

The Warehouse Group

Wind in its Sails, on the Foils

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RESEARCH INSIGHTS

The Warehouse (WHS) provided yet another upgrade to its earnings guidance, following strong January trading with better than expected gross margin. The buoyant consumer backdrop has provided a significant tailwind for WHS, lifting 1H21 NPAT guidance three times in the last three months. We expect WHS and the retail sector to continue to benefit from border closures and reallocation of travel spend in the near-term. However, we currently assume sales momentum slows into 2H21E as it cycles tougher comparable periods, and as vaccine news may lead to income preservation for travel. However, should sales momentum continue, the high degree of operating leverage could provide material upside to near-term forecasts.

NZX Code	WHS	Financials: Jul/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$3.40	NPAT* (NZ\$m)	80.0	150.2	92.0	97.3	PE	14.7	7.8	12.8	12.1
Issued shares	345.3m	EPS* (NZc)	23.2	43.5	26.6	28.2	EV/EBIT	14.7	8.0	11.7	11.2
Market cap	NZ\$1,174m	EPS growth* (%)	7.7	87.8	-38.8	5.7	EV/EBITDA	4.9	4.8	6.0	5.8
Avg daily turnover	83.0k (NZ\$199k)	DPS (NZc)	0.0	24.0	18.0	20.0	Price / NTA	4.9	3.8	3.4	3.1
		Imputation (%)	100	100	100	100	Cash div yld (%)	0.0	7.1	5.3	5.9
		*Based on normalised profits					Gross div yld (%)	0.0	9.8	7.4	8.2

What's changed?

- **Earnings:** We lift our FY21E underlying NPAT forecast to NZ\$150m from NZ\$131m (up +14%). 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.

Another month, another upgrade

WHS lifted 1H21 Adjusted NPAT guidance +NZ\$20m (c. +22%) to in excess of NZ\$110m (previously in excess of NZ\$90m). This follows two prior upgrades 1) December 2020 guidance of in excess of NZ\$70m, and 2) January 2021 guidance of in excess of NZ\$90m. WHS lifted its gross margin expectations c. +185bp above the prior comparable period (1H20 33.6%, prior guidance +170bp), as tight inventory positions and motivated consumers reduced discounting activity across the sector.

WHS will report 1H21 results on 25 March

WHS is set to announce its interim result on 25 March 2021. While the reporting period will be defined by strong sales and operating leverage, we expect investor focus to be on operating expenses. WHS has targeted operating cost efficiencies through its transformation programme, with evidence of improvements a positive signal for more enduring margin gains.

Balance sheet well positioned

WHS also provided updated balance sheet commentary, indicating that it expects to report a 1H21 net cash position of NZ\$183m (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 boosted by lower inventory levels (FY20 c. -NZ\$100m lower than the prior period) due to supply chain congestion, with possible inventory shortage risk signalled in 4Q21. We expect the working capital position will need to reverse as supply chains normalise, although we note scope for product rationalisation.

The Warehouse Group (WHS)

Priced as at 25 Feb 2021 (NZ\$)

3.40

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)	7.5	3.6	2.7	3.5	3.3
Normalised EBITDA	173.0	312.4	388.2	317.5	332.4	EV/EBIT (x)	12.6	10.8	4.5	6.7	6.5
Depreciation and amortisation	(60.6)	(154.7)	(144.7)	(153.8)	(161.9)	PE (x)	15.8	14.7	7.8	12.8	12.1
Normalised EBIT	102.9	104.7	235.5	163.7	170.4	Price/NTA (x)	3.3	4.9	3.8	3.4	3.1
Net interest	(8.9)	(46.7)	(34.9)	(35.9)	(35.3)	Free cash flow yield (%)	11.6	29.3	2.5	6.7	12.3
Associate income	0	0	0	0	0	Net dividend yield (%)	5.0	0.0	7.1	5.3	5.9
Tax	(29.3)	(31.1)	(58.4)	(35.8)	(37.8)	Gross dividend yield (%)	6.9	0.0	9.8	7.4	8.2
Minority interests	0.1	(0.8)	(0.8)	(0.8)	(0.8)						
Normalised NPAT	74.2	80.0	150.2	92.0	97.3	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	6.7	4.6	4.8
Reported NPAT	67.4	43.7	95.9	92.0	97.3	Interest cover EBITDA (x)	19.5	6.7	11.1	8.8	9.4
Normalised EPS (cps)	21.5	23.2	43.5	26.6	28.2	Net debt/ND+E (%)	13.7	-80.4	-20.3	-3.1	-2.9
DPS (cps)	17.0	0	24.0	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	4.1	-2.2	0.4	Return on assets (%)	9.8	5.6	12.0	8.0	8.3
EBITDA (%)	14.5	80.6	24.3	-18.2	4.7	Return on equity (%)	13.4	7.3	32.4	19.3	19.0
EBIT (%)	12.6	1.7	>100	-30.5	4.1	Return on funds employed (%)	12.4	9.5	15.3	9.6	9.6
Normalised NPAT (%)	25.3	7.7	87.8	-38.8	5.7	EBITDA margin (%)	5.6	9.8	11.8	9.8	10.2
Normalised EPS (%)	25.3	7.7	87.8	-38.8	5.7	EBIT margin (%)	3.4	3.3	7.1	5.1	5.3
Ordinary DPS (%)	6.3	-100.0	n/a	-25.0	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	388.2	317.5	332.4	Pay-out ratio (%)	79	0	55	68	71
Working capital change	57.0	162.1	(101.8)	(54.1)	(0.8)						
Interest & tax paid	(35.2)	(66.5)	(93.3)	(71.7)	(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	144.6	191.7	258.4	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	(45.2)	5.4	72.7	Total revenue	3,071.4	3,172.8	3,302.0	3,230.6	3,244.5
Dividends paid	(52.3)	(27.9)	(48.3)	(65.6)	(72.5)						
Equity raised/(returned)	0	0	0	0	0	Gross profit (NZ\$m)	1,028.6	1,034.9	1,136.4	1,068.0	1,068.8
(Increase)/decrease in net debt	86.2	244.2	(93.6)	(60.2)	0.2	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	144	92	95
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	65	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	235	164	170
Total funds employed	648.9	1,266.0	1,412.7	1,497.5	1,518.8						
Net debt/(cash)	76.2	(168.1)	(74.5)	(14.3)	(14.5)	EBIT margins (%)					
Lease liability	0	934.8	922.4	908.8	894.0	Red Sheds	5.0	5.6	8.1	5.3	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	441.8	480.1	516.3	Noel Leeming	4.1	4.6	6.4	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	7.1	5.1	5.3

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

Earnings changes

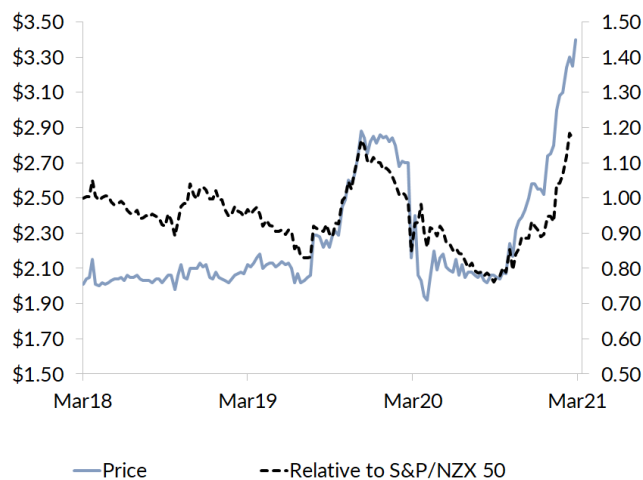
WHS has updated its 1H21 earnings guidance, indicating it expects underlying NPAT to be in excess of NZ\$110m, up c. +22% on its prior guidance commentary in January 2021, and up c. +57% on its December 2020 guidance. We lift our FY21E forecast to NZ\$150m from NZ\$131m reflecting revised 1H21 guidance. NPAT guidance is normalised for the accounting impact of wage subsidy repayment (post-tax payment c. NZ\$49m)

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)

	Old	FY21E New	% chg	Old	FY22E New	% chg	Old	FY23E New	% chg
Sales	3,302.0	3,302	-	3,230.6	3,231	-	3,244.5	3,244	-
EBIT	209.5	235.5	12%	161.6	163.7	1%	168.4	170.4	1%
Normalised profit	131.2	150.2	14%	90.0	92.0	2%	95.2	97.3	2%
Underlying EPS	38.0	43.5	15%	26.1	26.6	2%	27.6	28.2	2%
DPS	22.0	24.0	9%	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%

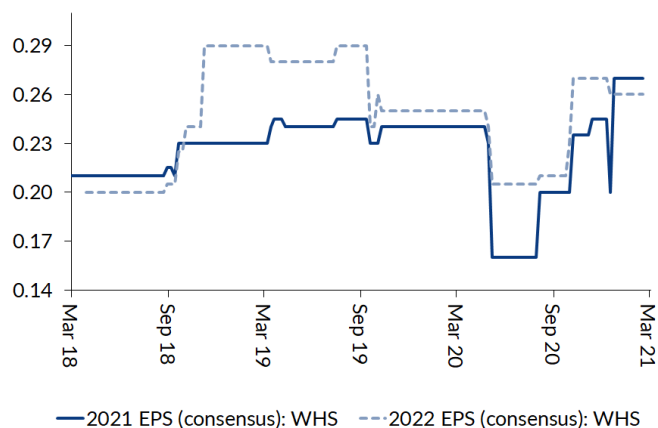
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 4. International valuation comparisons

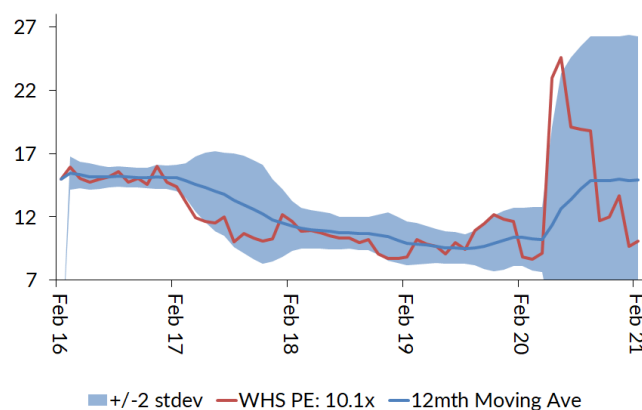
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect WHS's balance date - July)										
			(m)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
The Warehouse Group	WHS NZ	NZ\$3.40	NZ\$1,174	7.8x	12.8x	2.6x	3.2x	4.3x	6.1x	5.3%
BRISCOE GROUP *	BGP NZ	NZ\$5.80	NZ\$1,290	17.6x	17.5x	8.6x	8.6x	10.7x	10.7x	4.4%
COSTCO WHOLESALE CORP	COST US	US\$344.79	US\$152,727	34.1x	31.6x	18.7x	17.5x	23.8x	22.0x	0.9%
TARGET CORP	TGT US	US\$185.67	US\$92,979	20.6x	20.0x	11.7x	11.7x	16.2x	16.3x	1.5%
REJECT SHOP/THE	TRS AT	A\$7.02	A\$269	32.2x	18.8x	12.8x	9.6x	27.6x	16.5x	1.2%
WALMART INC	WMT US	US\$135.36	US\$382,975	26.4x	23.6x	12.6x	12.2x	19.0x	18.3x	1.7%
KATHMANDU HOLDINGS *	KMD NZ	NZ\$1.29	NZ\$915	19.2x	11.5x	4.7x	4.0x	12.4x	8.1x	5.4%
MICHAEL HILL INTL *	MHJ NZ	A\$0.76	A\$295	7.8x	9.2x	2.6x	2.8x	4.9x	5.6x	6.5%
Compc Average:				22.6x	18.9x	10.3x	9.5x	16.4x	13.9x	3.1%
WHS Relative:				-65%	-32%	-75%	-67%	-74%	-56%	71%
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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