

The Warehouse Group

Wind in its Sails

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RESEARCH INSIGHTS

The Warehouse (WHS) upgraded its 1H21 earnings guidance, highlighting strong sales as consumer momentum continued through the important holiday trading period. A buoyant consumer backdrop, exposure to favourable retail categories, and lower sector discounting activity supported further earnings growth. WHS has issued 1H21 earnings guidance of underlying NPAT in excess of NZ\$90m (Forsyth Barr NZ\$93m), pre the re-payment of the government wage subsidy.

| NZX Code | WHS | Financials: Jul/ | 20A | 21E | 22E | 23E | Valuation (x) | 20A | 21E | 22E | 23E |
|--------------------|------------------|------------------------------|------|-------|-------|------|-------------------|------|------|------|------|
| Share price | NZ\$2.80 | NPAT* (NZ\$m) | 80.0 | 131.2 | 90.0 | 95.2 | PE | 12.1 | 7.4 | 10.7 | 10.2 |
| Issued shares | 345.3m | EPS* (NZc) | 23.2 | 38.0 | 26.1 | 27.6 | EV/EBIT | 12.8 | 8.0 | 10.6 | 10.2 |
| Market cap | NZ\$967m | EPS growth* (%) | 7.7 | 64.0 | -31.4 | 5.8 | EV/EBITDA | 4.3 | 4.6 | 5.5 | 5.2 |
| Avg daily turnover | 73.1k (NZ\$165k) | DPS (NZc) | 0.0 | 22.0 | 18.0 | 20.0 | Price / NTA | 4.0 | 3.3 | 2.9 | 2.7 |
| | | Imputation (%) | 100 | 100 | 100 | 100 | Cash div yld (%) | 0.0 | 7.9 | 6.4 | 7.1 |
| | | *Based on normalised profits | | | | | Gross div yld (%) | 0.0 | 10.9 | 8.9 | 9.9 |

What's changed?

- **Earnings:** We lift our FY21E underlying NPAT forecast to NZ\$131m from NZ\$92m (up +43%). Our forecasts assume sales slow in 2H21 (+2% growth on 2H19), with upside should the current consumer momentum continue. We make limited changes to later forecast years.
- **Dividend:** We lift our FY21E dividend forecast +57% to 22cps (58% payout). We expect an update to WHS's dividend policy when it announces its 1H21 result in March.

Christmas better than expected

WHS lifted 1H21 Adjusted NPAT guidance +NZ\$20m (c. +30%) to in excess of NZ\$90m following strong trading through the Christmas period, continued momentum into January, and reflecting further confidence in its short-term outlook. Red Sheds and Noel Leeming remain the standout performers, likely benefitting from favourable category exposure. In addition, its online channel likely performed well against a weak prior period, which had been impacted by fulfillment issues.

Operating leverage key driver of earnings upgrade

WHS reiterated its gross margin expectations, c. +170bp above the prior comparable period (1H20 33.6%), as tight inventory positions and motivated consumers reduced discounting activity across the sector. We estimate the updated 1H21 guidance implied sales c. +5% ahead of our prior expectations, with the high degree of operating leverage, particularly through Red Sheds, driving the significant earnings upgrade.

Balance sheet well positioned, although inventory levels a possible risk

WHS reiterated balance sheet commentary, indicating it expects to report a 1H21 net cash position in excess of FY20 (NZ\$168m), after having repaid the government wage subsidy of NZ\$68m. Whilst its cash balance is in part driven by earnings strength, it is also supported by lower inventory levels (FY20 c. NZ\$100m lower than the prior period). We expect the working capital position to largely reverse as supply chains normalise, although with possible inventory shortage risk signalled in 4Q21.

The Warehouse Group (WHS)

Priced as at 08 Jan 2021 (NZ\$)

2.80

Research Insights

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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 | 3,302.0 | 3,230.6 | 3,244.5 | EV/EBITDA (x) | 6.3 | 2.9 | 2.3 | 2.9 | 2.7 |
| Normalised EBITDA | 173.0 | 312.4 | 362.2 | 315.4 | 330.3 | EV/EBIT (x) | 10.6 | 8.8 | 4.1 | 5.6 | 5.4 |
| Depreciation and amortisation | (60.6) | (154.7) | (144.7) | (153.8) | (161.9) | PE (x) | 13.0 | 12.1 | 7.4 | 10.7 | 10.2 |
| Normalised EBIT | 102.9 | 104.7 | 209.5 | 161.6 | 168.4 | Price/NTA (x) | 2.7 | 4.0 | 3.3 | 2.9 | 2.7 |
| Net interest | (8.9) | (46.7) | (35.3) | (36.6) | (36.1) | Free cash flow yield (%) | 14.1 | 35.5 | 1.0 | 7.9 | 14.8 |
| Associate income | 0 | 0 | 0 | 0 | 0 | Net dividend yield (%) | 6.1 | 0.0 | 7.9 | 6.4 | 7.1 |
| Tax | (29.3) | (31.1) | (51.0) | (35.0) | (37.0) | Gross dividend yield (%) | 8.4 | 0.0 | 10.9 | 8.9 | 9.9 |
| Minority interests | 0.1 | (0.8) | (0.8) | (0.8) | (0.8) | | | | | | |
| Normalised NPAT | 74.2 | 80.0 | 131.2 | 90.0 | 95.2 | Capital Structure | 2019A | 2020A | 2021E | 2022E | 2023E |
| Abnormals/other | 2.8 | 16.0 | (47.1) | (0.8) | (0.8) | Interest cover EBIT (x) | 11.6 | 2.2 | 5.9 | 4.4 | 4.7 |
| Reported NPAT | 67.4 | 43.7 | 76.9 | 90.0 | 95.2 | Interest cover EBITDA (x) | 19.5 | 6.7 | 10.3 | 8.6 | 9.1 |
| Normalised EPS (cps) | 21.5 | 23.2 | 38.0 | 26.1 | 27.6 | Net debt/ND+E (%) | 13.7 | -80.4 | -17.0 | 0.0 | 0.3 |
| DPS (cps) | 17.0 | 0 | 22.0 | 18.0 | 20.0 | Net debt/EBITDA (x) | 0.4 | n/a | n/a | n/a | 0.0 |
| | | | | | | | | | | | |
| Growth Rates | 2019A | 2020A | 2021E | 2022E | 2023E | Key Ratios | 2019A | 2020A | 2021E | 2022E | 2023E |
| Revenue (%) | 2.6 | 3.3 | 4.1 | -2.2 | 0.4 | Return on assets (%) | 9.8 | 5.6 | 10.7 | 7.9 | 8.2 |
| EBITDA (%) | 14.5 | 80.6 | 15.9 | -12.9 | 4.7 | Return on equity (%) | 13.4 | 7.3 | 28.8 | 19.5 | 19.2 |
| EBIT (%) | 12.6 | 1.7 | >100 | -22.9 | 4.2 | Return on funds employed (%) | 12.4 | 9.5 | 13.6 | 9.5 | 9.5 |
| Normalised NPAT (%) | 25.3 | 7.7 | 64.0 | -31.4 | 5.8 | EBITDA margin (%) | 5.6 | 9.8 | 11.0 | 9.8 | 10.2 |
| Normalised EPS (%) | 25.3 | 7.7 | 64.0 | -31.4 | 5.8 | EBIT margin (%) | 3.4 | 3.3 | 6.3 | 5.0 | 5.2 |
| Ordinary DPS (%) | 6.3 | -100.0 | n/a | -18.2 | 11.1 | Capex to sales (%) | 2.0 | 2.0 | 3.5 | 3.5 | 3.5 |
| | | | | | | Capex to depreciation (%) | 101 | 42 | 80 | 74 | 70 |
| Cash Flow (NZ\$m) | 2019A | 2020A | 2021E | 2022E | 2023E | Imputation (%) | 100 | 100 | 100 | 100 | 100 |
| EBITDA | 173.0 | 312.4 | 362.2 | 315.4 | 330.3 | Pay-out ratio (%) | 79 | 0 | 58 | 69 | 73 |
| Working capital change | 57.0 | 162.1 | (101.8) | (54.1) | (0.8) | | | | | | |
| Interest & tax paid | (35.2) | (66.5) | (86.3) | (71.6) | (73.2) | Operating Performance | 2019A | 2020A | 2021E | 2022E | 2023E |
| Other | 3.2 | 0 | (48.5) | 0 | 0 | Divisional revenue (NZ\$m) | | | | | |
| Operating cash flow | 198.0 | 408.0 | 125.6 | 189.8 | 256.3 | Red Sheds | 1,705.7 | 1,706.0 | 1,787.5 | 1,741.3 | 1,741.3 |
| Capital expenditure | (61.3) | (64.5) | (115.6) | (113.1) | (113.6) | Blue Sheds | 268.6 | 268.8 | 273.9 | 273.9 | 276.6 |
| (Acquisitions)/divestments | 3.7 | 12.0 | 0 | 0 | 0 | Noel Leeming | 924.6 | 1,010.0 | 1,014.7 | 984.2 | 989.1 |
| Other | (1.5) | (83.8) | (74.3) | (73.3) | (72.1) | Torpedo7 | 172.5 | 191.0 | 229.2 | 233.7 | 239.6 |
| Funding available/(required) | 138.9 | 271.7 | (64.2) | 3.4 | 70.6 | Total revenue | 3,071.4 | 3,172.8 | 3,302.0 | 3,230.6 | 3,244.5 |
| Dividends paid | (52.3) | (27.9) | (41.4) | (65.6) | (72.5) | | | | | | |
| Equity raised/(returned) | 0 | 0 | 0 | 0 | 0 | Gross profit (NZ\$m) | 1,028.6 | 1,034.9 | 1,123.6 | 1,068.0 | 1,068.8 |
| (Increase)/decrease in net debt | 86.2 | 244.2 | (105.7) | (62.2) | (1.9) | Gross margin (%) | 33 | 33 | 34 | 33 | 33 |
| | | | | | | | | | | | |
| Balance Sheet (NZ\$m) | 2019A | 2020A | 2021E | 2022E | 2023E | Divisional EBIT (NZ\$m) | | | | | |
| Working capital | 255.9 | 57.1 | 158.8 | 212.9 | 213.7 | Red Sheds | 85 | 96 | 123 | 91 | 94 |
| Fixed assets | 221.2 | 197.1 | 271.3 | 330.1 | 377.6 | Blue Sheds | 17 | 23 | 24 | 19 | 16 |
| Intangibles | 125.5 | 135.6 | 135.6 | 135.6 | 135.6 | Noel Leeming | 38 | 46 | 63 | 40 | 39 |
| Right of use asset | 0 | 774.2 | 745.0 | 716.8 | 689.8 | Torpedo7 | (7.0) | (14.7) | 0.5 | 2.6 | 7.0 |
| Other assets | 46.4 | 102.0 | 102.0 | 102.0 | 102.0 | Total EBIT | 103 | 105 | 209 | 162 | 168 |
| Total funds employed | 648.9 | 1,266.0 | 1,412.7 | 1,497.5 | 1,518.8 | | | | | | |
| Net debt/(cash) | 76.2 | (168.1) | (62.4) | (0.2) | 1.7 | EBIT margins (%) | | | | | |
| Lease liability | 0 | 934.8 | 922.4 | 908.8 | 894.0 | Red Sheds | 5.0 | 5.6 | 6.9 | 5.2 | 5.4 |
| Other liabilities | 90.7 | 122.9 | 122.9 | 122.9 | 122.9 | Blue Sheds | 6.2 | 8.5 | 8.9 | 6.9 | 5.9 |
| Shareholder's funds | 481.3 | 377.1 | 429.7 | 466.0 | 500.1 | Noel Leeming | 4.1 | 4.6 | 6.2 | 4.0 | 3.9 |
| Minority interests | 0.7 | (0.8) | 0 | 0 | 0 | Torpedo7 | -4.1 | -7.7 | 0.2 | 1.1 | 2.9 |
| Total funding sources | 648.9 | 1,266.0 | 1,412.7 | 1,497.5 | 1,518.8 | Group | 3.4 | 3.3 | 6.3 | 5.0 | 5.2 |

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

Earnings changes

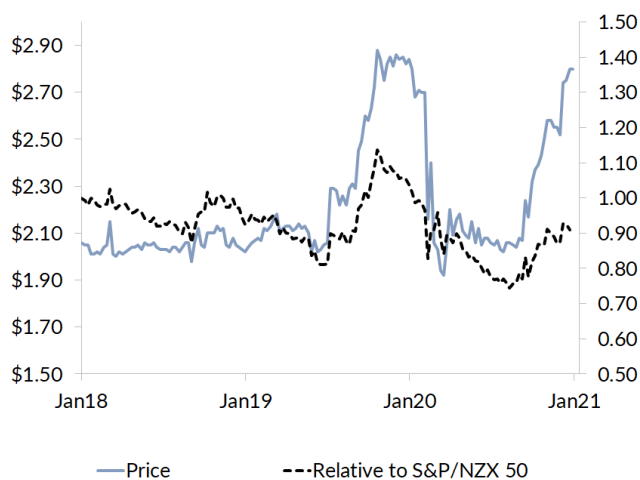
WHS has updated its 1H21 earnings guidance, indicating it expects underlying NPAT to be in excess of NZ\$90m, up c. +30% on its prior guidance commentary in December 2020. We lift our FY21E forecast to NZ\$131m from NZ\$92m reflecting revised 1H21 guidance, and higher sales growth and margin realisation in 2H21.

WHS's strong trading through the holiday period corroborates our view that the retail sector is benefitting from ongoing border closures and reallocation of travel spend. Our base case assumes sales momentum slows into 2H21E, as it cycles tougher comparable periods (particularly at Noel Leeming where products typically have a longer upgrade cycle), and as vaccine news leads to income preservation for travel. However, should sales momentum continue, the high degree of operating leverage could provide material upside to near-term forecasts.

Figure 1. Earnings changes (NZ\$m)

| | FY21E | | | FY22E | | | FY23E | | |
|--------------------------|---------|-------|-------|---------|-------|-------|---------|-------|-------|
| | Old | New | % chg | Old | New | % chg | Old | New | % chg |
| Sales | 3,190.7 | 3,302 | 3% | 3,229.1 | 3,231 | 0% | 3,256.1 | 3,244 | -0% |
| EBIT | 164.2 | 209.5 | 28% | 161.1 | 161.6 | 0% | 167.1 | 168.4 | 1% |
| Normalised profit | 91.7 | 131.2 | 43% | 90.0 | 90.0 | 0% | 94.6 | 95.2 | 1% |
| Underlying EPS | 26.6 | 38.0 | 43% | 26.1 | 26.1 | 0% | 27.4 | 27.6 | 1% |
| DPS | 14.0 | 22.0 | 57% | 18.0 | 18.0 | - | 20.0 | 20.0 | - |

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% |

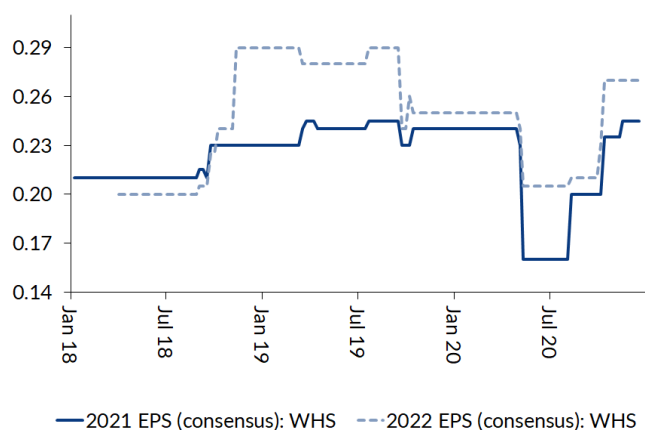
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 4. International valuation comparisons

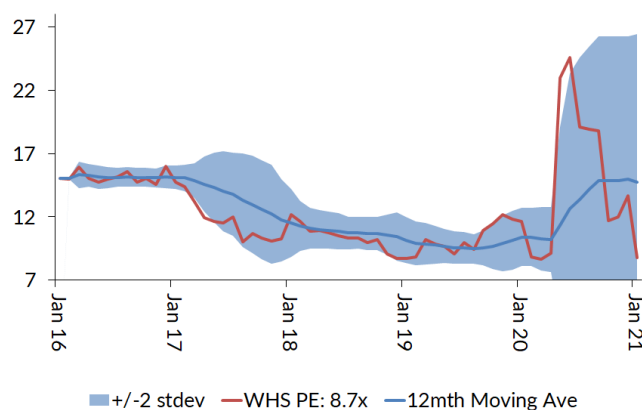
| Company | Code | Price | Mkt Cap (m) | PE 2021E | PE 2022E | EV/EBITDA 2021E | EV/EBITDA 2022E | EV/EBIT 2021E | EV/EBIT 2022E | Cash Yld 2022E |
|--|---------|------------|-------------|----------|----------|-----------------|-----------------|---------------|---------------|----------------|
| (metrics re-weighted to reflect WHS's balance date - July) | | | | | | | | | | |
| The Warehouse Group | WHS NZ | NZ\$2.80 | NZ\$967 | 7.4x | 10.7x | 2.2x | 2.5x | 3.8x | 4.9x | 6.4% |
| 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: | | | | -68% | -45% | -79% | -74% | -78% | -66% | 92% |

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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|-------------------|----------------|---------------------|
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