

Michael Hill Intl

1Q21 Sales Checkout

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OUTPERFORM

Michael Hill (MHJ) delivered a robust 1Q21 trading result despite a backdrop of fluid COVID-19 operating restrictions, illustrating early signs of execution on key strategic initiatives. Whilst heightened uncertainty remains, we take a more positive view on the immediate outlook into Christmas and lift our near-term earnings assumptions. In addition, the company's balance sheet remains healthy with a net cash position at the end of the quarter. MHJ is trading on undemanding multiples (one year forward PE ratio of 8x) more than compensating for the risks of an uncertain backdrop. Reiterate OUTPERFORM (high risk).

NZX Code	MHJ	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$0.50	NPAT* (NZ\$m)	15.6	24.3	24.3	27.2	PE	12.3	7.9	7.9	7.0
Target price	NZ\$0.55	EPS* (NZc)	4.1	6.4	6.3	7.1	EV/EBIT	6.2	4.5	4.5	4.0
Risk rating	High	EPS growth* (%)	-35.9	56.5	-0.3	12.0	EV/EBITDA	2.2	2.0	2.0	1.8
Issued shares	382.5m	DPS (NZc)	1.6	2.7	3.8	4.5	Price / NTA	1.1	0.9	0.9	0.9
Market cap	NZ\$191m	Imputation (%)	100	80	80	80	Cash div yld (%)	3.2	5.4	7.6	8.9
Avg daily turnover	304.8k (NZ\$123k)	*Based on normalised profits					Gross div yld (%)	4.4	7.1	9.9	11.7

What's changed?

- **Earnings:** Lift FY21 NPAT +10% to A\$22.5m. More modest increases to NPAT over the medium-term (+3%)
- **Target price:** Lifted to NZ\$0.55 (from NZ\$0.49), reflective of earnings revisions and higher peer multiples

A good start to FY21 delivering SSS growth across all markets

MHJ reported strong 1Q21 group same-store-sales (SSS), up +7.3% (adjusted for store closures) on the prior year period. Total sales fell -3.6%, a credible result, particularly given the impact of temporary closures in Victoria and Auckland (44 stores), and permanent store closures (15 stores) across the group. All markets delivered positive physical store SSS growth, while online sales continue to surge (off a low base), up +129% on the prior year period and representing 5.3% of total sales. Online growth is favourable for margin mix, with sales weighted to lower price point, higher margin products.

Margin improvements a positive sign of strategy execution

MHJ reiterated its strategic direction of balancing sales growth with margin expansion. 1Q21 showed further signs of execution achieving +100bp to +200bp gross margin expansion, supported by both product/channel mix and improvements made in the supply chain. We estimate a group gross margin for the quarter of 62% to 63%, in line with our full year expectations (Forsyth Barr 62.8%). We see scope for further upside as a marginal foreign exchange tailwind comes into effect in 2Q21, and should MHJ continue to deliver incremental strategy benefits through improved product mix.

Improving Christmas outlook but uncertainty remains

MHJ has started the year well, albeit 1Q21 is the seasonal low with 2Q21 the seasonal high. Whilst the medium-term backdrop remains highly uncertain with COVID-19 restrictions fluid and economic pressures yet to become clear, we have taken a more positive view on the immediate outlook into the key Christmas trading period. We expect the improving economic sentiment, continued consumer momentum, and healthy inventory levels (limiting margin pressure), to support 2Q21 trading.

Michael Hill International Ltd (MHJ)

Priced as at 14 Oct 2020 (NZ\$)					0.50						
12-month target price (NZ\$)*					0.55	Spot valuations (NZ\$)					
Expected share price return					10.0%	1. DCF					0.51
Net dividend yield					6.1%	2. Sum of the parts					0.58
Estimated 12-month return					16.1%	3. n/a					n/a
Key WACC assumptions						DCF valuation summary (NZ\$m)					
Risk free rate					1.30%	Total firm value					647
Equity beta					1.15	(Net debt)/cash					1
WACC					7.6%	Less: Capitalised operating leases					453
Terminal growth					1.5%	Value of equity					195
Profit and Loss Account (A\$m)	2019A	2020A	2021E	2022E	2023E	Valuation Ratios	2019A	2020A	2021E	2022E	2023E
Sales revenue	571.1	512.6	518.4	524.9	537.8	EV/EBITDA (x)	1.5	0.9	1.2	1.5	1.4
Normalised EBITDA	54.0	86.8	88.3	86.5	88.9	EV/EBIT (x)	2.3	2.6	2.8	3.5	3.1
Depreciation and amortisation	(19.4)	(55.6)	(50.1)	(48.6)	(48.2)	PE (x)	7.9	12.3	7.9	7.9	7.0
Normalised EBIT	34.6	31.2	38.2	38.0	40.7	Price/NTA (x)	1.1	1.1	0.9	0.9	0.9
Net interest	(2.5)	(9.6)	(8.4)	(8.2)	(8.3)	Free cash flow yield (%)	12.2	34.8	21.3	19.4	20.7
Associate income	0	0	0	0	0	Net dividend yield (%)	8.5	3.2	5.4	7.6	8.9
Tax	(2.3)	(1.4)	(7.3)	(7.3)	(8.1)	Gross dividend yield (%)	8.5	3.2	5.4	7.6	8.9
Minority interests	0	0	0	0	0						
Normalised NPAT	22.8	14.8	22.5	22.5	24.3	Capital Structure	2019A	2020A	2021E	2022E	2023E
Abnormals/other	(6.3)	(11.7)	0	0	0	Interest cover EBIT (x)	14.0	3.3	4.5	4.6	4.9
Reported NPAT	16.5	3.1	22.5	22.5	24.3	Interest cover EBITDA (x)	21.9	9.1	10.5	10.6	10.7
Normalised EPS (cps)	5.9	3.8	5.8	5.8	6.3	Net debt/ND+E (%)	12.3	-0.3	-3.7	-3.6	-3.5
DPS (cps)	4.0	1.5	2.5	3.5	4.0	Net debt/EBITDA (x)	0.5	n/a	n/a	n/a	n/a
Growth Rates	2019A	2020A	2021E	2022E	2023E	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)	-5.5	-10.2	1.1	1.3	2.4	Return on assets (%)	9.1	6.2	8.1	8.0	8.5
EBITDA (%)	-10.4	60.9	1.6	-2.0	2.7	Return on equity (%)	16.9	10.3	10.1	10.1	10.9
EBIT (%)	-13.7	-9.7	22.3	-0.6	7.1	Return on funds employed (%)	15.7	14.9	15.4	15.8	17.0
Normalised NPAT (%)	-27.5	-35.3	52.4	-0.1	8.2	EBITDA margin (%)	9.5	16.9	17.0	16.5	16.5
Normalised EPS (%)	-27.5	-35.3	52.4	-0.1	8.2	EBIT margin (%)	6.1	6.1	7.4	7.2	7.6
Ordinary DPS (%)	-20.0	-62.5	66.7	40.0	14.3	Capex to sales (%)	2.7	3.4	3.9	4.3	4.2
Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Capex to depreciation (%)	81	31	40	46	47
EBITDA	54.0	86.8	88.3	86.5	88.9	Imputation (%)	100	100	80	80	80
Working capital change	(7.4)	22.0	(3.8)	(3.4)	(2.3)	Pay-out ratio (%)	67	39	43	60	63
Interest & tax paid	(7.6)	(6.2)	(23.6)	(23.5)	(24.4)						
Other	0	(18.9)	0	0	0	Operating Performance	2019A	2020A	2021E	2022E	2023E
Operating cash flow	39.0	83.7	60.8	59.7	62.1	Divisional revenue (A\$m)					
Capital expenditure	(15.7)	(17.2)	(20.0)	(22.5)	(22.5)	New Zealand	113.0	101.3	102.4	105.6	105.1
(Acquisitions)/divestments	0	0	0	0	0	Australia	313.6	266.6	279.3	285.0	292.1
Other	0	(35.5)	(23.8)	(23.8)	(24.1)	Canada	140.4	123.0	125.2	132.8	139.0
Funding available/(required)	23.3	31.0	17.0	13.3	15.5	Other	4.1	21.7	11.6	1.6	1.6
Dividends paid	(19.4)	(5.8)	(9.7)	(13.6)	(15.5)	Total revenue	571.1	512.6	518.4	524.9	537.8
Equity raised/(returned)	0	0	0	0	0						
(Increase)/decrease in net debt	3.9	25.2	7.3	(0.2)	(0.0)	Divisional EBIT (A\$m)					
Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E	New Zealand	22.7	20.0	20.0	21.0	21.6
Working capital	131.8	112.9	138.6	143.3	146.9	Australia	32.9	27.4	28.8	28.8	29.5
Fixed assets	63.2	45.4	45.6	48.5	51.1	Canada	10.2	(2.6)	3.5	7.2	9.8
Intangibles	15.4	24.4	24.4	24.4	24.4	Corporate and other	(31.3)	(13.6)	(14.1)	(19.0)	(20.2)
Right of use asset	0	123.9	118.4	113.1	113.1	Total EBIT	34.6	31.2	38.2	38.0	40.7
Other assets	83.5	92.9	84.9	82.9	80.9						
Total funds employed	293.9	399.5	412.0	412.3	416.5	Store numbers					
Net debt/(cash)	24.8	(0.5)	(7.9)	(7.6)	(7.6)	New Zealand	52	49	49	49	49
Lease liability	0	115.8	116.9	116.7	120.8	Australia	168	155	154	154	154
Other liabilities	92.4	88.3	81.3	81.3	81.3	Canada	86	86	86	86	86
Shareholder's funds	176.8	196.0	221.7	221.9	222.0						
Minority interests	0	0	0	0	0						
Total funding sources	293.9	399.5	412.0	412.3	416.5						

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

1Q21 sales

Figure 1. Quarterly same store sales (adjusted for store closures)

	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21
Australia	-4.0%	-3.4%	-2.4%	6.8%	1.6%	-10.4%	-8.1%	12.5%
New Zealand	-4.8%	-6.3%	-0.3%	10.1%	5.0%	-8.4%	-10.9%	4.7%
Canada	10.9%	0.1%	-0.1%	16.4%	1.4%	-21.1%	38.1%	5.9%
Group	-3.0%	-1.5%	0.1%	11.9%	4.0%	-11.2%	-4.1%	7.3%

Source: Company reports, Forsyth Barr analysis

Earnings changes

We increase our near-term earnings expectations reflecting 1) a more positive immediate outlook into Christmas, 2) signs of strategy execution providing confidence in continued gross margin expansion, and 3) a foreign exchange tailwind. We make more modest changes to our medium-term outlook with both economic and COVID-19 uncertainty still a key feature.

Figure 2. Earnings changes (A\$m)

	FY21E			FY22E			FY23E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Sales Revenue	517.8	518.4	0.1%	528.2	524.9	-0.6%	539.6	537.8	-0.3%
EBIT	35.7	38.2	6.9%	38.1	38.0	-0.3%	40.8	40.7	-0.2%
Normalised Profit	20.5	22.5	10.0%	21.9	22.5	2.5%	23.7	24.3	2.5%
Underlying EPS	5.3	5.8	10.0%	5.7	5.8	2.5%	6.1	6.3	2.5%
DPS (AUD)	2.5	2.5	-	3.5	3.5	-	4.0	4.0	-

Source: Forsyth Barr analysis

Figure 3. Price performance


Source: Forsyth Barr analysis

Figure 4. Substantial shareholders

Shareholder	Latest Holding
Hoggett Hamlett Limited	38.3%
Spheria Asset Management	8.7%
ACC	7.4%

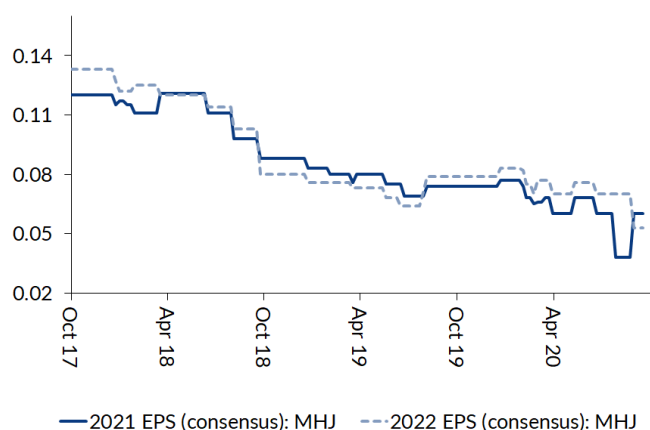
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 5. International valuation comparisons

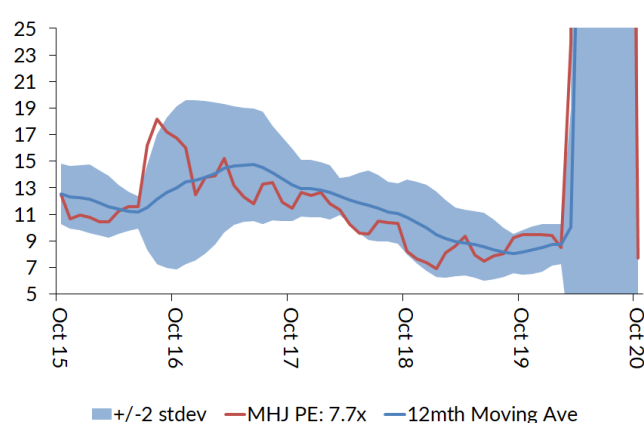
Company	Code	Price	Mkt Cap (m)	PE 2021E 2022E	EV/EBITDA 2021E 2022E	EV/EBIT 2021E 2022E	Cash Yld 2022E
(metrics re-weighted to reflect MHJ's balance date - June)							
Michael Hill Intl	MHJ NZ	NZ\$0.50	NZ\$191	7.9x 7.9x	2.0x 2.0x	4.6x 4.6x	7.6%
SIGNET JEWELERS	SIG US	US\$21.53	US\$1,127	<0x 10.2x	13.3x 9.1x	<0x n/a	0.0%
LOVISA HOLDINGS	LOV AT	A\$8.17	A\$878	43.5x 25.9x	16.2x 11.3x	34.3x 19.9x	2.7%
MYER HOLDINGS	MYR AT	A\$0.21	A\$168	<0x 10.2x	7.6x 6.7x	23.3x 17.8x	0.3%
TIFFANY & CO	TIF US	US\$118.47	US\$14,378	39.6x 27.0x	22.4x 16.2x	38.0x 22.4x	1.8%
KATHMANDU HOLDINGS *	KMD NZ	NZ\$1.30	NZ\$922	20.0x 12.3x	9.2x 6.8x	13.5x 8.8x	5.2%
BRISCOE GROUP *	BGP NZ	NZ\$3.91	NZ\$870	14.0x 14.4x	6.4x 6.5x	8.2x 8.4x	5.8%
THE WAREHOUSE GROUP *	WHS NZ	NZ\$2.20	NZ\$763	11.1x 9.8x	5.2x 4.7x	8.2x 7.2x	7.3%
Compco Average:				25.6x 15.7x	11.5x 8.7x	20.9x 14.1x	3.3%
MHJ Relative:				-69% -50%	-83% -77%	-78% -67%	129%

EV = Current Market Cap + Actual Net Debt

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (MHJ) companies fiscal year end

Figure 6. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 7. One year forward PE (x)


Source: Forsyth Barr analysis

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