Research Update:

New Academy Holding Co. LLC Upgraded To 'B+' On Debt Redemption And Performance; Outlook Positive; New Debt Rated

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Rating Action Overview

- U.S.-based outdoor and sports retailer New Academy Holding Co. LLC (Academy, a subsidiary of Academy Sports and Outdoors Inc.) is exploring plans to redeem $99 million in term loan debt along with a repricing of the secured facility. This follows the recently announced secondary equity offering that resulted in the financial sponsor reducing their ownership below 40%.
- We raised our issuer-credit rating to 'B+' from 'B' on improved credit measures and our expectation for a less aggressive financial policy.
- At the same time, we assigned a 'B+' issue-level rating and '3' recovery rating to Academy's repriced term loan facility. The '3' recovery rating reflects our expectation for a meaningful recovery (50%-70%; rounded estimate: 55%) in a payment default or bankruptcy.
- The positive outlook reflects the potential for an upgrade over the next 12 months if Academy demonstrates consistent performance and S&P adjusted leverage remaining below 3x on sustained basis.

Rating Action Rationale

The upgrade reflects our view of Academy's improved credit metrics and financial policy. Academy recently stated that its financial sponsors reduced their ownership position to about 32% from 44% as of May 2021 and 55% as of the end of Jan. 2021, thus mitigating the private equity firm's influence on financial policy. The company is also exploring a contemplated redemption of $99 million in debt funded with cash generation and at the same time is seeking a repricing of the secured term loan facility. In addition, Academy's operating performance exceeded our expectations last year as consumers purchased sporting goods in increasing amounts. Moreover, recent performance trends appear to have continued into the first half of this year, as Academy reported significantly stronger-than-projected first-quarter comparable store sales of about 39%.

Following the planned redemption, Academy's funded financial obligations will include $300 million in first-lien term loan debt along with $400 million in pari passu secured notes both maturing in 2027. Although the repayment is not significant relative to total S&P Global Ratings-adjusted debt of around $2 billion, we believe the action indicates the company's willingness to manage its debt leverage with excess cash over time. In addition, we think the repricing will result in a meaningful reduction in the company's interest burden. The repricing and the debt redemption (along with our updated performance projections) leads us to revise our financial risk profile assessment to significant from aggressive. This assessment also incorporates our projection for S&P Global Ratings-adjusted leverage in the mid- to high-2x range and funds from operations (FFO) as a percentage of debt in the mid- to high-20% area.

Moreover, in combination with the recent equity sale reducing KKR's (Kohlberg, Kravis, Roberts) ownership to below 40%, two affiliates of KKR resigned from Academy's board of directors while an independent replacement was appointed by the board. Following shareholder approvals, the company's board will be comprised by a majority of independent directors with six out of eight board members defined as independent. In our view, Academy is no longer a financial sponsor-controlled company, and we have accordingly revised our financial policy assessment to neutral from FS-5.

Following good performance in 2020, we expect continued but moderating growth over the next 12 to 18 months. Academy's operating performance recently benefited from its market position as a value-oriented retailer along with increased customer traffic and demand for sporting goods. Sales growth approached 18% last year while S&P adjusted EBITDA increased more than 50% to $754 million. At the same time, S&P adjusted EBITDA margins improved 300 basis points to 13.3% in 2020, as Academy benefitted from sales leverage, lean inventory levels, and cost-containment efforts. We had expected sales growth around 12% and EBITDA growth around 20% with S&P adjusted EBITDA margins approaching the 11% range.

For 2021, we project moderating but continued growth with good first-half performance that offsets normalizing results later this year. Although we think Academy's performance benefitted from some transitional events like government stimulus, we think company initiatives also helped drive growth. This includes good inventory management and promotional cadence along with in-store and omni-channel investments. In addition, our expectations incorporate the strong performance in the first half of the year, noting the nearly 39% comparable store sales growth in the first quarter. We think this growth mitigates slowing growth over the coming 12 months and expect sales and S&P adjusted EBITDA to increase at a low- to mid-single rate this year.

Academy participates in the highly competitive and mature sports retailing industry and we believe it will maintain a limited market position and remain predominantly a physical retailer. We view the company as a regional player, with stores primarily in Texas and adjacent southern states. The company positions itself as a value player and competes with significantly larger and better-capitalized competitors, competitors focused on either the mass market or whom provide specialized sports products. We think this puts the company at a potentially long-term disadvantage, as we think the sector is 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 from many players, including larger specialty retailers such as Bass Pro, pure-play e-commerce competitors such as Amazon, and big-box retailers such as Walmart.

Moreover, we believe Academy and the sports retailing industry may experience more volatile performance over the medium term, as the positive demand generated during the pandemic normalizes. In addition, we project Academy's digital sales penetration will remain about 10% of its total sales despite its increased investments in omni-channel capabilities, lower than many retailing peers. We continue to view the company's as largely a brick-and-mortar, regional retailer operator in a highly competitive space. These factors, including near-term performance uncertainty and a relative limited track record as a public company, lead us to maintain our negative comparative ratings analysis modifier.

Outlook

The positive ratings outlook reflects the potential for an upgrade over the next 12 months if Academy demonstrates sustained consistent performance gains, resulting in our expectations for adjusted leverage remaining below 3x on sustained basis.

Upside scenario

We could raise the rating on Academy if:

- The company sustains good operating performance and profitability as operations normalize over the next 12 months;
- Under this scenario we would expect Academy to sustain adjusted leverage below 3x and FFO to debt approaching 30%, supported by the company's financial policy.

Downside scenario

We could revise the outlook back to stable if:

- The company meaningfully underperforms our base case, potentially due to increased competition, inventory challenges, strategy execution issues, or a significant normalization in performance over the next 12 months.
- The company shifts to a more aggressive financial policy resulting in adjusted leverage that is sustained above 3x.

Company Description

New Academy Holding Co. LLC (doing business as Academy Sports + Outdoors) is a full-line sporting goods and outdoor recreation products retailers in the U.S. with over $5.5 billion of net sales. As of January 2021, the company operated close to 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

S&P Global Ratings believes there remains high, albeit moderating, uncertainty about the evolution of the coronavirus pandemic and its economic effects. Vaccine production is ramping up and rollouts are gathering pace around the world. Widespread immunization, which will help pave the way for a return to more normal levels of social and economic activity, looks to be achievable by most developed economies by the end of the third quarter. We use these assumptions about vaccine timing in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). That said, our performance projections for the company include the following assumptions:

- U.S. GDP increases 6.5% in 2021 and about 3% in 2022, with a U.S. unemployment rate of 5.5% in 2021.
- Revenue increases at a mid-single-digit-percent rate in 2021 primarily on higher same-store sales in the first half of the year and a normalization in sales in the back half.
- A low-single-digit sales increase in 2022 because of eight new store openings and relatively flat to a modest increase comparable revenue.
- Adjusted EBITDA margins around 13% over the next 12 months on sales leverage, reduced store spending, and cost-management initiatives partially offset by somewhat higher inflationary pressures and labor costs.
- Increased capital spending of about $75 million in 2021 and around $125 million 2022 on omni-channel investments, spending on new store openings, maintenance, other capital investments.
- No meaningful additional debt reduction for the next 12 to 18 months and the company maintains balance sheet cash of at least $400 or more for the medium term.

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

- S&P Global Ratings-adjusted leverage in the mid- to high-2x area over the next 12 months, pro forma for the $100 million debt redemption;
- FFO to debt in the mid- to high-20% range;
- Adjusted interest coverage around 5x over the next 12 to 18 months; and
- Free operating cash flow generation of about $350 million in 2021 and in the $200 million range in 2022.

Liquidity

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

Principal liquidity sources

- Balance sheet cash of about $377 million as of January 2021;
- FFO generation of about $480 million to $500 million; and
- Availability under the revolving credit facility.

Principal liquidity uses

- Capital expenditure of about $75 million over the next 12 months;
- Seasonal working capital needs of $150 million annually; and
- Modest debt amortization and non-seasonal working capital annually.

Covenants

The company's $1 billion asset-based loan (ABL) facility is subject to a fixed-charge coverage covenant if its 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 availability under the revolver for that period.

Issue Ratings--Recovery Analysis

Key analytical factors

- We maintain our '3' recovery rating on Academy's senior secured debt but have revised our rounded estimate to 55% from 50% because of the proposed $100 million term loan redemption.
- We simulate a default occurring in 2025 because of lower consumer discretionary spending in a volatile economy and increased competition. This leads to declining consumer spending on sporting goods and, consequently, lower sales and operating margins all leading to constrained liquidity.
- We believe the company's senior secured debt holders would maximize their recoveries if the company emerges from default given its lack of owned assets. We applied a 5x multiple to our forecast emergence EBITDA to value Academy. This multiple is in line with the multiples we use for its similar sporting good and 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: 2025
- 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
- --Recovery expectations: Not applicable
- Senior secured debt claims: $705 million
- --Recovery expectations: 50%-70%; rounded estimate: 55%

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

Ratings Score Snapshot

Issuer credit rating: B+/Positive/--

Business risk: Weak

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

Financial risk: Significant

- Cash flow/leverage: Significant

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: b+

Related Criteria

- 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: 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

Upgraded

	To	From
New Academy Holding Co. LLC		
Academy Ltd.		
Issuer Credit Rating	B+/Positive/--	B/Positive/--
Issue-Level Ratings Raised; Recovery Ratings Revised		
Academy Ltd.		
Senior Secured	B+	B
Recovery Rating	3(55%)	3(50%)
New Rating		
Academy Ltd.		
Senior Secured		
US$299 mil 1st lien term bank ln due 11/30/2027	B+	
Recovery Rating	3(55%)	

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