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Abercrombie & Fitch Equity Research
The Ex-clusionary to In-clusionary swap: A comeback success or a fading turnaround momentum?

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Abstract

The purpose of this report is to assess the future of Abercrombie & Fitch, an American fast-fashion brand that focuses mainly on younger audiences. This Equity Research aims to evaluate the company's positioning among the competition, analyze the macroeconomic and intrinsic factors that can affect the company's performance, and recommend a target price to investors based on 5 different scenarios and the DCF model. This individual report contains crucial topics that were essential to understanding the main trends in the apparel market and their associated risks, elucidating on Abercrombie & Fitch's future performance.

Keywords
Abercrombie & Fitch, Equity Research, Apparel, Stores

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This report is part of the Equity Research report “Ex-clusionary to In-clusionary swap: A Reinvention masterpiece or a fading turnaround momentum?” (annexed), developed by João Carecho and Miguel Cardoso and should be read as an integral part of it.

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Introduction

The objective of this Equity Research is to estimate how Abercrombie & Fitch's growth strategy will evolve based on the analysis of the Apparel industry, its trends, the most direct competitors, the associated risks, and through our line of critical thinking. In order to provide investors with a final recommendation on the share price for FY25, 5 different scenarios for the company's future were considered and the use of the Discounted Cash Flow Model. The final recommendation for investors is to SELL the shares, as its target price is set at $76.22, generating a negative return of -12.06% compared to their value on 18th December 2023 ($86.67).

In order to segment Equity Research into two parts that complement each other and add value individually to help predict the company's future, this individual report covers the following topics. Firstly, the Company Overview is presented, which describes the company's business model and how it is segmented. Subsequently, this report addresses the analysis of the sector, carrying out a segmented analysis of growth between the various regions of the globe, an economic outline of the global economy, with greater emphasis on the United States, highlighting the current state of inflation and short-term forecasts. Next, are identified the main risks that could impact the company's activity and the industry's growth (inflation, geopolitical conflicts, operational risks). In addition to these topics mentioned, are presented the main consumer shifts that, in our view, have affected the consumer profile, which is proven through some statistics made by reputable studies. Finally, the last topic refers to the analysis of the competition, in which was analyzed Abercrombie & Fitch's positioning among its peers and whether it presents conditions to continue growing in the future, based on solid financial health. To carry out this analysis were used as a comparison method, liquidity and profitability ratios, capital structure, and cash conversion cycle.

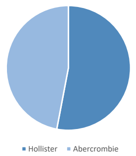
The remaining sections present in the joint report and in the individual part of my pair specifically address how we think about the drivers that allowed us to estimate net sales, cost of sales, and other types of costs for the company. Furthermore, it also described how we proceeded to obtain the future values of each item of Main Core invested capital and how we calculated the cost of capital (WACC) and the terminal growth rate. Then, it incorporates a section related to the DCF method and another type of valuation using multiples.

Below, it includes a section with the sensitivity analysis of WACC, terminal growth rate, terminal value, and the impact that the first two have on the implied share price. Finally, an analysis of scenarios with 5 possible equations of how the company's future can be projected (Blue Skies, Sun Showers, Base Scenario, Stormy Weather, and Downdraft) and to conclude the final SELL recommendation.

Company Overview

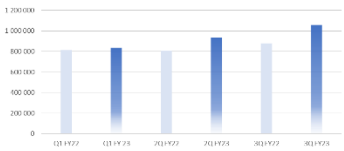
Since its founding in 1892, the brand Abercrombie & Fitch, headquartered in New Albany, Ohio, has been associated with American fashion and has undergone a tremendous transition. The business was first established as a renowned sporting goods and outdoor gear store in New York City, by David T. Abercrombie. It has developed into a global lifestyle brand that personifies casual luxury over the years. The brand identity of Abercrombie & Fitch is characterized by a relaxed, all-American look, that places a focus on luxurious and cozy clothing. The company's striking moose logo has gained international recognition as an emblem. Young adults and teenagers between the ages of 18 and 24 are drawn to the glamorous lifestyle that A&F portrays through marketing and visuals. It is a brand that appeals to people looking for fashionable, yet casual clothing, since it captures the spirit of youth and adventure. Nowadays, Abercrombie operates in three different continents, offering products throughout its integrated online platform and +762 stores spread across Europe, Asia, Canada, the Middle East, and the United States. Four geographic regions make up the net sales breakdown: EMEA, APAC, Other (Canada), and the US, its major playground. US net sales are those contributing the most to the company's top line results. Over the years, the business has run four concept brands in addition to its namesake. These brands have been referred to as subsidiaries, but function as divisions of the business: Abercrombie Kids, Hollister Co, Gilly Hicks, and Social Tourist.

Exhibit 1: Net sales split per brand, FY22
Source: Annual Report



These operating segments have been combined into a single reportable segment since they present similar economic traits, consumer classes, product types, and production and distribution processes. They also operate in comparable regulatory contexts. In recent years, there has been greater growth in Abercrombie's net sales compared to Hollister. However, the latter represents 53% of the firm's total net sales in FY22. Abercrombie's repositioning in the market, over the last decade, has allowed it to gain some ground over Hollister. Nevertheless, both brands have been growing throughout this year, which is essentially due to cost reductions, specifically costs related with raw materials freight, increased production capacity and greater efficiency in the supplier network, consequently allowing the company to cut its inventories by 30% in the second quarter of 2023. With lower stocks, the company can chase products, and better manage its promotional campaigns for the future, allowing for higher pricing that benefits its operational margins.

Exhibit 2: Net sales Evolution YoY
Sources: Annual Report

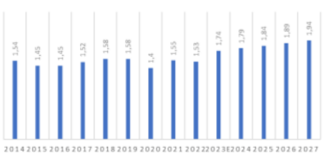


Industry Analysis

Apparel Market Analysis

The Apparel retail industry is made up of businesses that sell clothing, accessories, and other items of apparel in several categories to consumers of all ages, including men, women, and children. Typically, manufacturers and wholesalers supply clothing and accessory products to apparel shops, which then market the goods to the general public without changing the original clothing or any other item made by the supplier. Businesses that sell formal dresses, activewear, necessities, casual wear, outerwear, and children's and infants' clothing, fall under the umbrella of the apparel retail industry. Between 2023 and 2027, it was predicted that the worldwide apparel market would generate a total of $0.2 trillion in net sales. This indicator is predicted to reach $1.94

Exhibit 3: Global Apparel Markets' Net Sales evolution (2014A-2027E)
Source: Statista

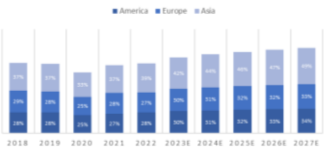


trillion in 2027[1], following five years of continuous growth, at a CAGR of 2.82%. This is an opposite scenario when compared to the negative CAGR observed between 2019 and 2022. Despite the difficult times brought by the global pandemic, in which the year of 2020 was characterized by trade restrictions, the industry quickly returned to pre-pandemic levels.

Segment Analysis

The geographic segmentation reveals the significance of each location and the possible growth prospects that the most prominent apparel corporations should follow in the near future, after an in-depth industry and competition research. In the year of 2022, Asia contributed to 39% of industries' net sales, with both America and Europe contributing 28% and 27%, respectively, to the total apparel market revenue.

Exhibit 4: Apparel Markets' Net sales % per region
Source: Statista



Asia grew at a CAGR of 1.33% between the years of 2018 and 2022, as opposed to the European continent experiencing a decline of 2.33% and other continents exhibiting higher stability. This intuitively makes sense, since Asia was the quickest continent recovering from the pandemic due to inferior widespread effects. Consequently, there has been a noticeable rise in investment in the vicinity of this location, where most global apparel firms, including A&F, have established their manufacturing hubs, spreading their presence in emerging markets. Europe and America were the most affected markets during the global pandemic, but these have already reached pre-pandemic levels and it is estimated that the market will continue to further expand itself through increasing preponderance of the digital channels, a phenomenon that is disrupting the industry and allowing clothing companies to rely on its digital sales to boost its results, thus relying less on its historical and preponderant in-store sales. Looking into the future, the Asian and European markets are the ones with the best growth prospects until 2027. Despite the high inflation rates observed in Europe, as well as the strong monetary policy imposed by the European Central Bank, it is expected that Europe will gain ground in the Apparel Industry. This is essentially due to the evolution of consumer preferences, which increasingly focus on the importance of using sustainable products in the manufacturing of the products these customers are willing to buy. As such, Europe always assumes a forward-looking position when it comes to the topic of sustainability, as this industry is known for being extremely polluting when it comes to the fabric of all types of merchandise. As a result, this paradigm shift in the European continent is essentially justified by the change in the profile of the global consumer and its technological development when compared to the other continents.

Abercrombie & Fitch follows a growth trend in the United States, with a 4% CAGR between FY18 and FY22. Conversely, the company's net sales derived from both the European and Asia continents saw a decreasing trend during the same period, with CAGRs of -4% and -23%, respectively. However, these numbers do not represent a major drop in total net sales over the last few years, as the US region is responsible for a 75% weight in the company's total net sales figures[2]. Historically, the Asian market was never really a significant geographical powerhouse in Abercrombie's global sales, and contrary to the positive apparel industry's outlook in the Asiatic market, it is difficult to infer that the company's Asian market share will suddenly start to increase in the near future. As to the United States market, A&F's US net sales are expected to continue delivering robust growth rate figures, even outperforming the average US fast-fashion industry growth, thus continuing to assume the role of geographical net sales leader within the company's

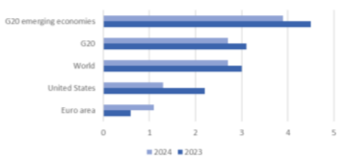
[1] Statista, 2023, "Revenue of the apparel market worldwide from 2014 to 2017"
[2] Abercrombie & Fitchs' Annual Report, FY22

operations. With respect to the European market, projections of A&F's management team also exceed industry prospects. In the event of the company embracing sustainability, as well as knowing how to leverage it this ever-growing trend to its fullest potential, this market may experience an increased importance in the company's global top line.

Economic Context

During the first half of 2023, the global economy performed better than anticipated, but the GDP forecast is still weak. Global GDP growth is anticipated to be lower in 2024 than in 2023 due to the growing monetary policy impositions and a lower than anticipated recovery in China[3]. Although core inflation has been holding steady whilst headline inflation has been recently dropping, this can be explained due to the services industry and the still relatively tight labour markets, whose risks are still skewed towards negative grounds. A more pronounced recession in China would further hold global GDP growth back. In many worldwide nations, the public debt levels are still dangerously high.

Exhibit 5: Projected GDP growth rate (2023 & 2024)
Source: OECD Economic Outlook



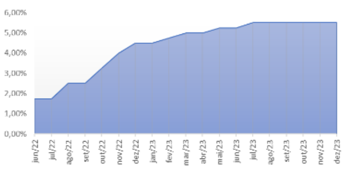
It is anticipated that the global economy will grow 3% in 2023 before dropping to a 2.7% growth in 2024. Despite China's slower-than-expected recovery, Asia is anticipated to continue to contribute with a high disproportionate amount to global growth in the 2023 to 2024 period.

The observed decrease in food and energy costs during the first half of the year of 2023 has contributed to the sustained decline in headline inflation in several countries. The most volatile components of inflation, namely energy and food prices, are excluded from core inflation, which has not really slowed down, being still well above central banks' main objectives. One significant risk going forward is the possibility of inflation continuing to be more persistent than anticipated, necessitating further tightening and increases in interest rates.

Despite market estimations that anticipated a drop to 3.3%, the US inflation rate decreased to 3.2% in October 2023[4]. However, there is still a long way to go when taking into account the Fed's 2% inflation target.

Economic Outlook in the US

Exhibit 6: US Interest Rates
Source: FED



Supply chains are no longer that disrupted as they were in years 2020 and 2021, since the effects that the war in Ukraine had on raw materials, oil, and gas markets have diminished as supply chains have adjusted thereafter. With the absence of new variants of the Covid-19 pandemic, countries were able to remain open. Global demand increased as a result of China's "Zero-Covid" easing policy, but supply did not follow the recovery pattern of the Chinese manufacturing industry. The Fed's interest rate increases have reduced inflation levels and lessened the contractionary effect on US GDP, in conjunction with this relief in the supply chain environment. Unemployment rates have been positively decreasing since the effects of the pandemic stabilized, having reached historical low levels in April 2023, in the order of 3.4%.[5] Although the rate is now slightly higher, in the order of 3.7%, the increase in job demand and supply together with the reduction in widespread dismissals have contributed to the stabilization of this value at historic lows. Combined with these factors, the Fed has not increased interest rates since July, further indicating that the world is now facing a stabilization of rates, with many even expecting a slight decline in interest rates in the meetings ahead. Jerome Powell, the current chair of the

Exhibit 7: US Unemployment Rates
Source: Investing.com

[3] OECD Economic Outlook, September 2023
[4] Bloomberg, 2023
[5] FRED, Graph observations

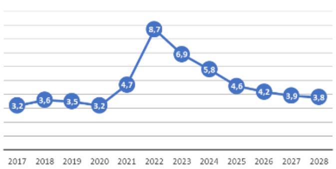
Federal Reserve of the US, also admitted that a cut on interest rates may be underway, but reinforced that the war against inflation is not over yet.[6] Currently, the rate is set at 5.5%. Thus, the likelihood of a gentle landing is increased by the union of robust U.S. labor market, revived supply chains, and an attentive and engaged Fed, which makes us believe that inflation could reach 2.5% by 2025.

Major Risks

We identified two types of risks that both Abercrombie & Fitch and the Apparel industry will face moving forward: Macroeconomic risks, as well as Operating risks. Regarding the macroeconomic risks, these are viewed as threats associated with recent labor and raw material inflationary pressures, as well as global supply chain blockages that have affected and may continue to affect the cost of freight, transportation, and other expenses, reducing companies' profit margins. Another risk is associated with geopolitical conflicts, where it is essential to consider the consequences of the war in Ukraine. China is one of the largest suppliers of the textile industry, also serving as an ally of Russia, which particularly concerns North American and European companies due to their enormous dependence on China's labour activities. Another critical challenge is the ability of companies to adapt to the evolution of both the consumer profile and the market, while also understanding how to monetize their current customers and attract additional ones, being thus agile on adapting to consumer shifts. In addition to these more threatening risks arising from the world's political and economic conjecture, there are others that, despite not having as much preponderance in the company's estimates when thinking about the main threats for the future, are also expected to cause major disruptions. This is the case of risks related to natural disasters, climate change, uncertainties related to changes in industry legislation, fluctuations in exchange rates, or even the inability of companies to put their strategy plans into practice. All these factors can impact a company's production capacity, thus consequently affecting their ability to generate net sales without an increase in the cost of sales rubric.

The Impact of Inflation on the Industry

Exhibit 8: World Inflation Rate
Source: International Monetary Fund



The Covid-19 pandemic revealed the limits and vulnerabilities of the dependency of the global Apparel supply chains on China, a continent responsible for half of the world's clothing and shoes aggregated market value. As a result, the situation for market participants has gotten worse with all-time high inflation levels observed in both years of 2022 and 2023. Retailers and brands are under pressure from the rising cost of goods sold, but they also do not want to compromise and risk net sales volumes by bypassing all of these increasing expenses down to consumers, who are already struggling with tight budgets. Inflation is the economic factor with the greatest impact on the activity of an industry like fast-fashion, where a tremendous amount of total merchandise costs hinges on the prices of raw materials that are very sensitive to changes in inflation rates. As previously mentioned, we estimate that inflation in the United States will decrease by 2025 and stabilize at the 2.5% level, slightly above Deloitte's expectations, which point out to a target mark of 2%.[7] According to the International Monetary Fund, global inflation is expected to hit the 4.6% level[8] in the year of 2025, a considerable drop compared to the 8.7% peak reached in 2022,

[6] CNBC, Dec 13 2023, Jesse Pound, "Here's why bringing down inflation has been different this time, according to Jerome Powell"
[7] Deloitte, April 2023, "The Inflation Outlook – Four Scenarios for 2023-2025"
[8] International Monetary Fund, October 2023, "Inflation Rate, average consumer prices"

resulting in A&F's highest cost of sales figure in the last six years, which amounted to $1.5 billion in FY22 and a respective 43% proportion to total net sales in that given year. The expectations regarding a future slowdown in world inflation is deemed as positive for A&F, as it will consequently reduce the company's net sales costs, thus improving gross profit margins in the future. The factor most responsible for the company's high net sales costs in FY22 was the inflated price of cotton that hit historical levels in June of 2022. Since then, its price has been falling around 40%, anticipating that cotton prices should reach pre-pandemic levels.

Geopolitical Influence on the Industry

Due to political instability, international companies are finding more urgent to reduce their dependence on China for production. This is so because China's response to the Ukrainian war differs from the one defended by the US, adding to the fact that there remains uncertainty surrounding China's intentions towards Taiwan. Hence, government efforts are also being considered, such as the new global investment map and the US government's 2021 "Call to Action for Northern Central America".[9] This call to action, which has already received pledges totaling more than $3.2 billion from private US-based companies, promotes local sourcing and production in the textile sector. This could be an important measure to significantly reduce the dependence that large North American companies have on China, preventing a possible obstacle to the company's production if a possible conflict between the United States and China arises. Additionally, it also promotes the creation of jobs in the country, contributing to further reduced unemployment rates and wealth creation in the country. Investing in national labor may result in increased costs when compared to cheaper labor supplied in the Asian market. However, this type of program may allow the contracting of more qualified labor skills with increased capacity to add value to Abercrombie's operating business. Increasingly observable, most fast-fashion brands have been diversifying the number of suppliers they work with in other Asian manufacturing centers, including Thailand, Vietnam, India, the Philippines, and Indonesia. However, they are also attempting to establish proximity tracks nearer to their target markets.

Operating Risks

Elaborating on the operating risks faced by A&F, these are closely related to the possibility of failure to operate effectively in a highly competitive and ever-changing industry. The sale of apparel, personal care products and accessories for men, women and kids is a highly competitive business with numerous participants, including individual and chain specialty apparel retailers, local, regional, national, and international department stores, discount stores and online-exclusive businesses. Proliferation of the digital channel within the last years has permitted the entry of many new competitors, resulting in competition increase from established companies. We expect that this rise in competition could reduce the company's ability to retain and grow sales, since the company's success largely depends on its ability to anticipate and gauge the fashion preferences of its customers, providing merchandise that satisfies constant shifts in product demand. Since we believe that A&F has been able to enter agreements with respect to the manufacturing and purchasing of merchandise well in advance of applicable selling seasons, the company is thus vulnerable to changes in consumer preferences and demand, pricing shifts, as well as sub-optimal selection and timing of merchandise purchases. We are cautious regarding the future continuation of the company's ability to anticipate consumer demands and accurately plan its

[9] EuroMonitor International, September 2023, "What inflation pressures mean for fashion supply chains today"

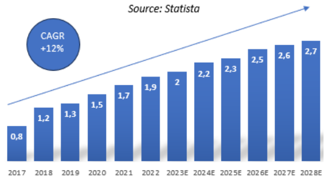
inventory levels accordingly. As already mentioned, changing consumer preferences and fashion trends, as well as the company's ability to anticipate, identify and quickly respond to them, could adversely impact the firm's top line results. What if inventory levels for certain merchandise styles are no longer deemed as "trendy"? This would naturally lead to higher markdowns to sell through excess inventory, resulting therefore in lower than planned margins.

Consumer Shifts

The performance of fashion enterprises in the market and their respective operational strategies are being impacted by customer behavior. Three main pillars, such as E-commerce and AI, Sustainability, and Omnichannel Retail, will enable to company's core activity to deliver high growth prospects in the future.

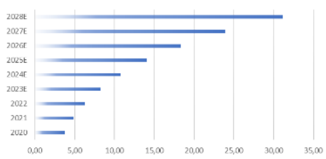
E-commerce and AI

Exhibit 9: E-commerce users, in billions
Source: Statista



Over the past years, consumers have been adapting the way they shop, thus gaining increased preference for online commerce. In the year of 2022, there were 1.9 billion online users in the clothing industry. The trend is expected to continue its growth with a projected 2.7 billion digital users in the long term, with a corresponding expected CAGR of 6.2% in the period between 2023 and 2028. According to Forbes, 12.7% of worldwide employees work from home, while 28% work in a hybrid system.[10] This could be one of the main reasons why e-commerce has grown so much in recent years. The increasing convenience and ease of this type of commerce forces companies to gradually invest more in their respective digital channels. Artificial Intelligence is the world's expected next big disruption that will completely transform the consumer experience, allowing for more personalized services that will reduce the number of shipping returns for companies, as an example. Furthermore, its ability to read patterns and anticipate trends will allow companies to better control and deliver on the strategies they may see fit in the future. According to a McKinsey study, Artificial Intelligence could increment profits of between $150 billion and $275 billion in the apparel sector within the next three to five-year period.[11] This could have a material impact on company's store expansion plans, reduced labour costs, as there will not be necessary to hire as many store operators as before, also allowing to decrease costs related to store rents. On the other hand, it will be necessary to hire other type of skill set to maintain the AI systems up and running. It is further expected that global e-commerce apparel net sales will generate $808 billion in the year of 2027, representing growth prospects of approximately 47% in the period between the years of 2023 and 2027.

Exhibit 10: Global AI in retail market size
Source: Fortune Business Insights



Sustainability

Sustainable fashion trends are gaining traction as the Apparel sector keeps changing. Over than 60% of respondents to a McKinsey study[12], stated they would pay extra for a product made with sustainable materials. Clothing retailers have an exceptional opportunity to adopt these trends and integrate sustainable business practices into their operations. They can satisfy the growing demand for sustainable fashion from consumers and make a positive impact on the environment by concentrating efforts on circular economy concepts, ethical supply chains, new materials, and digitalization. It was predicted that between the years of 2023 and 2026, the worldwide revenue

Exhibit 11: Revenue share of sustainable apparel worldwide
Source: Statista Consumer Market Insight

[10] Forbes Advisor, June 2023, "Remote work statistics and trends in 2023"
[11] McKinsey & Company, March 2023, "Generative AI: Unlocking the future of fashion"
[12] McKinsey & Company, February 2023, "Consumers care about sustainability – and back it up with their wallets"

share in the sustainable apparel market will rise steadily by a total of 1.4%. This forecast states that in the year of 2026, this revenue share will have climbed to 6.14%. According to the European Parliament, it is estimated that 10% of the world's carbon emissions will derive from the clothing industry, while 20% of global clean water contamination will be caused by textile production, specifically the dyeing and finishing processes.[13] It is imperative that A&F should follow this market trend and contribute not only to both reducing levels of pollution and waste, but also causing a good impression to consumers, showcasing awareness and focus on fighting on behalf of environmental issues. This will certainly impact the consumer's perception of the brand, directly contributing to net sales increases and a more efficient and reduced cost-structure strategy, as this allows for more efficient resources management.

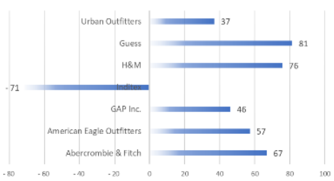
Omnichannel retail

Although digital sales are increasingly becoming more prominent, constituting around 22% of the apparel markets' net sales in the year of 2022, in-store sales still constitute the main source of income for companies, also representing a great significance for customers, who still deem the "store experience" as something invaluable. This opens up a window of opportunity for companies that are able to develop and put into practice omni-channel concepts efficiently, thus putting themselves one step ahead of the competition. The term "omni-channel" refers to the seamless integration of different net sales channels, providing consumers with a consistent experience regardless of whether they are shopping online, in a physical store, or via mobile devices. An example of this strategy is, for example, the act of purchasing a product through a digital platform and picking up the order in a physical store. Companies operating in this fast-paced sector must explore synergies between physical stores and online platforms, such as websites and social media, providing customers with the best possible experience through greater convenience and personalization efforts. Furthermore, by correctly assessing and building on customer analytics, the company can enhance the ability to predict the needs of each channel, avoiding inventory shortages and solving last-minute constraints in a quicker and more efficient way. According to a study carried out by Zendesk, 64% of respondents stated they will spend more money if some kind of problem is solved while they remain in-store.[14] Moreover, the customer-to-brand relationship is also expected to grow if the company is able to deliver on its consumer analytics efforts.

Competition

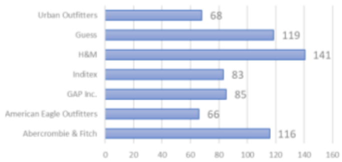
Global brands' extensive distribution networks impact global markets, but they also face fierce competition from local producers in terms of "pricing wars" and fashion choices specific to the region. American Eagle Outfitters, Gap Inc., Inditex, Guess, H&M, and Urban Outfitters are just a few of numerous leading companies constituting the fast-fashion industry. Although some of these companies have significantly larger market capitalizations when compared to Abercrombie & Fitch, we considered these companies being those whose operating business, as well as target consumer, more similarly relates to A&F. Hence, we are now able to situate Abercrombie in relation with its peers in terms of liquidity and profitability performance to better gauge its momentaneous standing in this highly competitive industry, while also evaluation cash flow management capacities and company's capital structure.

Exhibit 12: FY22s' Cash Conversion Cycle - A&F + Peers
Source: Annual Reports



[13] European Parliament, November 2023, "The impact of textile production and waste on the environment"
[14] Zendesk, May 2023, Erin Hueffner

Exhibit 13: Average Holding Period comparison, FY22
Source: Annual Reports & own calculations



The Cash Conversion Cycle is a metric that allows us to assess how long it takes for a regular operational cycle of a given company to be converted into cash. The average of the last six years indicates that A&F requires 59 days to perform its regular trade cycle. It stands slightly above its peers, meaning that the competition is on average faster in generating cash from their operations, which is indeed very desirable from a cash flow management perspective. In this respect, Inditex leads the competition with a negative net trade cycle, meaning that its suppliers are essentially financing the operational activity of the company. This means that the company can invest without having to use its own funds and use customers' money to finance its operations. Conversely, Guess has the worst Cash Conversion Cycle period, with a value well above average, which can be justified by its high Average Holding Period, reflecting the company's difficulties in selling its inventories.

Profitability analysis is also essential to complement this reasoning and evaluate the company's ability to generate profits concerning its costs, assets, or even equity. Abercrombie & Fitch has an average Return on Assets, between 2017 and 2022, of 4.21%. A value that is below its peers' average, which can essentially be explained by a drop on its operational result during the pandemic years and increasing recognition of assets. Once again, Inditex presents the best ratio among the competition, obtaining very stable indicators throughout the period analyzed, with the exception of the year of 2020. On the other hand, Guess is the company that presents the lowest RoA. To be noted, however, that in year 2022, this ratio performed well above its historical average due to the high operational results recorded and a stabilization in the growth of its assets. The Asset Turnover ratio is a metric used to measure any given firm's efficiency in using its assets, thus indicating the amount of sales generated for each unit of asset invested. Abercrombie's position, according to the profitability analysis, is consolidated among its competitors, however Inditex appears as the most inefficient company on using its resources, demonstrating that the ratio analysis must be always analyzed as a comparison with competition, and not on an individual basis.

Table A: A&F + Peers - Average RoA & Asset Turnover
Sources: Annual Report & own calculations

	RoA	Asset Turnover
Abercrombie & Fitch	4,21%	126,60%
American Eagle Outfitte	9,39%	156,34%
GAP Inc.	6,52%	148,70%
Inditex	16,19%	104,51%
H&M	10,16%	149,79%
Guess	3,98%	121,92%
Urban Outfitters	11,11%	148,63%
Average	**8,79%**	**136,64%**

Liquidity ratios allow us to evaluate whether any given company has indeed the ability to meet its short-term obligations according to its current activity parameters. Analyzing Abercrombie's indicators internally, it is important to highlight the negative impact that the Covid-19 outbreak pandemic brought to the company's ability to settle-down its short-term debts. However, if we analyze each ratio individually in comparison with the other competitors, we can conclude that A&F, as well as its peers, present very comfortable liquidity levels. With regards to the Current Ratio, Abercrombie ranks above the average, indicating the firm's ability on meeting its short-term obligations using all of its short-term assets, thus proving minimum short-term equilibrium. However, this positive indicator does not necessarily mean that the company will not have short-term problems in the future. The company's situation may hinge on the firm's ability to execute its current assets, particularly inventories and receivables, so there may be execution risk involved. That is why we further complemented our analysis with the remaining liquidity ratios. The Quick Ratio measures a company's ability to pay down its short-term obligations using the cash flow currently available, as well as the assets are more likely to be quickly converted into cash while assuming that the firm is unable to sell any of its inventories. Abercrombie is above average, with a ratio of 1.23, meaning that the company has a more robust position within its most liquid assets, when compared to its peers, in order to cover its short-term debts. The company's Cash Ratio gives us the firm's ability to meet its short-term obligation using its available cash, assuming the firm is unable to sell any inventories or to receive any of the amount

Exhibit 14: Average Current Ratio comparison
Source: Annual Reports & own calculations

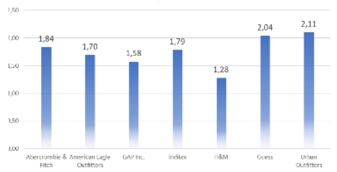
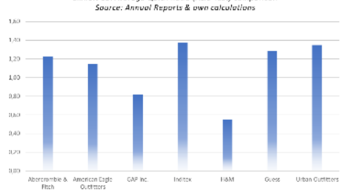
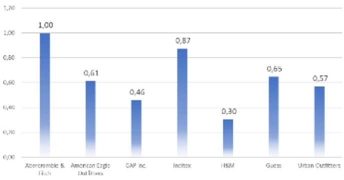


Exhibit 15: Average Quick Ratio (Acid Test) comparison
Source: Annual Reports & own calculations



pending. Again, Abercrombie ranks higher than the average of its peers, which leads us to conclude that A&F has a better capacity to cover its current obligations with cash than its most direct competitors. Conversely, GAP and H&M are the ones with the worst liquidity indices with values below the competitors' average. This means that these companies have difficulty paying their short-term debts if they fall due immediately, even using their cash resources. To conclude our liquidity analysis, and even though A&F presents stable and comfortable liquidity ratios, these high ratios prove that the company has a lot of cash lying around the company that is not being used. As such, we anticipate that the company will work hard on finding additional investment opportunities within its scope of activity, namely through increasing investments in its Abercrombie kids, Gilly Hicks, and Social Tourist brands. Also, while we do not expect the company to give back money to investors as a form of dividends soon, since it is still underway of performing on its strategy plan, we do assume that the company will utilize its excess cash to gradually pay down all its outstanding debt.

Exhibit 16: Average Cash Ratio comparison
Source: Annual Reports & own calculations



Finally, a capital structure analysis must be performed as a complement to determine the company's financial stability and understand how the company is financing itself looking at the mix of debt and equity. A high portion of debt to equity can be a determining factor in the existence of greater associated risk, thus less attractive from an investor perspective. The Debt-to-Equity ratio[15] provides a more accurate view of the company’s outstanding debt obligations after stripping out its excess cash. In the past four years, Abercrombie has had an average ratio of 0.82, a value lower than its competitor’s average ratio. As this indicator is less than 1, it suggests that the company is using a balanced combination of net debt and equity, translating into good prospects for the future, since it is not overly dependent on debt capital. On the other hand, GAP has high levels of leverage, which can be explained by the D/E ratio of 2.17 and a Gearing ratio of 68%. This means that in periods of higher debt interest rates, in which the company is unable to obtain more debt at decent yields, this may result in difficulties in renegotiating its debt with creditors, meaning higher pressure on generating sustainable cash flows. Conversely, Inditex presents enormous financial stability, as it can be viewed as a “debt-free” company.

The PP&E/Assets ratio is identical and relatively high in all companies, which intuitively makes sense in this industry, since these companies’ PP&E rely heavily on its stores. As such, a high PP&E/Assets ratio means that, in practice, these companies have more collateral to “give” in return of debt. It is important to highlight that during the year of 2022, all companies but H&M faced a decrease in this ratio when compared to the year of 2019. The ongoing proliferation of digital commerce is “stealing” sales previously generated in-store, causing in some cases some sort of disinvestment in this type of physical assets, which further explains the decrease in this ratio over time.

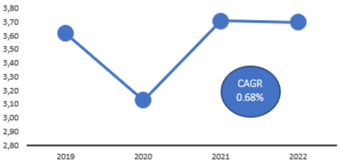
Table B: A&F + Peers - Average Gearing Ratio, D/E, Debt/Op. Income, Net PP&E/Assets, Solvency Ratio, Financial Autonomy
Sources: Annual Reports & own calculations

Historical Years - Averages	Gearing Ratio	D/E	Debt/Op. Income	Net PP&E/Assets	Solvency Ratio	Financial Autonomy
Abercrombie & Fitch	44%	0,82	-7,76	0,46	0,02	0,28
American Eagle Outfitters	49%	0,96	2,41	0,55	0,64	0,38
GAP Inc.	68%	2,17	-15,61	0,54	0,27	0,21
Inditex	2%	0,03	-0,01	0,46	1,21	0,55
H&M	41%	0,80	8,21	0,44	0,56	0,35
Guess	58%	1,37	-1,37	0,41	0,52	0,32
Urban Outfitters	41%	0,71	86,72	0,59	1,14	0,50
Average	**43%**	**0,98**	**10,37**	**0,49**	**0,62**	**0,37**

Unlike liquidity ratios, which reflect the prospects for a company's financial health in the short term, the Solvency ratio indicates the firm’s ability to meet its obligations using the capital that

[15] Debt-to-Equity ratio: Net Debt/Gross Debt-Excess Cash

Exhibit 17: A&Fs' Net Sales evolution
Source: Annual Report & own calculations



has been invested or generated by the firm. A&F has a ratio of 0.4, lower than its peers' average, which translates into the company's weak ability to cover its long-term obligations through its own capital. Inditex is once again a leader and presents solid levels of solvency, also benefiting from the almost total absence of debt on its liability levels. However, GAP is the company with the worst ratio, situated around 0.27, which confirms its enormous dependence on its current debt levels to sustain its business, placing the company in a more fragile position when compared to its most direct peers.

To complement the analysis of the company's positioning among its direct rivals, we analyzed A&F's CAGR with respect to its net sales between FY19 and FY22. Looking at the graph, we can see that Abercrombie registered a CAGR of 0.68%, which allows us to infer that the company managed to find solutions to combat the two years of COVID-19, with a special emphasis on 2020, a year in which the world practically "froze", with stores closed almost the entire year. Looking at the competition, American Eagle, Inditex, and Urban Outfitters recorded CAGRs close to 5% under the same period, thus outperforming A&F, since they were not underway of a dramatic turnaround strategy, that evidently takes time before the benefits start to reap off. Nevertheless, GAP, H&M, and Guess had more difficulties in dealing with the pandemic and achieved negative CAGRs. While American Eagle, Inditex, and Urban Outfitters present very satisfactory ROICs, ranging from 10% to 15% in FY22, A&F records a lower Core ROIC, in line with H&M and GAP. This showcases that American Eagle, Inditex and Urban Outfitters have higher ability to get return from their investments by finding investment opportunities though its brands, in which these companies' customers are more willing to pay a premium based on the brand itself, even without a substantial quality difference on their product offering. Abercrombie, on the other hand, is underway of being able to achieve similar returns in the near future if its turnaround strategy playbook continues to deliver as it been delivering recently.

Exhibit 18: A&F + Peers ROIC's, FY22
Source: Bloomberg & own calculations