

The Warehouse Group

Shepherd's Delight

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RESEARCH INSIGHTS

The Warehouse (WHS) has delivered an early Christmas present highlighting both strong sales performance and margin expansion year to date. A buoyant consumer backdrop and exposure to retail categories benefitting from nesting and athletic trends are likely to support continued momentum into the key Christmas sales period. WHS has issued 1H21 guidance of underlying NPAT in excess of NZ\$70m (Forsyth Barr NZ\$73m). In addition, WHS has signalled plans to repay the government wage subsidy (NZ\$68m) following recent earnings strength.

NZX Code	WHS	Financials: Jul/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$2.55	NPAT* (NZ\$m)	80.0	49.0	90.0	94.6	PE	11.0	18.0	9.8	9.3
Issued shares	345.3m	EPS* (NZc)	23.2	14.2	26.1	27.4	EV/EBIT	11.9	9.8	10.5	10.1
Market cap	NZ\$880m	EPS growth* (%)	7.7	-38.8	83.8	5.1	EV/EBITDA	4.0	5.1	5.4	5.1
Avg daily turnover	68.4k (NZ\$152k)	DPS (NZc)	0.0	14.0	18.0	20.0	Price / NTA	3.6	2.7	2.4	2.2
		Imputation (%)	100	100	100	100	Cash div yld (%)	0.0	5.5	7.1	7.8
		*Based on normalised profits					Gross div yld (%)	0.0	7.6	9.8	10.9

What's changed?

- **Earnings:** We materially lift our underlying FY21E NPAT forecast, up +32% to NZ\$92m (FY21E reported profit forecast falls as a result of wage subsidy repayment). We make small positive changes to our sales assumptions but lift gross margin expectations, driving an increase of +14% and +4% to FY22E and FY23E NPAT respectively.
- **Dividend:** We lift our FY21E dividend assumption +40% to 14cps, reflecting the underlying earnings strength and net cash position. We also lift FY22E and FY23E dividend assumptions in line with earnings changes. WHS offers an attractive 6.1% 12 month forward cash dividend yield.

Sales accelerate into Christmas sales period

Sales momentum accelerated through November and December, with group sales up +6.6% year to date, ahead of the 1Q21 run rate (+6.3%). We suspect Noel Leeming is the standout performer, benefitting from increased nesting spend and a buoyant consumer backdrop. Whilst supply chain congestion remains a theme, WHS has indicated it expects to have sufficient inventory in place through the peak Christmas sales period, with some scope for shortages of winter product in 4Q21.

Gross margin expansion

WHS has maintained higher gross margins through recent weeks, with the company expecting 1H21E gross margin will be c. 170bp ahead of the prior period (1H20 33.6%). We suspect the supportive retail backdrop is contributing to lower sector discounting activity, particularly for Red and Blue Sheds.

Half year guidance provided

WHS has guided to 1H21 NPAT in excess of NZ\$70m, pre-repayment of the government wage subsidy (NZ\$68m), implying underlying growth of at least +52% on the prior year period (1H20 NPAT NZ\$46.2m). With strong earnings and a smaller inventory balance, WHS expect to report a 1H21 net cash balance ahead of FY20 (NZ\$168m). FY21 guidance is expected at the interim result announcement, with our base case currently assuming underlying sales momentum slows into 2H21E, turning negative in 4Q21E as the company cycles an abnormal 4Q20.

The Warehouse Group (WHS)

Priced as at 21 Dec 2020 (NZ\$)

2.55

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)	2019A	2020A	2021E	2022E	2023E	Valuation Ratios	2019A	2020A	2021E	2022E	2023E
Sales revenue	3,071.4	3,172.8	3,190.7	3,229.1	3,256.1	EV/EBITDA (x)	5.8	2.7	2.5	2.8	2.6
Normalised EBITDA	173.0	312.4	316.9	314.1	328.4	EV/EBIT (x)	9.7	8.0	4.8	5.4	5.2
Depreciation and amortisation	(60.6)	(154.7)	(144.7)	(153.0)	(161.3)	PE (x)	11.9	11.0	18.0	9.8	9.3
Normalised EBIT	102.9	104.7	164.2	161.1	167.1	Price/NTA (x)	2.5	3.6	2.7	2.4	2.2
Net interest	(8.9)	(46.7)	(36.8)	(36.1)	(35.8)	Free cash flow yield (%)	15.5	39.0	-6.1	13.9	15.9
Associate income	0	0	0	0	0	Net dividend yield (%)	6.7	0.0	5.5	7.1	7.8
Tax	(29.3)	(31.1)	(37.9)	(35.0)	(36.8)	Gross dividend yield (%)	9.3	0.0	7.6	9.8	10.9
Minority interests	0.1	(0.8)	(0.8)	(0.8)	(0.8)						
Normalised NPAT	74.2	80.0	91.7	90.0	94.6	Capital Structure	2019A	2020A	2021E	2022E	2023E
Abnormals/other	2.8	16.0	(42.8)	(0.8)	(0.8)	Interest cover EBIT (x)	11.6	2.2	4.5	4.5	4.7
Reported NPAT	67.4	43.7	49.0	90.0	94.6	Interest cover EBITDA (x)	19.5	6.7	8.6	8.7	9.2
Normalised EPS (cps)	21.5	23.2	14.2	26.1	27.4	Net debt/ND+E (%)	13.7	-80.4	-2.9	-2.1	-1.1
DPS (cps)	17.0	0	14.0	18.0	20.0	Net debt/EBITDA (x)	0.4	n/a	n/a	n/a	n/a
Growth Rates	2019A	2020A	2021E	2022E	2023E	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)	2.6	3.3	0.6	1.2	0.8	Return on assets (%)	9.8	5.6	8.1	7.8	8.0
EBITDA (%)	14.5	80.6	1.4	-0.9	4.6	Return on equity (%)	13.4	7.3	19.7	17.9	17.6
EBIT (%)	12.6	1.7	56.8	-1.9	3.8	Return on funds employed (%)	12.4	9.5	10.3	9.1	9.2
Normalised NPAT (%)	25.3	7.7	-38.8	83.8	5.1	EBITDA margin (%)	5.6	9.8	9.9	9.7	10.1
Normalised EPS (%)	25.3	7.7	-38.8	83.8	5.1	EBIT margin (%)	3.4	3.3	5.1	5.0	5.1
Ordinary DPS (%)	6.3	-100.0	n/a	28.6	11.1	Capex to sales (%)	2.0	2.0	3.5	3.5	3.5
						Capex to depreciation (%)	101	42	77	74	71
						Imputation (%)	100	100	100	100	100
						Pay-out ratio (%)	79	0	99	69	73
Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Operating Performance	2019A	2020A	2021E	2022E	2023E
EBITDA	173.0	312.4	316.9	314.1	328.4	Divisional revenue (NZ\$m)					
Working capital change	57.0	162.1	(183.9)	(7.3)	(2.0)	Red Sheds	1,705.7	1,706.0	1,745.5	1,760.9	1,769.7
Interest & tax paid	(35.2)	(66.5)	(74.7)	(71.1)	(72.5)	Blue Sheds	268.6	268.8	269.8	273.8	276.6
Other	3.2	0	0	0	0	Noel Leeming	924.6	1,010.0	970.1	984.7	994.5
Operating cash flow	198.0	408.0	58.4	235.7	253.8	Torpedo7	172.5	191.0	208.2	212.3	217.6
Capital expenditure	(61.3)	(64.5)	(111.7)	(113.0)	(114.0)	Total revenue	3,071.4	3,172.8	3,190.7	3,229.1	3,256.1
(Acquisitions)/divestments	3.7	12.0	0	0	0						
Other	(1.5)	(83.8)	(74.3)	(73.3)	(72.1)	Gross profit (NZ\$m)	1,028.6	1,034.9	1,080.3	1,068.6	1,075.8
Funding available/(required)	138.9	271.7	(127.6)	49.4	67.7	Gross margin (%)	33	33	34	33	33
Dividends paid	(52.3)	(27.9)	(27.6)	(51.8)	(72.5)						
Equity raised/(returned)	0	0	0	0	0	Divisional EBIT (NZ\$m)					
(Increase)/decrease in net debt	86.2	244.2	(155.2)	(2.3)	(4.8)	Red Sheds	85	96	103	98	97
						Blue Sheds	17	23	21	19	16
						Noel Leeming	38	46	49	40	40
						Torpedo7	(7.0)	(14.7)	(7.5)	(5.5)	1.0
						Total EBIT	103	105	164	161	167
Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E	EBIT margins (%)					
Working capital	255.9	57.1	240.9	248.2	250.2	Red Sheds	5.0	5.6	5.9	5.6	5.5
Fixed assets	221.2	197.1	267.4	326.9	375.5	Blue Sheds	6.2	8.5	7.8	6.9	5.9
Intangibles	125.5	135.6	135.6	135.6	135.6	Noel Leeming	4.1	4.6	5.1	4.0	4.0
Right of use asset	0	774.2	745.0	716.8	689.8	Torpedo7	-4.1	-7.7	-3.6	-2.6	0.4
Other assets	46.4	102.0	102.0	102.0	102.0	Group	3.4	3.3	5.1	5.0	5.1
Total funds employed	648.9	1,266.0	1,490.9	1,529.6	1,553.2						
Net debt/(cash)	76.2	(168.1)	(12.8)	(10.5)	(5.7)						
Lease liability	0	934.8	922.4	908.8	894.0						
Other liabilities	90.7	122.9	122.9	122.9	122.9						
Shareholder's funds	481.3	377.1	458.4	508.4	541.9						
Minority interests	0.7	(0.8)	0	0	0						
Total funding sources	648.9	1,266.0	1,490.9	1,529.6	1,553.2						

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

Forecast changes

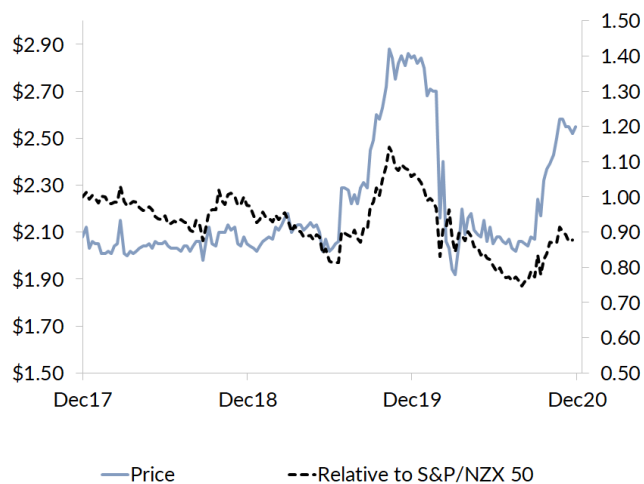
We make material near-term earnings changes to FY21E, lifting group gross margin expectations and reducing our expected earnings drag from Torpedo7. We lift FY12E underlying NPAT +35% to NZ\$92m, with reported NPAT falling -28% as we factor in the repayment of the government wage subsidy. We also lift our gross margin expectations in FY22E and FY23E, driving +14% and +4% increases to Underlying NPAT respectively.

We lift our FY21E dividend forecast +40% to 14cps, recognising underlying earnings momentum and a robust balance sheet position.

Figure 1. Earnings changes (NZ\$m)

	FY21E			FY22E			FY23E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Sales	3,143.6	3,191	1%	3,181.5	3,229	1%	3,231.6	3,256	1%
EBIT	126.5	164.2	30%	148.5	161.1	8%	162.5	167.1	3%
Underlying NPAT	67.7	91.7	35%	79.2	90.0	14%	90.8	94.6	4%
Reported NPAT	67.7	49.0	-28%	79.2	90.0	14%	90.8	94.6	4%
Reported EPS	19.6	14.2	-28%	22.9	26.1	14%	26.3	27.4	4%
DPS	10.0	14.0	40%	17.0	18.0	6%	19.0	20.0	5%

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%

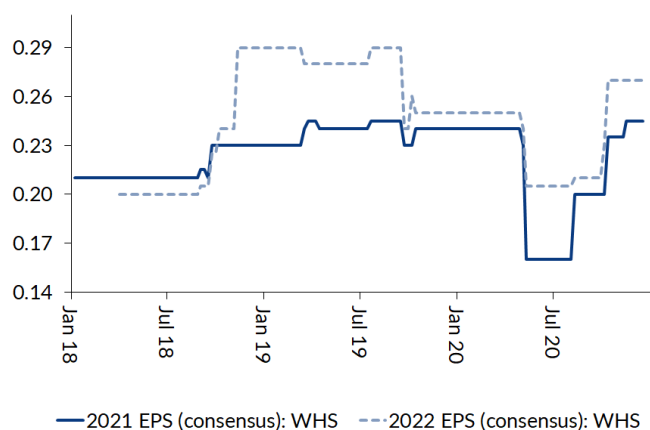
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 4. International valuation comparisons

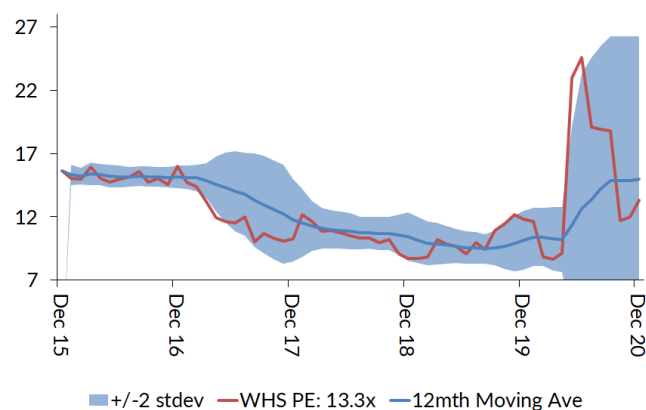
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect WHS's balance date - July)										
			(m)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
The Warehouse Group	WHS NZ	NZ\$2.55	NZ\$880	18.0x	9.8x	2.2x	2.3x	4.3x	4.4x	7.1%
BRISCOE GROUP *	BGP NZ	NZ\$5.07	NZ\$1,128	18.1x	18.6x	8.4x	8.5x	10.8x	11.0x	4.4%
COSTCO WHOLESALE CORP	COST US	US\$371.42	US\$164,496	36.8x	34.3x	20.3x	19.0x	26.0x	24.0x	0.9%
TARGET CORP	TGT US	US\$171.77	US\$85,993	19.9x	19.6x	11.1x	11.3x	15.5x	16.1x	1.7%
REJECT SHOP/THE	TRS AT	A\$7.46	A\$286	36.5x	21.2x	13.0x	10.4x	31.9x	18.6x	1.1%
WALMART INC	WMT US	US\$145.60	US\$411,916	25.8x	24.6x	13.2x	12.9x	19.5x	18.9x	1.6%
KATHMANDU HOLDINGS *	KMD NZ	NZ\$1.26	NZ\$893	18.8x	11.2x	4.6x	3.9x	12.1x	7.9x	5.6%
MICHAEL HILL INTL *	MHJ NZ	A\$0.61	A\$237	7.3x	8.2x	2.2x	2.4x	4.5x	5.1x	8.2%
Compc Average:				23.3x	19.7x	10.4x	9.7x	17.2x	14.5x	3.4%
WHS Relative:				-23%	-50%	-78%	-77%	-75%	-70%	111%
EV = Current Market Cap + Actual Net Debt										

EV = Current Market Cap + Actual Net Debt

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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