SECTOR RETAILING

Cornerstones crumble

Rising vacancies in shopping centres are a symptom of the industry's troubles

Retailing in Australia is in the midst of unprecedented turbulence. Aside from relatively depressed consumer demand, such is the pace of change and the status of the brands being impacted that some are questioning the very viability of what were once cornerstone names in the retailing landscape.

Consider, for example, the significance of chatter that Myer and David Jones – once arch rivals – may merge as their share of wallet and, more importantly, share of mind shrink. Perhaps even more importantly, the Australian Competition and Consumer Commission may now let a merger proceed, such is the weakened market power of each department store.

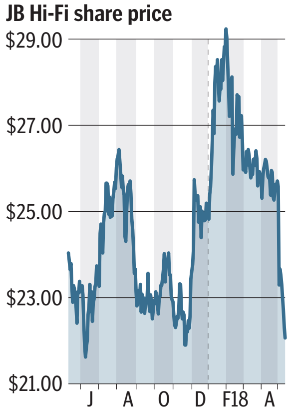
Now Amazon plans to open a distribution centre in western Sydney, allowing it to offer same-day and next-day delivery to its biggest market, in a clear shot across the bow to those who underestimated the significance of Amazon's arrival in 2017.

If leading brands decide that paying significant margins to bricks-and-mortar retailers to distribute their products is inferior to paying Amazon a smaller margin, it could be some time before the dust settles on this period of retail disruption.

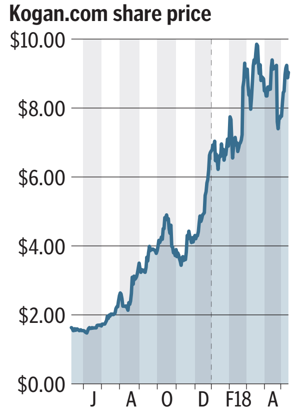
According to one report, a sign of the challenges in retailing is the rising number of retail vacancies in Brisbane's major shopping centres. Carindale – one of Brisbane's largest regional shopping centres covering 115,000 square metres, with two department stores (Myer and David Jones), two discount department stores (Target and Big W), three supermarkets (Aldi, Woolworths and Coles) and over 290 specialty retailers – is boarding up sites at an accelerating rate.

While it remains possible that booming government infrastructure spending could support construction salaries, it is also possible that a slowing property market and rising bank funding costs could combine to further dampen consumer demand. Should consumer confidence or wage growth fall, and if consumer credit costs were to rise, the pain for battling retailers may become even more acute.

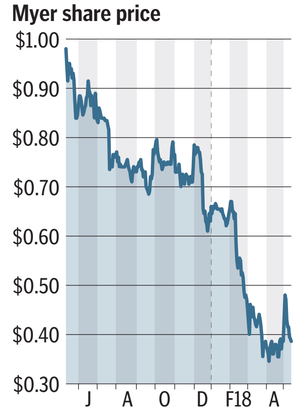
JB Hi-Fi share price



Kogan.com share price



Myer share price



❶ JB Hi-Fi

ASX code JBH
Price $22.05
52wk ▲ $29.47
52wk ▼ $21.20
Mkt cap $2.53bn
Dividend $1.34
Dividend yield 5.99%
PE ratio 11.97

SELL

We have maintained for some time that JB Hi-Fi's acquisition of The Good Guys was poorly timed at best and misguided at worst. When it downgraded earnings guidance in May, it suggested that unfavourable weather had hit sales of air conditioners and heaters at The Good Guys. But it also revealed that price cuts to maintain market share had crimped margins. The forces on margins are unlikely to relent any time soon and a company generating an operating profit of $235 million on sales of almost $7 billion is not one to write home about.

❷ Kogan

ASX code KGN
Price $9.03
52wk ▲ $10
52wk ▼ $1.46
Mkt cap $844m
Dividend 10.7¢
Dividend yield 1.18%
PE ratio 79.73

SELL

Kogan has managed to capture a reasonable share of a market saturated with alternatives. The impact of Amazon's proposed Sydney distribution centre may not be felt overnight but Kogan's diversification strategy – pet insurance, travel, mobile phone and internet services – suggests management is looking beyond traditional business lines for growth. Add to this our concerns when senior management sell significant parcels of shares and we have sufficient reason to believe the current market valuation is factoring in growth that might be unachievable.

❸ Myer

ASX code MYR
Price 38¢
52wk ▲ $1.02
52wk ▼ 34¢
Mkt cap $316m
Dividend 2¢
Dividend yield 5.3%
PE ratio –

SPECULATIVE HOLD

In 2008, Myer reported a normalised net profit of over $330 million. Today, just a decade later, the company is expected to earn nearly 90% less. Despite population growth, Myer's foot traffic is declining, rendering its large store footprint and the associated long-term leases a noose around its neck. And given the retail environment is not assisting the company, it appears Myer is being slowly strangled by the $2.75 billion worth of non-cancellable operating leases, of which $230 million is payable this financial year.

Prices as at close of business, 11-May-18.