Property assets bring nothing but pain: study

Real estate firms failing to create shareholder wealth

By Kalpana Rashiwala

SINCE the 1997 Asian financial crisis, listed companies in Singapore, Hong Kong and Malaysia with no involvement in real estate have strongly outperformed pure-property firms and diversified groups involved in property, a study shows.

It was conducted by CFO Asia magazine—which is part of The Economist Group—and two dons from the Singapore Management University’s School of Accountancy, Andrew Lee and Kevin Ow Yong.

Companies involved in property have struggled to create shareholder wealth—if they have not destroyed it—and posted lower returns on capital employed (ROCE) compared with those that have steered clear of real estate.

The study was based on the 1997-2001 performance of listed companies on benchmark stockmarket indices in the three countries—the Hang Seng, Straits Times and KL Composite indices.

It showed that almost half of the biggest companies in Hong Kong, Singapore and Malaysia have some involvement in real estate.

"Despite six years of plummeting property prices, companies in Asia remain deeply exposed to real estate and that’s seriously damaging their performance," said the study.

CFO Asia executive editor Justin Wood noted: "Companies in Asia are massively more involved with real estate activities than their counterparts elsewhere in the world, and yet property businesses have dramatically underperformed the market.”

"Given that property is neither the core business nor the only business at many companies, it is surprising that so many firms are hanging on to their property assets," he added.

The study acknowledges that many companies made "extremely healthy profits" from investing in property in the late 1980s and early 1990s. "But since the Asian financial crisis struck, real estate assets have brought nothing but pain," it said.

The researchers divided the companies on each stockmarket index into three groups—those whose primary business is real estate development and investment; those with no property interests at all (other than owner-occupied factory and office premises); and diversified conglomerates with property and non-property businesses.

The five-year average ROCE for pure property companies on the STI was only 3.7 per cent—lower than the 7.5 per cent for diversified groups. However, both figures were way below the healthy 15 per cent return achieved by non-property groups.

The trend was similar in Hong Kong and Malaysia.

The pure property Singapore companies in the study included CapitaLand, Keppel Land and Singapore Land, while diversified conglomerates covered the likes of Cycle & Carriage, Fraser & Neave, Jardine Matheson, SembCorp Industries and Want Want Holdings. Non-property groups included NatSteel, SingTel and Venture.

The study used market value added (MVA), which measures the difference between the cash that investors have put into a company and the cash they could take out if they sold it at today's prices.

Positive MVA shows the company increased the value of the capital entrusted to it, and so created shareholder wealth, while negative MVA reflects investor wealth destruction.

Once again, the research found that companies that diversified into property created much less wealth for their investors than those that steered clear of it.

In Singapore, for example, latest MVA figures show that while non-property firms created significant wealth, both diversified and pure property companies have destroyed wealth.

The study also looked at earnings multiples—calculated by dividing a firm’s enterprise value (EV) by its earnings before interest, tax, depreciation and amortisation (EBITDA).

"The MVA and ROCE results show that companies which diversify into property fail to improve returns. However, managers might believe that moving into real estate would lower their firm's risk,” it said. "If investors found this to be true, then companies with property businesses would expect to trade on higher earnings multiple than their non-property counterparts. But as the results show, this isn’t the case."