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Research Update:

Academy Sports And Outdoor Inc. Upgraded To 'BB+' On Sustained Modest Leverage Despite Softer Customer Traffic

October 2, 2024

Rating Action Overview

- U.S.-based retailer Academy Sports and Outdoor Inc. has sustained S&P Global Ratings-adjusted leverage well below the 2x area despite modest EBITDA margin contraction.
- We believe expense management initiatives will help Academy maintain relatively steady operating margins and healthy free cash flow generation over the next 12 months despite our expectation for sales contraction of roughly 4% in fiscal 2024 on softer industry demand trends.
- Therefore, we raised our issuer credit rating on Academy to 'BB+' from 'BB'.
- At the same time, we affirmed our 'BB+' issue-level rating on the company's senior secured debt.
- The outlook is stable, reflecting our expectation for steady operating performance over the next 12 months despite softer consumer demand within its segments, leading to S&P Global Ratings-adjusted leverage in the mid-1x area.

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Rating Action Rationale

The rating reflects our expectation that Academy's S&P Global Ratings-adjusted leverage will remain below 2x despite softer operating performance in fiscal 2024. During the second quarter ended Aug. 3, 2024, the company's S&P Global Ratings-adjusted leverage ticked up slightly to roughly 1.4x due to lower sales volume and modestly lower-than-expected EBITDA margin. We now project Academy's S&P Global Ratings-adjusted leverage will be roughly 1.6x at year-end fiscal 2024 and 2025 as it continues to navigate a challenging operating environment. However, we expect operating income and EBITDA margins to improve modestly in fiscal 2025 as the company prioritizes strategic expense management initiatives to reduce costs and drive profitability.

We anticipate Academy will continue focusing on managing robust inventory levels, leverage and utilize its supply chain more efficiently, and drive labor costs down through enhanced labor scheduling systems. Furthermore, we expect reduced freight expenses and a normalized supply chain environment will improve margins in fiscal 2025.

We continue to apply a negative comparable rating analysis modifier to Academy due to its smaller and more geographically concentrated sales base as well as weaker online penetration relative to peers in the highly fragmented outdoor and sporting goods sector, which continues to face significant competition.

We expect Academy's sales growth to remain pressured in fiscal 2024, improving modestly in fiscal 2025. In the second quarter ended Aug. 3, 2024, Academy's total revenues decreased 2.2% year over year, with comparable same-store sales down 6.9% as discretionary spending within the sporting goods and outdoor recreation market remained pressured. We project total sales will be down roughly 4% in fiscal 2024 as Academy continues to navigate through a challenging operating environment. However, we anticipate the company will improve traffic and sales volumes in fiscal 2025 as it continues to implement ongoing promotional initiatives, open new store locations, and refresh its existing store fleet.

Furthermore, we expect customer disposable income levels will likely improve toward the second half of 2025 as inflationary pressures continue to abate, supporting sales growth of roughly 2% for the company in fiscal 2025. Academy has consistently grown its store count over the past several years, primarily through organic growth initiatives. We expect it will continue to grow its store count to 297 to 299 by the end of this year (from 285 currently), expanding its locations further toward 310 to 315 by the end of fiscal 2025.

We expect Academy's conservative financial policy and solid free operating cash flow (FOCF) generation to support the ratings. During the second quarter, Academy revised its 2024 capital spending guidance downward by roughly $50 million as it benefitted from optimizing and reducing costs around its new store openings. As such, we forecast reported FOCF of about $278 million and $289 million after roughly $225 million and $250 million of capital spending in fiscal years 2024 and 2025, respectively. We expect the bulk of expenditures will go toward new store openings, store refreshes and remodels, and new technology investments.

We believe Academy's consistent FOCF provides the company with ample room to fund its growth initiatives, maintain its dividend policy, and continue to execute on its share repurchase program. As of the end of the second quarter of 2024, Academy had $325 million of cash on hand with an undrawn balance under its $1 billion asset-based lending (ABL) facility. In addition, Academy has no near-term maturities, with its $400 million senior secured notes and $400 million term loan facility (of which $90 million is outstanding) both maturing in November 2027 and its $1 billion ABL facility maturing in March 2029. Furthermore, we do not anticipate the company will need to take on additional debt over the next 12 months given its ability to fund its growth and operations through its cash generation.

Outlook

The stable outlook reflects our expectation that Academy will maintain relatively steady credit metrics over the next 12 months, leading to S&P Global Ratings-adjusted leverage in the mid-1x area and consistent FOCF generation despite a challenging operating environment.

Downside scenario

We could lower our ratings on Academy if we expect its S&P Global Ratings-adjusted leverage to rise and remain above 2x. This could occur if:

- Operating performance falls below our base case, particularly from weaker-than-expected profitability and cash flows; or
- The company's financial policy became more aggressive, potentially led by large share repurchases or debt-funded acquisitions.

Upside scenario

While unlikely over the next 12 months, we could raise our ratings on Academy if:

- The company's operating prospects and competitive standing improves such that we would compare it more closely with larger and more diversified competitors. This could occur if the company meaningfully expands its operating scale beyond its current regional scope and expands its competitive position through meaningful growth in its customer base; and
- The company maintains its conservative financial policy, supporting S&P Global Ratings-adjusted leverage sustained comfortably below 2x.

Company Description

Texas-based Academy operates as a full-line sporting goods and outdoor recreation products retailer in the U.S. with more than $6 billion of net sales. As of Aug. 3, 2024, the company operated about 285 retail locations in 19 states with an average size of 70,000 square feet along with three distribution centers. Most of Academy's stores are regionally concentrated in Texas and adjacent southern U.S. states.

Our Base-Case Scenario

Assumptions

- U.S. GDP expands about 2.7% in 2024 and 1.8% in 2025.
- The U.S. unemployment rate rises modestly to 4.1% in 2024 and 4.4% in 2025.
- Revenue declines 3.8% in 2024 before growing 2.2% in 2025 as customer traffic improves from promotional initiatives, store refreshes, and new store openings.
- S&P Global Ratings-adjusted EBITDA margins decline toward the mid-15% area in 2024 before improving to roughly 16% in 2025 due to reduced labor costs and expense management initiatives.
- Capital spending totals about $225 million for new store growth, store refreshes, technology upgrades, and maintenance of its existing locations.
- Annual dividends of $25 million-$30 million and moderate share repurchases.

Based on the above assumptions, we arrive at following metrics over the next 12 months:

- S&P Global Ratings-adjusted leverage of 1.6x in 2024 and 2025;
- Funds from operations to debt of roughly 44% in 2024 and 2025; and
- Positive FOCF generation of $270 million-$290 million over the next two years.

Key metrics

Table 1

Academy Sports and Outdoor Inc.--Forecast summary

	--Fiscal year ended Jan. 31--								
(Mil. $)	**2020a**	**2021a**	**2022a**	**2023a**	**2024e**	**2025f**	**2026f**	**2027f**	**2028f**
Revenue	5,689	6,773	6,395	6,159	5,923	6,054	6,344	6,677	7,048
EBITDA (reported)	526	1,013	953	789	663	696	742	781	825
Plus: Operating lease adjustment (OLA) rent	197	197	201	215	229	240	251	263	275
Plus/(less): Other	32	39	21	24	30	32	32	35	35
EBITDA	754	1,250	1,176	1,028	922	968	1,026	1,079	1,134
Less: Cash interest paid	(213)	(154)	(149)	(154)	(150)	(155)	(159)	(164)	(170)
Less: Cash taxes paid	(16)	(125)	(168)	(132)	(120)	(127)	(137)	(144)	(153)
Funds from operations (FFO)	526	971	858	742	653	686	730	771	812
Debt (reported)	785	687	587	488	485	482	479	476	473
Plus: Lease liabilities debt	1,230	1,161	1,181	1,209	1,278	1,339	1,403	1,468	1,533
Less: Accessible cash and liquid Investments	--	--	(320)	(331)	(297)	(254)	(223)	(220)	(248)
Plus/(less): Other	11	13	17	--	--	--	--	--	--
Debt	2,027	1,860	1,465	1,366	1,466	1,567	1,659	1,724	1,757
Cash and short-term investments (reported)	378	486	337	348	312	267	234	231	262
Adjusted ratios									
Debt/EBITDA (x)	2.7	1.5	1.2	1.3	1.6	1.6	1.6	1.6	1.5
FFO/debt (%)	25.9	52.2	58.6	54.3	44.5	43.8	44.0	44.7	46.2

All figures include S&P Global Ratings adjustments' unless stated as reported. a--Actual. e--Estimate. f--Forecast. $--U.S. dollar.

Liquidity

We assess Academy's liquidity as adequate, supported by full availability under its $1 billion ABL revolving credit facility, cash on hand, and positive funds from operations. We expect liquidity sources will exceed uses by more than 2x over the next 12 months and believe net sources would remain positive even with a 15% decline in EBITDA. However, our liquidity assessment is limited due to qualitative factors, including our view that the company would not be able to absorb high-impact, low-probability events without refinancing.

Principal liquidity sources:

- Balance sheet cash of about $325 million as of Aug. 3, 2024;
- Undrawn balance under its $1 billion ABL facility due March 2029; and
- Roughly $552 million of funds from operations over the next 12 months.

Principal liquidity uses:

- Capital expenditures of roughly $225 million;
- Cash dividends of $25 million-$30 million; and
- Moderate working capital outflows.

Covenants

The company's $1 billion ABL facility is subject to a fixed-charge coverage covenant if excess availability is less than the greater of either 10% of the line cap (lesser of the aggregate amount of the ABL commitments and the borrowing base) or $60 million. We do not expect the company's springing fixed-charge covenant will become applicable over the next 12 months because we forecast ample cash flow generation and no significant revolver borrowings.

Environmental, Social, And Governance

Social factors have a negative consideration in our credit rating analysis of Academy. The company has meaningful exposure to firearms and ammunition sales, which add volatility to its sales and profitability because of the significant unpredictability and meaningful fluctuations in demand, especially before national elections. In addition, regulators and lawmakers have looked to impose increased restrictions on firearm sales. While no new legislation has been enacted, potential changes in the regulatory climate could increase future performance risks. At the same time, we believe this exposure could expose the company to unknown litigation risks.

Issue Ratings - Recovery Analysis

Key analytical factors

- We affirmed our issue-level rating on Academy's secured debt at 'BB+', which is in line with our issuer credit rating.
- The '3' recovery rating reflects our expectation for meaningful (50%-70%; rounded estimate: 55%) recovery in a simulated bankruptcy or payment default.
- We simulate a bankruptcy occurring in 2029 because of lower consumer discretionary spending in a volatile economy, along with a significant step up in competition. This leads to declining consumer spending on sporting goods and, consequently, lower sales and operating margins for Academy, constraining its liquidity.
- We believe the company's senior secured debtholders would maximize recoveries if the company emerges from bankruptcy given its competitive position and the lack of significant owned assets.

- We accordingly estimate Academy's post-emergence value by applying a 5x multiple to our forecast emergence EBITDA. This multiple is in line with the multiples we use for its similar sporting good and other retail peers.

Simulated default assumptions

- Simulated year of default: 2029
- EBITDA at emergence: $187 million
- Implied enterprise value (EV) multiple: 5x
- Estimated gross EV at emergence: $935 million
- A 60% draw on the ABL facility on the path to default

Simplified waterfall

- Net EV (after 5% administrative costs): $888 million
- Priority ABL claims: $603 million
- Remaining value after priority claims: $285 million
- Senior secured debt claims: $494 million
- --Recovery expectations: 50%-70%; rounded estimate: 55%

Note: All debts amounts include six months of prepetition interest.

Ratings Score Snapshot

Issuer credit rating: BB+/Stable/--

Business risk: Fair

- Country risk: Very low
- Industry risk: Intermediate
- Competitive position: Fair

Financial risk: Modest

- Cash flow/leverage: Modest

Anchor: bbb-

Modifiers:

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)

- Management and governance: Neutral (no impact)
- Comparable rating analysis: Negative (-1 notch)

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Upgraded; Outlook Action

	To	From
Academy Sports and Outdoor Inc.		
Academy Ltd.		
Issuer Credit Rating	BB+/Stable/--	BB/Positive/--

Issue-Level Ratings Affirmed; Recovery Ratings Revised

	To	From
Academy Ltd.		
Senior Secured	BB+	BB+
Recovery Rating	3(55%)	2(75%)

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.