Hugo Boss

Price EUR56.14

Initiatives deliver their very first positive impacts but still a long way from turnaround

Fair Value EUR74 vs. EUR77 (+32%) **NEUTRAL**

Bloomberg	BOSS GR
Reuters	BOSG_p.DE
12-month High / Low (EUR)	113.4 / 46.4
Market Cap (EURm)	3,952
Ev (BG Estimates) (EURm)	4,035
Avg. 6m daily volume (000)	469.1
3y EPS CAGR	-7.7%

	1 M	3 M	6 M	31/12/15
Absolute perf.	18.9%	1.4%	-20.1%	-26.7%
Pers & H/H Gds	2.0%	4.5%	7.8%	2.7%
DJ Stoxx 600	5.3%	2.6%	4.7%	-6.7%

YEnd Dec. (EURm)	2014	2015	2016e	2017e
Sales	2,572	2,809	2,689	2,785
% change		*9.2%*	*-4.3%*	*3.6%*
EBITDA	571	590	409	504
EBIT	448.7	447.7	258.9	359.5
% change		*-0.2%*	*-42.2%*	*38.9%*
Net income	333.3	319.3	189.8	269.5
% change		*-4.2%*	*-40.6%*	*42.0%*

	2014	2015	2016e	2017e
Operating margin	17.4	15.9	9.6	12.9
Net margin	13.0	11.4	7.1	9.7
ROE	39.5	34.0	20.5	25.3
ROCE	33.2	29.1	16.3	21.7
Gearing	5.1	8.8	14.8	5.0

(EUR)	2014	2015	2016e	2017e
EPS	5.04	4.67	3.42	3.96
% change	-	*-7.3%*	*-26.9%*	*15.9%*
P/E	11.1x	12.0x	16.4x	14.2x
FCF yield (%)	7.2%	7.4%	5.4%	7.7%
Dividends (EUR)	3.62	3.62	2.90	3.40
Div yield (%)	6.4%	6.4%	5.2%	6.1%
EV/Sales	1.6x	1.4x	1.5x	1.4x
EV/EBITDA	7.0x	6.8x	10.0x	7.9x
EV/EBIT	8.9x	9.0x	15.5x	10.9x

The conference call last Friday was the opportunity for CEO Mark Langer to update us on the Group's main initiatives (i.e. U.S. distribution upgrade, store network review, etc.). Despite a better-than-expected Q2 performance, the latter cannot be extrapolated over H2 as the revised guidance imply fairly the same top line and earnings trends than in H1. With regards to our FY16 estimates, our adj. earnings were only reduced by 2% because of one-off charges mostly related to future store closures, our reported earnings were cut by 20%. Neutral recommendation confirmed and new FV of EUR74 vs. EUR77.

ANALYSIS

- **U.S (-19% in H1) still affected by sluggish market trends and self-inflicted injuries.** The sales decline was slightly more significant in Q2 (-21% FX-n) than in Q1 (-16% FX-n), mostly due to painful actions implemented by the Group: the **category migration** that reduces the presence of the BOSS core brand within the wholesale channel, the latter being also affected by the **distribution upgrade** that implies a rationalisation of the wholesale network. As expected, the positive results from these initiatives are slower to appear given the sluggish apparel market conditions.
- **Mainland China: price adjustments have a positive impact on volumes.** Indeed, they were up by 15% in H1 (vs. +10% in Q1) thanks to the price adjustments of 20% implemented earlier this year. However, like in the U.S., these first promising signs are currently overshadowed by double-digit declines in H-K and Macau that have not stabilised yet, leading to 14% sales decrease in H1 in Greater China.
- **Good rebound in Europe in Q2 but is it sustainable over H2?** Sales increased 7% FX-n in Q2 vs. -1% in Q1, but it was not driven by retail whose growth remain unchanged over the first two quarters (+3% FX-n). This rebound was fuelled by the wholesale channel that was up 15% FX-n vs. -4% in Q1 and the management admitted it was explained by a phasing effect (i.e. early shipments to wholesalers). Furthermore, we expect that the lack of traction with tourists will continue in the coming months given the latest terror attacks in the region. Like for other luxury groups, the UK is the most resilient market with +9% FX-n in H1 16.
- **Cost-cutting initiatives in the retail channel.** Following the detailed analysis of the retail network announced in May (~443 freestanding stores at end-June), the Group will close around 20 unprofitable stores by the end of 2016 and throughout 2017. This decision explains the ~EUR52 one-off charge passed in Q2 from which a significant accretive impact is expected next year as these unprofitable stores had a 60bp-dilutive impact on the 2015 adj. EBITDA margin. Moreover, Hugo Boss continues to renegotiate rental contracts in all regions.
- **Revised guidance: we lower our adj. earnings assumptions by 2%.** The Group has revised down its sales target (flat to -3%), mainly because of a more significant sales decline in the wholesale channel ("up to -10% FX-n") due to the distribution upgrade in the U.S. Consequently, we now anticipate 2.5% sales decline FX-n after -2% in H1. As for the profitability, we expect a 21% decline in the adj. EBITDA (new guidance: between -17% and -23%), representing the same contraction in H2 than in H1 (-21%).

VALUATION

- Although the lowered targets were anticipated by investors, they show that Hugo Boss remains impacted by the necessary but painful actions in the ST. As such, the very first positive effects from these initiatives are currently masked by the very challenging market conditions. Pending the first signs of a tangible turnaround, we remain Neutral with a new FV of EUR74 to reflect our new estimates.

NEXT CATALYSTS

- Q3 16 Results on 2nd November // Investor Day (London) on 16th November.

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Analyst :
Cédric Rossi
33(0) 1 70 36 57 25
crossi@bryangarnier.com

Sector Team :
Nikolaas Faes
Loïc Morvan
Antoine Parison
Virginie Roumage

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London
Beaufort House
15 St. Botolph Street
London EC3A 7BB
Tel: +44 (0) 207 332 2500
Fax: +44 (0) 207 332 2559
Authorised and regulated by the
Financial Conduct Authority (FCA)

Paris
26 Avenue des Champs Elysées
75008 Paris
Tel: +33 (0) 1 56 68 75 00
Fax: +33 (0) 1 56 68 75 01
Regulated by the
Financial Conduct Authority (FCA) and the
Autorité de Contrôle prudential et de
resolution (ACPR)

New York
750 Lexington Avenue
New York, NY 10022
Tel: +1 (0) 212 337 7000
Fax: +1 (0) 212 337 7002
FINRA and SIPC member

Munich
Widenmayerstrasse 29
80538 Munich
Germany
+49 89 2422 62 11

New Delhi
The Imperial Hotel Janpath
New Delhi 110 001
Tel +91 11 4132 6062
+91 98 1111 5119
Fax +91 11 2621 9062

Geneva
rue de Grenus 7
CP 2113
Genève 1, CH 1211
Tel +4122 731 3263
Fax+4122731 3243
Regulated by the FINMA