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Boohoo vows to rectify failings but margins remain a question

Boohoo Group PLC (LON:BOO) has vowed to address its corporate governance responsibilities after an independent review confirmed poor working conditions and low rates of pay in its supply chain.

The report found that Its senior directors "knew for a fact that there were very serious issues about the treatment of factory workers in Leicester and whilst it put in place a programme intended to remedy this, it did not move quickly enough".

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Boohoo's solutions

To address the issues in Leicester, Boohoo said on Friday it would engage with new ethical and sustainable suppliers (maintaining "a significant presence" in the Leicester garment industry) publish a list of audited UK partners annually and working more closely with them to ask a more predictable flow of orders, among other measures.

It will also appoint two new non-executive directors with experience in environmental, social and governance (ESG) matters, set up new committees to better monitor its operations as well as providing support for the workers of Leicester.

Question marks

But analysts at AJ Bell remain puzzled about the company's finances and how it can make, according to the last set of annual accounts, gross margins of 54% and operating margins of 8.7% (on an underlying basis) when its average selling prices are so competitive.

On Friday afternoon, Boohoo's online website, for example, was offering women's white T-shirts for at £4, reduced from the full price of £5, while the men's version was reduced to £6.40 from £8.

"June's new management incentive package, tied purely to the share price, that could net three executives a maximum of £150 million, also raised concerns that this was not best practice," noted Russ Mould, investment director at AJ Bell.

The issues are old news

Workers' rights alliance Ethical Trading Initiative (ETI) stressed last month that the problems reported in Leicester have existed in the UK garment sector for decades and the focus should be extended beyond the English city.

"This is a supply chain issue that begins with corporate business practices around purchasing and costing, but includes workplace & community exploitation and in this scenario it is often the workers that suffer as businesses avoid taking responsibility," ETI said.

"We are working with responsible business members to eradicate these issues throughout their businesses and supply chains in a meaningful and long-lasting manner, but this does mean making significant changes to existing practices."

"One of those changes will mean assessing whether the price paid for a low-cost item feeds modern slavery," the organisation added.

Potential higher costs ahead

In fact, AJ Bell observed that the fast-fashion giant is going to have to change its processes, potentially resulting in higher costs which may ultimately be passed on to customers.

"A key appeal of Boohoo is its relatively low prices so management are going to have to weigh up whether the company will stomach some of the extra costs to avoid alienating customers or whether it has the magic of pricing power. The latter is where a business has the confidence that it can push up prices without causing demand to fall," Mould said.

"Getting its house in order could ultimately benefit Boohoo in the long term… ESG issues are now front and centre and companies which aren't looking at how they operate and work with suppliers will feel the pressure from investors to make sure they do address the issue," he continued.

"Fans of the business might suggest Boohoo could go from villain to a trailblazer in how to make amends and improve standards to make them fit for the modern world. That obviously depends on the company acting on the recommendations in its independent review and not simply brushing them under the carpet."

Shares in Boohoo jumped 15% to 371.4p on Friday afternoon, up 77% from July lows and only 7% lower than 'pre-scandal' levels.

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