Retail Industry Roundup

March 2009

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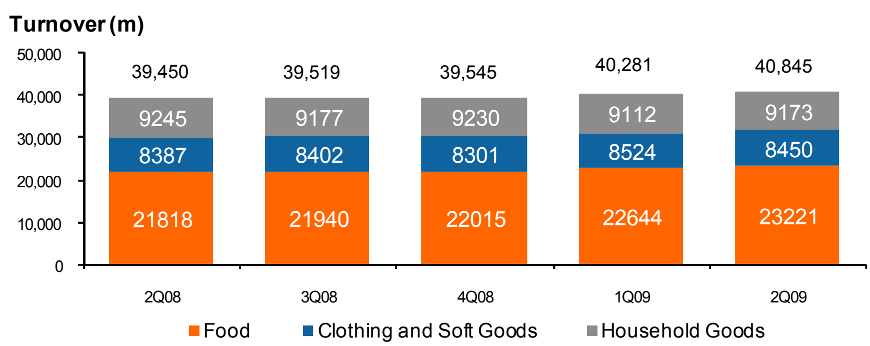
Retail Industry Roundup

Overview

- December 2008 quarter retail sector sales grew 3.5% compared to the prior comparable period ("PCP"), after a 1.4% increase from the September 2009 quarter. Whilst on the face of it these results appear strong, what has not been widely reported is that this growth was experienced almost wholly in Food, with Clothing and Soft Goods experiencing quarter on quarter contraction and Household Goods remaining flat.
- The government's $10.4b Christmas fiscal stimulus helped boost trade as retail sales surged 3.8% in December 2008. However, many retailers have noted the short term impact of these measures stating that consumers remain cautious amidst continued economic softening. Absent the stimulus package, it is almost certain the retail sector would have contracted.
- In January the Westpac-Melbourne Institute consumer sentiment index fell 2.2% or 2.1 points to 89.9. One measure included in this index, which gauges concern over the economic outlook, slumped 18.4% to its lowest level since July 1992.
- The global economic crisis is continuing to impact Australia with GDP forecasts halved by the government to 1% for 2009. The International Monetary Fund has estimated domestic growth to contract 0.2% or remain flat at best. In light of this the federal government recently announced an additional $42b stimulus package. This included $12.7b in cash payments to low-mid income earners which may go some way towards aiding retail spend over the third and fourth quarter of FY09.
- The weakened Australian dollar is continuing to impact import prices and increasing pressure on margins, especially in the electronics and the household goods sector.
- The Christmas period saw Herringbone, the Strathfield Group and Australian Discount Retail enter into some form of external administration, highlighting some of the current distress in the sector.

Retail turnover by Sector ($ million)



Source: *Australian Bureau of Statistics.*
Notes:
1. *Seasonally Adjusted Estimates.*
2. *Quarterly data based on quarter ended 31 December 2008.*
3. *"Clothing and Soft Goods" sector data includes department store data.*
4. *Analysis based on core retail operations of food, clothing and soft goods, and household goods only.*

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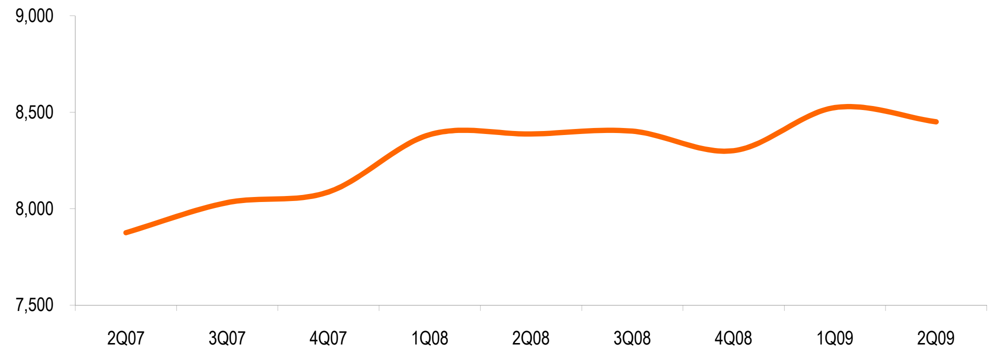
Clothing and Soft Goods Retailing

- December quarter clothing and soft good retail sector sales increased 0.8% PCP but declined 0.9% from 1Q09.
- Month of December sales were up 5.4% to PCP, which is a direct impact of government fiscal stimulus package. This followed October and November PCP declines in growth of 1.0% and 2.1% respectively.

Sector Turnover ($ million)



Source: Australian Bureau of Statistics.
Notes: 1. Seasonally Adjusted Estimates.
2. Quarterly data based on quarter ended 31 December 2008.
3. Includes department store data.

Recent developments of key sector players are summarised below:

David Jones

- 1H09 sales were down 6.5% to $1.1bn, however CEO Mark McInnes reaffirmed 0-5% profit growth for FY09 with an expected significant downturn in winter sales. This follows six quarters of falling sales, a situation not faced in 20 years.
- The Company recently made 150 head office staff redundant and reduced working hours for sales personnel.

Myer

- 1H09 sales were down 3.8%, with sales down 4.8% in the first quarter and down 3.1% in the second quarter following an increase in Christmas and stock-take trading.
- CEO Bernie Brookes commented that trading conditions would continue to be difficult, but that FY09 EBIT was expected to be up 1-6% as the Company's focus continues on margin improvement, operational efficiency and store investment.

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Country Road

- 1H09 sales were up 19.9% to $176.7m with like for like sales up 12.8%. 1H09 NPAT was up 84% to $10.3m. The Company noted that the increase in sales was a result of customers switching from more expensive brand competitors.
- The Company recently launched a new brand "Trenery" aimed at the 40-plus market. Three Trenery stores are expected to open in Australia in September with three more before the end of FY10.

Pacific Brands Group

- 1H09 NPAT was down 6% to $56.5m on 1H09 EBITDA of $113.0m. The result included a $206.4m impairment of Goodwill ($128m), Brand Names ($52m) and other assets ($25m).
- The Company announced plans to undertake brand rationalisation, cost reduction (reducing staff levels by 1,850 in Australia over the next 18 months), property sales and suspension of its dividend.
- The Company extended the maturity of two debt tranches by six months to August 2010 and also negotiated a short term reduction in its interest cover covenant.

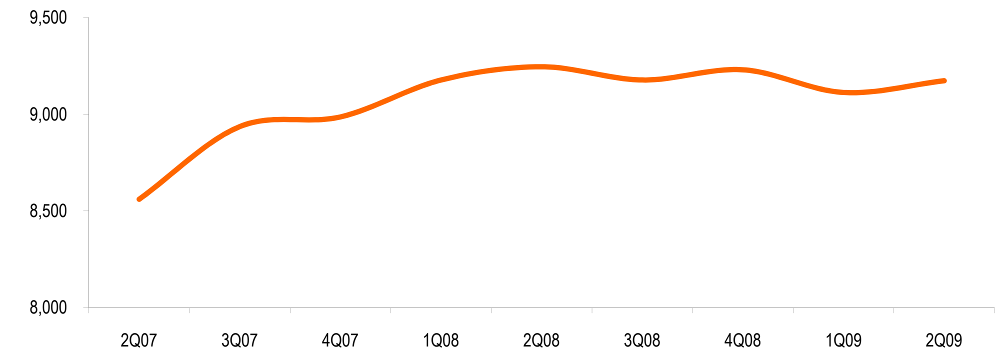
Herringbone

- Voluntary administrators were appointed to upmarket clothing retailer Herringbone in December 2008 after a slump in sales and downturn in forecasts for 2009. Sales slumped 23% over November-December 2008 compared to the corresponding period in 2007. The upmarket retailer stated the global financial crisis had directly impacted them as many customers from the financial sector cut back on retail spending.
- The Administrators recently announced that the Company had been sold to the Australian arm of van Laack GmbH which was established in Germany in 1881 and trades in 14 countries, although at the time of publishing completion of the transaction had not been confirmed.

Household Goods Retailing

- December quarter household goods sales decreased 0.8% PCP but increased 0.7% from 1Q09.
- Month of December sales rose 9.9% compared with November and 4.2% PCP, a direct impact of the government fiscal stimulus. This followed October and November PCP declines in growth of 3.0% and 3.7% respectively.

Sector Turnover ($ million)



Source: Australian Bureau of Statistics.
Notes: 1. Seasonally Adjusted Estimates.
2. Quarterly data based on quarter ended 31 December 2008.

Recent developments of key sector players are summarised below:

Harvey Norman

- Like for like sales were down for each month from July 2008 to November 2008. However, December 2008 sales were up boosted by the government's $10.4b fiscal stimulus package to help strengthen overall 1H09 sales. 1H09 sales increased 3.5% to $3.2b.
- 1H09 NPAT was down 29% to $123.5m subdued by lower earnings from franchise operations in Australia (margins were down 102bp), significant losses from Ireland operations (~$20m) and share trading losses (~$7m).
- In February 2009, Chairman Gerry Harvey announced five OFIS office supply stores would close amid tough economic times. The joint venture was launched to compete against Westfarmers' Officeworks, however the venture has struggled, recording a FY08 loss of ~$8m.

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JB Hi-Fi

- 1H09 sales surged 27.6% to $1.3b increasing net profit by 41.0% to $59.0m. The Company opened 14 stores during 1H09 and plans to open another seven stores in 2H09. The Company noted that increased home entertainment sales boosted the result.
- Comparable store growth rose 11.1% and margins remained stable at 21.4% despite tough retail conditions. The Company reaffirmed FY09 sales guidance of $2.4bn up 28.0% on FY08.
- Continued strong performance reflects the robust business model (low cost, large range and quality goods) of the Company and continuing Generation Y consumer spend.

Strathfield Group

- Vaz Hovanessian was appointed Chairman of the group following the appointment of Voluntary Administrators in January 2009.
- The Company reported an FY08 loss of $7.6m and suffered from poor Christmas trading and cash flow issues.
- The administrator announced that the group of seven telco businesses acquired by Strathfield in late 2008 for $115m is now likely to be worth ~$40m.

Fantastic Holdings

- 1H09 NPAT was down 37.3% to $7.4m despite increased revenue, up 21% to $191.5m. The Company stated like for like sales excluding recent acquisitions of Dare and Le Cornu remained static as a result of the tightening of Australian consumer spending.
- Managing director Julian Tertini cited development of acquisitions into the West Australian market would impact labour, marketing and property expenses but Mr Tertini expected benefits to flow through.

Australian Discount Retail

- Administrators and receivers were appointed to the Company in January 2009.
- The Company reported a net loss of $8.2m for FY08 compared to a profit of $21.3m for the previous year. Tough trading conditions, difficulties with a new stock handling system and numerous senior management changes were all cited as causes for the decline.
- At the time of publishing no sale has been announced by the Receivers.

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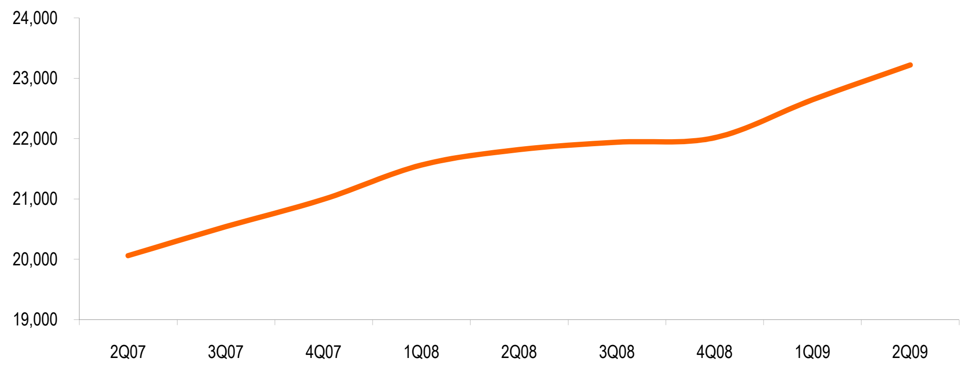
Food Retailing

- December quarter food sales increased 6.4% PCP, and 2.6% from 1Q09 reflecting the staple nature of this sector.
- Month of December food sales grew 1.4% and 7.7% PCP. This followed October and November PCP growth of 5.0% and 6.6% respectively.

Sector Turnover ($ million)



Source: Australian Bureau of Statistics.
Notes: 1. Seasonally Adjusted Estimates.
2. Quarterly data based on quarter ended 31 December 2008.

Recent developments of key sector players are summarised below:

Coles

- In January 2009, Coles' owner Wesfarmers announced $2.9b in capital raisings through a $2b rights issue and $900m in private placement to pay off debt from a total of at least $9.7b at the end of 2009. The retail stock offering was completed in February securing $1.8b from investors.
- 2Q09 sales were up 3.8% compared to a rise of 1.3% in the first quarter. CEO Ian Mcleod was upbeat with the result stating market share for Coles was stable.

Woolworths

- 1H09 sales were up 8.8% to $26.1b with supermarket sales up 8.7% to $20.3b and BIG W sales up 10.0% to $2.4b. 1H09 profit was up 10.3% to $983.3m. Despite the economic slowdown, CEO Michael Luscombe has remained cautiously optimistic for FY09 predicting sales growth of 9-12%.
- In 1H09 Woolworths opened 122 new stores and refurbished 190 stores as part of a $1b capital investment program. The Company noted that it created 9,000 jobs in 1H09 and expected another 7,000 to be created in 2H09.
- The Company recently launched a new logo, designed to strengthen the Company's market position.

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Metcash

- The Company acquired Queensland-based food wholesaler and distributor Solomon Food Group in February. Solomon Food Group was estimated to be worth nearly $200m in 2007.

Sector Outlook

- Total retail sales increased a seasonally adjusted 0.2% in January 2009 to $19.2b. Clothing and soft goods sector increased 0.8% in January with PCP growth over 6%. Food grew 1.5% in January, or 9% PCP. The moderately positive numbers are in our view attributable in large part to the ongoing impact of the federal government fiscal stimulus package.
- The RBA left interest rates on hold at 3.25% in March 2009 citing domestic demand (having not weakened as much as other countries) and strength of the domestic financial system as reasons for the decision. RBA Governor Glenn Stevens also noted that the 400bps in rate cuts since September last year, combined with the federal government's fiscal stimulus packages, would continue to provide support to domestic demand.
- However, in January 2009, the Australian Retailers Association released survey results indicating that consumers intended to reduce discretionary spending by an average of 21%, over the first half of 2009.
- The retail industry faces significant challenges over 2009 with the continued decline in economic conditions and lower consumer confidence. Many companies will be attempting to reduce costs through advertising cuts, staff redundancies and work hour reductions.
- The Australian Retailers Association has reported around 45,000 retail jobs were lost in the 12 months preceding November 2008 and believe a further 50,000 retail jobs are at risk during 2009.
- Overall, with the discretionary nature of the majority of the retail sector and likely continued deterioration in global economic conditions, retail sector turnover is likely to suffer further declines.
- Tightening cash flows and increased scrutiny by secured financiers is likely to lead to strategic and operational reviews with potential for further fallout. This will particularly be an issue for highly leveraged players, and those with inflexible open to buy measures and systems.

About The KordaMentha Research Unit

Background

KordaMentha is an independent professional services firm specialising in corporate restructuring, corporate advisory and real estate services.

Our national practice spans all major cities in Australia and comprises in excess of 180 staff. Internationally, we work in cooperation with AlixPartners, a global restructuring firm covering North America, Europe and Asia.

Our partners, directors and staff have extensive experience across a broad range of industries and our firm has a culture based on creative solutions and implementation. The strength of KordaMentha's experience makes us well placed to monitor, evaluate and comment on issues and developments in industry, and in corporate restructuring, workouts and insolvency generally.

Statement of Direction

The KordaMentha Research Unit aims to:

- develop intellectual property
- share our knowledge of specialist topics with insolvency stakeholders; and
- develop balanced solutions for issues in the industry.

Personnel

The KordaMentha Research Unit is headed by Andrew Malarkey (amalarkey@kordamentha.com). KordaMentha Partners and Directors contribute to the KordaMentha Research Unit.

Current Research

In addition to general publications, the KordaMentha Research Unit regularly publishes Industry Roundups and Industry Vitals.

Industry Roundups provide a concise summary of recent news and development, covering a number of industry sectors.

Industry Vitals provide a snapshot of key issues relating to selected industries.

All KordaMentha Research Unit publications can be accessed via our website – www.kordamentha.com

KordaMentha

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