Company: Nick Scali Furniture Ltd
Analyst: Alistair Cowley
Date of Analysis: 13/09/2020

Nick Scali Furniture Ltd

Checklist Overview

Overall Checklist Result	Number of Risks
89.7%	4

Business Characteristics		
Moat	Acquisitions	Overall
75%	Not Applicable	80%

Financial Characteristics			
Income Statement	Balance Sheet	Cash Flow Statement	Overall
98%	98%	97%	98%

Management Characteristics	Competitor Characteristics	Ethical Characteristics	Growth Characteristics
93%	82%	90%	92%

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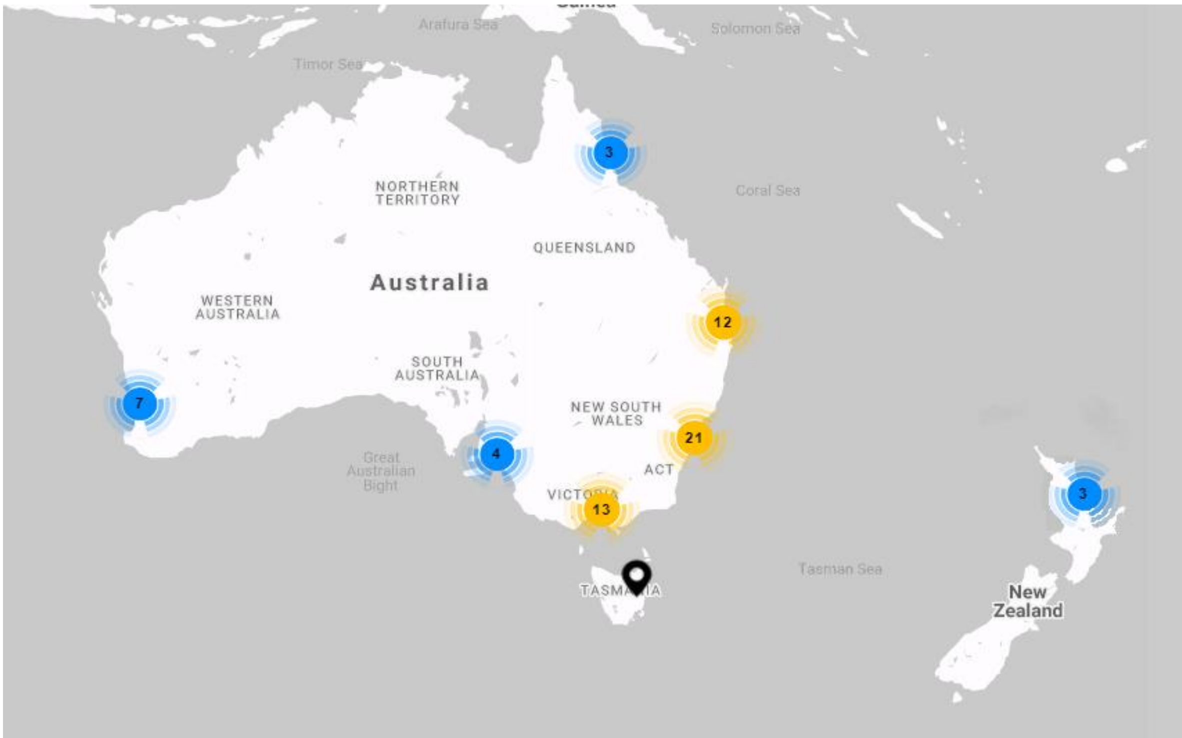
Alistair Cowley
Email: alistair.cowley@growthwithvalue.com

1 Business Description

Nick Scali Limited is Australia's premier furniture retailer, offering a lifetime warranty on framework and 2 years on all leather and other fabrics. Nick Scali Limited is a family run business established in 1962 by Nick Scali. Nick Scali successfully ran the business for over 50 years until he passed over the reigns to his son Anthony Scali who has been with the business since 1982. The family has sold down much of its holding within the business over a 3 year period to FY18 but still retains a 13.6% stake (down from 50% in FY15). Currently the company has a network of 64 stores across Australia (61 stores) and New Zealand (3 stores), opening its first store in New Zealand at the end of 2017. Nick Scali sells a range of furniture from lounges and dining tables to rugs and mirrors. The company has two store networks comprising the traditional Nick Scali Furniture store providing the latest high end furniture and 5 Nick Scali Clearance stores where end of line issues are offered at discounted rates to help reduce inventory build up and carrying costs at its traditional stores.

Nick Scali is a relatively small player in the Australian furniture retail sector which produced revenues of $6.6b in FY20, with Nick Scali representing just about 4.0% of industry revenue in FY20. Nick Scali's competitors include; Harvey Norman (19.0% Market Share as of FY20), IKEA (17.7% Market Share as of FY19), Greenlit Brands (13.1% Market Share as of FY19) which is the holding company of Freedom, Fantastic Furniture, Snooze, Plush and until recently Harris Scarfe and lastly BBQSAM (10.9% Market Share as of FY19) which owns Amart Furniture and BBQ's Galore.

Nick Scali Store Network



2 Why I like this investment

Nick Scali is a clear leader within the furniture retail industry in terms of quality, branding and financial strength. The business has proven over many years that it is able to continue to provide quality furniture at competitive prices and still maintain high Profit Margins and impressive shareholder returns. Nick Scali is only a small player within the industry at just 4.0% market share but is continuing to roll out new stores across Australia and New Zealand with the aim of increasing its network to 80-85 stores. The industry has been consolidating over the last decade with the top four players increasing their total market share from 30% in 2011 to almost 60% in FY19. The majority of these larger players are also unprofitable and have been for the last 2 to 3 years with no signs of improving the situation. Harvey Norman is the only one of the large players to operate profitably. This could potentially provide opportunity for Nick Scali to increase its market share organically or with target expansion of new stores.

Alistair Cowley
Email: alistair.cowley@growthwithvalue.com

The majority of Nick Scali's 13% growth in Sales and Earnings has come from increasing its store network, as Same Store Sales growth has averaged only about 2% per year. Same Store Sales growth has slightly outperformed inflation which has averaged about 1.6% for the last 5 years in Australia. Nick Scali has opened on average 3.7 new stores a year for the last 10 years. At this rate the business will likely reach its desired store network of 80-85 stores across Australia and New Zealand within the next 5 to 6 years. If this is the case and assuming the company can achieve 10% growth in sales and earnings (higher growth from increasing the store network vs 2% growth in its existing stores) over the next five years and then 2% thereafter, there may be an opportunity to invest at attract levels given recent share price performance over the last year or two. There is also the potential for Nick Scali to take market share from existing unprofitable competitors, particularly given its very strong Balance Sheet and Net Cash position. This would result in increased Sales growth in addition to the boost from the store roll-out and would possibly continue over a longer period than just the next five years.

3 Greatest Risks of Ownership

Total Risks 4

I have identified four major risks in relation to Nick Scali and its operations. First is the abundance of choice available to customers, second is the risks of an economic downturn, third is increasing online competition and fourth is the levels of debt within the business. The fourth point is not so concerning given the majority of the debt is actually Operating Lease Liabilities.

Abundance of Choice:
There is a strong competitive risk amongst furniture retailers as there is no shortage when it comes to choice in the retail furniture market. This leads to price wars amongst competitors as they all vie for business. This is clearly taking its toll on many furniture retailers reflected in average industry profit margins of just 1.7% in FY19 (most likely propped up by Harvey Norman with a 12% margin as well as Nick Scali's 16% margin but on a much smaller scale). Many firms are also becoming increasingly unprofitable and there has been no shortage of bankruptcies within the industry.

Economic Downturn:
Furniture sales are highly dependant on new home construction and existing housing renovations. Economic cycles are nothing new and Nick Scali has been in business for over 50 years, during which time it has faced many economic downturns. However, economic downturns will always be a potential risk for the furniture retail industry. With its strong Balance Sheet and Net Cash position, Nick Scali is well positioned to ride out these short term economic market cycles.

Online Competition:
As with all retail markets, online competition within the retail furniture industry continues to be a very large threat. At this stage given the physical size of most furniture items and the need to "try before you buy", online sales have not shown any significant signs of taking business from bricks and mortar furniture retailers like Nick Scali. Nick Scali averages about 150,000 visits to its website each month compared to IKEA and Fantastic Furniture with millions of visits to their respective sites. Much of the furniture sold by the likes of Fantastic and in particular IKEA, is better suited for the online market given the lighter weight materials used (lower quality), flat pack designs and lower price points resulting in a product that appeals to the lesser discerning online customer. It would appear the target market for Nick Scali may be prepared when buying furniture.

The higher quality and more bespoke product offered by Nick Scali may somewhat insulate it from its online competitors and allow it to maintain its profit margins.

Debt Levels:
With a Debt to Equity Ratio of 2.9, the levels of debt appear to be high for the business but this is largely due to operating leases. In terms of actual debt that is owed to a bank or creditor, Nick Scali carries a very conservative level with a Debt to Equity Ratio of 0.45 (excluding operating leases). Total Debt was only about 80% of Net Profit in FY20 and with an Interest Coverage Ratio of 8.5, this provides added assurance that the level of debt within the business is not excessive. Operating leases are a form of leverage however and it is real money that is required to be paid at some point in the future. For this reason, operating leases do increase insolvency risks if the business is unable to make its lease payments, and with $29.3 million, or 11.2% of revenue, going to operating lease payments, this is not a small expense.

Alistair Cowley
Email: alistair.cowley@growthwithvalue.com

4 Long term prospects

I can not see the need for furniture reducing at all in my life time. I believe there will always be a need to have a couch to sit on, a dining table to eat dinner with the family and a bed to sleep in. These have been and always will be basic necessities of the human race. Styles and fashions may change but there is no reason Nick Scali can not keep up with changing trends, they have been able to do so for over 50 years. The largest threat to the long term prospects of Nick Scali would be how customers choose to purchase their furniture, be it online or through bricks and mortar retail stores. If furniture sales move to predominantly being online, this will greatly increase the direct competition of Nick Scali with large global retailers such as Amazon, eBay and IKEA. At this stage, it is unlikely you can find the range and quality that is offered through Nick Scali stores via online retailers such as Amazon and eBay. IKEA is the best positioned to dominate in the online furniture retail market due to their flat pack designs. However, as mentioned in point three above (Online Competition), I don't see this as being a significant risk to Nick Scali in the foreseeable future given its higher quality product range and more discerning target market.

5 Key findings in relation to the Business

Rating 80%

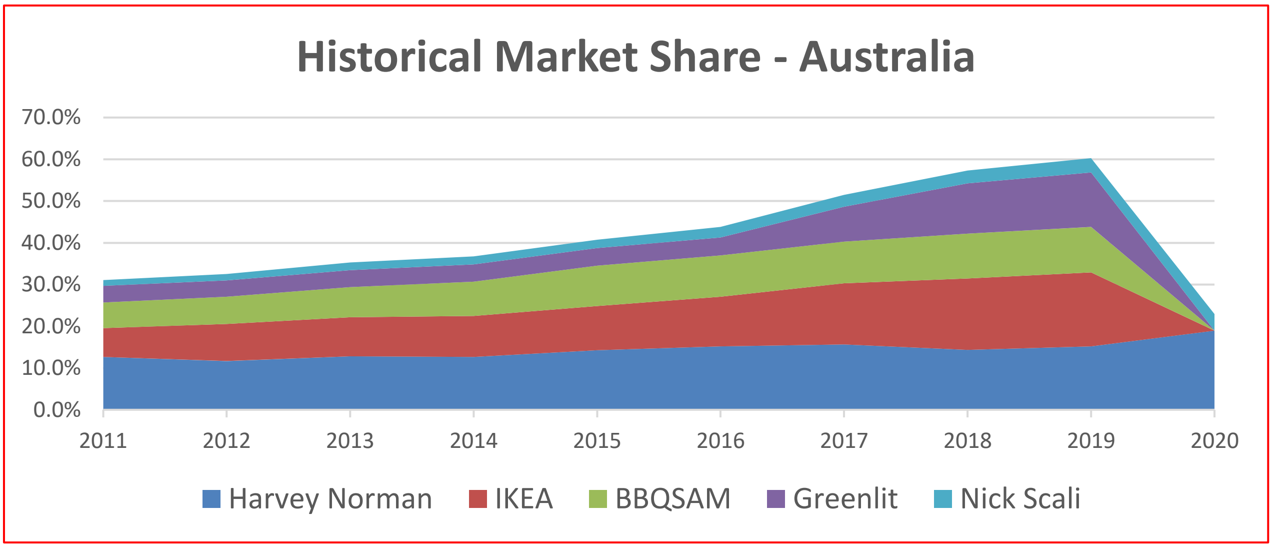
Nick Scali operates in a very competitive industry. The top four players control just over 50%, indicating a low to medium level of concentration within the industry. The industry has been increasing in concentration from only 30% in 2011. Due to this high level of competition and low industry concentration, many of many of the firms are unprofitable and have been for a number of years, including IKEA. Nick Scali has been able to keep costs down and expand its store network at a conservative rate, without the need to take on excessive levels of debt. It's store expansion has been through organic growth and not through rapid expansion via acquisitions which can result in increased risk of overpaying for the acquired business.

Nick Scali has an impressive history of providing solid Returns on Equity. It has maintained Return on Equity of between 40% and 60% over the last decade. The company has also been able to produce solid Returns on Invested Capital, which up until the last two years has been on a steady rise from a low of 12% in FY09 to a high of 31% in FY17. Currently Return on Invested Capital is about 21%. This is well above the company's cost of capital, which has averaged below 10% for the last 10 or so years. This indicates that the business and management have been able to deploy investors' money wisely in assets and investments which have returned well above the expected returns of investors. The last 10 years has seen increased Capital Expenses, mainly due to expanding the store network at a faster pace than in previous years. Since 2010, about 3.7 new stores have been opened each year, versus about 2.2 new stores a year in the preceding 10 years. This has resulted in an increase in Capital Expenses of about 6.5% of Revenue a year on average versus only about 2% a year before 2011. The target total store network across Australia and New Zealand is between 80 and 85 stores.

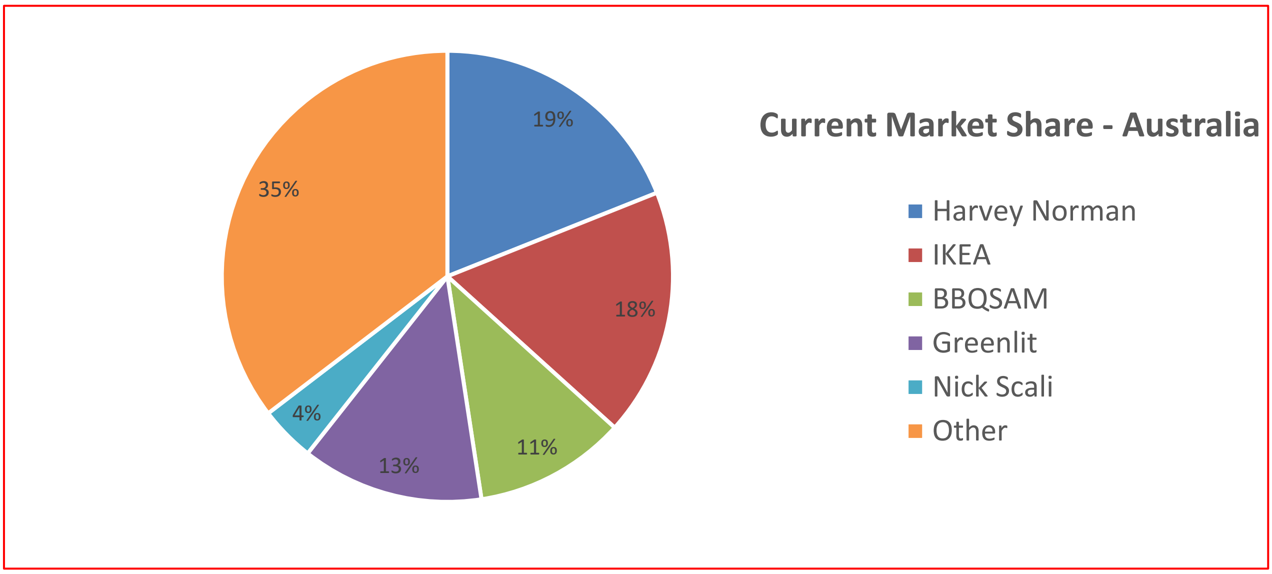
Nick Scali sources its furniture from overseas with about 40% coming from China, down from 80% 8 years ago. It also sources product from Vietnam and Malaysia amongst others. Sourcing its products from countries such as China and Vietnam allows Nick Scali to reduce one of the industries largest expenses in wages, taking advantage of the low wages across many of these Asian countries. Wage expense averages about 13% of revenue across the industry, compared with Nick Scali wage expense of around 11.4% of revenue. This highlights Nick Scali's ability to keep costs low and is one of the reasons it has managed to continue to produce high margins. By sourcing its inventory from China, it provides Nick Scali with many options, with over 50,000 furniture manufacturing companies across China. China is also the largest exporter of furniture in the world, taking the number one spot from Italy in 2004. This large number of potential suppliers allows Nick Scali to negotiate attractive rates without compromising on quality. Most of its furniture is built to order, further reducing inventory holding costs, which can be rather large for furniture retailers given the size of their products. This potentially longer delivery time can cause some customer angst and provides a contrast with IKEA's ability to offer immediate supply of its product range through its flat pack design. This convenience can however come at a cost of poorer quality.

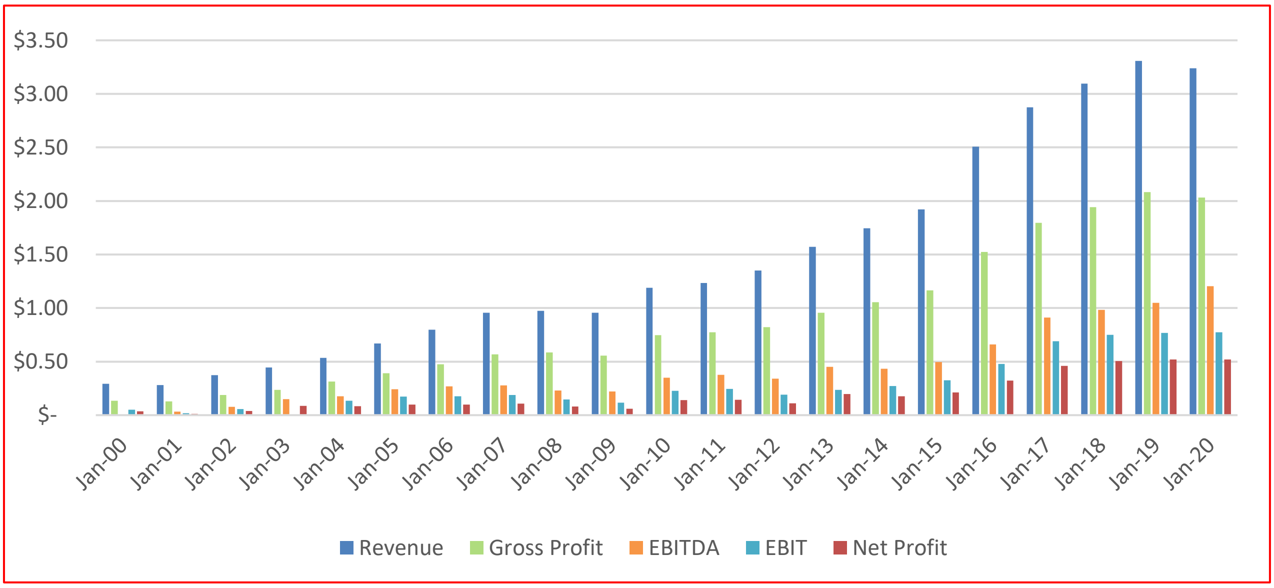
Nick Scali along with Harvey Norman are both well above the rest of the retailers in the industry when it comes to reducing expenses and maximising profits. Across the major players, Harvey Norman and Nick Scali look to be by far the most efficient, which is evident not only in the high profit margins of about 12% for Harvey Norman and 16% for Nick Scali, but also in the fact they both produce about $580,000 sales revenue per employee, versus $366,000 for IKEA, $400,000 for BBQSAM and $110,000 for Greenlit Brands. It is not surprising that these other retailers have not made a profit for the last 2-3 years.

Alistair Cowley
Email: alistair.cowley@growthwithvalue.com



Note: FY20 Results are not yet available for IKEA, BBQSAM and Greenlit Brands, therefore their respective Market Share calculations have not been updated for FY20.





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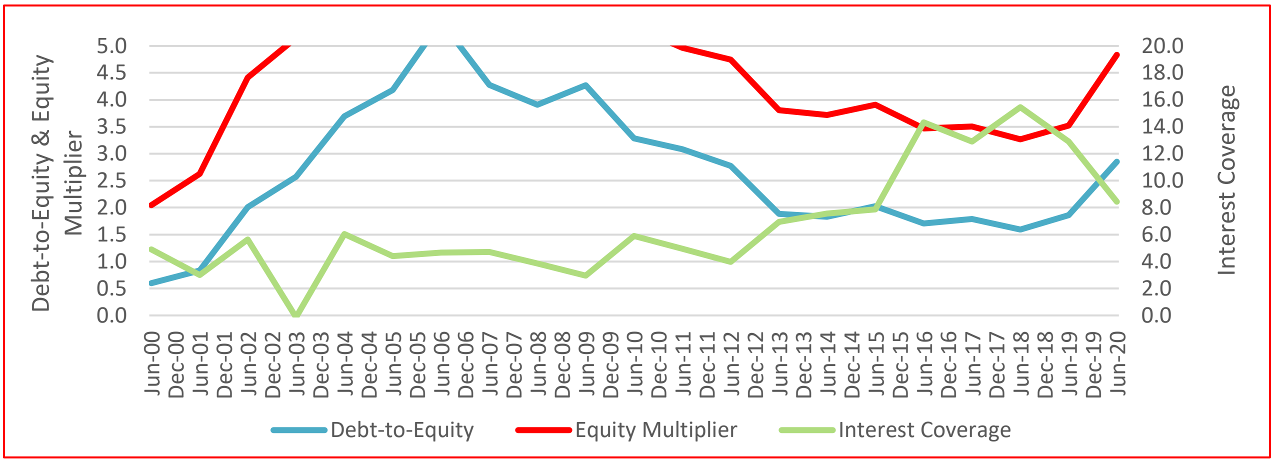
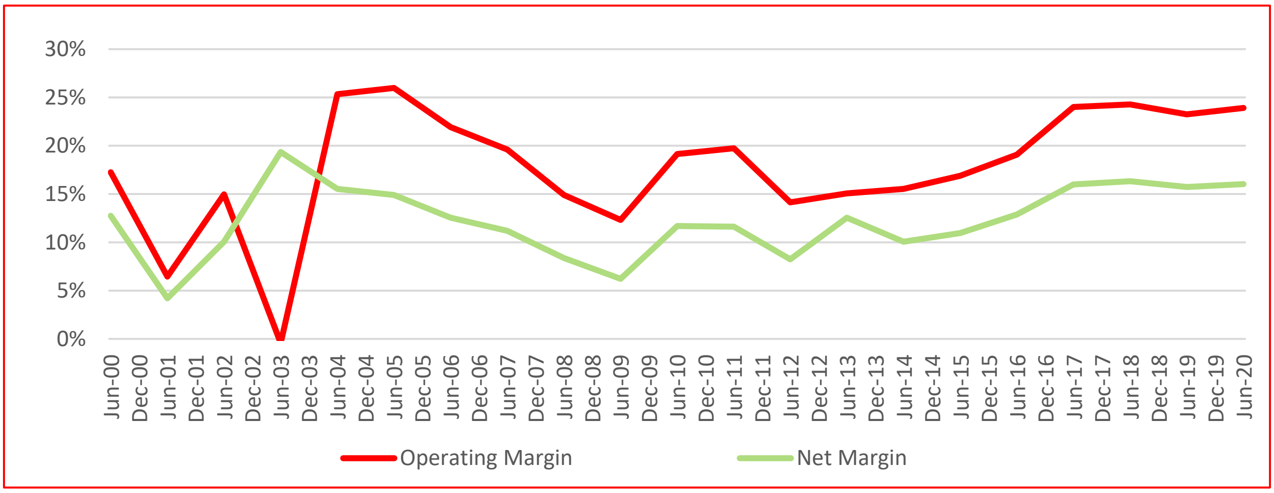
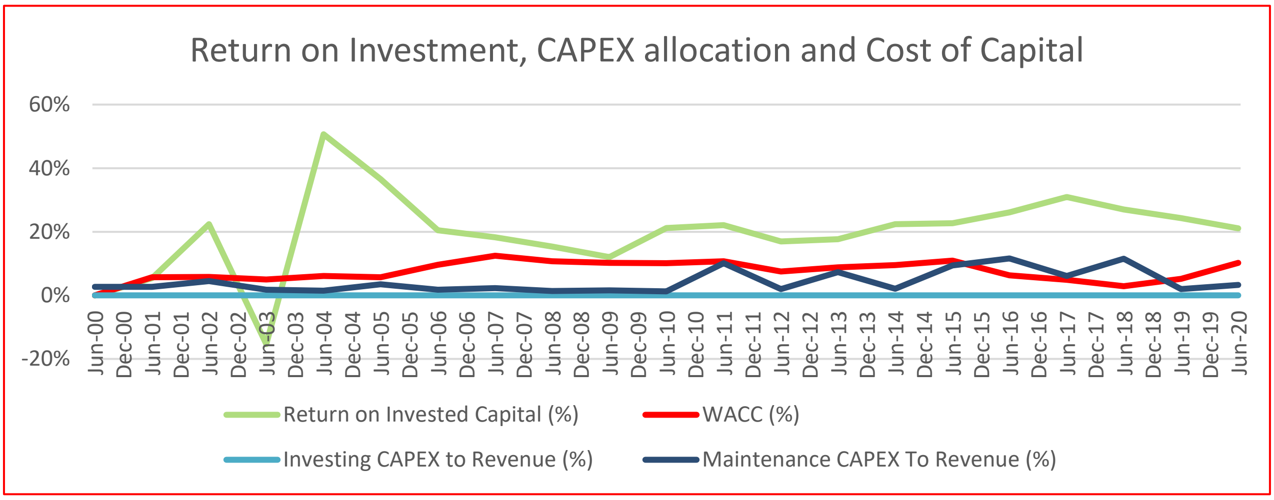






Alistair Cowley
Email: alistair.cowley@growthwithvalue.com

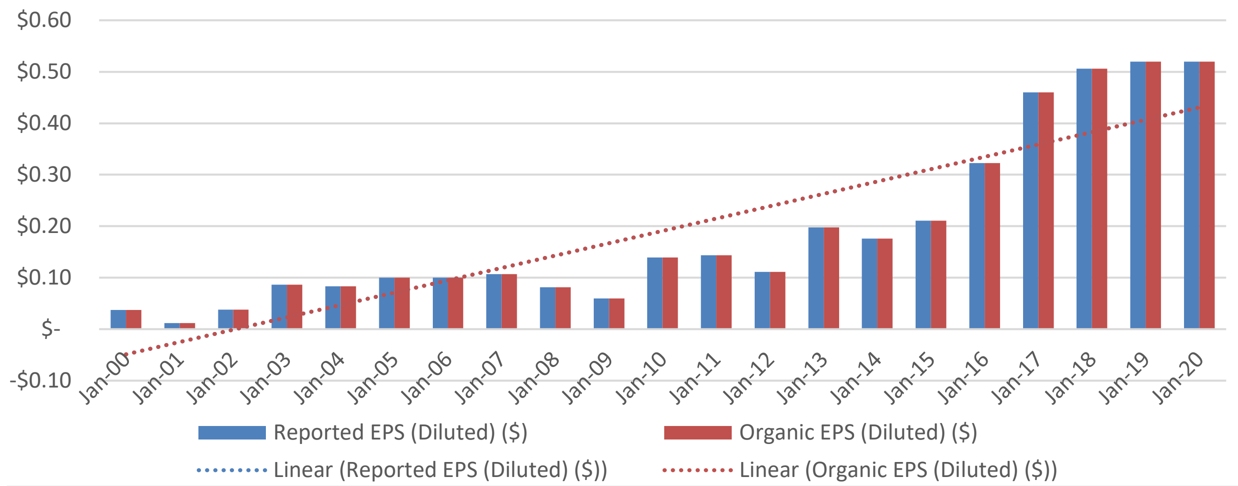
6 Key findings in relation to Growth

Rating 92%

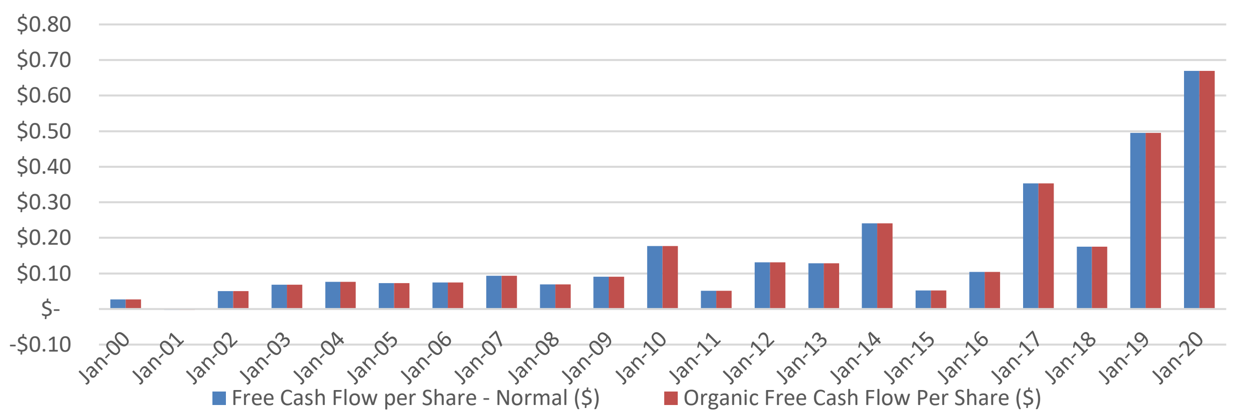
The furniture retail industry has grown at a rate of 1.4% a year over the 5 years to FY19. Year on year growth to FY20 has seen fall of about 19% in industry sales due to the negative impact of COVID-19. The industry is projected to grow between 0.6% and 2% for the next 5 years. This growth is bolstered by Australia's rising population due to increased immigration which results in increased demand for new housing. The high wages and very high standards of living in Australia result in a high level of residential property renovations which in turn leads to increased furniture sales. This all results in continuing demand for new fashionable furniture. Nick Scali has been growing its sales revenue well above the industry average and as a result has managed to increase its market share from 1.4% in 2011 to 4.0% in 2020. The industry has also seen consolidation and therefore increased market share amongst the top four retailers in the industry.

Nick Scali has stated it intends to eventually increase its store network to 80 - 85 stores across Australia and New Zealand. This will result in increased sales revenue and earnings. The industry will not experience rapid levels of growth in the near future, so Nick Scali will need to grow its market share to be able to outperform the industry and continue its current rates of growth.

Over the last 20 years, Nick Scali has managed to grow its Revenue at an annualised rate of about 12.8%. It has increased its earnings by about 14% a year over the same period. During the last 5 years, Revenue growth has averaged about 11% per annum with Earnings growing at almost 20% per annum over the same period. This is probably a direct reflection of its store roll out strategy being lifted during the last 5 years.



This chart displays Reported EPS vs Organic EPS. Organic EPS have been adjusted to account for one time impacts resulting from the purchase or sale of an investment. For example, if a business which made $100m in profit was to acquire another business which also earned $100m profit, it would result in a boost of $100m, or a 100% increase in reported earnings. By removing this one time boost in earnings and only accounting for subsequent growth from here on will help analyse the actual "organic" growth of the business.



This chart compares Free Cash Flow, as calculated by deducting CAPEX from Operating Cash Flow, vs. Organic Free Cash Flow. Organic Free Cash Flow accounts for acquisitions and other investing activities. For example, a business which grows organically through internal R&D projects will see a higher operating expense and thus lower operating cash flow. Whereas a business which chooses to acquire other businesses to expand will include this cost under investing activities, thus seeing a higher cash flow from operations. Even though the end result may be very similar between these two businesses, you can clearly see that the business undertaking growth via acquisition will report much larger cash flow from operating activities. The inventories received from the acquisition will also boost Operating Cash Flow as

Alistair Cowley
Email: alistair.cowley@growthwithvalue.com

7 Key findings in relation to the Financials

Rating 98%

The company has a very strong Balance Sheet with little debt and a very sound Net Cash position. The business has consistently increased sales and profit margins have also remained very steady, providing shareholder's with exceptional returns. The business has also proven it can generate high levels of Free Cash Flow with Free Cash Flow margins between 10% and 14% (excluding purchases of property and buildings). Capital Expenses have also been very low, less than 2% of Revenue, again this is excluding purchases of property and buildings.

The business has provided exceptional returns to shareholder's over its history with Return on Equity ranging between 40% and 60% per annum. This is an outstanding result, especially considering it has been achieved consistently over the last two decades. Return on Invested Capital has also provided excellent returns of about 23% per annum on average over the last 10 years. Due to the high levels of operating leases, which is a result of renting the majority of the store network, Return on Assets is significantly lower than Return on Equity, but still at a very acceptable level. Return On Assets has averaged close to 15% for the last 10 years and has improved sightly in the last 3 to 4 years. The major difference, as just mentioned, between Return on Equity and Return on Assets is due to capitalising operating leases. Operating leases provide the business with a form of leverage which therefore boosts Return on Equity. Debt also will increase Return on Equity but in the case of Nick Scali debt makes up only 9.2% of Total Assets whereas Operating Leases are 49.6% of Total Assets.

Looking to the three Statements, starting with the Income Statement;

Income Statement:
Revenue has been growing at about 13% each year for the last two decades. This has been boosted by increasing store numbers with an average of 3 new stores opened each year since the year 2000. Since 2010, the number of new stores opened has averaged around 3.7 a year. On a like for like basis, same store sales has been relatively flat, with an annualised growth of about 2%, indicating the majority of the 13% growth in reported revenue has come from new stores being opened, with existing stores increasing sales by about 2% each year. Currently, management plans to continue opening new stores to reach a network of between 80 and 85 stores across Australia and New Zealand, an additional 20 stores from current levels. Using the current rate of new store openings, Nick Scali should hit this target in the next 5 to 6 years and from this point we can expect sales to slow down significantly.

The company has managed to remain extremely profitable through both pricing power and low operating expenses. The Gross Profit Margin has consistently been at 60% since 2004 when the company listed. This high profit margin is a result of the company sourcing its product at very competitive prices, a strict cost management regime and the ability to achieve attractive prices for its products due to its trusted brand and high quality. Operating Margins have been increasing from a low of 12.3% in FY09 (post Global Financial Crisis) to current level of 23% to 24%, where it has been for the last 3 years. This is a very positive sign the business is continuing to look for more efficient ways to operate and reduce costs. Net Profit has also been increasing and at 16% it is well above the industry average of 2%. At 156% Nick Scali is the industry leader in terms of profitability with its nearest rival in Harvey Norman producing a Net Margin of between 12% to 13%. The industry is weighed down by 3 of the largest 4 firms all reporting losses for the last 2-3 years. These stores include major brands IKEA, Greenlit Brands (Freedom, Fantastic Furniture, Plush, Best&Less and Snooze) and BBQSAM (Barbeques Galore and Amart Furniture).

Earnings have been growing at about 12.5% a year since 2004. Growth has been fairly consistent, increasing most years. The majority of this growth is also likely due to the expanding store network.

Balance Sheet:
The Balance sheet is very strong and well managed. The company operates in a net cash position with almost $30 million in net cash at the end of financial year 2020. Debt is only about 9.2% of Total Assets and excluding Operating Leases, the Debt to Equity Ratio is 0.45, which is very conservative. The Current Ratio has averaged about 1.0 for the last 10 years, with the Quick Ratio at about 0.6 over the same period. These numbers are not overly conservative, but given the debt levels within the business have historically been very low it is less worrisome. Current Liabilities equate to about 27% of Total Assets, comprising operating leases 6.4%, prepayments 11.0%, accounts payable 4.9% and short term debt obligations of 0.6%. Around 17.3% of current assets are held in cash deposits. The Interest Coverage Ratio of 8.5 provides a very comfortable buffer at the current level of earnings. This ratio was at a more concerning level of 4 in FY12, but since then it has improved consistently to its current healthy level. Although the Debt to Equity Ratio seems quite high, the majority of the debt comprises operating leases which provide the company with significant financial leverage reflected in its high Return on Equity. For FY20 the Debt to Equity Ratio (including operating leases) was at 2.85, reflecting the continuing trend down from its high of 5.5 in FY06.

Shareholder's Equity has been growing at a commendable rate of 17.6% since listing in 2004. As the Company has not raised additional capital since its listing, the growth in Shareholder's Equity has come through Retained Earnings, a sign of a well managed business. Including Dividend payments, Shareholder's Equity has been growing at strong rate of around 23% per annum.

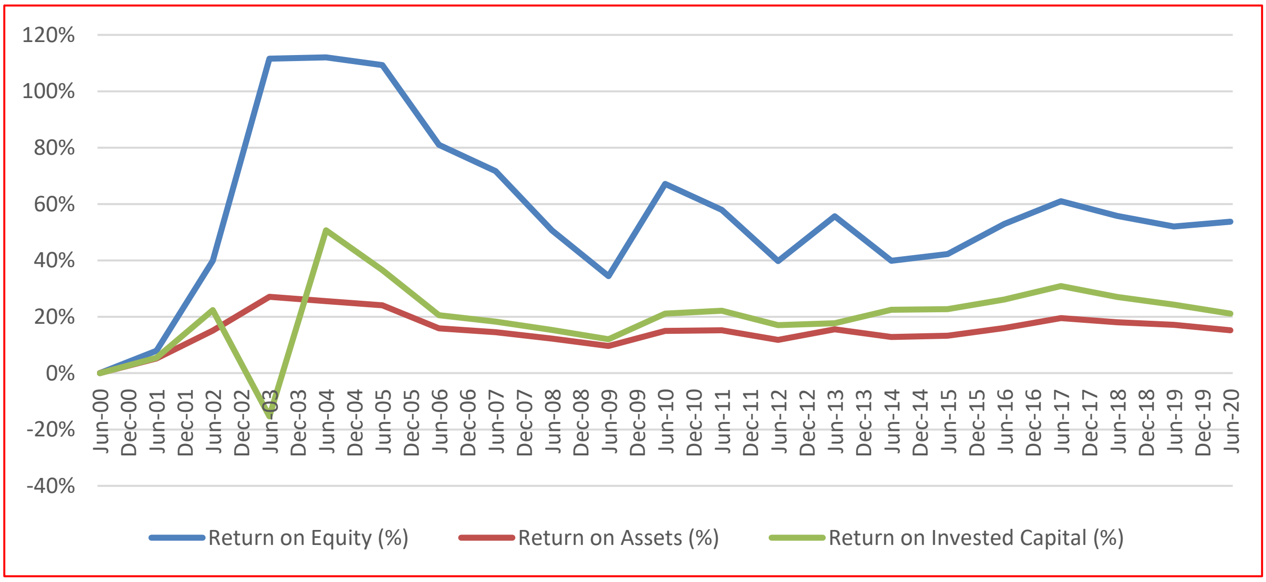
Cash Flow Statement:
Free Cash flow has been increasing at a consistent rate of 13% per annum since listing. Over the past 5 years, this rate of growth has increased to over 20% annually. There has been some fluctuation in Free Cash Flow since 2011 when the Company started purchasing the freehold of some of its expanding retail outlets as shown below:

Alistair Cowley
Email: alistair.cowley@growthwithvalue.com

- FY11 - Alexandrina NSW ($8.5m)
- FY13 - Fyshwick ACT ($6.5m)
- FY15 - Caringbah NSW ($6.3m)
  FY15 - Joonalup WA ($4.5m)
- FY16 - Macgregor QLD, Nunawading VIC (both property purchases)
  FY16 - Caringbah NSW (built new store)
  FY16 - Casula NSW, Midland WA (new store fit outs)
  (FY16 CAPEX = $23.6m)
- FY17 - Manly Vale NSW ($6.2m)
  FY17 - Nunawading VIC (building works)
  (FY17 CAPEX = $11.3m)
- FY18 - Auburn NSW ($22m - purchased from Scali family)
- FY20 - Auburn NSW ($4.7m - adjacent to existing Auburn property purchased in FY18)

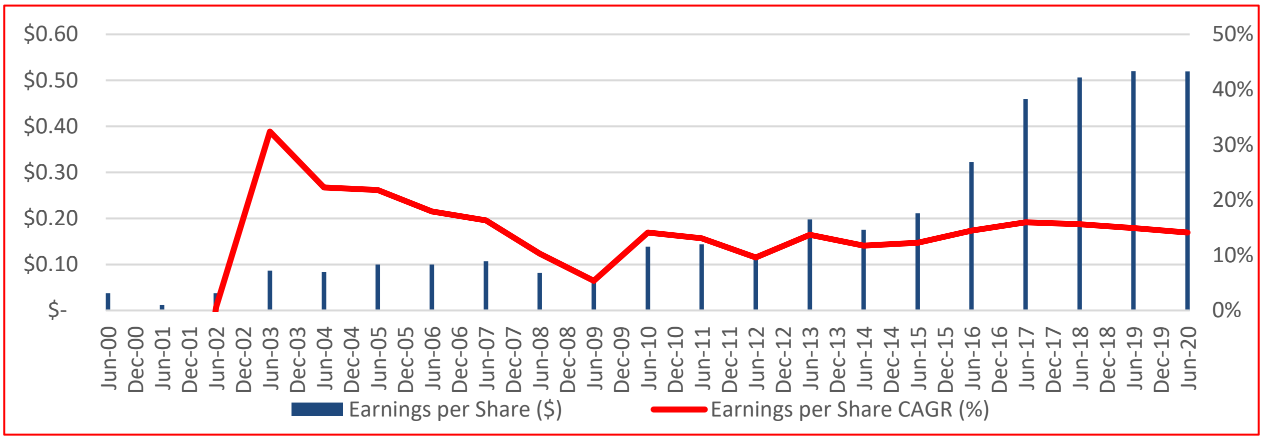
The Free Cash Flow Margin has ranged between 10% and 15%, after excluding the investing expenses in relation to the purchase of Land and Building Assets. Capital Expense has typically been about 2% of Revenue or less, also after excluding the more recent investments in Land and Buildings. If the costs of Land and Building are included as a Capital Expense, the ratio increases to around 10% to 12% in those years the properties were purchased. At these levels, Capital Expenses are no course for concern and allow the business to remain competitive.

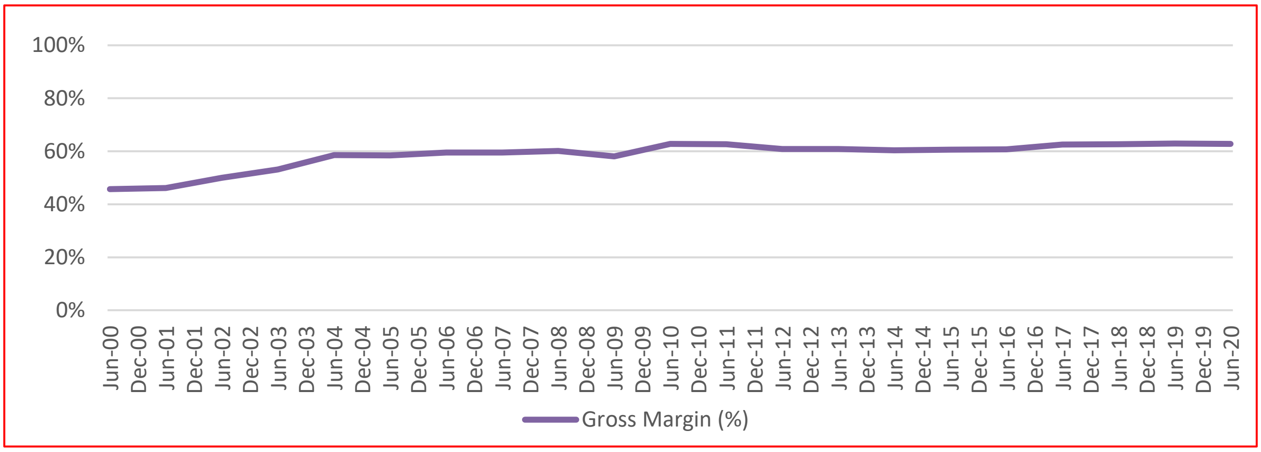
Operating Cash Flow has been growing at an annualised rate of 14.6% since FY04. This rate of growth has increased to 22% a year over the last 5 years.

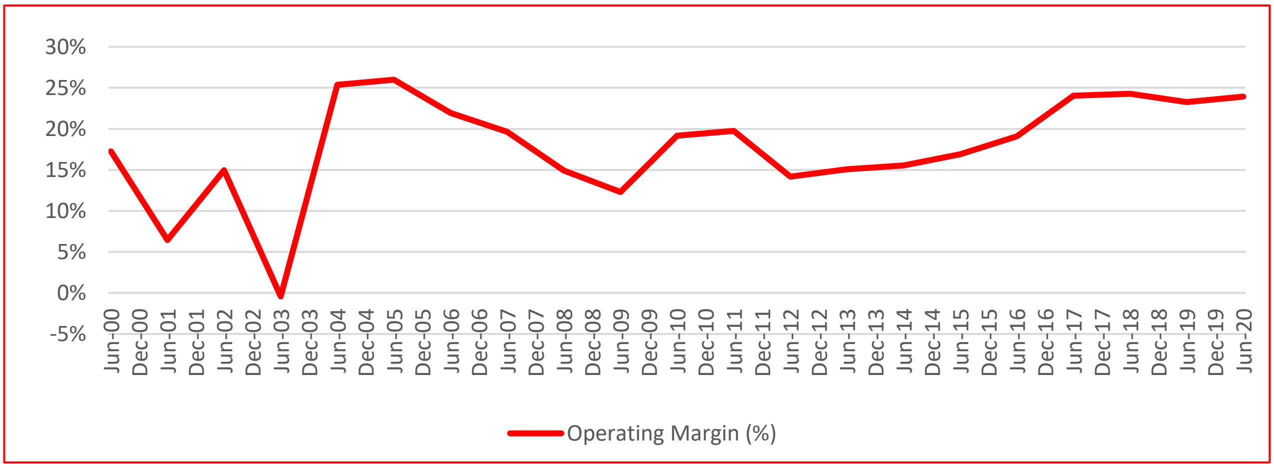


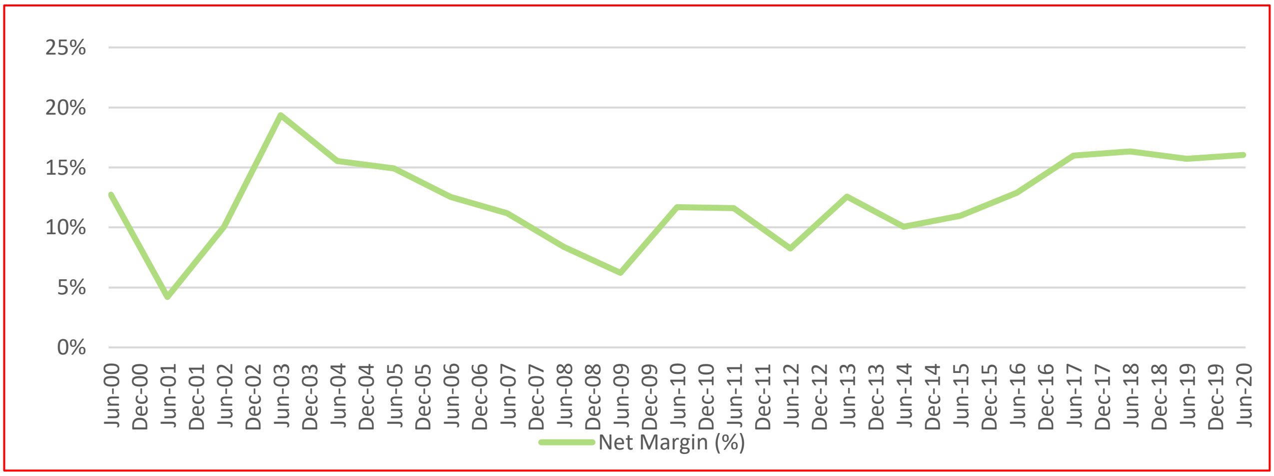
Alistair Cowley
Email: alistair.cowley@growthwithvalue.com

Charts concerning the Income Statement



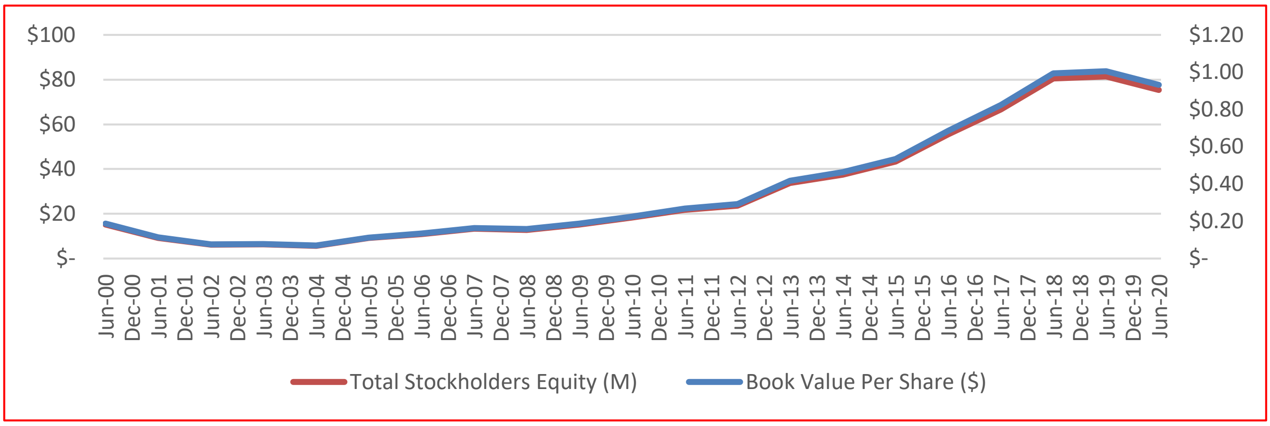


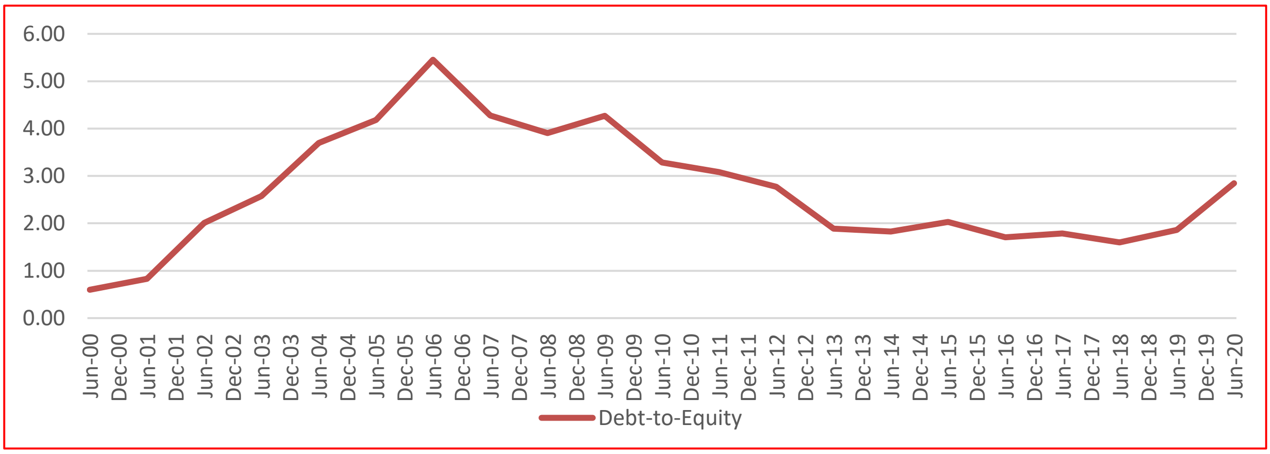


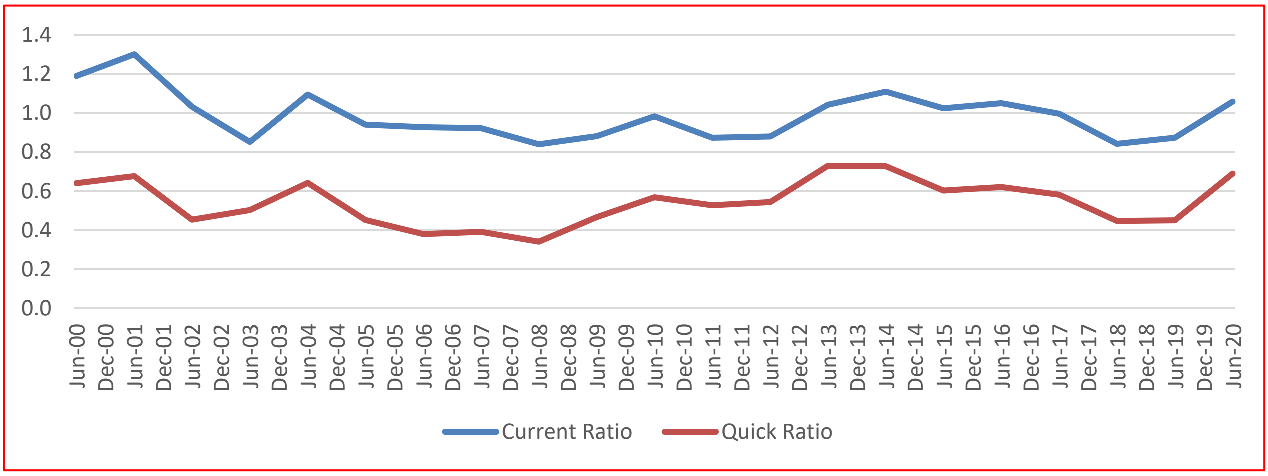


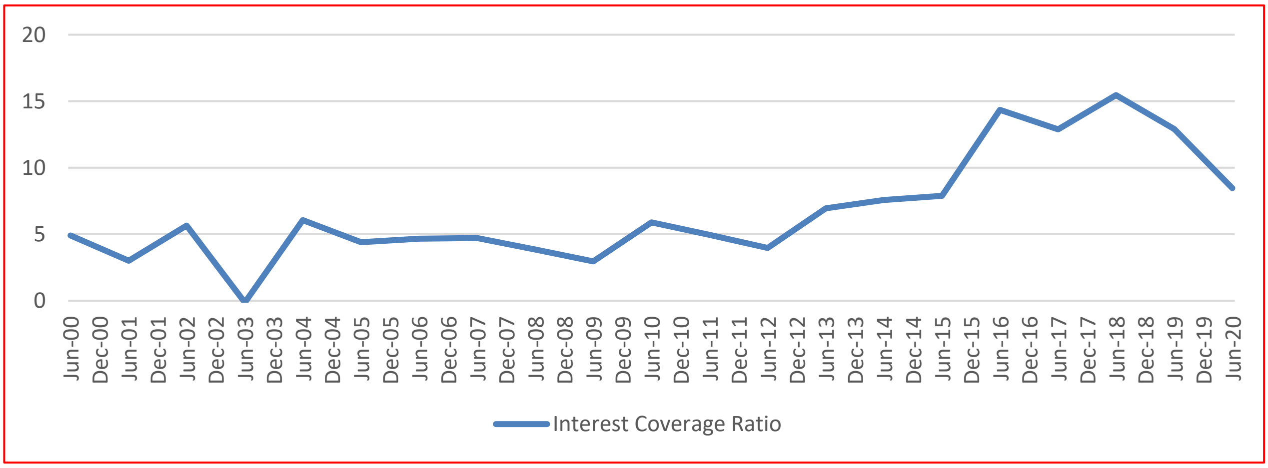
Alistair Cowley
Email: alistair.cowley@growthwithvalue.com

Charts concerning the Balance Sheet









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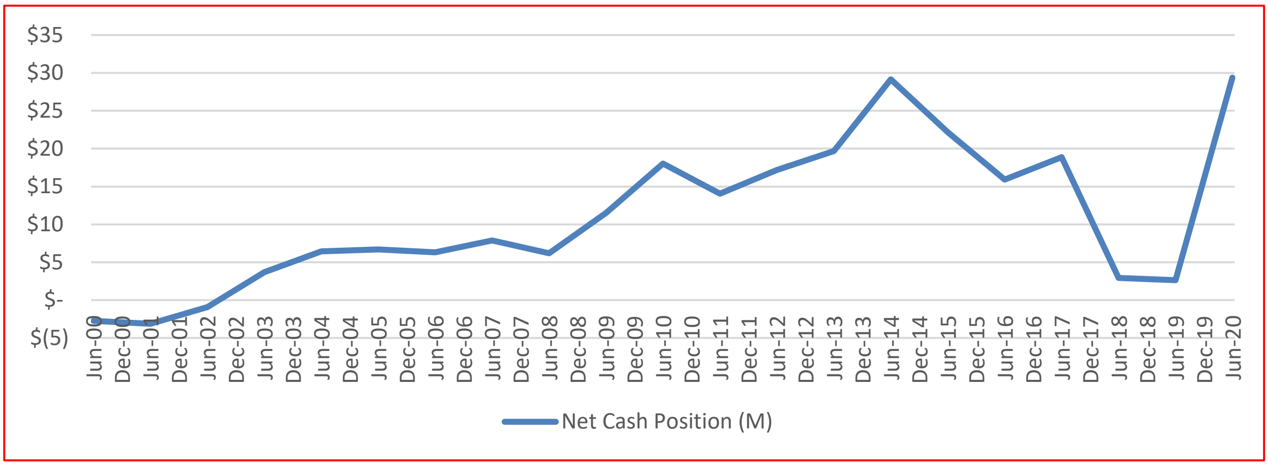
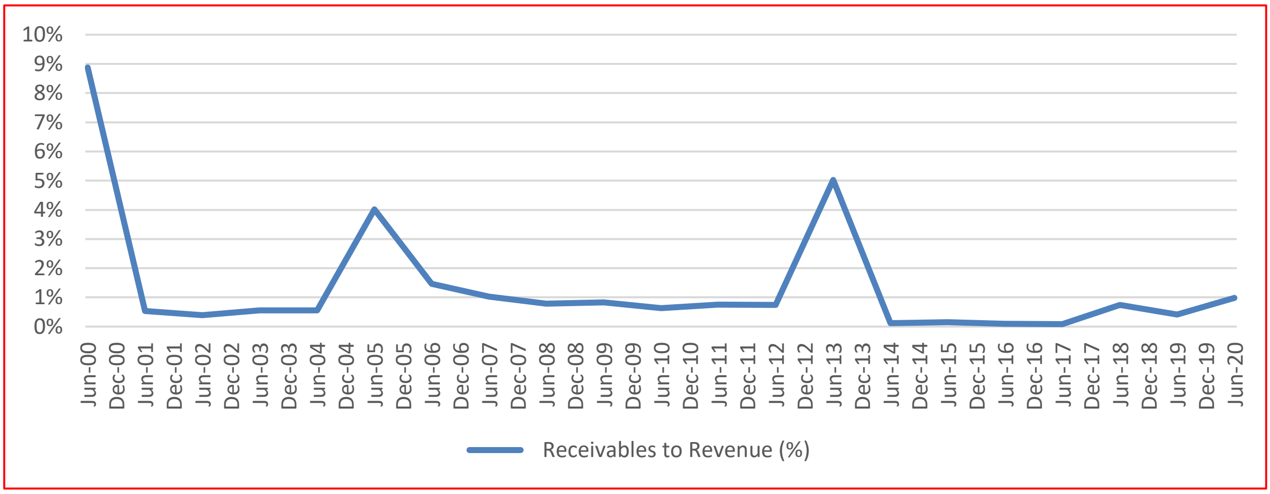
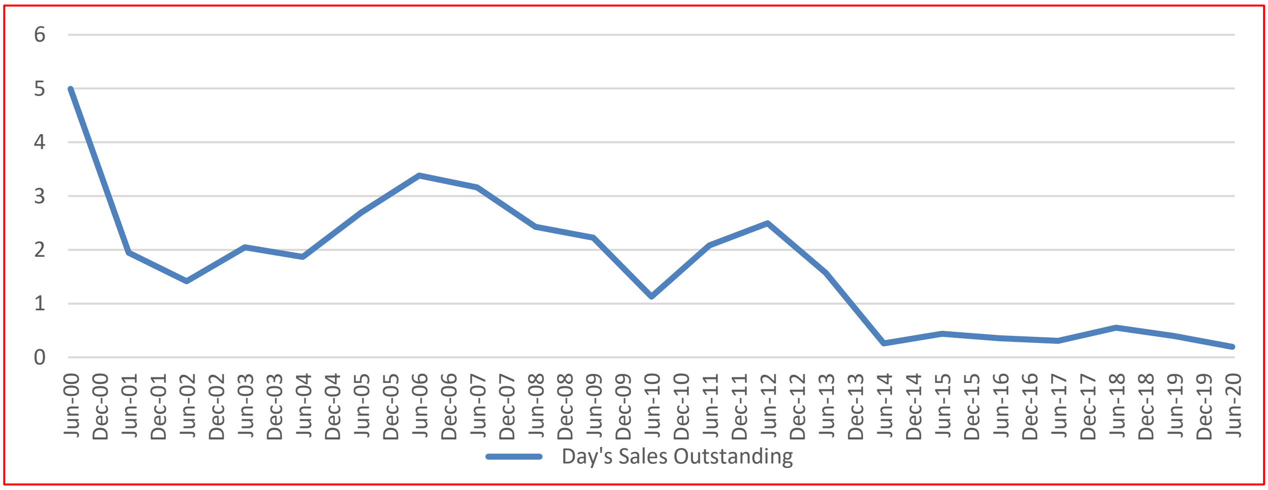
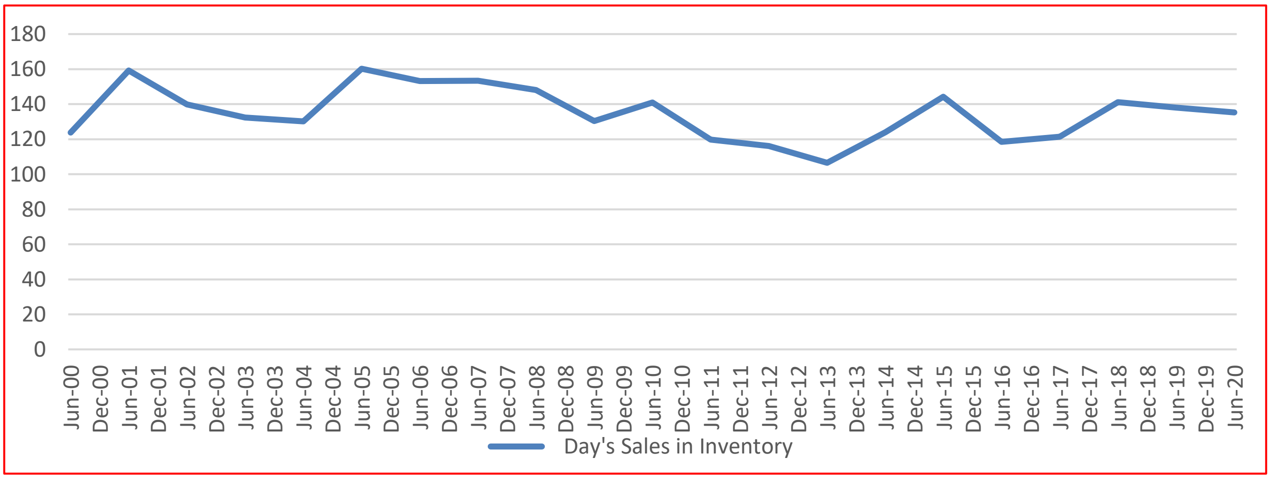


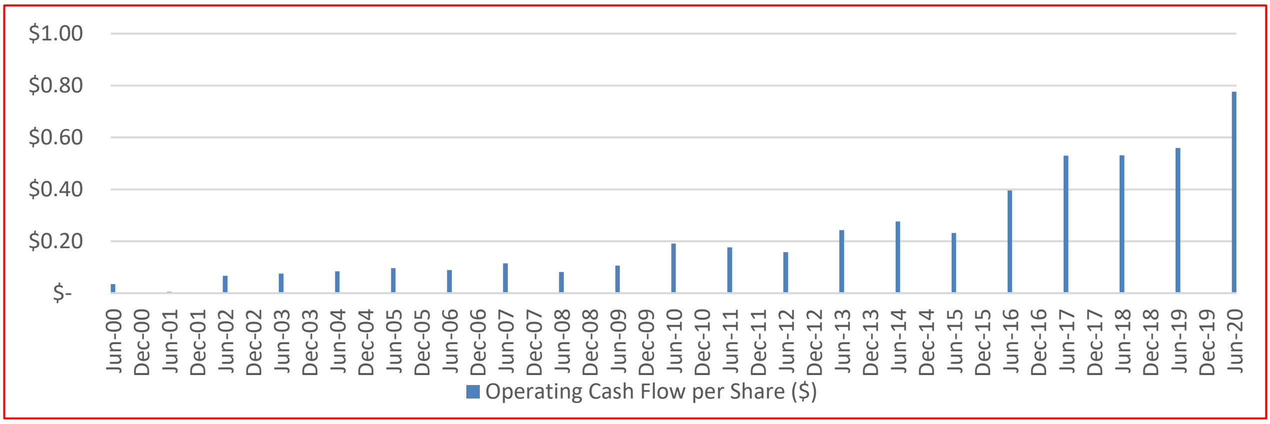


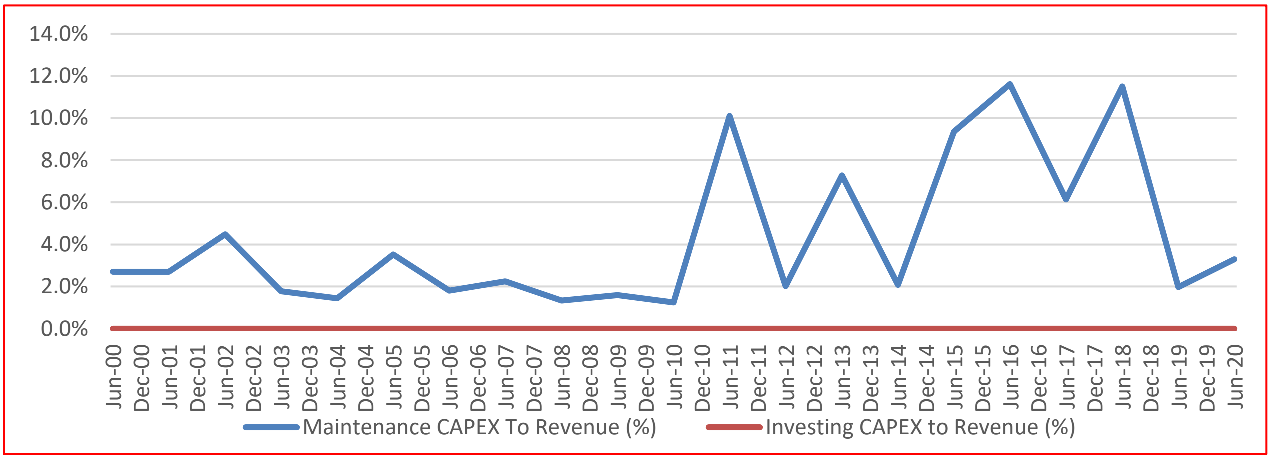


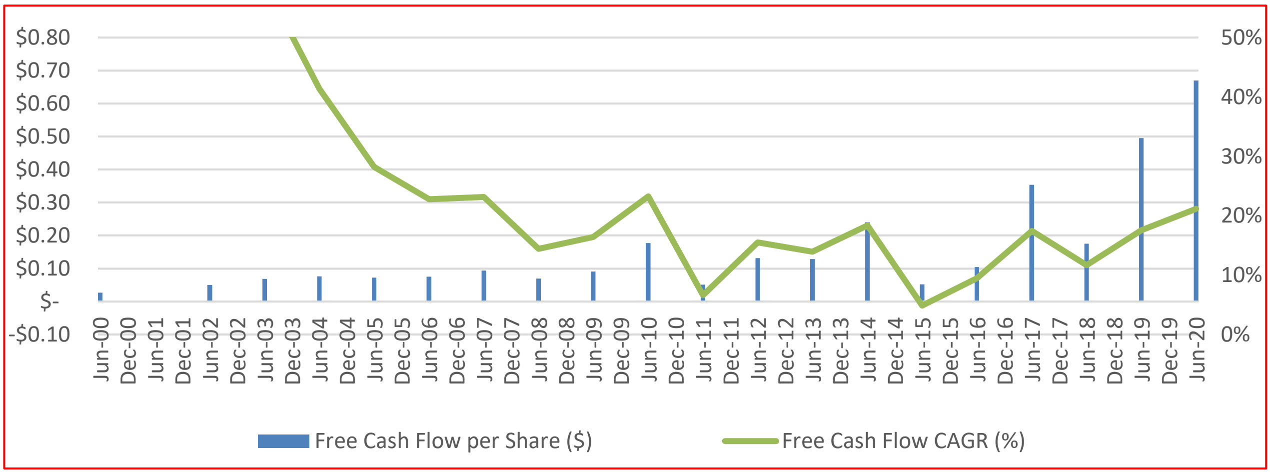


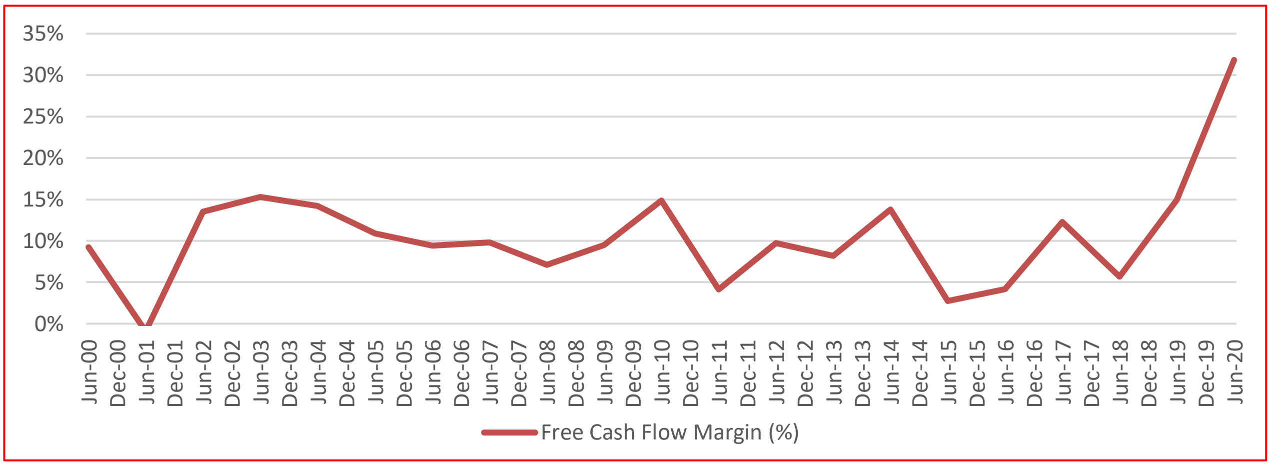
Alistair Cowley
Email: alistair.cowley@growthwithvalue.com

Charts concerning the Cash Flow Statement

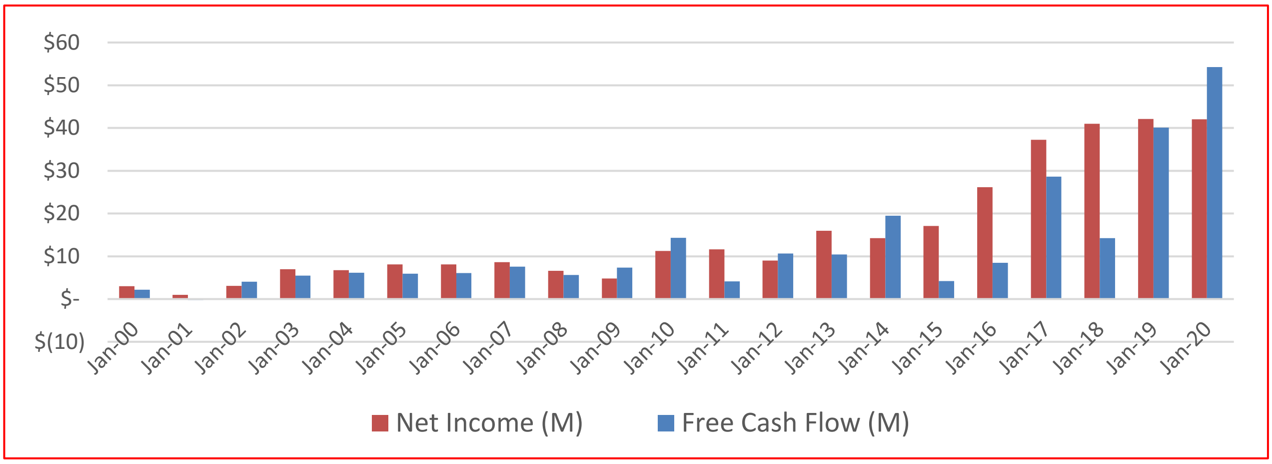








Alistair Cowley
Email: alistair.cowley@growthwithvalue.com



8 Key findings in relation to Management

Rating 93%

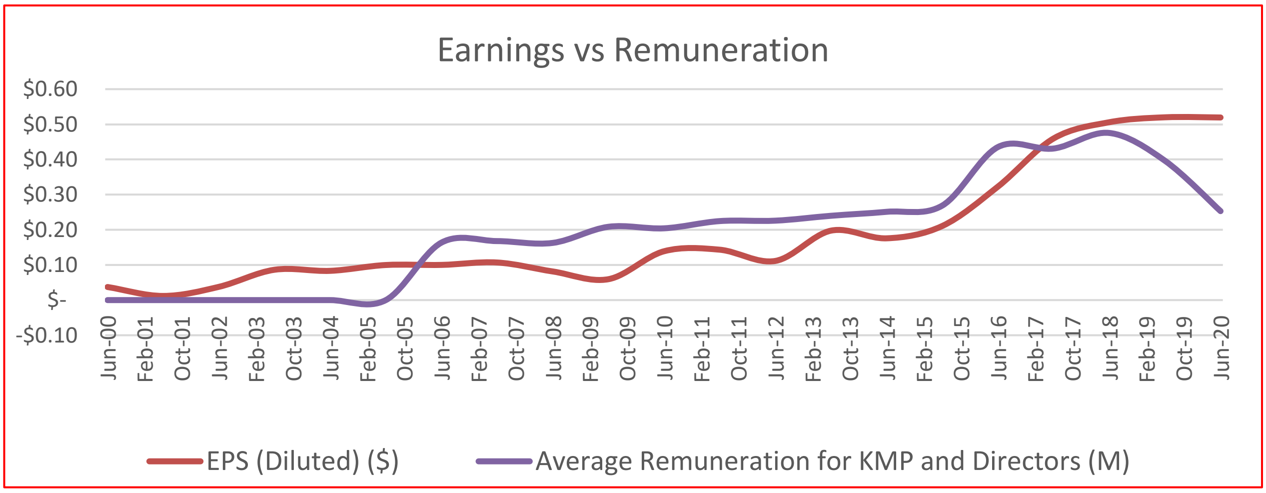
There has only been two CEO's at Nick Scali, the first being the founder Nick Scali, who was with the business for 55 years until he retired from his Non-Executive Director position in October 2016. Currently, Anthony Scali serves as Chief Executive Officer, Managing Director of Nick Scali Ltd. He joined the Company full-time in 1982 after completing his Bachelor of Commerce degree from the University of New South Wales. Anthony has over 30 years' experience in retail, including the design and sourcing of product from manufacturers both in Australia and overseas.

John Ingram is the current Chair of the board and has been in the position since the business listed on the ASX. Greg Laurie, who was an inaugural Non-Executive Board Member, recently passed away in March 2020; Greg Laurie's replacement is William (Will) Koek. Will Koek has experienced in Mergers and Acquisitions and is also a member of the Takeovers Panel (which is a peer review body that regulates corporate control transactions in widely held Australian entities, primarily by the efficient, effective and speedy resolution of takeover disputes.). Carole Molyneux has been on the board for 6 years and Stephen Goddard for almost 3 years.

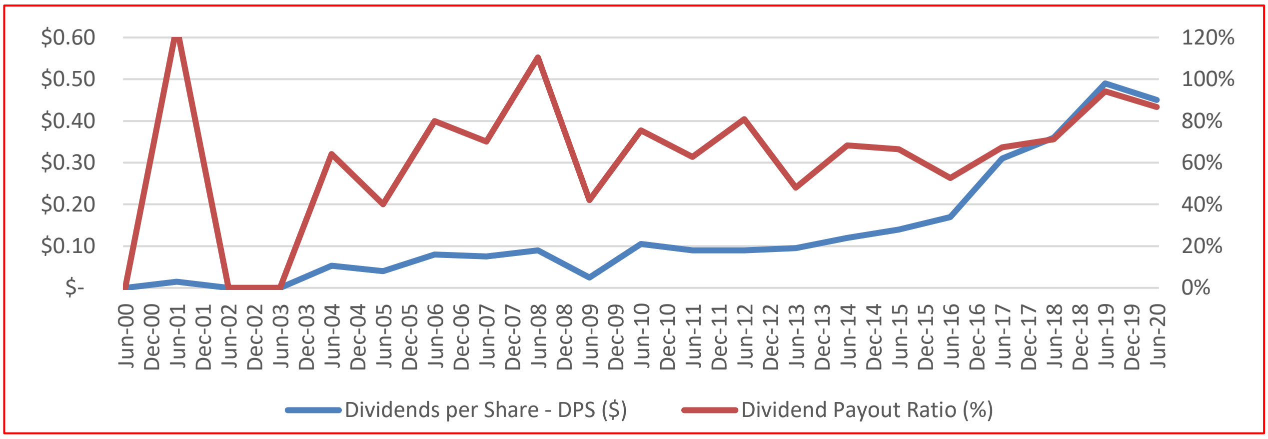
The board and Key Management Personnel have historically received generous amounts of remuneration, but over the last 5 years this has reduced to a much more acceptable level. When compared to Net Profit, the Board and Managers remuneration was equal to 3.6% of Net Profit, 1.7% of which went to the CEO Anthony Scali. Remuneration has been decreasing over the years which is a good sign. Before FY17 the Board and Management remuneration was equal to about 12% to 13% of Net Profit, which is quite a large share. As long as the ratio of Net Profit paid to management doesn't begin to increase again, the current levels are acceptable.

The Scali Family owns 13.6% of the Company, down from 50% which the family retained after listing the business.

Management has significantly increased dividends over the last 4 years. Since FY16 dividends have grown at 27.5% a year, up from 10% per annum growth previously. This has seen the payout ratio increase from about 70% to 90% in FY19. There has been no mention of why the payout ratio has increased other than management considers this to appropriately balance the distribution of profit to shareholders with the need to reinvest earnings for future growth.



Alistair Cowley
Email: alistair.cowley@growthwithvalue.com



9 Key findings in relation to Competitors — Rating 82%

There is strong competition amongst furniture retailers, evidenced by a very low Profit Margin of 1.7% across the industry. There has also been continued consolidation over the last decade with the top four players increasing their market share from 30% in 2011 to almost 60% today.

A the end of FY19 the major players within the industry include Harvey Norman with a 15.2% market share (19% at FY20), IKEA 17.7%, Greenlit Brands 13.1% (Fantastic, Freedom, Plush and Snooze) and BBQSAM 10.9% (Barbeques Galore and Amart Furniture). Nick Scali's market share is just 3.4% (4% at FY20). Each of these businesses has increased market share, with the largest increase being IKEA which increased its market share from 6.9% in 2011 to 17.7% today. Many of these businesses have been unprofitable for the last 2-3 years, including IKEA, Greenlit and BBQSAM. Harvey Norman and Nick Scali have shown a consistent ability to remain profitable and produce solid Net Profit Margins averaging 12.5% over the last 5 years for Harvey Norman and 15.5% for Nick Scali. Even during economic downturns, both these businesses have performed well.

When it comes to product reviews, the largest players in IKEA and Harvey Norman have faired the worst with only a 1.9 and 2.2 star rating for both. Plush has received the highest review with 4.8 stars, next is Fantastic with 4.6 stars closely followed by Nick Scali at 4.5 stars. Freedom and Amart Furniture have not received very high reviews, with Freedom at 3.6 stars and Amart only obtaining 1.9 stars. The businesses which have returned the worst ratings are also those which provide lower end furniture at cheap prices, with the exception of Freedom. There is also increased competition at this level as IKEA, the largest player, predominantly targets the low end customer with its self assemble flat pack furniture. If we look at online traffic, Nick Scali lags the rest, receiving about 155,000 views vs 2 million for Fantastic, 1.6 million for Amart, 900,000 for Freedom and 185,000 for Plush. The stores with the highest online traffic are also those which have the cheapest products to offer. For Nick Scali and Plush, I believe they will see fewer online sales given their more decerning target market and higher price points.

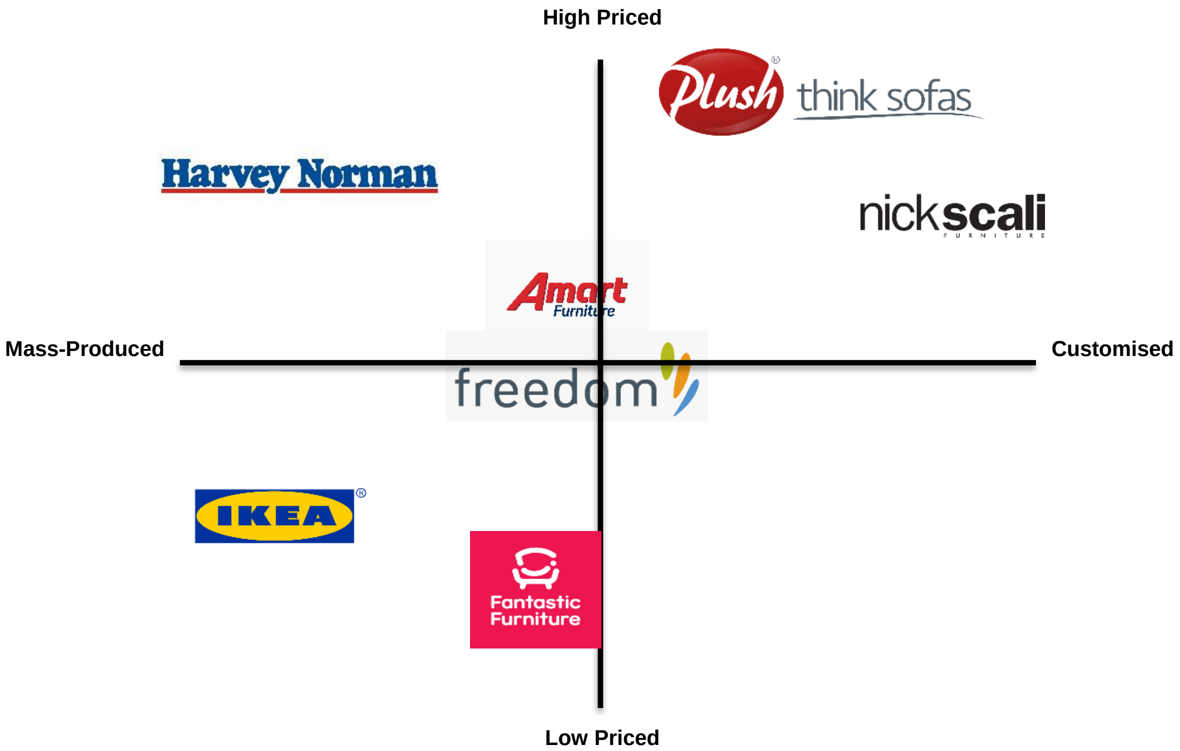
The major difference between the furniture retailers pivots around the price and quality of their offerings. The broad product range is similar, but the majority of the market is targeted towards the cheaper product range offered by IKEA and Fantastic Furniture. Given the fact that 40% of furniture retail customers come from the highest income quintile, this suggests that Nick Scali's higher quality product range is a winning strategy.

Future growth within the industry is projected to continue between 0.6% and 2% a year. If we are to see further consolidation within the industry it should result in increasing Revenues for the remaining businesses. Nick Scali is also currently rolling out about 3.7 new stores a year across Australia and New Zealand with the end goal of 80-85 stores and at the current rate this will be achieved in 5-6 years. If the roll-out is successful, this will result in the continued higher Revenue growth we have become accustomed to with Nick Scali over the years. On a same store basis though, the growth in sales for Nick Scali is about that 2% rate of growth, inline with the higher end of the industry projections.

Given the strong Balance Sheet, strong past sales performance and profitability of Nick Scali, I see opportunity for it to increase market share if and when these unprofitable furniture retailers are forced to close stores. It is a sign of Nick Scali's strong brand and reputation that it is able to price its furniture at very profitable levels and not run the risk of losing customers. Many of its competitors are forced to set prices that are too low to operate at a profit.

Alistair Cowley
Email: alistair.cowley@growthwithvalue.com

Perceptual Map of Competitors



10 Key findings in relation to Ethics **Rating** 90%

Nick Scali offer some gender diversification at the top level, with 20% of Board Members being female and 29% of all management being female. For all other staff members the ratio of gender diversity is acceptable with 41% of staff members being female. In terms of benefits and flexible work arrangements, Nick Scali appear to lack in this department. Reviews from current and past employees state that it is compulsory to work weekends, indicating a lack of more flexible work arrangements. These measures will keep costs low but may impact on moral amongst employees.

Much of the furniture available at Nick Scali includes leather products, which although perhaps not preferred from an ethical standpoint, in terms of quality and durability, leather is currently perceived as a premium product. There is little information available about sustainable sourcing of materials in the manufacture of Nick Scali furniture, only that the furniture is REACH compliant, which means no chemicals are used which could be harmful to people or the environment in the manufacturing process.

Nick Scali is a Silver Member of the You Can Sony Foundation which helps kids suffering from Cancer. There is no information regarding the level of donations made to the You Can Foundation. Nick Scali also does not report any other community or charitable activity. This is an area of possible improvement but always has the potential to distract management from their integral roles in running the business.

Alistair Cowley
Email: alistair.cowley@growthwithvalue.com

11 Valuation

Disclaimer: The valuations provided within this analysis are not to be seen as recommendations or investment advice and are based on my personal opinion and experience. All information, data and valuations are for general information purposes only. Investors are recommended to seek advice from a financial professional before making any investment decisions. My thoughts and opinions will also change from time to time as I learn and accumulate more knowledge. I may hold a position or other interests in the business analysed.

Discounted Cash Flow (Stable Growth Model)

Cash Flow	$ 0.52
Growth Rate	2.0%
Discount Rate	12.0%
Margin of Safety	20%
Start Date	01/07/2020

Intrinsic Value	$ 5.30
Margin of Safety	20.0%

The Intrinsic Value of Nick Scali Furniture Ltd using the Discounted Cash Flow (Stable Growth Model) and after applying a 20% Margin of Safety

Nick Scali Furniture Ltd Intrinsic Value using the Stable Growth Model: $ 4.24

Discounted Cash Flow (High Growth Model)

Cash Flow	$ 0.52
High Growth Rate	10.0%
High Period (Years)	5 - 7
Terminal Growth Rate	2.0%
Discount Rate	12.0%
Margin of Safety	20%
Start Date	01/07/2020
Dilution from issuance of stock and/or options	0.0%

Present value of High Growth Period	$ 3.32
Present Value of Stable Growth Period	$ 4.26

Intrinsic Value	$ 7.58
Margin of Safety	20.0%
Dilution/Concentration*	0%

High Growth Period Cash Flow Calculations

Year	Future Value	Present Value
1	$ 0.57	$ 0.51
2	$ 0.63	$ 0.50
3	$ 0.69	$ 0.49
4	$ 0.76	$ 0.48
5	$ 0.82	$ 0.47
6	$ 0.88	$ 0.45
7	$ 0.92	$ 0.42
Total		$ 3.32

The Intrinsic Value of Nick Scali Furniture Ltd using the Discounted Cash Flow (High Growth Model) and after applying a 20% Margin of Safety and accounting for dilution/concentration in shares of 0%

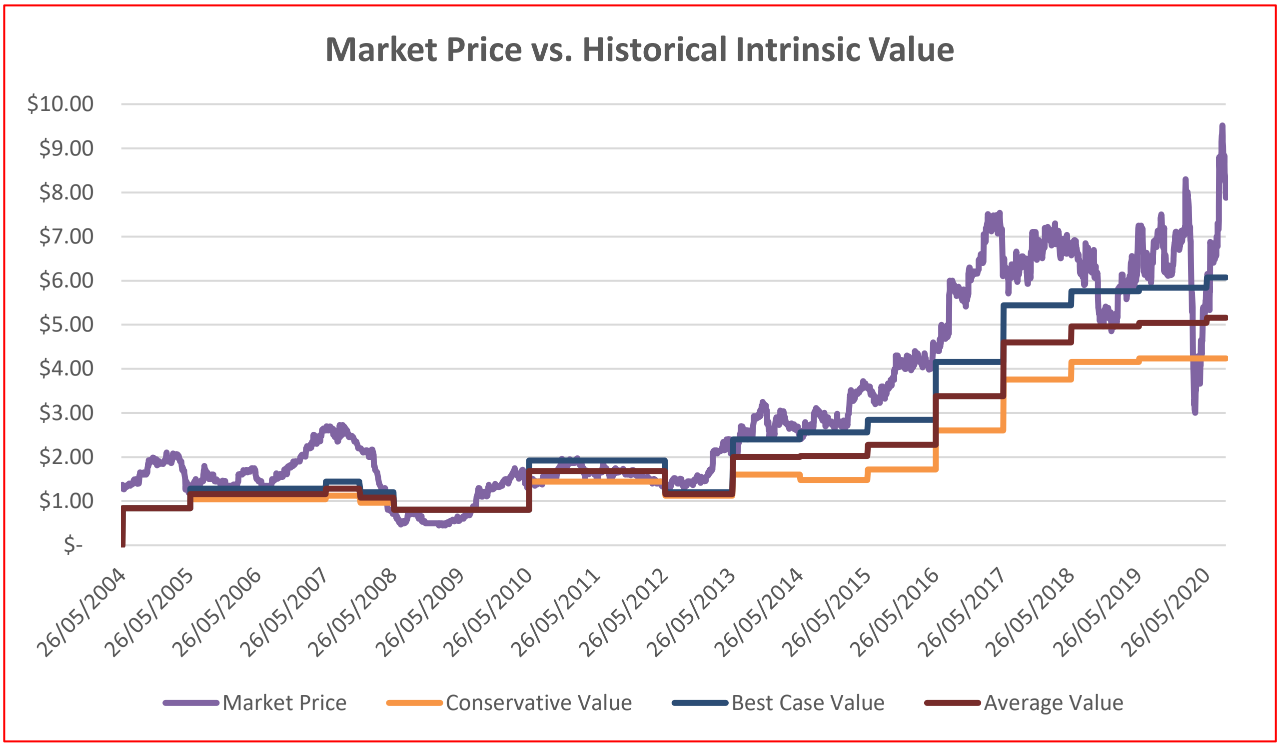
Nick Scali Furniture Ltd Intrinsic Value using the High Growth Model: $ 6.07

Note: Dilution/concentration accounts for any issuance of shares or options as well as any share buybacks. If this number is negative, it indicates the company has issued new shares or options, which has resulted in a devaluation of the pre-existing issued shares by that amount. Share buybacks will effectively increase the per share value of the remaining issued shares. If this number is positive, it indicates the company has implemented a share buyback which has consolidated the number of issued shares resulting in a positive revaluation of those remaining shares.

Alistair Cowley
Email: alistair.cowley@growthwithvalue.com

12 Historical Valuations

The graph below illustrates the historical Discounted Cash Flow valuations in comparison to the historical share price. The graph highlights periods in time when the shares became cheap and also how the business value has tracked market prices.



Alistair Cowley
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