

14 February 2018

Shriro Holdings Limited (SHM)

BUY

Share Price: A\$1.57

Barbecue sales set to heat up in 2H18

Target Price:

A\$1.77

After adjusting for one-off cost benefits in CY17, Shriro's net profit increased by 2.2 percent, but fell short of our estimate by 2.9 percent in what was a challenging period for retail sales. Notwithstanding this and the likelihood that the operating environment will be similar in CY18, we remain upbeat about the company's growth prospects. Our revised forecasts reflect this view, with Shriro entering CY18 with a strong balance sheet, some sales momentum in Casio, the upcoming launch of its new range barbecues in the US and Germany, and a strong pipeline of product innovations. While we expect CY18 earnings growth will be contained by pockets of weakness in Kitchen Appliances, it should be sufficient to maintain the full-year dividend at 11 cents per share, ahead of a return to double-digit growth in CY19-CY20.

Full-year result

- Shriro delivered a CY17 net profit that was ahead of our expectations (\$14.5m actual versus \$13.9m forecast). However, after adjusting for one-off cost reductions in CY17, Shriro's net profit result was \$13.5m, or 2.2 percent above CY16. A fully franked final dividend of 7 cents was declared, bringing the full-year dividend to 11 cents, up from 10 cents in CY16.

Key takeaway

- While Shriro's underlying earnings performance in CY17 was credible in the context of challenging markets, the highlight of the result was arguably the company's strong cash generation, which reduced net debt to \$2m, from \$5.5m in CY16. This, in combination with Shriro's diverse portfolio of brands, pipeline of product innovation and international expansion plans, bodes well for future earnings growth.

Earnings revisions

- With management guiding to a CY18 net profit below Shriro's CY17 result, we have downwardly revised our forecast by 7.1 percent and 5.7 percent in CY18 and CY19, respectively. Our net profit estimate for CY20 has increased by a more modest 0.7 percent.

Investment view

- We view Shriro as being a well-managed company with a diverse portfolio of brands, a strong balance sheet and pipeline of product innovations, and a clear and defined growth strategy. We expect the realisation of this strategy to drive Shriro's share price closer to our DCF valuation of \$2.21 per share, or 15.1x CY18 earnings.

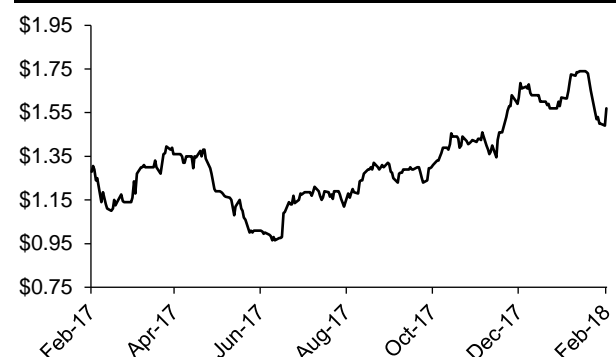
Company Data

| | |
|--------------------------------|--------------------|
| Shares – ordinary (M) | 96.0 |
| Dilution (M) | 0.0 |
| Total (fully diluted) (M) | 96.0 |
| Market capitalisation (\$M) | 150.7 |
| 12 month low/high (\$) | 0.9 - 1.75 |
| Average monthly turnover (\$M) | 4.7 |
| Index | Nil |
| GICS Industry | Household Durables |

Financial Summary (fully diluted/normalised)

| Year end Dec | 2016A | 2017A | 2018F | 2019F | 2020F |
|------------------------|-------|-------|-------|-------|-------|
| Revenue (\$M) | 183.5 | 188.3 | 196.7 | 211.7 | 219.9 |
| Costs (\$M) | 160.4 | 163.4 | 172.9 | 184.7 | 190.2 |
| EBITDA (\$M) | 23.0 | 24.9 | 23.8 | 27.0 | 29.7 |
| NPAT (\$M) | 13.2 | 14.5 | 14.1 | 16.3 | 18.2 |
| EPS (¢ps) | 13.7 | 15.1 | 14.7 | 17.0 | 19.0 |
| EPS Growth (%) | 6.1 | 10.2 | -2.6 | 15.3 | 11.7 |
| PER (x) | 11.4 | 10.4 | 10.7 | 9.3 | 8.3 |
| Free Cashflow (\$M) | 12.2 | 13.6 | 12.3 | 12.6 | 16.3 |
| FCFPS (¢ps) | 12.8 | 14.1 | 12.9 | 13.1 | 17.0 |
| PFCFPS (x) | 12.3 | 11.1 | 12.2 | 12.0 | 9.2 |
| Enterprise Value (\$M) | 158.0 | 154.5 | 151.9 | 150.6 | 146.8 |
| EV / EBITDA (x) | 6.9 | 6.2 | 6.4 | 5.6 | 4.9 |
| Payout ratio (%) | 72.2 | 77.7 | 74.7 | 73.6 | 71.2 |
| Dividends (¢ps) | 10.0 | 11.0 | 11.0 | 12.5 | 13.5 |
| Yield (%) | 6.4 | 7.0 | 7.0 | 8.0 | 8.6 |

SHM – performance over one year



Disclosure and Disclaimer

This report must be read with the disclosure and disclaimer on the final page of this document.

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Analysis

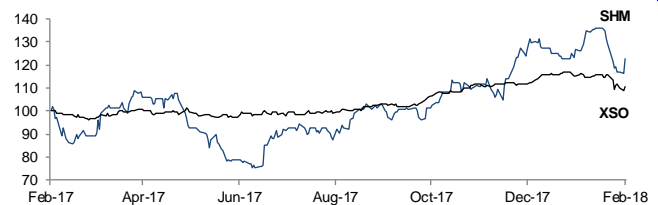
Shriro Holdings Limited

Year Ending 31 December

MARKET DATA

| | | |
|---------------------------|-----|------------|
| Recommendation | | Buy |
| Price | \$ | 1.57 |
| Price target (12-month) | \$ | 1.77 |
| 52 week high / low | \$ | 0.9 - 1.75 |
| Market capitalisation | \$m | 150.7 |
| Shares on issue (basic) | no. | 96.0 |
| Performance rights | no. | 0.0 |
| Other equity | no. | 0.0 |
| Shares on issue (diluted) | no. | 96.0 |

12-MONTH SHARE PRICE PERFORMANCE



INVESTMENT FUNDAMENTALS

| | 2016A | 2017A | 2018F | 2019F | 2020F | |
|--|------------|--------------|--------------|--------------|--------------|--------------|
| Reported net profit | \$m | 13.2 | 13.5 | 14.1 | 16.3 | 18.2 |
| Normalised net profit | \$m | 13.2 | 14.5 | 14.1 | 16.3 | 18.2 |
| Reported EPS (diluted) | ¢ | 13.7 | 15.1 | 14.7 | 17.0 | 19.0 |
| Normalised EPS (diluted) | ¢ | 13.7 | 14.0 | 14.7 | 17.0 | 19.0 |
| ...Growth | % | 6.1 | 2.2 | 5.1 | 15.3 | 11.7 |
| Normalised diluted PER | x | 11.4 | 11.2 | 10.7 | 9.3 | 8.3 |
| Operating cash flow per share | ¢ | 16.6 | 17.9 | 16.7 | 16.9 | 20.9 |
| Free cash flow per share | ¢ | 12.8 | 14.1 | 12.9 | 13.1 | 17.0 |
| Price to free cash flow per share | x | 12.3 | 11.1 | 12.2 | 12.0 | 9.2 |
| Free cash flow yield | % | 8.1 | 9.0 | 8.2 | 8.3 | 10.8 |
| Dividend per share | ¢ | 10.0 | 11.0 | 11.0 | 12.5 | 13.5 |
| Payout ratio | % | 72.2 | 77.7 | 74.7 | 73.6 | 71.2 |
| Yield | % | 6.4 | 7.0 | 7.0 | 8.0 | 8.6 |
| Franking | % | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Enterprise value | \$m | 158.0 | 154.5 | 151.9 | 150.6 | 146.8 |
| EV/EBITDA | x | 6.9 | 6.2 | 6.4 | 5.6 | 4.9 |
| EV/EBIT | x | 8.1 | 7.3 | 7.5 | 6.4 | 5.6 |
| Price to book (NAV) | x | 2.8 | 2.6 | 2.5 | 2.3 | 2.1 |
| Price to NTA | x | 2.8 | 2.6 | 2.5 | 2.3 | 2.1 |

KEY RATIOS

| | 2016A | 2017A | 2018F | 2019F | 2020F | |
|---|-------|-------|-------|-------|-------|-------|
| EBITDA margin | % | 12.5 | 13.2 | 12.1 | 12.8 | 13.5 |
| EBIT margin | % | 10.6 | 11.2 | 10.3 | 11.1 | 11.9 |
| Underlying net profit margin | % | 7.2 | 7.7 | 7.1 | 7.7 | 8.3 |
| Return on average equity | % | 26.1 | 26.3 | 23.9 | 25.9 | 26.9 |
| Return on average assets | % | 21.7 | 22.3 | 20.2 | 21.9 | 22.7 |
| Net tangible assets per share | ¢ | 56.1 | 60.2 | 63.2 | 67.7 | 73.2 |
| Net debt/(cash) | \$m | 7.3 | 3.8 | 1.2 | (0.1) | (3.9) |
| Interest cover (EBIT / net interest) | x | 15.4 | 26.5 | 75.7 | 113.6 | 214.7 |
| Leverage (net debt / EBITDA) | x | 0.3 | 0.2 | 0.1 | n/a | n/a |
| Gearing (net debt / net debt plus equity) | % | 12.0 | 6.2 | 2.0 | n/a | n/a |

DUPONT ANALYSIS

| | 2016A | 2017A | 2018F | 2019F | 2020F | |
|-------------------------|----------|-------------|-------------|-------------|-------------|-------------|
| Net Profit Margin | % | 7.2 | 7.7 | 7.1 | 7.7 | 8.3 |
| Asset Turnover | x | 2.0 | 1.9 | 1.9 | 1.9 | 1.9 |
| Return on Assets | % | 14.4 | 14.8 | 13.6 | 14.7 | 15.3 |
| Financial Leverage | x | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 |
| Return on Equity | % | 24.7 | 25.4 | 23.2 | 25.1 | 25.9 |

DIVISIONAL BREAKDOWN

| | 2016A | 2017A | 2018F | 2019F | 2020F | |
|----------------------|------------|--------------|--------------|--------------|--------------|--------------|
| Revenue | \$m | 183.5 | 188.3 | 196.7 | 211.7 | 219.9 |
| Kitchen Appliances | \$m | 81.5 | 83.3 | 82.9 | 85.2 | 87.4 |
| Consumer Products | \$m | 99.8 | 103.6 | 111.8 | 124.4 | 130.6 |
| Other | \$m | 2.3 | 1.4 | 2.0 | 2.0 | 2.0 |
| EBITDA | \$m | 23.0 | 24.9 | 23.8 | 27.0 | 29.7 |
| Kitchen Appliances | \$m | 6.6 | 8.5 | 6.5 | 6.8 | 7.8 |
| Consumer Products | \$m | 16.1 | 16.2 | 17.3 | 20.2 | 21.9 |
| Other | \$m | 0.3 | 0.2 | 0.0 | 0.0 | 0.0 |
| EBITDA margin | % | 12.5 | 13.2 | 12.1 | 12.8 | 13.5 |
| Kitchen Appliances | % | 8.1 | 10.2 | 7.8 | 7.9 | 9.0 |
| Consumer Products | % | 16.2 | 15.6 | 15.5 | 16.3 | 16.8 |
| Other | % | 12.0 | 17.5 | 0.0 | 0.0 | 0.0 |

PROFIT AND LOSS

| | 2016A | 2017A | 2018F | 2019F | 2020F | |
|-----------------------------|------------|-------------|-------------|-------------|-------------|-------------|
| Total revenue | \$m | 183.5 | 188.3 | 196.7 | 211.7 | 219.9 |
| EBITDA | \$m | 23.0 | 24.9 | 23.8 | 27.0 | 29.7 |
| Depreciation & amortisation | \$m | 3.6 | 3.8 | 3.4 | 3.5 | 3.6 |
| EBIT | \$m | 19.4 | 21.2 | 20.4 | 23.5 | 26.1 |
| Net interest | \$m | 1.3 | 0.8 | 0.3 | 0.2 | 0.1 |
| Non-operating income | \$m | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Pretax Profit | \$m | 18.2 | 20.4 | 20.1 | 23.3 | 26.0 |
| Tax expense | \$m | 5.0 | 5.9 | 6.0 | 7.0 | 7.8 |
| Minorities | \$m | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reported NPAT | \$m | 13.2 | 14.5 | 14.1 | 16.3 | 18.2 |
| Significant items | \$m | 0.0 | (1.1) | 0.0 | 0.0 | 0.0 |
| Underlying NPAT | \$m | 13.2 | 13.5 | 14.1 | 16.3 | 18.2 |

GROWTH PROFILE

| | 2016A | 2017A | 2018F | 2019F | 2020F | |
|-------------------|-------|-------|-------|-------|-------|------|
| Operating revenue | % | (1.5) | 2.7 | 4.4 | 7.6 | 3.9 |
| EBITDA | % | 1.5 | 8.3 | (4.5) | 13.4 | 10.0 |
| EBIT | % | 0.7 | 8.9 | (3.9) | 15.4 | 11.2 |
| Operating NPAT | % | 6.1 | 10.2 | (3.1) | 15.9 | 11.7 |
| Normalised EPS | % | 6.1 | 10.2 | (3.6) | 15.3 | 11.7 |
| DPS | % | 66.7 | 10.0 | 0.0 | 13.6 | 8.0 |

BALANCE SHEET

| | 2016A | 2017A | 2018F | 2019F | 2020F | |
|-----------------------------|------------|-------------|-------------|--------------|--------------|--------------|
| Cash | \$m | 0.0 | 3.5 | 6.0 | 7.6 | 11.6 |
| Receivables | \$m | 34.9 | 36.3 | 37.4 | 40.2 | 41.8 |
| Inventory | \$m | 39.7 | 42.2 | 43.3 | 46.6 | 48.4 |
| Other | \$m | 1.8 | 1.6 | 1.6 | 1.6 | 1.6 |
| Current | \$m | 76.4 | 83.5 | 88.2 | 96.0 | 103.4 |
| Prop, plant & equip | \$m | 10.0 | 9.7 | 9.8 | 10.0 | 10.2 |
| Goodwill | \$m | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | \$m | 5.2 | 5.0 | 5.0 | 5.0 | 5.0 |
| Non current | \$m | 15.2 | 14.7 | 14.9 | 15.0 | 15.2 |
| Total assets | \$m | 91.5 | 98.2 | 103.1 | 111.0 | 118.6 |
| Accounts Payable | \$m | 20.7 | 23.2 | 23.6 | 25.4 | 26.4 |
| Borrowings | \$m | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 |
| Other | \$m | 12.0 | 12.4 | 13.3 | 15.2 | 16.5 |
| Total liabilities | \$m | 38.3 | 41.1 | 42.4 | 46.0 | 48.4 |
| Net assets | \$m | 53.3 | 57.2 | 60.7 | 65.0 | 70.2 |
| Equity | \$m | 53.3 | 57.2 | 60.7 | 65.0 | 70.2 |
| Minorities | \$m | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Shareholder's equity | \$m | 53.3 | 57.2 | 60.7 | 65.0 | 70.2 |
| Shares on issue | m | 95.0 | 95.0 | 96.0 | 96.0 | 96.0 |

CASH FLOW

| | 2016A | 2017A | 2018F | 2019F | 2020F | |
|-------------------------------------|------------|---------------|---------------|--------------|---------------|---------------|
| EBITDA | \$m | 23.0 | 24.9 | 23.8 | 27.0 | 29.7 |
| Change in working capital | \$m | (1.4) | (1.5) | (1.7) | (4.4) | (2.4) |
| Net interest | \$m | (1.2) | (0.8) | (0.3) | (0.2) | (0.1) |
| Tax paid | \$m | (4.9) | (5.7) | (5.9) | (6.2) | (7.1) |
| Other | \$m | 0.5 | 0.2 | 0.0 | 0.0 | 0.0 |
| Operating cash flow | \$m | 15.9 | 17.2 | 15.9 | 16.3 | 20.1 |
| Capital expenditure | \$m | (3.7) | (3.6) | (3.6) | (3.7) | (3.7) |
| Acquisitions/divestment/other | \$m | 0.2 | 0.2 | 0.0 | 0.0 | 0.0 |
| Investing cash flow | \$m | (3.5) | (3.4) | (3.6) | (3.7) | (3.7) |
| Free cash flow | \$m | 12.2 | 13.6 | 12.3 | 12.6 | 16.3 |
| Equity | \$m | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Increase / (decrease) in borrowings | \$m | (4.9) | (0.1) | 0.0 | 0.0 | 0.0 |
| Dividend/other | \$m | (8.6) | (10.5) | (9.8) | (10.9) | (12.3) |
| Financing cash flow | \$m | (13.4) | (10.5) | (9.8) | (10.9) | (12.3) |
| Net cash flow | \$m | (1.1) | 3.2 | 2.5 | 1.6 | 4.0 |

Source: Petra Capital

Full-year result

Shriro delivered a CY17 net profit (Figure 1) that was ahead of our expectations (\$14.5m actual versus \$13.9m forecast). While reported CY17 revenue was below our forecast (\$188.3m actual versus \$193.1m forecast), the earnings impact of this was more than offset by the company's strong margin performance, both at the gross profit (42.3 percent actual versus 41.9 percent forecast) and operating line (13.2 percent actual versus 12.3 percent forecast).

However, after adjusting for one-off cost reductions (i.e. relating to property lease renegotiations that resulted in a \$1.5m cost saving) in CY17, Shriro's net profit result for the 12 months to 31 December 2017 is closer to \$13.5m, or 2.2 percent above the previous corresponding period. Although this is a relatively modest rate of growth, it represents the third successive year of net profit growth since the company listed in June 2015 – the three-year profit CAGR to 31 December 2017 is 16.2 percent.

In terms of dividends, Shriro declared a fully franked final dividend of 7 cents per share, bringing CY17 dividends to 11 cents (11 cents forecast), up from 10 cents in CY16. While Shriro's payout ratio was below our expectations at 72 percent (75 percent forecast), on underlying basis it was above our expectations at 78 percent. Given Shriro's earnings track record and strong capital position (net debt declined to \$2m, from \$5.5m as at CY16), we view a payout ratio of 70-80 percent as sustainable.

Figure 1: Full-year Profit & Loss Summary

| Year Ending 31 December | 1H16A | 2H16A | 2016A | 1H17A | 2H17A | 2017A | 2H17/ 2H16 | 2H17/ 1H16 | 2017/ 2016 |
|------------------------------|--------|-------|--------|--------|--------|--------|---------------|---------------|---------------|
| Profit & Loss | | | | | | | | | |
| Sales Revenue | 79.2 | 104.2 | 183.5 | 86.3 | 102.0 | 188.3 | -2.1% | 18.3% | 2.7% |
| COGS | 45.2 | 60.1 | 105.3 | 50.8 | 57.8 | 108.6 | -3.8% | 13.9% | 3.1% |
| Gross Profit | 34.1 | 44.1 | 78.2 | 35.5 | 44.2 | 79.8 | 0.2% | 24.5% | 2.0% |
| Non-sales Revenue | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0% | 0.0% | 0.0% |
| Operating Costs | 27.1 | 28.0 | 55.2 | 28.4 | 26.5 | 54.8 | -5.6% | -6.6% | -0.6% |
| EBITDA | 6.9 | 16.1 | 23.0 | 7.2 | 17.8 | 24.9 | 10.4% | 147.6% | 8.3% |
| Depreciation | 1.8 | 1.8 | 3.6 | 1.9 | 1.9 | 3.8 | 5.2% | -1.0% | 5.1% |
| EBITA | 5.1 | 14.3 | 19.4 | 5.3 | 15.9 | 21.2 | 11.0% | 200.7% | 8.9% |
| Amortisation | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0% | 0.0% | 0.0% |
| EBIT | 5.1 | 14.3 | 19.4 | 5.3 | 15.9 | 21.2 | 11.0% | 200.7% | 8.9% |
| Net Interest Expense | 0.6 | 0.6 | 1.3 | 0.4 | 0.4 | 0.8 | -43.2% | -20.6% | -36.7% |
| Pre Tax Profit | 4.5 | 13.7 | 18.2 | 4.8 | 15.5 | 20.4 | 13.5% | 221.1% | 12.0% |
| Tax Expense | 1.4 | 3.7 | 5.0 | 1.5 | 4.4 | 5.9 | 19.4% | 191.3% | 16.9% |
| Minorities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0% | 0.0% | 0.0% |
| Underlying NPAT | 3.1 | 10.0 | 13.2 | 3.3 | 11.2 | 14.5 | 11.3% | 234.5% | 10.2% |
| Non Recurring Items | 0.0 | 0.0 | 0.0 | 0.0 | -1.1 | -1.1 | 0.0% | 0.0% | 0.0% |
| Reported NPAT | 3.1 | 10.0 | 13.2 | 3.3 | 10.1 | 13.5 | 0.9% | 203.1% | 2.2% |
| Other Information | | | | | | | | | |
| EPS (underlying) | 3.3 | 10.6 | 13.9 | 3.5 | 11.8 | 15.3 | 11.3% | 234.5% | 10.2% |
| EPS (underlying, diluted) | 3.3 | 10.4 | 13.7 | 3.5 | 11.6 | 15.1 | 11.3% | 234.5% | 10.2% |
| DPS (¢) | 3.0 | 7.0 | 10.0 | 4.0 | 7.0 | 11.0 | 0.0% | 75.0% | 10.0% |
| Shares - Closing Balance (m) | 95.0 | 95.0 | 95.0 | 95.0 | 95.0 | 95.0 | 0.0% | 0.0% | 0.0% |
| Margin/Ratio Analysis | | | | | | | | | |
| Gross Margin | 43.0% | 42.3% | 42.6% | 41.2% | 43.3% | 42.3% | 101bps | 218bps | -28bps |
| EBITDA Margin | 8.8% | 15.4% | 12.5% | 8.3% | 17.4% | 13.2% | 197bps | 909bps | 69bps |
| EBIT Margin | 6.5% | 13.7% | 10.6% | 6.1% | 15.6% | 11.2% | 184bps | 945bps | 64bps |
| Effective tax rate | 30.3% | 26.7% | 27.6% | 31.0% | 28.1% | 28.8% | 139bps | -288bps | 120bps |
| GOCF/Adj EBITDA | 108.4% | 98.8% | 102.2% | 101.7% | 100.0% | 101.0% | 123bps | -162bps | -112bps |
| Interest Cover (EBIT) | 8.0 | 23.0 | 15.4 | 11.8 | 44.9 | 26.5 | n/a | n/a | n/a |

Source: Company data, Petra Capital

Shriro's Consumer Products segment reported a 3 percent increase in revenue to \$105m, with some margin compression reducing the EBITDA growth rate to 0.6 percent. This is despite the bulk of the segment's product lines having made positive contributions to CY17, with the key laggard being Casio watches, which were unable to recover from a weak 1H17 despite some new product releases late in 2H17.

Although Shriro's Kitchen Appliance segment reported a similar revenue growth rate (2.3 percent in CY17) to Consumer Products, the segment's margin performance was much better. Management attributed this, in part, to (i) the realignment of sales channels across key products in CY16, (ii) a resilient renovation market, and (iii) Shriro's limited exposure to the multi dwelling commercial sector. Key in this regard was the increase in sales through Bunnings, with Blanco being a key beneficiary.

Key takeaways

Shriro is continuing to operate well in what remains a difficult market for wholesale distribution. Notwithstanding these macro uncertainties, management has continued to prove itself adept at using its numerous operating levers to manage Shriro's sales volumes and margins. These include the realignment of sales channels across key product lines, adjusting prices and/or altering product specifications to manage margins, introducing product innovations, and entering new markets.

With these levers, in combination with a reduction in working capital, having generated surplus cash flow and consequently a lower net debt (i.e. \$2m) position in CY17, we conclude that Shriro remains well positioned to continue to deliver on its track record of generating underlying earnings growth year-on-year. While we expect Shriro to increase underlying earnings organically in CY18, the company's current balance sheet and cash conversion does make acquisitions a viable option.

Outlook

Management has flagged that it expects the company's net profit in CY18 to be below CY17. The reasons given for this comprised (i) the uncertain outlook for sales across Shriro's portfolio, particularly commercial property and watches, (ii) the committed increase in marketing expenditure for the upcoming launch of Shriro's new BBQ range in the US and Germany in March/April, and (iii) the higher comparable period (i.e. CY17) inclusive of the one-off cost reduction benefit.

Earnings revisions

Following Shriro's CY17 results, we have made downward revisions to our earnings forecasts over the next two years, with CY20 largely unchanged (Figure 2). Key drivers of the changes include (i) weaker earnings contributions from Omega by Neil Perry, Blanco, Robinhood and Omega, (ii) a re-basing of Casio sales in CY17 – revenue growth rate for CY18 remains unchanged, and (iii) a lower earnings contribution from Everdure by Heston Blumenthal in CY18 due to higher marketing costs.

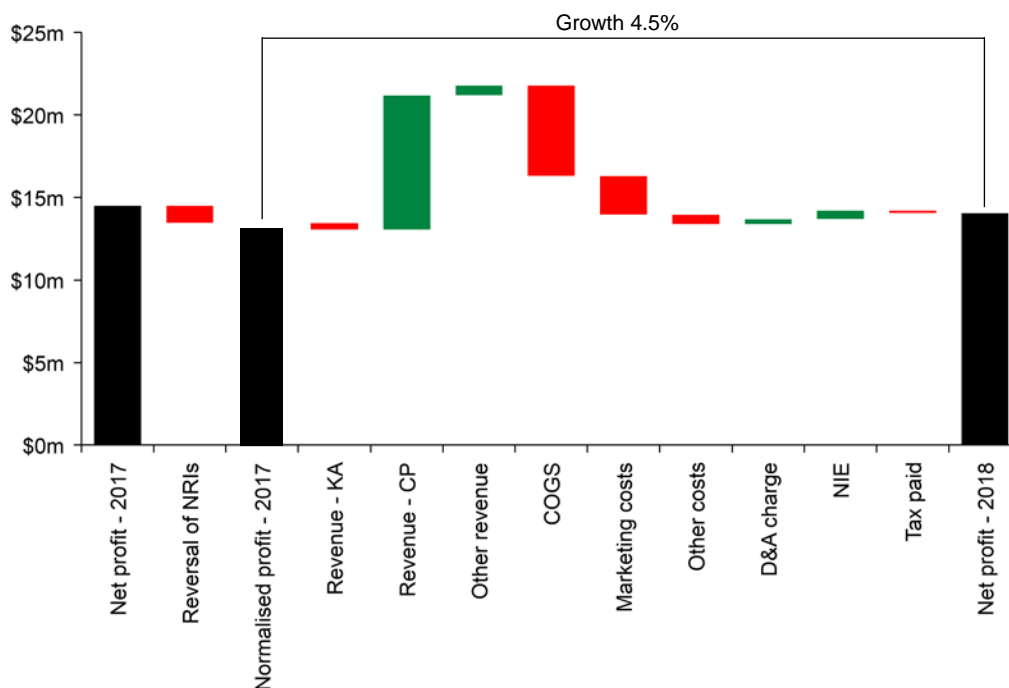
Figure 2: Changes to forecasts

| Year Ending 31 Dec | 2018F | | | 2019F | | | 2020F | | |
|------------------------|-------|------|-------|-------|------|-------|-------|------|-------|
| | Old | New | Chg | Old | New | Chg | Old | New | Chg |
| EBITDA (A\$m) | 25.6 | 23.8 | -7.0% | 28.6 | 27.0 | -5.8% | 29.8 | 29.7 | -0.3% |
| NPAT (A\$m) | 15.1 | 14.1 | -7.1% | 17.3 | 16.3 | -5.7% | 18.1 | 18.2 | 0.7% |
| Normalised NPAT (A\$m) | 15.1 | 14.1 | -7.1% | 17.3 | 16.3 | -5.7% | 18.1 | 18.2 | 0.7% |
| EPS ¢ | 15.9 | 14.7 | -7.1% | 18.0 | 17.0 | -5.6% | 18.8 | 19.0 | 0.8% |
| Normalised EPS ¢ | 15.9 | 14.7 | -7.1% | 18.0 | 17.0 | -5.6% | 18.8 | 19.0 | 0.8% |
| DPS ¢ | 12.0 | 11.0 | -8.3% | 13.0 | 12.5 | -3.8% | 13.5 | 13.5 | 0.0% |
| Free cash flow (A\$m) | 12.7 | 12.3 | -3.0% | 13.8 | 12.6 | -8.8% | 15.6 | 16.3 | 4.3% |

Source: Petra Capital

The incremental drivers of our net profit forecast for CY18 are summarised in Figure 3. Re-basing Shriro's CY17 net profit for non-recurring items (i.e. cost benefit from lease renegotiations), our net profit forecast for CY18 implies growth of 4.5 percent. The key drivers are (i) a decline in revenues and margins in Kitchen Appliances (i.e. sector weakness, mix skew towards lower margin renovation market, and competitive pressures), and (ii) higher earnings contributions from Casio and barbecues.

Figure 3: CY18 forecast net profit waterfall



Source: Petra Capital

There are several catalysts for upgrades to our earnings forecasts for Shriro in CY18. These include (i) new product releases, both proprietary (i.e. Robinhood, Everdure by Heston Blumenthal) and third-party (i.e. Casio watches), (ii) potential school curriculum changes in Queensland, which could drive increased demand for Casio calculators, and (iii) an acquisition, most likely in the form of a small bolt-on.

Price target

Given the earnings revisions outlined above and following the roll-forward of our DCF valuation, our fair value estimate/price target for Shriro has increased to \$1.77 per share, from \$1.58 per share previously. Our price target implies a CY18 PER, yield, and price to free cash flow of 12.0x, 6.2 percent, 13.7x, respectively. In terms of Shriro's PER, our CY18 estimate compares to the company's average 12-month forward PER over the last 24 months of 7.9x (Figure 4).

Figure 4: DCF

| | |
|--|---------------|
| Year ending 31 December | CY18 |
| DCF: WACC 10.7%, I-t growth 2.0%, liquidity discount 30% | \$2.21 |
| PER: 30% discount to Breville Group (year-end adjusted) | \$2.50 |
| Blended valuation (average) | \$2.35 |
| Share liquidity factor | 0.75 |
| Estimated fair value | \$1.77 |

Source: Petra Capital

Investment view

We view Shiro as being a well-managed company with a diverse portfolio of commercial brands and a strong balance sheet. It is for these reasons that we remain upbeat about Shiro's ability to deliver on management's growth strategy over the next 24 months, a key feature of which is pushing additional product innovations through an expanding international distribution network. To this end, Shiro's upcoming launch in the US and Germany looms as a key milestone.

We expect the realisation of this strategy, in combination with increasing share liquidity, to drive Shiro's share price closer to our DCF valuation of \$2.21. Based on our net profit estimate for CY18, our DCF valuation implies a PER of 15.1 times, which we view as increasingly warranted the more Shiro is able to reduce its proportionate earnings exposure to Casio – we estimate that Casio will account for circa 34 percent of Group sales in CY18.

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