

# Prada SpA (1913 HK)

## Re-rating is not over when Prada remains hugely sub-scale to its global peers; initiate at Buy

Subsequent to top management rotations in the last three years, which included personnel changes in the creative team (2020), Head of Miu Miu (2020), Head of Fine Jewelry (2021), a new CFO (2022) and lastly a new Prada brand/ Prada Group CEO (2023), Prada is back to shape and has made every right decision to fuel a neat business turnaround. The refocusing of retail business, termination of in-store discount, and increasing efficiency of marketing campaigns etc., in our view, have begun to manifest into strong financial metrics with 4Q22 probably just being one of the milestones of this upcycle. Prada's re-rating has yet to be over. Comparing to its soft luxury peers, Prada's sales is just 10% of LVMH and approximately <50% of Hermes and Gucci etc. Given a parallel reputation and brand appeal, we still see room for Prada to catch up globally. Beyond the strong performance in ready-to-wear and footwear, we expect leather goods (c.50% of sales) to catch up based on management's vision of having a balanced growth portfolio. Prada is also looking into entering new categories in fine jewelry (debuted in 4Q22) and personal beauty (first fragrance launched in 4Q22). We think the new initiatives should act as emerging drivers by creating synergy with existing business lines in promoting customer loyalty. Prada is the only global luxury play listed in HK. With its investment scarcity and ongoing turnaround, we initiate Prada at BUY.

- **Management guidance.** Prada's management targets to reach EUR4.5bn revenue with a 20% adjusted EBIT margin (attained already) in the medium term. Considering a strong start for 2023, thanks to China's reopening, we envisage Prada to reach the revenue target this year, and extent the momentum to 2025E at a cFX 10% 3-year CAGR.
- **Technical bottlenecks.** Prada's limited market free float (~20%) has been a known demerit to the investment case. The potential inclusion in the Southbound Connect scheme could be a silver bullet to this technical bottleneck. Of note, Samsonite (1910HK, Buy) and L'Occitane (973HK, NR) were included in the last round of assessment. Separately, the beginning of quarterly sales reporting (from May 2023 onwards), in our view, is a step forward in standardizing its corporate governance with its luxury peers.
- **Valuation.** Our TP is DCF-based. In our model, we assume WACC of 7.7%, risk-free rate of 3.5%, risk premium of 5.0% and beta of 1.0. Our TP implies c.39.0x end-23E P/E.

### Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (EUR mn)	3,366	4,201	4,599	5,046	5,552
YoY growth (%)	38.9	24.8	9.5	9.7	10.0
Net profit (EUR mn)	294.3	465.2	562.2	624.7	695.8
YoY growth (%)	na	58.1	20.9	11.1	11.4
YoY growth (%)	na	58.1	20.9	11.1	11.4
EPS (Reported) (EUR)	0.11	0.18	0.22	0.24	0.27
P/E (x)	47.5	29.2	30.2	27.2	24.4
P/B (x)	4.5	3.9	4.5	4.2	3.9
Yield (%)	1.3	2.1	2.0	2.2	2.5
ROE (%)	9.9	14.1	15.5	16.0	16.5
Net gearing (%)	(7.7)	(15.4)	(19.6)	(23.2)	(26.6)

Source: Company data, Bloomberg, CMBIGM estimates

**BUY**

**Target Price** HK\$72.13  
**Up/Downside** 25.8%  
**Current Price** HK\$57.35

**China Consumer**

**Joseph WONG**

(852) 3900 0838

josephwong@cmbi.com.hk

#### Stock Data

Mkt Cap (HK\$ mn)	146,748.6
Avg 3 mths t/o (HK\$ mn)	66.3
52w High/Low (HK\$)	60.50/35.00
Total Issued Shares (mn)	2558.8

Source: FactSet

#### Shareholding Structure

Prada Holding SpA	79.9%
Invesco	4.9%

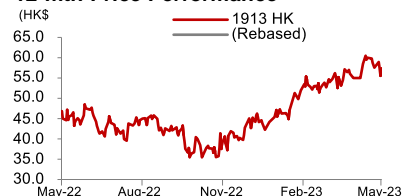
Source: HKEx

#### Share Performance

	Absolute	Relative
1-mth	4.5%	NM
3-mth	10.2%	NM
6-mth	47.4%	NM

Source: FactSet

#### 12-mth Price Performance



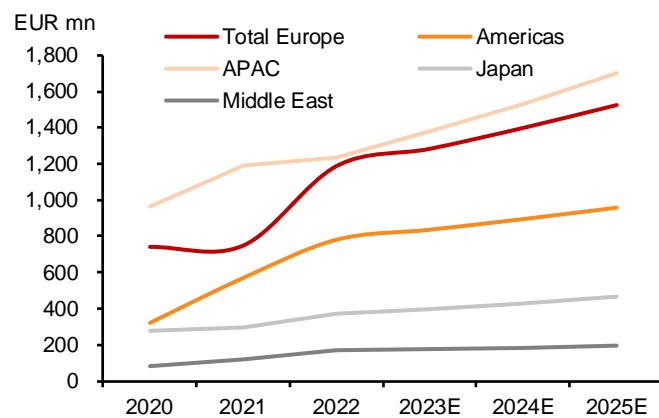
Source: FactSet

## Financial analysis

- **Revenue:** We project Prada to grow at a 3-year revenue CAGR of 10% to EUR 4.9bn between 2022-25E, driven mainly by a 10% CAGR of sales from DOS (directly operated stores), which we think Prada has recently devoted resources to re-focus on the segment. Of note, Prada has restructured its wholesale business and since then we think that brand appeal is more visible and impactful to consumers with a more consistent pricing strategy.

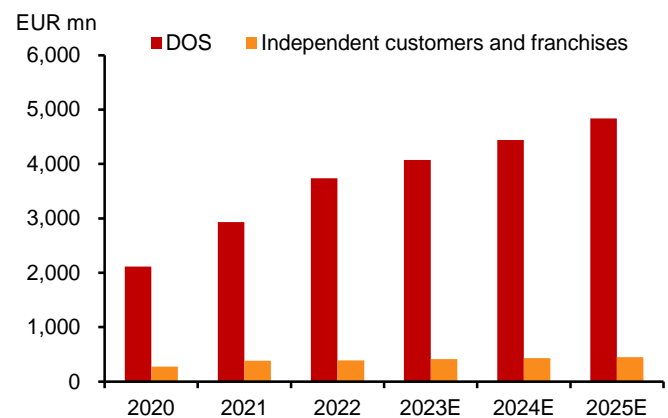
By region, we forecast APAC to grow at low-teens. This is not only driven by post-pandemic domestic China spending, but also the travel momentum within APAC, such as Hong Kong, driven by Chinese touristic spending. In Europe, we expect continuous support from global touristic spending, but look for growth to normalize on a high base. For the rest of the regions, we assume mid-to-high-single digit CAGR which we extrapolate from historical growth trajectory.

**Figure 1: We expect APAC revenue to catch up**



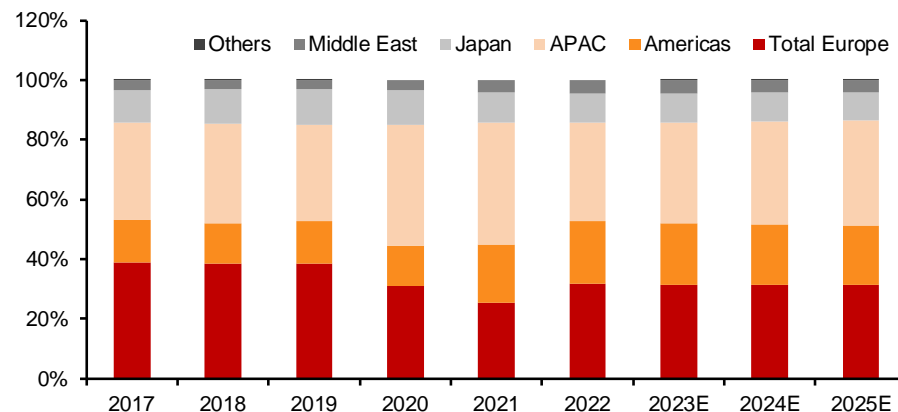
Source: Company data, CMBIGM estimates

**Figure 2: Net sales breakdown by business lines**



Source: Company data, CMBIGM estimates

**Figure 3: Revenue breakdown by regions 2017-25E**



Source: Company data, CMBIGM

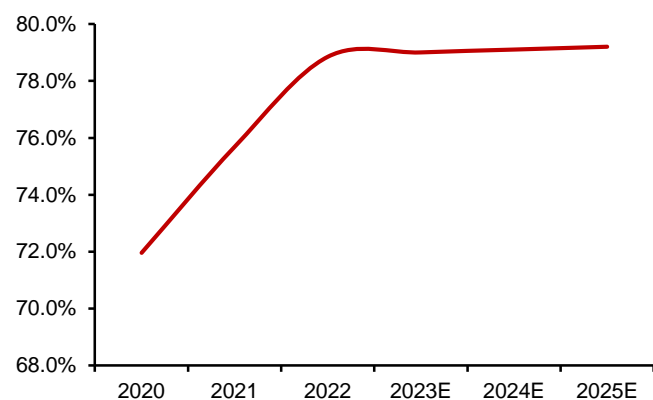
Figure 4: Major revenue assumptions 2018-25E

Revenue by channel (EUR mn)	2018	2019	2020	2021	2022	2023E	2024E	2025E
DOS	2,532	2,636	2,115	2,931	3,737	4,073	4,440	4,839
Independent customers and franchises	566	547	275	386	388	411	431	449
<b>Net sales</b>	<b>3,098</b>	<b>3,183</b>	<b>2,391</b>	<b>3,317</b>	<b>4,125</b>	<b>4,484</b>	<b>4,871</b>	<b>5,288</b>
Net sales	+3.0%	+2.8%	-24.9%	+38.7%	+24.4%	+8.7%	+8.6%	+8.6%
Royalties	44	42	32	49	76	115	174	264
<b>Total sales</b>	<b>3,142</b>	<b>3,226</b>	<b>2,423</b>	<b>3,366</b>	<b>4,201</b>	<b>4,599</b>	<b>5,046</b>	<b>5,552</b>
Total sales	+2.8%	+2.7%	-24.9%	+38.9%	+24.8%	+9.5%	+9.7%	+10.0%
<b>DOS</b>	<b>2,532</b>	<b>2,636</b>	<b>2,115</b>	<b>2,931</b>	<b>3,737</b>	<b>4,073</b>	<b>4,440</b>	<b>4,839</b>
y-y	+3.6%	+4.1%	-19.8%	+38.6%	+27.5%	+9.0%	+9.0%	+9.0%
<b>Independent customers and franchises</b>	<b>566</b>	<b>547</b>	<b>275</b>	<b>386</b>	<b>388</b>	<b>411</b>	<b>431</b>	<b>449</b>
y-y	+0.3%	-3.3%	-49.7%	+40.0%	+0.5%	+6.0%	+5.0%	+4.0%
<b>Royalties</b>	<b>44</b>	<b>42</b>	<b>32</b>	<b>49</b>	<b>76</b>	<b>115</b>	<b>174</b>	<b>264</b>
y-y	-8.5%	-4.1%	-24.6%	+53.9%	+55.1%	+51.4%	+51.4%	+51.4%
<b>as % of group sales</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
DOS	80.6%	81.7%	87.3%	87.1%	89.0%	88.6%	88.0%	87.2%
Independent customers and franchises	18.0%	17.0%	11.4%	11.5%	9.2%	8.9%	8.6%	8.1%
Royalties	1.4%	1.3%	1.3%	1.5%	1.8%	2.5%	3.5%	4.8%

Source: Company data, CMBIGM estimates

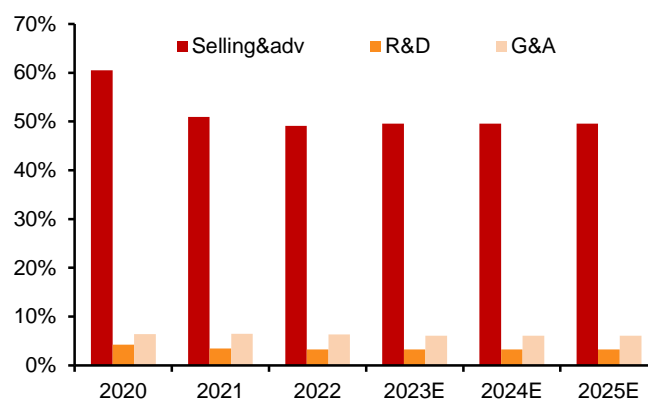
- **EBIT:** On operation level, we envisage offline traffic recovery will prompt for an increase in promotional expense, not to mention the dedication of brand rebuilding from the new management team. This will mean an average 0.4pp increase in our selling and advertising expense assumption. However, the uptick will be partially neutralized by a more cost efficient operation, in our view, which numerically manifested into a lower G&A ratio to revenue by a 0.2pp reduction per annum.

Figure 5: Gross margins trajectory 2020-25E



Source: Company data, CMBIGM estimates

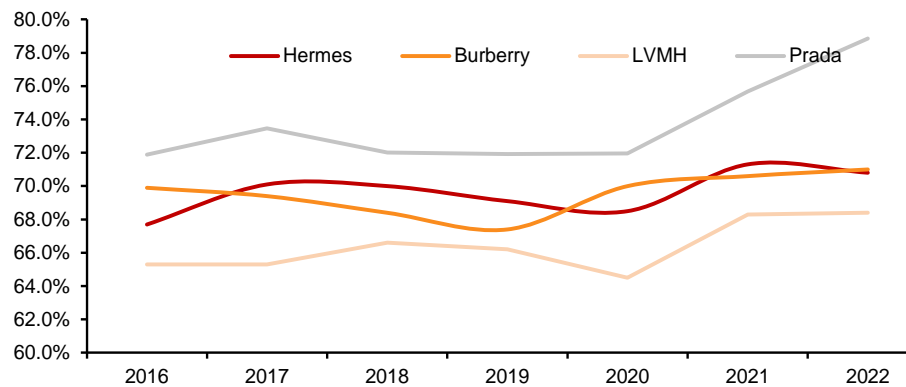
Figure 6: Opex ratio breakdown 2020-25E



Source: Company data, CMBIGM estimates

- **GPM:** On gross level, thanks to the high pricing power and improvement of sales mix, we expect GPM to edge up by 0.1pp per annum within 2023-25E, even considering the huge jump we seen in 2021 and 2022, thanks to new launches that brought by the new creative team. In fact, Prada has already achieved the highest GPM across its major peers, such as LVMH, Hermes, Burberry etc. And we think there is still small expansion room thanks to mix change and full-year impact of full-prices sales, which initiated in 2022.

**Figure 7: Prada's GPM is the highest among major peers**



Source: Company data, CMBIGM

## Update on key management rotation

There have been quite a lot of management changes in the last three years, ranging from Board of Directors rotations to new CEO appointment, and even down to operation level on new recruits for brand icon and designers. Thankfully, these changes have started bearing fruit and Prada has been on its way back with almost every right decision made. These include, but not limited to, wholesales business restructuring which now the segment represented less than 10%, lowering from almost 20% five years ago, elimination of in-store discount that enables margins expansion upon full-year impact, expanding into new business lines and refocusing of key legacy collections etc.

**Figure 8: Management rotation in the last three years**

Person-at-stake	Title/ key responsibility	Join date
Gianfranco D'Attis	Prada brand CEO	2023
Timothy Iwata	Fine jewelry Director	2021
Benedetta Petruzzo	Head of Miu Miu	2020
Raf Simons	New creative team leader	2020
Andrea Guerra	Prada Group CEO	2023
Andrea Bonini:	Prada Group CFO	2022

Source: Company data, CMBIGM

## Valuation

Given a stable growth outlook and hence a steady cash generation from the luxury retail business, our TP is DCF-based. In our model, we assume WACC of 7.7%, risk-free rate of 3.5%, risk premium of 5.0% and beta of 1.0. Our TP implies c.39.0x end-23E P/E, roughly at par to its +1sd above average. We consider this reasonable when we believe Prada should outgrow its luxury peers in the near term driven by market share gain and mix improvement (higher weighting from APAC).

**Figure 9: Our major DCF assumption**

DCF Valuation Summary (€m / HKD)	
Net Present Value	8,163
+ Terminal Value	13,334
<b>= Enterprise value</b>	<b>21,497</b>
- Net debt and other adjustments	736
<b>= Total Equity value</b>	<b>22,233</b>
Number of shares (mn)	2,559
<b>DCF value per share (HK\$)</b>	<b>72.1</b>

WACC assumptions	
Debt level	12.9%
Equity level	87.1%
Tax rate	34.0%
Borrowing premium	0.0%
<b>Post-tax cost of debt</b>	<b>2.3%</b>
Risk free rate	3.5%
Risk Premium	5.0%
Beta	1.0
<b>Cost of equity</b>	<b>8.5%</b>
<b>WACC</b>	<b>7.702%</b>
Long-term growth	2.0%
EUR/ HKD =	8.3

Source: Bloomberg, CMBIGM estimates

**Figure 10: DCF sensitivity analysis**

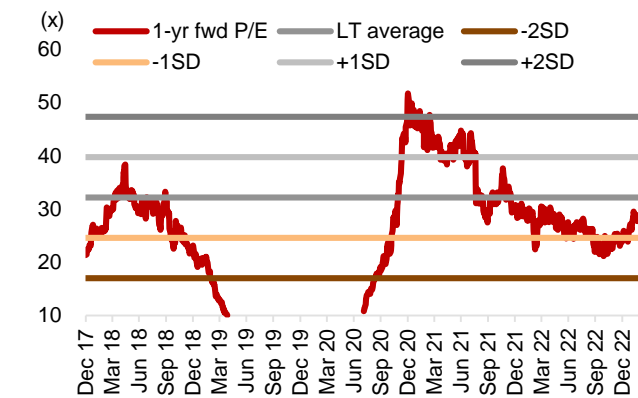
Sensitivity to WACC and long-term growth					
	7.5%	7.6%	7.7%	7.8%	7.9%
1.8%	73.1	71.8	70.5	69.3	68.1
1.9%	73.9	72.6	71.3	70.0	68.8
<b>2.0%</b>	<b>74.8</b>	<b>73.4</b>	<b>72.1</b>	<b>70.8</b>	<b>69.5</b>
2.1%	75.7	74.2	72.9	71.6	70.3
2.2%	76.6	75.1	73.7	72.4	71.1

Sensitivity to RF and long-term growth					
	3.3%	3.4%	3.5%	3.6%	3.7%
1.9%	73.8	72.5	71.3	70.1	68.9
2.0%	74.2	72.9	71.7	70.5	69.3
<b>2.0%</b>	<b>74.6</b>	<b>73.3</b>	<b>72.1</b>	<b>70.8</b>	<b>69.6</b>
2.1%	75.1	73.7	72.5	71.2	70.0
2.1%	75.5	74.2	72.9	71.6	70.4

Source: Bloomberg, CMBIGM estimates

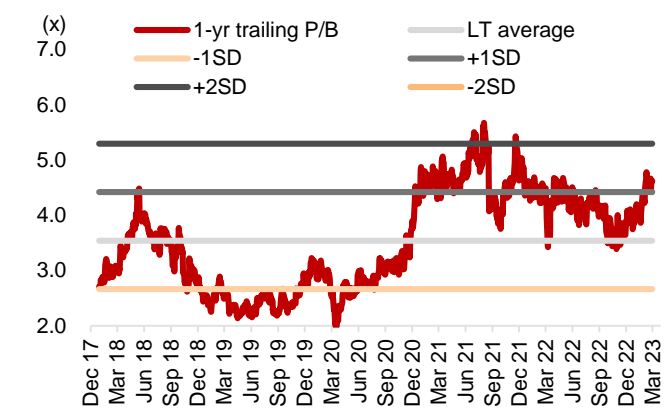
Figure 11: 12M forward P/E chart



Source: Bloomberg, CMBIGM estimates

Note: we do not show the PE when Prada was loss-making

Figure 12: Trailing P/B chart



Source: Bloomberg, CMBIGM estimates

Figure 13: Earnings revisions

EUR mn	New			Old			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	4,599	5,046	5,552	n.a	n.a	n.a	n.a	n.a	n.a
Gross Profit	3,634	3,991	4,397	n.a	n.a	n.a	n.a	n.a	n.a
EBIT	923	1,018	1,126	n.a	n.a	n.a	n.a	n.a	n.a
Net profit	562	625	696	n.a	n.a	n.a	n.a	n.a	n.a
Gross Margin	79.0	79.1	79.2	n.a	n.a	n.a	n.a	n.a	n.a
EBIT margin	20.1	20.2	20.3	n.a	n.a	n.a	n.a	n.a	n.a
Net margin	12.2	12.4	12.5	n.a	n.a	n.a	n.a	n.a	n.a

Source: Company data, CMBIGM estimates

Figure 14: CMBIGM estimates vs consensus

EUR mn	CMBIGM			Consensus			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	4,599	5,046	5,552	4,637	5,027	5,405	-0.8%	0.4%	2.7%
Gross Profit	3,634	3,991	4,397	3,671	3,997	4,288	-1.0%	-0.1%	2.6%
EBIT	923	1,018	1,126	974	1,083	1,251	-5.2%	-6.0%	-10.0%
Net profit	562	625	696	621	710	784	-9.5%	-12.0%	-11.3%
Gross Margin	79.0%	79.1%	79.2%	79.2%	79.5%	79.3%	-0.2ppt	-0.4ppt	-0.1ppt
EBIT margin	20.1%	20.2%	20.3%	21.0%	21.5%	23.1%	-0.9ppt	-1.4ppt	-2.9ppt
Net margin	12.2%	12.4%	12.5%	13.4%	14.1%	14.5%	-1.2ppt	-1.7ppt	-2ppt

Source: Company data, CMBIGM estimates

## Key investment risks

- Forex fluctuation
- Deteriorating brand equity
- New management team not generating performance as expected
- Any policy risk that weighs on luxury spending sentiment
- Unexpected global economy downturn

## Company background

Founded in 1913 by Mario Prada, Prada Group is a luxury company that specializes in leather handbags, travel accessories, shoes, ready-to-wear, and other fashion accessories. More recently, with the addition to the new management team, the company licenses its name and branding to Luxottica for eyewear and the Puig company for perfumes. Prada derives 80%+ of its sales from the Prada brand which is now mainly self-operated. Prada's brand pillar also consists of Miu Miu and other brands such as Car Shoe, Church's and Marchesi 1824 etc. Some latest development about Prada's product and designs include, but not limit to, the appointment of the Belgian designer Raf Simons as co-creative director. In June 2011, Prada raised US\$2.14bn and listed in the HK Stock Exchange.



## Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (EUR mn)						
Revenue	2,423	3,366	4,201	4,599	5,046	5,552
Cost of goods sold	(679)	(818)	(889)	(966)	(1,055)	(1,155)
Gross profit	1,743	2,547	3,312	3,634	3,991	4,397
Operating expenses	(1,723)	(2,048)	(2,467)	(2,710)	(2,973)	(3,271)
Selling expense	(1,260)	(1,421)	(1,704)	(1,886)	(2,069)	(2,276)
Admin expense	(154)	(217)	(266)	(281)	(308)	(339)
SG&A expense	(207)	(294)	(359)	(393)	(431)	(475)
R&D expense	(102)	(115)	(137)	(151)	(165)	(182)
Operating profit	20	499	845	923	1,018	1,126
EBITDA	768	1,167	1,508	1,685	1,838	2,023
Depreciation	(183)	(158)	(169)	(221)	(242)	(261)
Other amortisation	(42)	(40)	(42)	(46)	(35)	(39)
EBIT	20	499	845	923	1,018	1,126
Interest income	2	3	7	7	7	7
Interest expense	(10)	(9)	(6)	(6)	(6)	(6)
Net Interest income/(expense)	(8)	(7)	1	1	1	1
Foreign exchange gain/loss	(2)	(4)	(18)	0	0	0
Other income/expense	(17)	(29)	(71)	(25)	(25)	(25)
Others	(45)	(39)	(46)	(41)	(41)	(41)
Pre-tax profit	(52)	422	711	858	953	1,060
Income tax	(3)	(127)	(242)	(292)	(324)	(361)
After tax profit	(54)	295	469	566	629	700
Minority interest	0	(1)	(4)	(4)	(4)	(4)
Discontinued operations	0	0	0	0	0	0
Net profit	(54)	294	465	562	625	696
Adjusted net profit	(54)	294	465	562	625	696

BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (EUR mn)						
Current assets	1,655	2,170	2,425	2,729	3,050	3,404
Cash & equivalents	442	982	1,092	1,292	1,497	1,719
Account receivables	290	330	332	363	399	439
Inventories	666	663	760	833	913	1,005
Other current assets	256	196	241	241	241	241
Non-current assets	4,873	4,789	4,953	4,971	4,981	4,998
PP&E	1,506	1,565	1,577	1,654	1,725	1,808
Intangibles	832	829	818	759	698	632
Other non-current assets	2,535	2,395	2,558	2,558	2,558	2,558
Total assets	6,528	6,959	7,378	7,700	8,032	8,402
Current liabilities	1,227	1,420	1,490	1,528	1,571	1,619
Short-term borrowings	301	249	161	161	161	161
Account payables	290	390	402	440	483	531
Tax payable	69	144	278	278	278	278
Other current liabilities	568	636	650	650	650	650
Non-current liabilities	2,449	2,411	2,387	2,387	2,387	2,387
Long-term borrowings	451	493	396	396	396	396
Deferred income	29	30	41	41	41	41
Other non-current liabilities	1,968	1,888	1,950	1,950	1,950	1,950
Total liabilities	3,676	3,830	3,877	3,915	3,957	4,006
Share capital	256	256	256	256	256	256
Retained earnings	(54)	294	465	562	625	696
Other reserves	2,630	2,564	2,761	2,945	3,167	3,414
Total shareholders equity	2,832	3,114	3,482	3,763	4,047	4,365
Minority interest	20	15	19	23	27	31
Total equity and liabilities	2,852	3,129	3,501	3,786	4,074	4,396

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
<b>YE 31 Dec (EUR mn)</b>						
<b>Operating</b>						
Profit before taxation	(52)	422	711	858	953	1,060
Depreciation & amortization	648	624	662	702	759	831
Tax paid	(44)	(37)	(220)	(292)	(324)	(361)
Change in working capital	(82)	108	(104)	(66)	(73)	(83)
Others	123	27	74	59	61	66
<b>Net cash from operations</b>	<b>592</b>	<b>1,144</b>	<b>1,124</b>	<b>1,262</b>	<b>1,375</b>	<b>1,513</b>
<b>Investing</b>						
Capital expenditure	(107)	(219)	(241)	(285)	(288)	(316)
Acquisition of subsidiaries/ investments	0	0	0	0	0	0
Net proceeds from disposal of short-term investments	0	0	0	0	0	0
Others	(43)	82	(9)	0	0	0
<b>Net cash from investing</b>	<b>(150)</b>	<b>(137)</b>	<b>(250)</b>	<b>(285)</b>	<b>(288)</b>	<b>(316)</b>
<b>Financing</b>						
Dividend paid	0	(91)	(180)	(281)	(340)	(378)
Net borrowings	(65)	(11)	(179)	(494)	(542)	(597)
Proceeds from share issues	0	0	0	0	0	0
Others	(330)	(393)	(428)	0	0	0
<b>Net cash from financing</b>	<b>(395)</b>	<b>(495)</b>	<b>(787)</b>	<b>(776)</b>	<b>(883)</b>	<b>(975)</b>
<b>Net change in cash</b>						
Cash at the beginning of the year	421	442	982	1,092	1,292	1,497
Exchange difference	(26)	28	24	0	0	0
<b>Cash at the end of the year</b>	<b>442</b>	<b>982</b>	<b>1,092</b>	<b>1,292</b>	<b>1,497</b>	<b>1,719</b>
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
<b>YE 31 Dec</b>						
Revenue	(24.9%)	38.9%	24.8%	9.5%	9.7%	10.0%
Gross profit	(24.8%)	46.1%	30.0%	9.7%	9.8%	10.2%
Operating profit	(93.5%)	2,389.8%	69.2%	9.3%	10.3%	10.6%
EBITDA	(23.0%)	52.0%	29.2%	11.7%	9.1%	10.0%
EBIT	(93.5%)	2,389.8%	69.2%	9.3%	10.3%	10.6%
Net profit	na	na	58.1%	20.9%	11.1%	11.4%
Adj. net profit	na	na	58.1%	20.9%	11.1%	11.4%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
<b>YE 31 Dec</b>						
Gross profit margin	72.0%	75.7%	78.8%	79.0%	79.1%	79.2%
Operating margin	0.8%	14.8%	20.1%	20.1%	20.2%	20.3%
EBITDA margin	31.7%	34.7%	35.9%	36.6%	36.4%	36.4%
Adj. net profit margin	(2.2%)	8.7%	11.1%	12.2%	12.4%	12.5%
Return on equity (ROE)	(1.9%)	9.9%	14.1%	15.5%	16.0%	16.5%
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
<b>YE 31 Dec</b>						
Net debt to equity (x)	0.1	(0.1)	(0.2)	(0.2)	(0.2)	(0.3)
Current ratio (x)	1.3	1.5	1.6	1.8	1.9	2.1
Receivable turnover days	43.7	35.7	28.8	28.8	28.8	28.8
Inventory turnover days	100.4	71.9	66.1	66.1	66.1	66.1
Payable turnover days	43.6	42.3	34.9	34.9	34.9	34.9
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
<b>YE 31 Dec</b>						
P/E	na	47.5	29.2	30.2	27.2	24.4
P/E (diluted)	na	47.5	29.2	30.2	27.2	24.4
P/B	3.1	4.5	3.9	4.5	4.2	3.9
P/CFPS	14.6	12.2	12.1	13.5	12.4	11.2
Div yield (%)	1.0	1.3	2.1	2.0	2.2	2.5

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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## CMB International Global Markets Limited

**Address:** 45/F, Champion Tower, 3 Garden Road, Hong Kong. Tel: (852) 3900 0888 Fax: (852) 3900 0800

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