

Is the Wealth Effect the Saviour For Retail?

Alert: Harvey Norman and Myer may have more upside

- **Watch house prices** – Australians love talking house prices. After three years of weakness, house prices rose 5% in the June 2013 quarter. The last big retail upswing in 2007 was correlated with high house price growth. We are cautious because net wealth is still not back to those highs. However, 10%+ house price growth could lead to a short-term retail upswing. Shoppers may spend up on their credit cards if they feel wealthy. An upside case is strongest for Myer and Harvey Norman when we consider the PE re-rating and EPS upside. See Figures 1 and 2.
- **Historical correlations** – Over the past 15 years, the strongest correlation to retail spending is with house prices and credit growth. Falling interest rates are not correlated with accelerating retail sales. See Figure 3.
- **Credit growth the key** – Australians savings rates is 9.8% of household income. This savings rate is higher than Canada, NZ, the UK or the US. If retail spending is going to accelerate in Australia, it won't come from income growth, it will come from reduced savings and more credit card usage. Over the last fifteen years, credit card spending growth averaged 15% p.a. In the past 12 months it was only 6%. See Figure 4 and 5.
- **Stocks to play for the wealth cycle (if you're brave)** – We're not advocating these retailers, given any sales uptick is likely to be short-lived, but Harvey Norman and Myer would be best placed to benefit from rising household wealth. The sales correlation with house prices is strong and the upside in PE and earnings could be significant should house price growth accelerate further. Our stretch case for Harvey Norman is \$3.88 and for Myer it is \$3.81. See Figure 1. For more information on the stretch case click: [Can Retail Really Rally on Rate Cuts? - The Upside Scenario](#).
- **Why it may be different this time** – We can see three reasons why wealth may not provide the kick to spending this time: 1) debt levels are already very high 2) there is weaker household income growth given rising unemployment and living costs. 3) these retailers are mature and need to close stores. They also need to deal with a new form of competition in online.

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Figure 1. Citi retail stock – stretch case if wealth effect takes hold

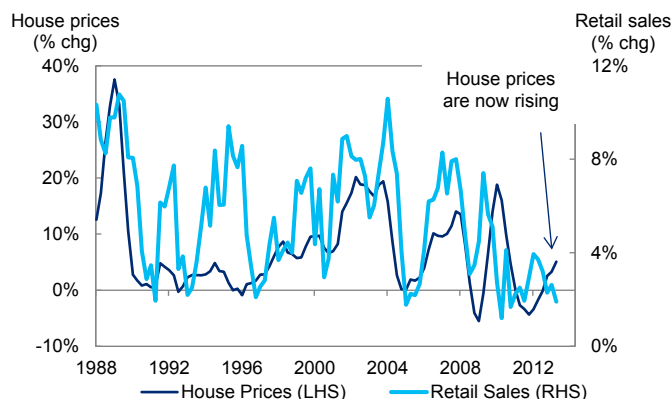
Company	Code	Stretch EPS FY14e	Stretch PE FY14e	Implied stretch price	Current share price	Difference
David Jones	DJS	19.2	16.3x	\$3.13	\$2.84	10%
Harvey Norman	HVN	24.7	15.7x	\$3.88	\$2.88	35%
JB H-Fi	JBH	143.8	13.8x	\$19.84	\$18.80	6%
Myer	MYR	27.2	14.0x	\$3.81	\$2.69	42%
Premier Investments	PMV	56.5	15.8x	\$8.92	\$8.00	12%
Super Retail Group	SUL	80.2	16.9x	\$13.56	\$12.21	11%

Source: Citi Research estimates. Note: Pricing at close 29-Aug-2013.

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

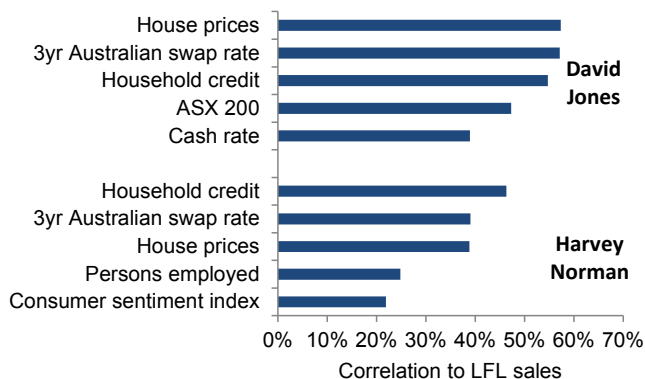
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Figure 2. House Prices vs Retail Sales



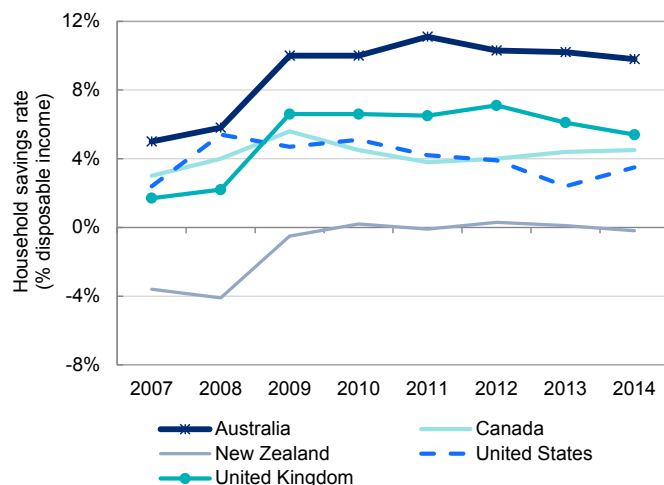
Source: ABS 6416 & 8502, Citi Research

Figure 3. LFL sales correlations - the top 5



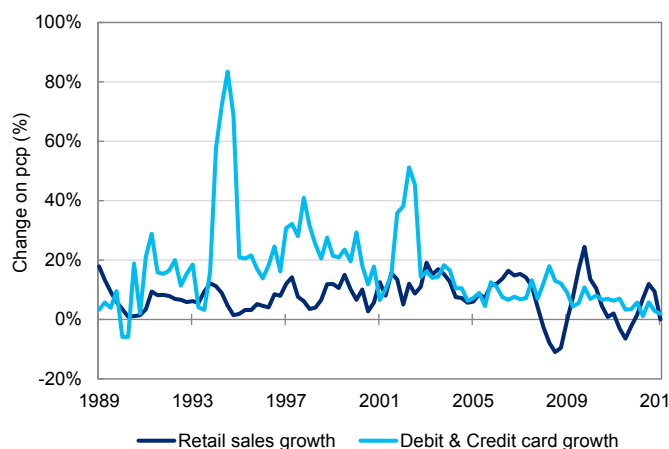
Source: RBA, ABS 8502, Citi Research

Figure 4. International Household Savings Rates



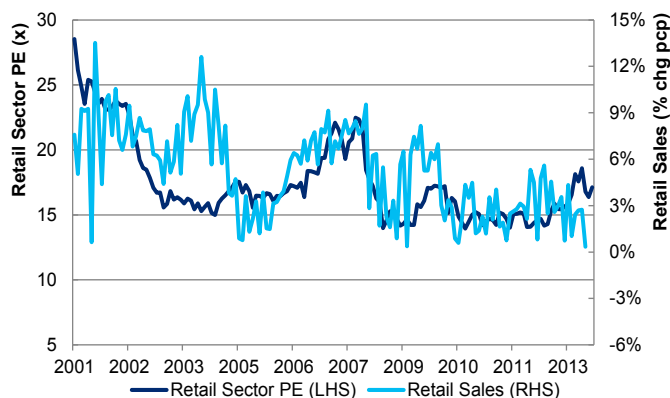
Source: OECD, Citi Research

Figure 5. Credit card spending and retail sales



Sources: ABS, RBA

Figure 6. Retail Sales and Retail PEs



Source: dataCentral, ABS, Citi Research

Figure 7. Citi stock recommendations

Stock	Ticker	Rating	Target price	EPS FY14e	PE FY14e
David Jones	DJS	Sell	\$2.35	15.7	18.1
Harvey Norman	HVN	Sell	\$2.15	18.8	15.3
JB Hi-Fi	JBH	Sell	\$13.90	121.1	15.5
Myer	MYR	Neutral	\$2.40	22.3	12.1
Premier Inv	PMV	Neutral	\$6.70	45.0	17.8
Super Retail	SUL	Sell	\$10.60	66.2	18.4

Source: Citi Research. Note: EPS in ¢.

Appendix A-1

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