Company Name: Hermes International SA
Ticker: RMS FP **Market Cap:** €9.9bn **EV:** €9,4bn
Shareholders: Hermes Family: 72%; FF: 28%
Current Price: €97 **Entry Price:** €100
Target Price: €64 per share (36% upside from entry price)
Type of Idea: *Short* event-driven on non-materialization of bid **Duration:** 3-6 months

Company Description: Hermes International SA, engages in the manufacture, sale, and retail of luxury goods primarily in France (20% sales), rest of Europe (21% sales), Japan (24% sales), the Asia-Pacific (17% sales), and Americas (15% sales). It sells its products through company-operated retail stores, other retail outlets, network of specialist stores, airport duty free stores, and onboard aircraft.

Share Price Graph:

Investment Overview:

With Hermes trading at a 100%+ premium to the luxury goods sector, mainly supported by largely unsubstantiated takeover speculation, Hermes stock is highly vulnerable to a re-rating which could be driven by the speculative appeal to vanish. Similar to what happened mid-07 and early-09, we expect the unjustified take over premium to phase out and the large premium to sector average to compress in the short term.

Short Thesis:

- Although probably one of most resilient business models in luxury goods sector, valuation is extremely stretched for a low-double digit earnings/sales growth profile:
  - Hermes trades at an excessive 100%+ P/E premium to the luxury goods sector
  - This compares with a long-term historical forward P/E premium of 30-40% to luxury peers
  - Although Hermes' profile proves to be late-cyclical and its products' price points are within the highest of the luxury, recent observations start pointing to a slow-down in top- end luxury sales' growth: RMS has lowest exposure to emerging markets' customers from Russia/Middle East/ China (24% of sales vs sector average of 29%), the main current luxury sales' growth driver. RMS exposure to more slowing markets as Japan (29% vs 23% sector) is among the highest in the sector.
- Current pricing and 50% rise since early March-09 (vs CAC40 rise of 20%) is mainly driven by renewed take over speculation which seems very unrealistic to materialize in the short/mid term:
  - Family partnership (72% of voting rights/capital) publicly stated it was **not willing to sell** anytime soon and is well decided to keep its investment
  - **Presence of poison pill** ("Loi Breton")**:** Articles of Association delegate special powers to Executive Management to issue share purchase warrants and carry out capital increase
  - The emphasis of the company's control has been put on the **transition to the next generation** with the appointment of 6 members from the 6th generation to the management board, replacing the 5th generation members, who now number 5 on the board. This is in addition to the appointment of 3 members of the 6th generation to the supervisory board.
  - The company is structured as "Societe en Commandite par Actions" (limited partnership): a structure which concentrates **most operating decisions within the hands of the families** and whereby the CEO can only be appointed by the families.
  - "Loi Dutreil": shareholder agreement whereby the families can **benefit from a rebate on wealth tax** if they **keep the stocks for a minimum of 6 years** (i.e. until 2011)
  - Any shareholder who reaches 0.5% (and subsequent 0.5% increments) of Hermès' capital or voting

rights must reveal its position to the management, or lose their voting rights. So far, nobody has disclosed any such positions.

- **If families would need the cash, they could easily re-leverage to raise special dividend**, as currently the company has net cash position of €0.5bn. If they would leverage up to 2* Net Debt/EBITDA (cfr PPR at 2.8x), they could distribute up to €1.6bn to all shareholders (about €1.2bn to the family alone).
- **Financials do not work** for the 3 parties (LVMH, Richemont and PPR) who have been rumoured in the last 18 months to be building stakes and/or looking at Hermes. Luxury sector has become more rigorous since early 2000, with transaction multiples coming down: early 2000 transactions were typical at 2.5-3.5x sales, while recent transactions have been done at average 2x sales *(RMS currently at 6.4x sales),* displaying the higher (capital return) discipline of the sector.
  At 34x '08 guidance earnings and 22x EBIT, any premium over current price offered is **dilutive** for both LVMH and Richemont. After its Apr-07 PUMA acquisition, PPR is highly leveraged at 2.8x with BBB- credit rating. A cash acquisition of Hermes would increase PPR's net leverage to 5.5-6x, making such an acquisition highly improbable.
- At a road show with Merrill Lynch, Hermes' CFO reinstated even if LVMH would offer double of current share price, they wouldn't sell (highlighting deeper **conflict between Hermes and LVMH**).

Negative risks:

- **Short squeeze** (*understood that currently 20% of float is on borrow)* on possible CAC40 index inclusion, given limited FF of the company: however on 28-May-09, the Euronext Expert Committee ruled against RMS inclusion
- **Renewed take-over rumors** in luxury goods sector
- Deteriorating health/death news of Jean-Louis Dumas, former CEO of Hermes, still exercising significant influence on company's strategy

Next Events

21-Jul-09	1H09 Sales Announcement
28-Aug-09	1H09 Results

Steep valuation even on stretched multiples:

EURm	2008A	2009E BEAR	2009E BASE (Consensus)	2009E BULL
Sales	1764.6	1800	1828	2029
% growth	8.58%	2.0%	3.6%	15.0%
EBIT	449.2	432	441	528
EBIT margin	25.5%	24.0%	24.1%	26.0%
Net financials/Other	6.2	7	7	7
Pre-tax profit	455.4	438	447	534
Tax	-160	-149	-152	-182
Tax rate	35%	34%	34%	34%
Post-tax profit	295	289	295	353
Minority interest	-5	-5	-5	-5
Net Income	290	284	290	348
PE Multiple @ historical 40% premium to sector		23.2x	23.2x	23.2x
Target Price Hermes		**62.7**	**64.0**	**76.6**
Premium/(Discount) from EUR 100 entry price		*-37%*	*-36%*	*-23%*

Comps Analysis:

Company		Stock Price	Currency	Number of Shares	Market Cap (Local)	EV	P/E 2007A	P/E 2008A	P/E 2009E	P/E 2010E	EV / Sales 2007A	EV / Sales 2008A	EV / Sales 2009E	EV / Sales 2010E	EV / EBIT 2007A	EV / EBIT 2008A	EV / EBIT 2009E	EV / EBIT 201
Bulgari	BUL IM	3.79	€	300.6	1,139	1,486	7.5x	13.7x	27.0x	18.5x	1.4x	1.4x	1.5x	1.5x	9.0x	13.4x	21.2x	17.
Burberry	BRBY LN	3.87	£	433.1	1,676	1,668	13.0x	12.6x	13.6x	12.8x	1.7x	1.5x	1.4x	1.3x	8.8x	9.0x	9.2x	8.
LVMH	MC FP	58.21	€	473.7	27,574	31,814	13.6x	13.6x	15.0x	14.1x	1.9x	1.9x	1.8x	1.8x	9.3x	9.1x	9.8x	9.
PPR	PP FP	60.53	€	126.5	7,657	13,413	7.2x	8.7x	11.7x	10.4x	0.7x	0.7x	0.7x	0.7x	7.9x	7.8x	9.1x	8.
Richemont	CFR VX	23.35	CHF	561.1	13,102	11,695	8.7x	10.9x	18.6x	21.4x	2.3x	2.2x	2.3x	2.4x	11.0x	11.5x	15.2x	15.
Geox	GEO IM	5.29	€	259.2	1,371	1,348	11.1x	11.1x	15.7x	14.7x	1.8x	1.5x	1.5x	1.4x	7.5x	7.8x	9.6x	9.
Coach	COH US	26.83	$	317.6	8,521	7,997	12.4x	12.5x	14.2x	14.2x	2.8x	2.5x	2.5x	2.4x	7.4x	7.4x	8.5x	8.
Average							***10.5 x***	***11.9 x***	***16.6 x***	***15.2 x***	***1.8 x***	***1.6 x***	***1.7 x***	***1.6 x***	***8.7 x***	***9.4 x***	***11.8 x***	***11.***
Hermes	RMS FP	94	EUR	105.10	9,879	9,394	35.2x	33.8x	34.0x	31.6x	5.8x	5.3x	5.1x	4.9x	22.7x	20.9x	21.3x	19.
Premium/(Discount) to Average									***105.2%***	***108.7%***			***206.3%***	***200.1%***			***80.8%***	***80.***

Company	EV / EBITDA 2007A	EV / EBITDA 2008A	EV / EBITDA 2009E	EV / EBITDA 2010E	EV / (EBITDA -Capex) 2007A	EV / (EBITDA -Capex) 2008A	EV / (EBITDA -Capex) 2009E	EV / (EBITDA -Capex) 2010E	EBIT Margin 2007A	EBIT Margin 2008A	EBIT Margin 2009E	EBIT Margin 2010E	Sales Growth 2008A	Sales Growth 2009E	Sales Growth 2010E
Bulgari	7.2x	9.0x	11.4x	10.1x	12.3x	17.8x	29.5x	17.7x	15.08%	10.32%	7.10%	8.38%	-1.43%	-7.95%	2.99%
Burberry	7.5x	7.2x	7.3x	6.8x	9.5x	11.3x	10.0x	9.1x	19.86%	16.18%	15.11%	15.68%	19.90%	4.51%	3.12%
LVMH	8.0x	7.7x	8.1x	7.8x	10.6x	10.3x	10.5x	10.0x	20.81%	20.27%	18.82%	19.16%	4.32%	0.12%	2.22%
PPR	6.4x	6.3x	7.1x	6.7x	8.9x	8.6x	10.0x	9.4x	8.58%	8.52%	7.52%	7.85%	2.23%	-3.29%	0.97%
Richemont	9.7x	9.6x	12.0x	12.4x	12.5x	12.7x	15.9x	16.5x	20.45%	18.81%	15.33%	14.99%	3.97%	-6.67%	-1.53%
Geox	6.7x	6.7x	7.7x	7.2x	8.6x	12.8x	10.2x	9.8x	23.34%	19.32%	15.85%	16.05%	15.89%	-0.69%	5.01%
Coach	6.8x	6.7x	7.4x	7.4x	7.9x	7.9x	8.7x	8.4x	37.50%	33.65%	29.31%	29.12%	10.38%	0.94%	2.66%
Average	***7.5 x***	***7.6 x***	***8.7 x***	***8.4 x***	***10.0 x***	***11.6 x***	***13.5 x***	***11.5 x***	***20.80%***	***18.15%***	***15.58%***	***15.89%***	***7.89%***	***-1.86%***	***2.21%***
Hermes	19.6x	18.3x	18.3x	17.1x	25.3x	25.0x	25.7x	22.6x	25.51%	25.46%	24.12%	24.79%	8.58%	3.57%	4.13%
Premium/(Discount) to Average			***110.3%***	***105.1%***			***89.7%***	***96.2%***							

Important Legal and Regulatory Disclosures & Disclaimers

We, Panta Capital Advisors, in our role as investment insight advisors, hereby certify that the views about the companies and their securities discussed in this report are accurately expressed we have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Legal disclaimer

Reports produced by Panta Capital Advisors are based on public information and Panta Capital Research considers the same to be reliable, comprehensive information, but makes no representation or warranty that it is accurate or complete. Panta Capital Advisors has no obligation to tell you when opinions or information in this report change apart from when we intend to discontinue research coverage of a subject company. Panta Capital Advisors has no obligation to tell you when opinions or information in this report change apart from when we intend to discontinue research coverage of a subject company.

This research report is not an offer to buy or sell or solicitation of an offer to buy or sell any security in any jurisdiction where such an offer or solicitation would be illegal. This research is not a personal recommendation or otherwise to participate in any trading strategy or transactions. Any recipient of this research report should consider obtaining independent advice specific to their personal circumstances before undertaking any investment activity.

Facts, views or opinions presented in this report have not been reviewed by, and may not reflect information known to, employees or other professionals within Panta Capital Advisors. The value of and income from your investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors. There may be time limitations on the exercise of options or other rights in your securities transactions. Past performance is not a guide to future performance. Estimates of future performance are based on assumptions that may not be realised.