On the road.

With Alphinity Investment Management.

WHO	Bruce Smith	WHERE	UK/USA	WHEN	October 2016

WHAT WERE YOU LOOKING FOR?

Insights into likely future developments for the Australian-listed globally-focused property companies: two in which we presently have positions (Goodman Group and Lendlease) and one we don't presently own but may consider at some point (Westfield).

WHAT DID YOU DISCOVER?

While these three companies have very different specialisations, each has the strategy of concentrating their efforts on "Gateway Cities". By this they mean the most important cities in regions that are, and will remain, the most important regions in the world regardless of the ups and downs of economic cycles.

Goodman Group is one of the largest, most focused and (we believe) probably the best developer and operator of modern logistics facilities in the world. Goodman identified some years ago that ecommerce would make traditional warehouses increasingly obsolete and set about ensuring it possessed the skills to enable it to position and build warehouses that would suit the needs of both e-commerce companies themselves (like Amazon and Zalando) and third party logistics operators (like DHL and UPS). It is concentrated in areas of the world in which trade is centred and generally only in the very best hubs.

Despite the economic turmoil in much of Europe in recent years Goodman has managed to win new tenants and build many new facilities, earning good returns. Japan's economic sloth has been no barrier to much activity and strong returns in that market for some years. China appears to be awash with warehouses in some second and third-tier cities but Goodman's properties around Shanghai are well tenanted and in great demand.

It only entered the enormous US market a few years ago but has concentrated on areas servicing ports in Los Angeles and New York, through which the vast bulk of trade flows. Impressively, the vast vacant block just to the east of Los Angeles that we saw in November 2015 is now a 500,000 square foot (~50,000 m^2) fully-completed and occupied Amazon distribution centre, with lots more construction going on around it. Goodman's strength has been recognised by major capital providers around the world, with more than $30 billion of external funds invested in the logistics property space. And it has achieved all this at the same time as taking the debt on its balance sheet down to negligible levels, leaving it with little financial risk and lots of capacity to take advantage of any opportunities that might arise.

Lendlease on the other hand has expertise in Urban Regeneration. Those familiar with London would know that much of it appears to be in need of redevelopment. It is in the middle of reviving one site in central London, Elephant & Castle, on behalf of the local council. It has already completed a community centre and a high-rise apartment building (with surprisingly good views across London) and is in the process of building a number of much lower density properties nearby.

Lendlease has been working on this project since 2006 and has up to the mid-2020s to complete it. It is in the process of doing the same thing in the US where it has been a large and credible construction company for many years. It has recently entered the development side, mostly in conjunction with local operators, and is most keen on hubs like New York, Boston, Chicago, LA and San Francisco. There is a lot of effort involved in winning the right to develop such projects, but once won the work tends to go on for years.

Westfield obviously specialises in shopping centres and seeks to have the biggest and the best in the key cities in highly developed nations around the world. It is presently only in the UK and USA, although its site in Milan, Italy is about to start construction. Westfield has nothing in Australia (our Westfields are owned by a different company, Scentre Group), making it quite an oddity in our market: pure offshore exposure. It has two superb centres in London (where incidentally retail is booming thanks to a boost in tourism driven by currency devaluation post Brexit) with a third underway. It has also just opened the stunningly-designed World Trade Center in New York City which, being the hub of several train lines, has half a million people a day pass through. A surprising proportion of the centre's revenue will come from advertising as it has some enormous display screens in strategic positions. While Westfield always makes excellent shopping centres, and will no doubt generate good returns over time, as it is in the middle of quite a significant development phase, earnings revisions could remain subdued for some time.

WHAT DOES THIS MEAN FOR THE ALPHINITY PORTFOLIO?

Of immediate concern to property companies is the sharp upward move in bond yields that is causing most stocks with long-dated cash flows to suffer, however the specific characteristics of high quality developers, as opposed to those who passively own property and collect rent, should allow them to be good performers nonetheless. Goodman Group remains a core holding in the portfolios. We feel that the trend it is exploiting is only part-way through and should have several years to run. Lendlease is in a modest upgrade cycle and has solid earnings growth prospects yet trades on a low multiple - a rare combination. And while Westfield doesn't meet our investment criteria right now, there is a good chance that one day it will so we'll keep watching for that.