

The Warehouse Group

FY20 Preview — Positive Sales Momentum

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RESEARCH INSIGHTS

The Warehouse Group (WHS) has pre-released headline FY20 results, reporting sales and underlying NPAT ahead of our expectations as it maintained positive trading momentum through June and July. Strong sales growth in FY20 (outside of store closures) was concentrated in brands linked to favourable category trends; work from home, home entertainment, and sporting goods. The outlook for the retail sector and WHS remains uncertain, with the nature and speed of economic recovery unknown. However, retail spending momentum has continued and sector inventory levels appear healthy, reducing the risk of elevated discounting activity. It is now clear the impact of COVID-19 lockdowns has been less worse than expected. We have made significant upgrades to our earnings forecasts as we unwind our prior assumptions.

NZX Code	WHS	Financials: Jul/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$2.20	NPAT* (NZ\$m)	74.1	84.8	67.5	78.7	PE	10.2	9.0	11.3	9.7
Issued shares	345.2m	EPS* (NZc)	21.5	24.6	19.5	22.8	EV/EBIT	7.8	6.0	5.9	5.0
Market cap	NZ\$760m	EPS growth* (%)	25.6	14.5	-20.5	16.6	EV/EBITDA	5.1	4.1	3.7	3.2
Avg daily turnover	62.7k (NZ\$142k)	DPS (NZc)	17.0	10.0	6.0	17.0	Price / NTA	1.6	1.4	1.3	1.3
		Imputation (%)	100	100	100	100	Cash div yld (%)	7.7	4.5	2.7	7.7
		*Based on normalised profits					Gross div yld (%)	10.7	6.3	3.8	10.7

WHS pre-releases FY20 headline result, full release on Thursday 15 October

WHS delivered like for like FY20 revenue growth of +1.5% on the prior year period (+3.3% when including the additional week in FY20), despite lockdowns. In June WHS provided a trading update, with year to date sales growth of +0.8%, suggesting positive sales momentum was maintained into year end. WHS reported FY20 revenue of NZ\$3.2bn and underlying NPAT of NZ\$81m, c. +1% and c. +15% ahead of expectations respectively. WHS will not pay a final dividend but expects to return to normal dividends in line with its stated policy of 75% to 85% of normalised net profit in FY21.

Key points of interest at its result

WHS will report its full FY20 result on Thursday 15 October, we look for additional detail on:

- **Recent trading performance** — Wage subsidies and other Government stimulus payments have tapered off from July. However, with the exception of the second Auckland lockdown, we suspect underlying retail activity has been robust, likely supported by a buoyant housing market and re-allocation of travel spend towards other categories.
- **Online fulfillment** — Online sales surged during New Zealand's higher alert levels, albeit penetration has lagged other retailers with fulfillment challenges limiting adoption, whilst also weighing on margins of the channel. We look for an update on status.
- **Healthy balance sheet** — WHS reported FY20 net cash position of NZ\$168m, supported by working capital management and better than expected trading. Its pre-released net cash position has reduced to c. NZ\$80m since balance date as working capital levels normalise.
- **Cost base** — WHS has made progress in addressing its labour cost base in recent months, reducing headcount. Guidance on its new cost base will be a focus for investors.

WHS will host a conference call with investors on 15 October at 9:15am NZT. Pre-register at <http://apac.directeventreg.com/registration/event/8298304>.

The Warehouse Group (WHS)

Priced as at 08 Oct 2020 (NZ\$)

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Research Insights

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.

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Valuation Ratios	2018A	2019A	2020E	2021E	2022E
Sales revenue	2,994.6	3,071.4	3,155.0	3,080.4	3,109.2	EV/EBITDA (x)	6.1	5.1	4.1	3.7	3.2
Normalised EBITDA	151.1	173.0	175.3	160.1	182.1	EV/EBIT (x)	10.1	7.8	6.0	5.9	5.0
Depreciation and amortisation	(59.6)	(60.6)	(55.6)	(59.4)	(64.1)	PE (x)	12.9	10.2	9.0	11.3	9.7
Normalised EBIT	91.4	112.4	119.6	100.8	118.0	Price/NTA (x)	1.7	1.6	1.4	1.3	1.3
Net interest	(9.2)	(8.9)	(1.6)	(6.9)	(8.6)	Free cash flow yield (%)	5.0	18.0	36.7	-13.3	3.8
Associate income	0	0	0	0	0	Net dividend yield (%)	7.3	7.7	4.5	2.7	7.7
Tax	(23.0)	(29.3)	(33.0)	(26.3)	(30.6)	Gross dividend yield (%)	10.1	10.7	6.3	3.8	10.7
Minority interests	0.2	0.1	0.1	0.1	0.1						
Normalised NPAT	59.0	74.1	84.8	67.5	78.7	Capital Structure	2018A	2019A	2020E	2021E	2022E
Abnormals/other	(31.8)	(6.8)	(36.3)	0	0	Interest cover EBIT (x)	10.0	12.7	73.9	14.7	13.7
Reported NPAT	27.3	67.3	48.6	67.5	78.7	Interest cover EBITDA (x)	16.5	19.5	>100x	23.3	21.2
Normalised EPS (cps)	17.1	21.5	24.6	19.5	22.8	Net debt/ND+E (%)	26.1	13.9	-46.8	-8.7	-2.8
DPS (cps)	16.0	17.0	10.0	6.0	17.0	Net debt/EBITDA (x)	1.1	0.4	n/a	n/a	n/a
Growth Rates	2018A	2019A	2020E	2021E	2022E	Key Ratios	2018A	2019A	2020E	2021E	2022E
Revenue (%)	0.5	2.6	2.7	-2.4	0.9	Return on assets (%)	8.9	10.8	12.7	9.8	10.9
EBITDA (%)	-9.1	14.5	1.3	-8.6	13.7	Return on equity (%)	12.8	15.7	16.1	11.7	13.1
EBIT (%)	-15.2	22.9	6.5	-15.8	17.1	Return on funds employed (%)	10.4	13.8	19.0	16.3	15.2
Normalised NPAT (%)	-13.4	25.6	14.5	-20.5	16.6	EBITDA margin (%)	5.0	5.6	5.6	5.2	5.9
Normalised EPS (%)	-13.2	25.6	14.5	-20.5	16.6	EBIT margin (%)	3.1	3.7	3.8	3.3	3.8
Ordinary DPS (%)	0.0	6.3	-41.2	-40.0	>100	Capex to sales (%)	2.3	2.0	1.0	2.1	3.7
						Capex to depreciation (%)	118	101	54	110	179
						Imputation (%)	100	100	100	100	100
						Pay-out ratio (%)	94	79	41	31	75
Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Operating Performance	2018A	2019A	2020E	2021E	2022E
EBITDA	151.1	173.0	175.3	160.1	182.1	Divisional revenue (NZ\$m)					
Working capital change	(23.6)	57.0	165.1	(166.6)	(2.4)	Red Sheds	1,716.6	1,705.7	1,703.3	1,681.7	1,687.7
Interest & tax paid	(23.4)	(35.2)	(34.7)	(33.2)	(39.2)	Blue Sheds	263.8	268.6	268.0	267.4	270.1
Other	3.9	3.2	3.2	3.2	3.2	Noel Leeming	880.5	924.6	994.5	941.9	956.0
Operating cash flow	107.9	198.0	309.0	(36.4)	143.7	Torpedo7	163.4	172.5	188.9	188.9	194.5
Capital expenditure	(70.2)	(61.3)	(30.0)	(65.0)	(115.0)	Total revenue	2,994.6	3,071.4	3,155.0	3,080.4	3,109.2
(Acquisitions)/divestments	29.5	3.7	0	0	0						
Other	0	(1.4)	0	0	0	Gross profit (NZ\$m)	991.2	1,028.6	983.0	989.4	1,010.3
Funding available/(required)	67.2	139.0	279.0	(101.4)	28.7	Gross margin (%)	33	33	31	32	32
Dividends paid	(55.8)	(52.3)	(34.5)	(20.7)	(58.7)						
Equity raised/(returned)	0	0	0	0	0	Divisional EBIT (NZ\$m)					
(Increase)/decrease in net debt	11.4	86.7	244.5	(122.1)	(30.0)	Red Sheds	71	85	91	86	89
						Blue Sheds	11	17	17	15	15
						Noel Leeming	31	38	47	33	38
						Torpedo7	(1.4)	(7.0)	(5.3)	(6.7)	0.8
						Total EBIT	91	112	120	101	118
Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E	EBIT margins (%)					
Working capital	324.6	255.9	90.7	257.3	259.6	Red Sheds	4.2	5.0	5.3	5.1	5.3
Fixed assets	353.9	346.7	321.0	326.7	377.6	Blue Sheds	4.0	6.2	6.4	5.7	5.5
Intangibles	0	0	0	0	0	Noel Leeming	3.5	4.1	4.7	3.5	4.0
Right of use asset	0	0	0	0	0	Torpedo7	-0.9	-4.1	-2.8	-3.5	0.4
Other assets	46.7	38.5	38.5	38.5	38.5	Group	3.1	3.7	3.8	3.3	3.8
Total funds employed	725.2	641.0	450.2	622.4	675.7						
Net debt/(cash)	162.3	76.2	(168.3)	(46.2)	(16.2)						
Lease liability	0	0	0	0	0						
Other liabilities	101.6	90.7	90.7	90.7	90.7						
Shareholder's funds	460.4	473.4	527.6	577.7	601.1						
Minority interests	0.9	0.7	0.1	0.1	0.1						
Total funding sources	725.2	641.0	450.2	622.4	675.7						

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

Earnings changes

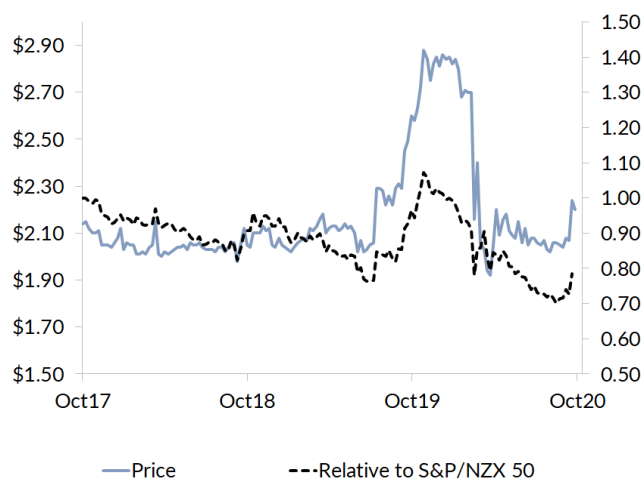
The impact of COVID-19 and temporary store closures has been less worse than expected for the retail sector and WHS. Consumer activity surged as lockdowns were lifted and has maintained positive momentum for the remainder of the period. As a result sector inventory levels appear healthy, alleviating risk of elevated discounting activity and therefore margin pressure. We have made significant changes to FY21 and FY22 earnings assumptions, as we unwind our prior COVID-19 downgrades.

Upgrades are driven by increased sales per store and group gross margin assumptions. In addition we lower our operating cost base as we give more credit on cost out initiatives and reflect store closures.

Figure 1. Earnings changes (NZ\$m)

	Old	FY20E New	% chg	Old	FY21E New	% chg	Old	FY22E New	% chg
Sales	3,117.4	3,155	1%	3,001.4	3,080	3%	3,054.9	3,109	2%
EBIT	110.4	119.6	8%	55.5	100.8	82%	98.7	118.0	20%
Normalised profit	74.0	84.8	15%	34.9	67.5	93%	64.7	78.7	22%
Underlying EPS	21.4	24.6	15%	10.1	19.5	93%	18.8	22.8	22%
DPS	10.0	10.0	-	6.0	6.0	-	14.0	17.0	21%

Source: Forsyth Barr analysis

Figure 2. Price performance


Source: Forsyth Barr analysis

Figure 3. Substantial shareholders

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

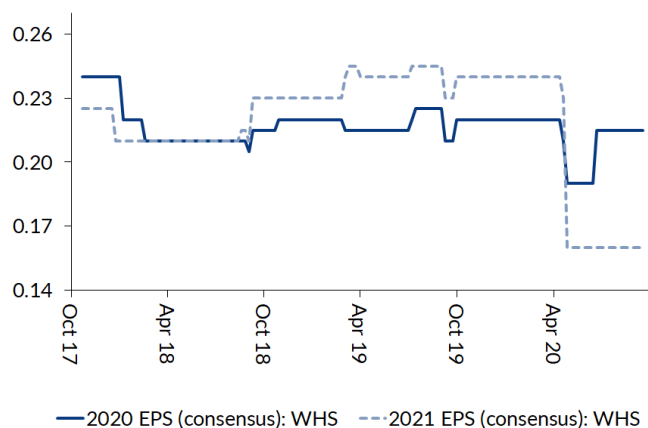
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 4. International valuation comparisons

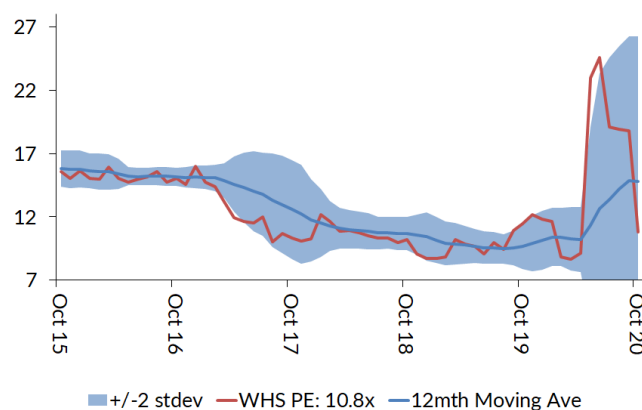
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect WHS's balance date - July)										
			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
The Warehouse Group	WHS NZ	NZ\$2.20	NZ\$760	9.0x	11.3x	4.8x	5.2x	7.0x	8.3x	2.7%
BRISCOE GROUP *	BGP NZ	NZ\$3.95	NZ\$879	13.7x	14.3x	7.1x	6.5x	8.2x	8.3x	5.4%
COSTCO WHOLESALE CORP	COST US	US\$363.99	US\$160,603	38.2x	34.7x	20.8x	19.2x	26.6x	24.2x	0.9%
TARGET CORP	TGT US	US\$161.14	US\$80,670	23.7x	21.7x	12.2x	11.9x	18.8x	17.4x	1.7%
REJECT SHOP/THE	TRS AT	A\$6.86	A\$263	>50x	33.6x	3.8x	12.2x	38.4x	30.0x	0.1%
WALMART INC	WMT US	US\$141.30	US\$400,409	26.6x	25.6x	13.5x	13.4x	21.3x	19.9x	1.6%
KATHMANDU HOLDINGS *	KMD NZ	NZ\$1.28	NZ\$908	28.8x	18.8x	11.0x	8.9x	16.3x	13.0x	3.1%
MICHAEL HILL INTL *	MHJ NZ	A\$0.43	A\$167	<0x	7.4x	2.2x	1.8x	10.6x	4.3x	6.5%
Compc Average:				26.2x	22.3x	10.1x	10.6x	20.0x	16.7x	2.8%
WHS Relative:				-66%	-50%	-53%	-51%	-65%	-50%	-1%
EV = Current Market Cap + Actual Net Debt										

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

Figure 5. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 6. One year forward PE (x)


Source: Forsyth Barr analysis

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