Chanticleer

For crowing there was not his equal in all the land...

ISSN 0404-2918
9 770404 201020

www.afr.com | Tuesday 12 April 2016

Target tactics 'mind blowingly stupid'

Wesfarmers managing director Richard Goyder perfectly summed up the short-term profit boosting effort at discount department store Target when he said its creators were "mind blowingly stupid".

The stupidity, which was confirmed by an investigation by external auditors Ernst & Young, has led to about 10 people being forced out of Target.

The company was not willing to name those who were involved but Wesfarmers finance director Terry Bowen said that if former Target chief financial officer Graeme Jenkins did not know then he should have. Former Target CEO Stuart Machin resigned from Wesfarmers on Friday to take responsibility for the scandal even though he denied any knowledge of it.

Machin was replaced in February as CEO of Target by Guy Russo, who was made head of a new department store division and is now responsible for both Kmart and Target.

Goyder said the strategy for boosting Target's first half earnings before interest and tax by 39 per cent to $74 million was clearly stupid because no cash changed hands and the impact would have washed through in the second half.

Bowen made clear why it was a stupid strategy when he explained how it came to light. Someone in the Target accounting department brought it to the attention of the new managers at Target in March because of the complexity of the accounting reconciliation involved.

Goyder said the cash from the suppliers was never paid but there would be no restatement of the Target first half accounts because it will all be made good in the June full year accounts.

There are several other good reasons why the Target staff involved in demanding rebates from 30 foreign suppliers to boost the first half profit were mightily dumb.

The first is that they breached a clear company policy against delivering short term profits.

The second reason is that Wesfarmers has shown extraordinary patience in allowing managers to get a better return from Target.

Dene Rogers, who was CEO of Target before Machin, left his successor with a mess after two years in the job.

Machin was given three to four years to turn it around but after two and a half years he was replaced by Russo. Now Russo is talking about a two to three year turnaround strategy.

By the time Target is back to delivering the high performance under Launa Inman a full decade could well have passed by.

A third reason why the perpetrators were dumb is that they failed to understand the dynamics of a CEO change. Machin was never going to last forever and Russo was always going to turn over every rock he could find in Target.

In other words, there was always an incentive for a new CEO at Target to rebase the profits to a realistic level.

But talking about the stupidity of the staff who were involved in the Target profit rigging exercise should not distract from the poor underlying performance of the business. Target is clearly not performing that well. It has been steam rolled by the performance of Kmart which is the discount department store category killer. Kmart under Russo's leadership has caused enormous damage to both Target and the Woolworths owned Big W.

Wesfarmers will have to revisit its profit forecasts for Target in June this year as part of its annual asset valuation process. At this stage it would appear that a large impairment charge will be required.

Guy Russo was always going to turn over every rock he could find in Target.

Wesfarmers said in February that every 10 per cent downward movement in Target's profitability would have a $200 million negative impact upon its valuation. The actual half year results to December were 39 per cent worse than those published by the company.

If that pattern of trading performance is repeated in the second half then it is possible the write-down against the value of Target will be as high as $800 million. But it is probably more realistic to factor in a write down of $300 million to $500 million.

An impairment of that size would not augur well for the bonuses of the top management team at Wesfarmers. In fact, based on bonuses paid in prior years an impairment of $500 million at Target would definitely have a negative impact on executive bonuses.

Target is a worrying case study of what can happen within a conglomerate structure with complete autonomy given to executives running the various satellite businesses.

An internal Target document obtained by Chanticleer reveals that Target was a basket case when Machin took over in June 2013. He found no clear purpose or strategy, 26 direct reports and a "broken culture".

The document says Machin also found 75 per cent of products sold on discount, customer numbers had been declining for three years and there was lack of capital investment in stores and systems.

Machin inherited a huge inventory problem. There was about $1 billion worth of inventory with $300 million that needed to be cleared over the next 18 months. Target was carrying fabric liabilities of more than $200 million and it had $3 million of grey-market beauty products to destroy and settle a legal claim on.

One of the most extraordinary numbers is in relation to consultants. The document says Rogers spent $50 million on consultants.

Now the company faces a new turnaround strategy under Russo which is all about getting synergies from its buying, logistics and back office support.

Machin slashed the support headcount at the North Geelong office from 1200 to 900. Russo has operated with support headcount at Kmart of 600. It would not be surprising if he moved to a similar level of support staff at Target, which would be a blow to the Geelong economy.

Liquidity platform

The decision by American entrepreneur Philip Reicherz to join the advisory panel of PrimaryMarkets is a significant development that endorses the idea that the locally spawned platform for trading unlisted securities and investments can go global.

Reicherz was the first employee and founding partner of SecondMarket, a platform created in the United States in 2004 to trade unlisted shares and warrants. Its most high profile claim to fame was trading $US500 million of Facebook shares before its initial public offering.

Reicherz told Chanticleer that when he read about PrimaryMarkets earlier this year in a Street Talk item in *The Australian Financial Review* he immediately contacted one of the founders, Sydney lawyer and investment banker, Gavin Solomon.

Solomon's decision to create PrimaryMarkets was inspired by the success of SecondMarket and another US platform for trading unlisted securities called SharesPost. Once he raised the $1 million in seed funding, Solomon brought in Nick Capp as chief executive. He is the former retail president of Linfox.

Reicherz says there is an opportunity for PrimaryMarkets to become the preferred platform for a range of unlisted assets. It could complement the services offered by crowd funding companies.

Two recent endorsements of the PrimaryMarkets business model were a joint venture with South American peer-to-peer lender, Cumplo, and last week's arrangement with Blackwall Property Funds for the trading of units in 13 unlisted property funds. Reicherz, who will be introducing Solomon to a range of contacts in the US this week, is willing to take up a board position at PrimaryMarkets if it is offered.

In a nutshell, the PrimaryMarkets business model is innovative rather than disruptive. It only acts for the seller, there are no listing or membership fees, it is paid an introduction fee upon completion of each transaction, each seller sets their own transaction rules and all buyer/members of the platform are professional, wholesale or institutional investors.

Tony Boyd
Twitter: @TonyBoydAFR
tony.boyd@afr.com.au

Rear Window

Joe Aston & Will Glasgow

joe.aston@afr.com.au; Twitter: @mrjoeaston
wglasgow@afr.com.au; Twitter: @wmdglasgow

'Stalker' Michael Fraser press club lunch star

Fairfax business journalist **Adele Ferguson** has (deservedly) won every gong bar the Nobel Peace Prize in the last two years for her series of investigations into appalling malpractice in financial planning and life insurance divisions of Commonwealth Bank and wholesale wage fraud at convenience store operator 7-Eleven.

Accepting the prestigious Graham Perkin Australian Journalist of the Year Award for the latter last month, Ferguson paid tribute to a key source, tweeting that "it was a great effort by [consumer advocate] **Michael Fraser**".

And on Thursday this week, Ferguson is sharing top billing with Fraser at a Melbourne Press Club luncheon at Crown, along with CBA whistleblower **Jeff Morris** and head of 7-Eleven's inquiry **Allan Fels**.

But who is Michael Fraser? Yes, he is rightly applauded for helping ripped-off 7-Eleven workers, but according to NSW Supreme Court Justice **Lucy McCallum**, he's also a homophobic stalker.

His target was CBA's customer relations head **Brendan French**. While high-profile CommBank victims like **Merilyn Swan** are intensely critical of Dr French's role in the remediation processes (for customers ripped off by the bank's financial planning arm between 2003 and 2012, the first of which was found sorely wanting by ASIC), McCallum says, "There is not the smallest suggestion of any actual wrongdoing on [his] part."

But that didn't stop Fraser, who "subjected French to a hellish two years of bullying and harassment. In a disturbingly more sinister private campaign, Fraser has bombarded French with hundreds of emails, texts and voice messages [making contact several times each day], many containing thinly veiled threats evidently motivated by homophobia."

Fraser repeatedly mocked French on the basis of his sexuality, suggesting he'd [sexually] enjoy being in prison, that French would enjoy searching Fraser for any strap-on devices and wrote to bank colleagues accusing him of paedophilia. Much of the correspondence was then published by Fraser, effectively "outing" French on his website and social media accounts.

"No rational person," McCallum continued, "with a genuine concern for the interests of consumers could seriously think that was an appropriate communication in consumer advocacy. It is no exaggeration to say that Mr Fraser became Dr French's stalker."

In December, the court awarded a whopping $300,000 in aggravated damages against Fraser, the second highest award of damages for defamation in a non-newspaper

Continued p37