BELL POTTER

23 April 2015

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Super Retail Group (SUL)

Transitioning to growth

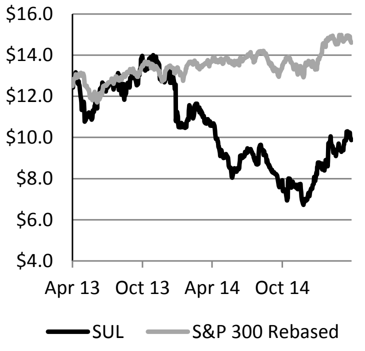
Recommendation
Buy (unchanged)
Price
$9.79
Target (12 months)
$11.00 (unchanged)

Expected Return	
Capital growth	12.4%
Dividend yield	4.4%
Total expected return	16.8%
Company Data & Ratios	
Enterprise value	$2,301m
Market cap	$1,964m
Issued capital	198.7m
Free float	100%
Avg. daily val. (52wk)	$9.3m
12 month price range	$6.70 - $10.77
GICS sector	Retailing

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	9.61	8.08	10.69
Absolute (%)	2.71	22.15	-7.67
Rel market (%)	2.96	14.38	-15.67

Absolute Price



SOURCE: IRESS

Strong earnings growth to emerge in FY16/FY17

With the benefit of important business transformation initiatives undertaken over the past two years, and bed-down of execution hick-ups that unfortunately accompanied, we believe SUL is now entering its next earnings growth phase. We are forecasting EPS growth of 18.1%/16.8% in FY16/FY17 driven by the combination of leverage benefits off initiatives recently complete or well advanced (including new DC network, JDA rollout and SAP), the closure of loss-making stores in 2H15 (FCO and 5xRays), cycling of weaker comparatives, and the progressive unwind of investments.

…notwithstanding some near-term pressure from mining

We believe the continued steep fall in iron ore prices will likely place some near-term pressure on regional Leisure store sales, with Easter typically a popular camping period. Consumer nerves leading into the budget may also temper April sales. That said, notwithstanding these near-term issues, we remain of the view that the broader macro economy remains "conducive" and supportive over a medium-term timeframe. We also believe the forthcoming budget will prove to have less damaging ramifications vs last year's which should help with comparatives through May/June and into FY16.

Earnings changes

We have tempered our 2H15 Leisure estimates, but there is no material EPS change. SUL typically provides a market update in early May at which point we will undertake a more formal review. Including time-creep, our PT is unchanged at $11.00.

Investment view – retain Buy, PT $11.00

Following a transitionary period of important business investment over the past ~2 years, we believe SUL is better placed to grow earnings over the medium-term. Notwithstanding continued pressures stemming from mining, we believe the business will benefit from a number of internal drivers as well as the conducive macro backdrop. At FY16 PE of ~15x, we view valuation as undemanding given SUL's strong earnings growth outlook (*& bottom-of-cycle earnings profile*), portfolio of leading retail platforms and solid ff yield. We retain our Buy rating with an unchanged 12-month PT of $11.00.

Earnings Forecast

Jun Year end	2014a	2015e	2016e	2017e
Sales (A$m)	2,095.9	2,223.1	2,368.2	2,530.0
EBITDA (A$m)	227.4	240.2	271.9	298.6
NPAT (reported) (A$m)	108.4	81.3	125.0	146.0
NPAT (underlying) (A$m)	106.2	105.8	125.0	146.0
EPS underlying (cps)	53.5	53.3	62.9	73.5
EPS underlying growth (%)	-7.1%	-0.5%	18.1%	16.8%
PER (on underlying EPS) (x)	18.3	18.4	15.6	13.3
EV/EBITDA (x)	10.0	9.5	8.4	7.6
Dividend (¢ps)	40.0	39.5	43.5	47.2
Yield (%)	4.1%	4.0%	4.4%	4.8%
Franking (%)	100%	100%	100%	100%
ROE (%)	14.2%	13.9%	15.8%	17.2%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Multiple earnings growth drivers

We provide the following summary of what we believe will be the key earnings growth drivers for SUL over the medium-term.

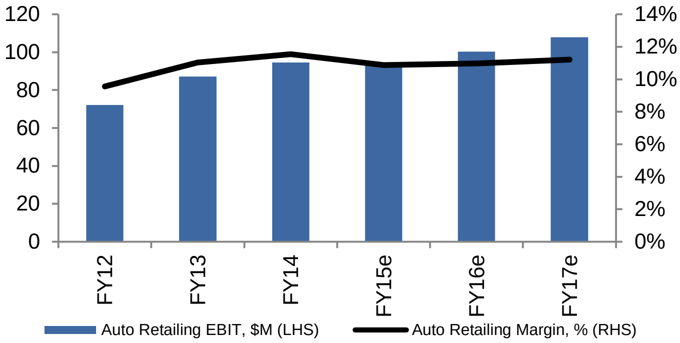
- **Leveraging off new DC network**: SUL expects cost savings of '1% of sales' over FY16/FY17, plus an additional 0.5% from procurement savings & process efficiencies.
- **Auto store refurbishments**: Stores that have been refurbished to date have experienced mid-single digit like-for-like sales uplift. The refurbishment program is in its early stages with circa 85% - 90% of SuperCheap Auto network still to benefit.
- **Multiple drivers for Leisure**: These include: 1) BCF cannibalisation impacts having now washed through since 3Q15; 2) the planned closure of five key loss-making Ray's stores in 2H15; and 3) the planned closure of the loss-making FCO business in New Zealand in 2H15 (note, FCO incurred a -$2.0m loss in 1H15).

  On the negative side for Leisure (over the near-term) is the continued downturn in key commodities (esp. iron ore) which we believe may place some further pressure on regional Leisure store sales through the Easter period (*a popular camping period*).
- **Multiple drivers also for Sports**: including 1) scope to leverage off SAP; 2) the continued rollout of Amart stores; and 3) the lower $A providing some competitive pressure relief for certain product categories, particularly footwear.
- **Rollout of JDA** (new inventory planning system): The Leisure and Auto divisions are now on stream, with Sports next in line. The expected net working capital benefit with JDA is ~$50m, with most of this yet to be delivered.
- **The progressive unwind of investments**: ~$6m change management program cost expected in 2H15, but not beyond. This unwind itself will lift EBIT by ~3% in FY16.
- **Cycling last years' May Federal Budget impacts (May/June and 1Q16 benefit).** While consumers are somewhat nervous leading into this years' budget (as evident by the 3.2% fall in the April consumer sentiment read), we are hopeful that the Government has learned from its experience last year & believe this time there will be reduced post-budget ramifications on consumer discretionary spending. Accordingly we expect SUL will benefit from cycling weaker comparatives during May/June and 1Q16.

Forecasts overview by division and unallocated

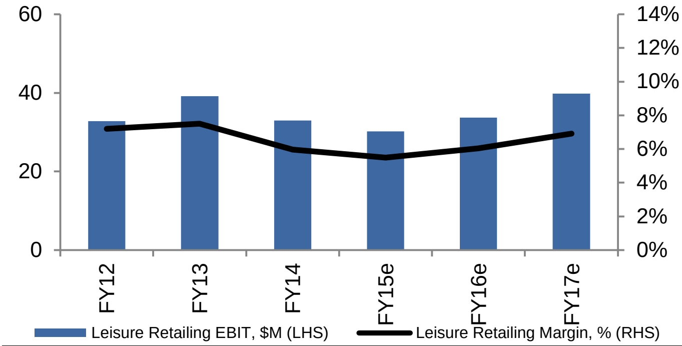
We have tempered our 2H15 Leisure estimates, but there is no material EPS (<3%) change at a total group level. Note, Leisure is the smallest earnings contributing division with a first-half weighting. SUL typically provides a market update in early May at which point we will undertake a more formal review. The following Figure 1 through to Figure 3 chart EBIT and EBIT margin for each division including our forecasts through to FY17.

Figure 1 – Auto division EBIT and EBIT margin trajectory



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

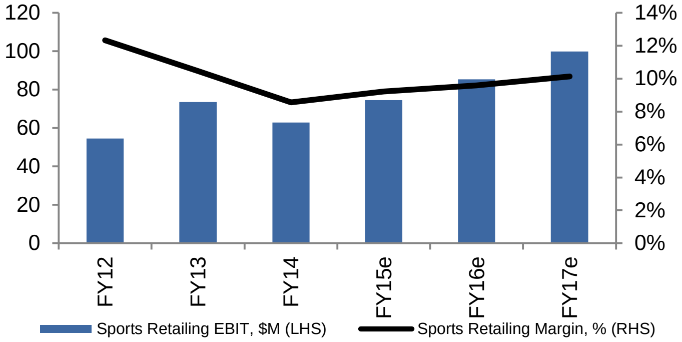
Figure 2 – Leisure division EBIT and EBIT margin trajectory



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

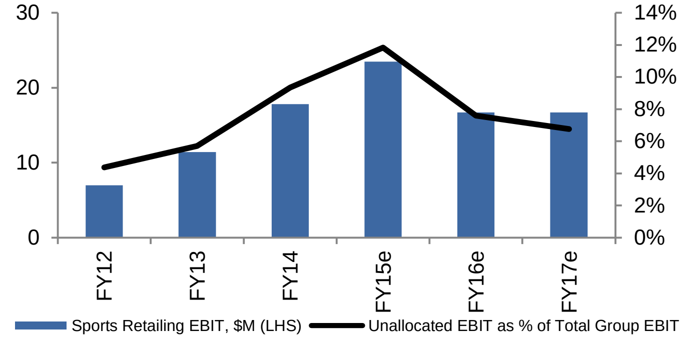
In Figure 4 we chart unallocated corporate costs. As illustrated, we are forecasting unallocated corporate costs will peak in FY15.

Figure 3 – Sports division EBIT and EBIT margin trajectory



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 4 – Unallocated corporate EBIT



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Super Retail Group (SUL)

Company Description

Super Retail Group Limited (SUL) is an Australian specialty retailer which operates stores across Australian and New Zealand. They operate in the automotive parts and accessories market along with the leisure and recreational goods market. SUL has six retail businesses comprising Supercheap Auto, Boating Camping and Fishing (BCF), Ray's Outdoors, Fishing Camping Outdoors (FCO), Rebel/Amart, and Workout World.

Investment Strategy

We rate SUL **Buy** with a PT of $11.00. There are five key focus points that make up SUL's "Strategic Agenda". These include: 1) customer understanding & experience; 2) brand, range & service development; 3) supply chain & inventory management; 4) operating model & reporting; and 5) attracting & engaging staff. At the heart of these five focus points is SUL's "integrated multi-channel" platform framework. This strategic agenda aims to inspire/engage/understand/communicate/influence customers; facilitate customer shopping preferences however, where-ever and when-ever; develop best in class sourcing, supply chain, and fulfilment capabilities; optimise operating efficiency and productivity; and attract, engage & retain team members who share SUL's passion for its products & performance.

Valuation

Our blended 12-month price target is $11.00. Our DCF is $11.37 (WACC of 10.7%) and our SOTP (EV/EBITDA basis) is $9.91. We take a 75%/25% split to derive our target.

Risk to Investment Thesis

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

- **Slowdown in consumer spending**. A more material or prolonged downturn would place pressure on revenues and margins, placing downside risk to dividends.
- **Increased Competition**. Increased competitive intensity (includes the threat of **online competition**) may place pressure on sales and margins. We believe SUL's Sporting Retail division is the most vulnerable to online competition, while Auto Retailing is least.
- **Store rollout changes**. This may impact our revenue and earnings forecasts.
- **Movements in AUD/USD**. SUL sources the majority of its products from overseas. Material movements in the AUD/USD can impact sourcing cost and earnings.
- **Acquisition/Integration**. Failure to generate adequate synergies from acquisitions.
- **Brand equity deterioration**. This may be due to poor product quality, poor customer service, poor marketing programs or negative press. Brand deterioration will lead to loss of market share and pricing power in highly competitive markets.
- **Impairments**. Risk of impairment charges on intangibles due to difficult market conditions or the deterioration in brand equity.
- **Weather** – prolonged adverse weather may impact demand for outdoor related goods.

Super Retail Group
as at 23 April 2015

Recommendation	Buy
Price	$9.79
Target (12 months)	$11.00

Table 1 - Financial summary

Jun Year end	2012	2013	2014	2015e	2016e	2017e
Profit & Loss (A$m)						
Sales revenue	1,654.9	2,018.0	2,095.9	2,223.1	2,368.2	2,530.0
. . . Change	51.3%	21.9%	3.9%	6.1%	6.5%	6.8%
EBITDA	187.9	234.8	227.4	240.2	271.9	298.6
. . . Change	70.3%	24.9%	-3.2%	5.6%	13.2%	9.8%
Deprec. & amort.	(35.4)	(46.3)	(54.9)	(65.4)	(69.0)	(67.7)
EBIT	152.5	188.5	172.5	174.8	202.8	230.9
Net Interest	(20.6)	(25.5)	(24.0)	(24.3)	(24.9)	(23.0)
Pre-tax profit	131.9	163.0	148.5	150.5	177.9	207.9
Tax expense	(36.8)	(49.0)	(41.5)	(45.1)	(53.4)	(62.4)
. . . tax rate	28%	30%	28%	30%	30%	30%
Associates	-	-	(0.8)	-	-	-
Minorities/Prefs	-	-	-	0.5	0.5	0.5
Underlying Net Profit	**95.0**	**114.0**	**106.2**	**105.8**	**125.0**	**146.0**
. . . Change	71.0%	19.9%	-6.8%	-0.4%	18.2%	16.8%
Abs. & extras.	(11.5)	(11.3)	2.2	(24.5)	-	-
Reported Profit	**83.5**	**102.7**	**108.4**	**81.3**	**125.0**	**146.0**
Cashflow (A$m)						
EBITDA	187.9	234.8	227.4	240.2	271.9	298.6
Working capital change	(54.7)	26.8	(31.8)	7.8	11.6	8.6
Net Interest Expense	(16.7)	(24.7)	(27.9)	(24.7)	(24.9)	(23.0)
Tax	(34.3)	(48.0)	(55.0)	(44.6)	(47.2)	(57.6)
Other operating items	36.3	11.5	26.6	(0.1)	(14.6)	5.7
Operating Cash Flow	**118.5**	**200.4**	**139.3**	**178.6**	**196.8**	**232.3**
Capex	(60.4)	(103.4)	(111.6)	(79.5)	(71.0)	(75.9)
Free Cash Flow	**58.1**	**97.0**	**27.7**	**99.1**	**125.8**	**156.4**
Acquisitions	(621.7)	(6.0)	(4.4)	(1.5)	(1.5)	(1.5)
Disposals	0.2	-	1.0	-	-	-
Dividends paid	(31.7)	(70.7)	(77.7)	(78.8)	(85.4)	(88.6)
Other investing items	-	-	(3.7)	-	-	-
Equity	328.8	0.6	-	-	-	-
Debt increase/(reducti	**287.5**	**(45.7)**	**58.7**	**28.0**	**(38.9)**	**(66.3)**
Balance Sheet (A$m)						
Cash	47.0	22.3	24.2	67.7	67.7	69.8
Receivables	28.5	42.3	41.1	37.2	34.1	36.4
Inventories & WIP	416.7	452.6	490.1	510.4	522.7	533.5
Other current assets	-	-	-	5.7	5.7	5.7
Current Assets	**492.3**	**517.2**	**555.4**	**621.1**	**630.2**	**645.4**
Receivables	-	-	3.7	-	-	-
Assoc & investments	-	-	4.7	-	-	-
Fixed Assets	170.9	192.6	197.6	225.2	241.0	262.5
Intangibles	722.4	769.7	813.4	800.8	788.5	776.8
Other mom-curr assets	-	-	-	-	-	-
Non Current Assets	**893.2**	**962.3**	**1,019.4**	**1,026.0**	**1,029.5**	**1,039.2**
Total Assets	**1,385.5**	**1,479.5**	**1,574.8**	**1,647.0**	**1,659.6**	**1,684.6**
Short term debt	0.0	3.3	2.7	3.4	3.4	3.4
Creditors	197.9	274.3	278.8	303.1	323.8	345.5
Provisions	29.0	35.7	29.9	40.4	38.1	40.0
Other curr liabilities	-	-	6.3	4.0	4.0	4.0
Current Liabilities	**226.9**	**313.3**	**317.7**	**350.8**	**369.3**	**393.0**
Long term debt	388.0	348.3	404.1	428.3	389.4	325.2
Creditors	17.5	22.8	27.0	29.0	29.0	29.0
Provisions	64.2	63.6	65.6	69.1	56.8	60.6
Other non curr liabilities	-	-	-	-	-	-
Non Current Liabilitie	**469.7**	**434.7**	**496.7**	**526.4**	**475.3**	**414.9**
Total Liabilities	**696.6**	**748.0**	**814.4**	**877.3**	**844.6**	**807.8**
Net Assets	**688.9**	**731.5**	**760.4**	**769.8**	**815.0**	**876.8**
Share Capital	541.8	542.3	542.3	542.3	542.3	542.3
Reserves	(0.7)	9.5	7.7	15.9	15.9	15.9
Retained Earnings	147.7	179.7	210.4	211.1	256.8	319.1
Shareholders Equity	**688.9**	**731.5**	**760.4**	**769.3**	**815.0**	**877.3**
Outside Equity Interests	-	-	-	0.5	-	(0.5)
Total Equity	**688.9**	**731.5**	**760.4**	**769.8**	**815.0**	**876.8**
Net debt/(cash) $m	341.0	329.3	382.6	364.0	325.1	258.8

Price	$9.79
Recommendation	Buy
Diluted issued capital (m)	198.7
Market cap ($m)	1,945.6
Target Price (A$ps)	$ 11.00

Jun Year end	2012	2013	2014	2015e	2016e	2017e
Valuation Ratios						
Underlying EPS (¢ps)	52.6	57.6	53.5	53.3	62.9	73.5
. . . % change	23.8%	9.4%	-7.1%	-0.5%	18.1%	16.8%
PE (on underlying EPS) (x)	18.6	17.0	18.3	18.4	15.6	13.3
EV/EBITDA (x)	12.15	9.72	10.04	9.50	8.40	7.64
EV/EBIT (x)	14.97	12.11	13.23	13.06	11.25	9.88
NTA ($ps)	- 0.17	- 0.19	- 0.27	- 0.16	0.13	0.50
P/NTA (x)	- 57.75	- 50.73	- 36.65	- 62.72	73.22	19.45
Book Value ($ps)	3.49	3.70	3.83	3.87	4.10	4.41
Price/Book (x)	2.81	2.65	2.55	2.53	2.39	2.22
DPS (¢ps)	32.0	38.0	40.0	39.5	43.5	47.2
. . . % pay-out	65.8%	65.4%	74.1%	74.0%	69.1%	64.3%
Yield (%)	3.3%	3.9%	4.1%	4.0%	4.4%	4.8%
Franking (%)	100%	100%	100%	100%	100%	100%
Performance Ratios						
Revenue growth (%)	51.3%	21.9%	3.9%	6.1%	6.5%	6.8%
EBITDA growth (%)	70.3%	24.9%	-3.2%	5.6%	13.2%	9.8%
EBITDA/sales margin (%)	11.4%	11.6%	10.8%	10.8%	11.5%	11.8%
EBIT/sales margin (%)	9.2%	9.3%	8.2%	7.9%	8.6%	9.1%
Gross cash conversion (%)	90.2%	116.3%	98.1%	103.2%	98.9%	104.8%
Free cash-flow yield (%)	3.3%	5.0%	1.4%	5.1%	6.5%	8.0%
ROE (%)	17.3%	16.0%	14.2%	13.9%	15.8%	17.2%
ROIC (%)	13.3%	13.0%	11.1%	10.9%	12.8%	14.6%
Capex/Depn (x)	2.0	2.7	2.6	1.6	1.3	1.4
Net interest cover (x)	7.4	7.4	7.2	7.2	8.1	10.0
Net Debt/EBITDA (x)	1.8	1.4	1.7	1.5	1.2	0.9
Net debt/equity (%)	49.5%	45.0%	50.3%	47.3%	39.9%	29.5%
Net debt/net debt + equity (%)	33.1%	31.0%	33.5%	32.1%	28.5%	22.8%
Segmental Information						
Auto Retailing	755.8	789.0	818.2	861.1	914.7	962.0
Leisure Retailing	456.3	522.5	552.5	549.2	557.1	576.1
Sports Retailing	441.9	703.5	734.0	807.1	890.4	985.4
Corp/Elimin/Adj.	0.9	3.0	(8.8)	5.7	6.0	6.4
Total Revenue (A$m)	**1,654.9**	**2,018.0**	**2,095.9**	**2,223.1**	**2,368.2**	**2,530.0**
Auto Retailing	89.8	107.9	115.7	118.2	126.3	133.4
Leisure Retailing	42.0	50.8	47.9	48.3	52.9	58.6
Sports Retailing	62.9	87.5	80.6	95.7	107.9	121.9
Corp/Elimin/Adj.	(6.8)	(11.4)	(16.8)	(22.0)	(15.2)	(15.2)
Total EBITDA (A$m)	**187.9**	**234.8**	**227.4**	**240.2**	**271.9**	**298.6**

Half yearly (A$m)	**2H13**	**1H14**	**2H14**	**1H15**	**2H15e**	**1H16e**
Sales revenue	980.5	1,097.6	998.3	1,159.7	1,063.4	1,232.0
EBITDA	115.4	125.2	102.2	124.0	116.2	136.3
Deprec. & amort.	(26.7)	(24.1)	(30.8)	(29.9)	(35.5)	(33.0)
EBIT	88.7	101.1	71.4	94.1	80.7	103.3
Interest expense	(12.1)	(13.1)	(10.9)	(11.8)	(12.5)	(14.2)
Pre-tax profit	76.7	88.0	60.5	82.3	68.2	89.1
Tax expense	(23.3)	(26.4)	(15.1)	(24.7)	(20.4)	(26.7)
. . . tax rate	30%	30%	25%	30%	30%	30%
Associates	-	-	(0.8)	-	-	-
Minorities	-	-	-	0.5	-	0.5
Underlying Net Profit	**53.4**	**61.6**	**44.6**	**58.1**	**47.7**	**62.9**
Abs. & extras.	(11.3)	-	2.2	(24.5)	-	-
Reported Profit	**42.1**	**61.6**	**46.8**	**33.6**	**47.7**	**62.9**

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.

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Sam Haddad owns 5,000 shares in SUL

ANALYST CERTIFICATION

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