



Holland Views – Sports Direct – Price: 270p; MCap: £1,421m

Under earning, undervalued and unloved

For clients that are brave enough or open-minded enough to still be interested in our views on Sports Direct we share some new thoughts below. These are mainly in response to a patient and thoughtful read of the company's recently published accounts and our attendance of the AGM. Hopefully most readers will by now have seen the open letter we wrote to Mike Ashley in August¹. We also offer some context: relative to 2012, SPD revenues have doubled but its share price is the same. Today we estimate the company to be trading on an EV/EBITDA of 4x and a PE of 6x.

Blood on the high street

Baron Rothchild famously talked about the right time to invest being “when there was blood on the streets”. John Templeton embraced the same logic but with a gentler refrain (saying “be greedy when others are fearful”). Mike Ashley is taking a similarly contrarian and blood thirsty approach to the UK high street.

[Price is what you pay – value is what you get](#)

We have spent much time reading Sports Direct's just published report and accounts – we recommend it to interested investors particularly Ashley's 16-page CEO letter.

Our findings lend much credence to Ashley's contrarian vigour. For example:

- Sports Direct acquired Evans Cycles for £8.7m. Included in the purchase was £7.4m of inventory.
- Sports Direct acquired House of Fraser for £90m which included £82.8m of inventory.
- Sofa.com was acquired for a pound. A cursory search of Companies House says this business had c.£1m of stock at the end of its prior financial year.
- As each of these companies was acquired out of administration (CVA – company voluntary arrangement), Sports Direct is not thus liable for the terms of the legacy lease portfolio. Crucially, SPD can walk away or renegotiate.
- These deals, and Sports Direct's £120m sales and leaseback of the Shirebrook distribution centre follow a similar trend: Mike Ashley is going long the UK high street.

[SPD sceptics and value-seekers should read the 2019 annual report – in detail](#)

We are very focussed on the House of Fraser deal, not least because its acquisition brought Sports Direct 4.6m sq.ft. of new city-centre store space over 54 stores. This compares to SPD's existing UK sports retail estate of 5.6m sq.ft., an estate that still earns SPD a fairly stable £300m of gross cash flow per year – as we will show later.

HoF generated just £300m of revenues last year within SPD compared to c.£800m in each of the last two years for which it filed accounts as an independent business (2016 and 2015). House of Fraser's £90m annual rental bill was a major factor in its demise – a factor that can be addressed

¹ <http://www.hollandadvisors.co.uk/cms/resources/hollandadvisors-open-letter-to-spd-final-copy-26919.pdf>

resolutely by Ashley and team. More importantly HoF brings the prime located sites and space SPD's premiumisation strategy needs. Mike Murray says this plainly:

“Earlier this year, Sports Direct’s head of elevation Michael Murray told the Sunday Times that the company planned to convert 31 stores to the Frasers format — provided it could secure three-year rent-free periods.” – Financial Times², August 5th, 2019 (emphasis ours)

We suspect that city by city locations are/have been renegotiated with a view to how each will fit in to supplement or replace the existing SPD store estate at a low rental cost. Additionally Ashley is busy buying up other brands (often for nearly free) to draw in future customers.

Ashley Armstrong @AArmstrong_says · 16h
Sports Direct has already shut 8 Jack Wills stores after landlords refuse to cut rents according to @TheCoStarGroup. SD's Michael Murray said last week it wasn't a "question of what's the right number of stores but what's the right rent". SD pushing for zero rent on some shops

Source: Ashley Armstrong, Times Retail Journalist

Other relevant points to consider:

1. During the year to June 2019 HoF generated a £50m EBITDA loss within SPD, thus reducing SPD group 'underling EBITDA' and PBT.
2. At group level, the growth in SPD's headline group OPEX seems worrying. Until you realise that all of the OPEX growth in 2019 was all due to HoF. In fact underlying OPEX actually fell YoY in 2019. At the same time gross margins actually rose 300bps.

Method in his madness

To many the purchase of Evans/HoF, Jack Wills, BHS old stores etc looks 'scattergun'. To us it looks opportunistic and a way to build scale. That is:

- Scale in prime high street locations
- Scale in the breadth of facia that space can be used for: USC, Flannels, Frasers
- Scale in a wide variety of brands that may draw customers and scale in its efficient distribution network of retail and online fulfilment

Our main focus is to look at the core cash generation of the existing SPD business and how that could rise were an elevation strategy be executed successfully. However the evolvement of the Fraser's idea (with low rents and owned brands to sell in-house) has echoes of Ashley's purchase of sportswear brand 15-20 years ago. Any hint of success in this area would catch almost all observers off guard.

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

² <https://www.ft.com/content/456ed954-b79e-11e9-96bd-8e884d3ea203>

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