

Hyperion Asset Management

Company Profile

Hermes International SCA

Main Business Activities

Hermes International (Hermes) is a designer, manufacturer and retailer of high-end luxury products, and was started in 1837 in Paris making high quality harnesses for aristocrats throughout the country. Hermes is involved in a range of different product segments including leather goods (comprising 50% of sales), silks, ready to wear clothing, perfumes, watches, footwear, tableware and jewellery. Hermes is one of the very few companies in the absolute luxury segment at the top of the luxury pyramid. The company has 51 production sites in France, two sites in the U.S., five sites in Australia (where they collect crocodile/alligator skins from crocodile farms) and six other sites in Europe.

Key Value Proposition to Customers

Brand strength is the key value proposition for Hermes customers, by offering ultra-luxury products renowned for high quality craftsmanship through its 184 year heritage. The brand benefits from both heritage with a long, storied history, and provenance. Being a French luxury brand, this presents an advantage for Hermes as the majority of luxury brands come from France or Italy, other than watches from Switzerland. These factors provide significant barriers to entry for competitors. The high price point, limited supply of product (demand outstrips supply) and being handmade in France provides consumers with a feeling of exclusivity and luxury.

Sustainable Competitive Advantages and Outlook

Hermes sustainable competitive advantage is its brand, supported by a business model that cultivates scarcity and exclusivity. Hermes' reputation for high quality luxury goods has been built up over 184 years, and is growing over time as its 'old world' by-hand manufacturing model becomes more distinguished. All leather goods are manufactured internally in France. Hyperion believes its brand heritage is hard to replicate, and the brand strength provides almost unparalleled pricing power and allows the company to generate attractive returns despite restricting supply.

Overall Company Growth Options

Hyperion believe Hermes' revenue growth will primarily come from increasing sales density in existing stores rather than increasing the current store footprint. As an ultra-luxury brand, Hermes has significant pricing power. Hermes is in the enviable position of 'managing' growth, rather than 'chasing' growth, with revenue growth constrained not by demand, but by production. This is particularly evident in leather goods, where there are long waiting lists for its key bags: Birkin and Kelly.

The luxury market itself is growing at an estimated 4% to 6% per annum, with future growth driven by the trend to premiumisation and the emergence of the middle class in the developing world, particularly China.

Hyperion expect growth to be skewed to China given their increasing demand for luxury items as a result of the following:

- 1) GDP growth fueling the wealth effect;
- 2) Demographics with millennials and Gen Z typically supported by parents and grandparents;
- 3) Social issues through a lack of social stratification leading desire for luxury brands to portray social status, and growing empowerment of women in the workforce; and
- 4) The rise of technology, particularly social media.

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