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.

Unveiling a New Era in High Fashion – Navigating the New Shifts in Luxury Fashion

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A Project carried out on the Master in Finance Program, under the supervision of:

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Abstract:

This equity research is conducted on Kering SA, a French Luxury-Fashion conglomerate, known for brands such as Gucci, Yves Saint Laurent, Bottega Veneta, Balenciaga and Alexander McQueen. Kering SA operates solely within the luxury segment were respectively, fashion and Eyewear are the main segments. Through the application of the DCF model and based on our projections, the expected share price by the end of FY2024 is 530,16 EUR with an expected dividend of 7,41 EUR, leading to a total shareholder return of 25,88% vs current share price of 427,05, issuing a BUY recommendation.

Keywords (up to four)

Valuation, Luxury, Finance, Fashion

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

Table of Contents

Introduction

The main purpose behind the joint report is determining whether Kering is a company worthy of investing in. Through conducting thorough research on the company and industry, macroeconomic landscape, and financial statements we built a solid foundation to provide a fair recommendation based on our projections.

Through the application of the DCF-model based on our projections, we arrived at an estimated share price of 530,16 EUR by the end of FY2024 and an expected yield of 7,4 EUR, for a total shareholder return of 25,88% vs current price of 427,05 - issuing a BUY recommendation.

The first chapters cover the fundamentals concerning the company, a theoretical part covering competitiveness, and a part regarding the macroeconomic trends in current time and future possible trends that could impact Kering SA. After, a strategical analysis to gather a greater insight into Kering SA value drivers and a segment analysis on Kering SA covering geographical and customer numbers. The following chapters cover the projections made and the calculation of the necessary values to conduct a DCF valuation. Lastly, the last chapters we conducted a relative valuation to support our DCF valuation and sensitivity analysis to understand how changes to key values may affect the valuation.

In this part, the sections covered are the company analysis, the macroeconomic state, the sector analysis, and competitive landscape. Following two chapters concerning value drivers and segment analysis are covered by my partner. Following, the projections with the DCF and relative valuation are covered in this report. Lastly, the last chapters regarding sensitivity analysis, challenges and constraints, and the final recommendation are covered in my partners individual report.

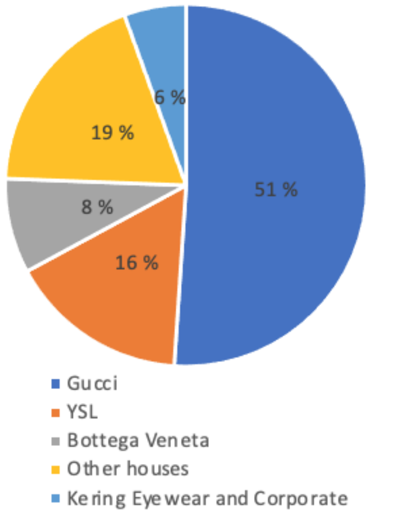
Company Overview

The global luxury goods company Kering, headquartered in Paris, France, operates in the fashion industry, designing, manufacturing, and selling high-end fashion products, including apparel, accessories, and footwear. Since the establishment of Kering in 1962 by Francois Pinault, Kering has risen to become a leading figure in the luxury market[1].

Kering has a diversified portfolio comprising of a broad range of luxury brands that cater to various market segments and consumer preferences. Gucci, regarded as Kering´s crown jewel brand, is a dominant player in global markets and generates a majority share of Kering´s comprehensive revenues.

Furthermore, Kering owns numerous prestigious brands such as Saint Laurent, which offers an abnormal aesthetic with a touch of modern characteristic, and Bottega Veneta which is renowned for their exquisite craftsmanship. Other noteworthy brands under Kering´s umbrella is Balenciaga, Alexander McQueen, Boucheron and Ulysse Nardin. Each brand offers a unique identity, and combined, Kering has been able to develop a portfolio that enriches their creative expression and dominance in the market.

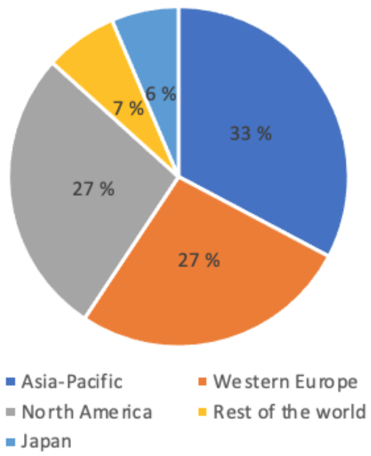
Figure 1: Brand Breakdown of Revenues



Source: Kering Universal Document, 2022

Kering operates globally and has a strong presence in markets in all continents. Moreover, the company has developed an extensive retail network with boutiques worldwide and strategically located main boutiques in fashion capitals and established luxury locations. Kering has integrated tremendously into the digitalization by developing a strong e-commerce platform where the customers can have accessibility to their luxury products online.

Figure 2: Geographical Breakdown of Revenues

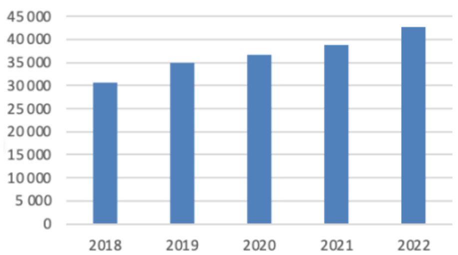


Source: Kering Universal Document, 2022

With a **headcount of 47227**, of whom **4590** are part time or freelance employees, who have their backgrounds from a diverse range of nationalities and genders, Kering can nurture their creative expressions, explore artistic freedom, and challenge their entrepreneurial spirit.

Shareholder structure and dividend policy

Figure 3: Average FTE Headcount



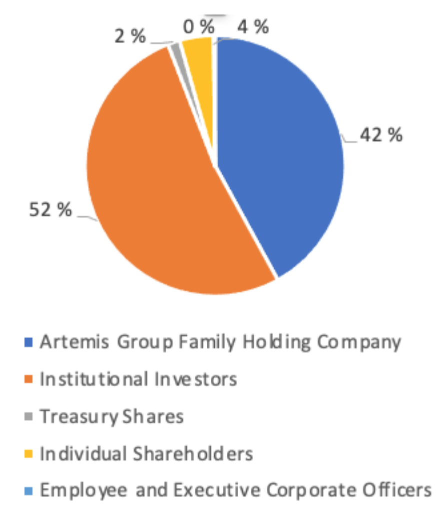
Source: Kering Universal Document, 2022

The group´s shareholder structure shares common characteristics with other major companies. The breakdown of the share capital showcases that **42%** of Kering is **owned by Artemis**, the main shareholder and the holding company controlled by the Pinault family. The remaining shares, **58%**, are held by private investors, institutions, and executive corporate officers. Kering´s family-like shareholder structure introduces unique dynamics that can influence the company´s vision, decision-making and comprehensive risk profile. Family-owned companies typically settle on decisions with a long-term mindset meaning they are more inclined towards investing in projects that may take time to materialize any benefits, foster long-lasting relations to shareholders and ensure solid financial health. Hence, short-term investors need to be mindful when allocating capital into Kering.

Kering has constructed a dividend payout system where shareholders are paid

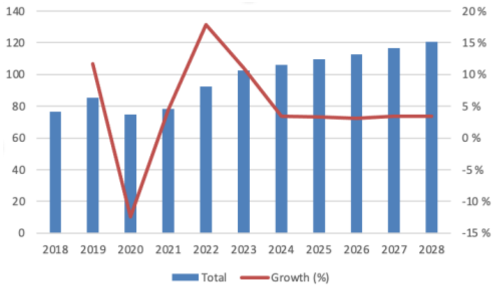
[1] https://www.kering.com/en/group/culture-and-heritage/group-history/

Figure 4: Shareholders of Kering



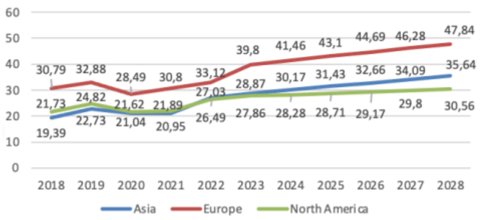
Source: Kering Universal Document, 2022

Figure 5: Revenues in the Luxury Fashion industry between 2018-2028 in million (in €)



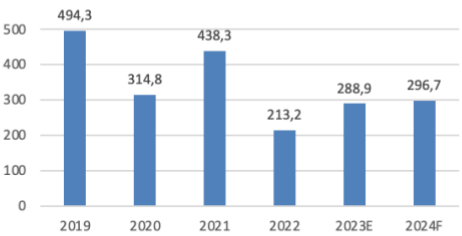
Source: Statista, Luxury Fashion Market, 2023

Figure 6: Revenues in the three major regions of the Luxury Fashion industry between 2018-2028 in millions (in €)



Source: Statista, Luxury Fashion Market, 2023

Figure 7: Revenues in the Luxury Fashion industry in Russia between 2019-2024 in millions (in €)



Source: Statista, Luxury Fashion Market, 2023

dividend semi-annually, respectively in **January and May**. Consequently, Kering aims for a well-proportioned dividend payout ratio which historically has approximately **been 47,7%** which is not a fair estimate due to Covid-19 ramifications in 2020 and 2021 dragging the average down. Despite Covid-19, the dividend payout ratio has remained positive over the last five years, which showcases to their shareholders that even in rough periods, the company manages to be financially stable and deliver on its obligations.

The Sector - Luxury Fashion Industry and market outlook

The Luxury fashion industry is divided into a broad number of segments from footwear and clothes to bags and eyewear. The industry provides unique and high-class goods that could be classified as non-necessary goods, but with a **strong social representative** factor. Luxury fashion goods is a way for consumers to express themselves and a sign of social status. Luxury items possess as an opportunity for people under the upper class to resemble the upper class from an aesthetic standpoint.

On a global scale, the industry went through a rollercoaster ride over the last five years due to **the implications of COVID-19**, **the geopolitical tensions worldwide** and **challenging macroeconomic landscape**, which inhibited the growth patterns of the past to continue. Despite the circumstances, the luxury fashion industry has demonstrated a quick recovery compared to other industries, mainly due to a capital-strong customer base. Hence, the average CAGR between 2018-2022 **was 2,07%**[2].

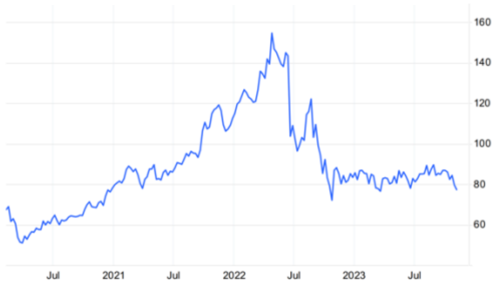
Furthermore, the industry is projected to experience a significant increase in revenues over the next years as previous disruptions subside, and the industry can thrive again in more predictable conditions. Consequently, the average CAGR is forecasted **to increase by 3,34%** on a YoY-bases for the period between 2023-2028 according to statista. For these projections to occur, industry stakeholders will have to adhere to the new consumer demands, changing macroeconomic landscape and improve innovation.

The current challenging geopolitical state of the world is affecting the overall global economic growth. Due to the impact being of indirect nature, there are difficulties in quantifying the impact on the luxury market accurately. However, the luxury market has an understanding that suspension of business in the Russian market shuts down a market that **brought in 438,3 MEUR in revenues in 2021**, which **shrunk by 54,2%** from 2021 to the end of 2022 and has not recovered nor projected to recover in the long-term. Moreover, shortage and disruptions in supply chains of core raw materials like cotton has **elevated in price**[3](Although starting to normalize again) constraining industry players from fully operating towards their set ambitions[4].

Macroeconomic state

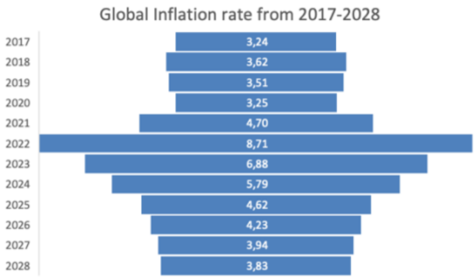
[2] https://www.statista.com/outlook/cmo/luxury-goods/worldwide
[3] https://tradingeconomics.com/commodity/cotton
[4] https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2022/12/how-strong-is-the-pricing-power-of-luxury-goods.pdf

Figure 8: Cotton Price from outbreak of the Russian war to now



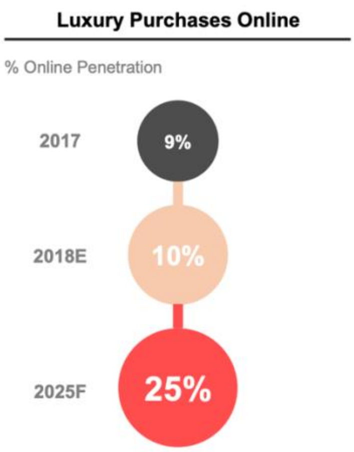
Source: tradingeconomics, 2023

Figure 9: Global Inflation Rate from 2017-2028



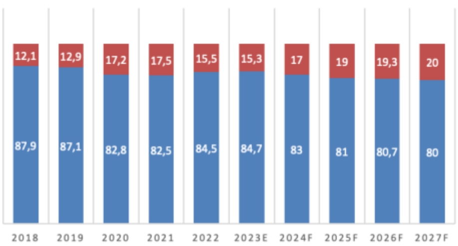
Source: IMF, 2023

Figure 10: Past projection of Luxury Purchase Online



Source: Bain & Company, 2017

Figure 11: Proportion of Online vs Offline sales for Luxury Fashion (in %)



Source: Statista Market Insights, 2023

The current challenging geopolitical state worldwide is affecting the overall global economic growth. While Covid-19 undoubtably impacted the global economy, most developing countries have displayed a commendable resilience and made respectable recovery compared to emerging nations. The global economy remains in a precarious state where inflation, **recorded at a 6,9%** and expected to be **5,8% in 2024**, surpasses initial expectations. To counteract the elevated inflation, the CPI has spiked to unforeseen levels, reflecting the ongoing state of the global economy. The prolonged high inflation has imposed reduction in consumers savings, purchasing power and consumer confidence, disrupting the global market.

Effects on the luxury fashion industry:

Consequently, companies are compelled to comprehend the regional and economic realities and adapt their operations. The ramifications on the luxury fashion industry can´t be generalized as market research demonstrate that the mainstream luxury market is **less inflation-resistant** than the high-end luxury market which makes sense as the customer base of the mainstream market has a smaller portion of affluent customers. The luxury fashion industry is dynamic, and brands may navigate between both categories. Thus, Luxury Fashion may be regarded elastic as demand will be changing in accordance with the macroeconomic landscape, which we are seeing clear evidence of in the second half of 2023 where customers demand is considerably low which is reflected in our instance by the **-13% reported change** from Q2 for Kering[5]. Furthermore, as Figure 9 indicates, the inflation is not expected to regress towards normal state for a while, causing uncertainties amongst consumers and weighing heavy down on household saving constraining spending.

Digitalization in Luxury Fashion Industry

Covid-19 has transformed e-commerce into more than JUST an additional source for shopping, but one of the primary avenues for shopping. Although the growth during Covid-19 exceeded any forecast at that time, the growth of the e-commerce market is expected to maintain its momentum at the **pre-pandemic rate of 10%**[6] which is still unprecedentedly high. As figure 10 demonstrates, Bain believed in 2017 **one-fourth of all luxury purchases** would be executed over web by 2025 which after Covid-19 changed to **one-third of all luxury purchases** are anticipated to be executed over the web by 2025[7], demonstrating the frenetic pace of e-commerce development in the industry. The rapid digital revolution within the industry is pushing the industry into omnichannel 3.0 faster than expected. Furthermore, figure 11 demonstrates that online channels are projected to account for **20% of total sales** in the industry by 2027, equaling to a **30,7% increase from 2023-2027**.

The bolstered increase in digitalization has compelled companies to adapt their marketing strategies and how they facilitate their investment in marketing. The

[5] https://www.kering.com/api/download-file/?path=Kering_Presentation_Third_quarter_2023_revenue_a49e1e9840.pdf
[6] https://www.statista.com/outlook/emo/ecommerce/worldwide
[7] https://www.bsr.org/en/blog/luxurys-move-to-e-commerce-and-its-implications-for-sustainability

surge of digital influencers and diverse platforms has contributed to fashion being marketed on a wider scope[8]. Digital Marketing has opened the portal to personalized and targeted marketing, proving to be significantly more cost-efficient and **yielding higher ROI** compared to traditional marketing[9]. McKinsey states in their latest fashion industry report that **capitalizing on social media** will be a key driver for increasing sales in the future[10].

Sustainability, innovation, and synergies

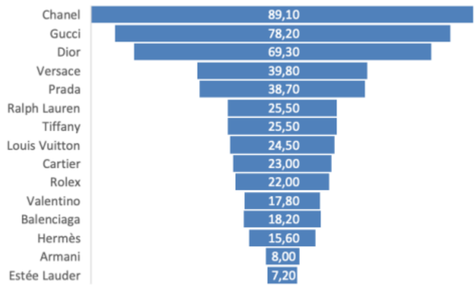
The industry is moving towards a circular economy where the focus is to implement systems that encourage reusing and reducing waste, and recycling materials to fabricate products[11]. The fashion industry is a large sinner in excessive pollution, ranking amongst the top seven most polluting accounting for **5% of the total carbon** emission amongst the top seven and **4%[12] of global GHG emission**[13]. In response, stakeholders in the fashion industry have been enforced to abide to stricter regulations from governmental bodies and embrace sustainable approaches to reduce the industry's carbon emissions[14] and align with the wishes from the evermore environmental aware customer base. Notably, amongst affluent consumers in the USA**, 47% have stated social responsibility** as an important factor upon making a purchasing decision, and **22% have boycotted** a brand that conflicted with meeting the social responsibility standards. Globally, **77% of consumers** express a will to change their consumption habits to improve the environmental footprint. Ultimately, these analyses indicate that the topic of sustainability is at the core of consumers demand and aligning with the demand is/will be indispensable/crucial for future value creation as Deloitte stated in 2020 that the younger generation will account for **50% of all sales** of luxury goods[15].

Luxury Fashion Competition

The Luxury brand industry comprises of a diverse range of players, with LVMH and Kering being **the dominant figures** from a conglomerate perspective. The Luxury fashion industry is saturated with both mature and early-stage companies constantly challenging industry leaders, where the top 10 companies account **for 56,2% of the market share**[16].

Kering positions itself adequately to its peers due to their decision to exit the general retailing sector (divesting the remaining Puma shares in 2020) which ironically strengthened their competitive advantage as their focus shifted to **exclusively luxury**[17]. Consequently, this has allowed Kering to narrow their focus

Figure 12: List of brands with the highest social media following (in millions)



Source: Statista, 2023

Figure 13: Annual GHG Emissions Amongst the Top Seven Biggest Polluters

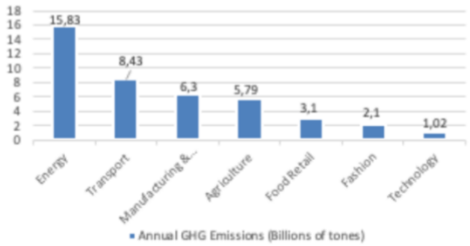
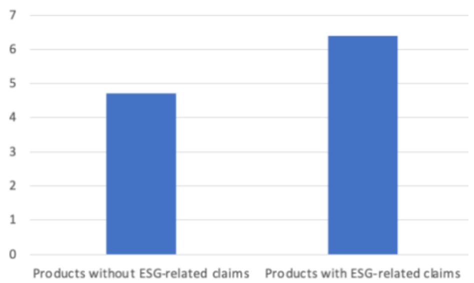


Figure 14: Retail sales growth, US, 2018-2022 (In %)

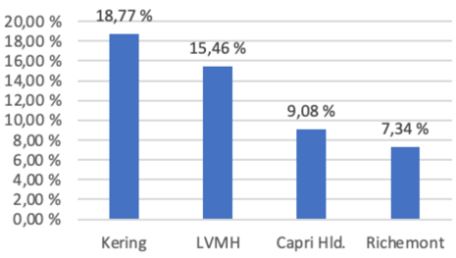


Source: Mckinsey - Consumers care about sustainability – and back it up with their wallets, 2023

[8] https://womenshine.in/fashion-in-the-digital-age-the-impact-of-social-media-and-influencer-marketing/
[9] https://economictimes.indiatimes.com/jobs/mid-career/digital-marketing-vs-traditional-marketing-whats-the-difference/articleshow/102196585.cms
[10] https://www.mckinsey.com/featured-insights/mckinsey-explainers/what-is-social-media
[11] https://www.sciencedirect.com/science/article/pii/S0148296322010724#b0095
[12] https://www.theecoexperts.co.uk/blog/top-7-most-polluting-industries
[13] https://www.mckinsey.com/industries/retail/our-insights/fashion-on-climate
[14] https://www.mckinsey.com/industries/retail/our-insights/state-of-fashion
[15] https://www2.deloitte.com/content/dam/Deloitte/at/Documents/consumer-business/at-global-powers-luxury-goods-2020.pdf
[16] Deloitte: Global Powers of Luxury Goods 2022
[17] https://martinroll.com/resources/articles/strategy/kering-evolution-of-a-global-luxury-brand-company/

to their smaller house leading to Kering´s non-flagship brands (houses besides Gucci) performing comprehensively greater than LVMH and Capri´s non-flagship brands. Moreover, although the brands operate largely autonomously, Kering has two **centralized product development centers** aimed to optimize/accelerate the process of an initial design to market release to revenues. This gives the smaller portfolio brands a helping hand in shortening their product development cycle and adjust faster to the industry's rapid trend shifts. Additionally, Kering´s flagship brand Gucci, has a strong brand identity enabling them to charge a premium for their goods, which effectively gives them a competitive edge.

Figure 15: Average ROIC-rates between 2018-2022 (2020 was excluded due to Covid 19)



Source: Own estimations and Yahoo Finance

To further establish a clearer consensus of Kering´s position in the industry, a closer investigation into comparable key financial variables was conducted. As Figure 15 indicates, Kering generates a higher value from their investments compared to their luxury conglomerate peers. Their righteous comparable in terms of business structure, Louis Vuitton, present a robust ROIC-rate, slightly weaker than Kering which may be due to Louis Vuitton operating in numerous segments which may impact return on investments, their resource efficiency, and costs differently. Following are Capri Holding and Richemont who achieved significantly weaker ROIC-rates which is not surprising considering their respective product mix differs from Kering. Richemont produces mainly product of high craftmanship and labor cost, along with expensive material. These costs may lower the ROIC when sales are not increasing proportionally. Lastly, related to value creation for Kering, the cost of capital has remained in the range between 9,5-11% over the last five years. Kering achieved a ROIC yearly above the cost of capital which would incite continuous value creation over the past five years.

Valuation:

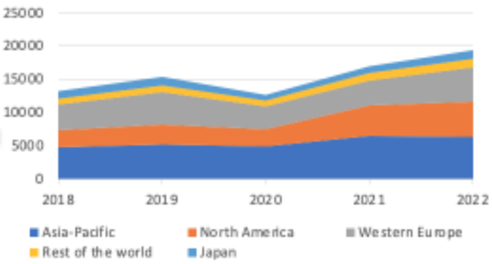
Obtaining an accurate projection is not optimistic but multiple methods can be employed to mitigate bias and achieve a reasonable projection. Applying a mix of three common models for projection known as the naive model, the bottom-up model and top-down model alleviate the risk of producing a biased and inaccurate valuation[18]. This approach will incorporate industry trends, brand trends, customer trends and past data to capitulate a projection that is as accurate as possible. Kering is a mature firm with a strong capital structure and less implicit to cyclical risks due to their prestigious customer base. Hence, we opted for a projected period of 7 years as we believe Kering will reach perpetuity by 2031 at a growth level of 3,67%. Consequently, in relation to the sector analysis, we project that Kering will exceed the forecasted growth of the sector.

Revenues Forecast:

Overall, Kering experienced a steady revenue growth between 2018-2022, besides a **substantial dive in 2020** due to Covid, seeing their revenues ascending from **13,66 BEUR to 20,35 BEUR**, accumulating to a **12,18% YoY-**

[18] https://gocardless.com/guides/posts/top-down-vs-bottom-up-forecasting/

Figure 16: Revenues over the last five years



Source: Company data and own estimates

Figure 17: Gucci Revenues between 2021-2031 in millions (in €)

Source: Company data and own estimates

growth and a total growth for the period of **48,93%.** Kering witnessed an **15,33% increase** on their revenues in 2022, driven mainly by strong growth in all segments linked to re-opening of stores and increased spending power, especially by **YSL (30%) and Eyewear (55%)**. The underlying growth was driven by **increased tourism** in Western European and North America, acquisitions in the Eyewear segment, and simultaneously, held back by the Asian-Pacific market being subjected to anti-covid-19 measures.

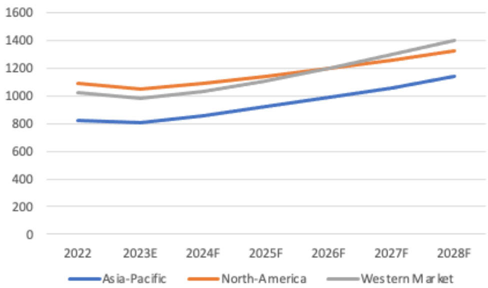
Gucci

As Kering´s gold mine, **Gucci accounts for 52%** of Kering´s revenues and is the main brand that competes on an industry spectrum against their arch-rival Louis Vuitton. The Chinese market has been an integral part to Gucci's impressive **trebling in revenues** in the period between 2015-2019[19]. The importance of the Chinese market was emphasized thoroughly after COVID-19 as it was evident that one of the reasons for the slowdown on Gucci's revenues was the international stop on traveling young Chinese shoppers and shutdowns of Gucci stores in China[20]. Therefore, aligning with studies showing that the Chinese market is set to become **the biggest within 2025**, Gucci recognizes the imperative of globalizing their operations to better understand the culture of the markets which are driving their revenues to accelerate their revenue growth again. Hence, Gucci has appointed the experienced director, Laurent Cathala, to oversee the Chinese market with the purpose of enhancing product accessibility, gather influence from the Chinese market and understands its unique needs, and to have a person of knowledge in leading changes. Gucci estimates **that 3% of their revenues** need to be dedicated as Capex to nurture these implementations. These implementations are expected to be integral for Gucci to reach their **ambition of 15 BEUR**[21] in revenues in the future. In Western Europe and North America. expectations are continuous steady growth but 2023, and possibly 2024, will face **stagnating growth due to high inflation** decreasing consumer demand in the industry.

Yves Saint Laurent

Kering is anticipating an extraordinary evolution for YSL in the coming years and is expected to solidify its position as Kering´s second-largest luxury house. Yves Saint Laurent has always been a staple brand in the luxury world, and for the last decade, the brand has developed in a frenetic pace demonstrating **an 89,3% increase between 2018-2022** as a result of aligning perfectly with the fashion trends of Gen Z. Moreover, Kering reported in the recent annual report that they expect YSL sales to **double in the future** as the brands popularity is still on a rise and has set their ambitions on **reaching 5 BEUR**[22] in medium-long term. Thus, Kering has announced they will expand the YSL geographical footprint by opening/reshuffling stores to reach their ambitions of an **average store size of 200 sqm** in the medium-long term compared to the **current average of 150 sqm**.

Figure 18: YSL Revenues in their three major regions between 2022-2028 in millions (in €)



Source: Company data and own estimates

[19] https://www.statista.com/statistics/267476/global-revenue-of-the-kering-group-by-brand/
[20] https://www.reuters.com/business/retail-consumer/we-need-talk-about-gucci-kering-sets-plan-boost-brand-china-2022-06-07/
[21] https://www.kering.com/api/download-file/?path=CMD_Gucci_Presentation_09062022_d9c8d5013c.pdf
[22] https://www.kering.com/api/download-file/?path=CMD_SL_Presentation_062022_6c82ce87d3.pdf

Figure 19: YSL´s current stores and stores opened in the last year

Source: YSL Capital Market Day, 2022

The Northern American and Western market stand for the biggest portions of sales for YSL, **respectively standing for 33% and 31%**. Hence, the intensified push into the northern American market as market researchers indicate high potential for YSL to derive value from there. However, North America, which has been the brand´s most popular market, is forecasted to continue having good growth although **the western market is expected** to overtake as YSL greatest market by 2026 because of increase in American tourist traveling to Europe.

In 2021 and 2022, the gross CAPEX growth equaled **respectively to +55% and +36%**, mainly tied to high investments to better brand visibility, client experience, elevating the production capacity to meet future demand and expanding across regions. Expanding their,digital footprint by being more visible on social media platforms, apps and other digital avenues will be critical to aid YSL in their way to double their sales as market research recognize this as crucial to appeal to millennials and Gen-Z which are the core customer base of YSL, while at the same time resolving YSL´s brand recognition deficiency. Hence, YSL is dedicated to allocating a CAPEX amount **equal to 4-5%** of revenues yearly to achieve set ambitions.

Bottega Veneta

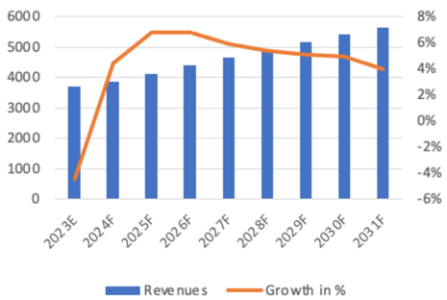
Figure 20: Bottega Veneta Revenues between 2018-2031 in millions (in €)

Source: Company data and own estimates

Bottega Veneta is expected to continue growing in a steady state as there are no clear indications that point to a significant decrease or increase. The brand has a loyal customer base which contributes to maintaining a steady growth on year-to-year basis equal to **9,42%** during the historical period. Historically, the brand has generated lower average increase in revenues amongst Kering portfolio of brands which is not necessarily a negative factor but just to emphasize they are growing slowly with minimal volatility, even in periods of difficulty. Ultimately, their **exclusivity and strong customer loyalty** enables them to maintain a steady growth, anticipated to continue into the forecasted period at an average yearly rate of **3,41%**.

Other Houses

Figure 21: Other Houses Revenues between 2023-2031 in millions (in €)



Source: Company data and own estimates

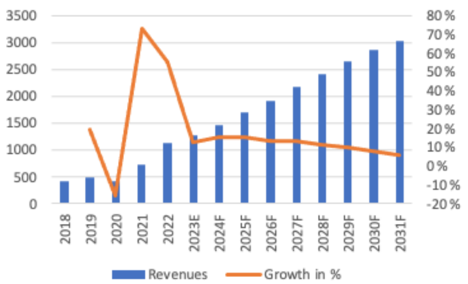
The Other houses segment has experienced enormous revenue growth over the last two years, and a total increase of **84% between 2018-2022**. This is mainly tied to Alexander McQueen, Boucheron and Balenciaga´s amazing performance despite Balenciaga experiencing a small bump in the development due to a controversial campaign leading to backlash on the revenues in the Q4 of 2022. Future projection for this segment is entirely depended on Kering´s M&A activity in the coming years and maintaining the development of the current brands under the umbrella of this post. Kering has already announced the acquisition of 30% of world renown fashion house, Valentino, which by 2030 they expect to acquire a 100% of the stakes[23]. The effects of the acquisition on the revenues are difficult to

[23] https://www.kering.com/en/news/kering-and-mayhoola-announce-that-kering-becomes-a-significant-a-shareholder-of-valentino-as-part-of-a-broader-strategic-partnership/

predict at the current time due to insufficient information on the deal but Kering expects the acquisition to strategically benefit the company by offloading the independence of Gucci and utilizing its expertise in turning a smaller brand into a major brand. Geographically, after 2023, exceptional and steady growth is anticipated in all regions with Asia-Pacific edging a bit higher growth. This is attributed to the Asian market lagging behind the rest as a result of longer lockdown in the previous years. The middle eastern market, which is classified under “the rest of the world” by Kering, is poised for substantial growth, forecasted to double in size by 2030 according to BCG. For all the segments, but especially other houses, Kering are planning on following this development through continuous expansions as the middle eastern market, mainly driven by UAE and the emerging market in Saudi Arabia, have a customer base that is overly interested in luxury and have the financial capabilities to afford it. Therefore, we expect the growth in the regions to be growing proportionally to the inflation level while the Asian Market and RoW will edge out with stronger growth as a result of Kering´s elevation strategy related expansions in the following regions.

Eyewear and Corporate

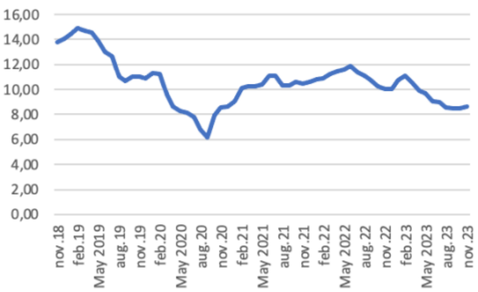
Figure 22: Eyewear and Corporate Revenues between 2018-2031 in millions (in €)



Source: Company data and own estimates

Eyewear and corporate is the segment Kering have evoked remarkable growth in revenues. Ultimately, the constant significant year-to-year growth is due to Kering´s frequent procurements of solid companies which have contributed positively to the revenue growth. In the instance of 2022, the accretive nature of the Lindberg and Jim Maul acquisitions where massive contributors to **the 6,5% increase** in operating margin[24]. In the annual report, the **importance of acquisitions to broaden their product and brand mix** is recognized as of high significance for further revenue growth and acknowledgement of this emerging segment. This segment was established in recent years as a part of Kering´s vertical integration progression. Thus, building a portfolio with recognized brands over time is crucial for becoming a staple brand in the eyewear segment, and reach their **ambitions of 2 BEUR** in revenues and **an EBIT-margin of 15%** in the medium term set by them in 2021. Nevertheless, the segment is expected to triple their revenues figures by the end of the projected period and reach their **2 BEUR goal by 2027**. The exponential growth is presumed to subside and reach a stage of incremental growth towards the end of the projected period as we anticipate them to be a mature segment by then.

Figure 23: Fine Wool Price per Kilogram between 2018-2023 (in €)



Source: Indexmundi, 2023

Cost Forecast:

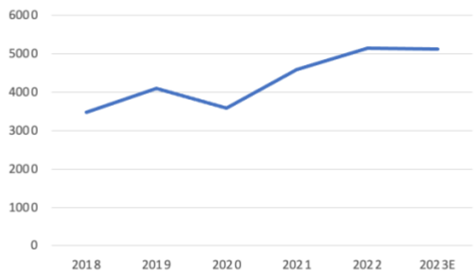
The section primarily includes raw materials and related products. Historically, the cost of sales has tightly correlated with the revenues at an **approximate rate of 25,3-25,9%**, with 2020 being the anomaly **at 27,4%** due to Covid-19. The challenging geopolitical situation has increased the uncertainty around prices on core raw materials but currently Kering have not experienced any detrimental changes. As the figures 23 and 24 illustrate, there doesn’t seem to be a

[24] https://www.kering.com/api/download-file/?path=KERING_DF_2022_US_c9860510de.pdf

Figure 24: Cotton Price per Kilogram between 2018-2023 (in €)

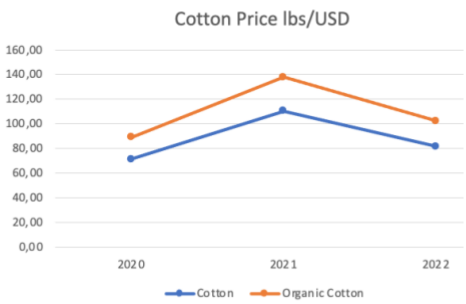
Source: Indexmundi, 2023

Figure 25: Cost of Sales between 2018-2023 in millions (in €)



Source: Company data

Figure 26: Cotton Price vs Sustainable cotton



correlation between changes in core raw materials and gross margin, suggesting that the increase in price of raw materials **are offsetted by higher selling prices** on Kering´s products. However, as Kering established in their latest report, the main component that we anticipate driving the cost of sales up during the projected area is the higher prices on sustainable textiles and the cost related to the innovation and production of these materials[25]. Market analysis on the price of sustainable substitutes like organic cotton demonstrates **a price difference of 20-30%** compared to conventional cotton[26], which is a result of the low supply where only **1% of total cotton production** is organic, meets the current high demand of it from the industry. Moreover, the price on cotton has, in general, **increased by 45% and 30%** over the last two year due to the inflation levels[27]. Kering has reported that 72%[28] of the cotton utilized in the production is organic cotton, and their main goal is reaching 100% use of organic cotton/traceable material within 2025-2027.

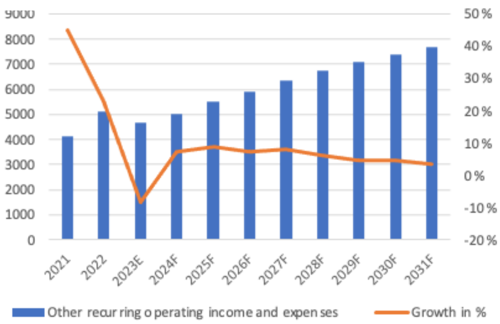
Consequently, our forecasted cost of sales indicates that the gross margin will endure a slight decrease over the first in the projected period, ranging from **0-0,3%**. However, it is anticipated to rebound to pre-projected period gross margin rate towards the last years of the projected period. The decrease is of deficient nature which is reasonable as Kering has previously shown that they are able to offset the higher cost with higher pricing on products. Important to emphasize this forecast is assuming a perfect state economy and world order from 2025 onwards.

Personnel Expenses

In 2022, Kering had **47 227 employees** working in the company. Majority of the employees work in operated stores and development centers around the globe. Kering has expressed future store expansions for all their segments as a part of their vision to increase their presence globally. Thus, an increase in the wages is anticipated due to demand for employees to operate the new stores. Typically, this would not necessarily increase the personnel expenses more than normal, and we expect the expenses per employee to remain at a steady level resembling the pre- and post-covid rates. During Covid-19, Kering managed to contain the personnel expenses at a historical low due to bloom in e-commerce and less physical operated stores leading to reduce in headcount. Additionally, labor costs have been increasing slightly globally as a byproduct of the challenging macroeconomic landscape. The increase is assumed to persist throughout the projected period for Kering as well, and we anticipate the expenses per employee to **increase by 1,5%** on a year-to-year basis, resembling natural growth of the expenses. Ultimately, the expenses per employee are expected to increase from **0,060€ to 0,072€** by the end of the projected period.

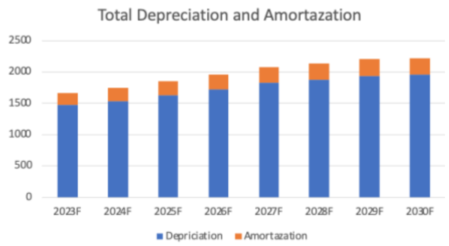
[25] https://www.kering.com/api/download-file/?path=Kering_2021_Financial_Document_ENG_4fa3b7a30c.pdf
[26] https://goodmakertales.com/why-are-sustainable-clothes-so-expensive/
[27] https://www.mckinsey.com/industries/retail/our-insights/state-of-fashion
[28] https://www.kering.com/api/download-file/?path=Kering_Sustainability_Progress_Report_2020_2023_7d06687606.pdf

Figure 27: Other Recurring operating income and expenses between 2021-2031 in million (in €)



Source: Company data and own estimates

Figure 28: Total D&A between 2018-2028 in millions (in €)



Source: Own estimates

Figure 29: Estimates to reach our WACC estimations

WACC parameters	
Raw Beta Kering	0,99
Industry B_u	1,12
Kering B_L	1,25
Net debt/ EV	12,69 %
Risk free rate	3,55 %
MRP	6,50 %
Cost of Equity	11,80 %
Cost of debt	3,59 %
Cost of debt a/tax	2,66 %
Equity Value	52186
Debt Value	7586
WACC	10,64 %

Source: Own estimates

Other recurring income and expenses + D&A Forecast:

Regarding the recurring income and expenses, there are difficulties in projecting these values. This is due to the inconsistency in information surrounding the posts which accounts as recurring income and expenses. Moreover, the annual reports don't offer the decomposition of the post causing issues in finding the appropriate item(s) to project it against. However, the pattern from the historical data pinpoint that the post historically grows proportionally to the growth in revenues. Thus, for the projected period we anticipate the growth to **follow the historical pattern of 23-24%.**

Property, plant and equipment is the key value for projecting the depreciation value, given its inherent connection to PP&E activity[29]. Analyzes highlight that over the last two years, the percentage has been **around 44%.** The projection showcases that the depreciation level is increasing throughout the forecasted period, aligning with the expected expansion of stores and development centers reported in the annual report. Moreover, in terms of projecting amortization, the main factor is the right-of-use assets. Consequently, the following analyzes establish that the amortization will grow at a **rate of 3,5%** for the projected period which is a continuation of the historical growth.

WACC:

Estimating the cost of equity through the CAPM-formula is the first stage for deriving the cost of capital rate. It is common practice to apply the yield of the nation's 10-year treasury bond as a risk-free rate when estimating the CAPM. Thus, the risk-free rate is set to the equivalent of the yield on the French 10-year treasury bond that **is 3,55%.** The penultimate parameter needed, the market risk premium, is derived from Aswath Damodaran´s database on market risk premium **which accumulates to 6,5%**. Lastly, the computation of the beta was completed through regressing the monthly market returns of Kering against the monthly market returns of a suitable diverse market index which was **STOXX 600** over the last five years. Daily and weekly returns was avoided as we want to mitigate the risk of any short-term systematic bias that may deflect us from the true beta[30] and to regress a sufficient number of observations. Thus, monthly returns seemed like the rational choice in this instant. Upon obtaining the estimate of the raw beta, which equaled to 0,99, it was obvious that the beta was not totally reflective of reality as the R^2 was mid-low **(32,9%)** meaning low explanatory level of the variables. Consequently, the 95% confidence interval reveal that the beta may lie **between 0,62-1,37**, and **the standard error of 7,2%** suggest that the lies close to the estimated beta.

Due to the obtained beta being inconsistent with the industry and competitors average, we analyzed both beta factors to generate a precise beta estimation. After unlevering the betas of Kering and their peers the derived unlevered industry

[29] Koller, T., Goedhart, M., & Wessels, D. (2020). Mechanics of forecasting. In I. McKinsey & Company, *Valuation: Measuring and managing the value of companies* (p. 279)
[30] Koller, T., Goedhart, M., & Wessels, D. (2020). Mechanics of forecasting. In I. McKinsey & Company, *Valuation: Measuring and managing the value of companies* (p. 317)

beta **equaled 1.14**[31], meaning that Kering is **more volatile** than the overall market which is not surprising considering Kering is sensitive to market changes. Due to the challenging macroeconomic landscape with high inflation levels, purchasing power decreases, and luxury goods become a secondary necessity for parts of their customer base. Historically, the luxury industry outperforms the market in good economic states, but also performs worse in periods of macroeconomic uncertainty. Hence, considering current macroeconomic landscape, the beta reflects the realities Kering has had to face and is a fair beta estimate for the current market status. Moreover, we re-levered the unlevered industry beta by applying our target net debt/enterprise value for Kering which we assume to remain constant leaving us with **a levered beta of 1,26**.

Furthermore, the cost of debt was calculated by taking the YTM of Kering´s outstanding A-rated long-term bond and subtract it by the estimation of probability of default multiplied with loss given default. The computed cost of debt **equaled to 3,59%,** which seems like a fair estimate given the high interest rates in today´s global market.

Aswath Damodaran emphasizes in his book, the dark side of valuation, that the steady growth rate should not exceed the GDP growth[32]. In today´s macroeconomic climate where GDP growth subceed the inflation rate, it can be difficult establishing a suitable steady growth rate. Hence, the steady growth rate was **set to 3,6%** reflecting the steady growth the forecast presumes for perpetuity and aligns within the global GDP growth.

Lastly, the fair market value of equity was calculated and for the market value of debt we utilized the book value as they are almost identical. Through the estimation of the parameters, we arrived to a **WACC estimate of 10,64%.**

Valuation outcome - DCF and multiples

DCF

We opted for the DCF-model to derive the value of Kering which discounts the free cash flow with the WACC. Due to the comprehensive nature of the DCF-model, it was natural to utilize the model for a mature firm like Kering where there are numerous parameters to be accountable for and a steadfast capital structure. The free cash flow stream indicates **a positive development over the first period of the projected period** before it decreases slightly towards the end which mainly stems from the revenue increase stabilizing towards the end. Upholding industry standards regarding sustainability and digitalization will be essential for maintaining a competitive and up-to-date business. After discounting the cash flows, we were able to compute the terminal value which equaled to **47 600 MEUR** and our enterprise value **71 672 MEUR**. The number of outstanding shares was set to a fixed number reflecting the number of outstanding shares from 2022. Projecting this value seemed a bit farfetched as there are no well-established source to project this number. Hence, to avoid biases and inaccurate

Figure 30: Share Price obtained through DCF-Model

Share price 31.12.2024	
Exit Terminal Value Gordon shapiro	96606
PV of Terminal Value	47600
PV of Free cash flow	24072
DCF	71672
Minority interest	-785
Net debt outstanding	-6101
Equity value	64786
Outstanding shares	122,2
Share Price	530,16
Growth	24,15 %
Capital Gains	103,11
Expected dividend	7,41
Total Shareholder Return	25,88 %

Source: Own estimates

[31] Unlevered Beta = Raw Beta * (EV/Net debt + EV) + Debt Beta (Net debt/Net debt + EV))

[32] Damodaran, A. (n.d). *pages.stern.nyu*. Retrieved from The Stable Growth Rate: https://pages.stern.nyu.edu/~adamodar/New_Home_Page/valquestions/stablegrowthrate.htm

assumptions we left it constant to the level in culmination of the historical period which is **122,2**. Consequently, if our assumptions become reality, the share price of Kering is **valued at 530,16** which would equal a significant increase of **24,15%.** The estimate is fair considering at the time of the valuation the market is/was in a precarious state, effecting the luxury fashion harshly. Hence, a respectable part of the growth can be attributed to natural regrowth as the market returns to a normal state. With a **capital gain of 103,11 EUR,** expected **dividend yield of 7,41 EUR** and a total **shareholder return of 25,88%,** the DCF model concludes with a **BUY recommendation.**

Figure 31: Selected comparables and their respective P/E and EV/EBIT values

	P/E	EV/EBIT
Kering SA	16,21	12,31
LVMH	24,24	17,48
Prada	29	19,45
Richemont	21,31	16,13
Ralph Laurent	13,95	12,13
Capri holdings	15,7	11,79
Burberry Group	17,66	15,27
Average	20,31	15,38
Median	19,485	15,70
25th Quartile	15,95605	12,222
50th Quartile	17,66	15,27
75th Quartile	22,775	16,805
100th Quartile	29	19,45

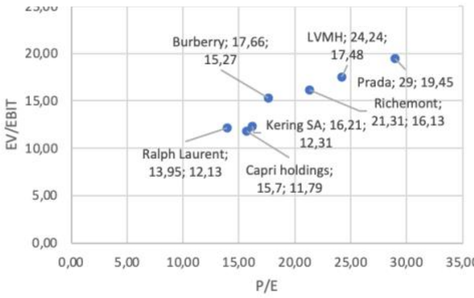
Source: Bloomberg and Own estimates

Figure 32: Share Price

Share Price	P/E	EV/EBIT
Median	592,68	681,93
25th Quartile	485,34	528,38
50th Quartile	537,17	662,95
75th Quartile	692,76	730,71
100th Quartile	882,10	847,49

Source: Own estimates

Figure 33: Respective Multiples of Kering and Peers



Source: Bloomberg and Own estimates

Relative Valuation

In selecting suitable comparable for Kering, we assessed companies based on similarities in business model, revenue growth pattern, EBITDA-Margin and capital structure. Therefore, upon following requirements, the companies decipted in figure 31 emerged as the most compatible. Ultimately, as already presumed from the beta calculations, LVMH is the most compatible comparable with the lowest EBIDTA-margin deviation of **1,4%**, D/E deviation of **4,5%** and revenue growth deviation of **7%**. Both companies share similar characteristic in operating on a global scale, both being **French family-structured conglomerates** with a hyper-focus on luxury and share a common audience. Prada follows closely after due to their common global presence, similar target audience and business model. Surprisingly, the luxury brand Burberry ranks next on the list which may seem odd given their singular brand focus. However, the factor that makes them similar is their focus on luxury solely, which Kering also committed to when divesting their **remaining in PUMA** in 2020. Followed by is Richemont, arguably the **most luxurious** out of every brand on the list, but the distance between them and Kering is mainly to their product mix which is mostly exclusive jewelry and watches tied to brand such as Cartier and Van Cleef & Arpels. Hence, their production costs are quite different due to their business model, and target audience is the most affluent customers in the market that can afford their high prices. Lastly, Ralph Lauren and Capri are the ones deviating the most from Kering which is due to their products being regarded as “accessible” luxury targeting a different set of audience compared to Kering. Hence, their operational structure is more like the apparel industry.

When examining comparable companies, notable deviations exist in terms of P/E and EV/EBIT values. To avoid extremes, we maintain the focus between **the 25th quartile and 75th quartile**, yielding a share price range of **485,34-692,76 for the P/E multiple**, and **528,38-730,71 through the lens of the EV/EBIT multiple**. Hence, upon reviewing the quartiles, we decided to use the Harmonic median of the list which estimated **a share price of 592,68** with the P/E multiple, and **a share price of 681,93** through the EV/EBIT lens. These values are quite optimistic considering Kering having a more conservative outlook on the future. However, both values have been achieved by the firm on previous occasions signaling that it is perfectly feasible. Consequently, with the current macroeconomic landscape causing a lower consumer demand, these values may be overvaluing Kering slightly.