# Picking survivors amid the Amazon onslaught

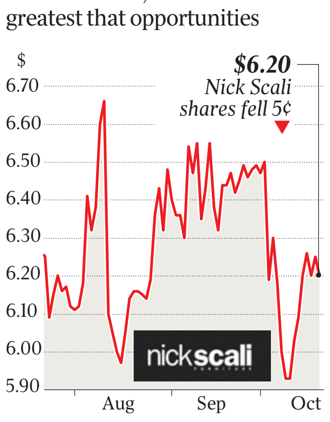
ROGER MONTGOMERY

In retail, investors have been focusing on what has been described as an "inevitable" cratering of sales from the arrival of Amazon and Amazon Prime to Australia's shores.

With rumours of a November launch of Amazon's local website, JB Hi-Fi's shares are down 25 per cent from their highs of $30.44 in 2016, Harvey Norman is nearly 30 per cent lower than its 2016 highs and Super Retail Group, which houses the BCF, Supercheap Auto and Rebel chains, is down 40 per cent from its 2013 highs. By any measure these falls represent a crash.

But it will be the longer-term changes to the competitive landscape that will determine investor returns. If the market reactions are overreactions there could be some value, which of course can turbocharge returns.

Remember, it is when fear is greatest that opportunities



Source: Bloomberg

abound. But before wading into retail, what should you be considering?

Amazon's arrival in Australia will have an impact. Keeping in mind that online retail sales in Australia topped $20 billion for the first time in 2016, according to NAB, if the US online retailing behemoth can capture $15bn of revenue within a couple of years, that amounts to about 5 per cent of the total $300bn retail market in Australia.

One analyst from Citi believes Amazon may capture $3.5bn-$4bn in revenue — based on analysis of other developed markets. While this would represent about 20 per cent of online sales, it represents just over 1 per cent of Australian retailing, and still less than 5 per cent if the supermarkets' collective $75bn is removed from the total. That alone isn't enough to wipe out bricks and mortar retailing.

Of course, in some sectors, for example sporting goods and consumer electronics, the online giant captures much larger shares where it has already established its presence. In electronics, for example, some believe Amazon will capture more than a third of online sales and more than 10 per cent of sporting and outdoor goods. That partly explains the sharp declines in the valuations for JB Hi-Fi and Super Retail.

Even if Amazon doesn't capture a large share of revenue, its aggressive pricing algorithms could have a much bigger impact on margins and therefore profits.

Bricks and mortar retailers have large fixed overheads and contingent liabilities in the form of leases, which Amazon does not. If (when) prices are pressured, gross margins and EBIT margins will likewise be adversely impacted.

Again, Citi's research produces an estimate of the potential impact to the EBIT margins of JB Hi-Fi, Harvey Norman and Myer of circa 20 per cent. A decimation of profits has already had real-world effects in the US, where companies including Toys R Us, American Apparel, RadioShack, Payless Shoes and many more have filed for bankruptcy and shuttered stores or are on the brink of doing so.

Another issue facing retail in Australia is the material drop in approvals and commencements of apartment projects.

Apartment construction in NSW is expected to fall by almost 40 per cent over the next four years, according to a forecast by the Master Builders Australia.

This rapid decline in work for tradies, along with rapidly rising utility costs and record high levels of mortgage and credit card debt, will have a negative impact on optimism and consumption.

Perhaps the construction downturn, debt and rising household expenses is already biting. The worst slump in Australian retail sales in seven years saw sales collapse 0.6 per cent in August, and 0.2 per cent in July, against economist expectations of growth. These factors are likely to be a significant consideration in the RBA's decision to hold off raising rates.

Finally, the longer-term impact on retailers is far more concerning. Currently a manufacturer of a product pays about half its margin to a bricks and mortar retailer to distribute its product. Why? Because that's just the way it has been. But Amazon, where more than 55 per cent of online shoppers start their product search, offers brands the possibility of their own page where they can control their merchandising and pricing. If such an offer, along with full logistics support, only costs 15 per cent, why would brands persist with supporting much more expensive bricks and mortar retail networks?

Of course, not every retailer will suffer. Three stocks stand out:

- Nick Scali, a well established furniture retailer;
- ARB Corp, a four-wheel-drive accessories supplier;
- Bapcor, a general auto parts supply company.

These companies may discover that Amazon simply isn't interested in delivering heavy items such as sofas and dining tables, or 4WD bullbars, nor might Amazon be interested in stocking the broad but specialist array of auto parts that garages require immediately.

Ultimately, it will be the changes to the competitive landscape that determine investors' long-term returns, and while Amazon will play a disruptive part, the initial reactions could provide opportunities.

*Roger Montgomery is founder and chief investment officer of the Montgomery Fund.*

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# Happy to take the default position

**MY WAY**
Sam Sicilia says it's best not to take risks with the future

RICHARD FERGUSON

Sam Sicilia is the chief investment officer at Hostplus, the industry fund for hospitality workers. A physicist by training, he came late to investment management and is an outspoken traditionalist when it comes to superannuation management.

**What's your customer ratio for default funds?**

More than 90 per cent of our customers are in the default option. For most people, for at least 99.9 per cent of the population, including myself, it's better never to exercise choice. I've always been in the default option and I will be till the day I retire.

Let's look at a bank and its share price and predicting what its share price will be. There are entire firms with entire departments analysing financial stocks. Within those departments, there are entire groups who eat and breathe the four major banks. And even though they eat and breathe those stocks, they still get it wrong. If you learn to exercise choice, you need to learn to be consistently right.

**It sounds as though you don't have much time for DIY super?**

Well, can I clarify that? There are two forms of DIY super. There are SMSF, or DIY funds, and there is the option of being able to choose your stocks within a large super fund. We offer the latter. So why do we offer it when I said it was a bad idea? Well, just because you're offered a choice doesn't mean you have to exercise it.

Talking about self-managed funds, it was pretty seductive to say "I can do better myself" post-global financial crisis.

That trend was pretty strong for a couple of years. But now they've seen how hard it is to get good returns ... the only net winner has been the accountants who do the auditing of the SMSFs. And now some people have unwound their SSMF and put it back into super.

**Are you investing in fossil fuels and gambling stocks?**

STUART McEVOY

**Hostplus chief investment officer Sam Sicilia: 'I've always been in the default option and I will be till the day I retire'**

> 'Just because you're offered a choice doesn't mean you have to exercise it'
>
> SAM SICILIA
> CHIEF INVESTMENT OFFICER AT HOSTPLUS

For the record, all of Hostplus's money is externally managed by fund managers, not internally. We leave the decisions in what to invest in fund managers' hands.

But your question is a reasonable one.

We get people coming to see us about divesting in this company or this industry. I've no doubt they're very passionate. But when I'm divesting something, it means I need to find another buyer.

All divestment does is transfer that stock to someone else who either doesn't know or doesn't care. The problem doesn't go away.

Let's instead have a conversation about what the company is doing wrong. You can't change a company's behaviour if you've given away your stocks and your vote at the AGM.

**You're one of the best-performing super funds in Australia — what's the key to your success?**

Hostplus's investment philosophy is pretty resilient to what happens in financial markets. We have a board that backs us.

And look at the demographics: a million members, average age of 33, not retiring anytime soon, which means we have a lot of cash coming in and not a lot leaving. Therefore, we can invest for much longer time horizons than our peers.

**How are you competing with robo-advisers? Would you ever introduce them into Hostplus?**

Artificial intelligence will get better and better over time. Arguably, AI will get better at every job in every industry eventually.

We're not dismissive of AI coming into our fund; it may come in five to 10 years, it may come sooner than that. When it gets to a certain level of sophistication, why would we say no? But today, and in the past, we've backed our own judgment over the technology.

**What was your reaction to Peter Costello's proposal of allowing the Future Fund to run a government super fund?**

The Future Fund is a sovereign wealth fund: it has no members, no cashflow, it has political masters. Superannuation funds are in a different boat.

The question is why? Why would you dismantle one of the best systems in the world? And if you can give me two or three ideas why you should, can we fix it without dismantling the system?

**Wouldn't some people be attracted to the idea? Many people believe we have the most expensive super system in the world?**

Saying our system is the most expensive would involve including the retail super funds into that equation. Our membership fee is $1.50 a week. Does that sound expensive to you? And the Future Fund isn't costless either. It has trustees, analysts; it needs to pay for the tea and biscuits in the staffroom.

**How did you get into investing?**

I was a theoretical physicist. I have a doctorate in theoretical psychics and applied mathematics. I had tenure at Swinburne, which is really a shackle to the university so you never leave. I got a phone call from someone who heard me speak at a conference, and he asked me if I'd like a real job. I joined an asset consulting firm called Towers Perrin. Later I was offered the post of the inaugural chief investment officer at Hostplus. They'd never had one before.

**Do you ever wonder what life would have been like if you had stuck with physics?**

It was a role of the dice to give up tenure but it's arguably worked out rather well for me. Physics has given me a strong logical framework in my current work which has guided me. Some people who studied economics in the industry look at the past decade and wonder if they missed a lecture..

# Be prepared for bill shock when taxman eyes his cut of rollover cash

MONICA RULE

Some people are not aware there may be tax payable when they transfer money from a retail or industry superannuation fund into their self-managed super fund. They may face problems with the Australian Taxation Office if tax is not paid on the money received by the SMSF.

The way it work is that superannuation funds in Australia are either taxed funds or untaxed funds. Most government funds are untaxed and most retail and industry funds are taxed. The difference between the two is the timing of when tax is paid on contributions and investment earnings received by the fund and benefits paid by the fund.

Some super funds also have taxed schemes and untaxed schemes for their members. For example, in Western Australia, the Government Employee Superannuation Board has a taxed scheme, GESB Super, and untaxed schemes West State Super and Gold State Super.

As you may gather, this is a difficult area and I will use an example later to try to show it in action.

The key issue to understand is that concessional (pre-tax) contributions — such as employer contributions, salary sacrificed contributions and personal contributions — where tax deduction is claimed on the contributions, when received by an SMSF, will attract 15 per cent tax.

An SMSF also pays a maximum of 15 per cent tax on investment earnings. This money is recorded as a taxable component in an SMSF's financial records. Then when a superannuation benefit is paid from an SMSF, this money will be shown as a taxable component and may attract tax for recipients aged under 60 depending on the amount of the money.

On the other hand, an untaxed super fund does not pay any tax on these contributions or investment earnings received by the fund. As there was no tax paid, the money is recorded as an untaxed component in the fund's financial records. Then when a superannuation benefit is paid from the untaxed super fund, this money is shown as an untaxed component and will attract tax for recipients of any age.

Now, when money is rolled over or transferred from an untaxed super fund into an SMSF, the rolled-over money will contain an untaxed component. The untaxed fund will pay tax at a flat rate of 49 per cent (the top marginal tax rate plus Medicare levy) on the untaxed component that exceeds $1.445 million (the untaxed plan cap for the 2017-18 financial year). The untaxed component, which has attracted the 49 per cent tax, will be included as a tax-free component when it is rolled into the SMSF. The SMSF will pay tax at 15 per cent on the untaxed component for amounts up to $1.445m.

## Doing the maths

On September 20, 2017, John asks his untaxed super fund to roll over his super totalling $1.6m into his SMSF. The money consists entirely of an untaxed component. The untaxed plan cap for the 2017-18 financial year is $1.445m. This means, John's rollover amount exceeds the cap by $155,000. The untaxed fund will withhold tax of $75,950 ($155,000 x 49 per cent equals $75,950) on the amount in excess of $1.445m.

The amount reported by the untaxed super fund to the SMSF on the rollover benefits statement will show a tax-free component of $79,050 ($155,000 minus $75,950 tax payable equals $79,050) and an untaxed component of $1.445m ($1.6m minus $155,000 — the excess amount — equals $1.445m). John's SMSF will report the $1.445m as income in the SMSF's annual tax return and pay 15 per cent tax on the rolled-over money.

It is important to understand what sort of fund you are rolling money out of. It can come as quite a shock when the ATO takes a large chunk of your super if you aren't prepared for it.

*Monica Rule is an SMSF specialist and author of The Self Managed Super Handbook.*

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