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Best & Less Group Holdings Ltd

Growth off the FY23 base not dependent on sales growth

Best & Less (ASX:BST) is a leading 'value apparel speciality retailer' with a particular focus in baby and kids wear (~50% of revenue). The group has 245 stores under the Best & Less brand in Australia (183 stores) and Postie brand in New Zealand (61 stores). As an apparel based omni-channel retailer the cycling of lockdowns and a wet/cold beginning to the FY23 summer period impacted both like store sales and resulting gross margins due to clearance activity. Acknowledging a cautious consumer management appear very confident around the prospects for growth in H2 FY23, FY24 and FY25, with COGS, operating costs and freight all moving in their favour. In our view consensus estimates do not reflect this outlook, creating an opportunity for both earnings beats and multiple expansion. We rate the BST model in the top quartile of peers when considering stockturns, gross margin, vertical integration, seasonality and Average Selling Price (ASP).

Business model

BST operates a vertically integrated, omni channel retail model with ~86% of products designed in-house and distributed under their own brands through the groups store and on-line networks. The group broadly retails clothing and footwear with a particular focus on baby and kids wear with a 'good, better, best' ranging strategy. Growth avenues include further store openings (target of 15-25 new stores), growing the on-line presence (currently ~10% of total sales currently), improving gross margins which are lower than most vertically integrated retailers and increasing share in the womenswear category where they already have a captive customer.

Supportive commentary despite the environment

Consensus reaction (in terms of earnings changes) to the H1 FY23 result and more importantly the outlook for FY24 has this analyst feeling he listened to a different conference call. Outlook commentary while acknowledging a cautious consumer environment had positive implications for earnings in H2 FY23, FY24 and FY25, driven by a range of factors. In fact, management suggested it is "the most stable and predictable (retail) environment for the last 3-years". Positive drivers for growth into FY25 include COGS (expected to be deflationary by year-end), freight (material cost reductions with minimal disruptions from January 2023), lower operating costs (from December 2022 in reaction to slowing sales) and positioning (value conscious with an ASP of ~$9. The table on page 10 of the H1FY23 result presentation summarises this well. Consensus EBIT estimates post result were lowered ~1% and the consensus GP% for FY24 is 47.7% and for FY25 48.1%. Every 1% move in GP% adds 12% to EBIT all else being equal.

Valuation discussion points

We have not built a model to derive a DCF valuation and as a result look to peers for a guide to an appropriate earnings multiple. Listed peers are small-cap speciality omni-channel retailers and include TRS, BBN, MYR and AX1. Looking at stockturn, percentage own brand sales (vertical integration), gross margin, seasonality and ASP, we place BST in the top quartile of business models among the peer group, particularly on a GP% x stockturn basis. Using the average PER of (11) peers based on consensus estimates, BST is trading at a 45% discount to the peer average in both FY24 and FY25.

Historical earnings (in A$m unless otherwise stated)

Year end	Total Revenue	Gross Profit	EBITDA	NPAT	EPS (c)	EV/Sales (x)	EV/EBITDA (x)	PER (x)	Div. Yield (%)
06/19a	608.7	275.4	23.0	13.8	0.11	0.38	10.1	16.9	n.a
06/20a	625.0	278.6	27.0	16.1	0.13	0.37	8.6	14.5	n.a
06/21a	663.2	324.5	71.6	47.0	0.37	0.30	2.8	5.1	n.a
06/22a	622.2	305.4	62.5	41.1	0.33	0.32	3.2	5.8	12.2

Source: Company data, RaaS analysis

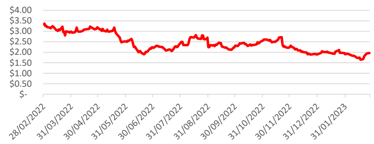
Share Details

ASX code	BST
Share price (27-Feb)	$1.965
Market Capitalisation	$246M
Shares on issue	125.3M
Net cash at 31-Dec	$14.7M
Industry Sector	Retail
Free float	~35%

RaaS RAP 5-point score* = 3/5

Revenue increasing (1); EPS increasing (0), Return on Capital Employed [ROCE] (0); EBIT interest cover >3x (1) Gross Operating cash flow/EBITDA >90% (1)

Share Price Performance (12-months)



Upside Case

- Gross margins return to top of 48%-50% range
- Improved efficiency from new systems
- Like store sales hold-up better than expected

Downside Case

- Competitive environment intensifies, impacting GP%
- Consumer spending slows more than expected
- Loss of key personnel

Catalysts

- Delivery of H2 FY23 guidance
- Positive sales in H1 FY24 cycling adverse weather.
- Valuation

Comparative Companies (Australia & NZ)

The Reject Shop (ASX:TRS), Baby Bunting (ASX:BBN), Myer Holdings (ASX:MYR)

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***The analyst holds shares**

*The RaaS RAP 5-point scorecard is derived from the last reported financial year's performance over the prior year. Past performance is not a guarantee of future performance.

This report should be read in conjunction with the FSG and disclosures on pages 2-4.

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Corporate Authorised Representative, number 1248415

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