



Hermès International Equity Research Report

CUIRS GET Team

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Hermès International | Europe

Unrivaled among luxury players, galloping in the macro waves

Stock rating | Target Price
Over-weight | € 2255

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Target Price	EUR € 2255
Share price (24/01/24)	€ 1809.4
Up/downside (%)	24.6%
52-Week Range	€ 1,636.50-2,063.50
Shares Out. (mn)	104.73
Mkt Cap	€ 192.28 bn
EV/EBITDA	30.43x
Diluted EPS	€ 37.64
P/LTM EPS	48.69x

Key Positive

Strong underlying momentum supported by Chinese demand

The luxury sector in the Asia Pacific region exhibited a rapid recovery in 3Q-23, surpassing pre-pandemic levels and outperforming the Europe region. Note that the main consumer source of the Asia Pacific and the whole luxury market is Chinese consumers, associated with great growth expectations. Another noteworthy point is the shift in Chinese consumers' preferences, as they have begun favoring domestic luxury purchases over traveling to Europe just to get a bargain price (Exhibit 1 & Exhibit 2).

Moreover, we observed that long-term trends in China such as individualism, delayed marriage, and the rising influence of Gen Z and Millennials will sustain demand for luxury products. As these demographics often consume luxury goods as a self-reward, when their earning power and disposable income are increasing from time to time, we expect their contribution to luxury products will be further brought up in the long term. Highlighted the region's importance as a key market for luxury goods, Hermès' China brand, Shang Xia, offers a distinctive advantage in capturing the Chinese luxury market. The recent alignment of Shang Xia with De Wu, a China popular social media platform for Gen Z specializing in authenticating and selling fashion items, enhances its growth potential. Shang Xia is so recognized as a key contributor to Hermès future growth, positioning it favorably against competitors.

High cohort loyalty leading to high retention

Hermès owns high customer loyalty which leads to higher retention and greater sales visibility over peers. Its attractiveness to customers derive from the outstanding reputation, quality and rich product portfolio. It has established itself as a high-end luxury brand in the personal luxury product market with a rich heritage and a long-standing reputation for craftsmanship and quality, which gives Hermès a competitive advantage, as it appeals to a discerning customer base that values quality and exclusivity. Furthermore, Hermès has a diversified product portfolio, reducing the company's reliance on leather products. There exists an underlying 'spending ratio rule' which means that the customer will need to purchase a certain amount of Hermès' non-leather products to get the permit for buying leather products. Therefore, Hermès is expected double up customers' spending with such a ratio and drive its customers to purchase other products. These several key strengths made Hermès stand out as a formidable competitor in the industry. In an environment where uncertainty remains high and growth is decelerating, we assume that brands with high retention are likely to outperform.

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Fiscal year (12/31 End)

(EUR€ mn)	2022A	2023E	2024E
Revenue	11,602	13,259	15,392
YoY (%)	29%	14%	16%
Gross Profit	8,213	9,306	10,890
GPM	71%	70%	71%
EBIT	4,820	5,013	6,125
OPM (%)	42%	38%	40%
Pretax Income	4,633	4,875	5,978
Net Income	3,365	3,461	4,244
NPM	29%	26%	28%
Basic EPS	32.2	33.1	40.6

Exhibit 1: Value-After Tax (VAT) 9% higher before the pandemic which signals rapid recovery on luxury products in Asia Pacific

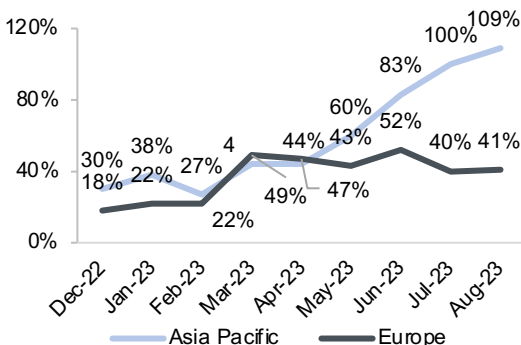
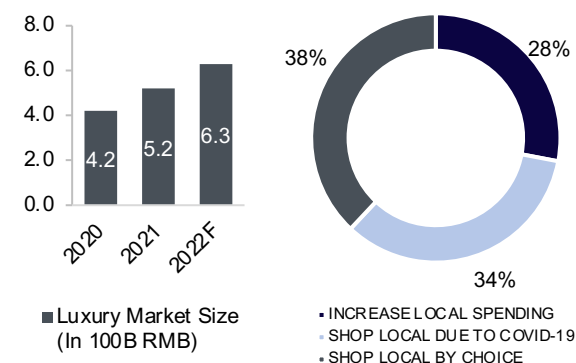


Exhibit 2: Luxury market size and local luxury goods spending in Mainland China.



(Source: CUIRS Research, Company Annual Report, Yahoo Finance, Bain, BCG, Global Blue, Morningstar)

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Initiate OW, with 12-month TP at € 2255 (+24.6% upside)

We first adopted a Relative Valuation model at TP € 2255 Per Share as our target price (Implied 25E P/E of 47.0x) with a potential +24.6% upside as of closing price on 2024 January 24th. We justified this valuation is reasonable if we look at historical Hermès' valuation level, in which implied 25E P/E of 47.0x lies in the historical implied ratio median plus 1 standard deviation.

Key Risk

Limited room for valuation

Hermès has the highest valuation compared to its peers judging from a price-earning point of view. It's currently trading at an 11% premium to its 10Y P/E Average while most of its peers are all trading at a discount. During a high interest rate environment, this may be a vulnerable position for Hermès and investors may find it hard to justify the premium the stock is currently trading at.

Further deterioration of Chinese market slowdown

Although Hermès has a high over-indexation to its VVICs (Very Very Important Clients) and a loyal cohort of ultra wealthy clients, it's inevitable that Hermès also has a high exposure to the APAC market and especially Chinese consumers. A further slowdown in the China market may in turn affect company sales.

Unprecedented actions from Chinese policy makers

The Chinese market slowdown started with events like property market slowdown, crackdown of corruption on health sector, which were mainly influenced by policymakers. Investors may need to watch out for further actions from policy makers, specifically regulations on the ultra-high net worth population which are the main target consumers of Hermès.

Unprecedented foreign exchange fluctuations

Currency fluctuation plays a key role in determining sales of the products. A currency appreciation of the euro relative to other countries may lead to higher prices of products in other regional stores, especially in China, where the Yuan has deliberately devalued over the years. Furthermore, this correlates to the purchasing power of tourists which may affect demand from international customers.

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Valuation

#1 Relative Valuation

The valuation consists of scenario analysis under the bull case and bear case. Therefore, our analysis adopted current multiples to tie to the market dynamics and historical valuation movement in different scenarios.

Bull, Base, Bear scenarios under 24P/E Frameworks:

€2941 Bull Case (+62.6% Upside):

Given that Hermès' net profit margin (30%) outperformed the industry's average (16%), showing its better profitability and cost control, it is justifiable to support a P/E ratio that is higher than the industry's average for Hermès. Also, we expect the market to continue to favor Hermès due to its strong cash flow, high profit margin, and increasing profit. Thus, we took the market's past consensus as reference, and the bull case in 2025 multiples is capped at a 3-year average of 58.4x from 2021-2023.

€2255 Base Case (+24.6% Upside):

Although Hermès has a better performance than its peer, its current P/E ratio of 48.3x is already a few times of its major competitors (LVMH 21.8x, Kering 13.6x). We believe the current high P/E ratio already reflects investors' optimistic sentiment and opinions to Hermès, and the upside for Hermès is limited. Therefore, we assigned a P/E ratio of 47x for the 2025 base case, which is similar to the P/E ratio at the end of 2023.

€1599 Bear Case (-11.6% Downside):

In view of the economic downturn across the world and the pessimistic economic outlook, it is expected that Hermès' profit growth will be affected. However, we still have confidence in Hermès as it maintained a growing profit and profit margin in the past 10 years. The bear case multiples are expected not to be less than the 10-year median of Hermès' P/E ratio. Thus, we take the 10-year median P/E ratio minus 0.5 standard deviation of 35x as the bear case multiples.

Exhibit 13: Relative Valuation – Target Price at €2255

Company Information					
Name	Hermès INTL				
Ticker	RMS FP				
Market Cap (EUR mn)	225,895				
Share outs (mm)	106				
Price (Trading Currency)	1809.40	EUR			
Fund to Price FX	1.00				
Pricing Currency	EUR				
Fund Currency	EUR				
Net Debt	-7356				
Key Financial Metrics					
Consensus	2021	2022	2023	2024	2025
Sales	8,982	11,602	13,429	15,009	16,499
Net Income	2,445	3,367	4,030	4,461	4,917
EPS	23.4	32.2	38.4	42.5	46.8
CUIRS Estimate	2021	2022	2023	2024	2025
Sales	8,982	11,602	13259	15392	18093
Net Income	2,445	3,367	3461	4250	5028
EPS	23.4	32.2	33.1	40.6	48.0
Hermès's Historical TTM Valuation Multiples					
10y History	P/E	EV/EBITDA	EV/Sales		
Median	39.5x	22.7x	8.8x		
SD	9.8x	5.6x	2.8x		
Max	70.1x	40.8x	17.4x		
Min	25.3x	14.5x	5.2x		
24E P/E Framework - Implied Multiple Method					
	PE (x)	EPS	TP	Return (%)	
Upside	58.4	50.4	2941	62.6%	
Base	47	48.0	2255	24.6%	
Downside	39.5	45.7	1599	-11.6%	
Selected Comps Multiples					
Multiples	P/E				
Years	21A	22A	23E	24E	25E
Hermès INTL	84.4x	61.3x	51.2x	46.2x	41.9x
LVMH MOET HENNE	29.4x	25.1x	22.2x	20.8x	19.0x
KERING	15.8x	13.9x	15.1x	14.3x	12.8x
CIE FINANCI-REG	51.4x	32.3x	16.9x	16.1x	13.5x
CAPRI HOLDINGS L	-NM-	7.0x	10.2x	8.5x	7.6x
CHRISTIAN DIOR	24.9x	21.2x			
PRADA	44.7x	28.3x	20.3x	18.0x	16.1x
Multiples					
Years	21A	22A	23E	24E	25E
Hermès INTL	27%	29%	30%	30%	30%
LVMH MOET HENNE	19%	18%	18%	18%	19%
KERING	18%	18%	17%	17%	18%
CIE FINANCI-REG	10%	12%	19%	19%	21%
CAPRI HOLDINGS L	-2%	15%	10%	12%	13%
CHRISTIAN DIOR	8%	7%			
PRADA	9%	11%	14%	14%	15%

(Source: CUIRS Research, Company Annual Report, Yahoo Finance, Bain, BCG, Global Blue, Morningstar)

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Regionally, China will gain ground while U.S. and Europe lose market share

The Chinese personal luxury goods market remained double digit growth over the past few years, driven by the reduction of import duties and the rapid rise of a more affluent middle class. Although the COVID-19 pandemic led to a sharp dip in revenues, we see the medium term bodes well for the market, mainly supported by the strong spending by the Millennials who have rapidly emerged as the major consumer segment.

U.S. and Europe, the leading market in the world, proved very strong during Covid-19, expected to grow at a CAGR of 2% and 1.2% respectively. However, factors such as political uncertainty, cutbacks on discretionary spending, especially in response to the COVID-19 pandemic, and low sales to international tourists due to the strong dollar are expected to affect market growth in the coming years.

In the next decade, the emerging market will play a crucial role in the luxury sector. They are poised to gain about 70 million mid- and high-income consumers by 2030, bringing new forces to the luxury houses.

Exhibit 16: Share of global personal luxury goods market, by region (US\$ bn)

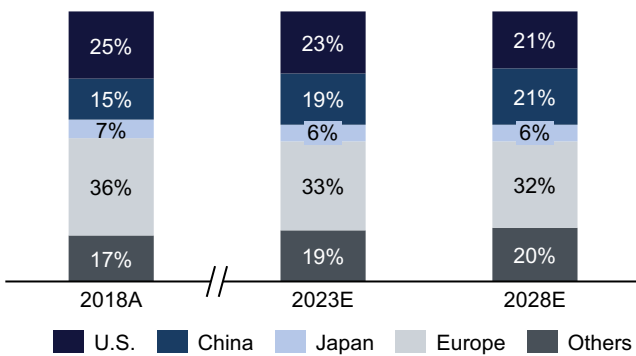


Exhibit 17: Personal luxury goods market, top countries, 2023E

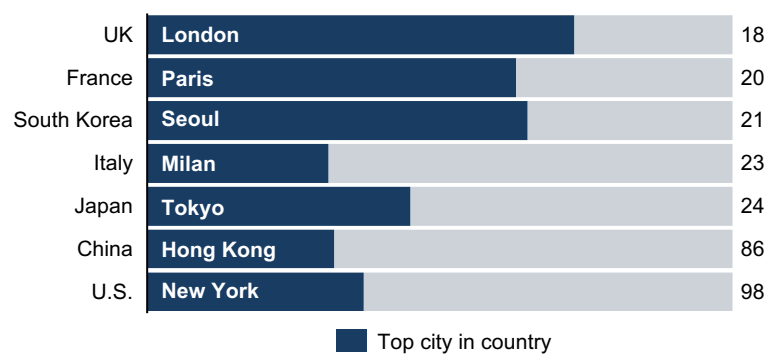
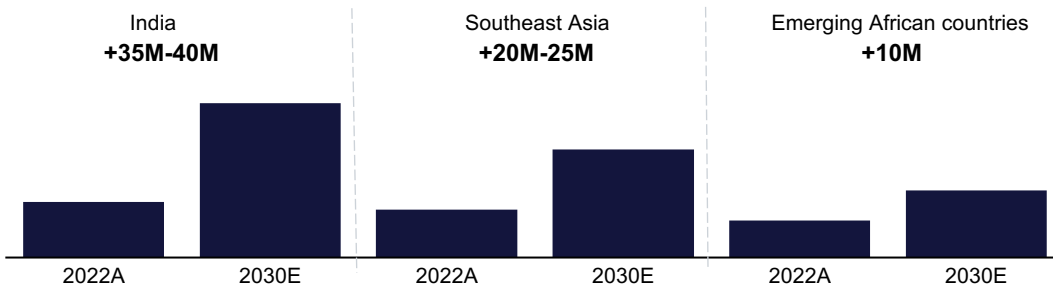


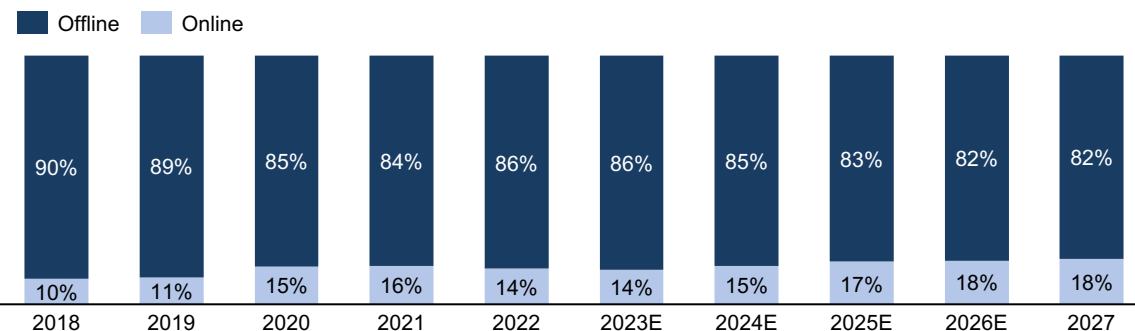
Exhibit 18: Projected number of new mid- and high-income consumers between 2022 and 2030



Importance of physical stores continues to rise in the days ~f eCommerce

Even as the global luxury goods market gradually moves towards online retailing with digital revenues quickly outpacing brick-and-mortar, interestingly digital-born luxury companies such as Warby Parker, Bonobos, and Glossier are now opening physical stores of their own. This is because physical stores provide a platform for consumers to have a more immersive brand experience than what is possible online. Additionally, it is the brick-and-mortar stores that are leveraging the interpersonal interaction to drive conversion rates and enhance average purchase values.

Exhibit 19: Share of global personal luxury goods market, by region (US\$ bn)



(Source: CUIRS Research, Company Annual Report, Yahoo Finance, Bain, BCG, Global Blue, Morningstar)

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Growth factors by 2030

Younger generations become another new force into the luxury houses

According to OC&C, younger generations are showing an increased willingness to spend on luxury items even if they cannot afford it. This is mainly because they believe that the use of luxury items can reflect one's financial and social status. We expect that younger generations (Generations Y, Z, and Alpha) will become the biggest buyers of luxury by 2030, representing 80% of global purchases.

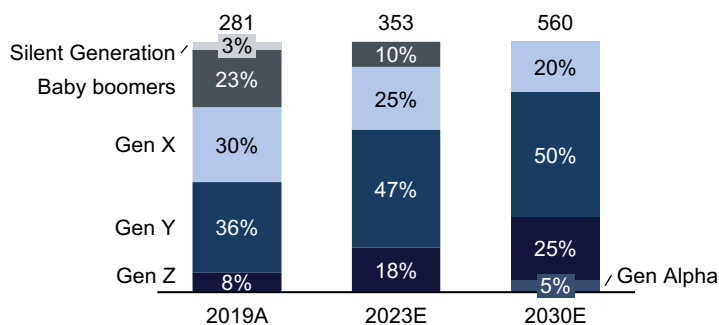
Luxury menswear grows twice as fast as womenswear

The past few years have signaled a shift in the way men dress and experiment with new styles. With a wider access to luxury fashion, a surging number of men becomes interested in new fashion trends. This increased activity has resulted in brands such as Prada, Gucci, and Dolce & Gabbana, which traditionally have not been known for their menswear lines, to open stores focused only on men.

Boarder meanings and business models to emerge

By 2030, luxury should have expanded beyond its traditional business model. We expect that the growth of new types of activities, often powered by technology, will result in an additional €60 billion to €120 billion of luxury industry sales. This could include revenues generated by the metaverse and NFTs (such as through collectibles and other new products and services); the monetization of communities (through virtual events and data monetization); and "3.0 experiences" (such as virtual stores, digital shopping assistants, and ultra-luxury travel and hospitality).

Exhibit 20: Share of global personal goods luxury, by generation (US\$ bn)



Challenges face the luxury companies

China faces a slew of challenges that threaten to slow down the global market

China has been key driver in the sector, but with increasing nationalistic sentiments, unprecedented aging problem and low birth rate, and geopolitical tensions with the Western countries, China could drag down the luxury market in the future.

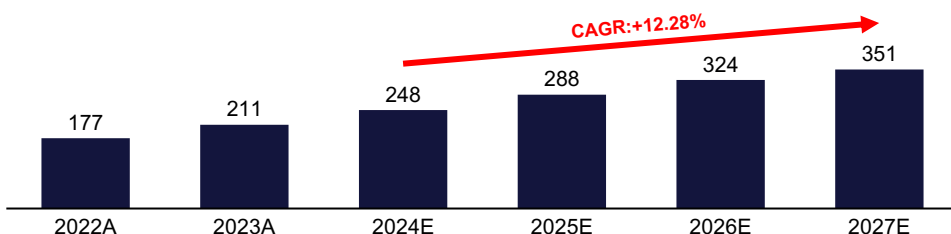
Global uncertainties could make the current luxury rebound short-lived

Although the luxury market took a leap in 2022, the rebound could be short-lived due to the various economic and geopolitical pressures. This presents a challenge for luxury brands in terms of forward planning and production targets. If they produce too little, they run the risk of not meeting the demand, and if they produce too much, the product surplus could damage brand equity. Therefore, meeting and balancing demand has emerged as one of the biggest challenges luxury companies are facing today.

Rise of vintage fashion gives a punch to luxury companies

Currently, the secondhand apparel market is valued at US\$211 bn, with a CAGR of 12.28%. As the increasing popularity of vintage fashion, luxury companies might lose control over its product distribution and product authenticity. Also, it can potentially impact pricing and exclusivity. This particularly hurts the top-tier brands where certain amount of match purchases ratio exists, such as Hermès and Chanel.

Exhibit 21: Secondhand apparel market value worldwide, 2022 – 2027 (US\$ bn)



(Source: CUIRS Research, Company Annual Report, Yahoo Finance, Bain, BCG, Global Blue, Morningstar)

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Competition Landscape

As a leading position in personal luxury industry with leather goods as its core, Hermès faces challenges from other major competitors, including LVMH, Kering, and Prada. We listed the major competitors below for comparison.

Exhibit 22: Overview of the competition landscape in personal luxury industry (Fashion & Leather goods as the core)

	Hermès International	LVMH	Kering Group	Prada Group
Listed Exchange	Euronext Paris	Euronext Paris	Euronext Paris	Hong Kong Exchange
Ticker	RMS.PA	MC.PA	KER.PA	1913.HK
Founding Year	1837	1987	1963	1913
Product Offerings	Mainly fashion & leather goods, but also engages in perfumes, furniture and watches.	Wide range of offerings including wine & spirits, perfume & cosmetics, Fashion & leather goods, watches & jewelry, and selective retailing.	Fashion & leather goods as the core business, with eyewear and jewelry on the side	Primarily concentrate on fashion and leather goods.
Subsidiaries	 	 	 	
Strengths	<ul style="list-style-type: none"> Owning the most coveted bags allows exclusive business model of "Match Purchases Ratio" Focusing on the most affluent that are resilient to economic turmoil 	<ul style="list-style-type: none"> Strong net cash position, allowing active M&A activity 75 well-known brands spanning across six different sectors 	<ul style="list-style-type: none"> More streamlined business line that delve into fashion & leather goods Dominating position in the lower-end personal luxury industry 	<ul style="list-style-type: none"> Successful talent strategy for brand endorsement to increase brand exposure Excellent control over gross margin: usage of low-cost nylon to create desirable products
Future Growth Point	Leather goods to lead the way, while cosmetic business takes a leap	Selective retailing grows as global tourism exceeds pre-Covid level	Continuous momentum at the younger brands, including BV & Alexander McQueen	MiuMiu sees growth acceleration internationally
Valuation				
EV/EBITDA	37.5x	14.1x	8.5x	10.3x
P/E	61.3x	25.1x	13.9x	28.3x

Financially, Hermès stands out among the top luxury goods conglomerates

Hermès has consistently maintained a high gross profit margin and net profit margin, surpassing its industry peers. LVMH have relatively stable gross profit margins, but their overall values are lower than that of Hermès. Kering Group's profitability has significantly increased since 2016, mainly due to the addition of luxury product categories with higher profit margins, while the other two companies focus primarily on luxury goods in their core operation.

Exhibit 23: Revenue growth comparison with industry peers

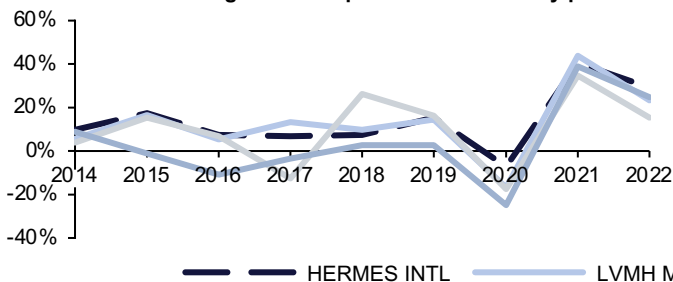
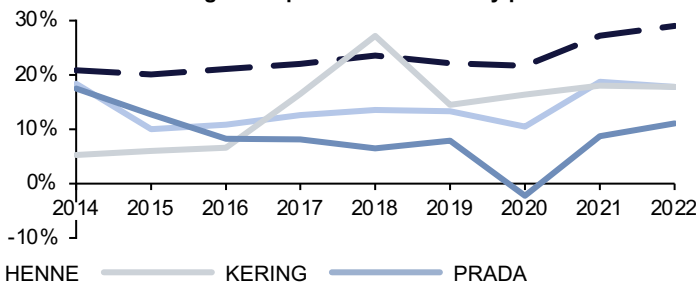


Exhibit 24: Net margin comparison with industry peers



(Source: CUIRS Research, Company Annual Report, Yahoo Finance, Bain, BCG, Global Blue, Morningstar)

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Company Profile

Company Introduction

Founded in 1837, Hermès began as a harness workshop in Paris, catering to European noblemen. In 1924, Hermès established a presence in the U.S and opened two shops outside of Paris. Over time, the company expanded its operations globally and solidified its position as a leading brand in the luxury industry. With a presence in 42 countries and a strong international footprint, Hermès has achieved remarkable growth through strategic acquisitions and overseas ventures.

One notable advantage of Hermès is its family-run feature, which enables consistent control over strategies and decision-making. This ownership structure reduces the risk of being acquired by competitors, a common occurrence in the luxury market, as seen with Kering's acquisition of Valentino and LVMH's acquisition of Tiffany.

Hermès is driven by a mission to create unique and original objects that elegantly satisfy the needs and desires of its discerning customers. The company's pursuit of excellence is guided by three key pillars: Creation, Craftsmanship, and an Exclusive Distribution Network. Creation lies at the heart of Hermès, with a commitment to innovative and exceptional designs. Craftsmanship reflects the brand's dedication to maintaining an integrated model of skilled craftsmanship, ensuring the highest standards of quality. The Exclusive Distribution Network emphasizes the dynamic nature of Hermès' exclusive omnichannel distribution strategy, allowing for a seamless and luxurious shopping experience for customers.

Business Model

Hermès employs a focused and high-end business model, prioritizing premium price points and capitalizing on its most profitable product category. This approach allows the brand to achieve the highest margins among its industry peers. The desirability of Hermès products, particularly its iconic Kelly and Birkin bags, often leads to long waiting lists, further reinforcing the brand's premium position.

Hermès places a strong emphasis on quality throughout its production process. The brand's commitment to craftsmanship is shown in its handmade production techniques and limited supply, which generates high demand for its products. The brand invests in its craftsmen, providing them with salaries that exceed industry standards, ensuring their dedication to producing exceptional pieces. Additionally, Hermès employs rigorous quality checks to maintain the highest standards of excellence.

Exclusive "Match Purchases Ratio"

Hermès implements an exclusive sales tactic that contributes to what is known as the "Hermès bag drought." One notable strategy is the implementation of a underlying 1:1 match purchases ratio, where customers spend a certain amount, such as \$10,000, on other products before being placed on a priority waiting list for purchasing a leather bag. This approach not only enhances the rarity and exclusivity of sought-after models but also increases customer buying willingness and drives higher inventory turnover rates. Bags with higher quality and desirability, including Birkin 26 and Mini Kelly, potentially require even higher spending ratio.

Exhibit 25: Craftsman Salary In Leather Goods Industry 2022

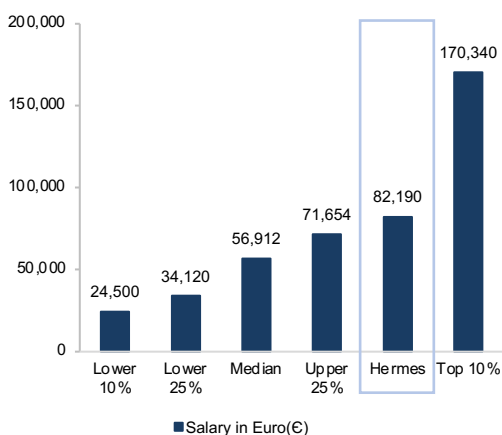


Exhibit 26: Hermès Geography Exposure 2022(inner circle) vs 2021(outer circle)

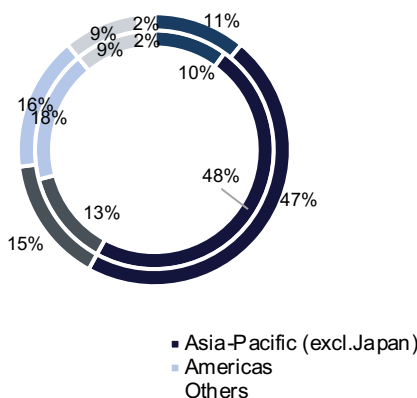


Exhibit 27: Hermès Equity Ownership Status

Top Holders	%
Family Hermès	66.70%
LVMH	1.87%
Blackrock	1.41%
Capital Group Companies	1.16%

(Source: CUIRS Research, Company Annual Report, Yahoo Finance, Bain, BCG, Global Blue, Morningstar)

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Product Analysis

Product Series

Hermès has a diverse product portfolio with 19 categories of products, while of the portfolio, the leather goods remain the core business line, contributing 43% of the total revenue. The company takes creation, craftsmanship, and exclusive distribution networks as its main strategies. In-depth research and careful selection of various leathers are important factors that contribute to the global reputation of Hermès bags. Hermès has the priority selection rights to leather from top-tier leather suppliers worldwide. The leather used includes high-quality cowhide, goatskin, as well as the extremely rare leathers such as crocodile, lizard, and ostrich. Each type of leather at Hermès has its own specific title, which adds a certain level of social and conversational aspect to its allure.

Exhibit 29: Rare and high-end leather to create superior bag quality

Skin	Demonstration	Title	Texture	Representative	Rarity
Crocodile		Porosus Crocodile	From Saltwater Crocodile of Australia, wool felt and spot off polishing	Birkin	5
		Niloticus Crocodile	A shiny appearance on the matte finish, and provide a grainy feel to the touch	Birkin	5
		Alligator Crocodile	From Mississippi Alligator, created by polishing the spots with agate for a Lisse finish.	Birkin	5
Ostrich			Soft leather, light, durable and not easily deformed.	Birkin, Kelly	4
Lizard			From lizards in Southeast Asia, durable and smooth	Constance, Birkin, Kelly	4
Basics		Mysore Goatskin	Waterproof, scratch-proof and wear-resistant	Constance	3
		Togo / Clemence	The appearance is smooth and bright, with fine and long lines.	Picotin, Lindy, Garden Party	2

“Three Pillars” BKC remains highly desirable among the affluent

Hermès’ ‘Three Pillars’, the BKC (Birkin, Kelly, and Constance), are considered top-tier products in the luxury market. With the value retention property, they have an average reselling ratio of 101%, 95% and 93% respectively. Their prices depend on various factors, including the size, material, color, and accessories of the bags. However, due to their relative scarcity and high demand, purchasing these bags often requires waiting in line, with a potential match purchases ratio topping 1:4 for one BKC bag.

Exhibit 30: The Hermès bag pyramid (US\$)



(Source: CUIRS Research, Company Annual Report, Yahoo Finance, Bain, BCG, Global Blue, Morningstar)

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