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Retailing - Broadlines (Citi)
Australia/NZ | Australia

What's In Store? Issue 51

Australian Retail Floor Space – It's in the Zone

- **Risk of zoning laws changing** — Australia has an abundance of retail floor space and space growth which has outstripped population increases over many years. In Issue 51 of What's In Store?, we explore the growth in retail floor space in Australia, which is of increasing significance as zoning laws may be relaxed to broaden the scope for supermarket openings. The medium-term risks are negative for Metcash, Wesfarmers and Woolworths' profit margins.

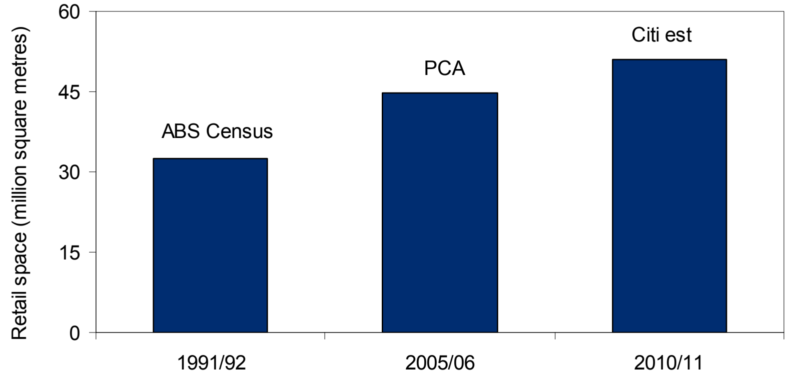
- **Australian floor space per capita** — Australia has 51 million sqm of floor space on our estimates. That is 2.3 sqm per capita. The highest provision of floor space is in food retailing at 13 million sqm and furniture & hardware at 10 million sqm.

- **Strong growth and more than many other countries** — Australian floor space has grown 57% over the past 20 years, while the population has only grown 28%. Moreover, Australia's floor space per capita is almost 50% higher than the UK, but much lower than the US. High land prices and wage rates should ideally lead to lower floor space per capita in Australia than these other countries.

- **Greatest risk to margins for supermarkets** — Planning laws in NSW and Victoria may change. Current proposals would allow supermarkets less than 2,000sqm in bulky goods zones in Victoria (eg furniture and hardware sites). An acceleration in space growth would hamper margins. We calculate a 100bp drop in margins for Metcash, Wesfarmers and Woolworths, would lower valuation by at least 10%.

- **Citi Retail Sales Indicator for June 2012 up 6.2%** — Retail spending spiked in June following government handouts and timing of key promotional events.

Retail Floor Space in Australia (since 1992)



Source: ABS, PCA, Citi Research estimates

■ Industry Overview

Craig Woolford
+61-2-8225-4302
craig.woolford@citi.com

Michael Goltsman, CFA
+61-2-8225-4836
michael.goltsman@citi.com

Lokesh Gusain
lokesh.gusain@citi.com

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What's In Store? Issue 51

How much retail floor space is there in Australia? We set out to answer this simple question, but found reliable data was missing. In *What's In Store?* Issue 51, we provide a detailed estimate of floor space, the growth over the last 20 years and how it compares to other countries. The question is crucial given property zoning laws may change in Australia that would allow more supermarkets to open and relax some of the barriers to entry. The greatest risk is for Metcash, Wesfarmers and Woolworths, in our view, given food retailing currently has the tightest restrictions and highest returns. Margins could easily fall 100bp, which is worth more than 10% to valuation to these companies.

How much retail space does Australia need?

Understanding the breadth of retailing floor space is an important starting point for any analysis of retailing competition and profit margins. We explore retail floor space in Australia by dividing the topic into three areas below:

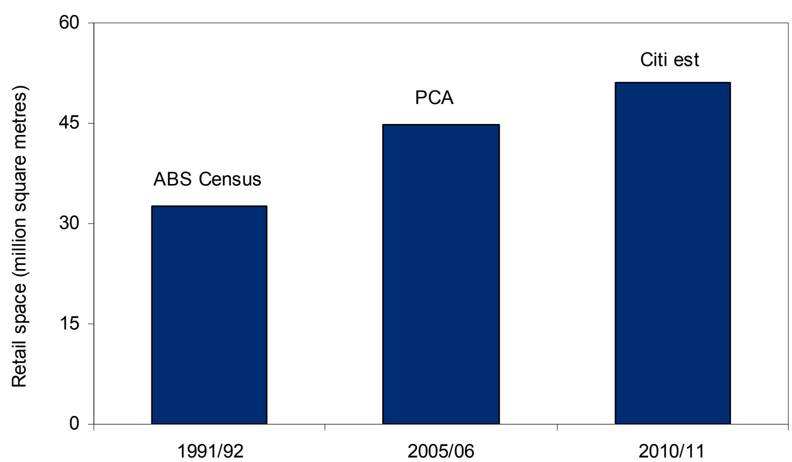
1. How much retail floor space does Australia have?
2. Has Australian retail floor space growth been excessive compared with history and with other countries?
3. What risks are posed to retailers if retail zoning laws change?

1. How much retail floor space does Australia have?

We estimate Australia has 51 million square metres (sqm) of retail floor space. This equates to 2.3 sqm for each Australian. Arriving at this figure required digging through the archives. The last time it was measured accurately was 1992 through a Retail Census by the Australian Bureau of Statistics.

We summarise the change in retail floor space in Australia in Figure 1. In 1991/92, the ABS census stated there was 32.6 million sqm of floor space across 147,000 retail outlets.[1] We show the growth in floor space through to 2005/06 when the Property Council of Australia provided an estimate, and our calculation for 2010/11 of 51 million sqm.

Figure 1. Retail floor space trend in Australia (1991/1992 through to 2010/11)



Sources: ABS, Productivity commission, Citi Research

[1] Our measure of "retailing" excludes equipment repairs, video hire, dry cleaners and hairdressers.

Category breakdown

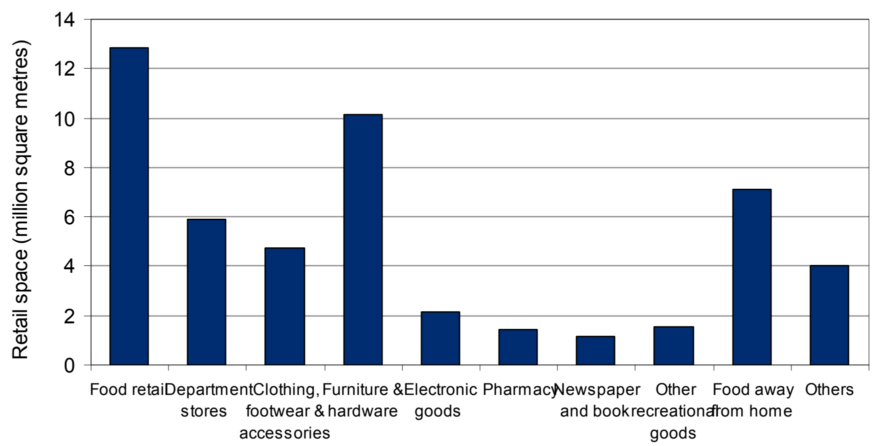
The largest share of retail space is taken by food retailing at 12.8 million sqm. This includes supermarkets, specialty bakers, delicatessens, butchers and greengrocers. This also includes off-premise liquor retailing.

It is worth noting the second largest retail category in terms of retail floor space is furniture and hardware retailing. We estimate this at 10 million sqm.

The breakdown of square metres by retailer type is shown in Figure 2. Cafes, restaurants and takeaway food retailing is also a significant category for retailing floor space.

The significance of this data is high as retail floor space is controlled by zoning in Australia, which restricts supply. If that zoning is relaxed, there are risks that low return retail categories like furniture or bulky goods will be re-mixed to higher-return categories like supermarkets.

Figure 2. Square metres by retailer type (FY11)



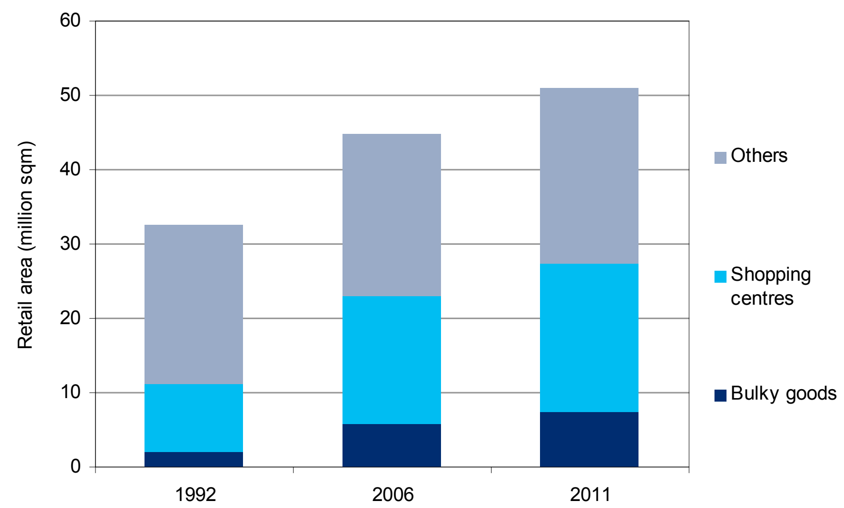
Note others includes antiques, optometry and "unclassified" retailers by the ABS
Source: Citi Research estimates

Retail format breakdown

Australia is known to have a very developed shopping centre industry. Even so, almost half the retail floor space in Australia is destination outlets, or street-based locations. We show our estimate of the split of floor space from 1992 through to 2011 in Figure 3.

The bulky goods format has seen the strongest growth. This format has the most relaxed zoning given it is often "industrial"-type land. Shopping malls have taken share from high street locations.

Figure 3. Retail floor space by format



Source: ABS, PCA, Citi Research

So the listed retailers are how big?

The two major listed retailers, Wesfarmers and Woolworths, dominate retail floor space in Australia. Wesfarmers is the largest retailer by floor space at 5.5 million sqm on our estimates, which is 11% of all Australian space. We estimate Woolworths has 3.3 million square metres in Australia (6% of all floor space). Interestingly, each retailer has roughly 18% of all retail spending.

Possibly the most encouraging angle for the large ASX-listed retailers is that they are typically more productive retailers. They generate a higher sales per sqm. The scope to take market share through this competitive advantage is significant.

The major retailer's share of floor space is low compared with their share of sales. Therefore when industry returns tighten, the listed retailers will typically fare better and maintain a presence. We show the Australian retailer's share of floor space in Figure 4.

Figure 4. Major retailer share of Australian floor space (FY11)

Source: Company reports, Citi Research estimates

2. Is there too much floor space in Australia?

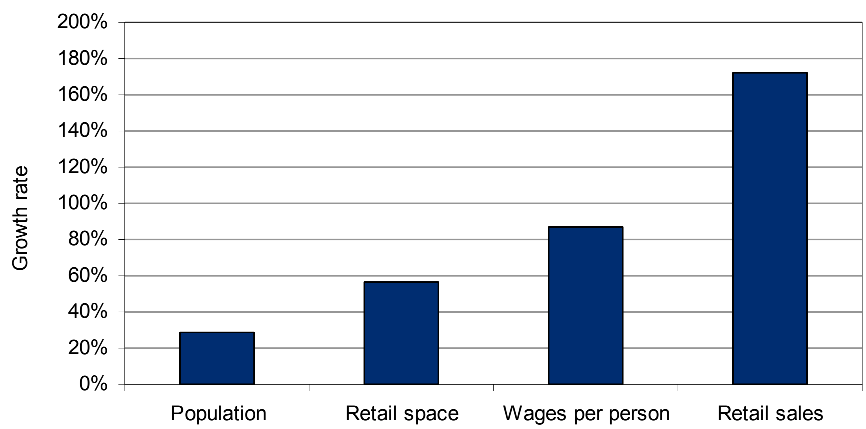
Australia's floor space growth has outstripped population growth over the past 20 years. Despite strong space growth, retailer's earnings have increased because retail spending has grown more rapidly and there have also been reductions in sourcing costs. Australia also has more floor space per capita than most countries, other than the United States and Canada.

Floor space versus history

Over the past 20 years, Australia's floor space has grown 57%, while the population has grown 28%. The sales growth over that same time period is 172%.

Interestingly, on our numbers, the growth in floor space and unit wages growth is very close to overall retail sales growth, which we see as a rational outcome. Extra stores have opened, so long as the cost of operating that store is covered and a return above a cost of capital is achieved.

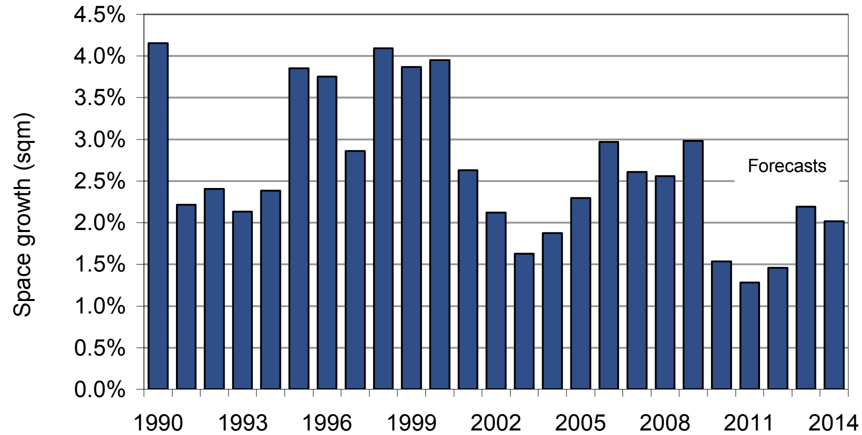
Figure 5. Total growth rate between 1992 and 2011



Source: ABS, Citi Research

We show the space growth in shopping centres and bulky goods in Figure 6, which has outstripped overall retail space growth. The growth in floor space is slowing given lower returns and a higher cost of capital for property developers. We expect space growth of 1.5%-2.5% per annum over the next 3-5 years. This growth will primarily come through supermarkets and bulky goods outlets. Major retailers like Woolworths and Wesfarmers have invested in their own property developments, offsetting some of the slowdown by third party developers.

Figure 6. Shopping centre space growth (including forecasts)



Source: JLL, Citi Research

Floor space compared with other countries

Australia's floor space density is much higher than the UK, but lower than the US. Australia is also higher than other developed Asian markets like Japan and Singapore. The floor space estimates are somewhat dated, but provide a benchmark in Figure 7. Which is the right global benchmark? In our view the amount of floor space a country can accommodate is dependent on two factors:

1. **The cost and availability of land:** The cost of land will be the primary determinant of rental costs and therefore the viability of retail formats. Interestingly, Australian land prices are high, which leads Australian retailers to often operate in smaller shop formats than offshore peers.

2. **The cost of wages:** The largest operating cost for most retailers is staff wages. The hourly wage rates in Australia are higher than many developed markets, particularly the US and UK.

Given Australia has both high land prices and high wages compared with other developed markets, we see Australia needing to index at a lower floor space per capita than its current level.

Any change in floor space will likely be very gradual. The shorter-term response by retailers and landlords is a remixing towards different retail categories. We also expect a slower rate of property development.

Figure 7. Floor space per capita – global benchmarks

Country	Shopping centre floor space per capita (sqm)	Total retail floor space per capita (sqm)
USA (2003)	1.88	3.64
Canada (2003)	1.19	na
NZ (2000)	0.40	2.40
Australia (2003)	**0.59**	**1.90**
United Kingdom (2000)	0.30	1.30
Hong Kong (2003)	na	1.20
South Korea (2002)	na	1.20
Singapore (2003)	0.40	1.00
Japan (2002)	0.30	1.00

Brackets is year of estimate.
Source: M Baker, Shopping Centre Industry Benchmarks

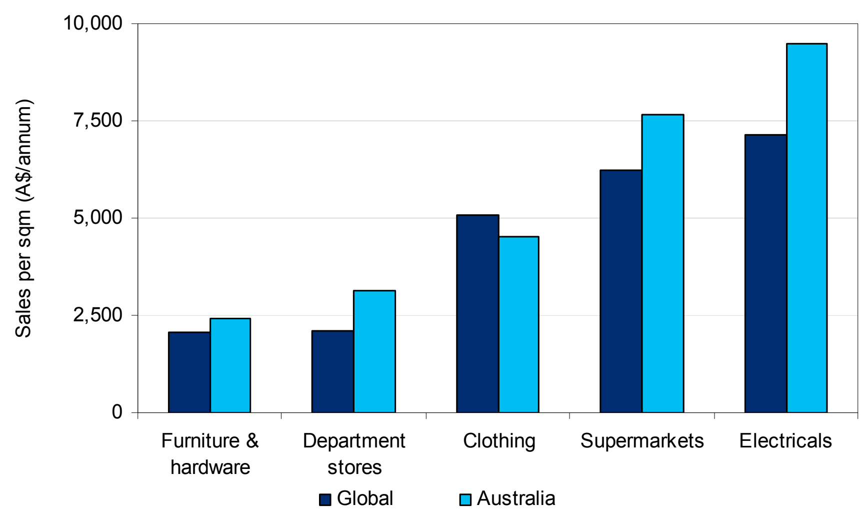
Note that Australia's floor space per capita has risen from 1.9 sqm to 2.3 sqm from 2003 to 2011.

Australia vs global benchmark retailers

Australian retailers tend to generate higher sales per sqm than offshore retailers. This may be a reflection of store format or restrictive land availability in certain categories.

In Figure 8, we show the sales per sqm for Australian retail categories, compared with offshore benchmarks. The offshore benchmarks are the three to five largest retailers in these categories. See Appendix 1 for a list of these retailers. The productivity of Australian retailers is more pronounced in supermarkets and department stores.

Figure 8. FY11 sales per square metres by major retail categories (Australia vs. Global) in AUD



Note: Sales per square metres is based on Gross lettable area (GLA). Department stores includes discount department stores.
Sources: Company reports, ABS, Citi Research

Conclusion

Australia has a high density of retail floor space, especially given high costs of operating retail in rent and labour. The ability to change retail formats to address

these high costs is restricted by zoning and leases. However, proposed changes in two key states could free up competition and lower profit margins. We discuss the potential zoning law changes below.

3. Risk of retail zoning law changes

This assessment of the retail floor space is important because retail zoning restrictions currently in place may be relaxed. Supermarkets are most vulnerable given the high EBIT per sqm and return on capital for this format.

Zoning is a key barrier to entry in retail

The operation of retail stores is restricted by zoning regulations. These zones are determined by local government councils (below State level).

Retail zoning limits the type of retail activity. Most parts of Australia have zoning that restricts where large supermarkets can operate as well as shopping centres and large bulky goods stores. The zoning is intended to centralise retailing activity for the purpose of ensuring that public infrastructure is available. However, market distortions arise from this zoning.

The barriers to entry created by zoning laws include:

- Reduced number of competitors in some areas. Sydney has a lower density of supermarket and hardware retailing competition, generated by a lack of appropriately zoned sites.
- Ability for existing retailers to object to new entry on the basis of financial impact on the existing player.
- Increasing the cost of land and rents for retail. This typically flows through as higher retail prices.

Governments may relax these restrictions

The planning laws may change in Australia. At a national level, in 2011 the Productivity Commission has reported to the Government on the need to relax planning laws in 2011. Both NSW and Victoria (combined 56% of Australian retail) have proposals that may loosen planning laws related to retailing.

The changes are summarised in Figure 9. For NSW, the proposal was put forward as a Green paper in July 2012 and will result in inability of existing retailers to object to new developments on the basis of economic impact.

For Victoria, the proposed changes make retail zoning less prescriptive. Supermarkets less than 2,000sqm can operate in bulky goods precincts.

Figure 9. Summary of proposed zoning changes in NSW and VIC

State	Next step	Current legislation	Proposed changes
NSW Discussion paper released: Green paper 14 July 2012	Submissions close 14 September2012 . Legislation planned for early 2013.	Regulations set at local council level and vary widely, but often allow existing retailers to object to new developments.	More consistency across local councils and inability to object based on adverse impact.
Victoria Discussion paper released: 11 July 2012	Submissions close 21 September 2012	Five business zones restrict retail activity depending on products sold. Food retail is restricted than non-food retail.	Two commercial zones to enhance flexibility and mixed use development. Supermarkets <2,000sqm can operate in bulky goods locations.

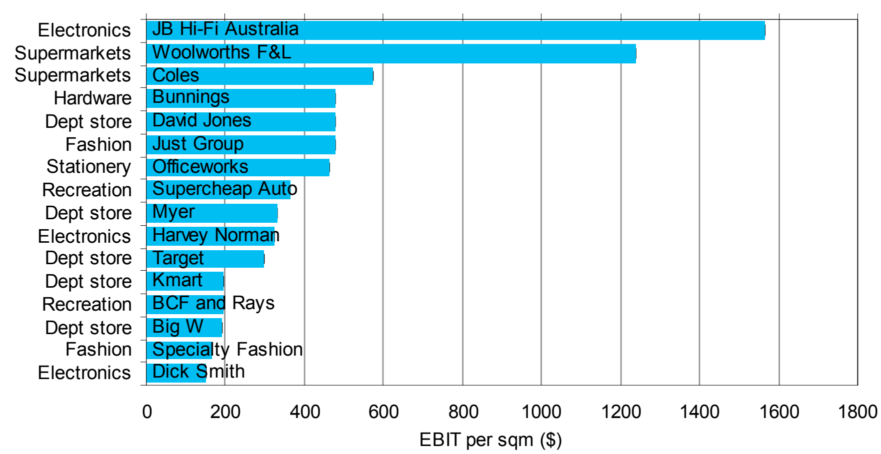
Source: Government websites, Citi Research

Who is vulnerable?

Changes in retail zoning laws is a medium-term risk (3-5 years), but one of the most significant for Australian retailers as supply of floor space in some categories could rise at a time when demand is weak. We see Woolworths and Wesfarmers as most vulnerable. They both have supermarkets where margins are high compared with global peers. In addition, they are likely to accelerate store openings which will dilute long-run margins.

Retail floor space would migrate to the areas where returns and profits are highest. In Figure 10, we show the EBIT per sqm of floor space for major listed retailers. This shows a clear trend where the strongest EBIT per sqm is reported by JB Hi-Fi and both major supermarket operators that combined account for two-thirds of the supermarket industry. Some segments of electronics will be vulnerable like mobile phones and tablets, where stock turns are very high.

Figure 10. EBIT per sqm for major listed retailers (FY11)



We exclude Oroton, which has $3,823 per sqm and distorts the chart presentation.
Source: Company Reports, Citi Research estimates

Risk to valuations from lower margins

In Figure 11**Error! Reference source not found.**, we show the estimated impact of a 100bp move in EBIT margins for each retailer. This shows a significant valuation impact across most businesses. The impact of a 100bp fall in margins for

Woolworths is $3.36 per share, or 13% fall in share price. For Wesfarmers, a 100bp drop in margins for Coles could reduce valuation by 10%, while for Bunnings, the estimated impact is -3%.

Figure 11. Estimated valuation impact from a 100bp drop in EBIT margin (key segments)

Retailer	Segment	Rating	EV/EBIT	$m sales FY12	Valuation per share	Share price	Impact
DJS.AU	David Jones (dept store)	Neutral	8.8	1,881	-$0.31	$2.59	-12%
MYR.AU	Myer	Neutral	6.5	3,101	-$0.35	$1.62	-21%
HVN.AU	Harvey Norman (Aust)	Sell	9.1	4,791	-$0.41	$1.95	-21%
JBH.AU	JB Hi-Fi Australia	Sell	6.5	2,904	-$1.92	$8.86	-22%
ORL.AU	OrotonGroup	Sell	6.9	186	-$0.31	$7.30	-4%
PMV.AU	Just Group	Neutral	6.4	839	-$0.34	$4.65	-7%
SUL.AU	Supercheap Auto	Neutral	9.8	725	-$0.36	$7.19	-5%
WOW.AU	Woolworths F&L	Neutral	11.1	37,549	-$3.36	$26.80	-13%
WES.AU	Coles	Sell	12.8	26,561	-$2.92	$29.90	-10%
WES.AU	Bunnings	Sell	12.8	7,181	-$0.79	$29.90	-3%

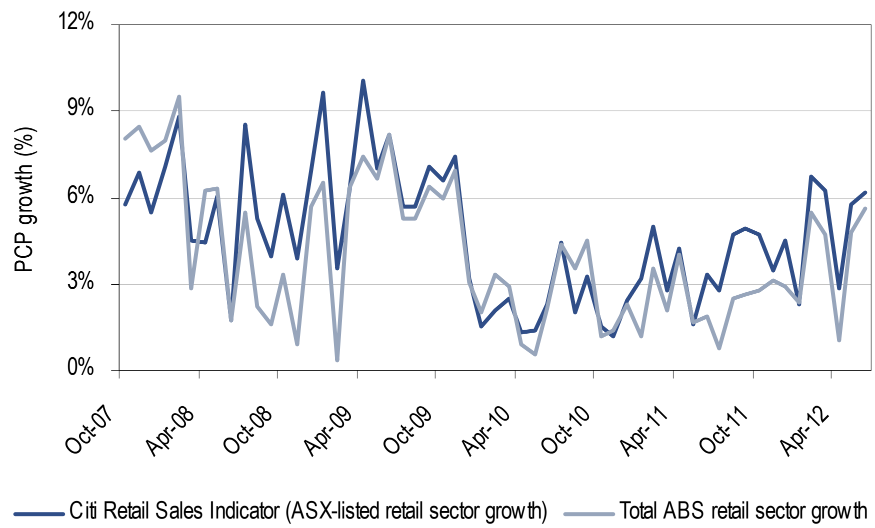
Source: Citi Research estimates

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 6.2% in June 2012, only slightly above the ABS total retail sales growth of 5.6%.

Figure 12. Citi Retail Sales Indicator (retail sector sales growth for ASX-listed companies)



Source: ABS, Citi Research

Sector performance for June 2012

Figure 13. Retail category monthly growth rate on pcp (%)

Month ended:	Jun-11	May-12	Jun-12
Supermarket	4.4	4.9	5.0
Department	-5.1	3.4	9.8
Clothing	-1.9	1.3	5.0
Furniture,	4.3	-3.2	-3.4
Electrical	-8.4	4.7	4.2
Hardware	3.4	1.0	2.1
Total (Industry)	1.9	4.8	5.6

Source: ABS, Citi Research

ABS retail sales for June 2012 rose 5.6% on June 2011. The rate of growth has accelerated in the past two months; however we see this as being a temporary factor driven by government handouts in May and June 2012. Department stores were the strongest performers in June 2012.

Key points

- **Supermarkets up 5.0%** – Supermarket sales have remained robust at 5.0%, despite prices remaining soft. Implied deflation for supermarkets was 0.8% in the three months to June 2012. Woolworths Food & Liquor recorded 3.8% sales growth in 4Q12 but has still lost market share to Coles.

- **Department stores up 9.8%** – Discount department stores were the biggest beneficiary in June 2012. Big W, Target and Kmart all recorded LFL sales growth in the June 2012 quarter. We expect Myer and David Jones sales to have received less benefit during the quarter.

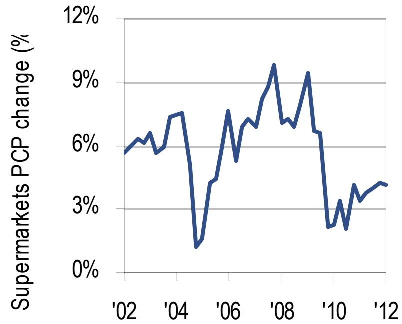
- **Clothing specialties up 5.0%** – Clothing specialties sales improved to 5.0% growth in June 2012 from 1.3% growth in May 2012. The rebound is notable and may have been supported by cooler weather in June however is more likely to be an outcome of stimulus payments.

- **Electronics up 4.2%** – Electronics sales have remained steady rising 4.2% in June 2012 compared to 4.7% growth in May 2012. The growth rates are pleasing and reflect new model introductions which have offset the continued industry-wide price deflation.

- **Hardware up 2.1% and Furniture down 3.4%** – Housing related categories have experienced less benefit from the government handouts compared to other discretionary retail categories. We expect sales trends to remain soft given weak housing activity.

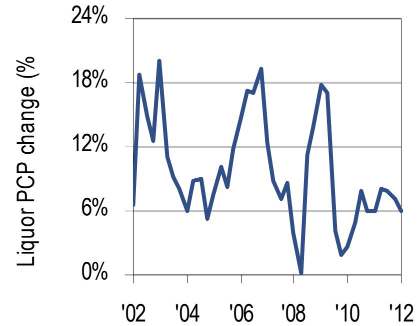
Sector specific performance – rolling 3 months to June '12

Figure 14. Supermarkets



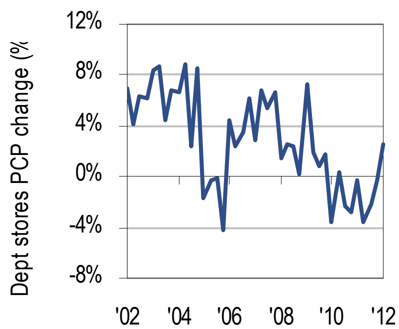
Source: ABS 8501.0

Figure 15. Liquor Retailing



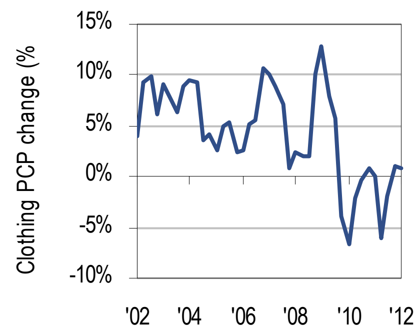
Source: ABS 8501.0

Figure 16. Department Stores



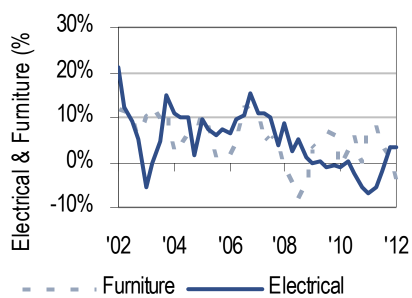
Source: ABS 8501.0

Figure 17. Clothing



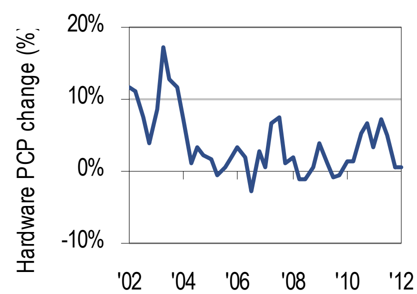
Source: ABS 8501.0

Figure 18. Electrical and Furniture



Source: ABS 8501.0

Figure 19. Hardware

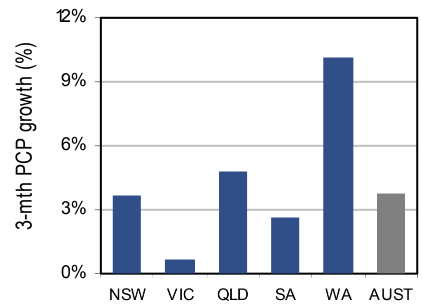


Source: ABS 8501.0

State based performance

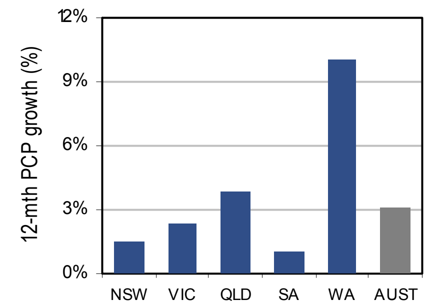
Figure 20 and Figure 21 show the quarterly and yearly sales growth performance for each state respectively.

Figure 20. 3-month sales growth by state



Source: ABS 8501.0

Figure 21. 12-month sales growth by state



Source: ABS 8501.0

Economic outlook

Citi Economists forecast a slightly slower pace of improvement in GDP growth in 2013, mainly as the mining strength is largely offset by weakness in other sectors.

Figure 22. Citi economic forecasts for Australia

Calendar year	2011	2012	2013
GDP growth	1.9%	3.7%	3.4%
CPI	3.1%	1.6%	2.7%
Unemployment rate (end of period)	5.3%	5.5%	5.1%

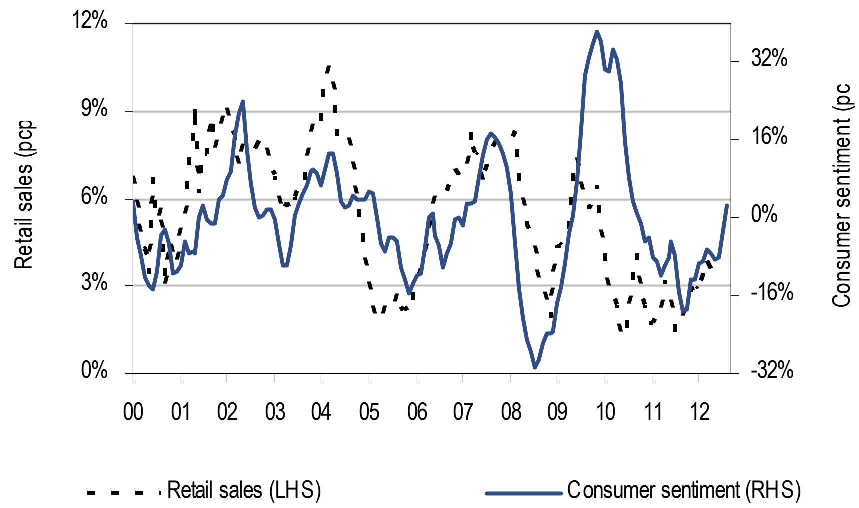
Period	17-Aug-12	30/06/2012	30/06/2013
Cash rate	3.50%	3.50%	3.50%
AUD/USD	1.05	1.02	0.98

Note: Forecast data as of 17th August 2012; Source: Citi Research

Consumer Sentiment

We find the change in consumer sentiment has a strong co-incident correlation with retail spending. In the most recent reading for August 2012, consumer sentiment was at 96.6. This is down 2.5% vs. July 2012, but up 7.8% compared to the prior year.

Figure 23. Consumer sentiment and retail sales

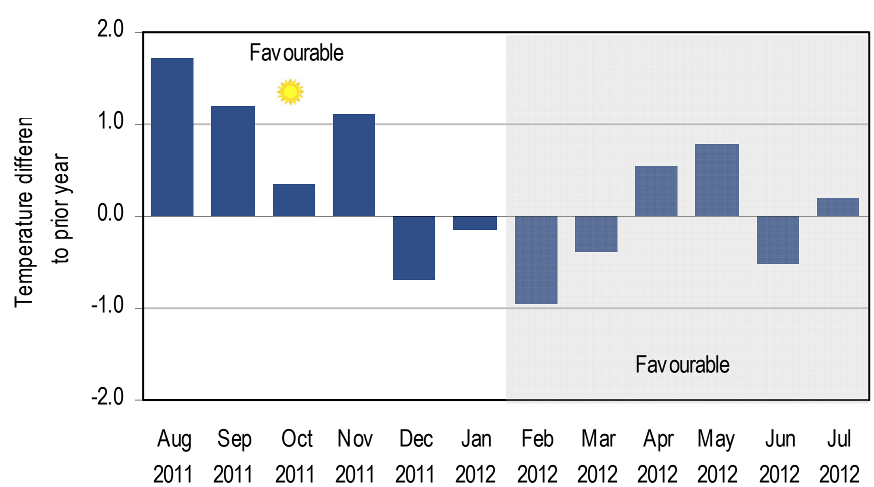


Source: Westpac, ABS, Citi Research

Weather

Figure 24 shows the weighted average temperature difference to the prior year, in the past 12 months. Trend for winter fashion sales has not been favourable as only 3/6 months experienced colder weather patterns.

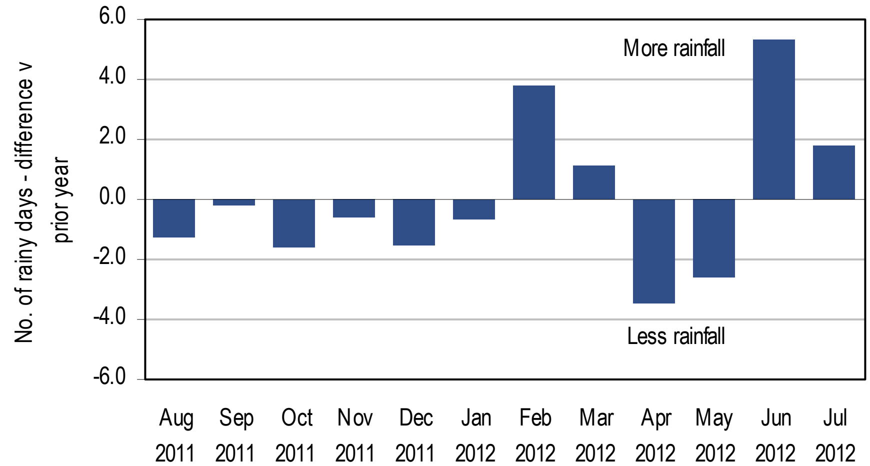
Figure 24. Temperature change – weighted national average



Source: BOM, Citi Research

Figure 25 shows the weighted average difference in rainfall days to last year.

Figure 25. Rainfall change – weighted national average

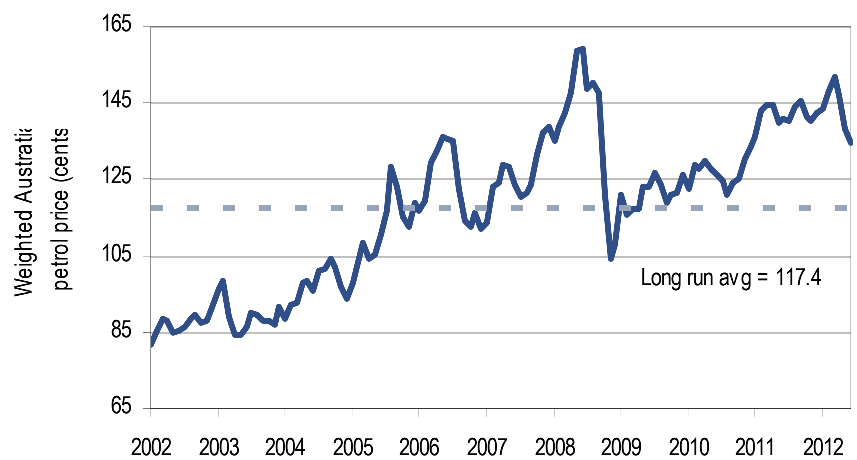


Source: BOM, Citi Research

Petrol prices

Petrol prices averaged 134.6 cents per/litre in July 2012. Prices are 4.5% lower compared to the last year. This should help household spending as their net cash in had for retail is increasing.

Figure 26. Australian petrol prices

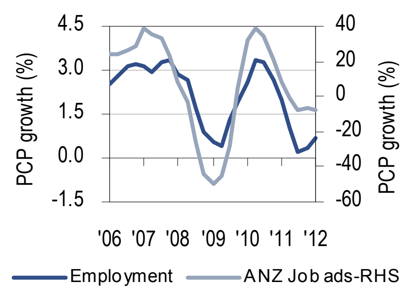


Source: Aust. Automobile Association

Employment

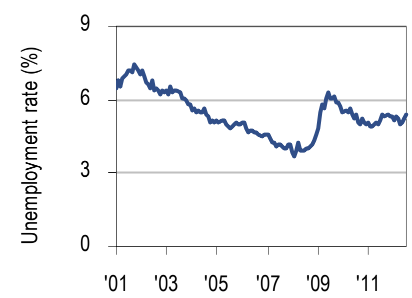
The jobs market recovered in 2010 and 2011 after a sharp decline during the 2008-09 global financial crisis. However, the job ads growth has been in decline since September 2011, with the latest reading at -9.1% for July 2012. While the overall employment is still in growth, we note that the rate of increase is below 1.0%. The unemployment rate has consistently increased between April and July 2012.

Figure 27. Employment and job ads growth



Source: ABS, ANZ

Figure 28. Unemployment rate

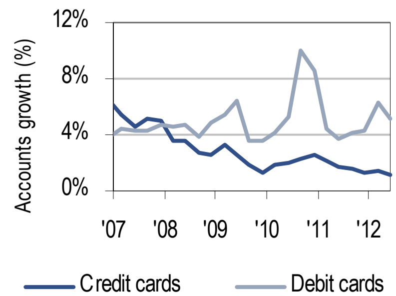


Source: ABS

Credit and debit card spending growth

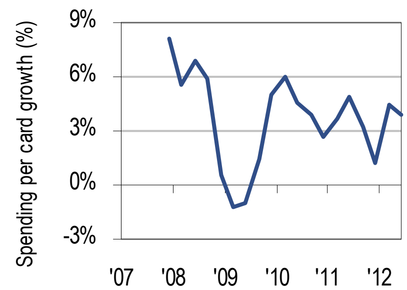
We show in Figure 29 to Figure 32, key Australian credit and debit card statistics. Debit card growth accelerated in 2011 through a combination of strong account growth and increased spending per debit card holder. This contrasts with credit card accounts that have had slowing spending growth per credit card.

Figure 29. Credit and debit card accounts



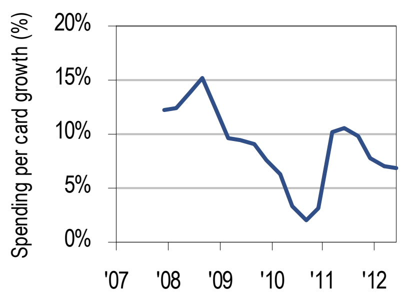
Source: RBA

Figure 30. Spending per credit card holder



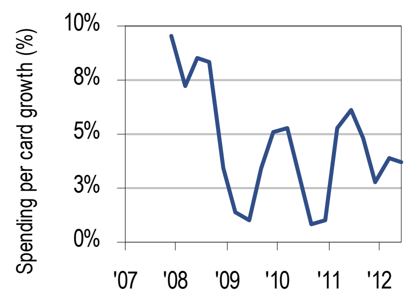
Source: RBA

Figure 31. Spending per debit card holder



Source: RBA

Figure 32. Spending per all card holders



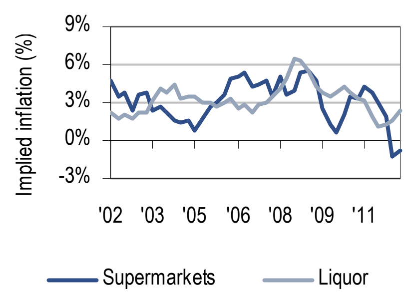
Source: RBA

Retail price inflation

- **Food & Liquor** – Supermarkets inflation remained negative in the June quarter mainly driven by heavy deflation in fresh produce. Liquor inflation however remained positive as brewers continued to compromise volumes for additional pricing.
- **Clothing** – Clothing prices remained flat (down 0.3%) in the June 2012 quarter. 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 but the competitive landscape is an offset.
- **Electronics** – After a brief period of supply disruptions and high metal prices, the deflationary trend seems to have returned in the electrical category. There is intense competition between suppliers. The category continued to be in a deflationary trend in the June 2012 quarter.

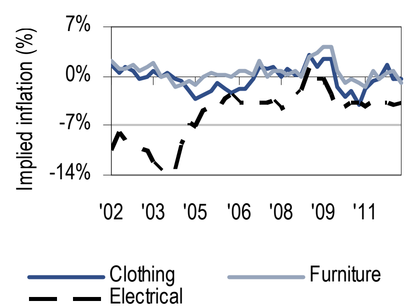
We show implied retail price inflation for a number of key categories in Figure 33 and Figure 34 below.

Figure 33. Food and Liquor inflation



Source: ABS, Citi Research

Figure 34. Non-food sector inflation



Source: ABS, Citi Research

Input cost pressures

- **Food & Liquor** – Input prices declined 5.5% on pcp, in the three months to July 2012 mainly driven by lower dairy, sugar, palm oil and packaging material partly offset by higher grain prices.
- **Clothing** – Cotton prices have softened since their highs in February 2011 and continue to follow a slight deflationary trend. There is usually a 6-9 month lag between changes in spot prices and retail shelf prices. Overall, our input cost basket deflation continued in the 3-month period to July 2012.
- **Electronics** – In the 3-months to July 2012, our electrical input basket declined 4.2% as deflation in LCD and NAND more than offset the slight inflation DRAM and gold.

We show our Citi input cost monitor for July 2012 on a monthly and rolling-three month basis in Figure 35 and Figure 36 below.

Figure 35. Citi input cost monitor (1 mth)

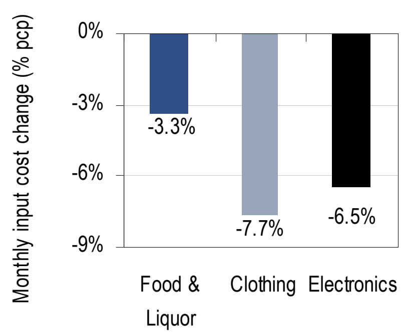
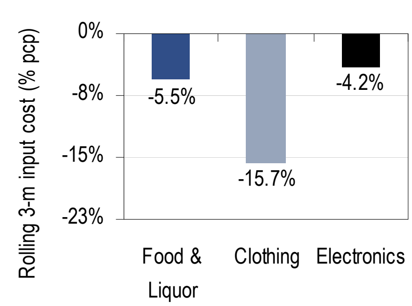


Figure 36. Citi input cost monitor (3 mths)

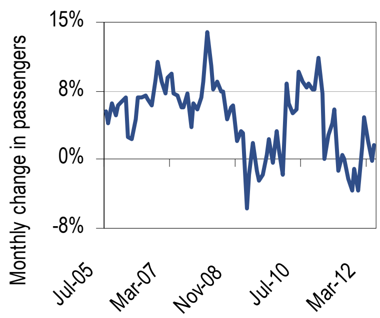


Source: Citi Research

On the move – transport indicators

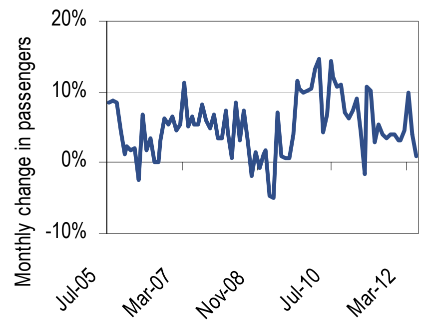
In Figure 37 to Figure 40 we show areas where consumers are "on the move". We include air and road transport indicators as a guide to business and consumer activity. International travel remains strong, while domestic road-traffic has been declining, a sign of weak economic activity.

Figure 37. Change in domestic air passenger traffic (monthly)



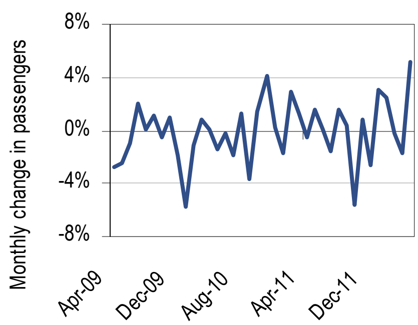
Source: Statistics New Zealand, Citi Research

Figure 38. Change in international air passenger traffic (monthly)



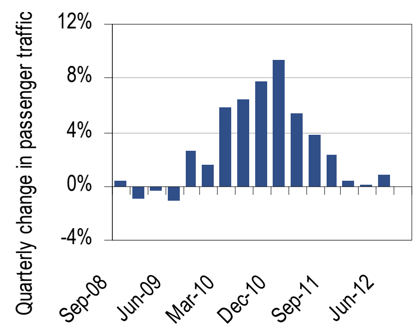
Source: Statistics New Zealand, Citi Research

Figure 39. Automotive fuel sales change against pcp



Source: Statistics New Zealand, Citi Research

Figure 40. Change in quarterly road traffic volume at tolled roads



Source: Transurban, Citi Research

Kiwi corner

In Figure 41 we show Citi forecasts for New Zealand's key economic variables.

Figure 41. Citi economic forecasts for New Zealand

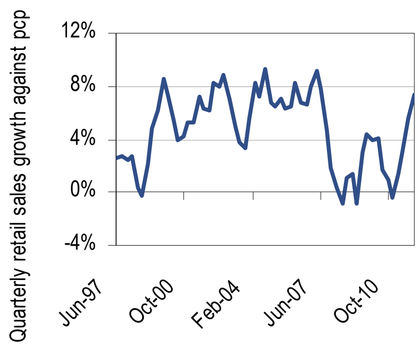
Calendar year	2011	2012	2013
GDP growth	1.3%	2.3%	2.8%
CPI	2.6%	1.5%	2.2%
Unemployment rate (end of period)	6.5%	6.4%	5.6%

Period	17-Aug-12	30/06/2012	30/06/2013
Cash rate	2.50%	2.50%	2.75%
NZD/USD	0.81	0.79	0.74

Note: Forecast data as of 17th August 2012; Source: Citi Research

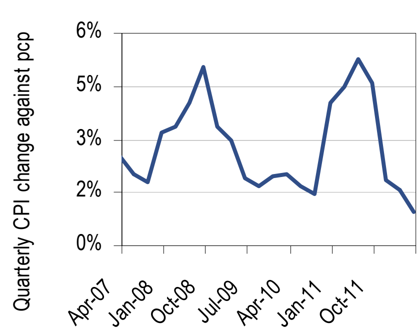
In Figure 42 to Figure 45 we show New Zealand's retail sales growth, CPI growth, unemployment rate and electronics cards transaction growth. In Figure 46 and Figure 47, we show the stock performance chart for selected New Zealand stocks in retail.

Figure 42. Retail sales growth



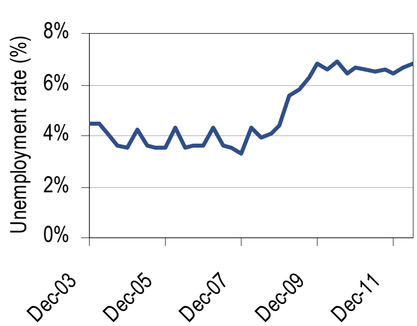
Source: Statistics New Zealand, Citi Research

Figure 43. CPI growth



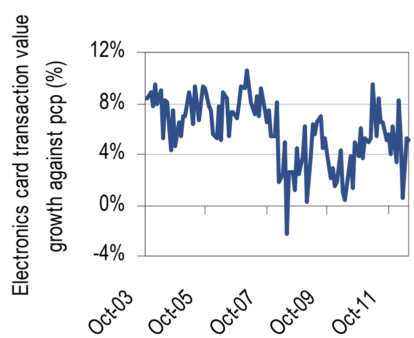
Source: Statistics New Zealand, Citi Research

Figure 44. Unemployment rate



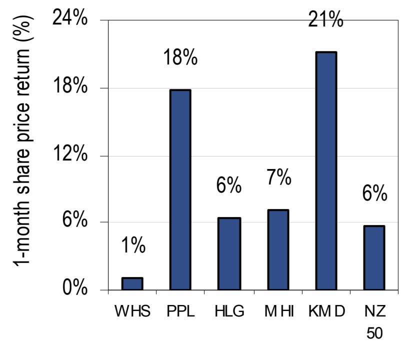
Source: Statistics New Zealand, Citi Research

Figure 45. Electronic card transaction value growth



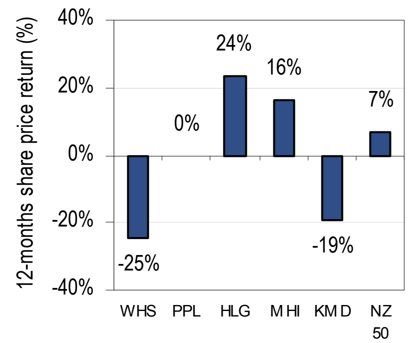
Source: Statistics New Zealand, Citi Research

Figure 46. Stock performance chart, 1-month return



Note: Market data as of 20th August 2012; Source: Citi Research

Figure 47. Stock performance chart, 12-months return

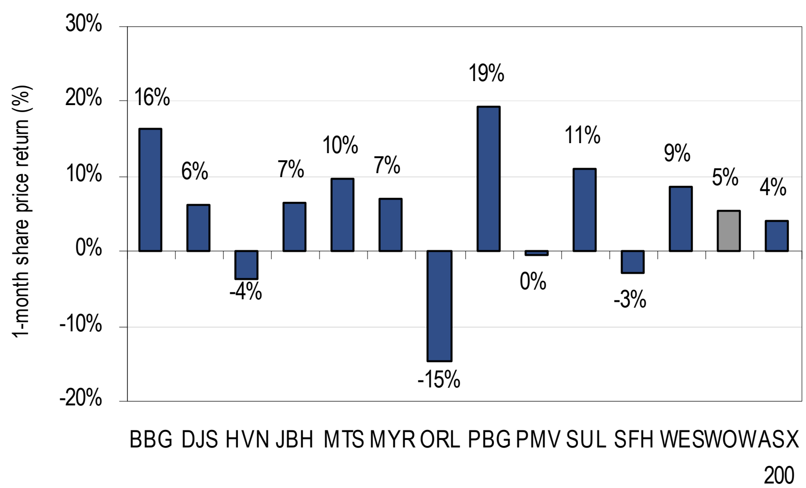


Note: Market data as of 20th August 2012; Source: Citi Research

Share price performance

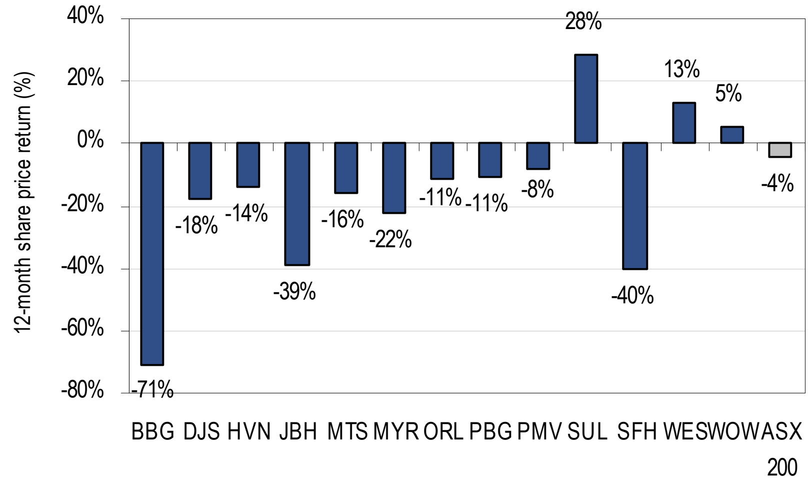
In Figure 48 and Figure 49 we show the 1-month and 12-month share price performance of listed Australian retailers and the ASX 200 Index.

Figure 48. 1-month share price return for Australian retailers



Note: Market data as of 20th August ; Source: Citi Research

Figure 49. 12-month share price return for Australian retailers

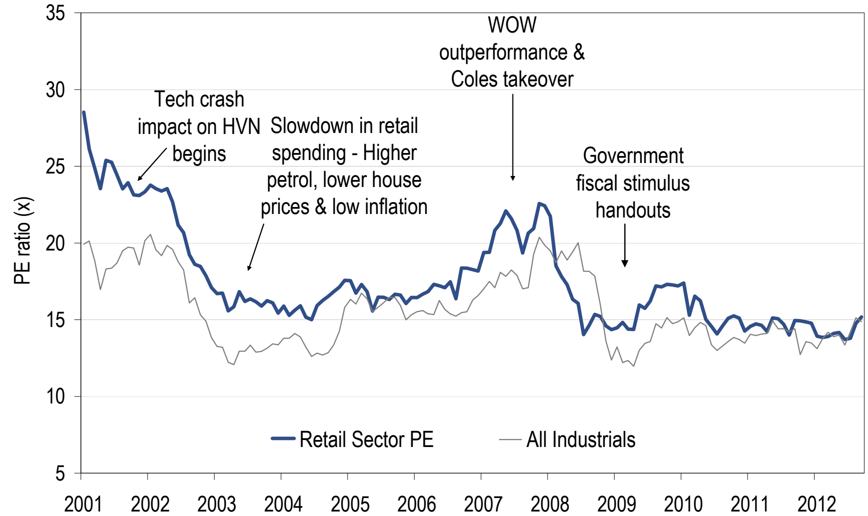


Note: Market data as of 20th August 2012; Source: Citi Research

Valuation and financial performance

Figure 50 shows that the retail sector PE is currently trading at only a 4% discount to its five-year average.

Figure 50. Retail sector PE ratio



Note: Market data as of 20th August 2012; Source: Citi Research

Retail Sector Valuation

Figure 51. 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
Supermarkets											
Woolworths Ltd (WOW.AX)	2	27.55	29.03	11.9	11.1	16.3	15.3	4.3%	4.7%	1.8%	3.9%
Wesfarmers Ltd (WES.AX)	3	31.10	34.71	13.4	12.7	18.9	17.0	4.8%	5.0%	2.5%	3.0%
Metcash Ltd (MTS.AX)	1	4.25	3.53	9.0	8.4	10.4	10.3	7.9%	8.0%	7.9%	8.3%
Global comparable				***8.2***	***7.7***	***11.8***	***11.2***	***3.8%***	***4.3%***		
Department Stores											
David Jones Ltd (DJS.AX)	2	2.30	2.56	8.6	8.8	11.8	12.4	7.9%	7.8%	9.2%	6.3%
Myer Holdings Ltd (MYR.AX)	2	1.80	1.90	6.4	6.6	7.8	8.4	10.4%	9.6%	14.3%	10.8%
Global comparable				***10.3***	***9.9***	***12.9***	***12.2***	***2.1%***	***2.2%***		
Electrical Retailers											
Harvey Norman Holdings Ltd (HVN.AX)	3	1.75	2.05	9.6	9.2	12.5	11.6	4.4%	4.4%	3.6%	2.3%
JB Hi-Fi Ltd (JBH.AX)	3	8.05	9.46	6.9	6.5	8.9	9.1	6.9%	7.1%	18.1%	6.6%
Global comparable				***4.4***	***4.9***	***14.2***	***9.6***	***0.4%***	***2.2%***		
Surf/Street wear											
Billabong International Ltd (BBG.AX)	2	1.45	1.38	12.1	13.1	8.2	13.0	1.7%	1.5%	1.0%	9.7%
Global comparable				***12.4***	***10.4***	***17.7***	***15.1***	***1.6%***	***1.7%***		
Wholesaler											
Pacific Brands Ltd (PBG.AX)	1H	0.75	0.59	6.0	5.3	7.8	6.7	6.8%	8.5%	10.3%	16.7%
Global comparable				***11.8***	***9.9***	***16.1***	***15.1***	***0.6%***	***0.8%***		
Clothing retailing											
Premier Investments Ltd (PMV.AX)	2	4.50	4.84	6.4	6.4	13.3	13.1	7.4%	7.4%	9.0%	8.1%
Specialty Fashion Group Ltd (SFH.AX)	1H	0.60	0.49	n.m	8.7	n.m	11.7	0.0%	2.1%	8.0%	5.9%
Global comparable				***16.5***	***14.7***	***18.8***	***18.1***	***3.4%***	***3.3%***		
Luxury Goods											
OrotonGroup Ltd (ORL.AX)	3	5.45	6.48	7.4	6.9	10.6	10.3	7.7%	7.7%	8.2%	17.4%
Global comparable				***12.9***	***11.3***	***17.9***	***16.0***	***2.1%***	***2.5%***		
Auto-parts retail											
Super Retail Group Ltd (SUL.AX)	2	7.50	8.21	11.4	9.8	16.0	14.0	4.0%	4.3%	5.1%	4.3%
Global comparable				***9.2***	***9.1***	***14.9***	***13.4***	***0.2%***	***0.2%***		

Note: Market data as of 20th August 2012; Source: Citi Research

Retail Sector Financial Forecasts

Figure 52. 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
Sales ($m)													
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	56,700	57,685	12,255	1,873	3,142	5,746	3,128	1,653	1,362	836	571	188	1,649
FY13e	59,648	60,002	12,489	1,897	3,172	5,654	3,217	1,514	1,338	856	568	188	1,960
Sales growth (%)													
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	4.7%	5.8%	-0.9%	-4.5%	-0.5%	-7.0%	5.7%	-1.9%	-15.6%	-4.5%	0.4%	14.1%	51.0%
FY13e	5.2%	4.0%	1.9%	1.3%	0.9%	-1.6%	2.9%	-8.4%	-1.8%	2.4%	-0.6%	0.2%	18.8%
EBIT margin (%)													
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%	6.0%	3.6%	8.8%	7.5%	18.7%	5.2%	5.3%	9.4%	8.9%	0.2%	20.1%	9.6%
FY13e	6.1%	6.1%	3.7%	8.9%	7.1%	20.2%	5.1%	4.1%	10.4%	8.5%	2.3%	20.3%	10.1%
Core EPS (cents)													
FY11a	173.6	166.3	33.3	32.4	27.8	22.4	124.0	37.4	11.1	33.0	7.6	60.6	40.1
FY12e	178.0	183.8	34.0	20.7	23.8	16.4	105.9	16.8	7.5	36.7	-0.3	61.2	51.3
FY13e	189.7	203.6	33.8	20.6	22.5	17.7	104.1	10.6	8.8	36.9	4.2	63.2	58.8
EPS growth (%)													
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%	22.4%
FY12e	2.5%	10.5%	2.0%	-36.0%	-14.1%	-27.0%	-14.6%	-55.2%	-32.1%	11.2%	-104.4%	1.0%	28.1%
FY13e	6.6%	10.8%	-0.4%	-0.9%	-5.6%	8.2%	-1.6%	-36.8%	16.4%	0.6%	n.m	3.3%	14.5%
DPS (cents)													
FY11a	122.0	150.0	27.0	28.0	22.5	12.0	77.0	23.1	6.2	36.0	4.0	50.0	27.3
FY12e	126.0	165.0	28.0	19.5	19.5	9.0	65.0	2.4	4.0	36.0	0.0	50.0	32.5
FY13e	137.0	175.0	28.0	20.0	18.0	9.0	67.0	2.0	5.0	36.0	1.0	50.0	35.5
ROE (%)													
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	24.7%	8.3%	6.8%	13.9%	16.2%	7.9%	62.1%	5.1%	-35.0%	4.8%	-1.2%	79.2%	17.1%
FY13e	27.2%	9.1%	19.2%	14.0%	14.9%	7.1%	50.8%	4.5%	10.0%	4.8%	13.7%	71.1%	16.4%
Working cap to sales (%)													
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%	3.4%	3.6%	2.5%	-0.4%	8.3%	2.7%	19.1%	21.2%	3.2%	0.2%	17.4%	14.9%
FY13e	-1.3%	3.2%	3.6%	2.5%	-0.6%	9.2%	3.4%	17.6%	20.9%	2.3%	0.9%	6.9%	14.1%
Capex to sales (%)													
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%	4.6%	0.6%	4.1%	1.9%	3.9%	1.5%	5.6%	1.6%	1.9%	2.5%	2.5%	2.8%
FY13e	3.5%	3.9%	0.7%	4.2%	3.5%	2.6%	1.6%	4.6%	1.5%	2.7%	2.7%	2.3%	2.8%
EBITDA interest cover (x)													
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	14.3	12.3	7.3	21.0	9.4	8.0	14.8	4.5	5.2	nm	11.8	33.5	7.9
FY13e	15.9	14.6	10.2	17.4	9.2	7.7	14.4	13.5	6.6	nm	21.9	40.8	7.3

Note: Market data as of 20th August 2012; Source: Citi Research

Appendix 1 Global benchmarks on sales per square metre

Figure 53. Global benchmarks for sales per square metre

	Ticker	FY11 Sales (A$ million)	FY11 Sales / sqm (A$)
Hardware / Furniture			**2,490**
Home Depot Inc	HD.US	73,551	3,073
Lowe's Cos Inc	LOW.US	52,803	2,615
Home Retail Group	HOME.GB	9,681	1,586
Bed Bath & Beyond Inc	BBBY.US	9,383	2,686
Department Stores			**2,635**
Target Corp	TGT.US	72,895	3,301
Macys Inc	M.US	27,045	1,892
Kohl's Corp	KSS.US	19,893	2,710
Clothing retailing			**5,569**
Gap Inc. - company owned	GPS.US	14,266	3,458
Abercrombie & Fitch Co.	ANF.US	4,158	4,750
Limited Brands Inc.	LTD.US	10,364	7,134
Next Group PLC	NXT.GB	5,856	5,759
Inditex SA	ITX.ES	17,850	6,744
Supermarkets			**7,732**
Wal-Mart Stores Inc	WMT.US	456,304	5,053
Carrefour	CARR.FR	109,569	8,795
Tesco	TSCO.GB	100,800	9,347
Electrical Retailers			**14,287**
Best Buy Co Inc	BBY.US	53,926	8,723
Dixons Retail PLC	DXNS.GB	13,381	19,850

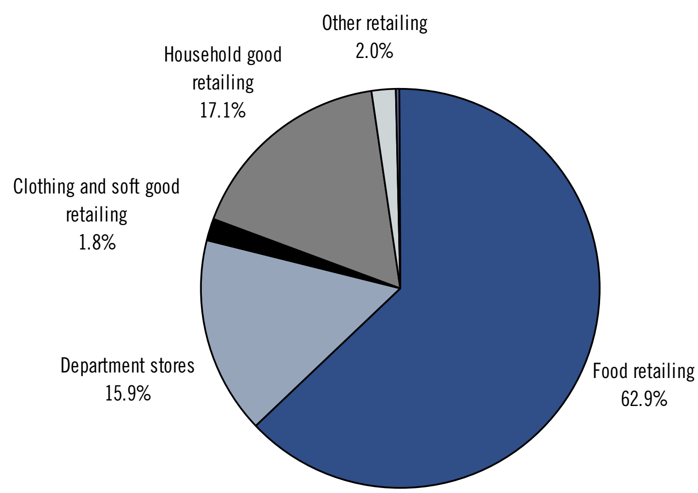
Source: Company reports, Citi Research

Appendix 2 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 31 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 Research

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 3 Previous Issues

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.

url: Retailers addicted to discounts

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.

url: FY11 Retail Results: Trying to Protect Margins

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.

url: An Age Old Question for Retailers

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.

url: Elusive Factory Outlet Options

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.

url: Consumers Spending Elsewhere

Issue 46 (5 March2012)

Private Equity Eyes on Retail

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

Issue 46: Private Equity Eyes on Retail

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.

url: Private Equity Eyes on Retail

Issue 47 (10 April 2012)

Close to the Edge

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

Issue 47: Close to the Edge

The retail sector earnings result season provides a great snapshot of the painful adjustments retailers need to make. Most retailers reported weak sales and rising operating costs during 1H12. The only saviour was the higher Australian dollar by supporting gross profit margins. In Issue 47 of What's in Store?, we analyse the recent financial results and implications for future profitability. The sales headwinds will persist, primarily through deflation and living cost pressures. Currency gains may carry through for another six months, but the need to become price competitive will be a bigger headwind over the medium term. Moreover, over three quarters of the 31 retailers we analyse reported an increase in inventory days, posing risks for the next year's profit margins. Given these challenges, our stock preferences are Metcash and Woolworths, where the online retailing threat is minimal and industry structure highly attractive. We have Buy ratings on both companies.

url: 1H12 Retail Results – Close to the Edge;

Issue 48 (9 May 2012)

Focusing on Shrinkage To Grow Profit

Companies mentioned: BBG, DJS, HVN, JBH, MYR, ORL, PMV, SFH, SUL, WES, WOW

Issue 48: Focusing on Shrinkage To Grow Profit

Shrinkage is the billions of dollars of inventory that goes "missing" in retail stores. There are many reasons for it and the impact on profits can be significant. In Issue 48 of What's In Store?, we assess the sources of shrinkage and look at the retailers like Coles, Myer and JB Hi-Fi which release details of shrinkage. Finally, we estimate the opportunity for retailers to lift profitability by reducing their shrinkage rate. Myer has halved its shrinkage in three years, while Coles has captured more than 100bp in margin gains. We see soft goods retailers as the best beneficiaries going forward, such as Premier Investments, David Jones and Target.

url: Focusing on Shrinkage to Grow Profit

Issue 49 (6 June 2012)

The Wardrobe Is Full – The Replacement Cycle in Retailing

Companies mentioned: BBG, DJS, HVN, JBH, MYR, ORL, PMV, SFH, SUL, WES, WOW

Issue 49: The Wardrobe Is Full – The Replacement Cycle in Retailing

Retailing in Australia and overseas has relied on consumers more frequently updating their wardrobes and upgrading their electronics and furniture over the past ten years. In this issue of What's In Store?, we look at the shopper's replacement cycle as an influence on retail spending. In non-food categories, like clothing and electronics, more than three-quarters of the volume growth has been driven by a shorter replacement cycle. Price is the biggest influence. Bigger homes and innovation have also been large drivers. We expect a lack of replacement cycle compression to lead to softer retail sales trends over the next decade. We estimate 3%-5% growth in non-food retailing versus 5% in the past ten years. Food retailing is much better placed with stronger pricing power. We have Buy ratings on Metcash and Woolworths.

url: The Wardrobe Is Full – The Replacement Cycle in Retailing

Issue 50 (13 July 2012)

Shopping for imports

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

Issue 50: Shopping for imports

Australia exports large quantities of raw materials but imports the majority of its finished goods. In Issue 50 of What's in Store?, we look at the retail sector's reliance on imports and likely impact on sourcing costs over the next five years. Relative wage costs and productivity make China the natural destination for sourcing in future, despite cost pressures. We expect a notable increase in imports for food and beverages and furniture, which may create deflationary pressures in those categories. This would pose risks for Harvey Norman, Wesfarmers and Woolworths.

url: Shopping for Imports

Appendix A-1

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