24th February 2016

Luxury & Consumer Goods

Hugo Boss

Price EUR56.00

Profit warning for 2016 as the group is swept away by challenging US and Chinese markets

Fair Value EUR87 vs. EUR103 (+55%) **NEUTRAL**

Bloomberg	BOSS GR
Reuters	BOSG_p.DE
12-month High / Low (EUR)	120.0 / 56.0
Market Cap (EUR)	3,942
Ev (BG Estimates) (EUR)	4,029
Avg. 6m daily volume (000)	302.6
3y EPS CAGR	-2.9%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-20.9%	-34.4%	-44.4%	-26.9%
Pers & H/H Gds	1.6%	-7.7%	2.4%	-3.3%
DJ Stoxx 600	-3.1%	-13.8%	-9.3%	-10.4%

YEnd Dec. (EURm)	2014	2015e	2016e	2017e
Sales	2,572	2,809	2,852	3,008
% change		*9.2%*	*1.5%*	*5.5%*
Reported EBITDA	571	591	514	563
EBIT	448.7	447.5	377.3	419.0
% change		*-0.3%*	*-15.7%*	*11.0%*
Net income	333.3	321.9	278.5	316.4
% change		*-3.4%*	*-13.5%*	*13.6%*

	2014	2015e	2016e	2017e
Operating margin	17.4	15.9	13.2	13.9
Net margin	13.0	11.5	9.8	10.5
ROE	39.5	34.4	27.1	27.9
ROCE	33.2	29.3	24.4	26.6
Gearing	5.1	9.3	0.9	-6.9

(EUR)	2014	2015e	2016e	2017e
EPS	5.04	4.71	4.09	4.62
% change	*-*	*-6.7%*	*-13.1%*	*12.9%*
P/E	11.1x	11.9x	13.7x	12.1x
FCF yield (%)	7.2%	7.4%	9.1%	10.2%
Dividends (EUR)	3.62	3.75	4.20	4.65
Div yield (%)	6.5%	6.7%	7.5%	8.3%
EV/Sales	1.5x	1.4x	1.4x	1.3x
EV/EBITDA	7.0x	6.8x	7.7x	6.9x
EV/EBIT	8.9x	9.0x	10.5x	9.2x

Yesterday just before the market closure, Hugo Boss again warned on its sales and earnings development for 2016. Headwinds are similar to those that caused the first PW last October: the US and Chinese markets (~18% and ~8% of sales respectively) remain very challenging and highly promotional. As a consequence, the German group has reduced its sales outlook but more importantly, it now expects a low double-digit decline in adj. EBITDA whereas the consensus was expecting a fairly stable figure for 2016, due to price adjustments in China and significant operating deleverage. We are cutting our 2016/2017 assumptions by 14% on average, leading to a new FV of EUR87 vs. EUR103 previously.

ANALYSIS

- **Market turbulence in the US is far from over…** The recent PW from Ralph Lauren (4th Feb) showed that the US apparel market remained very challenging and heavily promotional over the first months of 2016, all the more so since these deflationary trends were exacerbated by a mild winter and a decline in foreign tourist traffic (stronger USD). As such, premium/luxury players like Ralph Lauren or Hugo Boss that did not enter this damaging price spiral for the brand's image have struggled. The German group therefore decided to limit distribution of the BOSS brand among US wholesalers to mitigate the negative impact of markdowns. This strategy will certainly cause some sales disruption.

- **… Same goes for China.** In 2015 the luxury apparel market fell in the double-digits for the second consecutive year (-10% in 2014) due to an increasing number of Chinese customers shopping abroad (Japan, South Korea, Europe) and a volatile environment. Unlike some luxury groups that have reported the first signs of stabilisation in Mainland China, the German group is still witnessing weaker-than-expected retail sales there, in addition to double-digit declines in HK/Macau. In the press release, Hugo Boss confirmed it had adjusted prices in Greater China (~20%e on average) to narrow the pricing gap between Asia and Europe, which is consistent with the initiatives announced during the Investor Day last November. Naturally this pricing harmonisation will negatively impact gross margin.

- **2016 outlook: Hugo Boss has revised down its sales guidance…** At the Investor Day, the group was already anticipating a sales development to be under the LT target of high single-digit growth. Yet given weaker trends in the US and in China, the group is further lowering its sales guidance and now expects low single-digit growth for 2016. **We have therefore adjusted our FX-n sales forecast to 2% from 5% previously.** On our estimates, **Europe** is expected to increase 5% FX-n (+5% in 2015), whilst we anticipate -3% for the **Americas** (vs. -1% in 2015) and **Asia-Pacific** (-3% in 2015).

- **… and warned that adj. EBITDA would fall low double-digit.** Hugo Boss is clearly affected by a margin squeeze as it continues to invest to support MT/LT growth drivers (retail expansion, marketing spend, etc.) in addition to two significant headwinds: **(i)** flat SSSG expected for 2016 (Hugo Boss must achieve at least 4-5% to benefit from a positive operating leverage) and **(ii)** the negative impact of price adjustments in Greater China. All this margin pressure is only set to be partially offset by cost-cutting initiatives within the group. Prior to yesterday's publication the consensus was expecting anearly flat adj. EBITDA at EUR600m (2014: EUR594m) but Hugo Boss now expects it to decline at a low double-digit rate. **We have cut our FY16-17 adj. EBITDA assumptions by 14% on average, implying a 12% decline in 2016 adj. EBITDA (margin: -310bp to 18.2%).**

VALUATION

- Our new FV of EUR87 vs. EUR103 previsouly reflects our new FY16-17 and LT normative margin assumptions, consistent with the revised targets communicated by Hugo Boss.

NEXT CATALYSTS

- FY15 Results and Analysts' Conference on 10th March 2016.

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