FINANCIAL REVIEW

HD Leighton rises from the ashes

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T he $1.15 **billion Chinese** takeover of the John Holland construction and engineering **group** should grab the attention of Australian investors wanting to ride the infrastructure boom under way here and overseas.

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The first and most obvious parochial point of interest is the impact it has upon the locally listed Leighton Holdings. This was once a pariah stock because of its excessive salaries, poor corporate governance and frankly silly **business** model.

Three separate construction businesses under the Leighton umbrella used to compete with each other for the same pieces of **business**.

However, the Spanish construction **company** that controls Leighton, ACS, is methodically cleaning up the **business** and restoring lustre to its market valuation.

The stock is up 22 per cent since ACS took control and Chanticleer reckons it is no coincidence that the John Holland deal was accompanied by an announcement of a new incentive package for Leighton CEO Marcelino Fernández Verdes.

Never underestimate the power of **equity** and cash incentives to motivate senior management in public companies. Sometimes the incentives can drive bad behaviour but Fernández Verdes has shown a laser-like focus on performance.

Instead of receiving a salary, he will pick up an annual allowance for personal expenditure in Australia of $495,000 a year plus **equity** incentives.

It is the **equity** incentive package that jumps out of the page. He has been granted 1.2 **million** shares and is entitled to a cash payment reflecting the increase in value from a base price of $17.71. The maximum payment of $32.29 tells you he won't get any more cash once the stock hits $50 a share.

The shares vest in March 2016 and are exercisable for three years from that date.

It would be overdoing it to say Leighton is on a roll in Australia. But it has been winning competitive tenders for key infrastructure projects including, in the past week, a new hospital on Sydney's northern beaches.

It is a contrarian bet at the moment given that the majority of analysts have the stock as a sell or an underperform. Goldman Sachs analyst Nathan Reilly is an outlier with a **buy** recommendation an price target of $25.75 according to Bloomberg.

The second aspect of the deal is the attention it draws to the buyer of John Holland, CCCC International Holdings (CCCI). CCCI is the international arm of **China** Communications Construction

Company which is listed on Shanghai and HK exchanges. It is 63 per cent owned by Chinese state-owned enterprise CCCC.

It is significant that an SOE is the first entity to make a large takeover in Australia following the signing of the China Australia Free Trade Agreement.

James Philips, the head of the MinterEllison Mergers and Acquisitions group in Sydney, says the CCCC takeover of John Holland is significant because it marks a shift from purchasing tangible assets in resources and agriculture to investing in Australia's project management and professional engineering skills.

He said the acquisition provided the Chinese with expertise in an industry characterised by complex regulations.

The lawyers involved in the deal were Allens for the Chinese and Freehills for Leighton. Macquarie advised the Chinese while Leighton was advised by Morgan Stanley. The Macquarie connection with CCCC is strong. Last month, Macquarie formed Macquarie Development Capital to invest in infrastructure developments in Latin America. It partnered with CCCC and Banco Modal. CCCC has infrastructure investments around the world including some very large rail projects in Africa in Ethiopia and Kenya.

The CCCI shares listed in Hong Kong have been benefiting from the bull market in Chinese stock over the past two months. While some have described this activity as a bubble, there are strong foundations to the CCCI business model.

One person who has kept a close eye on the fortunes of John Holland is former owner Janet Holmes á Court. She has kept in close contact with John Holland chief executive Glenn Palin.

Holmes a Court says CCCC brings a financial strength and technical expertise to John Holland "that will enable it to continue the impressive growth that it has enjoyed over the last decade."

"When Heytesbury purchased John Holland in the early 1990s, I was excited by the range of projects and the skill and passion with which its employees tackled challenges on a daily basis. In my view, none of this will change with the new ownership."

Wine lovers are suffering from "Penfolds fatigue" according to Deutsche equity analyst Michael Simotas.

Simotas says his industry feedback found consumers and retailers suffering fatigue because of two Penfolds releases in one year. There was a release in the first half of this year.

The 2015 Penfolds release was brought forward to October this year as part of a permanent change in the way the company sells its premier products. Simotas says the October release was based on the "highly anticipated 2012 vintage".

Nevertheless, he downgraded earnings by 5 per cent and maintained his "sell" rating on TWE shares. He reckons they are too expensive given the weak returns and volatility.

Beleaguered oil and gas stock Santos bounced 16¢ higher on Friday to close at $7.16 giving a market cap of $7 billion. The market value of the stock has fallen about $5 billion in the past month as oil prices have crashed.

UBS analysts Nik Burns concluded on Friday that if oil prices stabilise around current levels, Santos could scrape by and not need to raise equity to protect its investment grade credit rating.

"With further downside risk in oil price ahead, the market will likely continue to factor in the risk of a dilutive equity raising into Santos's share price in our view."

He says with most fund managers away in the early part of January, the earliest Santos could realistically look to raise equity would be mid to late January.

A former chief financial officer who tried and failed to make the transition to line management was once famously described by his boss as follows: "He can count it but he can't make it."

However, it would be a mistake to apply that as a generalisation to all the country's highly paid number crunchers.

CFOs who have made it as CEOs include Matt Bekier at Echo Entertainment, Michael Cameron at GPT, Brian Benari at Challenger and Graham Kerr at BHP Billiton's spinoff South32. Other successful transitions were Chip Goodyear at BHP Billiton and Chris Lynch at Transurban.

Mind you, Trevor O'Hoy transitioned from CFO to CEO at Foster's and it all went flat.

The CFO as CEO may get a kick along at Wesfarmers, where Terry Bowen is said to be prime candidate to succeed Richard Goyder, at Telstra, where Andy Penn is in line to replace David Thodey and at BHP Billiton, where Peter Beaven is said to in the running of Andrew Mackenzie's job in a few years time.

Management changes at Qantas on Friday raise the possibility that CFO Gareth Evans is being groomed for the top job. He will now run Qantas International and Freight.

One thing is for sure CEO Alan Joyce has no obvious replacement now that the CEO of Qantas Domestic, Lyell Strambi, has decided to leave.

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