BRYAN, GARNIER & CO

INDEPENDENT RESEARCH

28th November 2016

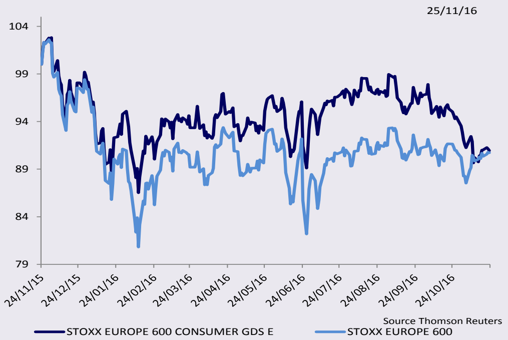
H&M/Inditex

Fast-Fashion: a fast-changing industry

H&M/Inditex

H & M		NEUTRAL	FV SEK295
Bloomberg	HMB SS	Reuters	HMb.ST
Price	EUR268,3	High/Low	325,7/236,6
Market cap.	EUR444,056m	Enterprise Val	EUR435,383m
PE (2016e)	24.0x	EV/EBIT (2016e)	18.2x

INDITEX		BUY	FV EUR38
Bloomberg	ITX SM	Reuters	ITX.MC
Price	EUR31,395	High/Low	34,585/26,7555
Market Cap.	EUR97,847m	Enterprise Val	EUR91,504m
PE (2016e)	30.5x	EV/EBIT (2016e)	22.2x



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.

- **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.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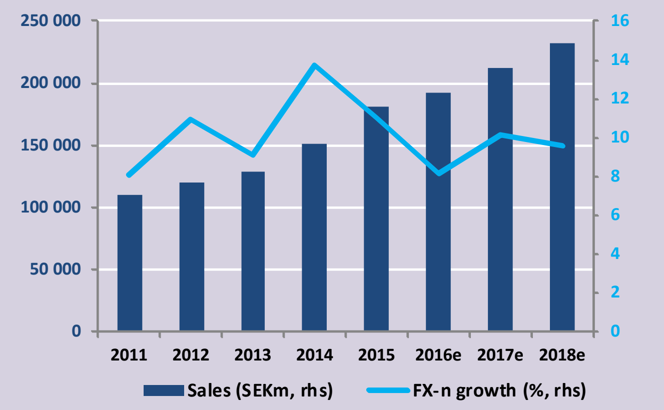
1. Presentation in six charts

1.1. H&M

Sales (SEKm) and FX-n growth (%) over 2011-18e

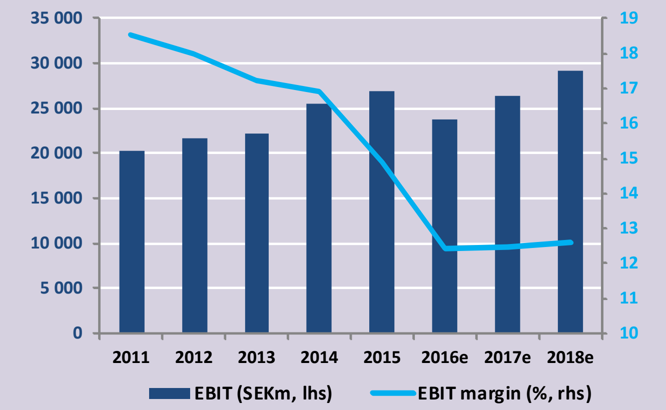
We believe that **FX-n growth expected over 2016-18e will be mostly driven by new space** (~7% on average).



Source: Company Data, Bryan, Garnier & Co ests

EBIT (SEKm) and EBIT margin (%) over 2011-18e:

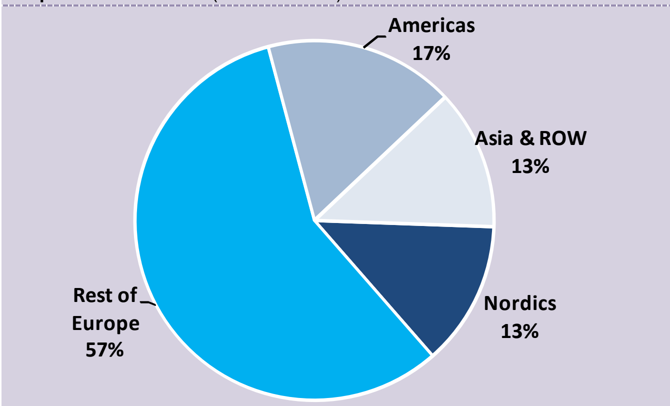
On our estimates, the **EBIT margin should stabilize in 2016 (at 12.4%) and improve slightly over 2017-18.**



Source: Company Data, Bryan, Garnier & Co ests

Sales Breakdown by Region (2015, %):

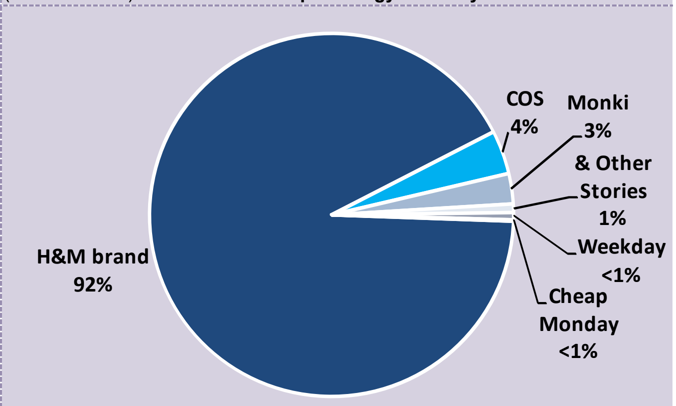
Germany is H&M's main market (~18% of sales) and the Group has **a bigger footprint on US market** (~12% of sales).



Source: Company Data

Sales Breakdown by Brand (2015, %):

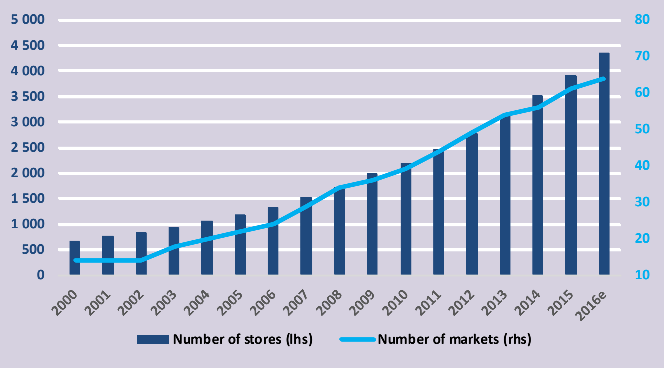
The H&M **Group is less diversified and more reliant on its eponym brand** (~92% of sales) as the **multi-concept strategy was only introduced in 2007.**



Source: Bryan, Garnier & Co ests

Store Network (2000-16e):

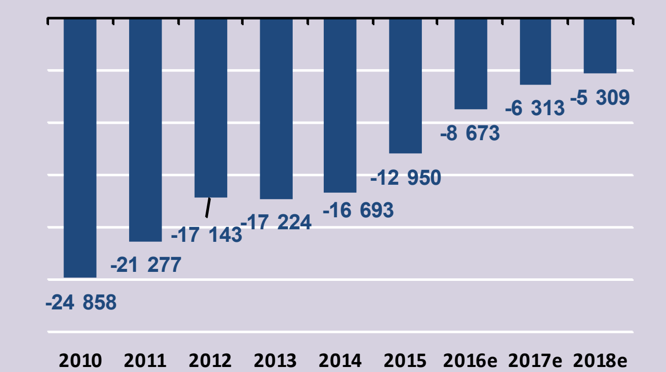
By the end of FY16, **H&M will have more than 4,300 stores in approx. 64 markets.**



Source: Company Data

Net debt or cash (SEKm) over 2010-18e:

H&M has burnt a substantial proportion of its cash pile because of **pressure on margins** and **heavier capex investments.**

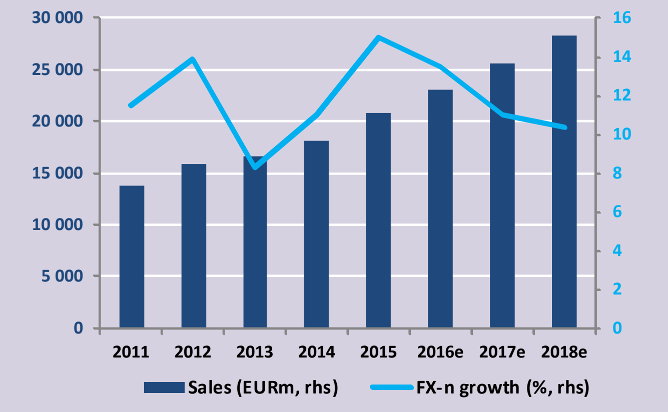


Source: Company Data, Bryan, Garnier & Co ests

1.2. Inditex

Sales (EURm) and FX-n growth (%) over 2011-18e

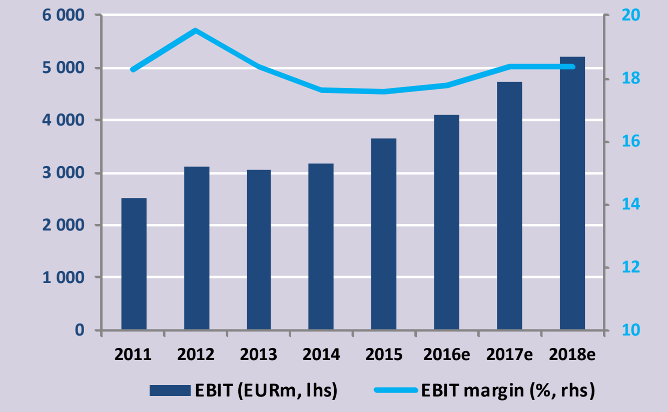
We believe Inditex should **continue to grow sales in the double-digits over 2016-18 (average LFL performance: approx. 6%).**



Source: Company Data, Bryan, Garnier & Co ests

EBIT (EURm) and EBIT margin (%) over 2011-18e:

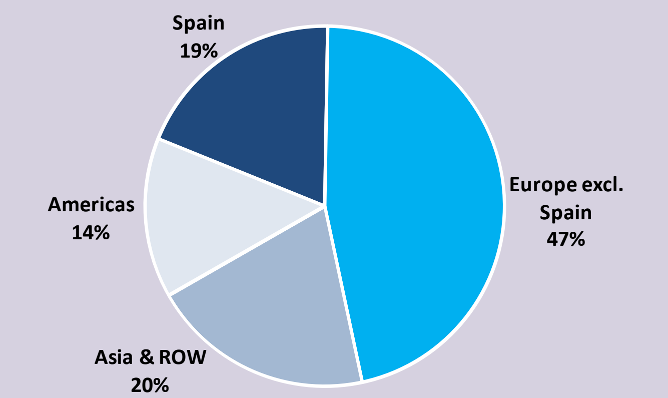
On our estimates, **the EBIT margin is set to expand gradually from 2016**, driven by a less adverse FX environment and a positive operating leverage.



Source: Company Data, Bryan, Garnier & Co ests

Sales Breakdown by Region (2015, %):

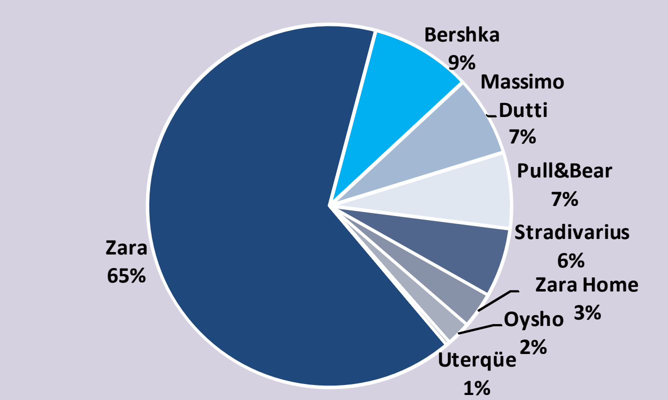
Spain is Inditex's biggest market (~18% of sales) whilst the **US** (~4-5% of sales) harbours growth opportunities for the Group.



Source: Company Data

Sales Breakdown by Brand (2015, %):

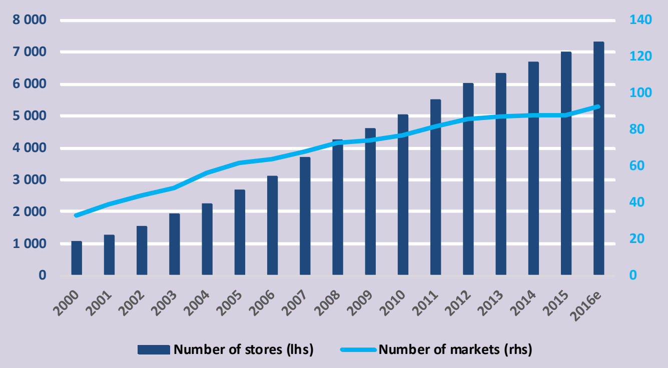
Zara accounts for 65% of group sales but the multi-concept strategy is underway.



Source: Bryan, Garnier & Co ests

Store Network (2000-16e):

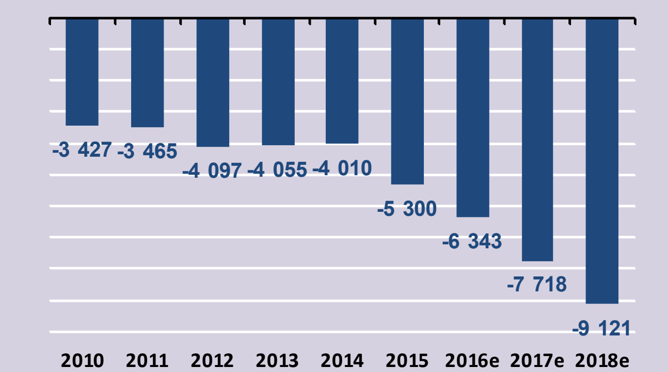
Inditex should count over 7,300 stores by the end of FY16, **Zara stores represent approx. 31%** of the total store network.



Source: Company Data

Net debt or cash (SEKm) over 2010-18e:

We expect Inditex to build up a significant cash pile by 2018e given the FCF generation and lower capex investments (as a % of sales).



Source: Company Data, Bryan, Garnier & Co ests

2. Two global leaders in "accessible fashion"

The global fashion market (ready-to-wear and accessories) is vast, amounting to more than EUR1,200bn. The 'mass-market' or 'accessible fashion' segment naturally represents the bulk of this market (c. EUR1,100bn) and remains highly fragmented since the two flagship brands, H&M and Zara, are likely to account for respective global market shares of 1.7% and 1.4%.

The fragmentation of this market has enabled, firstly, the emergence of new brands like **Primark**, **Forever21 and Topshop,** which are pursuing very aggressive price strategies and have embarked on international growth and, secondly, the growth in online players like **Amazon**, **Zalando** and **ASOS** offering a virtually-unlimited choice of items and increased customer experience.

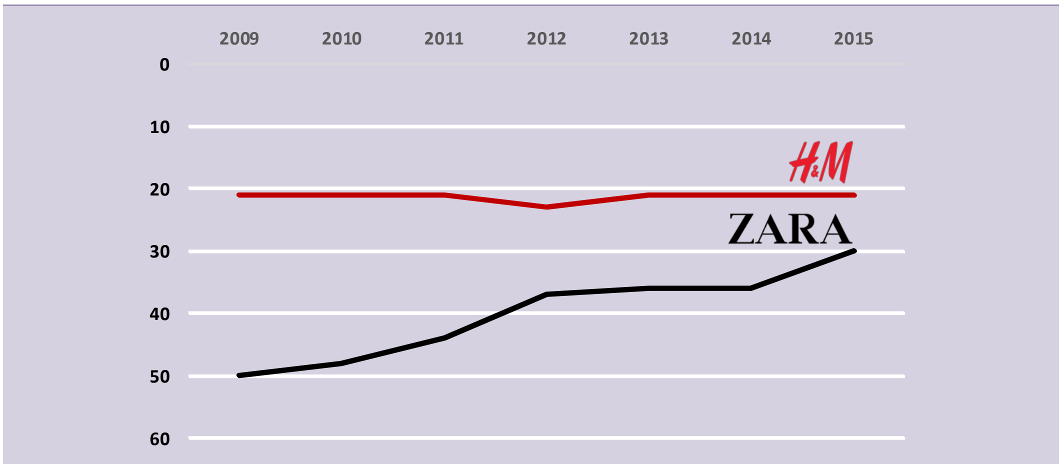
The H&M and Inditex groups do, however, possess some major assets they can leverage when it comes to contending with this competition. Even before the emergence of most of these online retailers, H&M and Inditex already had robust commercial strategies focused on: **(i)** international markets, **(ii)** multichannel (then omnichannel) and **(iii)** multi-concept, while **(iv)** shortening the lifespan of the collections to keep pace with changing fashions. In short, exactly what the internet players are trying to establish!

2.1. Major strengths when it comes to attracting consumers

2.1.1. The two flagship brands are in robust health

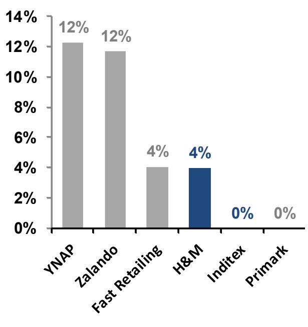
The brand strategy and design company, Interbrand, publishes an annual ranking of the 100 most valuable global brands, based on their operating performance, the role of the brand and its ability to influence consumer choices and its prospects. The following chart shows that, for many years, the **H&M** brand has occupied 21st place in this ranking whereas **Zara** moved up from 50th to 30th place between 2009 and 2015. There are no other accessible fashion brands in this ranking.

Fig. 1: Interbrand ranking of H&M and Zara (2009-2015):



Source: Interbrand

Weight of advertising spend (2015, % of sales):



Source: Company Data Bryan, Garnier & Co ests.

The reputation and success of these two brands is all the more remarkable in that the two groups spend very little on marketing (H&M: c.4% of total sales according to our estimates), or even nothing at all in the case of Inditex. It is true that these two groups can now rely on the development of the **social media** where advertising is looked after by the consumers themselves, but it is especially the **physical stores and their display windows which are the main vector in brand marketing,** hence the strategic choice of the locations for future stores.

2.1.2. 'Fast-Fashion' = accelerated international development

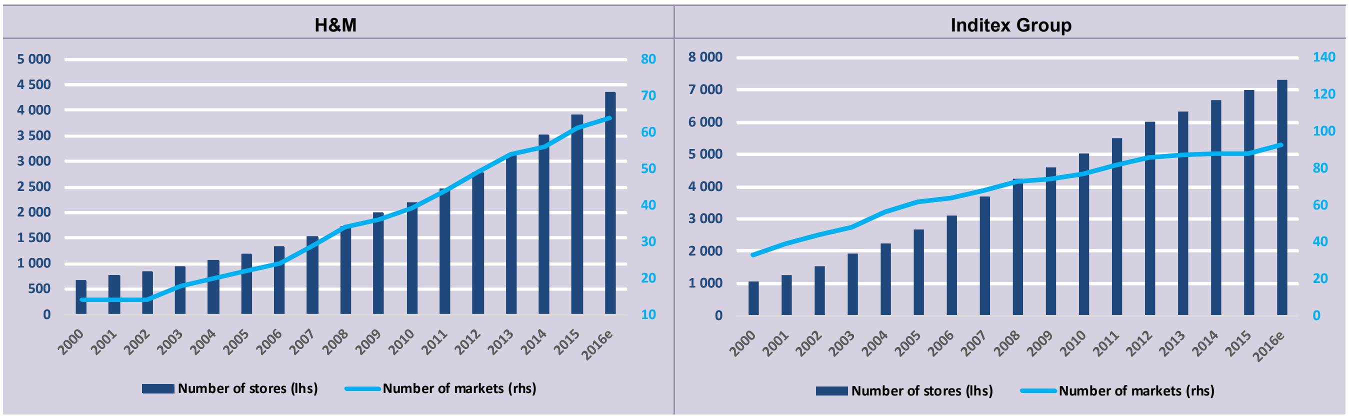
Backed by two brands which play very effective roles as standard bearers in a highly-fragmented global market, the two groups significantly accelerated their international development as of the early 2000s:

(i) **H&M:** Whereas the Swedish group was present in only 14 countries with 682 stores in 2000, it is expected to operate in 64 markets by the end of the year (Porto Rico, New Zealand and Cyprus opening in 2016) with more than 4,300 stores worldwide. The **H&M brand** is naturally present in these 64 countries and represents close to 92% of the total number of stores.

(ii) **Inditex:** The group's history may more recent than that of H&M, but Inditex was already established in 33 countries with 1,080 stores in 2000. At the end of 2016, Inditex should maintain its advance with at least five new market openings this year (Aruba, Paraguay, Nicaragua, Vietnam and New Zealand) bringing the total to 93 countries, and manage more than 7,300 stores of which 2,100 for the **Zara** brand alone.

It is worth mentioning two interesting differences between the two groups: **1/** the proportion of sales in the domestic market is naturally more sizeable for Inditex (Spain = c.19% of 2015 sales) than for H&M (Sweden: c.5% of sales) but nonetheless remains one of the latter's ten main markets and **2/** Inditex is ahead in terms of the international roll-out of its other concepts which are already in more than 55 countries on average, versus an average of 12 for those of H&M. It is true that H&M's multi-concept strategy is more recent than that of Inditex.

Fig. 2: A rapid international roll-out since the early 2000s:



Source: Company Data

2.1.3. A multi-concept strategy to 'cover all the bases'

One of the competitive advantages of an ASOS, Zalando or even YNAP in the premium/luxury segment, is the vast choice of items available on their websites whereas traditional retailers obviously have a limited amount of commercial space. To contend with this competition, H&M and Inditex are deploying a segmented multi-concept-based offer (or multi-brand) to reach the widest-possible ready-to-wear customer base, in terms of style, age bracket and price.

H&M: the multi-concept strategy dates back to 2007

The H&M group's growth has been exclusively based on its eponymous brand as highlighted in the following table. The launch of the multi-concept strategy thus dates back to 2007 with the launch of H&M's upscale **COS** brand (2007), then the acquisition of **MONKI**, **WEEKDAY** and **Cheap Monday** in 2008. **& Other Stories** is the most recent concept, launched in 2013. Given this fairly recent history, **the H&M brand still represents nearly 92% of the total number of stores** (H&M does not disclose its sales by brand)

The H&M brand has always been positioned in the 'value fashion' segment with a very broad apparel customer base (Women, Men, Children) and two sub-concepts outside textiles: H&M Home (2009) and H&M Beauty (2015). The other concepts have slightly higher positioning (e.g.: COS and & Other Stores are positioned just below 'affordable luxury') where the pressure on prices is less intense.

Lastly, H&M will pursue this multi-brand strategy since, in 2015, the CEO announced plans to **launch one or even two new brands in 2017,** which will be '*radically different from the current roster of in-house brands*'.

Fig. 3: The H&M group's six brands (data at end November 2015):

Brand	H&M	COS	MONKI	& Other Stories	WEEKDAY	Cheap Monday
Founded In…	1947	2007	2006 / 2008 *	2013	2002 / 2008 *	2004 / 2008 *
Number of Stores	3,610	153	106	30	20	5
Number of Markets	61	30	13	10	5	4 (35 in wholesale)

** Joined H&M following the acquisition of Fabric Scandinavien AB (2008)* *Source: Company Data*

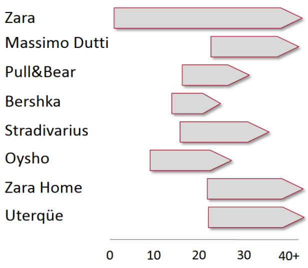
Since 2004, the **H&M brand has every year worked in partnership with designers and/or luxury brands** to launch limited edition collections. This enables the brand to strengthen its reputation with aspirational customers (or those with higher spending power than its usual customers) and to compensate for its lower exposure to higher price segments. The pricing level for the limited collections is thus on average 30% higher than the price positioning for the brand.

Fig. 4: Some examples of 'capsule' collections:

Year	Designer / Brand
2004	Karl Lagerfeld
2005	Stella McCartney
2009	Jimmy Choo
2015	Balmain
2016	Kenzo (launched on 3rd November)

Source: Company Data

Target customers for the Inditex brands, by age bracket:



Source: Company Data

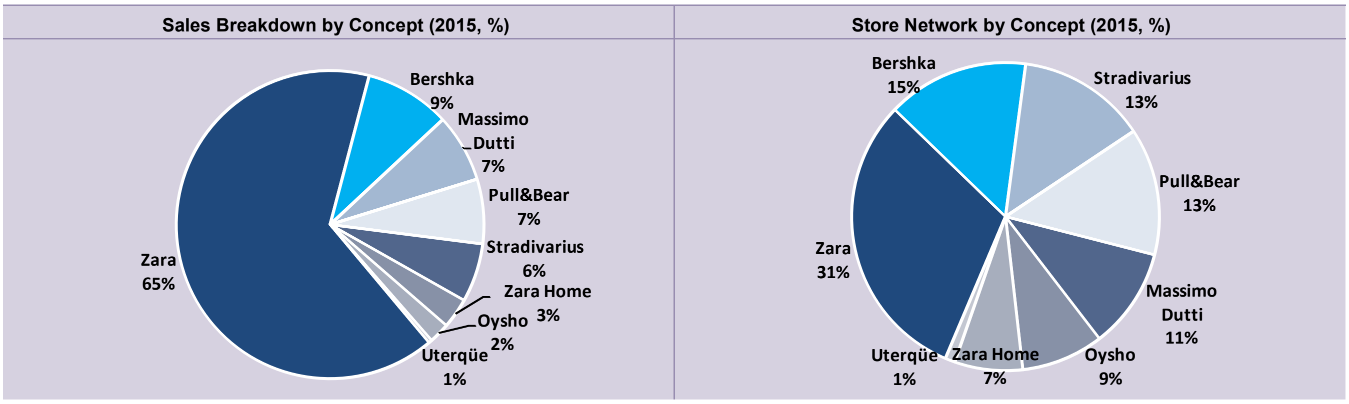
Inditex: multi-concept already effectively mastered

Inditex's experience in terms of multi-brand strategy dates back even further in that it began in 1991 with the creation of **Pull&Bear** and the acquisition of **Massimo Dutti**. Then came the creation of **Bershka** (1998) and the purchase of **Stradivarius** (1999). Lingerie brand **Oysho** was launched in 2011, followed by **Zara Home** (2003) and **Uterqüe** in 2008.

Like the H&M brand, Zara addresses the widest possible customer base (Women, Men, Children) and all age brackets as shown in the chart on the left. It was however vital to have an even-more segmented offer addressed at young people (Bershka, Oysho) and adults who also have higher purchasing power, explaining the higher price positioning of Massimo Dutti (superior mass market) and Uterqüe (entry level affordable luxury).

Since Inditex's multi-concept strategy has been in place for longer, the group has had time to successfully develop other brands, making it slightly more diversified than its Swedish competitor since Zara represents 'only' 65% of sales, even if this percentage has seen virtually no change in recent few years (Zara contributed 64% of sales in 2009).

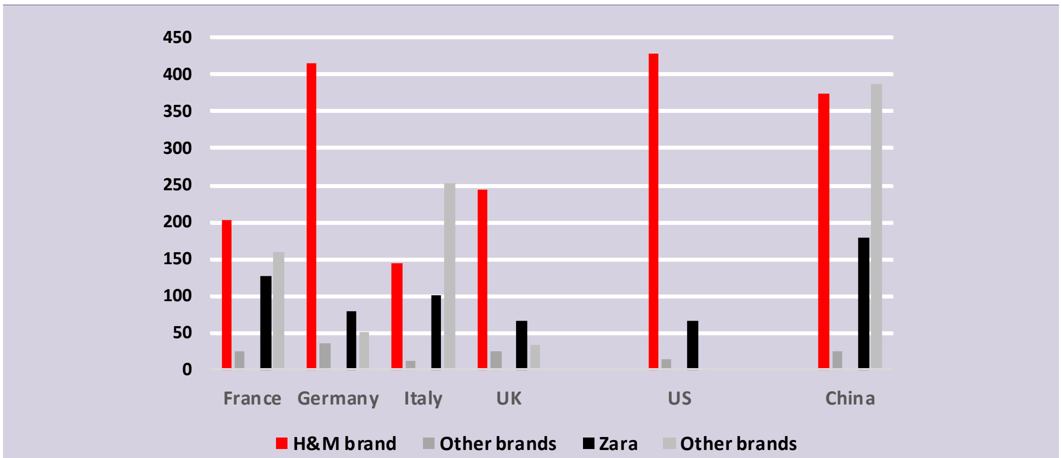
Fig. 5: Sales and store breakdown by brand 2015, in %):



Source: Company Data

With the exception of Germany (H&M's number one market) and the United States where H&M has found it easier to grow than Inditex, the latter generally numbers more stores that its competitor thanks to the presence of points of sale for the other brands. Of the four leading European markets, Zara accounts for on average 50% of the country's points of sale, versus 91% for H&M. In Spain, Zara stores represent only 25% of the total!

Fig. 6: Breakdown of H&M/Zara stores vs other concepts:



Source: Company Data; Bryan, Garnier & Co ests.

2.1.4. Main challenge: adapt to the consumer as rapidly as possible!

H&M: A classical supply chain close to traditional players

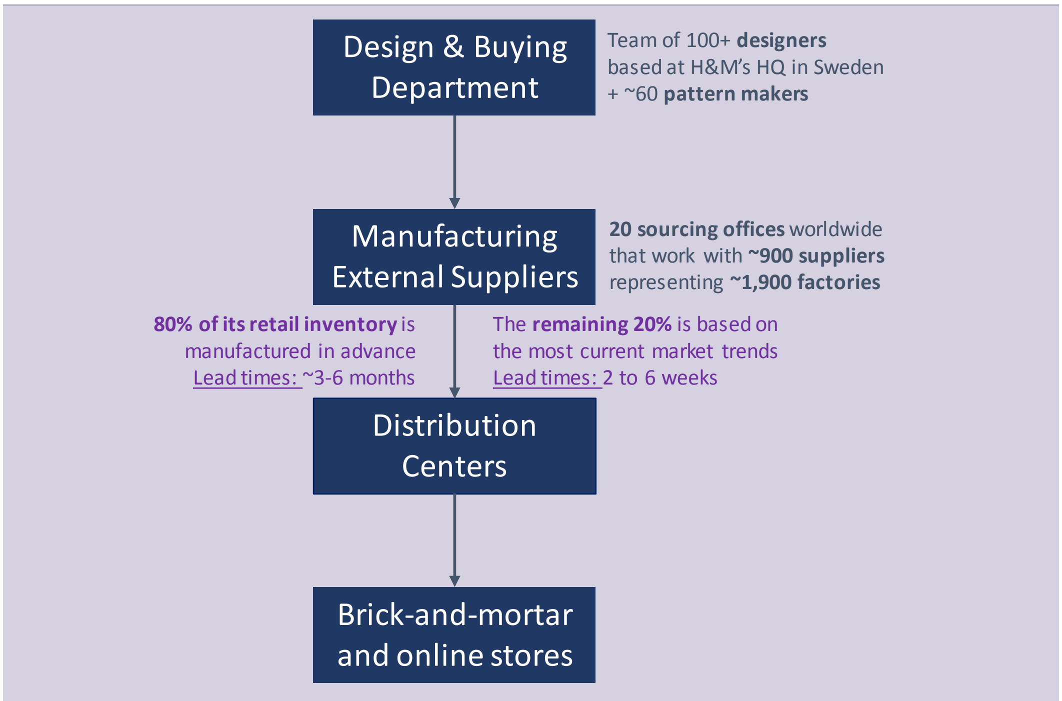
As shown in the chart on the next page, the H&M supply chain is more classical than that of its Spanish competitor, whether this be top down at the level of collection design (everything starts with the design team) or the supply chain lead times given that its manufacturing is mostly located in Asia.

(i) **Design:** H&M's design team regroups over **one hundred designers and is entirely based at its headquarters in Stockholm**. For more than 20 years, this team has been headed by Margarita van den Bosch who has now taken more of a back seat and oversees only the H&M capsule collections.

(ii) **Manufacturing:** once a collection has been designed, H&M's 20 sourcing offices are responsible for entrusting its manufacturing to 900 suppliers (representing more than 1,900 factories). Nearly **80% of sourcing is from Asia** and the fact that the collections are global means that H&M can thus concentrate the volumes, giving it purchasing conditions which are key to its price-competitiveness. Note also that **80% of its retail inventory is manufactured in advance (3 to 6-month lead time)**, these figures remaining close to textile industry norms.

(iii) **Distribution:** the references produced are then shipped to the **H&M warehouses located world-wide.** One warehouse can cover one or several countries depending on the size of the market.

Fig. 7: H&M's simplified supply chain, close to industry norms:



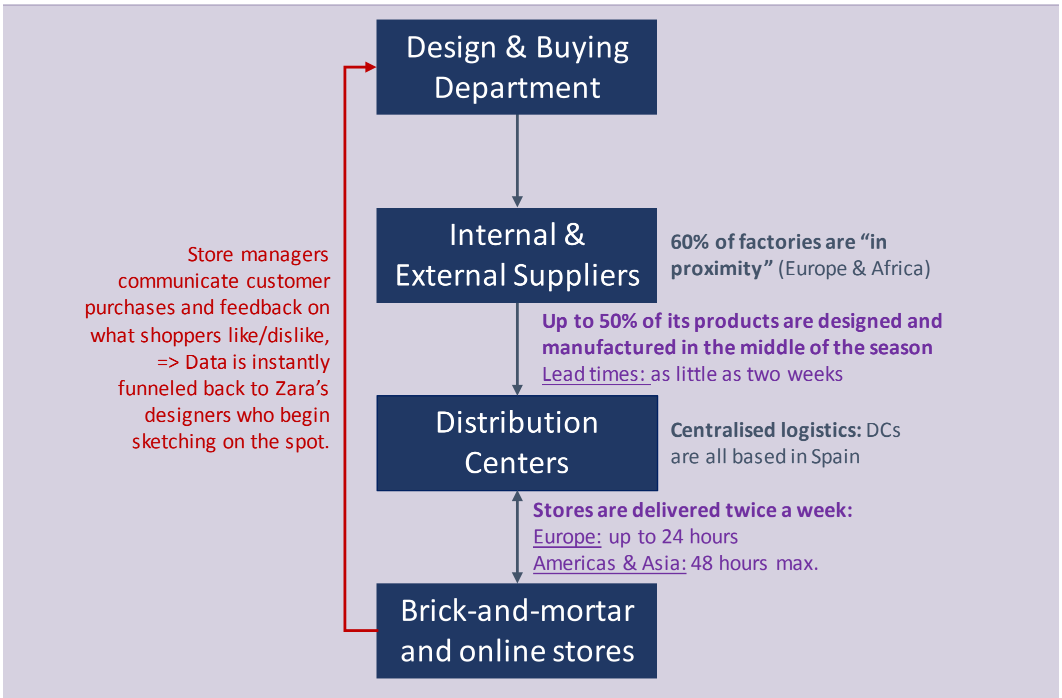
Source: Company Data; Bryan, Garnier & Co ests.

Inditex: revolutionary and unrivalled vertical integration

With regard to the organisational chart below, it is legitimate to say that Inditex has invented a proprietary supply chain which is unrivalled in the textile industry. This clearly responds to the definition of fast fashion (short manufacturing cycles and a relatively short product lifespan compared with the industry norms) and has been conceived to ensure maximum 'adherence' to consumer trends.

The following simplified organisational chart clearly illustrates this integration which is unique in the industry, placing the consumer and responsiveness at the heart of every stage.

Fig. 8: Inditex's vertical integration is unique in the industry:



Source: Company Data; Bryan, Garnier & Co ests.

The stages listed below primarily concern Zara but most also apply to Inditex's other brands.

(i) **Store Manager:** since Inditex directly controls its distribution, the founder effectively understood the key role the stores could play in analysing sales trends, **with each store manager responsible for feeding back consumer reactions, which models are selling and any product failures to** the designers to rapidly adapt the upstream design and manufacturing.

(ii) **Design:** while the design teams also produce most collections in advance (c.37,000 designs per year, of which c.20,000 for Zara), they work closely with the sales and merchandising teams who relay the feedback from store managers to be able to be constantly adapting the manufacturing. **Note that around 15% of a store's retail proposition changes every week and the lifespan of a model in stores is generally fifteen days**.

(iii) **Manufacturing:** this has also been organised to be able to rapidly react to changing consumer trends: **1/ nearly 60% of manufacturing is located in "proximity countries" close** to the design centres and warehouses which are all located in Spain, Portugal, Morocco, etc.), **2/ up to 50% of a collection can be designed and manufactured in the middle of a season (minimum lead time: two weeks)** whereas only 15% to 25% of the collection is programmed six months in advance (vs. 80% for H&M) and **3/ Zara has over ten own plants** to manufacture the most complex pieces (jackets, coats, etc.) within very short lead times (two weeks).

(iv) Distribution: unlike the other groups, **Inditex has a centralised organisation since 100% of the retail inventory passes through the group's warehouses in Spain.** Store managers place orders and take deliveries twice a week (lead times: max 24 hours for Europe, 48 hours for the Americas and Asia). While this centralisation may look onerous at first sight, it enables the company to ensure that the models in each store/country keep pace with the consumer trends and sales.

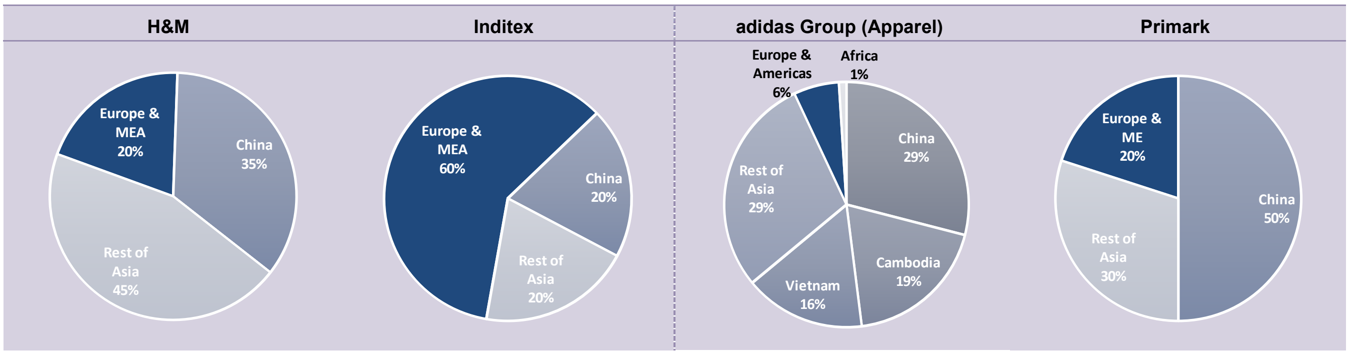
The responsiveness and adaptability of its offer to changes in fashion (and to weather conditions) enables Zara to keep its markdowns low (c.15%-20% vs. industry average of c.30%-40%) together with a very low unsold inventory rate (c.10% vs. c.15%-20% for the industry).

In our view, this responsiveness is Inditex's main competitive advantage, not only compared with traditional retailers but also with the internet players. The latter will have a wider choice of products but their sourcing mainly takes place in Asia, making them slower to adapt their offer.

In effect, most of the ready-to-wear brands locate their manufacturing in Asia, as seen in the following charts. **H&M's** sourcing is close to that of adidas Group and Primark but **Inditex** really stands out with 60% of its manufacturing in European or neighbouring countries (Turkey, Morocco, Africa).

This sourcing makes the group less sensitive to moves in the dollar (~35% of Inditex's COGS vs. >80% for H&M). Note that last year's appreciation in the dollar has had a significant impact on the gross margin rates of most textile players.

Fig. 9: Sourcing breakdown for four ready-to-wear players:



Source: Company Data; Bryan, Garnier & Co ests.

2.2. Omnichannel at H&M and Inditex

Although the two companies do not disclose their online sales we estimate that, in 2015, they represented around 7-8% of H&M sales and c.5-6% of Inditex sales. We shall see that the influence of this channel is set to increase over the next few years, but that it is even more important for these two companies to successfully implement an omnichannel strategy to minimise the risks of cannibalisation (= reduction in footfall in the physical stores), especially given their plans to open several hundred new stores a year in the medium term.

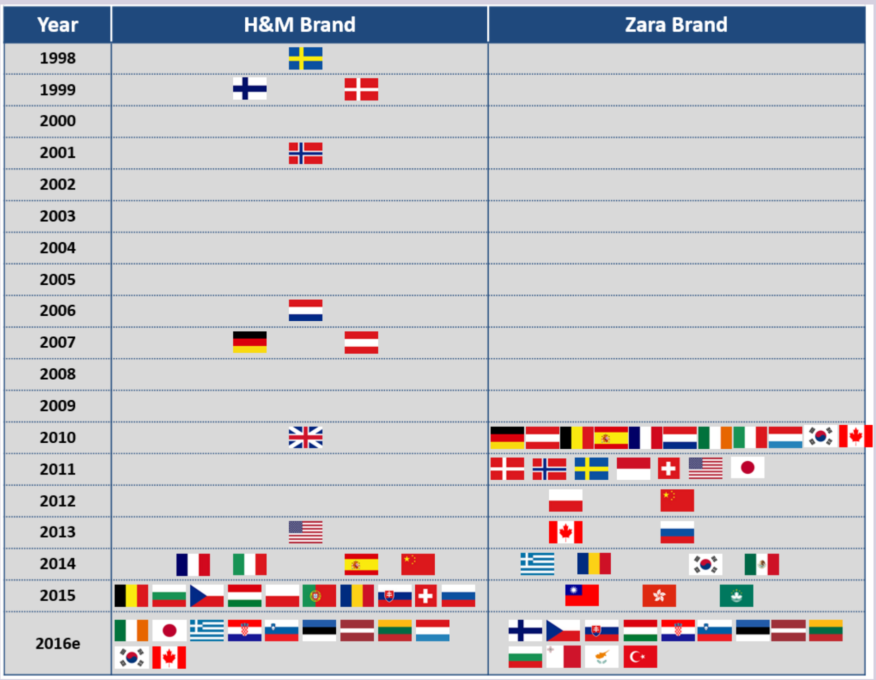
In our view, omnicanal will be a catalyst for sales growth. It will, on the other hand, be more difficult precisely to measure the contribution of the online channel to results. However, one thing is sure: not having an e-commerce platform presents a major risk. **Primark**, for example, has seen its annual comparable store growth decline by 2% (to end September) for the first time in 16 years, this decline is due to an inability to purchase online from the brand's website.

2.2.1. The online deployment continues

The fact that the proportion of e-commerce is slightly higher with H&M than with Inditex can be explained by the increased share of its eponymous brand within the group but also because H&M rolled out its first e-commerce website in 1998, i.e. twelve years before Zara. However, as of 2010, Zara launched platforms in 11 countries, their deployment having been more aggressive in recent years:

- **The H&M brand** should have an e-commerce website available in 34 countries by the end of the year (vs. 23 at end November 2015);
- **Zara** has an e-commerce website in 40 countries versus 27 at end January 2016. Note that, since April 2016, all the Inditex brands will have at least a presence in the 28 EU countries.

Fig. 10: E-commerce: H&M started 12 years before Zara:



Source: Company Data; Bryan, Garnier & Co ests.

In our view, by the end of the year, H&M and Inditex will thus have an online presence in respectively 34 and 40 markets that account for around 90% of the two groups' sales. As a result, while the opening of commercial websites in new markets will contribute to the growth of online sales, the main catalyst will be the growth in sales on the existing websites, operating in the main markets of the two companies.

Based on our 2015 online sales forecasts for H&M and Inditex, we have modelled the trends in these online sales (% of total sales) and their theoretical contribution to comparable store growth for each group over the 2016-18 period.

Fig. 11: H&M: e-commerce trend and contribution to like-for-like growth:

H&M	2015	2016e	2017e	2018e
If CAGR of 20% – Online as a % of total sales	7.0	7.9	8.7	9.5
Estimated contribution to LFL sales growth	**-**	**1.4pp**	**1.6pp**	**1.7pp**
If CAGR of 30% – Online as a % of total sales	7.0	8.5	10.2	12.1
Estimated contribution to LFL sales growth	**-**	**2.1pp**	**2.6pp**	**3.1pp**
If CAGR of 40% – Online as a % of total sales	7.0	9.2	11.8	15.2
Estimated contribution to LFL sales growth	**-**	**2.8pp**	**3.7pp**	**4.7pp**

Source: Company Data; Bryan, Garnier & Co ests.

Note that the ramp up of e-commerce seems in theory to have a lesser impact on Inditex than on H&M. This is because **(i)** it accounts for a slightly lower proportion of sales at Inditex (c.5% of sales vs. c.7% for H&M), but also because **(ii)** our growth forecasts for total sales are more cautious at H&M.

Fig. 12: Inditex: e-commerce trend and contribution to like-for-like growth:

Inditex	2015	2016e	2017e	2018e
If CAGR of 20% – Online as a % of total sales	5.0	5.4	5.8	6.4
Estimated contribution to LFL sales growth	**-**	**1.0pp**	**1.1pp**	**1.2pp**
If CAGR of 30% – Online as a % of total sales		5.9	6.9	8.1
Estimated contribution to LFL sales growth	**-**	**1.5pp**	**1.8pp**	**2.1pp**
If CAGR of 40% – Online as a % of total sales		6.3	8.0	10.1
Estimated contribution to LFL sales growth	**-**	**2.0pp**	**2.5pp**	**3.2pp**

Source: Company Data; Bryan, Garnier & Co ests.

2.2.2. Physical stores remain the focus of the growth strategy (for the moment)

Despite the growth in the online channel, stores remain the favoured point of contact with customers at both H&M and Inditex. Furthermore, **their stores and window displays are the primary vector of communication when it comes to building their reputations** since, unlike nearly all the ready-to-wear players, **these two groups spend virtually nothing on advertising and marketing: ~0% for Inditex and around 3%-4% for H&M!**

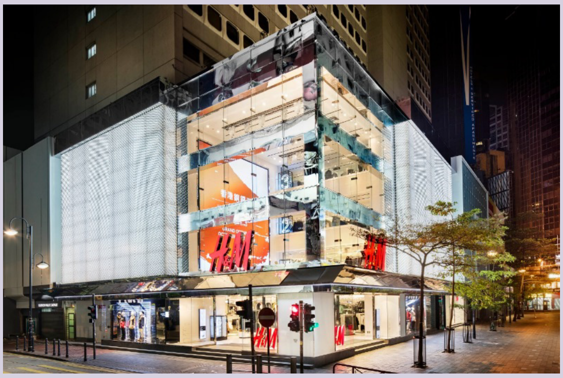
The retail strategy for the H&M and Zara brands is very similar to those of the higher-end players: concentrate in particular on the opening of flagship stores in areas where the commercial potential is greatest. As addressed later in this section, we are effectively seeing an increase in average store size year after year.

H&M: a steady 10-15% space expansion every year

H&M is maintaining its objective of growing its commercial space by 10-15%/year. However, in our view, H&M will be towards the bottom end of the range for 2016-18 (c.10%), nonetheless implying the opening of at least 420 stores over the same period:

(i) **H&M brand:** brand expansion will represent a little under 80% of the total openings for the period. This brand naturally has the potential to conquer new markets in addition to the more than 61 countries where it is already present but also to reinforce several of the Top 10 markets for which the market share is below 0.5%, like the **US** (445 DOS at end August) and where the brand is enjoying more rapid success than Inditex, and **China** (400 DOS). Note that the average size of the new stores (>1,500m²) is higher than the historic average (1,300-1,400m²), driven notably by the flagships which often exceed 3,000m² (*see Fig 13*) since these new stores dedicate space to the home (H&M Home) and beauty (H&M Beauty) in addition to the usual categories.

Fig. 13: Two examples of H&M flagships opened in 2015:

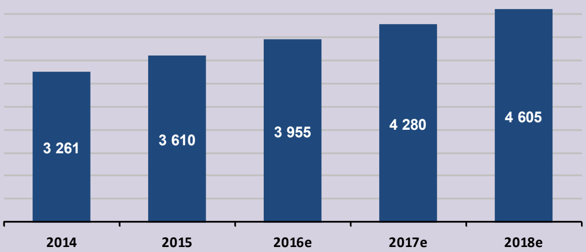
H&M's largest store in the world (Herald Square, NYC): c.5,800 sqm	H&M's largest store in Asia (Causeway Bay, HK): c.4,400 sqm
	

Source: Company Data; Bryan, Garnier & Co

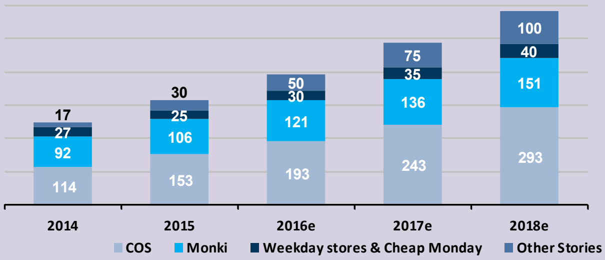
(ii) **COS:** Its upscale positioning in mass market retailing offers attractive growth prospects when faced with the move up market represented by the 'affordable luxury' brands. The brand has already shown that it could diversify internationally since it numbered 177 DOS in more than 30 countries at the end of August, but can still develop along with brands such as **Banana Republic** (Gap, 668 DOS of which 607 in North America) and **Massimo Dutti** (Inditex, 749 DOS) which also operate in this market segment. Note that the COS stores and those of H&M's four other brands have a smaller average floor area: we estimate this figure to be around 450m² for **COS**, **Weekday** (+**Cheap Monday**) and **& Other Stories** and 275m² for **Monki**.

Fig. 14: Trend in the H&M group's store network (2014-18e):

H&M Brand



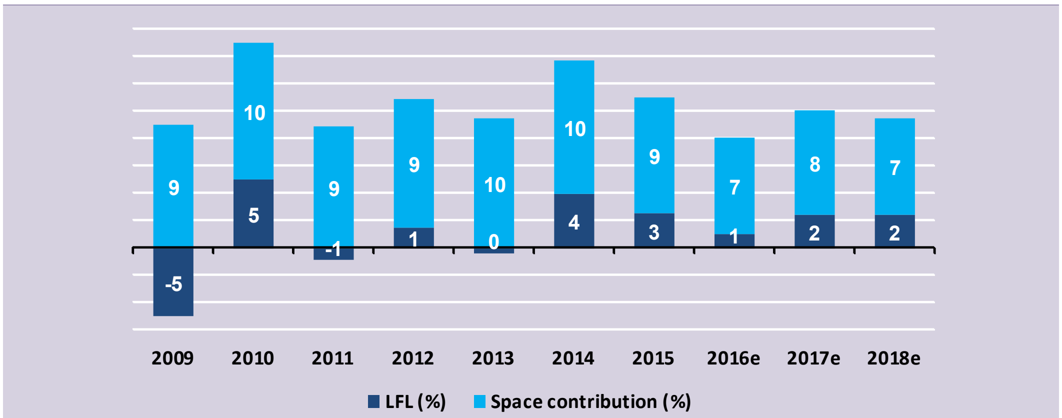
Other Brands:



Source: Company Data; Bryan, Garnier & Co

H&M's FX-n growth trend since 2009 is presented in the following chart. Between 2016 and 2018, we thus forecast around 10% growth in commercial space (i.e. the bottom end of the medium-term guidance of +10-15%), in addition to productivity of 60% in 2016, followed by 70% in 2017-18, i.e. a space contribution of between 7% and 8% over the period.

Fig. 15: Trend in H&M's FX-n growth rate (2009-2018e, in %):



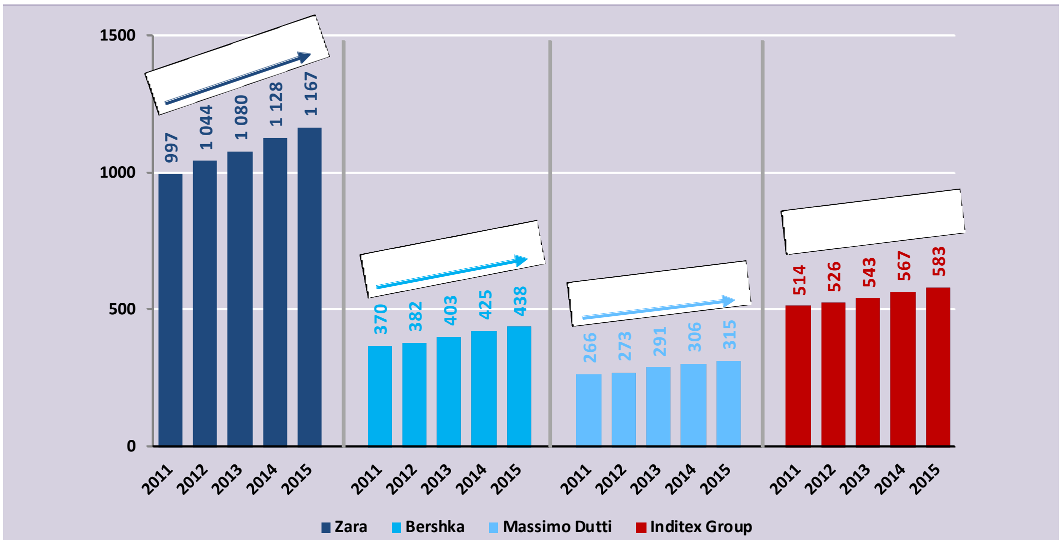
Source: Company Data; Bryan, Garnier & Co ests.

Inditex: towards fewer openings but the size of the stores is also increasing

Inversely to H&M, at the beginning of the year, Inditex reduced its medium-term growth target for space expansion, which now stands at +6-8%/year vs. +8-10% previously. While it is true that the Spanish company already has more stores than its leading competitor (FY15: 7,000 stores versus 3,924 for H&M), the CEO has also explained that, taking into account the growth of the online channel, this new guidance reflected the group's plans to open fewer points of sale but larger in size.

The following chart shows that, for the three leading Inditex brands, **the average floor area of the stores increased by 4% over the 2011-15 period and by more than 3% for the Inditex group.**

Fig. 16: Average floor area of Inditex stores (in m²):

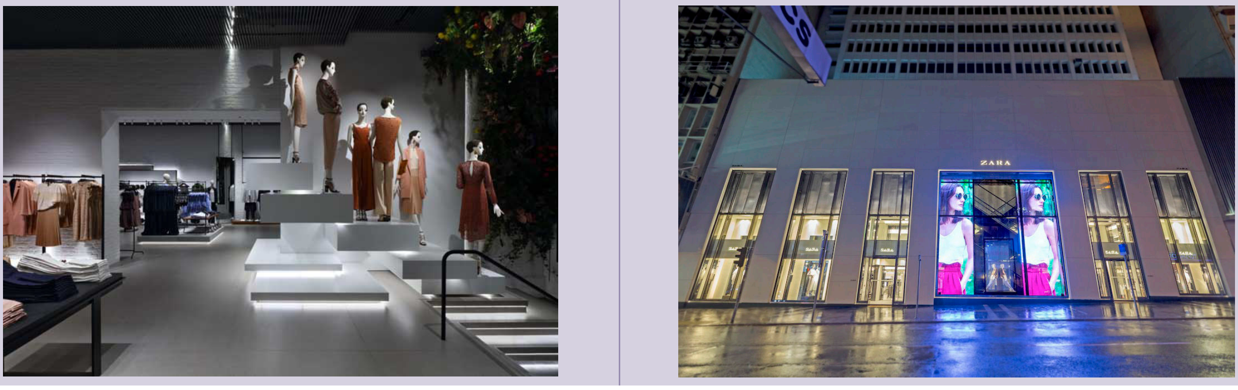


Source: Company Data; Bryan, Garnier & Co ests.

In March 2016, the Zara brand opened its new flagship store in New York's SoHo district (4,400m²) while the brand's largest store can be found in Hong Kong (5,100m²). It is interesting to note that Zara (and H&M) continues to open stores in markets like the United States and Mainland China where numerous brands are seeing a decline in footfall in their stores.

Fig. 17: Two examples of Zara flagship stores:

Zara's flagship store in SoHo (NYC): 4,400 sqm	Zara's flagship store in Hong Kong (Queen's Road): 5,100 sqm



Source: Company Data; Bryan, Garnier & Co

H&M and Inditex: priority given to the best locations

The following table lists the world's ten most expensive retail locations, which are also highly sought after by luxury brands. Note that, despite their 'value' positioning, H&M and Zara do not hesitate to open stores in the same streets!

In addition to the need to take advantage of the natural traffic in these commercial thoroughfares, these flagships play a key role in communication and the development of the reputation of these brands which spend very little on advertising (or even nothing in the case of Inditex!). In our view, this shows the decompartmentalisation of consumer purchasing habits; they may purchase luxury products but they are also customers of H&M and/or Zara. This trend is accelerating as the Millennial generation comes to prominence.

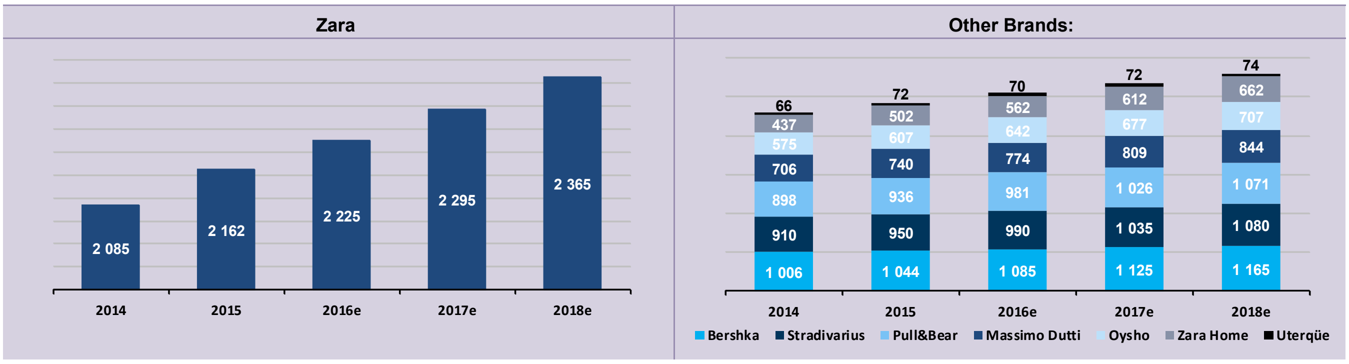
Fig. 18: The H&M and Zara stores are close to those of the luxury brands:

Rank	City	Street	H&M	Zara	Comments
1	**New York**	Upper 5th Avenue (49th-60th)	✓	✓	H&M store is on 5th Av & 48th
2	**Hong-Kong**	Causeway Bay	✓	✓	
3	**Paris**	Av. des Champs Elysées	✓	✓	Two Zara stores + 1 Zara Home
4	**London**	New Bond Street	✓	✓	H&M and Zara stores are on the corner of Oxford St. and New Bond St.
5	**Milan**	Via Montenapoleone	✗	✗	
6	**Sydney**	Pitt Street Mall	✓	✓	
7	**Zurich**	Bahnhofstrasse	✓	✓	
8	**Tokyo**	The Ginza	✓	✓	
9	**Seoul**	Myeongdong	✓	✓	
10	**Vienna**	Kohlmarkt	✗	✗	No Zara store but Massimo Dutti is there

Source: Cushman & Wakefield, Company Data, Bryan, Garnier & Co.

Based on our forecasts, as shown in the charts on the following page, the Inditex group is expected to have nearly 8,000 stores by the end of the 2018 fiscal year (January 2019), implying the opening of around 320 points of sales (of which 70 for the Zara brand alone) per year.

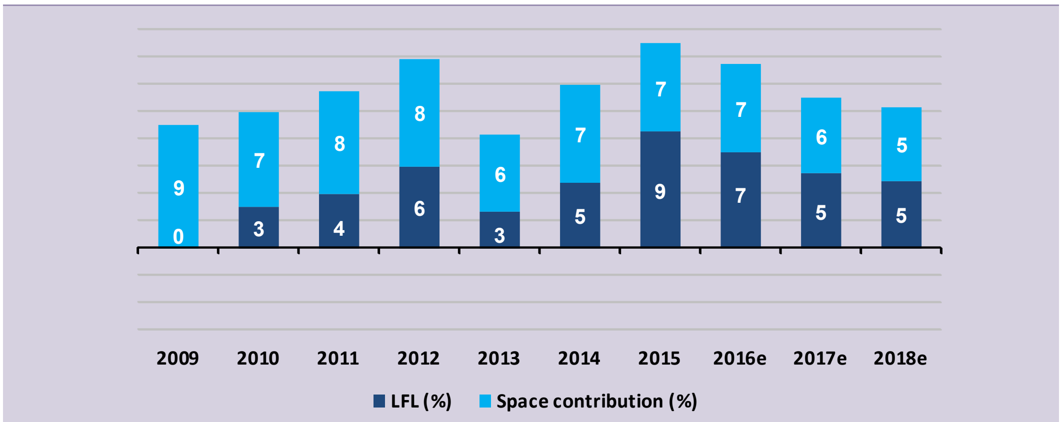
Fig. 19: Trend in the Inditex store network (2014-18e):



Source: Company Data; Bryan, Garnier & Co

The reduction in the growth target for commercial space is reflected in our space contribution forecasts below (c.6% in 2017 and c.5% on 2018), which assume productivity linked to the additional floor area of 75% over the 2017-18 period.

Fig. 20: Trend in Inditex FX-n growth (2009-2018e, in %):



Source: Company Data; Bryan, Garnier & Co ests.

2.2.3. What's the situation with 'Click-and-Collect'?

The **Inditex management** recently unveiled two interesting trends**: one third of online orders are collected in store and nearly two-thirds of returns are made in store.** H&M has not disclosed any information on this subject but, since its online channel is slightly larger than that of Inditex as a percentage of sales, in our view the Swedish company must be witnessing the same phenomenon with its customers.

These consumer habits thus justify the relevance of the omnichannel model, in which stores remain an obligatory step, representing two important advantages for the brands:

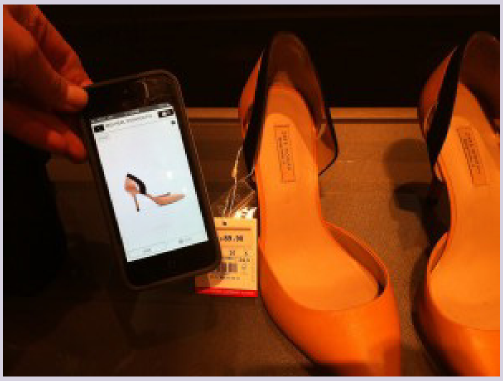
(i) **Logistics costs remain under control** and, in particular, those associated with returns (such costs can represent up to 14-15% of sales for players like ASOS and Zalando)

(ii) **New purchasing opportunities:** customer visits to stores effectively represent an additional opportunity to sell them one or several additional items and enhance the purchasing experience.

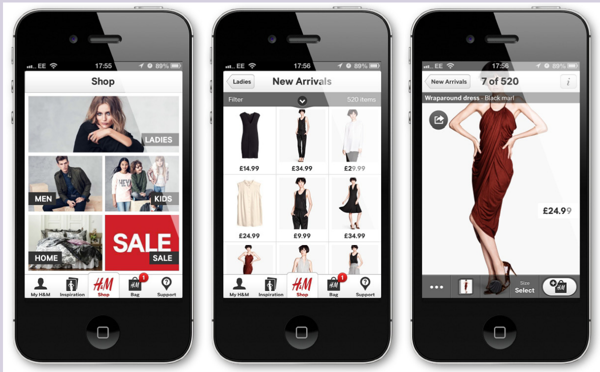
The two groups have developed mobile applications to give their customers continuity with the physical store. Customers obviously have the opportunity to purchase online using their smartphones but the main aim of these applications is to lure their users to one of the brand's stores. They receive promotional offers and alerts on the arrival of new products. In the event an article is not available in the store, visitors can then scan the barcodes and immediately verify online availability.

Fig. 21: Mobile applications to attract footfall to stores:

Zara App: scan any barcode to check in store availability



H&M App: buy online and receive push offers



Source: Company Data; Bryan, Garnier & Co

The 'Click and Collect' service illustrates the roll-out of an omnichannel strategy by the brands, even if its implementation requires significant supply chain investment to ensure the link between the warehouses and the store network. To contend with these additional costs, below a minimum purchase amount, a charge is made for the 'Click and Collect' service by some retailers like **John Lewis** (40% of its sales on the internet) which has decided to charge GBP2 for any orders worth less than GBP30 while **Tesco** charges an extra GBP4 for orders below GBP40.

We have compared the delivery and return options offered by **H&M/Zara** and those of **ASOS** and **Zalando**, two leading mid-range fashion e-retailers. The following table shows that H&M and Zara offer virtually identical services to those of the online players. On the other hand, in our view, H&M et Zara have a significant advantage with their stores. They can offer a better customer experience within the framework of 'click-and-collect' (verification of sizes, fitting rooms, advice from sales staff, additional purchases, etc.) and returns (reason for the return, immediate exchange, orientation/advice on an alternative solution, etc.)

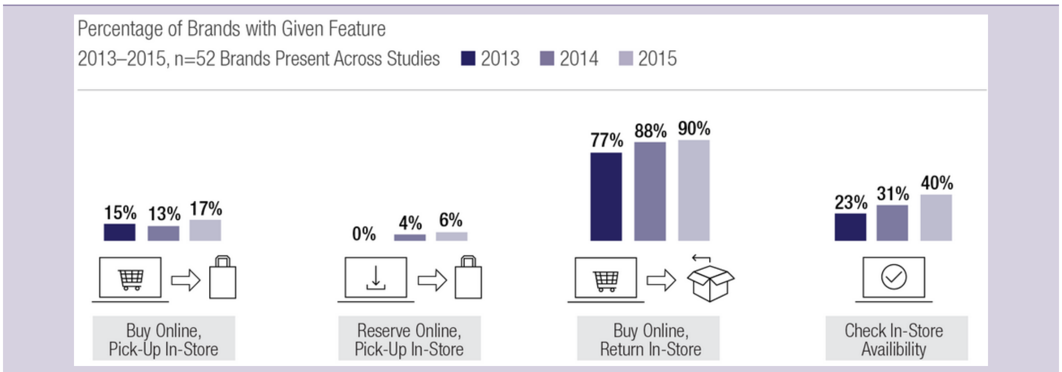
Fig. 22: Delivery and return options on UK commercial websites:

Delivery & Returns	H&M brand	Zara (Inditex)	ASOS	Zalando
Free Delivery?	YES – Free standard delivery (2-3 days) **over GBP50**	YES – Free standard delivery (2-3 days) **over GBP50**	YES – Free standard delivery (2-3 days) **over GBP20**	YES – Free standard delivery (2-4 days) and **no minimum**
Next Day Delivery?	YES – Fee of GBP5.99	YES – Fee of GBP9.95	YES – Fee of GBP5.95 and free over GBP100	YES – Fee of GBP5.95
Click-and-Collect option?	YES – **Free**	YES – Free but not available everywhere (e.g. France)	YES – Fee of GBP5.95 and free over GBP100	YES, in a Parcel Shop – **Free**
Returns for online orders	YES – **Free**: all returns must be made within **1 month**	YES – **Free**: all returns must be made within **1 month**	YES – **Free**: all returns must be made within **28 days**	YES – **Free**: all returns must be made within **100 days**

Source: Company Data, Bryan, Garnier & Co.

Paradoxically, while 90% of the textile brands reviewed by the digital marketing consultancy L2 already enable their customers to return their products in stores (thereby avoiding sizeable logistics costs), they offer very few additional services like online reservation/purchasing + in-store product collection which require substantial investment at the level of the supply chain (synchronisation of inventory management, etc.). **H&M and Inditex are thus some way ahead of their industry when it comes to the omnichannel strategy.**

Fig. 23: Omnichannel strategy: H&M and Inditex are ahead relative to the rest of the industry:



Source: L2 Digital IQ Index

2.2.4. The social media: H&M is more active than Zara

The following table shows that H&M is more committed to the social media than its Spanish competitor, and particularly Facebook and Twitter. The two brands use the social media to unveil their new collections and reinforce the links with customers while minimising marketing expenditure, especially in the case of Zara.

However, in our view, H&M's strong presence on these platforms may be explained by the fact that it regularly calls on muses (e.g.: Gisele Bündchen, David Beckham, etc.), particularly when it comes to promoting its 'capsule' collections which create an enormous buzz on the internet.

Fig. 24: The brands and their presence on the social media:

Social Media	H&M brand	Zara	adidas	ASOS	Gap brand	Mango	Nike	Primark	Zalando
Facebook *(Likes)*	28.8m	24.7m	25m & 29.1m *	4.4m	8.2m	10.3m	27.2m	4.7m	4.1m
Instagram *(Followers)*	17.4m	14.4m	11.4m & 15.5m *	5.1m	1.5m	5.8m	65.9m	3.6m	334k
Pinterest *(Followers)*	295k	302k	82k	534k	140k	65k	Nike Women: 10k	56k	DE: 7.5k FR: 3k
Twitter *(Followers)*	8.19m	1.19m	2.9m & 3.5m *	1.0m	675k	774k	6.66m	182k	DE: 17k FR: 16k
Youtube *(Views)*	117.8m	3.2m	72.3m & 51.3m *	23.3m	17.7m	10m	179.3m	3.2m	15.6m

* = *adidas Originals*

Source: Company Data, Bryan, Garnier & Co.

2.3. H&M and Inditex: our 2016-18 sales growth forecasts

Although the global economic environment remains weak, we expect H&M (2016-18e CAGR: +8.7%) and Inditex (2016-18e CAGR: +10.8%) to deliver strong sales growth. The two groups will continue to pursue their strategies based on: **(i)** their ability to execute well and outperform the global market **(ii)** the ramp up of omnichannel and **(iii)** store openings.

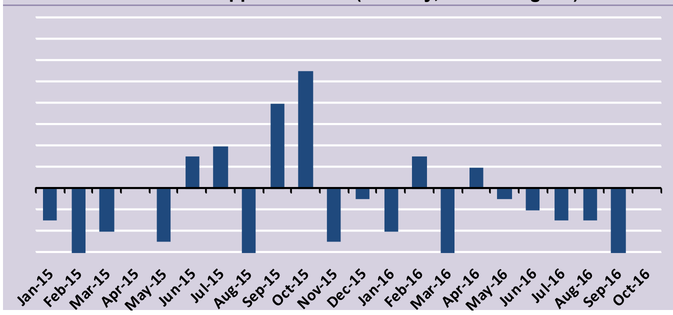
2.3.1. How are they performing in their respective leading markets?

H&M generates 18% of sales in Germany (market share: c.5%) and Spain also accounts for 18% of Inditex sales (market share: c.15%). In these markets, which are relatively mature for each of the groups and despite different market conditions, this analysis shows if the strategy and execution are good, something that will naturally have an incidence on their like-for-like growth.

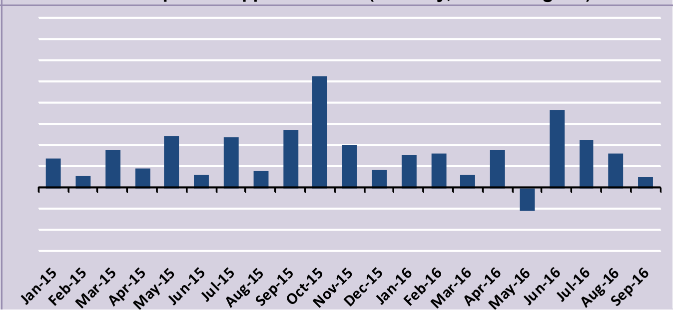
The following two charts highlight the more favourable market conditions for clothing in Spain relative to Germany, despite a slight downturn in recent months explained by Spanish concerns given the absence of a government although this political crisis was resolved in late October. The German market remains negatively affected by cautious German consumers and somewhat unfavourable weather conditions relative to the timing for the unveiling of collections (no real winter early in the year and very little sun over the summer).

Fig. 25: Trend in the ready-to-wear market in Germany and Spain:

H&M: German Apparel Market (monthly, YoY change %):



Inditex: Spanish Apparel Market (monthly, YoY change %):

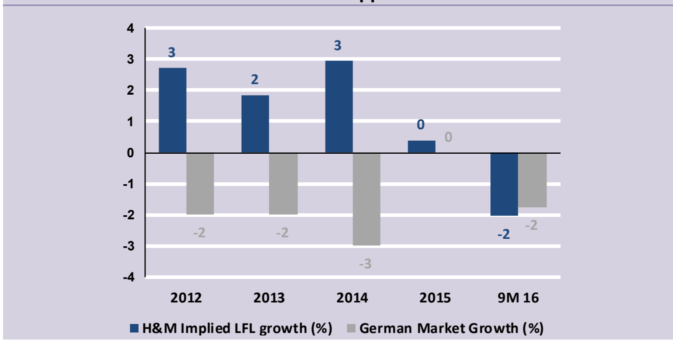


Source: Textilwirtschaft, INE, Bryan, Garnier & Co ests.

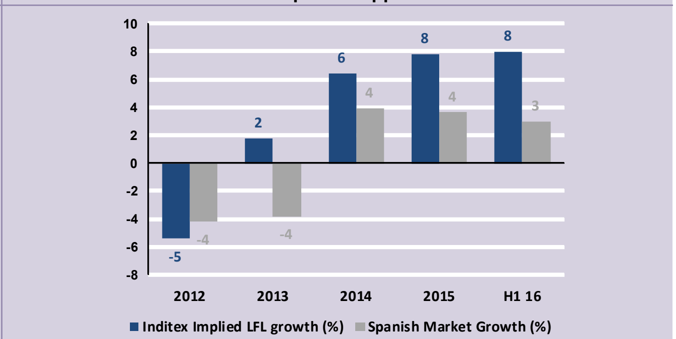
While **H&M** has regularly outperformed the German market in recent years, this has not been the case this year with a like-for-like decline of 2% given a difficult German market and the increasing competition from Primark (21 stores in Germany), whereas **Inditex** has maintained very strong momentum in Spain (BG estimate: c.+8%e vs the domestic market at c. +3%).

Fig. 26: Implied LFL performances vs the German and Spanish markets:

H&M vs. German Apparel Market



Inditex vs. Spanish Apparel Market



Source: Textilwirtschaft, INE, Bryan, Garnier & Co ests.

2.3.2. Responsiveness to changing trends: Inditex has the advantage

As seen in section 2.1.4, H&M's supply chain and sourcing are fairly traditional and similar to those of the rest of the industry: a 'top-down' approach (with the design team deciding the orientation for the collection) and **manufacturing mainly located in Asia (c.80%).**

As a result, around 80% of the collections are designed and ordered six months prior to their delivery to the stores, **making H&M, like the industry, sensitive to any changes in trend (fashion, consumers. etc.) and weather conditions,** as seen in the following table:

Fig. 27: H&M sales are sensitive to unfavourable weather conditions:

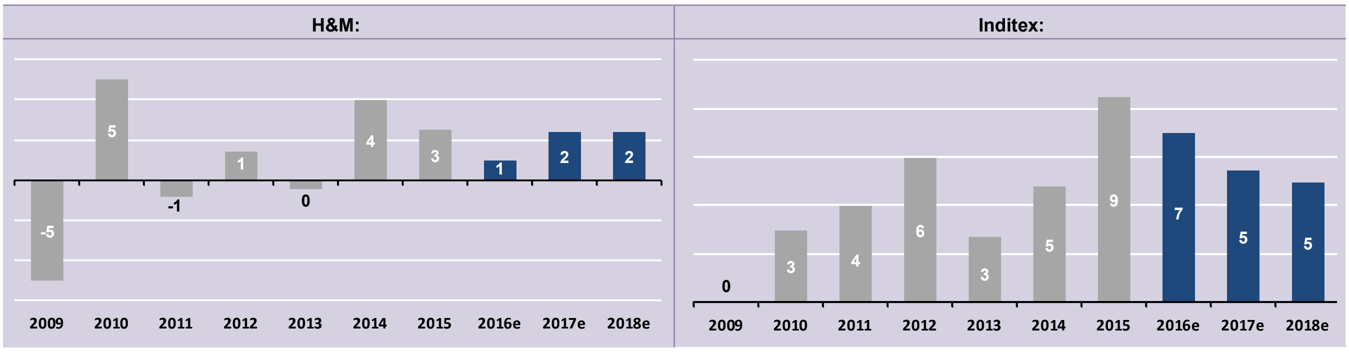
Month	FX-n growth and implied LFL (%)	H&M comment:
March 2016	+2% / -6%	*"Weather conditions in March last year were favourable for the season, while the opposite is true this year"*
April 2016	+5% / -3%	*"The cold spring which continued into April in several of H&M's large markets has had an unfavourable impact on sales of transitional garments"*
August 2016	+7% / -1%	*"Sales development in August had a very good start. But sales were negatively affected in the second half of the month by exceptionally hot weather in most of the group's markets"*
September 2016	+1% / -7%	*"The unseasonably warm weather in September had a very negative impact on the H&M group's sales in the month of September".*

Source: Company Data, Bryan, Garnier & Co ests.

Right from the inception, the Inditex group was built around a highly agile and responsive supply chain: **1/** every store manager gives product feedbacks to store product teams and place an order with the central logistics DCs twice a week, **it is customers who orient the design team** in terms of fashion trends, **2/** nearly **60% of manufacturing is based 'in proximity'** (i.e. mainly in Spain, Portugal and Morocco), enabling the: **3/ design and manufacturing of c. 50% of a collection in the middle of a season** (this figure is particularly true for the Zara brand) and **4/ its delivery within two weeks of the original design.**

Inditex is thus less exposed to shifts in fashion and to weather conditions which are rarely mentioned in its communication. It does not disclose monthly like-for-like growth figures but, during the H1 16 2016 results released on 21 September, Inditex stipulated that sales had increased by 13% on a FX-n basis over the first seven weeks of the first half (1 August => 18 September), i.e. estimated LFL growth of 7-8%.

Fig. 28: Trend in like-for-like growth at H&M and Inditex (2009-18e, in %):



Source: Company Data, Bryan, Garnier & Co ests.

2.3.3. Growth of online sales and price harmonisation under way

Like numerous brands, H&M and Inditex have launched a strategy to harmonise prices at global level. However, the rapid price review in the following table reveals that H&M's pricing strategy is more homogeneous than that of Zara.

Note that, due to sourcing mostly based in Asia, **H&M** orders substantial amounts of products destined to be sold in virtually all of its markets, making the pricing strategy more transparent but potentially also exposing the company to an exchange rate risk if the brand cannot/wants to increase its prices in the event of a depreciation in some currencies like, for example, the GBP.

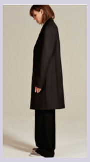
Fig. 29: A reduced price gap at H&M…:

		Spain	UK	France	Germany	China	US
Cold Shoulder Dress Price in local currency		EUR39.99	GBP29.99	EUR39.99	EUR39.99	CNY349	USD49.99
Price in EUR (base 100 = Spain)		100	86	100	100	118	115
Wool-blend Coat Price in local currency		EUR99	GBP79.99	EUR99	EUR99	CNY899	USD129
Price in EUR (base 100 = Spain)		100	99	100	100	123	120

Source: HM.com (14 November 2016), Bryan, Garnier & Co ests

At **Zara**, the price differential remains substantial even within the euro zone (+33% in France and Germany vs. Spain) even if it has been reduced with some countries thanks to currency exchange rates (GBP, CNY). Although most of the collections are destined for the whole world, the brand adapts the volumes and size of some collections as a function of the demand and trends in each country, making the price gap less of an issue in the short term. However, the Inditex group plans to pursue these harmonisation efforts over the next few years.

Fig. 30: … while it remains substantial at Zara:

		Spain	UK	France	Germany	China	US
Knot Skirt Dress Price in local currency		EUR29.95	GBP29.99	EUR39.95	EUR39.95	CNY299	USD49.90
Price in EUR (base 100 = Spain)		100	115	133	133	135	153
Long Masculine Coat Price in local currency		EUR149	GBP179	EUR199	EUR199	CNY1,999	USD299
Price in EUR (base 100 = Spain)		100	138	133	133	181	184

Source: Zara.com (14 November 2016), Bryan, Garnier & Co ests

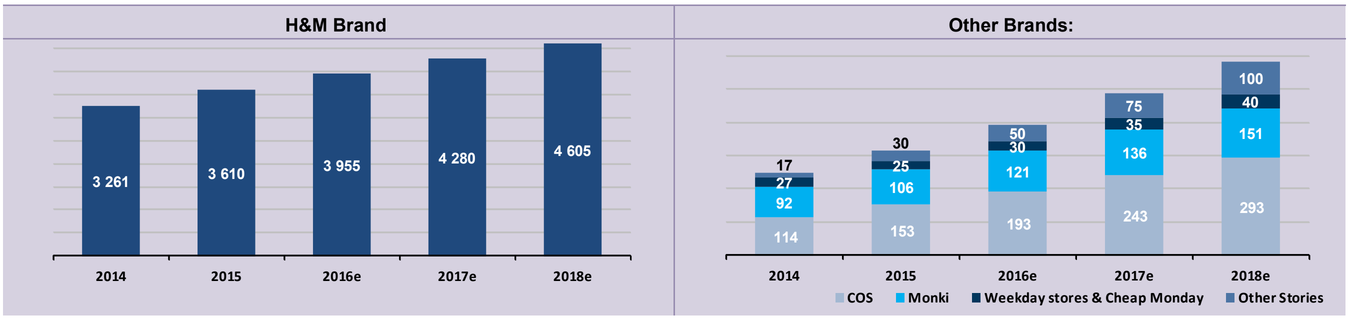
Based on our forecasts, in 2016 online sales should represent around 8% of H&M's sales (*see Fig. 11*:) and 5.5% at Inditex (*see Fig. 12*:). The growth of this channel is likely to make a positive contribution to the two groups' like-for-like growth: based on a CAGR of 20%, we derive a theoretical positive impact for H&M and Inditex of respectively 2 percentage points and 1 percentage point as of 2018.

2.3.4. 2016-18: towards a slower space expansion

Although H&M and Inditex had already numbered a respective 3,924 and 7,013 stores in 2015, the 'mass market' or 'accessible fashion' segment of the worldwide ready-to-wear market is very large (c.EUR1,100bn) and highly fragmented since the two flagship H&M and Zara brands are estimated to command respective market shares of 1.7% and 1.4%. Hence, they still have the option to expand their store networks.

H&M has maintained its target of increasing its space by 10% to 15% per year. **Our forecasts are based on the bottom of this range (c.10%), implying the opening of at least 420 stores over the 2016-18 period, not including the launch of new concepts.** At the end of September, the CEO of H&M reiterated that one or even two new brands *'would be completely different from the six existing brands'* would be launched in 2017, potentially implying a larger new store opening programme than in our assumptions.

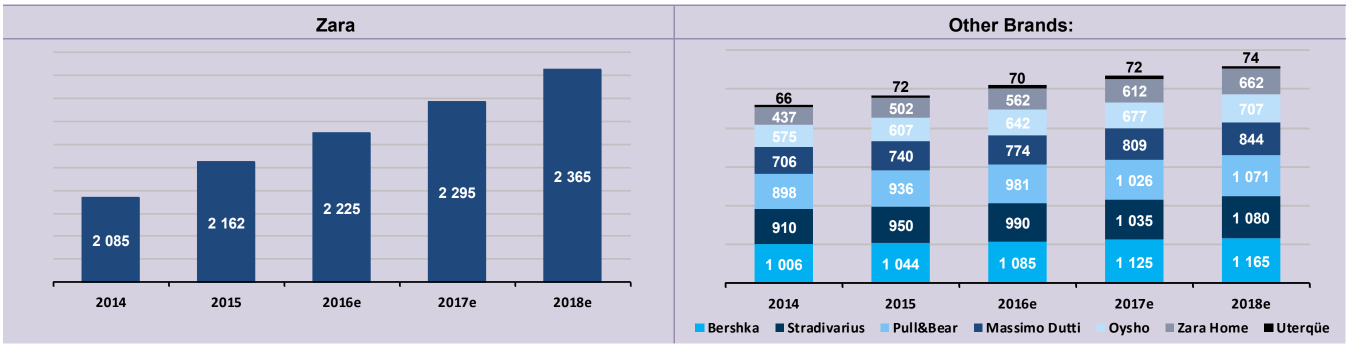
Fig. 31: Trend in the H&M group's store network (2014-18e):



Source: Company Data; Bryan, Garnier & Co

Inversely, early this year **Inditex reduced its MT growth outlook for space expansion (+6-8% per annum against +8-10% previously),** i.e. around **320 new stores per year** on our forecasts. To justify this reduction in guidance, the CEO mentioned the ramp-up of the online channel and plans to open fewer stores but larger in size. In our view, **this strategy would make the cost structure less exposed to a possible "operating deleverage"** (i.e. weak LFL growth, combined with opex inflation).

Fig. 32: Trend in the Inditex store network (2014-18e):

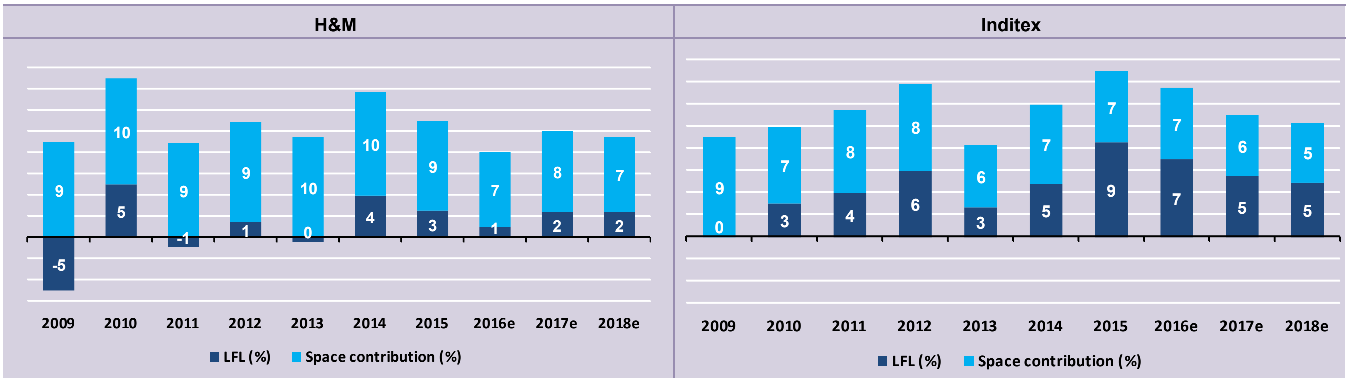


Source: Company Data; Bryan, Garnier & Co

Between 2016 and 2018, we are thus forecasting space expansion growth approaching 10% for **H&M** (medium-term target of +10-15%) and return on new space of 60% in 2016, followed by 70% in 2017-18, i.e. a space contribution of between 7% and 8% over the period. As regards **Inditex**, the slowdown in the growth target for space expansion is reflected in our floor area forecasts below (c.6% in 2017 and c.5% in 2018), implying return on new space of 75% over the 2017-18 period.

For the two companies, the space effect contribution will be lower than in previous years, as shown in the following charts. In our view, investors will again be more focused on like-for-like growth!

Fig. 33: H&M and Inditex: trend in FX-n growth (2009-18e, in %):



Source: Company Data; Bryan, Garnier & Co ests.

2.4. Our profitability forecasts for 2016-18

H&M and Inditex continue to invest and open stores within an increasingly competitive industry and with very limited pricing power since they operate in the mass market/value segment of clothing. In this section, we thus analyse the risk factors (sourcing, currency, price deflation, etc.) that could negatively impact profitability levels and the levers with the potential to increase them.

2.4.1. The flexible supply chain is also beneficial for gross margin rates

As highlighted in 2.3.2 concerning the difference in agility at the level of the supply chain, **H&M's** supply chain is close to the industry norms (lead times of six months for 80% of production), making it sensitive to changing trends (fashion, consumption, etc.) and weather conditions. H&M, which generally discloses the impact at promotional level, stipulated that the growing share of markdowns had a 25bp negative effect in 2015 and, in our view, the magnitude should be similar for 2016.

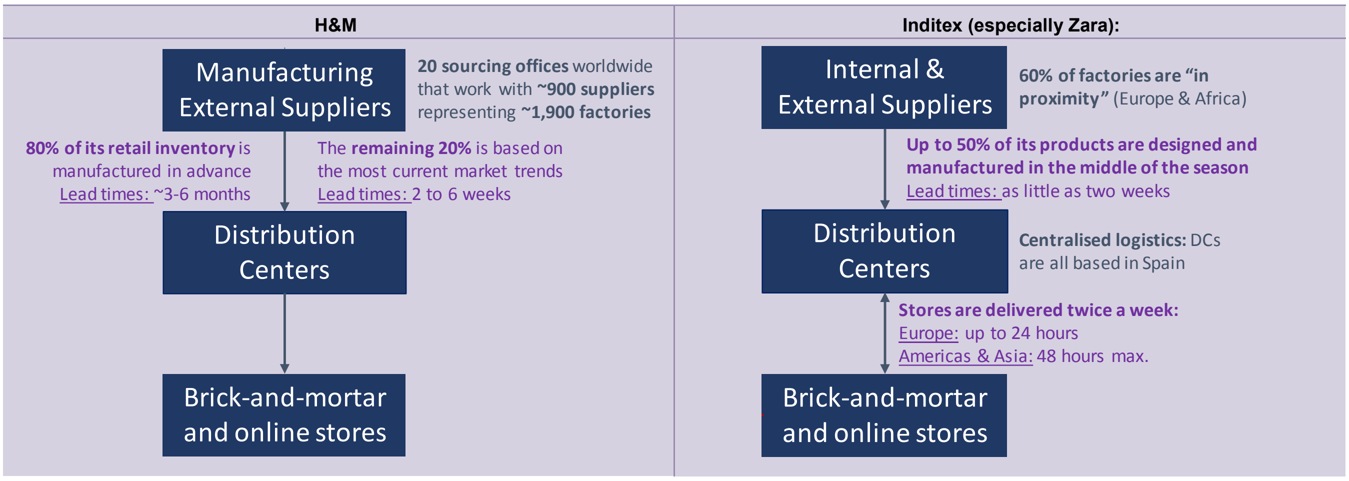
Inditex's greater flexibility allowing at least 50% of its manufacturing within a maximum lead time of a few weeks, enables the company to be highly responsive to any changes in trend linked to consumers or weather conditions. **This shortening of lead times can also be found in the stores since any one article remains in the store for no more than fifteen days on average and is not the subject of replenishments.** This approach offers a number of advantages relative to the rest of the industry:

(i) **Unsold items represent less than 10% of its inventory whereas the industry average is closer to 20%.**

(ii) **The return rate is 25% to 30% against an average of 50% for the industry,** making the management of returned products less complex and cheaper (for the online channel) especially when nearly two-thirds of returns are made in the group's stores.

(iii) **The positive consequence is that around 80% to 85% of Inditex products are sold at full price against a 60% to 70% average for the industry.**

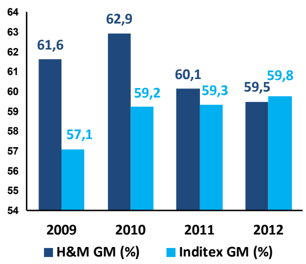
Fig. 34: The shorter the manufacturing lead times, the better it is!



Source: Bryan, Garnier & Co ests.

2.4.2. The raw materials environment is not a threat in the short term

Trend in gross margin rates (2009-12, in %):



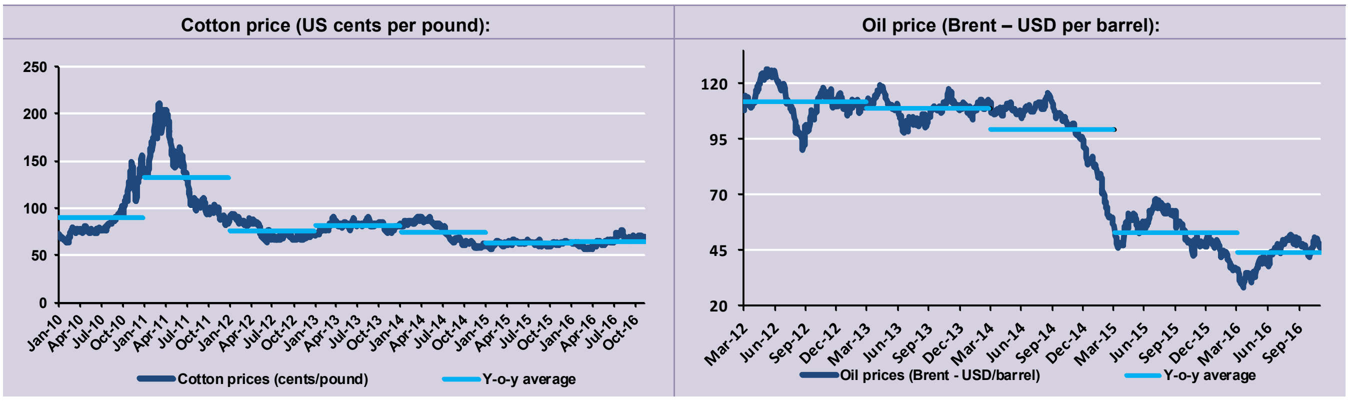
Source: Company Data

The main raw material to which H&M and Inditex are exposed is clearly **cotton**. Since procurement contracts are generally negotiated six months in advance (80% of H&M manufacturing, up to 50% of Inditex manufacturing), **any move in the cotton price has a lag effect of around three (Inditex) to six months (H&M) on the gross margin rate.**

As seen in the lhs chart below (*Fig. 35*: , the last time the cotton price soared higher was in 2010-11 with a material negative impact on the gross margin rate at H&M and Inditex in 2011-12 (see chart on the left). Unlike many competitors (particularly sports equipment companies) H&M and Inditex chose not to pass on this inflation in higher prices although the latter managed to absorb the shock rather more effectively thanks to its structural flexibility and vertical integration (productivity/efficiency gains offsetting the increase in sourcing costs).

Oil prices also need to be watched in that it can have two repercussions: **(i)** it can influence the prices of other materials used in the manufacturing of clothing and footwear (nylon, rubber, etc.) and **(ii)** have an impact on logistics costs. The two charts below show that, in 2017, the two companies need not fear a major increase in their COGS linked to raw materials and transport.

Fig. 35: The raw materials environment is not a threat in the short term:



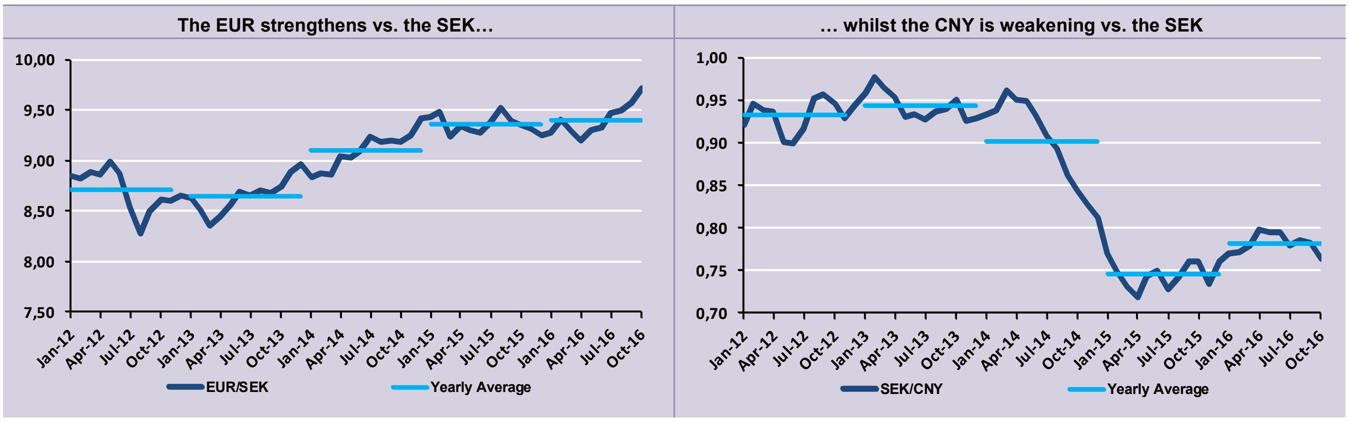
Source: Datastream; Bryan, Garnier & Co ests.

2.4.3. A progressive lull at currency level

As for all companies with a significant proportion of their manufacturing in Asia, **H&M** had to cope with the highly unfavourable hedging conditions resulting from the soaring dollar in 2015. On our calculations and the indications given by the management, the strength of the dollar is likely to have led to a negative impact of between 200bp and 500bp on the gross margin rate over the last six quarters (Q2 15 => Q3 16).

In our view, the pressure on the gross margin rate should still represent a modest negative in Q4 16 (to end November 2016) but, thanks to a slight depreciation in the CNY combined with a stabilisation in the EUR/USD exchange rate (*see Fig. 36: on the following page*), this impact could reverse as of Q1 17 (to end February 2017). The depreciation in the Swedish krona relative to the euro, which admittedly benefits sales (positive currency conversion impact since 43% of sales) does, however, need to be watched although around 20% of manufacturing is invoiced in this currency.

Fig. 36: Currencies: the worst is behind H&M:

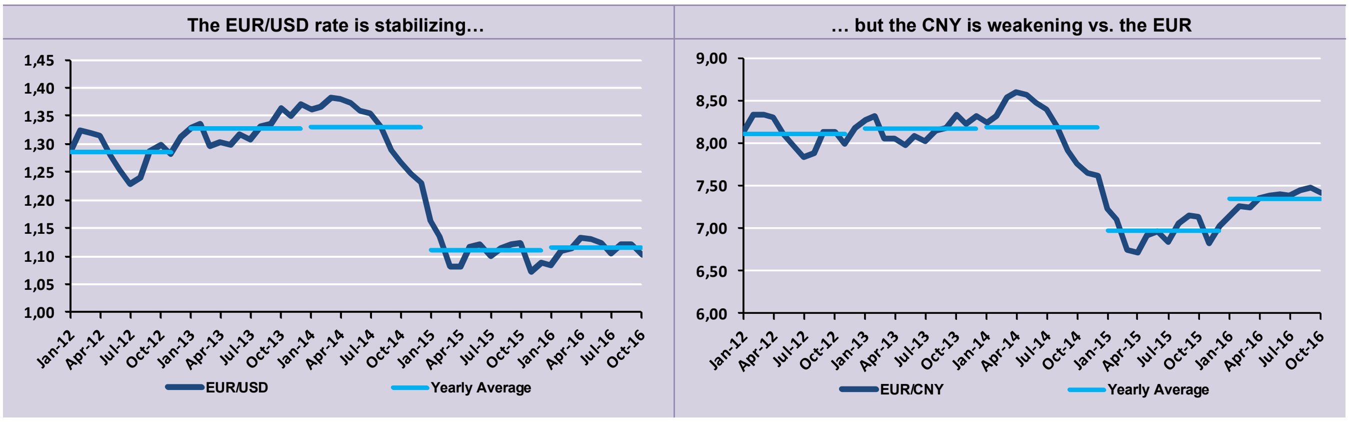


Source: Datastream; Bryan, Garnier & Co ests.

Thanks to manufacturing mostly located in "proximity" countries, around 60%-65% of Inditex's COGS is euro denominated and the remainder (c.35%-40%) is purchased in USD, versus c.80% for the rest of the industry. The transaction risk linked to the dollar is thus markedly lower at Inditex than with its competitors.

Due to its centralisation strategy (= all the HQs and logistics DCs are located in Spain) the bulk operating costs are in euros. **According to our calculations, around 60% of the cost structure (COGS and OPEX) is likely to be euro denominated, compared with c.45% of sales.** Everything else being equal, **a 10% reduction in the euro would lead to a theoretical 5.5% impact on sales and 18% on EBIT.** As a result, Inditex is more sensitive to the currency conversion risk.

Fig. 37: Even if Inditex were less impacted, the environment is also improving:



Source: Datastream; Bryan, Garnier & Co ests.

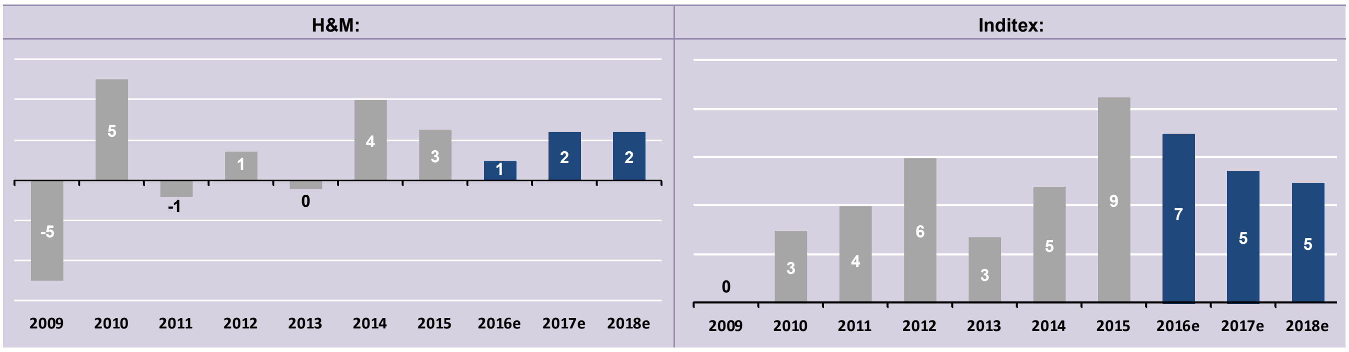
2.4.4. OPEX: the sources of operational leverage are mostly found in the stores

Benefiting from the store opening effect is fine for driving sales growth but posting comparable store growth is even better, especially at the level of profitability. Furthermore, remember that H&M and Inditex should see their space contribution decelerates slightly over the next few years, meaning that investor attention will turn more to performance on a LFL basis.

This issue of operational leverage is naturally shared by all the brands that have opted to control their distribution (headed by the luxury goods companies), but it is even more true for H&M and Inditex who are continuing to expand their store networks. Furthermore, more selective locations for stores and a progressively larger average store size are leading to some inflation in operating costs which must be contained.

Against this backdrop, we would be more comfortable with Inditex which is expected to post higher like-for-like growth performances than H&M over the 2016-18 period, as shown in the following charts.

Fig. 38: Trend in like-for-like growth at H&M and Inditex (2009-18e, in %):

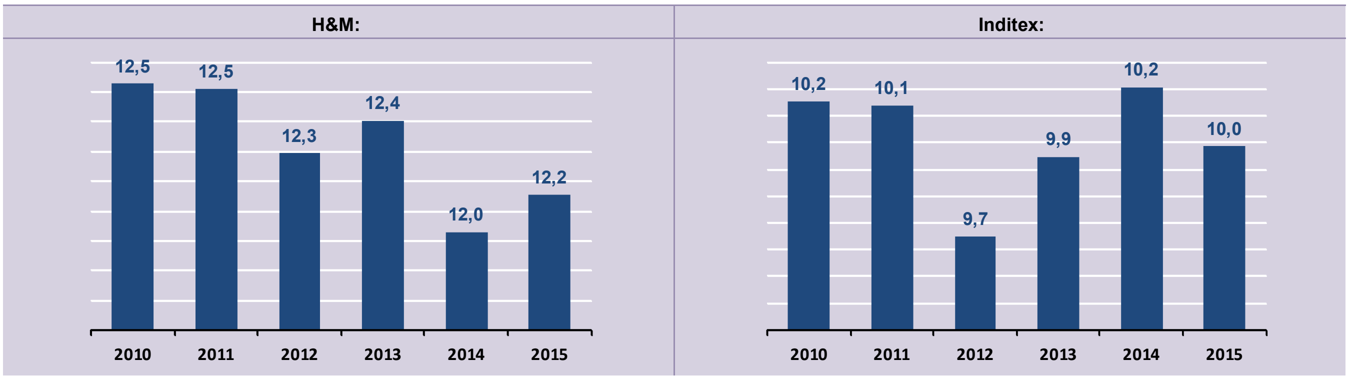


Source: Company Data, Bryan, Garnier & Co ests.

Rents remain under control

H&M and Inditex rent virtually all their stores except some Zara stores whose buildings belong to the founder Mr. Ortega. As seen in the following charts, rental costs have been fairly stable for the two groups in recent years, **at around 12% for H&M and 10% for Inditex**. In our view, the Spanish company has more leverage potential on this cost line since it has decided to open fewer stores but larger in size.

Fig. 39: Trend in rental costs (2010-2015, % of sales):



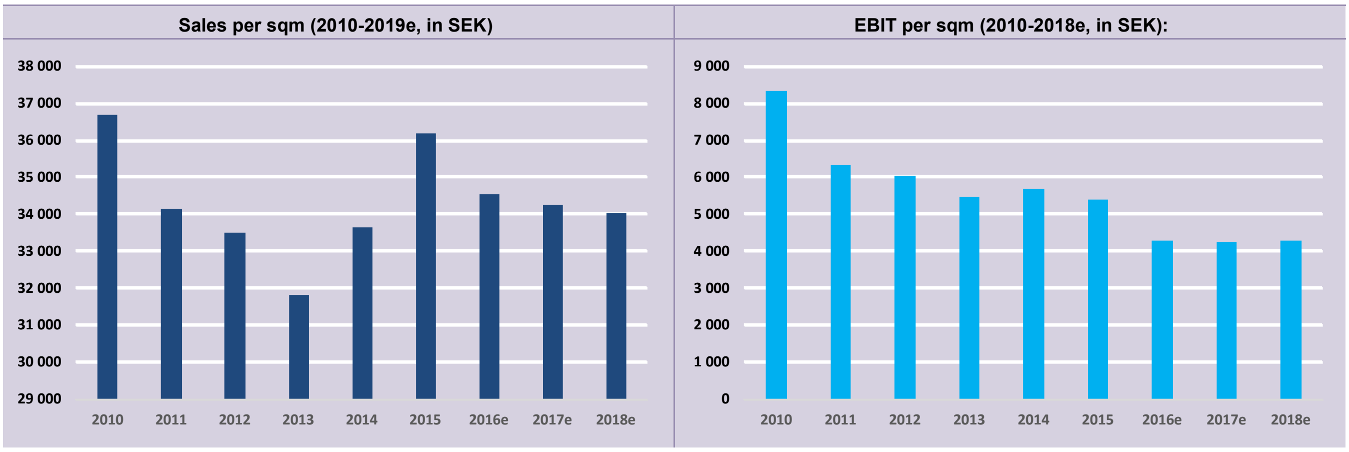
Source: Company Data, Bryan, Garnier & Co ests.

Ongoing ratio erosion at H&M before stabilising in 2018?

H&M does not disclose its total selling area. Our assumptions progressively increase the average size of an **H&M store** (1,350m² in 2015 => 1,430m² in 2018) since we understand that the new stores have an average floor area of at least 1,500m² to present the H&M Beauty and H&M Home concepts. The **COS**, **Weekday** and **& Other Stories** brands have an average store size of 450m² while those of **Monki** are smaller (275m²).

This erosion in the sales per sqm and EBIT per sqm ratios illustrated in the following charts reflects: **(i)** the negative like-for-like growths (2011, 2013) or performances not strong enough to leverage the operational costs like this year (+1%e) and **(ii)** a decline in profitability since 2010 marked by the substantial level of investment (IT, online, retail expansion) and external factors such as the currency impact and higher sourcing costs.

Fig. 40: H&M: sales/m² and EBIT/m² ratios

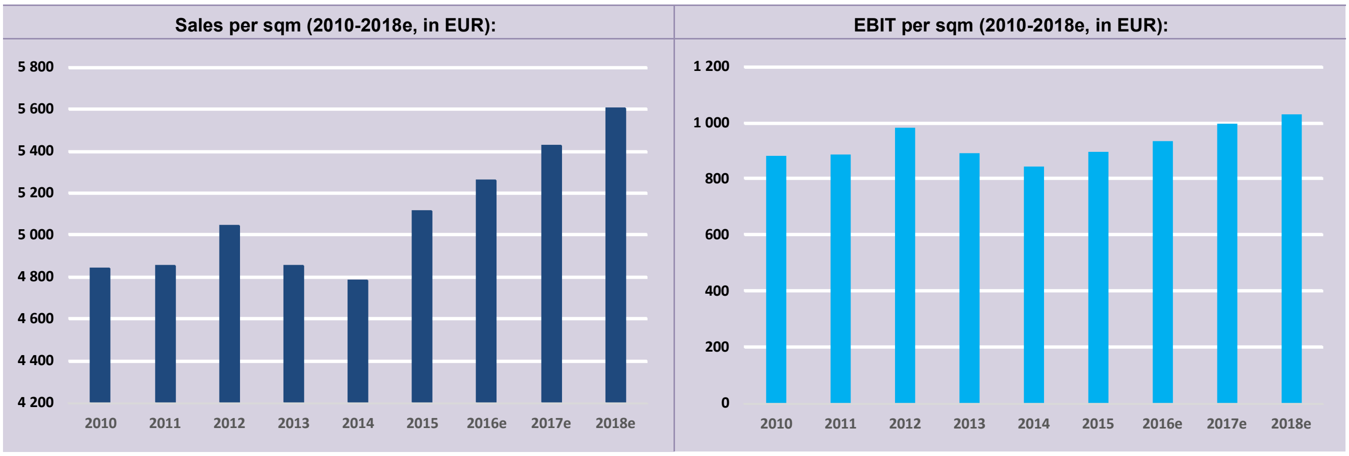


Source: Company Data; Bryan, Garnier & Co

The rebound begun in 2014 will continue in future

Inditex has also invested massively in recent years (logistics, IT, online, etc.) while suffering from a negative currency effect. This phase is, however, almost behind us and, since we are forecasting fairly strong life-for-like growth (+7%e in 2016, +5%e in 2017-18), the group will be able to capitalise all the more on its investment.

Fig. 41: Inditex: the ratios are improving:



Source: Company Data; Bryan, Garnier & Co

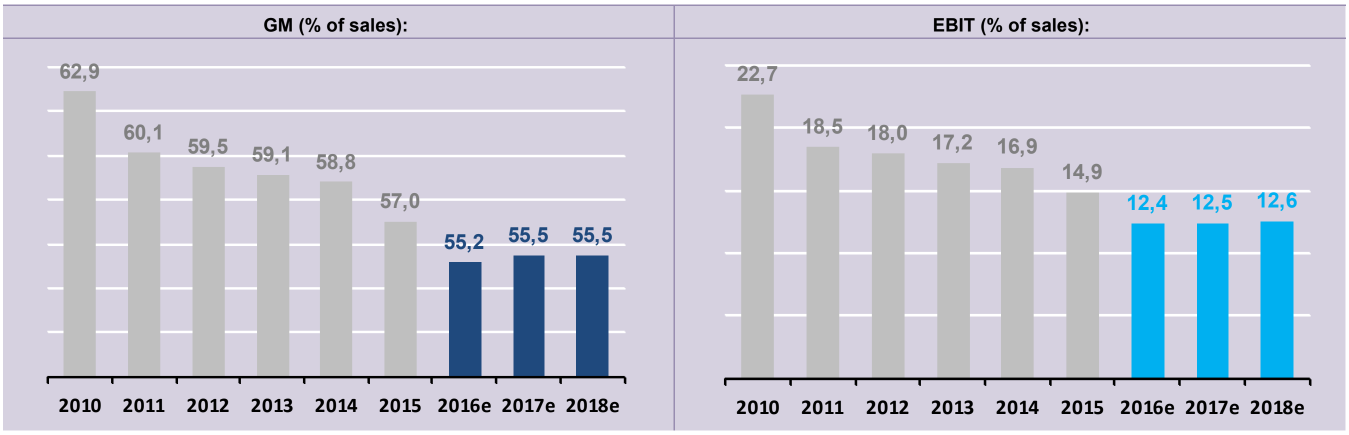
2.4.5. Summary of our profitability forecasts

H&M's gross margin rate fell sharply between 2010 and 2015 (-590bp) under the impact of very negative raw material (around -250bp between 2010 and 2012) and currency effects that the group opted not to pass on in price hikes. The Swedish company also invested significant sums in reinforcing its sourcing teams and developing its other brands (including the launch of & Other Stories in 2013).

Now that the bulk of the investment cycle has been completed and the currency environment is almost returning to normal, we see H&M being able to slightly increase its gross margin rate in 2017 (+30bp) and stabilise it at around 55.5%. Beyond the currency issue, there are two limiting factors on these forecasts: **(i)** the proportion of markdowns could have a more-negative-than-expected impact (little risk of this in H2 16 in our view) and **(ii)** they do not include investment linked to the launches of one or even two new brands in 2017.

While the fall in the gross margin rate is the main reason for the decline in EBIT margin (-780bp between 2010 and 2015), the "operating deleverage" is also responsible, with total opex moving from 40.2% of sales (2010) to 42.1% (2015). Despite a high opening rate, with LFL growth rates of c.2% in 2017-18, in our view the group will also manage to stabilise the weight of its operating costs at these levels and may even benefit from a slightly positive leverage effect in the event of higher LFL growth.

Fig. 42: H&M: trend in gross margin rates and EBIT (2010-18e, % of sales):



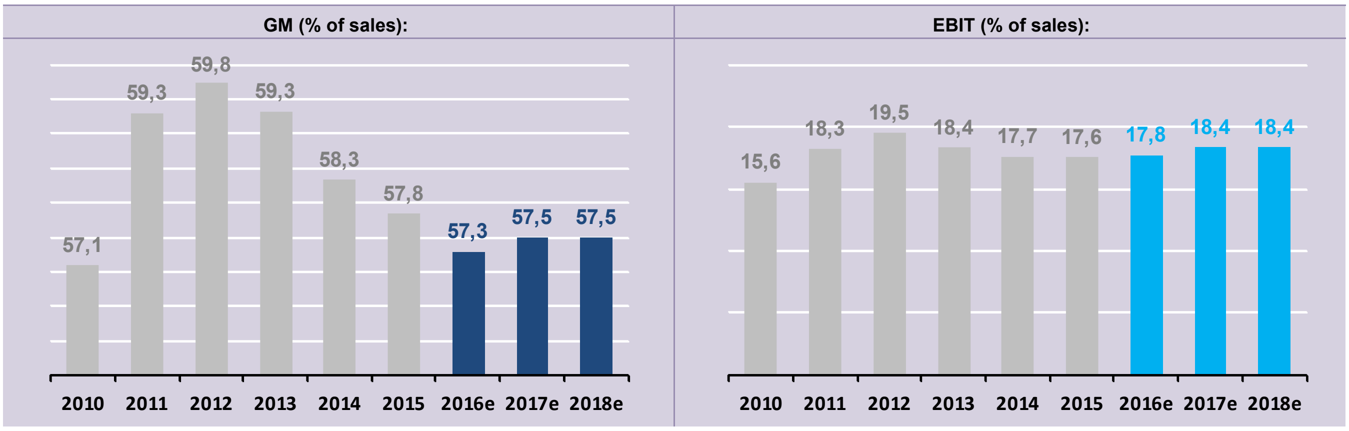
Source: Company Data; Bryan, Garnier & Co

Inditex's GM rate has also suffered from the same negative factors as its Swedish competitor, namely COGS inflation and an unfavourable currency effect, but also investment in its other brands (distribution centres, IT, online). However, thanks to its business model which is unique to the industry, these impacts have been lower, with a decline in GM rate limited to 200bp between 2012 and 2015, while remaining at a level higher than in 2010.

In our view, Inditex will also be able to slightly improve its gross margin rate in 2017-18 (+20bp vs. 2016e to 57.5%). We see Inditex as better armed to maintain its prices in this competitive environment thanks to its supply chain, the strength of its brand and its slightly higher positioning than H&M.

We see the potential leverage effect being higher at Inditex which will: **(i)** slow its store opening rate (=> lower increase in rents and salaries), **(ii)** not launch new brands and **(iii)** benefit from the ramp up of its 'other brands' thanks to the investment made over the past few years. Operating costs should thus fall by 100bp to 34.4% relative to 2015.

Fig. 43: Inditex: trend in gross margin rate and EBIT (2010-18e, % of sales):



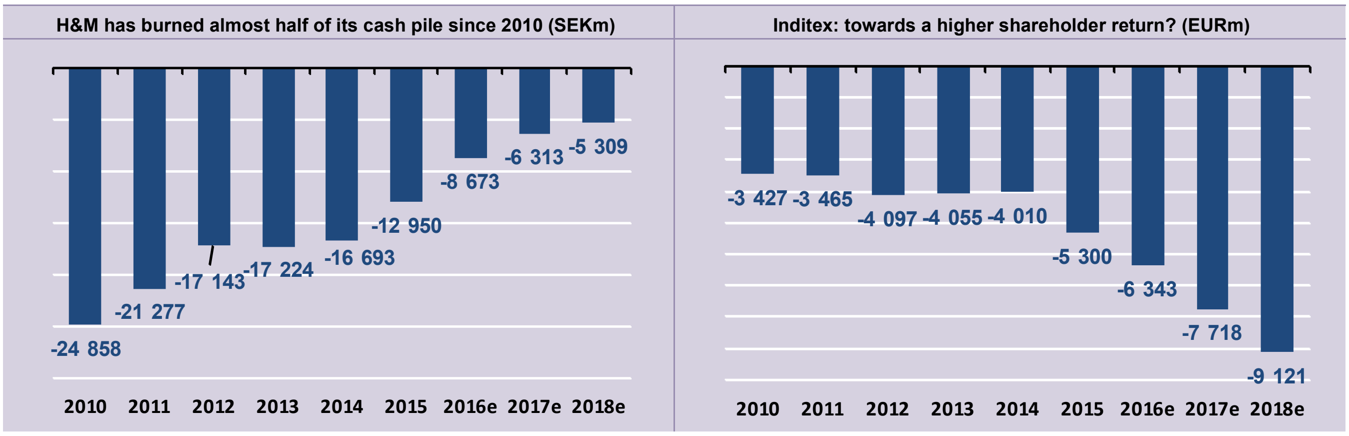
Source: Company Data; Bryan, Garnier & Co

2.5. Cash: two contrasting situations

H&M and Inditex were in a fairly comfortable net cash position in 2015 as seen in the following charts. However, **H&M** has 'burned' more than half its net cash in recent years since it wanted to maintain a relatively generous dividend payout (*see next page*) despite a significant level of investment and declining profitability. On our forecasts, this trend will prevail at least until 2018 since H&M has no plans to sacrifice its attractive payout ratio.

Inditex is in precisely the reverse situation, the Spanish company being expect to double its cash pile between 2010 and 2016. While capex may have been higher as a % of sales (8% on average over the period vs. c.6% for H&M), Inditex's profitability has proven more resilient while the payout rate is some twenty points below that of H&M.

Fig. 44: Net cash position: two contrasting situations:

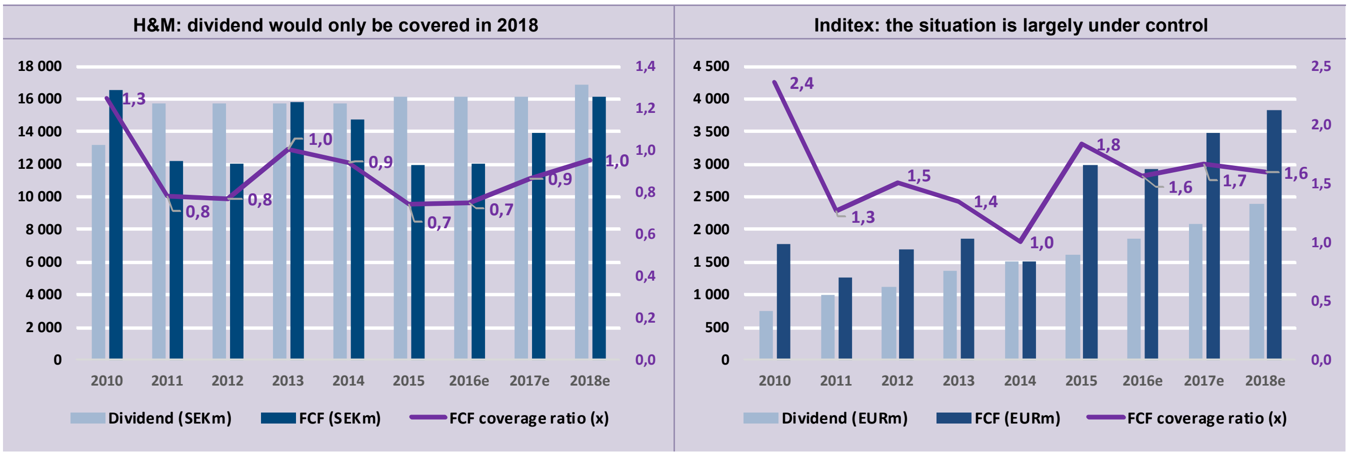


Source: Company Data; Bryan, Garnier & Co

The situations outlined above are reflected in the following charts. Since 2011, **H&M's** FCF generation has not been high enough to cover dividend payments since the group has always maintained a very high level of payout (c.90% on average between 2010 and 2015) and this generous dividend policy is expected to be maintained. As indicated in the left-hand chart, it is only in 2018 that FCF generation (reduction in capex as a % of sales, stabilisation in profitability) is expected to fully cover the dividend payment. According to our forecasts, this payout will remain above 80%.

Inditex's FCF generation comfortably covers its dividend payment, particularly since the payout rate amounted to a little over 60% for the 2010-15 period, substantially below that of H&M. At this stage, we expect a 65% payout between 2016 and 2018 but, in view of the very positive net cash position and a slowdown in the rate of store openings, investors are increasingly expecting an increase in this payout rate.

Fig. 45: No emphasis on dividends:



Source: Company Data; Bryan, Garnier & Co

3. Valuation

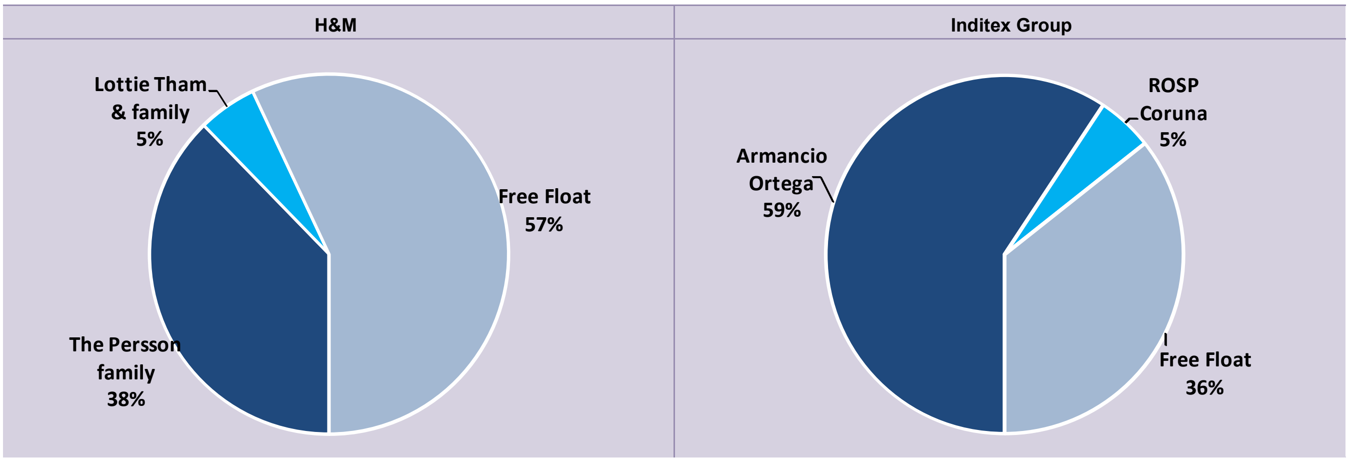
3.1. Groups still owned by their founding families

The heirs to the founder of the **H&M** fashion group (Erling Persson) are fully involved in H&M's operational management since one son (Stefan Persson) is Chairman of the Board of Directors and his grandson, Karl-Johan Persson, has been the group's CEO since 1 July 2009. Stefan Persson holds all of the 194.4 million 'A' shares (unlisted) together with more than 403 million 'B' shares (listed for trading) through a holding company known as Ramsbury Invest AB. In total, members of the Persson family hold 37.7% of the shares and 69.7% of the voting rights. Note that Stefan Persson's sister, Lottie Tham, holds 5.3% of the share capital and 2.6% of the voting rights.

At **Inditex**, the founder Amancio Ortega naturally remains the main shareholder with 59% of the share capital and voting rights. His shareholding is regrouped in two family holding companies: **(i)** Pontegadea (1.558 million shares = 50% of the share capital) and **(ii)** Partler 2006 (289 million shares = 9.3% of the share capital). The Pontegadea holding company is also represented on the Board of Directors by Amancio Ortega's wife, Mrs. Flora Pérez Marcote. Lastly, the ROSP Coruna holding company (c.5% of the share capital) regroups the shareholding owned by Amancio Ortega's daughter (Sandra Ortega Mera).

Since 2005, Pablo Isla has been CEO of Inditex and even became Chairman of the Board of Directors in 2011 when Amancio Ortega took more of a back seat.

Fig. 46: Shareholder structure of H&M and Inditex (% of total shares):



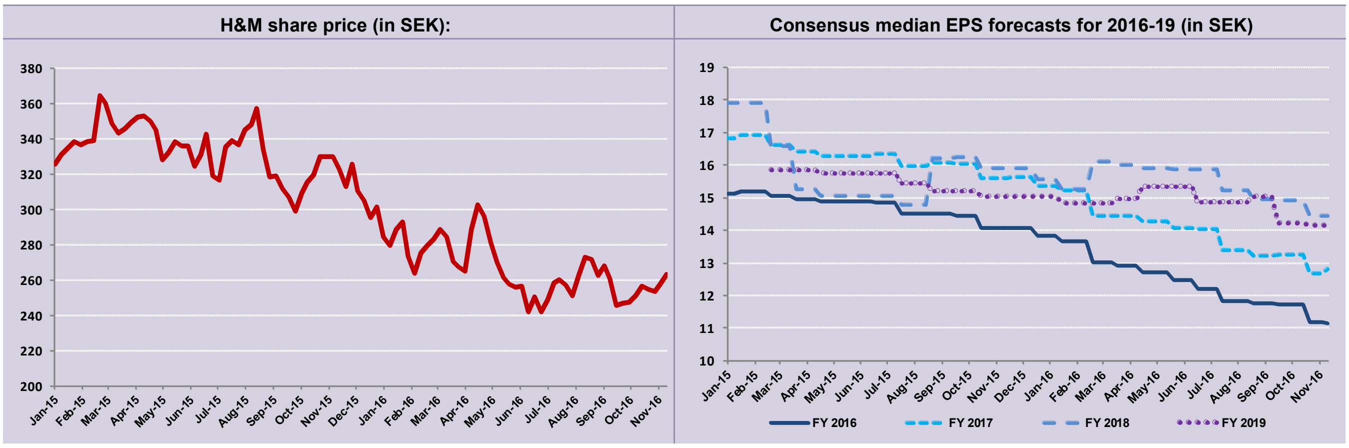
Source: Company Data; Bryan, Garnier & Co

3.2. Consensus expectations

The **H&M** and **Inditex** share price performances (*see left-hand charts and Figs 47 and 48*) are consistent with the earnings forecast revisions made by the market. Since early 2015, the median consensus has revised down its 2016 EPS forecasts for **H&M** by 26% given the very unfavourable currency environment and a negative "operating deleverage" on the Swedish group's margins (top-line growth insufficient, inflation in operating costs).

This year, the market has cut its 2017 and 2018 estimates by a respective 17% and 7% but, in the past few weeks, the downwards spiral seems to have slowed in that H&M is gradually exiting the negative currency effects. Can we then conclude that the bear phase is definitively behind us? We are not totally convinced of this since the consensus seems fairly aggressive in our view, forecasting respective 2017-18 operating margin increases of 50bp (BG: +10bp) and 20bp (BG: +10bp). This seems a bit punchy in view of the prudent LFL growth forecasts (=> little potential for leverage effect) and investments linked to the launch of one or even two new brands in 2017.

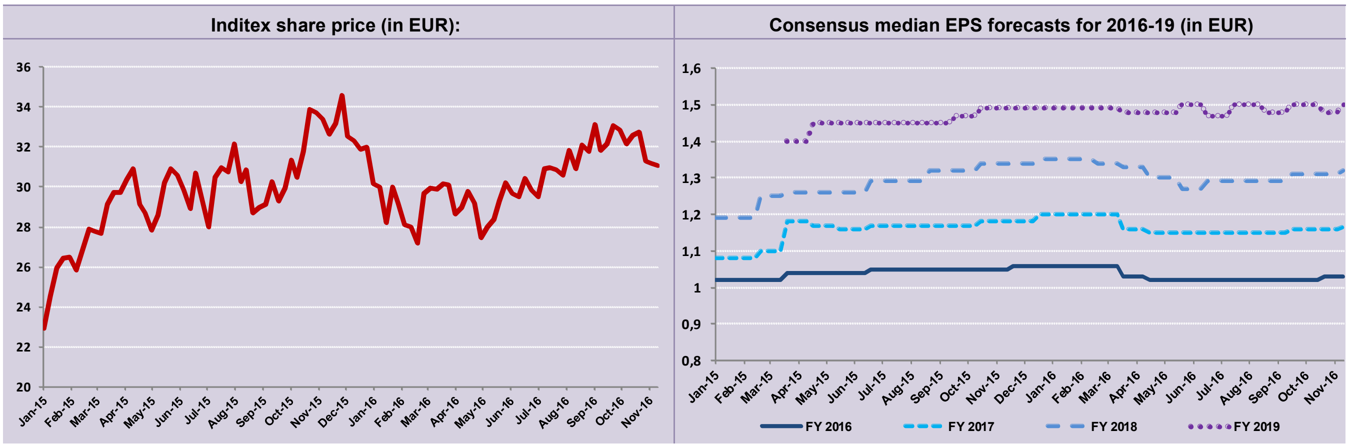
Fig. 47: Consensus expectations: an end to downgrades for H&M?



FY 2016: FY ending November 2016 *Source: Datastream; Bryan, Garnier & Co*

It is striking to note that the consensus expectations for **Inditex's** EPS have remained broadly unchanged (-3% in 2017 and -2% in 2018) since the beginning of the year. This low dispersal shows the market's confidence in the solidity of its business model and the relatively limited risk of disappointment (good historic track record).

Fig. 48: Consensus expectations: forecasts reflect the market's confidence:



FY 2016: FY ending January 2017 *Source: Datastream; Bryan, Garnier & Co*

3.3. H&M's and Inditex' multiples

3.3.1. 12-month forward P/Es

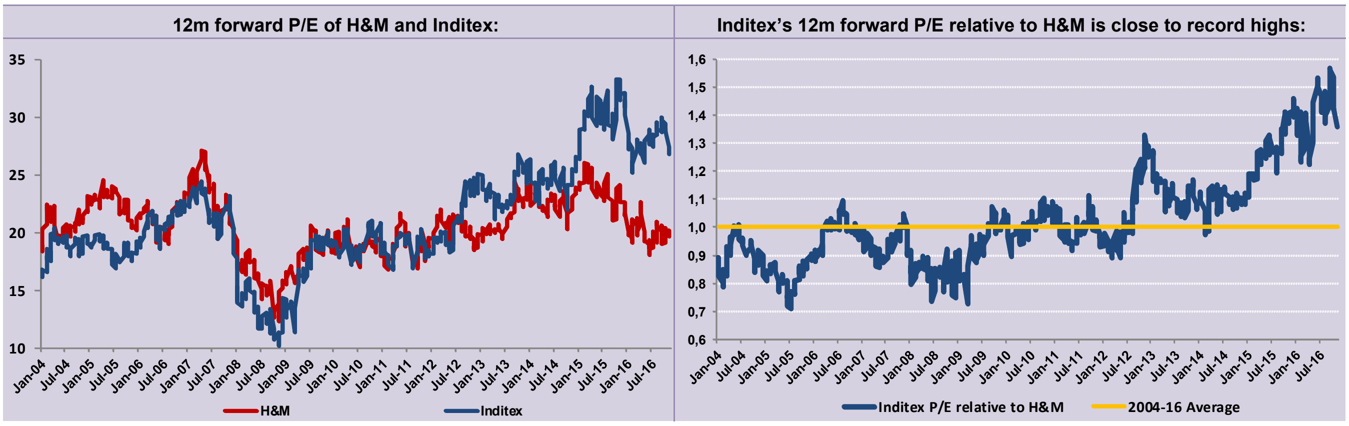
The charts show that, in terms of 12-month forward P/Es, the **H&M** and **Inditex** share prices had tended to trade in line. When we compare Inditex's 12-month forward P/E with that of H&M, we arrive at an average of 1x over the 2004-16 period (*see right-hand chart*).

However, as of early 2015, **Inditex** shares started to trade at a premium to **H&M** and the gap has steadily increased, reaching a new record of 60% in September 2016. The constitution of this premium was justified by the differential in terms of earnings growth momentum: thus, for the 2016 fiscal year, we are forecasting 11.5% growth in Inditex's EPS (to end January 2017) while H&M's EPS are expected to fall by 11% (to end November 2016).

Currently, Inditex is trading at a 36% premium, a level that seems to us to be sustainable given the superior growth outlook for the Spanish company (*see the following section*).

Admittedly the idea of switching back into H&M to play the reduction in this premium may seem tempting. However, this convergence could only be justified if the Swedish company manages to return to LFL growth figures similar to those of Inditex (+5-7%e) and to improve its profitability which has been in steady decline since 2010. Furthermore, the valuation remains at historic levels in absolute terms (19.7x on the 12-month forward P/E).

Fig. 49: Trend in the 12-month forward P/E for H&M and Inditex:



Source: Datastream; Bryan, Garnier & Co

3.3.2. Valuation/growth ratios

Given that H&M and Inditex trade at high multiples in absolute terms, it seems more relevant to compare this valuation with their growth prospects. Note that we already carry out this exercise with Optical g which also have high multiples.

In addition to the two global fashion leaders, we have also looked at other retailers operating in the ready-to-wear segment, all of which are in the UK: **(i) Associated British Foods** which owns the Primark brand (c.44% of sales and c.58% of group EBIT), **(ii) Marks & Spencer** (General Merchandise = c.37% of sales), **(iii) Next** and **(iv) SuperGroup** (Superdry brand). With the exception of SuperGroup (-7% ytd), the share prices of the other three UK retailers have seen a significant correction since the beginning of the year (-26% on average) due to difficult market conditions (UK consumers' wait-and-see attitude, online competition, GBP/USD transactional FX impact).

The following table shows that the 'EV/EBIT to growth' ratios for **H&M** and **Inditex** remain relatively affordable: while their spot multiples are effectively above those of the UK peers, this level of valuation is underpinned by a stronger growth outlook, particularly at Inditex.

Fig. 50: 'EV/EBIT to growth' ratios of the main textile groups:

Companies	Market Cap (EURm)	2017e EV/EBIT (x)	2018e EV/EBIT (x)	EBIT CAGR 2016-2019e (%)	EV/EBIT to growth 2017e (x)	EV/EBIT to growth 2018e (x)
H&M – SEK	**45,369**	**16.6**	**15.0**	**10.3**	**1.6**	**1.5**
Inditex	**97,737**	**19.0**	**17.0**	**12.1**	**1.6**	**1.4**
AB Foods – GBP	20,789	16.9	15.6	13.3	1.3	1.2
M & S – GBP	5,492	11.3	11.0	7.2	1.6	1.5
Next – GBP	7,146	9.9	10.0	0.2	46.2	46.5
SuperGroup – GBP	1,242	11.8	10.5	15.1	0.8	0.7

Source: IBES consensus, Bryan, Garnier & Co ests

In terms of PEG ratio, the H&M ratio is slightly below that of Inditex due to the underperformance of H&M shares relative to those of its Spanish competitor. We are forecasting double-digit EPS growth over the 2016-19 period. Note, however, that like other retailers in our sample, H&M's earnings growth is more volatile since its cost structure is more sensitive to external pressures like currencies, changes in trends and competitive pressure.

Fig. 51: PEG ratios of the main textile groups:

Companies	Market Cap (EURm)	2017e P/E (x)	2018e P/E (x)	EBIT CAGR 2016-2019e (%)	PEG 2017e (x)	PEG 2018e (x)
H&M – SEK	**45,369**	**21.7**	**19.6**	**10.3**	**2.1**	**1.9**
Inditex	**97,737**	**26.5**	**24.0**	**12.0**	**2.2**	**2.0**
AB Foods – GBP	20,789	22.2	20.0	11.3	2.0	1.8
M & S – GBP	5,492	11.5	11.3	3.1	3.7	3.6
Next – GBP	7,146	11.3	10.8	4.1	2.7	2.6
SuperGroup – GBP	1,242	16.5	14.6	13.6	1.2	1.1

Source: IBES consensus, Bryan, Garnier & Co ests

3.4. DCF-derived valuation

H&M: a FV of SEK295

As mentioned above, the top-line growth admittedly remains strong between 2017 and 2021, but it will mostly be driven by the store opening effect since we expect comparable store growth to average 2.5% over the period. Our top-line growth rate forecasts are then progressively reduced to converge with our growth rate to perpetuity of 2.5%.

We expect H&M's operational profitability to reach its low in 2016, before seeing a modest increase over the 2017-19 period (+30bp to 12.7%) thanks to a stabilisation in the currency environment and the beginning of an operational leverage effect as of 2019. From 2020, we forecast a normative operating margin of 13% which remains far from the historic high reached in 2007 (23.5%).

We arrive at a WACC of 7.2%, based on a risk-free rate of 1.6%, a risk premium of 7% and a beta of 0.80.

Fig. 52: H&M: DCF valuation:

SEKm	2017e *	2018e	2019e	2020e	2021e	2022e	2023e	2024e	2025e	2026e
Net Sales	**212 025**	**232 252**	**253 155**	**270 875**	**289 837**	**307 227**	**322 588**	**335 492**	**345 557**	**354 196**
% change	*10.1%*	*9.5%*	*9.0%*	*7.0%*	*7.0%*	*6.0%*	*5.0%*	*4.0%*	*3.0%*	*2.5%*
EBIT	26 397	29 264	32 024	35 078	37 534	39 786	41 775	43 446	44 750	45 868
EBIT margin (%)	12.5%	12.6%	12.7%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%
Income taxes	-6 116	-6 773	-7 408	-8 068	-8 633	-9 151	-9 608	-9 993	-10 292	-10 550
Tax rate (%)	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%
Operating profit after taxes	**20 281**	**22 491**	**24 616**	**27 010**	**28 901**	**30 635**	**32 167**	**33 454**	**34 457**	**35 319**
+Depreciations	8 693	9 987	11 392	12 189	13 043	13 825	14 516	15 097	15 550	15 939
-Change in WCR	2 458	2 556	2 641	2 817	3 014	3 195	3 355	3 489	3 594	3 684
-Investments in fixed assets	12 721	13 935	15 189	14 898	14 492	13 825	14 516	15 097	15 550	15 939
Operating cash flow	**13 795**	**15 986**	**18 177**	**21 484**	**24 438**	**27 440**	**28 812**	**29 964**	**30 863**	**31 635**

PV of terminal value	326,050
+PV of future cash flows (2017-26)	160,328
= Enterprise Value	**486,378**
Net debt (2017e)	-6,313
Other liabilities	449
Minority interest	0
Financial assets	2,338
Theoretical value of equity	**494,581**
Number of shares (m)	1,665
Theoretical FV per share (SEK)	**295**

** = 2017e: FY ending in November 2017* *Source: Bryan, Garnier & Co ests*

We are re-initiating coverage of the stock with a FV of SEK295 and a Neutral recommendation given the limited upside potential and a few risk factors which remain outstanding (volatility in like-for-like growth, operating cost inflation, investment linked to the launch of one or even two new brands in 2017).

Inditex: a FV of EUR38

We see Inditex being able to maintain double-digit growth between 2017 and 2020 with a good balance between like-for-like growth and surface effect. Remember that, over the medium term, the Spanish group plans to open fewer stores but the latter will be larger in size. As of 2021, we gradually reduce this sales growth to converge with our growth rate to perpetuity (2.5%).

Inditex's operating margin is expected to see a steady improvement over the 2017-21 period (60bp to 19%), which becomes our normative level of profitability as of 2021. In our view, this growth is less 'at risk' thanks to two main factors **(i)** stronger like-for-like growth (+5.5% vs. +2.5% for H&M) with reduced volatility thanks to the 'fast fashion' approach (very short manufacturing lead times and **(ii)** a slowdown in the number of store openings (lower opex inflation).

We arrive at a WACC of 7.4%, based on a risk-free rate of 1.6%, a risk premium of 7% and a beta of 0.85.

Fig. 53: Inditex: DCF valuation

EURm	2017e *	2018e	2019e	2020e	2021e	2022e	2023e	2024e	2025e	2026e
Net Sales	**25 724**	**28 393**	**31 233**	**34 356**	**37 104**	**39 702**	**42 084**	**44 188**	**45 955**	**48 253**
% change	*11.0%*	*10.4%*	*10.0%*	*10.0%*	*8.0%*	*7.0%*	*6.0%*	*5.0%*	*4.0%*	*5.0%*
EBIT	4 728	5 219	5 809	6 459	7 050	7 543	7 996	8 396	8 732	9 168
EBIT margin (%)	18.4%	18.4%	18.6%	18.8%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
Income taxes	-1 103	-1 218	-1 336	-1 453	-1 586	-1 697	-1 799	-1 889	-1 965	-2 063
Tax rate (%)	23.0%	23.0%	23.0%	22.5%	22.5%	22.5%	22.5%	22.5%	22.5%	22.5%
Operating profit after taxes	**3 626**	**4 001**	**4 473**	**5 006**	**5 464**	**5 846**	**6 197**	**6 507**	**6 767**	**7 105**
+Depreciations	1 209	1 334	1 437	1 546	1 670	1 787	1 894	1 988	2 068	2 171
-Change in WCR	-126	-118	-156	-172	-186	-199	-210	-221	-230	-241
-Investments in fixed assets	1 543	1 704	1 562	1 546	1 670	1 787	1 894	1 988	2 068	2 171
Operating cash flow	**3 417**	**3 751**	**4 504**	**5 177**	**5 649**	**6 045**	**6 407**	**6 728**	**6 997**	**7 347**

PV of terminal value	74,755
+PV of future cash flows (2017-26)	36,774
= Enterprise Value	**111,529**
Net debt (2017e)	-7,718
Other liabilities	950
Minority interest	41
Financial assets	898
Theoretical value of equity	**119,154**
Number of shares (m)	3,113
Theoretical FV per share (EUR)	**38**

** = 2017e: FY ending in January 2018* — *Source: Bryan, Garnier & Co ests*

We are re-initiating coverage of the stock with a FV of EUR38 and a Buy recommendation. In our view, given its global, multi-concept strategy and backed by the 'fast fashion' organisation which is unrivaled in the industry enabling the company to respond effectively to the changing needs of consumers, Inditex is well-equipped to thrive within a competitive and volatile environment.

4. Appendix

4.1. H&M: multi-concept launch in 2007

In 1947, Erling Persson, the grandfather of Karl-Johan Persson who currently heads up the group, opened his first women's fashion store in Sweden and founded the Hennes brand ('for her' in Swedish). In 1968, Hennes acquired a Swedish hunting brand Mauritz Widforss and the group was thus renamed H&M. That same year, H&M also launched its men's and children's fashion lines.

The Swedish company's growth has long been based on its single eponymous brand which currently represents more than 92% of the total number of worldwide stores (H&M does not disclose sales by brand).

H&M only expanded its concept offer in 2007 with the launch of the **COS** brand in London. The following year, H&M purchased 60% of the Swedish fashion group Fabric Scandinavien AB for SEK564 million (the remaining 40% was to be acquired in 2010), giving it three additional brands: **Monki**, **Weekday** and **Cheap Monday**. In 2013, H&M launched **& Other Stories**.

It is important to note that H&M could launch one or even two new brands in 2017, which are likely to be '*completely different from the six existing brands*', according to the CEO.

Fig. 54: Presentation of the six brands (data at end November 2015):

Concept	Number of stores	Number of markets	Comments
H&M	**3,610** 92%	**61** **23 online**	**H&M** offers fashion and quality at the best price for women, men, teenagers, children and the home (**H&M Home** since 2009). The brand also sells cosmetics (**H&M Beauty** since 2015).
COS	**153** 4%	**30** **19 online**	**COS** (=" Collection of Style") was launched in 2007, it is a fashion brand for women and men with a modern and functional style. The price positioning (i.e. upper end mass market) is higher than H&M brand and the customer base is also older.
MONKI	**106** 3%	**13** **18 online**	**MONKI** is a fashion brand offering clothing and accessories primarily for young women. Yet, the brand is positioned within the mass-market (> H&M).
& other Stories	**30** 1%	**10** **13 online**	**& Other Stories** is the most recent format launched by H&M, launched in 2013.The fashion brand focusing on the whole look, i.e. selling clothing, shoes, bags, accessories and beauty to women. Like COS, the brand operates in the upper end of the mass market.
WEEKDAY	**20** <1%%	**5** **18 online**	**WEEKDAY** is a modern fashion and denim brand influenced by Scandinavian style, for women and men.
CHEAP MONDAY	**5** <1%%	**4 (35 incl. 2,000 wholesale retailers)** **18 online**	**CHEAP MONDAY's** collections are mostly sold via wholesalers. It is a denim brand selling clothing and accessories to men and women.

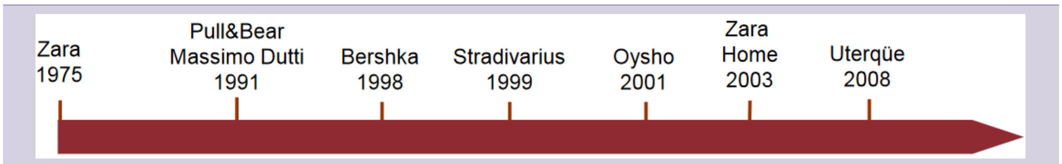
Source: Company Data, Bryan, Garnier & Co

4.2. Inditex: a multi-concept offer dating back 25 years

Having worked in the textile sector for many years, the founder of the Inditex group, Amancio Ortega Gaona, opened his first Zara store in 1975 at La Coruna in Spain, the Inditex holding company (= '**IN**dustria de **DI**seno **TEX**til') was founded in 1985 to regroup the different companies owned by Amancio Ortega Gaona.

The multi-concept strategy was launched in 1991 with the creation of the **Pull&Bear** brand at the time of the **Massimo Dutti** acquisition. Then came the creation of **Bershka** (1998) and the acquisition of **Stradivarius** (1999). The lingerie brand **Oysho** was launched in 2011, followed by **Zara Home** (2003) and **Uterqüe** in 2008.

Fig. 55: A portfolio of concepts that has been built progressively:



Source: Company Data

The following table presents the Spanish group's eight brands together with their positioning.

Fig. 56: Inditex's eight 'brands' (2015 figures at end January 2016):

Concept	Sales (EURm) % of total	Number of stores	Number of markets	Comments
ZARA	13,628 65%	2,162 31%	88 27 online	**Zara** stores have men's clothing and women's clothing for customers of all ages, as well as children's clothing (Zara Kids).
Bershka	1,875 9%	1,044 15%	70 17 online	Latest fashions aimed at a younger customer base than Zara (i.e. men and women from 13 to 23). Hence **Bershka's** price positioning is also the Group's most affordable brand.
Massimo Dutti	1,498 7%	740 11%	69 24 online	More elegant design for men, women and children. **Massimo Dutti's** price range (just below affordable luxury) is one of the highest among the portfolio. The brand also has a Personal Tailoring service.
PULL&BEAR	1,417 7%	936 13%	68 21 online	**Pull&Bear** focuses on casual fashion and sport styles for young men and women (i.e. 14 to 28). The concept has a value fashion position like Bershka.
stradivarius	1,289 6%	950 13%	60 18 online	**Stradivarius** is a clothing fashion concept only for women from 18 to 35 years old. The price positioning is close to Zara's.
ZARA HOME	666 3%	502 7%	53 25 online	**Zara Home** specializes in textile ranges for the home, which is completed by bedding and bed linen, tableware, bath linen and other accessories (dishware, glassware, etc.).
OYSHO	452 2%	607 9%	42 16 online	**Oysho** has different product lines in women's lingerie, gymwear, sleepwear, beachwear, accessories and footwear.
UTERQÜE	75 1%	72 1%	25 16 online	**Uterqüe** is a sophisticated women's clothing and accessory brand, positioned in the lower end of the affordable luxury segment.

Source: Company Data, Bryan, Garnier & Co

H & M

Income Statement (SEKm)	30/11/13	30/11/14	30/11/15	30/11/16e	30/11/17e	30/11/18e
Revenue	128,562	151,419	180,861	192,575	212,025	232,252
Change (%)	*6,4%*	*17,8%*	*19,4%*	*6,5%*	*10,1%*	*9,5%*
Change LFL (%)	*-0,4%*	*4,0%*	*2,5%*	*1,0%*	*2,4%*	*2,4%*
Gross Profit	76,033	89,052	103,167	106,301	117,674	128,900
EBITDA	26,359	30,628	33,341	31,390	35,090	39,251
EBIT	22,168	25,583	26,942	23,879	26,397	29,264
Change (%)	*1,9%*	*15,4%*	*5,3%*	*-11,4%*	*10,5%*	*10,9%*
Financial results	358	312	300	198	195	185
Pre-Tax profits	22,526	25,895	27,242	24,077	26,592	29,449
Tax	(5,374)	(5,919)	(6,344)	(5,538)	(6,116)	(6,773)
Minority interests	0,0	0,0	0,0	0,0	0,0	0,0
Net profit	17,152	19,976	20,898	18,539	20,476	22,676
Change (%)	*1,7%*	*16,5%*	*4,6%*	*-11,3%*	*10,4%*	*10,7%*
Cash Flow Statement (SEKm)						
Operating cash flows	23,590	24,949	26,647	26,050	29,169	32,662
Change in working capital	(250)	793	2,580	1,480	2,458	2,556
Capex, net	8,027	9,391	12,059	12,517	12,721	13,935
Financial investments, net	31,0	21,0	153	193	212	232
Dividends	15,723	15,723	16,137	16,137	16,137	16,944
Other	(22,0)	(448)	(539)	0,0	0,0	0,0
Net debt	(17,224)	(16,693)	(12,950)	(8,673)	(6,313)	(5,309)
Free Cash flow	15,813	14,765	12,008	12,052	13,989	16,171
Balance Sheet (SEKm)						
Cash & liquid assets	13,918	14,091	12,950	8,673	6,313	5,309
Other current assets	25,270	28,650	32,586	34,455	37,558	40,785
Tangible fixed assets	22,186	26,948	32,962	37,969	41,997	45,946
Intangible assets	2,004	2,737	3,937	3,937	3,937	3,937
Other assets	2,298	3,171	3,378	3,378	3,378	3,378
Total assets	65,676	75,597	85,813	88,412	93,184	99,354
LT & ST debt	0,0	0,0	0,0	0,0	0,0	0,0
Other liabilities	20,428	24,041	27,764	28,153	28,798	29,469
Shareholders' funds	45,248	51,556	58,049	60,259	64,386	69,885
Total liabilities	65,676	75,597	85,813	88,412	93,184	99,354
Capital employed	39,394	47,452	59,931	66,418	72,904	79,409
Financial Ratios						
Gross Margin (% of sales)	59,14	58,81	57,04	55,20	55,50	55,50
EBITDA margin (% of sales)	20,50	20,23	18,43	16,30	16,55	16,90
EBIT margin (% of sales)	17,24	16,90	14,90	12,40	12,45	12,60
Tax rate	23,86	22,86	23,29	23,00	23,00	23,00
Net Margin	13,34	13,19	11,55	9,63	9,66	9,76
ROE (after tax)	37,91	38,75	36,00	30,77	31,80	32,45
ROCE (after tax)	42,85	41,59	34,49	27,68	27,88	28,38
Gearing	(38,07)	(32,38)	(22,31)	(14,39)	(9,81)	(7,60)
Pay out ratio	91,67	80,78	77,22	87,04	82,75	82,75
Number of shares, diluted	1,655,072	1,655,072	1,655,072	1,655,072	1,655,072	1,655,072
Per share data (SEK)						
EPS	10,36	12,07	12,63	11,20	12,37	13,70
Restated EPS	10,36	12,07	12,63	11,20	12,37	13,70
% change	*1,7%*	*16,5%*	*4,6%*	*-11,3%*	*10,4%*	*10,7%*
BVPS	27,34	31,15	35,07	36,41	38,90	42,22
Operating cash flows	14,25	15,07	16,10	15,74	17,62	19,73
FCF	9,55	8,92	7,26	7,28	8,45	9,77
Net dividend	9,50	9,75	9,75	9,75	10,24	11,34

Source: Company Data; Bryan, Garnier & Co ests.

Inditex

Income Statement (EURm)	31/01/14	31/01/15	31/01/16	31/01/17e	31/01/18e	31/01/19e
Revenue	16,724	18,117	20,900	23,166	25,724	28,393
Change (%)	*4,9%*	*8,3%*	*15,4%*	*10,8%*	*11,0%*	*10,4%*
Change LFL (%)	*2,7%*	*4,8%*	*8,5%*	*7,0%*	*5,5%*	*5,0%*
Gross Profit	9,923	10,569	12,089	13,274	14,791	16,326
EBITDA	3,926	4,103	4,699	5,231	5,937	6,554
EBIT	3,071	3,198	3,677	4,119	4,728	5,219
Change (%)	*-1,5%*	*4,1%*	*15,0%*	*12,0%*	*14,8%*	*10,4%*
Financial results	(18,2)	14,5	10,1	0,0	10,0	15,0
Pre-Tax profits	3,053	3,245	3,743	4,169	4,794	5,296
Tax	(671)	(735)	(861)	(959)	(1,103)	(1,218)
Minority interests	(4,5)	(9,6)	(7,6)	(6,0)	(6,0)	(6,0)
Net profit	2,377	2,501	2,875	3,204	3,685	4,072
Change (%)	*0,7%*	*5,2%*	*15,0%*	*11,5%*	*15,0%*	*10,5%*
Cash Flow Statement (EURm)						
Operating cash flows	3,237	3,415	3,904	4,322	4,900	5,412
Change in working capital	121	102	(602)	(118)	(126)	(118)
Capex, net	1,250	1,796	1,518	1,506	1,543	1,704
Financial investments, net	159	29,2	22,3	23,2	25,7	28,4
Dividends	1,378	1,510	1,626	1,868	2,082	2,395
Other	370	22,3	49,8	0,0	0,0	0,0
Net debt	(4,055)	(4,010)	(5,300)	(6,343)	(7,718)	(9,121)
Free Cash flow	1,865	1,517	2,988	2,934	3,483	3,827
Balance Sheet (EURm)						
Cash & liquid assets	3,847	3,798	4,226	5,269	6,643	8,046
Other current assets	2,918	3,308	4,224	4,595	5,021	5,480
Tangible fixed assets	5,138	6,041	6,597	6,991	7,326	7,695
Intangible assets	642	684	695	695	695	695
Other assets	1,211	1,546	1,616	1,616	1,616	1,616
Total assets	13,756	15,377	17,357	19,165	21,301	23,531
LT & ST debt	4,7	10,1	11,0	11,0	11,0	11,0
Other liabilities	4,473	4,898	5,895	6,385	6,937	7,514
Shareholders' funds	9,278	10,469	11,451	12,770	14,352	16,006
Total liabilities	13,756	15,377	17,357	19,165	21,301	23,531
Capital employed	6,824	7,709	9,136	9,648	10,109	10,596
Financial Ratios						
Gross Margin (% of sales)	59,33	58,34	57,84	57,30	57,50	57,50
EBITDA margin (% of sales)	23,47	22,65	22,48	22,58	23,08	23,08
EBIT margin (% of sales)	18,36	17,65	17,60	17,78	18,38	18,38
Tax rate	21,98	22,64	23,00	23,00	23,00	23,00
Net Margin	14,21	13,80	13,75	13,83	14,33	14,34
ROE (after tax)	25,76	24,07	25,26	25,17	25,75	25,50
ROCE (after tax)	35,11	32,09	30,99	32,87	36,02	37,93
Gearing	(43,70)	(38,31)	(46,29)	(49,67)	(53,77)	(56,98)
Pay out ratio	63,44	64,75	64,98	65,00	65,00	65,00
Number of shares, diluted	3,115,562	3,113,773	3,113,152	3,113,152	3,113,152	3,113,152
Per share data (EUR)						
EPS	0,76	0,80	0,92	1,03	1,18	1,31
Restated EPS	0,76	0,80	0,92	1,03	1,18	1,31
% change	*0,7%*	*5,3%*	*15,0%*	*11,5%*	*15,0%*	*10,5%*
BVPS	2,98	3,36	3,68	4,10	4,61	5,14
Operating cash flows	1,04	1,10	1,25	1,39	1,57	1,74
FCF	0,60	0,49	0,96	0,94	1,12	1,23
Net dividend	0,48	0,52	0,60	0,67	0,77	0,85

Source: Company Data; Bryan, Garnier & Co ests.

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Bryan Garnier stock rating system

For the purposes of this Report, the Bryan Garnier stock rating system is defined as follows:

Stock rating

BUY Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

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.

SELL Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 55,7% NEUTRAL ratings 32,9% SELL ratings 11,4%

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