SHADOWFALL

BOOHOO: THE CATCH ~~20~~22

FOR PROFESSIONAL CLIENTS ONLY. ShadowFall Fund is short BOOHOO Group Plc (BOO).

At £4.6bn market cap, BOO is the largest listed company on AIM.

Since 2014, we believe that BOO has provided a misleading impression of its cumulative Free Cash Flow (FCF) by 67%. Most recently, in 2020 we calculate that BOO's FCF was misrepresented by £32.2m or 65%. We take this view since:

1. BOO doesn't appear to include any tax payment within its FCF, even though its own auditor guides that this should be included. Maybe BOO sees tax as a discretionary payment?
2. BOO includes in FCF all cash generated by PrettyLittleThing (PLT), as though it were 100% wholly owned. However, by 2022, we calculate that BOO could be due to pay dividends of at least £77m to PLT's 34% Non-Controlling Interest (NCI), aka the son of BOO's Chairman.
3. In 1H20, BOO even began paying out some of this cash to PLT's NCI yet still excluded this pay-out from its FCF.

By early 2022, BOO has the option to buy out the 34% PLT NCI. The son of BOO's Chairman must be rubbing his hands with glee at the prospect of a near £1bn pay day, driven by further potential dividend distributions (which BOO doesn't account for in its FCF) and the proceeds of a buy-out. Two weeks ago, BOO made a sizeable c. £200m cash call. We reckon there's a risk that BOO doesn't end up using this for M&A opportunities but instead combines it with its already considerable £241m net cash balance to cover the PLT NCI dividends and buy-out price with as much cash as possible. Either way, if BOO elects not to significantly deplete its cash for this, then we believe that BOO's shareholders should likely brace themselves for further dilution to acquire this NCI interest.

In the meantime, we believe that PLT's numbers are flattered by other segments of BOO wearing some of PLT's costs; we estimate that this boosted PLT's profit by c. £10.7m in FY19. The upshot is that it presents PLT as more profitable than it might ordinarily be without this arrangement, which could lead to a higher buy out price paid to PLT's NCI. For example, if PLT's NCI was bought out today at BOO's current multiple, then we calculate that this £10.7m effective "profit boost" could result in an additional £193m being paid to the NCI for no other reason than other BOO entities absorbing PLT costs which should instead be attributable to PLT. We suppose that if it's not used for M&A, then BOO's recent cash call for c. £200m could cover this.

Meanwhile, BOO's shareholders had better look out. BOO and PLT have competition: ISawItFirst (ISIF). ISIF appears to us to have a similar supply chain as BOO and PLT, as well as a virtually identical product offering and pricing point to the same demographic. Senior PLT personnel have even joined ISIF. ISIF is majority owned by the brother of BOO's Chairman. Perhaps after BOO buys out the Chairman's son's NCI in PLT, it will set its sights on buying the Chairman's brother's stake in ISIF? Or maybe, since ISIF is gaining considerable traction on Instagram and search rankings, ISIF will continue to compete with BOO? Either-way, it doesn't seem clear to us how BOO's shareholders would benefit.

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DRESSED FOR SUCCESS

On the face of it, boohoo (BOO) is a remarkable success story. Brought to the market by Zeus Capital in March 2014, BOO's market valuation has risen c. 650% since its IPO, making it the largest AIM listed company.

When it comes to profitability, for an online fashion retailer, BOO breaks the mould. Whereas its much larger (by revenue) peers, ASOS (ASC LN) and Zalando's (ZAL GR) respective FY19 gross margins are 48.8% and 42.5%, BOO's FY20 gross margin is 54.0%; an astonishing 514bp above ASOS' and a dazzling 1,140bp higher than Zalando's.[1]

As far as operating margins go, BOO's stand apart. BOO's FY20 operating margin of 8.7% is nearly 7x greater than that of ASOS (FY19: 1.3%) and 3.4x that of Zalando (FY19: 2.6%).

In recent years, BOO's growth driver has largely been PrettyLittleThing.

It took BOO's original businesses, boohoo.com UK, seven years to grow its revenue from £24m to £374m. It took PrettyLittleThing three years to get from £22m in 2016 to £374m in 2019, and then rise to £516m in FY20.

Whilst boohoo.com UK reported a FY19 operating margin of 7.5% (FY18: 9.2%), we calculate that PrettyLittleThing's FY19 operating margin was an extraordinary 11.1% (FY18: 8.9%).

PrettyLittleThing has grown its revenue over twice as fast as boohoo.com UK and is considerably more profitable.

Unfortunately for BOO's shareholders, BOO doesn't own 100% of PrettyLittleThing. BOO owns 66% of PrettyLittleThing. The remaining 34% is mostly owned by 32-year-old, Umar Kamani, the son of Mahmud Kamani.

Mahmud Kamani hoo? The Chairman, co-founder and majority shareholder of BOOHOO.

Figure 1 Los Angeles, Ca, USA. 30th June, 2019. Ashanti (left), Umar Kamani (right, CEO of PrettyLittleThing). Source: MediaPunch Inc, Alamy Stock Photo.

[1] BOO's year end is to 28 February. ASOS' year end is to 31 August. Zalando's year end is to 31 December.

Summary of Findings

A misleading impression of Free Cash Flow? (page 13)

Since 2014, we calculate that BOO has provided a misleading impression of its cumulative Free Cash Flow (FCF) by 67%.

We believe that this misleading impression has been produced by the company since:

1. BOO fully consolidates PrettyLittleThing (PLT) as though it were 100% wholly owned and then at the base of its Income Statement details the profits attributable to the non-controlling interest (NCI), aka the son of BOO's Chairman, in PLT. **However, within neither its Cash Flow Statement or reported FCF, BOO does not separate out – or provide guidance – on the cash which is attributable to the NCI in PLT.** As such, we believe that this provides the reader with little to no understanding of the true cash generation and more specifically FCF, which is attributable to shareholders of BOO.

   To put this into context as to how significant this may be, in FY20, PLT was the most profitable segment of BOO. BOO reported £72.9m in profit after tax (PAT) in FY20. PLT is indicated by BOO to have achieved £45.2m in PAT. PLT accounted for 62% of BOO's PAT in FY20. However, in both its Operating Cash Flow section of its Cash Flow statement and its reported FCF for FY20, BOO includes all the cash generated by PLT as though PLT were 100% wholly owned. If PLT is owned 34% by a NCI, then 34% of PLT's profit is attributable to the NCI and 34% of the corresponding cash generation is attributable to the NCI.

   For example, in calculating its FCF for FY20, BOO begins its calculation with PAT of £72.9m. However, we believe that 34% or £15.4m of this accrues to the NCI and would have nothing to do with BOO's shareholders. We note that in FY20, BOO reports that it converted 112% of its PAT into FCF. If this rate of conversion was applied to the £15.4m of PAT that had nothing to do with BOO's shareholders, then **we believe that £17.2m or 21.5% of BOO's FY20 reported FCF is not attributable to BOO's shareholders.**

2. **NCI attributable profits are scheduled to be distributed to PLT's NCI by February 2022.** BOO has an option to acquire the 34% NCI in PLT on 14 March 2022.[2] Ahead of any potential buy out by BOO of PLT's NCI, according to the original disclosure of the PLT acquisition, if the option to acquire is not exercised by 28 February 2022, then a dividend of up to all of PLT's distributable reserves will be paid to its shareholders on a pro rata basis. In the original announcement of the acquisition of 66% of PLT, this was detailed as follows (our bold):

[2] boohoo 2019 Annual Report (page 72): The company has an option to buy the non-controlling interest of 34% of the share capital of PrettyLittleThing.com Limited (formerly 21Three Clothing Company Limited) on 14 March 2022 for market value or less, subject to performance criteria. Umar Kamani, the son of Mahmud Kamani, Executive Chairman and director of boohoo Group plc, is a director and shareholder of PrettyLittleThing.com Limited.

> *"If the boohoo Group does not exercise the option to acquire the remaining 34% of PLT* ***by 28 February 2022, a dividend of up to all of the PLT distributable reserves at that time will be payable to all PLT shareholders including boohoo, pro rata to their shareholdings."*** [3]

Clearly the distributable reserves within PLT is the accumulated profit after tax (PAT) or retained earnings. For the year ended 28 February 2019, PLT's retained earnings were £43.9m (FY18: £13.6m). By February 2022, these retained earnings (together with any retained earnings which might be achieved in FY20, FY21 and FY22), will be eligible to be paid out to PLT's shareholders in accordance with their respective shareholdings. If any dividends are distributed, then the NCI will expect to receive 34% of these dividends. However, since the 66% of PLT was acquired by BOO in December 2016, BOO has been reporting the cash generation of PLT in its Cash Flow Statement and reported FCF as though PLT was 100% wholly owned. Any reasonable reader could be led to believe that BOO's cash generation and reported FCF is entirely attributable to BOO's shareholders and not that a significant portion of this will become due to be paid to PLT's NCI in February 2022.

Since BOO is scheduled to pay out 34% of PLT's retained profits to its NCI, we believe that BOO's inclusion of PLT's cash generation as though it were 100% wholly owned, makes a mockery of BOO's reported FCF. Further, we're unconvinced that the market realises this potential large cash dividend pay out to PLT's NCI exists. We believe this highlights the importance of adjusting for minorities in the FCF calculation and that investors should instead focus on a Free Cash Flow to Equity Holders metric (FCFE).

3. **PLT's NCI have <u>already begun receiving dividends</u>, which are unaccounted for in BOO's reported FCF.** On 10 May 2019, the Directors of PLT approved a dividend of £10m. Within the six-month period to 31 August 2019, BOO reported a £3.4m cash "dividend paid to non-controlling interests". As would be expected, the £3.4m was paid in accordance with the shareholdings of PLT (i.e. 34% or £3.4m of the declared dividend of £10m is payable to the PLT NCI). However, BOO does not account for this cash payment by subtracting it from its reported FCF. Clearly this cash dividend payment to the PLT NCI has nothing to do with BOO's shareholders since it is in relation to the profits which have accrued to PLT's NCI. Again, we believe that the presentation of BOO's FCF in this manner could be misleading and that FCFE is a more reflective measure.

   If BOO had deducted this dividend payment to PLT's NCI from its 1H20 reported FCF, then this alone would have reduced reported 1H20 FCF by 11.3%.

4. **BOO doesn't account for taxes in its reported FCF.** Whereas it is common practice for a company to calculate its FCF inclusive of cash corporate taxes paid, BOO elects not to subtract its corporate tax paid from its FCF figure and instead subtracts it lower down in the cash statement. We believe that this presents a further misleading impression of BOO's true FCF. Indeed, we would highlight that under IAS 7 "Statement of Cash Flows", it states that *"cash flows arising from taxes on income are normally classified as operating, unless they can be specifically identified with financing or investing activities [IAS 7.35]"*.

   We note that **BOO's own auditor, PwC, itself guides to deriving FCF by subtracting corporate taxes**, so we are surprised that this is not reflected in BOO's financial statements. Moreover, the disclosure appears to be internally inconsistent. In the calculation of FCF and the first mention of the "Consolidated cash flow statement", "Tax

[3] https://otp.tools.investis.com/clients/uk/boohoo/rns1/regulatory-story.aspx?cid=798&newsid=828784

paid" comes below "Operating cash flow" however in the second "Consolidated cash flow statement", "Tax paid" comes before "Net cash generated from operating activities". We believe this is potentially misleading to the reader. Maybe BOO sees tax as a discretionary payment?

To put this all into context as to its significance, we note that within the publication of its final results for the year ended 29 February 2020, BOO details its FY20 FCF as £81.7m (FY19: £65.1m). However, this FCF figure is arrived at after adding back £19.3m (FY19: £12.4m) in P&L tax expense. Neither this P&L tax expense nor cash tax of £11.6m (FY19: £10.4m) is subtracted to arrive at BOO's reported FCF. When combining the above £17.2m in likely PLT NCI related FCF with the fact that also in FY20, BOO did not subtract £11.6m in cash tax expense, we believe that BOO's true FCF would have been £28.8m lower in FY20. Then there is also the £3.4m in cash for dividends paid to PLT's NCI.

In reporting £81.7m FCF in FY20, we believe that BOO has provided a misleading impression of its true FCF by £32.2m or by 65% against this true FCF figure.

In general, we believe that if management is unclear with how it reports cash generation to its equity holders (the key factor in determining its value), then we question if other important financial disclosures can be relied upon?

STRANGER THINGS: INCONSISTENCIES AND A P&L GIMMICK? (PAGE 19)

BOO has the option to acquire the remaining 34% in PLT by 28 February 2022. Or is it on 14 March 2022? It depends on which section and set of BOO's financial statements you read. If it's not by 28 February 2022, then the original PLT acquisition disclosure suggests that PLT's NCI will receive a dividend for 34% of PLT's cumulative profit since acquisition.

As inconsistent, in our view, is whether any price paid for PLT's NCI, would be based on 79% or 100% of the market value if maximum performance conditions are met. Again, it depends on which set of BOO's financial statements you read.

Things become apparently stranger still in FY20. In its full year results for the year to 29 February 2020, BOO highlights a change of accounting policy for the NCI in PLT. **We believe that this restatement provides for more confusion to readers of BOO's financial statements and is nothing other than a gimmick**, which could misleadingly suggest to BOO's shareholders that they are entitled to a greater share of PLT's profits than they are due between now and February 2021. In our view, that thinking would be flawed since, as mentioned above, by 28 February 2022, PLT's NCI would apparently be due its share of total cumulative distributable reserves on a 34% basis.

SIGNIFICANT DIVIDENDS TO PRETTYLITTLETHING'S NON-CONTROLLING INTEREST (AKA THE SON OF BOO'S CHAIRMAN) (PAGE 25)

We calculate that PLT's NCI could be due total dividends of at least £77m by FY2022. As detailed above, BOO is liable to pay dividends to PLT's NCI in proportion to the NCI share of PLT's distributable reserves by February 2022.

In FY20, we calculate that c. £30.4m in dividends is due to PLT's NCI. £3.4m of this was paid in 1H20; an 88% pay-out ratio of the NCI FY19 earnings. Meanwhile ZERO dividends are paid to BOO's shareholders. **We're unconvinced that this expected cash outflow is realised by the market.**

While BOO's shareholders receive zero dividends paid out, nor any other capital returns, they may be heartened to at least see so much cash being built up on BOO's balance sheet. **On 15 May 2020, this cash balance was bolstered even further by a c. £200m cash raise.** However, considering these growing potential NCI dividend pay-outs, **there is a risk that BOO's sizeable cash pile is merely sat there to later cover these potential dividends in cash.**

THE BIG COST FOR THE BUY-OUT OF PRETTYLITTLETHING'S NON-CONTROLLING INTEREST (AKA THE SON OF BOO'S CHAIRMAN)? (PAGE 28)

BOO announced its acquisition of 66% of PrettyLittleThing (PLT), in December 2016. The remaining 34% NCI was deemed to be used "to incentivise CEO Umar Kamani and PrettyLittleThing's senior management". BOO has an option to acquire the NCI (34%) in PLT at a "market value" by early 2022.

Exactly how BOO will arrive at the valuation determinants for a "market value" is, in our view, somewhat unclear. In its original announcement BOO merely states that it would be determined by a "Big Four accounting firm". **If PLT were acquired at the average market multiples as BOO and its peers trade at today, then this cost to buy-out the NCI could be almost £1 billion. Maybe this is why BOO continues to build up so much cash and not distribute it to its shareholders?**

THE £200M CASH CALL FOR….? (PAGE 30)

On 14 May 2020, BOO announced its intention to raise approximately £200m and in the event raised gross proceeds of £197.7m. Despite BOO reporting net cash of £241m as at 29 February 2020, BOO felt it needed a further £200m in order to "take advantage of numerous opportunities **that are likely to emerge** in the global fashion industry over the coming months." We place an emphasis on the term "likely to emerge", suggesting that opportunities are yet to emerge.

We find it odd that even though BOO held £241m in net cash, it required a further £200m for such opportunities. Further, should such opportunities emerge, then given the group's sizeable cash balance, we believe that it would have been more beneficial for BOO to tap into this or to use either debt or its own paper to conduct any M&A. **In our view, there's a risk that if few opportunities emerge, then BOO might end up using a significant portion of its £241m in net cash and the proceeds of its £197.7m cash call to fund the dividend pay-out to and the buy-out of the PLT NCI.**

CONSENSUS CONFUSION (PAGE 32)

Broker notes from several Sell Side analysts on BOO are available to download from Bloomberg Finance L.P. We were surprised to find that **some brokers do not appear to recognise that BOO is likely to have to pay-out a dividend by February 2022 of up to all PLT's distributable reserves on a pro-rata basis to its NCI.** For example, in one Sell Side analyst's model, they already appear to forecast distributable reserves to PLT's NCI of £72.7m by FY22 but do not appear to have this distribution factored into their cash flow. This appears to be reflected by several Sell Side analysts.

~~Hoo~~ Who wears the costs? (page 33)

PrettyLittleThing achieves, in our view surprisingly, far superior EBIT margins as compared to other BOO group entities, and even more noticeably to its much larger peers (ASOS and Zalando). A main driver of PLT's margin supremacy appears to be due to it administering and delivering orders to its customers at a much lower cost than peers and other BOO group holdings. Since PLT was acquired by BOO, these costs have significantly fallen. Also, after it was acquired, PLT began making payments to boohoo.com UK for distribution and administrative costs. Effectively boohoo.com UK is fulfilling distribution and administrative functions on behalf of PLT and then being reimbursed for these costs. But is PLT paying boohoo.com UK enough?

We calculate that if PLT's total distribution and administrative costs per order were in line with those of the wider BOO group, then its EBIT would have been £10.7m lower and its EBIT margin would have been 8.3% as compared to a reported 11.1% in FY19.

If PLT's NCI were bought-out today at BOO's current multiple, **we calculate that this £10.7m effective "profit boost" would result in an additional £193m being paid to PLT's NCI** for no other reason than other BOO entities potentially absorbing some of PLT's costs which should instead be attributable to PLT. We suppose that if not used on M&A, then the recent £200m cash call would prove useful in settling this.

If BOO is now paying dividends to PLT's NCI and might be asked to buy out that NCI on the basis of PLT's relative profit supremacy, then we believe BOO's shareholders had better be sure that PLT's super profits are sustainable and not bolstered by a subsidy from other entities in the BOO group.

The competition or the next buy-out target?: the Brother of BOO's Chairman (page 47)

BOO and PLT have competition. Incorporated in 2016, ISawItFirst.com appears to a have a similar supply chain as BOO and PLT, as well as a virtually identical product offering to the same demographic. Key personnel such as PLT's Head of Commercial Marketing and Head of Merchandising have even jumped *shop* to join ISawItFirst. Perhaps they see ISawItFirst as having greater potential in a competitive market? Recent Instagram data and internet search trends certainly give the impression that **the competition is heating up. In August 2017, PLT led I Saw It First by a ratio of 26:1 in terms of the number of Google searches in the UK. By May 2020, this had fallen to a c. 7:1 ratio.**

ISawItFirst is majority owned by Jalaludin Kamani, the brother of BOO's Chairman. Perhaps, after the PLT NCI (BOO's Chairman's son) is bought out, BOO will set its sights on buying out its Chairman's brother? Or maybe the Kamanis will continue to sell down their BOO stock and go head to head? **Either-way, it doesn't seem clear to us what significant barriers to entry exist in BOO's market, if a virtual replica company to BOO and PLT can be set-up and grown relatively quickly, nor how BOO's shareholders would stand to benefit?**

~~HOO~~ WHO WORE IT BETTER?

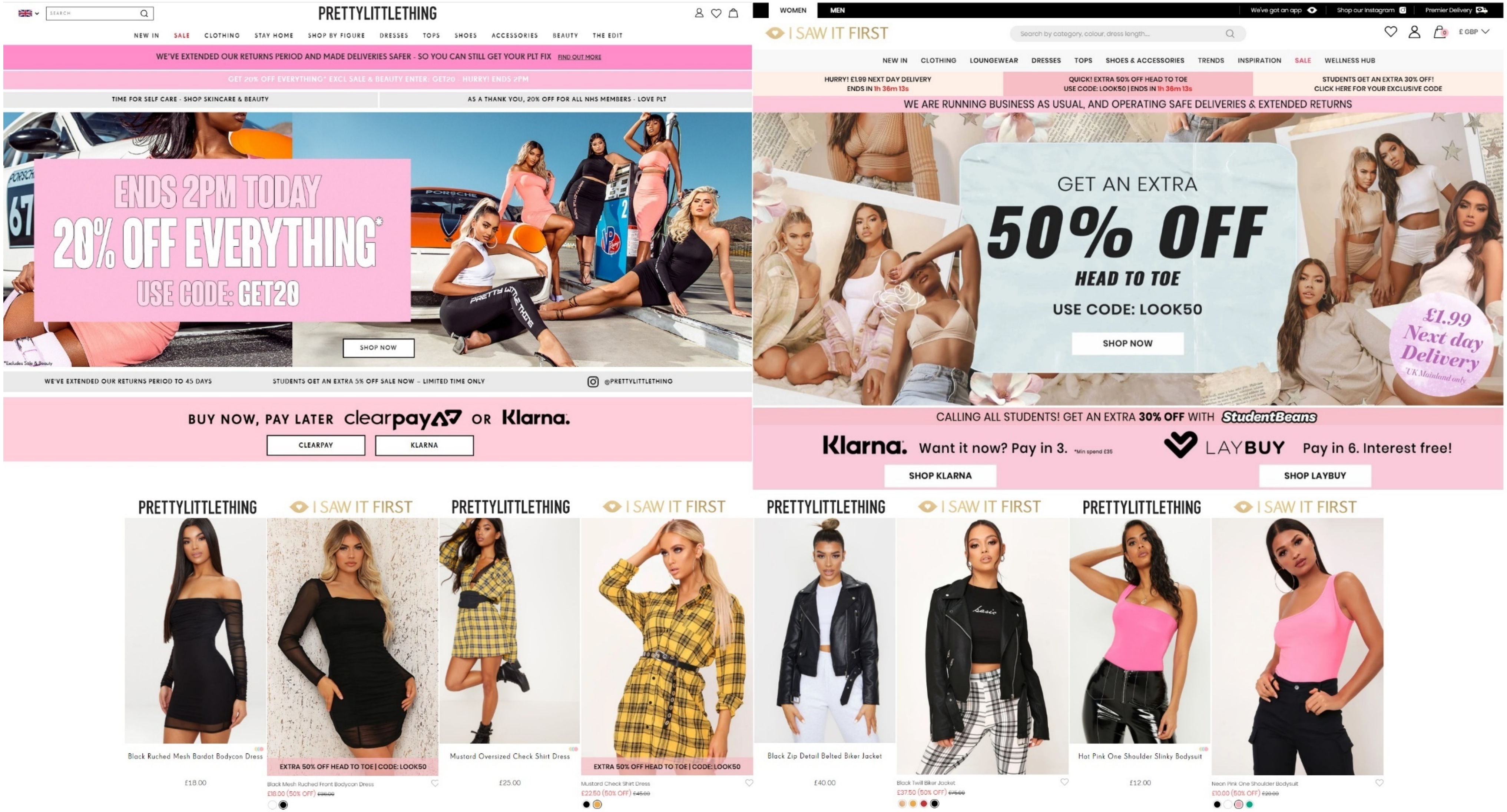

Figure 2 Clothing samples from PrettyLittleThing.com and isawitfirst. Source: www.prettylittlething.com, www.isawitfirst.com, ShadowFall.

Company Description

boohoo (BOO) is a Manchester based online fashion retail group which operates a number of brands. These include boohoo, boohooMAN, PrettyLittleThing, Nasty Gal, Karen Millen and Coast. The group designs, sources, markets and sells clothing and other fashion products to customers. The group focuses on trending styles and targets a younger value-orientated audience.

In FY20 boohoo group plc generated total revenues of £1,234m with boohoo generating 49%, PrettyLittleThing 42% and Nasty Gal 8%. The group generated Segment result (gross profit after distribution costs, but before distribution expenses) of £381m with boohoo generating 50%, PrettyLittleThing 42% and Nasty Gal 9%.

Summary Financials (Reported)	2015	2016	2017	2018	2019	2020	Bloomberg consensus 2021E	2022E
Revenue	139.9	195.4	294.6	579.8	856.9	1,234.9	1,484.3	1,841.0
% change		39.7%	50.8%	96.8%	47.8%	44.1%	20.2%	24.0%
Gross Profit	85.0	112.9	160.8	306.4	469.0	666.2	791.6	839.5
% change		32.8%	42.4%	90.5%	53.1%	42.0%	18.8%	6.0%
% margin	60.8%	57.8%	54.6%	52.8%	54.7%	53.9%	53.3%	45.6%
EBITDA	12.9	18.7	37.0	56.9	84.5	126.5	137.9	176.9
% change		45.4%	97.6%	54.0%	48.5%	49.6%	9.0%	28.3%
% margin	9.2%	9.6%	12.5%	9.8%	9.9%	10.2%	9.3%	9.6%
Adj. EBIT	10.9	15.7	32.6	50.4	75.1	107.0	116.4	152.7
% change		44.0%	108.5%	54.4%	48.9%	42.5%	8.8%	31.2%
% margin	7.8%	8.0%	11.1%	8.7%	8.8%	8.7%	7.8%	8.3%
Net Debt/(Cash)	(54.1)	(58.3)	(58.4)	(133.0)	(190.7)	(240.7)	(317.0)	(394.8)
ND/EBITDA	-4.2x	-3.1x	-1.6x	-2.3x	-2.3x	-1.9x	-2.3x	-2.2x
FCF*	5.8	6.5	5.4	29.9	65.1	81.7	73.3	80.0
% EBITDA	45.4%	34.6%	14.7%	52.4%	76.9%	64.6%	53.1%	45.2%

** note IFRS 16 was implemented in 2020, potentially skewing the consensus and 2020 figures*

Figure 3 boohoo summary financials, Source: boohoo plc filings, Bloomberg Finance L.P. ShadowFall calculations.

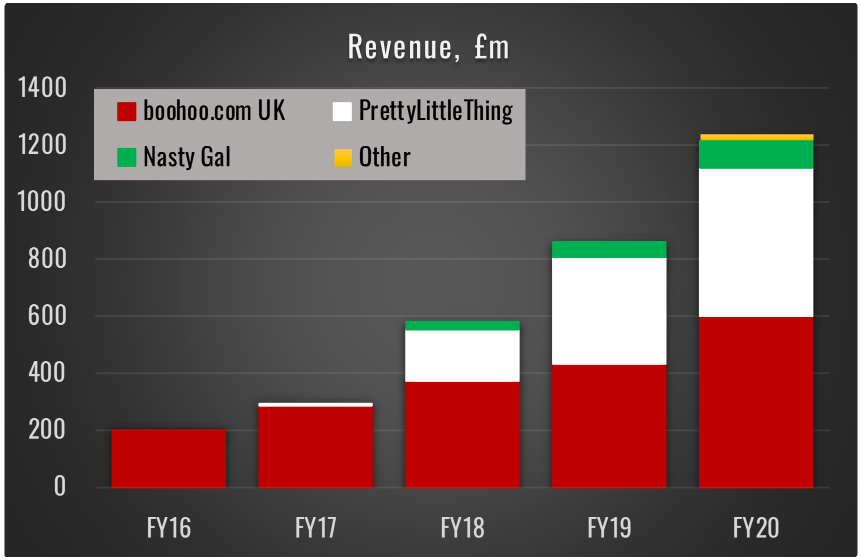

Figure 4: boohoo reported revenue split by segment. Source: boohoo plc filings, ShadowFall.

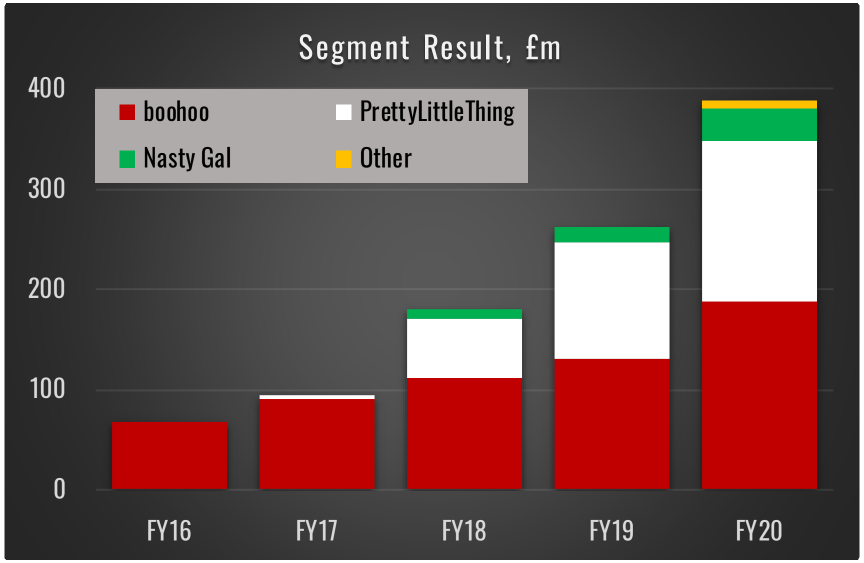

Figure 5: boohoo segment result. Source: subsidiary filings, ShadowFall calculations.

BOO: Key Information

BooHoo Group plc market information

	London Stock Exchange
Ticker	BOO LN
Share price	360 GBp
Market Cap (M)	£4,404
3 month average daily volume	7,757,886
3 month average daily value (M)	£27.9
Short interest	1.1%
Days to cover	0.6
Active available quantity (M)	115.6
Active available value (M)	£416.2

	Top holders	% Out
1	Mr Mahmud Kamani	12.5%
2	Merian Global Investors	11.1%
3	Invesco	7.0%
4	Baillie Gifford	4.7%
5	Rabia Kamani	4.7%
6	Hargreaves Lansdown	3.8%
7	Franklin Resources	2.9%
8	Eleva Capital	2.9%
9	Standard Life Aberdeen	2.6%
10	Ms Carol Kane	2.6%
	Total	**54.8%**

Figure 6: Key market information, Source: Bloomberg Finance L.P, Apps Black, Data as of 22 May 2020

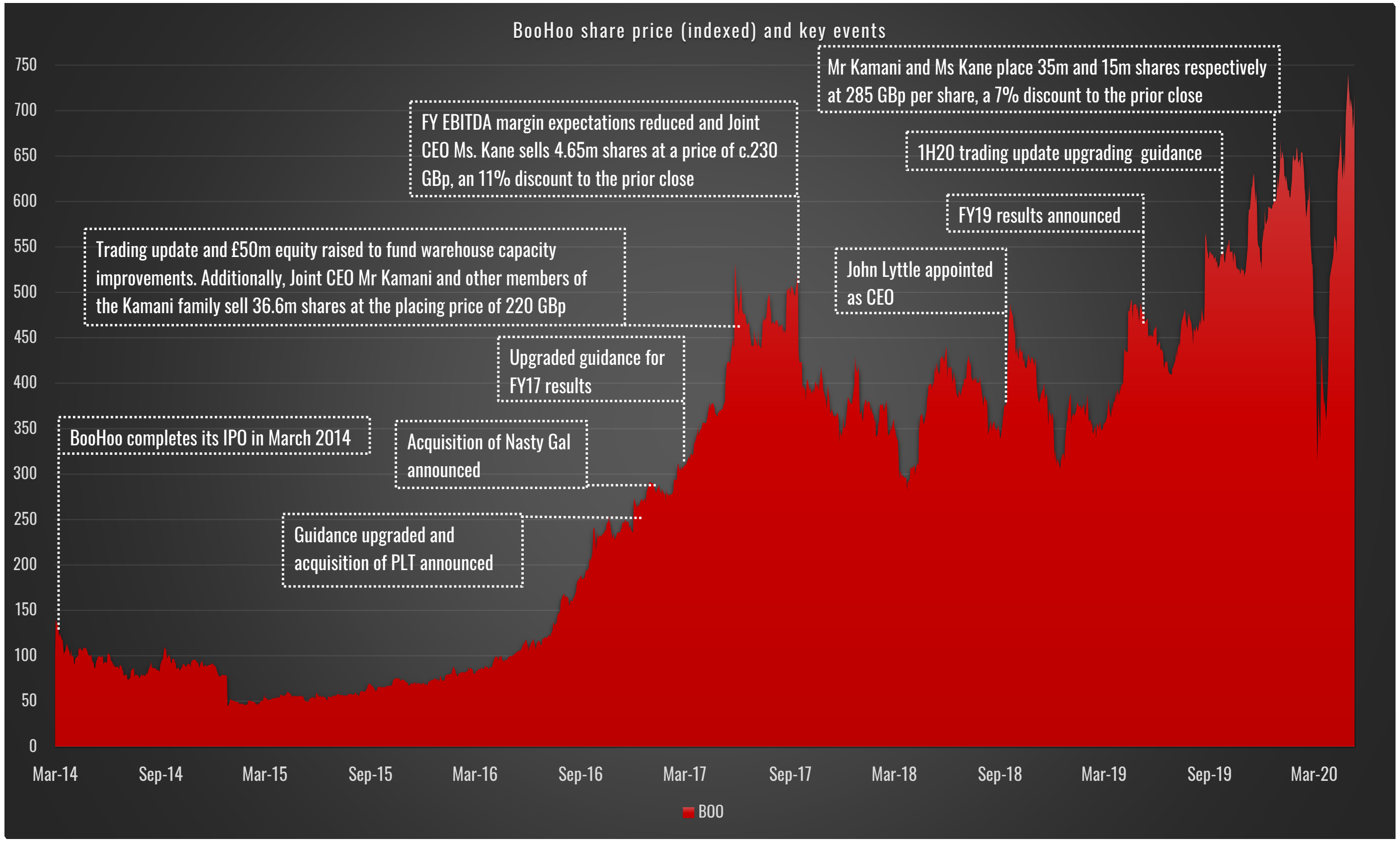

Figure 7: BooHoo share price indexed to 100 and key events. Source: ShadowFall, Bloomberg Finance L.P.

Outperformance vs ASOS and Zalando

Since its IPO in 2014, BOO has outperformed its two closest peers, in our view, ASOS and Zalando, in a remarkable fashion. BOO has grown its revenue at a 57% CAGR vs. 24% and 22% for ASOS and Zalando, gross profit has grown at 53% CAGR vs 24% and 20% for ASOS and Zalando, while EBIT has grown at 62% vs -7% and 17% for ASOS and Zalando, respectively.

Against this backdrop, despite what we would assume to be an industry with significant economies of scale, gross and operating margins have always been substantially ahead of the two closest peers BOO despite being a fraction of their size.

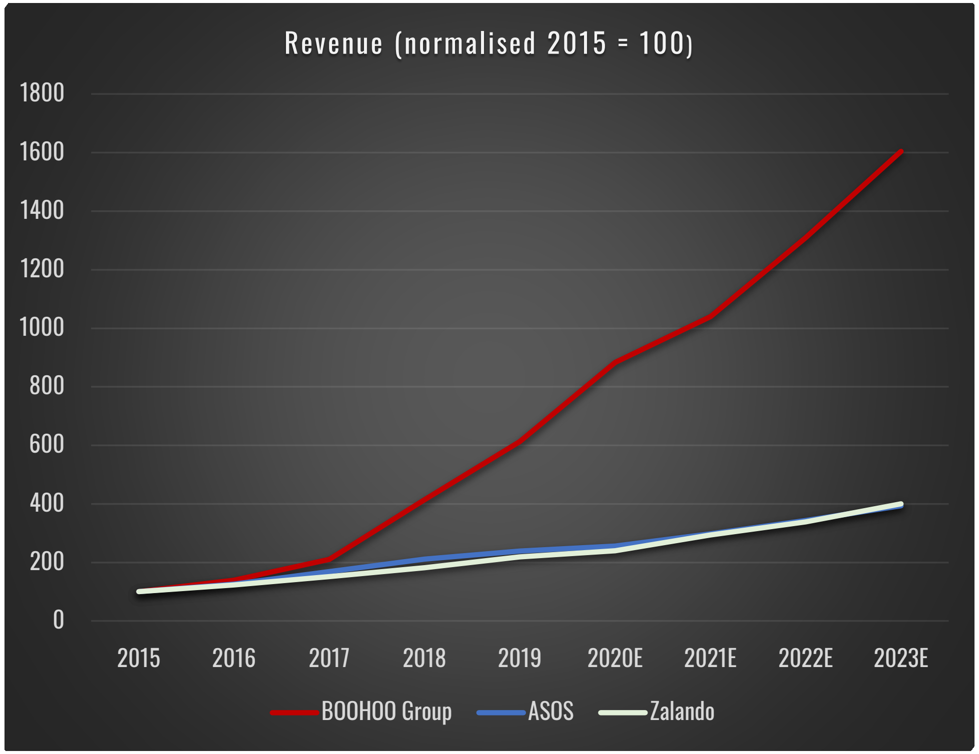

Figure 8: Revenue indexed to 100 in 2015, boohoo, ASOS and Zalando. Bloomberg consensus (BOO FY20A) for FY20E-22E, Source: company filings, Bloomberg Finance L.P., ShadowFall calculations.

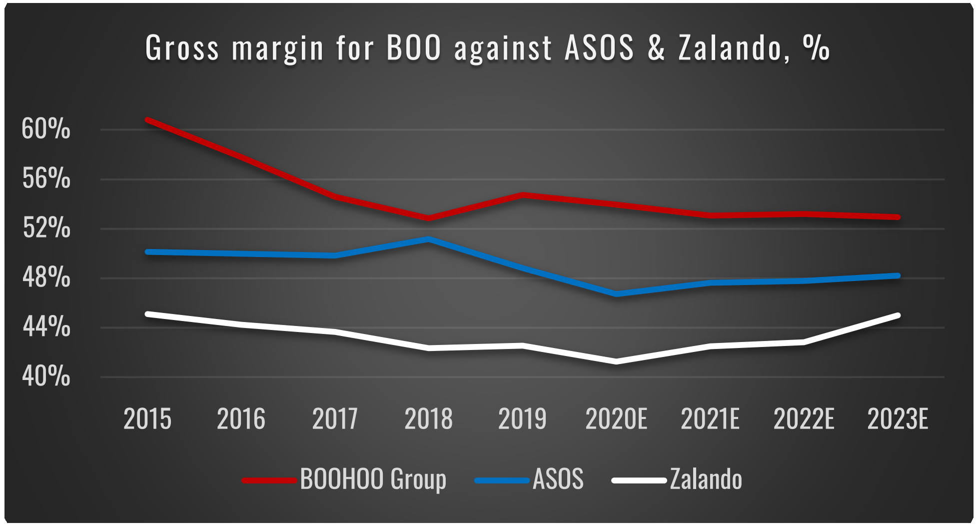

Figure 9 Gross margins for boohoo and peers. Bloomberg consensus for (BOO FY20A) FY20E-22E, Source: company filings, Bloomberg Finance L.P., ShadowFall calculations.

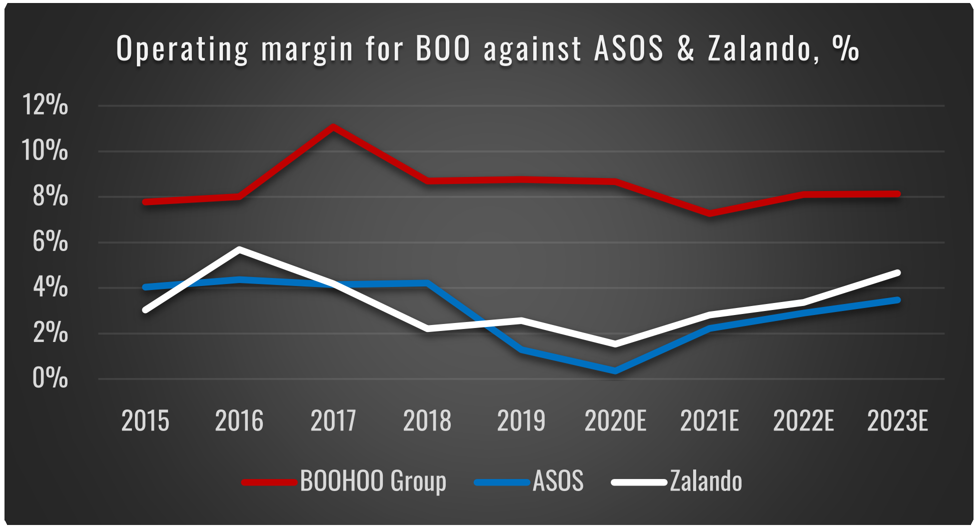

Figure 10: Operating margins for boohoo and peers, Bloomberg consensus for (BOO FY20A) FY20E-22E. Source: company filings, Bloomberg Finance L.P., ShadowFall calculations.

A MISLEADING IMPRESSION OF FREE CASH FLOW?

Figure 11 Stretched Dollar. Making money go further. Source: Ian McKinnell, Alamy Stock Photo.

Since 2014, we calculate that BOO has provided a misleading impression of its cumulative Free Cash Flow (FCF) by 67%. We believe that this repetitive misrepresentation has been produced by the company since:

1. BOO includes in its FCF all cash generated by PrettyLittleThing (PLT) as though it were 100% wholly owned. However, by 2022, we calculate that BOO could be due to pay dividends of at least £77m to PLT's 34% Non-Controlling Interest (NCI), aka the son of BOO's Chairman. On this basis, we believe that BOO's inclusion of PLT's cash generation as though it were 100% wholly owned, makes a mockery of BOO's reported FCF. Further, we're unconvinced that the market realises this large cash dividend disbursement is likely. We believe this highlights the importance of adjusting for minorities in the FCF calculation and that investors should instead focus on a Free Cash Flow to Equity Holders metric (FCFE).

2. In FY20, BOO even began paying out some of this cash to PLT's NCI and yet still excluded this pay-out from its reported FCF. If BOO had deducted this dividend payment from its 1H20 reported FCF, then this alone would have reduced reported 1H20 FCF by 11.3%.

3. BOO doesn't appear to include any tax payment within its FCF, even though its own auditor guides that this should be included. Maybe BOO sees tax as a discretionary payment?

Most recently in FY20, by excluding any tax (either £19.3m in P&L tax or £11.6m in cash tax), and including a full cash contribution from PrettyLittleThing (where we estimate £17.2m could have been attributable to PLT's NCI), <u>we calculate that BOO's true FY20 FCF was misrepresented by £32.2m or 65%</u>.

PRETTYLITTLETHING.COM (PLT)

BOO announced its acquisition of 66% of PrettyLittleThing (PLT), on 14 December 2016. The 66% of PLT was acquired for a relatively modest cash consideration of £3.3m. The remaining 34% minority interest was deemed to be used "to incentivise CEO Umar Kamani [the son of Mahmud Kamani, the founder and Chairman of BOO] and PLT's senior management". According to the latest ownership filing, Umar Kamani retains 31.5% of PLT's equity and 2.5% is held by PLT's Chief Operating Officer, Paul Papworth.

At the time of the 66% purchase of PLT, BOO highlighted that:

- PLT had grown its revenue by 400% to £17.0m in the financial year to 29 February 2016 (FY15: £3.1m);
- PLT had delivered revenue of £19.0m in the six months to 31 August 2016 (1H16: £6.4m); and
- PLT was expected to achieve revenue growth in excess of 150% in the financial year to 28 February 2017 and be broadly breakeven at the EBITDA level.

We believe it's fair to say that the addition of PLT has been a tremendous success for BOO. Within four years of its acquisition, PLT's revenue has grown to £516m in FY20. We calculate that PLT has contributed 56% to BOO's overall revenue growth in 2018-20.

In terms of profitability, by FY20, PLT was BOO's most profitable brand. We calculate that PLT accounted for 62% of BOO's reported FY20 Profit After Tax. PLT's filings show that it reported adjusted EBIT of £41.7m in FY19, as compared to boohoo.com UK reporting £32.5m and the recent addition to BOO's brands, Nasty Gal a loss of £3.1m.

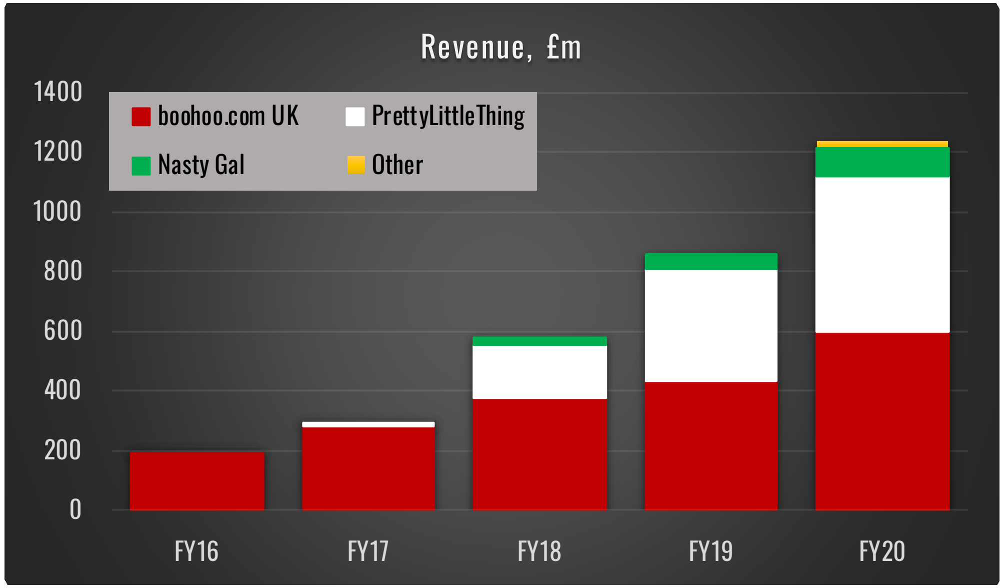

Figure 12 Revenue by brand. Source: Company filings, ShadowFall.

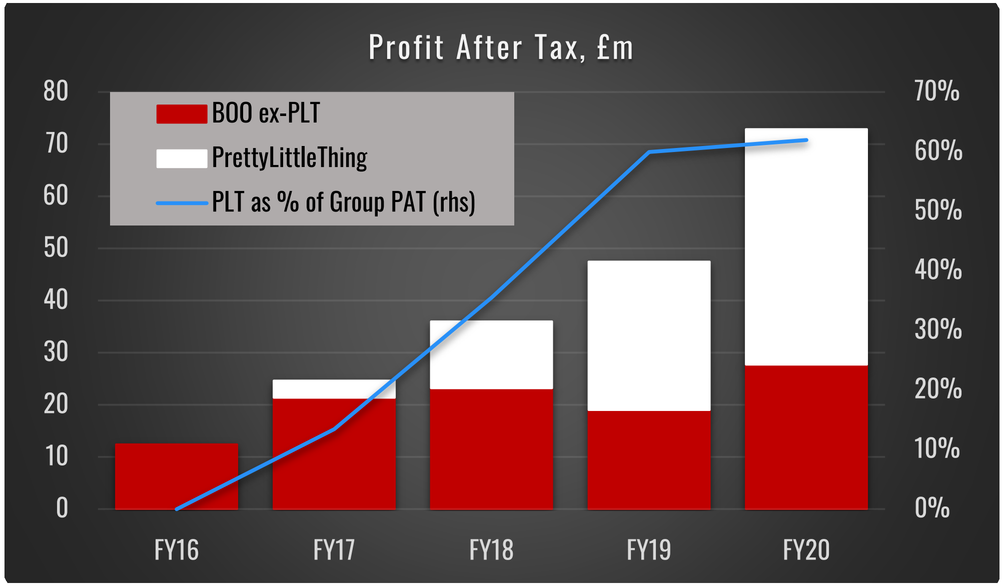

Figure 13 Adjusted EBIT by brand. Source: Company filings, ShadowFall.

Include minority cash but forget tax and minority dividends

The top half of figure 15 below, is BOO's reconciliation and presentation of its Free Cash Flow to its investors within its financial statements. An example of BOO's actual presentation from its FY20 statement is also presented in figure 16.

As can be seen from BOO's presentation, in FY20, BOO reported £81.7m in FCF (FY19: £65.1m). However, in arriving at this figure for FY20:

1. BOO adds back the P&L tax expense of £19.3m (FY19: £12.4m) but elects not to include the actual cash tax paid of £11.6m (FY19: £10.4m). In effect BOO excludes both P&L and actual cash tax paid from its calculation of its FCF. **We question if BOO's management is inclined to believe that tax payments to HMRC are a discretionary payment?**
2. BOO paid out a dividend to the NCI in PLT in 1H20 of £3.4m (FY19: £0). Clearly this cash has nothing to do with BOO's shareholders. However, BOO does not exclude this dividend payment from the £81.7m in FCF it announced to its shareholders that it achieved.

In calculating its FCF for FY20, BOO begins its calculation with Profit After Tax (PAT) of £72.9m (FY19: £47.5m). In FY20, we calculate that 62.0% or £45.2m of BOO's total PAT was attributable to PLT. BOO presents its FCF as though PLT were 100% wholly owned, however, 34% or £15.4m of PLT's PAT contribution accrues to the NCI and has nothing to do with BOO's shareholders. Considering that these earnings are due to be paid out to the PLT NCI in 2022, in our view, this is a perversion of calculating FCF; especially when there is no clarifying guidance in the notes. We note that in FY20, BOO converted 112% of its PAT into FCF. If this rate of conversion was applied to the £15.4m of PAT that had nothing to do with BOO's shareholders, then we believe that BOO has provided a misleading impression of its FCF by an additional £17.2m in FY20 (FY19: £13.3m).

In FY20, by excluding tax, whether £19.3m in P&L tax or £11.6m in cash tax, and including a full cash contribution from PLT, of which we estimate £17.2m could have been attributable to and £3.4m was attributable to PLT's NCI, we believe BOO provided a misleading impression of its FCF by £32.2m or 65%.

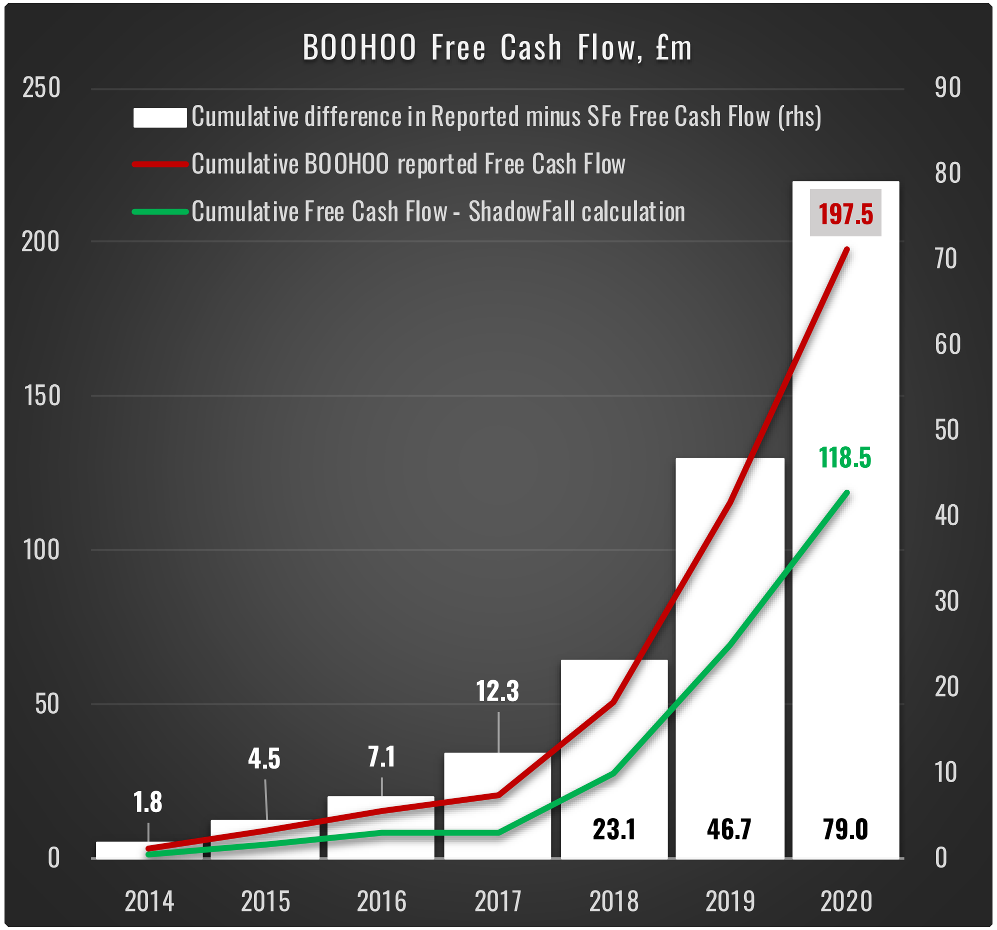

Figure 14 BOOHOO reported cumulative FCF since 2014 & cumulative FCF if tax & dividends to PLT Minority Interest had been deducted, & estimated FCF to PLT MI had been excluded in 2018 & 2019. Source: BOOHOO financial statements, ShadowFall calculations.

BooHoo Reported Free Cash Flow, £m	2014	2015	2016	2017	2018	2019	2020	Total
BooHoo Group Profit After Tax (PAT)	8.4	8.4	12.4	24.7	36.0	47.5	72.9	210.3
Depreciation charges and amortisation	1.0	2.0	3.1	4.8	11.0	13.9	24.7	
Share-based payments charge	0.0	0.3	0.6	1.9	3.3	5.3	11.0	
Loss on sale of fixed assets	-0.1	0.0	0.0	0.0	0.0	0.0	0.3	
Tax expense	2.3	2.7	3.2	6.3	7.3	12.4	19.3	
Finance income	0.1	-0.5	-0.6	-0.6	-0.8	-1.3	-1.7	
Finance expense	0.0	0.0	0.0	0.0	0.1	0.1	0.4	
Increase in inventories	-3.0	-1.4	-7.5	-11.9	-14.1	-18.6	-32.3	
Increase in trade and other receivables	-3.2	-0.5	-3.2	-4.1	-5.4	-4.9	-9.4	
Increase in trade and other payables	2.1	3.1	12.1	15.2	38.8	57.5	42.2	
Operating cash flow	**7.8**	**14.0**	**20.1**	**36.1**	**76.2**	**111.9**	**127.3**	**393.4**
Capital expenditures and intangible asset purchases	-4.6	-8.2	-13.6	-30.7	-46.4	-46.9	-45.6	-195.9
REPORTED FREE CASH FLOW	**3.1**	**5.8**	**6.5**	**5.4**	**29.9**	**65.1**	**81.7**	**197.5**
Cash tax paid	-1.8	-2.7	-2.6	-5.2	-7.2	-10.4	-11.6	-41.5
Dividends paid to non-controlling interests	0	0	0	0	0	0	-3.4	-3.4
SFe FREE CASH FLOW	**1.3**	**3.2**	**3.8**	**0.2**	**22.6**	**54.7**	**66.7**	**152.6**
Difference in Reported minus SFe FREE CASH FLOW	1.8	2.7	2.6	5.2	7.2	10.4	15.0	44.9
% Difference in Reported vs. SFe FREE CASH FLOW	**139%**	**83%**	**68%**	**2356%**	**32%**	**19%**	**23%**	**29%**
BooHoo Group Profit After Tax (PAT)	8.4	8.4	12.4	24.7	36.0	47.5	72.9	210.3
PrettyLittleThing PAT				3.3	12.8	28.4	45.2	89.7
PrettyLittleThing PAT as % of BooHoo Group PAT					35.5%	59.9%	62.0%	42.7%
34% of PLT PAT attributable to Minority Interest				1.1	4.3	9.7	15.4	30.5
BooHoo conversion of PAT to reported FCF	37.0%	69.5%	52.0%	22.0%	82.9%	137.1%	112.1%	93.9%
Estimated FCF attributable to PLT Minority Interest if same conversion as wider BooHoo Group					3.6	13.3	17.2	34.1
SFe FREE CASH FLOW IF PLT Minority Interest is deducted	**1.3**	**3.2**	**3.8**	**0.2**	**19.0**	**41.4**	**49.5**	**118.5**
Difference in Reported minus SFe FREE CASH FLOW	1.8	2.7	2.6	5.2	10.8	23.6	32.2	79.0
% Difference in Reported vs. SFe FREE CASH FLOW	**139%**	**83%**	**68%**	**2356%**	**57%**	**57%**	**65%**	**67%**

Figure 15 BOOHOO reported FCF since 2014 and FCF if tax and dividends to PLT Minority Interest had been deducted, and estimated FCF to PLT MI had been excluded in 2018 and 2019. Source: BOOHOO financial statements, ShadowFall calculations.

MARKS AND SPENCER GROUP PLC

STRATEGIC REPORT

FREE CASH FLOW (PRE SHAREHOLDER RETURNS) APM

£584.1m +39.9%

The business generated an increase in free cash flow year-on-year primarily as a result of working capital inflow, lower capital expenditure and lower interest and taxation payments.

Some businesses, such as Marks and Spencer, use the common approach to calculating its Free Cash Flow. This INCLUDES accounting for cash tax paid.

By contrast, BOOHOO seems to employ a treatment ignoring cash tax in its Free Cash Flow calculation, almost as though Her Majesty's Revenue and Customs (HMRC) is a discretionary payment choice.

boohoo group plc - final results for the year ended 29 February 2020

Liquidity and financial resources

Operating cash flow was £127.3 million compared to £111.9 million in the previous year and free cash flow was £81.7 million compared to £65.1 million in the previous financial year. We have adopted industry-leading 14-day payment terms with our key UK product suppliers. Capital expenditure and intangible asset purchases was £45.6 million, which includes a £14.9 million investment in our distribution centres to support projected growth in the business. The closing cash balance for the group was £245.4 million and the net cash balance (cash less bank borrowings), £240.7 million.

Consolidated cash flow statement

	2020 £000	2019 £000
Profit for the year	72,883	47,459
Depreciation charges and amortisation	24,650	13,921
Share-based payments charge	10,957	5,278
Loss on sale of fixed assets	294	24
Tax expense	19,339	12,397
Finance income	(1,716)	(1,320)
Finance expense	390	144
Increase in inventories	(32,301)	(18,558)
Increase in trade and other receivables	(9,434)	(4,935)
Increase in trade and other payables	42,219	57,513
Operating cash flow	127,281	111,923
Capital expenditure and intangible asset purchases	(45,562)	(46,867)
Free cash flow	81,719	65,056
Net proceeds from the issue of ordinary shares	2,665	3,653
Purchase of own shares by EBT	(14,906)	(1,833)
Proceeds from the sale of fixed assets	-	59
Finance income received	1,807	1,249
Finance expense paid	(286)	(144)
Dividend paid to non-controlling interests	(3,400)	-
Lease payments	(6,031)	-
Tax paid	(11,610)	(10,361)
Repayment of borrowings	(2,382)	(2,382)
Net cash flow	47,576	55,297

Figure 16 Comparison of Free Cash Flow accounting between Marks and Spencer Group and BOOHOO Group. Source: Company filings, ShadowFall.

BOO's auditor seems to calculate FCF differently to its client

The great irony we find in all this, is that PricewaterhouseCoopers (PwC), which has been auditor to BOO for over five years, indicates in its valuation guide that corporate taxes should be deducted in a calculation of FCF. In PwC's guide for calculating discounted FCF, PwC states (our bold for emphasis):

> *"The starting point for the determination of the free cash flows are the forecasted EBIT of the budgeted financial years.* ***First, corporate taxes are subtracted from EBIT*** *under the assumption that the company is debt-free."*

PwC guide to calculating Enterprise Value from future free cash flows

PwC specifically states that corporate taxes should first be deducted from EBIT. However, in arriving at its reported FCF, BOOHOO adds back its P&L tax to its starting point of Profit for the Period, and then seems to ignore the second step of subtracting any cash tax paid. Quite why BOO feels that tax paid should not be deducted for calculating FCF is beyond us. **Maybe BOO's management feel that tax payments to HMRC are a discretionary payment?** Either way, we find it remarkable that it goes against the definition as provided by its own auditor and are surprised that PwC would not flag this method of calculation as odd in BOO's accounts.

As figure 16 demonstrates above, BOO's definition of FCF also appears to be against its industry – and for that matter the market's – standard definition. For example, in arriving at its FCF for 2019, Marks and Spencer Group deducts taxation payments in its calculation. Maybe this is an "old fashioned" approach? Further, to be fair to some of the covering sell side analysts, they appear to amend BOO's FCF calculation to the more standard method.

pwc eValuation

DE EN

eValuation is based on the discounted cash flow method, which is characterised by a two-step approach. As a first step, the company's overall market value (i.e. enterprise value) is derived as the sum of the present values of all future financial surpluses (free cash flows) available to capital providers (i.e. equity investors and debt holders). As a second step, the market value of debt is deducted from the overall enterprise value in order to determine the market value of equity.

Derivation of the free cash flows

With eValuation, the free cash flows are derived using the "indirect method", which is based on the planned income statement and the projected balance sheet of the company to be valued.

The starting point for the determination of the free cash flows are the forecasted EBIT of the budgeted financial years. First, corporate taxes are subtracted from EBIT under the assumption that the company is debt-free. Second, to determine the free cash flows available to equity investors and debt holders, non-cash earnings and expenses are eliminated. Accordingly, capital expenditures are included while amortisation and depreciation are removed. Further changes not affecting the net income must also be taken into account, e.g. changes in net working capital.

Figure 17 PricewaterhouseCoopers derivation of Free Cash Flow. Source: PwC, ShadowFall.

STRANGER THINGS: INCONSISTENCIES AND A P&L GIMMICK?

Figure 18 Stranger Things, Winona Ryder. Source: Everett Collection Inc, Alamy Stock Photo.

BOO has the option to acquire the remaining 34% in PLT by 28 February 2022. Or is it on 14 March 2022? It depends on which section and set of BOO's financial statements you read. If it's not by 28 February 2022, then the original PLT acquisition disclosure suggests that PLT's NCI will receive a dividend for 34% of PLT's cumulative profit since acquisition.

As inconsistent, in our view, is whether any price paid for PLT's NCI, would be based on 79% or 100% of the market value if maximum performance conditions are met. Again, it depends on which set of BOO's financial statements you read.

We reckon things become stranger still in FY20. In its full year results for the year to 29 February 2020, BOO highlights a change of accounting policy for the NCI in PLT. **We believe that this restatement provides for more confusion to readers of BOO's financial statements and is nothing other than a gimmick**, which could misleadingly suggest to BOO's shareholders that they are entitled to a greater share of PLT's profits than they are due between now and February 2021. In our view, that thinking would be flawed since, as mentioned above, by 28 February 2022, PLT's NCI would apparently be due its share of total cumulative distributable reserves on a 34% basis.

THE HISTORY OF THE CALL OPTION AND TARGETS

Originally, BOO had a call option (entered on 5 March 2014) to purchase 100% of PLT for £5m before March 2017. However, when it acquired 66% of PLT, BOO highlighted that this consideration was below the fair value of the net assets of PLT due to its high growth (i.e. valuation wise this was seemingly better for BOO's shareholders). Instead of acquiring the entire 100% of PLT for a relatively low value, BOO elected to purchase 66% of PLT and leave 34% with PLT's senior management and retain the option to buy the remaining 34% later at an implied higher cost to shareholders.

Having bought 66% of PLT, BOO then revised the payment terms for this remaining 34%, from the original £5m price, to reflect a more open-ended valuation which would be determined by the market value of the equity at the time of any exercise.

PLT VALUATION FACTORS

The price payable for the remaining 34% of the equity in PLT could be 100% of the market value if the maximum performance conditions are met.

The principal factors for valuation are:

- Market value; and
- A minority interest discount factor.

Market value

Exactly how BOO will arrive at the valuation determinants for a "market value" is, in our view, somewhat unclear. In its original announcement BOO stated that this would be determined by a "Big Four accounting firm". When considering that there are three main European listed online fashion retailers, ASOS, Zalando and BOO, we believe it's likely that any Big Four accounting firm will simply refer to the prevailing market valuation of BOO or a combination of the average valuation for the three. In terms of valuation metric, obvious candidates to use would be EV to: Sales, EBITDA, or EBIT.

The minority discount factor

BOO also indicates that:

> *"The market value used in the calculation will take into account a minority interest discount of up to 30%."*

We find this somewhat ambiguous. Does this imply that the Big Four audit firm's valuation would include a minority discount and thus the market value could be higher by 42.9%, or does it imply that BOO will pay a discount for the stake? If it were a discount which would be preferable to BOO's shareholders, then why is it not more prominently highlighted by BOO?

For immediate release 14 December 2016

Trading Update and Acquisition
boohoo.com plc

"boohoo.com plc upgrades guidance and announces the acquisition of forward-thinking fashion brand PrettyLittleThing."

Acquisition of PrettyLittleThing
The boohoo Group today announces the acquisition ("the transaction") of 66% of PrettyLittleThing for a cash consideration of £3.3 million. The transaction is expected to complement the Group's presence both in the UK and internationally.

Transaction Highlights:

- The 34% retained by PLT management will be subject to the management team remaining with PLT over the five-year period to 28 February 2022, and achieving demanding revenue and EBITDA targets
- At 28 February 2022, the boohoo Group will have the option to acquire this remaining 34% at market value[3]

Notes
1. The transaction is expected to complete on 3 January 2017.
2. PLT revenue is unaudited, and on an annualised basis.
3. The market value for the remaining 34% will be determined by a Big Four accounting firm. The consideration will be satisfied in cash and/or boohoo Group shares at the discretion of the Group Board. A reduced consideration will be payable if Umar and the management team do not meet the necessary retention and performance criteria. If the boohoo Group does not exercise the option to acquire the remaining 34% of PLT by 28 February 2022, a dividend of up to all of the PLT distributable reserves at that time will be payable to all PLT shareholders including boohoo, pro rata to their shareholdings.

Figure 19 Announcement of acquisition of 66% of PrettyLittleThing. Source: Company filings, ShadowFall.

The inconsistencies in the filings

Within BOO's and its subsidiary filings, we find several inconsistencies regarding the timing and cost of exercising the call option for PLT.

For example:

Inconsistency 1

- In December 2016, the time of its announcement of the acquisition of 66% of PLT, BOO indicated that it had the option to acquire the remaining 34% in PLT **by 28 February 2022**.
- In its 2017 annual filing, BOO indicates that it can acquire the remaining 34% PLT **on 14 March 2022**.
- The 2018 filing indicates that it can acquire 34% of PLT at **any time after 28 February 2022**.
- As does the 2019 filing state **any time after 28 February 2022**.
- However, also in the 2019 filing it states it can acquire the remaining 34% **on 14 March 2022**.

It is unclear to us why BOO's filings are so inconsistent and ambiguous as to when the option can be exercised. However, the ambiguity of timing may have something to do with a pay-out of retained earnings within PLT to the minorities by way of dividend ahead of any exercise of the option (see the next section on: **Significant Dividend's to PrettyLittleThing's Non-Controlling Interests**.

Inconsistency 2

In BOO's 2018 annual filing, it highlights the details of any share-based payment charge should the option to acquire the remaining 34% of PLT be exercised at any time after 28 February 2022. PLT states that (our bold):

> *"The price payable for the shares could be based on 34% of £1.9 million plus either* ***79% of the market value if maximum performance conditions*** *are met or 74% of the market value if none of the performance criteria are met."*

However, a year later, in BOO's 2019 annual filing, it highlights:

> *"The price payable for the shares could be based on* ***100% of the market value if maximum performance conditions are met****, or £0.6 million plus 74% of the market value if none of the performance criteria are met."*

Seemingly in between 2018 and 2019, **the price to pay rose from 79% to 100% of the market value!** It is unclear to us why or how the price rose, effectively by 26.6% within a year. We would have assumed that the terms of the buy-out would have remained consistent.

boohoo

Trading Update and Acquisition

Released : 14/12/2016 07:00

RNS Number : 7639R

boohoo.com plc

14 December 2016

Notes

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2. PLT revenue is unaudited, and on an annualised basis.
3. The market value for the remaining 34% will be determined by a Big Four accounting firm. The consideration will be satisfied in cash and/or boohoo Group shares at the discretion of the Group Board. A reduced consideration will be payable if Umar and the management team do not meet the necessary retention and performance criteria. If the boohoo Group does not exercise the option to acquire the remaining 34% of PLT by 28 February 2022, a dividend of up to all of the PLT distributable reserves at that time will be payable to all PLT shareholders including boohoo, pro rata to their shareholdings.

BOOHOO.COM PLC / ANNUAL REPORT AND ACCOUNTS 2017

The company has an option to buy the non-controlling interest of 34% of the share capital of PrettyLittleThing.com Limited (formerly 21Three Clothing Company Limited) on 14 March 2022 for market value or less, subject to performance criteria. Umar Kamani, the son of Mahmud Kamani, joint CEO and director of boohoo.com plc, is a director and shareholder of PrettyLittleThing.com Limited.

ANNUAL REPORT AND ACCOUNTS 2018 / BOOHOO.COM PLC 75

Share-based payment charge for option to acquire shares in PrettyLittleThing

Under the terms of the Shareholders Agreement relating to 21 Three Clothing Company Limited (company name now changed to PrettyLittleThing.com Limited) (PLT), boohoo.com plc has the option to acquire the remaining 34% of the share capital of PLT at any time after 28 February 2022. As there are performance conditions that determine the price boohoo will pay for the shares, if the option is exercised, this gives rise to a share-based payments charge in the accounts of PLT and hence in the group accounts also. This charge is not for the issue of shares in boohoo.com plc but for the shares that are already held by the directors of PLT and which boohoo has the option to acquire at the end of the option period in 2022 or sooner if the directors leave or default. The price payable for the shares could be based on 34% of £1.9 million plus either 79% of the market value if maximum performance conditions are met or 74% of the market value if none of the performance criteria are met. Performance between minimum and maximum is calculated on a pro-rata basis. The performance criteria are a range of EBITDA targets and sales targets as follows:

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23 SHARE-BASED PAYMENTS CONTINUED

Share-based payment charge for option to acquire shares in PrettyLittleThing

Under the terms of the Shareholders Agreement relating to 21Three Clothing Company Limited (company name now changed to PrettyLittleThing.com Limited) ("PLT"), boohoo group plc has the option to acquire the remaining 34% of the share capital of PLT at any time after 28 February 2022. As there are performance conditions that determine the price boohoo will pay for the shares, if the option is exercised, this gives rise to a share-based payments charge in the accounts of PLT and hence in the group accounts also. This charge is not for the issue of shares in boohoo group plc, but for the shares that are already held by the directors of PLT and which boohoo has the option to acquire at the end of the option period in 2022, or sooner if the directors leave or default. The price payable for the shares could be based on 100% of the market value if maximum performance conditions are met, or £0.6 million plus 74% of the market value if none of the performance criteria are met. Performance between minimum and maximum is calculated on a pro-rata basis. The market value used in the calculation will take into account a minority interest discount of up to 30%. The performance criteria are a range of EBITDA targets and sales targets as follows:

The company has an option to buy the non-controlling interest of 34% of the share capital of PrettyLittleThing.com Limited (formerly 21Three Clothing Company Limited) on 14 March 2022 for market value or less, subject to performance criteria. Umar Kamani, the son of Mahmud Kamani, Executive Chairman and director of boohoo group plc, is a director and shareholder of PrettyLittleThing.com Limited. Related party transactions are considered to be on arm's length commercial terms.

Option to acquire the remaining 34% of PLT:

Orginal announcement states BY 28 February 2022.

2017 annual filing says ON 14 March 2022.

2018 annual filing says AT ANY TIME AFTER 28 February 2022.

Meanwhile if all performance criteria are met:

2018 filing states price payable for shares is 79% of the market value.

2019 annual filing says AT ANY TIME AFTER 28 February 2022.

2019 filing states price payable for shares is 100% of the market value.

BUT ALSO ...

says ON 14 March 2022.

Figure 20 The range of exercise dates available to BooHoo to acquire the remaining 34% of PrettyLittleThing.com. Source: BooHoo Plc filings, ShadowFall.

A STRANGE TURN OF EVENTS

By the time of the FY20 results, announced on 22 April 2020, BOO restates its accounting for PLT's NCI, highlighting:

> *Following a review of the accounting treatment of the non-controlling interest of shareholders in PrettyLittleThing.com Limited [PLT], it has been determined that the restrictions imposed by the Shareholders' Agreement require the proportion of the non-controlling interests' share of the profits of PLT to accrue in accordance with certain terms of the agreement and not as 34% as previously stated. The accumulated profit attributable to non-controlling interests of £8,761,000 as at 28 February 2018 has been adjusted to £4,018,000 and the share of profits for the year to 28 February 2019 from £9,687,000 to £3,875,000 and the difference added to retained earnings. The share of profits recognised by the non-controlling interest increases each year by 20% of 34% of the earnings of PLT from 20% of 34% to 100% of 34% over the five-year period of the agreement, as does the non-controlling interests' share of the net assets.*
>
> *Basic earnings per share of boohoo group plc in 2019 has changed from 3.27p to 3.78p and diluted earnings per share from 3.22p to 3.71p. The adjusted diluted earnings per share is calculated on the same basis as in previous years at 34% of the net assets and profits, reflecting the fact that the reported non-controlling interest will accumulate to 34% at the end of the five-year period of the Shareholders' Agreement in February 2022.*

This seems to us to be a strange turn of events for the following reasons:

1. It is odd that this restatement is implemented some three years after a controlling interest in PLT was acquired. Surely BOO would have understood the accounting treatment from the point of acquisition?
2. Section 15.2 of the Resolutions filed for PrettyLittleThing indicates that although BOO holds 660 of the A shares in PLT and Mr Umar Kamani and Mr Paul Papworth hold 315 B shares and 25 B shares respectively, that (our bold for emphasis):

   > ***On a return of capital on liquidation or capital reduction or otherwise, the surplus assets of the Company remaining after the payment of its liabilities shall be distributed*** *first in the repayment to the C Ordinary Shares [Paul Papworth holds 28 C shares] of their Issue Price and then* ***amongst the holders of the A Ordinary Shares and the B Ordinary Shares pari passu as if the same <u>constituted one class of Share in proportion to the number of Shares</u> held by them in the Company****. The holders of the C Ordinary Shares shall have no other rights to participate in the surplus assets of the Company.*

3. On 10 May 2019, PLT announced a dividend (see figure 22 below). This dividend was for £10m. In 1H20, a £3.4m dividend was paid in cash to the PLT NCI. Hence, the PLT NCI is benefiting as of now from the returns of PLT in accordance with its 34% equity interest.
4. By February 2022, all the distributable reserves of PLT can be distributed to PLT's shareholders on a pro rata basis. Hence, between now and February 2022, if more dividends are paid out then presumably this will again be on a 66%/34% weighting. If not, then by February 2022, PLT's NCI ends up with 34% of the accumulated profits anyway.

We believe that this restatement provides for more confusion to BOO's shareholders and is nothing other than a gimmick, which could misleadingly suggest to BOO's shareholders that they are entitled to a greater share of PLT's profits than they are due between now and February 2022.

Significant Dividends to PrettyLittleThing's Non-Controlling Interest

(aka the Son of BOO's Chairman)

Figure 21 Source: Jim Corwin, Alamy Stock Photo

According to the original disclosure of the PLT acquisition, BOO is liable to pay a dividend to PLT's NCI in proportion to the NCI share of PLT's distributable reserves by February 2022. **We calculate that this dividend payment to PLT's NCI could be at least £77m by FY22.** And yet as highlighted above, in the present, BOO includes all the cash generation from PLT's profit in its BOO's FCF statement as though PLT were 100% wholly owned.

As of FY20, we calculate that c. £27m in dividends is already due to PLT's NCI. In 1H20, a £3.4m dividend was already paid; an 88% pay-out ratio of the NCI FY19 earnings. Meanwhile ZERO dividends are paid to BOO's shareholders. **We're unconvinced that this potential large dividend pay-out is realised by the market.**

While BOO's shareholders neither receive dividends nor other capital returns, they may be heartened to see so much cash being built up on BOO's balance sheet. Recently this was boosted by a £197.7m cash call. However, in the light of any further NCI related dividend pay-outs, we believe that **there is a risk that BOO's sizeable cash pile is merely sat there, and its recent cash call doesn't get used, until later to cover these PLT NCI dividend disbursements in cash.**

Zero dividends for shareholders, but Non-Controlling Interests? Well that's different.

Ahead of any potential buy-out by BOO of PLT's NCI, according to the original disclosure of the PLT acquisition, if the option to acquire is not exercised by 28 February 2022, then a dividend of up to all of PLT's distributable reserves could be paid to its shareholders on a pro rata basis. In the original announcement of the acquisition of 66% of PLT, this was detailed as follows (our bold):

> *"If the boohoo Group does not exercise the option to acquire the remaining 34% of PLT **by 28 February 2022, a dividend of up to all of the PLT distributable reserves at that time will be payable to all PLT shareholders including boohoo, pro rata to their shareholdings.**"*

However, as highlighted above, we believe that BOO's disclosures since the original announcement are somewhat ambiguous. These disclosures either state that BOO can acquire 34% of PLT at any time after 28 February 2022, or that BOO can acquire the remaining 34% on 14 March 2022. Either way, it doesn't seem to us that BOO will be acquiring the PLT NCI by 28 February 2022, suggesting that PLT's NCI will be due a significant cash dividend pay-out. We believe this could be at least £77m by FY22E (detail below). We're unconvinced this potential sizeable cash disbursement has been recognised by the market.

PLT's NCI starts receiving dividends

It doesn't appear to us that BOO is waiting to pay these dividends to its NCI. In 1H20, PLT paid its maiden dividend, although this wasn't to BOO's shareholders. PLT declared a dividend of £10m in May 2019 and BOO paid 34% of this to PLT's NCI in 1H20, and no dividends were paid to BOO's shareholders.

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On 10 May 2019 the Directors approved a dividend of £10,000,000 (£10,000 per share) (year ended 28 February 2018: £nil).

Figure 22 PrettyLittleThing.com dividend. Source: PLT filings, ShadowFall.

PLT declared a dividend of £10m in May 2019, of which 34% was paid to BOO's Non-Controlling Interest. BOO shareholders received zero dividend. Curiously, BOO's FCF is stated without accounting for this £3.4m dividend payment to Non-Controlling Interest.

Consolidated cash flow statement

	6 months to 31 August 2019 £000	6 months to 31 August 2018 £000
Profit for the period	36,075	19,830
Depreciation charges and amortisation	11,807	6,477
Share-based payments charge	4,355	2,464
Tax expense	9,076	4,867
Finance income	(770)	(577)
Finance expense	196	79
Increase in inventories	(27,084)	(5,054)
Increase in trade and other receivables	(16,397)	(17,569)
Increase in trade and other payables	38,630	45,216
Operating cash flow	55,888	55,733
Capital expenditure and intangible asset purchases	(6,449)	(31,185)
Acquisition of new brands (intangible assets)	(19,370)	-
Free cash flow	30,069	24,548
Proceeds from the issue of ordinary shares	771	2,087
Purchase of own shares by EBT	(4,809)	-
Finance income received	740	495
Finance expense paid	(70)	(79)
Dividend paid to non-controlling interests	(3,400)	-
Lease payments	(2,798)	-
Tax paid	(3,792)	(4,546)
Repayment of borrowings	(1,191)	(1,191)
Net cash flow	15,520	21,314

Figure 23 BOO 1H20 Cash Flow Statement. Source: BOOHOO filings, ShadowFall.

88% DIVIDEND PAY-OUT TO NCI

In 1H20 BOO paid cash dividends of £3.4m to NCI. Following the NCI restatement within the FY20 results, profit attributable to NCI totalled £3.875m in 2019. This represents a pay-out ratio of 88%.

We find it odd that the NCI receives an 88% dividend pay-out from its share of PLT's earnings and yet BOO's shareholders receive zero in dividends whilst the company continues to pile up net cash and raise further cash from the market.

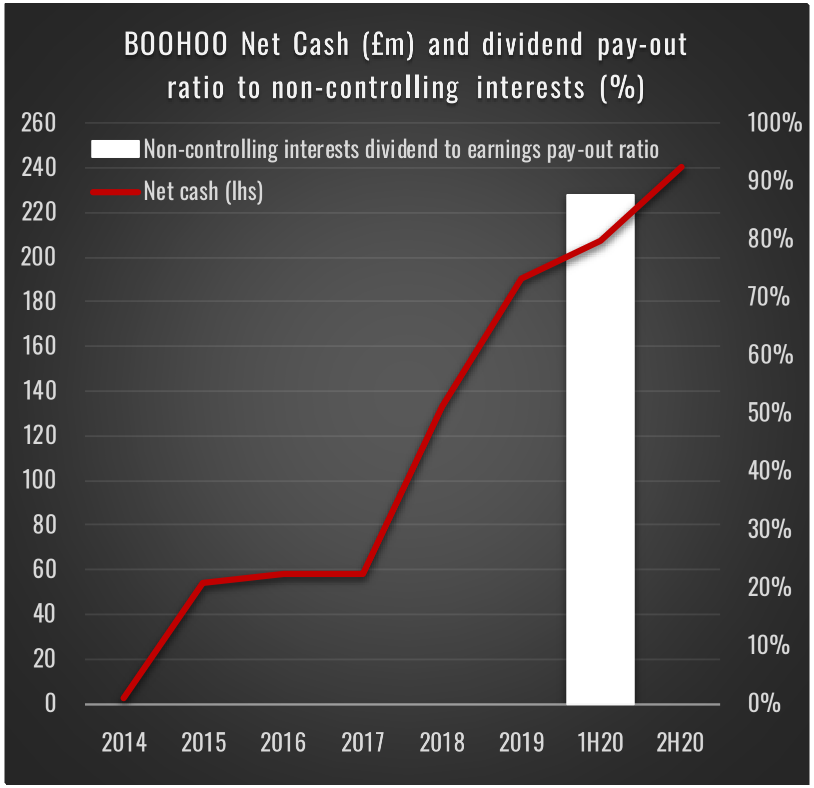

Figure 24 BOOHOO net cash position and dividend to earnings pay-out ratio to non-controlling interests. Source: BOOHOO financial statements, ShadowFall calculations.

A POTENTIAL £77M OR 20% OF GROUP NET CASH TO NCI

As of FY19, PLT reported retained earnings of £43.9m. We believe that consensus is projecting PLT's EBITDA to rise to c. £99m by FY22E. On this basis, we calculate that PLT's retained earnings would be c. £227m by FY22E (see figure 26). In this event, PLT's NCI could be due dividends of c. £77m. A pay-out of this magnitude would equate to 16% of Bloomberg consensus forecast FY22E net cash. We do not believe this has been factored in by the market. However, as highlighted above, BOO has already started paying out some of PLT's retained earnings as dividends to the NCI.

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Statement of financial position
at 28 February 2019

	Note	2019 £000	2018 £000
Equity			
Called up share capital	14	-	-
Retained earnings		43,910	13,628
Total equity		43,910	13,628

Figure 25 PrettyLittleThing.com retained earnings and ShadowFall projections. Source: PLT filings, Bloomberg L.P., ShadowFall.

PrettyLittleThing retained earnings, £m	2017	2018	2019	FY2020E	FY2021E	FY2022E
EBITDA	3.5	16.5	36.4	58.5	77.3	99.2
Operating profit	3.3	16.1	35.1	56.3	74.4	95.5
Profit before tax	3.3	16.1	35.3	56.3	74.4	95.5
Tax	(0.0)	(3.4)	(6.9)	(10.7)	(14.1)	(18.1)
Tax rate	0.8%	20.8%	19.5%	19.0%	19.0%	19.0%
Profit after tax	3.3	12.8	28.4	45.6	60.3	77.3
Retained earnings	(0.4)	13.6	43.9	89.5	149.8	227.1
34% of retained earnings	**(0.1)**	**4.6**	**14.9**	**30.4**	**50.9**	**77.2**
Group net cash	58.4	133.0	190.7	358.7	439.3	479.7
% of group net cash	**na**	**3%**	**8%**	**8%**	**12%**	**16%**

Figure 26 PrettyLittleThing.com retained earnings and ShadowFall projections. Source: PLT filings, Bloomberg L.P., ShadowFall.

THE BIG COST FOR THE BUY-OUT OF PRETTYLITTLETHING'S NON-CONTROLLING INTEREST?

(AKA THE SON OF BOO'S CHAIRMAN)

Figure 27 LOS ANGELES, CA, USA - FEBRUARY 20: Ashley Graham, Co-Founder and CEO of PrettyLittleThing Umar Kamani and Khloe Kardashian. (Photo by Xavier Collin/Image Press Agency). Source: Image Press Agency, Alamy Stock Photo.

BOO has an option to acquire the 34% Non-Controlling Interest (NCI) in PrettyLittleThing (PLT) at a "market value" by 2022.

This "market value" will be determined by a "Big Four accounting firm".

If PrettyLittleThing were acquired at the average market multiple of BOO and its peers, ASOS and Zalando, are valued at, then this cost to buy-out the NCI could be c. £929m. Maybe the reason why BOO continues to build up so much cash and is not distributing it to its shareholders is so that it can settle the PLT dividends and potential buy-out due to the NCI with as much cash as possible?

At a share price of 360p per share, we calculate that to buy-out the PrettyLittleThing Non-Controlling Interest could lead to BOO being left with zero net cash and further dilution to shareholders.

THE PERFORMANCE CRITERIA FOR THE AWARD VALUATION APPEARS TO BE A "*SHOO*-IN"

In terms of the cost for any buy-out of PLT's NCI, we believe it is likely that it will be in line with the maximum performance conditions being met.

The performance criteria for the price of PLT is set out in figure 29.

This performance criteria centres on revenue and EBITDA targets.

When considering that in FY19, PLT reported revenue of £374m (2018: £181m) and adjusted EBIT of £41.7m (2018: £16.1m), we believe that it is safe to assume that the maximum performance conditions of sales of £155m and EBITDA of £8.1m by FY22 will be met.

Hence, the buy-out cost of PLT's NCI will likely be 100% of the "market value".

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The market value used in the calculation will take into account a minority interest discount of up to 30%. The performance criteria are a range of EBITDA targets and sales targets as follows:

	Minimum threshold		Maximum threshold	
Fiscal year ending	EBITDA	Sales	EBITDA	Sales
28/02/2018	£2,462,000	£57,789,000	£2,645,000	£62,412,000
28/02/2019	£3,201,000	£69,347,000	£3,702,000	£81,136,000
29/02/2020	£4,001,000	£79,749,000	£4,998,000	£101,420,000
28/02/2021	£4,801,000	£91,711,000	£6,498,000	£126,775,000
28/02/2022	£5,522,000	£100,882,000	£8,122,000	£154,665,000

	Year ended 28 February 2019	Year ended 28 February 2018
	PLT £000	PLT £000
Revenue	**374,445**	181,269
Cost of sales	**(162,687)**	(81,175)
Gross profit	**211,758**	100,094
Distribution costs	**(90,000)**	(40,661)
Exceptional distribution costs	**(6,162)**	
Segment result	**115,596**	59,433
Administrative expenses – other	–	–
Exceptional administrative expenses	–	–
Amortisation of acquired intangibles	–	–
Other income	–	
Operating profit	–	–
Finance income	–	–
Finance expense	–	–
Profit before tax	–	–

Figure 28 Performance criteria for minimum and maximum pay-out to 34% shareholders in PLT. Source: BooHoo Plc 2019 financial statements, ShadowFall.

THE £200M CASH CALL … AND HOW MIGHT BOO PAY IF IT ACQUIRES THE NON-CONTROLLING INTEREST IN PLT?

BOO has built up a sizeable net cash pile of £241m over recent years.

On 14 May 2020, BOO announced its intention to raise approximately £200m and a day later announced it had managed to raise gross proceeds of £197.7m.

Despite BOO reporting net cash of £241m as at 29 February 2020, BOO felt it needed a further £200m in order to "take advantage of numerous opportunities **that are likely to emerge** in the global fashion industry over the coming months." We place an emphasis on the term "likely to emerge", suggesting that opportunities are yet to emerge.

We find it odd that even though BOO held £241m in net cash, it required a further £200m for such opportunities. Further, should such opportunities ever emerge, then given the group's sizeable cash balance, we believe that it would have been more beneficial for BOO to tap into this or to use either debt or its own paper to conduct any M&A.

In our view, there's a risk that if few opportunities emerge, then BOO might end up using a significant portion of its net cash and the proceeds of its £197.7m equity raise to fund the dividend pay-out to and buy-out of the PLT NCI.

Meanwhile, BOO pays no dividend to its shareholders and since it has just raised cash, will presumably continue to steer towards zero dividends for some time. The sizeable cash balance will remain sat on its balance sheet earning a negligible return until its either spent or distributed. However, some of the cash has begun to be distributed, although not to BOO's shareholders.

BOO started paying a dividend to PLT's NCI in 1H20 of £3.4m. As detailed above, this looks to be the initial disbursement on what we calculate could be at least £77m in dividends due to PLT's NCI by FY22.

IN THIS LIFE, ONE THING COUNTS….

BOO's net cash position has significantly risen over recent years, rising from £2.7m in FY14, to £241m by FY20.

Prior to BOO's 15 May 2020 cash call for £197.7m, Bloomberg consensus projected this net cash pile rising even further over the next few years, to c. £379m by FY22E. As analysts begin to update their net cash forecasts over the next few weeks to account for the £197.7m equity raise, we expect consensus net cash projections to rise, most likely to over half of the total it would cost to settle any dividends due to and to buy-out PLT's NCI.

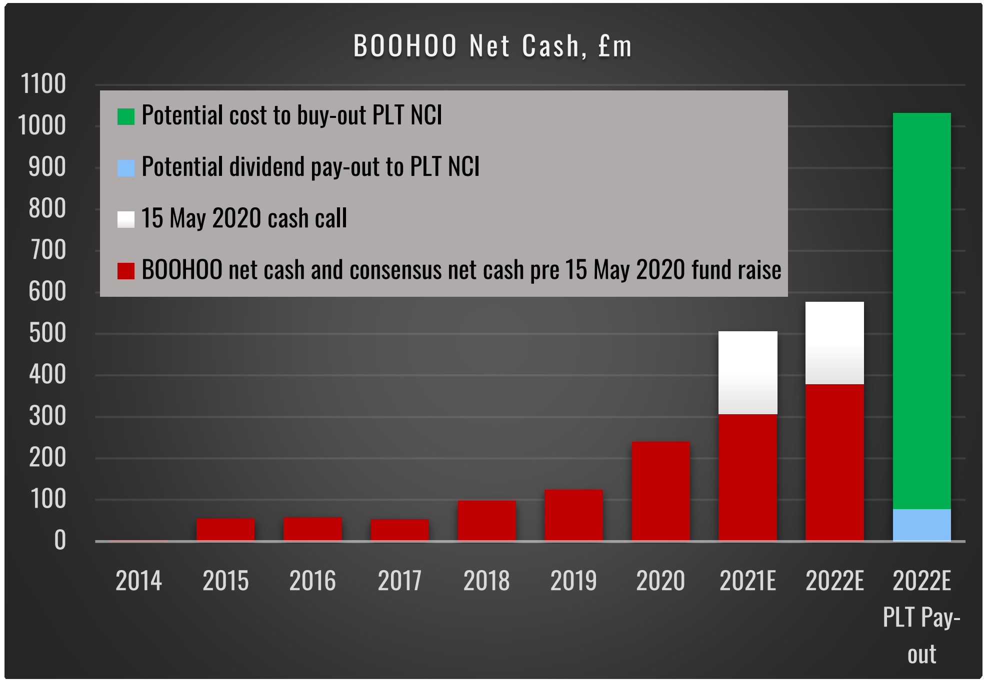

Figure 29 boohoo net cash and consensus net cash FY21E-22E pre-equity raise. Source: boohoo, Bloomberg Finance L.P., ShadowFall.

POTENTIAL NET CASH IMPACT AND DILUTION FROM PLT NCI BUY OUT

BOO currently trades on FY20 consensus EV to Sales and EV to EBIT multiples of 3.2x and 40.5x respectively. These multiples fall to 2.3x and 28.0x respectively for FY22E consensus.

For PLT, we believe the market is factoring in FY22E sales and EBIT of c. £790m and c. £87m respectively.[4]

In terms of its peers, BOO, ASOS, and Zalando are valued at an average 31.3x FY22E EBIT.

If PLT achieves £87m in EBIT by FY22 and this is valued at a 31.3x multiple, then this would imply that PLT would be valued at £2,709m. The PLT NCI of 34% would be £921m of this valuation.

The PLT NCI would be due its full pro rata share of retained earnings in PLT by February 2022 (estimated at £77m).

By FY22, if BOO decides to purchase the PLT NCI, then combined with the potential dividends due to PLT's NCI, this could cost c. £1 billion.

To put this into context, we calculate that this would equate to a multiple of 15 times BOO's FY20 FCF to settle these potential costs to PLT's NCI.

In this event, we believe that BOO's shareholders would need to be confident that PLT's relatively high margins are sustainable and that significant barriers exist to limit PLT's competition. We question both these assumptions in the following sections.

BooHoo and listed peers' valuations	EV/EBIT			
Company	**FY19**	**FY20E**	**FY21E**	**FY22E**
BooHoo	55.4	40.5	39.4	28.0
ASOS	80.1	-	37.3	24.7
ZALANDO	61.4	127.2	56.4	41.0
Average	**65.7**	**83.8**	**44.4**	**31.3**

PrettyLittleThing.com	FY19	FY20	FY21E	FY22E
PLT sales, £m	**374.4**	**516.3**	**629.9**	**787.4**
PLT sales growth, %YoY	106.6%	37.9%	22.0%	25.0%
PLT sales as % of total BooHoo sales	43.7%	41.8%	43.3%	43.0%
PLT EBIT, £m	**41.7**	**56.5**	**69.3**	**86.6**
PLT EBIT margin, %	11.1%	10.9%	11.0%	11.0%
PLT EBIT as % of total BooHoo EBIT	55.6%	52.8%	65.6%	58.4%
PLT valuation based on average of BooHoo and peer EV/EBIT valuations, £m	2,741.2	4,736.0	3,074.9	2,708.6
Value of 34% PLT non-controlling interest, £m			**1,045.5**	**920.9**
Dividends due to PLT non-controlling interest, £m	**14.9**	**30.4**	**50.9**	**77.2**
Total dividends due to and potential acquisition cost of PLT non-controlling interest, £m			**1,096.4**	**998.2**

SFe Free Cash Flow	**54.7**	**66.7**		
Multiple of 2020 FCF to settle dividends due to and acquire PLT non-controlling interest				**15.0**

Actual	Forecast

Figure 30 Valuation scenarios for PrettyLittleThing.com. Source: BooHoo filings, Bloomberg Finance L.P., ShadowFall.

[4] For example an 11 Feb 2020 note from an investment bank with an Overweight rating, forecasts PLT as achieving base case EBITDA of FY21E £77.3m, FY22E £99.2m, upside EBITDA of FY21E £82.4m, FY22E £109.8m, and Blue sky EBITDA of FY21E £87.6m, FY22E £121.1m. There is little Depreciation and Amortisation associated with PLT since as of 2019 its PPE totalled a mere £6.0m and intangible assets were £0.7m.

CONSENSUS CONFUSION

Broker notes from several Sell Side analysts on BOO are available to download from Bloomberg Finance L.P. When we read these notes, we were surprised to find that the brokers appear to NOT recognise that BOO is likely to have to pay-out a dividend by 2022 of up to all of PrettyLittleThing's distributable reserves on a pro-rata basis to its NCI.

For example, in one Sell Side analyst's model, the analyst already appears to forecast these distributable reserves to PLT's NCI will be £72.7m by FY22.

However, regarding the dividends associated with this, which would be scheduled to be distributed, the analyst might be factoring this into the cash flow for FY23, since any corresponding cash outflows are not reflected in the analyst's cash flow forecast for FY22. **Note:** unfortunately, the analyst's model only runs to FY22!

This inclusion of PLT's cash contribution to BOO's FCF but omission of recognising that eventually the PLT profit will be distributed on a 34% basis in the form of a dividend to the NCI, seems to be reflected by several Sell Side analysts.

Segment from a Sell Side analyst's Income Statement forecast for BOO relating to PrettyLittleThing Non-Controlling Interest (NCI)

Adjusted Profit After Tax (PAT)		**2017A**	**2018A**	**2019A**	**2020A**	**2021E**	**2022E**
Full Group	£m	25.1	42.3	60.8	86.0	86.6	116.3
Attributable to:							
Shareholders	£m	21.3	376.0	48.8	69.9	70.2	94.2
Non-controlling interest (PLT)	£m	3.8	4.7	12.0	16.0	16.5	22.1
Implied total PAT for PLT	£m	11.2	13.8	35.3	47.1	48.5	65.0
Implied PLT PAT as % of Full Group PAT	%		33%	58%	55%	56%	56%

Analyst's forecasts for PrettyLittleThing's NCI		**2017A**	**2018A**	**2019A**	**2020A**	**2021E**	**2022E**
PLT reported retained earnings attributable to PLT NCI	£m	(0.1)	4.6	14.9	30.4		
Increase in retained earnings attributable to PLT NCI on basis of Analyst's forecast	£m					16.5	22.1
Implied retained earnings attributable to PLT NCI	£m	(0.1)	4.6	14.9	30.4	46.9	69.0

Segment from a Sell Side analyst's Balance Sheet Statement forecast for BOO relating to PrettyLittleThing NCI

		2017A	**2018A**	**2019A**	**2020A**	**2021E**	**2022E**
Equity attributable to PLT NCI	**£m**	**4.0**	**8.8**	**19.1**	**32.1**	**49.8**	**72.7**

Segment from a Sell Side analyst's Cash Flow Statement forecast for BOO relating to PrettyLittleThing NCI

		2017A	**2018A**	**2019A**	**2020A**	**2021E**	**2022E**
Full Group Free Cash Flow	£m	(1.2)	22.6	54.7	89.5	62.0	103.1
Dividends paid to PLT NCI	**£m**	**-**	**-**	**-**	**(3.4)**	**-**	**-**

The analyst appears to understand that PrettyLittleThing earns income attributable to a non-controlling interest (NCI). However, the analyst doesn't seem to appreciate that this income accumulates as distributable reserves, which ultimately will be paid to PLT's NCI as a dividend. Indeed, in FY20, the PLT NCI received some of these distributable reserves in the form of a £3.4m dividend.

However, the analyst seems to see this as a one-off and doesn't factor in to their cash flow forecast that if BOO does not acquire the PLT NCI, then these distributable reserves become due to be paid in FY22. Perhaps the analysts assumes that this will be paid out in FY23? Either way, the £3.4m dividend already paid to PLT's NCI in FY20, is not reflected in the analyst's calculation of FCF.

Meanwhile, the analyst appears to calculate BOO's FCF as though PLT was wholly owned and doesn't take into account that eventually, 34% of PLT's accumulated profit will be paid out to the NCI.

We note that the analyst's implied distributable reserves to PLT's NCI is £72.7m by FY22, which is close to our forecast.

Figure 31 A Sell side analyst's forecast for PrettyLittleThing's Minority Interest (NCI). Source: Sell side broker note from 15 May 2020, Company filings, ShadowFall.

~~Hoo~~ Who Wears the Costs?

Figure 32 boohoo website under spyglass. Source: Louise Svennson, Alamy Stock Photo

PrettyLittleThing achieves, in our view surprisingly, far superior EBIT margins as compared to other BOO group entities, and even more noticeably to its much larger peers, such as ASOS and Zalando. Part of PLT's margin supremacy is driven by a higher gross margin. However, the real advantage appears to us to be down to PLT administering and delivering orders to its customers at a much lower cost. Since PLT was acquired by BOO, these costs have significantly fallen. Also, since it was acquired, PLT began paying to boohoo.com UK, payments regarding distribution and administrative costs. Effectively boohoo.com UK is fulfilling distribution and administrative functions on behalf of PLT and is then being reimbursed for these costs. But is PLT paying boohoo.com UK enough?

We calculate that if PLT's total distribution and administrative costs per order were in line with those of the wider BOO group, then its EBIT would have been £10.7m lower and its EBIT margin would have been 8.3% as compared to a reported 11.1% in FY19.

If PLT's NCI were bought-out today at BOO's current multiple, we calculate that this £10.7m of costs being absorbed by other BOO entities **could result in an additional £193m in value paid to PLT's NCI for no other reason than other BOO entities absorbing some of PLT's costs which should instead be attributable to PLT.** We suppose that if not used on M&A, then the recent £197.7m cash call would prove useful in settling this.

If BOO is now paying dividends to PLT's NCI and might be asked to buy out that NCI on the basis of PLT's relative profit supremacy, then we believe BOO's shareholders had better be sure that PLT's super profits are sustainable and not bolstered by a subsidy from other entities in the BOO group.

~~Hoo~~ Who wears the costs?

In 2019, 81% or £26.3m of boohoo.com UK's (BOO's initial core business) total operating profit stemmed from other income which came from PLT. This related to PLT related distribution and administrative costs which were covered by boohoo.com UK for which boohoo.co UK was reimbursed by PLT.

boohoo.com UK is wearing some of PLT's costs. But is boohoo.com UK being reimbursed enough? We question this, as since PLT was acquired, boohoo.com UK's operating margin has declined, from 10.5% in 2017 to 7.5% in FY19. Meanwhile, PLT's operating margin has risen from 7.0% in FY17 to a group and peer leading 11.1% in FY19. PLT's profitability as a stand-alone entity will undoubtedly be a key factor in determining its valuation in the event of a buy-out of the NCI. And in early FY22, BOO's shareholders may be asked to fund the buy-out the NCI in PLT. We believe that BOO's shareholders should be confident that boohoo.com UK isn't wearing too many costs on behalf of PLT.

The Reimbursements

PTL's growth has been remarkable. Whereas boohoo.com UK, the initial core business of BOO, took seven years to grow from £24m in revenue to £374m, PLT achieved growth of a similar order within just three years. In terms of profit, PLT's progression has, in our view, been even more astonishing. PLT's profitability surpassed that of boohoo.com UK in FY19, with its EBIT rising from £16.1m in FY18 to £41.7m in FY2019. By contrast, **boohoo.com UK's EBIT declined**, from £34.6m in FY18 to £32.5m in FY19. Boohoo.com UK failed to demonstrate the operational gearing it has typically enjoyed in the past.

BOO acquired its 66% interest in PLT in December 2016. From 2016, BOO's subsidiary, boohoo.com UK, began receiving other income in the form of "income from warehouse management services" and "income from central management services" from PLT. Initially at £1.0m in 2016, by 2019, this had risen to £26.3m in other income from PLT.

For some unobvious reason to us, since BOO acquired PLT, boohoo.com UK has become considerably less profitable. This decline in profitability has also occurred since boohoo.com UK began being reimbursed by PLT for fulfilling some of PLT's administrative and distribution functions. The significant deterioration in boohoo.com UK's profitability leads us to question whether the reimbursement that PLT pays to boohoo.com UK sufficient to cover the costs it is absorbing on PLT's behalf?

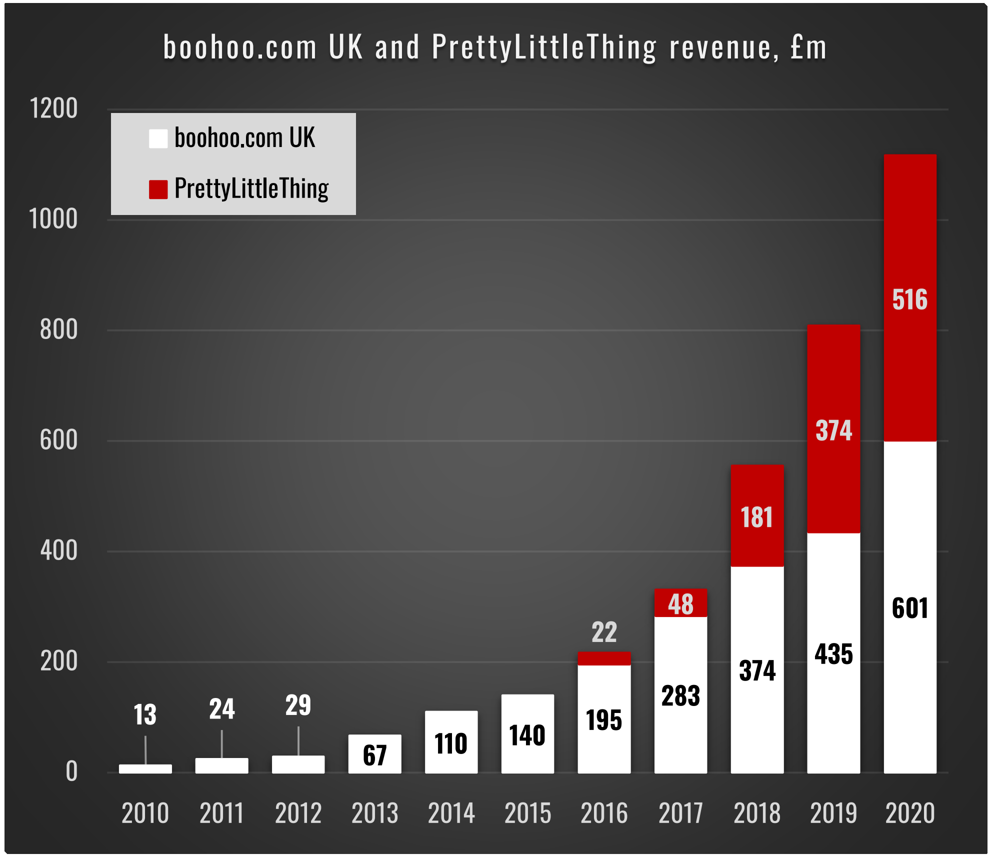

Figure 33 Revenue for boohoo.com UK and PrettyLittleThing. Source: company filings, ShadowFall.

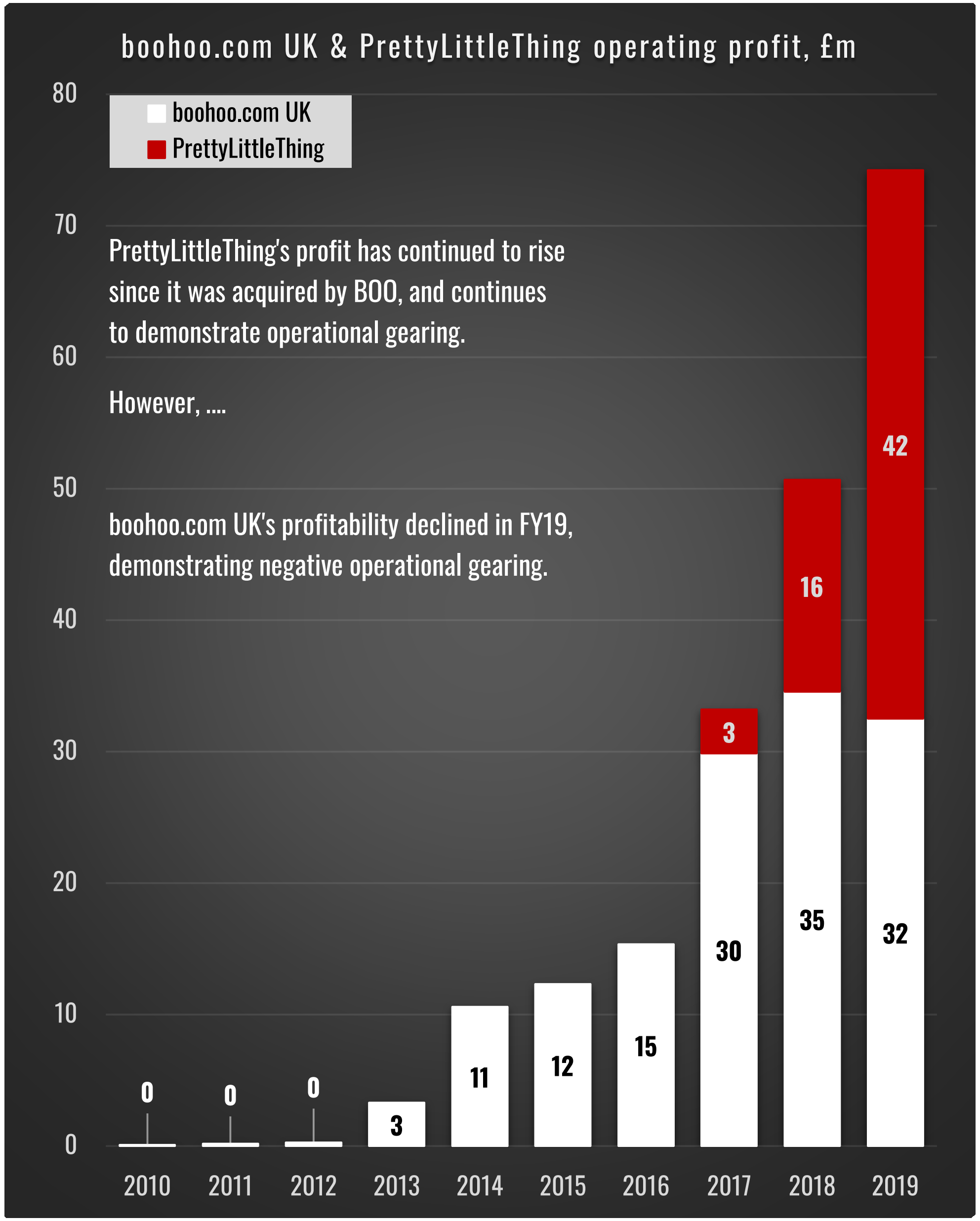

Figure 34 Operating income for boohoo.com UK and PrettyLittleThing. Source: company filings, ShadowFall.

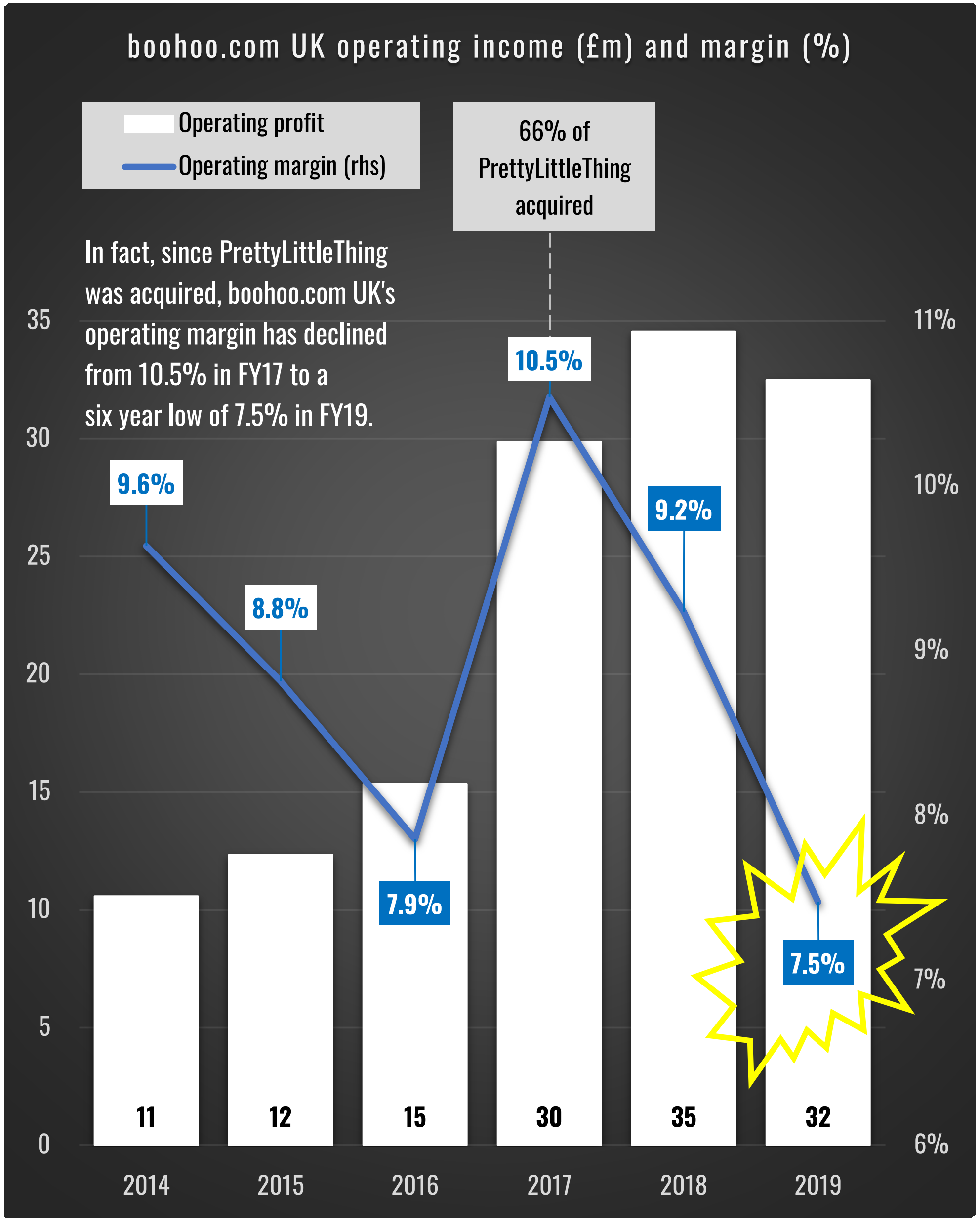

Figure 35 boohoo.com UK's operating profit and margin. Source: company filings, ShadowFall.

As figures 36 and 37 highlight, we find it interesting to review what a single business would look like if boohoo.com UK and PrettyLittleThing were combined into one single entity. In this event, boohoo.com UK would not incur PrettyLittleThing related costs and PrettyLittleThing would not reimburse boohoo.com UK for these costs. We note that instead of the individual margins diverging, the combined operating margin would have modestly fallen, however been relatively more stable than the significant 300bps decline in boohoo.com UK's operating margin since it began the cost/reimbursement arrangement with PrettyLittleThing.

		2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue											
boohoo.com UK	£m	13.2	24.5	29.0	67.3	109.8	139.9	195.4	283.4	374.1	434.6
PrettyLittleThing	£m								47.7	181.3	374.4
Combined revenue	**£m**	**13.2**	**24.5**	**29.0**	**67.3**	**109.8**	**139.9**	**195.4**	**331.1**	**555.4**	**809.0**
Operating profit											
boohoo.com UK	£m	0.1	0.2	0.3	3.3	10.6	12.3	15.4	29.9	34.6	32.5
PrettyLittleThing	£m								3.3	16.1	41.7
Combined operating profit	**£m**	**0.1**	**0.2**	**0.3**	**3.3**	**10.6**	**12.3**	**15.4**	**33.2**	**50.7**	**74.2**
Income received by boohoo.com UK from PrettyLittleThing	**£m**							1.0	4.4	20.0	26.3
As a % of boohoo.com operating profit								6.7%	14.8%	57.8%	81.0%
Operating margin											
boohoo.com UK	%	0.6%	0.7%	0.9%	4.9%	9.6%	8.8%	7.9%	**10.5%**	**9.2%**	**7.5%**
PrettyLittleThing	%								**7.0%**	**8.9%**	**11.1%**
Combined operating margin	**%**	**0.6%**	**0.7%**	**0.9%**	**4.9%**	**9.6%**	**8.8%**	**7.9%**	**10.0%**	**9.1%**	**9.2%**

66% controlling interest acquired in PrettyLittleThing in December 2016

Figure 36 Operating income of boohoo.com UK and PrettyLittleThing and combined. Source: company filings, ShadowFall.

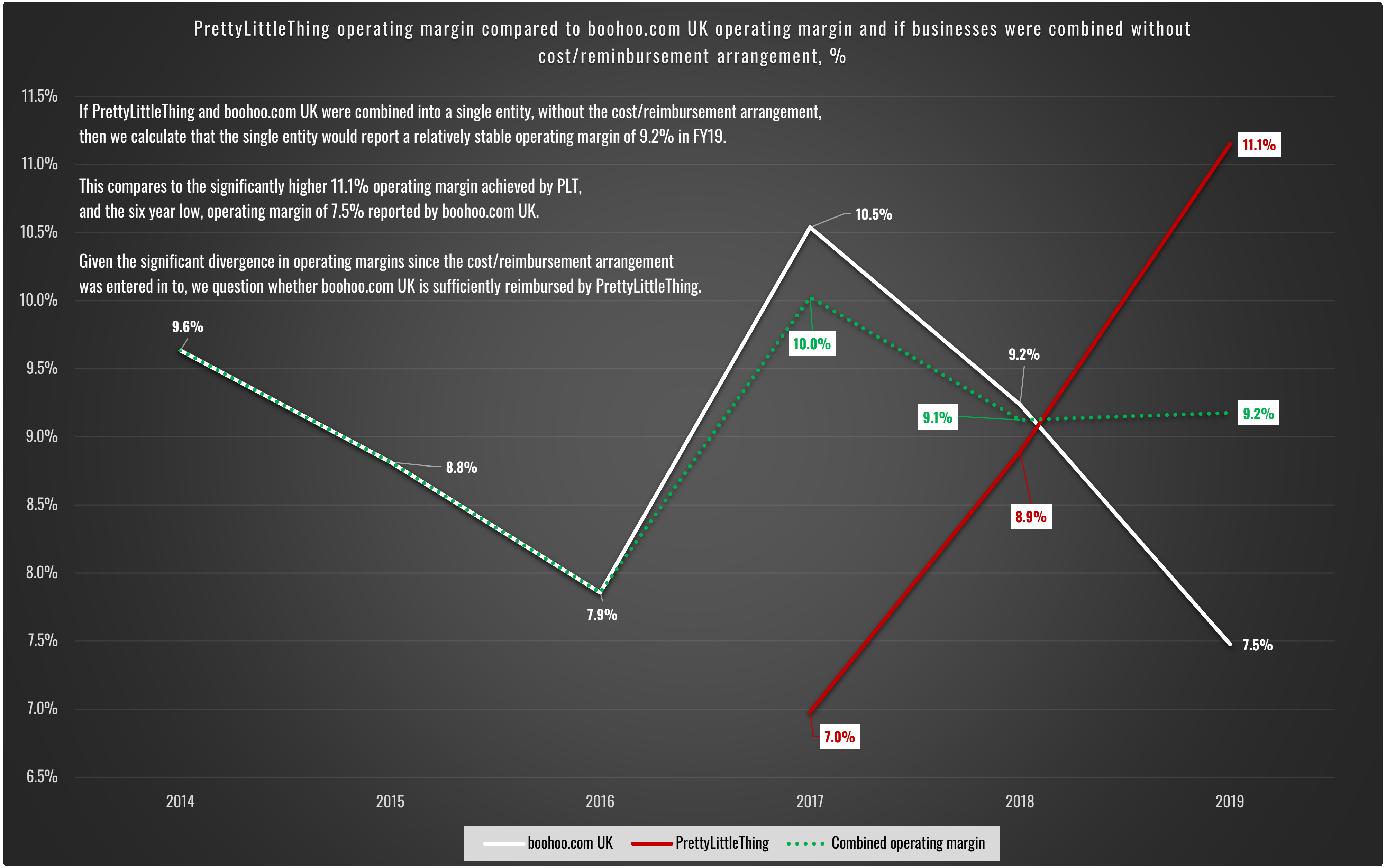

Figure 37 boohoo.com UK and PrettyLittleThing operating profit and combined. Source: Company filings, ShadowFall..

BOOHOO.COM UK REPORTS RECEIVING £26.3M FROM PLT IN 2019. PLT REPORTS PAYING BOOHOO.COM UK £27.2M IN 2019.

boohoo.com UK Limited
Notes to the financial statements
For the year ended 28 February 2019

19 Related party disclosures

Related party	Nature of relationship	2019 £000	2018 £000
Amounts included in the statement of financial position			
Amounts due from related party undertakings			
PrettyLittleThing.com Limited	Shareholder and director is the son of Mahmud Kamani	20	5,734
Nasty Gal UK Limited	Subsidiary of ultimate parent undertaking	16,092	881
boohoo.com USA Inc	Subsidiary	840	831
Nasty Gal USA Inc	Subsidiary of ultimate parent undertaking	1,546	1,725
ABK Limited	Immediate parent undertaking	509	498
Amounts owed to related party undertakings			
Kamani Commercial Property Limited	Common directors and shareholders	-	31
boohoo group plc	Ultimate parent undertaking	60,075	46,925
boohoo.com Australia Pty Ltd	Subsidiary	23	-
Fixed assets – motor vehicles			
The Pinstripe Property Investment Co. Limited	Common directors and shareholders	-	115
Amounts included in the statement of comprehensive income			
Other income			
PrettyLittleThing.com Limited	Shareholder and director is the son of Mahmud Kamani	26,317	19,982
Nasty Gal UK Limited	Subsidiary of ultimate parent undertaking	1,355	-
Purchases			
Kamani Construction Limited	Common directors and shareholders	-	173
Admin costs - marketing			
The White Cube Creative Limited	Director of supplier is the husband of director	86	104
Kamani Global Investments Limited	Common directors and shareholders	12	-
boohoo.com USA Inc	Subsidiary	1,157	808
Admin costs – office rental			
Kamani Commercial Property Limited	Common directors and shareholders	675	679
Pinstripe Hong Kong Limited	Common directors and shareholders	58	40
Loan interest – received/(paid)			
ABK Limited	Immediate parent undertaking	14	14
boohoo group plc	Ultimate parent undertaking	(1,547)	(1,118)

£26,317 vs. £27,210
a £0.9m discrepancy?

prettylittlething.com Limited
Annual report and financial statements
For the year ended 28 February 2019

Notes to the financial statements (continued)

15 Related party disclosures

Related party	Nature of relationship	2019 £000	2018 £000
Amounts included in the statement of financial position			
Amounts owed to related party undertakings			
boohoo.com UK Limited	Directors are family members of Umar Kamani	21	5,734
Amounts included in the income statement			
Distribution costs			
boohoo.com UK Limited	Directors are family members of Umar Kamani	19,271	16,984
Pinstripe Limited	Directors are family members of Umar Kamani	-	1,641
Admin costs – customer services			
boohoo.com UK Limited	Directors are family members of Umar Kamani	5,735	2,372
Admin costs – office rental			
Kamani Commercial Property Limited	Directors are family members of Umar Kamani	145	80
Admin recharge – other			
boohoo.com UK Limited	Directors are family members of Umar Kamani	2,204	627
Admin recharge – other			
Kamani Commercial Property Limited	Directors are family members of Umar Kamani	23	326

£19,984 vs. £19,983
Close enough!

Figure 38 Related party transactions discrepancy in values between boohoo.com UK and PrettyLittleThing. Source: Company filings, ShadowFall.

Aside from profitability, In many ways, boohoo.com UK and PLT are remarkably similar.

Aside from the latter's more rapid growth, in many ways the original boohoo.com UK business is very similar to PLT. For example, during the 18 months to 31 Aug 2019, boohoo.com UK and PLT had a broadly similar number of orders, numbers of items per basket, average order value and conversion rate to sale.

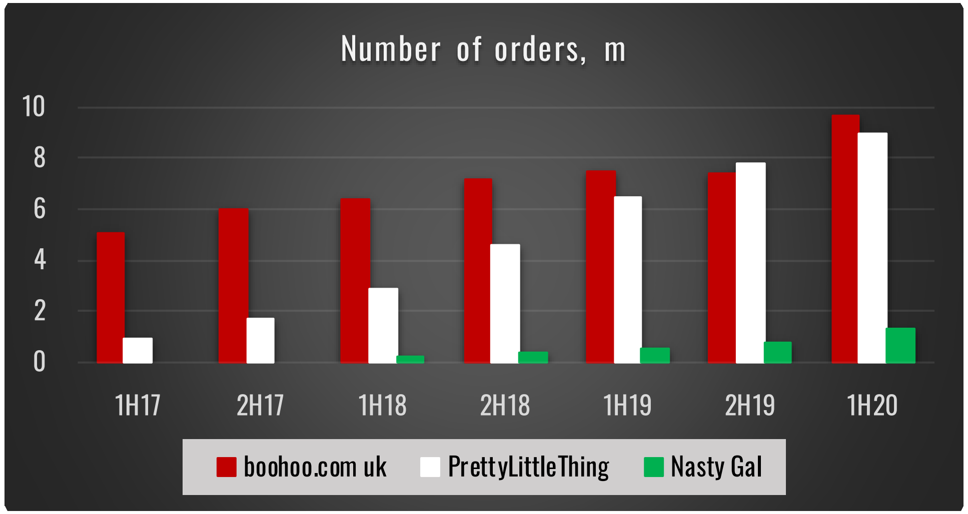

Figure 39 Number of orders among BOO's brands (millions). Source: Company filings, ShadowFall.

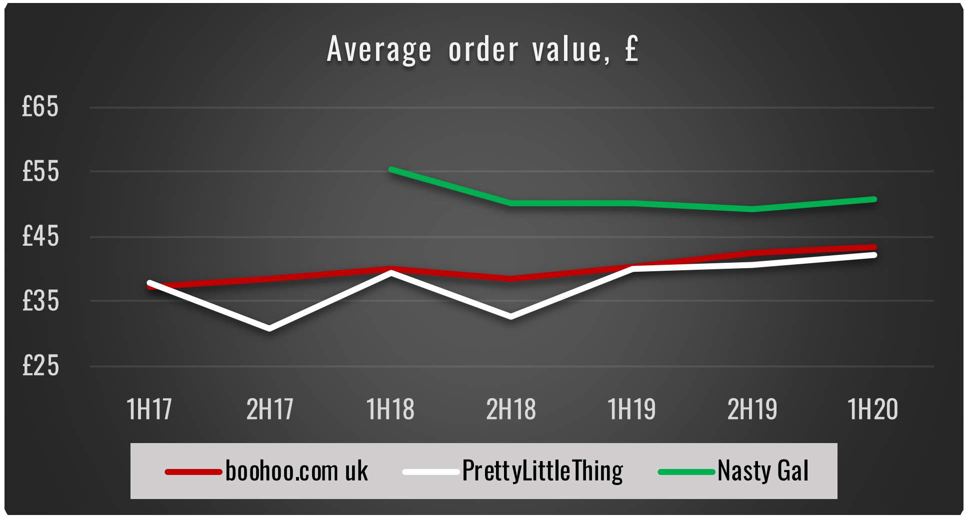

Figure 41 Average order value among BOO's brands (£). Source: Company filings, ShadowFall.

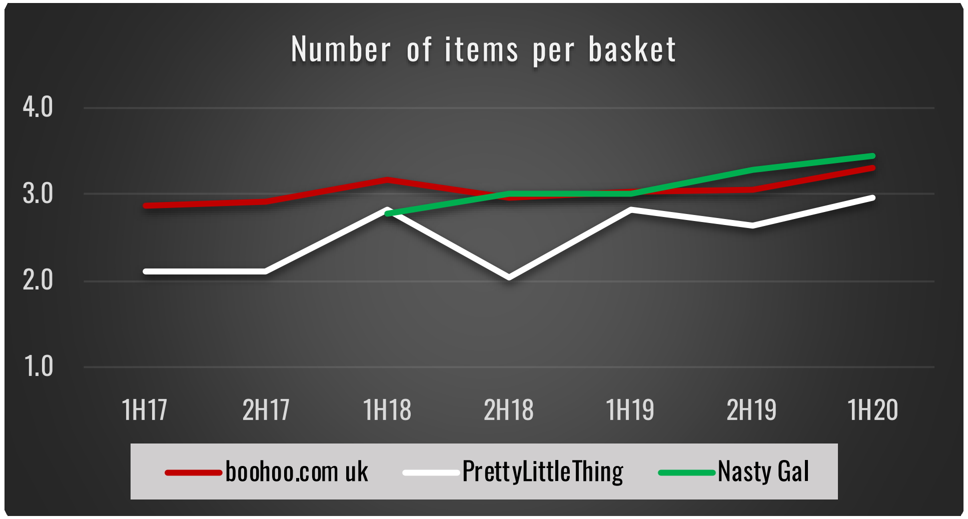

Figure 40 Number of items per basket among BOO's brands (millions). Source: Company filings, ShadowFall.

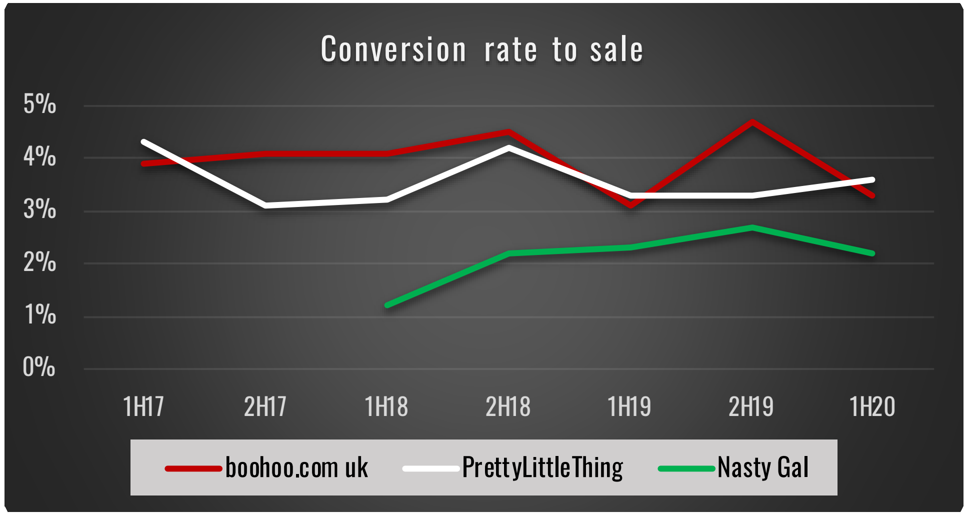

Figure 42 Conversion rate to sale among BOO's brands (£). Source: Company filings, ShadowFall.

What if, instead of a cost/reimbursement arrangement, the Distribution and Administrative costs per order where the same?

We calculate that if PLT's distribution and administrative costs per order were in line with the BOO Group average, then PLT would have incurred additional costs of £1.9m in FY18 and **£10.7m in FY19**. Put another way, if PLT's costs were in line with the wider group, then PLT would have paid boohoo.com UK £37m in FY19 instead of £26.3m. We calculate that this would have resulted in PLT achieving **an EBIT margin of 8.3% in 2019 and not its reported 11.1%**.

PLT reported 14.3 million orders in FY19 (FY18: 7.5m). PLT also reported £88.5m in distribution costs and £81.6m in administrative costs in FY19. Combined, these costs came to £170m, which also included £1.4m in depreciation and amortisation (D&A). Excluding D&A, we calculate that PLT spent £168.7m on distribution and administrative costs in FY19 (FY18: £83.6m). This would equate to an average cost of £11.80 per order in FY19 (FY18: £11.10).

BOO as a group reported 30.5 million orders in FY19 (FY18: 21.7m). BOO also reported £200.9m in distribution costs and £198.5m in administrative costs in FY19. Combined these costs came to £399.4m, which also included £13.9m in depreciation and amortisation (D&A). Excluding D&A, we calculate that BOO spent £385.5m on distribution and administrative costs in FY19 (FY18: £248.4m). This would equate to an average cost of £12.60 per order in FY19 (FY18: £11.40).

However, the BOO group figures include the lower end costing per order achieved by PLT and a higher end costing per order of the smaller business, Nasty Gal.

We believe that boohoo.com UK is a better proxy for the costs per order to compare to PLT. When we strip out the contribution that PLT makes to boohoo.com UK, on a similar basis as above, we calculate that boohoo.com UK's distribution and administrative cost per order is £12.80 in FY19 (FY18: 11.10). Hence in FY19, **we calculate that boohoo.com UK's cost per order was £1.00 greater than PLT's. When multiplied by millions of orders, this difference adds up.**

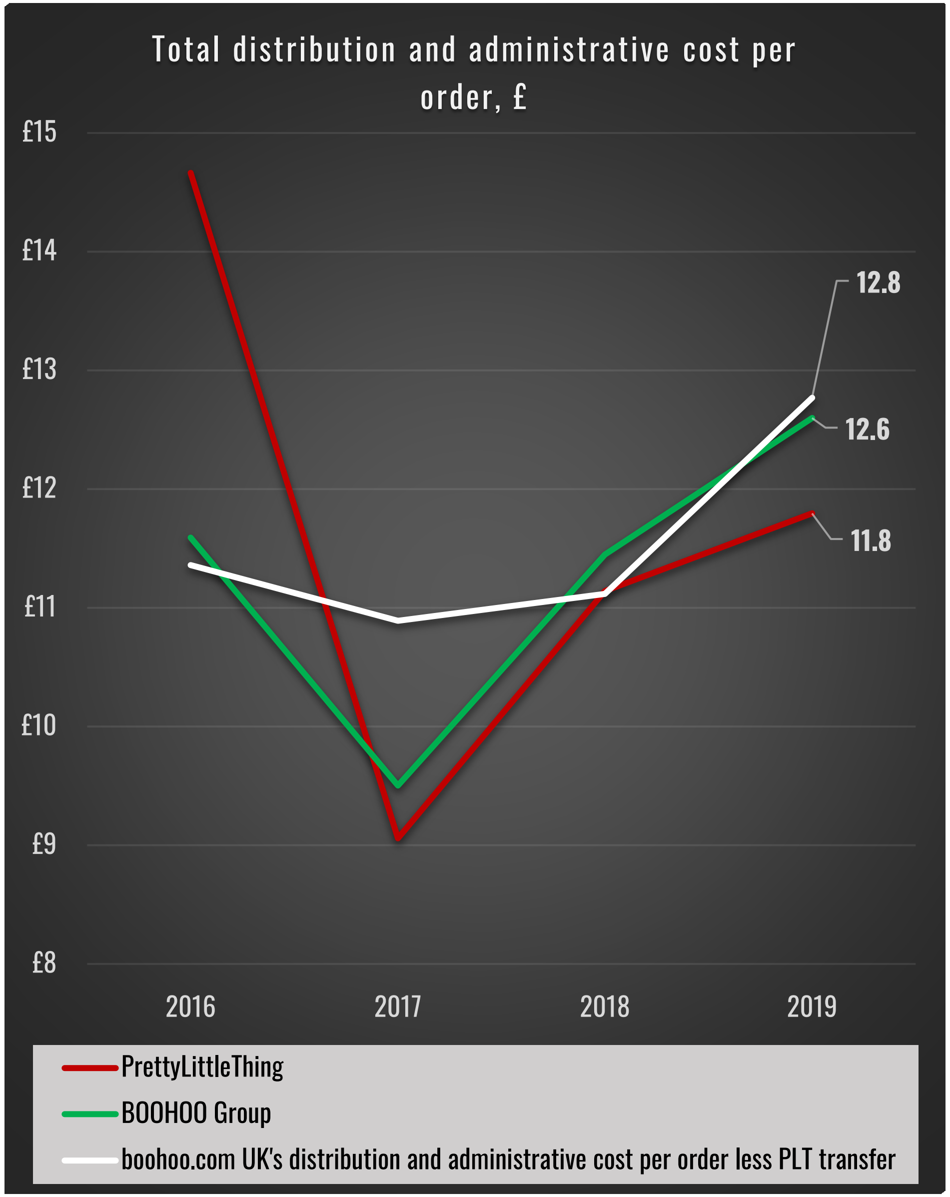

Figure 43 Costs per order between BOOHOO entities. Source: Company filings, ShadowFall.

We find it curious that since 66% of PLT was acquired in December 2016, PLT's distribution and administrative costs per order have significantly fallen from £14.70 in FY2016 to £11.80 in FY2019. By contrast the costs per order for boohoo.com UK and the BOO group have risen. We can't help but note that if PLT's NCI is bought out in early FY22, then PLT's relatively higher profitability may result in a higher take out price than would otherwise be achieved if PLT's distribution and administrative costs per order were in line with the rest of the BOO group.

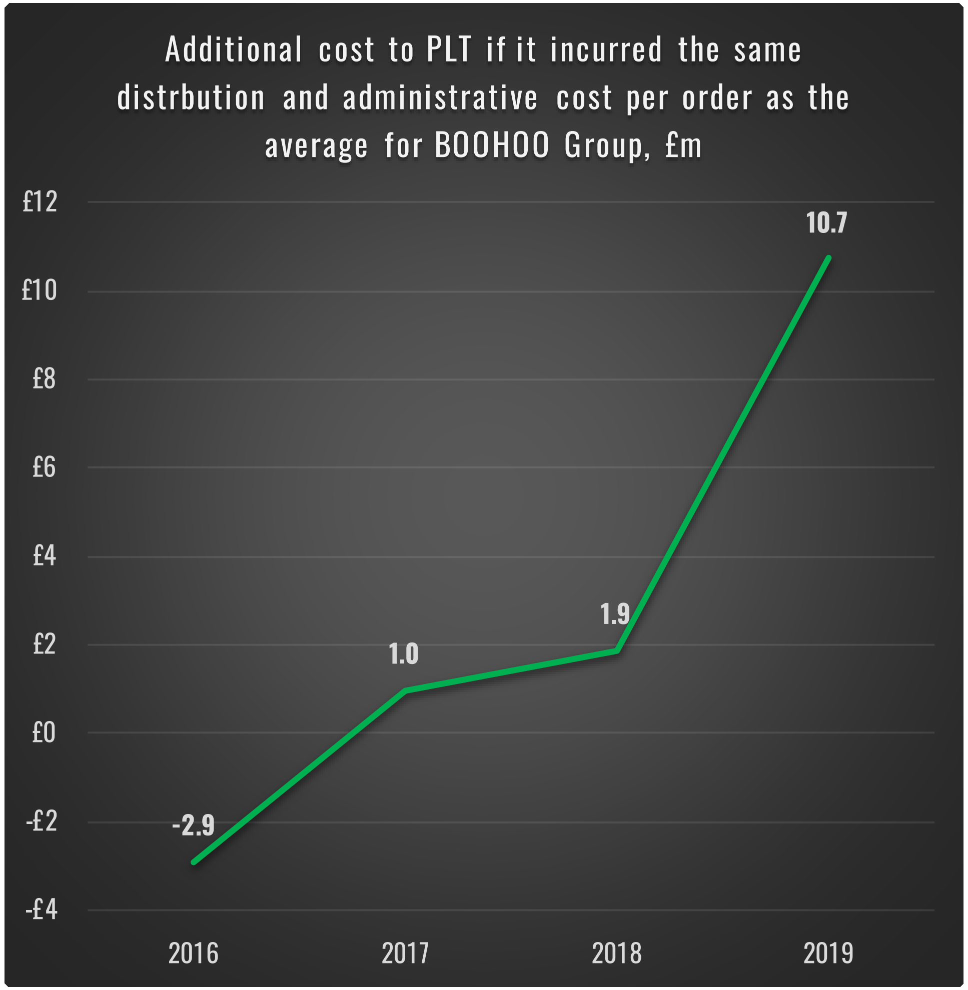

Figure 44 Additional cost to PLT if it incurred the same distribution and administrative cost per order as the wider group. Source: Company filings, ShadowFall calculations.

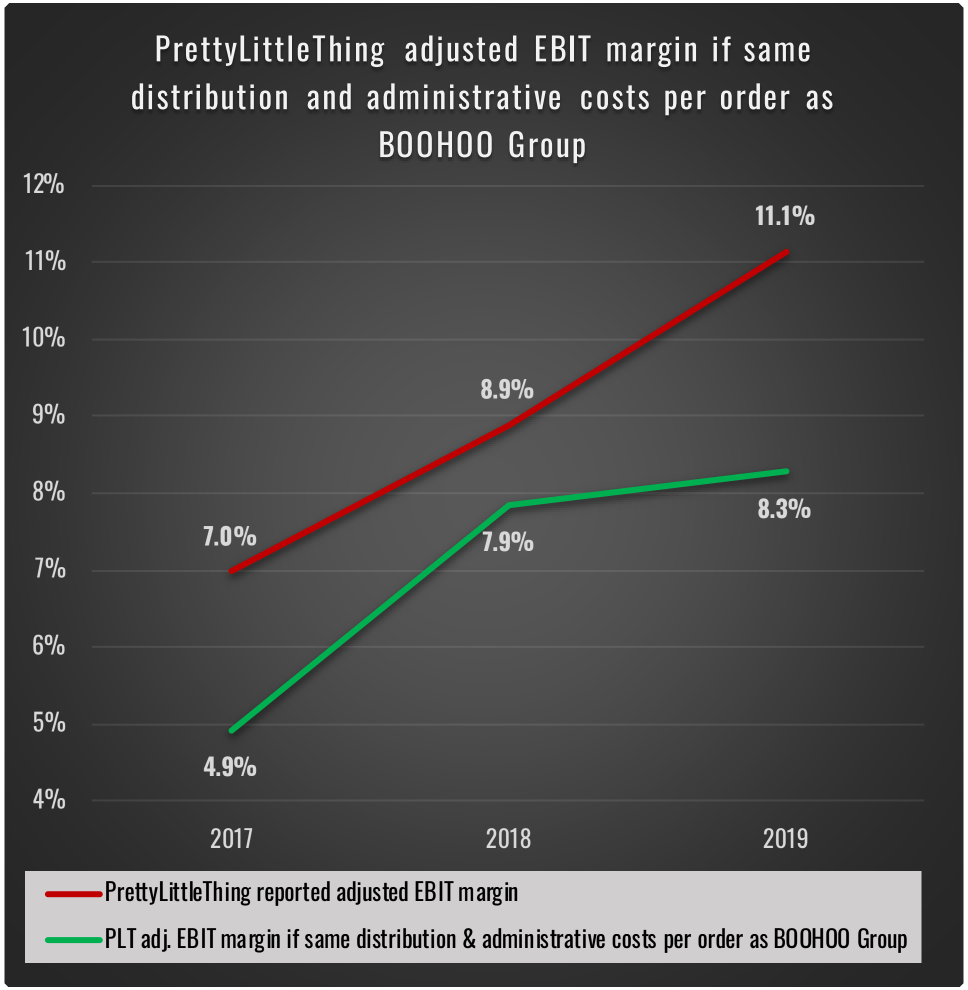

Figure 45 PLT's adjusted EBIT margin if it incurred the same distribution and administrative cost per order as the wider group. Source: Company filings, ShadowFall calculations.

Compared to peers, both BOO's and more noticeably PLT's distribution and administrative costs per order are considerably lower. So much for efficiencies among larger peers.

We calculate that ASOS and Zalando reported total distribution and administrative costs per order of £17.00 and £14.00 respectively in 2019. These costs per order are markedly higher than PLT's and BOO's as a group. If PLT's costs per order were of this magnitude, then it could have added between £30.2m to £72.8m additional cost in FY19.

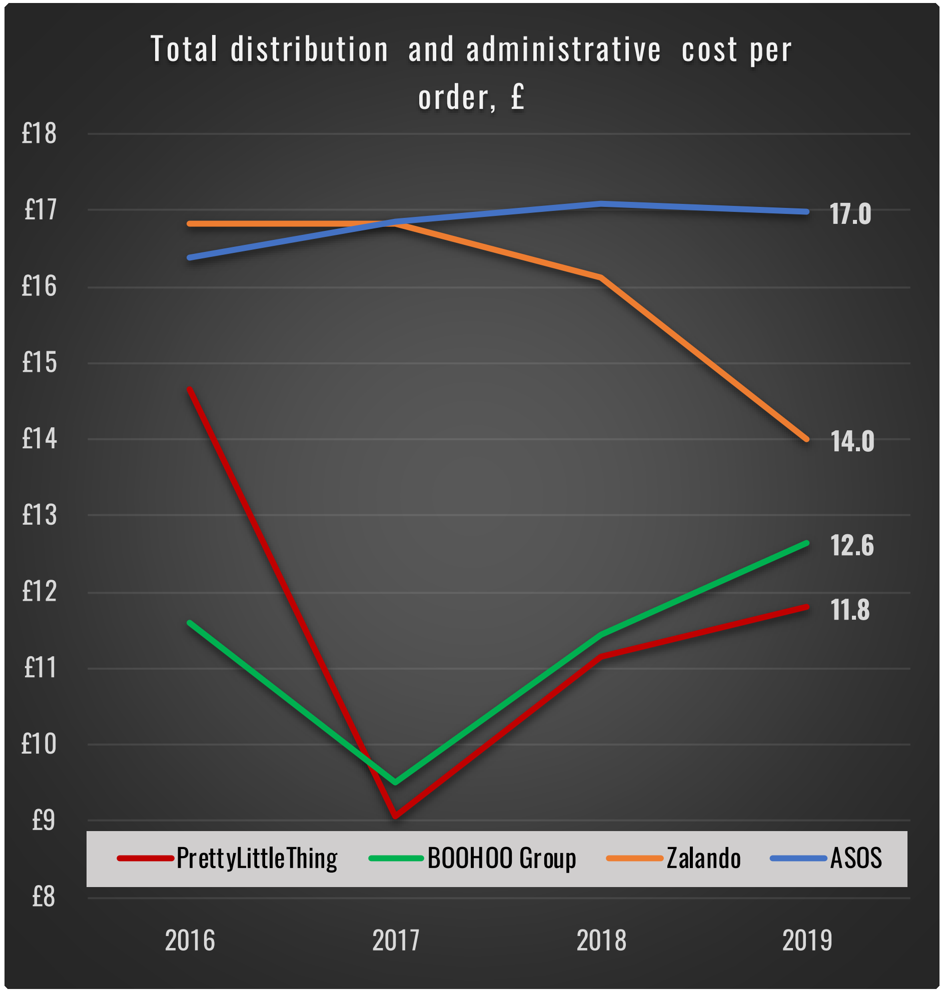

Figure 46 Total distribution and administrative costs per order. Source: Company filings, ShadowFall calculations. Zalando FX adjusted to GBP based on respective annual GBP:EUR average.

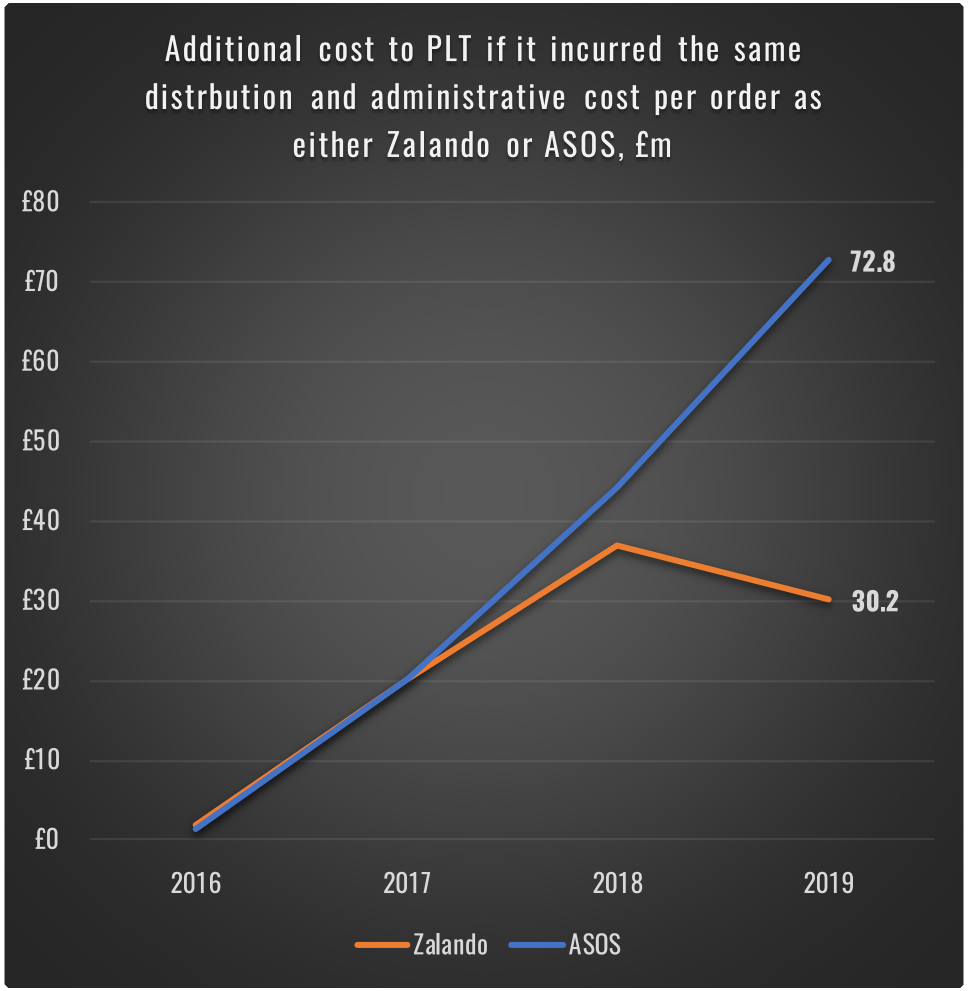

Figure 47 Additional cost to PLT if it incurred the same distribution and administrative cost per order as either ASOS or Zalando. Source: Company filings, ShadowFall calculations.

Somehow, PLT achieves far superior EBIT margins as compared to other BOO group entities, and even more noticeably, compared to much larger peers. Part of this margin supremacy is driven by gross margin. However, the real advantage appears to us to be due to PLT administering and delivering orders to its customers at a much lower cost. If BOO's shareholders are now paying dividends to PLT's NCI or might be asked to buy-out the Minority Interest on the basis of PLT's profit supremacy, then we believe BOO's shareholders had better hope that these super profits are real, sustainable and are not bolstered by a subsidy from other entities in the BOO group.

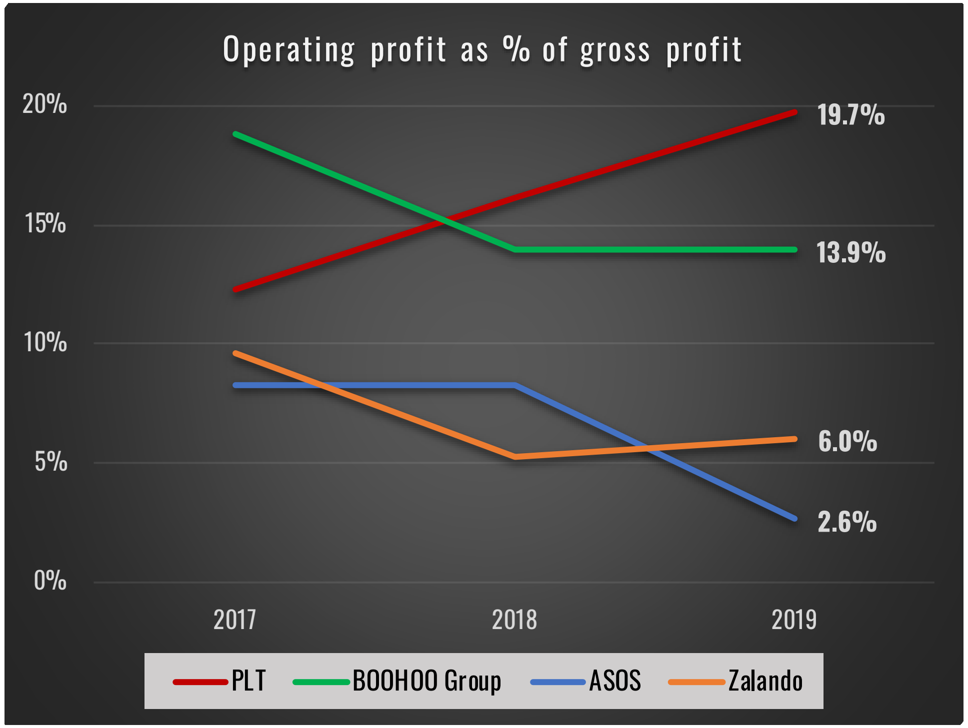

Figure 48 Operating profit as a percentage of gross profit. Source: Company filings, ShadowFall calculations.

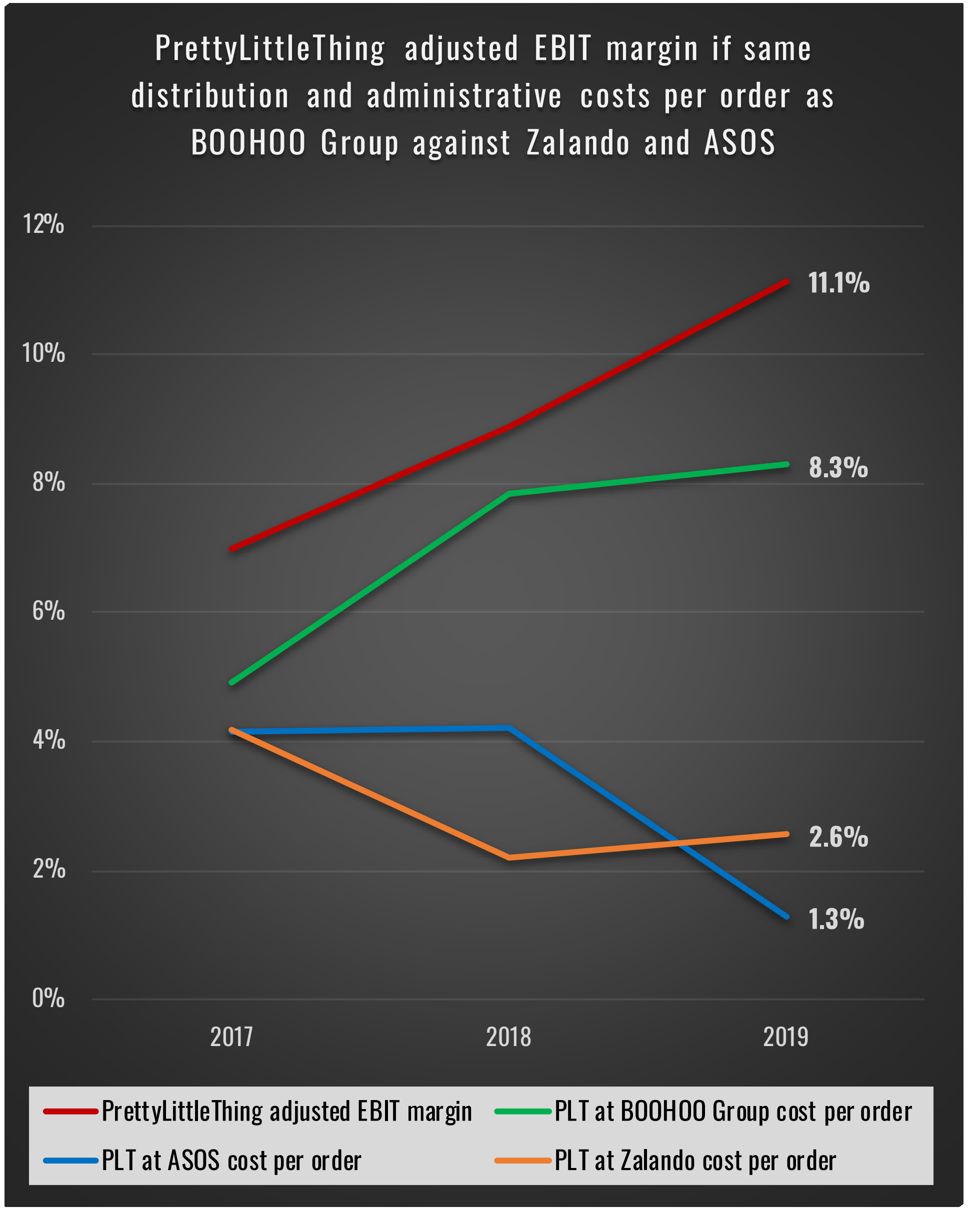

Figure 49 PLT's adjusted EBIT margin if it incurred the same distribution and administrative cost per order as the either ASOS or Zalando. Source: Company filings, ShadowFall calculations.

DISTRIBUTION AND ADMINISTRATIVE COSTS PER ORDER		2016	2017	2018	2019
Orders	Unit				
PrettyLittleThing (PLT)	m	0.9	2.6	7.5	14.3
boohoo.com UK	m	8.3	11.1	13.6	14.9
Nasty Gal	m	0.0	0.0	0.6	1.3
BOOHOO Group	m	8.3	13.7	21.7	30.5
ASOS	m	38.3	49.6	63.2	72.3
Zalando	m	69.2	90.5	116.2	144.9
Distribution costs					
PrettyLittleThing	£m	4.8	10.0	40.7	88.5
boohoo.com UK	£m	45.5	65.2	97.4	117.9
Nasty Gal	£m			4.5	12.0
BOOHOO Group	£m	45.5	66.8	126.8	200.9
Distrubution costs paid by PLT to boohoo.com UK	**£m**	**1.3**	**3.2**	**17.0**	**19.3**
boohoo.com UK's distribution costs less PLT transfer	£m	44.2	62.0	80.4	98.7
ASOS	£m	216.0	299.2	380.8	415.6
Zalando	£m	1043.1	1359.5	1707.6	1941.0
Administrative costs					
PrettyLittleThing	£m	8.5	13.7	43.3	81.6
boohoo.com UK	£m	53.5	63.8	79.9	107.6
Nasty Gal	£m			9.4	18.2
BOOHOO Group	£m	53.8	68.1	132.6	198.5
Administrative costs paid by PLT to boohoo.com UK	**£m**	**0.3**	**0.6**	**3.0**	**7.9**
boohoo.com UK's administrative costs less PLT transfer	£m	53.1	63.2	76.9	99.6
ASOS	£m	443.2	579.5	754.4	883.6
Zalando	£m	163.1	215.7	241.8	252.8
Depreciation and amortisation					
PrettyLittleThing	£m	0.1	0.2	0.4	1.4
boohoo.com UK	£m	3.1	4.3	6.1	8.1
Nasty Gal	£m				1.8
BOOHOO Group	£m	3.1	4.8	11.0	13.9
ASOS	£m	31.7	42.3	54.6	71.3
Zalando	£m	41.1	52.1	77.8	164.7
Total distribution and administrative costs ex D&A					
PrettyLittleThing	£m	13.2	23.6	83.6	168.7
boohoo.com UK	£m	95.9	124.6	171.2	217.5
Nasty Gal	£m			14.0	28.4
BOOHOO Group	£m	96.2	130.2	248.4	385.5
Total distribution and administrative costs paid by PLT to boohoo.com UK	**£m**	**1.6**	**3.7**	**20.0**	**27.2**
boohoo.com UK's total distribution and administrative costs less PLT transfer	£m	94.3	120.9	151.2	190.3
ASOS	£m	627.5	836.4	1080.6	1227.9
Zalando	£m	1165.1	1523.1	1871.6	2029.0
Distribution and administrative costs per order					
PrettyLittleThing	£	14.7	9.1	11.1	11.8
boohoo.com UK	£	11.6	11.2	12.6	14.6
Nasty Gal	£			23.3	21.8
BOOHOO Group	£	11.6	9.5	11.4	12.6
boohoo.com UK's distribution and administrative cost per order less PLT transfer	**£**	**11.4**	**10.9**	**11.1**	**12.8**
ASOS	£	16.4	16.9	17.1	17.0
Zalando	£	16.8	16.8	16.1	14.0

Difference between PLT distribution and adminstrative cost per order and:		2016	2017	2018	2019
BOOHOO Group	**£**	**-3.1**	**0.4**	**0.3**	**0.8**
boohoo.com UK	**£**	**-3.3**	**1.8**	**0.0**	**1.0**
ASOS	**£**	**1.7**	**7.8**	**6.0**	**5.2**
Zalando	**£**	**2.2**	**7.8**	**5.0**	**2.2**
PrettyLittleThing distribution and administrative costs if same distribution and administrative costs per order as:					
BOOHOO Group	£m	10.4	24.7	85.9	180.8
boohoo.com UK	£m	10.2	28.3	83.4	182.6
ASOS	£m	14.7	43.8	128.2	242.9
Zalando	£m	15.2	43.8	120.8	200.2
PrettyLittleThing total reported distribution and administrative costs	£m	13.3	23.7	84.0	170.0
Additional cost to PLT if it incurred the same distrbution and administrative cost per order as:					
BOOHOO Group	£m	-2.9	1.0	1.9	10.7
boohoo.com UK	£m	-3.1	4.6	-0.6	12.6
ASOS	£m	1.4	20.1	44.3	72.8
Zalando	£m	1.8	20.0	36.8	30.2
PrettyLittleThing reported adjusted EBIT	**£m**	**-1.3**	**3.3**	**16.1**	**41.7**
PrettyLittleThing adjusted EBIT if same distribution and administrative costs per order as:					
BOOHOO Group	£m	1.6	2.4	14.2	31.0
boohoo.com UK	£m	1.9	-1.3	16.7	29.2
ASOS	£m	-2.7	-16.8	-28.1	-31.1
Zalando	£m	-3.1	-16.7	-20.7	11.5
PrettyLittleThing adjusted EBIT margin	**%**	**-5.7%**	**7.0%**	**8.9%**	**11.1%**
PrettyLittleThing adjusted EBIT margin if same distribution and administrative costs per order as:					
BOOHOO Group	%	7.5%	4.9%	7.9%	8.3%
boohoo.com UK	%	8.5%	-2.6%	9.2%	7.8%
ASOS	%	-12.2%	-35.2%	-15.5%	-8.3%
Zalando	%	-14.1%	-35.0%	-11.4%	3.1%

Figure 50 Distribution and administrative costs per order. Source: Company filings, ShadowFall calculations.

BOO currently trades on an Enterprise Value multiple of 53x its 2019 EBIT. As we detail above, we estimate that in 2019, c. £10.7m of additional cost to PLT could have effectively been shielded from PLT and absorbed by other BOO entities. As such, if the 34% NCI was purchased at a 53x EV/EBIT multiple, we calculate that PLT's valuation could be inflated by £567m (£10.7m x 53). With 34% of this to be paid to PLT's NCI, we calculate that this could result in £193m of value paid to PLT's NCI for no other reason than costs being absorbed by other BOO entities.

We suppose that if not used on M&A, then the recent £197.7m cash call would prove useful in settling this.

If BOO's shareholders are now paying dividends to PLT's NCI and might be asked to buy-out that NCI on the basis of PLT's relative profit supremacy, then we believe BOO's shareholders had better be sure that PLT's super profits are real, sustainable and are not bolstered by a subsidy from other entities in the BOO group.

THE £50 MILLION MANAGEMENT INCENTIVE – ALREADY IN THE MONEY….

On September 17, 2018, BOO announced the appointment of current CEO, John Lyttle. As part of this announcement BOO provided details on Mr Lyttle's remuneration package and how this links to value creation for shareholders. The BOO board proposed a '5 year Growth Share Plan', with the pay-out being subject to a greater than 10% CAGR in the market capitalisation of BOO; the maximum award is capped at £50m if a market capitalisation CAGR of 23% is achieved. This would correspond to a period ending share price of c. £2.85 per share for the threshold level and c. £5 per share for the maximum pay-out assuming no change in the number of shares. The market capitalisation CAGR is also to be adjusted for corporate events such as share issuance for acquisitions. What the adjustment for corporate events means in practice we are yet to observe but **we note that it could provide no downside to Mr Lyttle if BOO issues shares to settle the option to acquire PLT.**

The scheme was implemented as of Mr Lyttle's first day as CEO. Importantly however, the reference share price for the base of the CAGR calculation is the closing price on the date of the announcement September 17, 2018, or £1.77 per share. Mr Lyttle joined the group on March 15, 2019. The closing share price the day before he began was £1.78, unfortunately for Mr Lyttle, he didn't begin his tenure as CEO already in the money. However, we believe that this policy opened a risk that Mr Lyttle could effectively be compensated for the period in which he was not at the company.

The growth share plan is to be settled in shares upon the completion of the performance period which is assumed to be September 2023; given that was the opening reference price for the calculation. In the c. 18 months since the scheme was announced the shares are up +103% to £3.60 at the time of writing, putting Mr Lyttle in the money only 1 year after starting employment.

boohoo

Appointment of CEO and Board Re-alignment

Released : 17/09/2018 07:00

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boohoo group plc
17 September 2018

For Immediate Release **17 September 2018**

The information contained within this announcement is deemed by the Company to constitute inside information stipulated under the Market Abuse Regulation (EU) No. 596/2014. Upon the publication of this announcement via the Regulatory Information Service, this inside information is now considered to be in the public domain.

boohoo group plc
("boohoo" or the "Company" and together with its subsidiaries the "Group" or "the boohoo group")

Appointment of CEO and Board Re-alignment

Positioning for next phase of growth

Remuneration

John Lyttle's remuneration package will be heavily related to creating premium growth in shareholder value over the next five years:

- Annual salary of £615,000
- Annual Bonus of up to 150% of annual salary
- Pension of 5% of annual salary
- Growth Share Plan ("the Plan") to be implemented relates to the compound annual growth rate ("CAGR") in market capitalisation over the five year period starting on the date John joins as CEO. The starting market capitalisation will be based on the closing share price on the date of this announcement. CAGR of less than 10% yields nil value. The Plan is capped at £50m of gross value before tax at the end of the performance period in the event of achieving CAGR of at least 23%. For example, if the starting market capitalisation was £2bn it would have to increase by at least 60% or £1.2bn to £3.2bn to create any value at all for the CEO-designate. To achieve the maximum £50m (before tax) the market capitalisation would have to increase by £3.6bn or by 180% to £5.6bn. Such an outcome would mean the £50m represented approximately 1.4% of the increase in the market capitalisation. Provisions have been made to make the adjustments for increases in market capitalisation arising from corporate events such as issuing shares for acquisitions so that the benefits derived from the Plan only arise from organic growth.

Figure 51 Appointment of BOO's CEO. Source: Company filings, ShadowFall.

YOU'RE MY ~~COMPETITION/NEXT BUY-OUT TARGET~~ BROTHER, JALALUDIN.

Figure 52 Prod DB © Paramount Pictures - The Coppola Company / DR LE PARRAIN 2 (THE GODFATHER, PART 2) de Francis Ford Coppola 1974 USA avec John Cazale et Al Pacino suite, sequelle, mafia italienne, caid, supplier, demander pardon, Don Michael Corleone, Fredo Corleone, gomina d'apres le roman de Mario Puzo. Source: TCD/Prod.DB, Alamy Stock Photo.

BOO and PLT have competition. Incorporated in 2016, ISawItFirst.com appears to a have a similar supply chain as BOO and PLT, as well as a virtually identical product offering to the same demographic. Key personnel such as PLT's Head of Commercial Marketing and Head of Merchandising have even jumped *shop* to join ISawItFirst. Perhaps they see ISawItFirst as having greater potential in a competitive market? Recent Instagram data and internet search trends certainly give the impression that the competition is heating up.

ISawItFirst is majority owned by Jalaludin Kamani, the brother of BOO's Chairman. Perhaps, after the PLT NCI (BOO's Chairman's son) is bought out, BOO will set its sights on buying out its Chairman's brother? Or maybe the Kamanis will continue to sell down their BOO stock and go head to head? Either-way, it doesn't seem clear to us what significant barriers to entry exist in BOO's market, if a virtual replica company to BOO and PLT can be set-up and grown relatively quickly, nor how BOO's shareholders would stand to benefit?

ISAWITFIRST THE NEXT PRETTYLITTLETHING?

On 17 May 2016, seven months before BOO purchased 66% of PrettyLittleThing, I Saw It First Limited (ISawItFirst) was incorporated in the UK. Just over a year later, on 22 May 2017, Jalaludin Kamani, who is the brother of the Chairman of BOO, became the major shareholder in ISawItFirst, alongside a corporate entity, M&R Developments Limited.

Jalaludin Kamani, who was previously a director in BOO and according to Bloomberg retains a c. 2.5% stake, resigned from his role shortly after its IPO. On his Linkedin profile Jalaludin Kamani describes himself as **the "Founder of the Test and Repeat model at boohoo.com"**, a model which we assume has been implemented across I Saw It First.

I Saw It First: Shareholders at 21/08/2019

A Shares	**% voting rights**
M&R Developments	28.6%
J A Kamani	55.6%
The Robert Street Hub Ltd (J Kamani the major shareholder)	15.8%

	Share class			
Shareholders	**A**	**B**	**% ownership**	**Redeemable preference**
M&R Developments Limited	2,500,000		24.2%	
J Kamani	4,853,000		46.9%	
The Robert Street Hub Ltd (J Kamani the major shareholder)	1,380,000		13.3%	
J Kamani				2,399,996,000
L Holmes		500,000	4.8%	
M Marzouk		200,000	1.9%	
A Stevenson-Thorpe		200,000	1.9%	
S Irshad		200,000	1.9%	
S Lockhard		167,000	1.6%	
N Parry		57,471	0.6%	
B Yarwood		57,471	0.6%	
L Sewak		57,471	0.6%	
T Holland		57,471	0.6%	
N Smiith		114,943	1.1%	
Total	**8,733,000**	**1,611,827**		**2,399,996,000**

Class of share	A ORDINARY
Prescribed particulars ❶	A ORDINARY SHARES HAVE FULL RIGHTS IN THE COMPANY WITH RESPECT TO VOTING, DIVIDENDS AND CAPITAL DISTRIBUTIONS INCLUDING ON WINDING UP. ON A RETURN OF ASSETS ON A LIQUIDATION OR OTHERWISE THE SURPLUS ASSETS SHALL BE DISTRIBUTED FIRSTLY TO THE REDEEMABLE PREFERENCE SHARES, LIMITED TO THEIR ISSUE PRICE, SECONDLY TO THE A ORDINARY SHARES, SO THAT THEY RECEIVE THEIR ISSUE PRICE BEFORE BEING DISTRIBUTED AMONGST THE A ORDINARY SHARES AND B ORDINARY SHARES PARI PASSU. THE A ORDINARY SHARES ARE NOT REDEEMABLE.
Class of share	B ORDINARY
Prescribed particulars ❶	THE B ORDINARY SHARES DO NOT HAVE ANY VOTING RIGHTS. PROVIDED THEY HAVE VESTED, THE SHARES HAVE ATTACHED TO THEM DIVIDEND AND CAPITAL DISTRIBUTION RIGHTS, INCLUDING ON A WINDING UP. ON A RETURN OF ASSETS ON A LIQUIDATION OR OTHERWISE THE SURPLUS ASSETS SHALL BE DISTRIBUTED FIRSTLY TO THE REDEEMABLE PREFERENCE SHARES, LIMITED TO THEIR ISSUE PRICE, SECONDLY TO THE A ORDINARY SHARES, SO THAT THEY RECEIVE THEIR ISSUE PRICE BEFORE BEING DISTRIBUTED AMONGST THE A ORDINARY SHARES AND B ORDINARY SHARES PARI PASSU. THE B ORDINARY SHARES ARE NOT REDEEMABLE.
Class of share	REDEEMABLE PREFERENCE
Prescribed particulars ❶	RESTRICTED REDEEMABLE PREFERENCE SHARES NOT FORMING PART OF THE ORDINARY SHARE CAPITAL OF THE COMPANY. NON-VOTING. THE PREFERENCE SHARES ARE ENTITLED TO A FIXED DIVIDEND OF £0.0000001 PER SHARE PER ANNUM. ON A RETURN OF ASSETS ON A LIQUIDATION OR OTHERWISE, THE SURPLUS ASSETS OF THE COMPANY AVAILABLE FOR DISTRIBUTION TO MEMBERS SHALL BE DISTRIBUTED FIRSTLY TO THE PREFERENCE SHAREHOLDERS, LIMITED TO THEIR ISSUE PRICE.

Figure 53 ISawItFirst shareholders. Source: Company filings, ShadowFall.

Let the hiring commence

Around the time Jalaludin Kamani became involved in ISawItFirst, the company began hiring senior staff from BOO. For example:

- In November 2016, [Ms. Sophie Lockard], left BOO, where she was Head of Commercial Marketing, and joined ISawItFirst in February 2017 as its Marketing Director.
- In May 2017, [Ms. Leanne Holmes], left PrettyLittleThing, where she was Head of Merchandising, and joined ISawItFirst in June 2017 as its Buying and Merchandising Director.

As of 21 August 2019, Ms. Lockard and Ms. Holmes, are among the shareholders of ISawItFirst.

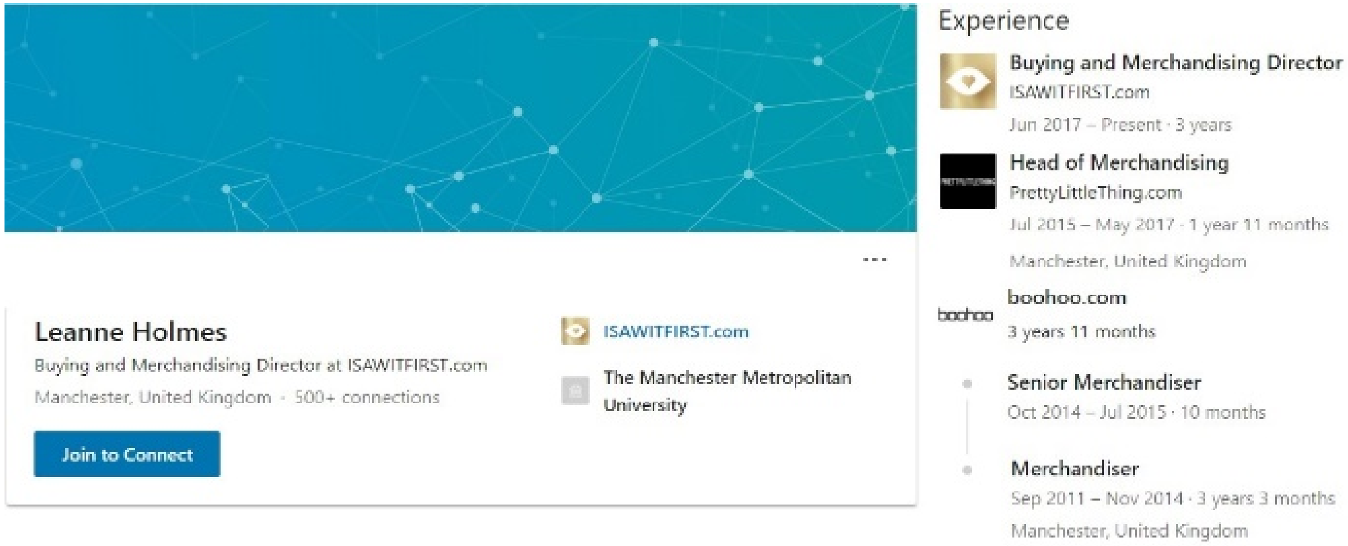


Figure 58 LinkedIn profile of Leanne Holmes, former Head of Merchandising at PrettyLittleThing and now Buying and Merchandising Director at ISAWITFIRST. Source: LinkedIn, ShadowFall.

Competition or the next acquisition?

While currently smaller in scale, ISawItFirst bears a striking resemblance to both BOO and PrettyLittleThing.

- The web layouts are virtually identical.
- The product offerings are almost impossible to tell apart.
- The pricing points are remarkably similar.
- The target demographic seems to be the same.

It all sort of begs the question, *why*? Why does the brother of the Chairman and major shareholder of BOO own a remarkably similar company which competes with BOO and PrettyLittleThing? **What does this suggest for barriers to entry?** Does Jalaludin Kamani have the secret recipe of the "Test and Repeat Model"? Where does each company source its product? Will BOO seek to buy or buy into ISawItFirst from BOO's Chairman's brother, as it did by buying into PrettyLittleThing from BOO's Chairman's son? **Other than the Kamani family, how do BOO's other shareholders benefit from this competition?**

RELATED COMPANY SUPPORT

The most recent available accounts for ISawItFirst show a reported loss of £9.7m in the year to 30 September 2018 and net current liabilities of £9.8m. The majority of the current liabilities relate to an "Other creditors" line which increased from £800k in 2017 to £11.4m in 2018. Whilst appreciating that the business was a start-up, we were surprised to read in the going concern statement that I Saw It First was being supported by other companies under common ownership, see below [our bold for emphasis]:

> *"Going Concern*
>
> *At the time of approving the financial statements, the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Thus the directors continue to adopt the going concern basis of accounting in preparing the financial statements. During the period to 30 September 2018 the company made losses of £9.7m and current assets exceeded [sic] current liabilities by £9.8m [the balance sheet shows liabilities exceeding assets by £9.8m so assumed to be a typo], however it is the belief of the directors that the company will continue in operational existence for the foreseeable future* ***with the continued support from the directors and other companies under common ownership.****"*

We wonder what this support from directors or other companies under common ownership refers to. Could it be the undisclosed "Other creditors"? Unfortunately, there is no related party transaction disclosure within the accounts, so we are unable to trace the source of the "continued support".

I SAW IT FIRST LIMITED (FORMERLY I SAW IT FIRST LONDON LTD)

BALANCE SHEET

AS AT 30 SEPTEMBER 2018

	Notes	2018 £	2018 £	2017 £	2017 £
Fixed assets					
Intangible assets	3		57,126		-
Tangible assets	4		68,760		-
			125,886		-
Current assets					
Stocks		1,791,019		-	
Debtors	5	1,036,967		19,010	
Cash at bank and in hand		1,385,114		780,978	
		4,213,100		799,988	
Creditors: amounts falling due within one year	6	(13,993,449)		(800,000)	
Net current liabilities			(9,780,349)		(12)
Total assets less current liabilities			(9,654,463)		(12)
Capital and reserves					
Called up share capital	7		100		1
Profit and loss reserves			(9,654,563)		(13)
Total equity			(9,654,463)		(12)

Figure 59 ISawItFirst Balance Sheet for the year ended 30 September 2018. Source: Company filings, ShadowFall.

SOCIAL MEDIA ADVERTISING – NOT JUST A PLT SPECIALTY

One of the contributing factors for the rapid growth at PLT has been its marketing strategy. The business has partnered with numerous celebrities and influencers to connect with its target market, including the likes of: Kylie Jenner, Kourtney Kardashian, Maya Jama and Ashley Graham. This strategy has not gone unnoticed at I Saw It First with the brand becoming the exclusive fashion partner for the hit ITV show Love Island in 2019 and renewing the deal for 2020. The competition doesn't stop there, while I Saw It First had the headline deal, BOO and PLT signed up deals with 3 of the 4 female finalists for the 2019 series. We believe that I Saw It First is following a remarkably similar marketing strategy to reach its target audience and is directly competing with BOO and its brands.

INSTAGRAM TRENDS

Whilst currently smaller in scale, ISawItFirst markets to its target audience similarly to PLT by using social media platforms such as Instagram. Our findings suggest that I Saw IT First is gaining traction with higher levels of engagement and faster growth than PLT. We also find that I Saw It First has been catching up with PLT away from Instagram. In August 2017, PLT led I Saw It First by a ratio of 26:1 in terms of the number of Google searches in the UK. By May 2020, this had fallen to a c. 7:1 ratio. We believe that PLT's competition is heating up.

Sample taken at 12:50 on May 25, 2020	PLT	ISIF
Followers (000's)	12,400	1,100
Average likes per post	30,806	6,404
Average likes per thousand followers	2.5	5.8

Figure 60: Instagram follows and the likes of the last 20 posts as of 12:50 on May 25, 2020. Source: Instagram, ShadowFall.

Social Blade	PLT	ISIF	PLT to ISIF Ratio
Instagram followers (000s)	12,421	1,110	11.2x
Monthly average followers gained (000s)	34.2	27.9	1.2x
Monthly growth rate	0.3%	2.5%	0.1x
Engagement rate*	0.18%	0.43%	0.4x

** based upon the last 20 pictures uploaded to instagram*

Figure 61: Social Blade Instagram data for PLT and I Saw It First as of May 25, 2020, Source: Social Blade, ShadowFall.

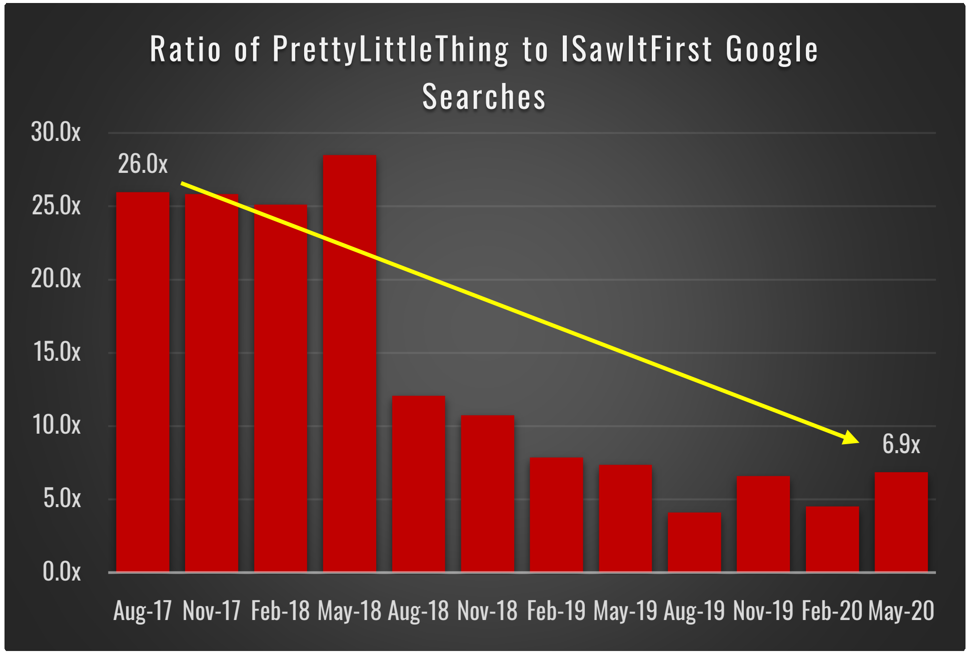
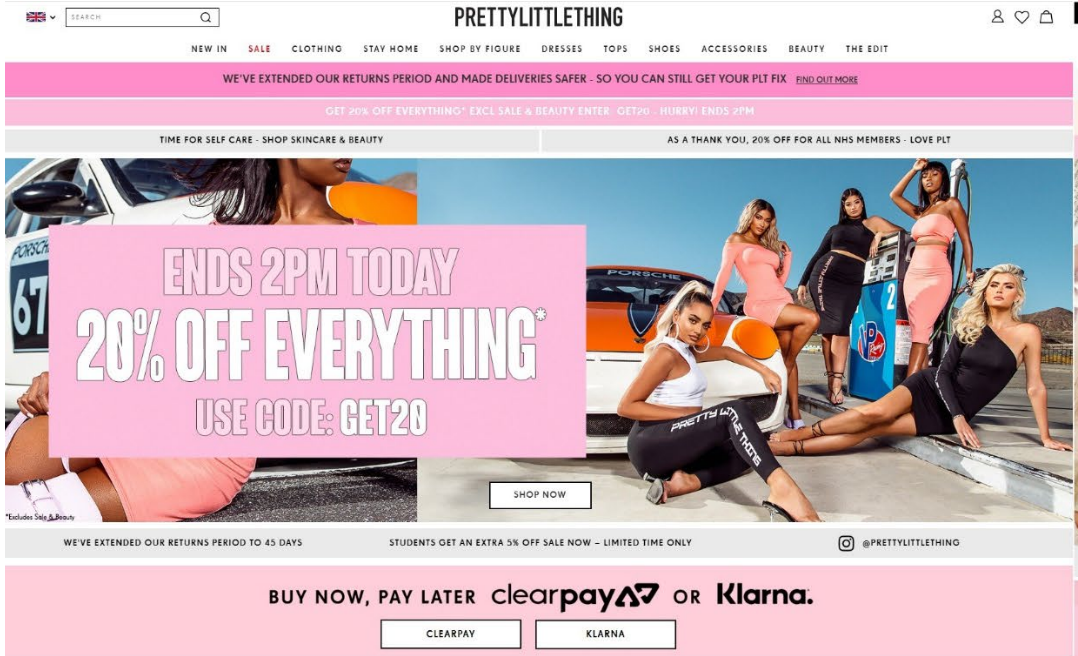
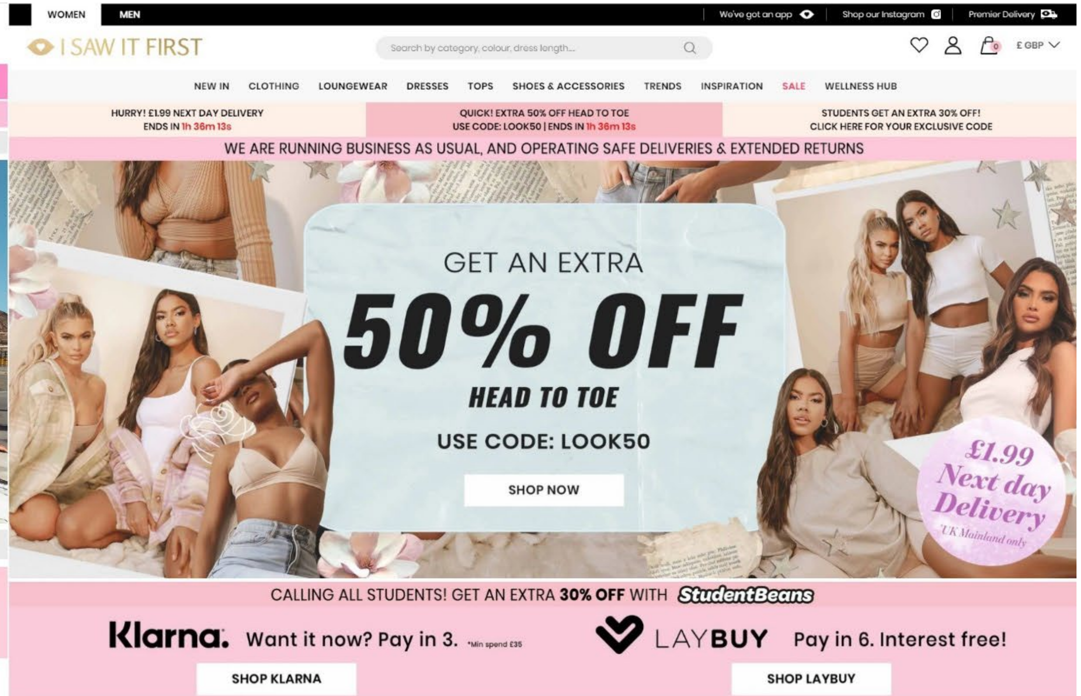


Figure 62: Ratio of monthly Google searches in the UK for PLT against I Saw It First, Source: Google Trends, ShadowFall.

~~HOO~~ WHO WORE IT BETTER?





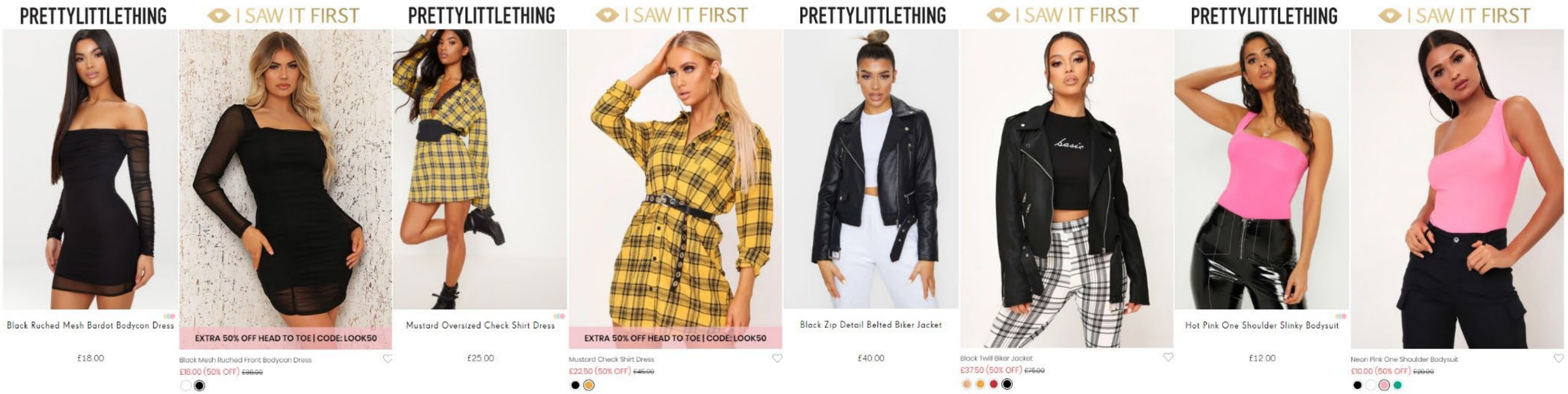


Figure 63 Clothing samples from PrettyLittleThing.com and isawitfirst. Source: www.prettylittlething.com, www.isawitfirst.com, ShadowFall.

Figure 64 Clothing samples from BOOHOO and isawitfirst. Source: www.boohoo.com, www.isawitfirst.com, ShadowFall.


SHADOWFALL