

JPM-pp1

Asia Pacific Equity Research

11 March 2015

L'Occitane International SA (973 HK)

Overweight

Price: HK\$20.45

11 Mar 2015

Price Target: HK\$21.20

PT End Date: 31 Mar 2016

Thoughts on ~5% share price movement today and additional colour on FX sensitivity

L'Occitane shares are up ~5% today. We believe this share price movement is a function of the recent weakness in the EUR which is positive for L'Occitane's earnings (as L'Occitane reports in EUR). Assuming spot FX rates as of today into perpetuity, we are forecasting a ~10% FX tailwind on sales for 1H16. We also note that a 1% fall in EUR also translates to more than a 1% rise in earnings for L'Occitane. Retain Overweight.

- **L'Occitane share price up ~5% today.** L'Occitane's share price increased ~5% today, compared to a ~1% decline in the Hang Seng Index. We think the share price movement has been driven by recent weakness in the EUR, which will positively impact the company's earnings. We note the L'Occitane share price has been relatively flat before today despite ongoing EUR depreciation.

- **At the underlying operating level, EUR depreciation positively impacts L'Occitane earnings both from a translation and margin perspective.** We believe FX movements impact L'Occitane's underlying earnings in two ways: 1) FX translation impact on revenue as L'Occitane earns revenues outside of Europe, with a lower EUR implying higher revenues in EUR terms, and 2) EBIT margin improvement on reduced cost as ~45% of the company's costs are in EUR but ~25% of the company's sales are in EUR. In other words, a ~1% fall in the EUR for L'Occitane would positively impact L'Occitane's earnings by more than ~1%, in our view. In turn, even after translating the higher EUR earnings back in HKD, we expect a positive impact on the share price.

- **Assuming spot FX rates as of today into perpetuity, we would forecast a ~10% FX tailwind on sales for 1H16.** Following L'Occitane's 3Q15 update on 20 January 2015, we updated our forecasts for spot FX rates at the time. Assuming spot FX rates on 20 January 2015 into perpetuity, we forecast a ~5% sales tailwind in 1H16 and ~3% sales tailwind in 2H16 (implying ~4% sales tailwind for FY16 as whole). Since then, the EUR has fallen further against major currencies. *Assuming spot EUR rates as of today into perpetuity, we would be forecasting a ~10% sales tailwind in 1H16 and a ~7% sales tailwind in 2H16 (implying ~9% sales tailwind for FY16 as whole).*

- **Historical FX sensitivity.** The company has previously disclosed sensitivities in its earnings relative to changes in FX rates. We detail this sensitivity in the table below (noting that calculations hold all other variables constant). In FY14 (year ended Mar-14), a 10% fall in the EUR relative to just the USD and JPY would have had a ~16% positive impact on net profit (assuming a ~10% fall relative to USD would also imply a ~10% fall relative to the HKD). This analysis does not take into consideration the impact on FX derivative instruments and realised exchange gains/losses.

- **Retain Overweight.** We remain OW for the following reasons: 1) Positive FX tailwinds; 2) Short-term organic sales momentum; and 3) Over the longer term, we see multiple drivers of sales and earnings growth, in particular e-commerce, emerging brands such as *Melvita* and *L'Occitane au Bresil*.

Table 1: L'Occitane – Historical Sensitivity to FX Movements (Impact of 10% Fall in EUR Relative to Respect Currency Holding Other Variables Constant)

€in thousands

| | Currency translation differences (other comprehensive income) | | Net sales | | Profit for the year | |
|-----|---|--------|-----------|--------|---------------------|-------|
| | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 |
| USD | 5,420 | 4,710 | 13,790 | 12,492 | 5,121 | 4,004 |
| JPY | 9,592 | 12,670 | 17,775 | 21,945 | 5,262 | 7,782 |
| HKD | 6,989 | 8,029 | 9,476 | 9,742 | 4,287 | 4,924 |
| GBP | 3,059 | 2,571 | 5,993 | 5,663 | 2,723 | 2,227 |

Source: Company reports. March year end

Investment Thesis

We remain OW for the following reasons: 1) Positive FX tailwinds; 2) We continue to believe short-term organic sales momentum exists; and 3) longer-term, we see multiple drivers of sales and earnings growth, in particular e-commerce and emerging brands such as *Melvita* and *L'Occitane au Bresil*.

Valuation

Our Mar-16 PT of HK\$21.20 is based on a target P/E of 21x and our earnings forecasts for the year ending Mar-17. Our target P/E of 21x is at a slight discount to the average trading multiple of international cosmetics brand peers.

Risks to Rating and Price Target

Downside risks to our view include: 1) a downturn in the retail environment for cosmetics globally; 2) changes in consumer tastes with respect to natural/organic cosmetics; 3) a downturn in the retail environments of key geographic regions; 4) higher-than-expected operating cost growth; 5) adverse FX movements; and 6) events that damage the brand image of L’Occitane.

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|-----------|--------|--------------------|----------------------|
| 17-Mar-11 | OW | 17.30 | 24.00 |
| 12-Oct-11 | OW | 16.00 | 20.00 |
| 29-Nov-11 | N | 15.42 | 16.00 |
| 18-Jun-12 | N | 19.30 | 18.00 |
| 27-Nov-12 | N | 25.60 | 22.00 |
| 26-Apr-13 | N | 23.15 | 19.50 |
| 17-Jun-13 | N | 22.90 | 19.10 |
| 25-Jul-13 | N | 19.82 | 18.00 |
| 25-Oct-13 | N | 19.10 | 15.30 |
| 10-Mar-14 | N | 18.52 | 18.40 |
| 11-Jun-14 | N | 17.90 | 18.20 |
| 30-Jul-14 | OW | 18.40 | 21.70 |
| 03-Oct-14 | OW | 17.80 | 21.50 |
| 24-Nov-14 | OW | 17.80 | 20.80 |
| 20-Jan-15 | OW | 19.10 | 21.20 |

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|---|----------------------------|--------------------------|------------------------------|
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| IB clients* | 75% | 67% | 52% |

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