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Breville Group (BRG)

Downgrade to Hold based on valuation

Recommendation
Hold (Buy)
Price
\$25.00
Target (12 months)
\$26.00 (previously \$23.00)

GICS Sector
Retailing

Expected Return

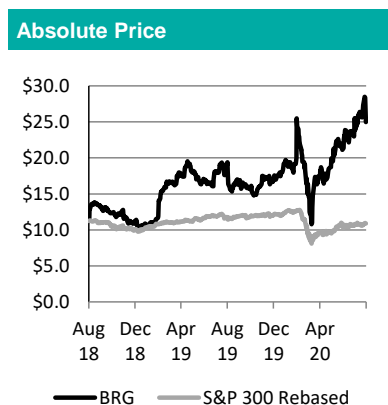
Capital growth	4.0%
Dividend yield	1.9%
Total expected return	5.9%

Company Data & Ratios

Enterprise value	\$3,331m
Market cap	\$3,436m
Issued capital	137.4m
Free float	72.7%
Avg. daily val. (52wk)	\$7.3m
12 month price range	\$10.00 - \$28.84

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	23.69	18.52	18.83
Absolute (%)	5.45	34.88	32.66
Rel market (%)	2.69	22.04	40.17



Resilient FY20 result, delivers ahead of pre-COVID guidance

BRG announced underlying FY20 EBIT (pre-AASB 16) of \$111.1m, up 14.3% on pcp. We note the underlying result adds back salary reductions & cuts to marketing spend. Notwithstanding the disruption from COVID-19, the result slightly exceeded BRG's withdrawn guidance (FY20 EBIT pre-AASB16 of ~\$110m). Key result takeaways are:

- Strong revenue growth throughout the year across all key markets:** BRG's Global Product segment achieved 20.1% constant currency (cc) revenue growth over the year. Strong double-digit sales continued in 2H20 despite retailers in key regions closing stores with 2H20 cc sales up ~20% after achieving 20.3% growth in 1H20. We believe BRG's strong online presence in offshore markets (direct to consumer channel, Amazon, William Sonoma & John Lewis) was a key factor to the resilient 2H20 result. All regions contributed positively, with (cc growth): North America +11.3%; Europe +54.8%; ANZ +18.3%; & Rest of World (RoW) +25.6%.
- International rollout plan remains on track:** BRG's rollout in Europe continues to progress strongly. The strong cc sales result reflects a strong result in the UK, traction in Germany/Austria (launched in 2H18/1H19) & the Benelux/Switzerland (launched 2H19) and early benefits in Spain (launched 1H20). France launched in 2H20, with Portugal/Italy to follow in FY21. In the Americas, BRG announced it plans to launch into Mexico in FY21, while in the Middle East BRG is switching to the Sage brand to enable a wider product range and shorter lead times.
- Although some near-term uncertainties to be mindful of:** Aside from COVID-19 risks, key swing factors for FY21 include: 1) the need to replenish inventory back to target levels, which may constrain near-term sales and timing of launches into new markets; 2) timing of Amazon Prime Day clashing with Cyber Monday/Black Friday; & 3) the lumpy nature of RoW sales cycling a strong FY20 baseline.

Earnings changes/Investment View: Move to Hold, PT \$26.00

The stronger than expected result increases our FY21/FY22/FY23 EPS by 8%/3%/0% and our PT increases to \$26.00 (previously \$23.00). We have a positive view on BRG on several fronts: growth prospects in several large markets, flexible cost structure & strong balance sheet. However, given the strong share price run, and mindful of near-term uncertainties, we believe BRG is now fair-value and downgrade from Buy to Hold.

Earnings Forecast

Jun Year end	2020a	2021e	2022e	2023e
Sales (A\$m)	952.2	1,086.3	1,256.1	1,448.2
EBITDA (A\$m)	138.8	156.7	178.3	207.4
NPAT (reported) (A\$m)	66.2	89.5	103.6	122.3
NPAT (underlying) (A\$m)	75.0	89.5	103.6	122.3
EPS underlying (cps)	56.7	65.2	75.4	89.0
EPS underlying growth (%)	10.4%	14.9%	15.7%	18.1%
PER (on underlying EPS) (x)	44.1	38.4	33.2	28.1
EV/EBITDA (x)	24.0	21.3	18.7	16.1
Dividend (cps)	41.0	46.5	53.6	63.6
Yield (%)	1.6%	1.9%	2.1%	2.5%
Franking (%)	60%	60%	60%	60%
ROE (%)	21.0%	19.8%	21.2%	23.1%

FY20 EBIT ahead of pre-COVID guidance

Headline result

Breville Group Ltd (BRG) announced underlying FY20 EBIT (post-AASB16) of \$113.1m, 6.1% ahead vs BPe \$106.7m. Pre-AASB16, FY20 EBIT was \$111.1m, up 14.3% on pcp & slightly ahead of BRG's pre-COVID guidance (i.e. FY20 EBIT pre-AASB16 of ~\$110m). Underlying NPAT was \$75.0m, 4.3% ahead vs BPe \$71.9m. We note the underlying result adjusts for: 1) double debt charges; 2) non-cash write-down of IoT platform; 3) adding back compensation reductions and 4) adding back cuts to marketing spent. Post these one-off items reported NPAT was \$66.2m. A final dividend of 20.5cps (60% franked) was declared, up 2.0cps on pcp.

An overview of the result is below in Figure 1.

Figure 1 – Actual vs expected summary

	Actuals History (FY20 and beyond is post AASB-16)					Actual FY20	Expected FY20e	Actual vs Expected
	1H19	2H19	FY19	1H20	2H20			
Total Revenue	440.4	319.6	760.0	552.1	400.1	952.2	888.4	7.2%
% - Growth (pcp)	15.2%	20.4%	17.3%	25.4%	25.2%	25.3%		
EBITDA	70.5	43.5	114.0	85.2	53.6	138.8	130.9	6.0%
%-Margin	16.0%	13.6%	15.0%	15.4%	13.4%	14.6%	14.7%	-1.1%
% - Growth (pcp)	14.6%	12.3%	13.7%	20.8%	23.3%	21.8%		
Depn & Amort.	-8.2	-8.5	-16.6	-9.0	-10.2	-19.2	-17.9	7.5%
EBIT	62.3	35.0	97.3	73.0	40.2	113.1	106.7	6.1%
%-Margin	14.2%	11.0%	12.8%	13.2%	10.0%	11.9%	12.0%	-1.0%
% - Growth (pcp)	12.9%	10.4%	12.0%	17.1%	14.7%	16.2%		
Net Interest	-1.5	-1.5	-3.0	-4.2	-4.0	-8.2	-7.2	
Profit before Tax	60.8	33.5	94.3	68.8	36.2	105.0	99.5	5.5%
Tax	-17.3	-9.6	-26.9	-19.1	-10.9	-30.0	-27.6	8.7%
Associates/Minorities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Underlying NPAT	43.5	23.9	67.4	49.7	25.3	75.0	71.9	4.3%
%-Margin	9.9%	7.5%	8.9%	9.0%	6.3%	7.9%	8.1%	-2.7%
% - Growth (pcp)	19.7%	7.6%	15.2%	14.1%	5.9%	11.2%		
Abnormals post tax	0.0	0.0	0.0	0.0	-8.8	-8.8	-4.5	94.5%
Reported NPAT	43.5	23.9	67.4	49.7	16.5	66.2	67.4	-1.7%
DPS (cps)	18.5	18.5	37.0	20.5	20.5	41.0	37.2	10.3%

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Forecast changes

The stronger than expected result increases our FY21/FY22/FY23 EPS by 8%/3%/0%. Including model roll-forward our 12-month price target increases to \$26.00 (previously \$23.00). Figure 2 summarises our forecast changes for FY21e-FY23e.

Figure 2 – Earnings revisions summary

		FY21e			FY22e			FY23e		
		Old	New	% Change	Old	New	% Change	Old	New	% Change
Revenue	\$m	981.7	1086.3	10.7%	1143.9	1256.1	9.8%	1292.5	1448.2	12.1%
EBITDA	\$m	144.7	156.7	8.3%	171.1	178.3	4.2%	202.0	207.4	2.6%
EBITDA Margin	%	14.7%	14.4%	-0.3%	15.0%	14.2%	-0.8%	15.6%	14.3%	-1.3%
Underlying NPAT	\$m	82.8	89.5	8.2%	100.9	103.6	2.7%	122.3	122.3	0.0%
Underlying EPS	¢ps	60.2	65.2	8.2%	73.4	75.4	2.7%	89.0	89.0	0.0%
DPS	¢ps	43	46	8.6%	52	54	3.1%	64	64	-0.6%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Breville Group Limited

Company Description

Breville Group Limited (BRG) is the active manager of a number of consumer electrical appliance brands, with a core focus in the small kitchen appliances segment. BRG owns the Breville, Sage (*UK and certain European markets*), Kambrook and Ronson brands and has a license agreement with Nestle Nespresso SA for the distribution of Breville co-branded Nespresso portioned (*capsule system based*) espresso machines in a number of markets (including Australia, New Zealand and North America).

Investment Strategy

We rate BRG Hold with a price target of \$26.00.

BRG's core strategy is to invest in and build the Breville brand globally by leveraging its products and capabilities across multiple geographies. The two key ingredients to this strategy include product innovation (undertaken by a Sydney based products development team) and investment in infrastructure to support global operations.

Growth in North America, the UK and through BRG's international distributor network is targeted at the mid to high-end segment of the small appliances market. BRG's product range in these regions is more focused and primarily "New Product Development" products that are designed and development by BRG from the ground-up. By contrast, BRG's growth in Australia and New Zealand is across a broader market value segment from the low/mid to up-market end. This is matched by broader product range that is weighted to "Sourced Developed Products" which use an externally sourced (from Asia) product base.

Valuation

Our blended 12-mth price target is \$26.00. Our DCF is \$26.00 (WACC of 9.5%), while our SOTP (EV/EBITDA basis) is \$26.02. We take a 75%/25% split to derive our price target.

Risk to Investment Thesis

Key downside risks to our valuation include (but are not limited to):

- **COVID-19:** The substantial impact of COVID-19 on the global & domestic economies together with the Saudi Arabia-Russia oil price war is creating enormous volatility and uncertainty in global share markets. The forecasts in the report may be subject to significant changes if this situation continues for an extended period of time.
- **Exposed to cyclical risk:** More material or prolonged weakness in discretionary spending than expected, placing additional pressure on earnings than forecast. This in turn will have downside risk to dividends. The impact to earnings varies by region, with ANZ exhibiting the highest sensitivity given BRG's mature presence in these markets.
- **Deterioration in brand equity risk due to poor product quality:** Brand deterioration will lead to loss of market share and pricing power in highly competitive markets.
- **Brand acceptance risk** in new markets such as the UK, Germany, France and others.
- **Material impairment charge risks on intangibles** due to difficult market conditions or the deterioration in brand equity.
- **House-brands** impinging on market share and placing downward pressure on price.
- **Product & Supply Chain:** BRG's products are manufactured in China and hence are exposed to risks around sourcing, production, warehousing & supply chain disruptions.

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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