sales management before leaving in 2014.

Dack, who reportedly had not spoken to McGrath in the six years before his departure, did not return calls.

A competitor who said he was on friendly terms with McGrath described him as an early-to-bed, early-to-rise "control freak" who planned his outfits a week in advance.

But the competitor said McGrath's ego was no bigger than any other salesperson's. If he craved attention, why say no to a second season of the entrepreneur TV program *Shark Tank*?

Legacy

"Legacy" is a word people use when discussing McGrath's decision to float.

He is 52, unmarried and childless. Racehorses can take up only so much time.

A public listing was considered the best way to expand and the new company immediately bought out a north-west Sydney franchise network, Smollen Group, for \$52 million.

McGrath now blames this foray for the profit downgrade; Smollen sales fell 25 to 30 per cent in the first two months of the year.

"What we have seen play out is a level of reduction in listings in certain areas that was far greater than any softening we expected," chief operating officer Geoff Lucas said this week.

Not all McGrath's rivals in the area claim to have experienced such declines. But Alison Mifsud of Epping First National said while her agency's sales numbers had remained steady, inquiries had dropped 30 per cent on last year and clearance rates were below 70 per cent.

"McGrath probably just got out in time," Mifsud said, referring to the money he earned in the float.

That view remains popular, even though McGrath retained two thirds of his stake and has bought more shares since. Some investors might have wondered why they should buy just as Mr Real Estate stepped back.

Downturn

The median price for a Sydney home has now fallen below \$1 million.

But JPMorgan analyst Russell Gill said it was too cynical to think McGrath had been simply shoring up cash and hedging risk before a downturn.

"There's nothing worse for him and his brand and his name than to have a share price that keeps getting lower," Gill said.

One bright spot for McGrath is its dominance of the government's \$500 million public housing sale at Millers Point. Rival agencies expect McGrath to win the next tranche of 153 terraces in Millers Point on top of the 48 it has already sold.

The float brokers also point to the cycles of large US real estate companies to suggest a McGrath comeback later in the year.

But they admit overseas comparisons are far from perfect. McGrath, Australia's only listed real estate agent, continues to forge its own path.

"The journey must be the reward," McGrath writes in his self-help book.

Correction: A previous version of this story said Mr McGrath sold half of his stake in the company as part of its float. He in fact sold a third.

This story was found at: <http://www.smh.com.au/business/property/john-mcgrath-horror-week-for-mr-real-estate-four-months-after-float-20160422-goces5.html>