BRYAN, GARNIER & CO

INDEPENDENT RESEARCH

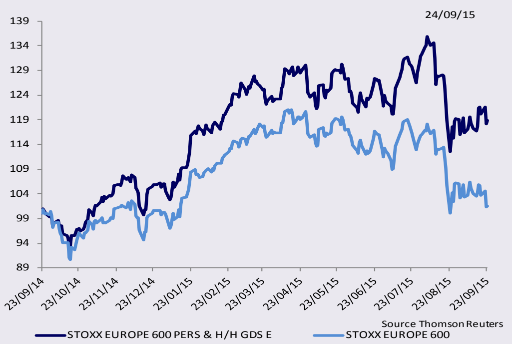
25th September 2015

Luxury & Consumer Goods

China is suffering... long live the Chinese!

Luxury & Consumer Goods

CHRISTIAN DIOR		**BUY**	**FV EUR172 vs. 178**
Last Price	EUR160.25	*Market Cap.*	EUR29,122m
HERMES Intl		**BUY**	**FV EUR350**
Last Price	EUR316.350	*Market Cap.*	EUR33,397m
HUGO BOSS		**BUY**	**FV EUR128**
Last Price	EUR98.06	*Market Cap.*	EUR6,903m
KERING		**NEUTRAL**	**FV EUR177 vs. 183**
Last Price	EUR145.9	*Market Cap.*	EUR18,423m
LVMH		**BUY**	**FV EUR182 vs. 186**
Last Price	EUR147.6	*Market Cap.*	EUR74,990m
PRADA		**NEUTRAL**	**FV HKD52**
Last Price	EUR33.25	*Market Cap.*	EUR85,081m
RICHEMONT		**BUY**	**FV CHF95**
Last Price	CHF74.1	*Market Cap.*	CHF41,496m
SALVATORE FERRAGAMO		**BUY vs. NEUTRAL**	**FV EUR29 vs. 30**
Last Price	EUR23.34	*Market Cap.*	EUR3,940m
THE SWATCH GROUP		**NEUTRAL**	**FV CHF430 vs. 450**
Last Price	CHF361.9	*Market Cap.*	CHF19,832m
TOD'S GROUP		**NEUTRAL**	**FV EUR85 vs.88**
Last Price	EUR80.2	*Market Cap.*	EUR2,455m



Recent events in China and uncertainty in emerging markets have prompted us to notch down our forecasts for 2016, but not those for 2015. In addition, business with Chinese customers should remain robust! Similarly, we still favour LVMH (FV: EUR182), Hermès Intl (FV: EUR350) and Richemont (FV: CHF95). We have upgraded Ferragamo to Buy (FV: EUR29).

- **Luxury groups are highly dependent on China,** with almost 30% of the luxury market accounted for by Chinese customers (tourists and local consumers). This ratio even exceeds 45% for groups like Swatch. In contrast, we estimate that Louis Vuitton and Gucci generate 27% and 35% of their sales respectively with these customers.

- **Business with Chinese customers at groups in our sample remain robust and even picked up in Q2.** While sales are still in sharp decline in Hong Kong and Macau and have deteriorated slightly in Mainland China since January due to the increasing difference between selling prices in Europe and China, offshore business remains positive and should stay so, thereby suggesting further beneficial momentum with Chinese customers.

- **Although we have made virtually no changes to our 2015 estimates** in view of the amounts already generated in H1, recent events and uncertainty concerning China make us slightly more cautious for 2016. As such, we have reduced our sales forecasts by an average of 1% with an impact of around 2% on EBIT.

- We have adjusted our Fair Values to take account of this downgrade but have made no change to our ranking of stocks within the sector and continue to favour **LVMH** (FV: EUR182), **Hermès Intl** (FV: EUR350) **Hugo Boss** (FV:EUR128) and **Richemont** (FV: CHF95). We have also upgraded our recommendation on **Salvatore Ferragamo** to Buy with a FV of EUR29.

Analyst:
Loïc Morvan
33(0) 1 70 36 57 24
lmorvan@bryangarnier.com

Sector Analyst Team:
Nikolaas Faes
Antoine Parison
Virginie Roumage

Table of contents

1. A sluggish Chinese economy

For several months, clear signs of a slowdown in economic activity (industrial output, exports, retail sales etc.) have multiplied in China and the situation has even worsened very recently with the bursting of the stockmarket bubble and three successive devaluations in the Chinese currency against the US dollar as of 10th August in order to stimulate exports, which dropped 8.3% in July and even fell 12% for trade with the EU.

A clear slowdown in the Chinese economy...

1.1. Economic activity on a drip

The Chinese economy accounts for 16.5% of global GDP (6.5% in 1997) compared with 20% for the US. China has multiplied its average standard of living by more than 10 over the past 35 years. As the chart below shows, the pace of growth has constantly slowed since the peak of 10% reached in 2011 (meaning that the current trend is not new) to stabilise at 7% (the official figure, the reliability of which is not 100% certain) over the first two quarters of this year. Since 7% is also the Chinese authorities' official target and given the current situation (bursting of the stockmarket bubble for example), we cannot even be sure that this target will be reached! If we rule out the assumption of 2% growth, a pace of 6% seems more likely! A hard landing is therefore not certain but the prospect cannot be ruled out however. The medium-term trend is more likely to see annual growth in GDP at 4%.

Fig. 1: Change in Chinese GDP and Chinese exports

Source: Datastream; Bryan, Garnier & Co ests.

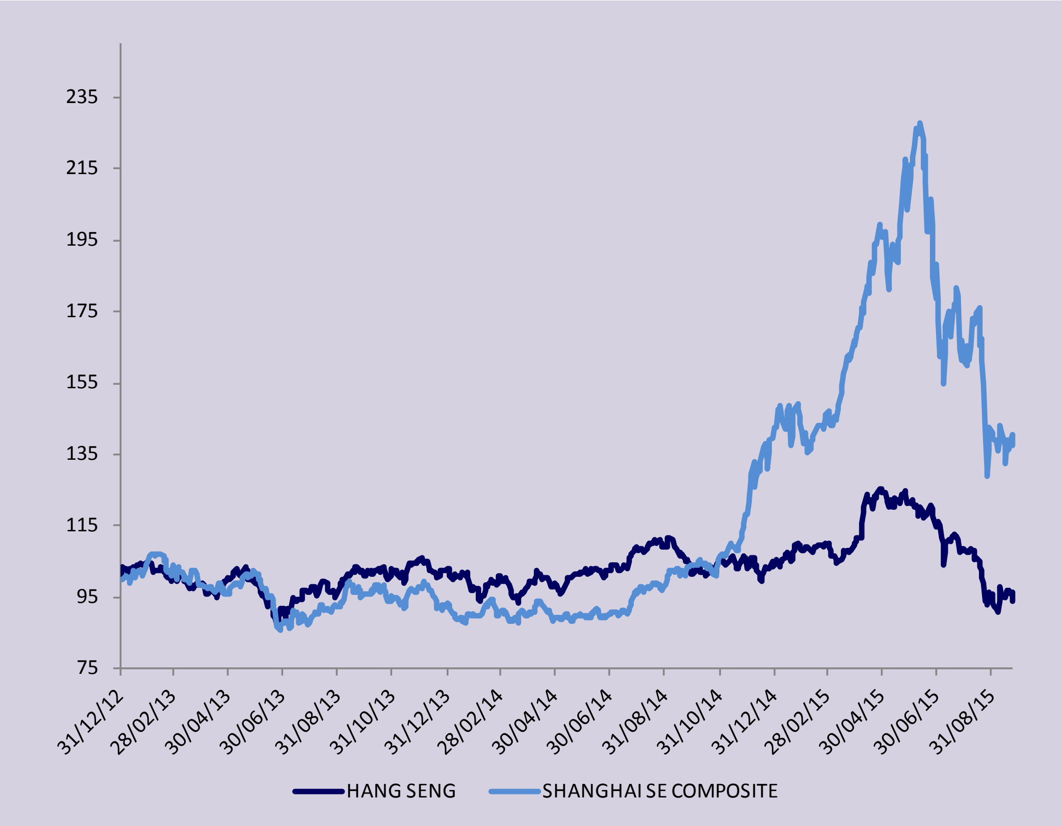
Another worrying sign that prompted the Chinese authorities to devalue their currency was the clear decline in exports (-8.3% in July) due to a lack of competitiveness compared with other emerging markets, following the hike in the US dollar.

1.2. Recent downturn on financial markets

… and a clear decline on financial markets since mid-June

The Chinese stockmarkets have plummeted since their peak levels of mid-June, with the Shanghai index losing 40% and the Hong Kong index even shedding 22%. We should nevertheless bear in mind that between January 2015 and the peak level of mid-June, the Shanghai stockmarket gained a massive 60%, thereby putting into perspective the recent bursting of the stockmarket bubble. As such, 2015 now looks virtually neutral (-3.7%). In contrast, the violent nature of the stockmarket correction can only cause uncertainty among small Chinese savers and has affected the pace of consumer spending.

Fig. 2: Shanghai and Hong Kong stock markets index



Source: Datastream; Bryan, Garnier & Co ests.

The nosedive on the Shanghai and Hong Kong stockmarkets since mid-June implies a clear loss of wealth, prompting another massive loss in confidence for Chinese individuals, with the two trends generally not good news for consumer spending in coming months. This is all the more true in that the authorities, after trying to stem the downtrend using numerous regulatory devices, apparently want to allow the markets to move more freely, hence the worsening in the correction in recent weeks, with the Shanghai index plummeting 8.5% on Monday 24th August and 7.6% on Tuesday 25th August. In short, it appears that the authorities have lost control.

The unofficial backing by Chinese public authorities of this craze for stockmarket investments by individuals, on the back of fairly flexible stockmarket rules for example, was an unstated means not only of underpinning consumer spending (in the majority of cases, Chinese citizens take out debt to play on the stockmarket in order to try and generate additional spending capacity), but also of tackling the currently insufficient level of social protection (virtually non-existent pensions for example). At this stage, note that a large share (but probably not the majority) of the market capitalisation on Chinese stockmarkets is directly-owned by individuals (in China, the passion for gambling is legendary, hence the importance of Macau), contrary to western stockmarkets where capital is majority owned by institutional investors. The inverse scenario can also be put forward, namely that Chinese citizens who are now wary of the stockmarket consume more, including luxury products, considering this a safer investment.

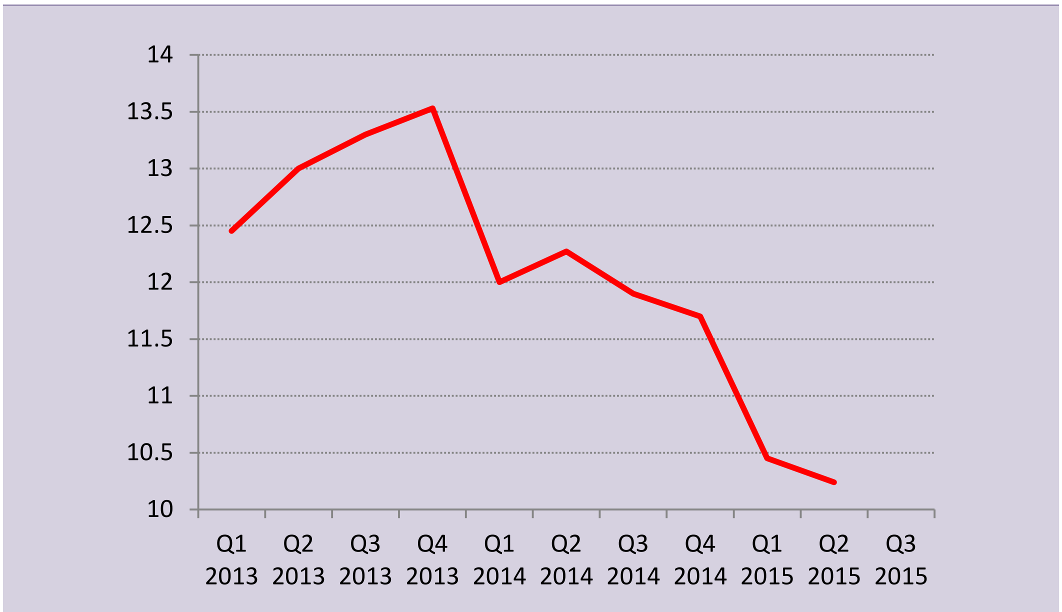
1.3. Local consumer spending lagging behind...

Consumption is not very strong in China...

Here again, various indicators show the slowdown in consumer spending in Mainland China. Far from creating fresh capacity to consume, the wage increases implemented by the authorities (annual increases between 2011 and 2014 of 13% in local currencies), have made Chinese products less competitive for export. In a way, this policy has triggered a downward spiral and it is now an admitted fact that the policy has failed since it has not achieved its aim and has even deteriorated the economic situation and contributed to the current slowdown. By increasing wages, the Chinese authorities were also aiming to avoid social movements. Since the Chinese economy is still just as dependent on its exports, the government has been obliged to devalue its currency in order to make its exports more competitive.

The chart below shows the substantial downturn in retail sales in China, which "only" rose by 10% in Q2, with a constant deterioration in momentum from the peak level reached during Q3 2013. Admittedly, for most, growth of 10% could appear very strong, especially from a European perspective, but we prefer to assume a steady slowdown in the.

Fig. 3: Change in retail sales in China (chge in %)



Source: Company Data; Bryan, Garnier & Co ests.

Even less in Hong Kong and Macau...

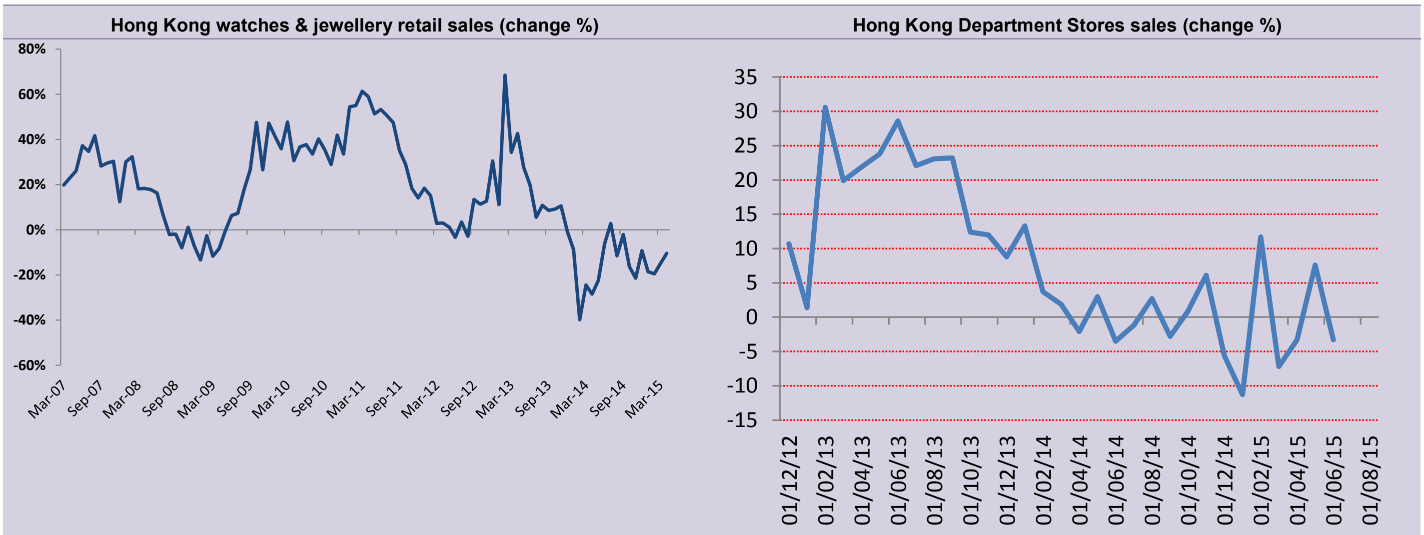
The charts on the following page also show how the downturn has worsened in Greater China (Mainland China, Hong Kong and Macau) and not just in Mainland China. Indeed, Department store sales in the former British colony fell 7% in July after -3% in June. In general, since the start of this year, sales in Hong Kong department stores have remained virtually stable (-1.5%).

In contrast, the sluggish trend has been even more pronounced for luxury sales, with watch and jewellery retail sales dropping by 5% in July, 10% in June, 15% in May and 15% YTD. Note that this segment includes jewellery (including gold jewellery) and not just watches, thereby prompting the risk of wrongly comparing these figures with those of Swiss watch exports.

Luxury brands have been particularly affected in Hong Kong, especially since October 2014…

This sluggishness in Hong Kong has primarily stemmed from aversion to the country by Chinese tourists from Mainland China due to the political tension that emerged as of October 2014. Indeed, several brands in the sector have pointed out that business with consumers resident in Hong Kong is nevertheless still strong. Finally, despite the sales decline in Hong Kong, groups in the sector have underscored the still high level of profitability in the region.

Fig. 4: Change in department store sales and watch and jewellery retail sales in Hong Kong



Source: Company Data; Bryan, Garnier & Co ests.

1.4. The CNY devalued three times in a week!

Surprise devaluations in the Chinese currency!

During the week of 10th August, the Chinese central bank devalued the Chinese Yuan (CNY) three times (by -1.9% on Tuesday 11th, followed by -1.6% on Wednesday 12th and -1.1% on Thursday 13th) bringing the currency to its lowest level against the dollar for three years, despite a small upswing on Friday 14th August (+0.05%).

This triple decision by the People's Bank of China (PBoC) nevertheless seems logical since the recent strength of the CNY against the USD as well as other emerging currencies (Malaysian Ringgit and Indonesian Rupiah) and also against the Japanese Yen and the Korean Won, had caused a clear loss of competitiveness relative to other emerging markets in recent months. The need to stimulate exports was imperative especially after the 8.3% decline in exports in July and since local consumer spending is currently not strong enough to underpin economic growth.

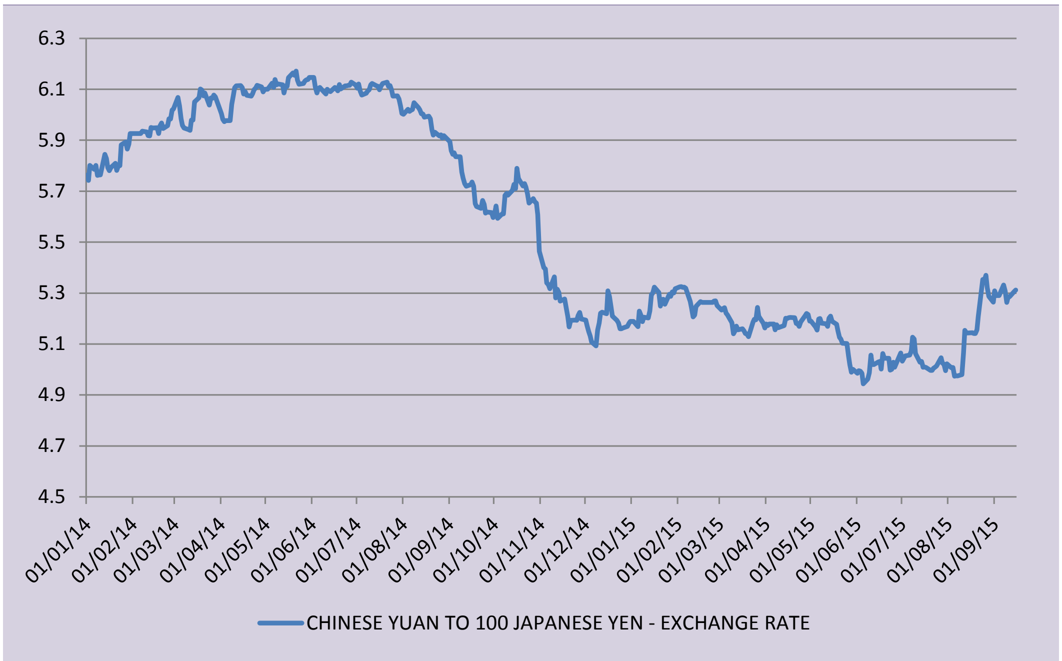
Fig. 5: CNY vs USD and EUR

Source: datastream

Beyond these three devaluations, we could also fear that other emerging markets, whether in Asia (Malaysia) or not (South Korea, Taiwan), could follow suit and devalue their currencies in order to keep their exports competitive. As such, a negative domino effect could start that would affect all emerging markets, which contribute almost 40% to global GDP. Beyond the situation in China, currency uncertainty affects the economic health of emerging markets.

The decision to devalue the CNY against the USD has also perhaps prompted the Fed to delay the increase in its interest rates, initially expected in September, in order not to feed a further strengthening of the US currency against the CNY. This devaluation above all highlights the risk of further economic slowdown in China and hence an eventual contagion to the US, such that the time would not be particularly smart for a hike in interest rates under these conditions.

Fig. 6: CNY vs JPY



Source: Datastream

2. Luxury groups are very present in China

For the main luxury brands, the Chinese region (Mainland China, Hong Kong, Macau) has become a major challenge, driven by the extremely buoyant growth rates noted over the past 10 years, especially since 2007. This is all the more true if we reason by customer base, since the Chinese account for almost a third of the global luxury market, whether locally or abroad.

This development has gone hand in hand with an unbridled store opening strategy, sometimes with no real distinction in terms of the quality of location, even though the trend has slowed clearly since 2012 and even in some cases inversed (store closures) over the past two years.

2.1. Around 20% of sales generated in Greater China

Luxury groups have significant presence in Greater China and Mainland China!

The table below illustrates the weight of Greater China (21% on average) in luxury group sales. Given their exposure to the watch-making sector, note unsurprisingly that Swiss group Swatch Group has the highest presence in China, which accounts for almost 20% of its sales (37% in Greater China), followed by Richemont (12% of sales and even 26% in Greater China). We estimate that LVMH and Kering Luxury derive 10% and 11% of their sales respectively from Mainland China. The Gucci brand has almost 14% of its sales in Mainland China and between and 10% in Hong Kong/Macau whereas for the Bottega Veneta brand, these figures stand at 13% and 17% respectively.

More modestly sized players such as Tod's and Salvatore Ferragamo already generate 20% of their sales in the region. In contrast, on our estimates, Hugo Boss is the group in our sample the least exposed to China (8% of sales in Greater China including 5% in China).

Despite this high presence in Greater China, the geographical breakdown of sales at groups in the sector remains very homogenous with three main blocks (Asia excluding Japan, North America and Europe), except maybe for watch-making groups where Asia excluding Japan is over-represented for historical reasons (strong Chinese demand for watches and men's luxury).

Fig. 7: Breakdown of luxury group sales by region

As % of 2014 sales	Europe	N Am	Japan	Asia ex Japan	o/w MC	o/w HK	o/w RoA	Others
Burberry	31	26	4	33	15	8	10	6
Ferragamo	27	23	8	37	12	10	15	5
Hermes	35	17	12	34	10	10	14	2
Hugo Boss	61	23	1	14	6	2	6	1
Kering Luxe	32	18	10	31	11	8	12	9
LVMH	29	24	7	29	10	8	11	11
Richemont	30	15	8	40	12	16	12	7
Swatch	34	8	3	52	20	16	16	3
Tod's	57	9	4	29	12	10	7	1
Average	**37**	**18**	**6**	**34**	**12**	**10**	**12**	**5**

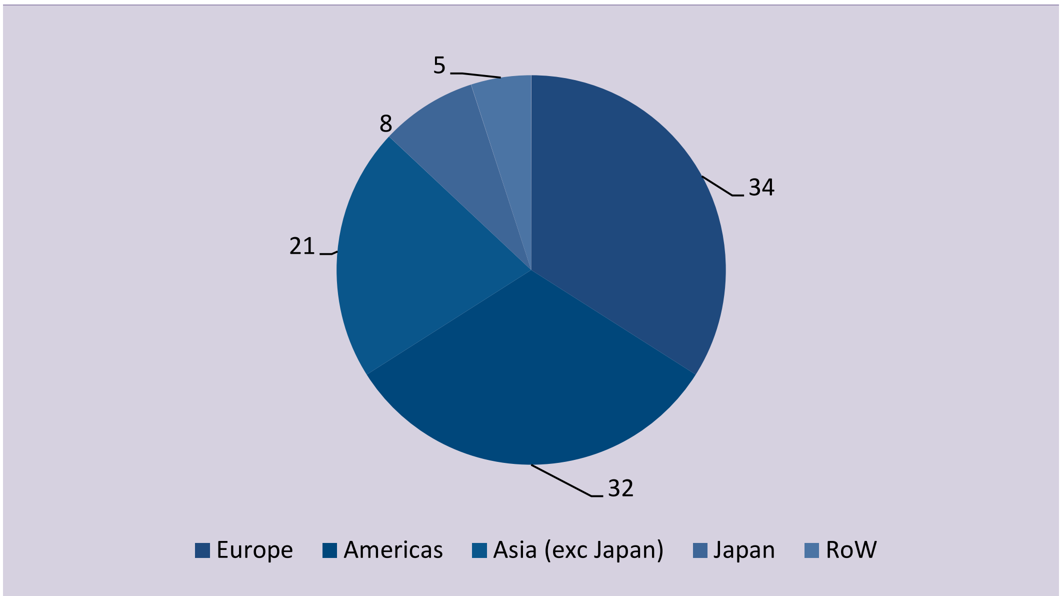
Source: Company Data; Bryan, Garnier & Co ests.

Bain & Cie estimates the global luxury market at EUR223m for 2014, i.e. 21% in Asia excluding Japan...

This homogenous nature is confirmed by the chart below which shows the still predominant weight of the Americas and Europe in the overall global luxury market, valued by Bain & Cie strategy consultants (in association with Altagamma) at almost EUR223bn in 2014 (excluding cars, spirits and hotels). For 2015, the first forecasts by Bain & Cie point to growth in the global market of 2-4%.

Asia excluding Japan already accounts for 21% of this market however, compared with just 13% in 2008. Over 2008-2014, the CAGR in the Asia-Pacific luxury market stood at 15% compared with 5% for Europe and 9% for the Americas. In Mainland China in particular, average annual growth in the luxury market even reached more than 20% over this period. We are far from this level at present (virtual stability or even a slight downturn) and nothing suggests a return to this type of momentum in the short/medium terms, quite the contrary!

Fig. 8: Breakdown of global luxury market by region (%)



Source: Bain & Cie; Bryan, Garnier & Co ests.

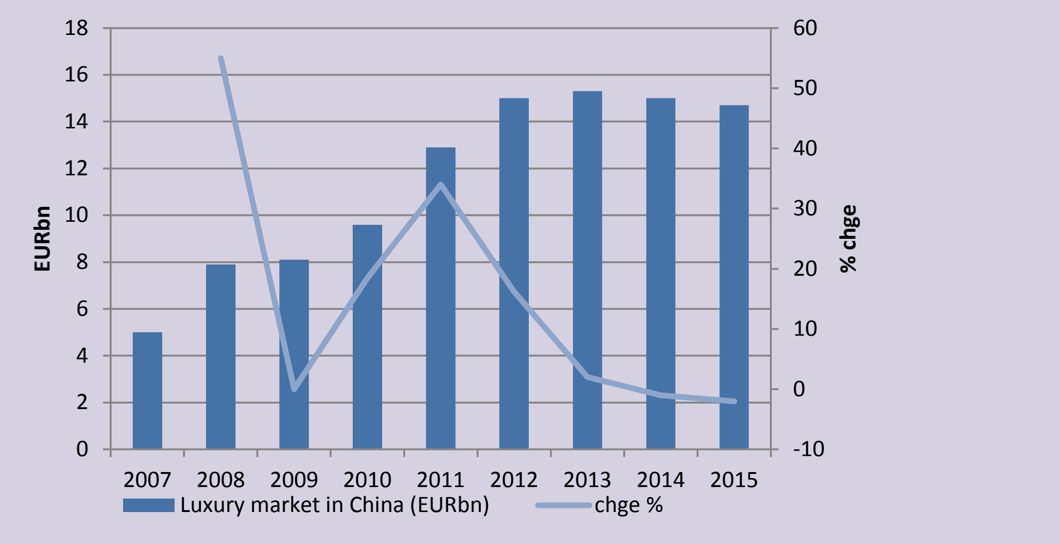
... of which 15% in Greater China and 7% in Mainland China...

The chart on the following page highlights the virtual stability in the luxury market in Mainland China over the past two years, after it posted a CAGR of 27% between 2008 and 2012. Bain & Cie values the luxury market in Mainland China at virtually EUR15bn, or 7% of the overall global market, and that in Hong Kong at EUR8bn (4% of the total), namely as much as in Korea and the entire Middle East. We expect the trend in Mainland China to remain the same this year and expect a slight downturn (-1%), which might seem optimistic in view of recent events (devaluation, stockmarket crash etc.) and current uncertainty.

... but, on average, China accounts for 10-12% of luxury group sales

Note that for major players in the luxury sector, the weight of China in their respective sales is slightly higher (between 10% and 20%) than the weight of the country in the overall market given the often high level of penetration for listed groups. Louis Vuitton opened its first store in Beijing (at the Palace hotel) in 1992 whereas Hermès inaugurated its store in 1998. However, the first luxury group to arrive in China was clearly Swatch Group with its watch brands and Omega in particular, thereby explaining the significant weight of Mainland China in its sales, i.e. 37%, including almost 20% for China alone, the highest level among the groups in our luxury sample.

Fig. 9: Change in luxury market in China (2007-2015e)



Source: Bain & Cie; Bryan, Garnier & Co ests.

2.2. Very strong distribution presence in China

As of 1992, luxury brands set up in Mainland China and have a large number of stores after a very (overly?) ambitious retail expansion strategy.

Luxury brands have 20-70 stores in Mainland China

From around 23 stores for Hermès to more than 70 stores for Salvatore Ferragamo and more than 60 for Italian brand Gucci, luxury brands have very dense coverage in Mainland China, primarily in Tier 1, Tier 2, in few Tier 3 cities and preferring nevertheless not to head into Tier 4 towns (China has 100 cities with a population of at least one million), in order not to trivialise the brand's image. Hermès has virtually as many directly-operated stores in China (23) as it does in the US (27), whereas Louis Vuitton has almost 110 stores in the US and 49 in Mainland China (+2 in 2014). In addition, note that on average, the most emblematic luxury brands have eight stores in Hong Kong (even 12 for Gucci and 11 for Ferragamo) and around three or four in Macau (and even five for Bulgari and Ferragamo).

Fig. 10: No. of stores by region

No. of stores	Mainland China	Hong Kong	Macau
Cartier	36	9	3
Gucci	63	12	3
Louis Vuitton	49	8	4
Bottega Veneta	39	9	4
Bvlgari	28	9	5
Hermès	23	7	3
Chanel	11	8	2
Ferragamo	72	11	5
Tod's	35	7	2

Source: Company Data; Bryan, Garnier & Co ests.

2.3. Chinese customers account for almost 30% of the global luxury market

Chinese customers account for almost 30% of the luxury market vs. 10% in 2008...

Chinese customers from Greater China currently account for almost 30% of the global luxury market compared with around 10% in 2008. We estimate the weight of Chinese customers from Mainland China alone at just under 20%. Over the past five years, the CAGR in the luxury market for Chinese customers stood at 20% vs. just 8% for the market as a whole, while more than two thirds of market growth was driven by Chinese customers. We even estimate average growth at 30% over 2010-2012 before this slowed massively to stand at 10% over the following two years (2013-2014). For the current year, we are forecasting an increase of 7%, primarily driven by the purchases made outside Greater China, especially in Europe and Japan.

2.3.1. Chinese have replaced Japanese

… including a third in Mainland China, a third in HK/Macau and the last third elsewhere (Japan, Europe).

In Hong Kong, 70% of the luxury products market is generated by Chinese consumers from Mainland China. Asian customers as a whole, excluding Japan, account for almost 40% of the global market on our estimates, and in addition to Chinese customers primarily come from Korea and also increasingly from Indonesia. We estimate that a third of this 30% attributable to Chinese customers is generated in Mainland China, another third in Hong Kong/Macau together and the last third in other Asian countries, in Europe and more recently in the US.

Similarly, while customers from Greater Chinese accounted for 30% of the global luxury market in 2014, note that this figure stood at just 12% in 2008, whereas at the same time, the weight of Japanese customers has fallen from 22% to 13%. That of US customers and European remained generally stable over the period (see table below).

Fig. 11: Luxury market by nationality

in %	2008	2014
Chinese	12	29
European	28	24
American	17	15
Japanese	22	13
Others	21	19

Source: Bain & Cie; Bryan, Garnier & Co ests.

US customers represent 15% of the global market and European customers 24%. In contrast, the weight of Japanese customers fell drastically during the 1990s, from 40% to 13% at present in view of the mature local market caused partly by sluggish demographical factors, the lack of new store openings and often disadvantageous monetary fluctuations. In addition, we estimate the weight of Russian customers (including tourists) at almost 3% of the overall market, mostly spread over the local market, in Dubai, and in western Europe (France and London especially), despite a clear slowdown in these two regions since the emergence of geopolitical tension caused by the situation in Ukraine.

After the Chinese, US and European customers are the second and third largest clientele!

Customers from the Middle-East account for around 5% of the overall market, with the region representing almost 4% of sales at LVMH for example. In the Middle-East, in addition to local customers, we would highlight the significant weight of Russian clients (despite a downturn recently), as well as Chinese and Indian customers.

Fig. 12: Breakdown of luxury group sales by nationality

As % of 2014 sales	West Eur	North Am	Greater China	Others Asia	Japan	East Eur	Middle East
Burberry	14	20	35	16	5	5	5
Hermes	17	14	28	16	13	6	6
Ferragamo	12	19	32	15	11	4	4
LVMH	18	18	29	11	10	5	6
Louis Vuitton	12	17	33	11	14	5	7
Kering Luxe	18	18	28	10	17	5	4
Richemont	12	11	35	17	10	4	8
Swatch	10	7	55	12	3	4	8
Tod's	40	11	27	7	4	5	5
Average	**18**	**15**	**33**	**13**	**10**	**5**	**5**

Source: Company Data; Bryan, Garnier & Co ests.

2.3.2. No real source of fresh growth in the short-term

Beyond the healthy performances generated in mature countries, often due to exchange rates, we see no real source of fresh growth in emerging markets. As such, in our view Brazil and India are not in a similar situation to offset the GC decline.

India is penalised by prohibitive import fees and the lack of a genuine infrastructure (shopping malls or streets) dedicated to luxury stores. Store networks remain limited in India, with the majority located in Mumbai and New Delhi, with just four stores for Louis Vuitton and two for Gucci. Only the Hermès brand has a free-standing store in a Mumbai district, with the others all located in hotels. In contrast, Indian visitors are the third-largest tourism customers in Dubai (along with Russian and Chinese tourists) for luxury brands.

The same goes for Brazil, which apart from the economic crisis that the country is suffering at present, compounded by political tension, is also penalised by customs barriers such that the majority of luxury products acquired by Brazilian consumers are purchased in the US (Florida especially) and also in Europe. Note that Louis Vuitton only has four stores in the country and Gucci just three. Here again, the luxury brands are focused in two cities, Rio de Janeiro and Sao Paulo and primarily in shopping centres such as the *Citade Jardim* in Sao Paulo.

3. A clear slowdown in sales... for several years now

The slowdown in China is nothing new!

The slowdown in the luxury market in Greater China is not a recent event, having started as of 2013 in Mainland China, in the wake of the new Chinese President Xi Jinping coming into power. The trend took shape during Q3 2014 in Hong Kong following the demonstrations of October 2014 and has gained momentum since the start of this year, especially in Hong Kong and Macau. The trend in Mainland China is more one of stabilisation or a slight deterioration, following the worsening of price differences in luxury products between Europe and Mainland China in recent quarters (due to the stronger USD and hence the CNY against the EUR).

Luxury groups are therefore facing a generally dismal backdrop in the region that does not seem to have improved over recent weeks and on which visibility remains very poor.

3.1. Double-digit sales decline in Hong Kong and Macau...

Double digit sales decline in HK and Macau!

Since the start of this year, luxury product sales have dropped by at least 10% (or even almost 20% for certain brands) in the former UK colony and in Macau, and above all have shown no improvement in recent months and no signs of a change in coming weeks or months, despite less demanding comparison with the year-earlier period as of Q3 and especially Q4. This negative trend is primarily due to the lower number of Chinese tourists in Hong Kong and Macau, whereas local clients in Hong Kong remain robust according to the majority of groups in the sector. These two regions together account for an average of 10-12% of luxury market sales, excluding the watch segment where the figure is higher.

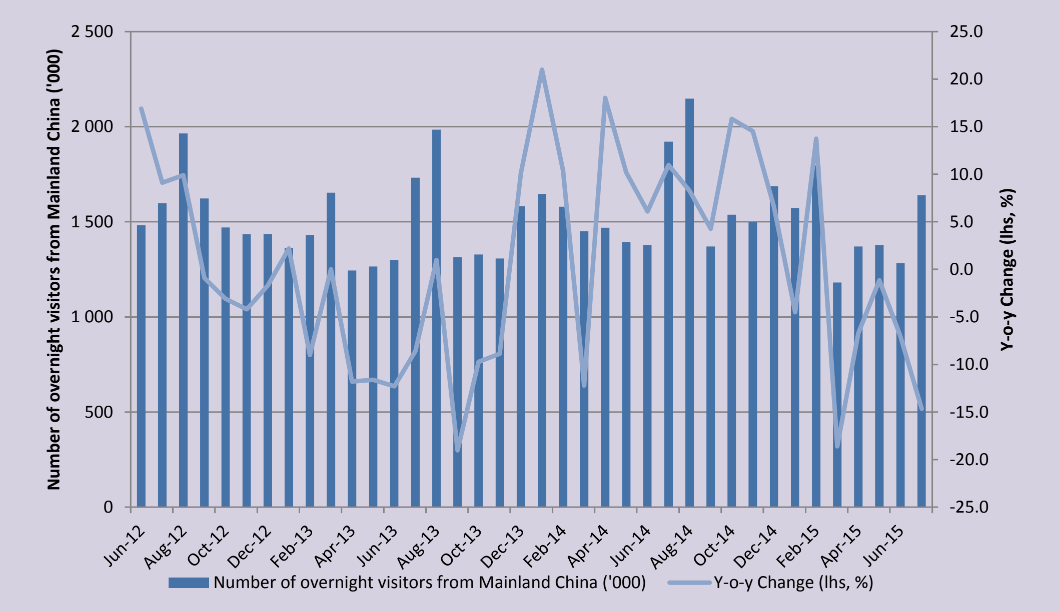
Richemont derives almost 18% of its sales from the region (16% in Hong Kong), Swatch around 15% whereas for LVMH the figure is lower at around 10% (including 8% in Hong Kong). As a counter example in the soft luxury segment, note the Bottega Veneta brand (Kering), which generates 17% of sales in these two regions.

3.1.1. Fewer and fewer Chinese visitors in Hong Kong

Political tension between the former UK colony and Mainland China worsened after the demonstrations seen in October 2014 and combined with the search for new shopping experiences (more sophisticated with more service), has contributed to a clear aversion to Hong Kong by Chinese tourists, and especially for overnight visitors, those that stay in Hong Kong the longest, but above all those that spend the most on shopping and especially on high-end products.

The chart on the following page is a perfect illustration of this trend. Indeed, the number of Chinese overnight visitors to Hong Kong dropped by 15% in July (the fifth consecutive month of decline) after falling 10% in June. The negative trend is therefore taking shape and suggests that sales could fall again in Q3 at luxury groups present in the region.

Fig. 13: No. of overnight visitors to Hong Kong from Mainland China



Source: Company Data; Bryan, Garnier & Co ests.

However, we should not forget that in 2014, more than 60% of Chinese tourists focused their travel on these two regions, including 45% for Hong Kong and 18% for Macau, whereas the weight of France and Japan for example only stood at 2% each. Similarly, Chinese tourist flows to Hong Kong multiplied by 1.6x between 2009 and 2014, thereby putting this recent trend in perspective.

Causeway Bay is the second most expansive world place after Fifth Avenue!

Despite the negative trend in the former British colony, luxury brands have insisted on the fact that the market remains highly profitable. This also explains why they have not yet managed to negotiate rent reductions with their landlords, despite the attempts clearly announced by Prada, Louis Vuitton and Tod's. Causeway Bay in Hong-Kong remains the second most expensive district in the world after 5th Avenue in New York! In contrast, over the medium term, if the negative trend continues, questions concerning the relevance of such a sizeable store network in Hong Kong are likely to arise. Closures could therefore be envisaged.

Fig. 14: Property prices in main global sales districts

Rank 2014	Location	City, Country	Rent EUR/sqm/yr	2008-14 CAGR (%)
1	Upper 5th Avenue	NYC, USA	29 822	15.4
2	Causeway Bay	H-K, China	23 307	11.5
3	Champs Elysées	Paris, France	13 255	9.4
4	New Bond Street	London, UK	10 361	11.1
5	Pitt Street Mall	Sydney, Australia	8 658	14.9
6	Via Montenapoleone	Milan, Italy	8 500	4.0
7	Ginza	Tokyo, Japan	8 120	7.0
8	Myeongdong	Seoul, South Korea	7 942	14.5
9	Bahnhofstrasse	Zurich, Switzerland	7 456	7.0
10	Stoleshnikov	Moscow, Russia	4 749	7.0

Source: Cushman & Wakefield

The two charts on the following page also show how the slowdown has worsened in Greater China (including Hong Kong and Macau) and not just in Mainland China, and especially the luxury market since the beginning of the year.

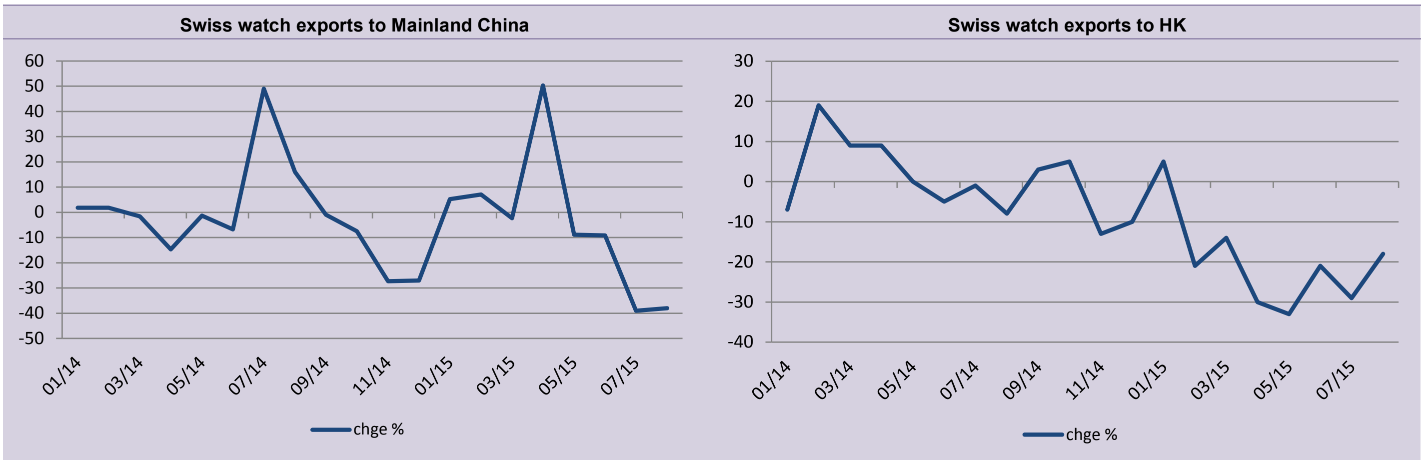
Indeed, Swiss watch exports plummeted almost 40% in Mainland China in July and in August, admittedly against very demanding comparison with the 49% increase seen in July 2014, but also fell by 9% in May and June. Watch exports to the country have fallen by 9% since the beginning of 2015. For the full year, we are forecasting a 8% decline, following decreases of 12% in 2013 and 3% in 2014.

As such, despite fairly attractive comparison with the year-earlier period that could have suggested better trends were on the cards, the upscale watch segment remains totally depressed in China due to the economic slowdown and also the all-out fight against corruption led by the Chinese public authorities. Richemont noted hefty falls in sales over April-August 2015 in Hong-Kong/Macau and a still negative trend in the wholesale network in Mainland China.

A sharp decline in watch exports to Hong Kong and Mainland China since the beginning of the year...

At the same time, Swiss watch exports to Hong Kong (which is also a base for re-exports to other Asian regions such as Macau where the luxury market has dropped by at least 20% since the beginning of the year following a more than 30% plunge in gambling revenues) have also fallen massively, with a 27% nosedive in July for example, -18 % in August and even -20% over the first eight months of the year, following a stable year in 2014 and a 5% decline in 2013. Hong Kong is the leading global market for Swiss watches with market share of 18%, followed by the US (11%). Mainland China accounts for 10% of the global market.

Fig. 15: Swiss watch exports to Hong Kong and Mainland China



Source: FHS; Bryan, Garnier & Co ests

3.1.2. Sharp downturn in gambling revenues in Macau

The chart below highlights the sharp deterioration in the gaming industry in Macau with a 35% plunge in gambling revenues, partly due to stricter new regulations and also the credit crisis in the former Portuguese colony (the Chinese tend to contract debt to play in Macau casinos). As such, since the beginning of the year, the luxury market has fallen by around 20%. The main brands in the sector have three to four stores in Macau, which generate around 2% of their respective sales.

Here again, as in Hong Kong, questions concerning the renegotiation of rental leases could emerge in coming months, and if necessary (if this very negative momentum continues and rent reduction requests fail), adjustments to the store network, even if what's at stake remains fairly modest relative to the total number of stores owned by the main brands in the sector (Louis Vuitton had more than 460 directly-operated stores and Gucci 505 at end-2014).

Fig. 16: Change in gambling revenues in Macau (in %)

Source: Gaming Coordination Bureau Macau; Bryan, Garnier & Co ests.

3.2. … sales in Mainland China have virtually stabilised …

A luxury market almost stable in Mainland China in 2014!

While the situation is clearly negative in Hong Kong and Macau, it is more mixed in Mainland China, affected not only by economic slowdown but also three major factors: **i/** the fight against corruption, **ii/** price differences and **iii/** the virtual lack of store openings over the past two years.

3.2.1. The fight against corruption

The fight is against what is known as corruption or extravaganza, and hence against the gifting market (estimated by Bain & Cie at almost a third of the Chinese market in 2012). This policy was initiated by the Chinese authorities as of the arrival of Xi Jinping as President in November 2012 (officially instated in March 2013) with a fight against "both tigers and flies" and has clearly affected the luxury market in China (probably by more than the majority of groups in the sector and analysts expected) and widely explains why growth has slowed. The watch market as well as spirits and especially cognac have suffered and continue to suffer the most.

This policy has made the Chinese far more distrustful and has also had a wider negative psychological effect and therefore affected a population that was initially not concerned. Consumption of overly ostentatious luxury products such as luxury watches and dinners serving XO cognac have therefore suffered massively. It is now widely accepted that the gifting market has definitively disappeared and is unlikely to return in the short term, or even perhaps over the medium term (or not under the same President at least).

3.2.2. Price differences

Whereas in historical terms, the price difference between China and Europe has run at around 35%, the level is now closer to 60% in view of the weak EUR against the USD since summer 2014. However, the majority of brands have been and still are cautious in terms of price adjustments in China (few price cuts in Mainland China), with the exception of Chanel, Patek Philippe and

Richemont brands (as Cartier) as of 1st May. The recent devaluations of the Chinese currency against the dollar iares good news in this respect since they reduce the price difference somewhat. However, the CNY has not really dropped against the EUR recently, thereby reducing the relevance of this argument.

The two charts below set out price differences between the various regions (Europe: base 100) for the main brands in the sector. Unsurprisingly, the widest gap is between prices in Europe and those in China, which generally stand at 50 or even 60%. In our sample below, only Cartier (Richemont) stands out in view of the prices increases implemented in Europe and the price cuts applied on 1st May in USD zones, which seem to have paid off in view of double-digit growth in the retail network in Mainland China over the first five months of the year (April to August).

Fig. 17: Comparison of selling prices

	LV	Gucci	Cartier	Hermès	Tod's	Ferragamo
Europe	100	100	100	100	100	100
US	130	115	100	130	130	125
China	160	150	110	na	150	170
Japan	120	115	100	125	na	125

Source: Company Data; Bryan, Garnier & Co ests.

The table below shows the change in price differences between China and Europe for the emblematic Louis Vuitton handbag, the *Speedy Monogram 30,* this having risen from 30% in 2013 (fairly classic level) to 60% at present.

Fig. 18: Price difference for the Louis Vuitton *Speedy 30 Monogram* handbag

	2013	2015
Europe	100	100
US	110	130
China	130	160
Japan	115	115

Source: Company Data; Bryan, Garnier & Co ests.

3.2.3. Fewer store openings in China over the past two years

After several years (especially between 2008 and 2012) of unbridled store openings in Asia-Pacific and especially in China, brands in the sector have been more discriminating in the pace of store openings. For example, whereas Gucci opened 59 stores in 2011 (in all regions combined), followed by 52 in 2012, it only inaugurated or brought back under internal control 30 stores in 2014. In Mainland China, Gucci had 39 stores in 2010 and 58 at end-2012 (+19 over two years), but at end-2014, the group had 63 stores, representing just four net openings over the past two years. A similar trend is visible at the group's rivals. Indeed, Louis Vuitton has only opened 2 stores (in net terms) in Mainland China in 2014.

In contrast, the majority of luxury brands have renovated, extended, or even relocated a large number of stores in order to move their retailing network upscale with the aim of improving the purchasing experience in the country (higher level of service and wider range of products) and to take account of urban upheaval in the majority of major cities (emergence of new districts, dislike of older ones etc.). Brands have therefore favoured quality over volumes.

3.2.4. Economic slowdown

As developed earlier in this report, the economic slowdown in China is also, in our view, a major reason why the luxury sector momentum is less dynamic than three or four years ago. Actually, beyond healthier Chinese that have still enough purchasing power to buy luxury products (even if they spend more money in art, cruise, SPA or exclusive hotels), the former luxury industry growth was driven by the new aspirational clientele which are likely the most affected by the current economic slowdown as they have benefited during the period 2009-2012. According to Mac Kinsey, 21 millions of households will have an annual income above USD34,000 in 2020.

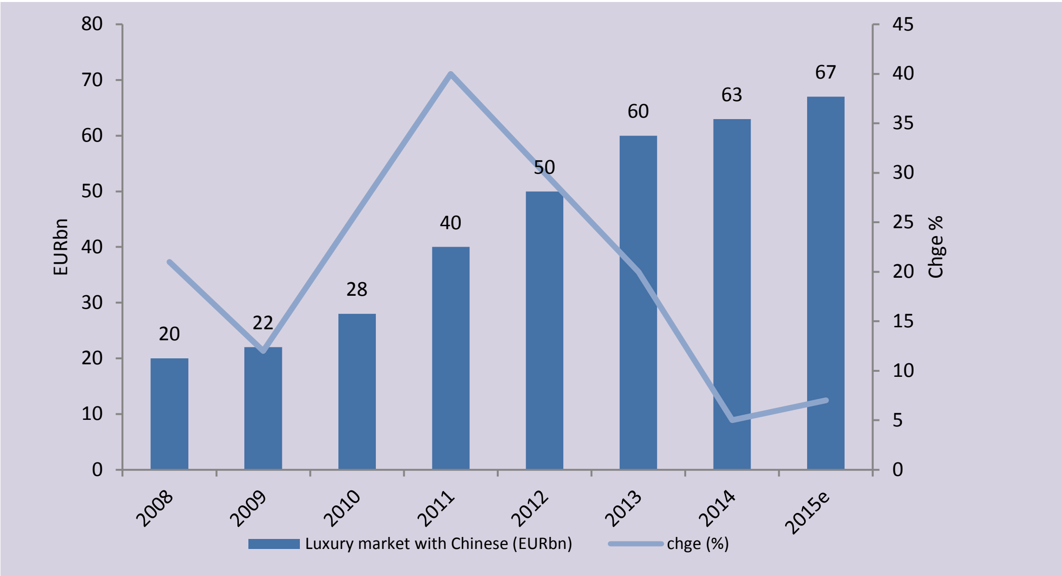
3.3. …But sales growth with Chinese customers

Analysis of the luxury market by nationality is even more accurate in our view as almost 40% of the luxury market is achieved through tourists. And the Chinese clientele remains well oriented with for instance +10% for LV in Q2 and +5% for Gucci (helped by more discounted sales).

3.3.1. Chinese clientele still well oriented

The chart below highlights our estimate of growth in the luxury market with Chinese customers that we estimate at almost EUR67bn in 2015, up by almost 7% after growth of 5% in 2014. While this figure is reassuring, it is nevertheless well below the momentum enjoyed over 2010-2013 (+25% on average). The current trend is the consequence of a number of economic factors (price differential due to currencies limiting local consumer spending, economic slowdown in China reducing wealth creation etc.), as well as structural factors (fight against corruption which is a widely stated policy of the current authorities, a degree of saturation in the store network in China etc.).

Fig. 19: Change in luxury market generated by Chinese customers



Source: Company Data; Bryan, Garnier & Co ests.

3.3.2. A world tourism with a positive momentum

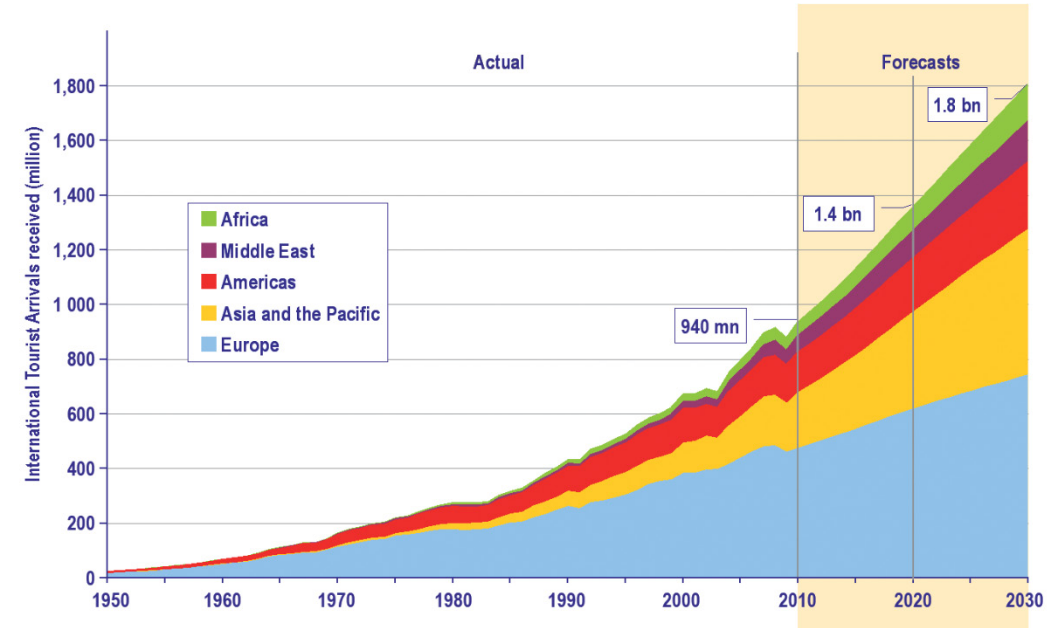
Indeed, in addition to currency fluctuations (and hence selling prices), which is a vital parameter, but often a short-term one (as seen this year with the decline of the EUR), we would underscore two more structural factors.

- Firstly, the ongoing sharp increase in global tourism is a significant catalyst for the luxury market. After a rise of 4.3% in 2014 to 1.133 billion arrivals, the WTO estimates that the CAGR in global tourism is set to total 3.3% to reach 1.8 billion arrivals in 2030.

…almost 40% of the luxury market is made up of tourists!

- The second factor is the weight of purchases generated by tourists in the global luxury market. We estimate this at around 40% of the market, with more than 80% in Hong Kong but less than 30% for the US market. Furthermore, shopping is one of the main reasons highlighted by Chinese travellers (the 2014 Hurun survey put this as second reason after visits). High Net Worth Individuals (HNWI) in China generally spend a week away when travelling and this naturally favours consumption of luxury products. The same Hurun survey estimates that the wealthiest Chinese tourists spend an average of USD1,000-5,000 per trip and are neglecting organised trips in favour of individual travel, which is again synonymous with higher spending on shopping.

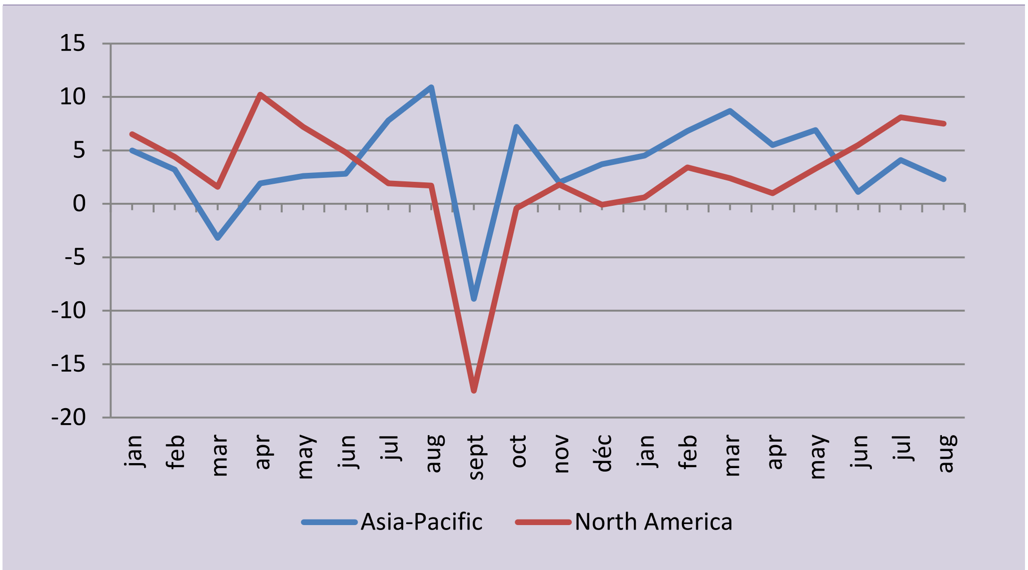
Fig. 20: Change in global tourism



Source: WTO.

The chart below also shows the healthy momentum in passenger traffic at the Paris airports Roissy-Charles de Gaulle and Orly with arrivals stemming from North America and Asia Pacific. The slight slowdown in August of arrivals from Asia-Pacific (+2% after +4% in July) was due to far more demanding comparison with the year-earlier period. We see that the trend from Asia-Pacific remains positive and we argue that one of the reasons of this dynamic momentum is driven by Chinese tourists.

Fig. 21: Change in passenger arrivals at ADP (change in %)



Source: ADP; Bryan, Garnier & Co ests.

3.3.3. More and more Chinese travel

In 2014, 109 millions of Chinese have travelled over the world (of which more than 60% in HK and Macau) versus 57 millions in 2010. They should be close to 124 millions in 2015 (+14%). Given this momentum (+10% of CAGR vs +16% on last five years), we could see around 200 millions of Chinese tourists. This positive momentum of Chinese tourists is clearly a catalyst for the luxury goods industry growth.

124 millions of Chinese tourists expected in 2015!

Fig. 22: Number of Chinese tourists

Source: Company Data; Bryan, Garnier & Co ests.

Despite the virtual stability in sales in Mainland China (or even a slight downturn) and the plunge in sales in Hong Kong, the luxury market for Chinese customers remains buoyant thanks to the sales generated by Chinese tourists primarily in Europe, Japan and to a lesser extent Korea (apart from during the MERS outbreak in recent months) and finally on the US west coast (despite the strong dollar). As such, sales at Louis Vuitton to Chinese customers rose by more than 10% in H1 and even picked up slightly in Q2. Furthermore, it is worth noting the Swiss watches exports in August which show clear decrease in GC (-38% in HK and -20% in MC) while in all the Western countries, the growth was double digit. We argue that one of these growth drivers was the Chinese tourist's flows.

The same trend is true for Gucci (growth of almost 5% in H1), admittedly partly aided by the extension of the discount sales period in dollar regions including Asia-Pacific (especially Greater China moreover) in order to sell off stocks of collections designed by Frida Giannini, the brand's former Creative Director. The main reason for robust momentum in sales to Chinese tourists is clearly the difference in prices (more than 60% compared with Europe), prompted by currency fluctuations (weak JPY and EUR vs. USD and hence CNY).

3.3.4. Chinese: 1st clientele of Tax Free shopping

Chinese have spent 14% more in Duty Free shopping in 2014!

According to Global Blue (see table below), Chinese are the first worldwide clientele for Duty Free shopping with a 30% market share while, the second clientele, the Russians account for 14% of the Tax Free shopping around the world. The Duty Free shopping done by Chinese grew 18% in 2014 with still positive momentum.

Fig. 23: Duty free market by clientele (2014)

	weight of total Duty Free sales (%)	2014 chge (%)
China	30	18
Russia	14	-17
US	4	8
Indonesia	3	-10
Japan	2	-12

Source: Global Blue; Bryan, Garnier & Co ests

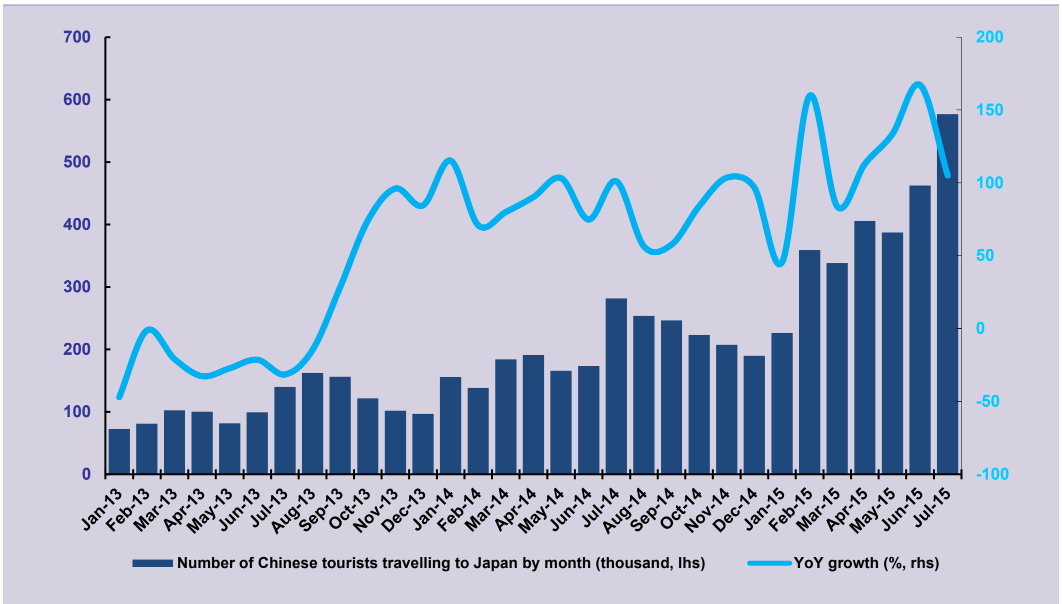
3.3.5. More and more Chinese visitors in Japan...

Despite a virtual doubling in the number of Chinese visitors to Japan since the beginning of the year (see chart below), these still only account for 5-10% of the Japanese luxury market. The country remains above all a local market, like the US market moreover (80% local customers and 20% tourists) despite the influx of Chinese visitors on the west coast. However, the strong dollar reduces the country's appeal for European tourists. However, tourists still only account for a small amount of no more than 10% in Japan (even if almost two third of purchases by foreign customers are made by Chinese visitors).

The health of the luxury market in Japan stems primarily from momentum with local customers (admittedly driven by current weakness in the JPY making purchases abroad less attractive). Note importantly that the purchase experience is far more gratifying in Japan than in Mainland China, in view of a level of service at the top end of the scale in the Osaka stores and the Japanese capital with staff often better qualified and also wider range of products.

Beyond beneficial comparison with the year-earlier period, we understand more the sales increases of 48% at Richemont in Japan between April and August, 27% for Kering's luxury division in Q2 and 34% at LVMH for the same quarter.

Fig. 24: Chinese tourism statistics in Japan



Source: IATA; Bryan, Garnier & Co ests.

Louis Vuitton has 60 directly operated stores, while Hermès has 30 and Gucci more than 40 stores. Furthermore, although the Japanese luxury market is structurally mature, partly for demographic reasons, it is currently benefiting from the weak JPY, which makes travel more expensive and therefore less frequent, with Japanese customers making more local purchases and fewer abroad. These various factors, combined with particularly advantageous comparison with the year-earlier period due to the impact of the increase in VAT on 1st April 2014, meant Japan was the best performing region in Q2 (sales up 25% on average including +34% for LVMH and +20% for Hermès).

The chart on the following page shows the weak Japanese Yen relative to the CNY as of July 2014 until the Chinese currency was devalued in August (from CNY6.1 for JPY100 in July 2014 to CNY 5.0 in July), which enabled the JPY to strengthen to CNY5.3 in early September. In our view, it is still too early to expect a lower flow of Chinese visitors to Japan, in view of the weak recovery in the Japanese currency relative to the CNY, with its current level still far lower than that of August 2014.

Fig. 25: A weak JPY vs CNY

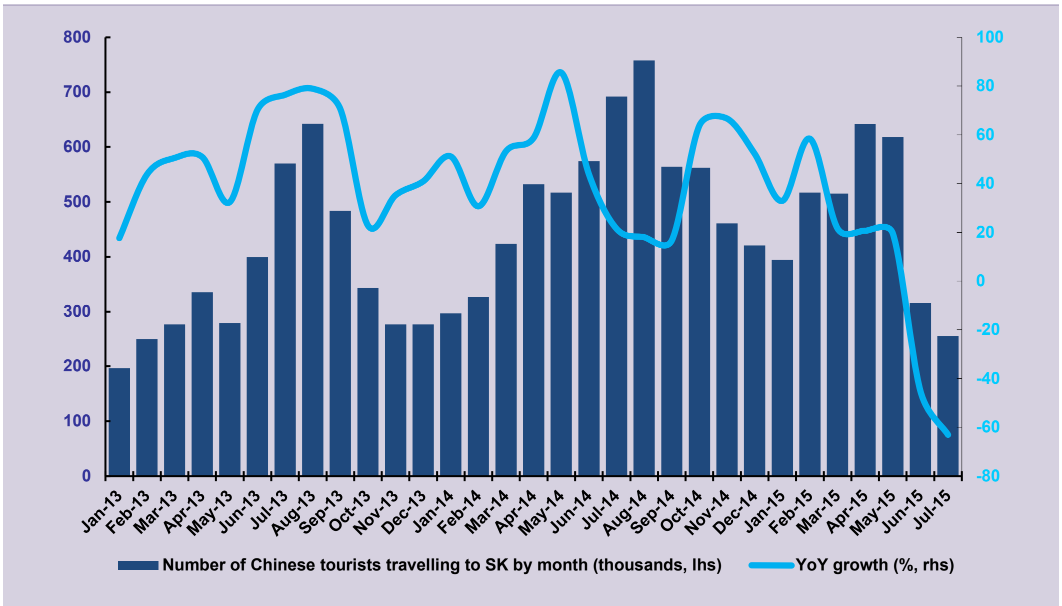
Source: Company Data; Bryan, Garnier & Co ests.

3.3.6. … and in Korea

South Korea is another country increasingly visited by Chinese tourists from Mainland China (primarily those from Tier 1 and Tier 2 cities) looking for a better welcome than in Hong Kong, where the market has tended to become less exclusive with customers stemming from Tier 3 and 4 cities.

Only the recent MERS outbreak (Middle East Respiratory syndrome) has placed a serious brake on this trend, notably with declines of 45% in June and 63% in July (see the chart on the following page). We nevertheless expect positive momentum to gradually return as the risks fade. Chinese tourists account for virtually half of the visitors to Korea (six million our of a total of 14 million in 2014). In addition, Chinese travellers spend double the amount on shopping than Japanese visitors on average (USD2,500 vs. USD1,000). Chinese travellers spend almost 55% of their budget on shopping during a trip to Korea (average of 43% for travellers from all nationalities). The luxury market is valued at almost EUR10bn, or almost 5% of the global market. We estimate that tourists represent around half of the Korean luxury market, such that the weight of Chinese tourist spending is close to a third of the Korean luxury market.

Fig. 26: Chinese tourism statistics in Korea



Source: Company Data; Bryan, Garnier & Co ests.

4. Cautious forecasts for 2016!

Thanks to an excellent second quarter boosted by i/ more beneficial comparison with the year earlier period, especially in Japan, ii/ massive tourist flows of travellers visiting Europe from Asia and especially China, but also from the US given the strength of the dollar, and despite the current situation in Asia, we are making virtually no changes to our forecasts for the current year and are forecasting organic growth of 5%. In contrast, and for caution's sake, we have preferred to reduce our forecasts for 2016 and are now looking for a similar level of momentum, namely average organic sales growth of 5% vs. 6% previously.

4.1. An excellent Q2!

Buoyant Q2… but cautious for Q3!

Whereas average organic growth in sales in our sample of luxury groups was sluggish in Q1 (+0.7%), Q2 was far more dynamic thanks to average growth of 6% (or +3% over H1) with in particular **i/** double-digit growth (+10%) in **LVMH's** fashion and leather goods division, hence at Louis Vuitton (i.e. the best performance since Q1 2012) and **ii/** at **Kering**, with a recovery in momentum at Gucci (+4.6% vs -8% in Q1), admittedly partly helped by the extension of the sales period in dollar regions (US and Greater China mostly). **Hermès** again posted the best performance in our sample during the quarter (+10%) as was already the case in Q1 (+8%). Finally **Richemont** posted like-for-like sales growth of 4% over the first four months of the year (April-August), which was a reassuring performance, reflecting high growth in Europe (+26%) and especially in Japan (+48%) whereas the situation remains dismal in Asia-Pacific (-18%). However, while the decline remained significant in Hong Kong and Macau, the group highlighted a return to growth in Mainland China, with double-digit growth in the directly operated store network but a decline in the wholesale network. This suggests that the positive momentum stems from jewellery but probably not yet from watch sales.

Caution is nevertheless still necessary. Indeed, a large part of the recovery in Q2 was technical since it was due to the situation in Japan. As such, excluding Japan, the increase in sales at LVMH stood at 7% and not 9% as reported. However, in Q1, excluding Japan, growth stood at 4%, which nevertheless points to an acceleration in Q2. The other information provided by the Q2 figures was the acceleration in sales with Chinese customers and primarily outside China (Europe and China).

Fig. 27: Quarterly sales growth (like-for-like)

LFL sales growth (%)	Q1 14	Q2 14	Q3 14	Q4 14	2014	Q1 15	Q2 15
Hermès	15	10	11	10	11	8	10
LVMH	6	4	4	5	5	3	9
o/w F& L division	9	0	2	4	3	1	10
Kering	4	4	4	5	5	-1	8
Kering Luxury	6	6	4	4	5	-3	8
o/w Gucci brand	0	-1	-2	0	-1	-8	5
Prada	4	5	3	0	2	-6	-6
Richemont	15	5	4	0	2	2	2
Salvatore Ferragamo	8	8	3	8	7	2	3
Swatch Group	6	3	2	0	1	4	4
Tod's Group	2	-4	0	2	0	-3	8
Average Luxury	**7**	**4**	**3**	**3**	**4**	**0.7**	**6**

Source: Company Data; Bryan, Garnier & Co ests.

By region, we noted no real change in momentum between Q1 and Q2, with the noticeable exception of Japan, where the two quarters were affected by totally opposite comparison bases. We nevertheless noted that in Q2, sales in Europe remained on a very positive trend, and even picked up slightly, thanks partly to Asian customers but also US customers in view of euro weakness.

Fig. 28: Quarterly growth in sales by region

Lfl sales growth (%)	Q1 13	Q2 13	Q3 13	Q4 13	Q1 14	Q2 14	Q3 14	Q4 14	Q1 15	Q2 15
Europe	2	13	5	10	3	3	3	4	9	10
North America	13	13	11	9	7	12	11	9	10	10
Asia-Pacific	9	12	12	9	5	5	4	2	-7	-7
Japan	10	9	7	7	25	-10	-7	2	-15	25
Average Luxury	**8**	**12**	**8**	**9**	**7**	**4**	**3**	**3**	**0.7**	**6**

Source: Company Data; Bryan, Garnier & Co ests

4.2. Greater caution for 2016!

FY 2016 organic sales growth expected at 5% vs 6% previously!

Thanks to the good news from Q2, the H1 momentum which was still valid in July in our view, and less demanding comparison with the year-earlier period in H2, and despite the current backdrop, and especially uncertainty for coming months, we leave almost unchanged our average organic sales growth at luxury groups this year with a growth of close to5% versus and +4% in 2014 and +8% in 2013. Unsurprisingly, the main reason for our slight downgrade to sales growth is the situation in China and more generally in Asia-Pacific. In mid-September, we already reduced our forecasts for Richemont from +4% to +2% for 2015-16 (FYE 31st March), in view of the weight of Asia (39% of sales including 27% in GC).

As in 2014 and in line with its H1 performance, Hermès should post the highest organic sales growth among the luxury groups in our sample, with our estimate at 9%. In contrast, Richemont (+2%) and Swatch (+3%) are likely to be the most affected by the current situation in China with a more modest pace of growth than the sector average. Finally, LVMH should post sales growth of around 6% (including +5% for the fashion and leather goods division), after 6% in H1 whereas Kering's luxury division should generate sales growth of 4% including +1% for the Gucci brand (even if Q3 should show some slowdown as Q2 performance has not to be extrapolated), pointing to +4% for the Kering group as a whole.

On the other hand, for 2016, we are more cautious than before due to the uncertainties in Asia-Pacific and we are forecasting average sales growth for groups in our luxury sample of almost 5% compared with +6% previously, namely a similar level to 2015. This downgrade of almost one point in organic growth is due to the Asia-Pacific region where we were forecasting sales growth of 3% previously but now expect stable sales after a prospective decline of 6% in 2015. Our previous 3% forecast was primarily based on advantageous comparison with the year-earlier period. In contrast, we are making no change to our forecasts for other regions (see table following page).

Fig. 29:

Fig. 30: Organic sales growth at luxury groups

Change in %	2010	2011	2012	2013	2014	2015e	2016e
Ferragamo	17	22	13	11	7	5	6
Hermès	19	18	16	13	11	9	9
Kering	4	16	11	4	5	4	6
o/w Kering Luxe	12	22	15	7	5	2	6
LVMH	13	14	9	8	5	6	6
o/w F&L div	13	16	7	4	3	6	5
Prada	24	27	25	13	0	0	6
Richemont	19	29	8	10	2	2	5
Swatch Group	22	21	12	6	1	3	4
Tod's	9	14	8	2	0	3	4
Average	**16**	**20**	**13**	**8**	**4**	**5**	**5**

Source: Company Data; Bryan, Garnier & Co ests.

The table below highlights our organic sales growth by geographical. In Asia-Pacific, we expect a decline of around 6% after the 7% reported in H1 as comparison basis are easier in particularly in Q4, as the slowdown in HK and Macao began in October 2014. We are still optimistic for Europe with almost the same trend than the one in H1, hence our +11% expected on FY thanks to dynamic local clientele and tourists flows from USD areas.

In US, we anticipate the same positive trend even if some brands have highlighted some volatility in recent months with still domestic clientele that remains dynamic thanks to positive macro environment; hence our 8% sales increase. Lastly, in Japan, we expect 8% organic sales growth (+3% in 2014) following the 11% on average in H1. For 2016, we are quite cautious in Asia-Pacific with a sales stability.

Fig. 31: Organic sales growth at luxury groups by geographical area

Lfl sales growth (%)	2010	2011	2012	2013	2014	2015e	2016e
Europe	11	15	13	7	3	11	8
North America	11	15	13	11	11	8	7
Asia-Pacific	28	30	16	10	4	-6	0
Japan	5	10	5	8	3	8	5
Average Luxury	**16**	**20**	**13**	**8**	**4**	**5**	**5**

Source: Company Data; Bryan, Garnier & Co ests.

The table below sets out our new sales figures for luxury groups in our sample in comparison with our previous figures. In general, we have left almost unchanged our estimates for 2015 but reduced our organic sales growth forecasts for 2016 by one point.

Fig. 32: Downgrade to sales forecasts at luxury groups (2015-2016)

EURm	2014	2015e prev	2015e new	Dev (%)	2016e prev	2016e new	Dev (%)
Ferragamo	1,331	1,460	1,460	0	1,600	1,560	(2.0)
Hermès	4,119	4,910	4,910	0	5,350	5,330	(0.5)
Hugo Boss	2,572	2,841	2,841	0	3,027	3,027	0
Kering	10,037	11,565	11,485	(1.0)	12,475	12,325	(1.5)
LVMH	30,638	35,900	35,800	(0.5)	38,400	38,160	(1.0)
Prada	3,551	3,841	3,841	0	4,013	4,013	0
Richemont	10,410	11,450	11,450	0	12,200	12,200	0
Swatch Group (CHFm)	8,709	8,830	8,800	(0.5)	9,320	9,245	(1.0)
Tod's	966	1,035	1,035	0	1,110	1,095	(1.3)
Average (%)	**na**	**na**	**na**	**0**			**(1.0)**

Source: Company Data; Bryan, Garnier & Co ests.

The table of the following page highlights the changes that we made on luxury groups EBIT. On average, we have revised down our 2016 EBIT by 2% with almost no change for 2015. The main adjustments have been done on Swatch Group, LVMH and Kering. We had already fine-tuned our estiamtes on Richement ahead of 5m sales trading statement. Furthermore, we do not change our estimates on Hugo Boss as exposure to Greater China is not significant.

Fig. 33: Downgrade to EBIT forecasts at luxury groups (2015-2016)

EURm	2014	2015e prev	2015e new	Dev (%)	2016e prev	2016e new	Dev (%)
Ferragamo	245	280	280	0	315	305	(2.5)
Hermès	1,299	1,541	1,541	0	1,740	1,740	0
Hugo Boss	449	492	492	0	542	542	0
Kering	1,664	1,740	1,720	(0.5)	2,060	1,970	(3.5)
LVMH	5,715	6,685	6,650	(0.5)	7,560	7,380	(2.5)
Prada	702	676	676	0	763	763	0
Richemont	2,436	2,570	2,570	0	2,910	2,910	0
Swatch Group (CHFm)	1,752	1,670	1,670	0	1,825	1,795	(2.0)
Tod's	148	160	160	0	177	172	(3.0)
Average (%)	**na**	**na**	**na**	**0**	**na**	**na**	**(2.0)**

Source: Company Data; Bryan, Garnier & Co ests.

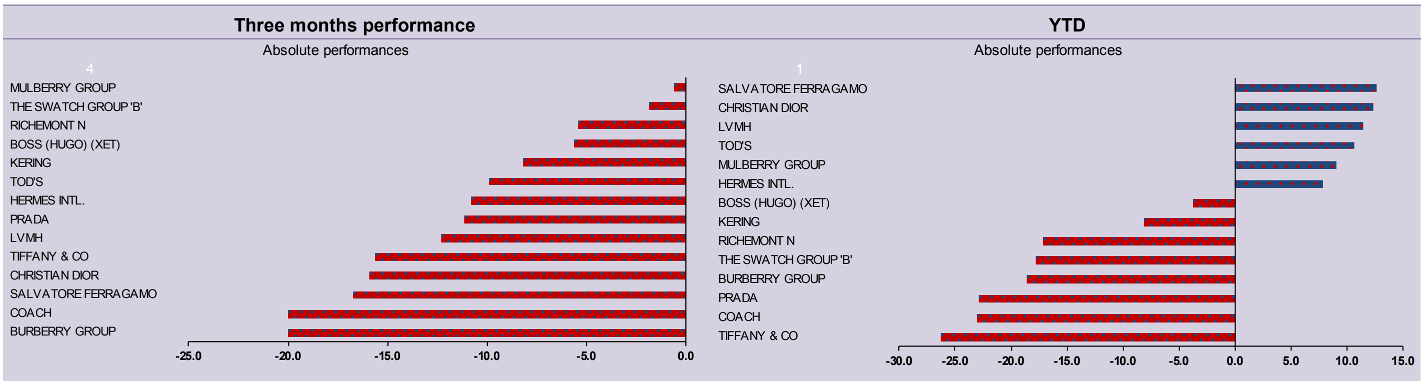
5. Valuation and recommendation

Beyond stockmarket performances that have been, unsurprisingly, under pressure on last three months, we can add that the current luxury sector is not overvalued as it is trading with a 10% discount versus its historical average. Furthermore our estimates downwards lead us to adjust our FV.

5.1. Stockmarket performances under pressure

Unsurprisingly, luxury stocks have suffered considerable downturns in recent months, with an average decline of 111% for our universe over the past month (-3% on one month), which is globally in line with the DJ Stoxx. Among the stocks under coverage, we would point out the plunge by **Salvatore Ferragamo** (-17% including -10% over the past month in particular, representing the worst performance in our sample). Inversely, **Hugo Boss** posted the best achievement in the sector (-1%), thanks to its high exposure to the European market (61% of sales) and its relatively low presence in China (8% of sales). Since the beginning of the year, the sector has dropped 5% on average, with **LVMH** coming off well with a 11% increase in the share price, representing one of the best performances in the sector, whereas at the same time, the **Kering** share lost 9%.

Fig. 34: Stockmarket performances of luxury groups



Source: Datastream

5.2. Peer comparison

The table below shows that shares of watchmakers and **LVMH** are trading below the sector average (12.8x on 2015 EV/EBIT). In contrast and without surprise, **Salvatore Ferragamo** and **Tod's** are trading above the average. Some speculative appeal can perhaps explain this premium. Nevertheless, we see unlikely any change of the shareholding structure of Tod's Group. Actually, M. Diego Della Valle has recently stated that he was not seller of the control of the company.

Fig. 35: Peer comparison

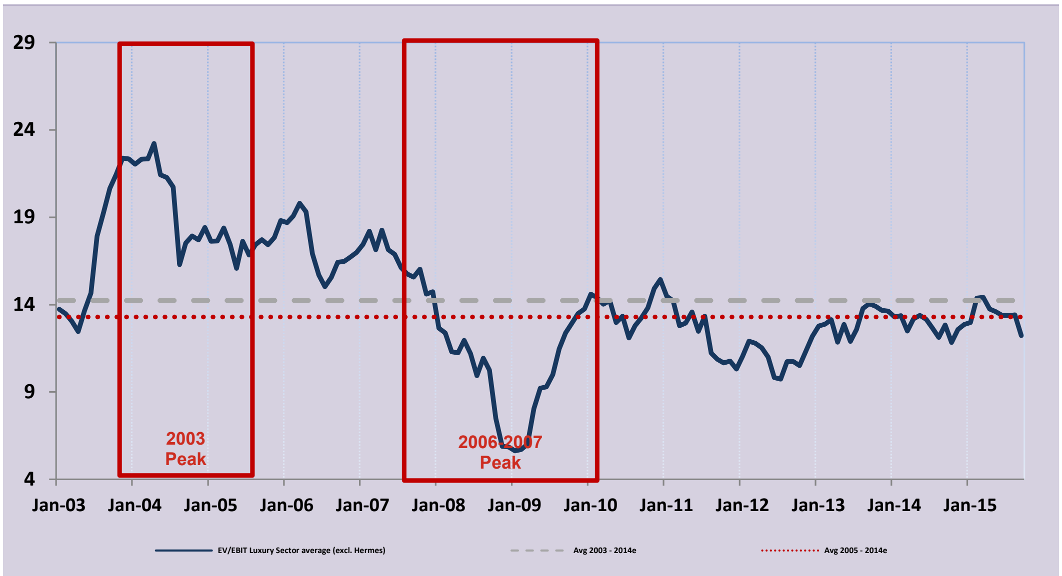
x	2015e EV/EBIT	2016e EV/EBIT	2014 premium on average (ii)	2015 premium on average (ii)
Burberry	11.7	10.4	-10%	-11%
Hermès Intl	20.9	18.4	-	-
Kering	12.7	11.1	0%	-5%
LVMH	11.8	10.5	-7%	-9%
Prada	13.1	13.4	2%	10%
Richemont	11.5	10.5	-9%	-9%
Salvatore Ferragamo	13.6	12.4	9%	6%
Swatch Group	11.2	10.6	-12%	-10%
Tiffany	12.2	10.9	-5%	-7%
Tod's Group	14.2	13.0	11%	11%
(i) Luxury average	**13.6**	**12.4**	-	-
(ii) Luxury average (excl. Hermés)	**12.8**	**11.7**	-	-

Source: Company Data; Bryan, Garnier & Co ests

Note interestingly that the most important shares in the sector are trading on fairly similar levels. Only the two Italian groups stand out, partly for speculative reasons in our view, whether justified or not.

The chart below highlights the recent derating in the luxury sector, which is now trading below its historical average since 2003 with an EV/EBIT multiple of 12.8x compared with an average of 14.2x. Unsurprisingly, this trend has been particularly sharp since the devaluation of the Chinese currency, which has prompted investor fears over uncertainty in China's economic growth potential.

Fig. 36: Average historical valuation of the luxury sector



Source: Company Data; Bryan, Garnier & Co ests.

5.3. Changes to Fair Values and recommendation

In view of the downgrade to our earnings estimates for certain luxury groups, we have also reduced our Fair Values for these same groups.

We leave unchanged our Buy Recommendation on **Hermès, Hugo Boss, LVMH and Richemont** and we upgrade our recommendation on Salvatore Ferragamo from Neutral to Buy.

Hermès Intl (Buy, EUR350):

This group will benefit from its exclusive and very high end positioning which allowed him to outperform in H1 with a 9% organic sales growth vs +3% for the sector on average. We expect in 2015 a 9% organic sales growth (guidance: +8%) and almost an EBIT margin stability at 31.3%.

Hugo Boss (Buy, EUR128):

Hugo Boss has the highest exposure to Europe (61% of sales) amongst our luxury sample, followed by North America (21% of sales). Consequently, the acceleration in Europe in Q2 (+7% FX-n vs. +3% in Q1) was clearly the main positive point of the H1 15 results publication: whilst Q2 growth in Germany and the UK were in line with Q1 (+5% FX-n and +11% FX-n respectively), the group accelerated in France (+9% FX-n vs. +2% in Q1) thanks to a pick-up in domestic demand and the opening of new shop-in-shops at Galeries Lafayette.

LVMH (Buy, EUR182 vs EUR186):

LVMH, thanks to its homogeneous sales breakdown by geographical area and the strength of its brands in each of the divisions has strong assets in such difficult environment. Furthermore, Louis Vuitton has recovered in Q2 a growth momentum which is reassuring for the future. Its transition period has been a success.

Richemont (Buy, CHF95):

The Swiss group benefits from its exposure to jewelry business (32% of sales) which was up double digit on first five months of the March 2016 year, even if its exposure to HK (16% of sales) can be seen as a weakness. 4% organic sales growth on first five months of the year is reassuring ansd highlights the strength of the group business model.

Salvatore Ferragamo (Buy vs Neutral, EUR29 vs EUR30):

We are upgrade our recommendation from Neutral to But on the stock given the significant share decline on recent period (-17% on last three months and -24% since its highest level end of March 2015 when we downgraded the stocks from Buy to Neutral). The current share price is, in our view, a buy opportunity thanks to, here again, an interesting sales breakdown. Furthermore, we cannot rule out a speculative interest on the group. Ferragamo family holds 69% (directly and indirectly) of the shares.

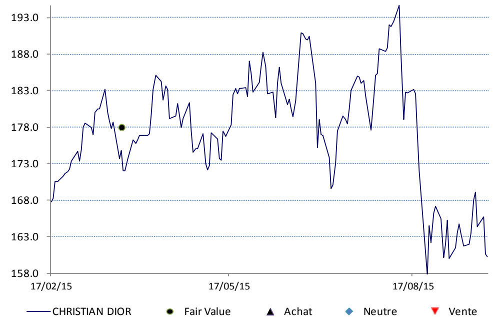
Fig. 37: Changes to Fair Values

EUR	prev recommendatio	new recommendation	previous FV	new FV
Christian Dior	Buy	Buy	178	172
Hermès Intl	Buy	Buy	350	350
Hugo Boss	Buy	Buy	128	128
LVMH	Buy	Buy	186	182
Kering	Neutral	Neutral	183	177
Prada (HKD)	Neutral	Neutral	53	52
Richemont (CHF)	Buy	Buy	95	95
Salvatore Ferragamo	Neutral	Buy	30	29
Swatch Group (CHF)	Neutral	Neutral	450	430
Tod's	Neutral	Neutral	88	85

Source: Company Data; Bryan, Garnier & Co ests.

Price Chart and Rating History

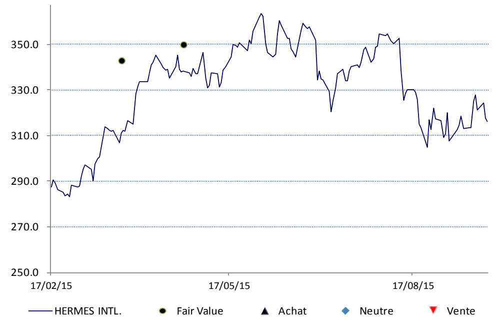
Christian Dior



Ratings Date	Ratings	Price
12/12/12	BUY	EUR129.3
10/10/12	NEUTRAL	EUR107.45
28/11/11	BUY	EUR89.18

Target Price Date	Target price
24/03/15	EUR178
13/01/15	EUR156
10/01/14	EUR151
16/01/13	EUR145
12/12/12	EUR142
10/10/12	EUR127
30/07/12	EUR130
16/03/12	EUR132

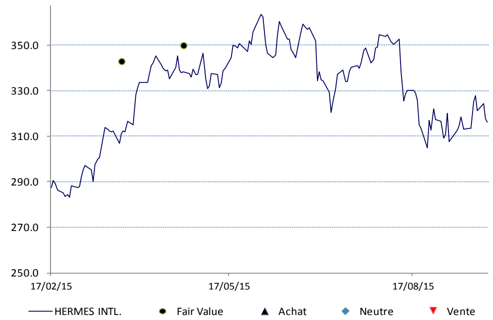
Hermes



Ratings Date	Ratings	Price
28/11/14	BUY	EUR262.75
28/11/11	NEUTRAL	EUR150

Target Price Date	Target price
24/04/15	EUR350
24/03/15	EUR343
13/02/15	EUR315
28/11/14	EUR305
10/01/14	EUR225
19/07/13	EUR205
22/03/13	EUR200
16/01/13	EUR194
12/12/12	EUR186
04/05/12	EUR170
28/11/11	EUR150

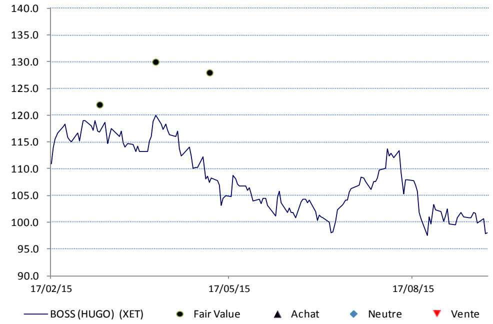
Hermes



Ratings Date	Ratings	Price
28/11/14	BUY	EUR262.75
28/11/11	NEUTRAL	EUR150

Target Price Date	Target price
24/04/15	EUR350
24/03/15	EUR343
13/02/15	EUR315
28/11/14	EUR305
10/01/14	EUR225
19/07/13	EUR205
22/03/13	EUR200
16/01/13	EUR194
12/12/12	EUR186
04/05/12	EUR170
28/11/11	EUR150

Hugo Boss

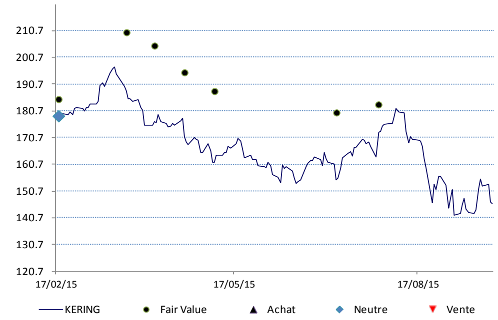


Ratings Date	Ratings	Price
11/04/14	BUY	EUR105.85
02/08/13	end of coverage	EUR89.91
31/10/12	BUY	EUR76.94
19/04/12	NEUTRAL	EUR87

Target Price Date	Target price
07/05/15	EUR128
10/04/15	EUR130
13/03/15	EUR122
04/11/14	EUR118
02/08/13	EUR0
16/01/13	EUR95
31/10/12	EUR90
05/07/12	EUR88
19/04/12	EUR90

Please see the section headed "Important information" on the back page of this report.

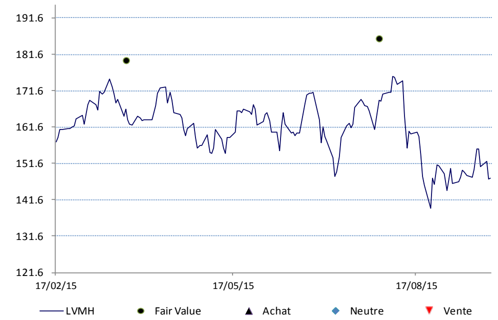
Kering



Ratings Date	Ratings	Price
18/02/15	NEUTRAL	EUR185
15/01/14	BUY	EUR146.15
28/11/11	NEUTRAL	EUR101.35

Target Price Date	Target price
28/07/15	EUR183
07/07/15	EUR180
07/05/15	EUR188
22/04/15	EUR195
07/04/15	EUR205
24/03/15	EUR210
18/02/15	EUR185
13/01/15	EUR176
08/10/14	EUR172
10/01/14	EUR178
26/07/13	EUR174

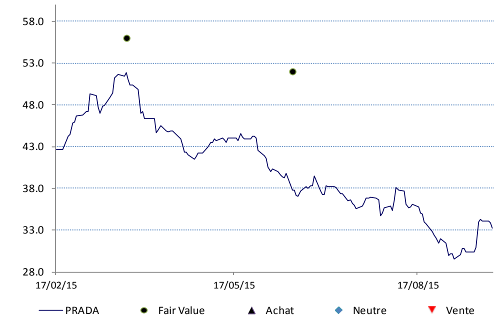
LVMH



Ratings Date	Ratings	Price
04/02/15	BUY	EUR144.5
25/07/14	NEUTRAL	EUR139.8
12/12/12	BUY	EUR140
10/10/12	NEUTRAL	EUR122.1
10/10/11	BUY	EUR107.3

Target Price Date	Target price
29/07/15	EUR186
24/03/15	EUR180
04/02/15	EUR158
13/01/15	EUR145
18/12/14	EUR140
08/10/14	EUR150
25/07/14	EUR156
10/01/14	EUR167
17/10/13	EUR162
03/10/13	EUR165
16/01/13	EUR160

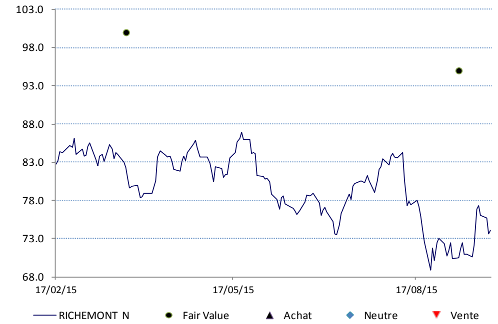
Prada



Ratings Date	Ratings	Price
22/09/14	NEUTRAL	HKD51.5
10/10/12	BUY	HKD59.5

Target Price Date	Target price
15/06/15	HKD52
24/03/15	HKD56
08/12/14	HKD53
22/09/14	HKD60
07/08/14	HKD70
06/06/14	HKD76
03/04/14	HKD80
08/04/13	HKD87
18/01/13	HKD82
07/12/12	HKD72
10/10/12	HKD70

Richemont

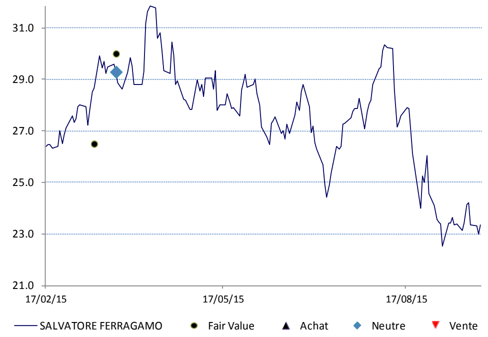


Ratings Date	Ratings	Price
28/11/11	BUY	CHF56

Target Price Date	Target price
07/09/15	CHF95
24/03/15	CHF100
26/01/15	CHF86
16/01/15	Under review
15/01/15	CHF102
13/01/15	CHF105
08/10/14	CHF100
17/09/14	CHF106
01/07/14	CHF110
16/01/14	CHF105
10/01/14	CHF107
17/05/13	CHF95
16/01/13	CHF82

Please see the section headed "Important information" on the back page of this report.

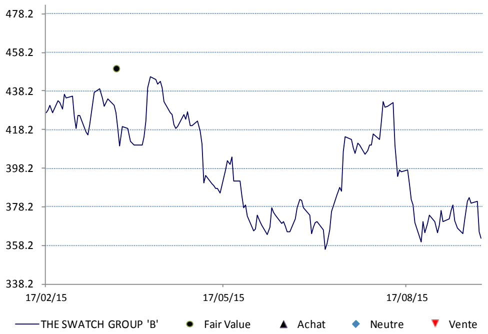
Salvatorre Ferragamo



Ratings Date	Ratings	Price
24/03/15	NEUTRAL	EUR29.6
29/08/14	BUY	EUR20.62
30/08/12	NEUTRAL	EUR17.07
06/06/12	BUY	EUR15.36
23/03/12	NEUTRAL	EUR16.22

Target Price Date	Target price
24/03/15	EUR30
13/03/15	EUR26.5
30/01/15	EUR25.5
13/01/15	EUR23.6
14/11/14	EUR23.4
29/08/14	EUR23.7
21/01/14	EUR23
10/01/14	EUR23.5
14/05/13	EUR21.8
22/03/13	EUR20
16/01/13	EUR18.6
12/12/12	EUR17.7
30/08/12	EUR17.1
15/05/12	EUR17.5
28/03/12	EUR16

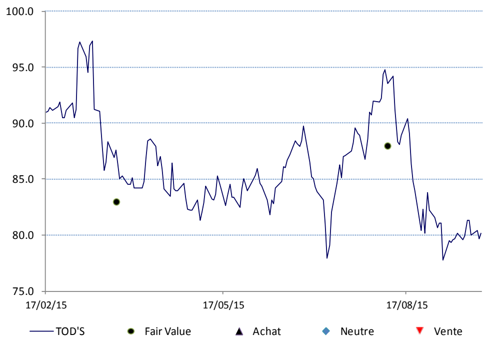
The Swatch Group



Ratings Date	Ratings	Price
05/06/14	NEUTRAL	CHF535
04/02/13	BUY	CHF517.5
10/10/12	NEUTRAL	CHF378.3
28/11/11	BUY	CHF331.6

Target Price Date	Target price
24/03/15	CHF450
05/02/15	CHF400
26/01/15	CHF430
16/01/15	Under review
13/01/15	CHF535
30/09/14	CHF520
23/07/14	CHF575
05/06/14	CHF600
10/01/14	CHF672
29/11/13	CHF650
24/07/13	CHF595
04/02/13	CHF555
10/01/13	CHF490
12/12/12	CHF455
10/10/12	CHF420
08/02/12	CHF440
28/11/11	CHF425

Tod's Group



Ratings Date	Ratings	Price
23/01/15	NEUTRAL	EUR80.9
23/05/12	SELL	EUR80.7
13/05/11	NEUTRAL	EUR91.85
27/07/07	BUY	EUR57.9419

Target Price Date	Target price
07/08/15	EUR88
24/03/15	EUR83
23/01/15	EUR78
13/01/15	EUR74
13/11/14	EUR72
08/10/14	EUR88
08/08/14	EUR92
12/03/14	EUR100
30/01/14	EUR106
24/01/14	EUR111
10/01/14	EUR114
08/08/13	EUR107
02/08/13	EUR104
15/05/13	EUR85
16/01/13	EUR80

Bryan Garnier stock rating system

For the purposes of this Report, the Bryan Garnier stock rating system is defined as follows:

Stock rating

BUY Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements including a SWOT analysis, positive momentum, technical aspects and the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

NEUTRAL Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

SELL Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements including a SWOT analysis, positive momentum, technical aspects and the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 64.3% NEUTRAL ratings 31.3% SELL ratings 4.3%

Research Disclosure Legend

1	Bryan Garnier shareholding in Issuer	Bryan Garnier & Co Limited or another company in its group (together, the "Bryan Garnier Group") has a shareholding that, individually or combined, exceeds 5% of the paid up and issued share capital of a company that is the subject of this Report (the "Issuer").	No
2	Issuer shareholding in Bryan Garnier	The Issuer has a shareholding that exceeds 5% of the paid up and issued share capital of one or more members of the Bryan Garnier Group.	No
3	Financial interest	A member of the Bryan Garnier Group holds one or more financial interests in relation to the Issuer which are significant in relation to this report	No
4	Market maker or liquidity provider	A member of the Bryan Garnier Group is a market maker or liquidity provider in the securities of the Issuer or in any related derivatives.	No
5	Lead/co-lead manager	In the past twelve months, a member of the Bryan Garnier Group has been lead manager or co-lead manager of one or more publicly disclosed offers of securities of the Issuer or in any related derivatives.	No
6	Investment banking agreement	A member of the Bryan Garnier Group is or has in the past twelve months been party to an agreement with the Issuer relating to the provision of investment banking services, or has in that period received payment or been promised payment in respect of such services.	No
7	Research agreement	A member of the Bryan Garnier Group is party to an agreement with the Issuer relating to the production of this Report.	No
8	Analyst receipt or purchase of shares in Issuer	The investment analyst or another person involved in the preparation of this Report has received or purchased shares of the Issuer prior to a public offering of those shares.	No
9	Remuneration of analyst	The remuneration of the investment analyst or other persons involved in the preparation of this Report is tied to investment banking transactions performed by the Bryan Garnier Group.	No
10	Corporate finance client	In the past twelve months a member of the Bryan Garnier Group has been remunerated for providing corporate finance services to the issuer or may expect to receive or intend to seek remuneration for corporate finance services from the Issuer in the next six months.	No
11	Analyst has short position	The investment analyst or another person involved in the preparation of this Report has a short position in the securities or derivatives of the Issuer.	No
12	Analyst has long position	The investment analyst or another person involved in the preparation of this Report has a long position in the securities or derivatives of the Issuer.	No
13	Bryan Garnier executive is an officer	A partner, director, officer, employee or agent of the Bryan Garnier Group, or a member of such person's household, is a partner, director, officer or an employee of, or adviser to, the Issuer or one of its parents or subsidiaries. The name of such person or persons is disclosed above.	No
14	Analyst disclosure	The analyst hereby certifies that neither the views expressed in the research, nor the timing of the publication of the research has been influenced by any knowledge of clients positions and that the views expressed in the report accurately reflect his/her personal views about the investment and issuer to which the report relates and that no part of his/her remuneration was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in the report.	Yes
15	Other disclosures	Other specific disclosures: Report sent to Issuer to verify factual accuracy (with the recommendation/rating, price target/spread and summary of conclusions removed).	No

A copy of the Bryan Garnier & Co Limited conflicts policy in relation to the production of research is available at www.bryangarnier.com

BRYAN, GARNIER & CO

London
From 28th September 2015
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

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

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