31st March 2016

Luxury & Consumer Goods

Richemont

Price CHF64.15

Cartier watch inventories buy-back likely in HK….

Fair Value CHF81 vs. CHF90 (+26%) **BUY**

Bloomberg	CFR VX
Reuters	CFR.VX
12-month High / Low (CHF)	86.9 / 60.8
Market Cap (CHFm)	35,924
Ev (BG Estimates) (CHFm)	27,925
Avg. 6m daily volume (000)	1,749
3y EPS CAGR	17.1%

	1 M	3 M	6 M	31/12/15
Absolute perf.	0.5%	-11.0%	-15.3%	-11.0%
Pers & H/H Gds	2.4%	-0.3%	4.0%	0.4%
DJ Stoxx 600	2.2%	-7.2%	-1.9%	-6.7%

YEnd Mar. (EURm)	03/15	03/16e	03/17e	03/18e
Sales	10,410	11,160	11,460	12,290
% change		*7.2%*	*2.7%*	*7.2%*
EBITDA	3,060	2,660	2,750	3,125
EBIT	2,436	2,250	2,340	2,715
% change		*-7.6%*	*4.0%*	*16.0%*
Net income	1,336	1,770	1,800	2,145
% change		*32.5%*	*1.7%*	*19.2%*

	03/15	03/16e	03/17e	03/18e
Operating margin	23.4	20.2	20.4	22.1
Net margin	12.8	15.9	15.7	17.5
ROE	9.3	10.3	9.0	9.4
ROCE	23.3	18.9	17.7	19.2
Gearing	-39.6	-42.6	-45.8	-48.6

(EUR)	03/15	03/16e	03/17e	03/18e
EPS	2.39	3.16	3.21	3.83
% change	-	*32.5%*	*1.7%*	*19.2%*
P/E	24.6x	18.6x	18.3x	15.3x
FCF yield (%)	4.5%	7.5%	8.3%	9.4%
Dividends (EUR)	1.60	1.85	2.10	2.20
Div yield (%)	2.7%	3.2%	3.6%	3.7%
EV/Sales	2.6x	2.3x	2.1x	1.8x
EV/EBITDA	8.9x	9.6x	8.6x	7.0x
EV/EBIT	11.2x	11.4x	10.2x	8.0x

Given the high level of watch inventories in HK, including for Cartier, we consider that the brand could well clean up its inventories in the trade, particularly in HK, in order to buy back slow moving watches. Although we consider this the right thing to do in the current environment, the move will have an impact on sales and EBIT margin as early as this year (end of March 2016). Consequently, we have cut our FY March 2016 and March 2017 EBIT estimates by 7%. Hence our new CHF82 FV vs CHF90 previously. We are maintaining our Buy recommendation however, given i/ still healthy momentum in jewellery sales (32% of CFR sales), ii/ the net cash position (EUR5.5bn estimated at end March 2016) that should allow management to maintain a dynamic distribution policy: dividend increase (+15% expected this year), special dividend and iii/ current upside on our FV (26%).

ANALYSIS

- **Swiss watch exports reflceted a fairly tough situation in January and February (-5% over the first two months)** even if the decline in February (-3%) was less significant than in January (-8%). We estimate that Richemont's Q4 sales momentum should be even worse than in Q3, particularly in Europe as tourists are not yet back in France (7% of group sales, mainly via Cartier brand) and in Paris (close to 4% of Group sales). Furthermore, the situation in HK is still very challenging (exports fell 23% in 2015 and 29% over the first two months of 2016), partly due to the 3% decline in inbound Chinese tourists in 2015. We estimate that HK accounts for 20% of Cartier sales.

- Consequently, we think Cartier (45% of group sales) is likely to clean up its watch inventories particularly in HK and for slow-moving Cartier lines. HK sales were clearly affected by the 3% decline in in bound Chinese tourists. Cartier watches account for 40% of Cartier brand sales (jewellery accounts for 50%) and for around 20% of Richemont group sales. Its is worth noting at this stage, that this inventories buyback (from watch retailers) should not concern “specialist watches” like Jaeger Lecoultre or IWC, as inventory levels for these brands are not an issue. We also estimate that this decision, taken by the new management team with Cyrille Vigneron as the new Cartier CEO since January 2016, is positive for the medium term. Actually, it will allow retailers to buy new Cartier lines, but probably less high-end (fewer gold and jewelled watches and more likely steel/gold watches…).

- **As such, we have adjusted our FY March 2016 sales to expect a 1% organic sales decline** versus stability previously implying -6% in Q4 alone whereas we were expecting -3% previously. Inventory buybacks are set to impact sales hence this adjustment. For March 2017, we expect sales to grow no more than 2% (including a slight decline for Cartier) with a still tough H1 as inventory buybacks will affect sales, while we are more optimistic for H2 (easier comps and no further buybacks impact). Gross profit and EBIT should also be impacted by this policy. Hence our new March 2016 EBIT margin assumption of 20% (-320bp) versus 21.2% expected previously (our March 16 EBIT is cut by 7% to EUR2.25bn). We assume that the buyback and destruction of Cartier watches could have a negative impact of around EUR100m on March 2016 EBIT. Our FY March 16 adjustment implies a 490bp profitability erosion in H2 alone after -200bp in H1.

VALUATION

- **Despite this significant results adjustment, we are maintaining our Buy recommendation, with a new EUR81 FV vs EUR90 previously**, given, **i/** still healthy momentum in jewellery sales (32% of CFR sales) and **ii/** the net cash position (EUR5.5bn estimated at end March 2016) that should allow management to maintain a dynamic distribution policy: dividend increase, special dividend) even during the tough period and perhaps even more during this period **iii/** current upside on our FV (26%).

- The stocks is down 11% YTD (stability for sector average) and it is trading at 11.4x on 2016 EV/EBIT, a 4% discount vs the peer average.

NEXT CATALYSTS

- FY March 2016 results to be reported on May 20th.

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