

Michael Hill Intl

3Q21 Sales Checkout

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OUTPERFORM

Michael Hill (MHJ) has delivered another strong quarterly (3Q21) trading update, highlighted by its seventh consecutive quarter of gross margin expansion, attributable to continued execution on its strategic initiatives. Alongside +200bps of gross margin expansion on the prior year period, MHJ recorded group same store sales (SSS) growth of +16%. We are encouraged by continuing signs of execution, providing further confidence in management's ability to grow earnings. Trading on a one year forward PE ratio of 10x and offering a 12 month forward cash yield of 5.9%, we continue to see value at current levels. We reiterate our OUTPERFORM rating.

NZX Code	MHJ	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$0.89	NPAT* (NZ\$m)	27.0	38.2	33.5	34.3	PE	12.6	8.9	10.2	9.9
Target price	NZ\$1.02	EPS* (NZc)	7.1	10.0	8.8	9.0	EV/EBIT	12.6	7.5	8.4	8.3
Risk rating	High	EPS growth* (%)	11.5	41.2	-12.2	2.2	EV/EBITDA	4.5	4.0	4.3	4.3
Issued shares	382.5m	DPS (NZc)	1.6	6.3	4.8	5.4	Price / NTA	1.9	1.8	1.7	1.7
Market cap	NZ\$340m	Imputation (%)	100	80	80	80	Cash div yld (%)	1.8	7.1	5.4	6.1
Avg daily turnover	400.6k (NZ\$206k)	*Based on normalised profits					Gross div yld (%)	2.5	9.3	7.1	7.9

What's changed?

- **Earnings:** We make limited changes to our FY21 forecasts. Recent performance provides further confidence in management's ability to grow earnings, we lift FY22 and FY23 NPAT estimates +8.0% and +9.8% respectively.
- **Target price:** Our target price increases +15cps to NZ\$1.02 on the back of earnings changes and higher peer multiples.

Sales growth across all markets despite disruption

MHJ delivered 3Q21 total group sales growth of +12% on the prior year period, despite 1) lost trading days due to COVID-19 restrictions, and 2) a -5% reduction in group store numbers. On an SSS (adjusted for lost trading days) basis, sales were up +16% on the prior year period and +11% against 3Q19. All markets performed well with Australia and New Zealand 3Q21 total sales up +20% and +17% respectively on the prior year. Canada total sales increased +0.2% (SSS +31%), despite significant COVID-19 restrictions and lost trading days. We believe this illustrates good brand engagement, with its customer base across various channels enabling concentrated sales growth while stores are open.

Delivering on margin initiatives

The trend of year on year quarterly gross margin expansion continues for a seventh consecutive quarter, up +200bps against the prior year period and consistent with our expectations. 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. MHJ continues to grow its loyalty programme with membership up c. +25% on the prior quarter. 3Q21 online sales increased +69% on the prior year period. Both loyalty and online represent higher margin sales.

Large cash position, albeit a seasonal low for working capital

At quarter end MHJ had a significant net cash position, in excess of A\$50m. While 3Q21 represents a seasonal working capital low, and there remains c. A\$10m of wage remediation yet to be paid, MHJ's balance sheet is very healthy.

Michael Hill International Ltd (MHJ)

Priced as at 15 Apr 2021 (NZ\$)						0.89						
12-month target price (NZ\$)*						1.02	Spot valuations (NZ\$)					
Expected share price return						14.6%	1. DCF					0.99
Net dividend yield						5.7%	2. Sum of the parts					0.89
Estimated 12-month return						20.3%	3. n/a					n/a
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						2.30%	Total firm value					812
Equity beta						1.15	(Net debt)/cash					1
WACC						7.8%	Less: Capitalised operating leases					432
Terminal growth						1.5%	Value of equity					380
Profit and Loss Account (A\$m)						Valuation Ratios						
	2019A	2020A	2021E	2022E	2023E		2019A	2020A	2021E	2022E	2023E	
Sales revenue	571.1	512.6	546.5	530.6	540.4	EV/EBITDA (x)	n/a	n/a	n/a	n/a	n/a	
Normalised EBITDA	54.0	86.8	107.2	99.4	100.0	EV/EBIT (x)	n/a	n/a	n/a	n/a	n/a	
Depreciation and amortisation	(19.4)	(55.6)	(50.1)	(48.6)	(48.2)	PE (x)	14.0	12.6	8.9	10.2	9.9	
Normalised EBIT	34.6	31.2	74.1	50.8	51.8	Price/NTA (x)	2.0	1.9	1.8	1.7	1.7	
Net interest	(2.5)	(9.6)	(8.6)	(8.5)	(8.7)	Free cash flow yield (%)	6.8	19.5	21.0	11.7	12.4	
Associate income	0	0	0	0	0	Net dividend yield (%)	4.8	1.8	7.1	5.4	6.1	
Tax	(2.3)	(1.4)	(13.0)	(11.1)	(11.3)	Gross dividend yield (%)	6.6	2.5	9.3	7.1	7.9	
Minority interests	0	0	0	0	0	Capital Structure						
Normalised NPAT	22.8	(8.6)	52.5	31.2	31.8	Interest cover EBIT (x)	14.0	3.3	6.6	6.0	5.9	
Abnormals/other	(13.3)	0	0	0	0	Interest cover EBITDA (x)	21.9	9.1	12.5	11.7	11.5	
Reported NPAT	16.5	3.1	52.5	31.2	31.8	Net debt/ND+E (%)	12.3	-0.3	-2.5	-1.7	-1.0	
Normalised EPS (cps)	5.9	(2.2)	13.6	8.0	8.2	Net debt/EBITDA (x)	0.5	n/a	n/a	n/a	n/a	
DPS (cps)	4.0	1.5	6.0	4.5	5.0	Key Ratios						
Growth Rates							2019A	2020A	2021E	2022E	2023E	
Revenue (%)	-5.5	-10.2	6.6	-2.9	1.9	Return on assets (%)	9.1	6.2	15.7	10.8	11.0	
EBITDA (%)	-10.4	60.9	23.4	-7.3	0.7	Return on equity (%)	16.9	13.1	33.0	19.0	19.0	
EBIT (%)	-13.7	-9.7	>100	-31.5	2.0	Return on funds employed (%)	15.7	16.5	34.2	23.2	26.9	
Normalised NPAT (%)	-27.5	n/a	n/a	-40.7	2.0	EBITDA margin (%)	9.5	16.9	19.6	18.7	18.5	
Normalised EPS (%)	-27.5	n/a	n/a	-40.7	2.0	EBIT margin (%)	6.1	6.1	13.6	9.6	9.6	
Ordinary DPS (%)	-20.0	-62.5	>100	0.0	11.1	Capex to sales (%)	2.7	3.4	3.7	4.2	4.2	
Cash Flow (NZ\$m)							2019A	2020A	2021E	2022E	2023E	
EBITDA	54.0	86.8	107.2	99.4	100.0	Capex to depreciation (%)	81	31	40	46	47	
Working capital change	(7.4)	22.0	13.7	(9.5)	(7.2)	Imputation (%)	100	100	80	80	80	
Interest & tax paid	(7.6)	(6.2)	(29.5)	(27.6)	(28.1)	Pay-out ratio (%)	67	22	63	55	60	
Other	0	(18.9)	0	0	0	Operating Performance						
Operating cash flow	39.0	83.7	91.4	62.3	64.8	Divisional revenue (A\$m)						
Capital expenditure	(15.7)	(17.2)	(20.0)	(22.5)	(22.5)	New Zealand	113.0	101.3	111.8	105.5	107.4	
(Acquisitions)/divestments	0	0	0	0	0	Australia	313.6	266.6	302.7	294.0	296.9	
Other	0	(35.5)	(43.8)	(23.8)	(24.1)	Canada	140.4	123.0	130.4	129.6	134.5	
Funding available/(required)	23.3	31.0	27.6	15.9	18.2	Other	4.1	21.7	1.6	1.6	1.6	
Dividends paid	(19.4)	(5.8)	(23.2)	(17.4)	(19.4)	Total revenue	571.1	512.6	546.5	530.6	540.4	
Equity raised/(returned)	0	0	0	0	0	Divisional EBIT (A\$m)						
(Increase)/decrease in net debt	3.9	25.2	4.3	(1.5)	(1.2)	New Zealand	22.7	20.0	25.4	21.3	21.3	
Balance Sheet (NZ\$m)							2019A	2020A	2021E	2022E	2023E	
Working capital	133.2	114.3	122.5	133.3	141.8	Australia	32.9	27.4	42.9	39.9	41.2	
Fixed assets	63.2	45.4	45.6	48.5	51.1	Canada	10.2	(2.6)	8.3	8.9	9.6	
Intangibles	15.4	24.4	24.4	24.4	24.4	Corporate and other	(31.3)	(13.6)	(2.5)	(19.3)	(20.2)	
Right of use asset	0	123.9	118.4	113.1	113.1	Total EBIT	34.6	31.2	74.1	50.8	51.8	
Other assets	83.5	92.9	84.9	82.9	80.9	Store numbers						
Total funds employed	295.3	401.0	395.9	402.3	411.3	New Zealand	52	49	49	49	49	
Net debt/(cash)	24.8	(0.5)	(4.9)	(3.4)	(2.2)	Australia	168	155	153	153	153	
Lease liability	0	158.0	159.0	158.9	163.0	Canada	86	86	86	86	86	
Other liabilities	93.7	89.7	82.7	82.7	82.7							
Shareholder's funds	176.8	153.8	159.0	164.1	167.8							
Minority interests	0	0	0	0	0							
Total funding sources	295.3	401.0	395.9	402.3	411.3							

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

3Q21 sales highlights

- **Group sales** – MHJ achieved impressive 3Q21 group, same store sales (SSS) growth, up +16.4% (9m21 +8.7%) on the prior year period. As MHJ begins to cycle COVID-19 disruption, comparisons to pre COVID-19 periods become more relevant, with MHJ 3Q21 SSS up +11% against 3Q19.
- **Gross margin** – Margin commentary indicates continued gross margin improvement, +200bp above the prior year period and broadly consistent with recent quarters (1H21 62.7%, FY21E 63.0%).
- **E-commerce** – 3Q21 online sales jumped another +69% year on year (up +93% year to date). Year to date, penetration has materially increased against the prior year, representing 5.6% of total sales vs. 2.9%, however, has tracked backwards on 1H21 (5.8%).
- **Significant cash position** – MHJ currently has a net cash position >A\$50m. This will fall due to MHJ's wage remediation liability (c. A\$10m), although the underlying cash position is still very healthy.
- **COVID related closures** – Encouragingly, MHJ achieved sales growth across all markets despite the challenges from rolling COVID-19 restrictions, particularly in Canada, with 2,364 lost trading days in the quarter. We believe this illustrates improved engagement with its customer base across various channels, enabling concentrated sales growth while stores are open. Temporary store closures occurred across all markets during the period. 41 Canada store doors are currently closed due to COVID-19 restrictions.

Figure 1. Quarterly and year to date total sales (local currency)

	3Q19	3Q20	3Q21	% chg vs 19	% chg vs 20	9m19	9m20	9m21	% chg vs 19	% chg vs 20
Australia	65.5	58.9	70.3	7.4%	19.5%	240.3	232.5	245.5	2.2%	5.5%
New Zealand	25.5	23.7	27.9	9.4%	17.4%	90.8	93.7	97.2	7.0%	3.7%
Canada	26.2	21.7	21.7	-17.2%	0.2%	98.9	99.8	95.5	-3.5%	-4.4%
Total (AUD)	117.6	106.2	118.5	0.8%	11.6%	429.4	432.7	436.0	1.5%	0.8%

Source: Company reports, Forsyth Barr analysis

Earnings changes

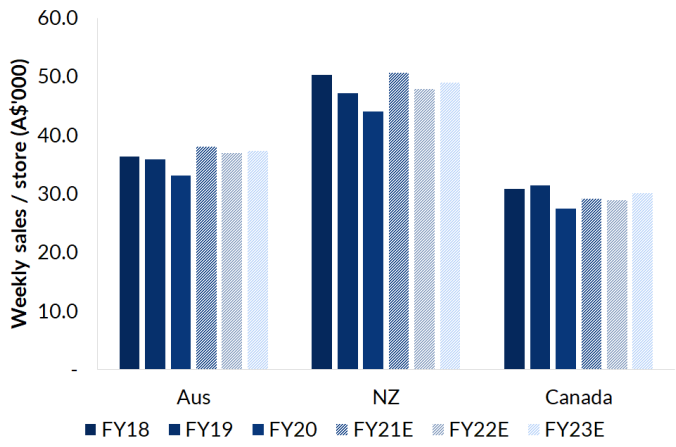
We make limited changes to our FY21 forecasts. Recent strong performance provides further confidence in management's ability to grow earnings. We lift FY22 and FY23 NPAT estimates +8.0% and +9.8% respectively. Our earnings upgrades are driven by 1) improved productivity of Canadian stores, 2) higher gross margin assumptions, and 3) operating leverage.

Figure 2. Forecast changes (A\$m)

	FY21E			FY22E			FY23E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Sales Revenue	535.7	546.5	2.0%	523.8	530.6	1.3%	533.2	540.4	1.4%
EBIT	73.9	74.1	0.3%	48.3	50.8	5.3%	48.1	51.8	7.8%
Normalised Profit	52.1	52.5	0.9%	28.9	31.2	8.0%	29.0	31.8	9.8%
Underlying EPS	13.4	13.6	0.9%	7.4	8.0	8.0%	7.5	8.2	9.8%
DPS (AUD)	6.0	6.0	-	4.5	4.5	-	5.0	5.0	-

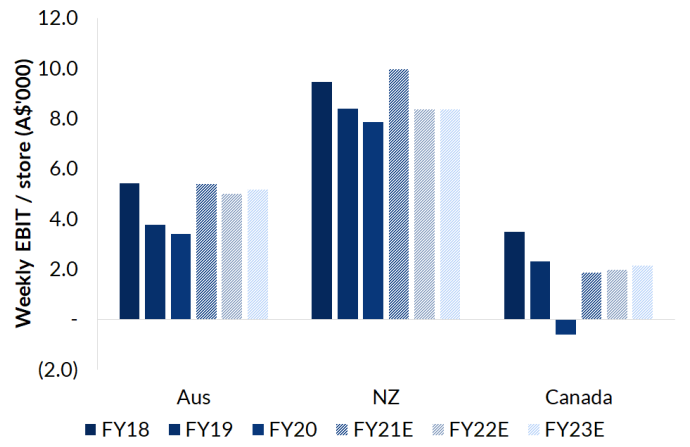
Source: Forsyth Barr analysis

Figure 3. Weekly sales/store

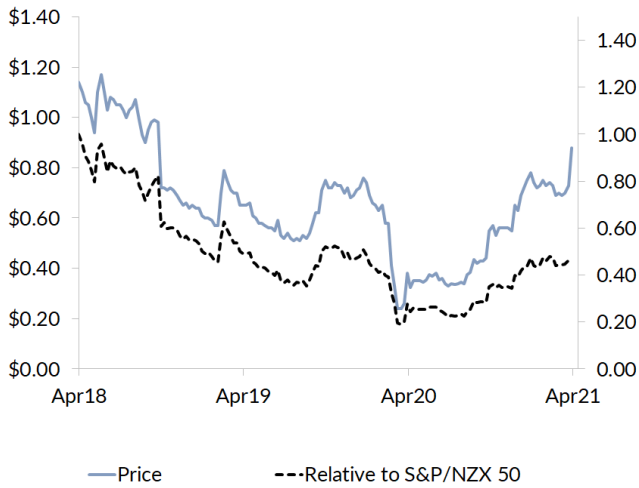


Source: MHJ, Forsyth Barr analysis

Figure 4. Weekly EBIT/store



Source: MHJ, Forsyth Barr analysis

Figure 5. Price performance


Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
Hoglett Hamlett Limited	38.3%
Spheria Asset Management	11.5%

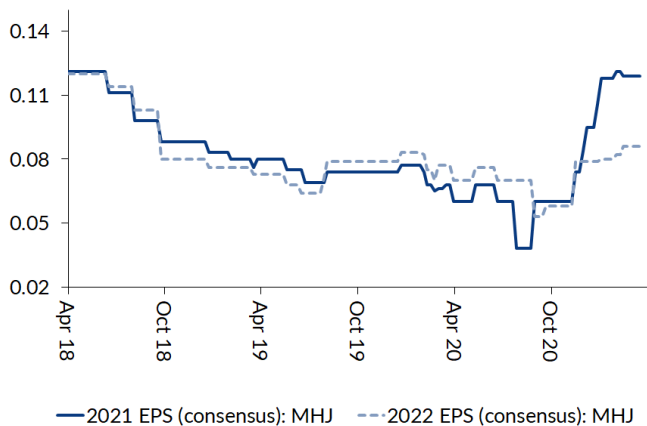
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 7. International valuation comparisons

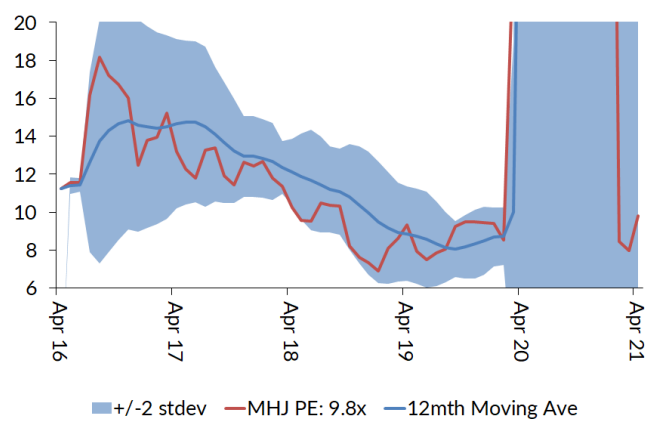
Company (metrics re-weighted to reflect MHJ's balance date - June)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2022E
				2021E	2022E	2021E	2022E	2021E	2022E	
Michael Hill Intl	MHJ NZ	NZ\$0.89	NZ\$340	8.9x	10.2x	3.0x	3.2x	5.5x	6.2x	5.4%
SIGNET JEWELERS	SIG US	US\$64.89	US\$3,397	<0x	n/a	7.2x	n/a	n/a	n/a	n/a
LOVISA HOLDINGS	LOV AT	A\$15.15	A\$1,628	60.1x	36.0x	20.5x	14.6x	42.2x	25.8x	2.1%
MYER HOLDINGS	MYR AT	A\$0.32	A\$265	12.7x	12.1x	6.0x	6.3x	10.3x	14.3x	0.0%
KATHMANDU HOLDINGS *	KMD NZ	NZ\$1.39	NZ\$986	15.3x	10.8x	4.5x	4.0x	10.0x	7.6x	4.9%
BRISCOE GROUP *	BGP NZ	NZ\$5.70	NZ\$1,269	17.1x	16.8x	8.1x	8.1x	10.0x	10.0x	4.4%
THE WAREHOUSE GROUP *	WHS NZ	NZ\$3.51	NZ\$1,217	7.8x	12.3x	2.6x	3.2x	4.5x	6.0x	5.7%
Compco Average:				22.6x	17.6x	8.1x	7.2x	15.4x	12.8x	3.4%
MHJ Relative:				-61%	-42%	-64%	-56%	-64%	-51%	59%

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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