4th October 2016

Luxury & Consumer Goods

Richemont

Price CHF59.30

Still cautious on short term even if fundamentals remain healthy

Fair Value CHF60 vs. CHF63 (+1%) **NEUTRAL**

Bloomberg	CFR VX
Reuters	CFR.VX
12-month High / Low (CHF)	86.6 / 53.5
Market Cap (CHF)	33,208
Ev (BG Estimates) (CHF)	23,243
Avg. 6m daily volume (000)	1 902
3y EPS CAGR	0.4%

	1 M	3 M	6 M	31/12/15
Absolute perf.	1.3%	3.4%	-4.8%	-17.8%
Pers & H/H Gds	-2.8%	0.2%	4.2%	2.0%
DJ Stoxx 600	-2.1%	3.3%	3.0%	-6.2%

YEnd Mar. (EURm)	03/16	03/17e	03/18e	03/19e
Sales	11,076	10,290	10,830	11,500
% change		*-7.1%*	*5.2%*	*6.2%*
EBITDA	2,471	1,880	2,190	2,520
EBIT	2,061	1,470	1,840	2,190
% change		*-28.7%*	*25.2%*	*19.0%*
Net income	1,688	1,210	1,440	1,710
% change		*-28.3%*	*19.0%*	*18.8%*

	03/16	03/17e	03/18e	03/19e
Operating margin	18.6	14.3	17.0	19.0
Net margin	15.2	11.8	13.3	14.9
ROE	9.8	6.1	6.3	6.6
ROCE	18.6	11.9	12.8	14.2
Gearing	-42.6	-45.8	-48.6	-51.0

(EUR)	03/16	03/17e	03/18e	03/19e
EPS	3.01	2.16	2.57	3.05
% change	-	*-28.3%*	*19.0%*	*18.8%*
P/E	18.0x	25.2x	21.1x	17.8x
FCF yield (%)	8.1%	8.9%	10.1%	11.4%
Dividends (EUR)	1.85	1.55	1.90	2.00
Div yield (%)	3.4%	2.9%	3.5%	3.7%
EV/Sales	2.1x	2.1x	1.8x	1.5x
EV/EBITDA	9.4x	11.3x	8.8x	6.8x
EV/EBIT	11.2x	14.5x	10.5x	7.8x

We prefer to remain cautious ahead of H1 results due out on 4th November and have consequently adjusted our FY March 2017 estimates, cutting our 2016-17 EBIT estimate by 5%. Nevertheless, we argue that the group's fundamentals (brand strength, portfolio balance, strong net cash) remain healthy, hence our Neutral recommendation. Given our downward earnings revision, our FV has dropped from CHF63 to CHF60.

ANALYSIS

- H1 2016-17 sales (April to September) are set to fall by around 12% in organic terms (-13% over 5m) including -18% for watchmakers and -15% for Jewellery Maisons (Cartier and VCA). A negative FX impact is expected to account for almost one point. Company management added that high-end watches (particularly jewellery lines) inventories buy backs (mainly at Cartier and also at Piaget) from multi-brand retailers in the US, Europe (particularly in France and the UK) and Hong Kong/Macau should have a negative impact of around 3% on sales, implying an underlying sales organic 10% decline. By region, the H1 sales decline is set to be driven by Europe (-17%) while in APAC, revenues are expected to fall 9%. Europe was affected by the lack of tourists due to attacks in France in November 2015 and July 2016, while the expected 25% revenue decline in Japan is the consequence of very demanding comps and also lower tourist flows in Japan given the strong JPY.
- H1 EBIT should be down 45% to EUR765m, implying an 870bp margin decline to 15.2%. Nevertheless, the move is partly due to a one-off restructuring charge of approximatly EUR65m for Fashion and Leather goods brands, namely Dunhill and particularly Lancel. The French leather goods brand is, among others issues, clearly the most affected by lower tourist flows in France YTD. This means that H1 recurring EBIT should be down 40% to EUR830m, implying a 16.5% EBIT margin, down 740bp.
- For FY March 2017, we prefer to remain cautious and have reduced our EBIT estimate by 5%. We expect FY sales to fall 7% in organic terms (-5.5% previously), implying near-stability in H2 (-2%) as H2 will no longer be penalised by Cartier watch buy-backs (the brand buy-back is completed) and will face a far less demanding comparison base (-5% in H2 March 2016 vs +3% in H1). Management's initial guidance for gross margin of around 65% is no longer valid in our view and is likely to be revised down by management during the analysts meeting following the H1 results publication. Actually, the slow-moving watch buy backs are set to have a clearly negative impact on gross margin. For this reason, we now expect gross margin to be close to 66% versus 64.3% in FY March 2015. March 2017 recurring EBIT is therefore expected to fall 29% to EUR1,535m (reported EUR1,470m), implying a recurring EBIT margin at 14.9%, down 460bp. This move is expected to be particularly strong for Watchmakers (-640bp to 10.5%), as the activity is particularly dependant on wholesalers destocking.
- Nevertheless, Richemont group's fundamentals remain very healthy with very strong brands both in jewellery and watches, which together account for 80% of group sales. Furthermore, jewellery sales which account for 35% of group March 2016 sales (27% in March 2013) were still well oriented (or at least better oriented than watches) despite some slowdown in H1 (due to a significant sales decline in Japan and in France). Lastly, we would again highlight the very healthy financial situation with a EUR5.3bn net cash pile at end of March 2016.

VALUATION

- Even if the CFR share price has been strongly penalised YTD (-18%), in the more recent period, it has been better oriented and even gained 3% over 3m but remains one of the worst performers in our luxury stocks sample over the period. We are making no change to our Neutral recommendation with a new CHF60 Fair Value versus CHF63 previously in view of our downward revision to estimates.

NEXT CATALYSTS

- H1 March 2017 results to be reported on 4th November.

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