

April 25, 2018

Skechers USA Inc. : (SKX)

Ryan O'Connor

Sector: Consumer Goods

Industry: Textile-Apparel Footwear & Accessories

Current Price: \$29.21

Target Price: \$40.63

Company Description: Skechers USA Inc. designs, develops, and markets footwear for men, women, and children. Skechers has three segments: Domestic Wholesale Sales, International Wholesale Sales, and Retail Sales. Of these three segments they have two main divisions of their products- lifestyle and fitness. Their lifestyle line includes Bobs from Skechers, and their fitness division includes GOrun, GOwalk, and Skechers GOplay. The company was founded in 1992 and is headquartered in Manhattan Beach, CA.

BUY

Current Price:	\$29.21
Target Price:	\$40.63
Market Cap:	4.7B
Beta:	1.00
EBITDA Margin:	11.13%
MV D/E:	0.018
Float:	98%
Credit Rating:	a-
Average Volume:	3.04M
ROIC:	18.0%
ROIC/WACC:	2.17

Compare: IYK Consumer Goods Index SMAVG (50,100,200)



Thesis: After Skechers most recent earnings call their stock dropped 16%, this is an immense overreaction by the market. Skechers is an extremely cheap stock right now. Sales have continued to grow in their 3 segments over the last few quarters, and they have managed to increase ROI and will continue to drive strong operating leverage. Overall the company has a strong balance sheet, and growing margins that are higher than the industry average. Strong cash flows and almost no debt make this company poised for recovery and further growth.

Catalysts:

- **Short Term(within the year):** Oversold, overreaction by the market for weak Q1 and soft Q2 forecasts- *undervalued
- **Mid Term(1-2 years):** Increased ROI and return to strong operating leverage stemming from last year's investments
- **Long Term(3+):** Strong balance sheet, revenue growth, and growing margins- solid CF in international growth

Earnings Performance:

Skechers USA Inc. has shown tremendous strength both domestically and internationally over the last few quarters in terms of sales growth and expanding business segments. Sales Q1 2018 marked a quarterly sales record of \$1.25 billion, and provided a 16.5% increase from Q4 2017. Domestic wholesale business increased 8.5% for Q1 2018- this is attributed to both a reduction in shoe prices that drove higher volumes in pairs sold. International wholesale grew 17.9% and company owned global retail sales grew 26.4%. Gross profit and gross margins were up this past quarter. Gross profits were up \$106.6 million to \$583.1 million, and gross margins increased by 2.3% to 46.7%. SG&A expenses were up to 28.4% of sales compared to last year's 26.3% of sales. Skechers has been committed to long term growth with investing large amounts of cash in joint venture and subsidiary businesses.

Focused marketing helped drive strong growth in sales as well. Camila Cabello helped market through social media as well as a TV Commercial for the women's Skechers D'lites. Marketing for men revolved around David Ortiz, Howie Long, and a new ad campaign with Tony Romo.

International wholesale is Skechers largest segment, representing 46.2% of total sales. International wholesale increased by 17.9% in Q1 2018. The two drivers for this international growth were the international subsidiary business and joint venture sales. These two investments are projected to drive operating leverage for the next few years. Both the subsidiary businesses and joint venture sales grew by about 25%. Most sales in Asia are coming from China- China ordered 4.4 million pairs in Q1 2018.

On the retail end- international sales increased 62.1% and domestic sales increased 13.5%. For the rest of 2018 Skechers is planning to open 60-75 new stores, and remodel 15-20 new stores. Lastly, the e-commerce business had a great quarter, increasing 12.7%. Skecher's stock price got rocked after their most recent earnings call due to disappointing guidance for 2018. As Skechers aggressively tried to grow their sales numbers they lost most of their efficiencies in the supply chain, and operating margins shrunk. Management believes that they can return to these operating margins with the operating leverage from their most recent investments (mentioned above).

Second quarter guidance on sales is forecasted to be \$1.12 billion - \$1.15 billion, driven by new product deliveries and expanded global infrastructure.

<https://seekingalpha.com/article/4164258-skechers-usa-skx-q1-2018-results-earnings-call-transcript>

Industry Performance & Outlook:

Differentiation in the Consumer Goods Sector is one of the most important factors to add value. As the US and World Economies prosper as we enter Q2 2018, the Consumer Goods Sector is poised for strong growth, as the economy is forecasted to grow at 2-2.5%. Although there has been some uncertainty in the political arena in the US and abroad, consumer confidence remains high. In Deloitte's Consumer Products Industry Outlook, they outlined 4 areas of increased growth over the next year: 1. Globalization 2. Innovation

3. M&A Activity 4. Digitization. Globalization has been the most important of these factors. Globalization has been driven by global partnerships, by tapping into consumer insights, and by entering into emerging markets.

Skechers has done a fantastic job of focusing on international expansion. As mentioned in the earnings performance, international retail sales increased 62.1%, and international wholesale increased by 17.9%- now representing almost half of all total sales. Skechers had invested in subsidiary businesses internationally and they had made partnerships in joint venture sales. These investments have not turned a profit yet, but they are only a few quarters away from doing so.

<https://www2.deloitte.com/us/en/pages/consumer-business/articles/consumer-products-industry-outlook.html>

Competitor Analysis:

Skechers operates in a highly competitive space. Powerful titans of the industry like Nike, Under Armour, Reebok, and Adidas dominate the athletic apparel and shoe markets. However, they have done well to maintain their market share in the industry. At a market cap of \$4.68B, they compete directly with mid-cap and large-cap companies. Skechers has been creating value for their shareholders by maintaining a high ROIC/WACC ratio- approximately 1.26. This is much higher than the industry average of 0.60. Skechers also has an above average EBITDA/ Net Sales % of 11.18%. Skechers is trading at a P/E of 15.81, which is well below the industry average of 20.52. Skechers management has made it a priority for deliberate growth in the next few years, this growth will drive value through operating leverage.

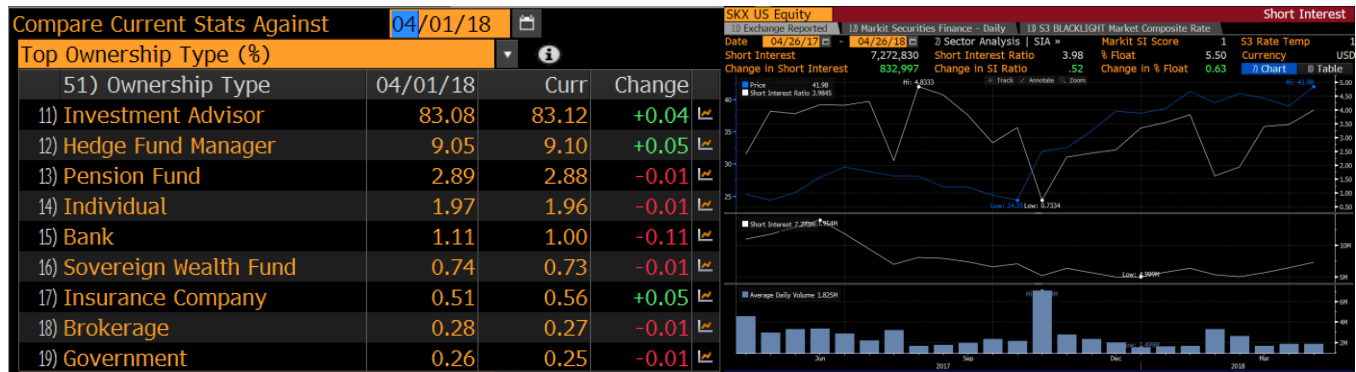
Name (BICS Best Fit)	Mkt Cap† (USD)	Last Px	EBITDA to Net Sales:Y	Op ROIC	ROIC/WACC Ratio	1Y Tot Ret	P/E	ROE	Deg Op Lev
Median	4.68B	47.50	10.74%	17.81	0.60	24.08%	20.52	15.87%	0.90
100) SKECHERS USA INC-CL A	4.68B	29.22	11.18%	20.01	1.26	14.63%	15.81	15.87%	0.16
101) MOVADO GROUP INC	910.69M	39.70	9.98%	12.57	0.60	68.09%	19.76	9.84%	5.08
102) CROCS INC	1.08B	15.84	4.93%	9.35	0.20	154.25%	179.32	4.69%	--
103) STEVEN MADDEN LTD	2.78B	47.50	12.36%	23.66	0.92	24.08%	20.52	17.30%	0.92
104) WOLVERINE WORLD WIDE ...	2.83B	29.68	2.60%	12.88	-0.24	22.23%	18.43	16.01%	-14.67
105) DECKERS OUTDOOR CORP	2.91B	91.51	2.83%	20.54	0.51	51.13%	17.16	17.11%	-1.82
106) CARTER'S INC	4.95B	104.91	14.82%	29.36	2.70	15.70%	17.71	34.69%	0.57
107) COLUMBIA SPORTSWEAR CO	5.65B	80.70	13.09%	17.81	1.20	37.46%	26.83	13.28%	1.89
108) UNDER ARMOUR INC-CLA...	6.77B	16.44	4.05%	5.28	-0.22	-16.59%	85.52	4.38%	--
109) PVH CORP	12.22B	158.77	10.74%	9.04	0.55	53.66%	20.52	11.76%	0.90

(Accounting Adjustments: Adjusted for Abnormal Items When Applicable)

10 Analyze List

Ownership Summary:

Skechers float is 98%. Ownership is heavily focused on Investment Advisors at 83% and the next largest holding comes from Hedge Fund Managers at 9%. Ownership has not changed much in the last month- even after the 16% drop to under \$30 a share. Both Hedge Fund Managers and Investment Advisors have slightly increased their positions since April 1st, when the stock was trading around \$37. Short interest has increased in the last few days, once again due to the soft earnings from their most recent earnings call and poor guidance for Q2 2018. However, if you look historically Q2 is the worst quarter for not only Skechers, but for the entire industry. This increase in short interest can be attributed to profit taking by some investors.



Revenue Multiples Valuation:

A more simple valuation, on top of the proforma valuation, makes it easy to see that Skechers is undervalued. The top competitors to Skechers are: Under Armour, DSW, Crocs, Steve Madden, and Columbia. Each of these companies are relatively the same in market cap, and revenue growth. Skechers is actually the outlier in terms of 2018E Revenue Growth- due to the increase in operating leverage and profitability of their LT investments. Skechers has some fixed cost investments in both an automation and distribution centers in Europe and China- but these should open in the next 12 months. The last metric is Enterprise Value/ Next 12M Revenue. The average multiple of the competitors is 1.24x. Using this average multiple and multiplying by 2018E Revenue, you get an EV of \$5.87B. Less Net Debt and dividing by shares outstanding, you get a Value Per Share of \$40.72. This is a current upside of 39% from the current price of \$29.20. If this multiple was only 1.05x, the Value Per Share would still be \$35.08- this provides a 20% 1YR return.

SKX Comps			
Company	Market Cap	2018E Revenue Growth	EV/NTM Revenue
SKX	4.68B	14%	0.86x
UAA	6.77B	3%	1.47x
DSW	1.75B	6%	0.53x
CROX	1.08B	2%	1.09x
SHOO	2.78B	6%	1.56x
COLM	5.65B	6%	1.91x
Average		6%	1.24x

SKX Valuation based on Comps	
2018E Revenue (\$B)	4.73
Applicable Multiple	1.24x
EV (\$B)	5.87
Less: Net Debt	-0.655
Equity Value (\$B)	6.525
Shares Outstanding	0.16025
Value Per Share	\$40.72
Upside from current price	39%
Current Price:	\$29.20

Conclusion:

In conclusion, Skechers got crushed from their poor guidance on their last earnings call, but the selloff is overdone. Skechers' margins are solid within the industry, and they have the strongest revenue growths in terms of the competitors outlined in the Revenue Multiples Valuation model. They will begin to turn a profit from their two large investments overseas- in automation and in distribution centers. This will contribute to their operating leverage. Overall, Skechers has a strong balance sheet, no debt, and very strong international CF growth. At \$29 they are drastically underpriced, and should be bought now. I wouldn't hold the shares for longer than 8 months- since the volatility in the price has caused investors to be wary.

Skechers U.S.A., Inc. (SKX)

CENTER FOR GLOBAL FINANCIAL STUDIES

BULLISH

Analysis by Al Capone

4/26/2018

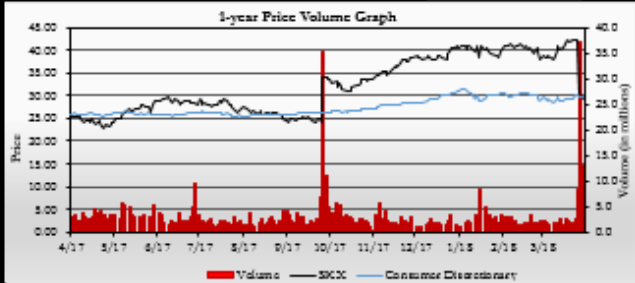
Current Price: \$29.21

Dividend Yield: 0.0%

Intrinsic Value: \$37.37

Target Price: \$39.87

Target 1 year Return: 36.53%
Probability of Price Increase: 100%



Description	
Skechers U.S.A., Inc. designs, develops, markets, and distributes footwear for men, women, and children; and performance footwear for men and women under the Skechers GO brand worldwide.	
General Information	
Sector	Consumer Discretionary
Industry	Textiles, Apparel and Luxury Goods
Last Guidance	February 12, 2018
Next earnings date	July 18, 2018
Market Assumptions	
Estimated Equity Risk Premium	6.86%
Effective Tax rate	23%

Market Data	
Market Capitalization	\$4,675.23
Daily volume (mil)	3.04
Shares outstanding (mil)	160.06
Diluted shares outstanding (mil)	156.95
% shares held by institutions	109%
% shares held by investment Managers	59%
% shares held by hedge funds	9%
% shares held by insiders	8.87%
Short interest	4.54%
Days to cover short interest	2.37
52 week high	\$43.08
52 week low	\$22.64
Volatility	46.95%

Quarter ending	Revenue	EBITDA
3/31/2017	1.10%	0.14%
6/30/2017	6.32%	-9.02%
9/30/2017	2.40%	17.31%
12/31/2017	10.67%	-60.24%
3/31/2018	4.02%	-100.00%
Mean	4.90%	-30.36%
Standard error	1.0%	4.4%

Part Earning Surprise		Market and Credit Scores	
Recommendation (STARS) Value	-3	Recommendation (STARS) Description	Hold
Quality Ranking Value	-E	Quality Ranking Description	Below Average
Short Score	-0	Market Signal Probability of Default % (Non-Rating)	-0.515%
		Credit Model Score (Non-Rating)	-a

Industry and Segment Information	
LTM Revenue by Geographic Segment	LTM Revenue by Business Segment
United States--49%	Domestic Wholesale--30%
Canada--4%	International Wholesale--42%
Other International--47%	Retail (Inclusive e-Commerce)--28%
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Management	Position	Total Compensation Grant	Stock Price Growth During Tenure
Greenberg, Robert	Co-Founder, Chairman of the Board & CEO	42.27% per annum over 5y	13.27% per annum over 5y
Greenberg, Michael	Co-Founder, President & Director	36.31% per annum over 5y	13.27% per annum over 5y
Weinberg, David	Executive VP, COO & Director	46.28% per annum over 5y	13.27% per annum over 5y
Pacciano, Philip	Executive VP of Business Affairs, General Coun	31.19% per annum over 5y	13.27% per annum over 5y
Naran, Mark	Executive VP of Product Development	24.94% per annum over 5y	13.27% per annum over 5y
Vandemare, John	Chief Financial Officer		

Profitability	SKX (LTM)	SKX Historical	Peers' Median (LTM)
Return on Capital (GAAP)	18.0%	14.72%	9.99%
Operating Margin	10%	7.62%	9.75%
Revenue/Capital (GAAP)	1.82	1.93	1.02
ROE (GAAP)	16.5%	12.8%	11.2%
Net margin	6.5%	5.1%	5.0%
Revenue/Book Value (GAAP)	2.54	2.49	2.26

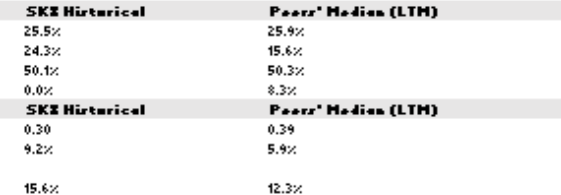
Peers	
Under Armour, Inc.	Ralph Lauren Corporation
DSW Inc.	Columbia Sportswear Company
Foot Locker, Inc.	Steven Madden, Ltd.
Walvenero World Wide, Inc.	NIKE, Inc.
Deckers Outdoor Corporation	Tapscott, Inc.

Inverted Funds	SKX (LTM)	SKX Historical	Peers' Median (LTM)
Cash/Capital	28.4%	25.5%	25.9%
NIWC/Capital	24.6%	24.3%	15.6%
Operating Assets/Capital	47.0%	50.1%	50.3%
Goodwill/Capital	0.0%	0.0%	8.3%

Capital Structure	SKX (LTM)	SKX Historical	Peers' Median (LTM)
Total Debt/Market Capitalization	0.35	0.30	0.39
Cost of Debt	7.3%	9.2%	5.9%
CGFS Rating (F-ratio, Z-ratio, and default Probability): AA			
WACC	8.3%	15.6%	12.3%



Forecast Assumptions	Explicit Period (9 years)	Continuing Period
Revenue Growth CAGR	12%	2%
Average Operating Margin	7%	6%
Average Net Margin	4%	4%
Growth in Capital CAGR	11%	2%
Growth in Claims CAGR	11%	2%
Average Return on Capital	7%	6%
Average Return on Equity	10%	9%
Average Cost of Capital	7%	7%
Average Cost of Equity Ke	10%	10%



Sensitivity Attribution Analysis	
Revenue	30.3%
Operating costs	63.7%
Capital expenditures	21.0%
Discount Rate	8.4%