

Superdry: A management-led turnaround

Company:	Superdry (SDRY LN)	Market Cap:	£100mio
Industry:	Clothing/Retail	Net Debt:	£38mio (peak working capital)
Country:	UK, worldwide	Revenue:	£610mio
Date:	24 th November 2022	Net Income:	£10mio (1.6%)
Dividend:	-	Free Cash Flow:	£0mio (0%)
Entry:	£107mio	Target Market Cap:	£150mio

Introduction

Superdry is a clothing brand that focuses on casual wear for young adults & teenagers. The brand makes around 36% of their revenues in the UK, 47% in Europe and 15% in the US. Their best sellers are their winter coats and jackets, as they are priced at the bottom range of the industry, yet are seen more towards the upper middle in terms of style and quality.

Mediocre numbers

Usually, the turnarounds I pick are very much focused on numbers with a decent margin of error and then an external factor comes into play making this an interesting turnaround. In the case of Superdry, this margin of error is quite small. However, given that Superdry incurred a £-22mio cash outflow in FY22, I expect this outflow to be £-16.5mio worst case in the current FY (This is estimated by using the most recent sales increase of 7% and -230bps in margins). Management, on the other hand, expects net debt to be at zero by the end of the FY (unch y-o-y), which is taking £10-20mio pre-tax profits into account. Therefore, the remainder of ~£16.5mio as per below is likely driven by a reduction in inventories. In any case, the numbers show an improvement y-o-y and this should not lead to further deterioration in the market capitalization.

Superdry pessimistic cash flow FY 23 estimate

Item	in £ mio
Annualised Revenue based on trading update	652.7
Gross profit with margin -230bps y-o-y	351.8
Selling and admin expenses	-330
Finance expense	-10
Pretax profit	11.8
Depreciation	48.7
Operating cash flow	60.5
Leases	-60
Free cash flow	0.5
Capex	-17
Net cash flow	-16.5

Source: Superdry, own estimates

Superdry topline results in £ mio

Year	Revenue	Adj profit before tax	Operating cash flow	Cash flow after leases	Leases	Lease deferrals	Lease deferrals remaining
2022	610	22	47.6	-19.00	66.6	15.7	8.2
2021	556	-13	50.1	3.10	47		
2020	704	-42	85.3	24.20	61.1		
2019	872	42	37.7	37.70			
2018	872	97	80.1	80.10			
2017	752	87	62.3	62.30			

Source: Superdry

Abercrombie & Fitch trading update

Earlier this week a trading update by Abercrombie & Fitch has beat expectations, leading to a 15%+ market valuation appreciation in A&F. The earnings call was interesting, as they mentioned that the warmer weather end of October/beginning of November has caused a slowdown, which has, however, reverted as the colder weather kicked in. This is likely what happened to Superdry as well, especially given their focus on winter coats and jackets. On the other hand, A&F mentioned easing cost pressures, such as cotton and freight rates, which should help in Q4. A&F, although larger and focused on the US vs. Superdry's focus on Europe, has a similar style and therefore is perhaps a good indicator for what lies ahead of Superdry. A&F mentioned that Europe had a slowdown, which was reflected in the numbers being down over 22% y-o-y vs. down 13% the prior quarter – a warning sign for Superdry. Although, A&F is better known for their summer collection such as T-shirts in Europe, rather than winter coats.

The Wholesale opportunity

Earlier this week, M&S announced to push menswear by adding clothing ranges from brands such as Superdry. Julian Dunkerton, Superdry's CEO, founder and 22% shareholder, who has bought £2mio of shares in October, has flagged the wholesale opportunity on the most recent earnings call. As per table below, wholesale operating profit margins are a lot higher than from their own retail shops. This makes a push towards more wholesale opportunities such as with M&S so attractive.

Superdry's Wholesale opportunity

in £ mio	2022	2019
Retail revenue	384.1	536.7
Wholesale revenue	225.5	335
Retail operating profit	38.7	27.1
Wholesale operating profit	49	95.6

Source: Superdry

A going concern

The £38mio net debt on 1st October during their peak working capital season was £24.3mio higher than last year. The reason for this were mostly deferred lease payments of between £15.7mio and £23.9mio as well as £4mio higher capex. As of January 2023 this asset-backed lending facility is expiring. After six weeks from the annual results announcement, management was due to update markets on half-year trading. However, six weeks later no announcement was made, and newspapers began flagging a risk of going concern. At the same time, 20% discounts for Black Friday hit stores mid-November, a week before the actual Black Friday event and will end on Nov 28th. Overall, this makes this investment a bit riskier than what I usually pursue. The FT ran an article this morning that Bangladesh, the clothing manufacturing hub of the world, is receiving fewer orders, as inventories of the likes of Target, Walmart, Next, Primark and co are full. However, given that Superdry's net current assets are £53mio and peak season working capital requires around £40mio, they should be able to make it through this year. A 20% discount on Superdry's £132.7mio inventories would equate to £26.54mio, which could put pressure on next year's working capital cycle. Therefore, key is to exit this festive season with a net cash position. An announcement of an extension of the working capital facility could boost Superdry's valuation.



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