Wesfarmers shareholders wait for return on takeover

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Wesfarmers' $20 billion purchase of the Coles group is Australia's biggest takeover but may not be giving value to shareholders.

Transcript

TICKY FULLERTON, PRESENTER: Academic studies consistently show that about 80 per cent of takeovers add no value to shareholders of the acquiring company.

With that in mind, Lateline Business has been investigating Australia's biggest takeover, which is Wesfarmers' $20 billion purchase of the Coles Group in November 2007.

While there's no doubt Coles is in much better shape now than it was four years ago, can Wesfarmers shareholders make the same claim? Andrew Robertson reports.

ANDREW ROBERTSON, REPORTER: It was a transforming moment for Wesfarmers as it paid more than $22 billion for an iconic retail conglomerate which had been allowed to fall into disarray. And like all takeover victors, Wesfarmers boss Richard Goyder trumpeted it as a victory for shareholders.

RICHARD GOYDER, WESFARMERS (Nov. 7, 2007): A really terrific opportunity to create value for our shareholders and all stakeholders in the years ahead.

ANDREW ROBERTSON: But while Coles' latest sales figures confirm it's emerging from the dark days of its previous management, Wesfarmers shareholders are still waiting for that value.

MICHAEL PETERS, UNSW: The true value they got out of that takeover is more or less that they got back what they would've got if they had invested it in bank pools, for instance.

ANDREW ROBERTSON: A reference to Wesfarmers' return on equity. In 2007 Wesfarmers was earning 25 per cent on its shareholders' funds. In 2010 that figure had plummeted to 6.4 per cent, which Michael Peters points out is not really equivalent to the return on a bank bill because of the risks involved for Wesfarmers shareholders.

MICHAEL PETERS: A different culture, different organisations, different logistics coming into Wesfarmers' predominantly agricultural, mining, hardware diversified company. So realistically, the return should've been substantially higher to justify that particular risk.

ANDREW ROBERTSON: Just months after Wesfarmers completed the purchase of Coles, the global financial crisis began to bite and the company was forced into two capital raisings. Dividends per share were cut and today its share price is significantly lower than 2007.

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ROGER MONTGOMERY, MONTGOMERY INVESTMENT MGMT: If you were an owner in the business in 2007, the company was earning about $700-odd million, $750 million profit. Today it earns $1.6 billion profit. However, back in 2007 if you owned that business, you'd only injected about $3.5 billion into the company to keep it running. Since then you've put in another $20 billion to generate that additional $20 billion of profit, not even that $800 million profit, you've injected another $20 billion of your money. So I would argue that you're getting now a return that's less than what you can get in a term deposit and therefore you're worse off.

ANDREW ROBERTSON: Not surprisingly, Richard Goyder has a different view. He points to total shareholder return, which is capital gains plus dividends. In Wesfarmers' case, it also includes the two rights issues since the Coles takeover.

RICHARD GOYDER: I think every five shares you had, you got to buy two or three at $13.50. And so that plus the dividends gives you over your portfolio a fairly significant capital appreciation, compared to the market.

ANDREW ROBERTSON: The Wesfarmers rights issues were heavily subscribed and for a typical shareholder who took up 100 per cent of their allocation, their total return is nearly eight per cent since the Coles takeover. Since the crash of Lehman Brothers in September 2008, the total return is 21 per cent, with both figures being well ahead of the market.

Fund manager Scott Maddock from 2MG Asset Management agrees with Richard Goyder's view that the Coles takeover has been good for Wesfarmers shareholders.

SCOTT MADDOCK, 2MG ASSET MANAGEMENT: While the share price itself is down, you also have more shares, there was more capital put in the company. So, really the measure is: did the capital which went in get a return? And I think it is on target to actually get that return.

ANDREW ROBERTSON: Scott Maddock says Wesfarmers shareholders need to be patient. He believes the value from the Coles purchase will come, but it will take time, possibly another two years.

SCOTT MADDOCK: The bank won't grow your money. You can compound it, sure. But Wesfarmers has a long history of taking that money and getting 12 and 13 and 14 and in particular businesses 20 and 30 per cent. I'm prepared to bet with the management on this one.

ANDREW ROBERTSON: Scott Maddock does concede though that because Wesfarmers is now predominantly a retail business, it's heavily exposed to consumer sentiment and spending, which at the moment is depressed.

Roger Montgomery points that in the long run, share prices tend to follow a company's value. He expects Wesfarmers shares to eventually halve in price if it can't significantly lift its return on equity.