STOCKS DOWN UNDER

1 AUG 2022

ASX Top 200 Stocks Down Under

The individual should act consistently as an investor and not as a speculator.

- Benjamin Graham (1894-1976), Economist and "Father of Value Investing"

ASX

EXCHANGE CENTRE

BREVILLE

Now it looks more reasonable

BREVILLE

Now it looks more reasonable

Stocks Down Under rating: ★★★★

ASX: BRG
Market cap: A$3BN

52-week range: A$16.65 / A$33.61
Share price: A$20.95

Tech stocks – move over. Since its IPO in 1999, Breville has achieved growth of over 2,000%. This company is a premium kitchen appliances business with a presence in Australia, Europe and the Americas – the latter is responsible for just over 50% of revenues. It has been sold off over concerns that, on one hand, its share price ran too hard during COVID-19 as people stocked up on household goods and, on the other, that these consumers will cut back on spending as inflation rises – if they haven't already. Even if you accept the first concern, we find it too hard to accept the second. We think Breville's category of goods will not see as significant a cutback as predicted and it can grow through international expansion.

Share price chart

Source: Tradingview

Breville is not cheap, but maybe worth its price

We last covered Breville in mid-August last year, giving it two stars predominantly on a valuation basis - observing the one-off boom as people worked from home. We also took into account low profit margins and a low dividend yield. The latter was due to its high share price as well as its habit of reinvesting profits to support growth plans. But 12 months on, things do look better in some respects even if these are not reflected in the share price.

We concede its dividend yield (while slightly higher than a year ago) is lower than some investors may be comfortable with – at 1.5% on an annualised basis. Likewise, its EBIT margin is largely flat at 12.8% in 1HY22. However, it has a ROIC of over 25% given low capital intensity. And it's EV/EBITDA looks more reasonable now – at 13.9x for FY23 as opposed to ~20x a year ago.

For FY23, consensus estimates expect $1.6bn in revenue and $208.2m in EBITDA. This would represent growth of 10% and 11% from FY22 consensus estimates. However, FY22 consensus estimates suggest $186.2m in EBITDA, while BRG previously gave guidance of ~$156m and reiterated it back in early June. So, maybe the market expectations are too high. We'll know later this month (on August 23) when the company reports earnings.

If Breville achieved its guidance for FY22 and then reached $208.2m in EBITDA for FY23, it would represent growth of 33%. But if Breville grew by just 10% next year from its guided EBITDA of $156m for FY22, that would represent $171.6m in EBITDA in FY23. While we think $208m might be a stretch, the company should be able to at least meet the latter growth rate, maybe even exceed it.

Four reasons why we're optimistic

We think there are four reasons why Breville can grow. First, it's track record of sales growth with 14.6% CAGR in EBIT over the last seven years. While this isn't a guarantee it can achieve the same results, it does inspire confidence. Breville's 1HY22 results saw a 24% jump in revenues to $878.7m and a 23% jump in EBIT to $112.5m.

Second, the company is planning to enter new markets. We don't think investors appreciate that it already makes a large proportion of its money from overseas. The European markets Breville is already in account for 24% of sales and the Americas make up just over 50%. It is either entering or is about to enter Mexico, France, Portugal, Italy and South Korea. Goldman Sachs has estimated that these five combined could add at least $150m in revenues, translating to an extra 2.5% of sales CAGR.

The third reason we think Breville can grow is the markets the company is in. Breville offers premium and functional goods, targeted at consumers with higher disposable income. It is therefore less likely to be hit by a slowdown in consumer spending, at least to the extent of companies with goods targeting people with lower incomes. Consumers feeling the pinch might view upfront investments in Breville's products - coffee machines, ovens and juicers - as saving money in the long run, because they keep power costs lower, with devices being more efficient, and save money from not dining out or grabbing takeaway food.

Fourth, we observe that Breville has not had the same supply chain issues other companies have had. Unlike Kogan (ASX: KGN), Breville did not overinvest in new inventories predicting the boom would go on indefinitely. See last Friday's Small Caps Stocks Down Under publication for more about Kogan. Still, Breville has not been and is not immune to economic slowdowns. In the US, it has encountered shipping delays in light of issues with the Los Angeles port delaying the delivery of its goods to US consumers. It has therefore 'stocked up' for 1HY23 with the hope of minimising delays.

Not risk-free, but well positioned

We concede it is not impossible that Breville could be hit by supply chain issues given the bulk of its products are manufactured in China and we also acknowledge there is a risk that the slowdown could be worse than forecast and it could hit Breville substantially. A big slowdown may force it to discount its products as Kogan have done. But the US economy is several months ahead of Australia in opening up post COVID and has higher inflation. Yet, electronics and appliance sales were only down 0.1% between March and May 2022. And even if sales fall by a low amount, earnings could be higher if margins are increased.

We also take courage that although Breville's increased working capital position of $334m, up $203m just 12 months ago, the company reported that it is still running slightly behind sales growth. And it recently acquired LELIT – a European coffee equipment group that manufactures in Italy. This could help it reduce its reliance on China.

Investors looking for dividends would be better off elsewhere given Breville's habit of reinvesting profits. But for investors looking for a profitable growth stock that is well positioned to handle tailwinds, this company is worth considering, especially after the big sell off since February. Four stars from us.

Pitt Street Research Pty Ltd

3 Spring Street, Sydney, NSW 2000, Australia

Stocks Down Under gives you an information advantage to better invest and trade in ASX-listed stocks!

Stocks Down Under (Pitt Street Research AFSL 1265112) provides actionable investment ideas on ASX-listed stocks. The Content is financial advice but is not (and cannot be construed or relied upon as) personal financial advice. No investment objectives, financial circumstances or needs of any individual have been taken into consideration in the preparation of the Content. Please make sure that investing in such products is suitable for your circumstances, and ensure you obtain, read and understand any applicable offer document.

Financial products are complex, entail risk of loss, may rise and fall, and are impacted by a range of unpredictable market and economic factors.

All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior written permission from Pitt Street Research Ltd Pty. All intellectual property relating to the Content vests with Pitt Street Research/ Stocks Down Under unless otherwise noted.

Stocks Down Under/Pitt Street Research directors and staff may own shares in the companies mentioned in our articles, videos, reports and analyses.

You are receiving this email because you subscribed to our newsletter.