

Hermès Intl.

Price EUR320.00

Ebit margin expansion expected in 2016!**Fair Value EUR360 (+13%)****BUY**

Bloomberg	RMS FP
Reuters	HRMS.PA
12-month High / Low (EUR)	363.4 / 291.6
Market Cap (EURm)	33,782
Ev (BG Estimates) (EURm)	32,482
Avg. 6m daily volume (000)	55.70
3y EPS CAGR	14.6%

We assume that 2016 sales should increase by 7.5% organically, slightly below the MT target (+8%). While 2015 EBIT margin was up 30bp despite a negative hedging impact, we expect profitability to improve more strongly in 2016 (+70bp to 32.5%). We reiterate our Buy recommendation with an unchanged EUR360 FV.

ANALYSIS

- **2015 EBIT grew 19% to EUR1.54bn, implying a 30bp gain in EBIT margin to 31.8%**, globally in line with company guidance (“close to 2014 level of 31.5%”). This slight improvement was achieved despite a gross margin decline of 80bp to 66.1% due to a negative hedging impact even if a positive product (strong performance of leather goods sales with a 12.6% increase) and distribution mix (retail sales outperformed) had a positive impact on GM level. Total OPEX grew 14% and accounted for 34.2% of sales versus 35.3% in 2014. The positive operating leverage impact stemmed from cost control and also 8% organic sales growth. Communication costs remained almost stable and declined as a % of sales (4.4% vs 5.0% in 2014) as in 2015 the group did not launch any major perfumes and 2014 was affected by heavy investments linked to the opening of the Shanghai Maison. Furthermore, SG&A declined also as % of sales (25% vs 26.3%).
- **Last year, net cash reached EUR1.57bn versus EUR1.42bn in 2014**, thanks to strong Cash Flow increase (+16% to EUR1.22bn) and also lower cap ex (EUR267m versus EUR325m in 2014), despite EUR840m dividends paid including around EUR500m linked to the EUR5 per share exceptional dividend.
- **For 2016, we expect organic sales growth 7.5%**, slightly below the 8% MT target, given current uncertainties on macro economic prospects and also geopolitics risks. Q1 will be again br affected in France by the tragic events in November, as activity in Paris has not yet fully recovered the pre-attacks level. Leather goods sales should grow 10% thanks to a production capacity increase of around 7%. Actually, each year, the group hires 250/300 new craftsmen. Each new plant is fully operational within 18/24 months. There are close to 15 workshops in France, a last one (Héricourt, east of France) was inaugurated in Q4. Hermès will be cautious in pricing policy with a 3% increase in Europe but not in other regions, in order to reduce the pricing gap. Furthermore in 2016, Hermès should open four new stores including one in mainland China in a “new” city (Chongking) for the brand, one in Rio (a small one), one in Macau and lastly a store in Hong Kong airport. Beyond these openings, Hermès will renovate and expand around 15 to 20 stores (Roma, Liat Tower in Singapore, Hawaii...).
- **In our view, 2016 EBIT margin should increase by 70bp to 32.5%** (management did not give any guidance on 2016 profitability), partly thanks to a positive hedging impact while 2015 suffered a negative effect (-50bp on EBIT margin) and also thanks to cost control as was already the case in 2015 (with no major store openings). Furthermore, net cash should reach around EUR1.9bn in 2016 in our view, allowing management to be more aggressive in terms of dividend policy. We do not rule out a new “exceptional” dividend that should be paid in 2017 given the fact that Hermès is very cautious in terms of M&A.

	1 M	3 M	6 M	31/12/15
Absolute perf.	-0.1%	3.0%	1.2%	2.6%
Pers & H/H Gds	2.2%	-0.9%	4.7%	-1.1%
DJ Stoxx 600	3.7%	-7.2%	-2.0%	-7.0%

YEnd Dec. (EURm)	2014	2015e	2016e	2017e
Sales	4,119	4,841	5,225	5,700
% change		17.5%	7.9%	9.1%
EBITDA	1,365	1,605	1,761	2,045
EBIT	1,299	1,541	1,698	1,885
% change		18.6%	10.2%	11.0%
Net income	858.1	973.0	1,145	1,290
% change		13.4%	17.7%	12.7%

	2014	2015e	2016e	2017e
Operating margin	31.5	31.8	32.5	33.1
Net margin	20.8	20.1	21.9	22.6
ROE	24.9	26.8	27.6	25.4
ROCE	41.3	41.4	42.6	42.5
Gearing	4.5	4.2	3.7	3.0

(EUR)	2014	2015e	2016e	2017e
EPS	8.16	9.26	10.89	12.27
% change	-	13.4%	17.7%	12.7%
P/E	39.2x	34.6x	29.4x	26.1x
FCF yield (%)	2.0%	2.4%	2.7%	NM
Dividends (EUR)	7.95	3.35	4.00	4.55
Div yield (%)	2.5%	1.0%	1.3%	1.4%
EV/Sales	7.9x	6.7x	6.2x	5.6x
EV/EBITDA	23.7x	20.2x	18.3x	15.5x
EV/EBIT	24.9x	21.1x	19.0x	16.8x

**VALUATION**

- **Hermès' share price has gained 3% YTD** and has outperformed the DJ Stoxx by 9%. The stock is trading at 19x on 2016 EV/EBIT vs 12.4x for our luxury sample average. We reiterate our Buy recommendation with an unchanged EUR360 FV.

NEXT CATALYSTS

- Q1 2016 sales to be reported on April 28th.

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