

Nick Scali's Overseas Expansion

STOCK STORY

Few public company announcements strike as much fear into investors' hearts as the headline 'equity raise to fund acquisition and expansion into new overseas market'.

There are countless examples of Australian businesses who have been humbled by their global ambitions: Bunnings' entry into the UK with Homebase, Boral's foray into the US with Headwaters or Orora's recent entry into Europe with Saverglass. During the June quarter, our fears were realised when one of our core holdings, Nick Scali, announced its expansion into the UK market with the acquisition of Fabb Furniture.

Fortunately, there are a few reasons why we are much more optimistic about the prospects for Nick Scali's acquisition. For one, the acquisition itself is a relatively low-cost bet. The Fabb Furniture business is currently loss-making, with the main attraction being the acquisition of the 21-store footprint, which Nick Scali will spend \$27m rebranding and refurbishing. The total estimated cost of the venture is \$50m – or just ~5% of Nick Scali's market capitalisation at the time of acquisition. Compare this to Boral's ~58% dilution for Headwaters or Orora's ~45% dilution to acquire Saverglass. It's fair to say that, for Nick Scali, this is far from a 'bet the farm' acquisition.

Additionally, management have a demonstrated track record of creating value through acquisition. The company acquired Plush in 2021 for \$103m, or just 4x EBITDA. The acquisition made strategic sense, leveraging Nick Scali's scale in upholstery to materially improve Plush's gross margins from 54.8% to 62.7%. The playbook for Fabb Furniture is largely the same – refurbish the store network and leverage the Nick Scali supply chain to improve gross margins.

And finally, you have one of Australia's most talented retailers at the helm in Anthony Scali. While it's true that he has significantly reduced his shareholding, Anthony still holds ~8% of the company, and his track record for creating value for shareholders over the past 20 years is stellar. The importance of good management in retail is paramount, and in this case, there are few managers you would back more to execute this expansion than Anthony Scali.

If the venture does prove successful, the upside case is obvious; the UK furniture market is twice the size of the Australian market, so there is scope to build a business that one day dwarfs the size of the existing business. For these reasons, Nick Scali remains a core holding in the Airlie Small Companies Fund

By Will Granger, Portfolio Manager

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