

The Warehouse Group

FY20 Preview – Positive Sales Momentum

GUY HOOPER

 guy.hooper@forsythbarr.co.nz
 +64 4 495 5255

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\$)

2.20

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						
EBITDA	151.1	173.0	175.3	160.1	182.1	Operating Performance	2018A	2019A	2020E	2021E	2022E
Working capital change	(23.6)	57.0	165.1	(166.6)	(2.4)	Divisional revenue (NZ\$m)					
Interest & tax paid	(23.4)	(35.2)	(34.7)	(33.2)	(39.2)	Red Sheds	1,716.6	1,705.7	1,703.3	1,681.7	1,687.7
Other	3.9	3.2	3.2	3.2	Blue Sheds	263.8	268.6	268.0	267.4	270.1	
Operating cash flow	107.9	198.0	309.0	(36.4)	143.7	Noel Leeming	880.5	924.6	994.5	941.9	956.0
Capital expenditure	(70.2)	(61.3)	(30.0)	(65.0)	(115.0)	Torpedo7	163.4	172.5	188.9	188.9	194.5
(Acquisitions)/divestments	29.5	3.7	0	0	0	Total revenue	2,994.6	3,071.4	3,155.0	3,080.4	3,109.2
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						
(Increase)/decrease in net debt	11.4	86.7	244.5	(122.1)	(30.0)						
Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Divisional EBIT (NZ\$m)					
Working capital	324.6	255.9	90.7	257.3	259.6	Red Sheds	71	85	91	86	89
Fixed assets	353.9	346.7	321.0	326.7	377.6	Blue Sheds	11	17	17	15	15
Intangibles	0	0	0	0	0	Noel Leeming	31	38	47	33	38
Right of use asset	0	0	0	0	0	Torpedo7	(1.4)	(7.0)	(5.3)	(6.7)	0.8
Other assets	46.7	38.5	38.5	38.5	38.5	Total EBIT	91	112	120	101	118
Total funds employed	725.2	641.0	450.2	622.4	675.7	EBIT margins (%)					
Net debt/(cash)	162.3	76.2	(168.3)	(46.2)	(16.2)	Red Sheds	4.2	5.0	5.3	5.1	5.3
Lease liability	0	0	0	0	0	Blue Sheds	4.0	6.2	6.4	5.7	5.5
Other liabilities	101.6	90.7	90.7	90.7	90.7	Noel Leeming	3.5	4.1	4.7	3.5	4.0
Shareholder's funds	460.4	473.4	527.6	577.7	601.1	Torpedo7	-0.9	-4.1	-2.8	-3.5	0.4
Minority interests	0.9	0.7	0.1	0.1	0.1	Group	3.1	3.7	3.8	3.3	3.8
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

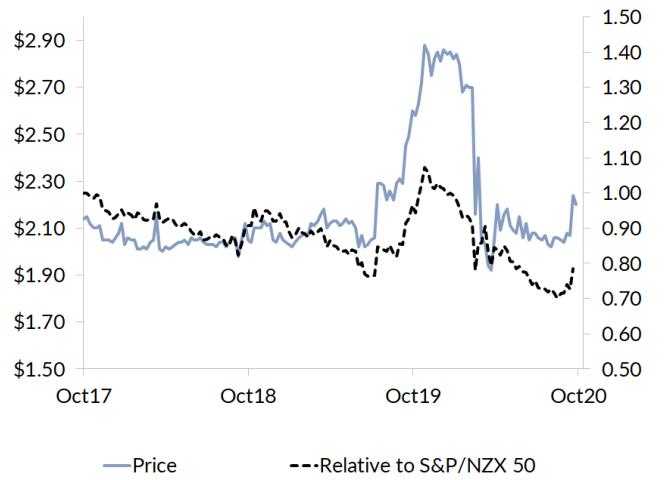
The impact of COVID-19 and temporary store closures has been less worse than expected for the retail sector and WHS. Consumer activity surged as lockdowns were lifted and has maintained positive momentum for the remainder of the period. As a result sector inventory levels appear healthy, alleviating 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)

	FY20E		% chg	FY21E		% chg	FY22E		% chg
	Old	New		Old	New		Old	New	
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

Figure 3. Substantial shareholders

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

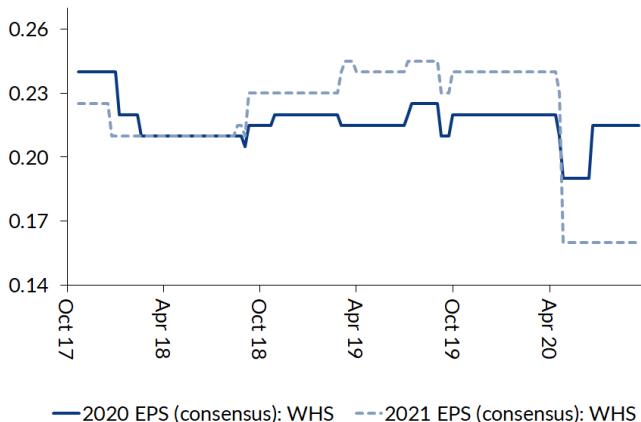
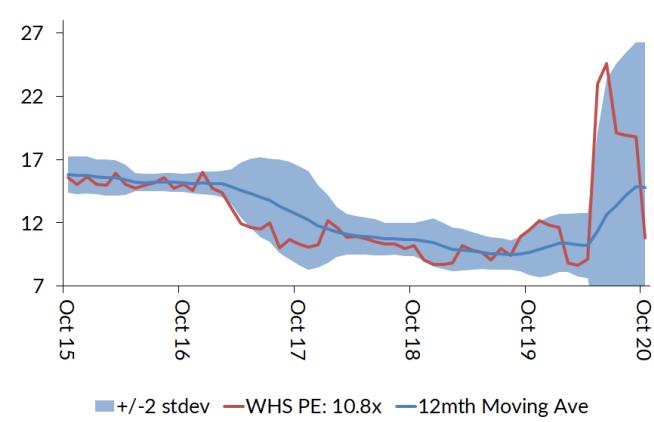
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 4. International valuation comparisons

Company (metrics re-weighted to reflect WHS's balance date - July)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E	
				2020E	2021E	2020E	2021E	2020E	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%	
				Compco 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

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

Figure 5. Consensus EPS momentum (NZ\$)

Figure 6. One year forward PE (x)


Analyst certification: The research analyst(s) primarily responsible for the preparation and content of this publication ("Analysts") are named on the first page of this publication. Each such Analyst certifies (other than in relation to content or views expressly attributed to another analyst) that (i) the views expressed in this publication accurately reflect their personal views about each issuer and financial product referenced and were prepared in an independent manner, including with respect to Forsyth Barr Limited and its related companies; and (ii) no part of the Analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that Analyst in this report.

Analyst holdings: The following Analyst(s) have a threshold interest in the financial products referred to in this publication: N/A. For these purposes, a threshold interest is defined as being a holder of more than \$50,000 in value or 1% of the financial products on issue, whichever is the lesser.

Ratings distributions: As at 7 Oct 2020, Forsyth Barr's research ratings were distributed as follows:

	OUTPERFORM	NEUTRAL	UNDERPERFORM
41.5%	45.3%	13.2%	

Forsyth Barr's research ratings are OUTPERFORM, NEUTRAL, and UNDERPERFORM. The ratings are relative to our other equity security recommendations across our New Zealand market coverage and are based on risk-adjusted Estimated Total Returns for the securities in question. Risk-adjusted Estimated Total Returns are calculated from our assessment of the risk profile, expected dividends and target price for the relevant security.

Disclosure: Forsyth Barr Limited and its related companies (and their respective directors, officers, agents and employees) ("Forsyth Barr") may have long or short positions or otherwise have interests in the financial products referred to in this publication, and may be directors or officers of, and/or provide (or be intending to provide) investment banking or other services to, the issuer of those financial products (and may receive fees for so acting). Forsyth Barr is not a registered bank within the meaning of the Reserve Bank of New Zealand Act 1989. Forsyth Barr may buy or sell financial products as principal or agent, and in doing so may undertake transactions that are not consistent with any recommendations contained in this publication. Other Forsyth Barr business units may hold views different from those in this publication; any such views will generally not be brought to your attention. Forsyth Barr confirms no inducement has been accepted from the issuer(s) that are the subject of this publication, whether pecuniary or otherwise, in connection with making any recommendation contained in this publication. In preparing this publication, non-financial assistance (for example, access to staff or information) may have been provided by the issuer(s) being researched.

Investment banking engagements: Other than confidential engagements, Forsyth Barr has not within the past 12 months been engaged to provide investment banking services to the issuer that is the subject of this publication. For information about whether Forsyth Barr has within the past 12 months been engaged to provide investment banking services to any other issuer referred to in this publication, please refer to the most recent research report for that issuer's financial products.

Not personalised financial advice: The recommendations and opinions in this publication do not take into account your personal financial situation or investment goals. The financial products referred to in this publication may not be suitable for you. If you wish to receive personalised financial advice, please contact your Forsyth Barr Investment Adviser. The value of financial products may go up and down and investors may not get back the full (or any) amount invested. Past performance is not necessarily indicative of future performance. Disclosure statements for Forsyth Barr Investment Advisers are available on request and free of charge.

Disclaimer: This publication has been prepared in good faith based on information obtained from sources believed to be reliable and accurate. However, that information has not been independently verified or investigated by Forsyth Barr. Forsyth Barr does not make any representation or warranty (express or implied) that the information in this publication is accurate or complete, and, to the maximum extent permitted by law, excludes and disclaims any liability (including in negligence) for any loss which may be incurred by any person acting or relying upon any information, analysis, opinion or recommendation in this publication. Forsyth Barr does not undertake to keep current this publication; any opinions or recommendations may change without notice to you. Any analyses or valuations will typically be based on numerous assumptions; different assumptions may yield materially different results. Nothing in this publication should be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from doing so, or to engage in any other transaction. This publication is not intended to be distributed or made available to any person in any jurisdiction where doing so would constitute a breach of any applicable laws or regulations or would subject Forsyth Barr to any registration or licensing requirement within such jurisdiction.

Terms of use: Copyright Forsyth Barr Limited. You may not redistribute, copy, revise, amend, create a derivative work from, extract data from, or otherwise commercially exploit this publication in any way. By accessing this publication via an electronic platform, you agree that the platform provider may provide Forsyth Barr with information on your readership of the publications available through that platform.