Equities

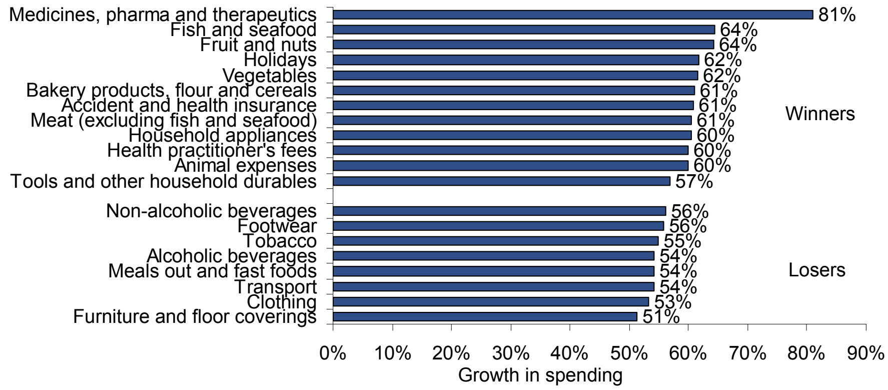
9 November 2011 │ 32 pages

What's in Store? Issue 43

An Age Old Question for Retailers

- **Baby boomers approaching retirement** — In Issue 43 of *What's In Store?,* we address the ageing population and its implications for retail spending. Overall spending growth is set to slow given weaker population growth. However, there are some winners, such as medical expenses, fresh foods and holidays. In our view the retailers best positioned for this thematic are Specialty Fashion Group (Buy/High Risk, TP $0.90), which caters to an older customer, and Flight Centre (Buy, TP $23.10), which should benefit from the trend towards travel.
- **The next 40 years** — Using ABS projections, population growth will average 1.0% over the next 40 years, compared with 1.4% over the past 20 years. The population aged over 65 should grow at 2.3%. By 2050, 23% of Australia's population will be over 65, up from 13% today.
- **Age and frugality** — The average household over 65 spends $726 per week, while those aged 35-44 spend $1,462 per week. Older demographics will tend to spend more on necessities and recreation. We also note there is a general pattern over many years of retail spending declining as a share of income across the economy.
- **Which retail categories will benefit?** — Looking at the ageing population over the next 40 years and spending by age group, medical expenses are set to grow 81%, seafood will likely rise 64% and holiday travel should increase by 62%. At the lower end, furniture sales should only rise 51% and clothing will likely only grow 53% over the next 40 years, in real terms.
- **Citi Retail Sales Indicator up 4.0% in September 2011** — Retail spending is running at a slow, but steady growth rate. Supermarkets were growing at 4.7%, while clothing was down 6.4% and electrical fell 2.9%. Furniture is an outlier, up 10.2% for the month.

Retail product category growth given ageing population (2009/10 to 2049/50)



Source: ABS, Citi Investment Research and Analysis

■ Industry Overview

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

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What's In Store? Issue 43

Australia's population is ageing, 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 is set to grow by 2.3% per annum over the next 40 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. In our view, there are two retail companies set to benefit from the ageing 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.

An Age Old Question for Retailers

An ageing population is an emerging theme and will become a more prominent feature as the baby boomers enter retirement over the next 20 years. We explore the evolution of Australia's population and the implications for retail spending. Unfortunately there are few winners given per capita spending is inversely correlated with age profile.

The three areas we cover are:

1. The outlook for Australia's ageing population;
2. Spending patterns by age group; and
3. The real growth attributable to population trends for key retail and consumer spending categories.

1. Australia's population profile

Australia's population was 22.3 million people as at 30 June 2010. This has increased from 17.1 million in 1990. Over that period, the ageing population profile has been modest. There were 1.9 million people aged 65 or older in 1990, which had risen to 3.0 million in 2010.

Looking forward, Australia's population is expected to rise to 33.9 million people by 2050 according to Australian Bureau of Statistics (ABS) estimates. This is likely to see the ratio of those aged over 65 increase much faster than any other age group given fertility rates and the average life expectancy.

In Figure 1, we show that population growth over the next 40 years is likely to average 1.0% per annum, down from 1.4% growth over the past 20 years. Moreover, the age group of 65+ is likely to grow at 2.3%.

Figure 1. Australia's population profile for 1990, 2010 and 2050e

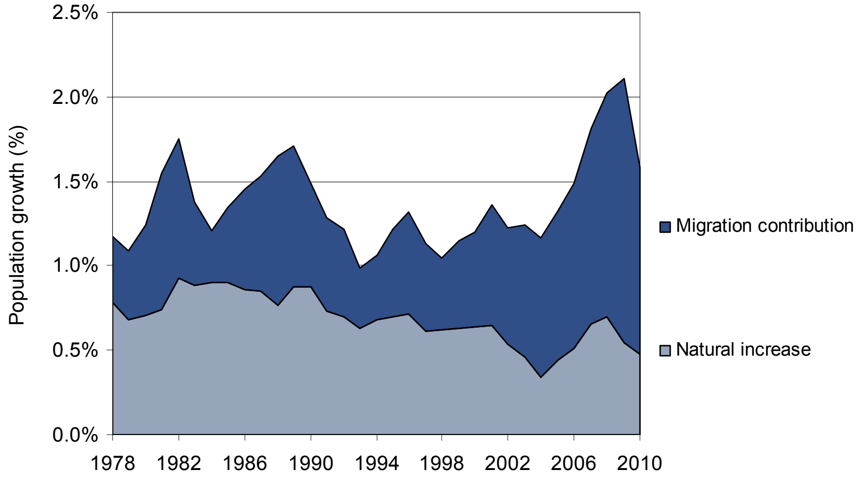
Age bracket	Jun-90	Jun-10	Jun-50 est	CAGR past 20 years	CAGR next 40 years
0-14	3.8m	4.2m	5.7m	0.6%	0.7%
15–24	2.8m	3.2m	4.0m	0.7%	0.6%
25–34	2.8m	3.2m	4.3m	0.6%	0.8%
35–44	2.6m	3.2m	4.4m	1.0%	0.8%
45–54	1.8m	3.0m	4.1m	2.7%	0.7%
55–64	1.5m	2.5m	4.0m	2.8%	1.1%
65 and over	1.9m	3.0m	7.5m	2.3%	2.3%
Total	**17.1m**	**22.3m**	**33.9m**	**1.4%**	**1.0%**

Estimates are Series B by the ABS. Source: ABS, Citi Investment Research and Analysis

Importance of migration compared with natural increase

Australia's population growth has been boosted by net migration over a number of years. Over the past 20 years, net migration has averaged 146,000 people. However, the peaks and troughs have been noticeable. In Figure 2, we show the contribution to Australia's population growth from net migration and natural increase (difference between birth and death rate).

Figure 2. Australia's population growth – split between net migration and natural increase



Source: ABS, Citi Investment Research and Analysis

The ABS estimates for population growth has three different series. We use ABS series B projections for future population trends, which are mid-point estimates. This series assumes:

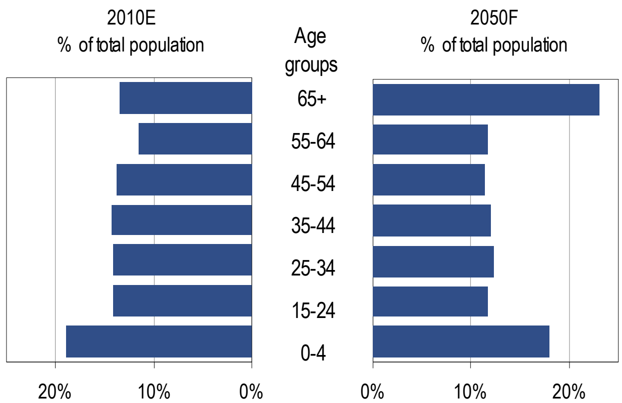
- 1.8 births per woman,
- 180,000 net migration, and
- Life expectancy for men of 85 and women 88 years.

These assumptions assume higher net migration, compared with the past 20 years, and will require a step-up under the government's current immigration policy, which is tracking about 170,000.

Australia's ageing population compared with other countries

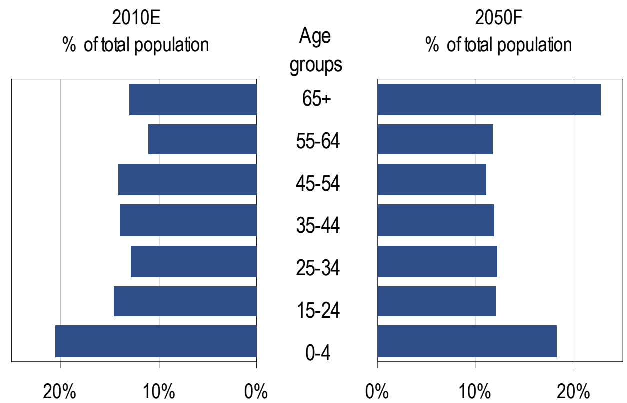
Australia's ageing population is fairly similar to the outlook for both New Zealand and the United States. Australia's population over 65 is set to rise from 13% of the total in 2010, to 23% in 2050. New Zealand has the same proportions according to United Nations projections. As shown in Figure 3 to Figure 6, the most dramatic change will likely be seen in China, where currently 8% of the population is over 65, rising to 26% by 2050.

Figure 3. Population distribution for Australia (2010 vs. 2050F)



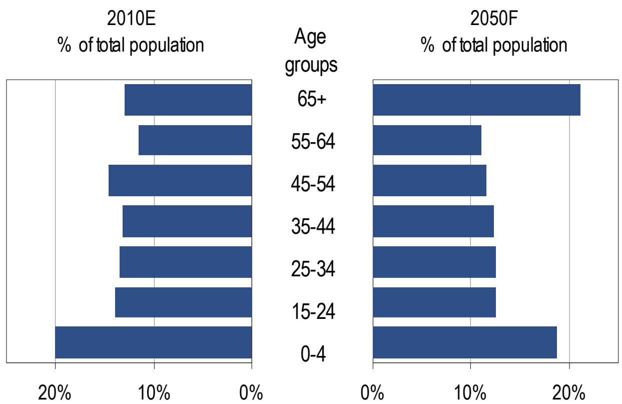
Sources: United Nation estimates and forecast, Citi Investment Research and Analysis

Figure 4. Population distribution for New Zealand (2010 vs. 2050F)



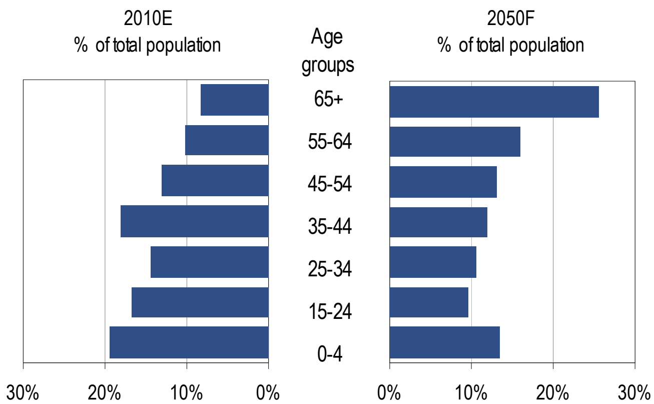
Sources: United Nation estimates and forecast, Citi Investment Research and Analysis

Figure 5. Population distribution for United States (2010 vs. 2050F)



Sources: United Nation estimates and forecast, Citi Investment Research and Analysis

Figure 6. Population distribution for China (2010 vs. 2050F)



Sources: United Nation estimates and forecast, Citi Investment Research and Analysis

2. What are the spending patterns by age demographic?

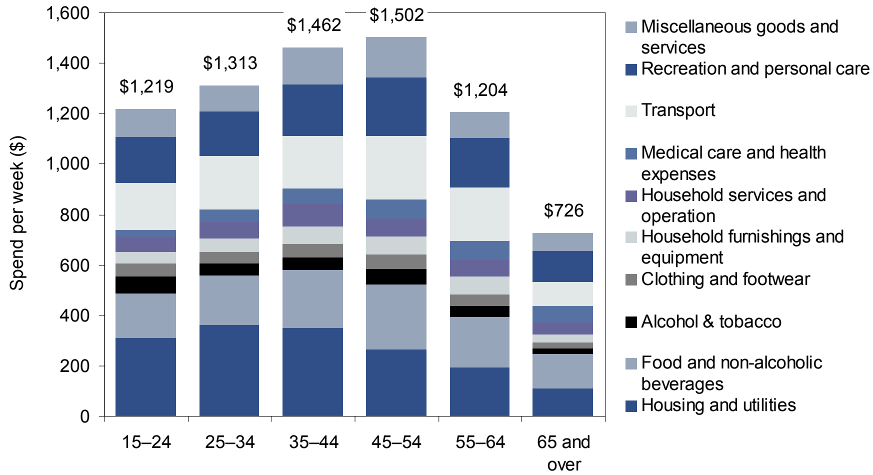
The spending patterns of Australians are changing with retail goods receiving a smaller share of spending and services receiving a greater share of spending. Older people, unsurprisingly, spend more on health, but also spend more on holidays, fresh foods and insurance.

Spending by age group

Household spending has been measured by the ABS according to household age groups.[1] We show the split of dollar spending in each age group in Figure 7. There are two points of note. Older people spend less in retail and have lower overall spending. This is true, even adjusting for the number of people per household. In Figure 8, we show the spend per person in households, which shows that those aged over 65 spend $427 per week, while those aged 15-24 spend $508.

[1] The ABS uses the "reference person" in their survey to classify the age group of the household. As an example, a household that is classified as 65+ may have another resident under 65.

Figure 7. Household spending by age group (2009/10)



Source: ABS, Citi Investment Research and Analysis

Figure 8. Spend per person by age group

Age group	15–24	25–34	35–44	45–54	55–64	65 and over
People per household	2.4	2.5	3.4	3	2.2	1.7
People over 18 per household	2.1	1.8	1.9	2.4	2.0	1.7
Spend per person ($)	508	525	430	501	547	427
Spend per person over 18 ($)	580	730	769	626	602	427

Source: ABS, Citi Investment Research and Analysis

Changes in spending patterns

The spending trends over the past decade show retailing losing its share of the consumer's wallet. People are inclined to spend their extra income on housing, or services and recreation.

We show the change in percentage of income spent on selected items in Figure 9. Spending on mortgages accounted for 9.1% of income in 2009/10. This ratio has increased from 7.7% in 1998/99. Note that 36% of households have a mortgage and if apportioned to these only, mortgages account for 25% of the mortgagee's income.

Figure 9. Spending behaviour on key expenditure items (2009/10 vs. 1998/99)

Period	1998/99	2009/10
Average household income after tax (A$/week)	702	1,428
Average spend on mortgage (A$/week)	54	130
Average spend as % of income on		
Food	16.3%	13.2%
Beverages	1.8%	1.1%
Alcohol	2.9%	2.3%
Clothing	3.6%	2.5%
Household appliances	1.5%	0.9%
AV/IT	2.1%	2.0%
Recreation	4.6%	6.7%
Average number of persons/household	2.6	2.6
Average number of working persons/household	1.2	1.4

Sources: ABS 6530, Citi Investment Research and Analysis

In retailing, food, beverages, clothing and appliances have failed to retain their share of income between 1998/99 and 2009/10. On the other hand, recreation has increased from 4.6% to 6.7%. Recreation includes gambling, sporting fees, theatre, concerts and pay television.

Changes in household characteristics

The ABS has run the Household Expenditure Survey for many years and shows changes in spending as well as household characteristics. Below are five insights we feel are worth noting:

- Households, on average, receive 25% of their income from government pensions and allowances. This has reduced from 29% in 1998/99.
- Households with a mortgage represented 36% of all households in 2009/10. Renters are 28% of households. Those with a mortgage were only 30% of households in 1998/99.
- The average household has 2.6 people. Lone person households are 24.5% of all households.
- 63% of households are in Australia's capital cities with growth in capital cities slightly outpacing regional areas.

3. What is the ageing profile impact on spending?

Given spending patterns differ by age group and Australia has an ageing population, we can calculate the differential in real growth for retail categories.

- The winners are medical expenses, fresh foods and holiday travel.
- The losers are furniture, takeaway meals and clothing.

Our framework for forecasting the impact of an ageing population is to use the ABS forecasts for Australia's population and the current spending patterns by age group. We show the calculations below.

Figure 10. Framework for forecasts

1. Ageing population	2. Spending patterns by age group
Over 65 will grow at 2.3% pa.	Retail spending is lower per person.
Under 65 will grow at 0.8%	More spending on necessities

Retail spending implications
- Medical expenses will rise
- Fresh food retailing will benefit
- Holidays will benefit

Source: Citi Investment Research and Analysis

Household forecast growth

The number of Australian households should grow faster than the population because there will likely be more single person households. We use the ABS

forecasts for population, which is broken down to each age and then classify those into households. We hold constant the number of people per household for each age grouping. The growth in households by age group is shown in Figure 11. The population growth over the next 40 years is 56%, while the number of houses rises by 64%.

Figure 11. Household number projections (000s)

Households	15–24	25–34	35–44	45–54	55–64	65 and over	All
June 2010	324	1,417	1,720	1,765	1,472	1,758	8,456
June 2050	457	1,977	2,370	2,545	2,168	4,364	13,882
Growth	41%	39%	38%	44%	47%	148%	64%

Source: ABS, Citi Investment Research and Analysis estimates

We use these forecasts for households and the current spending patterns by age group to forecast the change in total spending over the next 40 years. The growth in population by age group provides some notable winners and losers. In Figure 12, we show the total growth in spending for key categories. Note that this is presented in 2010 dollars, so is before any changes in price and also changes in consumption patterns by those in each age group.

As expected the strongest growth should be in the medical care and health category at 67% over the next 40 years. Energy costs will likely grow as should services and recreation. Interestingly, at the other end of the spectrum, housing costs should grow more slowly given higher home ownership while clothing and footwear sales should be slow.

Figure 12. Household spending growth given population trends (to 2049/50) in current dollars

Period	2009/10	2049/50	% Change	CAGR
Current housing costs (selected dwelling)	97,451	146,896	51%	1.0%
Clothing and footwear	19,382	29,864	54%	1.1%
Transport	84,231	129,808	54%	1.1%
Alcoholic beverages	14,129	21,787	54%	1.1%
Tobacco products	5,488	8,506	55%	1.1%
Household furnishings and equipment	25,615	39,871	56%	1.1%
Miscellaneous goods and services	50,911	79,772	57%	1.1%
Personal care	10,506	16,542	57%	1.1%
Food and non-alcoholic beverages	89,180	141,021	58%	1.2%
Recreation	70,505	111,628	58%	1.2%
Household services and operation	29,668	47,017	58%	1.2%
Domestic fuel and power	14,204	22,847	61%	1.2%
Medical care and health expenses	28,650	47,815	67%	1.3%

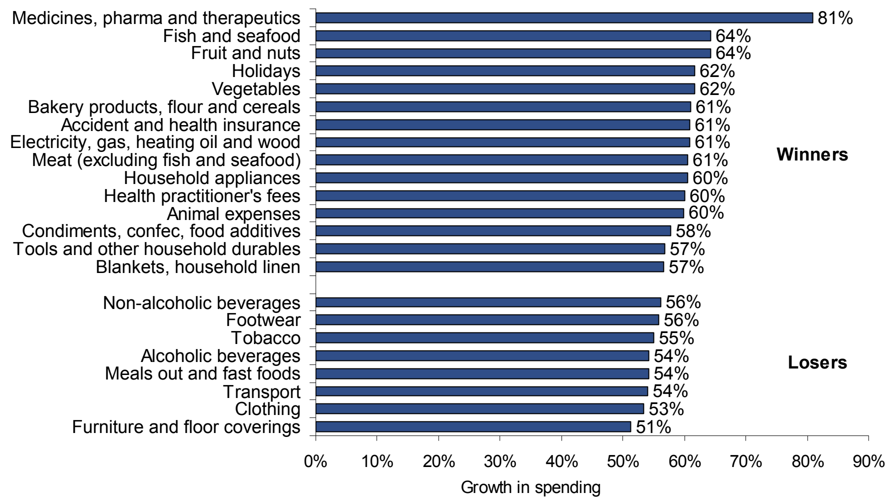
Source: ABS, Citi Investment Research and Analysis estimates

The winners and losers

The table above (Figure 12) shows the broad categories of spending. We break down the analysis further to individual product categories. We present these in Figure 13. This shows the real growth given an ageing population.

The highest spending growth is in medical devices, pharmacy and theraputics at 81% growth, the next largest growth categories are seafood and fruits, shortly followed by holidays. At the other extreme, furniture, clothing and transport costs will see slower growth.

Figure 13. Product category growth given ageing population (2009/10 to 2049/50)



Source: ABS, Citi Investment Research and Analysis

Implications for retail

The population projections for an ageing population will take away from future retail sales growth compared with the past 20 years. Growth will be approximately 0.5% slower given this effect alone. The fact that those aged 65 or older spend less is the most powerful trend.

While the general conclusions are negative, amongst the listed retail and consumer stocks, there are two companies that we believe are clear beneficiaries of an ageing population:

- **Specialty Fashion (SFH.AX; A$0.56; 1H):** We have a Buy / High Risk rating and target price of $0.90 per share. The company sells clothing primarily to the older demographic. Specialty Fashion's key retail banner is Millers, which is over 50% of sales, and targets women aged over 65. While overall clothing spend will likely slow, retailers targeting the older demographic should benefit with a growing target market.

- **Flight Centre (FLT.AX; A$20.00; 1):** We have a Buy rating and target price of $23.10. Flight Centre is a travel agent with over 2,000 shops in 11 countries. While there are concerns about the growth in direct online bookings, Flight Centre's services help with complex and high value travel itineraries and will likely be more suitable to the older demographic.

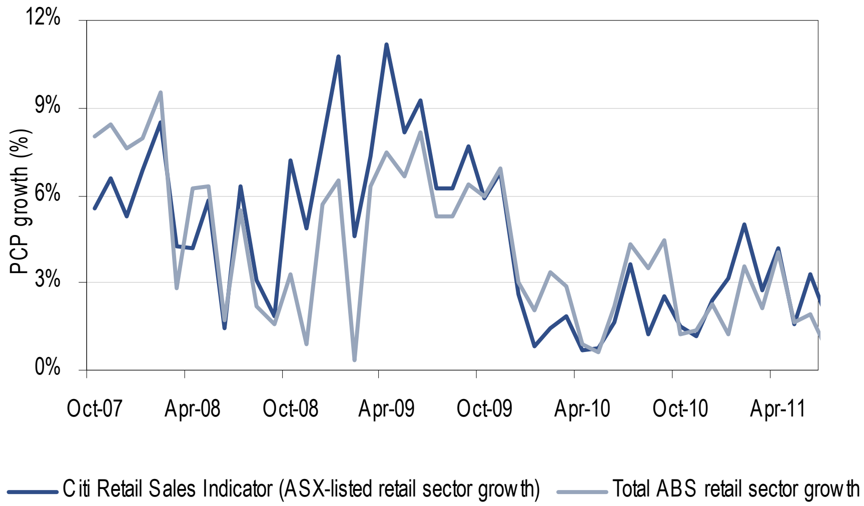
In addition, supermarkets are generally better placed given fresh food sales, but some packaged goods, alcohol and tobacco are likely to suffer.

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 4.0% in September 2011, above the ABS total retail sales growth of 2.6% due to the indicators' greater exposure to supermarket retailing.

Figure 14. Citi Retail Sales Indicator (retail sector sales growth for ASX-listed companies)



Source: ABS, Citi Investment Research and Analysis

Sector performance for September 2011

Figure 15. Retail category monthly growth rate on pcp (%)

Month ended:	Sep-10	Aug-11	Sep-11
Supermarket	3.2	4.3	4.7
Department stores	1.6	-2.3	-5.4
Clothing	-0.1	-5.1	-6.4
Furniture	2.1	8.6	10.2
Electrical	1.3	-6.7	-2.9
Hardware	2.9	9.8	7.3
Total (Industry)	4.5	2.5	2.6

Sources: ABS, Citi Investment Research and Analysis

Australian retail sales trends remain subdued. Retail sales rose 2.6% in September 2011 on the previous corresponding month. Supermarket sales were slightly stronger and growth in housing related categories continues to surprise to the upside. Department stores and clothing specialties had the most notable sales declines.

Key points

- **Supermarkets sales up 4.7%** – Although September was a slight improvement from August, growth is below long-run averages and is being impacted by softening produce prices. Coles had further market share gains in the three months to 30 September 2011.

- **Department stores down 5.4%** – Department stores had another soft month in September 2011, extending consecutive sales declines from May 2011. Discount department stores outperformed David Jones and Myer during the quarter.

- **Clothing down 6.4%** – Clothing sales fell by 6.4% in September 2011. The strong Australian dollar continues to support price deflation and weigh down retail sales growth. Feedback for October remains challenging.

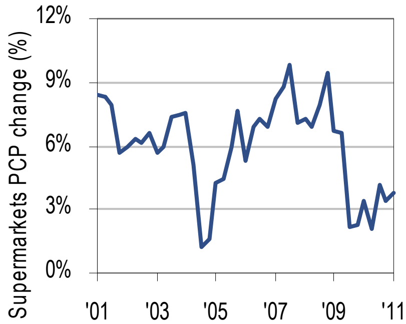
- **Electrical down 2.9%** – Electrical sales declines have started to slow. The 2.9% decline in September 2011 compares to -6.7% in August and -7.3% in July 2011. Price competition in computers and televisions continues to be elevated.

- **Furniture up 10.2%** – Furniture was one of the strongest retail categories in September. Sales were up 10.2% for the month and were up 8.0% for the quarter. We see the recent strength being a function of strong home renovation activity.

- **Hardware up 7.3%** – Hardware sales rose 7.3% in September 2011 and are up 7.2% for the quarter. The strength relates to the industry cycling the adverse impacts of wet weather and withdrawal of government stimulus for home insulations in the prior year. The baseline will be more challenging to cycle in the next 12 months.

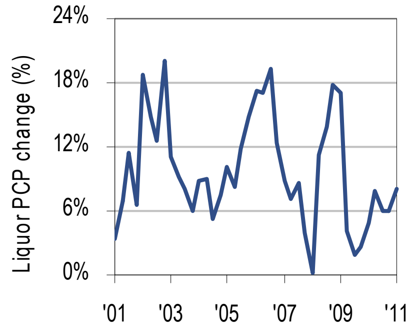
Sector specific performance – rolling 3 months to Sep '11

Figure 16. Supermarkets



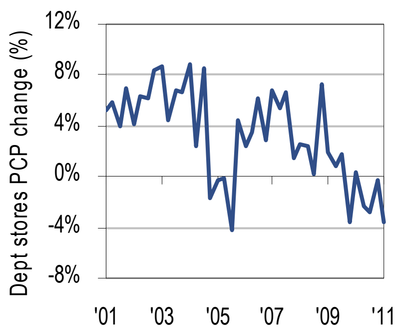
Source: ABS 8501.0

Figure 17. Liquor retailing



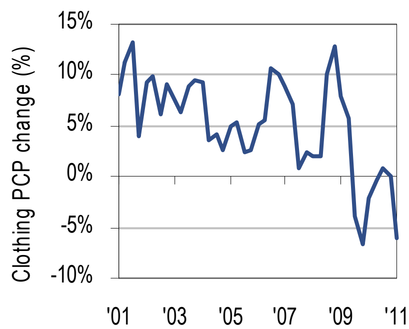
Source: ABS 8501.0

Figure 18. Department stores



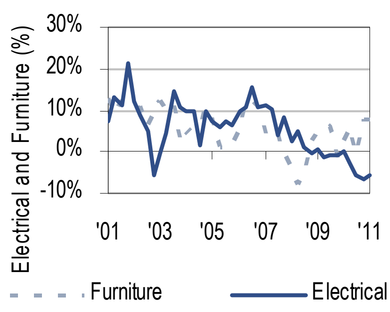
Source: ABS 8501.0

Figure 19. Clothing



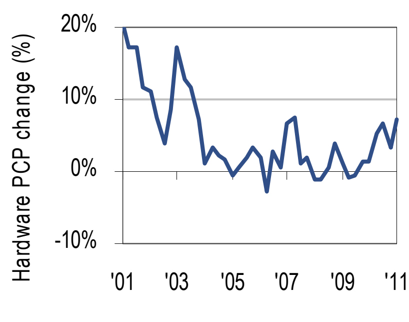
Source: ABS 8501.0

Figure 20. Electrical and Furniture



Source: ABS 8501.0

Figure 21. Hardware

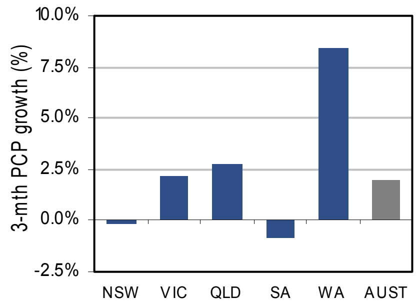


Source: ABS 8501.0

State based performance

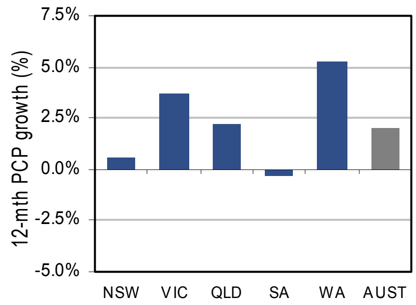
Figure 22 and Figure 23 show the quarterly and yearly sales growth performance for each state respectively.

Figure 22. 3-month sales growth by state



Source: ABS 8501.0

Figure 23. 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 24. Citi economic forecasts

Calendar year	**2010**	**2011**	**2012**
GDP growth	2.7%	1.4%	3.7%
CPI	2.8%	3.2%	2.9%
Unemployment rate (end of period)	5.0%	5.5%	5.0%

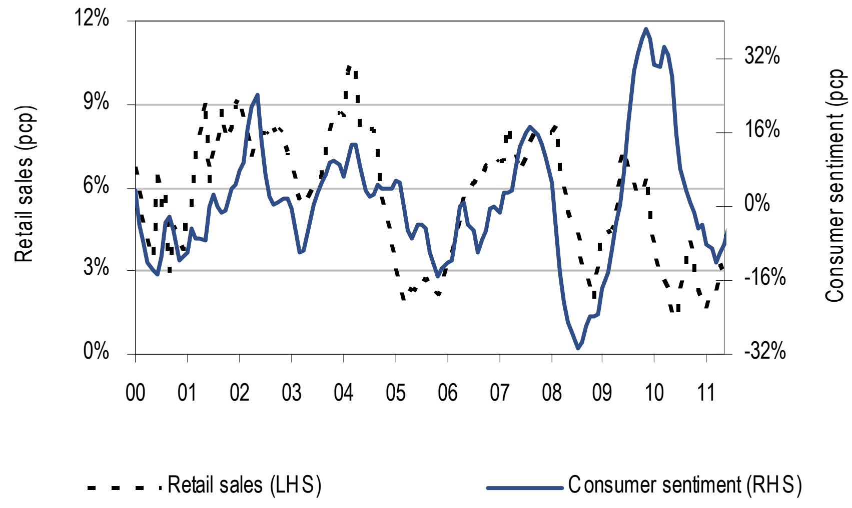
Period	**04-Nov-11**	**Dec-11**	**Jun-12**
Cash rate	4.75%	4.50%	4.50%
AUD/USD	1.04	0.98	1.00

Note: Forecasts as at November 4th, 2011; 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 October 2011, consumer sentiment was at 97.2. This is flat vs. September 2011, but 16.9% lower compared to the prior year.

Figure 25. Consumer sentiment and retail sales

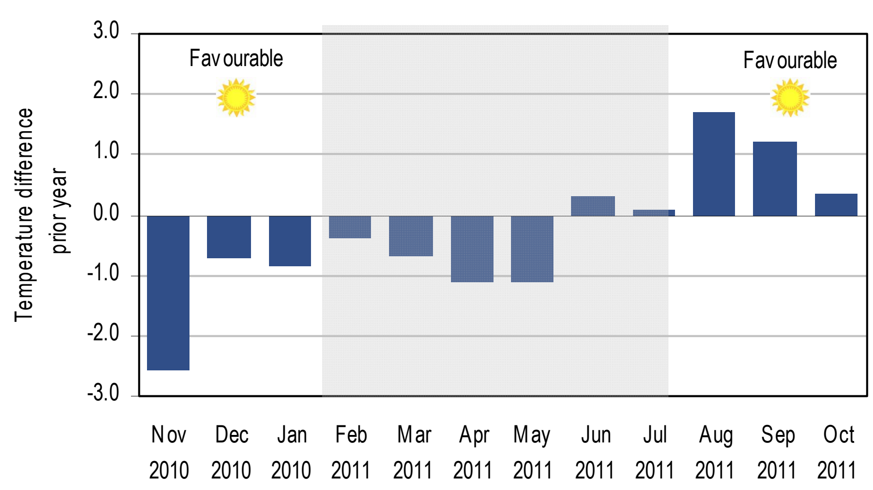


Source: Westpac, ABS, Citi Investment Research & Analysis

Weather

Figure 26 shows the weighted average temperature difference to the prior year, in the past 12 months. The start to the summer fashion season has benefited from warmer weather relative to last year.

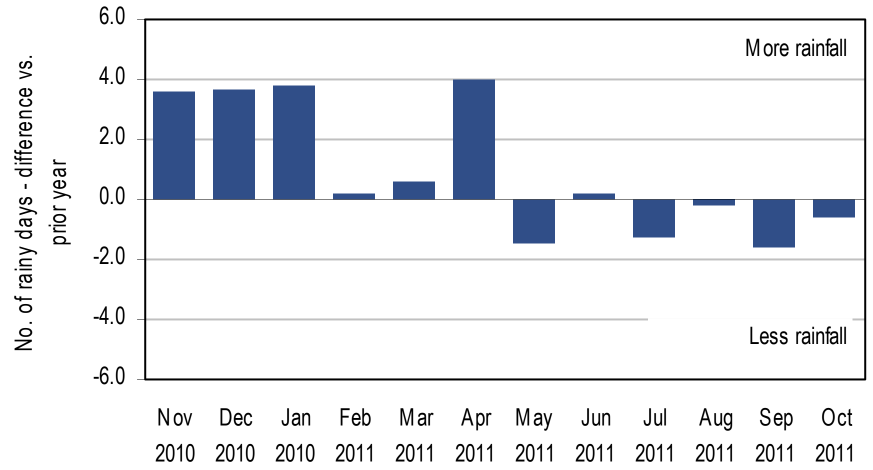
Figure 26. Temperature change - weighted national average



Source: BOM, Citi Investment Research & Analysis

Figure 27 shows the weighted average difference in rainfall days to last year.

Figure 27. Rainfall change – weighted national average

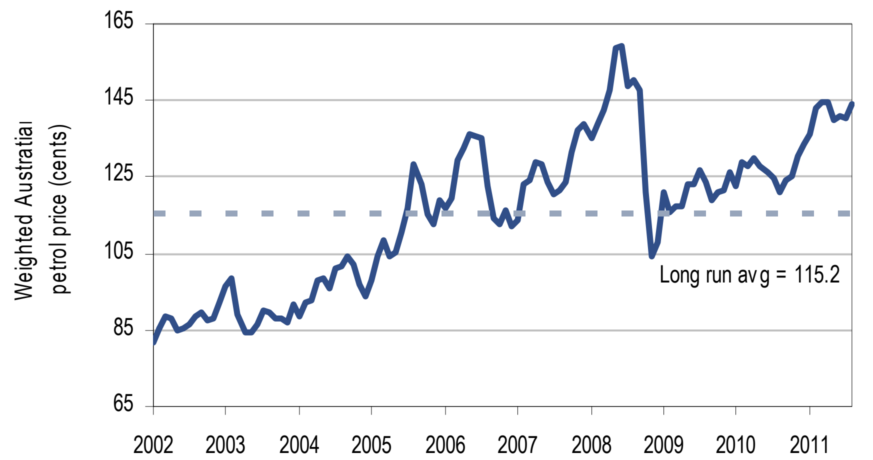


Source: BOM, Citi Investment Research & Analysis

Petrol prices

Petrol prices averaged 143.8 cents per/litre in September 2011. Prices are 18.9% higher compared to September 2010. Continued rises in the price of petrol will drain available household income for retail purchases.

Figure 28. Australian petrol prices

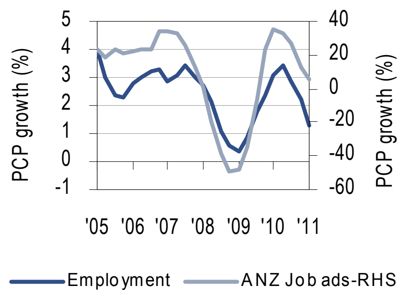


Source: Aust. Automobile Association

Employment

A softening in employment conditions during 2008-09 pressured income growth for Australian households. As shown in Figure 29 and Figure 30, 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 although the mining boom should provide some support.

Figure 29. Employment and job ads growth



Source: ABS, ANZ

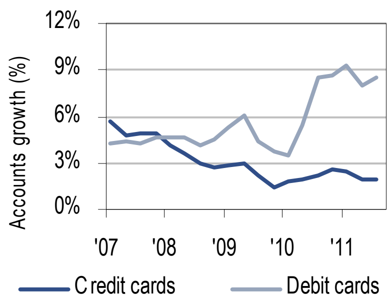
Figure 30. Unemployment rate

Source: ABS

Credit and debit card spending growth

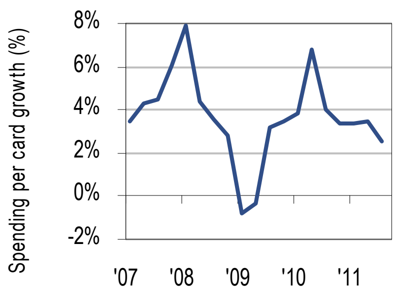
We show in Figure 31 to Figure 34, key Australian credit and debit card statistics. Debit card growth has accelerated over 2011 through a combination of strong account growth and increased spending per debit card holder. This contrasts with credit card accounts that have had slowing spending growth per credit card.

Figure 31. Credit and debit card accounts



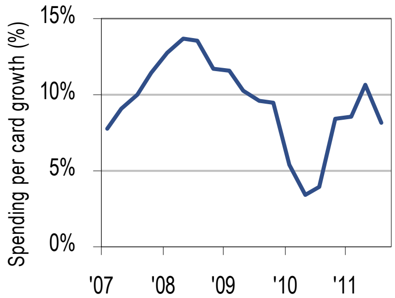
Source: RBA

Figure 32. Spending per credit card holder



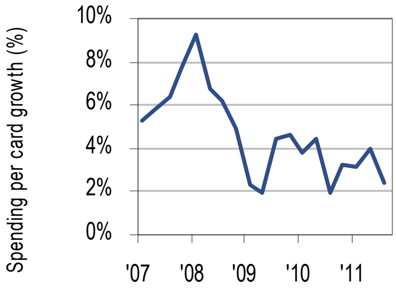
Source: RBA

Figure 33. Spending per debit card holder



Source: RBA

Figure 34. Spending per all card holders



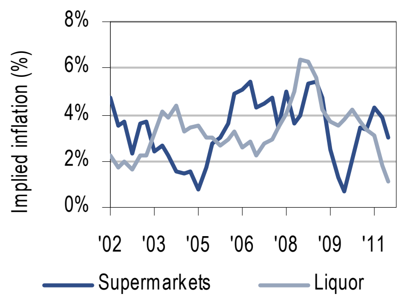
Source: RBA

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** – Clothing has experienced significant price deflation given strong competitive pressure, a higher Australian dollar and lower import tariffs. However, this slowed in September 2011 as the implied retail basket declined just 0.4%.
- **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.

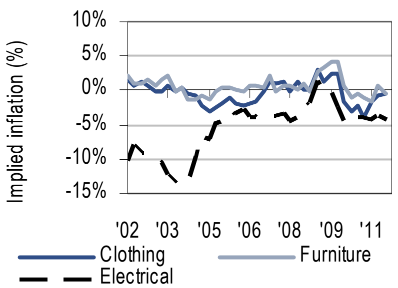
We show implied retail price inflation for a number of key categories in Figure 35 and Figure 36 below.

Figure 35. Food and Liquor inflation



Source: ABS, Citi Investment Research & Analysis

Figure 36. Non-food sector inflation



Source: ABS, Citi Investment Research & Analysis

Input cost pressures

- **Food & Liquor** – Input prices rose 14.4% on pcp, in the three months to October 2011 driven by soft commodities such as oil, coffee, rice and meat along with slight weakness in the AUD.
- **Clothing** – Rising cotton costs will impact clothing prices over the next 12 months. We expect clothing costs to increase 15-20%, in USD terms, for the Summer 2011/12 season. However, a strong Australian dollar will shield much of the impact. We expect clothing retailers to increase prices by 5-10% on average.
- **Electronics** – The run-up in prices of gold, polystyrene and steel was the main reason for inflation in recent months. Core items including LCD, DRAM and NAND remained deflationary. However, current supply disruptions and higher labour costs combined with high metal prices can potentially lead to inflationary pressures.

We show our Citi input cost monitor for October 2011 on a monthly and rolling-three month basis in Figure 37 and Figure 38 below.

Figure 37. Citi input cost monitor (1 mth)

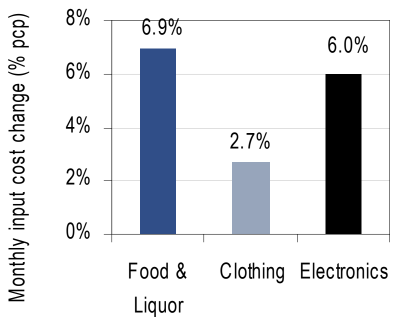
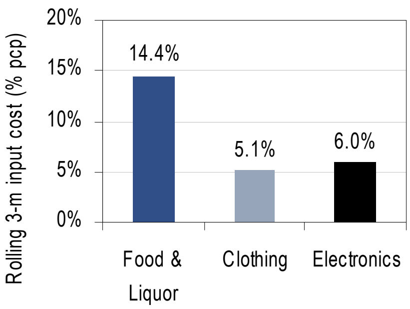


Figure 38. Citi input cost monitor (3 mths)

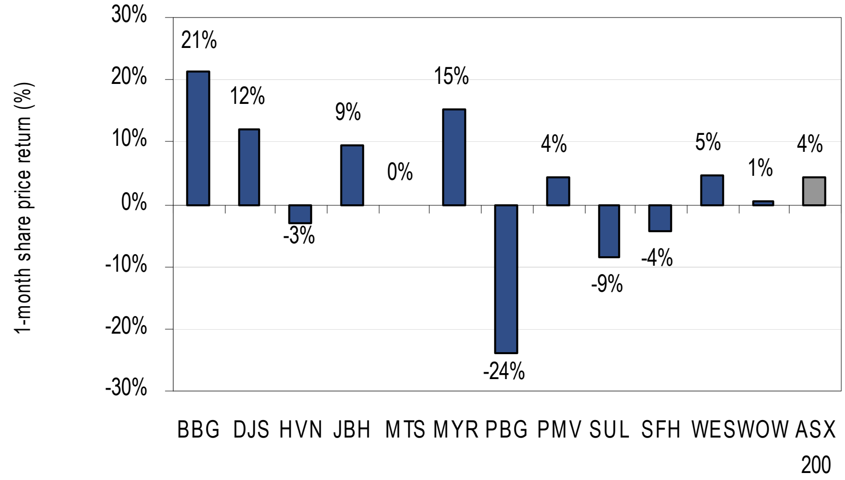


Source: Citi Investment Research and Analysis

Share price performance

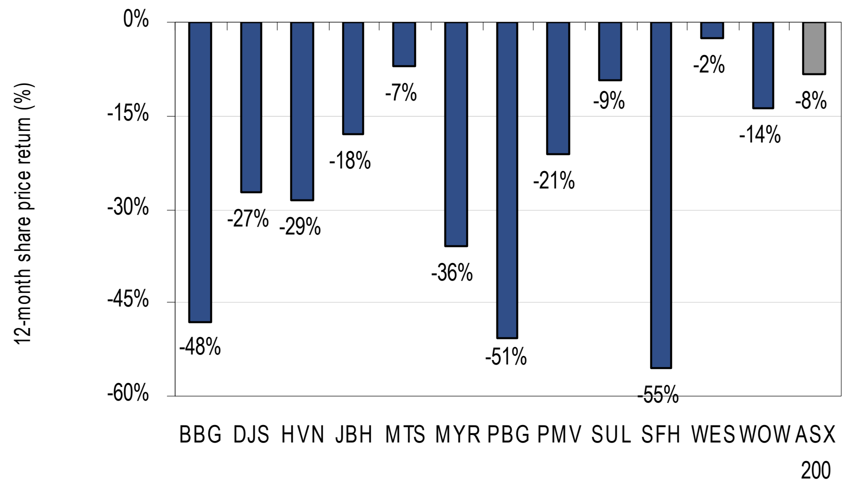
In Figure 39 and Figure 40 we show the 1-month and 12-month share price performance of listed Australian retailers and the ASX 200 Index.

Figure 39. 1-month share price return for Australian retailers



Note: Market data is as of 9 November 2011 close; Source: Citi Investment Research and Analysis

Figure 40. 12-month share price return for Australian retailers

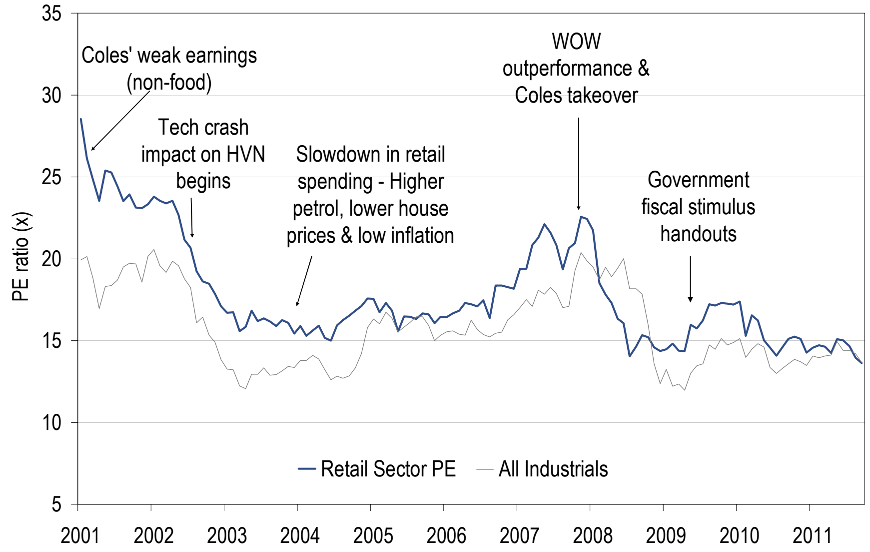


Note: Market data is as of 9 November 2011 close; Source: Citi Investment Research and Analysis

Valuation and financial performance

Figure 41 shows that the retail sector PE is currently trading at an 20% discount to its five-year average. The discount reflects concern for discretionary retailers due to the uncertain recovery in retail spending activity.

Figure 41. Retail sector PE ratio



Source: IBES, Citi Investment Research & Analysis

Retail Sector Valuation

Figure 42. 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	26.40	24.78	10.1	9.0	13.9	12.7	5.2%	5.7%	4.3%	5.4%
Wesfarmers Ltd (WES.AX)	2	32.00	32.75	11.1	10.2	15.0	13.5	5.5%	5.8%	2.2%	4.2%
Metcash Ltd (MTS.AX)	1	5.05	4.16	8.3	7.6	11.5	10.7	6.8%	7.2%	10.1%	8.4%
Global comparable				***8.7***	***8.4***	***12.2***	***10.8***	***3.8%***	***4.1%***		
Department Stores											
David Jones Ltd (DJS.AX)	2	2.70	3.29	8.3	8.0	11.8	11.6	7.5%	7.6%	8.0%	6.5%
Myer Holdings Ltd (MYR.AX)	2	2.10	2.48	7.5	7.3	9.8	9.8	8.0%	8.0%	10.8%	9.0%
Global comparable				***9.3***	***8.2***	***12.2***	***11.2***	***2.1%***	***2.4%***		
Electrical Retailers											
Harvey Norman Holdings Ltd (HVN.AX)	2	2.30	2.19	7.3	6.1	10.3	9.0	5.5%	5.9%	1.9%	6.6%
JB Hi-Fi Ltd (JBH.AX)	1	17.50	15.75	7.9	7.1	11.2	10.0	5.6%	6.7%	9.9%	7.8%
Global comparable				***4.7***	***4.6***	***8.4***	***7.7***	***0.0%***	***0.0%***		
Surf/Street wear											
Billabong International Ltd (BBG.AX)	1	3.80	4.41	9.3	8.1	10.3	9.5	5.0%	5.4%	11.0%	7.9%
Global comparable				***10.5***	***9.2***	***15.4***	***13.3***	***2.0%***	***2.1%***		
Wholesaler											
Pacific Brands Ltd (PBG.AX)	1H	0.95	0.57	5.6	4.6	6.6	5.0	10.9%	13.2%	18.1%	19.8%
Global comparable				***9.3***	***7.5***	***13.5***	***12.8***	***0.8%***	***1.0%***		
Clothing retailing											
Premier Investments Ltd (PMV.AX)	2	5.35	5.37	6.9	5.6	14.1	11.8	6.7%	6.7%	9.1%	8.8%
Specialty Fashion Group Ltd (SFH.AX)	1H	0.90	0.56	6.0	3.9	7.8	5.3	0.0%	9.9%	15.4%	12.0%
Global comparable				***8.6***	***6.5***	***16.3***	***12.8***	***2.0%***	***2.4%***		
Auto-parts retail											
Super Retail Group Ltd (SUL.AX)	2	6.50	5.48	8.0	7.3	10.2	10.3	5.7%	5.9%	0.7%	6.3%
Global comparable				***8.0***	***7.6***	***13.3***	***11.7***	***0.4%***	***0.4%***		

Note: Market data as of 9th November 2011; Source: Citi Investment Research and Analysis.

Retail Sector Financial Forecasts

Figure 43. Citi retail sector forecasts

	Woolworths	Wesfarmers	Metcash	David Jones	Myer	Harvey Norman	Billabong	Pacific Brands	JB Hi-Fi	Premier Investments	Super Retail Group	Specialty Fashion Group
	WOW	WES	MTS	DJS	MYR	HVN	BBG	PBG	JBH	PMV	SUL	SFH
Sales ($m)												
FY11a	54,143	54,513	12,364	1,962	3,159	6,176	1,685	1,615	2,959	876	1,092	569
FY12e	57,203	58,151	13,007	1,898	3,155	6,133	1,743	1,423	3,152	886	1,607	597
FY13e	61,509	61,797	13,630	1,957	3,272	6,322	1,826	1,447	3,444	923	1,919	639
Sales growth (%)												
FY11a	4.7%	5.9%	7.4%	-4.4%	-5.0%	1.6%	13.6%	-7.3%	8.3%	-0.3%	16.5%	-0.4%
FY12e	5.7%	6.7%	5.2%	-3.3%	-0.1%	-0.7%	3.4%	-11.9%	6.5%	1.2%	47.1%	4.8%
FY13e	7.5%	6.3%	4.8%	3.1%	3.7%	3.1%	4.7%	1.7%	9.3%	4.1%	19.4%	7.0%
EBIT margin (%)												
FY11a	6.1%	5.7%	3.5%	12.6%	8.2%	25.3%	8.9%	11.5%	6.6%	7.4%	8.0%	4.0%
FY12e	5.9%	6.8%	3.5%	11.5%	7.8%	26.8%	9.9%	9.8%	7.0%	9.0%	9.5%	3.5%
FY13e	6.1%	7.1%	3.6%	11.7%	7.6%	31.5%	10.7%	11.5%	7.0%	10.2%	9.6%	4.6%
Core EPS (cents)												
FY11a	173.6	166.3	33.3	32.6	27.8	22.4	47.7	11.1	124.0	33.0	41.0	7.6
FY12e	177.9	218.3	35.6	27.5	25.0	21.3	42.8	8.6	141.2	38.6	53.8	7.1
FY13e	195.7	241.9	38.3	28.5	25.4	24.5	46.3	11.4	157.6	46.3	53.5	10.5
EPS growth (%)												
FY11a	6.4%	15.6%	4.3%	-1.8%	-5.6%	-17.8%	-17.8%	14.4%	14.3%	-21.1%	16.6%	-51.8%
FY12e	2.5%	31.3%	6.9%	-15.5%	-10.1%	-5.2%	-10.3%	-22.7%	13.9%	17.3%	31.0%	-5.5%
FY13e	10.0%	10.8%	7.4%	3.6%	1.9%	15.0%	8.2%	32.7%	11.6%	19.9%	-0.6%	47.1%
DPS (cents)												
FY11a	122.0	150.0	27.0	28.0	22.5	12.0	29.0	6.2	77.0	36.0	27.3	4.0
FY12e	128.0	180.0	28.0	24.5	19.5	12.0	22.0	6.2	88.0	36.0	31.0	0.0
FY13e	141.0	190.0	29.5	25.0	20.0	13.0	24.0	7.5	105.0	36.0	32.5	5.5
ROE (%)												
FY11a	28.0%	7.7%	17.9%	22.0%	18.7%	11.7%	9.9%	-10.3%	49.2%	3.4%	19.4%	25.5%
FY12e	27.3%	10.1%	18.9%	18.3%	16.8%	9.9%	9.1%	6.5%	78.2%	5.1%	16.2%	23.9%
FY13e	27.2%	10.7%	19.8%	18.6%	16.5%	11.3%	9.6%	8.3%	67.4%	6.0%	14.7%	29.2%
Working cap to sales (%)												
FY11a	-1.2%	3.8%	4.7%	4.7%	-0.2%	8.9%	22.5%	19.3%	5.5%	3.8%	17.6%	0.4%
FY12e	-1.5%	3.4%	3.9%	3.5%	-0.2%	9.0%	19.4%	20.8%	4.2%	2.4%	15.8%	0.5%
FY13e	-1.7%	2.8%	3.9%	3.3%	-0.3%	9.4%	18.8%	20.7%	4.3%	2.0%	14.5%	1.0%
Capex to sales (%)												
FY11a	3.9%	3.8%	0.3%	4.1%	4.3%	5.6%	3.1%	1.3%	1.5%	2.6%	3.4%	6.0%
FY12e	3.5%	4.8%	0.6%	4.3%	2.4%	4.1%	4.0%	1.4%	1.5%	1.3%	3.4%	2.9%
FY13e	3.2%	3.9%	0.4%	4.9%	3.6%	2.6%	4.0%	1.4%	1.5%	2.1%	3.0%	3.7%
EBITDA interest cover (x)												
FY11a	15.8	10.6	7.3	40.8	9.5	13.7	8.3	5.8	55.4	nm	11.2	28.5
FY12e	14.0	12.7	7.5	26.2	9.4	11.6	7.0	5.4	14.2	nm	6.3	34.2
FY13e	14.8	13.0	7.8	21.2	9.6	13.5	6.1	6.3	17.8	nm	5.9	68.1

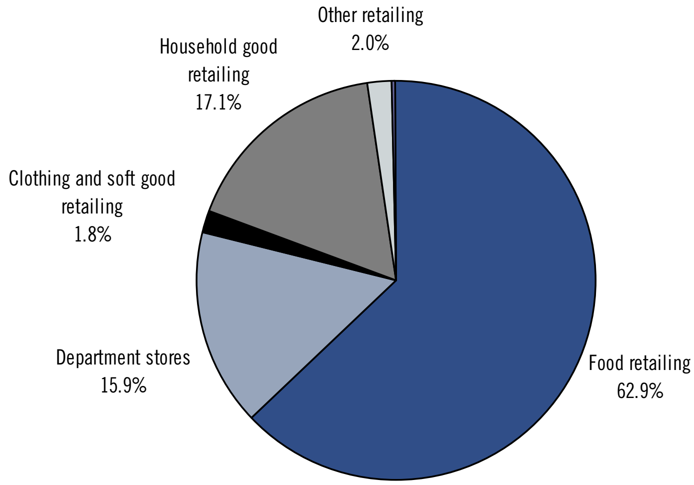
Note: Forecasts as of November 9th 2011; Source: Citi Investment Research and Analysis

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 31 shows the sales base of the listed company's, with an obvious bias towards Food retailing, given Woolworths and Wesfarmers' inclusion.

Figure 44. Listed company sales base assumption



Source: Citi Investment Research & Analysis

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 33 (9 December 2010)
Is it an Online Christmas?

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

Issue 33: Is it an Online Christmas?

An increasing number of Australian consumers are shopping online. Perhaps it will be an online Christmas in 2010? In issue 33 of What's In Store?, we size the online retail market and analyse the risks and opportunities for listed retailers. We estimate that 3.1%, or $7.5 billion of retail is online. Leakage to offshore websites represents another $3.5-$4.5 billion in sales. Apparel is the largest category online and is susceptible to the GST and tariff arbitrage for offshore purchases. The listed retailers are slow off the mark. We estimate they have an average of 0.4% of their sales online, far below the national average of 3.1%. The threat from online must be placed into context though. Australian retailers are the most visited websites and the erosion to sales is less than 0.6%. The retailers with the most advanced online presence are Premier Investments and JB Hi-Fi.

https://www.citigroupgeo.com/pdf/SAU10411.pdf

Issue 34 (11 February 2011)
The Mysterious Phenomenon of Price

Companies mentioned: WOW, WES, MYR, MTS, PBG, PMV

Issue 34: The Mysterious Phenomenon of Price

There is no single uniform measure of price inflation in retail. In Issue 34 of What's In Store?, we analyse the inflation measures used by Coles and Woolworths and more broadly look at the sensitivity of retail products to price movements. Coles and Woolworths both report inflation, but neither retailer's measure can be used to calculate volume growth. We believe Coles' measure over-states deflation because the company has increasingly used deep promotions, which alters the basket mix. The price sensitivity of food is very low. This bodes well for revenue growth at Coles, Metcash and Woolworths later in 2011 as food inflation rises. Clothing also has a low price elasticity, which raises questions about Kmart's lower price strategy, but is encouraging for the industry given higher cotton prices will force up clothing prices. The electrical, furniture and hardware categories have higher price elasticity.

https://www.citigroupgeo.com/pdf/SAU10755.pdf

Issue 35 (2 March 2011)
Retail Correlations

Companies mentioned: WOW, MTS, DJS, HVN

Issue 35: Retail Correlations

What influences retail spending? In Issue 35 of What's In Store?, we identify the factors that have a strong correlation with retail spending. There are some surprising results. Retail spending tends to rise when interest rates are rising. The best factors to watch are food inflation and petrol prices for food retailing. In discretionary retailing, house prices and disposable income are most significant. The prognosis is good for 2011. We expect food inflation to rise, which benefits retailers like Woolworths and Metcash. In addition, discretionary retailing should recover. Our preferred picks in discretionary retailing are David Jones and Harvey Norman.

https://www.citigroupgeo.com/pdf/SAU11029.pdf

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

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

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