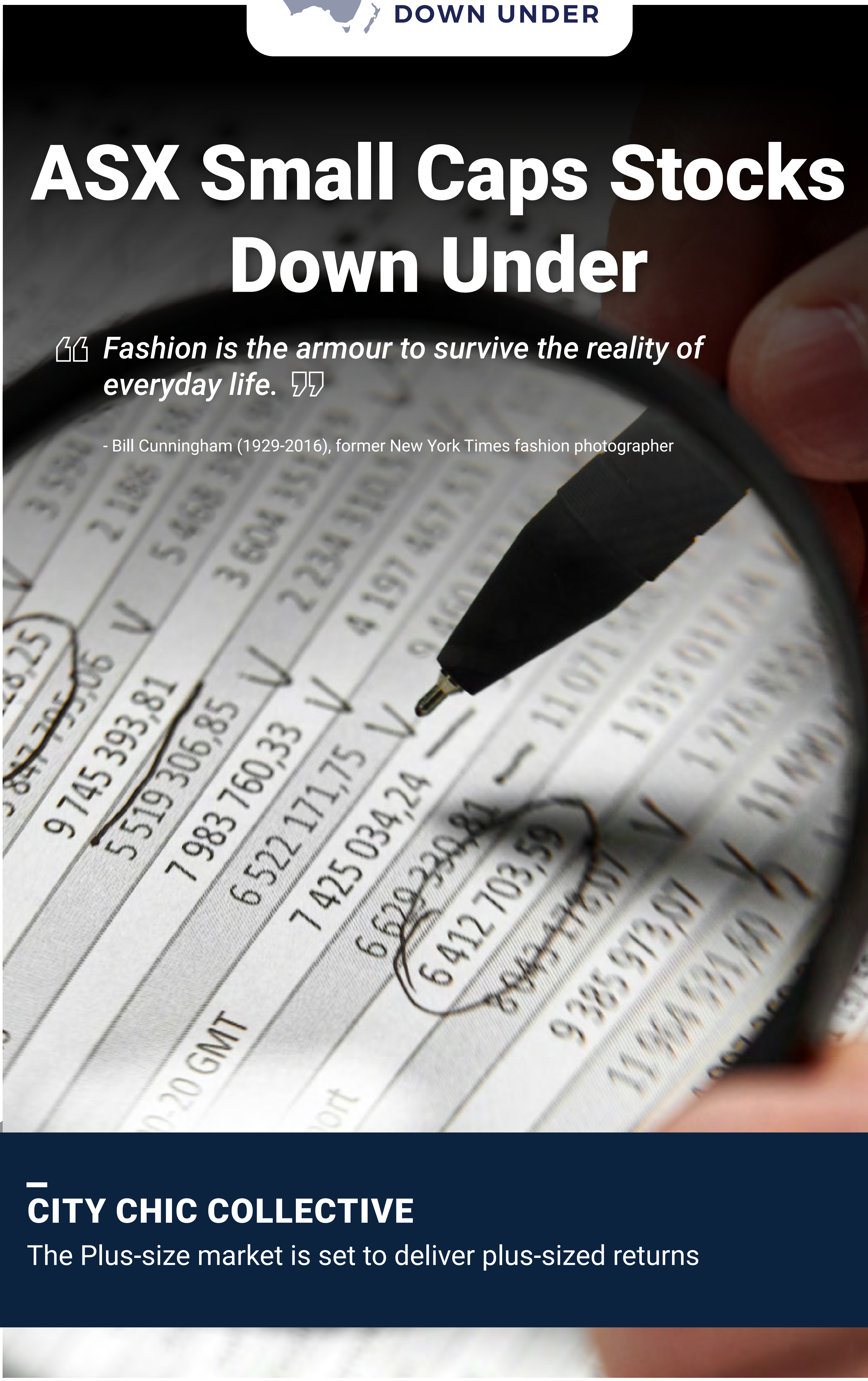
STOCKS DOWN UNDER

25 NOV 2022



ASX Small Caps Stocks Down Under

> *Fashion is the armour to survive the reality of everyday life.*
>
> - Bill Cunningham (1929-2016), former New York Times fashion photographer

CITY CHIC COLLECTIVE

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Stocks Down Under rating: ★★★★

ASX: CCX
Market cap: A$333M

52-week range: A$1.08 / A$6.38
Share price: A$1.39

City Chic Collective (ASX: CCX) is a fashion chain that sells apparel and accessories for plus-sized women. The share price is 500% higher than it was five years ago and deservedly so. After a few years of underperformance, the company changed its name and restructured with a fresh approach on plus-sized women. With the world getting heavier, and the body acceptance movement, the company was in the right place at the right time and was able to capitalise on this trend. Although shares are well off their 2021 highs, we think this might be an opportunity for investors to get in.

Share price chart

Source: Tradingview

A global business with a global opportunity

You'll probably have seen City Chic stores at shopping centres – it has 90 of them in Australia and New Zealand. But it also has a significant presence in North America and Europe with fulfillment sites in Dallas, Toronto and Gateshead in the UK along with regional offices in New Jersey and London.

The pandemic had a significant impact on the fashion industry, but City Chic took the opportunity to buy good assets at distressed prices, buying UK-based Evans and the eCommerce assets of Avenue Stores, the parent behind American brand Avenue – for A$41m and US$16.5m respectively.

In FY22, North America and EMEA generated ~$210m in revenue while Australia only generated $161.8m. And online sales in North America and EMEA exceeded 85%, while in Australia it was only 62%. Don't get us wrong, the Australian figures are good, but North America and EMEA are even better especially considering it is less established in those markets.

FY22 results disappoint

City Chic released its results for FY22 (the 12 months to 3 July 2022) and to say the market hated it was an understatement – shares dropped by nearly 20% on reporting day. At first glance, it is difficult to see what was wrong. Revenues grew 39% to $369.2m, EBITDA by 11% to $47.1m and NPAT grew by 3% to $22.3m. The retailer had 1.4m active customers (up 30%) and 78.6m in global traffic (up 35%).

However, investors were looking beyond the top line. Turning to the cash flow statement, City Chic lost $51.9m from operations after an inflow of $15.2m in FY21. It had a net outflow of $61.7m compared to a $51.7m inflow in FY21, although FY21 would have been negative but for capital raisings, which brought in $108.6m. CCX had a $4m net debt position, with $10m in cash and $14m in debt. Its inventory balance was $195.9m, up 56% from a year ago and 192% from two years ago. Similar to Kogan, it bulked up on inventory as eCommerce demand ran hot in the early days of the pandemic. While City Chic expects a net cash position in FY23, investors seemingly won't believe it until they see it.

What will FY23 hold?

The company reported that trading in the opening weeks of FY23 was in line with FY22. It has promised to hike prices where it is in a position to do so and cut closing inventory by roughly a third to $125-$135m by year's end. Consensus estimates for FY23 call for $401.3m revenue and $52.4m EBITDA, up 9% and 11% respectively. For FY24, $444.6m in revenue (up 11%) and $60.9m EBITDA (up 16%). The company is attractively priced with multiples for FY23 of 6.7x EV/EBITDA and 10.9x P/E, while for FY24 it is trading at 5.8x EV/EBITDA and 9.1x P/E. Its PEG multiples paint a more mixed picture. Assuming a 9% long-term growth rate, City Chic's PEG multiple FY23 is 1.2x which suggests it is overvalued. For FY24, however, it just below 1x.

Why is it trading so cheaply? Obviously, investors aren't a fan of inventory levels, thinking the company will have to heavily discount to sell these products. And this is easier said than done in these difficult economic times considering the company targets younger consumers. But it isn't all bad news in the short-term. The high inventory levels, plus its diversification from Chinese product sourcing and shift to in-country ownership of factories, mean that supply chain issues won't be as significant a problem going forward. And remember, this isn't a company that sells dresses for black-tie events, it sells everyday wear.

The longer term holds promise

The company claims the addressable market is US180bn globally, more than half of which is in North America (US$49bn), Europe (US$45bn) and the UK (US$7bn). It has set itself up well with its acquisitions. Unlike other ASX companies, it has hardly binged, only buying a few companies, picking them strategically and at an opportunistic time – when prices were temporarily distressed during the pandemic.

Yet, it is still at an early stage in all of its markets except Australia and we think it can continue to grow. Its inventory allows it some scope for discounting, but it can also grow through marketing as well. The plus size market is anticipated to grow 7% annually as plus-sized women gain confidence in themselves and embrace fashion shopping (particularly online). We also think City Chic can stand out by being dedicated to these consumers. At the moment, they face either a choice of a limited number of independent plus-sized brands or 'one size fits all' department stores.

Although the share price may face some turbulence, while inventory levels remain high, we think it will deliver in the medium to long term. Four stars.

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