Dr. Martens Plc (DOCS.L – £1.63)

May 04, 2023*

Dr. Martens Plc (DOCS.L) manufactures and sells footwear products. The Company offers boots, shoes, sandals, shoe care products, laces, and socks. The Company sells its products directly to consumers and through other third-party retailers. The Company was founded in 1945 and is headquartered in London, the United Kingdom. Its fiscal year ends on 03/31.

Thesis Summary

We are concerned a planned shift to the direct-to-consumer (DTC) channel may drive near-term revenue pressure as the Company attempts to convert customers that previously purchased through the wholesale channel. In addition, we believe the Company may be compelled to ramp marketing spend and margins may be pressured to the extent DTC growth underperforms. We believe a reluctance to discount in a more promotional environment may drive wallet share loss. In addition, we believe a revenue mix shift away from "iconic" brands in recent years may increase Dr. Martens' exposure to discounting. In our view, a distribution center transition may drive persistent business disruption and elevated supply chain costs. In our view, elevated inventory levels may portend margin pressure driven by elevated carrying costs and/or discounting of non-iconic products. In addition, we believe inventory normalization may be difficult given long-term supplier agreements and the Company's reluctance to discount "iconic" products. In our view, elevated receivable levels and certain commentary suggest channel inventory levels may be elevated and wholesale revenue may be pressured. Our earnings sustainability concerns are heightened given (1) depressed inventory/receivable provision/allowance levels, (2) elevated capital expenditure levels, (3) depressed cash flow levels, and (4) a recently announced CFO retirement.

Company Data	
Country/Exchange	England/LSE
Reporting currency	£
Accounting standard	IFRS
Shares Outstanding (mil)	1,000.8
Float (mil)	602.3
Average Volume (mil)	£4.4
52 Week Range	£1.27 – £2.95
Dividend Yield	1.9%
Market Cap (bil)	£1.6
Net Debt (bil)	£0.2
Enterprise Value (bil)	£1.8
FY 22 Rev (mil)/Rev Growth	£908.3 / 17.5%
FY 22 EBITDA (mil)	£263.0
FY 22 GM %/Change	63.7% / 290 bps
FY 22 EBITDA %/Chg	29.0% / 20 bps

Valuation (as of report date)	
NTM P/S	1.7x
NTM EV/ EBITDA	7.2x
NTM P/E	12.6x

Consensus Estimate Drift

	EST	1M Ago	6M Ago	1YR Ago
FY 23 Rev	£999.1	£1,006.6	£1,090.3	£1,058.7
FY 24 Rev	£1,048.2	£1,048.2	£1,225.2	£1,213.4
FY 23 EPS	£0.14	£0.15	£0.21	£0.19
FY 24 EPS	£0.13	£0.13	£0.23	£0.22

Peers Mentioned In This Report
N/A

Catalysts and Timing
Weaker-than-expected FY 24 margin guidance
Overbuilt inventory drives persistent margin pressure
Reduced FY 24 revenue growth guidance
DC transition disruption persists longer-than-expected

*** All research is completed as of 4:00PM – 4:15PM Eastern Time unless otherwise noted.**
Please refer to the end of this report for an updated version of *The Short List*.

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Company Background

Company description: Dr. Martens Plc (DOCS.L) manufactures and sells footwear products. The Company offers boots, shoes, sandals, shoe care products, laces, and socks. The Company sells its products directly to consumers and through other third-party retailers. The Company was founded in 1945 and is headquartered in London, the United Kingdom. Its fiscal year ends on 03/31.

Revenue by channel: In FY 22, direct-to-consumer (DTC) accounted for 49.3% of revenue and wholesale accounted for 50.7%. The DTC channel includes sales directly to consumers through its ecommerce website (28.9% of revenue) and Company-owned retail stores (20.4% of revenue). The wholesale channel includes sales to wholesale customers, distributors, and franchisees.

Revenue By Channel Analysis (as % of total)	FY 22
Ecommerce	28.9%
Retail	20.4%
Direct-to-consumer (DTC)	49.3%
Wholesale	50.7%
Total	100.0%

Revenue by product category: In FY 22, Originals products accounted for 51.0% of revenue, Fusion accounted for 36.0%, Casual accounted for 6.0%, Kids accounted for 4.0%, and Accessories accounted for 3.0%. In its FY 22 Annual Report, the Company disclosed Originals included its "icons" including the 1460 boot, 1461 shoe, and 2976 Chelsea boot. Dr. Martens indicated the "icons" were the "core" of its product architecture and informed the aesthetics of all other footwear categories. Fusion products include the Sinclair boot, Audrik Quad Neoteric, Jadon, and sandals. Casual products include the Combs and Tarik boots. Kids products include "mini-me" versions of Originals. Accessories include shoe-care products and leather bags among other products.

Revenue By Product Category Analysis (as % of total)	FY 22
Originals	51.0%
Fusion	36.0%
Casual	6.0%
Kids	4.0%
Accessories	3.0%
Total	100.0%

Revenue by geography: In FY 22, EMEA accounted for 43.9% (48.5%) of revenue (segment EBITDA), Americas accounted for 42.1% (40.5%), and APAC accounted for 14.0% (11.0%).

FY 22 Geography Analysis (as % of total)	Revenue	EBITDA
EMEA	43.9%	48.5%
Americas	42.1%	40.5%
APAC	14.0%	11.0%
Total	100.0%	100.0%

Background on manufacturing: In its FY 22 Annual Report, the Company disclosed the majority of its footwear was manufactured by "Tier 1" suppliers with a "small amount" manufactured at its owned facility in the UK. In addition, the Company has certain "key Tier 2" suppliers that manufacture a "strategic" component and other "Tier 2" suppliers that manufacture other components.

Seasonality: In the past three years H2 (period ended 03/31) accounted for 59.4% of revenue on average. In its FY 22 Annual Report, the Company highlighted Q3 (period ended 12/31) was the "peak" direct-to-consumer selling season.

Seasonality Analysis (as % of total)	H1	H2
FY 22 revenue contribution	40.7%	59.3%
FY 21 revenue contribution	41.2%	58.8%
FY 20 revenue contribution	40.0%	60.0%
Three-year average	40.6%	59.4%

Competition: In its Registration Statement on 01/10/21, Dr. Martens disclosed Nike, Adidas, Vans, and Converse were its main competitors in terms of share of customer wallet. Dr. Martens competes with other shoe and apparel brands and manufacturers.

Voyant's Earnings Risk Assessment

We are concerned a planned shift to the direct-to-consumer (DTC) channel may drive near-term revenue pressure as the Company attempts to convert customers that previously purchased through the wholesale channel. In addition, we believe the Company may be compelled to ramp marketing spend and margins may be pressured to the extent DTC growth underperforms. We believe a reluctance to discount in a more promotional environment may drive wallet share loss. In addition, we believe a revenue mix shift away from "iconic" brands in recent years may increase Dr. Martens' exposure to discounting. In our view, a distribution center transition may drive persistent business disruption and elevated supply chain costs. In our view, elevated inventory levels may portend margin pressure driven by elevated carrying costs and/or discounting of non-iconic products. In addition, we believe inventory normalization may be difficult given long-term supplier agreements and the Company's reluctance to discount "iconic" products. In our view, elevated receivable levels and certain commentary suggest channel inventory levels may be elevated and wholesale revenue may be pressured. Our earnings sustainability concerns are heightened given (1) depressed inventory/receivable provision/allowance levels, (2) elevated capital expenditure levels, (3) depressed cash flow levels, and (4) a recently announced CFO retirement.

DTC Shift May Pressure Growth And/Or Margins, In Our View

Background on revenue by channel and guided shift to increased direct-to-consumer mix: As mentioned, in FY 22, direct-to-consumer (DTC) accounted for 49.3% of revenue and wholesale accounted for 50.7%. The DTC channel includes sales directly to consumers through Dr. Martens' ecommerce website (28.9% of revenue) and Company-owned retail stores (20.4% of revenue). The wholesale channel includes sales to wholesale customers, distributors, and franchisees. In its FY 22 Annual Report, the Company highlighted it focused on DTC "first" and guided for 60.0% of revenue to be generated from DTC (40.0% ecommerce and 20.0% retail) in the "medium-term." On its Q3 23 Conference Call on 01/19/23, the Company represented DTC was four times more profitable than wholesale.

> Our medium-term milestones are unchanged: 60% of revenue from DTC, 40% of revenue from ecommerce and 20% from retail. (FY 22 Annual Report)

Revenue By Channel Analysis (as % of total)	FY 22	Medium-Term Target
Ecommerce	28.9%	40.0%
Retail	20.4%	20.0%
Direct-to-consumer (DTC)	49.3%	60.0%
Wholesale	50.7%	40.0%
Total	100.0%	100.0%

Transition from EMEA "etailers" guided to pressure near-term revenue and highlights DTC shift risk: In its H1 23 Earnings Presentation on 01/19/23, the Company guided to reduce volume sold to EMEA "pure play" wholesale ecommerce accounts (i.e. etailers). The Company guided for the reduction to benefit DTC mix expansion "over time" but acknowledged FY 24 revenue growth would be impacted. Specifically, on its Q3 23 Conference Call, the Company guided for the reduced selling to etailers to negatively impact FY 24 growth by 3.0% to 4.0%. Dr. Martens represented it would continue to sell products to etailers but it would "curate" the products it puts into the etailer channel. While we acknowledge the decision may accelerate the mix shift to DTC, we are concerned revenue pressure may persist to the extent Dr. Martens is unable to drive consumer traffic to its own ecommerce platform and/or retail stores and consumers purchase alternative products through etailers.

> We have been reviewing the strategic and economic benefits of continuing to sell into pure play wholesale ecommerce accounts (etailers), particularly in EMEA, and as a result, we have therefore decided to reduce

> volume into these accounts in FY24. **Over time, the benefit will be to underpin DTC mix expansion but in FY24, revenue growth will be impacted.** (H1 23 Earnings Presentation, 01/19/23) [emphasis added]

DTC transition may drive elevated marketing spend and potential margin pressure, in our view: In its H1 23 Interim Report, the Company guided to increase marketing spend as a percentage of revenue by 50 basis points per year. In our view, the Company may be compelled to increase marketing spend levels as it attempts to drive traffic to its own ecommerce platform and retail stores. While we acknowledge DTC is significantly more profitable than wholesale, we are concerned marketing spend levels may drive margin pressure to the extent the Company is unable to drive traffic to its DTC platform/stores and DTC revenue underperforms. Our concerns are heightened given the Company's guidance to move away from certain wholesale partners that likely have established customers/consistent traffic.

Reluctance To Discount May Drive Share Loss And/Or Delay Inventory Normalization

Background on promotional strategy and Originals product category (i.e. iconic brands): Previously, on its FY 22 Conference Call on 06/01/22, the Company highlighted its promotional strategy focused on a 90.0% full price and 10.0% markdowns mix. In addition, Dr. Martens highlighted its strategy entailed <u>not</u> discounting its "core iconic products." Specifically, the Company highlighted its three "icon" products were the 1460 boot, 1461 shoe, and 2976 boot. The 1460 boot, 1461 shoe, and 2976 boot are included in the "Originals" product category.

FY 22 benefit from return to normalized promotions guided to not recur: On its FY 22 Conference Call, the Company represented FY 22 promotional levels returned to more "normal" levels from elevated levels impacted by the COVID pandemic. The Company attributed the return to "normal" to its strategy of not discounting core iconic products. In addition, the Company guided for full price mix to be maintained at approximately 90.0% (i.e. the "normal" level) and represented the FY 22 promotional mix benefit (i.e. lower promotional mix relative to the prior year) would not recur.

> In the prior year, working together with our wholesale partners, we agreed to cancel certain seasonal orders due to the impact of COVID. This enabled us to manage our brand by clearing this product via our own e-commerce channel. This was not repeated in the current financial year and resulted in full year price mix -- full price mix increasing to more normal levels, around 90%. This reflects the high level of continuity product we sell and our strategy of not discounting our core iconic products. We believe full price mix will broadly be maintained at around 90%, and therefore, this improvement is not expected to reoccur. (CFO Mr. Jon Mortimore, FY 22 Conference Call, 06/01/22)

<u>We have the following observations about promotions and the promotional environment:</u>

1. **Reluctance to discount may drive iconic brand wallet share loss as promotional environment intensifies:** On its Q3 23 Conference Call on 01/19/23, the Company acknowledged there was "a lot" of discounting at the end of CY 22. However, the Company represented it only participated in the discounting in a "very small way." Further, Dr. Martens acknowledged consumers may spend on "heavily discounted" products instead of full price Dr. Martens' products. Given a more promotional environment and the Company's reluctance to discount, we are concerned Dr. Martens may lose wallet share to "heavily discounted" alternative products.

   > There was a lot of discounting out in the marketplace across December, in particular, but really from the Black Friday weekend through to Christmas. We only participated in that in a very small way through some seasonal markdowns that we took in our two biggest markets, in EMEA and in North America. And we've said all along, we don't discount the iconic product, the Dr. Martens brand…**But will consumers have spent their pound or their euro or their dollar on something that was so heavily discounted? Yes**, but I don't think that's the right way to manage the brand for the long term. So we will not be in an environment of heavy discounting. (CEO Mr. Kenny Wilson, Q3 23 Conference Call, 01/19/23) [emphasis added]

2. **Limited discounting may delay iconic brand inventory level improvement:** On its Preliminary H2 23 Conference Call on 04/14/23, the Company represented "higher than optimal" inventory levels (discussed herein) were "predominantly" composed of continuity products with minimal market down risk. Accordingly,

we believe the inventory overbuild may have been driven, in part, by iconic (i.e. low markdown risk) products. While overbuilt iconic product inventory may not be discounted, we are concerned limited discounting in a more promotional environment may delay the Company's ability to normalize inventory levels.

> Inventory at the balance sheet -- year-end balance sheet date will be approximately £258 million, being broadly similar to the quantum of inventory at the half-year balance sheet date. This figure is higher than optimal, but is predominantly continuity product in nature with minimal markdown risk. (CFO Mr. Jon Mortimore, Preliminary H2 23 Conference Call, 04/14/23)

3. **Reduced iconic brand revenue contribution in recent years suggests certain promotions may increase:** In FY 22, Originals revenue declined 600 basis points as a percent of total revenue to 51.0%, the at least second consecutive decline. Given reduced Originals (i.e. iconic brand) revenue contribution in recent years, we believe contribution from products the Company may be willing to discount (i.e. non-iconic brands) may have increased and non-iconic brand discounting may drive margin pressure.

Originals Revenue Contribution Analysis (as % of total revenue)	FY 20	FY 21	FY 22
Originals revenue	60.0%	57.0%	51.0%
Change	--	*(300 bps)*	*(600 bps)*

Distribution Center Transition Disruption May Increase Revenue/Margin Risk

Distribution Center transition disruption drove weak Q3 23 results: On its Q3 23 Conference Call, the Company represented a Distribution Center (DC) transition from its Portland DC to Los Angeles (LA) drove weaker-than-expected Q3 23 results. Specifically, the Company highlighted (1) early shipment of Portland stock to LA pressured capacity, (2) key customers rerouted direct orders to the LA DC, and (3) certain inventory arrived earlier than planned due to improved supplier transit times. Accordingly, the LA DC received too much inventory which created a "bottleneck" and impacted the Company's ability to pick and pack orders. In our view, the DC transition disruption may have resulted in lost sales and/or elevated costs and may continue to pressure results given the disruption lasted longer than expected and cost more than expected to resolve (discussed next).

> Firstly, we planned to exit our old Portland DC by the end of September 2022. Our U.S. operations team decided to ship all Portland stock to LA early, putting pressure on our capacity. Secondly, some key customers asked us to reroute direct orders to our LA DC as they had their own distribution capacity challenges. The USA team agreed to this. Thirdly, and ironically, transit times from our suppliers to our LA DC improved a lot, meaning that more inventory arrived in LA earlier than we had in our plan. We could have coped with any of these factors individually but not all three together. (CEO Mr. Kenny Wilson, Q3 23 Conference Call, 01/19/23)

Larger-than-expected DC transition impact and ongoing changes suggest disruption may persist: Previously, in its Q3 23 Trading Statement, the Company guided to incur £9.5 million of supply chain costs to resolve the bottleneck. On its Preliminary H2 23 Conference Call, the Company represented the FY 23 cost of resolving the distribution center issues was £15.0 million, 57.9% above its prior guidance at midpoint. In addition, the Company represented it conducted a review of the transition and it was "working through" a number of changes. In our view, the larger-than-expected FY 23 DC transition impact and ongoing changes suggest the disruption may persist.

> In FY23, we estimate that the bottleneck will reduce wholesale revenue by £15-25m and EBITDA by £16-25m, including £8-11m of supply chain costs. (Q3 23 Trading Statement, 01/19/23)

> The actual cost of resolving the issues in LA have been higher than we initially thought at £15 million in this financial year versus the £8 million to £11 million, which was anticipated in January. Our internal audit and legal teams have conducted a full review into what happened in Los Angeles and have recommended a number of changes that we are now working through. (CEO Mr. Kenny Wilson, Preliminary H2 23 Conference Call, 04/14/23)

DC Transition Disruption Cost Guidance (£ in millions)	Guided Cost Impact
Initial FY 23 cost impact guidance at midpoint	£9.5
Updated FY 23 cost impact guidance	£15.0
Above (below) prior guidance	*57.9%*

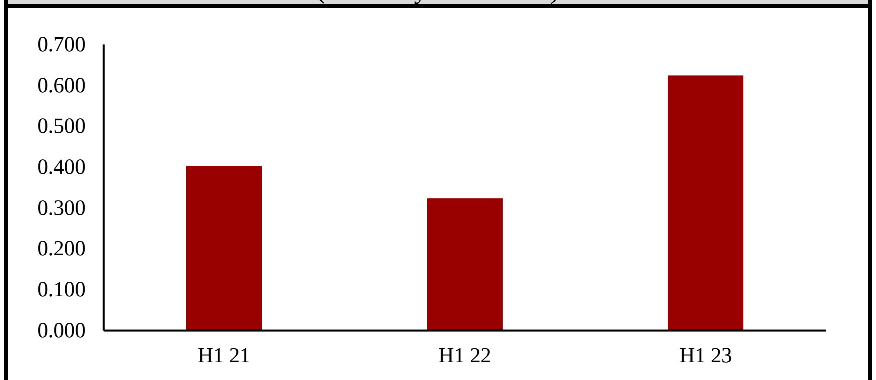
Inventory Level Surge Suggests Margins May Be Pressured, In Our View

Background on H2 23 pre-announcement and inventory disclosure: In its 04/14/23 Press Release, the Company preannounced H2 23 results. While the Company did not disclose a H2 23 balance sheet in its preannouncement, the Company disclosed H2 23 inventory was £258.0 million and FY 23 revenue increased 10.0% year-over-year. Accordingly, we estimated FY 23 revenue was approximately £999.8 million based on FY 22 reported revenue of £908.3 million.

H1 23 inventory build attributed to low prior-year inventory levels: Previously, in H1 23, inventory surged 118.2% year-over-year to £261.4 million, while revenue increased 13.2% to £418.6 million. Accordingly, inventory-to-revenue surged 92.8% to 0.624, the highest seasonal level in at least three years. On its H1 23 Conference Call on 11/24/23, the Company represented it had "nowhere near enough" inventory in H1 22 (i.e. base period) and attributed the higher H1 23 inventory levels to product availability improvements. In addition, the Company represented it built inventory due to strong wholesale sell-through and new US retail store openings.

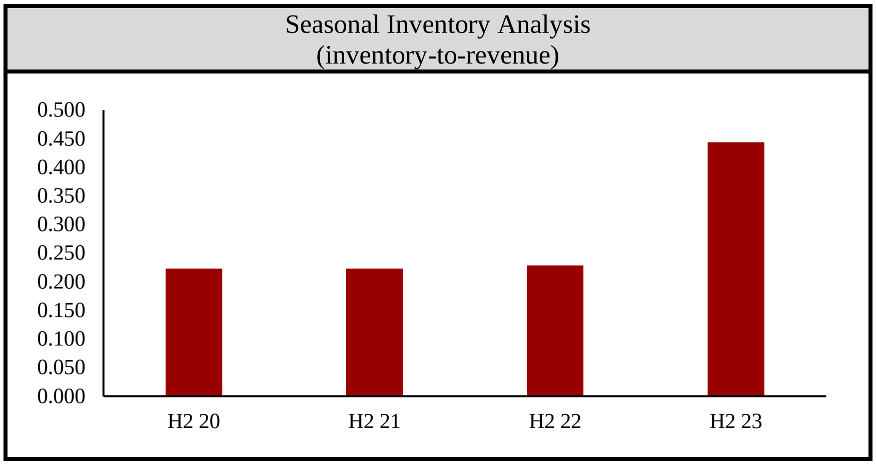
> **We just had nowhere near enough product this time last year because of what happened in the supply chain.** We've restocked for success and the reason we've bet on that is we've got a strong brand and we're in the fortunate position that we've got continuity product. (CEO Mr. Kenny Wilson, H1 23 Conference Call, 11/24/22) [emphasis added]

Seasonal Inventory Analysis
(inventory-to-revenue)



Elevated H2 23 inventory levels may drive margin pressure, in our view: In H2 23, inventory surged 109.8% year-over-year to £258.0 million, while we estimate revenue increased 7.9% to £580.5 million. Accordingly, inventory-to-revenue surged 94.5% to 0.444, the highest seasonal level publicly reported. On its Preliminary H2 23 Conference Call, the Company acknowledged inventory levels were higher than "optimal" and guided to buy less inventory to normalize inventory levels by year-end FY 24. Further, the Company guided for no material inventory-driven margin pressure given the "vast majority" of its inventory was "evergreen" but acknowledged "carrying cost" may be elevated. We are concerned inventory may be overbuilt and margins may be pressured to the extent the Company does not qualify for certain volume-related discounts and/or the Company incurs elevated inventory carrying costs. To the extent the Company is compelled to discount and/or write down inventory, our concerns would be heightened.

This year, **we have higher levels of inventory than optimal**…We plan to have a much more optimized optimal level of inventory by the exit period of FY24, so March '24. And we'll achieve that by essentially buying less than we plan to sell. (CFO Mr. Jon Mortimore, Preliminary H2 23 Conference Call, 04/14/23) [emphasis added]



<u>We have the following observations about elevated inventory levels:</u>

1. **Temporary warehouse retention suggests inventory may remain elevated, in our view:** As mentioned, the Company previously highlighted it had too much inventory at its LA distribution center. In its Q3 23 Trading Statement, the Company represented it rented three temporary warehouses to accommodate the inventory overflow. On its Preliminary H2 23 Conference Call, the Company represented throughput had normalized at the LA distribution center as all of the operational problems had been resolved. However, the Company guided to maintain the temporary warehouse leases throughout FY 24 to store excess inventory. In our view, the Company's decision to retain temporary warehouses suggests inventory levels may remain elevated and our margin pressure concerns are heightened.

   In addition, in order to minimize risk and ensure continued smooth distribution, **we intend to maintain the three temporary warehouses in Los Angeles through FY24**. As a result of the annualization of rent associated with these warehouses, we estimate an incremental £15 million of cost will be incurred in FY24 before normalizing in FY25 (CEO Mr. Kenny Wilson, Preliminary H2 23 Conference Call, 04/14/23) [emphasis added]

2. **Prior-year commentary highlights risk non-iconic brand promotions may increase, in our view:** Previously, on its Q3 22 Conference Call on 01/27/22, the Company represented "scarcity" of supply increased focus on full price sales. Specifically, Dr. Martens highlighted there was "no need" to promote when supply was limited and highlighted other brands also had limited promotions due to limited supply. While we acknowledge supply constraints may have limited promotions throughout FY 22, we are concerned (1) supply dynamics have improved, (2) Dr. Martens inventory levels were elevated (discussed above), and (3) industry-wide inventory may be elevated. Accordingly, we believe the promotional environment may remain intense as brands attempt to right-size inventory levels. While we acknowledge Dr. Martens may not discount "iconic" brands, we believe non-iconic brand promotions may increase and/or Dr. Martens may lose wallet share to other discounted products.

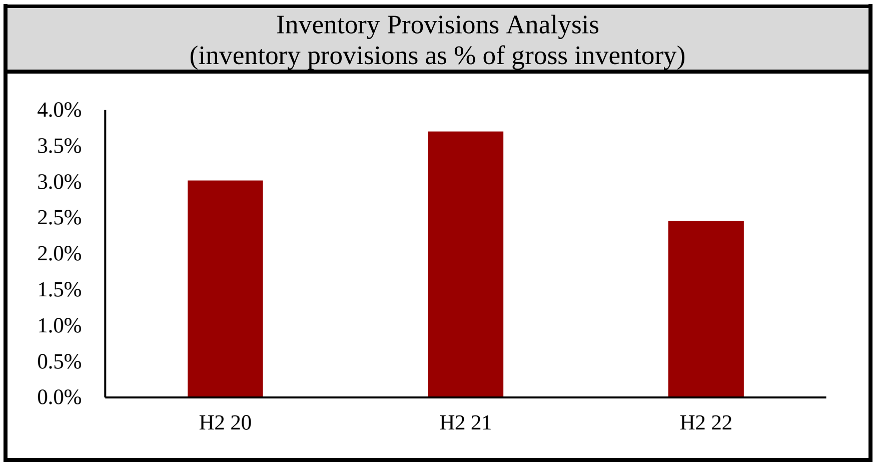
   When you have scarcity of supply, you focus on full price sales, that is exactly what we've done and seeing a lot of other brands report. That's exactly what everyone else has been doing. There's no need to promote when you have scarcity supply. And any way, our strategy is not to promote our core icons. (CFO Mr. Jon Mortimore, Q3 22 Conference Call, 01/27/22) [emphasis added]

3. **Long-term contracts may limit the Company's ability to normalize inventory, in our view:** In its FY 22

Annual Report, the Company disclosed it agreed to fixed-price contracts with factories six to nine months prior to a season. Dr. Martens indicated the contracts provided a high degree of visibility over cost of goods sold. On its Preliminary H2 23 Conference Call, the Company guided for inventory normalization to "predominantly" take place in H2 24 due to the "lead times" involved in the business. While we acknowledge the contracts may have locked in pricing and provided certain visibility, we are concerned long-term supplier contracts may (1) have delayed certain cost inflation-driven margin pressure and (2) limit the Company's ability to reduce inventory levels in the near term.

We agree fixed-price contracts with factories 6-9 months prior to a season. (FY 22 Annual Report)

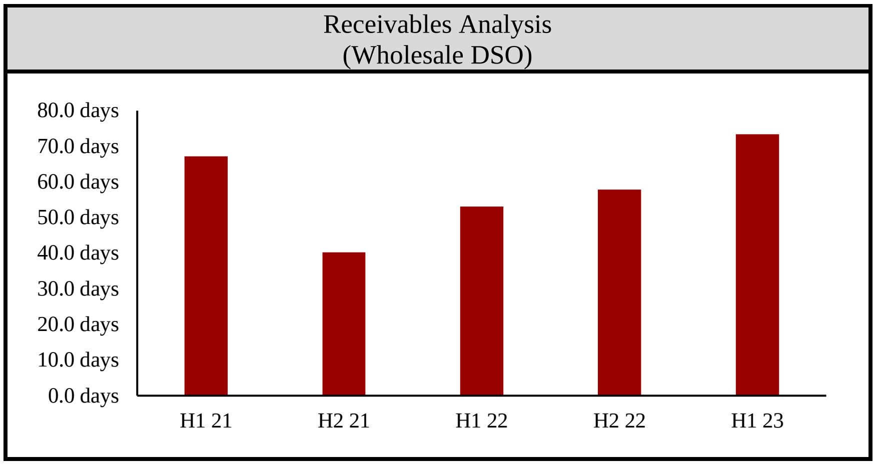
4. **Depressed inventory provision levels may have provided unsustainable earnings benefit:** In H2 22, inventory provisions declined 20.5% year-over-year to £3.1 million, while gross inventory increased 19.6% to £126.1 million. Accordingly, inventory provisions as a percent of gross inventory declined 120 basis points to 2.5%, the lowest level publicly reported. In our view, the inventory provision level decline may (1) be unwarranted and/or (2) may have provided an unsustainable earnings benefit. To the extent inventory write-downs/provisions increase, our margin pressure concerns would be heightened.



Wholesale DSO Build Highlights Elevated Channel Inventory Levels & Revenue Pressure

Background on wholesale DSO analysis: In its FY 22 Annual Report, the Company disclosed retail sales were primarily settled in cash or by major credit/debit card. Accordingly, we believe direct-to-consumer receivables may be immaterial and we analyzed receivable levels relative to wholesale revenue.

Elevated wholesale DSOs highlight elevated channel inventory, in our view: In H1 23, accounts receivable surged 49.2% year-over-year to £95.8 million, while wholesale revenue increased 7.9% to £238.8 million. Accordingly, wholesale days sales outstanding (DSO) surged 38.3% to 73.4 days, the highest seasonal level in at least three years. In its H1 23 Interim Report, the Company attributed the receivable level increase to customer mix. In our view, elevated receivable levels suggest channel inventory levels may have increased and revenue may be pressured.



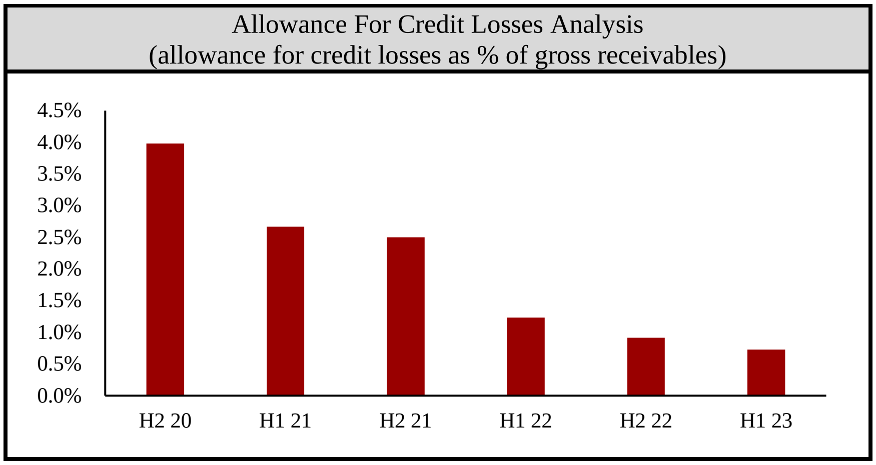
Customers rerouting direct orders to Dr. Martens may highlight elevated channel inventory, in our view: On its Q3 23 Conference Call, the Company represented certain "key" customers rerouted direct orders to the Dr. Martens Los Angeles distribution center given the customers had "their own distribution capacity challenges." We believe the commentary suggests certain "key" customers had excess inventory and our concerns about elevated wholesale channel inventory levels are heightened.

> Some key customers asked us to reroute direct orders to our LA DC as they had their own distribution capacity challenges. The USA team agreed to this. (CEO Mr. Kenny Wilson, Q3 23 Conference Call, 01/19/23)

Recent commentary suggests certain channel inventory remained elevated: On its Preliminary H2 23 Conference Call, the Company represented certain US wholesale customers had elevated inventory levels. Specifically, the Company highlighted two US customers had channel inventory higher than Dr. Martens "would like." We are concerned the commentary suggests channel inventory levels remained elevated and we will review the receivable disclosure in the FY 23 Annual Report to assess H2 23 receivable levels.

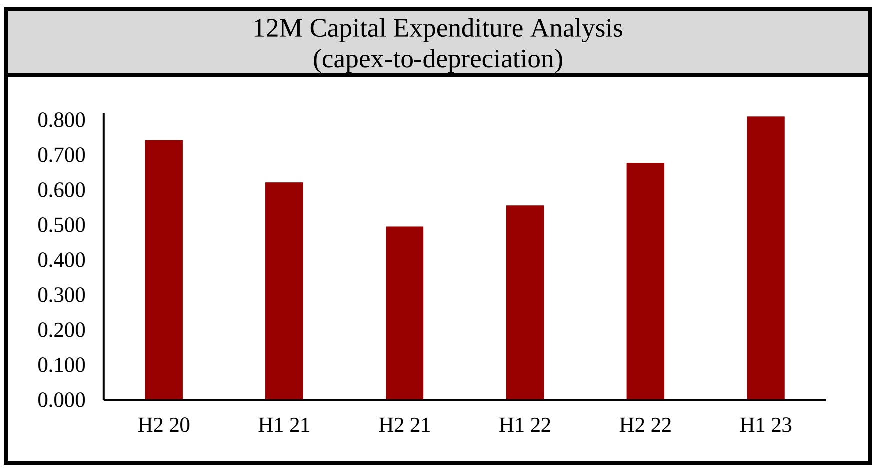
> In terms of your second question, which is around wholesale inventories in the US. At a macro level, we don't have significant issues around wholesale inventory and **we've said previously that there are two customers in the US that we think the inventories are higher than we would like** and therefore, to an earlier question around the Autumn Winter 23 order book, as we manage forward orders with those two customers, will just manage that down. (CEO Mr. Kenny Wilson, Preliminary H2 23 Conference Call, 04/14/23) [emphasis added]

Depressed allowance for credit loss levels may be unwarranted, in our view: In H1 23, allowance for credit losses declined 12.5% year-over-year to £0.7 million, while gross trade receivables surged 48.5% to £96.5 million. Accordingly, allowance for credit losses as a percent of gross receivables declined 50 basis points to 0.7%, <u>the lowest level publicly reported</u>. In our view, depressed allowance for credit loss levels may be unwarranted given elevated receivable levels and/or may have provided an unsustainable margin benefit.



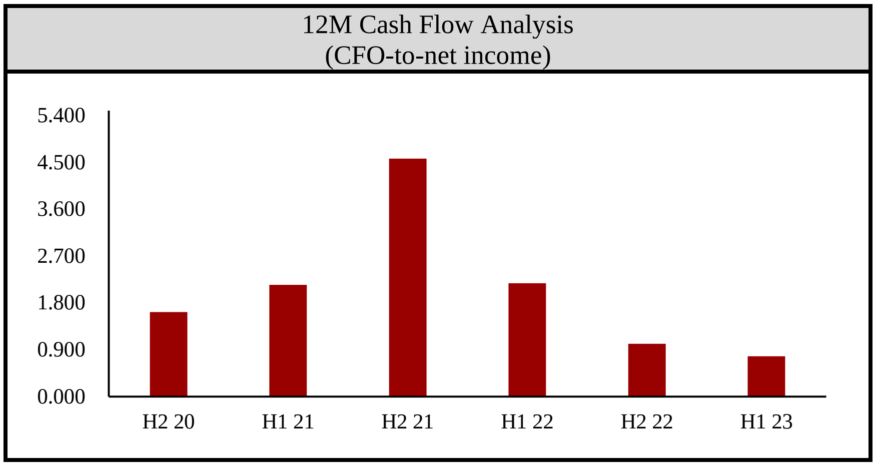
Capital Expenditure Surge Highlights Potential Depreciation Ramp, In Our View

Capex surge suggests depreciation may ramp and margins may be pressured: In the twelve months ended H1 23, capital expenditure (capex) surged 78.1% year-over-year to £34.2 million, while depreciation increased 22.3% to £42.2 million. Accordingly, capex-to-depreciation surged 45.6% to 0.810, the highest level publicly reported. In its H1 23 Interim Report, the Company attributed elevated capex levels to new retail store openings, distribution center racking, and certain IT spending. While we acknowledge the new stores and distribution center racking may enable further growth, we are concerned elevated capex levels suggest depreciation may ramp as investment projects are completed and placed into service.



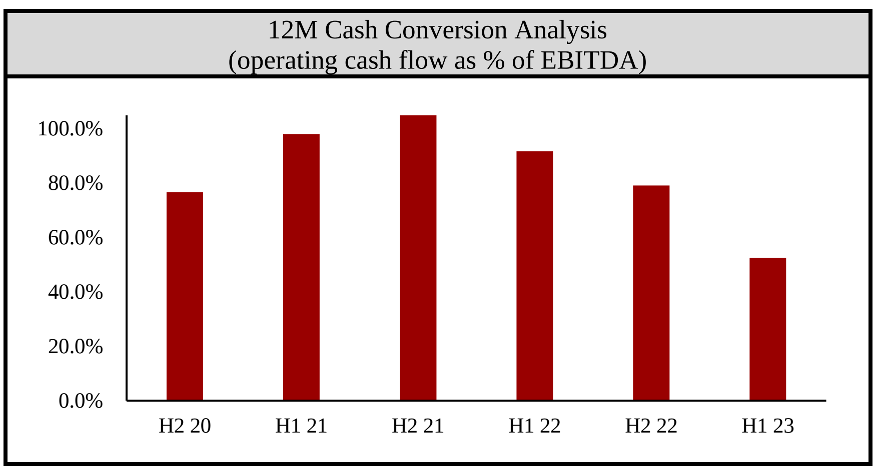
Depressed Cash Flow Levels Highlight Elevated Earnings Sustainability Risk, In Our View

Cash flow deterioration highlights elevated earnings sustainability risk: In the twelve months ended H1 23, cash from operations (CFO) increased 17.4% year-over-year to £137.8 million, while net income increased 229.6% to £177.3 million. Accordingly, twelve-month CFO-to-net income declined 64.4% to 0.777, the lowest level in at least three years. In its H1 23 Interim Report, the Company attributed the weak CFO to its decision to increase inventory ahead of peak trading in the US and Japan, as well as higher receivables driven by higher levels of wholesale trading. The Company also noted prior-year cash generation was higher because of lower inventory due to supply chain delays. In our view, the cash flow deterioration driven by working capital cash consumption highlights elevated earnings sustainability risk.

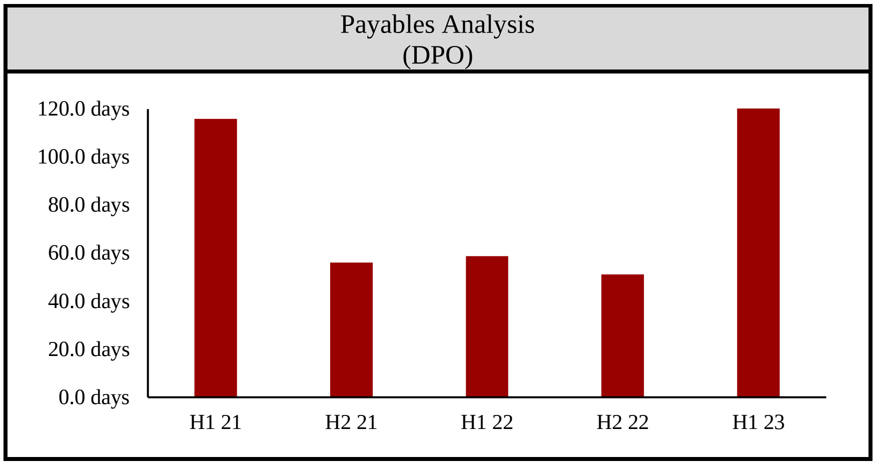


Depressed cash conversion levels heighten our concerns: In its H1 23 Interim Report, the Company defined cash conversion as operating cash flow divided by EBITDA. Previously, in its Registration Statement on 01/10/21, the Company guided for medium term cash conversion of 75.0% to 85.0%. In the twelve months ended H1 23, cash conversion declined 3,920 basis points year-over-year to 52.6%, <u>the lowest level in at least three years</u>. In its H1 23 Interim Report, the Company attributed the decline primarily to elevated working capital cash consumption due to the inventory build. Specifically, working capital consumed £96.9 million of cash in the twelve months ended H1 23 compared to consuming £1.2 million in the prior year. Materially depressed and below-targeted cash conversion levels driven by working capital cash consumption heighten our earnings sustainability concerns.

> The Company expects that the Group's operating cash flow conversion will be 85% – 95% of EBITDA in FY21 due to the timing of debtors and inventory purchases related to the COVID-19 pandemic, which will unwind in FY22 driving operating cash flow conversion to 65% – 75% of EBITDA. The Company anticipates that operating cash flow conversion in the medium term will be 75% – 85% of EBITDA. (Registration Statement, 01/10/21)



Payables may have provided unsustainable cash flow benefit: In H1 23, trade payables surged 129.8% year-over-year to £105.7 million, while cost of goods sold increased 12.2% to £160.8 million. Accordingly, days payable outstanding (DPO) surged 104.8% year-over-year to 120.3 days, <u>the highest level in at least three years</u>. In the twelve months ended H1 23, trade and other payables provided £42.2 million of cash compared to consuming £20.4 million in the prior year. The Company did not discuss payable levels on its H1 23 Conference Call or in its H1 23 Interim Report. In our view, the payable level surge may have provided an unsustainable cash flow benefit and cash flow may be pressured to the extent payable levels normalize.



No Like-For-Like Disclosure, CFO Retirement Announced, & Auditor Change

No like-for-like disclosure may obfuscate DTC performance, in our view: Previously, in its Registration Statement on 01/10/21, the Company defined like-for-like growth as growth of same owned store revenue on a constant currency basis representing stores open for at least a full twelve-month period. However, the Company did not disclose like-for-like growth metrics in subsequent Annual/Interim Reports. Given the Company's focus on DTC growth, we are concerned limited like-for-like (i.e. comparable sales) disclosure may obfuscate analysis (i.e. difficult to determine growth driven by new store openings versus existing store growth).

Chief Financial Officer retirement may increase near-term business disruption risk, in our view: In its 04/14/23 Press Release, the Company announced CFO Mr. Jon Mortimore decided to retire. Mr. Mortimore has served as CFO since April 2016. The Company represented Mr. Mortimore would continue to serve as CFO until a successor was in place. We are concerned the CFO retirement decision amidst an ongoing distribution center transition disruption and elevated balance sheet inventory levels may increase near term business disruption risk.

Auditor change may increase accounting irregularity identification risk, in our view: In its FY 22 Annual Report, the Company disclosed it appointed a new auditor. Specifically, the Company disclosed it appointed PricewaterhouseCoopers LLP as its auditor effective for FY 23 (i.e. the fiscal year ended 03/31/23). Ernst & Young LLP served as the Company's auditor since 2005. In our view and experience, the appointment of a new auditor may increase the risk of accounting irregularity identification.

Conclusion

We are concerned a planned shift to the direct-to-consumer (DTC) channel may drive near-term revenue pressure as the Company attempts to convert customers that previously purchased through the wholesale channel. In addition, we believe the Company may be compelled to ramp marketing spend and margins may be pressured to the extent DTC growth underperforms. We believe a reluctance to discount in a more promotional environment may drive wallet share loss. In addition, we believe a revenue mix shift away from "iconic" brands in recent years may increase Dr. Martens' exposure to discounting. In our view, a distribution center transition may drive persistent business disruption and elevated supply chain costs. In our view, elevated inventory levels may portend margin pressure driven by elevated carrying costs and/or discounting of non-iconic products. In addition, we believe inventory normalization may be difficult given long-term supplier agreements and the Company's reluctance to discount "iconic" products. In our view, elevated receivable levels and certain commentary suggest channel inventory levels may be elevated and wholesale revenue may be pressured. Our earnings sustainability concerns are heightened given (1) depressed inventory/receivable provision/allowance levels, (2) elevated capital expenditure levels, (3) depressed cash flow levels, and (4) a recently announced CFO retirement.

Risks to Our Thesis & Valuation

DTC Transition, "Iconic" Brand, Evergreen Products, & China LT Opportunity

Guided transition to higher DTC mix may benefit margins: In FY 22, DTC accounted for 49.3% of revenue. As mentioned, in its FY 22 Annual Report, the Company highlighted it focused on DTC "first" and guided for 60.0% of revenue to be generated from DTC (40.0% ecommerce and 20.0% retail) in the "medium-term." On its Q3 23 Conference Call, the Company represented DTC was four times more profitable than wholesale.

> Last year we had 49% of revenue through DTC and we just reported this year to date that we have improved DTC mix by two percentage points. **DTC is four times more profitable than wholesale and that key driver is still valid**. (Q3 23 Conference Call, 02/02/23) [emphasis added]

"Iconic" brand highlighted as competitive differentiator: In its Registration Document on 01/10/21, the Company represented its "iconic" brand, British heritage, and rich history differentiated it from competitors. In addition, the Company highlighted it had a "loyal and broad" customer base. On its Q3 23 Conference Call, the Company guided to not discount its "iconic" product to maintain its brand value.

> While Dr. Martens' competes in a highly fragmented market, the Directors believe there are many factors that differentiate the Group from the competition, including Dr. Martens' iconic brand, its British heritage and rich history, the products' legendary durability, and most importantly Dr. Martens' loyal and broad consumer base with a culturally eclectic core consumer. (Registration Document, 01/10/21)

Evergreen products guided to limit discounting: On its Preliminary H2 23 Conference Call, the Company indicated the "vast majority" of inventory was "evergreen." Specifically, the Company highlighted the "continuity nature" of its products with four out of every five pairs it sells being black. Accordingly, the Company guided for no material marked down inventory margin impact in FY 24.

> Your second question regarding any margin pressure next year -- as we said earlier, the vast majority of our stock is evergreen. We do not anticipate any material marked down P&L pressure through next year. (CFO Mr. Jon Mortimore, Preliminary H2 23 Conference Call, 04/14/23)

China highlighted as a long-term growth opportunity: In its FY 22 Annual Report, the Company disclosed China was a "small part" of its business and accounted for 3.0% of revenue. However, the Company guided for to establish the brand in China and highlighted China as a "long-term" growth opportunity.

> China is a small part of our overall business, accounting for a fifth of APAC and only 3% of Group revenues. We are focused on establishing our brand and laying the foundations for the long term in this market. (FY 22 Annual Report)

Valuation Analysis

As of the date of this publication, Dr. Martens shares traded at 12.6x next-twelve month earnings, 8.7% below the peer group average.

Valuation Analysis	NTM P/E
Dr. Martens (DOCS.L)	12.6x
V.F. Corporation (VFC)	9.4x
Puma SE (PUMG.DE)	18.7x
Under Armour Inc. (UAA)	13.3x
Peer average	13.8x
DOCS.L above (below) peer average	*(8.7%)*

Disclaimer and Disclosure

This report was produced by Voyant Advisors, LLC ("Voyant"). The following Research Analysts employed by Voyant contributed to this report: Graeme Lazarus, Ryan DesJardin, Michael Meehan, and Andrew Brown. Voyant's home office is at 15373 Innovation Dr, Suite 365 San Diego, CA 92128. The firm's home office is where information about the valuations herein are located, unless otherwise indicated in the report.

At the time of this report, Voyant expects to provide updates on a quarterly or semi-annual basis depending on the frequency of when the above company discloses material financial results. We will cease providing updates if we are discontinuing research coverage as disclosed on the front page of this report in the Thesis Summary.

Voyant has not provided previous recommendations concerning the same financial instrument or issuer during the preceding twelve-month period.