Skechers USA Inc.

May 10th, 2024
Ticker: SKX

Current Price: $ 67.78

Target Price (6-12 months):

Base Case: $ 68.46
Probability Weighted: $ 72.85

Outlook: Long

Multiples:

EV/EBITDA:	10.33x
EV/EBIT:	12.40x
EV/SALES:	1.25x
P/E:	17.84
Forward P/E:	14.07
Price/Sales:	1.26x
Price/Book Value:	2.49

Financial Ratios (3Y avg):

ROA:	8.31%
ROE:	15.59%
ROIC:	16.25%
Debt/EBITDA:	0.42
FCF/Debt:	1.16

Highlights:

I issued a **Long** recommendation on Skechers USA Inc. (SKX) based on a 6 months to one-year probability weighted price target price of **$72.85** per share, offering a **7.48%** upside potential, from its closing price of $67.78 on May 10th, 2024. My recommendation is primarily driven by:

Macroeconomic Outlook – The world's economy is recovering from the pandemic and geopolitical shocks. Inflation has been falling in the last year and the most relevant Central Banks seem to be convinced to lower interest rates in the next quarters. Furthermore, demand in China is recovering (imports for April 2024 increased 8.4%, beating an expected 4.8% rise and reversing a 1.9% fall in March), as is the global economy, which has been going through a difficult environment for the past three years. The expected U.S. GDP growth rate for 2025 is now around 2.3% and consumer spending is set to increase by 2.0% this year and by 2.2% YoY until 2026.

Brand diversity – Skechers offers a wide range of footwear for men, women, and children, from casual shoes to performance sneakers and workwear. With its diverse product lineup, including sub-brands such as BOBS, Twinkle Toes, and Relaxed Fit, Skechers effectively target a broad spectrum of consumer preferences. Beyond footwear, the brand actively participates in marketing and sponsorships to enhance its brand identity. Notably, Skechers has been a consistent advertiser at prominent events like the Super Bowl and has forged partnerships with sports teams and athletes, such as soccer star Harry Kane and several prominent golf players.
Additionally, the company has ventured into emerging sports like pickleball while maintaining strong ties in the classical ones, such as golf.

Growth Strategy – For the full year 2023, total gross profit increased by 18.12% y/y and operating profit increased of more than 43% y/y. The company plans to grow its product portfolio significantly, as well as to open new stores and distribution centers both in Domestic and International markets, especially in APAC region. Skechers recently released great results for Q1 24, showing record sales of $2.25 billion (12.5% increase y/y) and diluted earnings per share of $1.33, (+30.4% y/y). Both the Wholesale (+9.8% sales y/y) and Direct to Consumer (+17.3% sales y/y) channels are growing, and this is essential to maintain the company's competitive advantage.

Valuation – Valuation method indicate a current intrinsic value on the base case of $ 68.46 per share, and a target probability weighted price of $ 72.85 per share, offering an upside from 1.01% to 7.48%. Furthermore, based on the Footwear apparel industry's multiples (see Table 1) such as EV/EBITDA and P/E, Skechers appears to be undervalued by the market (Median EV/EBITDA: 16.59x & Median P/E: 26x), and this could be translated into further potential upside in the next future.

Main Risk factors – Fashion obsolescence remains a significant concern for Skechers' business model, which relies heavily on continuous product and design innovation. Delays in product launches could potentially undermine the company's competitive position in the market. Operating in the strong competitive athletic footwear and apparel sector, Skechers faces strong competition from various outlets, including athletic footwear specialty stores, sporting goods stores, and traditional shoe stores. Moreover, fluctuations in consumer confidence pose a notable risk to sales. The health of the economy heavily depends on consumer confidence, and any downturn could lead to reduced consumer spending. Skechers' customer base is particularly sensitive to macroeconomic factors such as potential interest rate hikes, rising fuel and energy costs, changes in credit availability, fluctuations in unemployment rates, and high levels of household debt. These external factors significantly influence consumer sentiment, potentially leading to altered spending patterns and posing challenges to the company's growth and profitability. Finally, the exposure to the FX market needs to be controlled and managed, since the FX market had been quite volatile in the past three years, especially for certain currencies.

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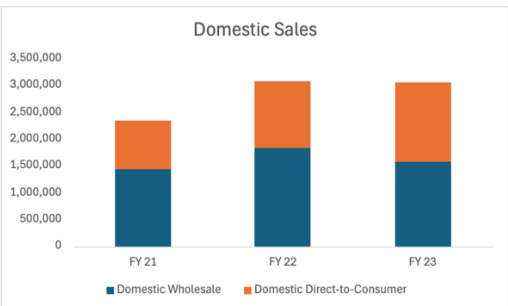
		TTM Multiples		
Comparable Companies	**Country**	**EV/EBITDA**	**EV/EBIT**	**P/E**
Skechers USA Inc.	US	10.33	12.40	17.84
Nike Inc.	US	20.20	23.10	26.80
Deckers Outdoor Corp	US	21.40	22.70	30.10
On Holding AG	Switzerland	34.80	47.30	111.40
Crocs Inc	US	9.20	9.60	10.90
Birkenstock Holding PLC	UK	25.70	32.90	110.10
Asics Corp	Japan	22.30	29.30	45.50
Adidas AG	Germany	16.59	29.11	N/A
Under Armour Inc.	US	6.10	9.20	7.30
Steve Madden Ltd	US	11.64	12.02	17.10
Foot Locker Inc.	US	11.48	6.91	10.60
Puma SE	Germany	8.40	13.30	25.20
Average		**17.07**	**21.40**	**39.50**
Median		**16.59**	**22.70**	**26.00**

Table 1 - Source: Financial Model

Company Overview:

Founded in 1992 and headquartered in Manhattan Beach, California, Skechers U.S.A., Inc. designs, develops, markets, and distributes footwear for men, women, and children in the United States and overseas under the SKECHERS name, as well as under several uniquely branded names. Through its distribution networks, joint venture partners in Asia and the Middle East, and wholly owned subsidiaries in Canada, Japan, throughout Europe and Latin America, Skechers' products are available in more than 180 countries and territories. As of Mar 31, 2024, the company had 5,203 stores, including 565 domestic stores, 1,106 international locations, and 3,532 distributors, licensee, and franchise stores. Skechers offers a comprehensive range of footwear for all ages and styles, including casuals, dress casuals, comfort, lightweight, sandals, and fusion categories under the Skechers USA brand. The company operates through Wholesale and Direct-to-Consumer segments, and it also offers footwear under Skechers Hands Free Slip-ins, Skechers Arch Fit, and Skechers Air-Cooled Memory Foam brands. In particular, the revenue split shows that the DTC is currently growing more and producing more Gross Profit than the Wholesale channel, although the latter is still dominant, especially in international sales (Chart 1). Moreover, of all sales, about half are made in the American region, while the other half are divided more or less equally between EMEA and APAC (average of the last three years). Of the latter, the APAC area is becoming increasingly important, not only for the growth in sales, but also for the numerous factories Skechers owns through leasing in China, which is of great importance, as it accounts for approximately 55.3% of Asian sales (FY 2023).



Industry Overview:

The apparel and footwear industry encompasses a wide array of product categories, spanning from essential to high-end offerings. This sector is notably dynamic, influenced by evolving designs, consumer preferences, and retail strategies. The industry is expected to grow at a CAGR of 5.8% from 2023 to 2032, reaching $ 661.9 bn. Over recent years, there has been a notable shift in the landscape of clothing and shoes manufacturing, with many companies opting to outsource production to lower-cost regions worldwide. Consequently, countries such as China, Bangladesh, Turkey, India, and Cambodia have emerged as prominent exporters of shoes. Despite the prevailing global economic challenges, certain segments of the apparel market have experienced heightened demand. Notably, the surge in interest for leisure and activewear during the pandemic has provided a boost to the industry. Additionally, there's a growing market for second-hand apparel (increasing by roughly 100 billion dollars by 2026), driven by consumers' increasing awareness of environmental concerns and their desire to make more sustainable purchasing decisions.

Regarding the regional split, the market is currently dominated by Asian consumption, of which China is the industry leader for the apparel segment, while the US is the leader for the footwear segment. An important factor to consider is that make profits in EMEA region is becoming increasingly-challenging. Most global brands saw meaningful decelerations in the region during 2023, especially NIKE and Adidas (EMEA Gross Margin 2023: - 4%). In this context, Skechers appears to be well positioned (Table 2), having a good ROIC compared to the industry and Gross and Net Margin above the median of the main competitors.

			LTM Performance Indicators ($ th)			
Comparable Companies	**Country**	**Market Cap ($ th)**	**Gross Margin**	**Operating Margin**	**Net Margin**	**ROIC**
Skechers USA Inc.	US	10,340,000	51.90%	9.81%	8.12%	15.16%
Nike Inc.	US	137,400,000	44.00%	12.00%	10.00%	20.00%
Deckers Outdoor Corp	US	22,100,000	54.00%	22.00%	18.00%	56.00%
On Holding AG	Switzerland	9,700,000	60.00%	10.00%	4.00%	22.00%
Crocs Inc	US	8,700,000	56.00%	26.00%	20.00%	22.00%
Birkenstock Holding PLC	UK	8,500,000	62.00%	20.00%	5.00%	3.00%
Asics Corp	Japan	10,150,000	52.00%	10.00%	6.00%	12.00%
Adidas AG	Germany	40,200,000	49.00%	3.00%	1.00%	2.00%
Under Armour Inc.	US	2,920,000	46.00%	5.00%	7.00%	11.00%
Steve Madden Ltd	US	3,080,000	42.00%	11.10%	9.22%	21.00%
Foot Locker Inc.	US	1,720,000	32.01%	7.91%	5.40%	2.90%
Puma SE	Germany	7,600,000	46.00%	7.00%	4.00%	10.00%
Average		22,915,455	**49.36%**	**12.18%**	**8.15%**	**16.54%**
Median		8,700,000	**49.00%**	**10.00%**	**6.00%**	**12.00%**

Table 2 - Source: Financial Model

Events & Catalysts:

China Growth Estimates - After a very tough 2022 due to the "Zero COVID" lockdown policy, Skechers saw a strong recovery in China last year, with revenues growing 16%

overall (which the estimation set it was around +20% in constant-FX terms). Despite a solid rebound, business in China has not fully recovered from the impact of the "Zero COVID" policy. In 2023, revenues remained slightly below 2021 levels, indicating a slower growth trajectory compared to pre-pandemic years. While the region has shown a 10% compound annual growth rate (CAGR) since 2019, lower than previous years, there's still potential for double-digit growth ahead. It is certainly a measure to track, since this suggests an opportunity for Skechers to further accelerate growth in the coming years.

Inventory Management - Following years of supply chain disruptions caused by the pandemic, Skechers seems to have successfully managed their inventories by the close of 2023, which is coherent with the different changes in Net Working Capital over the past three years. Despite experiencing inventory growth from 2022 to the second quarter of 2023, the company systematically reduced inventory levels and concluded 2023 with a 16% decrease in inventories. In this sense, tracking the inventory measures and the overall efficiency of the company would be useful to project the stock price even further.

Valuation:

Long View Supported by:

Strategic Initiatives: Skechers maintains a diverse range of brands offering various footwear styles at attractive prices, embracing a multi-brand strategy to expand its customer base without diluting existing brand and overcoming the recent focus on comfort-based footwear. Furthermore, the company is making numerous strategic investments in infrastructure, particularly in retail, e-commerce, and distribution, support omnichannel growth and product innovation, including omnichannel integration. This is supported by the financial management of the company, which has not high level of indebtedness and has good financial position and solidity.

DTC and Wholesale Growth – Skechers has a big sales recapture opportunity in the wholesale channel, since it has experienced a 27% delta between 2023 DTC growth (+24%) and 2023 wholesale growth (-3%). If we assume that the strong DTC growth is indicative of good sell-through trends in the wholesale channel, then this would suggest a great opportunity for the company in the coming years, especially in the APAC region. This is also supported by the good metrics of profitability, and the good ROIC compared to the industry.

Intrinsic Valuation (DCF):
The Base Case DCF based Target Price of $ 68.46 is based on consistent FCF growth due to increase in Revenue growth and Operating Margins, which is in line with the company positioning in the sector. The terminal growth of 4% was set considering GDP growth, inflation and industry growth. Finally, for the calculation I considered a tax rate of 20% and WACC of 10.30%. I built the valuation based on three different scenarios, which represent a Downside, Base Case and Upside case, and for each of them I assigned a probability of

happening (out of 100) based on the current economic landscape and I calculated a probability weighted price, which is the final target in 6/12 months.

- ***The Downside or Conservative Case*** implied -3% in Revenue Growth and EBIT Margin (related to the base case) and a Higher WACC of +0.5% (10.80%). It shows the possible risks of this investment, considering the current transitioning phase from a high inflation and uncertain economy. In this case the possible downside is about -50%, which is reflected by a price per share of $33.89. I assigned a probability of 25% to this scenario since global demand is now recovering and industrials/retail stocks could benefit from this in the next future.

- ***The Base Case:*** Based on the basic assumptions of the model, the company appears to be currently fairly valuated. The identified share price of $68.46 is slightly higher than the current one ($67.78), with a possible upside of 1.01%. The company remains a BUY, but would be better for an investor to wait for a small correction in the price before entering, since the risk/reward would be better. I assigned a 30% probability for this outcome, since it can happen that the stock price could be stable or around this level before taking a momentum directionality.

- ***The Upside or Optimistic Case*** implied +3% in Revenue Growth and EBIT Margin (related to the base case) and a lower WACC of -0.5% (9.80%). The Optimistic Case shows results that exceed the expectations in the future will probably be awarded by very positive future cash flows and a possible positive upside of +49.07%, determining a price of $ 101.04. I assigned a probability of happening of 40%, which is higher than the Conservative and the Base case. This is because inflation has been now falling for months and central banks seem to be convinced to lower rates soon. Furthermore, demand in China is recovering, as is the global economy, which has been going through a difficult environment for the past three years.

Probability Weighted Target Price: Based on these three scenarios, it is possible to weigh the probabilities and share prices by making a risk/return-weighted average. This calculation reveal the final target share price of $ 72.85, with an upside of 7.48%.

Valuation Multiples: Based on the estimations of the multiples (EV/EBITDA, EV/EBIT, P/E) Skechers appears to be underestimated compared to its competitors.

Outstanding Diligence:

To gain further conviction to my thesis I would need more disclosure information on costs split by region and brand, to better project the revenues and the margins, as well as to better predict future EPS.