

Europe Satellite*

Recommended since 31.01.2023

01.02.2023



Country DE	Market capitalization (bn) EUR	11.3	Perf. since reco. (%)	
Sector Retail	Free float	88.8%	Zalando SE	0.0
Factset ZAL-DE	Closing price EUR	42.59	Sector	0.0
ISIN DE000ZAL1111	ESG Risk score*	13.5	Low risk	



Profile

Zalando is Europe's largest online fashion retailer. Its strategy is to turn its technology platform into a marketplace that offers a complete assortment in clothing by developing partnerships (15% commission on sales) with brands that remain responsible for logistics (inventory, shipping, returns). Connected retail works the same, but the product comes from a physical store. Covid highlighted the importance of e-commerce and Zalando is a major player in digitalization, European leader with 12% of online fashion retail volumes - a market of €120bn in 2022 (30.5% of the total fashion & apparel market).

Strengths/opportunities

- European leader / strong brand / solid logistics
- Benefits of economies of scale / growth
- Revised strategy -> better visibility on margin potential.

Weaknesses/threats

- More intense competition.
- Increased logistics costs / pressure on margins.
- Development limited to Europe.

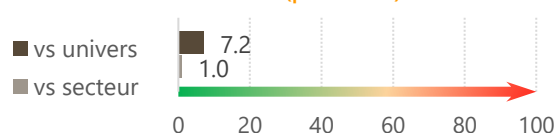
Investment case

- In 2020, faced with closed stores (Covid), people found in Zalando a marketplace, and brands a digital partner. Containment in Europe accelerated online consumption in 2020-21. But 2022 was more difficult for Zalando in the face of multiple constraints: store reopenings affecting online sales, high inventory, poor purchasing management, late cost-cutting measures. As a result, estimates have been massively revised (EBIT 2022 & 2023 -65%), with the share price falling by 53% over the year (low point €20 in October). If the rebound since November reflects the stock market rally fueled by the easing of interest rates, a company-specific rerating should materialize.
- 2023 will see the beginning of a rebound in sales, but will be more of an optimization year as food and energy inflation should curb household spending. We see Zalando evolving from a growth-at-all-costs strategy to a balanced growth and profitability strategy. Estimate revisions have already priced in quite a few issues that are being resolved: resumption of merchandise volume growth, clearing of excess inventory, normalization of return rates, absorption of operating expense inflation, and FCF generation. The consensus target for 2023 EBIT is barely €240mio (2.2% margin) and does not take into account the move towards higher profitability. Zalando might revise its ambitions for 2023-25: while the Gross merchandise volume growth target will be more reasonable, the profitability improvement trajectory should be more secure and faster aiming at the top of the EBIT margin range of 3-6%. In addition, the group is reassuringly providing a strong balance sheet (net cash > €700mio / total liquidity of €2.6bn). We consider that a revaluation of the stock towards a level of 1.3/1.4x in EV/Sales close to its 5-year average and to European omni channel retailers would be justified.

Valuation

Zalando's valuation may appear high (PE) but only partially incorporates the prospect of strong earnings growth and is barely in line with its 5-year average and well below the 2020 peak.

ESG risk vs. universe & sector (percentile)*



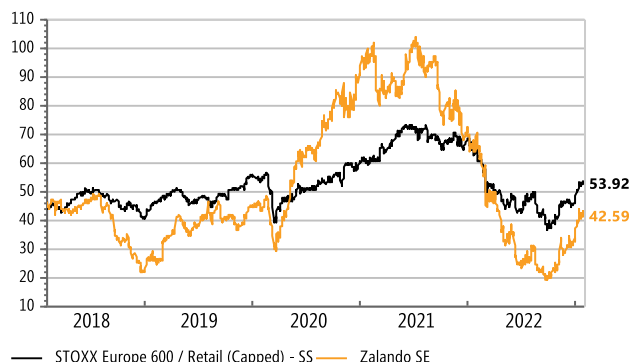
EUR	12/2021	2022e	2023e
Sales revenue (mio)	10'354	10'381	10'958
Sales growth	29.7%	0.3%	5.6%
EBIT adjusted (mio)	425	139	240
% of sales	4.1%	1.3%	2.2%
Net income (mio)	235	39	121
Net income growth	3.7%	-83.5%	212.7%
FCF/Sales	2.2%	-1.1%	1.0%
Net debt/Ebitda	-2.2x	-1.7x	-1.2x
Dividend yield	0.0%	0.0%	0.0%
PE	78.2x	181.1x	79.2x
P/BV	5.1x	4.9x	4.6x

Factset estimates

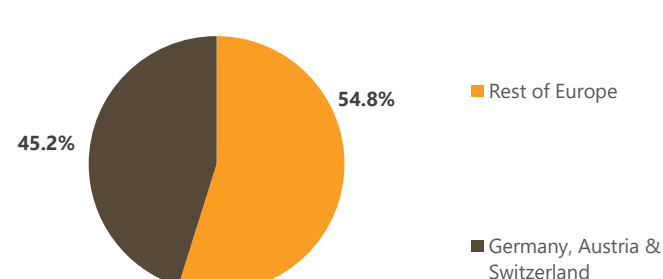
ESG - risks and key points

- As an operator in the digitalisation space, Zalando has an excellent ESG rating.
- There is little financial risk for Zalando due to its low exposure and strict management of key ESG issues.
- Furthermore, the company has not been the subject of any major controversies.

5-year performance vs sector



Sales breakdown - 12/2021



*: see overleaf

Source: Factset, Sustainabilitys

Glossary

Satellite

From 2015, B&Cie separates its investment recommendations into Core Holdings (higher organic growth potential, high free cash flow, ROCE in excess of the cost of capital and balance sheet efficiency throughout the cycle) and Satellite Recommendations, which do not meet the above criteria but are likely to outperform in the short-to-medium term.

ESG Risk Score

At B&Cie, we take particular care to ensure that the companies in which we recommend investing are sustainable. Accordingly, our selection process takes account of risks relating to environmental, social and governance (ESG) issues. This approach is underpinned by research from Sustainalytics, the global leader in ESG and corporate governance analysis, whose methodology aims to identify major controversies and risks and assess a company's ESG risks relative to both its sector and the investment universe as a whole. The corresponding score is expressed as a percentile: the lower the overall risk score, the lower the risk within the investment universe.

b-Digital, b-Transition & b-Well

Over and above the conventional geographical and sectoral approaches to asset management, at B&Cie we believe the world of tomorrow is being shaped by structural trends. We have identified three main megatrends: ongoing digital globalisation of the economy; economic transition, particularly in the energy sector; and the quest for wellness. We believe selecting and investing in companies that play an active role in these transformations should lead to more resilient portfolios that generate higher long-term returns. Our investment recommendations in the digital globalisation space are labelled "b-Digital", those in the economic transition space "b-Transition" and those in the wellness space "b-Well". A given recommendation may fall under more than one theme, in which case it will carry the relevant matching labels.

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