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HD **Store wars: a new hope for merger between Myer and David Jones?**

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Would a Myer-David Jones merger rescue the ailing department store giants, or is their model too antiquated to be saved?

David Jones and Myer are already shaping up as the business story of 2014. Two of Australia's most venerable companies are mired in a clumsy debacle that has left their 20,000 employees in limbo, with both CEOs departing, and a $3 **billion** merger proposal—somehow alive and dead, unthinkable and inevitable—swinging in the breeze.

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David Jones chairman Peter Mason's decision to approve share purchases by two of his directors—a day after receiving Myer's undisclosed merger proposal, and three days before release of a market-sensitive sales update they were privy to—has gone beyond a dry governance debate about appropriate share trading windows for directors. The Australian Securities and Investments Commission did a two-month investigation into allegations of insider trading and came up with insufficient evidence, surprising most commentators, and today's explanation in The Australian Financial Review by ASIC commissioner John Price raises more questions than it answers.

But if the regulator won't act to take on the big fish, even under pressure from a looming Senate inquiry that is likely to be hostile, it will be up to angry shareholders to exercise their rights. That means rolling the David Jones board—either by requisitioning an extraordinary general meeting or by voting down the remuneration report at the next annual general meeting.

Meanwhile, there is a merger proposal up for discussion, and it is a curious one. Myer chief Bernie Brookes told The Australian the merger was "dead and buried" after David Jones' initial rejection, but shareholders will have the final say on that.

If combined, David Jones and Myer would have a total monopoly over the department store sector (which excludes discount stores Kmart, Target and Big W). The question for the Australian Competition and Consumer Commission is to decide whether department stores compete solely against each other, or whether they compete against other retailers too. It is difficult to anticipate what stance the competition regulator will take—so far the ACCC has simply confirmed it was consulted by Myer last year and will review any forthcoming proposal—and the experience of Metcash and Franklins shows there can be hurdles around the competitive impact at the wholesale level. Myer's proposal asserted a merger with David Jones would be "pro-competition".

Most investors agree it would be hard for the ACCC to argue department stores do not compete with other retailers: the overwhelming evidence is in their declining market share. ABS figures lump the two department and discount department stores together but are broadly indicative of the long-term trend: over the last 30 years the department store share of national retail turnover has halved from 14% to 7%. Similarly, Citi analysis showed DJs and Myer's share of non-food retailing has fallen by a third in the last 15 years, to just over 6.5%.

This is due partly to fragmentation in the retail market—with the entry of more foreign retailers and the advent of online retail—and partly due to the massive increase in shopping centre floor space developed for smaller, specialty retailers over the years.

Either way, the market share of the traditional department store is too small nowadays to sustain two operators, especially when both retailers are five to 10 years off the pace with online sales—witness

Myer's website meltdown over Christmas—and are playing expensive catch-up. Listed property fund manager Andrew Parsons, founder of Resolution Capital, says our department stores have become easy targets for retailers like Zara and Topshop—once-foreign, now here—and are also having to compete with retailers that haven't even set up here like US department store Nordstrom and UK department store John Lewis which get up to 25% of their sales online. By comparison Myer gets just 1% and David Jones get almost 2% of sales online, and have to fund construction of websites that will only appeal to 23 **million** Australians.

David Jones was launched in Sydney in 1838, listed in 1920. Myer was launched in Bendigo in 1900 and, after 20 years as part of Coles Myer, was bought by private **equity** group TPG for $1.4 **billion** in 2006 and floated three years later. Myer and David Jones have competed vigorously, with a healthy dose of old-school Melbourne-Sydney rivalry thrown in, but they may have to cast history aside and combine to survive from now on. Despite Myer's stated commitments, there is widespread scepticism that a merged entity could sustain both brands—a high and low nameplate like the upmarket Bloomingdale's, owned and operated by the mid-market Macy's in the US—particularly if streamlining head- and back-office functions fails to generate the touted $85 **million** in synergies, as most expect.

Myer's merger document seems to want it both ways: it talks about growing both businesses as an "omni-channel platform with two virtual experiences", while canvassing further store optimisation, rationalisation and consolidation; it promises separate teams working on merchandise procurement and store **operations** behind **Chinese** walls while saying the merger would aim to create a single end-to-end supply chain.

Retail consultant Michael Baker expects a merger would **lead** naturally to common buying and it would get harder and harder to maintain and justify separate store identities, as it did after Myer's **acquisition** of Grace Bros in 1983. The logical step would be to remove duplication of stores, especially where both are in the same shopping centre. Myer has 67 stores nationally and DJs 38.

Crikey's analysis found 17 shopping centres containing both Myer and DJs. Of those, at least four massive malls—Chadstone and Highpoint in Melbourne, plus Westfields at Sydney's Bondi Junction and Parramatta—are probably big enough to sustain both stores. That leaves more than a dozen facing possible closure or consolidation. Eight are Westfields: at Hornsby, Miranda, and Warringah Mall in Sydney; at Southland and Doncaster in Melbourne, plus Chermside and Carindale in Brisbane and Marion in Adelaide. They are not doing well: Westfield figures show sales at the two department stores are off 10% over the last five years, which is double the actual fall in combined sales at DJs and Myer. The others malls with both DJs and Myer are QIC's Robina Town Centre in Queensland, Castle Towers in Sydney, and the Canberra Centre, and AMP's Garden City and Karrinyup in WA.

Consolidation would not be sudden—the stores are on long-term leases, and there are stiff penalties for tenants who try to get out early—but it presents a challenge for employees, shareholders, suppliers and landlords, all left to rack up the losses and missed opportunities. Over the last five years both sales and profits have gone roughly nowhere. At Myer sales were $3.26 **billion** in the 2009 financial year and $3.14 **billion** in the 2013 financial year, while net profits after tax (NPAT) have gone from $109 **million** to $127 **million** in the same period. At David Jones, sales were $1.99 **billion** in the 2009 financial year and $1.85 **million** in the 2013 financial year, while NPAT has fallen from $157 **million** to $102 **million**.

A read through the Myer 2009 prospectus is instructive. I might have missed something, but I couldn't find any mention of online retail at all. The then national footprint of 65 stores was to expand to 80 within five years (er, that's now), and there was supposed to be long-term potential for growth to 100 stores. The reality has been completely different. In round figures, the float raised some $2.2 **billion** at $4.10 a share—more than $1.7 **billion** of which went to TPG, which additionally made a handsome profit selling off Myer's Melbourne CBD property. Myer shares never traded above their issue price and are now trading at $2.40, worth just $1.3 **billion**, and after some $432 **million** in dividends have been paid, roughly $470 **million** or almost half a **billion** dollars has gone up in smoke.

David Jones is in a better position—in particular it has less debt and still has its landmark CBD properties on the books, worth up to $1 **billion** after redevelopment. It is understandable shareholders will want a premium to **merge** with Myer. But the imperative is clear.

This story has a long way to run.

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