4th May 2016

Luxury & Consumer Goods

Hugo Boss

Price EUR57.65

FY16 outlook requires a clear improvement in persistently challenging market conditions

Fair Value EUR77 vs. EUR80 (+34%) **NEUTRAL**

Bloomberg	BOSS GR
Reuters	BOSG_p.DE
12-month High / Low (EUR)	113.8 / 51.3
Market Cap (EURm)	4,059
Ev (BG Estimates) (EURm)	4,141
Avg. 6m daily volume (000)	418.7
3y EPS CAGR	-5.0%

	1 M	3 M	6 M	31/12/15
Absolute perf.	2.9%	-18.2%	-38.4%	-24.7%
Pers & H/H Gds	-0.1%	-0.3%	-6.6%	-2.2%
DJ Stoxx 600	0.7%	1.9%	-11.3%	-8.3%

YEnd Dec. (EURm)	2014	2015	2016e	2017e
Sales	2,572	2,809	2,803	2,956
% change		*9.2%*	*-0.2%*	*5.5%*
Reported EBITDA	571	590	495	544
Reported EBIT	448.7	447.7	349.8	393.3
% change		*-0.2%*	*-21.9%*	*12.5%*
Net income	333.3	319.3	257.5	295.4
% change		*-4.2%*	*-19.4%*	*14.7%*

	2014	2015	2016e	2017e
Operating margin	17.4	15.9	12.5	13.3
Net margin	13.0	11.4	9.2	10.0
ROE	39.5	34.0	25.4	25.4
ROCE	33.2	29.1	22.3	23.9
Gearing	5.1	8.8	4.2	-4.2

(EUR)	2014	2015	2016e	2017e
EPS	5.04	4.67	3.82	4.32
% change	-	*-7.3%*	*-18.3%*	*13.2%*
P/E	11.4x	12.3x	15.1x	13.3x
FCF yield (%)	7.0%	7.2%	7.6%	8.2%
Dividends (EUR)	3.62	3.62	3.20	3.65
Div yield (%)	6.3%	6.3%	5.6%	6.3%
EV/Sales	1.6x	1.5x	1.5x	1.4x
EV/EBITDA	7.2x	7.0x	8.3x	7.4x
EV/EBIT	9.1x	9.2x	11.7x	10.2x

During the conference call yesterday, CFO Mark Langer updated us on the two main initiatives that are underway (i.e. category migration in the US and price adjustments in China) and which should pay off mainly in H2. This is why the groups expects more beneficial sales and earnings momentum over the second half of the year, especially since the group has identified additional cost savings of EUR50m. We remain a bit more cautious than the group's targets after some minor adjustments (mostly FX). Neutral recommendation and FV nudged down to EUR77 vs. EUR80.

ANALYSIS

- **US: negative underlying trends are not helping.** The sales decline in the **US** (-16% FX-n) was broadly similar between Retail and Wholesale (59%-41% of 2015 US sales respectively), confirming that the US premium apparel market is clearly affected by a number of headwinds (deflationary trends, declines in footfall, lack of tourists). In the meantime the group continues to upgrade its distribution in both channels: improving execution and focusing on achieving healthy inventory levels (almost completed) in its own stores and continuing the category migration and some takeovers to better control distribution. However the positive results from these initiatives are slower to appear given the sluggish market conditions.
- **Mainland China: price adjustments were welcomed by consumers.** Indeed the 10% rebound in volumes in Q1 encompassed the 2015 F/W collection and the 2016 S/S collection on which prices were adjusted by 20%. Consequently, the increase in volumes for this Spring collection was even higher, revealing a relatively high price elasticity as well as Chinese consumers' prompt reactivity, also backed by a successful digital marketing campaign. Management is confident in a gradual recovery over the rest of the year, but the negative trends in HK-Macau (double-digit decline) have not stabilised yet.
- **Hugo Boss is aggressive on cost savings...** The group has identified additional cost savings of around EUR50m over 2016 thanks to: **(i)** the first renegotiations of rental contracts, mostly in China, while the group is currently reviewing its rents with landlords concerning larger stores, **(ii)** more selective and targeted marketing expenses (=> difference between the initial marketing spend budget and the current budget = cost savings) and **(iii)** fewer store openings (~15 DOS) than the initial MT target of 20-25 openings. Last but not least, Mark Langer also declared that he was analysing the 15-20 least profitable stores, which could lead to some store closures.
- **… and is comfortable with FY16 guidance.** In light of this difficult start to the year, FY16 targets are becoming more challenging but management remains confident in achieving them: **(i) GM** should remain stable (Q1: -140bp) as the headwinds (inventory write-downs, price adjustments, discounts) should gradually diminish and the channel-mix will remain favourable, **(ii) adj. EBITDA** is expected to decrease in low double-digits (Q1: -29%) thanks to a less harmful operating deleverage (company guides on a flat SSSG over 2016 vs. -6% in Q1) combined with tight opex control (o/w cost-savings).
- **We have nudged down our FY16 estimates by 3%.** These adjustments are a consequence of the Q1 publication (below our expectations) and reflect a more negative FX impact at the top line level. Like the consensus estimates, we remain more cautious than the group's targets: we expect 1% FX-n growth (vs. +2% previously) and a 15% decline in adj. EBITDA, close to the CS expectations prior to yesterday's publication.

VALUATION

- The group has clearly implemented a proactive and ambitious reset plan but the FY outlook requires a significant improvement over H2 and the group noticed no signs of a recovery in April. Since visibility remains low, we maintain our Neutral recommendation pending the first positive impact of these initiatives on the group's operating performance. Our FV is slightly reduced to EUR77 vs. EUR80 following our estimates adjustments.

NEXT CATALYSTS

- AGM on 19th May // H1 results on 5th August. [Click here to download](#)

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