Boohoo Group PLC

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Boohoo factory scandal raises tough questions for ESG and fashion investors, analysts say

Shares in Boohoo Group PLC (LON:BOO) continued to fall as it was ESG investors and with analysts warning that it will be hard to keep prices down if it keeps manufacturing in the UK.

The fast-fashion e-retailer has been rocked by a modern slavery scandal after it was connected to garment factories in Leicester as the city was hit by a second coronavirus lockdown.

Shares in the 'king of AIM' halved as the extremely poor pay and conditions in the factories was laid bare and reflected badly on the company.

The company could be subject to prolonged further investigations, the Sunday Times has reported, while the FT questioned how so many ESG funds could have invested in the company.

READ: Boohoo launches supply chain probe as clothing giants drop its brands

MSCI, the rating and index provider, had Boohoo on its second-highest rating thanks to superlative scores on supply-chain labour standards.

"The allegations have raised many questions on corporate governance and culture," acknowledges analyst Wayne Brown at broker Liberum in a note on Monday.

"The accusations of modern day slavery against fast fashion retailer Boohoo have not only railed its share price, but also sent shockwaves through the ESG investing world."

With several ESG funds invested in the stock and one fund that claimed to pay particular attention to labour conditions even had Boohoo as largest holding in its fund, Brown looked at how this might happen.

Looking at the average ESG ratings on CSRhub, he noted that Boohoo had an ESG rating in the top 29th percentile of more than 19,000 companies worldwide, so was was rated better than 71% of all companies, based on an average of nine different ratings providers.

ASOS PLC (LON:ASC) and Zalando are covered by 16 providers and had only slightly better average ratings.

Furthermore, the analyst noted that none of the nine ratings agencies flagged any material controversial practices for Boohoo, though ASOS's involvement in sourcing materials from Burma and Sudan were flagged as potential risk factors.

"Investors who only looked at the ratings or the ESG data the companies disclosed could easily believe that Boohoo was a pretty good investment from an ESG perspective," Brown said.

Price:	336.9
Market Cap:	£4.25 billion

1 Year Share Price Graph

Share Information

Code:		BOO
Listing:		AIM
52 week	**High**	**Low**
	433.5	**133.1**
Sector:		**Retail**
Website:		**www.boohooplc.com**

Company Synopsis:
Boohoo Group PLC is a leading online fashion retail group. Its brands, boohoo, boohooMAN, PrettyLittleThing and Nasty Gal target fashion-conscious 16-24 years olds in the UK and internationally.

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"However, the reliance on simple ESG ratings or solely on publicly available information disclosed by the company, can lead to some fundamental errors."

As ESG ratings are usually based on a wide range of variables published by a company, which is mixed together "in a more or less opaque manner" by the ratings agencies, Brown says, this can lead to problems.

For one thing, ESG ratings agencies "can only work with the data that a company discloses in the first place", similar to credit ratings agencies, and without any unified standard of disclosure, every company is free to choose which metric it wants to publish.

With disclosure of ESG information being an extra cost for companies, even though ESG investors and ESG rating agencies want as much information as they can get, they have to make do with what companies are willing to publish.

In order not to unfairly penalise smaller companies, ESG rating agencies often calculate their ratings or make their investment decisions based on the available data and simply ignore the missing data, Brown says.

"That opens up an opportunity for companies to game the system. If you have something to hide, you can simply choose to disclose only favourable information about your company.

"This way, you look much better to ESG investors and it may even be possible to look better than companies that are following better practices overall, but disclose more information about their business."

Looking at Boohoo specifically, the saga "has some way to play out", Brown reckons, and he expects initial details of the investigation led by lawyer Alison Levitt this week or next and noted insinuation that Boohoo is being investigated by the National Crime Agency after pressure from the Home Secretary.

As such, Brown says it is hard to provide investment advice due to "so many unknowns" and as the decision to buy or sell shares likely to be impacted by the many investigations that are still to play out.

The exposure of the practices in the Leicester apparel trade have led investors and analysts alike to wonder how a garment produced in the UK to be sold so cheaply and still make good profit margins.

As an example, Clive Black at Shore Capital wondered how could a dress or a top be sold £10 while the company also achieves a margin of 10% trading margin, with returns in the pure-play fast-fashion channel sometimes reaching as high as 40%.

Taking what he acknowledges is "a simplistic look" at the garment manufacturing model, Black comes to the conclusion that to comply with UK minimum wage requirements "it is difficult, nay impossible, to achieve such a margin".

Following on from that, if Boohoo, for example, has to move sourcing overseas, the labour costs may be a fraction of the UK but extra costs of shipping costs extra time of offshoring "will serve to also make such fast-fashion garments less profitable at the same price", Black says.

As such, for fast-fashion businesses such as Boohoo and Quiz (LON:QUIZ), he says the only future is one that leads to "either prices rising, which would mean reduced competitiveness and potentially lower volumes, or lower margins".

Black adds: "All this assumes no brand damage, which could be penal, especially if the agents of influencers, and licensees, of labels take flight. With these thoughts in tow we remain concerned about forthcoming news flow and the ongoing de-rating potential for Boohoo."

On Monday, Boohoo boss John Lyttle announced plans to build a 'model factory' in Leicester where the online retailer will make sure staff work in fair conditions.

Boohoo has said it found no evidence of low salaries at its suppliers but admitted that its code of conduct had been breached.

"It is clear there are some very important failings made by Boohoo and while they refute some of the allegations, it may be too early to rule anything out at this stage," Liberum's Brown added.

"However, these scandals can be a force for change and Boohoo, seemingly rather slowly and begrudgingly in the early part of the crisis, started to appreciate the sheer scale of this scandal, when nearly £2bn of its equity value was wiped out in two days."

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