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Equity Valuation – Hermès International SCA

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Abstract

In this dissertation, a valuation of Hermès International is performed. Hermès is an apparel and accessories company, present in the luxury goods industry. Four methods were applied – Discounted Cash Flows using WACC, Dividend Discount Model, Economic Value Added and a Relative Valuation – after which, a sensitivity analysis was performed. As a result of the Discounted Cash Flows approach, a share price of 413,58€ was reached, whereas with Dividend Discount Model and Economic Value Added the share prices were 185,65€ and 344,21€, respectively. Accordingly, a Market-Perform recommendation was given. The Relative valuation is considered only as a validation tool, thus, there is no recommendation based on its results. To conclude, a comparison between the dissertation's values and Bernstein's report of September 15th 2016 was made, stressing the major differences between both.

Resumo

Nesta dissertação é apresentada a avaliação da Hermès International. A Hermès é uma empresa de vestuário e acessórios, presente na indústria de bens de luxo. Quatro métodos de avaliação foram usados – Fluxos de Caixa Descontados usando o custo médio ponderado do capital, Desconto de Dividendos, Valor Económico Acrescentado, e uma Avaliação Relativa – depois das quais, uma análise de sensibilidade foi realizada. Como resultado do método de Fluxos de Caixa Descontados, um preço de 413,58€ por ação foi alcançado, enquanto com o Desconto de Dividendos e Valor Económico Acrescentado foram alcançados preços por ação de 185,65€ e 344,21€, respetivamente. De acordo com os resultados, a recomendação de manter aplica-se. A Avaliação Relativa foi considerada somente como uma ferramenta de validação, portanto nenhuma recomendação advém dos resultados obtidos por este método. Em jeito de conclusão, foi feita uma comparação dos resultados obtidos nesta dissertação com os do relatório da Bernstein de 15 de Setembro de 2016, realçando as diferenças entre os dois.

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List of abbreviations

APV	Adjusted Present Value
CAGR	Compounded Annual Growth Rate
CAPEX	Capital Expenditure
CAPM	Capital Asset Pricing Model
D&A	Depreciation and Amortization
DCF	Discounted Cash Flows
DDM	Dividend Discount Model
EBIT	Earnings Before Interest and Taxes
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortization
EV	Enterprise Value
EVA	Economic Value Added
FCFE	Free Cash Flows to Equity
FCFF	Free Cash Flows to the Firm
GDP	Gross Domestic Product
PER	Price/Earnings
ROE	Return on Equity
ROIC	Return On Invested Capital
WACC	Weighted Average Cost of Capital
WC	Working Capital

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1. Introduction

The recent financial crisis has changed the consumer behaviors, being a challenge for companies to overcome this shift.

Especially in the Apparel and Accessories sector, consumers are more focused on lower prices, even in the Luxury Goods industry. They still want high-value products, but are more attentive to prices. Additionally, the idea of a world with traveled consumers, always connected to each other due to new technologies, is also an interesting challenge for Hermès

Here lies the interest in valuing Hermès International, to understand how the company has adapted its products to the new consumer demand.

This dissertation is structured as follows: the first chapter is the “state of the art”, with descriptions of the models presented through different authors’ perspectives. Secondly, a Luxury Goods Industry overview; thirdly, a company overview, where the past financial performance is presented; fourthly, the company valuation, based on own assumptions and forecasts, including a sensitivity analysis; and lastly, a comparison with a report of an equity research company, where the main differences are highlighted.

2. Literature review

2.1 Valuation approaches

A valuation can be used for several purposes: either buying/selling operations, mergers or acquisitions or simply to know how much the company is worth. In listed companies, valuation is typically performed to relate the value one obtains, to the value of the stock in the market and therefore make a decision to buy, sell or hold the shares. (Fernandéz, 2007)

Additionally, according to Fernandéz (2007), the methods for valuing a company can be classified in six groups:

Balance Sheet	Income Statement	Mixed (Goodwill)	Cash Flow Discounting	Value Creation	Options
Book Value	Multiples	Classic	Equity cash	EVA	Black and
Adjusted Book Value	Price/Earnings	Union of	flow	Economic	Scholes
Liquidation value	Sales	European	Dividends	Profit	Investment
Substantial value	P/EBITDA	Accounting	Free Cash Flow	Cash Value	Option
	Other multiples	experts	Capital Cash Flow	Added	Expand the
		Abbreviated	Flow	CFROI	project
		Income	Adjusted		Delay the
		Others	Present Value		investment
					Alternative use

Table 1: Methods of valuing a company. Source: Fernandéz (2007)

In the sections below, one will describe the most common approaches used in equity valuation: the Discounted Cash Flows, Adjusted Present Value, Dividend Discount Model, Economic Value Added and the Relative Valuation technique.

2.2 Discounted Cash Flows

The Discounted Cash Flows Valuation is the basis on which several valuation methods are built on. It expresses the value of an asset as a function of the future cash flows it is predicted to generate, discounted at a rate that reproduces the riskiness of the cash flows. The value of the asset does not depend on someone's perception but it depends on cash flow forecasts. Thus, one will have higher valuations on assets with higher or more foreseeable cash flows than on assets with lower or unpredictable cash flow forecasts (Damodaran, 2006).

Fernández (2007) states that the company is viewed as a “cash flow generator” and therefore, its value is achieved by discounting the forecasted cash flows at an appropriate discount rate. This cash flow forecast is based on a complete analysis of the financial statements of the company, along with a close look at the environment surrounding the company so that one can estimate company’s operations reliably, such as for example, sales, cost of goods sold, administrative expenses.

In the following chapters will be presented the phases to estimate the discounted cash flows and examine in detail the three methods deriving from this concept: Discounted Cash Flows using Weighted Average Cost of Capital, Adjusted Present Value (APV), Dividend Discount Model (DDM) and Economic Value Added (EVA).

2.2.1. Cash Flows

According to Damodaran (2006) estimating the cash flows has to do with the intrinsic value of the assets. It is the value of an asset, calculated by an analyst who possesses all the knowledge and information needed, and a perfect valuation model. Thus, one has two ways of estimating cash flows, one is valuing the entire business and the other is to value the equity portion of the business.

In the first method, valuing the entire business, one uses the assets’ cash flows before debt payments but after the reinvestment needed; the discount rate used is the cost of capital, as it reflects the cost of financing with both equity and debt, taking into account the proportions of their use.

These cash flows are called Free Cash Flows to the Firm (FCFF) and the discount rate used is the Weighted Average Cost of Capital (WACC). These Free Cash Flows to the Firm are also the after tax cash flows from operations, or the money that the company have left after the required investments and working capital. (Damodaran 2006 and Fernández 2007). This valuation method will, from now on, be called DCF.

$$FCFF = EBIT \times (1 - t) + Depreciations \text{ and } Amortizations - \Delta Working \text{ Capital} - CAPEX \quad (1)$$

The value of the business can, therefore, be written as:

$$Enterprise\ Value = \sum_{t=1}^{t=\infty} \frac{FCFF_t}{(1+WACC)^t} \quad (2)$$

The second method of measuring cash flows is to value just the equity portion of the business, which means that one considers cash flow from assets, after debt repayments and after the reinvestment needed; the discount rate to use, on the other hand, is the cost of equity (r_e), as it reflects just the cost of equity financing. These cash flows are called Free Cash Flows to the Equity (FCFE).

$$FCFE = FCFF - Interest \times (1 - t) + \Delta Net\ Debt \quad (3)$$

The Equity Value could, therefore, be written as:

$$Equity\ Value = \sum_{t=1}^{t=\infty} \frac{FCFE_t}{(1+r_e)^t} \quad (4)$$

If the assumptions and calculations are made in an accurate way, the equity value should be the same either valuing the entire business and then subtracting the non-equity claims or by valuing directly the equity (Damodaran, 2006).

2.2.2. Discount rates

As Fernández (2007) states, an appropriate discount rate is the one who reflects the risk associated with the forecasted cash flows. Calculating this rate is probably the most challenging and significant step in firm valuation, because it measures the risk, volatility and returns of the forecasted cash flows.

The discount rate computed takes into consideration the origin of the capital, if it is from debt, equity or both.

2.2.2.1. Weighted Average Cost of Capital

The WACC is the most common discount rate used in equity valuation. It weights the cost of equity and debt in its proportion used in the capital structure of the firm.

As stated by Koller, Goedhart and Wessels (2005), it represents the opportunity cost investors face for investing in one particular business instead of another with similar risk. It is computed as:

$$WACC = \frac{D}{V} \times r_d(1 - t) + \frac{E}{V} r_e \quad (5)$$

Where:

D is the Market Value of D

E is the Market Value of E,

V is Debt plus Equity,

r_d is the Cost of Debt

r_e is the Cost of Equity

t is the Tax Rate

When calculating WACC, one should take into account some important details. Fernández (2011) identified some common errors when performing a valuation. Firstly, one should use the market values of both equity and debt and not their book values. Additionally, using debt and equity ratios that are neither the actual ones neither the forecasted; the proportion of debt and equity should be revised frequently and the WACC changed if needed, to provide an accurate measure of the cost of capital.

Although widely used in Finance, WACC is not the most accurate methodology. As Luehrman (1997) states, WACC fails at treating financial side effects in companies with a complex capital structure since it only recognizes tax benefits. Another critic from Luehrman (1997) is that WACC operates with market values of debt and equity, which are not always easily observable.

In the next chapters, will be described the several methods to measure cost of equity and the cost of debt.

2.2.2.2. Cost of Equity

Regarding the cost of equity, there are three major models to compute it. The most common is the Capital Asset Pricing Model (CAPM), the Fama-French Three-Factor Model and the Arbitrage Pricing Theory (APT).

2.2.2.2.1. Capital Asset Pricing Model

As introduced by Sharpe (1964) in the CAPM, the investor faces two prices, given by the market: the price of time, also known as the usual interest rate, and the price of risk, the return

one can obtain per additional unit of risk. The cost of capital corresponds to the return required by the investors to compensate the risk they are undertaking.

This risk can be divided into two sub categories: the systematic risk (β), the risk of being exposed to the market or the volatility, and the unsystematic risk, the portion of risk that does not depend on the market but it is company specific. The systematic risk will vary across companies and will show how the company responds to changes in the market. The formula can be described as follows:

$$r_e = r_f + \beta \times (r_m - r_f) \quad (6)$$

Where:

r_f is the risk-free rate, the theoretical return of an investment with zero risk,

r_m is the market risk, risk that investors undertake for being present in a certain market, and

β is the systematic risk

To use this model, one should accurately estimate the Risk Free rate (R_f), the Market Risk Premium ($R_m - R_f$) and the systematic risk (β).

Risk-free Rate

In finance, risk is viewed as the difference between the expected returns and the actual returns of an investment. Therefore, a risk free investment should be one whose actual returns are equal to the expected returns (Damodaran, 2008).

There are two conditions for risk free investments: no risk of default associated with the investments' cash flows and no reinvestment risk. Therefore, one looks at government default-free bonds, with maturities from 5 to 20 years as it is the closest to a risk free rate. If one is valuing companies based in the United States, the typical bond to use is a 10-year government bond; if one is valuing a European company, the common proxy is a 10-year German Eurobond (Koller, Goedhart, & Wessels, 2005).

Market Risk Premium

“The most important number in Finance” (Zenner, 2008)

The Market Risk Premium is the additional return expected by investors in a specific portfolio, relatively to risk-free assets.

The expected return of the market is not evident, thus there are several methodologies to measure it, proposed by Koller, Goedhart and Wessels (2005).

The first method is estimating the future risk premium by analyzing historical excess returns. It is a method often used but has some limitations, namely the time horizon. If one chooses a more expansive or more restrictive time horizon it will conduct to different market risk premiums. (Zenner, 2008)

The second method proposed by Koller, Goedhart and Wessels (2005) is estimating market ratios as dividend-to-price or book-to-market, and with a regression analysis deriving the market risk premium estimate. One of the limitations of this type of approach is that it assumes a specific beta, which may not be the most accurate measure.

Estimating Beta

Estimating the Beta is also an important action when estimating the cost of capital as it represents the systematic risk of the investment. As Koller, Goedhart and Wessels (2005) state, it measures the volatility of the stock's return in relation to the market's return.

A levered or unlevered beta should be used, according to the capital structure of the firm as follows:

$$r_e = r_f + \beta_{Lev} \times (r_m - r_f) \quad (7)$$

$$r_u = r_f + \beta_{Unlev} \times (r_m - r_f) \quad (8)$$

The first equation is used when the DCF applies, whereas the second is used in the APV valuation, as one is only valuing equity.

If one assumes that debt carries no market risk, the levered beta can be written as a function of the unlevered beta:

$$\beta_{Lev} = \beta_{Unlev} \times \left[1 + (1 - t) \times \frac{D}{E} \right] \quad (9)$$

The levered beta is the unlevered beta times the riskiness of the amount of leverage. Therefore, as Damodaran (2002) states, as the amount of leverage increases, the more it will make net income fluctuate, making the investment riskier.

Two of the methods for estimating beta proposed by Damodaran (2002) are to do a regression analysis and to analyze comparable companies.

The first is to do a regression analysis with historical returns on the investment and the historical returns on a market index. This approach is relatively easy to use for companies that are public for a considerable time but has some limitations regarding the choice of period and the market index to use.

Additionally, a service beta can be used in this method. This beta, provided by Bloomberg (for example), is estimated through a regression, and adjusted to reflect what analysts feel are better estimates of future risk. The adjusted beta is calculated as follows:

$$\text{Adjusted } \beta = \frac{2}{3} \text{Raw Beta} + \frac{1}{3} \beta_{\text{market}} \quad (10)$$

The second method is determining beta by looking at the fundamentals of the business the company is operating in, also known as the Bottom-up Beta. It has five steps: 1) Identify the business the company is in; 2) Finding other listed firms in the same business areas, extract their betas, and their amount of leverage; 3) Estimate the unlevered beta for the business, by dividing the beta of the comparable firms by their D/E ratio; 4) Estimate the unlevered beta for the company, by performing an average of the unlevered betas calculated; 5) Using the debt and equity proportions and this unlevered beta for the company, one can derive the value of the levered beta for the company.

An alternative to these methods is to look at Damodaran's beta for the industry where the company operates. This approach is the least reliable from the three, as one is assuming the company being studied is comparable to every company in that industry, which might not be true.

2.2.2.2.2. Fama French Three Factor Model

This model was introduced in 1996 by Fama and French and it suggests that other variables should be accounted for, when calculating the cost of capital. Such as the market's return, the company size and the market to book value. The equation is as follows:

$$E(r_i) = r_f + \beta_M(r_M - r_f) + \beta_{SMB}E(r_{SMB}) + \beta_{HML}E(r_{HML}) + \alpha \quad (11)$$

Where $E(r_{HML})$ is the difference between the high and low returns, $E(r_{SMB})$ is the difference

between the returns of small and big companies and α is the specific non-systematic risk of company. (Fama & French, 1996)

2.2.2.2.3. Arbitrage Pricing Theory

Ross (1976) proposed an alternative method for CAPM. The Arbitrage Pricing Model states that two investments subject to the same risk exposure should have the same expected return. This method has been subject to several critics, therefore is rarely used when computing the cost of equity.

2.2.2.3. Cost of Debt

One has already analyzed the cost of equity and the required estimations one must do to compute it. Nevertheless, another important part of the cost of capital is the cost of debt, where one needs into take in consideration the required returns asked by the lenders, proportionally to their stake in the company.

As stated by Hitchner (2006), the cost of debt is the rate a company pays on interest bearing debt, the pre-tax cost of debt.

$$\text{After - tax cost of debt} = \text{Pre - tax cost of debt} \times (1 - t) \quad (12)$$

According to Damodaran (2002), the cost of debt is determined by three variables: the riskless rate, the default risk and the tax benefits associated with debt. Firstly, the higher the risk-free rate (r_f), the higher the cost of debt (r_d). Additionally, as the default risk of the firm increases, the cost of borrowing will as well increase, as the firm has less likelihood to pay for its liabilities. Lastly, interest is tax deductible; therefore, the tax benefit deriving from paying interest makes after-tax cost of debt lower than pre-tax cost of debt.

$$r_d = r_f + \text{default spread} \quad (13)$$

2.2.3 Time Frame

To perform a reliable valuation, one needs to estimate cash flows during a certain period. It is important to devote some time estimating the optimal forecasted period, as one will assume the company will grow at a constant rate after this period.

As stated by Damodaran (2002), the forecasted period should be equal to the time a company takes to reach a steady state, namely by a stable growth and capital structure. On the other hand,

one is not able to estimate cash flows infinitely, so this time frame should not be extended beyond the time frame where one can do projections reliably.

According to Koller, Goedhart and Wessels (2005), the time frame should be long enough to attain a steady state, fulfilled by three requirements: 1) the company is growing at a constant rate, reinvesting the same proportion of earnings every year 2) the return on invested capital is constant 3) the return on new capital invested is also constant. These three conditions will allow the cash flows to grow at a constant rate and, therefore, one will be able to apply a perpetuity when estimating the terminal value.

Numerous authors find that a reasonable time should be between five and ten years, depending on the structure and characteristics of the firm (Damodaran 2002). Authors as Koller, Goedhart and Wessels (2005), recommend a period of ten to fifteen years or even longer “for cyclical companies or those experiencing very rapid growth”.

Furthermore, Myers (1974) demonstrated that increasing the number of years of forecasts could decrease estimation or assumption errors.

2.2.4 Terminal Value

The terminal value is the final stake of the valuation, where one projects cash flows to grow as a perpetuity.

According to Damodaran (2002) there are three ways to estimate the terminal value of a company: liquidation value, multiple approach and stable growth model.

In the first method, the liquidation value, one assumes that at a certain point in time, the company will terminate its activity. Therefore, one estimates the value of selling all the assets of the firm – liquidation value.

The second approach is to estimate the terminal value by using a multiple to firm’s revenues. Besides being the simplest alternative, it is not the most accurate. If the multiple is estimated by looking at comparable firms, it is not a discounted cash flow valuation but a relative valuation. If, on the other hand, the multiple is estimated using fundamental information on the company, it becomes the Stable Growth Model, the third approach proposed by Damodaran (2002).

In this last method, one assumes that cash flows will grow forever, the opposite of liquidation value method where one assumed the firm had a finite life. The terminal value can be written as follows:

$$\text{Terminal Value}_t = \frac{\text{Cash Flow}_{t+1}}{r - g_{\text{stable}}} \quad (14)$$

Where it is assumed the company will grow forever at a stable growth rate, and where the cash flows and discount rate will depend if the method of valuation is considering the whole business or only equity.

2.2.5 Growth rate

The growth rate has a fundamental role in estimating the terminal value, as a small change will significantly influence its value.

As recognized by Damodaran (2002), the fact that the growth rate is constant endlessly has some constraints on forecasting its value. It is unmanageable for a firm to grow at a higher growth than its economy, thus the growth rate assumed for the firm cannot be higher than the economy's growth rate.

Additionally, Koller, Goedhart and Wessels (2005) consider that the best estimate for the growth rate is the expected long-term rate of consumption growth for the industry, plus inflation.

2.2.6 Adjusted Present Value

As Damodaran (2006) states, in the adjusted present value one separates the effects of debt financing from the effects of equity financing of a business. According to Luehrman (1997), it values the business as a sum of parts taking into consideration two main classes of cash flows: associated with the business operation, such as revenues and capital expenditures; and the side effects associated with the financing program the firm is expected to use, such as interest tax shields. The company is firstly valued as if it was entirely equity financed; then one adds the benefits of debt and lastly, one deducts the expected bankruptcy costs.

$$\begin{aligned} \text{Value of business} &= \text{Value of business with 100\% equity financing} + \\ &\text{Present value of Expected Tax Benefits of Debt} - \\ &\text{Expected Bankruptcy Costs} \end{aligned} \quad (15)$$

Moreover, APV appears to be a better tool to measure a company's value. As stated by Luehrman (1997), not only the APV method is more responsive to changes in the capital structure of the company, as it helps managers to see where the value of the business comes from.

Lastly, and according to Damodaran (2006), one of the limitations of this approach is related with bankruptcy, neither the probability nor the costs of bankruptcy can be predicted or estimated reliably.

Interest Tax Shields

The value of interest tax shields is the increase in the company's value as a result of interest being tax deductible. In other words, the tax benefit deriving from paying interest makes after-tax cost of debt lower than pre-tax cost of debt. There is no consensus about the correct way of measuring it, nevertheless, Modigliani and Miller (1958), Myers (1974), Luehrman (1997) and Damodaran (2006) propose discounting the tax savings due to interest payments on debt at the cost of debt.

$$Value\ of\ Tax\ Benefits = \sum_{t=1}^{t=\infty} \frac{Tax\ rate_t \times Interest\ rate_t \times Debt_t}{(1+r_d)^t} \quad (16)$$

2.2.7. Dividend Discount Model

The Dividend Discount Model is the oldest discounted cash flow method and has the main advantage of being simple and relatively intuitive, as stated by Damodaran (2006).

There are two main reasons why investors buy stocks: to receive dividends during the holding period and to receive the expected price when the stock is sold. As this expected price is determined by the amount of dividends, the value of a firm can be estimated through discounting dividends, as follows:

$$Value\ per\ share\ of\ stock = \sum_{t=1}^{t=\infty} \frac{E(DPS_t)}{(1+r_e)^t} \quad (17)$$

Where $E(DPS_t)$ are the expected dividends per share and r_e is the cost of equity.

According to Damodaran (2006), and as stated before, to calculate the expected dividends of a stock, one needs to do assumptions on earnings and growth rates, nevertheless one cannot make assumptions infinitely. To overcome this obstacle, some variations of the primary model of DDM have arisen.

The simplest method is the Gordon Growth Model, developed by Gordon and Shapiro (1956), which assumes that a firm has well established dividend payout policies and intend to continue in the future. Thus, the value of the firm per share of stock can be written using the expected dividends of next time period, as follows:

$$\text{Value of a stock} = \frac{\text{Expected Dividends next period}}{(r_e - \text{Expected growth in perpetuity})} \quad (18)$$

Besides being the most accepted variation of Dividend Discount Model, the Gordon Growth Model has its limitations. Namely, the assumption that dividend payout ratio will grow at a constant rate forever. It is very unusual for a company to keep a constant growth rate of dividends, as companies have business cycles and unexpected events may occur. Other limitation is the fact that companies may pay higher dividends than they have availability for, often being funded with equity or debt. Obviously, from this last case derive too optimistic assumptions, as it assumes the firm will be able to rely on external funds to meet dividend payment deficits infinitely, which is not true. (Damodaran 2006)

2.2.8. Economic Value Added

The EVA is a measure for excess return calculation, it represents the surplus of value created by an investment. Cash flows are, therefore, separated into excess return cash flows and normal return cash flows. (Damodaran, 2006)

The value of a company can, thus, be written as following:

$$\text{Value of a company} = \text{Capital Invested in the firm today} + \text{Present value of EVA from both existing and future projects} \quad (19)$$

$$\text{And where } EVA = (ROIC - WACC) * \text{Invested Capital} \quad (20)$$

Besides being a good tool to evaluate a company, as it takes into consideration all the actions management undertake, sometimes the ROIC or WACC estimated do not reflect the actual return and cost of capital of the company. (Damodaran, 2006)

2.3. Relative Valuation

An alternative to the Discounted Cash Flows techniques described before is the relative valuation or multiples valuation.

In a Discounted Cash Flow approach, one is valuing an asset based on its ability to produce cash flows in the future. In relative valuation, one is valuing an asset by looking to the price of similar assets in the market. If both valuations are made correctly, valuations might converge. (Damodaran, 2002)

As stated by Damodaran (2006) assets are valued based on comparable assets priced in the market. Thus, one can determine the value of a firm by looking at the value of similar firms.

Three crucial steps need to be made while performing a relative valuation: 1) Find comparable assets that are priced in the market; 2) Scaling the market prices to common variables to able comparison, which may not be needed if assets are identical but is crucial when comparing assets that vary in size or units; 3) Adjusting for differences in standardized values. As an example, higher growth companies should have higher multiples, and this should be taking in consideration when making comparisons. (Damodaran 2002)

According Koller, Goedhart and Wessels (2005), a comparison of a firm's multiples to a comparable firm's multiples is a major tool to test validity of projected cash flows and to search for strategic potential of the company, in relation to the set of firms.

Nevertheless, performing a relative valuation can be a challenging job. Not only with the choice of comparable firms but also which multiple to use.

As stated by Damodaran (2006), the simplest and primary assumption is that firms in the same sector have similar growth, risk and cash flow projections, enabling a reliable comparison.

After identifying the company industry's players, Koller, Goedhart, and Wessels (2005) recommend a four step process to identify comparable firms reliably: choose companies with similar ROIC and growth, use forward-looking multiples, use enterprise-value multiples based on EBITDA to diminish problems with capital structure and unexpected events, and finally, adjust the enterprise-value for non-operating items such as excess cash.

Supporting the use of forward-looking multiples is Liu, Nissim, and Thomas (2001), who provided evidence that multiples based on future earnings are more accurate than historical multiples, which might seem realistic, as the cash flows projections reflect better the future performance of the firm. Moreover, a valid reason to use these multiples would be the increasing accessibility of earnings' projections.

According to Fernández (2001), multiples rely on three categories: based on the company's equity value such as PER or Price to Sales, based on the enterprise value (debt and equity) such as EV/EBITDA and growth-reference multiples such as EV/EG (EBITDA Growth).

Koller, Goedhart, and Wessels (2005) defend one should use enterprise multiples rather than equity multiples, because of the easy manipulation of equity multiples when changes in the capital structure of the firm occur.

In his findings, Fernández (2001) showed that PER and EV/EBITDA are the most widely used multiples for valuing firms. Nevertheless, PER has its limitations. As stated by Koller,

Goedhart, and Wessels (2005), it is systematically affected by the chosen capital structure. Additionally, it includes non-operating gains or losses, which can be one-time events, and mislead the over or undervalue the multiple. Regarding EV/EBITDA, it is a good alternative to PER ratio as it is less dependent on the capital structure of the company.

A drawback of this approach, as mentioned by Koller, Goedhart, and Wessels (2005) is the assumption that returns and growth are typically similar for companies in the same industry. Differences in accounting methods, effects of inflation, the stage of the company or unexpected events may mislead the result of the multiples and thus, result in an inaccurate valuation.

2.4. The case of Hermès International

After analyzing the present literature, one is now prepared to choose the methods to value Hermès International.

Regarding the Discounted Cash Flows Method, the Discounted FCFE appear as the most suitable method. The APV technique does not seem reasonable, as the company has a very low volume of debt and its D/E has been quite constant over the past years, suggesting that there were not significant changes in the capital structure of the firm.

Furthermore, one will also apply the DDM, as the company's dividends almost totaled the FCFE. The dividend policy is not expected to change, as the company pays dividends as a strategy to reduce the amount of retained cash.

Moreover, one will perform an EVA valuation, as it is a performance measure widely used in finance. It is important to analyze the creation of value for Hermès' shareholders

Lastly, one will conduct a relative valuation, with the P/E, EV/EBITDA and EV/EBIT multiples, since they are common multiples used for companies in the apparel industry.

3. Industry Overview

In this chapter, one will start by introducing the luxury goods industry; secondly, will describe the drivers for growth in this industry, followed by a geographic analysis. Finally, the future of the industry is going to be presented.

3.1 Luxury Goods Industry

“Something inessential but conducive to pleasure and comfort. Expensive and hard to obtain”
– American Heritage Dictionary

Luxury can be seen as an industry with “a strong branding that relates to an exclusive lifestyle, superior quality and timeliness, premium pricing and stylish and extravagance when comes to design” Comité Colbert (2001). Goods are distinguished by their uniqueness and intrinsic value. They are often associated with apparel, jewelry and perfumes but the sector is much wider, from yachts to cars and furniture.

Luxury goods companies’ value chain comprises manufacturing, production, distribution and retailing. While several luxury companies as Guess or Max Mara, tend to focus on design and retail, many companies control the entire value chain, as it is the case of Louis Vuitton or Hermès.

There are three main segments when defining the luxury industry: absolute luxury, aspirational luxury and accessible luxury.

The first segment, absolute luxury, is characterized by unique items, made with precious materials, often inaccessible and related with the brand’s heritage. The high quality and price of products, combined with these high principles, results in a sense of exclusivity and uniqueness given by the brand.

Furthermore, in the second segment, the aspirational luxury, there is a limited production in series, the quality and style remain in the front line and each product represents the brand’s reputation. Advertising, in contrary of the absolute luxury where there is no advertisement, plays an important role.

Lastly, the accessible luxury segment, where standardized products and more affordable prices take place. Customers have a notion of status and membership of the brand. The advertising needs to be regular and the aspirational advertising is used, where the customer wishes to own the product, regardless of its price.

Bearing in mind these three segments in the luxury goods industry, Hermès International is positioned in the absolute luxury segment. It is a brand with an unmeasurable heritage and several iconic products, as we will examine in the next chapter.

3.2 Drivers for growth

The luxury goods industry has three main drivers for growth: the continuously internationalization of companies, brand and line extension, and the distribution channels.

As a company becomes internationally developed, it deals with different cultures and values widely distributed between countries. While in traditional markets, consumers expect quality and innovative products, with some degree of exclusivity; consumers in emerging markets search for extravagance and ostentation.

Being able to serve both types of customers is a good source of potential growth, as the company expands its activities to a wider range of markets. Nevertheless, it is a big challenge to try to please such different customers, without diluting the brand awareness.

Additionally, the global tourism is a booming trend. The demand for health and wellness tourism destinations increased significantly in the last years, with the desire for VIP treatment. There is an increase in women travelling alone or in groups, looking for SPAs and shopping destinations. Meeting these new demand trends, is nowadays a big growth opportunity for companies. (Bain&Co, 2015)

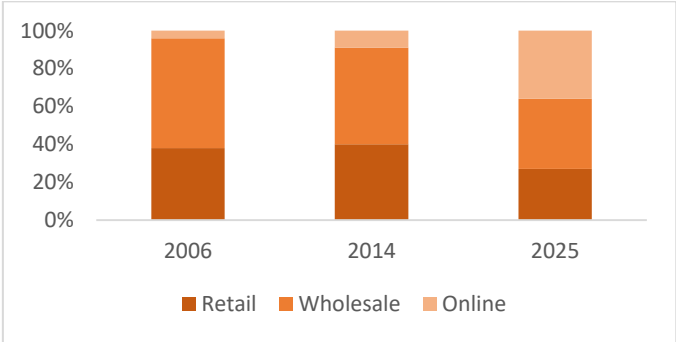
Furthermore, the brand and line extension have a positive impact on consumers' perception of what the meaning of luxury is today. Many luxury brands that started with apparel and fragrances have expanded to accessories, sportswear, furniture, home wear, cell phones or cafés.

Lastly, the distribution strategy is an important driver of growth because it impacts the brand recognition and the margins of the products sold. If a consumer buys a product in a retail store, it has a more impacting contact with the brand's image, it engages in the retail experience through the store. Furthermore, typically retail business give higher margins than wholesale business.

On the opposite, in the wholesale business there is a high number of brands selling in the same physical space. Therefore there is a high diffusion of brands and a lower brand image, being harder to give a customer the true shopping experience. This type of distribution has lower margin of contribution to the business but it has also lower investment risk.

Besides these two distribution strategies, a new tendency is arising: the e-commerce. Many luxury brands have for a long time, resisted to this channel because it was associated with discounts or counterfeiting products. Nowadays, with the increasing presence of the internet in people’s life, luxury brands felt the need to adopt this new distribution channel. In most of the times, it is not used to sell products but to announce fashion shows and to show collections.

According to Goldman Sachs, it is predicted that e-commerce represents the same percentage of revenues as wholesale, in 2025.



Graph 1: Share of Global Revenue across the different distribution channels. Source: Goldman Sachs Equity Research 2015

As showed in the graph 1, e-commerce’s percentage of revenues shows a small increase in the period 2006-2014, decreasing the market share from retailer and wholesales.

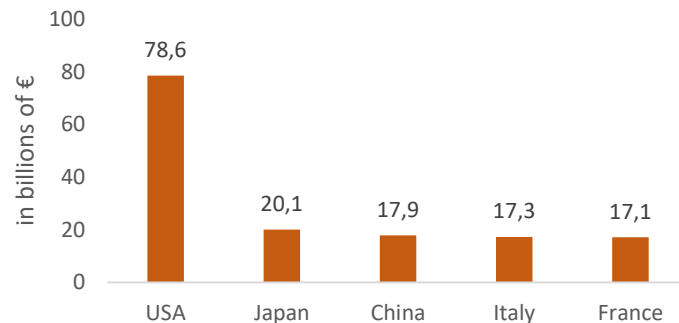
A strategy performed by several companies, namely Hermès, is to combine wholesale, e-commerce and retail. This strategy, called Omnichannel, has high growth potential for a company being the only challenge, to find an optimal point between the three channels.

3.3 Geographic analysis

“With luxury goods, we are seeing the emergence of a new normal: The global market is maturing, stabilizing and consolidating. It is becoming more resilient to economic crises, more responsive to a demanding and highly mobile global consumer base, and less reliant on market booms for growth. For all these reasons, luxury brands everywhere should be focusing on how to build growth organically.” (Claudia D’Arpizio, Bain&Company)

In the past, luxury companies’ main activity was in the US and in Europe. Nowadays, almost all luxury companies’ activity is spread worldwide, therefore, companies need to change practices to meet consumer demand.

As one can see by graph 2, USA remains a significantly big market. Nevertheless, Japan and China also represent a high level of consumption, and according to Bain&Co (2016), their markets are predicted to grow even more.



Graph 2: Consumption in Luxury Goods by country in 2015. Source: Bain&Co 2015

For the sake of this work, one will analyze geographic trends in Europe with a special focus in France; Japan, Asia-Pacific and Americas.

Europe

Europe maintains a leading position in the luxury goods industry, as it entails five of the seven top luxury markets: France, Italy, Switzerland, United Kingdom and Spain. (Global Powers of Luxury Goods, Deloitte 2016)

A big consumption trend in Europe is related to tourism, as 58% of total luxury goods consumption is made by tourists, primary Chinese. Chinese consumers increased by 64% as they prefer to shop in foreign countries where they have tax-free shopping. (Deloitte, 2016)

France

France has a natural heritage in the luxury goods industry has many headquarters of luxury companies were, and still are, located in Paris. As one is going to see in the following chapter, it is the case of the company studied, Hermès International.

The year of 2015 was specially challenging for the country, as Paris was the target of a terrorist attack. This event affected the performance of the country, as France recorded a lower growth compared to previous years. (See table 5)

According to Deloitte's report on Global Powers of Luxury Goods in 2016, France entails the headquarters of ten of the top 100 companies in the industry, where the first three – LVMH, Kering and L'Oréal Luxe – represent 78% of total sales.

Japan

Japan's relation with luxury goods began in the 1970s, where Japanese consumers' belief European products had higher quality and were longer-lasting than local ones. According to McKinsey, Japanese consumers possessing a European luxury good sensed an emotional connection with the luxury brand and it was a symbol of economic success and social recognition.

It is expected, therefore, that these consumers spend a considerable amount of income in luxury goods. Actually, they are one of the "world's biggest spenders" according to McKinsey.

As one can see in graph 2, Japan is the second biggest market in the luxury goods industry. It represented 12% of Hermès International's revenues in 2015.

Another growth driver of this country is the amount of tourists it receives every year. Tourists find Japan an attractive destination for shopping.

Asia-Pacific

The Asia-Pacific region, excluding Japan, represented 35% of Hermès International total revenue in 2015.

Historically, the luxury goods sector has considerably high growth rates in this region, mainly due to the expansion in emerging luxury markets.

China a big responsible for this growth. In 2010, the country was the fifth biggest market in luxury goods. It is now the third biggest market, representing about one third of global market, according to Bain&Co (2015).

Another factor driving this region's growth is the increased number of High Net Worth Individuals, with higher purchasing power. Nevertheless, the increase in import tariffs and the well-known counterfeiting luxury goods in this region, represent a challenge for growth.

Americas

Enhanced by a strong dollar, the Americas are the biggest global market for luxury goods. The USA alone, represents a higher percentage of the total market than the combination of Japan, China, Italy and France.

New York is an unavoidable city to mention, when the matter is luxury goods. According to Bain&Co (2015), the amount spent in luxury goods in New York City, is greater than the total amount spent in Japan.

In 2014, the total number of High Net Worth Individuals was 33 million, 16 million of this were Americans.

3.4 Future of the Industry

"I think this year could be a low point for the industry," Claudia d'Arpizio, Bain&Company Partner 2016.

Besides a lower expected growth for this year, the luxury goods industry is predicted to increase its growth pace in the next few years.

Additionally, consumers are changing. They are being shaped by several trends, which are creating better-informed and more demanding consumers. Two crucial trends are the tourism and the new digital era.

The increase in tourism affects the luxury goods industry, as it becomes a global integrated market. In the past, companies would implement pricing strategies based on the country they were selling in. International travel is, thus, a challenge to this strategy. Specifically, Chinese consumers are transforming travel in a synonym of shopping, as they are buying the majority of luxury goods abroad. By 2020, is expected that luxury brands are able to smooth international price differences. (Bain&Co, 2015)

Additionally, it is inevitable to discuss how much technology has changed the world. It has shaped consumers and their needs. With digital technology the consumer is always connected to his favorite brands, increasing the brand awareness and customers' expectations.

Moreover, the digital consumer is also influenced by social media. Social media as Instagram or Facebook are filled with shopping on the Fifth Avenue, hotel stays at Ritz-Carlton or Chanel purses. This increases even more the brand awareness and desire on consumers.

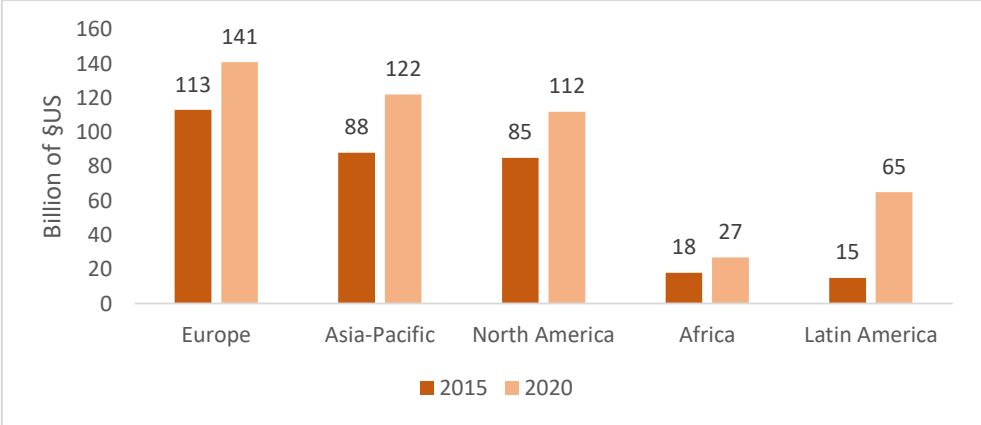
It is estimated by Deloitte (2016) that the percentage of sales influenced by digital technology is around 40% and it is expected that e-commerce reaches 10% of sales by 2020.

Geographically, the United States market is declining, without the support of tourism or local demand. However, the spending on luxury goods in Latin America is contributing to a slightly increase in the growth in this region.

European countries are still suffering from a downside. In particular, French growth is tightly related to GDP variations. A recovery is expected in the country until 2020, however the purchase power of French consumers will continue restricted, favoring lower prices.

Mainland China is showing signs of recovery, after a slowdown period. While Japan will continue a top market for growth, with a 5% expected growth in the following years, according to Bain&Company in *Spring Luxury Update 2016*. Additionally, Japan is hosting the Olympic Games in 2020, which will bring around 20 million tourists to the country according to the Japanese government.

In the graph 3, one can see the forecasted sales for 2020, by Bain&Co:



Graph 3: Luxury Goods Sales by Region 2015-2020. Source: Bain&Co, 2015

Europe will continue to be the most powerful market, as Asia-Pacific is expected to grow at a higher pace than North America.

Bain&Company predicts, therefore, a growth of 2-3% in the global luxury market, reaching a sales volume of €280-€295 billion by 2020.

4. Company Overview

4.1 History

Hermès International SCA was established in 1837 by Thierry Hermès as a harness producer. In 1839, Charles-Émile Hermès took over the management of the company and extended its line of production. The first bag was produced in 1900 and it was specially designed for riders.

As the time passed, Hermès began producing luxury goods, maintaining, until today, its unique quality thanks to the generations of skilled craftsmanship.

In 1993, the company went public on the Paris Stock Exchange. In the end of 2015, Hermès had 307 exclusive stores, operating in 48 countries, 12 244 employees and it is active in 14 sectors ranging from leather goods or footwear, to wallpaper and tableware. Watches, perfumes and tableware are also sold in department stores, airport duty-free stores and online.

In 2015, Hermès was the third highest valued brand in the luxury sector, according to Forbes.

4.2 Products Offered

Hermès has a wide range of products, being present in the following sectors (métiers): Leather Goods – saddlery; Bags and Luggage; Diaries, Small Leather Goods and Writing objects; Equestrian; Ready-to-Wear and Accessories; Silk and Textiles; Art of Living; Jewellery; Fragrances and Watches. Besides these sectors, the company also incorporates other group brands and products, such as petit H. (Hermès, 2015)

a) Leather Goods – saddlery

This métier is the original line of production. It is expressed by bags, where one can find the famous Birkin and Kelly, clutches, diaries, writing products saddles and equestrian clothing. It is the biggest source of revenue, representing 47% of total sales in 2015.

b) Ready-to-Wear and Accessories

The Ready-to-Wear and Accessories is the second biggest métier in the Hermès Group. In 2015, 23% of the Group's sales belonged to this sector. It comprises women and men collections, and accessories as jewellery, belts, hats and shoes.

c) Silk and Textiles

Silk and Textiles is the third largest sector and represented, in 2015, 11% of sales. It comprises the iconic Hermès' scarves as well as ties.

d) Art of Living

Hermès Art of Living purpose is to be an elegant supplement to its customers' daily lives, by personalizing their living spaces. Without detaching from its culture and values, the company offers several unique items in a simple and assertive style. In this métier, one can find from furniture to home textiles, wallpapers and tableware.

e) Fragrances

In 2015 Fragrances continue an uptrend, reaching €241m of sales. In 2016, a new perfume was introduced: Galop d'Hermès. According to Alex Dumas, "This (the perfume) is going to live on, it's so Hermes!"

f) Watches

Besides the crisis in the Swiss watchmaking sector, Hermès has succeeded in maintaining a growth in its watch sales. In 2015, watchmaking achieved €163m of sales. An important growth driver in 2016 will be the launch of Apple Watch Hermès: an Apple Watch with a Hermès bracelet.

g) Other Hermès' products and brands

Although the Hermès brand is the main business of the Group, there are also other brands under the Hermès International name. This segment is comprised by: petit H; Hermès Horizons; John Lobb bootmaker; Cristalleries de Saint-Louis, Verel de Belval, Bucol, Créations Métaphores and Le Crin textiles; and lastly, Shang Xia.

4.3 Shareholders' structure

According to Hermès' Annual Report of 2015, the company has 105 569 412 shares outstanding.

This share capital is majorly owned by the Hermès family, under the name of Émile Hermès SARL. As Hermès remains a familiar company, members of the family and their descendants have priority to acquire shares.

In the end of 2015, the Hermès' family held 65,2% of the capital, the Arnault family – comprising the chairman and CEO of LVMH conglomerate – held 8,5% and 5,8% were held by Nicolas Puech Foundation. The free float available for trading represents 19,4% of the share capital.

4.4. Financial Analysis

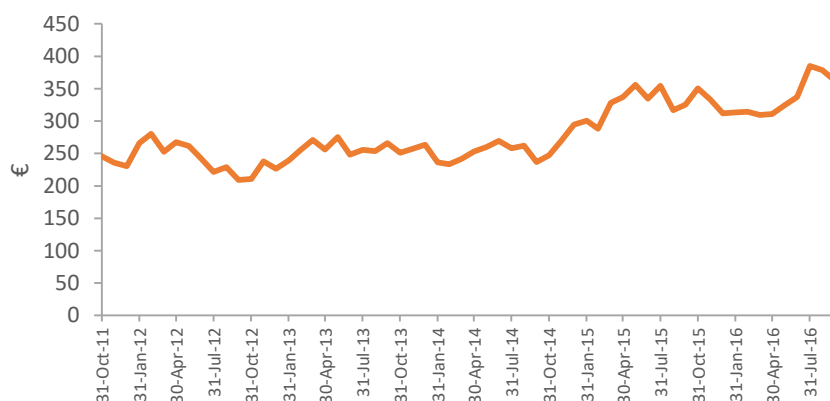
By analyzing Hermès' recent financial statements, one can see a clear strong performance throughout the years. The assets of the company accounted for 5187M€ in 2015, while in 2014 the amount was of 4768M€.

Regarding the capital structure of the company, equity represents 73.3% of 2015 total assets (book values) and this proportion has been approximately the same since 2011. The liabilities accounted for 1438M€ in 2015, where current liabilities are the major item. Furthermore, the net income accounted for 972M€ in 2015, following a positive steady path.

The cash flow management of Hermès allowed an investment in CAPEX of 252M€ in 2015, which represented 5,2% of revenues. This investment represented a slightly decrease compared with 2014, where investment in CAPEX accounted for 6,7% of revenues. Moreover, the company holds a substantial amount of cash and cash equivalents. In 2015, this accounted for 1589M€, 30,6% of total assets.

In 2015, Hermès decided to increase the amount of dividends per share to 3,35€ instead of 2,95€ in 2014. For the following years, the dividend policy is expected to continue.

Lastly, the share price evolution has been positive. Profits have been growing at a stable pace, as one can see by looking at the graph 4. The lowest closing price in 2015 was 277€ registered in January, the highest was 360€, in June. This represented an increase of 30% within 5 months.



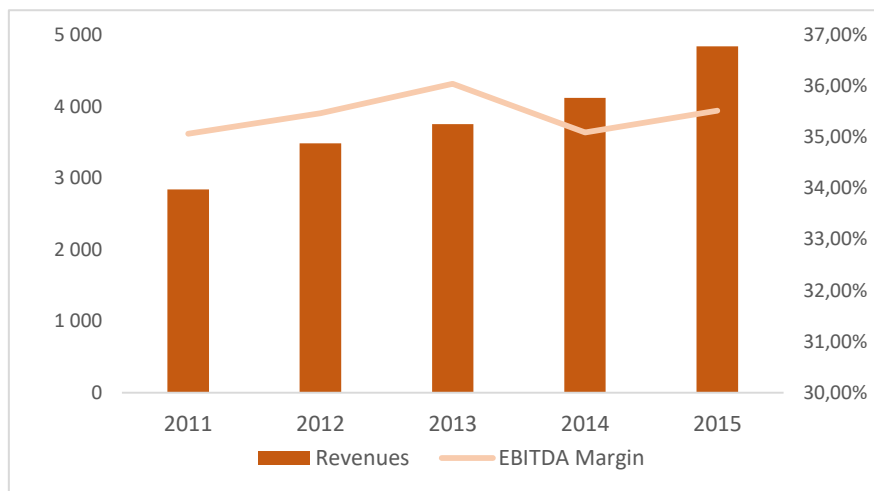
Graph 4: Hermès Stock Performance 2011-2016. Source: Reuters

Since the beginning of 2016, the share price revealed an extraordinary performance, recording in August the highest value ever: 398,6€

a) Revenues

For Hermès, 2015 was a tough year. Besides the economic instability living in Europe in the last years, 2015 was target for a terrorist attack, which directly affected Hermès sales. Hermès is a French company with headquarters in Paris, the city that was victim of terrorism.

Nevertheless, Hermès managed to sustain a positive growth in revenues by standing “our feet on the ground” as stated by Alex Dumas, CEO of Hermès, and by delivering a continuing high value to customers.



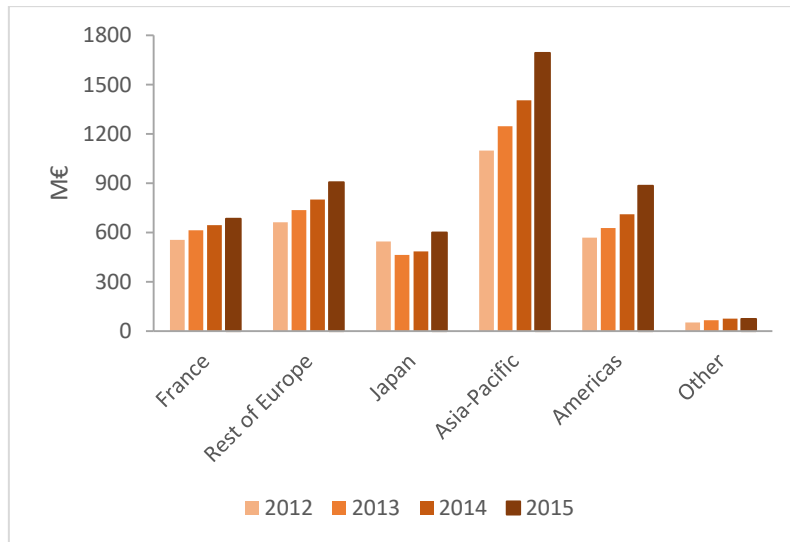
Graph 5: Revenue and EBITDA margin 2011-2015. Source: Annual reports

In 2015, revenues accounted for 4841M€, an 18% increase comparing to 2014, where revenues amounted for 4118M€. EBITDA margin recorded 35,5% in 2015, compensating the small decrease in 2014.

The company announced in February (2016) that this year’s sales could be below the target of 8% growth, driven by both like-for-like growth in already existing stores and expansion of distribution channels.

- Revenues by Geography

To have an increasing global presence, Hermès’ strategy has been to open stores or create partnerships in appealing markets. Currently, the leading regions are France, Europe (excluding France), Japan, Asia-Pacific (excluding Japan) and Americas, as showed in the graph 6.



Graph 6: Revenues breakdown by geography 2012-2015. Source: Annual reports

The Asia-Pacific region is the most powerful one, representing the highest stake of revenues. In 2015, 35% of Hermès revenues accounting for 1694M€. This region was consistent in like-for-like sales and experienced a 20% growth in volume compared to 2014, mainly due to the extraordinary development in the Chinese market. On the other hand, Japan also represents a significant stake of revenues. The country accounted for 13% of revenues, meaning a volume of 600M€.

In 2015, Europe experienced a small growth. In 2015 the region accounted for 33% of total sales, representing 1590M€. In relation to 2014, it corresponds to a 10% increase in sales of this region. This was mainly due to the renovation of the Bond Street Store in London and the opening of stores in Moscow, Sardinia and Heathrow Airport.

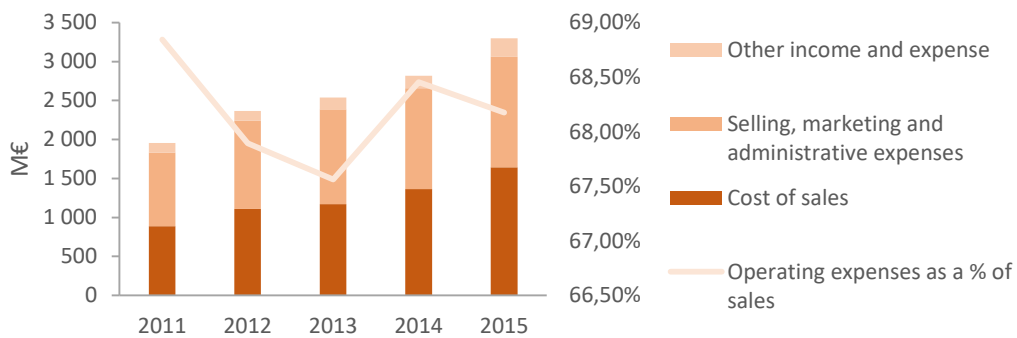
Yet, France plays an important role for Hermès' revenues in Europe, as it is the country with higher and consistent like-for-like sales. In 2015, France accounted for 14% of the company's revenues. Besides the unfavorable events in the country, it still experienced a 6% growth in sales mainly due to the opening of a store in Cannes and a store expansion in Paris.

In the Americas, revenues accounted for 884M€ in 2015 which represented a 24% increase in relation to 2014. This increase was mainly due to new store openings or extensions in Miami, Washington, Seattle and New York. Lastly, Brazil had contributed to the increase in sales due to the reopening of the store in São Paulo. In 2016, to profit from the Olympic Games, a store in Rio de Janeiro just opened.

b) Operating expenses

Throughout the years, Hermès' operating expenses have been increasing mainly due to the expansion of the business, the continuously opening of new stores, new business lines and renovation projects.

In 2015, operating expenses accounted for 3300M€, a 17% increase comparing to 2014.



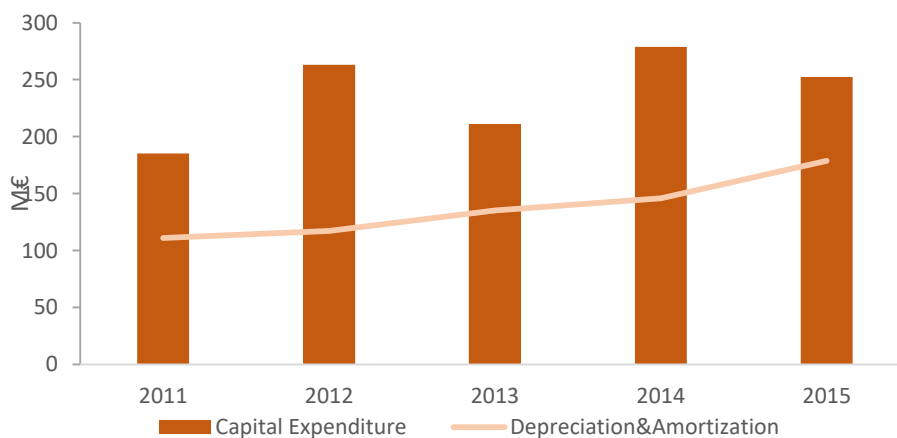
Graph 7: Breakdown of operating expenses 2011-2015. Source: Annual reports

As one can see by the graph 7, the Cost of sales are the biggest stake of operating expenses, representing 1642M€ (50%) in 2015, an increase of 20% since 2014.

The company is improving its efficiency, as the operating expenses as a percentage of sales decreased since 2014.

c) Capital Expenditures and D&A

Capital expenditures in Hermès are associated with expansion, either domestic or international, to fulfill consumer demand. In 2015, 2 stores opened and 15 were refurbished.



Graph 8: Capital expenditure and D&A 2011-2015. Source: Annual reports

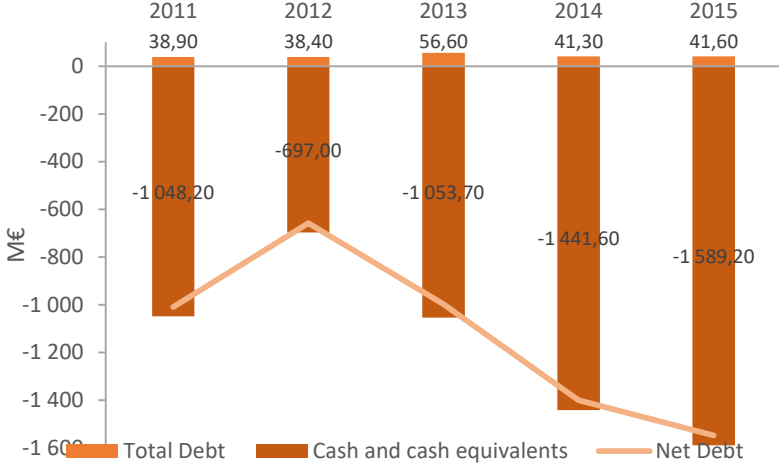
The company holds nowadays a wide range of distribution, being present in 48 countries and having 49 production units.

Capital Expenditure decreased 9% in 2015, which goes in line with the company’s objective to give priority to renovation and extensions of existing stores, opening stores at a smoother pace.

The Depreciation and Amortization increased 22% in 2015, mainly due to the depreciation of buildings and of store fixture and furnishings.

d) Net Debt

Net Debt has been decreasing in the last years, due to the company’s policy to preserve a high level of cash and cash equivalents.



Graph 9: Net Debt 2011-2015. Source: Annual reports

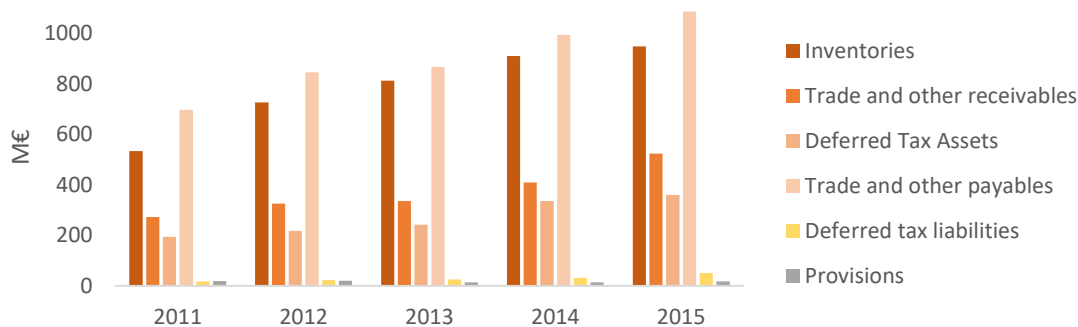
Hermès’ presents a negative net debt, which means that the company presents higher values in cash than in debt.

The continuously increase in the level of cash is mainly to prevent the risk of capital loss and to sustain liquidity, in case Hermès wants to implement rapid strategic changes.

e) Working Capital

In Hermès’ Working Capital is included all receivables and payables due within one year, inventories, operational provisions and deferred taxes.

The two most relevant parts are inventories and trade and other payables, which makes sense given the company’s business. Regarding deferred taxes, receivables and provisions, they show a clear increasing tendency.



Graph 10: Working Capital 2011-2015. Source: Annual reports and own Calculations.

Additionally, the days of receivables are increasing, while the days of payables and of inventories are decreasing. However, the days of receivables are still much lower than the days of payables.

f) Risk Parameters

There are a few risks associated Hermès' activity that may influence the assumptions being made in the following valuation.

Firstly, the concern for lower prices. Nowadays' consumers are much more sensitive to prices than before. This is a challenge for companies, as they need to keep delivering value but with a price constraint, if they do not want to lose customers.

Secondly, the tourism flows. Taking as an example the attacks occurred in Paris, last year, one can easily see how tourism affects the luxury goods' consumption. The attacks affected tourism flows, as less people visited Paris after them, making consumption decrease in that period.

Additionally, the currency fluctuations have strengthened price differences among countries, which change consumers' behavior in this industry. As Hermès' activity is widely spread around the world, low power currencies, as Japan Yen, will diminish profits and affect Hermès' results.

g) Competitors

Competition in the luxury goods industry is very strong, with few companies representing the majority stake of the market. For Hermès, the major competitors are Louis Vuitton Moët Hennessy (LVMH), Kering (Gucci Group) and Richemont. The three are conglomerates of luxury companies, being LVMH the most powerful as it is not only a competitor of Hermès but also a shareholder.

Company		Hermès International	LVMH	Richemont	Kering
Country		France	France	Switzerland	Paris
Price		369,45 €	162,50 €	65 CHF	195,40 €
2013	ROIC	28,6%	9,5%	20%	4,6%
	EBITDA Margin	36,1%	25,8%	27,7%	21,6%
2014	ROIC	25,2%	14,6%	17,40%	6,0%
	EBITDA Margin	35,3%	23,0%	28,5%	19,9%
2015	ROIC	24,8%	9,6%	9,50%	3,9%
	EBITDA Margin	35,8%	23,0%	28,2%	18,3%

Table 2: Hermès Competitors. Source: Reuters. Extracted at 16/11/2016

As one can see in table 2, the three firms had high ratios of profitability in the past three years. Kering is the one with lowest EBITDA Margin and ROIC, while LVMH is the one with higher ROIC and Richemont with higher EBITDA Margin in 2015.

The uniqueness of Hermès is also shown in the table, as it is a sole company, not a conglomerate, but still has higher profitability and operational ratios than the three groups.

5. Company Valuation

After analyzing the luxury goods industry and the main characteristics of the company, the valuation of Hermès International can now be executed. All the following assumptions are based on historical consolidated data provided by the company and on own calculations.

All values are in Euros (€) and no currency impact is assumed, as this feature is extremely difficult to foresee.

5.1 Explicit period and Terminal Growth Rate

This valuation is performed considering a time period of 10 years, 2016-2026, as the company is not yet in a steady state.

in M€	2012	2013	2014	2015
Revenue	3 484,10	3 754,76	4 118,60	4 841,00
YoY growth (%)	23%	8%	10%	17,54%

Table 3: Revenues growth 2011-2015. Source: Annual reports

The volatility of sales growth in the past 4 years suggests that Hermès still needs some years to stabilize its growth and therefore, one choses a time frame of 10 years.

Regarding the terminal value growth rate, we assumed 1,5%, as one considers illustrative of the company and industry situation, besides a bit conservative, and it is in line with the predictions for the future economic growth rate, 2%.

5.2. Stores growth

In order to estimate the growth in the number of stores, one collected and analyzed historical data.

As one can see by table 4, the number of stores has been decreasing. If we take a deeper look, the number of franchised stores is decreasing while the number of fully-owned stores is increasing. This is a proof of Hermès' strategy of increasing the power over its sales channels.

	2013	2014	2015	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
Number of stores	315	311	307	305	304	302	302	302	302	303	304	305	306	309
Stores opened	2	6	2	4	4	4	5	4	5	5	5	4	5	6
Franchised stores	112	103	97	91	86	80	75	71	66	62	58	55	51	48
YoY growth (%)	-4,27%	-8,04%	-5,83%	-6,04%	-6,04%	-6,04%	-6,04%	-6,04%	-6,04%	-6,04%	-6,04%	-6,04%	-6,04%	-6,04%
Company-owned stores	202	208	210	214	218	222	227	231	236	241	246	250	255	261
YoY growth (%)	1%	3%	1%	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%

Table 4: Number of stores forecast 2016-2026. Source: Own calculations

For the period 2016-2020, one assumes this strategy will continue. Thus, the growth in stores is estimated through the average of the last years. For the franchised stores, a 6,04% decrease, while for the company-owned stores a 2% increase per year.

By doing so, the company will continue to grow organically and expand its network of stores.

5.3. Operational Forecasts

5.3.1. Sales

To estimate the sales value, one first looked at the historical data provided by the company, as well as the region breakdown. Later on, we computed weighted averages of GDP growth and inflation and combine them with the growth of Hermès' market share.

By looking at table 5, one can clearly see how important is France for Hermès, as it is the country with the highest percentage of sales, and how the Asia-Pacific region is becoming a powerful market.

In M€	2011	2012	2013	2014	2015
Revenue	2 841,20	3 484,10	3 754,76	4 118,60	4 841,00
growth		23%	8%	10%	17,54%
France	495	556	613	644	684
as a % of revenue	17,42%	15,96%	16,33%	15,64%	14,13%
Rest of Europe	560	662	737	800	906
as a % of revenue	19,71%	19,00%	19,63%	19,42%	18,72%
Japan	472	545	463	484	600
as a % of revenue	16,61%	15,64%	12,33%	11,75%	12,39%
Asia Pacific	808	1100	1248	1405	1694
as a % of revenue	28,44%	31,57%	33,24%	34,11%	34,99%
Americas	464	569	627	711	884
as a % of revenue	16,33%	16,33%	16,70%	17,26%	18,26%
Other	43	53	66	75	73
as a % of revenue	1,51%	1,52%	1,76%	1,82%	1,51%

Table 5: Revenue breakdown by region 2011-2016. Source: Annual reports

Understanding the percentage of revenues coming from each region, one computed the GDP and inflation growth for those regions.

First of all, one extracted absolute GDP values forecasted by OECD and computed a Year-on-Year growth. For the inflation, one used the percentages also forecasted by OECD.

The percentages of sales in the regions were computed as last years' percentage plus the growth of the region for the corresponding year, weighted for all regions. Later on, one computed the weights of each region's GDP and inflation.

Regarding the whole luxury goods market, one observed that the company is increasing its market share, from 4,2% in 2011 to 4,8% in 2015. One assumes, therefore, that the company will continue to increase its market share until it reaches 5,5% by 2020, where afterwards it will stabilize.

Looking at table 6, one can see that it seems reasonable for Hermès to achieve 5,5%, as observing Gucci's example, which declined from 5,5% to 4,7% in the period 2011-2015.

	2011	2012	2013	2014	2015
Hermès International	4,20%	4,30%	4,30%	4,60%	4,80%
Gucci	5,50%	5,70%	5,20%	4,70%	4,70%

Table 6: Hermès and Gucci market share 2011-2015. Source: Barclays (2016)

To achieve a 5,5% market share by 2020, Hermès' market share needs to grow at 2,76% Year-on-Year.

Lastly, combining the three percentages one arrives to the final sales growth percentage.

	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
Weighted GDP growth	3,39%	3,38%	3,34%	3,31%	3,31%	2,96%	2,97%	2,97%	2,98%	2,99%	3,00%
Weighted Inflation	1,10%	1,32%	2,36%	2,39%	2,37%	2,24%	2,24%	2,25%	2,25%	2,26%	2,26%
Market share growth (%)	2,76%	2,76%	2,76%	2,76%	2,76%	0%	0%	0%	0%	0%	0%
Total Sales growth	7,4%	7,7%	8,7%	8,7%	8,7%	5,3%	5,3%	5,3%	5,3%	5,3%	5,3%

Table 7: Breakdown of sales growth forecast 2016-2026. Source: Own calculations, OECD data

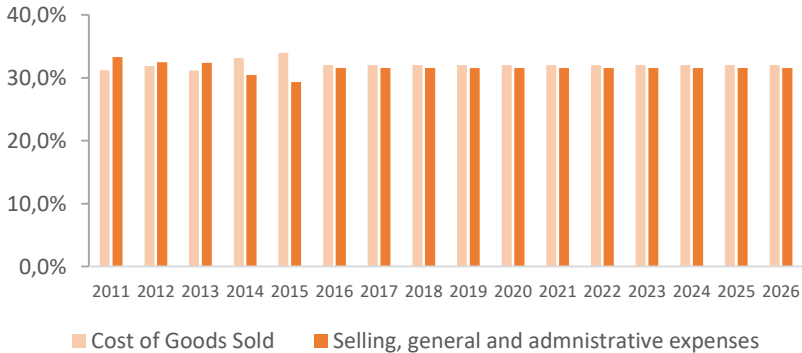
One can see an increasing tendency until 2020, which will then become stable until the company reaches the steady state, by 2026.

For 2016, Hermès announced sales would not meet the initial target of 8% for sales growth, which also goes in line with one's projections.

5.3.2. Operating expenses

This section comprises the cost of goods sold and the selling, marketing and administrative expenses.

Regarding the cost of goods sold, it includes all the costs incurred to produce the products available at Hermès' stores, including raw materials such as leather and cotton. As the price of raw materials is extremely hard to forecast, the percentage of operating expenses will be an average percentage of last years.



Graph 11: Operating expenses. Source: Own calculations

5.3.3. Operating Margin

After analyzing the revenues and operational costs, one can analyze the EBITDA margin. It is computed by dividing EBITDA by revenues and gives an overview of company’s profitability.

In M€	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
Revenue	5200,07	5597,26	6084,00	6613,33	7187,01	7565,46	7964,57	8385,74	8830,32	9299,68	9795,1
EBITDA	1894,43	2039,13	2216,46	2409,30	2618,29	2756,16	2901,56	3055,00	3216,96	3387,96	3568,45
EBITDA Margin	36,43%	36,43%	36,43%	36,43%	36,43%	36,43%	36,43%	36,43%	36,43%	36,43%	36,43%

Table 8: EBITDA Margin 2016-2026. Source: Own calculations

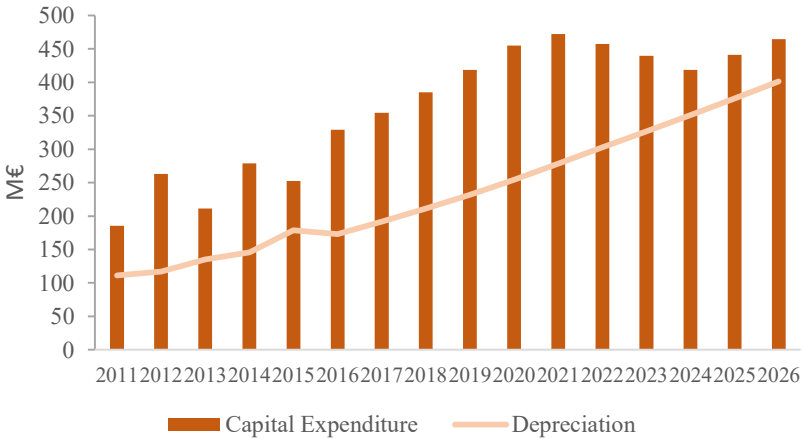
Considering the table 8, one can see that EBITDA Margin will be 36,4% in the forthcoming years. The result is in line with previous years (see graph 5) being smoothly higher, showing a small improvement on the company’s performance.

5.3.4. Capital Expenditures and D&A

In a company as Hermès, the capital expenditures occurred mainly due to the opening of new stores, refurbishment of existing ones, new factories and improvements in the central services.

To estimate the CAPEX in the subsequent years, one can look at which percentage of revenues was invested in the past and replicate it.

Regarding D&A, one estimated the rate of depreciation/amortization, simply by dividing the amount depreciated by last year’s asset value.



Graph 12: Capital Expenditure and D&A 2011-2026. Source: Annual Reports and Own calculations

5.3.5. Working Capital

Regarding the working capital needs, one started by collecting operating items of current assets and liabilities, and also some non-current items that the annual report had the information of being due to one year or less.

Regarding Inventories, Trade and other Receivables and Trade and other Payables, because of the lack of information regarding future behaviors of this items, one calculated the working capital by using the average Days of Inventories (DSI), Days of Sales Outstanding (DSO) and Days of Payables Outstanding (DPO).

Concerning Deferred Taxes, they were estimated as a percentage of EBT. Lastly, Provisions were assumed to remain 2015th value, as one did not had the information needed to perform a more accurate estimation.

in M€	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
Current Assets	1 945,30	2 092,55	2 273,76	2 470,88	2 684,57	2 823,45	2 970,39	3 125,38	3 292,81	3 469,26	3 655,36
Inventories	1 064,36	1 145,66	1 245,28	1 353,62	1 471,05	1 548,51	1 630,20	1 716,40	1 807,40	1 903,47	2 004,87
Days of Inventories	230,27	230,27	230,27	230,27	230,27	230,27	230,27	230,27	230,27	230,27	230,27
Total receivables	506,19	544,85	592,23	643,76	699,60	736,44	775,29	816,29	859,57	905,25	953,48
Days of Receivables	35,04	35,04	35,04	35,04	35,04	35,04	35,04	35,04	35,04	35,04	35,04
Deferred Tax Assets	374,75	402,04	436,25	473,50	513,92	538,50	564,90	592,68	625,84	660,54	697,01
Current Liabilities	-1 300,12	-1 397,89	-1 517,82	-1 648,26	-1 789,63	-1 882,58	-1 980,67	-2 084,17	-2 194,01	-2 309,92	-2 432,24
Total Payables	1 225,98	1 319,63	1 434,38	1 559,18	1 694,43	1 783,65	1 877,75	1 977,05	2 081,86	2 192,52	2 309,32
Days of Payables	265,23	265,23	265,23	265,23	265,23	265,23	265,23	265,23	265,23	265,23	265,23
Deferred Tax Liabilities	56,73	60,86	66,04	71,68	77,80	81,52	85,52	89,73	94,75	100,00	105,52
Provisions	17,40	17,40	17,40	17,40	17,40	17,40	17,40	17,40	17,40	17,40	17,40
WC	645,18	694,66	755,93	822,62	894,94	940,87	989,72	1 042,32	1 098,80	1 159,34	1 223,12
Changes in WC	-31,57	49,48	61,28	66,69	72,31	45,93	48,85	52,60	56,49	60,54	63,78

Table 9: Working capital 2016-2026. Source: Own calculations

Trade and Other Payables and Inventories will remain the most relevant portion on working capital, while Provisions and Deferred Taxes will continue to be the lowest.

5.3.6. Dividends

Hermès' dividends account for a big part of earnings. The company distributes dividends every year, and in some years still pays extraordinary dividends. This is part of a strategy to prevent the accumulation of cash.

One forecasted 45% of dividend being distributed from 2016 onwards, which goes in line with the company's strategy and with the percentage of previous years.

5.3.7. Net Financial Income

Net financial income is composed by Interest expense, Interest income and Other financial income/expenses.

	2011	2012	2013	2014	2015	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
Net Financial Income	12,44	-18,60	-23,49	-24,70	-45,60	-48,27	-52,54	-57,77	-63,47	-69,64	-73,71	-78,00	-82,53	-87,31	-92,36	-97,69
Financial Income	10,9	11,3	6,1	6,7	7,3	8,49	8,49	8,49	8,49	8,49	8,49	8,49	8,49	8,49	8,49	8,49
<i>as a % of loans and deposits</i>		32,29%	14,22%	16,03%	16,78%	16,78%	16,78%	16,78%	16,78%	16,78%	16,78%	16,78%	16,78%	16,78%	16,78%	16,78%
Financial Expenses	-0,4	-1,5	-1	-0,4	-0,7	-0,69	-0,67	-0,66	-0,65	-0,63	-0,62	-0,61	-0,60	-0,58	-0,57	-0,56
<i>as a % of borrowings</i>	-1,0%	-3,9%	-1,8%	-1,0%	-1,68%	-1,68%	-1,68%	-1,68%	-1,68%	-1,68%	-1,68%	-1,68%	-1,68%	-1,68%	-1,68%	-1,68%
Other expenses/revenues	1,9	-28,40	-28,60	-31,00	-52,20	-56,07	-60,35	-65,60	-71,31	-77,50	-81,58	-85,88	-90,42	-95,22	-100,28	-105,62
<i>as a % of revenues</i>	0,07%	-0,82%	-0,76%	-0,75%	-1,08%	-1,08%	-1,08%	-1,08%	-1,08%	-1,08%	-1,08%	-1,08%	-1,08%	-1,08%	-1,08%	-1,08%

Table 10: Net Financial Income Calculation. Source: Own calculations

For the interest expense, one assumed it a percentage of borrowings, whereas interest income it is assumed to be a percentage of loans and deposits of the previous year. Other financial income/expense, one had no information available, therefore it is assumed to be last year's percentage of revenues.

5.4. Discounted Cash Flows Valuation

In this section, one will explain the different valuation methods in more detail. Firstly, one will present the cost of capital; moreover, the FCFF, expected dividends and finally, EVA.

5.4.1. Cost of Capital

Hermès has a small portion of debt, yet, it cannot be considered a debt free company. For this reason, one will calculate the cost of capital by equation 5, taking into consideration the cost of equity, debt and the percentages of equity and debt.

Cost of Equity

The cost of equity was computed by equation 6, where risk-free, levered beta and market risk premium are taken into consideration.

For the risk-free, analysts favor German government bonds when the matter is an European company. Therefore, one used the current yield of this 10-year bond for the risk-free, -0,12%.

Regarding the market risk premium, 6% was used as it is a commonly accepted value among analysts.

When calculating the beta, one used four different techniques: the bottom-up beta, the regression beta with the Euronext index, the beta provided by Reuters and the beta provided by Damodaran.

Regarding the regression beta, one used daily data for two years, reaching a levered beta of 0,22. The levered beta provided by Damodaran was 1,06, whereas Reuters' levered beta for Hermès was 0,59.

From the methods mentioned above, one decided to use the bottom-up approach to determine Hermès' beta, as the latter do not seem reasonable or accurate.

For the peer group, one chose companies similar in capital structure.

Company Name	Beta Lev	Tax Rate	D/E	Beta Unlev
Swatch Group SA	1,19	20,2%	0,4%	1,18
Hermès International SCA	0,51	33,2%	1,1%	0,51
Burberry Group PLC	1,30	25,2%	3,3%	1,27
Tod's SpA	0,48	31,1%	9,7%	0,45
Compagnie Financiere Richemont SA	1,01	16,6%	16,5%	0,88
Average				0,86
Adjusted Unlevered Beta				0,91

Table 11: Beta calculation: Bottom-up approach. Source: Reuters and own calculations

After calculating the unlevered beta, one used the equation 10 to adjust the beta, reaching a value of 0,91 for the adjusted unlevered beta. Lastly, to calculate the levered beta, one used the equation 9, having a levered beta of 0,92 for Hermès.

Once all components were calculated, the value for cost of equity was calculated, attaining 5,43%.

Risk-free	-0,12%
Risk Premium	6,00%
Beta Levered	0,92
Cost of equity	5,43%

Table 12: Levered cost of equity calculation. Source: Own calculations

Cost of debt

The cost of debt was calculated with the equation 13. For the pre-tax cost of debt, one simply used the risk-free presented above and the spread.

Computing the spread did not follow the most widely used method. Typically, the spread is calculated according to the rating an agency (like Moody's) gives to the company's debt. In this case, the company did not disclose any information regarding their debt's rating. Thus, one computed the spread according to the interest coverage ratio:

$$\text{Interest coverage ratio} = \frac{\text{EBIT}}{\text{Net interest}} \quad (21)$$

Hermès interest coverage ratio is 35,66 and according to Damodaran, the corresponding spread is 0,75%. Lastly, adding these two components, one reaches a cost of debt of 0,63%.

WACC Calculation

After calculating the parcels of the cost of capital, one can finally compute the value of cost of capital. Applying equation 5, one reaches a cost of capital of 5,28%.

Cost of debt	0,63%
Cost of equity	5,43%
D/V	2,93%
E/V	97,07%
D/E	3,02%
Tax Rate	33,30%
WACC	5,28%

Table 13: WACC Calculation. Source: Own calculations

5.4.2. Free Cash Flows to the Firm

After estimating all the components, one was able to calculate FCFF as explained in equation 1.

	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
EBIT	1 721,27	1 847,38	2 005,30	2 177,31	2 363,93	2 477,72	2 599,87	2 734,28	2 881,26	3 041,18	3 209,34
Tax on EBIT	-573,18	-615,18	-667,76	-725,05	-787,19	-825,08	-865,76	-910,51	-959,46	-1 012,71	-1 068,71
D&A	173,17	191,75	211,16	231,98	254,36	278,44	301,69	320,72	335,71	346,77	359,11
CAPEX	-329,16	-354,31	-385,12	-418,62	-454,94	-472,08	-457,17	-439,41	-418,56	-440,80	-464,29
Δ in WC	31,57	-49,48	-61,28	-66,69	-72,31	-45,93	-48,85	-52,60	-56,49	-60,54	-63,78
FCFF	1 023,66	1 020,17	1 102,30	1 198,94	1 303,85	1 413,06	1 529,79	1 652,48	1 782,46	1 873,90	1 971,67

Table 14: FCFF Calculation 2016-2026. Millions of Euros. Source: Own Calculations

Furthermore, one discounted them at the WACC, calculated the terminal value and summed the parts, arriving to the enterprise value. To calculate the terminal value, one used a long-term growth rate of 1,5% and discounted it, as well, at the cost of capital.

After calculating the enterprise value, the non-operating assets (net of liabilities) were added, the Net Debt was deducted, as well as the minority interests. For the minority interests, one computed last year's minority interests plus the net income attributable to non-controlling interests.

For the calculation of Net Debt, one had to estimate the market value of debt. To do so, all debt elements were considered: borrowing and debt (current and non-current), a portion of provisions and derivatives financial instruments. For borrowings and debt, one assume it will decrease at a 2% rate, which seems reasonable as the company has small amounts of debt as source of financing. As the company becomes mature, this amount is expected to decrease and the company's financing to be only through own equity. Regarding provisions and derivatives, one will assume they will remain constant over time, as the company does not disclose enough information to estimate them.

All elements of debt were discounted at the cost of debt, arriving to a market value of debt of 1137 M€.

In M€	
PV FCFF	10960,75
PV TV	31664,37
Enterprise Value	42625,13
(+) Non-operating Assets (net of non-operating liabilities)	95,5
(-) Debt (Market Value)	-1137,03
(+) Cash	2079,19
(-) Minority Interest	-1,36
Equity Value	43661,43
<i>Shares outstanding</i>	<i>105,56</i>
Price per share	413,58€

Table 15: Output of FCFF Valuation. Source: Own calculations

After computing all the elements, one is able to arrive to a share price of Hermès: 413,6€. This is a price 8% higher than today's price of 381,90€ (25/11/2016), which results in a hold recommendation.

5.4.3. Dividend Discount Model

Using the DDM, aims at calculating directly the equity value, in order to determine the value of its shares. To do so, one will use equation 17 to determine the value during the explicit period, and equation 18 to estimate the terminal value.

Hermès has been distributing a lot of their earnings in dividends, having a dividend payout ratio of 45,86% on average (excluding extraordinary dividends paid in 2012). Therefore, one assumed the company will continue this policy and the dividend payout ratio will be 45% from now onwards.

Additionally, one assumes the capital structure of the company will remain stable and therefore, they will continue to finance dividends with equity, as it has been doing until now.

Dividends were estimated as being 45% of earnings, discounted at the cost of equity. For the terminal value of dividends, it seems reasonable to assume a long-term growth rate of 1,5%.

	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
Dividends per share	4,81	5,15	5,59	6,06	6,57	6,88	7,21	7,58	7,98	8,42	8,88
Earnings per share	10,69	11,45	12,41	13,46	14,59	15,28	16,03	16,84	17,74	18,71	19,73
	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%
PV(Dividends)	51,87										
PV(TV)	133,78										
Price	185,65€										

Table 16: Output of DDM Valuation. Source: Own calculations

The value reached was 185,65€, which is significantly lower than DCF approach. This shows one of DDM's pitfalls, it undervalues firms who accumulate cash, as it is Hermès' case. Thus, no recommendation will arise from this calculation.

5.4.4. Economic Value Added

To use the economic value added approach, one followed equation 19 and 20. When calculating the invested capital, one added the equity value plus non-current liabilities. For the ROIC calculation, one simply divided returns by the invested capital.

The cash flows were then discounted at WACC, summed with the terminal value, where a 1,5% long-term growth rate was used, and summed with 2016th invested capital.

In M€	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
Inv Capital	4259,86	4896,32	5582,45	6326,34	7133,01	7992,21	8892,62	9837,88	10832,39	11880,69	12986,51
ROIC	26,2%	24,5%	23,3%	22,3%	21,5%	20,1%	18,9%	18,0%	17,2%	16,6%	16,0%
WACC	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%
EVA	891,03	938,70	1004,32	1075,99	1153,77	1181,60	1212,68	1249,42	1291,77	1339,73	1387,97
PV (EVA)	9756,28										
PV (TV)	22322,42										
IC 2016	4259,86										
Equity Value	36338,56										
Price	344,21€										

Table 17: Output of EVA valuation. Source: Own calculations

A price of 344,21€ was reached, which is 10% lower than today's price. This different may arise from one of EVA's drawbacks, this method is based on performance measures rather than cash flows. The ROIC calculated might suffer from accounting distortions and, therefore, not reflect the actual Hermès' ROIC.

5.5. Relative Valuation

In this chapter, the valuation through multiples is going to be analyzed. To do so, a peer group was chosen, and the most popular and widely used multiples: P/E, EV/EBITDA and EV/EBIT, were applied.

The most critical part in this valuation method is to determine the peer group. This group must contain similar companies to the one being valued. The peer group for the relative valuation is different from the one chosen for the beta calculation, as for the first one should pay attention to the profitability of companies, as in the latter, one should look at the company's capital structure.

The first step is to choose companies in the same market and industry. To do so, 13 companies were extracted from Reuters.

Furthermore, a deeper analysis was performed, narrowing the group based on company's market capitalization, sales growth, ROIC, EBITDA Margin and ROE.

After this analysis, the peer group chosen was the one below:

Company Name	Company Market Cap	5Y CAGR Sales Growth	ROIC	EBITDA Margin	ROE
Hermès International SCA	40 709,72	9,4%	26,1%	35,8%	29,2%
Ferrari NV	9 653,56	16,4%	17,1%	25,2%	23,3%
Pandora A/S	12 941,78	21,9%	70,4%	37,1%	96,6%
Moncler SpA	3 835,78	12,4%	33,1%	34,1%	35,2%
Brunello Cucinelli SpA	1 202,56	10,9%	19,2%	17,1%	17,3%
LVMH	85 865,74	8,3%	16,5%	23,0%	15,5%
Lululemon Athletica Inc	7 267,63	15,8%	50,7%	21,6%	23,9%
H & M Hennes & Mauritz AB	39 529,63	7,4%	45,7%	18,4%	34,4%

Table 18: Peer group analysis. Source: Reuters

Moreover, and as recommended by the literature, the most accurate method to perform a relative valuation is by using forward multiples, extracted from Reuters' terminals.

Rather than a simple average of multiples, a weighted average was performed, based on the market capitalization. The companies were initially narrowed by this variable but there are still significant differences. The result is presented in the table below:

Company Name	EV/EBITDA	P/E	EV/EBIT
Hermès International SCA	19,39	34,11	21,71
Ferrari	12,93	23,19	18,14
Pandora A/S	11,65	14,52	12,52
Moncler SpA	10,82	18,42	12,46
Brunello Cucinelli SpA	15,38	29,84	21,19
LVMH Moët Hennessy Louis Vuitton SE	10,22	19,88	12,76
Lululemon Athletica Inc	13,00	23,35	15,46
H & M Hennes & Mauritz AB	10,64	20,77	13,98
Average	12,09	21,42	15,22
Weighted Average	10,00	18,67	12,45

Table 19: Multiples. Source: Reuters

By looking at the table, one can also conclude that Hermès is more expensive than its peers, having the highest ratio in every multiple. This might reflect that analysts are anticipating the reaction of the market, generated by a possible increase in profitability by Hermès.

Finally, the following table gives Hermès' relative valuation:

in M€	EV/EBITDA	P/E	EV/EBIT
Enterprise Value	18 952,75	21 061,19	21 431,03
(-) Debt (Market Value)	-1 137,03	-	-1 137,03
(+) Cash	2 079,19	-	2 079,19
(-) Minority Interest	-1,36	-	-1,36
Equity Value	19 893,55	21 061,19	22 371,83
#shares	105,57	105,57	105,57
Price	188,44	199,50	211,92

Table 20: Multiples' calculation. Source: Own calculations

The share prices obtained through this valuation were 188,44€ using EV/EBITDA, 199,50€ using P/E and 211,92€ using EV/EBIT, which were much lower than using DDM, DCF, EVA or the actual share price. The main reason for that is the impossibility to find comparable companies to Hermès, due to its uniqueness.

Yet, relative valuation is only used as a validation tool, therefore it will not be present in one's recommendations.

5.6. Sensitivity Analysis

The output of a valuation depends on the assumptions made, therefore, it is important to study how much certain variables are sensitive to changes. As the target price will be the DCF valuation, our sensitivity analysis will be based on this method.

Firstly, one examines how combined variations of 0,25% in WACC and 0,5% in the growth rate, affect the share price. Afterwards, one constructed pessimistic and optimistic scenarios with 2% changes in the variables, to analyze the changes in the share price.

WACC/g	0,5%	1,0%	1,5%	2,0%	2,5%	3,0%
3,28%	614,73	724,91	897,01	1 203,55	1 903,09	5 101,01
3,53%	562,04	651,19	784,25	1 004,28	1 437,93	2 689,80
3,78%	517,43	590,77	696,27	861,05	1 154,55	1 824,34
4,03%	479,18	540,37	625,73	753,15	963,84	1 379,09
4,28%	446,03	497,68	567,91	668,95	826,75	1 107,83
4,53%	417,02	461,08	519,68	601,44	723,47	925,26
4,78%	391,43	429,35	478,83	546,10	642,88	794,03
5,03%	368,70	401,59	443,79	499,93	578,25	695,15
5,28%	348,48	377,22	413,58	461,03	525,55	618,38
5,53%	330,18	355,45	386,98	427,46	481,30	556,43
5,78%	313,64	335,97	363,52	398,36	443,82	505,65
6,03%	298,62	318,45	342,66	372,89	411,68	463,27
6,28%	284,91	302,61	324,01	350,42	383,81	427,38

Table 21: Sensitivity Analysis with WACC and growth rate. Source: Own calculations

By looking at the table, direct conclusions can be drawn. As the WACC increases, the share price decreases, and as the growth rate increases, the share price increases. Moreover, one can conclude that minor changes in the growth rate and WACC, can induce significant changes in the share price.

	Pessimistic Scenario (-2%)	Base Case	Optimistic Scenario (+2%)
Revenues Growth	351,05€	413,58€	487,31€
% Of change	-15,1%		17,8%
	Pessimistic Scenario (+2%)	Base Case	Optimistic Scenario (-2%)
Selling Marketing and Administrative Expenses	158,29€	413,58€	519,34€
% Of change	-61,7%		25,6%
Depreciation & Amortization	413,68€	413,58€	413,32€
% Of change	0,0%		-0,1%
CAPEX	379,04€	413,58€	448,11€
% Of change	-8,4%		8,3%
Working Capital	409,13€	413,58€	421,53€
% Of change	-1,1%		1,9%
	Pessimistic Scenario (+1%)	Base Case	Optimistic Scenario (-1%)
Risk-free	316,91€	413,58€	542,08€
% Of change	-23,4%		31,1%

Table 22: Sensitivity Analysis. Source: Own calculations

After performing a more detailed analysis, one can draw some conclusions. Firstly, this valuation is more sensitive to changes in selling, marketing and administrative expenses than in revenues growth, both in pessimistic and optimistic scenarios.

Furthermore, the risk free is also a variable that affects a lot the outcome of this valuation. Nowadays this rate is negative, but as we can see, a small change will make the share price fluctuate significantly, 31,1% in the optimistic scenario and 23,4% in the pessimistic scenario.

Lastly, one can also observe the almost zero variance in the share price, when fluctuations in depreciation and amortization or working capital occur.

5.7. Recommendations

Due to the drawbacks of the relative valuation and DDM, recommendations will only be based on DCF and EVA. The results of Hermès' DCF valuation show an 8% increase in the share price, while results of EVA show a 10% decrease.

This leads us to a Market-perform recommendation, since we expect the stock to perform in line with the market, with a maximum variance of 15%, in the next 12 months; the target price will be the output of the DCF valuation, 413,58€/share.

6. Equity Research Comparison

In this last section, one will compare the valuation from this dissertation to the valuation performed by Bernstein in September 2016.

The Equity Research Company suggests a “Market perform” recommendation, which means that the stock will perform in coherence with the market, with fluctuations of maximum 15%.

The report presents two valuations for Hermès, one with P/E multiple, reaching a target price of 315€/share; another with DCF, reaching a target price of 274€/share. Nevertheless, both prices are lower than today’s actual share price of 381,90€.

The values also differ from this dissertation’s results, and it is important to denote some dissimilarities. Bernstein recommendation is the result of a DCF and a P/E valuation. While the dissertation’s recommendation is based on DCF and EVA techniques.

Furthermore, the explicit period is also different. Our consideration was 2016-2026, while Bernstein considered 2015-2020. Likewise, the CAPEX’s estimations are also different, as Bernstein’s are lower than ours.

Yet, regarding gross and EBIT margin, both the dissertation and the report have similar values (around 68% and 33%, respectively)

	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
Revenue growth											
Dissertation	7,42%	7,64%	8,70%	8,70%	8,67%	5,27%	5,28%	5,29%	5,30%	5,32%	5,33%
Bernstein	6,60%	7,70%	7,50%	7,50%	7,50%	N/A	N/A	N/A	N/A	N/A	N/A
EBIT Margin											
Dissertation	33%	33%	33%	32%	33%	33%	33%	33%	33%	33%	33%
Bernstein	33%	33%	33%	33%	33%	N/A	N/A	N/A	N/A	N/A	N/A
CAPEX											
Dissertation	-329	-354	-385	-418	-454	-472	-457	-439	-418	-440	-464
Bernstein	-278	-299	-321	-345	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Table 23: Comparison with equity research report. Source: Bernstein report 15/09/2016

Moreover, and taking a closer look at the DCF valuation, one can easily see the differences. The report uses a WACC of 7,3%, while our WACC is 5,28%. This difference can be a result of the present negative risk free rate. Additionally, Bernstein uses a beta of 0.72, while our dissertation uses a levered beta of 0.92.

Finally, the long-term growth in the terminal value considered by Bernstein was 2,5%, which can be too optimistic and perhaps, beyond GDP. Our estimate was of 1,5%.

Analyzing the P/E valuation, Bernstein did an estimate of P/E ratio based on the premium at which Hermès trades, in relation to the Luxury Coverage P/E. Hermès’ P/E ratio would therefore be, 16 plus a 62% premium, reaching a value of 315€/share. Here lies the main

difference between Bernstein and our valuation: in this dissertation, comparable companies were used, reaching a peer P/E of 18,67; while Bernstein used a P/E of 26.

Thus, these differences in the prices are justified by dissimilarities in assumptions, rates and methods of calculation.

7. Conclusion

By performing this equity valuation, we were able to know more in depth the luxury goods industry, as well as its main drivers of growth, profitability and risk.

Through the DCF methodology, we reached a price target of 413,58€/share, which represents an 8% increase in relation to today's price, 381,90€. According to the literature, we found it more realistic than basing our recommendation in multiples, EVA and DDM, as DCF is the most reliable tool.

The target price represents a Market-Perform estimation, the same recommendation as given by Bernstein, besides the several dissimilarities in assumptions for discount rates, betas and time period.

However, the current risk-free rate is negative, what may question if DCF methodology is, in fact, the best measure for equity valuation.

8. Appendixes

1) PESTEL Analysis

Political	Economic
<ul style="list-style-type: none"> - Politics play a fundamental role in foreign trade - Emerging markets have restrict policies about luxury goods 	<ul style="list-style-type: none"> - An economic boom in emerging markets are driving the demand for luxury goods - Recent Brexit
Social	Technological
<ul style="list-style-type: none"> - Geographical segmentation divides market into the various geographic areas - Targeting people with high income - Brand value and premium services attract customers 	<ul style="list-style-type: none"> - Production technology is not a key point – focusing on craftsmanship - Involving high technological products – Apple watch - Online advertising goes up - Gathering reviews in various online forums.
Environmental	Legal
<ul style="list-style-type: none"> - Environmental damages: toxins used in tanning leather - Environmental protection: reducing water consumption, respecting the land and optimizing the consumption of raw materials 	<ul style="list-style-type: none"> - Anti-counterfeiting trade agreement - Shares battle with LVMH - Most leather comes from developing countries where animal welfare laws are either non-existent or not enforced

2) Historical Income Statement

	2011	2012	2013	2014	2015
Revenue	2 841,20	3 484,10	3 754,76	4 118,60	4 841,00
<i>France</i>	495	556	613	644	684
<i>Rest of Europe</i>	560	662	737	800	906
<i>Japan</i>	472	545	463	484	600
<i>Asia Pacific</i>	808	1100	1248	1405	1694
<i>Americas</i>	464	569	627	711	884
<i>Other</i>	43	53	66	75	73
Cost of sales	-886,40	-1 110,80	-1 170,34	-1 365,60	-1 642,50
Gross Margin	1 954,80	2 373,30	2 584,42	2 753,00	3 198,50
Selling, marketing and administrative expenses	-945,70	-1 130,84	-1 215,24	-1 253,20	-1 418,90
Other income and expense	-12,76	-6,74	-15,84	-54,60	-60,30
Current Operating Income (EBITDA)	996,34	1 235,72	1 353,34	1 445,20	1 719,30
Depreciation and Amortization	-111,10	-117,10	-135,30	-145,90	-178,60
Operating Income (EBIT)	885,24	1 118,62	1 218,04	1 299,30	1 540,70
Net financial income	12,44	-18,60	-23,49	-24,70	-45,60
Pre-tax income (EBT)	897,68	1 100,02	1 194,55	1 274,60	1 495,10
Income tax expense	-289,75	-349,10	-397,64	-423,70	-535,60
Net income from associates	-4,49	-0,40	2,00	12,40	17,70
Consolidated Net Income	603,44	750,52	798,91	863,30	977,20
Net income attributable to non-controlling interests	-9,15	-10,59	-8,61	-4,50	-4,60
Net Income attributable to owners of the parent company	594,29	739,93	790,30	858,80	972,60
Earnings per share	5,68	7,11	7,59	8,24	9,32
<i>n° of shares</i>	105,57	105,57	105,57	105,57	105,57
Diluted earnings per share	5,66	7,07	7,54	8,19	9,26

3) Historical Balance Sheet

In MC	2011	2012	2013	2014	2015
Non Current assets	1 377,19	1 603,00	1 688,40	1 976,59	2 092,40
Goodwill	38,69	79,30	51,35	37,35	37,90
Intangible Assets	96,70	101,60	108,85	117,45	122,30
PP&E	869,40	1 007,50	1 025,10	1 181,45	1 287,40
Investment Property	98,80	98,30	94,10	97,45	100,20
Financial assets	29,80	28,50	59,10	60,99	42,40
Investments in associates	12,90	25,80	44,50	91,30	85,40
Loans and deposits	35,00	42,90	41,80	43,50	50,60
Deferred tax assets	194,20	217,80	242,50	335,80	360,30
Other non-current assets	1,70	1,30	21,10	11,30	5,90
Current Assets	1 871,20	1 802,80	2 249,20	2 791,65	3 095,20
Inventories and work-in-progress	534,50	726,90	813,40	912,00	949,20
Trade and other receivables	175,70	207,10	193,60	249,25	303,00
Current tax receivables	0,80	0,80	5,80	8,70	31,80
Other current assets	94,40	116,60	115,70	140,70	183,00
Derivative financial instruments	17,60	54,40	67,00	39,40	39,00
Cash and cash equivalents	1 048,20	697,00	1 053,70	1 441,60	1 589,20
TOTAL ASSETS	3 248,39	3 405,80	3 937,60	4 768,24	5 187,60
Equity and Liabilities					
Equity	2 325,49	2 358,30	2 841,20	3 458,50	3 748,70
Share capital	53,80	53,84	53,80	53,80	53,80
Share premium	49,60	49,64	49,60	49,60	49,60
Treasury shares	-304,10	-313,25	-313,90	-266,90	-271,80
Reserves	1 881,20	1 742,24	2 248,70	2 719,50	2 750,30
Foreign currency translation adjustments	67,10	46,00	-33,40	47,70	165,30
Financial instruments attributable to equity	-29,10	26,00	30,50	-13,50	22,20
Net income attributable to owners of the company	594,29	739,93	790,30	858,80	972,60
Non-controlling interests	12,70	13,90	15,60	9,50	6,70
Non-current liabilities	147,60	183,60	216,40	265,84	281,70
Borrowings and debt	18,40	23,70	24,60	19,50	11,40
Provisions	14,50	16,40	14,70	2,74	2,60
Post-employment and other employee benefit obligations	60,80	66,50	83,20	123,80	155,00
Deferred tax liabilities	17,50	23,00	25,70	31,20	50,70
Other non-current liabilities	36,40	54,00	68,20	88,60	62,00
Current liabilities	775,30	863,90	880,00	1 043,90	1 157,20
Borrowings and debt	20,50	14,70	32,00	21,80	30,15
Provisions	28,80	33,20	26,60	36,90	58,80
Post-employment and other employee benefit obligations	6,20	3,70	5,30	5,10	4,80
Trade and other payables	299,70	345,50	362,10	398,60	440,30
Derivative financial instruments	58,30	19,30	15,60	73,10	37,10
Current tax liabilities	89,90	124,10	94,80	121,40	115,00
Other current liabilities	271,90	323,40	343,60	387,00	471,05
Total Equity and Liabilities	3 248,39	3 405,80	3 937,60	4 768,24	5 187,60

4) GDP and Inflation Calculation

	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
GDP YoY growth France	2,70%	2,80%	2,66%	2,55%	2,50%	2,48%	2,48%	2,48%	2,48%	2,48%	2,46%
Inflation France	0,50%	0,75%	2,10%	2,10%	2,10%	2,10%	2,10%	2,10%	2,10%	2,10%	2,10%
<i>% of revenues in France</i>	<i>14,04%</i>	<i>13,96%</i>	<i>13,87%</i>	<i>13,77%</i>	<i>13,67%</i>	<i>13,61%</i>	<i>13,54%</i>	<i>13,48%</i>	<i>13,42%</i>	<i>13,35%</i>	<i>13,28%</i>
GDP YoY growth Japan	0,65%	0,64%	0,76%	0,88%	0,97%	1,04%	1,09%	1,14%	1,19%	1,23%	1,26%
<i>Inflation Japan</i>	<i>-0,20%</i>	<i>0,15%</i>	<i>1,70%</i>	<i>1,70%</i>	<i>1,70%</i>	<i>1,70%</i>	<i>1,70%</i>	<i>1,70%</i>	<i>1,70%</i>	<i>1,70%</i>	<i>1,70%</i>
<i>% of revenues in Japan</i>	<i>12,07%</i>	<i>11,75%</i>	<i>11,46%</i>	<i>11,19%</i>	<i>10,94%</i>	<i>10,74%</i>	<i>10,54%</i>	<i>10,36%</i>	<i>10,18%</i>	<i>10,00%</i>	<i>9,84%</i>
GDP YoY growth Europe excl France	2,74%	2,75%	2,62%	2,50%	2,43%	2,39%	2,37%	2,35%	2,34%	2,33%	2,33%
Inflation Europe excl France	0,80%	0,80%	2,00%	2,00%	2,00%	2,00%	2,00%	2,00%	2,00%	2,00%	2,00%
<i>% of revenues in Europe excl France</i>	<i>18,60%</i>	<i>18,49%</i>	<i>18,37%</i>	<i>18,22%</i>	<i>18,07%</i>	<i>17,98%</i>	<i>17,87%</i>	<i>17,77%</i>	<i>17,66%</i>	<i>17,55%</i>	<i>17,43%</i>
GDP YoY growth Asia-Pacific excl Japan	5,03%	5,03%	5,03%	5,03%	5,03%	4,11%	4,11%	4,11%	4,11%	4,11%	4,11%
Inflation Asia-Pacific excl Japan	2,00%	2,00%	2,80%	2,80%	2,80%	2,80%	2,80%	2,80%	2,80%	2,80%	2,80%
<i>% of revenues in Asia-Pacific excl Japan</i>	<i>35,55%</i>	<i>36,13%</i>	<i>36,73%</i>	<i>37,34%</i>	<i>37,97%</i>	<i>38,40%</i>	<i>38,83%</i>	<i>39,26%</i>	<i>39,70%</i>	<i>40,13%</i>	<i>40,57%</i>
GDP YoY growth Americas	3,17%	2,92%	2,75%	2,65%	2,59%	2,54%	2,52%	2,49%	2,48%	2,47%	2,46%
Inflation Americas	0,82%	1,54%	2,37%	2,49%	2,34%	1,60%	1,60%	1,60%	1,60%	1,60%	1,60%
<i>% of revenues in Americas</i>	<i>18,22%</i>	<i>18,15%</i>	<i>18,05%</i>	<i>17,93%</i>	<i>17,81%</i>	<i>17,74%</i>	<i>17,67%</i>	<i>17,59%</i>	<i>17,50%</i>	<i>17,41%</i>	<i>17,32%</i>
GDP YoY growth rest of the world	3,93%	3,78%	3,63%	3,51%	3,42%	3,35%	3,29%	3,24%	3,20%	3,16%	3,12%
Inflation rest of the world	3,00%	3,40%	3,40%	3,40%	3,40%	3,40%	3,40%	3,40%	3,40%	3,40%	3,40%
<i>% of revenues rest of the world</i>	<i>1,52%</i>	<i>1,52%</i>	<i>1,53%</i>	<i>1,53%</i>	<i>1,53%</i>	<i>1,54%</i>	<i>1,54%</i>	<i>1,55%</i>	<i>1,55%</i>	<i>1,55%</i>	<i>1,56%</i>
Weighted GDP growth	3,39%	3,38%	3,34%	3,31%	3,31%	2,96%	2,97%	2,97%	2,98%	2,99%	3,00%
Weighted Inflation	1,10%	1,32%	2,36%	2,39%	2,37%	2,24%	2,24%	2,25%	2,25%	2,26%	2,26%

5) Rating, Spread and Interest Coverage Ratio

<i>If interest coverage ratio is</i>			
>	≤ to	Rating is	Spread is
8.50	100000	Aaa/AAA	0.75%
6.5	8.499999	Aa2/AA	1.00%
5.5	6.499999	A1/A+	1.10%
4.25	5.499999	A2/A	1.25%
3	4.249999	A3/A-	1.75%
2.5	2.999999	Baa2/BBB	2.25%
2.25	2.499999	Ba1/BB+	3.25%
2	2.2499999	Ba2/BB	4.25%
1.75	1.999999	B1/B+	5.50%
1.5	1.749999	B2/B	6.50%
1.25	1.499999	B3/B-	7.50%
0.8	1.249999	Caa/CCC	9.00%
0.65	0.799999	Ca2/CC	12.00%
0.2	0.649999	C2/C	16.00%
-100000	0.199999	D2/D	20.00%

Source: Damodaran

6) Working Capital Calculation

Working capital	2011	2012	2013	2014	2015	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
Inventories	534,50	726,90	813,40	912,00	949,20	1 064,36	1 145,66	1 245,28	1 353,62	1 471,05	1 548,51	1 630,20	1 716,40	1 807,40	1 903,47	2 004,87
<i>Days of Inventories</i>	217,08	235,58	250,20	240,42	208,04	230,27	230,27	230,27	230,27	230,27	230,27	230,27	230,27	230,27	230,27	230,27
Receivables	175,70	207,10	193,60	249,25	303,00	308,77	332,36	361,26	392,69	426,76	449,23	472,93	497,94	524,33	552,20	581,62
Current tax receivables	0,80	0,80	5,80	8,70	31,80	10,12	10,90	11,84	12,88	13,99	14,73	15,51	16,33	17,19	18,11	19,07
Other current assets	94,40	116,60	115,70	140,70	183,00	177,17	190,70	207,28	225,32	244,86	257,75	271,35	285,70	300,85	316,84	333,72
Other non-current assets	1,70	1,30	21,10	11,30	5,90	10,12	10,90	11,84	12,88	13,99	14,73	15,51	16,33	17,19	18,11	19,07
Total receivables	272,60	325,80	336,20	409,95	523,70	506,19	544,85	592,23	643,76	699,60	736,44	775,29	816,29	859,57	905,25	953,48
<i>Days of Receivables</i>	34,54	33,66	32,23	35,83	38,94	35,04	35,04	35,04	35,04	35,04	35,04	35,04	35,04	35,04	35,04	35,04
Deferred Tax Assets	194,20	217,80	242,50	335,80	360,30	374,75	402,04	436,25	473,50	513,92	538,50	564,90	593,99	625,84	660,54	697,01
<i>as a % of EBT</i>	21,6%	19,8%	20,3%	26,3%	24,1%	22,4%	22,4%	22,4%	22,4%	22,4%	22,4%	22,4%	22,4%	22,4%	22,4%	22,4%
Trade and other Payables	299,70	345,50	362,10	398,60	440,30	502,65	541,05	588,10	639,26	694,72	731,30	769,88	810,59	853,56	898,93	946,82
Current tax liabilities	89,90	124,10	94,80	121,40	115,00	147,12	158,36	172,13	187,10	203,33	214,04	225,33	237,25	249,82	263,10	277,12
Other current liabilities	271,90	323,40	343,60	387,00	471,05	490,39	527,85	573,75	623,67	677,77	713,46	751,10	790,82	832,74	877,01	923,73
Other non-current liabilities	36,40	54,00	68,20	88,60	62,00	85,82	92,37	100,41	109,14	118,61	124,86	131,44	138,39	145,73	153,48	161,65
Total Payables	697,90	847,00	868,70	995,60	1 088,35	1 225,98	1 319,63	1 434,38	1 559,18	1 694,43	1 783,65	1 877,75	1 977,05	2 081,86	2 192,52	2 309,32
<i>Days of Payables</i>	283,44	274,50	267,21	262,46	238,54	265,23	265,23	265,23	265,23	265,23	265,23	265,23	265,23	265,23	265,23	265,23
Deferred tax liabilities	17,50	23,00	25,70	31,20	50,70	56,73	60,86	66,04	71,68	77,80	81,52	85,52	89,92	94,75	100,00	105,52
<i>as a % of EBT</i>	1,9%	2,1%	2,2%	2,4%	3,4%	3,4%	3,4%	3,4%	3,4%	3,4%	3,4%	3,4%	3,4%	3,4%	3,4%	3,4%
Provisions	18,70	19,50	13,80	13,70	17,40	17,40	17,40	17,40	17,40	17,40	17,40	17,40	17,40	17,40	17,40	17,40
Working Capital	267,20	381,00	483,90	617,25	676,75	645,18	694,66	755,93	822,62	894,94	940,87	989,72	1 042,32	1 098,80	1 159,34	1 223,12
Changes in WC	267,20	113,80	102,90	133,35	59,50	-31,57	49,48	61,28	66,69	72,31	45,93	48,85	52,60	56,49	60,54	63,78

Formulas used to compute Days of Inventories (DSI), Days of Sales Outstanding (DSO) and Days of Payables Outstanding (DPO):

$$DSI = \frac{\text{Inventories}}{\text{Cost of Sales}} * 360$$

$$DSO = \frac{\text{Accounts Receivables}}{\text{Revenues}} * 360$$

$$DPO = \frac{\text{Accounts Payables}}{\text{Cost of Sales}} * 360$$

7) Regression analysis using Reuters for determining Beta, using Hermès and Euronext Index

HRMS.PA ENX.PA ▼ 34.835 +1.520 +4.56% EUR

Regression Analysis

Updated at 13:03:51

Periodicity: Daily Start Date: 20 jun 2014 20 jun 2014 For Missing Data: Use Previous
 Use Intermediary Date: End Date: 00 10 nov 2016 Quick Beta Mode:
 Range From 20 jun 2014 To 10 nov 2016 Last Calculated at 13:04 (10/11/2016) **Calculate**

Regression Analysis

Variables Rows: Add Variable / Delete Variable (Note: the first row is the dependent variable.) Show Operator

Incl.	Transformation	Variables	Instrument RIC	FID 1	Scale	Lag
<input checked="" type="checkbox"/>	Ln Return	Y (Dependent)	HRMS.PA	Trade Price		0
<input checked="" type="checkbox"/>	Ln Return	X1	ENX.PA	Trade Price		0

Main Model Forecast Chart Data

1:1 Regression Outputs

Model Equation
 Y (Dependent) , X1 , is in return
 $HRMS.PA_{Trade Price,t} = 0.0004 + 0.2181 \times ENX.PA_{Trade Price,t}$

Model Regression Output

	RICs	Standardized	Standard Error	T-Test	P-Value	Sign
Alpha		0,00	0,00	0,67	0,505	.
X1	ENX.PA(Trade Price)	0,22	0,03	7,33	0,000	***

Sign Codes: 0 '****' 0.001 '**' 0.01 '*' 0.05 '.' '1''

Model Statistics

Observations: 614 Standard Error: 0,01 Multiple (R) (%): 28,41
 R-Squared (%): 8,07 R-Squared Adj (%): 7,92 $\frac{R^2 - R^2_{Adj}}{R^2}$ (%): 1,86

Model Analysis of Variance

	DF	SS	MS	F-Test	P-Value	DW
Regression Model	1	0,01	0,01	53,72	0,000	2,11
Residual	612	0,13	0,00			
Total	613	0,14	0,00			

8) Market Value of Debt

In M€	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
Borrowings and Debt	10,95	10,73	10,51	10,30	10,10	9,90	9,70	9,50	9,31	9,13
Provisions	44,00	44,00	44,00	44,00	44,00	44,00	44,00	44,00	44,00	44,00
Borrowings and Debt	29,00	28,42	27,86	27,30	26,75	26,22	25,69	25,18	24,68	24,18
Derivative financial instruments	37,10	37,10	37,10	37,10	37,10	37,10	37,10	37,10	37,10	37,10
Debt	121,05	120,25	119,47	118,70	117,95	117,21	116,49	115,78	115,09	114,41
Cost of Debt	0,63%	0,63%	0,63%	0,63%	0,63%	0,63%	0,63%	0,63%	0,63%	0,63%
Discounted Debt	120,29	118,75	117,24	115,76	114,30	112,88	111,48	110,11	108,76	107,45
Market Value of Debt	1137,03									
Market Capitalization	38786,2									

9) DCF Valuation

IN M€	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
EBIT	1847,38	2005,30	2177,31	2363,93	2477,72	2599,87	2734,28	2881,26	3041,18	3209,34
Tax on EBIT	-615,18	-667,76	-725,05	-787,19	-825,08	-865,76	-910,51	-959,46	-1012,71	-1068,71
Depreciation & Amortization	191,75	211,16	231,98	254,36	278,44	301,69	320,72	335,71	346,77	359,11
CAPEX	-354,31	-385,12	-418,62	-454,94	-472,08	-457,17	-439,41	-418,56	-440,80	-464,29
Changes in working capital	-49,48	-61,28	-66,69	-72,31	-45,93	-48,85	-52,60	-56,49	-60,54	-63,78
FCFF	1020,17	1102,30	1198,94	1303,85	1413,06	1529,79	1652,48	1782,46	1873,90	1971,67

In M€	
WACC	5,28%
PV(FCFF)	10960,75
PV(TV)	31664,38
Enterprise Value	42625,13
(+) Non operating Assets (net of non operating liabilities)	95,50
(-) Debt (Market Value)	-1137,03
(+) Cash	2079,19
(-) Minority Interest	-1,36
Equity value	43661,43
<i>Shares outstanding</i>	<i>105,57</i>
Price per share	413,58€

10) Dividend Discount Model Valuation

In M€	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
Net income	1209,14	1310,50	1420,92	1540,71	1613,55	1691,79	1778,01	1872,41	1975,23	2083,32
Shares	105,57	105,57	105,57	105,57	105,57	105,57	105,57	105,57	105,57	105,57
Dividends	544,11	589,73	639,41	693,32	726,10	761,30	800,10	842,58	888,85	937,49
Dividends per share	5,15€	5,59€	6,06€	6,57€	6,88€	7,21€	7,58€	7,98€	8,42€	8,88€

Cost of Equity	5,43%
PV(Div)	51,87
PV(TV)	133,78
Price	185,65 €

11) Economic Value Added Valuation

In M€	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
IC	4259,86	4896,32	5582,45	6326,34	7133,01	7992,21	8892,62	9837,88	10832,39	11880,69	12986,51
ROIC	26,2%	24,5%	23,3%	22,3%	21,5%	20,1%	18,9%	18,0%	17,2%	16,6%	16,0%
WACC	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%
EVA	891,03	938,70	1004,32	1075,99	1153,77	1181,60	1212,68	1249,42	1291,77	1339,73	1389,97

PV (EVA)	9756,28
PV (TV)	22322,42
IC 2016	4259,86
Equity value	36338,56
Price	344,21€

12) Peer Group Analysis

Company Name	Company Market Cap	5Y CAGR Sales Growth	ROIC	EBITDA Margin	ROE
Hermes International SCA	40.709,72	14,0%	26,1%	35,8%	29,2%
Ferrari NV	9.653,57	16,4%	17,1%	25,2%	23,3%
Pandora A/S	12.941,78	21,9%	70,4%	37,1%	96,6%
Moncler SpA	3.835,78	12,4%	33,1%	34,1%	35,2%
Salvatore Ferragamo SpA	3.481,13	6,7%	33,3%	22,8%	28,6%
Brunello Cucinelli SpA	1.202,57	10,9%	19,2%	17,1%	17,3%
LVMH Moet Hennessy Louis Vuitton SE	85.865,75	8,3%	16,5%	23,0%	15,5%
Kering SA	25.341,68	15,1%	3,9%	18,3%	6,3%
Tod's SpA	1.785,99	-2,1%	12,0%	19,1%	8,6%
Compagnie Financiere Richemont SA	31.363,39	-8,2%	9,5%	24,2%	7,2%
Swatch Group SA	15.105,04	1,1%	5,0%	22,0%	7,6%
Lululemon Athletica Inc	7.267,63	15,8%	50,7%	21,6%	23,9%
H & M Hennes & Mauritz AB	39.529,63	7,4%	45,7%	18,4%	34,4%

13) Peer Group Chosen

Company Name	EV/EBITDA	P/E	EV/EBIT
Hermes International SCA	19,39	34,11	21,71
Ferrari NV	12,93	23,19	18,14
Pandora A/S	11,65	14,52	12,52
Moncler SpA	10,82	18,42	12,46
Brunello Cucinelli SpA	15,38	29,84	21,19
LVMH Moet Hennessy Louis Vuitton SE	10,22	19,88	12,76
Lululemon Athletica Inc	13,00	23,35	15,46
H & M Hennes & Mauritz AB	10,64	20,77	13,98

14) Recommendations

Variation	Rating
Increase more than 15%	Outperform
Increase/decrease until 15%	Market-perform
Decrease more than 15%	Underperform

15) Forecasted Income Statement 2016-2026

	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
Revenue	5200,07	5597,27	6084,01	6613,33	7187,01	7565,46	7964,57	8385,74	8830,33	9299,68	9795,11
<i>France</i>	729,97	781,47	844,07	910,94	982,38	1029,39	1078,68	1130,41	1184,69	1241,57	1301,03
<i>Rest of Europe</i>	967,25	1034,99	1117,36	1205,27	1298,95	1359,93	1423,49	1489,85	1559,23	1631,79	1707,65
<i>Japan</i>	627,55	657,72	697,22	740,15	786,29	812,34	839,74	868,51	898,69	930,33	963,48
<i>Asia Pacific</i>	1848,79	2022,19	2234,49	2469,73	2729,16	2905,23	3092,79	3292,59	3505,44	3732,21	3973,81
<i>Americas</i>	947,67	1015,70	1097,98	1186,06	1280,14	1342,23	1407,00	1474,66	1545,37	1619,35	1696,83
<i>Other</i>	78,83	85,20	92,89	101,18	110,10	116,35	122,89	129,73	136,91	144,43	152,32
Cost of sales	-1664,02	-1791,13	-1946,88	-2116,27	-2299,84	-2420,95	-2548,66	-2683,44	-2825,70	-2975,90	-3134,44
Gross Margin	3.536,05	3.806,14	4.137,12	4.497,07	4.887,17	5.144,51	5.415,91	5.702,31	6.004,62	6.323,78	6.660,67
Selling, marketing and administrative expenses	-1.641,62	-1.767,01	-1.920,67	-2.087,77	-2.268,88	-2.388,35	-2.514,35	-2.647,31	-2.787,66	-2.935,83	-3.092,23
Other income and expense	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Current Operating Income (EBITDA)	1.894,43	2.039,13	2.216,46	2.409,30	2.618,29	2.756,16	2.901,56	3.055,00	3.216,97	3.387,96	3.568,45
Depreciation and Amortization	-173,17	-191,75	-211,16	-231,98	-254,36	-278,44	-301,69	-320,72	-335,71	-346,77	-359,11
Operating Income (EBIT)	1.721,27	1.847,38	2.005,30	2.177,31	2.363,93	2.477,72	2.599,87	2.734,28	2.881,26	3.041,18	3.209,34
Net financial income	-48,27	-52,54	-57,77	-63,47	-69,64	-73,71	-78,00	-82,53	-87,31	-92,36	-97,69
Pre-tax income (EBT)	1.673,00	1.794,84	1.947,52	2.113,85	2.294,29	2.404,02	2.521,87	2.651,75	2.793,95	2.948,83	3.111,65
Income tax expense	-557,11	-597,68	-648,53	-703,91	-764,00	-800,54	-839,78	-883,03	-930,39	-981,96	-1036,18
Net income from associates	17,70	17,70	17,70	17,70	17,70	17,70	17,70	17,70	17,70	17,70	17,70
Consolidated Net Income	1.133,59	1.214,86	1.316,70	1.427,64	1.547,99	1.621,18	1.699,79	1.786,42	1.881,26	1.984,57	2.093,17
Net income attributable to non-controlling interests	-5,34	-5,72	-6,20	-6,72	-7,29	-7,63	-8,00	-8,41	-8,86	-9,34	-9,85
Net Income attributable to owners of the parent company	1.128,25	1.209,14	1.310,50	1.420,92	1.540,71	1.613,55	1.691,79	1.778,01	1.872,41	1.975,23	2.083,32
Earnings per share	10,69	11,45	12,41	13,46	14,59	15,28	16,03	16,84	17,74	18,71	19,73
<i>n° of shares</i>	105,57	105,57	105,57	105,57	105,57	105,57	105,57	105,57	105,57	105,57	105,57

16) Forecasted Balance Sheet 2016-2026

In M€	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
Non Current assets	2267,07	2457,69	2666,80	2891,73	3133,84	3352,80	3535,45	3684,05	3799,62	3929,26	4071,88
Goodwill	37,90	37,90	37,90	37,90	37,90	37,90	37,90	37,90	37,90	37,90	37,90
Intangible Assets	131,43	141,31	152,41	164,77	178,41	191,58	204,54	217,50	230,65	244,11	258,01
PP&E	1.436,47	1.591,35	1.756,39	1.932,88	2.122,01	2.304,69	2.449,40	2.557,33	2.629,24	2.712,01	2.805,49
Investment Property	98,00	95,80	93,60	91,40	89,20	87,00	84,80	82,60	80,40	78,20	76,00
Financial assets	42,40	42,40	42,40	42,40	42,40	42,40	42,40	42,40	42,40	42,40	42,40
Investments in associates	85,40	85,40	85,40	85,40	85,40	85,40	85,40	85,40	85,40	85,40	85,40
Loans and deposits	50,60	50,60	50,60	50,60	50,60	50,60	50,60	50,60	50,60	50,60	50,60
Deferred tax assets	374,75	402,04	436,25	473,50	513,92	538,50	564,90	593,99	625,84	660,54	697,01
Other non-current assets	10,12	10,90	11,84	12,88	13,99	14,73	15,51	16,33	17,19	18,11	19,07
Current Assets	3.678,61	4.244,26	4.868,87	5.548,38	6.286,97	7.040,02	7.877,21	8.801,08	9.815,41	10.878,02	11.993,02
Inventories and work-in-progress	1.064,36	1.145,66	1.245,28	1.353,62	1.471,05	1.548,51	1.630,20	1.716,40	1.807,40	1.903,47	2.004,87
Trade and other receivables	308,77	332,36	361,26	392,69	426,76	449,23	472,93	497,94	524,33	552,20	581,62
Current tax receivables	10,12	10,90	11,84	12,88	13,99	14,73	15,51	16,33	17,19	18,11	19,07
Other current assets	177,17	190,70	207,28	225,32	244,86	257,75	271,35	285,70	300,85	316,84	333,72
Derivative financial instruments	39,00	39,00	39,00	39,00	39,00	39,00	39,00	39,00	39,00	39,00	39,00
Cash and cash equivalents	2.079,19	2.525,65	3.004,20	3.524,87	4.091,32	4.730,80	5.448,23	6.245,72	7.126,64	8.048,40	9.014,73
Total Assets	5.945,69	6.701,96	7.535,67	8.440,10	9.420,81	10.392,82	11.412,66	12.485,13	13.615,03	14.807,28	16.064,89
Equity	4.363,90	5.023,21	5.737,79	6.512,57	7.352,67	8.232,49	9.154,98	10.124,47	11.145,44	12.222,47	13.358,44
Share capital	53,80	53,80	53,80	53,80	53,80	53,80	53,80	53,80	53,80	53,80	53,80
Share premium	49,60	49,60	49,60	49,60	49,60	49,60	49,60	49,60	49,60	49,60	49,60
Treasury shares	-271,80	-271,80	-271,80	-271,80	-271,80	-271,80	-271,80	-271,80	-271,80	-271,80	-271,80
Reserves	3.215,19	3.799,33	4.418,74	5.089,83	5.817,43	6.632,04	7.484,28	8.375,96	9.311,39	10.294,95	11.332,68
Foreign currency translation adjustments	165,30	165,30	165,30	165,30	165,30	165,30	165,30	165,30	165,30	165,30	165,30
Financial instruments attributable to equity	22,20	22,20	22,20	22,20	22,20	22,20	22,20	22,20	22,20	22,20	22,20
Net income attributable to owners of the company	1.128,25	1.209,14	1.310,50	1.420,92	1.540,71	1.613,55	1.691,79	1.778,01	1.872,41	1.975,23	2.083,32
Non-controlling interests	1,36	-4,35	-10,55	-17,27	-24,56	-32,19	-40,19	-48,60	-57,46	-66,80	-76,65
Non-current liabilities	311,32	321,79	334,78	348,94	364,32	374,08	384,46	395,61	407,58	420,39	433,90
Borrowings and debt	11,17	10,95	10,73	10,51	10,30	10,10	9,90	9,70	9,50	9,31	9,13
Provisions	2,60	2,60	2,60	2,60	2,60	2,60	2,60	2,60	2,60	2,60	2,60
Post-employment and other employee benefit obligations	155,00	155,00	155,00	155,00	155,00	155,00	155,00	155,00	155,00	155,00	155,00
Deferred tax liabilities	56,73	60,86	66,04	71,68	77,80	81,52	85,52	89,92	94,75	100,00	105,52
Other non-current liabilities	85,82	92,37	100,41	109,14	118,61	124,86	131,44	138,39	145,73	153,48	161,65
Current liabilities	1270,46	1356,96	1463,10	1578,59	1703,82	1786,25	1873,22	1965,05	2062,01	2164,42	2272,55
Borrowings and debt	29,60	29,00	28,42	27,86	27,30	26,75	26,22	25,69	25,18	24,68	24,18
Provisions	58,80	58,80	58,80	58,80	58,80	58,80	58,80	58,80	58,80	58,80	58,80
Post-employment and other employee benefit obligations	4,80	4,80	4,80	4,80	4,80	4,80	4,80	4,80	4,80	4,80	4,80
Trade and other payables	502,65	541,05	588,10	639,26	694,72	731,30	769,88	810,59	853,56	898,93	946,82
Derivative financial instruments	37,10	37,10	37,10	37,10	37,10	37,10	37,10	37,10	37,10	37,10	37,10
Current tax liabilities	147,12	158,36	172,13	187,10	203,33	214,04	225,33	237,25	249,82	263,10	277,12
Other current liabilities	490,39	527,85	573,75	623,67	677,77	713,46	751,10	790,82	832,74	877,01	923,73
Total Equity and Liabilities	5.945,69	6.701,96	7.535,67	8.440,10	9.420,81	10.392,82	11.412,66	12.485,13	13.615,03	14.807,28	16.064,89

17) Forecasted Cash Flow Statement

	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
Adjusted EBIT	1.721,27	1.847,38	2.005,30	2.177,31	2.363,93	2.477,72	2.599,87	2.734,28	2.881,26	3.041,18	3.209,34
Taxes (33,3%)	-573,18	-615,18	-667,76	-725,05	-787,19	-825,08	-865,76	-910,51	-959,46	1.012,71	1.068,71
NOPAT	1.148,08	1.232,20	1.337,53	1.452,27	1.576,74	1.652,64	1.734,11	1.823,76	1.921,80	2.028,47	2.140,63
Depreciation and Amortisation	173,17	191,75	211,16	231,98	254,36	278,44	301,69	320,72	335,71	346,77	359,11
Operational Cash-flow	1321,25	1423,96	1548,69	1684,25	1831,10	1931,08	2035,81	2144,49	2257,51	2375,24	2499,74
CAPEX	-329,16	-354,31	-385,12	-418,62	-454,94	-472,08	-457,17	-439,41	-418,56	-440,80	-464,29
Net working capital	31,57	-49,48	-61,28	-66,69	-72,31	-45,93	-48,85	-52,60	-56,49	-60,54	-63,78
Free cash flow to the firm	1.023,66	1.020,17	1.102,30	1.198,94	1.303,85	1.413,06	1.529,79	1.652,48	1.782,46	1.873,90	1.971,67
Net financial income	-48,27	-52,54	-57,77	-63,47	-69,64	-73,71	-78,00	-82,53	-87,31	-92,36	-97,69
Interest Tax Shield (ITS)	16,07	17,49	19,24	21,13	23,19	24,54	25,97	27,48	29,07	30,76	32,53
Cash flow after net financial result	991,46	985,13	1.063,77	1.156,61	1.257,40	1.363,90	1.477,77	1.597,43	1.724,22	1.812,29	1.906,51
Change in Provisions	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Change in Derivatives	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Changes in Goodwill	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Change in Financial assets	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Change in Investments in associates	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Change in Loans and deposits	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Net income from associates	17,70	17,70	17,70	17,70	17,70	17,70	17,70	17,70	17,70	17,70	17,70
Net income attributable to non-controlling interests	-5,34	-5,72	-6,20	-6,72	-7,29	-7,63	-8,00	-8,41	-8,86	-9,34	-9,85
Change in Borrowings	-0,78	-0,82	-0,80	-0,78	-0,77	-0,75	-0,74	-0,72	-0,71	-0,69	-0,68
Other operating	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Change in Post Employment benefits	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Cash flow available to shareholders	1.003,04	996,29	1.074,47	1.166,80	1.267,05	1.373,22	1.486,73	1.606,00	1.732,36	1.819,96	1.913,68
Change in Capital	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Change in Treasury shares	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Change in Reserves											
Dividends	-507,71	-544,11	-589,73	-639,41	-693,32	-726,10	-761,30	-800,10	-842,58	-888,85	-937,49
Change others	-5,34	-5,72	-6,20	-6,72	-7,29	-7,63	-8,00	-8,41	-8,86	-9,34	-9,85
Net change in the period	489,99	446,46	478,55	520,67	566,44	639,49	717,42	797,49	880,92	921,76	966,33
Total Cash and Cash Equivalents at the end of the period	2.079,19	2.525,65	3.004,20	3.524,87	4.091,32	4.730,80	5.448,23	6.245,72	7.126,64	8.048,40	9.014,73



Equity research

Hermès International SCA

Hermès is a luxury goods company focused on high-end leather goods and silks. Besides the last difficult times for luxury companies, Hermès has been able to maintain the desirability for its products, as the famous Kelly and Birkin bags, with waiting lists of more than one year.

The recommendation presented is market-performing, with a target of 413,58€ per share. This is justified by Hermès' capability of preserving the trend of "flight to quality", besides difficult market conditions. Additionally, Hermès is a strong cash generator, and its EBIT Margin has been constant around 33%.

- 1) Store expansion is predicted to continue, shifting from franchised stores, to fully owned stores, which will increase the company's earnings.
- 2) Investment will remain high due to refurbishment and opening of stores
- 3) Unique company positioning, being a sole company compared to big conglomerates like LVMH.
- 4) Consistent EBIT and Gross margins, which suggests Hermès as a solid company.
- 5) Growth of Japan and Mainland China, as a main driver of company's profitability in Asia.
- 6) Accumulation of cash as a strategy to rapid and small investments, avoiding debt issuance.
- 7) Hermès' stock price has an increasing tendency in the past years

Market-Perform

RMS.PA

Price: 381,90€

Price target: 413,58€

Luxury goods

Company data

Price (€) 381,90

Date of the price 29/11/2016

Price target (€) 413,58

Market Cap (M€) 38 786,20

Shares outstanding (M) 105,57



Valuation

We value Hermès' equity through a DCF, DDM and EVA valuation, endorsed by performing a relative valuation, using a peer group. As the capital structure of Hermès has been constant over time, and as the level of debt is small, we chose not to use the APV valuation method.

Assumptions

<i>Cost of debt</i>	0,63%
<i>Cost of equity</i>	5,43%
<i>D/V</i>	2,93%
<i>E/V</i>	97,07%
<i>D/E</i>	3,02%
<i>Risk-free</i>	-0,12%
<i>MRP</i>	6%
<i>Beta Levered</i>	0,92
<i>Beta Unlevered</i>	0,91
<i>Ru</i>	5,32%
<i>Tax Rate</i>	33,30%
<i>WACC</i>	5,28%

1) DCF Valuation

<i>IN M€</i>	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
<i>EBIT</i>	1847,38	2005,30	2177,31	2363,93	2477,72	2599,87	2734,28	2881,26	3041,18	3209,34
<i>Tax on EBIT</i>	-615,18	-667,76	-725,05	-787,19	-825,08	-865,76	-910,51	-959,46	-1012,71	-1068,71
<i>Depreciation & Amortization</i>	191,75	211,16	231,98	254,36	278,44	301,69	320,72	335,71	346,77	359,11
<i>CAPEX</i>	-354,31	-385,12	-418,62	-454,94	-472,08	-457,17	-439,41	-418,56	-440,80	-464,29
<i>Changes in working capital</i>	-49,48	-61,28	-66,69	-72,31	-45,93	-48,85	-52,60	-56,49	-60,54	-63,78
<i>FCFF</i>	1020,17	1102,30	1198,94	1303,85	1413,06	1529,79	1652,48	1782,46	1873,90	1971,67

In M€

<i>PV(FCFF)</i>	10960,75
<i>PV(TV)</i>	31664,37
<i>Enterprise Value</i>	42625,13
<i>(+) Non operating Assets (net of non operating liabilities)</i>	95,5
<i>(-) Debt (Market Value)</i>	-1137,03
<i>(+) Cash</i>	2079,19
<i>(-) Minority Interest</i>	-1,36
<i>Equity value</i>	43661,43
<i>Shares outstanding</i>	105,57
<i>Price per share</i>	413,58

2) DDM Valuation

<i>In €</i>	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
<i>Dividends/share</i>	5,15	5,59	6,06	6,57	6,88	7,21	7,58	7,98	8,42	8,88
<i>Earnings/share</i>	11,45	12,41	13,46	14,59	15,28	16,03	16,84	17,74	18,71	19,73
<i>Dividend Payout ratio (DPR)</i>	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%
<i>PV (Dividends)</i>	51,87									
<i>PV (TV)</i>	133,78									
<i>Price per share</i>	185,65€									

3) EVA valuation

<i>In M€</i>	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
<i>Inv Capital</i>	4896,32	5582,45	6326,34	7133,01	7992,21	8892,62	9837,88	10832,39	11880,69	12986,51
<i>ROIC</i>	24,5%	23,3%	22,3%	21,5%	20,1%	18,9%	18,0%	17,2%	16,6%	16,0%
<i>WACC</i>	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%	5,28%
<i>EVA</i>	938,70	1004,32	1075,99	1153,77	1181,60	1212,68	1249,42	1291,77	1339,73	1387,97
<i>PV (EVA)</i>	9756,28									
<i>PV (TV)</i>	22322,42									
<i>IC 2016</i>	4259,86									
<i>Equity Value</i>	36338,56									
<i>Price per share</i>	344,21€									

4) Relative valuation

When compared to its peers, Hermès is more expensive, having higher ratios. There is no single company 100% comparable to Hermès, therefore this valuation will not be the base for a recommendation, being only a validation tool.

<i>Company Name</i>	EV/EBITDA	P/E	EV/EBIT
<i>Hermès International SCA</i>	19,39	34,11	21,71
<i>Ferrari</i>	12,93	23,19	18,14
<i>Pandora A/S</i>	11,65	14,52	12,52
<i>Moncler SpA</i>	10,82	18,42	12,46
<i>Brunello Cucinelli SpA</i>	15,38	29,84	21,19
<i>LVMH</i>	10,22	19,88	12,76
<i>Lululemon Athletica Inc</i>	13,00	23,35	15,46
<i>H & M Hennes & Mauritz AB</i>	10,64	20,77	13,98
<i>Average</i>	12,09	21,42	15,22
<i>Weighted Average</i>	10,00	18,67	12,45

<i>in M€</i>	EV/EBITDA	P/E	EV/EBIT
<i>Enterprise Value</i>	18 952,75	21 061,19	21 431,03
<i>(-) Debt (Market Value)</i>	-1 137,03	-	-1 137,03
<i>(+) Cash</i>	2 079,19	-	2 079,19
<i>(-) Minority Interest</i>	-1,36	-	-1,36
<i>Equity Value</i>	19 893,55	21 061,19	22 371,83
<i>#shares</i>	105,57	105,57	105,57
<i>Price per share</i>	188,44	199,50	211,92

Risks

- 1) **The demand for lower prices:** Consumers are much more sensitive to prices than before. This is a challenge for companies, as they need to keep delivering value but with a price constraint, if they do not want to lose customers.
- 2) **Tourism flows:** Taking as an example the attacks occurred in Paris, last year, one can easily see how tourism affects the luxury goods' consumption. The attacks affected tourism, as less people visited Paris after them, making consumption decrease.
- 3) **Currency fluctuations:** Besides not having them into account in the present work, currency fluctuations have strengthened price differences among countries, which change consumers' behavior in this industry. As Hermès' activity is widely spread around the world, low power currencies, as Japan Yen, will diminish profits and affect Hermès' results.

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