

As China e-commerce basks in Alibaba IPO glow, aging warehouses lure global investors
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Alibaba Group Holding Ltd's plans for a giant initial public offering in New York highlight vast potential for e-commerce in China – and the weak link the logistics industry must fix if explosive growth projections are to be reached.

The aging warehouses that supply goods to customers across the world's second-largest economy are already creaking under the strain, lacking the automation and state-of-the-art technology that has fuelled the rise in the United States and Europe of Amazon.com Inc. By 2020 China's e-commerce sector will be larger than those of the US, Britain, Japan, German and France combined, KPMG said in a recent report.

To cope with the China surge, as much as US\$2.5 trillion (RM8.07 trillion) may need to be invested in buying land and constructing warehouses alone over the next decade and a half, according to one builder. That's drawing the attention of global private equity firms like Blackstone Group LP and Carlyle Group LP as they seek to benefit from an anticipated investment boom.

"Over the next 15 to 20 years, the real cost of building warehouses is going to be staggering," said Jeff Schwarz, co-founder of Global Logistic Properties Ltd (GLP), the biggest foreign builder of logistics facilities in China.

With each new facility the size of several large sports stadiums, that translates to around 2.4 billion square metres of new warehouses – an area close to two-thirds of the total land mass of Taiwan. And GLP estimates the US\$2.5 trillion needed over the next 15 years will still only increase per capita fully automated modern warehouse space to just a third of that of the US.

Alibaba controls 80% of all online retail in China, and its logistics partners delivered five billion packages last year from deals struck on its internet marketplaces.

While transport infrastructure has kept pace so far with Alibaba's rise, warehousing is a key to the supply chain across the e-commerce industry that logistics specialists say is in serious need of a makeover: Boston has more modern warehouses than the whole of China, says Stuart Ross, head of Industrial at real estate consultancy firm JLL China.

Less than 20% of China's warehouses are categorised as modern, with fully computerised tracking systems and the latest in retail technology, according to GLP and other warehouse builders. Many facilities serving Alibaba and its peers are located in areas that are tough for trucks to access. They often lack raised loading bays to let packages simply roll off conveyor belts into the back of trucks: Instead, trucks are loaded and unloaded by manual labour.

That's a headache that can cut into profits for e-commerce firms. Despite China's wages being much lower than in the US, it can cost over twice as much to transport goods in China compared with the US, says GLP.

"Logistics is one of the major building blocks for a successful e-commerce business model," said Praveen Sengar, principal analyst at Gartner in Singapore. While a lack of infrastructure could be an impediment to growth, Sengar said, Alibaba and other e-commerce firms are investing heavily, and have been able to cope with peak demand so far, offering next-day or even same-day deliveries in many large cities.

Improving the logistics of China's warehouses has been prioritised by none other than Alibaba co-founder Jack Ma. Last year, Alibaba announced a plan to lead a consortium to invest US\$16 billion in the first phase of building a national logistics business, a unit of Alibaba to be chaired by Ma. Alibaba declined to comment for this article.

Alibaba's efforts to update logistics in China haven't gone unnoticed. US e-commerce company ShopRunner, a rival to Amazon, will use Alibaba's domestic logistics network when it launches in China later this year.

JD.com Inc, ranked second behind Alibaba in China e-commerce if a long way behind, is also investing. In a filing for its own US listing worth up to US\$1.7 billion, it said it plans to spend up to US\$1.2 billion over the next three years to buy land and vehicles and build warehouses for its logistics network.

Since the beginning of 2013, around US\$22 billion has been earmarked by buyout firms, including Blackstone and Carlyle, and private companies to buy land and build new warehouses in China.

That is just a fraction of what the logistics industry expects will be needed to keep pace with the country's consumer boom.

Beijing has also made a modern supply chain a priority as it looks to build a consumer-driven economy. The warehouse building boom has lured not just buyout firms such as Carlyle, China's Hopu Investment Management and RRJ Capital, but specialist international companies like GLP, Goodman Group and Prologis Inc are already sinking money into building large warehouses in China.

The sector is also attractive to investors seeking a proxy for e-commerce industries, while real estate developers such as China Vanke Co Ltd are diversifying into warehousing as a hedge against a faltering residential property market.

"China's warehouse and logistics providers are trading at favourable valuations. In China, logistics space per capita is only 1/12th of that in the US and providers stand to benefit as e-commerce expands," said Tony Hsu, a portfolio manager at hedge fund Dalton Investments.

So far this year, GLP has built 280 warehouses in China, creating around two million square metres of floorspace, at a cost of US\$1.2 billion. That represents a cost of US\$600 a square metre, a figure the firm estimates will rise 6% each year to hit around US\$1,357 in 2029.

Blackstone, Asia's largest private equity real estate investor, said it is in talks with several China real estate developers as it eyes the warehouse sector. Carlyle declined to comment.

"Usually in China what we see is oversupply," Chris Heady, Blackstone's head of Asia real estate said. "This is a highly unusual situation where there is a lack of supply, and every time a new facility opens up the space just flies off the shelf," he added.

While Beijing is backing a revamp of the country's supply chain that should mean new business opportunities, foreign firms face some resistance from local governments with other ambitions in mind. Warehouses don't bring in as much tax revenue for a municipality, nor create as many jobs as a factory or shopping mall.

"In the West, whoever stumps up the money gets the opportunity, but here it's heavily regulated so logistics companies are competing with manufacturing firms," JLL's Ross said.

While Chinese e-commerce firms like Alibaba already have political clout, foreign investors are teaming with influential local partners to help them buy land.

GLP, for instance, linked up with politically connected deal maker Fang Fenglei's Hopu for a US\$2.5 billion deal earlier this year, which also included Bank of China. Since signing that deal, GLP has also established partnerships with China's largest food and agricultural products supplier Cofco and logistics company Sinotrans. – Reuters, May 12, 2014.

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