

CHINA
DEVELOPMENT
FINANCIAL

Tactical Play: US Luxury Market

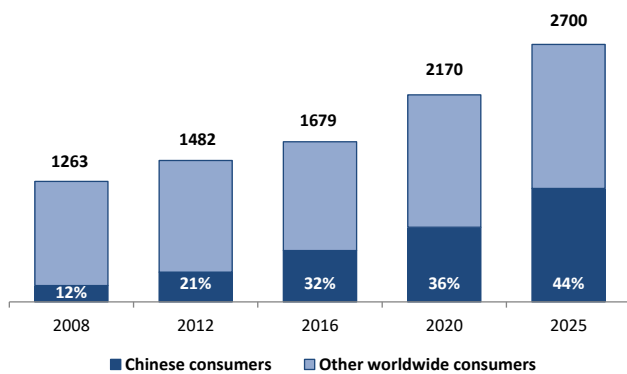
(LVMHF US, TPR US, CPRI US)

Easing trade war tension and global luxury consumption

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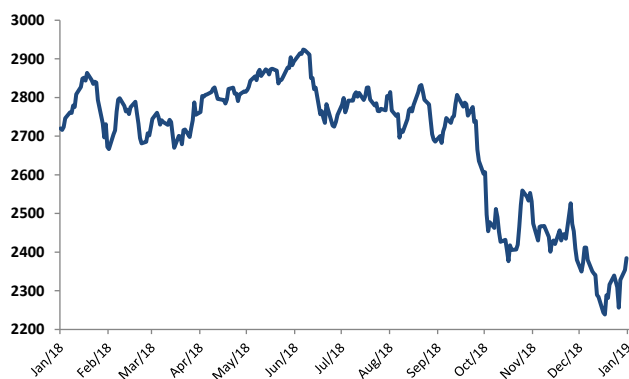
Event. Luxury retailers were negatively hit by Apple's revenue forecast cuts in the face of ailing Chinese demand. Statistics by Euromonitor International showed that Chinese Consumers currently account for about 30% of the US\$1tn spending on luxury goods globally. Concerns over the loss of appetite for luxury goods had sent luxury stocks falling. The S&P Global Luxury index, which tracks 80 of the largest publicly listed companies engaged in the business of luxury goods and services globally, had fallen 11.04% since 2018.

Figure 1: Contribution of Chinese consumers to the global luxury market (in Bn RMB)



Source: Mckinsey, KGI Research

Figure 2: S&P Global Luxury Index historical 1Y price movement (US\$)



Source: Bloomberg, KGI Research

While LVMH, parent company of Luxury bag maker Louis Vuitton assured that declining consumer sentiments had not dented Chinese demand, a good indicator for brands would be the festive expenditure across the Chinese New Year holidays.

The consensus view is that FY2018 revenue growth is still coming in positive for the majority of the luxury houses. Are current fears overplayed?

Tactical Play. China and US met in Beijing on 7-9 January. Since the agreement to a 90-day trade war truce was decided on 1 December 2018, China and the US would be required to reach a deal by 1 March 2019.

Share prices of some of the top global luxury houses such as LVMH (LVMHF US) and Kering (PPRUF US), parent company of Gucci, declined 12.5% and 17.7% in the past 6 months.

Figure 3: 6M price movements of LVMH (LVMHF US), Kering (PPRUF US), Estee Lauder (EL US), Michael Kors (CPRI US) and Tapestry, Inc. (TPR US) (US\$)



Source: Bloomberg, KGI Research

Our current view is that trade war concerns and weak sentiments after Apple's cut in revenue forecast have already been priced into luxury stocks. Hence, given the undemanding valuations, risk-reward looks attractive for investors to take a tactical bet on the easing of trade tensions.

We now revisit some of the top laggards within the benchmark. Key dates that investors should take note on for this tactical play would be included within the risk segment of this report.

Financial Snapshot

Going forward into turbulent times, we favour luxury stocks with the following characteristics:

1. Near 3 year historical low PE ratio
2. Forecasted revenue growth of at least 5% for FY2018
3. Net margins above benchmark of 8.8% (Deloitte, Global Power of Luxury Goods 2018 statistics)
4. Less than 25% geographical exposure to China

We highlight key information of **LVMHF**, **TAPESTRY (TPR US)**, and **CAPRI (CPRI US)** in the following pages.

Company Profile: LVMH

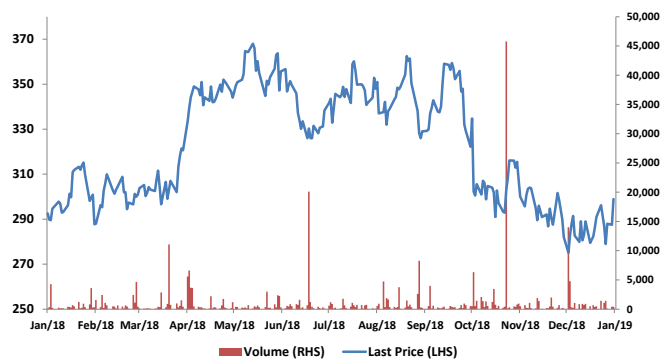
LVMH Moët Hennessy Louis Vuitton SE (LVMHF US) is a french luxury conglomerate, parent company of notable luxury brands such as luxury bag maker, Louis Vuitton and high end jewelry maker, Bulgari. LVMH is home to over 70 brands, with exposure in 5 major segments within the luxury market – Wines & Spirits, Fashion & Leather Goods, Perfumes & Cosmetics, Watches & Jewelry and Selective retailing. LVMH’s strategy moving forward will be focused on innovation and targeted geographic expansion.

Figure 4: Brands owned by LVMH



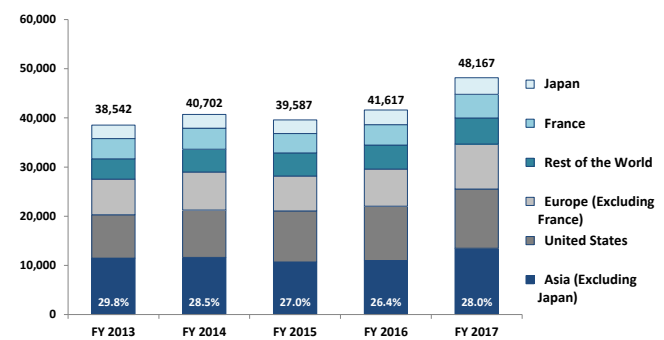
Source: KGI Research

Figure 5: LVMH’s 1 YR Historical Price Movement (USD\$)



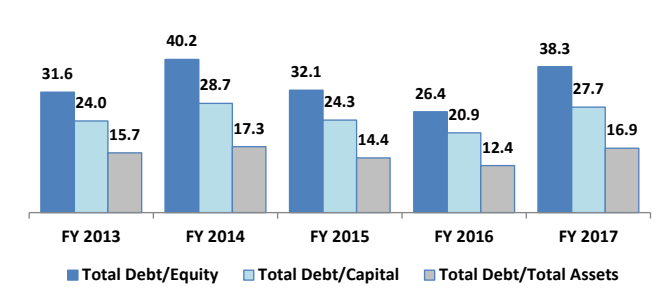
Source: Bloomberg, KGI Research

Figure 6: LVMH’s revenue by geographical region (USD\$mn)



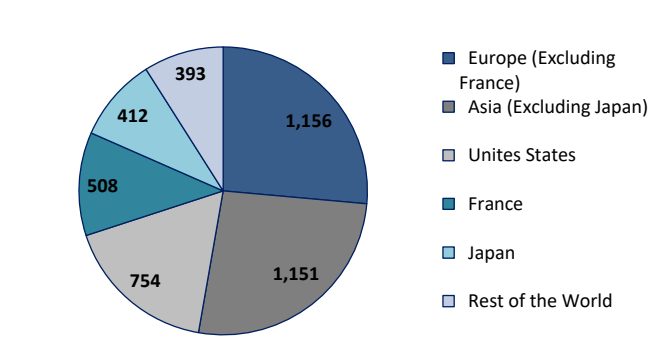
Source: Bloomberg, KGI Research

Figure 7: LVMH’s Debt Servicing Ratios (%)



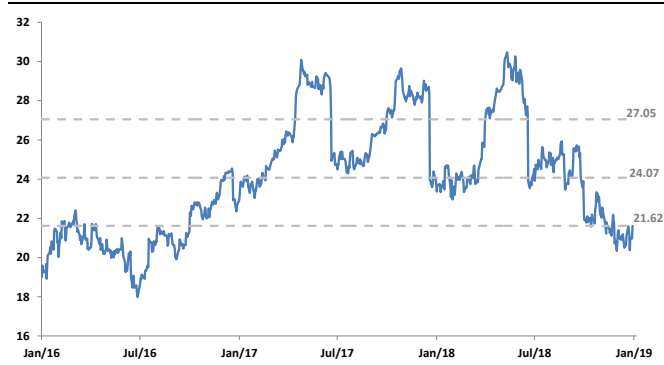
Source: Bloomberg, KGI Research

Figure 8: LVMH’s retail location count by geographical region



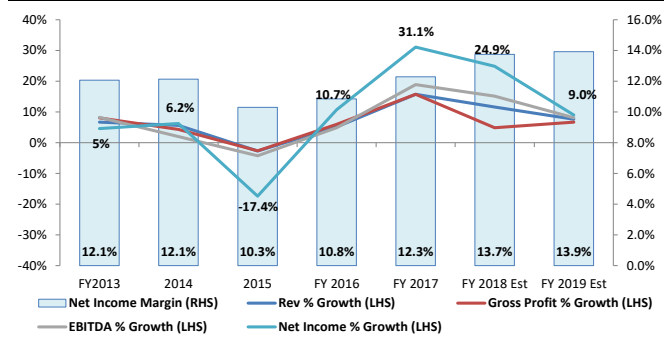
Source: Bloomberg, KGI Research

Figure 9: LVMH’s 3 YR Historical PE Ratio



Source: Bloomberg, KGI Research

Figure 10: LVMH’s consensus forward profitability margins



Source: Bloomberg, KGI Research

Company Profile: Tapestry, Inc.

Tapestry, Inc. (TPR US) is a New York-based fashion house with portfolio brands Coach, Kate Spade New York and Stuart Weitzman. The company bought out Kate Spade in 2017 in a \$2.4bn deal which added a 24.7% increment to revenue in FY2017.

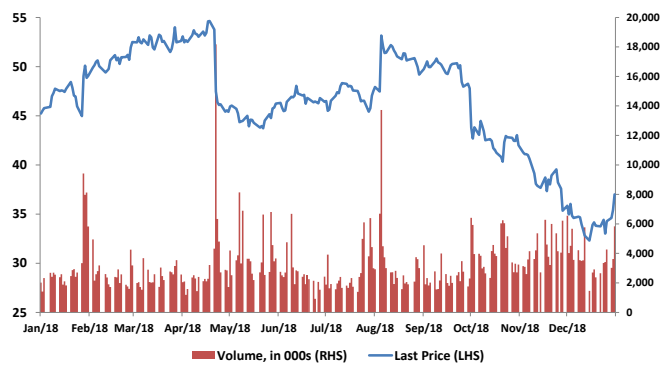
Home brand Coach had also seen much success in their strategic turnaround in the face of stronger competition from competitors such as Michael Kors, softer retail sales and a greater reliance on ecommerce.

Figure 11: Brands owned by Tapestry, Inc.



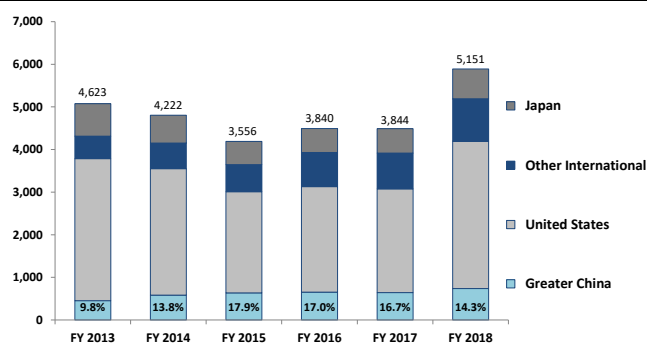
Source: KGI Research

Figure 12: TPR's 1 YR Historical Price Movement (USD\$)



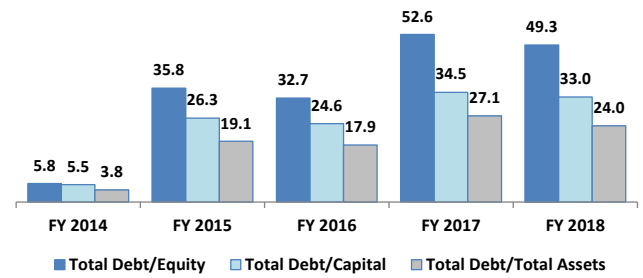
Source: Bloomberg, KGI Research

Figure 13: TPR's revenue by geographical region (USD\$mn)



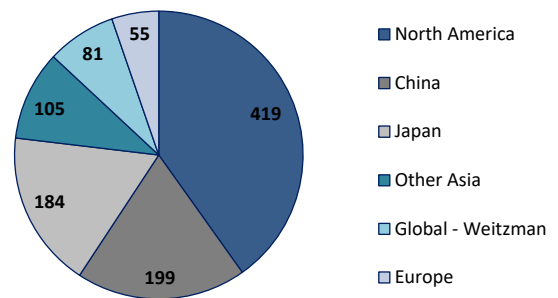
Source: Bloomberg, KGI Research

Figure 14: TPR's Debt Servicing Ratios (%)



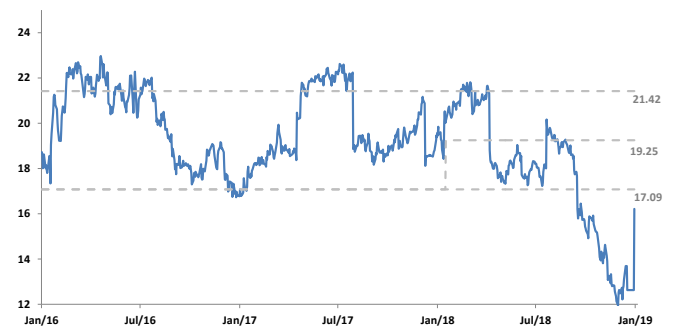
Source: Bloomberg, KGI Research

Figure 15: TPR's retail location count by geographical region



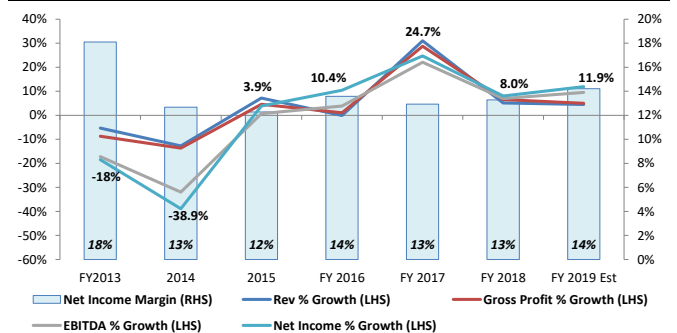
Source: Bloomberg, KGI Research

Figure 16: TPR's 3 YR Historical PE Ratio



Source: Bloomberg, KGI Research

Figure 17: TPR's consensus forward profitability margins



Source: Bloomberg, KGI Research

Company Profile: Capri Holdings Ltd

Capri Holdings (CPRI US) is one of the first luxury conglomerate based in the US. Formerly known as Michael Kors, the company acquired brand Jimmy Choo and Versace in 2017 and on the eve of 2019 respectively.

The stock price of Capri Holdings plunged 34.5% since 2018, significantly greater than the index loss of 11.04%. Revenue figures released in November 2018 fell short of analyst expectations and consumer dismay resulted from MK's acquisition of Versace, which might have translated to lower revenue from European consumers during the same period.

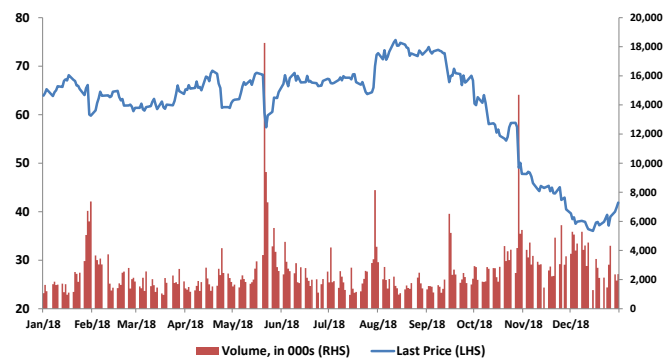
Nonetheless, acquisition of Versace would be material for the firm's strategy going forward in diversifying across geographical regions and brands. Going forward, MK is confident of scaling up Versace's ecommerce footprint and global retail stores. Many operational synergies would also be expected from the merger.

Figure 18: Brands owned by Capri Holdings



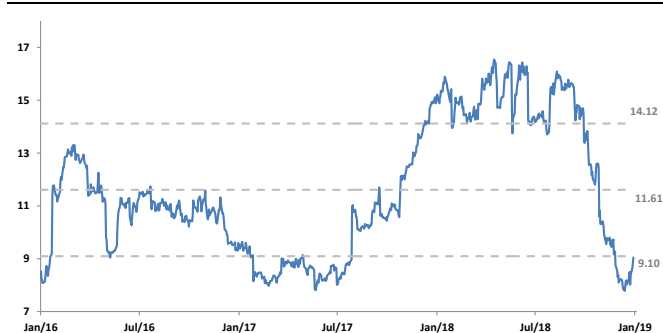
Source: KGI Research

Figure 19: CPRI 1 YR Historical Price Movement (USD\$)



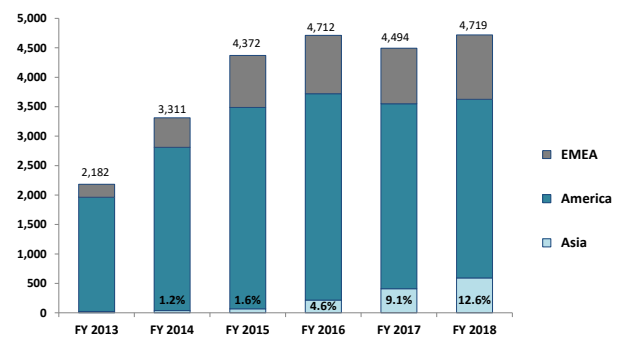
Source: Bloomberg, KGI Research

Figure 20: CPRI's 3 YR Historical PE Ratio



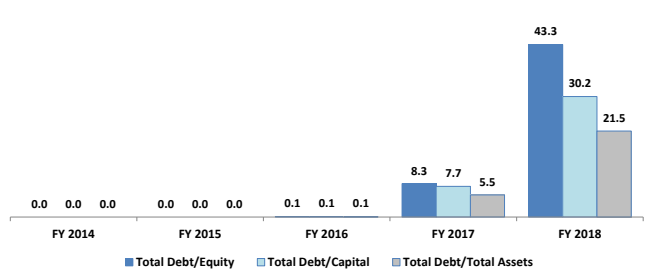
Source: Bloomberg, KGI Research

Figure 21: CPRI's revenue by geographical region (USD\$mnn)



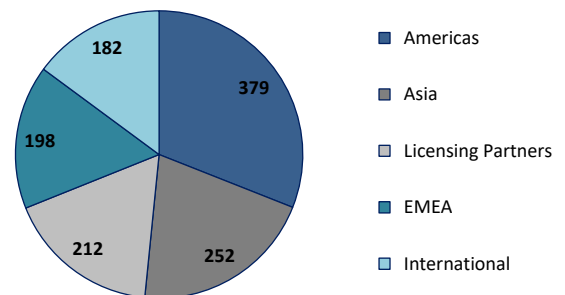
Source: Bloomberg, KGI Research

Figure 22: CPRI's Debt Servicing Ratios (%)



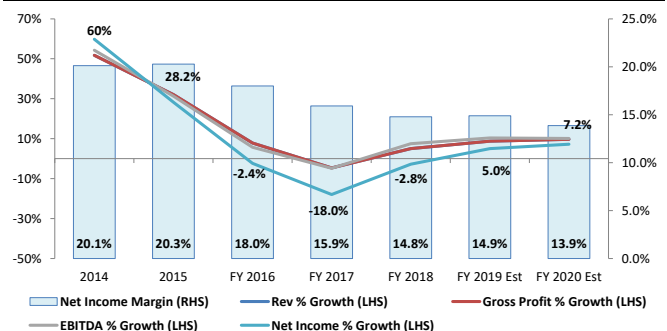
Source: Bloomberg, KGI Research

Figure 23: CPRI's retail location count by geographical region



Source: Bloomberg, KGI Research

Figure 24: CPRI's consensus forward profitability margins



Source: Bloomberg, KGI Research

Risks

- Further escalation of trade war tensions might cause Chinese consumers to protest against the consumption of US luxury brands. We had seen similar impact to Korean sales and inbound Chinese tourism to the country during the geopolitical tensions following THAAD.
- Geographical exposure may not be a good indicator of Chinese demand as spillover to other geographical regions may be significant. Consumption pattern shows that the Chinese have a huge appetite for luxury spending during vacations, away from their domestic market.
- The backlash against the wealthy may further dampen luxury spending sentiments going into 2019. Inequality trends worldwide have exacerbated since the late 1970s. Social issues surrounding income inequality intensified in recent years. The most recent occurrence was the Yellow-Vest protests in Paris, the global luxury capital, after President Macron repelled French tax on wealthy households with assets above Euro1.3mn. The wealthy may defer spending on luxury items in the midst of the current negative sentiments.
- Investors should pay close attention to the following events: (1) Announcement of festive expenditure by Chinese consumers this Chinese New Year would give a good indication of consumer spending sentiments going into 2019, (2) 2018 results for several luxury houses would be reported in 1Q19, including LVMH. This would be a potential time to short luxury stocks if share prices were to rally after announcement of positive results, and (3) Market volatility expected approaching 1st of March, when the 90 day trade war truce expires, with the second wave expected to hit on the 29th March, when Brexit formally commences.

Company	Bloomberg Ticker	Currency	Price	Mkt Cap (\$m, lcl currency)	Total Returns YTD	Total 1 YR Returns	5 YR historical P/E (x)	Last P/E (x)	12M Return Potential	Est Forward Rev Growth (% YOY)	Net Gearing (%)
Diversified Segments											
Salvatore Ferragamo SpA	SFER IM	EUR	18.02	3,516	2.1%	-6.9%	24.9	31.2	3.9%	(2.4)	11
LVMH Moet Hennessy Louis Vuitton	LVMHF US	USD	300.31	152,729	1.4%	4.7%	19.7	21.9	19.3%	9.7	38
PRADA SpA	1913 HK	HKD	25.00	8,161	-3.1%	-5.9%	28.1	33.3	42.5%	5.2	35
Cie Financiere Richemont SA	CFR SW	CHF	65.92	38,890	4.6%	24.9%	27.6	13.3	28.2%	23.0	56
Capri Holdings Ltd	CPRI US	USD	41.87	6,290	10.4%	34.4%	15.9	9.0	49.0%	8.8	43
Tapestry Inc	TPR US	USD	37.00	10,722	9.6%	9.5%	18.1	13.7	40.1%	5.1	49
Hermes International	RMS FP	EUR	491.20	59,950	1.3%	11.3%	35.8	38.7	(1.8%)	8.8	1
Burberry Group PLC	BRBY LN	GBp	1,790.00	9,414	3.1%	2.8%	22.4	22.5	7.6%	(3.9)	2
Kering SA	PPRUF US	USD	492.00	62,129	4.9%	12.2%	26.5	24.3	17.9%	(12.6)	44
HUGO BOSS AG	BOSS GY	EUR	58.94	4,797	9.3%	6.3%	20.3	19.0	24.1%	1.5	14
Diversified Segments					4%	-10%	22	23	23.1%	4	29
Jewelry Makers											
Tiffany & Co	TIF US	USD	86.48	10,542	7.4%	-17.1%	21.0	18.1	33.2%	6.6	31
Chow Tai Fook Jewellery Group	1929 HK	HKD	6.44	8,216	-1.4%	-17.5%	19.0	15.1	19.1%	9.4	39
Swatch Group AG/The	SWGAY	USD	15.22	16,920	4.4%	-26.0%	22.0	17.0	20.9%	8.0	0
Jewelry Makers					0.03	-20%	21	17	24.4%	8	23
Apparels											
Lululemon Athletica Inc	LULU UW	USD	136.00	18,007	11.8%	71.0%	30.8	41.3	16.7%	21.2	-
Ralph Lauren Corp	RL UN	USD	109.46	8,805	5.8%	6.4%	18.2	16.3	19.7%	0.6	17
G-III Apparel Group Ltd	GIII US	USD	31.57	1,558	13.2%	-18.8%	20.4	12.1	47.6%	8.5	35
Ted Baker PLC	TED LN	GBp	2,120.00	1,208	36.8%	-23.3%	28.5	17.9	(3.1%)	0.2	57
PVH Corp	PVH US	USD	102.61	7,771	10.4%	-27.2%	15.5	11.0	35.6%	6.4	56
Apparels					16%	2%	23	20	23.3%	7	33
Alcohol											
Diageo PLC	DGE LN	GBp	2,729.50	84,382	-2.3%	5.1%	21.2	22.5	8.6%	(0.3)	85
Brown-Forman Corp	BF/B US	USD	46.45	22,187	-2.4%	-11.3%	29.8	29.2	9.9%	3.8	194
Constellation Brands Inc	STZ US	USD	150.94	28,691	-6.1%	-31.1%	27.6	18.1	50.1%	6.3	126
Pernod Ricard SA	RI FP	EUR	138.25	42,419	-3.5%	5.4%	24.3	23.2	1.6%	(0.7)	51
Marie Brizard Wine & Spirits S	MBWS FP	EUR	2.68	88	1.9%	-78.8%	-	3.3	(4.9%)	0.4	22
Remy Cointreau SA	RCO FP	EUR	100.10	5,895	1.2%	-10.8%	37.7	34.1	10.1%	3.3	33
Davide Campari-Milano SpA	CPR EU	EUR	7.57	10,157	2.4%	20.6%	25.5	-	(7.6%)	(5.9)	67
Alcohol					-1%	-22%	21	19	7.9%	0.9	75

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Rating	Definition
	KGI Securities Research's recommendations are based on an Absolute Return rating system.
BUY	>10% total return over the next 12 months
HOLD	-10% to +10% total return over the next 12 months
SELL	<-10% total return over the next 12 months

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