

Leslie's

# A path to sales/margin recovery, despite industry headwinds; Reiterate Buy

Reiterate Rating: BUY | PO: 8.00 USD | Price: 7.00 USD

## EPS beat on sales, despite continued margin headwinds

Leslie's (LESL) reported F1Q24 adjusted EPS ahead of consensus estimates, driven by better than expected sales. Despite the beat, management maintained full year guidance, as F1Q is typically the lowest sales quarter. We increase our F2024E adjusted EPS by 3% and our F2025E adjusted EPS is 19% above the Street. We raise our PO to \$8 (from \$7) now based on 16x F2025E adjusted EPS (vs. 16x F2024E/F2025 avg. adjusted EPS), as we roll our PO forward to F2025E.

## Sales continue to decline, but some signs of stabilization

Sales declined 11% YoY (comp sales -12% YoY) in F1Q24 with transactions down 6% and average order value was down 5%. Nondiscretionary sales (80% of revenues) declined 18% YoY with hot tub sales also down 18% and continued weakness in heaters and above-ground pools. Despite the sales decline, the order book for hot tubs was flat after declining for several quarters and could signal an improvement in YoY growth going forward. Chemicals sales (est. 50% of sales) were down just 3%, despite a 5% decline in price YoY. We expect chemical volumes to continue to improve post customer destocking and believe LESL could regain some lost share now that prices are more in line with competitors.

## Clear path to gross margin recovery

F1Q24 gross margin (GM) declined -450 bps YoY (vs. -870bps in F4Q23) to 29.0%, driven by -235bps from rebate timing, -125bps from previously capitalized DC costs, and -200bps from occupancy leverage, partially offset by +110bps from positive inventory adjustments (-315bps impact in F4Q23). Importantly, LESL was able to offset the impact of the June chemical price cuts (-260bps GM impact in F4Q23) with price/cost actions on other products. Going forward, we expect the shift in rebate timing to have a positive YoY impact and the impact of the elevated DC costs to runoff as LESL draws down inventory. For F2024, we forecast GM to increase 90bps with most of the benefit in F4Q.

## F1Q EPS beat on better revenue; Reiterate Buy

LESL reported F1Q24 adjusted EPS of -\$0.20, above the Streets -\$0.21 estimate, driven by higher sales, partially offset by lower gross margin. Revenue declined -11% YoY with hot tub sales -18%, residential sales -10% YoY, and Pro -8%.

Estimates (Sep) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	0.95	0.28	0.32	0.50	0.60
GAAP EPS	0.85	0.15	0.27	0.45	0.55
EPS Change (YoY)	11.8%	-70.5%	14.3%	56.3%	20.0%
Consensus EPS (Bloomberg)			0.28	0.41	0.53
DPS	0	0	0	0	0
Valuation (Sep)					
P/E	7.4x	25.0x	21.9x	14.0x	11.7x
GAAP P/E	8.2x	46.7x	25.9x	15.6x	12.7x
EV / EBITDA*	7.2x	12.5x	12.0x	9.9x	8.9x
Free Cash Flow Yield*	2.7%	-2.5%	8.9%	4.9%	6.1%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 4.

02 February 2024

### Equity

#### Key Changes

(US\$)	Previous	Current
Price Obj.	7.00	8.00
2024E Rev (m)	1,461.2	1,452.8
2025E Rev (m)	1,534.3	1,518.2
2026E Rev (m)	1,611.0	1,586.5
2024E EPS	0.31	0.32
2025E EPS	0.57	0.50
2026E EPS	0.62	0.60

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### Stock Data

Price	7.00 USD
Price Objective	8.00 USD
Date Established	2-Feb-2024
Investment Opinion	C-1-9
52-Week Range	4.39 USD - 17.13 USD
Mrkt Val (mn) / Shares Out (mn)	1,292 USD / 184.5
Free Float	91.5%
Average Daily Value (mn)	17.15 USD
BofA Ticker / Exchange	LESL / NAS
Bloomberg / Reuters	LESL US / LESLOQ
ROE (2024E)	NA
Net Dbt to Eqty (Sep-2023A)	NA
ESGMeter <sup>TM</sup>	Medium

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Timestamp: 02 February 2024 06:24PM EST

# iQprofile<sup>SM</sup> Leslie's

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	26.4%	12.6%	13.5%	16.2%	16.5%
Return on Equity	NM	NM	NM	NM	215.8%
Operating Margin	16.8%	9.2%	9.7%	11.9%	12.8%
Free Cash Flow	35	(32)	116	63	79

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	0.4x	0.1x	2.8x	1.3x	1.3x
Asset Replacement Ratio	1.0x	1.1x	1.6x	1.8x	1.8x
Tax Rate	23.7%	25.5%	22.6%	24.0%	24.0%
Net Debt-to-Equity Ratio	NM	NM	NM	NM	452.0%
Interest Cover	NA	NA	NA	NA	NA

## Income Statement Data (Sep)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	1,562	1,451	1,453	1,518	1,587
% Change	16.3%	-7.1%	0.1%	4.5%	4.5%
Gross Profit	674	548	562	612	647
% Change	13.2%	-18.6%	2.6%	8.7%	5.8%
EBITDA	293	168	175	214	237
% Change	7.9%	-42.5%	4.0%	22.2%	10.7%
Net Interest & Other Income	(30)	(65)	(65)	(60)	(58)
<b>Net Income (Adjusted)</b>	<b>176</b>	<b>51</b>	<b>60</b>	<b>92</b>	<b>111</b>
<b>% Change</b>	<b>9.2%</b>	<b>-71.0%</b>	<b>16.6%</b>	<b>53.9%</b>	<b>20.6%</b>

## Free Cash Flow Data (Sep)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	176	51	60	92	111
Depreciation & Amortization	31	34	33	33	33
Change in Working Capital	(141)	(69)	81	(5)	(8)
Deferred Taxation Charge	2	(6)	(8)	0	0
Other Adjustments, Net	(2)	(3)	3	3	3
Capital Expenditure	(32)	(39)	(53)	(60)	(60)
<b>Free Cash Flow</b>	<b>35</b>	<b>-32</b>	<b>116</b>	<b>63</b>	<b>79</b>
<b>% Change</b>	<b>-75.1%</b>	<b>NM</b>	<b>NM</b>	<b>-45.2%</b>	<b>25.0%</b>
Share / Issue Repurchase	1	0	0	0	0
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	0	(8)	(52)	(30)	0

## Balance Sheet Data (Sep)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	112	55	99	132	211
Trade Receivables	NA	NA	NA	NA	NA
Other Current Assets	430	365	326	332	344
Property, Plant & Equipment	78	90	109	136	163
Other Non-Current Assets	489	524	514	514	514
<b>Total Assets</b>	<b>1,110</b>	<b>1,034</b>	<b>1,048</b>	<b>1,114</b>	<b>1,232</b>
Short-Term Debt	8	8	8	8	8
Other Current Liabilities	340	218	235	237	241
Long-Term Debt	780	773	722	692	692
Other Non-Current Liabilities	180	197	183	183	183
<b>Total Liabilities</b>	<b>1,308</b>	<b>1,196</b>	<b>1,148</b>	<b>1,120</b>	<b>1,124</b>
<b>Total Equity</b>	<b>(198)</b>	<b>(161)</b>	<b>(100)</b>	<b>(5)</b>	<b>108</b>
<b>Total Equity &amp; Liabilities</b>	<b>1,110</b>	<b>1,034</b>	<b>1,048</b>	<b>1,114</b>	<b>1,232</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 4.

## Company Sector

Retailing-Specialty

## Company Description

Leslie's is the largest US retailer of pool & spa supplies and accessories, primarily serving customers directly through its >1,000 physical stores and online channels. The company also operates a small number of Leslie's PRO locations and is building its reach to the professional pool & spa care industry. The pool & spa care industry is approximately \$11bn, of which Leslie's has about a 15% market share, and has more physical locations than its next 20 largest competitors combined.

## Investment Rationale

As the dominant retailer in a fragmented direct-to-consumer pool & spa supplies industry, Leslie's has a significant competitive advantage over its peers, which do not have the omnichannel capabilities, services, or scope of reach as Leslie's. We also now view valuation as attractive relative to our growth outlook.

## Stock Data

Average Daily Volume 2,450,009

## Quarterly Earnings Estimates

	2023	2024
Q1	-0.16A	-0.21A
Q2	-0.17A	-0.20E
Q3	0.39A	0.42E
Q4	0.09A	0.27E

## Price objective basis & risk

### Leslie's (LESL)

Our price objective of \$8 is based on a P/E of 16x FY25E. This about in line with the hardline retail average, which we view appropriate given that Leslie's has a dominant market position, and has above-average margins, but does operate in a somewhat cyclical industry.

Upside risks to our price objective are 1) stronger-than-expected US economic growth, 2) increased usage of recently-built pools and extension of the pool season, 3) higher than expected inflation, resulting in upside to top-line growth.

Downside risks are 1) supply constraint in key products such as pool chemicals that could hinder near-term sales growth, 2) faster-than-expected return to pre-COVID-19 behavior and weaker-than-expected materialization of the pool construction backlog, 3) margin pressure from further channel shift from store to online.

## Analyst Certification

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### US - Homebuilders and Building Products Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Armstrong World Industries, Inc.	AWI	AWI US	Rafe Jadrosich
	Builders FirstSource Inc	BLDR	BLDR US	Rafe Jadrosich
	D.R. Horton, Inc.	DHI	DHI US	Rafe Jadrosich
	Latham Group, Inc.	SWIM	SWIM US	Shaun Calnan, CFA
	Leslie's	LESL	LESL US	Shaun Calnan, CFA
	NVR, Inc.	NVR	NVR US	Rafe Jadrosich
	Owens Corning	OC	OC US	Rafe Jadrosich
	PulteGroup Inc.	PHM	PHM US	Rafe Jadrosich
	The AZEK Company Inc.	AZEK	AZEK US	Rafe Jadrosich
	Toll Brothers, Inc.	TOL	TOL US	Rafe Jadrosich
	TopBuild Corp	BLD	BLD US	Rafe Jadrosich
	Trex Company, Inc.	TREX	TREX US	Rafe Jadrosich
<b>NEUTRAL</b>				
	Dream Finders Homes, Inc.	DFH	DFH US	Rafe Jadrosich
	KB Home	KBH	KBH US	Rafe Jadrosich
	Lennar Corporation	LEN	LEN US	Rafe Jadrosich
<b>UNDERPERFORM</b>				
	Fortune Brands Innovations Inc	FBIN	FBIN US	Rafe Jadrosich
	Hayward Holdings, Inc.	HAYW	HAYW US	Rafe Jadrosich
	Masco Corp	MAS	MAS US	Rafe Jadrosich
	Mohawk Industries	MHK	MHK US	Rafe Jadrosich
	Patrick Industries, Inc.	PATK	PATK US	Rafe Jadrosich
	Pool Corporation	POOL	POOL US	Shaun Calnan, CFA



## iQmethod<sup>SM</sup> Measures Definitions

### Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

### Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

### Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

### Numerator

$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

### Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

### Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} +$

Other LT Liabilities

Enterprise Value

### Denominator

$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill}$

Amortization

Shareholders' Equity

Sales

N/A

N/A

### Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

### Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$

Sales

Basic EBIT + Depreciation + Amortization

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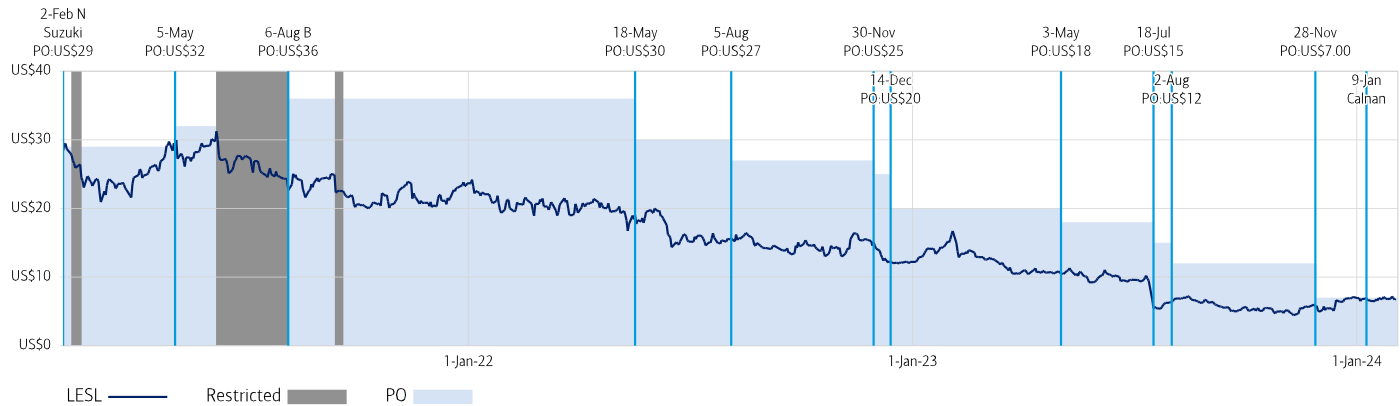
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### Leslie's (LESL) Price Chart



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### Equity Investment Rating Distribution: Retailing Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	96	57.83%	Buy	39	40.63%
Hold	32	19.28%	Hold	12	37.50%
Sell	38	22.89%	Sell	18	47.37%

### Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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