

The Warehouse Group

RESEARCH INSIGHTS[#]

What's in Store

The Warehouse Group (WHS) provided updated FY19 earnings guidance implying a ~+7% upgrade on the prior range, as a result of incentive payments that did not accrue. WHS has pre-released its FY19 result — with improved underlying trading pleasing, following a period of considerable strategic change. We look for 1) divisional detail, 2) outlook insight, and 3) targets for its online platform TheMarket when WHS reports on 25 September.

What's changed?

- **Earnings:** Revised FY19 normalised profit +8% to NZ\$74m, the midpoint of updated guidance range

Earnings upgrade

WHS provided updated FY19 normalised profit guidance of NZ\$73m to NZ\$75m, ~+\$4.5m ahead of the prior guidance range of NZ\$67m to NZ\$70m. We have accordingly upgraded our FY19 normalised NPAT forecast +8% to NZ\$74m. The uplift is not a result of a change to underlying trading but instead removing the impact of incentive payments that did not fully accrue during the period.

Key issues to consider at WHS' FY19 result

WHS is due to report FY19 earnings on 25 September. Key issues to look for in the result:

- **Transformation progression** — WHS is in the midst of a business transformation. Recent operating upgrades suggest initial execution. We look for divisional detail and outlook commentary.
- **Balance sheet** — WHS previously indicated it expects net debt to be in the range of NZ\$60m to NZ\$80m, a material reduction on the prior period (FY18 NZ\$162m), driven by a release of working capital. We understand the release relates to a change in the terms of trade with international suppliers.
- **TheMarket** — WHS recently launched its online platform, TheMarket, in August. We estimate FY19 capex relating to the platform to be ~NZ\$8m. Key questions for management include estimated breakeven timeframe, near-term earnings drag, and continued investment requirements.

Figure 1. FY19 result expectations

	FY18	FY19E	% chg	Consensus
Revenue	2,995	3,049	2%	3,066
EBITDA	151	166	10%	164
Underlying profit	59	74	25%	66
Underlying EPS (cps)	17	21	25%	19
Dividend (cps)	16	16	0%	15

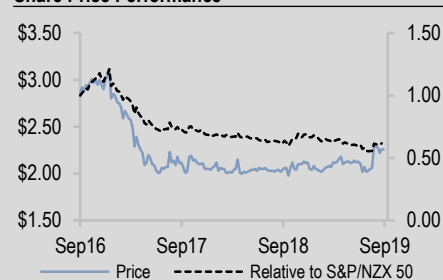
Source: Bloomberg, Forsyth Barr analysis

Investment View

WHS operates The Warehouse, Warehouse Stationery, Noel Leeming and Torpedo7. Material business transformation is underway which brings considerable moving parts and a wide range of outcomes. This follows underwhelming returns in recent years. We retain a cautious stance with material risk at this stage of the transformation around execution, 'cost-in', and time to see results; but there are some initial encouraging signs.

NZX Code	WHS
Share price	NZ\$2.26
Issued shares	346.8m
Market cap	NZ\$784m
Average daily turnover	52.1k (NZ\$110k)

Share Price Performance



Financials: July	18A	19E	20E	21E
NPAT* (NZ\$m)	59.0	73.8	79.3	94.8
EPS* (NZc)	17.1	21.3	22.9	27.3
EPS growth* (%)	-13.2	24.6	7.4	19.5
DPS (NZc)	16.0	16.5	16.0	16.5
Imputation (%)	100	100	100	100

Valuation (x)	18A	19E	20E	21E
EV/EBITDA	6.3	5.4	4.8	4.3
EV/EBIT	10.3	8.1	7.1	6.2
PE	13.2	10.6	9.9	8.3
Price / NTA	1.7	1.6	1.5	1.4
Cash dividend yield (%)	7.1	7.3	7.1	7.3
Gross dividend yield (%)	9.8	10.1	9.8	10.1

*Historic and forecast numbers based on underlying profits

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The Warehouse Group (WHS)

Priced as at 23 Aug 2019: NZ\$2.26

July year end

Research Insights						Valuation Ratios																																			
Forsyth Barr Research Insights focuses on qualitative rather than quantitative assessments of an equity investment. We do not provide valuation, target prices or investment ratings for companies in the Research Insights series. It is targeted at selected smaller cap stocks with typically higher risk attributes, or those under transitional coverage. Our earnings and cashflow forecasts, together with key valuation and ratios provided on this page should assist investors in determining the relative valuation merits of the company.						2017A						2018A						2019E						2020E						2021E											
						EV/EBITDA (x)						6.1						6.3						5.4						4.8						4.3					
						EV/EBIT (x)						9.4						10.3						8.1						7.1						6.2					
						PE (x)						11.5						13.2						10.6						9.9						8.3					
						Price/NTA (x)						1.6						1.7						1.6						1.5						1.4					
						Free cash flow yield (%)						7.3						4.8						19.0						5.0						8.2					
						Net dividend yield (%)						7.1						7.1						7.3						7.1						7.3					
						Gross dividend yield (%)						9.8						9.8						10.1						9.8						10.1					
						Imputation (%)						100						100						100						100						100					
						Pay-out ratio (%)						81						94						77						70						60					

Investment summary

The Warehouse Group (WHS) is a multi-business retailer which operates four retail chains having undergone a period of change following a suite of acquisitions and investments. The current phase is reducing complexity and driving flexibility in the model through a material business transformation. Recent signs are encouraging but it is early days.

Earnings and cash flow outlook

- **Red Sheds:** Is the key contributor to profit and is the main area of focus in the business transformation. Following a very disappointing FY17, FY18 was a year of transition, with FY19 the first 'clean' year to assess changes.
- **NZDUSD and hedging:** All market participants are affected by FX movements, but given price conscious consumers, we don't expect retailers to be able to pass on the full impact of unfavourable FX movements.

Business quality

- **Strategic change:** WHS is in the midst of a shift in strategic focus, aiming to leverage the existing asset base, optimise the model and reduce complexity. WHS itself acknowledges there is a significant range of outcomes in its internal financial modelling of the strategic plan.
- **Competitive positioning:** While WHS faces strong competition from existing retailers, possible new entrants, and online retailers, it has a market leading store footprint and three very strong brands.

Financial structure

- **Balance sheet analysis:** Gearing is around 25% and WHS is looking to reduce debt through its transformation process. Operating cash flow shows the benefit of an improved working capital position, while capital expenditure is on improving the businesses systems and operations.
- **Dividends:** We expect dividend growth to be relatively modest in the near-to-medium-term given the reinvestment into the business that is underway.

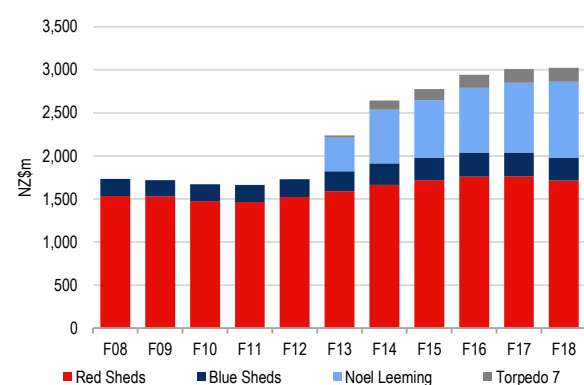
Risks factors

- **Competitive environment:** Particularly with the expansion of Kmart in New Zealand and the entry of Amazon into Australia.
- **Consumer sentiment and cost inflation:** Deterioration in economic conditions or general consumer sentiment. Cost inflation, particularly rising wages and rent.

Company description

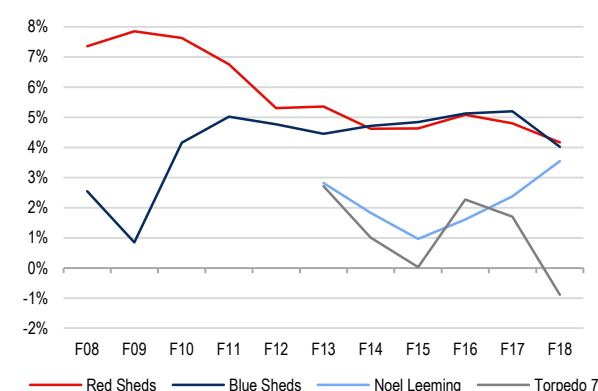
The Warehouse Group is a major listed retailer in NZ with a general merchandise chain of 92 stores (The Warehouse) and a stationery chain of 66 stores (Warehouse Stationery). The company acquired Noel Leeming for NZ\$65m in December 2012 and pure-play online retailer, Torpedo7 in April 2013 for up to NZ\$33m. Noel Leeming is a leading consumer electronics and appliances retailer.

Figure 1. Divisional revenue (NZ\$m)



Source: Forsyth Barr analysis, company reports

Figure 2. Divisional EBIT margin (%)



Source: Forsyth Barr analysis, company reports

Figure 2. Substantial Shareholders

Shareholder	Latest Holding
Stephen Robert Tindall	27.0%
The Tindall Foundation	21.3%
James Pascoe	19.7%
Foodstuffs	9.9%

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

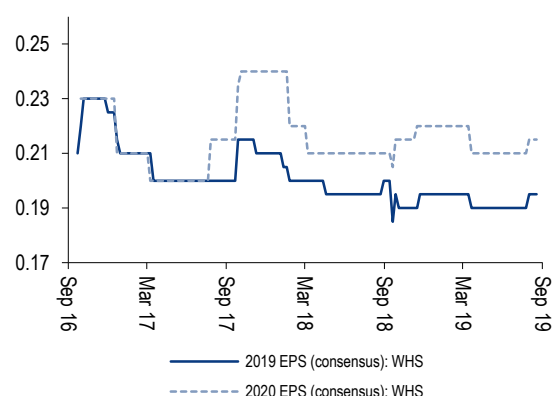
Figure 3. International Compcos

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
(metrics re-weighted to reflect WHS's balance date - July)			(m)	2019E	2020E	2019E	2020E	2019E	2020E	2020E
The Warehouse Group	WHS NZ	NZ\$2.26	NZ\$784	10.6x	9.9x	5.7x	5.3x	8.5x	7.9x	7.1%
Briscoe Group *	BGP NZ	NZ\$3.57	NZ\$792	12.3x	12.1x	7.6x	7.5x	8.1x	8.0x	5.7%
Hallenstein Glasson Holdings	HLG NZ	NZ\$5.37	NZ\$317	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Kathmandu Holdings *	KMD NZ	NZ\$2.55	NZ\$578	10.2x	10.1x	6.2x	6.1x	7.3x	7.3x	5.9%
Michael Hill Intl *	MHJ NZ	A\$0.52	A\$202	8.2x	7.9x	4.0x	3.9x	6.2x	5.8x	10.1%
Restaurant Brands NZ *	RBD NZ	NZ\$10.25	NZ\$1,279	28.6x	25.2x	13.6x	12.6x	20.8x	19.0x	0.0%
Costco Wholesale Corp	COST US	US\$279.98	US\$123,132	34.6x	32.8x	19.3x	17.7x	25.2x	23.3x	1.0%
Target Corp	TGT US	US\$106.23	US\$54,319	18.2x	16.8x	9.8x	9.6x	15.7x	14.6x	2.5%
Reject Shop/The	TRS AT	A\$1.99	A\$57	<0x	16.0x	1.1x	1.6x	n/a	n/a	n/a
Walmart Inc	WMT US	US\$111.79	US\$319,129	35.8x	22.3x	11.7x	11.5x	17.3x	17.2x	1.9%
Compcop Average:				21.1x	17.9x	9.2x	8.8x	14.4x	13.6x	3.9%
EV = Current Market Cap + Actual Net Debt				WHS Relative:	-50%	-45%	-38%	-40%	-41%	+83%

$$EV = \text{Current Market Cap} + \text{Actual Net Debt}$$

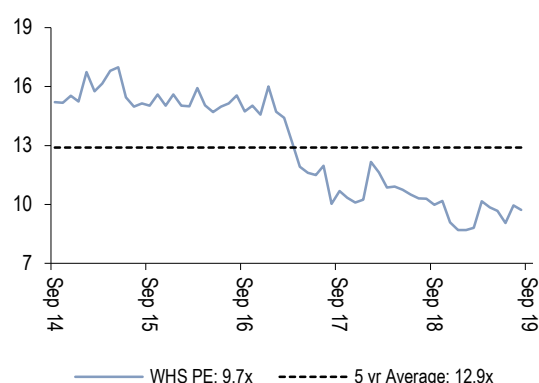
Source: *Forsyth Barr analysis. Bloomberg Consensus. Compco metrics re-weighted to reflect headline (WHS) companies fiscal year end

Figure 4. Consensus EPS Momentum



Source: Forsyth Barr analysis

Figure 5. 12 Month Forward PE



Source: Forsyth Barr analysis

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