

The Warehouse Group

FY20 — Pandemic Purchases Offset Closure

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RESEARCH INSIGHTS

The Warehouse Group (WHS) delivered a strong sales recovery led by Noel Leeming and Torpedo7 as pent up demand and nesting behaviour benefitted the technology and recreational categories. With its headline-results having been pre-released last week, the announcement provided divisional detail with few surprises. Outlook commentary was limited, citing both the elevated levels of uncertainty (economic and COVID-19 related) and the importance of the Christmas trading period. We have left our underlying forecasts effectively unchanged and continue to expect a recovery to pre COVID-19 (FY19) profitably by FY22. WHS is partway through a material transformation programme, with heightened investment requirements which continue to weigh on reported profit. With strategy execution risk, a challenging competitive backdrop, and uncertain operating conditions, we believe investors should be cautious when considering the discounted nature of its forward valuation multiples.

NZX Code	WHS	Financials: Jul/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$2.17	NPAT* (NZ\$m)	80.7	67.7	79.2	90.8	PE	9.3	11.1	9.5	8.3
Issued shares	345.2m	EPS* (NZc)	23.4	19.6	22.9	26.3	EV/EBIT	4.5	4.9	5.0	4.6
Market cap	NZ\$749m	EPS growth* (%)	8.9	-16.1	16.9	14.7	EV/EBITDA	2.3	2.3	2.5	2.4
Avg daily turnover	63.4k (NZ\$143k)	DPS (NZc)	0.0	10.0	17.0	19.0	Price / NTA	3.1	2.6	2.3	2.1
		Imputation (%)	100	100	100	100	Cash div yld (%)	0.0	4.6	7.8	8.8
		*Based on normalised profits					Gross div yld (%)	0.0	6.4	10.9	12.2

Sales bounce back following lockdown

The strong bounce back in retail activity post-lockdowns enabled WHS to report group revenue growth of +1.5% on a like for like basis (excluding the impact of an additional week in FY20) despite seven weeks of store closures. Sales growth has been category specific with technology and outdoors/recreational the highlights, underpinning strong sales performances from Noel Leeming and Torpedo7. The lower margin nature of these businesses, in combination with clearance activity and inventory write-downs, resulted in a contraction of group retail gross margin (32.6% vs FY19 33.5%). WHS reported underlying NPAT of NZ\$81m (ahead of our prior expectations), as the wage subsidy contribution (NZ\$68m) offset the earnings drag from Torpedo7 and TheMarket which continue to see elevated levels of investment. We expect TheMarket to achieve breakeven by FY24.

Balance sheet healthy

WHS reported a net cash position of NZ\$168m at year end, driven by tight working capital control as it limited inventory purchases and increased payables. We expect to see a normalisation of working capital requirements in FY21E, albeit below FY19 as it maintains lower seasonal stock keeping units (SKU). Net cash has already declined to c. NZ\$80m as inventory builds up into the Christmas trading period, and capex requirements increase. WHS guided to capex in the range of NZ\$100m to NZ\$120m over the next three years, in line with pre COVID-19 guidance.

Positive sales momentum continues although economic uncertainty overhangs outlook

Recent trading commentary suggests continued momentum, with sales tracking +6% ahead of the prior year period, albeit driven by lower margin product categories. Whilst the immediate backdrop into the key Christmas trading period has improved, we note Noel Leeming will be cycling a strong prior period and there remains some level of caution around supply chain and the developing economic backdrop (more of a 2H21 concern). WHS did not pay a final dividend, but expects to resume dividends in FY21.

The Warehouse Group (WHS)

Priced as at 15 Oct 2020 (NZ\$)

2.17

Research Insights

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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	3,143.6	3,181.5	3,231.6	EV/EBITDA (x)	5.0	2.3	2.3	2.5	2.4
Normalised EBITDA	173.0	312.4	285.0	300.3	312.1	EV/EBIT (x)	7.7	4.5	4.9	5.0	4.6
Depreciation and amortisation	(60.6)	(154.7)	(150.5)	(151.8)	(149.6)	PE (x)	10.1	9.3	11.1	9.5	8.3
Normalised EBIT	112.4	157.8	134.5	148.5	162.5	Price/NTA (x)	2.2	3.1	2.6	2.3	2.1
Net interest	(8.9)	(46.7)	(41.5)	(39.6)	(37.5)	Free cash flow yield (%)	18.2	45.9	-9.7	14.4	15.5
Associate income	0	0	0	0	0	Net dividend yield (%)	7.8	0.0	4.6	7.8	8.8
Tax	(29.3)	(31.1)	(26.0)	(30.5)	(35.0)	Gross dividend yield (%)	10.9	0.0	6.4	10.9	12.2
Minority interests	0.1	(0.8)	(0.8)	(0.8)	(0.8)						
Normalised NPAT	74.1	80.7	67.7	79.2	90.8	Capital Structure	2019A	2020A	2021E	2022E	2023E
Abnormals/other	(6.8)	(36.3)	(5.8)	0	0	Interest cover EBIT (x)	12.7	3.4	3.2	3.7	4.3
Reported NPAT	67.3	44.4	61.9	79.2	90.8	Interest cover EBITDA (x)	19.5	6.7	6.9	7.6	8.3
Normalised EPS (cps)	21.5	23.4	19.6	22.9	26.3	Net debt/ND+E (%)	13.6	-80.5	-0.9	1.8	5.2
DPS (cps)	17.0	0	10.0	17.0	19.0	Net debt/EBITDA (x)	0.4	n/a	n/a	0.0	0.1
Growth Rates	2019A	2020A	2021E	2022E	2023E	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)	2.6	3.3	-0.9	1.2	1.6	Return on assets (%)	10.7	8.5	6.7	7.3	7.9
EBITDA (%)	14.5	80.6	-8.8	5.4	3.9	Return on equity (%)	15.3	21.4	15.9	17.3	18.7
EBIT (%)	22.9	40.4	-14.8	10.5	9.4	Return on funds employed (%)	13.6	14.2	8.5	8.5	9.1
Normalised NPAT (%)	25.6	9.0	-16.1	16.9	14.7	EBITDA margin (%)	5.6	9.8	9.1	9.4	9.7
Normalised EPS (%)	25.6	8.9	-16.1	16.9	14.7	EBIT margin (%)	3.7	5.0	4.3	4.7	5.0
Ordinary DPS (%)	6.3	-100.0	n/a	70.0	11.8	Capex to sales (%)	2.0	2.0	3.5	3.6	3.7
						Capex to depreciation (%)	101	42	73	76	80
Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Imputation (%)	100	100	100	100	100
EBITDA	173.0	312.4	285.0	300.3	312.1	Pay-out ratio (%)	79	0	51	74	72
Working capital change	57.0	162.1	(180.3)	(7.2)	(3.8)						
Interest & tax paid	(35.2)	(66.5)	(67.5)	(70.1)	(72.5)	Operating Performance	2019A	2020A	2021E	2022E	2023E
Other	3.2	0	0	0	0	Divisional revenue (NZ\$m)					
Operating cash flow	198.0	408.0	37.2	223.0	235.8	Red Sheds	1,705.7	1,706.0	1,703.5	1,718.5	1,744.3
Capital expenditure	(61.3)	(64.5)	(110.0)	(115.0)	(120.0)	Blue Sheds	268.6	268.8	264.4	268.3	272.4
(Acquisitions)/divestments	3.7	12.0	0	0	0	Noel Leeming	924.6	1,010.0	970.1	984.7	999.4
Other	(1.4)	(83.8)	(74.3)	(73.2)	(72.1)	Torpedo7	172.5	191.0	208.2	212.3	217.6
Funding available/(required)	139.0	271.7	(147.1)	34.8	43.7	Total revenue	3,071.4	3,172.8	3,143.6	3,181.5	3,231.6
Dividends paid	(52.3)	(27.9)	(17.3)	(46.6)	(62.2)						
Equity raised/(returned)	0	0	0	0	0	Gross profit (NZ\$m)	1,028.6	1,034.9	1,027.2	1,042.9	1,062.0
(Increase)/decrease in net debt	86.7	243.8	(164.4)	(11.9)	(18.4)	Gross margin (%)	33	33	33	33	33
Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Divisional EBIT (NZ\$m)					
Working capital	255.9	57.1	237.3	244.5	248.3	Red Sheds	85	96	86	87	89
Fixed assets	221.2	197.1	247.8	298.7	353.5	Blue Sheds	17	23	15	16	17
Intangibles	135.6	135.6	135.6	135.6	135.6	Noel Leeming	38	46	37	39	43
Right of use asset	0	774.2	745.0	716.8	689.8	Torpedo7	(7.0)	(14.7)	(9.7)	(2.9)	1.1
Other assets	38.5	101.8	101.8	101.8	101.8	Total EBIT	112	158	134	149	163
Total funds employed	651.1	1,265.7	1,467.4	1,497.4	1,529.0						
Net debt/(cash)	76.2	(168.1)	(3.7)	8.2	26.6	EBIT margins (%)					
Lease liability	0	934.8	922.4	908.8	894.0	Red Sheds	5.0	5.6	5.0	5.1	5.1
Other liabilities	90.7	122.9	122.9	122.9	122.9	Blue Sheds	6.2	8.5	5.6	5.8	6.3
Shareholder's funds	483.4	376.9	426.6	458.3	486.2	Noel Leeming	4.1	4.6	3.8	4.0	4.3
Minority interests	0.7	(0.8)	(0.8)	(0.8)	(0.8)	Torpedo7	-4.1	-7.7	-4.7	-1.4	0.5
Total funding sources	651.1	1,265.7	1,467.4	1,497.4	1,529.0	Group	3.7	5.0	4.3	4.7	5.0

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

FY20 result summary

Divisional summary

- **Red Sheds** — Like for like (LfL, excludes impact of additional week in FY20) sales fell -1.6%. Gross margin contracted (-70bps) as it wrote-down inventory impacted by temporary store closures (groceries, green gardening etc.). One store closed during the period with three more closures announced.
- **Blue Sheds** — LfL sales fell -1.6% on the prior year period, with office furniture growth partially offsetting temporary store closures. Despite higher clearance activity, gross margin improved +50bps and EBIT margin lifted +230bps, as further store-within-a-store integrations were carried out.
- **Noel Leeming** — A standout period from Noel Leeming (record store EBIT, up +21% on the prior year period), as it benefitted from both the Rugby World Cup and work from home (WfH) driven uplifts. LfL sales increased +7.1% on the prior year period.
- **Torpedo7** — LfL sales lifted +9.2% as it benefitted from favourable category exposure. However, ongoing store investment means it continues to be an earnings drag. Two new stores were opened during the period.
- **Ecommerce** — Online sales surged (+55%), albeit penetration has generally lagged the wider retail sector with fulfilment challenges likely impacting adoption whilst also weighing on the margin achieved through the channel. Ecommerce represented 11.4% of group sales (7.8% in FY19). Penetration has normalised towards c. 9% since retail doors re-opened.

Earnings changes

Our headline earnings changes reflect the impact of IFRS-16, which has the effect of lifting reported EBIT. We have made limited changes to our underlying earnings assumption. We lift our FY21E dividend assumption to 10cps, with WHS signalling a possible return to dividends in FY21. Further guidance on its dividend policy going forward is expected at 1H21. At this stage we have taken a cautious approach to our dividend forecast, given heightened economic and COVID-19 uncertainty alongside elevated capex requirements.

Figure 1. Earnings forecast changes (NZ\$m)

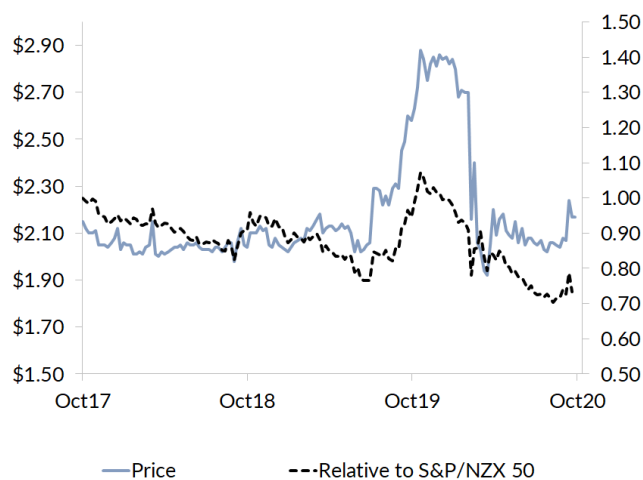
	FY21E			FY22E			FY23E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Sales	3,080.4	3,144	2%	3,109.2	3,182	2%	-	3,232	-
EBIT	100.8	134.5	33%	118.0	148.5	26%	-	162.5	-
Normalised profit	67.5	67.7	0%	78.7	79.2	1%	-	90.8	-
Underlying EPS (cps)	19.5	19.6	0%	22.8	22.9	1%	-	26.3	-
DPS (cps)	6.0	10.0	67%	17.0	17.0	-	-	19.0	-

Source: Forsyth Barr analysis

Figure 2. FY20 result breakdown (NZ\$m)

	FY19A	FY20A	Change	Comments
Profit and Loss Account				
Sales	3,071.4	3,172.8	+3.3%	+1.5% when normalising for 52 week year
Cost of Sales	(2042.7)	(2138.0)	+4.7%	Impacted by product mix, increased inventory provisioning, and higher clearance
Gross Profit	1,028.6	1,034.9	+0.6%	Gross margin down -90bps to 32.6% (FY19 33.5%)
SG&A Costs	(855.6)	(859.8)	+0.5%	CODB% down -90bps due to investment in The Market offset by wage subsidy
Total EBITDA	173.0	175.0	+1.2%	Excludes impact of IFRS-16 (reported EBITDA NZ\$312.4m)
Depreciation & Amort.	(60.6)	(58.2)	-3.9%	Excludes right of use depreciation (NZ\$96.4m)
EBIT	112.4	116.8	+3.9%	EBIT margin flat at 3.7%
Net Interest	(8.9)	(5.8)	-35.2%	Material reduction in net debt
Profit Before Tax	103.5	111.1	+7.3%	
Tax	(29.3)	(31.1)	+6.2%	Effective tax rate 28.0%
Normalised Profit	74.1	80.7	+9.0%	
Adjustments	(6.8)	(36.3)		IFRS-16, restructuring costs, derivative FV gains, and write-down of Torpedo7
Reported Profit	67.3	44.4	-34.0%	Includes wage subsidy of NZ\$67.8m
Underlying EPS (cps)	21.5c	23.4c	+8.9%	
DPS (cps)	17.0c	0.0c	-100.0%	Expect dividends to resume 1H21
Balance Sheet Summary				
Operating Cashflow	198.0	324.2	+63.7%	Driven by a significant reduction in working capital (pre IFRS-16 impact)
Inventory	517.8	393.6	-24.0%	Took on less inventory during lockdown, paired with impact of pent up demand
Fixed Assets	271.2	259.7	-4.2%	FY21-FY23 capex guidance of NZ\$100m to NZ\$120m
Working Capital	255.9	57.1	-77.7%	Since year end, working capital levels have continued to normalise (higher)
Net Debt	76.2	(168.1)	-320.7%	Cash balance expected to decline as working capital normalises
Divisional Analysis				
Red Sheds Sales	1,705.7	1,706.0	+0.0%	Same store sales (SSS, adjusted for store closures) growth of +10.4%
Blue Sheds Sales	268.6	268.8	+0.1%	SSS up +7.1%
Noel Leeming Sales	924.6	1,010.0	+9.2%	SSS up +17.2%
Torpedo7 Sales	172.5	191.0	+10.7%	SSS up +10.4%
Other	(0.0)	(3.0)	-	
Total Sales	3,071.4	3,172.8	+3.3%	
Margin and Efficiency Analysis				
Red Sheds EBIT	85.1	96.3	+13.2%	EBIT margin 5.6% (FY19 5.0%)
Blue Sheds EBIT	16.7	22.8	+36.6%	EBIT margin 8.5% (FY19 6.2%)
Noel Leeming EBIT	38.1	46.0	+20.8%	EBIT margin 4.6% (FY19 4.1%)
Torpedo7 EBIT	(7.0)	(14.7)	+109.8%	
Other EBIT	(20.4)	(33.5)	-64.1%	
Total EBIT	112.4	116.8	+3.9%	

Source: Company reports, Forsyth Barr analysis

Figure 3. Price performance


Source: Forsyth Barr analysis

Figure 4. Substantial shareholders

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

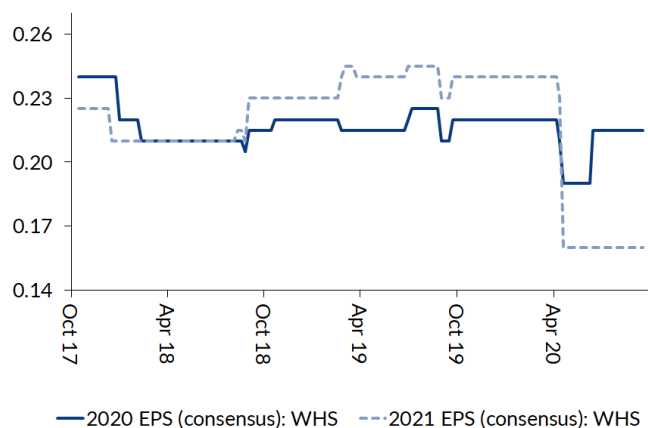
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 5. International valuation comparisons

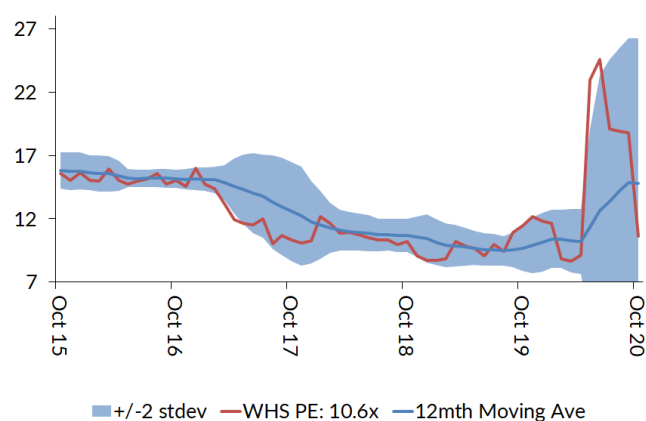
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect WHS's balance date - July)										
			(m)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
The Warehouse Group	WHS NZ	NZ\$2.17	NZ\$749	11.1x	9.5x	2.0x	1.9x	4.3x	3.9x	7.8%
BRISCOE GROUP *	BGP NZ	NZ\$3.91	NZ\$870	14.1x	14.3x	6.5x	6.4x	8.3x	8.3x	5.9%
COSTCO WHOLESALE CORP	COST US	US\$380.32	US\$167,808	39.8x	36.1x	21.7x	20.0x	27.7x	25.3x	0.9%
TARGET CORP	TGT US	US\$165.68	US\$82,942	22.3x	20.7x	12.2x	11.8x	17.8x	17.1x	1.7%
REJECT SHOP/THE	TRS AT	A\$6.95	A\$266	34.0x	19.7x	12.3x	9.8x	30.3x	17.7x	1.2%
WALMART INC	WMT US	US\$145.57	US\$412,509	26.4x	25.1x	13.7x	13.3x	20.5x	19.8x	1.5%
KATHMANDU HOLDINGS *	KMD NZ	NZ\$1.30	NZ\$922	19.1x	11.7x	9.1x	6.6x	13.2x	8.4x	5.4%
MICHAEL HILL INTL *	MHJ NZ	A\$0.44	A\$171	6.9x	6.9x	1.8x	1.8x	4.1x	4.1x	8.7%
Compc Average:				23.2x	19.2x	11.0x	10.0x	17.4x	14.4x	3.6%
WHS Relative:				-52%	-51%	-82%	-81%	-75%	-73%	116%
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 6. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 7. One year forward PE (x)


Source: Forsyth Barr analysis

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