



# SumZero Top Stocks for 2018

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# Finalist

## Best Shorts


**Xxl Asa**

Asset Class: **Equity**    Symbol: **XXL:NO**    Updated: **12/30/2017**    Submitted: **12/27/2017**

EXPECTED RETURN  
**45.7%**


COMMUNITY RATING  
★★★★☆

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BY:  
**Carl Rydin**

CURRENTLY AT:  
**Origo Capital AB**



SHORT

ATTACHMENTS:



TIMEFRAME:

**6 Mo. - 1 Year**

SITUATION:

**Contrarian**


MARKET CAP:

**12.7B NOK**

Sports retailer with aggressive like-for-like accounting at an unreasonable price. Several insiders selling shares!

## About Carl Rydin

Swedish Portfolio Manager with a long/short equity mandate. Origo Capital is an investment firm based in Stockholm with a focus on long-term, active ownership in Nordic equities. We are value investors and manage a concentrated portfolio with a private equity mindset to investing. Our short positions consist of companies with accounting irregularities, balance sheet risk, and/or operating in industries with structural declining characteristics.

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# Xxl Asa

Asset Class: **Equity**    Symbol: **XXL:NO**    Submitted: **12/27/2017**    Updated: **12/30/2017**



BY:  
**Carl Rydin**

CURRENTLY AT:  
**Origo Capital AB**

Pricing & Return Details		SHORT
EXPECTED RETURN		45.7%
INITIAL PRICE		84.50 NOK
TARGET PRICE		50.00 NOK

COMMUNITY RATING: ★★★★★

PERCENTILE: 71%

Sports retailer with aggressive like-for-like accounting at an unreasonable price. Several insiders selling shares!



ASSET CLASS:  
Equity



SITUATION:  
Contrarian



TARGET ALLOCATION:  
2% - 5%



CATALYSTS:  
Accounting  
Irregularities/  
Fraud and 1 more



TIMEFRAME:  
6 Mo. - 1 Year

## Investment Thesis

### Company Overview

XXL is a Norway-based sports retailer with high growth ambitions across the Nordic region and Austria. The company focuses on selling apparel and equipment at low prices from its large physical stores as well as selling online. The company started in 2001 with store openings in Norway and followed with new stores in Sweden, Finland and Austria (online in Denmark). XXL's strategy has been based on operating with low OpEx and therefore allowing low prices to consumers. XXL's EBITDA margin has been around 10% and is very dependant on keeping the OpEx low. Its Nordic expansion took place while its competitors struggled to manage costs, leading to XXL gaining market share.

In 2010, the Swedish PE-firm, EQT, bought 65% of XXL. They managed to further streamline the cost structure and investing heavily in new store growth. XXL went public

in 2014 and EQT subsequently sold part of its ownership and later all of its stake in a placing. Today, the largest shareholder is founder, Øivind Lønnestad Tidemandsen (24%).

XXL has grown from NOK 4bn in sales in 2013 to over NOK 8.5bn in 2017. Current market cap is NOK 11.8bn with NOK 1.9bn in net debt.

According to XXL's 2016 annual report, it's mission and strategy are: "XXL's mission is to be a leading European sports retailer for branded sports, outdoors and wilderness products at the best prices. XXL expects to sustain continued like-for-like growth and believes in a potential to grow further in Norway, Sweden, Finland and Denmark".

"XXL believe we may increase the store base in the Nordics to around 85 stores in total in the coming years. With the Group's cost control, uniform store layout and broad product ranges, XXL is able to take advantage of synergies

during roll-outs with minimal incremental investments and costs at headquarters and central warehouses”.

#### Financials

NOKm	2012	2013	2014	2015	2016
Revenues	3,107	4,010	5,215	6,487	7,812
Gross margin (%)	39.4	40.2	40.8	39.8	39.9
EBITDA	371	460	600	726	823
EBITDA margin (%)	11.9	11.5	11.5	11.2	10.5
Change in WC	-184	-55	-198	-214	-588
Operating cash flow	114	211	448	350	31
Capital Expenditures	-138	-152	-152	-169	-239
Free cash flow	-24	59	296	181	-217
Dividend paid	0	0	0	-277	-277
ROIC (%)	6.6	7.5	12.3	10.4	11.3

NOKm	2015	2016	Q1 2017	Q2 2017	Q3 2017
Cash	87	115	46	292	95
Bank loan	1,100	1,044	1,110	1,096	1,082
Total long term debt	1,094	1,038	1,110	1,096	1,082
Short term debt	0	549	710	1,099	918
Total debt	1,094	1,587	1,820	2,195	2,000
Total net debt	1,007	1,472	1,774	1,903	1,905
12m trailing EBITDA	726	823	756	745	783
Net debt / EBITDA	1.4x	1.8x	2.3x	2.6x	2.4x

## Competitive Landscape

Competition includes primarily traditional local sport retailers and online retailers. As E-commerce is becoming a more important channel, XXL – and other retailers – also compete the owners of the very brands they sell. XXL sells 90% branded goods, and for the most part XXL only sells the low-end products from brands such as Nike, Adidas etc.

In Norway, XXL is on average 8% cheaper than its competitors. Price competition primarily comes from the pure e-commerce players, Boozt, Zalando and Sportamore.

XXL is also the cheapest chain among the Swedish sports retailers, with an average price difference between XXL and a sample of competitors of 8% according to ABGSC. The only retailer with lower prices than XXL in Sweden is Boozt.com. In Sweden, the biggest threat is most likely if and when Amazon will push into the market. Amazon has recently bought the domain amazon.se and is also expanding fast within its AWS platform in the region.

## Short Case - Highlights

The XXL short case is based on several different issues. First, the company suffers from short-term issues including high inventory levels as last winter was warmer than expected, leading to slow seasonal sales. For six straight quarters the inventory to 12m trailing sales have been above 30% (35% as of Q3 2017). The gross margin will suffer as XXL aims to lower this inventory level via major promotions. Also, the expansion outside of the Nordic region will require more capital and be more costly than previous growth within the Nordics.

On a more longer view, a structural shift within consumer shopping behavior from traditional physical stores to higher portion E-commerce will have an effect on XXL given its core focus on large store locations. Its competitive advantage will diminish over time as the best-in-class online retailers such as Zalando and Amazon eventually will take market share in XXL's core markets.

As for the capital structure, the Net Debt to EBITDA is at high levels (2.4x), which puts the future dividend at risk. The dividend has recently been debt financed as the free cash flow is not sufficient to cover the dividend payments. XXL's asset-light model via leased real estate will disappear as IFRS 16 accounting will move off-balance-sheet leases amounting to approximately NOK 4bn onto the balance sheet from 2019.

In XXL's IPO prospectus the accounting methodology for like-for-like growth calculation was very aggressive as it excluded any cannibalization effects from new store openings, refurbished, or moved stores. It basically showed, like-for-like growth without anything negative based on management's opinion. The following is a definition from XXL's IPO prospectus: "Like-for-like growth represents the percentage change in same-store sales in the period presented compared to the same period in the prior year. Same-store sales exclude the total operating revenue of a store for a period if the store was not open for the full period and the entire corresponding period in the prior year. The stores included in the like-for-like growth in total operating revenue are redefined every year. Management excludes stores from like-for-like growth figures for a period if the Company considers the figures to be disrupted during the relevant periods, for example if the stores were moved or were refurbished during the period. Like-for-



like growth (excluding cannibalisation) presents figures on the same basis as described above, but excludes from the calculation stores that the Company believes were “cannibalised” as a result of new XXL stores opening nearby.

Another concern regarding XXL is that insiders have recently been net sellers of shares. The CEO decided to take a few minutes of Q3 2017 earnings call to verbally criticizing short sellers although he decided to sell 665,000 shares the same day.

Overall, XXL has been a darling among sell-side community since its IPO and forward consensus figures have not taken into account tougher competition or any additional costs associated with a European expansion and IT infrastructure related to larger portion online sales.

## Relative Valuation

XXL trades at multiples more than double of international peers. US sporting goods retailers, such as Dick’s Sporting Goods and Foot Locker, with a branded goods product offering are trading at 5x 2018 EV/EBITDA. Applying a more reasonable EV/EBITDA multiple of 8x on 2018e consensus figures implies more than 40% downside to current share price.

XXL versus International Peers

Company	P/E					EV/Revenue					EV/EBITDA					P/Book		
	Last	LTM	NTM	2017e	2018e	Last	LTM	NTM	2017e	2018e	Last	LTM	NTM	2017e	2018e	Last	2017e	2018e
XXL ASA	22.85	25.25	16.66	23.07	16.59	1.70	1.59	1.26	1.52	1.26	16.13	16.94	12.17	16.05	12.12	3.27	3.09	2.77
Peer Median	8.73	10.58	12.60	12.85	12.69	0.50	0.51	0.50	0.50	0.50	4.20	4.55	5.13	4.95	5.16	1.63	1.59	1.41
Sports Direct International pl...	8.90	8.90	21.74	22.87	21.20	0.68	0.68	0.64	0.65	0.64	9.02	9.02	7.17	7.58	6.96	1.65	N/A	N/A
Dicks Sporting Goods Inc	10.77	10.40	11.88	9.99	12.13	0.37	0.35	0.34	0.34	0.33	4.32	3.88	4.39	3.91	4.45	1.60	1.59	1.41
Hibbett Sports Inc.	6.58	10.76	13.32	14.03	13.24	0.38	0.39	0.38	0.38	0.38	3.16	4.41	5.02	4.94	5.03	1.20	1.36	1.24
Foot Locker Inc.	8.55	10.87	11.54	11.67	11.53	0.61	0.62	0.61	0.61	0.61	4.07	4.69	5.24	4.95	5.28	2.09	2.33	2.18

XXL Valuation - Based on Fair 2018e EBITDA Multiple

NOK m except share price	
2018e EBITDA	1,097
Fair Multiple	8.0x
Implied EV	8,772
Net Debt (minus)	1,905
Implied Equity Value	6,867
Shares Outstanding	138
Fair Share Price	49.65
Downside	-41.8%

## Risks

In addition to the obvious risks of shorting a stock, there are company- specific risks associated with the XXL short case:

**Consolidation:** XXL could become a takeover target for a European consolidator looking to gain market share in a specific region (Nordics) as well as operation know-how into OpEx efficiencies.

**Lowest price could win the game:** Some competitors, such as the incumbent sports retailers, have stopped trying to compete on price as they have a hard time maintaining profitable with a lower gross margin caused by discounts. Unless large online retailers, such as Amazon and Zalando, take customer traffic from XXL, customers could view XXL as the best shop for bargain prices.

**European expansion successful:** If management manage to execute a perfect expansion into central Europe XXL would prove its growth success was not limited to its home market in the Nordics.

**Justified relative valuation:** If XXL manages to maintain its growth at double digits as it expands outside of Europe, investors could view the case as a long-term growth story and therefor justify the significant multiple to international

XXL is trading at significant premium to international peers  
An 8x EV/EBITDA multiple on 2018e consensus figures applies more than 40% downside to current share price

peers. This is also what the sell-side community believes is justified currently.

Insiders buying shares: Should insiders buy shares, as oppose to sell which has been the case lately, investors might view this as a strength and sentiment would be positive.

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