FINANCIAL REVIEW

HD Stockland play smart or $435m of trouble?

BY Tony Boyd

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The fact that the $2.3 billion Australand Property Group is in play has a lot to do with the strategic decisions made by one of the most astute property investors in Asia.

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Stockland owns a 19.9 per cent stake in Australand and is poised to bid for more, thanks to the Singapore-listed CapitaLand taking the view that it has far better growth opportunities in Singapore and China.

There are a couple of messages investors can take from CapitaLand's stance.

The company has an independent board of directors and should not be seen as an arm of Singapore Inc. The property specialist is reminding Australians that we live and work in a low growth market, irrespective of the current boom in residential apartment development. Australia's gross domestic product growth is sub-trend, household debt remains high and there is considerable uncertainty about consumer and business confidence.

CapitaLand is also letting local investors know Australia's real estate investment trusts are ripe for further consolidation. It regards Australand as a sub-optimal real estate play with little opportunity to achieve the sort of growth in China and Singapore.

CapitaLand has collected about $1.3 billion in the past four months by selling its 64 per cent stake in Australand in two tranches, both handled by Citi.

Citi is justifiably pleased with Tuesday's Australand block trade, the largest in Australia since March 2013, when Queensland's government sold down a stake in Aurizon. Citi may have broken the UBS monopoly on block trades but only time will tell.

Mark Steinert at Stockland was happy to buy 115 million shares in Australand at $3.75 even though he could have bought the same stake for $3.68 in December when Citi sold the first chunk offered by CapitaLand.

Steinert's move was not greeted with cheering by fund managers given the company's history of buying stakes in companies at the top of the market and selling them at the bottom. But as a former property industry analyst, Steinert has the respect of fund managers. They trust his analytical skills and think he can extract value for Stockland shareholders.

The end game is not clear but Steinert needs to fill gaps in the Stockland portfolio, the largest of which is in residential apartment development.

One fund manager who has run the numbers on a possible takeover bid by Stockland for Australand says the transaction would be accretive. The bigger question for many will be as follows: where are we in the residential apartment cycle?

If you take the view that the cycle has a long way to run, fuelled by the lowest interest rates in 15 years, then Steinert's move is smart. It can be seen as positive given plenty of investors were willing to **buy** the Australand stock, house prices are up and building approvals are up.

But if you think the cycle is at its peak, then Steinert has just bought about $435 million worth of trouble. This view is held by those who have counted the cranes on **apartment** sites in Melbourne at a time when Victoria's economy is underperforming and set for big hits to its manufacturing sector.

Steinert has talked to his counterpart at Australand, Bob Johnston, but has not given any indication how those discussions went.

Johnston knows that performance is the best defence against attack. Also, having been in the **property** sector for many years, he would also know that sometimes the best thing a chief executive can do is sell the **company** at a premium.

CapitaLand's strategic decision to dump Australand and focus on markets in Asia was driven by the quest for long-term growth. **Property** development in Asia is a highly capital-intensive business for a number of reasons.

In Singapore, land is scarce and whenever new development areas are released all the money must be paid up front. In **China**, land is scarce and expensive near transport hubs and in areas which are attractive for **residential** development.

CapitaLand is 40 per cent owned by Temasek which invests Singapore's retirement savings. The Asian emphasis on long term growth contrasts with the focus of real **estate** investment trust investors in Australia who have been seeking yield. Australand's 6 per cent yield is in excess of the bank debt Stockland borrowed to pay for its stake.

After lagging the world in online shopping for years, David Jones has now recognised its growth will primarily be through the internet. The question investors need to ask is whether its new target of 10 per cent of online sales by 2017 is ambitious enough.

The 2017 target was released on Wednesday with mediocre first-half results that were dragged down by the poor performance of its financial services business, which is transitioning to a less lucrative profit-sharing arrangement with American Express.

To get an idea of how far behind David Jones is when it comes to online shopping you only need compare its target of 10 per cent of online sales by July 2017 with the existing online sales at the Wesfarmers-owned Officeworks of 12 per cent in the year ended June 30.

At Officeworks and other successful online retailers, the internet channel ends up being the single biggest store with the largest range of products.

Officeworks is clearly a different internet proposition to a department store. It is not selling suits, shirts and shoes that may need to be tried on in the store.

But under the leeadership of Mark Ward, Officeworks has transformed its internet offering over the past few years. Success in its internet strategy has involved consistent capital investment and innovation.

Officeworks this year had a back to school special that included buying and delivering all books on the curriculum.

Online shopping at David Jones accounted for about 2.2 per cent of sales in the second quarter of financial 2014 but the exact level of online sales was not disclosed by the **company**.

However, if the **company** maintains that run rate for the full financial year, its online sales this year will be about $40 million out of total sales of about $2 billion.

David Jones only got serious about the internet in November 2012.That explains why the second-quarter sales released on Wednesday provide the first snapshot of a previous corresponding period.

The year-on-year growth in online sales was about 150 per cent.

But the more interesting numbers are in relation to the composition of like-for-like sales across the whole **company**. Like-for-like sales rose 1.1 per cent with store sales rising 0.2 per cent and online sales gaining 0.9 per cent.

New stores contributed 2.5 per cent sales growth taking the total sales rise to 3.6 per cent for the half year.

Online shopping is of great strategic importance to David Jones because the experience at department stores overseas such as Nordstrom and John Lewis shows a customer who shops both in store and online spends four to six times more than a customer who shops through a single channel.

Nordstrom, which is regarded as a market leader, has internet sales of about 10 per cent but that is no reason for David Jones to issue a less ambitious online sales target.

Analysis of online shopping trends and the new internet target will undoubtedly form a key part of the strategic analysis conducted by Port Jackson Partners which has been employed by the **board** to review the value of synergies from a merger between David Jones and Myer Holdings.

The shifting of the duties and responsibilities of Assistant Treasurer Arthur Sinodinos to Finance Minister Mathias Cormann should ensure the reforms to the Future of Financial Advice are shepherded through parliament without a hiccup.

Whether the reforms, which were tabled on Wednesday, get through parliament is another matter. But at least Cormann has a better understanding of the changes than anyone else in parliament apart from Sinodinos.

tony.boyd@afr.com.au Twitter @TonyBoydAFR

Tony Boyd

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