September 2021

Richemont

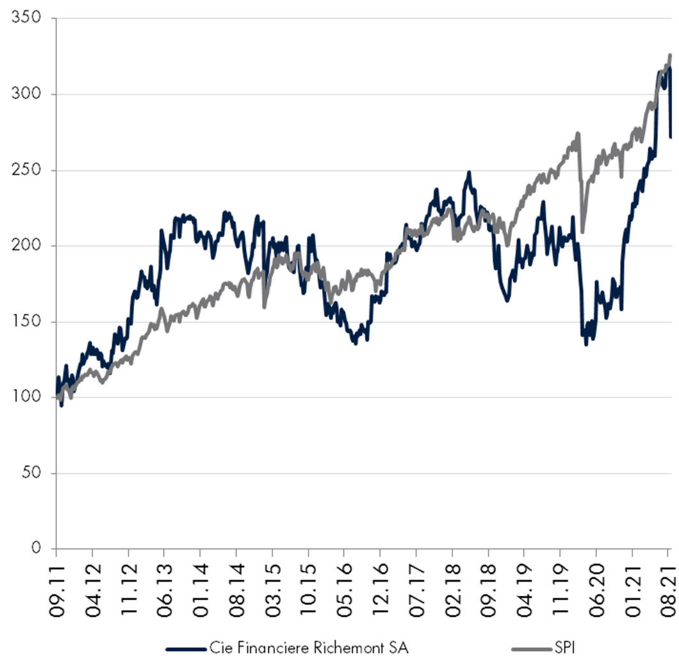
Market profile

Country	Switzerland
Sector	Luxury Goods
Market cap (CHF million)	59'113
52-week high / low (CHF)	119.13 / 56.20
Price per share (CHF)	103

Key metrics (CHF)

	2021	2022e	2023e
EPS	2.29	1.52	1.69
PE	41.8	26.7	22.4
P/Book	3.06	2.90	2.74
Dividend yield	1.14%	2.17%	2.45%

Evolution of stock price with respect to benchmark (rebased)
Source: IAM



Executive summary

Compagnie Financière Richemont SA was founded in 1988 by Johann Rupert through the spin-off of the international assets owned by Rembrandt Group Limited of South Africa (known today as Remgro Limited). In 1993 the Group realized the strategic separation of Richemont's luxury goods holdings into Vendôme Luxury Group, a newly-created, UK-listed group, and its tobacco business into Rothmans International. In 1998, Richemont bought out Rothmans International minority shareholders and merges its tobacco interests with those held by Rembrandt Group in South Africa. In 1999, the management and executive board structures of Richemont and Vendôme merged. The same year, the merger of Rothmans International with British American Tobacco sees Richemont become a pure play in the luxury goods sector.

Investment case

Richemont probably owns the best hard jewelry portfolio of the entire luxury industry, with prestigious brands like Cartier, Van Cleef & Arpels, or Vacheron Constantin and Jeager LeCoultre. While still loss making, the soft luxury business is being turned around and should become profitable in the coming quarters. The group is catching up on its lag in online distribution and Yoox Net-A-Porter clearly has the potential to become a premier platform in this field. The group's governance has also improved and new board's members with expertise in ESG, e-commerce and the evolution of the luxury sector have been appointed. Recently, growing concerns about the situation in China have resulted in a de-rating across the sector. However, recent data (Swiss watch exports) and CEO comments were reassuring. As a result, we stay positive about Richemont.

Richemont

Olivier Aeschlimann, Senior Financial Analyst **September 2021**

Company description and history

Compagnie Financière Richemont SA was founded in 1988 by Johann Rupert through the spin-off of the international assets owned by Rembrandt Group Limited of South Africa (known today as Remgro Limited). Established by Dr. Anton Rupert in the 1940s, Rembrandt Group owned significant interests in the tobacco, financial services, wines and spirits, gold and mining industries as well as the luxury goods investments that, along with the investment in Rothmans International, would form Richemont. In 1993 the Group realized the strategic separation of RIchemont's luxury goods holdings into Vendôme Luxury Group, a newly-created, UK-listed group, and its tobacco business into Rothmans International. In 1998, Richemont bought out Rothmans International minority shareholders and merges its tobacco interests with those held by Rembrandt Group in South Africa. In 1999, the management and executive board structures of Richemont and Vendôme merged.

The same year, the merger of Rothmans International with British American Tobacco sees Richemont become a pure play in the luxury goods sector.

Group structure

Today, Richemont consist of four business units: Jewelry Maisons, Specialist Watchmakers, Online Distributors and Other Businesses.

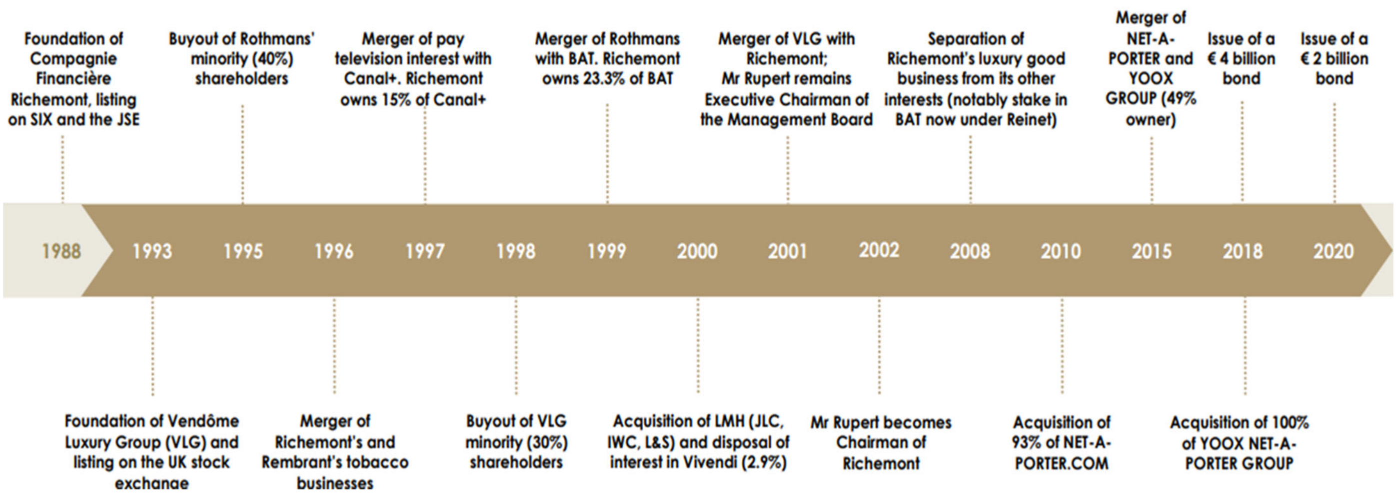
Graph1: Net revenues 2020 by divisions

Jewelry Maisons

Richemont owns three prestigious Jewelry Maisons: Buccellati, Cartier and Van Cleef & Arpels.

Buccellati is one of the most prestigious Italian jewelers, established in Milan in 1919. Its jewelry, silver pieces and watches are all characterized by a highly distinctive style inspired by Italian Renaissance art. During 2020, Buccellati will continue its retail expansion with new stores in London, Hong Kong and Shanghai.

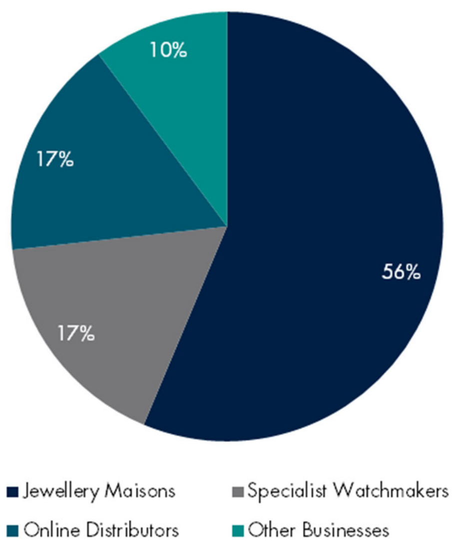
Fig.1: Significant dates in the Richemont's history
Source: TRichemont



Cartier, founded in 1847, is not only one of the most established names in the world of jewelry and watches; it is also the reference of true and timeless luxury.

Van Cleef & Arpels, created in 1906, is a High Jewelery Maison embodying the values of creation, transmission and expertise. It will continue to maintain a balanced presence and development all over the world.

Fig.2: Revenue by business segments
Source: Richemont



Specialist Watchmakers

This division consists of eight internationally recognized brands: A. Lange & Söhne, Baume & Mercier, IWC Schaffhausen, Jeager-LeCoultre, Panerai, Piaget, Roger Dubuis and Vacheron Constantin.

A.Lange & Söhne, which originally started in 1845, creates outstanding had-finished mechanical timepieces with challenging complications that follow a clear and classical design line.

Baume & Mercier has been creating watches of the highest quality since 1830, combining performance, technical achievement and refined design.

IWC Schaffhausen, founded in 1868, is the engineer of fine watchmaking and the choice for ambitious individuals with an appreciation of mechanics, a sense of style and a taste for adventure.

Jaeger-LeCoultre has created over 1200 calibres and registed more than 400 patents since its founding in 1833, placing the Manufacture at the forefront of invention in fine watchmaking. Its leading position stems from its full integration with over 180 areas of expertise gathered under one roof, in the heart of the Vallée de Joux in Switzerland.

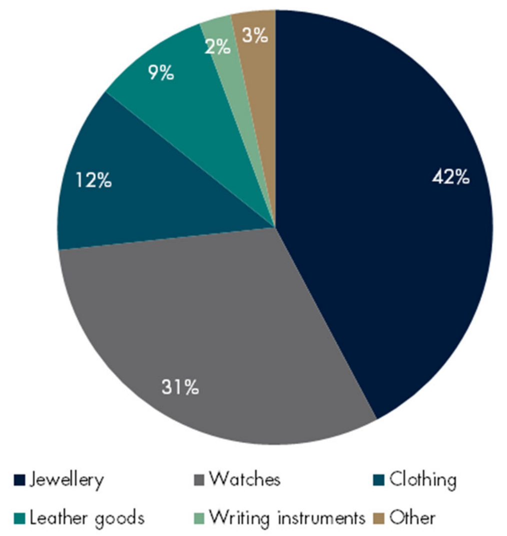
Panerai, created in 1850, is an exclusive technical sports watch Maison; its products feature unmistakable Italian design and creative innovations, closely associated to the world of the sea.

Piaget began in 1874 with a unique vision: always push the limits of innovation to be able to liberate creativity.

Roger Dubuis represents a disruptive blend of distinctive character and Haute Horlogerie expertise. It has been at the forefront of the contemporary watchmaking scene since 1995.

Vacheron Constantin is the world's oldest watch Manufacture in continuous production, crafting watches since 1755. It faithfully perpetuates a proud heritage based on transmitting expertise through generations.

Fig.3: Revenue by categories
Source: Richemont



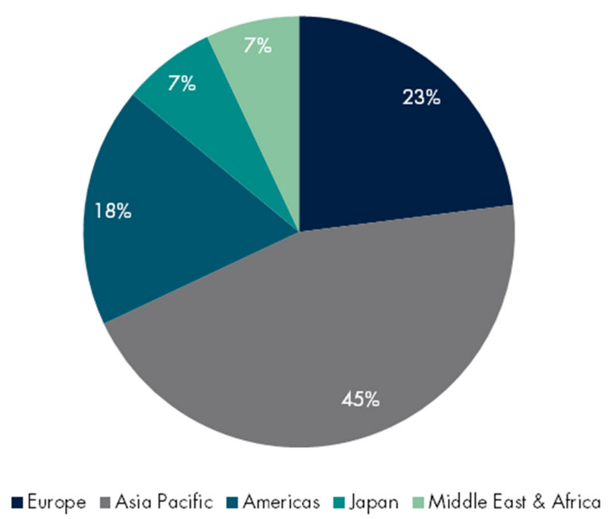
Online Distributors

Richemont owns two online distributors: Watchfinders & Co and Yoox Net-A-Porter. This division represents 15% of the group's sales.

Watchfinder & Co was founded in 2002. It buys services and sells pre-owned watches. Watchfinder operates both online and through its network of boutiques and showrooms, predominantly in the UK, enabling to reach customers wherever they are through a fully integrated, omni-channel approach.

Yoox Net-A-Porter is the world leader in online luxury fashion. As the pioneers in combining the realms of luxury and technology, it has two decades of experience in global e-commerce, meeting the needs of modern luxury customers through superior service, mobile-led innovation, high quality content and an expertly curated multi-brand selection.

Fig.4: Turnover by regions
Source: Richemont



Other Businesses

Richemont's other Businesses are made up of eight Maisons: Alaïa, Chloé, Dunhill, Mont Blanc, Peter Millar, and Purdey.

Alaïa has been a legendary Parisian Couture House since 1964, which, beyond fashion, reveals the power of femininity and the timelessness of beauty in the spirit of its namesake creator.

Chloé, founded in 1952 by Gaby Aghion, established itself as the most naturally feminine Parisian fashion Maison.

Founded in 1893 in London, *Dunhill* has been design-driven with style and purpose for 128 years. Today the Maison is of the moment yet enduring, representing the best of British leather goods and menswear.

For over a century, *Montblanc's* writing instruments have been the symbol of the art of writing. Montblanc provides elegant, sophisticated and innovative creations in the fields of fine watchmaking, fine leather, new technologies and accessories.

Peter Millar design classic, luxury sportswear embracing timeless style with a modern twist. Peter Millar lifestyle apparel offers a distinctive vision of casual elegance.

James Purdey & Sons, holder of three Royal Warrants as gunmakers to the British Royal Family, was founded in 1814 and has been crafting the finest shotguns and rifles for more than two centuries.

Regional and Central Functions

Richemont regional and central functions provide the business operations system to the Maisons in order to develop their activities, covering a large spectrum of services in more than 130 countries. The development of the operational backbone of the historical Maisons, the integration of new Maisons and the geographical expansion of recently acquired Maisons is a major point of focus of these functions.

Strategy and competitive position

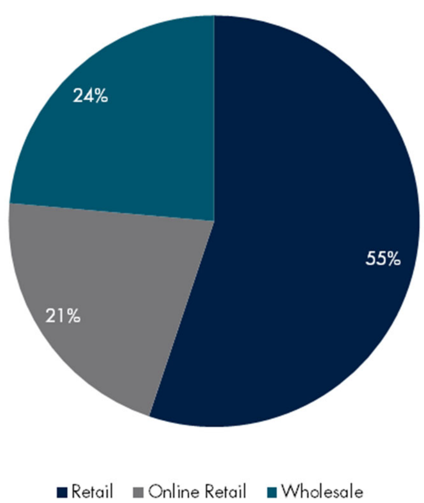
In this section, we will analyse how Richemont is positioned in terms of markets exposures, categories of products, distribution channels and does the company compares with its main competitors in terms of sales growth and margins.

Markets: Asia Pacific is the group's main market and mainland China is the region's growth driver. This region is more important than the USA and Europe combined. Therefore the evolution of China in terms of economic growth and regulation is of paramount importance to Richemont. The recent change in Chinese policy towards a more egalitarian society, the will to generate a more qualitative growth, as well as the fight against "corruption" should be closely monitored as they may not bode well for luxury goods makers. That said, China is still a very attractive market and Richemont is continuing its effort to invest in the APAC region.

Categories of products: Jewellery and Specialist Watchmakers contribute to 73% of Richemont's sales, but to 119% of the group's operating result as the two other divisions, *Online Distribution* and *Other Businesses* are loss making. Richemont has very strong brands in hard luxury; Cartier and VC&A for example are outstanding assets. However, the group may lack focus in soft luxury. In addition some of its categories, such as Writing instruments, lighters or even some watches may no longer be considered as a "must" by younger generations.

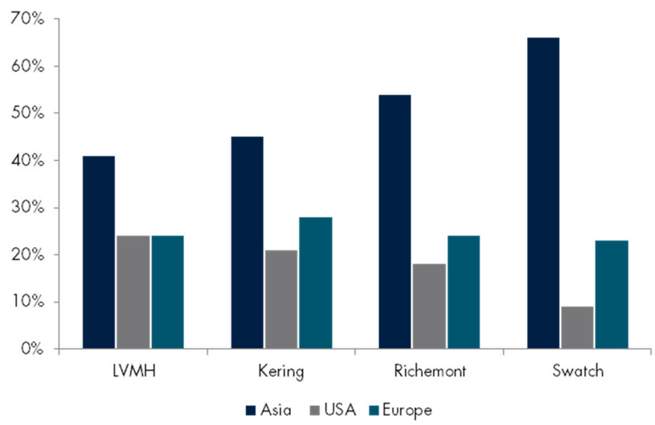
Distribution channels: Richemont breaks down its distribution channels into three categories: Retail, Online and Wholesale. Retail represented 55% of FY 2021 sales, Online sales (including the Online Distributors division), was 21% and Wholesale and royalty income were 24% of FY 2021 turnover.

Fig.5: Distribution channels
Source: Richemont



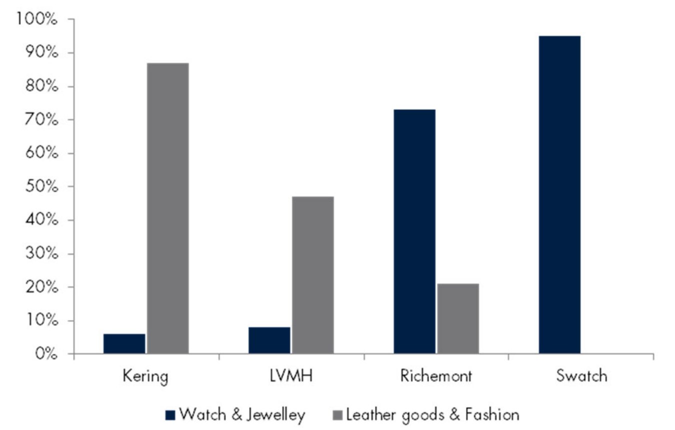
Online retail is developing fast, but from a relatively slow base. If we exclude the Online Distributors division, the Maison's online sales have increased to over 7% of total turnover in FY 2021, from below 3% in FY 2020. This is an impressive progression, but it is estimated that by 2025, over 30% of the luxury sector sales would be online. Direct to Customers (DTC): The group has about 76% of its sales generated through DTC, both online and offline. There has been an expansion of franchise stores in recent years, 443 for Specialist Watchmakers and 137 for Jewellery Maisons in FY 2021. This is due to the fact that multi-brand sales stores have been transformed into franchise stores.

Fig.6: Turnover by regions: LVMH, Kering, Richemont, Swatch
Source: Companies' data



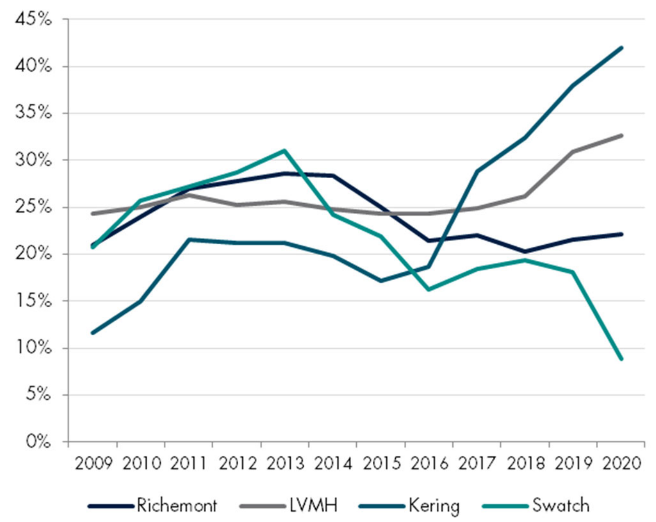
In comparison to its peers, Richemont is characterised by two main factors: its reliance on the Chinese market and its strong focus on hard luxury (jewellery and watches). Only Swatch is even more dependent on the Chinese markets but as a pure play on watches this company cannot really be considered as a peer. In terms of growth, Richemont's EBITDA has increased by 167% since 2009. Over the same time period, the EBITDA margin slightly increased from 21 to 22%. Looking at LVMH and Kering, their EBITDA growth was respectively of 251 and 249%. As to their EBITDA margin, LVMH improved it from 24 to 33% and Kering from 12 to 42%. We should specify that Kering went through a complete transformation of its business model and was referred to as Pinault-Printemps-Redoute or PPR until 2013. Therefore the sharp margins increase is chiefly due to a complete overhaul of the company. The margins level of Kering and LVMH clearly

Fig.7: Turnover by categoies: Kering LVMH, Richemont, Swatch
Source: Companies' data



shows that it is possible to have a very profitable portfolio of soft luxury brands. In contrast, Richemont's soft luxury brands are still loss making. However, according to Richemont's chairman, the goal of the company :"has always been to build brand equity and to build value, instead of just buying it and paying goodwill, even though I guess the markets reward the second strategy a lot quicker". Therefore it may just be a matter of time for the soft brands to become profitable…

Fig.8: EBITDA margins: Richemont, LVMH, Kering, Swatch
Source: Companies data

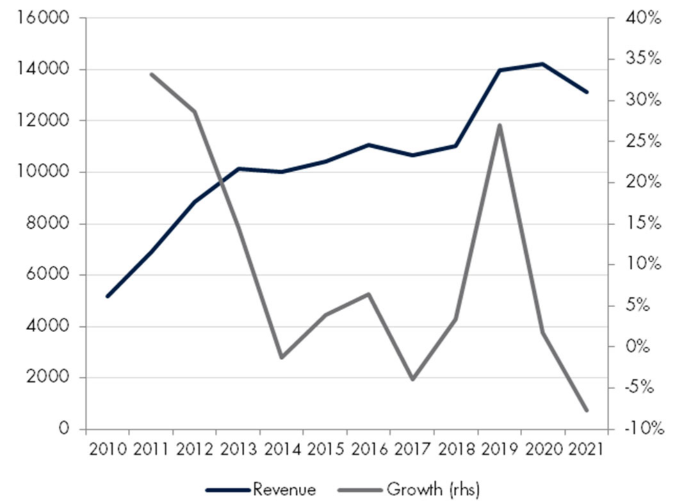


Financial analysis

Revenue

The evolution of Richemont's revenue shows a cyclical pattern. They increased strongly from 2009 to 2012, thanks to the recovery following the financial crisis. Then, revenue growth was much softer until 2017. In 2018, the consolidation of Yoox Net-A-Porter gave noticeable boost the group's revenue. Finally, in 2020 Richemont's sales were strongly penalised by the Covid-19 crisis.

Fig.9: Richemont's evolution of revenue
Source: Richemont



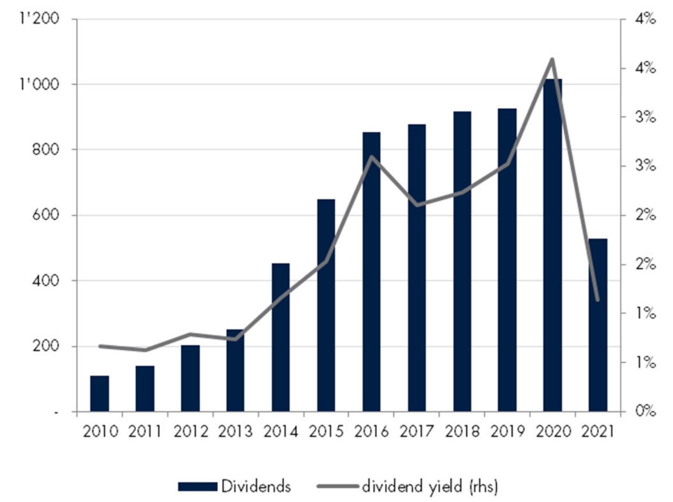
Profitability

The group's profitability has declined since 2013 in terms of EBIT margin, return on assets and return on equity. In terms of gross profit margin, Richemont reached a top in 2015. Although the relatively low return on assets can be explained by the large amount of cash held by the company, the declining trend in EBIT margin is a bit worrying, especially when compared with the margin improvements achieved by some of Richemont's peers, as illustrated in Fig.8.

Capital distribution

Richemont's operations are highly cash generative. The free cash flow yield of 6.8% in FY 2021 is largely sufficient to cover a dividend yield of about 3%, which has been prevalent since 2016.

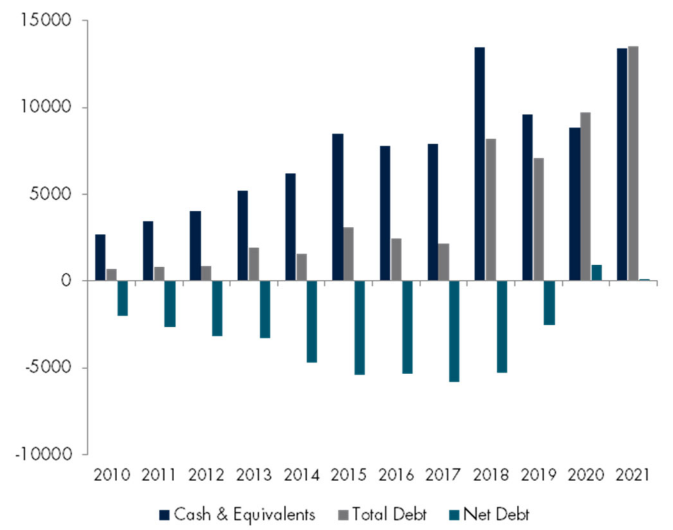
Fig.10: Dividends and dividend yields
Source: Richemont



Strong balance sheet

The company's balance sheet is still very strong with a net debt of only EUR 124 million. However, the company has been net debt negative until 2019.

Fig.11: Evolution of debt
Source: Richemont



In 2018 Richemont issued a EUR 4 billion bond, in part to complete the acquisition of Yoox Net-A- Porter. Then in 2020 a new EUR 2 billion bond was issued. According to Mr. Rupert, the group "has enormous liquidity". The reason for this is to withstand further shocks as Mr. Rupert is more concerned about being protected from those potential shocks than to improve short term financial profitability.

ESG considerations

Richemont conducted a materiality assessment in 2019. This is a comprehensive review identifying the key ESG issues that matter most to both the business and its stakeholders. The top priority issues are:

- Human rights & labor standards in the supply chain.

- Transparency & traceability of raw materials.

The group's ESG committee remarked that climate change had not been rated highly by stakeholders (as it is by the management). This is due to the age of the cohort of respondents. Therefore, to capture the concerns and view of the next generation, Richemont reassessed its material issues with the help of stakeholders aged 25 and under. In this assessment, *Climate change & other environmental impacts* was the top priority.

The luxury industry does not face major ESG challenges from its own operations. However, as it uses precious metals, woods, gems or animal skins, sourcing and supply chains management can be more challenging. For example creating a gold necklace with diamonds will not generate so much CO_2. But the mining and refining industries producing gold and gems are highly polluting, and not only in terms of CO_2 emissions. In addition, labor conditions in some mining companies may be questionable. Richemont participated to the recent launch of the Gemstones and Jewellery Community Platform to promote responsible business practice across the gemstone industry. In addition over 90% of the gold used by Richemont is RJC Chain of Custody certified and comes from recycled origins. At the time of writing, we are not aware of any major controversies regarding Richemont's activities.

Governance

The Board of Directors has delegated the entire management of the company to the Senior Executive Committee. On paper, the governance structure looks all right as the CEO and Chairman functions are clearly separated. However, the entire Senior Executive Committee is also part of the Board which consists of 20 members, including 4 women. Richemont's board of director is still characterized by a high number of members directly or indirectly affiliated with the company or its controlling entity, and having worked in finance, economics or accounting rather than in the luxury goods sector. That said, some members have expertise cybersecurity and new technologies. In fact the board is poised to change over the next few years as Mr. Ruppert has indicated that he wants the board composition to reflect the opportunities and challenges the world is facing, evolving tastes, consumption habits, training needs, change management etc. In August 2021 the company announced the nomination of Patrick Thomas, former Hermès CEO and Jasmine Whitebread, an ESG specialist to the board and that Gary Sage, a former CEO and long-term Rupert insider, as well as Jan Rupert, cousin of the Chairman, will step down. These changes are in the right direction, to our view. Finally, the Chairman, Mr. Ruppert also is the sole General Managing Partner of Compagnie Financière Rupert, which holds 5'221'000 Richemont A shares and 522'000'000 B shares representing 10% of Richemont's capital and 51% of the voting rights. Therefore, we can question the real autonomy of the Senior Executive Committee.

Investment case

Richemont probably owns the best hard jewelry portfolio of the entire luxury industry, with prestigious brands like Cartier, Van Cleef & Arpels, or Vacheron Constantin and Jeager LeCoultre. While still loss making, the soft luxury business is being turned around and should become profitable in the coming quarters. The group is catching up on its lag in online distribution and Yoox Net-A-Porter clearly has the potential to become a premier platform in this field. The group's governance has also improved and new board's members with expertise in ESG, e-commerce and the evolution of the luxury sector have been appointed.

Recently, growing concerns over the growth outlook for luxury goods centered around the risks relating to rising Covid cases in China as well as a potential changes in the regulatory environment in China, has resulted in a de-rating across the sector. However, recent data (Swiss watch exports) and CEO comments about their sales' outlook were reassuring. As a result, we stay positive about the outlook for the luxury sector in general and Richemont in particular, as Asia remains the continent that will produce the most new millionaires over the coming decades.

SWOT analysis

Strengths:

Strong brands in high-jewelry and watches

High barriers to entry in hard luxury

Strong balance sheet.

Weaknesses:

Concerns about governance and Johann Rupert succession

Difficulties in the development of soft luxury business

Still low profitability

Opportunities:

Well positioned to capitalize on the growing number of billionaires in Asia.

Some markets like India or Brazil are still underpenetrated.

Threats:

Chinese regulations for a more "balanced" growth and anti-billionaires policies

Increased competition in branded jewelry segment