HIBBETT, INC.

Valuation Report

Target: Hibbett Sport (NASDAQ: HIBB)

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Hibbett Company Description

Hibbett Sports (NASDAQ: HIBB; "**Hibbett**") is an American sports retailer with a focus on footwear, athletic apparel, and light sports equipment. The company operates under three distinct brands, Hibbett, City Gear, and Sports Additions and is primarily positioned in high-traffic areas such as strip centers and malls. Hibbett is focused on low-competition areas, with a regional focus on the midwestern United States, and as of the end of FYE2023[1], Hibbett operated over 1,100 locations combined across the three store brands.

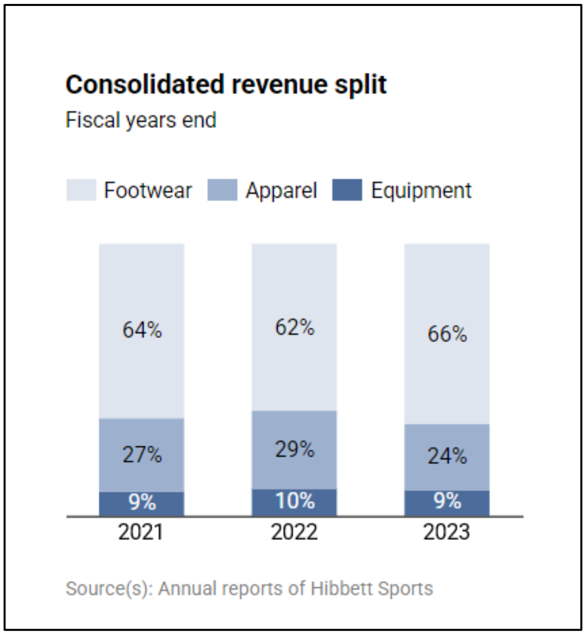

Figure 1: Revenue breakdown of Hibbett's consolidated revenue by product type

Among all three brands, Hibbett's products mainly comprise footwear, as shown in Figure 1. All product types fundamentally revolve around the theme of sports, although consumers appear to wear these sporting goods and footwear for recreational purposes. Sport-specific equipment and footwear exists for certain sports which include but are not limited to basketball, baseball, football, golf, and running. The athletic goods are sourced from manufactured retail brands which include mainly large manufacturers such as Nike, Adidas and Under Armor.

[1] As is common in the retail industry, the fiscal year ends at the end of January or the beginning of February. The conversion as to whether the fiscal year refers to the year in which it begins, or ends is subject to differing convention among Hibbett and its competitors. For the sake of clarity and consistency, this report keeps referring to the Fiscal Year End ("FYE") in all years.

The store mix of the three brands Hibbett, City Gear, and Sports Additions, has changed over time, as illustrated in Figure 2. While the overall number of stores decreased over the period from FYE2019-2023, the number of City Gear stores grew, and the number of Hibbett stores declined. Due to these changes in the business and the partly different nature of the three brands, this section will discuss all three brands in separate sections.

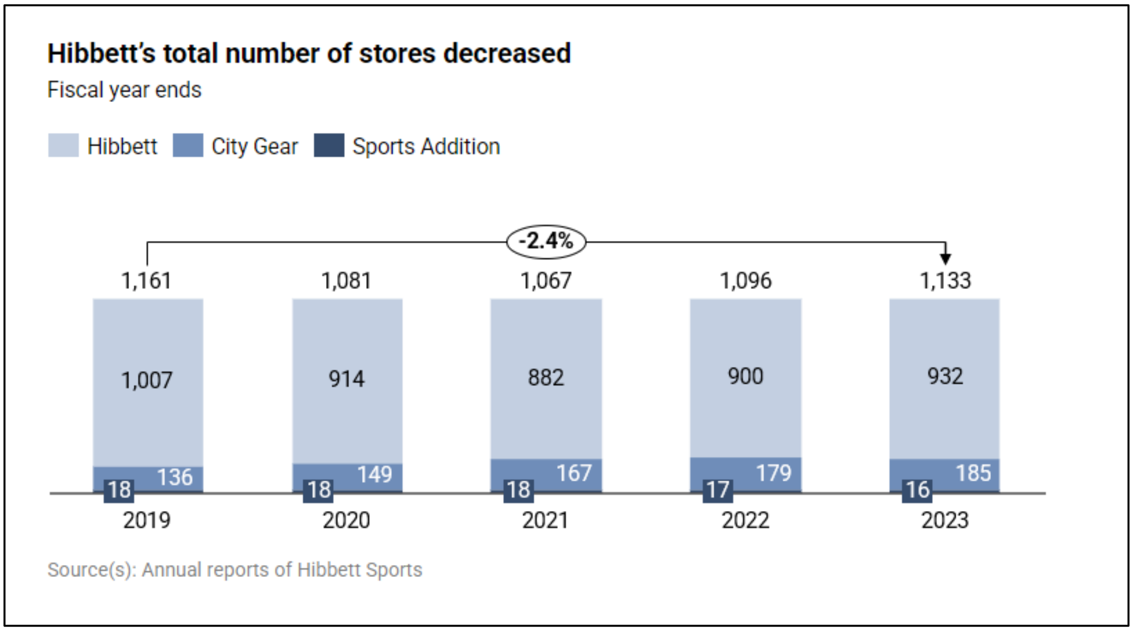

Figure 2: Development of number of stores and store mix for Hibbett

Brand: Hibbett

The main brand "Hibbett" operates medium-sized retail locations that sell a mix of footwear, apparel, and equipment. The Hibbett branded locations have an average location size of 5,800 square feet.

Customer Description. The Hibbett brand is targeted as "fashion" brand with a strong focus on desirable apparel and footwear offerings. The company has a strong relationship with their supplier Nike to consistently hold "in-style" inventory. The target customer of Hibbett is broken into two main groups, the first is younger millennials and generation Z (18-25), and the second is

K-12 students. For each of these categories the main appeal is both the brand value of the merchandise, and the customer shopping experience from each Hibbett Sport location. [2]

Hibbett Store Fronts. During the COVID-19 pandemic, Hibbett reduced the total number of locations from 1,161 to 1,067. Since 2021, the company has focused on steadily increasing the total number of locations under their three Hibbett brands. The placement strategy for Hibbett remains consistent across the three branded stores. The company operates 80% of their stores through strip centers and 20% through malls.[3] Within Hibbett, Hibbett retail locations average 5,800 square feet in which of the current 932 locations, 754 are in strip centers and the remaining 178 Hibbett stores are in malls. Hibbett does not typically operate free-standing locations with only thirty-six of these storefronts in operation. The growth of new locations is undertaken through a clustered expansion program. The company targets new locations near their existing storefronts to save on transportation costs, lower marketing costs, and gain advantages from regional management structures.

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[2] Based on Hibbett 2023 10-K, "Business"

[3] Hibbett 10-K FY2023 under "Our Store Brands" pg.6

Figure 3: Exemplary Hibbett Sports store

The typical Hibbett storefront provides a product offering of Apparel, Footwear, and Sports Goods. The inside stands are typically stocked with T-Shirts, Hoodies, and Sports Jerseys. Moreover, the outside walls are stocked with Footwear and sports equipment.[4]

Brand: City Gear

City Gear is an American sports apparel retailer that was acquired by Hibbett in 2018 as an inorganic expansion into the midwestern United States. As of Fiscal Year 2023, the City Gear brand operates at 185 locations, of which 148 stores are in strip centers and the remaining 37 are in malls. Although the core merchandise is similar across stores, Hibbett considers different demographic considerations between their Hibbett and City gear brands. Typical City Gear

[4] Hibbett "Our Timeline" Website

locations are targeted towards areas that are very low rent and are primarily African American (~90%)[5].

However, it is important to note that City Gear should be seen as a separate entity as opposed to being a Hibbett's store as they appeal to different target markets and represent different brand values. While Hibbett store is branded and structured as a popular and ease of convenience sports and fashion retail store, City Gear was to be seen as a more urban and street fashion store that would be composed of brands and models unique to the store.

City Gear is known for the trend and large cultural influence of popular but unique sneakers have on the community that sports good manufacturers like Nike may benefit from[6].

Brand: Sports Additions

The company brand "Sports Additions" is a segment almost entirely focused on the sale of footwear. Over 90% of the merchandise carried by Sports Additions is athletic footwear[7]. This brand operates most of their locations from malls and are strategically placed near "Hibbett" branded store fronts. As the smallest brand, the company operates 16 stores in the U.S. The Sports Additions locations are the smallest at an average size of 2,900 square feet. The interior of each location resembles that of the main brand "Hibbett Sports" with a noticeable increase in the total volume of shoes relative to other merchandise. The sports addition locations are utilized to rotate inventory for Hibbett, as merchandise that requires a longer time to sell will trickle to Sports Additions locations.

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[5] John Hempton's Newsletter; Hibbett – an informal stock note

[6] John Hempton's Newsletter

[7] Sourced from Hibbett Annual Report 2023; pg. 6.

Industry Overview

The sports retail industry consists of a diverse range of products. It provides products for a wide array of sports such as football, basketball, soccer, running, and other fitness-related activities. Serving a broad customer base, retail sales in sporting goods stores amounted to $63.8b in the U.S. in 2023 [8] . Products include footwear and apparel, sports equipment, nutrition, and recreational equipment. The composition of competitors in the industry ranges from mega-retail and mass merchant locations, specialty and outdoor retailers, and sports retailers. Additionally, this industry offers a plethora of services that support the products offered like sports medicine and recovery, consultation services, and customization services for sports equipment. The sporting goods industry attracts many different consumers with different preferences like fashion, gym equipment, and team sports. Primary customer segments within this industry include professional and amateur athletes, active families, fitness influencers, and casual consumers who generally engage in physical and recreational activities. The sporting goods retail industry has implemented different sales channels like online purchases, brick-and-mortar shops, and a mixture of the two such as online order and in-person pickup.

Market Dynamics. The industry's growth has historically improved consistently with a +6% CAGR (Compound Annual Growth Rate) from 2022 to 2023 globally and a +2% CAGR in North America[9]. Additionally, the industry in North America is expected to grow +6% CAGR by 2027. The retail sales in sporting goods stores have an average growth rate of +4.3% since 2015 to 2023 with spikes in 2020 (+17.2%) and 2021(+22.3%) as a result of the COVID-19 pandemic[10].

This industry tends to a wide target market from sports enthusiasts to individuals seeking fitness and recreational activities. For instance, sports participation has been rising in the US with 78%

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[8] Source from FRED, Retail Sales: Sporting Goods Stores 2023

[9] McKinsey Sporting Goods Report 2024; pg. 20

[10] Source from FRED, Retail Sales: Sporting Goods Stores 2023

of the population identifying as being "active" as opposed to the 73% in 2018 with consistent annual growth in participation. Those whose earn less than $25,000 annually are less "active" than higher income consumers[11]. Therefore, we can infer those with higher income will participate more in sports and recreational activities as well as contribute a larger portion of sales in sports goods. From 2019 to 2022, participation in sports have grown – pickleball/paddle tennis (+159%), basketball (+13%), skateboarding (+36%), golf (+57%), soccer (+9%), and tennis (+33%).

Market Drivers. Sporting goods retail industry is influenced by key drivers that have shaped its growth. These include the rising health and fitness trends, eCommerce and digital expansion, and partnerships/collaboration. The industry is highly competitive with a wide range of retailers holding inventory of sporting goods such as footwear specialty stores, sporting goods stores, department stores, mass merchandisers, and online retailers. Moreover, the industry has a unique dynamic where many retailers such as Nike are a large supplier of merchandise for sports goods stores.

Aligning supply with demand has been a big issue in the sports retail industry with spikes in undersupply and oversupply present over the last three years. Supply chain volatility associated with demand has persisted over the last several years that resulted in an oversupply of sporting goods according to the GEP Global Supply Chain Volatility Index. From the second half of 2020 to the second half of 2022 (throughout the duration of the COVID-19 pandemic), stockpiling due to supply or price concerns alongside increasing transport costs, item shortages, and backlogs contributed to a volatile undersupply of sporting goods[12].

82% of US consumers consider health and wellness one of their top priorities in everyday life. With the wellness market valued at $480b in the US, growing 5-10% annually, younger consumers

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[11] McKinsey Sporting Goods Report 2024; pg. 32

[12] McKinsey Sporting Goods Report 2024. Demand volatility persisting with magnitude volatility indexes ranging from –1.0 to 1.0. GEP Global Supply Chain Volatility Index reached indexes of 6.7 at the peak of the COVID-19 pandemic.

like Gen Z and millennials are purchasing more wellness products and services.[13] With fitness included in the wellness market, the sports retail industry may follow similar growth patterns.

In the third quarter of 2023, eCommerce sales increased 2.3% from the second quarter of 2023, and 7.6% from third quarter of 2023, while total retail sales only grew 1.2% and 2.3%, respectively.[14] Revenue generated in the eCommerce market in the United States has increased at an annual average growth rate of 16.1% and is forecasted to continue to grow by 56.3% ($475.2b) between 2024 and 2028[15]. With over 260m online buyers in 2023 and rapid growth rates in eCommerce sales, sales in the sports retail will be easily influenced and driven by spending habits in the growing eCommerce sector.

Digital and social media expansion has shifted spending habits to a more omnichannel approach to searching for fitness and wellness services. 36-40% of consumers are influenced by social media when considering fitness and wellness services, apparel, and sports equipment[16]. Of the consumers who follow sporting influencers on social media, 88% are open-minded to recommendations influencers promote and 55% have bought something because of the influencer's recommendation.

The sporting goods industry covers a wide range of consumers from fashion to utility in sports and while a large range of products and services are offered, it is important to take a holistic approach when understanding the market competitors for this sector. A market analysis using Porters Five Forces will help to better understand the sports retail industry and Hibbett's position in it.

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[13] McKinsey report on wellness market in 2024

[14] U.S. Census Quarterly Retail ECommerce Sales 3Q 2023

[15] Statista: Revenue of the eCommerce industry I the U.S. 2018-2028

[16] McKinsey Sporting Goods Report 2022; pg. 33

Porters Five Forces

The sport retail market has become a focal point for industry stakeholders seeking to navigate its competitive landscape and identify strategic opportunities for expansion and sustainability. This section aims to conduct a comprehensive market analysis of the sport retail sector, leveraging Porter's Five Forces framework as a foundational tool for evaluating the intensity of competition and the profitability potential within the market.

Porter's Five Forces analysis is a widely recognized methodology for industry analysis and business strategy development. It examines the competitive environment through five critical lenses: the threat of new entrants, the bargaining power of suppliers, the bargaining power of buyers, the threat of substitute products or services, and the intensity of competitive rivalry. By applying this framework to the sport retail market, this valuation report intends to uncover underlying competitive pressures, assess the potential for profitability, and identify strategic imperatives that companies must consider to successfully compete and thrive in this arena.

The section is broken down into five sections for the five forces, the key findings are shown in Figure 4.

The sports retail industry is overall stable but faces pressures mainly from its suppliers and existing competitors

Attractive — Unattractive

Factor	Positive considerations for sports retailers	Negative considerations for sports retailers	Evaluation of the industry
Threat of New Entrants	• Capital requirements are a barrier to entry • Supplier relationships are a barrier to entry • Barriers to exit reduce the attractiveness for new entrants • Brand perception and loyalty are barriers to entry	• Low product differentiation facilitates market entry • Social media reach facilitates market entry from influencer-branded D2C sporting goods	
Threat of Substitutes	• Customer loyalty and customer preferences for retail is empirically strong • Retailers' omni-channel strategies reduce the risk of substitutes	• eCommerce represent a substitute to the brick-and-mortar retail shopping • Many mass-merchant, specialty and discount retailers carry sports apparel and equipment	
Bargaining Power of Suppliers	• Retailers generate significant sales for sport brands • Sport brands can improve operational efficiency through inventory offloading • Sport brands gain access to complimentary customers segments through retailers	• Retailers' revenues are strongly dependent on purchase agreements with sport brands • Retailers compete fiercely for partnerships with sport brands	
Bargaining Power of Customers	• Differentiation and service reduce the bargaining power of consumers • Consumers have little bargaining power with large sport brands	• Sporting goods eCommerce has grown strongly and reduces "switching costs" for customers • High price elasticity for functional products increases the bargaining power of consumers	
Rivalry Among Existing Competitors	• Partnerships with sport brands help sport retailers to maintain a competitive position • Brand building loyalty enables sport retailers to differentiate and avoid competing on prices	• Direct-to-consumer (D2C) sales of sports brands become more popular • Low product differentiation intensifies the head-on rivalry	

Figure 4: Overview of the market analysis using Porter's Five Forces

Threat of New Entrants

The threat of new entrants in the sports retail industry is low. The industry has several factors that limit the attractiveness of an investment in the industry. The power of economies of scale, customer loyalty, and supplier relationships makes it difficult for new entrants to gain substantial traction in the sports retail industry.

There are four main factors that decrease the threat of new entrants.

1. Capital requirements are a barrier to entry. In the sports retail industry, the average revenue carried in each store is worth several hundred thousand to several million dollars. For example, in FY2022, Hibbett average $340k[17] of inventory per store and Dick's Sporting Goods carried an average of $3,600k of inventory per store. The fixed costs for each location are high as the initial cost to open, fill and operate a new store is typically inaccessible for smaller operations. The

[17] Sourced from Hibbett 2023 Annual Report, pg.2

monetary barrier is a deterrent to the expansion of smaller retailers as the initial outflow of capital is significant.

Last, each of the current incumbents have dedicated distribution centers for their retail operations. The cost of purchased transportation for new entrants could be a significant drag on their relative profitability. Purchased transportation is one of the largest expenses in the sports retail industry, and each firm focuses on optimization of their supply chain. As a new entrant builds their economies of scale, each mile of travel will be more expensive than each of the largest competitors in the sports retail industry.

2. Supplier relationships are a barrier to entry. Moreover, the relationship with large suppliers is one of the most important barriers to entry. In most cases, Nike is the largest supplier of sports retailers, accounting for between 40-75% of total inventory purchases from Hibbett, Dick's Sporting Goods, and Foot Locker[18]. In the past, Nike has frequently changed their relationship with suppliers due to performance, strategy, or operational disagreements. For example, after Nike changed their wholesale relationship with Foot Locker, the company's operating margin has trickled down from 8.8% in 2019 to 6.6% in 2023. For new retailers, the volatile relationship with Nike would increase their risk expectations and reduce the expected return of investment into the sports retail industry. The impact would be a reduction in first-time investments in the industry.

3. Barrier to exit reduce the attractiveness for new entrants. The sports retail industry is consolidated as the top five sporting goods companies control more than 70% of the retail market.[19] If a new entrant were to gain substantial size in the industry, the buyer universe is small. In the past five years, the exit of Sporting Goods retailers has comprised of M&A transactions by larger retailers such as the acquisition of City Gear by Hibbett Sports in 2018.

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[18] Sourced from Hibbett, Dick's Sporting Goods, and Foot Locker Annual Report

[19] Top Five companies include Nike, Dick's Sporting Goods, Academy Sports, Foot Locker, and Hibbett

Moreover, the high specialization in the business model, limiting the exit possibilities. The main asset consists of physical locations which are catered to the specific growth strategy of the existing firm, decreasing the attractiveness to a buyer. For sports retail, the main asset for a sports retail business is their inventory, which constitutes 75%-90% of current assets and 40%-50% of total assets. This inventory's value declines quickly, potentially creating a future loss upon the investment's exit[20].

4. Brand perception and loyalty are barriers to entry. A barrier to entry for new entrants is the barrier of customer loyalty. The established competitors in the sports retail industry have several decades of marketing spend, customer loyalty, and brand recognition. The cost of this investment is a nominal amount of several billion dollars, but also includes a time horizon of several years. For a new entrant, the task of differentiating brand identity to change consumer behavior is a significant barrier to entry. The cost related to increasing their brand recognition is not a recoverable cost and is extremely risky.

There are two main factors that increase the risk of new entrants.

1. Low product differentiation makes the market entry easy. In the sports retail industry, the product offerings from each competitor are comparable. Each retailer will typically carry a basket of products from the same supplier at comparable prices. The impact is low product differentiation, which means a new entrant could obtain the exact same product offerings as the incumbent retail companies.

2. Social media reach facilitates market entry from influencer-branded direct-to-consumer sporting goods. The threat of entry from exclusive Direct to consumer fitness brands is high. Over the past decade, social media platforms have given rise to a range of sportswear brands such as Gymshark and YoungLA. According to Pew Research, 30% of young adults have purchased retail

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[20] Sourced from 2023 Hibbett 10-K

products promoted by social media influencers[21]. Online brands benefit from lower costs due to disintermediation of brick-and-mortar retailers. An online brand is typically a direct-to-consumer product with outsourced manufacturing, removing the need for physical retail locations. The low-cost structure removes one of the legacy barriers to the industry: significant capital investment.

Threat of Substitutes

The sports retail segment has a high threat of substitutes. There are several channels to purchase sports goods including online retail, mass merchandise retail, specialty retail, discount retail, and original retailers[22]. The low level of product differentiation means that competitors with established economies of scale can sell comparable products to major sports retailers including apparel, footwear, and equipment. This leaves most sports retailers defenseless from large retailers such as Walmart or Amazon from mimicking their product offerings. A material volume of sales is completed through online retail channels such as Amazon and eBay. This section will focus on alternative methods of purchase to the traditional sports retail channels.

There are two main factors that increase the threat of substitutes.

1. eCommerce represents a substitute to brick-and-mortar retail shopping. Over time, eCommerce channels have increased the accessibility of sports apparel and equipment and threatened market share from the sports retail industry. For example, Amazon, the largest eCommerce platform, provides a platform for thousands of individuals sellers to distribute sports and retail products. The total transaction volume on Amazon in 2022 was $242b, with a considerable amount of apparel sales at 24.7% of total volume. Moreover, sales on Amazon accounted for 31.7% of all online apparel sales in the United States in 2023.

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[21] Pew Research “Impact of Influencers”: https://www.pewresearch.org/short-reads/2022/11/21/for-shopping-phones-are-common-and-influencers-have-become-a-factor-especially-for-young-adults

[22] Original Retailers include companies such as Nike, Adidas, and Under Armor. We denote these companies based on their multi-faceted value offering of manufacturing, physical and online retail.

Specifically for sport retail, Amazon accounted for $3.1B in sales of sports and outdoors goods in 2021, or approximately 17.1% of total eCommerce sales in the segment. In comparison, Dick's Sporting Good only accounted for 10.6% of total sports and outdoor eCommerce sale in the same period. The performance of eCommerce platforms indicates consumers utilize multiple channels to purchase sports goods. Although not a one-to-one replacement to the traditional brick and mortar consumer experience, the rise of eCommerce partly replaces sports retailers' sales.

2. Many mass-merchant, specialty and discount retailers carry sports apparel and equipment. To continue the discussion of sales channel, many merchants with high economies of scale offer products akin to those sold in many sports retailers. Moreover, Walmart and Target are the third and fourth largest online retailers for sports and outdoor equipment at 15.2% and 11.9% respectively. The impact of mass merchants is not yet identifiable in the financial statements as our identified peer set has gradually increased their operating margin since 2018. However, the long-term increase in supply can lead to a decline in profitability for sports retail. The largest barrier to entry for sports retail is the economies of scale required for a national operation, but mass merchants and specialty retailers have the necessary resources to enter the market segment. For example, Walmart shares several joint costs to manufacture, store, and distribute sports equipment as they do to sell groceries. This increases the expected return from an investment in sports retail products, subsequently attracting potential investment. With higher availability of resources, mass merchants can sustain slimmer profit margins justified by higher quantities, therefore, substituting existing products in sports retail for mass merchant cheaper options.

There are two main factors that mitigate the threat of substitution.

1. Customer loyalty and customer preferences for retail are empirically strong. According to McKinsey's 2024 Sporting Goods Report [23], Gen Z and millennial consumers prefer an

[23] https://www.mckinsey.com/industries/retail/our-insights/sporting-goods-industry-trends

omnichannel experience over a purely digital or physical experience due to the nature of them being more digitally knowledgeable. Because of this, 50% of these consumers demand frictionless payment systems and 74% are willing to switch brands if the omnichannel experience is not provided or if the experience is not seamless. Therefore, if Hibbett can maintain and grow its omni channel presence, it should be able to limit the impact of the threat of substitutes on its business. As the nation slowly reopened, demand for sporting goods/apparel has experienced steady demand.

2. Retailers' omnichannel strategies reduce the risk of substitutes. Among other retailers, Hibbett makes use of such an omnichannel strategy. Hibbett's omnichannel platform aims to merge the digital and in-person shopping process into one seamless customer experience. Hibbett achieves this by maintaining a digital marketing and shopping presence outside of stores through social media and their Hibbett | City Gear app, which is a mobile shopping extension of their main website Hibbett.com. Moreover, Hibbett also uses technology to optimize their cost and time efficiency, including buy online pickup in store ("BOPIS"), reserve online pickup in store ("ROPIS") and buy online ship to store ("BOSS") customer fulfillment options. Hibbett's adaptability to the online retail marketplace and offering the omnichannel platform can compete with the adapting nature of less reliance on solely brick-and-mortar shops in the sports retail industry. Therefore, the threat of substitution diminishes as Hibbett can compete with online retail sales channel substitutes.

Bargaining Power of Suppliers

In the highly competitive sports retail industry, the bargaining power of suppliers is high. To evaluate the dynamics of the supplier relationships, this section will discuss both the factors that increase the bargaining power of sport brands and retailers. This section will place a central focus on the supplier Nike, as it is the major supplier in the sport retail industry and its position is a significant consideration when analyzing the industry landscape.

There are two main factors that increase the bargaining power of sport brands.

1. Retailers' revenues are strongly dependent on purchase agreements with sport brands. For instance, in 2022, Nike accounted for an astonishing 70% of Hibbett's merchandise sales, 65% of Foot Locker's, and 23% of Dick's Sporting Goods' total inventory. The significant proportion of revenue that sport retailers derive from Nike products notably increases Nike's bargaining power. This heavy reliance means that losing Nike as a supplier could potentially destabilize these retailers financially, potentially even pushing them towards insolvency. The sheer volume of sales attributed to Nike underscores the sportswear giant's dominant position in the market and the extent to which retailers depend on its brand to drive customer traffic and sales. This gives Nike considerable leverage in negotiations. Whether this revenue will remain the same is hard to predict. The growing share of Nike products suggests the prospect that Nike might remain the prominent brand for the sports retail segment. A "slew of new" brands in certain geographies, own-brand initiatives of sport retailers and changing consumer preference[24] suggest the prospect that sport retailers' supplier concentration may change in the future.

2. Retailers compete fiercely for partnerships with sport brands. Nike's high demand across retailers allows it to be selective in its partnerships. While sport retailers in the industry often face a strong supplier concentration (see point 1 above), Nike does not face retailer concentration. In fact, in the Q1 FY2024 earnings release, Nikes CFO Matthew Friend shared that "no single partner [represented] more than a mid-single digit of Nike's total business."

This diversified retailer base has given Nike the space to focus its partnerships by cutting ties with several retailers over the past years. The competitive environment among retailers like Hibbett to maintain and enhance their relationship with Nike. The pursuit of exclusivity in product offerings, as envisioned by leaders like Dick's CEO Lauren Hobart, further intensifies this competition, amplifying Nike's bargaining power with its other retailers.

However, there are also three main factors that mitigate Nike's bargaining power.

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[24] https://www.mckinsey.com/industries/retail/our-insights/state-of-fashion

1. Retailers generate high sales for sport brands. Despite a strategic shift towards direct-to-consumer channels, a significant two-digit portion of the largest sport brands still comes from retail partners (see Figure 5). For instance, in FY2023 Nike's sales through retailers accounted for approximately 52% of its North American sales. This figure underscores the ongoing importance of wholesale partnerships in Nike's distribution strategy and suggests a level of bargaining leverage for retailers, albeit moderated by the growing emphasis on direct-to-consumer sales.

However, it is unclear whether sport brands will require retailers in the long term to maintain their sales. A change of the channel mix to direct sales may be induced both by the consumer, and by the brands. First, it may be induced by the consumer. Recent growth in sector agnostic direct-to-consumer sales (see Figure 5) can be interpreted as a change in consumers' preferences. Market evaluations from KPMG[25] and McKinsey[26] suggest that this pattern in commerce is there to stay. This trend of consumers to buy directly from brands may also apply to sports brands because they fulfill certain motivational reasons for consumers' direct-to-consumer desire. Notably, they can offer a better price for consumers -- the main motivator for direct-to-consumer sales, as found by a study in 2023[27]. If these changing consumer preferences continue to induce more willingness to buy directly from brands, sport brands might not require retailers to the same extent in the long run to maintain their sales.

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[25] https://kpmg.com/xx/en/home/insights/2022/10/the-rise-of-direct-to-consumer.html

[26] https://www.mckinsey.com/industries/consumer-packaged-goods/our-insights/direct-to-consumer-eCommerce-in-appliances-a-strategic-growth-opportunity

[27] Censuswide; Wunderman Thompson Commerce: The Future Shopper 2023, page 47

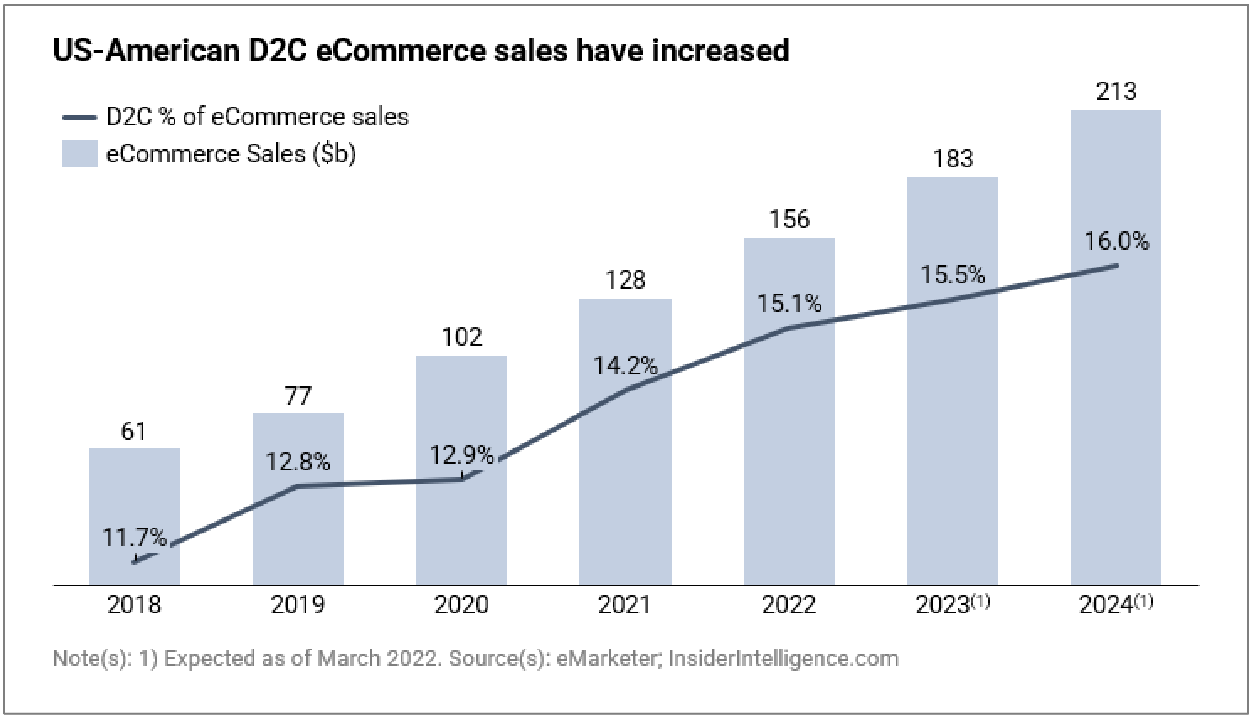

Figure 5: Development of US-American direct-to-consumer eCommerce sales, 2018-2024E

Second, even if consumers don't drive the change in the channel mix, sport brands may be able to successfully induce the change from their end. The main catalysator for this is a strong brand which enables the sport brands to recapture the sales of previous retail partners. The prospect of this catalysator has already been discussed. For example, Nike mentioned it on several occasions, including on previous investor relations presentations.

FY22 Q2 Nike conference call[28]	"Over the past four years, North America has reduced the number of wholesale accounts by roughly 50 percent, <u>while delivering strong growth and recapturing consumer demand</u> through Nike Direct and our strategic wholesale partners."

[28] https://s1.q4cdn.com/806093406/files/doc_financials/2022/q2/FY-2022-Q2-Earnings-Release-Conference-Call-OFFICIAL-TRANSCRIPT-FINAL-(1).pdf

FY21 Q2 Nike conference call[29]	"As we look forward, we're going to be more aggressive in adjusting our plans with undifferentiated wholesale, but what I would tell you is that we believe that we, and our partners, are very well-positioned to capture demand that gets dislocated from changing the profile and the shape of the marketplace"

If sport brands achieve a change in the channel mix to direct sales, be it induced by the consumer or by the brand directly, this would reduce retail partners contribution to the brands sales and thereby undermine their bargaining power.

2. Sport brands can improve operational efficiency through inventory offloading. Nike's inventory tends to lose value quickly due to changing consumer preferences and seasonal shifts. The company can mitigate this depreciation by offloading inventory through retail partners like Hibbett if stockpiles up. This strategy is evidenced by the events during the Covid-19 pandemic. Nike faced a glut of inventory due to supply chain disruptions and temporarily reversed its strategy of reducing reliance on wholesale partnerships[30]. This necessity highlights a dependence on retailers for inventory management, and thereby slightly reducing its bargaining power.

3. Sport brands gain access to complimentary customers segments through retailers. Hibbett Sports plays a crucial role in expanding Nike's reach into new customer segments. This includes customers who prefer to physically try on products before purchasing and those in underserved markets without direct access to Nike flagship stores or its digital platforms. These areas

[29] https://s1.q4cdn.com/806093406/files/doc_financials/2021/q2/Nike-Inc.-Q2FY21-OFFICIAL-Transcript-with-QA.pdf

[30] https://www.cnbc.com/2023/03/20/foot-locker-renewed-Nike-relationship.html

underscore Hibbett's value in complementing Nike's geographical footprint and tapping into a broader consumer base. This dependency curtails brands bargaining power, as they benefit from the diverse market access provided by sport retailers. For example, in the FY2023 Q4 Earnings Release Conference Call, Nike's CEO Donahoe explained as a reason to move back to retail partnerships was, they are those certain partnerships "help us serve distinct segments of consumers or price points" and that Nike will "continue to expand our marketplace strategy to enable access to as many consumers as possible".

The bargaining power of suppliers, as illustrated by the relationship between Hibbett Sports and Nike, is a multifaceted force shaped by operational, strategic, and market dynamics. While factors such as inventory offloading and access to new customer segments provide Hibbett with some leverage, the overarching trends favoring direct-to-consumer sales, higher margins, and Nike's selective partnership strategy enhance Nike's bargaining position. As sport retailers navigate this complex landscape, they must leverage their value propositions to maintain a favorable position in their relationship with wholesalers like Nike.

Bargaining Power of Customers

With the growing popularity of eCommerce making sporting goods more accessible, countered by consumers' preference for physical shopping, the bargaining power of customers is moderate.

There are two main factors that increase the bargaining power of consumers.

1. Sporting goods eCommerce has grown strongly and reduces "switching costs" for customers. Over the past decade global sporting goods eCommerce revenues have increased from $36.9b in 2017 to $84.3b in 2023, and global revenues are projected to grow at a 9% CAGR until 2027.[31] With the adoption of eCommerce, it becomes easier for customers to switch to another competitor carrying the same branded merchandise within their own eCommerce channel because Hibbett offers a broad selection of branded merchandise that is not unique to their retail

[31] https://www.statista.com/forecasts/1362447/sports-and-outdoor-eCommerce-revenue-worldwide

brand (i.e. Nike Shoes, Adidas Shirts, etc.). In fact, 89% of digital consumers browse multiple sites before making significant purchases,[32] which suggests that there are insignificant switching costs for digital consumers. This easy access to online channels provides generally greater bargaining power to customers.

2. High price elasticity for functional products increases the bargaining power of consumers. With many private label options providing the same functionality of equipment as branded equipment, there is more bargaining power of consumers who value functionality over brand. For example, a mouthguard sold by Nike is $16.00 while a similar mouthguard sold by the smaller brand Shock Doctor Pro is sold for $7.99.[33] A consumer who cares more about functionality would have greater bargaining power because they could easily switch to the cheaper Shock Doctor Pro mouthguard which costs half the price of the branded Nike mouthguard. However, the bargaining power of customers is limited by the fact that although brand quality is not always directly correlated with product functionality, in some cases it is. Therefore, customers would have less bargaining power with larger, quality brands with greater pricing power.

There are two main factors that decrease the bargaining power of customers.

1. Differentiation and service reduce the bargaining power of consumers. Although the total eCommerce revenues from sporting goods online sales is growing, the fraction of eCommerce sales out of total sales is growing at a much slower rate, projected to stabilize at just under 30% of total annual sales until 2027.[34] With around 70% of sports and outdoor goods sales projected

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[32] https://1worldsync.com/wp-content/uploads/2023/10/1WorldSync-2023-Consumer-Product-Content-Benchmark-Report.pdf

[33] https://www.hibbett.com/accessories/sport-accessories/mouthguards/?srule=top-sellers&start=0&sz=24

[34] https://www.statista.com/forecasts/1365646/sports-and-outdoor-eCommerce-online-offline-sales-distribution

to be in-store and offline[35], consumers seem to value coming into retail stores to purchase sporting goods. This value may come from interactions with sales representatives, experiential offerings within the physical store, omnichannel fulfillment strategies, or another mix of value-adds that can only be present in a physical store. For example, Dick's Sporting Good's Golf Galaxy Performance Centers are equipped with golf-specific technologies and trained service representatives that cater directly to consumers who are interested in golf products.[36] This immersive experience offered by Dick's builds brand loyalty and decreases the bargaining power of golf enthusiasts, who care about receiving expert and premium service. Outside of Dick's, specific stores have differentiated service offerings which cater to different consumers with varying service expectations, limiting the options of each individual consumer to choose a store that fits their needs. Thus, the customer demand for tailored in-store experiences decreases the bargaining power of consumers.

Hibbett in particular also decreases the bargaining power of customers between stores through their niche growth strategy and local market focus. In dense metropolitan areas with many different retail competitors, the bargaining power of customers may still be high because it is easy for customers to go to another store. However, Hibbett specifically targets underserved markets in the South and Midwestern U.S. which don't have access to competitor retailers. In fact, in Q3 FY2022's conference call, management stated that within three miles of a Hibbett store location, 50% of have no competition, and 70% have one or less competitors.[37] Thus, by strategically targeting these smaller, underserved communities, Hibbett limits the bargaining power of customers between stores to a medium level.

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[35] https://www.statista.com/forecasts/1365646/sports-and-outdoor-eCommerce-online-offline-sales-distribution

[36] Sourced from Dick's Sporting Goods FY2022 10k, Pg. 4

[37] https://justvalue.substack.com/p/hibbett-sports-hibb-a-pure-value

2. Consumers have little bargaining power with large sport brands. Most sports retailers like Hibbett carry a portfolio of branded and private label products within their physical and online channels. When considering the bargaining power of consumers with sport brands, consumers have little influence over the pricing power of major brands like Nike and Adidas. These two brands are the two largest sportswear brands by revenue ($49b and $22b in FYE2023, respectively[38]). Thus, although there exist many brands and suppliers in the space, these two brands receive enough significant demand that limits the bargaining power of their many customers.

Rivalry Between Existing Competitors

The sports retail industry is highly competitive with several national, regional, and local chains of retailers, each selling comparable products. Each competitor in the industry sells a product mixed with little supplier differentiation. The result is a homogenous expense margin across each of the companies in the competitive universe.

There are two main factors that explain the rivalry between existing competitors.

1. Direct-to-consumer (D2C) sales of sports brands become more popular. The direct-to-consumer business model has become more popular among sport brands. As illustrated in Figure 6, the share of direct-to-consumer sales versus wholesale has increased for four of the five largest sportwear brands measured by sales[39].

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[38] https://www.statista.com/statistics/900271/leading-sportswear-and-performance-wear-companies-by-sales-worldwide/

[39] S&P Capital IQ; Hexagon Capital Alliance Market Monitor: Outdoor & Recreation, page 8

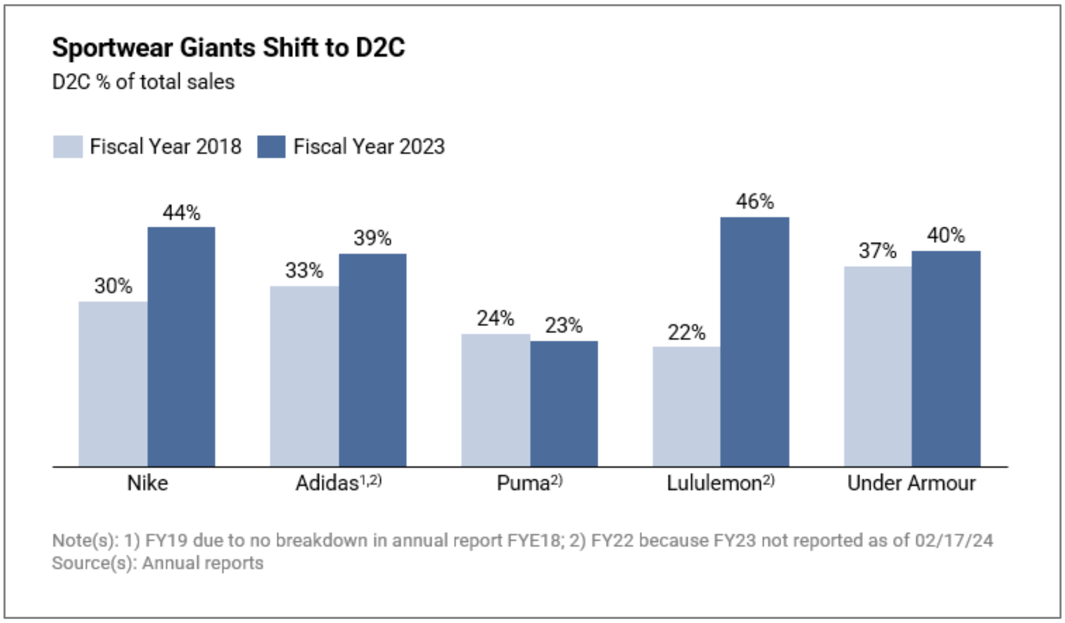

Figure 6: Breakdown of revenues by channel for largest sportwear brands, FY2018 and FY2023

Furthermore, not only did the mix between wholesale and direct-to-consumer sales change, but also the growth of the absolute direct-to-consumer net sales looked promising for sport brands. For example. The direct-to-consumer business demonstrated a 14.2% sales CAGR from fiscal years 2016 to 2023, compared to a mere 0.8% sales CAGR for the wholesale business in the same period. See Figure 7 for details.

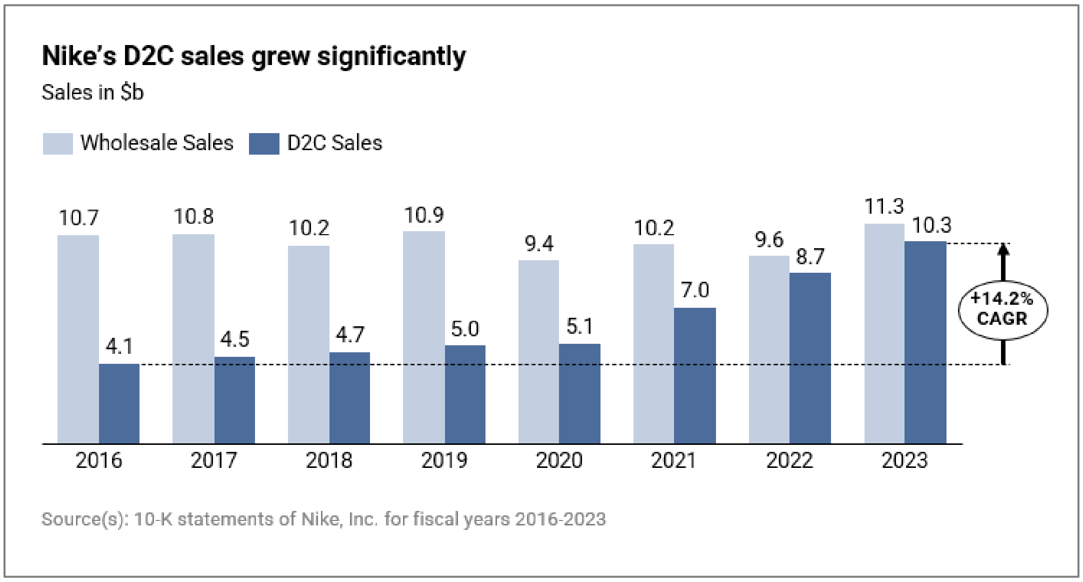

Figure 7: Revenue breakdown of Nike by channel from fiscal years 2016-2023

This stark financial contrast underscores the shifting focus towards direct-to-consumer as a long-term strategic priority for several sport retailers. For example, Adidas AG set itself the goal to "shift to a DTC-led business model" which Adidas "projected to account for around half of the company's total net sales by 2025 and to generate more than 80% of the targeted top-line growth"[40].

Ceteris paribus, the financially more attractive sales through own channels represents a strong alternative to the wholesale business of sport brands. This alternative diminishes the relative importance and bargaining power of wholesale partners like Hibbett.

As discussed in the threat of substitutes section, the competitiveness of the industry extends beyond the scope of physical sports retail. Each of the above-mentioned competitors offer an eCommerce platform to sell similar products to customers through their personal applications or websites. The impact of this omnichannel solution limits the total up-charge of products as the

[40] https://www.adidas-group.com/en/media/news-archive/press-releases/2021/adidas-presents-growth-strategy-own-the-game-until-2025/

customer has a wide range of options to purchase a comparable good. Moreover, as many of the sport retailers carry identical goods, it is easy for a counterthreat to benefit from customer experience of the physical locations but purchase their products from a direct competitor.

2. Low product differentiation intensifies the head-on rivalry. The sports goods retail industry is saturated with numerous players with similar product mixes. Hence, the broad spectrum of competitors leads to a high level of competition outside of the sports brands space. With little differentiation in products among suppliers, customer choice and differentiation lie in the quality of the shopping experience, culture, and brand loyalty. As elaborated on in the Threat of New Entrants section, the main value proposition is the customer experience at the respective competitor's store. Each competitor in the industry benefits from long-term customer loyalty and brand identification from their advertising and product placement.

However, the actual products that are sold in each sports retailer are essentially identical. For example, the same pair of Nike "Jordans" shoes can be purchased from Nike, Foot Locker, Hibbett, and other market participants. The industry thus largely competes on price per unit, as the consumer has many options to purchase the same good. Consequently, sport retailers are not only dependent on having the same supplier drive their sales, but also run the same risk of timely merchandise shipping and judgement of appealing products.

Additionally, by having comparable product offerings at similar price points, the customer segments that are attracted to popular products react similarly, regardless of the company the product is distributed towards. For example, the all-white Nike Air Force 1 '07, notably one of the most popular sneakers of recent years with the most popular sneaker brand, is offered through Hibbett and its competitors at $115. However, given they're the same product, Hibbett has 4,555 customer reviews to the sneakers with an average rating of 4.6/5.0 stars, Foot Locker has 1,930 customer reviews with an average rating of 4.6/5.0 stars, and Dick's Sporting Goods has 1,837 customer revies with an average 4.6/5.0 stars rating[41]. Despite being different companies, by offering the exact same product at the same price, the customers gave in aggregate similar reviews. However, it is important to note that Hibbett received more than twice the reviews than Foot Locker and Dick's Sporting Goods. Therefore, similar reviews for similar products irrelevant to the company offering the product indicate low product differentiation, resulting in more emphasis on the customer experience and brand loyalty when assessing Hibbett's company growth.

Generally, price parity holds for the products being sold at sports retail stores. Popular sports apparel and equipment will not have much differentiation in pricing across companies. Therefore, because of insignificant price changes among competitors, consumers have few reasons to switch between retailers when considering their purchases. Moreover, the price differences and premiums that competitors implement are through online orders and shipping fees. For instance, Dick's Sporting Goods has shipping fees that range from $8.99-$24.99 or free shipping if the order amount surpasses a certain threshold. Hibbett offers a standard shipping fee of $7.99 and free shipping for members, and Foot Locker offers shipping ranging from $9.99-$27.99. Outside of in-store orders and exclusively with online orders, the premiums that these companies can set are on their shipping fees. However, making the shipping fee separate from the actual product price, consumers may be more inclined to switch to the retailer with the cheapest shipping fee. However, entrenched in the price of products, the price differences are insignificant for consumers to switch between retailers strictly for product price changes.

Though, of the main competitors of Hibbett, Dick's Sporting Goods incudes vertical brands that it owns and are exclusively available in their own stores. Therefore, although the majority of sales are from national brands, Dick's Sporting Goods can compete and rival Hibbett more due to having an increased product mix in both inventory purchase depth and vertical branding.

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[41] Hibbett, Foot Locker, and Dick's Sporting Goods Website for Nike Air Force 1

There are two main points that help retailers mitigate the rivalry in the industry.

1. Partnerships with sport brands help sport retailers to maintain a competitive position. One method of mitigating increased rivalry is to maintain close relationships with main suppliers like Nike that drive sales and growth for them. By establishing and maintaining a strong relationship with their suppliers, strategic partnerships foster benefits for both parties in brand loyalty and customer experience. For instance, in Nike's Q2 FY2024 call, Nike management had noted Hibbett as one of its "key partners", acknowledging the alliance the companies have with each other.

2. Brand building loyalty enables sport retailers to differentiate and avoid competing on prices. One way that sport retailers, such as Hibbett, Dick's Sporting Goods, Footlocker, and Academy Sports, demonstrated to build stronger brand loyalty is to emphasize the consumer and in-store experience. Sports retail stores may push loyalty programs and an immersive experience of online and in-store that is unique to their own company brand. By doing so, consumers may be more attracted to the brand of the retail store, rather than the sport brand manufacturing the product. The cultural proximity of City Gear to the Afro American community is a point in case.

Overview of closest sport retail competitors

Hibbett mainly faces competition from its three American competitors Dick's Sporting Goods, Academy and Foot Locker. The section will discuss each competitors positioning and differentiation; the main results are shown in Figure 8.

Hibbett Sports mainly faces competition from three American publicly listed sports retailers

Dimension	Dick's Sporting Goods	Academy Sports	Foot Locker	Hibbett Sports
Stock Ticker	NYSE: DKS	NASDAQ: ASO	NYSE: FL	NASDAQ: HIBB
Description	Mainly a one-stop-shop for consumers who desire sporting products, significant part of revenues is from sports equipment	Regional retailer concentrated in the Southern U.S. with a broad mix of branded and private label sporting goods; emphasis on outdoors equipment	Global retailer that specializes in offering athletic footwear which premium products and in-store shopping experience	Southwestern Sports Retailer specializing mostly in athletic footwear with some apparel, and equipment; stores often in underserved areas
Revenue (FYE2023)	$12.37 billion	$6.40 billion	$8.75 billion	$1.71 billion
Enterprise Value (as of February 19, 2024)	$16.65 billion	$ 6.64 billion	$5.65 billion	$1.25 billion
Number of Stores	853	268	2,873	1,133

Figure 8: Overview of Hibbett Sport's main competitors

Dick's Sporting Goods

Company Description. Dick's Sporting Goods is large national sports retailer that offers products including sportswear, footwear, light and heavy sports equipment, and outdoor goods. Dick's primarily operates larger retail locations as the anchor tenant of large malls and other shopping centers. Dick's operates a total of 850 locations with 730 of those locations operated under their core "Dick's Sporting Goods" brand. Dick's also operates a plethora of specialty stores including Golf Galaxy, Field and Stream, Public Lands, and Going Going Gone!

The brand focuses on the sale of Sports Goods, Apparel, and Footwear. The breakdown of revenue in FY2022 was 40% Sports Goods and Outdoors, 34% Apparel, 24% Footwear, and 2% non-merchandise revenue. Dick's has a strong focus on their outdoor and heavy sports gear equipment through the sale of hunting and fishing gear, small boats, and workout equipment. Moreover, the business focuses their footwear offerings on recreational sports such as

Basketball, Soccer, Football, and Golf. Dick's has focused on their "Vertical Brands" strategy which is inclusive of their in-house brands. This segment constituted 14% of their FY2022 revenue[42]. The benefit to the company is the higher gross margin from the sale of in-house merchandise as they eliminate the upcharge from their main supplier Nike. The product differentiation is Dick's attempt to reduce the total influence that large suppliers have over the company's inventory, distribution network and price to acquire goods.

Dick's Sporting Goods Differentiator. Dick's Sporting Good's product offerings are more focused on everyday apparel items, footwear and outdoor rather than a "fashion" product offering. Their primary footwear product offerings are concentrated in the Sports Recreation and Team Sports segments, a consumer mix that primarily consists of younger children and young adults. For this reason, the impact of sports involvement, sports entertainment, and the disposable income are significant variables in the expected performance of the company.

Figure 9: Exemplary Dick's Sporting Goods store

[42] Sourced from Dick's Sporting Goods 10-K FY 2022, pg. 5 "Vertical Brands"

Academy Sports

Company Description. Academy Sports is a large sports and outdoor retailer with a strong concentration in the Southern United States. The company has a strong focus on camping, fishing, and hunting product offerings, alongside a healthy offering of apparel and footwear. Academy operates approximately 280 locations with a primary focus on the Southern United States. As a result, 40% of their total locations are in Texas. Academy Sports' FY2022 revenue breakdown was 30% outdoor products, 27% Apparel, 21% Sports and Recreation, 20% Footwear, and 2% accessories sales. [43]

Academy Sports operates three distribution centers in the Southern U.S to receive, store and distribute merchandise to their retail locations. The company has indicated that each distribution center can manage 120 locations, for a maximum number of locations of 360.

The company has a wide range of popular sports good brands such as Nike, as well as a portfolio of twenty private label brands. The breakdown was 80% from national brands, and 20% from private labels. In this mix, no individual brand accounted for more than 11% of their FY2022 sales. Moreover, the company derived 10.7% of their sales through their eCommerce platform in the total amount $684.3m.

Academy Sports Differentiator. The company differentiates itself with a stronger focus on outdoor product sales compared to the stronger focus on sports apparel from peers. Unlike their peers, Academy Sports is not under one primary supplier of goods, instead focused on the brand equity of their portfolio of product offerings.

[43] Sourced from Academy Sports 10-K FY2022, pg.6 "Business"

Figure 10: Exemplary Academy Sports store

Foot Locker

Company Description. Foot Locker is a footwear and apparel retailer operating over 2,700 retail locations in 29 countries across the United States, Europe, Asia, Australia and New Zealand. Foot Locker's product offering is focused on a strong portfolio of popular release of athletic sneakers from manufacturers such as Nike. Foot Locker heavily emphasizes their sneaker culture making footwear consist of 80% of total sales, while apparel and accessory sales compose the remaining 20%[44].

The Foot Locker company operates under several household brands such as "Foot Locker", "Kids Foot Locker", "Champs", and "WSS". In terms of banner and operating segments, the sales breakdown for Foot Locker FY2022 in the U.S. was 51.4% Foot Locker, 26.2% Champs Sports, 11.0% Kids Foot Locker, 9.4% WSS, and 2.0% other.

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[44] Sourced from Foot Locker 10-K FY2022, pg. 34 "Overview of Consolidated Results"

Foot Locker operates eight distribution centers, of which six are in the United States. Abroad, excluding Canada and Netherlands, Foot Locker utilizes services of third-party providers for operations in the U.K., Australia, New Zealand, and Asia.

Figure 11: Exemplary Foot Locker store

Foot Locker Differentiator. The company uses their omnichannel capabilities offering services beyond a brick-and-mortar store. With buy online and pickup-in-store, buy online and ship-from-store as well as eCommerce, Foot Locker FY2022 had sales metrics by sales channel of 82.5% from store sales and 17.5% direct-to-consumer sales, adding to $8.75b in total sales.[45]

Future Growth Drivers. Foot Locker acquired two companies in 2021, WSS and atmos. WSS is an athletic-inspired retailer focused on the growing Hispanic consumer demographic and atmos is a digitally led global premium sneaker/apparel company. Hence, Foot Locker focuses on their

[45] Sourced from Foot Locker 10-K FY2022, pg. 38 "Segment Reporting and Results of Operations"

athletic footwear and appeal to the consumer experience through social and digital channels as opposed to a broader sports apparel/goods product offering from competitors. Comparatively, Foot Locker's product mix concentrates in a wide array of distinct colors/models of sneakers and apparels while maintaining a small mix of brands, whereas other competitors' product mixes offer more range in the several types of apparel and larger range of brands.

Ratio Analysis

For the comparative set, we have selected Hibbett's direct competitors in the sports retail industry inclusive of Dick's Sporting Goods, Academy Sports, and Footlocker.

Return on Capital Ratios

This section will analyze the financial metrics ROA and ROE of Hibbett Sports. A comparative overview of the ratios, including its adjustments, for Hibbett Sports and its competitors is shown in Figure 12.

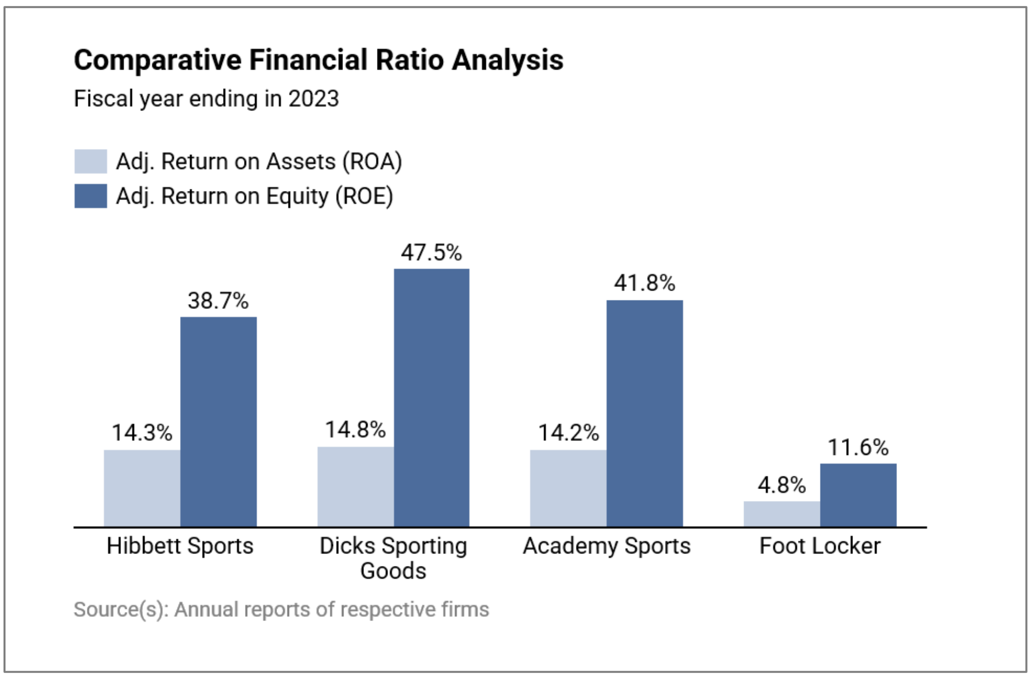

Figure 12: Comparative overview of ROA and ROE

Return on Assets

Comparison to Peer Group. Hibbett Sports has underperformed their peer group based on ROA in FYE 2023 with an ROA of 14.3% compared to Dick's and Academy sports at 14.8% and 14.2%

respectively.[46] In the peer-set, Foot Locker performed the worst at an ROA of 4.8%, driven by a lower operating margin and asset turnover ratio than the average. The company performed relatively better than their peer-set on asset turnover with a turnover ratio of 1.9x compared to the average of 1.4x. The difference is even more pronounced compared to Foot Locker as the gap was 0.8x.

ROA	FYE 2019	FYE 2020	FYE 2021	FYE 2022	FYE 2023
Hibbett	5.8%	4.1%	12.3%	23.9%	14.3%
Dicks Sporting Goods	7.4%	4.7%	8.1%	22.6%	14.8%
Academy Sports	2.6%	3.9%	8.7%	16.0%	14.2%
Foot Locker	15.3%	10.0%	3.4%	9.1%	4.8%

Drivers of Return on Assets. The partially higher ROA in the past years was primarily driven by a lower asset base due to focus on less expensive geographies. The typical Hibbett location is in rural, low-cost areas which have a lower average rent and purchase price. On the balance sheet, this impact reduces to total asset base, subsequently improving the Asset turnover ratio. The difference is substantially driven by the real estate that is reflected on the balance sheet. As a ratio, (PP&E + right-of use assets) / Revenue depicts this setting well and provides a common numerator that is independent of the financing of the real estate (i.e. whether it is leased or owned). As can be qualitatively described by the focus on the less competitive regions, Hibbett demonstrated the lowest average ratio of 22.1% over the period from FYE2019 to FYE2023, while its competitors Academy Sports, Dick's Sporting Goods and Foot Locker had higher ratios of 27.5%, 30.5% and 36.3%, respectively. in FYE 2023.

Sustainability of Return on Asset. In efficient markets in the long run, it seems unlikely that one firm will maintain a consistently higher ROA than its competitors. The company does not have a substantial advantage in their return on assets compared to their peers. We expect their range of ROA to converge near the current industry average of 14.5%. However, our analysis discusses component parts of ROA that may change the long-term performance for Hibbett.

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[46] Peer Set Average is inclusive of the performance of Hibbett

Adjustments. Our analysis has adjusted the return on assets for a comparable unlevered profit margin. The unlevered profit margin excludes gains and losses from securities, gains and losses from one/time events. Moreover, our analysis is inclusive of impairments of goodwill and inventory as we consider these two expenses to be reflective of operational performance. Additionally, we adjusted the total assets by introducing a required cash amount on the balance sheet for each at 5.7%.

For companies such as Dick's Sporting Goods, we have chosen not to remove their increase in cash balance from their ROA calculation as their money market accounts along with commercial paper are utilized to purchase inventory and protect against inflation.

ROA	FYE 2019	FYE 2020	FYE 2021	FYE 2022	FYE 2023
Hibbett	5.6%	4.1%	11.3%	23.1%	15.7%
Dicks Sporting Goods	8.0%	5.1%	7.7%	18.5%	12.2%
Academy Sports	2.7%	4.0%	8.8%	15.7%	14.1%
Foot Locker	13.7%	9.1%	2.9%	8.1%	4.7%

Return on Equity

Over the past five years, Hibbett Sports Return on Equity has substantially increased. The two main drivers of this change were the impact of financial leverage and the increase in unlevered operating margin. The industry experiences a similar trend in the average return on equity nearly Dick's and Academy Sports.

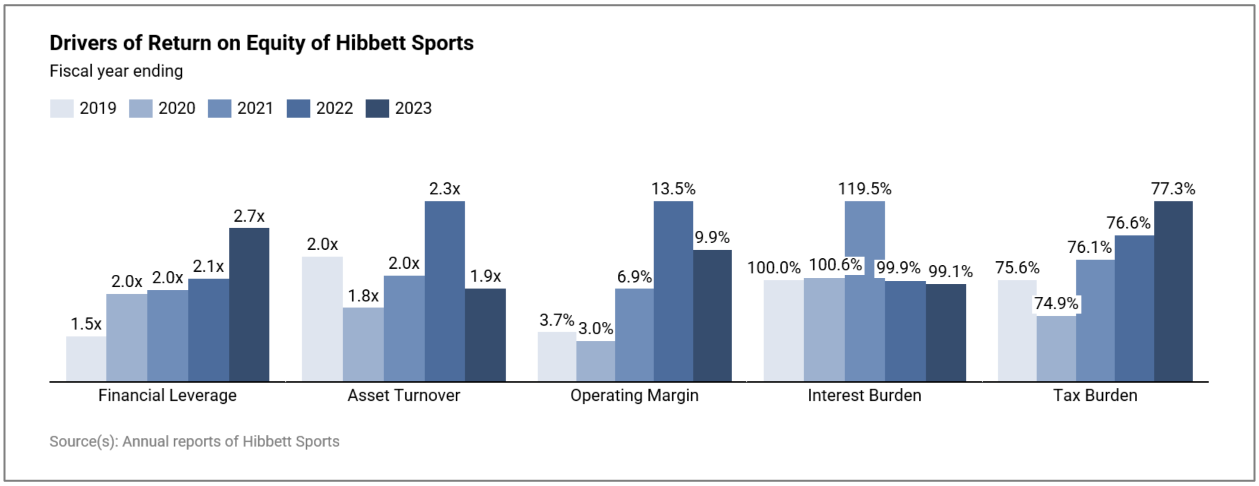

Figure 13: Overview of drivers of ROE

Impact of Financial Leverage. The financial leverage of Hibbett and its comparable companies increased in FYE2020 because of the introduction of ASC842, an accounting standard update by the Financial Accounting Standards Board (FASB) that required companies to recognize lease liabilities and corresponding right-of-use assets on the balance sheet for lease contracts. This change had a profound impact on the balance sheets of many retail companies, including Hibbett, by significantly increasing their reported assets and liabilities.

Prior to ASC842, operating leases were not recorded on the balance sheet, which meant that companies could lease significant properties or equipment without impacting their balance sheet leverage ratios. However, with the implementation of ASC842, these previously off-balance sheet financing activities became visible, leading to an apparent increase in debt levels for companies with substantial operating leases. This was particularly noticeable in sectors like retail, where companies often lease store locations for extended periods.

For Hibbett and its peers, the adaptation of ASC842 meant that the leases for the stores, which are per its definition a substantial part of the brick-and-mortar retail business, were now shown on the balance sheet. Consequently, this increase in reported leverage did not necessarily indicate a deterioration in the financial condition of these companies but rather a more transparent view of their financial commitments.

Sustainability of Return on Equity. The increase in leverage has not resulted in an increase interest burden for Hibbett nor the competitive set. The financial leverage on the balance sheet is reflecting financial leverage that existed prior to the ASC842 change. For this reason, the relative amount of leverage is not unsustainable in the long-term. However, the main driver of ROE in the near-term was a substantial increase in leverage. As the competitive set reaches an equilibrium of Capital Expenditure and Deprecation, we will see a long-term leverage ratio.

Expense Ratios

The expense ratios for each competitor inclusive of Hibbett is homogenous indicating a high degree of competitiveness. The relative difference in expense ratios is typically less than 50bps in each of the historical years, which muddles a clear advantage or disadvantage compared to their peer-set. Our analysis is focused on breaking down the drivers of ratios in the time series and provide context on the differences among competitors.

Cost of Goods Sold Margin[47]

Comparison to Peer Group. Hibbett has performed in-line with the 5-Year historic COGS margin. The average COGS margin has gradually declined from 69.5% in 2019 to 65.9% in 2023. Hibbett performed better than Dick's and Academy Sports by 60bps at 64.8% COGS Margin vs 65.4%. The difference of 60bps in 2023 is attributable to differences in utility and occupancy costs of 45bps[48] and 30bps[49] respectively.

Drivers of Hibbett. The long-term decline in the cost of goods sold margin is attributable to an increase in their inventory turnover, more commonly referred to as an increase in sell-through. Their increase in sell through rate is a positive indicator that Hibbett is progressively increasing

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[47] COGS Margin defined as GAAP Cost of Goods Sold / GAAP Revenue

[48] Sourced from Hibbett FY 2023 10-K, pg.27

[49] Sourced from Dick's Sporting Goods FY2023 10-K, pg.30

their inventory efficiency. We can observe this in the financials as Hibbett's inventory turnover ratio has increased from 2.5x in FYE 2019, to 3.4x in FYE 2023. Moreover, the uptick in gross margin is attributable to the Nike strategic shift to reduce stock from many major sports retailers. As the company grows, we should expect their economies of scale to continue to improve over time.

Sustainability of COGS Margin. As we mentioned above, the total decline in supply has contributed to an increase in profitability for Hibbett. In the near term, we can expect their COGS performance to remain stable as Nike has decided to further improve their relationship with Hibbett through their joint loyalty program. For Nike, Hibbett's niche market share in the rural areas with "Hibbett" and African Americans with "City-Gear" incentivizes a sustained relationship with Hibbett in the future.

However, Nike has indicated an interest in improving their direct-to-consumer channel and has taken action to reduce competition for their retail locations.

Zoom-in: Foot Locker Higher COGS Margin. In 2022, Nike decided to loosen their relationship with Foot Locker as part of their strategy to bolster their own retail and direct-to-consumer channel. Compared to the peer group, the margin impact can be observed in 2023, as their COGS margin compared to FYE 2022 increased by 250bps. Of that change, 240bps was associated with a change in their "Merchandise Margin". [50] The other impacts on Merchandise Margin other than the change in Foot Lockers relationship with Nike are unclear, but it's clear that their performance lagged competitors after the decision.

Adjustment. Our COGS margin is inclusive of impairments related to inventory, inventory shrinkage, and impairments to retail locations. The recurring nature of these expenses gives an indication that they are part of the regular operations in the industry.

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[50] Sourced from Foot Locker FYE 2023 10-K, pg. 23

COGS Margin	FYE 2019	FYE 2020	FYE 2021	FYE 2022	FYE 2023
Hibbett	67.4%	67.6%	64.5%	61.8%	64.8%
Dicks Sporting Goods	71.1%	70.8%	68.2%	61.7%	65.4%
Academy Sports	71.4%	70.4%	69.5%	65.3%	65.4%
Foot Locker	68.2%	68.2%	71.0%	65.5%	68.0%

SG&A Margin[51]

Comparison to Peer Group. Relative to the competitive set, Hibbett has recorded a higher-than-average SG&A expense over the over the period, Hibbett lagged their peer set average, but has closed the difference from 330bps in 2019 to 80bps in 2023. The peer set has remained homogenous since FYE 2022 with the largest spread between Hibbett and Footlocker at 200bps in 2022 and 110 bps in 2023.

Drivers for Hibbett's SG&A Margin. In 2018, Hibbett acquired City Gear as part of their plan to increase their niche market position. From 2019 to 2021, the company recorded expenses associated with goodwill impairments and acquisition costs. Hibbett placed these expenses inside of their SG&A.[52] If the company had excluded these sales, their margin in FYE 2021 would have been 23.7% compared to 25.1%. The company claims that the further decline in SG&A spend is attributable to a year-over-year increase in revenue. The expenses are associated with an options structure that compensated city-gear shareholders over the past five years.

Drivers of SG&A for Competitors. The performance of the peer-set over the period remained stable with the largest difference in the reported SG&A margin for Academy Sports. A large impact for both Dick's and Academy Sports was the increase in revenue relative to their asset base. Although not disclosed, the firms indicate that their fixed expenses are growing slower than their revenue. In other words, the companies are benefiting from improvements in economies of scale.

Academy Sports had a significant decline in their SG&A margin from 25.9% in FYE 2019 to 21.4% in FYE2023. The company experience 100bps associated with their revenue growth outpacing

[51] SG&A Margin defined as GAAP SG&A Expense / GAAP Revenue

[52] Sourced from Hibbett 2021 10-K, pg.33

the growth of SG&A, 70bps related to a decrease in employee costs and a 20bps improvement associated with their IPO related expenses.[53]

SG&A expenses for Dick's remained relatively stable with small changes related to stock-based compensation, employee payroll, and COVID-19 related expenses in FYE 2021 and FYE 2022.

Sustainability of SG&A Margin. In the long term, Hibbett's SG&A margin has steadily declined from 26.2% to 22.8%, and we do not expect this trend to reverse significantly. The historical SG&A margin was weighed down by the acquisition costs associated with City Gear, and as the company has fully integrated the acquisition, their SG&A margin should stabilize near the industry average. As the returns of products along with rebates from suppliers are embedded into the SG&A margin, the strong relationship with Nike could potentially improve their total recoveries from inventory and sales, reducing their SG&A Margin.

Adjustments. Our SG&A margin is exclusive of impairment charges related to goodwill. The SG&A margin utilized in our calculation corresponds to expenses of logistics, salaries, and general overhead.

SG&A Margin	FYE 2019	FYE 2020	FYE 2021	FYE 2022	FYE 2023
Hibbett	26.2%	26.9%	25.1%	22.6%	22.8%
Dicks Sporting Goods	23.5%	24.8%	24.0%	21.7%	22.7%
Academy Sports	25.9%	25.9%	23.1%	21.3%	21.4%
Foot Locker	20.3%	20.6%	21.0%	20.6%	21.7%

Interest and Tax Expense

For the comparable universe, the impact of leverage is relatively homogenous. Of the three comparable companies none were impacted by a large interest expense. The relative amount of operating income that flows into interest payments is less than 10%. However, this figure is relatively understated as the interest expense from operating leases will be displayed in the COGS margin.

[53] Sourced from Academy Sports 2021 10-K, pg. 51

Comparison to Peers. Hibbett compared to their peers experience a lower interest tax burden at 99.1% compared to the peer average of 96.3%. The gap has slightly declined over time as Hibbett has started to use debt instruments on their balance sheet such as a revolving credit facility balance of $36.3m in FYE 2023.

Moreover, the company has experienced a slightly higher tax burden than Dick's and Academy Sports. The company's average tax expense of 25% was above the average tax expense of Dick's at 24.5% As the three are domestic players, the relative tax rates of all three are lower than Foot Locker.

Drivers of Hibbett Additional Expenses. In 2023, Hibbett renewed their revolving credit facility for a max drawdown of $160m. The company typically carried a balance close to zero with a low interest rate, minimizing their total interest expense. In FYE 2023, Hibbett held an average of balance of $40.8m an interest rate 3.2%.[54] The additional borrowing coupled with an above average interest rate led to a 100% increase in the company's interest expense. As the total amount of debt is low relative to the size of the company, the impact on the financial statements is minimal.

The tax rate has remained relatively flat at an average of 24.0% over the time series. The tax expense has been driven by slight changes in federal income tax credits, equity compensation, and a slight increase in the state income tax rate. For example, the state income tax has increased from 2.86% in FYE 2019 to 3.33% in FYE 2023.

Sustainability. We expect the company to continue to utilize their revolving credit facility in the future, and potentially transition to a capital structure more akin to their competitors. Hibbett has a lower-than-average level of 2.7x compared to 2.8x.[55]

[54] Sourced from Hibbett 2023 10-K, pg. 32

[55] Financial Leverage measured as [Average Total Assets / Average Shareholders Equity]

The company's current tax rate is driven mostly by state and federal income taxes. Their federal income taxes remained within 50bps of the average federal and state tax rate of 25%. The overall impact of federal tax credits was minimal during the time series of Hibbett, and we expect this impact to be minimal in the future. Moreover, we do not foresee significant changes in their equity compensation or other expenses that would wedge a tax rate in the range of 23.5% - 25.0%.

Zoom-in: Foot Locker Tax Burden. Foot Locker has experienced a higher-than-average tax expense over the time series. The typical tax expense for the company is between 25% - 35% of pre-tax income. The companies operate a large part of their business internationally. For this reason, the company has experienced an increased burden of 8% from their international sales. This is partially offset by international tax credits, but the total impact is an above average tax expense of 34.3% in FYE 2023.

Academy Sports Tax Burden. In 2019, Academy Sports completed their Initial Public Offering. Due to their existing structure prior to the IPO, the company had a long-term tax benefit from their pass-through income that mitigated most of their tax expense through 2021. During this period their average tax expenses ranged from 2.3% - 9.0% of Pre-Tax income but have since returned to 23.3%.

Interest Burden [Pre-Tax Income / Operating Income]	FYE 2019	FYE 2020	FYE 2021	FYE 2022	FYE 2023
Hibbett	100.0%	100.6%	119.5%	99.9%	99.1%
Dicks Sporting Goods	97.7%	95.5%	93.4%	97.2%	93.5%
Academy Sports	15.7%	43.5%	79.4%	94.6%	94.5%
Foot Locker	101.3%	101.7%	97.7%	98.4%	97.9%

Tax Burden [Unlevered Net Income / Pre-Tax Income]	FYE 2019	FYE 2020	FYE 2021	FYE 2022	FYE 2023
Hibbett	75.6%	74.9%	76.1%	76.6%	77.3%
Dicks Sporting Goods	75.8%	76.4%	79.8%	78.4%	80.6%
Academy Sports	578.2%	224.4%	114.3%	82.2%	80.8%
Foot Locker	75.0%	72.0%	66.4%	73.0%	66.9%

Summary of Expense Ratios

The combination of the COGS Margin, SG&A Margin, and other expenses culminate into the final unlevered profit margin. Over the course of the historical period, the unlevered profit margin has gradually increased for all the competitors in the industry including Hibbett. The cumulative impact of all the above analysis flows into a singular number we have estimated for each company. We summarize our analysis through the bottom measure of unlevered profit margin.

Adjusted Unlevered Profit Margin

Comparison to Peer Group. Over the time series, Hibbett has gradually improved its unlevered profit margin from 2.8% in FYE 2019 to 7.6% FYE 2023. The industry average has trickled to upwards from an average of 4.0% in 2019 to 7.7% in 2023. The overall industry has gradually increased their unlevered profit margin in part due to a decline in COGS and SG&A Margin. The highest growth has come from Academy Sports with a 700bps improvement since 2019 to a 2023 unlevered profit margin of 10.1%.

Key Drivers of Profit Margin. There are two key drivers of the profit margin.

- **Relationship with Nike.** Over the past time series, Hibbett has substantially improved the strength of their relationship with Nike. This has brought the company a considerable number of benefits that we've mentioned above. Their overall COGS margin has improved as the total retail volume of Nike products has declined and the overall pass through has improved as a result. Moreover, the relationship with Nike has yielded a decline in the price to acquire inventory for the business.
- **Reduction in Acquisition Related Costs.** After the acquisition of City Gear, Hibbett recorded several recurring expenses related to the acquisition such as goodwill impairment, stock-based compensation, and other acquisition costs. The impact of the transaction muddled the relative performance compared to their peer-set, as their SG&A margin was 300bps above the average. After the successful integration in 2022, the SG&A margin improved by 200bps, a margin that we expect to persist in the long-term.

Zoom-in: Foot Locker Profit Margin. Over the course of the time series, Foot Lockers profit margin has steadily declined. One source of their decline is related to the deterioration of their relationship with Nike. As a result of a change in their relationship their COGS margin increased by 300bps in FYE 2022. Moreover, the companies average interest rate internationally has increased by 400bps, as the company pays more international tax with fewer international tax credits. In the long-term Foot Lockers relationship with Nike will determine the difference in their COGS margin compared to their peers. However, the company may still be plagued with an above average tax expense.

Sustainability of Unlevered Profit Margin. As we noted earlier, Hibbett and City Gear both dominate a niche market segment with rural customers and African American customers. The company has established a positive relationship with their main supplier Nike, as both companies mutually benefit. The long-term benefits that Hibbett has gained from the relationship inclusive of the joint loyalty program, reduced costs, and decreased competition are expected to persist into the long-term. Nike plans to reduce their total exposure through their wholesale channel, but Nike will retain Hibbett as a key part of their long-term strategy. The long-term unlevered margin will remain close to the industry average, and a long-term leading position is unlikely.

Unlevered Profit Margin	FYE 2019	FYE 2020	FYE 2021	FYE 2022	FYE 2023
Hibbett	2.8%	2.3%	6.3%	10.3%	7.6%
Dicks Sporting Goods	3.9%	3.1%	5.8%	12.6%	8.9%
Academy Sports	2.5%	3.6%	6.7%	10.4%	10.1%
Foot Locker	6.7%	5.9%	2.7%	6.9%	4.3%

Adjustments. Our analysis has made several adjustments to the unlevered profit margin to improve comparability across the sports retail industry. The unlevered profit margin is adjusted for non-operating gains and losses inclusive of gains from the sale of subsidiaries, gains from securities, and gains/losses from discontinued operations. We did not adjust for losses related to the impairment of inventory, goodwill or restructuring as the recurring nature in the income statement gives us confidence these are operational.[56]

[56] Appendix: Disclosure of Adjustments completed to each competitor

Efficiency Ratio Analysis

Our analysis indicates Hibbett has an above average inventory turnover ratio related to the difference in cost between their locations and their competitors. Moreover, the company has a lower proportion of their assets as inventory compared to physical assets.

Turnover Ratios

Comparison to Peers. Relative the peer-set Hibbett has performed in line on inventory turnover ratio at 3.4x compared to Dick's 3.2x, and Academy Sports' 3.4x. The company has operated below Foot Lockers inventory ratio in each of the historical years. Moreover, the company has performed better than their competitors with a total asset turnover of 1.9x compared to Foot Locker at 1.1x and Dick's at 1.7x. The higher total turnover rate is a substantial driver to Hibbett's ROA, giving them a favorable ROA compared to the industry.

Drivers of Turnover Ratios. Hibbett's Inventory Turnover Ratio has gradually improved from 2.5x in FYE 2019 to 3.4x in FYE 2023. One of the primary drivers of this change is the gradual decline of inventory relative to their revenue. Since 2019, the company has changed their inventory as a percentage of revenue from 26.4% to 18.8%. The relative decline in inventory volume indicates the company either has an improved foresight on inventory needs or the relative purchase price of inventory has declined. Although not clear, the COGS has declined by over 300bps in the same period, contributing to a decreased inventory balance per item.

Moreover, Hibbett's asset turnover ratio has remained relatively stable. We attribute part of the difference in asset turnover related to the composition of Hibbett stores. On average, Hibbett stores are in more rural and low-cost areas, decreasing the relative property value. The companies earn a lower revenue per square foot as compared to their peers, but this is offset by the difference in the price of the locations. Compared to the growth strategy of Foot Locker, the company does not operate in large cities which typically have higher rents and acquisition prices for new locations. In other words, the company can extract more revenue from each dollar of PP&E.

Foot Locker Inventory Turnover. Hibbett has a higher inventory as a percentage of revenue compared to Foot Locker during the historical period at 18.8% compared to 16.6%. The result is a smaller nominal value of inventory scaled by revenue on Foot Lockers balance sheet. Foot Locker's average cost for inventory is higher than the industry average as their composite profitability is 4.3% compared to Hibbett's 7.6%. The combination of these two facts muddles the nature of inventory turnover for Foot Locker.

Sustainability of Turnover Ratios. As we mentioned before, a part of their asset turnover difference is linked with Hibbett strategy to target more rural areas. As the company is unlikely to radically change the composition of their locations in the near term, we expect this performance to persist. Moreover, since the company has established a quality relationship with their supplier, Nike, we do not expect a large change in the value of their inventory over time. The result would be a stable Inventory Turnover Ratio, closely in-line with the competitive set.

Inventory Turnover Ratio	FYE 2019	FYE 2020	FYE 2021	FYE 2022	FYE 2023
Hibbett	2.5x	2.8x	3.7x	4.9x	3.4x
Dicks Sporting Goods	3.5x	3.1x	3.1x	3.6x	3.2x
Academy Sports	2.9x	3.0x	3.8x	4.1x	3.4x
Foot Locker	4.2x	4.4x	5.0x	5.4x	4.1x

Asset Turnover [Revenue / Avg. Total Assets]	FYE 2019	FYE 2020	FYE 2021	FYE 2022	FYE 2023
Hibbett	2.0x	1.8x	2.0x	2.3x	1.9x
Dicks Sporting Goods	1.9x	1.5x	1.4x	1.8x	1.7x
Academy Sports	1.1x	1.1x	1.3x	1.5x	1.4x
Foot Locker	2.3x	1.7x	1.3x	1.3x	1.1x

Cash Conversion Cycle

Comparison to Peers. Relative to their peer set the company operates in line with the cash conversion cycle. The company's cash conversion cycle in FYE 2023 of 63.2 days was behind the industry average of 58.2 days. Compared to just Dick's and Foot Locker, the company lags the industry average of 61.8 days by 1.4 cash conversion days.

Drivers of Cash Conversion Cycle. There are three main drivers of the cash conversion cycle.

Inventory Days. The company's inventory days outstanding have gradually declined from 143.2 days to 105.9 days. Moreover, the company has focused on a more inventory centric view of current assets as inventory as a percentage of current assets has grown from 73.0% to 79.9%. The main driver behind this change is a marginal reduction in their inventory as a percentage of revenue. The industry has followed a general decline in inventory holdings, and Hibbett has followed suit.

Account Receivable Days. The company's account receivable days have remained stable and have a low impact on the total cash conversion cycle. The accounts receivable days outstanding decline from 2.9 days in 2019 to 2.8 days in 2023. The company has held less than 1% accounts receivable to revenue throughout the time series. As a retailer their relative A/R is accounting for minor transactions and as such has a small impact on the total cash conversion cycle.

Account Payable Days. Due to the concentration of suppliers for the competitive set, the accounts payable days are homogenous as their established contracts with Nike are likely similar. The company's payable days have gradually decreased from 53.9 days to 45.6 days. Although unclear, the driver of this change could be from a change with their agreement with Nike.

Zoom-in: Academy Sports Cash Conversion Cycle

Academy sports have a substantial advantage over their peer set regarding the cash conversion cycle. The difference is based on a lower inventory days outstanding compared to Dick's and Hibbett, and a longer payable days outstanding compared to the entire peer set. One reason behind this difference is attributable to the Academy's diversity of suppliers compared to their peer-set. Their relative concentration with Nike is the lowest at 11% of total inventory compared to 70% of Hibbett's, 65% of Foot Locker's, and 23% of Dick's Sporting Goods' total inventory.[57]

The lower reliance on Nike as a supplier is noticeable in the payable days outstanding. The company has a payable days outstanding 10 days higher than their closest competitor Dick's. Moreover, the company's payable days have gradually increased from 49.9 days in 2019 to 62.1 days in 2023. This could indicate their composition of brands has less supplier power than their

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[57] Sourced from Hibbett Sports 2023 10-K, pg 50

competitors, meaning that Academy can extend their payment period. Additionally, the company has gradually decreased their inventory days outstanding from 126.0 days to 107.1 days in the same period. This is an indicator that lower reliance on a single supplier in the industry could improve the cash conversion cycle and lower total inventory.

Sustainability of Cash Conversion

In the long-term, the current cash conversion cycle of Hibbett will reflect the industry average in a range of 60.0 – 65.0 days. The company has actively focused on declining their total inventory on the balance sheet and inventory as a percentage of revenue. Hibbett could potentially improve their inventory days outstanding. A mitigating factor is the relationship with Nike. Over time, their payable days outstanding have declined, and is likely driven by a change in their payment structure with the company. As the total inventory as a percentage of revenue declines in the industry, Hibbett is likely to track with the trend, and remain competitive in their cash conversion cycle.

Cash Conversion Cycle	FYE 2019	FYE 2020	FYE 2021	FYE 2022	FYE 2023
Hibbett	92.2	77.8	52.7	43.0	63.2
Dicks Sporting Goods	57.8	64.8	55.0	43.0	61.7
Academy Sports	77.6	75.0	41.1	27.1	46.0
Foot Locker	68.6	63.0	52.9	42.2	61.9

Analysis of Competitive Advantage

Hibbett Sports competes in a competitive market with comparable companies. However, while doing so, there are three aspects that stand out and provide indications for the competitive advantages and disadvantages. First, Hibbett's access to underserved markets is a competitive advantage. Second, Hibbett Sport communicates that it has strong brand loyalty but if it has such a competitive advantage is not entirely clear. Third, Hibbett's lack of own brands puts the firm at a competitive disadvantage from a valuation standpoint. All three aspects will be discussed in the respective following three sections.

Hibbett's access to underserved markets is a competitive advantage

Hibbett Sports appears to demonstrate a competitive advantage through its presence in underserved markets with little competition. This is particularly prevalent after its acquisition of City Gear which complements Hibbett's strategy to further engage with the African American community in urban areas. City Gear's stores are typically found in areas with a significant African American population and provide brands and items that align with the community's tastes and cultural movements.

Indicators of the competitive advantage

There is little physical competition around Hibbett stores. There are two pieces of evidence which underline this point. First, 70% of Hibbett stores have two or less competitors within a 15-minute drive[58]. Second, the fast-growing City Gear segment addresses unmet requirements of their customer segment. According to research by a minority shareholder, John Hempton, City Gear customers resonate with two preferences of the customer segment: cultural relevance through tailored fashion and shopping that mitigates security concerns.

[58] CEO Michael Longo Q4 2022 Earnings Conference Call March 4, 2022, 10:00 AM ET

Nike maintained the partnership despite Hibbett's small scale. As of September 2021, Nike had "exited about 50%" of its retail partners, as Nike finance chief Matthew Friend said at the time. Nike envisioned reducing the number of 30,000 retailers to about 40 partners, removing nameable partners including Big Five Sporting Goods[59], Dunham's Sports, Urban Outfitters, and Dillard's. However, Hibbett Sport remained as partner and Nike listed them as one of the three most important partners in North America while leaving Foot Locker out from the listing. This is particularly significant given the comparatively low purchase volume of Hibbett, as illustrated in Figure 14.

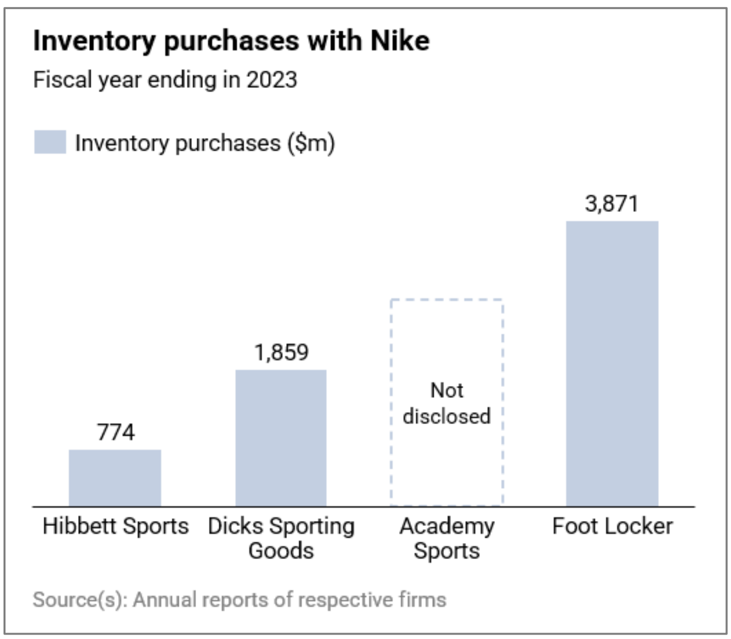

Figure 14: Overview of the total purchase volume with Nike

Among its competitors, had a still very small scale. Even while 70% of its FYE2023 inventory was purchased from Nike, in absolute terms it only reflected approximately 20% of the volume that it's competitor Foot Locker purchased from Nike in the same year (3,871m$ which translates to 65% of Foot Locker's FYE2023 inventory).

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[59] Meanwhile, 5 Sporting Goods has been introduced as a partner again

Hibbett changed its focus more towards City Gear stores. Over the past four years, Hibbett has seen a 7.4% reduction in traditional stores, dropping from 1,007 to 932, while simultaneously expanding City Gear locations by 36%, from 136 to 185. See Figure 2 for details. While no detailed explanation has been provided, this transition can be interpreted as Hibbett's acute recognition of evolving market demands and consumer preferences, particularly within urban and underserved communities. By reallocating resources and focus from traditional Hibbett stores to the more culturally resonant and rapidly growing City Gear brand, Hibbett would capitalize on the unique strengths of City Gear's competitive market positioning.

Discussion of the limitation

It needs to be acknowledged that this competitive advantage only partly appears in the financial data. This can be mainly traced back to three reasons.

Limited Qualitative Disclosure. One of the primary limitations in fully appreciating Hibbett and City Gear's combined competitive advantage arises from the limited public disclosure. The management's strategic choice not to openly discuss the role, demographics, and financial contributions of City Gear may be a tactical move to preserve competitive edge.

Quantitative Obfuscation. The reliance on consolidated financial statements further dilutes the ability to discern the specific contribution of City Gear to Hibbett's financial health. For example, one would expect higher sales per square foot than its competitors because of the competitive position in the market. However, as shown in Figure 15, this is not the case.

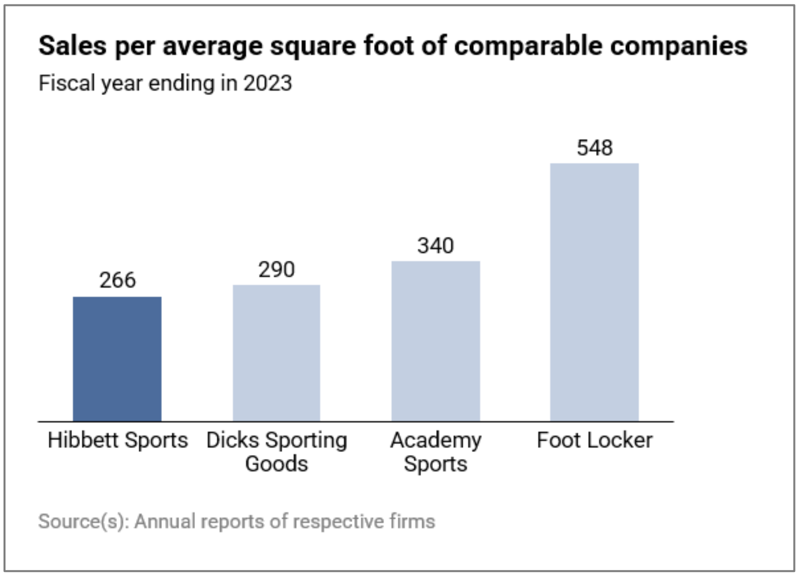

Figure 15: Comparison of the sales per average square foot among the peer group

While one might suggest the underperformance in which Hibbett and City Gear operate, the reality might be obscured by the consolidation of financials. In the financial statements there is no further disclosure about what the sales per square foot look like when segmented by Hibbett's core business and City Gear stores. Instead, however, one can obtain that the sales per square foot grew significantly better for Hibbett Sports since the reorganization toward City Gear stores that have the competitive advantage, see Figure 2. In fact, during the period from FYE2019 to FYE2023, sales per square feet increased with a 14.3% CAGR for Hibbett Sport (compared to only 9.8%, 6.2% and 2.1% for Dick's Sporting Goods, Academy Sports, and Foot Locker, respectively. Therefore, it appears that management may try to obfuscate the competitive advantage in the financial statements to prevent competition by avoiding elaborate disclosures.

Sustainability of this competitive advantage

While the financial outlook appears favorable, there are two critical risks that could erode Hibbett's competitive advantage.

Changes in Consumer Behavior. The retail landscape is profoundly influenced by shifts in consumer behavior, and Hibbett Sports is no exception. A significant risk to Hibbett's competitive advantage arises from the potential change in purchasing habits of the African American communities that form its core customer base. Two primary areas of concern include:

1. **Shift to Online Shopping.** The trend towards digital commerce has been accelerating, driven by convenience, broader selection, and often competitive pricing. For Hibbett, which relies heavily on physical stores in specific neighborhoods, a widespread shift by its target demographic towards online shopping could undermine its physical store model. This shift not only threatens to reduce foot traffic and sales in brick-and-mortar locations but also exposes Hibbett to heightened competition from online retailers who can offer a wider range of products without being limited by geographical boundaries.
2. **Cultural Shifts.** Hibbett's success is partly due to its ability to cater to the cultural preferences and trends within the African American community, particularly in urban areas. However, cultural trends are inherently fluid, and a shift away from the current pop and sneaker culture that Hibbett capitalizes on could significantly impact its product relevance and, consequently, its revenue. The risk is compounded if these cultural shifts lead to a change in brand loyalty or if new preferences emerge that are not adequately represented in Hibbett's product offerings.

These consumer behavior changes are magnified by the potential for an accelerated digital transformation across the retail sector. As more consumers become accustomed to the convenience and variety offered online, physical stores, especially those operating in niche markets, must innovate continuously to maintain customer engagement and loyalty.

Increased Competition. Another significant risk to Hibbett's competitive advantage stems from increased competition. As Hibbett has successfully tapped into underserved markets, its model could attract competitors, including both established retailers and new entrants, leading to several potential challenges:

1. **Market Entry by Competitors.** Recognizing Hibbett's success, competitors may attempt to replicate its strategy by entering these underserved markets with similar offerings. This

could lead to saturation in markets previously dominated by Hibbett, diluting its market share. Competitors may also leverage economies of scale, extensive marketing resources, and broader inventory assortments to appeal to Hibbett's target demographic.

2. **Price Wars and Margin Pressure.** Increased competition in these niche markets could lead to price wars as companies strive to capture or maintain their market share. Hibbett may find itself compelled to engage in discounting strategies to compete, which can erode margins and profitability. While striving to remain competitive on price, maintaining the quality and cultural relevance of its offerings becomes even more critical, albeit challenging, in the face of shrinking margins.

3. **Loss of Unique Market Positioning.** Hibbett's unique market positioning is a key component of its competitive advantage. However, as more competitors enter the space with similar strategies, Hibbett's differentiation in the eyes of its target consumers could diminish. This loss of uniqueness could affect customer loyalty and the perceived value of shopping at Hibbett's stores, further impacting its revenue and market position.

Hibbett Sport communicates that is has strong brand loyalty but if it has such a competitive advantage is not entirely clear

Customer loyalty appears to be medium to high.

Indicators of the competitive advantage

Hibbett has a comparatively high share of repeat customers. Hibbett sports drives 60% of their net sales through their loyalty program members. [60] During this period, most growth in their loyalty program was driven by an increase in revenue per customer from their repeat customers.

[60] Information from the Q3 FY2023 Earnings Call Transcript

However, the definition of the "loyalty customers" is unclear, indicating Hibbett's percentage of sales through their loyalty program could be overstated.

The accruals of the loyalty program on the balance sheet grew. The accrual account in Hibbett's loyalty program for loyalty points increased. The accrual has grown from $2.2m in 2019 to $4.1m in 2023. The change in value indicates that the combination of Hibbett's loyalty program with Nike's loyalty program, along with organic loyalty growth have increased over time. This indicates the more individuals are utilizing their loyalty program and accruing points with the brand. A high number of points are an indicator of recurring customer loyalty.

However, compared to Dick's the competitive advantage is unclear as Dick's reports that 70% of their sales come through their loyalty[61]. For example, at Dick's a cashier will ask for a phone number to open an account with the company, and asking a customer for their phone number again at the point of sale would constitute a sale under the loyalty program. Although not specifically stated, if Hibbett's reward program is similar, the 60% sales through the loyalty program would grossly overestimate the customer loyalty of the company.

Discussion of the limitation

The loyalty is not reflected in a higher gross margin. If Hibbett had an advantage due to strong brand loyalty, this may be reflected in two ways. First, in more purchases. Second, in higher prices per purchase. While the first aspect may indeed have happened, there does not appear to be evidence for the second point in the financial metrics. The gross margin of Hibbett is comparable to the gross margin of competitors, which suggests that the firm was not able to charge above average prices for their products and thereby outperform their peer-set based on gross margin.

The brand engagement on social media suggests lower loyalty. As a proxy for loyalty and engagement with the brand, one may compare the engagement level of users with the brand on

[61] Sourced from the Dick's Sporting Goods 2023 10-K

social media. As can be obtained from Figure 16, almost on all social media channels, Hibbett has fewer subscribers than its competitors[62].

	Followers per channel		
Sports retailer	TikTok	Instagram	YouTube
Hibbett	1k	262k	3k
Dick's Sporting Goods	306k	705k	82k
Academy Sports	6k	238k	42k
Foot Locker	1,600k	12,000k	174k

Figure 16: Comparison of social media reach of peer set

Certainly, this alone does not provide sufficient evidence against a competitive advantage because it does necessarily affect revenues from loyal customers. However, one may suggest that the lower engagement on social media raises concerns about the proclaimed loyalty.

Sustainability of this competitive advantage

In the long-term, the sustainability of Hibbett's competitive advantage in customer loyalty will be a factor of their relationship with the supplier Nike, along with their ability to successfully create more brand equity through social media platforms and their loyalty programs. The Q3 earnings report of FY2024 was a positive indicator as the firm continued to gain momentum in their loyalty program. Hibbett has formed a niche market share in the rural market with Hibbett and urban communities with their City Gear brand. The relative positioning of these two brands increases the competitive moat around their customer loyalty, and possibly ensures a long-term value driver.

[62] Data sourced directly from YouTube, TikTok, Instagram from the profile pages of the respective firms, as of February 19, 2024

Hibbett's lack of own brands puts the firm at a competitive disadvantage from a valuation standpoint

Hibbett Sports' absence of proprietary brands stands out as a strategic gap, especially when compared to its main competitors, Dick's Sporting Goods and Footlocker, both of which have successfully established and marketed their own brands. This distinction has implications for Hibbett's market positioning, cost structure, and ultimately, its valuation.

For competitors like Dick's and Footlocker, owning brands confers several competitive advantages.

- **Higher gross profit margins.** Private labels typically offer higher profit margins than third-party brands due to the elimination of middleman fees and the ability to control production costs more directly. Even while the gross profit margin is comparable among the peers, without their own brands, their gross profit margin would likely be lower.
- **Brand loyalty and differentiation.** Having unique products enhances customer loyalty and can differentiate the retailer in a crowded market. It provides consumers with exclusive choices not available from other retailers.
- **Negotiation leverage with suppliers.** Retailers with strong private labels have better leverage in negotiations with third-party suppliers, as they are not as dependent on external brands to drive traffic and sales.

From a cost-benefit perspective, Hibbett's decision against developing its own brands seems like a strategically reasonable decision. The process of building a brand from scratch may require significant investment in product development, marketing, and supply chain management. Given Hibbett's smaller scale relative to giants like Dick's, the upfront costs and operational complexities might outweigh the immediate benefits. Additionally, the effort to establish a new brand in a market already crowded with established names demands a long-term commitment and poses considerable risk.

However, this lack of own-brand offerings can be interpreted as a competitive disadvantage from a valuation standpoint, particularly due to the inherent risks associated with high supplier concentration. With the reliance on a few key suppliers, with Nike being a prime example, having a downside protection through own brands reduces the overall impact of such a discontinuation. For instance, if Nike were to discontinue its partnership with Hibbett, the impact on Hibbett would be considerably more detrimental than it would be for Dick's or Footlocker, which have their own brands to cushion the blow.

The absence of proprietary brands not only limits Hibbett's ability to mitigate risks associated with supplier relationships but also hampers its potential for margin expansion and revenue diversification. Therefore, while the decision against owning brands seems reasonable from a short-term operational perspective, it constitutes a strategic vulnerability that could detract from Hibbett's valuation and reflect a higher risk profile in the eyes of investors.

Valuation Part II

Financial Forecast

Overview

The financial forecast of Hibbett is based on an analysis of three mutually exclusive and collectively exhaustive ("MECE") scenarios. These scenarios represent the key events that can happen to Hibbett on an annual basis. These are:

1. **Bankruptcy.** Hibbett's continuing operations are largely contingent of the supplier relationship with Nike that makes up approximately 80% of the revenue. In case this contract is terminated, we estimate the potential of a bankruptcy in the form of a Chapter 11 filing.
2. **Going concern.** This scenario describes that the contract with Nike is not terminated, and Hibbett continues operating as an entity in similar ways as historically. Different sub-cases exist for key drivers of the operations for the going concern case.
3. **Acquired.** Since Hibbett is largely a reseller of Nike products in locations that Nike cannot serve well on a standalone basis, there is the opportunity for Nike to vertically integrate by acquiring Hibbett.

The key idea of these scenarios is shown in Figure 17. Each of the three cases will be discussed in the following separate sections.

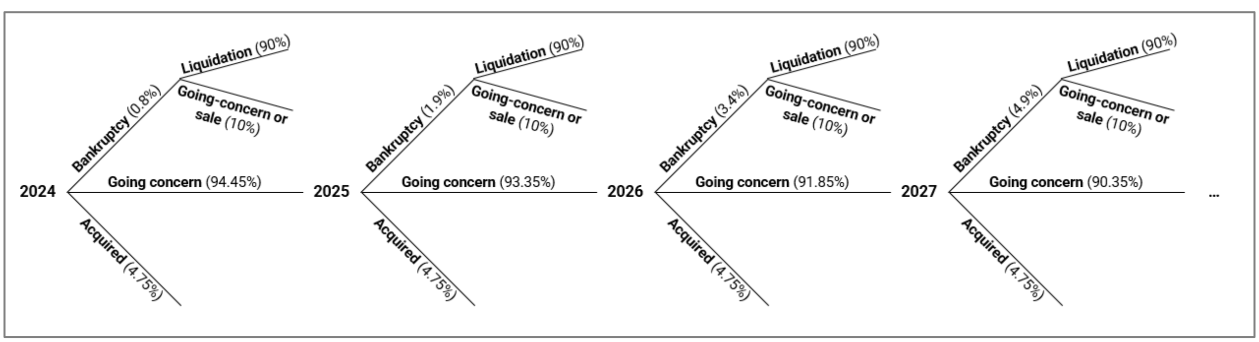

Figure 17: Visualization of the probabilistic valuation tree

Hibbett Going Concern Scenario

Forecast Horizon

For our valuation, we have considered several scenarios in which Hibbett's competitive landscape changes, relationships with key suppliers change, and competitive advantages and competitive disadvantages change. We selected a period that allow sufficient time for all the above-mentioned changes to be incorporate and for Hibbett to reach a steady state growth rate.

- **Our financial projects Hibbett expected operational performance until all assumptions and drivers of our unlevered free cash flow are in a steady state.** Our forecast models a 30-year time horizon, based on the required amount of time to reach a steady state growth rate of all assumptions in our operational forecast. We have observed our working capital, capital expenditure, and unlevered free cash reach a steady state of 0.5%. All line items that include an impact from deprecation, have reached a steady state convergence of 0.8%. Due to the nature of our annuity for capex the subsequent impact drives a wedge between the long-term growth rate and long-term steady state of EBIT, EBITDA, and net income growth. The growth drivers of our unlevered free cash flows have stabilized over the forecast period, and we confidence that our financial model has achieved a steady state view of Hibbett.
- **We have considered the amount of value considered in our forecast period compared to the perpetual period.** Based on the analysis provided in Professor Vincent Glode's lecture material, we have estimated that close to 75-85% of the value of Hibbett will be projected in our forecast horizon.[63]
- **We have extended our forecast until our long-run capital expenditure / depreciation ratio has reached an equilibrium.** In the long-term we expect this ratio to be 1 to represent that we replace each dollar of depreciated with a new dollar of capital expenditure and vice versa. We understand that Hibbett will have a period of expansion followed by a prolonged period of

[63] FNCE 2070 Valuation ; Lecture 10, Slide 6 Vincent Glode, CFA

stability of growth. We shall detail our assumption in more detail in our section on drivers of capital expenditure and depreciation.

Long-Term Continuing Value Revenue Growth Rate

Rationale

This analysis uses a long-term continuing value revenue growth rate of 0.5%. This value is below the expected long-term GDP growth rate of 2.9% and therefore reflects the possibility that Hibbett will cease to exist at some point. The exact numerical figure is derived using the weighting of 11 distinct cases in the model.

- **Our expected free cash flow growth is in-line with our long-term revenue growth rate.** We expect our long-term growth rate to grow at 0.5% in the perpetual period. We have estimated our expected free cash flow growth rate by utilizing our return on invested capital[64] and reinvestment rate into the business.[65] This calculation yields an estimated growth rate of unlevered free cash flows of 0.2%. We have utilized material from Professor Vincent Glode, along with work by Aswath Damodaran as a basis for our congruence with our long-term growth rate. We consider the long-term growth rate to be indicative of vulnerability of Hibbett in the long-term. We have considered several threats to their business model along with considerations for the long-term viability of their industry, and our analysis drives conviction that there are several possibilities for their eventual deterioration.
- **Our approximate return on capital is in-line with our industry peers and above our expected cost of capital.** When adjusting for capital leases, our expected return on capital is approximately 14.5%. Our competitive set has unlevered return on assets of 14.5%, matching exactly with our long-term return on capital. We estimate that our long-term cost

[64] Return on Invested Capital defined as (EBIT * (1-t)) / Book Value of Equity

[65] Reinvestment Rate defined as (CAPEX – Depreciation – Net Working Capital) / (EBIT *(1-t))

of capital will be in the range of 10.0% - 13.0%, meaning that in the long-term the return of capital is above our required return on capital.

- **Forecasting the firm with no competitive advantages nor competitive disadvantages.** We have considered several scenarios that consider the long-term growth potential of the sports apparel industry. Moreover, we have considered strategics changes with key suppliers in the competitive landscape along with changes in macroeconomic variables. We have weighted the probability of each scenario to get an expected value of unlevered free cash flow that represents a “base” case for the firm. In other, words our base case is our best estimate for Hibbett as a company that operates in the long-term without competitive advantages.

Key factors driving Hibbett’s Revenue

Our analysis will underscore a bottom-up build of revenue rather than a top-down build of revenue. It breaks down revenue growth into two primary drivers: revenue growth per location, and the average number of Hibbett locations. We have selected these two drivers based on the available information from Hibbett’s financial statements along with the available information in Hibbett’s peer set. We expect that both revenue per location growth along with growth in the average number of locations to reach an equilibrium close to the industry average. Although we considered several other drivers such as sales by revenue category, sales by segmented locations, and take-rate of the total addressable market, neither was sufficiently educational or substantive to complete a full operational model. We utilized a mixture of scenarios based on macro-economic changes, changes in competitive advantages, changes in contracts with key suppliers, and changes in the competitive landscape to estimate our expected revenue forecast. As revenue is the most substantial driver of our operating model, the following section will give an in-depth analysis of the key scenarios influencing Hibbett’s long-term revenue growth.

Revenue per Location

Revenue per location is primarily driven by changes in consumer spending, macro-economic conditions, competition, relationships with suppliers, and competitive advantages. We have weighed each the scenarios based on their magnitude and probability of occurrence. The overall probability-weighted revenue is shown in Figure 18.

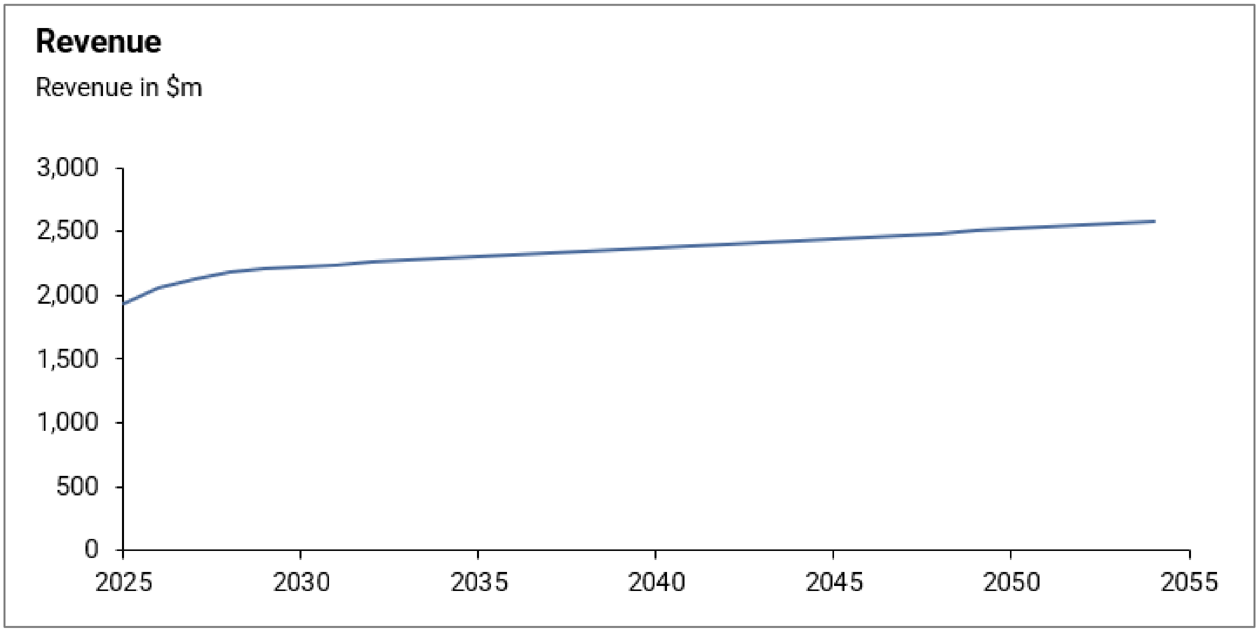

Figure 18: Probability-weighted revenue

Macro-Economic / Consumer Spending

One of the primary drivers of revenue growth in the retail sector are changes in GDP along with changes in consumer spending. As sports apparel categorized as consumer discretionary, we have conviction that in the near-term revenue growth of Hibbett will trend similarly to near-term consumer discretionary growth. As the near-term growth rate of consumer spendings[66] outpaces the near-term growth rate of the nominal U.S GDP growth, we have selected to include both a

[66] Federal Reserve Economic Data: Personal Consumption Durable Goods (2007 – 2023)

measure of Long-Term GDP Growth[67] (1947 – 2023) and a measure of Near-Term GDP Growth[68] (2007 - 2023) to consider the possibility that consumer discretionary spending slows in the future. In our assumptions, forecasted Hibbett's 5-Year revenue per location CAGR of 9.4% to gradually converge with the near-term consumer spending median of 4.2%, near-term GDP growth rate of 4.2%, and long-term GDP growth rate of 2.9%. Each scenario is volume weighted at 25%, 15%, and 15% respectively.

Discussion of Limitations

Although the long-term growth rate will have a strong likelihood of converging with the historical long-term growth rate of the U.S GDP, there is substantial uncertainty as to when this will occur for Hibbett. We have considered several growth scenarios to mitigate this uncertainty but there are unforeseen changes in consumer behavior, economic output, and sustainability of long-term U.S economic variables. Moreover, our analysis of macro-economic factors does not include analysis on drivers of global retail. As 100% of the operations of Hibbett are within the United States, we selected U.S economic variables to drive part of the expected revenue of Hibbett.

Changes in Contractual Agreement with Nike

As we discussed earlier, the relationship with Hibbett's main supplier, Nike, will have a significant influence on expected future free cash flows. Most Hibbett's sales are the sale of Nike products. The ability to generate is contingent on Hibbett's ability to receive and sell Nike products in their store fronts. We have considered several scenarios in which the ability to execute the above contingency changes. We have considered several scenarios in which our relationship with Nike increases revenue, decreases revenue, and has no impact on revenue. Moreover, we have considered our revenue growth as a function of the long-term competitive advantages of Nike.

Negative Shift in Contract with Nike

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[67] Federal Reserve Economic Data: Nominal GDP (1947 – 2023)

[68] Near-Term GDP Growth defined as Nominal GDP growth between 2007 - 2023.

A driver of our expected revenue would be a negative shift in our relationship with Nike. In this scenario, Nike would elect to change our relationship to be akin to the relationship with Foot Locker. In other words, a relationship where we receive less inventory from Nike, and lower quality inventory as Nike's strategy would seek to reduce competition with their own store fronts. In this case, we expect Hibbett's long-term revenue growth rate to be negative 2.8%. We base this number on the long-term expected growth rate of our competitor Foot Locker. As we discussed previously, Nike elected to cut their contract with Foot Locker, and Foot Locker's CAGR since the decision was (5.0%).[69] Nike's decision to cut their relationship with Foot Locker is a clear example of a competitive disadvantage and we thus, expect revenue growth in a scenario in which this relationship changes to be significantly below the industry average.

Positive Shift in Contract with Nike

A similar driver of our expected revenue would be a positive shift in our relationship with Nike. We consider this case to be homogenous to our current relationship with Nike, in other words our relationship with the firm does not change. We are currently one of three of the most important companies for Nike, and we do not expect a marginal improvement in this position to be significant to our financial estimate. For this scenario, we expect that Hibbett, with the support of Nike, would have a competitive advantage and as such grow above the average industry growth rate in the long-term at 4.2%. We have pegged a growth rate with a competitive advantage to converge with the near-term consumer discretionary spend.[70]

Discussion of Limitations

The past changes in Nike's strategy are not indicative of their future decisions. In the past, Nike cut their relationship with our competitor, Foot Locker, to strengthen their own shoes sales within Nike branded locations. The decision to cut their relationship with Foot Locker could be a strong

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[69] Revenue CAGR calculated using FY2020 Revenue and FY2023 Expected Revenue from Footlocker 10-K

[70] Federal Reserve Economic Data: Personal Consumption Durable Goods (2007 – 2023)

indicator that as Nike continues to expand their number of stores fronts, the relationship with Hibbett will begin to erode. However, Hibbett Sport has remained as partner and Nike listed them as one of the three most important partners in North America while leaving Foot Locker out from the listing. [71]

Changes in Nike's Brand and Likeness

A driver of our revenue growth is the value of Nike's brand. Our business has exposure to the strength of Nike's brand and as such we would be materially impacted by an increase or decrease in the value of Nike's brand image. Nike's brand value is contingent on their ability to continue to generate NPV positive projects and retain the competitive advantage in sports apparel. The company has contractual agreements to provide apparel for U.S and international professional sports leagues along with a high amount of visibility in other sports events. We have considered scenarios where we grow relative to Nike's ability to maintain competitive advantages. As the sports apparel industry is highly competitive, we expect Nike in the long-term to perform in-line with the industry.

Nike Long-Term Competitive Advantage

If Nike were to retain a relative competitive advantage, we expect the revenue growth of Hibbett to converge with the long-term consumer discretionary spend at 4.2%[72]. As we discussed previously, consumer discretionary spend outpaces long-term GDP growth and as sports apparel falls into this category, we could reasonably expect a scenario where the company grows in-line with this economic measure. We would expect that Hibbett would receive a significant benefit from the long-term competitive advantage of Nike as the increased revenue growth expectations from Nike sales would trickle down to the distributors of Nike products. However, the increased revenue from Nike products could also increase competition as other distributors in our

[71] CEO Michael Longo Q4 2022 Earnings Conference Call March 4, 2022, 10:00 AM ET

[72] Federal Reserve Economic Data: Personal Consumption Durable Goods (2007 – 2023)

competitive set would react and subsequently increase their share of Nike products. We will consider this increase in competition in Nike product sales as an impact to operational expenses rather than an influence on revenue.

Nike Long-Term Competitive Disadvantage

If Nike were to lose their competitive advantages, the overall impact to Hibbett would be significant as the expected revenue growth of Nike would decline. As Hibbett has a uniquely high amount of exposure to Nike products compared to their peers, the impact would likely result in growth rate lower than their competitive set. We estimate the long-term growth rate in this scenario would be akin to the same-store sales growth of their competitive set from 2018-2020 at (6.4%).[73] Although Hibbett has organic sales growth from their unique brand, we expect most of their foot-traffic to be driven by the customers desire to purchase Nike products. We consider this scenario to be the least likely between Nike retaining competitive advantage and Nike retaining neither competitive advantage nor competitive disadvantages.

Nike Long-Term Without Competitive Advantage / Disadvantage

We also considered a scenario in which Nike continues in the long-term with no competitive advantages or disadvantages. We consider this to be the scenario as we expect companies in the sports apparel industry in the long-term to operate without competitive advantages. The revenue growth rate in this scenario would converge with the long-term GDP growth rate of 2.9%, an indication that Hibbett grows in line with both Nike and the industry.

Discussion of Limitations

In the past, Nike has participated in a modern wave of corporate social responsibility. The brand has made conscious decisions to take a stance on social issues such as racism and sexism. Their change in marketing strategy historically improved Nike's brand value as was the case in

[73] Comparable Companies Include: Foot Locker, Dicks Sporting Goods, and Academy Outdoors

the Colin Kaepernick case.[74] We cannot assume the impact of future social responsibility on Nike's operations either positively or negatively. As the occurrence of financially meaningful events are unpredictable, we have elected to exclude a direct analysis of the impact. Instead, the impact will be implicitly assumed inside of competitive advantages and disadvantages of Nike. Additionally, as the focus of their advertisement are U.S centric, we do not have an explicit assumption of the impact on Nike's global operations.

Changes in Hibbett Long-Term Competitive Advantages

In the near-term, Hibbett's revenue growth rate has outpaced both nominal increases in discretionary consumer spending, near-term nominal GDP growth, and long-term GDP growth. In the long-term, we have conviction that Hibbett's long-term growth rate in revenue per location will gradually converge with the industry average. However, we have also considered scenarios in which, Hibbett retains competitive advantages and competitive disadvantages in the long-term.

Hibbett Without Competitive Advantage / Disadvantage

In the long-term we expect the industry as whole to move from a growth rate more akin to the near-term consumer discretionary spend to a growth rate more like the overall movement of the U.S economy. For this reason, we have a reasonable estimate that the overall sports apparel industry will grow their revenue per location by 2.9% in the long-term.[75] In the case that Hibbett continues their operations with neither competitive advantages nor competitive disadvantages, we expect the company's revenue per location rate to be resemblant of the 2.9% long-term GDP growth rate.

Hibbett with Competitive Advantage

We consider Hibbett to have a competitive advantage related to the placement of their store locations outside the vicinity of their nearest competitors and a competitive advantage related to

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[74] ABC News, Nike sales booming after Colin Kaepernick ad, 2018

[75] Federal Reserve Economic Data: Nominal GDP (1947 – 2023)

their customer mix with City Gear. In the case that Hibbett's first mover advantage in each case remains persistent, we expect that Hibbett's revenue growth would be positively impacted into the perpetual period. If the above competitive advantages are sustainable into the future, we expect Hibbett's revenue growth per location to be higher than the industry average. In this case their revenue growth rate into the perpetual period would converge above the growth rate without competitive advantages at a growth rate of 3.9%. Although this case considers Hibbett's with competitive advantages, it's uncertain that these strengths alone would yield a long-term growth rate of the near-term consumer discretionary spend of 4.2%.

Hibbett with Competitive Disadvantage

To complete our analysis of Hibbett's revenue with consideration for competitive advantages, we considered a case in which Hibbett has a competitive disadvantage. We utilized Foot Locker's Five-Year revenue CAGR as our long-term revenue growth rate for a case in which Hibbett has a competitive disadvantage. In this case, Hibbett would grow at a rate of (0.1%), as their revenue would gradually shrink in the long-term. We consider Foot Locker as our example in this case as their business has declined their long-term store openings along with a gradual slowdown in their average revenue per location.

Store Growth

A secondary drivers of Hibbett's revenue growth is the addition of new Hibbett locations in the forecast period. We have driven our assumption for store location growth based on the direct competitive landscape, macro-economic conditions, and information from other retailers. As opposed to revenue growth per location, the expansion of new stores is more strategic rather than associated with an economic variable. For this reason, we have elected to only consider changes Hibbett's competitive advantages, changes in the competitive landscape, and changes in their strategic relationship with Nike. We have considered several scenarios in which Hibbett expands, contracts and maintains their current location count. In each scenario we have considered the respective capital inflows an outflow associated with expansion or contraction.

For the purposes of our analysis, we have considered the store's operational performance at an aggregate level rather than on a store-to-store basis.

Hibbett's Current Long-Term Expansion Strategy / No Competitive Advantages

Hibbett's long-term growth strategy has hinged on the expanding into areas that were not previously serviced by their competitors. This included targeting rural areas as opposed to suburban or urban targets. Due to a mix of the above factor and the relatively small location size, Hibbett has been able to outpace the expansion of their competitors. The management team expect their current pace of their new locations to persist for the next several years as Hibbett focuses on growth stage of their business. We expect that in the long-term Hibbett will reach a point of saturation in which their decision to open new location will be an NPV negative project due to both an increase in operational expense, and cannibalization from other locations. Since their main expansion strategy targets rural areas, Hibbett runs the risk of encroaching on their own locations. We expect Hibbett's location count to slowly decline over time, until they reach a perpetual growth of three new locations per year. The overall number of locations in this scenario would grow from 1,158 to 1,270 over the forecast period.

Hibbett with Competitive Advantages

We've considered a scenario in which Hibbett retains their competitive advantages in location strategy and customer segments. In this scenario, we expect the overall revenue growth per location to be higher and the overall operating margins to be higher than the industry average. For this reason, Hibbett would elect to expand beyond their expansion strategy without competitive advantages. In this scenario, we expect the long-term growth of store locations to be five new locations per year for a total of 170 new openings during the forecast period. Our assumption is based on the average store openings from 2018 – 2023. The pace of openings would be a best-case scenario for the business and would include some decline in revenue growth as Hibbett reaches the maximum saturation of sports apparel locations.

Hibbett with Competitive Disadvantages

As with revenue growth per location, we've considered a store location growth if we operate with competitive disadvantages. In the case we operate with competitive disadvantages, we expect revenue growth per location to slow and an increase in the expected operational expense. Due to this the strategic decision would be to either stop the opening of new stores or gradually decline the total number of locations. In aggregate, we expect the total number of locations to decline in this case. As this scenario is not inclusive of the impact of a change in the relationship with Nike, the decline will be substantially lower than the aggregate decline in Foot Locker locations when their relationships with Nike was negatively impacted. We expect the perpetual decline of store locations to be in the amount of 1 store closure per year. Over the forecast horizon this scenario would observe a closure of 33 locations for a store location total 1,125.

Changes in Strategic Relationship with Nike

As with our revenue growth forecast, we've considered several scenarios dictated by changes in the long-term strategy of Nike. We've considered scenarios in which Hibbett's relationship with Nike erodes, and scenarios in which Hibbett's relationship with Nike remains resilient.

Negative Change in Contract with Nike

In the first case, we've considered a scenario in which Hibbett's contact with Nike erodes. As we observed with Foot Locker, the present value of expansions is dictated based on the supplier contract with Nike. Without favorable terms, the plan to expand is no longer NPV positive, and would require an immediate shift in strategy. In the immediate aftermath of the contract change with Nike, Foot Locker announced that closing of 400 locations.[76] Although it is unclear what the long-term strategy of Foot Locker will be after their new agreement with Nike, it's clear that a negative change Hibbett's contract with Nike will result in a closure of stores. For this reason, we have projected a case in which we expect a negative change in the contract with Nike to result in

[76] Retail Dive "Foot Locker to shutter 400 mall-based stores by 2026", March 2023

a perpetual decline of 5 stores per year. The overall result would be a decline of 10% of Hibbett's store front count, a similar percentage to Foot Locker's closures.

Positive Change in Contract with Nike

We've established that Nike values the current expansion strategy of Hibbett along with the value of City Gear locations. If the improvements in SG&A spend, along with the improvement in topline revenue remain consistent, it would be in the best interest of Hibbett to expand their locations more rapidly than currently anticipated. We expect their overall expansion to slow from approximately 25 locations per year over the past two years to a perpetual opening of five new locations per year. In aggregate, the positive change in the contract with Nike will result in Hibbett constructing 170 new locations over the forecast horizon for a total size of 1,328 locations.

Discussion of Limitations

In the long-term, the ability to open new locations is ambiguous. If we take a step outside of the sports apparel sector and look at older retailers, we can observe a point of maximum saturation followed by a long-term decline in the total number of locations. For example, companies such as Sears, Macy's, and J.C Penny have all lost their competitive advantages and as a result have each closed locations over the course of multiple years.[77] We have not considered the loss of competitive advantages of all the peers in the competitive set, nor a major consumer shift that would change the competitive advantages for brick-and-mortar retail.

[77] Retail Dive, "Macy's Plans to Close 150 Locations by 2026", March 2024

Graph of Store Growth

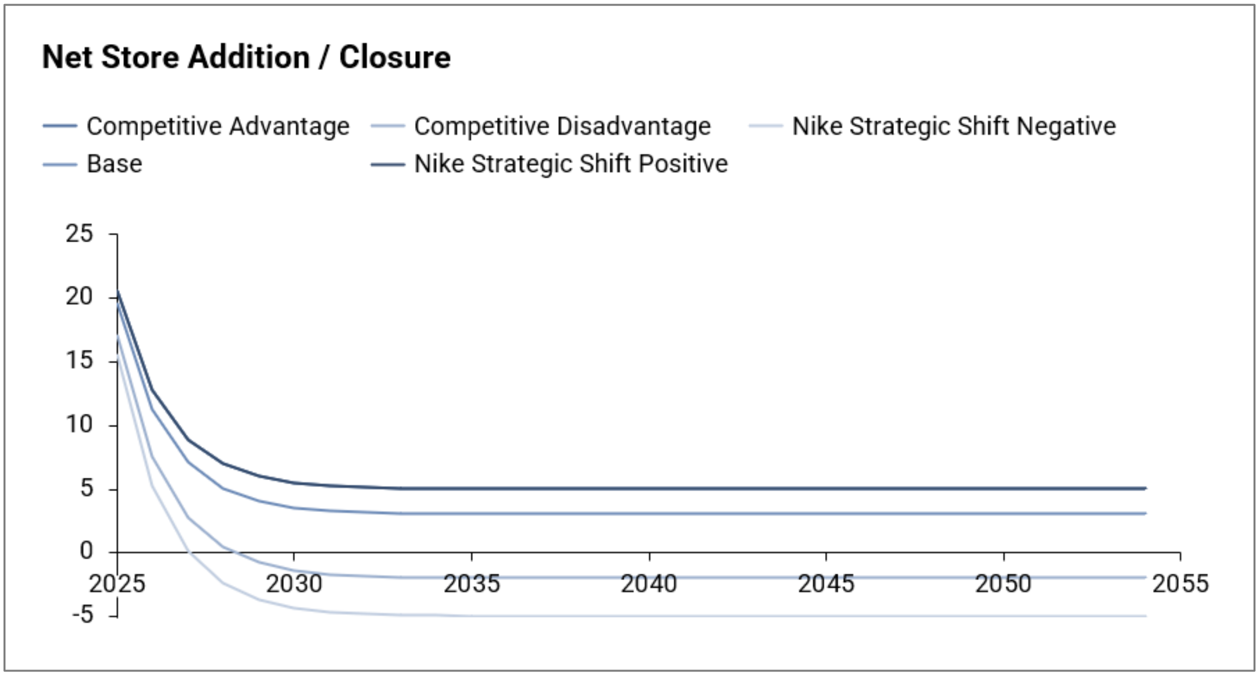

Figure 19: Visualization of store growth forecasts

Reasonableness of Aggregate Revenue Growth

The expected long-term revenue growth of our financial forecast is 0.5%. The expected revenue growth can be benchmarked slightly below the long-term GDP growth rate of 2.9%. We have generated the reasonableness of our revenue growth in part to the above scenarios. We have considered a wide range of scenarios that could happen to Hibbett over the financial period and estimated their impact on our long-term revenue growth. Additionally, we have calculated our long-term expected unlevered free cash flow growth and compared to our long-term revenue growth rate.

Key factors driving Hibbett's Cost of Goods Sold

Based on our available information, our analysis has divided our change in cost of goods sold into two segments, operating lease costs and cost of goods sold per location. Our analysis indicates that the operating leases will grow in magnitude with the operations of our firm as well as a function of the total number of Hibbett locations. Moreover, as cost of goods sold is comprised mostly of inventory, we expect their cost of goods sold per location to scale with the business.

Operating Lease Cost of Goods Sold

We estimated the expected cost of our operating leases in the forecast period based on not on strategic changes of our competitive environment but rather related to our ability to maintain the sufficient scale to receive favorable contractual agreements with our leaser and based on our relative pricing power to our leasers. We have implicitly assumed the impact of competition of our scenarios based on our relative competitive advantages. Based on our available information, we were able to triangulate an approximate annual value associated with our operating leases, which we have built into our balance sheet and income statement. In a later discussion, we will explain in depth the mechanism of our forward operating lease estimation, but this section will focus on the annual cost on the income statement. Moreover, we have elected to include the "interest expense" in the operating income of the firm as the net impact on valuation will be accounted for later through our weighted average cost of capital and enterprise value bridge. Based on research conducted by Aswath Damodaran, the overall impact on equity value will not be impacted.[78]

Hibbett with No Competitive Advantages

The scenario for Hibbett is that they have no competitive advantages nor disadvantages impacting the price at which they can renew their lease contracts. In this scenario, we based our long-term operating cost to be 5.7% of revenue per year based on the five-year average cost to Hibbett. The expected cost per year is based on the presumed number of Hibbett locations. We do not expect Hibbett location growth to expand significantly over the hold period without

[78] Dealing with Operating Leases in Valuation, Aswath Damodaran

competitive advantages as such we do not project improvements in their economies of scale with operating lease expenses. We have scaled our assumption by revenue to scale the growth in operating functions with the overall growth of our operations. Inside of our yearly cost is the implicit borrowing rate, in a case with no competitive advantages our disadvantages we expect the rate of 3.5% provided in the FY2023 10-K to remain constant.[79]

Hibbett with Competitive Advantages

We have considered a scenario in which Hibbett retains long-term competitive advantages. We have considered their long-term advantage to be inclusive of their ability to maintain lower than average operating leases costs. In this case we expect their long-term yearly cost to be 4.5% over the forecast period. In this scenario we expect the implicit interest rate to remain constant at a rate of 3.5%.

Hibbett with Competitive Disadvantages

We have considered a scenario in which Hibbett retains a long-term competitive disadvantage. In this scenario, Hibbett would close many locations associated with a decline in revenue per location growth. The decreased size of their operations coupled with the decrease in Hibbett locations would mean the company would gradually lose economies of scale. The impact would be an above average cost per location for their operating leases along with an increased implicit interest rate. We project the long-term cost as a percentage of revenue to be 7.4%, benchmarked by an industry high along with an increase in their implicit interest rate cost to above 5.0%.

Discussion of Limitations

We do not information on the concentration of operating lease agreements for Hibbett. In the case in which one leaser held a concentrated number of leases of Hibbett locations, the relative impact of competitive advantages could increase or decrease in magnitude. If the contracts are held with several smaller leasers, the overall power of Hibbett increases as their ability to

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[79] Hibbett 2023 10-K, Operating Lease Interest Rate

negotiate terms for new Hibbett locations increases. In the opposite case, Hibbett could have exposure to increases borrowing costs related to their lease expenses. The implicit rate at which Hibbett can borrow could also have a material impact on the long-term capital expenditure forecast as if the rate increase, Hibbett could seek to open new locations with the rights to the building. Moreover, the implicit interest rate that is utilized to calculate our lease agreements is based on a synthetic rating derived from our operational performance along with our competitive set. At current, the competitive set is rated between Standard and Poor's BBB and BB.[80] We do not have an extensive insight into the criteria utilized for the risk of bankruptcy outside of the key performance measures included in Corporate Valuation page 410.[81] We have utilized the provided discount rate of 3.5%[82] provided in Hibbett operating lease disclosure as a proxy for their interest rate on operating leases.

Cost of Goods Sold Per Location

Our analysis indicates that our cost of goods sold margin is driven by both our competitive advantages and disadvantages along, competitiveness in the sports apparel industry, and Hibbett relationship with Nike. As such we consider a range of scenarios based on the above-mentioned criteria. We have focused on our primary competitive set of Dick's Sporting Goods, Foot Locker, and Academy Sports are proxies for operational performances with competitive advantages and disadvantages. Moreover, we have utilized the changes in Nike's agreement with Foot Locker to consider changes to cost of goods sold margin based on a change in the supplier relationship with Nike.

Hibbett without Competitive Advantages or Disadvantages

[80] S&P Credit Ratings; Dick's Sporting Goods BBB; Academy Sports BB+; Foot Locker BB

[81] Corporate Valuation Theory, Evidence, and Practice Holthausen

[82] Hibbett Sport 10-K, Operating Lease Disclosure

The industry average for cost of goods sold in the last fiscal year for our competitive set was 65.9%, with Hibbett, Dicks, and Academy all within fifty basis points of this COGS margin. As we discussed in our COGS margin analysis, the total COGS / Revenue has gradually decline from an industry average of 69.5% to 65.9%. The largest contributor to this change was decrease in overhead expenses along with a decrease in the cost of inventory. Due to the relationship with Nike, Hibbett has historically had the lowest COGS / Revenue of their competitive set, but we expect the long-term average for Hibbett to revert to the industry average of 65.9%.[83] We expect this to be the most likely scenario for the company in the long-term as there is significant uncertainty to their long-term relationship with Nike. Moreover, as the sports apparel industry continues to saturate, the low product differentiation means that their competitors will compete to buy and sell the same items.

Hibbett with Competitive Advantages

We have considered a scenario in which Hibbett's location strategy along with their unique customer base allow them to hold a competitive advantage over their peer group. As of FY2023, Hibbett had the lowest COGS / Revenue margin at 64.0% compared to the peer set of 65.9%. Their advantage is two-fold. Hibbett operates in lower cost per location areas alongside their lower cost of inventory associated with their strong relationship with key supplier Nike. If Hibbett were able to maintain their strong competitive advantage, we expect their COGS margin per store to be 59.0% for a combined COGS / Revenue of 63.5% with operating lease costs.

Hibbett with Competitive Disadvantages

We have considered a scenario in which Hibbett operates in the long-term with a competitive disadvantage. We have based our consideration on their closest competitor Foot Locker. We have elected to use Foot Locker as our benchmark based on their similar input costs and similar fixed costs of goods sold expenses. In this case, Hibbett would expend more for each unit of inventory

[83] Industry Average based on the FY2023 average COGS Expense

along with less favorable expenses related to their operating lease contracts. This would result in COGS margin per location of 61.3% for a total COGS / Revenue margin of 68.7%.

Nike Positive Strategic Shift

Hibbett has a competitive advantage through their City Gear Brand and “Hibbett” brand location strategy (see section on competitive advantage above). If Nike continues to value the strength of Hibbett as a distributor, Hibbett could benefit from long-term operational benefits. In this case, Hibbett would receive improvements in their inventory purchase costs, defective inventory costs, and returns of inventory. In other cases, Hibbett would incur significant costs related to purchases of excess inventory, unsold inventory, and defective merchandise. With more favorable terms from Nike, we would expect the long-term COGS margin to decrease. Over the forecast period, the COGS margin per location would decline 57.3% for a total COGS / Revenue margin of 61.8%.

Nike Negative Strategic Shift

We expected the relationship with Nike to slowly deteriorate as a more likely scenario than a continued positive relationship. Over-time, Nike has shifted to more of their own company branded locations and there is uncertainty if this strategy stands in direct contract to offering Hibbett a discounted price on inventory and advertising. If Nike cuts the magnitude of their relationship with Hibbett, we expect that Hibbett’s operational expenses, COGS, to rise. If Hibbett were to lose their contract with Nike, the cost to acquire and hold inventory would increase substantially. In this case, we expect the acquisition cost of inventory to be reflect that of Foot Locker. We expect the COGS margin per location to be 65.2% for a total COGS margin of 72.7%.

Discussion of Limitations

We do not have sufficient information to delineate between the fixed and variable cost of goods sold. We have scaled our cost of goods sold with the size of our operations, but if there are exists substantive amounts of fixed cost of goods sold, the recognized expense of cost of goods sold could exceed the actual cost of goods sold. Additionally, we do not have information on the acquisition costs of inventory, nor do we have information on the composition of inventory. The composition of promotional, seasonal, or other specialty items could significantly influence write downs in the value of inventory. Moreover, we do not have information on the rebate agreement with Nike and Hibbett. We presume the contract structure has some ability for Hibbett to return unsold items to Nike. If this return value were to change substantially over the forecast period, our assumption for COGS / Revenue could be materially impacted.

Graph of COGS Margin

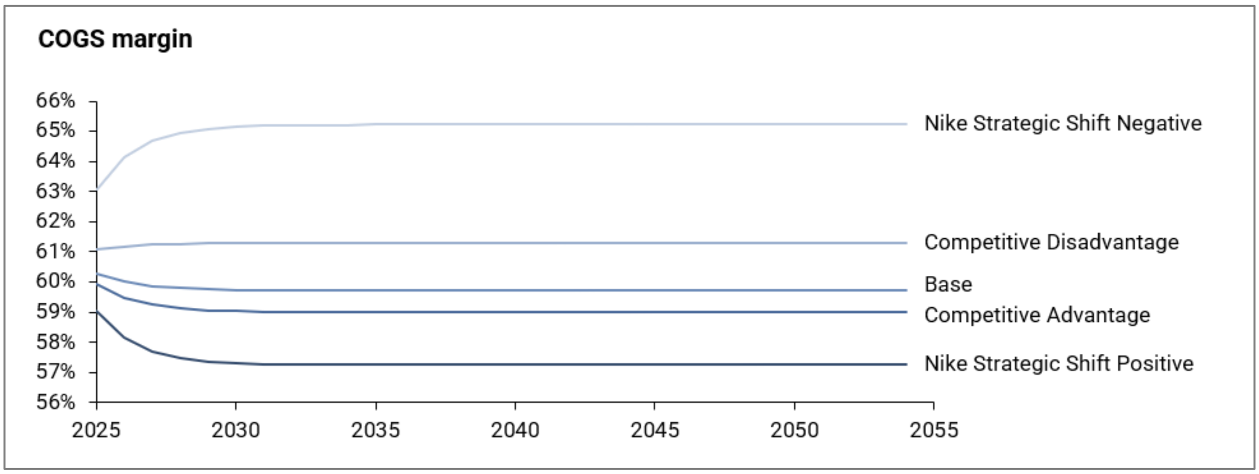

Figure 20: Visualization of COGS margin forecasts

Key factors driving Hibbett's Selling, General and Administrative Expense

SG&A Per Location

We have considered SG&A per location to be key driver of our business. Based on the available information we have elected to grow our SG&A per location rather than at the aggregate revenue level. Although both would have created a similar SG&A margin, we have considered this to scale more precisely based on the components of SG&A. As we discussed earlier in our section on SG&A, our spend in this category is related to employee salaries and advertising spend. We have considered both to scale with the relative size of our operations. We have considered the industry average, industry low, and industry high SG&A margin to consider scenarios in which Hibbett retains competitive advantages or competitive disadvantages. Moreover, we have considered Foot Locker's SG&A spend as a proxy for a scenario in which we lose our contractual relationship with Nike. In aggregate we expect our long-term SG&A margin to be 22.6%, above our FY 2023 SG&A margin of 18.2%.

Hibbett without Competitive Advantages and Disadvantages

We forecasted the scenario where Hibbett operates in the long-term without competitive advantages. In this case we expect the company's long-term SG&A margin to increase as the company must extend increasing amounts of cash on advertising and employees to maintain the same size. We have benchmarked our long-term SG&A margin with the average five-year SG&A margin of our competitors at 22.1%.[84]

Hibbett with Competitive Advantages

We also consider a scenario in which Hibbett can retain their competitive advantages with their current customers, and as a result have operational performances above the industry average. The industry has historically operated at 22.1% SG&A margin with a gradual decline in SG&A margin average over the past five years. The relative differences in SG&A margins from our competitive set are within 100bps, and as such, we expect a case with a competitive advantage to be marginally lower than without an advantage. We expect to be on the lower bound of our peer-sets five-year average at 21.4% SG&A margin.

Hibbett with Competitive disadvantages

We have considered a scenario in which Hibbett operates with a competitive disadvantage. Based on our analysis this disadvantage for SG&A would manifests as long-term increase in their SG&A margin above the industry average. The increased SG&A margin would be a result of an increase in marketing, advertising, and personal spend to retain their competitive positioning in the industry. The expected investments into to SG&A would be higher but they would not result in

[84] Competitors include Dick's Sporting Goods, Academy Sports, and Foot Locker

improvements in their long-term operational performance. We have benchmarked Hibbett's SG&A / Revenue in this scenario to the max five-year average of the competitive set at 22.8%.[85] We expected that even with the substantial increase in SG&A spend each dollar would either be at or slightly above the cost of capital. In other words, with the competitive disadvantage the company would not elect to liquidate.

Hibbett Negative Shift in Contract with Nike

A different situation we have considered is a negative shift in our contract with Nike. We consider this scenario to have a more significant impact to the SG&A margin than a long-term competitive disadvantage. Our rationale is that Hibbett currently benefits from the annual marketing spend by Nike. If Nike advertises their own products, the net result will increase traffic to Hibbett locations. If Nike were to reduce this spend, Hibbett would be obligated to increase their marketing spend as a response. We have modeled this scenario based on recent changes in Foot Locker's SG&A spend and have benchmarked to Foot Lockers average SG&A spend from 2020-2023 at 26.9%.

Hibbett Positive Shift in Contract with Nike

The final scenario we modeled was a consideration for a positive shift in the relationship with Nike. In this scenario we expect the magnitude of the improvement in long-term SG&A spend to be in-line with Hibbett with a competitive advantage. If we utilize the same rationale, we expect our SG&A spend to be lower in part due to the beneficial SG&A spend from our contract with Nike along with a lower cash spend to retain an above average operational performance. The long-term SG&A margin in this scenario is benchmarked against the low of the five-year industry average of 21.4%.

Discussion of Limitations

As we discussed earlier in our section on SG&A, our spend in this category is related to employee salaries and advertising spend. The information provided by Hibbett and their competitors is

[85] Competitors include Dick's Sporting Goods, Academy Sports, and Foot Locker

relatively scarce on specific information breaking down their SG&A spend. We have conviction that our SG&A spend will grow with respect to the size of Hibbett's operational and with consideration for their cost of capital. However, we do not have a conclusive understanding of the growth of component parts of Hibbett's SG&A spend. As we do not have nominal value related to the joint advertising with Nike, we are unable to explicitly project differences in the assumed relationship with Nike's marketing spend and Hibbett's marketing spend.

Graph of SG&A Margin

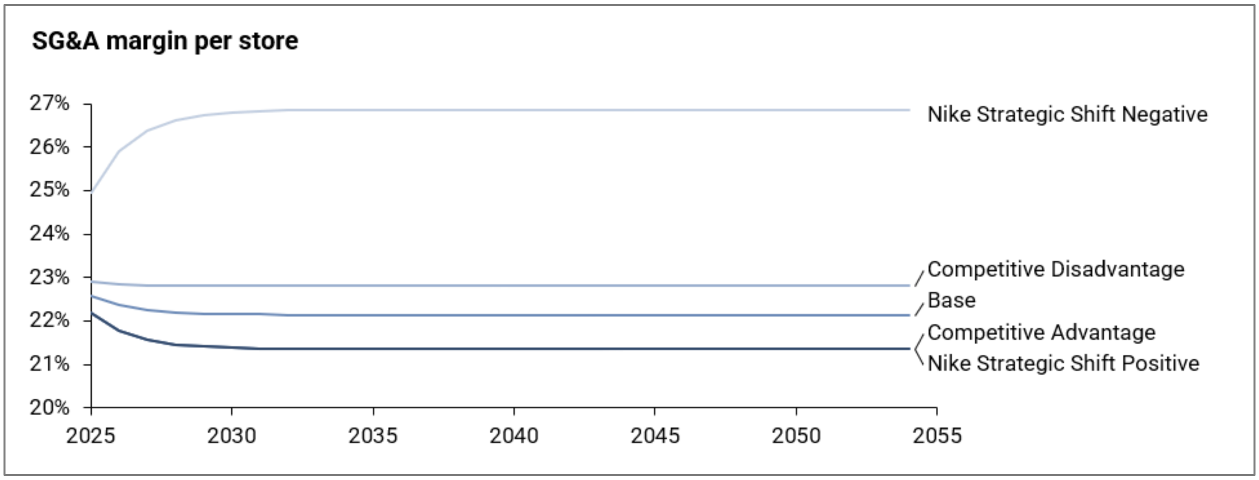

Figure 21: Visualization of SG&A margins per store forecasts

Key factors driving Hibbett's Depreciation and Amortization

Capital Expenditure

One of the drivers of Hibbett's depreciation and amortization is its capital expenditures. Aside from Hibbett's acquisition of City Gear in 2019, Hibbett's investment in opening new stores, renovating or changing layouts, and other operations related to store growth directly link their depreciation expenses. However, due to the nature of our competitor set, we approached capital expenditures as a percentage of revenue.

With competitors like Foot Locker and Dick's Sporting Goods having different competitive advantages to Hibbett's and having store locations of different size and layout, calculating capital expenditures as a percentage of revenue presents a comparable metric and straight lines forecasts that standardizes these differently sized companies. Therefore, the ratio indicates the growth and investment Hibbett is attributing its revenue into acquiring new assets and other capital expenditures. As such, the capital expenditure's relation to its stores and locations are inherently embedded from the ratio from how we calculate revenue and the number of Hibbett locations that exist following additions/closures. Therefore, we depreciate the forecasted capital expenditures over the PP&E's useful life of 9 years.

Property Plant and Equipment Useful Life

Hibbett utilizes a straight-line method for the depreciation on property and equipment. Therefore, to accommodate their mixed asset portfolio of buildings, leasehold improvements, furniture and fixtures, and equipment, we follow the assumption of useful lifetime of property plant and equipment to be 9 years. These mixed assets present different estimated service lives. For example, buildings follow an estimated service life of 39 years whereas equipment follow an estimate useful lifetime of 3-7 years.[86] Due to the variability in lifetimes, we assume a useful life of PP&E to be a weighted value of the mixed assets' lives proportion to their costs of Fiscal Year 2023 as distribution of PP&E costs across mixed assets annually stay relatively similar.

Intangibles / Amortization

The intangibles on our balance sheet consists of only indefinite live intangibles related to the acquisition of City Gear in 2021. As such, we have not introduced functionality to amortize the value of this asset over the forecast period as we do not plan to sell, impair, or recognize a loss on the asset. The intangible asset is related to the trade name "City Gear". In the historic period,

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[86] Sourced from Hibbett 2023 Annual Report, pg. 44

Hibbett has not impaired the value of $23,500k and in our forecast we do not expect an impairment related to this intangible asset.

Hibbett with Competitive Advantages

In this scenario, we expect the overall reinvestment into capital expenditures from revenue to be higher than the industry average. With their competitive advantages, Hibbett would be operating at a positive NPV. Along this vein, a higher percentage of revenue would be reinvested into capital expenditures to sustain their competitive advantage and expand their market share through store additions and other related positive NPV investments. Our assumption is based on the maximum CAPEX / Revenue ratio in FY2023 for Hibbett and its following competitors: Foot Locker, Dick's Sporting Goods, and Academy Sports. A high CAPEX / Revenue ratio may signal an aggressive growth strategy, which in the case of a company with a competitive advantage, is sensible.

Hibbett with Competitive Disadvantages

On the other side of the previous scenario, we also present the case in which Hibbett is at a competitive disadvantage. In this scenario, Hibbett would invest a smaller percentage of its revenue back into capital expenditures. As a result, having a competitive disadvantage would prompt Hibbett to scale back the number of stores being opened and their capital expenditures in the long-term would be lower than the industry standard. We project the assumed CAPEX / Revenue ratio to be 1.7% that was calculated with the minimum CAPEX / Revenue ratio in FY2023 with regards to Hibbett and its competitors. The company with the minimum value would be recognized as the company with the competitive disadvantage relative to their competitors for the fiscal year, which we identified as the long-term ratio for Hibbett in this scenario.

Hibbett without Competitive Advantages and Disadvantages

When Hibbett operates with neither a competitive advantage or a competitive disadvantage, we expect capital expenditure spending to follow a trend that is aligned with an aggregate of its competitors and benchmarked with the rest of the industry. These values would then be driven by the average reinvestment that the industry is taking their revenue back into their capital expenditures. Therefore, reasonably, we can expect Hibbett in the long run to follow the average CAPEX / Revenue ratio from it and its competitors from 2019-2023 with a ratio of 2.9%.

Hibbett Negative Shift in Contract with Nike

If Hibbett has a negative shift in their contract with Nike, Hibbett in the long run would have to decrease the amount of revenue is put into capital expenditures. Being that Hibbett would experience less sales with a negative shift in contract with Nike, Hibbett would have to reduce its capital expenditures to conserve cash and adapt to these conditions. In this situation, this would put Hibbett at a large competitive disadvantage with the rest of the industry that would yield worse results than Hibbett's competitive disadvantage scenario. As a result, we expect Hibbett to have a CAPEX / Revenue ratio of 0.7% that was estimated using the minimum ratio between Hibbett and its competitors from fiscal year 2019-2023.

Hibbett Positive Shift in Contract with Nike

Similar to the competitive advantage scenario, a positive shift in the contract Hibbett has with Nike would yield higher capital expenditure spending, hence a higher percentage of CAPEX spending from revenue compared to the rest of the industry. A positive shift in contract with Nike would mean Nike would continue and improve being a large contributor to the inventory and sales of Hibbett stores. As a result of this increased growth, Hibbett would utilize this opportunity and as an incorporation into their growth strategy, take a larger percentage of the revenue they generate and reinvest it into capital expenditures. Congruent with the scenario of Hibbett with a competitive advantage, we can reasonably expect the CAPEX / Revenue ratio to be 3.7%, indicating a more aggressive growth strategy relative to the industry by means of their beneficial relationship with Nike.

Discussion of Limitations

With using CAPEX / Revenue ratios from FY2019-FY2023 for long term ratios in scenarios for Hibbett's, we are subject to any unexpected or specific market events/conditions that may have been exclusive to that time. In the scenario of taking the minimum ratio value in the competition pool for Hibbett in the negative shift with Nike period, we use Big Academy's ratio in FY2021 as it is the minimum value among competitors and Hibbett in the 2019-2023 period.[87] However, it is indefinite that the value was due to a significant competitive advantage or subject to the events of the COVID-19 pandemic. During the pandemic, store operations and additions decreased due to consumers staying at home. This may have caused capital expenditures during this time frame to be less than normal market conditions.

Graph of CapEx / Revenue

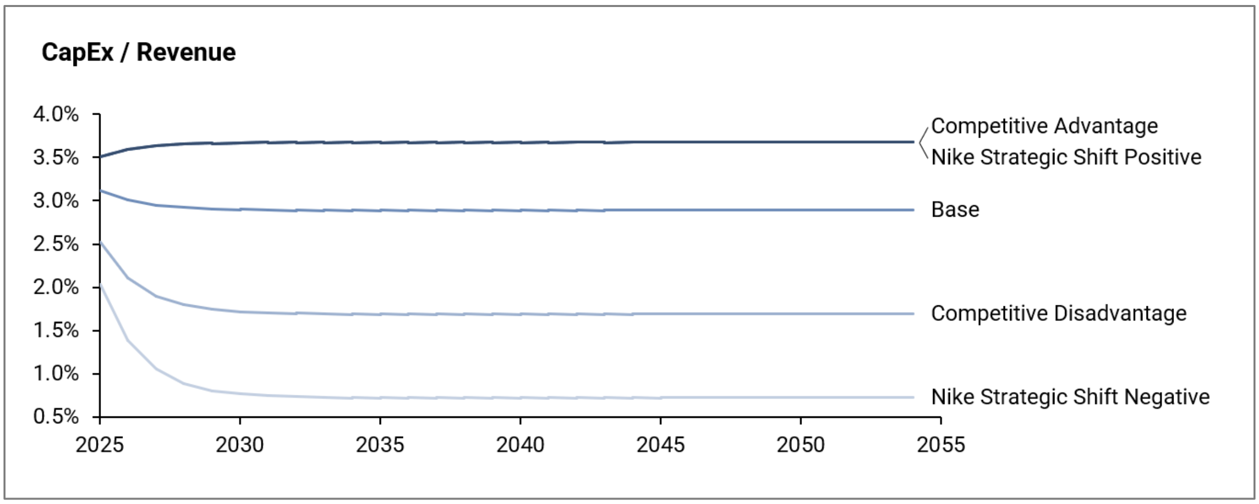

Figure 22: Visualization of CAPEX / Revenue ratio forecasts

Key factors driving Hibbett's Interest Expense

We have estimated our approximate interest expense based on the nominal value of finance leases and a credit facility. The expected value of our interest expenses to $2.6m over the forecast period per year.

Forecasted Debt Level

[87] Academy Sports 2021 10-K

We have forecasted two tranches of debt in our financial model, Finance Leases and a Short-Term Credit Facility. We have elected to keep both tranches of debt at the same nominal rate over the hold period. We have elected to simplify our assumption as at current we do not have a sophisticated method to value Hibbett's equity, nor do we have a strong assumption on the company's long-term capital structure goals. At current, Hibbett has a relatively low amount of debt in the capital structure at 10% Debt / Enterprise Value.[88] We have elected to exclude operating leases from our consideration of debt as congruent with an academic paper written by Professor Damodaran.[89] Our analysis of both interest expense and FCF will be congruent with a model proposed in both this paper and by a popular finance resource website Mergers and Inquisitions.[90] Additionally, we have elected to remove operating leases from our calculation of interest expense as the literature by accounting standards does not specifically explain the treatment of interest expenses payments in lease costs for the purpose of a future carryforward.

Finance Leases

Hibbett primarily classifies their leases as operating, but some are considered as financing leases. For those considered finance leases, we have considered the instrument to be like debt. The nominal value of financing leases $2m as of FY2023. We have considered the increase in locations in the future to be linked with operating leases and for that reason we have elected to keep their finance lease constant.[91]

Credit Facility

The nominal value of current credit facility is $45m with a gradual, with the primary use of the instrument to provide liquidity for the purchase of inventory. We have decided to keep the size of

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[88] Enterprise Value based on Hibbett Market Cap as of 3/25/2024.

[89] Dealing with Operating Leases in Valuation, Aswath Damodaran

[90] Lease Accounting: Operating Leases, Finance Leases, and the Confusing, Changing Rules, M&I

[91] Note 3 Leases, Hibbett 2023 10-K

our credit facility constant throughout the forecast period. Hibbett's credit facility has several covenants that would result in a limitation of Hibbett's future draw of the instrument. The first is an advance limitation of 55% of book value of inventory. The second is a maximum draw of 3.5x EBITDA. The final is a 1.2x EBITDA minimum coverage of fixed expenses. The maximum limit of our credit facility at $100m will not violate the covenants of the credit facility based on our expected inventory value nor our expected EBITDA multiple. [92]

Interest Rate on Debt Tranches

Finance Leases

We have based our interest rate on finance leases based on the synthetic credit rating provided by Hibbett in their annual report. The interest rate on finance leases was 4.6%. The statical likelihood of default on this financial instrument is considered in our analysis of liquidation scenarios. Utilizing both the nominal value of finance leases and interest rate, we expect the interest expenses from finance leases to be 90k.

Credit Facility

The Credit Facility is determined based on the Bloomberg Short-Term Bank Yield (BSBY) Index Rate. The credit facility has a floating rate but for the purpose of our forecast we have elected to fix the interest rate of 6.4% over the forecast period. Utilizing both the nominal value on the credit facility and interest rate, we expect the interest expenses from credit facility to be $2.8m.

Reasonableness of Interest Expenses

We expect the interest expense to be reasonable based on the use case of Hibbett's debt. At current, the credit facility along with the finance leases are a small percentage of the capital structure and each have remained unaffected by changes in both the operational performance of Hibbett and the equity value of the business. The current balance of the credit facility is not based

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[92] Note 4 Debt, Hibbett 2023 10-K

on the operations of the firm as the nominal value has fluctuated significantly over the past reporting periods.

Key factors driving Hibbett's Tax Forecast

We have forecasted Hibbett's expected tax expenses based on their expected tax rate, nominal debt amount, net operating losses, and future net operating losses. At current, Hibbett does not have either past net operating losses or past interest carryforwards. In expectation, Hibbett is unlikely to create future NOLs or interest carryforwards. As such their marginal tax rate will converge with the industry average marginal tax rate in the near term and continue into perpetuity. We have created a tax schedule with capability for NOLS and carryforwards.

Debt Schedule / Interest Expenses

As we discussed previously, the expected interest expense to be $3.0m based on the nominal value of our two tranches of debt. We have not forecasted scenarios in which our expected debt changes in the forecast period as we have presumed that the current debt level is not related to the operations of the firm. As such, the level of debt will remain constant throughout the forecast period.

Expected Tax Rate

We estimate a marginal tax rate of 24.7%. As such, we took the average of the marginal tax rate before interest deductions of a distribution of 12,000 observations from the Wharton Research Database Services (WRDS)[93]. Because we do not expect Hibbett to experience Net Operating Losses (NOLs), we match the average marginal tax rate before interest deductions to be the long-term tax rate for Hibbett as it matches and becomes a benchmark with the industry standard.

[93] Corporate Valuation: Theory, Evidence & Practice Second Edition; Holthausen and Zmijewski

Given this, we can expect the marginal tax rate before interest deductions to directly apply to income taxes.

Past Net Operating Loss Carryforward / Interest Carryforwards

At current, the deferred taxes on Hibbett's balance sheet are related to inventory, rent, and stock-based compensation. We do not observe any mention of net operating losses or interest carryforwards. Moreover, throughout the forecast period, we do not calculate any periods in which Hibbett operates at a loss or is unable to utilize the maximum value of their interest tax shield.[94] At the start of the unlevered period, Hibbett will not have any net operating losses or interest carryforwards.

Future Net Operating Losses / Future Interest Carryforwards

In the future, our expected revenue, expected COGS margin, expected SG&A margin will result in a positive Earning before Interest and Taxes (EBIT). The expected EBIT is a magnitude substantially greater than the minimum EBIT necessary to realize the full value of their interest tax shield. For this reason, we have the functionally for future NOLs and future interest carryforwards but do not expect our firm to have a prolonged period of economic weakness that would trigger the use of the schedule. In past reporting period, Hibbett had an EBIT of $168.4, with a possible deduction of $50.5m, well above the interest expense of $5.3m.

Tax Expenses Summary

We expect our income tax expense to be the average marginal tax rate of 24.7%. Statutory federal and state tax is in the amount of 24.5%, with small fluctuations related to our stock-based compensation and tax credits. We expect our average tax rate to return to the average of all publicly traded companies over the forecast period. The net impact of the 24.7% tax rate is an approximate interest tax shield of $733k.

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[94] Note 10, Income Taxes Hibbett 2024 10-K

Key factors driving Hibbett's Required Cash

We have considered our long-term required cash based on our industry competitors. We have considered the level of cash that is required to operate a profitable business along with considerations for the nature of our business. We have looked at the competitive set of Academy, Dick's and Foot Locker to triangulate an approximate minimum cash balance of 6.9%. We have considered our minimum cash based on scenarios in which we retain a competitive advantage, competitive disadvantage, and no competitive advantages or disadvantages. We have not considered the changes in strategy of Nike or macro-economic factors in the consideration for Hibbett's long-term minimum cash holdings.

Discussion of Required Cash of Competitors

As we discussed briefly in the analysis of Return on Assets, the average required cash balance for the competitive set is 6.5% of revenue. We have considered adjustments for excess assets as we've reduced several percentage points of marketable securities from each competitor. We have observed the relative amount of cash holdings has a relationship with the top-line revenue of each competitor. Our closest competitor Foot Locker has the highest cash to revenue percentage at 9.0%, an indication that as the financial health of a company declines, their relative cash holdings increase. Moreover, our competitors Academy Sports and Dick's hold 5.3% and 5.9% respectively. Although only Foot Locker operates similarly sized retail locations, we've utilized this competitive set as our estimation for required cash.

Hibbett without Competitive Advantages or Disadvantages

Although Hibbett has been profitable with a required cash value of 1.1% Cash / Revenue, we recognized that the business is likely to converge with the industry average in the long-term as their next lowest competitor holds a cash / revenue balance of 5.3%. We've considered the industry average Cash / Revenue ratio as the long-term cash holdings required by Hibbett at 6.5%.

Hibbett with Competitive Advantages

We've considered a scenario in which retains their competitive advantages into the long-term. In this scenario, the required cash as a percentage of revenue would be 5.3%, matching the current cash / revenue ratio of Academy Sports.[95] In a scenario with competitive advantages, the relative uncertainty in the long-term health of Hibbett would be low, meaning the company would have more flexibility to invest their required cash balance into NPV positive projects. In other words, as Hibbett's expected performance increases the company can afford the premium of not holding onto a high required cash balance.

Hibbett with Competitive Disadvantages

Last, we've considered a scenario in which Hibbett has a long-term competitive disadvantage. In this scenario the performance of Hibbett would decline as signaled by their lower revenue growth and a mix of store closures. If in this case, the opposite to the above case would apply. The company's financial risk would increase and subsequently their cash holdings would rise. The increase in cash holdings could either be self-imposed or based on before mentioned financial covenants. We expect their long-term cash / revenue ratio to be benchmarked with Foot Locker's recent performance at 9.0%.

Key factors driving Hibbett's Working Capital

We've broken the key drivers of our working capital assumptions into our cash conversion cycles, prepaid assets, deferred tax assets, accrued expenses, and other liabilities. We've considered these balance sheet items to be the main drivers of working capital in the long-term. We've discussed several scenarios from each driver along with the impact on operating working capital.

[95] Academy Sports 2023 10-K

Cash Conversion Cycle

One of the drivers of Hibbett's working capital is its cash conversion cycle. We divided this into the different factors that play a role in the cash conversion cycle: accounts receivable days, inventory days, and accounts payable days. In each of these factors, we present scenarios where Hibbett's competitive advantage, disadvantage, or lack of both, affect the cash conversion cycle that ultimately drive Hibbett's working capital.

Accounts Receivable Days

Hibbett's accounts receivable days are driven by the brand loyalty of their customer base. As such, we realize scenarios in which Hibbett's presence of a competitive advantage or lack thereof, affects its operational efficiency and payment collections in relation to accounts receivable days. The time in which payments can be collected, thus, affects Hibbett's ability to pay debt collections and how timely their receivables outstanding can be liquid.

Hibbett with Competitive Advantages

In the scenario where Hibbett has a competitive advantage, we expect Hibbett to operate in higher efficiency, yielding accounts receivable days more quickly than industry standards. This lower number is driven by the higher efficiency in which payments for sales can be collected. Under the case in which Hibbett's has a competitive advantage, we expect Hibbett to have a higher loyalty customer base. As a result, customers will be more reliable in making quicker and timely payments. In this competitive advantage, Hibbett will have more leverage in negotiating favorable payment terms with customers. We expect a long-term accounts receivable day of one day, taken from the quickest accounts receivable days from Hibbett and its competitors from FY2023. With a quicker accounts receivable day, the operational efficiency and liquidity of Hibbett drives an enhanced working capital.

Hibbett with Competitive Disadvantages

In the scenario where Hibbett is at a competitive disadvantage, we expect the accounts receivable days for Hibbett to be below the industry average. In this case, Hibbett would lose its brandy loyalty customer base and be in a position of unfavourability when it came to payment methods from the consumer. We expect the accounts receivable days to be the longest duration of Hibbett and its competitors of FY2023 with a time of 6.1 days. This increases risk of default for Hibbett as with longer accounts receivable days, collection of their payments may delay how quickly they are able to liquidate their receivables outstanding, presenting credit and default risk to their working capital strategy.

Hibbett without Competitive Advantages or Disadvantages

When Hibbett operates without competitive advantages or disadvantages, we expect Hibbett's operational performance to converge to the industry or Hibbett and its competitors' average of 3.0 days that payments may be collected from sales.

Inventory Days

Hibbett's inventory days are largely driven by their ability to predict and adapt to consumer trends and preferences in selling brand name merchandise. We weigh different scenarios based on the presence of Hibbett's competitive advantage, competitive disadvantage, or neither in affecting its working capital.

Hibbett with Competitive Advantages

We expect Hibbett's long-term inventory days to converge to 89.2 days from the minimum value of inventory days among Hibbett and its competitors in FY2023 when Hibbett operates at a competitive advantage. In this scenario, having a competitive advantage likely means the transition from inventory to sales to be much quicker due to Hibbett being able to effectively adapt their merchandise to customer preference as well as use their loyal customer base as a catalyst to quicker transition to customers purchasing from their inventory. Therefore, we can expect a quicker days of inventory outstanding compared to the rest of the industry, enhancing working capital from inventory into sales.

Hibbett with Competitive Disadvantages

Unlike the scenario in which Hibbett has a competitive advantage, when Hibbett is under the disadvantage of a decreased or no longer present loyal customer base, we expect Hibbett's inventory days to be much higher than normal or compared to the industry. Therefore, by taking the longest value from FY2023 of the inventory days of Hibbett and its competitors, we expect Hibbett to operate with long-term inventory days of 115.8 days under a competitive disadvantage. By having longer inventory days, working capital is worsened due to the operational inefficiency of Hibbett's merchandise being unsold to customers and affecting cash flow efficiency.

Hibbett without Competitive Advantages or Disadvantages

In this scenario, we expect Hibbett to operate with inventory days that match the industry average of 104.5 days. Being on par with the rest of the industry, there would be no notable factors that would deviate Hibbett from outperforming or underperforming the rest of the competition in this scenario.

Accounts Payable Days

Hibbett's supplier relationships with brands such as Nike play a significant role in how Hibbett is able to operate their accounts payable days. We present three different scenarios in which Hibbett's competitive advantage or disadvantage may affect its accounts payable days and how that might be driven by its relationships with suppliers.

Hibbett with Competitive Advantages

In this scenario, Hibbett's competitive advantage of a beneficial relationship with Nike and Hibett's ability to effectively optimize its cash flow improves a longer payable day. We expect a longer accounts payable day of 62.1 days. By maintaining and improving healthy supplier relationships with companies like Nike, Hibbett's working capital is enhanced with leveraging supplier financing and delaying cash outflows. However, it is important to note that the

Nike/Hibbett relationship is also contingent on Nike's operations and strategy and how this may shift their contract with Hibbett.

Hibbett with Competitive Disadvantages

When Hibbett operates at a competitive disadvantage, Hibbett's financial leverage falls due to a faster turnover of accounts payable to their suppliers. In this case, Nike and Hibbett's other suppliers may have more leverage in asking for payment terms more favorable to them than to Hibbett. As Hibbett's inventory and sales consist of a large percentage of Nike merchandise, it would be inadvisable for Hibbett to put any strain on its supplier relationship with Nike. As a result, we expect a shorter accounts payable day of 33.3 days in the scenario that Hibbett operates at a competitive disadvantage.

Hibbett without Competitive Advantages and Disadvantages

When Hibbett does not have competitive advantages nor disadvantages, we expect Hibbett to align and converge to the industry average of Hibbett and its competitors accounts payable days of 49.3 days, slightly below Hibbett's long-term average of 48.3 days. In this case, we assume there are no significant changes in the relationships Hibbett would have with its suppliers and no large changes in its working capital.

Prepaid Assets

Hibbett's prepaid assets are primarily comprised of advance payments on rent of related to their Hibbett locations. We've considered several scenarios based on Hibbett's long-term competitive advantage, long-term competitive disadvantage, and Hibett with neither a competitive advantage nor disadvantage. Our prepaid assets are a minor component of our operating working capital, but improvements in our operational performance.

Hibbett without Competitive Advantages or Disadvantages

In the case in which Hibbett does not retain any competitive advantage or disadvantage we expect for Hibbett's long-term Prepaid / Revenue ratio to converge with the industry average of 1.7%. Although it's unclear of the total composition of our prepaid assets, we expect them to scale with operations and in expectation be near our competitive average. In this case the impact on working capital would be a decline in the working capital as it's above our five-year average of 1.5%.

Hibbett with Competitive Advantages

Second, in the case in which Hibbett retains a competitive advantage into the long-term, we expect the Prepaid Assets / Revenue to perform better than the industry average and be lower than the previous scenario at 1.0%. As we assume that the prepaid asset is related to our operations, we expect that with a competitive advantage our operational performance will improve. Moreover, if this asset is a holding by our leasers, we would expect this value to decrease nominally as the relative risk associated with Hibbett declines. We've benchmarked this to the low of the five-year industry average of our competitive set. Our operational improvements in this case would result in an increase in our operating working capital as the relative asset size would be smaller than the previous case.

Hibbett with Disadvantages

In our final scenario, we consider Hibbett without a competitive advantage. In this case our operational performance deteriorates as we lose both revenue growth and the total number of locations. The relative risk of our business increases with the decline of Hibbett's performance. The double impact would lead to an increase in the prepaid asset, leading to a decrease in working capital from the previous case. We have benchmarked this case based on the highest average over the past-five years from our competitive set 2.9%.

Deferred Income Taxes (DTA)

We have considered the long-term impact of deferred taxes as a part of our working capital. Our deferred taxes primarily occur due to stock-based compensations and deferred rent. As such, we have dictated the DTAs on our balance sheet are linked with the operations of our business rather than one-time instances. We have scaled based on revenue, with our competitive set along with Hibbett's operational performance as benchmark for the DTA balance. Our model mechanically treats the deferred tax assets as a part of the working capital with changes in the magnitude of our DTA balance associated with the size of our operations. We have an expected DTA / Revenue of 0.6% in the long-term.

Hibbett without Competitive Advantages or Disadvantages

In the case in which Hibbett operates without a competitive advantage or disadvantage, we expect the ratio of DTA / Revenue to converge with the industry average of 0.5%, slightly below Hibbett's long-term average of 0.6%. We have considered this scenario to be the for the business into the perpetual period.

Hibbett with Competitive Advantages

Second, in the case Hibbett operates with a competitive advantage into the long-term we expect their DTA / Revenue to be lower than the above case and increase their operating working capital. We have benchmarked this scenario on the low of the five-year industry average at 0.2%. In this case, the recognition of deferred taxes would occur sooner, and allow for Hibbett to consistently generate a slight increase in working capital.

Hibbett with Competitive Disadvantages

The last case we considered was a case in which Hibbett operates in the long-term with competitive disadvantages. The DTA / Revenue in this case would be marginally higher than the first case as Hibbett's ability to turn their deferred tax assets into cash would be less efficient. The result would be a decrease in their working capital and DTA / Revenue ratio of 1.0%.

Accrued Expenses / Other Liabilities

Our accrued expenses and other liabilities are related to payroll expenses and customer loyalty points. We do not have sufficient information to grow our accrued payroll at the headcount level and have instead elected to grow with the size of Hibbett's operations. We have considered scenarios based on Hibbett's competitive advantages, disadvantages, and neither advantages or disadvantages to estimate a holistic impact on operating working capital.

Hibbett without Competitive Advantages or Disadvantages.

Without competitive advantages nor disadvantages, Hibbett would most likely follow the industry average for its Accrued Expenses / Revenue ratio of 4.0%, exactly aligning with Hibbett's long-term ratio of 4.0%.

Hibbett with Competitive Advantages

In the scenario that Hibbett operates at a competitive advantage, accrued expenses are expected to be higher with increased operational efficiency in cash flows. As such, this can be attributed to Hibbett's customer loyalty points system in their omni-channel platform that allows them to defer cash outflows. We expect Hibbett to operate at the higher industry average of 6.5% in the Accrued Expenses / Revenue ratio, signifying a larger percentage of revenue allocated to accrued expenses and recognized later, which may improve cash flow and working capital. However, it is important to note that although higher accrued expenses may improve short term liquidity, current liabilities in the fiscal year would also increase.

Hibbett with Competitive Disadvantages

Considering a case in which Hibbett operates at a competitive disadvantage, we expect Hibbett at the low of the industry average with an Accrued Expenses / Revenue ratio of 1.6%. A potential factor includes a shift in the contract Hibbett has with Nike and their joint loyalty program that may bring new rewards or offers. In this scenario, Hibbett's ability to defer cash outflows and delay payments would decrease and may be caused by unfavorable payment terms, affecting its working capital and operational efficiency with expenses such as payroll.

Hibbett Sale to Strategic Acquirer

Due to the dependence on Nike, it seems feasible that Nike could acquire Hibbett in the next years. There are three main reasons why this could happen:

- **Nike's interest in vertically integrating its distribution channels is evident.** By acquiring Hibbett, Nike would achieve higher profit margins and a closer contact with its customers. This vertical integration strategy aligns with Nike's broader ambitions to enhance control over its distribution network and consumer engagement channels.
- **The acquisition could serve as a means for Nike to effectively eliminate competition within its retail environment.** Owning Hibbett would allow Nike the opportunity to curate a product selection that exclusively or predominantly features its own products, effectively sidelining other brands that Hibbett currently stocks. This would not only reinforce Nike's brand presence but also potentially convert Hibbett's customer base to Nike customers, especially those who might have previously patronized other brands available at Hibbett.
- **Nike’s leverage in partnership may lead to a cheap buying opportunity.** Should there be speculation or risk of Nike terminating its contracts with Hibbett, the latter's valuation could suffer a significant blow due to the anticipated negative impact on its business operations and revenue. This scenario could lead to Hibbett's shareholders being more inclined to accept an acquisition offer from Nike, possibly at a lower premium than would otherwise be expected. The threat of bankruptcy might likely make such an offer, even at a modest premium, appear more attractive by comparison.

The expected probability of sale is based on the average probability of a publicly listed company being bought out and can be interpreted as a lower bound. The number incorporated in the model is 5%. This number is based on a McKinsey study from 2021. Out of approximately 4,000 publicly listed companies, approximately 200 were delisted yearly. Out of these delisting’s, 95% belonged to acquisitions. Consequently, the probability of being bought out as a publicly listed company is about 4.75%.[96]

[96] There were 4,000 publicly listed companies in 2020 and approximately 200 annual buyouts over the period from 2016 to 2020. The percentage of being acquired (95%) refers to the horizon from 2020-20. Source: https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/reports-of-corporates-demise-have-been-greatly-exaggerated

Hibbett Bankruptcy Value Scenario

This section assesses the liquidation scenario for Hibbett Sports, contingent upon the potential termination of its sales agreement with Nike. Hibbett's ability to remain operational is conditional on its ability to retain and maintain a strong relationship with its key vendor, Nike. This is mainly for two reasons. First, Nike makes up approximately 70% of the revenue of Hibbett. Without revenue, Hibbett would face negative cash flows. Second, one of the key motivators of Hibbett customers to go into the store in the first place is to explore Nike products. This is particularly noteworthy in the more "underserved markets", in which Hibbett operates in. In these, Afro American customers value Nike's partnerships with rappers and influencers (see Section on competitive advantage). The reason three main reasons that would make Nike terminate the agreement and thus lead to the bankruptcy scenario are:

- **Strategic realignment towards fewer potentially exclusive partnerships.** The competitive dynamics within the sports retail industry might motivate Nike to establish exclusive partnerships with other retailers, possibly in pursuit of improved margins. This strategic shift, evidenced by Nike's recent reduction in its retail partner base, could be exacerbated by competitors like Dick's Sporting Goods seeking similar exclusive agreements.
- **Focus on direct-to-consumer sales.** Nike's D2C sales have demonstrated a CAGR of 14.2%, outstripping its retail sales growth. The company's strategic focus on D2C channels, motivated by higher margins, suggests a diminishing reliance on traditional retail partnerships, including that with Hibbett.
- **Change in consumer behaviors**. Hibbett's strategic value to Nike is currently augmented by its presence in locations underserved by online retail, notably within certain demographic communities. However, shifts in consumer purchasing behaviors or Hibbett's inability to sustain its market position in these areas could reduce its relevance to Nike. The opportunity cost of maintaining the partnership, especially considering the higher margins from D2C sales, may prompt Nike to reevaluate its relationship with Hibbett.

The expected probabilities of a bankruptcy scenario for each year are estimated using the empirical bankruptcy probability based on the credit rating. This method, of estimating a company's probability of default using its credit rating as a proxy is a widely adopted method in financial analysis. This approach uses the empirical bankruptcy probabilities associated with different credit ratings to predict the likelihood of a firm, such as Hibbett, ending up bankrupt after a certain amount of years after the credit rating[97]. Credit ratings, assigned by rating agencies, are meant to reflect a firm's financial health and its ability to meet its obligations. They therefore encapsulate a myriad of quantitative and qualitative factors, including financial performance, industry position, and economic conditions. By relying on these ratings, analysts can use a standardized metric to infer the default probability without needing access to the proprietary methodologies used by rating agencies.

However, the limitations of this approach are noteworthy. First, credit ratings are not updated in real-time. They reflect the rating agencies' latest assessment, which may not capture recent developments or future uncertainties. This time lag can lead to discrepancies between the current risk profile and the one indicated by the rating. Additionally, while credit ratings are based on extensive analysis, they are not infallible predictions of the future. The methodologies and the weight given to various factors are not fully transparent, and different agencies might have slightly different assessments. Furthermore, this method does not account for idiosyncratic risks specific to a company that may not be fully captured by its credit rating. For example, operational risks, management changes, or industry-specific shocks might significantly impact a company's default probability, independently of its credit rating.

The credit rating that is used for Hibbett is BB according to Moody’s scale. While this report will discuss the credit rating in Stage 3, an estimate was derived at this point by comparing Hibbett

[97] The table with the probability of bankruptcy per credit rating for the respective years after the rating has been issued was obtained from „Corporate Valuation: Theory, Evidence and Practice (2nd Edition)“ by Robert Holthausen and Mark Zmijewski.

with its close competitors Academy Sports, Dick's Sporting Goods and Foot Locker which face the same supplier situation with Nike.

If the Chapter scenario happens, there are two potential outcomes: a restructuring or a liquidation. The probability of a restructuring is based on empirical data which show that this outcome happens in approximately 10% of the cases, while a liquidation happens in 90% of the remaining cases[98]. Both scenarios, the restructuring and the liquidation, will be discussed in the following sub-sections.

Restructuring scenario

In the scenario where Hibbett faces Chapter 11 due to a breakdown in its partnership with Nike, opting for restructuring under Chapter 11 represents a strategic pathway to regain financial stability and operational viability. The restructuring process begins with the company formally filing for Chapter 11 bankruptcy protection, allowing it to maintain control over its assets and business operations as a debtor in possession (DIP). This status is crucial as it permits Hibbett to continue its day-to-day operations under the supervision of the bankruptcy court, providing a semblance of operational normalcy during the restructuring phase.

The core of the restructuring process involves the development and negotiation of a reorganization plan, a comprehensive document that outlines how Hibbett intends to modify its business structure, operational strategies, and financial obligations to creditors. This plan is pivotal, as it must provide a viable blueprint for the company's future operations, detailing specific measures for debt repayment, equity restructuring, and potentially, the divestment of non-core assets to streamline operations and focus on profitable segments. The reorganization plan requires approval from a majority of creditors and the bankruptcy court, underscoring the need for consensus among stakeholders about the company's post-bankruptcy path. How exactly this plan would look like for Hibbett is unclear at this point. Options include a strategic shift from

[98] https://www.incharge.org/bankruptcy/chapter-11

begin a sports retailer to using the store for different purposes or renegotiating with Nike in return for lower margins.

Financially, restructuring under Chapter 11 aims to enhance Hibbett's value by addressing its debt structure and improving operational efficiencies. The negotiation process with creditors often involves adjusting the terms of existing debts, which may include extending payment timelines, reducing the principal amount owed, or converting debt into equity. These adjustments are designed to relieve the immediate financial burden on the company, providing it with a more manageable debt load and improving cash flow dynamics. From a valuation perspective, successful restructuring can lead to a positive reassessment of the company's worth, reflecting its prospects for sustainable profitability and growth post-restructuring. Due to the uncertain nature of the exact scope of the liquidation value, this report assumes a sale at a premium of 25% above the liquidation value. This represents both the opportunity by rightening the ship by continuing the operations internally and the opportunity of the assets being acquired in the Chapter 11 process for a value higher than the liquidation value. Numerically, the 25% are the mean premium that is assumed in the acquisition case. It is applied to the market value of the firm, which in the case of a liquidation, would be the liquidation value.

Liquidation scenario

When a Chapter 11 restructuring effort fails, the case may be converted to a Chapter 7 bankruptcy for liquidation. This conversion can happen for several reasons, including the inability to formulate a viable reorganization plan, failure to gain creditor approval for the proposed plan, or simply because the business's financial situation is beyond recovery through restructuring efforts.

Liquidation under Chapter 7 entails the orderly winding down of the company's operations and the sale of its assets. The primary objective of this process is to maximize the returns from the sale of assets to distribute among creditors and stakeholders, according to the priorities established by bankruptcy laws. Assets may include inventory, real estate, intellectual property, and any other tangible or intangible assets the company owns. The proceeds from these sales are then used to pay off creditors to the extent possible, starting with secured creditors who have a lien on specific assets, followed by unsecured creditors, and if funds allow, equity holders, though the latter often receive little to nothing in a liquidation scenario.

The financial valuation of the firm in liquidation would be lower than from the restructuring scenario. In liquidation, the valuation is based on the liquidation value of the assets, which is often lower than the going concern value because assets may be sold quickly and under distressed conditions and therefore not reflect their true market value if sold under normal circumstances. This can lead to a considerable reduction in the financial value of the firm, with stakeholders potentially receiving less than what they might expect under a reorganization plan.

The value of the firm in case of a liquidation is calculated as the book value of the firm's assets, multiplied by a recovery rate.

The expected liquidation amount is calculated by multiplying the expected book value with the expected recovery percentage in the case of a liquidation. The expected book value of the firm is calculated by subtracting the total liabilities of the total assets of Hibbett in the given year.

The expected recovery percentage in the case of a liquidation is based on empirical studies which show that is uses usually tends to be a maximum of 80% of the book value. Thus, this model uses 80% and considers it an upper bound[99].

[99] Bris, A., Welch, I. and Zhu, N. (2006), The Costs of Bankruptcy: Chapter 7 Liquidation versus Chapter 11 Reorganization. The Journal of Finance, 61: 1253-1303. https://doi.org/10.1111/j.1540-6261.2006.00872.x

HIBBETT, INC.

Valuation Report Appendix

Target: Hibbett Sport (NASDAQ: HIBB)

Analysts: D. Cruz, J. Schenk, M. Su

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