

Turners Automotive Group Ltd

Core Auto Retailing Continues to Drive Results

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Turners Automotive's (TRA) FY24 trading update and commentary from management at its ASM highlight the continued resilience of its businesses and the success of its strategy, despite a challenging operating backdrop. TRA now expects FY24 profit before tax (PBT) to surpass the record NZ\$45.5m it achieved in FY23. Given the ongoing decline in New Zealand used car transactions and general consumer weakness amidst rising interest rates and cost of living pressures, this will be an impressive outcome. TRA expects total FY24 fully-imputed dividends to be at least NZ24cps (+4% on FY23), with the 1Q24 dividend of NZ6cps payable on 27 October 2023. Management continues to execute its strategy of generating market share gains (and shortly achieve its target of 10% market share) and cross-selling its Finance and Insurance products via its retail network. On the back of this strong execution, we raise our FY24 estimate for PBT by +11%, driven primarily by lifts to our revenue and margin assumptions in TRA's core Auto Retail segment. This flows through to +6% and +5% increases in PBT for FY25 and FY26 respectively. Our blended spot valuation increases by +8% to NZ\$4.25.

NZX Code	TRA	Financials: Mar/	23A	24E	25E	26E	Valuation (x)	23A	24E	25E	26E
Share price	NZ\$3.71	Rev (NZ\$m)	335.8	358.8	375.9	392.0	PE	10.0	9.6	8.8	8.3
Spot Valuation	NZ\$4.25 (from 3.95)	NPAT* (NZ\$m)	32.6	33.8	36.6	38.9	EV/EBIT	58.2	47.1	45.5	40.5
Risk rating	Medium	EPS* (NZc)	37.1	38.7	41.9	44.5	EV/EBITDA	29.3	24.6	24.3	22.7
Issued shares	87.4m	DPS (NZc)	23.0	24.0	28.5	29.0	Price / NTA	3.1	2.8	2.5	2.3
Market cap	NZ\$324m	Imputation (%)	100	100	100	100	Cash div yld (%)	6.2	6.5	7.7	7.8
Avg daily turnover	22.9k (NZ\$80k)	*Based on normalised profits					Gross div yld (%)	8.6	9.0	10.7	10.9

What's changed?

- **Earnings:** PBT increases by +11%/+6%/+5% in FY24/FY25/FY26.
- **Spot valuation:** Our blended spot valuation rises +NZ30cps to NZ\$4.25.

Solidifying its position as a leader in the used car market

TRA has thus far been able to successfully insulate its core Auto Retail business from general economic weakness by generating significant market share gains in New Zealand's used car market. This has been made possible by (1) investing in new sites, (2) expanding existing sites, and (3) successful advertising campaigns which have enhanced TRA's brand position. The Auto Retail business has also benefitted from favourable supply and demand dynamics in the wake of government restrictions on importing second-hand vehicles. TRA's focus on domestic sourcing has been a major competitive advantage in this regard. Two new branches in Timaru and Napier are expected to contribute in the second half of FY24, continuing the positive momentum. The company said it shortly to achieve its target of a 10% market share in used car sales.

Exposure to both sides of the credit cycle

As expected, arrears in TRA's Finance book have begun to increase as consumers are squeezed by rising interest rates and intensifying cost of living pressures. However, TRA's shift towards premium lending has continued and further protected the loan book from the ongoing credit cycle. The 'premium' proportion of TRA's finance book has grown from ~2% in FY19 to >50% in FY23. Further, TRA's credit management business benefits from heightened credit stress, providing a partial hedge. Commentary from management suggests the debt load in the credit management business is starting to increase, which should lead to a recovery in this segment and is in line with our forecasts.

Turners Automotive Group Ltd (TRA)

Market Data (NZ\$)						Spot valuation (NZ\$)					
Priced as at 23 Aug 2023						3.71	4.25				
52 week high / low						3.82 / 3.12	Discounted cash flow (DCF) 4.42				
Market capitalisation (NZ\$m)						324.1	Peers multiples 4.30				
						Discounted dividend model (DDM) 4.10					
Key WACC assumptions						DCF valuation summary (NZ\$m)					
Risk free rate						4.50%	Total firm value 882				
Equity beta						1.00	(Net debt)/cash (400)				
WACC						9.1%	Less: Capitalised operating leases (101)				
Terminal growth						1.5%	Value of equity 387				
Profit and Loss Account (NZ\$m)						Valuation Ratios					
	2022A	2023A	2024E	2025E	2026E		2022A	2023A	2024E	2025E	2026E
Revenue	298.5	335.8	358.8	375.9	392.0	EV/Sales (x)	2.1	2.0	1.9	1.8	1.7
Normalised EBITDA	18.8	23.1	27.2	27.1	29.0	EV/EBITDA (x)	n/a	n/a	n/a	n/a	n/a
Depreciation and amortisation	(10.7)	(11.5)	(13.0)	(12.6)	(12.8)	EV/EBIT (x)	n/a	n/a	n/a	n/a	n/a
Normalised EBIT	8.1	11.6	14.2	14.5	16.2	PE (x)	10.2	10.0	9.6	8.8	8.3
Net interest	35.1	33.9	32.7	36.4	37.8	Price/NTA (x)	3.8	3.1	2.8	2.5	2.3
Associate income	0	0	0	0	0	Free cash flow yield (%)	-17.5	4.5	8.1	5.9	1.7
Tax	(11.8)	(13.0)	(13.1)	(14.3)	(15.1)	Adj. free cash flow yield (%)	-13.3	15.3	12.2	9.9	5.9
Minority interests	0	0	0	0	0	Net dividend yield (%)	6.2	6.2	6.5	7.7	7.8
Normalised NPAT	31.3	32.6	33.8	36.6	38.9	Gross dividend yield (%)	8.6	8.6	9.0	10.7	10.9
Abnormals/other	0	0	0	0	0	Capital Structure					
Reported NPAT	31.3	32.6	33.8	36.6	38.9	Interest cover EBIT (x)	n/a	n/a	n/a	n/a	n/a
Normalised EPS (cps)	36.3	37.1	38.7	41.9	44.5	Interest cover EBITDA (x)	n/a	n/a	n/a	n/a	n/a
DPS (cps)	23.0	23.0	24.0	28.5	29.0	Net debt/ND+E (%)	61.7	60.0	58.1	57.1	57.1
Growth Rates						Net debt/EBITDA (x)	21.3	17.3	14.3	14.3	14.0
	2022A	2023A	2024E	2025E	2026E	Key Ratios					
Revenue (%)	14.7	12.5	6.9	4.8	4.3	Return on assets (%)	6.5	7.7	9.3	9.6	9.7
EBITDA (%)	12.1	23.1	17.6	-0.3	7.3	Return on equity (%)	12.6	12.2	12.1	12.6	12.7
EBIT (%)	51.7	44.1	22.3	1.9	12.2	Return on funds employed (%)	3.9	3.9	4.0	4.2	4.3
Normalised NPAT (%)	27.5	4.1	3.8	8.4	6.1	EBITDA margin (%)	6.3	6.9	7.6	7.2	7.4
Normalised EPS (%)	26.7	2.1	4.3	8.4	6.1	EBIT margin (%)	2.7	3.5	4.0	3.9	4.1
Ordinary DPS (%)	15.0	0.0	4.3	18.8	1.8	Capex to sales (%)	5.2	12.9	4.5	4.1	4.1
Cash Flow (NZ\$m)						Capex to depreciation (%)	179	439	142	133	136
	2022A	2023A	2024E	2025E	2026E	Imputation (%)	100	100	100	100	100
EBITDA	18.8	23.1	27.2	27.1	29.0	Pay-out ratio (%)	63	62	62	68	65
Working capital change	(83.1)	9.9	9.2	(2.8)	(20.5)	Operating Performance					
Interest & tax paid	25.7	23.5	19.6	22.2	22.6	2022A	2023A	2024E	2025E	2026E	
Other	(4.2)	12.3	0	0	0	Automotive Retail					
Operating cash flow	(42.7)	68.7	56.0	46.4	31.2	Revenue	242.5	278.2	300.4	315.2	328.2
Capital expenditure	(15.5)	(43.2)	(16.0)	(15.5)	(16.2)	Revenue growth (%)	20.7	14.7	8.0	4.9	4.1
(Acquisitions)/divestments	3.4	0	0	0	0	Operating margin (%)	8.0	9.0	9.9	9.3	9.0
Other	(5.6)	(7.5)	(7.9)	(8.1)	(8.3)	Finance					
Funding available/(required)	(60.4)	18.0	32.1	22.8	6.8	Revenue	51.9	58.6	67.4	71.3	73.4
Dividends paid	(13.8)	(19.9)	(20.9)	(22.2)	(25.1)	Revenue growth (%)	8.4	13.0	15.0	5.8	2.9
Equity raised/(returned)	1.2	1.4	0	0	0	Operating margin (%)	34.7	25.5	18.0	22.0	24.0
(Increase)/decrease in net debt	(72.9)	(0.4)	11.2	0.6	(18.3)	Insurance					
Balance Sheet (NZ\$m)						Revenue	40.4	43.6	46.1	46.9	47.7
	2022A	2023A	2024E	2025E	2026E	Revenue growth (%)	-3.7	7.9	5.7	1.7	1.9
Working capital	412.3	402.5	393.2	396.0	416.5	Operating margin (%)	28.7	28.9	29.8	30.3	30.3
Fixed assets	67.6	106.0	117.3	126.7	136.1	Credit Management					
Intangibles	164.5	163.6	162.6	162.6	162.5	Revenue	9.7	9.2	10.6	12.8	14.9
Right of use asset	23.5	22.2	21.0	20.8	21.3	Revenue growth (%)	-24.2	-4.6	15.4	20.0	17.0
Other assets	94.4	89.8	93.5	95.1	96.6	Operating margin (%)	31.4	31.1	31.1	31.1	31.0
Total funds employed	762.2	784.1	787.7	801.3	833.0						
Net debt/(cash)	399.4	400.2	389.0	388.3	406.6						
Lease liability	25.9	27.1	22.0	21.8	22.2						
Other liabilities	84.6	84.5	85.6	86.7	87.8						
Shareholder's funds	252.4	272.3	291.1	304.5	316.3						
Minority interests	0	0	0	0	0						
Total funding sources	762.2	784.1	787.7	801.3	833.0						

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

Earnings revisions

TRA's FY24 guidance underscores the strong market share gains and brand strength which lead us to upgrade our earnings estimates. We increase our revenue estimates by +5% in FY24, +4% in FY25 and +5% in FY26, primarily due to higher volumes in Auto Retail. The success of TRA's strategic shift towards premium lending means arrears in its Finance book continue to track behind our expectations. As such, we reduce our impairment provision expense by -11% in FY24 and -6% in FY25 respectively. However, commentary from management that higher interest rates are squeezing Finance margins leads us to increase our interest expense by +7% across the board in FY24, FY25 and FY26. We also make upwards revisions to Auto Retail margins and Insurance premium growth in FY24. In aggregate, these changes see our PBT forecasts increase by +11%, +6% and +5% in FY24, FY25 and FY26 respectively.

We now see TRA achieving its three year FY25 target of >NZ\$50m in PBT with our increased estimate of NZ\$50.9m in that year.

Figure 1. Earnings revision table

	FY24E			FY25E			FY26E		
	Old	New	Change	Old	New	Change	Old	New	Change
Operating Revenue	404.3	424.5	+5%	426.9	446.1	+4%	443.6	464.2	+5%
Other Income	0.1	0.1		0.1	0.1		0.1	0.1	
Total Income	404.5	424.6	+5%	427.0	446.2	+4%	443.8	464.3	+5%
Cost of goods sold	176.7	185.3	+5%	188.1	199.1	+6%	196.3	207.8	+6%
Interest expense	30.8	33.1	+7%	31.6	33.8	+7%	32.1	34.5	+7%
Impairment provision expense	5.6	5.0	(11%)	5.3	5.0	(6%)	4.5	4.9	+8%
Subcontracted service expense	12.4	13.0	+5%	13.0	13.4	+3%	13.4	13.9	+4%
Employee benefits	63.0	66.2	+5%	63.7	65.9	+3%	65.9	68.3	+4%
Commission	14.5	15.3	+5%	14.8	15.3	+3%	15.3	15.8	+4%
Advertising expense	5.6	5.6	+0%	6.1	6.1	+0%	6.5	6.5	+0%
Depreciation & amortisation expense	12.5	13.0	+4%	13.1	12.6	(4%)	13.3	12.8	(4%)
Systems maintenance	5.4	5.4	+0%	5.4	5.4	+0%	5.6	5.6	+0%
Claims	21.6	22.1	+3%	21.7	22.3	+3%	22.0	22.6	+3%
Other expenses	14.2	13.7	(3%)	16.1	16.4	+2%	17.2	17.5	+2%
Total Expenses	362.3	377.7	+4%	378.8	395.3	+4%	392.2	410.3	+5%
Profit before taxation (PBT)	42.2	46.9	+11%	48.2	50.9	+6%	51.5	54.0	+5%
Taxation (expense)/benefit	11.8	13.1	+11%	13.5	14.3	+6%	14.4	15.1	+5%
Net profit after tax (NPAT)	30.4	33.8	+11%	34.7	36.6	+6%	37.1	38.9	+5%

Source: Company data, Forsyth Barr analysis

The Colonial Motor Company – FY23 result summary

Who is the Colonial Motor Company?

Colonial Motor Company (CMO) is a prominent player in the NZ automotive industry and relevant peer to TRA, with diverse operations spanning light vehicle dealerships, tractor dealerships and heavy truck dealerships. CMO is a public company listed on the NZX with a market capitalisation of NZ\$302m. It is one of NZ's largest motor vehicle dealerships, with 12 dealerships nationwide. CMO's primary focus is Ford vehicles, and seven of its dealerships also sell Mazda vehicles. CMO has dealerships selling heavy trucks and tractors. The company also develops property, offers financing options and provides maintenance and repair services for all vehicle makes and models.

See more information at <https://www.colmotor.co.nz/>

Financial results

On 22 August 2023, CMO announced its results for the financial year ending 30 June 2023 with a trading profit after tax of NZ\$30.3m, -9% on the NZ\$33.3m achieved in FY22. This was achieved on total revenue down -0.6% to NZ\$1.0b. Regarding SMO's revenue segments, the results were:

- **Products** revenue decreased by -1% to NZ\$914m
- **Services** revenue increased by +11% to NZ\$81m
- **Other income** declined -50% to NZ\$2m

Total dividends for the year amounted to 57 cents per share (cps), constituting 61% of the after-tax trading profit. The company noted that, "Light vehicle trading conditions have been inconsistent through the second half of the financial year. In particular, this has been due to changes in the Clean Car Scheme and taxes on higher emitting vehicles; driving short-term, artificial demand". Despite light vehicle trading and a challenging quarter for tractor dealerships, overall results were robust, with heavy truck dealerships' results remaining steady "with strong demand persisting throughout the year". The company has also reported increased inventory levels (lifting from NZ\$137m to NZ\$206m) resulting from volatile supply chains and local building capacity constraints. On the property front, escalating building costs have led to a focus on committed refurbishment projects, with some major developments still in the planning stages.

Outlook or industry comments

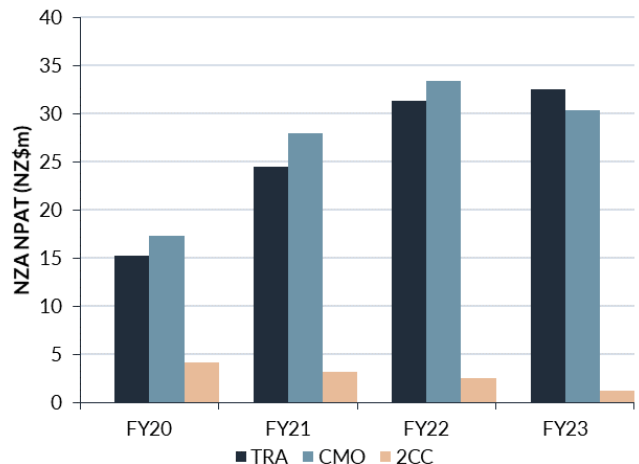
CMO anticipates the FY24 year to be affected by higher fuel prices, inflation, government interventions and a cooling economy. CMO says these factors could pressure customers and the business in 2024 and potentially beyond. However, management said that new product refreshes from Ford and Mazda and the improving availability of hybrid and electrified vehicles could support customer interest in a weakening market. The Group is also actively exploring new opportunities to expand its core competencies, aiming to provide resilience to its overall operations. Management's focus will include carefully considering capital investment requirements and the potential returns that new opportunities may present.

Figure 2. Share price movements for TRA, CMO and 2CC



Source: Refinitiv, Forsyth Barr analysis

Figure 3. Results comparison for TRA, CMO and 2CC



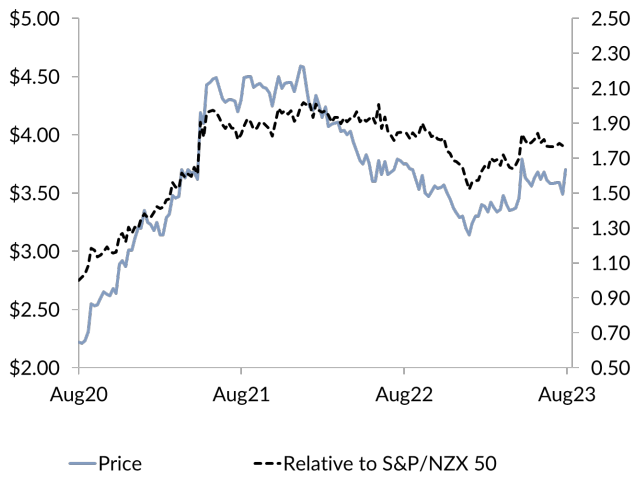
Source: Company data, Forsyth Barr analysis

Figure 4. New Zealand auto retail FY23 results comparison

Balance date	TRA 31/03/2023	2CC 31/03/2023	CMO 30/06/2023
Operating Revenue	389.0	82.7	995.3
Other Income	0.6	0.0	1.9
Total Income	389.6	82.7	997.2
Cost of goods sold	(174.0)	(67.9)	(801.9)
Interest expense	(19.9)	(1.1)	(9.3)
Impairment provision expense	(3.7)		
Subcontracted service expense	(11.9)		
Employee benefits	(60.7)	(4.1)	(93.8)
Commision	(12.0)		
Advertising expense	(4.9)	(1.7)	
Depreciation & amortisation expense	(11.5)	(2.1)	(8.2)
Systems maintenance	(5.1)		
Claims	(21.8)		
Other expenses	(18.5)	(3.9)	(39.0)
Total Expenses	(344.1)	(80.9)	(952.1)
Profit before taxation (PBT)	45.5	1.8	45.1
Taxation (expense)/benefit	(13.0)	(0.5)	(12.6)
Non controlling interest			(2.1)
Profit for the year year (NPAT)	32.6	1.3	30.3
One year revenue growth	+14%	+28%	-1%
One year NPAT growth	+6%	-50%	-9%

Source: Company data, Forsyth Barr analysis

Figure 5. Price performance



Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
Bartel Holdings	11.7%
Baker Investment Trust No 2	7.5%
Harrigens Trustee Limited	6.1%

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

Figure 7. International valuation comparisons

Company (metrics re-weighted to reflect TRA's balance date - March)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld		
				2024E	2025E	2024E	2025E	2024E	2025E			
Turners Automotive	TRA NZ	NZ\$3.71	NZ\$324	9.6x	8.8x	24.8x	24.5x	47.5x	45.9x	7.7%		
KMD Brands *	KMD NZ	NZ\$0.84	NZ\$598	12.5x	9.7x	4.1x	3.7x	9.7x	8.1x	6.5%		
The Warehouse Group *	WHS NZ	NZ\$1.67	NZ\$579	12.9x	9.4x	5.2x	4.7x	13.5x	11.0x	7.7%		
Briscoe Group	BGP NZ	NZ\$4.49	NZ\$1,000	12.4x	12.0x	7.3x	7.1x	9.3x	9.0x	6.2%		
Michael Hill International L	MHJ NZ	A\$0.97	A\$368	n/a	8.4x	3.6x	3.4x	6.8x	6.4x	8.0%		
Eagers Automotive	APE AT	A\$14.16	A\$3,638	12.9x	13.6x	9.7x	9.9x	11.4x	11.8x	4.6%		
Autosports Group	ASG AT	A\$2.39	A\$480	7.3x	8.2x	6.3x	6.7x	8.4x	9.1x	7.1%		
Motorcycle Holdings	MTO AT	A\$1.73	A\$127	6.0x	5.9x	5.7x	5.6x	7.6x	7.5x	9.3%		
Peter Warren Automotive Hold	PWR AT	A\$2.61	A\$449	8.6x	8.9x	7.3x	7.5x	9.5x	9.8x	7.7%		
Kamux Corp	KAMUX FH	€5.95	€238	16.0x	11.0x	9.6x	7.4x	15.1x	10.2x	4.0%		
America'S Car-Mart Inc	CRMT US	US\$103.18	US\$657	21.5x	15.2x	10.5x	10.4x	17.1x	16.7x	n/a		
Idom Inc	7599 JP	¥794.00	¥84,869	6.9x	6.3x	5.2x	4.7x	5.7x	5.2x	4.6%		
Compc Average:				11.7x	9.9x	6.8x	6.5x	10.4x	9.5x	6.6%		
EV = Mkt cap+net debt+lease liabilities+min interests-investments				TRA Relative:		-18%	-10%	267%	279%	358%	382%	17%

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

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