15th December 2016

Luxury & Consumer Goods

Inditex

Price EUR32.00

Upbeat outlook supported by a best in class execution

Fair Value EUR38 (+19%) **BUY**

Bloomberg	ITX SM
Reuters	ITX.MC
12-month High / Low (EUR)	33.4 / 26.8
Market Cap (EUR)	99,733
Ev (BG Estimates) (EUR)	93,407
Avg. 6m daily volume (000)	2 394
3y EPS CAGR	11.9%

	1 M	3 M	6 M	31/12/15
Absolute perf.	3.5%	0.5%	14.4%	1.0%
Consumer Gds	5.8%	0.0%	5.1%	-3.3%
DJ Stoxx 600	5.2%	5.1%	11.0%	-2.8%

YEnd Jan. (EURm)	01/16	01/17e	01/18e	01/19e
Sales	20,900	23,277	25,846	28,529
% change		*11.4%*	*11.0%*	*10.4%*
EBITDA	4,699	5,209	5,849	6,500
EBIT	3,677	4,103	4,634	5,159
% change		*11.6%*	*12.9%*	*11.3%*
Net income	2,875	3,192	3,613	4,025
% change		*11.0%*	*13.2%*	*11.4%*

	01/16	01/17e	01/18e	01/19e
Operating margin	17.6	17.6	17.9	18.1
Net margin	13.8	13.7	14.0	14.1
ROE	25.3	25.1	25.4	25.3
ROCE	31.0	32.7	35.2	37.4
Gearing	-46.3	-49.6	-53.5	-56.7

(EUR)	01/16	01/17e	01/18e	01/19e
EPS	0.92	1.03	1.16	1.29
% change	-	*11.0%*	*13.2%*	*11.4%*
P/E	34.7x	31.2x	27.6x	24.8x
FCF yield (%)	3.0%	2.9%	3.4%	3.8%
Dividends (EUR)	0.60	0.67	0.75	0.84
Div yield (%)	1.9%	2.1%	2.4%	2.6%
EV/Sales	4.5x	4.0x	3.6x	3.2x
EV/EBITDA	20.1x	17.9x	15.7x	14.0x
EV/EBIT	25.7x	22.8x	19.9x	17.6x

At the conference call yesterday, management stressed that the full-integrated approach was ITX's recipe for success to drive LFL growth from both online/offline channels. The group's perfect execution in the implementation of this omnichannel is also reflected in strong top-line momentum (1st Nov to 12th Dec: +16% FX-n o/w ~10%e LFL). In our view, yesterday's correction was only temporary, explained by profit-takings (1M: +8%) and sector rotation. Buy recommendation and FV of EUR38 reiterated.

ANALYSIS

- **Solid 9M top-line performance (+14.5% FX-n) fuelled by strong execution.** Indeed, implied LFL growth amounted to approx. 9% (o/w+6% in Q3), almost twice as fast as space growth that was up by approx. 5%. This solid comparable growth was driven by a perfect in-store execution as well as the Group's centralized and vertical integration (shorter lead times, strong responsiveness to changes in trends). As a whole, we also believe that weather conditions are generally more favourable than last year. By concept *(see chart overleaf)*, Pull&Bear and Massimo Dutti outperformed the Group average over the first 9M and it is worth noting that there were no under-performing brand.

- **Strong belief in the full-integrated approach...** During the conference call, CEO Pablo Isla often repeated that the successful implementation of the omnichannel strategy was driving LFL growth. This full-integrated approach is all the more crucial for ITX since: **(i)** one third of online orders are collected in store and nearly two-thirds of returns are made in store, **(ii)** multichannel offers additional purchasing opportunities and **(iii)** it ensures a higher customer experience (vs. pure online players) thanks to additional services such as verification of sizes, fitting rooms, advice from sales staff, additional purchases, etc.

- **… supported by store openings.** Although ITX has reduced its MT growth target for space expansion, which now stands at +6-8% p.a. vs. +8-10% previously, the Spanish should open between 300-340 stores per year. Physical stores are key to increase the brand awareness (ITX spends virtually nothing on A&P) and to offer a favoured point of contact for consumers within the full-integrated approach. The latter also relies on a large number of stores to offer options like in-store pickups, ship-from-store, etc. A good example is the US market that is still tiny for ITX (~4-5% of sales, 71 Zara stores in H1 16) but it harbours significant omnichannel growth opportunities: the ramp up of online operations goes along with store openings/enlargements, such as the Zara Block 37 store in Chicago whose size is doubling to reach a size of ~2,800sqm.

- **Start of Q4 16 tops expectations: +16% FX-n from 1st November to 12th December.** This better-than-expected increase (CS: ~12-13% FX-n) marks an acceleration vs Q3 trends, fuelled by a higher LFL growth (~+10% vs. ~+6% in Q3) and an acceleration of the space growth (Q4: +6-6.5%e) since ITX was particularly active in new store openings during Q3, as shown in the table below. However, management confirmed that capex growth should remain below space growth over the next 3-5 years.

	Q1 16	H1 16	9M 16
Net Openings (YTD)	72	83	227

Source: Company Data

VALUATION

- In our view, yesterday's correction could be explained by temporary profit-taking moves triggered by the recent performance (1M: +8% prior to publication) and sector rotation into cyclical stocks. On the back of a strong start of Q4 and the Group's sound fundamentals, we recommend to take advantage of any weakness in the share price. The valuation (2017e PEG ratio of 1.7x) remains attractive. Buy recommendation and FV of EUR38 confirmed.

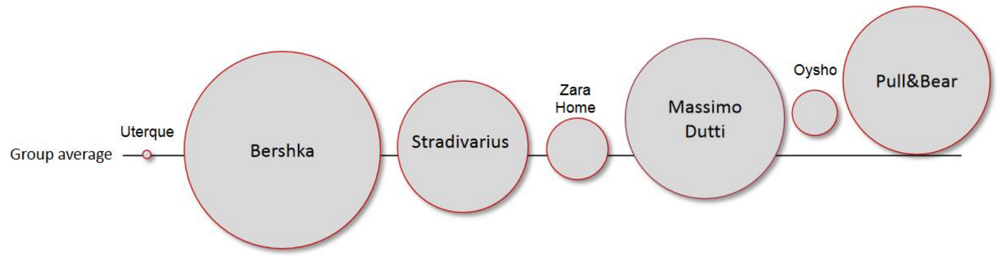
- We have made minor P&L adjustments that have no material impact on our FV, which is maintained at EUR38. Buy recommendation confirmed.

NEXT CATALYSTS

- Inditex will report FY 2016 results on 15th March 2017.

(To be continued next page)

9M performance by concept:



Source: Company Data

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