TFM Inditex - Natalia Niederleytner

por Natalia Niederleytner Enciso

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ICADE BUSINESS SCHOOL MÁSTER UNIVERSITARIO EN FINANZAS

VALUATION OF INDITEX GROUP

Master's Thesis

Author: Natalia Niederleytner Enciso Supervisor: María Luisa Mazo Fajardo

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Abstract

With almost 7,500 stores worldwide and presence in 96 different markets, Inditex has been considered to be the "perfect company" in many occasions. Strong international growth in the last years, an effective and efficient supply chain management and a very healthy financial situation are some of the key factors that have allowed the Group to become as successful as it is today.

However, will Inditex continue to grow as it has been growing in the last years? In order to answer this question we will need to analyze the Company from a strategic point of view. In particular, some specific key questions to be answered will be: Which are the Company strengths? Is there potential for further expansion? Which is the degree of competition that Inditex faces nowadays?

On the other hand, from a financial point of view, it is relevant for us to know how the Company's revenue and gross margin have evolved over time. Furthermore, how is it financed? Does it have enough liquidity? The answer to these questions will allow us to obtain a general picture of the Inditex financial situation and evolution. Then, knowing the Company from a strategic and financial perspective we will be in good position to evaluate it through the discounted cash flow and the multiples of comparable companies' methods.

The market values Inditex at 29.64€ today (6th July, 2018), but do we recommend buying, selling or holding? The answer will depend on the results of our valuation, which will allow us to determine the upside or downside potential of Inditex stock price.

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List of abbreviations

- CAPEX Capital expenditure
- CAPM Capital asset pricing model
- CCF Capital cash flow
- CF Cash Flow
- CFd Cash Flow to debt holders
- COGS Cost of goods sold
- DCF Discounted cash flow
- DOI Days of inventory
- DPO Days payable outstanding
- DSO Days sales outstanding
- EBIT Earnings before interest and taxes
- EBITDA Earnings before interest, taxes, depreciation and amortization
- EPS Earnings per share
- EV Enterprise value
- FCF Free cash flow
- FCFE Free cash flow to equity
- INDITEX Industria de diseño textil
- Kd Cost of debt
- Ke Cost of equity
- NOPAT Net operating profit after taxes
- OWC Operating working capital
- PEG Price earnings to growth
- PER Price earnings ratio
- PESTLE Political, economic, social, technological, legal and environmental
- PPE Property, plant and equipment
- P&L Profit and loss account
- P/S Price to sales
- P/BV Price to book value
- Rf Risk free rate
- Rm Return of market
- ROA Return on assets
- ROCE Return on capital employed
- ROE Return on equity
- RS Residual value
- SWOT Strengths, weaknesses, opportunities and threats
- WACC Weighted average cost of capital

Chapter 1. Introduction

1.1. Objective of the work

The main objective of the present Master's Thesis is to carry out a valuation of Inditex Group through the discounted cash flow and the multiples methods

Therefore, the present Thesis aims to achieve a deeper knowledge of the company under valuation from both a strategic and financial point of view, as well as to achieve a target price for the Company through the use of the previously mentioned valuation methods. A second objective is to get a deeper understanding of the two business valuation methods used in our work, the discounted cash flows method and the valuation by multiples of comparable companies. The discounted cash flows (DCF) method is the most widely used in finance and therefore it is key to use it for our analysis. On the other hand, the multiples method can be thought as a means of backing the final valuation made through the DCF method.

1.2. Structure

We will start our work with a theoretical framework, in which we will review the main valuation methods with the help of bibliographical references as well as the available resources from this Master's degree.

Then we will continue with the strategic analysis of the Group. In particular, we will carry out a SWOT, PESTLE and Porter's 5 forces analysis in order to get a general picture of the Company's strategic position. A brief history of Inditex will be also included in this chapter.

A financial analysis of Inditex will follow. For this purpose, we will gather information from the Group's annual reports and other relevant sources. In first place, we will carry out both a horizontal and vertical analysis of the Company's consolidated income statement and balance sheet in order to understand how the financial situation of Inditex has evolved over the past five years. Then we will also carry out a ratio analysis. Finally, we will proceed with the valuation through the discounted cash flows method and the valuation by multiples method. We will explain the projections done for the purpose of the discounted cash flow valuation. Then we will apply the two methods in order to arrive to a final price for Inditex. After that, we will finalize our work with the main conclusions obtained.

Chapter 2. Literature review of valuation methodologies

We are going to review the most common methods used for company valuation. According to Professor Pablo Fernández, these methods can be classified in four categories: value based on assets, value based on multiples, mixed methods and discounted cash flows methods. Within each category we will explain the main methods.

2.1. Value based on assets

This is a static approach which states that the value of the company is based on its balance sheet. As a consequence, the methods included in this category rely on data from the past since the balance sheet reflects the situation of a company at the end of its last fiscal year. Therefore, this approach doesn't take into consideration the future evolution of the company, the time value of money, nor other factors which affect the value of a company and are not reflected in the financial statements such as the existing conditions in the sector (Fernández P., 2017). The three main methods within this category are book value, replacement value and liquidation value.

2.1.1. Book value

Book value is one of the simplest methods to calculate the value of a company. In order to calculate book value, we must subtract the value of total outstanding liabilities of a company to the value of its total assets. By making this calculation we obtain the net worth of the company, which is basically the contribution that the shareholders have made throughout the history of the company, from its foundation until the moment in which the company is valued, both in the form of capital contribution and self-financing (Santandreu & Pruñonosa, 2012). However, the value of assets and liabilities in the balance sheet may differ substantially from their fair market value when a company applies accounting rules in which historic value is used to account for assets and liabilities. In such case, it may be relevant to calculate the adjusted book value, in which the market value of the different assets and liabilities is used in order to calculate book value.

2.1.2. Replacement value

Replacement or substantial value is defined as the investment that would be required in order to create a new company which has the same conditions as the one under valuation. It is, in essence, the replacement value of the company's assets assuming the on-going concern principle, i.e. that the company will continue operating in the future. Usually, assets which are not used for the operations of the company like unused land or minorities in other companies are not taken into account (Fernández P. , 2017). Therefore, the financial structure of the company is not relevant in this method. Finally we can differentiate between three different types of substantial value (Fernández P. , 2017):

- Gross substantial value: is the value of the asset valued at market price.
- Net substantial value: is the gross substantial value minus outstanding liabilities. It
 is also known as adjusted net worth.
- Reduced gross substantial value: it is the gross substantial value reduced only by the value that corresponds to the suppliers.

2.1.3. Liquidation value

Unlike substantial value, which was based on the going concern premise, the liquidation value method calculates the value of a company assuming it is going to cease its operations, meaning that its assets will be sold and its liabilities will become due with immediate effect. Therefore, liquidation value can be calculated as the adjusted book value minus all the expenses incurred in the liquidation process such as dismantling costs, indemnity payments to employees or fiscal expenses among others (Fernández P., 2017). Liquidation value represents the minimum value of the company since the buyer will be willing to pay less for a company it plans to liquidate than for one that will continue to operate and therefore could report additional benefits in the long term to the buyer.

2.2. Value based on multiples

Multiples include all the valuation methods which are based on the income statement or balance sheet of the company. Therefore, the valuation by multiples consists of relating the market price with the financial statements of the company, taking into consideration some financial magnitudes such as profits, sales or EBITDA. Through the use of this method we are able to compare different companies in the same sector, which allows us to calibrate the valuation made and identify differences between the company being valued and the rest of the competitors within the sector. We can also compare the multiples of a company with those the company had in the last few years, in this way we will check whether the current valuation is higher, equal or lower than the multiples of the past (Fernández A. , 2017).

We can classify multiples in three broad categories (Fernández A., 2017):

- Multiples based on market capitalization
- Multiples based on enterprise value
- Multiples related to growth

We are going to explain one multiple within each category.

2.2.1. Multiples based on market capitalization: PER and P/BV

The price earnings ratio (PER) represents the multiple of the earnings per share paid on the stock exchange. Therefore, we can calculate the value of the shares by multiplying the annual net profit by the PER.

 $PER = \frac{Market \ capitalization}{Net \ profit}$ Shares value = PER * Net profit

Then, another relevant multiple is P/BV, which allows us to compare the company's market value to its book value. It is calculated by dividing price per share by book value per share (Investopedia, LLC., 2018).

$$P_{BV} = \frac{Market \ price \ per \ share}{Book \ value \ per \ share}$$

2.2.2. Multiples based on enterprise value: EV/EBITDA

This method aims to determine the value of the company based on EBITDA multiplier. This ratio tells investors how many times EBITDA they have to pay, were they to acquire the entire business (CFI Education Inc., 2018) and can be calculated as:

 $\frac{EV}{EBITDA} = \frac{Market\ cap\ +\ Net\ debt}{EBITDA}$

Finally, enterprise value to sales or EBIT are other common multiple used to belonging to this category.

2.2.3. Multiples related to growth: PEG

Price earnings to growth multiple is the PER divided by the earnings per share growth expected for the following years.

 $PEG = \frac{PER}{EPS \ expected \ growth}$

2.3. Discounted cash flows methods

Methods based on discounted cash flows are probably the most highly accepted ones from an academic point of view. They aim at determining the value of the company through the estimated cash flows that the company will generate in the future (Fernández P., 2017). These cash flows, discounted at an specific interest rate which takes into consideration the risk assumed, will result in the present value of such flows (Fernández P., 2017). Therefore, discounted cash flows methods assess the company's ability to generate value for its shareholders in the future.

One of the key decisive elements in the valuation of a company through these methods is the determination of the discount rate, which is, in many occasions, set by those concerned with the valuation. Furthermore, future cash flows determination is also of key relevance and it is important to remark that there are different ways of calculating such flows depending on the specific method that we are using. However, all methods based on discounted cash flows are built up on the following formula (Fernández P., 2017):

$$V = \frac{CF_1}{1+K} + \frac{CF_2}{(1+K)^2} + \frac{CF_3}{(1+K)^3} + \dots + \frac{CF_n + RV_n}{(1+K)^n}$$

Where: CF_i = cash flow generated by the company in period i; RV_n = residual value, i.e. expected company value in year n; K = discount rate adjusted to the cash flows' risk

The residual value of the company in year n can be calculated by discounting the future cash flows expected from that year onwards (Fernández P., 2017). If we assume those future flows to be indefinite over time we can settle a constant growth rate (g) of the cash flows to be applied from year n. This way, if we applied the perpetuity formula with constant growth, the residual value would be calculated as follows:

$$RV_n = \frac{CF_n(1+g)}{(K-g)}$$

Regarding the cash flows, the following table shows which are the most used types of cash flows and the most appropriate discount rate for each of them (Fernández P., 2017):

Cash Flow	Discount Rate
FCF. Free cash flow	WACC. Weighted average cost of capital
FCFE. Free cash flow to equity	Ke. Return on equity
CFd. Cash flow to debt holders	Kd. Return on debt
CCF. Capital cash flow	WACC before taxes

Table 1: Types of Cash Flows

Source: Métodos de valoración de empresas, Pablo Fernández, 2017

The free cash flow (FCF) is the cash flow generated through the company's operations without taking into consideration the financial structure and after covering investment needs in fixed assets (CAPEX) and investment needs in OWC. Therefore, FCF measures the level of cash available to a company's investors after required investment to maintain or expand its asset base (Investopedia, LLC., 2018).

The free cash flow to equity (FCFE) represents the cash that the company has generated and is available for shareholders after having paid suppliers of goods, services and external financing (Velasco, 2017). The free cash flow to equity is obtained after subtracting interest and principal payments (after taxes) and adding the variation of debt to the FCF (Fernández P., 2017).

 $FCFE = FCF - [(interest paid x (1 - t) - principal payments + \Delta debt]$

The variation of debt may have a negative or a positive effect on the free cash flow to equity. If new debt is added (i.e., a positive variation), this will represent a cash inflow, which will be available to the shareholders. On the other hand, if debt is decreased (i.e., a negative variation), this will imply that there will be a cash outflow in order to cancel the debt and therefore the cash available to shareholders will decrease (Velasco, 2017).

The **cash flow to debt holders (CFd)** represents the cash that flows from the company to the debt holders in order to meet the interest payments as well as the principal repayments. Only financial debt is considered in the calculation of the cash flow to debt holders, like for example bank loans. Those debts that are derived from the company's daily operations are not included (Velasco, 2017).

$CFd = I - \Delta D$

In this case, the effect that the variation of debt has on the cash flow to debt holders is just the opposite as it was in the case of the free cash flow to equity. If the company increases its debt, this will imply a cash inflow for the company and, as a consequence, a decrease in the cash flow available to the debt holder. On the contrary, if the company's debt decreases, the cash flow to the debt holders will increase as the company is repaying the debt to them (Velasco, 2017).

Finally, the **capital cash flow (CCF)** is the cash generated by the company during the year for its investors, understood these as both the shareholders and the creditors (Velasco, 2017). It is obtained from the addition of the cash flow to debt holders and the free cash flow to equity.

 $CCF = FCFE + CFd = FCFE + I - \Delta D$ $I = D \cdot Kd$

On the one hand, the company must remunerate its shareholders, who expect a return from the resources they have invested in the company. On the other hand, the company must also remunerate its creditors, who have lent money to the company in exchange of a return and the repayment of the amount lent at maturity (Velasco, 2017).

2.4. Mixed methods based on goodwill

In order to close this chapter, we will mention that there exists mixed methods based on goodwill but we are not going to explain them in depth.

Briefly, goodwill is the value that the company receives above its adjusted book value and corresponds to a set of strengths and competitive advantages, which are intangible and are not reflected in the company's accounts (Pereyra, 2008). We could say that goodwill measures the value of the company's reputation, given that this reputation affects positively the value of the company. Therefore, valuation under these methods implies taking into account these intangible elements together with the company's net assets.

Chapter 3. Strategic analysis of the company

3.1. Introduction to the company

Industria de Diseño Textil (Inditex) is a Spanish multinational group which operates in the textile industry as a manufacturer and distributor. The Group is headquartered in A Coruña, Spain, place in which Inditex first started its activity in 1963. Today Inditex is one of the biggest fashion distribution companies of the world with presence in 96 markets, in which the Company already owns around 7500 stores (Inditex, 2018). The Group is formed by eight different brands: Zara, Pull&Bear, Massimo Dutti, Bershka, Stradivarius, Oysho, Zara Home and Uterqüe.

Through the study of the Group's history and the analysis of its strengths, weaknesses, opportunities and threats we will get a clear picture of the Company's evolution and its overall current situation from a strategic point of view.

3.1.1. Brief history

As mentioned before, the history of Inditex Group started in 1963, year in which Amancio Ortega Gaona created Confecciones GOA in A Coruña, Spain, whose activity consisted in the manufacture and distribution of women's clothes. After twelve years of activity in the textile industry, the first Zara store was opened in A Coruña. In the following years the expansion of Zara to the main Spanish cities took place. Furthermore, in 1977 the GOA and Samlor factories were constructed in Arteixo, A Coruña, which has remained the Group's headquarters ever since. It wasn't until 1985 that Inditex was founded as the holding company of the Group.

The international expansion of Inditex started in 1988, when Zara opened its first store abroad, in Oporto, Portugal. As the Company continued to expand globally, two new brands, Pull&Bear and Massimo Dutti, were incorporated to the Group in 1991. After that, Bershka and Stradivarius were incorporated in 1998 and 1999 respectively. Later, in 2001, another two important events in the history of Inditex took place: first, Oysho was launched as the new brand specialized in lingerie and, second and most importantly, Inditex started to trade in the Madrid Stock Exchange. Then in 2003 Zara Home was

created as the seventh brand of the Inditex Group and by 2004 the Group already had 2000 stores around the world. In 2007 Inditex jumped into the online selling business with its first online shop Zarahome.com. In 2008 the brand Uterqüe was born and Inditex opened its store number 4000 in Tokyo, Japan, doubling the number of stores that it had 4 years before. Finally, the online expansion continued with the opening of the Zara online shop in 2010, which would be followed by further growth in the online business in the succeeding years.

3.1.2. SWOT Analysis

The SWOT analysis allows us to make a diagnosis of the current situation of the targeted company both at the internal as well as at the external level (Suport Associatiu, 2017). At the internal level we will identify the strengths and weaknesses of the company and at the external level the analysis will be focused on the opportunities and threats that the outside environment poses to the Inditex Group.



Figure 1: SWOT Analysis

Source: Own elaboration

3.1.2.1. Strengths and weaknesses

Inditex has numerous strengths which have allowed the Company to become one of the world's leading fashion distributors:

- Brand name: The different brands that form the Group have a high reputation, especially if we think of Zara, the Group's flagship brand. In fact, "the high investment in the Zara brand name is an asset for Inditex, as well as their other retail formats through association" (Vincent, Kantor, & Geller, 2013). Furthermore, this reputation facilitates the entry into new markets and the consequent increase in sales.
- Vertical integration: Inditex has control over the entire value chain (design, manufacturing and distribution). The Company implements processes that allow it to shorten the production cycle, contrary to those competitors which are more reliant on third parties and as a result less flexible in their response time (Vincent, Kantor, & Geller, 2013).
- Strong international presence: The Group benefits from its presence in 96 different markets, where it owns around 7500 stores, and it continues to grow to new markets each year. Moreover, the online presence in 49 different markets allows Inditex to have a great reach not only internationally but within the industry by arriving to shoppers farther from its storefronts who are time sensitive (Vincent, Kantor, & Geller, 2013).
- Store location: The decision on where to locate its stores is a key part of the Group's strategy. Inditex stores are spacious establishments which can be found in the best locations in the cities.
- Real-time data and communication: There is an on-going communication between product teams of each of the Inditex retail formats and store staff. These product teams are formed by designers, merchandisers, and store liaison managers who work together on the development of new products and the analysis of current sales data (Vincent, Kantor, & Geller, 2013). This coordination allows to have a tailored offer in each of the Company's stores based on real-time data such as detailed sales information and customer feedback.

On the other hand, we can highlight some weaknesses which need to be corrected in order not to let them hinder the success of the Group:

- Centralization of logistics in Spain: Inditex has ten logistic centers, all of them located in Spain. This centralization represents a disadvantage for the international expansion of the Group since it can result in a more costly and slower distribution (GESCO ESIC, 2016).
- High reliance on European markets: Even though the proportion of sales in Europe decreases steadily each year thanks to the international expansion, Inditex sales in Europe still account for roughly 60% of total sales. Only in Spain the Group's sales were 16.9% of the total in 2016. This strong dependence on Europe "could leave the company more vulnerable to economic fluctuations in times of fiscal crisis" (Vincent, Kantor, & Geller, 2013).
- Overdependence on Zara brand: For the Group Zara represents around 66% of total sales, which implies that the seven remaining brands together only represent 34% of sales. Relying as heavily on only one of the Group's retail formats could be risky since the fashion industry changes quickly.

3.1.2.2. Opportunities and threats

There are a number of opportunities that could be exploited by Inditex:

- International expansion: As we have mentioned in the previous section, 16.9% of Inditex revenues come from sales in Spain. Therefore, the Spanish market might be becoming a saturated one for the Company. Inditex can take advantage of the opportunities for further expansion and sales growth beyond domestic borders since there is still room for growth within Europe and, most importantly, in other attractive markets such as emerging markets (Vincent, Kantor, & Geller, 2013).
- Online expansion: Technology is gaining more and more importance in the daily lives of millions of people all across the globe. For instance, people perform many tasks through the use of Internet in a much different and convenient way than in the past: writing an email, reading the online newspaper or buying online in their favorite shops. Inditex can benefit from this global trend by growing the online

presence of their brands since currently the Company only reaches 49 markets online out of the 96 where it operates.

 Technological development: In line with the previous point, making continuous technological improvements in its manufacturing, distribution and sales processes can be a great opportunity for Inditex in order to maintain its leadership position. Technological growth within the Company can help create faster information exchange systems or implement just-in-time production with more complex machines and logistics systems among others (GESCO ESIC, 2016).

Finally, Inditex needs to face a series of **threats** in order to keep its leading position in the industry:

- Increasing competition: The fashion industry is becoming highly competitive since barriers to entry are low. H&M has traditionally been the main competitor of Inditex, however there are many other established competitors such as GAP, Mango or Primark. Moreover, each time there are more and more new players threatening the Group's leadership in the industry. This is could be the case for instance of Uniqlo, a Japanese casual wear designer, manufacturer and retailer which is expanding quickly on a global level. In fact, Tadashi Yanai, Uniqlo founder, said in an interview with "El País" newspaper "We want to be bigger than Spain's Inditex". As a result, such competitive environment forces Inditex to seek new strategies to expand and keep pace with innovations in the fashion industry.
- Product imitation: Inditex products, especially those from its brand Zara, are often imitated by other companies. These companies are usually online stores which make international shipments and replicate some of the Group's star products. Examples of these online stores would be Sheinside or Romwe. They offer the imitated products at lower prices, usually at the expense of a worse product quality. However, this strategy is effective and it captures a portion of the demand for Inditex products since exclusivity is lost and customers can decide among different offerings for apparently the same product.

3.2. External analysis

The external analysis consists of the identification of national and sectoral variables with a direct and indirect impact on the company and over which the company has no control or capacity to modify its behavior (Paredes, 2010). For this purpose we will carry out a Pestle analysis and a Porter's five forces analysis.

3.2.1. Pestle analysis

The Pestle analysis is a tool which will help us to describe the framework in which Inditex operates in terms of the political, economic, social, technological, legal and environmental factors that surround and influence the Group.

Political factors

The internationalization strategy of Inditex has led to the Group being present in 96 different markets and this fact has a direct effect on its political dimension. As a consequence, Inditex is subject to the different commercial and fiscal policies implemented in each of the countries where it operates. Furthermore, the Group's operations in each country can also be affected by the existing political developments such as periods of instabilities, disputes or tensions. At present, we can highlight the protectionist measures implemented by Donald Trump, president of the United States. Such measures have risen a global concern about a possible trade war between the US and China, which creates a climate of uncertainty.

Economic factors

Economic developments are critical to the good functioning of the Group. On the one hand, economic downturns can seriously affect the purchasing capacity of customers, which leads to a reduction in consumption and, as a result, to a reduction of companies' sales. On the other hand, companies can benefit from boom periods in order to grow and improve their performance. The 2008 crisis hurt the economies of countries all around the globe. This global economic crisis caused thousands of companies to cut substantially their profits and led some others to bankruptcy. Despite the crisis, Inditex didn't experience any sales decrease, in fact the Group continued to expand to other markets and its revenues increased year after year. This reflects the solidity and success of Inditex business model. However, the Company must always keep an eye on economic conditions in order to be able to react properly and avoid damage to the extent possible.

Social factors

There are several social factors that influence Inditex strategic decisions and such factors vary from country to country. Each society is defined by a series of characteristics to which the Company must adapt.

For instance, birth rates in most European countries are significantly lower than those from South American countries. Talking generally, this implies that while European population is aging, population in South America has a higher share of young people. Inditex must therefore adapt its product offering and other strategic decisions in accordance with the population structure of each country. There are other factors such as the climate or the culture and customs of a country, which will shape the Group's strategic decisions.

Furthermore, Inditex is highly committed to society and it aims to "improve the inclusion in the area of work of vulnerable people or groups with special needs that make it more difficult for them to find employment" (Inditex, 2018). For that purpose, the Group invests in different social programs related to important matters such as education or humanitarian aid. The investment in this type of programs increased by a 55% in the 2014-2016 period.

Technological factors

Currently there are several technological trends which have been shaping the way companies carry out their businesses. For Inditex we can highlight three main trends that have a direct impact on its daily operations.

The first trend is global access to the Internet, which results in each time more and more people being able to use the Internet. The Group is taking advantage of this trend by expanding gradually to online markets in order to allow customers to shop in Zara, Pull&Bear or Stradivarius without the need of leaving their houses.

Another relevant trend is connectivity. Consumers are constantly connected through their phones, tablets and other devices. They check the weather forecast from their phone or read their favorite newspapers from their tablet. In order to benefit from the trend, Inditex has moved a step forward and has developed mobile applications for each of its brands. This way customers can have look at the catalogues of the brands and shop online easily from any location.

Finally, improvements in technology makes it necessary for the Group to make use of such new technologies in order to achieve more efficient and faster distribution and logistics. For instance, Inditex has developed an internal system based on technology and automation which allows employees in the different stores to monitor inventories in real time. Through a device that employees carry with them they can check whether there is a particular item being demanded by a customer in the warehouse of the store or in any other store in case it is not found in the original one.

Legal factors

Inditex is subject to as many legislations as countries where it conducts business. As a result, the Company must be aware of all the relevant regulations for its type of business and also be able to mitigate any legal risk that may arise. For this purpose, the Group needs both internal and external auditing processes in order to ensure compliance with regulations. Furthermore, Inditex uses policies as a measure to protect against possible risks that may generate sanctions for the Group.

An important aspect to consider for legal purposes is the role of digital developments. As we have explained, Inditex incorporates digital technologies in its business model. Therefore, the Company must be aware of all the regulations related to these technologies such as data protection and information security since Inditex deals with big amounts of information coming from its customers.

Environmental factors

Nowadays there is a global concern about the need for a sustainable development. Scarcity of resources, pollution and climate change are some of the most relevant topics and governments are taking action in order to reduce the negative impact that the society in general has on the environment. Along the years several measures have been put in place such as laws regarding CO2 emissions or incentives to recycle among others.

For its part, Inditex is highly committed to environmental sustainability and has developed several measures in order to protect biodiversity, reduce its consumption of water, energy and other resources, avoid waste, and combat climate change (Inditex, 2018). Some strategies include optimization of packaging and waste, eco-stores and the use of sustainable materials coming from sustainable managed forests for instance. This initiatives have allowed the Company to achieve a leading position in the Dow Jones Sustainability Index. Moreover, the Group is member FTSE4Good, which is "a sustainability stock index that includes global companies with a greater commitment in the field of corporate responsibility, taking into account their environmental, social and corporate governance practices" (Inditex, 2015).

3.2.2. Porter's five forces analysis

Porter's five forces analysis, developed by Michael Porter, is a tool used to analyze a sector or industry through the identification and analysis of five forces: competitive rivalry, supplier power, buyer power, threat of substitutes and threat of new entrants. This five forces are the ones which have the greatest impact on the competitive strategy of a company (Paredes, 2010) since it helps to know the level of competition inside the industry to which the company belongs.

3.2.2.1. Competitive rivalry

There are many fashion retailers in the industry, which means that competitive rivalry is very high. We can find aggressive price competition between companies in the industry, however, these can also compete in other dimensions such as quality, design, marketing or innovation. Companies like H&M, GAP or Benetton are also global players with physical and online stores around the world and, therefore, direct competitors of the Inditex Group. Other direct competitors are national brands which operate also outside the Spanish territory such as Mango or Adolfo Domínguez as well as small local fashion shops.

Despite the strong rivalry, Inditex has managed to achieve and maintain a leading position in the industry by leveraging on its competitive advantages. The Company has based its growth strategy on a solid internationalization process which has allowed it to become a world leader in the global fashion industry. Furthermore, Inditex brands are positioned differently allowing the Group to compete in different customer segments and, therefore, diversify. For instance, brands like Pull&Bear, Stradivarius and Bershka target the younger segments of the population and sell trendy fashion at low prices while, at the other end, we find brands like Uterqüe or Massimo Dutti which target upper middle-class women and men.

3.2.2.2. Supplier power

There is a large number of suppliers in the industry and they have little bargaining power as a result. If suppliers do not comply with quality standards, established prices or delivery time, companies can decide to change suppliers at little or no cost thanks to the large range of existing suppliers.

Inditex has a high degree of vertical integration since it has control over the majority of the activities which are part of its value chain. A large part of the Company's production process is carried out in the factories owned by the Group, subcontracting only part of the supply process and the manufacturing phase. In total figures, the Company works with 6,959 factories and 1,805 suppliers around the world. Finally, it is relevant to highlight that all suppliers must comply with the values defined by Inditex in its "Code

of conduct for manufacturers and suppliers" regarding social and environmental responsibility. This is ensured by the Group through exhaustive auditing and compliance processes, as well as constant training of internal and external suppliers.

3.2.2.3. Buyer power

Customers do not have a strong bargaining power in the textile industry since, as many as there are, they don't usually have organizations through which they can put pressure on the companies in the industry and defend their interest. Moreover, when individual clients go shopping for clothes they typically buy in small quantities which also reduces their bargaining power.

On the other hand, customers have the possibility to change from one brand to another at no cost. Furthermore, nowadays consumers can have access to a lot of different information about the companies to which they buy their clothes, like for example, the policies they implement, news about the company and even reviews and other customers' opinions. These two facts together contribute to increase buyer power.

Focusing on Inditex, we find that their customers are a highly important stakeholder and they are positioned at the center of the Group's business model. Therefore, it is crucial for the Company to properly meets their customer's needs by "listening to feedback, analyzing real-time sales data, making short production runs, and investing in state-of-the art logistics" (Inditex, 2018).

3.2.2.4. Threat of substitutes

Clothing could be classified as a primary necessity good and it has a function that no other good can serve, which is to dress people. As a consequence, the threat of substitutes, understood as an alternative and different product that can meet the need of dressing, is very low. However, if we think of the wide product offering within the textile industry we can find substitutes. Brands that position themselves similarly can offer clothing items which are similar in quality, features and price and, therefore, consumers can substitute one for the other. For instance, an individual could either buy a pair of skinny jeans from H&M or, alternatively, buy it from Pull&Bear. What the client will focus on in order to decide which one to buy will be features like design or differences in price, if any. Similarly, clothing products could be substitutes if they perform the same function but do not belong exactly to the same product category. As an example, consumers can cover their feet with different types of footwear such as boots, sneakers, shoes or high heels and, therefore, this footwear categories become substitutes among them.

As we have explained, Inditex targets different customer segments through its different brands. As a result, the threat of substitutes is different for each of the Group's commercial formats and there may even be some cannibalization effect between them. Finally, it is relevant to remark that the brand Zara Home does not compete in the textile industry but in the industry of home décor and furniture and therefore the threat of substitutes it faces is significantly higher.

3.2.2.5. Threat of new entrants

There are not many entry barriers in the textile industry, however, the existing ones might be difficult to overcome by new entrants.

First, new players will not be able to benefit from economies of scale at their initial stages which can make it harder for them to compete in prices with well-established international fashion retailers. Furthermore, experience has allowed this well-established companies to obtain a deeper knowledge and know-how over time, which helps them to introduce improvements in their production or distribution methods in order to be more efficient.

Another barrier could be high initial investment, which will depend on the business plan of the company. A new entrant wishing to compete internationally will have higher upfront costs than one that plans to operate locally. Moreover, new entrants may also face the barrier of developing a strong and efficient distribution network, which is key to efficient operations and fast distribution and can be costly to attain.

Inditex Group has been constantly growing since its inception and this has allowed it to take advantage of economies of scale. Furthermore, Inditex has managed to become a well-known international company with strong competitive advantages like product differentiation, excellent store locations and efficient distribution networks.

Chapter 4. Financial analysis

In this chapter we will carry out a financial analysis of Inditex. For that purpose, we will use three different methodologies in order to get a deeper understanding of the financial situation and evolution of the Group. We will analyze the past performance of the Company. For that purpose, we will use the information contained in the financial statements of the last five years (2013-2017). In first place we will start with a vertical analysis, which is a static approach since it is focused on the financial situation of a company at a given point in time without taking into consideration the changes that have taken place over time. Then we will continue with a horizontal analysis, which, as opposed to the vertical one, takes into account time since it compares the financial statements of a company from one period to another in order to measure the changes that have occurred and analyze the trend that the financial statements have followed. Finally, we will carry out a ratio analysis, which is a quantitative analysis of the information contained in a company's financial statements (Investopedia, LLC, 2018). With these three different approaches we will reach a fair conclusion about the financial reality of the company, which will allow us to take the appropriate decisions based on such reality (Gerencie.com, 2018).

4.1. Vertical analysis

Reading the financial statements presented by a company is always convenient since we can get a lot of relevant information from them. However, vertical analysis facilitates the understanding and interpretation of both the income statement and the balance sheet. As we have already mentioned it is a static approach since the analysis is focused on the information of the financial statements at a particular time. Furthermore, vertical analysis helps us to determine how a company's assets are distributed. The analysis consists in taking a single financial statement and relate each of the accounts it contains to a specific total within the same financial statement (Navarro, 2016).

For the analysis of the income statement of Inditex, we will take sales as the base figure meaning that they will represent 100%. Then we will relate the rest of the items in the income statement to sales and we will explain the main conclusions we can get from

the analysis. Similarly, for the balance sheet analysis we will take two different base figures, one for the assets side and the other for the liabilities side. For the asset side we will take total assets as the total and for the liabilities side we will take total equity and liabilities as the base figure.

(figures in million €)	2013	%	2014	%	2015	%	2016	%	2017	%
Sales	16,724.4	100.0%	18,116.5	100.0%	20,900.4	100.0%	23,310.5	100.0%	25,336.0	100.0%
Cost of goods sold	-6,801.5	-40.7%	-7,547.6	-41.7%	-8,811.1	-42.2%	-10,032.0	-43.0%	-11,076.0	-43.7%
Gross profit	9,922.9	59.3%	10,568.9	58.3%	12,089.3	57.8%	13,278.6	57.0%	14,260.0	56.3%
Operating expenses	-5,998.3	-35.9%	-6,457.6	-35.6%	-7,391.8	-35.4%	-8,175.6	-35.1%	-8,944.0	-35.3%
Other losses and income, net	1.3	0.0%	-8.3	0.0%	1.7	0.0%	-19.5	-0.1%	-38.0	-0.1%
Gross operating profit (EBITDA)	3,926.0	23.5%	4,103.1	22.6%	4,699.2	22.5%	5,083.4	21.8%	5,278.0	20.8%
Depreciation and amortization	-855.1	-5.1%	-904.9	-5.0%	-1,021.7	-4.9%	-1,062.7	-4.6%	-963.0	-3.8%
Net operating profit (EBIT)	3,070.9	18.4%	3,198.2	17.7%	3,677.4	17.6%	4,020.7	17.2%	4,315.0	17.0%
Financial results	-18.2	-0.1%	14.5	0.1%	10.1	0.0%	10.0	0.0%	-5.0	0.0%
Results of companies accounted for using equity method	0.0	0.0%	32.1	0.2%	55.6	0.3%	47.6	0.2%	42.0	0.2%
Profit before taxes	3,052.7	18.3%	3,244.8	17.9%	3,743.1	17.9%	4,078.3	17.5%	4,352.0	17.2%
Income tax	-671.1	-4.0%	-734.6	-4.1%	-860.9	-4.1%	-917.2	-3.9%	-979.0	-3.9%
Net profit	2,381.6	14.2%	2,510.2	13.9%	2,882.2	13.8%	3,161.1	13.6%	3,373.0	13.3%
Net profit attributable to non-controlling interests	-4.5	0.0%	-9.6	-0.1%	-7.6	0.0%	-4.1	0.0%	-5.0	0.0%
Net profit attributable to the parent	2,377.1	14.2%	2,500.5	13.8%	2,874.6	13.8%	3,157.0	13.5%	3,367.0	13.3%

Table 2: Vertical Analysis Consolidated P&L

Source: Own elaboration based on Inditex annual accounts

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(figures in million €)	2013	%	2014	%	2015	%	2016	%	2017	%
ASSETS										
NON-CURRENT ASSETS	6,991.3	50.8%	8,271.0	53.8%	8,907.9	51.3%	9,723.1	49.6%	10,084.0	49.8%
Rights over leased assets	508.9	3.7%	531.1	3.5%	504.4	2.9%	505.0	2.6%	457.0	2.3%
Other intangible assets	133.4	1.0%	153.0	1.0%	190.3	1.1%	210.5	1.1%	255.0	1.3%
Goodwill	203.5	1.5%	197.9	1.3%	193.5	1.1%	195.7	1.0%	207.0	1.0%
Property, plant and equipment	5,137.6	37.3%	6,040.6	39.3%	6,597.5	38.0%	7,283.4	37.1%	7,644.0	37.8%
Investment property	82.8	0.6%	81.5	0.5%	21.2	0.1%	21.2	0.1%	21.0	0.1%
Financial investments	20.6	0.1%	151.3	1.0%	183.8	1.1%	231.4	1.2%	237.0	1.2%
Other non-current assets	374.9	2.7%	472.1	3.1%	523.8	3.0%	553.7	2.8%	520.0	2.6%
Deferred tax assets	529.7	3.9%	643.6	4.2%	693.4	4.0%	722.0	3.7%	744.0	3.7%
CURRENT ASSETS	6,765.0	49.2%	7,106.0	46.2%	8,449.2	48.7%	9,898.3	50.4%	10,147.0	50.2%
Inventories	1,676.9	12.2%	1,859.5	12.1%	2,195.0	12.6%	2,549.2	13.0%	2,685.0	13.3%
Trade and other receivables	815.2	5.9%	861.8	5.6%	668.8	3.9%	861.0	4.4%	778.0	3.8%
Income tax receivable	95.6	0.7%	68.3	0.4%	89.1	0.5%	107.5	0.5%	110.0	0.5%
Other currents assets	212.9	1.5%	222.3	1.4%	139.4	0.8%	141.2	0.7%	160.0	0.8%
Other financial assets	13.0	0.1%	168.9	1.1%	45.8	0.3%	86.9	0.4%	12.0	0.1%
Current financial investments	104.6	0.8%	127.2	0.8%	1,085.6	6.3%	2,036.6	10.4%	1,472.0	7.3%
Cash and cash equivalents	3,846.7	28.0%	3,797.9	24.7%	4,225.5	24.3%	4,115.9	21.0%	4,931.0	24.4%
TOTAL ASSETS	13,756.3	100.0%	15,377.0	100.0%	17,357.1	100.0%	19,621.4	100.0%	20,231.0	100.0%

Table 3: Vertical Analysis Consolidated Balance Sheet (Assets)

Source: Own elaboration based on Inditex annual accounts

EQUITY AND LIABILITIES

EQUITY	9,278.4	67.4%	10,468.7	68.1%	11,450.8	66.0%	12,751.6	65.0%	13,522.0	66.8%
Equity attributable to the Parent	9,246.2	67.2%	10,430.7	67.8%	11,410.2	65.7%	12,713.4	64.8%	13,497.0	66.7%
Equity attributable to non-controlling interests	32.1	0.2%	38.0	0.2%	40.6	0.2%	38.2	0.2%	25.0	0.1%
NON-CURRENT LIABILITIES	1,015.6	7.4%	1,159.5	7.5%	1,236.2	7.1%	1,419.3	7.2%	1,536.0	7.6%
Provisions	147.8	1.1%	200.6	1.3%	145.3	0.8%	241.6	1.2%	259.0	1.3%
Other non-current liabilities	648.4	4.7%	715.8	4.7%	805.0	4.6%	920.1	4.7%	1,005.0	5.0%
Financial debt	2.1	0.0%	2.3	0.0%	0.7	0.0%	0.5	0.0%	4.0	0.0%
Deferred tax liabilities	217.3	1.6%	240.8	1.6%	285.2	1.6%	257.1	1.3%	268.0	1.3%
CURRENT LIABILITIES	3,462.3	25.2%	3,748.8	24.4%	4,670.2	26.9%	5,450.6	27.8%	5,173.0	25.6%
Financial debt	2.5	0.0%	7.8	0.1%	10.3	0.1%	61.7	0.3%	12.0	0.1%
Other financial liabilities	38.3	0.3%	83.2	0.5%	68.5	0.4%	63.7	0.3%	105.0	0.5%
Income tax payable	89.0	0.6%	149.9	1.0%	77.1	0.4%	230.1	1.2%	151.0	0.7%
Trade and other payables	3,332.5	24.2%	3,507.9	22.8%	4,514.3	26.0%	5,095.1	26.0%	4,906.0	24.2%
TOTAL EQUITY AND LIABILITIES	13,756.3	100.0%	15,377.0	100.0%	17,357.1	100.0%	19,621.4	100.0%	20,231.0	100.0%

Table 4: Vertical Analysis Consolidated Balance Sheet (Equity and Liabilities)

Source: Own elaboration based on Inditex annual accounts

There are several conclusions we can draw from the vertical analysis of the profit and loss account of Inditex:

- Cost of goods sold has gone from 40.67% of sales in 2013 to 43.72% in 2017. This implies that the proportion of cost of goods sold to sales has increased and therefore it is more costly for Inditex to sell the same volume now than it was in 2013.
- As a consequence of the prior statement, Inditex has experienced a margin erosion: as costs of goods sold increase in relation to sales, gross margin decreases. During the period under analysis we can see that it has gone from 59.33% of sales to 56.28%.
- Operating expenses have remained stable over time at around 35.5% of sales.
- EBITDA represented 20.83% of sales in 2017 which is a lower proportion if we compare it with 2013, year in which EBITDA was 23.47% of sales.
- Depreciation and amortization has remained stable at around 5% of sales during the period 2013-2016. Then in 2017 depreciation and amortization as a percentage of sales fell to 3.8%.
- EBIT has represented around 17.5% of sales during the whole period 2013-2017.
- Finally, net profit has also remained constant over time (around 13.5% of sales).

Regarding the vertical analysis of the consolidated balance sheet, the main conclusions are:

- Both non-current and current assets have remained stable over time since they have maintained a proportion of around 50% over total assets respectively during the whole period.
- Within non-current assets, property plant and equipment is the asset with the highest weight, representing around 37.5% of total assets and 74% of non-current assets. This allow us to see how relevant this type of assets are for Inditex business.
- On the other hand, within current assets the account which has a greater weight is cash and cash equivalents, which has ranged from 21% to 28% of total assets during the period 2013-2017 and 41% to 56% of current assets. This is a very high proportion and it implies that the Company has excess of liquidity.

- While we find cash and cash equivalents in such high proportions, trade and other receivables do not exceed 6% of total assets in any of the periods we are analyzing. This makes sense if we think of the type of business Inditex carries out. Customers go to the stores, they buy an item and they pay for it at the moment, and this precisely represents the main source of revenue of the Company: the sale of its products. So from the analysis of cash and cash equivalents and trade and other receivables we can say that the Company does not have liquidity problems.
- Finally, from the asset side we should highlight that inventories have remained stable throughout the years at around 12.5% of total assets. The fact that inventories are quite low is because of the ability of Inditex to adapt quickly to the demand for its products as we have seen in the SWOT analysis carries out in previous sections.
- Then, within the passive side, equity attributable to the parent represents around 66% of total equity and liabilities and has remained more or less stable over time.
- The account with the second highest weight after equity attributable to the parent is trade and other payables. This account represents around 24% of total equity and liabilities. This is a desirable situation since it means that Inditex suppliers are indirectly financing the Company's operations.
- Finally, both long- and short-term financial debt are in very low proportions in relation to total equity and liabilities. In no case these accounts exceed 1% of total assets and liabilities.

4.2. Horizontal analysis

The horizontal analysis of a company's income statement and balance sheet aims at determining the absolute and relative variation that each of the items contained in these financial statements has experienced from one period to another. By absolute variation we are referring to the difference between a particular account in two different periods. On the other hand, relative variation is the absolute variation expressed in percentage terms.

By comparing two or more different and consecutive periods we can observe the behavior of the financial statements during the period under analysis (Gerencie.com,

2018). Therefore, with horizontal analysis we will be able to determine the increase or decrease of a particular account during a period of time.

Since horizontal analysis takes into account the evolution of the financial statements over time we can say that it is a dynamic approach. As a consequence, the analysis allows us to identify the trend that the different accounts in the financial statements have followed during the predetermined period of time. It will therefore help us to identify which are the accounts that have experienced the greatest variations throughout the different periods so that we can focus our attention on them (Navarro, 2016).

The information derived from horizontal analysis can be useful for making projections and establishing new objectives. For that purpose, the causes and consequences of the financial evolution of the company must be identified so that the necessary action paths can be traced in order to improve the situation of the company (Gerencie.com, 2018).

_(figures in million €)	2013	2014	Absolute change	% change	2015	Absolute change	% change	2016	Absolute change	% change	2017	Absolute change	% change
Sales	16,724.4	18,116.5	1,392.1	8.3%	20,900.4	2,783.9	15.4%	23,310.5	2,410.1	11.5%	25,336.0	2,025.5	8.7%
Cost of goods sold	-6,801.5	-7,547.6	-746.1	11.0%	-8,811.1	-1,263.5	16.7%	-10,032.0	-1,220.8	13.9%	-11,076.0	-1,044.0	10.4%
Gross profit	9,922.9	10,568.9	646.0	6.5%	12,089.3	1,520.4	14.4%	13,278.6	1,189.3	9.8%	14,260.0	981.5	7.4%
Operating expenses	-5,998.3	-6,457.6	-459.3	7.7%	-7,391.8	-934.3	14.5%	-8,175.6	-783.7	10.6%	-8,944.0	-768.4	9.4%
Other losses and income, net	1.3	-8.3	-9.6	-734.1%	1.7	9.9	-120.5%	-19.5	-21.2	- 1256.0%	-38.0	-18.5	94.4%
Gross operating profit (EBITDA)	3,926.0	4,103.1	177.1	4.5%	4,699.2	596.1	14.5%	5,083.4	384.3	8.2%	5,278.0	194.6	3.8%
Depreciation and amortization	-855.1	-904.9	-49.8	5.8%	-1,021.7	-116.8	12.9%	-1,062.7	-41.0	4.0%	-963.0	99.7	-9.4%
Net operating profit (EBIT)	3,070.9	3,198.2	127.3	4.1%	3,677.4	479.3	15.0%	4,020.7	343.3	9.3%	4,315.0	294.3	7.3%
Financial results	-18.2	14.5	32.7	-179.7%	10.1	-4.4	-30.5%	10.0	-0.1	-0.7%	-5.0	-15.0	-150.0%
Results of companies accounted for using equity method	0	32.1	32.1	0.0%	55.6	23.5	73.1%	47.6	-8.0	-14.4%	42.0	-5.6	-11.7%
Profit before taxes	3,052.7	3,244.8	192.1	6.3%	3,743.1	498.3	15.4%	4,078.3	335.2	9.0%	4,352.0	273.7	6.7%
Income tax	-671.1	-734.6	-63.5	9.5%	-860.9	-126.3	17.2%	-917.2	-56.3	6.5%	-979.0	-61.8	6.7%
Net profit	2,381.6	2,510.2	128.6	5.4%	2,882.2	372.1	14.8%	3,161.1	278.9	9.7%	3,373.0	211.9	6.7%
Net profit attributable to non-controlling interests	-4.5	-9.6	-5.1	114.2%	-7.6	2.0	-20.7%	-4.1	3.5	-45.5%	-5.0	9	20.5%
Net profit attributable to the parent	2,377.1	2,500.5	123.5	5.2%	2,874.6	374.0	15.0%	3,157.0	282.4	9.8%	3,367.0	210.0	6.7%

Table 5: Horizontal Analysis Consolidated P&L

Source: Own elaboration based on Inditex annual accounts

(figures in million £)	2013	2014	Absolute	% change	2015	Absolute	% change	2016	Absolute	% change	2017	Absolute	% change
ASSETS	2015	2014						2010			2017		
NON-CURRENT ASSETS	6,991.3	8,271.0	1,279.7	18.3%	8,907.9	636.9	7.7%	9,723.1	815.2	9.2%	10,084.0	360.9	3.7%
Rights over leased assets	508.9	531.1	22.2	4.4%	504.4	-26.7	-5.0%	505.0	0.6	0.1%	457.0	-48.0	-9.5%
Other intangible assets	133.4	153.0	19.6	14.7%	190.3	37.3	24.4%	210.5	20.2	10.6%	255.0	44.5	21.1%
Goodwill	203.5	197.9	-5.6	-2.7%	193.5	-4.4	-2.2%	195.7	2.2	1.1%	207.0	11.3	5.8%
Property, plant and equipment	5,137.6	6,040.6	903.0	17.6%	6,597.5	556.9	9.2%	7,283.4	686.0	10.4%	7,644.0	360.6	5.0%
Investment property	82.8	81.5	-1.3	-1.6%	21.2	-60.3	-74.0%	21.2	0.1	0.3%	21.0	2	-1.0%
Financial investments	20.6	151.3	130.6	633.0%	183.8	32.6	21.5%	231.4	47.6	25.9%	237.0	5.6	2.4%
Other non-current assets	374.9	472.1	97.3	25.9%	523.8	51.7	10.9%	553.7	29.9	5.7%	520.0	-33.7	-6.1%
Deferred tax assets	529.7	643.6	113.9	21.5%	693.4	49.9	7.7%	722.0	28.6	4.1%	744.0	22.0	3.0%
CURRENT ASSETS	6,765.0	7,106.0	341.0	5.0%	8,449.2	1,343.3	18.9%	9,898.3	1,449.1	17.2%	10,147.0	248.7	2.5%
Inventories	1,676.9	1,859.5	182.6	10.9%	2,195.0	335.5	18.0%	2,549.2	354.2	16.1%	2,685.0	135.8	5.3%
Trade and other receivables	815.2	861.8	46.6	5.7%	668.8	-193.0	-22.4%	861.0	192.2	28.7%	778.0	-83.0	-9.6%
Income tax receivable	95.6	68.3	-27.4	-28.6%	89.1	20.8	30.5%	107.5	18.4	20.6%	110.0	2.5	2.4%
Other currents assets	212.9	222.3	9.4	4.4%	139.4	-82.9	-37.3%	141.2	1.8	1.3%	160.0	18.8	13.3%
Other financial assets	13.0	168.9	155.9	1197.4%	45.8	-123.2	-72.9%	86.9	41.2	90.0%	12.0	-74.9	-86.2%
Current financial investments	104.6	127.2	22.6	21.6%	1,085.6	958.4	753.4%	2,036.6	951.0	87.6%	1,472.0	-564.6	-27.7%
Cash and cash equivalents	3,846.7	3,797.9	-48.8	-1.3%	4,225.5	427.6	11.3%	4,115.9	-109.6	-2.6%	4,931.0	815.1	19.8%
TOTAL ASSETS	13,756.3	15,377.0	1,620.7	11.8%	17,357.1	1,980.1	12.9%	19,621.4	2,264.3	13.0%	20,231.0	609.6	3.1%

Table 6: Horizontal Analysis Consolidated Balance Sheet (Assets)

Source: Own elaboration based on Inditex annual accounts

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EQUITY AND LIABILITIES

EQUITY	9,278.4	10,468.7	1,190.3	12.8%	11,450.8	982.1	9.4%	12,751.6	1,300.8	11.4%	13,522.0	770.4	6.0%
Equity attributable to the Parent	9,246.2	10,430.7	1,184.4	12.8%	11,410.2	979.5	9.4%	12,713.4	1,303.2	11.4%	13,497.0	783.6	6.2%
Equity attributable to non-controlling interests	32.1	38.0	5.9	18.5%	40.6	2.6	6.7%	38.2	-2.4	-6.0%	25.0	-13.2	-34.5%
NON-CURRENT LIABILITIES	1,015.6	1,159.5	143.9	14.2%	1,236.2	76.7	6.6%	1,419.3	183.1	14.8%	1,536.0	116.7	8.2%
Provisions	147.8	200.6	52.8	35.8%	145.3	-55.3	-27.6%	241.6	96.3	66.3%	259.0	17.4	7.2%
Other non-current liabilities	648.4	715.8	67.4	10.4%	805.0	89.2	12.5%	920.1	115.1	14.3%	1,005.0	84.9	9.2%
Financial debt	2.1	2.3	.1	6.2%	0.7	-1.5	-66.9%	0.5	3	-33.5%	4.0	3.5	703.2%
Deferred tax liabilities	217.3	240.8	23.5	10.8%	285.2	44.4	18.4%	257.1	-28.1	-9.8%	268.0	10.9	4.2%
CURRENT LIABILITIES	3,462.3	3,748.8	286.5	8.3%	4,670.2	921.3	24.6%	5,450.6	780.4	16.7%	5,173.0	-277.6	-5.1%
Financial debt	2.5	7.8	5.3	210.3%	10.3	2.4	31.1%	61.7	51.4	501.7%	12.0	-49.7	-80.5%
Other financial liabilities	38.3	83.2	44.9	117.1%	68.5	-14.7	-17.6%	63.7	-4.9	-7.1%	105.0	41.3	64.9%
Income tax payable	89.0	149.9	60.9	68.5%	77.1	-72.8	-48.6%	230.1	153.0	198.4%	151.0	-79.1	-34.4%
Trade and other payables	3,332.5	3,507.9	175.4	5.3%	4,514.3	1,006.4	28.7%	5,095.1	580.9	12.9%	4,906.0	-189.1	-3.7%
TOTAL EQUITY AND LIABILITIES	13,756.3	15,377.0	1,620.7	11.8%	17,357.1	1,980.1	12.9%	19,621.4	2,264.3	13.0%	20,231.0	609.6	3.1%

Table 7: Horizontal Analysis Consolidated Balance Sheet (Equity and Liabilities)

Source: Own elaboration based on Inditex annual accounts

From the horizontal analysis of the consolidated income statement we can highlight the following key ideas:

- Sales have increased from period to period between years 2013 and 2017. However, this growth has not been regular and the year in which sales have grown the most is 2015: 15.37% of sales growth with respect to the previous year. On the other hand, sales grew only by 8.3% and 8.7% in years 2014 and 2017 respectively.
- Cost of goods sold has also grown in every period and it has done it in a greater proportion than sales have. This fact also helps to explain why the gross margin has become smaller over this period of time as we have explained in the vertical analysis. If cost of goods sold experiments a higher growth than sales during the period, a direct consequence is that gross margin will get smaller over time.
- On the other hand, operating expenses have experienced the highest growth in year 2015: 14.5% growth with respect to 2014. Furthermore, the growth experienced by operating expenses has been smaller than that experienced by sales in every period.
- Finally, net profit has increased in every period but in an irregular way. It
 experienced the highest growth in 2015 (15% with respect to the previous year)
 while in 2017 it has only grown by 6.7%.

On the other hand, the main conclusions we obtain from the horizontal analysis of the consolidated balance sheet are:

- Total assets have grown during the whole period. The growth has been rather regular during the period 2013-2016 (around 12.5%). However, growth of total assets in 2017 was just 3.11%.
- Within non-current assets, even though the growth of the different accounts has not been very regular we can highlight that financial investments grew by 633% in 2014.
- On the other hand, within current assets, other financial assets grew by 1197% in 2014 and 90% in 2016, while current financial investments grew by 753% and 87.5% in years 2015 and 2016 respectively. From this we can conclude that the accounts that have experienced the highest growth in this period both within non-

current and current assets are mainly related to financial investments that Inditex has carried out in order to make use of the excess of cash generated.

- Regarding, total equity and liabilities they have grown following the same pattern as total assets.
- Within current liabilities we can see that financial debt has decreased in years 2015 and 2016 by 67% and 33.5% respectively and it has grown by 703% in 2017.
- On the other hand, financial debt within non-current liabilities have grown by 210%, 31% and 501% in years 2014, 2015 and 2016 respectively while in 2017 it has decreased by 80.5%. Finally, other financial liabilities have grown significantly in 2014 and 2017 (117% and 64% respectively).

4.3. Ratio analysis

In order to conclude the financial analysis of Inditex we are going to carry out a ratio analysis of the Company's financial statements. Ratio analysis is part of fundamental analysis and it is used to quantitatively analyze the information that the financial statements of a company contain. This way we can evaluate the performance and financial health of a company by using data from the current and historical financial statements (Investopedia, LLC, 2018).

We are going to categorize the different rations employed in the analysis into four categories: liquidity ratios, solvency ratios, activity ratios and profitability ratios.

Liquidity ratios

These ratios are used to determine the degree of liquidity a company has, which is the capacity to have money available in order to meet its short-term payment obligations such as suppliers, payroll or rents (Credy, 2016). We have focused our attention in four particular liquidity ratios: cash ratio, quick ratio, current ratio and working capital.

Liquidity	2013	2014	2015	2016	2017
Cash ratio	1.11	1.01	0.90	0.76	0.95
Quick Ratio	1.47	1.40	1.34	1.35	1.44
Current Ratio	1.95	1.90	1.81	1.82	1.96
Working Capital (in thousands of €)	3,302,668.0	3,357,125.0	3,779,084.0	4,447,773.0	4,974,000.0

Table 8: Liquidity Ratios

Source: Own elaboration based on data retrieved from Reuters and Inditex annual accounts

Except for the year 2016, cash ratio indicates that Inditex was able to meet its current liabilities alone with cash and cash equivalents in years 2013 and 2014 and was really close to it in years 2015 and 2017. This again demonstrates how the Company enjoys high liquidity levels. Regarding quick ratio and current ratio, it is a consequence of the prior cash ratio analysis that these two ratios are above one since they include other highly liquid assets in their formulas. Particularly, current ratio, which is current assets

over current liabilities, shows how the company can meet almost twice its short-term obligations with current assets since the ratio is around 1.85 throughout the whole period.

Working capital for its part is not a ratio itself. However, it allows us to see the implication that the current ratio has for working capital, which is the difference between current assets and current liabilities. If we have seen that current ratio is very close to two, working capital will necessarily be an amount that is slightly above cash and cash equivalents. In this case, in 2017, current ratio was 1.96 and working capital €4,974 million. If we have a look at cash and cash equivalents in the 2017 balance sheet we find that it is €4,931 million.

Solvency ratios

As opposed to liquidity ratios, solvency ratios measure the ability of the company to meet its long-term payment obligations.

Table 9: Solvency Ratios

Solvency	2013	2014	2015	2016	2017
Debt to assets	0.33	0.32	0.34	0.35	0.33
Long term debt to assets	0.074	0.075	0.071	0.072	0.076
Debt to equity	0.48	0.47	0.52	0.54	0.50
Financial leverage	1.48	1.47	1.52	1.54	1.50

Source: Own elaboration based on data retrieved from Reuters and Inditex annual accounts

Debt to assets ratio measures the percentage of total assets financed with debt. In this case, Inditex has a ratio of around 0.33 constant over time. Therefore, 33% of the Company's assets are financed with debt. Just around 7% of assets is financed with longterm debt.

Debt to equity ratio analyses the relationship between debt and shareholders' equity. It allows us to see the extent to which the capital contributed by shareholders can fulfill a company's obligations to creditors in the event of a liquidation (InvestingAnswers, Inc., 2018). The higher the ratio, the weaker the solvency of the company. In the case of Inditex, the ratio has remained stable over time at around 0.5, which means that equity is about twice the size of total liabilities.

Finally, financial leverage is the ratio of total assets to shareholders' equity and as we can see it is constant at around 1.5 in every period.

Activity ratios

Activity ratios measure the ability of a business to use its assets and liabilities to generate sales (AccountingTools, 2018). In other words, they measure the relative efficiency of the company based on the use it makes of assets, leverage or other balance sheet items and help to determine whether a company is generating enough revenues and cash from its resources (Investopedia, LLC, 2018). In Table 10 we can see the different activity ratios we are going to analyze.

2013	2014	2015	2016	2017
4.2	4.3	4.3	4.2	4.2
18.4	19.7	24.8	27.0	27.3
90	89.9	90.9	92.7	88.5
17.8	17.4	11.7	13.5	11.2
176.4	165.6	180.1	179.1	159.7
	2013 4.2 18.4 90 17.8 176.4	2013 2014 4.2 4.3 18.4 19.7 90 89.9 17.8 17.4 176.4 165.6	2013201420154.24.34.318.419.724.89089.990.917.817.411.7176.4165.6180.1	20132014201520164.24.34.34.218.419.724.827.09089.990.992.717.817.411.713.5176.4165.6180.1179.1

Table 10: Activity Ratios

Source: Own elaboration based on data retrieved from Reuters and Inditex annual accounts

In first place, regarding inventory, we can observe that the inventory turnover has remained constant over time at around 4.2. This means that the average amount of inventory available throughout a year has been renewed and consequently sold 4.2 times during the year. The average inventory days ratio expresses the same in different terms. We can see that average inventory days is around 90 every year, which means that each year it took 90 days to sell average inventory.

On the other hand, if we look at accounts receivable turnover we see that it has increased over the years. It has gone from 18.4 in 2013 to 27.3 in 2017. Having an accounts receivable turnover of 27.3, for example, means that the average accounts receivable during in a year have been collected 27.3 times throughout the year. Similarly, looking at average accounts receivable days ratio we find that they have decreased over time since it measures the number of days that average receivables remained in the

company before being collected. So the more times receivables rotate during the year, the lower the number of days it will take the company to collect them.

Finally, average accounts payable days ration has remained more or less constant over time at around 165, which means that it took on average 165 days for Inditex to pay its average accounts payable. This is a good thing as we have commented in previous sections since the company collects money from customers faster than it pays suppliers.

Profitability ratios

Profitability ratios help to compare a company's earnings with particular items in the income statement and the balance sheet such as revenue, operating costs or shareholders' equity in a specific period of time. Therefore, these ratios allow us to assess how efficiently a company has managed its resources. In the following table we have the profitability ratios that we have selected for our analysis.

Profitability	2013	2014	2015	2016	2017
Gross Margin	59.3%	58.3%	57.8%	57.0%	56.3%
Operating Margin	18.4%	17.7%	17.6%	17.2%	17.0%
Net Margin	14.2%	13.9%	13.8%	13.6%	13.3%
ROE	26.9%	25.4%	26.3%	26.2%	25.7%
ROCE	31.2%	29.2%	30.2%	29.9%	29.5%
ROA	17.9%	17.2%	17.6%	17.1%	16.9%

Table 11: Profitability Ratios

Source: Own elaboration based on data retrieved from Reuters and Inditex annual accounts

In Figure 2 we can see a graph representing the evolution of the three margin ratios we have selected: gross margin, operating margin and net margin. As we have already seen in our vertical analysis, the gross margin of Inditex has decreased over these period of time from 59.3% in 2013 to 56.3% in 2017. Operating and net margin have also decreased over time but in a smaller proportion than gross margin has.



Figure 2: Evolution of Gross Margin, Operating Margin and Net Margin

Source: Own elaboration based on data retrieved from Reuters and Inditex annual accounts

On the other hand, return on equity (ROE), return on assets (ROA) and return on capital employed (ROCE) which are return ratios, have remained more or less in a constant level: around 25.5% of ROE, 17% of ROA and 30% of ROCE.

Chapter 5. Projections

We have projected the main accounts of the income statement, the balance sheet and the cash flow statement of Inditex. The time horizon we have used for the valuation is three years-time (from 2018 to 2020). In the following sections we will explain the assumptions in which we have based the projections of the different accounts.

5.1. Income statement

In first place, we have projected sales by calculating the average sales per store of the last five years. Then, we have estimated the number of stores for the three forecasted years with a linear regression. By multiplying the average sales per store by the number of stores in each of the years we have obtained a sales growth rate of around 9% for 2018, 8% for 2019 and 7% for 2020.

Then we have calculated gross profit by maintaining the 2017 gross margin constant for the projected years. Cost of goods sold for its part has been calculated as the difference between projected sales and gross profit.

Operating expenses were projected by adding a spread of 0.1% to the previous year's operating expenses growth rate, assuming they will remain more or less stable over the projected period. On the other hand, other losses and income have had strong variations during the past five years, therefore, we have assumed that the result will remain constant from 2017 onwards (-38,000 \in).

Regarding depreciation and amortization, we have calculated it on the basis of property, plant and equipment initial balance and capex projections. We have taken the investment in property, plant and equipment as well as the depreciation expense of previous years from Inditex cash flow statement. Then we have also taken the final balance of property, plant and equipment from Inditex balance sheet and we have assumed that the initial balance is the prior year's final balance. Once we have plugged all that information in Table 12, we have developed our capex and depreciation hypothesis. In first place, we have calculated the percentage of capex over PPE initial balance and we have assumed it to be constant for our three-year projection taking as

reference last historic year's percentage. Then, we have proceeded in the same way with depreciation. With these two projected hypothesis we have been able to calculate capex and depreciation for each of the projected years as well as the final PPE balance, which is the addition of the three first rows in Table 12.

Property, plant and equipment	2014	2015	2016	2017	2018e	2019e	2020e
Initial	5,137.6	6,040.6	6,597.5	7,283.4	7,644.0	8,301.0	9,014.4
CAPEX	1,629.5	1,353.6	1,258.5	1,589.0	1,667.7	1,811.0	1,966.7
Depreciation	-904.9	-1,021.7	-1,062.7	-963.0	-1,010.7	-1,097.5	-1,191.9
Final	6,040.6	6,597.5	7,283.4	7,644.0	8,301.0	9,014.4	9,789.2
Hyp. CAPEX	31.7%	22.4%	19.1%	21.8%	21.8%	21.8%	21.8%
Hyp. Amortization	-17.6%	-16.9%	-16.1%	-13.2%	-13.2%	-13.2%	-13.2%

Table 12: PPE, Capex and Depreciation (figures in million €)

Source: Own elaboration based on data retrieved from Inditex annual accounts

Then we have calculated net financial results on the basis of the projected balance sheet, which will be explained in detail in the next section. Net financial debt has been calculated as the sum of long and short-term financial debt and other financial liabilities less most liquid assets (cash and cash equivalents, current financial investments and other current financial assets). Then, in order to calculate net financial results in the projected years we have taken the cost of debt of Inditex from Bloomberg and we have assumed it to remain constant over the next three years since we expect that the European Central Bank will not increase rates until the second half of 2019 or first half of 2020. By multiplying the cost of debt by the projected net financial debt we have obtained the net financial result. As we can see, the company enjoys a large net cash position and, therefore, it generates net financial revenues.

	Table 13: Net	financial debt and	net financial re	esult (figures in	million \in)
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Net financial result	2014	2015	2016	2017	2018e	2019e	2020e
Net financial debt	-4 ,000.8	-5 ,277.4	-6 ,113.6	-6 ,294.0	-6 ,973.7	-7,427	-7,443
Net financial result	-40.0	-52.8	-61.1	-62.9	-69.7	-74.2	-74.5
Interest rate (%)	1%	1%	1%	1%	1%	1%	1%

Source: Own elaboration based on data retrieved from Bloomberg and Inditex annual accounts

In order to project results of companies accounted for using equity method, we have assumed a constant growth rate of 2% for the three projected years.

Regarding income tax, we have calculated the percentage that income tax represented over profit before taxes in order to obtain the effective tax rate. Then we have taken last historic year's tax rate and we have kept it constant for the three projected years.

Finally, in order to project net profit attributable to non-controlling interests we have taken the percentage of net profit attributable to non-controlling interests over total net profit of 2017 and we have maintained it for the three projected years.

5.2. Balance sheet

5.2.1. Assets

Within the assets side we have projected other intangible assets, property, plant and equipment, inventories, and trade and other receivables based on our assumptions. Cash and cash equivalents have been also projected on the basis of certain assumptions, which will be explained in the cash flow statement section (point 5.3). For the rest of assets we have assumed they will remain constant in the next three years due to the lack of information regarding their future development.

For other intangible assets, we have proceeded in the same way as we have done with property, plant and equipment, which we have explained in the previous section together with depreciation. The investment in other intangible assets together with the investment in PPE is the total capex for Inditex.

Other intangible assets	2014	2015	2016	2017	2018e	2019e	2020e
Initial	133.4	153.0	190.3	210.5	255.0	476.7	891.1
CAPEX	166.7	164.3	173.0	183.0	221.7	414.4	774.7
Final	153.0	190.3	210.5	255.0	476.7	891.1	1,665.8
Hyp. CAPEX	125%	107%	91%	87%	87%	87%	87%

Table 14: Other Intangible Assets and Capex (figures in million €)

Source: Own elaboration based on data retrieved from Inditex annual accounts

Regarding inventory, we have done our projections based on days of inventory sold, which we have assumed to be equal to last year's one during the three projected years. By multiplying DOI by cost of goods sold divided by 365 we have obtained inventory in each year.

Table 15: 1	Inventory (f	igures in	milli	on 6	E)
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Inventory	2014	2015	2016	2017	2018e	2019e	2020e
Inventory	1,859.5	2,195.0	2,549.2	2,685.0	2,926.4	3,160.5	3,381.7
COGS	7,547.6	8,811.1	10,032.0	11,076.0	12,071.6	13,037.4	13,950.0
COGS /365	20.7	24.1	27.5	30.3	33.1	35.7	38.2
DOI	89.9	90.9	92.7	88.5	88.5	88.5	88.5

Source: Own elaboration based on data retrieved from Inditex annual accounts

Finally, trade and other receivables have been projected using days of sales outstanding, which we have assumed to be constant from 2017 onwards. By multiplying DSO by sales divided by 365 we have obtained the projected trade and other receivables for each year.

Table 16: Trade and	Other Receivables	(figures in million)	E)
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Trade and other receivables	2014	2015	2016	2017	2018e	2019e	2020e
Trade and other receivables	861.8	668.8	861.0	778.0	847.9	915.8	979.9
Sales	18,116.5	20,900.4	23,310.5	25,336.0	27,613.5	29,822.5	31,910.1
Sales / 365	49.6	57.3	63.9	69.4	75.7	81.7	87.4
DSO	17.4	11.7	13.5	11.2	11.2	11.2	11.2

Source: Own elaboration based on data retrieved from Inditex annual accounts

5.2.2. Equity and liabilities

On the other hand, for the passive side we have projected equity attributable to the parent, equity attributable to non-controlling interests, and trade and other payables based on several assumptions. The rest of items in the passive side have been kept constant over the three projected years with respect to last historic year.

Regarding equity attributable to the parent, we have calculated the percentage of dividends over net income for the previous years. Then we have assumed this proportion to be constant from 2017 onwards. This way we have been able to calculate the projected final balance of equity attributable to the parent by adding the net income projected for the year to the initial balance and subtracting dividends. On the other hand, equity

attributable to non-controlling interests has been projected as the final balance of the prior year plus the net profit attributable to non-controlling interests projected for the year.

Total equity shareholders' funds	2014	2015	2016	2017	2018e	2019e	2020e
Initial	9,246.2	10,430.7	11,410.2	12,713.4	13,497.0	14,879.3	16,333.1
Net Income	2,510.2	2,882.2	3,161.1	3,373.0	3,741.9	3,935.5	3,949.3
Dividends	-1,510.4	-1,625.9	-1,871.5	-2,127.0	-2,359.6	-2,481.7	-2,490.4
Final	10,430.7	11,410.2	12,713.4	13,497.0	14,879.3	16,333.1	17,792.0
Hyp. Dividends	-60.2%	-56.4%	-59.2%	-63.1%	-63.1%	-63.1%	-63.1%

Table 17: Total Equity Shareholders' Funds (figures in million €)

Source: Own elaboration based on data retrieved from Inditex annual accounts

Finally, trade and other payables have been projected on the basis of days payable outstanding which we have kept constant over the three projected years taking as reference DPO of year 2017. Then, projected trade and other receivables has been the result of multiplying DPO by the purchases divided by 365. Purchases have been calculated as current inventory minus prior year's inventory plus cost of goods sold of the year.

Table 18: Trade and Other Payables (figures in million €)

Trade and other payables	2014	2015	2016	2017	2018e	2019e	2020e
Trade and other payables	3,507.9	4,514.3	5,095.1	4,906.0	5,387.8	5,807.3	6,201.0
Purchases	7,730.3	9,146.6	10,386.2	11,211.8	12,313.0	13,271.5	14,171.2
Purchases / 365	21.2	25.1	28.5	30.7	33.7	36.4	38.8
DOP	165.6	180.1	179.1	159.7	159.7	159.7	159.7

Source: Own elaboration based on data retrieved from Inditex annual accounts

5.3. Cash flow statement

In first place we have calculated gross cash flow as seen in Table 19. To net income of the year we have added depreciation and minorities.

CASH FLOW STATEMENT	2014	2015	2016	2017	2018e	2019e	2020e
Net Income	2,510.2	2,882.2	3,161.1	3,373.0	3,741.9	3,935.5	3,949.3
Depreciation	904.9	1,021.7	1,062.7	963.0	1,010.7	1,097.5	1,191.9
Minorities	9.6	7.6	4.1	5.0	5.5	5.6	5.8
GROSS CASH FLOW	3,424.6	3,911.5	4,227.9	4,341.0	4,758.1	5,038.7	5,146.9

Table 19: Gross Cash Flow (figures in million €)

Source: Own elaboration based on data retrieved from Inditex annual accounts

In Table 20, we can see how we have calculated the cash flow from investment as well as the operating working capital. First we have calculated operating working capital for each year as the difference between current operating assets and current operating liabilities. In current operating assets we have included inventories, trade and other receivables, income tax receivable and other current assets. On the other hand, current operating liabilities include income tax payable and trade and other payables. Then we have calculated the cash flow from investment activities, which is the addition of capex and investment in working capital, calculated as the difference between current year OWC and previous year OWC.

<i>Tuble 20.</i> Cash i low nom myestment and Owe (neuros in minion c	Table	20:	Cash	Flow	from	Investment	and	OWC	(figures in	million	E
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CASH FLOW - INVESTMENT	2014	2015	2016	2017	2018e	2019e	2020e
CAPEX	-1,796.3	-1,517.9	-1,431.6	-1,772.0	-1,889.3	-2,225.4	-2,741.3
Inv. Operating Working capital	25.1	853.1	167.3	-342.3	170.6	117.5	108.4
CASH FLOW - INVESTMENT	-1,771.1	-664.8	-1,264.3	-2,114.3	-1,718.8	-2,107.9	-2,633.0
Current assets - OP	3,011.9	3,092.3	3,658.9	3,733.0	4,044.3	4,346.2	4,631.6
Current liabilities - OP	3,657.8	4,591.4	5,325.2	5,057.0	5,538.8	5,958.3	6,352.0
OWC	-645.9	-1.499.1	-1.666.3	-1.324.0	-1.494.6	-1.612.0	-1.720.4

Source: Own elaboration based on data retrieved from Inditex annual accounts

Finally, we have calculated the cash flow to shareholders as seen in Table 21. We have assumed no capital increase nor decrease in the next three years. Therefore, cash flow to shareholders is equal to the dividends paid in the year.

CASH FLOW - SHAREHOLDERS	2014	2015	2016	2017	2018e	2019e	2020e
Dividends	-1,510.4	-1,625.9	-1,871.5	-2,127.0	-2,359.6	-2,481.7	-2,490.4
Capital Increase							
Capital Decrease							
CASH FLOW - SHARHOLDERS	-1,510.4	-1,625.9	-1,871.5	-2,127.0	-2,359.6	-2,481.7	-2,490.4

Table 21: Cash Flow to Shareholders (figures in million \mathcal{E})

Source: Own elaboration based on data retrieved from Inditex annual accounts

By adding gross cash flow, cash flow from investment and cash flow to shareholders we have obtained cash generated for the year. In order to project cash and cash equivalents in the balance sheet we have taken prior year's cash and cash equivalent ending balance and we have added cash generated to it in the three projected years.

Chapter 6. Valuation

6.1. Discounted free cash flow

In order to value Inditex through the discounted free cash flow method we have first calculated the free cash flow for years 2018, 2019 and 2020 as we can see in Table 22. To EBIT we have subtracted effective tax rate times EBIT in order to obtain NOPAT. Then, to NOPAT we have added depreciation, capex, which is negative since each year there is an investment in fixed assets, and OWC needs, which are positive. With the previous calculus we obtain the free cash flow for each of the projected years. Then, as we can also see, we have included a projection of the free cash flow for year 2021. We have assumed that in this year Inditex will no longer open new stores and thus will only grow through recurring revenues (i.e. revenue that is predictable, stable and can be counted on in the future with a high degree of certainty (Investopedia, LLC., 2018)). For this reason we have projected EBIT by taking the prior year's EBIT and updating it with CPI (2%). We have proceeded in the same way with depreciation. Regarding capex, since we are assuming no new stores will be opened, capex has been projected as the necessary amount to cover depreciation and allow the Company to remain constant in terms of assets. Finally OWC has been assumed to be cero.

DISCOUNTED CASH FLOW	2018e	2019e	2020e	2021e
EBIT	4,855.2	5,108.6	5,125.7	5,228.2
Taxes on EBIT	-1,092.4	-1,149.4	-1,153.3	-1,176.4
Effective tax rate	-22.5%	-22.5%	-22.5%	-22.5%
NOPAT	3,762.8	3,959.2	3,972.4	4,051.9
Depreciation	1,010.7	1,097.5	1,191.9	1,215.7
CAPEX	-1,889.3	-2,225.4	-2,741.3	-1,215.7
OWC needs	170.6	117.5	108.4	0
FREE CASH FLOW	3.054.6	2.948.8	2.531.3	4.051.9

Table 22: Free Cash Flow (figures in million €)

Source: Own elaboration

Then we have calculated the weighted average cost of capital, which we have used as the discount rate for our cash flows. Table 23 illustrates how we have calculated WACC. As we can see the weight assigned to cost of debt is cero, since net financial debt is negative for the three years (i.e. most liquid assets are higher than financial debt). Therefore, in the case of Inditex WACC is equal just to cost of equity.

Cost of equity has been calculated using the capital asset pricing model (CAPM). For the risk free rate we have used the return on the 10-year Spanish government bond. Then we have obtained the 5-year monthly beta of Inditex from Reuters. Finally, the market risk premium was taken from the paper "Market Risk Premium and Risk-Free Rate used for 59 countries in 2018: a survey" by Pablo Fernandez, Vitaly Pershin and Isabel F. Acin. By introducing all this data in the CAPM formula we have obtained cost of equity, which, as we have said, is the same as WACC in our particular case.

Table 23: WACC

WACC	2018e	2019e	2020e	2021e
D/D+E	0.0%	0.0%	0.0%	0.0%
Kd	1.00%	1.00%	1.00%	1.00%
(1-t)	77.50%	77.50%	77.50%	77.50%
E/D+E	100.0%	100.0%	100.0%	100.0%
Ke	6.20%	6.20%	6.20%	6.20%
Rf	1.38%	1.38%	1.38%	1.38%
BETA	0.72	0.72	0.72	0.72
(Rm-Rf)	6.7%	6.7%	6.7%	6.7%
WACC	6.20%	6.20%	6.20%	6.20%

Source: Own elaboration

Once we have calculated WACC, we have calculated residual value as a perpetuity. The perpetual growth rate assumed is 2% since we expect CPI to be around this level.

Table 24: Residual Value (figures in million €)

RESIDUAL VALUE	
FCF 2021e	4,051.9
WACC 2021e	6.20%
GROWTH RATE (g)	2.0%
RESIDUAL VALUE	98,309.1

Source: Own elaboration

Finally, we can see the results obtained from the valuation through discounted free cash flow method in Table 25. Enterprise value is 88.1 billion \in and equity value stands at 94.3 billion \in . The target price of Inditex shares for its part stands at 30.27 \in .

Table 25: Enterprise value, equity value and share value (figures in million €)

SHARE VALUE	30.27
NUMBER OF SHARES	3,116.7
EQUITY VALUE	94,356.0
NET FINANCIAL DEBT 2017	-6,294.0
ENTEPRISE VALUE	88,062.0
PRESENT VALUE OF PERPETUITY	77,273.4
PRESENT VALUE OF FCF	10,788.6

Source: Own elaboration

6.2. Multiples

Finally, we have valued the Company with the multiples method. For that purpose, we have obtained the PER, EV/EBIT, EV/EBITDA and P/BV multiples of Inditex and four comparable companies in the industry (H&M, GAP, Fast Retailing and Next) in order to calculate an industry average for each multiple. The figures can be seen in Table 26, which shows that, except for P/VB multiple, Inditex is trading relatively more expensive than the average in the industry.

	PER			3	EV/EBIT			EV/EBITDA			P/BV		
	2018e	2019e	2020e	2018e	2019e	2020e	2018e	2019e	2020e	2018e	2019e	2020e	
Inditex	25.6	23.3	21.3	18.6	16.7	15.0	14.9	13.4	12.2	4.82	4.54	3.86	
Н&М	16.1	15.9	15.2	13.2	12.9	12.2	8.6	8.4	7.9	3.97	4.00	3.95	
GAP	12.4	11.8	11.7	8.4	8.1	8.3	6.1	5.8	5.8	3.58	3.20	2.89	
Fast Retailing	36.4	31.5	28.0	21.0	18.2	16.0	17.5	15.3	13.5	5.95	5.16	4.49	
Next	14.0	13.4	12.9	12.5	12.3	12.0	10.7	10.5	10.2	14.3	10.2	8.8	
Industry average	19.7	18.1	17.0	13.8	12.9	12.2	10.7	10.0	9.4	6.9	5.6	5.0	
Theoretic target price	22.42	22.74	23.35	22.3	23.2	24.2	21.7	22.4	23.2	32.8	29.0	28.2	

Table 26: Inditex and Peer Companies Multiples

Source: Own elaboration based on data retrieved from Bloomberg

With the DCF method, we have obtained a target price for Inditex stock of $30.27 \in$. Then, with the multiples method the theoretic target price we have obtained based on the industry average can be observed in the previous table. As we can see, the price for Inditex ranges from 21.7 to 32.8.

Chapter 7. Conclusions

The purpose of the present thesis has been to estimate the market value of Inditex in order to compare it with its current market price. For that purpose, we have developed a valuation model based on the DCF method, which has been the main method used in our work. Then, a relative valuation through multiples has been developed in order to supplement the DCF valuation.

Before proceeding with the valuation of Inditex we have analyzed the Group both from a strategic and a financial perspective. The strategic analysis has shown that Inditex has a leading position in the fashion retail industry. This is possible thanks to the Group's key strengths such as a well-known brand name, the vertical integration in the value chain and the flow of real-time data between the different stores and management teams, which is key to Inditex daily operations. Moreover, it is relevant to highlight that the industry is becoming highly competitive since barriers to entry are low and this puts considerable pressure on the Group.

On the other hand, the financial analysis has revealed that the Company enjoys a large net cash position, with low indebtedness and high levels of liquidity. It is remarkable the fact that the Group's gross margin has been declining over the past five years due to a relatively higher growth of cost of goods sold compared to sales.

Projected figures indicate that Inditex will continue to produce strong and positive sales growth in the predetermined period. For its part, gross margin has been estimated in a slightly more conservative way by maintaining 2017 gross margin constant for the three forecasted years instead of assuming an increasing trend.

With the DCF valuation the target price of Inditex has been estimated at 30.27. On 6th of July 2018, Inditex stock price closed at 29.64€, which indicates that the market is underpricing Inditex equity by 2.1%. On the other hand, with the relative valuation we have seen that, in general terms, Inditex is trading more expensive relative to its peers and we have obtained a range for its theoretic target price that goes from 21.7 to 32.8. Based on these results, we conclude our work by issuing a hold recommendation for Inditex stock since we don't expect a great upside potential in the short term.

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Appendixes

Appendix 1 – Consolidated Income Statement Projections

(figures in million €)	2013	2014	2015	2016	2017	2018e	2019e	2020e
Sales	16,724.4	18,116.5	20,900.4	23,310.5	25,336.0	27,613.5	29,822.5	31,910.1
% inc.	4.9%	8.3%	15.4%	11.5%	8.7%	9.0%	8.0%	7.0%
Cost of goods sold	-6,801.5	-7,547.6	-8,811.1	-10,032.0	-11,076.0	-12,071.6	-13,037.4	-13,950.0
Gross profit	9,922.9	10,568.9	12,089.3	13,278.6	14,260.0	15,541.8	16,785.2	17,960.2
% sales	59.3%	58.3%	57.8%	57.0%	56.3%	56.3%	56.3%	56.3%
Operating expenses	-5,998.3	-6,457.6	-7,391.8	-8,175.6	-8,944.0	-9,793.6	-10,733.7	-11,774.7
% inc.	7.0%	7.7%	14.5%	10.6%	9.4%	9.5%	9.6%	9.7%
Other losses and income, net	1.3	-8.3	1.7	-19.5	-38.0	-38.0	-38.0	-38.0
% inc.	-111.2%	-734.1%	-120.5%	-1256.0%	94.4% -	-		
Gross operating profit (EBITDA)	3,926.0	4,103.1	4,699.2	5,083.4	5,278.0	5,710.3	6,013.5	6,147.4
Depreciation and amortization	-855.1	-904.9	-1,021.7	-1,062.7	-963.0	-855.1	-904.9	-1,021.7
Net operating profit (EBIT)	3,070.9	3,198.2	3,677.4	4,020.7	4,315.0	4,855.2	5,108.6	5,125.7
Financial results	-18.2	14.5	10.1	10.0	-5.0	-69.7	-74.2	-74.5
Results of companies accounted for using equity method	0.0	32.1	55.6	47.6	42.0	42.8	43.7	44.6
% inc			73.1%	-14.4%	-11.7%	2.0%	2.0%	2.0%
Profit before taxes	3,052.7	3,244.8	3,743.1	4,078.3	4,352.0	4,828.3	5,078.1	5,095.8
Income tax	-671.1	-734.6	-860.9	-917.2	-979.0	-1,086.4	-1,142.6	-1,146.6
% profit before taxes	-22.0%	-22.6%	-23.0%	-22.5%	-22.5%	-22.5%	-22.5%	-22.5%
Net profit	2,381.6	2,510.2	2,882.2	3,161.1	3,373.0	3,741.9	3,935.5	3,949.3
Net profit attributable to non-controlling interests	-4.5	-9.6	-7.6	-4.1	-5.0	-5.5	-5.6	-5.8
% net profit	-0.2%	-0.4%	-0.3%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%
Net profit attributable to the parent	2,377.1	2,500.5	2,874.6	3,157.0	3,367.0	3,736.4	3,929.9	3,943.5

(figures in million €)	2013	2014	2015	2016	2017	2018e	2019e	2020e
ASSETS								
NON-CURRENT ASSETS	6,991.3	8,271.0	8,907.9	9,723.1	10,085.0	10,963.7	12,091.5	13,641.0
Rights over leased assets	508.9	531.1	504.4	505.0	457.0	457.0	457.0	457.0
Other intangible assets	133.4	153.0	190.3	210.5	255.0	476.7	891.1	1,665.8
Goodwill	203.5	197.9	193.5	195.7	207.0	207.0	207.0	207.0
Property, plant and equipment	5,137.6	6,040.6	6,597.5	7,283.4	7,644.0	8,301.0	9,014.4	9,789.2
Investment property	82.8	81.5	21.2	21.2	21.0	21.0	21.0	21.0
Financial investments	20.6	151.3	183.8	231.4	237.0	237.0	237.0	237.0
Other non-current assets	374.9	472.1	523.8	553.7	520.0	520.0	520.0	520.0
Deferred tax assets	529.7	643.6	693.4	722.0	744.0	744.0	744.0	744.0
CURRENT ASSETS	6,765.0	7,106.0	8,449.2	9,898.3	10,148.0	11,139.0	11,890.0	12,198.9
Inventories	1,676.9	1,859.5	2,195.0	2,549.2	2,685.0	2,926.4	3,160.5	3,381.7
Trade and other receivables	815.2	861.8	668.8	861.0	778.0	847.9	915.8	979.9
Income tax receivable	95.6	68.3	89.1	107.5	110.0	110.0	110.0	110.0
Other currents assets	212.9	222.3	139.4	141.2	160.0	160.0	160.0	160.0
Other financial assets	13.0	168.9	45.8	86.9	12.0	12.0	12.0	12.0
Current financial investments	104.6	127.2	1,085.6	2,036.6	1,472.0	1,472.0	1,472.0	1,472.0
Cash and cash equivalents	3,846.7	3,797.9	4,225.5	4,115.9	4,931.0	5,610.7	6,059.7	6,083.3
TOTAL ASSETS	13,756.3	15,377.0	17,357.1	19,621.4	20,231.0	22,102.7	23,981.5	25,839.8

Appendix 2 – Consolidated Balance Sheet Projections

EQUITY AND LIABILITIES								
EQUITY	9,278.4	10,468.7	11,450.8	12,751.6	13,522.0	14,909.8	16,369.2	17,833.9
Equity attributable to the Parent Equity attributable to non-controlling	9,246.2	10,430.7	11,410.2	12,713.4	13,497.0	14,879.3	16,333.1	17,792.0
interests	32.1	38.0	40.6	38.2	25.0	30.5	36.2	41.9
NON-CURRENT LIABILITIES	1,015.6	1,159.5	1,236.2	1,419.3	1,536.0	1,536.0	1,536.0	1,536.0
Provisions	147.8	200.6	145.3	241.6	259.0	259.0	259.0	259.0
Other non-current liabilities	648.4	715.8	805.0	920.1	1,005.0	1,005.0	1,005.0	1,005.0
Financial debt	2.1	2.3	0.7	0.5	4.0	4.0	4.0	4.0
Deferred tax liabilities	217.3	240.8	285.2	257.1	268.0	268.0	268.0	268.0
CURRENT LIABILITIES	3,462.3	3,748.8	4,670.2	5,450.6	5,174.0	5,655.8	6,075.3	6,469.0
Financial debt	2.5	7.8	10.3	61.7	12.0	12.0	12.0	12.0
Other financial liabilities	38.3	83.2	68.5	63.7	105.0	105.0	105.0	105.0
Income tax payable	89.0	149.9	77.1	230.1	151.0	151.0	151.0	151.0
Trade and other payables	3,332.5	3,507.9	4,514.3	5,095.1	4,906.0	5,387.8	5,807.3	6,201.0
TOTAL EQUITY AND LIABILITIES	13,756.3	15,377.0	17,357.1	19,621.4	20,231.0	22,102.7	23,981.5	25,839.8