Deutsche Bank
Markets Research

Fundamental, Industry, Thematic, Thought leading

Industry
Luxury Goods

Date
28 September 2015

Europe
Italy
Consumer Discretionary & Luxury

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F.I.T.T. for investors

From growth to brand productivity

From growth to productivity, from PE to FCF Yield

Growth has been easy to achieve in the past decade: store footprint, price, and mix have been the drivers to capture booming demand and mechanically grow profits. This was helped by demographics in China and emerging markets. Today, the luxury market is more competitive and crowded, demand has moderated, and consumers are less predictable. However, luxury brands have opportunities to improve productivity in stores, leading to unprecedented cash generation, hence our refocus on EV and FCF metrics. Productivity, cash flow, and valuation metrics identify LVMH (Buy), Richemont (from Hold to Buy), and Prada (from Hold to Buy) as the names with the greatest potential.

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Deutsche Bank does and seeks to do business with companies covered in its research reports. Thus, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision. DISCLOSURES AND ANALYST CERTIFICATIONS ARE LOCATED IN APPENDIX 1. MCI (P) 124/04/2015.

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From booming growth to margin protection

We argued in 2007 that "BRIC growth changes the cycle": the advent of the unprecedented demographics from China has translated into unprecedented levels of growth (cE70bn incremental luxury demand created in the past five years) and profitability. Sector sales CAGR of 10% and margin expansion of 5pp have been driven by easy store roll-outs and a seemingly endless ability to raise price and mix. This easy growth is no longer to be taken for granted, we believe, and as such, the sector will need to refocus on productivity.

From growth to cash flow

Things have been changing again in luxury. Demographics remain supportive, but we believe growth will be more challenging to achieve and resistance to price/mix expansion will be higher. More moderate growth (from 8% five-year average to estimated 5-6% in the next ten years) and increased competition must drive companies toward improving productivity. We identify retail productivity (sales/stores and sales/sqm), brand productivity (FCF/overall brand sales), and ROCE as key discriminating factors in our Brand Power Index ("BPI"). Hermes, LV, and Cartier are ranking at the top, but Prada, Gucci, and Moncler, among others, enjoy significant opportunities. In a high growth environment, profits were reinvested for further growth. Now, with consolidating growth, capex requirements will be declining and focus on efficiencies will increase, driving unprecedented levels of cash flow generation, which we believe could flow incrementally into the shareholders' pockets.

Cash is king: from PE to EV multiples and FCF; risks

With financial leverage being below 5% vs. 40% ten years ago and a growing portion of the earnings being converted into cash for shareholders (cash conversion from 60% average in the past five years to 90% average in FY16E), the relative appeal of the luxury sector should probably be judged increasingly more on FCF yield than on PE ratios. The sector is trading today on 17x PER 12M forward and a 20% premium to the market (vs. 40% 10Y average). However, its FCF yield of 5.5% is superior to the historical average (4.5%). Furthermore, luxury trades on 3x EV/CE (vs. 5-6x for staples). Currency volatility and macro dynamics are the key risks for the industry, but we note that, in a more complicated environment, cash is generally more protected from deleveraging than earnings.

Key Changes

Company	Target Price	Rating
BRBY.L	1,750.00 to 1,530.00(GBP)	-
CFR.VX	88.00 to 90.00(CHF)	Hold to Buy
1913.HK	53.00 to 47.00(HKD)	Hold to Buy

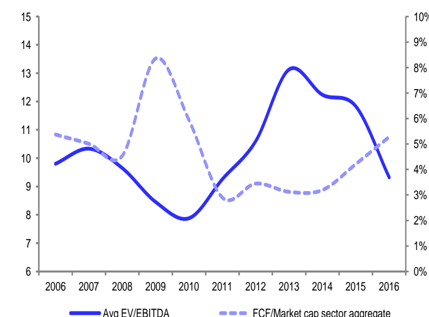
Source: Deutsche Bank

Top picks

LVMH (LVMH.PA),EUR151.15	Buy
Richemont (CFR.VX),CHF75.10	Buy
Moncler (MONC.MI),EUR16.20	Buy

Source: Deutsche Bank

Sector EV/EBITDA and FCF Yield



Source: Deutsche Bank

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Executive summary

From growth to cash flow generation

After years of strong top-line growth, fuelled by demographic trends and investments in distribution, growth has moderated, and margins have been under pressure for two years in a row, leading to a vibrant debate about sustainability of profitability in the industry, spurred by a few illustrious victims of current demand volatility such as Prada or Tod's. In 2015, we estimate that 95% of the companies in the sector will report margins below peak levels. Hence, industry focus is shifting toward productivity. We introduce in this report multiple definitions of productivity, and we use them as a filter to identify the brands that will exit the current phase of extreme sales volatility, with greater market share and with cash flow generation above historical levels. Indeed, as *growth capex* slows on average for the industry, a bigger portion of this cash generation will be available for shareholders or for reinvestment in the brands with returns on average in excess of 25%.

In this context, we take a more constructive stance on luxury, with a renewed focus on industry leaders and companies with best-in-class strategies and opportunities: LVMH (Buy, target price E175) remains our top pick in the sector; we upgrade Richemont from Hold to Buy (target price CHF90); we upgrade Prada from Hold to Buy (target price HK$47). Among smaller opportunities, Moncler represents an attractive self-help growth story and remains a Buy (target price E18.5).

Productivity ranking to identify potential winners

An easy E70bn opportunity fully captured in the past five years…

We wrote in 2007 that China and other emerging consumers were changing the growth profile of the industry. Indeed, the past five years have been blessed with unprecedented growth, with a 10% demand CAGR translating into E70bn of incremental demand and substantial ROCE expansion from the high-teens before the crisis to 30% today.

In 2012, in our FITT report "*Stronger Brand, higher profits*", we examined how luxury companies were meeting the global challenge of delivering sustainable growth through a greater control of the supply chain from design to distribution and greater "ownership" of their brands. The retail business model focus has yielded superior growth and enhanced returns in the industry. However, industries which generate superior returns are bound to attract new entrants, leading eventually to the normalization of super earnings, and this has also happened in the past decade. A market that used to be for a few brands has become a more competitive place, allowing new entrants to enjoy growth profiles never seen before. Management teams are now facing increasing challenges in selecting the optimal business model and channel strategy, as the supremacy of retail is no longer obvious, and as we show in this report, successful strategies require a more selective approach and will differ depending on brand positioning and long-term targets.

…growth normalization requires renewed focus on brands

Over the next five years, we expect demand growth to moderate to, at best, its historical average of c.6% p.a.; this "new normal", made of higher competition and lower expected growth, with the consumer becoming more sophisticated and volatile both in tastes and geographical patterns, will require going back to the fundamental sustainable competitive strength: the brand and its ability to generate sales, margins, and cash flow.

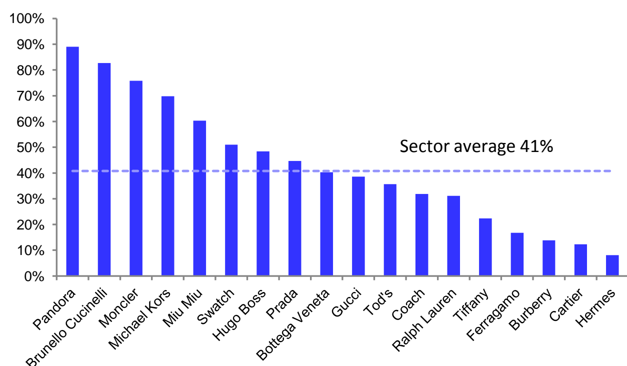
Together with the brand, management actions will be critical, as companies will be increasingly required to tailor strategic decisions around the brand and the company's medium- and long-term targets, taking individual decisions on price, distribution footprint, positioning, and costs that will make the difference.

Retail productivity has lagged demand due to fast network expansion

The capability of the brands to generate sales in their owned and operated stores is the key metric to assess the quality of investments in the network and the momentum of the brands.

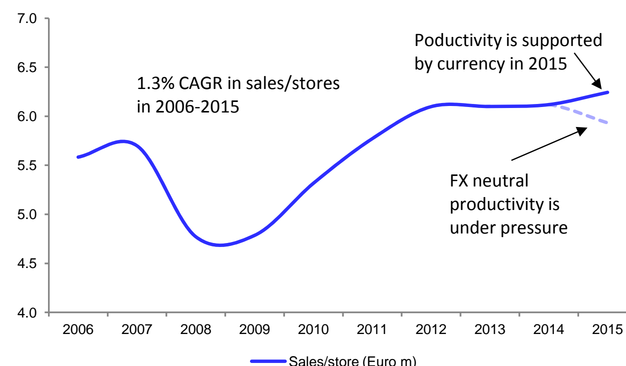
Network expansion has been much faster than industry demand growth over the past five years, and this has led to increasingly depressed store productivity across the industry and reduced performances of the selling areas. Our analysis suggests that, on average, 40% of the directly operated stores (DOS) have been opened in the past five years. This compares with 30% of the global demand being new and represents a particularly big number in an industry dominated by century-long brand history.

Figure 1: 40% of DOS opened in the past five years…



Source: Deutsche Bank, Company data

Figure 2: …leading to pressure on retail productivity



Source: Deutsche Bank

"Retail at all costs" is obsolete…

The multiple advantages of the retail business model are still valid (customer ownership, better brand management, pricing discipline, gross margin benefit, and hence higher absolute margin). However, in general, the shift to retail was pursued mostly indiscriminately, with the share of retail increasing from below 60% of sales in 2005 to c.70% today, which not only makes retail productivity even more relevant but has also created cost inflation, in particular for rents and labor, which has translated into structural pressure on retail margins that is mostly new to the luxury industry, widening the gap between best-in-class and laggards.

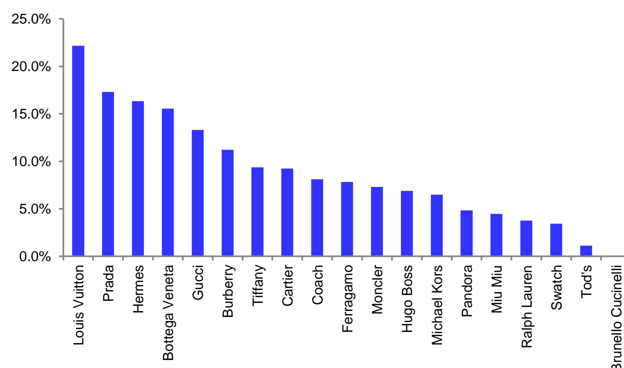
So, while store roll-out has been a key bull argument in the sector, it is now the maturity of the retail network that is becoming the focus as a key source of margin opportunities.

Brand productivity offers opportunities for improvement

Brand productivity reflects the broader capability and appeal of the brands to generate sales across all channels: this includes sales in the directly operated boutiques, franchised stores, multi-brand stores, and sales from licenses. We see this as a broader concept of productivity and believe it is set to be the key driver of cash flow and assessment of brand potential. We have proprietarily defined this metric as brand FCF as a percentage of brand sales at retail value and calculated it for our companies and their key brands

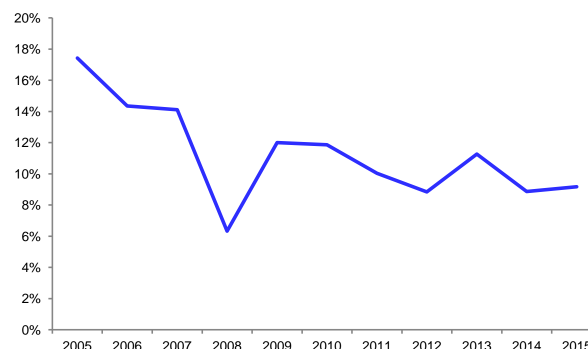
Our analysis of cash flows suggests there are brands that are experiencing pressure both on margin and top line but still should have the ability to generate superior performances on the cash generation front. Figure 4 shows the ranking in the industry by FCF generated out of the totality of brand sales. Brand productivity has also been overcast by absolute profit growth in the past years and is today close to the lowest point in years.

Figure 3: Brand productivity ranking (2014)



Source: Deutsche Bank, Company data

Figure 4: Brand FCF/retail value of brand sales*



Source: Deutsche Bank – Brand productivity is defined as FCF to the brand divided by brand sales
**Brand sales represent the sum of retail sales and retail value of the sales generated in the wholesale channel (both franchising and multibrand), plus the value of licensed sales*

We believe that productivity is the best framework to assess the sustainability of margins in the long term and that this should be a much greater factor than any other distinctive element such as the channel or geographical mix. Also, luxury is a top-line industry and not a P&L industry; hence, we see cost management as an opportunity but not the key driver.

Maturity is a good thing …

We see two key dynamics that will drive improving LFLs in the coming years, and both rely on the transition from a phase of fast network expansion to a phase of store network maturity:

- **Supply-demand rebalance**. With demand still expected to grow broadly in line with long-term trends at around 5% this year and 6% next year, we believe that the supply-demand balance should be gradually restored: network investments are moderating as players optimize their global retail presence and rethink expansion plans to ensure that it is accretive to earnings and return on capital.

- **The "retail detail"**. A phase of more moderate growth should force companies to refocus on the key retail metrics (traffic, conversions, average transaction size, optimum merchandising, etc.) in order to drive same-store sales growth. Brands have the opportunity to embark on different initiatives very much specific to their positioning and long-term targets: the refurbishment of stores representing 30% of sales at Gucci; Prada slowing store opening and redefining price architecture; Louis Vuitton exploring mix opportunities moving from canvas to leather; Hugo Boss elevating the brand to capture price/mix opportunities; and Burberry pushing its digital edge forward.

There is not a unique recipe that maximizes ROCE. Channel mix and store productivity have to be balanced against the positioning of the brand, its strength, and its opportunities. Ultimately, productivity would directionally show the sustainability of margins and ROCE over the years.

In our forecasts, luxury sector margins are set to expand already in 2016 by 70bps on average, to just above 20%, with most of the players remaining below the peak margins experienced in the past five years. As a result, ROCE is also expected to improve by 3pp between 2015 and 2016 to reach 30% next year, at the higher end of the range of the past decade. FCF is the metric that will show the greatest improvements as a percentage of sales, moving from 8% in 2014 to 11% on average in 2016.

…captured by our synthetic "Brand Power Index"

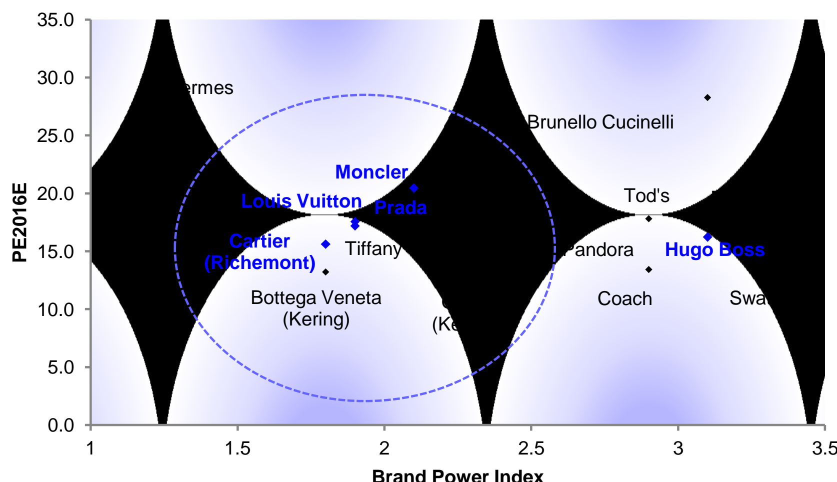
This is why we have developed a support framework that can help identify the brands that on top of their numerical productivity have the better potential and opportunities to support margins and cash flow.

The track record suggests that brands that have focused on productivity already in past years – such as Hermes, LV, and Cartier – are already reporting sustainable outperformance in sales and profitability. Higher levels of productivity give room to invest in the brand equity for the long term and finally create unprecedented levels of cash flow. In this volatile environment, these qualities are even more valuable than catch-up opportunities, in our view. At the opposite side of the spectrum, brands that have lower-than-average productivity are likely to face increasing margin pressure: the risk is a short-term reaction, at the expense of the brand equity, with a potentially higher toll to be paid in the longer term.

We have therefore summarized into a unique **Brand Power Index** the weighted average combination of the quartile ranking across seven dimensions for each brand. Three quantitative measures have received a 20% weight each: retail productivity, brand productivity, and Return on Capital. Four more qualitative and therefore discretionary variables have received a 10% weight each: pricing discipline, exclusivity, brand momentum, and organic opportunity to improve margins. Based on the relative positioning across several variables, we have identified, as shown in Figure 5, the brands that rank in top quartiles. This provides a framework, as objective as possible, to evaluate brand productivity, margin sustainability, and opportunities to improve. An interesting fact about this index is that successful implementation of appropriate strategies can help companies improve their scores.

In Figure 5, we are mapping our Brand Power Index against valuation (PE), and we identify the area that offers the best risk/reward, in our view.

Figure 5: Luxury goods – Brand Power Index ranking and valuation

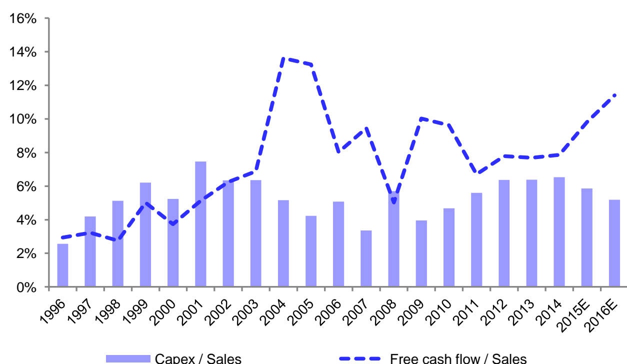


Source: Deutsche Bank. BPI calculated as the weighted average of seven variables: Retail productivity (20% weight), brand productivity (20%), ROCE (20%), pricing discipline (10%), exclusivity (10%), brand momentum (10%), and opportunities (10%)

Valuation: focusing on FCF Yield and EV multiples

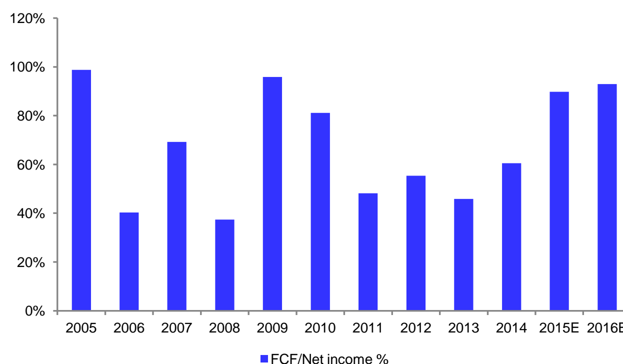
The luxury sector has been traditionally rated based on price-to-earnings ratio and growth to reflect the industry's attractive growth profile as well as the fact that companies were reinvesting all their profits into further growth. As the industry's growth is moderating and investment requirements are becoming less relevant in both absolute terms and relative to the size of the companies, we believe the sector will see an unprecedented wave of free cash flow generation: we estimate approximately E15bn of free cash flow generation in 2016 in considering the sum of the companies under our coverage, almost doubling the E8.5-9.0bn generated in 2012-14. This cash will represent 90% of the earnings generated next year vs. c.60% on average in the past three years.

Figure 6: Average sector FCF/sales is set to expand to record levels…



Source: Deutsche Bank, Company data

Figure 7: …and cash conversion will rise further



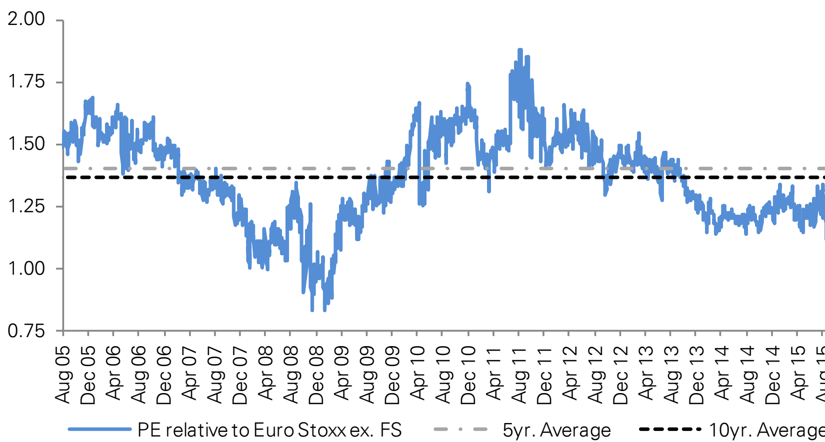
Source: Deutsche Bank, Company data

As a larger share of the earnings is converted into cash, we believe that investors have not yet realized that the cash flow will become as relevant as earnings momentum. As cash flow is significantly less volatile than earnings, also due to the significant amount of discretionary capex, we believe that PE

valuation today should reflect the different environment and that the valuation approach should become more similar to staples; therefore, a FCF yield of 6% on average for the sector becomes more relevant than PE. Should organic and external investment opportunities fail to materialize (reinvestments would, in any case, have ROCE typically in excess of 25%), excess cash generation could eventually translate into incremental returns for shareholders as the gearing level is at its historical low point, so that special dividends (e.g., Luxottica, Hermes, LVMH) or share buybacks (e.g., Pandora) could be potentially replicated and should further enhance shareholders returns.

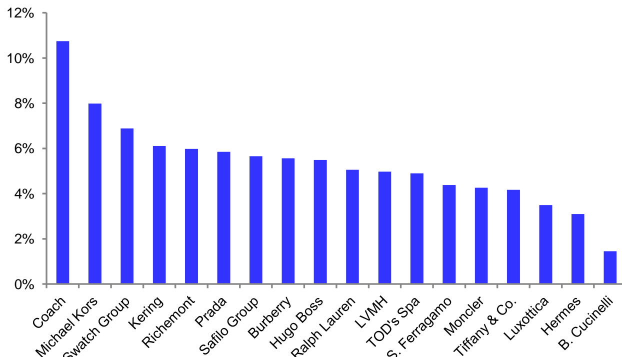
In relative terms, we believe that this implies that the sector no longer deserves to trade at the low end of its relative valuation range (20%) vs. its historical premium to the broad market (40% average)

Figure 8: Luxury sector trading below long-term average vs. market



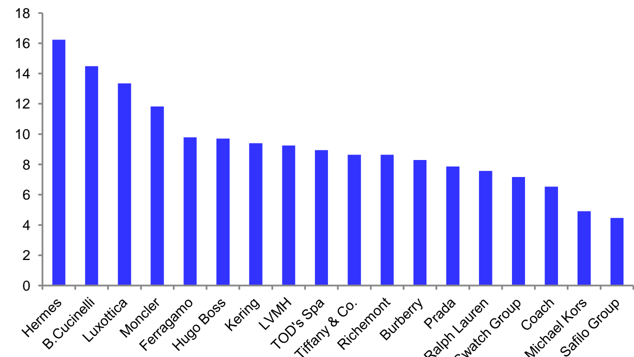
Source: Deutsche Bank, DataStream, IBES

Figure 9: FY16E FCF yield (%) ranking



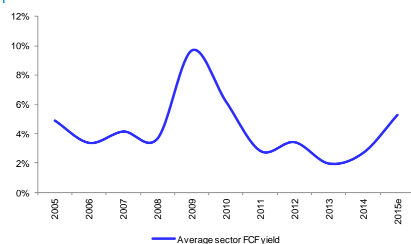
Source: Deutsche Bank estimates

Figure 10: FY16E EV/EBITDA ranking



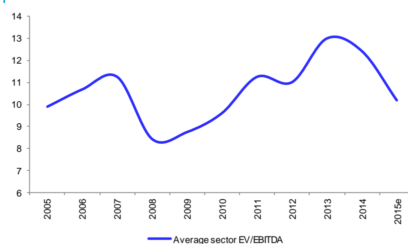
Source: Deutsche Bank

Figure 11: Average sector FCF Yield



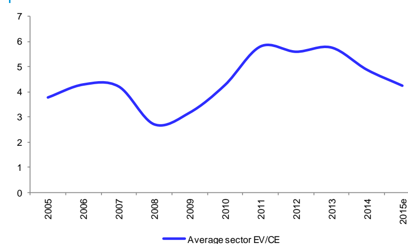
Source: Deutsche Bank ,Company data Note: sector FCF yield is simple average for coverage stocks 2009 FCF yield is high because of Hugo Boss FCF yield of 50%

Figure 12: Average sector EV/EBITDA



Source: Deutsche Bank estimates, Company data

Figure 13: Average sector EV/CE



Source: Deutsche Bank estimates, Company data

Upgrading Richemont and Prada to Buy, confirming LVMH as a key Buy

The current environment is increasingly differentiating among luxury players that can afford a long term view also in the short term and players that are mostly impacted by volatility. Differently from the past two decades, when luxury strategies were mostly copycats of Louis Vuitton's "luxury blueprint strategy" and companies had only limited decisions to make benefitting from booming demand, the environment today requires management to take actions on price, distribution footprint, the right positioning and brand message, cost investments, or streamlining opportunities. In a nutshell, strategy and execution will be critical and increasingly a responsibility for management, and it is the opportunities laying in front of the companies and our level of confidence in the execution which drives our stock picking, for both the best-in-class and the catch-up plays.

As we move from self-help stories to structurally praise the FCF generation capabilities of the sector, we believe that multiples have room to rerate. **Luxottica** and **Hermes** look to be the benchmark in this perspective, with their expensive valuations reflecting a superior ability to convert ROCE into cash.

In this framework, our stock selection is a mix of best-in-class companies, showing different degrees of further productivity and ROCE opportunities, and catch-up stories, in which the solid execution of a sound strategy can result in a return to higher profitability. Valuation is as always a filter in this process.

We confirm LVMH (Buy, target price E175) as a key Buy. We continue to believe Louis Vuitton, which represents c.50% of group profits, to be one of the best positioned luxury brands. It has maintained high margins, even in the past two years, through careful management of the brand. Its store expansion has been more focused on store enlargement than net additions. We see medium-term potential to shift its product mix more toward leather products, which typically command a price premium of c.60% to its canvas ranges. In this way, we see price/mix as a continued revenue driver for the brand. On CY16 PE of16.8x, the stock is trading toward the bottom end of its historical premium to the wider market.

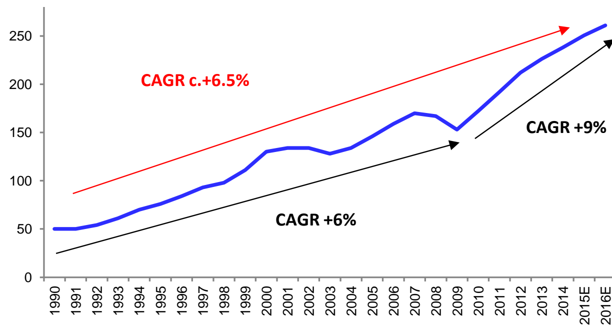
We are upgrading **Richemont** to Buy with a target price of CHF90. Richemont's key brand Cartier is a best-in-class on most metrics, and valuation is attractive. The stock has underperformed the industry by 25% in the past 12 months and is now looking attractive on both valuation and fundamental opportunity: E5.5bn cash on the balance sheet, a 12M rolling PER of 15.5x (PER ex-cash of 14x) and EV/EBITDA of 9.4x, a 6% FCF yield, and an EV/CE of 3x vs. 6x for staples. Richemont is the largest jewelry player worldwide: the sector is posed for solid structural growth, and Richemont is making the right decisions in terms of footprint and of merchandising, successfully developing both the high-end jewelry segment and product lines across a wide range of price points. As the destocking cycle has remained very harsh in Asia, we think this might turn over the next 6-12 months, offering some respite to forecasts, while one of the best global footprints allows Richemont brands to capture changing travel flows easily.

Moncler remains a Buy (target price E18.5). It is one of the few players that still has in front of it the easy growth opportunity based on a disciplined and compelling retail store roll-out. Moncler momentum is one of the strongest in the industry, and while exploiting the geographical opportunity, Moncler has maintained a strict focus on productivity. The retail performances are at the top of the industry, and further productivity gains are targeted with the diversification of product category as well as the further development of Spring/Summer collections. The results are mid-teens top-line growth projected for the coming years and 17% EPS growth, which is not fully reflected in the 20x 2016 PE multiple, a 15% premium to European peers.

We also upgrade **Prada** to Buy with a target price of HKD47 (from 53 before). The stock is down over 60% from its peak and has de-rated significantly on the back of well-known top-line weakness, which has translated into 800bps margin erosion from peak. The company has swiftly addressed some of the structural flaws by strengthening and streamlining the supply chain and allowing sustainable GM support. As the brand regains momentum and scale we think the profit rebound is due to be significant (we estimate 30% operating profit growth in 2H and 15% in FY16, and we are significantly above consensus). With the stock trading on 17x FY16 PE and with a FCF yield of 5.8%, we feel comfortable on the downside.

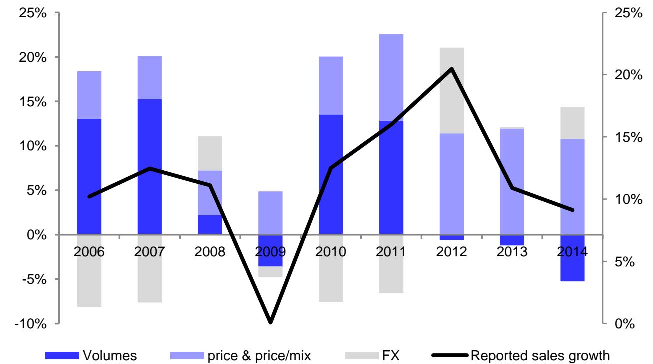
Summary in charts

Figure 14: Luxury demand expanded by E70bn in the past five years alone, or 30% of total demand…



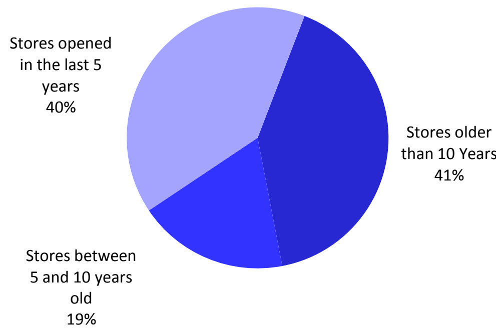
Source: Deutsche Bank estimates, , Altagamma Luxury Monitorr by Bain &C

Figure 15: …a luxury cakewalk with easy wins from demographics, pricing/mix…



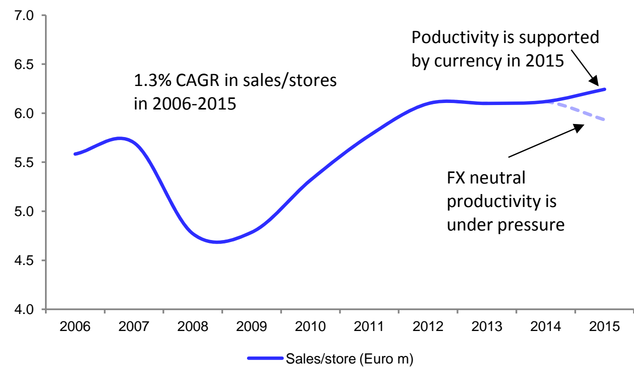
Source: Deutsche Bank

Figure 16: …and network growth: on average, 40% of the DOS capacity has been added in the past five years…



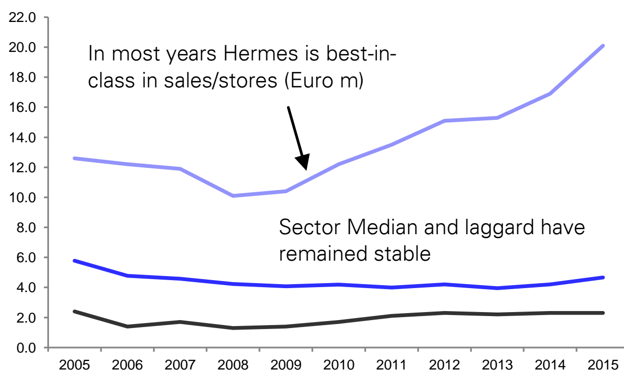
Source: Deutsche Bank, Company data

Figure 17: …leading to depressed productivity and negative LFLs, as the network is immature…



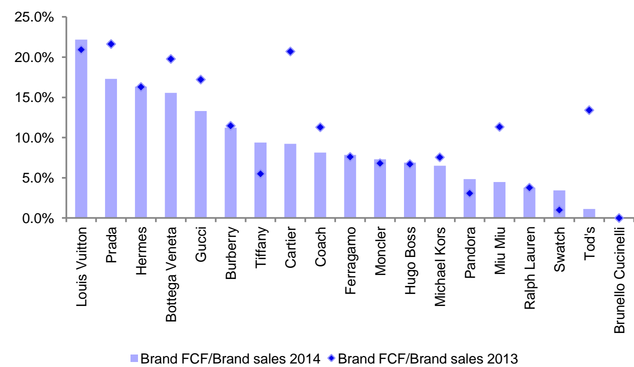
Source: Deutsche Bank

Figure 18: …leading to differentiated retail performance between best-in-class and average…



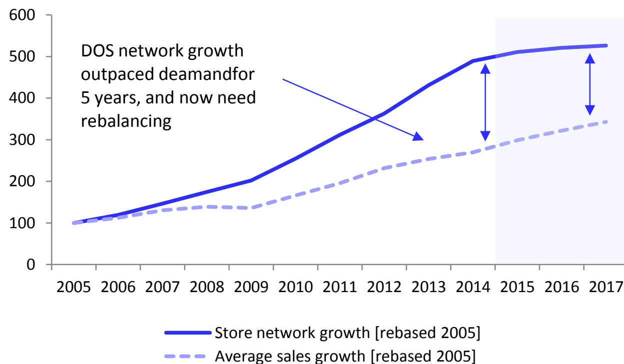
Source: Deutsche Bank

Figure 19: …putting brand productivity under pressure



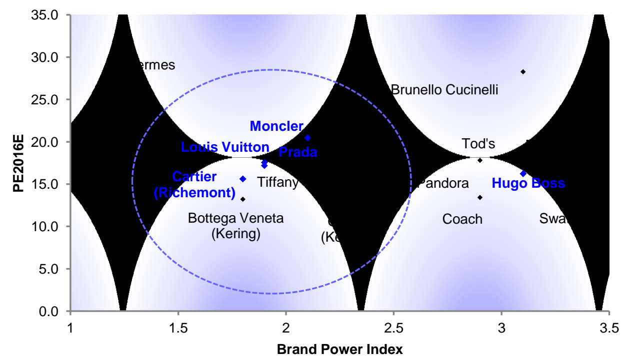
Source: Deutsche Bank

Figure 20: The easy LFLs opportunity: slowing network growth will direct demand to existing stores



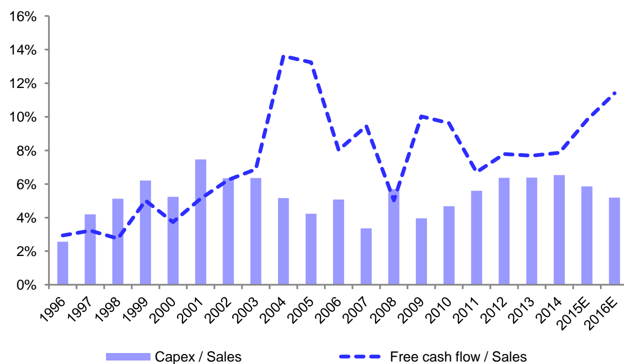
Source: Deutsche Bank estimates

Figure 21: The challenging LFLs opportunity: identified by our the Brand Power Index



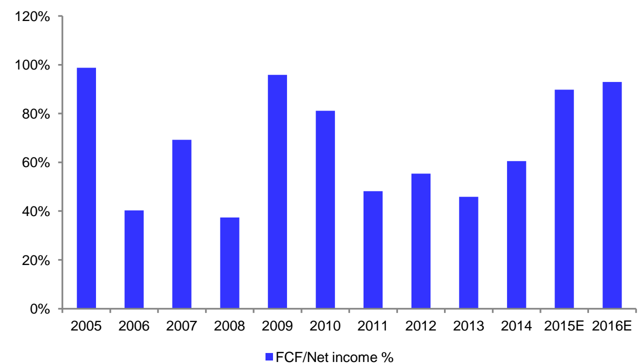
Source: Deutsche Bank. BPI calculated as the weighted average of seven variables: Retail productivity (20% weight), brand productivity (20%), ROCE (20%), pricing discipline (10%), exclusivity (10%), brand momentum (10%), and opportunities (10%)

Figure 22: Lower capex and refocus on productivity will drive unprecedented cash flow generation…



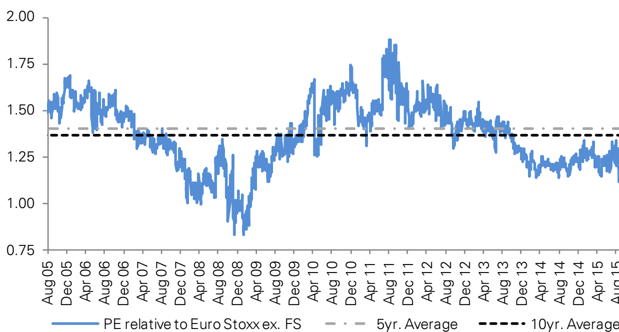
Source: Deutsche Bank estimates, Company data

Figure 23: …transforming earnings into cash



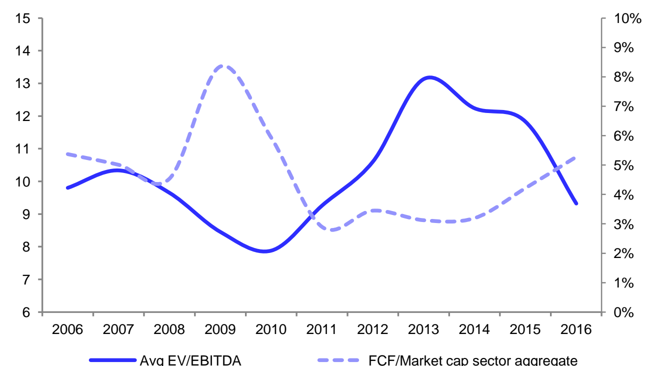
Source: Deutsche Bank estimates, Company data

Figure 24: Cash earnings conversion commands a convergence to PE historical premium vs. market…



Source: Deutsche Bank, DataStream IBES

Figure 25: …and refocus on EV/metrics and cash flow generation matrix, now more attractive



Source: Deutsche Bank estimates

From growth to productivity

Growth has been an easy game in the past ten years

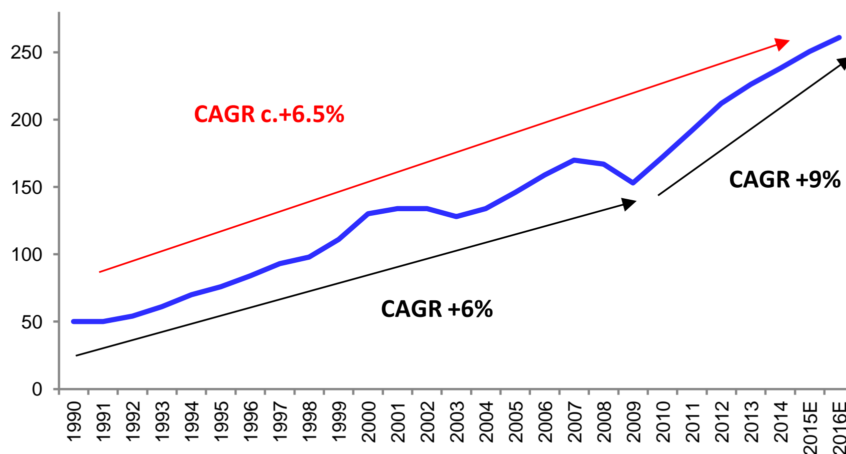
From unprecedented growth with easy wins …

Luxury goods are un-necessary products that, for their quality, their rarity, and their prices, are affordable to a limited portion of the population and are consequently associated with status and desirability. For this reason, luxury has historically enjoyed strong growth in the context of healthy global growth, wealth polarization, and powerful demographics. Exclusivity and desirability are associated with premium positioning and pricing power, creating the base for superior profitability.

Unprecedented growth: E70bn incremental demand in the past five years

In the past 30 years, worldwide demand for luxury products has grown by a 6.5% CAGR, and the past 10 years have especially seen an unprecedented burst in demand driven by wealth creation, wealth polarization, and demographics, with a special contribution from Chinese consumers. We review in this section how the luxury market has changed in the past three decades.

Figure 26: Enjoying in the old days



Source: Deutsche Bank, Altagamma Luxury Monitor by Bain &C

The "*Old normal*": the luxury cakewalk

1990-2000: from "niche" to "market"

Until the burst of the tech bubble and 9/11, the sector benefited from a long period of expansion in three main regions: Japan, Europe, and the US.

- The coming of age of the Japanese luxury population: started in the 1970s, Japanese luxury consumers peaked in the late 1990s to early 2000s, reaching E55bn in size.

- The democratization of the consumer base in Europe: luxury penetration has grown in line with GDP per capita.
- Growing penetration of the US market through new stores; luxury spending per capita grew to E107 (in real terms) from E33 in the previous decade, with a CAGR of over 10%.

2003-08: democratization

After the retracement and moderation experienced in 2001-03, the sector had an upswing that lasted unabated until mid 2008.

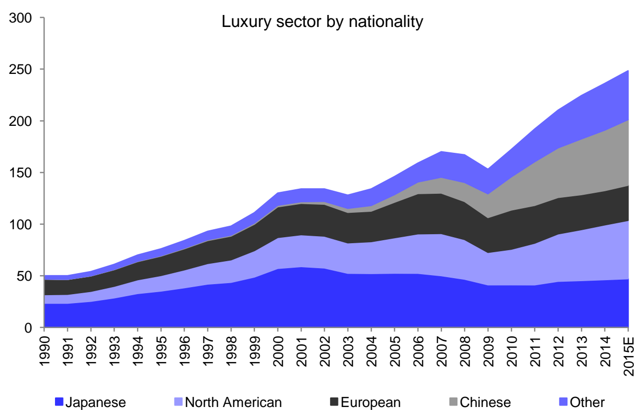
- The sector benefited from 'premiumization', with demand increasingly skewed toward richer mix/more expensive products, especially in Europe and the US. As an illustration, Swiss watch export value grew 11%, while volumes have remained at around 26 million in the period.
- The aspirational shopper emerged, especially in the US, with easy credit driving accessible luxury. Luxottica estimated this to have accounted for c.10% of purchases in the boom of 2006 and 2007.
- BRIC consumers emerged and accelerated in importance.

2008-2014: BRIC changed the cycle

... boosted by BRICs ...

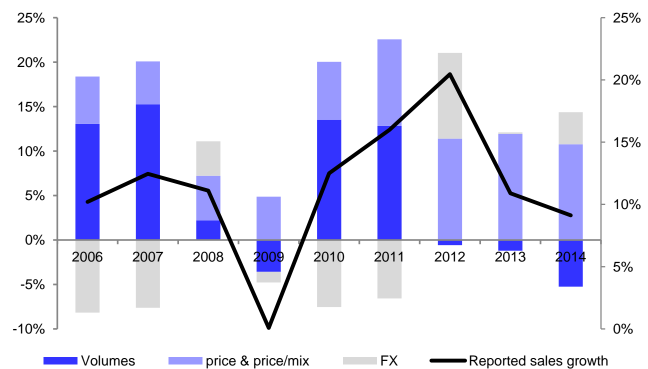
Between the end of 2008 and the end of 2010, the sector experienced a well known exceptional period of extremes. In particular, in 2008/09, China started to become a key influence in the industry. E70bn of new demand has been created in the past five years, and Chinese consumers have moved from 1% in 2000 to c20% in 2010 to almost 30% today. Not only growth has been material; what is also relevant is that this growth has been relatively "easy", driven by pricing and price/mix, new stores, channel shift, and increasing penetration, but more importantly with almost unlimited demand driven by Chinese customers.

Figure 27: Global luxury demand growth by nationality



Source: Deutsche Bank, Altagamma Luxury Monitorr by Bain &C

Figure 28: Global luxury demand growth by nature



Source: Deutsche Bank

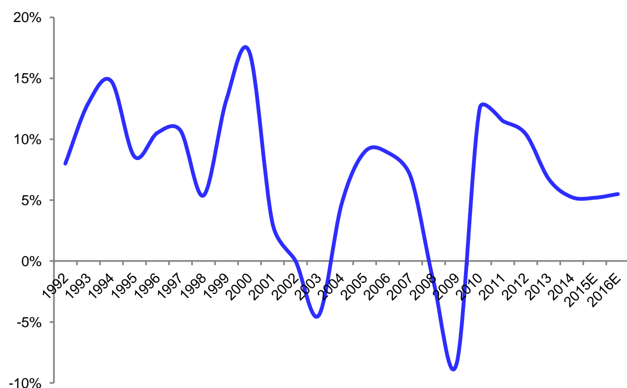
The "*New normal*": opportunities require more hard work

... to a more complicated environment

Still well supported by secular trends, we estimate that the luxury market should grow by c.4-6% p.a. in the coming 10 years, given a combination of maturity in some of the key regions but further demographics-driven opportunities in China, the rest of Asia, and other new markets.

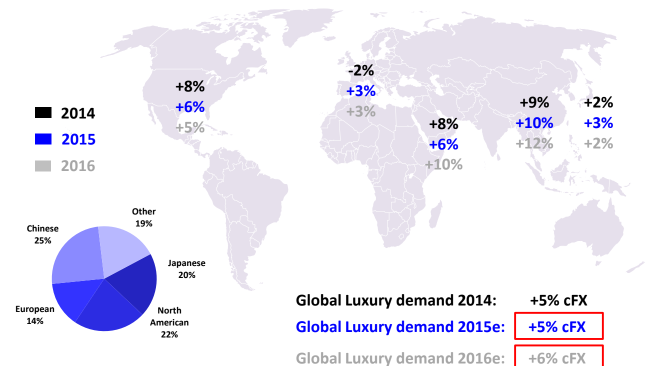
We will not review here the powerful support of demographics in the industry, although our reader might be able to find extensive coverage of the luxury sector demand in the following reports: "*BRIC growth changes the cycle*", "*Still more opportunities than risks from EMs*".

Figure 29: Luxury demand growth (% yoy change)



Source: Deutsche Bank estimates

Figure 30: Demand by nationality



Source: Deutsche Bank

Demand assumptions

Volatility in geographical demand does not change the medium-term outlook

We update our industry demand estimates by geography in this report, while there is no change in the overall demand growth that we still see at +5% in 2015 and +6% in 2016, while regarding the demand by nationality, we only fine tune the 2015/2016 timing of demand growth from emerging consumers.

Demand by nationality, summarized in Figure 30, is in fact broadly consistent with the expectations we had at the beginning of 2015. We still see high-single-digit to low-double-digit growth of Chinese consumers, a slight acceleration by European consumers, a slight improvement and then consolidation by Japanese consumers, and a slight deceleration of North American consumers. What has changed – and has changed materially – is the geographical destination of the shopping.

FX has swiftly changed the shopping map, moving consumers away from US and Asian countries to Europe and Japan, also exacerbating the dynamics of the grey market, especially as far as Europe is concerned. We are today assuming that Japan will grow 12% and Europe will grow 14%. The US is forecast to grow 3% only, and Asia Pac, dragged down by HK and Mainland China difficulties, is expected to fall 10%.

Figure 31: Luxury demand growth by nationality

	2014	2015E	2016E
Japanese	2%	3%	2%
North American	8%	6%	5%
European	-2%	3%	3%
Chinese	9%	10%	12%
Other	8%	2%	6%
Total	**5.2%**	**5.0%**	**6.0%**
- Mature customer	*3%*	*4%*	*3%*
- Emerging customer	*8%*	*6%*	*10%*
Total	**5.2%**	**5.0%**	**6.0%**

Source: Deutsche Bank estimates

Figure 32: Luxury demand by geography (Ebn)

	2013	2014	2015E	2016E
Europe	77	78	89	96
Americas	72	77	78	81
Japan	18	18	20	21
Greater China	32	35	32	33
Rest of Asia	17	18	19	19
Rest of the World	12	13	13	14
Luxury sector	**226**	**238**	**250**	**264**
yoy				
Europe	3%	2%	14%	8%
Americas	10%	7%	3%	3%
Japan	-10%	-2%	12%	7%
Greater China	18%	10%	-10%	3%
Rest of Asia	10%	7%	3%	5%
Rest of the World	15%	10%	4%	7%
Luxury sector	**6.7%**	**5.2%**	**5.0%**	**5.5%**

Source: Deutsche Bank estimates

Productivity: the new magic word

Easy growth inevitably attracts new entrants…

Growth has been almost a cakewalk for most of the brands. It should not surprise investors that relatively easy top-line and profits growth has attracted many new entrants. With the exception of the ultra high-end segment of the luxury industry, every single category has seen brands developing with a speed that was impossible to imagine only ten years ago.

The past five years of astounding demand growth have seen the affirmation of new entrants as well as the resuscitation of historical brands. Instances in point are the growth of Michael Kors, Bottega Veneta, Moncler, or Jimmy Choo, among others, or the renewed international ambitions, with more extensive footprint, of brands like Missoni, Mulberry, Givenchy, Lanvin, Etro, etc. Those are brands that were either not on the luxury map in the early 2000s or that were much more restrained in their geographical ambitions and diversification efforts. The success of these brands has not eroded the market shares of brands with deeper roots in the history of luxury such as Louis Vuitton, Hermes, Tiffany, Gucci, or Prada. This was true until 2014.

…and luxury players need to refocus on productivity

Today, the world has changed. There are more players competing for a share of the global shopper wallet, for a window in the most glamorous locations, and for a corner in the busiest airports. In a world that is running at unprecedented speed, luxury brands can also rise and fall as never before.

On top of markets dynamics and technological changes, the luxury market also faces new complex dynamics: consumers are more sophisticated and unpredictable in their tastes and in their shopping patterns, which makes investments critical more in customer recruitment and retention.

Ultimately, all these forces are compelling companies to refocus on productivity as a driver of margins, as a driver of cash flow, and as a driver of returns.

Productivity is becoming increasingly important in the industry. This has resulted in this theme becoming a central topic of management discussions in the past quarters. Below, we have reported a few instances.

Burberry. "*As we look to build on the investments of recent years to drive enhanced profitability, we are embedding a more productive and efficient mindset across the business, together with tight control of operating costs, consistent with our stated ambition to drive margin progression over time*" (Christopher Bailey, 20 May 2015).

Coach. "*We continue to expect that our square footage globally and across all channels will increase slightly in FY 2015, reflecting our North American fleet optimization. Our overarching focus will be on renovations and remodels to drive productivity*" (Victor Luis, 28 April 2015).

Kering. "*We are focusing on providing the best customer experience in Gucci stores, leveraging CRM capabilities and improving sales productivity*" (Jean-François Palus, 27 July 2015).

Tiffany. "*Our strategy for this year and over the long term is to keep inventory growth below the rate of sales growth through better productivity in our stores as well as in our overall supply chain*" (Ralph J. Nicoletti, 27 May 2015).

As not all players have the same business model flexibility and focus, in the past few quarters, differentiated companies' dynamics in response to external demand and macro challenges have raised concerns that all these forces could actually converge to put industry margins under pressure. On the contrary, we see that not all companies will be equally affected, and productivity is the filter to assess winners in the current environment.

We note, however, that luxury companies' management teams have typically best-in-class track records and are determined and focused, which suggests that, as productivity becomes a key management target, results should not lag. Burberry represents a good example in this direction, having enjoyed one of the highest productivity improvements in the past five years and having been one of the first companies to focus on this area.

Defining luxury goods productivity

The allure of a brand, its strength and desirability, and the ability to reach out to consumers and maintain a credible dialogue with them over time is what translates into sales and profits. Thus, brand productivity stands out as the most important factor influencing sustainable profitability and cash generation, in our view, especially as growth trends are consolidating, depriving companies from the easy sales and profit drivers of the recent past.

As such, we see luxury as a top-line industry and not a P&L industry, i.e., an industry in which the numbers are driven by the brand equity and decisions on how to valorize it through positioning, marketing, merchandising, distribution, etc., while cost management is an opportunity but not the key driver.

Because of these reasons, it is not obvious how to define productivity in luxury goods. Our approach is based on the following definitions:

- **Retail productivity**: We define retail productivity simply as retail sales divided by the number of directly operated retail stores (DOS) or their sqm. We show both measures, although we caution that store

productivity is a more accurate measure, as sqm productivity calculation relies on an additional set of assumptions regarding average store size of the existing network and average store size of recent openings.

- **Retail profitability**: We define the retail profitability as the operating profit generated by a brand divided by the number of retail stores (DOS) or their estimated selling surface.
- **Brand Productivity**: As it would be impossible to calculate the Brand Productivity as the sales generated by a brand divided by the overall number of points of sales including both retail and wholesale doors, we have developed a proprietary framework to calculate a proxy of this metric. We define brand productivity as the FCF generated by the brand sales available for both the company and the wholesale partners.

In the following chapters, we show how the analysis of different definitions of productivity results into a potentially differentiated performance, and we define a synthetic index, the Brand Power Index, which is meant to help in identifying the companies offering the best risk/reward potential in luxury.

Incidentally, Luxottica and Safilo will not be included in the analysis because of non-comparable business models.

Retail productivity

"*More stores*" was the mantra …

Network expansion has been much faster than industry demand growth over the past five years. While this aggressive footprint expansion was regarded as a bull point for luxury, as it has been a key driver of top-line growth (we estimate around 50% of total growth), we now have to reconsider this, as this development has led to increasingly depressed store productivity across the industry and reduced performances of the selling areas.

Indeed, the past five years have seen an unprecedented level of investments in directly operated stores, fuelled by insatiable consumer demand, new regions opening up to the luxury industry, and the desire to capture a greater portion of the margins across the value chain while elevating the brand positioning. Our analysis suggests that the multiple advantages of the retail business model are still valid (better brand management, pricing discipline, gross margin benefit, and hence higher absolute margin). However, the shift toward retail generated a loss of focus on LFLs as a flipside and created cost inflation, particularly for rents and labor, which has translated into pressure on retail margin that is mostly new to the luxury industry.

Currency swings have added a new variable to the picture, as demand is more flexible than the retail cost structures. Changing the global price architecture has been one of the actions to offset this element, although it is unlikely to be the answer in a sector in which demand elasticity has been historically low.

…maturity is now the key word

Now with a more volatile, less robust demand scenario, it is the maturity of the retail network that becomes a positive, as it offers opportunities for operating leverage as companies' focus moves back to LFL. We believe that the industry will generally be able to offset pressure on margin in the medium term. However, the flexibility to absorb margin pressure in the short term and the ability to stick to a long-term vision is likely to differentiate the industry winners from laggards.

We note that Hermes, Louis Vuitton (LVMH), Cartier (Richemont), and Moncler stand out as best-in-class, but we see significant upside opportunity for a few names as they consolidate their store footprint, allowing productivity to increase.

Network growth has been too fast

DOS growth outpaced demand increase

Our global luxury demand assumptions are outlined in the previous chapter. Over the past 30 years, the industry has obtained a 6-7% annual growth rate. We believe that a 5-6% CAGR should be sustainable in the medium term, and in the short term, 5% constant currency growth for 2015, in line with 2014, is the base assumption.

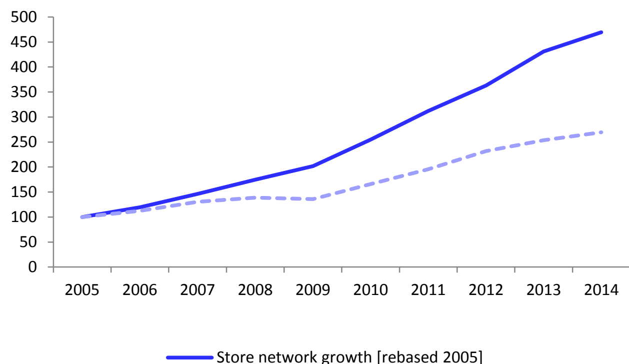
Structurally, luxury players have been able to capture industry growth in the past decade through a combination of store productivity enhancement and network expansion, mostly with directly operated store (DOS) additions. Just focusing on the recent 10 years, however, DOS expansion/space growth has been by far the largest contributor to sales growth.

Figure 33: Number of directly operated stores by brand

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Bottega Veneta (Kering)		97	111	121	135	148	170	196	221	236
Brunello Cucinelli							23	46	61	71
Burberry	66	77	97	119	131	174	192	206	215	215
Coach		505	572	624	725	799	891	953	1014	1019
Hermes	136	145	156	166	180	193	205	205	203	207
Hugo Boss	47	106	143	176	203	276	359	427	484	510
Gucci (Kering)	207	219	233	258	283	317	376	429	474	505
Luxottica*		5302	5767	5696	5682	5824	6533	6417	6472	6471
Louis Vuitton (LVMH)	345	368	390	425	446	459	461	467	469	471
Michael Kors		23	48	74	106	166	237	304	405	515
Miu Miu (Prada)			27	36	51	71	94	126	150	169
Moncler						39	61	83	107	134
Pandora						47	136	167	206	317
Prada			154	166	177	207	245	283	330	362
Ralph Lauren	289	292	313	326	350	367	379	388	433	483
Cartier	157	161	163	172	171	186	194	192	195	201
Salvatore Ferragamo				273	299	312	323	338	360	373
Swatch Group	700	750	820	890	990	1140	1260	1380	1860	2000
Tiffany & Co.	154	167	184	206	220	233	247	275	289	295
TOD's Group	105	110	125	150	149	159	176	193	219	232

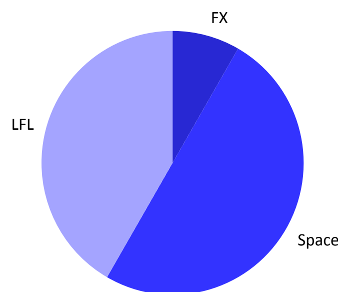
*Source: Deutsche Bank, Company data; * Luxottica has been included in the table but has been excluded from the considerations for the rest of the business due to the different nature of its optical business*

Figure 34: DOS growth vs. sales growth



Source: Deutsche Bank

Figure 35: Sales growth split by new space, LFL, FX (average 2005-2014)



Source: Deutsche Bank

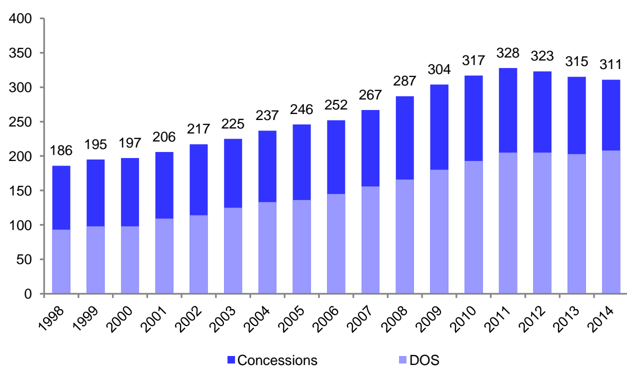
This has offered significant opportunities to industry leaders to consolidate their position and profitability, while it has allowed smaller and under-penetrated brands to develop their footprint and increase their global market share.

For most of the brands, network development has translated into a channel shift from wholesale to retail, through store openings and a rationalization of third-party operated stores or wholesale presence. However, for others, wholesale still represents a key focus for relatively less risky growth.

Mature brands have worked more on balance …

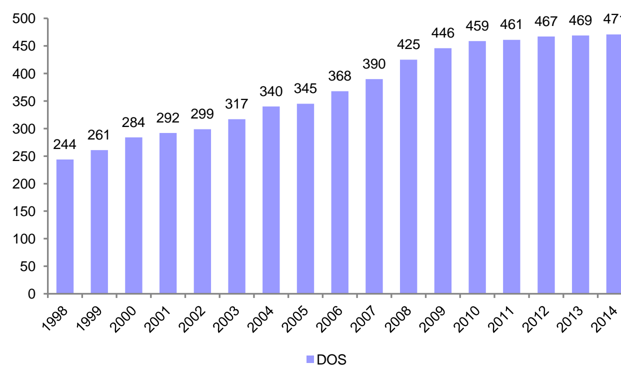
Mature brands like Hermes and Louis Vuitton, which could be seen as the strategy leaders in the luxury industry, have opted for a balancing of their store presence in the past few years following the financial crisis. Hermes's number of points of sales peaked in 2011 with 328 stores, and since then, a gradual rationalization strategy has been implemented (17 net store closures in four years, or 5% of the overall footprint), with overall DOS remaining substantially stable (from 205 in 2011 to 208 at the end of 2014). LV has only marginally increased the store count from 2011 to 2014, with the addition of just 10 DOS, while maintaining its pure 100% retail distribution model.

Figure 36: Hermes: DOS and third-party operated stores



Source: Deutsche Bank, Company data

Figure 37: LV: DOS and third-party operated stores

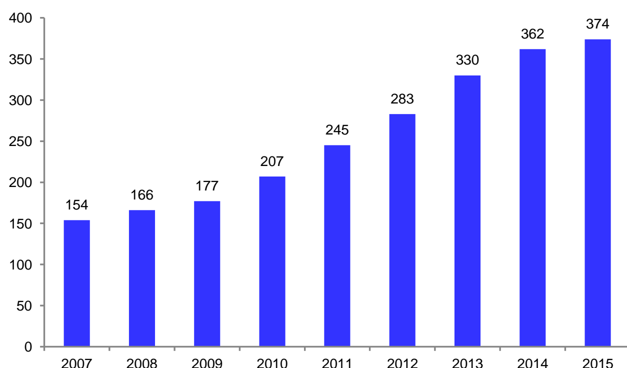


Source: Deutsche Bank, Company data

…smaller brands have opened at full speed!

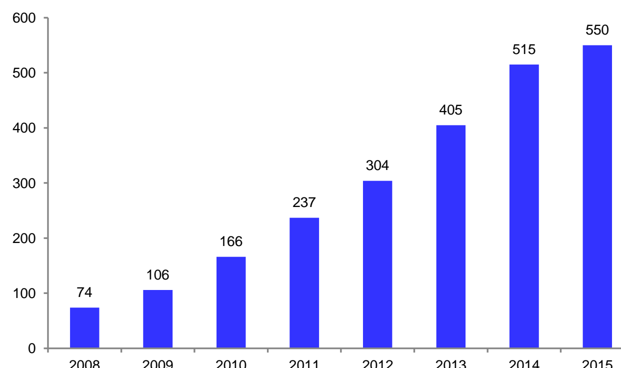
Smaller brands have developed their networks faster, in order to catch up with more mature brands and fully benefit from the growth of Chinese customers, the real powerful driver of the luxury industry in the past decade. Network-driven growth has been a key theme for all luxury categories, from soft luxury like Prada, Michael Kors, Moncler, or Bottega Veneta, to shoes like Tod's and Jimmy Choo. We note that younger brands are still surfing these opportunities.

Figure 38: Prada* brand – DOS evolution



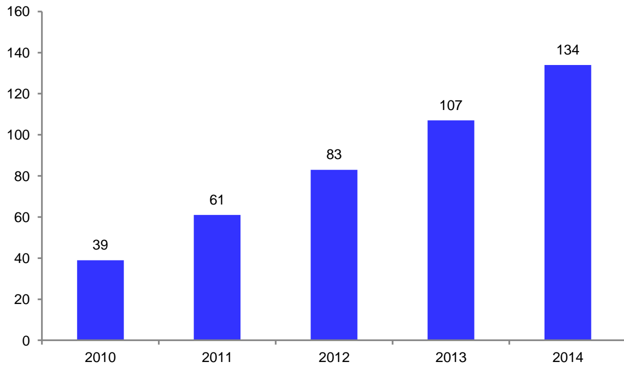
*Source: Deutsche Bank, Company data, *Reporting as of January 31*

Figure 39: Michael Kors – DOS evolution



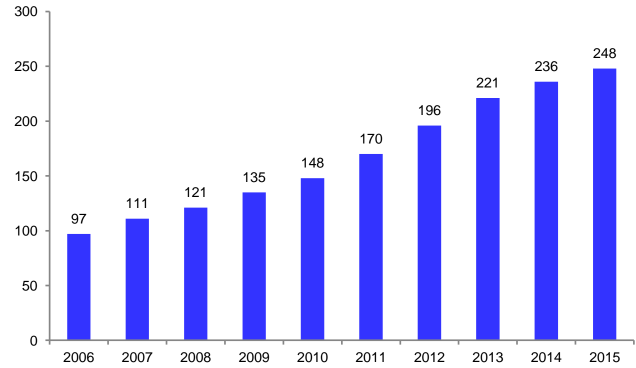
Source: Deutsche Bank, Company data

Figure 40: Moncler – DOS evolution



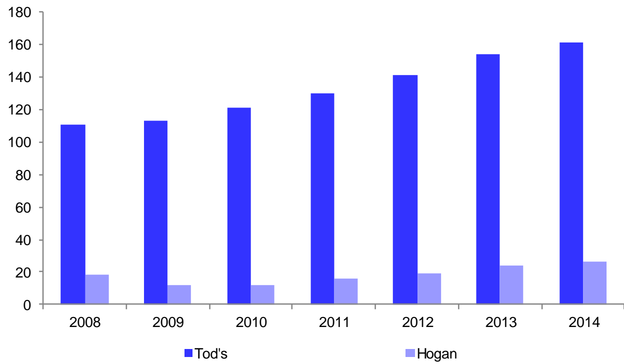
Source: Deutsche Bank, Company data

Figure 41: Bottega Veneta – DOS evolution



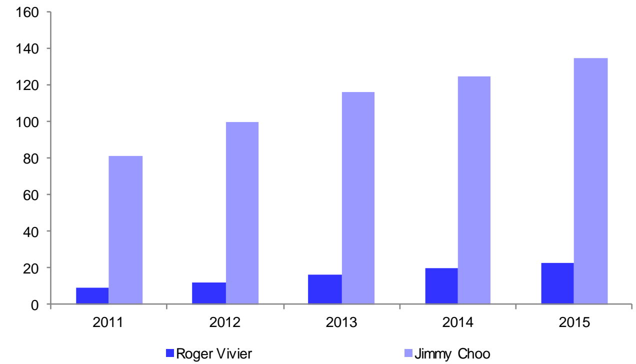
Source: Deutsche Bank, Company data

Figure 42: Tod's and Hogan – DOS evolution



Source: Deutsche Bank, Company data

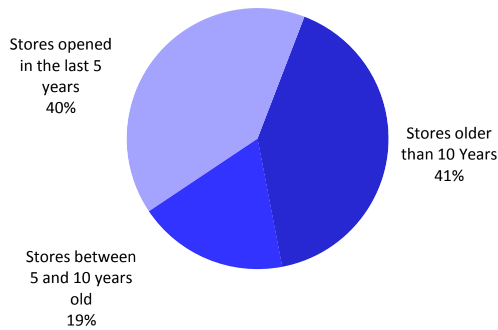
Figure 43: Roger Vivier and Jimmy Choo*



*Source: Deutsche Bank, Company data; * reporting as of March 31*

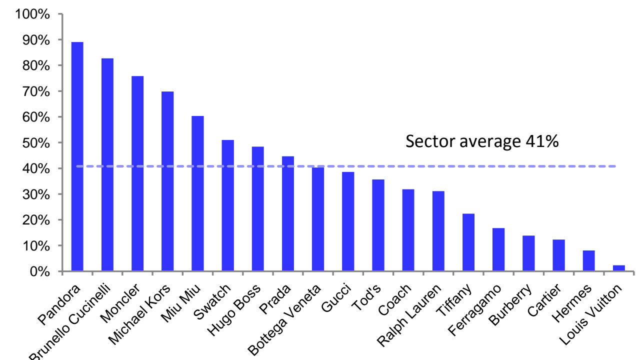
On average, we estimate that more than one-third of the DOS network has been opened in the past five years.

Figure 44: Average age of the luxury network



Source: Deutsche Bank

Figure 45: % of stores opened in the past five years



Source: Deutsche Bank

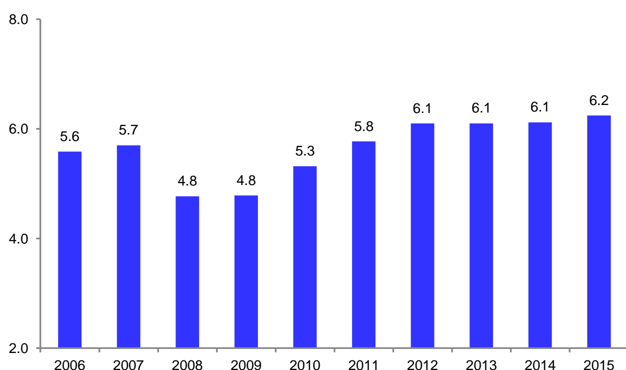
Productivity of the retail space has reached a plateau

Our analysis suggests that the industry has gone a bit too far in terms of network expansion, and the marginal sales generated by store additions are becoming less relevant for the top line.

One of the opportunities quickly to improve store productivity is through the rationalization of the network. It is not the purpose of this report to assess what is the optimal store network size for each brand (we leave this challenging task to the individual management teams). Certainly, some fine tuning is needed and together with relocations and refurbishment might absorb part of the attention of the management. However, even a strategy of no or limited openings helps in this direction: with demand running at the current pace of 5-6% growth p.a., we believe that, with the current network, the sector will return to peak levels of productivity in real terms in four to five years

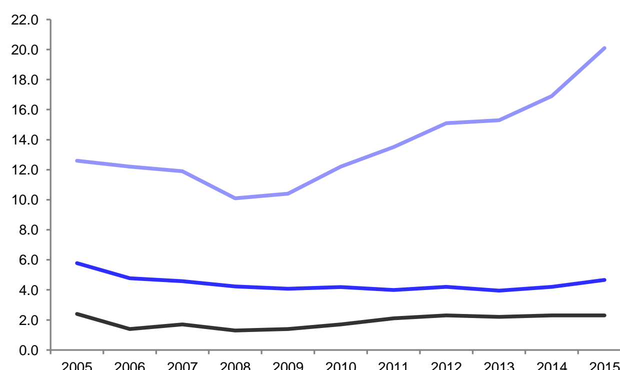
On average for the sector, sales per store are set to expand in 2015 only as a result of positive currency evolution, after having been stale for the past three years at record levels. Net of currency, retail productivity on average would have been declining in 2015 for the first time since 2008.

Figure 46: Luxury goods average sales/store (Euro m)



Source: Deutsche Bank, Simple average of the following brands: Hermes, Hugo Boss, Gucci, Moncler, Ferragamo, Tod's, Brunello Cucinelli, Burberry, Bottega Veneta, Tiffany, CartierLouis Vuitton, Michael Kors, Coach, Ralph Lauren, Prada, Miu Miu, Pandora

Figure 47: Best-in-class, median, laggard sales/store (Euro m)

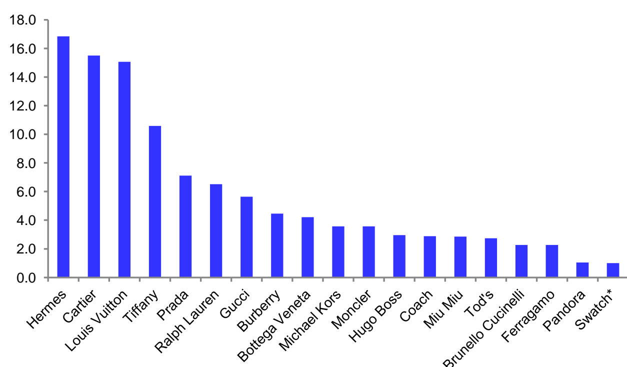


Source: Deutsche Bank, Simple average of the following brands: Hermes, Hugo Boss, Gucci, Moncler, Ferragamo, Tod's, Brunello Cucinelli, Burberry, Bottega Veneta, Tiffany, CartierLouis Vuitton, Michael Kors, Coach, Ralph Lauren, Prada, Miu Miu, Pandora

However, those averages hide the fact that, over the past decade, best-in-class have extended their gap vs. the rest of the sectors. In Figure 47, we show how year after year the best-in-class players (in most years it is Hermes) have extended the lead vs. the median of the sector, which has remained rather stable. As a result, in light of rising costs (rents above all but also labor costs, for example), the profitability has been under pressure recently for many players in the industry. We show in Figure 48 and Figure 49 the relative productivity of different brands. It is interesting to note that the companies at the top end of this ranking are either with a relatively small retail footprint or have opened few stores in the past five years, compared with their store size. This supports the idea that many players/brands have actually overgrown their network to a level that is not consistent with the current trends and would therefore need to become more selective on their opening strategy. In other words, while store roll-out has been a key bull argument in the sector, it is now the maturity of the retail network that is becoming the focus as a key driver of margin opportunities.

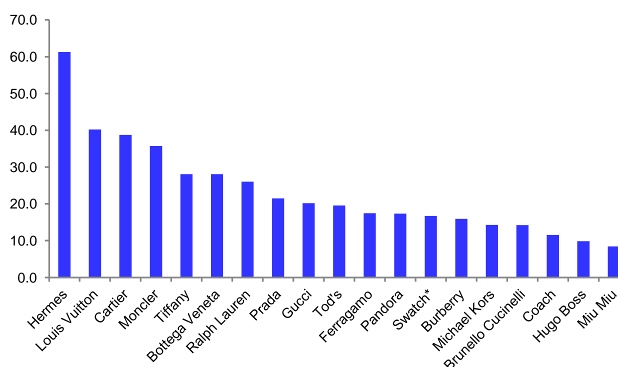
We have extended our analysis to take into consideration the relative size and size evolution of the stores. Results show that, while discrepancies in terms of productivity are potentially even bigger on a sqm basis, they offer a good indication of the difference in retail profitability between brands. Interestingly, we also note that the average sales/sqm is different depending on the positioning of the brand, which typically goes hand in hand with the locations. As a result, the average sales/sqm of luxury brands that only are represented in the top quality locations are substantially above average, while more affordable brands (e.g., Hugo Boss, Coach, and Pandora) are at the opposite end of the spectrum. Other brands such as Brunello Cucinelli are clearly penalized by the immaturity of the network and lower scale, with the positioning representing a strong support for future progression of these metrics.

Figure 48: Sales per store 2014E (Euro m)



Source: Deutsche Bank **Swatch Group's average is influenced by swatch brand stores

Figure 49: Retail sales/sqm (Euro k)



Source: Deutsche Bank, *Swatch Group's average is influenced by swatch brand stores

With sales per store clearly being affected by the network expansion, the next step of the analysis is to understand the impact that this is having on the actual productivity of the retail space and profitability.

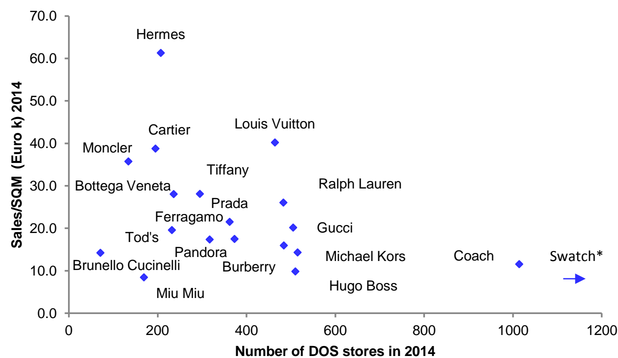
This is a more ambitious exercise, as it is impossible to assess what is the impact of network expansion on average store size. Flagship stores obviously inflate average store size, while department store concessions or travel retail points of sales work in the opposite direction. In addition, each individual brand has its own store layout expansion story, which can follow the introduction of new categories, as is happening for Moncler (introducing knitwear, shoes, and leather goods) or for Brunello Cucinelli (formal menswear introduction).

Our calculation of sales density is, in our view, a good proxy of how successfully brands have been balancing growth and profitability with largely fixed and increasing cost bases. The productivity of the selling area has indeed become the key focus to drive profitability.

In Figure 50 and Figure 51, we show the results of our calculation of the average increase in store productivity since 2009 for the key brands under our coverage. It should not come as a surprise to the reader that there is a negative correlation between productivity and the number of stores, as well as in terms of network growth vs. productivity increase.

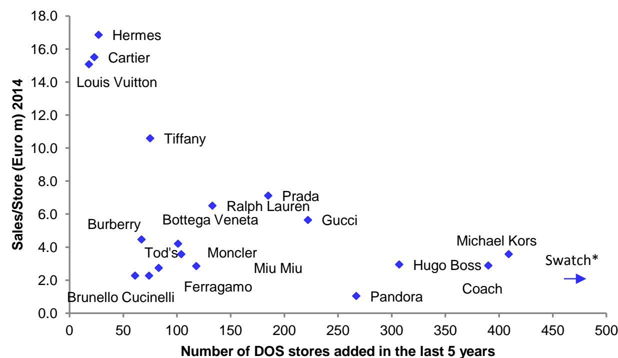
Specifically, we highlight that players like Brunello Cucinelli that have an immature network also have obtained the lowest profitability improvement in the industry, which is also the case for Miu Miu. On the other hand, Michael Kors and Swatch Group, despite significant openings, have obtained a significant increase in sales productivity due to their strong momentum in the past years and the very limited starting productivity.

Figure 50: Retail Productivity vs. number of stores (2014)



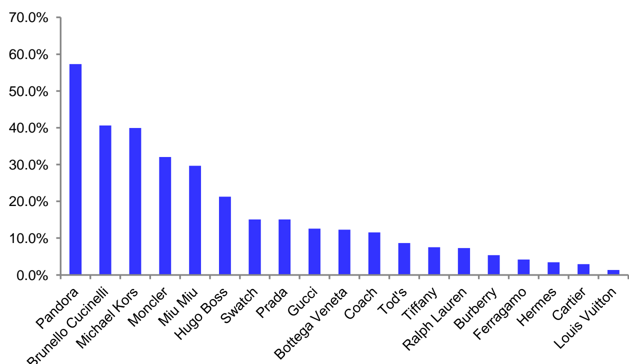
Source: Deutsche Bank; *Swatch Group includes both multibrand and monobrand DOS

Figure 51: Retail Productivity vs. network growth



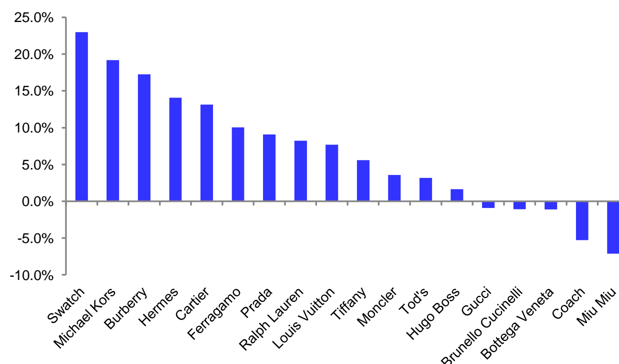
Source: Deutsche Bank

Figure 52: Annual network growth, 2009-14



Source: Deutsche Bank, *Swatch Group includes both multibrand and monobrand DOS

Figure 53: Annual increase in store productivity, 2009-14



Source: Deutsche Bank, *Swatch Group includes both multibrand and monobrand DOS

Store economics increasingly relevant for profitability

Retail might be better, but not at all costs

With the growing importance of retail in the mix, store profitability and overall retail profitability are becoming critical.

There is a widespread conviction in the industry that retail is better, at all costs. We had many times highlighted the advantages of retail over wholesale or licensing, and brand control is by far the most important one. However, the idea that in addition to brand control retail also brings in more incremental bottom-line profits (margin or EBIT) than wholesale is not universally applicable.

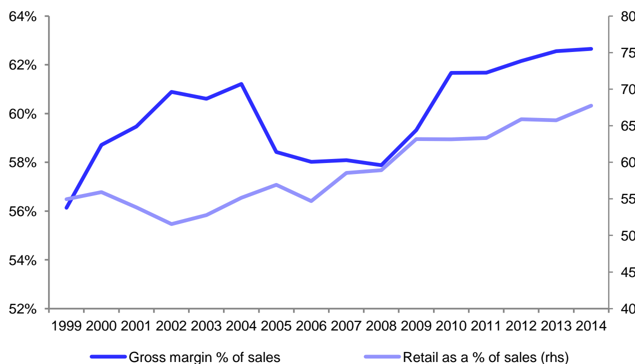
The reality is that this paradigm, while directionally true in the expansion phase of a brand, certainly depends on whether the productivity of incremental stores and better gross margin is covering for the incremental costs and the productivity of the existing stores remains unaffected. It will also depend on the long-term targets and on the speed at which retail stores reach full productivity.

Retail mix is boosting gross margin …

Luxury companies have experienced a significant expansion of 7pp in their average gross margin. Both intuition and mathematics indicate that the shift toward retail has been a key driver of gross margin.

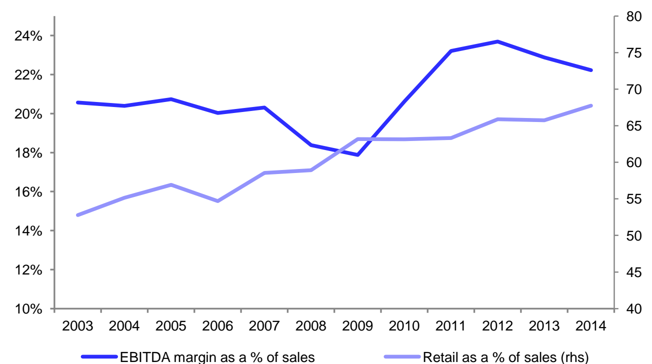
- **Channel mix.** Typically, retail gross margin is 10-20% higher than the corresponding wholesale profitability. The industry moving from an average of 59% retail in 2005 to 68% in 2015 explains 30% of the expansion.
- **Price and price/mix.** We estimate that this element could have accounted for 60% of the gross margin expansion over the past decade. We see price/mix largely dictated by brand power rather than any input cost pressure.
- **Geographical mix.** Geographical factors also contributed to profitability expansion (10% impact), as the profitability in Asia is typically higher at the gross margin level.

Figure 54: Luxury peers gross margin from 56% to 63%



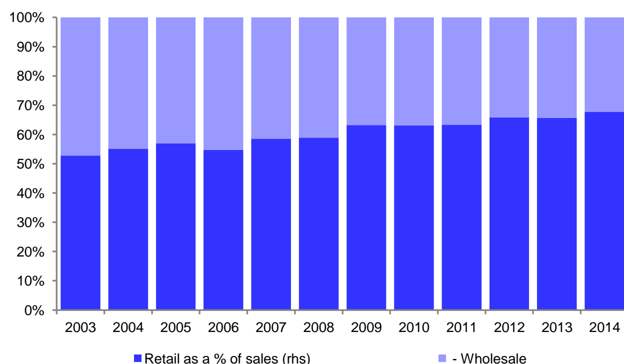
Source: Deutsche Bank.

Figure 55: EBITDA margin and shift toward retail



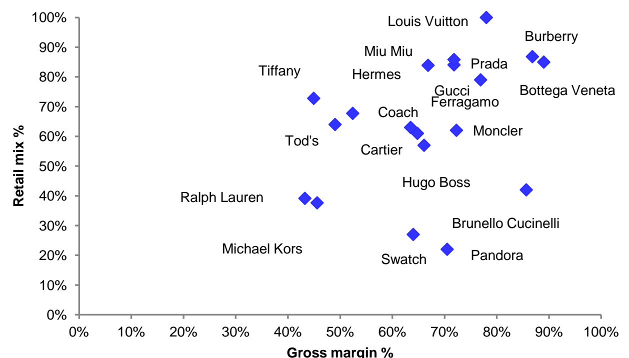
Source: Deutsche Bank.

Figure 56: Channel shift



Source: Deutsche Bank.

Figure 57: Gross margin and retail mix



Source: Deutsche Bank.

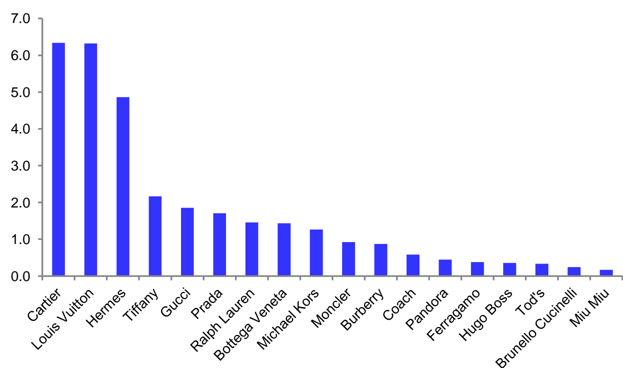
…but retail EBIT is under pressure …

To assess whether retail expansion is ultimately benefiting industry margins, we have calculated the retail EBIT margin and the EBIT/store as the ultimate measure of retail productivity for each brand based on the following assumptions:

- Deutsche Bank estimate of the retail gross margin
- Costs allocated to retail according to the following drivers: 1) rents: 100% retail; 2) A&P: retail mix as a % of the overall brand sales; and 3) SG&A: retail mix as a % of reported revenues

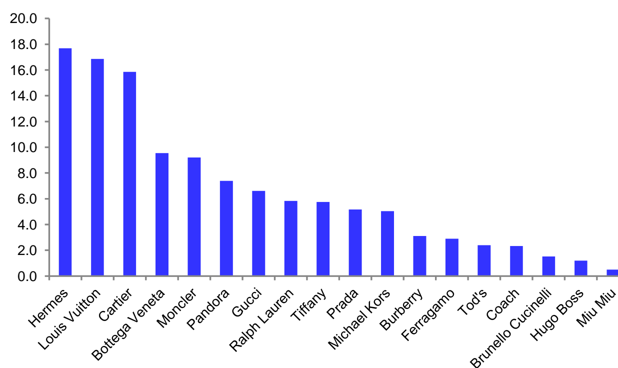
The results of our analysis are reported in Figure 58 and Figure 59, and they broadly reflect the sales density of the brands. Notable exceptions would be Moncler (the size of the stores, the focused product range, and the very high density justify very high profitability per store) and Pandora (high-traffic but second-tier locations explain the very high margin despite a relatively low productivity).

Figure 58: EBIT/store (Euro m)



Source: Deutsche Bank

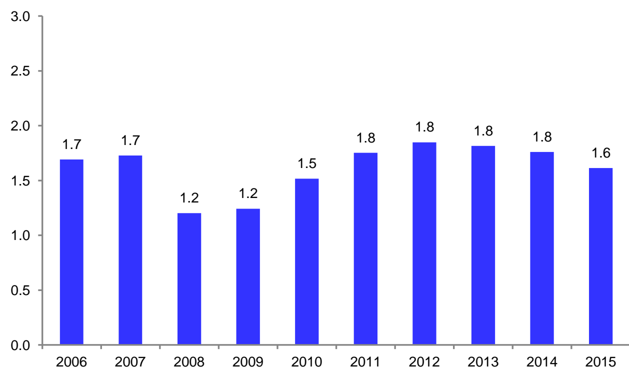
Figure 59: EBIT/sqm (Euro k)



Source: Deutsche Bank

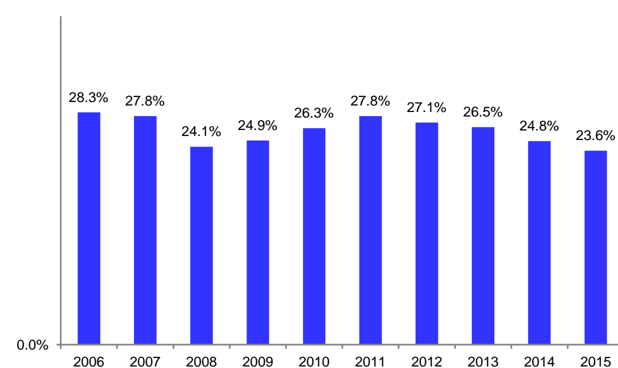
Historical evolution of retail EBIT for the sector is even more relevant, as it confirms that the network expansion has been too aggressive, resulting in margin pressure at retail, mostly visible in the performances of brands that have indiscriminately expanded the network (e.g., Prada, Tod's).

Figure 60: Estimated sector average EBIT/store evolution (Euro m)



Source: Deutsche Bank

Figure 61: Estimated sector average retail margin evolution

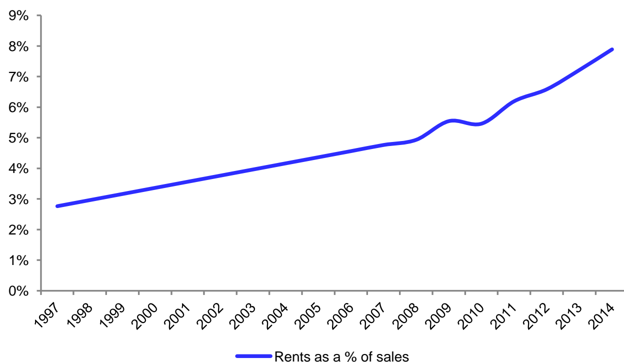


Source: Deutsche Bank

… as input costs have been rising, driven by rents

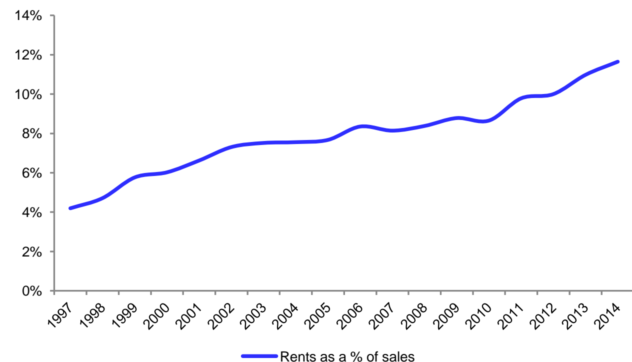
With demand becoming softer and more volatile, there is increasing focus on the evolution of input costs and the pressure they inflict on retail margins.

Figure 62: Rents as a % of sales



Source: Deutsche Bank

Figure 63: Rents as a % of retail sales



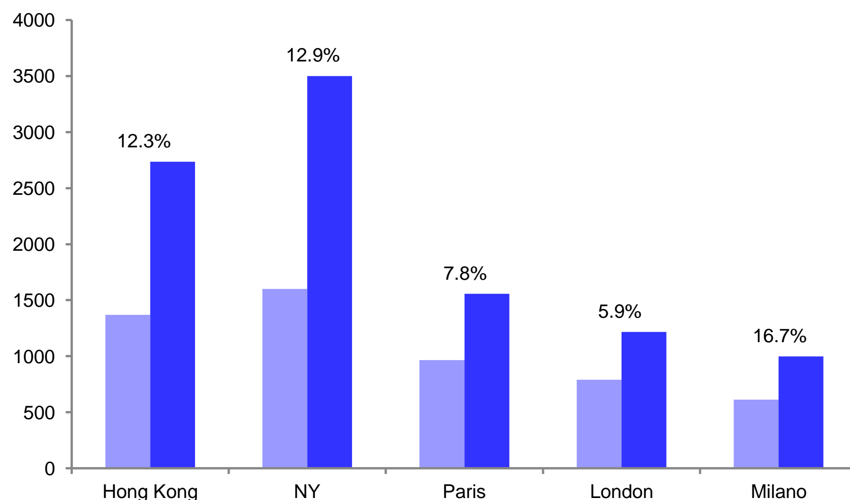
Source: Deutsche Bank

Generally speaking, rents have different dynamics in different geographies.

- **Rents in Europe** are typically based on long-term leases up to 10 years and are substantially fixed, or updated mechanically on an annual basis, which typically results in very high operational leverage (de-leverage) as well as potentially steep increases in the lease costs upon renewal.
- **Rents in the US** are typically five to ten years and are largely fixed as far as freestanding stores are concerned, while they are typically turnover related in department stores.
- **Rents in Asia** are traditionally turnover related, with minimum amount of rent guaranteed defined in hard currency. The duration of the contracts is traditionally about three years, implying that, on average, 30% of the contract leases expires every year. This means that very sparkling or difficult market conditions might result in much faster updates in the average rents structure on the positive (or negative) side.

The differential in prime location rents in 2014 is detailed in Figure 64.

Figure 64: Most expensive high-street locations, 2007-2014 (rents US$/sqft/year, label show CAGR)



Source: Deutsche Bank, C&W

While the increase in productivity and the luxury industry market growth have both been below the average rents increase in all key destinations (HK, NY, Paris, or London), the result is that rents are now eating a larger part of the overall gross profits of luxury brands.

What are the drivers behind this growth of prime locations?

- Big conglomerates are increasingly aware of the importance of top locations for the development of smaller brands in their portfolio.
- Top brands have accepted that, to remain relevant with consumers, locations represent a key barrier to entry; hence, they are ready to accept higher rents as a form of investment.
- Productivity of the best-in-class players allows them easily to swallow higher rents, raising the bar for the rest of the industry.
- There is increased appetite for top locations by new brands that are currently underdeveloped and are today expanding their presence and looking for top locations (e.g., brands that target growth supported by private equities).

For this reason, we expect the trend to remain on a solid note in Europe and the US, where momentum is picking up strongly, but also in Hong Kong, where top locations remain attractive and there is a relative concentration of demand for those locations compared with tier two locations. In the latter, we might see a rationalization of the footprint and a decrease in the rental costs, which is what is currently being hinted at by retailers such as Chow Tai Fook.

Volatility, currency, and online complicate the environment

Dealing with greater volatility

In addition to softening global demand and overcapacity in the distribution networks, volatility at the trade is putting supply chains under stress. Largely driven by currency swings, tourist flows have become less and less predictable and increasingly powerful to drive sales performances.

These trends are displacing network capacity as far as merchandising assortment, in-store service, and network investments are concerned. Rarely in the past have we seen the magnitude of volatility in sales trends as we are experiencing in 2015.

A case in point was the sales performance of Richemont in the five months ending in August, which shows tourist destination areas such as Europe and Japan showing incredibly strong performances (26% and 48%, respectively), counterbalancing the heavily negative performance in Asia (-18%).

We are not discussing in this report the flexibility of the supply chain of individual players and their ability to respond to these elements. Indeed, we believe this would go beyond the analysis of the productivity and open a whole new chapter that requires deep dives into each category (jewelry, apparel, handbag, shoes, and accessories) and each manufacturing business model. Should the reader think that this is a theme to be analyzed further, we encourage letting us know.

When demand shifts from, for example, HK/Macau to Europe, based on the productivity of each individual store and on the ability to convert into sales the unexpected incremental traffic in one region and deal with the consequences of a drop in visitors and shoppers in another, each brand will be in a different position to react to demand shifts.

If a store is extremely productive, the marginal sales decrease in HK should represent a moderate margin dilution in that store, largely balanced by the lower rents in the same store and ultimately offset by the greater absolute sales and margins achieved in Europe. However, should we assume that the productivity of the HK store is more limited and actually just consistent with minimum rents, the drop in profit would be significant.

In this context, wholesale, although not immune to volatility, is much more flexible than retail and thus allows companies to better cope with swings in demand. This is why we explained that retail is not necessarily the most valid alternative for each company.

The price of luxury

In addition to trade volatility, currency fluctuations have been a key theme that has displaced brand strategy over the past 12 months.

Sharp currency movements have stretched price differences across regions to unprecedented levels. In response, Chanel earlier this year rebalanced its global price architecture by cutting prices in Asia and raising prices in Europe. Patek Philippe cut prices in Hong Kong in February, while many Swiss watch brands have been also adjusting prices in Asia (and other US$ related geographies) while have been raising prices in Europe, cumulating up to

double-digit price hikes. Harmonizing prices in this way may solve the issue of parallel importing and stop the leaking of Asian sales to the lower-margin European region, but any loss in price integrity risks brand damage. We have discussed this together with potential pricing implications in our note "*The price of Luxury*", published on March 27, 2015, in which we also concluded that the best outcome for a brand is to maintain price consistency and only gradually absorb price differential across regions. Champions in this respect are Louis Vuitton, Hermes, and Moncler. The importance of this aspect is also the key reason why we believe that pricing discipline should be one of the elements to be considered when building our Brand Power Index, which is discussed in the following chapter.

Online is not the straightforward answer to the productivity issues

Within retail, we need to look at online sales as an intelligent opportunity for the future. E-commerce means more retail with proportionally little incremental capex and fixed opex, and the integration of online and offline can also drive higher conversion of in-store traffic and higher cross-selling, as some experiences (Burberry) suggest. Online sales have lower costs (no rents, which account on average for 10-12% of luxury sales; no sales personnel, which on average is another c.10% of sales). However, with a similar level of gross margin, while the cost of physical retail is actually rather fixed, online adds additional variable costs (fulfillment), which suggest that e-commerce should be disproportionally accretive if it is bringing additional sales.

To conclude, we believe that the paradigm that retail is necessarily better than wholesale is currently being challenged, and we assess that different levels of retail productivity justify different retail footprints and different optimal channel mixes.

We also assess that, in the current environment, the brands that are experiencing the highest retail productivity on average are likely to be able to better offset the volatility in demand and in LFLs with more limited EBIT margin impacts.

Among players with high retail productivity, **Louis Vuitton, Hermes, Cartier, Moncler**, and **Tiffany** stand out as extremely productive and hence extremely profitable. We also see opportunity at **Prada** and **Gucci**, as notwithstanding ongoing issues with brand positioning, pricing, and potentially excessive network capacity, these players have maintained outstanding control over their productivity, which is the precondition to restore higher levels of margins in the coming years. Most of the other listed players should be carefully balancing their investments in the network and wholesale exposure, managing potential cannibalization and assessing their own way to generate return for shareholders.

From retail to brand productivity

Brand productivity is the best way …

We detailed in the previous section that retail performance has been under pressure recently. We showed that differentiated retail productivity could justify and sometimes require different retail footprints and strategies in order to remain relevant with consumers and maximize margins and cash flow generation.

In this chapter, we extend the analysis of productivity to capture brand potential and its capability to generate cash flow across all channels to the benefit of all investors across the luxury value chain, and most importantly, to brand shareholders.

The higher a brand productivity, the stronger is the brand's potential, in our view. Ultimately, this will allow the maximizing of cash flows and return on capital, and help to find the optimal balance in the channel mix. This is, in our view, the best way to ensure margin protection in a brand if volatility persists and greater opportunities for margin recovery in the mid-term.

Retail productivity and brand productivity finally contribute to the definition of our **Brand Power Index**, a weighted average combination of quartile rankings across seven dimensions for each brand. Three quantitative measures receive a 20% weight each: retail productivity, brand productivity, and return on capital. Four more qualitative and therefore discretionary variables receive a 10% weight each: pricing discipline, exclusivity, brand momentum, and organic opportunity to improve margins.

… to transform brand sales into cash

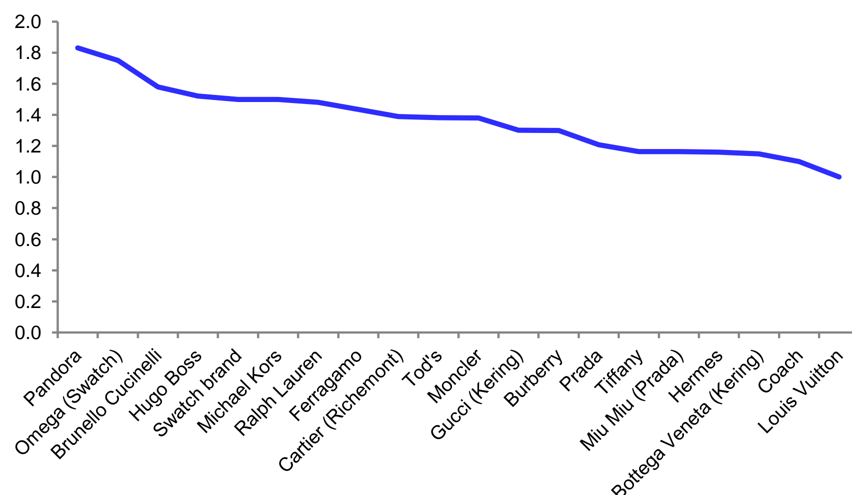
The result of our analysis is that the undisputable leaders in terms of ability to transform their brand sales into cash are the usual suspects: **LV, Hermes, and Cartier**. We see opportunity for margin sustainability and cash return for shareholders in brands that might have been under pressure recently, but could take the current volatility as a chance to perfect their strategy (Prada, Gucci, Burberry, and BV). Most of the other brands are in need of additional investments and strategic efforts to sustain their growth and protect their margins, which would eventually pose question marks on their capability to outperform in an industry that is becoming more competitive and difficult to predict.

Brands generate cash flow, retail maximizes it

We define brand productivity as FCF generated by the brand sales available for both a company and its wholesale partners.

Brand sales may vary significantly depending on a brand's strategic choices. In the luxury sector, business models range from full control of a brand with pure retail operations to exposure to franchise/wholesale businesses. At one end of the spectrum are licenses (perfumes, eyewear), in which distribution is by far less controllable. We show in Figure 65 that the difference in brand size and the reported revenues for the brands under our coverage could be as high as 50%.

Figure 65: Brand sales / reported sales 2014



Source: Deutsche Bank, Company data

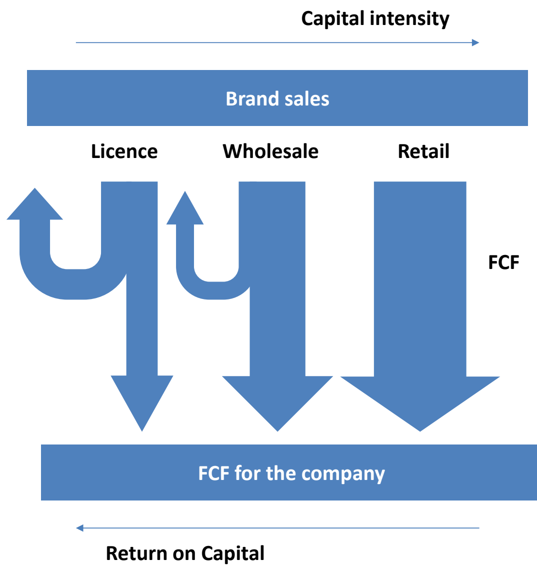
The different business models have a significant trade-off between cash flow, capital intensity, and brand control:

- **Retail** distribution allows brands to capture entirely the cash flow generated by brand sales. This is the reason for a business model that theoretically maximizes cash flow. Due to the relevance of retail investment and off-balance sheet commitments in the form of operating leases, it increases capital employed and depresses ROCE.
- **Wholesale/Franchise** business model represent a compromise on brand control and invested capital. The margins and cash flows generated by retail partners are the price to guarantee return on their retail investments and cover their commitments.
- **License** business has potentially infinite return on capital, although it typically allows a brand to capture only a limited portion, ranging from 10% to 20% of the retail sales in the form of royalties.

In this report, we have developed an innovative analysis of FCF generated by the brands. Starting from FCF generated by individual companies, we have calculated across the years the relationship between channel mix and the FCF/ brand sales ratio. This framework has allowed us to sterilize cash flow generation against the channel mix. Intuitively, the higher the retail mix, the greater is its portion of brand FCF generated by the brand sales.

Visually this is represented in Figure 66 and Figure 67.

Figure 66: Channel mix and cash flow generation



Source: Deutsche Bank

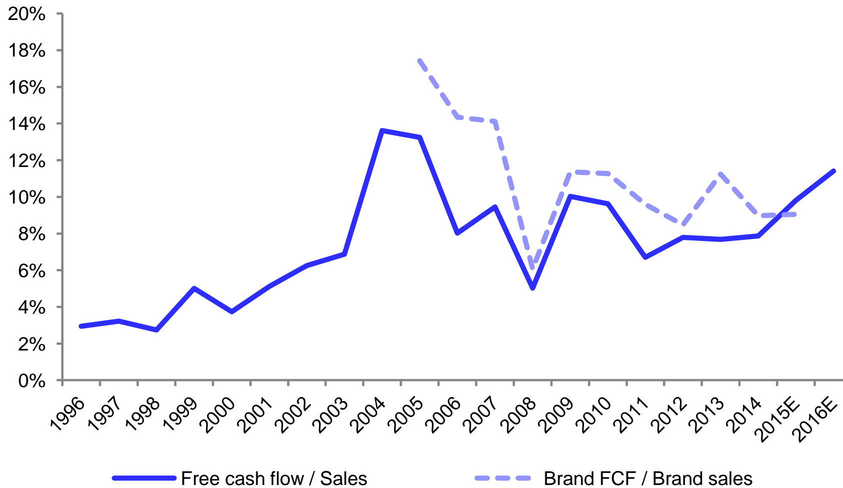
Figure 67: Channel mix and ROCE % – illustrative examples

	License	Wholesale	Retail
Retail sales	100	100	100
Brand revenues share	15	50	100
Gross margin	95%	65%	85%
EBIT margin	95%	30%	30%
ROCE	infinite	53%	42%

Source: Deutsche Bank

The result of our analysis across the years for the sector is reported in Figure 68. Those charts illustrate that over time FCF generation across the industry has remained relatively stable since 2008. The shift in the channel mix and the much reduced need for growth capex in the coming years translate into higher cash flow generation for the brand companies.

Figure 68: Luxury Brand FCF/Brand sales vs. FCF/Sales generation

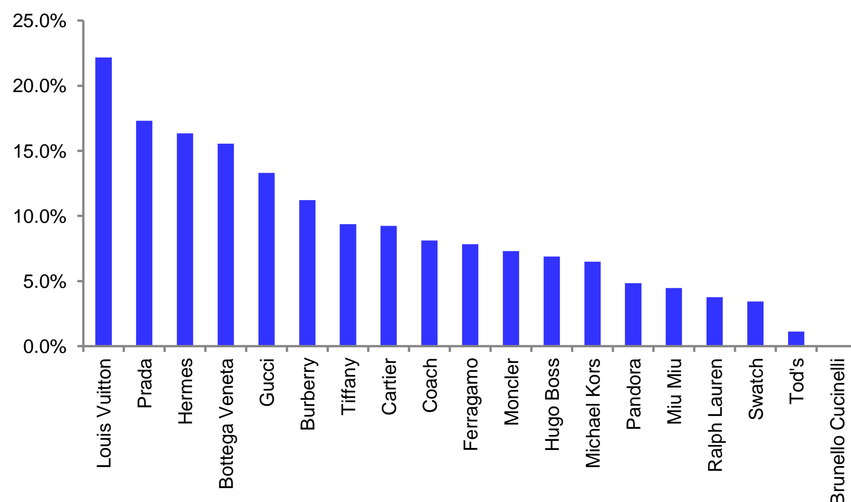


Source: Deutsche Bank estimates

We show in Figure 70 that the players have completely different productivity in terms of FCF generation as a percentage of retail sales. Specifically, we show that Louis Vuitton is in a class of its own, while Prada, Hermes, and Kering brands (Gucci and Bottega Veneta) score very highly in the capability to transform brand sales into cash flow. The chart also shows that in general terms higher exposure to retail goes hand in hand with FCF generation,

intuitively supporting the argument for retail being a better business than wholesale (Figure 69). On average, we calculate that brands are able to capture variable portions of the cash flow generated.

Figure 69: Brand FCF generated as % of brand sales (2014)



Source: Deutsche Bank

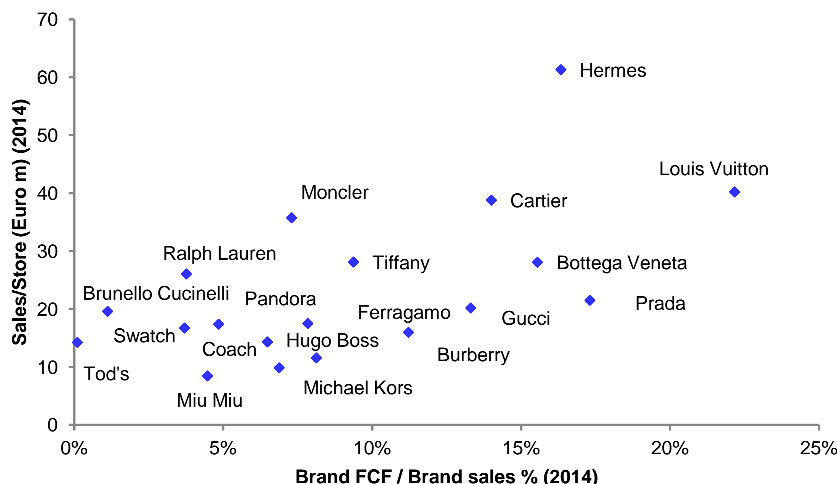
However, we believe a better mix lies in the capability to correctly balance network sales productivity, scale, and the possibility to benefit or take advantage of a goods wholesale business that is professionally run and offers strong brand control.

Visually, the relation between brand productivity and retail productivity is shown in the value map in Figure 70.

As expected, the correlation is high, which we mainly attribute to the following reasons:

- **Relative store size and relative number of stores** in different channels (retail having bigger and better stores, but at a lower count).
- **Effectiveness of sales efforts likely higher in retail stores** due to prime locations, dedicated and focused personnel, tailored merchandising and up-to-date assortment and re-assortment, brand control, and pricing discipline, etc. Of course, there are different nuances in the ability to deliver on best-practice retail, which reflects in different retail/store metrics for the different brands in our universe.

Figure 70: Brand productivity vs. retail productivity 2014



Source: Deutsche Bank

ROCE varies across business models

Retail shift has its advantages…

The desire to increase control over a brand and retail 100% of the profit, together with the dilutive impact of wholesale, has led many companies to focus more on direct retail by opening new DOS, buying back franchised stores, and eventually streamlining the number of wholesale doors. Most of the brands in our universe have been through this "**Retail shift**" with the aim of improving control of the brand and its productivity and sales profitability via: a better shopping experience, better assortment of merchandise, product rotation, new stock management, lower markdowns, etc.

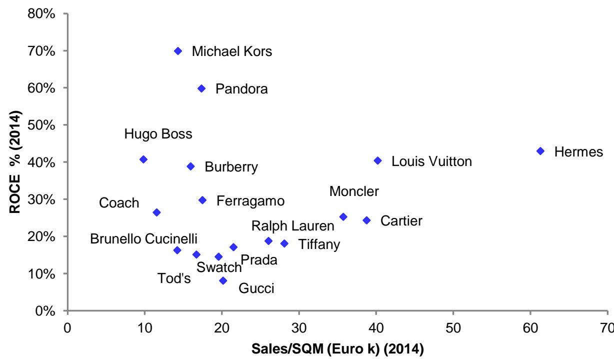
…but does not necessarily maximize ROCE…

We show in Figure 71 and Figure 72 the relationship that both Productivity measures have with ROCE. While we have demonstrated that retail maximizes cash flow, it is not necessarily true that it also maximizes ROCE.

…so each player has to find its own balance

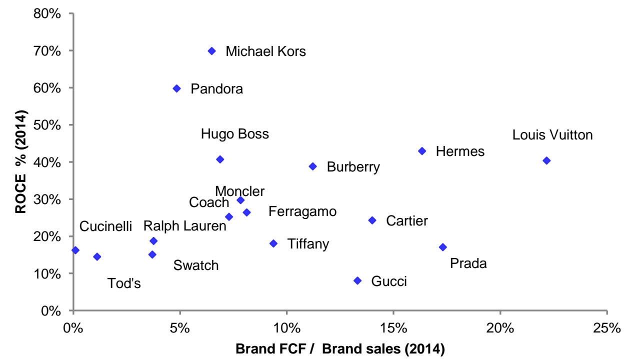
We therefore believe that every company will have to find its own balance to maximize returns based on the productivity of its retail network and the positioning of a brand. This means that players with high-end positioning but insufficient retail productivity like Brunello Cucinelli will find it increasingly difficult to boost ROCE and profitability in the current environment, while brands with low productivity, but have a retail network balanced with brand positioning (e.g., Pandora) should offer a good chance to retain higher returns. Brands such as Hugo Boss that target higher positioning but with underperforming retail productivity might find it more difficult to solve the trade-off successfully in the short term.

Figure 71: Retail productivity vs. ROCE % (2014)



Source: Deutsche Bank

Figure 72: Brand FCF/sales vs. ROCE (2014)

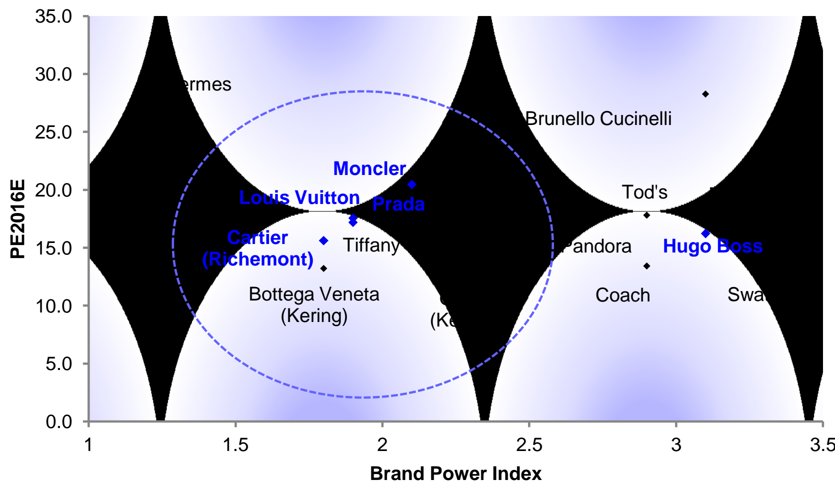


Source: Deutsche Bank

We complement the quantitative analysis of brand and brand retail productivity with a more qualitative assessment of the quality and consistency of the brand strategy.

We have come up with the definition of a synthetic index as Brand Power Index, which should help identify winners in the currently volatile market.

Figure 73: Deutsche Bank's Brand Power Index summary vs. PE2016E



Source: Deutsche Bank. : BPI calculated as the weighted average of 7 variables: Retail productivity (20% weight), brand productivity (20%), ROCE (20%), pricing discipline (10%), Exclusivity (10%), Brand Momentum (10%) and Opportunities (10%)

Figure 74: Brand Power Index composition – ranking in quartiles (relative)

Company	Retail Prod.	Brand Prod.	ROCE	Pricing Discipline	Exclusivity	Brand momentum	Opportunity*	Comments
Bottega Veneta (Kering)	2	1	2	2	1	1	4	Some LFL but limited cost opportunities and prepared to allow a ST margin dilution for the sake of brand expansion.
Brunello Cucinelli	4	4	3	2	1	3	3	BC has not yet been able to translate appeal, desirability, exclusivity, and superior positioning into productivity and profitability. We see this mostly as a scale and timing issue, with 80% of DOS opened in last 5 Y.
Burberry	3	2	1	3	3	2	2	A solid track record, with still more LFL opportunities and leverage to drive returns.
Cartier (Richemont)	1	2	2	1	1	2	4	Cyclical opportunity for brand productivity and structural via further distribution fine-tuning and jewelry opportunities.
Coach	4	2	1	4	4	4	3	Addressing issues in terms of requalification of distribution (FP and outlets). Good opportunities in working on brand appeal and shopping experience. Outlets remain a key issue.
Ferragamo	3	2	2	3	2	2	1	Upside from better retail management, which could drive LFL and margin. The opportunity is highest through footprint rethinking and the supply chain
Gucci (Kering)	2	1	4	2	2	4	2	Work on brand repositioning is key to driving incremental productivity.
Hermes	1	1	1	1	1	1	3	The best in class. Margin expansion is just a choice for them, i.e., how much they decide to invest. Opportunities capped by high starting point
Hugo Boss	4	3	2	4	3	3	3	Wholesale still more productive than retail. Reflects on average profitability. Key is LFL, which seems tough to achieve, and continued focus on operations.
Louis Vuitton (LVMH)	1	1	4	1	2	2	2	Not much room for improvement. Can continue to sustain LFL through brand/products.
Miu Miu (Prada)	4	4	4	2	2	3	2	Needs to work on brand awareness and scale, which would drive significant upside to profits.
Moncler	1	3	3	1	3	1	2	Upside to productivity could come from merchandising diversification, smooth seasonality, and price/mix. Opportunity capped by high starting point
Pandora	3	3	1	4	4	1	3	Strong brand momentum, relatively low retail productivity justified by Tier 2 locations. Key opportunity from expansion in mass consumer emerging markets.
Prada	2	1	2	2	2	4	1	Lost some momentum but could regain it quickly through fresh products and brand image. Opportunity from LFL and from cost and operations discipline.
Swatch	3	4	3	3	3	3	4	FCF generation is a major opportunity, which requires some change of priorities.
Tiffany	1	2	4	1	2	2	1	One of the key self-help stories if execution is successful on: 1) LFL from better brand, merchandising, and customer-targeting management; 2) costs from supply chain, GM/pricing, distribution, logistics, opex
Tod's	2	4	3	3	3	4	1	Significant upside from 1) better brand recognition, 2) success in LG, 3) better fixed cost coverage; 4) scale; cost opportunities

*Source: Deutsche Bank * See Figure 76 . BPI calculated as the weighted average of 7 variables: Retail productivity (20% weight), brand productivity (20%), ROCE (20%), pricing discipline (10%), Exclusivity (10%), Brand Momentum (10%) and Opportunities (10%)*

Brand power to sustain margins

Profits are below peak

After exploring the level of productivity that retail networks and the overall distribution set-up allow companies to generate, we move on to explore their potential in working on LFL opportunities and cost streamlining, with a view on how margins could develop.

The striking premise is that this year 95% of the companies in the sector will report margins below peak levels. For most of them, this occurred in 2012 (median), while ROCE peaked in 2011 (median). Over the past two decades, this has been despite average EBIT margin expanding 500bps in five years for our universe of luxury goods players, and a 10pp increase in average ROIC.

Figure 75: Luxury goods peak margin and peak ROCE %

Company	EBIT margin 2015	Peak margin	Peak Year	ROCE 2015	Peak ROCE	Peak Year
Brunello Cucinelli	12.9%	14.4%	2013	14.7%	26.6%	2011
Burberry	17.4%	21.4%	2012	37.4%	49.4%	2011
Coach	18.0%	38.0%	2009	27.3%	94.9%	2011
Hermes	31.6%	32.5%	2013	53.9%	45.7%	2013
Hugo Boss	17.0%	19.2%	2011	38.5%	44.8%	2011
Kering	15.1%	18.6%	2011	8.5%	10.0%	2012
Luxottica	16.1%	16.8%	2007	16.2%	14.4%	2006
LVMH	18.6%	21.8%	2011	14.9%	15.2%	2007
Michael Kors	25.9%	30.5%	2013	54.4%	77.8%	2013
Moncler	29.3%	29.9%	2012	30.2%	25.3%	2014
Prada	18.8%	27.0%	2012	18.5%	31.7%	2012
Ralph Lauren	11.3%	16.5%	2012	15.3%	25.6%	2012
Richemont	23.2%	26.4%	2014	25.5%	32.2%	2011
Salvatore Ferragamo	19.3%	18.2%	2014	40.2%	36.7%	2013
Swatch Group	19.2%	27.4%	2013	14.5%	25.2%	2007
Tiffany & Co.	19.5%	21.0%	2014	16.7%	19.5%	2007
TOD's Spa	16.3%	21.8%	2011	15.6%	22.5%	2011
Pandora	35.1%	36.2%	2010	65.9%	55.5%	2014

Source: Deutsche Bank, Company data

Individual opportunities to drive and sustain margins

Our key conclusion is that brand productivity is going to be the key element to sustain profitability and ROCE, and their expansion over time. Costs are an opportunity and not the key focus, but we believe some margin help is going to come from that area, too.

Ultimately, as luxury becomes less and less a uniform universe, different drivers emerge for different companies to drive LFL and profitability, which make strategy and execution a key theme.

We believe companies have many opportunities to expand LFL by focusing on the key retail metrics, from driving traffic into stores and conversions, expanding into new product categories, enriching the mix, to exploiting the online opportunity. The mix of retail strategies will vary and our level of

confidence in the expected achievements should drive our stock preference. Ultimately, we believe LFL has suffered from a lack of focus. Management track record in the industry suggests that once they decide to tackle an issue as a priority, they are bound to deliver successful implementation.

We have tried to identify for each of the companies the main sources of productivity and profitability opportunities.

Figure 76: LFL and cost opportunities

	LFL opportunity	Cost opportunity	Comment
Bottega Veneta (Kering)	LFL Opportunity - broadening product category and broadening choice within handbag range. Maturing of flagship stores	Opex opportunity - limited: A&P if anything likely to increase	Productivity/ROCE drivers - focusing on expanding brand from E1bn to E2bn sales and prepared to allow margins to decline to c.30% in the short run.
BC	LFL is solid and consistently driven by price and volumes. BC to continue strategy of annual 3-4% price increase and mix improvement (new categories, richer collections)	Scale is the issue at a time when the co is investing in international expansion and in the supply chain. Also cost management follows social responsibility criteria	Capex peaked. Next capex cycle will be more modest but leverage is limited due to intrinsic cost inflation which despite positioning, caps productivity and ROCE
Burberry	LFL opportunity - flagship store maturity, simplification of product ranges, online continuing to offer incremental opportunities. Sales densities low relative to peer group but product mix unlikely to change.	LFLs to leverage opex base rather than specific cost saving program. Should enjoy benefits of online sales growing into the heavy upfront investment already made	Productivity/ROCE drivers - margins below level three years ago. Still in investment phase in Japan.
Cartier (Richemont)	Cyclical opportunity for brand productivity and structural improvement via further distribution fine-tuning and jewelry opportunities	Fine-tuning of costs and distribution is standard practice at Cartier	Best in class, especially for cash flow, more limited upside, but cyclical opportunity ahead
Coach	Addressing issues in terms of requalification of distribution (FP and outlets). Good opportunities working on brand appeal and shopping experience in order to re-attract traffic and boost conversions.	Lean company from COGS to opex. Issue has been scale	Outlets remain a key issue, which keeps risk high, however some of the improvement should be mechanical
Ferragamo	LFL growth/productivity opportunity a key must. On the right track to improve sales efficacy through products, merchandising efforts and pricing as well as through a better store and customer experience. However LFL capped by extensive footprint	Lean opex but potential room in supply chain hence GM to benefit. Brand-related costs might need to grow	GM, EBIT mg and ROCE underpinned. Capex intensity to reduce and WC efficiency to increase. Efficacy linked to decision regarding possible network streamlining
Gucci (Kering)	LFL opportunity - total brand relaunch after dramatic cuts in wholesale channel and underperforming stores.	Opex opportunity - unlikely in short term as focus is on brand relaunch including store refurbishment	Productivity/ROCE drivers - margins below peak. Sales density improvement the main focus.
Hermes	Always possible to drive price and p/mix for HRMS as well as volumes across a wider price bracket	Essentially a discretionary decision of how much to invest	Productivity and ROCE expansion to be driven by LFLs
Hugo Boss	LFL opportunity – mid-single-digit LFLs needed for opex leverage. Price/mix opportunity from upscaling brand and controlling distribution. Optimizing recently taken-over franchise stores. Online improvements in 2016 and further women's wear development.	Opex opportunity - already an efficient model. Franchise stores profitability opportunity.	Productivity/ROCE drivers - capex and P&L investment both likely to remain elevated but highly cash generative.
Louis Vuitton (LVMH)	LFL opportunity - price mix. Two-thirds of luggage/bag business is canvas. The less developed leather category is one-third and leather SKU prices are typically c.60% higher than canvas.	Opex opportunity - limited. Some further cost leverage as average store size continues to grow	Productivity/ROCE drivers – best-in-class productivity and ROCE.
Michael Kors	LFL Opportunity from roll out Kors Concierge service in stores, new advertising campaign, and more innovative product. In 2H, FX pressures will fade, y/y compares will ease, and e-commerce will be included in comps.	Operating expense deleverage will begin to ease in 2H as KORS begins to anniversary last year's investments and as comps hopefully improve.	Stability in North America comps is key for KORS

Source: Deutsche Bank. Opportunity Index score linked to assessed feasibility

Figure 77: LFL and cost opportunities ('cont)

	LFL opportunity	Cost opportunity	Comment
Moncler	LFL opportunity – product mix diversification including knitwear, shoes, and leather goods. Development of S/S collections to complement very high sales density in winter months	Already one of the most efficient players in the industry has opportunities in improving gross margin of new categories and further channel mix	Starting from very high productivity and profitability Moncler has the price discipline and the strategic vision to become a global luxury brand
Pandora	Maturity of the network, rationalization of multi-brand point of sales, new retail layout	Margin expansion due to scale and favorable commodities	Retail network expansion is a potentially significant development as most of the stores are franchising
Prada	Brand momentum, success of LG/handbags is the key to LFL, together with a possible rethinking of some store presence. Brand elevation with higher price architecture. Store maturity and online opportunity	Successfully addressing P&L issues. Supply chain efficiencies banked in largely while opex would readjust with lower openings	The worst seems to be behind and the co is preparing for better sales, which could see a huge rebound in margins and returns. Still not 100% risk-free
Ralph Lauren	LFL Opportunity from success with Polo women's & Polo Sport initiatives and the accessories category. Continued strong e-commerce growth would also help.	Next year, RL will generate greater cost savings from this year's restructuring actions. Overall y/y SG&A dollar spend may also decelerate as spending on SAP implementation tapers off. But spending on e-commerce will ramp and other areas of incremental investments may emerge.	In order for operating margin to improve, top-line needs to re-accelerate and SG&A spend rates needs to slow
Swatch	Retail is a small part of the business while productivity of overall sales efforts depends on brands and general distribution and commercialization, marketing decisions	Main efficiencies would come from WC and supply chain management. , Co is running a very lean cost base and has always had efficiencies as a top priority	Co focused on lowest unit cost and not on FCF generation. If this changes, it would provide massive upside
Tiffany	LFL through better brand, merchandising and customer targeting management. Better CRM and more consistent retail presence and customer experience:	Costs from supply chain, GM/pricing, distribution, logistics, opex	The best opportunity in the sector for top line and costs driven upside
Tod's	Brand momentum, commercial shoe collections and assortment, and leather goods success are the key focus in order to drive traffic and conversions, and fully capitalize on 30%+downsizing of wholesale network.	Cost efficiencies to be visible from 2H. The streamlining should continue until the co recovers scale. However it is still investing for growth (stores, designers, A&P etc)	Scale issues outweigh cost issue, although there is room to improve returns

Source: Deutsche Bank. Opportunity Index score linked to assessed feasibility

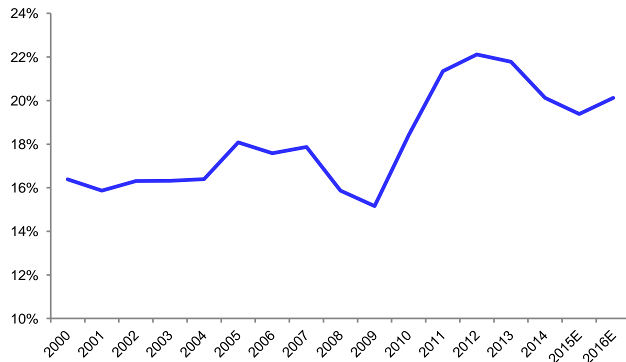
Productivity is key to support margins

As we have extensively discussed, the challenge for luxury companies now is to work on a fine balance between network development and store productivity in order to be relevant and profitable at the same time.

Multiple margin drivers in the past 15 years

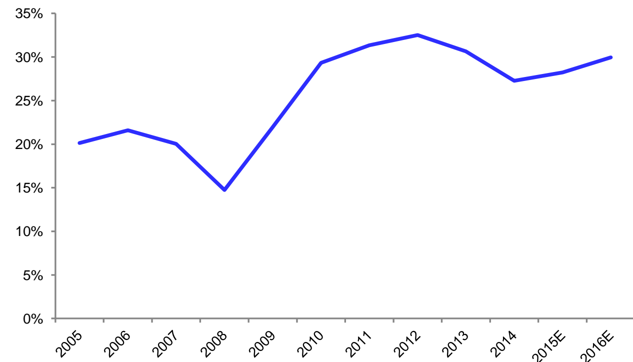
Along with growth has come sustained margin expansion. In the past two decades, we have witnessed an impressive development in luxury goods companies' profitability: our universe of luxury goods players has seen over 500bps expansion in the average EBIT margin in five years, and a 10pp increase in average ROIC. This was driven not only by scale, but also to a large extent by positive price and price/mix. However, with underlying luxury demand booming, margin expansion has been almost mechanical.

Figure 78: Luxury peers EBIT margin from 15% to 20%



Source: Deutsche Bank, Company data

Figure 79: ROCE %



Source: Deutsche Bank. Company data

LFL matters now

The shift from wholesale to retail has generated a major change in the P&L elevating the top line and expanding the gross margin but increasing the fixed cost base. The prerequisite of this strategy being successful and allowing it to expand EBIT margin and increase the Euro margin is that the brands are able to leverage on the existing cost base through increased productivity, or in other words, that they are able, through their brand power, to stay relevant for consumers, driving incremental same-store sales growth.

As we have also seen, companies have experienced an accelerated development of their store base while average productivity has plateaued. Looking at individual brand performance, we find that mature and more successful brands are outperforming the industry, with Hermes, Louis Vuitton leading the pack, but smaller and faster-growing brands such as Moncler, YSL and Bottega Veneta have also enjoyed a strong uplift in density.

3% LFL to maintain margin levels

What is the LFL that the luxury industry requires to maintain EBIT margin? We have calculated that on average to reflect a 5% annual rent increase and 3% growth in other opex, a luxury company that has a retail gross margin of 80% and retail EBIT of 30% needs LFL of 3% to maintain EBIT level.

The cost base has also grown significantly in recent years and we expect this growth to moderate. To simplify, there are potentially four main examples of companies:

- **Highly productive brands** are already very profitable (LV, Hermes, BV, Cartier): the key to sustaining/expanding margins is LFL growth that covers or is below cost inflation, or in the case of steady productivity, the company should act on costs.
- **Brands once productive with recent weak LFL** records (e.g., Prada, TOD, and Gucci): the key to margin recovery is action on costs and supply chain/P&L productivity, as well as a recovery in sales/sqm through a rise in LFL.
- **Brands with low productivity** and an average/decent margin: work on distribution balance to decide whether it is preferable to defocus from wholesale to have a retail store productivity increase to better cover retail fixed costs, or rather enjoy a profitable wholesale business (e.g., Burberry, HB, SFER) while seeking overall cost efficiency.

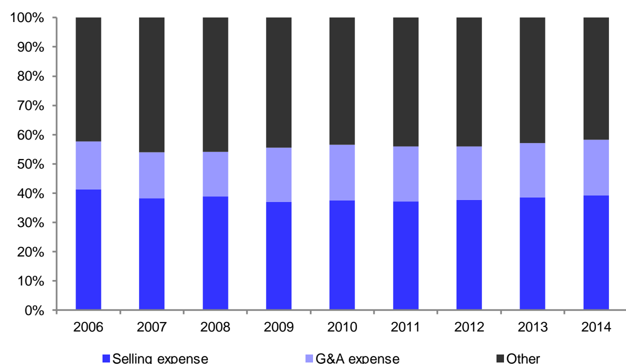
- **Small brands** with below-average margins (e.g., BC) that visibly have a scale issue: channel mix decisions are critical but so are a correct evaluation of the real market potential for the brand and cost control.

Cost opportunities are limited, but exist

The luxury sector has been living with very high gross margins, which have traditionally given the justification to run a high level of expenses rather than focus on efficiencies. What is the real room to reduce cost? Could it be more of a margin driver than LFL/store productivity? Looking at cost is useful but not conclusive in aggregate as we believe that industry profitability is more a function of brand strength than cost, as we have explained, but there are individual opportunities. We think Tod's, Prada, Ferragamo, and Tiffany's are the companies that will likely benefit from increased efficiencies.

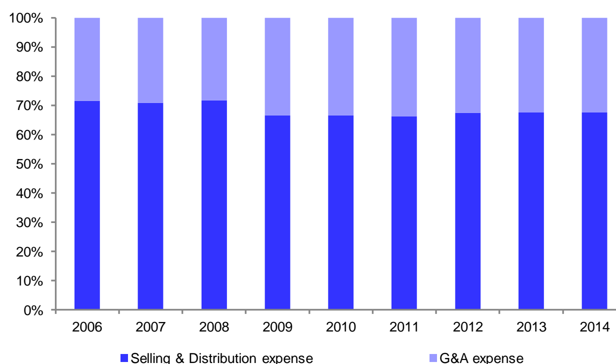
Some costs have increasingly become structurally important, as we have been saying for a while: essentially these are customer acquisition and retention costs, i.e., being able to provide the best and most desirable product with the best quality at the right price with the best service, best shopping, and brand experience seamlessly across an omnichannel platform. This translates into high hurdle levels for A&P, rents, CRM, systems/technology, supply chain, logistics, etc.

Figure 80: Opex composition as % of total (sector avg.)



Source: Deutsche Bank estimates, Company data

Figure 81: SG&A composition (sector average)

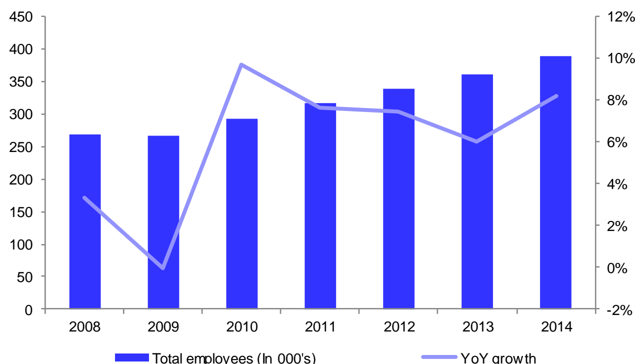


Source: Deutsche Bank, Company data

This area remains an opportunity which companies might want to selectively exploit.

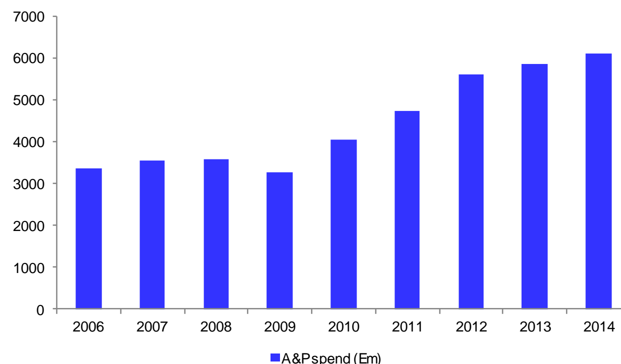
- **COGS**: generally efficiently managed and generally allow a healthy GM. However, further improvements in the overall supply chain could continue as companies roll out newer and better planning, logistics, and IT systems. Prada's recent H1 results showed that efforts and good execution in this area can have a strong payout. In this area, we identify TOD, SFER, TIF, and BC as the companies with most room for improvement, although we expect all companies to manage this cost line actively.
- **Labor:** the ramp-up of the companies' presence globally, as well as investments in capacity expansion and in IT have translated into a surge in the number of people employed in the industry. In addition, the industry is increasingly competitive and increasingly performance driven, and staff turnover tends to be high in the industry, which is reflected in high salary cost.

Figure 82: Cumulative employees and growth



Source: Deutsche Bank

Figure 83: Evolution of aggregate A&P spending (Euro m)



Source: Deutsche Bank

- **Rents** are a significant cost and in a competitive environment unlikely to be cut
- **A&P** on average has increased from less than 5% to almost 7% of sales. Brands are investing more in absolute terms, maintaining investment percentage on a larger sales base. We see little room for downsizing, although marketing costs should increase less than sales, especially for bigger players, and as retail sales continue to grow as a percentage of the total.
- **G&A.** As companies upsize, we believe growth in G&A will be subdued. However, two important factors could translate into an ad hoc step up: IT/software investments including digital related costs; and the opening of new markets (India, LatAm, and Africa), although this is long term, we believe.
- **Other costs.** In general, costs linked to new product development/prototypes, manufacturing quality, CRM, services, after-sales, etc., will become increasingly important in absorbing some of the efficiencies that scale is creating.
- **Cash flow:** better systems, supply chain, and logistics, together with reduced requirements for store and manufacturing expansion, are likely to translate into increased levels of free cash flow generation, despite commitments on store maintenance, and upgrading and relocations. We will develop the cash-flow angle in the following section.

As we combine our considerations on brand productivity and cost opportunities, we believe that margins are set to expand in 2016 by 70bps on average to just above 20%, with most of the players remaining below the peak margins experienced in the past five years. As a result, ROCE should also improve 3pp between 2015 and 2016 to reach 30% next year, at the higher end of the range of the past decade. FCF is the metric that will show greater improvements as a percentage of sales, moving from 8% in 2014 to 11% on average in 2016.

From growth to cash conversion

Moving toward unprecedented FCF generation

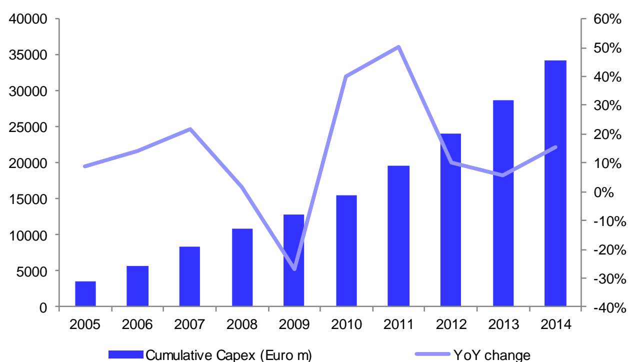
Luxury companies have ramped up their presence quickly in recent years: the ramp-up of the global strategy and retail footprint has translated into increased capex and working capital investments ultimately increasing capital employed. We believe luxury companies are now generally better positioned to manage normalized growth environment than in the 2010-14 demand boom. Oversupply in distribution implies lower capex needs going forward, while a refocus on productivity should generate an unprecedented amount of cash-flow. Pursuing new growth opportunities is always a focus for management teams, but the more limited opportunities might lead to increasing return to shareholders. We believe examples of more favorable cash return to shareholders have already occurred, via special dividends (Hermes, LVMH, or Luxottica) or share buyback (Pandora).

Capex should go down from peak levels

With investments in the network set to fade in the coming years, we see capex declining as a percentage of sales. Luxury companies have been responding to the slowing demand cycle by slowing the number of net store openings. Prada and Tod's among others have reduced store openings; Moncler will see 2015 as the peak year for new DOS openings. Most of the brands have completed the buyback of franchisee stores in the past two years.

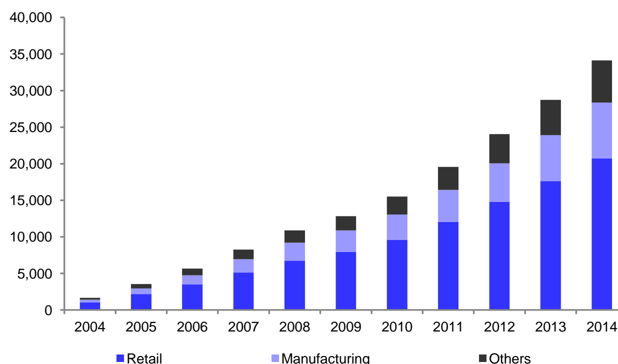
New areas of investment are gaining traction (online and logistics are top of the list), but these should be absorbed easily by expanded scale. Over the past five years, 60% of investments in the industry have been directed toward retail expansion (Figure 85). This implies that – even if IT, CRM, and e-commerce opportunity might attract more investment – we expect lower capex even in absolute terms.

Figure 84: Cumulative capex and growth for luxury



Source: Deutsche Bank, Company data (excludes companies Prada, Ferragamo, Moncler, Brunello Cucinelli)

Figure 85: Cumulative breakdown of capex (Euro m)



Source: Deutsche Bank, Company data

As a reference, in the past five years, cumulated capex in the luxury space has been in nominal terms almost 3.0x bigger than in the previous five years (Figure 84). After having sustained an above-long-term average of 5.5% since 2010, and having peaked in the past two years at around 7%, capex spending expressed as a percentage of sales by luxury companies should gradually moderate. In the coming years, we expect capex/sales levels to generally decline below those in 2014 and to approach the long-term average. This implies investment levels in absolute terms will remain very high.

Figure 86: We expect capex to slow as a % of sales, after peaking in 2013-14

	2009	2010	2011	2012	2013	2014	2015E	2016E
Brunello Cucinelli	3%	3%	5%	10%	12%	11%	8%	5%
Burberry	5%	7%	8%	9%	6%	6%	7%	7%
Coach	NA	NA	NA	5%	5%	8%	7%	7%
Hermes	10%	6%	8%	11%	6%	8%	6%	6%
Hugo Boss	3%	3%	5%	7%	7%	5%	8%	5%
Kering	2%	2%	3%	4%	7%	2%	5%	5%
Luxottica	4%	4%	5%	6%	2%	5%	5%	5%
LVMH	4%	5%	7%	6%	6%	6%	6%	5%
Michael Kors	6%	7%	7%	6%	6%	8%	8%	8%
Moncler	NA	NA	NA	NA	6%	7%	6%	5%
Prada	9%	9%	11%	11%	17%	10%	9%	8%
Ralph Lauren	4%	5%	4%	4%	5%	5%	6%	4%
Richemont	3%	5%	5%	11%	7%	8%	7%	6%
Safilo Group	3%	3%	2%	2%	4%	3%	3%	3%
Salvatore Ferragamo	3%	3%	4%	5%	5%	6%	6%	5%
Swatch Group	5%	5%	8%	6%	8%	14%	7%	7%
Tiffany & Co.	3%	4%	7%	6%	5%	6%	6%	5%
TOD's Spa	4%	12%	8%	5%	6%	7%	5%	5%
Capex / Sales simple average	**4%**	**5%**	**6%**	**6%**	**6%**	**7%**	**6%**	**5%**

Note: 2014E is to FY15 (January) for Prada, Tiffany &Co; to FY15 (March) for Richemont, Burberry, Ralph Lauren, Michael Kors,; and to FY15 (June) for Coach; same for 2015E
Source: Deutsche Bank estimates, Company data

Working capital absorption should stabilize

Working capital productivity should also improve as companies invest in supply chain efficiencies and systems. Although retail diversification requires higher levels of stock, we believe the past is now behind.

Figure 87: WC should slow as a % of sales, after peaking in 2013-14

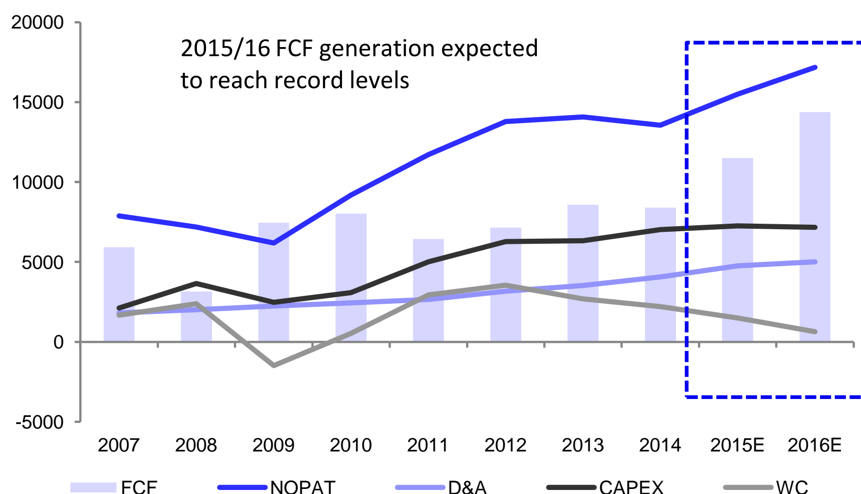
	2009	2010	2011	2012	2013	2014	2015E	2016E
Brunello Cucinelli	33%	25%	24%	23%	23%	30%	32%	32%
Burberry	18%	19%	18%	20%	20%	21%	21%	22%
Coach	10%	11%	11%	10%	12%	12%	13%	1%
Hermes	25%	19%	18%	19%	20%	22%	18%	17%
Hugo Boss	20%	19%	20%	18%	18%	20%	18%	18%
Kering	9%	9%	22%	21%	20%	23%	22%	22%
Luxottica	14%	12%	12%	11%	10%	10%	9%	9%
LVMH	30%	26%	27%	25%	26%	27%	27%	27%
Michael Kors	20%	18%	19%	18%	18%	17%	17%	17%
Moncler	NA	NA	NA	7%	8%	14%	14%	13%
Prada	17%	16%	14%	10%	11%	16%	13%	13%
Ralph Lauren	15%	16%	18%	17%	19%	20%	20%	20%
Richemont	45%	37%	39%	39%	41%	48%	45%	44%
Safilo Group	32%	27%	26%	24%	22%	23%	24%	25%
Salvatore Ferragamo	23%	20%	19%	17%	17%	23%	22%	22%
Swatch Group	64%	54%	62%	66%	72%	77%	73%	69%
Tiffany & Co.	50%	50%	53%	56%	54%	53%	52%	52%
TOD's Spa	28%	24%	25%	26%	23%	28%	28%	27%
WC / Sales simple average	**27%**	**24%**	**25%**	**24%**	**24%**	**27%**	**26%**	**25%**

Note: 2014E is to FY15 (January) for Prada, Tiffany &Co; to FY15 (March) for Richemont, Burberry, Ralph Lauren, Michael Kors,; and to FY15 (June) for Coach; same for 2015E
Source: Deutsche Bank estimates, Company data

FCF statement for the industry points to unprecedented cash generation

Figure 88 summarizes cumulated FCF variables for the sector for the upcoming two years. Substantial improvements in operating cash generation since 2009 have yet to translate into higher free cash generation, but we expect this to become finally visible in 2015-16 as capex and WC requirements stabilize.

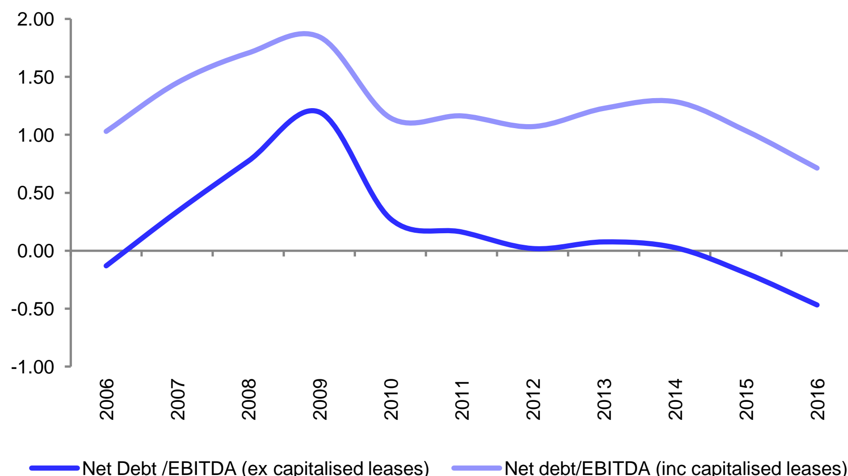
Figure 88: Cumulated sector FCF statement (Euro bn)



Source: Deutsche Bank estimates

We note that the luxury sector's balance sheets are in the best condition since the start of the 2000s. Even if growth comes in below our expectations or in the worst-case scenario an unexpected political/economic development results in an economic recession, the luxury sector is in a much stronger position to weather balance sheet risks than during economic recessions in the past 10 years. Including and excluding capitalized leases, we expect leverage in the luxury industry to be at a record low level by 2016.

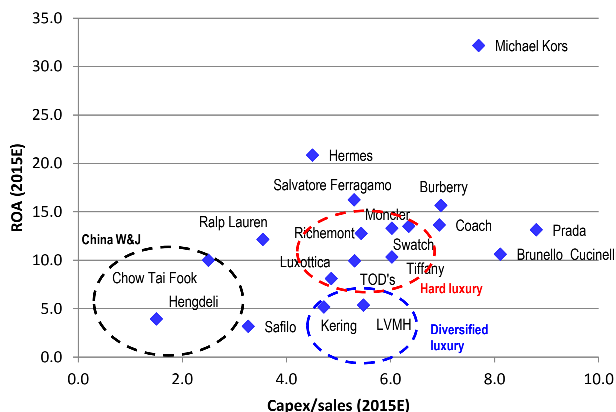
Figure 89: Net Debt/EBITDA average



Source: Deutsche Bank estimates

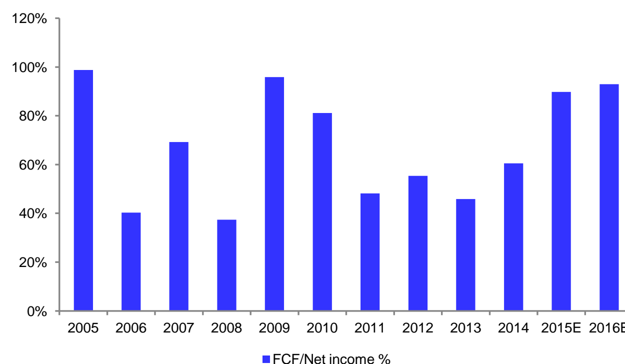
The sector's balance sheet strength allows it sufficient capacity to invest diligently and opportunistically without major risk of diluting asset productivity. In the long term, the positive correlation between high capex/sales and investment return for luxury companies remains in effect. Excluding the China watch and jewelry retailers and diversified luxury companies, we project most others will generate ROA of above 10% in 2015 while maintaining good levels of capex spending. We see this as a positive development that should result in attractive operating leverage when luxury demand growth starts recovering cyclically, most likely from 2H 2015. The overall implication is the global luxury sector largely being on top of optimizing cost structures and capacities during the present soft-demand patch. Combined with our view that global luxury demand will start recovering in 2H 2015, we see cash conversion ratios in general improving next year.

Figure 90: Asset productivity correlates with luxury segment and investment



Note: 2015E is to FY16 (January) for Prada, Tiffany &Co; to FY16 (March) for Richemont, Burberry, Ralph Lauren, Michael Kors, Chow Tai Fook; and to FY16 (June) for Coach
Source: Deutsche Bank, Company data

Figure 91: Improving cash conversion in store for 2015



Source: Deutsche Bank estimates, Company data

Retail impact on financial structure

Our analysis of asset productivity and return on capital concludes that companies are well positioned for increasing levels of FCF generation.

Admittedly our analysis is only partial as it did not incorporate all off-balance sheet costs linked to new-stores-led growth. Even with the capitalizing of these leases however, the financial structure of luxury companies appears sound and sustainable.

As our focus shifts toward the cash flow and balance sheet side of the sector, we note that retail expansion comes at a price that affects not only the P&L. Long-term lease obligations and commitments are additional financial leverage that is not captured in the accounts.

The luxury industry is cash positive or neutral, and as such, no financial issue derives from the express inclusion of capitalized leases in the companies' accounts even though net debt/EBITDA moves higher by c. 1 point, as shown in Figure 89.

We also look at how significant are minimum guaranteed lease obligations relative to the size of the companies.

Figure 92: Breakdown of minimum lease obligations for the sector (2014)

	<1 yr	2-5 yrs	>5 yrs	Total min lease obligation
Brunello Cucinelli	NA	NA	NA	NA
Burberry(£m)	205	513	264	983
Coach($m)	243	685	428	1,356
Hermes	123	358	107	587
Hugo Boss	232	667	409	1,308
Kering	NA	NA	NA	NA
Luxottica	NA	NA	NA	338
LVMH	NA	NA	NA	NA
Michael Kors($m)	177	720	695	1,593
Moncler	37	98	69	205
Prada	407	1,228	850	2,485
Ralph Lauren($m)	322	1,065	733	2,120
Richemont	2	6	113	121
Safilo Group	22	48	12	83
Salvatore Ferragamo	107	326	234	667
Swatch Group	NA	NA	NA	NA
Tiffany & Co.($m)	237	669	556	1,462
TOD's Spa	86	253	134	472

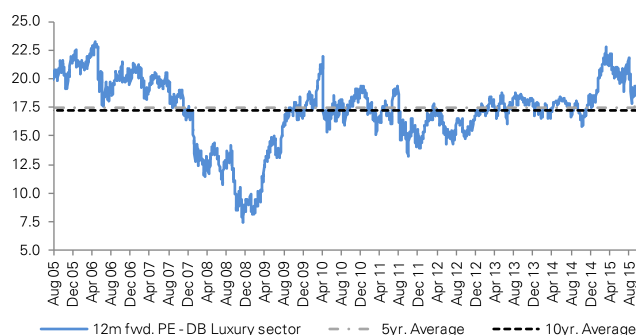
Source: Deutsche Bank, company data

Valuation: cash is king

From PE to FCF yield

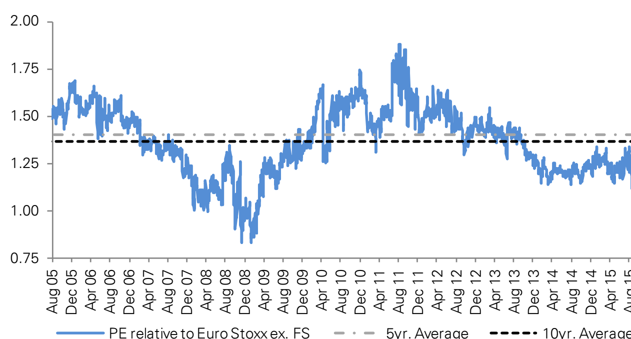
The sector now trades at 17x PER 12M forward (IBES), slightly below its 15-20 years' absolute valuation range, but trades at only a 20% premium vs. the overall market ex-financials, one of the lowest since 2008 (average of 40% in the past 10 years).

Figure 93: PE sector average



Source: Deutsche Bank, IBES

Figure 94: PE relative

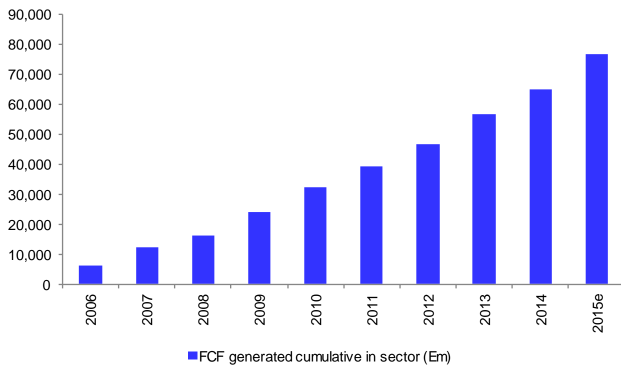


Source: IBES, DataStream

As growth rates moderate in the industry, the argument to support a PE rerating might be unconvincing. However, the sector is turning into a cash cow, with cash generation accelerating as investments needs also moderate. In the next few years we predict luxury companies will generate an unprecedented level of cash: c E15bn in FY16 (almost twice the E8.8bn generated annually in the 2012-14 period).

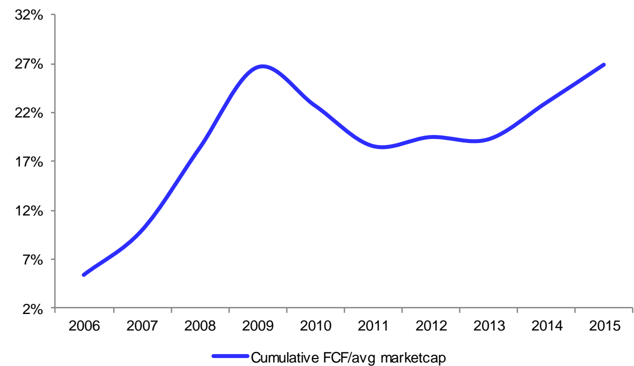
As such, we feel higher cash flow generation should help the sector PE to rerate. In the past, the luxury sector has traded at an average >40% premium to the market (ex financials), which was justified by an extraordinary growth profile. Growth is more normal now but the nature of earnings is changing as they increasingly become cash earnings, and with the focus moving to cash flow generation, we see rerating as plausible. This is implicitly captured by our primary valuation methodology, i.e., discounted cash flow models.

Figure 95: Cash generation



Source: Deutsche Bank estimates

Figure 96: Cash as % of market cap: sector aggregate

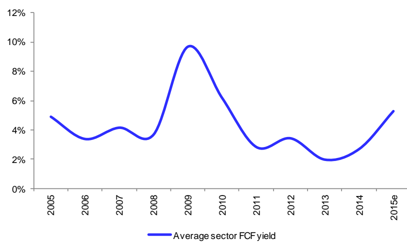


Source: Deutsche Bank estimates

So, despite the fact that the automatic sales growth drivers are losing power and the risk profile of the sector might be increasing, we find that cash is very supportive of valuation. These are the two reasons: first, cash helps offset the impact of operating deleveraging; and second, cash flow will increasingly be available for shareholders distribution, we believe.

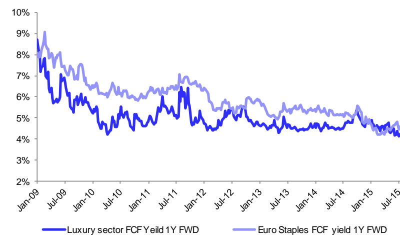
We find that an average FCF yield of 5.5% is very attractive and compares well with the market and other consumers sectors such as staples. Indeed, luxury is not only cheaper on PE vs. stables but is also more attractive on FCF yield and EV multiples.

Figure 97: FCF yield history



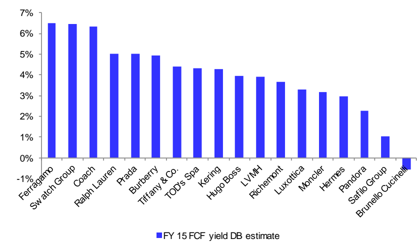
Source: Deutsche Bank estimates, company data Note: sector FCF yield is simple average for coverage stocks 2009 FCF yield is high because of Hugo Boss FCF yield of 50%

Figure 98: FCF yield vs. staples 1Y fwd



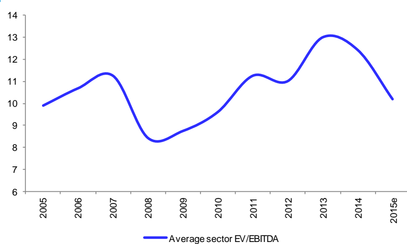
Source: Deutsche Bank

Figure 99: FCF yield ranking



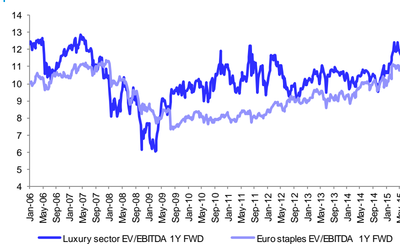
Source: Deutsche Bank

Figure 100: EV/EBITDA history



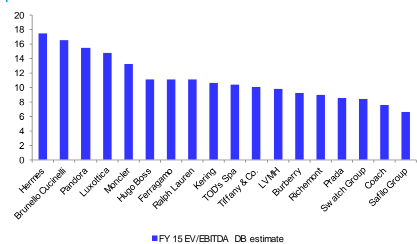
Source: Deutsche Bank estimates

Figure 101: EV/EBITDA vs. staples 1Y fwd



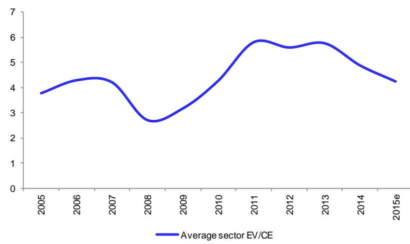
Source: Deutsche Bank

Figure 102: EV/EBITDA ranking



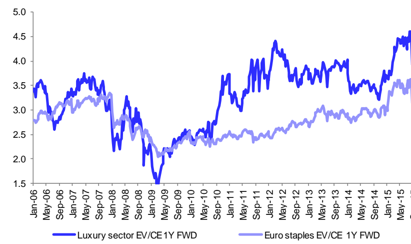
Source: Deutsche Bank estimates

Figure 103: EV/CE history



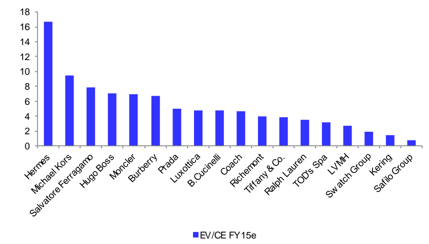
Source: Deutsche Bank estimates

Figure 104: EV/CE vs. staples 1Y fwd



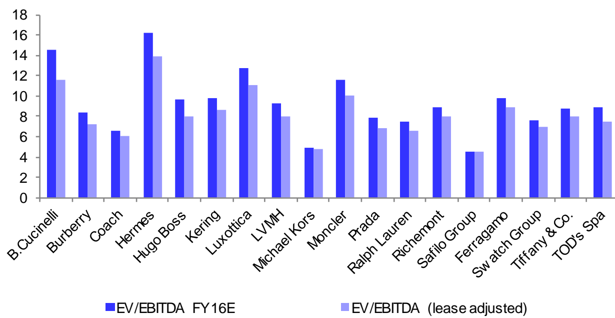
Source: Deutsche Bank

Figure 105: EV/CE ranking



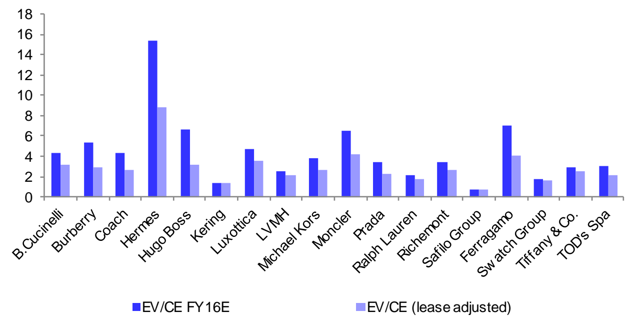
Source: Deutsche Bank

Figure 106: EV/EBITDA FY16E



Source: Deutsche Bank estimates

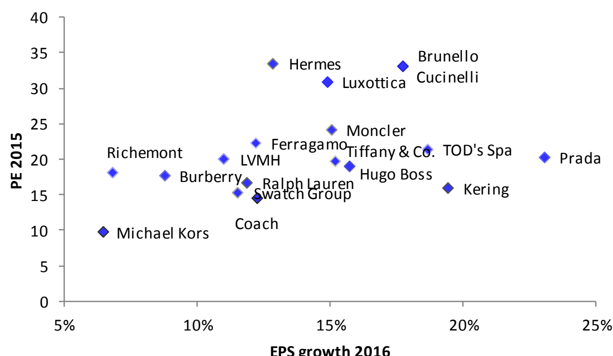
Figure 107: EV/CE FY16E



Source: Deutsche Bank estimates

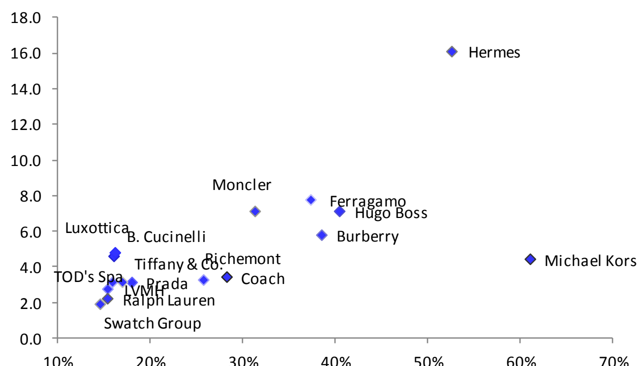
Value maps

Figure 108: PE2015 vs. EPS growth 2016E



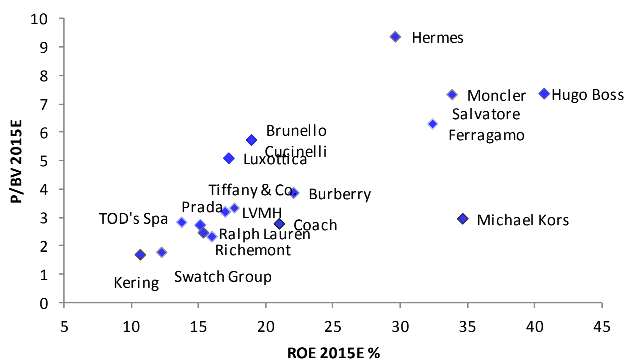
Source: Deutsche Bank estimates

Figure 109: EV/CE 2015 vs. ROCE 2015E



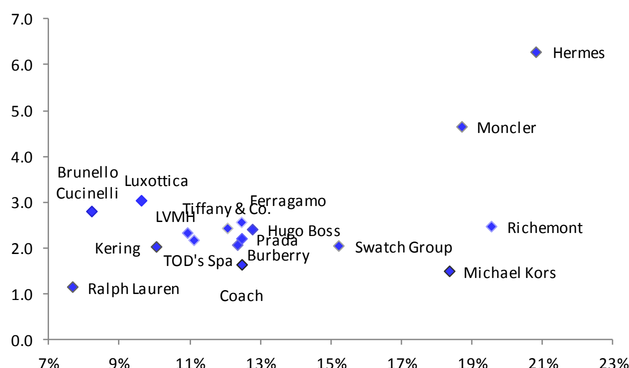
Source: Deutsche Bank estimates

Figure 110: P/BV2015 vs. ROE 2015E



Source: Deutsche Bank estimates

Figure 111: EV/sales 2015 vs. net margin % 2015E



Source: Deutsche Bank estimates

Top picks

As we move from self-help stories to structurally praise the FCF generation capabilities of the sector, we believe multiples have room to rerate. **Luxottica** and **Hermes** appear to be the benchmark from this perspective, with their expensive valuation reflecting a superior ability to convert ROCE into cash.

In this framework, our stock selection is a mix of best-in-class companies, showing different degrees of productivity and ROCE opportunities, and catch-up stories, where the solid execution of a sound strategy could result in a return to higher profitability. Valuation is as always a filter in this process.

We confirm LVMH (Buy, target price E175) as a key Buy. We continue to believe Louis Vuitton, which represents c.50% of group profit, to be one of the best positioned luxury brands. It has maintained high margins even in the past two years, through careful management of the brand. Its store expansion has been more focused on store enlargement than net additions. We see medium-term potential to shift its product mix more towards leather products, which

typically command a price premium of c.60% to its canvas range. In this way, we see price/mix as a continued revenue driver of the brand. On CY16 PE 16.8x, the stock trades toward the bottom end of its historical premium range to the wider market.

We upgrade **Richemont** to Buy with a target price of CHF90. Richemont's key brand Cartier is best-in-class on most metrics, and its valuation is attractive. The stock has underperformed the industry by 25% in the past 12 months and is now looking attractive on both valuation and fundamental opportunity: E5.5bn cash on the balance sheet, a 12M rolling PER of 15.5x and EV/EBITDA of 9.4x, a 6% FCF yield, and an EV/CE of 3x vs. 6x for staples. Richemont is the largest jewelry player worldwide: the sector is posed for solid structural growth, and Richemont is making the right decisions in terms of footprint and of merchandising, successfully developing both the high-end jewelry segment and product lines across a wide range of price points. As the destocking cycle has remained very harsh in Asia, we think this might turn over the next 6-12 months, offering some respite to forecasts, while one of the best global footprints allows Richemont brands to capture changing travel flows easily.

We also upgrade **Prada** to Buy with a target price of HKD47 (from 53 before). The stock is down over 60% from its peak and has de-rated significantly on the back of well-known top-line weakness, which has translated into 800bps margin erosion from peak. The company has swiftly addressed some of the structural flaws by strengthening and streamlining the supply chain and allowing sustainable GM support. As the brand regains momentum and scale, we think the profit rebound is due to be significant (we estimate 30% operating profit growth in 2H and 15% in FY16, and we are significantly above consensus). With the stock trading on 17x FY16 PE and with a FCF yield of 5.8%, we feel comfortable on the downside.

Moncler remains a Buy (target price E18.50) for the following key reasons: 1) superior top-line (13%) and EPS growth (20%) in 2014-17E; 2) a visible retail roll-out plan to add 15-20 DOS per year from a base of 151 stores (to drive 20% compound retail sales growth and an improving channel mix with retail moving from 57% of group sales in 2013 to 70% of sales in four years); 3) an improving geographical mix with successful expansion in the Americas (<10%) and Asia Pac (<20%) of group sales; and 4) product range development from outerwear into new categories including knitwear and shoes. Key drivers of LFL opportunities are product mix diversification, including knitwear, shoes and leather goods, and the development of S/S collections to complement very high sales density in the winter months.

Our views on other stocks

Brunello Cucinelli (Hold, target price E21) Brunello Cucinelli's business model relies on a unique combination of product excellence, "Made in Italy" craftsmanship, a heritage of superior-quality cashmere knitwear, and exclusive distribution. This places the brand firmly in the absolute luxury segment and allows for pricing power. The strategy is to be at the top of the luxury pyramid, with the brand targeting the wealthiest luxury clients only, and with consistency in quality, taste, and positioning/distribution as the main focus. The company aims to rebalance its business model to align it to the best-in-class in the industry, including improvements in its channel mix and global international expansion. The significant number of new stores added to the

platform has resulted in margin compression as scale is not yet large enough. The company's ambition is to maintain a controlled ("gracious") growth to preserve quality and brand perception and exclusiveness. We believe that the growth profile is well understood by the market.

Burberry (Hold, target price 1530p) is particularly exposed to Greater China, which represents one third of retail sales, and underweights Japan due to its transition from license to retail in the market. Hence, it is somewhat more exposed to the shift in Chinese spending from inside to outside Greater China, and in this context may continue to find margin expansion a challenge. In the medium term, we see the potential to raise margins and surplus cash to be returned to investors, but the downside risk to consensus earnings keeps our Hold rating unchanged.

Coach's (Hold, target price USD39) repositioning journey, which started over 12 months ago, is proceeding in line with expectations. The road to restored sales productivity and profitability is long, and the actions are concentrated on the top line and brand, while opex and balance sheet are well managed. The source of potential upside is therefore concentrated in top-line improvement via better brand perception, product, merchandising, positioning, a new upgraded store environment, and customer experience. While so far in line with expectations, visibility on the turnaround is low, which brings a risk on cash generation and hence its below-average valuation.

Hermes (Hold, target price E310). Hermes ranks as a best-in-class company in retail in the luxury industry: it has the highest retail sales density and has consistently applied a forward-looking strategy that allowed focusing on productivity earlier than peers. Over the past years, Hermes brand has enjoyed the best momentum in the industry, which allowed it to consistently report 8-10% organic growth and should drive record operating margin in 2016. However at 28x PE 2016E, we believe that Hermes's superior performance is fairly priced, and we thus maintain a Hold recommendation.

Hugo Boss (Buy, target price E125) continues to offer disproportionate exposure to the European consumer, which we feel is more attractive than Asian exposure. The brand still has a shift from wholesale to retail to execute, and this is keeping investment levels high in the near term, but management has proven its ability to expand margins and execute its strategy. A generous payout of c.75% results in a supportive dividend yield of 4.2% in 2015 and 4.8% in 2016. With improved momentum in Europe, the completion of buy-ins in Asia, new management in the Americas, and omnichannel improvements set for 2016, we continue to see good momentum.

Kering (Hold, target price E165) remains a stock with potential positive catalysts, especially in the form of Gucci and possibly Puma. However, Gucci's sales and margin progression relies heavily on its turnaround being engineered by new management. Significant destocking in H1 and store refurbishment in H2 are helpful factors, but we have limited visibility on the impact that new creative direction will have on a P&L that continues to have attractive, rather than trough, margins. We do not as yet envisage the strong cash flow dynamics expected elsewhere in the sector. Hence, we retain our Hold recommendation.

Luxottica (Hold, target price E60) is a best-in-class company in its own league. We have not mapped Luxottica's productivity and returns in this report as the business model is not strictly comparable, yet we note that Luxottica is a top cash flow producer and has a dividend distribution policy that has become more generous over time. A 26x PE and a 3.6% FCF yield discount the positives well.

Michael Kors (Buy, target price USD50). Our Buy rating is based on our view that the Kors global lifestyle brand has one of the best growth trajectories in the sector. Key drivers: (1) huge global accessories share gains, (2) an impressive NA retail store runway, (3) continued productivity lift via shop-in-shop conversions, and (4) tight promotions

Pandora (Hold, target price DKK770). Pandora is one of the most successful stories of the past decade in jewelry. The equity story has many attractions: it offers top-line opportunity with retail expansion and geographical expansion, has margin support from commodities and scale opportunities. This would result in a 15% top-line and a 20% three-year EPS CAGR expected, with generous shareholder return. However, we believe that Pandora limited price/mix opportunity, its penetration in mature markets, and its growing complexity are underestimated by the market in the medium term. We believe that a further re-rating is unlikely and that, at a 2016E PE of 18x, Pandora looks fairly valued.

Ralph Lauren (Hold, target price USD136). We're cautious on RL's ability to grow constant current revenues by a +MSD/HSD CAGR over time, given the company's tourist/outlet exposures (both weak) and a lack of scale in winning categories such as accessories and athletic. Furthermore, out-year operating margin growth appears challenged, as management keeps finding new initiatives in which to invest, which precludes bottom-line profit flow-through. This tempered view is balanced somewhat by the reality that Ralph Lauren is a well-run company, with broad customer acceptance and brand recognition.

Salvatore Ferragamo (Hold, target price E27.5) remains an attractive catch-up story despite the progress made since prior to the IPO (EBIT margin +7pp). The company is on the right track to improve sales results through products, merchandising efforts, and pricing as well as through a better store and customer experience. However, store productivity upside is capped by an extensive retail and wholesale footprint, which creates cannibalization. In addition, there is room in the supply chain, and hence GM, to benefit from investments in efficiencies, logistics, and systems. However, the 2pp margin improvement to FY17E is in our view correctly valued with the stock trading at 19x PE and a 4% yield.

Swatch Group (Hold, target price CHF475) remains one of the key plays on a number of long-term luxury themes, thanks to its superior exposure to emerging markets, relative under-penetration in the US, strength of its brand portfolio, distribution enhancement opportunities, and state-of-the-art manufacturing platform and industry leadership in components. However, watch industry de-stocking, a high inventory level, soft demand in Greater China, and, since January 2015, additional pressure on margin from a stronger Swiss franc are major elements that balance the potential for high return and compelling valuation. We see potential upside on FCF and returns from better working capital management but limited visibility on supply chain or cost action.

Tiffany (Hold, target price USD93) is attractive due to 1) its jewelry exposure; 2) its productivity ranking that is close to best-in-class or in the top quartile, and especially 3) the upside from bottom-up initiatives across the brand, costs, and the supply chain. However, we feel that its relative valuation is less compelling than Richemont's (17x PER and 4% FCF yield), and Q3 presents a tough comparison, especially in North America.

TOD's (Hold, target price E86.5). While it is too early to call an inversion in the trend, we note that the company is working to restore brand and distribution credibility. It is working strenuously on brand momentum, the appeal of the collections, merchandising in both the footwear category and especially leather goods, and is hopeful its new leather goods collection next season will prove successful and benefit H2. The company needs to step up its scale to cover the fixed costs from a period of rapid expansion, and productivity improvement could take a while. We assume comps will stay positive for the rest of the year, which together with a low base of comparison, positive FX, and effective cost control, should allow for an improvement in profitability. This explains our above-consensus numbers. However, we feel the risk/reward is slightly tilted to the downside, with consensus upgrades depending on a revival of brand momentum, and with uncertainty over a deal on Roger Vivier looming for a few more months.

Sector valuation methodology

The comparative valuations of our entire Luxury Goods coverage universe are shown in Figure 112. However, we believe investors should focus mainly on absolute valuations, based on the specific prospects of each company. Our preferred measure for this is a discounted cash flow valuation, but we also use a sum-of-the-parts methodology or a combination of the two methodologies when more applicable.

We base our DCF valuations on WACCs varying between 8.0 and 10.0, depending on capital structure and perceived risk (betas between 1.0 and 1.1). We use a risk-free rate of 3.5% and a risk premium of 4.5%. Our terminal nominal growth rates vary between 2% and 3%, depending on relative maturities, growth prospects, and brand strength (ability to pass on inflation). Where there is family control, we discount our valuations to account for the risk that the interests of minority shareholders are not aligned with those of the controlling family.

Sector risks

The biggest negative risk to our forecasts and the sector would be renewed turmoil in worldwide financial markets, the persistence of concerns regarding sovereign debt, slowing world GDP growth, or negative economic developments. The second key risk is if sector troubles are exacerbated by a slowdown in tourist travel, as was the case in 2001-02. The third risk would be a strengthening of the Euro to the USD and Yen for Euro-denominated luxury companies, as well as CHF evolution, or any FX shock.

In terms of upside, the greatest risk would be if the sector proved to be responsive to an emerging recovery in Europe. The impact of the weak Euro on global travel is another source of possible upside risks. For China, which is a major engine of sector growth, decisions by the authorities that affect Chinese consumer spending and travel would also be significant, as well as the end of destocking and increasing strength of Chinese tourist spending.

Figure 112: Global luxury valuation multiples

25 Sep 2015

Company	Ticker	Current Price	Price Target	Upside/ Downside	Total Return	Rating	FX	Mkt Cap Local m	Mkt Cap Euro m	EV m Local m	Year End	Free Float	Absolute 1 Mth	Absolute 3 Mths	Absolute 12 Mths	Relative to DJ Stoxx 600 1 Mth	Relative to DJ Stoxx 600 3 Mths	Relative to DJ Stoxx 600 12 Mths
				Stock data										**Performance**				
Yoox	YOOX.MI	26	32	24%	24%	Buy	Euro	1,423	1,423	1,379	31.12	78%	-4%	-17%	48%	-1%	-4%	50%
Hermes	HRMS.PA	309	310	0%	3%	Hold	Euro	32,166	32,166	30,540	31.12	18%	-1%	-13%	26%	2%	1%	28%
Brunello Cucinelli	BCU.MI	16	21	33%	34%	Hold	Euro	1,073	1,073	1,137	31.12	33%	-3%	-9%	-7%	0%	6%	-6%
Luxottica	LUX.MI	58	60	4%	5%	Hold	Euro	27,349	27,349	27,713	31.12	25%	-4%	-7%	41%	-1%	8%	43%
Moncler	MONC.MI	15	19	20%	20%	Buy	Euro	3,870	3,870	3,898	31.12	31%	-2%	-12%	33%	1%	3%	35%
Pandora	PNDORA.C	765	770	1%	2%	Hold	DKK	95,199	12,758	94,213	31.12	96%	3%	6%	68%	7%	23%	70%
Salvatore Ferragamo	SFER.MI	22	28	23%	25%	Hold	Euro	3,756	3,756	3,621	31.12	25%	-11%	-22%	-1%	-8%	-9%	0%
TOD's Spa	TOD.MI	80	87	8%	11%	Hold	Euro	2,417	2,417	2,216	31.12	43%	-0%	-10%	-3%	3%	5%	-1%
LVMH	LVMH.PA	144	175	21%	24%	Buy	Euro	72,214	72,214	77,625	31.12	50%	-1%	-16%	20%	2%	-2%	22%
Hugo Boss	BOSSn.DE	96	125	30%	34%	Buy	Euro	6,626	6,626	6,616	31.12	83%	-4%	-7%	-4%	-1%	8%	-2%
Richemont	CFR.VX	73	90	24%	26%	Buy	Euro*	37,380	37,380	31,329	31.03	99%	3%	-8%	-11%	7%	7%	-10%
Burberry	BRBY.L	1,333	1,530	15%	17%	Hold	GBp	5,865	7,939	5,328	31.03	100%	-1%	-19%	-11%	2%	-6%	-10%
Kering	PRTP.PA	139	165	19%	22%	Hold	Euro	17,557	17,557	22,898	31.12	59%	-8%	-14%	-13%	-5%	0%	-12%
Swatch Group	UHR.VX	350	475	36%	38%	Hold	CHF	18,955	17,340	17,190	31.12	59%	-4%	-8%	-25%	-1%	7%	-24%
Safilo Group	SFLG.MI	10	17	64%	64%	Buy	Euro	641	641	786	31.12	49%	-1%	-24%	-8%	2%	-11%	-7%
European Luxury				**17%**	**19%**								**-2%**	**-11%**	**13%**	**2%**	**3%**	**15%**
Tiffany & Co.	TIF.N	78	93	19%	21%	Hold	US$	10,066	8,915	10,411	31.01	100%	-8%	-17%	-21%	-6%	-3%	-20%
Ralph Lauren	RL.N	109	136	25%	26%	Hold	US$	9,730	8,617	8,996	31.03	100%	2%	-20%	-35%	5%	-6%	-34%
Coach	COH.N	29	39	36%	41%	Hold	US$	8,053	7,132	7,380	30.06	100%	-2%	-20%	-23%	1%	-6%	-21%
Michael Kors Holdings Ltd.	KORS.N	43	50	17%	17%	Buy	US$	8,795	7,789	7,111	31.03	100%	4%	-6%	-43%	7%	10%	-42%
US Luxury				**24%**	**26%**								**-1%**	**-16%**	**-30%**	**2%**	**-1%**	**-29%**
Prada	1913.HK	31.85	47.00	48%	50%	Buy	Euro*	9,313	9,313	9,233	31.01	20%	-1%	-17%	-34%	2%	-3%	-33%
Chow Tai Fook	1929.HK	6.81	7.26	7%	11%	Hold	HKD	68,100	7,782	71,120	31.03	11%	1%	-20%	-35%	4%	-6%	-34%
Hengdeli	3389.HK	1.17	1.23	5%	8%	Hold	CNY*	4,624	642	5,742	31.12	45%	16%	-25%	-12%	19%	-13%	-11%
Asia				**28%**	**31%**								**0%**	**-18%**	**-34%**	**4%**	**-5%**	**-33%**
Global Luxury				**18%**	**21%**				**294,696**			**58%**	**-1%**	**-12%**	**6%**	**2%**	**2%**	**7%**

Multiples & Yields (calendarised)

	EV/Sales (x) 2014	EV/Sales (x) 2015	EV/Sales (x) 2016	EV/EBITDA (x) 2014	EV/EBITDA (x) 2015	EV/EBITDA (x) 2016	EV/EBIT (x) 2014	EV/EBIT (x) 2015	EV/EBIT (x) 2016	P/E (x) 2014	P/E (x) 2015	P/E (x) 2016	Dividend Yield (%) 2014	Dividend Yield (%) 2015	Dividend Yield (%) 2016	FCF Yield (%) 2014	FCF Yield (%) 2015	FCF Yield (%) 2016
Yoox	2.3	2.2	1.9	24.4	22.7	18.8	51.2	109.9	37.5	98.8	77.6	66.6	0.0%	0.0%	0.0%	-0.8%	0.1%	-1.7%
Brunello Cucinelli	3.7	2.8	2.5	20.7	16.5	14.1	26.5	21.7	18.3	35.2	32.1	27.3	0.7%	0.8%	0.9%	-1.7%	-0.6%	1.5%
Hermes	6.0	6.2	5.6	16.9	17.3	15.4	19.0	19.6	17.3	37.7	31.6	28.0	2.6%	1.2%	1.5%	2.3%	3.0%	3.3%
Luxottica	2.6	3.0	2.7	13.1	14.5	12.6	17.4	18.4	15.8	40.4	29.5	25.7	1.2%	1.6%	1.9%	2.5%	3.4%	3.7%
Pandora	4.1	5.9	5.2	11.5	15.8	13.5	12.2	16.7	14.3	31.9	23.4	17.5	1.2%	1.6%	2.0%	3.8%	2.3%	4.5%
Moncler	4.6	4.4	3.8	14.1	13.5	11.3	15.8	15.1	12.8	29.3	23.0	20.0	0.6%	0.8%	1.0%	2.1%	3.2%	4.4%
TOD's Spa	2.6	2.1	1.9	13.0	10.5	8.9	16.9	13.2	11.1	24.9	21.1	17.8	2.4%	2.8%	3.3%	0.6%	4.3%	4.9%
Salvatore Ferragamo	2.8	2.5	2.2	12.7	10.7	9.4	15.2	12.8	11.2	24.4	20.6	18.4	2.1%	2.4%	2.7%	1.0%	6.8%	4.6%
LVMH	2.4	2.2	2.0	10.9	9.6	8.8	13.6	11.7	10.7	24.4	18.6	16.8	2.2%	2.4%	2.6%	4.0%	4.1%	5.3%
Hugo Boss	2.7	2.3	2.1	11.9	10.6	9.3	15.0	13.5	11.7	19.0	18.0	15.6	3.8%	4.2%	4.8%	4.0%	4.1%	5.7%
Richemont	3.0	2.7	2.5	10.0	9.4	8.8	11.7	11.2	10.6	25.2	17.9	15.1	2.2%	2.5%	2.6%	2.0%	3.6%	5.6%
Burberry	2.6	2.0	1.9	11.0	9.2	8.7	14.0	11.9	11.3	17.4	17.7	16.7	2.6%	2.7%	3.1%	5.0%	5.2%	5.6%
Kering	2.4	2.0	1.8	12.1	10.9	9.4	14.5	13.1	11.3	14.9	14.4	12.0	2.9%	3.2%	3.4%	5.2%	4.4%	6.4%
Swatch Group	3.0	1.9	1.8	12.4	8.3	7.2	15.0	10.1	8.6	13.7	14.1	12.6	2.1%	2.3%	2.4%	2.8%	6.9%	7.1%
Safilo Group	0.9	0.6	0.5	9.3	6.4	4.3	13.7	9.2	5.6	16.4	13.8	8.4	0.0%	0.0%	0.0%	3.6%	1.1%	5.9%
Euro Luxury	**0.0**	**3.1**	**2.8**	**12.3**	**11.6**	**10.4**	**15.0**	**14.4**	**12.5**	**27.2**	**21.5**	**18.8**	**2.1%**	**2.2%**	**2.4%**	**3.2%**	**3.9%**	**5.0%**
Euro Luxury Adj**	**2.8**	**2.7**	**2.4**	**11.9**	**11.1**	**9.9**	**14.7**	**14.0**	**12.0**	**26.2**	**20.5**	**17.8**	**2.1%**	**2.4%**	**2.6%**	**3.4%**	**4.2%**	**5.4%**
Tiffany & Co.	3.0	2.4	2.2	12.3	9.8	8.6	15.2	12.2	10.6	18.7	19.1	16.8	1.8%	2.1%	2.4%	5.5%	4.6%	4.2%
Ralph Lauren	1.8	1.8	1.7	10.2	11.1	11.3	12.9	15.1	14.7	13.6	15.5	14.8	1.6%	1.8%	1.8%	5.2%	5.0%	5.0%
Coach	2.2	1.7	1.4	9.0	7.5	6.0	10.5	9.2	7.4	11.4	14.5	13.3	5.6%	6.3%	3.3%	7.8%	6.5%	10.9%
Michael Kors Holdings Ltd.	3.7	3.3	3.0	11.6	11.0	10.4	12.8	12.3	11.9	10.6	9.6	9.1	0.0%	0.0%	0.0%	5.6%	3.5%	6.5%
US Luxury***	**2.7**	**2.3**	**2.1**	**10.8**	**9.9**	**9.2**	**13.0**	**12.3**	**11.3**	**13.8**	**14.9**	**13.6**	**2.1%**	**2.4%**	**1.9%**	**5.9%**	**4.8%**	**6.4%**
Prada	3.7	2.4	2.2	13.6	9.3	7.9	18.3	12.9	10.9	20.0	19.7	17.0	2.0%	2.1%	2.6%	3.7%	5.3%	6.1%
Chow Tai Fook	1.1	1.1	1.1	8.6	10.2	10.1	9.5	11.6	11.6	11.5	14.6	14.8	4.4%	3.5%	3.5%	3.5%	7.3%	6.7%
Hengdeli	0.5	0.4	0.4	6.9	5.6	4.7	8.0	6.7	5.6	10.0	11.3	9.9	2.6%	2.6%	3.0%	-2.2%	20.7%	15.1%
Asia	**2.4**	**1.8**	**1.6**	**11.2**	**9.6**	**8.8**	**14.1**	**12.1**	**11.0**	**15.9**	**17.2**	**15.8**	**3.1%**	**2.7%**	**3.0%**	**3.4%**	**6.7%**	**6.7%**
Global Luxury **	**2.8**	**2.6**	**2.3**	**11.7**	**10.8**	**9.7**	**14.5**	**13.7**	**11.9**	**24.3**	**19.7**	**17.2**	**2.2%**	**2.4%**	**2.6%**	**3.6%**	**4.4%**	**5.6%**

Source: Deutsche Bank

Top picks pages

Rating
Buy

Europe
France

Consumer Discretionary & Luxury
Luxury Goods

Company
LVMH

Reuters	Bloomberg
LVMH.PA	MC FP

Price at 25 Sep 2015 (EUR)	151.15
Price Target (EUR)	175.00
52-week range (EUR)	175.60 - 123.75

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Key message

In our view, LVMH offers defensiveness through diversity and an improving momentum at Louis Vuitton, which represents around 50% of group profit. The brand is best-in-class in the luxury sector: it shifted from prioritizing store openings to store relocations/enlargements several years ago, has been focusing on product development, and maintained its price integrity globally with a 'no discount' policy and judicious price rises. With exceptionally high sales productivity, it generates EBIT margins over 40%, and we see growth through the gradual price mix effect of shifting towards leather goods. With the stock trading on a discount to the sector, we maintain our Buy rating.

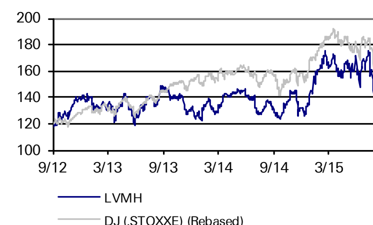
Next news flow

The next news will be Q3 sales, expected toward the end of October. We expect underlying trends broadly to be the same as in H1 for most brands, but the company should benefit from softer comparatives as the Hong Kong downturn annualizes.

Valuation and risks

LVMH trades on a CY16 PE 16.8x or a 6% discount to the luxury sector ex-Hermes, in line with its 5/10 year average discount of 8% but with better-than-average prospects, in our view. It trades on a PE premium to the Euro Stoxx ex-financials of 25%, compared with a 5/10 year average premium of c.30%. Our target price of E175 is based on DCF and SoTP valuations. Downside risks include the execution of LV's product adjustments, continued weak consumer demand, and a stronger Euro.

Price/price relative



Performance (%)	1m	3m	12m
Absolute	2.4	-11.6	15.6
DJ (.STOXXE)	-2.7	-12.4	2.0

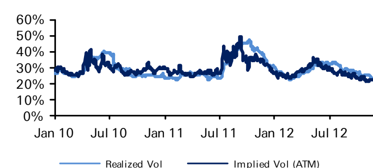
Source: Deutsche Bank

Stock & option liquidity data

Market cap (EUR)(m)	75,772.9
Shares outstanding (m)	504
Free float (%)	50
Option volume (und. shrs., 1M avg.)	99,642

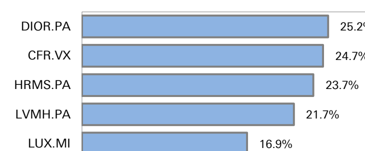
Source: Deutsche Bank

Implied & Realized Volatility (3M)



Source: Deutsche Bank

Implied Volatility (3M, ATM) vs. Peers



*Weighted-avg. of index components
*Data as of 22-Jan-13

Source: Deutsche Bank

Forecasts And Ratios

Year End Dec 31	2013A	2014A	2015E	2016E	2017E
Revenue (EURm)	29,016	30,638	35,654	38,107	40,493
EBITDA (EURm)	7,052	6,767	8,092	8,694	9,234
EBITA (EURm)	5,921	5,436	6,620	7,138	7,596
DB EPS (EUR)	6.83	5.90	7.73	8.58	9.29
DB EPS growth (%)	0.1	-13.6	31.1	11.0	8.3
P/E (DB EPS) (x)	19.9	22.9	19.6	17.6	16.3
EV/EBITDA (x)	10.5	10.9	10.0	9.2	8.5
EV/EBITA (x)	12.5	13.6	12.3	11.2	10.3
DPS (EUR)	3.10	3.20	3.50	3.70	3.90
Yield (%)	2.3	2.4	2.3	2.4	2.6

Source: Deutsche Bank estimates, company data

Rating
Buy

Europe
Switzerland

Consumer Discretionary & Luxury
Luxury Goods

Company
Richemont

Reuters	Bloomberg
CFR.VX	CFR VX

Price at 25 Sep 2015 (CHF)	75.10
Price Target (CHF)	90.00
52-week range (CHF)	91.75 - 68.85

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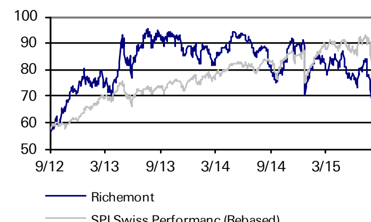
Price/price relative



Performance (%)	1m	3m	12m
Absolute	4.6	-4.6	-8.0
SPI Swiss Performance IX	-2.6	-5.4	0.4

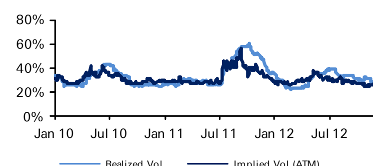
Source: Deutsche Bank

Stock & option liquidity data

Market cap (CHF)(m)	42,326.4
Shares outstanding (m)	566
Free float (%)	100
Option volume (und. shrs., 1M avg.)	352,844

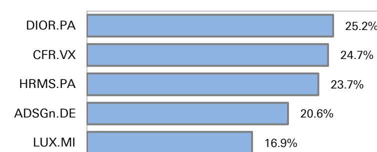
Source: Deutsche Bank

Implied & Realized Volatility (3M)



Source: Deutsche Bank

Implied Volatility (3M, ATM) vs. Peers



*Weighted-avg. of index components
*Data as of 22-Jan-13

Source: Deutsche Bank

Best-in-class with opportunities

We upgrade Richemont to Buy with a target price of CHF90. Richemont's key brand Cartier is best-in-class on most of the metrics we have examined in this report, and valuation is attractive. The stock has underperformed the industry by 25% in the past 12 months and is looking attractive on both valuation and fundamental opportunities: E5.5bn cash on the balance sheet, a 12M rolling PER of 15.5x and EV/EBITDA of 9.4x, a 6% FCF yield and an EV/CE of 3x vs. 6x for staples. Richemont is the largest jewelry player worldwide: the sector is poised for solid structural growth, and Richemont is making the right decisions in terms of footprint and merchandising, successfully developing the high-end jewelry segment and product lines across a wide range of price points. As the destocking cycle has been very harsh in Asia, this might turn over in the next 6-12 months, offering some respite to forecasts, while one of the best global footprints allows its brands to capture changing travel flows.

Next news flow: H1 results on November 6

Richemont is due to report its H1 results for the March-September 2015 period on November 6. After releasing better-than-expected 5M sales trends with 4% cFX vs. 1-2% expected by consensus, which triggered an initial return of interest into the stock, we believe H1 results will be satisfactory with at least similar cFX sales growth of 4% and sound margins: we see 65% GM (+50bps yoy with input cost tailwinds) and a 23.1% EBIT margin (-100bps).

Valuation and risks

We value Richemont using a DCF valuation with a WACC of 8.5% (risk-free rate: 3.5%, equity risk premium: 4.5%, long-term beta: 1.1x), exit EBIT of 24.5%, and a perpetuity growth rate of 2.5%. Risks continue to relate to macro and financial volatility, global and China GDP growth, travel flows, the length of the destocking cycle in China; within company-specific risks, we see slow progress on the relaunch of the smaller brands.

Forecasts And Ratios

Year End Mar 31	2014A	2015A	2016E	2017E
Revenue (EURm)	10,023	10,410	12,064	12,787
EBITDA (EURm)	2,822	3,216	3,359	3,610
EBITA (EURm)	2,427	2,753	2,809	3,005
DB EPS (EUR)	3.69	2.28	4.17	4.45
DB EPS growth (%)	3.4	-38.2	82.9	6.9
P/E (DB EPS) (x)	19.0	31.8	16.4	15.4
EV/EBITDA (x)	12.6	11.2	9.8	9.6
EV/EBITA (x)	14.7	13.1	11.7	11.6
DPS (EUR)	1.17	1.60	1.68	1.76
Yield (%)	1.6	2.2	2.4	2.6

Source: Deutsche Bank estimates, company data

Rating
Buy

Europe
Italy

Consumer Discretionary & Luxury
Luxury Goods

Company
Moncler

Reuters	Bloomberg
MONC.MI	MONC IM

Price at 25 Sep 2015 (EUR)	16.20
Price Target (EUR)	18.50
52-week range (EUR)	18.91 - 10.25

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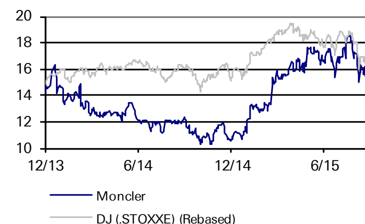
Price/price relative



Performance (%)	1m	3m	12m
Absolute	2.1	-7.6	45.3
DJ (.STOXXE)	-2.7	-12.4	2.0

Source: Deutsche Bank

Stock & option liquidity data

Market cap (EUR)(m)	4,050.0
Shares outstanding (m)	253
Free float (%)	31
Option volume (und. shrs., 1M avg.)	–

Source: Deutsche Bank

A story of retail growth and brand momentum

We continue to rate Moncler as one of our top picks, thanks to: 1) superior top-line (13%) and EPS growth (20%) in 2014-17E, 2) a visible retail rollout plan with the addition of 15-20 DOS per year from a base of 151 stores (to drive 20% compound retail sales growth and an improving channel mix, 3) an improving geographical mix with successful expansion in the Americas (<10% of sales) and Asia Pac (<20%), and 4) product range development from outerwear into new categories including knitwear and shoes. Key drivers of LFL opportunities are product mix diversification including knitwear, shoes and leather goods, and the development of S/S collections to complement very high sales density in the winter months.

Next news flow: 3Q results on November 9

Volatility during the summer months in China and US should be compensated by Europe and Japan, and Q3 includes wholesale delivery ahead of the winter. Easy comps in September should also support retail. While we assume that LFL could deteriorate vs. the strong performance in 1H15, we believe that 2H-15 should remain very solid with high-single-digit growth.

Valuation and risks

We value Moncler with a DCF approach, using a WACC of 8.5% (90% equity and 10% debt; cost of equity of 8.5% based on a 3.5% risk-free rate, 4.5% risk premium, and 1.1x beta) and a terminal growth rate of 3%, the latter being the above-average rate we use for bigger brands that reflect the company's higher growth potential. Company-specific risks relate to: 1) execution of its planned retail expansion; 2) gross margin sustainability; 3) availability/price of key raw materials; 4) the fashion risk of goose-down jackets and its demand seasonality; and 5) a shareholders' overhang from PE investors owning 23%. Sector issues are GDP, the global shoppers' trend, Chinese demand, and FX.

Forecasts And Ratios

Year End Dec 31	2013A	2014A	2015E	2016E	2017E
Revenue (EURm)	581	694	880	985	1,084
EBITDA (EURm)	186	226	289	332	375
EBITA (EURm)	167	202	258	294	331
DB EPS (EUR)	0.39	0.53	0.67	0.77	0.88
DB EPS growth (%)	–	35.6	27.3	15.0	13.7
P/E (DB EPS) (x)	37.9	23.3	24.1	21.0	18.4
EV/EBITDA (x)	20.8	14.1	14.1	11.9	10.1
EV/EBITA (x)	23.1	15.8	15.8	13.4	11.4
DPS (EUR)	0.01	0.10	0.12	0.15	0.18
Yield (%)	0.1	0.8	0.7	0.9	1.1

Source: Deutsche Bank estimates, company data

Appendix – Historical valuation charts

Brunello Cucinelli

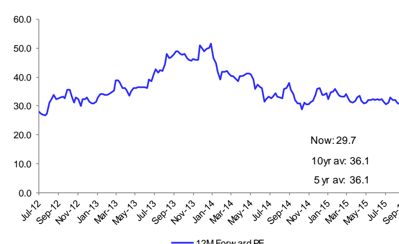
Figure 113: EV/Sales 12M fwd (x)

Source: I/B/E/S, DataStream

Figure 114: EV/EBIT 12M fwd (x)

Source: I/B/E/S, DataStream

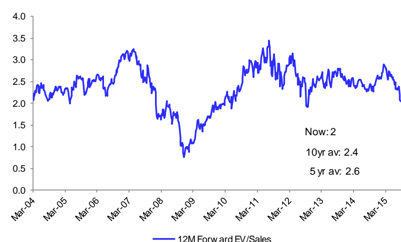
Figure 115: PE 12M fwd (x)



Source: I/B/E/S, DataStream

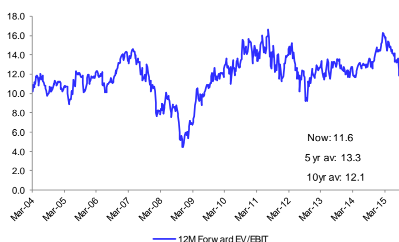
Burberry

Figure 116: EV/Sales 12M fwd (x)



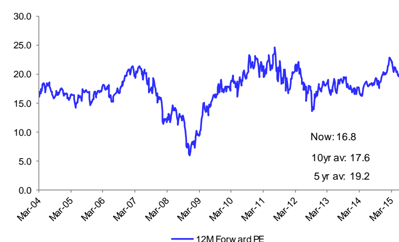
Source: I/B/E/S, DataStream

Figure 117: EV/EBIT 12M fwd (x)



Source: I/B/E/S, DataStream

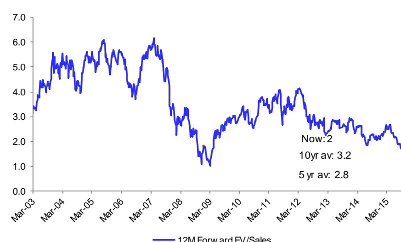
Figure 118: PE 12M fwd (x)



Source: I/B/E/S, DataStream

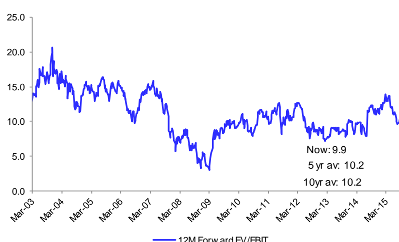
Coach

Figure 119: EV/Sales 12M fwd (x)



Source: I/B/E/S, DataStream

Figure 120: EV/EBIT 12M fwd (x)



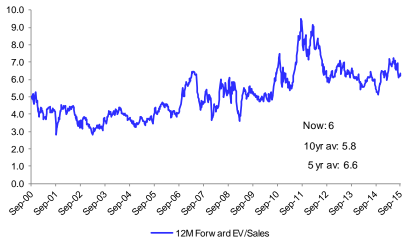
Source: I/B/E/S, DataStream

Figure 121: PE 12M fwd (x)

Source: I/B/E/S, DataStream

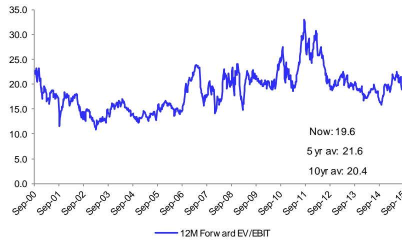
Hermès

Figure 122: EV/Sales 12M fwd (x)



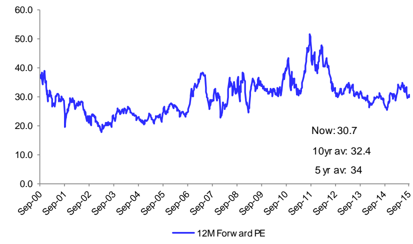
Source: I/B/E/S, DataStream

Figure 123: EV/EBIT 12M fwd (x)



Source: I/B/E/S, DataStream

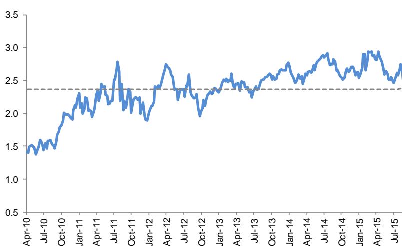
Figure 124: PE 12M fwd (x)



Source: I/B/E/S, DataStream

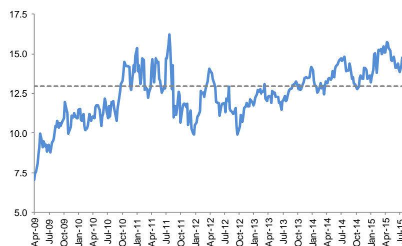
Hugo Boss

Figure 125: EV/Sales 12M fwd (x)



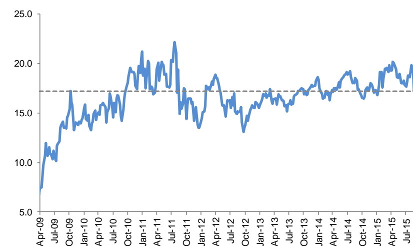
Source: I/B/E/S, DataStream

Figure 126: EV/EBIT 12M fwd (x)



Source: I/B/E/S, DataStream

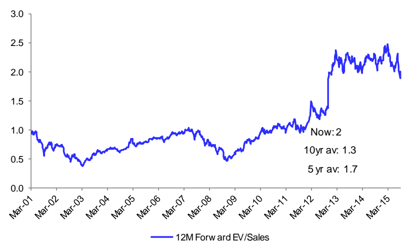
Figure 127: PE 12M fwd (x)



Source: I/B/E/S, DataStream

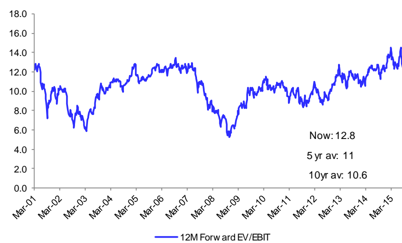
Kering

Figure 128: EV/Sales 12M fwd (x)



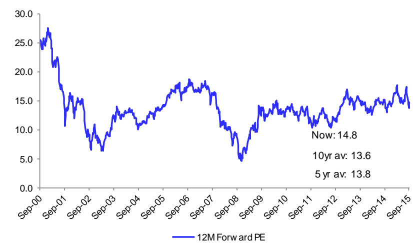
Source: I/B/E/S, DataStream

Figure 129: EV/EBIT 12M fwd (x)



Source: I/B/E/S, DataStream

Figure 130: PE 12M fwd (x)



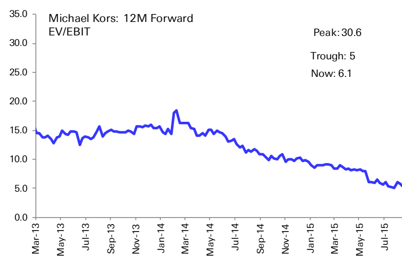
Source: I/B/E/S, DataStream

Michael Kors

Figure 131: EV/Sales 12M fwd (x)

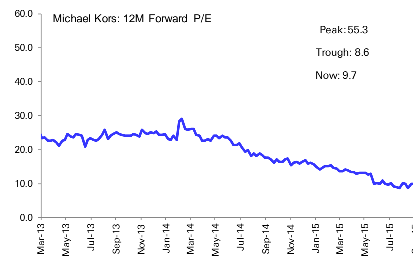
Source: I/B/E/S, DataStream

Figure 132: EV/EBIT 12M fwd (x)



Source: I/B/E/S, DataStream

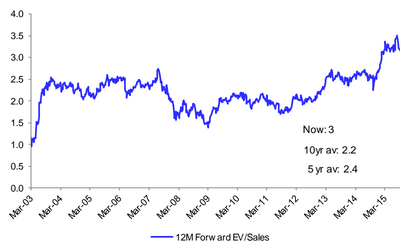
Figure 133: PE 12M fwd (x)



Source: I/B/E/S, DataStream

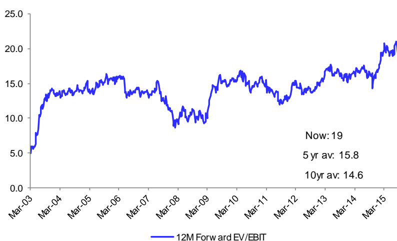
Luxottica

Figure 134: EV/Sales 12M fwd (x)



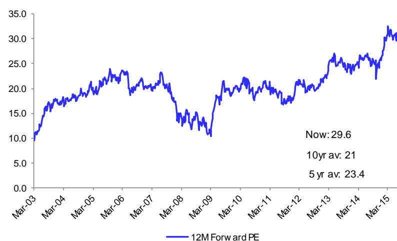
Source: I/B/E/S, DataStream

Figure 135: EV/EBIT 12M fwd (x)



Source: I/B/E/S, DataStream

Figure 136: PE 12M fwd (x)



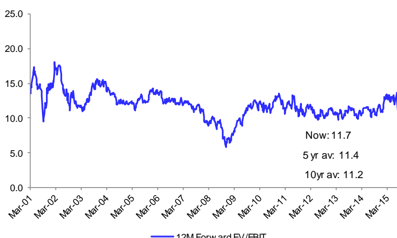
Source: I/B/E/S, DataStream

LVMH

Figure 137: EV/Sales 12M fwd (x)

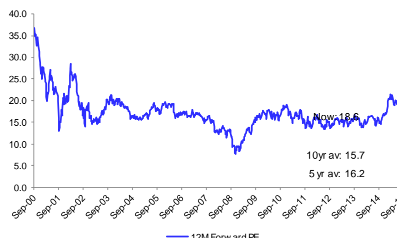
Source: I/B/E/S, DataStream

Figure 138: EV/EBIT 12M fwd (x)



Source: I/B/E/S, DataStream

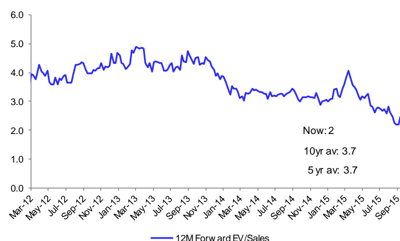
Figure 139: PE 12M fwd (x)



Source: I/B/E/S, DataStream

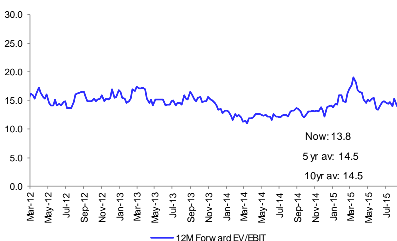
Prada

Figure 140: EV/Sales 12M fwd (x)



Source: I/B/E/S, DataStream

Figure 141: EV/EBIT 12M fwd (x)



Source: I/B/E/S, DataStream

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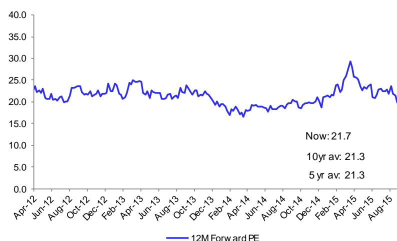
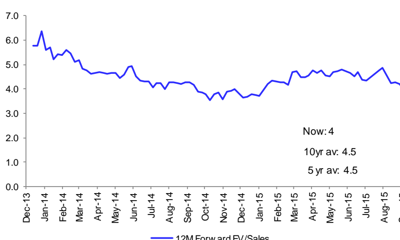


Source: I/B/E/S, DataStream

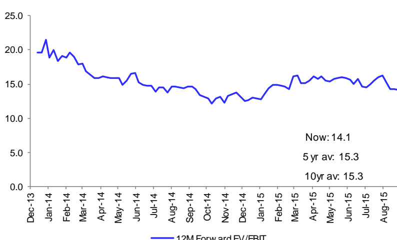
Moncler

Figure 143: EV/Sales 12M fwd (x)



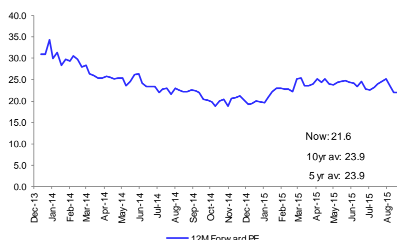
Source: I/B/E/S, DataStream

Figure 144: EV/EBIT 12M fwd (x)



Source: I/B/E/S, DataStream

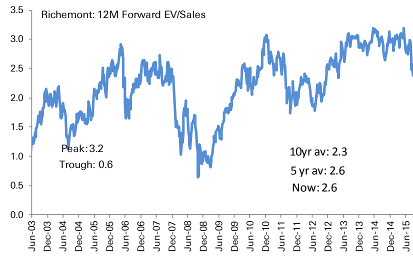
Figure 145: PE 12M fwd (x)



Source: I/B/E/S, DataStream

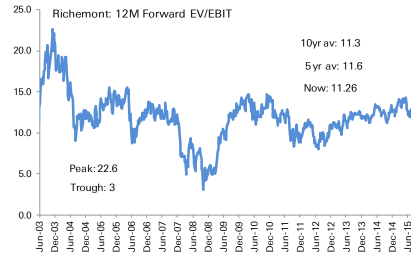
Richemont

Figure 146: EV/Sales 12M fwd (x)



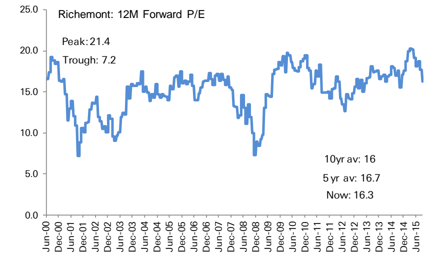
Source: I/B/E/S, DataStream

Figure 147: EV/EBIT 12M fwd (x)



Source: I/B/E/S, DataStream

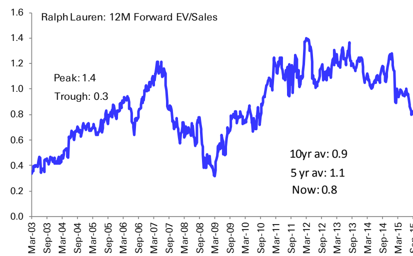
Figure 148: PE 12M fwd (x)



Source: I/B/E/S, DataStream

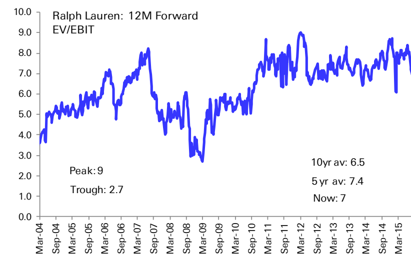
Ralph Lauren

Figure 149: EV/Sales 12M fwd (x)



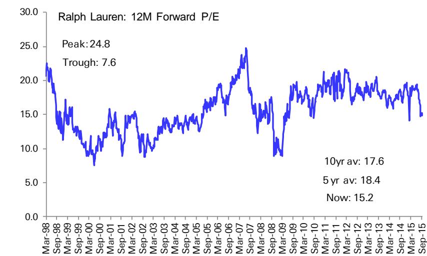
Source: I/B/E/S, DataStream

Figure 150: EV/EBIT 12M fwd (x)



Source: I/B/E/S, DataStream

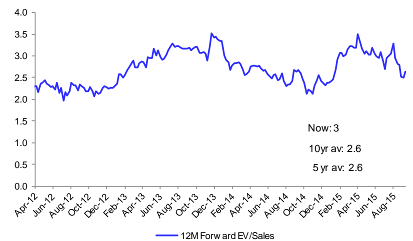
Figure 151: PE 12M fwd (x)



Source: I/B/E/S, DataStream

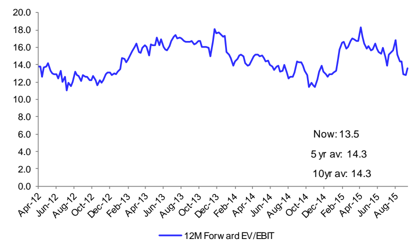
Salvatore Ferragamo

Figure 152: EV/Sales 12M fwd (x)



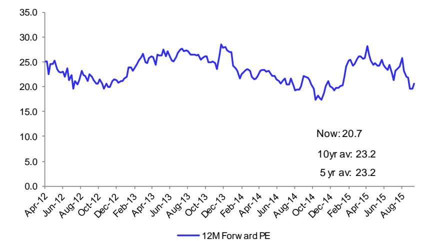
Source: I/B/E/S, DataStream

Figure 153: EV/EBIT 12M fwd (x)



Source: I/B/E/S, DataStream

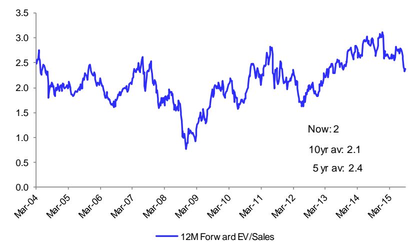
Figure 154: PE 12M fwd (x)



Source: I/B/E/S, DataStream

Tiffany

Figure 155: EV/Sales 12M fwd (x)



Source: I/B/E/S, DataStream

Figure 156: EV/EBIT 12M fwd (x)

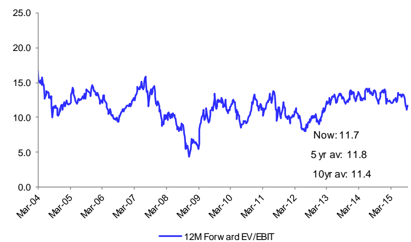


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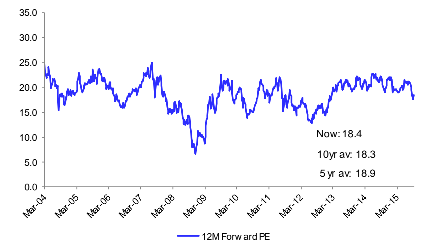
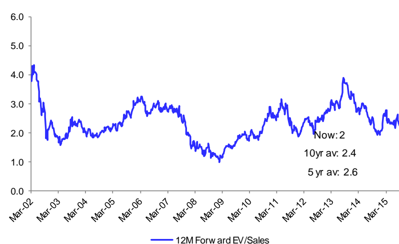
Figure 157: PE 12M fwd (x)



Source: I/B/E/S, DataStream

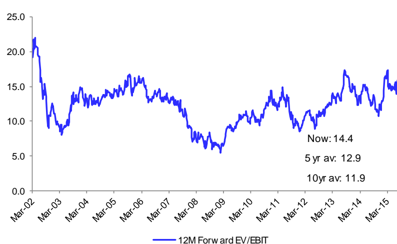
Tod's

Figure 158: EV/Sales 12M fwd (x)



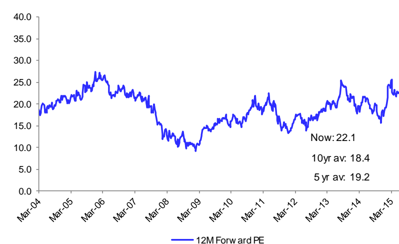
Source: I/B/E/S, DataStream

Figure 159: EV/EBIT 12M fwd (x)



Source: I/B/E/S, DataStream

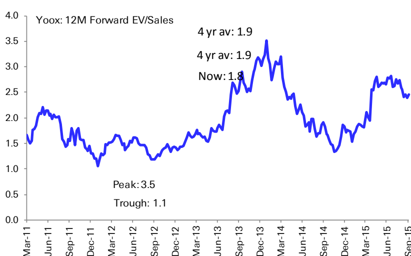
Figure 160: PE 12M fwd (x)



Source: I/B/E/S, DataStream

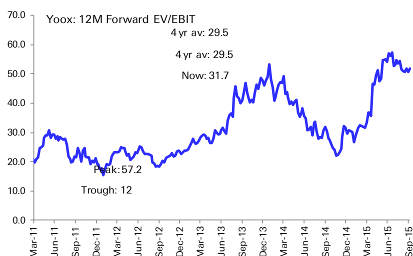
Yoox

Figure 161: EV/Sales 12M fwd (x)



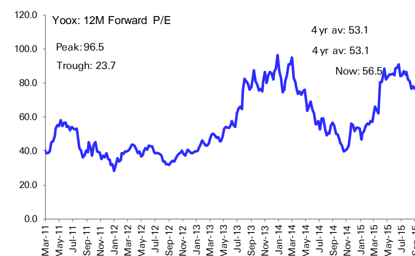
Source: I/B/E/S, DataStream

Figure 162: EV/EBIT 12M fwd (x)



Source: I/B/E/S, DataStream

Figure 163: PE 12M fwd (x)



Source: I/B/E/S, DataStream

Appendix 1

Important Disclosures

Additional information available upon request

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors . Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr

Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst about the subject issuers and the securities of those issuers. In addition, the undersigned lead analyst has not and will not receive any compensation for providing a specific recommendation or view in this report. Francesca Di Pasquantonio/Gilles Errico/Warwick Okines

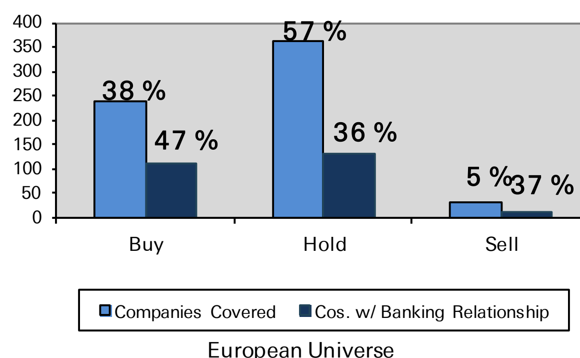
Equity rating key

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.
Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock
Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.
Notes:

1. Newly issued research recommendations and target prices always supersede previously published research.
2. Ratings definitions prior to 27 January, 2007 were:

   Buy: Expected total return (including dividends) of 10% or more over a 12-month period
   Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period
   Sell: Expected total return (including dividends) of -10% or worse over a 12-month period

Equity rating dispersion and banking relationships



European Universe

Regulatory Disclosures

1.Important Additional Conflict Disclosures

Aside from within this report, important conflict disclosures can also be found at https://gm.db.com/equities under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

2.Short-Term Trade Ideas

Deutsche Bank equity research analysts sometimes have shorter-term trade ideas (known as SOLAR ideas) that are consistent or inconsistent with Deutsche Bank's existing longer term ratings. These trade ideas can be found at the SOLAR link at http://gm.db.com.

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Macroeconomic fluctuations often account for most of the risks associated with exposures to instruments that promise to pay fixed or variable interest rates. For an investor who is long fixed rate instruments (thus receiving these cash flows), increases in interest rates naturally lift the discount factors applied to the expected cash flows and thus cause a loss. The longer the maturity of a certain cash flow and the higher the move in the discount factor, the higher will be the loss. Upside surprises in inflation, fiscal funding needs, and FX depreciation rates are among the most common adverse macroeconomic shocks to receivers. But counterparty exposure, issuer creditworthiness, client segmentation, regulation (including changes in assets holding limits for different types of investors), changes in tax policies, currency convertibility (which may constrain currency conversion, repatriation of profits and/or the liquidation of positions), and settlement issues related to local clearing houses are also important risk factors to be considered. The sensitivity of fixed income instruments to macroeconomic shocks may be mitigated by indexing the contracted cash flows to inflation, to FX depreciation, or to specified interest rates – these are common in emerging markets. It is important to note that the index fixings may -- by construction -- lag or mis-measure the actual move in the underlying variables they are intended to track. The choice of the proper fixing (or metric) is particularly important in swaps markets, where floating coupon rates (i.e., coupons indexed to a typically short-dated interest rate reference index) are exchanged for fixed coupons. It is also important to acknowledge that funding in a currency that differs from the currency in which coupons are denominated carries FX risk. Naturally, options on swaps (swaptions) also bear the risks typical to options in addition to the risks related to rates movements.

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