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Ratings

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Research Update:

Academy Sports And Outdoor Inc.Rated 'BB-' On Performance And Better Expected Leverage; Outlook Stable

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Rating Action Overview

- U.S.-based outdoor and sports retailer Academy Sports and Outdoor Inc. (Academy, the public parent of New Academy Holding Co. LLC and Academy Ltd.) continues to post strong gains in sales and EBITDA, resulting in better leverage.
- We assigned our 'BB-' issuer credit rating to Academy and raised all other ratings including the issuer credit rating on New Academy Holding Co. to 'BB-' from 'B+'. We also raised the issue-level rating to 'BB-' commensurate with the issuer credit rating.
- We are withdrawing the ratings on New Academy Holding Co. LLC following our upgrade.
- The stable ratings outlook reflects our expectation for adjusted leverage to sustain in the 2x range, while performance normalizes from recent elevated levels.

Rating Action Rationale

Our ratings reflect better-than-expected sales and EBITDA generation, contributing to a significant improvement in credit metrics, which we expect the company to sustain despite moderating performance in 2022. Academy's operating performance over the past year benefited from its market position as a value-oriented retailer along with increased customer traffic and demand for sporting goods and outdoor equipment. Sales growth increased 20% for the 12-month period ended Oct. 30, 2021, while S&P Global Ratings' adjusted EBITDA increased more than 80% to more than $950 million. At the same time, adjusted EBITDA margins improved to the high-teens area, as Academy benefitted from sales leverage, relatively lean inventory levels, and cost-containment efforts helped by lower product promotions. As a result, we expect revenue growth approaching 20% for the fiscal year 2021 compared with our previous expectation of high single-digit increases. In addition, we expect a meaningful improvement in EBITDA and credit metrics including leverage in the high-1x to low-2x range for fiscal year end 2021.

Moreover, we expect the company to sustain adjusted leverage in the 2x area over the next 12 months even after projecting a modest slowdown in performance. This includes an expectation for a low single-digit decline in sales and adjusted EBITDA margins falling to the low- to mid-15% range. We forecast revenue and margin trends to moderate in 2022, reflecting our expectations for higher levels of product promotions, increased competition among direct and indirect sports retailers, and cost pressures amplified by commodity and wage inflation. Our performance expectations also consider slowing consumer spending on sporting and outdoor goods with customers likely scrutinizing spending habits and rebalancing funds toward travel and going out as COVID concerns gradually subside. Still, we think company initiatives will help support performance over the next several years. This includes good inventory management and promotional cadence along with in-store and omnichannel investments. We also believe initiatives like regionally based product assortment, continued merchandise improvement, and new store development will help support business.

We think Academy will maintain a relatively conservative financial policy, supporting the upgrades. Academy has consistently reduced debt since its initial public offering in October 2020, deleveraging by about $800 million in debt. This debt deleveraging and ongoing operating performance growth resulted in an improvement in adjusted credit metrics, including leverage in the mid- to high-1x range recently compared with the low-4x area prior to the initial public offering. Looking ahead, we expect the company to continue to generate healthy cash flow, with meaningful free operating cash flow of more than $400 million. While we expect the company to use most of its excess cash flow for shareholder initiatives, noting the recently announced $500 million share buyback program, we also expect Academy to fund these initiatives using internally generated cash and maintain leverage in the 2x range. We accordingly revise our financial risk profile assessment to intermediate from significant.

Near-term performance volatility and Academy's operating scale remains a risk. We continue to view Academy as a regional sports and outdoor retailer with physical stores primarily in Texas and adjacent southern states. The company positions itself as an everyday low price value player and competes with significantly larger and better-capitalized competitors, companies that include a focus on the mass market or provide specialized sports products. This includes specialized retailers likes Dick's Sporting Goods Inc, (BBB/Stable) and Great Outdoors Group LLC (BB-/Positive) or mass merchants like Walmart Inc. (AA/Stable). We think this puts the company at a potentially long-term disadvantage, as the industry remains prone to product promotions and competitive pricing along with changing customer habits. We also believe sporting goods and related products remain a highly fragmented sector with increasing competition, including both physical retailers and pure-play e-commerce competitors

We also believe Academy and the sports retailing industry may experience more volatile performance over the near term. Following years of relatively modest and stagnant performance, Academy's EBITDA base and cash flow generation expanded significantly during the past two years, partly driven by favorable consumer trends during the pandemic. We estimate adjusted EBITDA will approach $1.2 billion in fiscal 2021, more than double its base of $499 million in 2019. While we expect sports and outdoor goods product categories will continue to see longer-term tailwinds, we also think customers will likely scrutinize spending habits. This will, in our view, result in near-term performance volatility and an overall EBITDA decline of about 15% to a more normalized new base going forward in 2022.

Academy remains largely a physical retailer despite continued investments in omnichannel. We project Academy's digital sales penetration will remain less than 10% of its total sales, which is below that of sports and retail peers such as the 30% at Dick's Sporting Goods Inc.. Moreover, nearly half of its stores are in Texas, significantly more geographically concentrated than peers. While the company further invests in its online capabilities and expands its store base, we continue to view the company as largely a brick-and-mortar, regional retailer operator in a highly competitive space. These factors, in addition to what we consider near-term performance uncertainty, lead us to apply a negative comparative ratings analysis modifier.

Outlook

The stable ratings outlook reflects our expectation that Academy will remain a regional player in the highly competitive sports and outdoor retailing industry. It also reflects our projection for relatively stable credit protection metrics, including adjusted leverage in the 2x area as performance normalizes in fiscal 2022.

Downside scenario

We could lower the rating on the company if:

- Meaningfully underperforms our base case, potentially due to increased competition, inventory challenges, or an inability to execute on strategic initiatives leading to a significant decline in performance over the next 12 months; and
- It sustains leverage above 3x because of underperformance or a more aggressive financial policy.

Upside scenario

We could raise the rating on Academy if:

- The company maintains good operating performance and profitability while expanding its operating scale, especially online over the next few years;
- Under such a scenario, execution of operating initiatives would result in a record of sales growth and stable or expanding adjusted EBITDA margins; and
- The company maintains a relatively conservative financial policy supporting leverage below 3x.

Company Description

Academy Sports + Outdoors (the public parent of New Academy Holding Co. LLC and Academy Ltd.) operates as a full-line sporting goods and outdoor recreation products retailers in the U.S. with more than $6 billion of net sales. The company recently operated about 260 Academy Sports + Outdoors retail locations in 16 states with approximately 18 million square feet of retail space, the majority of which are regionally concentrated in Texas and adjacent southern states.

Our Base-Case Scenario

The recent rapid spread of the Omicron variant highlights the pandemic's inherent uncertainties. While the risk of new, more severe variants displacing Omicron and evading existing immunity cannot be ruled out, our current base case assumes that existing vaccines can continue to provide significant protection against severe illness and economic impact. Furthermore, many governments, businesses, and households around the world are tailoring policies to limit the adverse economic impact of recurring COVID-19 waves. Consequently, we do not expect a repeat of the sharp global economic contraction during the second quarter 2020. Meanwhile, we continue to assess how well individual issuers adapt to new waves in their geography or industry.

- After an estimated increase of 5.5% last year, S&P Global economists forecast U.S. GDP gains nearly 4% in 2022 and around 3% next year while unemployment rate remains low at about 4%.
- We believe revenue increases approaching 20% in 2021, driven by elevated demand levels, followed by a low- to mid-single digit decline in sales this year.
- Our sales projections for the next 12 months assume eight new store openings offset by a modest mid-single decline in comparable store sales.
- Adjusted EBITDA margins in the low- to mid-15% range this year, lower-than-estimated margins around 18% in 2021, falling because of increased promotional activity, competitive pricing, and operating costs.
- A meaningful step up in capital spending to about $150 million annually with investments on omnichannel initiatives, new store openings, general maintenance, and other capital investments.
- No meaningful additional debt reduction for the next 12 to 18 months; and
- We project around $200 million share buybacks over the next 12 months following the announced repurchase program.

Based on our operating assumptions, we arrive at the following credit metric projections:

- S&P Global Ratings-adjusted leverage in the low- to mid-2x range over the next 12 months;
- Funds from operations (FFO) to debt in the mid-30% area in 2022; and
- Reported free operating cash flow generation more than $400 million in 2022 following a projection for nearly $700 million generation in 2021.

Liquidity

We assess Academy's liquidity as adequate and project that it will have ample liquidity sources to satisfy its needs over the next 12 months. This reflects our qualitative analysis of the company's liquidity position. Specifically, we view Academy as having a limited ability to absorb high-impact, low-probability adversities without refinancing given its geographic scope along with highly competitive industry dynamics. In addition, we think Academy maintains a generally satisfactory standing in the credit markets. That said, we project Academy's liquidity sources will remain more than 2x its uses even if its EBITDA unexpectedly declines by 15%.

Our quantitative liquidity forecast assumes:

Principal liquidity sources

- Balance sheet cash of about $401 million as of October 2021;
- FFO of about $$670 million to $700 million annually; and
- Estimated availability under the $1 billion revolving credit facility due 2025.

Principal liquidity uses

- Capital expenditures of about $150 million over the next 12 months;
- Seasonal working capital needs of $150 million annually; and
- Modest contractual debt amortization and non-seasonal working capital investments annually.

Covenants

The company's $1 billion asset-based loan (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 borrowings under the revolver for that period.

Environmental, Social, and Governance

ESG credit indicator: E2, S3, G2

Social factors are a moderately negative consideration in our credit rating analysis of Academy. The company has substantial exposure to firearms and ammunition sales, which add volatility to the company's 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.

Issue Ratings--Recovery Analysis

Key analytical factors

- Our '3' recovery rating on Academy's senior secured debt reflects the value we attribute to the company in a simulated emergence following a default.
- We simulate a default occurring in 2026 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 all leading to constrained liquidity.
- We believe the company's senior secured debt holders would maximize their recoveries if the company emerges from bankruptcy given its lack of significant owned assets.
- We accordingly value the company upon emergence 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.
- After adjusting for the value we attribute to estimated administrative expenses and revolver-related claims, we forecast approximately $410 million in collateral value available to

the secured debtholders.

Simulated default assumptions

- Year of default: 2026
- Emergence EBITDA: $215 million
- Implied enterprise value (EV) multiple: 5.0x
- Estimated gross EV at emergence: About $1.08 billion

Simplified waterfall

- Net EV after 5% administrative costs: $1.02 billion
- Secured revolver claims: $614 million
- Senior secured debt claims: $700 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: Weak

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

Financial risk: Intermediate

- Cash flow/leverage: Intermediate

Anchor: bb

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (No impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: bb-

ESG credit indicator: E2, S3, G2

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

New Rating; Outlook Action		
Academy Sports and Outdoor Inc.		
Issuer Credit Rating	BB-/Stable/--	
Upgraded; Outlook Action		
	To	**From**
New Academy Holding Co. LLC		
Academy Ltd.		
Issuer Credit Rating	BB-/Stable/--	B+/Positive/--
Ratings Affirmed		
Academy Ltd.		
Senior Secured	BB-	B+
Recovery Rating	3(55%)	3(55%)
Rating Withdrawn		
	To	**From**
New Academy Holding Co. LLC		
Issuer Credit Rating	NR	BB-/Stable/--

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.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.