INTUITION
30 AUGUST 2024

NEXT: UK's Mr Price

NEXT plc is a large multinational clothing, footwear and home retailer. Similar to Mr Price, but based in the UK, this company has delivered good growth through various strategic investments. NEXT plc is a frontrunner in omni-channel sales, with physical stores playing an important role in supplying their online customers. Although the Group doesn't have as broad a store footprint as Mr Price, NEXT is able to generate much higher revenues thanks to its superior online capabilities. A testament to its online efficiencies, NEXT plc was able to generate peer-leading operating margins when most other pure online apparel retailers fell short. In this article we take a closer look at NEXT and the outlook to ascertain whether this is a company that suits our philosophy here at Harvard House.

Jana
van Rooyen

London Stock Exchange listed company NEXT plc ("NEXT") was founded by Joseph Hepworth & Son in 1864 and started as a tailoring business in Leeds. In 1982 the first NEXT womenswear store was opened and today, NEXT is a multinational clothing, footwear and home retailer with 800 stores across the UK, Ireland and 34 other countries. These stores play an important role in supplying their online customers, who total 7.6 million in the UK and 1.7 million overseas.

With a market cap of £12 billion, NEXT is a constituent of the FTSE 100 Index. Just to give some context, Mr Price's market cap in Sterling is a mere £258 million. Much like Mr Price though, NEXT is known for quality fashion at affordable prices, but at a much larger scale. Its range covers 75,000 different products, giving their consumers a much larger breadth of choice. We delve into some key considerations to ascertain whether this is a company suited to our investment philosophy.

SPEED READ

- **NEXT plc is a multinational clothing company with excellent online capabilities as it leverages off a well-established, efficient distribution network.**
- **Its operating margin is peer-leading - a testament to its online capabilities and efficiencies, as most online retailers usually struggle to generate adequate profits.**
- **Consequently, NEXT was able to increase its diluted Earnings Per Share by 15% to 655.9p for the full year, and with a dividend payout ratio of 31%, declared a DPS of 207p.**
- **NEXT is also a discretionary retailer poised to benefit from a consumer recovery. The Group is guiding for sales and profit growth of 6% and 7% respectively for FY25, which is conservative, in our opinion.**
- **Much like Mr Price here in South Africa, NEXT should deliver inflation-beating dividend growth to its shareholders.**

Online excellence

The sheer volume of products in their range is not due to their store footprint (800 stores) – in contrast to Mr Price with almost 3,000 - but rather due to their online capabilities. NEXT's proportion of online revenue (excluding Total Platform that I will delve in to shortly) to total revenue is 53%, versus just 2.1% for Mr Price.

It all started in the late 1980s when NEXT launched Next Directory, the company's mail-order arm and a big gamechanger for the company. Supermodels like Naomi Cambell and Yasmin Le Bond graced its covers and much like how we order online today from the comfort of our home, one could order clothes via mail-order and wear it within days. This meant that the warehousing, distribution, credit and logistics operations that were put in place were miles ahead of their competitors. Today when you go to NEXT's website there are dozens of apparent competitor brands all under one roof, all thanks to CEO Simon Wolfson's "Total Platform" concept that was launched recently.

Total Platform provides a complete suite of services to third party brands, including websites, marketing, warehousing, distribution network and contact centers, so that these third-party brands can leverage from NEXT's infrastructure. NEXT also has a minority shareholding in some of these third-party brands. Total Platform now contributes 7% of the total group revenue and saw a 380% growth in revenue for the 2024 financial year.

For the American apparel retailer, GAP, this platform was a saving grace. Between 2019 and 2020 Gap was forced to close all 81 stores in the UK and Ireland, as they were unable to keep up with the evolution of online shopping. NEXT now owns 51% of the UK operations in a joint venture with GAP, where NEXT opened new GAP shop-in-shops withing flagship NEXT stores. Gap's e-commerce operations have been transferred over to NEXT's Total Platform and leverages from their free next-day delivery and returns system across NEXT's store network.

"NEXT generated group sales of £5.8 billion in the 2024 financial year (January year-end), growth of 6% in a year where UK GDP growth was a mere 0.1%."

The numbers

NEXT generated group sales of £5.8 billion in the 2024 financial year (January year-end), growth of 6% in a year where UK GDP growth was a mere 0.1%. That revenue growth translated in growth in operating profit of 5%, caused by higher costs, and earnings per share growth of 0.3% - due to higher interest paid and higher taxes, offset by a smaller number of shares in issue from ongoing share buybacks.

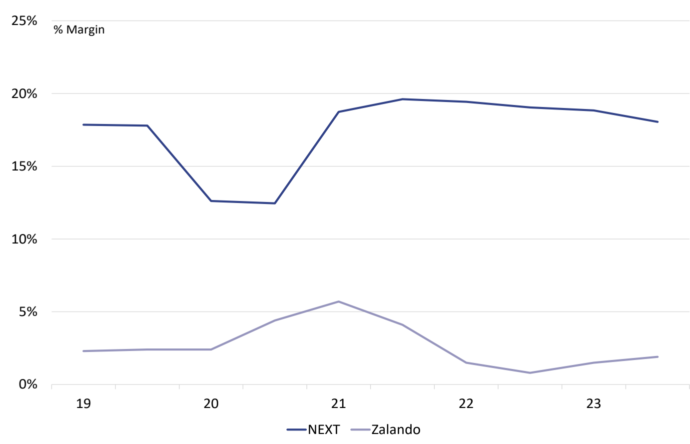
Given their high proportion of online sales, NEXT has an enviable operating margin, especially compared to other online fashion retailers across the EU. This is illustrated in the chart below, which compares NEXT to Zalando (online fashion retailer based in Germany). Margins are more than 5x higher due to their omni-channel presence and the combined efficiencies of their physical stores and logistics infrastructure.

This high level of profitability allows it to generate substantial free cash flow after allowing for annual capital expenditure, which is either reinvested into the business, used to reduce debt or to reward shareholders. Last year, NEXT generated free cash flow of £880 million, more than 3x the amount of Mr Price's market capitalization. Encouragingly, dividends paid only comprise 29% of free cash flow, so there is ample cushion to absorb a tougher year without dividends being affected.

Looking forward

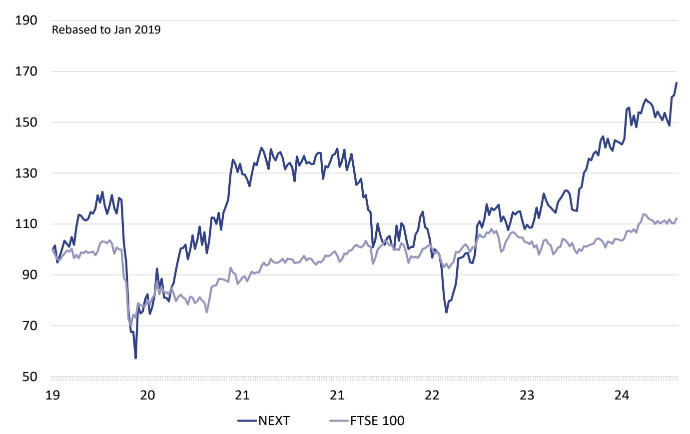
As much as NEXT is driven by its technology and logistics advantage, it is still ultimately a discretionary retailer poised for growth as the global consumer cycle turns more positive. UK GDP expanded 0.7% in Q1 2024, which was higher than initial estimates, and a further 0.6% in Q2 2024. It is the strongest rate of growth in over two years, signaling an end of the recession that they entered during the latter part of 2023. The Group has already beat estimates for revenue growth in the first 2 quarters of FY25. Having guided for growth of 2.5% for the first half of their current financial year, NEXT actually delivered growth of 4.4%,

COMPARISON OF OPERATING MARGIN



NEXT generates margins more than 5x those of Zalando, thanks to its wealth of experience and its ability to leverage efficiencies from its store network and logistics infrastructure.

SHARE PRICE PERFORMANCE



NEXT has outperformed the broader UK market, especially over the past 18 months. Over that period, NEXT has risen 74% versus a comparable gain of 12% for the FTSE 100.

rising further to 8% if sales from subsidiaries are included. That firmly beat expectations, resulting in a rise in the share price of 7.8% for the day.

Apart from a turn in the consumer cycle, NEXT continues to develop their brand and infrastructure which gives them three distinct new avenues of growth:

- Growth of the NEXT brand overseas in existing and new territories.
- The development of new brands and licenses.
- Generation of revenues from Total Platform and its equity investments.

The Group is guiding for conservative sales growth of 6% for FY25 and expected profit of £980 million, which is an increase of 6.7% from this past financial year. The probability of further dividends declared for the FY25 year, should they achieve their own guidance, is bullish, supported by a reasonably geared balance sheet and strong free cash flow generation.

The share price trades at an attractive PE Ratio of 15x, very much in line with its long-term average valuation. Like Mr Price in South Africa, NEXT has proven its ability to deliver growing returns over time, even through the tough times. That stands the company in good stead, and places it firmly on our watchlist for offshore portfolios.

NEXT PE RATIO

NEXT's valuation is very much in line with its long-term average, despite the strong growth in recent years and the prospect of a better consumer cycle.

NEXT has exceeded expectations again in 2Q 25, despite the high base from favourable weather last year. That has prompted the company to raise its full year guidance."

Our next seminar will focus on financial planning, and will deal with the perception of common risks, and how to mitigate them.

Topic:	Unpacking Investment Risk
Natal Midlands	
Date:	12 September, 2024
Venue:	Christ Church Howick, 23 Mare Street, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg	
Date:	10 September, 2024
Venue:	Rosebank Union Church, Cnr Winne Mandela Drive and St Andrews Road, Hurlingham
Time:	7am for 7.30am

Cape Town	
Date:	n/a
Venue:	SSISA Conference Centre, Boundary Road, Newlands, Classroom 1, 3rd Floor
Time:	7.30am
Venue:	ABRU Motor Studio, Lourensford Wine Estate, Somerset West
Time:	5.30pm for 6pm

Harvard House is on Facebook

Harvard House is on YouTube

CONTACT DETAILS:

For more information on the range of products and services offered by Harvard House Investment Management and its associated companies (including Harvard House, Chartered Accountants), or for any financial advice, please contact the Company at:

HARVARD HOUSE GROUP

3 Harvard Street, Howick, 3290, South Africa

P.O. Box 235, Howick, 3290, South Africa

+27 (0) 33 330 2164

+27 (0) 33 330 2617

@ admin@hhgroup.co.za

W www.hhgroup.co.za