

Analyst

Sam Haddad 612 8224 2819

Authorisation

Jonathan Snape 613 9235 1601

Best & Less Group (BST)

Strong debut result

Recommendation
Buy (unchanged)
Price
\$2.75
Target (12 months)
\$3.30 (unchanged)

GICS Sector
Retailing

Expected Return

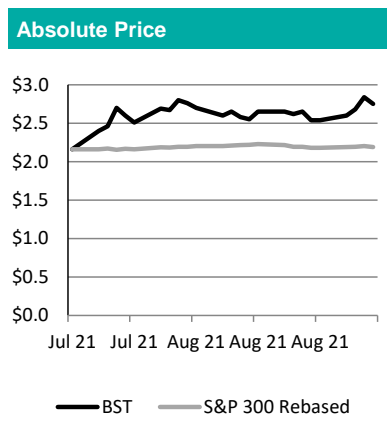
Capital growth	20.0%
Dividend yield	7.2%
Total expected return	27.2%

Company Data & Ratios

Enterprise value	\$507.5m
Market cap	\$345.5m
Issued capital	125.7m
Free float	~85%
Avg. daily val. (52wk)	\$117k
12 month price range	\$2.16 - \$2.89

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	2.16		
Absolute (%)	27.31		
Rel market (%)	25.96		



Strong FY21 result, EBITDA slightly ahead vs 26 July update

BST delivered a strong debut FY21 result that was well ahead of Prospectus forecasts and slightly ahead of the company's 26th July update. FY21 pro-forma EBITDA (pre-AASB16) was \$71.6m, 18.0% ahead Prospectus & well up on pcp of \$27.0m. EBITDA (post-AASB16 basis) was \$124.4m, slightly ahead vs BPe \$121.3m. The result was underpinned by +10.8% like-for-like (LFL) sales growth, with total sales up 6.1% to \$663.2m (0.8% ahead vs Prospectus). Of this, 9.2% was online sales (up vs 7.3% in the pcp). The result was also underpinned by strong margin gains reflecting a clearer pricing strategy, a heightened focus on inventory management, and continued focus on cost control. BST exited FY21 with pro-forma net cash of \$35.7m.

Lockdowns obviously impacting, although levers to cushion

BST provided a trading update for the first 8 weeks of 1H22. Key points are: 1) total sales are down -25.7%, with LFL sales down -11.7% on FY21 & flat on FY20; 2) gross margin is ahead of expectations; and 3) tightly managing inventory, costs & cash flow.

BST reaffirmed its Prospectus pro-forma EBITDA & NPAT forecasts for CY21. For the 1H22 period, achieving Prospectus forecasts remains dependent upon the intensity and duration of lockdowns. While lockdowns will result in a shortfall in 1H22 sales, this is expected to be cushioned by: a better-than-expect start for Postie (pre lockdowns); a favourable FX hedge on COGS; cost saving measures in response to lockdowns; and an expectation consumer demand will rebound in Nov/Dec should restrictions lift.

Earnings changes & Investment View: Retain Buy, PT \$3.30

We already assume a moderate miss vs 1H22 Prospectus EBITDA (due to lockdowns which we assume will continue to end of October), although expect CY21 Prospectus EBITDA will be exceeded. We remain comfortable with our forecasts and our PT is unchanged at \$3.30. We believe BST is well positioned in the current environment given its strength in defensive essentials such as baby / kidswear, value-quality market position (trading-down behaviour by mums is a likely tailwind), plus opportunities to expand in womenswear and further strengthen online capabilities. BST trades at an undemanding FY22 PE of ~8x, with an attractive ff yield of >7%. Buy rating retained.

Earnings Forecast

Jun Year end	2021a	2022e	2023e	2024e
Sales (A\$m)	663.2	663.8	715.2	741.1
EBITDA (A\$m)	124.4	119.1	126.3	130.3
NPAT (reported) (A\$m)	41.3	41.3	44.2	44.5
NPAT (underlying) (A\$m)	41.3	41.3	44.2	44.5
EPS underlying (cps)	32.9	32.9	35.1	35.4
EPS underlying growth (%)	250.0%	0.0%	6.9%	0.8%
PER (on underlying EPS) (x)	8.4	8.4	7.8	7.8
EV/EBITDA (x)	4.1	4.3	4.0	3.9
Dividend (€ps)	-	19.7	21.1	21.2
Yield (%)	-	7.2%	7.7%	7.7%
Franking (%)	-	100%	100%	100%

SOURCE: IRESS
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 ABN 25 006 390 772
 AFSL 243480

SOURCE: BELL POTTER SECURITIES ESTIMATES

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Best & Less Group

Company Description

Best & Less Group (BST) is an omni-channel value apparel retailer with an established store network in ANZ, plus a growing online platform, across its two brands: Best & Less in Australia; and Postie in New Zealand. BST's target consumers are mums on a budget aged 18-54 years with children under the age of 17 years. BST believes it has established a strong connection to its target customers built on: trust; a positioning statement of *twice the quality at half the price*; being a first choice for baby apparel; and a convenient omni-channel shopping experience. Approximately 86% of sales was comprised of in-house brands which leverage BST's design, sourcing and quality assurance capabilities

Investment Strategy

BST is positioned as a value retailer in the Australian and New Zealand apparel markets. BST's business model is centred on maintaining and growing its strength in its core baby & kidswear category which creates a "halo" with other categories (i.e. provides opportunity to grow womenswear, menswear as well as ancillary/impulse items). Being a market leader in the baby apparel market is the customer acquisition engine of BST and the centrepiece of the company's business model.

Valuation

Our 12 month valuation is \$3.30 based on a DCF methodology. Major DCF assumptions are a WACC of 11.4% and a terminal growth rate of 3.0%.

Risks to Investment Thesis

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

- **Retail environment:** Factors that may adversely affect BST's sales include rising interest rates, economic shocks, increased unemployment and declining home values.
- **COVID-19:** The substantial impact of COVID-19 on the global & domestic economies is creating volatility & uncertainty in global share markets. Forecasts in the report may be subject to significant changes if this situation continues for an extended period of time.
- **Increased competition:** BST operates in a competitive market and there is a risk that BST may lose market share to new or existing competitors.
- **Mismatch between fashion trends vs consumer preferences:** Risk that the product ranges developed/sourced by BST do not align with consumer preferences. Further, a sustained mismatch in demand between customer preferences and BST stock may result in stock shortages (leading to lost sales) or excess stock (leading to markdowns).
- **Retain/secure suitable store sites:** BST's performance & growth is in part dependent on its ability to retain/secure store sites in suitable locations and on acceptable terms.
- **Product sourcing may be disrupted and/or there may be adverse FX movements:** While BST has a diversified supplier base, the business still relies on Chinese & other Asian suppliers. Any material adverse changes in these markets may adversely impact BST's ability to source/sell its products reliably and without material delays. Also, as most of BST's overseas purchases are \$US denominated, BST's financial position may be negatively affected by a severe and/or sustained decline in the \$A against the \$US.
- **Lose of key management personnel:** If a key member of the management team were to resign/leave the business this could have an adverse effect on BST's performance.

Table 1 - Financial summary

Jun Year end	2019	2020	2021	2022e	2023e	2024e
Profit & Loss (A\$m)						
Sales revenue	608.7	625.0	663.2	663.8	715.2	741.1
... Change		2.7%	6.1%	0.1%	7.7%	3.6%
EBITDA	78.0	83.7	124.4	119.1	126.3	130.3
... Change		7.3%	48.6%	-4.2%	6.0%	3.2%
Deprec. & amort.	(59.1)	(55.3)	(54.9)	(51.2)	(55.0)	(58.1)
EBIT	18.9	28.4	69.5	67.9	71.3	72.3
Net Interest	(10.9)	(11.5)	(10.6)	(8.9)	(8.2)	(8.7)
Pre-tax profit	8.0	16.9	58.9	59.0	63.1	63.6
Tax expense	(2.4)	(5.1)	(17.6)	(17.7)	(18.9)	(19.1)
... tax rate	30%	30%	30%	30%	30%	30%
Associates	-	-	-	-	-	-
Minorities/Prefs	(0.0)	-	-	-	-	-
Underlying Net Profit	5.6	11.8	41.3	41.3	44.2	44.5
... Change		111.4%	250.0%	0.0%	6.9%	0.8%
Abs. & extras.	(0.7)	-	-	-	-	-
Reported Profit	4.9	11.8	41.3	41.3	44.2	44.5
Assumed AASB16 adjustment to Underlying EBITD		(56.7)	(52.8)	(55.5)	(58.9)	(61.9)
Underlying EBITDA (Pre-AASB16)		27.0	71.6	63.6	67.4	68.5
Cashflow (A\$m)						
EBITDA	78.0	83.7	124.4	119.1	126.3	130.3
Working capital changes	-	-	(13.3)	(30.4)	(5.4)	(7.4)
Net Interest Expense	(0.7)	(0.6)	(15.8)	(8.9)	(8.2)	(8.7)
Tax	(5.9)	(6.9)	(22.1)	(17.3)	(19.4)	(19.1)
Other operating items	(3.4)	58.7	(4.5)	(2.5)	(1.1)	(1.3)
Operating Cash Flow	65.0	134.9	68.7	59.9	92.2	93.8
Capex	(5.3)	(3.9)	(4.7)	(7.3)	(7.9)	(8.2)
Free Cash Flow	59.7	131.0	64.0	52.6	84.3	85.7
Acquisitions	-	-	123.7	-	-	-
Disposals	-	-	0.3	-	-	-
Payment of leases	(61.2)	(63.0)	(36.9)	(35.9)	(60.3)	(63.3)
Dividends paid	-	-	(43.2)	(12.7)	(27.2)	(26.8)
Other investing items	-	-	-	-	-	-
Equity	-	-	0.0	-	-	-
Core debt increase/(reduction)	-	-	(72.2)	(3.9)	3.2	4.5
Balance Sheet (A\$m)						
Cash	-	-	35.7	20.0	20.0	20.0
Receivables	-	-	4.9	1.4	1.5	1.5
Inventories & WIP	-	-	80.5	98.7	106.3	113.7
Other current assets	-	-	1.0	1.0	1.0	1.0
Current Assets	-	-	122.2	121.1	128.8	136.3
Receivables	-	-	-	-	-	-
Assoc & investments	-	-	-	-	-	-
Fixed Assets (PP&E)	-	-	9.8	13.8	17.6	21.1
Right-of-use Assets	-	-	186.6	212.3	223.7	234.6
Intangibles	-	-	11.8	11.8	11.8	11.8
Other non-curr assets	-	-	12.6	12.6	12.6	12.6
Non Current Assets	-	-	220.8	250.6	265.7	280.1
Total Assets	-	-	342.9	371.7	394.4	416.4
Short term debt	-	-	-	-	-	-
Creditors	-	-	72.2	56.4	58.6	58.8
Provisions	-	-	25.1	22.3	21.0	19.5
Other curr liabilities	-	-	37.2	42.4	44.6	46.8
Current Liabilities	-	-	134.5	121.0	124.3	125.1
LT debt (incl. leases)	-	-	160.4	162.9	175.8	189.7
Creditors	-	-	-	-	-	-
Provisions	-	-	4.8	5.2	5.4	5.6
Other non curr liabilities	-	-	-	-	-	-
Non Current Liabilities	-	-	165.3	168.1	181.2	195.3
Total Liabilities	-	-	299.8	289.1	305.5	320.4
Net Assets	-	-	43.1	82.6	88.9	96.0
Share Capital	-	-	0.0	0.0	0.0	0.0
Reserves	-	-	5.1	5.1	5.1	5.1
Retained Earnings	-	-	38.0	77.5	83.9	90.9
Shareholders Equity	-	-	43.1	82.6	88.9	96.0
Outside Equity Interests	-	-	-	-	-	-
Total Equity	-	-	43.1	82.6	88.9	96.0
Core Net debt/(cash) \$m	-	-	(35.7)	(39.7)	(36.5)	(32.0)
Net debt/(cash) [incl. leases] \$m	-	-	161.9	185.2	200.5	216.5

Price	\$2.75
Recommendation	Buy
Diluted issued capital (m)	125.7
Market cap (\$m)	345.5
Target Price (A\$m)	\$ 3.30

Jun Year end	2019	2020	2021	2022e	2023e	2024e
Valuation Ratios						
Underlying EPS (eps)	-	9.4	32.9	32.9	35.1	35.4
... % change		250.0%	0.0%	0.0%	6.9%	0.8%
PE (on underlying EPS) (x)	-	29.3	8.4	8.4	7.8	7.8
EV/EBITDA (x)	6.51	6.06	4.08	4.26	4.02	3.89
EV/EBIT (x)	26.85	17.87	7.30	7.47	7.12	7.02
NTA (\$ps)	-	-	0.25	0.56	0.61	0.67
P/NTA (x)	-	-	11.04	4.88	4.48	4.11
Book Value (\$ps)	-	-	0.34	0.66	0.71	0.76
Price/Book (x)	-	-	8.01	4.18	3.89	3.60
DPS (eps)	-	-	-	19.7	21.1	21.2
... % pay-out	0.0%	0.0%	0.0%	60.0%	60.0%	60.0%
Yield (%)	0.0%	0.0%	0.0%	7.2%	7.7%	7.7%
Franking (%)	-	-	-	100%	100%	100%

Performance Ratios						
Revenue growth (%)		2.7%	6.1%	0.1%	7.7%	3.6%
EBITDA growth (%)		7.3%	48.6%	-4.2%	6.0%	3.2%
EBITDA/sales margin (%)	12.8%	13.4%	18.8%	17.9%	17.7%	17.6%
EBIT/sales margin (%)	3.1%	4.5%	10.5%	10.2%	10.0%	9.8%
Gross cash conversion (%)	95.6%	170.1%	85.7%	72.3%	94.9%	93.4%
Free cash-flow yield (%)	-	37.9%	18.5%	15.2%	24.4%	24.8%
ROE (%) (on adj NPAT)	-	-	190.0%	60.0%	50.0%	46.6%
ROIC (%)	-	-	2148.5%	184.8%	105.2%	86.9%
Capex/Depn (x)	1.4	1.2	1.2	2.3	1.9	1.8
Net interest cover (x)	-	2.5	6.6	7.6	8.6	8.3
Core net Debt/EBITDA (pre-AASB16) (x)	n/a	n/a	n/a	n/a	n/a	n/a
Net debt/equity (%)	-	-	375.5%	224.3%	225.4%	225.5%
Net debt/net debt + equity (%)	-	-	79.0%	69.2%	69.3%	69.3%

Half yearly (A\$m)	1H20	2H20	1H21	2H21
Sales revenue	322.3	302.7	333.6	329.6
EBITDA	46.1	37.6	66.3	58.1
Deprec. & amort.	(27.1)	(28.2)	(28.0)	(26.9)
EBIT	19.0	9.4	38.3	31.2
Interest expense	(5.2)	(6.3)	(6.9)	(3.7)
Pre-tax profit	13.8	3.1	31.4	27.5
Tax expense	(4.2)	(0.9)	(9.4)	(8.2)
... tax rate	30%	30%	30%	30%
Associates	-	-	-	-
Minorities	-	-	-	-
Underlying Net Profit	9.6	2.2	22.0	19.3
Abs. & extras.	-	-	-	-
Reported Profit	9.6	2.2	22.0	19.3

SOURCE: BELL POTTER SECURITIES ESTIMATES

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.

Research Team

Staff Member	Title/Sector	Phone	@bellpotter.com.au
Chris Savage	Head of Research/Industrials	612 8224 2835	csavage
Analysts			
TS Lim	Banks	612 8224 2810	tslim
John Hester	Healthcare	612 8224 2871	jhester
Tanushree Jain	Healthcare	612 8224 2849	tnjain
Elyse Shapiro	Healthcare	613 9235 1877	eshapiro
Steven Anastasiou	Industrials	613 9235 1952	sanastasiou
Sam Brandwood	Industrials	612 8224 2850	sbrandwood
James Filius	Industrials	613 9235 1612	jfilius
Sam Haddad	Industrials	612 8224 2819	shaddad
Alex McLean	Industrials	612 8224 2886	amclean
Hamish Murray	Industrials	613 9235 1813	hmurray
Jonathan Snape	Industrials	613 9235 1601	jsnape
David Coates	Resources	612 8224 2887	dcoates
Stuart Howe	Resources	613 9235 1856	showe
Brad Watson	Resources	618 9326 7672	bwatson
Joseph House	Resources	613 9235 1624	jhouse
Associates			
Olivia Hagglund	Associate Analyst	612 8224 2813	ohagglund
Michael Ardrey	Associate Analyst	613 9256 8782	mardrey

Bell Potter Securities Limited
 ABN 25 006 390 772
 Level 29, 101 Collins Street
 Melbourne, Victoria, 3000
 Telephone +61 3 9256 8700
 www.bellpotter.com.au

Bell Potter Securities (HK) Limited
 Room 1701, 17/F
 Prosperity Tower, 39 Queens Road
 Central, Hong Kong, 0000
 Telephone +852 3750 8400

Bell Potter Securities (US) LLC
 Floor 39
 444 Madison Avenue, New York
 NY 10022, U.S.A
 Telephone +1 917 819 1410

Bell Potter Securities (UK) Limited
 16 Berkeley Street
 London, England
 W1J 8DZ, United Kingdom
 Telephone +44 7734 2929

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