

Woolworths

Strong quarter of sales despite disruption in supply chains. Reiterate Buy.

Reiterate Rating: BUY | PO: 42.00 AUD | Price: 38.47 AUD

5.8% growth in Australian Supermarkets a positive result...

...particularly when it is noted how disrupted the quarter has been for supply chain and delivery of stock into stores due to high levels of team absenteeism. We expect WOW gained market share in Australian Food over the trading period which we see a positive outcome. After a disappointing 1H22 performance, where EBIT fell by 8%, we believe WOW is on track to meet the guidance it set at 1H22 where it stated EBIT should improve in 2H22. And we think WOW is on track to deliver strong EBIT recovery/growth in FY23 when supply chain functionality should normalise.

NZ highly disrupted...causes 1% cut for Group earnings

Despite sales in NZ looking to be okay (LFL growth of 3.1% in the quarter), earnings have been impacted from supply chain disruptions (more than in Australia) which has led to WOW calling out NZ 2H22 EBIT to be down 16-28%. This has led to us cutting our forecast Group earnings for WOW by around 1%. Although we expect supply chains to normalise, we have cut FY23 and FY24 earnings in NZ (factoring in sustained disruption). The impact on our valuation from the cut is immaterial. There is no change in our PO of \$42. We reiterate our Buy.

Big W looks to be performing well

Total sales growth was down only 3.5% in 3Q22, although it needs recognizing that sales growth in 3Q21 was nearly 20% (and 10% in 3Q20). It appears to us that Big W has its purchasing and inventory management performing strongly, when its competitors such as Kmart and Target look to have fallen back in this area. After a difficult 1H22 for earnings (due to store closures during Covid-19 lockdowns), we expect Big W to deliver a positive performance in 2H22 and into FY23.

WOW set for a strong FY23 earnings performance

We are bullish toward Woolworths as we expect its earnings to grow/recover after a disappointing 1H22. We see WOW continuing to gain market share and reduce its costs (increasing efficiencies) as its supply chains normalize.

Estimates (Jun) (A\$)	2020A	2021A	2022E	2023E	2024E
Net Profit b/f Abnormals	1,602	1,504	1,458	1,848	2,100
EPS	1.27	1.20	1.18	1.53	1.73
EPS Change (YoY)	-5.1%	-6.1%	-1.7%	29.7%	13.6%
Dividend / Share	0.940	1.01	0.867	1.12	1.28
Free Cash Flow / Share	1.92	1.78	0.859	1.87	2.30
Valuation (Jun)					
P/E	30.20x	32.15x	32.72x	25.23x	22.20x
Dividend Yield	2.44%	2.63%	2.25%	2.92%	3.32%
EV / EBITDA*	11.50x	12.92x	12.98x	11.21x	10.27x
Free Cash Flow Yield*	5.17%	4.79%	2.28%	4.87%	5.99%

* For full definitions of *IQmethod*SM measures, see page 5.

03 May 2022

Equity

Key Changes

(A\$)	Previous	Current
2022E EPS	1.21	1.18
2023E EPS	1.54	1.53
2024E EPS	1.75	1.73
2022E EBITDA (m)	4829.5	4771.7
2023E EBITDA (m)	5412.6	5382.7
2024E EBITDA (m)	5816.4	5793.3

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Stock Data

Price	38.47 AUD
Price Objective	42.00 AUD
Date Established	25-Jan-2022
Investment Opinion	A-1-7
52-Week Range	32.92 AUD - 42.66 AUD
Mrkt Val (mn) / Shares Out (mn)	46,625 AUD / 1,212.0
Average Daily Value (mn)	65.93 AUD
BofA Ticker / Exchange	WOLWF / ASX
Bloomberg / Reuters	WOW AU / WOW.AX
ROE (2022E)	130.0%
Net Dbt to Eqty (Jun-2021A)	798.1%

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Refer to important disclosures on page 6 to 8. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.

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iQprofileSM Woolworths

Key Income Statement Data (Jun)

(A\$ Millions)

	2020A	2021A	2022E	2023E	2024E
Sales	63,675	55,676	57,603	60,997	64,644
Associates & Other Revenue	175	135	135	135	135
Operating Expenses	(58,173)	(50,968)	(52,967)	(55,750)	(58,986)
EBITDA	5,677	4,843	4,772	5,383	5,793
Depreciation & Amortization	(2,458)	(2,079)	(2,250)	(2,330)	(2,410)
EBIT	3,219	2,764	2,521	3,053	3,383
Net Interest & Other income	(843)	(613)	(561)	(543)	(522)
Pretax Income	2,376	2,151	1,961	2,510	2,862
Tax (expense) / Benefit	(730)	(647)	(503)	(661)	(761)
Outside Equity interest in Npat	(44)	0	0	0	0
Preference dividends	0	0	0	0	0
Net Profit b/f Abnormals	1,602	1,504	1,458	1,848	2,100
Non-Recurring Items	(437)	102	0	0	0
Net Income (Reported)	1,165	1,606	1,458	1,848	2,100

Key Cash Flow Statement Data

EBITDA	5,677	4,843	4,772	5,383	5,793
Change in Working Capital	620	352	(961)	(200)	91
Other C'flow Items before int & tax	0	0	0	0	0
Net Interest Paid	(856)	(800)	(561)	(543)	(522)
Tax Paid	(650)	(739)	(588)	(753)	(858)
Other C'flow from Operations	(230)	968	85	91	97
Cash Flow from Operations	4,561	4,624	2,747	3,978	4,602
Capital Expenditure (PP&E)	(2,149)	(2,389)	(1,682)	(1,708)	(1,810)
(Acquisition) / Disposal of Investments	(91)	0	0	0	0
Other C'flow from Investing	34	(554)	0	0	0
Cash Flow from Investing	(2,206)	(2,943)	(1,682)	(1,708)	(1,810)
Shares Issue / (Repurchase)	0	0	0	0	0
Dividend paid	(1,133)	(1,104)	(1,050)	(1,362)	(1,548)
Other C'flow from Financing	0	0	(2,000)	0	0
Cash Flow from Financing	(1,133)	(1,104)	(3,050)	(1,362)	(1,548)
Free Cash Flow	2,412	2,235	1,065	2,270	2,792
Net Debt	16,591	13,879	13,864	13,356	12,512

Key Balance Sheet Data

Cash Equivalents	2,068	1,009	1,009	1,009	1,009
Receivables & Inventories	5,328	3,914	4,823	3,488	3,688
Property, Plant & Equipment	8,742	7,477	8,147	8,497	8,847
Intangibles	7,717	4,671	4,671	4,871	5,071
Other assets	14,617	22,165	20,466	20,165	19,898
Total Assets	38,472	39,236	39,117	38,030	38,513
Payables	7,508	6,467	6,416	4,880	5,172
Provisions	1,965	14,784	14,784	14,809	14,834
Short term debt & Long term debt	18,659	14,888	14,873	14,365	13,521
Other Liabilities	1,308	1,358	1,358	1,804	2,262
Total Liabilities	29,440	37,497	37,431	35,858	35,789
Total Equity	9,032	1,739	1,686	2,172	2,725

iQmethodSM - Bus Performance*

Return on Capital Employed	11.6%	9.7%	12.3%	14.3%	15.4%
Return on Equity	20.1%	36.3%	130.0%	136.9%	114.9%
Operating Margin	5.1%	5.0%	4.4%	5.0%	5.2%
EBITDA Margin	8.9%	8.7%	8.3%	8.8%	8.9%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	2.4x	2.5x	1.6x	1.9x	1.9x
Dividend Payout Ratio	73.8%	84.4%	73.7%	73.7%	73.7%
Tax Rate (Reported)	30.7%	30.1%	25.6%	26.4%	26.6%
Net Debt-to-Equity Ratio	183.7%	798.1%	822.2%	614.8%	459.2%
Interest Cover	3.8x	4.5x	4.4x	5.5x	6.3x

Key Metrics

Franking	100%	100%	100%	100%	100%
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* For full definitions of iQmethodSM measures, see page 5.

Company Sector

Supermarkets/Food Retailers

Company Description

Woolworths (WOW) is a leading supermarket retailer operating throughout Australia and New Zealand. WOW also has a large general merchandising business with Big W.

Investment Rationale

In our view, Wow's performance will benefit from better than average industry growth, and better online sales positioning. We expect these factors to underpin a favourable store network structure, a step up in its competitive advantages, and ultimately, to deliver strong earnings growth.

Stock Data

Price to Book Value

35.2x



Summary Financials

Exhibit 1: Summary forecasts and estimate changes

We have cut our forecast earnings for NZ, resulting in around 1% cut to overall NPAT forecasts. There is an immaterial impact to our valuation. No change to PO

	FY20	FY21	FY22E			FY23E			FY24E		
	Actual	Actual	Old	New	Chg	Old	New	Chg	Old	New	Chg
Sales	63,675	55,676	57,603	57,603	0.0%	60,997	60,997	0.0%	64,644	64,644	0.0%
AU Food	42,151	44,441	45,996	45,996	0.0%	48,940	48,940	0.0%	52,072	52,072	0.0%
NZ Food	6,823	6,652	7,230	7,230	0.0%	7,461	7,461	0.0%	7,700	7,700	0.0%
Big W	4,106	4,583	4,377	4,377	0.0%	4,596	4,596	0.0%	4,871	4,871	0.0%
EBIT	3,219	2,764	2,579	2,521	-2.2%	3,082	3,053	-1.0%	3,406	3,383	-0.7%
AU Food	2,232	2,432	2,277	2,277	0.0%	2,692	2,692	0.0%	2,942	2,942	0.0%
NZ Food	358	336	369	311	-15.7%	388	358	-7.7%	408	385	-5.7%
Big W	39	172	44	44	0.0%	115	115	0.0%	170	170	0.0%
Corporate	-151	-176	-110	-110	0.0%	-112	-112	0.0%	-114	-114	0.0%
NPAT	1,602	1,504	1,498	1,458	-2.7%	1,870	1,848	-1.1%	2,117	2,100	-0.8%
EPS	127.4	119.7	120.8	117.6	-2.7%	154.3	152.5	-1.1%	174.7	173.3	-0.8%
DPS	94.0	101.0	89.1	86.7	-2.7%	113.7	112.4	-1.1%	128.7	127.7	-0.8%

Source: BofA Global Research estimates, company data

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Exhibit 2: Forecast earnings

We expect a strong increase in earnings in FY23 after a drop in earnings forecast in FY22

A\$m	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E
Sales	59,984.0	63,675.0	55,676.0	57,603.3	60,997.3	64,644.0
Growth	-2.8%	6.2%	-12.6%	3.5%	5.9%	6.0%
Other Revenue	239.0	175.0	135.0	135.0	135.0	135.0
EBITDA	3,946.0	5,677.0	4,843.0	4,771.7	5,382.7	5,793.3
Growth	3.3%	43.9%	-14.7%	-1.5%	12.8%	7.6%
EBITDA margin	6.6%	8.9%	8.7%	8.3%	8.8%	9.0%
Depreciation & Amortisation	1,222.0	2,458.0	2,079.0	2,250.2	2,330.2	2,410.2
EBIT	2,724.0	3,219.0	2,764.0	2,521.5	3,052.6	3,383.2
Growth	0.3%	18.2%	-14.1%	-8.8%	21.1%	10.8%
EBIT margin	4.5%	5.1%	5.0%	4.4%	5.0%	5.2%
Net interest expense	-126.0	-843.0	-613.0	-561.0	-542.7	-521.6
Profit before Tax	2,598.0	2,376.0	2,151.0	1,960.5	2,509.8	2,861.5
Tax	780.0	730.0	647.0	588.2	752.9	858.5
Underlying NPAT	1,752.0	1,602.0	1,504.0	1,457.8	1,848.3	2,100.3
EPS Reported	215.4	92.2	126.7	120.3	152.5	173.3
DPS	102.0	94.0	101.0	86.7	112.4	127.7
EBIT - Segmental	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E
Supermarket - AU	1,857.0	2,232.0	2,432.0	2,276.8	2,691.7	2,942.1
Margin	4.7%	5.3%	5.5%	5.0%	5.5%	5.7%
Supermarket - NZ	277.0	358.0	336.0	310.9	358.2	385.0
Margin	4.4%	5.2%	5.1%	4.3%	4.8%	5.0%
Liquor	474.0	569.0	669.0	0.0	0.0	0.0
Margin	5.5%	6.1%	6.6%	0.0%	0.0%	0.0%
Big W	-85.0	39.0	172.0	43.8	114.9	170.5
Margin	-2.2%	0.9%	3.8%	1.0%	2.5%	3.5%
Hotels	261.0	172.0	261.0	0.0	0.0	0.0
Margin	15.6%	13.0%	18.4%	-	-	-
Petrol	112.0	0.0	0.0	0.0	0.0	0.0
Margin	n/a	n/a	n/a	n/a	n/a	n/a
Corporate & Other	-60.0	-151.0	-176.0	-110.0	-112.2	-114.4
Total EBIT	2,836.0	3,219.0	3,694.0	2,521.5	3,052.6	3,383.2

Source: BofA Global Research estimates, company data

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Price objective basis & risk

Woolworths (WOLWF)

Our PO of \$42.0/shr is based on an equal blended P/E and DCF valuation.

Our P/E valuation is based on an FY23E market multiple of 21.9x and an overall WOW group premium of 15%. This yields a value of \$37.3/shr.

Our DCF valuation is \$46.7/shr, based on a WACC of 6.4% with a terminal growth rate of 3%. Our cost of equity inputs include a risk free rate of 1.5% (in line with 10 year Australian bond yields) and equity risk premium of 7.0%.

Downside risks to our PO are greater than expected moderation in supermarkets and Big W sales, slower than expected decrease in COVID-19 costs.

Analyst Certification

I, David Errington, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Australia - Consumer Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Coles	CLEGF	COL AU	David Errington
	Collins Foods	CLLFF	CKF AU	Sriharsh Singh
	Endeavour Group	EDVGF	EDV AU	David Errington
	IDP Education	IDPUF	IEL AU	Sriharsh Singh
	Inghams Group	XINRF	ING AU	David Errington
	JB Hi-Fi Ltd	JBHIF	JBH AU	David Errington
	Treasury Wine Estates	TSRYF	TWE AU	David Errington
	Wesfarmers	WFAFF	WES AU	David Errington
	Woolworths	WOLWF	WOW AU	David Errington
NEUTRAL				
	Bega Cheese	BEGAF	BGA AU	David Errington
	Domino's Pizza Enterprises	DPZUF	DMP AU	Paul Dewberry
	Temple & Webster	TPLWF	TPW AU	Sriharsh Singh
UNDERPERFORM				
	A2 Milk Company Limited	XMCAF	A2M AU	David Errington
	A2 Milk Company Ltd	ACOPF	ATM NZ	David Errington
	Blackmores	BLMMF	BKL AU	Sriharsh Singh
	Kogan.com	KGGNF	KGN AU	Sriharsh Singh
	Metcash Ltd	MCSHF	MTS AU	David Errington



IQmethodSM 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

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + 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
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + 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
Market Cap = Current Share Price × Current Basic Shares
Sales

Basic EBIT + Depreciation + Amortization

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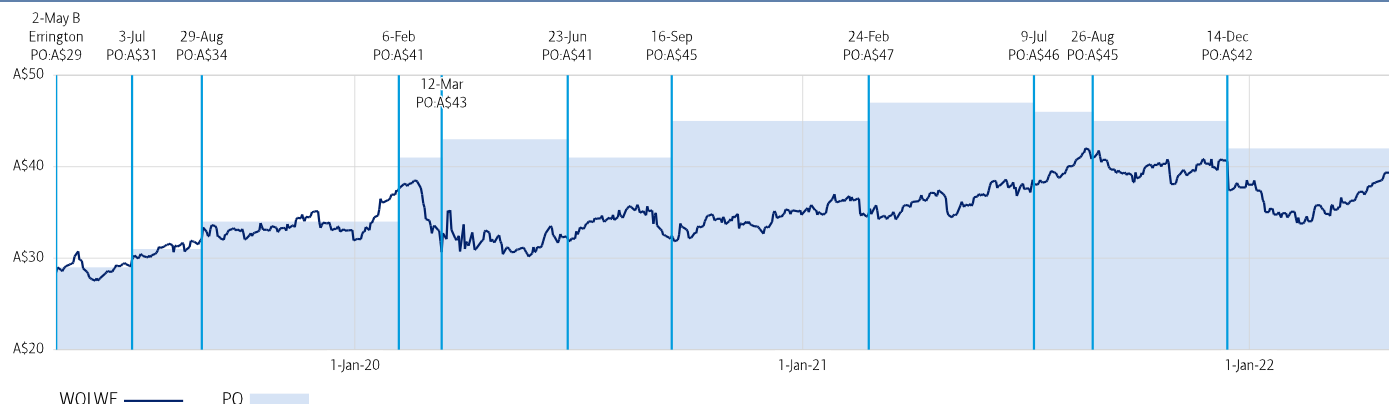
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Disclosures

Important Disclosures

Woolworths (WOLWF) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Retailing Group (as of 31 Mar 2022)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	88	56.77%	Buy	46	52.27%
Hold	27	17.42%	Hold	15	55.56%
Sell	40	25.81%	Sell	18	45.00%

Equity Investment Rating Distribution: Global Group (as of 31 Mar 2022)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1916	57.18%	Buy	1207	63.00%
Hold	705	21.04%	Hold	452	64.11%
Sell	730	21.78%	Sell	362	49.59%

^{R1} 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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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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