VALUATION OF INDITEX, INDUSTRIAS DE DISEÑO TEXTIL S.A.

Autor:

Eva Faus Redón

Tutora/or:

Alejandro José Barrachina Monfort

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Abstract:

Business Valuation is a methodology that serves to determine the intrinsic value that a company has, analyzing thus all aspects and key characteristics of the company, to be able to conclude whether the company is profitable in the long term and thus be able to decide the investor whether to invest in the company.

The objective of this paper is to determine a range of different intrinsic values of the company Inditex, Industrias de Diseño Textil, S.A, leader in the Spanish textile sector, analyzing its beginnings, its strengths and weaknesses, its competitors, its strategies, and its future as a company, calculating its intrinsic value through the Discounted Cash Flow model, forecasting its future evolution.

Keywords: Intrinsic Value, Value Investing, Financial Analysis.

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1.- Introduction

Investors throughout history have used different methods to choose whether to invest in a company. An investor's objective is to maximize his profits over time, and for this he must choose which companies to invest in.

Therefore, one of the most effective tools to know if a company is going to grow in the long term, to know what its real value and the real value of its shares, is the Valuation of Companies. This method consists of evaluating the company in the long term, using its financial statements, as an important source of information, and it's studying its environment to estimate its intrinsic value.

There are many types of valuation methods, but in this paper, we will focus on the method of discounting cash flows, known as the Discounted Cash Flow Model, which consists of estimating company's future free cash flows and discounting them to the present to know the actual current value of the company.

More precisely, the main objective of this paper is to study and evaluate the company Inditex, analyzing its evolution, characteristics, competitors, its financial statements, etc... and apply the Discounted Cash Flow Model to obtain a reasonable range of estimated intrinsic values for the company considering different plausible scenarios with respect to the future growth of the economy and the company.

1.1.- Business Valuation and the difference between of price and value

Business Valuation is the discipline that suggests processes and models through which the intrinsic or fundamental value of a company is quantified, or better said, it is estimated. According to the Discounted Cash Flow Model, this intrinsic or fundamental value is understood as the present value of the financial cash flows that a given firm is capable to generate in the future, discounted at a rate that includes the risk associated with this cash flows. The company is considered, therefore, an entity that generates future cash flows and, ultimately, the value of a company is determined by its ability to generate them.

If stock markets were perfectly efficient, price and value of publicly traded firms would coincide. But history tells us that this is not the case. At certain moments in history, the markets move through cycles, moments of euphoria and moments of decline, which makes it possible to analyze moments where the price of assets is altered, and therefore, at some moments the price can be greater or less than its intrinsic value. A clear example would be the real estate bubble of 2008 or the crack of 1929. For this reason, is important to know the difference of price and value.

According to **Benjamin Graham**, forerunner of value investing, legendary American investor and author of books that are considered fundamental in the investment world, intrinsic value corresponds to the value that is justified by the data, that is, the assets, benefits, dividends, clear prospects

The price of a share or product is the amount of money we pay to buy it, while the intrinsic value represents the benefit or utility, we obtain by acquiring it. The famous investor **Warren Buffett** perfectly defined this concept as the price is what you pay, and value is what you get.

1.1.1.- Definition of intrinsic value

The intrinsic value allows investors to calculate the **real value of a certain company**, which does not have to be equal to its price.

The intrinsic value, theoretical price, or fundamental value of an asset, is the value that is obtained by considering all the components that surround an asset, including tangible and intangible elements. It is sometimes also known as actual value.

Intrinsic value is used when we assume that the business will continue to operate in the future. On the other hand, if we cannot assume that the company will continue to operate in the future, we must calculate the liquidation value.

Also, when we must calculate the intrinsic value, it is advisable to carry out a rigorous analysis of the company, both financially and strategically.

1.1.2.- The importance of values company for the investing

The valuation of companies or businesses is due to multiple reasons, among the very various objectives of business valuation, the following stand out:

- Operations trading
- M&A operations: mergers, acquisitions, divisions, etc.
- Valuation of companies listed on the stock market
- IPOs; (and capital increases with non-monetary contributions
- Bond issue
- Inheritances and wills
- Director remuneration systems of the company based on the creation of value for the shareholder
- Identification of the sources of value creation (value drivers)
- Strategic decision planning

As can be seen, there are multiple situations that require a valuation of a company, but they all share the same common goal: determine a value of the asset in question to make decisions using as much reliable and objective information as possible.

1.2.-The beginnings of value investing

The concept of Business Valuation is not a current concept, it is a very important concept since the crisis of 1929, when many investors lost so much money, had to design new investment models to prove that the companies where they were going to invest their money would be profitable in the long run.

In the next subsections, it will be explained what valuation is, how it was born and who is its creator.

1.2.1-What is Value Investing?

Value Investing is an investment philosophy and strategy that consists of acquiring companies with a wide safety margin between the price you pay for them and the intrinsic value that you estimate they have.

An investment operation is one that, after an exhaustive analysis, promises security for the principal and an adequate return. Transactions that do not meet these requirements are speculative.

Warren Buffett for his part comments that volatility is our friend and not our enemy. What we must do is benefit from the panic instead of participating in it.

In the end, Value Investing is about buying good companies that are cheap for some reason like the following:

- Liquidity factors
- Shareholding structures (family businesses)
- cyclical business
- Stocks with different characteristics (preferred, etc.)
- Geographic reasons (businesses and shareholders are in different regions)
- impatient markets
- Small company size
- Holding companies

1.2.2.-How and when was Value Investing born?

Value Investing was born with **Benjamin Graham** during the crash of 1929. During that period, the investor suffered considerable losses: -50% in 1930, -16% in 1931 and -3% in 1932.

This bad experience made him rethink his strategy of investment, so he developed a philosophy with the objective of minimizing the probability of losing the capital invested.

1.2.2.1.- Who was Benjamin Graham?

He was the Chief Investment Officer at Graham-Newman Corp and professor of Securities Analysis at Columbia University for 28 years. The author of “Security Analysis” in 1934, of “The Intelligent Investor” in 1949 and 3 more book considering that Investors' main problem, even their worst enemy, is probably themselves.

Benjamin Graham proposed some value metrics about companies to make good investment decisions, they are summarized in the following points:

- Right size (>$100M revenue)
- Financial health (2:1 solvency ratio)
- Income stability (benefits for the last 10 years)
- Good dividends (uninterrupted for 20 years)
- Growth potential (1/3 EPS growth in last 10 years)
- moderate PER (less than x15)
- Moderate Book Value (P/B <x1.5)

1.3.- Methods to estimate the intrinsic value of a firm

There are many major business valuation methods:

1) Methods based on the **balance sheet** (equity value): they consider that the value of a company lies in its assets, so they make the valuation from a static perspective, without considering the future evolution of the company. Among these methods, the following stand out: accounting value, or value in books, adjusted book value, liquidation value, real net assets, etc.
2) Methods based on the **income statement** (multiples): they value the company at through the magnitude of profits, sales, or another indicator. The classic PER (Price to Earnings Ratio) stands out, that is, the value obtained multiplying the annual net profit by a multiplier coefficient called PER, the value of the shares will be the result of multiplying the PER by

the benefit. The multiples which are often used are: Price/sales, EV/EBITDA and EV/FCF, among others.

3) Mixed methods based **on goodwill**: they determine that the value of a company is equal to its net assets plus the value of the fund. Trade the difference between the price paid for a business and the value accountant with which the purchase is reflected. It is assumed that the background. Trade reflects the value of the company's intangible assets, such as brands, strategic alliances, industry leadership, among others, each of which is increasingly relevant in the digital economic environment.
4) Methods based on the **discount of cash flows:** the value of the company It is calculated based on the estimate of the cash flows that it will generate in the future, discounting them with an appropriate required return according to the risk of these flows.
5) **Break-up value**: the value of the company is the sum of its different divisions or business units. East method is useful for valuing listed holding companies that own of other listed companies. The capitalization of these is added and if it is higher to that of the holding company, it will mean that it is listed with the respective discount.

The Discounted Cash Flow Model, employed in the present paper to estimate the Value of Inditex, is part of the methods based on discount of cash flows.

1.3.1- The Discounted Cash Flow (DCF) Model

The **Discounted Cash Flow Model (DCFM)** calculates the value of the company based on the estimate of the free cash flows that it will generate in the future, discounting them at an appropriate required return according to the risk of these cash flows.

In other words, this method considers that the value of a company is determined by the present value of the treasury that it can generate over time, discounted at a rate of cost of capital that appropriately reflects the risk of this treasury.

Therefore, the value of a company will be greater the more cash flows it generates for its shareholders in the future. Furthermore, the more predictable and persistent these future cashflows are, the greater the value of the company will be.

The formal expression of the DCFM is:

$$V = \sum_{i=1}^{\infty} \frac{Q_i}{(1+k)^i}$$

Formula 1:The Discounted Cash Flow Model

Where Qi is a representation of the forecast of the free cash flow generated by the company at period i and k is the risk-adjusted discount rate used to calculate their present value.

1.3.1.1. -Weighted Average Cost of Capital (WACC)

The appropriate discount rate for the DCF is the **weighted average cost of capital** (WACC):

$$\text{WACC} = \frac{EqV}{EqV+D}\ x\ K_e + \frac{D}{EqV+D}\ \text{x}\ K_d\ \text{x}\ (1-t)$$

Formula 2 : WACC

To calculate the cost of capital we need to calculate the following:

-EqV: the capital contributed by the shareholders: it is provided in the Balance Sheet, in the Shareholder's Equity section.

-D: the net financial debt

For the calculation of D, the following calculation of the balance sheet is made:

$$TOTAL\ DEBT = total\ liabilities - Commercial\ Creditors - Provision$$

-t: represents the tax shield

For the tax calculation, the percentage between Net Income and EBIT will be calculated.

$$t = 1 - (\,Net\ Income\ /\ EBIT\,)$$

-Ke: the return required from shares

For the particular case of publicly traded firms (which is the case in the present paper), the formula provided by the equilibrium of the Capital Asset Pricing Model (CAPM) can be used to estimate the cost of equity (Ke) based on the interest rate of a risk-free asset (RF), the expected return of the stock market as a whole and the degree to which systematic risk is affecting the company (in this sense the WACC as the adequate discount rate for the DCFM is risk-adjusted). More precisely,

$$K_e = R_F + \beta \text{ x } (R_M - R_F)$$

Formula 3 : Ke

-RM: represents the expected return of the market in which the company's stocks are traded.

-RF: indicates the return of a risk-free asset.

-B: The beta is a specific parameter for each company. This beta measures the degree to which systematic risk is affecting the company.

-Kd: the cost of raising capital through debt

To finish, to calculate Kd it is necessary to divide the financing cost between the average debt of period t and period t-1.

$$Kd = \frac{Financing\ Cost}{\frac{(Dt+Dt-1)}{2}}$$

Formula 4 : Kd

1.3.1.2.-Free Cash Flow (FCF)

Free Cash Flows (FCFs) are the flows generated by company's operations, after taxes. Basically, they are the cash flows that could be distributed to the company's shareholders and debtholders after having covered the needs of reinvestment in fixed assets and in operating needs for funds. In other words,after taxes, considering investments necessary for the continuity of the business, both in non-current assets and in capital circulating.

According to the Corporate Finance Institute (for more details see the link https://corporatefinanceinstitute.com/resources/knowledge/valuation/fcf-formula-free-cash-flow/), the generic formula for calculating the FCF of each period is:

FCF = Net Income + Non-Cash Expenses – Incrase in Working Capital – Capital Expenditures

Formula 5 :FCF source: Corporate Finance Institute

1.3.1.3.- Forecasted Free Cash Flow.

To be able to calculate the intrinsic value of the company, it is necessary to forecast future FCFs. In the present paper, these forecasts are obtained assuming that FCFs will vary in the future at their historical average percentage change.

In this process, two phases must be identified:

-The forecasted of FCFs, within the Interim Value, are obtained as:

$$FCF\ t+1\ =\ FCF\ t\ *\ (1+\ Av.FCF)$$

-The Terminal Value is the last forecasted FCF, this is FCF at period T, within the Interim Value which is assumed to grow at perpetuity at some rate g, reflecting the dynamics of the company and the economy in which it is operating, and it reflects the steady-state of the company from year T and beyond (over an infinite horizon of time). In the case in which k>g, the value at period T-1 of this growing perpetuity is:

$$\frac{FCF\ T}{k-g}$$

2.- The Analysis of Inditex

Inditex is currently the leader in the textile industry, above companies such as H&M, GAP, and Mango.

This multinational company has stores all over the world, always carrying the latest fashion trends, has a very wide target audience due to its wide range of companies.

This company has been chosen as the objective of analysis, since it is the Spanish company that leads the textile industry, it is also listed in the IBEX 35 (Spanish stock index) and its future growth, its strategies, its competitors are under investigation...

Therefore, we are going to proceed to analyse this company, first we will analyse its evolution, its main competitors, its environment, and its brands.

2.1.- History of Inditex

Inditex, Industrias de Diseño Textil, S.A, is the main fashion distributor in the world. The Group is made up of 7 commercial brands -Zara, Massimo Dutti, Pull & Bear, Bershka, Stradivarius, Oysho, and Zara Home.

It has more than 4,500 establishments in 73 countries and its headquarters are in Arteixo, La Coruña. In addition to the 8 banners mentioned, the Group has two other brands that today are extensions of the flagship that is Zara, and that are; Kiddy's Class and Lefties, focused on children's fashion and "outlet" fashion respectively.

Now, we're going to introduce the history of Inditex.

- **1963**: **D. Amancio Ortega Gaona** founded a company dedicated to the manufacture of clothing that grew progressively until it had several manufacturing centers that distributed its product to different countries.
- **1975**: **The first Zara store** opened in La Coruña, the place where the Group began its activity and where the company's central services are located today.

- **1985**: During the following ten years, the chain spread rapidly throughout Spain and **INDITEX** was created as the head of the group of companies.
- **1988**: After the expansion in Spain is when the factories of the organization direct all their production towards the Zara chain. In the following years, the exit outside the Spanish borders takes place, opening stores in **Porto, New York, and Paris**. Its stores, always located in privileged locations, are already present in more than 400 cities in **Europe, America, Asia, and Africa**.
- **1989**: **Tempe** was created, a company that designs, manufactures, and distributes footwears for all the stores of the eight commercial formats of Inditex. It is the great unknown of the group, since it does not operate under the name of its brand, however it currently has the capacity to produce more than 33 million pairs of shoes per year. The first footwear collection arrived at Zara stores with a children's section in 1990.
- **1991**: the Group expanded with the creation of the **Pull & Bear** chain and the acquisition of 65% of the **Massimo Dutti** chain, a purchase that would be completed in 1995. In addition, the **first Kiddy's Class** store opened in Spain in the same year. Its stores were integrated into the figures of the Zara chain, and it was in 2002 when the Group decided to strengthen its presence in the **children's fashion segment** with the development of Kiddy's Class as an independent chain.
- **1998**: **Bershka**, was created for the younger audience, opens its doors and the following year, in **1999**, Inditex acquires **Stradivarius**, becoming the fifth Inditex chain. In this same year, **Lefties** becomes part of Inditex, as a **Zara outlet**, although today it incorporates its own collection, it is estimated that around 70% of what it sells, to the point that, from sources outside the organization, it is said that it could become the 9th ensign in a short time.
- **2001**: the lingerie chain **Oysho** was launched and Inditex began trading on the stock market. Two months later the Group was already part of the **Ibex 35.**
- **2006**: Inditex expands its strength in Spain with the opening in León of an important **Logistics Center** for the entire Northwest.

- **2007**: the Logistics Platform is inaugurated in Alcalá Meco, Madrid. It was in this same year when the first **online store** of the group was launched by Zara Home.
- **2008**: Inditex launched what is to date its latest firm, **Uterqüe,** dedicated to the world of complements and accessories. At the end of that year, Inditex already extended its presence to **72 countries**.
- **2010-2022**: Despite the crisis, and after the 45 years that separate us from the opening of the first Zara store, today Inditex continues to maintain its position of world leadership, ahead of GAP and H&M.

2.2.- Description of the group

For the analysis of the company, it is necessary to know its trajectory, its beginnings, its main competitors, its strategies, its environment, and its main characteristics. For this reason, in this section will analyze the company, its competitors, its different companies, and the analysis of the Inditex environment.

2.2.1.-Inditex stores and products

As I explained in the previous section, Inditex has created successful companies, currently the group is made up of seven companies, each one dedicated to a different sector of the population, thus distinguishing the companies according to their target audience.

ENTERPRISE	**PRODUCT**	**TARGET**
ZARA	**Clothing and accessories**	**Men, women, and children**
PULL&BEAR	**Clothing and accessories**	**Young people**
STRADIVARIUS	**Clothing and accessories**	**Young women**

Massimo Dutti	**Clothing and accessories**	**Middle-aged men and women**
OYSHO	**Underwear and sportswear**	**Young women**
Bershka	**Clothing and accessories**	**Young people**
ZARA HOME	**Home accessories**	**Middle-aged men and women**

Source: own elaboration.

As we observed in the table, **Zara** is a brand focused on women, men, and children, with more classic designs but at the same time in trend, with striking prices, since they are garments like those of luxury but at lower prices.

On the one hand, **Pull&Bear** is a brand focused on young people, both boys and girls, where youth trends are found at an affordable price for them.

Stradivarius is a youth brand focused mainly for young women, where you will find all kinds of casual clothing.

On the other hand, the brand **Massimo Dutti,** offers more elegant designs at a higher price for middle-aged men and women offering more classic and elegant looks.

Oysho is a brand that offers underwear, sports, pyjamas and swimwear for women, especially young women.

Bershka is a clothing brand for young people, both boys and girls at lower prices and offers the most daring and youthful looks at low prices.

Finally, **Zara Home** is a brand that offers all kinds of accessories for the decoration of the home, giving a youthful and modern style.

As we can see, Inditex has a large group of companies that each specializes in a type of customers, so we could conclude in this section that the company is using a market **diversification strategy**, since for each of its target audience it provides different products depending on their age and income.

2.2.2.- Analysis SWOT

In the following point, we proceed to analyze the strengths, weaknesses, opportunities, and threats of the Inditex group, thus making an analysis Swot.

Strengths	Inditex has a quality and design, they made fashion with the latest designs at very reasonable prices.
	They use Just in time, the production of garments that are going to be sold and quickly distributed to stores thanks to an important system of logistics. Allows high rotation product and not having stocks.
	Inditex has a strong financial system; they are a solid company and profitable. Sales and gross margin have risen, and the shares are well appreciated.
	The group make Mini collections all year round, this has great variety of models, and all adapted to the tastes and weather of the moment. Avoiding having products that they are not sold.
Weaknesses	Their Market saturation: by having products of good quality and good prices, everyone has them so that with them no differentiation is acquired.
	Cannibalism between brands: Brands play the competition between them.
	Centralized distribution in Spain: Disadvantage in its international expansion because it is more costly and slow product distribution.
	Weak personnel policy: unmotivating employment, with low wages, long hours of work, contract temporary, without the

	possibility of promotion, without training and without participation systems or contribution to improve the product.
Opportunities	Growth of municipalities: due to price of dwellings in cities, the population is moving to outlying municipalities that are growing little by little. are places where new stores can be opened.
	Creation of outlets: clothes from other seasons at lower prices. It is a possibility of reaching more people and trying to sell not-so-consumed products.
	Population aging: increase in life expectancy. The population is more mature and is a sector that generally has higher purchasing power. They can increase the sales.
	Growing interest in personal image: and, for fashion, including the youngest, men, and even pregnant women, disinterested sectors in the past.
Threats	Current economic crisis: people spend less money on unnecessary things like fashion.
	Increased competition in the sector: because in recent years, fashion has ceased to be for the higher classes.
	Demanding customers: Everyone knows about fashionable today and almost everyone cares about dressing well. In addition, there are groups of people who don't want to go dressed like others want to stand out.
	Creation of online stores: they have lower costs, and they also allow people to buy clothes from anywhere in the world without having to commute. You can access all fashions.

Source: own elaboration.

The company has many strengths, and the environment offers opportunities that it can still exploit. In terms of threats the company faces some such as the current economic crisis or weaknesses competition between their own brands. The Inditex group can continue expanding and increasing their market share and continue being the leader of the textile industry.

2.2.3.-Analysis of the competitors

Currently, the Inditex company is the leader in the textile market, but even so there are great competitors of the group, of which we can highlight **Mango, H&M** and **GAP**.

- **Mango:**

  Punto Fa, S.L., operating as Mango, is a Spanish multinational dedicated to the design, manufacture and marketing of clothing and accessories for women, children, and men.It is considered the main rival of Inditex.Its fashion and designs are very similar to those of Inditex, consumers loyal to Inditex are also loyal to this company.

  Mango bases its logistics on an internal system that has been developed progressively since its opening, what has made this company in the second largest exporter of textiles in Spain. To guarantee the quality of your products, the company delivers the finished goods to their franchisees.
- **H&M:**

  The H&M group is one of the most important fashion companies in the world, thus also being one of the most important in Sweden. The group has 8 brands: H&M, Weekday, Monki, COS (Collection of Style), H&M Home, & Other Stories, Arket and AFound.

  H&M sells mostly its own products made by its designers, although it also offers garments from both designers external to the company, like other brands. However, what attracts the consumer is the brand H&M itself, not feeling any loyalty towards the different brands marketed by this company. It is important to mention that the consumers choose this retailer because it offers products like those of large and expensive haute couture brands, at affordable prices. This means that H&M not only competes with other companies that offer low price but also with the other brands you imitate. Like Zara, H&M is not the one dictating trends in the industry but is able to adapt them quickly.

- **GAP:**

  Gap employs more than 150,000 people and owns more than 3,000 stores in several countries. It is a major American clothing retailer based in San Francisco. It has clothing chains, Old Navy, and the shoe brand Piperlime. Its revenue in 2005 was 16 billion dollars.

  Like some of its closest competitors, Gap has developed collaborations with recognized couture clothing brands. Valentino created an exclusive collection for women that was presented by Gap in November 2010. Gap had previously partnered with Stella McCartney to launch a children's collection.

To conclude with the competitors of Inditex, as can be seen, both Mango and Inditex are characterized by their large distribution to the Spanish market, therefore they are in the first and second position of major Spanish textile exporters respectively, while H&M and GAP are characterized by their extensive collaborations and the brand loyalty of their customers.

Figure 1 Fashion Groups in Spain (Source: Moda.es)

As we can see in the Figure 1, in Spain, the fashion industry is led by Inditex and followed by Mango. Globally it is followed by HyM, but in Spain this company does not have as much power as Mango or Cortefiel. In summary, Inditex dominate the textile sector in Spain.

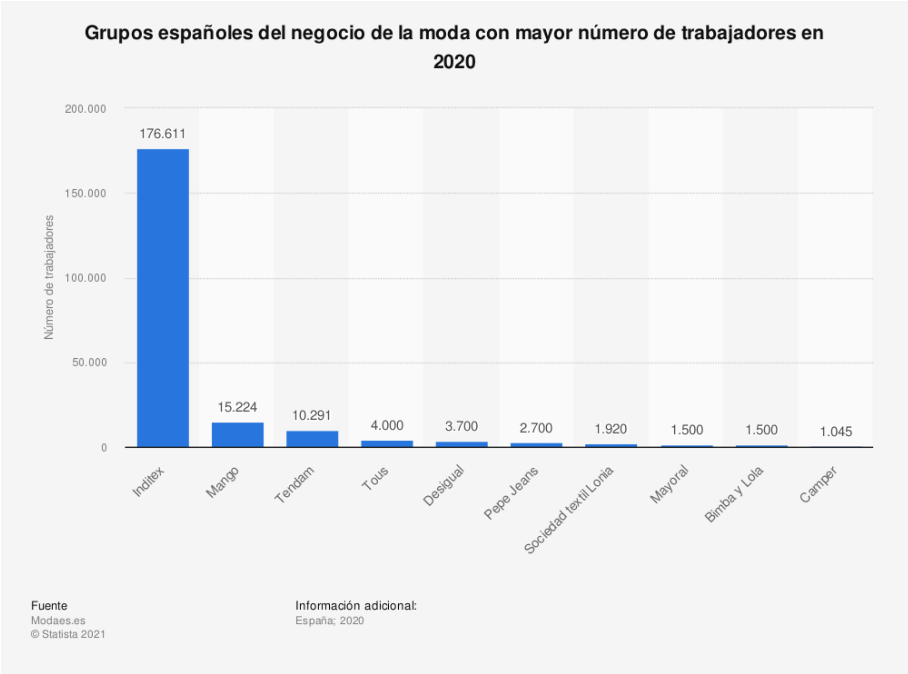

Figure 2 Spanish Fashion Groups Employers (Source: Stastica.com)

In the previous figure of Stastica.com, the figures of workers in the Spanish textile enterprises in 2020 are shown, as can be seen, the list is headed again by Inditex with the largest number of employees in 2020, proving once again that it is the leader in the industry.

2.2.4.- Analysis PESTEL

In the next point we will analyze the general environment of the company using the PESTEL analysis. The company is in **Spain**; therefore, the analysis of the general environment is focused on this country.

Political and legal factors

Spain is a member of the European Union, whose form of government is the parliamentary monarchy and constituted a social and democratic State under the rule of law. It governs a coalition government formed largely by the socialist left and the president of the government is Pedro Sánchez.

On the other hand, it is a country marked by nationalisms where in addition to Spanish there are more co-official languages such as Galician, Basque, or Catalan; a noteworthy point since companies must follow a series of rules at national level, for example, customer support in different languages.

Economic Factors

The Spanish economy, like its population, is the fifth largest in the European Union and the thirteenth in the world. The service sector is the most important, it is worth highlighting the importance of tourism in this.

Since 2008, the Spanish economy has been suffering a major recession, which has led to a fall in public spending, consumption, employment, income, and investment.

Gradually, the economy has been recovering until March 2020 where the covid-19 pandemic has created a health crisis and again an economic recession. The purchasing level of the population is medium-high, and inequality levels have increased during the covid-19 crisis.

Social Factors

The society in Spain is dynamic and advanced, it has been growing remarkably, which has achieved that the industry is modernized and that the construction of equipment and infrastructure has been possible.

The population has a minimum monthly wage of 800€ per month, and a PIB per capita around 22300€ per year. Life expectancy in Spain is 83 years.

Technological Factors

Spain presents a wide variety of high and medium-high technology technological factors. Renewable energies, such as wind and solar energy, cover many subsectors, increasing many jobs.

On the other hand, more and more companies are introducing new technologies, with the aim of obtaining greater profits, reducing costs, and improving production, the use of information and communication technologies means accelerating and automating the processes of the production chain.

Ecological Factors

Spain assumes environmental policies, thus presenting almost no water pollution, as well as good air quality compared to other European countries, but many of the Spanish provinces are contaminated by the abuse of motor transport and the emission of toxic gases and waste by many of the industries operating in our country, In addition, it is the second country in the European Union with the largest forest area and 40% of this area is located in protected areas.

Legal Factors

As regards fiscal tasks:

Spain has one of the highest tax systems in the euro area, characterised by:

• IVA of 21%.

• corporate profit tax of 30% for large companies.

• tax on corporate profits of 25% for small and medium-sized companies.

2.2.5.-Business Strategy

The company's strategy is how the company competes in the industry to achieve its main objectives. In this section we will analyse the strategy that Inditex to be leader in the Spanish textile industry.

First, the nature of the product is analysed, in this case Inditex uses a low-cost strategy, since their designs tend to be unique designs but at low prices.

Second, the integration of the value chain, in this case Inditex is fully integrated into it, since it is the company that takes care of everything in the process of manufacturing and distribution of its products.

Third, the diversification of the company is considered, as explained in the section on products and brands, Inditex has a wide variety of brands, each focusing on a different sector of the population according to their income and age.

Finally, the geographical diversification of the company, Inditex is a company that has more than 7500 stores throughout the world, therefore Inditex is geographically diversified.

Concluding in this section, we could confirm that the success of the company Inditex is to follow a low-cost product strategy, to be fully integrated in its value chain, to diversify in different markets, both at the target audience level and geographically.

3.- Financial Analysis of Inditex

As we have seen in the various previous sections, the Inditex company is the head of the textile industry in Spain, so we will proceed to analyze the accounts of the company, to verify with figures, the good performance of the company and in turn calculate its intrinsic value to know if it is a good option for investors to invest in Inditex in the long term.

Having analyzed the environment in which Inditex operates and the strategies implemented to continue to be a reference point in the Spanish market, the next step is to observe its economic and financial performance.

3.1.- Balance sheet and Income Statement.

The first step is to analyse the evolution of the company's main items to have an overview of the company's development.

	2021	2020	2019	2018	2017
Non-current assets	**15.460**	**16.977**	**11.064**	**10.084**	**9.723**
intangible Assets	6.122	6.660	1.016	919	911
Property, Plant and Equipement	7.401	8.355	8.339	7.644	7.283
Other Non current-Asssets	1.937	1.962	1.709	1.521	1.528
Var. Non current Assets (%)	**-8,9%**	**53,4%**	**9,7%**	**3,7%**	
Current Assets	**10.958**	**11.414**	**10.620**	**10.147**	**9.898**
inventory	2.321	2.269	2.716	2.685	2.549
Accounts Receivable	973	954	928	1.047	969
Other Current Assets	7.664	8.191	6.976	6.415	6.381
Cash ans Cash Equivalents	7.398	4.780	4.866	4.931	4.116
Var. Current Assets (%)	**-4,00%**	**7,48%**	**4,66%**	**2,51%**	
Total Assets	**26.418**	**28.391**	**21.684**	**20.231**	**19.621**
Var. Assets (%)	**-6,95%**	**30,93%**	**7,18%**	**3,11%**	

Table 1 Inditex Assets evolution (thousands €), 2021-2017 (Source: own elaboration with data from SABI).

The evolution of the assets of the Inditex company explains the company's growth process in recent years. As can be seen in the table, the company has grown slightly over the years, highlighting the great growth in 2020 and the decrease in 2021, due to the 2019 Sars-Covid19 health crisis.

The notable growth in 2020 is reflected above all in non-current assets, where we can see how from 2019 to 2020 it increases significantly.Looking at the company's assets, Inditex mainly invests its assets in plant and production, since being a company of the textile industry its biggest assets are related to the production and distribution of its products.

Regarding current assets, we observe that during the years it grows little, highlighting in 2020 the growth of other current assets, which increases compared to 2019.

Concluding with this part of the balance, we could conclude that the assets of the Inditex company have a positive and notable growth.

	2021	2020	2019	2018	2017
Shareholder's Equity	**14.550**	**14.949**	**14.683**	**13.522**	**12.752**
Registred Capital	94	94	94	94	94
Other Funds	14.456	14.855	14.589	13.428	12.658
Var. Shareholder's Equity (%)	**-2,67%**	**1,81%**	**8,59%**	**6,04%**	
Non-current Liabilities	**5.530**	**6.136**	**1.618**	**1.536**	**1.419**
Lon-term Creditors	4.602	5.169	5	1.009	0
Other Non-current Liabilities	928	967	1.613	527	1.419
Provisions	252	217	229	259	242
Var. Non-current Liabilities (%)	**-9,88%**	**279,23%**	**5,34%**	**8,22%**	
Current Liabilities	6.338	7.306	5.383	5.173	5.451
Financial Debts	11	32	84	12	62
Commercial Creditors	4.659	5.443	5.099	3.577	5.095
Other Current Liabilities	1.668	1.831	200	1.584	294
Var. Current Liabilities (%)	**-13,25%**	**35,72%**	**4,06%**	**-5,09%**	
Total Liabilities	**23.988**	**27.101**	**14.231**	**13.677**	**13.981**
Var. Total Liabilities (%)	**-11,49%**	**90,44%**	**4,05%**	**-2,18%**	
Total Liabilities and SE	**26.418**	**28.391**	**21.684**	**20.231**	**19.621**
Var. Total Liabilities and SE (%)	**-6,95%**	**30,93%**	**7,18%**	**3,11%**	

Table 2 Inditex Liabilities and Equity evolution (thousands €), 2021-2017 (Source: own elaboration with data from SABI)

As for the company's liabilities, during the years 2017 to 2019 it grew little, in 2020 there was a notable increase in long-term creditors and commercial creditors.

Therefore, we conclude that as well as the assets of the company, its debts and liabilities have also grown a little.

	2021	2020	2019	2018	2017
Total Operating Income	**20.402**	**28.286**	**26.145**	**25.336**	**23.311**
Var. Operating Income (%)	**-27,87%**	**8,19%**	**3,19%**	**8,69%**	

Table 3. Operating Income of Inditex (thousands €), 2021-2017. (Source: own elaboration with data from SABI)

	2021	2020	2019	2018	2017
Procurements	9.065	12.033	11.360	11.076	10.032
Personal Expenses	3.376	4.430	4.136	3.961	3.643
Depreciation and Amortization	2.742	2.824	1.210	963	968
Other Expenses	-3.764	-3.780	-5.113	-5.022	-4.647
Total Operating Expenses	**11.419**	**15.507**	**11.593**	**10.978**	**9.996**
Var. Operating Expenses (%)	**-26,36%**	**33,76%**	**5,60%**	**9,83%**	

Table 4 Operating Expenses of Inditex (thousands €), 2021-2017.(Source: own elaborationwith data from SABI)

	2021	2020	2019	2018	2017
Inditex Employees	**144.117**	**176.611**	**174.386**	**171.839**	**162.450**
Var. Nº Employees	**-18,40%**	**1,28%**	**1,48%**	**5,78%**	

Table 5 Number of Inditex employees, 2021-2017. (Source: own elaborationwith data from SABI)

As can be seen in the table, the company's employees increase progressively except for 2021, when the number of employees decreases sharply due to the consequences of the Sars Covid-19 pandemic.

	2021	2020	2019	2018	2017
EBIT	**1.507**	**4.772**	**4.357**	**4.314**	**4.021**
EBITDA	**4.249**	**7.596**	**5.567**	**5.277**	**4.989**
Var EBIT (%)	**-68,42%**	**9,52%**	**1,00%**	**7,29%**	
Var EBITDA (%)	**-44,06%**	**36,45%**	**5,50%**	**5,78%**	

Table 6 Inditex's EBIT and EBITDA (thousands €), 2021-2017. (Source: own elaborationwith data from SABI)

The operating result grows year after year, except in 2021, that decreases in the last period.

	2021	2020	2019	2018	2017
EBIT	**1.507**	**4.772**	**4.357**	**4.314**	**4.021**
Financing Revenue	39	92	86	67	69
Financing Expenses	145	183	15	30	11
Common size of Financial expenses with respect to EBIT	**1039,31%**	**2607,65%**	**29046,67%**	**14380,00%**	**34975,07%**
Financing Income	-106	-91	71	37	58
Corporate Tax	297	1.034	980	979	917
Net Income	**1.104**	**3.647**	**3.448**	**3.372**	**3.161**
Var. Net Income (%)	**-69,73%**	**5,77%**	**2,25%**	**6,67%**	

Table 7 Inditex's EBT and Net Income (thousands €), 2021-2017. (Source: own elaboration with data from SABI)

This part of Net Income represents the favorable financial situation of Inditex. As can be seen, except for 2021, as we have explained in the previous sections, the company's net income grows during the 2020-2017 period, once again demonstrating the company's financial strength.

In general, the Balance Sheet and Income Statement shows the image of a company that is making a strong investment in the future.

We can conclude that, except for the year 2021 when the company, like the entire economy, is having the consequences of the pandemic, the company shows its firm and consolidated accounts.

Therefore, Inditex is an apparently profitable and financially company and therefore appears to have a large operating margin in the short and medium terms.

3.2. Intrinsic value of Inditex.

After analyzing the history of the company, its competitors, its environment, and its strategies, in addition to analyzing its financial statements and verifying that Inditex is a firm company with prospects, it is now possible to proceed to obtain a reasonable range of estimated values for it, which is done in the present subsection of the paper.

As stated before, the Discounted Cash Flow Model (DCFM) is applied to define this reasonable range of value estimates. Such application follows all the methodological aspects discussed in subsection 1.3.1. above. Given that it is assumed that Inditex Free Cash Flows (FCFs) will vary in the future at their historical average percentage change, the first thing needed to do is to obtain the company's FCFs for several historical accounting years. This is done obtaining Inditex accounting information from SABI and applying the generic formula for calculating FCF according to the Corporate Finance Institute (see subsection 1.3.1.2. above):

FCF = Net Income + Non-Cash Expenses – Incrase in Working Capital – Capital Expenditures

equation 6 FCF (Source: Corporate Finance Institute)

For representative and practical considerations, the historical years chosen to obtain Inditex FCFs are from 2015 to 2021. After obtaining Inditex FCFs for each one of these seven accounting years, their historial average percentage change is calculated. Table 8 below summarizes the results obtained.

	2021	2020	2019	2018	2017	2016	2015
Net Income	1.104	3.647	3.448	3.372	3.161	2.882	2.510
Amortizations	2.742	2.824	1.210	963	968	957	843
Var AR	19	26	-119	79	211	-172	19
Var I	52	-447	31	136	354	335	183
Var AP	-567	5.164	-1.004	1.009	0	-2	0
CapEx	-954	16	695	361	686	557	903
IntEx	-538	5.644	97	8	23	6	36
Amortizations	2.742	2.824	1.210	963	968	957	843
Free Cash Flow	**3.092**	**-6.756**	**3.748**	**1.781**	**1.888**	**2.157**	**1.369**
Var. Free Cash Flow	145,77%	-280,26%	110,46%	-5,65%	-12,50%	57,59%	
Average Var. Free Cash Flow	**2,57%**						

Table 8 Inditex Free Cash Flows (thousands €), 2015-2021. (Source: own elaboration with data from SABI)

Once obtained the historical average percentage change of the seven annual FCFs of Inditex, it is assumed that its future annual FCFs will vary at this historical average to forecast them for the next four years (2022-2025). The following table summarizes the calculations made to obtain the WACC and the growth rate of Inditex.

	2021	2020	2019	2018	2017
SE/D+SE	43,27%				
D/D+SE	56,73%				
R_f	1,13%				
R_M	15,2260%				
β	1,2228				
ke	0,1837				
kd	0,0072				
kd*(1-Tax Rate)	0,0056				
WACC	**8,27%**				
PIBpc	23693	27.057	26.440	25.370	24.970
Var. PIBpc	-12,43%	2,33%	4,22%	1,60%	
Average Var. PIBpc	**-1,07%**				
var.Deua+neto	-7,592745%	54,286441%	0,954501%	9,192363%	
average deuda+neto	**14,210140%**				
average pib y deuda+neto	**6,570%**				

Table 9 Inditex's Discount Rate and Growth Perpetuity Rate. (Source: own elaboration)

Let us explain a little bit the calculations summarized in Table 9. For the calculation of WACC in year 2021 we use the formula 2, explained in section 1.3, where the method of discounting cash flows is explained. On the one hand, for the case of the cost of debt (Kd), Inditex's accounting information for year 2021 has been employed. On the other hand, for the case of the cost of equity (Ke), the CAPM is applied with the following estimation of its parameters:

- First the obtaining of the Return of a risk-free asset, according to the statistics of the Public Treasury in 2022, the effective interest rate in December 2021 of bonds and bonds at 2025 years is **1,128%.**
- Secondly, for the calculation of the expected return of the stock market in which Inditex's shares are traded, the series of daily returns in 2021 of the IBEX35 Index has been calculated from the daily values of the index obtained from the website Investing. Afterwards, the expected daily return of the index is calculated, obtaining a return of **0,0388%**, and the expected annual return has been calculated using the annual effective interest rate formula, obtaining an expected return of the market in annual terms equal to **15,2260%.**
- Thirdly, the Inditex Beta at 1 year according to SABI at 22/04/2022 with the reference index IBEX 35 is **1,22**.

The value of the WACC calculated in this way is **8,27%.**

For the calculation of the growth rate, two elements have been considered. The first one is the historical average percentage change of the Spanish GDP per capita over years 2017-2021. The second one is the historical average percentage change of the Inditex accounting value (Equity and Debt) over the same rage of years. The first growth rate employed to estimate the intrinsic value of Inditex is the arithmetic mean of these two historical average percentage changes. More precisely, it is assumed that Inditex and its FCF at year 2025 will grow at perpetuity at a growth rate of **g=6,57%.**

Table 10 below synthetizes the estimated future annual FCFs over years 2022-2025 with the calculations in Table 9 to estimate the intrinsic value of Inditex applying the Discounted Cash Flow Model (DCFM) as explained in subsection 1.3.1 above.

FORECASTING PROCESS AND INTRINSIC VALUE					
	2021	2022	2023	2024	2025
Net Income	1.104,00	1.132,35	1.161,43	1.191,25	1.221,84
Amortizations	2.742,00	2.812,41	2.884,63	2.958,71	3.034,69
Var AR	19,00	19,49	19,99	20,50	21,03
Var I	52,00	53,34	54,70	56,11	57,55
Var AP	-567,00	-581,56	-596,49	-611,81	-627,52
CapEx	-954,00	-978,50	-1.003,63	-1.029,40	-1.055,83
IntEx	-538,00	-551,82	-565,99	-580,52	-595,43
Amortizations	**2.742,00**	2.812,41	2.884,63	2.958,71	3.034,69
Free Cash Flow	**3.092,00**	**3.171,40**	**3.252,84**	**3.336,37**	**3.422,05**
***1000**	3.092.000,00	3.171.400,28	3.252.839,50	3.336.370,02	3.422.045,54
g	**6,57%**				
r	**2,57%**				
wacc	**8,27%**				201.634.023,02
FCF to Discount	**3.092.000,00**	**3.171.400,28**	**3.252.839,50**	**3.336.370,02**	**3.422.045,54**
Discounted Cash Flows		**2929233,617**	**2775035,44**	**2628954,43**	**158.881.256**
suma	**167214479,2**				
Number of shares outstanding (2021)	**3.116.652.000**				
Intrinsic Value of a share	**0,053651957**				

Table 10 Inditex's forecasted accounts and FCF (thousands €), 2022-2025. (Source: own elaboration)

As seen in the Table 10, the estimated future annual FCFs considered are positive and the estimated intrinsic value of Inditex according to the DCFM is **167.214.479,2€**, and its shares have an estimated value of **0,053€.** The company obtains a high intrinsic value and a positive value of its shares; therefore, we can conclude that the company in a favorable scenario obtains positive FCFs and therefore can invest in Inditex in the long term.

Therefore, in this section we can conclude that if in the meantime the company grows by 6,57% at a weighted average cost of capital of 8,27% the Inditex company will obtain positive net cash flows in the future, thus concluding that it is a firm enterprise in which it can be invested in the future.

Now the next step is the calculation of the different scenarios in which the company can be found according to the characteristics of the economy at the time.

It is very important to calculate the scenarios to know how the company and its net cash flows react to the different situations in which the economy can find itself in the future.

But before performing the different scenarios, you must calculate the WACC and the growth rate at which net cash flows will grow in the long-run future. As the company and the economy can grow in different ways, the following scenarios have been contemplated:

-The **first scenario** contemplated is the one considered above in which the long-run growth rate of Inditex is g= 6,57% and that their net cash flows will be discounted to a WACC of 8,27%.

	SCENARIO 1				
	2021	2022	2023	2024	2025
Forecasted Free Cash Flows	**3.092.000**	**3.171.400**	**3.252.839**	**3.336.370**	**3.422.046**
Discount Rate (k)	**8,267%**				
Growth Perpetuity Rate (g)	**6,570%**				
Terminal Free Cash Flow					**201.634.023**
Discounted Cash Flows		**2.929.234**	**2.775.035**	**2.628.954**	**158.881.256**
Firm's Value	**167.214.479**				
Number of shares	3.116.652.000				
Intrinsic Value of a share	**0,05365**				

Table 11 Inditex's Intrinsic Value Calculation on an optimistic scenario (Source: own elaboration.

-In the **second scenario**, it will be assumed that the company follows its strategy correctly, thus using a discount rate k=8,27%, In terms of the long-run growth rate, we are going to assume that this growth rate is a weighted average in which the weight of economic fluctuations is going to be considered more important than the weight of company growth. Therefore, the economy is weighted at 80%, while the company at 20%, thus obtaining a growth rate of 1,99%.

As can be seen in Table 12, Inditex estimated intrinsic value per share in this pessimistic scenario for the economy is equal to 0,01645. Note that a decrease in the long-run growth rate of 69,71% implies a smaller decrease in Inditex intrinsic value (a decrease equal 68.96%). We can conclude that Inditex is a strong company and although the economy is in recession, the company can go on getting a relatively high intrinsic value.

	SCENARIO 2				
	2021	2022	2023	2024	2025
Forecasted Free Cash Flows	**3.092.000**	**3.171.400**	**3.252.839**	**3.336.370**	**3.422.046**
Discount Rate (k)	**8,27%**				
Growth Perpetuity Rate (g)	**1,99%**				
Terminal Free Cash Flow					**54.480.821**
Discounted Cash Flows		**2.929.234**	**2.775.035**	**2.628.954**	**42.929.170**
Firm's Value	**51.262.393**				
Number of shares	3.116.652.000				
Intrinsic Value of a share	**0,01645**				

Table 12 Inditex's Intrinsic Value under an economic deceleration. (Source: own elaboration)

-In the **third scenario**, the possibility arises that the company is in a crisis phase, either because its products are no longer sold, or because of financial problems or because its competitors have taken over the entire market. Therefore, FCFs will be required a discount rate of k=10%, while the growth rate remains g=6,75%.

As shown in Table 13, Inditex estimated intrinsic value per share in this pessimistic scenario for the company is equal to 0,026643. Note that an increase of the WACC of 20,92% implies a higher decrease in Inditex intrinsic value (a decrease equal 49,73%). This implies that, according to our value estimates of Inditex applying the DCFM, the company is more sensitive to internal problems than to economic difficulties.

	scenario 3				
	2021	2022	2023	2024	2025
Forecasted Free Cash Flows	3.092.000	3.171.400	3.252.839	3.336.370	3.422.046
Discount Rate (k)	10,00%				
Growth Perpetuity Rate (g)	6,57%				
Terminal Free Cash Flow					99.770.402
Discounted Cash Flows		2.883.091	2.688.297	2.506.664	74.958.980
Firm's Value	83.037.032				
Number of shares	3.116.652.000				
Intrinsic Value of a share	0,026643				

Table 13 Inditex's Intrinsic Value under operating difficulties. (Source: own elaboration)

-In the **last scenario** it will be assumed that Inditex is facing internal problems, reflected by a WACC equal to 10%, but at the same time the effect of the relatively bad economic situation is softened by its strength (in this sense it is assumed that the long-run growth rate is a weighted average in which economic fluctuations represent a 40%), obtaining a long-run growth rate of 8,10%.

Although the company is in its two worst situations, the company still obtains positive FCF and a positive intrinsic value, which allows us to state that although Inditex is at its worst scenario it is still a strong company and that it can grow favorably in the future.

	scenario 4				
	2021	2022	2023	2024	2025
Forecasted Free Cash Flows	3.092.000	3.171.400	3.252.839	3.336.370	3.422.046
Discount Rate (k)	10,00%				
Growth Perpetuity Rate (g)	8,10%				
Terminal Free Cash Flow					179.926.930
Discounted Cash Flows		2.883.091	2.688.297	2.506.664	135.181.766
Firm's Value	143.259.818				
Number of shares	3.116.652.000				
Intrinsic Value of a share	0,045966				

Table 14 Inditex's Intrinsic Value under operating difficulties in a decelerating economy. (Source: own elaboration)

Once the 4 stages are calculated, we can observe the difference in the value of the shares of Inditex. From favorable conditions for the company to the next possible situation, the company Inditex shows strength and demonstrates to investors that it is possible to invest in Inditex because, although the company were in an unfavorable scenario, its intrinsic value per share according to our estimations and application of the DCFM is relatively high.

Finally, after calculating the different intrinsic values per share in the scenarios considered, we can conclude that a reasonable range of Inditex estimated intrinsic values per share is the following:

Vo€ = (0,016, 0,053)

4.-Conclusion

The main purpose of this work is to obtain different intrinsic values of the company Inditex to be able to check if the company works in the long term assuming different scenarios in which it can be found following the growth of the company and the economy. As has been observed, the company Inditex is firm and obtains in all the scenarios intrinsic values reasonable to the characteristics of the company and the evolution of the economy in the future.

For the calculation of the intricate value of the company, a previous analysis of the company, the industry, its strengths, and weaknesses, in addition to the analysis of its balance sheet and profit and loss account has been made. But before this there is a reason to study, and it is the Spanish company Inditex is the head of the textile industry in Spain, in addition to having stores around the world and leading in exports in the textile sector.

This work has allowed me to learn a lot about the company Inditex, first its evolution as a company, as its owner, Amancio Ortega, went from opening a simple clothing store to having eight different clothing brands where their stores have been implanted all over the world. Besides knowing in detail all its companies, its different products, and its target audience.

Secondly, at work I have learned the place where Inditex is positioned as leader of the textile industry, in addition to knowing its main competitors, Mango, H&M and GAP and buy their similarities and differences and their environment as a Spanish company. I have also been able to know their weaknesses and strengths, and their threats and opportunities, as well as their strategies of low prices and product and geographic diversification.

On the other hand, I have delved into the concept of valuation of companies. I have known its beginnings and its creator Benjamin Graham, as his intentions as an investor created a very useful financial tool for any investor who wants to invest in a long time in a company and to do so want to know the real value of it, its value by action and its evolution in the future.

In addition to delving into the importance of this financial tool and the types of valuations that we can find according to which parts of the Balance and the account of losses and profits you decide to predict.

Finally, the most important part and the objective of the work, the calculation of intrinsic values. For this I have delved into the discount method of FCF, where the main objective is to predict the future FCF of the company, through a growth rate of the present FCF, and establish different scenarios where the company and the economy grow differently, to see how the intrinsic value of the company varies according to the different conditions of the economy and the company. For the calculation of the intrinsic value, the FCFs are updated at a pre-calculated cost of capital and at a growth rate g, also calculated.

In this last section, in terms of financial results, we can see how the company grows continuously except for 2021, which has been affected by the global pandemic of Covid-19. Even so, it maintains a strong growth in its accounts demonstrating that it has financial capacity to meet its debts, has a large amount of assets dedicated exclusively to the manufacture and distribution of its products, net results are also increasing.

To conclude with this work, the main objective is the calculation of the different intrinsic values of Inditex, in this case the company reacts to its different scenarios in a reasonable way.

Therefore, we could conclude the work by stating that Inditex, that the leading company in the textile industry, is a good option to invest in the long term, since its evolution in the future is positive and its intrinsic values are favorable.

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