Thursday, 18 March 2010 / One comment

Myer over-priced as shareholders find out the hard way

by Adam Schwab

Myer over-priced as shareholders find out the hard way
by Adam Schwab

The most surprising aspect of last year's float of Myer was not that its performance has been horrid, but rather, than anyone thought buying a department store business from a private equity firm would be a good idea. After being sold to gullible retail investors for $4.10 per share, Myer is currently trading at about $3.50—a drop of about 15%. During that same period, the broader market has risen by 5%, making Myer's performance all the more galling for shareholders.

Myer's first-half results were a mixed bag. Earnings (before the costs of the float) were up 38% (EPS beat prospectus forecasts by 10%), however sales figures rose by only 2% (barely beating inflation) while like-for-like sales were up an anemic 1.2%. Sales are still below what they were in 2007. Given Australia is enjoying near record low unemployment and well-below historical interest rates, this does not bode especially well.

It should also be remembered that Myer would have benefited from a rapidly appreciating Australian dollar (although the company's cost of goods sold did rise marginally).

An enormous amount of credit must be given the Bernie Brookes and his team. Myer's profit was also able to rise on the back of stringent cost control—virtually all of the profit improvements were due to lower selling and administrative costs and reduced finance charges.

But as good as Brookes has been, that doesn't change the fact that Myer shareholders were sold a lemon. Of course, they can hardly say that they weren't warned. Arguably Australia's best investor, Roger Montgomery, told subscribers to his blog before Myer's float that:

With all the relevant data to value the business now available and using the pro-forma accounts supplied in the prospectus, I value the company at between $2.67 and $2.78, substantially below the $3.90 to $4.90 being requested. It appears to me that the float favours existing shareholders rather than new investors.

Investing safely in the share market requires a wonderful business and a rational price. Myer is arguably now a much better business than it was, but the price being requested is even hotter than the cover.

Montgomery was in the fortunate position of being able to provide an un-conflicted opinion of the value of Myer—the same cannot be said for the investment banking analysts who covered the stock. At the time of Myer's float, Goldman Sachs had a price target of $4.99 on the stock, Credit Suisse $5.10 and Macquarie $4.66. Coincidentally, those three broking houses were all lead managers of the Myer float. Any client of those firms who believed the sage advice kindly provided by their brokers should be looking for a new financial adviser. (The also brilliant Mike Mangan noted in Business Spectator this week that "one likely reason why almost every broker continues to recommend Myer is because almost all of them urged their clients into the initial float. Their clients are suffering, so as is industry custom, the brokers must appear to suffer as well. Of course, broker suffering is soothed somewhat by the collective $60 to $70 million in advisory fees they collected from the IPO.")

While some commentators have sought to criticise the book-build process (which determined the price of Myer shares) that argument is somewhat irrelevant. Retail shareholders knew exactly who they were buying the business from—that is, private equity vendors (or they should have known, had they bothered to look past the pretty pictures of Jennifer Hawkins). As this column noted in September, a couple of months before Myer floated:

In its latest iteration, Myer was purchased in 2006 by a private equity consortium led by TPG. Many private equity floats do not turn out well for public shareholders in the re-listed vehicle. Recent examples include Pacific Brands, Repco, Vision Group, Bradken and Emeco—all of which ranged from flop to unmitigated disaster.

The main reason for poor investor returns is that private equity seek to maximise their return, that necessarily involves selling the business at the optimal time (after growth has peaked or costs have been cut as much as possible) for the highest possible amount. As TPG noted in the prospectus, proceeds of the sale will be applied to repay existing owners and repay debt - not expand the business.

Myer isn't a bad business, and it is brilliantly managed, but that doesn't mean it isn't over-priced. As shareholders are finding out the hard way.

http://www.crikey.com.au/2010/03/18/myer-over-priced-as-shareholders-find-out-the-hard-way/