HollAnd Advisors

Holland Views – Richemont: Price: CHF55.85; MCap: €29,064m

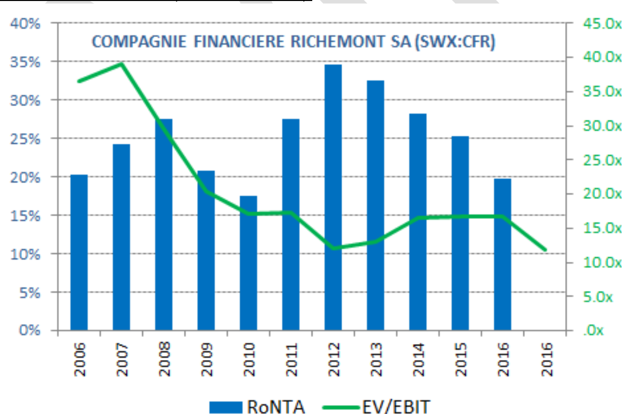
Building goodwill, not buying it.

Some companies make our job as analysts seem redundant. Their managers say things so clearly and honestly and execute the stated strategies so well that there really is little to add. In the UK, Next plc is one such company. We think we have found another – in Switzerland.

What we have found is a new business to add to our 'Franchise' list (and a new owner-manager for our 'Outsider' list to boot!). It is a luxury goods business that 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. The business is Richemont, the purveyor of ultra-high-end watches and jewellery to the rich and famous. The Outsider is its Founder and Chairman Johann Rupert.

As is often the case in Franchises and Outsiders, this research is as much about the person as it is about the business. We are very impressed with Rupert. While we might not be able to afford his merchandise, at 12x EV/EBIT (17x PE, 14x ex-cash PE) his company's share price is now as cheap as it's ever been and looks to be good value notwithstanding Mr Market's worries about growth.

Fig.1: Cheap stocks or Good News (never both)



Source: Capital IQ

This is not our first foray into the luxury goods investment world. Our in-depth work on Swatch in 2012 (Holland Views – Swatch – Like Father, Like Son?) proved very instructive in helping us assess Richemont. Whilst there are many similarities (not just that both businesses are Swiss peers, built by exceptional entrepreneurs of their day), Richemont stands out from Swatch and the whole sector for one big reason: goodwill is miniscule at about 3% of assets. Apart from the iconic brands, the manufacturing excellence and distribution reach – Richemont really stands out as a capital allocator par excellence.

"Our job here is to create goodwill, not to buy it" – Johann Rupert, Chairman of Richemont

A high-return business with unique global brands, exceptional management and capital discipline at what looks a reasonable price: what's not to like?

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Editor's note: There are two ways to read this report: either start at the beginning as we introduce you to the company and its owner-manager or; start at the end, with the reams of quotations direct from the man himself! Unless otherwise stated, assume all quotes are attributable to Mr Rupert!

Richemont Rarity– A European Franchise stock that can 'allocate'

- Richemont owns a portfolio of iconic luxury brands (these are most definitely not "affordable luxury" – think Cartier, A. Lange & Sohne, Piaget, Van Cleef & Arpels).
- A long history of impressive (and, importantly, largely organic) sales growth (+10% cagr since 2006) and returns (18% median ROE, 26% median RoNTA since 2006).
- Book value has compounded at 8% since 2006 (understated by the divestment of tobacco company BAT). Shareholder return has compounded at 15% since floatation in 1998 including the divestment of BAT.
- A consistently prudent capital structure with net cash today of c.CHF5.3bn (17% of Market Cap).
- Richemont was originally spun-out of the Rembrandt conglomerate in 1998 which was setup by the South African industrialist Anton Rupert decades earlier. Rupert proved to be a savvy accumulator of assets having acquired and reconsolidated the core Cartier brands in the 1970s – a time when few realised the potential of luxury goods.
- His son and successor Johann Rupert is (perhaps unusually for a second generation) also a true industrialist with a multi-faceted background and entrepreneurial streak. A former banker with Lazards, he setup his own bank in South Africa in the early 1980s, setup Vodacom and spun-out the luxury goods assets in 1988 into what ultimately became Richemont (the remaining business is the $8bn M. Cap conglomerate Remgro). His family own c.10% of Richemont equity and control c.50% of the voting rights.
- The elder Rupert showed a keen understanding of branding and innovation from his early days as a cigarette manufacturer (naming cigarettes Rembrandts and Peter Stuyvesants) and developing the world's first king size cigarette.

  His son carried on this tradition by expanding brand equity (e.g. moving Cartier carefully into men's' watches), realising the importance of vertical integration and using the best of contemporary management practices.
- Case in point: Cartier, which used to rely on third-party mechanical movements, moved to an integrated model and won the prestigious 'Geneva Seal' for the first time in 2008 – no mean feat and an indication of the innovative capability of the business.

  Cartier is indeed the jewel in the crown and, whilst not disclosed explicitly, likely accounts for over 50% of revenue but possibly much higher percentage of profits (due to lossmaking 'Other' divisions such as Mont Blanc, Dunhill etc.).

  Cutting these losses (-€94m last year) would of course be an opportunity for profit appreciation.
- We also note the company's 50% stake in online business 'Net a Porter-Yoox' post their merger last year (today's Market Cap c.€3bn).

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

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