Accuracy X KERING

Bayes Business School

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Executive Summary: To achieve revenue leading market position, Kering should acquire Safilo

	Market	Financial Analysis	Financing Operation
Analysis Dimensions	• **Market Overview** – Industry Trends – Key Drivers • **Competitive Analysis**	• **Balance Sheet & Debit Ratio Analysis** • **Cashflow & Liquidity Analysis** • **Activity Ratio** • **Profitability & Equity Analysis**	• DCF Modeling • Safilo PV valuation • Expected Return of Safilo
Implications	• Eyewear market is a lucrative market. Spectacles and Sunglasses have the most potential	• Kering could obtain over 800 million euros if acquired successfully and integrated smoothly, at the cost of nearly half of its potential returns • Safilo can provide Kering with strong operational capabilities, and its flexibility and recovery ability.	

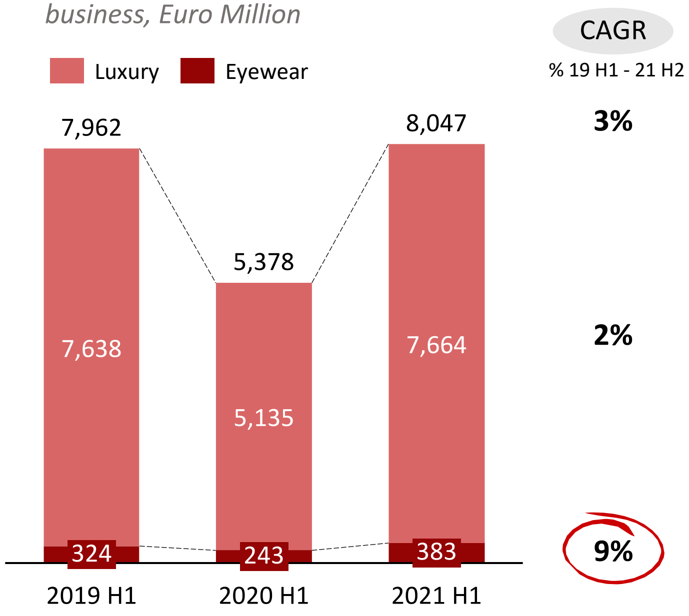
Safilo demonstrates that it's a good target for Kering's acquisition plan

Source:

Following strategic direction, Kering eyewear performed well; APAC market continues driving the revenue growth

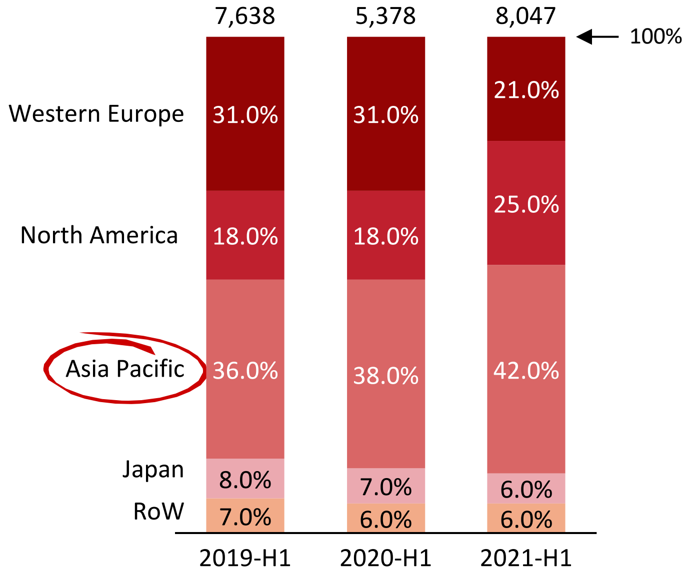
Kering eyewear's revenue outperformed its luxury house by three times in terms of CAGR

Kering group's revenue break down by business, Euro Million



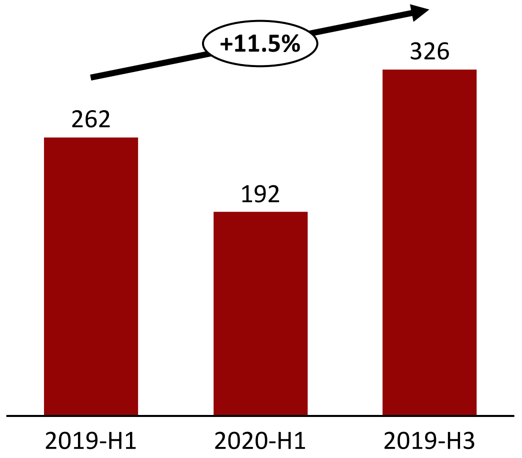
APAC Market remain the biggest market for Kering, which continues to growth even in Covid

Kering group's revenue break down by region



Kering eyewear has stronger growth after eliminating intragroup sales and royalties to the Houses

Kering eyewear revenue Euro Million



% of Eyewear	81%	79%	85%

KERING — 15 Brands → High-end frames and sunglasses market

Long Term Strategy

Group

- Accelerate digitalization
- Use new technology to update distribution, CRM, supply chain technology
- Focus on personal luxury goods market, serve new customers

Eyewear

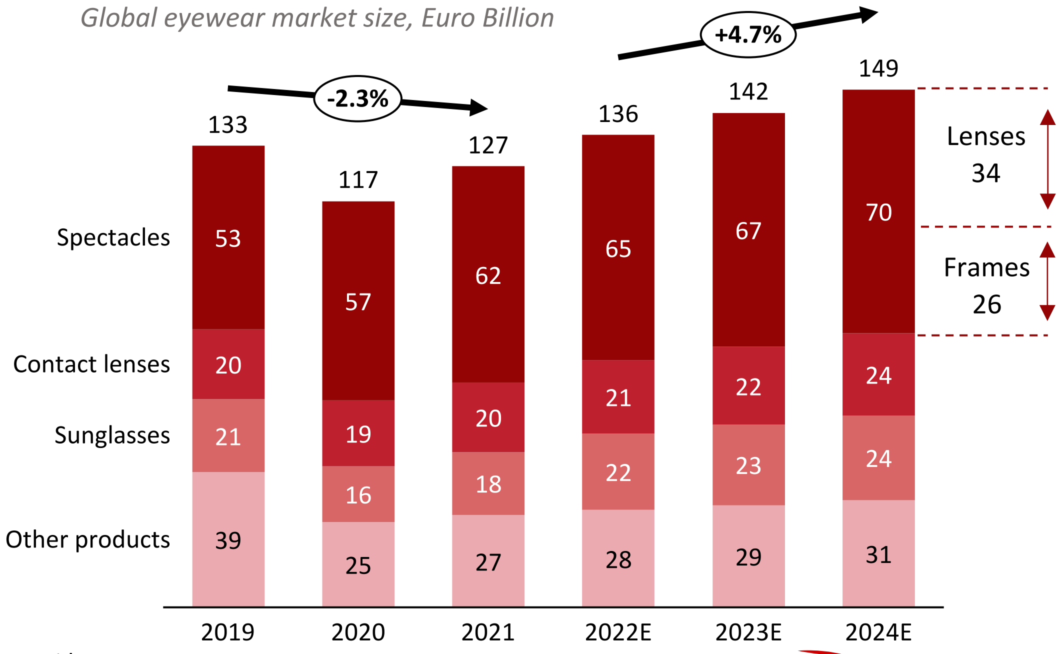
- Internalise entire value chain
- Expand presence in new channels
- Leverage unique positioning

Source: Euromonitor; Kering Annual Report

Spectacles and Sunglasses have the biggest share in the market and are expected to grow in coming years; Kering has opportunities to further consolidate value chain

Global eyewear market saw a decrease but are expected to bunce back in the coming years

Global eyewear market size, Euro Billion

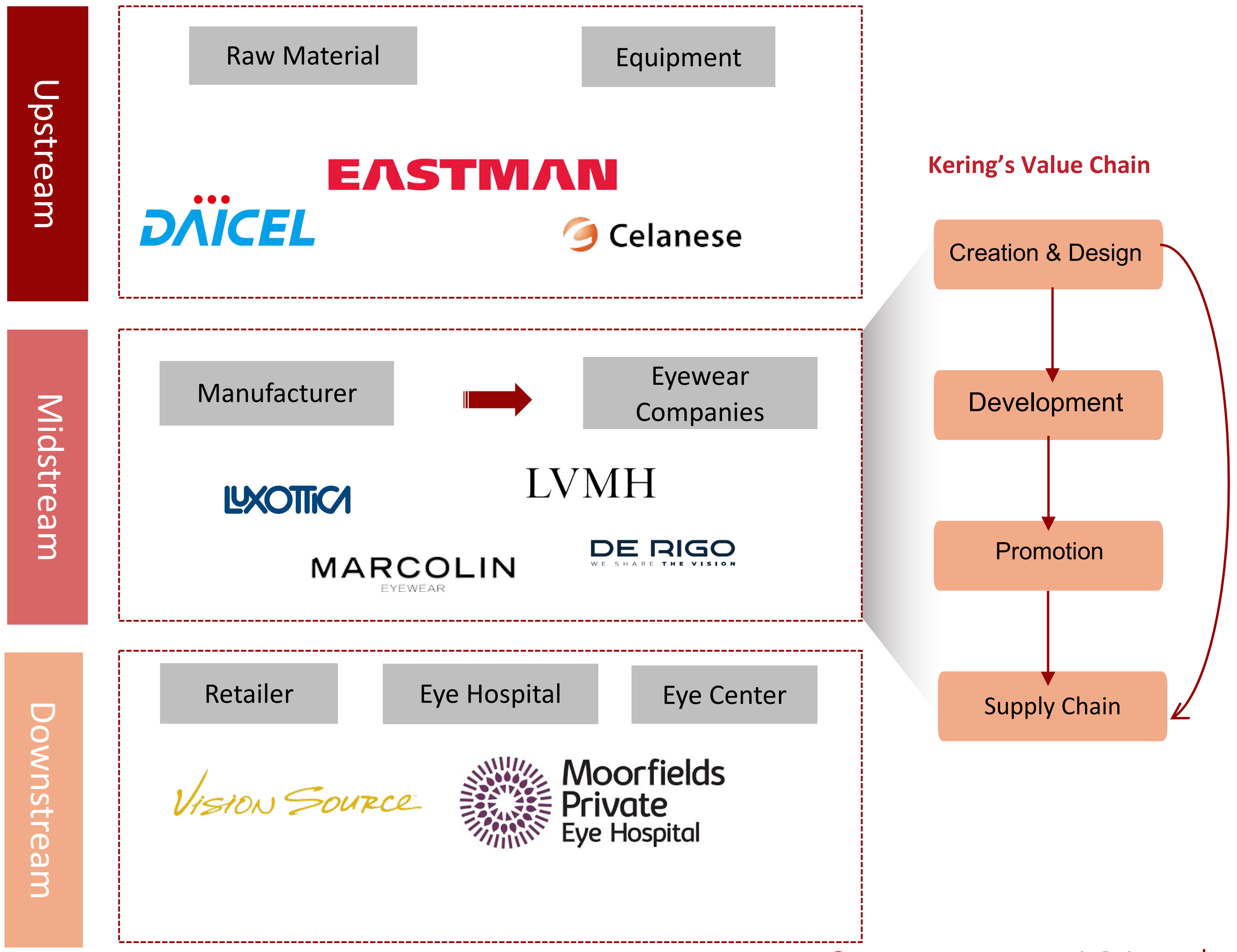


% by Region: Western Europe: 27.6% | APAC: 27.5% | North America: 29.4% | RoW: 15.6%

Key Drivers

- Aging population and the corresponding demand for ophthalmic solutions.
- The development of emerging markets.
- Increased awareness among global consumers of the need for visual protection/correction due to greater screen time.
- Optometrist recommendations advocating the use of spectacles

In the Industrial Chain of Eyewear Kering is in the midstream. It has an internalized value chain; further control on manufacturing side can boost its ability



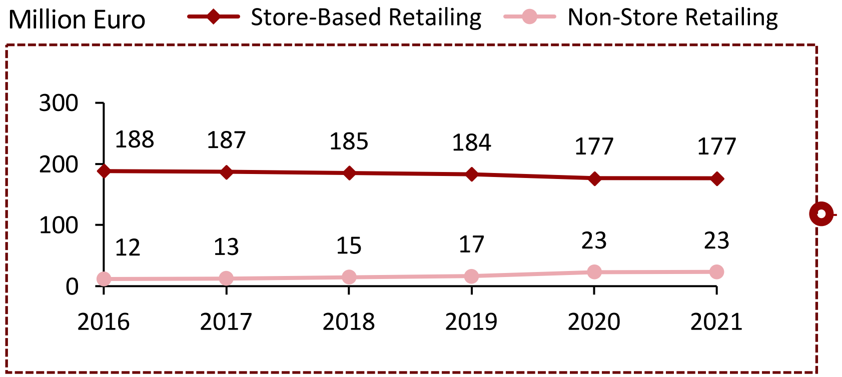
Source: Euromonitor; Kering Annual Report

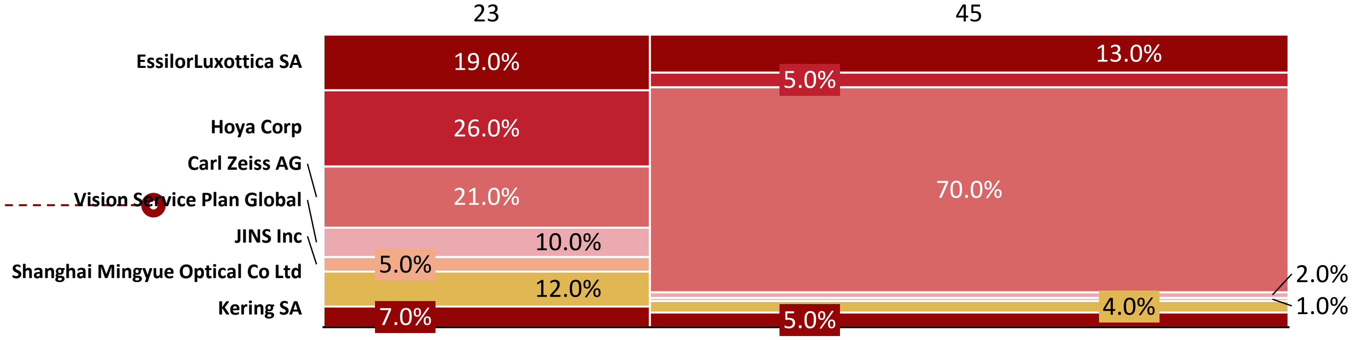
The market is very fragmented, among companies EssilorLuxittica, Hoya Corp and Carl Zeiss AG have leading position in the market

Spectacles and Sunglasses revenue by channel 2016 - 2021

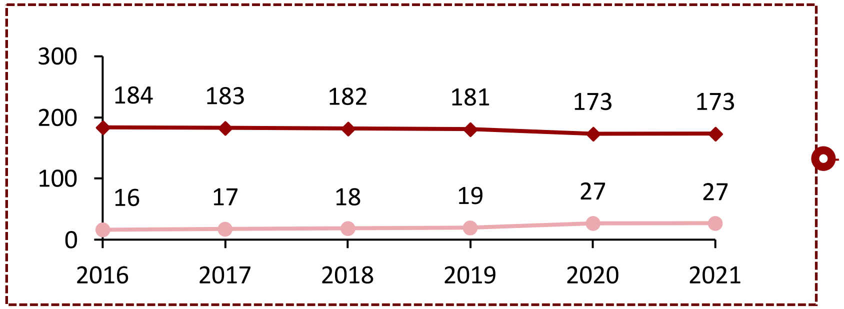
Top 7 Companies market share in Spectacles and sunglasses market

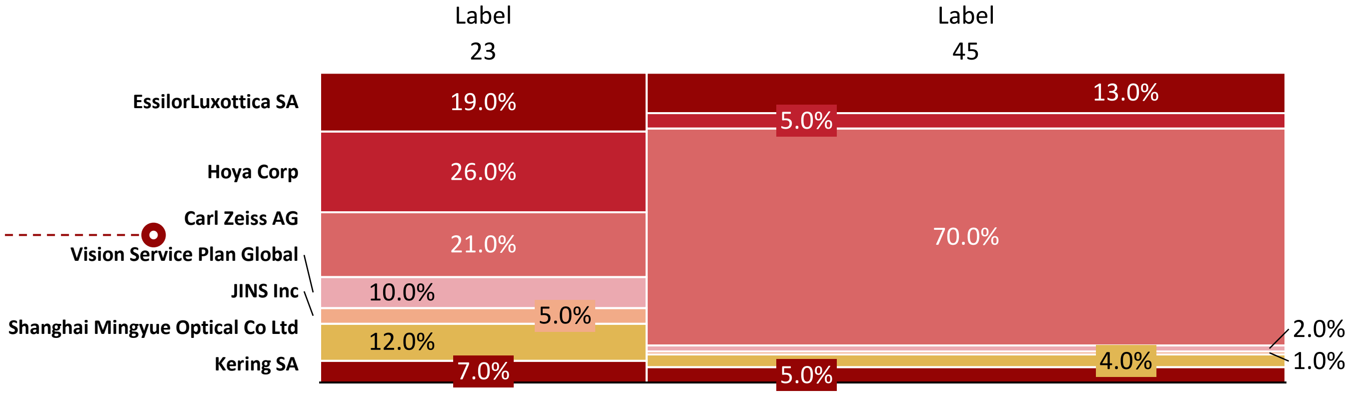
Asia Pacific



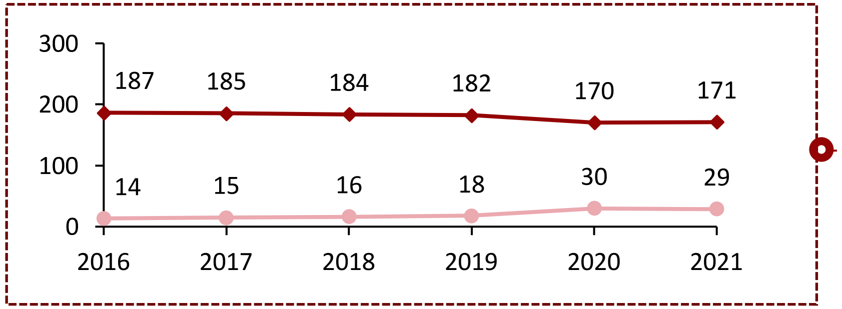


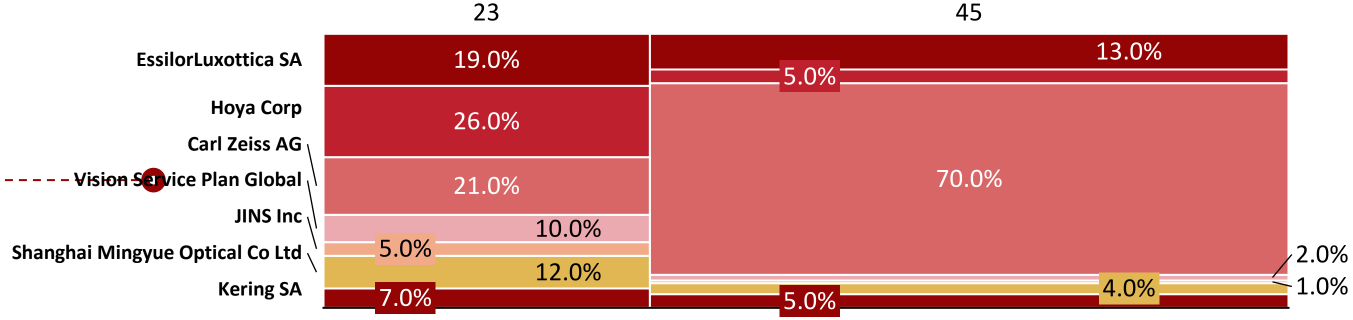
North Ameria





Western Europe



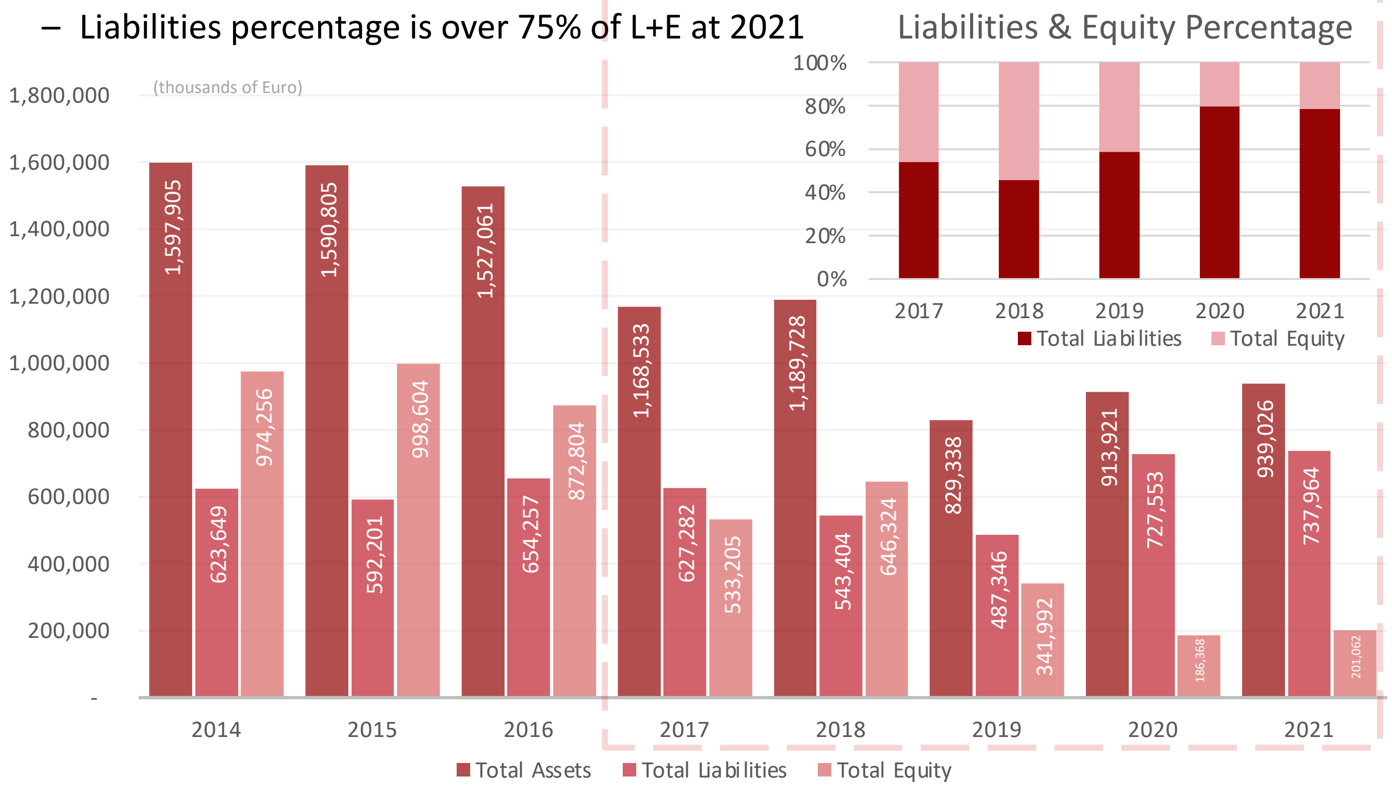


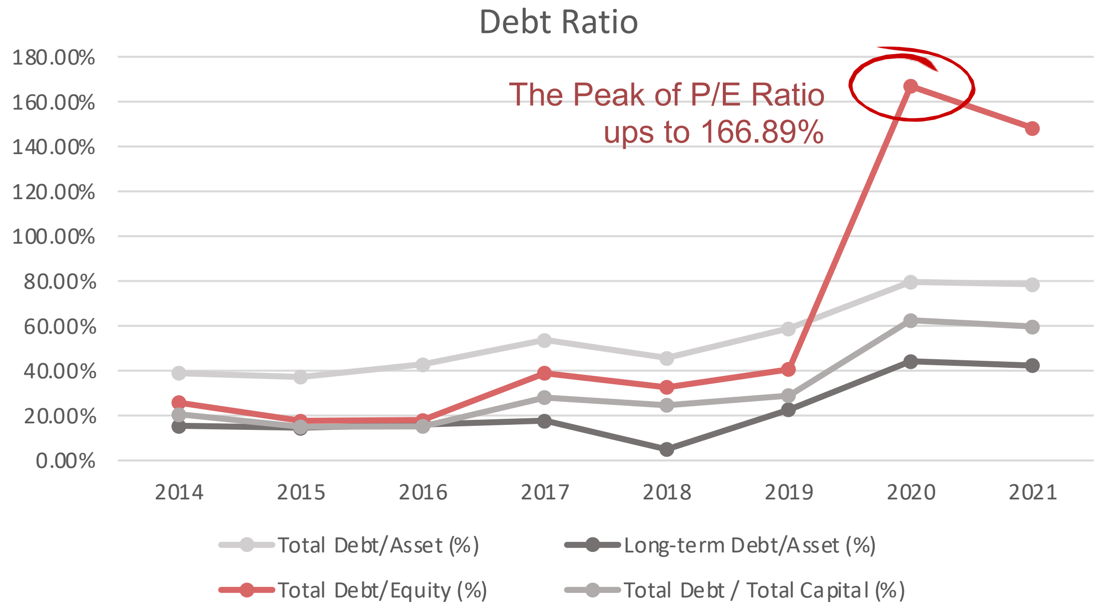
Source:

financial review of the target : **Safilo with strong operational capabilities**

Balance Sheet + Debt Ratio

- **Total Asset Decreasing**
  - Resulting from the continuous operating loss of the company
  - Made also the equity smaller
  - Liabilities percentage is over 75% of L+E at 2021





- **Total Asset Decreasing**
  - With high D/E Ratio, Safilo has higher leverage and interest costs
  - Risk increasing: meaning Safilo is having high financial leverage, and would have requirements for great cash flow
  - Causing greater repayment pressure

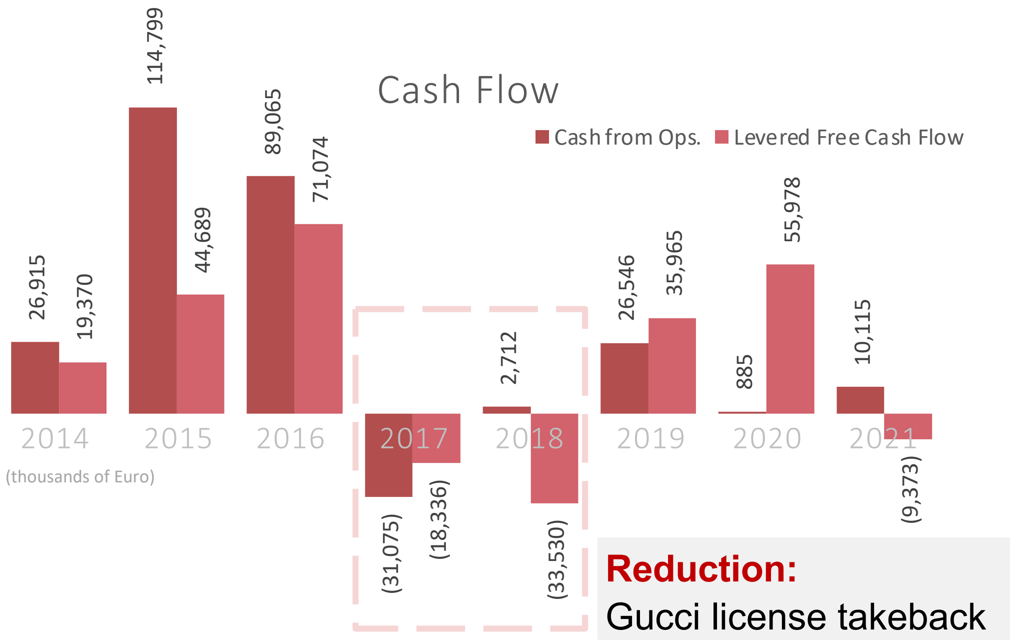
The debt deficit is considerable relative to its market capitalization, indicating that shareholders might have the risk to be heavily diluted. However:

1. Safilo’s recent debt to EBITDA ratio is with 2.6
2. Safilo turned last year's EBIT loss into a gain of €37m over the last twelve months

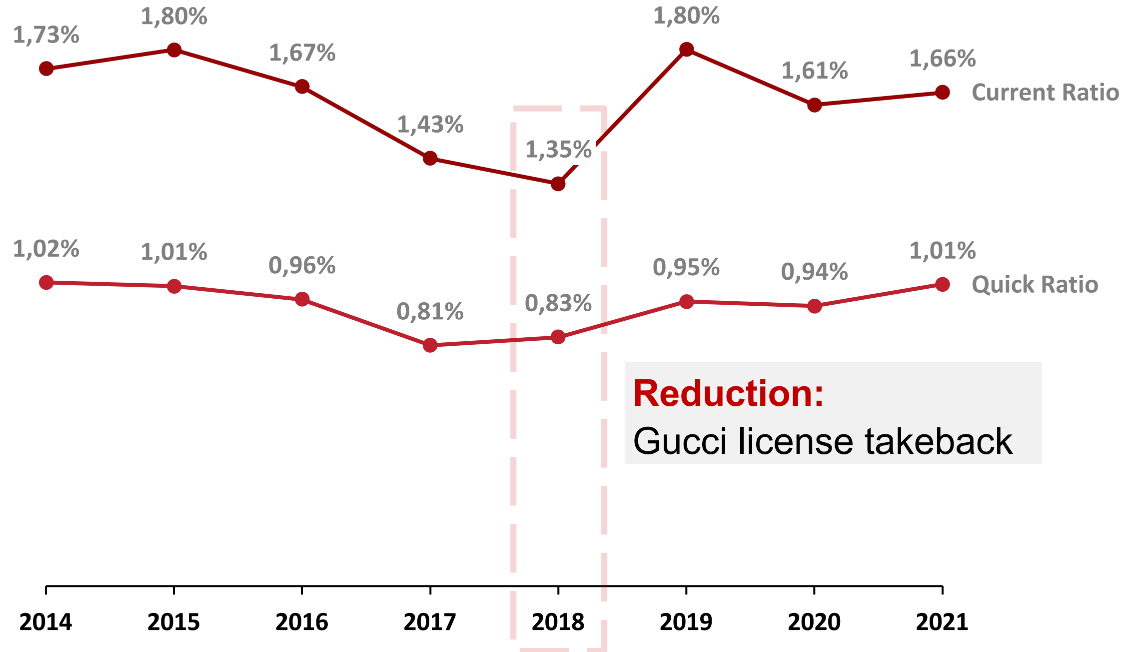
- **Safilo can provide Kering with strong operational capabilities**
- **Kering can also mitigate Safilo's liquidity risk**

A financial review of the target: **Safilo with quick recovery after license takeback**

Cashflow Ratios & Liquidity Ratio



- **Free cash flow shows total cash remaining from operating activities decreasing in 2017:**
- Because of the Gucci license takeback impact, but the quick action Safilo took immediately rose up to positive
- **Leveraged free cash flow shows debt levels of bankruptcy risk activities decreasing in 2017:**
- After the Gucci license takeback impact, Safilo only took two years to escalate its leveraged free cash flow (though the Debt is high), and still could show its good ability to operating

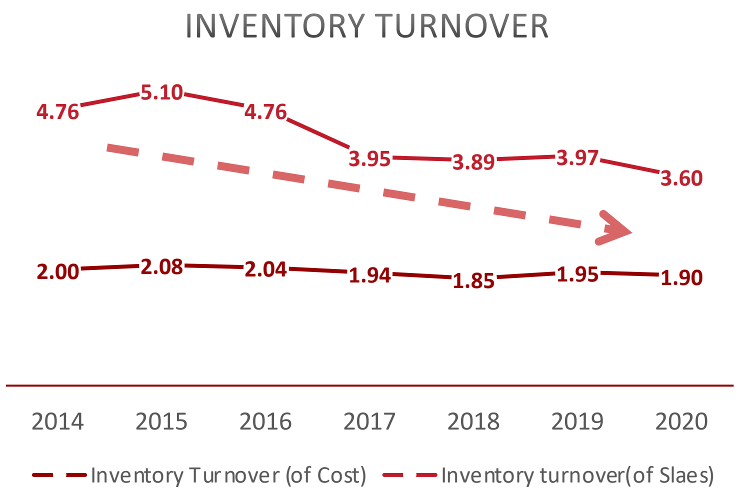


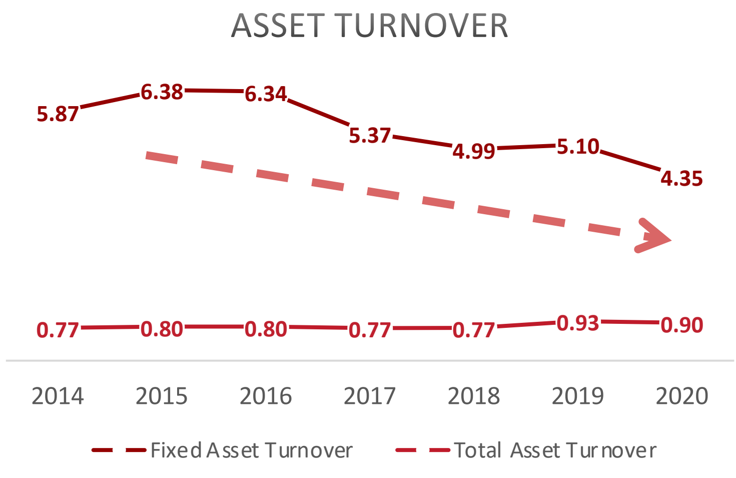
- **The reduction of sale impact:**
- mainly driven by the change of the Gucci license into a supply agreement, representing a net decline of Euro 155 million (-12%)
- Implementation of the new Order-to-Cash IT system in the Padua distribution center early in 2017
- That event negatively affected deliveries and, while operationally recovered from mid-year, impacted order taking and thus reduced sales and profit up

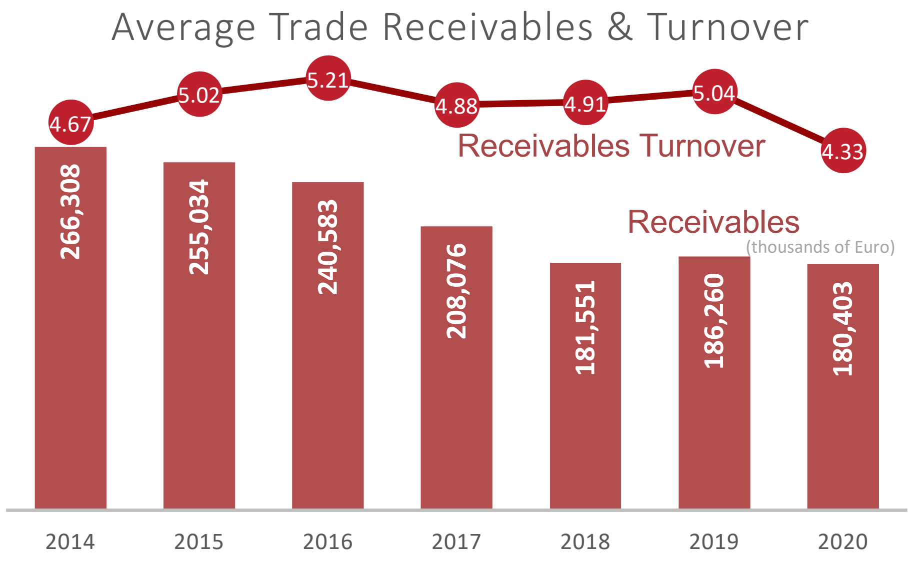
Source:

A financial review of the target: **enormous synergy of the value chain after acquisition**

Activity ratio







Safilo's operational problems:

Although the accounts receivable turnover rate did not have magnificent chaning, the accounts receivable decreased significantly, might be:

- The customer is in good repayment condition
- Decrease in revenue resulting in a decrease in overall accounts receivable

According to the inventory turnover ratio and asset turnover ratio, it can be found that the reason is the decline in net sales

Although fixed asset turnover ratio has been decreasing for many years, the overall asset turnover ratio is still rising slightly:

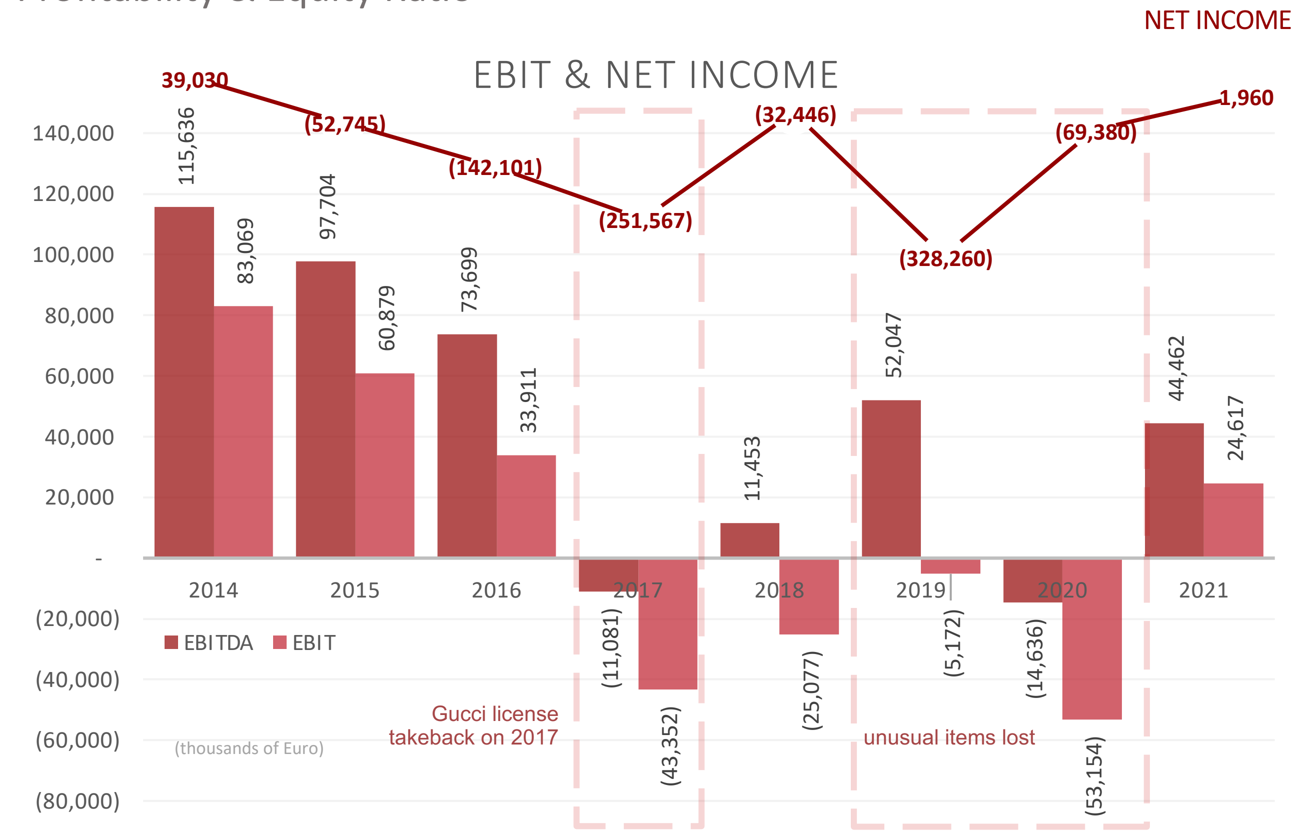
- By analogy, Safilo can gradually profit from non-factory production
- This is also in line with Kering's goal in recent years: switching to e-commerce channels instead of Brick and Mortar (B&M)

It is believed that with such a vertical effect, the synergy of the value chain can be brought into play after the merger and acquisition

Source:

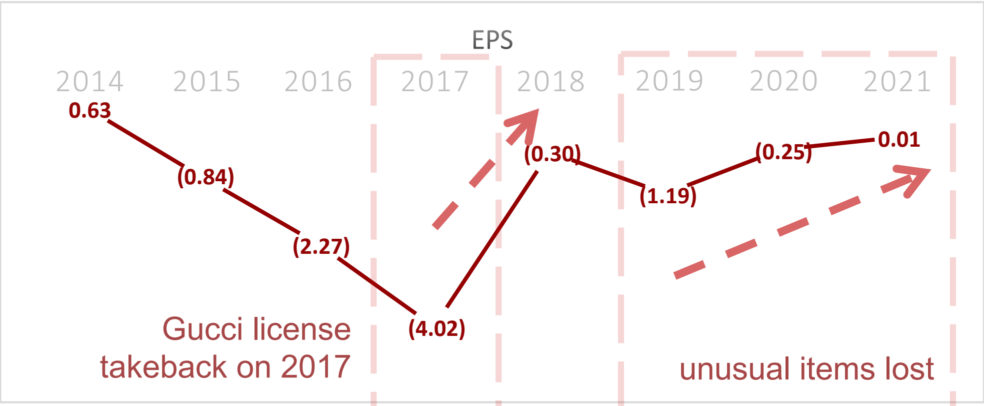
A financial review of the target: **Safilo's potential earnings profitability**

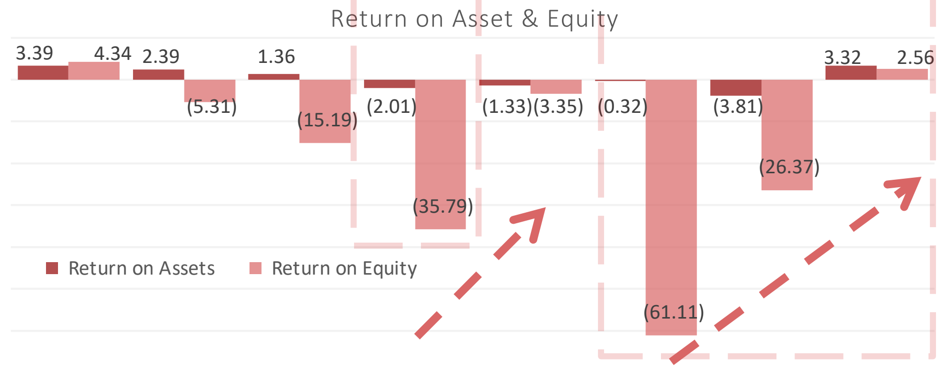
Profitability & Equity Ratio



Date	2014	2015	2016	2017	2018	2019	2020	2021
Gross Profit	718,554	756,956	715,628	519,549	453,215	476,889	369,163	270,637
Gross margin	60.96%	59.19%	57.12%	50.18%	49.76%	50.78%	47.31%	52.99%

- **The Reduction of EBIT and Income**
  - On 2017 was influenced by Gucci license takeback
  - Statutory profit over the last two years was massively reduced due to unusual items, but Safilo's quickly responding and improvement proves its potential earnings profitability





- **EPS & ROE Quick Recovery from impacts**
  - Gross profit margin has remained almost the same for several years. On behalf of the company, Safilo is still doing a good job of grasping the profit
  - Both EPS and ROE is turning to positive on 2021

The flexibility and recovery ability of Safilo demonstrates that it's a good target for Kering's acquisition plan

Source:

The financing of the operation: **market cap overestimate the real value**

Safilo PV valuation

- **Using DCF Model to value Safilo PV**

– T=24%, r_f=0.135%,

– β_{im}=1.3934, WACC=3.5598%

– Initial revenue growth rate=4.30%

– growth decay=0.4%(growth rate converges to Italy nominal growth rate in 7 years)

– Cash flow=8.8 million

Net Profit	8.8000	9.4130	9.9886	10.5146	10.9789	11.3703	11.6791	11.8970
Growth Rate	6.9656%	6.1156%	5.2656%	4.4156%	3.5656%	2.7156%	1.8656%	1%

– **PV=481.88 million**

– **(market cap: 646 million)**

Source:

The financing of the operation: **potential returns for Kering after acquisition**

Expected return of Safilo acquisition

- **What if after acquisition, revenue and capital cost of Safilo functions in Kering's rate?**
- T=25%, r_f=0.135%,
- β_{im}=0.0285, WACC=2.3590%
- Initial revenue growth rate=6.97%
- growth decay=0.85%(growth rate converges to France nominal growth rate in 7 years)

EBITDA	8.8000	9.1780	9.5356	9.8689	10.1744	10.4487	10.6886	10.8912
Growth Rate	4.2957%	3.90%	3.50%	3.10%	2.70%	2.30%	1.90%	1.50%

- **PV=819.94 million**
- **(PV status quo: 481.88 million)**
- Kering could obtain over 800 million euros if acquired successfully and integrated smoothly, at the cost of nearly half of its potential returns

Source: