Kering

Price EUR159.35

2016: a year of profitability improvement and net debt reduction

Fair Value EUR180 (+13%) **BUY**

Bloomberg	PP FP
Reuters	PRTP.PA
12-month High / Low (EUR)	197.0 / 139.1
Market Cap (EUR)	20,121
Ev (BG Estimates) (EUR)	23,951
Avg. 6m daily volume (000)	366.1
3y EPS CAGR	5.8%

	1 M	3 M	6 M	31/12/15
Absolute perf.	5.9%	-4.6%	-4.8%	0.9%
Pers & H/H Gds	3.4%	-6.7%	-2.8%	-2.8%
DJ Stoxx 600	-2.0%	-14.3%	-14.4%	-10.8%

YEnd Dec. (EURm)	2014	2015e	2016e	2017e
Sales	10,037	11,584	12,210	12,800
% change		*15.4%*	*5.4%*	*4.8%*
EBITDA	2,044	2,056	2,305	2,510
EBIT	1,664	1,646	1,885	2,070
% change		*-1.1%*	*14.5%*	*9.8%*
Net income	1,177	1,017	1,238	1,403
% change		*-13.6%*	*21.7%*	*13.3%*

	2014	2015e	2016e	2017e
Operating margin	16.6	14.2	15.4	16.2
Net margin	11.7	8.8	10.1	11.0
ROE	10.5	8.7	9.6	10.2
ROCE	6.7	5.8	6.9	7.4
Gearing	39.0	37.7	27.1	21.9

(EUR)	2014	2015e	2016e	2017e
EPS	9.31	8.05	9.79	11.01
% change	-	*-13.6%*	*21.7%*	*12.4%*
P/E	17.1x	19.8x	16.3x	14.5x
FCF yield (%)	2.8%	1.4%	3.5%	4.5%
Dividends (EUR)	4.00	4.00	4.40	5.00
Div yield (%)	2.5%	2.5%	2.8%	3.1%
EV/Sales	2.4x	2.1x	1.9x	1.8x
EV/EBITDA	11.7x	11.6x	9.9x	8.9x
EV/EBIT	14.4x	14.6x	12.2x	10.8x

After 2015 was marked by a sales rebound at Gucci in Q4, but generally disappointing profitability and FCF, Kering's CEO was very clear at Friday's analysts' meeting: in 2016 the focus will be on margin recovery and CF generation in order to reduce the net debt level. We are maintaining our Buy recommendation and our FV of EUR180.

ANALYSIS

- **A look back at 2015 figures**: we would highlight three factors: **i/** the Gucci rebound in Q4 (+4.8% vs -0.4% in Q3) was driven by Alessandro Michele's new collections that accounted for 30% of sales and were up double digit and with no higher weight of markdown. Brand transformation is well on track. 34 stores have been renovated with the new store concept, including the Milano Via Montenapoleone flagship, which was welcomed warmly by clientele; **ii/** the Asia-Pacific region of the luxury division improved in Q4 with 2% organic sales growth versus -12% in Q3 (-17% for Gucci), helped by slightly better momentum in Mainland China while the situation remained very challenging in Hong Kong and Macau. Note that all of Kering's luxury competitors witnessed the same trend in MC. Could this be the first stage of a return to normal in the country? If it is, it should be a very positive catalyst for the luxury sector. While it is perhaps too soon to tell, we would remain cautious and wait for Q1 2016 figures; **iii/** Luxury EBIT margin narrowed by 290bp to 21.7%, 40% of which 40 due to a FX impact including a negative hedging impact (50% at Gucci).
- **What can we expect for 2016?:**
  - Clearly 2016 could be the year of the Gucci sales growth recovery. Actually, in Q1, the new collection should account for 50% of sales, rising to 100% by the end of the year and this is quite promising given the strong welcome for the new Alessandro Michele collection. Furthermore, 60 stores (on a total of 525 stores at the end of 2015) should be renovated to adopt the new store concept that should be a catalyst for sales momentum. At this stage, we anticipate a 5% FY organic sales increase for the group's iconic brand with a very undemanding comparison basis in Q1 (-8% in Q1 2015). This implies almost 6% growth for the luxury division and combined with 8% at Puma (in line with HSD guidance) this should lead to +6.2% for the Kering group.
  - The second point is the focus on profitability for all the luxury brands and first of all for Gucci and Bottega Veneta, that Kering's management admitted were dispointing last year with a 290bp decline for the luxury division to 21.7% of which -370bp for Gucci (26.5%). Gucci's management wants to improve store productivity and will not open new stores at Gucci this year (net of closing) after +20 in 2015. Some stores have already been closed in MC and in HK for Gucci and BV and we are not ruling out further decisions. Even if for Gucci the target is to return to the 30% level, we do not expect this to happen this year! At this stage, we expect EBIT margin to be up 110bp to 15.3%.
  - The third point is FC generation. After the disappointing level of EUR600m in 2015, management expects to reach FCF of close to EUR1bn that could allow Kering to reduce its net debt. The ultimate target is to deliver a net debt/EBITDA ratio below 2x versus 2.28x in 2015 and finally, to implement a more aggressive distribution policy (after stability in 2015). Consequently, do not expect any acquisitions in 2016 (which is good news in our view, as there is already enough work to do with existing brands!).

VALUATION

- Buy recommendation and EUR180 FV unchanged. The stock has gained 6% over the last month and has outperformed DJ Stoxx by 8%.

NEXT CATALYSTS

- Q1 sales due out in April.

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