Hugo Boss

Price EUR59.08

Higher savings help mitigate the margin decline pending the next sales rebound

Fair Value EUR74 (+25%) **NEUTRAL**

Bloomberg	BOSS GR
Reuters	BOSG_p.DE
12-month High / Low (EUR)	93.5 / 46.4
Market Cap (EUR)	4,159
Ev (BG Estimates) (EUR)	4,307
Avg. 6m daily volume (000)	409.8
3y EPS CAGR	-5.0%

	1 M	3 M	6 M	31/12/15
Absolute perf.	20.0%	12.1%	5.3%	-22.9%
Pers & H/H Gds	-4.6%	-4.6%	-1.5%	-2.7%
DJ Stoxx 600	-3.3%	-1.2%	-2.8%	-9.4%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	2,809	2,700	2,756	2,866
% change		*-3.9%*	*2.1%*	*4.0%*
EBITDA (rep.)	590	416	511	534
EBIT	447.7	262.6	339.8	361.9
% change		*-41.3%*	*29.4%*	*6.5%*
Net income	319.3	193.5	252.9	272.8
% change		*-39.4%*	*30.7%*	*7.8%*

	2015	2016e	2017e	2018e
EBIT margin	15.9	9.7	12.3	12.6
Net margin	11.4	7.2	9.2	9.5
ROE	33.4	20.8	25.3	26.4
ROCE	29.6	16.9	21.9	22.9
Gearing	9.9	15.9	8.1	6.6

(EUR)	2015	2016e	2017e	2018e
EPS	4.67	3.51	3.72	4.01
% change	-	*-25.0%*	*6.1%*	*7.7%*
P/E	12.6x	16.9x	15.9x	14.7x
FCF yield (%)	6.9%	5.2%	5.8%	5.6%
Dividends (EUR)	3.62	2.24	2.93	3.16
Div yield (%)	6.1%	3.8%	5.0%	5.4%
EV/Sales	1.5x	1.6x	1.5x	1.5x
EV/EBITDA	7.2x	10.3x	8.3x	7.9x
EV/EBIT	9.5x	16.4x	12.5x	11.7x

As expected, the market welcomed positively the better-than-expected adj. EBITDA performance (thanks to a higher cost savings target) and the gradual improvement in China, which was also shared by other luxury groups. Now that Hugo Boss has managed to consolidate the business, the second step would be to restore traction at the top line level and recover part of the lost profitability. The group's management will certainly spend some time presenting these initiatives at the Investor Day on 16th November.

ANALYSIS

- **Cost-cutting initiatives deliver more than expected.** The higher cost savings target announced yesterday (EUR65m instead of EUR50m) stemmed from a more effective streamlining of the cost structure: **(i)** renegotiation of rental contracts across the globe, **(ii)** a tight opex cost management and **(iii)** lower marketing expenses as a % of sales (CEO guided for a stability over 2016). At this stage, the group has closed three stores out of the 20 unprofitable DOS that are expected to close by the end of 2017.

- **Sequential improvements in China (8% of sales) …** After five consecutive quarters in negative territory, trends in these two regions have gradually improved over Q3. As expected, the recovery was faster in **China** despite an ongoing double-digit decline in HK/Macau, helped by a more favourable market environment highlighted by other luxury peers, but also thanks to own initiatives (i.e. price cuts of 20%, improved merchandise planning, new digital approach). It is worth noting that comparable growth in Mainland China was even positive in Q3 (vs. -6% for the Group).

- **… and in the US (19% of sales).** The situation has improved slightly (Q3: -14% vs. -19% in H1) but remains volatile: while half of the sales decline was due to the group's distribution upgrade in wholesale, the other half is explained by lingering poor footfall, as LFL sales figures were still below the group's average. Once the distribution upgrade in the wholesale channel and the category migration are completed, Hugo Boss expects that in-store traffic would improve and return to positive territory. This recovery would be a catalyst for 2017 in our view.

- **Let's hope Hugo Boss stems the decline in Europe (60% of sales).** Although Europe was the only region showing positive growth over 9M (+1% FX-n), trends worsened in Q3 (-2% FX-n vs. +3% in H1) in a context of an overall market deterioration in key countries such as Germany, France or Spain. Although the brand has increased prices in Germany (e.g. which is now 20% cheaper than France vs. 30% previously), it did not underperform the (weak) German market. If the market is not better oriented in Q4, we hope that Hugo Boss will implement measures to restore momentum as the comparison base is quite challenging (Q4 2015: +10% FX-n vs. +5% in 9M).

- **We leave our FY16 assumptions unchanged.** We anticipate a 2% FX-n sales decline for 2016 (guidance: 0 to -3%), implying a flat performance over Q4. As for adj. EBITDA, we expect a 19% contraction for the year. The group has not revised up its FY target (decrease between 17% to 23%) despite higher cost savings but CEO Mark Langer confirmed that Hugo Boss would not be in the lower end of the guidance even if comparable store sales performance does not improve vs 9M (-7%). Interestingly, he also specified that the bar for operating leverage was lowered (mid single-digit LFL growth previously) thanks to savings and tight cost management.

- **All eyes on the Investor Day.** Now that Hugo Boss has shown that its initiatives have started to pay off in some markets and in profitability, the market now wants to have a detailed roadmap for the MT-LT, particularly with regard to brand positioning, the online channel (-15% in Q3) and upside potential to profitability over the MT.

VALUATION

- At 12.2x 2017e EV/EBIT, the stock trades at 4% discount to our luxury sample excl. Hermès.

NEXT CATALYSTS

- Investor Day on 16th November.

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