

Consumer & Retail
Personal Products
 Equity – Hong Kong

Overweight

| | |
|----------------------|-------|
| Target price (HKD) | 24.00 |
| Share price (HKD) | 19.46 |
| Potential return (%) | 23.3 |

Note: Potential return equals the percentage difference between the current share price and the target price

| Performance | 1M | 3M | 12M |
|---------------------------|-----|------|------|
| Absolute (%) | 0.0 | 0.8 | 5.1 |
| Relative ^A (%) | 1.6 | -1.8 | -1.3 |

Index^A HANG SENG INDEX

RIC 0973.HK
 Bloomberg 973 HK

Market cap (USDm) 3,703
 Market cap (HKDm) 28,742

Enterprise value (EURm) 3,108
 Free float (%) 31

Note: (V) = volatile (please see disclosure appendix)

10 March 2015

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L'Occitane International (973 HK)

OW: FX and new distribution channels to support margins

- ▶ **We believe the consensus inappropriately reflects recent FX movements, notably the fall in the EUR/USD**
- ▶ **E-commerce and travel retail are two outperforming and margin-accretive distribution channels**
- ▶ **Reiterate OW and increase TP to HKD24 (from HKD23) as P&L increases are partly lost in translation; increase FY March 2016e EBIT by 6%, 20%+ above the consensus**

FX matters (at least on the P&L). We're still getting calls from investors wondering if it is still an issue that L'Occitane is heavily exposed to Japan, when, actually, year-on-year the JPY has strengthened against the EUR... More importantly, L'Occitane remains a company that produces in EUR and sells in USD (and related currencies), so we believe upgrades to the consensus need to come through now that the EUR/USD is at 1.08. Total costs are 44% in EUR, 20% in USD and related currencies, and 13% in JPY, when sales are "only" 21% EUR denominated and USD-related sales are close to 40%. A 10% EUR/USD move has a c4% impact on sales and a c15% impact on net profit. This is one of the reasons we are more than 20% above the consensus for FY March 2016e net income, in our view.

Back to 2010 margins? In FY March 2010, L'Occitane reached an 18.0% EBIT margin with only EUR612m of sales. While FY March 2015e will likely show twice the sales amount (EUR1.2bn), EBIT margin should barely surpass 14%, as the business model has changed and the space has become more crowded. However, the faster than average growth of both e-commerce and travel retail sales could well put the group again on a trajectory of a high teen margin by FY March 2017e. E-commerce is already 8.5% of retail sales (there are also wholesale partners, such as US department stores and platforms), and it was growing at 33% in Q3 2015a (ending December 2014). This is more profitable, as the group does not bear rent and staff costs while selling at the same full price points. Travel retail sales are 8.5% of total group sales with opportunities to open more doors and launch Melvita and Erborian. The channel has like the rest of "sell-in" a higher operating margin.

Substantial upgrades, small TP uptick. We are increasing our net income estimates by 6% and 10% for FY March 2016-17e, respectively, on the back of the strong downward EUR move. This only translates, however, into a 4% target price increase (to HKD24), as the shares are denominated in HKD; as such, the benefits are partly lost in translation. Details of our DCF assumptions can be found on page 2. The stock is trading at a 19.8x FY March 2016e PE. Key downside risks: currency (a strengthening EUR), poor consumer sentiment in key markets, such as Japan and the US, and a worse operating leverage of past investments than we forecast.

Financials & valuation

Financial statements

| Year to | 03/2014a | 03/2015e | 03/2016e | 03/2017e |
|---------|----------|----------|----------|----------|
|---------|----------|----------|----------|----------|

Profit & loss summary (EURm)

| | | | | |
|-----------------------------|-------|-------|-------|-------|
| Revenue | 1,055 | 1,177 | 1,373 | 1,485 |
| EBITDA | 183 | 223 | 288 | 337 |
| Depreciation & amortisation | -50 | -57 | -66 | -75 |
| Operating profit/EBIT | 133 | 166 | 223 | 262 |
| Net interest | -1 | -1 | -1 | 0 |
| PBT | 119 | 174 | 222 | 261 |
| HSBC PBT | 119 | 174 | 222 | 261 |
| Taxation | -27 | -35 | -45 | -54 |
| Net profit | 89 | 134 | 170 | 201 |
| HSBC net profit | 89 | 134 | 170 | 201 |

Cash flow summary (EURm)

| | | | | |
|---------------------------|-----|-----|-----|------|
| Cash flow from operations | 120 | 194 | 202 | 284 |
| Capex | -78 | -70 | -70 | -76 |
| Cash flow from investment | -79 | -70 | -70 | -76 |
| Dividends | -43 | -47 | -60 | -70 |
| Change in net debt | -3 | -72 | -66 | -131 |
| FCF equity | 57 | 115 | 133 | 209 |

Balance sheet summary (EURm)

| | | | | |
|-------------------------|-------|-------|-------|-------|
| Intangible fixed assets | 205 | 194 | 184 | 174 |
| Tangible fixed assets | 177 | 200 | 215 | 226 |
| Current assets | 610 | 727 | 842 | 1,003 |
| Cash & others | 319 | 391 | 457 | 589 |
| Total assets | 1,075 | 1,208 | 1,332 | 1,497 |
| Operating liabilities | 230 | 276 | 289 | 323 |
| Gross debt | 79 | 79 | 79 | 79 |
| Net debt | -240 | -312 | -378 | -510 |
| Shareholders' funds | 757 | 845 | 955 | 1,086 |
| Invested capital | 443 | 456 | 495 | 492 |

Ratio, growth and per share analysis

| Year to | 03/2014a | 03/2015e | 03/2016e | 03/2017e |
|---------|----------|----------|----------|----------|
|---------|----------|----------|----------|----------|

Y-o-y % change

| | | | | |
|------------------|-------|------|------|------|
| Revenue | 1.1 | 11.6 | 16.6 | 8.2 |
| EBITDA | -8.6 | 21.8 | 29.2 | 16.8 |
| Operating profit | -16.0 | 25.0 | 33.9 | 17.6 |
| PBT | -23.0 | 45.6 | 27.5 | 18.0 |
| HSBC EPS | -27.2 | 50.3 | 26.7 | 18.0 |

Ratios (%)

| | | | | |
|-----------------------------|-------|-------|-------|-------|
| Revenue/IC (x) | 2.4 | 2.6 | 2.9 | 3.0 |
| ROIC | 23.9 | 29.6 | 37.2 | 42.2 |
| ROE | 12.0 | 16.8 | 18.9 | 19.7 |
| ROA | 8.8 | 12.2 | 13.9 | 14.7 |
| EBITDA margin | 17.4 | 19.0 | 21.0 | 22.7 |
| Operating profit margin | 12.6 | 14.1 | 16.2 | 17.6 |
| EBITDA/net interest (x) | 133.2 | 173.5 | 292.5 | 812.6 |
| Net debt/equity | -31.4 | -36.7 | -39.4 | -46.7 |
| Net debt/EBITDA (x) | -1.3 | -1.4 | -1.3 | -1.5 |
| CF from operations/net debt | - | - | - | - |

Per share data (EUR)

| | | | | |
|------------------------------|------|------|------|------|
| EPS reported (fully diluted) | 0.06 | 0.09 | 0.12 | 0.14 |
| HSBC EPS (fully diluted) | 0.06 | 0.09 | 0.12 | 0.14 |
| DPS | 0.02 | 0.03 | 0.04 | 0.05 |
| Book value | 0.52 | 0.57 | 0.65 | 0.74 |

DCF analysis

| HSBC assumptions | DCF, comprising | | |
|---------------------|-----------------|-------------------------------|-----|
| Risk-free rate | 3.5% | EBIT growth 2015-25e CAGR (%) | 9.7 |
| Equity risk premium | 5.0% | EBIT growth 2025-45e CAGR (%) | 3.5 |
| Sector beta | 1.00 | Fade period 2045-51e | |
| Specific beta | 1.10 | WACC | 9.0 |

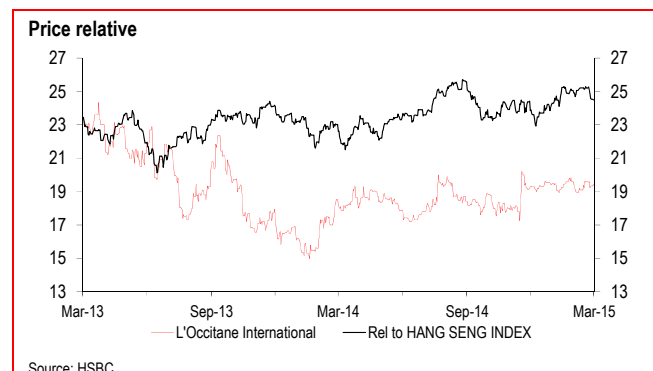
Sensitivity and valuation range

| Cost of capital vs fade period | 4 years | 8 years | 12 years |
|--------------------------------|---------|-------------|----------|
| 8.0% | 26.9 | 27.6 | 28.0 |
| 8.5% | 25.1 | 25.7 | 26.1 |
| 9.0% | 23.5 | 24.0 | 24.4 |
| 9.5% | 22.1 | 22.5 | 22.9 |
| 10.0% | 20.8 | 21.2 | 21.5 |

Valuation data

| Year to | 03/2014a | 03/2015e | 03/2016e | 03/2017e |
|--------------------|----------|----------|----------|----------|
| EV/sales | 3.0 | 2.6 | 2.2 | 2.0 |
| EV/EBITDA | 17.4 | 13.9 | 10.6 | 8.6 |
| EV/IC | 7.2 | 6.8 | 6.1 | 5.9 |
| PE* | 38.1 | 25.3 | 20.0 | 16.9 |
| P/Book value | 4.5 | 4.0 | 3.6 | 3.1 |
| FCF yield (%) | 1.7 | 3.4 | 3.9 | 6.1 |
| Dividend yield (%) | 0.9 | 1.4 | 1.8 | 2.1 |

Note: * = Based on HSBC EPS (fully diluted)



Note: price at close of 09 Mar 2015

Valuation and risks

We increase our target price to HKD24 from HKD23 on the back of the mentioned earnings estimate increases, which are partly mitigated by the fact the shares are denominated in HKD. Details of our DCF assumptions can be found on page 2. The stock is trading at a 19.8x FY March 2016e PE. Looking at Bloomberg consensus estimates for FY March 2016-17e, we are 22% and 26%, respectively, above on EBIT and net profit. Note that for the year ending now (FY March 2015), we are in line with the consensus on sales and 5% above the consensus on EBIT.

Under our research model, for stocks without a volatility indicator, the Neutral band is 5ppt above and below the hurdle rate for Hong Kong stocks of 8.5%. Our target price implies a potential return of 23.3%, above the Neutral band; therefore, we reiterate our Overweight rating. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Key downside risks: currency (a strengthening EUR), poor consumer sentiment in key markets, such as Japan and the US, and a worse operating leverage of past investments than we forecast.

L'Occitane simplified P&L

| EURm YE March | 2011a | YoY | 2012a | YoY | 2013a | YoY | H1 14a | HoH | H2 14a | HoH | 2014a | YoY | H1 15a | HoH | H2 15e | HoH | 2015e | YoY | 2016e | YoY | |
|----------------------------------|--------------|-----------|--------------|-----------|--------------|-----------|-------------|------------|--------------|------------|--------------|------------|-------------|------------|--------------|-----------|--------------|-----------|--------------|-----------|--|
| Sales | | | | | | | | | | | | | | | | | | | | | |
| Sell-out (retail) | 569 | 27 | 684 | 20 | 785 | 15 | 327 | -1 | 468 | 3 | 796 | 1 | 354 | 8 | 528 | 13 | 882 | 11 | 1,024 | 16 | |
| Sell-in (wholesale) | 203 | 25 | 230 | 13 | 259 | 13 | 119 | 1 | 140 | 0 | 259 | 0 | 132 | 11 | 163 | 16 | 296 | 14 | 349 | 18 | |
| Total net sales | 772 | 26 | 913 | 18 | 1,043 | 14 | 446 | -1 | 609 | 2 | 1,055 | 1 | 486 | 9 | 691 | 14 | 1,177 | 12 | 1,373 | 17 | |
| Gross profit | 637 | 28 | 755 | 19 | 855 | 13 | 363 | -2 | 493 | 1 | 856 | 0 | 390 | 8 | 561 | 14 | 951 | 11 | 1,127 | 19 | |
| <i>Gross margin</i> | 82.5% | | 82.7% | | 82.0% | | 81.2% | | 81.0% | | 81.1% | | 80.3% | | 81.1% | | 80.7% | | 82.1% | | |
| <i>Sell-out (retail)</i> | 88.7% | | 87.9% | | 86.8% | | 85.8% | | 85.3% | | 85.5% | | 85.4% | | 85.3% | | 85.4% | | 86.8% | | |
| <i>Sell-in (wholesale)</i> | 65.1% | | 67.2% | | 67.4% | | 68.6% | | 66.9% | | 67.7% | | 66.4% | | 67.2% | | 66.9% | | 68.5% | | |
| EBIT | | | | | | | | | | | | | | | | | | | | | |
| Sell-out (retail) | 191 | 29 | 234 | 22 | 252 | 7 | 71 | -22 | 159 | -1 | 230 | -8 | 80 | 12 | 184 | 16 | 265 | 15 | 326 | 23 | |
| Sell-in (wholesale) | 95 | 32 | 113 | 18 | 125 | 11 | 57 | 3 | 67 | -4 | 124 | -1 | 60 | 5 | 76 | 14 | 136 | 10 | 167 | 23 | |
| Non-allocated expenses | -154 | 39 | -195 | 26 | -218 | 12 | -107 | 2 | -114 | 0 | -221 | 1 | -109 | 2 | -126 | 10 | -234 | 6 | -270 | 15 | |
| Total EBIT | 132 | 20 | 152 | 15 | 158 | 4 | 21 | -49 | 111 | -4 | 133 | -16 | 31 | 47 | 135 | 21 | 166 | 25 | 223 | 34 | |
| <i>EBIT margin</i> | | | | | | | | | | | | | | | | | | | | | |
| <i>Sell-out (retail)</i> | 33.6% | | 34.3% | | 32.1% | | 21.8% | | 33.9% | | 29.0% | | 22.7% | | 34.9% | | 30.0% | | 31.8% | | |
| <i>Sell-in (wholesale)</i> | 46.9% | | 49.2% | | 48.4% | | 48.0% | | 47.5% | | 47.7% | | 45.4% | | 46.5% | | 46.0% | | 48.0% | | |
| Total | 17.1% | | 16.7% | | 15.2% | | 4.8% | | 18.3% | | 12.6% | | 6.5% | | 19.5% | | 14.1% | | 16.2% | | |
| PBT | 128 | 14 | 157 | 23 | 155 | -1 | 13 | -65 | 106 | -10 | 119 | -23 | 40 | 204 | 134 | 26 | 174 | 46 | 222 | 27 | |
| Taxes | 25 | | 32 | | 29 | | -1 | | 28 | | 27 | | 3 | | 32 | | 35 | | 45 | | |
| <i>Tax rate</i> | 19.5% | | 20.7% | | 19.0% | | -9.7% | | 26.5% | | 22.5% | | 7.4% | | 23.8% | | 20.0% | | 20.5% | | |
| Minority interest | 3 | | 3 | | 3 | | 1 | | 3 | | 3 | | 1 | | 4 | | 5 | | 6 | | |
| Net profit | 100 | 22 | 121 | 22 | 123 | 1 | 14 | -59 | 75 | -15 | 89 | -27 | 37 | 163 | 98 | 29 | 134 | 50 | 170 | 27 | |
| <i>Net margin</i> | 12.9% | | 13.3% | | 11.8% | | 3.1% | | 12.4% | | 8.5% | | 7.5% | | 14.1% | | 11.4% | | 12.4% | | |
| EPS (reported, EUR cents) | 6.84 | 7 | 8.22 | 20 | 8.34 | 2 | 0.95 | -58 | 5.13 | -15 | 6.07 | -27 | 2.49 | 163 | 6.64 | 29 | 9.13 | 50 | 11.57 | 27 | |

Source: Company data, HSBC estimates

Disclosure appendix

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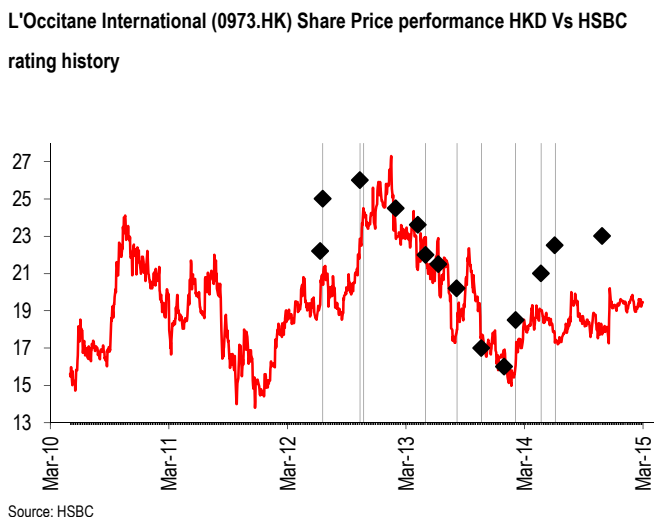
*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

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| | | |
|---------------------------|-----|--|
| Overweight (Buy) | 42% | (30% of these provided with Investment Banking Services) |
| Neutral (Hold) | 39% | (28% of these provided with Investment Banking Services) |
| Underweight (Sell) | 19% | (20% of these provided with Investment Banking Services) |

Share price and rating changes for long-term investment opportunities



Recommendation & price target history

| From | To | Date |
|----------------|----------------|------------------|
| Neutral (V) | Overweight (V) | 26 June 2012 |
| Overweight (V) | Overweight | 18 October 2012 |
| Overweight | Neutral | 30 October 2012 |
| Neutral | Underweight | 09 May 2013 |
| Underweight | Neutral | 13 August 2013 |
| Neutral | Underweight | 28 October 2013 |
| Underweight | Overweight | 10 February 2014 |
| Overweight | Neutral | 29 April 2014 |
| Neutral | Overweight | 11 June 2014 |
| Target Price | Value | Date |
| Price 1 | 22.20 | 18 June 2012 |
| Price 2 | 25.00 | 26 June 2012 |
| Price 3 | 26.00 | 18 October 2012 |
| Price 4 | 24.50 | 06 February 2013 |
| Price 5 | 23.60 | 15 April 2013 |
| Price 6 | 22.00 | 09 May 2013 |
| Price 7 | 21.50 | 17 June 2013 |
| Price 8 | 20.20 | 13 August 2013 |
| Price 9 | 17.00 | 28 October 2013 |
| Price 10 | 16.00 | 06 January 2014 |
| Price 11 | 18.50 | 10 February 2014 |
| Price 12 | 21.00 | 29 April 2014 |
| Price 13 | 22.50 | 11 June 2014 |
| Price 14 | 23.00 | 04 November 2014 |

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

| Company | Ticker | Recent price | Price Date | Disclosure |
|-------------------------|---------|--------------|-------------|------------|
| LOCCITANE INTERNATIONAL | 0973.HK | 19.46 | 09-Mar-2015 | 5, 6, 7 |

Source: HSBC

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