REPORT ON DAVID JONES LIMITED.

By P.D. Thomas and M. Wilson

(This is a summary of the Report to Members prepared by Messrs. Thomas and Wilson as a Work Party and discussed at a meeting of the New South Wales Branch on 26 August 1970. Questions posed by the Work Party were discussed by the Chairman and Executives of the Company at a further Branch meeting on 4 November 1970. The full report and discussions are necessarily confidential but the Company has kindly agreed to the publication of this summary.)

A. Management

The competitive nature of the retailing industry and the fine profit margins evident demand top managerial talent to operate a retail group. In particular, the following require exceptional skills:-

(1) Store Location

Here, David Jones' recently formed planning group prepares recommendations to the board on the strategic and tactical locations of new retail outlets. The criteria used include "population growth and anticipated future growth, the income levels of the area concerned, existing and potential competition, estimated returns on investment, the cost of the real estate concerned and its anticipated appreciation in value, the motor car population of the primary and secondary trade areas, the anticipated period in which break-even turnover would be achieved, and the distance of the proposed site from any of the company's major stores and so on".

Whether these criteria were applied fully to some of David Jones' earlier developments is a matter for conjecture.

(2) Methods of Financing the Expansion

In the past, the industry financing methods have been rather conservative with equity finance being the main source of funds in most cases, although Woolworths has led the field in the use of fixed interest finance. Sale and lease back financing methods are being increasingly used and higher gearing can be expected in the seventies.

(3) Picking the Trend

Trying to guess the length of skirts next year would be hard enough for the best of security analysts, but for retailers there's big money involved. Fashion trends, tastes and fads are all part of attracting the elusive customer to buy your goods.

In another area, it is equally important to anticipate trends towards discount selling such as those Coles' K Mart and Myers' Target stores are establishing in suburban areas. On this matter, David Jones told the workparty:-

> "The development of discount stores will affect the percentage of consumer expenditure currently being won by traditional retailers. We doubt if they will have any substantial effect on profit margins. We feel that the development of exclusive merchandise, and merchandise of the boutique variety will more than counteract the effect of the discount stores".

> "The two main avenues open (to David Jones) to protect sales and profit margins against discount selling is firstly, exclusive merchandise and secondly, the quality of the merchandise offered."
>
> "Basically, we see two major developments in selling methods in the next ten years - firstly, the low margin discount store and secondly, self-service".

There appears no doubt that the pattern of the last decade will continue into the seventies - that is the larger aggressive retailers growing even larger at the expense of the smaller inefficient industry members.

Amongst the major retailers the retention or otherwise of their comparative position will depend on management's ability to read trends ranging from population growth to fashion designs.

B. THE COMPANY

The Company's Philosophies and Policies

In assessing past performance and future development, it is appropriate to consider the company's comments to us on a variety of policy matters. Comments made were:-

(a) Sales and Advertising Policy

"Basically, the company's advertising and sales promotion campaigns are directed towards the whole of the population, although the upper and middle brackets of income earners receive greater attention than the lower end of the market. As the proportion of the population under thirty increases relative to the total, we obviously concentrate more on younger fashions rather than on older fashions. However, we do maintain a healthy balance between all age groups."

(b) Competition

"If we are to maintain our existing share of retail consumer expenditure we will most certainly be forced to move into more service industries and this is currently being planned."

(c) Future Industry Development

"The anticipated population of Sydney by the year 2000 will exceed 5 million. Obviously, the existing shopping facilities will be inadequate to service this huge increase in population and it is inevitable that new centres will be opened during this period."

(d) General Philosophy

"The general philosophy of David Jones is based on a high level of service, concentrating on the upper and middle income sections of the population," we were told.

"As a department store catering to the predominantly upper and middle income groups of the economy, it would be correct to say that the main competitive advantage we currently enjoy and will undoubtedly continue to enjoy is in the fact that we give our customers a far better standard of service than any of our rivals. To become too carried away with the concept of self-service, would amount to dissipating our principal competitive advantage. We will have to decide which areas of our business should concentrate on self-service and which sections should concentrate on maximum service."

It does appear that the company will continue to follow its existing policy of concentrating on the middle to upper income brackets and relying on a higher degree of "service" to expand sales.

ACTIVITIES

David Jones operates some 22 stores, which may be summarized as follows:

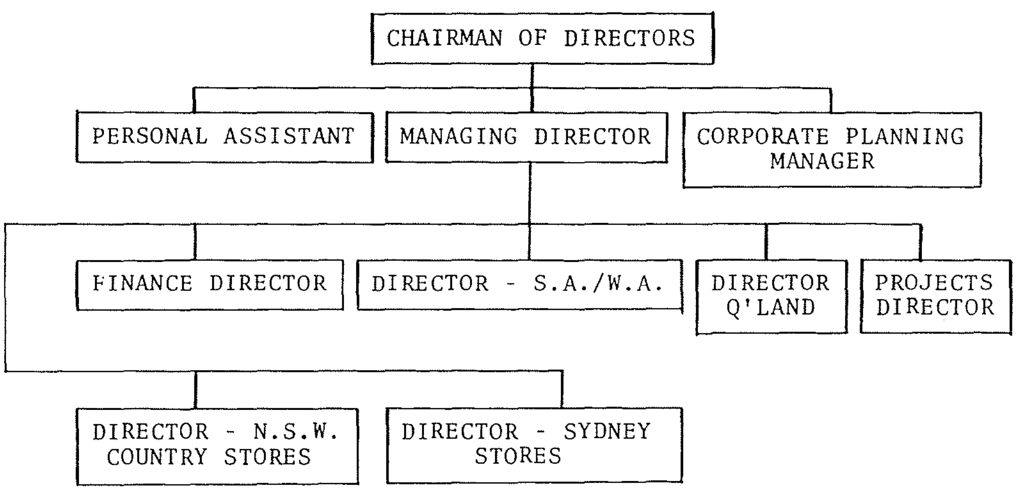
State	Floor Area	Contribution to Turnover
N.S.W.	1,690,000 sq.ft.	58%
A.C.T.	125,000 "	5%
Queensland	745,000 "	15%
South Australia	375,000 "	13%
Western Australia	370,000 "	9%

The most notable gap in State representation is Victoria and in this regard the company commented to us:-

> "There is no historic reason for the Company's lack of representation in Victoria. Its main reason is that in recent years the capital cost of acquiring or developing a store in Melbourne has been too expensive. This is particularly so at present as the value of real estate appreciates so rapidly.
>
> "As regards the Company's plans for entering the Victorian market, this is constantly in our minds. We regard ourselves as a national organization and yet we are not represented in either Victoria or Tasmania. Naturally we would like to be represented in both these States, provided that the return on investment meets the Company's basic requirements. To date, this has not been possible."

1. Senior Management Structure

Following a recent survey by Management Consultants, W.D. Scott & Company, Senior Management structure has been re-organized. The changes have been implemented over the past 12 months and further changes at more junior levels will gradually be implemented over a period. The structure is now:-



A group of Store Managers reports to the four regional merchandising directors listed above. Functional subordinates report to the Finance and Projects Directors.

The senior Executives of the Company are a mixture of those who have come up through the ranks and those who have been recruited from outside the organization, e.g. the undermentioned have been recruited from outside the Company:-

D. McHolick, M.A. - Sales Promotion Manager, was recruited from the Macey Organization in San Francisco. D.P. Hobbs, B.A., B.Ec., - Corporate Planning Manager was recruited from a textile manufacturer. L. Jewson - Operations Manager, is retired Lieutenant-Colonel from the Australian Army, specializing in Supply, N. Oastler - Advertising Manager, previously Advertising Manager in F.J. Palmer Limited, M.R. Hartley - Manager, Market Street Store and Senior Merchandising Manager Hardwares, was recruited from the H.G. Palmer Organization.

The individual managers of stores set their objectives in conjunction with Head Office executives and are required to work within general policies set by Head Office. However, each store manager enjoys almost complete autonomy within this general framework. This includes authority for the purchasing of stock required for the particular store together with the recruitment of staff and general management of the store.

2. Staff Training

The Company has a series of training schemes which are currently being revised and substantially extended. There are programmes for four levels of management from the initial indoctrination through to the top management level. In addition to this there are also junior executive training courses lasting one year and senior executive training courses lasting three years, which are conducted quite separately from the general courses and are specialized programmes for promising members of the staff - giving them an opportunity to receive a well rounded education in retailing.

The company is also developing courses on specialized activities within the organization, covering the requirements of individual departments.

3. Staff Incentives

A stock option scheme exists for the benefit of senior executives. The options do not have any connection with the existing employees shares which are available to any employee after 5 years service with the Company. The executives and buyers throughout the organization receive an annual bonus based on their performance during the previous year and at a lower level the sales staff are paid incentive payments based on their sales effort.

4. Staff Numbers

The company employs 12,200 permanent and casual staff throughout Australia. The male/female distribution is approximately 35/65.

PERFORMANCE

The company does not earn at a particularly high rate on shareholders' funds - the relative earning rate on shareholders' funds over the last 5 years has moved 7.36%, 8.42%, 7.83%, 7.14%, 7.24%, 7.77%. Net return on total assets amounted to 5.73% in 1968/9. This compares with the other retailers:-

Grace Bros.	4.93
Myers	6.15
Waltons	6.42
Coles	5.83
Woolworths	5.65

This ratio can of course, be affected by the degree of conservatism used in valuing assets, and the degree of use of leasehold rather than wholly owned property.

Shareholders' interest is quite high (66% of tangible assets) and until the recent debenture issue there has been little evidence of any gearing up in the last few years, with the long term debt/shareholders' funds ratio remaining reasonably steady.

It is clear that the company could have expanded at a faster rate in the past 5 years if it had desired - in fact an examination of its five major competitors indicates that each of them increased tangible assets by more than 55% in this period compared with David Jones' 20%, and each of them with the exception of Coles, had a greater overall profit growth rate than David Jones. This does not necessarily indicate a better performance in either earnings per share or market terms.

CURRENT AND FUTURE DEVELOPMENT

The group is now concentrating on its concept of "Garden City" shopping centres. Although the functional purpose of these centres is no different from that of any other major regional shopping complex, management is attempting to introduce more aesthetic qualities to the centres' environment - particularly in external surrounds. The rationale behind this move is the wish to provide more attractive surroundings in which the type of customer they wish to attract (middle/upper income) will shop. Current and planned developments include:-

(a) Garden City - Mt. Gravatt, Queensland

Situated on 25 acres at Mt. Gravatt, a suburb about 8 miles from Brisbane. Commenced October 1967 - opening date 30/9/70. Cost approximately $8 million.

This is David Jones' first fully owned and financed regional shopping centre. Apart from the 170,000 sq.ft. David Jones store in the centre, a rival Queensland retailer, McDonnell & East, will be represented. The third major tenant will be a Woolworths Supermarket, with about 50 other shops making up the complex.

Financing costs will probably rise in the 1969/70 year and 1969/70 and 1970/71 could be affected by pre-opening expenses. Profits should begin to flow through in the 1970/71 year and be fully reflected in the 1971/72 results.

(b) Garden City - Booragoon, Perth

A $7 million shopping centre complex is planned for completion in late 1972/early 1973. The centre will cover about 24 acres of a 40 acre site with the balance reserved for a civic centre, high rise residential development, an hotel and two service stations. The actual Garden City was originally intended to cover about 250,000 square feet with the company occupying 120,000 square feet. The centre will also house another major retailer, a supermarket and 40/50 smaller shops. We understand from the company that the centre will now be larger than originally intended.

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As with Mt. Gravatt, the company will be both owner and major tenant.

(c) St. Ives, Sydney

The company had planned to establish a "Garden Centre" at St. Ives but met strong opposition from the Kuringai Municipal Council, who refused the company's application. The company jointly with R.D.C. Holdings Ltd. now plans to lodge an application to extend the existing shopping centre presently owned by R.D.C. through its wholly owned subsidiary, Suburban Centres Pty. Ltd. David Jones will purchase a half interest in Suburban Centres and has been allotted 200,000 shares in the parent company, R.D.C., at a cost of $340,000. The planned extensions are expected to cost $12 million.

Other Development Plans

(i) Additions to Market Street store.
(ii) Redevelopment of St. George's Terrace/Hay Street store in Perth.
(iii) Discussions with Development Finance Corporation Ltd. re the redevelopment of city properties.

Financing Methods

Overall, it appears the company has forward commitments for:-

Mt. Gravatt	$8 m.
Booragoon	$7 m.
St. Ives	$6 m.*
Other Development Plans, say	$5 m.

* may be raised through Suburban Centres Pty. Ltd. rather than D.J.'s.

with redevelopment of city properties still being an unknown quantity - however, it does appear that the company will need to find at least $25/30 million over the next 5 years for developments which have been made public. It appears highly likely that the company has further plans which have not yet been made public.

The recent debenture issue raised some $5 m., the sale of Ryde land following abortive attempts to establish a shopping centre there should assist, while retained profits provide some $2 - 2.5 million a year. Even so, the company will need to either increase outside borrowings or call on shareholders to complete current expansion plans. Scope still exists to gear up to present capital if the company so desires.

To date, the company does not appear to have used the sale/lease back principle to any great extent and it may not do so while it still has margin to finance new developments on a wholly owned basis.

The company expressed no particular preference for any one method of finance, but would be prepared to use any, or all of, equity, debenture, mortgage or sale/lease back, depending on the circumstances at the time. With the exception of an equity issue the company says it has used all of these methods in varying degrees, to finance recent expansion. We were advised that the company is endeavouring to raise its earning rate substantially before making any further equity issues.

SALES

The sale of men's and women's wear is still the most important sector to the group. The "Homewares" group is the section showing the fastest growth and this is expected to continue. Of the various groups of merchandise sold, hardware is of the least importance.

The company does not publish sales figures, nor has any indication of annual sales growth been regularly given. However, the company did advise us that it did not match the usual U.S.A. experience of sales of $70/80 per square foot, but on average would be some 10% - 20% below this. On this basis, assuming floor area 3.135 m. sq.ft. (ex Mt. Gravatt) and sales per foot running between $56 and $72, estimated sales are $175 m. - $225 m.

In the last two interim reports the company has given an indication of sales growth in the first seven months of each year, i.e. 6.4% and 5.5%. Earlier statements suggest that sales growth was probably 7% in 1966/67. On this slim information we hazard a guess that annual sales growth has been running at between 5% p.a. and 8% p.a. In 1961 sales amounted to $86 million. The physical growth in the early 1960's probably led to higher sales growth than has recently applied, so we favour an estimated average growth in sales of 8% p.a. which implies a sales figure in the vicinity of $170 m. Had we used 9%, the figure would have been $187 m.

All we can say is that to the best of our knowledge, sales are between $170 - $200 m.

Comparable figures for other retailers are:-

	Sales	Growth Rate
Myers	$381 m.	(+12% p.a.)
Coles	$346 m.	(+8½% p.a.)
Woolworths	$462 m.	(+14% p.a.)

In the past decade overall Australian retail sales have had an average compound growth of 6% p.a.

Seven of David Jones stores are situated in central city areas and these stores probably account for at least half the company's present turnover. With the possible exception of Myers, the company has a deeper involvement with central city stores than any of its major competitors. Management does not consider this either an advantage or a disadvantage, but in view of the workparty this involvement may well have been a contributing factor to moderate sales growth in recent years, although management states that the stores have performed extremely well. The development of projects like "Centrepoint" should give the company's Sydney sales a boost in future as its completion will significantly increase the office population in the immediate vicinity of two of the company's stores.

If we assume sales of say $170 m. in David Jones case, then net profit per $1 of sales amounts to 3.20 cents compared with Myers 3.90 cents, Woolworths 2.00 cents and Coles 2.80 cents.

David Jones' estimated sales growth of 5-8% p.a. was achieved in a period when tangible asset growth averaged 10% p.a. Myers sales grew 12% p.a. on a tangible asset growth also of around 10% p.a. This suggests that Myers new projects have been comparatively more successful or at least have contributed to sales quicker than those of David Jones.

As stated earlier, David Jones have forward development commitments of at least $25-30 million. This will probably be necessary to support sales growth of 6-8%. In view of the continued physical expansion of Myers, Grace Bros., Coles and Woolworths, it does seem that development expenditure of at least this order will be necessary for the company to maintain its relative sales position in the industry.

COSTS

Some 65% of the company's work force are female. The equal pay decisions have not had any great effect on the organization's wage structure to date, as the company was already required to pay male rates to females in several of the areas affected by the changes. As to the future, the company advises:-

> "It is difficult to say what effect future changes are likely to have as there is no way of judging which particular occupation will be affected by the changes. However, it would probably be correct to say that if equal pay rates apply to all employees irrespective of their function, then over a period of time the wage cost structure could rise substantially."

The question of shopping hours is presently in a state of flux, with the unions 'for' and the Retailer Traders' Association 'against'. If a change in shopping hours does come, it could add significantly to the cost structure of all retailers.

The company currently leases an N.C.P. computer on which it presently has a sales analysis and the stock register. The company's payroll will shortly be handled by the computer and other proposed applications include budget records, stock control, accounts payable, accounts receivable and market research. Management considers that not only will considerable administrative cost savings eventuate, but the wealth of information stored will make analytical techniques and merchandising activities more effective.

The lower "sales per employee" ratio (David Jones estimate $13,900, Woolworths $16,900) suggests that rising wage costs would have a greater effect on David Jones than on some of its major competitors. This is one of the penalties the company must pay for its policy of providing a high degree of service.

COMPETITION

The need to maintain and increase sales in city areas is one of the company's major challenges and in the clothing area it must also compete with the rash of boutiques and "In Shops" which have sprung up in an effort to trap the affluent young consumer's dollar, as well as aggressive men's wear specialists. This atmosphere is not conducive to the maintenance of profit margins by the large retailer faced with higher overheads including the maintenance of expensive freeholds. That the company is aware of these problems is clear from the recent statement regarding examination of redeveloping some of its store sites.

In suburban areas the increasing number of major shopping centres being built and the move by some of the larger retailers into discount retailing, is bringing increasing pressures on all retailers. The combined effects of costs and competition make it imperative for retailers to either increase sales or move into areas where pressures on margins are not so severe. It appears that David Jones are tackling the problem two ways - first, by possible redevelopment of city sites to provide a higher return on assets than that available from pure retailing and secondly, by retaining ownership of suburban centres developed to provide rental returns. In addition, we may see moves into service activities similar to the selling of insurance.

The company's policy of concentrating on "quality and service" for the middle and upper income brackets does of course separate it somewhat from the cut-throat competition of the chain stores aiming at the mass market. At the same time, however, this policy must reduce the number of potential customers.

TOTAL PROFIT GROWTH

The company's planned development should enable sales growth of at least 6-8% - it could be higher if new developments are well sited and existing centres such as Bankstown continue their recent favourable trend. Margins on pure retailing may become finer due to increased competition and costs, but countering this should be an increasing cash flow from rentals as the company moves further into the property owning field.

Overall, it seems likely that the company should do at least as well in terms of total profit growth as it has in the past - and over the last 10 years total net profit growth has averaged 8½% p.a. and over the last 5 years 5½% p.a.

EARNINGS PER SHARE GROWTH

One of the company's advantages over its competitors is its internal financial strength and its comparatively low gearing which provides it with a margin to increase external borrowing without calls on shareholders. The company has not had a public issue for some years and while a share issue may play a part in the next five years expansion, it will probably be later rather than sooner.

We asked the company whether 8% p.a. was a reasonable estimate of future earnings per share growth and the reply received was:-

> "8% per annum over the next 5 years would be a reasonable estimate of our earnings growth although this may be a trifle conservative. It is probably that this will be fairly correct up to 1972 and 1973 but after that we anticipate that the growth earnings will start to accelerate as the return from new developments start to pay off."

Subsequent to the foregoing report, the Society was pleased to have senior personnel from David Jones at a meeting in November 1970 to discuss the report.

Present from David Jones were Mr. Charles Lloyd Jones, Mr. Geoffrey Hanson and Mr. David Hobbs. Following are their comments on questions asked at the meeting.

Sales

The ground floors of the Market and Elizabeth Street stores contribute about 25% of each store's turnover. Mr. Hobbs said that the turnover falls off floor by floor as they go up. Sales average $65 per square foot.

As to total sales volume:- when it was suggested to Mr. Lloyd Jones that David Jones' sales were between $170 and $200 million a year, he replied that the lower figure was "very, very close to the mark."

Staff

As to poaching between staff of Myers and David Jones - "in the past there has not been much poaching but this is increasing."

Out of their total staff of 12,000 the company has 800 casuals who come in between 10 a.m. and 4 p.m. to take care of the lunchtime rush.

Growth

It was suggested to Mr. Lloyd Jones that the company has shown a lack of aggressiveness over the last few years. Mr. Lloyd Jones agreed but said that over the last twelve months they have "had an infinitely more aggressive approach to merchandising."

Regarding the development of new stores, Mr. Lloyd Jones said that "the three paramount features are location, location and location."

On new stores, Mr. Hanson said that they are looking for a 12½% return before interest and tax. But it may take two years before each new store becomes profitable. On finance, the company is very conscious of the need of greater leverage in their financing.

Saturday Shopping

The position regarding Saturday shopping has changed with the stores now favouring it and the unions being against it. However, the union wages demands are so heavy that Mr. Hanson considers that if Saturday shopping is introduced it will add 17% to David Jones' wages bill. He does not think that this will be compensated by an offsetting rise in sales, so there would be no advantage to David Jones in Saturday shopping.

REVIEWS

THE MONEY SUPPLY, ECONOMIC MANAGEMENT AND THE GILT-EDGED MARKET

By G.T. Pepper, Journal of the (U.K.) Institute of Achuaries, June 1970

This paper deals specifically with the situation in the U.K. but some of the views expressed are relevant to Australian conditions. The present experience of currency debasement and the divergence of opinion as to the role of the money supply makes a reading of the paper well worth while.

The author's approach can be summed up in his view that discussion of money supply should be divided into two parts -

> "The first is the way in which current inflationary pressures cause alterations in the money supply. The second is the way in which alterations in the money supply affect future spending and investment and, therefore, future inflationary pressures. The system is a dynamic one, feeding on itself."

> "In my opinion the cause side is the key to the discussion and may assist in resolving the controversy surrounding the effect side."

Reference is made to the revival of the Quantity Theory of Money with the comments that (i) Quantity Theorists now understand Keynesian economics and (ii) if Keynes were alive he might disagree with the views of some of his followers.

Statistical evidence in the U.K. appears inconclusive as between Quantity Theorists and Keynesians but in any case it is considered that money supply is a useful economic statistic. The consideration of economic management and the gilt-edged market is highly technical but some aspects are clarified in the contributions of other speakers. The summing up by one contributor is worth quoting -

> "The paper as a whole may be regarded as an account of a syndrome. What is the underlying disease? One explanation is that Keynesian remedies applied at what their creator would surely consider to be wrong times have nibbled away at the public's faith in money as a store of value. Until that faith can be restored prices in the gilt-edged market are unlikely to rise substantially."