

Ermenegildo Zegna N.V

Still on the road to tomorrow

Reiterate Rating: BUY | PO: 14.00 USD | Price: 11.31 USD

Key themes for luxury in 2024

Sector revenues +4% cFX in 2024: luxury demand is normalising post COVID, but is still running ahead of its historical trend (10% CAGR in 2019-23 vs 9% long term).

Chinese travel the only obvious tailwind: Chinese luxury spend was +50% in 2023, recovering 9 points of share back to 30% of the market. We expect Chinese spend +10% in 2024, accounting for 80% of incremental sector revenues.

American & European consumption to remain soft: American luxury growth has now given back all the outsized consumption since 2019. European demand is following this trend with a 1-year lag, Japanese consumer with a 2-year lag.

“Mix” to be big tailwind: pricing was +7% in 2022-23, and the key driver of revenues. In 2024 growth will shift to mix. The top 1% of clients will take share.

Quiet luxury has peaked: the dominant fashion aesthetic is still for understated, classic product. However, expect companies to reignite volume growth through fashion & newness into 2025.

Ad spend to be stable: luxury companies spent >€15bn on advertising in 2023, up by €6bn since 2019 (LVMH €5bn of the increase). 2024 ad budgets to be flat in €m terms.

Operating deleverage to result in >100bps margin pressure: the cost base in luxury is largely fixed and related to the staff & stores, which is still experiencing MSD inflation. This will lead to >100bps of margin pressure between 2022-24E.

Zegna remains well-positioned for share gains in luxury

We believe that Zegna remains well-positioned amid luxury normalisation thanks to (1) brand heat at Zegna brand, see Exhibit 1, buoyed by the quiet luxury aesthetic & affluent sticky (89% retention rate) consumer base where top 5% customers represent 40% of sales, enabling to leverage on the “mix” component of growth, as well as (2) continued reinforcement and roll-out of smaller but faster-growth brands (Thom Browne and Tom Ford). We forecast +12% growth (5% organic) for Zegna Group in 2024, +2% ahead of consensus, but we now model 50bps of EBIT margin contraction YoY given more limited operating leverage over the fixed cost base, continued brand reinvestment and shift to greater retail exposure at smaller brands. As a result, we cut our EBIT by 5-7% for 2023-25E and move PO to \$14. However, the stock is not expensive at 20x P/E for 18% 2024-27E EPS CAGR.

Estimates (Dec) (EUR)	2021A	2022A	2023E	2024E	2025E
EPS (Adjusted Diluted)	0.33	0.25	0.45	0.52	0.63
EPS Change (YoY)	844.3%	-23.6%	82.4%	14.4%	20.7%
Dividend / Share	0	0.10	0.14	0.17	0.20
Valuation (Dec)					
P/E	30.6x	42.6x	22.6x	20.0x	16.5x
Dividend Yield	0%	0.97%	1.38%	1.60%	1.93%
EV / EBITDA*	12.1x	11.4x	9.05x	8.35x	7.30x
Free Cash Flow Yield*	8.87%	2.97%	3.69%	6.44%	9.08%

* For full definitions of *iQmethod*SM measures, see page 6.

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Refer to important disclosures on page 7 to 9. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.

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Timestamp: 10 January 2024 11:41AM EST

10 January 2024

Equity

Key Changes

(EUR)	Previous	Current
Price Obj.	US\$16.00	US\$14.00
2023E EPS	0.48	0.45
2024E EPS	0.56	0.52
2025E EPS	0.67	0.63
2023E DPS	0.15	0.14

Daria Nasledysheva >>

Research Analyst
MLI (UK)
+44 20 7996 1087
daria.nasledysheva@bofa.com

Ashley Wallace >>

Research Analyst
MLI (UK)
+44 20 7996 0104
awallace3@bofa.com

Geoffroy de Mendez >>

Research Analyst
MLI (UK)
+44 20 7995 8920
geoffroy.de_mendez@bofa.com

David Roux >>

Research Analyst
MLI (UK)
+44 20 7996 9236
david.roux@bofa.com

Adam Gildea >>

Research Analyst
MLI (UK)
+44 20 7996 4249
adam.gildea@bofa.com

Stock Data

Price	11.31 USD
Price Objective	14.00 USD
Date Established	10-Jan-2024
Investment Opinion	B-1-7
52-Week Range	10.40 USD-16.36 USD
Mrkt Val / Shares Out (mn)	3,008 USD / 266.0
Average Daily Value (mn)	4.87 USD
Free Float	21.6%
BofA Ticker / Exchange	ZGN / NYS
Bloomberg / Reuters	ZGN US / ZGN.N
ROE (2023E)	17.2%
Net Dbt to Eqty (Dec2022A)	29.6%
ESGMeter™	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

iQprofileSM Ermenegildo Zegna N.V

Key Income Statement Data (Dec)

(EUR Millions)	2021A	2022A	2023E	2024E	2025E
Sales	1,301	1,507	1,892	2,111	2,290
EBITDA Adjusted	312	331	417	452	517
Depreciation & Amortization	(163)	(174)	(189)	(209)	(227)
EBIT Adjusted	149	158	228	243	290
Net Interest & Other Income	(2.90)	(46.7)	(10.4)	(10.5)	(10.4)
Tax Expense / Benefit	(30.7)	(35.8)	(79.0)	(91.8)	(111)
Net Income (Adjusted)	66.6	59.8	114	131	158
Average Fully Diluted Shares Outstanding	205	241	252	252	252

Key Cash Flow Statement Data

Net Income (Reported)	(136)	51.5	110	128	155
Depreciation & Amortization	163	174	189	209	227
Change in Working Capital	(5.94)	(176)	(110)	(43.8)	(32.4)
Deferred Taxation Charge	0	0	0	0	0
Other CFO	260	97.6	19.1	20.1	21.2
Cash Flow from Operations	281	146	208	313	371
Capital Expenditure	(94.3)	(73.3)	(114)	(148)	(137)
(Acquisition) / Disposal of Investments	0	0	0	0	0
Other CFI	12.3	16.0	(118)	16.5	16.5
Cash Flow from Investing	(82.0)	(57.3)	(232)	(131)	(121)
Share Issue / (Repurchase)	5.96	3.39	0	0	0
Cost of Dividends Paid	(0.65)	(26.0)	(23.8)	(35.5)	(41.3)
Increase (decrease) debt	(35.8)	(158)	0	0	0
Other CFF	(33.6)	(116)	(130)	(136)	(142)
Cash Flow from Financing	(64.1)	(297)	(154)	(172)	(183)
Total Cash Flow (CFO + CFI + CFF)	135	(208)	(177)	10.6	67.2
FX and other changes to cash	7.45	2.35	0	0	0
Change in Cash	143	(206)	(177)	10.6	67.2
Change in Net Debt	(178)	47.7	177	(10.6)	(67.2)
Net Debt	169	217	394	384	316

Key Balance Sheet Data

Property, Plant & Equipment	111	126	129	140	131
Goodwill	NA	NA	NA	NA	NA
Other Intangibles	425	456	493	542	587
Other Non-Current Assets	536	559	573	588	604
Trade Receivables	160	177	227	249	266
Cash & Equivalents	460	254	76.9	87.5	155
Other Current Assets	764	854	954	1,003	1,039
Total Assets	2,458	2,427	2,454	2,610	2,781
Long-Term Debt	472	185	185	185	185
Other Non-Current Liabilities	639	643	643	643	643
Short-Term Debt	157	286	286	286	286
Other Current Liabilities	545	581	632	669	699
Total Liabilities	1,813	1,694	1,745	1,782	1,813
Total Equity	644	732	709	827	969
Total Equity & Liabilities	2,458	2,427	2,454	2,610	2,781

Business Performance*

Return On Capital Employed	6.88%	5.42%	7.46%	7.75%	8.65%
Return On Equity	11.1%	9.35%	17.2%	18.6%	19.2%
Operating Margin	-7.22%	9.81%	11.0%	11.4%	12.5%
Free Cash Flow (MM)	187	73.1	94.9	166	234

Quality of Earnings*

Cash Realization Ratio	4.22x	2.45x	1.83x	2.40x	2.35x
Asset Replacement Ratio	0.58x	0.42x	0.60x	0.71x	0.60x
Tax Rate	NM	35.4%	40.0%	40.0%	40.0%
Net Debt/Equity	26.2%	29.6%	55.6%	46.4%	32.7%
Interest Cover	NM	3.38x	21.9x	23.2x	28.0x

* For full definitions of iQmethodSM measures, see page 6.

Company Sector

Luxury Goods

Company Description

Ermenegildo Zegna is an Italian luxury group founded in 1910. The group operates across two key segments: 1) Zegna segment (consisting of Zegna brand, Textiles and Third Party Product/Strategic Alliances) and 2) Thom Browne segment. The group is a vertically-integrated luxury menswear player, present in approximately 80 countries through its DTC network.

Investment Rationale

Zegna is a leading name in the luxury menswear market. Its growth is supported by the Zegna brand re-set and Thom Browne expansion. We rate Zegna Buy as we think we already see clear signs of Zegna executing well on its turnaround strategy and showing solid improvement in profitability & sales densities. We believe current valuation of 19x 2024 P/E is not expensive for 17% EPS CAGR name.

Stock Data

Price to Book Value

4.0x

BofA Brand Leading Indicator: Dec-23

For 44 listed and private soft luxury brands, we track (1) the total number of social media followers, (2) web search queries, Google Trends, (3) Baidu search queries and (4) website traffic. The equally weighted average of year-on-year growth trends across these platforms is used to create the Monthly BofA Brand Leading Indicator.

Exhibit 1: Zegna continues to experience positive brand momentum dynamic

BofA Brand Leading Indicator

Monthly Brand Momentum and Monthly movements in rank			
	Dec-23	Nov-23	Change
Ferragamo	1	3	2
Dior	2	5	3
Goyard	3	1	(2)
Jimmy Choo	4	6	2
Hugo Boss	5	4	(1)
Brunello Cucinelli	6	2	(4)
Loro Piana	7	19	12
Hermes	8	13	5
Armani	9	8	(1)
D&G	10	15	5
Fay	11	16	5
Zegna	12	20	8
Miu Miu	13	14	1
Moncler	14	9	(5)
Ralph Lauren	15	12	(3)
Prada	16	34	18
Saint Laurent	17	36	19
Valentino	18	23	5
LOEWE	19	22	3
Fendi	20	27	7
Hogan	21	24	3
Bottega Veneta	22	30	8
Coach	23	18	(5)
Chloe	24	33	9
Louis Vuitton	25	28	3
Canada Goose	26	11	(15)
Supreme	27	38	11
Chanel	28	32	4
Tod's	29	26	(3)
Versace	30	7	(23)
Tory Burch	31	17	(14)
Burberry	32	39	7
Michael Kors	33	10	(23)
Kenzo	34	35	1
Celine	35	21	(14)
Marc Jacobs	36	31	(5)
Alexander McQueen	37	25	(12)
Gucci	38	40	2
Givenchy	39	37	(2)
Roger Vivier	40	29	(11)
Kate Spade	41	41	-
Off White	42	42	-
Balenciaga	43	43	-
Emilio Pucci	44	44	-

Source: BofA Global Research estimates

BofA GLOBAL RESEARCH

Price objective basis & risk

Ermenegildo Zegna N.V (ZGN)

Our \$14 price objective is based on a DCF valuation with a WACC of 7% and terminal growth rate of 3% and EURUSD FX spot. We assume terminal EBIT margin for Zegna at 17.0%. We then cross-check the DCF output with P/E and EV/Sales multiples of the luxury goods sector peers.

Upside risks: 1) faster-than-expected Zegna brand turnaround, 2) faster-than-expected Thom Browne DOS roll-out, 3) larger-than-expected impact of China re-opening, 4) better-than-expected store productivity, 5) higher-than-expected pricing, 6) bolt-on M&A (primarily within Textiles) and 7) new contracts for the Third Party segment.

Downside risks: 1) bigger-than-expected impact on revenue growth and EPS from a macroeconomic slowdown, 2) weaker China, 3) inability to further improve store productivity primarily at Zegna, 4) inability to drive incremental pricing,

Analyst Certification

I, Daria Nasledysheva, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

EMEA - Luxury & Retail Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY	Adidas AG-ADR	ADDYY	ADDYY US	David Roux
	adidas Group	ADDDF	ADS GY	David Roux
	B&M European Value Retail	BMRPF	BME LN	David Roux
	B&M European Value Retail	BMRRY	BMRRY US	David Roux
	Brunello Cucinelli	BCUCF	BC IM	Daria Nasledysheva
	Carrefour	CRERF	CA FP	Ashley Wallace
	Carrefour	CRRFY	CRRFY US	Ashley Wallace
	CTS Eventim	CEVMF	EVD GY	Daria Nasledysheva
	DocMorris AG	ZRSEF	DOCM SW	Adam Gildea
	Dr. Martens PLC	DOCMF	DOCS LN	David Roux
	Ermenegildo Zegna N.V	ZGN	ZGN US	Daria Nasledysheva
	EssilorLuxottica	ESLOF	EL FP	Geoffroy de Mendez
	EssilorLuxottica	ESLOY	ESLOY US	Geoffroy de Mendez
	Hermès	HESAF	RMS FP	Ashley Wallace
	Hermès	HESAY	HESAY US	Ashley Wallace
	Hugo Boss	HUGPF	BOSS GY	Daria Nasledysheva
	Inditex	IDEXF	ITX SQ	Geoffroy de Mendez
	Inditex	IDEXY	IDEXY US	Geoffroy de Mendez
	JD Sports	JDDSF	JD/ LN	David Roux
	L'Oreal	LRLCF	OR FP	Ashley Wallace
	L'Oreal	LRLCY	LRLCY US	Ashley Wallace
	LVMH	LVMHF	MC FP	Ashley Wallace
	LVMH	LVMUY	LVMUY US	Ashley Wallace
	Marks and Spencer	MAKSF	MKS LN	David Roux
	Marks and Spencer	MAKSY	MAKSY US	David Roux
	Moncler	MONRF	MONC IM	Geoffroy de Mendez
	Next PLC	NXGPF	NXT LN	David Roux
	Ocado	OCDGF	OCDO LN	Geoffroy de Mendez
	Ocado	OCDDY	OCDDY US	Geoffroy de Mendez
	Pandora	XNPUF	PNDORA DC	Daria Nasledysheva
	PUMA	PMMAF	PUM GY	David Roux
	Redcare Pharmacy NV	SHPPF	RDC GY	Adam Gildea
	Sanlorenzo	XWGHF	SL IM	Daria Nasledysheva
	SES-imagotag	SRBEF	SESL FP	Adam Gildea
	Swatch Group	SWGAF	UHR SW	Ashley Wallace

EMEA - Luxury & Retail Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	The Hut Group	THGPF	THG LN	Adam Gildea
	Zalando	ZLDSF	ZAL GY	Geoffroy de Mendez
	Zalando	ZLNDY	ZLNDY US	Geoffroy de Mendez

NEUTRAL

	Ahold Delhaize	ADRY	ADRY US	Ashley Wallace
	Ahold Delhaize	AHODF	AD NA	Ashley Wallace
	Ceconomy	MTAGF	CEC GY	Adam Gildea
	De' Longhi S.p.A	DELHF	DLG IM	Ashley Wallace
	Fielmann AG	FLMNF	FIE GY	Geoffroy de Mendez
	Groupe SEB	SEBYF	SK FP	Ashley Wallace
	H&M	HMRZF	HMB SS	Geoffroy de Mendez
	Interparfums	IPAFF	ITP FP	Daria Nasledysheva
	Prada	PRDSF	1913 HK	Geoffroy de Mendez
	Richemont	XRCMF	CFR SJ	Ashley Wallace
	Richemont	CFRHF	CFR SW	Ashley Wallace
	Richemont	CFRUY	CFRUY US	Ashley Wallace
	SMCP	SMCSF	SMCP FP	Adam Gildea
	Tesco	TSCDF	TSCO LN	David Roux
	Tesco	TSCDY	TSCDY US	David Roux
	Watches of Switzerland	WOSGF	WOSG LN	Daria Nasledysheva
	WH Smith	WHTPF	SMWH LN	David Roux

UNDERPERFORM

	ASOS	ASOMF	ASC LN	Geoffroy de Mendez
	Associated British Foods plc	ASBFF	ABF LN	David Roux
	Associated British Foods plc	ASBFY	ASBFY US	David Roux
	boohoo Group PLC	BHHOF	BOO LN	Geoffroy de Mendez
	Burberry	BBRYF	BRBY LN	Ashley Wallace
	Burberry	BURBY	BURBY US	Ashley Wallace
	Fraser's	SDIPF	FRAS LN	Adam Gildea
	Kering	PPRUF	KER FP	Ashley Wallace
	Kering	PPRUY	PPRUY US	Ashley Wallace
	Kingfisher	KGFHF	KGF LN	David Roux
	Kingfisher	KGFHY	KGFHY US	David Roux
	Metro AG	MTTWF	B4B GY	Ashley Wallace
	On Holding AG	ONON	ONON US	David Roux
	Sainsbury	JSNSF	SBRY LN	David Roux
	Sainsbury	JSIY	JSIY US	David Roux
	Salvatore Ferragamo SpA	SFRGF	SFER IM	Daria Nasledysheva
	Tods	TODGF	TOD IM	Daria Nasledysheva

iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales

Basic EBIT + Depreciation + Amortization

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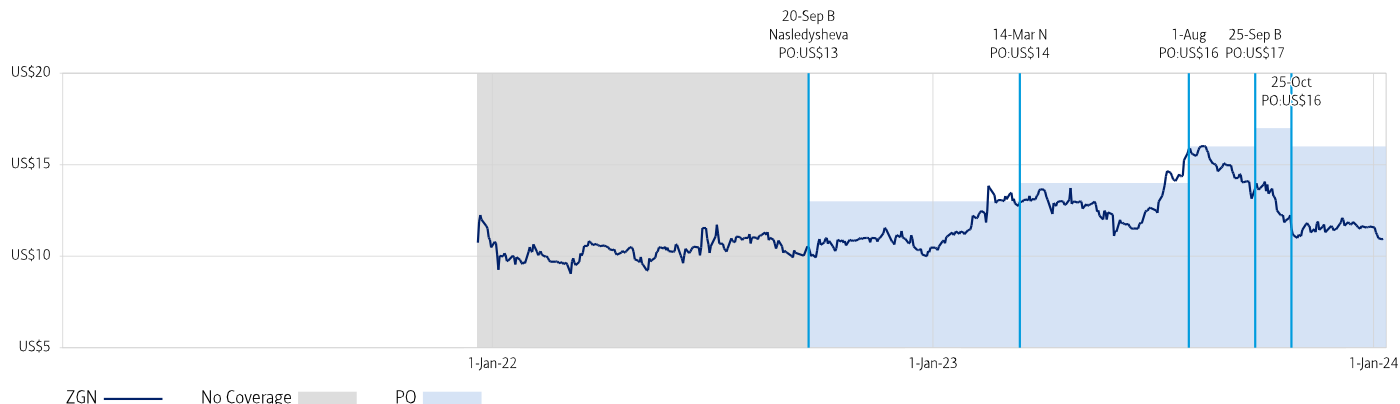
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Zegna (ZGN) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Consumer Products Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	32	50.00%	Buy	16	50.00%
Hold	19	29.69%	Hold	8	42.11%
Sell	13	20.31%	Sell	7	53.85%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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