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Retailing - Broadlines (Citi)
Australia/NZ | Australia

Can Retail Really Rally on Rate Cuts?

The Upside Scenario

- Industry Overview

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- **The extent of the upside** — Australian discretionary retail shares have risen 28% to 47% in 2013 in anticipation of a better retail cycle. While our base case is bearish, it is plausible there is a wealth-induced retail sales spike over the next six months. In our upside scenario, there may be consensus EPS upgrades of as much as 28%. Harvey Norman has the greatest upside. However, as interest rate stimulus fades, sales and earnings will then subside. We remain bearish on a 12-month view with Sells on all the large discretionary retailers.

- **The cycle lives on....but it's short-lived** — Lower interest rates could lead to a 3% spike in retail sales over the next six months. The crucial link is that lower interest rates seem to have triggered a rise in house prices. The positive wealth effect may lead to a drop in the savings rate and stronger retail spending. A sales spike has occurred in past rate-cutting cycles, but buying the retail cycle driven by interest rate stimulus is fraught with danger. There is a hangover the following year.

- **Harvey Norman has the greatest operating leverage** — Furniture retailers and department stores perform better during a rate cutting cycle. In addition, Harvey Norman has the greatest scope for margin recovery. Each 1% improvement in sales could lead to a 4.7% improvement in EBIT for Harvey Norman. This contrasts JB Hi-Fi where a 1% lift in sales only leads to a 2.5% increase in EBIT.

- **Myer has better valuation support** — Retail stocks could trade at 16x PE with LFL sales momentum usually positively correlated with the PE ratio. However, DJS, PMV and HVN are already trading at these levels. Looking at the stretch scenario of higher sales, better earnings and expanding PE ratios, Myer offers relative valuation support.

- **Citi's view on fundamentals** — A rally in retail stocks is likely to be short-lived as the driver is a only short-term spike in retail sales. The fundamentals remain very challenging, particularly given stores need to close, barriers to entry have reduced and gross margins are already at record levels. We have Sell ratings on David Jones (TP $2.60), Harvey Norman (TP: $2.00), JB Hi-Fi (TP:$10.20), Myer (TP:$2.60) and Premier Investments (TP: $6.70).

Stretch case scenario for large cap discretionary retailers

	Code	Stretch EPS FY14e (cents)	Stretch PE FY14e	Implied price	Current share price	Difference
David Jones	DJS	21.1	16.3x	$3.44	$2.99	15%
Harvey Norman	HVN	24.6	15.7x	$3.87	$2.73	42%
JB H-Fi	JBH	128.3	13.8x	$17.71	$14.76	20%
Myer	MYR	28.2	14.0x	$3.95	$2.95	34%
Premier Investments	PMV	57.7	15.8x	$9.12	$8.57	6%

Source: Citi Research. Pricing as at close 28 March 2013.

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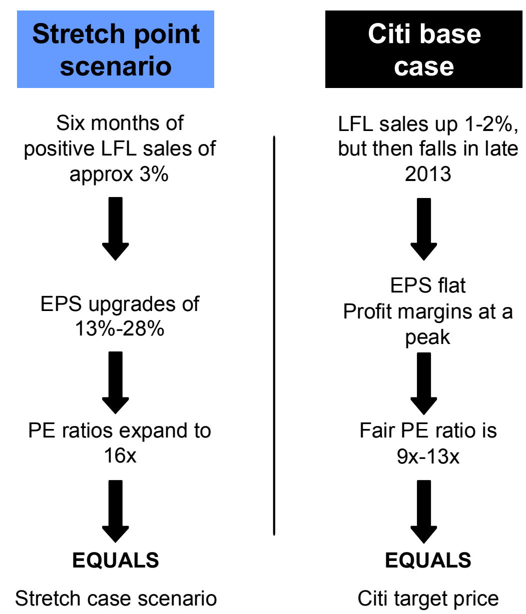
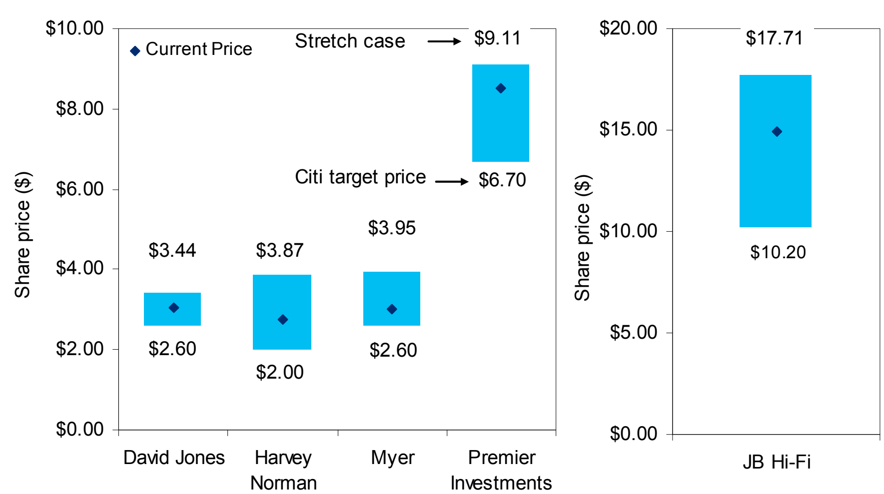
What are we missing? Given we have five Sell ratings across the five large cap Australian discretionary retailers, we feel it is appropriate to deal with an "upside risk" scenario. Falling interest rates and rising house prices make for a possible retail sales spike of 3% as consumers dip into their savings. The retailer's operating leverage is high and upside risk to consensus FY14e EPS is anywhere from 13% (JBH) to 28% (HVN). PE ratios often expand as sales improve making it an even greater stretch case. This stretch case scenario may play out, but it'll be over quickly. Interest rate reductions do not sustain retail cycles. The structural issues will resurface. In a relative sense, Myer has the least downside to our target price and greatest upside scenario. JB Hi-Fi has the largest downside to our target price.

Figure 1. The upside (stretch case) vs Citi base case



Source: Citi Research

Figure 2. Stretch case scenario for retailers vs Citi target price



Source: Citi Research

Given recent strength in retail sales for January and rising house prices, we explore the scenario where lower interest rates lead to a spike in retail spending. We address the following:

1. **The upside risk to sales:** Based on previous interest rate reductions, spending can spike by 3% to 7%. However, the spike lasts a short-time and there is always a sharp reversal of the growth trend. Furniture and department stores tend to perform better. A spike of 3% is possible in the next six months, driven by lower savings rates.

2. **The nature of the earnings risks:** If retail spending surprises on the upside, retailers will benefit in terms of gross margin and also operating leverage, as they have set their inventory and costs at a conservative level. The strongest operating leverage exists for Harvey Norman, Premier Investments and Myer.

3. **The stretch case vs Citi base case:** We explore an upside (stretch) case where there are earnings upgrades and further PE expansion to test the boundaries for these retail stocks. Typically, PE ratios would expand to 16-17x and the EPS upside vs consensus is 13% to 28% depending on the retailer.

The stretch case is shown in Figure 3 and highlights that Harvey Norman and Myer have the greatest upside potential.

Figure 3. Stretch case scenario for large cap discretionary retailers

	Code	Stretch EPS FY14e (cents)	Stretch PE FY14e	Implied price	Current share price	Difference
David Jones	DJS	21.1	16.3x	$3.44	$2.99	15%
Harvey Norman	HVN	24.6	15.7x	$3.87	$2.73	42%
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Source: Citi Research. Pricing as at close 28 March 2013.

Citi's view

The upside scenario described above may play out short-term, but the long-term reality is that retail remains challenged. Retail spending is likely to be less than the long-term average and online will absorb half the growth. The large ASX-listed retailers are mature and need to close stores, while gross margins are already at record levels. In our view, profit margins are near a peak, earnings will decline and therefore the stocks should trade at a PE discount to the market. We summarise our stock ratings in Figure 4.

Figure 4. Citi recommendations for large cap discretionary retailers

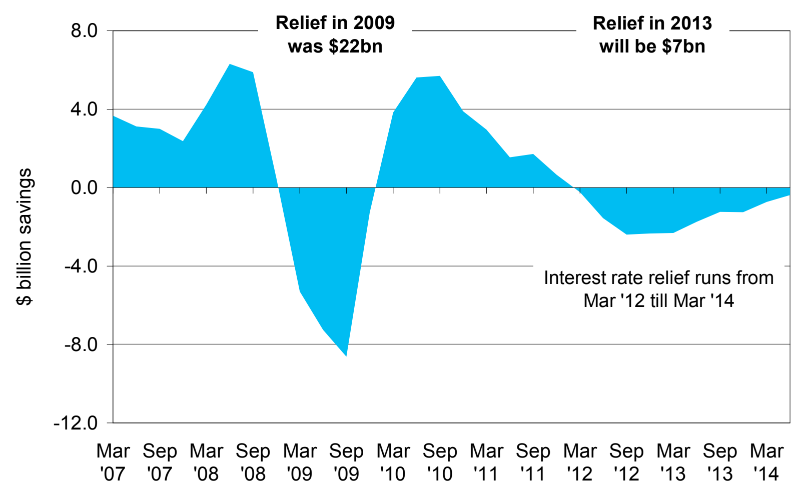
Company	Code	Rating	Share price	Target Price	Dividend Yield	PE (FY13e)	PE (FY14e)	EV/EBIT FY13e	EV/EBIT FY14e
David Jones	DJS.AU	Sell	$2.99	$2.60	5.6%	15.5	15.6	11.2	11.0
Harvey Norman	HVN.AU	Sell	$2.73	$2.00	3.3%	16.3	14.7	14.9	10.9
JB Hi-Fi	JBH.AU	Sell	$14.76	$10.20	4.5%	13.4	13.4	9.4	9.2
Myer	MYR.AU	Sell	$2.95	$2.60	6.3%	12.6	12.7	9.3	9.0
Premier Invstmts	PMV.AU	Sell	$8.57	$6.70	4.3%	18.7	19.6	10.2	9.9

Source: Citi Research. Pricing as at close 28 March 2013.

1. What is the upside risks to sales?

Retail spending has not yet responded to a sustained period of interest rate cuts. We estimate households are $7 billion better off in 2013 compared with 2012. This is equivalent to 0.6% boost to household income. While small, the chances are that the rise in household wealth may boost retail spending. The upside case is a 3% sales acceleration from trough levels for six months. That's the good news. The bad news is that retail sector investors need to be careful. Retail spending is likely to trough again shortly afterwards because the interest rate stimulus peters out or is removed. Underlying household income growth needs to follow through.

Figure 5. Interest rate relief for households ($ billion)

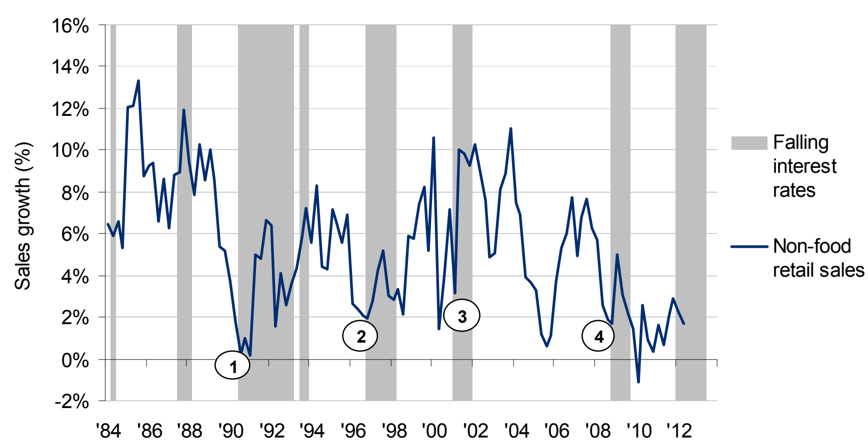


Assumes one more rate cut of 25bp in June 2013. Source: ABS, Citi Research

Lessons from previous rate cuts – there is a spike

There are four major episodes of interest rate cuts over the past 25 years that provide an insight to the impact of rate cuts. We show the interest rate cycles in Figure 6 and non-food retail sales growth. In each episode, there was a 3 to 7 percentage point acceleration in retail sales from trough to peak. However, there was an almost as large fall in retail sales post the six month spike.

Figure 6. Interest rate cycles and the non-food retail spending response



Source: ABS, Citi Research

To understand the factors that impacted spending in each episode, we provide more detail below:

- **Episode 1: June 1991– March 1992 (9 month spike of 6% from trough to peak)** This period was the last Australian recession. Interest rate relief was equivalent to a 1.6% change in household income. It took a while for spending to respond and the downturn was almost as sharp within six months of the peak. Unemployment was at 11% when spending peaked.
- **Episode 2: June 1997– December 1997 (6 month spike by 3%)** Retail spending spiked by a smaller amount as the cash rate change from peak to trough was 50bp. In this episode, unemployment began falling and house prices also rose.
- **Episode 3: June 2001– June 2002 (12 month spike of 7%)** A rapid spike that is distorted by the introduction of a GST in June 2000. The improvement in spending ties in with a 40bp drop in unemployment rate and over 20% increase in house prices.
- **Episode 4: March 2009 – June 2009 (3 month spike of 3%)** A sharp spike following the global financial crisis where the government and RBA both combined to stimulate consumer spending. The interest rate stimulus was $22 billion during 2009, plus another $21 billion in Government handouts. However, the retail spending spike was modest by historical standards as savings rates increased. House prices actually declined during the majority of 2009.
- **Episode 5: Citi estimate December 2012–June 2013 (six month spike of 3%)** We see the possibility of a short-sharp spike in retail spending, but consumers better start spending in retail. The March and June quarters of 2013 will be the key months and the movement in asset prices, savings rates will be the factors that determine the size of the spike.

Lower savings is the key factor

The interest rate relief for 2013 is meaningful at $7 billion, but only represents a 0.6% improvement in income. The spike in retail spending will most likely come from a lower savings rates. We present the connection in Figure 7.

Figure 7. The connection between rate cuts and retail spending

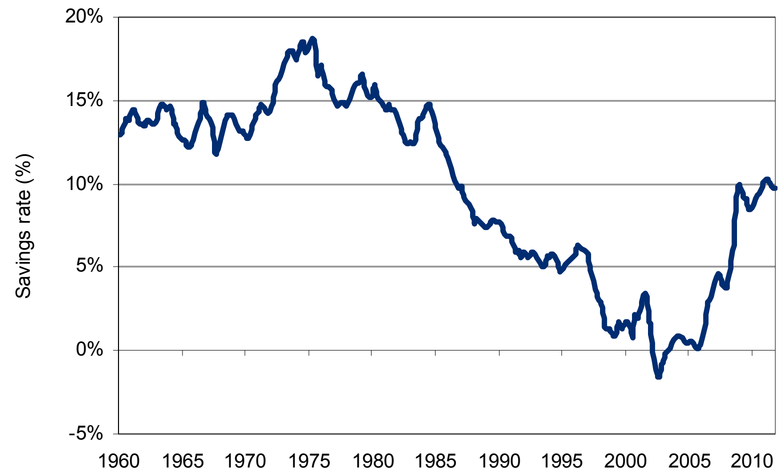
Source: Citi Research

Australian household savings rates are at 9.5% annualised. The fifty year average is 9.0%. Australians are saving at a sensible level given modest asset price increases. Some commentators point to “record” level of savings, but that analysis fails to consider savings rates before 1980.

It is also worth noting that superannuation contributions are included in the calculation of savings. In other words, the 9% compulsory contributions for eligible employees is part of the 9.5% in household savings. The actual cash savings is much lower. This is reflected in the fact that household debt levels have not fallen at all since the spike in savings rates in 2006. Debt has remained broadly inline with asset prices.

We show the long-run history of the savings rate in Figure 8. The savings rate often moves by a full two percentage points between quarters and such a move is possible in 2013 if asset prices move higher.

Figure 8. Household savings rate since 1960 – near long-term trend

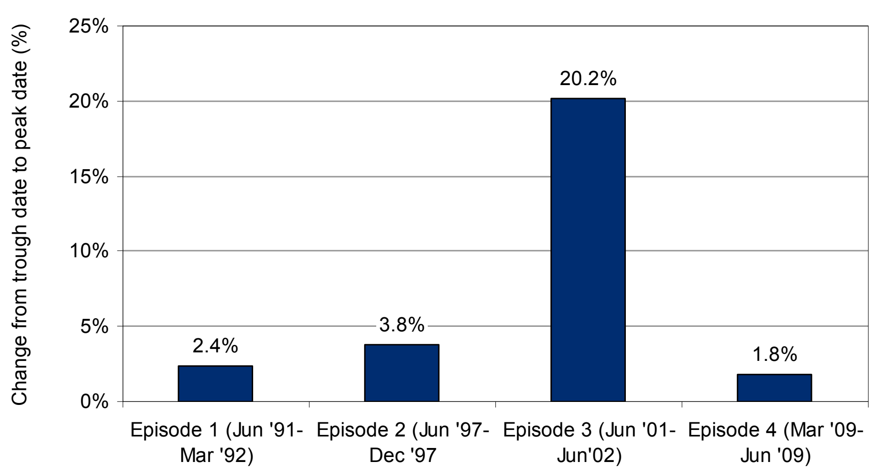


Source: Citi Research

House prices are important

Housing represents two-thirds of household wealth, which makes it a key driver of changes in household savings rates. One of the most significant increases in spending, in 2001, was associated with a 20% increase in house prices. However, the other rate-cutting episodes were not tied to housing. Other economic factors, like tax cuts and reduced household expenses provided a boost for spending.

Figure 9. House price change during previous rate cutting cycles



Source: ABS, Citi Research

What are the downside risks?

Retail spending should have responded already to the rate-cut cycle. The September and December quarters of 2012 had strong benefits from rate cuts for households, but there was no evidence for better spending.

The short-term downside risks are:

- **Product – shoppers need a reason to buy goods:** The pace of innovation and change has slowed in most retail categories over the past three years. In fashion, the Winter 2013 direction is similar to 2012, while in electronics, there is a heavy reliance on strong sales from tablets. Most other categories are simply offering a new version of an existing product.

- **Weather:** The weather patterns in February and March 2013 have been warmer than the previous year. That is a soft start to the Winter season and may hurt sales.

- **Government stimulus fades:** The retail sector benefited from Government handouts in June 2012 and January 2013. This was approximately $500 million in each instance. The payment in 2013 will shift to July. Investors should be mindful about weak June statistics, but stronger July monthly sales.

Fundamentally, retail spending needs to be supported by stronger household income growth, once interest rate stimulus and changes in savings have washed through. The areas for longer-term improvement in income may be:

1. **Employment and wages:** Australian unemployment is at its lowest starting point for an interest rate cutting cycle. Wages growth is also at 4% already, making it difficult to provide an acceleration beyond 2013.

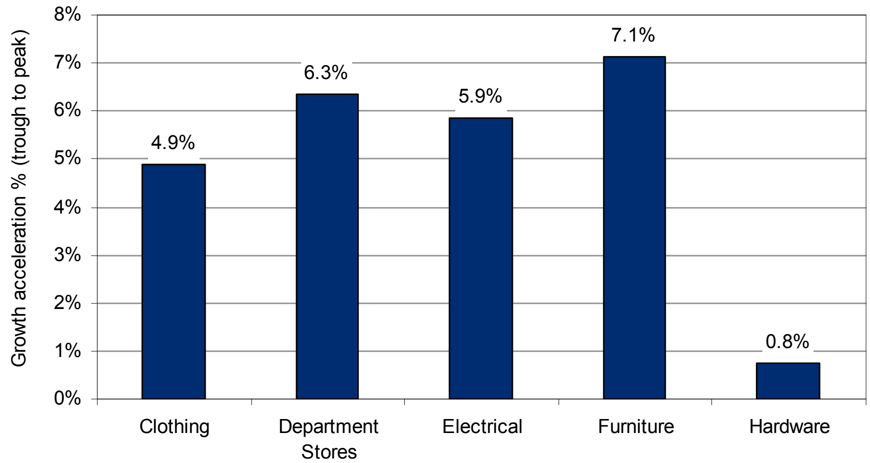
2. **Social assistance or tax cuts:** The Government stimulus has provided a significant boost in the past and there may be scope to stimulate spending. However, both major political parties seem more focused on managing a balanced budget. Given pressure on government receipts from lower mining income, there seems little scope for tax cuts.

Which categories do best?

We expect low single-digit sales growth across retail categories over the next 12 months. However, we acknowledge the upside scenario of lower interest rates may push that higher by 3 percentage points. The categories best placed to benefit from better spending are furniture and department stores based on previous experience.

Looking at the four previous rate-cutting cycles, the category to perform the best is furniture, slightly outperforming department stores. Hardware has lagged and electrical is most likely linked to household appliances, rather than consumer electronics. The stronger performance in furniture and department stores seems to link most closely to the wealth effect of lower interest rates.

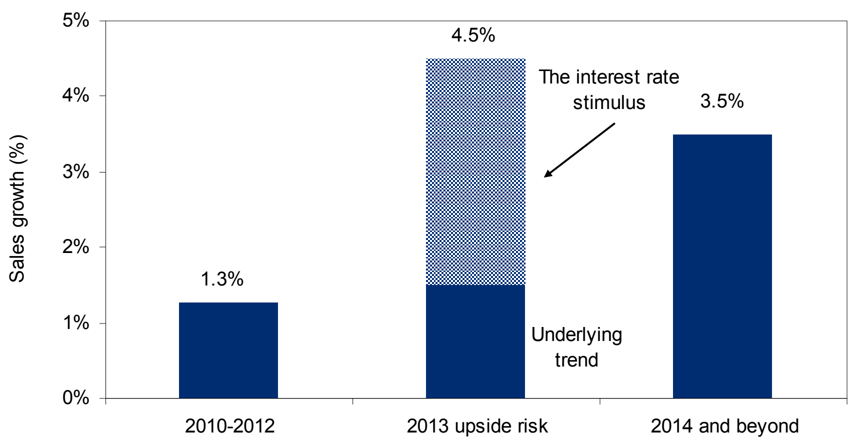
Figure 10. Category acceleration during past rate cutting cycles (average of 4 episodes)



Source: ABS, Citi Research

We expect a spike in retail spending of roughly 3% in 2013 boosted by a change in household savings. However, by the end of 2013, the interest rate stimulus will have passed and the underlying income growth for households only supports 3.5% non-food retail spending growth, a 1% slowdown. This would lead to LFL sales of 0%-1% for most retailers.

Figure 11. Discretionary retail spending growth outlook – 3% upside risk



Source: ABS, Citi Research

Looking to 2013, we summarise our growth outlook for retail categories in Figure 12. We expect furniture and department stores to once again fare the best given the upside risk to house prices.

Figure 12. Category outlook

Category	Rank	2012 sales growth	2013 outlook	Rationale
Furniture	1	-4.4%	3%-4% growth	Best leverage to improving house prices
Department stores	2	0.9%	2%-3% growth	Price deflation to persist and weaker fashion trends yoy
Electronics	3	2.5%	2%-3% growth	Stronger tablet sales and some leverage to house prices
Clothing & footwear	4	2.5%	1%-2% growth	Weaker Winter and Summer fashion trends likely

Source: Citi Research

The category outlook puts Harvey Norman, David Jones and Myer in the strongest position. JB Hi-Fi and Premier Investments sell fewer retail goods that are not leveraged to asset prices movements.

2. Where are the earnings risks?

Retailers remain cautious about the outlook, even if share prices already factor in a stronger retail cycle. The upside risk to earnings will come from a reduction in discounting and operating leverage if retail spending is stronger.

Gross margin upside risks

More than two-thirds of the listed retailers in Australia reported gross margin expansion over the past six months. Looking forward, the scope for improved gross margins is more reliant on reduced discounting than lower input costs. Most retailers have captured currency hedge gains and hedge rates are now flat year over year. The upside risk to gross margins is 100-250bp depending on the retail category and prospect for reduced discounting.

We summarise our gross margin upside case in Figure 13. We note the following:

- **David Jones has the largest gain**: David Jones is on a path towards gross margin recovery after a clearing excess inventory in FY12. The company's gross margin guidance range is 39.5%-40.0%.
- **Harvey Norman also has significant margin rebound:** Harvey Norman has significantly reduced its inventory holdings and the gross margin rebound will partly come through mix as furniture and small appliances have stronger sales.
- **JB Hi-Fi has the smallest margin gain:** JB Hi-Fi faces the greatest natural headwind as its sales mix shifts away from software towards lower margin hardware like tablets. We estimate the mix change detracts 20bp per annum from gross profit margins.

Figure 13. Gross margin upside risk for retailers

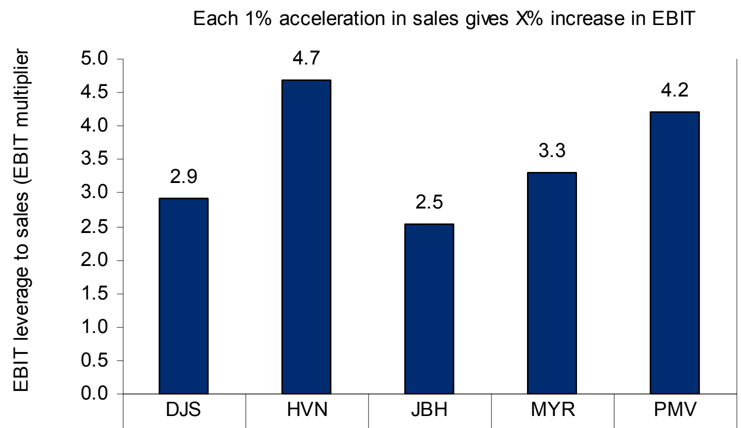
	MYR	DJS	PMV	HVN	JBH
Gross margin FY12	41.3%	37.5%	61.2%	27.1%	21.1%
Gross margin FY14e - upside case	42.3%	40.0%	62.4%	29.0%	21.9%
Margin expansion	99bp	253bp	124bp	185bp	80bp

Note HVN gross margin reflects its offshore/retail segments, but represents a proxy for the Franchise system too.
Source: Company reports, Citi Research

Operating leverage

Retailers have placed a tight rein on costs. A positive surprise in sales would lead to a much larger increase in earnings. For the large retailers, we estimate a 1% improvement in sales equals a 4.7% increase in EBIT for Harvey Norman, and only a 2.5% increase in EBIT for JB Hi-Fi. We summarise the leverage factors in Figure 14.

Figure 14. Operating leverage for discretionary retailers (1% sales growth = x% EBIT growth)



	DJS	HVN	JBH	MYR	PMV
Operating leverage factor	2.9	4.7	2.5	3.3	4.2
% of CODB fixed	50%	80%	50%	50%	65%

Source: Citi Research

Generally, we assume 50% of costs are fixed. The most significant cost is labour, which has been rising at 3% in terms of wage rate. However, to offset this pressure, retailers have lowered hours worked, or refined labour rosters. Rents are usually fixed and a more significant cost specialty retailers like Premier Investments.

EPS upside compared with consensus

If there is a spike in retail sales and it lasts a full 12 months, then there is anywhere from 13%-28% EPS upside compared with consensus estimates for FY14e.

Our methodology in determining the EPS upside case is:

- Assume 3% LFL sales growth
- Gross margin upside case (see Figure 13)
- Operating leverage factor (2.5x to 4.7x depending on retailer, see Figure 14)

We summarise the EPS upside case, compared with consensus in Figure 15.

Figure 15. Upside scenario risk to EPS vs consensus

	DJS	HVN	JBH	MYR	PMV
Consensus EPS FY14e (cents)	18.1	19.2	113.2	23.9	50.2
Stretch EPS FY14e (cents)	21.1	24.6	128.3	28.2	57.7
EPS upside risk	16.5%	28.3%	13.3%	18.1%	15.0%

Source: Bloomberg consensus, Citi Research estimates

3. What is the upside scenario?

Retail share prices have rallied significantly, attempting to "price in" a retail sales recovery. We see downside on a 12-month horizon as the short-term sales spike reverses. However, share prices will be volatile and we attempt to provide the absolute stretch-point where a bullish upside scenario is fully reflected in the share price.

The stretch point is the share price where a retail stock factors in both a retail cycle rebound into earnings at a full PE ratio. This provides an upside case where a holder should clearly lock in the outperformance. The stretch case is shown in Figure 16 and reveals there is much stronger upside for Harvey Norman and Myer.

Figure 16. Stretch case scenario for retailers

	Code	Stretch EPS FY14e (cents)	Stretch PE FY14e	Implied price	Current share price	Difference
David Jones	DJS	21.1	16.3x	$3.44	$2.99	15%
Harvey Norman	HVN	24.6	15.7x	$3.87	$2.73	42%
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Source: Citi Research. Pricing as at close 28 March 2013.

Our base case valuations are anchored around much more conservative assumptions for both sales and margins. Our rationale is:

- Most Australian retailers are mature. Store growth is limited and for some, like the department stores and Harvey Norman, stores need to be closed.
- Barriers to entry are fundamentally lower given the growth in online retailing.
- Price and volume growth for non-food retailing only supports 3%-4% retail sales growth, of which online is taking 2%. The like-for-like sales potential for retailing is 0%-1%.
- Gross margins are already near record levels for most retailers.
- Operating cost growth remains closer to 3% given rising wage costs and utilities.

We summarise our fair value PE ratio and target price in Figure 17.

Figure 17. Citi target price and fair value PE ratio (one year forward)

	DJS	HVN	JBH	MYR	PMV
Fair PE	13.0	10.0	9.0	10.5	14.4
Citi target price	$2.60	$2.00	$10.20	$2.60	$6.70

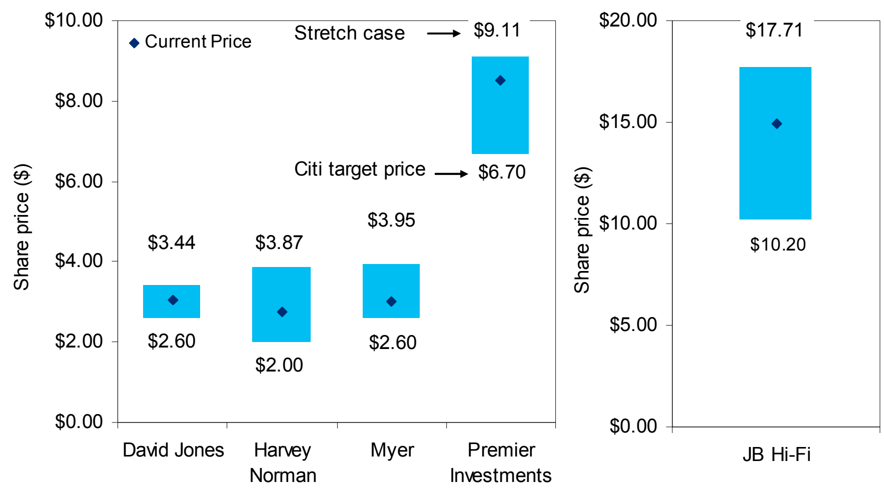
Source: Citi Research

Below we discuss in more detail the factors that drive the stretch case scenario and our more conservative forecasts.

The relative rank of discretionary retailers

We show the asymmetry between the stretch point and our target price in Figure 18. We use this asymmetry to provide a relative risk profile for holding each discretionary retail stock.

Figure 18. Stretch case scenario and Citi target prices



Source: Citi Research

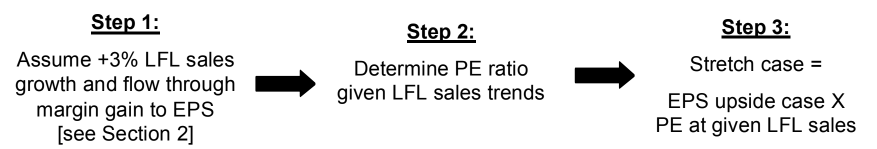
Our risk ranking from lowest to highest is:

1. Myer – stretch point is $3.95. Citi target price is $2.60.
2. David Jones – stretch point is $3.44. Citi's target price is $2.60
3. Premier Investments – stretch point is $9.11. Citi's target price is $6.70.
4. Harvey Norman – stretch point is $3.87. Citi's target price is $2.00
5. JB Hi-Fi – stretch point is $17.71. Citi's target price is $10.20.

The methodology for our stretch case

In order to assess how far retail stocks may factor in an upside scenario, we use the premise that PE ratios are tied to LFL sales trends. We have observed this over many retail cycles in Australia and the same connection is seen in other developed markets.

Figure 19. Methodology to determine stretch case scenario share price



Source: Citi Research

The methodology to arrive at the stretch PE ratio is:

1. Assume 3% like-for-like sales acceleration for each retailer.
2. Use David Jones and Harvey Norman's long-run PE ratios to determine the connection between sales and its PE ratio. We also use JB Hi-Fi's total sales to determine its fair PE ratio. We use total sales given the significant distortion its

store rollout has on sales and LFL sales. Apply the typical PE ratio discount or premium between David Jones and Myer and Premier Investments. These companies are all seen as fashion retailers.

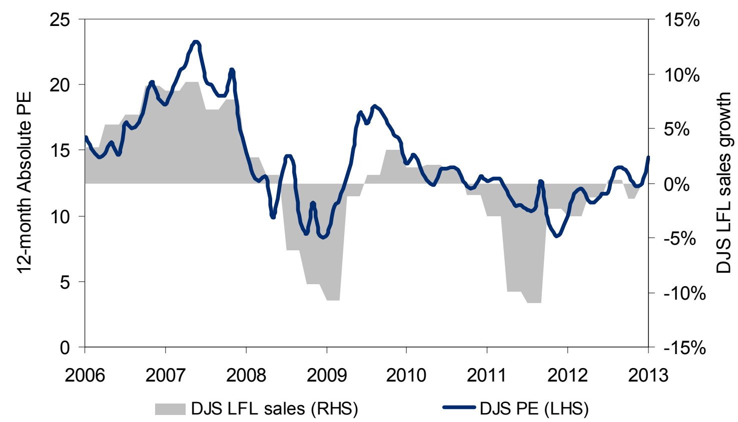
3. Apply the adjusted PE ratio to the upside EPS scenario assuming 3% LFL sales growth to derive a share price outcome.

Retail stocks trade with their sales performance

The two retail stocks with the longest share price history are David Jones and Harvey Norman. Both display a clear positive correlation between like-for-like sales and PE ratio. This is also true of their PE relative to the ASX 200.

In Figure 20, we show David Jones long-run PE ratio has been near 14x. If LFL sales growth is 3%, based on the previous correlation, its PE ratio would be 16.3x.

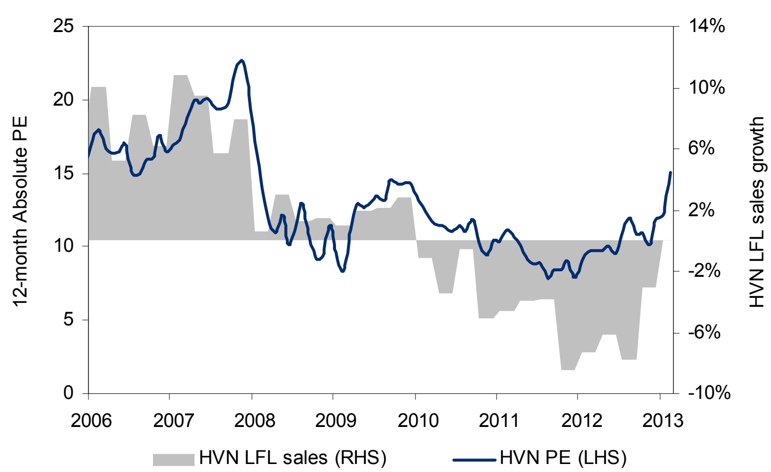
Figure 20. David Jones PE Ratio and LFL sales



Source: Citi Research

In Figure 21, we show Harvey Norman's long-run PE ratio has been near 14x and if LFL sales growth is 3% would be nearer to PE of 15.7x.

Figure 21. Harvey Norman PE ratio and LFL sales growth

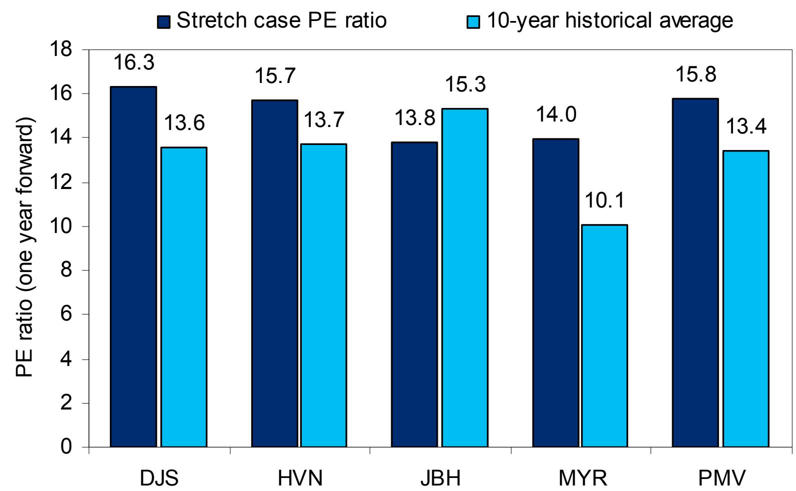


Source: Citi Research

What is the right PE ratio?

The PE ratio we apply in our stretch case reflects the more bullish sales backdrop of that scenario. We show the stretch PE vs the 10-year average in Figure 22.

Figure 22. PE ratio – stretch case vs historical average



Source: dataCentral, Citi Research

The reality is that those PE ratios need to be supported by 10% EPS growth in our view. That will be a challenge beyond a year or two of sales recovery. In Figure 23, we show the PE ratio and PE relative, combined with the average annual EPS growth since FY03 for each retailer. Given slower EPS growth, PE ratios should be closer to 13x.

Figure 23. Retail PE ratios historically

Company	MYR	DJS	PMV	HVN	JBH
10 year average PE ratio, or since listing	10.1	13.6	13.4	13.7	15.3
PE relative to ASX 200	81%	100%	100%	100%	112%
EPS growth average (past ten years)	-7%	10%	-4%	3%	29%

All PE ratios are one year forward. MYR and JBH are since listing. PMV is since January 2009.
Source: Citi Research

Citi's view on the retailers

This upside case is in stark contrast to our view on the retailers. We summarise our forecasts below.

Sales outlook

We have a soft sales outlook for the discretionary retailers because income growth is modest and online spending growth will constrain LFL sales. We summarise our LFL sales forecasts in Figure 24.

Figure 24. Citi forecasts for like for like sales

	FY11	FY12	FY13e	FY14e
DJS	-2.8%	-4.3%	-0.1%	1.0%
HVN	-2.8%	-7.0%	-3.0%	2.3%
JBH	-1.2%	-1.0%	-3.4%	-0.9%
MYR	-5.5%	-2.0%	1.5%	1.1%
PMV	-2.8%	-6.7%	1.0%	1.0%

Source: Citi Research

Operating earnings outlook

We expect slight margin contraction for all retailers, except for Harvey Norman, which has had the sharpest fall in margins over the past two years. In Fig 19, we show our forecast EBIT. The only retailer to surpass the FY11 high watermark is Premier Investments. However, the company recorded a number of short-term costs in that year. In FY10, EBIT was $84 million.

Figure 25. Citi forecasts for EBIT ($ million)

	FY11	FY12	FY13e	FY14e
David Jones	246	154	154	155
Harvey Norman	393	252	228	310
JB Hi-Fi	196	161	167	166
Myer	259	230	227	228
Premier Investments	64	86	91	87

Source: Citi Research

In Fig 20, we show our EBIT margin forecasts. Australian EBIT margins are healthy even at the "trough" levels of FY12 compared with their own history and offshore peers.

Figure 26. Citi forecasts for EBIT margins

	FY11	FY12	FY13e	FY14e
David Jones	12.6%	8.3%	8.2%	7.9%
Harvey Norman	6.1%	4.8%	5.0%	5.4%
JB Hi-Fi	6.6%	5.2%	5.2%	5.0%
Myer	8.2%	7.4%	7.2%	7.1%
Premier Investments	7.4%	10.3%	10.7%	10.0%

Margin is based on system sales for HVN.
Source: Citi Research

EPS profile

We have a subdued EPS growth profile for each retailer. The benefits from lower interest costs show through in FY13e. With weak sales and rising costs, there is little scope to grow underlying earnings. We summarise our forecasts in Figure 27.

Figure 27. Citi forecasts for EPS (cents)

	FY11	FY12	FY13e	FY14e
DJS	32.4	19.4	19.3	19.2
HVN	22.4	15.8	16.8	18.6
JBH	124.0	105.9	109.9	110.2
MYR	27.8	23.7	23.5	23.3
PMV	33.0	43.5	45.8	43.7

Source: Citi Research

Figure 28. Citi forecasts for EPS growth

	FY11	FY12	FY13e	FY14e
DJS	-2%	-40%	0%	-1%
HVN	-18%	-29%	6%	11%
JBH	14%	-15%	4%	0%
MYR	-6%	-15%	-1%	-1%
PMV	-21%	32%	5%	-4%

Source: Citi Research

Recommendations

Figure 29. Citi recommendations for large cap discretionary retailers

Company	Code	Rating	Share price	Target Price	Dividend Yield	PE (FY13e)	PE (FY14e)	EV/EBIT FY13e	EV/EBIT FY14e
David Jones	DJS.AU	Sell	$2.99	$2.60	5.6%	15.5	15.6	11.2	11.0
Harvey Norman	HVN.AU	Sell	$2.73	$2.00	3.3%	16.3	14.7	14.9	10.9
JB Hi-Fi	JBH.AU	Sell	$14.76	$10.20	4.5%	13.4	13.4	9.4	9.2
Myer	MYR.AU	Sell	$2.95	$2.60	6.3%	12.6	12.7	9.3	9.0
Premier Invstmts	PMV.AU	Sell	$8.57	$6.70	4.3%	18.7	19.6	10.2	9.9

Source: Citi Research. Pricing as at close 28 March 2013.

David Jones Ltd

(DJS.AX; A$3.04; 3)

Valuation

We value DJS at $2.45 per share. Our 12-month target price is $2.60 per share. Our target price is derived by rolling forward our valuation at the cost of equity of 11.1% less the next 12 months of dividends to be paid.

Our valuation is derived through a blended average of our:

- PE relative valuation of $2.40
- DCF valuation of $2.40 and
- Sum-of-the-parts valuation of $2.60.

There is a mixture of factors influencing the valuation of David Jones. Using a PE relative measure, we value DJS using a discount of 10% to the All Industrials, ex banks and property. This discount is in-line with its four year average. The inferred FY14e PE ratio is 12.6x.

Our DCF valuation is derived using an equity beta of 1.1 and a WACC of 10.8%. We use a risk free rate of 5.5%. Our cost of capital is high reflecting the volatile nature of department store retailing. We use a terminal growth rate of 2.5%.

Our sum of the parts valuation is derived comparing DJS to international peers. We apply a multiple that is below global peers given risks to David Jones peak margin levels. Our group-wide EV/EBITA fair value multiple is 8.9x.

Risks

The upside risks to our forecasts are:

- Acceleration in retail sales will boost DJS sales and profit margins.
- More rational marketplace. DJS' margins will benefit from competitors behaving rationally.
- Successful expansion in financial services. DJS joint-venture with American Express. A larger credit card balance for cardholders could result in higher EBIT growth.

The downside risks to our forecasts are:

- A fall in retail spending. If interest rates increase significantly or if house prices and share prices fall substantially, then retail sales growth will slow for DJS' customers.
- Long-term credit card earnings. In the long-term the company will be exposed to customer acceptance for the card.
- Competitors changing strategy. If competitors develop a strategy that focuses more on branded products and attracts more affluent customers, it will directly challenge DJS' sales base.

- Loss of share to specialty retailers. While direct competitors remain rational, DJS also competes with numerous specialty retailers which may act irrationally.
- Internet retailing. The growth of internet retailing may take market share and also reduce gross profit margins for David Jones, especially given the internet improves a shoppers price discovery.

Adverse or positive developments in these risk factors may cause DJS' share price to deviate from our valuation.

Harvey Norman Holdings Ltd

(HVN.AX; A$2.79; 3)

Valuation

We value HVN at $1.84 per share. Our 12-month target price is $2.00 per share. Our target price is derived by rolling forward our valuation at the cost of equity of 11.7% less the next 12 months of dividends to be paid.

Our valuation is derived through an average of our:

- PE relative valuation of $1.83,
- DCF valuation of $2.01 and
- Sum-of-the-parts valuation of $1.69.

Using a PE relative measure, we value HVN using a discount of 30% to the All Industrials, ex banks and property. This discount is in line with its three year average. The inferred PE ratio is 9.9x FY14e.

Our DCF valuation is derived using an equity beta of 1.2 and a WACC of 10.4%. We use a risk free rate of 5.5%. Our cost of capital is high reflecting the cyclicality of electronics and furniture retailing. We use a terminal growth rate of 3.3%.

Our sum of the parts valuation is derived comparing HVN’s franchising operations to international peers. We apply a multiple in line with the median of international electrical and furniture retailing peers. Our fair value EV/EBIT multiple for HVN’s franchise operations is 7.3x FY14e.

We value HVN’s Property segment at a yield of 9.0%. The Property segment is valued primarily based on the retail sites for Harvey Norman stores.

Risks

The upside risks to our forecasts are:

- Faster retail spending growth. The benefits of lower interest rates and household income growth could boost Harvey Norman's sales.
- Successful offshore expansion. HVN’s offshore business may reach a large size and acceptable return on capital in a short amount of time, boosting the company’s earnings.
- Stronger Franchise segment margins. If HVN can lower operating costs and improve buying terms relative to its competitors, the segment's margins may rise further than we forecast.

The downside risks to our forecasts are:

- Slowdown in economic growth and in particular the housing market. A severe correction in Australian house prices would hurt HVN's sales.
- Increased competition. New competitors are opening stores rapidly and attempting to take share from HVN. Many of these competitors are high-volume, low-margin retailers.
- Key personnel risk. The senior management at HVN have worked at the company for a number of years. If these people were to leave the business, it would expose significant strategic and operational risks for HVN.
- Offshore business risks. HVN's offshore operation exposes the company to country, political and currency risks.

Adverse developments in these risk factors may impede HVN's share price reaching our valuation.

JB Hi-Fi Ltd

(JBH.AX; A$15.07; 3)

Valuation

We value JBH at $9.69 per share. Our 12-month target price is $10.20 per share. Our target price is based on the roll forward of our valuation at the cost of equity of 11.7% less the next 12 months of dividends to be paid.

Our valuation is derived through a blended average of our:

- PE relative valuation of $11.70
- DCF valuation of $8.57; and
- Sum-of-the-parts valuation of $8.81.

Using a PE relative measure, we value JBH using a discount of 22% to the All Industrials, ex banks and property. The inferred FY13e PE ratio is 10.6x.

Our DCF valuation is derived using an equity beta of 1.2x and a WACC of 11.5%. We use a risk free rate of 5.5%. Our cost of capital is high reflecting the discretionary nature of JBH's products. We use a terminal growth rate of 3.5%.

Our sum of the parts valuation is derived comparing JBH to international peers. Our group-wide EV/EBIT FY13e fair value multiple is 5.5x.

Risks

The downside risks to our forecasts are:

- A slowdown in retail spending. If macroeconomic conditions, particularly interest rates, house prices and petrol prices worsen, then industry retail sales growth will contract, impacting JBH's financial performance.
- Increased competition. Increased price investment by competitors to clear overhanging inventory or win market share, would hurt JBH's sales growth and profit margins.

- The threat of new entrants may alter the returns profile throughout the domestic appliance industry. Further expansion of product categories by big box value based offerings such as the discount department stores and the impending entry of Costco in Australia, may impact JBH's share.
- Price inflation, given both input cost increases and adverse currency movements, will adversely impact demand for products within JBH stores.
- Reduced sales in product categories that are in decay, such as music and DVDs, will impact both product mix and demand for JBH products.
- Key personnel risk. The senior management at JBH have worked at the company for a number of years. If those people were to leave the business, it would expose significant strategic and operational risks for JBH.
- Increased operating costs. Higher rental terms from landlords or increased wage pressures across the industry could impact JBH's profit margins.

The upside risks to our forecasts are:

- High profit margin expansion. Our valuation is sensitive to the long-run assumed EBIT margin. While we have modest margin expansion, we expect price competition, product mix changes and the small format store to limit the upside. A more rational electronics market could provide additional margin expansion.
- Faster retail spending growth. The benefits of income tax cuts and other government incentives could boost JBH's sales.
- Continued store rollout. A faster store rollout or larger than expected smaller store format expansion could boost JBH's long-run growth opportunities.
- Successful brand expansion. JBH's Clive Anthony's and New Zealand businesses may reach a large size and acceptable return on capital in a short amount of time, boosting the company's earnings.
- Increased product innovation. Further roll-out of new categories and products will support demand within JBH stores.

If the impact of these risks is greater or less than we assume, JBH's share price could exceed or undershoot our target price.

Myer Holdings Ltd

(MYR.AX; A$2.95; 3)

Valuation

We value Myer at $2.44 per share. Our 12-month target price is $2.60 per share. Our rounded target price is derived by rolling forward our valuation at the cost of equity of 11.8% less the next 12 months of dividends to be paid.

Our valuation is derived through an average of our:

- PE relative valuation of $2.53,
- DCF valuation of $2.31 and
- Sum-of-the-parts valuation of $2.48.

Using a PE relative measure, we value Myer using a discount of 23% to the All Industrials, ex banks and property, based on a rolling three-year average for stock. This discount reflects Myer's positioning as a discretionary retailer and is a steeper discount than its nearest rival, given their different asset mix.

Our DCF valuation is derived using an equity beta of 1.3 and a WACC of 11.0%. We use a risk free rate of 5.5%. Our cost of capital is reflective of the asset beta for department stores across the world, adjusted for the leverage embedded in Myer. We use a terminal growth rate of 2.25%. Our sum-of-the-parts valuation is derived comparing Myer with domestic and international department store peers. We apply a multiple slightly below the median of its peer group given our forecast for declining margins. Our fair value EV/EBIT multiple is 7.9x FY14e.

Risks

The downside risks to our forecasts and target price are:

- Lower retail sales demand could influence Myer's ability to grow profit margins. Australian households have low levels of savings and are reliant on income growth to drive spending.
- A fall in the Australian dollar could increase the cost of goods sold and likely impact gross profit margins.
- Rapid industry-wide store rollout may dilute returns for all operators.
- Myer may experience greater cannibalisation at its existing stores from new store openings.
- The department store industry has benefited from leaner inventory and more rational management. If management focus turns to market share gains, profit margins may contract.
- Myer service levels are below prior years and industry peers. Consumers may react to lower staffing levels by increasingly shopping at rival stores, or specialty outlets.
- Sass & Bide may fail to drive increased customer traffic and/or cannibalise on existing sales, which could mean the business does not generate the required return on capital.

The upside risks to our forecasts and target price include:

- Better retail sales growth in Australia, driven by stronger GDP and credit fuelled spending.
- Greater success from private label expansion and Myer One utilisation boosting gross profit margins
- Greater cost savings from areas such as new IT systems, overhead cost leverage and lower marketing costs.
- Further store rollout in areas such as Western Australia where the brand is under-penetrated.
- Rollout of specialty stores under Myer Exclusive Brands may drive higher than expected profit growth.

Positive developments in these risk factors may keep Myer's share price above our valuation. Conversely, adverse developments in these risk factors may cause Myer's share price to undershoot our valuation.

Premier Investments Ltd

(PMV.AX; A$8.60; 3)

Valuation

We value PMV at $6.30 per share. Our 12-month target price is $6.70 per share. Our target price is based on the roll forward of our valuation at the cost of equity of 11.8% less the next 12 months of dividends to be paid.

Our valuation is derived through a blended average of our:

- PE relative valuation of $5.69
- DCF valuation of $6.13; and
- Sum-of-the-parts valuation of $7.06.

Using a PE relative measure, we value PMV using a discount of 7% to the All Industrials, ex banks and property. The inferred FY13e PE ratio is 13.0x.

Our DCF valuation is derived using an equity beta of 1.3 and a WACC of 11.8%. We use a risk free rate of 5.5%. Our cost of capital is high reflecting the high risk nature of apparel retailing. We use a terminal growth rate of 3.5%.

Our sum of the parts valuation is derived comparing PMV to international peers. We apply a multiple below the median of international peers given the need for store closures in mature brands. Our group-wide EV/EBITA fair value multiple is 8.1x FY14e.

Risks

The company specific risks to our forecasts include:

- Fashion risk: PMV is exposed to changing fashion trends and will lose sales and experience margin contraction if it fails to adapt.
- Security of product sourcing: PMV relies on Chinese factories for sourcing its products. If the factories attract alternative customers, the company's supply chain would be disrupted.
- Rental cost risk: Shopping centre owners may increase rental costs when agreements are renewed.
- Future acquisition: An acquisition of a small network of stores with a successful brand will have a positive impact on the company's EPS and our valuation.

The industry risks to our forecasts for PMV include:

- Retail spending: A significant slowdown in consumer clothing spending would impact PMV's sales and profitability. Profitability is impacted as PMV leverages its sales growth against its fixed cost base.
- Currency movements: A continued downward movement in the AUD/USD will increase PMV's product costs and is likely to compress margins as PMV cannot pass on the entire product cost increase.
- Competitor store openings: Competitors can open stores that compete directly with PMV brands.

Adverse developments in these risk factors may impede PMV's share price reaching our valuation.

Appendix A-1

Analyst Certification

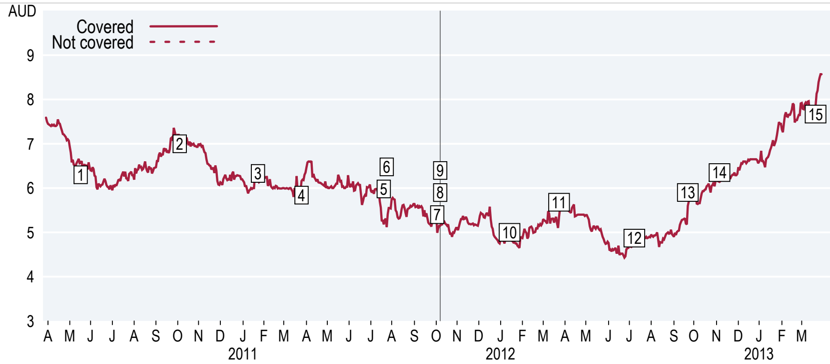
The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each 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.

IMPORTANT DISCLOSURES

Premier Investments Ltd (PMV.AX)

Ratings and Target Price History
Fundamental Research

Analyst: Craig Woolford



	Date	Rating	Target Price	Closing Price
1	18-May-10	*1H	*7.89	6.57
2	5-Oct-10	1H	*8.00	7.05
3	24-Jan-11	1H	*7.20	6.17
4	25-Mar-11	1H	*7.10	6.16
5	20-Jul-11	*2H	*5.60	5.18
6	25-Jul-11	2H	*5.75	5.12
7	4-Oct-11	2H	*5.35	4.99
8	7-Oct-11	Stock rating system changed		
9	7-Oct-11	*2	5.35	5.15
10	13-Jan-12	2	*5.25	5.00
11	23-Mar-12	2	*5.60	5.35
12	9-Jul-12	2	*4.50	4.78
13	21-Sep-12	2	*5.30	5.60
14	6-Nov-12	2	*5.80	6.14
15	21-Mar-13	*3	*6.70	7.86

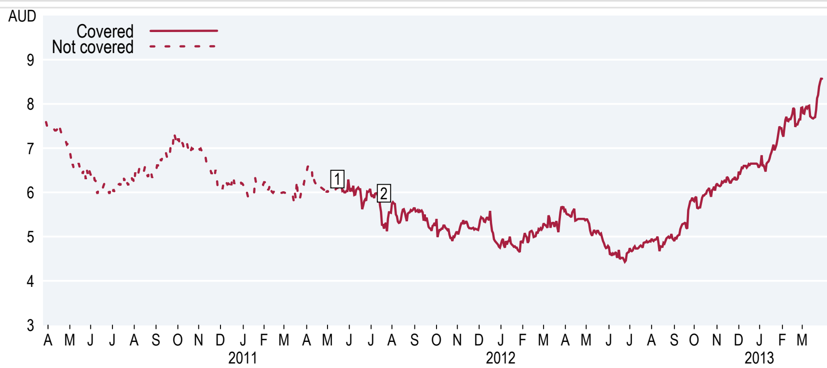
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Premier Investments Ltd (PMV.AX)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Craig Woolford



	Date	Rating	Target Price	Closing Price
1	15-May-11	*ADD MP	-	6.10
2	20-Jul-11	*REM MP	-	5.18

* Indicates change

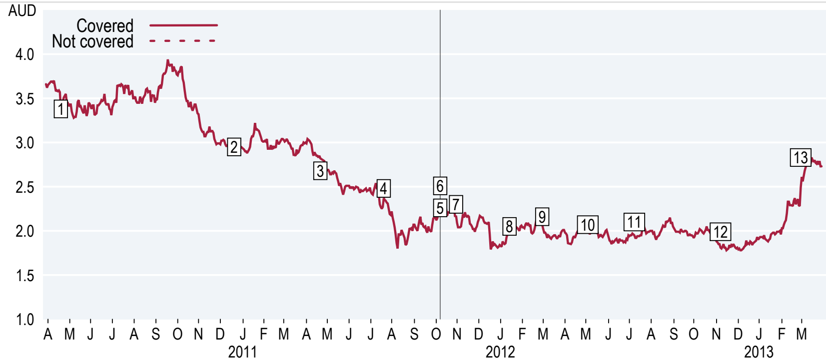
Rating/target price changes above reflect Eastern Standard Time

Harvey Norman Holdings Ltd (HVN.AX)

Ratings and Target Price History

Fundamental Research

Analyst: Craig Woolford



	Date	Rating	Target Price	Closing Price
1	20-Apr-10	*1M	4.00	3.38
2	21-Dec-10	1M	*3.60	3.00
3	21-Apr-11	1M	*3.40	2.82
4	20-Jul-11	1M	*2.80	2.37
5	7-Oct-11	Stock rating system changed		
6	7-Oct-11	*1	2.80	2.26
7	31-Oct-11	*2	*2.30	2.17
8	13-Jan-12	2	*2.10	1.98
9	29-Feb-12	2	*2.00	2.07
10	3-May-12	2	*1.95	2.04
11	9-Jul-12	*3	*1.75	1.95
12	7-Nov-12	3	*1.65	1.81
13	28-Feb-13	3	*2.00	2.49

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

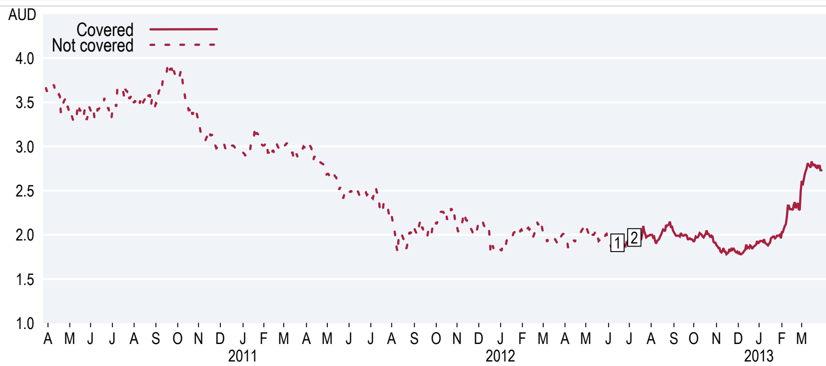
Harvey Norman Holdings Ltd (HVN.AX)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Craig Woolford



	Date	Rating	Target Price	Closing Price
1	14-Jun-12	*ADD LP	-	1.88
2	9-Jul-12	*REM LP	-	1.95

* Indicates change

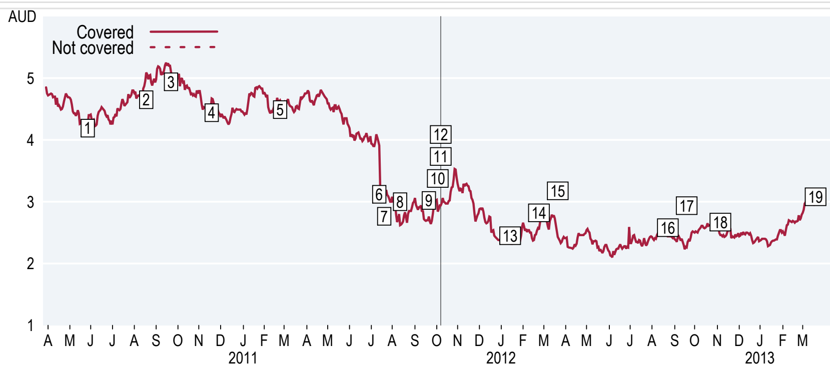
Rating/target price changes above reflect Eastern Standard Time

David Jones Ltd (DJS.AX)

Ratings and Target Price History

Fundamental Research

Analyst: Craig Woolford



	Date	Rating	Target Price	Closing Price
1	27-May-10	*1H	4.85	4.24
2	18-Aug-10	*2M	*5.20	5.09
3	22-Sep-10	2M	*5.35	5.10
4	18-Nov-10	*1M	5.35	4.67
5	23-Feb-11	1M	*5.20	4.64
6	13-Jul-11	*2H	*3.70	3.91
7	20-Jul-11	2H	*3.40	3.16
8	11-Aug-11	2H	*2.90	2.62
9	21-Sep-11	2H	*2.80	2.76
10	4-Oct-11	2H	*2.70	2.84
11	7-Oct-11	Stock rating system changed		
12	7-Oct-11	*2	2.70	2.94
13	13-Jan-12	2	*2.55	2.37
14	23-Feb-12	2	*2.65	2.55
15	21-Mar-12	2	*2.30	2.43
16	23-Aug-12	2	*2.45	2.44
17	19-Sep-12	2	*2.35	2.26
18	6-Nov-12	2	*2.50	2.46
19	20-Mar-13	*3	*2.60	3.08

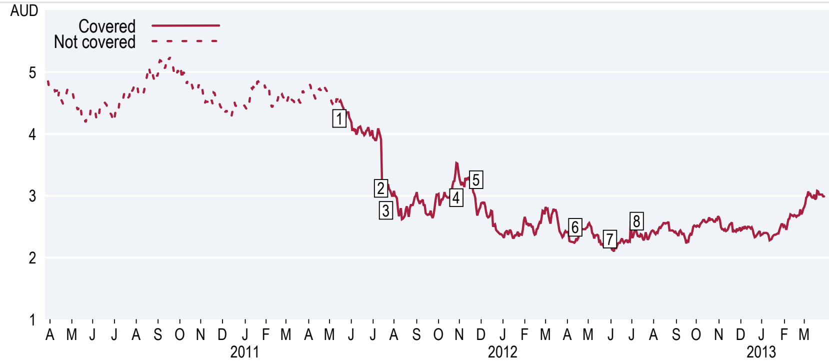
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

David Jones Ltd (DJS.AX)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Craig Woolford



#	Date	Rating	Target Price	Closing Price
1	15-May-11	*ADD MP	-	4.49
2	13-Jul-11	*REM MP	-	3.91
3	20-Jul-11	*ADD LP	-	3.16
4	27-Oct-11	*REM LP	-	3.53
5	24-Nov-11	*ADD LP	-	2.81
6	12-Apr-12	*REM LP	-	2.26
7	31-May-12	*ADD MP	-	2.21
8	9-Jul-12	*REM MP	-	2.40

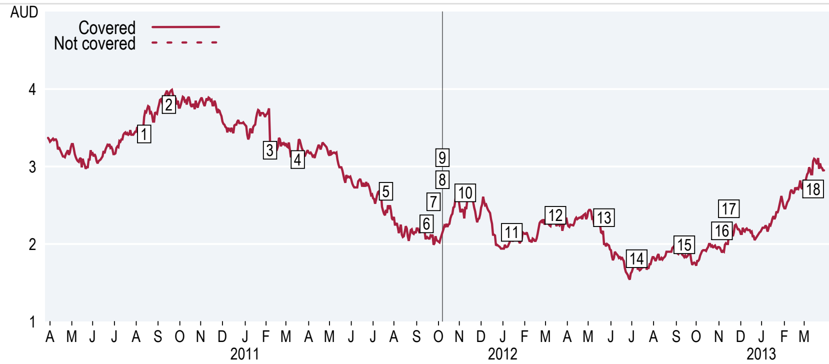
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Myer Holdings Ltd (MYR.AX)

Ratings and Target Price History
Fundamental Research

Analyst: Craig Woolford



#	Date	Rating	Target Price	Closing Price
1	12-Aug-10	1H	*4.15	3.64
2	16-Sep-10	*2H	*4.35	3.92
3	7-Feb-11	2H	*3.70	3.32
4	17-Mar-11	*1H	3.70	3.22
5	20-Jul-11	*2H	*2.65	2.44
6	15-Sep-11	2H	*2.20	2.10
7	26-Sep-11	2H	*2.10	1.99
8	7-Oct-11	Stock rating system changed		
9	7-Oct-11	*2	2.10	2.15
10	9-Nov-11	2	*2.50	2.48
11	13-Jan-12	2	*2.10	2.07
12	15-Mar-12	2	*2.30	2.29
13	23-May-12	2	*2.05	2.00
14	9-Jul-12	2	*1.80	1.80
15	13-Sep-12	2	*1.85	1.83
16	6-Nov-12	*1	*2.15	1.89
17	15-Nov-12	*2	2.15	2.13
18	14-Mar-13	*3	*2.60	3.07

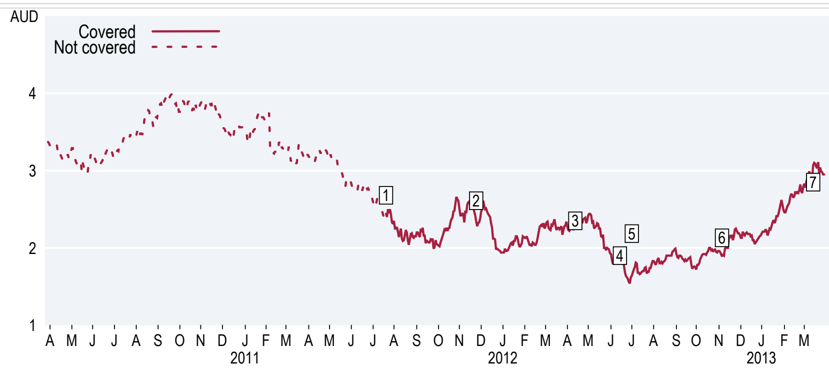
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Myer Holdings Ltd (MYR.AX)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Craig Woolford



#	Date	Rating	Target Price	Closing Price
1	20-Jul-11	*ADD LP	-	2.44
2	24-Nov-11	*REM LP	-	2.34
3	12-Apr-12	*ADD LP	-	2.32
4	14-Jun-12	*REM LP	-	1.83
5	30-Jun-12	*N	-	1.62
6	6-Nov-12	*ADD MP	-	1.89
7	14-Mar-13	*REM MP	-	3.07

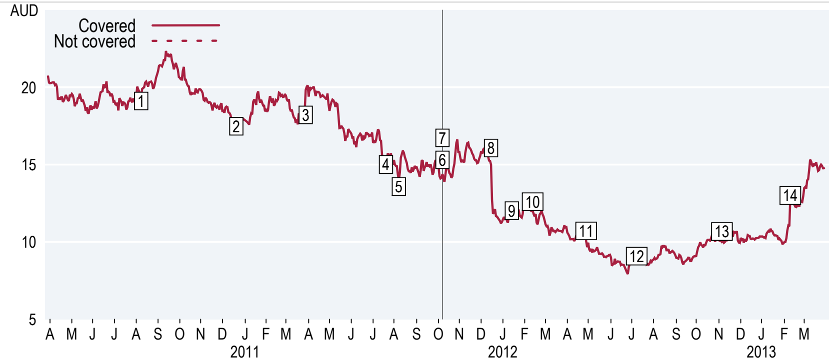
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

JB Hi-Fi Ltd (JBH.AX)

Ratings and Target Price History
Fundamental Research

Analyst: Craig Woolford



	Date	Rating	Target Price	Closing Price
1	9-Aug-10	*2M	*20.20	19.45
2	21-Dec-10	2M	*19.50	17.89
3	29-Mar-11	2M	*20.10	19.83
4	20-Jul-11	*1M	*18.50	15.36
5	8-Aug-11	1M	*17.50	14.00
6	7-Oct-11	Stock rating system changed		
7	7-Oct-11	*1	17.50	14.39
8	15-Dec-11	*2	*15.70	15.00
9	13-Jan-12	2	*12.65	11.88
10	13-Feb-12	2	*12.50	12.03
11	27-Apr-12	2	*10.80	10.04
12	9-Jul-12	*3	*8.05	9.00
13	6-Nov-12	3	*9.30	9.99
14	11-Feb-13	3	*10.20	12.89

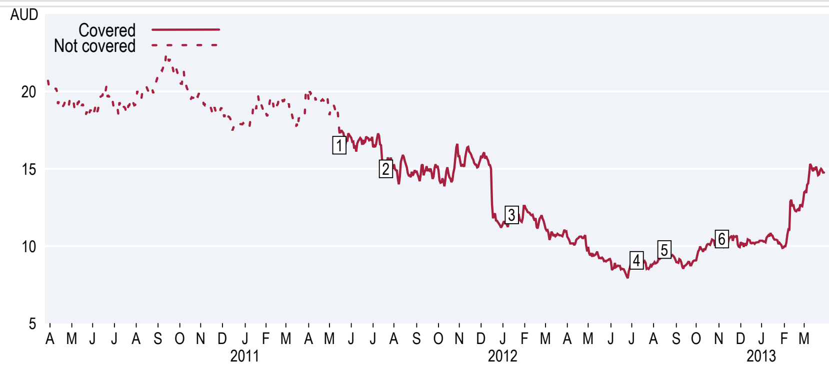
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

JB Hi-Fi Ltd (JBH.AX)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Craig Woolford



	Date	Rating	Target Price	Closing Price
1	15-May-11	*ADD LP	-	18.20
2	20-Jul-11	*ADD MP	-	15.36
3	13-Jan-12	*REM MP	-	11.88
4	9-Jul-12	*ADD LP	-	9.00
5	16-Aug-12	*REM LP	-	9.65
6	6-Nov-12	*ADD LP	-	9.99

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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	12 Month Rating			*Relative Rating*		
Data current as of 31 Mar 2013	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
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% of companies in each rating category that are investment banking clients	53%	49%	43%	65%	49%	51%

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