

A Work Project, presented as part of the requirements for the Award of a Master Degree in Finance from the  
NOVA School of Business and Economics.

Silk Road of Luxury: Kering's expedition between  
technology and sustainability

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## Abstract

- Given our estimates through the DCF-model, we recommend for a fictive investor to **BUY** positions in Kering SA seeing as our 2024 target price of 530,16 EUR gives a **total return of 23,88%**.
- Kering SA has recovered impressively after COVID-19 reporting a **revenue growth of 55,35%** and an **EBIT growth of 61,43%** from 2020. In present time, Kering SA is experiencing difficulties in continuing this growth pattern as consumer demand is halted due to a prolonged high inflation coupled with the weak development of flagship brand Gucci.
- We believe forward that the industry will regain its momentum back in the second half of 2024 as America and China are forecasted to have reached a healthy inflation level while Europe is halting behind expected to catch up by 2025.
- DCF used to target the share price at the end of 2024, with a **WACC of 10.64%** and **terminal growth rate of 3.6%**.

## Keywords (up to four)

DCF

Valuation

Luxury industry

Luxury brand

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This report is part of the joint report (annexed), developed by Souhail Chakir and Zakaria Zoulali and should be read as an integral part of it.

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# Introduction

This joint equity research report on Kering serves the purpose of providing a comprehensive analysis of Kering's financial health, performance, and future prospects. The report, structured collaboratively, encompasses an array of key sections, each delving into specific aspects of Kering's operations and market positioning. The parts I covered in this individual report were the value drivers, a geographical segmentation analysis, capital expenditures and net working capital forecasts, future risks and limitations, a sensitivity analysis, and final recommendation about Kering. The other parts were covered by my partner.

The value drivers section provides an explanation of the fundamental factors that will contribute to Kering's growth in the future. For the geographical segmentation, it highlights the performance of each key market for the company, growth prospects and relevance of each segment for Kering. The capital expenditures and net working capital shows the company's investment strategies in key assets, and the financial liquidity of the company. Risks and limitations will outline challenges that Kering may face in the foreseeable future, including industry-specific and company-specific considerations. Sensitivity analysis will explore the impact of various factors on Kering's valuation, offering an understanding of the company's vulnerability to fluctuations in key variables such as sales and cost of goods sold. Finally, the final recommendation will be about summarizing the key findings about the company, and what should they keep an eye on in the future.

The report concludes with an overall valuation of Kering at €528.24 per share, with a buy recommendation, indicating a positive outlook on the company's future performance. This conclusion draws from an in-depth examination of all factors contributing to Kering's valuation.

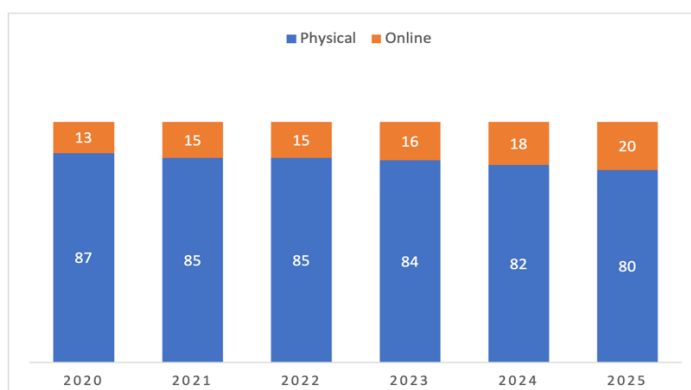
# Value drivers

Aligned with the previous *Sector* and *Competitors* analysis, the main value drivers for the growth of Kering and the luxury industry as a whole in the future will be centered on these key factors: digital transformation with a store and online integration, and sustainability. Other important value drivers for Kering will be the revival of Gucci in the coming years, the exclusive products and collaborations with other brands, and M&A activities and synergies between its Houses.

The first value driver will be the digitalization of the Group. As the market becomes more sophisticated, the integration and development of the various distribution channels, especially of the digital luxury experience in e-commerce platforms and the expansion of in-store sales in emerging nations, are fueling the industry's and Kering's long-term growth<sup>1</sup>. There was an unprecedented surge in online sales in 2020 due to COVID-19, with a 67% increase reaching 13% of Kering total sales. This momentum did not diminish in the next years, up by 55% in 2021 and 11% in 2022 totaling 15% of total sales. As described before in the *Sector* analysis, looking ahead, industry trends and consumer preferences indicate an uptrend in online shopping, and we expect e-commerce share to continue increasing for Kering to reach 20% of the Group's total sales by 2025.

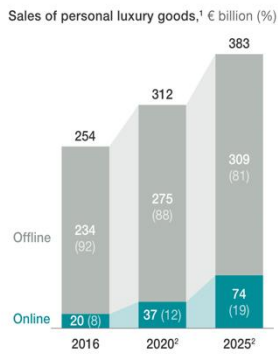
To meet the exponential growth of e-commerce and new customers' expectations, the Group has prioritized a more solid and resilient e-commerce model, by internalizing the management of its Houses' sites as part of an integrated approach to improve the interactivity and complementarity between their physical and online stores, which will lead to customers having a smoother experience. The ever-growing digitalization of the Group is helping accelerate the store and online integration and make the environmental efforts of the company more efficient, which will contribute to reducing costs in the future. For instance, with their improved data collection and analysis, Kering is refining sales projections and are setting production levels accordingly, which will lead them to be better at meeting customer demand, which will in turn contribute to lower inventories and reduce their environmental impact. In 2021, Kering started a plan to revamp its supply chain, which resulted in the opening of its new global distribution hub in northern Italy. This platform guarantees better product availability and reduced delivery times, which enhances the shopping experience for customers, while improving inventory management. All these elements will contribute to better efficiency, and will reduce inventory on sales, leading to a continuous decrease in Average Holding Period (AHP) and increase in cost savings.

**Figure 17: Evolution of Kering online sales from 2020 to 2025**



Source: Own estimations and company data

**Figure 16: Sales of personal luxury goods and share between online and offline**



<sup>1</sup>Accessories, apparel, beauty products and perfumes, footwear, jewelry and watches, and leather goods.  
<sup>2</sup>Forecast.  
 Source: Euromonitor, Forrester

Source: McKinsey and Euromonitor

<sup>1</sup> <https://www.mckinsey.com/industries/retail/our-insights/luxury-in-the-age-of-digital-darwinism>

It appears that Kering does not disclose the specific amounts of these investments in their public documents, but for example for Gucci, the company says they are aiming for around 3% of revenue as an investment in their store upgrades and expansions, and their logistics and digital transformation to increase efficiency. Additionally, Kering is very present on social media, with Gucci the third most followed luxury brand with 52.7 million followers on Instagram, and other important Kering brands such as Saint Laurent, Balenciaga, and Alexander McQueen all having more than 10 million followers. As previously mentioned, social media is becoming more and more important for the luxury industry, and we believe that in the upcoming years Kering will continue growing in this aspect, which will contribute to a higher revenue. These brands also have an important presence on WeChat and Weibo, the Chinese social media.

The Group has also started to gradually reduce its presence in the wholesale distribution channels, to put a greater emphasis on their own retail distribution, a process that has already been completed at Gucci and is being carried out according to the maturity of each House. Kering was down 20% in the wholesale category in the third quarter of 2023, while retail only fell 6%. This process often results in short-term losses, but we believe that this strategic move will ultimately pay off in the long run. By owning its own retail channels, Kering will have more control and can ensure that its brands are presented in a luxurious manner across all touchpoints which will reinforce the prestige and exclusivity of its brands. The Group will have direct access to all customer data from their retail stores, allowing them to better understand customer preferences and tailor their products and inventories accordingly, and will capture higher profit margins due to absence of intermediaries.

Concerning sustainability, Kering has made it a central pillar of its business strategy, embracing a circular economy approach to boost their long-term growth while minimizing their environmental impact. Modern consumers are increasingly conscious about the environment and social impact, and the industry has already been subject to heavy criticism for its negative impact on the environment. Kering aims towards zero product destruction, zero single-use plastics materials, and 100% of raw materials being responsibly sourced by 2025, and zero microfiber leakage by 2030<sup>2</sup>. Starting in 2021, the Group also committed to cutting its absolute greenhouse gas emissions by 40% by 2035. It will also be using organic cotton, with 80% less environmental impact than traditional cotton. Kering is already using 100% renewable electricity in all its stores and reduced their water consumption by 40%.

To strengthen their upstream capabilities in the luxury goods value chain, the Group started making strategic supplier acquisitions to protect their sourcing and internalize product creation, to guarantee complete traceability of the materials used by its Houses, such as cotton, leather, and precious skins. In 2021, The Group made a €178 million investment in Vestiaire Collective, a marketplace for desirable pre-owned clothing in Europe. The investment meets Kering's objectives to promote emerging sustainability trends, as well as supporting innovative business models. Another instance is Kering's investment in VitroLabs, a startup that specializes in producing lab-grown leather. Balenciaga's 2022 Winter Collection featured a coat entirely made of a bio-based material derived from mycelium mushrooms.

While Kering's sustainability efforts can promote the brands' reputation in the eyes of consumers, we believe they will lead to increased costs in the coming years, due to sustainable materials and processes being more expensive to produce than traditional ones. For example, organic cotton

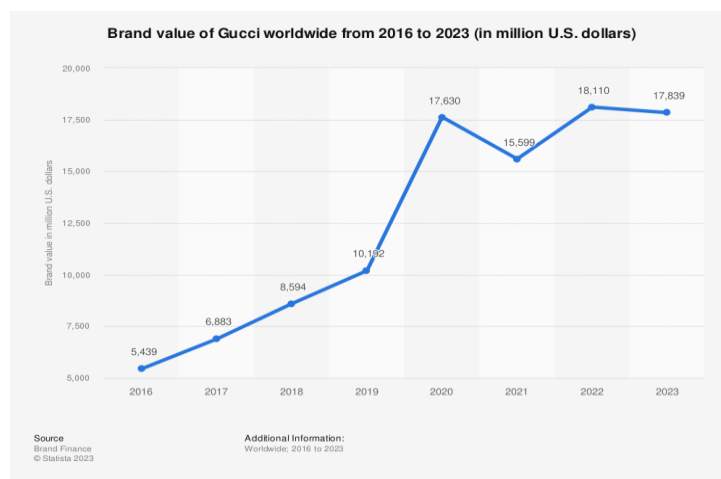
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<sup>2</sup> [https://www.kering.com/api/download-file/?path=Kering\\_Circularity\\_Ambition\\_8150120e01.pdf](https://www.kering.com/api/download-file/?path=Kering_Circularity_Ambition_8150120e01.pdf)

is typically more expensive than conventional cotton<sup>3</sup>, and upcycling and recycling is more labor-intensive and traditional manufacturing methods. In addition to the increased costs, Kering will need to continue to invest in research and development of sustainable materials and technologies. We expect the costs of goods sold as a percentage of sales to continue increasing until 2028. However, the gross margin will only decrease slightly, due to the higher prices of the sustainable products sold and will go back to same historical levels of --% by then. As we have said before in the industry analysis, a company following sustainable practices does not necessarily mean revenue growth, but luxury consumers consider sustainability important when choosing a brand<sup>4</sup>, so it is important for the company's reputation.

An important value driver in the future for Kering will be the revival of Gucci. Gucci is Kering's flagship brand, responsible for more than 50% of the Group's revenue, and has fell by 7% on the third quarter of 2023<sup>5</sup>. Gucci's brand image and appeal among young consumers has diminished the last few years. With the current trends of "quiet luxury" and "old money", the former creative director Alessandro Michele's highly maximalist style, characterized by vibrant prints and bold logos is no longer appealing to customers and a significant change to the style is necessary for Gucci to regain its position and brand image. Sabato de Sarno, Gucci's new creative director, focused on a more minimalist approach, more in touch with the current trend of "quiet luxury", showing an understanding of changing consumer preferences who value style and quality over extravagance. The unveiling of the new Gucci collection made Kering SA shares rise by 4%<sup>6</sup>, which shows interest and confidence in the new style, but it will only be available for sale in January. Sabato de Sarno has already been highly successful in reviving Valentino from the ashes into a global brand<sup>7</sup>, and we believe he will be also successful in bringing back Gucci to prominence.

**Figure 18: Brand value of Gucci from 2016 to 2023**



**Source: Statista**

Another value driver for Kering will be their exclusive and limited-edition products and ideas, and collaborations with other brands. Collaborations are business ideas that appeal to the younger

<sup>3</sup> <https://eachnight.com/bedding-resources/organic-cotton-vs-cotton/>

<sup>4</sup> <https://fortune.com/europe/2023/05/12/gen-zers-are-redefining-the-values-of-the-luxury-market-status-and-prestige-are-out-sustainability-and-inclusivity-are-in/>

<sup>5</sup> <https://www.bloomberg.com/opinion/articles/2023-10-25/kering-s-gucci-can-t-keep-up-with-billionaire-favorites-hermes-brunello>

<sup>6</sup> [https://www.washingtonpost.com/business/2023/09/25/milan-fashion-week-gucci-s-new-designer-sabato-de-sarno-is-making-kering-happy/b46973c0-5b5d-11ee-b961-94e18b27be28\\_story.html](https://www.washingtonpost.com/business/2023/09/25/milan-fashion-week-gucci-s-new-designer-sabato-de-sarno-is-making-kering-happy/b46973c0-5b5d-11ee-b961-94e18b27be28_story.html)

<sup>7</sup> <https://www.theguardian.com/fashion/2023/jan/28/gucci-announces-sabato-de-sarno-as-its-new-creative-director>

audiences that will be the main consumers of luxury in the future, whether through using ephemeral pop-up stores and limited-edition items to generate excitement and hype, or through collabs with other popular brands or video games outside of the luxury industry. For example, Gucci opened their own restaurants in Florence, Los Angeles, and Tokyo. Saint Laurent reported greater than expected clientele in their pop-up shows in Paris, Hong Kong, and New York, and Bottega Veneta pop-up in New York garnered a lot of media attention and social media buzz. We should note that there were no specific sales figure available for these events. Another strategy used by luxury brands is the targeting of very young audiences with branded video game purchases, and Kering has already a strong position in this niche, on Fortnite with Balenciaga and on Roblox with Gucci, two very popular games with young audiences, with 231 million<sup>8</sup> and 214 million<sup>9</sup> active monthly users respectively as of 2023, which suggests very high visibility for the brands. Another example is the Gucci x North Face and Pokémon Go collaboration that increased the presence of luxury fashion in the digital world through collectibles, that in order to collect, players had to travel to a Gucci pop-up store shop in one of the participating locations, which contributed to more traffic in their 100 participating physical stores.

Gucci, and now all the brands under Kering have an inclusive attitude towards brand collaborations to generate growth. We expect that they will continue innovating in this aspect and will enable Kering to reach new audiences and generate more sales.

Finally, the last value driver will be the M&A activities of Kering and the synergies between the Houses under it. In 2023, Kering completed the acquisition of Creed and 30% of Valentino with an option to purchase the rest of the capital before 2028, for €3.5 billion and €1.7 billion respectively. The acquisition of Creed expands the group's presence in the high-end fragrance segment, and the acquisition of Valentino complements Kering's existing fashion portfolio, further diversifying the Group's offerings. Creed is an already established brand with a strong reputation in the luxury fragrance industry, and will expand Kering Beauty's reach and market share to solidify its position as an important player in the industry. High-end fragrances and niche beauty brands have experienced a rush in popularity in social media after COVID-19<sup>10</sup>, especially on TikTok, further accentuated by the current trend of quiet luxury aesthetic, with Creed Aventus being the most popular and talked about niche fragrance in the world<sup>11</sup>.

Concerning Valentino, it is also an iconic luxury brand that has gained massive popularity in recent years, being a favorite among celebrities and fashion influencers in red carpet events and parties. The addition of Valentino to Kering's portfolio will further strengthen its position in this segment of the market. We think that Kering will definitely acquire the rest of Valentino's capital even before 2028, to capitalize on its potential for growth. Both those acquisitions represent strategic moves by Kering to strengthen its position in the luxury goods industry, with Creed

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<sup>8</sup> <https://www.demandsage.com/fortnite-statistics/#:~:text=Fortnite%20has%20500%20million%20registered,revenue%20came%20in%202022%20alone.>

<sup>9</sup> <https://www.demandsage.com/how-many-people-play-roblox/#:~:text=Roblox%20has%20214.10%20million%20Monthly,the%20coronavirus%20pandemic%20scenario%20intensified.>

<sup>10</sup> <https://www.reuters.com/markets/deals/kering-snaps-up-fragrance-label-creed-new-beauty-division-2023-06-26/>

<sup>11</sup> <https://fourthsense.co/creed-aventus-review/#:~:text=It's%20literally%20the%20most%20popular,re%20talking%20about%20Creed%20Aventus.>

having €250 million of revenue in 2023 and double-digit growth in the past years<sup>12</sup>, and Valentino generating €1.4 billion of sales and 10% year over year growth<sup>13</sup>.

An important part for a company like Kering, that has a wide portfolio of brands under its wing is to benefit from synergies between the different lines. The Group's success lies in its ability to strike a balance between the autonomy of individual Houses and the synergies that come from shared resources. Kering provides its Houses with access to shared resources, such as logistics and IT infrastructure, to reduce costs and improve efficiency, in addition to the exchange of best practices and insights in certain areas such as product development and sustainability. Kering is also using cross collaboration between its brands to generate new exclusive product ideas to create more hype and demand. For example, the Gucci x Balenciaga collaboration was sold out in hours<sup>14</sup>.

In addition to all these factors, global revenue growth will also be primarily driven by sustained growth in demand in key emerging markets, and the cultural openness of new audiences to global brands, which reflect both local and tourist consumption, with help from the rise of number of the middle class and aspirational shoppers that have access to more disposable income to spend on luxury goods<sup>15</sup>.

## Segment analysis

Together with the *Industry* and *Competitor* research, the regional segmentation highlights each market's importance and potential growth opportunities that Kering should explore in the following years. According to Exhibit X, the Americas and Asia regions are the largest contributors to the global luxury market, accounting together for 70% of the worldwide sales, followed by Europe with 27% of the market share. Excluding mainland China and Japan, Asia rose by 43% which reflects the performance of other Southeast Asian countries such as Thailand, in addition to a great year for South Korea that helped decrease the gap with Japan in terms of market share. The Japanese market grew by 18%, bringing it back to pre-Covid levels, aided by local consumption and the return of tourists.

On the other hand, mainland China experienced a slight decline, falling 1% from 2021, due to prolonged Covid lockdowns, which lowered consumer trust and led to weak performance across all channels, even online. However, there was a rebound when the restrictions were lifted. Since the mainland reopened, Hong Kong and Macau, two popular Chinese tourist destinations, have seen a sharp increase in luxury spending. The recovering Chinese market, added to the explosive growth of other Asian countries show that this region has a high potential for future development.

Concerning the Americas region, even if it showed significant growth in 2022, reaching €113 billion and growing by 25% over 2021, the US slowdown is expected to continue, as growing fears of recession and increasing inflation rates make consumers limit their spending in luxury goods. Americans are also choosing to buy luxury goods abroad, due to the widening of price differentials between regions. Latin America also experienced strong growth, especially in Brazil and Mexico. Finally, consumption in Europe has been strong in the first quarter of 2023, helped by local

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<sup>12</sup> <https://www.premiumbeautynews.com/en/kering-beaute-acquires-heritage,22239>

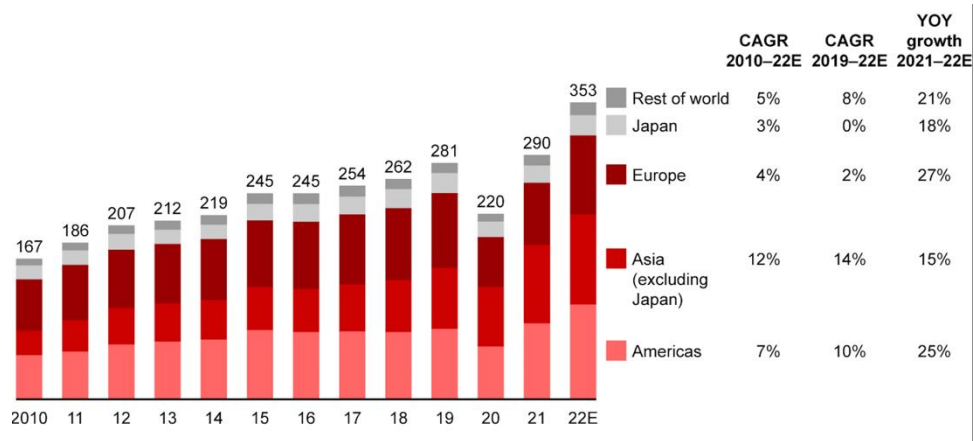
<sup>13</sup> <https://www.businessoffashion.com/news/luxury/valentino-reports-10-percent-rise-in-annual-sales/>

<sup>14</sup> <https://culted.com/gucciaga-dropped-sold-out-landed-on-ebay-in-hours/>

<sup>15</sup> <https://activity-report.kering.com/en-business-model.html>

demand and tourists from the Middle East and United States, and could see even further growth with the return of Chinese tourists. One of those key emerging markets will be the Middle East, with the rising number of high-net-worth individuals and the growing population in multiple countries. An example of this is Saudi Arabia<sup>16</sup>, with sales expecting to double by 2030, from €3 billion to €6 billion, with around 60% of the population being less than 30 years old.

Figure 19: Global personal luxury goods market by region (€ billion)



Source: Bain & Company

Following the industry trends outlined above, Kering has a geographical revenue breakdown similar to that of the industry. The most important market for Kering is Asia-Pacific with 37% of total sales, up 22% on a YoY comparable basis. Japan is the market with strongest growth in the first half of 2023, with a 26% YoY increase, especially thanks to Gucci that has seen a 32% increase. Contrary to the Asian Market, the North American market is the one showing most signs of weaknesses, with a 23% decrease on a comparable basis, but still representing 22% of total sales. The European market is relatively stable for Kering, up 4%, mainly due to the return of tourists, and the rest of the world is up 5%.

Figure 20: Revenue Breakdown by Region H1 2023



Source: company data

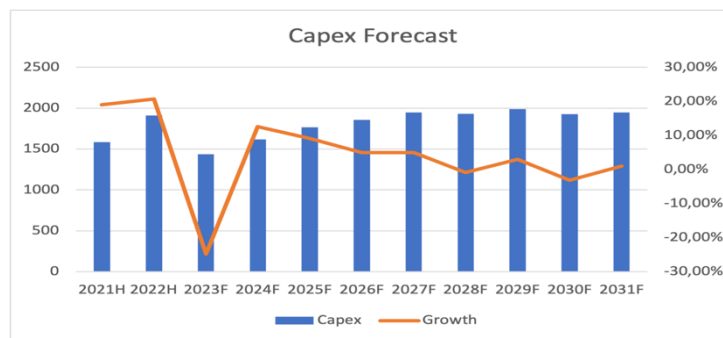
## Capital Expenditures

Kering's significant capital expenditures have been instrumental in the company's considerable growth in recent years, be it through the openings of new stores and the improvement of older ones, or through their acquisitions of other luxury Houses. These transactions show Kering's commitment to strategic expansion and market consolidation. From 2018 to 2022, their CapEx

<sup>16</sup> <https://web-assets.bcg.com/d7/7b/ac47bd5c4f018aa58d0449b96590/bcgxaltagamma-true-luxury-global-consumer-insight-2023-final4.pdf>

increased from €828 million to €1.1 billion euros, representing 5.3% of its revenue, and with a CAGR of 7.36%. This shows a trend of consistent CapEx allocation, as we can see in the first half of 2023, with CapEx amounting to 5.2% of total revenue. To support its elevation strategy, Gucci will continue to invest in CapEx with a focus on network enhancement, by new openings with a 15% network increase and the expansion of existing locations. Saint Laurent continuous new store openings in key markets, with 12 new openings in 2022 and 29 in 2021, especially in Asia Pacific and North America, and reinforcement of their production capacity suggests that they are still planning to invest in CapEx in the coming years. For Bottega Veneta, their CapEx is expected to increase, directed towards enhancing its store network, including its penetration of the Middle East market. Finally, the CapEx plans for other Houses will be focused on penetration of new markets and new store openings. This shows a strategic and brand specific approach to CapEx, but it remains somewhat constant when taking the whole Group into account. For example, Kering has said that they will open at least 10 new stores annually in China, one of their most important markets<sup>17</sup>. Moreover, Kering recognizes the importance of new technologies in improving operations and achieving full integration between their physical and online stores, as such, the Group will continue to invest in logistics and IT transformation to increase efficiency. Given the historical trend, we expect Kering to continue investing heavily in their brands at the same rate of last few years, at 5.3% of total revenue.

**Figure 33: CapEx forecast between 2021-22031 in millions (in €)**



Source: Own estimates

## Net Working Capital

The Group's ability to manage its working capital efficiently is an important basis for its ability to generate value in the future. Kering has to be able to meet its short-term obligations and an effective working capital management ensures that they maintain financial flexibility and have the resources to grow their business. The net working capital input changes depending on Inventories, Receivables and Other current assets, Payables and Other current liabilities, Other current tax liabilities and provisions.

The average holding period (AHP), calculated using inventories as a percentage of COGS, has been slowly increasing the past few years, and expect it to continue slightly increasing during the forecasted period. The future expansion in stores will facilitate a prolonged holding of inventory, which explains the slight year-to-year increase in inventories. Looking at other luxury counterparts like LVMH and Richemont reveals a common trend of higher holding periods in the industry. Even though it is at a satisfactory level, we also know that historically, they have been able to maintain

<sup>17</sup> <https://www.chinadaily.com.cn/a/202311/16/WS65556ffca31090682a5ee69f.html>

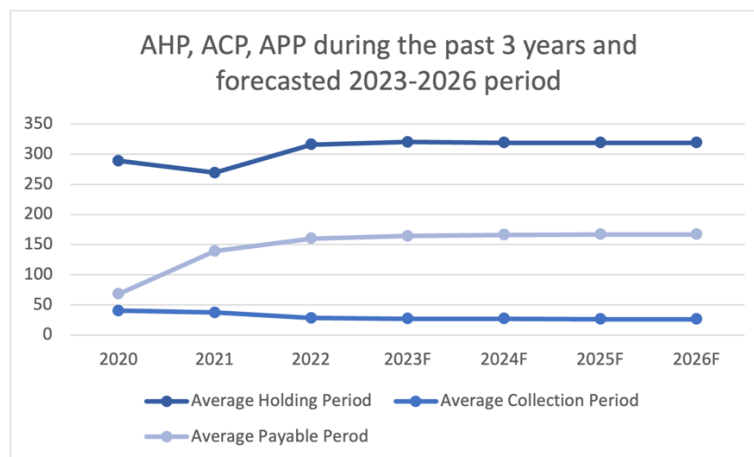
it lower than the current rates, which suggest a possible future improvement in the holding period. The challenging macroeconomic landscape has impacted customer spending, leading to extended storage durations. Looking forward, we anticipate positive shifts in the macroeconomic environment by 2024, and Kering's investments in supply chain and distribution centers will help reduce pressure on inventory.

Concerning their receivables, Kering has demonstrated stability and a consistently low figure in their average collection period (ACP) over the last years. We expect Kering to keep its current trade terms agreement and that ACP will continue gradually decreasing in the future to reach 24 days in 2029. It has been on a declining trend, but we expect it to remain stable in 2023 and 2024 due to disruptions caused by the current macroeconomic environment.

Regarding their account payables, their average payable period (APP) increased drastically the last two years, reaching 160 days in 2022, from only 68 days in 2020, which shows that Kering has better deals with its suppliers and is able to take longer to complete their accounts payable obligations. However, we anticipate a slower growth in the future, as the growth witness during the last years is very high and expecting the same rate for the future would be unrealistic.

This shows that the Group receives money for their products faster than they are paying their creditors, which is normal for the industry as they get the money directly from customers after an item is purchased but are able to delay their supplier payments.

**Figure 34: AHP, ACP, APP during past 3 years and forecasted period 2023-2026**

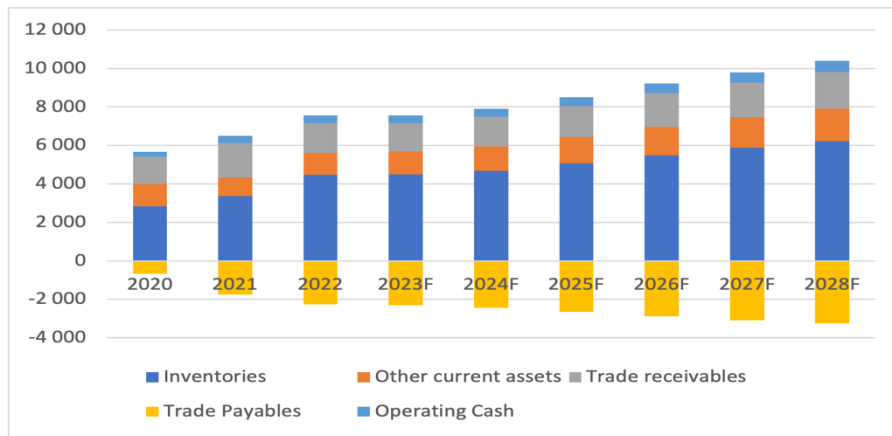


**Source: Own estimates**

Their cash conversion cycle (CCC), calculated as the difference between both inventory holding and receivables period, and the payables period, is back on the same level as 2018 and will remain constant at around 200 days for the future.

However, we can see a substantial improvement of their net working capital across the years, as it was at €(664) million in 2018 and has increased to €2416 million in 2022, which shows a remarkably better management of the working capital that we expect to continue to improve in the future.

Figure 35: Working capital components over the years



Source: Own estimates

## Risks and challenges

We consider that there are still some risks that could potentially hurt Kering's business and limit their future performance. First, the rising cost of living and inflation are making it more difficult for customers to afford luxury goods. Young adults, who represent a significant portion of the market are the most affected by this. The threat of a coming economic slowdown is weighing on the luxury industry, as consumers are spending less money overall, they are likely to cut back on luxury purchases first. The luxury sectors tends to be a late-cyclical industry, and is not completely impervious to macroeconomic forces, even if it had been more resilient recently<sup>18</sup>. With a looming recession, Kering could see its sales decline in the coming years, as during economic downturns, the luxury industry has shown a tendency to underperform the global economy. This is particularly true for American and European consumers who are the most hit by high inflation, and they represent together around 50% of the whole market share for luxury goods<sup>19</sup>. China, another important market for luxury industry growth, is also showing signs of weakness, with their slow economic recovery and their youth population reaching an alarming rate of unemployment. As we have said before, young adults around the world have been a very strong factor of growth for the luxury industry and being affected the most by the current economic uncertainty and rising costs of living, they are most likely to cut back their spending on luxury goods, and as a result, sales would be lower than expected during the coming years. In the case of the persistence of inflation and economic slowdown, we will explore it further in the *Sensitivity analysis* section.

Secondly, the over-dependence of Kering and the overall luxury industry on few markets that represent most of the market share can be dangerous, as it is more vulnerable to economic downturns in those particular markets. We can see that today with the reduced demand in the American and Chinese markets Kering and other luxury companies are taking big hits in their global sales and stock prices, with Kering being down from their all-time high of €528.4 per share to currently being €417.9 per share, down more than 20% in less than 6 months.

Kering should also be more aware of their competitors. Gucci, the biggest source of revenue for Kering has seen its momentum stalling these past three years, losing ground to their rivals Louis Vuitton and Dior owned by its most important competitor LVMH. Its revival with its new creative

<sup>18</sup> <https://www.jpmorgan.com/insights/global-research/retail/luxury-market>

<sup>19</sup> <https://www.reuters.com/business/retail-consumer/kering-sales-down-9-luxury-slowdown-weighs-turnaround-efforts-2023-10-24/>

designer and collection will be crucial to relaunch brand momentum and regain their market position<sup>20</sup>. The collection will be available early 2024, and if it fails to reboot Gucci sales growth, Kering could lose even more ground to their competitors. The impact on share price if Gucci sales continue to stall will be further explored in the *Sensitivity analysis* part.

Kering should be also more aware of scandals that could hurt the company. We have seen this with the fallout after the failed marketing campaign of Balenciaga, which sparked a huge backlash with fans and that hurt massively their sales in Europe and the US<sup>21</sup>. Scandals nowadays spread very fast, and people are quick to act on them, which damages the brand's reputation worldwide, and could spread to the parent company, in this case, Kering.

Finally, Kering is committed to their sustainability efforts, and the Group could see their cost of goods sold increase more than expected, due to a rise in the price of sustainable raw materials. There is more demand for this type of material, and any disruption in the production of certain raw materials could exert significant pressure on Kering's cost of goods sold, and subsequently their operational margins. We will explore the potential impact on Kering's stock price more in the following *Sensitivity analysis* section.

## Sensitivity analysis

The purpose of this part is to test the share price of the company when there is a change in some important drivers. Like all other companies in the industry, Kering is facing an unpredictable environment, and little adjustments to those inputs will have a big impact on the anticipated share price.

First, we thought of doing a sensitivity analysis on the share price, with changes in the terminal growth rate and the WACC. We used a terminal growth rate of 3.6% as the first input and explored various scenarios by adjusting the rate between 2% and 5%. A continued slowdown in sales growth for Kering, like it has been the case in the second half of 2023 might result in a lower terminal growth rate and could signal potential challenges for Kering to keep its growth momentum. Concerning the WACC, we used a 10.64% rate that ranged between 9% and 12% in the scenario analysis. Kering's exposure to macroeconomic shifts make its beta subject to changes. We explored the changes in Beta and MRP later in this section. Kering's stock price is highly sensitive to fluctuations in both parameters, going from €379.26 per share in the lower bound, to €924.22 in the higher bound, as we can see in the table below.

**Figure 41: Kering share price with varying WACC and growth rate.**

|        | 2,00%  | 2,5 %  | 3,00%  | 3,60%  | 4,00%  | 4,50%  | 5,00%  |
|--------|--------|--------|--------|--------|--------|--------|--------|
| 530,16 | 581,00 | 616,20 | 657,27 | 716,59 | 764,05 | 835,24 | 924,22 |
| 9,00%  | 536,04 | 565,72 | 599,97 | 648,73 | 687,15 | 743,81 | 813,07 |
| 9,50%  | 496,75 | 522,02 | 550,90 | 591,52 | 623,11 | 669,06 | 724,19 |
| 10,0 % | 453,13 | 473,95 | 497,49 | 530,16 | 555,22 | 591,13 | 633,41 |
| 10,64% | 431,40 | 450,17 | 471,29 | 500,40 | 522,58 | 554,15 | 590,97 |
| 11,00% | 403,94 | 420,29 | 438,56 | 463,54 | 482,42 | 509,05 | 539,77 |
| 11,50% | 379,26 | 393,59 | 409,51 | 431,11 | 447,31 | 469,99 | 495,91 |
| 12,00% |        |        |        |        |        |        |        |

**Source: Own estimates**

The second scenario analysis we did was with changes in the Beta and the Market Risk Premium (MRP). As beta fluctuates, so does the risk perception by investors, consequently

<sup>20</sup> <https://www.ft.com/content/e6d63009-2d2d-496b-9ae6-58c59e62650b>

<sup>21</sup> <https://www.nytimes.com/2022/11/28/style/balenciaga-campaign-controversy.html>

impacting the cost of equity calculation for the WACC. A higher beta indicates greater volatility than the market and coupled with a rising market risk premium will lead to an increase in the cost of equity. Conversely, a lower beta with a stable or decreasing market risk premium could contribute to a better cost of equity positively influencing the stock price. We used a range of 0.9 to 2 for beta, and a MRP ranging from 5.75% to 7%. We can see in the table below that the share price ranged from €272.78 per share in the lower bound, to €898.28 in the higher bound, also showing a high sensitivity to changes in these two parameters.

**Figure 42: Kering share price with varying Beta and market risk premium.**

|        | 0,90   | 1,00   | 1,27   | 1,50   | 2,00   |
|--------|--------|--------|--------|--------|--------|
| 530,16 |        |        |        |        |        |
| 5,75%  | 909,08 | 806,28 | 612,26 | 503,04 | 354,63 |
| 6,0 %  | 866,15 | 767,94 | 582,54 | 478,14 | 336,25 |
| 6,5 %  | 790,54 | 700,41 | 530,16 | 434,25 | 303,85 |
| 6,8 %  | 751,96 | 665,95 | 503,42 | 411,83 | 287,30 |
| 7,0 %  | 726,09 | 642,84 | 485,47 | 396,78 | 276,20 |

Source: Own estimates

Finally, we carried out a sensitivity analysis for the three scenarios described before in the previous *Risks and Limitations* section, in the case of prolongation of macroeconomic environment in 2024, where Gucci fails to deliver on its number of sales and where the cost of goods sold increases more than expected, that are important value drivers for Kering in the future and could impact its financial performance.

We started by doing a sensitivity analysis to gauge the impact of a persistence of current macroeconomic conditions, leading to sales in Kering's most important markets, being North America, Europe, and China staying low. This scenario unfolds with a darker outlook on the share price being €472.8 per share, still giving a positive return of 10.71%, but much lower than the current valuation of €530.16, which gives a positive return on investment of 24.15%. This shows the risk of the reliance on few key markets representing the majority of the sales of the Group.

Secondly, we explored an alternate scenario where Gucci, key revenue driver for Kering, fails to deliver on sales after the launch of their new collection in January 2024. In this instance, a delayed recovery to the 2022 sales levels is envisioned, extending the timeline to 2026. The adjustment with the uncertain future of Gucci, and the potential implications of a slower recovery of the brand on the overall growth trajectory of the company, results in a share price of €477.28, which represents an increase of 11.76% compared to the current share price, but still far from the share price where Gucci performs well, showing the sensitivity of Kering's valuation to the performance of its flagship brand, and the danger of one brand generating more than half of the total revenue of the Group.

Lastly, an analysis of Kering's sustainability efforts reveals a potential impact on the company's cost of goods sold, that could increase more than expected and affect its valuation. Kering is placing a very high emphasis on sustainability, and adopting environmentally friendly practices and sourcing materials responsibly, there may be a rise in production costs, as we have seen before in other sections. We considered a scenario where the cost of goods sold increased by 2% more than expected, as a percentage of sales. This results in a valuation of €484,28 per share, reflecting the potential cost implications of Kering's sustainability initiatives on its stock price. While these efforts align with the company's commitment to corporate social responsibility, it's essential to acknowledge the relationship between ethical practices and profitability.

Conversely, a scenario where the COGS decreases by 2% leads to a valuation of €576,05 per

**Figure 43: Risks and challenges scenario analysis.**

|                                      |         |
|--------------------------------------|---------|
| Persisting macroeconomic environment |         |
| Share price                          | €472,80 |
| Return                               | 10,71%  |
| Gucci momentum stalling              |         |
| Share price                          | €477,28 |
| Return                               | 11,76%  |
| Higher COGS increase                 |         |
| Share price                          | €484,28 |
| Return                               | 13,40%  |
| Lower COGS increase                  |         |
| Share price                          | €576,05 |
| Return                               | 34,89%  |

Source: Own estimates

share, with a return of 34.89%, much higher than the scenario where COGS increase with only a 13.4% return. While it may not align with the sustainability efforts of the Group, it illustrates the potential for higher profit margins and stock price. The resulting share price of €530.16 in the normal valuation indicates a delicate equilibrium that companies like Kering must navigate to ensure a harmonious integration of sustainable practices without compromising financial performance and that could provide valuable insights into the company's strategic priorities.

## **Final recommendations**

Kering faces a dynamic and ever-changing landscape, with shifting consumer preferences, evolving economic conditions, and emerging technologies shaping the industry's trajectory. The Group should keep an eye on the current inflation, macroeconomic environment, and geopolitical tensions that could pose challenges for the company. It should keep making the necessary investments in technology and acquisition of key companies that are making their growth possible, while being more prudent with their sustainability efforts that could be expensive to implement at the speed they are going right now. The rise of the affluent middle class in Asia and other emerging markets presents huge new opportunities for the company, and they should tailor their product offerings accordingly to these demographics. Kering should be more aware of risks that could hinder their future growth, such as an increase in cost of goods sold, or their over-reliance on certain markets and Gucci, which could be fatal.

In short, Kering's success hinges on its ability to adapt to the evolving luxury landscape, balancing modern innovative approaches with traditional luxury values. By embracing all trends currently driving the luxury industry, sustainability, digital transformation, and strategic partnerships, they will maintain their position as a global luxury leader and continue growing in the future.