stuff.co.nz

Kirks' days may be numbered

'CHALKIE' Last updated 05:00 09/11/2011

It is no coincidence that those two veteran investment knights of the realm Sirs Ron Brierley and Selwyn Cushing have both ended up prominently positioned on the share register of Wellington institution Kirkcaldie & Stains.

Cushing and his son David hold 17.1 per cent of the company. Brierley has 5.7 per cent. The two knights, ex-Brierley Investments colleagues, may have noticed that Kirkcaldies runs a department store, but Chalkie reckons only in a peripheral way. Mere details. What lured them was the indefinable scent that has been driving them both for years – the whiff of undervalued assets.

Kirkcaldies has existed since 1863. It is inextricably linked with Christmas shopping for Wellingtonians in the way that Smith & Caughey's is for Aucklanders and Ballantynes for those in Christchurch.

But Kirkcaldies has seen better days. In the year till August it slumped to a $54,000 pre-tax loss compared with a $1.37million pre-tax profit the year before.

In its current form the company has been listed on NZX since 2001 and has more than 1300 shareholders. Because of various restructurings and redevelopments, Kirkcaldies has not actually owned the building that bears its name in Lambton Quay for many years.

Seeing this as a weakness, the company in 2001 bought the adjacent Harbour City Centre retail building for $29m.

This allowed more space for the department store to expand and provided a source of rental income – $4m to $5m a year – to back up the retail arm. The strategy has worked. The rental income has been strong and has helped support the whole business.

The company decided not to treat the building as an investment property, but instead value it as a fixed asset. Kirkcaldies' 2011 financial accounts valued the building at $23.26m. However, directors cited independent valuations suggesting that once current earthquake strengthening and refurbishment of the building was completed, it would have a market value of $48.65m.

So, to put this into language that Brierley and Cushing most definitely understand, there is $25.4m of hidden value not currently recognised in Kirkcaldies' accounts.

Kirkcaldies' official stated net tangible assets per share figure – theoretically what shareholders would each get if the company cashed up all its assets – is $1.81.

But that "hidden" $25.4m of property value alone equates to $2.48 for each of the 10.25m Kirkcaldies shares on issue. Add that to the stated net tangible assets value and you have a potential actual value of $4.29 per share – compared with a current share price of just $2.72.

Did someone say undervalued assets?

What is likely to happen next seems fairly obvious. The two sirs will almost certainly campaign to "unlock the value" of that property investment.

Chalkie reckons Kirkcaldies has seen this one coming for a while. The Cushing family started buying Kirkcaldies shares in 2004 – though the buying has really stepped up in the past two years.

A glance at previous Kirkcaldies annual reports suggests that Brierley has probably had a significant slice of the company since at least 2006. He only breached the 5 per cent public disclosure level in September this year. In the event the first public call to do something about unleashing the unrealised value in the property actually came from another Kirkcaldies investor, Elevation Capital, earlier this year.

Kirkcaldies to date has been non-committal. Chairman Falcon Clouston told BusinessDay in September that no decision had been made. However, work was going on within the company that would make a splitting out of the property easier. "I'm not saying we're breaking the company up, but we're really tidying everything up," he said.

The biggest shareholder in Kirkcaldies is a company called LQ Investments. It bought its 19.4 per cent stake for $5.8m in 2006. Chalkie does wonder if this acquisition was a defensive move encouraged by Kirkcaldies, aware even then of the looming presence of the Cushings and Brierley.

Among those involved in LQ are Marc Lindale, Brian Fitzgerald and Graham Jackson. In 2006 all of them were senior executives for the now collapsed Strategic Finance group. What their attitude to a sale or separation of the property interest would be is not clear, though given that their stake is currently worth about $350,000 less than they paid for it, they may too now be of a view that getting direct value out of the property investment is the way to go.

Chalkie reckons Kirkcaldies will be under pressure to put forward measures at its next annual meeting, probably in February, to either propose a splitting of the company or a sale of the property. If the company doesn't itself propose this then your columnist reckons Brierley and the Cushings themselves will push for it. If the board is not responsive, it is probable the two sirs could muster enough voting support to get control of the board and push through their plans anyway.

Your columnist reckons that Brierley and the Cushings would probably favour a straight-out sale of the property followed by a – presumably hefty – capital return to shareholders. Then they would presumably take their leave. Chalkie reckons the Cushings alone, having paid about $4.6m for their stake, could easily reap a profit of $3m to $4m. But what would happen to Kirkcaldies after the property is divested?

Its retail business is faced with diminishing returns. Ten years ago the store had annual turnover of $35.4m. If you inflation-adjust the 2001 revenue figure it should have translated to sales of about $46.4m a decade on. But actual sales in 2011 were just $35.9m.

In 2001 the retail arm had after-tax earnings of $2.1m. This year there was a $465,000 loss. Over the same period dividends have plummeted from 35c a share to just 5.5c a share. The gross yield for shareholders has dropped from around 7 per cent to about 2 per cent.

The 2001 decision of Kirkcaldies to buy the Harbour City Centre was a prescient one. Owning the building has insulated the whole Kirkcaldie business. But without the property?

Chalkie reckons there might be a broader issue here that goes beyond Kirkcaldies.

Has commercial logic now reached a point where every business is simply seen as something to be broken up and the profits from that process pocketed? If so, is that how the country as a whole will ultimately grow?

Surely there is room to accept that a company might not make as much money short term running an ongoing department store business as it can flogging its commercial property – but just maybe that is OK sometimes. Maybe a business doesn't always have to go down the path that simply puts a short-term bulge in shareholders' wallets. Perhaps there is room for longer-term objectives. The Kirkcaldies shareholders will do what they feel they have to do. But unless surplus money is left in the company after any sale of the property – and frankly it is hard to imagine Brierley and Cushing agreeing to that – then Kirkcaldies department store may soon find itself right up against the tide.

Perhaps it could be sold as a going concern and become part of another retailing group, retaining the name and appearance of a stand-alone business.

But Chalkie reckons once the property assets are sold then the days of Kirkcaldies might actually be numbered. Some people are likely to get even richer along the way. Wellington and the country as a whole could be poorer.

- David Hargreaves is a former Fairfax business reporter and columnist now writing freelance. Chalkie's name is derived from the people who used to "chalk" up the share prices on trading floors before the market went electronic.