Ivey | Publishing

W32391

CARLING PROPERTY DEVELOPMENT: REFLECTIONS OF AN ENTREPRENEUR

In February 2020, Peter Maxwell received his share from the sale of the Australian property development company he had co-founded in 2002: US$115 million.[1] Following the receipt of this settlement, he took some extended time off; he would turn 60 in April 2020 and it seemed like an appropriate time to assess his future priorities. Meanwhile, Bond University (his alma mater) had asked him to come and speak to a group of students. In preparation, he began organizing his reflections on four of the company's most significant decisions in the previous seven years and how they had impacted the business. These decisions focused on

- installing effective governance;
- rejecting a move into resort development;
- maintaining ownership and control; and
- considering the personal health of the senior executives.

Maxwell was planning to ask the students to rank them in order of importance.

BACKGROUND

Maxwell and Mark Spelling (both Bond University MBA graduates) commenced trading as the Carling Group (Carling) in 2002. Initially, Carling focused on property marketing and home building in Australia's Southeast Queensland (SEQ) market. Equity was initially very limited; however, Maxwell and Spelling were able to build a successful small property development business. The early years saw difficult times, especially during a market downturn in 2005 when both Maxwell and Spelling had to take fulltime roles outside of Carling.

By the early 2010s, Carling was an experienced and entrepreneurial private property developer with a strong reputation that was still wholly owned by the two founding directors. By 2012, private equity investors were expressing support for its growth and the future looked very bright. However, Carling had still neither implemented a formal board structure nor adopted appropriate corporate governance standards.

[1] All currency amounts are in US$ unless otherwise specified.

2012 to 2017 saw the firm continue to grow, as did the buoyant real estate markets it operated in. The number and scale of its projects increased, and Carling enjoyed continued support from a small group of equity investors. Carling soon caught the eye of several leading developers and embarked on joint ventures (JVs) with these property groups. Simultaneously, Carling's continued success attracted the support of numerous high-net-worth individuals who began to back the group as it increased the scale and number of its development projects. (For background on real estate JVs, see Exhibit 1.)

Because of this increased activity, Carling had to introduce more professional processes and systems into its operations. It developed a streamlined project management capacity, which helped Carling absorb more risk. Carling also became recognized amongst its peers for its excellence in design and commitment to quality residential estates.

From 2002 to 2017, both Maxwell and Spelling had elected to pay themselves modest salaries. They also reinvested Carling's share of development profits back into the business to support further growth. Both directors believed in the group's potential and were determined to grow Carling into a leading residential developer and owner.

Over the years, Carling had refined a funding model which saw multiple projects undertaken simultaneously and backed by high-net-worth investors. These investors would contribute the majority of equity required to acquire sites and develop projects. This equity was then leveraged to raise senior debt. This financing model allowed Carling to reduce management fees which, in turn, had a positive impact on project profits. The private equity investors who supported Carling during this time were solid and reliable partners. Yet it was clear that as the scale and complexity of the projects increased, so too did the need to seek out more sophisticated and experienced capital partners with the capacity to fund ever-increasing capital requirements.

There was much excitement within the company and with existing investors, since all believed that Carling was maturing into a competent midsized developer. But cracks were beginning to appear. The company was experiencing difficulty recruiting key executives. In a heated marketplace, it became necessary to pay inflated salaries to secure competent team members, especially for senior finance roles. Some executives questioned whether Carling could grow at the projected rate while maintaining its commitment to delivering quality projects by experienced and competent management.

One morning on arriving at work, Maxwell noticed for the first time that the reception counter displayed 26 business cards. He was obviously aware that the company had grown very quickly, but this visualization gave him pause to reflect on whether the company was growing too quickly and if the growth was controlled. When Maxwell asked who was responsible for setting up the business card display in this manner, no one knew where the directive had come from. He thought briefly about the cash flow meeting scheduled for that afternoon and how group overheads were weighing on the bottom line. These thoughts reaffirmed for Maxwell the pressing need to settle on a medium/long-term funding solution.

SEQ'S PROPERTY MARKET

Carling's continued growth was boosted by a significant upturn in the SEQ property market during 2013 and 2014. The group continued to acquire premium land upon which it developed successful communities that offered significant lifestyle amenities. All Carling sites were near golf courses or park land and many were also close to natural water features. By 2015 Carling was developing and marketing sites in locations such as Noosa, Byron Bay, Lennox Head, Ormiston, Wellington Point, and Redland Bay. Carling's estates were in high demand as Queensland continued to be a desirable retirement and lifestyle destination.

Between 2015 and 2017, the property market continued to thrive and capital was readily available to established developers. Carling was presented with opportunities to diversify into developing retirement living and resort projects. It entered into due diligence to acquire an existing resort adjacent to one of its developments on the Noosa North Shore. Carling possessed limited experience in these new markets but given the current environment, Maxwell believed the group had the capacity and determination to develop new brands which could emulate its success in the mainstream residential market.

STRATEGIC PLANNING

The acquisition of new sites required the recruitment of more staff, and activity increased as Carling worked to complete the work on its books. The executive team conducted workshops to develop a business plan for the next five years (2017–2022) that merged existing projects with planned projects. The strategic plan indicated the capital requirements required for delivery and provided insight into how Carling must continue to grow its human resources if it was to successfully deliver on its grand vision.

As planning continued, the executive team made a decision to direct more resources towards establishing the retirement living and resort divisions. This decision was influenced by Carling's recent formation of a JV agreement with a major US-based group to initially develop 10 rental retirement communities within five years and ultimately build 40 communities total. It was also recognized that Carling's core residential competency better translated to retirement living developments as opposed to resort developments. Hence, the strategic plan focused on significant acquisitions to accommodate Carling's retirement projects.

As a result of these strategic planning sessions, Maxwell and the rest of the executive team became more aware of the cost implications of embarking on such an aggressive growth strategy. While the group was presently developing multiple blue-chip projects, the profits on those projects would take several years to be realized. If Carling was to proceed with its ambitious plans, then both an immediate injection of funding and significant annual injections of equity were required.

Broadly, the planning indicated that a short-term cash injection of approximately $4 million would be required in year 1 (2017/18) with a further $4 million in year 2 (2018/19). This $8 million in equity would sufficiently capitalize Carling to not only manage the pipeline but also to participate as an equity holder within various projects. Further, additional equity of approximately $30 million per year would be required at the project level from 2017 to 2022.

FUNDING OPTIONS AVAILABLE

Carling's executive team met regularly over a period of several months to identify and investigate potential funding solutions which would facilitate the implementation of its five-year plan. The following options were considered:

- Sell Carling as a whole (along with subsidiary investments).
- Sell shares in Carling to a party with similar values and objectives.
- Restrict projects and growth across the group and consolidate the company and balance sheet.
- Reduce Carling shareholding at the project level to reduce equity contributions.
- Issue a convertible note (or similar tool) in Carling to raise funds.