

Michael Hill Intl

2Q21 Sales Checkout

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OUTPERFORM

Michael Hill's (MHJ) 2Q21 trading update highlights robust trading through the holiday period, underpinned by sustained margin improvement, and same store sales (SSS) growth across all markets and channels. MHJ's 1H21 EBIT guidance of A\$56m to A\$60m was ahead of our prior expectations, and we make material upgrades to our near-term forecasts. MHJ also announced payment of its (previously deferred) AUD1.5cps 1H20 dividend. Given earnings strength and a net cash position, we see scope for a further dividend announcement at its interim result in February. We maintain our OUTPERFORM rating with MHJ showing signs of execution on its strategy, while providing investors with an attractive dividend yield.

NZX Code	MHJ	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$0.78	NPAT* (NZ\$m)	27.0	32.6	29.6	31.1	PE	11.0	9.2	10.1	9.6
Target price	NZ\$0.80	EPS* (NZc)	7.1	8.5	7.7	8.1	EV/EBIT	11.3	8.0	8.8	8.4
Risk rating	High	EPS growth* (%)	11.5	20.4	-9.0	5.0	EV/EBITDA	4.1	4.0	4.3	4.2
Issued shares	382.5m	DPS (NZc)	1.6	6.3	4.9	5.5	Price / NTA	1.7	1.6	1.6	1.6
Market cap	NZ\$298m	Imputation (%)	100	80	80	80	Cash div yld (%)	2.0	8.1	6.2	7.0
Avg daily turnover	356.4k (NZ\$151k)	*Based on normalised profits					Gross div yld (%)	2.8	10.6	8.2	9.2

What's changed?

- **Earnings:** We increase our FY21E EBIT forecast +33% to A\$65m, driven by margin improvements and operating leverage. We lift both our FY22E and FY23E EBIT forecasts +9% respectively.
- **Target price:** Our target price increases +12cps to NZ\$0.80 on the back of earnings upgrades peer multiple expansion.

Robust sales against a fluid backdrop

MHJ performed well over the 2Q21 period, capitalising on supportive trading conditions in the retail sector. Australia was the standout segment, delivering +11.6% SSS growth on the prior year period, despite sporadic disruptions due to regional COVID-19 outbreaks. New Zealand and Canada delivered SSS growth of +1.8% and +1.9% respectively. As at the end of 2Q21, 40 of MHJ's 86 stores in Canada are temporarily closed. Store closures are likely to feature throughout 2021, however, it is encouraging to see that alternative sales initiatives are mitigating some of this impact, with online sales doubling in 1H21, representing 5.8% of sales (1H20 2.8%).

Delivering on margin initiatives

Margin improvement was the key highlight of MHJ's trading update. 1H21 gross margin improved +150–250bps against the prior year period across its markets (1H20 61.8%). Margin expansion is a function of its ongoing strategic initiatives, including continued growth in its loyalty scheme, sales growth in the online channel, a shift in mix towards branded collections, and improved capability among its sales contingent.

1H21 guidance upgrade, OUTPERFORM retained

Strong sales propelled by gross margin achievement and operating cost improvement saw management issue (pre-IFRS 16) 1H21 EBIT guidance of A\$56m to A\$60m (includes c. A\$15m wage subsidy contribution captured in the period), against our 1H21E comparable EBIT of A\$57m. Given the supportive backdrop and signs of strategy execution we continue to see upside support at these levels, although, note the higher risk nature of its discretionary exposure.

Michael Hill International Ltd (MHJ)

Priced as at 15 Jan 2021 (NZ\$)

0.78

12-month target price (NZ\$)*

0.80

Expected share price return

2.6%

Net dividend yield

7.0%

Estimated 12-month return

9.6%

Spot valuations (NZ\$)

1. DCF

0.80

2. Sum of the parts

0.72

3. n/a

n/a

Key WACC assumptions

Risk free rate

1.30%

Equity beta

1.15

WACC

7.6%

Terminal growth

1.5%

DCF valuation summary (NZ\$m)

Total firm value

757

(Net debt)/cash

1

Less: Capitalised operating leases

453

Value of equity

304

Profit and Loss Account (A\$m)	2019A	2020A	2021E	2022E	2023E	Valuation Ratios	2019A	2020A	2021E	2022E	2023E
Sales revenue	571.1	512.6	526.1	522.3	533.0	EV/EBITDA (x)	3.3	2.1	2.0	2.2	2.1
Normalised EBITDA	54.0	86.8	100.3	95.0	95.9	EV/EBIT (x)	5.2	5.8	3.9	4.5	4.3
Depreciation and amortisation	(19.4)	(55.6)	(65.1)	(48.6)	(48.2)	PE (x)	12.3	11.0	9.2	10.1	9.6
Normalised EBIT	34.6	31.2	65.3	46.4	47.7	Price/NTA (x)	1.7	1.7	1.6	1.6	1.6
Net interest	(2.5)	(9.6)	(9.2)	(9.6)	(9.4)	Free cash flow yield (%)	7.8	22.3	17.0	16.0	14.9
Associate income	0	0	0	0	0	Net dividend yield (%)	5.5	2.0	8.1	6.2	7.0
Tax	(2.3)	(1.4)	(10.7)	(9.4)	(9.9)	Gross dividend yield (%)	5.5	2.0	8.1	6.2	7.0
Minority interests	0	0	0	0	0						
Normalised NPAT	22.8	(8.6)	45.4	27.4	28.4	Capital Structure	2019A	2020A	2021E	2022E	2023E
Abnormals/other	(6.3)	11.7	0	0	0	Interest cover EBIT (x)	14.0	3.3	5.4	4.8	5.1
Reported NPAT	16.5	3.1	45.4	27.4	28.4	Interest cover EBITDA (x)	21.9	9.1	10.9	9.9	10.2
Normalised EPS (cps)	5.9	(2.2)	11.7	7.1	7.3	Net debt/ND+E (%)	12.3	-0.3	7.4	4.4	4.0
DPS (cps)	4.0	1.5	6.0	4.5	5.0	Net debt/EBITDA (x)	0.5	n/a	0.2	0.1	0.1
Growth Rates	2019A	2020A	2021E	2022E	2023E	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)	-5.5	-10.2	2.6	-0.7	2.0	Return on assets (%)	9.1	6.2	13.8	10.0	10.1
EBITDA (%)	-10.4	60.9	15.5	-5.4	1.0	Return on equity (%)	16.9	10.3	23.1	13.9	14.4
EBIT (%)	-13.7	-9.7	>100	-28.9	2.8	Return on funds employed (%)	15.7	14.9	26.7	19.4	20.2
Normalised NPAT (%)	-27.5	n/a	n/a	-39.7	3.8	EBITDA margin (%)	9.5	16.9	19.1	18.2	18.0
Normalised EPS (%)	-27.5	n/a	n/a	-39.7	3.8	EBIT margin (%)	6.1	6.1	12.4	8.9	9.0
Ordinary DPS (%)	-20.0	-62.5	>100	0.0	11.1	Capex to sales (%)	2.7	3.4	3.8	4.3	4.2
						Capex to depreciation (%)	81	31	40	46	47
Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Imputation (%)	100	100	80	80	80
EBITDA	54.0	86.8	100.3	95.0	95.9	Pay-out ratio (%)	67	22	74	63	67
Working capital change	(7.4)	22.0	(1.7)	2.3	(1.6)						
Interest & tax paid	(7.6)	(6.2)	(27.8)	(27.0)	(27.4)	Operating Performance	2019A	2020A	2021E	2022E	2023E
Other	0	(18.9)	0	0	0	Divisional revenue (A\$m)					
Operating cash flow	39.0	83.7	70.8	70.3	67.0	New Zealand	113.0	101.3	106.2	104.6	106.1
Capital expenditure	(15.7)	(17.2)	(20.0)	(22.5)	(22.5)	Australia	313.6	266.6	289.7	287.0	291.3
(Acquisitions)/divestments	0	0	0	0	0	Canada	140.4	123.0	128.7	129.1	134.1
Other	0	(35.5)	(43.8)	(23.8)	(24.1)	Other	4.1	21.7	1.6	1.6	1.6
Funding available/(required)	23.3	31.0	7.0	24.0	20.3	Total revenue	571.1	512.6	526.1	522.3	533.0
Dividends paid	(19.4)	(5.8)	(23.2)	(17.4)	(19.4)						
Equity raised/(returned)	0	0	0	0	0	Divisional EBIT (A\$m)					
(Increase)/decrease in net debt	3.9	25.2	(16.2)	6.5	1.0	New Zealand	22.7	20.0	23.6	21.0	21.1
						Australia	32.9	27.4	38.1	36.1	37.2
Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Canada	10.2	(2.6)	7.6	8.3	9.6
Working capital	131.8	112.9	136.5	135.4	138.3	Corporate and other	(31.3)	(13.6)	(4.1)	(19.0)	(20.2)
Fixed assets	63.2	45.4	45.6	48.5	51.1	Total EBIT	34.6	31.2	65.3	46.4	47.7
Intangibles	15.4	24.4	24.4	24.4	24.4						
Right of use asset	0	123.9	118.4	113.1	113.1	Store numbers					
Other assets	83.5	92.9	84.9	82.9	80.9	New Zealand	52	49	49	49	49
Total funds employed	293.9	399.5	409.8	404.4	407.9	Australia	168	155	154	154	154
Net debt/(cash)	24.8	(0.5)	15.7	9.2	8.2	Canada	86	86	86	86	86
Lease liability	0	115.8	116.9	116.7	120.8						
Other liabilities	92.4	88.3	81.3	81.3	81.3						
Shareholder's funds	176.8	196.0	196.0	197.3	197.6						
Minority interests	0	0	0	0	0						
Total funding sources	293.9	399.5	409.8	404.4	407.9						

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

2Q21 sales

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

	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	SSS growth			
									3Q20	4Q20	1Q21	2Q21
Australia	63.4	67.6	66.9	103.5	56.8	32.0	64.2	109.8	-10.4%	-8.1%	12.5%	11.6%
New Zealand	25.2	27.3	25.5	42.8	23.1	12.7	24.4	44.0	-8.4%	-10.9%	4.7%	1.8%
Canada	26.1	27.8	27.2	48.7	20.6	7.1	28.2	42.0	-21.1%	38.1%	5.9%	1.9%
Total (AUD)	115.2	123.2	121.2	198.1	102.2	51.6	116.7	195.3	-11.2%	-4.1%	7.3%	5.6%

Source: Company reports, Forsyth Barr analysis

Earnings changes

We lift our FY21E EBIT forecast +33% to A\$65m on the back of updated half year guidance, as we increase our gross margin assumptions and lower operating costs, driving significant operating leverage. Operating cost gains are primarily driven by company specific factors and are therefore more likely to be enduring. We lower our near-term operating cost assumptions which drive c. +9% lifts to our FY22E and FY23E EBIT forecasts.

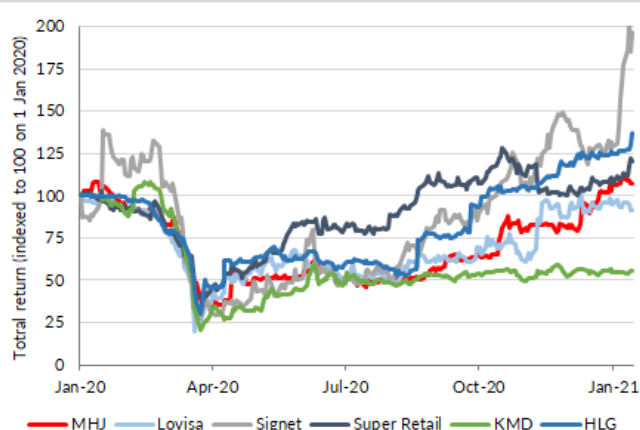
MHJ released 1H21 EBIT guidance of A\$56m to A\$60m (pre-IFRS 16 and including the c. A\$15m uplift from wage subsidies captured in the period). Our comparable 1H21E EBIT forecast is A\$57m. We assume underlying sales momentum slows into 2H21E (albeit well ahead of pcps as it cycles lockdowns), although currently view risk as skewed to the upside.

Figure 2. Forecast changes (A\$m)

	FY21E				FY22E				FY23E		
	Old	New	% chg		Old	New	% chg		Old	New	% chg
Sales Revenue	512.3	526.1	2.7%		519.7	522.3	0.5%		534.0	533.0	-0.2%
EBIT	48.9	65.3	33.5%		42.5	46.4	9.3%		43.8	47.7	8.8%
Normalised Profit	30.1	45.4	50.7%		25.8	27.4	6.2%		26.7	28.4	6.6%
Underlying EPS	7.8	11.7	50.7%		6.6	7.1	6.2%		6.9	7.3	6.6%
DPS (AUD)	4.5	6.0	33.3%		4.5	4.5	-		5.0	5.0	-

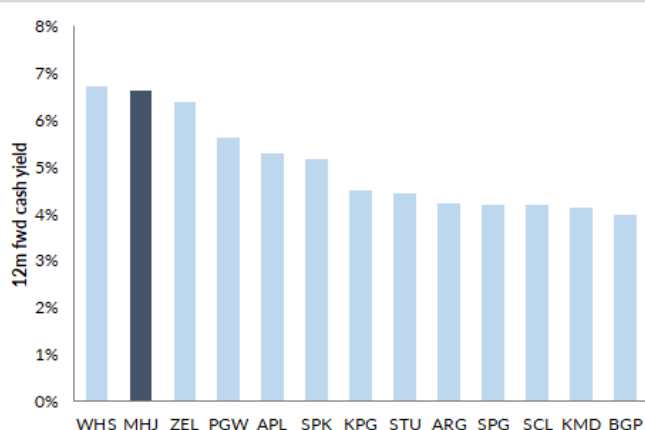
Source: Forsyth Barr analysis

Figure 3. Retail sector performance – total return (indexed)



Source: Datastream, Forsyth Barr analysis

Figure 4. MHJ offers an attractive yield



Source: Bloomberg, Forsyth Barr analysis

Figure 5. Price performance


Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
Hoggett Hamlett Limited	38.3%
Spheria Asset Management	9.9%
ACC	7.4%

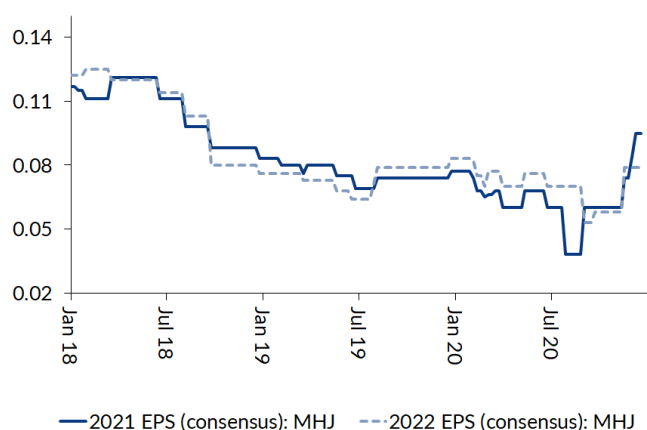
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 7. International valuation comparisons

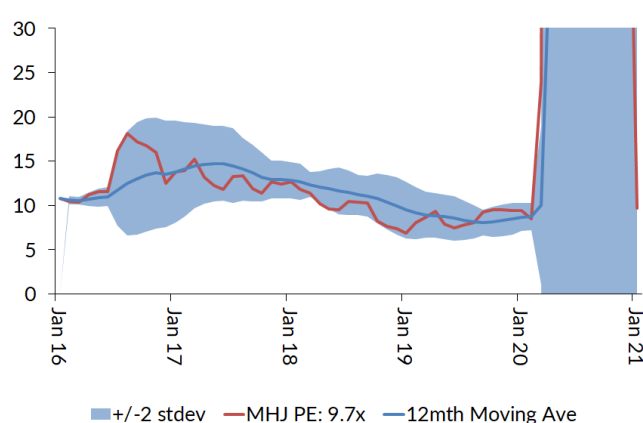
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect MHJ's balance date - June)										
Michael Hill Intl	MHJ NZ	NZ\$0.78	NZ\$298	9.2x	10.1x	2.8x	2.9x	5.5x	5.9x	6.2%
SIGNET JEWELERS	SIG US	US\$38.55	US\$2,018	37.9x	12.4x	10.6x	7.5x	67.5x	n/a	0.0%
LOVISA HOLDINGS	LOV AT	A\$11.39	A\$1,224	>50x	30.0x	19.3x	12.5x	43.9x	23.0x	2.1%
MYER HOLDINGS	MYR AT	A\$0.30	A\$242	<0x	14.6x	7.9x	6.9x	24.2x	18.4x	0.0%
TIFFANY & CO	TIF US	US\$131.46	US\$16,044	39.0x	29.7x	23.0x	17.7x	40.4x	25.0x	1.7%
KATHMANDU HOLDINGS *	KMD NZ	NZ\$1.26	NZ\$893	19.6x	11.9x	4.7x	3.9x	12.8x	8.2x	5.4%
BRISCOE GROUP *	BGP NZ	NZ\$5.34	NZ\$1,188	18.9x	19.7x	8.8x	9.0x	11.3x	11.7x	4.2%
THE WAREHOUSE GROUP *	WHS NZ	NZ\$2.98	NZ\$1,034	8.3x	11.1x	2.4x	2.7x	4.5x	5.3x	6.2%
Compco Average:				24.7x	18.5x	11.0x	8.6x	29.2x	15.3x	2.8%
MHJ Relative:				-63%	-46%	-75%	-66%	-81%	-61%	124%
EV = Current Market Cap + Actual Net Debt										

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 8. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)


Source: Forsyth Barr analysis

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