

Williams-Sonoma Inc. (WSM)

Updated May 29th, 2020 by Eli Inkrot

Key Metrics

Current Price:	\$85	5 Year CAGR Estimate:	-2.9%	Market Cap:	\$6.8 B
Fair Value Price:	\$49	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	07/23/20
% Fair Value:	174%	5 Year Valuation Multiple Estimate:	-10.5%	Dividend Payment Date:	08/28/20
Dividend Yield:	2.2%	5 Year Price Target	\$63	Years Of Dividend Growth:	14
Dividend Risk Score:	B	Retirement Suitability Score:	D	Last Dividend Increase:	11.6%

Overview & Current Events

Williams-Sonoma is a specialty retailer that operates home furnishing and houseware brands such as Williams-Sonoma, Pottery Barn, West Elm, Rejuvenation, Mark & Graham and others. Williams-Sonoma operates traditional brick-and-mortar retail locations but also sells its goods through e-commerce and direct-mail catalogs. Williams-Sonoma was founded in 1956, is headquartered in San Francisco, and currently trades with a market capitalization of \$7 billion.

On March 17th, 2020 Williams-Sonoma announced that the company temporarily closed all of its stores as a precautionary measure to combat the spread of the coronavirus. On May 15th, the company announced that it would continue its temporary closure of U.S. and Canada stores through May 31st in locations where retail restrictions have not been lifted. The company is re-opening stores on a market-by-market basis consistent with local guidelines.

On May 28th, 2020 Williams-Sonoma announced Q1 fiscal year 2020 results for the period ending May 3rd, 2020. (Williams-Sonoma's fiscal year ends the Sunday closest to January 31st.) For the quarter revenue equaled \$1.235 billion, down -0.5% compared to Q1 2019. Comparable brand revenue growth equaled 2.6% - including 8.5%, 5.4% and 3.3% respective growth at Pottery Barn Kids and Teens, Williams Sonoma and West Elm - despite having all 616 stores closed for more than half of the quarter, as the e-commerce business had breakout growth. Earnings-per-share equaled \$0.45 compared to \$0.66 in the prior year's quarter, while adjusted earnings-per-share totaled \$0.74 versus \$0.81 previously.

While Williams-Sonoma has suspended its 2020 guidance due to the uncertainty surrounding the coronavirus, the company does target mid-to-high single-digit revenue growth over the long-term.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$1.83	\$2.22	\$2.54	\$2.82	\$3.24	\$3.37	\$3.41	\$3.52	\$4.05	\$4.49	\$3.50	\$4.47
DPS	\$0.55	\$0.73	\$0.88	\$1.24	\$1.32	\$1.40	\$1.48	\$1.56	\$1.72	\$1.92	\$1.92	\$2.45
Shares¹	105	100	98	94	92	90	87	84	79	79	78	70

Williams-Sonoma has a solid growth history. Since 2010, the company has grown earnings-per-share by an average compound rate of over 10% per annum. However, this is skewed somewhat, as recent results have been aided significantly by a lower tax rate. Stripping away this benefit, the company has been able to improve in the mid-single digits. This mirrors the type of cautious growth expectation, 5% annually, that we are anticipating from this point.

Unlike many other retailers, Williams-Sonoma has been able to increase its profits through the last couple of years, which is, among other factors, due to its consistent revenue growth. Thanks to its robust Omni-channel sales strategy, Williams-Sonoma has established a strong e-commerce business. As online sales continue to outpace company-wide revenue growth, Williams-Sonoma will become even more of an online retail company in the coming years.

This strategy is showing promise amid the coronavirus crisis, as the e-commerce portion of the business took up the slack for closed retail locations in Q1. In the short-term the coronavirus poses a challenge, but early signs suggest Williams-Sonoma is better positioned to weather the storm. While earnings expectations will remain subdued, we are

¹ In millions.

Disclosure: This analyst has no position in the security discussed in this research report and no plans to initiate one in the next 72 hours

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encouraged by this initial report. Share repurchases have traditionally been a growth driver for the bottom-line and may continue to help moving forward. However, conservation of capital continues to be more pressing.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	15.8	16.6	15.8	19.4	20.8	22.2	15.5	14.1	14.0	14.3	24.4	14.0
Avg. Yld.	1.9%	2.0%	2.2%	2.3%	2.0%	1.9%	2.8%	3.1%	3.0%	3.0%	2.2%	3.9%

Williams-Sonoma has an interesting valuation history, with a typical multiple in the mid-teens coupled with occasional bouts of a 20+ earnings multiple. Taking into consideration the company's past performance, growth prospects, balance sheet and current situation, we believe a mid-teens multiple is a fair starting baseline for the security. This could be too ambitious if the company's growth rate deteriorates, but we have accounted for this somewhat in the lower earnings expectations. With today's valuation over 24 times expected earnings, this implies a significant valuation headwind.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	30%	33%	35%	44%	41%	42%	43%	44%	42%	43%	55%	55%

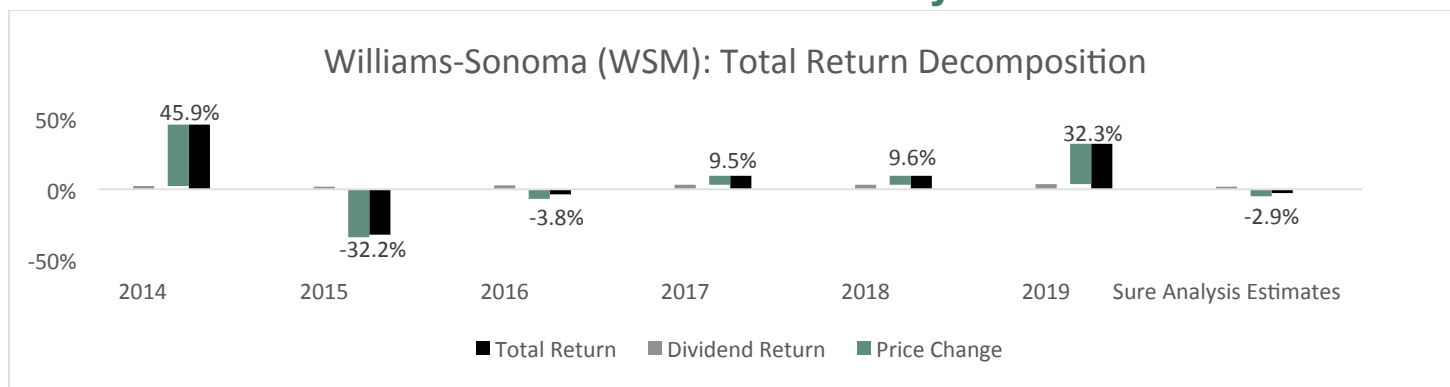
Williams-Sonoma's competitive advantage lies in its unique product portfolio and successful move to the online space. Still, the company competes against formidable foes including traditional brick-and-mortar home improvement retailers such as Home Depot and Lowe's, and e-commerce players such as Amazon. Results have been solid in the last decade, but we caution that the company's business model is quite cyclical, as consumers tend to avoid discretionary items during economic downturns. During the last recession Williams-Sonoma posted earnings-per-share of \$1.76, \$0.28, \$0.72 and \$1.83 during the 2007 through 2010 stretch while the dividend was held steady and ultimately increased.

Williams-Sonoma operates a relatively asset-light business model relative to other retailers, thanks to a high portion of online sales. As of the most recent report the company held \$861 million in cash, \$2.1 billion in current assets and \$4.4 billion in total assets against \$1.7 billion in current liabilities and \$3.2 billion in total liabilities.

Final Thoughts & Recommendation

Williams-Sonoma has transformed itself into an Omni-channel retailer with a large e-commerce presence, which is proving resilient during the current crisis. In our last report shares declined -55%. Since then, in just over two months, shares are up an eye-popping 185%. This has materially altered the investment thesis. Due to the materially higher share price, we are forecasting -2.9% annual total return potential, stemming from 5% growth and the 2.2% dividend yield offset by a significant valuation headwind. We are moving our rating from buy to sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	3504	3721	4043	4388	4699	4976	5084	5292	5672	5898
Gross Profit	1374	1460	1592	1704	1801	1844	1883	1932	2101	2139
Gross Margin	39.2%	39.2%	39.4%	38.8%	38.3%	37.1%	37.0%	36.5%	37.0%	36.3%
SG&A Exp.	1050	1078	1183	1252	1298	1356	1411	1478	1665	1673
D&A Exp.	145	131	134	150	162	168	173	183	189	188
Operating Profit	323	382	409	452	502	489	473	454	436	466
Operating Margin	9.2%	10.3%	10.1%	10.3%	10.7%	9.8%	9.3%	8.6%	7.7%	7.9%
Net Profit	200	237	257	279	309	310	305	260	334	356
Net Margin	5.7%	6.4%	6.4%	6.4%	6.6%	6.2%	6.0%	4.9%	5.9%	6.0%
Free Cash Flow	294	161	159	260	257	341	327	310	396	421
Income Tax	123	145	153	174	193	178	167	193	96	101

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	2132	2061	2188	2337	2330	2417	2477	2786	2813	4054
Cash & Equivalents	628	503	425	330	223	194	214	390	339	432
Accounts Receivable	42	46	63	60	67	79	89	90	107	112
Inventories	513	553	640	813	888	978	978	1062	1125	1101
Goodwill & Int. Ass.	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	85	85
Total Liabilities	873	806	879	1081	1106	1219	1229	1582	1657	2818
Accounts Payable	228	218	259	405	397	447	454	459	527	521
Long-Term Debt	9	7	5	4	2	0	0	299	300	300
Shareholder's Equity	1259	1255	1309	1256	1225	1198	1248	1204	1156	1236
D/E Ratio	0.01	0.01	0.00	0.00	0.00	0.00	0.00	0.25	0.26	0.24

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	9.5%	11.3%	12.1%	12.3%	13.2%	13.1%	12.5%	9.9%	11.9%	10.4%
Return on Equity	16.2%	18.8%	20.0%	21.7%	24.9%	25.6%	25.0%	21.2%	28.3%	29.8%
ROIC	16.1%	18.7%	19.9%	21.7%	24.8%	25.6%	25.0%	18.9%	22.6%	23.8%
Shares Out.	105	100	98	94	92	90	87	84	82	79
Revenue/Share	32.00	34.91	40.01	44.43	49.36	54.03	56.83	61.48	68.88	74.45
FCF/Share	2.69	1.51	1.57	2.63	2.70	3.70	3.66	3.60	4.81	5.31

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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