



Holland Views: Richemont – Price: CHF65; MCap: CHF36.5bn

## Scarcity Value

One of the fascinating aspects of our job is to assess how companies evolve over time – how they endure the inevitable shocks and stresses of the marketplace. If we are doing our job well, the true *prospects* of those businesses that we identify as Franchises, ought to remain undimmed, resilient or perhaps even enhanced in the face of such external shocks. The last few years have been an interesting test for one such Franchise of ours. In 2016 we noted that:

*“(the business) is run by an exceptional industrialist whose stewardship of this family business over 30+ years has been exemplary. It is also a high return business with excellent and unique mega brands that thinks counter-cyclically. Best of all its management has shown itself to be extremely careful with capital”<sup>1</sup>*

Notwithstanding such credentials, the last two to three years have tested the mettle of luxury goods behemoth Richemont and its inimitable Chairman Johann Rupert. Two years on, after a period of painful retrenchment and reorganisation, we are convinced that this is a great business and possibly, a cheap one too. Richemont’s shares at c.15.7x adjusted<sup>2</sup> P/E offer value (and optionality) for the investor seeking a quality, long-standing business with an excellent capital steward at the helm. A rare bird indeed.

### [2016-18: A review in five bullets](#)

1. It is now clear to us (and the company) that Richemont was unequivocally **over-earning** in the years 2010-2015 thanks to ‘exceptional’ Chinese corporate demand. The good news is that the then 15-20% sales cagr trend has now reverted to what we think is a more realistic, but still attractive, >7.5% sales cagr opportunity.
2. Yet, observers of the business still seems confused, unsettled or indeed sceptical about luxury goods **demand** in general and especially in China. Having thought much about this, we are sanguine that “status” will forever remain a strong human desire. Richemont’s Maisons will offer plenty of status signalling opportunity for future generations.
3. Some will say, Richemont got greedy in the infamous era of Chinese corporate ‘gifting’. Perhaps; but at least it had the fortitude to make the difficult decision to acknowledge the resulting over-earning and, more importantly, to revive and enforce the volume scarcity that is needed in this unique business. The company has reinstated its **pricing power**.
4. Some might also say that we were wrong too to rely on Johann Rupert’s assertion that Richemont would **only build, not acquire goodwill** and that the €2.7bn YNAP<sup>3</sup> e-commerce stake buyout disproves our point. We would suggest that acquiring the 50% remaining stake in YNAP was very strategic with much optionality. Crucially, the stake reflects distribution assets and not brand goodwill of an acquired luxury brand. We remain very trusting in Rupert’s capital allocation skills and stewardship.
5. Richemont’s core margins have now recovered. We estimate its **long term compounding prospects** are restored also.

<sup>1</sup> Holland Views – Richemont – Building goodwill, not buying it – CHF55 (July 2016)

<sup>2</sup> adjusted for amortisation charges and assuming Online business is just breakeven.

<sup>3</sup> Yoox Net a Porter

## Reflections on a business that was over-earning

Below, we expand in more detail on each of the five areas of focus referenced above. First though, a high level reminder on what attracted us to this share back in 2016. We point you to re-read our original in-depth work, but in simplistic terms, at that time, we saw:

1. A portfolio of organically built, exceptional luxury brands which drove great returns.
2. A great owner-manager who understood what was needed to protect those brands.
3. And a long track record of executing on those strategies.

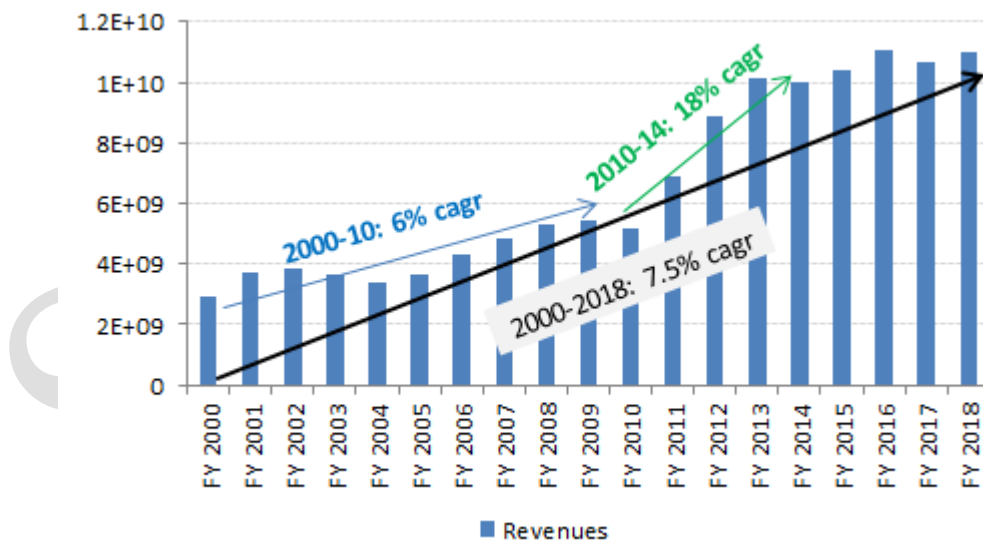
All three combine to form a rarity: a branded European Franchise with high returns that allocates capital very well. It's a great business and we think its shares are cheap for the quality they offer.

### So, a reflection of 2016-18 in some more detail:

#### 1. Are we back on-trend?

The story of the Chinese sales slowdown experienced by Richemont and the luxury watch industry is not new news and we don't feel the need to rehash the period in great detail here. However, we would like to comment on the impressive way in which Richemont learned from and dealt with the whole episode. In short, Johann Rupert showed impressive industry leadership in facing-up to the stark reality that his industry had 'stuffed the channel' so to speak. After a 2-year period of self-inflicted pain and enforced supply chain austerity, the Richemont business is today in far better shape. The period has caused major changes in management personnel of the Maisons, revised supply chain management (inventory tracking) and more brand protection (aka control of pricing).

Fig.1: Reversion to mean



Source: Bloomberg, Holland Advisors

To view the remainder of this in-depth report, please contact Andrew Hollingworth, [Andrew@hollandadvisors.co.uk](mailto:Andrew@hollandadvisors.co.uk) for a complete PDF copy.

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