12th April 2016

Luxury & Consumer Goods

Prada

Price HKD23.70

Many intiatives implemented, but there still a long way to recovery

Fair Value HKD35 vs. HKD37 (+48%) **NEUTRAL**

Bloomberg	1913 HK
Reuters	1913.HK
12-month High / Low (HKD)	44.9 / 20.4
Market Cap (HKD)	60,644
Ev (BG Estimates) (HKD)	60,133
Avg. 6m daily volume (000)	1 234
3y EPS CAGR	-3.3%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-7.6%	13.9%	-28.2%	-1.7%
Pers & H/H Gds	-1.4%	4.1%	-2.0%	-2.2%
DJ Stoxx 600	-2.7%	-2.2%	-8.3%	-9.0%

YEnd Jan. (EURm)	01/15	01/16e	01/17e	01/18e
Sales	3,552	3,548	3,583	3,691
% change		*-0.1%*	*1.0%*	*3.0%*
EBITDA	954	803	849	893
EBIT	701.6	502.9	562.6	616.4
% change		*-28.3%*	*11.9%*	*9.6%*
Net income	450.7	328.6	368.4	407.1
% change		*-27.1%*	*12.1%*	*10.5%*

	01/15	01/16e	01/17e	01/18e
Operating margin	19.8	14.2	15.7	16.7
Net margin	12.7	9.3	10.3	11.0
ROE	15.0	11.1	12.4	13.6
ROCE	16.2	11.5	12.9	14.3
Gearing	-6.3	-1.9	-4.6	-6.8

(EUR)	01/15	01/16e	01/17e	01/18e
EPS	0.18	0.13	0.14	0.16
% change	-	*-27.1%*	*12.1%*	*10.5%*
P/E	15.2x	20.8x	18.5x	16.8x
FCF yield (%)	1.8%	2.4%	5.5%	5.8%
Dividends (EUR)	0.11	0.11	0.12	0.14
Div yield (%)	4.1%	4.1%	4.5%	5.2%
EV/Sales	1.9x	1.9x	1.9x	1.8x
EV/EBITDA	7.0x	8.4x	7.9x	7.4x
EV/EBIT	9.5x	13.5x	11.9x	10.8x

At the analysts' meeting yesterday, management explained the FY15 results (released last Friday) in more detail and presented the actions aimed at revitalizing top-line growth and controlling opex costs more tightly. The main initiative involves the price harmonization strategy, as Prada intends to maintain a 10% price gap across the different regions, but only for specific products and categories (mainly Leather goods and Shoes). Management has also guided on flattish opex costs (in value terms) thanks to the end of the retail expansion and some cost-cutting measures, which is good news as current trading does not seem to be improving. We nudge down our FY16-17 assumptions by 3% on average, leading to our new FV of HKD35 vs. HKD37.

ANALYSIS

- **FY15 net revenues virtually stable at EUR3,548m (-7.7% FX-n)** were pre-announced on 17th February. In **Retail**, sales fell 5.3% FX-n, implying a very slight improvement in Q4 (-6%) vs Q3 (-8%) which was derived from the performance in **Asia-Pacific** (38% of retail sales: -10% in Q4 vs. -20% in Q3). **Wholesale** sales dropped by approx. 21% in Q4, justified by the rationalisation strategy which is now over in Europe. It is worth mentioning that the 13.5% increase in **royalties** was driven by a very successful year for eyewear (Luxottica) and fragrances (Coty).

- **Prada intends to gradually reduce the price gap to 10%.** The new price architecture will apply to the new S/S 16 collection, but management has already declared that this 10% price gap across the regions would mainly concern **Leather goods** (63% of sales) and **Footwear** (18%). Although we believe it might take time to fully achieve this objective, this price harmonization should reduce the business volatility caused by tourism flows since Prada estimates that travellers account for approx. 50% of group sales.

- **E-commerce: Prada wants to double its exposure in the MT.** The Italian group was relatively lagging its peers (~2-3%e of sales) vs. 6% on average (Bain & Company ests), but Prada has decided to catch up in this fast-growing channel (+22% FX-n in 2015) by: **(i)** doubling the product offering on its online platform (developed by Yoox), except Apparel, **(ii)** increasing its presence on social media (Instagram, Snapchat, etc.) and **(iii)** implementing the price harmonization.

- **Priority for 2016: revitalize organic sales growth.** Whilst some luxury brands have already decided not to follow the "see now, buy now" model, Prada has successfully tested it during its F/W 16 fashion show by selling two new handbag models (Pionnère at EUR1,600 and Cahier over EUR2,000). However, Prada is not willing to use this model on a larger scale, which will be limited to special projects only. All these above-mentioned measures are aimed at fuelling the organic sales growth for 2016, all the more since the group admitted that current trading has not improved vs Q4, i.e. **Europe** suffers from fewer tourists visiting the region, trends in **Asia-Pacific** are still negative and **US** consumers have adopted a wait-and-see behaviour. We now anticipate 1% organic growth for 2016 vs. +2% previously (after -7.7% in 2015).

- **Margin rebound in 2016?** Whilst FX should have a neutral impact on GM this year, opex cost inflation related to retail expansion would be significantly reduced this year as the retail network should remain unchanged at 618 DOS. Management expects that a tight cost control, except on A&P expenses, will enable the group to keep stable opex costs in value terms, hence a slight but symbolic operating leverage might be possible in 2016 after two successive years of EBITDA margin decline (-930bp between 2013 and 2015). Given a lower organic growth forecast for 2016, we have nudged down our margin assumptions by 3% over 2016-17.

VALUATION

- Our new FV of HKD35 vs. HKD37 reflects our margin adjustments over 2016-17. Neutral recommendation confirmed as it quite too early to play the improving sales and earnings momentum, particularly in tough market conditions.

- *In accordance with the regulation of HK's securities markets (+Italian new legislation), Prada will now report its results on a semi-annual basis.* *Click here to download*

Analyst:
Cédric Rossi
33(0) 1 70 36 57 25
crossi@bryangarnier.com

Consumer Analyst Team:
Nikolaas Faes
Loïc Morvan
Antoine Parison
Virginie Roumage

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London
Beaufort House
15 St. Botolph Street
London EC3A 7BB
Tel: +44 (0) 207 332 2500
Fax: +44 (0) 207 332 2559
Authorised and regulated by the
Financial Conduct Authority (FCA)

Paris
26 Avenue des Champs Elysées
75008 Paris
Tel: +33 (0) 1 56 68 75 00
Fax: +33 (0) 1 56 68 75 01
Regulated by the
Financial Conduct Authority (FCA) and the
Autorité de Contrôle prudential et de
resolution (ACPR)

New York
750 Lexington Avenue
New York, NY 10022
Tel: +1 (0) 212 337 7000
Fax: +1 (0) 212 337 7002
FINRA and SIPC member

Munich
Widenmayerstrasse 29
80538 Munich
Germany
+49 89 2422 62 11

New Delhi
The Imperial Hotel Janpath
New Delhi 110 001
Tel +91 11 4132 6062
+91 98 1111 5119
Fax +91 11 2621 9062

Geneva
rue de Grenus 7
CP 2113
Genève 1, CH 1211
Tel +4122 731 3263
Fax+4122731 3243
Regulated by the FINMA