

## Equities

5 March 2012 | 40 pages

# What's In Store? Issue 46

## Private Equity Eyes on Retail

### ■ Industry Overview

- **The private equity interest in retail returns** — Private equity firms have shown their hand in Australian retail. In Issue 46 of *What's In Store?*, we assess the drivers behind private equity interest. There are four companies that stand out given high potential internal rates of return – Billabong, Pacific Brands, Harvey Norman and Specialty Fashion Group. The interest from private equity is a support level for share prices, but it is worth noting that the stocks we identified are all trading at less than 10x FY13e PE.
- **The drivers of a private equity approach** — In retail, we see three areas of interest for private equity: margin recovery stories; under-valued asset plays; and cash flow generators. Billabong and Specialty Fashion are the two companies with scope for margin recovery. Asset plays are typically made around property holdings, with most significance for David Jones and Harvey Norman, relative to total assets.
- **Which stocks are most attractive?** — We develop a scorecard of attributes private equity will focus on as well as the leveraged buyout internal rate of return (IRR). At the top of the list is Specialty Fashion and Billabong. Towards the bottom of the list are Myer, Oron, Super Retail Group and Woolworths.
- **Private equity success rate** — Private equity firms had a taste of retail during 2005-2007. We identify over 20 retail companies in private equity ownership today. Of the deals we identify, the success rate is nine exits/IPOs and five failures. Myer and Kathmandu are some of the few IPOs over the past three years.
- **Citi Retail Sales Indicator up 2.4% for January 2012** — Retail sales only grew 2.3% in January, a soggy start to 2012. The supermarket category has slowed noticeably.

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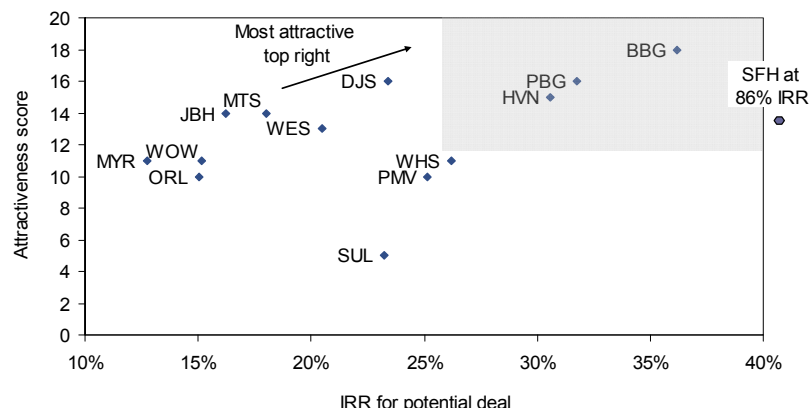
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### Citi private equity screen for Australian retail (Citi scorecard and IRR)



Source: Citi Investment Research and Analysis estimates

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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# What's In Store? Issue 46

Private equity is circling the Australian retail sector. In Issue 46 of What's In Store?, we analyse the private equity interest in listed retailers by using the typical private equity framework. There are three distinct groups of companies of interest – margin recovery, asset plays and cash flow returns. There are four companies that present the highest interest on our scorecard and the potential internal rate of return (IRR) – Billabong, Pacific Brands, Harvey Norman and Specialty Fashion Group. While Billabong and Pacific Brands are well known, Harvey Norman and Specialty Fashion have large blocking shareholders that present the most significant hurdle for potential bidders.

## Private Equity Circling Retail

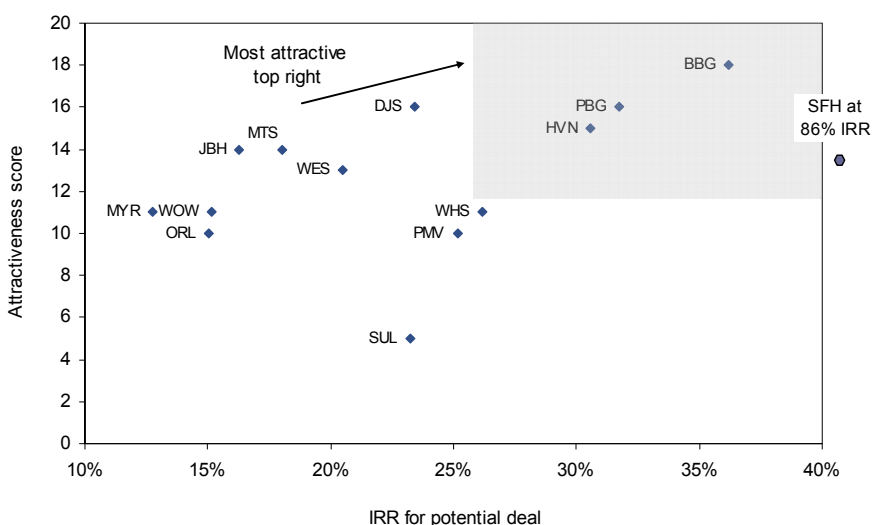
The retail sector is the most short-sold sector on the ASX. A share price tension is now building given acquisition interest by private equity has emerged. In this report, we look at the private equity approach to making a return on investment in the retail sector. We address the following questions:

- What is the business model for private equity?
- What retail stocks may be of interest?
- What do they already own and what is their success rate?
- Case studies of success and failure.

### Summary scorecard for private equity interest

We summarise the attractiveness of retail stocks to private equity in Figure 1. This chart addresses the private equity interest on two dimensions. Firstly, we look at the IRR for private equity. Secondly, we provide a scorecard, which ranks all the stocks on metrics such as margin recovery, scope for leverage and cash flow generation. We provide more detail on the scorecard later on in the report.

Figure 1. Citi private equity screen for Australian retail (Citi scorecard and IRR)



Source: Citi Investment Research and Analysis estimates

## Private equity model

The private equity investment approach is centred around a cash-flow driven return. Typically, a private equity fund would invest in a retail company looking to:

- improve EBITDA margins;
- use a high level of debt (we assume debt to EBITDA of 4x);
- release working capital;
- sell surplus or under-appreciated assets; and
- re-list or undertake a trade sale within 3-5 years.

As a rule of thumb, the objective is an internal rate of return (IRR) of 25%. A private equity fund's performance fees are linked to the IRR achieved.

## Classifying the private equity opportunities

We classify the private equity opportunities in the Australian retail sector in three categories:

1. Margin recovery.
2. Cash flow strength.
3. Asset plays.

We run the calculations to show indications of the potential IRR for each of our listed retail stocks under coverage. This table is summarised in Figure 2.

**Figure 2. Estimated IRR for retail stocks (holding constant takeover premium and debt to EBITDA ratio – assuming three year holding)**

Company	BBG	DJS	HVN	JBH	MTS	MYR	ORL	PBG	PMV	SFH	SUL	WHS	WES	WOW
Share price	\$2.92	\$2.79	\$1.98	\$11.04	\$4.17	\$2.34	\$8.95	\$0.70	\$5.26	\$0.50	\$7.19	\$2.53	\$29.46	\$25.24
Premium to share price	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%
Enterprise value	1,255	2,042	3,288	1,629	5,109	2,160	481	1,020	895	131	2,160	1,150	49,229	44,673
EV/EBITDA on acquisition	8.2	7.0	8.7	7.3	10.2	6.5	9.9	6.9	10.4	5.3	10.9	7.5	10.9	10.3
Net debt/EBITDA	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
<b>Margin recovery</b>														
Starting EBITDA margin	9.0%	14.9%	6.4%	7.5%	4.0%	10.5%	26.2%	10.8%	9.8%	4.3%	11.9%	9.2%	7.8%	7.6%
Ending EBITDA margin	14.7%	13.0%	8.4%	6.9%	4.0%	9.1%	24.3%	11.5%	10.9%	8.5%	11.8%	10.1%	9.5%	8.0%
<b>Cash flow</b>														
Release of working capital (% of sales)	6.0%	1.4%	10.8%	2.8%	2.9%	0.2%	3.6%	6.4%	1.1%	0.0%	4.5%	1.6%	1.0%	0.4%
<b>Asset play</b>														
Under-valued assets sold	50	850	2500	0	30	30	0	30	300	0	0	197	2000	3700
Yield on assets sold	8.0%	8.5%	10.0%	0.0%	8.5%	8.0%	0.0%	10.0%	8.0%	0.0%	0.0%	8.5%	7.5%	7.5%
<b>IRR</b>	<b>36%</b>	<b>23%</b>	<b>31%</b>	<b>16%</b>	<b>18%</b>	<b>13%</b>	<b>15%</b>	<b>32%</b>	<b>25%</b>	<b>86%</b>	<b>23%</b>	<b>26%</b>	<b>20%</b>	<b>15%</b>

Source: Citi Investment Research and Analysis estimates

We apply the following assumptions across the board:

- We assume a 30% takeover premium for all stocks to the prevailing share price on 5 March 2012.

- We assume net debt to EBITDA of 4x for all stocks. This is a simplistic assumption and some specialty retailers will require lower levels of debt given fixed lease obligations.
- We assume an exit multiple equivalent to the acquisition multiple.
- We assume the cost of debt is 8% and the holding period is three years.

A disclaimer is required for the table above. Our framework does not discriminate significantly between the stocks and should only be used as a guide. Any private equity investor will have very specific assumptions around margin recovery and asset values for particular companies.

## What retail stocks could they look at?

### Margin recovery

Generally speaking, Australian retailers achieve high profit margins by historical standards and compared with global peers. The scope for margin recovery in retail is scarce and only a motivation in a few select cases. There are four retailers that have experienced a drop in margins over the past five years:

- **Billabong:** Given a contraction in global demand for surfwear and the migration to its retail strategy.
- **Premier Investments:** Weak performance from its Portmans, Jacqui E and Jay Jays brands. In addition, general weakness in demand created negative operating leverage.
- **Specialty Fashion Group:** Rising staff and rent costs against a weak retail sales backdrop.
- **Warehouse Group:** Sales de-leverage in a weak NZ economy.

Figure 3. Retail EBIT margin trend (FY11 vs. FY06)

Company	Segment	FY06	FY11	Change (bp)
Billabong	Group EBITDA	23.0%	11.4%	-1,160bp
Premier Investments	Just Group EBITA	11.9%	7.4%	-456bp
Specialty Fashion Group	Group EBIT	7.5%	4.0%	-348bp
The Warehouse Group	Group EBIT	7.8%	6.8%	-100bp
Wesfarmers	Target	7.8%	7.4%	-43bp
Harvey Norman	Franchise segment	5.1%	5.3%	22bp
Woolworths	Big W	3.9%	4.3%	31bp
Metcash	Group EBITA	2.7%	3.6%	87bp
JB Hi-Fi	Group EBIT	4.7%	6.6%	193bp
Woolworths	Food & Liquor	5.0%	7.4%	238bp
Super Retail Group	Group EBIT	5.6%	8.0%	246bp
Wesfarmers	Kmart	1.9%	5.1%	315bp
David Jones	Dept stores	4.7%	10.1%	544bp
Myer	Dept Stores	2.3%	8.2%	590bp
Oroton Group	Group EBIT	12.2%	22.2%	1,002bp
Wesfarmers	Coles	n.a	4.2%	n.a

Sources: Company reports, Citi Investment Research and Analysis

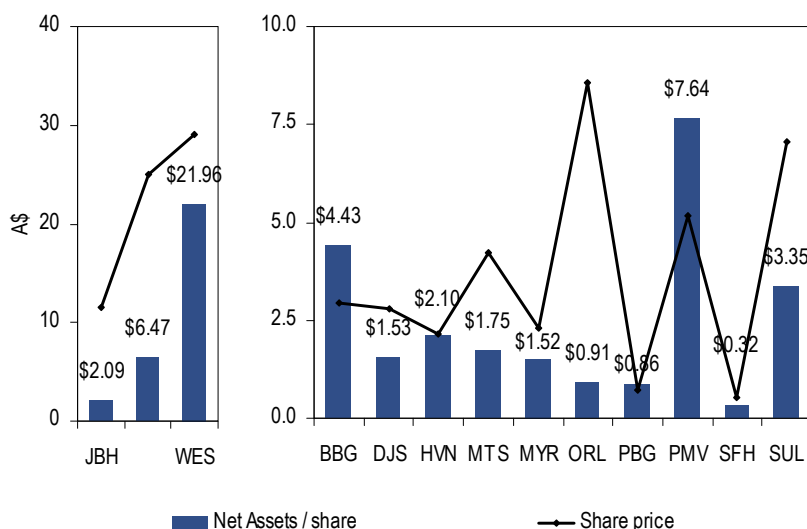
### Asset sales

The asset backing for many Australian retailers is low given most retailers lease their sites. However, some retailers have tangible assets. In Figure 4, we show the net asset per share, compared with the current share price for each of the listed

retailers under coverage. The following stocks are trading at a similar level to their book value of equity, or below:

- Billabong;
- Harvey Norman;
- Pacific Brands; and
- Premier Investments.

**Figure 4. Most recent net asset per share backing compared with share price**



Sources: Company reports, Citi Investment Research and Analysis

### Cash flow strength and re-gearing

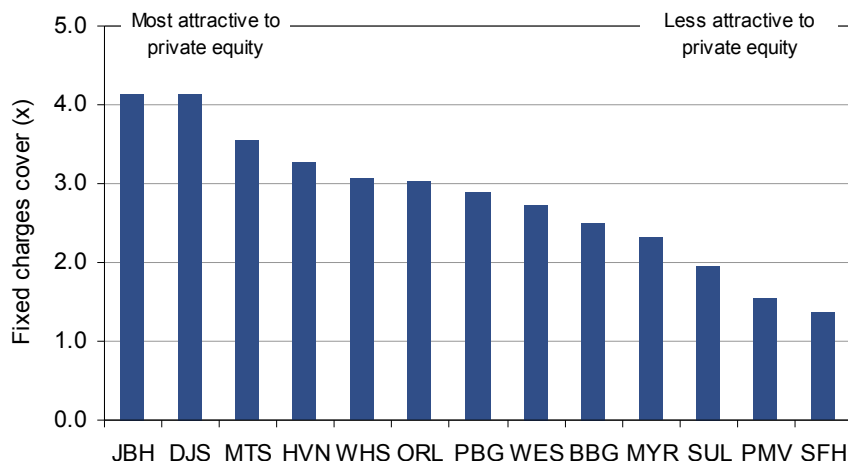
Private equity investments are heavily reliant on the ability to use debt to fund a large portion of the transaction value. Therefore, the pre-existing gearing, cash generation and cost of debt are all important in determining the level of interest of private equity firms.

### Debt levels are mixed

The most relevant ratio for interest coverage in retail is the fixed charges cover. This calculation includes the impact of off-balance sheet leases. Large-format retailers typically operate around 2.5x to 3.5x. Specialty retailers are inherently lower given high lease costs and typically have a fixed charges cover between 1.5x and 2.0x. In Figure 5, we show the fixed charges cover across the retail sector. The stocks that have the highest coverage ratios and therefore scope for re-gearing are:

- JB Hi-Fi;
- David Jones;
- Metcash; and
- Harvey Norman.

Figure 5. Fixed charges cover for retailers (FY11)

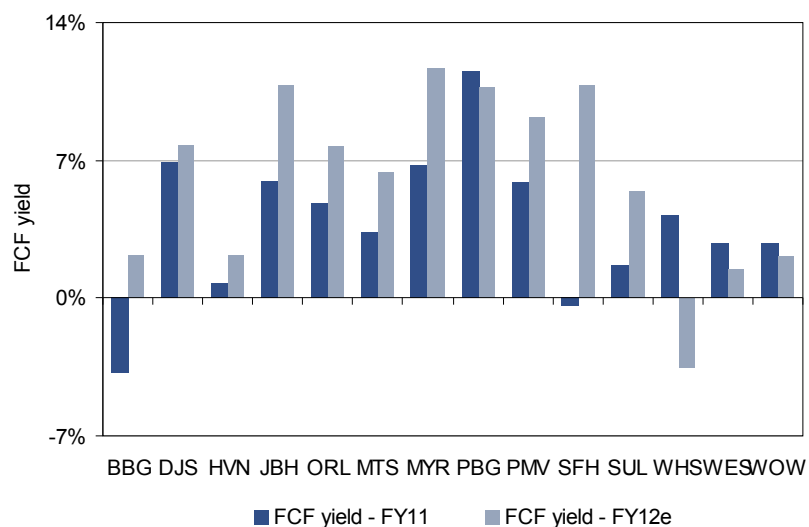


Sources: Company reports, Citi Investment Research and Analysis

### Good cash flow

Australian retailers typically operate with low levels of working capital, including negative working capital for Woolworths. They also manage modest capex, a reflection of the leased asset structure. We show the free cash flow yield for retailers in Figure 6.

Figure 6. Retail sector FCF yield for FY11 and FY12e



Source: Company reports, Citi Investment Research and Analysis

The highest free cash flow yield is shown for:

- David Jones;
- JB Hi-Fi;
- Myer;

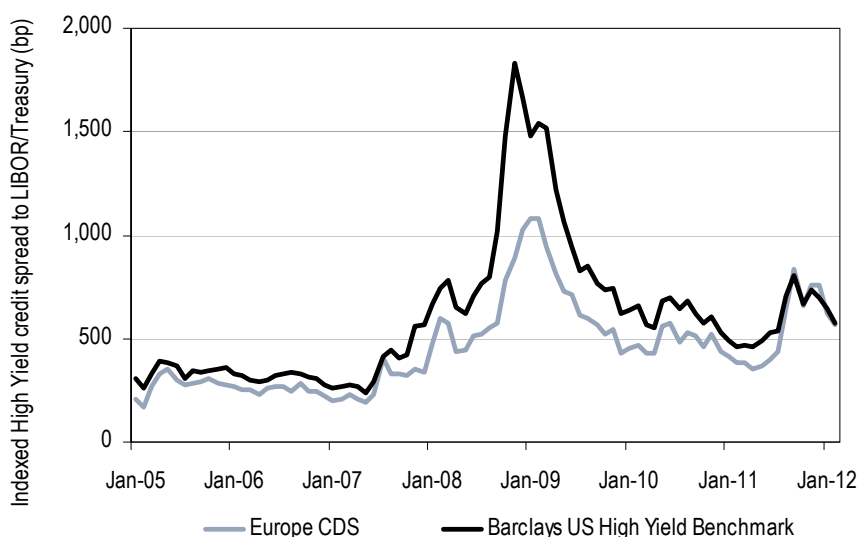
- Pacific Brands; and
- Specialty Fashion Group.

### Debt costs are falling

One key driver behind the increased interest in retail by private equity is the lower cost of debt and increased availability of debt in offshore markets. We show the credit spreads for high-yield debt in the US and European markets. This credit spread is near 500bp, compared with a peak over 1,500bp during the global financial crisis.

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Figure 7. High yield credit spreads



European CDS spread to LIBOR for 5 year maturity. US high yield benchmark to US treasuries for terms > 1 year.  
Sources: Bloomberg, Citi Investment Research and Analysis

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### Scorecard

We provide our own scorecard of the factors that would interest a typical private equity investor. This score card ranks from 1 (worst) to 5 (best) on five attributes:

- Margin recovery opportunity.
- Under-valued assets that can be sold.
- Fixed charges cover ratio that can increase.
- Cash flow generation and working capital release.
- Substantial shareholder that may block a deal.



Figure 8. Retail company Citi scorecard on private equity parameters

	Highest BBG	PBG	-----> DJS	HVN	JBH	MTS	SFH	WES	WOW	MYR	WHS	PMV	ORL	Lowest SUL
Margin recovery	5	1	1	1	1	1	4	2	1	1	3	5	1	1
Under-valued assets	3	2	4	5	1	1	3	1	1	1	1	1	1	1
Fixed charges increase	2	4	4	4	5	3	1	3	3	2	3	1	3	1
Cash flow/working capital release	5	4	2	4	2	4	3	2	1	2	3	2	3	1
Shareholder with > 25% stake	3	5	5	1	5	5	2	5	5	5	1	1	2	1
<b>Cumulative score</b>	<b>18</b>	<b>16</b>	<b>16</b>	<b>15</b>	<b>14</b>	<b>14</b>	<b>13</b>	<b>13</b>	<b>11</b>	<b>11</b>	<b>11</b>	<b>10</b>	<b>10</b>	<b>5</b>

Source: Citi Investment Research and Analysis

## What do they own in retail?

Private equity funds already have a “chequered” history in Australian retail. Many retail companies were acquired before the financial crisis in 2008. There is a mixture of successes and failures. In Figure 9, we show the retail companies we are aware of in private equity ownership (not all 100% ownership).

Figure 9. Private equity holdings in Australian retail

Private equity firm	Target	Sales or EV A\$m (FY)
ANZ Capital	Kikki.K	10 (2005)
	Michaelis Bayley	23 (2005)
	Netti	12 (2006)
	Kailis & France Foods/Australian Convenience Foods	160 (2005)
Archer	Quick Service Restaurants	235 (2011)
Catalyst Investment Managers	Moraitis (49%)	527 (2011)
	Ezibuy	170 (2006)
	Home & Décor Holdings	175m (2010)
Navis Capital	Retail Apparel Group	n.a
Next Capital	Next Athleisure (Glue and Topshop licence)	na (2011)
	Vitaco	41 (2007)
Crescent Capital	Aquarium Industries	14 (2011)
	Australian Music Group	76 (2011)
Gresham Private Equity	Awara (Experiential Travel Group)	115 (2011)
	Noel Leeming Group	NZ\$516m (2010)
	Witchery	EV \$130 m
Hastings Private Equity	NQR Grocery Clearance	44 (2008)
Ironbridge	Barbeques Galore	300 (2005)
	Super A-Mart	400 (2006)
Pacific Equity Partners	Godfreys	EV \$330m
Propel Investments	Pacific Apparel Solutions (PAS)	279 (2010)
Quadrant Private equity	Burson Auto Parts	300 (2011)
Unitas Capital	Godfreys	EV \$330m
	Repco Corp	910 (2006)
Wolseley	Freshmax	NZ\$365m (2012)

EV is noted in the table. Otherwise numbers show revenue.

Source: Company reports, PwC, Dun and Bradstreet, Citi Investment Research and Analysis

A number of these assets have been held in private equity for more than five years, which is a symbol of the difficult retail market backdrop and weak earnings multiples for listed peers.

## What assets have they exited?

Private equity has had some success over the past five years, despite a difficult retail sales backdrop. In Figure 10, we list the retail companies sold by private equity and the private equity retail assets that fell into voluntary administration. The list of asset sales includes three IPOs. More assets were sold to corporate buyers, or to another private equity firm.

**Figure 10. Private equity exits and administration**

Retail asset	Seller	Acquirer
Cellarmasters	Archer	Woolworths
Collins Foods	PEP	IPO
Kathmandu	Quadrant/GSJBW	IPO
Myer	TPG	IPO
Quick Service Restaurants	Quadrant	Archer
Rebel	Archer	Super Retail
Repco (small stake)	Unitas	GPC (US) sold one-third
Solomon Food Group	Advent	Metcash
The Jewellery Group	Quadrant	M Suresh Group
Assets in administration	Owner	Recapitalised
ADR	Catalyst/CHAMP	Yes
Colorado	Affinity	Yes
RAG	CHAMP	Navis Capital
Red Group	PEP	No
WOW Sight 'n Sound	NAB	TBA

Source: Citi Investment Research and Analysis

## Case Studies

Below we discuss some examples of successful transactions for private equity and those transactions that have failed to generate a satisfactory return. We look at Myer, Colorado and Red Group.

### A case study of the Myer transaction

The Texas Pacific Group (TPG), along with its associates<sup>1</sup>, bought Myer for \$1.4 billion (EV/EBITDA of 11.7x on FY07 forecast) in June 2006 with property of \$358 million and inventory of \$514 million. The transaction was funded from \$400 million equity and the rest in debt. After a number of savings initiatives and other operational measures, the company listed through an IPO in November 2009. The implied EV was \$2.8 billion and equated to an EV/EBITDA of 8.9x on FY10 forecast.<sup>2</sup> The implied IRR for the private equity firm was approximately 38% on an annualised basis.

We highlight the key changes that the management and owners made to the business during the transition period.

- **Inventory clearance** – \$400 million worth of “redundant” inventory was cleared for \$150 million in FY07<sup>3</sup>. While the company took one-off impact from clearing aged inventory. This move cleared shelf space for new stock and enabled working capital release.
- **Melbourne property sale** – The Melbourne flagship store was sold for \$605 million in FY07. The property was immediately leased back for \$19 million / annum.
- **Improved IT systems and supply chain** – More than \$200 million was invested in Myer supply chain in the transition period. Supply chain costs declined 45% while the speed to market improved 40%.

<sup>1</sup> Newbridge Capital, Blum Capital and the Myer family

<sup>2</sup> Company forecast

<sup>3</sup> FY end in July

- **Employee cost reduction** – Pre acquisition, store staff was allocated on a per square meter basis. TPG changed the criteria to sales and foot traffic at the respective location. Myer employee cost to sales ratio improved by 220bp to 15.0% between FY07 and FY09.

### A case study of the Colorado and Red Group deals

Colorado Group was purchased by Affinity Partners in August 2007. The group was subject to a hostile takeover that valued the company at over 11x EV/EBITDA. The debt drag that funded the acquisition was very large. Colorado Group owed its debtors closed to \$400 million, when it went into voluntary administration in March 2011. This proved to be a challenge to manage in the context of a soft retail environment as group EBITDA fell from \$55 million (pre-acquisition) in FY06 to under \$20 million in FY11.

Red Group was formed in 2004 when Pacific Equity Partners purchased Whitcoulls and Angus & Robertson for \$115 million. In 2008 the fund purchased Borders stores for \$105 million. The group went into voluntary administration in February 2011. Poor operating performance rather than debt levels was the reason for the group's failure. The strategic direction taken by Red Group was flawed as the group tried to grow its physical store presence, despite a distinct consumer shift to buying online. The result was a sharp decline in revenue with FY10 sales falling by 12%. Profit margins deteriorated given fixed rental and interest costs. The group had a NPAT loss of \$43 million in FY10.

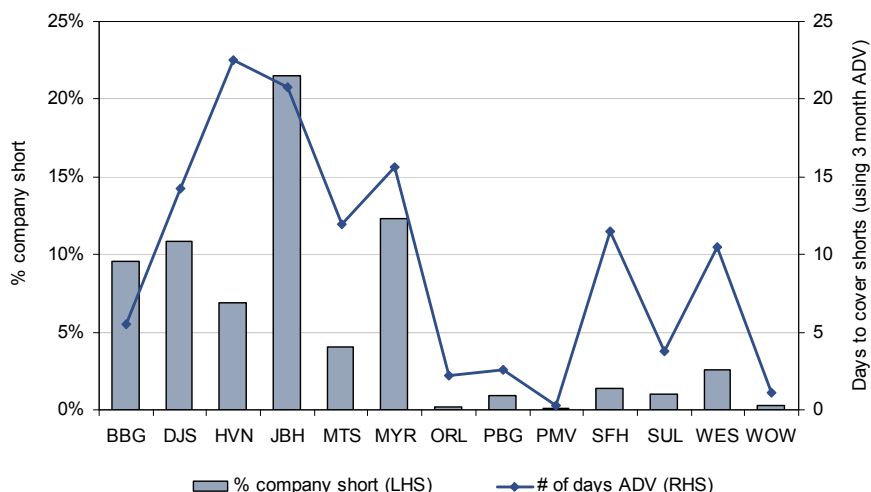
### Outlook for retail sector

The private equity interest in retail stocks has provided a floor on share prices for some companies. Our analysis places Billabong, Harvey Norman, Pacific Brands and Specialty Fashion Group at the top of the list of stocks that would be appealing.

This corporate appeal is in contrast to the short-interest in retail stocks which remains very high. Seven of the top 10 short-interest stocks on the ASX are retail stocks. See Figure 11 for the level of short-interest in retail companies.

### Short-interest in retail

Figure 11. Short-interest in retail stocks



Source: Citi Investment Research and Analysis

The likelihood of acquisitions coming to fruition will depend on shareholder acceptance, particularly given large stakes in most of the stocks we identified as interesting assets. We summarise our recommendations for the retail stocks and PE ratios in Figure 12. The PE ratio is typically lower than the past five year average, a reflection of the structural risks to profit margins for many of these companies. The companies with private equity appeal are all trading on less than 10x FY13e EPS.

**Figure 12. Listed retail sector PE ratios (FY12e and FY13e)**

Company	Code	Recom.	Share price	PE (FY12e)	PE (FY13e)	PE (5-yr avg)
Billabong	BBG.AU	Neutral	2.92	11.7	9.9	12.7
David Jones	DJS.AU	Neutral	2.79	10.3	9.9	14.0
Harvey Norman	HVN.AU	Neutral	1.98	10.6	9.4	12.5
JB Hi-Fi	JBH.AU	Neutral	11.04	9.1	8.8	15.6
Metcash	MTS.AU	Buy	4.17	12.2	11.1	12.9
Myer	MYR.AU	Neutral	2.34	9.6	9.4	10.5
OrotonGroup	ORL.AU	Neutral	8.95	13.3	12.5	11.1
Pacific Brands	PBG.AU	Buy / High Risk	0.70	9.0	6.6	7.7
Premier Investments	PMV.AU	Neutral	5.26	14.7	12.6	13.0
Specialty Fashion Group	SFH.AU	Buy / High Risk	0.50	76.9	10.8	7.6
Super Retail Group	SUL.AU	Buy	7.19	12.6	11.8	12.5
Warehouse Group	WHS.NZ	Neutral	2.53	12.3	10.2	na
Wesfarmers	WES.AU	Neutral	29.46	15.4	13.3	14.9
Woolworths	WOW.AU	Neutral	25.24	14.1	13.1	17.2

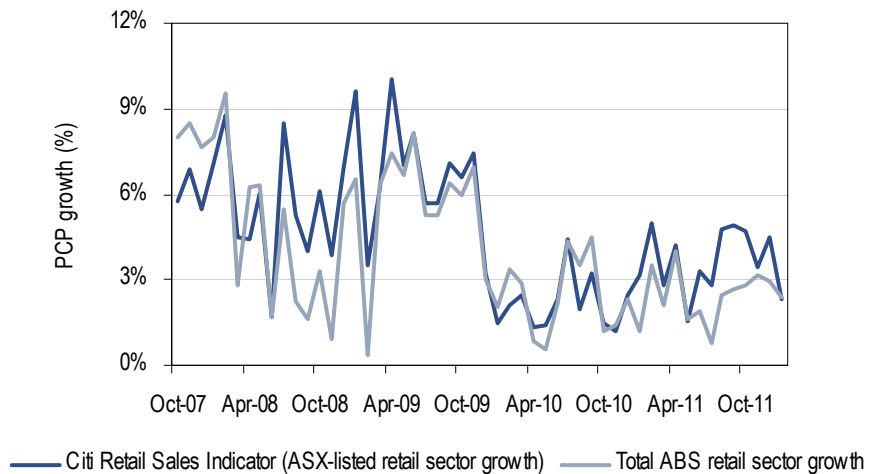
Source: Citi Investment Research and Analysis; share price 5<sup>th</sup> March 2012.

## Retail Sector Overview

### Citi Retail Sales Indicator

Citi's Retail Sales Indicator measures the growth of retail sales weighted by the categories relevant to ASX-listed retailers. The indicator grew 2.3% in January 2012, in line with the ABS total retail sales growth of 2.4%.

Figure 13. Citi Retail Sales Indicator (retail sector sales growth for ASX-listed companies)



Source: ABS, Citi Investment Research and Analysis

## Sector performance for January 2012

Figure 14. Retail category monthly growth rate on pcp (%)

Month ended:	Jan-11	Dec-11	Jan-12
Supermarket	3.9	4.6	1.5
Department stores	-3.8	-0.8	-3.6
Clothing	-2.8	0.7	1.5
Furniture	-2.6	4.6	4.3
Electrical	-8.3	-3.6	1.3
Hardware	5.1	4.6	2.1
Total (Industry)	1.2	2.9	2.4

Sources: ABS, Citi Investment Research and Analysis

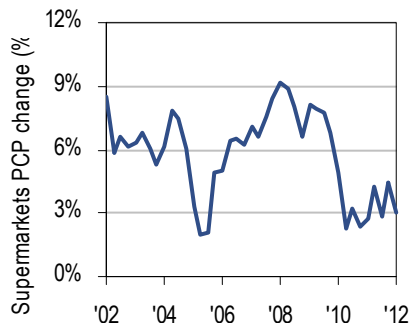
ABS retail sales for January 2012 have slowed to 2.4% growth on pcp, using original data. Over the past four months sales trends have been soft, but exhibited limited volatility across retailing. Supermarkets, discount department stores and hardware sales slowed in 2012 given the floods in 2011 boosted sales through re-stocking.

### Key points

- **Supermarkets up 1.5%:** Sales have slowed in January to 1.5% growth from the December 2011 quarter average growth rate of 4.0%. The impact of re-stocking following the January 2011 floods was significant for grocery retailers. We expect this weak trend to continue in February 2012. Café & Restaurant sales rose by 12%.
- **Department stores down 3.6%:** Department stores have remained below trend in January 2012 and have deteriorated from December 2011. The weakness is concentrated in discount department stores. David Jones commentary indicated improvement in January 2012 sales.
- **Clothing up 1.5%:** Clothing sales improved in January 2012 to growth of 1.5%. This compares to average December 2011 quarter sales which declined 1.9%. Clearance activity post-Christmas has been positive. However, the sales growth is still insufficient to offset underlying inflation in rents and staffing costs.
- **Electrical up 1.3%:** Electrical sales also improved in January 2012 to 1.3% growth from an average 2.2% decline in the December 2011 quarter. Harvey Norman's reported LFL sales decline of 9.5% in 2Q12 is indicative of market share loss.
- **Furniture up 4.3%:** Furniture sales have remained strong. Home renovation activity continues to underpin strong category growth that is above the broader discretionary retailing segment.
- **Hardware up 2.1%:** Hardware sales slowed in January 2012 to a growth rate of 2.1%. The hardware industry is beginning to cycle boosts from flood related activity in January 2011.

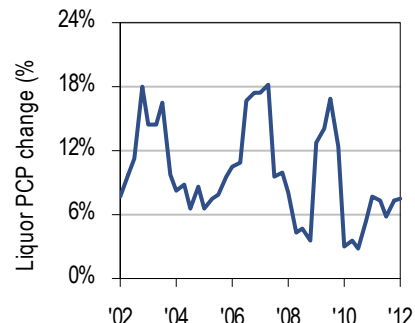
## Sector specific performance – rolling 3 months to Jan '12

Figure 15. Supermarkets



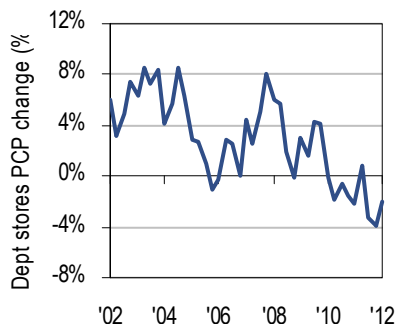
Source: ABS 8501.0

Figure 16. Liquor retailing



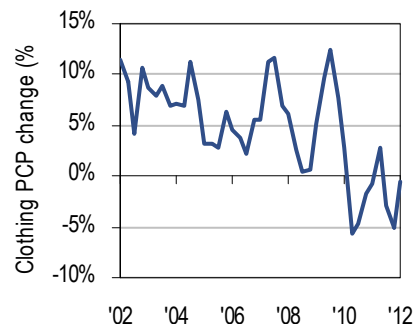
Source: ABS 8501.0

Figure 17. Department stores



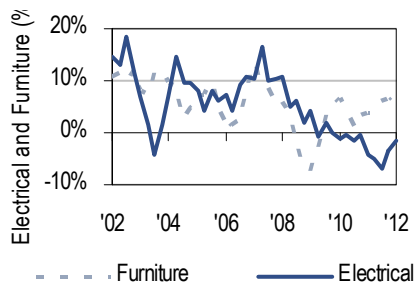
Source: ABS 8501.0

Figure 18. Clothing



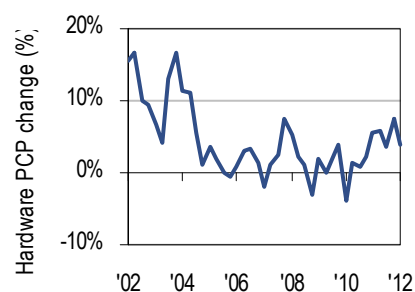
Source: ABS 8501.0

Figure 19. Electrical and Furniture



Source: ABS 8501.0

Figure 20. Hardware

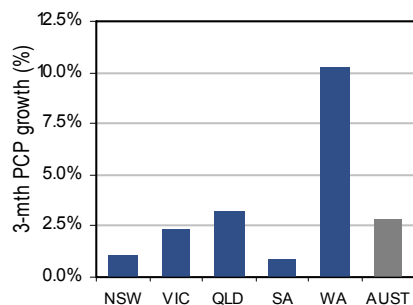


Source: ABS 8501.0

## State based performance

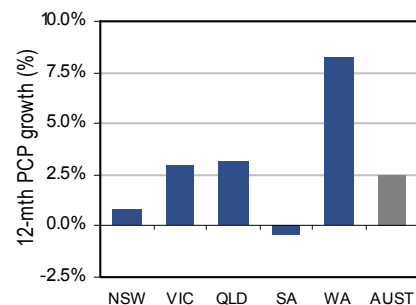
Figure 21 and Figure 22 show the quarterly and yearly sales growth performance for each state respectively.

Figure 21. 3-month sales growth by state



Source: ABS 8501.0

Figure 22. 12-month sales growth by state



Source: ABS 8501.0

## Economic outlook

Citi Economists forecast an improvement in GDP growth in 2012, primarily driven by increased capital investment and mining related export growth.

Figure 23. Citi economic forecasts for Australia

Calendar year	2010	2011	2012
GDP growth	2.7%	1.9%	3.4%
CPI	2.8%	3.1%	2.5%
Unemployment rate (end of period)	5.0%	5.3%	5.1%
Period	02-Mar-12	Dec-11	Jun-12
Cash rate	4.25%	4.00%	4.00%
AUD/USD	1.08	1.08	1.02

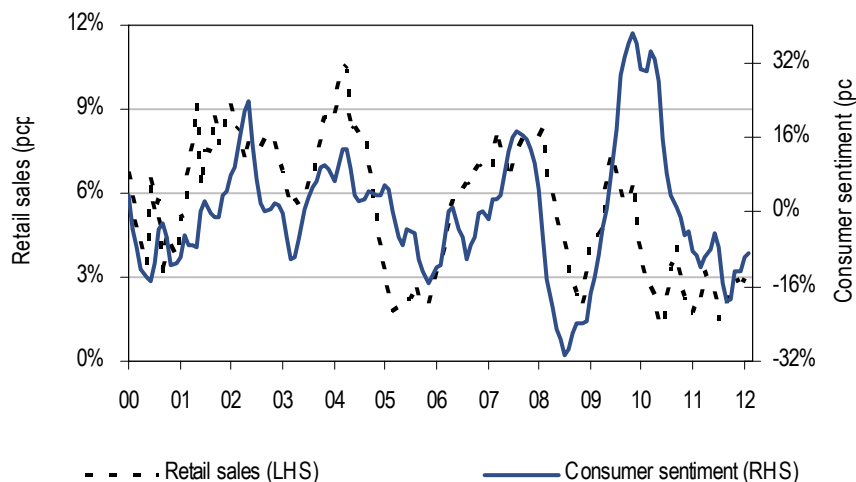
Note: Forecast data as of 5<sup>th</sup> March 2012; Source: Citi Investment Research and Analysis



## Consumer Sentiment

We find the change in consumer sentiment has a strong co-incident correlation with retail spending. In the most recent reading for February 2012, consumer sentiment was at 101.7. This is up 4.7% vs. January 2012, but 4.6% lower compared to the prior year.

Figure 24. Consumer sentiment and retail sales

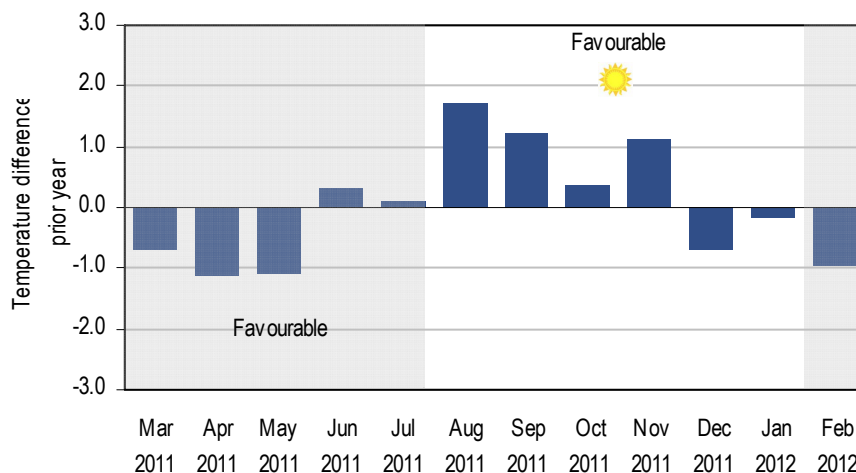


Source: Westpac, ABS, Citi Investment Research & Analysis

## Weather

Figure 25 shows the weighted average temperature difference to the prior year, in the past 12 months. January and February 2012 have been somewhat cooler and may have adversely impacted the current summer fashion season sales.

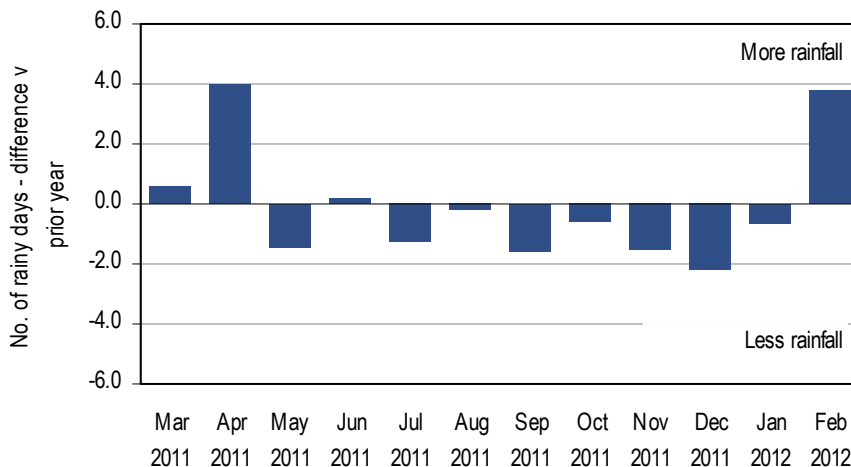
Figure 25. Temperature change – weighted national average



Source: BOM, Citi Investment Research & Analysis

Figure 26 shows the weighted average difference in rainfall days to last year.

Figure 26. Rainfall change – weighted national average

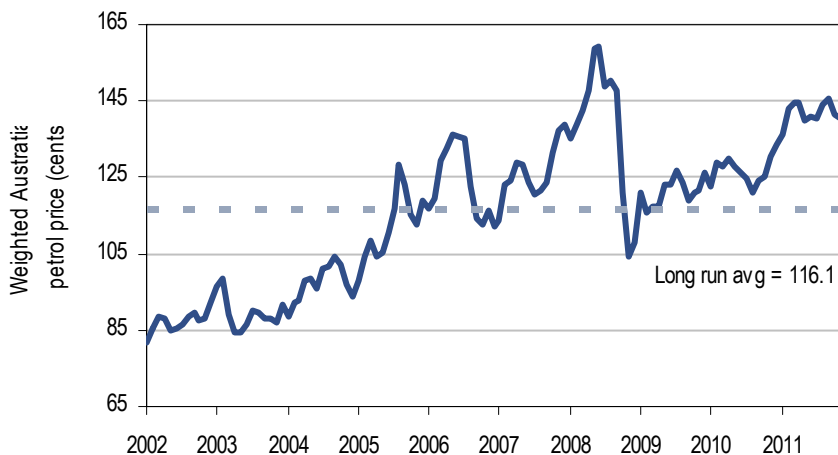


Source: BOM, Citi Investment Research & Analysis

## Petrol prices

Petrol prices averaged 116.1 cents per/litre in January 2012. Prices are 6.9% higher compared to the last year. Continued rises in the price of petrol are draining the available household income for retail purchases.

Figure 27. Australian petrol prices

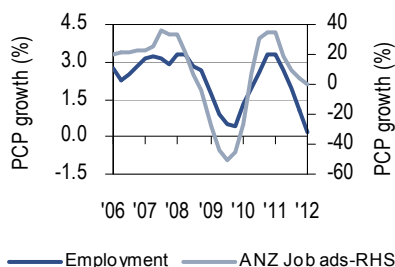


Source: Aust. Automobile Association

## Employment

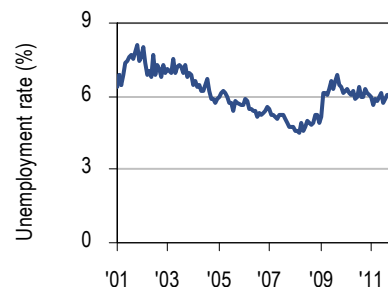
A softening in employment conditions during 2008-09 pressured income growth for Australian households. As shown in Figure 28 and Figure 29, job advertisements and employment growth dropped sharply while the unemployment rate steadily increased over the course of the year. However, conditions firmed in 2010 with a clear reversal in all three indicators. Employment and job ads data continued to show similar trends in 2011. While job ads are still in growth, the rate of increase has declined in recent months. This is an indicator of a higher unemployment rate.

Figure 28. Employment and job ads growth



Source: ABS, ANZ

Figure 29. Unemployment rate

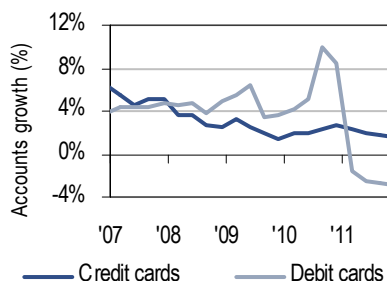


Source: ABS

## Credit and debit card spending growth

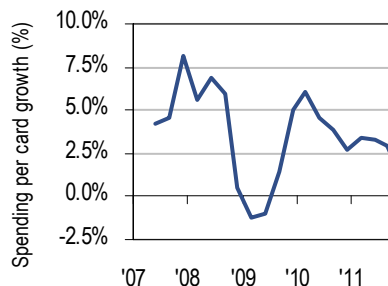
We show in Figure 30 to Figure 33, key Australian credit and debit card statistics. Debit card growth accelerated in 2011 through a combination of strong account growth and increased spending per debit card holder. This contrasts with credit card accounts that have had slowing spending growth per credit card.

Figure 30. Credit and debit card accounts



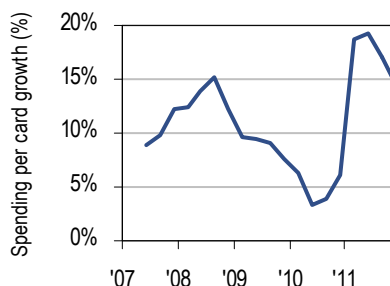
Source: RBA

Figure 31. Spending per credit card holder



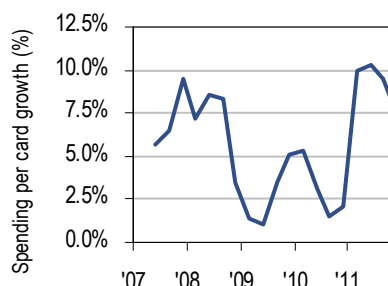
Source: RBA

Figure 32. Spending per debit card holder



Source: RBA

Figure 33. Spending per all card holders



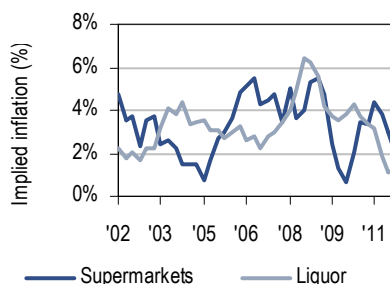
Source: RBA

## Retail price inflation

- **Food & Liquor** – Both Supermarket and Liquor inflation remains positive but is showing signs that it is slowing, given promotional activity by retailers.
- **Clothing** – In recent quarters, clothing experienced significant price deflation given strong competitive pressure, a higher Australian dollar and lower import tariffs. However, this slowed in September 2011 and the trend was inflationary (+1.4%) in the December quarter. Cotton price inflation is now flowing through retail while the AUD strength continues to be a partial offset.
- **Electronics** – Supply disruptions and high metal prices are adding inflationary pressure to electrical items in the short term. However, this is likely to be offset by intense competition between suppliers. The category continued to be in a deflationary trend.

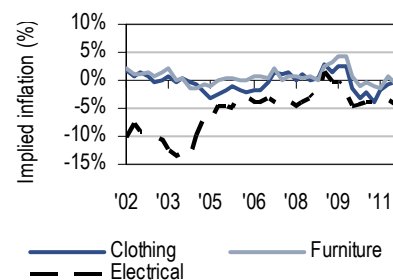
We show implied retail price inflation for a number of key categories in Figure 34 and Figure 35 below.

Figure 34. Food and Liquor inflation



Source: ABS, Citi Investment Research & Analysis

Figure 35. Non-food sector inflation



Source: ABS, Citi Investment Research & Analysis

## Input cost pressures

- **Food & Liquor** – Input prices rose 11% on pcp, in the three months to February 2012 mainly driven by a weaker AUD. The deflation in wheat, sugar and palm oil more than offset inflation in meat and packaging material. However, this excludes deflation in fresh produce.
- **Clothing** – Cotton prices have softened since their highs in February 2011. There is usually a 6-9 month lag between changes in spot prices and retail shelf prices.
- **Electronics** – Deflation in core electronic components (LCD, DRAM and NAND) more than offset the run-up in prices of gold and polystyrene in the three months to January 2012.

We show our Citi input cost monitor for February 2012 on a monthly and rolling-three month basis in Figure 36 and Figure 37 below.

Figure 36. Citi input cost monitor (1 mth)

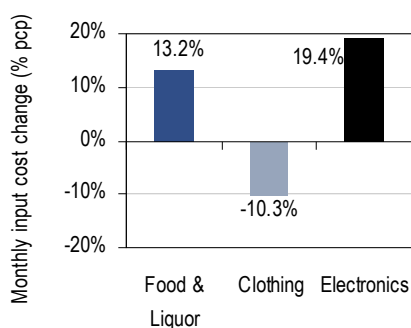
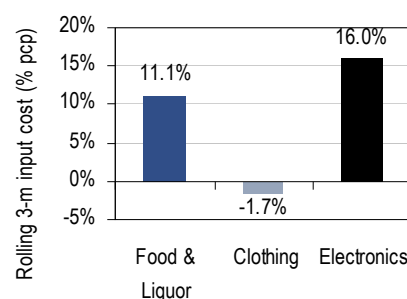


Figure 37. Citi input cost monitor (3 mths)

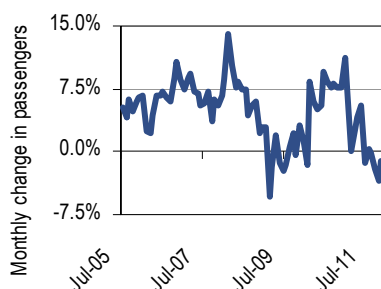


Inputs shown in AUD terms. Source: Citi Investment Research and Analysis

## Consumers on the move

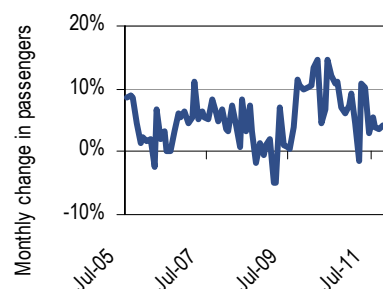
In Figure 38 to Figure 41 we show areas where consumers are “on the move”. We include air and road transport indicators as a guide to business and consumer activity. International travel remains strong, while domestic road-traffic has slowed, a sign of weaker domestic activity.

**Figure 38. Change in domestic air passenger traffic (monthly)**



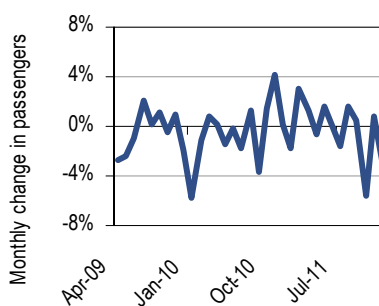
Source: Statistics New Zealand, CIRA

**Figure 39. Change in international air passenger traffic (monthly)**



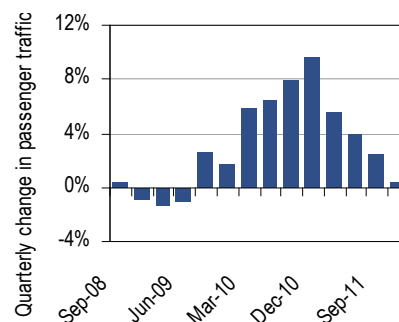
Source: Statistics New Zealand, CIRA

**Figure 40. Automotive fuel sales change against pcg**



Source: Statistics New Zealand, CIRA

**Figure 41. Change in quarterly road traffic volume at toll roads**

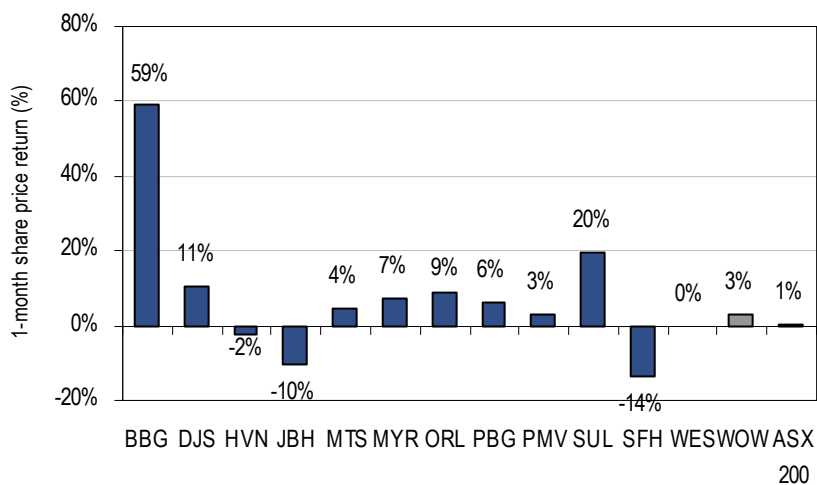


Source: Transurban, CIRA

## Share price performance

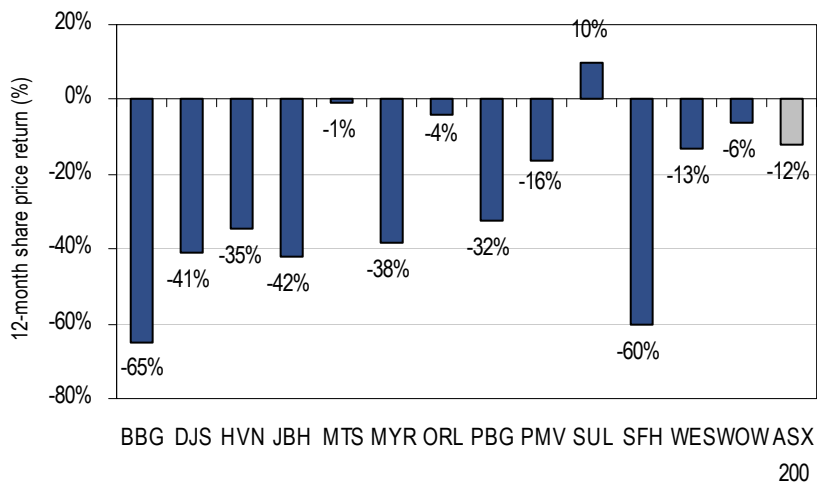
In Figure 42 and Figure 43 we show the 1-month and 12-month share price performance of listed Australian retailers and the ASX 200 Index.

Figure 42. 1-month share price return for Australian retailers



Note: Market data as of 5<sup>th</sup> March 2012; Source: Citi Investment Research and Analysis

Figure 43. 12-month share price return for Australian retailers



Note: Market data as of 5<sup>th</sup> March 2012; Source: Citi Investment Research and Analysis

## Kiwi corner

In Figure 44 we show Citi forecasts for New Zealand's key economic variables.

**Figure 44. Citi economic forecasts for New Zealand**

Calendar year	2010	2011	2012
GDP growth	0.80%	1.40%	2.60%
CPI	1.80%	2.60%	2.20%
Unemployment rate (end of period)	6.60%	6.50%	6.20%

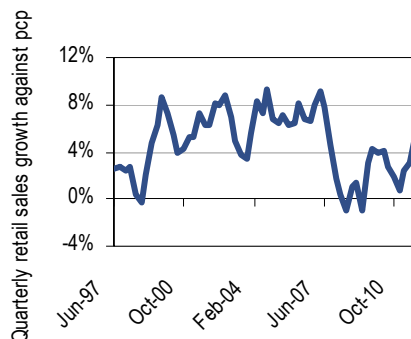
  

Period	02-Mar-12	Dec-11	Jun-12
Cash rate	2.50%	2.50%	2.50%
NZD/USD	0.84	0.84	0.77

Note: Forecast data as of 5<sup>th</sup> March 2012; Source: Citi Investment Research and Analysis

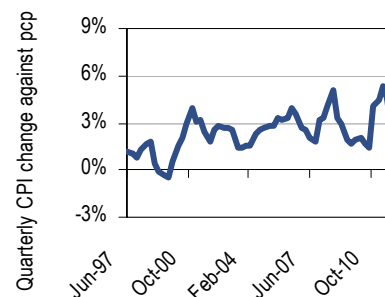
In Figure 45 to Figure 48 we show retail sales growth in New Zealand, CPI, unemployment rate and electronics cards transaction growth. In Figure 49 and Figure 50, we show the stock performance chart for selected New Zealand stocks in retail.

**Figure 45. Retail sales growth**



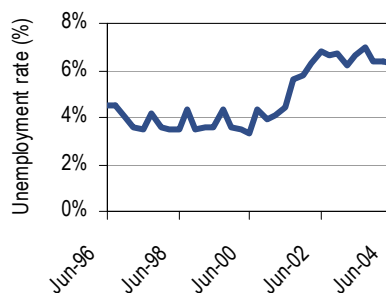
Source: Statistics New Zealand, Citi Investment Research and Analysis

**Figure 46. CPI growth**



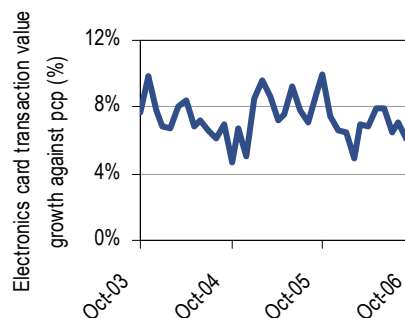
Source: Statistics New Zealand, Citi Investment Research and Analysis

**Figure 47. Unemployment rate**



Source: Statistics New Zealand, Citi Investment Research and Analysis

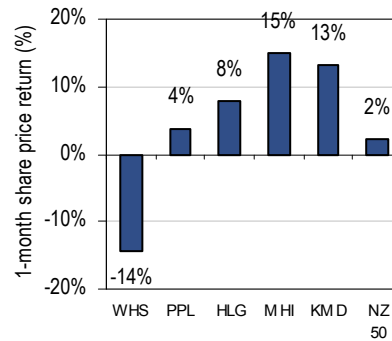
**Figure 48. Electronic card transaction value growth**



Source: Statistics New Zealand, Citi Investment Research and Analysis

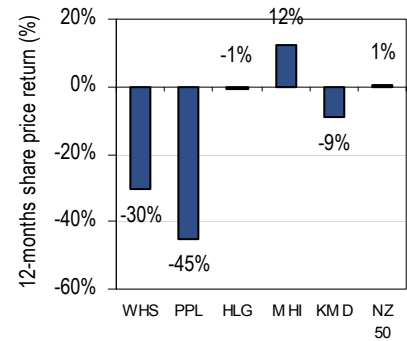


Figure 49. Stock performance chart - 1 month return



Note: Market data as of 5<sup>th</sup> March 2012; Source: Citi Investment Research and Analysis

Figure 50. Stock performance chart - 12 months return

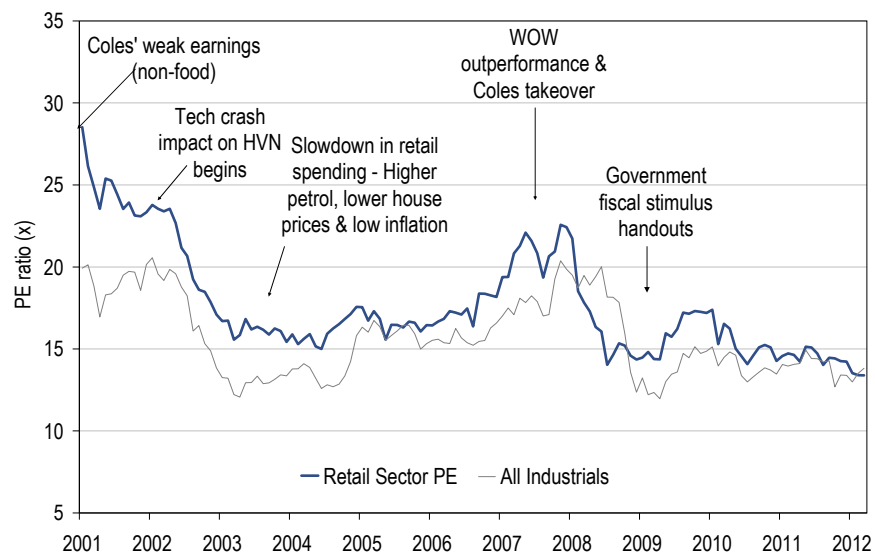


Note: Market data as of 5<sup>th</sup> March 2012; Source: Citi Investment Research and Analysis

## Valuation and financial performance

Figure 51 shows that the retail sector PE is currently trading at an 19% discount to its five year average. The discount reflects concern for discretionary retailers due to the uncertain recovery in retail spending activity.

Figure 51. Retail sector PE ratio



Note: Market data as of 5<sup>th</sup> March 2012; Source: IBES, Citi Investment Research & Analysis

## Retail Sector Valuation

Figure 52. Retail sector valuation metrics

Company	Rating	Target price	Share price	EV/EBIT FY12e	EV/EBIT FY13e	P/E FY12e	P/E FY13e	Div yield FY12e	Div yield FY13e	FCF yield FY12e	FCF yield FY13e
<b>Supermarkets</b>											
Woolworths Ltd (WOW.AX)	2	26.90	25.24	10.4	9.6	14.1	13.1	5.0%	5.5%	2.2%	5.0%
Wesfarmers Ltd (WES.AX)	2	30.70	29.46	11.5	10.1	15.4	13.3	5.6%	6.4%	1.3%	4.0%
Metcash Ltd (MTS.AX)	1	4.75	4.17	8.9	8.3	12.0	11.0	6.6%	6.9%	6.8%	8.9%
<b>Global comparable</b>				<b>8.6</b>	<b>8.4</b>	<b>11.3</b>	<b>10.5</b>	<b>3.8%</b>	<b>4.5%</b>		
<b>Department Stores</b>											
David Jones Ltd (DJS.AX)	2	2.65	2.79	7.3	7.1	10.1	10.0	8.9%	8.9%	7.6%	9.2%
Myer Holdings Ltd (MYR.AX)	2	2.10	2.34	7.3	7.2	9.5	9.4	8.6%	8.5%	11.2%	9.3%
<b>Global comparable</b>				<b>9.5</b>	<b>8.4</b>	<b>12.4</b>	<b>10.5</b>	<b>2.1%</b>	<b>2.3%</b>		
<b>Electrical Retailers</b>											
Harvey Norman Holdings Ltd (HVN.AX)	2	2.00	1.98	8.5	6.5	10.6	9.4	5.1%	6.1%	2.2%	4.1%
JB Hi-Fi Ltd (JBH.AX)	2	12.50	11.04	6.9	6.4	9.1	8.8	7.1%	7.4%	10.8%	10.2%
<b>Global comparable</b>				<b>5.0</b>	<b>4.6</b>	<b>7.2</b>	<b>13.9</b>	<b>0.0%</b>	<b>0.0%</b>		
<b>Surf/Street wear</b>											
Billabong International Ltd (BBG.AX)	2	2.80	2.92	10.5	9.0	11.7	9.9	2.1%	2.7%	2.2%	10.4%
<b>Global comparable</b>				<b>11.9</b>	<b>9.9</b>	<b>17.0</b>	<b>14.5</b>	<b>1.5%</b>	<b>1.6%</b>		
<b>Wholesaler</b>											
Pacific Brands Ltd (PBG.AX)	1H	0.90	0.70	6.7	5.4	9.0	6.6	5.8%	7.9%	-52.9%	17.5%
<b>Global comparable</b>				<b>10.1</b>	<b>9.0</b>	<b>14.9</b>	<b>14.0</b>	<b>0.7%</b>	<b>0.9%</b>		
<b>Clothing retailing</b>											
Premier Investments Ltd (PMV.AX)	2	5.25	5.26	7.3	6.1	14.8	12.7	6.8%	6.8%	8.8%	8.2%
Specialty Fashion Group Ltd (SFH.AX)	1H	0.60	0.50	31.1	7.8	76.9	10.8	0.0%	2.0%	10.8%	6.9%
<b>Global comparable</b>				<b>9.0</b>	<b>8.1</b>	<b>17.1</b>	<b>13.6</b>	<b>1.7%</b>	<b>1.8%</b>		
<b>Luxury Goods</b>											
OrotonGroup Ltd (ORL.AX)	2	8.30	8.95	9.4	8.8	13.4	12.6	6.2%	6.6%	7.5%	7.5%
<b>Global comparable</b>				<b>13.0</b>	<b>11.2</b>	<b>19.2</b>	<b>16.7</b>	<b>2.0%</b>	<b>2.3%</b>		
<b>Auto-parts retail</b>											
Super Retail Group Ltd (SUL.AX)	1	7.40	7.19	9.7	8.9	12.6	11.8	4.5%	4.8%	5.8%	4.5%
<b>Global comparable</b>				<b>10.1</b>	<b>9.1</b>	<b>16.1</b>	<b>13.9</b>	<b>0.1%</b>	<b>0.1%</b>		

Note: Market data as of 5<sup>th</sup> March 2012; Source: Citi Investment Research and Analysis

## Retail Sector Financial Forecasts

Figure 53. Citi retail sector forecasts

	Woolworths	Wesfarmers	Metcash	David Jones	Myer	Harvey Norman	JB Hi-Fi	Billabong	Pacific Brands	Premier Investments	Specialty Fashion Group	Oroton Group	Super Retail Group
	WOW	WES	MTS	DJS	MYR	HVN	JBH	BBG	PBG	PMV	SFH	ORL	SUL
<b>Sales (\$m)</b>													
FY11a	54,143	54,513	12,364	1,962	3,159	6,176	2,959	1,685	1,615	876	569	164	1,092
FY12e	56,870	57,360	12,732	1,889	3,160	5,879	3,109	1,691	1,372	886	568	186	1,667
FY13e	60,159	60,822	13,180	1,939	3,279	5,887	3,288	1,603	1,383	919	565	199	1,981
<b>Sales growth (%)</b>													
FY11a	4.7%	5.9%	7.4%	-4.4%	-5.0%	1.6%	8.3%	13.6%	-7.3%	-0.3%	-0.4%	12.3%	16.5%
FY12e	5.0%	5.2%	3.0%	-3.7%	0.1%	-4.8%	5.0%	0.3%	-15.0%	1.2%	-0.2%	12.9%	52.7%
FY13e	5.8%	6.0%	3.5%	2.6%	3.7%	0.1%	5.8%	-5.2%	0.8%	3.7%	-0.5%	7.3%	18.8%
<b>EBIT margin (%)</b>													
FY11a	6.1%	5.7%	3.5%	12.6%	8.2%	25.3%	6.6%	8.9%	11.5%	7.4%	4.0%	22.2%	8.0%
FY12e	6.0%	6.1%	3.5%	11.4%	7.6%	20.7%	5.9%	6.4%	9.5%	8.2%	0.7%	21.8%	10.0%
FY13e	6.1%	6.6%	3.7%	11.7%	7.5%	27.5%	5.9%	7.0%	11.3%	9.2%	2.5%	21.5%	9.9%
<b>Core EPS (cents)</b>													
FY11a	173.6	166.3	33.3	32.4	27.8	22.4	124.0	47.0	11.1	33.0	7.6	60.6	42.7
FY12e	178.7	191.3	34.1	27.0	24.4	18.7	121.2	25.0	7.7	35.8	0.6	67.3	57.2
FY13e	193.4	222.0	37.4	28.1	24.9	21.1	125.5	29.5	10.5	41.8	4.6	71.7	61.0
<b>EPS growth (%)</b>													
FY11a	6.4%	15.6%	4.3%	-1.9%	-5.6%	-17.8%	14.3%	-18.6%	14.4%	-21.1%	-51.8%	8.0%	21.2%
FY12e	3.0%	15.0%	2.3%	-16.6%	-11.9%	-16.5%	-2.3%	-46.8%	-30.4%	8.6%	-91.4%	11.0%	34.1%
FY13e	8.2%	16.1%	9.8%	3.9%	1.9%	12.5%	3.6%	18.0%	35.9%	16.7%	610.0%	6.6%	6.6%
<b>DPS (cents)</b>													
FY11a	122.0	150.0	27.0	28.0	22.5	12.0	77.0	29.0	6.2	36.0	4.0	50.0	27.3
FY12e	126.0	165.0	27.5	24.5	20.0	10.0	78.0	6.0	4.0	36.0	0.0	56.0	32.5
FY13e	140.0	188.0	28.5	25.0	20.0	12.0	82.0	8.0	5.5	36.0	1.0	59.0	34.5
<b>ROE (%)</b>													
FY11a	28.0%	7.7%	17.9%	22.0%	18.7%	11.7%	49.2%	9.9%	-10.3%	3.4%	25.5%	84.9%	19.4%
FY12e	24.8%	8.5%	16.5%	18.1%	16.5%	8.8%	64.6%	6.7%	-33.2%	4.7%	2.3%	86.1%	18.1%
FY13e	27.6%	10.1%	19.9%	18.5%	16.3%	10.0%	51.7%	6.5%	11.5%	5.5%	14.6%	79.4%	16.0%
<b>Working cap to sales (%)</b>													
FY11a	-1.2%	3.8%	4.7%	4.7%	-0.2%	8.9%	5.5%	22.5%	19.3%	3.8%	0.4%	14.1%	17.6%
FY12e	-1.2%	3.5%	4.1%	4.9%	-0.2%	8.6%	5.1%	19.9%	21.4%	2.4%	0.2%	11.9%	15.0%
FY13e	-1.5%	3.0%	3.9%	3.3%	-0.3%	9.4%	4.5%	18.4%	20.1%	2.0%	0.9%	12.2%	14.2%
<b>Capex to sales (%)</b>													
FY11a	3.9%	3.8%	0.3%	4.1%	4.3%	5.6%	1.5%	3.1%	1.3%	2.6%	6.0%	3.8%	3.4%
FY12e	4.0%	4.9%	0.6%	4.3%	2.4%	3.8%	1.7%	5.5%	1.6%	1.4%	2.4%	4.5%	2.9%
FY13e	3.5%	3.9%	0.4%	4.9%	3.6%	2.5%	1.7%	4.2%	1.5%	2.2%	2.6%	3.9%	2.9%
<b>EBITDA interest cover (x)</b>													
FY11a	15.8	10.6	7.3	40.8	9.5	13.7	55.4	8.3	5.8	nm	28.5	40.0	11.2
FY12e	14.5	11.7	7.1	26.0	9.2	8.8	16.6	5.2	5.2	nm	13.3	44.6	8.2
FY13e	16.7	12.4	7.4	22.0	9.5	10.5	17.2	6.9	7.1	nm	22.6	67.0	7.2

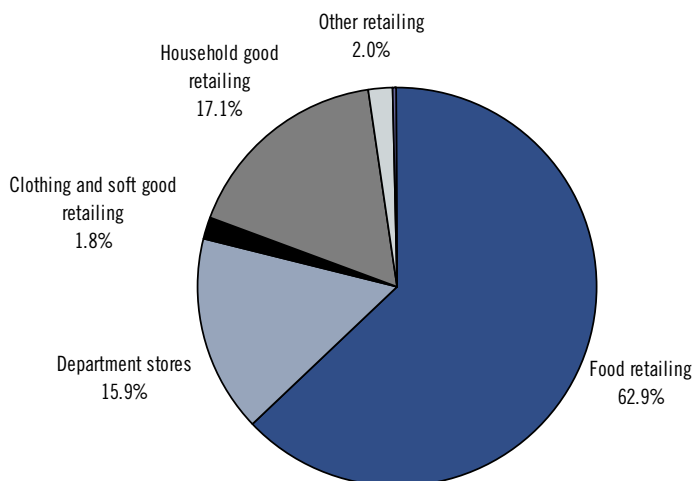
Note: Market data as of 5<sup>th</sup> March 2012; Source: Citi Investment Research and Analysis

## Appendix 1 Explanation of data

### Retail sales indicator

The Citi Retail Sales Indicator comprises of a basket of listed retail sector companies with market capitalisations above \$100 million. We calculate our indicator by weighting each retail category within the Australian Bureau of Statistics (ABS) Retail Trade series, by the total listed company sales mix. Figure 54 shows the sales base of the listed company's, with an obvious bias towards Food retailing, given Woolworths and Wesfarmers' inclusion.

Figure 54. Listed company sales base assumption



Source: Citi Investment Research & Analysis

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### Retail sales and prices

Industry retail sales performance is compared to the previous corresponding period, by category and is presented on a rolling quarterly basis. The data supplied by the ABS. We assess real growth and the implied inflation by category using chain volume data supplied by the ABS.

### Weather

We use a weighted average of the yearly difference in monthly maximum temperature readings from each major Australian capital city. The maximum temperature reading by capital city is supplied by the Bureau of Meteorology.

### Petrol

We use the average unleaded petrol price for each capital city in Australia to derive a weighted national petrol price. Our weights are population based.

### Valuation and financial forecasts

Our sector PE chart is derived from the one year-forward PE's. We weight each company's by the respective market capitalisation to compute our sector PE.

The remainder of the financial forecasts within the 'Valuation' section are Citi's forecasts.

## Appendix 2 Previous Issues

### Issue 36 (5 April 2011)

#### 1H11 Retail Results - Saved by the Dollar

Companies mentioned: WOW, WES, MTS, HVN, JBH, DJS, MYR, BBG, PMV, PBG, SUL

### Issue 36: 1H11 Retail Results - Saved by the Dollar

The Australian retail sector has suffered another six months of weak retail spending. The 1H11 reporting season has concluded and the results reveal the importance of currency gains in protecting profit margins. On average, gross margins actually rose, despite industry-wide discounting. The negative leverage to weak sales has resulted in a decline in EBIT margins and we see a rise in inventory levels for most retailers as a risk for 2H11e. The currency benefits should continue in 2H11e and sales conditions will improve. However, the next headwind is higher input costs from China. Our preferences are Woolworths and David Jones, which should benefit from accelerating sales growth and have strong market power to manage a rising input cost environment.

<https://www.citigroupgeo.com/pdf/SAU11222.pdf>

### Issue 37 (10 May 2011)

#### Entering Australian Retail: Oasis or Minefield?

Companies mentioned: WOW, WES, PMV, JBH

### Issue 37: Entering Australian Retail: Oasis or Minefield?

Zara has finally opened in Australia with plenty of publicity. The opening has triggered the debate about whether more international retailers will impact the incumbents in Australia. In this issue of What's In Store?, we analyse the financial performance of a cross-section of existing global retailers that operate in Australia and assess the risk to industry sales. Our findings show that international retailers typically underperform Australian-owned peers with lower margins. The key barrier to success is finding good locations. We estimate that new entry will detract near 0.5% from sales growth for Australian retailers like Woolworths, Wesfarmers, David Jones and Myer.

<https://www.citigroupgeo.com/pdf/SAU11461.pdf>

### Issue 37 (9 June 2011)

#### Thinking Like a Retailer

Companies mentioned: WOW, WES, PMV, JBH, DJS, MYR, SUL

### Issue 38: Thinking Like a Retailer

Measures of retail performance often focus on comparable stores sales growth and EBIT margins. These are limited and prone to being massaged to satisfy investor expectations. In Issue 38 of What's In Store?, we explore retail measures used by retailers themselves. These measures look at the productivity of floor space and success in working through inventory. On these measures Premier Investments is the strongest performing retailer, followed by David Jones, Woolworths and Myer. Moreover Australian retailers actually stack up well versus international peers, primarily associated the limited retail floor space in most categories.

<https://www.citigroupgeo.com/pdf/SAU81927.pdf>

### Issue 39 (8 July 2011)

#### Where does the Household Savings Rate Settle?

Companies mentioned: WOW, MTS, JBH, DJS, MYR, HVN

### Issue 39: Where does the Household Savings Rate Settle?

The Australian household has had a reality check over the past three years. After drawing on savings for many years, they have now developed a more rational balance between spending and saving. In this issue of What's In Store?, we assess at the outlook for the household savings rate and implications for retail spending. The fifty year average for savings is 8.8% of income and the current run-rate is 8.9%. In our view, the likely range is 8%-14%, with three factors to watch – house prices, interest rates and the AUD/USD. The implications for retail spending are sub-trend growth and we expect all discretionary categories to be affected. Food retailers are clearly more defensive, but discretionary retailers are already trading depressed PE ratios that reflect a weak outlook.

<https://www.citigroupgeo.com/pdf/SAU11780.pdf>

**Issue 40 (16 August 2011)**

**Demystifying Retail Leases**

**Companies mentioned:** WOW, JBH, DJS, MYR, HVN, WES, SUL, PMV

**Issue 40: Demystifying Retail Leases**

Leases are prevalent in Australian retailing and can be a source of cost pressure in a slow sales environment. In Issue 40 of What's In Store?, we delve into the detail to understand the nature of retail lease agreements and the implications for profit margins. "Anchor" tenants, such as Wesfarmers and Woolworths, and high profile retailers like JB Hi-Fi are best placed because their lease agreements typically provide for turnover contingent rents that ensure lease costs remain fairly constant with sales. However, specialty retailers like Premier Investments need sales growth ahead of inflation to avoid rental cost ratios escalating. We also explore the implications of placing leases on balance sheet, which may eventuate under new accounting rules. The most significant increase in balance sheet gearing is for Myer and Premier Investments.

<https://www.citigroupgeo.com/pdf/SAU12107.pdf>

**Issue 41 (9 September 2011)**

**Retailers addicted to discounts**

**Companies mentioned:** WOW, JBH, DJS, MYR, SFH, SUL, PMV

**Issue 41: Retailers addicted to discounts**

Retailers are searching for new ways to grow their profits. The focus is increasingly shifting to higher gross profit margins. In Issue 41 of What's In Store?, we assess the scope to reduce discounting. In our view, the discounting over the past year has been driven by the pass through of the higher Australian dollar. Retailers are more prepared to use discounts, rather than lower shelf price points in such an environment. The implication for retailers like David Jones, Myer and Premier Investments is that lower levels of discounting will be difficult to achieve unless shelf prices are reduced, or lower volumes budgeted for. We have Hold ratings on these retailers and see better value in electronics retailers JB Hi-Fi and Harvey Norman where valuation multiples are more attractive.

<https://www.citigroupgeo.com/pdf/SAU88689.pdf>

**Issue 42 (6 October 2011)**

**FY11 results - Trying to Protect Margins**

**Companies mentioned:** WOW, WES, MTS, HVN, JBH, DJS, MYR, BBG, PMV, PBG, SUL, SFH

**Issue 42: Trying to Protect Margins**

Retail reporting season has drawn to a close for FY11. The results were mixed, a reflection of the retail sales environment. In Issue 42 of What's In Store?, we analyse the results of 31 retailers. While sales have been weak, more than half the retailers had an increase in operating earnings, primarily through higher gross margins. Retailers are lucky that the surging Australian dollar has provided a gross margin cushion to the weaker sales backdrop. The outlook is more constrained. The majority of retailers had a rise in inventory and many are signaling an investment in online and staffing that may also crimp margins. Our investment preference is for companies that have store rollout opportunities such as JB Hi-Fi and Super Retail Group.

<https://www.citigroupgeo.com/pdf/SAU90508.pdf>

**Issue 43 (9 November 2011)**

**An Age Old Question for Retailers**

**Companies mentioned:** SFH, FLT

**Issue 43: An Age Old Question for Retailers**

Australia's population is aging, like many other developed countries. In Issue 43 of What's In Store?, we look at the changing age profile for Australia and the impact on retail spending. The population over 65 will grow by 2.3% per annum over the next forty years to 7.6 million, while those under 65 will only grow at 0.8%. Older Australians tend to spend more on medical expenses, fresh foods and holidays and less on furniture, clothing and alcohol & tobacco. There are two retail companies set to benefit from the aging profile – Specialty Fashion Group, which has clothing stores that target older demographics, and Flight Centre, which offers travel services. We have Buy ratings on both companies.

<https://www.citigroupgeo.com/pdf/SAU12788.pdf>

**Issue 44 (14 December 2011)**

**Elusive Factory Outlet Options**

**Companies mentioned: DJS, HVN, JBH, MYR, ORL, PBG, PMV, SFH**

**Issue 44: Elusive Factory Outlet Options**

Factory outlets are embraced by some retailers, but shunned by others. In Australia, it is a \$2 billion retail market and in our view a way to segment shopper preferences effectively. Moreover, the profit margins and return on capital are often higher in outlet stores because sales productivity is higher and rental costs are lower. While developing this channel may be a growth option for David Jones, Myer and Premier Investments, the under-utilised floor space for full-line department stores or specialty stores needs to reduce, a challenge given lease terms. We expect some growth in factory outlet retailing online, through flash sale websites.

<https://www.citigroupgeo.com/pdf/SAUT1NYT.pdf>

**Issue 45 (9 February 2012)**

**Consumers Spending Elsewhere**

**Companies mentioned: FLT, SUL, MTS**

**Issue 45: Consumers Spending Elsewhere**

Retailers are complaining because shoppers are not spending money in their stores. The reality is that retail spending is much weaker than broader consumer spending. In Issue 45 of What's In Store?, we explore the substitution between retail and other spending categories. In discretionary retailing, travel has taken almost half of the growth from retail. In food retailing, restaurants and café's are not taking away share from supermarkets but are rather complementing its growth. These trends are partly lifestyle driven and partly price driven. The implication is weak retail sales growth again in 2012 as consumers switch more of their spending to travel, recreation and personal care. We prefer Metcash for its defensive attributes and both Flight Centre and Super Retail Group for their ability to tap into these consumer trends.

<https://www.citigroupgeo.com/pdf/SAUJQYIU.pdf>









## Appendix A-1

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