

The Financial Statement Analysis of Hermès

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Abstract. This article analyzes the financial performance of Hermès and give an evaluation of the company stock price. Hermès is one of the largest luxury brand in the world, and it has just been through the COVID-19 period with the demand of expansion of their business. First, the paper gives an overview of Hermès' annual report and demonstrate common-size analysis and ratio analysis on three financial data. Then, Hermès' share price will be evaluated by using multiples valuation method (MVM). Diversified valuation can not only increase the reliability of the results, but also provide more dimensions for subsequent stock price analysis. Therefore, the three valuation methods selected in this paper are PE method, PS method and EV / EBITDA method and the price of Hermès equity is overvalued can help to reveal the company's market value and reduce the blindness investment behavior. The reason is that after the outbreak, the United States and other developed countries tried to relax monetary policy and promulgated various fiscal stimulus bills, resulting in the increase of foam.

Keywords: Financial Statement; Company Evaluation; Multiples Valuation.

1. Introduction

Hermès is the one of the largest luxury brands in the world that is listed in Euronext. Since its listing in 1933, Hermès's share price has increased 62 times [1]. In its early years, Hermès was famous for high grade riding gears and now, it sells handbags, wallets and other leather projects. Hermès is an independent business owned by family sharehold-ers. It has opened its stores worldwide and its main market is in Europe and East Asian. Hermès has a long operating history and is worth to analysis and discusses from the perspective of business performance.

1.1 Background

Hermès was founded by Thierry Hermès in Paris, France in 1837 [2]. At first, it was a small saddlery and sold high quality accessories that were very popular among the local aristocracy with its skills. In 1879, Charles-Emile Hermès expanded the business and allowed the company to expand throughout the world. In 1903, while Ford started to produce cars on a large scale in the United States, Hermès began to produce banknote clips, women's wallets and leather bags, and carried out diversified business policy. The company carried out new handbag designs and these products began to become a mark of social status. Today, the stores of Hermès are located throughout the world and after more than 180 years of development, the company still retains its unshakeable position in the fashion industry. Thus, using multiples valuation to evaluation Hermès' share prices to see whether the price is overestimated is reasonable.

1.2 Motivation

Hermès have been running their business successfully for 180 years. Due to the important role that luxury brand could play in societies and communities, providing a more comprehensive analysis on Hermès recent industry and financial performance has directive significance. Especially at present, the entire luxury industry has been seriously affected by the COVID-19 crisis. However, Hermes' share price has quickly recovered to its pre-epidemic figures, even though it was shaken during this period. Besides, its share price has climbed in recent years, outpacing the majority of companies in its fields.

1.3 Contribution

As the living standard continues to improve, people's consumption level also grows and the luxury market is growing. Hopefully, this article could provide some operating implication to some luxury brands, especially when the industry experience a down time while companies are trying to expand their business. Also, some inspiration to the potential future Hermès investors and lenders who would like to invest in the company could be brought by the analysis

2. Literature Review

Hermès is one of the world's largest luxury brands and is has been operating their business worldwide successfully. Unlike LVMH and Kering, Hermès is a family business and has not been acquired by other companies. The company's financial performance is worth studying. There are many articles focusing on Hermès' strategies and marketing methods. Qinnuo Xu conducts an analysis on Hermès marketing strategy and business philosophy [3]. Its limited number of hunger marketing maintaining core business of customization services help to increase turnover and raise the brand image. Siyao Li pays attention to consumer psychology when people buy luxuries [4]. She notices that people can gain confidence by buying those top luxuries and those products have become a symbol of status, that makes Hermès quite popular among customers. Comparing to Hermès' financial status, people prefer to study its business strategy.

During the COVID-19 pandemic, many luxury companies have been severely affected and Hermès is not alone. Jiali Xie and Chorong Youn use inductive contents analysis and selecting samples to conclude that the marketing actions, that Hermès have adopted to face the COVID-19, are summarized as the product donations and the monetary donations [5]. Hermès raised the price of its classical handbags and some tiny leather products by 2.6 to 7.0 percent in May 2022. They noticed that despite the fact that some consumers may be dispirited by the economic contraction and do not pay higher prices, the rising price actually has the effect of a reverse sales effect. Although the price rise has become the new normal of luxury brands, Hermès said at the financial report meeting that the brand would not use the price rise as a means to increase revenue.

In recent years, marketing strategies together with their accounting strategies have been adjusted. In order to resist the acquisition plan of LVMH, members of Hermès family adjusted its ownership system. Hermès family members established a holding company to ensure that the equity was not cashed out. They put 50.2% of their equity into the holding company. They can sell the equity of the holding company only after obtaining the approval of more than 75% of family members. The other 12.6% equity was not put into the holding company in order to leave some cash out space for family members.

3. The Analysis of Hermès

3.1 Revenue Recognition

According to Hermès' 2021 Universal registration document, consolidate revenue in 2021 is 8982 million euros. [6] Revenue recognition is categorized into three main sections. They are Leather goods & Saddlery, Ready-to-Wear and Accessories and other sectors.

The Leather Goods & Saddlery métier represents 46% of consolidated sales. In 2021, it generated €4,091 million in revenue [7]. For most of Hermès' products, leather is an important part. Leather and real leather both belong to animal fur, but the divergence is that leather is the product of a variety of physical and chemical treatments which uses animal skin. Therefore, because of the complicated process, the overall leather material is more valuable. Hermès' goods use different kinds of leathers includes lizard skin, ostrich skin, crocodile skin, calf leather, etc. These are expensive raw materials for making products. In 2021, Hermès has opened an apprentice training center which awards a state

diploma in leather work. This ensures that Hermès has sufficient craftsmen and stable manufacturing skills to ensure that its leather products have fairly stable quality.

3.2 Common-size analysis

Common-size analysis will compare Hermès' financial data horizontally through a period of time. And the changes will give an overview on Hermès' financial situation.

Table 1. Common-Size Analysis of Balance Sheet Items

	2021	2020	2019
Revenue	8,982	6,389	6,883
Growth at current exchange rate vs. n-1	41%	7%	15%
Growth at constant exchange rate vs.n-1	42%	6%	12%
Recurring operating income	3,530	1,981	2,339
In% of revenue	39%	31%	34%
Operating income	3,530	2,073	2,339
In% of revenue	39%	32%	34%
Net income attributable to owners of the parent	2,445	1,385	1,528
In% of revenue	27%	22%	22%
Operating cash flows	3,060	1,993	2,063
Operating investments	532	448	478
Adjusted free cash flows	2,661	995	1,406
Equity attributable to owners of the parent	9,400	7,380	6,568
Net cash position	6,695	4,717	4,372
Restated net cash position	7,070	4,904	4,562
Headcount(number of people)	17,595	16,600	15,417

Table.1. demonstrates that in 2021, the group's consolidated revenue was € 8.982 billion, an increase of 42% compared with 2020 at constant exchange rates and 41% at current exchange rates. The growth rate at a fixed exchange rate is calculated by applying the average exchange rate of the previous period to the current income of each currency. The recurring operating income reached 3.53 billion euros with an increase of 78% compared with 2020. After achieving a profit margin of 41% in the first half of the year, the profit margin in the second half of the year reached 38%. The reason is the increase in recruitment and communication costs and the negative im-pact of exchange rate on the second half of the year. This can be found in its 2021 an-nual report, consolidated statements of equity. The cash flow related to operating activi-ties reached € 3.4 billion due to the strong growth of operating cash flow and the sharp decline of working capital demand. The group maintained its strategic investments in 2020 and accelerated its projects in 2021. Operational investments amount to €532 million. Hermès spent 30% of its investment in renovating and expanding its exclusive dis-tribution network.

At the end of 2021, the Hermès Group's consolidated balance sheet totals €13.8 billion, compared to €11.1 billion at the end of 2020. Cash represents almost 50% of as-sets, with limited growth in inventories. On the liabilities side, current debt reflects the strong recovery in economic activity in 2021, with equity amounting to €9.4 billion at 31 December 2021, representing almost 70% of the balance sheet total.

Additionally, Morgan Stanley Capital International (MSCI) published an "A" rating in its resilience analysis of the company's environmental, social and governance risks. The significant improvement in the non-financial rating reflects the acceleration of the cor-porate social responsibility commitment and the sustainability of the Hermès process model. Sustainalytics ranked Hermès as the second-best player in the textile and apparel sector. Hermès' commitment to climate change is particularly recognized by the CDP rating, which gives Hermès an "A-" rating.

4. Multiples valuation of Hermès

The Multiples Valuation Method is very intuitive [8]. Multiples are used in research reports and stock recommendations of both buy-side and sell-side analysts, in fairness opinions, and pitch books of investment bankers, or at road shows of firms seeking an IPO (Initial public offering) [9]. The first essential step to conduct a multiples valuation is selecting suitable measures, and another one is recognition of its peer group. These individual multiples are then aggregated into a single number. After determining the comparable companies, it is necessary to calculate and summarize the value variables, market variables and the company's financial situation into a single comparable figure. Finally, the value estimate of the target company is determined by multiplying the product of the comprehensive peer group and the value drivers of the evaluated company. Even if companies with the same prospects are selected, the use of P / E ratio alone is unprecise because net income always mixes operating and nonoperating items. Therefore, the three valuation methods used are the P/E method, the P/S method and the EV/EBITDA method.

4.1 Peers with similar prospects

When choosing a comparator company, one need is to understand their types of commodities, their ways of making money, and how they grow. Only with this expertise will an enterprise's multiples appear in the proper context alongside the others. In the luxury sector, Chanel, Dior, Louis Vuitton, Gucci, Calvin Klein and Prada are known as the 'blue chip brands. Among these top brands, Dior and Louis Vuitton has been takeover by LVMH and Kering acquired Gucci in 1999. LVMH and Kering are both large groups of companies with businesses not only in the apparel sector, so they are not good analogues for Hermès. Chanel is an established French luxury brand whose product range also overlaps highly with Hermès, but this company is not listed and therefore not very comparable. PVH, Richemont, Moncler, Ralph Lauren, Tapestry, Prada, Burberry and Ferragamo are chosen as the potential peer companies. According to their financial reports, all of these companies are already listed and they rely on clothing as their main source of revenue. When selecting five peer companies, eight indicators are chosen in this paper. After comparing with Hermès' data, five companies are selected as peers.

Table 2. Comparing Multiples

	Herems	Pvh	Richemont	Moncler	Ralpa Lauren	Tapestry	Prada	Burberry	Ferragamo
Net sales (EUR mil)	8982	8695	16573	1659	5683	6184	3366	3198	1114
Gross margin	71.3	58.2	62.4	77	66.3	70.7	75.7	71.1	66.2
EBITda	4030	1325	4498	701	927	1221	1092	1113	270
financial leverage	1.47	2.34	2.01	1.69	2.99	2.71	2.23	2.34	2.34
debt/equity ratio	0.17	0.67	0.49	0.33	0.98	0.89	0.68	0.75	0.71
roe%	29.14	19.01	13.66	22.29	18.53	28.75	4.9	33.59	9.62
roic%	24.26	10.88	8	15.97	8.54	13.77	5.59	16.5	4.32
eps (EUR)	2.33	12.58	0.42	1.5	6.35	2.8	0.23	1.38	0.2

4.2 Models of valuation

Applying multiples in valuation is very common in financial analysis. Unlike the Dividend Discount Model, the Discounted Cash Flow approach, or the Residual In-come Model, the Multiples Valuation Model does not require detailed multi-year fore-casts of dividends, free cash flows or residual incomes [10]. One approach is to compare current multiples with historical multiples

measured at comparable points in the business cycle and macroeconomic environment. Another method is to compare the current multiple with that of other companies, an industry or a market, and compare the current price difference between them with the historical price difference [11]. The principles of valuation and the empirical evidence led us to recommend that multiples be based on forecast rather than historical profits [12]. In order to make the data consistent, all data sources are the latest financial statements of each company. Current data for price/earnings, price/sales and enterprise value/EBITDA were extracted from the latest financial analysis reports of the comparable companies.

Table 3. Comparing Multiples

	Hermès	PVH	Ralph Lauren	Tapestry	Prada	Burberry	Average
Price/earning	73.13	15.32	22.13	13.9	64.47	15.66	26.30
Price/shares	20.01	0.87	1.58	1.91	4.81	2.76	2.39
Enterprise value/EBITDA	42.15	8.73	10.29	10.11	16.93	8.09	10.83

Table 4. Hermès equity price

Earning Per Share	Sales Per Share	EBITDA	Enterprise Value
2.33	8.55	4.03bil	111.07bil

Use the current data to calculate the average value respectively to obtain the industry average index composed of Hermès comparable companies. Then, according to the price per share calculation formula given below corresponding to the three indicators, the indicators are multiplied by Hermès's 2021 annual earnings per share, sales per share and EBITDA to obtain Hermès valuation in euros. The results have been converted into USD.

$$\text{Value} = \text{Average P/E} * \text{Earning Per Share} \quad (1)$$

$$\text{Value} = \text{Average P/S} * \text{Sales Per Share} \quad (2)$$

$$\text{EV} = \text{Average EV/EBITDA} * \text{EBITD} \quad (3)$$

Table 5. Hermès multiples valuation

valuation	P/E method	P/S method	EV/EBITDA method	shareprice (2022.5.13)
Price(eur)	61.27	20.40	43.64	
price(usd)	63.76	21.23	45.52	106.84

At the end of the table, the stock prices of Hermès at 2022.5.13 this year are given. After comparison, it will be found that although there are differences in valuation due to different valuation methods, they are far less than the actual stock price of Hermès, so it is considered that Hermès is overvalued.

4.3 Result Analysis

From the results, it can be concluded that the share price of Hermès is overvalued. One reason is that after the outbreak of the epidemic, the United States and other developed countries tried to ease monetary policy. This policy is carried out to overcome unemployment and increase people's purchasing power and is applied when the economy is in a recession or depression [13]. That enacted various fiscal stimulus bills, leading to the increase of foam. Therefore, under the background of the United States opening the money printing machine and wantonly relaxing monetary policy, Hermès's share price stopped falling and rebounded, soaring all the way, reaching an all-time high of \$189 in November in 2021. In just over a year, the share price has more than tripled. In order to control inflation, the Federal Reserve has begun to raise interest rates. Under the strong expectation of raising interest

rates, market panic soared and the US stock market fell, and Hermès is no exception. This year's decline was due to an early rise in equity prices to higher levels and overvaluation. If the Federal Reserve raises interest rates and market liquidity is affected, it will be necessary to digest the bubble. On the other hand, although Hermès still performed well in the first quarter of the year, there is no optimism about the future of the luxury market against the backdrop of Covid-19, the conflict between Russia and Ukraine and the Fed's interest rate hike. The rich with higher debt ratios and more assets are only getting richer. As the prices of the assets of the wealthy soared under loose monetary policy, they were willing to spend money on luxury goods. As a result, the performance of the luxury goods sector has seen an explosion. Moreover, the scarcity of luxury goods dictates that it has strong anti-inflationary properties. Like luxury cars and watches, it is now not only a simple consumer good, but also assumes the financial attributes of financial management and investment. This explains why Hermès, which is at the forefront of the industry, has received more attention in the wake of the outbreak.

5. Conclusion

In a word, Hermès is gradually recovering from the impact of Covid-19 and they have a great potential of growth. From the annual report and share price, Hermès' financial situation has been gradually stable and getting better. However, Hermès shops have seen a sharp drop in customer traffic in China due to the increasingly strong anti-epidemic control measures in China. Depending on how much Hermès relies on the Asia Pacific region, especially the Chinese market, its sales will also receive an impact. According to MVM, Hermès shares are indeed overvalued in the market, but this does not negate the fact that Hermès does have investment value. With the US interest rate hike, it is believed that Hermès' performance will come under significant pressure and its share price will gradually fall back to a reasonable price.

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