28th November 2016

Sector View

Fashion

Fast-Fashion: a fast-changing industry (document released today)

	1 M	3 M	6 M	31/12/15
Consumer Gds	-3.0%	-5.2%	-4.2%	-6.4%
DJ Stoxx 600	-0.2%	0.1%	-1.8%	-6.4%

*Stoxx Sector Indices

Companies covered

H & M	**NEUTRAL**	**SEK295**
Last Price	*Market Cap.*	
INDITEX	**BUY**	**EUR38**
Last Price	*Market Cap.*	

We are reinitiating coverage of Inditex (BUY, FV: EUR38) and H&M (NEUTRAL, FV: SEK295). Both continue to enjoy strong growth profiles (EPS CAGR 2016-19e: +12.3% for ITX and +10.2% for H&M) but, in our view, Inditex offers a more defensive profile in this competitive industry.

ANALYSIS

- **The 'mass-market' or 'accessible fashion' segment of the global market is vast (c.EUR1,100bn) and remains very fragmented** since the two flagship brands, H&M and Zara, are likely to account for respective market shares of 1.7% and 1.4%. However, these two global brands need to contend with growing competition from new brands (Primark, Forever21, etc.) which are pursuing very aggressive price strategies and, secondly, the **growth in internet players** (Amazon, Zalando, ASOS, etc.) offering a virtually-unlimited choice of items and increased customer experience.
- **The H&M and Inditex groups dispose of some major assets they can leverage when it comes to contending with this multiform competition**. Even before the emergence of most of these online retailers, H&M and Inditex already had robust commercial strategies focused on: **(i)** international markets, **(ii)** multichannel (then omnichannel) and **(iii)** multi-concept, while **(iv)** shortening the lifespan of the collections to keep pace with changing trends.
- **In our view, Inditex is the best equipped to thrive in this environment:** its 'pull' strategy (= collection design based on customer purchasing decisions) and ability to launch a new collection within just two weeks (vs. 6 months for the industry) thanks to centralised, vertical integration, enable Inditex to enjoy mark-down and unsold inventory rates amongst the lowest in the industry. Furthermore, its new strategy combining flagship stores (= fewer DOS openings) and online offer (c.5.5% of 2016e sales) minimise the risks to earnings growth (EBIT CAGR 2016-19e: +12%).
- **H&M: some outstanding doubts.** The group generates c.8% of 2016e sales over the internet but is bearing the brunt of competition from discount brands (Primark, etc.) whereas its supply chain is similar to that of the industry (80% of manufacturing realised with 6-month lead times), making H&M more sensitive to changing trends. The earnings growth (CAGR 2016-19e: +10%) is more volatile due to sourcing in USDs (c.80%), an ambitious DOS opening plan (surface growth: +10-15% per annum) and plans to launch one or even two new brands in 2017.

VALUATION

- We are reinitiating coverage of **Inditex** (BUY, FV: EUR38) and **H&M** (NEUTRAL, FV: SEK295).

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NEUTRAL — Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

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Distribution of stock ratings

BUY ratings 72% NEUTRAL ratings 0% SELL ratings 28%

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