

Inditex

When fashion meets logistics

Inditex is a high-quality fashion retailer with strong competitive advantages, low financial risk and is well managed. The company has always been expensively priced and with the recent downturn in the equity markets we have the opportunity to potentially own a great business at a reasonable price.

WHAT DOES THE BUSINESS DO?

Inditex is one of the largest fashion retailers in the world with over 7400 stores in 96 markets worldwide and 202 markets through its online platform. Inditex is the parent company to well known brands such as Zara, Pull & Bear and Berksha amongst others. The company operates a unique business model whereby instead of committing a large percentage of production for the next fashion season, like most other clothing retailers, the company commits a small amount and uses customer feedback and an efficient production network to replenish stores with new and different products weekly. New styles are prototyped in just 5 days and a large part of the manufacturing happens locally to shorten lead-times. By doing this Inditex changed the landscape of the retail fashion industry and pioneered what is known today as "fast fashion".

INDITEX IS A HIGH-QUALITY BUSINESS WITH A UNIQUE BUSINESS MODEL

The business has been able to sustainably create shareholder value by providing returns on capital consistently above 35%, which is much greater than the cost of capital for the business. They can do this as they have margins of a premium brand with the asset turnover capabilities of a distributor. Inditex harnesses the advantages of huge scale but has strong growth potential due to the ability to continue rolling out stores in most markets.

THE BUSINESS HAS SIGNIFICANT COMPETITIVE ADVANTAGES

Inditex's production and supply chain is widely regarded as the best in the fashion business. They can design, produce and deliver an entire collection to the shop floor within a couple of weeks. They are able to do this thanks to their vertically integrated supply chain and their use of proximate sourcing and manufacturing for items with a high fashion content. They also have a state-of-the-art central logistics operation which is fully automated and acts as an intermediary between the factories and the stores. The constant feedback between the distribution centers and the stores together with the speed at which they are able to get their product to store shelters them from making severe fashion mistakes. This has ensured that they have lower markdowns compared to the rest of the industry. Zara for instance makes 85% of the full price on its clothes while the industry average is 60-70%.

The brand has become more powerful as they have been able to make the transition to a global multi-channel leader. They have been able to access markets outside their primary European market with strong sales performance showing that their brands have 'travelled' well. Inditex don't have much advertising costs, they have a strong social media presence and their website has over a couple of billion views each year, the brands tend to speak for themselves, which is a strong competitive advantage versus competitors that have to spend billions on advertising each year.

WELL PLACED TO TAKE ADVANTAGE OF THE SHIFT TO ONLINE IN RETAIL

The online market is concentrated on speed to market and speed of delivery. Inditex production and delivery systems are already set up to adapt to these changing demands. The nature of the Inditex business model makes it easier to cope with increased online orders. This contrasts with peers who face significant capex costs in order to adapt both from a technology and distribution perspective.

HIGHLY CASH GENERATIVE WITH A STRONG BALANCE SHEET AND LOW FINANCIAL RISK

Inditex is in a healthy financial position with cash reserves on hand exceeding debt by over €8 billion. The business is highly cash generative thanks to cash sales and a negative working capital cycle, which means that suppliers are generally paid after the goods are sold. Inditex, like most other retailers has had to close most of its stores due to the Covid-19 crisis and the strength of their balance sheet will help them endure these tough times better than the rest of the industry, many of whom have high debt burdens and will be unable to service this debt as cashflow is reduced.

EXTREMELY CAPABLE AND FORWARD-THINKING MANAGEMENT TEAM

Management has historically been very good in building brands; they now have 5 brands with over €1bn in revenues. By using their existing distribution and supply chain structures management has been able to build brands with a strong global presence without spending money on advertising. The management team has been ahead of the curve in terms of using data analytics and technology in enabling better operating performance. Management have also positioned the business very well in terms of their multi-channel offering and have been much better prepared for the structural shift in retail to online.

While we sympathize with everyone who has become ill and wish the world a speedy recovery, the Covid-19 virus has caused a market sell off with even good businesses with solid balance sheets becoming attractively priced. This enables Cadiz Asset Management to invest your capital in businesses which meet our quality, management and financial risk criteria while still providing attractive long-term returns.