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Myer Holdings 26/09/2017 **FAT-AUS-841**

MYR AUD $0.722 Spec. **HIGH**

Calling it a day

Australian retailer Myer Holdings (MYR:ASX) recently reported FY17 results which show that the company is not out of the woods yet, and continues to face headwinds with the arrival of foreign retailers, and increasing online disruption. We provide our two cents worth on the full year results, against the backdrop of a difficult retail environment.

Myer has certainly been a disappointment, and in line with our decision to take profits on Scentre Group this week, we for similar reasons believe it is time to call it a day on Myer. **We recommend that Members sell their holdings.**

Recap and What's New?

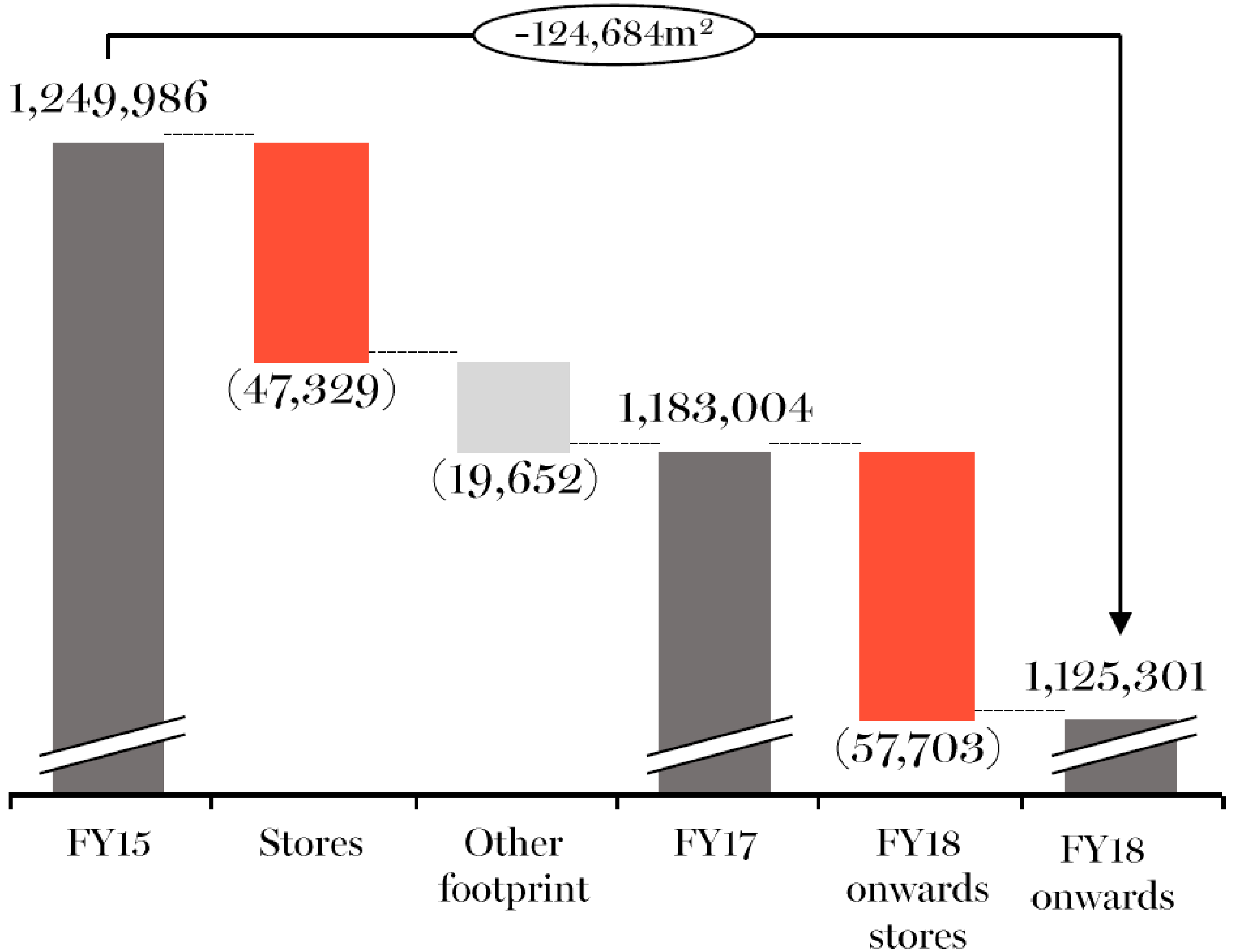
It continues to be a tough environment for retail especially with new market entrants, including the likes of Amazon, UNIQLO, Zara, and H&M pushing their way into the retail space. It shouldn't surprise though, as a number of retailers in Australia operate with fairly high gross margins which are attractive to well-funded overseas competitors.

Though the entry of these foreign retailers is fairly recent, the amount they (UNIQLO, Zara, and H&M) snatched up from the retail market is certainly nothing to scoff at, with a combined A$684 million in sales snared in 2016. Amazon's entry also has seen forecasts it will take up 14 percent of all online spend in Australia within the next 5 years.

Given such a challenging environment, Myer Holdings has responded with a "New Myer" plan, a five-year strategy with the intent of transforming the business away from expansion and "discounting" into "experiential retail" otherwise known as "Omni-channel" where the focus is on delivering an integrated shopping experience towards higher value customers.

This shift took place back in September 2015 and following the promotion of Richard Umbers to the CEO position. This strategy involves investing around $600 million over 5 years, rolling out digital hubs with wi-fi connections so that customers can shop online in-store, and build up data-analytics, allowing the company to be more agile and responsive to customers' needs.

As part of the transformation, Myer has been reducing the store footprint. In the 2 years since, the company has either closed down or announced an intention to exit in excess of 100,000 square metres (sqm) of space as shown in the graphic below.



Source: 14 September 2017 Myer's Investor Presentation

Furthermore, the company has also announced 3 additional store closures which cover the Belconnen, Hornsby, and Colonnades stores which will take a further 25,000 sqm out of the store network and reduce the total store count to 59.

These changes will lead to a reduction in operating costs and though management's cost-out initiatives are beneficial to the bottom line, they are clearly finite and it begs the question of "what's next?" as the path to growing sales while maintaining gross margin remains vague.

In line with the store closures is the shift in metrics as well. Management are now focussed on sales per sqm as the key productivity metric rather than like-for-like sales, which comes as no surprise given the store closures.

Ultimately, we view the "New Myer Strategy" as a sensible response, with a focus on what customers want to buy with superior digital analytics, and greater cost discipline. The question though remains over how management will grow the top line.

FY17 Results Review – Currency in AU$ unless noted otherwise

Moving on down to FY17 results, at first glance revenues look to be weak, having fallen 1.4 percent year-on-year to $3,201.9 million, though the result was generally in line with consensus estimates of $3,211.6 million.

More positively though, and given a cost out focus, the company's sales density was $4,055 per sqm compared to $3,910 per sqm in FY15 which is when the New Myer strategy started. This proves that the company is eking out more value with each store cranking out more sales.

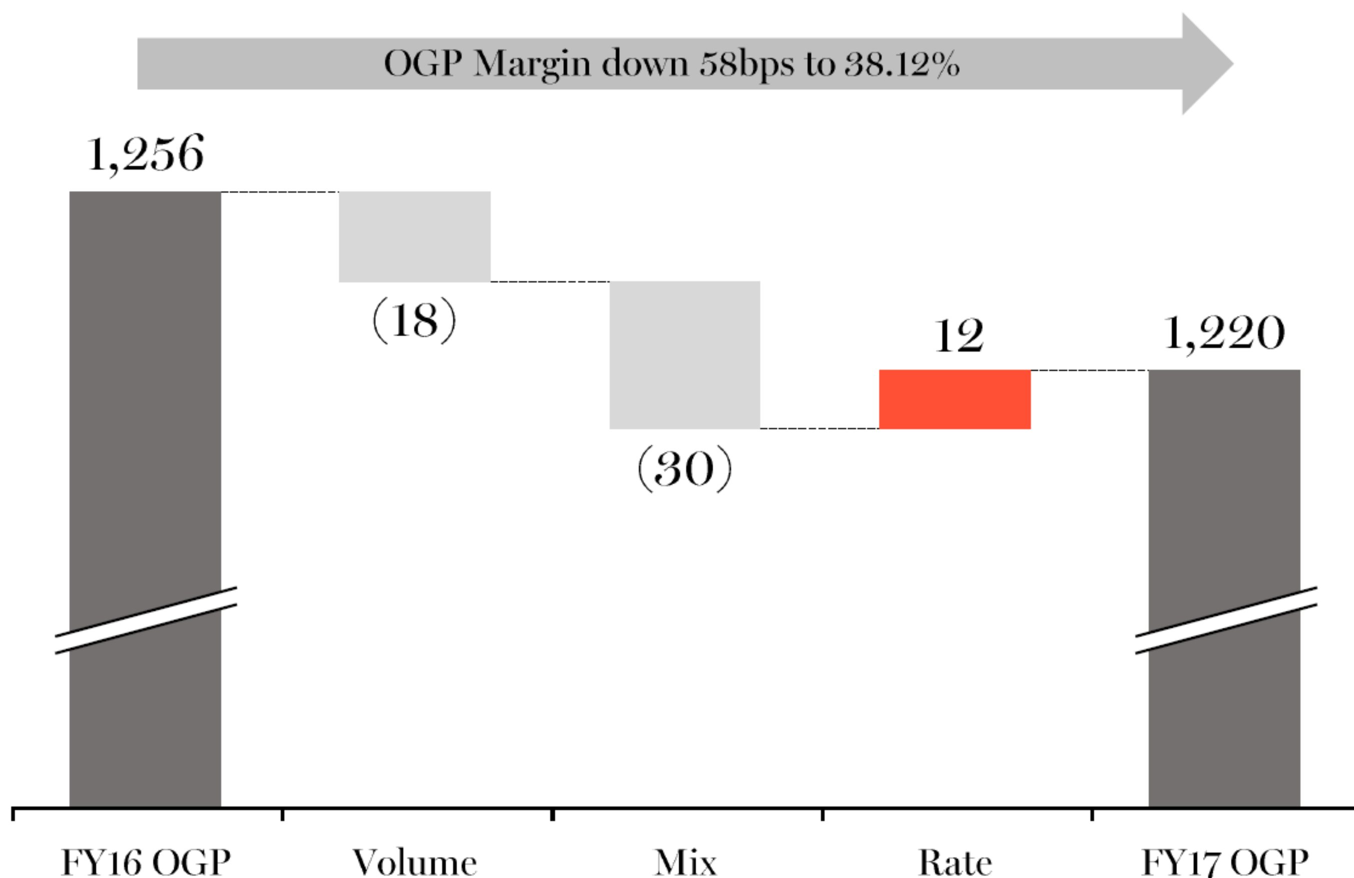
Another positive is that the **Omnichannel** continues to make headway with penetration now accounting for 5.5 percent of total sales. This has grown strongly compared to 2016 where it contributed 3.6 percent of the total.

$ MILLIONS	FY2017	FY2016	CHANGE
Sales	3,201.9	3,245.9	(1.4%)
OGP	1,220.4	1,256.0	(2.8%)
OGP margin (%)	38.12	38.70	(58 bps)
CODB	(1,019.8)	(1,051.2)	+3.0%
CODB margin (%)	31.85	32.39	+54 bps
Share of Associates	(2.5)	(0.6)	n/m
EBITDA	198.1	204.2	(3.0%)
EBITDA margin (%)	6.19	6.29	(10 bps)
Depreciation	(91.5)	(90.8)	(0.8%)
EBIT	106.6	113.4	(6.0%)
NPAT pre implementation costs and individually significant items	67.9	69.4	(2.2%)
Implementation costs and individually significant items (post tax)	(56.0)	(8.8)	n/m
NPAT post implementation costs and individually significant items	11.9	60.6	(80.3%)

Source: 14 September 2017 Myer's Investor Presentation

The Online channel is also proving to be a growth source, expanding over 40 percent year-on-year and excluding concessions (Omnichannel combination), online sales accounted for 11 percent of total sales for the year. Factoring in concessions, online sales was 8.2 percent of total.

We note that this figure is amongst the highest compared to peers in Australia, however, a closer look would indicate that a major factor for the higher contribution would have been driven by recent store closures. Nevertheless, having a growing presence online is one important way for Myers to grow the top-line in response to intensifying competition.



Source: 14 September 2017 Myer's Investor Presentation

Moving on, there was continued pressure on Myer's FY17 gross profit margins due to a higher proportion of concession sales (22% of the total), and lower volumes due to store closures. This was nevertheless offset by lower costs of doing business (-3%) due to improved efficiencies and benefits from restructuring.

Going forward, management highlighted the increase in MEBs (Myer Exclusive Brand) with its higher margins as another source for profit growth and increasing percentage of the sales mix. As Myer CFO Grant Devonport remarked, "pleasingly in the second half of the year, we did see an increase of the MEBs mix from 16.8 percent in the 1H to 17.4 percent in the 2H and an overall slowing of the concession mix."

All in all, underlying NPAT came in at $67.9 million, slightly ahead of consensus estimates of $67.85 million and down only 2.2 percent compared to last year. However, implementation costs associated with New Myer (lease, store exit costs, and redundancies) detracted from statutory NPAT which came in at $11.94 million, a significant 80 percent drop on last year.

Outlook

Though as we've noted in the previous section, there is a limit to the benefits from cost-out initiatives, and as such the company has to answer the all-important question of "what's next?"

Management did provide an update for first 6 weeks of FY18, which were below expectations, with July a poor month and August being seasonally small. Nevertheless, they provided assurance of a robust and detailed plan to match or even outperform the consensus NPAT estimates of $66m in FY18.

	NEW MYER TARGET METRICS	FY2017
SALES	Target average sales growth greater than 3% between 2016 - 2020	Average sales growth from July 2015 up 0.1%
SALES/ SQM	Target greater than 20% improvement by 2020	Sales per square metre increased by 3.7% to $4,055 / m² vs July 2015 base on a rolling 12 month basis
EBITDA	Target EBITDA growth ahead of sales growth by 2017	EBITDA down 3.0% Total sales down 1.4%
ROFE	Target ROFE greater than 15% by 2020	ROFE 8.9%

Source: 14 September 2017 Myer's Investor Presentation

We are however less confident about the outlook, and especially given a very fragile retail environment, with headwinds only likely to increase. As noted in our report on Scentre Group this week, this is evident when looking at recent trends in retail sales.

Data from the Australian Bureau of Statistics had retail sales coming in flat during July in seasonally adjusted terms, missing forecasts for an increase of 0.2 percent. This was the weakest result since March which was impacted by Cyclone Debbie.

Even more noteworthy was that weakness was led by department store sales which fell some 2.8 percent. We believe this situation is likely to get worse before it gets better, with the 'Amazon effect' seeing more sales move online, which will likely put further pressure on existing bricks and mortar retailers such as Myer. This has also been clearly evident in Myer's decision not to renew leases at Belconnen in Canberra or Hornsby in New South Wales.

In addition to online disruption, our other concern about the outlook for retail sales centres around a cash strapped consumer, who has elevated levels of debt. With lending rates already on the rise, the 'pinch' is going to be increasingly felt in our view, and potentially more so should a correction arise in the property market.

Turning to the daily chart, the bearish moving average crossover present since March is suggestive of momentum to favour the downside. This is when the 50-day moving average (red line) crosses below the 200-day moving average (green line). In order for the short-term technical landscape to improve, a decisive break above overhead resistance sighted at the July high of $0.79 (horizontal red line) is required. Should this occur, then this would likely strengthen upward momentum and thus increase the probability of further upside in share price over the medium-term timeframe.

With reference to the monthly chart, structural resistance was respected at the June 2012 low of $1.43 in August 2016 as shown by the horizontal solid-red line. Consequently, this has led to the broader downtrend to exert itself over the remainder of 2016 and to-date. Below, support is sighted at the September intra-month low of $0.68 (horizontal blue line). It is important that prices stabilise above this price point as this would encourage a period of price stabilisation to follow. Should this favourable scenario unfold, then this would increase the probability of an essential basing-formation to evolve. In order for the long-term technical outlook to improve, a sustained break above the long-term downtrend line (downward sloping green line) around the $1.00 vicinity is required.

Summary

Retail continues to be a tough environment, with Myer's results showing the impact of headwinds from intensifying competition. On the other hand, the company has sought to respond by targeting the online sales channel as well as making strides in growing exclusive brands. Whether this will be sufficient, only time will tell.

Currently Myer shares are trading at 9.0 times the FY18 earnings estimate, and offer a fully franked dividend yield of just 2 percent. We are wary that the retail environment will likely get worse before it gets better, and in this light, the company's ability to shore up earnings through taking costs out, may be limited. This could also mean that a floor in Myer's stock price has yet to be seen. We also think it unlikely that a predator would swoop in given the worsening outlook.

Accordingly, we recommend that Members sell their holdings in Myer. The stock will be removed from the Fat Prophets Portfolio.

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Snapshot MYR

Myer Holdings

Latest Closing Price: $0.722

Myer is a major Australian department store retailer. Its history dates back to 1900 when Sidney Myer opened the first store in Bendigo. With 65 stores and total sales in excess of $3.2 billion, Myer offers a comprehensive range of retail brands across a wide range of price points designed to appeal to all Australians.
Over the last three years, Myer has undergone a major transformation and has invested over $400 million to reinvigorate every aspect of its business.

Market Capitalisation:$592.96M

	FY1	FY2
Price to Earnings	9.0	9.0
Dividend Yield (%)	2.1	2.0
Price to Book	0.5	0.5
Return on Equity (%)	6.0	5.8
EV/EBITDA	3.6	3.6

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