

30 March 2023

## Step One Clothing Ltd

### Underwear under valued

Step One Clothing (ASX:STP) is a Direct to Consumer (DTC), 100%-own-brand underwear retailer specialising in anti-chafe bamboo underwear across men's and women's wear, with a core colour range supplemented by regular limited-edition releases, all with FSC (Forest Stewardship Council) certification throughout the supply chain. The company has operations in Australia (67% of sales), UK, (30% of sales) and the US (3% of sales). A H1 FY23 sales decline of 5.7% was better than our industry average estimate of -19% cycling lockdown, while lower sales and marketing spend saw EBITDA in-line with the pcp at \$7.6m, the highest of any industry peer. H2 FY23 should see similar trends and deliver EBITDA well above consensus. The STP business model should be seen as superior to peers given industry high gross margins (own brand), flexibility in sales and marketing spend, relatively low-cost 3PL distribution, no capex requirements, and low staffing requirements. On our estimates this superior business model currently trades at a PER of 1.0x ex-cash. Inventory is the key risk, currently representing ~two years' sales, but has low fashion risk and will benefit working capital as it is cleared.

### Business model

STP is a Direct-to-Consumer retailer of own-brand (Step One) men's and women's underwear, with a particular focus on its anti-chafe design and bamboo material. The group is FSC certified throughout the supply chain, even down to the compostable bag the product is delivered to customers in. The own-brand nature of sales provides industry high gross margins (~80%), well above most ASX-listed on-line retailers who mostly retail third-party brands. The largest cost item is the sales and marketing to attract new customers and/or retain existing customers. This can be adjusted for various macro and micro settings. Other key variable costs are distribution and merchant fees.

### The H1 FY23 result and H2 FY23 outlook is not being appreciated

Beginning with the H1 FY23 result, like all DTC retailers STP was cycling the benefits of lockdown in the pcp and delivered a 5.7% sales decline in H1 FY23. This compares to an estimated average on-line peer sales decline of 19% and omni-channel on-line decline of 19% over the same period. Lower sales and marketing spend over the period saw STP deliver EBITDA modestly above the pcp at \$7.6m, higher than any on-line peer including [ASX:TPW] (\$7.3m) which has a market capitalisation of \$450m. In H2 FY23 STP will be cycling a ~A\$2.8m loss in the US and well above target sales and marketing spend, partially a result of the US entry. If we assume flat sales growth, a US loss closer to H1 (\$0.3m), marketing spend at 38% of sales (up from 33% in H1 but down from 50% in H2 FY22), and a 15% decline in Australian EBITDA we arrive at H2 FY23 EBITDA of \$5.3m, resulting in FY23 EBITDA of \$13m. This compares with current forecasts in the market for EBITDA of \$9.0m.

### Valuation discussion points

The first point to make is that STP ended H1 FY23 with net cash of \$32.5m or \$0.18/share, and is forecast to end the year with \$40m (\$0.22/share). This implies an ex-cash PER of 1.0x. There are no genuine online-only listed peers for STP as most sell third-party brands at lower gross margins such as Adore Beauty (ASX:ABY), Booktopia (ASX:BKG) and Kogan (ASX:KGN), or are marketplaces for other brands such as Temple & Webster (ASX:TPW). City Chic is the most comparable with online sales of ~68%, historically high gross margins (down 800bps to 51.7% in H1 FY23) and offshore operations. All have larger market caps and lower forecast earnings than STP.

### Historical earnings and RaaS estimates (in A\$m unless otherwise stated)

| Year end | Total revenue (A\$m) | Gross profit | EBITDA | NPAT | EPS (c) | EV/Sales (x) | EV/EBITDA (x) | PER (x) | PE (ex-cash) (x) |
|----------|----------------------|--------------|--------|------|---------|--------------|---------------|---------|------------------|
| 06/21a   | 61.7                 | 51.0         | 12.1   | 8.5  | 0.056   | 0.63         | 3.2           | 4.8     | 3.5              |
| 06/22a   | 72.2                 | 59.2         | 10.4   | 7.3  | 0.044   | 0.22         | 1.5           | 6.2     | 1.5              |
| 06/23f   | 69.7                 | 56.1         | 13.0   | 9.3  | 0.050   | 0.14         | 0.8           | 5.4     | 1.0              |

Source: Company data, RaaS analysis and RaaS forecast for FY23f

### Share Details

|                         |          |
|-------------------------|----------|
| ASX code                | STP      |
| Share price (29-Mar)    | \$0.275  |
| Market capitalisation   | \$50.96M |
| Shares on issue         | 185.3M   |
| Net cash at 31-Dec-2022 | \$32.5M  |
| Industry sector         | Retail   |
| Free float              | ~18%     |

### RaaS RAP 5-point score\* = 4/5

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

### Share Price Performance (12-months)



### Upside Case

- Lower marketing spend per new/existing customer
- Crack womenswear and/or US markets
- Utilise >\$32m cash

### Downside Case

- Stock clearance impacts GP%, leads to write downs
- Pursue US/womenswear market too long
- Competition in the bamboo underwear space

### Catalysts

- Delivery of an improved H2 FY23 result
- Signs of US market penetration
- Capital management

### Comparative Companies (Australia & NZ)

Kogan (ASX:KGN), City Chic (ASX:CCX), Adairs (ASX:ADH)

### RaaS Contacts

|               |   |
|---------------|---|
| John Burgess* | +61 410 439 723<br>john.burgess@raasgroup.com |
| Finola Burke  | +61 414 354 712<br>finola.burke@raasgroup.com |

\* The author owns shares

## FINANCIAL SERVICES GUIDE

RaaS Advisory Pty Ltd

ABN 99 614 783 363

Corporate Authorised Representative, number 1248415

of

BR SECURITIES AUSTRALIA PTY LTD

ABN 92 168 734 530

AFSL 456663

Effective Date: 6<sup>th</sup> May 2021

## About Us

BR Securities Australia Pty Ltd (BR) is the holder of Australian Financial Services License ("AFSL") number 456663. RaaS Advisory Pty Ltd (RaaS) is an Authorised Representative (number 1248415) of BR.

This Financial Service Guide (FSG) is designed to assist you in deciding whether to use RaaS's services and includes such things as

- **who we are**
- **our services**
- **how we transact with you**
- **how we are paid, and**
- **complaint processes**

Contact Details, BR and RaaS

BR Head Office: Suite 5GB, Level 5, 33 Queen Street, Brisbane, QLD, 4000

RaaS, 20 Halls Road Arcadia, NSW 2159

P: +61 414 354712

E: [finola.burke@raasgroup.com](mailto:finola.burke@raasgroup.com)

RaaS is the entity providing the authorised AFSL services to you as a retail or wholesale client.

**What Financial Services are we authorised to provide?** RaaS is authorised to

- **provide general advice to retail and wholesale clients in relation to**
  - **Securities**
- **deal on behalf of retail and wholesale clients in relation to**
  - **Securities**

The distribution of this FSG by RaaS is authorized by BR.

## Our general advice service

Please note that any advice given by RaaS is general advice, as the information or advice given will not take into account your particular objectives, financial situation or needs. You should, before acting on the advice, consider the appropriateness of the advice, having regard to your objectives, financial situation and needs. If our advice relates to the acquisition, or possible acquisition, of a particular financial product you should read any relevant Prospectus, Product Disclosure Statement or like instrument. As we only provide general advice we will not be providing a Statement of Advice. We will provide you with recommendations on securities

## Our dealing service

RaaS can arrange for you to invest in securities issued under a prospectus by firstly sending you the offer document and then assisting you fill out the application form if needed.

## How are we paid?

RaaS earns fees for producing research reports. Sometimes these fees are from companies for producing research reports and/or a financial model. When the fee is derived from a company, this is clearly highlighted on the front page of the report and in the disclaimers and disclosures section of the report.

We may also receive a fee for our dealing service, from the company issuing the securities.

## Associations and Relationships

BR, RaaS, its directors and related parties have no associations or relationships with any product issuers other than when advising retail clients to invest in managed funds when the managers of these funds may also be clients of BR. RaaS's representatives may from time to time deal in or otherwise have a financial interest in financial products recommended to you but any material ownership will be disclosed to you when relevant advice is provided.

## Complaints

If you have a complaint about our service you should contact your representative and tell them about your complaint. The representative will follow BR's internal dispute resolution policy, which includes sending you a copy of the policy when required to. If you aren't satisfied with an outcome, you may contact AFCA, see below.

BR is a member of the Australian Financial Complaints Authority (AFCA). AFCA provide fair and independent financial services complaint resolution that is free to consumers.

Website: [www.afca.org.au](http://www.afca.org.au); Email: [info@afca.org.au](mailto:info@afca.org.au); Telephone: 1800931678 (free call)

In writing to: Australian Financial Complaints Authority, GPO Box 3, Melbourne, VIC, 3001.

## Professional Indemnity Insurance

BR has in place Professional Indemnity Insurance which satisfies the requirements for compensation under s912B of the Corporations Act and that covers our authorized representatives.

#### DISCLAIMERS and DISCLOSURES

This report has been prepared and issued by RaaS Advisory Pty Ltd (A.B.N. 99 614 783 363), trading as Research as a Service. RaaS Advisory's principals, employees and associates may hold shares in companies that are covered and, if so, this will be clearly stated on the front page of each report. This research is issued in Australia by RaaS Advisory and any access to it should be read in conjunction with the Financial Services Guide on the preceding two pages. All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable. Opinions contained in this report represent those of the principals of RaaS Advisory at the time of publication. RaaS Advisory provides this financial advice as an honest and reasonable opinion held at a point in time about an investment's risk profile and merit and the information is provided by the RaaS Advisory in good faith. The views of the adviser(s) do not necessarily reflect the views of the AFS Licensee. RaaS Advisory has no obligation to update the opinion unless RaaS Advisory is currently contracted to provide such an updated opinion. RaaS Advisory does not warrant the accuracy of any information it sources from others. All statements as to future matters are not guaranteed to be accurate and any statements as to past performance do not represent future performance.

Assessment of risk can be subjective. Portfolios of equity investments need to be well diversified and the risk appropriate for the investor. Equity investments in listed or unlisted companies yet to achieve a profit or with an equity value less than \$50 million should collectively be a small component of a balanced portfolio, with smaller individual investment sizes than otherwise.

The science of climate change is common knowledge and its impacts may damage the global economy. Mitigating climate change may also disrupt the global economy. Investors need to make their own assessments and we disclaim any liability for the impact of either climate change or mitigating strategies on any investment we recommend.

Investors are responsible for their own investment decisions, unless a contract stipulates otherwise. RaaS Advisory does not stand behind the capital value or performance of any investment. Subject to any terms implied by law and which cannot be excluded, RaaS Advisory shall not be liable for any errors, omissions, defects or misrepresentations in the information (including by reasons of negligence, negligent misstatement or otherwise) or for any loss or damage (whether direct or indirect) suffered by persons who use or rely on the information. If any law prohibits the exclusion of such liability, RaaS Advisory limits its liability to the re-supply of the Information, provided that such limitation is permitted by law and is fair and reasonable. Copyright 2023 RaaS Advisory Pty Ltd (A.B.N. 99 614 783 363). All rights reserved.