Lisbon School of Economics & Management
Universidade de Lisboa

MASTER
FINANCE

MASTER´S FINAL WORK
PROJECT

EQUITY RESEARCH: HERMÈS INTERNATIONAL

RITA LOPES SILVA

OCTOBER 2021

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SUPERVISION:

ANA ISABEL ORTEGA VENÂNCIO

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Abstract

This Equity Research aims to present a valuation of Hermès International in respect of ISEG – Lisbon School of Economics and Management's Master's in Finance final work. This document has been prepared in accordance with the recommendations of the Chartered Financial Analyst (CFA) Institute.

The choice for Hermès International was due to the fact that it is one of the leading companies in the Luxury Goods industry, holds the highest margins in the sector and, unlike its most direct competitors, does not have a portfolio of several strong commercial brands but a single really strong brand, Hermès.

The valuation exercise and the price target were obtained using the Discounted Cash Flows (DCF) method, namely the Free Cash Flows to Equity (FCFE). Complementarily, we conducted a valuation analysis from the perspective of Free Cash Flows to the Firm (FCFF), Dividend Discount Model (DDM) and relative valuation using the market multiples EV/EBITDA, EV/Revenue and P/E.

The price target obtained by DCF method was €994.05 per share, implying a potential downside of 16.9% compared to the closing price of €1,195.50 as of 30 September 2021 (valuation date). Taking in consideration the results obtained the final recommendation stands for **SELL**.

Resumo

O presente trabalho apresenta uma estimativa de valor da empresa Hermès International e das suas ações, no âmbito do Trabalho Final de Mestrado do Mestrado em Finanças do ISEG – Instituto Superior de Economia e Gestão. Este documento foi elaborado de acordo com as recomendações do CFA Institute.

A escolha pela Hermès International deveu-se ao facto da mesma ser uma das empresas mais conceituadas da indústria de *Luxury Goods*, deter as maiores margens do setor e, ao contrário dos seus mais diretos competidores não possuir um vasto portfólio de diversas marcas comerciais, sendo a sua principal marca a Hermès.

O exercício de avaliação e o preço-alvo foram obtidos através do método dos Fluxos de Caixa Descontados (DCF) na perspetiva do acionista (FCFE). Complementariamente foi realizada uma avaliação pelos fluxos de caixa libertos na perspetiva de empresa (FCFF), pelo método dos dividendos descontados (DDM) e pelo método relativo, nomeadamente os múltiplos de mercado EV/EBITDA, EV/Revenue e P/E.

O preço-alvo obtido pelo DCF foi de €994,05 por ação, o que implica uma desvalorização potencial de 16.9% face ao preço de fecho a 30 setembro 2021 (data da avaliação) de €1.195,50. Face aos resultados obtidos a nossa recomendação é de **VENDA**.

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Abreviations

€b	*euro billions*
€m	*euro millions*
CAG	*Compensation, Appointments and Governance*
CAGR	*Compound Annual Growth Rate*
CapEx	*Capital Expenditures*
CAPM	*Capital Asset Pricing Model*
CRP	*Country Risk Premium*
CSR	*Corporate Social Responsibiltiy*
D&A	*Depreciations and Amortizations*
DCF	*Discounted Cash Flow*
DDM	*Dividend Discount Model*
DPS	*Dividends Per Share*
E	*Earnings*
EBIT	*Earnings Before Interest and Taxes*
EBITDA	*Earnings Before Interest Taxes Depreciation and Amortization*
EMDE	*Emerging Markets and Developing Economies*
EPS	*Earnings Per Share*
EV	*Enterprise Value*
FCFE	*Free Cash Flow to Equity*
FCFF	*Free Cash Flow to Firm*
FMA	*Financial Markets Authority*
FMCG	*Fast Moving Consuming Goods*
GDP	*Gross Domestic Product*
IPO	*Initial Public Offering*
LG&S	*Leather Goods and Saddlery*
M&A	*Mergers and Acquisitions*
MRP	*Market Risk Premium*
P	*Price*
PP&E	*Property Plant and Equipment*
ROA	*Return on Assets*
ROE	*Return on Equity*
ROIC	*Return on Invested Capital*
SG&A	*Selling, General and Administrative*
WACC	*Weighted Average Cost of Capital*
xxxxA	*Actual Period*
xxxxF	*Forecast Period*
YE	*Year End*
YoY	*Year on Year*
YTD	*Year to date*

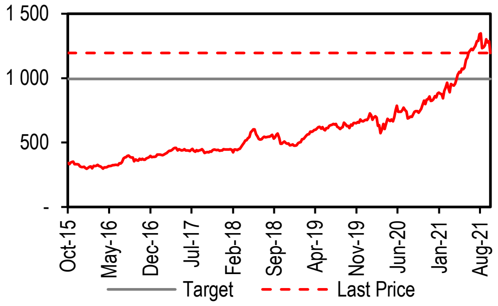
Hermès International

Outstanding brand outperforming the industry

Last Price	Fair Value	Recommendation	Industry	Ticker	Exchange
€1,196.50	€994.05	Sell (16.9% downside)	Luxury Goods	RMS	Euronext Paris

Figure 1: Fair Value range

Bear	Base	Bull
871	994	1,144



Source: *Capital IQ (CIQ); The Author*

Table 1: Key Statistics (09/30/2021)

Last price	€1,196.50
Market cap	€125,206m
Shares outstanding	104.60m
Free float	32,4%
52-Week High	€1,354.50
52-Week Low	€516.00
52-Total return	60.2%
YTD Total return	34.7%
Dividend yield	0,3%
Last results	H2FY2021
Price/Fair value	1.20
5-Yr Revenue CAGR	10.3%
5-Yr EBITDA CAGR	14.2%
5-Yr EPS CAGR	16.5%

Source: *CIQ; The Author*

Research Snapshot

Recommendation: Our recommendation for Hermès International is to **SELL**, with a 2021YE price target based on a DCF model of €994.05 per share, implying a downside potential of -16.9% from the closing price of €1,196.50 as of 30 September 2021 (see Figure 1). Over the last 52 weeks the stock rallied delivering an exceptional return of 60.2% and 34.7% YTD (see Table 1).

Outstanding exclusive brand

Hermès has a stable moat over his competitors that combines the perception of high exclusivity, historical heritage and best-in-class vertical integration, which is hard to replicate and should keep the company as one of the most desired brands in the high-net-worth luxury goods market. These characteristics, combined with significant pricing power, limited supply and demand visibility for its most iconic products make Hermès somewhat protected against cyclical headwinds.

Outperforming the industry

Over the years, Hermès has been consistently outperforming the market both in revenue growth and margins, delivering an EBITDA margin of 38% and 36% in 2019YE and 2020YE, respectively, against an average of 17% and 14% for its peers. For the years to come demand should be driven by the increasing number of middle-class and high-net-worth individuals globally, particularly in China, which is expected to remain the biggest growth driver. At the date of this report, it is still difficult to predict the economic impacts of the recent developments of the real estate market in China, therefore we have not considered any specific assumption regarding this matter.

After an impressive 2021H1, where the revenue came at €4,235m, a growth of 77% YoY and 33% against 2019, achieving a record EBIT margin of 40.7% (34.8% in 2019), we forecast a total revenue for the year of €8,358m and a total EBIT of €3,397m (40.6% margin). From 2021YE we model a CAGR 2021YE-25YE of 9%, with an average premium over the market of 2.1% (3.6 pp. less than the historical average), with a stable EBIT margin of 38.2% from 2023YE onwards (see Table 2).

Main risks

The main risks are a decline in the brand's products appeal, issues with supply constraints, resale market, counterfeits and economic factors, as the covid pandemic.

Table 2: Financial highlights

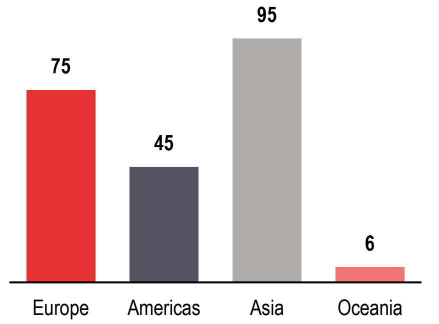
Highlights (€m)	2018A	2019A	2020A	2021F	2022F	2023F	2024F	2025F
Revenue	5,966	6,883	6,389	8,358	9,657	10,683	11,267	11,810
EBITDA	2,534	2,787	2,587	3,936	4,381	4,733	5,020	5,274
EBIT	2,128	2,339	2,073	3,397	3,780	4,083	4,306	4,514
Net income	1,406	1,528	1,385	2,236	2,494	2,698	2,848	2,987
EPS (€)	13.48	14.66	13.27	21.42	23.89	25.83	27.27	28.60
DPS (€)	4.55	4.55	4.55	8.03	9.55	10.33	10.91	11.44
Valuation	**2018A**	**2019A**	**2020A**	**2021F**	**2022F**	**2023F**	**2024F**	**2025F**
EV/Revenue	8.41	10.48	14.75	15.70	13.59	12.28	11.65	11.11
EV/EBITDA	21.26	25.07	40.32	33.34	29.95	27.73	26.14	24.88
EV/EBIT	23.41	29.80	51.61	38.63	34.71	32.14	30.47	29.07
P/E	38.42	48.14	83.21	55.87	50.09	46.31	43.88	41.84
Dividend yied (%)	0.90	0.68	0.80	0.61	0.73	0.79	0.83	0.87
ROIC (%)	0.51	0.54	0.41	0.59	0.61	0.61	0.61	0.61

Source: *CIQ; The Author*

Figure 2: Revenue by sector (2020YE)

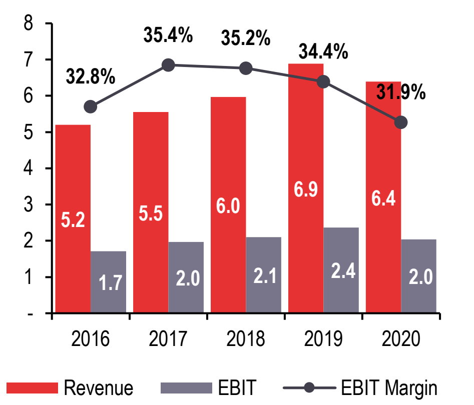
Source: *Hermès*

Figure 3: Branches (2020YE)



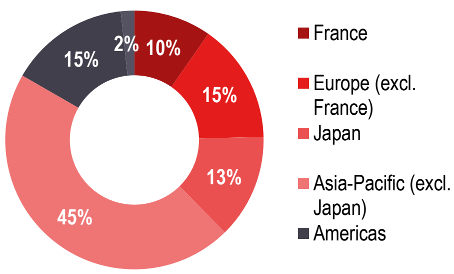
Source: *Hermès*

Figure 4: Revenue and EBIT (€b)



Source: *Hermès*

Figure 5: Revenue by region (2020YE)



Source: *Hermès*

Business Description

Hermès International SA (RMS) is a French leading luxury brand founded in 1837, in Paris, by the harness-maker Thierry Hermès, when he opened a workshop in rue Basse-du-Rempart. The harnesses he made combined discreet finesse and endurance, features that earned him an award at the Universal Exhibition of 1867. From that moment on, the six generations' company has an history composed of successful milestones detailed in appendix 17. The company is primarily involved in designing, manufacturing and marketing luxurious goods and is best known for its Birkin and Kelly bags. Its biggest segments are Leather Goods and Saddlery (50%), Ready-to-Wear and accessories (22%), Silk and Textiles (7%) (see Figure 2). The remaining segments include perfumes, watches, jewelry, and home furnishing products.

Hermès succeeds to deliver unique and luxury objects designed to last. Its high integrated business model, from the manufacturing facilities to the stores, allows Hermès to have fully control of the operational flows. Hermès products are sold worldwide through 306 exclusive stores, of which 221 are operated as branches. The company is owner of 60 of the 64 production sites that it operates, including 51 in France and the others spread across Switzerland, the United States, Australia, Italy, Portugal and the United Kingdom (see Figure 3).

Despite the headwinds from the pandemic, the revenue 2020YE came at €6,389m, which represented a decrease of only 6% YoY at constant rates, with Asia-Pacific being the biggest region achieving €3,749m (accounting for 45% of the revenues), followed by Europe (€1,573m) and Americas (€959m) (see Figure 4 and 5). Europe was the region most affected by the effects of the pandemic, with a decrease of 23.6%, followed by Americas (20.5%). On the other hand, the Asian market return its growth trajectory in the second half of the year, finishing the year with 9.9% YoY. The operating income was €2,073m representing a margin of 32.4%, a decrease of 1.6 pp. compared to 20219YE.

For 2021 the Group expects the return to grow at constant exchange rates, focusing on the development and launching of new products, reinforcing and diversifying its distribution network and investing in new production sites.

Strategy

Unique objects designed to last

Hermès is in its sixth generation of the family, which allowed to preserve the genesis of the company and its founders intact through the years. Based on the creativity freedom and *savoir-faire* of its craftspeople and the highest quality standards of its production processes and materials, Hermès creates unique objects designed to last and be passed on. The quality, timelessness and exclusivity of its products makes some of its more iconic products, like the famous bags Birkin and Kelly, being perceived as an investment, with their resale value market at a premium to retail price.

Integrated vertical network

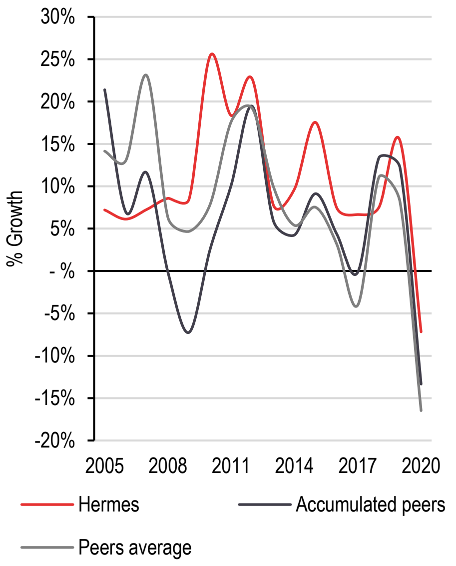
The company has a wide control on its production and distribution with an integrated vertical network from the sourcing and treatment of the raw materials, design and production of final products, distribution to its exclusive stores and sale to the customers. These rare characteristics allow Hermès to have a greater control across its entire value chain compared to its competitors, which outsource the majority of their production.

Anti-cyclical exclusivity

With a culture anchored in the timeless creation and quality of its manufactured products, the company is probably one of the most exclusive brands in the luxury goods market. The recognition and exclusivity of the brand is such that the demand for its products – especially from the Leather Goods & Saddlery like Birkin and Kelly bags – that the demand exceeds the supply for some of their products, leading to a significant pricing power, demand visibility, consistent top line growth and somewhat protected against cyclical headwinds.

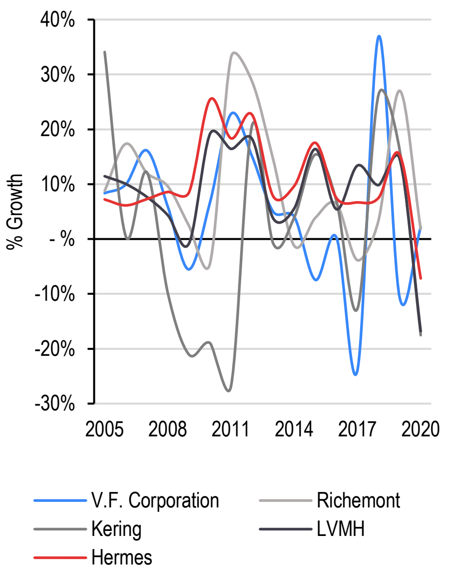
The defensiveness is also demonstrated by its consistent revenue outperformance versus the market and major peers (see Figures 6 and 7). During the recession

Figure 6: Revenue growth vs peers (1)



Source: *CIQ; The Author*

Figure 7: Revenue growth vs peers (2)



Source: *CIQ; The Author*

Table 3: Birkin's and Kelly's price evolution

Year	Kelly	Birkin
1950	€900	-
1960	€1,300	-
1970	€2,450	-
1980	€4,000	€2,000
1990	€5,100	€2,750
2000	€7,400	€4,000
2014	€9,250	€11,500

Source: *Bagover*

periods, the exceeding demand ahead of supply protects the downside, while in expansion periods the revenues is capped by the production capacity constraints.

The exclusivity of the brand is anchored in the craftsmanship, *savoir-faire* and quality since the company was founded by Thierry Hermès. The brand equity is such – especially in the leather products – that the LG&S division not only supports Hermès revenue by its own but also boosts other division revenue due to the accessory buying effect.

According to Lyst platform[1], although bags as category saw less demand over 2020 due to the pandemic, the interest for classic products, such as Hermès bags, spiked and the searches for pre-owned Hermès bags – especially Birkin, Kelly and Constance models - were up 430% compared to the previous equivalent period a year earlier.

Pricing power

As previously mentioned, all the unique characteristics of Hermès lead to a business model extremely difficult to replicate and a strong pricing power. Hermès' best-selling bags are sold on average at a price 4x-5x higher than most of its peers, therefore enjoys a privileged position compared to the competition. Additionally, the company is very disciplined with its pricing strategy. The fully controlled distribution and demand visibility helps mitigate the risk of overproduction without the need to use discounts.

Although the main revenue driver has been the volume increase, over the recent years the company has been constantly updating its prices (see Table 3), particularly in its Leather and Goods division with a price increase of 2% to 3.5% per year, in line with its competitors. Hermès' products experience low demand elasticity among its core customers, who tend to have higher purchasing power. Additionally, due to the exclusive nature and appeal of Hermès' products, the Veblen Good effect might work in favor, meaning that as the price of its products increases the demand follows.

Waiting list, accessory buying and secondary market

The structurally lower supply than the demand results in three compensation mechanisms: (i) waiting lists; (ii) secondary market and (iii) accessory buying:

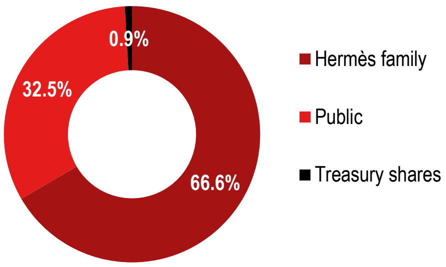
- **Waiting list** – Over the last years, for Birkin and Kelly bags, due to the lower supply, customers were put on a waiting list that would take as long as 6 years. More recently due to the demand being too high Hermès has been reluctant to put anyone on the waiting lists and has been working on shortening the waiting time. Instead, the costumers need to continue visiting the stores, and have a bit of luck to grab one before they sold out. Despite Hermès efforts, the waiting time to buy a Birkin or Kelly is still too long, surpassing months and even years, which lead more clients to buy in the secondary market or adopting the accessory buying strategy.

- **Secondary market** – The mismatch between the supply and demand led to the development of a secondary market where the pre-owned handbags are sold on legitimate platforms for a large premium over the retail price. In the resale market some of the most iconic handbags reach up to several tens of thousands of euros. The development of the resale market might be detrimental to Hermès' volume growth and potentially to brand equity. On the other side, one could argue that resale platforms can contribute to reinforce the interest and the exclusivity of the most iconic products of these lines. Although the eventual pros and cons of the secondary markets, what some fashion sites report is that price increases in these markets are even higher compared to Hermès' own stores. We think that if the company starts to perceive that the proliferation of the resale market is prejudicial, it will try to implement measures to contain the sale of its products on these channels.

- **Accessory buying** – In order to be perceived as important customers by the sales assistants, more clients are adopting the 'accessory buying' strategy. The general belief is that to buy the most iconic model's, clients may buy a considerable number of other less pricey products, such as watches or

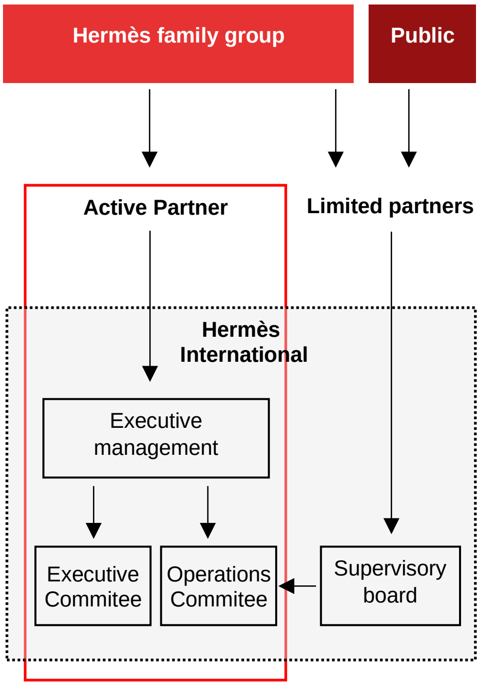
[1] https://www.lyst.com/data/data-drop-wednesday-02-10-21/

Figure 8: Shareholder's structure



Source: *Company data*

Figure 9: Governance structure



Source: *Company data*

Table 4: Supervisory board

Name	Position
Éric de Seynes	Chairman
Monique Cohen	Vice-Chairwoman
Dominique Senequier	Vice-Chairwoman
Dorothée Altmayer	Member
Charles-Éric Bauer	Member
Estelee Brachlianoff	Member
Mathieu Dumas	Member
Blaise Guerrand	Member
Julie Guerrand	Member
Olympia Guerrand	Member
Renaud Momméja	Member
Alexandre Viros	Member
Pureza Cardoso	Member
Rémy Kroll	Member

Source: *Company data*

clothes, and by doing that they get access to the most exclusive bags more easily.

Below is a testimonial from a Birkin buyer[2]

During these two months, I made few purchases of non-Birkin/Kelly items, such as cashmere shawls, silk scarves and fashion jewelries before I was finally offered a black Birkin in gold hardware. This one took a long time because the items I bought were popular Hermès products that had lower sales commissions. It would have been much quicker if I bought less popular products that had higher commissions, such as fine jewelry, clothing, and home products. While different stores have different requirements, the current general standard in the States is:

Spending $4,000 to $8,000 on non-Birkin/Kelly items to receive an offer for a basic leather Birkin/Kelly.

Spending over $20,000 on non-bags to get offered a special order (where you can design your own bag).

Spend a lot more and become a big client for an offer for a crocodile or ostrich Birkin/Kelly/Constance.

Iconic handbags

While the Leather and Goods division drives the overall group revenue, Birkin and Kelly represent the division's best-selling. These two handbags have represented more than 50% in the past but as more products are launched this percentage has been declining.

Kelly, launched in the 30s, and Birkin, in 1984, are perceived as really masterpieces. What makes these handbags so unique is essentially the craftsmanship involved and the scarcity of high-quality materials used. Below are some of the most relevant characteristics associated to these two icons:

- Each handbag is totally handmade by one single artisan in the entire production process.
- An artisan needs on average 5 years of training before being allowed to create a Birkin on his or her own.
- It takes 18h to 30h, depending on the details, for an artisan to produce one single bag and each artisan can produce 10 to 15 bags a month.
- Each Birkin is unique. Each bag is marked with a code that identifies the year it was produced, the artisan who made it and the workshop.
- The handbag is reparable for life. Each handbag is sent to its original artisan to be repaired as new.
- The raw materials used have the best quality and are worked with extremely care.

Corporate Governance

Shareholder Structure

Hermès is a family company where Hermès family owns directly 66.6% of its share capital. The main shareholder is Émile Hermès SARL, whose partners are the direct descendants of Émile-Maurice Hermès and his wife. 32.5% of the remaining share capital is public and 0.9% are treasury shares due to buybacks. The largest shareholder after the members of the family is the Capital Research and Management Company (1,89%), followed by Morgan Stanley Investment Management (1,37%) and The Vanguard Group (0,99%) (see Figure 8).

The Executive Chairmen's roles are distributed as follows: (i) Axel Dumas is in charge of strategy and operational management, (ii) Émile Hermès SARL, through its

[2] https://koboguide.com/where-to-buy-birkin-bag/

Table 5: Executive committee

Name	Position
Axel Dumas	Executive Chairman
Florian Craen	Executive Vice-President Sales & Distribution
Charlotte David	Executive Vice-President Communication
Pierre-Alexis Dumas	Artistic Executive Vice-President
Olivier Fournier	Executive Vice-President of Governance and Organizational Development
Catherine Fulconis	Executive Vice-President Leather Goods-Saddlery
Wilfried Guerrand	Executive Vice-President Information Systems and Data
Éric do Halgouet	Executive Vice-President Finance
Guillaume de Seynes	Executive Vice-President Manufacturing Division & Equity Investments

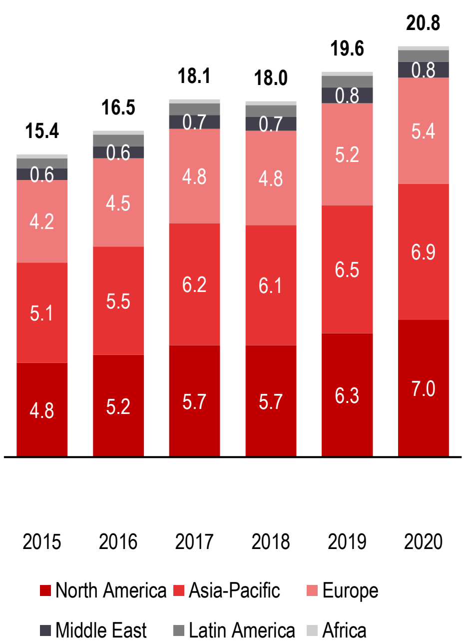
Source: *Company data*

Table 6: Management compensation

Year	Axel Dumas	Henri-Louis Bauer
2017	2,774,656	1,256,409
2018	3,092,816	1,256,409
2019	3,403,423	1,381,933
2020	3,403,423	1,381,933

Source: *Company data*

Figure 10: High net worth individuals by region (millions)



Source: *Capgemini*

Executive Management Board, is responsible for the vision and strategic priority areas.

The current CEO, Axel Dumas, is part of the sixth generation of the Hermès-Dumas family, having held various positions in the company since joining in 2003 until becoming CEO in 2014.

Emile Hermès SARL is an entity whose partners are direct descendants of Émile Maurice-Hermès and his wife. Its Executive Chairman is Henri-Louis Bauer, also a direct descendant.

Governing Bodies and Corporate Governance

Hermès International is a partnership limited by shares, an hybrid structure with two types of partners: (i) one active partner or partners who carry on the business and are jointly and severally liable for all the Company's debts, represented by Emile Hermès SARL, and (ii) the limited partners (or shareholders), who contribute capital, are liable only up to the amount of their contribution (see Figure 9).

In return for unlimited liability, the Active Partner, is a stakeholder in the operation and organization of Hermès International. It has structuring powers such as strategic, operating and investment options and appointment of the Executive Chairmen. The limited partners, in return for liability limited to the amount of their contributions, have their powers limited mostly to approving consolidated financial statements, appointing Statutory Auditors and appointing the members of the Supervisory Board. By law, the limited partners are prohibited from having any interference in company's external management on pain of being liable under the same conditions as the Active Partner.

The framework of corporate governance followed by Hermès is the Afep-Medef since 2009. The Group also follows the recommendations issued by the French Financial Markets Authority (FMA). An Executive Committee supports the Executive Chairmen (see Table 5). This committee consists of eight managing directors, each of whom with well-defined areas of responsibility. Its role is to oversee Hermès' strategic and operational management.

The supervisory board, represented by 14 members, of which 50% are women and one third are independent members, whose main function is to control company's management (see Table 4). The Audit and Risk Committee is composed by 5 of the 14 members and the Compensation, Appointments, Governance and CSR Committee (CAG-CSR) by 3 of the 14 members.

Executive compensation system

The compensation for the Executive Chairmen follows a 4 stage process: (i) the Active Partner proposes the compensation for the year, (ii) the CAG-CSR committee verifies that the actual proposed compensation complies with the compensation policy and assesses the criteria for the variable compensation, (iii) the Supervisory Board issues a decision on the actual compensation and (iv) "ex-post" vote on actual compensation on the Ordinary General Meeting.

The actual compensation for the Executive Chairmen comprises a fixed and a variable component. The fixed compensation is capped at €457,347, this limit was introduced in 2001. Since then this component is indexed upwards only in accordance with any increase in consolidated revenue for the previous financial year over the year before that at constant scope and exchange rates. The variable component, that has remained constant since the IPO, is capped at 0.20% of the consolidated net income before tax generated in the previous financial year (see Table 6).

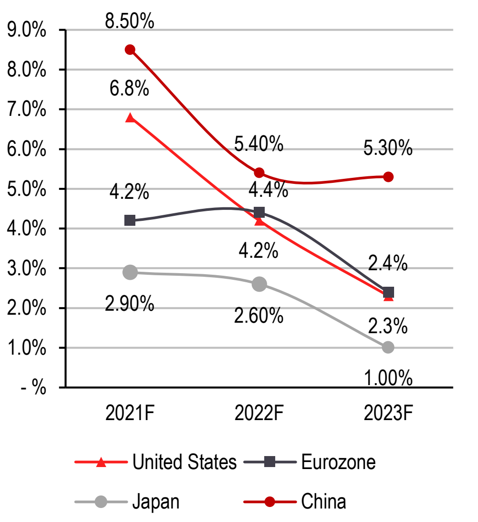
Industry Overview and Competitive Positioning

Macroeconomic summary

After contracting 3.5% in 2020 due to the covid-19 pandemic, the global economy has gained momentum in 2021. Nevertheless, it remains at lower levels compared to pre-pandemic projections and this recovery is unbalanced between different countries.

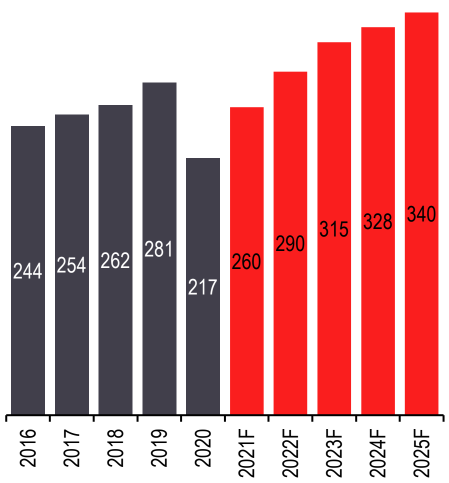
In developed economies, progresses in containing the pandemic, in particular through the ramp up of the vaccination programs, are expected to stimulate demand and reduce the gap between advanced-economy output and its pre-pandemic trend.

Figure 11: GDP growth



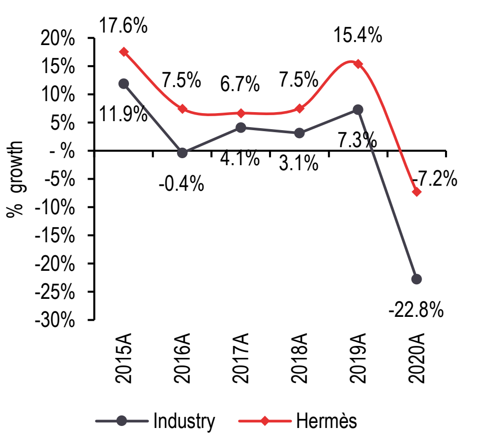
Source: *World Bank*

Figure 12: Market size (€b)



Source: *Bain Altagamma*

Figure 13: Market growth vs Hermès (€b)



Source: *Bain Altagamma; Company data*

Additionally, the economic and fiscal incentives of the governments and main central banks have accelerated this process.

According to the World Bank (2021) we are witnessing a two-speed recovery in developed economies, where product sales are practically at pre-covid levels while services continue to struggle to overcome the constraints of the pandemic. It is estimated that growth in these economies will be 5.4% in 2021, 4.3% in 2022 and 2.2% in 2023. The main driving force behind this recovery is the United States, supported by its aggressive fiscal incentive program, with an estimated growth of 6 .8% in 2021, 4.2% in 2022 and 2.3% in 2023.

In the **Eurozone,** including France, although the slower vaccination process delayed the economic recovery, an acceleration is expected in the second half of 2021, with an annual growth of 4.2%, 4.4% in 2022 and 2.4% in 2023.

Japan, after having an economic recovery in the second half of 2020, the economy contracted again at the beginning of 2021, hampered by the tightening of measures for fear of a new wave after the second wave in Europe. The GDP is expected to grow 2.9% in 2021, 2.6% in 2022 and 1.0% in 2023.

In **China**, after a 2.3% growth in 2020, the trend is expected to continue, with a growth of 8.5% in 2021, 5.4% in 2022 and 5.3% in 2023. In order to reduce the risk of financial stability, support measures have been gradually being withdrawn in 2021 (see Figure 11).

In **emerging markets and developing economies** (EMDE), despite the increase in external demand driven by the developed economies, recovery has been limited due to the emergence of new waves and variants of covid-19, as well as the delay the in vaccination programs and reduced macroeconomic supporting measures. According to the World Bank (2021), the delay in economic recovery could have structural impacts on the long-term economic growth forecast before the pandemic. Currently, the most recent estimates, including China, point to an aggregate growth of 6.0% in 2021, 4.7% in 2022 and 4.4% in 2023.

Luxury Goods Industry and its Main Drivers

The Luxury Goods industry includes leather goods, apparel, shoes, perfumes and cosmetics, jewelry, watches and others. Luxury goods are characterized by:

- **High production costs** essentially due highly manual manufacturing processes, quality of raw materials and highly specialized craftspeople.
- **High sales prices** made up of both the gross value of the product, but also the value of the brand.
- **Non-essential goods** that, for their practicality, could be replaced by goods with the same function at a much lower price.
- **Source of satisfaction and inner fulfillment** for owning the products is greater than the value of using the products itself.
- **Scarcity and preciousness** make the products exclusive and intended only for a limited number of consumers.

This industry has been facing several changes in the past decades, where varying economic trends, rapid digital transformation and evolving consumer preferences created a completely different competitive landscape over the years.

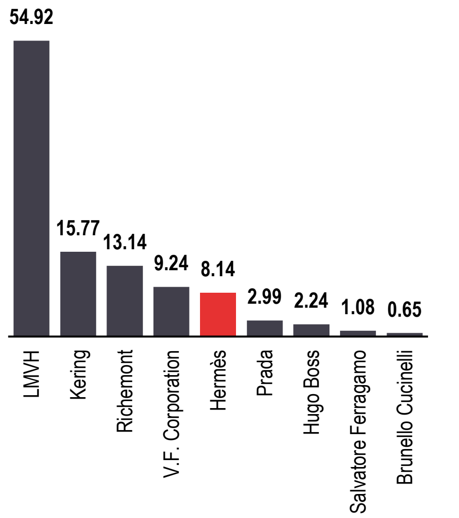
A new ground has been set for the industry, where the demand increases more than proportionally with the rise in real income of consumers despite any geopolitical and economic factors.

Market overview and outlook

Globally, this industry tends to be classified as monopolistic competition in a multiregional business sphere. The personal luxury goods market can be segmented by product basis (accessories, apparels and beauty items), distribution (wholesale and retail) and channel (offline and online).

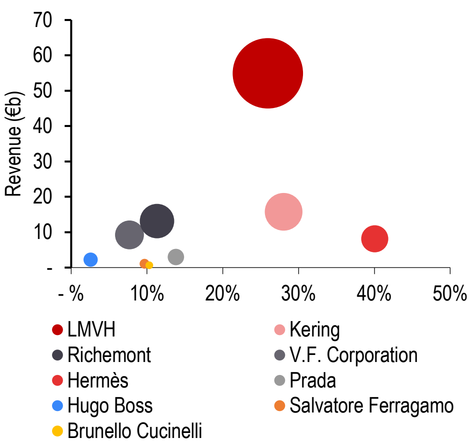
According to Bain Altagamma (2021), the personal luxury goods market achieved in 2020 a total of €217b in revenue, a contraction YoY of 22% at constant rates (€281b in 2019). After the financial crisis of 2007-2008 the market grew at a CAGR 2009YE-2019YE of 6.7%. In 2019 the main segment was apparel, driving 23% of the market's total revenue, followed by perfumes and cosmetics (21%), leather goods (20%),

Figure 14: Revenue vs peers (€b)



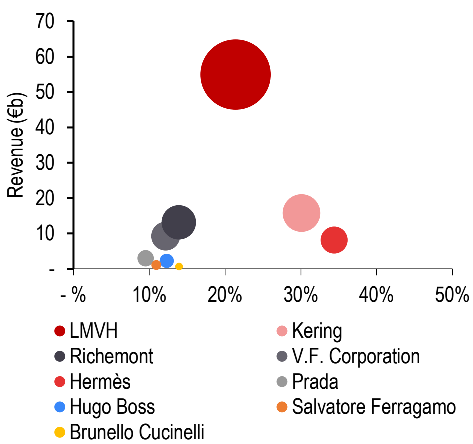
***Source:** Companies' data*

Figure 15: Revenue and operating margin vs peers (2021 LTM)



***Source:** Companies' data*

Figure 16: Revenue and operating margin vs peers (2019)



***Source:** Companies' data*

watches (14%), shoes (7%) and jewelry (7%). The study estimates an overall market recovery of 20% in 2021, to €260b, and a CAGR 2021YE-25YE of 7%, reaching €340b in 2025YE (see Figures 13 and 14).

Overall, the continuous and sustainable upward trend of the industry has reinforced its position, as one of the most profitable, stable and attractive industries to invest in, worldwide.

Key to sound revenues

Worldwide revenues are mostly driven by high-end sustained growth of demand in key regions, reflecting both local and tourist robust consumption and the rise in the number of high-net-worth-individuals, which is directly related with the growing net household affluence.

Furthermore, as the market rises in sophistication, the integration of different retail channels allied with the evident development of the digital luxury experience in *e-commerce* platforms and the retail evolution through the opening of single brand stores, where the customers can enjoy the luxury experience, are also driving the sustained growth in the industry.

The decline in the negative sentiment regarding excessive consumption and the rise in self-reward, status-seeking, connoisseurship and individuality expenses, which is fueled by the renewed confidence in the future economic prospects, leads to an increase in the industry's global revenues

A costly innovation.

Luxury is an innovation-driven industry, which relies not only on the ability to continuously innovate the artistic and handicraft abilities, but also on increasingly efficient distribution and logistics models.

In order to succeed, luxury brands must focus on strengthening its image and effectively communicate its value to consumers, which implies intense marketing related expenditures.

Additionally, with the outstanding development of the online channel, physical stores need to be reinvented to better engage with customers and to be transformed into deluxe places, delivering a distinctive and emotional luxury experience that younger generations, local consumers and tourists search for. In this context, companies are investing enormously in both physical stores and the recruitment of new talents with the higher specialization required to win in this luxury environment.

High-end demand outlook

Over the last year prior to the pandemic, there has been an overall YoY improvement, with a strong performance, sustained by the increasing demographics and a solid GDP growth. This has reflected in the rise of the purchasing power of the middle class, especially in emerging markets, leading to an increase of consumer demand for luxury goods. The rise in preferences for luxury goods can be pointed out as a strong reason for the development in the communication systems, which have greatly influenced market trends, such as luxury brands collaborations and the boom in the streetwear fashion statement.

The demand for luxury products is essentially driven by 3 reasons: social, individual and cultural. Customers tend to buy exclusive and expensive products due to a matter of status, whether for the pleasure associated with owning the goods or for the feeling of belonging to a group of consumers. The smaller the supply the greater the interest of the demand.

Luxury goods have income elasticity of demand, i.e. as individual income increase, so does demand. Conversely, a decrease in income also translates into a decrease in demand. Within luxury goods we have what are considered Veblen goods which are those with a positive price elasticity of demand relationship, that is, in products that are considered status symbols, if the price increases also does demand, as consumers perceive it as having a higher value.

Supply chains

Due to the scarcity of supply compared to demand, companies end up having some kind of visibility on market demand before the production process, which contributes to a certain stability. Unlike Fast Moving Consuming Goods (FMCG) industry, the

Table 7: Luxury brands Instagram followers (2021)

Name	Position	Followers
Chanel	Fashion	46.4
Gucci	Fashion	45.8
Louis Vuitton	Fashion	45.8
Dior	Fashion	37.7
Prada	Fashion	27.5
Versace	Fashion	24.9
Burberry	Fashion	18.3
Armani	Fashion	17.6
Valentino	Fashion	15.4
Tiffany	Jewellery	12.6
Rolex	Watch	12.0
Balenciaga	Fashion	12.0
Hermès	Fashion	11.1
Cartier	Jewellery	11.0

Source: *Instagram; The Author*

luxury goods are characterized by a long production cycle which in turn leads to a long delivery cycle. This contributes to the mismatch between supply and demand, with supply being reduced and demand being high. Brands are very strict in terms of the quality requirements of their final product and require maximum rigor and quality throughout the entire supply chain process. Unlike other industries, luxury brands sell

not only the final product but an entire experience in which they seek to offer the best

service, materials, and aesthetics. In recent years, due to a demand increase in the Chinese market, companies are making greater efforts trying to reduce delivery times in order to keep up with competition and gain market share in this huge market. Regarding products' development, companies have been turning themselves to be increasingly influenced by customers and to meet their interests. The design of the products is essential not only for their success but also to distinguish each brand from the others in order to make their pieces unique.

Resale market

With strong market drivers from both demand and supply, the resale market has grown in recent years. The primary driving forces from the demand side are (i) the increased perception of luxury goods as an investment, (ii) aspirational consumers who aspires to own luxury brands even though they are value constrained and (iii) the increase demand and difficulty to obtain products in the primary market. On the supply side the main drivers are (i) the strong market growth in recent years (increasing the overall number of products in circulation), (ii) increasing number of trustworthy platforms and (iii) online platforms have contributed to a more dynamic resale market and more recognition for both brands and platforms.

Strategies

The fashion industry is very propitious to M&A activity, as observed within the main conglomerates. Nevertheless, it is a key factor for all those groups to respect each brand individually, never corrupting its identity and values.

All peers present consistent and similar strategies, accordingly to the market evolution. With a client-oriented point of view, they try to meet customer expectations and needs. One way to accomplish that is to have a wide portfolio of products.

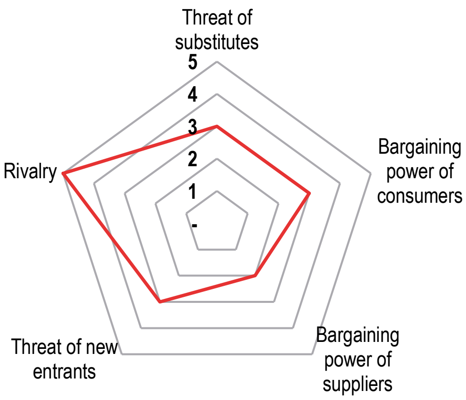
Consumer's behavior has changed throughout the years, starting with the "*millennials*", which are primarily using digital channels to keep up with trends. As such companies are continuously investing to improve their digital and social presence, not only through their website and social media networks, where they use fashion bloggers and influencers, but also in stores with the use of tablets (to manage inventories) and the implementation of large touch screens.

The implementation of an omni-channel is the crucial breakthrough of an integrated shopping involvement that seeks to deliver a seamless customer experience whether shopping in physical stores or online. It combines both using features as "Store availability", "*Click & Collect*" and "Order from store", which is aligned with the importance of immediacy: since trends are constantly changing, if some product is not available at the moment it might be a lost sale. The fashion industry requires increasingly efficient distribution and logistics models, that can provide fast response and immediate information. Companies try to achieve that with the introduction of technological features through the value chain.

SWOT analysis

Strengths	Weaknesses
▪ Demand-driven industry	▪ Dependence on the availability of raw materials (especially leather)
▪ Brand positioning and recognition	▪ Increasing dependence on the Asian market
▪ Wide and exclusive product range	
▪ Strong leadership	
▪ Vertical integrated network	
▪ Pricing power	
▪ Cross-selling	

Figure 17: Porter's five forces



Source: *The Author*

Opportunities	Threats
▪ Store expansion	▪ High competition
▪ Increasing purchasing power of the middle-upper class	▪ Counterfeit products
▪ Investing in digitalization and e-commerce	▪ Increasing resale market
▪ Strengthening other product lines	▪ Uncertain economic environment

Competitive positioning

Bargaining power of suppliers

Even though Hermès produces the majority of its products by hand and in-house, most companies of this industry rely on third parties for production of raw materials used by the manufacturers. There are some producers of raw materials and the prices are not expected to rise substantially.

Companies also rely on many independent non-exclusive manufacturers to produce the vast majority of their products. The high number of alternative manufacturers and the low wages paid to the employees makes the bargaining power of suppliers low.

Bargaining power of buyers

The final consumer does hold some bargaining power. Given the opportunity to choose between the wide variety of stores and brands, which could be described as poorly differentiated from each other in products and prices, the consumer does have the opportunity to choose the one that fits their preferences the best.

Regardless, taking a closer look towards the company perspective, its inventories are sold in an exclusive manner, to only a few selected large wholesale customers, making them dependent on these arrangements.

Threat of substitutes products

There is no substitute product to replace the function of dress, but the consumers of this industry buy luxury apparel clothing for fashion, trend, status and appearance and not for their basic needs. This means that the existent "substitutes" are nothing but the competition. On the one hand, big players have a strong reputation and brand recognition that creates loyalty among their clients. On the other, companies follow the same fashion trends and so, offer similar products.

Rivalry among existing companies

The industry is very competitive as result of its fashion orientation, where it holds a mix of large and small producers and wide diversity of retailing choices. Companies compete worldwide with numerous designers, brans, manufacturers and retailers of apparels, shoes, hard luxury, beauty products and jewelry.

Also, the rise of the online shopping results into more companies entering this industry given the low barriers to entry and increased level of transparency in pricing products and product comparison

Threat of new entrants

High investment needs in marketing and branding makes it challenging for new companies to enter the industry. Also, there is little space for innovation in this industry and when it does occur, new companies might not have the immediate recognition to endure its presence in the industry, being this the reason why few companies have joined in recently, with success.

Nevertheless, new firms might find unique ways to enter the industry through marketing, especially online, as was the case of Farfetch. If the companies do manage to effectively promote and popularize their products, creating a brand reputation with a clear positioning in the market, it is fair to conclude that there is a reasonable level of threat of new entrants.

Investment Summary

Our final recommendation for Hermès is to **SELL**. This recommendation derives from a target price of **€994.05** per share, using a FCFE method, with a downside potential of 16.9% as of 30 September 2021 (see table 8). The target price implies a 2021YE P/E of 46.4x, representing a significant premium to the luxury goods sector. This is justified by a superior and more defensive business model and a more sustainable revenue growth, cash-flows and margins.

Our bull case scenario results in a price target of €1,143.83, implying a downside potential of 4.4% and our bear case scenario a price target of €870.96, implying a downside potential of 27,2% (see Figure 18).

We predict that Hermès' moat will remain somewhat stable against its competitors. The limited supply, structurally lower than the recurring demand for its highly exclusive products, and the significant pricing power should keep the company protected against cyclical headwinds Additionally, its high brand equity, specifically the exclusivity and perceived quality of its products and the unique vertical integrated business model should maintain Hermès on the top of the most desirable luxury good brands in the world.

Figure 18: Base, Bull and Bear scenarios

Source: *The Author*

Table 8: Price target breakdown

DCF breakdown	
Equity Value (€m)	**103,901**
# shares outstanding (m)	104.6
Value per share (€)	**994,05**

Source: *The Author*

Projections

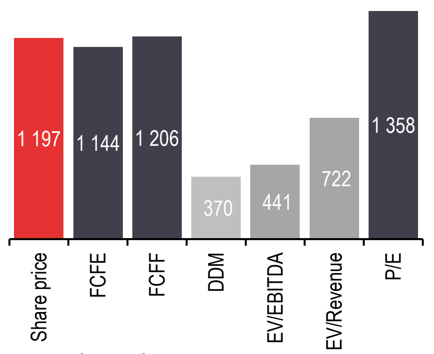
In the **base case** scenario, after an impressive 2021H1, where the revenue came at €4,235m, a growth of 77% YoY and 33% against 2019, we forecast a total revenue for the year of €8,358m and a CAGR 2021-25 of 9%, based on an average premium over the market of 2.1% (3.7 pp. less than the historical average). Over the years Hermès has a track record of beating the overall market and with its brand unique characteristics we estimate that will be able to deliver that premium.

The fast-growing Asian market, in particular China, driven by the increasing number of high-net-work and middle-class individuals should be the main growth driver in the coming years. We estimate the Asia-Pacific region growing 33.4% YoY in 2021YE and a CAGR from 2020YE-25YE of 15.8% (CAGR 2021YE-25YE of 11.8%), reaching €6,070m of revenue in 2025 with 50% of the total revenue (37.6% in 2019 and 45.6% in 2020).

Europe should remain the second most important region in the coming years. We forecast that the opening of the economies from the late part of the H1 of 2021 will allow the region to get back to pre-covid levels in 2022YE, with a CAGR 2019YE-25YE of 2.2% in France and 4.3% in Europe excluding France (CAGR 2020YE-25 of 9.8% and 10.1%, respectively). Please see appendix 10 for more details

After the decreasing trend of the operating margin from 35.7% in 2018YE to 32.4% in 2020YE we expect 2021 to be a turning point, where we estimate a 40.6% margin (40.7% in 2020H1) representing €3.397 of operating income. Nevertheless, with the pandemic being more under control and the consequent normalization of the global market and internal operational activity we expect the operating margin to contract to 39.6% in 2022YE and 38.2% from 2023YE onwards, closer to its historical figures. This contraction reflects the extinguishment of positive effects that the pandemic had on the margin expansion in 2021H1.

Figure 19: Valuation methods (€ per share)

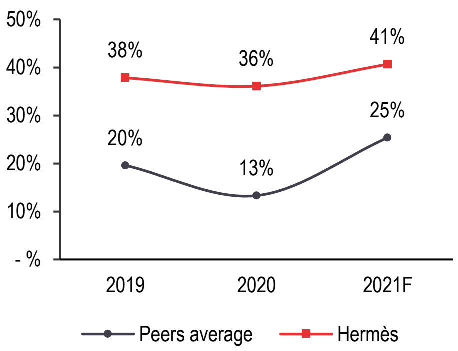


Source: *The Author*

Valuation methods

Our price target of €994.05 was computed using a Discounted Cash Flow Model, namely the Free Cash Flow to Equity. To complement the FCFE we also computed a DCF valuation using the Free Cash Flow to the Firm and the Dividend Discount Model. The FCFF approach resulted in share value of €1,048.43, implying a downside of 12.4%, and the DDM a share value of €320.91.

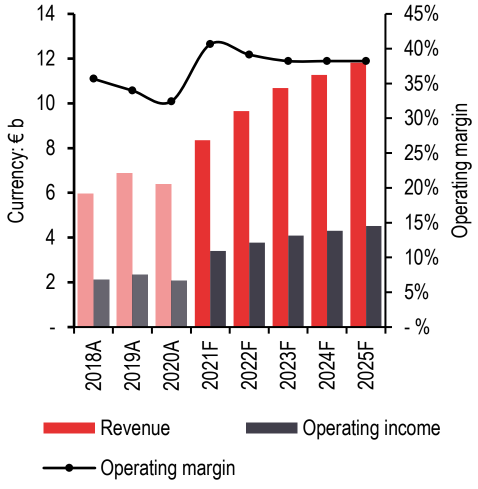
Figure 20: EBITDA margin vs. peers



Source: *CIQ; The Author*

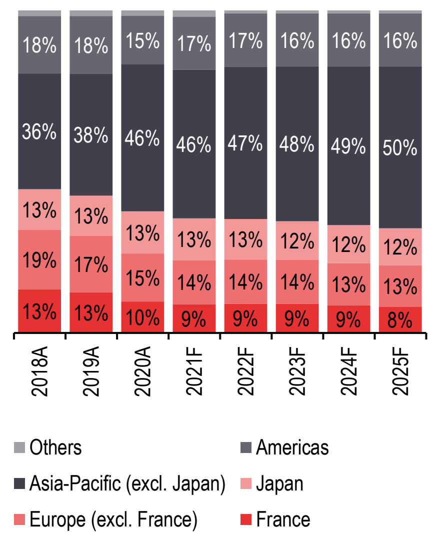
Additionally, we conducted a relative valuation approach, namely the market multiples of EV/EBITDA, EV/Revenue and P/E. Due to the high operating margins compared to its peers and a negative net debt position, the P/E was considered as the most appropriate multiple to be used. The median of the peers of 62.7x, based on the 2021YE earnings per share consensus estimates, results in a share price of €1,342.44, representing an upside of 12.2% from the closing price as of 30 September 2021 of €1,196.50. and 35.1% more than our target price using the FCFE approach (see Figure 19). Since Hermès has a relatively stable capital structure and residual

Figure 21: Revenue and operating income



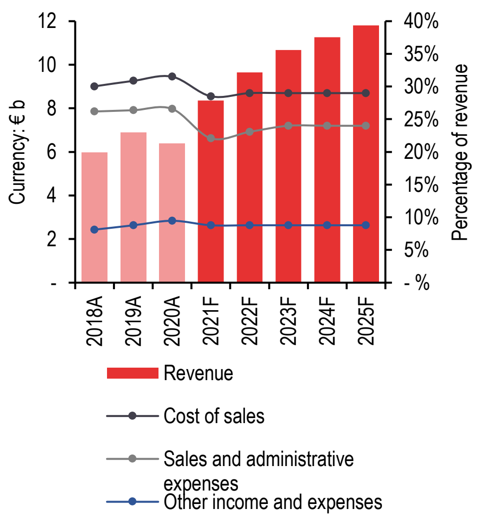
Source: *The Author*

Figure 22: Revenue breakdown



Source: *The Author*

Figure 23: Operating costs and revenue



Source: *The Author*

debt we considered the FCFE as the most appropriate approach to evaluate the equity.

Strong financial positioning and margins

Hermès enjoys strong margins compared to its most direct competitors, with higher EBITDA margins, of 38% in 2019YE and 36% in 2020YE, versus 20% and 13% respectively (see Figure 20). The company is virtually debt free with a net cash of €3,676m. In 2018YE and 2019YE generated around €2b of operating cash flow, which deducting approximately €600m-€700m of capex and repayment of lease liabilities still leave room for extraordinary dividends, additional M&A activity and buy-backs.

Investment risks

Over the last years, the Asian market (Asia-Pacific and Japan regions) represented around 50% of the total revenue and this share tends to increase with the fast-growing economies in these regions, specifically China. Going forward, the long cycle of production and the optimization of the processes might lead to the company not being agile and fast enough to respond to changes in this market as is competitors might be, therefore losing market share. The brand recognition, high prices and unmet demand contributes to a flourishing counterfeit market, putting in jeopardy the brand equity. A deepened analysis on the potential risk if presented in the Investment Risks section.

Valuation

The price target of €994.05 was computed using a Discounted Cash Flow Model, considering the FCFE. To complement the FCFE we also computed a DCF valuation using the Free Cash Flow to the Firm and the Dividend Discount Model. The FCFF approach resulted in share value of €1,048.43, implying a downside of 12.4%, and the DDM a share value of €320.91. Alternatively, we used a market multiples approach using the EV/EBITDA, EV/Revenue and P/E. Considering the high operating margins compared to its peers and a negative net debt position, the P/E was considered as the most appropriate multiple to be used and resulted in a share price of €1,342.44. From a long-term value generation perspective for investors, we considered both the FCFF and the FCFE as the preferable valuation methods. Nevertheless, our price target is based on the FCFE due to the relatively stable capital structure and residual debt levels.

Revenue

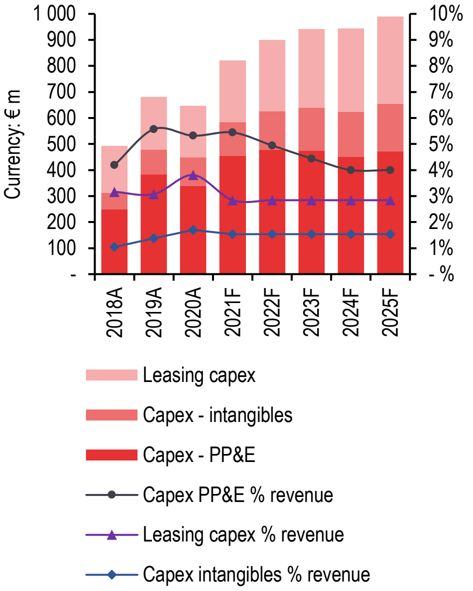
We forecast revenues to grow 31% in 2021YE, reaching €8,358m (€4,235m in H1), and from 2022 onwards to grow based on the market growth estimate according to Bain Altagamma (2021) plus an average premium of 2.1%, 3.6 pp. less than the historical average from 2015 to 2019. This premium starts in 4% in 2021 and gradually decreases towards 1% in 2025, where we estimate a total revenue of €11,810m, and assumes that the gap over the overall market will gradually decrease over the coming years (see Figure 21). The revenue estimate assumes that the product mix will remain the same as of 2020YE, only changing the mix amount per region (see Figure 22).

The Asian market is forecasted to stabilize in approximately 60% of total revenue, taking gradually market share from the other regions, with Japan region growing at a CAGR 2020YE-25YE of 10.3% and Asia-Pacific at a CAGR 2020YE-25YE of 15.2%, with China being the main driver. After an 2020H1 impacted by the pandemic, Europe should return the growth path in H2 and get back to pre-covid levels in 2022YE. These assumptions assume that after two strong recovery periods in 2021 and 2022 the growth will slow down and stabilize closer to each region expected stable growth rate.

Operating costs

Due to the strong pricing power, we estimate the gross margin to expand from 68.5% in 2020YE to 71.5% in 2021YE and to stabilize in 71% from 2022YE onwards. The decrease from 2021 reflects the expected normalization of the market and supply chains. The SG&A is estimated to represent 22.1% of total revenue in 2021YE, the same of H1, and gradually increase towards 24% from 2023YE onwards reflecting the normalization of the market conditions. The Other Income and Expenses are

Figure 24: Capex breakdown



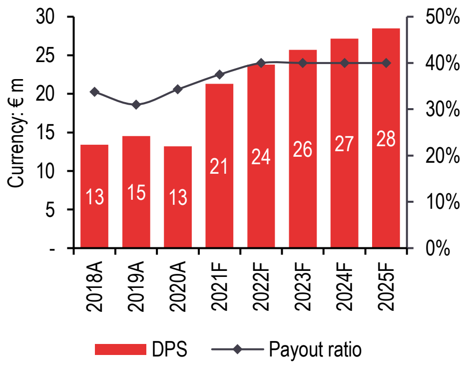
Source: *The Author*

Table 9: Discount rate assumptions

WACC assumptions (2021)	
Risk-free rate	0.05%
Country risk premium (CRP)	0.60%
Risk Free (Rf)	**0.65%**
Market risk premium (MRP)	5.50%
β Unlevered	1.09
β Levered	1.21
Cost of Equity (Rf+βL*MRP)	**7.31%**
Pre-tax cost of debt (Rd)	1.40%
Corporate income tax (T)	32.16%
Cost of debt after tax (Rd*(1-T))	**0.95%**
Debt to equity ratio (D/E)	0.17
Equity (E/(D+E))	0.85
Debt (D/(D+E))	0.15
WACC	**6.38%**

Source: *CIQ; The Author*

Figure 25: DPS and payout ratio



Source: *The Author*

estimated to remain the same historical average percentage of revenue from 2018YE-2020YE of 8.8% (see Figure 23).

Capex, D&A and Leasing capex

To support the estimated growth of the business we forecast capital expenditures in fixed assets owned by the company of 5.0% over revenue based on the historical average from 2018YE-20YE. As for D&A we apply the same historical percentage of D&A over beginning of period Property Plant and Equipment (PP&E), from 2019YE-20YE, of 13.6%. For the intangible assets we forecast an annual investment of 1.4% of revenues and an annual amortization of 35.5% based on the historical averages over revenue and beginning of period PP&E 2018YE-20YE, respectively (see Figure 24).

The annual costs with the existing and the additional leases were estimated as the 2021H1 percentage over revenue of 2.8%. These costs are included in the DCF as a deduction from the modelled DCF value.

Capital structure

Since the amount of borrowings is residual (€43m) we consider that this amount will remain stable over the years. Regarding lease liabilities we forecast the annual growth linked to the increase of the rights-of-use, estimated as the historical average over revenue of 15.3%. For more details please see apendix 2.

Discount rate assumptions

Cost of equity from 7.15% to 7.31% using the Capital Asset Pricing Model (CAPM), based on the following inputs (see Table 9):

- **Risk-free rate (0.05%)** – Based on the normalized return on the AAA Rated 10Y Eurozone Central Government Bond
- **Country risk premium (0.60%)** – Computed as the weighted average CRP of Hermès' main markets based on its revenues.[3]
- **Market risk premium (5.50%)** – Based on KPMG estimate as per 30 June 2021.
- **Unlevered beta (1.09)** – Based on peers' average unlevered beta.
- **Levered beta (from 1.18 to 1.21)** – Calculated considering the beta unlevered and Hermès' estimated capital structure. For more details, please see Appendix 12.

Cost of debt of 0.95% is derived from a pre-tax cost of debt of 1.40% based on the risk-free rate (0.05%), the CRP (0.60%) and a spread of 0.75% derived from Damodaran's synthetic ratings for AAA large company (interest coverage ratio always above 8.5x).

Terminal value assumptions

Due to the strong industry's growth drivers, we estimate that over the long-term the growth will exceed the inflation rate. Therefore, we consider a terminal growth rate of 4.00% based on a premium of 2% over the long-term inflation rate target of 2% for the FED and ECB. We believe that Hermès will be able to preserve its strong moat and the exclusivity, pricing power and the anticyclical characteristics will allow the company to top the market over the long run.

Dividend policy

We predict Hermès will increase its payout ratio up to 40% from 2022YE onwards. Considering its debt-free balance and its cash flow generating ability, the company enjoys a healthy margin to increase its payout ratio beyond the 40% and distribute extraordinary dividends (see Figure 25). Regarding share buy-backs, Management has bought up to €235m in shares from 2018YE to 2020YE and already €114.5m in 2021. The current share buy-back program has as limiting conditions, among others, purchases and sales of shares representing up to 10 % of the share capital and a maximum purchase price of €1,200.

[3] For Europe (excluding France) region we considered as a proxy the CRP of Germany, Italy, Spain and the United Kingdom, each of them as 25%. For the America region we considered as a proxy the CRP of the United States of America and for the Asia-Pacific (excluding Japan) we considered as a proxy the CRP of China.

Relative valuation

To corroborate our DCF valuation we used a relative valuation approach, namely the market multiples of EV/EBITDA, EV/Revenue and P/E. Due to the high operating margins compared to its peers and a negative net debt position, we considered the P/E as the most appropriate measure to be used. The median of the peers of 62.7x, based on the 2021YE earnings per share consensus estimates, results in a share price of €1,342.44, representing an upside of 12.2% from the closing price of €1,196.50, as of 30 September 2021, and 26.8% more than our target price using the DCF approach.

In selecting the peers, four parameters were considered: (i) products similarity, (ii) mature markets, (iii) market capitalization greater than €3b and (iv) EBITDA margin 2019YE greater than 10%. Additionally, from the sample than resulted from these criteria we excluded those whose trading multiples were outliers in order to have a low coefficient of variance.

This approach has some limitations since: (i) it is based on accounting information and therefore its vulnerable to the selected accounting policies of each comparable, (ii) reflects the market's general sentiment resulting in higher values when the market is overvaluing the selected peers and undervaluing when the opposite verifies and (iii) it depends on the market sentiment towards each peer and therefore vulnerable to their expected future performance (e.g. growth and profitability) (see Table 10).

Table 10: Peers summary

Peer valuation											
		EV/Revenue		EV/EBITDA		P/E (normalized)		Sales CAGR	EBITDA margin		
Company	**EV (€m)**	**2020**	**2021F**	**2020**	**2021F**	**2020**	**2021F**	**20-22F**	**2019**	**2020**	**2021F**
LMVH	351,448	7.9x	5.9x	27.7x	18.0x	73.7x	37.2x	22%	25%	23%	33%
Kering	98,331	7.5x	6.0x	21.6x	16.4x	54.1x	30.7x	18%	33%	28%	36%
Richemont	58,620	4.4x	3.8x	20.4x	18.2x	59.4x	58.9x	17%	19%	16%	21%
V.F. Corporation	32,164	4.1x	4.1x	25.7x	37.2x	88.7x	66.5x	19%	15%	15%	11%
Prada	18,915	7.6x	6.1x	23.9x	18.1x	n.m	77.7x	20%	16%	13%	33%
Hugo Boss	4,250	2.3x	1.8x	20.7x	8.7x	n.m	40.9x	19%	16%	-1%	21%
Brunello Cucinelli	3,962	7.3x	6.1x	31.8x	23.2x	n.m	108.6x	15%	18%	9%	26%
Salvatore Ferragamo	3,463	3.7x	3.0x	22.5x	14.1x	n.m	119.1x	17%	15%	3%	22%
Median		**5.9x**	**5.0x**	**23.2x**	**18.1x**	**66.6x**	**62.7x**	**18%**	**17%**	**14%**	**24%**
Coefficient variation		0.4x	0.3x	0.2x	0.4x	0.2x	0.5x	0.1x	0.3x	0.7x	0.3x
Hermès	**125,472**	**19.6x**	**15.3x**	**48.9x**	**37.6x**	**105.2x**	**68.2x**	**20%**	**38%**	**36%**	**41%**

Source: *CIQ; The Author*

Bull and Bear case scenarios

Our valuation considers two scenarios in addition to our base case: a bull case and a bear case. For both scenarios we consider the same macroeconomic and discount rate inputs. Our **bull case scenario** results in a price target of €1,143.83, implying a downside potential of 4,4% and assumes an average revenue premium of 3.8% and the operating margin stabilizing in 41.2% from 2024YE onwards. Our **bear case scenario** results in a price target of €870.96, implying a downside potential of 27,2% and it considers a revenue premium of 2% in 2022YE and none in the remaining provisional period and the operating margin stabilizing in 35.2% from 2023YE onwards.

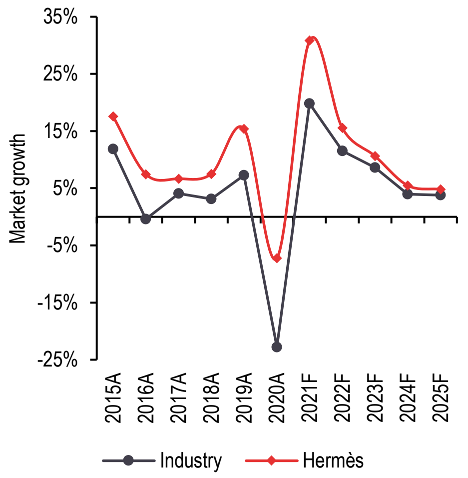
Financial analysis

Growth and profitability

Over the last years Hermès has consistently been able to outperform the industry[4], with an average premium of 5.7% since 2015 and 7.0% since 2010 (see Figure 27).

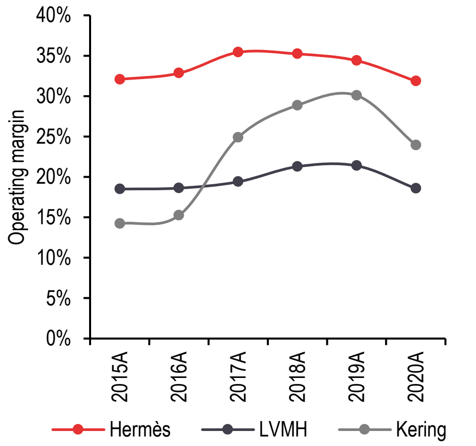
[4] Source: Standard and Poor's Capital IQ (2021) and Bain and Altagamma (2021)

Figure 27: Industry vs Hermès growth



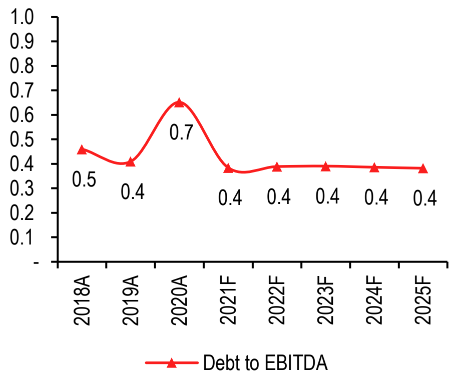
Source: *Bain Altagamma; The Author*

Figure 28: Operating margin vs peers



Source: *Company data; The Author*

Figure 29: Debt to EBITDA



Source: *Company data; The Author*

Since 2010 revenue grew at a CAGR 2010YE-19YE of 12.4%, which compares to the industry annual growth of 6.0% over the same period. Margin wise, the gross margin has contracted from 70% in 2018YE to 68.5% in 2020YE, which ultimately led to the operating margin to decrease, from 35.7% in 2018YE to 32.4% in 2020YE.

The 2021H1 reported results were extraordinary, with a revenue growth of 77% at constant rates compared to the previous year and 33% compared to 2019, showing the ability to outperform the market and thrive even with strong headwinds. The phenomenal performance was mainly driven by the Asian market, more specifically the Chinese market. The Asia-Pacific (excluding Japan) grew 81% YoY and 59% compared to 2019. America region also performed extremely well, with a revenue growth at constant rates of 115% YoY and 25% compared to 2019. Europe started to show signs of recovery in Q2, after the economies started to reopen, with a H1 growth of 45% YoY and 8% compared to 2019. The vertical integrated network and the extraordinary operational leverage allow the company to expand its gross margin to record a record value of 71.5% and consequently the operating margin to 40.7% (32.4% in 2020YE, 34.0% in 2019YE and 35.7% in 2018YE) (see Figure 28).

Despite the record results and the ongoing investment, the results were limited due to production constraints in some segments, particularly the Leather and Goods, where revenues represented 47% of the total.

After the strong 2021H1 the market was expected to slow down, especially in the Asian market, and therefore we estimate that the H2 will come up a bit shorter than H1, totaling €8,358m for 2021YE. For the remaining years, we forecast a CAGR 2021YE-25YE of 9.0%, in line with the CAGR 2015YE-19YE of 9.2% but with a lower average premium over the market of just 2.1% (5.7% from 2015 to 2019).

We estimate that the gross margin for 2021YE will be the same as of the H1, of 71.5%, but decreasing 0.5pp in 2022YE and stabilizing in 70% onwards, which compared to 2020YE, 2019YE and 2018YE implies an increase of 2.5 pp, 1.9 pp and 1.0 pp, respectively. We expected Hermès to be able to keep this high margin due to its strong pricing power and demand. After a record operating margin of 40.7% in 2021H1, we expect the margin to gradually stabilize in 38.2% from 2023YE onwards, still 4.2 pp higher than in 2019YE and 2.5 pp than in 2018YE. The decrease from 2021H1 reflects a normalization of the operational activity reflecting the extinguishment of positive effects that the pandemic had on the margin expansion in 2021H1. On the other hand, the forecast higher margin compared to the historical values is related to the gross margin increase and a greater efficiency of the SG&A costs.

Financial strength and dividends

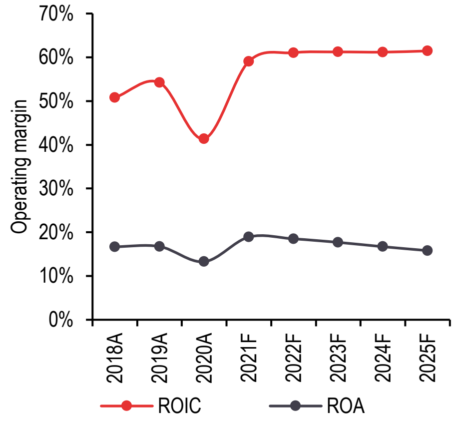
Hermès enjoys a strong financial position with residual debt (excluding leases) and a net cash position of €3,676m (including leases liabilities). Since the amount of borrowings is residual (€43m) we consider that this amount will remain stable over the years. Regarding lease liabilities we forecast a CAGR 2021YE-25YE of 5%, linked to the increase of the rights-of-use, implying a stable Debt to EBITDA of 0.4x (see Figure 29).

The company has a track record of dividend increases. In our projections we consider that the payout ratio will stay at 40% from 2022YE onwards, 7 pp more than the average 2018YE-2020YE. For 2021, we estimate a payout of 37.5% and €8.0 per share, implying a dividend yield of 0.61% as of 30 September 2021. Hermès generated approximately €2b of operating cash flow in 2018YE and 2019YE, which subtracting approximately €600m-€700m of capex and repayment of lease liabilities still leaves a healthy margin for payout increases, extraordinary dividends and buy-backs.

DuPont analysis

We expect that without a payout increase or extraordinary dividend distribution the Return on Equity (ROE) will slightly decrease over the years due to the increase of the reserves (see Table 11 and Figure 30). For illustrative purposes, if we had considered a hypothetical payout ratio of 100% the ROE would gradually increase up to 40% in 2025YE due to the high Return on Assets (ROA).

Figure 30: ROIC and ROA



Source: *Company data; The Author*

Table 11: DuPont analysis

Currency: €m	2018A	2019A	2020A	2021F	2022F	2023F	2024F	2025F
Net Income	1,411	1,535	1,390	2,245	2,504	2,708	2,858	2,998
Sales	5,966	6,883	6,389	8,358	9,657	10,683	11,267	11,810
Net Profit Margin	**23.6%**	**22.3%**	**21.7%**	**26.9%**	**25.9%**	**25.3%**	**25.4%**	**25.4%**
Net Income	1,411	1,535	1,390	2,245	2,504	2,708	2,858	2,998
EBT	2,066	2,270	1,986	3,309	3,690	3,992	4,213	4,419
Tax Burden	**68.3%**	**67.6%**	**70.0%**	**67.8%**	**67.8%**	**67.8%**	**67.8%**	**67.8%**
EBT	2,066	2,270	1,986	3,309	3,690	3,992	4,213	4,419
EBIT	2,128	2,339	2,073	3,397	3,780	4,083	4,306	4,514
Interest Burden	**97.1%**	**97.1%**	**95.8%**	**97.4%**	**97.6%**	**97.8%**	**97.8%**	**97.9%**
EBIT	2,066	2,270	1,986	3,309	3,690	3,992	4,213	4,419
Total Revenue	5,966	6,883	6,389	8,358	9,657	10,683	11,267	11,810
EBIT Margin	**34.6%**	**33.0%**	**31.1%**	**39.6%**	**38.2%**	**37.4%**	**37.4%**	**37.4%**
Sales	5,966	6,883	6,389	8,358	9,657	10,683	11,267	11,810
Total Assets	8,452	9,881	11,050	12,494	14,425	16,380	18,278	20,250
Return on Assets	**0.7x**	**0.7x**	**0.6x**	**0.7x**	**0.7x**	**0.7x**	**0.6x**	**0.6x**
Total Assets	8,452	9,881	11,050	12,494	14,425	16,380	18,278	20,250
Sh Equity	5,475	6,576	7,391	8,789	10,285	11,904	13,613	15,405
Leverage	**1.5x**	**1.5x**	**1.5x**	**1.4x**	**1.4x**	**1.4x**	**1.3x**	**1.3x**
Return On Equity	**25.8%**	**23.3%**	**18.8%**	**25.5%**	**24.3%**	**22.7%**	**21.0%**	**19.5%**

Source: *The Author*

Investment Risks

Financial Risks

Macroeconomic Environment (FR1)

Changes in luxury demand are correlated to the global macroeconomic environment and the health of consumer spending patterns. Hermès is exposed to several economies, being the most important the Asian-Pacific (excluding Japan) region (46% of revenues), and in particular China. It is also exposed to Japan (13% of revenues), Europe (25%) and Americas (15%). Therefore, any major change in the economic environment in these regions that may affect the spending habits is a risk to the group performance.

Exchange Rate (FR2)

The company is exposed to foreign exchange risk because its operating costs are mainly in Euros and the majority of its revenues are in other currencies than Euro (United States dollar, Japanese yen, Hong Kong dollar, Renminbi and other Asian currencies, etc.). In 2020, only approximately 25% of the total revenue was in Euros.

Operational Risks

Management of Supplies (OR1)

Hermès has a fully integrated production. The success of the business and the ability to grow is highly dependent on preserving good relationships with its suppliers. A supply shortage, either in terms of volume or quality of certain materials could lead to disruptions in the production.

Business Disruption (OR2)

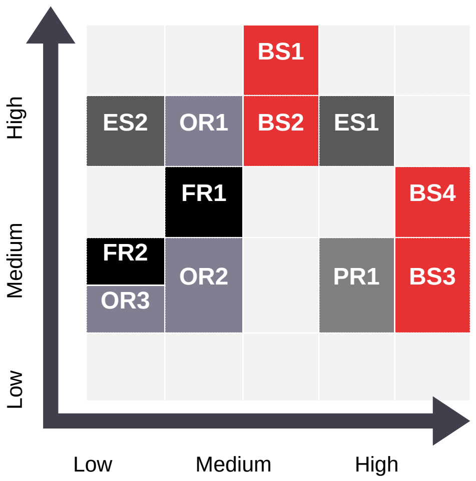
Hermès relies on highly integrated production processes. The ability to deal efficiently with a major disruption on production, logistics or distribution sites is key for the operations. The occurrence of such events would impact the processes having consequences on the overall commercial and financial performance.

Management of Talent (OR3)

One of Hermès' key assets is the *savoir-faire* of craftspeople, which is one of the foundations of the company and reason for its success. A loss of *savoir-faire* and craftspeople would have an impact on the operations and reputation of the Group.

Figure 31: Risk matrix

Financial Risks	
Macroeconomic environment	FR1
Exchange Rate	FR2
Operational Risks	
Management of supplies	OR1
Business Disruption	OR2
Management of Talent	OR3
Brand and Strategy Risks	
Image and Reputation	BS1
Commercial Appeal	BS2
Counterfeiting	BS3
Resale Market	BS4
Environmental and Social Risks	
Natural and Environmental Concerns	ES1
Human Rights and Ethics	ES2
Political and Regulatory Risks	
Compliance with laws and regulations	PR1
Human Rights and Ethics	PR2



Source: *The Author*

Table 12: Monte Carlo statistics

Monte Carlo Statistics	
Number of trials	100,000
Base case	994.05
Mean	960.14
Standard deviation	278.18
10th percentile	637.42
90th percentile	1,287.83

Source: *The Author*

Brand and Strategy Risks

Image and Reputation (BS1)

The reputation of Hermès is based on the quality, design and unique craftmanship of its products. In a globalized world and given the development of social media platforms any negative or inaccurate coverage could affect the Group's image and reputation.

Commercial Appeal (BS2)

The commercial appeal of Hermès' products is underpinned by its exclusivity, creativity, authenticity, quality and craftmanship. In a constantly changing world and industry, increasingly driven by newness and innovation, any failure to meet customer expectations and market trends could negatively affect the appeal of the brand and lead to a gradual loss of interest from customers.

Counterfeiting (BS3)

One characteristic of the luxury products is their high selling prices. This factor encourages product counterfeiting and consequently has the potential to affect its brand image and the perceived exclusiveness and quality of its products.

Resale Market (BS4)

Due to supply constraints on its most iconic handbags, some customers search for alternatives in the secondary market. The resale market for Hermès' handbags has become more active in recent years on legitimate platforms like Farfetch, where the price tag for a second-hand bag is higher than a brand-new bag purchased in an official Hermès store. Other factor that contributes for the development of the resale market is the increasingly perception of the iconic bags as an investment.

Although the supply-demand mismatch is considerable, the increased supply in the secondary market might undermine the exclusivity of the brand. Others can argue that the secondary market might reinforce the desirability of the brand as it did for some Rolex products, and drive prices higher.

Environmental and Social Risks

Natural and Environmental Concerns (ES1)

Hermès seeks to secure quality supplies of natural and renewable materials. Environmental changes can threat natural resources from which some materials are sourced, impacting supply chains and processes and decreasing products' quality. The conditions under which the materials are obtained, and their social acceptability may also be under some scrutiny due to the increasing stakeholders' awareness towards the usage of animal-origin materials.

Human Rights and Ethics (ES2)

Any situation that might question Hermès' ethic values and position regarding human rights, fundamental freedom and health and safety of its people would have strong impact on Hermès' reputation and image.

Political and regulatory risks

Compliance with laws and regulations (PR1)

Hermès' has operations in several countries where it has to comply with the laws and regulations. These laws and regulations are increasingly complex and numerous and regulatory non-compliance could have negative impact on Hermès' operations, reputation, and result in financial penalties.

Risks to Price Target

Discount Rate and Terminal Growth Rate

Both discount rate and terminal growth rate are key variables in DCF valuations. In our valuation we considered a WACC of 6.29% and a terminal growth rate of 4% and performed a sensitivity analysis to assess the impact that percentual changes in these two variables would have on our price target.

Table 13: Sensitivity analysis for the discount rate and terminal growth rate

		Ke Δ						
	1 144	**-1.50%**	**-1.00%**	**-0.50%**	**0.00%**	**0.50%**	**1.00%**	**1.50%**
Terminal growth rate	**4.75%**	1 420	1 409	1 398	1 387	1 377	1 366	1 356
	4.50%	1 251	1 241	1 232	1 222	1 213	1 204	1 195
	4.25%	1 120	1 112	1 103	1 095	1 087	1 079	1 071
	4.00%	1 017	1 009	1 001	994	987	979	972
	3.75%	932	925	919	912	905	899	892
	3.50%	863	856	850	844	838	831	825
	3.25%	804	798	792	786	781	775	769

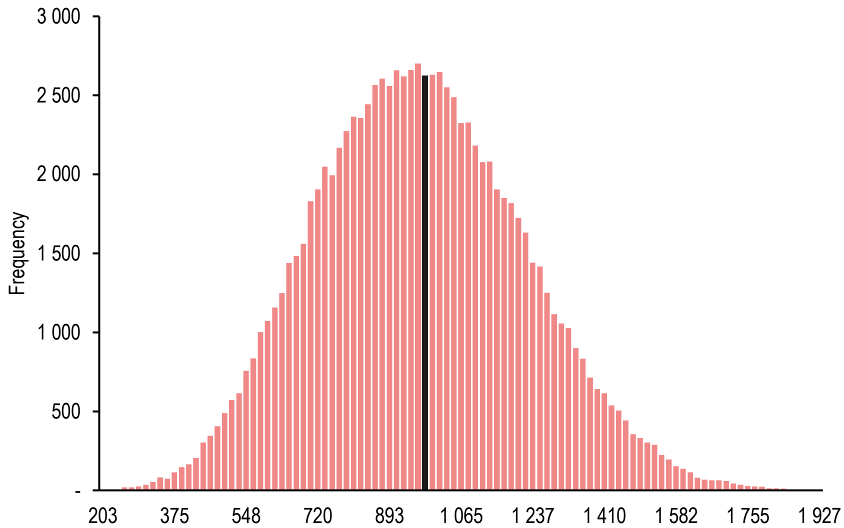
Legend	**> 10%**	**Buy**	**10% >**	**Hold**	**< -10%**	**> 10%**	**Sell**

Source: *The Author*

Monte Carlo Simulation

To complement the previous sensitivity analysis, we performed a Monte Carlo simulation. The average price target obtained is €1,027.04 per share and there is 58% probability of our recommendation to sell being correct (see Figure 31 and Table 11). Buy recommendation accounts for 15% and to hold 27%. Besides the discount rate and terminal growth rate, our model is most sensitive to changes in the market growth, cost of sales and SG&A.

Figure 31: Monte Carlo simulation



Source: *The Author*

Appendices

Appendix 1: Statement of Financial Position

Currency: €m	2018A	2019A	2020A	2021F	2022F	2023F	2024F	2025F	CAGR 21-25
Goodwill	16	16	42	42	42	42	42	42	-
Intangible assets	142	184	221	257	299	339	373	403	12.7%
Rights of use	983	954	1,446	1,268	1,465	1,620	1,709	1,791	4.4%
Property, plant and equipment	1,345	1,542	1,646	1,843	2,078	2,333	2,583	2,826	11.4%
Investment Properties	77	78	73	73	73	73	73	73	-
Financial assets	314	357	368	368	368	368	368	368	-
Investments in associates	75	79	49	49	49	49	49	49	-
Loans and deposits	47	58	56	56	56	56	56	56	-
Deferred tax assets	462	511	475	475	475	475	475	475	-
Other non-current assets	15	11	24	24	24	24	24	24	-
Non-current assets	**3,476**	**3,791**	**4,401**	**4,455**	**4,929**	**5,380**	**5,753**	**6,108**	**6.8%**
Inventories and work-in-progress	964	1,133	1,289	1,306	1,535	1,698	1,791	1,877	7.8%
Trade and other receivables	281	318	250	357	412	456	480	504	15.1%
Tax receivables	18	21	64	64	64	64	64	64	-
Other current assets	199	199	193	258	298	329	347	364	13.5%
Financial derivatives	35	37	121	121	121	121	121	121	-
Cash and cash equivalents	3,479	4,384	4,733	5,933	7,066	8,331	9,723	11,212	18.8%
Current assets	**4,976**	**6,091**	**6,650**	**8,038**	**9,496**	**11,000**	**12,526**	**14,142**	**16.3%**
Total assets	**8,452**	**9,881**	**11,050**	**12,494**	**14,425**	**16,380**	**18,278**	**20,250**	**12.9%**
Share capital	54	54	54	54	54	54	54	54	-
Share premium	50	50	50	50	50	50	50	50	-
Treasury shares	(465)	(509)	(464)	(464)	(464)	(464)	(464)	(464)	-
Reserves	4,290	5,256	6,212	6,759	7,997	9,413	10,971	12,624	15.2%
Foreign currency adjustment	88	139	38	38	38	38	38	38	-
Reevaluation adjustments	48	51	106	106	106	106	106	106	-
Net income	1,406	1,528	1,385	2,236	2,494	2,698	2,848	2,987	16.6%
Equity - Parent company	**5,470**	**6,568**	**7,380**	**8,778**	**10,275**	**11,893**	**13,602**	**15,394**	**15.8%**
Non-controlling interests	5	8	11	11	11	11	11	11	-
Equity	**5,475**	**6,576**	**7,391**	**8,789**	**10,285**	**11,904**	**13,613**	**15,405**	**15.8%**
Borrowings and financial liabilities	28	30	18	18	18	18	18	18	-
Lease liabilities	937	896	1,448	1,269	1,466	1,622	1,711	1,793	4.4%
Provisions	16	29	22	22	22	22	22	22	-
Employee benefits	196	270	275	275	275	275	275	275	-
Deferred Tax Liabilities	37	25	22	22	22	22	22	22	-
Other Liabilities	47	33	36	36	36	36	36	36	-
Non-current liabilities	**1,260**	**1,282**	**1,821**	**1,643**	**1,840**	**1,995**	**2,084**	**2,166**	**3.5%**
Borrowings and financial liabilities	23	21	25	25	25	25	25	25	-
Lease liabilities	179	196	196	196	196	196	196	196	-
Provisions	96	101	100	100	100	100	100	100	-
Employee benefits	7	18	28	28	28	28	28	28	-
Trade and other payables	467	480	448	461	542	600	631	663	8.1%
Financial derivatives	58	47	29	29	29	29	29	29	-
Tax liabilities	315	360	218	218	218	218	218	218	-
Other current liabilities	572	800	795	1,006	1,162	1,285	1,356	1,421	12.3%
Current liabilities	**1,717**	**2,024**	**1,839**	**2,062**	**2,299**	**2,480**	**2,582**	**2,679**	**7.8%**
Liabilities	**2,977**	**3,305**	**3,659**	**3,705**	**4,139**	**4,476**	**4,666**	**4,845**	**5.8%**
Total equity and liabilities	**8,452**	**9,881**	**11,050**	**12,494**	**14,425**	**16,380**	**18,278**	**20,250**	**12.9%**

Source: *Company data; The Author*

Appendix 2: Statement of Financial Position – common size

	2018A	2019A	2020A	2021F	2022F	2023F	2024F	2025F
Goodwill	0.2%	0.2%	0.4%	0.3%	0.3%	0.3%	0.2%	0.2%
Intangible assets	1.7%	1.9%	2.0%	2.1%	2.1%	2.1%	2.0%	2.0%
Rights of use	11.6%	9.7%	13.1%	10.1%	10.2%	9.9%	9.4%	8.8%
Property, plant and equipment	15.9%	15.6%	14.9%	14.8%	14.4%	14.2%	14.1%	14.0%
Investment Properties	0.9%	0.8%	0.7%	0.6%	0.5%	0.4%	0.4%	0.4%
Financial assets	3.7%	3.6%	3.3%	2.9%	2.5%	2.2%	2.0%	1.8%
Investments in associates	0.9%	0.8%	0.4%	0.4%	0.3%	0.3%	0.3%	0.2%
Loans and deposits	0.6%	0.6%	0.5%	0.4%	0.4%	0.3%	0.3%	0.3%
Deferred tax assets	5.5%	5.2%	4.3%	3.8%	3.3%	2.9%	2.6%	2.3%
Other non-current assets	0.2%	0.1%	0.2%	0.2%	0.2%	0.1%	0.1%	0.1%
Non-current assets	**41.1%**	**38.4%**	**39.8%**	**35.7%**	**34.2%**	**32.8%**	**31.5%**	**30.2%**
Inventories and work-in-progress	11.4%	11.5%	11.7%	10.5%	10.6%	10.4%	9.8%	9.3%
Trade and other receivables	3.3%	3.2%	2.3%	2.9%	2.9%	2.8%	2.6%	2.5%
Tax receivables	0.2%	0.2%	0.6%	0.5%	0.4%	0.4%	0.3%	0.3%
Other current assets	2.4%	2.0%	1.7%	2.1%	2.1%	2.0%	1.9%	1.8%
Financial derivatives	0.4%	0.4%	1.1%	1.0%	0.8%	0.7%	0.7%	0.6%
Cash and cash equivalents	41.2%	44.4%	42.8%	47.5%	49.0%	50.9%	53.2%	55.4%
Current assets	**58.9%**	**61.6%**	**60.2%**	**64.3%**	**65.8%**	**67.2%**	**68.5%**	**69.8%**
Total assets	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**
Share capital	0.6%	0.5%	0.5%	0.4%	0.4%	0.3%	0.3%	0.3%
Share premium	0.6%	0.5%	0.4%	0.4%	0.3%	0.3%	0.3%	0.2%
Treasury shares	5.5%	5.1%	4.2%	3.7%	3.2%	2.8%	2.5%	2.3%
Reserves	50.8%	53.2%	56.2%	54.1%	55.4%	57.5%	60.0%	62.3%
Foreign currency adjustment	1.0%	1.4%	0.3%	0.3%	0.3%	0.2%	0.2%	0.2%
Reevaluation adjustments	0.6%	0.5%	1.0%	0.8%	0.7%	0.6%	0.6%	0.5%
Net income	16.6%	15.5%	12.5%	17.9%	17.3%	16.5%	15.6%	14.7%
Equity - Parent company	**64.7%**	**66.5%**	**66.8%**	**70.3%**	**71.2%**	**72.6%**	**74.4%**	**76.0%**
Non-controlling interests	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Equity	**64.8%**	**66.6%**	**66.9%**	**70.3%**	**71.3%**	**72.7%**	**74.5%**	**76.1%**
Borrowings and financial liabilities	0.3%	0.3%	0.2%	0.1%	0.1%	0.1%	0.1%	0.1%
Lease liabilities	11.1%	9.1%	13.1%	10.2%	10.2%	9.9%	9.4%	8.9%
Provisions	0.2%	0.3%	0.2%	0.2%	0.2%	0.1%	0.1%	0.1%
Employee benefits	2.3%	2.7%	2.5%	2.2%	1.9%	1.7%	1.5%	1.4%
Deferred Tax Liabilities	0.4%	0.2%	0.2%	0.2%	0.2%	0.1%	0.1%	0.1%
Other Liabilities	0.6%	0.3%	0.3%	0.3%	0.3%	0.2%	0.2%	0.2%
Non-current liabilities	**14.9%**	**13.0%**	**16.5%**	**13.1%**	**12.8%**	**12.2%**	**11.4%**	**10.7%**
Borrowings and financial liabilities	0.3%	0.2%	0.2%	0.2%	0.2%	0.1%	0.1%	0.1%
Lease liabilities	2.1%	2.0%	1.8%	1.6%	1.4%	1.2%	1.1%	1.0%
Provisions	1.1%	1.0%	0.9%	0.8%	0.7%	0.6%	0.5%	0.5%
Employee benefits	0.1%	0.2%	0.3%	0.2%	0.2%	0.2%	0.2%	0.1%
Trade and other payables	5.5%	4.9%	4.1%	3.7%	3.8%	3.7%	3.5%	3.3%
Financial derivatives	0.7%	0.5%	0.3%	0.2%	0.2%	0.2%	0.2%	0.1%
Tax liabilities	3.7%	3.6%	2.0%	1.7%	1.5%	1.3%	1.2%	1.1%
Other current liabilities	6.8%	8.1%	7.2%	8.1%	8.1%	7.8%	7.4%	7.0%
Current liabilities	**20.3%**	**20.5%**	**16.6%**	**16.5%**	**15.9%**	**15.1%**	**14.1%**	**13.2%**
Liabilities	**35.2%**	**33.4%**	**33.1%**	**29.7%**	**28.7%**	**27.3%**	**25.5%**	**23.9%**
Total equity and liabilities	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: *The Author*

Appendix 3: Income Statement

Currency: €m	2018A	2019A	2020A	2021F	2022F	2023F	2024F	2025F	CAGR 21-25
Revenue	5,966	6,883	6,389	8,358	9,657	10,683	11,267	11,810	13.1%
Cost of sales	(1,792)	(2,125)	(2,013)	(2,383)	(2,801)	(3,098)	(3,267)	(3,425)	11.2%
Gross margin	**4,174**	**4,759**	**4,376**	**5,976**	**6,857**	**7,585**	**8,000**	**8,385**	**13.9%**
Sales and administrative expenses	(1,562)	(1,816)	(1,699)	(1,845)	(2,229)	(2,564)	(2,704)	(2,834)	10.8%
Other income and expenses	(484)	(604)	(605)	(734)	(848)	(938)	(989)	(1,037)	11.4%
Operating income	**2,128**	**2,339**	**2,073**	**3,397**	**3,780**	**4,083**	**4,306**	**4,514**	**16.8%**
Net financial income	(62)	(69)	(86)	(88)	(90)	(91)	(93)	(95)	2.0%
Net income before tax	**2,066**	**2,270**	**1,986**	**3,309**	**3,690**	**3,992**	**4,213**	**4,419**	**17.3%**
Income tax	(672)	(751)	(613)	(1,064)	(1,187)	(1,284)	(1,355)	(1,421)	18.3%
Net income from associates	17	16	16	-	-	-	-	-	n.a.
Consolidated net income	**1,411**	**1,535**	**1,390**	**2,245**	**2,504**	**2,708**	**2,858**	**2,998**	**16.6%**
Minority interest (after tax)	(5)	(7)	(4)	(8)	(9)	(10)	(11)	(11)	22.1%
Net Income	**1,406**	**1,528**	**1,385**	**2,236**	**2,494**	**2,698**	**2,848**	**2,987**	**16.6%**
Earnings per share (€)	13.5	14.7	13.3	21.4	23.9	25.8	27.3	28.6	16.6%

Source: *Company data; The Author*

Appendix 4: Income Statement – common size

	2018A	2019A	2020A	2021F	2022F	2023F	2024F	2025F
Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of sales	30.0%	30.9%	31.5%	28.5%	29.0%	29.0%	29.0%	29.0%
Gross margin	**70.0%**	**69.1%**	**68.5%**	**71.5%**	**71.0%**	**71.0%**	**71.0%**	**71.0%**
Sales and administrative expenses	26.2%	26.4%	26.6%	22.1%	23.1%	24.0%	24.0%	24.0%
Other income and expenses	8.1%	8.8%	9.5%	8.8%	8.8%	8.8%	8.8%	8.8%
Operating income	**35.7%**	**34.0%**	**32.4%**	**40.6%**	**39.1%**	**38.2%**	**38.2%**	**38.2%**
Net financial income	1.0%	1.0%	1.3%	1.1%	0.9%	0.9%	0.8%	0.8%
Net income before tax	**34.6%**	**33.0%**	**31.1%**	**39.6%**	**38.2%**	**37.4%**	**37.4%**	**37.4%**
Income tax	11.3%	10.9%	9.6%	12.7%	12.3%	12.0%	12.0%	12.0%
Net income from associates	0.3%	0.2%	0.3%	-	-	-	-	-
Consolidated net income	**23.6%**	**22.3%**	**21.7%**	**26.9%**	**25.9%**	**25.3%**	**25.4%**	**25.4%**
Minority interest (after tax)	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Net Income	**23.6%**	**22.2%**	**21.7%**	**26.8%**	**25.8%**	**25.3%**	**25.3%**	**25.3%**

Source: *The Author*

Appendix 5: Cash Flow Statement

Currency: €m	2018A	2019A	2020A	2021F	2022F	2023F	2024F	2025F	CAGR 21-25
Net income	1,406	1,528	1,385	2,236	2,494	2,698	2,848	2,987	16.6%
Depreciation	217	236	271	302	341	388	437	483	12.3%
Amortization of right-of-use assets	189	212	243	226	261	288	304	319	5.6%
Impairment losses	70	29	54	-	-	-	-	-	n.a.
n.1.Other items	(18)	59	39	-	-	-	-	-	n.a.
Operating Cash flows	**1,863**	**2,063**	**1,993**	**2,764**	**3,096**	**3,374**	**3,589**	**3,788**	**13.7%**
Changes in working capital requirements	77	24	(350)	35	(87)	(57)	(33)	(30)	38.8%
Cash Flow from Operating Activities	**1,940**	**2,087**	**1,642**	**2,799**	**3,009**	**3,317**	**3,555**	**3,758**	**18.0%**
Operating investments	(312)	(478)	(448)	(535)	(618)	(684)	(721)	(756)	11.0%
Acquisitions of investment securities	(8)	(13)	-	-	-	-	-	-	n.a.
Acquisition of consolidated shares	-	-	(72)	-	-	-	-	-	n.a.
Acquisitions of other financial assets	(80)	(77)	(36)	-	-	-	-	-	n.a.
Other items	161	96	124	-	-	-	-	-	n.a.
Cash Flow from Investing Activities	**(239)**	**(471)**	**(432)**	**(535)**	**(618)**	**(684)**	**(721)**	**(756)**	**11.8%**
Dividends paid	(958)	(487)	(490)	(839)	(998)	(1,079)	(1,139)	(1,195)	19.5%
Repayment of lease liabilities	(181)	(203)	(199)	(226)	(261)	(288)	(304)	(319)	9.9%
Treasury shares net of disposals	(60)	(53)	(122)	-	-	-	-	-	n.a.
Borrowing subscription	0	-	8	-	-	-	-	-	n.a.
Repayments of borrowings	(2)	(0)	(8)	-	-	-	-	-	n.a.
Cash Flow from Financing Activities	**(1,200)**	**(743)**	**(810)**	**(1,064)**	**(1,258)**	**(1,367)**	**(1,443)**	**(1,513)**	**13.3%**
Foreign currency translation adjustments	53	33	(55)	-	-	-	-	-	n.a.
Change in net cash	**553**	**907**	**345**	**1,200**	**1,133**	**1,266**	**1,391**	**1,489**	**34.0%**
Net cash at the beginning of the period	2,912	3,465	4,372	4,717	5,917	7,050	8,315	9,707	17.3%
Net cash at the end of the period	3,465	4,372	4,717	5,917	7,050	8,315	9,707	11,196	18.9%
Change in net cash position	**553**	**907**	**345**	**1,200**	**1,133**	**1,266**	**1,391**	**1,489**	**34.0%**
Overdrafts	-	13	17	17	17	17	17	17	-
Cash and cash equivalents	**3,479**	**4,384**	**4,733**	**5,933**	**7,066**	**8,331**	**9,723**	**11,212**	**18.8%**

Source: *Company data; The Author*

Appendix 6: Cash Flow Statement – common size

	2018A	2019A	2020A	2021F	2022F	2023F	2024F	2025F
Net income	72.4%	73.2%	84.4%	79.9%	82.9%	81.3%	80.1%	79.5%
Depreciation	11.2%	11.3%	16.5%	10.8%	11.3%	11.7%	12.3%	12.9%
Amortization of right-of-use assets	9.7%	10.1%	14.8%	8.1%	8.7%	8.7%	8.6%	8.5%
Impairment losses	3.6%	1.4%	3.3%	0.0%	0.0%	0.0%	0.0%	0.0%
Other items	(0.9%)	2.8%	2.4%	0.0%	0.0%	0.0%	0.0%	0.0%
Operating Cash flows	**96.0%**	**98.9%**	**121.3%**	**98.7%**	**102.9%**	**101.7%**	**100.9%**	**100.8%**
Changes in working capital requirements	4.0%	1.1%	(21.3%)	1.3%	(2.9%)	(1.7%)	(0.9%)	(0.8%)
Cash Flow from Operating Activities	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**
Operating investments	(16.1%)	(22.9%)	(27.3%)	(19.1%)	(20.5%)	(20.6%)	(20.3%)	(20.1%)
Acquisitions of investment securities	(0.4%)	(0.6%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Acquisition of consolidated shares	0.0%	0.0%	(4.4%)	0.0%	0.0%	0.0%	0.0%	0.0%
Acquisitions of other financial assets	(4.1%)	(3.7%)	(2.2%)	0.0%	0.0%	0.0%	0.0%	0.0%
Other items	8.3%	4.6%	7.5%	0.0%	0.0%	0.0%	0.0%	0.0%
Cash Flow from Investing Activities	**(12.3%)**	**(22.6%)**	**(26.3%)**	**(19.1%)**	**(20.5%)**	**(20.6%)**	**(20.3%)**	**(20.1%)**
Dividends paid	(49.4%)	(23.3%)	(29.8%)	(30.0%)	(33.2%)	(32.5%)	(32.0%)	(31.8%)
Repayment of lease liabilities	(9.3%)	(9.7%)	(12.1%)	(8.1%)	(8.7%)	(8.7%)	(8.6%)	(8.5%)
Treasury shares net of disposals	(3.1%)	(2.5%)	(7.4%)	0.0%	0.0%	0.0%	0.0%	0.0%
Borrowing subscription	0.0%	0.0%	0.5%	0.0%	0.0%	0.0%	0.0%	0.0%
Repayments of borrowings	(0.1%)	(0.0%)	(0.5%)	0.0%	0.0%	0.0%	0.0%	0.0%
Cash Flow from Financing Activities	**(61.9%)**	**(35.6%)**	**(49.3%)**	**(38.0%)**	**(41.8%)**	**(41.2%)**	**(40.6%)**	**(40.3%)**
Foreign currency translation adjustments	2.7%	1.6%	(3.3%)	0.0%	0.0%	0.0%	0.0%	0.0%
Change in net cash	**28.5%**	**43.4%**	**21.0%**	**42.9%**	**37.6%**	**38.2%**	**39.1%**	**39.6%**
Net cash at the beginning of the period	150.1%	166.0%	266.2%	168.5%	196.6%	212.6%	233.9%	258.3%
Net cash at the end of the period	178.6%	209.4%	287.2%	211.4%	234.3%	250.7%	273.0%	297.9%
Change in net cash position	**28.5%**	**43.4%**	**21.0%**	**42.9%**	**37.6%**	**38.2%**	**39.1%**	**39.6%**

Source: *The Author*

Appendix 7: Key Financial ratios

Ratios	Unit	2018A	2019A	2020A	2021F	2022F	2023F	2024F	2025F
Liquidity ratios									
Current ratio	times	2.9	3.0	3.6	3.9	4.1	4.4	4.9	5.3
Quick ratio	times	2.2	2.3	2.7	3.0	3.3	3.5	4.0	4.4
Cash ratio	times	2.0	2.2	2.6	2.9	3.1	3.4	3.8	4.2
Efficiency ratios									
Total assets turnover	times	0.7	0.8	0.6	0.7	0.7	0.7	0.7	0.6
Fixed assets turnover	times	2.6	2.9	2.3	2.7	2.9	2.8	2.7	2.7
Receivables turnover	times	21.3	23.0	22.5	27.7	25.1	24.6	24.1	24.0
Collection period (DSO)	days	17	16	16	13	15	15	15	15
Inventory turnover	times	1.9	2.0	1.7	1.8	2.0	1.9	1.9	1.9
Days in inventory (DIO)	days	196	180	220	204	185	190	195	195
Payables period (DPO)	days	62	75	78	66	60	64	67	67
Operating cycle	days	213	196	236	217	200	205	211	211
Cash cycle	days	152	121	158	151	139	141	144	143
Capex / D&A	times	1.5	2.0	1.7	1.9	1.9	1.9	1.8	1.7
Capex / Sales	%	4.2%	5.6%	5.3%	5.0%	5.0%	5.0%	5.0%	5.0%
PP&E / Sales	%	22.6%	22.4%	25.8%	22.0%	21.5%	21.8%	22.9%	23.9%
Operating costs / Sales	%	64.3%	66.0%	67.6%	59.4%	60.9%	61.8%	61.8%	61.8%
NWC / Sales	%	6.8%	5.4%	7.7%	5.4%	5.6%	5.6%	5.6%	5.6%
Profitability ratios									
Gross profit margin	%	70.0%	69.1%	68.5%	71.5%	71.0%	71.0%	71.0%	71.0%
EBITDA margin	%	42.5%	40.5%	40.5%	46.9%	45.4%	44.6%	44.8%	45.0%
Operating income margin	%	35.7%	34.0%	32.4%	40.6%	39.1%	38.2%	38.2%	38.2%
Net income margin	%	23.6%	22.3%	21.7%	26.9%	25.9%	25.3%	25.4%	25.4%
ROA	%	16.7%	16.7%	13.3%	19.0%	18.6%	17.6%	16.5%	15.6%
ROCE	%	31.6%	32.1%	24.3%	26.1%	33.5%	31.4%	29.1%	27.1%
ROIC	%	50.8%	54.2%	41.4%	45.8%	62.9%	60.2%	57.8%	56.3%
ROE	%	25.8%	25.5%	19.9%	27.7%	26.3%	24.4%	22.4%	20.7%
EPS	€ / unit	13.48	14.66	13.27	21.42	23.89	25.83	27.27	28.60
SG&A / Sales	%	26.2%	26.4%	26.6%	22.1%	23.1%	24.0%	24.0%	24.0%
Solvency ratios									
Debt to equity ratio	%	21.3%	17.4%	22.8%	17.2%	16.6%	15.6%	14.3%	13.2%
Total liabilities / total assets	%	35.2%	33.4%	33.1%	29.7%	28.7%	27.3%	25.5%	23.9%
Equity multiplier	times	1.5	1.5	1.5	1.4	1.4	1.4	1.3	1.3
Debt to EBITDA	times	0.5	0.4	0.7	0.4	0.4	0.4	0.4	0.4
Equity to assets	%	64.8%	66.6%	66.9%	70.3%	71.3%	72.7%	74.5%	76.1%

Source: *The Author*

Appendix 8: Income statement assumptions

	Unit	2021F	2022F	2023F	2024F	2025F	Assumptions
Revenue							
Market growth	% growth	19.8%	11.5%	8.6%	4.0%	3.8%	Market growth estimate according to Bain Altagamma.
Premium over market	% premium	11.0%	4.0%	2.0%	1.5%	1.0%	We expected that the premium over the market should decrease over the years until 1%.
Cost of sales							
Cost of sales	% revenue	28.5%	29.0%	29.0%	29.0%	29.0%	In 2021YE we expect the cost of sales to be the same as in H1 2021. Although the historical average 18YE-20YE was 30.8% we predict that with the normalization of the market conditions and supply chains this percentage will increase only 0.5pp, to 29% due to the strong pricing power and demand.
Other operating costs							
Sales and administrative expenses	% revenue	22.1%	23.1%	24.0%	24.0%	24.0%	The SG&A is estimated to represent 22.1% of total revenue in 2021YE, the same of H1, and gradually increase towards 24% from 2023YE onwards reflecting the normalization of the market conditions.
Other income and expenses	% revenue	8.8%	8.8%	8.8%	8.8%	8.8%	Historical average 18YE-20YE
Financial result							
Net financial income	€ m	(88)	(90)	(91)	(93)	(95)	Equal to the 2020YE nominal value and adjusted for the expected inflation rate.
Other							
Income tax	Effective tax rate	32.2%	32.2%	32.2%	32.2%	32.2%	H1 2021 effective tax rate.
Net income from associates	€ m	-	-	-	-	-	
Minority interest (after tax)	%	0.4%	0.4%	0.4%	0.4%	0.4%	Historical average 18YE-20YE.

Source: *The Author*

Appendix 9: Statement of Financial Position assumptions

	Unit	2021F	2022F	2023F	2024F	2025F	Assumptions
Non-current assets							
Goodwill	€ m	42	42	42	42	42	Equal to the 2020 YE nominal value.
Intangible assets	€ m	257	299	339	373	403	Appendix 11.
Rights of use	€ m	1,268	1,465	1,620	1,709	1,791	Appendix 11.
Property, plant and equipment	€ m	1,843	2,078	2,333	2,583	2,826	Appendix 11.
Investment Properties	€ m	73	73	73	73	73	Equal to the 2020 YE nominal value.
Financial assets	€ m	368	368	368	368	368	Equal to the 2020 YE nominal value.
Investments in associates	€ m	49	49	49	49	49	Equal to the 2020 YE nominal value.
Loans and deposits	€ m	56	56	56	56	56	Equal to the 2020 YE nominal value.
Deferred tax assets	€ m	475	475	475	475	475	Equal to the 2020 YE nominal value.
Other non-current assets	€ m	24	24	24	24	24	Equal to the 2020 YE nominal value.
Current assets							
Inventories and work-in-progress	Days	200	200	200	200	200	Average DIO of 2019YE-20YE.[5]
Trade and other receivables	Days	16	16	16	16	16	Average DSO of 2019YE-20YE.[6]
Tax receivables	€ m	64	64	64	64	64	Equal to the 2020 YE nominal value.
Other current assets	% revenue	3.1%	3.1%	3.1%	3.1%	3.1%	Average of the percentage over revenue of 2019YE-20YE.
Financial derivatives	€ m	121	121	121	121	121	Equal to the 2020 YE nominal value.
Equity							
Share capital	€ m	54	54	54	54	54	Equal to the 2020 YE nominal value.
Share premium	€ m	50	50	50	50	50	Equal to the 2020 YE nominal value.
Treasury shares	€ m	(464)	(464)	(464)	(464)	(464)	Equal to the 2020 YE nominal value.
Reserves	€ m	6,759	7,997	9,413	10,971	12,624	Reserves = Reserves in t-1 + Net income in t-1 - Dividend paid in t
Foreign currency adjustment	€ m	38	38	38	38	38	Equal to the 2020 YE nominal value.
Reevaluation adjustments	€ m	106	106	106	106	106	Equal to the 2020 YE nominal value.
Non-controlling interests	€ m	11	11	11	11	11	Equal to the 2020 YE nominal value.
Non-current liabilities							
Borrowings and financial liabilities	€ m	18	18	18	18	18	Debt is assumed to be constant from 2020YE onwards.
Lease liabilities non - current	€ m	1,269	1,466	1,622	1,711	1,793	Annual growth linked to the increase of the rights-of-use, estimated as the historical average over revenue of 15.3%.
Provisions	€ m	22	22	22	22	22	Equal to the 2020 YE nominal value.
Employee benefits	€ m	275	275	275	275	275	Equal to the 2020 YE nominal value.
Deferred Tax Liabilities	€ m	22	22	22	22	22	Equal to the 2020 YE nominal value.
Other Liabilities	€ m	36	36	36	36	36	Equal to the 2020 YE nominal value.
Current liabilities							
Borrowings and financial liabilities	€ m	25	25	25	25	25	Debt is assumed to be constant from 2020YE onwards.
Lease liabilities - current	€ m	196	196	196	196	196	Lease liabilities balance is assumed to be constant from 2020YE onwards. Nevertheless, the payments increases were still considered in the DCF computation.
Provisions	€ m	100	100	100	100	100	Equal to the 2020 YE nominal value.
Employee benefits	€ m	28	28	28	28	28	Equal to the 2020 YE nominal value.
Trade and other payables	Days	71	71	71	71	71	Average DPO of 2019YE-20YE.[7]
Financial derivatives	€ m	29	29	29	29	29	Equal to the 2020 YE nominal value.
Tax liabilities	€ m	218	218	218	218	218	Equal to the 2020 YE nominal value.
Other current liabilities	% revenue	1,006	1,162	1,285	1,356	1,421	Average of the percentage over revenue of 2019YE-20YE.

Source: *The Author*

[5,6,7] Note that the number of days differ from the Key Financial Ratios due to these ratios were computed considering the ending balance of each period while the ones of the Key financial Ratios considered the average balances of the periods.

Appendix 10: Revenue breakdown by region

Currency: €m	2018A	2019A	2020A	2021F	2022F	2023F	2024F	2025F
France	**802**	**867**	**620**	**736**	**869**	**961**	**959**	**964**
YoY	6.3%	8.1%	(28.6%)	18.7%	18.2%	10.6%	(0.2%)	0.5%
% Total sales	13.4%	12.6%	9.7%	8.8%	9.0%	9.0%	8.5%	8.2%
Europe (excluding France)	**1,107**	**1,202**	**953**	**1,145**	**1,327**	**1,453**	**1,476**	**1,506**
YoY	6.0%	8.6%	(20.7%)	20.1%	15.9%	9.5%	1.6%	2.0%
% Total sales	18.5%	17.5%	14.9%	13.7%	13.7%	13.6%	13.1%	12.8%
Japan	**748**	**864**	**834**	**1,091**	**1,217**	**1,282**	**1,335**	**1,364**
YoY	4.4%	15.5%	(3.5%)	30.8%	11.5%	5.4%	4.1%	2.2%
% Total sales	12.5%	12.6%	13.1%	13.1%	12.6%	12.0%	11.9%	11.6%
Asia-Pacific (excluding Japan)	**2,142**	**2,590**	**2,915**	**3,845**	**4,558**	**5,128**	**5,536**	**5,921**
YoY	10.1%	20.9%	12.6%	31.9%	18.6%	12.5%	8.0%	7.0%
% Total sales	35.9%	37.6%	45.6%	46.0%	47.2%	48.0%	49.1%	50.1%
Americas	**1,059**	**1,241**	**959**	**1,379**	**1,593**	**1,753**	**1,849**	**1,938**
YoY	6.3%	17.2%	(22.7%)	43.8%	15.5%	10.0%	5.5%	4.8%
% Total sales	17.7%	18.0%	15.0%	16.5%	16.5%	16.4%	16.4%	16.4%
Others	**108**	**120**	**108**	**163**	**92**	**106**	**112**	**117**
YoY	17.8%	11.0%	(9.9%)	50.7%	(43.3%)	14.8%	5.5%	4.8%
% Total sales	1.8%	1.7%	1.7%	1.9%	1.0%	1.0%	1.0%	1.0%
Total	**5,966**	**6,883**	**6,389**	**8,358**	**9,657**	**10,683**	**11,267**	**11,810**
YoY	7.5%	15.4%	(7.2%)	30.8%	15.5%	10.6%	5.5%	4.8%

Source: *Company data; The Author*

We forecast revenues to grow 31% in 2021YE, reaching €8,358m (€4,235m in 2021H1), and from 2022 onwards to grow based on the market growth estimate according to Bain Altagamma (2021) plus an average premium of 2.1%, 3.6 pp. less than the historical average from 2015 to 2019. This premium starts in 4% in 2021 and gradually decreases towards 1% in 2025, where we estimate a total revenue of €11,810m, and assumes that the gap over the overall market will gradually decrease over the coming years. The revenue estimate assumes that the product mix will remain the same as of 2020YE, only changing the mix amount per region.

The changing mix per region is based on an allocation which considers that the growth rate will tend to more stables rates based on the potential of each region. Regions where the overall market perceives as having more potential, like Asia-Pacific region, we estimate higher growth rates than more mature markets like Europe or Japan.

Appendix 11: Property Plant and Equipment, Intangible Assets and Rights of Uses (leasing capex)

PP&E capex is estimated as a percentage of revenue (5.0%) based on the historical average from 2018YE-20YE. For the depreciations we apply the same historical percentage of D&A over beginning of period PP&E, from 2019YE-20YE, of 13.6%.

Appendix 11.1: Property Plant and Equipment

Currency: €m	2018A	2019A	2020A	2021F	2022F	2023F	2024F	2025F
PP&E BoP	1,283	1,345	1,542	1,646	1,843	2,078	2,333	2,583
Capex	250	383	340	420	485	537	566	594
Depreciation	(170)	(188)	(203)	(223)	(250)	(282)	(317)	(350)
PP&E EoP	**1,345**	**1,542**	**1,646**	**1,843**	**2,078**	**2,333**	**2,583**	**2,826**
Capex (% revenue)	4.2%	5.6%	5.3%	5.0%	5.0%	5.0%	5.0%	5.0%
Depreciation (% PPE BoP)		13.9%	13.2%	13.6%	13.6%	13.6%	13.6%	13.6%

Source: *Company data; The Author*

For the intangible assets we forecast an annual investment of 1.5% of revenues and an annual amortization of 35.5% based on the historical averages over revenue and beginning of period PP&E 2018YE-20YE, respectively.

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Appendix 11.2: Intangible assets

Currency: €m	2018A	2019A	2020A	2021F	2022F	2023F	2024F	2025F
Intangibles BoP	-	142	184	221	257	299	339	373
Capex	-	95	109	115	133	147	155	162
Amortisation	-	(49)	(68)	(79)	(91)	(106)	(120)	(133)
Intangibles EoP	**-**	**184**	**221**	**257**	**299**	**339**	**373**	**403**
Capex (% revenue)	1.0%	1.4%	1.7%	1.4%	1.4%	1.4%	1.4%	1.4%
Amortisation (% BoP)	-	34.3%	36.7%	35.5%	35.5%	35.5%	35.5%	35.5%

Source: *Company data; The Author*

The annual costs with the existing and the additional leases were estimated as the H1 percentage over revenue of 2.8%. These costs are included in the DCF as a deduction from the modelled DCF value.

Appendix 11.3: Leasing capex

Currency: €m	2018A	2019A	2020A	2021F	2022F	2023F	2024F	2025F
Rights-of-use	189	212	243	237	274	303	320	335
% revenue	3.2%	3.1%	3.8%	2.8%	2.8%	2.8%	2.8%	2.8%

Source: *Company data; The Author*

Appendix 11.4: Total capex

Currency: €m	2018A	2019A	2020A	2021F	2022F	2023F	2024F	2025F
PP&E	250	383	340	420	485	537	566	594
Intangibles	62	95	109	115	133	147	155	162
Right-of-use assets	189	212	243	237	274	303	320	335
Total capex	**501**	**690**	**692**	**772**	**892**	**987**	**1,041**	**1,091**

Source: *Company data; The Author*

Appendix 12: Discount rate assumptions

The appropriate discount rate to be applied to the Free Cash Flows to the Firm is the Weighted Average Cost of Capital.

Assumptions	2021F	2022F	2023F	2024F	2025F	TV	Assumptions
Risk-free rate	0.05%	0.05%	0.05%	0.05%	0.05%	0.05%	AAA-rated euro area central government bond (10Y) - 30-6-2021
Country risk premium (CRP)	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	Weighted average CRP of Western Europe countries
Risk Free (Rf)	**0.65%**	**0.65%**	**0.65%**	**0.65%**	**0.65%**	**0.65%**	
Market risk premium (MRP)	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%	KPMG research
β Unlevered	1.09	1.09	1.09	1.09	1.09	1.09	Average of peers
β Levered	1.21	1.21	1.20	1.19	1.18	1.18	
Re	**7.31%**	**7.29%**	**7.25%**	**7.20%**	**7.15%**	**7.15%**	
Pre-tax cost of debt (Rd)	1.40%	1.40%	1.40%	1.40%	1.40%	1.40%	Rf + CRP + synthetic rating
Corporate income tax (T)	32.16%	32.16%	32.16%	32.16%	32.16%	32.16%	3Y average effective tax rate
Rd after tax	**0.95%**	**0.95%**	**0.95%**	**0.95%**	**0.95%**	**0.95%**	
Debt to equity ratio (D/E)	0.17	0.17	0.16	0.14	0.13	0.13	
Equity (E/(D+E))	85.36%	85.78%	86.48%	87.48%	88.35%	88.35%	
Debt (D/(D+E))	14.64%	14.22%	13.52%	12.52%	11.65%	11.65%	
WACC	**6.38%**	**6.39%**	**6.40%**	**6.42%**	**6.43%**	**6.43%**	

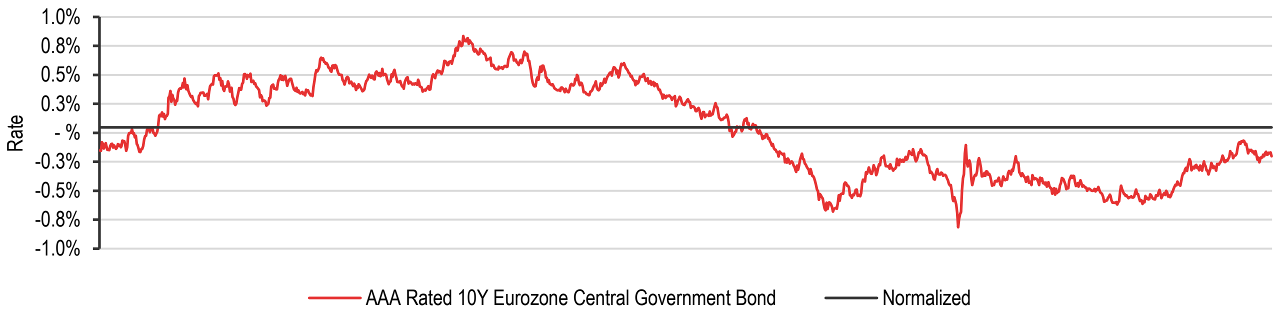
Source: *Capitcal IQ; The Author*

Cost of Equity

In order to estimate equity's required return, is applied the Capital Asset Pricing Model (CAPM) approach. CAPM defines the equity cost of opportunity as equal to the return of the risk-free (RFR) assets added by and individual premium. The individual risk premium, results from the systematic risk of the company (β) multiplied by the risk market value (Rm).

$$R_e = RFR + \beta \times R_m$$

- **Risk-free rate (0.05%)** – Based on the 5 year normalized return on the AAA Rated 10Y Eurozone Central Government Bond.



Source: *Capital IQ; The Authorc*

- **Country risk premium (0.60%)** – Computed as the weighted average CRP of Hermès' main markets based on its revenues. For Europe (excluding France) region we considered as a proxy the CRP of Germany, Italy, Spain and the United Kingdom, each of them as 25%. For the America region with considered as a proxy the CRP of the United States of America and for the Asia-Pacific (excluding Japan) we considered as a proxy the CRP of China.

Regions	Revenue share	CRP	Weighted CRP
China	45.6%	0.68%	0.311%
France	9.7%	0.48%	0.047%
Germany	3.7%	0.00%	0.000%
Italy	3.7%	2.13%	0.080%
Japan	13.1%	0.68%	0.089%
Spain	3.7%	1.55%	0.058%
United Kingdom	3.7%	0.59%	0.022%
USA	15.0%	0.00%	0.000%
Total			**0.606%**

Source: *Damodaran; Capital IQ; The Author*

- **Market risk premium (5.50%)** – Based on KPMG estimate as per 30 June 2021.
- **Unlevered beta (1.09)** – Pure-Play method based on peers' average unlevered beta.
- **Levered beta (1.24 – Approach A)** – Calculated considering the beta unlevered and Hermès' estimated capital structure.

Approach A: Obtained through an analysis performed to comparable companies from the Luxury Goods sector (Source: S&P Capital IQ). First, we calculated peers' beta unlevered by deleveraging their specific 5year average beta using their specific debt to equity ratio and tax rate and then re-levered the obtained beta using Hermés' capital structure.
Approach B: Same approach as in A but considering the beta unlevered for the Apparel, Accessories and Luxury Goods industry according to Damodaran instead of peers' beta unlevered.
Approach C: Regressions against the S&P500, CAC 40 and Dax.

	Approach A: Pure Play Method using Peers (2021)	Approach B: using the unlevered beta of the industry (2021)	Approach C: Regressions		
			S&P500	CAC 40	DAX
Beta	1.21	1.11	0.47	0.44	0.43

Source: *The Author*

Currency: €m	2018A	2019A	2020A	2021F	2022F	2023F	2024F	2025F
Equity	5,475	6,576	7,391	8,789	10,285	11,904	13,613	15,405
Borrowings	207	225	214	245	214	214	214	214
Lease liabilities	959	917	1,472	1,431	1,294	1,491	1,646	1,735
Total Debt	1,166	1,142	1,686	1,508	1,705	1,860	1,949	2,031
Debt to Equity ratio	0.21	0.17	0.23	0.17	0.17	0.16	0.14	0.13

Cost of debt
Cost of debt after taxes of 0.95% derived from a pre-tax cost of debt of 1.40% based on the risk-free rate (0.05%), the CRP (0.60%) and a spread of 0.75% derived from Damodaran's synthetic ratings for AAA large company (interest coverage ratio always above 8.5x).

Source: *Capital IQ; The Author*

Currency: €m	2018A	2019A	2020A	2021F	2022F	2023F	2024F	2025F
Operating income	2,128	2,339	2,073	3,397	3,780	4,083	4,306	4,514
Interest expense	(62)	(69)	(86)	(88)	(90)	(91)	(93)	(95)
Interest coverage ratio	34.4x	34.1x	24.1x	38.7x	42.2x	44.7x	46.2x	47.5x

Coverage Ratio	*Rating*	*Spread*
> 8.5	AAA	0.75%
6.5 - 8.5	AA	1.00%
5.5 - 6.5	A+	1.50%
4.25 - 5.5	A	1.80%
3 - 4.25	A-	2.00%
2.5 - 3	BBB	2.25%
2 - 2.5	BB	3.50%
1.75 - 2	B+	4.75%
1.5 - 1.75	B	6.50%
1.25 -1.5	B-	8.00%
0.8 - 1.25	CCC	10.00%
0.65 - 0.8	CC	11.50%
0.2 - 0.65	C	12.70%
<0.2	D	14.00%

Source: *Damodaran*

Appendix 13: FCFE valuation

According to the DCF methodology using the FCFE, the business value of a company currently operating consists of the sum of future cash flows generated in its useful life after the valuation date (in this case 30 September 2021), updated to the present value at a discount rate.

$$FCFE = Net\ income - (Capital\ expenditures - Depreciation) - (Change\ in\ net\ working\ capital) + (New\ debt\ issued - Debt\ repayment)$$

Currency: €m	2022F	2023F	2024F	2025F
Net income	**2,494**	**2,698**	**2,848**	**2,987**
(+) D&A	602	676	741	802
(-) Capex	(618)	(684)	(721)	(756)
(-) Leasing capex	(261)	(288)	(304)	(319)
(-) Δ Net Working Capital	(87)	(57)	(33)	(30)
(+) Net borrowings	-	-	-	-
Free Cash Flow to Equity	**2,130**	**2,345**	**2,530**	**2,684**
Sum of discounted FCFE	8,395			
Discounted terminal value	90,095			
Equity Value (€m)	**103,981**			
# shares outstanding (m)	104,602,664			
Value per share (€)	**994.05**			
Downside potential	-16.9%			

Source: *The Author*

Note that the net borrowings do not change despite thee changing capital structure because the cash flows from the lease liabilities are already reflected in the 'Leasing capex'.

Appendix 14: FCFF valuation

In order to determine the Equity Value and the value per share, should be subtracted to the Enterprise Value the net financial debt and other non-operating assets and liabilities.

Currency: €m	2022F	2023F	2024F	2025F
EBIT	3,780	4,083	4,306	4,514
Taxes	(1,172)	(1,266)	(1,335)	(1,399)
EBIT (1-tax)	**2,608**	**2,817**	**2,971**	**3,114**
(+) D&A	602	676	741	802
(-) Capex	(618)	(684)	(721)	(756)
(-) Leasing capex	(261)	(288)	(304)	(319)
(-) Δ Net Working Capital	(87)	(57)	(33)	(30)
Free Cash Flow to the Firm	**2,244**	**2,464**	**2,654**	**2,812**
Sum of discounted FCFF	8,956			
Discounted terminal value	96,837			
Enterprise Value (€m)	**105,793**			
Net debt	3,767			
Non-operational assets and liabilities	199			
Equity Value (€m)	**109,669**			
# shares outstanding (m)	104,602,664			
Value per share (€)	**1,048.43**			
Downside potential	-12.4%			

Source: *The Author*

Appendix 15: Dividend Discount Model

Currency: €	2022F	2023F	2024F	2025F
Dividend per share	9.6	10.3	10.9	11.4
Present value of dividends	**8.30**	**8.37**	**8.24**	**8.06**
Present value of terminal value	285.53			
Equity Value per share	320.91			

Source: *The Author*

Appendix 16: Relative valuation

To corroborate our DCF valuation we also conducted a relative valuation, namely the market multiples approach. This approach assumes that comparable companies are correctly evaluated by the market. The methodology of the market multiples corresponds to the application of a multiple of Revenue, EBITDA or Net Income, on the respective indicator of the company being evaluated. The comparable companies selected should be similar in terms of business activities, markets where they operate, size, geography and applicable tax rate.

In selecting the peers four parameters were considered: (i) products similarity, (ii) mature markets, (iii) market capitalization greater than €3b and (iv) EBITDA margin 2019YE greater than 10%. Additionally, from the sample than resulted from these criteria we excluded those whose trading multiples were outliers in order to have a low coefficient of variance.

Peer metrics											
		EV/Revenue		EV/EBITDA		P/E (normalized)		Sales CAGR	EBITDA margin		
Company	**EV (€m)**	**2020**	**2021F**	**2020**	**2021F**	**2020**	**2021F**	**20-22F**	**2019**	**2020**	**2021F**
LMVH	351,448	7.9x	5.9x	27.7x	18.0x	73.7x	37.2x	22%	25%	23%	33%
Kering	98,331	7.5x	6.0x	21.6x	16.4x	54.1x	30.7x	18%	33%	28%	36%
Richemont	58,620	4.4x	3.8x	20.4x	18.2x	59.4x	58.9x	17%	19%	16%	21%
V.F. Corporation	32,164	4.1x	4.1x	25.7x	37.2x	88.7x	66.5x	19%	15%	15%	11%
Prada	18,915	7.6x	6.1x	23.9x	18.1x	n.m	77.7x	20%	16%	13%	33%
Hugo Boss	4,250	2.3x	1.8x	20.7x	8.7x	n.m	40.9x	19%	16%	-1%	21%
Brunello Cucinelli	3,962	7.3x	6.1x	31.8x	23.2x	n.m	108.6x	15%	18%	9%	26%
Salvatore Ferragamo	3,463	3.7x	3.0x	22.5x	14.1x	n.m	119.1x	17%	15%	3%	22%
Median		**5.9x**	**5.0x**	**23.2x**	**18.1x**	**66.6x**	**62.7x**	**18%**	**17%**	**14%**	**24%**
Coefficient variation		0.4x	0.3x	0.2x	0.4x	0.2x	0.5x	0.1x	0.3x	0.7x	0.3x
Hermès	**125,472**	**19.6x**	**15.3x**	**48.9x**	**37.6x**	**105.2x**	**68.2x**	**20%**	**38%**	**36%**	**41%**

Source: *The Author*

Currency: €m	EV/Revenue	EV/EBITDA	P/E
Peer median (2021F)	**5.0x**	**18.1x**	**62.7x**
Enterprise Value (€m)	**41,827**	**71,080**	
Net debt	3,676	3,676	
Non-operational assets and liabilities	199	199	
Equity Value (€m)	**45,702**	**74,955**	**140,423**
# shares outstanding (m)	104.603	104.603	104.603
Value per share (€)	**436.91**	**716.57**	**1,342.44**

Source: *The Author*

Appendix 17: Hermès history and milestones

Hermès was founded in 1837, in Paris, by the harness-maker Thierry Hermès, when he opened a workshop in rue Basse-du-Rempart. The harnesses he made combined discreet finesse and endurance, features that earned him an award at the Universal Exhibition of 1867. From that moment on, the six generations' company has an history composed of successful milestones:

- 1880: Charles-Émile Hermès, the founder's son, opens a store at 24 Fauborg Saint-Honoré, where harnesses and saddles are made to measure, and the house's reputations is spread throughout Europe
- 1922: Émile Hermès, the founder's grandson, during the interwar period, obtained the exclusive rights to the system that is known today as the zip. It was a ground breaker at the time, and changed the course of the family business.
- 1925: Under Émile management, and following his passion by the new era, the house opened two new métiers, launching the first men's ready-to-wear garment, and later introducing jewellery, watches and sandals.
- 1937: Robert Dumas, Émile's son-in-law, created the *Jeu des omnibus et dames blanches*, the famous silk scarf, and first of a long series.
- 1949: The first ties were created, illustrating the entrepreneurial spirit of Hermès.
- 1951: Robert Dumas took over from his father-in-law, Émile Hermès, being responsible for several of the house's major successes, including the *Kelly* bag and the *Chaîne d'ancre bracelet.*
- 1956: Despite being designed in the 1930's, the *Kelly* bag history took a turn in 1956 when a photograph of Grace Kelly carrying the bag was published. The house named the bag Kelly in honour of the princess.
- 1967: launch of the first women's ready-to-wear collection
- 1978: Jean-Louis Dumas, Robert Dumas' son, from 1978 onwards, diversified and projected the house all over the world, embracing new métiers, founded on unique know-how, such as watchmaking, silversmiths and crystalworks.
- 1984: from a joint collaboration of Jean-Louis Dumas and the actress and singer Jane Birkin, the Birkin bag was born.
- 2000: Opening of Maison Hermès in New York. More stores followed all over the world, which combined the saddler's identity with local culture. In 2002, the e-commerce website was launched in the USA, and another in France in 2005.
- 2005: Pierre-Alexis Dumas, sixth generation family member, and son of Jean-Louis, was appointed artistic director of Hermès.
- 2006: At the request of Jean-Louis, Patrick Thomas, his former right-hand man and Managing Director of the group from 2003 to 2006, took over the development of the business. He decentralised the strategic organization of the métiers, and also ensured the transition between the two generations, until the appointment of Axel Dumas, Jean-Louis's nephew, as Executive Chairman in 2013.
- 2008: Launch of the Fondation d'enterprise Hermès, which works mainly on creation, transmission of know-how, preservation of the planet and solidarity.
- 2013: Axel Dumas is appointed Executive Chairman. He has driven the house's digital strategy and taken Hermès into the new technological era. In the following year Maison <hermès opens in Shanghai, and in 2015 Apple and Hermès launch the Apple Watch Hermès.
- 2018: Hermès enter the CAC 40 and the new hermes.com website is launched in Europe and in China

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