HollAnd Advisors

Holland Views: Boohoo plc – Price: 320p; MCap: £4bn, EV: £3,441m

We have seen this movie before

Are there similarities in being a movie critic and a business analyst? Assessing storylines, actors, blown budgets, dealing with suspense, rumours all seem to be at the heart of both fields. Today we discuss a movie that was released in 2014 but until recently we had yet to watch as it was targeted at a millennial audience (and frankly we were too snobby to review!). It is already deemed a box-office hit but we think it could in time be a classic.

We see many similarities within it and key elements of some of the old (out of favour) classics that we love. This particular movie got some very bad press earlier in the year with tabloid headlines along the lines of "*Billionaire impresario employs slave labour in Leicester sweat shop"*. This to us seemed like a re-run of a recent critic take-down of another cult classic "*Boss with wad of £50 notes pays less than minimum wage*" for which we had a ring side seat!

OK, enough of the awful analogies. The business at hand today is Boohoo.

Boohoo and the merits of cloning

Many years ago we saw there was often significant value in arriving second. We read constantly how master business people such as Michael O'Leary and Sam Walton set out to copy proven business practices. Pioneers in an unconventional sense, they cherry-picked a good idea that someone else was doing and just executed it <u>much</u> better. Memorably, we read of Sam Walton found lying down in a competitor's store to measure how wide the supermarket aisles were. Or how O'Leary sat drinking Bourbon all night with Herb Keller and almost forgot the wisdom gleaned the next morning. Interesting too, that Tim Martin gave a copy of Sam Walton's autobiography to all 400 of his pub managers.

The closer we get to understand these great founder CEOs and their methods, the more intelligent plagiarism we see all around us. We sense there is much of this at work at Boohoo. This observation is not designed to take anything away from the powerful business which the Boohoo entrepreneurial founders have built from scratch. Rather, we are trying to provide perspective on some of the intelligent building blocks employed and implications for Boohoo's future prospects.

<u>The lucky generation of retailers</u>

Many an established business when confronted with the ever-evolving dynamic of customer demand and the cost of fulfilling it is cursed with the "*you would start from here*" problem. In retail, that largely relates to legacy stores estates (and associated rates and labour burden) that were requisites of <u>past</u> growth. As a so-called "disruptive" business, Boohoo and others enjoy the advantage to solely sell via online retail channels. These disruptors also enjoy the benefits of large-scale data-driven insight into customer habits and ever improving supply chain and delivery infrastructure.

The barriers to entry are *theoretically* lower. But when exceptional operators take advantage of these new found business tools, and scale compounds, the result can be a tremendous flywheel as online operators outside fashion already demonstrate.

<u>Buy or build (or indeed both)?</u>

An obvious distinction in the world of fashion retail is whether a business choses to develop and distribute its own in-house brands or resell those of a third party (or indeed do both). Each strategy has its own attractions and drawbacks and its own eases and difficulties. A myriad of more mature businesses from Next to ASOS to Sports Direct and Superdry offer multiple approaches and thus learnings for investors thinking about Boohoo.

- The third party brand model means that the platform (business) can sell a broad range with the higher likelihood of traffic thanks to the attraction of known reputable brands. But resulting retail margins are likely lower on such products and come with the risk that in time, such brands might choose to exert excessive control over your supply and distribution of *their* products (ref. Nike's influence over SPD).

- Alternatively, retailers could develop and distribute their own brands. The challenges are obvious but doing so successfully builds brand loyalty if done right and results in higher margins. It also allows control and flexibility. Next plc, in its early days, was a good example of this. Interestingly Next's success in the area of own brand also reminds us of a resulting success orientated challenge. That of taking your customers with you as they get older and attracting a new demographic (daughters do not want to wear the brand their Mum's or Grandma's wear). Actually, Next's considerable achievements as a business should be seen against the formidable challenge that an aging brand comes with in the world of fashion.

Another ASOS? ASOS is an obvious comparison to make with Boohoo given their history as pure-play e-commerce disruptors. Actually, their brand strategies are very different. ASOS derives roughly 50/50 of revenues from own-brands and "curated" third party brands all sold via a single asos.com website. In fact, ASOS resells a long-tail of over 1,000 third-party brands. ASOS plausibly claims that its scale and real-time insight into customer demand trends is highly valuable to these third-party brands as vital customer feedback for the 'fast fashion' treadmill. Nevertheless, we think there is always a chance of tension between any retailer selling 50/50 own brand and third party brands. Notably, ASOS has never acquired any other brands. Would its third party suppliers be uncomfortable if it did?

By contrast, 100% of Boohoo products are sourced entirely in-house via the corporate's seven or so built or acquired brands. Each corporate brand has its own distinct website and identity (boohoo.com, prettylittlething.com, nastygal.com etc. – remember ASOS has only one website) but crucially each brand is aggregated and distributed over a common Boohoo logistics platform. We discuss later how the Boohoo corporate model lends itself to a continued accumulation of add on brands and how this potential for scaling the business excites us.

Cherry pickers

Having been close observers of both the Sports Direct and Next business models in recent years and adjacent business such as Superdry we thus find the Boohoo model of great interest. **Boohoo look to have cherry picked all the best bits from established player models.**

From day one, Boohoo has developed and promoted its own in-house brand, 'Boohoo' and later 'Pretty Little Thing' and currently those two brands account for c.90% of sales. But this is a dynamic business and it looks like it has learned how it might avoid Next's 'aging customer' dilemma by building/buying a collection of online brands that complement each other.

To view the remainder of this in-depth report, please contact Andrew Hollingworth, Andrew@hollandadvisors.co.uk for a complete PDF copy.

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