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EQUITY VALUATION: HENNES AND MAURITZ

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Abstract

Equity Valuation is both a science and an art, whoever looks at it from only one perspective might very well miss it half of the times. This Dissertation will cover both dimensions on the literature review and valuation exercise respectively. On the aftermath, a target price of SEK 246 and a NEUTRAL investment recommendation were attributed to the Swedish worldwide apparel retailer – H&M. Ultimately, these results were compared to BoAML report from 09/26/2013, highlighting structural differences on the investment cases.

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Part I - Literature Review

"A cynic knows the price of everything and the value of nothing"

Oscar Wilde

Introduction

Every asset, regardless of its nature, has an intrinsic value. Therefore, a stepping-stone to every investing decision lies on the ability to perceive the fair value of that asset as well as to comprehend its valuation drivers. Nowadays, the multitude of existing asset classes is responsible for the extensive literature on the subject. For the sake of simplicity, this Literature Review shall only be concerned with the ones of financial nature. This section is organized as follows: 1) market efficiency; 2) valuation methodologies; 3) retail valuation; 4) final remarks.

Why is valuation important?

To attribute a value to something is a mundane task that arises over and over again in everyone's life. Even when one narrow down this to the financial assets field, there are still several circumstances that are required to master this subject. Accordingly to Fernandez (2007) valuation can be used for a wide range of purposes: 1) valuing listed companies; 2) buying and selling operations; 3) initial public offerings; 4) inheritances and wills; 5) compensation schemes based on value creation; 6) identification of value drivers; 7) strategic decisions on company's continued existence; 8) strategic planning.

On a broader perspective, Damodaran (2012) philosophical approach to valuation claims that valuation is important because he/she who only knows the price, knows nothing and whoever adheres to this theory is a subscriber of the greater fool theory¹.

What are the main valuation methods?

Accordingly to Valentine (2010), former employee of Morgan Stanley, an Investment Bank, the most widely used valuation methodologies fall into two fields: single period multiples and multi-period cash flow. The first category values firms in relation to their peers, whereas the second aims to find the security respective intrinsic value. Albeit, other authors might divide it differently. For instance,

¹ The greater fool theory argues that is always possible to make money by buying securities as there is always someone willing to buy it a higher price.

Damodaran(2012) splits methods in three kinds: 1) absolute valuation; 2) relative valuation; 3) contingent valuation. In spite of the structural differences among these methods, accordingly to *Young et al. (1999)* "all roads lead to Rome", i.e., for these authors under certain assumptions all the models have an equivalent mathematical solution. At the time, these conclusions were important as the number of valuation models started to pile up.

Which model is the best?

The answer to this quintessential question is by no means settled, or will ever be. In fact, the diversity of asset classes makes it impossible to sort it as academics and practioners can have opposite views. The most prudent approach is to accept that every method has both benefits and limitations and thus, the choice depends on a careful analysis of given circumstances.

A recent study on sell-side analysts preferences conducted by *Barker and Clubb (2008)* reveals the most widely used methods to justify price targets are the following: 1) P/E; 2) DCF; 3) EV/EBITDA; 4) P/CF. From these results, it can be concluded that relative valuation models are chosen three out of four times by sell-side financial analysts.

On the other hand, academics, will likely argue more favorably on discounted cash flow methods due to their mathematical elegance and flexibility. *Luehrman (1997 a)* claims that usually DCF is the best practice for valuing corporate assets. Still, no method is flawless.

1) Market Efficiency

Before dwelling on the intricacies of some models a few words on market efficiency are of utmost importance due to its implications on investment decisions. First and foremost, a given market is considered to be perfectly efficient if it seemingly incorporates all new information on current stock prices – *Fama (1971)*. In different words, if a given market is perfectly efficient then, all the efforts developed by investors to predict future prices based on value investing, technical analysis or voodoo are equally wasteful. This hypothesis seems too strong to hold at all times for all asset classes. Otherwise, no single investor would be able to consistently beat the market and all the equity research departments, active portfolio management, would make no sense.

Ever since this idea was developed several empirical studies were published on the matter based on event studies, technical trading systems, portfolio returns and so forth. Even though this is a very rich field in financial literature, it simply transcends the stated purposes of this Dissertation.

Bottom line, past, current and future stock prices are/will be the outcome of countless valuations from the investment community. Hence, the first step to a sound valuation is to figure out which valuation method the bulk of market participants are using. Secondly, in order to generate alpha, the investment analysis must identify some catalyst that will trigger a deviation from the current market value and consequent adjustment afterwards.

2) Valuation Methodologies

2.1) Absolute Valuation

An absolute valuation model aims to make educated guesses on the fair value of an asset based on its fundamentals, where its value is primarily a function of: 1) its capacity to generate cash flows; 2) the expected growth of these cash flows; 3) the risk inherent to the cash flows. In a nutshell, this kind of valuation models claims that a given asset should be worth the sum of the present value of its future cash flows. In spite of the theoretical straightforwardness of this concept, nowadays, there are available countless versions of DCF models tailored to meet the specific needs of each valuation objective. *Young et al (1999)*, argues that this Darwinian process may have gone too far as each model entails only slight modifications from its peers. In the end, no single method stands out from the others and often assets can become overvalued using one approach and undervalued using other.

Fortunately, some authors have shed some light over this blurry scenario and came to realize that in spite of the variety of options, under certain assumptions, the majority the methods can be equivalent – *Young et al (1999)*.

2.1.1) DCF

The wide acceptance of DCF methodology by both the academia and professionals justifies its perception as the state of the art procedure. To deal with the meanders of this theme, this Dissertation shall follow Damodaran (2012) approach.

2.1.2) FCFF

This method computes the value of the firm by discounting future FCFF at the respective cost of capital - WACC. FCFF can be defined as the remaining cash flows after the firm meets its financial obligations towards bondholders, shareholders or preferred stockholders. FCFF is given by the equation (1), whilst the value of the firm is given by equation (2).

$$FCFF = EBIT (1 - \text{Tax rate}) + \text{Depreciation} - \text{Capex} - \Delta\text{NWC}$$

Equation (1)

$$\text{Value of the firm}_0 = \sum_{N=1}^T \frac{FCFF_T}{(1+r)^n}$$

Equation (2)

Albeit the simplified description outlined above, this method has a series of caveats that should be referenced, namely on computation of the WACC and TV.

2.1.3) WACC

On FCFF one discounts free cash flows belonging to all investors hence, the discount factor must represent the associated risk profile. The WACC, given by the equation (3), blends together the required rates of return demanded by both debt holders and equity holders (assuming no preferred equity).

$$WACC = \frac{D}{D+E} K_D (1 - T_C) + \frac{E}{D+E} K_E$$

Equation (3)

The WACC formula comprises four distinct inputs: 1) cost of equity - K_E ; 2) after tax cost of debt - $K_D(1-T_C)$; 3) capital structure. Quite often, it is not straightforward to gather these values as they are not directly observable thus, this Dissertation shall provide a brief discussion on each element.

2.1.3.1) Cost of Equity

The cost of equity it is usually computed through the CAPM – equation (4) (Sharpe 1964, Linter 1965 and Merton 1973). *Fama and French (2004)*, say that this intuitively simple model offers acceptable insights on the relationship between risk and return, where the systematic risk is the only source of risk.

This asset-pricing model requires three additional inputs: a) risk-free interest rate; b) equity risk premium; c) company's beta.

$$CAPM = R_F + \beta(ERP - R_F)$$

Equation (4)

2.1.3.1.1) Risk Free

Regarding the risk-free interest rate, it is common practice to look for the domestic long-term (e.g. 10 years) government zero-coupon stripped bonds yields. Damodaran (2012), highlights two conditions for an asset to be considered risk free: 1) there is no default risk²; 2) there is no reinvestment risk. In a perfect valuation world, each cash flow should be discounted at the respective interest rate, thereby taking full advantage of the default free term structure.

2.1.3.1.2) Equity Risk Premium

Given the positive relationship between expected returns and risk, reasonable investors will demand a premium for riskier investments. Though this idea is easy to agree with, its measurement can be ticklish. Under the CAPM framework, risk premium is the excess return demanded by investors over the risk-free asset return. In practice, forward-looking risk-premiums are an extrapolation from historical rates. Literature on this matter does not provide a definitive answer as the premiums fluctuate through time. Instead, there is a range of likely values (between 3% and 7%) that are a function of: 1) time period used; 2) choice of risk-free security; 3) computation procedure³; 4) market choice. Further, the undisputed data provider on this subject is *Ibbotson Associates*⁴.

2.1.3.1.3) Beta

Ultimately, the conventional procedure for estimating β is by regressing returns of a given stock on a market index returns, where β is the slope of the estimated regression. Within the framework of CAPM, β denotes the only source of risk – systematic risk. Alike ERP, β also fluctuates over time.

Once again, the estimation of beta is a subjective process with some intricacies on the data chapter. According to Damodaran (2012), the data frequency shall not be higher than weekly due to noise associated with shorter frequencies and the index chosen must be a proxy of the market portfolio. Thus, ideally, 2 to 5 years of monthly data shall be used and perfectly diversified indices such as S&P 500 or

² Only government bonds are truly risk-free due to their capacity to control money supply. Though, not all government bonds are risk-free. To assess this condition it is advisable to check credit agencies stance.

³ It is common to use both arithmetic and geometric averages.

⁴ Ibbotson Associates report "Stocks, Bonds, Bills and Inflation provides annual returns on these assets since 1926.

MSCI should be the market proxy. Alternatively, the so-called beta books can be used. These books display average betas for each industry relying on the assumption that these companies have similar risk characteristics. Later, each company beta shall be leveraged based on equation 5.

$$\beta_U = \frac{\beta_L}{[1 + (1 - T_c)(\frac{D}{E})]}$$

Equation (5)

Though, the CAPM is extensively used model by practioners, *Fama and French (2004)*, showed that the model has poor empirical results. Alternatively, other models such as *APT by Ross (1976)* might deliver better results.

2.1.3.1.2) After Tax Cost of debt

The cost of debt can be easily attained through the YTM of long-term debt outstanding. However, we must bear in mind that the YTM is only a good benchmark as long as the firm fulfills all interest and principal payments. Otherwise the promised yield will differ from the expected return. We can withstand that as long as a firm has investment grade, i.e., a credit rating above BBB, the YTM⁵ should be a good estimate. In case of illiquid trading of the debt instruments it is also helpful to look at rating agencies credit notes.

2.1.3.1.3) Capital Structure

The target capital structure is essential to compute the debt-to-equity ratio, which sets out the proportion for K_D and K_E . For the sake of simplicity, it is usually assumed that the book values, available on the company's balance sheet, are a good estimator of the market value.

2.1.4) Terminal Value

The TV, given by equation 6, is one of the most important aspects of each model as it, generally, accounts for over half of the total valuation. Theoretically, this concept

⁵ The YTM is the interest rate that makes the price of the bond equal to the present value of all future payments. In United States it is possible to gather, freely, information on fixed income applications through the TRACE database.

represents the point in time where the firm reaches a steady state and grows at a constant rate thereafter - g^6 , equation 7. From a certain time onwards (usually 10 years), it makes no sense to make forecasts due to the high uncertainty involved.

$$TV_T = \frac{Cash\ Flow_{T+1}}{k - g}$$

Equation (6)

$$E[g] = Reinvestment\ Rate * Return\ on\ Capital$$

Equation (7)

$$Reinvestment\ Rate = \frac{CAPEX - Depreciation + Investment\ in\ NWC}{EBIT * (1 - T_c)}$$

Equation (8)

2.1.5) Valuing non-operating assets

The great majority of firms have assets that do not play a direct role in generating revenues. These items tend to be omitted from the Income Statement and be included explicitly or implicitly on the balance sheet. A common example would be the minority stakes of ownership that a firm has on another firm. These revenues are not directly recognized as part of the owner's operational activity thus, they must be accounted for later on. Excess cash that the company has generated on past periods is also often disregarded by the firm main activity. All these items (e.g. debt, minority interests, employee options, preferred stock and so forth) have to be taken into consideration to move from enterprise value to equity value. The discussion on how to value these items goes beyond the scope of this Dissertation.

2.1.6) Limitations of the WACC DCF

As mentioned earlier, every valuation method has benefits and drawbacks. WACC DCF is often criticized due to the fact that, under changing capital structures, the constant discount rate calculation will be inconsistent hence harming the models predictions.

⁶ The constant, or stable growth rate, cannot be higher than the growth of the economy, in which the firm operates.

2.1.7) FCFE

FCFE can be defined as the remaining cash flows after the firm meets its financial obligations towards creditors and reinvestment needs. FCFE is given by equation 9.

$$FCFE = Net\ Income - (CAPEX - Depreciation) - \Delta NWC + (New\ Debt\ Issued - Debt\ Repayments)$$

Equation (9)

$$Equity\ Value_0 = \sum_{N=1}^T \frac{FCFE_t}{(1 + K_E)^N}$$

Equation (10)

Following the computation of the set of aforementioned cash flows, the value of the equity shall equal the correspondent sum discounted at the respective cost of capital. Additionally, it is important to highlight that the expected future growth rate is given by equation 7.

2.1.8) DDM

The DDM by Gordon (1962) given by equation 11, is a simplification of the FCFE.

$$Equity\ Value_0 = \frac{Dividends_1}{k - g}$$

Equation (11)

The differences amongst the two lie on the definition of cash flows. DDM considers the numerator to equal the expected dividends, whereas for FCFE the numerator is defined by equation 9. Thus, in case dividends equal FCFE the two methods shall generate the exact same outcome. On the other hand, for companies that don't have a constant dividend policy, DDM will become pointless.

2.1.9) APV

In spite the flaws that WACC DCF methodology has, its principles are still sound. *Luehrman (1997 b)* argues that there is a better alternative to value a business – APV. APV methodology was firstly suggested by *Myers (1974)* based on the idea that a firms intrinsic value should be assessed detached from its the financial side, i.e., excluding all cash flows associated with the financial side-effects. Usually, the benefits linked to borrowing are tax shields whereas the drawbacks are the hypothesis of default. On the other hand, the “real” cash flows shall be discounted

at the cost of equity – which can be estimated as we mentioned above. APV for a given firm is given by equation 12.

$$APV = \sum_{N=1}^T \frac{FCFF_N}{(1 + K_U)^N} + P.V. \text{ Financial Side – Effects}$$

Equation (12)

Financial side effects include interest tax shields, financial distress, agency costs, subsidized financing, issue costs and hedges.

At this stage it is worthwhile to highlight that the work developed by Myers (1974) has its roots on work of *Modigliani and Miller (1963)*⁷.

Alike, WAAC this model also has its own caveats namely on the discount rate applied to each financial side effect. For instance, there is a broad discussion on the correct discount rate for the interest tax shields. Some authors favor that tax shields are as unpredictable as interest payments hence, these cash flows should be discounted at the cost of debt (Ruback 2002). Additionally, the remaining side effects are also thought to have similar characteristics and the cost of debt can be used as discounting rate.

Sabal (2007) has stated that APV is adequate for circumstances where tax rates and debt-to-equity ratio fluctuate over time (in WACC DCF these inputs are assumed to be constant throughout the whole valuation period).

Bottom line, when comparing APV and WACC it can be sustained that APV suits better mature firms whose capital structure is not constant.

2.1.10) CCF

CCF Model, given by equation 13, is a slightly different version of APV tailored to circumstances where the capital structure of the firm changes quite often. As a result, both real and financial cash flows should be discounted at the same rate – K_U . This argument was made by Ruback (2002). Once again, provided the same set of the assumptions, the outcome should be equivalent to WACC DCF.

2.1.11) Return Based Approaches

Ultimately, to complete this section, it will be presented two return based approaches: 1) Economic Value Added; 2) Dynamic ROE. These methods aim to

⁷Both Modigliani and Miller have received the Nobel Prize in Economics at 1985 and 1990 respectively.

assess if the company is creating value in excess its cost of capital. They also provide powerful insights on the economic performance perspective.

2.1.11.1) Economic Value Added

EVA, also known as Economic Profit, was initially suggested by Stewart (1991) – equation 13. According to Goedhart (2005), even though the model presents a different perspective its results ought be equivalent to the firm DCF. Essentially, the firm is generating an economic profit whenever the capital invested is earning in excess of the cost of capital.

$$EVA = NOPLAT - (Invested\ Capital * WACC)$$

Equation 13

2.1.11.2) Dynamic ROE

Dynamic ROE, presents a similar version to EVA but focusing on value creation in excess of equity cost.

2.2) Relative Valuation

Though DCF methods are extensively supported by academics, the practioners regard relative valuation as a useful tool to justify price targets - Barker and Clubb (2008)-, as well as to gauge the quality of the assumptions made on the absolute models.

In a nutshell, multiples try to value an asset in relation to a given metric, which by definition does not have to be financial. For instance, if someone is interested in buying a house it will most likely compare it with others in the same district using the price per square feet. In fact, there can be several kinds of multiples. The main ones are: price-to-earnings; price-to-free cash flow; price-to-book; price-to-sales; ev-to-ebitda; sector multiples.

Though, as Damodaran (2012) puts it, "multiples are easy to use and misuse". Goedhart et al. (2005), corroborates this perspective arguing that the non-compliance of four basic principles can undermine the correct application of this simple methodology: 1) select an appropriate peer group; 2) usage of forward looking multiples; 3) usage of enterprise value multiples; 4) adjust enterprise value multiples to non-operating assets.

2.2.1) Peer Group

The peer group should comprise a restricted list of companies within the same industry that have similar characteristics regarding geography operations, growth expectations, capital structure among others. This process of handpicking companies can be simplified through the usage of a system like GICS. Alternatively, after drafting a list of potential peers the choice can be narrowed down through statistical methodologies such as cluster analysis, thus making this choice a process both qualitative and quantitative.

2.2.2) Forward looking multiples

Empirical studies demonstrate that forward multiples are more accurate than current or trailing. *Liu et al* (2002) claim that forward multiples were more accurate in pricing.

Valentine (2010) argues that forward multiples should be used because stocks trade on forward expectations.

2.2.3) Enterprise Multiples

As aforementioned P/E multiples are widely used. Nevertheless, this category displays two major flaws. Firstly, they disregard the capital structure of the firm, by favoring leverage, i.e., the higher the level of debt the higher will be the multiple (because the denominator gets lower). Secondly, P/E can be manipulated through non-operational items. Finally, enterprise multiples shall be adjusted to one-off changes in non-operational items such as: excess cash; operating leases; employee stock options; pensions.

On the other hand, Damodaran (2012) also points out four necessary conditions: 1) consistency; cross sectional distribution of the multiple; 3) fundamental link; 4) appropriate selection of peers.

Out of these factors it is important to emphasize the connection between multiples and fundamental variables. Multiples, as absolute valuation models, are also a function of three variables: risk, growth and cash flow generating potential. Therefore, firms with higher cash flows, higher expected growth rates and less uncertainty associated to the cash flows should trade at higher multiples than their counterparts.

Bottom line, relative valuation methods have the following benefits: 1) fewer assumptions and quicker computation; 2) straightforward; 3) reflect current market mood; 4) provides exclusive insights in strategic differences between companies. Regarding, the limitations: 1) ignore important variables; 2) easily manipulated; 3) inconsistency problems; 4) market mood vulnerable.

2.3) Contingent Claim Valuation

Finance theory argues that an investment project should only be accepted if the net present value associated is positive. As a result, to decide upon the investment opportunity we must discount future cash flows from the project at the constant current discount rate. Albeit that, the expected cash flows and the discount rates can change over time hence, so will the net present value. In different words, the intrinsic volatility of these factors will imply that the same project can be accepted or rejected over time. As Damodaran (2012) highlights, these circumstances are crucial in non-competitive environments. Whenever, a firm, due to some entry barrier of any kind, benefits from these special circumstances then it has the option to postpone the project and maximize its benefits – e.g. patents, undeveloped land or natural resources. For instance, an oil & gas company might want to explore pre-salt reserves if and only if the international oil price is above 120\$.

These special timing features allow the owner of the asset to think of it as a call option, where the downside is limited. Thus, the allure of contingent valuation is flexibility.

Despite of the three situations already aforementioned, options are particularly useful to value assets whose payoffs are a function of the value of the underlying. In reality, the main motivation behind this valuation technique is related with the fact that DCF models usually tend to underestimate the value of assets that are contingent on the occurrence of a given event.

Luehrman (1997 a), shares a similar perspective on this matter arguing that the value of choice can be underestimated by traditional discounted cash flow methods.

2.3.1) Option Pricing Models

Fisher Black and Myron Scholes (1972) have established the so-called B&S model to value traded options. Even though this model is widely used nowadays several improvements were made, namely to account for the existence of dividends and the possibility of early exercise.

A possible limitation of this model, when compared both with cash flow models and relative valuations, is related with the unavailability or misspecification of some of its inputs⁸. Firstly, in case the asset isn't publicly traded it will make it a lot harder to gather good estimates and consequently to increase the associated estimated error for the valuation. Secondly, some variables might not be correctly specified. For instance, variance is not constant through time and there is no optimal time period for its estimation.

Alternatively, the binomial model (Cox et al 1979), which is time-discrete, was also developed to value options. In practice, the values attained by both models should be more or less similar and suffers from the same limitations.

2.3.2) Further applications

Finally, I would also like to highlight that the B&S framework was also adopted by Merton to value equity. However, he did not stop there and adjusted the model so as to compute the likelihood and distance to default. Please bear in mind that as investors became more sophisticated their concerns about default events increased.

3) Retail Valuation

After the thorough discussion on valuation methodology, it is of utmost importance to highlight the standards in terms of retail company's valuation techniques. More specifically, the issues to be addressed are: 1) LFL; 2) growth rate of revenues;

3.1) LFL

The LFL, or comparable sales, is a comparison between the sales on two consecutive years, ignoring any increase due to stores expansion. This metric allows managers and investors to establish insightful comparisons between two given quarters or years. Despite its wide acceptance, lfl sales are not really comparable as there is no standard way to compute it in the industry. Beyond that, lfl relation to profitability is not straightforward as a given company might sell more per store due to promotions or sales, which do not imply more profit.

⁸ The inputs needed are the following: value of the underlying asset; variance; strike price; time to maturity; risk free rate.

3.2) Estimation of growth rate of revenues

Typically, for retailers, the growth rate of revenues, equation 14, is a function of 3 factors: 1) stores expansion; 2) lfl performance; 3) FX Effect.

$$\text{Growth rate of revenues} = \frac{\text{Sales}_{T-1}(1 + \Delta \text{Stores})(1 + \text{lfl})(1 + \text{FX})}{\text{Sales}_T} - 1$$

Equation (14)

4) Conclusions

In the aftermath of this chapter, some of the aspects discussed will be re-emphasized, as they provide critical insights on how H&M will be valued on **section 3**. First and foremost, to assess H&M fair value a two-stage WACC DCF methodology shall be used. This option is based on the fact that, currently, the company has no debt on its capital structure and no changes are expected. Thus, the main limitation of WACC DCF model is overcome. Regarding the cost of capital, the current figures for the Swedish Government 10 year yields are close to 2%. Still, these figures are perceived to be the result of current low interest rate framework and should revert to their long-term average in the coming years. Thus, a value of 4% was assumed. For the market risk, it was used Damodaran beta book for apparel retailing adjusted for leverage and cash position – 0.99. This number is broadly in line with the beta computed through the statistical regression of two years monthly returns to OMX Index.

Finally, a relative valuation analysis will be conducted to provide insights on the differences between H&M and its closest peers. On this aspect, given the conclusions drawn, the enterprise and PER ratios will be used. Regarding the peers, to select the appropriate group it will be used a cluster analysis from a pre-selected sample.

Part II - Valuation

Following, a thorough discussion on the existing valuation methodologies now we own the necessary tools to pursue the main objective of this Dissertation: assess H&M fair value. In this section, we will be using a top-bottom approach to evaluate H&M. This qualitative perspective will enhance the quantitative side to be developed later on. As Drew Jones, former Associate Director of Research at Morgan Stanley, puts it: *“Great analysts are those who work on a more macro level. Most equity analysts are expected to look at stocks from a bottom-up approach. Those who can also look at them from a top-down approach have a competitive advantage.”*

According to this view, we will be presenting an industry overview with the purpose of providing insights on the apparel retailing market namely market dynamics, key players and KPI's. Secondly, the company overview will highlight the main features of H&M namely, brand portfolio composition, share performance, shareholder structure, production process features, and strategic analysis. Ultimately, an investment case will be presented and a comparison to BoAML report of 26th of September of 2013 shall be done.

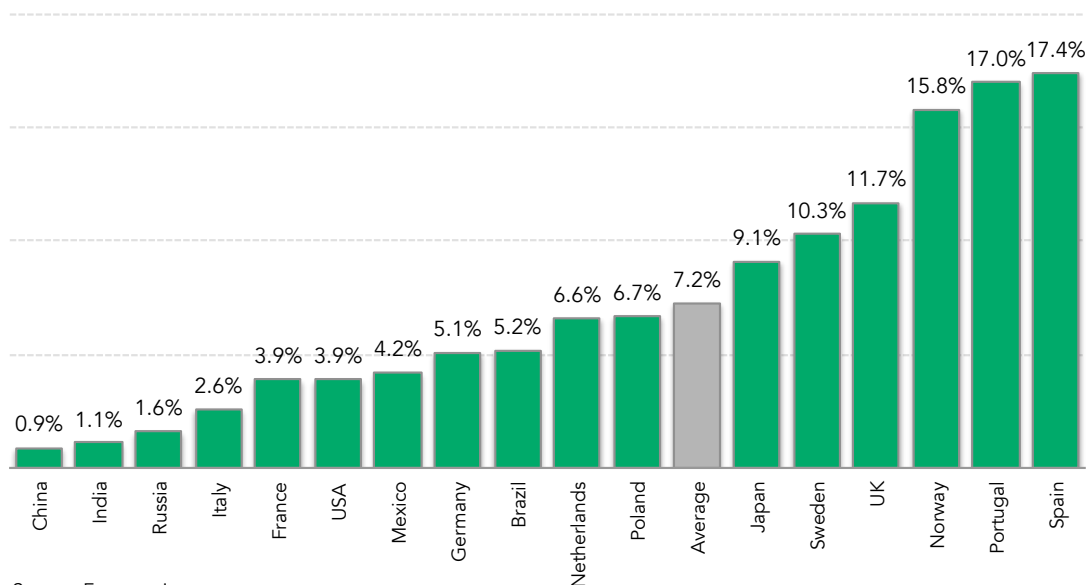
1. Industry Overview

According to the *Center for Retail Research*, in the United Kingdom, retail is: “the sale of goods to final consumers through stores, e-commerce and mail order, excluding petrol, travel agents, tickets and catering...”. This general definition includes all kinds of retailing namely: food, pharmacies, department stores, electronics, home improvement and so forth. Though, from the several categories within retail, this Dissertation will focus on apparel retailing.

1.1) Market Structure

One of the stepping-stones of apparel industry is the high sensitivity of the demand to prices. Leadership wise, **exhibit 1**, shows compelling evidence that apparel industry is highly fragmented. We notice that the average market share of the leader player, in each market, is roughly 7%.

Exhibit 1: Market share of number 1 retailer per country, 2012

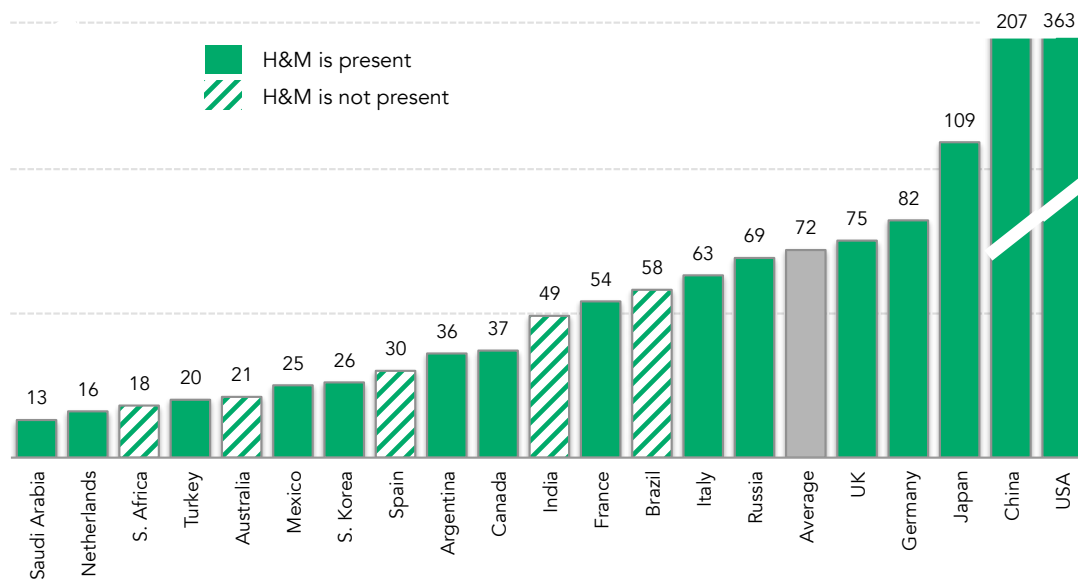


Source: Euromonitor

In spite of its high degree of concentration, the market as a whole is still sizable - \$ 1 443 bn. As **exhibit 2** demonstrates, United States and China clearly stand out as the two major markets worldwide. To put it in context, the sum of China and US market size is slightly inferior to the size of the remaining 18 markets, 634 \$bn and 692 \$bn respectively. Additionally, China and US are amongst the markets where the leader player has the lowest share, 0.9% and 3.9% respectively. For the foreseeable future, no major changes on the market structure dynamics of the industry are expected.

H&M, on FY12, had a market share of over 5% on the following markets: Germany, Sweden, Switzerland, Denmark, Belgium and Finland – **exhibit 3**.

Exhibit 2: Top 20 retail markets, 2012



Source: Euromonitor, Company Data, Berstein Research

Exhibit 3 – H&M market share 2012

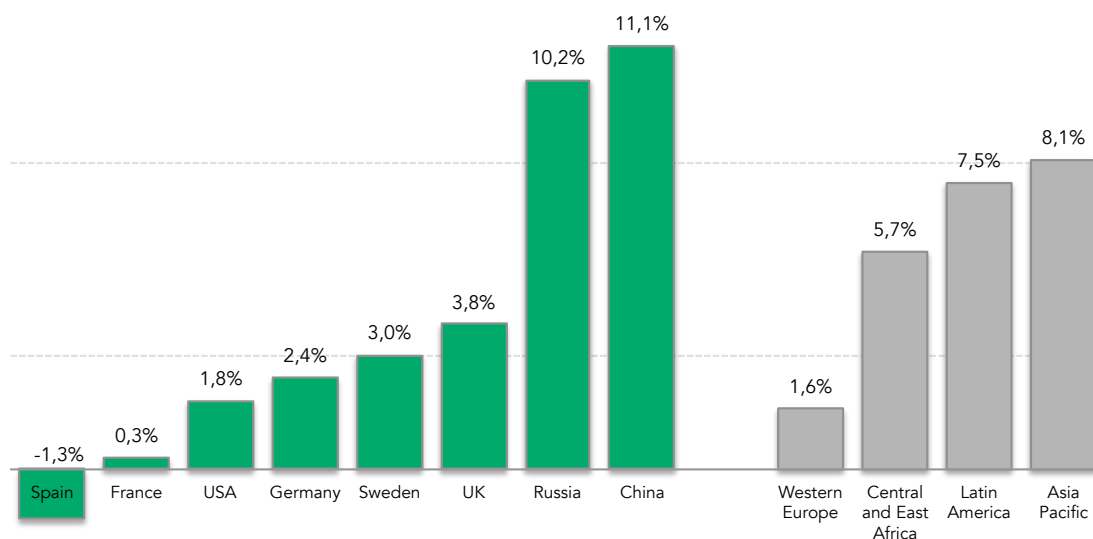
| Country | Sales 11/12 (SEK m) | % of Sales | Market Size | Share | Germany = 100 |
|-------------|---------------------|------------|-------------|-------|---------------|
| Germany | 30 303 | 21.5% | 555 466 | 5,5% | 100 |
| USA | 12 550 | 8.9% | 2 456 642 | 0,5% | 9 |
| UK | 10 413 | 7.4% | 508 540 | 2,0% | 38 |
| France | 9 976 | 7.1% | 363 519 | 2,7% | 50 |
| Sweden | 8 225 | 5.8% | 79 190 | 10,4% | 190 |
| Netherlands | 6 688 | 4.7% | 111 075 | 6,0% | 110 |
| Switzerland | 5 821 | 4.1% | 56 480 | 10,3% | 189 |
| Spain | 5 807 | 4.1% | 200 034 | 2,9% | 53 |
| Norway | 5 615 | 4.0% | 61 851 | 9,1% | 166 |
| China | 5 411 | 3.8% | 18 333 441 | 0,0% | 1 |
| Italy | 4 861 | 3.4% | 426 177 | 1,1% | 21 |
| Austria | 4 782 | 3.4% | 70 497 | 6,8% | 124 |
| Denmark | 4 297 | 3.0% | 42 176 | 10,2% | 187 |
| Belgium | 3 308 | 2.3% | 60 168 | 5,5% | 101 |
| Canada | 3 125 | 2.2% | 252 956 | 1,2% | 23 |
| Poland | 2 947 | 2.1% | 68 802 | 4,3% | 79 |
| Japan | 2 504 | 1.8% | 740 957 | 0,3% | 6 |
| Finland | 2 429 | 1.7% | 29 777 | 8,2% | 150 |
| Russia | 2 122 | 1.5% | 466 521 | 0,5% | 8 |
| Franchise | 1 914 | 1.4% | 280 580 | 0,7% | 13 |
| Other | 785 | 5.6% | 751 278 | 0,1% | 2 |

Source: Company Reports; Euromonitor; Bernstein Estimates and Analysis

Regarding growth perspectives, **exhibit 4**, points for two different paces worldwide. On one side, the selected developed markets display a CAGR 12-15E between -1%

to 4%, whereas, selected emerging markets in Latin America, China will deliver CAGR 12-15E at 8% and 6% a year, respectively. These circumstances, explain the strategic decisions that some of the players are pursuing in order to reallocating their worldwide footprint.

Exhibit 4: CAGR 12-15E by country and region: different paces, different opportunities



Source: Euromonitor

1.2) Who are the Players?

As stated by Deloitte in its annual report *Global Powers of Retailing 2014*⁹, H&M is the third largest apparel retailer in the world by revenues - **exhibit 5**. Moreover, it is important to highlight that the majority of players are either from Europe or United States. It can also be noted that the revenue CAGR 07-13 is quite volatile. The selected firms will be the cornerstone of the peer group to be dealt with in **section 4**.

1.3) KPI's

Following the market description, to perform a sound valuation it is essential to get the bigger picture of the industry. This section shall devote attention to macroeconomic variables that drive the industry performance. For instance, consumer spending is inextricably related to economic growth. If the economy is prospering both the wages and level of employment are expected to increase, leading to more consumption.

⁹ This rank includes only public companies, due to the data availability issues.

Exhibit 5: Apparel retailers by revenue, 2012

| Rank | Name | Country | 2012 Retail Revenue (US\$m) | Number of Countries | CAGR 07-13 Revenue |
|------|--------------------------|-----------------|-----------------------------|---------------------|--------------------|
| 1 | The TJX Companies, Inc | US | 25 878 | 7 | 6,8% |
| 2 | Inditex, S.A. | Spain | 20 560 | 88 | 11,1% |
| 3 | Hennes & Mauritz AB | Sweden | 17 800 | 49 | 9,0% |
| 4 | The Gap, Inc | US | 15 651 | 47 | -0,1% |
| 5 | Fast Retailing Co., Ltd. | Japan | 11 773 | 28 | 12,0% |
| 6 | L Brands, Inc. | US | 10 459 | 56 | 0,6% |
| 7 | Ross Stores, Inc | US | 9 721 | 1 | 10,2% |
| 8 | C&A Europe | Belgium/Germany | 8 904 | 20 | 2,5% |
| 9 | Kering S.A. | France | 6 293 | 85 | -19,1% |
| 10 | Foot Locker, Inc | US | 6 182 | 30 | 2,6% |
| 11 | Shimamura Co., Ltd. | Japan | 6 011 | 3 | 3,6% |
| 12 | Primark | UK | 5 524 | 8 | 16,9% |
| 13 | Next plc | UK | 5 501 | 72 | 2,2% |
| 14 | Belle International | Honk Kong | 5 213 | 3 | 23,0% |
| 15 | Deichman SE | Germany | 5 016 | 22 | 8,9% |
| 16 | Abercrombie & Fitch Co. | US | 4 511 | 20 | 3,8% |
| 17 | E.Land World | S.Korea | 4 427 | 15 | 13,4% |
| 18 | Nike, Inc. | US | 4 326 | 48 | n/a |
| 19 | Arcadia Group Limited | UK | 4 218 | 33 | 0,0% |
| 20 | Groupe Vivarte | France | 4 026 | 64 | 4,3% |

Source: Deloitte Superpowers

On a different level, whenever interest rates are low consumers tend to borrow more money and to increase their spending amounts. We decided to highlight the impact of macroeconomic variables through LFL sales figures as well as the impact of raw materials and currencies on the GMs. Albeit these, other factors such as markdowns or transportation costs can have a sizable impact on the financial results of global apparel retailers.

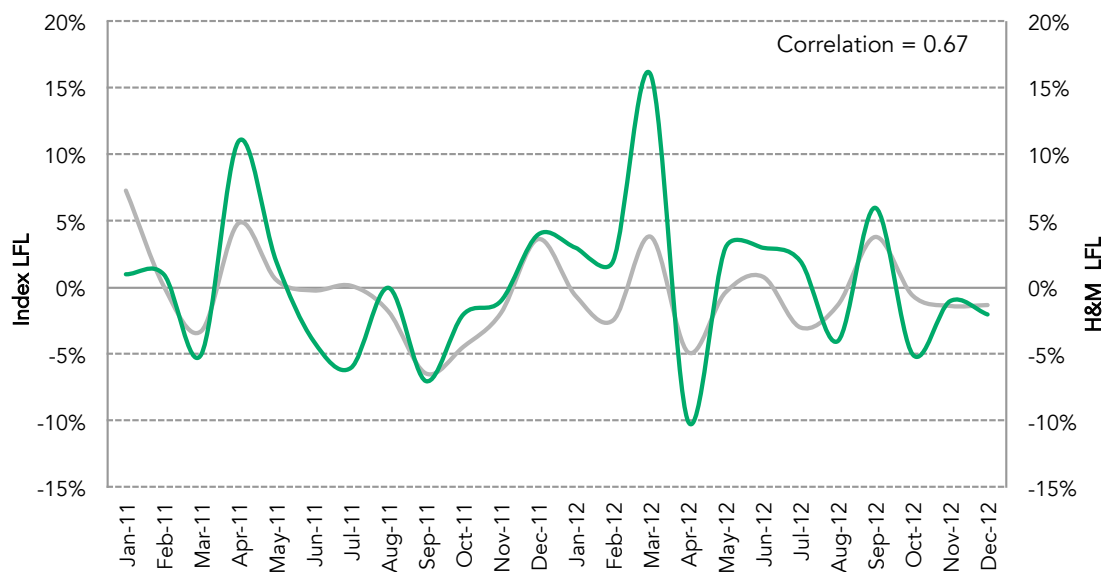
1.4) Macroeconomic framework

Exhibit 6 depicts an index on LFL retail sales on Germany, UK and Sweden in comparison to H&M group LFL sale figures - in 2012, these 3 countries accounted for c.36% of H&M sales. As expected, there is a mildly strong correlation between monthly LFL numbers on these 3 economies and the H&M due to its overdependence on Europe (c. 80% of revenues in 2012). This leads us to conclude that, despite the efforts to diversify their geographical sales footprint, Europe sales are still dominant for the overall performance of the group. **Annex 1** displays the macroeconomic framework for H&M main European markets.

1.5) Raw Materials

For apparel industry, cotton is one of the most important raw materials. Bernstein Research estimates that Cotton alone is responsible for nearly 60% of the COGS. As any commodity, it is subject to exogenous factors (e.g. weather conditions) that can cause sudden price peaks and dips - **Exhibit 7**.

Exhibit 6: LFL comparison: UK, Germany and Sweden LFL Retail Sales vs H&M LFL sales

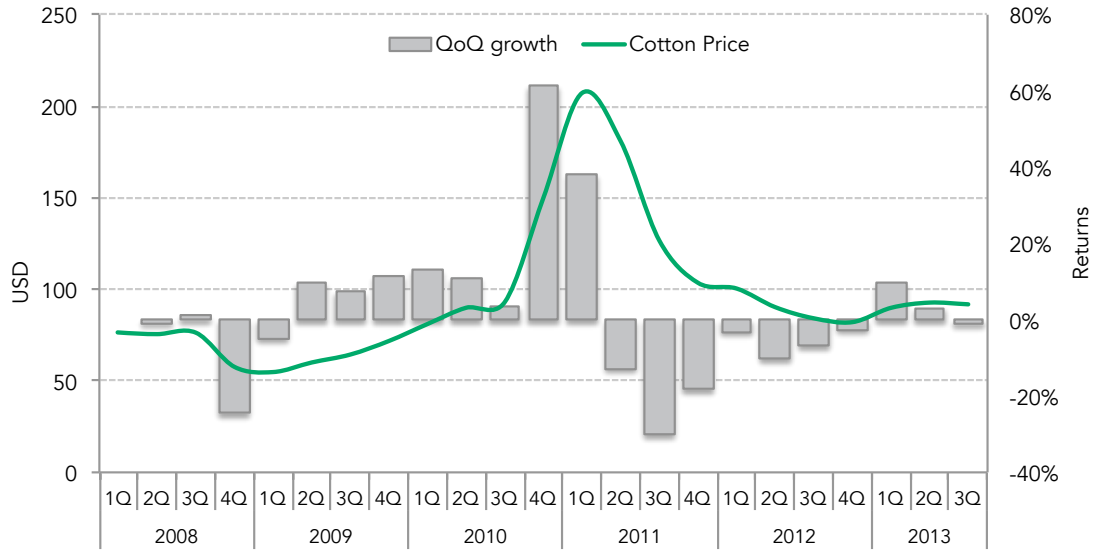


Source: Company Data, BDO, Textilwirtschaft, Svenks Handel Stil

As it can be seen, between 2008 and 2013 the price of cotton has revealed a slightly upward trend. Nonetheless, in early 2011, supply constraints on the main worldwide suppliers have triggered a surge on prices to levels over the \$ 200. Logically, these movements will have direct, but lagged (3 to 6 months), impacts on the gross margin performance of retailers. On **section 3**, a careful discussion will be made regarding the direct impacts that cotton prices have on H&M GMs.

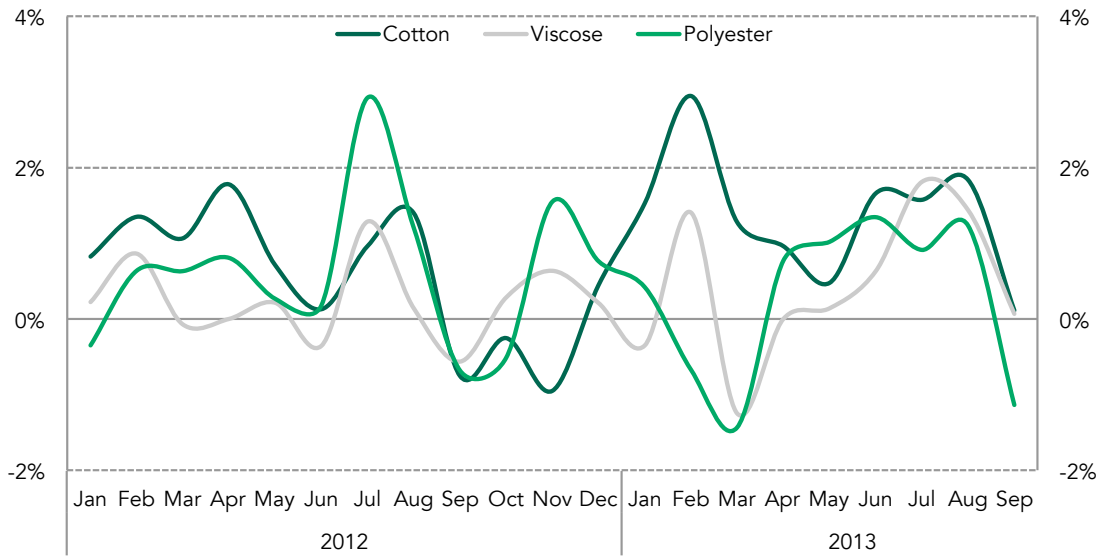
To hedge these risks, it would be plausible for retailers to change raw materials as a function of their relative price. Unfortunately, as **exhibit 8** illustrates, cotton prices, viscose and polyester are somewhat correlated, thus making this strategy pointless.

Exhibit 7: Price of cotton



Source: IMF

Exhibit 8: Correlation between cotton and other textiles returns



Source: India Ministry of Commerce and Industry

1.6) Currency Effects

In general, apparel retailers have operations on different countries and, as a result, are exposed to currency fluctuation risk. In 2012, H&M had operations in 49 countries, which entailed collecting revenues and paying for raw materials in different currencies which, later on, will all be converted into SEKs. The intrinsic uncertainty of these assets, makes it hard to model their impacts on revenues, costs and other financial items. This issue will be closely addressed at a later stage.

1.7) Industry Trends

"...shops are to shopping what typewriters are to writing: an old technology doomed by a better successor." *Economist, Shopping: The Emporium Strikes Back.*

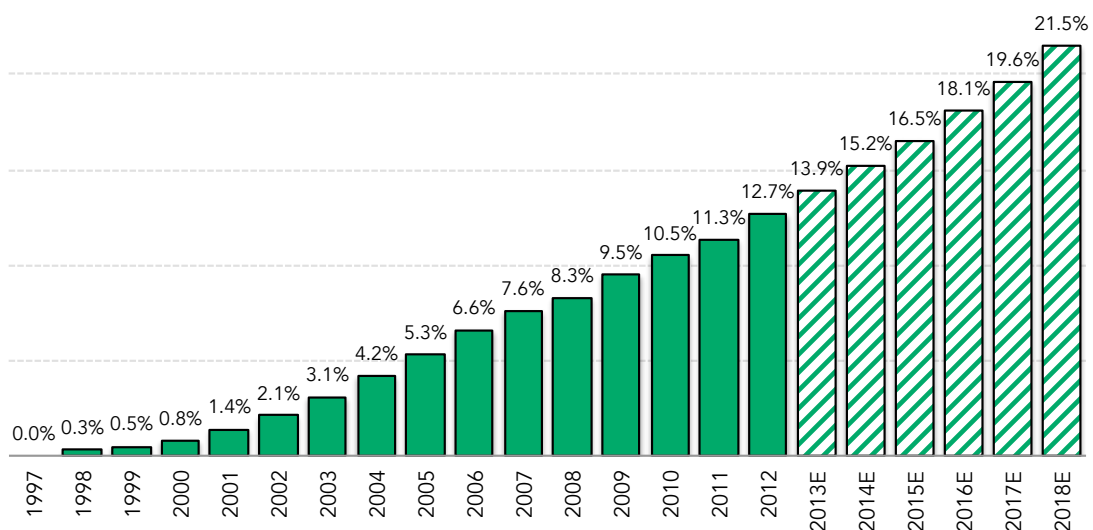
On the forthcoming years, the landscape of the apparel industry is set to be reshaped as tech savvy consumers will use Internet to disrupt its historical *modus operandi*. As of today, Internet channel already subdivides retailers as *bricks and mortars* for store only formats and *clicks and mortars* for multichannel ones. Whatever happens, one thing seems unquestionable: on the coming years the share of online sales will cannibalize stores sales as a percentage of a total sales – **exhibit 9**. From 1997 to 2018E, online sales surge from c.0% to c.22%.

Logically, the rate at which this phenomena will affect each country will be a function of the internet penetration, smartphone usage and so forth. According to **exhibit 10**, UK was the leading market with respect to online sales.

What yet remains to be settled is whether Internet will increase or decrease total sales volume. Our official stance, which will be translated into a quantitative assumption, considers that Internet will increase H&M total sales. For the sake of this discussion, it is crucial to highlight that the reason why costumers perceive the online option as valuable is intrinsically related to the inherent consumer surplus. Regardless, of how big a store can be, online is always vaster and cheaper.

If it is unquestionable that internet will halt the balance of the industry, it is also likely that its consequences will not be equal across all players. In fact the two extremes of the apparel market (low and high end) might not suffer from it at all. For instance, if a shopper is buying expensive clothes it will not do it over a tablet or a smartphone device. On the other end, all dollar stores do not benefit from internet, their price is already as low as it can possibly be (e.g. Primark, which is owned by Associated British Foods, sells nothing online).

Exhibit 9: UK online sales as percentage of total sales

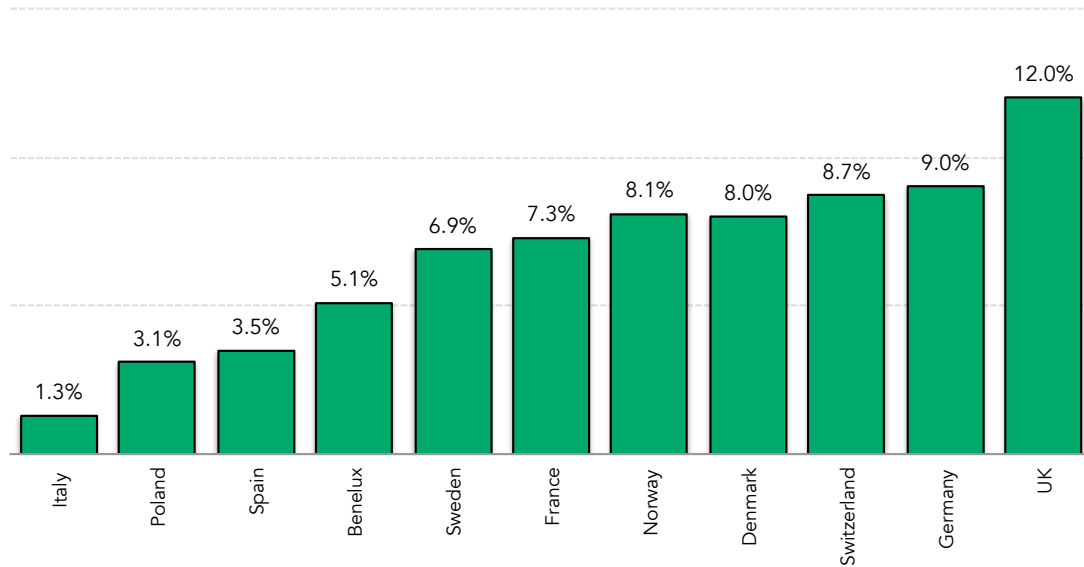


Source: Center for Retail Research, Retail Futures 2018

1.8) Apparel Segments

The apparel supply can be sub-divided based on the price range as well as on the trendiness of the products. In the past, these two variables used to be strongly correlated, i.e., only expensive brands had the resources to pay expensive designers and to dictate fashion trends.

Exhibit 10: Online share of retail sales, by country



Source: CCR, Online Trends, 2012, OECD Internet Economy Outlook

Nowadays, considering that intellectual property rights are hard to enforce, a new trend has emerged and it is hard to agree that low to mid-end brands can't be as fashionable as expensive ones. Based on this analysis and for the purposes of this Dissertation, the market will be split into three segments: low, mid and high-end. H&M locates itself on the low to middle-end.

2) Company Overview

This section will provide a brief overview of the main aspects of the company, which will be essential to comprehend the subsequent valuation chapter. Moreover, this section will only address aspects that characterize H&M business model thereby minimizing any financial analysis considerations.

Hennes and Mauritz was established back in 1947 in Västerås, Sweden. Ever since its inception their aim is to provide quality fashion at the best possible price. In the fiscal year of 2012, the Swedish company generated a turnover of SEK 140 948 m and created 10 000 jobs. Nowadays, H&M sells clothing, footwear, accessories,

cosmetics and home textiles under 7 brands. Their target customer is wide, ranging from children and teenagers to adults.

2.1) Brand Portfolio

H&M's brands portfolio is vast and the company shows no indications of slowing down. Most recently, the Swedish brand broadened their supply by both creating & *Other Stories* brand and adding sportswear to their garment collection.







The motivation behind this multi brand strategy is to fit the current consumer needs in the best way possible and hence, to capture a bigger share of each market. As **exhibit 11** illustrates, each insignia was developed to match given characteristics in terms of style and purchasing power. In spite of this diversity, the H&M brand is and will be the most important one in terms of revenues and number of stores.

2.2) Business Model

H&M truly believes that the secret within the apparel industry relies on designers and chiefly on the trends ideas, which they sell. This is why H&M has, on its headquarters, in Stockholm, a diverse working place focused in spotting and creating the next trends – the white room. Following the creative process, the company outsources the whole production process to external factories in Europe and Asia that guarantee highest quality standards and the most efficient cost structure. On **exhibit 12**, below, we can see the production model of the company.

H&M offers a value priced mass fashion product and relies on low cost sourcing and supply chain efficiencies to deliver strong margins. Whenever input costs increase H&M generally, does not increase prices and as a result the margins are affected.

Exhibit 11 – H&M brand portfolio

| Brand | Short Description |
|---|--|
|  | Combine influences from street fashion subculture with catwalk vibe. The cornerstone of the collection is its denim range. Succinctly, high fashion content at prices suitable to almost every budget. |
|  | The brand feature individualistic street wear collections aimed primarily at young women |
|  | Particular focus on personal expression and style. Extensive selection of shoes, bags, jewelry, cosmetics and clothes. |
|  | Weekday is a progressive multi brand concept with a strong focus on jeans. |
|  | Modern, timeless, tactile and functional exploring the concept of favoring style over fashion. It is design for fashion savvy costumers. |
|  | Offers fashion for every room in the house: towels, bed linen, curtains and other textiles in trendy colors. All this at the usual price range |

Source: Company Data

2.3) Advertising Strategy

The advertising policy puts a great emphasis on the company's values to deliver quality fashion at the best possible price. A striking example of this are the collaborations that H&M has established with big industry players from high-street stores such as *Jimmy Choo* or *Versace*, or even the advertisements campaigns with the well know personalities such as David Beckham.

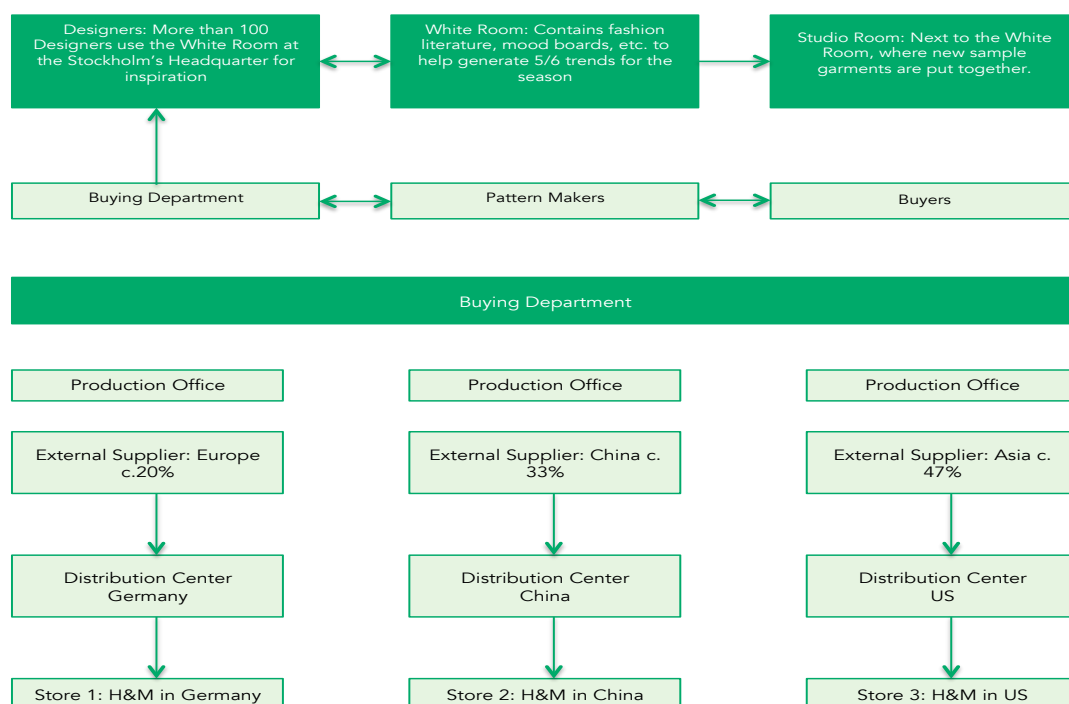
2.4) Rebranding

On February 2013, H&M participated at the Paris Fashion Week. This participation suggests a clear attempt of H&M to rebrand itself and to set them apart of the value segment of the industry, which operates on thinner margins.

2.5) Shareholder Structure

Notwithstanding the IPO in 1974, H&M is still a family/nationally owned company - **exhibit 13**. Accordingly the free-floating share of common stock is equivalent to c.44%. Historically, the shareholder structure has been stable and, for the future, it is perceived to stay that way as the low interest rate framework and the high payout ratios should deter any major change. Regarding the controlling interests, the company is dominated by the Persson family with c.70% of the voting rights.

Exhibit 12 - H&M production model



Source: Berstein Analysis

Exhibit 13 – Shareholder structure

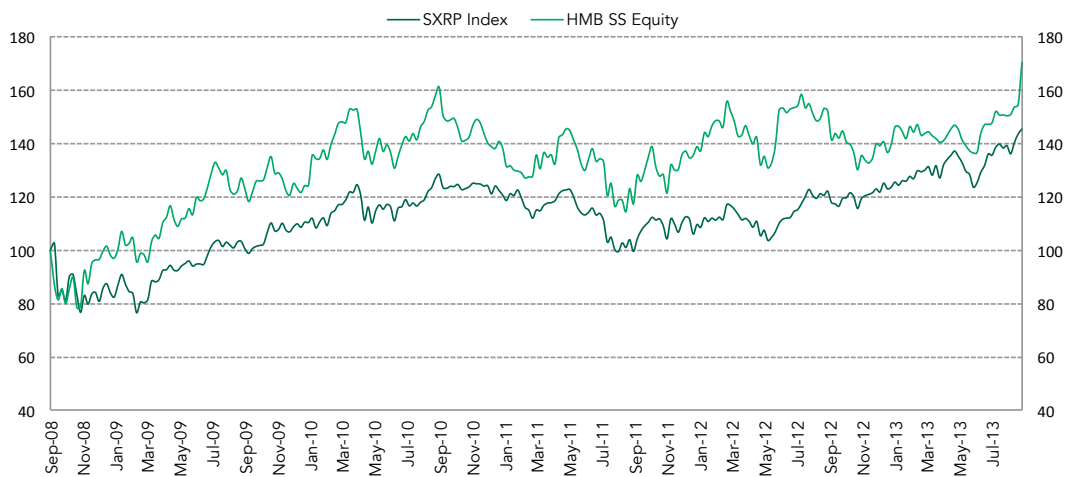
| Major Shareholders, 30 Nov 2012 | NOS (m) | % of Voting Rights | % of Total Shares |
|--|---------|--------------------|-------------------|
| The Persson Family and Related Companies | 624 | 69,71% | 37,69% |
| Lottie Tham and Family | 88 | 2,59% | 5,32% |
| Alecta Pensionsforsakring | 65 | 1,90% | 3,92% |
| Swedbank Robur Fonder | 46 | 1,35% | 2,78% |
| AMF Försäkring och Fonder | 32 | 0,93% | 1,91% |
| Afa Försäkring | 16 | 0,48% | 0,98% |
| SEB Investment Management | 16 | 0,46% | 0,95% |
| Fjärde AP-fonden | 16 | 0,46% | 0,95% |
| Handelsbanken Fonder | 15 | 0,45% | 0,92% |
| Jan Bengtsson | 14 | 0,42% | 0,86% |

Source: Company Data

2.6) Share Price Performance

On a 5 years window, H&M is c.70% higher than in 2008 and, on YTD perspective, is up by 21%. On the other hand, SXP is 45% and 23% higher for the same time frames. This performance illustrates clearly, the company dependence on European Markets as well as the strong correlation of the retail industry to the macroeconomic condition. When compared to the SXP we observe that the two lines have moved in tandem with no lagger nor follower. Despite of this global tendency, H&M has an historical premium over the European retailing index.

Exhibit 14 – Share price performance

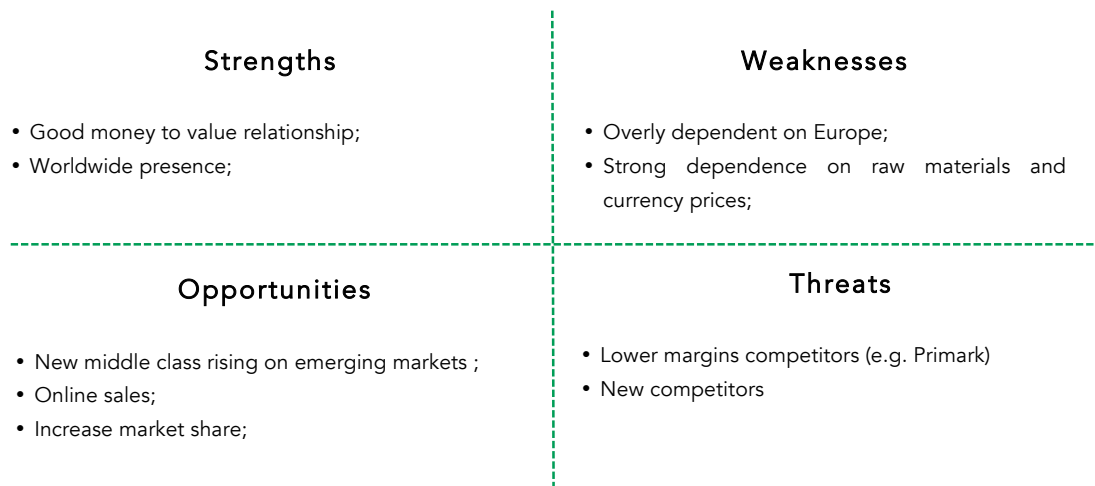


Source: Bloomberg

2.6) Strategic Analysis

To complement the company and industry overview we will also provide a strategic analysis on H&M. The analysis conducted below, through the SWOT, will shed some light over some of the assumptions to be made on **section 3**.

Exhibit 15: SWOT analysis



Source: Own Analysis

3) Valuation

As outlined at the end of the Literature Review, a two-stage WACC DCF should be used to assess the intrinsic value of H&M. This valuation technique was chosen on the basis that H&M is expected to grow faster over the coming years and to stabilize afterwards. Additionally, a multiples analysis will be conducted to triangulate the results and to provide further insights on the strategic differences against its closest peers. Furthermore, the results attained on this section will be compared to the report from BoAML on the date of 09/26/2013, being that the pricing date of the valuation

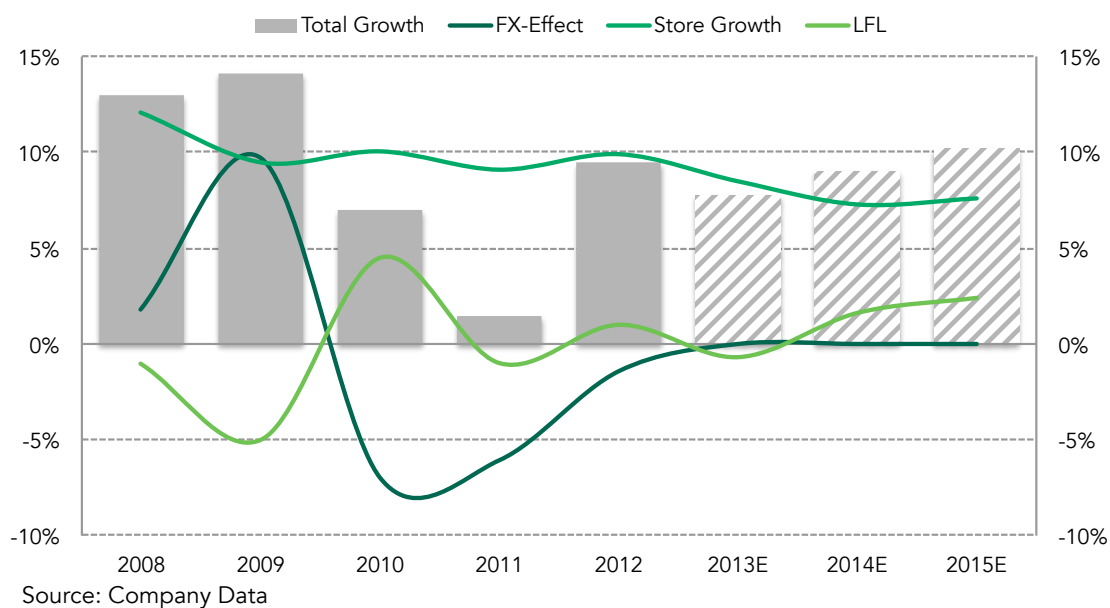
3.1) Sales Model

As aforementioned, it is a common practice in the industry to compute the growth rate of revenues based on the following three factors: 1) forex effect; 2) like-for-like; 3) area growth contribution. **Exhibit 16** breaks down the overall growth rate of revenues into the key drivers just mentioned. Over the past 5 years, the CAGR 08-12 was 8%. Since 2008, the area growth rate contribution has been the strongest one, with a conversion rate of c.90%. For the future, unless H&M is able to obtain

significant gains in market share, the store growth will still remain the main engine of growth.

The sales model presents forecasts spanning the next 20 years decomposed by factors – **annex2**. Overall, the model assumes a CAGR 13-23 of 11% and a CAGR 24-33 of 2%. For the sake of simplicity and due to the unpredictability of currency markets, it was assumed that the FX-effect would equal zero throughout the whole valuation period.

Exhibit 16: Growth rate drivers



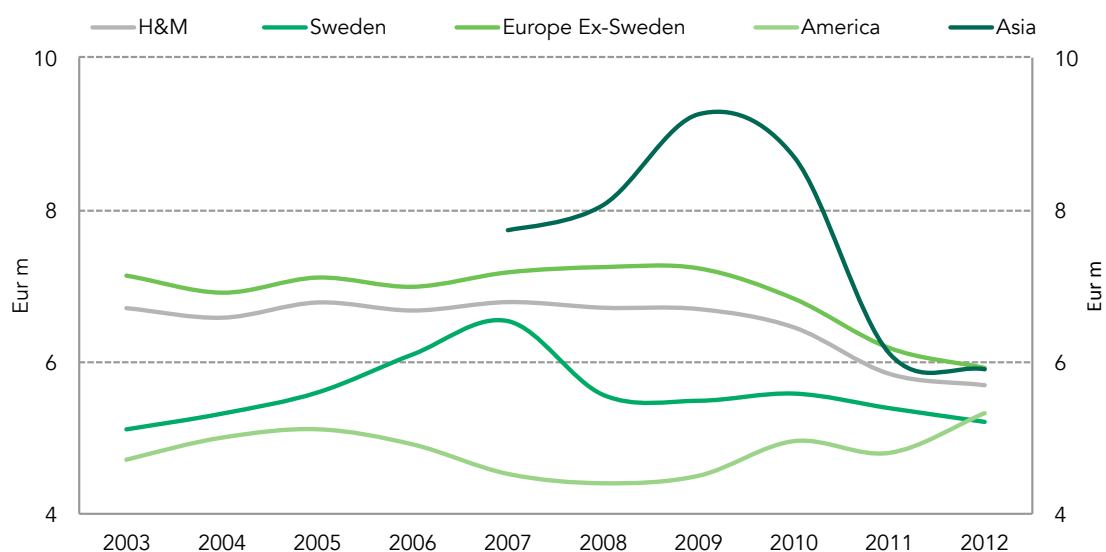
Though, the valuation risks associated with this variable are disclosed on **section 4**. The area contribution is derived directly from the assumptions made on the stores model, which are outlined on **section 4**. Conversion Rate figure assumed was c.80% based solely on a rolling historical average. Moreover, the LFL estimations are computed as a weighted average on the LFL of each relevant region, which subsequently depend chiefly on the nominal GDP growth.

3.2) Sales Densities

Yearly group sales figures, per store, have turned slightly downwards from 2003 to 2012, decreasing from Eur 7 m to lower than Eur 6 m per store, per year. These results make sense, as there is a kind of store cannibalization effect as the group expands. In spite of that, not all regions have behaved in the same way. For instance, Asia has delivered higher sales per store but it also charges the higher prices – **exhibit 17**. Nonetheless, the recent drop on sales per store for Asia suggests that H&M might also be adjusting its price strategy to become more

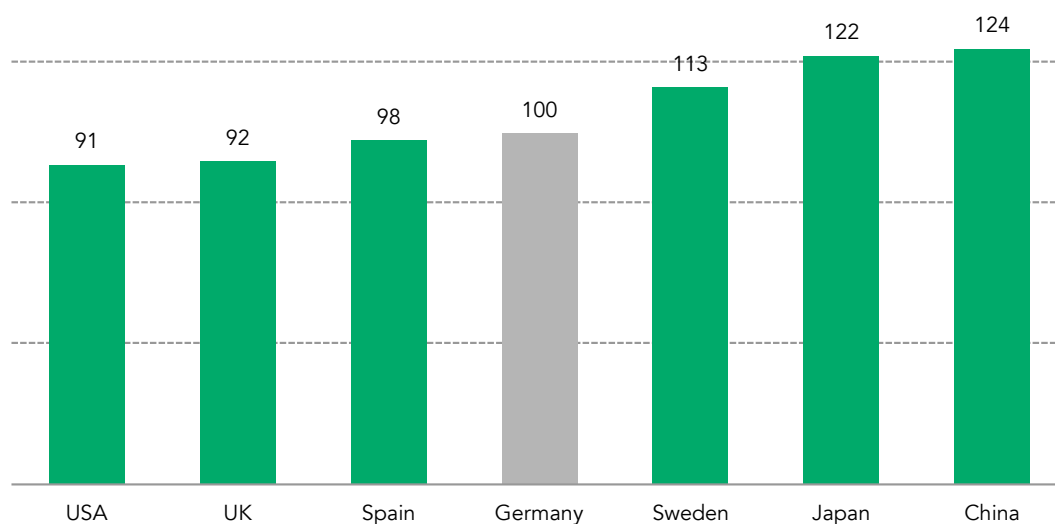
competitive hence, grabbing a bigger market share and due to increasing store base effects.

Exhibit 17: Sale densities are converging



Source: Company Data

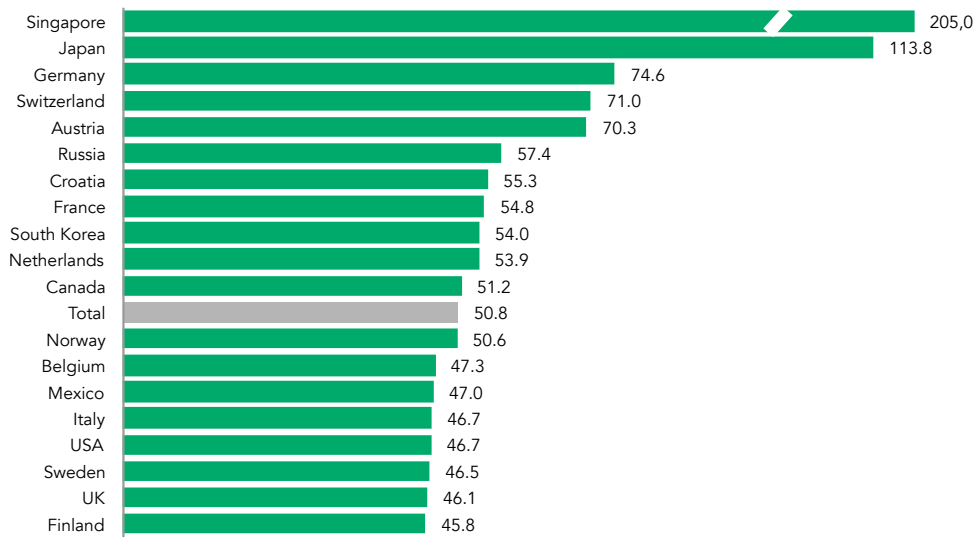
Exhibit 18: Prices are not homogenous across regions, 2012 (Germany = 100)



Source: Berstein Survey

Exhibit 18, reinforces **exhibit 17** perspective. Prices tend to be 24% higher on Asia than Germany. More importantly, for consolidated countries, **exhibit 19**, indicates where H&M is performing above the group figures. For instance, the sales per store on Sweden and UK are below the established benchmark allegedly due to competition issues hence, a lower price strategy is applied.

Exhibit 19: Sales per store

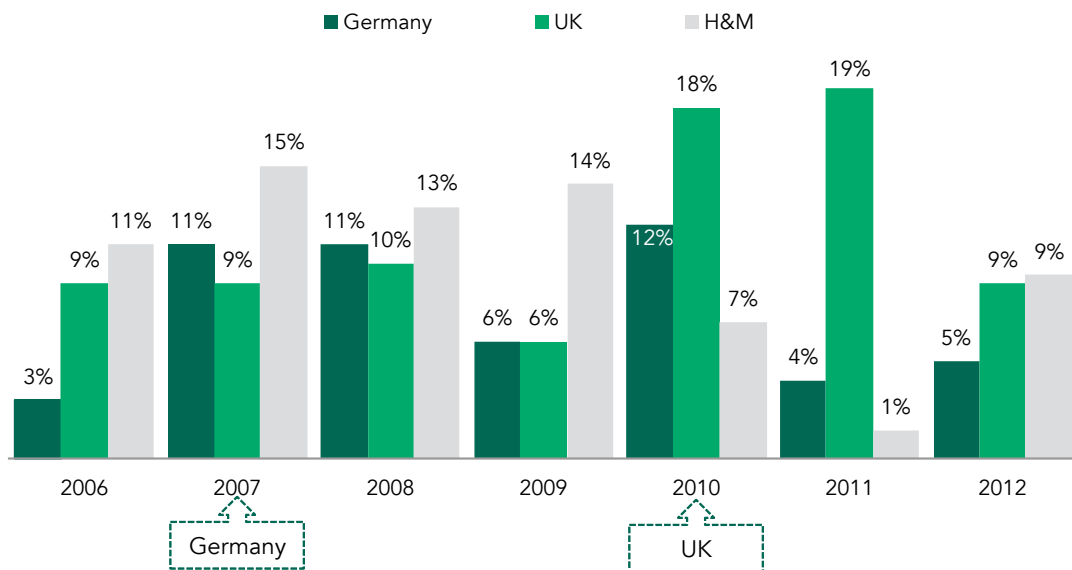


Source: Company Data

3.3) Online sales expansion to boost LFL

According to Deloitte, online sales do not cannibalize high-street sales, as common sense would suggest. In fact it might even increase overall consumption. For instance, if we analyze the impact of online platforms on H&M local currency growth in Germany (2007) and UK (2010), there is some evidence that internet boosts sales – German sales increased 11% in 2007 whereas for UK sales increased 18% from 3% and 6% respectively on the previous years.

Exhibit 20: Online offer to boost total sales



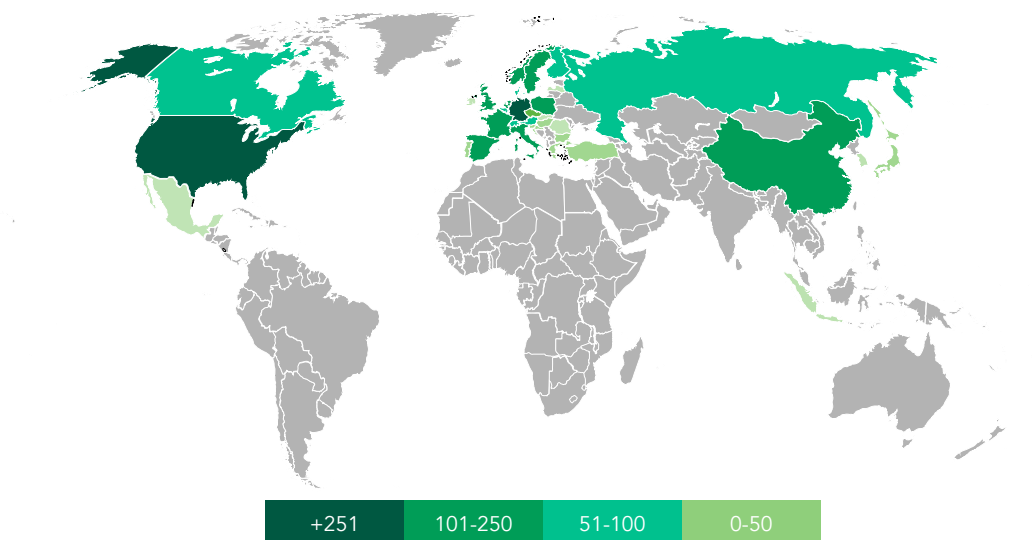
Source: Company Data

To back test the results mentioned by Deloitte, it was conducted an analysis on local currency growth rate (i.e., excluding exchange rate effect) for Germany and UK – **exhibit 20**. This small sample suggests that the addition of the online channel (click and mortar) in fact leads to increases on the overall growth rate. On UK, which is one of the leading countries on online adoption, the introduction of online option in 2010 led to a 12 p.p.YoY increase on sales growth rate. For the future, company guidelines and infrastructure investments indicate intentions to become a multichannel retailer on every geography. These guidelines will be reflected on the company’s sales model through a spread on LFL sales, which fades away over time.

3.4) Stores

In 2012, H&M store distribution exhibited an overdependence on Europe, accounting for roughly 80% (2175) of the total number of stores (including Sweden). These figures make sense as H&M only recently expanded towards America and Asia.

Exhibit 21: Geographical stores distribution, 2012

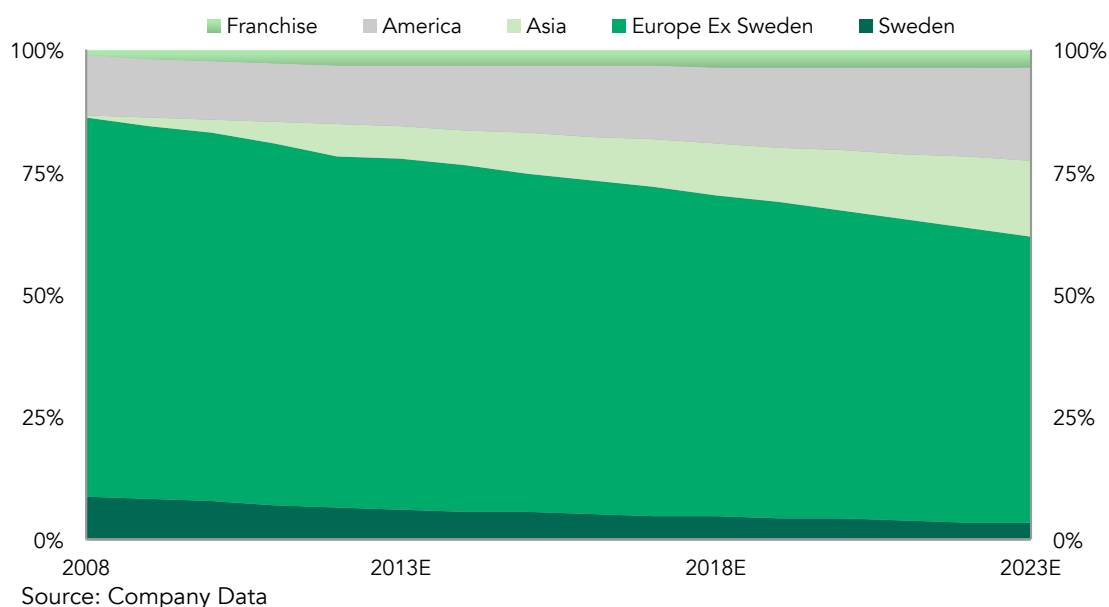


Source: Company Data

In spite of these circumstances, on the quest to become a truly global brand, H&M has set forth their ambitious intentions for the next decade, where the company guidelines indicate growth rates of 10 to 15% a year. In 2012 the company has opened over 300 net stores whereas in 2013 – almost 1 new net store per day throughout the year. ITX, also exhibits the same store distribution bias towards Europe, though less accentuated. Since 2002, the company has increased the pace

of expansion by entering an additional 35 countries, with a further 4 to be entered in 2013 (CAGR 2002-2012 of 13.1%). On the other hand, since 1947, the company entered 13 markets besides Sweden (CAGR 1947-2002 of 4.9%).

Exhibit 22: Stores distribution by region



Given these guidelines, the store distribution should become more balanced as **exhibit 22** illustrates. This structure will allow the company to benefit from the ever-growing purchasing power of the middle class in emerging markets. Ultimately, according to the IR department, the average size per store is 1350sqmand it shall not change within the explicit valuation period. A detailed analysis is made on **annex 4**.

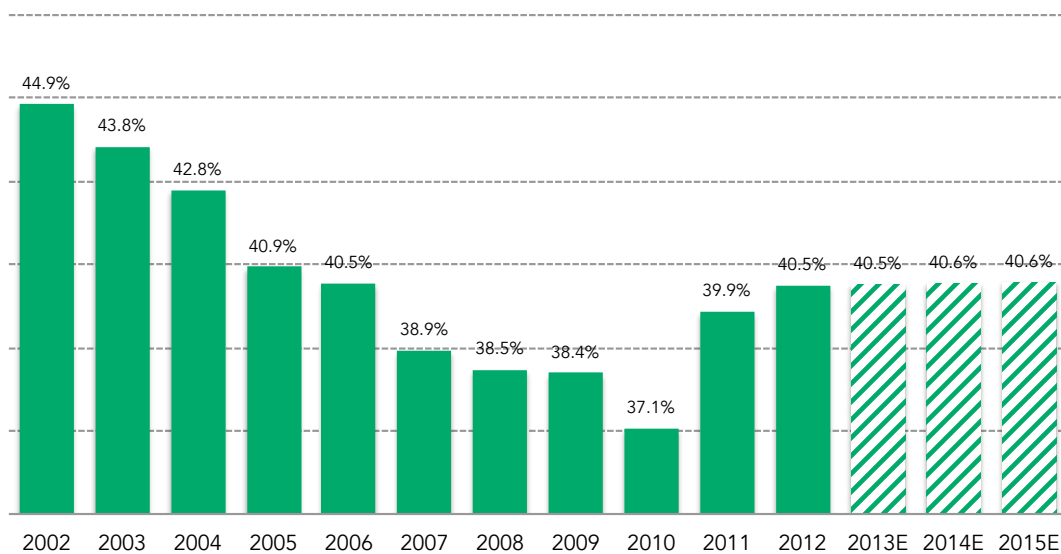
3.5) Costs Structure

Historical direct production costs, have exhibited a clear downward pattern as a result of efficiency gains linked to the outsourcing model and low prices of raw materials (e.g. cotton). From 2002 to 2010, COGS have decreased 7.8 p.p.. Nonetheless, in 2010/2011, this trend was inverted as, a spike on cotton prices (which account for c.60% according to COGS) motivated by unpredictable weather events, triggered an increase on production costs to all-time highs. On these situations, the historical company stance has been to remain faithful to its price principles and to not increase prices. Aside from commodities prices, H&M also relies heavily on the EUR/USD cross. The Swedish company purchases most of its raw materials in USD, sells in EUR and reports in SEK. Hence, an unstable currency scenario might disrupt the cost structure. **Exhibit 24**, illustrates the sensitivity of GM YoY changes to USD fluctuations as well as cotton prices. It can be noticed that

the cotton price swings have impacted GM more than currencies. For the rest of the year and 2014, the outlook for cotton is perceived to be stable. Still, this kind of occurrences is impossible to forecast and thus shall remain outside of the projections of the P&L statement – check valuation risks.

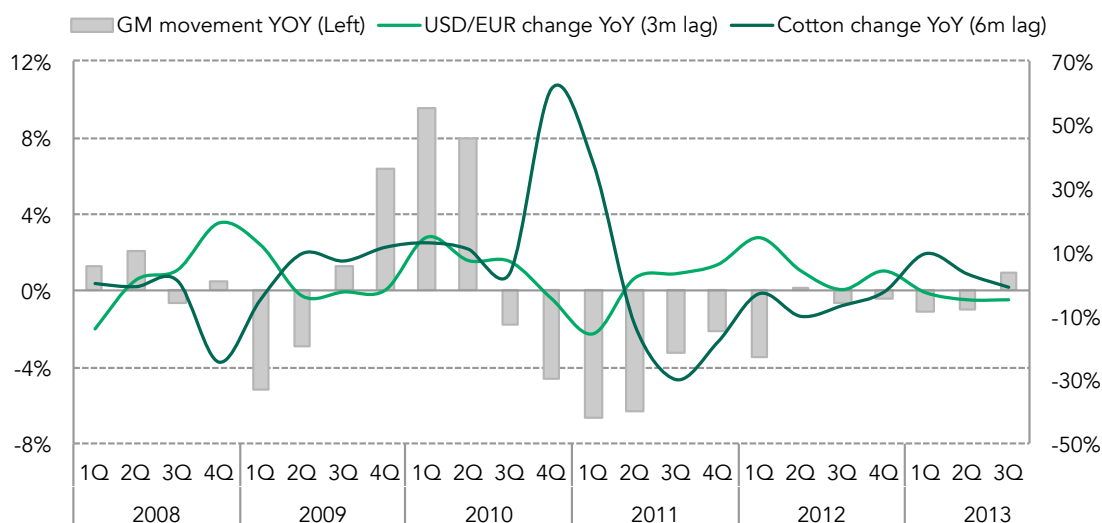
For the long-term, the model estimations assume a GM and OM of 41 and 18% (as % of sales), in line with the current values, assuming a stable raw materials and currency scenarios and reflecting the rebranding movement – **annex 5**. Selling, general and administrative costs have remained relatively stable. The long-term value assumed is c.40% of yearly sales due mostly to logistics and advertising costs.

Exhibit 23: COGS as % of sales, 2002-2015E



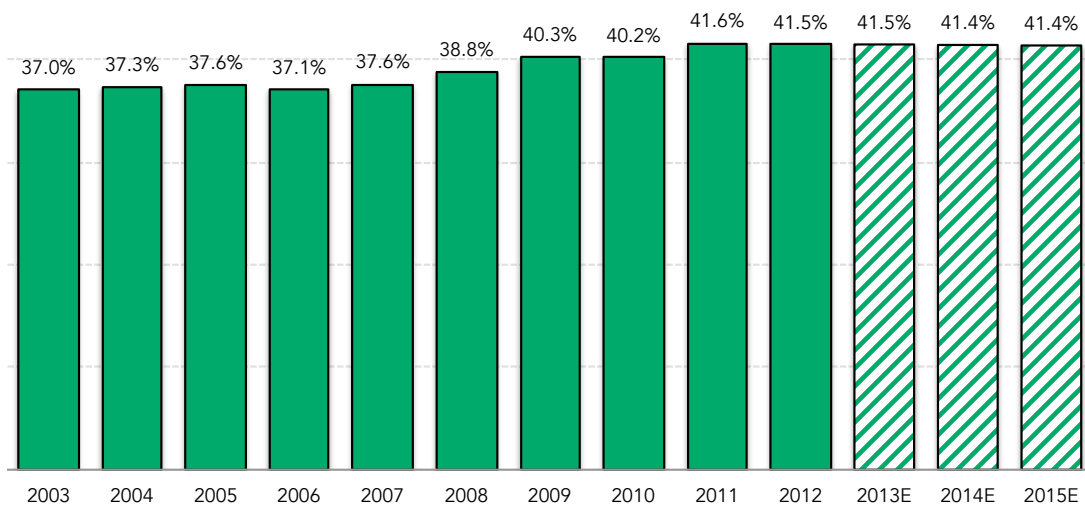
Source: Company Data

Exhibit 24: GM dynamics with cotton prices and USD/EUR



Source: IMF and Bloomberg

Exhibit 25: Selling, general and administrative expenses as % of sales

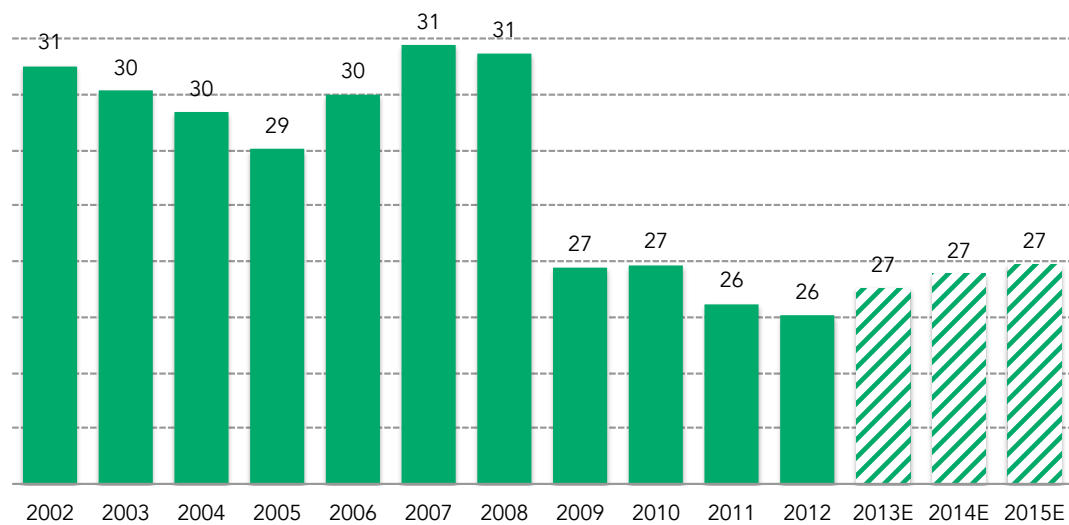


Source: Company Data

3.6) Employee trends

Broadly, the overall number of employees is directly related to the increase on the number of stores. The CAGR 02-12 was 10,9%, which is in line with the increases on the number of stores. Still, since the 2008 economic downturn, H&M has decided to reduce the number of employees per store from 30,7 to 26,0 in 2012 – 15% less. For the future it is foreseen that the number of employees will continue to grow in tandem with stores and no further decreases on the average number of employees per store.

Exhibit 26: Average number of employees per store



Source: Company Data

3.7) NWC

H&M way of computing NWC is described by equation 15. This item is crucial to compute the company's fair value as it has a direct impact on the FCF. As a result, estimations on the following balance sheet items will be made. Essentially, it all comes down to how H&M will pay its current debts and is able to collect money. As the company provides no insight on this subject, it was assumed that the future payment conditions would be identical to the current ones – **annex 6**.

$$NWC = \text{Accounts Receivables} + \text{Other Receivables} + \text{Stock in Trade} \\ - \text{Accounts Payable} - \text{Prepaid Income}$$

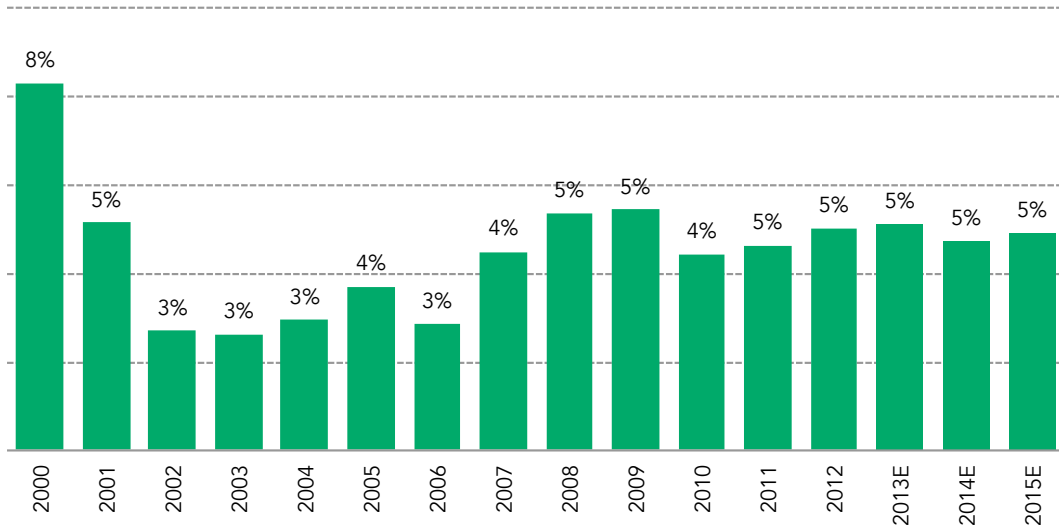
(equation 15)

3.8) CAPEX and Depreciation

As outlined before, currently H&M has several structural investments undergoing to consolidate its position as a global apparel brand, namely: 1) store expansion; 2) diversify brand portfolio; 3) online sales platform. **Annex 7**, decomposes CAPEX into intangibles and tangibles and presents the forecasts for the first explicit period, whereas for the second stage of the model we simply assume that the major investments are done and yearly CAPEX will equal depreciation.

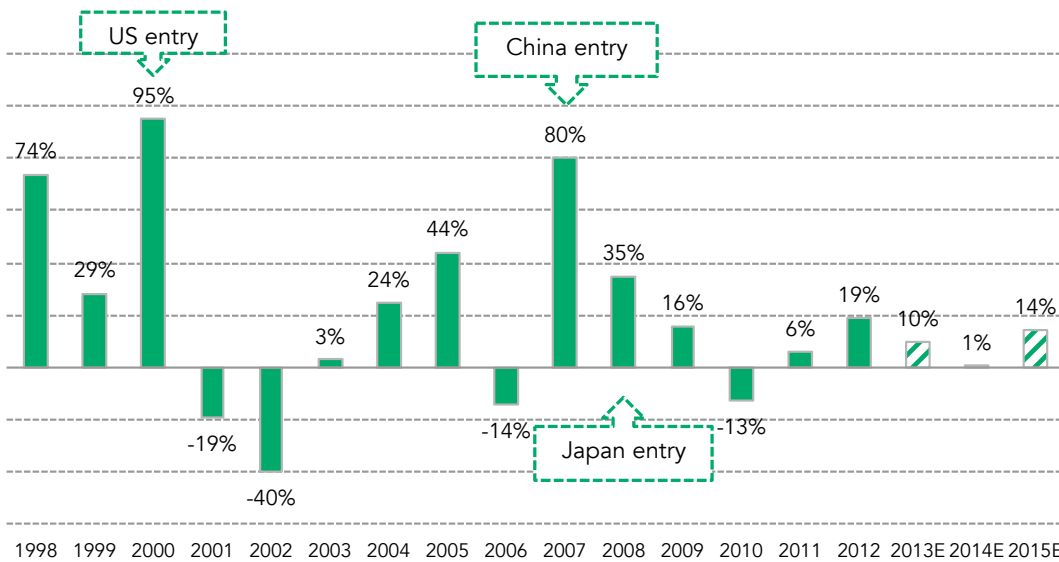
Throughout the last decade the CAPEX spending as percentage of sales - **exhibit 27**, has varied, chiefly, as a function of group's expansion towards America and Asia. **Exhibit 28** illustrates the YoY CAPEX performance and we can verify that the expansion movements of US, China and Japan required massive cash outflows.

Exhibit 27: CAPEX as % of sales



Source: Company data

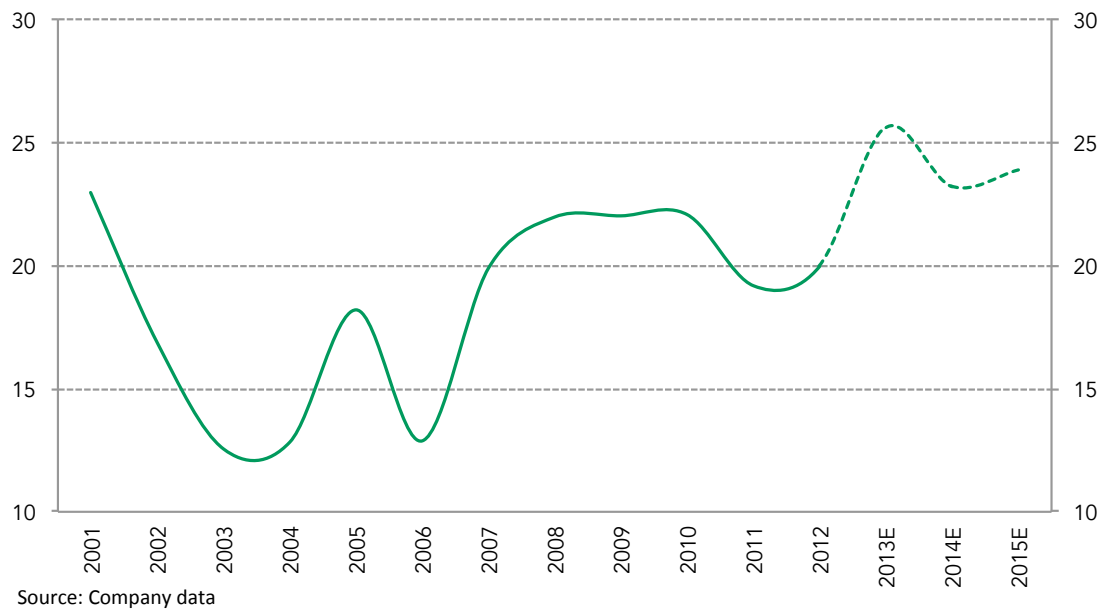
Exhibit 28: CAPEX YoY change



Source: Company Data

The cost per net store opening is estimated to increase over the coming years as a result of the following factors: 1) new stores on the south hemisphere are perceived to be more expensive on the basis of the lack distribution/logistics platform; 2) flagship stores – **exhibit 29**.

Exhibit 29: CAPEX per net store openings



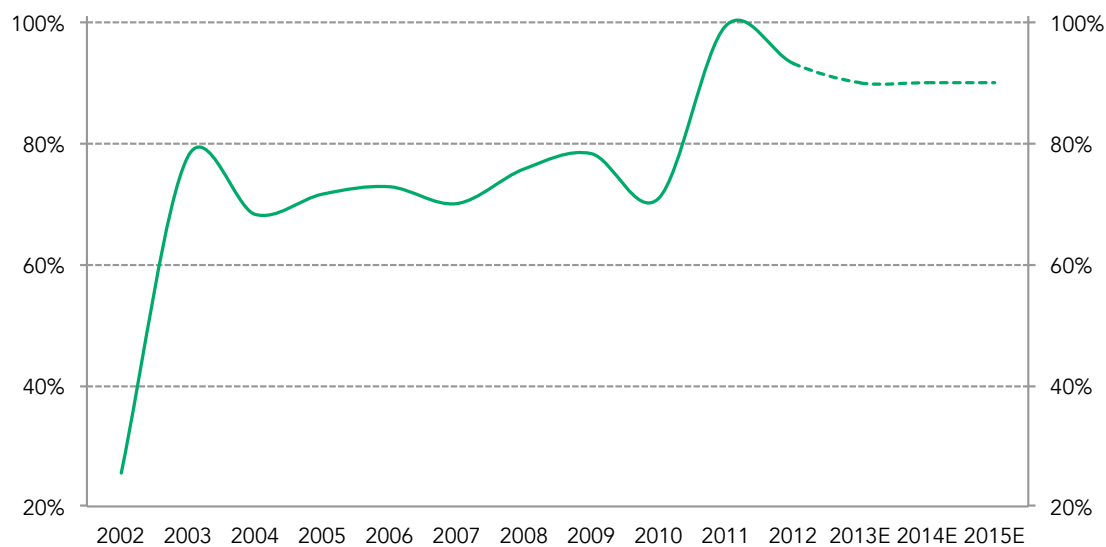
On the other hand, the depreciation figures have remained roughly constant throughout the whole period. We would like to recall that, H&M opts to lease its stores and to outsource production and, as a result, depreciation do not play a major role for the valuation exercise – **annex 7**

3.9) Dividends

According to the 2012 annual report, H&M dividend policy shall payout half of the profit after taxes. However, as long as a sound financial situation persists, the board is set to distribute higher percentages. On 2012, H&M had no debt on its balance and enjoyed SEK 9 566 m in cash.

Exhibit 30 illustrates, throughout the last decade the payout ratio has been significantly higher. In 2012, the proposed dividend per share was SEK 9.5, equivalent to 93% of the profit after taxes.

Exhibit 30: Payout ratio, 2002-2015E



Source: Company Data

3.10) Technical Valuation Caveats

Currently, H&M does not carry any financial debt on its capital structure and there is no indication of changing its debt-to-equity ratio in the near future. Thus, WACC is equivalent to the cost of equity.

As a result, a constant WACC rate of 9.36% can be assumed for the whole valuation period with no valuation drawbacks. Following the cost of capital discussion at **Part I** of this Dissertation, the CAPM was used to reach this value based on the following inputs: 1) Risk-free rate of 4%; 2) Beta of 0.99; 3) ERP¹⁰ of 5.41%. Secondly, for the terminal value growth rate, we assumed it to grow at 2%, a consensus figure, justified by the long-term economic growth.

Ultimately, to attain the Enterprise Value, we have adjusted the for the cash or net debt position, i.e., to the Enterprise value we add the cash (SEK 14 148 m) and subtract the provisions (SEK 377 m).

¹⁰ Due to the geographical diversity of H&M, a weighted average of each region ERP was computed.

4) H&M Investment Case

The fundamental analysis conducted above led us to reach a target price of SEK 246 per share and to issue a NEUTRAL/HOLD recommendation. This fair value implies a c.12% downside potential in relation to the current market price – SEK281. In our perspective, the current prices looks rather unjustified, but the dividend yield of c.4% is quite attractive, discouraging short positions. From a forward-looking multiple perspective (on PER and EV/EBITDA) the Swedish group is trading in line with its most direct peers (ITX), but more expensive than the average of the apparel retailing industry (see exhibits 35 and 36). On a YTD framework, H&M has outperformed both the SXP 600 and ITX with a 24% increase versus 18% and 4% respectively.

Exhibit 31: Pricing information

| Hennes&Mauritz | |
|----------------------------------|---------------------------|
| Pricing Information | |
| Rating | Neutral |
| Fair Value | SEK 246 |
| Share Price (09/26/2014) | SEK 281 |
| Downside Potential | 12% |
| Ticker (Bloomberg) | HMB SS |
| Number of Shares Outstanding (m) | 1 655 |
| Market Capitalization (m) | 465 055 |
| Forthcoming Catalysts | |
| 4Q13 Results | January 2014 |
| Analyst | |
| José Francisco Cravo | jfranciscocravo@gmail.com |

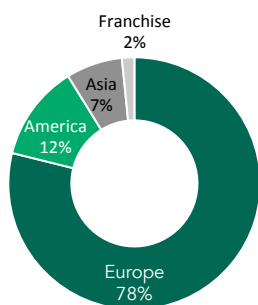
Revenue Growth



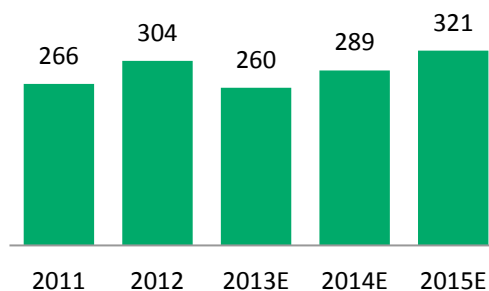
Gross Margin



Revenue Breakdown (2012)



Net New Stores



4.1) Earnings Momentum

Following the presentation of the 3Q results on the 16th of September, we have decided to update our forecasts for H&M. We should highlight that the price per share is currently benefiting from the earnings momentum as it rose roughly 9% since the event.

4.2) 4Q13 Results Preview

On the 4Q13, we anticipate a positive performance where revenues are expected to increase from SEK 32 502 m to SEK 38 078 m – 17% YoY (4% above consensus). The COGS will rise in tandem with revenues and we forecast a 27 bps increase on the GM, which is slightly above the consensus level by 15 bps. At the Net Profit level, H&M should deliver a 24% YoY increase to SEK 6 543 m, 9% above the consensus. Bottom line, for the 4Q13, we expect stable conditions on raw materials and currencies front. At the same time, better than expected macroeconomic environment in Europe – H&M main market – should provide a short-term boost on the Swedish group results as well as the introduction of the US online store. Also on the positive side, H&M is expected to continue to pay roughly 90% of its earnings as dividends sustaining its high dividend yield (3.4%) against the average of the industry (1.9%).

Even though, we are slightly more bullish than the consensus for the short-term, the bigger picture is still shadowed by the following factors which might reflect negatively on the FV: 1) lower geographical diversification when compared to ITX; 2) decreasing sale densities in Asia and America; 3) strong CAPEX investments are forecasted throughout the next decade as H&M quest towards the south hemisphere and online continues; 4) emergence of lower margin competitors such as Primark that “live well” with lower GM and OM.

4.3) CAPEX

We would like to re-emphasize that, given the current company guidance on physical and virtual expansion, the CAPEX figures should increase throughout the next decade, together with the cost per store and decline afterwards on the steady-state. For 2013, a one-off SEK 800 m is expected in intangibles.

4.4) Rebranding

On the GM and OM side, our official stance is that the company is looking to rebrand itself higher within the value/quality spectrum to avoid a stuck in the middle

situation. As a result, the long-term margins are likely to stay at the current levels, assuming neither cost tail nor headwinds.

Exhibit 31: H&M 4Q13 earnings preview

| 4Q13 Preview (SEK m) | 4Q12 | 4Q13E | YoY | Consensus | Cons/Est |
|----------------------|--------|--------|---------|-----------|----------|
| Sales Excluding VAT | 32502 | 38078 | 17% | 36393 | -4% |
| Cost of Goods Sold | 12485 | 14523 | 16% | 13934 | -4% |
| Gross Profit | 20017 | 23555 | 18% | 22459 | -5% |
| Gross Margin | 61.59% | 61.86% | 27 bps | 61.71% | -14 bps |
| Operating Profit | 6533 | 8497 | 30% | 7470.2 | -12% |
| Operating Margin | 20.10% | 22.32% | 221 bps | 20.53% | -178 bps |
| Profit | 5287 | 6543 | 24% | 5928 | -9% |
| Earnings Per Share | 3.19 | 3.95 | 24% | 3.58 | -9% |

Source: Bloomberg

4.5) 4Q13 Estimates Sensitivity Analysis

We have conducted a sensitivity analysis based on possible deviations from both currency effects and raw materials. These factors impact directly the GM hence we have decided to shift it by 100bps above and below our estimates. In practice, these deviations would trigger a 6% deviation on EPS, which would range between SEK 3.72 and SEK4.18 on the pessimist and optimistic scenario. Further, we highlight that higher than expected markdowns or transportation costs can also impact the results of the 4Q13. We recall that it has been H&M policy to not transfer higher production costs to costumers but to absorb them instead.

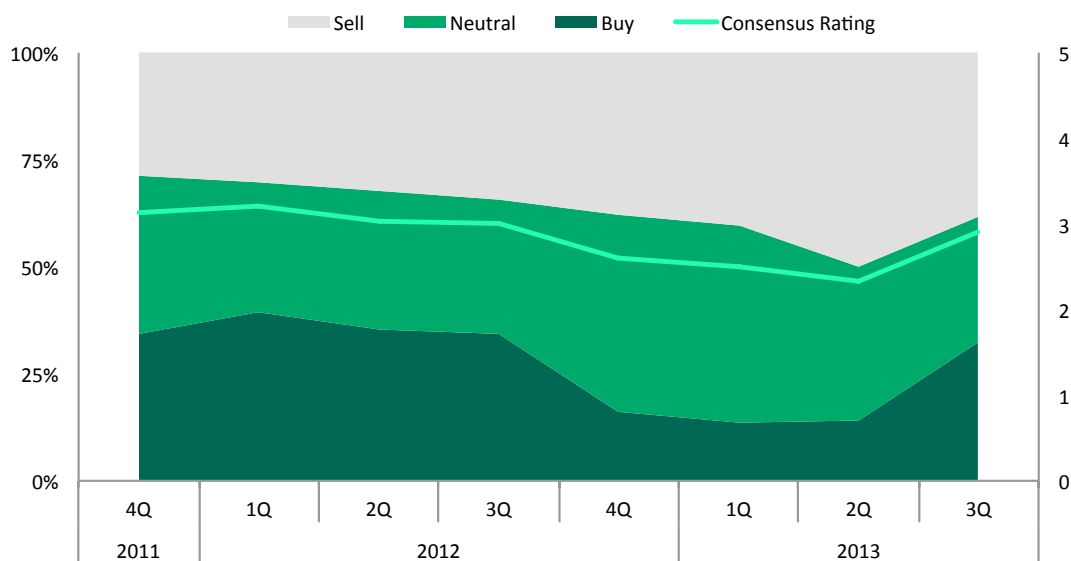
Exhibit 32: FY13/4Q13 Earnings Sensitivity analysis

| Scenario | Pessimistic | Base | Optimistic |
|------------------------------------|-------------|--------|------------|
| Gross Margin ($\Delta = 100$ bps) | 60,86% | 61,86% | 62,86% |
| Profit | 6162 | 6416 | 6923,6 |
| EPS | 3,72 | 3,88 | 4,18 |
| Deviation | -6% | | 6% |

Source: Own calculations

We would also like to highlight that our stance on H&M is in line with the average recommendation by sell-side analysts. On a total of 34 investment recommendations, 29% advocate a NEUTRAL posture, 38% Sell and 32% Buy. Since 2011, the overall opinion on H&M has decreased slightly.

Exhibit 33: Analyst rating recommendations



Source: Bloomberg

4.6) Two-Stage DCF Valuation

A summary of the main operation and technical assumptions is available below and a detailed version with forecasts for the explicit period can be found on **annex 9**.

- 1) Sales CAGR 2013-2023 of 11% and Y% for the period 2024-2033.
- 2) Overall stores expansion until 2023 9% and 2 % for 2024-2033.
- 3) CAPEX as a % of sales will gradually increase to 6% towards 2023 and decline thereafter.
- 4) The cost structure will reflect the brand re-rating and the long-term GM and OM will equal 40% and 18% respectively.
- 5) WACC rate of 9.36%.
- 6) Terminal growth rate of 2%.

4.7) FV Sensitivity Analysis

The FV of SEK 246 can vary widely based on the change of the overall cost of capital and the terminal growth rate. As **exhibit 31** illustrates, for minor changes on WACC and g the FV can range between SEK 202 and SEK 257.

Exhibit 34: Fair Value sensitivity analysis

| g/WACC | 8,9% | 9,4% | 9,9% |
|--------|------|------------|------|
| 1,5% | 235 | 217 | 202 |
| 2,0% | 245 | 246 | 210 |
| 2,5% | 257 | 236 | 218 |

Source: Own calculations

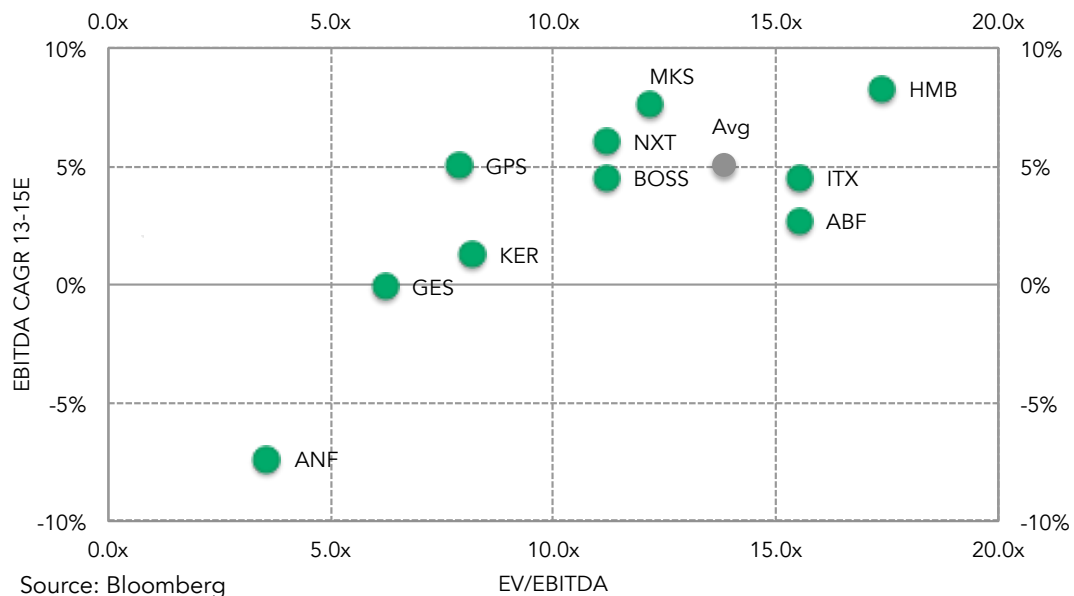
4.8) Multiples Valuation

From a multiples perspective, and taking into consideration the results attained on the cluster analysis, H&M is slightly more expensive than ITX on the EV/EBITDA comparison but roughly in line on the PER.

Moreover, we notice that for slightly lower EBITDA CAGR 13-15E there are cheaper companies trading at lower EV/EBITDA multiples such as MKS. From an EPS CAGR 13-15E and PER perspective, these circumstances are even more evident. H&M trades at 27.4x for an 8% EPS 13-15E CAGR, whereas MKS, GPS, NXT and BOSS trade below 20x its earnings for the similar growth perspectives.

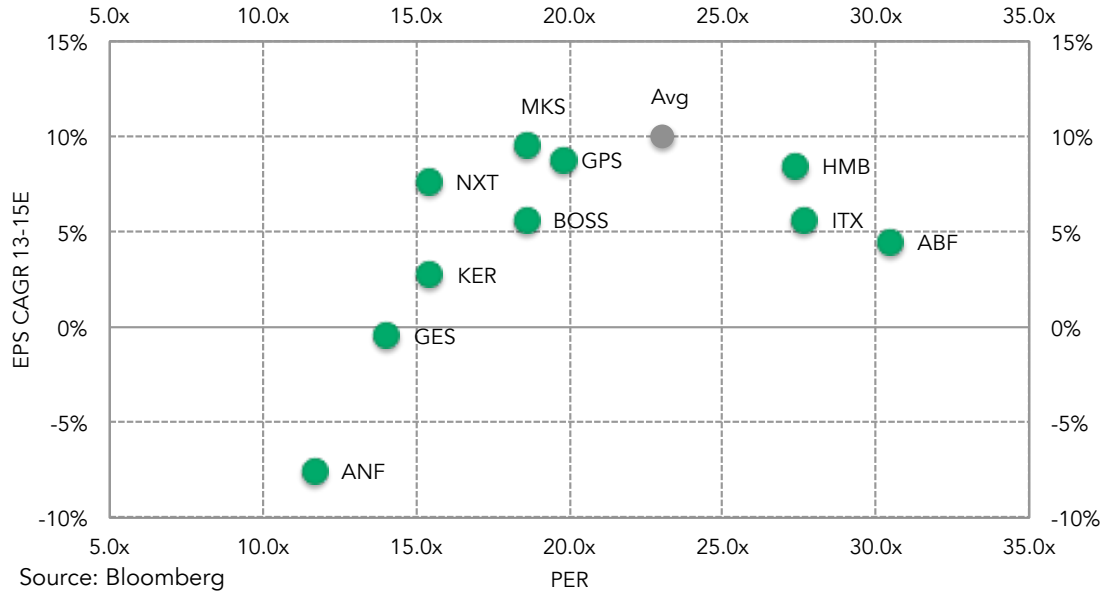
This analysis entails that H&M current market valuation is expensive in relation to its main peers (e.g. ITX), which have similar fundamental characteristics - **annex 10**

Exhibit 35: EV/EBITDA to EBITDA CAGR 13E-15E



Source: Bloomberg

Exhibit 36: PER CAGR 13E-15E



Furthermore, if we consider historical forward PER multiples, in 2013, H&M is trading at more than 1 standard deviation above the historical average of roughly 20x its earnings. As discussed on the Literature Review, this short-term deviation can result from a bullish market mood, which in our view is not justified.

Exhibit 37: Historical forward PER multiple

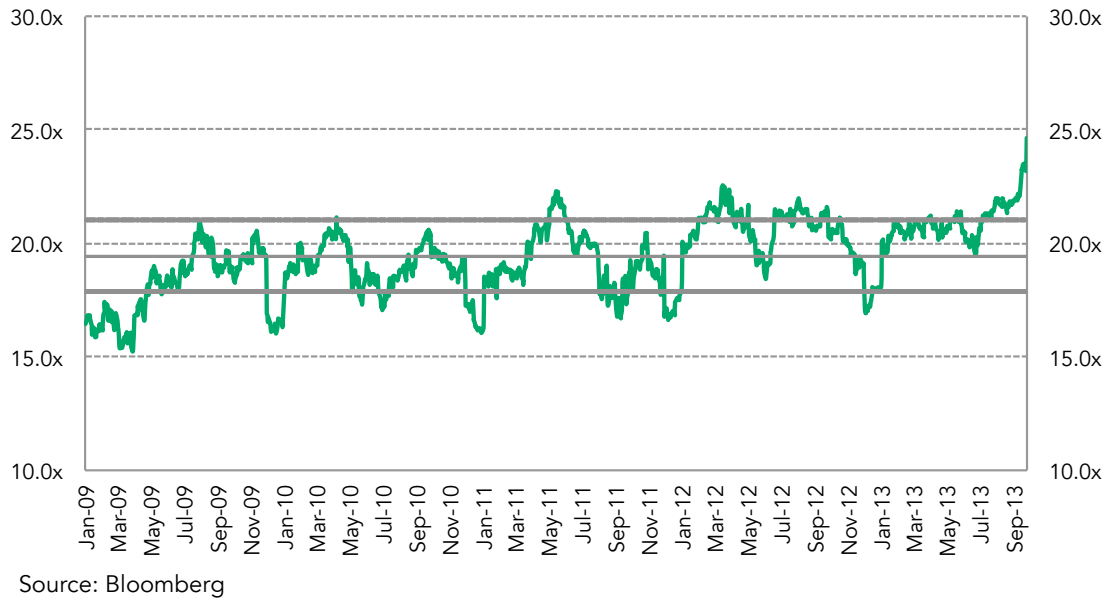
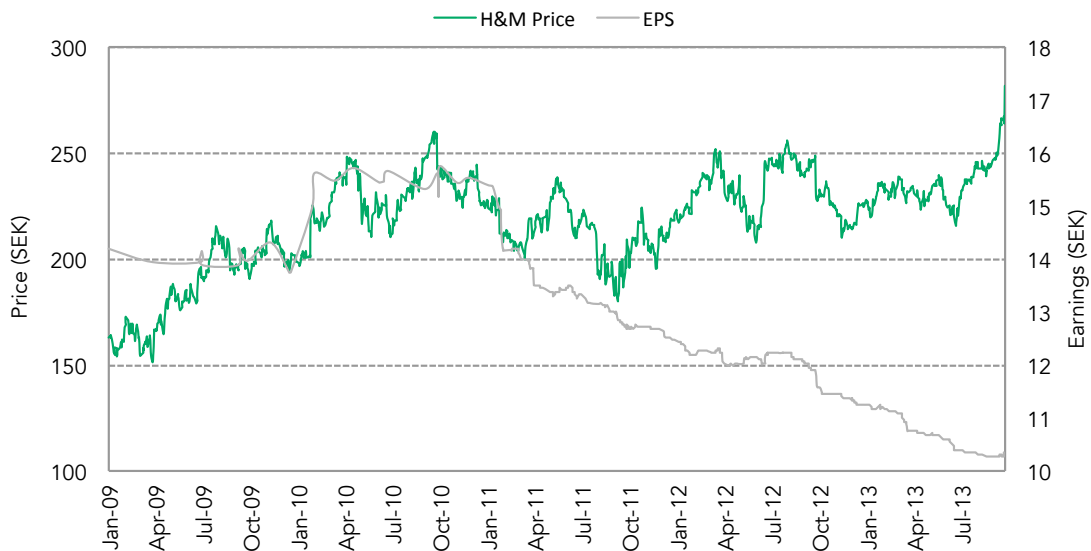


Exhibit 38: H&M price and EPS



Source: Bloomberg

From 2009 to early 2011, H&M price and EPS were tightly related as per the upward trend from both variables. Nonetheless, from mid-2011 onwards both variables apparently have lost traction and performed in opposite directions. We recall that for the latter part the number of outstanding shares has remained flat. Exhibit 36 reinforces our main valuation argument that H&M might be priced above its intrinsic value.

4.9) Valuation Risks

Several endogenous and exogenous factors may affect H&M results and operations and consequently impact either positively or negatively its financial performance. The main valuation risks for the PT (abbreviations) of SEK X are the following:

- 1) Currency Risk. H&M sells mostly in EUR, buys predominantly in USD and reports in SEK. Changes on these and other currencies might impact the financial performance of the group
- 2) Macroeconomic circumstances. A weaker than expected demand on important European markets (e.g. Germany, UK, USA, Sweden) may impact the overall sales performance of the group.
- 3) External factors in production countries. Unexpected changes on raw materials may impact the operating margins of the group. Still, H&M internal policy was devised to minimize the impacts of these events.

- 4) Fashion garments have a limited shelf-life and there is always a risk that a part of each collection does not fulfill the customer preferences.
- 5) Weather events- Deviation from standard weather patterns may affect the group sales due to the inherent impacts on garment collections utility.

4.10) Comparison with BoAML report of 09/26/2013

The main investment assumptions to justify the price target of SEK 275 are the following:

- 1) WACC discount rate of 8%;
- 2) Terminal growth rate of 2%;
- 3) 10Y CAGR of 9% based on 10% area growth, 80% conversion rate and 2% LFL.

We believe the main differences between the FV attained on this dissertation and the one published by BoAML lies on the technical assumptions as the operational seem to be quite similar. We feel comfortable with the assumptions made on the cost of capital as they are in line with other analysts' consensus. In spite of that, we reiterate that the FV concept is a powerful theoretical tool but it can extremely inaccurate on practice. The aforementioned results on exhibit 31 illustrate this perspective.

Additionally, we believe the current low interest rate scenario will not prevail over the long-term. Hence, to lower it as a result would underestimate the WACC for the whole valuation period. We consider, that BoAML does not share this perspective and lowers the cost of capital due to the current interest rate framework.

4.11) Investment Disclaimer

I, José Francisco Cravo, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

5) Conclusion

Equity Valuation is far from being a straightforward exercise. On Chapter I of this Dissertation, the major valuation methodologies were reviewed, outlining both benefits and limitations of most procedures. In the end, the only certainty is that no valuation method is better than all the others, in all circumstances. As of today, from both a theoretical and practical perspective the discounted cash flow models gather most preferences due to their mathematical elegance. Still, there are countless transformations and technical caveats that blur the valuation scenario. Please bear in mind that all single period – multiples – valuation methodologies rely to a certain extent on company fundamentals. For practical purposes, the market price is always the outcome of countless individual valuations - market consensus, which can easily be different from the valuation exercise.

Interestingly, in what concerns the valuation chapter, some of these issues were experienced. The attained target price for H&M (SEK 246) is broadly in line with the consensus for Equity Research Analyst, but slightly away from the current market price (SEK 281). Notwithstanding this analysis, and under the current market conditions, it is important to re-emphasize the weaknesses of the Fair Value concept. This is why a sensitivity analysis was conducted providing a price range from SEK 202 to SEK 257.

Bottom line, I believe the differences between my assessment and the current market prices rely on: 1) different perceptions regarding future interest rates; 2) current dividend yield figures, which do not provide an incentive to short positions and sustain a stable shareholder structure.

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6) Annexes

Annex 1 – Macroeconomic data on selected economies

| Country | Indicator | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------|-------------------|--------|--------|--------|--------|--------|--------|
| Austria | GDP (% change) | 0,386 | 1,638 | 1,843 | 1,723 | 1,495 | 1,416 |
| | CPI (% change) | 2,183 | 1,8 | 1,8 | 1,8 | 1,8 | 1,8 |
| | Unemployment rate | 4,8 | 4,8 | 4,6 | 4,4 | 4,2 | 4,2 |
| Belgium | GDP (% change) | 0,09 | 1,044 | 1,318 | 1,44 | 1,522 | 1,58 |
| | CPI (% change) | 1,394 | 1,222 | 1,173 | 1,183 | 1,214 | 1,241 |
| | Unemployment rate | 8,7 | 8,6 | 8,4 | 8 | 7,8 | 7,6 |
| Denmark | GDP (% change) | 0,083 | 1,228 | 1,54 | 1,527 | 1,527 | 1,527 |
| | CPI (% change) | 0,8 | 1,9 | 1,8 | 2 | 2 | 2 |
| | Unemployment rate | 7,1 | 7,1 | 7 | 6,8 | 6,6 | 6,4 |
| France | GDP (% change) | 0,186 | 0,981 | 1,493 | 1,717 | 1,801 | 1,922 |
| | CPI (% change) | 1,01 | 1,46 | 1,474 | 1,605 | 1,693 | 1,802 |
| | Unemployment rate | 10,953 | 11,131 | 10,939 | 10,518 | 10,16 | 9,985 |
| Germany | GDP (% change) | 0,491 | 1,4 | 1,386 | 1,315 | 1,267 | 1,2 |
| | CPI (% change) | 1,606 | 1,789 | 1,8 | 1,8 | 1,9 | 1,9 |
| | Unemployment rate | 5,591 | 5,49 | 5,459 | 5,459 | 5,459 | 5,459 |
| Italy | GDP (% change) | -1,776 | 0,712 | 1,06 | 1,4 | 1,401 | 1,2 |
| | CPI (% change) | 1,616 | 1,284 | 1,15 | 1,3 | 1,41 | 1,51 |
| | Unemployment rate | 12,5 | 12,4 | 12 | 11,2 | 10,4 | 9,8 |
| Netherlands | GDP (% change) | -1,274 | 0,311 | 1,631 | 1,844 | 2,039 | 2,236 |
| | CPI (% change) | 2,923 | 1,296 | 0,808 | 0,808 | 0,84 | 0,84 |
| | Unemployment rate | 7,136 | 7,418 | 7,021 | 6,565 | 6,122 | 5,835 |
| Norway | GDP (% change) | 1,568 | 2,278 | 2,27 | 2,213 | 2,219 | 2,235 |
| | CPI (% change) | 1,8 | 1,8 | 2 | 2 | 2,3 | 2,5 |
| | Unemployment rate | 3,3 | 3,3 | 3,3 | 3,4 | 3,5 | 3,5 |
| Poland | GDP (% change) | 1,331 | 2,361 | 2,65 | 3,064 | 3,341 | 3,455 |
| | CPI (% change) | 1,442 | 1,95 | 2,13 | 2,38 | 2,5 | 2,5 |
| | Unemployment rate | 10,883 | 11,033 | 10,827 | 10,364 | 9,725 | 9,009 |
| Portugal | GDP (% change) | -1,757 | 0,769 | 1,484 | 1,8 | 1,8 | 1,8 |
| | CPI (% change) | 0,683 | 1 | 1,495 | 1,502 | 1,522 | 1,508 |
| | Unemployment rate | 17,409 | 17,713 | 17,299 | 16,75 | 16,197 | 15,607 |
| Spain | GDP (% change) | -1,267 | 0,171 | 0,468 | 0,722 | 0,934 | 1,205 |
| | CPI (% change) | 1,767 | 1,456 | 1,213 | 1,244 | 1,229 | 1,228 |
| | Unemployment rate | 26,875 | 26,658 | 26,495 | 26,196 | 25,598 | 24,893 |
| Sweden | GDP (% change) | 0,858 | 2,299 | 2,297 | 2,311 | 2,351 | 2,355 |
| | CPI (% change) | 0,212 | 1,631 | 2,4 | 2,4 | 2,1 | 2 |
| | Unemployment rate | 8,025 | 7,725 | 7,5 | 7,14 | 6,72 | 6,4 |
| Switzerland | GDP (% change) | 1,749 | 1,787 | 1,89 | 1,89 | 1,94 | 1,94 |
| | CPI (% change) | -0,2 | 0,2 | 0,7 | 1 | 1 | 1 |
| | Unemployment rate | 3,233 | 3,214 | 3,035 | 2,866 | 2,812 | 2,705 |
| UK | GDP (% change) | 1,433 | 1,869 | 1,978 | 1,979 | 2,056 | 2,319 |
| | CPI (% change) | 2,7 | 2,3 | 2 | 1,9 | 2 | 2 |
| | Unemployment rate | 7,743 | 7,528 | 7,306 | 7,009 | 6,73 | 6,47 |

Source: International Monetary Fund, World Economic Outlook Database, October 2013

Annex 2 - Sales forecasts: 2013-2033

| Sales Model (SEK m) | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Sales Including VAT | 104041 | 118697 | 126966 | 128810 | 140948 | 151853 | 165546 | 182402 | 203002 | 226652 | 254570 | 282636 | 315110 | 351657 | 393568 | 440527 |
| Sales Growth Rate | 12,94% | 14,09% | 6,97% | 1,45% | 9,42% | 7,74% | 9,02% | 10,18% | 11,29% | 11,65% | 12,32% | 11,02% | 11,49% | 11,60% | 11,92% | 11,93% |
| Fx Effect | 1,75% | 9,70% | -6,99% | -6,06% | -1,42% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% |
| Area Growth | 12,12% | 9,47% | 10,05% | 9,09% | 9,90% | 8,48% | 7,28% | 7,60% | 7,69% | 7,81% | 7,88% | 8,00% | 8,17% | 8,32% | 8,46% | 8,59% |
| Like-for-like | -1,00% | -5,00% | 4,50% | -1,00% | 1,00% | -0,69% | 1,62% | 2,40% | 3,35% | 3,56% | 4,11% | 2,80% | 3,07% | 3,03% | 3,19% | 3,07% |
| CAGR 13-23 | 11% | | | | | | | | | | | | | | | |
| Sales Model | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 | | | | | | |
| Sales Including VAT | 462144 | 469256 | 476692 | 484466 | 492593 | 501089 | 509971 | 519252 | 528951 | 539085 | | | | | | |
| Sales Growth Rate | 4,91% | 1,54% | 1,58% | 1,63% | 1,68% | 1,72% | 1,77% | 1,82% | 1,87% | 1,92% | | | | | | |
| Fx Effect | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | | | | | | |
| Area Growth | 4,91% | 1,54% | 1,58% | 1,63% | 1,68% | 1,72% | 1,77% | 1,82% | 1,87% | 1,92% | | | | | | |
| Like-for-like | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | | | | | | |
| CAGR 13-23 | 2% | | | | | | | | | | | | | | | |

Source: Own calculations

Annex 3 - Sales by country

| Sales by country, 2002-2012 (SEK m) | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 5Y CAGR | 10Y CAGR |
|-------------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|----------------|----------------|----------------|----------------|--------------|---------------|
| Total | 45.522 | 48.238 | 53.695 | 61.262 | 68.400 | 78.346 | 88.532 | 101.393 | 108.483 | 109.999 | 120.799 | 8,08% | 10,74% |
| Sweden | 4.639 | 4.495 | 4.717 | 4.961 | 5.359 | 5.788 | 5.973 | 6.323 | 6.742 | 6.704 | 6.625 | 2,62% | 4,40% |
| Norway | 3.318 | 3.215 | 3.326 | 3.717 | 3.873 | 4.123 | 4.235 | 4.482 | 4.690 | 4.322 | 4.495 | 1,50% | 3,79% |
| Denmark | 1.933 | 2.015 | 2.183 | 2.405 | 2.638 | 3.003 | 3.102 | 3.411 | 3.493 | 3.362 | 3.444 | 2,65% | 6,14% |
| UK | 4.050 | 4.355 | 4.909 | 5.365 | 5.914 | 6.404 | 6.401 | 6.723 | 7.337 | 7.921 | 8.968 | 8,80% | 8,36% |
| Switzerland | 3.312 | 3.261 | 3.387 | 3.599 | 3.759 | 3.909 | 4.534 | 5.615 | 5.689 | 5.553 | 5.389 | 4,41% | 5,74% |
| Germany | 13.894 | 14.201 | 15.258 | 16.881 | 17.408 | 18.674 | 21.434 | 25.289 | 25.757 | 24.997 | 25.499 | 4,44% | 6,72% |
| Netherlands | 2.936 | 3.073 | 3.310 | 3.652 | 4.193 | 5.166 | 5.710 | 6.220 | 6.208 | 5.885 | 5.608 | -0,45% | 6,91% |
| Belgium | 1.512 | 1.676 | 1.819 | 2.084 | 2.295 | 2.344 | 2.581 | 2.894 | 2.765 | 2.609 | 2.696 | 1,10% | 5,42% |
| Austria | 3.224 | 3.414 | 3.485 | 3.578 | 3.585 | 3.797 | 4.195 | 4.598 | 4.389 | 4.002 | 3.992 | -1,23% | 1,75% |
| Luxembourg | 200 | 242 | 254 | 270 | 280 | 299 | 316 | 371 | 365 | 345 | 374 | 4,30% | 4,96% |
| Finland | 1.050 | 1.090 | 1.270 | 1.472 | 1.629 | 1.843 | 2.013 | 2.086 | 2.098 | 1.948 | 1.987 | -0,32% | 6,90% |
| France | 2.485 | 3.207 | 3.709 | 4.371 | 4.969 | 5.830 | 6.686 | 7.070 | 7.642 | 7.806 | 8.341 | 5,68% | 11,21% |
| USA | 2.355 | 2.680 | 3.231 | 3.819 | 4.926 | 5.612 | 6.264 | 7.173 | 8.490 | 9.209 | 11.950 | 17,52% | 18,07% |
| Spain | 614 | 1.036 | 1.685 | 2.494 | 3.317 | 4.428 | 5.006 | 5.448 | 5.257 | 4.968 | 4.917 | -0,45% | 18,89% |
| Poland | | 72 | 384 | 654 | 1.009 | 1.481 | 2.081 | 2.033 | 2.199 | 2.255 | 2.401 | 3,64% | 47,65% |
| Czech Republic | | 61 | 164 | 305 | 432 | 514 | 564 | 561 | 591 | 603 | 642 | 3,29% | 29,89% |
| Portugal | | 99 | 189 | 256 | 351 | 556 | 634 | 773 | 778 | 732 | 701 | 2,54% | 24,29% |
| Italy | | 46 | 197 | 498 | 830 | 1.452 | 2.229 | 3.013 | 3.610 | 3.667 | 4.016 | 15,86% | 64,31% |
| Canada | | | 168 | 542 | 905 | 1.290 | 1.629 | 1.972 | 2.442 | 2.491 | 2.802 | 14,52% | |
| Slovenia | | | 50 | 217 | 299 | 409 | 500 | 517 | 477 | 420 | 405 | -5,13% | |
| Ireland | | | | 114 | 279 | 358 | 418 | 476 | 443 | 441 | 495 | 4,32% | |
| Hungary | | | | 8 | 78 | 165 | 254 | 251 | 310 | 397 | 492 | 17,97% | |
| Slovakia | | | | | | 68 | 115 | 157 | 189 | 212 | 282 | 25,14% | |
| Greece | | | | | | 118 | 253 | 403 | 532 | 621 | 685 | 28,28% | |
| China | | | | | | 456 | 827 | 1.513 | 2.340 | 3.283 | 4.884 | 55,89% | |
| Japan | | | | | | | 188 | 1.111 | 1.708 | 1.476 | 2.385 | 88,73% | |
| Russia | | | | | | | | 319 | 785 | 1.299 | 1.824 | | |
| South Korea | | | | | | | | | 232 | 373 | 540 | | |
| Turkey | | | | | | | | | 26 | 283 | 408 | | |
| Romania | | | | | | | | | | 267 | 512 | | |
| Croatia | | | | | | | | | | 215 | 488 | | |
| Singapore | | | | | | | | | | 104 | 383 | | |
| Bulgaria | | | | | | | | | | | 101 | | |
| Malaysia | | | | | | | | | | | 84 | | |
| Latvia | | | | | | | | | | | 30 | | |
| Mexico | | | | | | | | | | | 40 | | |

Source: Company Data

Annex 4 - Stores model

| Stores Model, by Region | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|-------------------------|------------|------|------------|------|------|------|------|------|------|------|------|
| Total | 3036 | 3325 | 3646 | 4003 | 4401 | 4845 | 5342 | 5900 | 6528 | 7233 | 8029 |
| Sweden | 184 | 191 | 198 | 205 | 213 | 221 | 229 | 238 | 247 | 256 | 266 |
| Europe Ex-Sweden | 2169 | 2342 | 2529 | 2731 | 2949 | 3184 | 3438 | 3713 | 4010 | 4330 | 4676 |
| America | 380 | 437 | 502 | 577 | 663 | 762 | 876 | 1007 | 1158 | 1331 | 1530 |
| Asia | 205 | 246 | 295 | 354 | 424 | 508 | 609 | 730 | 876 | 1051 | 1261 |
| Franchise | 98 | 109 | 122 | 136 | 152 | 170 | 190 | 212 | 237 | 265 | 296 |
| | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 | |
| Total | 8183 | 8345 | 8516 | 8694 | 8882 | 9079 | 9286 | 9503 | 9731 | 9970 | |
| Sweden | 266 | 266 | 266 | 266 | 266 | 266 | 266 | 266 | 266 | 266 | |
| Europe Ex-Sweden | 4676 | 4676 | 4676 | 4676 | 4676 | 4676 | 4676 | 4676 | 4676 | 4676 | |
| America | 1607 | 1687 | 1771 | 1860 | 1953 | 2050 | 2153 | 2261 | 2374 | 2492 | |
| Asia | 1324 | 1390 | 1460 | 1533 | 1609 | 1690 | 1774 | 1863 | 1956 | 2054 | |
| Franchise | 311 | 326 | 343 | 360 | 378 | 397 | 417 | 437 | 459 | 482 | |
| | CAGR 13-23 | | CAGR 24-33 | | | | | | | | |
| Total | 10% | 2% | | | | | | | | | |
| Sweden | 4% | 0% | | | | | | | | | |
| Europe Ex-Sweden | 8% | 0% | | | | | | | | | |
| America | 15% | 5% | | | | | | | | | |
| Asia | 20% | 5% | | | | | | | | | |
| Franchise | 12% | 5% | | | | | | | | | |

Source: Own calculations

Annex 5 – Cost assumptions

| Cost Structure (SEK m) | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|-------------------------|-------|-------|-------|--------|--------|--------|--------|--------|--------|--------|--------|
| COGS | 52746 | 57538 | 63435 | 70643 | 78922 | 88698 | 98537 | 109926 | 122751 | 137465 | 153961 |
| Gross Margin | 77399 | 84343 | 92891 | 103339 | 115330 | 129481 | 143696 | 160138 | 178636 | 199842 | 223592 |
| Operating Costs | 53994 | 58791 | 64699 | 71919 | 80201 | 89971 | 99769 | 111097 | 123831 | 138421 | 154748 |
| Selling Expenses | 50279 | 54884 | 60550 | 67476 | 75434 | 84835 | 94309 | 105279 | 117640 | 131830 | 147748 |
| Labour Expenses | 21411 | 23290 | 25604 | 28431 | 31671 | 35491 | 39313 | 43728 | 48686 | 54360 | 60702 |
| Operating Leases | 15264 | 16771 | 18624 | 20889 | 23504 | 26602 | 29762 | 33435 | 37595 | 42394 | 47808 |
| Other | 13604 | 14822 | 16322 | 18156 | 20259 | 22742 | 25234 | 28117 | 31359 | 35076 | 39237 |
| Administrative Expenses | 3715 | 3908 | 4149 | 4444 | 4767 | 5136 | 5460 | 5818 | 6191 | 6592 | 7000 |
| EBIT | 23405 | 25551 | 28192 | 31420 | 35129 | 39510 | 43927 | 49041 | 54804 | 61420 | 68843 |
| As % of Sales | | | | | | | | | | | |
| COGS | 41% | 41% | 41% | 41% | 41% | 41% | 41% | 41% | 41% | 41% | 41% |
| Gross Margin | 59% | 59% | 59% | 59% | 59% | 59% | 59% | 59% | 59% | 59% | 59% |
| Operating Costs | 41% | 41% | 41% | 41% | 41% | 41% | 41% | 41% | 41% | 41% | 41% |
| Selling Expenses | 39% | 39% | 39% | 39% | 39% | 39% | 39% | 39% | 39% | 39% | 39% |
| Labour Expenses | 16% | 16% | 16% | 16% | 16% | 16% | 16% | 16% | 16% | 16% | 16% |
| Operating Leases | 12% | 12% | 12% | 12% | 12% | 12% | 12% | 12% | 12% | 13% | 13% |
| Other | 10% | 10% | 10% | 10% | 10% | 10% | 10% | 10% | 10% | 10% | 10% |
| Administrative Expenses | 3% | 3% | 3% | 3% | 2% | 2% | 2% | 2% | 2% | 2% | 2% |
| EBIT | 18% | 18% | 18% | 18% | 18% | 18% | 18% | 18% | 18% | 18% | 18% |

Source: Own calculations

Annex 6 – Net working capital map

| NWC Map | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|----------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Net Working Capital | 7633 | 8152 | 8807 | 9627 | 10586 | 11738 | 12909 | 14277 | 15830 | 17621 | 19638 |
| Δ Change | -402 | -519 | -655 | -820 | -960 | -1151 | -1172 | -1368 | -1552 | -1791 | -2017 |
| Accounts Receivables | 2378 | 2592 | 2856 | 3179 | 3549 | 3986 | 4426 | 4934 | 5506 | 6163 | 6898 |
| Other Receivables | 980 | 899 | 816 | 733 | 657 | 585 | 527 | 472 | 423 | 378 | 338 |
| Stock in Trade | 16390 | 17868 | 19687 | 21911 | 24463 | 27477 | 30506 | 34011 | 37956 | 42479 | 47548 |
| Accounts Payable | 4562 | 4973 | 5479 | 6098 | 6809 | 7647 | 8490 | 9466 | 10564 | 11823 | 13233 |
| Accrued Expenses | 7553 | 8235 | 9073 | 10098 | 11274 | 12663 | 14059 | 15674 | 17492 | 19577 | 21913 |
| Creditor Days | 13 | 13 | 13 | 13 | 13 | 13 | 13 | 13 | 13 | 13 | 13 |
| Stock Days | 46 | 46 | 46 | 46 | 46 | 46 | 46 | 46 | 46 | 46 | 46 |
| Debtor Days | 7 | 7 | 7 | 7 | 7 | 7 | 7 | 7 | 7 | 7 | 7 |

Source: Own calculations

Annex 7 – CAPEX and depreciation map

| CAPEX and Depreciation (SEK | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|-----------------------------|------|------|------|------|-------|-------|-------|-------|-------|-------|-------|
| Total CAPEX | 6667 | 6707 | 7669 | 8782 | 10078 | 11578 | 13335 | 15400 | 17824 | 20608 | 23933 |
| Tangible | 5737 | 6565 | 7513 | 8609 | 9885 | 11361 | 13094 | 15131 | 17524 | 20272 | 23557 |
| Intangible | 930 | 141 | 156 | 173 | 193 | 217 | 241 | 269 | 300 | 336 | 376 |
| Total Depreciation | 3992 | 4352 | 4795 | 5336 | 5958 | 6692 | 7429 | 8283 | 9244 | 10345 | 11580 |
| Tangible | 3792 | 4134 | 4555 | 5070 | 5660 | 6358 | 7058 | 7869 | 8782 | 9829 | 11002 |
| Intangible | 199 | 217 | 239 | 266 | 297 | 334 | 371 | 414 | 462 | 517 | 578 |

Source: Own Calculations

Annex 8 – BoAML Valuation

| DCF Analysis: Price Objective SEK 275 | | | | | | | | | | | | | | |
|---------------------------------------|--------|--------|--------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Year End November | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E | 2016E | 2017E | 2018E | 2019E | 2020E | 2021E | 2022E | 2023E |
| Revenue | 108483 | 109999 | 120799 | 128337 | 143096 | 158837 | 175514 | 193066 | 211407 | 230434 | 248868 | 266289 | 282267 | 296380 |
| % of growth | 7% | 1.4% | 9.8% | 6.2% | 11-5% | 11% | 10.5% | 10% | 9.5% | 9.5% | 8% | 7% | 6% | 5% |
| Gross Profit | 68269 | 66147 | 71871 | 75847 | 84856 | 94508 | 104431 | 114874 | 125787 | 137108 | 148077 | 158442 | 167949 | 176346 |
| Margin | 62.9% | 60.1% | 59.5% | 59.1% | 59.3% | 59.5% | 59.5% | 59.5% | 59.5% | 59.5% | 59.5% | 59.5% | 59.5% | 59.5% |
| Operating Costs | 43610 | 45768 | 50117 | 53902 | 59671 | 66235 | 73189 | 80315 | 87734 | 95400 | 102783 | 109711 | 116012 | 121516 |
| % Sales | 40.2% | 41.6% | 41.5% | 42% | 41.7% | 41.7% | 41.7% | 41.6% | 41.5% | 41.4% | 41.3% | 41.2% | 41.41% | 41% |
| Operating Profit | 24659 | 20379 | 21754 | 21946 | 25185 | 28273 | 31242 | 34559 | 38053 | 41709 | 45294 | 48731 | 51937 | 54830 |
| Margin | 22.7% | 18.5% | 18% | 17.1% | 17.6% | 17.8% | 17.8% | 17.9% | 18% | 18.1% | 18.2% | 18.3% | 18.4% | 18.5% |
| Tax | -6327 | -5121 | -5418 | -5142 | -5908 | -6629 | -7324 | -8101 | -8920 | -9777 | -10618 | -11423 | -12175 | -12853 |
| Tax Rate (%) | 26% | 25% | 25% | 23% | 23% | 23% | 23% | 23% | 23% | 23% | 23% | 23% | 23% | 23% |
| NOPAT | 18332 | 15258 | 16336 | 16804 | 19277 | 21644 | 23918 | 26458 | 29133 | 31931 | 34676 | 37308 | 39762 | 41977 |
| D&A | 3061 | 3262 | 3705 | 4107 | 4579 | 5083 | 5616 | 6178 | 6765 | 7374 | 7964 | 8521 | 9033 | 9484 |
| % Sales | 2.8% | 3% | 3.1% | 3.2% | 3.2% | 3.2% | 3.2% | 3.2% | 3.2% | 3.2% | 3.2% | 3.2% | 3.2% | 3.2% |
| Capex | -4955 | -5265 | -6864 | -7444 | -8156 | -8895 | -9829 | -10619 | -11627 | -12674 | -13688 | -14646 | -15525 | -16301 |
| % Sales | 4.6% | 4.8% | 5.7% | 5.8% | 5.7% | 5.6% | 5.6 | 5.5% | 5.5% | 5.5% | 5.5% | 5.5% | 5.5% | 5.5% |
| Chg in w/cap | -783 | -1238 | -79 | -213 | -417 | -444 | -471 | -576 | -694 | -825 | -825 | -1114 | -1265 | -1417 |
| % Sales | -0,7% | -1,1% | -0,1% | -0,2% | -0,3% | -0,3% | -0,3% | -0,3% | -0,3% | -0,4% | -0,4% | -0,4% | -0,4% | -0,5% |
| Free Cashflow | 15655 | 12017 | 13098 | 13254 | 15283 | 17387 | 19235 | 21441 | 23577 | 25806 | 25806 | 27986 | 32005 | 33743 |
| Timing | | | | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| Post Tax Discount Rate | | | | 8% | 8% | 8% | 8% | 8% | 8% | 8% | 8% | 8% | 8% | 8% |
| Value Multiple | | | | 1 | 0,93 | 0,86 | 0,79 | 0,74 | 0,68 | 0,63 | 0,58 | 0,54 | 0,50 | 0,46 |
| PV of Cashflow | | | | 13254 | 14151 | 14907 | 15269 | 15760 | 16046 | 16262 | 15058 | 15120 | 16010 | 15630 |
| Perpetual Growth % | | | | | | | | | | | | | | 2% |
| PV of Cashflows | | | | | | | | | | | | | | 156610 |
| PV of Terminal Value | | | | | | | | | | | | | | 289454 |
| Total Firm Value | | | | | | | | | | | | | | 446064 |
| Cash (Liquid Funds) | | | | | | | | | | | | | | 9061 |
| Equity Value | | | | | | | | | | | | | | 455125 |
| Share in Issue (m) | | | | | | | | | | | | | | 1655 |
| Implied Value per Share (SEK) | | | | | | | | | | | | | | 275 |

Source: BoAML

Annex 9 - Own Valuation

| DCF Analysis: Price Objective SEK 246 | | | | | | | | | | | | | | |
|---------------------------------------|--------|--------|--------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Year End November | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E | 2016E | 2017E | 2018E | 2019E | 2020E | 2021E | 2022E | 2023E |
| Revenue | 108483 | 109999 | 120799 | 130145 | 141880 | 156327 | 173982 | 194251 | 218179 | 242232 | 270064 | 301386 | 337306 | 377552 |
| % of growth | 7,0% | 1,4% | 9,8% | 7,7% | 9,0% | 10,2% | 11,3% | 11,7% | 12,3% | 11,0% | 11,5% | 11,6% | 11,9% | 11,9% |
| Gross Profit | 68269 | 66147 | 71871 | 77399 | 84343 | 92891 | 103339 | 115330 | 129481 | 143696 | 160138 | 178636 | 199842 | 223592 |
| Margin | 62,9% | 60,1% | 59,5% | 59,5% | 59,4% | 59,4% | 59,4% | 59,4% | 59,3% | 59,3% | 59,3% | 59,3% | 59,2% | 59,2% |
| Operating Costs | 43610 | 45768 | 50117 | 53994 | 58791 | 64699 | 71919 | 80201 | 89971 | 99769 | 111097 | 123831 | 138421 | 154748 |
| % Sales | 40,2% | 41,6% | 41,5% | 41,5% | 41,4% | 41,4% | 41,3% | 41,3% | 41,2% | 41,2% | 41,1% | 41,1% | 41,0% | 41,0% |
| Operating Profit | 24659 | 20379 | 21754 | 23405 | 25551 | 28192 | 31420 | 35129 | 39510 | 43927 | 49041 | 54804 | 61420 | 68843 |
| Margin | 22,7% | 18,5% | 18,0% | 18,0% | 18,0% | 18,0% | 18,1% | 18,1% | 18,1% | 18,1% | 18,2% | 18,2% | 18,2% | 18,2% |
| Tax | -6327 | -5121 | -5418 | -5769 | -6311 | -6966 | -7780 | -8714 | -9825 | -10967 | -12305 | -13823 | -15566 | -17534 |
| Tax Rate (%) | 25,3% | 24,5% | 24,3% | 24,3% | 24,3% | 24,3% | 24,3% | 24,3% | 24,3% | 24,3% | 24,3% | 24,3% | 24,3% | 24,3% |
| NOPAT | 18332 | 15258 | 16336 | 17636 | 19240 | 21226 | 23640 | 26415 | 29685 | 32960 | 36736 | 40982 | 45854 | 51310 |
| D&A | 3061 | 3262 | 3705 | 3992 | 4352 | 4795 | 5336 | 5958 | 6692 | 7429 | 8283 | 9244 | 10345 | 11580 |
| % Sales | 2,8% | 2,97% | 3,07% | 3,07% | 3,07% | 3,07% | 3,07% | 3,07% | 3,07% | 3,07% | 3,07% | 3,07% | 3,07% | 3,07% |
| Capex | 10121 | 4056 | 2901 | 6667 | 6707 | 7669 | 8782 | 10078 | 11578 | 13335 | 15400 | 17824 | 20608 | 23933 |
| % Sales | 9,3% | 3,7% | 2,4% | 5,1% | 4,7% | 4,9% | 5,0% | 5,2% | 5,3% | 5,5% | 5,7% | 5,9% | 6,1% | 6,3% |
| Chg in w/cap | -858 | -1196 | -178 | -402 | -519 | -655 | -820 | -960 | -1151 | -1172 | -1368 | -1552 | -1791 | -2017 |
| % Sales | -0,8% | -1,1% | -0,1% | -0,3% | -0,4% | -0,4% | -0,5% | -0,5% | -0,5% | -0,5% | -0,5% | -0,5% | -0,5% | -0,5% |
| Free Cashflow | 12130 | 15660 | 17318 | 15363 | 17404 | 19007 | 21014 | 23254 | 25950 | 28226 | 30988 | 33954 | 37383 | 40973 |
| Timing | | | | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| Post Tax Discount Rate | | | | 9,4% | 9,4% | 9,4% | 9,4% | 9,4% | 9,4% | 9,4% | 9,4% | 9,4% | 9,4% | 9,4% |
| Value Multiple | | | | 1 | 0,91 | 0,84 | 0,76 | 0,70 | 0,64 | 0,58 | 0,53 | 0,49 | 0,45 | 0,41 |
| PV of Cashflow | | | | 15363 | 15915 | 15894 | 16068 | 16260 | 16593 | 16504 | 16569 | 16601 | 16714 | 16752 |
| Perpetual Growth % | | | | | | | | | | | | | | 2% |
| PV of Cashflows | | | | | | | | | | | | | | 156610 |
| PV of Terminal Value | | | | | | | | | | | | | | 260492 |
| Total Firm Value | | | | | | | | | | | | | | 417102 |
| Cash (Liquid Funds) | | | | | | | | | | | | | | 9061 |
| Equity Value | | | | | | | | | | | | | | 426163 |
| Share in Issue (m) | | | | | | | | | | | | | | 1655 |
| Implied Value per Share (SEK) | | | | | | | | | | | | | | 246 |

Source: Own Calculations

Annex 10 – Comparable table

| 26/09/13 Company | Bloomberg Ticker | Currency | Last Price | Market Cap | EV/EBITDA | | | EBITDA CAGR | | P/E | | | FCF yield (%) | | | div yield (%) | | |
|------------------------------|----------------------|------------|---------------|---------------|--------------|--------------|--------------|-------------|--------------|--------------|--------------|-----------|---------------|-------------|-------------|---------------|-------------|-------------|
| | | | | | 2013E | 2014E | 2015E | 13-15E | 2013E | 2014E | 2015E | 13-15E | 2013E | 2014E | 2015E | 2013E | 2014E | 2015E |
| Inditex, S.A. | ITX SM Equity | EUR | 114 | 66 073 | 15,5x | 15,2x | 13,4x | 5% | 27,7x | 26,6x | 23,5x | 6% | 3,0% | 2,8% | 3,5% | 2,0% | 2,1% | 2,3% |
| Associated British Foods PLC | ABF LN Equity | GBP | 1 877,00 | 2 369 481 | 15,5x | 15,0x | 14,0x | 3% | 30,5x | 29,5x | 26,7x | 5% | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% |
| The Gap, Inc | GPS US Equity | USD | 40,67 | 19 203 | 7,9x | 7,5x | 7,0x | 5% | 18,6x | 15,7x | 14,1x | 10% | 5,3% | 5,3% | 6,3% | 1,2% | 1,5% | 1,9% |
| Abercrombie & Fitch Co. | ANF US Equity | USD | 36,51 | 2 662 | 3,6x | 5,2x | 4,2x | -7% | 11,7x | 21,7x | 14,8x | -8% | 6,8% | 0,6% | 7,1% | 1,9% | 2,1% | 2,2% |
| Kering S.A. | KER FP Equity | EUR | 166,90 | 19 117 | 11,2x | 10,3x | 8,9x | 6% | 15,4x | 14,1x | 12,4x | 8% | 3,2% | 5,0% | 5,7% | 2,5% | 2,7% | 3,2% |
| Marks & Spencer | MKS LN Equity | GBP | 497,00 | 816 679 | 8,2x | 8,6x | 7,8x | 1% | 15,5x | 16,0x | 14,2x | 3% | 0,0% | 0,0% | 0,1% | 0,0% | 0,0% | 0,0% |
| Hugo Boss | BOSS GY Equity | EUR | 95,97 | 6 810 | 12,2x | 10,9x | 9,6x | 8% | 19,8x | 17,6x | 15,4x | 9% | 4,4% | 4,8% | 5,7% | 3,6% | 4,1% | 4,7% |
| Next | NXT LN Equity | GBP | 5 175,00 | 1 010 035 | 13,8x | 12,6x | 11,8x | 5% | 23,0x | 18,7x | 17,3x | 10% | 0,1% | 0,1% | 0,1% | 0,0% | 0,0% | 0,0% |
| GUESS | GES US Equity | USD | 30,33 | 2 478 | 6,2x | 6,7x | 5,8x | 0% | 14,0x | 15,5x | 14,2x | 0% | 4,2% | 6,1% | 6,8% | 2,7% | 2,6% | 2,7% |
| Average | | | | | 11,2x | 10,3x | 8,9x | 5% | 18,6x | 17,6x | 14,8x | 6% | 3,2% | 2,8% | 5,7% | 1,9% | 2,1% | 2,2% |
| Hennes & Mauritz | HMB SS Equity | EUR | 281,70 | | 17,4x | 15,4x | 13,6x | 8% | 27,4x | 24,1x | 21,4x | 8% | 3,3% | 3,8% | 4,4% | 3,4% | 3,6% | 3,9% |
| | | | | | 1,0x | | | 5% | | | | | | | | | | |
| | | | | | 55% | 50% | 52% | 83% | 47% | 37% | 45% | | | | | | | |

Source: Bloomberg

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8) List of Exhibits

1. Market share of number 1 retailer per country, 2012
2. Top 20 retail markets, 2012
3. H&M market share 2012
4. CAGR 12-15E by country and region: different paces, different opportunities
5. Apparel retailers by revenue, 2012
6. LFL comparison: UK, Germany and Sweden LFL retail sales vs H&M LFL sales
7. Price of cotton, 2008-2013
8. Correlation between cotton returns and other textiles
9. UK online sales as percentage of total sales
10. Online share of retail sales, by country
11. H&M brand portfolio
12. H&M production model
13. Shareholder structure
14. Share price performance
15. SWOT analysis
16. Growth rate drivers
17. Sale densities are converging
18. Prices are not homogenous across regions, 2012 (Germany = 100)
19. Sales per store
20. Online offer to boost total sales
21. Geographical stores distribution, 2012
22. Stores distribution by region
23. COGS as % of sales, 2002-2015E
24. GM dynamics with cotton prices and USD/EUR
25. Selling, general and administrative expenses as % of sales
26. Average number of employees per store
27. CAPEX as % of sales
28. CAPEX YoY change
29. CAPEX per net store openings
30. Payout ratio, 2002-2015E
31. H&M 4Q13 earnings preview
32. FY13/4Q13 earnings sensitivity analysis
33. Analyst rating recommendations
34. Fair value sensitivity analysis
35. EV/EBITDA to EBITDA CAGR 13E-15E
36. PER CAGR 13E-15E
37. Historical forward PER multiple
38. H&M Price and EPS

9) List of Equations

Equation 1: FCFF

Equation 2: Firm value

Equation 3: WACC

Equation 4: CAPM

Equation 5: Unleveraged beta

Equation 6: Terminal value

Equation 7: Expected growth rate

Equation 8: Reinvestment rate

Equation 9: FCFE

Equation 10: Equity value

Equation 11: DDM

Equation 12: APV

Equation 13: EVA

Equation 14: Growth rate of revenues

Equation 15: Net working capital

10) Acronyms used:

APV – Adjusted present value
APT – Arbitrage Pricing Theory
BoAML – Bank of America Merrill Lynch
B&S – Black and Scholes
CAGR – Compounded Annual Growth Rate
CAPEX – Capital expenditures
CAPM – Capital Asset Pricing Model
CCF – Capital Cash Flow Model
COGS – Cost of Goods Sold
DCF – Discounted cash flows
DDM – Dividend discount model
ERP – Equity risk premium
EVA – Economic Value Added
EBIT – Earnings Before Interest Taxes
FCFF – Free cash flow to the firm
FCFE – Free cash flow to the equity
GM – Gross Margin
GICS – Global Industry Classification Standard
ITX - Inditex
IR – Investor Relations
KPI – Key Performance Indicator
LFL – Like-for-like
M&A – Mergers & Acquisitions
MSCI – Morgan Stanley Capital International
NWC – Net working capital
NOPLAT – Net Operating Taxes Less Adjusted Taxes
OM – Operating Margin
ROE – Return on equity
TV – Terminal Value
WACC – Weighted average cost of capital
YTD – Year to Date
YTM – Yield to maturity