STOCKS DOWN UNDER

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# ASX Small Caps Stocks Down Under

> *50% of a stock's move is the market, 30% the industry and 20% is the alpha from stock picking.*

- Scott Bessent (b. 1962), hedge fund manager & philantrophist


## BABY BUNTING

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**Stocks Down Under rating: ★★**

**ASX: BBN**
**Market cap: A$328.5M**

**52-week range: A$2.43 / A$5.89**
**Share price: A$2.48**

Baby Bunting's share price has more than halved this year. This can be said of plenty of other stocks, but this company is no unprofitable tech stock – it is Australia's largest baby goods store. Even with the share price decline, it is still capitalised at over $375m.

### Share price chart


*Source: Tradingview*

### A defensive retail play with growth potential ahead

Baby Bunting began in 1979 and listed in 2015 at $1.40 a share. It has 65 stores across Australia and has over $500m in sales. Why would you want to invest in a baby store? Well, this company has proven to be resilient to economic conditions throughout its history given the items it sells are essential goods. Hence, its stores were able to remain open throughout COVID, but it has also built a solid online presence, with over 20% of sales online. It has a total of 1.4m loyalty program members with 705,000 of them active.

You also have significant expansion to look forward to. Baby Bunting is at the early stages of entering New Zealand, having purchased its first warehouse in 2020 and opening its first store in Auckland in August 2022. It estimates that there is a NZ$450m opportunity on the other side of the Tasman and plans a second store in Christchurch early next year. The company also plans expansion in Australia. It estimates there is a Total Addressable Market of A$3.5bn and that it could have over 110 stores in the future. On top of all this, it is growing its own private label range, which now accounts for 45% of all sales and will increase margins as they continue to grow.

### A 'very successful' FY22 but uncertain FY23

Baby Bunting CEO Matt Spencer labelled FY22 a 'very successful year'. The company reached $507.3m in sales (up 8%), $112.7m in online sales (up 24.2%), $50.5m in EBITDA (up 16% and representing a 10% margin) and a $29.6m NPAT on a pro forma (up 14%). It paid a dividend of 15.6c per share which marked a yield of

3.4% at the share price on reporting day (which was August 12). But this performance hasn't spared it from a falling share price.

The company did not provide FY23 guidance due to economic uncertainty and inflationary pressures. It noted that comparable store sales were up 15.3% in the first six weeks of FY23, but this was in comparison to the period of Delta lockdowns. The company warned that rising prices for construction materials and labour could increase store development costs. It also revealed around $3m in sales had been deferred until FY23 because of delays in obtaining the company's top selling pram.

## The company is pessimistic but analysts are optimistic

A few weeks later, at its AGM, it revealed a gross profit margin decline from 38.7% to 37.2% - which led to its share price falling by over 20% in a day. The company blamed unrecovered cost increases, especially freight charges and forex movements. It stuck by its guidance to open 8 stores during FY23 and opened 3 in the first quarter. But there was still no financial guidance for the full year.

Analysts covering Baby Bunting are more optimistic, however. FY23 consensus estimates call for $556.3m in revenue and $76.8m in EBITDA, up 9.7% and down 5.6% respectively. For FY24, $610.8m in revenue and $87.3m in EBITDA which would be up 9.7% and 13.7%. Its EV/EBITDA and P/E multiples for FY23 look reasonable at 6.9x and 13.9x. But its PEG multiple for FY23 suggests it is overvalued at 2.3x (using a 6.1% long term growth rate).

## Not for all investors

There are a few things to this company that would appeal to ESG investors including that it gifts shares to employees and has a higher proportion of women than many other ASX companies in its staff (79%), regional operational management (58%) and its board (50%). However, it has not committed to Net Zero, with only 11% of its energy consumption being renewable.

We think the current troubles will not last forever and that it could return to its 2021 highs in the next couple of years. But investors will want clear evidence that things are turning around and it will be until at least early next year until we see it (at the company's half-yearly results due in February). We don't see any other catalysts that could propel it up before then. Baby Bunting is one for investors' watchlists but with plenty of companies facing less uncertainty, it's two stars right now. Management do deserve credit for being honest with shareholders, but we don't feel comfortable enough to give it the benefit of the doubt.

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