Research as a Service

Mid-cap discretionary retail analysis

Sector Screen

Screening for best recovery plays

Discretionary Retail

4 December 2023

We have applied some screens to 15 ASX-listed retail stocks to determine which potentially present the best returns. As a retail analyst in a former life, I have learnt two things about consumers: buyer fatigue and pent-up demand. We saw online buyer fatigue post-Covid and we are arguably in a period that will lead to pent-up demand following the tightening of consumer belts in the current cost-of-living/interest rate environment. Good returns can be made from buying well-run, highly-leveraged retailers before the cycle turns, particularly if earnings expectations and earnings multiples are low. We have used five screens to identify potential opportunities in the mid-cap omni channel space: (1) The cycling of weak like-for-like (LFL) comparative sales makes it easier to achieve sales growth one-year forward; (2) Companies with high gross margins are most leveraged to LFL sales growth; (3) Low consensus estimates provide a low hurdle for earnings surprises;(4) A low PER multiple provides an opportunity for a re-rating in conjunction with higher earnings; and, finally, (5) An assessment of the business model, and for this we use the GP% multiplied by stockturn as guide to capital intensity. Other factors such as market cap, debt levels, the store opening profile, and FX exposure could be overlaid. Investors may place more emphasis on one criteria over another but our analysis reveals (ASX:DSK), (ASX:UNI) and (ASX:NCK) tick the most boxes.

The five screens

1) The cycling of weak LFL sales comparisons, making it easier to record positive sales growth in future halves. This is particularly the case for the Christmas (December) half year.
2) High gross profit margins, as LFL sales growth provides more leverage to the bottom line for high gross margin retailers.
3) Low consensus expectations (measured by consensus CAGR growth expectations over FY24 and FY25), providing room for consensus upgrades.
4) A low PER ratio in FY25, offering the possibility of a re-rating from a low base.
5) Strong business model, which we measure by multiplying the GP% by stock turns as a gauge to capital intensity.

Stocks that satisfy most criteria

Home fragrance retailer Dusk (ASX:DSK) ticks all boxes, currently delivering the weakest LFL sales (-11%), a strong GP% (64%), top-five in our business model score with depressed earnings expectations and a low FY25 PER (6.7x). Furniture retailer Nick Scali (ASX:NCK) ticks four boxes including weak comps (-7.0%), a high GP% (64%), low earnings expectations, and the number-three business model. Youth apparel group Universal Store (ASX:UNI) also ticks four boxes, being easy comps (-6%), a high GP% (59%), a low FY25 PER (8.9x), and the number-one business model.

Current trading update observations

Using the most recent trading updates (which are pre-Christmas trading so should be viewed with some caution) there are some clear trends emerging by category. Big-ticket homeware/electrical based retailers are recording the largest declines in like-store sales, including Good Guys within JBH (-12.2%), Adairs (-9.0%), Harvey Norman (-8.7%), and NCK (-7%). Fragrance retailer DSK (-11%) and Baby Bunting (-11%) have also been weak.

The top-seven stocks for each screen

Easy LFL comps	DSK	ADH	NCK	BBN	UNI	LOV	JBH
High GP%	LOV	BLX	DSK	NCK	KMD	UNI	PMV
Business model	UNI	DSK	NCK	PMV	LOV	ADH	MYR
Low FY25 PER	ADH	DSK	MYR	KMD	UNI	BBN	AX1
Low earnings growth	JBH	NCK	MYR	SUL	DSK	PMV	BLX

Source: RaaS analysis

Stocks in this report and prices

ADH*	$1.52
AX1	$1.85
BAP	$5.34
BBN	$1.64
BLX	$2.00
DSK	$0.92
JBH	$47.76
KMD	$0.71
LOV	$19.32
MYR	$0.51
NCK	$10.88
PMV	$25.11
SUL	$14.11
TRS	$4.99
UNI	$3.53

Prices as at 1 December 2023

Stocks that tick the most boxes

- DSK (all five)
- NCK (four)
- UNI (four)

Stocks cycling challenging LFL sales (YTD FY24)

- DSK (-11%)
- ADH (-9%)
- NCK (-7%)

Stocks with best GP% * stockturn

- UNI (278%)
- DSK (198%)
- NCK (187%)

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*The author owns shares in ADH

Screens In Charts

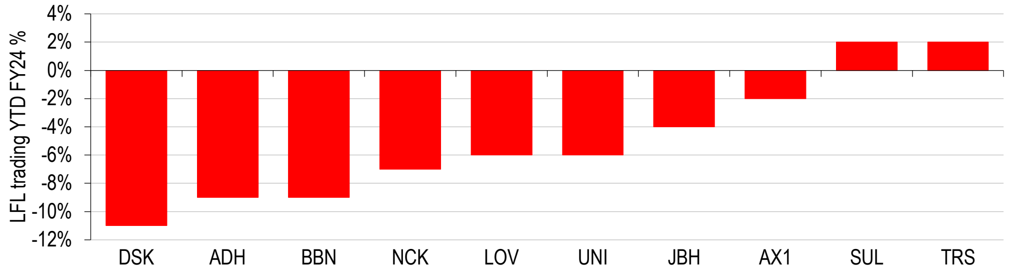
Easy LFL comparative sales

We have used the most recent trading updates as a guide to H1 FY24 trading, which will be cycled in FY25.

These updates range between late October and late November and generally do not include Black Friday and/or Christmas trading, so they could be misleading.

Big-ticket homeware/electrical based retailers are recording the largest declines in like-store sales, including Good Guys within JBH (-12.2%), Adairs (-9.0%), Harvey Norman (-8.7%), and NCK (-7%). Fragrance retailer DSK (-11%) and Baby Bunting (-11%) have also been weak. Trading updates are yet to be provided from PMV, KMD and BXL.

Exhibit 1: LFL sales of most recent trading updates



Source: Company announcements, RaaS analysis

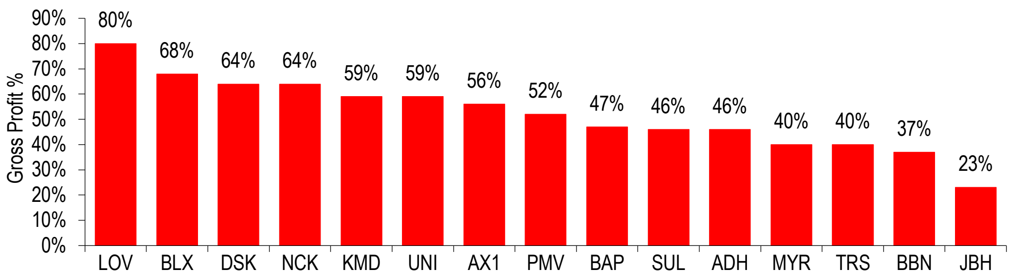
High GP%

Retailers with high gross margins generally have more sales leverage on both the upside and downside. They also require lower price increases to offset higher COGS.

High gross margins are generally a function of own brands where the retailer effectively takes the wholesale and retail margin, but also wears all the inventory risk.

Using FY23 reported margins on-trend costume jewellery retailer Lovisa Holdings (ASX:LOV) tops the list with a gross margin of 80%, followed by Beacon Lighting (68%), Dusk (64%), and Nick Scali (64%).

Exhibit 2: FY23 GP%



Source: Company announcements, RaaS analysis

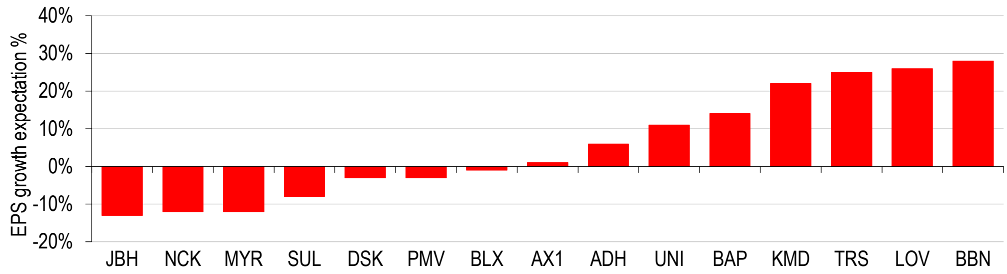
Low consensus EPS growth expectations

It goes without saying that when there are low consensus earnings expectations in forward years it should be easier to beat expectations in an improving environment.

We use the CAGR Refinitiv consensus estimates for FY24 and FY25 as a guide to consensus expectations.

Electrical retailer JBH, furniture retailer NCK, and department store Myer (MYR) currently have the lowest EPS expectations in the market. A gross margin recovery at Baby Bunting (BBN), global store rollout at Lovisa (LOV), and continued turnaround at Reject Shop (TRS) see relative high earnings expectations for these retailers.

Exhibit 3: CAGR FY24/FY25 consensus EPS growth



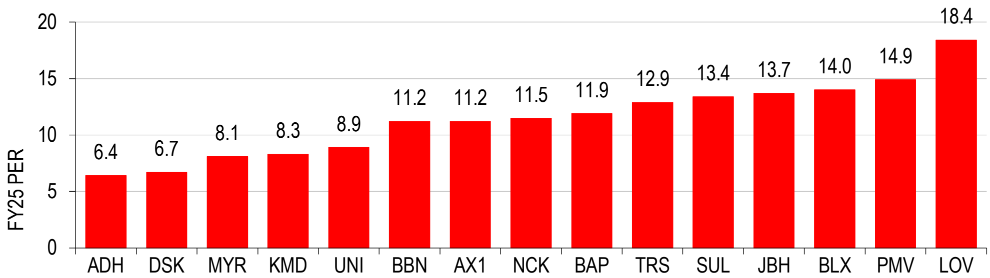
Source: Refinitiv

Low FY25 PER multiple

Stocks with low PER multiples are likely to re-rate more from the low base should earnings surprise on the upside, which could result in the double whammy of earnings increase and multiple increase.

There are five stocks currently trading under 10X consensus FY25 EPS, being homeware and furniture retailer Adairs (ADH), fragrance retailer Dusk (DSK), department store Myer (MYR), apparel and accessories retailer KMD Brands (KMD), and youth fashion retailer Universal Stores (UNI).

Exhibit 4: FY25 consensus PER multiple



Source: Refinitiv

GP% x stock turn

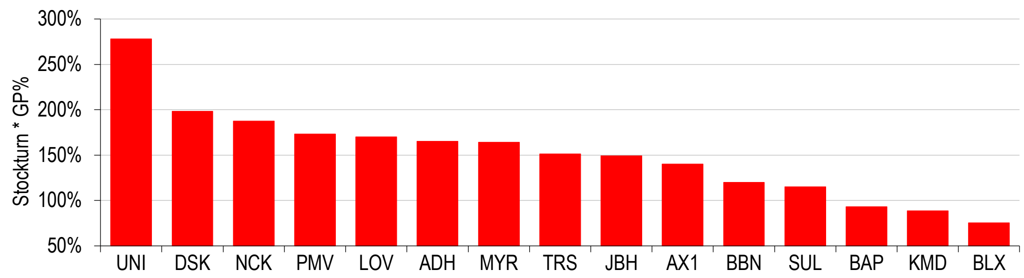
A legendary retailer once had a rule of thumb that the gross margin multiplied by stock turn should equal 160 or above. The rationale is that holding inventory needs to be appropriately rewarded by gross margin.

This is not a perfect measure with July year-end retailers potentially flattered by lower inventory holdings (post-clearance), little allowance for inventory levels outside of balance sheet year-end dates, and complexities around retailers with franchise sales and/or other business units outside of retail.

We use the FY23 reported GP% and the average inventory position in June 2022, December 2022 and June 2023.

Universal Stores (UNI) comes out clearly on top with a gross margin of 59% and estimated stock turn of 4.7x. DSK and NCK have similar gross margins (64%) and similar stock turns (3.0X).

Exhibit 5: FY23 GP% x FY23 stock turn



Source: Company announcements, RaaS estimates

Summary

Home fragrance retailer Dusk (ASX:DSK) ticks all boxes, currently delivering the weakest LFL sales (-11%), a strong GP% (64%), top-five in our business model score with depressed earnings expectations and a low FY25 PER (6.7x). Furniture retailer Nick Scali (ASX:NCK) ticks four boxes including weak comps (-7.0%), a high GP% (64%), low earnings expectations, and the number-three business model. Youth apparel group Universal Store (ASX:UNI) also ticks four boxes, being easy comps (-6%), a high GP% (59%), a low FY25 PER (8.9x), and the number-one business model.

Exhibit 4: Top-5 retailers in each chosen screen

Easy comps	DSK	ADH	NCK	BBN	UNI
High GP%	LOV	BLX	DSK	NCK	KMD
GP% * ST	UNI	DSK	NCK	PMV	LOV
Low PER	ADH	DSK	MYR	KMD	UNI
Low expectations	JBH	NCK	MYR	SUL	DSK

Source: Company announcements and RaaS estimates

FINANCIAL SERVICES GUIDE

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