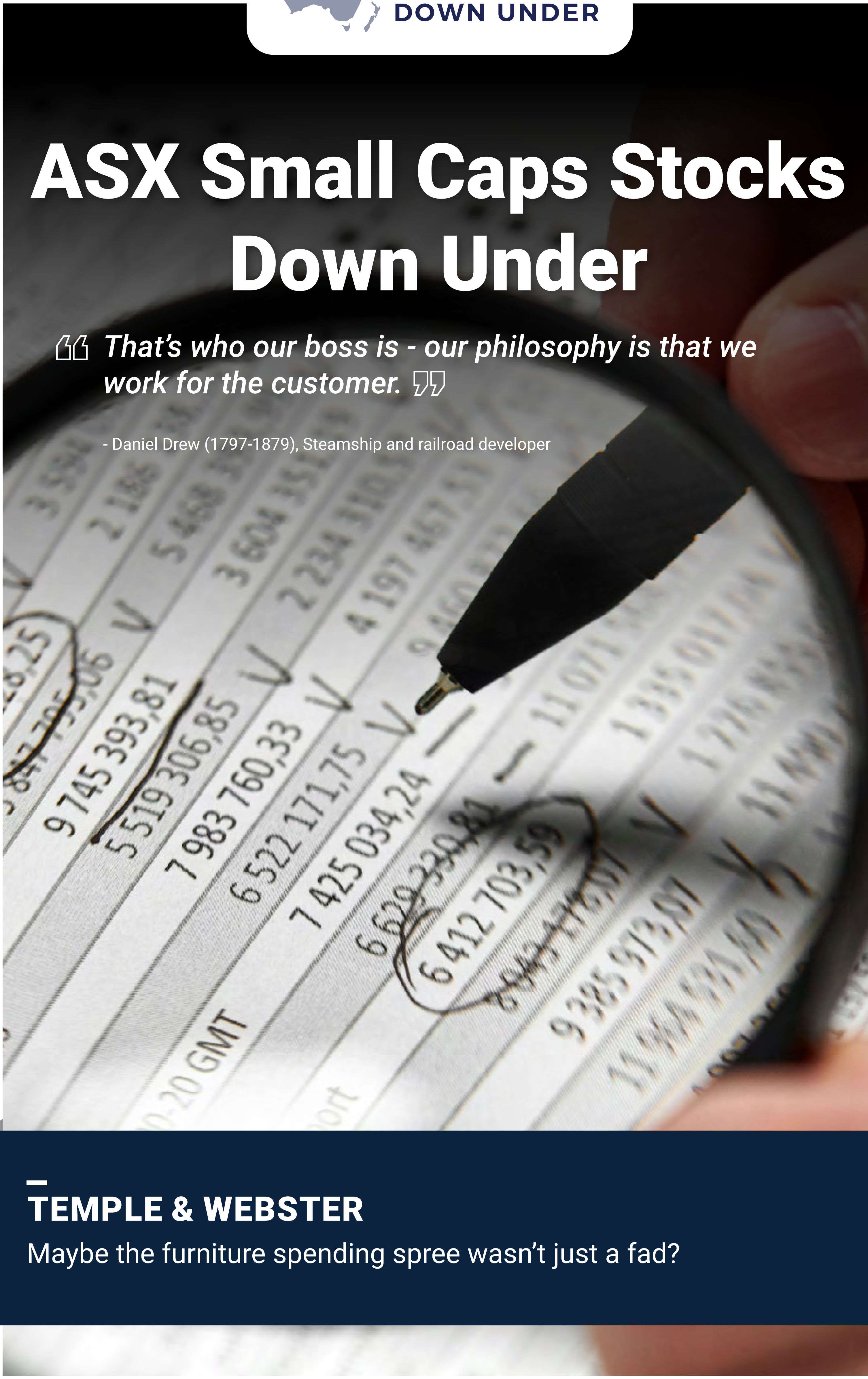
STOCKS DOWN UNDER

9 SEP 2022



ASX Small Caps Stocks Down Under

"That's who our boss is - our philosophy is that we work for the customer."

- Daniel Drew (1797-1879), Steamship and railroad developer

TEMPLE & WEBSTER

Maybe the furniture spending spree wasn't just a fad?

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Stocks Down Under rating: ★★★★

ASX: TPW
Market cap: A$681.2M

52-week range: A$2.96 / A$14.03
Share price: A$5.63

Temple & Webster (ASX: TPW) shareholders have had a rollercoaster ride ever since the pandemic. The stock rose nearly seven-fold in as many months during 2020 as stuck-at-home consumers stocked up on furniture and homewares. After losing nearly all of those gains during the Tech Wreck of 2022, the shares have begun rising again. And we think the FY22 results had a lot to do with this.

Share price chart

Source: Tradingview

A 100% online showroom

Temple & Webster was founded in 2011 and listed in 2015 at $1.10 per share for a market capitalization of just ~$117m. By 2019, the company had grown to $102m in revenue. [We last wrote about Temple & Webster in June 2020], observing a few secrets to its success. Yes, of course, being 100% online means lower costs, but that was the case for many other pureplay ecommerce companies on the ASX. Among the niches for Temple & Webster that we observed were 1) how easy it was to purchase merchandise; 2) how high-end the products were designed while being very reasonably priced, and 3) how smart the digital marketing strategies were proving to be.

The furniture boom during COVID-19 was lucrative for Temple & Webster. We think its share price rose more than many of its ecommerce peers because its supply chains were not excessively dependent on overseas countries, it had a reasonably amount of cash and had recorded growth even pre-pandemic. Unlike companies such as Zoono (ASX:ZNO), it was not simply a fad.

Still, we weren't sure how long the boom would last when we last covered Temple and Webster so gave it two stars purely on a valuation basis. Over the next year or so, it kept rising, but after the Tech Wreck drop, the share price is just under where it was when we last covered the company. So maybe we were right, albeit two years early...

Was the ecommerce boom a short-term fad, or not?

Investors have welcomed Temple & Webster's FY22 results. The numbers were inclusive of the Delta lockdowns so sales were obviously going to be higher than pre-COVID times. But sales still managed to exceed FY21. The company made $426.3m in revenue, up 31% on last year and 142% on FY20. It made a profit of $13.2m which was down 31% from last year, but represented CAGR of 29% over two years. Active customers grew 21% to a total of 940,000, the EBITDA margin came in at 3.8% (at the high end of its 2-4% target range) and the company closed the year with a cash balance of $101m.

What will FY23 hold? The only guidance Temple & Webster has given is its EBITDA margin which was upgraded from 2-4% to 3-5%. The company was able to do that because of its recently launched segment, The Build, which caters for people wanting to renovate their homes, operating as a one-stop shop. The Build is, apparently, doing very well. Now, Temple & Webster did disclose that July 2022 trading was down 21% compared to 2021, but this was ahead of its own estimates, and it tips double digit growth for the entire FY23.

Consensus estimates for FY23 suggest $442.9m in revenue and $16.5m in EBITDA, which would be 3.8% and 1.5% higher than the year before. Faster growth is expected in FY24 when revenue and EBITDA is estimated to be $525.8m and $21.9m, up 18% and 33% from FY23 consensus estimates. Temple & Webster's EV/EBITDA multiple for FY23 is 32.9x and its P/E is 73x, both of which appear far stretched when you consider the ASX 200 average (~14.7x right now) and the EV-EBITDA to EBITDA growth multiple of ~10x. Ultimately, your return is only your entry and exit price and while these multiples suggest the entry price is high, the current multiples will be long forgotten if investors who buy at the current price can exit for a price similar to its highs during the Corona Boom.

It's four stars, but with a catch

Ultimately, we are giving Temple & Webster four stars, but not without a caveat. We would urge caution amongst short-term day traders because it can only take one hawkish speech from Jerome Powell to send the market down 1-2% and Temple & Webster could drop more. Medium-term investors could be burnt by the company's 1HFY23 results given these will inevitably look worse. That is, the 1HFY23 numbers might be lower than the prior corresponding periods, lacking the lockdown boost, and the market might choose to shoot first and ask questions later. That said, we think longer-term investors who want to stick around for a while won't be disappointed, and this is four stars for them.

There are some risks with this company, particularly the risk that longer-term inflation eats into consumer demand and that supply chain issues hit the company. However, unlike many of its ecommerce peers, this is a profitable company with a long-term track record of growth. We like its recent entry into the home renovation market, which will help margins and be more resilient to inflation. Furniture is typically discretionary, but (as we have noted when we covered BWP Trust last month) some home renovations are essential and cannot be put off. And of course, even discretionary furniture bought during lockdowns won't last forever – it may wear down or break and customers looking to replace it will in many cases remember how well Temple & Webster served them.

We also think this company's smart digital marketing can separate it from the competition, encouraging customer loyalty and thereby reducing acquisition costs. With not a single brick and mortar store, it won't be on the hook for increased rent. And finally, the company's drop-ship model (which involves suppliers sending products directly to consumers with Temple & Webster being a mere intermediary between them) ensures there is low risk of overstocking. That is what brought down Kogan.com (ASX: KGN) recently. But, as we hope we've shown above, Temple & Webster is a cut above Kogan. Four stars.

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