02 August 2022

Unlockdown Losers

As we exit Covid-19, 'unlockdown' losers are becoming increasingly apparent. Prominent amongst them are recent IPOs, online vendors and Big Ticket retailers. We have deemed these to be the 'Unholy Trinity'…

Whilst Covid-19 represented a major shock to the economy as a whole, there were winners amongst the losers. These fortunate companies performed extremely well and, in several cases, came to the market via IPOs.

But that was then, this is now. Post unlockdown expectations regarding the 'new normal' have once again been revised. Indeed, the new normal now seems to look quite a lot like the pre pandemic normal. Recent IPOs, as a result, have performed less well, as shown below:

Ticker	Company Name	IPO date	IPO price (p)	Current Price (p)	% change
LON:MADE	Made.com	21/06/2021	200	11.84	-94.08%
LON:WIX	Wickes	28/04/2021	250	136.04	-45.58%
LON:MMAG	Music Magpie	22/04/2021	193	40.15	-79.20%
LON:ROO	Deliveroo	07/04/2021	390	90.98	-76.67%
LON:ITS	In The Style	15/03/2021	200	36.5	-81.75%
LON:VINO	Virgin Wines	02/03/2021	197	69	-64.97%
LON:MOON	Moonpig	05/02/2021	350	204	-41.71%
LON:DOCS	Doc Martens	01/02/2021	370	260.8	-29.51%

In addition, tomorrow is now today and, the economic cost of Covid is becoming clear. Inflation is rampant, real incomes are falling and a cost of living crisis is upon us.

This has implications for spending on non-essentials, particularly Big Ticket items. Hence, an Unholy Trinity of characteristics that are now deemed to be less desirable has emerged.

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EXECUTIVE SUMMARY

Introduction:

The end of lockdowns resulted in an increase in the number of leisure options - holidays, in-store shopping, restaurants, and pubs were now available. More things to spend money on, creating a tougher fight for share of wallet.

High inflation and rising energy costs have put a squeeze on disposable incomes, causing demand to shift in response.

Companies with certain traits (the 'Unholy Trinity') appear to be more vulnerable in the current macroenvironment. These are:

- Recent IPOs
- Online-only retailers
- Big Ticket/highly discretionary retailers

Food Delivery:

Delivery spend is being cut by consumers as it is being perceived as an area where they can tighten the belt. It has remained above its pre-pandemic levels but continues to trend downwards as a percentage of restaurant sales.

This downward trend could put a dent in the hockey stick chart, delaying profitability.

The threat of new entrants, particularly in the most popular micro markets, does not look like it will abate in the short term. Restaurants are also offering stiff competition, trying to turn app users into in-restaurant visits using loyalty schemes.

Online Retail:

Surveys are showing that consumers are planning to save money long term by spending less on clothes for themselves, as disposable incomes reduce. Online sales are more vulnerable than in-store sales, and are falling faster, according to the ONS.

Market visibility is currently poor. The next 6 months look very challenging for online clothes retailers as energy costs soar.

Hobbyists:

An increased amount of leisure options post unlockdown caused demand to disperse, with more places to spend money. At the same time discretionary income is being reduced, with necessities taking a larger share of spend. Subscription service models are firmly in the crosshairs for consumers who are chasing savings.

Big Ticket:

Reductions in disposable income gives consumers an incentive to delay large purchases (as they believe they can do so without adversely impacting their standard of living) to have more cash to cover food and necessities. Therefore, demand tends to tip, rather than fall gently.

Car dealers have benefited from windfalls on existing stock, but windfalls are not permanent. Demand looks uncertain in the near term, and if global supply chains are re-established, then the extranormal margins in this area will recede.

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INTRODUCTION

The market suffered a staggering sell-off as the pandemic loomed large back in March 2020, after which some stocks suddenly looked very favourable to investors, these became the ‘lockdown winners’. Companies that had a specialised online presence enabled customers to shop from home, becoming hubs of demand. For a time, these stocks looked like they would benefit from changing long-term consumer patterns triggered by the pandemic. This success encouraged a raft of IPOs, where owners looked to sell into an optimistic market.

When the lockdowns came to an end, the market entered a period of ‘unlockdown extravagance’ as leisure options increased - holidays, in-store shopping, restaurants and pubs were now available. More things to spend money on, creating a tougher fight for share of wallet. The hospitality industry talked about a ‘wall of money’ upon reopening, but there wasn’t really any more money around. Competition intensified as the cash that was visibly being spent in pubs, restaurants and on air travel had to come from somewhere.

The emergence of the cost of living crisis has wobbled confidence in a lot of these lockdown winners. High inflation and rising energy costs have put a squeeze on disposable incomes, causing demand to shift in response. Areas such as online clothes (ASC, BOO & ZAL), hobbyist retailers (G4M, HFD & NLFX) and online white goods retailers (AO & MADE) have lost their lustre to investors.

It became apparent that companies with certain traits (the ‘Unholy Trinity’) appear to be more vulnerable in the current macroenvironment. These are:

- Recent IPOs
- Online-only retailers
- Big Ticket/highly discretionary retailers

Where a company satisfies all three of these factors, the ‘Unholy Trinity’, it faces material adverse market conditions. One such example is Made.com, which listed at the end of the lockdown period, with the share price tumbling afterward.

It’s relatively easy to be wise after the event. To find reasons for why something happened. But it’s less easy looking forward. Especially when visibility is poor, and companies are understandably tight lipped with their comments on outlook.

The mechanical reasons for the recent market corrections can be examined as follows:

- As interest rates increase, so does the discount rate used to value a company's growth prospects. This is a denominator; therefore any increase starts to devalue growth.
- Changing consumer sentiment and lower visibility impacts on demand patterns and affects the accuracy of forecasts.
- Forecasts are revised, and the market updated - a profit warning is issued.

Hence, growth may slow, that growth may be valued more harshly and would-be investors could eschew any sort of growth premium that had previously been ascribed. Investors are a laterally thinking bunch and a profit warning in one stock can lead to harsh scrutiny of others in the same industry.

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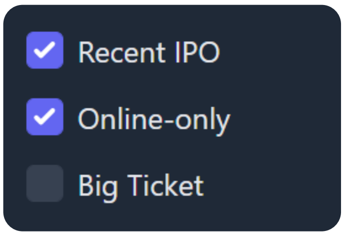
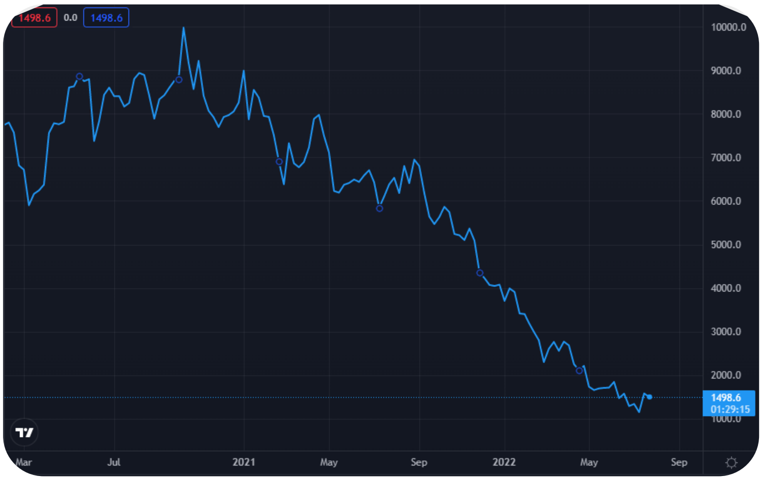
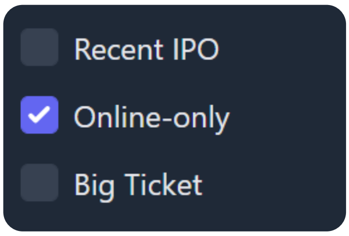
FOOD DELIVERY:

Deliveroo (ROO)
Peak 390p
Current 91p



Just Eat (JET)
Peak 8,750p
Current 1,499p





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Analysis:

Delivery boomed during lockdown. Restaurant food delivery companies, such as Just Eat (JET) and Deliveroo (ROO) and UberEats (unlisted), benefitted as consumers were told to stay home, leading to them ordering products online or through apps.

Restaurant Delivery, in very rough terms, trebled and then fell by a third. And it is that last third that hurts. Because it could put a dent in the hockey stick and delay (or even derail) moves towards profitability. As shown in the charts above, this has not escaped the market's notice.

- ROO listed in 2021 at 390p. This also represents the share's peak price. Since then it has fallen by 76.7% to 91p.
- JET is down 82.9% on its peak price of 8750p in 2020 to 1499p.

Delivery spend is being cut by consumers as it is being perceived as an area where they can tighten the belt. Consumers are opting to get fewer restaurant quality meals delivered to their doors, and instead are out bargain hunting for ingredients to cook themselves.

Premier Foods (PFD) Q1 Update:

"Consumers are increasingly looking to cook tasty affordable meals at home… with good value meal solutions proving increasingly popular as household budgets become ever stretched."

Delivery has experienced a boom and a fall, lockdowns created a captive audience and then reopening allowed that audience to flow back into physical sites. Delivery has remained above its pre-pandemic levels but continues to trend downwards. Restaurant competitors are also trying to channel delivery app users into site visits by using loyalty schemes that are only redeemable in person at the restaurant.

The Fulham Shore (FUL) FY, analysts' meeting:

Delivery and collection pre-Covid amounted to around 15-20% of sales. It rose to 100% during lockdowns and fell to around 50% on re-opening. It is now at 24% and is still falling steadily.

The delivery industry also is threatened by the emergence of new competitors, flush with cash and ready to expand rapidly, offering aggressive discounts. Fantuan, one such new entrant, has made it its mission to take East Asian food off the main delivery apps in London and onto its own. 'Second mover advantage' suggests that the threat of new entrants, particularly in the most popular (and profitable) micro markets, does not look like it will abate in the short term.

The area has become so maligned by investors that Deliveroo bounced on its latest set of downgrades. The more protracted path to profitability and higher discount rates hurt valuations. Downwards trends tend not to inspire confidence, and the threat of competition from both restaurants and other delivery operators looms heavy.

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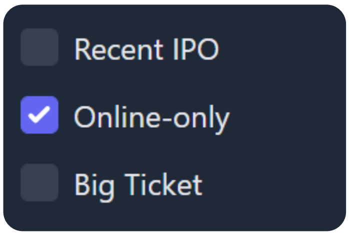
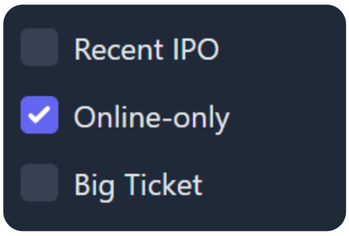
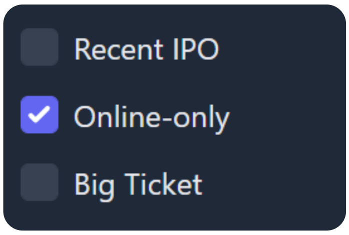
ONLINE CLOTHES:
ASOS (ASC)
Peak 5,600p
Current 1,043p



BOOHOO (BOO)
Peak 412p
Current 68p



ZALANDO (ZAL)
Peak €102
Current €26



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Analysis:

Online shopping thrived during lockdown. Companies such as ASOS (ASC), Boohoo (BOO) & Zalando (ZAL) benefitted as consumers ordered products from the comfort of their home during lockdowns. Growth from future periods was drawn forwards as consumers faced fewer costs by staying at home and the furlough cheques came rolling in.

These companies have gone on to give back considerable gains since being 'lockdown winners'. This has been driven by the resurgence of bricks and mortar operators and the current cost of living crisis, with inflation squeezing the disposable income of households.

Deloitte Consumer Tracker Q2 2022:
"Overall essential spending is down by two percentage points to minus 2% while discretionary spending has lost five percentage points to minus 8% compared with Q1…consumer spending will continue to decrease in Q3 2022. Our spending intention data points to a fall in both essential and discretionary categories in the next quarter."

- ASOS is down 81.4% from its peak price of 5600p in 2018 to 1043p.
- Boohoo is down 83.5% from its peak price of 412p in 2020 to 68p.
- Zalando is down 74.5% from its peak price of €102 in 2021 to €26.

A BBC survey found that 84% of consumers are planning to save money long term by spending less on clothes for themselves. Consumers may be swapping fast fashion for durability, keeping clothes until they wear out, or even buying second-hand. This will create a problem for fast fashion retailers going forwards.

Online sales are falling faster than in-store sales. The ONS reported that overall June retail sales volumes fell by 0.5% YoY, with non-store retailing (predominantly online) sales volumes falling by a disproportionately high 3.7% YoY.

Zalando in Germany has also experienced a torrid time with regards to its share price, stating that it is currently a 'volatile market environment'. Just like the others, it is managing expectations by moving forecasts to the lower end of its guidance range.

Investor sentiment has shifted quickly with regards to online-only clothes retailers. The former 'lockdown winners' have quickly turned into 'unlockdown losers' as discretionary spend comes under pressure.

So what now? The energy cap in the UK is now predicted to rise by 77% to £3,500 per annum in October, with a further rise likely in January. This suggests disposable income is set to deteriorate significantly as wage increases will not keep up. Despite the current limited visibility, the next 6 months look very challenging for online clothes retailers.

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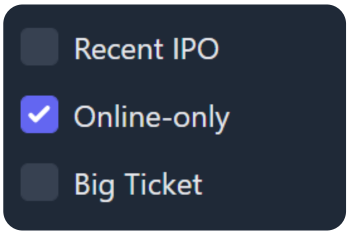
HOBBYISTS:

Gear4Music (G4M)

Peak 1,000p

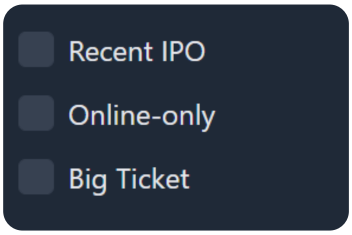
Current 177p



Halfords (HFD)

Peak 431p

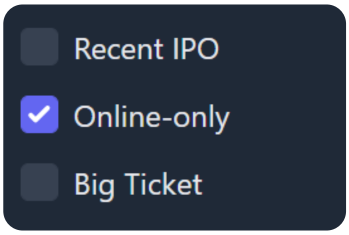
Current 171p



Netflix (NFLX)

Peak $690

Current $228



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Analysis:

Hobbies also enjoyed success during lockdown, with subscriptions growing significantly in popularity. Whether it was paying to watch Tiger King on Netflix (NFLX), buying bicycles from Halfords (HFD) or musical instruments from Gear4Music (G4M), many sales rose. However, with the general public largely back at work, and most in the office for some portion of the week, demand has tailed off.

Easing travel regulations now allow consumers to spend money on overseas holidays. The end of lockdowns led to customers returning to bricks and mortar sites. An increased amount of leisure options caused demand to disperse, with more places to spend money. At the same time discretionary income is being reduced, with necessities taking a larger share of spend. The squeeze on disposable incomes indicates that there is less money to spend in total.

The Fulham Shore (FUL) FY:
"Recent market analysis has detailed a shift in consumer spending to experiences and social outings rather than clothing or big-ticket items."

The hospitality industry had talked about a 'wall of money' upon reopening, but there wasn't really any more money around. The cash that was visibly being spent in pubs, restaurants and on air travel had to come from somewhere. The lockdown winners were coming under pressure.

- G4M has fallen by 82.3% from its pandemic high of 1000p in 2021 to 177p.
- HFD has fallen by 60.3% from its peak price of 431p in 2021 to 171p.
- NFLX has fallen by 67.0% from its 2021 peak price of $690 to $228.

The graphs above show that these 'hobbyist' stocks reached their peak share price around June-October 2021, around the time of 'freedom day' (19 July). This was before the financial cost of the pandemic was yet to be fully realised.

The fight for share of wallet looks set to get tougher, as inflation outstrips wage growth. Necessities such as energy will increase substantially in the autumn, and then again at the start of the new year.

For now, it looks as though consumers are still keen to get back to experiencing the pre-pandemic normality of holidays and group socialising, leaving the hobbyists at a significant disadvantage. Belt-tightening puts subscription service models in the crosshairs for consumers who are chasing savings. This was demonstrated by Netflix, which lost 200,000 subscribers in Q1 2022, falling well short of its forecast of adding 2.5 million.

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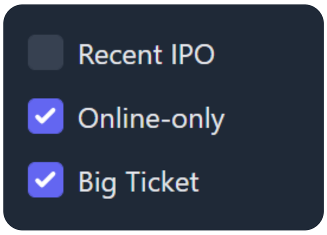
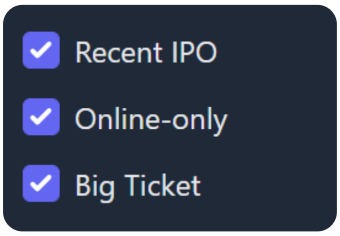
BIG TICKET:

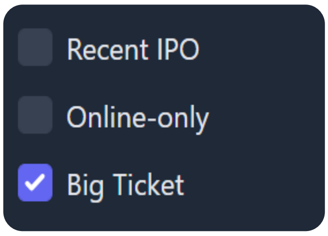
AO World (AO)
Peak 411p
Current 44p



Made.com (MADE)
Peak 200p
Current 12p



Lookers (LOOK)
Peak (post lockdown) 93p
Current 76p



Analysis:

Big Ticket retailers, with the possible exception of holiday retailers, may be in for a period of tough trading. The charts above show the performance of two online white goods retailers, AO World (AO) and Made.com (MADE). Global supply chain issues and the current consumer squeeze has put these stocks under pressure.

Reductions in disposable income gives consumers an incentive to delay large purchases (as they believe they can do so without adversely impacting their standard of living) to have more cash to cover food and necessities. This scenario creates a problem for retailers of highly discretionary items as demand tends to tip, rather than fall gently.

As such, this area has seen a litany of profit warnings and reduced forecasts. This has hammered share prices. MADE fell 45% in its latest update, a company which has all three factors of the Unholy Trinity in play – a recent IPO, an online-only sales channel, and Big Ticket products.

Made.com (MADE) Q2 update:

"Recent trading has been volatile, and the worsening of consumer confidence has impacted demand for discretionary big-ticket items, making new customer acquisition at financially attractive rates challenging."

- AO has fallen by 89.3% from its pandemic high of 411p in 2020 to 44p.
- MADE listed at 200p in June 2021. It has now fallen by 94% in just a year to 12p.
- LOOK has fallen by 18.3% from its post lockdown peak of 93p in January 2022 to 76p.

On the other hand, car dealers such as Lookers (LOOK) appear to be outliers in this area, falling by less than other Big Ticket retailers. It is a similar story of share price resilience for Pendragon as well. The car industry has benefitted from vehicle supply shortages pushing up margins and creating windfalls on existing stock.

Lookers (LOOK) H1:

"New and used vehicle margins remained strong throughout the Period driven primarily by vehicle supply shortages."

However, windfalls are not permanent, and therefore might be painting a misleading picture of the health of this area. If global supply chains were to re-establish themselves, then extranormal margins will recede. At the same time, demand may fall away as consumers look to get an extra year or two out of their current vehicle. This sets up the car dealers as an area of concern for investors, with little visibility over how the next 6-12 months might play out for them.

APPENDIX I - 27 Jul - General thoughts: Wisdom After the Event…

As seen in the Langton Capital Daily Newsletter:

Introduction
- It's relatively easy to be wise after the event. To find reasons for why something happened. But it's less easy looking forward. Here we consider some lockdown winners and why, by and large, they are turning out to be un-lockdown losers:

Delivery, hobbies etc boomed during lockdown:
- Warning. This is all with hindsight. There's a call for some help with foresight at the end.
- Delivery boomed during lockdown. Whether it was the restaurant food delivery companies, Just Eat and Deliveroo, or products such as ASOS & Ocado, consumers didn't go out and ordered products online.
- Hobbies likewise boomed. Whether it was books or bicycles, many sales rose.
- Similarly, subscription services also performed strongly. Netflix with its Tiger King, Disney at its launch and the like.

Un-lockdown:
- Consumers could once again spend money on air travel, holidays in general, eating in restaurants and in pubs.
- There was a 'wall of money' (which the current bout of inflation is proving was always illusory) and this may have cushioned things for a while.
- But there wasn't really any more money around so the cash that was visibly being spent in pubs, restaurants and on air travel had to come from somewhere.
- It wasn't coming from food or necessities and it wasn't coming from savings.
- So it had, assuming all other things stayed equal, come from belt-tightening in other areas including Netflix subs, Naked Wine purchases, Deliveroo sales and the like.

Evidence:
- And so, very much, has it proved.
- The argument from the above may be or could be that 'there has been a permanent shift'.
- And this may be true – but only to an extent.
- Restaurant Delivery, in very rough terms, trebled and then fell by a third. And it is that last third that hurts. Because it could put a dent in the hockey stick and delay (or even derail) moves towards profitability.
- This has led to a series of share price moves. Very few of them good.

A tiny worked example:
- Parsley Box, which delivers meal kits focusing on the over-65s market. It has a market cap of around £13m (at a share price of 17.5p). It listed earlier this year and its shares almost touched £2.
- The company has a 'better' demographic in that many pub & restaurant customers have commented that the older demographic still seems to be staying at home more than it did pre-Covid.
- But hopes have been dented and the company's shares have fallen by over 90%.

Other shares:
- Herewith a selection of share price moves compared with their Covid peak:
    - Ocado down 69%
    - Deliveroo down 77%
    - Just Eat and Naked Wines, both down 83%
    - Asos down 85%
    - Parsley Box down 91%

APPENDIX II - 20 Jul - Unlockdown Losers, Big Ticket, IPOs…
As seen in the Langton Capital Daily Newsletter:

Introduction:

- Market moves comprise the movements of a large number of shares, some of which can be dramatic and many of which will be in opposite directions.
- Yesterday, Hotel Chocolat (ex-glory stock) and Made.com both dropped by 45%.
- Hotel Chocolat hit its highs only earlier this year and is 76% off the top. Made.com is down around 90% on its one year highs.

The worm has turned…

- We've written a few pieces on un-lockdown losers (subscription, delivery, on-line retailers etc.)
- In addition, we have commented on the poor performance of a number of IPOs (in fact, most of them) over the last year.
- We have also suggested that big-ticket retailers, with the possible exception of holiday retailers, may be in for a period of tough trading

An unholy trinity…

- Deliveroo, which actually bounced on its latest downgrades, is an un-lockdown loser and it's a recent IPO. It isn't big ticket but its own RNS earlier this week did make reference to the consumer cutting back in some areas, namely, in this case, on spending with Deliveroo
- Made.com is an un-lockdown loser, it's a recent IPO and it retails big ticket items. It would be doing well to swim against such a tide. But it hasn't managed to do so. Big ticket may wobble if the consumer has no cash.
- Hotel Chocolat is also off our patch but it has some of the above characteristics.

A very little bit of maths…

- Blue sky stocks rely on sustained growth, sometimes into perpetuity. To value that growth, you need a discount rate and, as interest rates rise, so does the discount rate and growth is devalued.
- If forecasts are pulled back, that's a double whammy and, if sentiment changes, that's the hattrick.
- Hence, growth may slow, that growth may be valued more harshly and would-be investors could eschew any sort of growth premium that had previously been ascribed.

The winners:

- This may be a time for tortoises rather than hares.
- Having said that, some of our hospitality winners are hardly tortoises given their propensity for growth.

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