Hugo Boss

Price EUR54.75

CMD Feedback: first meaningful results to be seen in 2018

Fair Value EUR70 vs. EUR74 (+28%) **NEUTRAL**

Bloomberg	BOSS GR
Reuters	BOSG_p.DE
12-month High / Low (EUR)	87.0 / 46.4
Market Cap (EUR)	3,854
Ev (BG Estimates) (EUR)	4,002
Avg. 6m daily volume (000)	424.2
3y EPS CAGR	-5.6%

	1 M	3 M	6 M	31/12/15
Absolute perf.	2.6%	-5.5%	-1.7%	-28.5%
Pers & H/H Gds	-5.1%	-7.8%	-3.9%	-4.6%
DJ Stoxx 600	-0.4%	-1.4%	1.1%	-7.5%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	2,809	2,700	2,752	2,862
% change		*-3.9%*	*1.9%*	*4.0%*
EBITDA (rep.)	590	416	489	520
EBIT (rep.)	447.7	262.6	330.3	355.1
% change		*-41.3%*	*25.8%*	*7.5%*
Net income	319.3	193.5	245.7	267.6
% change		*-39.4%*	*27.0%*	*8.9%*

	2015	2016e	2017e	2018e
EBIT margin	15.9	9.7	12.0	12.4
Net margin	11.4	7.2	8.9	9.3
ROE	33.4	20.8	24.7	26.0
ROCE	29.6	16.9	21.1	22.1
Gearing	9.9	15.9	9.9	8.9

(EUR)	2015	2016e	2017e	2018e
EPS	4.67	3.51	3.61	3.93
% change	-	*-25.0%*	*3.1%*	*8.8%*
P/E	11.7x	15.6x	15.1x	13.9x
FCF yield (%)	7.4%	5.6%	5.8%	5.8%
Dividends (EUR)	3.62	2.24	2.85	3.10
Div yield (%)	6.6%	4.1%	5.2%	5.7%
EV/Sales	1.4x	1.5x	1.4x	1.4x
EV/EBITDA	6.7x	9.6x	8.1x	7.6x
EV/EBIT	8.8x	15.2x	12.0x	11.1x

To cope with profound changes in the apparel industry and further to the immediate actions launched this year, Hugo Boss has announced four main initiatives, the two most important being: (i) the focus on two brands (BOSS and HUGO) and (ii) a global pricing harmonisation with a maximum 30% price difference between Europe and Asia by 2018. In view of lead time of up to 12 months, "2017 will be a year of transition" and the acceleration is expected for 2018. The market, which was expecting a faster turnaround, was disappointed but the correction yesterday (-10.2%), exaggerated in our view, should be seen in perspective, given the 25% rally since the 7th October. We revise down our FY17-18 assumptions by 4% on average, leading to a new FV of EUR70 vs. EUR74.

ANALYSIS

- **Profound changes in the industry and HB weaknesses.** Besides challenging apparel market conditions, the group's management also admitted that **(i)** current brand positioning was unclear to consumers because of an overly aggressive premiumisation strategy and a lack of differentiation (identity, pricing, distribution) between BOSS, Green, Orange and HUGO, **(ii)** distribution and pricing strategies did not fit with the new industry's paradigm, **(iii)** it neglected the digital revolution and **(iv)** complex internal decision-making processes led to organizational inertia.

- **Refocus on two brands and Menswear.** In challenging times, groups refocus on their core brands/categories where their legitimacy is the strongest and Hugo Boss is no exception to this trend. Marketing and human resources will be rebalanced to **Menswear** (~89% of sales). From now on, HB will concentrate on its BOSS core brand that will absorb Green and Orange and HUGO (10% of sales). The latter will be at the forefront of the group's strategy to rejuvenate its customer base and expand presence in casual wear. Although HUGO's price positioning will be 30% lower than BOSS, management emphasized several times that HUGO would not be a BOSS' accessible sub-brand, but will be independent with a distinctive positioning (premium), customer target and communication channels. It is worth saying that BOSS and HUGO will be present in retail and wholesale channels, meaning the **end of the category migration** implemented over the past two years.

- **Price harmonisation to reduce harmful imbalances.** A growing presence online goes along with a transparent and coherent global pricing architecture. Hence, prices in some European markets were increased such as Germany in Q3 (DD increase) that was 30% below France, and prices in Asia will be further reduced (mid-teens %). By the end of 2018, compared to Europe, prices in Americas should not be higher than 20% and the maximum price difference with Asia should be 30%. While this future price architecture would be better perceived by consumers, also helped by the refocusing on two brands, the DD increase in Germany (17% of sales) is not without risk in light of a challenging apparel market (-3% ytd) with value-driven consumers

- **How this strategic plan will be implemented in the US (19% of sales) and China (8%).** Despite tough market conditions, the newly-appointed CEO for the **US** also acknowledged that mistakes had been made such as overly ambitious brand elevation, neglecting the Millennial generation and the online channel. As such, the group has decided: **(i)** to restore entry-level price points in the upper premium segment (=> reconquer its core customer base), **(ii)** to decrease the share of the off-price wholesale channel to less than 10% from 22% in 2015 (=> low DD decline in wholesale expected in 2017) and **(iii)** expand the online channel with the help of Mr Lloyd-Williams, Director of Digital Transformation since September 2016. In **China**, brand equity remained strong and the weak performance was mostly due to the adverse market conditions. The first price adjustment already showed promising results this year, the group will focus on enhancing the brand communication and of course, the digital platform.

- **Putting some figures in front of these initiatives.** According to CEO Mark Langer, the four fields of action will imply a lead time of up to 12 months, this is why 2017 will be a "year of transition". The global price harmonisation will have a neutral impact at the group level but the US distribution upgrade will hamper sales growth and limits any margin upside potential in 2017. Consequently we are reducing our FY17 adj. EBITDA assumptions by 4%. As a reminder, the 20 unprofitable stores should be all closed by the end of 2017, implying a full positive impact in 2018.

(To be continued next page)

VALUATION

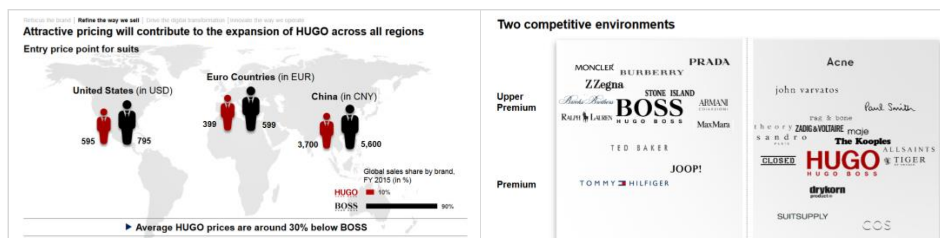
- The FCF generation is expected to remain stable this year as the fall in EBITDA will be offset by the decline in capex investments (EUR160-180m vs. EUR220m in 2015). The historical 60-80% dividend policy was reconfirmed but the group's management did not communicate any precise range for 2016 as he is currently assessing the FCF needed to finance these initiatives (BG ests: 80%)
- In light of the roadmap communicated by the Group yesterday (2017: "year of transition" / 2018: "return to growth and acceleration"), we believe that CS numbers should be revised down by no more than 3-4%, in the same range than our adjustments. Hence, we believe that the correction yesterday was quite exaggerated.
- Our new FV of EUR70 vs. EUR74 reflects our new estimates. Neutral recommendation confirmed as we believe it is too soon to play the successful turnaround (as highlighted by the company's roadmap) and the visibility remains limited.

NEXT CATALYSTS

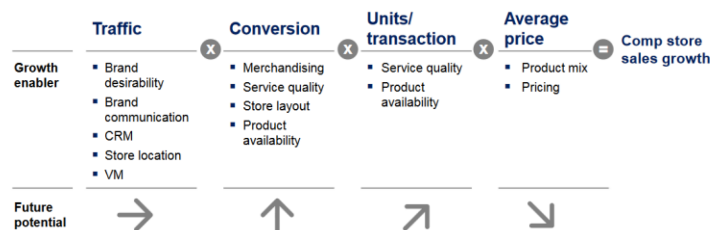
- FY16 Sales to be reported in February 2017.

Strategic Plan: Four field of action with a lead time of up to 12 months:

Pricing strategy: HUGO brand will be positioned around 30% below BOSS



Hugo Boss' equation to restore comparable growth with the new brand and merchandising strategy:



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