



SECTOR RETAILERS

Softer furnishings

Falling house prices and tighter lending take their toll

While we visited retail stocks a few months ago, so much has happened that it would be remiss not to provide a timely update in the form of a brief examination of the \$7 billion furniture retail business.

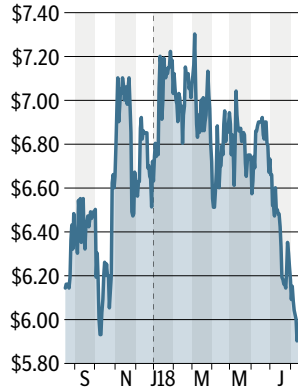
Most importantly, the housing sector and credit growth are trending the wrong way. Falling house prices have a negative impact on households' perception of their own wealth. Record leverage also has a negative impact on the capacity to spend more, and slowing housing activity has a negative impact on the incomes earned by tradies and contractors.

In the background is the Australia and New Zealand data released by South African-listed Steinhoff, which owns Freedom Furniture, Snooze and Plush furniture stores in Australia. Excluding the more recently acquired Fantastic Furniture, same-store sales growth was -6% in the six months to March. In the March quarter it is estimated sales fell by just over 9%.

The value of all home loans (excluding refinancing) fell by 1.2% in June compared with the previous month and by 8.4% compared with the previous year. It was the largest fall since April 2016. Loans to investors falling 18.1% year on year.

Housing "activity" (sales) is also decreasing

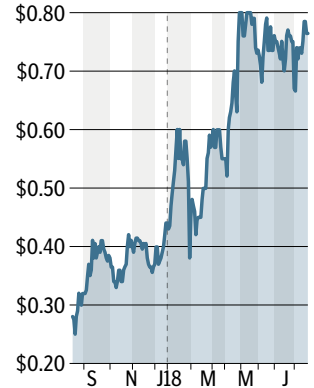
Nick Scali share price



Harvey Norman share price



Temple & Webster share price



with new and established home sales falling to almost the lowest level in the past two decades.

Interestingly, the tightening of credit conditions and falling home prices and sales are only now beginning to impact loan demand for renovations and additions. Owner-occupier loans for alterations and additions collapsed by about 20%.

According to APRA data, major banks wrote over \$32 billion of interest-only loans in the quarter to March 2017. In the quarter ending March 2018, the same banks wrote just \$13.6 billion in interest-only loans. The

corresponding numbers for investment loans were \$31 billion and \$26 billion respectively.

This data indicates that the renovation cycle can reasonably be expected to turn down now. Credit tightening will continue to reduce demand for (and supply of) loans and falling house prices will reduce the incentive for investors to renovate and "flip" properties and for owner-occupiers to "do up" properties.

Roger Montgomery is founder and CIO of the Montgomery Fund. For his book, Value.Able, see rogermontgomery.com.

1 Nick Scali

Nick Scali is expected to expand into bedroom furniture, adding incremental revenue, but the company's most recent earnings guidance implies low single-digit negative same-stores sales growth. While Nick Scali's name is being bandied about as the imminent acquirer of Steinhoff Asia Pacific's Freedom Furniture business, the share price has traded sideways for more than a year and acquisitive growth is rarely as appealing as organic growth.

ASX code NCK
Price \$6.85
52wk ▲ \$7.34
52wk ▼ \$5.77
Mkt cap \$555m
Dividend 40¢
Dividend yield 5.84%
PE ratio 13.54

SELL

2 Harvey Norman

Since 1982, Harvey Norman has not only been selling appliances, electronics and furniture but also "land banking". When land values and the potential for rezoning are considered, investors might be buying the retail businesses for very little. We don't believe, however, that the property and retail businesses can be separated easily and that leaves investors tied to the deteriorating credit cycle. One interesting possibility is that Gerry Harvey, being the largest shareholder, might be incentivised to pay a large special dividend if Labor were elected and reformed franking credits.

ASX code HVN
Price \$3.78
52wk ▲ \$4.62
52wk ▼ \$3.31
Mkt cap \$4.2bn
Dividend 24¢
Dividend yield 6.35%
PE ratio 10.54

HOLD

3 Temple & Webster

The share price of Australia's largest online-only furniture and homewares retailer has tripled in the year ahead of delivering its first profitable quarter ending June 30, 2018, with EBITDA of about \$500,000. It has a market capitalisation of \$82 million. Thomson Reuters, the only analyst to cover the company, expects Temple & Webster to deliver a maiden annual profit in 2019 of \$1.74 million. But as small local websites become more successful, its products hit the radar of Amazon, which offers the same, similar or knock-off items for a lower price.

ASX code TPW
Price 76.5¢
52wk ▲ 25¢
52wk ▼ 80¢
Mkt cap \$83m
Dividend -
Dividend yield -
PE ratio -

SPECULATIVE HOLD