HollAnd Advisors

Holland Views: Frasers – Price: 350p; MCap: £1.8bn

"He got you, didn't he?"

We are still believers in Frasers as an attractive owner managed investment and think the shares could easily double. We have written at length on the company in the past. Today we will be briefer for three reasons:

1. Because much of what we believe to be important for Fraser's recovery we have articulated before
2. Because we think very few non-shareholders will have much interest in our work, having labelled the shares un-investable
3. Because it is hard for any potential investor to co-corroborate our opinions unless they have access to management and the experience of watching recent year events unfold

First an admission

At times Frasers is a hard share to own. This is partly due to share price volatility and the past overactivity of the "haters" (press/politicians). But it is also because the company is unconventional, esoteric and sometimes accident-prone. Indeed, our sense of frustration on such matters lead us to write an open letter to them last year to encourage more professionalism in certain non-operational areas.

We have been attending investor group meetings with Mike Ashley and his team for some years now. They are never easy and sometimes annoying due to the scale of interference that can come from those with a non-investor axe to grind such as journalists or union representatives. However, the collective learnings we have from listening to Ashley and his team at these meetings is critical to the view we maintain today. With the company/Ashley rarely keen to lay out a smooth future road map for investors it has been akin to a jigsaw puzzle with different pieces being visible at different times (see *Holland Advisors Engine Overhaul - Jan 2018*).

We believe

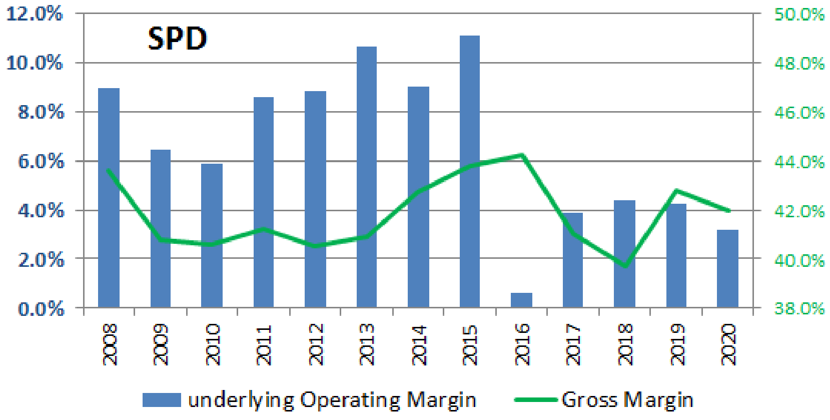
A summary of our previously written and still currently-held beliefs as to what is the most likely future of Frasers is as follows:

Margin Recovery

Whilst last week's share price rise was most likely due to the guidance for a 10-30% FY21 increase in EBITDA, we paid this guidance not a great deal of attention. Nor have we paid much attention to the last few years' guidance of +10% EBITDA. For us the longer-term prize has always been greater, i.e. that of a fuller recovery in profitability to past (or better) levels of margins. Figure 1 below we hope illustrates this potential.

When this company moved away from discounting in c.2016 we saw a likelihood that one day its margins would recover to their past levels. That it had previously made 8-10% EBIT margin in years 2011-2015 when making only 41-43% gross margins was appealing to us.

Fig.1: Margin trends



Source: Holland Advisors

At that time, it was a scale retailer who had low operating costs (see Opex comparison with JD in our model) and low selling prices. In time, we opined, reduced discounting and better product mix would inevitably lead to higher/recovered gross margins. Then if operating expense efficiency was maintained, past EBIT margins should be able to be recovered too. **(This has been our core thesis for c. 3years - It remains so)**

Elevation

Time spent in the company stores both new and old have informed our view that product elevation was always real and clearly in evidence. This could first be seen in the group's lower level of discounting of third party brands and more recently in less discounting of their own brands too. That this strategy was only really delivered best in a smaller number of stores confused investor perception of the company's recovery. Whilst we too would like to see a further acceleration in store conversions that 'less discounting' is now in the company's DNA is already clear to see.

Provisions and Prudence

Careful reading of the company's last 3-4years of accounts lead us to see the very prudent (perhaps exceptionally so) provisioning the company was doing. Inventory was growing fast during the Flannels build-out and post HOF/ other acquisitions. As a result, a much more prudent level of inventory provisioning (taken in COGS) was reasonable. However, our work suggests that the company actions in the area of inventory and other provisions are super prudent resulting in a likely under reporting of what might be considered core group profitability *(See Holland Views - SPD Underearning, Undervalued and Unloved- September 2019).*

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

Andrew & Mark **firstname@hollandadvisors.co.uk**

The Directors and employees of Holland Advisors may have a beneficial interest in some of the companies mentioned in this report via holdings in a fund that they also act as advisors to.

Contact:

HollAnd Advisors

Holland Advisors London Limited
2nd Floor, Berkeley Square House
London
W1J 6BD

Tel: (0)871 222 5521
Mob: (0)7775 826863
www.hollandadvisors.co.uk

Disclaimer

This document does not consist of investment research as it has not been prepared in accordance with UK legal requirements designed to promote the independence of investment research. Therefore even if it contains a research recommendation it should be treated as a marketing communication and as such will be fair, clear and not misleading in line with Financial Conduct Authority rules. Holland Advisors is authorised and regulated by the Financial Conduct Authority. This presentation is intended for institutional investors and high net worth experienced investors who understand the risks involved with the investment being promoted within this document. This communication should not be distributed to anyone other than the intended recipients and should not be relied upon by retail clients (as defined by Financial Conduct Authority). This communication is being supplied to you solely for your information and may not be reproduced, re-distributed or passed to any other person or published in whole or in part for any purpose. This communication is provided for information purposes only and should not be regarded as an offer or solicitation to buy or sell any security or other financial instrument. Any opinions cited in this communication are subject to change without notice. This communication is not a personal recommendation to you. Holland Advisors takes all reasonable care to ensure that the information is accurate and complete; however no warranty, representation, or undertaking is given that it is free from inaccuracies or omissions. This communication is based on and contains current public information, data, opinions, estimates and projections obtained from sources we believe to be reliable. Past performance is not necessarily a guide to future performance. The content of this communication may have been disclosed to the issuer(s) prior to dissemination in order to verify its factual accuracy. Investments in general involve some degree of risk therefore Prospective Investors should be aware that the value of any investment may rise and fall and you may get back less than you invested. Value and income may be adversely affected by exchange rates, interest rates and other factors. The investment discussed in this communication may not be eligible for sale in some states or countries and may not be suitable for all investors. If you are unsure about the suitability of this investment given your financial objectives, resources and risk appetite, please contact your financial advisor before taking any further action. This document is for informational purposes only and should not be regarded as an offer or solicitation to buy the securities or other instruments mentioned in it. Holland Advisors and/or its officers, directors and employees may have or take positions in securities or derivatives mentioned in this document (or in any related investment) and may from time to time dispose of any such securities (or instrument). Holland Advisors manage conflicts of interest in regard to this communication internally via their compliance procedures.