

Cie Financiere Richemont SA CFR (XSWX) | ★★★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
59.30 CHF	73.00 CHF	Medium	Wide	Stable	Standard	Retail - Apparel & Specialty

Despite Richemont's slower growth, cash flows are solid and brand desire hasn't changed.

Updated Forecasts and Estimates from 15 Sep 2016

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The primary analyst covering this company does not own its stock.

Research as of 01 Sep 2016
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Pricing data through 03 Oct 2016
Rating updated as of 03 Oct 2016

Currency amounts expressed with "\$" are in U.S. dollars (USD) unless otherwise denoted.

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Investment Thesis 01 Sep 2016

Richemont's brands, some of them hundreds of years old, have images of quality and high value that are deeply ingrained in consumers' minds. These brands, including Cartier, Van Cleef & Arpels, Piaget, Jaeger-LeCoultre, Baume & Mercier, and Montblanc, are the basis of the firm's wide economic moat. The brands charge premium prices for unique and high-quality products, resulting excellent gross margins—around 63% projected for the current fiscal year.

Our view that Richemont is a collection of competitively advantaged businesses is supported by operating margins in the high teens to 20% range and returns on capital that usually approach 20%. With such strong returns, Richemont's growing cash and investments totaled EUR 9.0 billion at fiscal year-end 2016. Cash returned is increasing, and acquisitions could be coming.

Although Richemont already has a global reach, we believe it can continue to expand in developing markets, despite concerns of uneven macroeconomic conditions in China. While an economic cooling in China is already happening as a result of Hong Kong, luxury sales are often planned purchases and we believe wealthy consumers span multiple segments. Luxury tourism is also driving sales around the globe, despite exchange rate volatility. Worries about Hong Kong and watch gift-giving should cycle, and interest in Swiss watches and Cartier jewels should remain high globally.

In the longer term, we see regions such as India and Latin America as opportunities. Historically, growth in economically developing markets has tended to favor the wealthy classes in the early stages of expansion. India, although a small market today, represents a large potential market, given the country's relatively high cultural affinity for gemstones. Despite their relative size and spending power compared with the population and wealth of mature markets, these new markets eventually will become important. Some estimates put the middle classes of China and India to be more than 600 million by roughly 2020 or 2025, depending on one's definition of middle class, and our own examination of available data on China supports these views.

Vital Statistics

Market Cap (CHF Mil)	33,481
52-Week High (CHF)	86.75
52-Week Low (CHF)	53.00
52-Week Total Return %	-18.3
YTD Total Return %	-15.4
Last Fiscal Year End	31 Mar 2016
5-Yr Forward Revenue CAGR %	4.3
5-Yr Forward EPS CAGR %	—
Price/Fair Value	0.81

Valuation Summary and Forecasts

	Fiscal Year:	2015	2016	2017(E)	2018(E)
Price/Earnings	—	—	20.2	17.4	
EV/EBITDA	12.0	10.7	9.9	8.6	
EV/EBIT	14.3	13.6	12.5	10.8	
Free Cash Flow Yield %	4.2	5.4	5.8	5.3	
Dividend Yield %	1.5	2.6	3.0	3.7	

Financial Summary and Forecasts (EUR Mil)

	Fiscal Year:	2015	2016	2017(E)	2018(E)
Revenue	10,410	11,076	10,776	11,464	
Revenue YoY %	-2.2	6.4	-2.7	6.4	
EBIT	2,670	2,061	2,037	2,350	
EBIT YoY %	10.4	-22.8	-1.2	15.4	
Net Income, Adjusted	1,334	2,227	1,674	1,936	
Net Income YoY %	-35.5	66.9	-24.9	15.7	
Diluted EPS	—	—	2.94	3.41	
Diluted EPS YoY %	—	—	—	16.0	
Free Cash Flow	1,493	1,721	1,805	1,691	
Free Cash Flow YoY %	-14.7	15.3	4.8	-6.3	

Historical/forecast data sources are Morningstar Estimates and may reflect adjustments.

Profile

Richemont is a conglomerate of luxury brands, including Cartier, Van Cleef & Arpels, Piaget, IWC, Jaeger-LeCoultre, Roger Dubuis, Baume & Mercier, and Montblanc. The company's products are sold through roughly 1,900 owned boutiques around the world, accounting for 55% of sales in the year ended March 2016, with about 30% of sales coming from Europe, 9% from the Middle East, 36% from Asia-Pacific (excluding Japan), 9% from Japan, and 16% from the Americas.

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Morningstar Analysis

Valuation, Growth and Profitability 01 Sep 2016

We are lowering our fair value estimate to CHF 73 per share from CHF 84 after taking a more conservative view of medium term profitability. Our valuation assumes a euro/Swiss franc exchange rate of 1.10, the spot rate on Sept. 1, and implies fiscal 2018 multiples of 22 times earnings, 12.7 times enterprise value/EBITDA, and a 3.9% free cash flow yield.

Our sales growth assumptions are largely unchanged. We assume a 3% revenue decline to EUR 10.8 billion in the year ending March 2017, largely due to weakness in Asia and lower growth in the Americas and Europe. Thereafter we expect growth to fluctuate mostly between 5% and 6%. We forecast Richemont's fiscal 2017 operating margin to remain between 18% and 19%, in line with last year. Our earnings per share forecast for the fiscal year remains EUR 2.96. We project capital expenditures of just over EUR 700 million this fiscal year, as the company has now completed several capacity-increase projects and store investments; now that it is comfortable with its store network, it will focus on updates and repositionings.

However, we have changed our opinion on medium- to long term profitability. We no longer expect normalized margins of above 24%, close to peak levels; we now forecast a 2021 margin of 21%. This is 50 basis points above the mean margin over the last 11 years, reflecting a small amount of gross margin expansion.

Scenario Analysis

In our upside scenario, global financial worries subside, while Asian demand, driven by China, continues with a rebound over several years and gains additional strength at the end of the period. Under these assumptions, Richemont will expand already high operating margins, averaging around 24% for the long run, driven by increasingly high gross margins of 65%-66%. Despite a lack of acquisitions, Richemont manages to increase sales, particularly in

developing markets, which remain robust even during a midcycle dip, offsetting still-sluggish sales in Japan and obtaining a long-run growth rate of around 6%-7%. In the later years of our explicit forecast period, this scenario would assume an increase in jewelry sales in emerging markets, which finish the forecast period at more than 50% of total sales. Under this scenario, our fair value estimate would be CHF 90.

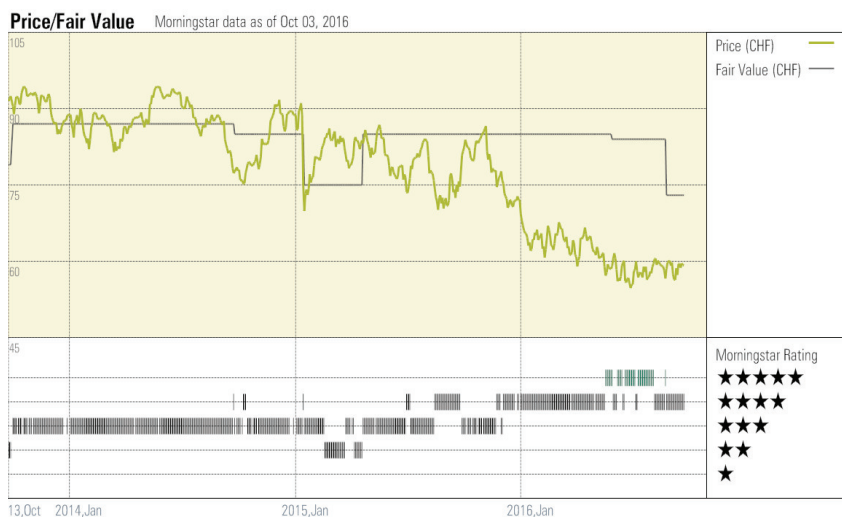
In our downside scenario, global demand slackens, the Swiss franc remains strong, and the firm cannot institute price increases despite being unable to reduce costs, pressuring margins. China's fixed-asset investment-driven economy weakens further, which is felt in the watchmaking business, causing the segment to have flat to negative growth periods intermittently and overall slower growth averaging just 2.6%, or below nominal inflation despite the many businesses with pricing power. Writing instruments are consistently negative, given the uptake of handheld computing. Sales to Asia are a drag on growth, pushing 10-year growth to 2% on average. Operating margins are lower than our base case and show greater volatility ranging from a low of 15% to a high of 17% and averaging 16%, compared with 20% on average in our base case. In this scenario, our fair value estimate would be CHF 56. We assign Richemont a medium uncertainty rating.

Economic Moat

We've assigned Richemont a wide economic moat, based on its high and stable returns on capital (high teens to approaching 20%, even accounting for leases and goodwill) and long-run viability of its brands (intangible assets), many of which are more than 100 years old. Richemont's premium luxury brands, such as Cartier, Van Cleef, and most of its specialist watchmakers, benefit from consumers' brand sensitivity and infrequency of purchase, which contribute to the premium in pricing and high margins. Consumers also have desire for certain brands that they see as valuable and may plan purchases as part of life events. In particular, we

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the way 100-year-old-plus luxury brands do. Ownership or long-term leases of central shopping district retail sites is also a source of advantage and stability.

judge the Cartier brand and most of its specialty watchmakers to be a drivers of our wide moat rating, as the images of these labels are so strong it would be hard to change their positions of luxury and value in consumers' minds, even if a brand were to fall out of fashion for a period.

Swiss watchmaking is also something that is very hard to copy. Even if artisans could be trained to make similar products, we believe a potential entrant's watches would not hold value like a fine Swiss timepiece and thus would not command the same premium pricing or commensurately high gross and operating margins.

Moat Trend

Richemont's moat trend is stable, in our opinion, as its sources of competitive advantage (intangible assets) have not changed over very long periods. We would become more negative on Richemont's overall competitive position and advantages if acquisitions outside the company's core luxury brand business were diluting returns on capital and overleveraged to short-term fashion businesses. Fashion-driven businesses have very high returns during the period when their styles are popular, but do not persist in their returns

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Bulls Say/Bears Say

Bulls Say

- ▶ Richemont owns some of the best-known and most valuable luxury brands in the world, including Cartier, Jaeger-LeCoultre, Montblanc, IWC, and Van Cleef & Arpels.
- ▶ Economic cycles are not new to this company; the majority of its brands have been in operation for a century or more. Its best brands have spanned many economic and fashion cycles.
- ▶ Richemont's cash pile can be invested or returned to shareholders. It could make a large acquisition if available at an attractive price, but the company's growth strategy doesn't depend on frequent mergers and acquisition.

Bears Say

- ▶ The shift away from luxury gifts and government officials using gifts for business purposes will have a lasting effect on long-term sales.
- ▶ Richemont has one of the highest levels of exposure to China through owned retail and wholesale accounts, including Hong Kong.
- ▶ Although the company hedges against foreign currency fluctuations and reports in euros, strength in the Swiss franc can pressure margins, and revenue in U.S. dollars, yen, or euros is also subject to swings.

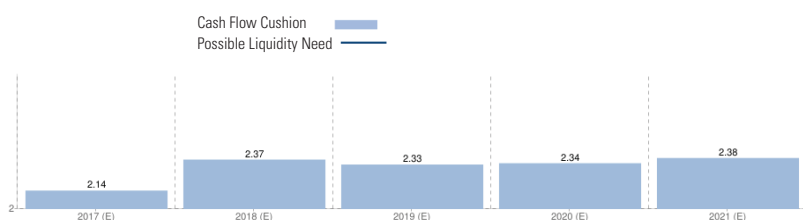
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Five Year Adjusted Cash Flow Forecast (EUR Mil)

	2017(E)	2018(E)	2019(E)	2020(E)	2021(E)
Cash and Equivalents (beginning of period)	4,569	5,731	6,106	6,236	6,433
Adjusted Available Cash Flow	2,320	2,168	1,943	2,148	2,393
Total Cash Available before Debt Service	6,889	7,899	8,049	8,384	8,826
Principal Payments	-2,203	-2,269	-2,337	-2,407	-2,479
Interest Payments	-200	-200	-200	-200	-200
Other Cash Obligations and Commitments	-820	-867	-916	-975	-1,030
Total Cash Obligations and Commitments	-3,223	-3,336	-3,453	-3,582	-3,709

Cumulative Annual Cash Flow Cushion



Adjusted Cash Flow Summary

	EUR Millions	% of Commitments
Beginning Cash Balance	4,569	26.4
Sum of 5-Year Adjusted Free Cash Flow	10,972	63.4
Sum of Cash and 5-Year Cash Generation	15,541	89.8
Revolver Availability	—	—
Asset Adjusted Borrowings (Repayment)	—	—
Sum of Cash, 5-Year Cash Generation, Revolver and Adjustments	15,541	89.8
Sum of 5-Year Cash Commitments	-17,304	—

Financial Health

Richemont is in sound financial health with a high level of cash and minimal long-term debt. The firm held EUR 4.5 billion in cash at the end of fiscal 2016, or EUR 8 per share. It held a net cash position, and debt/EBITDA was 0.95 times. We expect this to decline to 0.8 times over our five-year forecast period, with Richemont channeling a modest amount of its EUR 2 billion free cash flow generation to repaying debt as its opportunity set of high-return projects diminishes. As of fiscal year-end March 2016, Richemont had EUR 2.2 billion in short-term loans and funding and roughly EUR 380 million of long-term financial debt. Cash and financial assets on the balance sheet totaled more than EUR 9 billion, and inventory and receivables are also over EUR 6 billion (we believe inventory in the jewelry and watch businesses is of higher and more stable resale value). Rents, if capitalized at 8 times annual payments, would represent an additional obligation of EUR 6 billion. Given its cash flow and strong balance sheet, the firm has ample capacity to acquire luxury brands if attractive assets become available. Our forward-looking assumptions include an increasing dividend payout.

Enterprise Risk

A risk to Richemont's long-term value is that the company may search for growth by making expensive acquisitions at prices that imply aggressive future cash flow growth. Management has said it would be on guard to avoid making such an error, and as it has been through prior cycles, we regard the management team as prudent. We also believe that acquiring too many fashion brands could be hard to manage or make the company more dependent on fashion trends, and thus subject to more volatility from picking winners and losers. Management has said that its current strategy for lagging brands would be to invest in brand equity and increase the value of all owned labels. Historically, ready-to-wear and leather goods have proved less successful for Richemont than its watches or jewelry.

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segments. Global luxury goods consumption and growth is still very leveraged to China and other developing economies, and the Swiss watch business is overindexed to Hong Kong. Although growth in China continues to show question marks and risks, we do not believe that the desirability of Richemont's products will lessen, or that the total number of people purchasing luxury goods in emerging markets, including China, will not continue to climb. Another risk is overdistribution or a strategic shift to offer products at more affordable prices, which could affect the exclusivity of the companies' brands. Richemont and its brands have been in business for hundreds of years and in some cases are experts in expanding while protecting products' images of exclusivity, given the high prices some of its items command, but the risk of being too common will always exist. Production costs, which are often in Swiss francs or euros, do pose some risk, as does revenue that is affected by exchange rates. However, the company's pricing power in high-end jewelry and watches has historically allowed it to maintain a premium, even if costs of production are rising.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	Insider Activity
NA	NA	NA	NA	NA

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

Fund Ownership

Top Owners	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
Oakmark International Fund	1.49	2.14	-227	30 Jun 2016
Vanguard Total Intl Stock Idx Fund	1.00	0.15	27	31 Aug 2016
Artisan International Value Fund	0.67	1.99	1,303	30 Jun 2016
CSIF (CH) Swtzi Total Market Index Blue	0.63	2.41	-68	31 Aug 2016
Allianz Europe Equity Growth Fund	0.55	2.45	-76	31 Jul 2016

Concentrated Holders

NN (L) Prestige & Luxe	0.01	7.01	-1	30 Jun 2016
CAM South Africa Equity fund	—	6.12	—	07 Jul 2015
Schroder ISF Swiss Eq Opps	0.01	5.99	2	30 Jun 2016
iShares Swiss Dividend (CH)	0.03	5.94	—	29 Sep 2016
Lyxor ETF FTSE Developed Eurp Ex-UK (DR)	—	5.93	—	29 Feb 2016

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/Sold (k)	Portfolio Date
Artisan Partners Limited Partnership	0.67	1.99	1,303	30 Jun 2016
Massachusetts Financial Services Co	0.67	0.47	828	31 Aug 2016
Mackenzie Investments	0.69	1.24	613	31 Aug 2016
International Value Advisers, LLC	0.17	0.43	502	30 Jun 2016
Janus Capital Management LLC	0.16	0.85	462	30 Jun 2016

Top 5 Sellers

OFI Global Asset Management, Inc.	0.70	0.36	-2,014	31 Aug 2016
T. Rowe Price Associates, Inc.	—	0.23	-992	30 Jun 2016
BlackRock Investment Management (UK) Ltd.	0.32	0.76	-310	30 Jun 2016
Pictet Asset Management S.A.	0.23	1.01	-182	30 Jun 2016
Beutel, Goodman & Company Ltd.	0.08	0.79	-177	31 Aug 2016

Management

01 Sep 2016

Johann Rupert is chairman of Richemont, and his family group is the largest shareholder. Yves-Andre Istel is deputy chairman, and Richard Lepeu is CEO. Rupert has been involved at various levels in the day-to-day operations of the business since founding the company in 1988. He retains significant control of the firm as the sole general managing director of Compagnie Financiere Rupert, which has about a 9% equity stake in Richemont and controls 50% of the voting rights at shareholder meetings. The board of directors has 18 members, with each director serving a one-year term. Although seven nationalities and a wide range of professional backgrounds are represented on the board, a number of related-party transactions involve members, but 15 of the 18 are nonexecutive members. As a former banker, Rupert understands return on investment, and even if he is conservative in his deployment of capital, the team has done a fine job of investing the firm's cash flow. Overall, we rate corporate stewardship as Standard, but with high returns and careful management, the firm is certainly at the top of the Standard class. At some point, however, the conservative hoarding of cash could be seen as a negative. With such a large ownership stake in a company composed of many brands with histories of 100 years or more, Rupert and the board have a large incentive to preserve the equity built in all of its brands and to steadily increase dividends, in our opinion.

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Analyst Notes

Brexit Does Not Change Our Long-Term View on Luxury Goods Firms; Worries Over Security Short Term 29 Jun 2016

Britain's decision to leave the European Union triggered significant declines in most of our luxury coverage, but the short-term movements and worries do little to change our long-term view of these wide-moat stocks, and our fair value estimates are unchanged. We still see Swatch Group and Richemont as the most undervalued, and Burberry, Prada, LVMH, and Kering are all rated 4 stars.

We believe Brexit's near- and long-term implications, whatever timeline and ultimate rules are implemented, should have a minimal net impact on long-run luxury demand. While uncertainty in Britain may cause some local consumers to delay purchases, the weak local currencies have in the past proved positives for luxury goods companies that have significant local costs. Increased purchases by foreign tourists should also more than offset drops in local British demand, in our view.

Burberry is the one luxury name we cover that is headquartered in London and reports in pounds. We think the impact on its fair value is neutral, since costs and overhead in pounds are offset by sourcing in euro and revenue and store operations that are global. Operating expenses are roughly two thirds in pounds and 10% in euro, and the rest of its global operations more closely follow the dollar. Cost of goods is largely in euro because of leather, while high-end outerwear is still produced in pounds. Finally, on the revenue side, more than 50% of revenue is dollar-related, and thus magnified if sterling is weak relative to the dollar. Finally, Burberry has net monetary assets (in pounds sterling as of March 31, 2016) of \$30 million and EUR 8 million, and net monetary liabilities of CNY 47 million.

French luxury companies LVMH and Kering are global and have large businesses in the Americas and China, and likely

receive less than 5% of global revenue from the U.K. Of greater concern is the tourist season in France and the Continent, which is at risk, given reports of cancellations due to security concerns.

As for the two Swiss watchmakers we cover, Swatch and Richemont, Brexit's implementation will probably take a very long time, and although both companies have a greater exposure to revenue in U.S. dollars (nearly two thirds for Swatch), we think the risks are already largely priced in.

For several years now, Swiss watch companies have been dealing with destocking in Hong Kong and Macau, as well as exchange-rate volatility, and now dealers will eventually have to restock and prices have gradually been rebalanced globally. The 2015 surge of roughly 20% in the Swiss franc, subsequent rise and fall of the dollar in Swiss franc terms, and overall weaker euro and yen have caused both companies to examine costs and raise prices in weaker currency areas.

Now Europe, which was a bright spot in 2015, appears to still be suffering from a decline in tourism after terrorism attacks in Paris and Brussels, and the recent attack in Turkey likely contributes to fears. However, the euro has net appreciated year over year compared with the franc. Japan, which had seen growth while the yen was weak, could also see a stall as the yen has recently reappreciated with the global derisking around Brexit. Local buyers might see their yen go further, but Japanese company revenue and profits and tourists' and consumers' sentiments in Japan could reverse course in the second half of 2016. China, which represents revenue in the high-30% range for Swatch and Richemont, is again giving mixed signals, as sales in local company-owned stores appear solid, while wholesale-dominated areas such as Hong Kong and Macau have remained negative for more than two years.

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Analyst Notes

Overall, export numbers for Swiss watches continue to surprise to the downside: down 9.7% in May and down 9.5% year to date. Yet we believe midprice products in watches, and jewelry as a category, continue to be increasing sales in many regions, including company-owned stores in mainland China. If headwinds persist for the full year in watch exports, we do see some risk to our fair value estimates. Under a scenario where watch exports are down 9%, and Swatch revenue is down 6% this year and down 1% next year, we would see a 5% reduction in fair value if we assume half of the demand is eventually recaptured and a 10% drop if we assume the demand is lost forever. We also remind investors that Richemont reports in euro but trades in Swiss francs, while Swatch both reports and trades in Swiss francs. Including the cost of Cartier in euro, we would assume a greater impact on Richemont if the euro to franc moves negative, but less of a decline in fair value than Swatch if current exchange rates hold.

Judging the impact of Brexit in isolation, both companies likely have just over 5% of global sales in the U.K., based on Swiss watch export figures. We expect unit sales to rise with the weak pound, but it is difficult to state the net negative effect of the pound's depreciation. Local citizens without euro or dollar investments might feel less inclined to purchase because of negative sentiment about the future rather than an immediate wealth effect, but this may be washed over by global tourists rushing in to buy before prices are rebalanced.

Although the Swiss franc priced in pounds jumped roughly 20% on the Brexit vote, from the beginning of the year the pound has only weakened roughly 11% versus the franc, and it appreciated slightly in May. Thus, the sudden recent move in June is less impactful when considered in a relative context of what goods might have been booked at over the first half. Now, over the second half of the year, the value of the franc must be considered compared with 2015, and

thus far the pound has come back to levels that would put it nearly neutral to the franc year over year. Still, assuming 6% of total sales to the U.K. and a 15% decline in sterling relative to the franc year over year is only a 1% decline in revenue, or 0.5% given that we are halfway through the year. Compared with the weighting of the dollar in revenue and a range of \$0.98-\$1.04 per CHF 1, or \$1.05 for the first half of 2016, the dollar has seen a 0.5% appreciation versus the franc in the first half on over 60% of revenue. The euro has appreciated roughly 3% in francs, affecting nearly 20% of revenue. Thus, with multiple moving currencies, the year-over-year comparisons of the dollar and the euro should be more important than even a worsening of the current situation of a weak pound.

Obviously, these scenarios and discussions of currency comparisons do not contemplate some sort of global financial crisis triggered by the Brexit vote. Yet with the two-year clock to make the separation happen not even ticking, we suspect that luxury companies' operating results will be minimally affected by Brexit, and worries in the stock prices could prove overdone.

Despite Near-Term Headwinds, Richemont's Cash Flow and Brand Strengths Are Solid; Shares Undervalued 20 May 2016

Although we will wait for the annual report before updating our model, we don't see a major reduction to our CHF 85 fair value estimate, and our wide moat rating is also unchanged following Richemont's full-year March 2016 results presentation.

Despite worsening sales trends (up 6% reported to EU 11 billion, but down 1% organic and sequentially worse) and some cost deleveraging, cash flow from operations was actually above last year at EUR 2.42 billion versus a prior-year EUR 2.39 billion. Other items impacting valuation positively include lower cash taxes paid (taxes were level on a reported basis at EUR 370 million), and the expectation

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Analyst Notes

of higher gross margins in the 65% range next year. With a period of investment now past its peak, depreciation was below our model but should continue to grow while capital expenditures of a projected of EUR 715 million in 2017 compares favorably with our prior model of EUR 780 million, which we will adjust accordingly. Working capital, still a EUR 170 million use of cash, was EUR 400 million favorable, and should not be a headwind as fewer stores are opened. Contributing to the more than EUR 5.3 billion cash pile were lower cash financial expenses that were EUR 500 million favorable.

Although the company does not give sales guidance, sales through April were noted to be down 15%. Changes in buying patterns for tourists are significant, with Mainland China up 26% and a shift to Japan and Korea also taking place. But the negative trends in Hong Kong and Macau (which used to be around 30% of total sales), combined with weakness in Europe after terrorist attacks, has created a headwind that is hard to offset. Swiss watch exports to Hong Kong were down 30% in March, and management expects the decline could persist for a few more months. The U.S. was also noted to be weak, particularly in watches, with management offering only the explanation of election year hold back and the strong dollar impacting tourist spending.

Looking longer term, we don't think the brands, rich in history, have lost their luster and also note that the watch business has been more impacted than the jewelry segment. Jewelry generates a disproportionate amount of profit, although its sales are EUR 3.9 billion and watch makers are EUR 5.1 billion. For the year completed in March, Jewelry Maison sales were up 17% reported, or 8% in same currency and watches were down 1% reported, but down 8% in same currency. Cartier, which dominates the Jewelry Maisons segment, sells through its own stores, and also includes Cartier watches which were still up despite the difficult

sales year.

We also comment that although the Other segment is still generating a modest operating loss, the current headwinds in part are due to lower sales in Paris and tourist centers impacted by terrorist attacks and now a visa backlog for Chinese visitors. Mont Blanc, which had been declining, is now growing again, and we comment that 100-year-old luxury brands are hard to damage in the long run. A more recent acquisition, Peter Millar, is reported to be performing well despite exposure to the United States and the weak department store channel. We also add that the now remaining 49% stake in Yoox Net-a-Porter is still an asset, and the firm will maintain the position that we see as valuable in the long run, even if not reported as part of the segment.

Taken together, although the near term could get worse before it gets better, and with worries over summer tourist traffic being down just when they are needed to offset issues in Hong Kong and Macau, it might seem an inopportune time to invest in Richemont. But with more than EUR 5 billion in cash and the potential for high cash generation even during periods of weak results, we believe investors should be attracted to this house of incredible brands when risks seem high.

Cie Financiere Richemont SA CFR (XSWX) | ★★★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
59.30 CHF	73.00 CHF	Medium	Wide	Stable	Standard	Retail - Apparel & Specialty

Morningstar Analyst Forecasts

Financial Summary and Forecasts

Fiscal Year Ends in March

	3-Year Hist. CAGR	Forecast						5-Year Proj. CAGR
		2014	2015	2016	2017	2018		
Growth (% YoY)								
Revenue	3.0	4.9	-2.2	6.4	-2.7	6.4	4.3	
EBIT	-5.3	-0.3	10.4	-22.8	-1.2	15.4	6.8	
EBITDA	-2.4	1.5	11.3	-17.7	-1.8	15.5	6.6	
Net Income	3.6	3.1	-35.5	66.9	-24.9	15.7	1.4	
Diluted EPS	3.2	—	—	—	—	16.0	1.4	
Earnings Before Interest, after Tax	0.6	-1.1	-9.6	14.0	-21.0	8.3	0.7	
Free Cash Flow	57.6	298.1	-14.7	15.3	4.8	-6.3	3.1	
Profitability	3-Year Hist. Avg	2014	2015	2016	2017	2018	5-Year Proj. Avg	
Operating Margin %	22.3	22.7	25.7	18.6	18.9	20.5	20.2	
EBITDA Margin %	26.9	26.8	30.5	23.6	23.8	25.8	25.5	
Net Margin %	17.4	19.4	12.8	20.1	15.5	16.9	16.7	
Free Cash Flow Margin %	15.4	16.4	14.3	15.5	16.8	14.8	14.5	
ROIC %	16.9	18.1	18.6	14.1	13.8	14.9	14.8	
Adjusted ROIC %	17.5	18.9	19.2	14.4	14.1	15.2	15.1	
Return on Assets %	10.6	13.6	7.3	11.0	8.1	9.0	9.1	
Return on Equity %	14.6	18.6	10.1	15.1	10.8	11.9	11.9	
Leverage	3-Year Hist. Avg	2014	2015	2016	2017	2018	5-Year Proj. Avg	
Debt/Capital	0.14	0.12	0.18	0.14	0.14	0.14	0.14	
Total Debt/EBITDA	0.82	0.55	0.98	0.95	1.01	0.89	0.88	
EBITDA/Interest Expense	11.58	15.75	3.26	15.73	12.83	14.81	15.59	

Valuation Summary and Forecasts

	2015	2016	2017(E)	2018(E)
Price/Fair Value	1.04	0.75	—	—
Price/Earnings	—	—	20.2	17.4
EV/EBITDA	12.0	10.7	9.9	8.6
EV/EBIT	14.3	13.6	12.5	10.8
Free Cash Flow Yield %	4.2	5.4	5.8	5.3
Dividend Yield %	1.5	2.6	3.0	3.7

Key Valuation Drivers

Cost of Equity %	9.0
Pre-Tax Cost of Debt %	5.3
Weighted Average Cost of Capital %	8.7
Long-Run Tax Rate %	17.0
Stage II EBI Growth Rate %	4.0
Stage II Investment Rate %	13.3
Perpetuity Year	20

Additional estimates and scenarios available for download at <http://select.morningstar.com>.

Discounted Cash Flow Valuation

	EUR Mil	Firm Value (%)	Per Share Value
Present Value Stage I	6,864	22.5	12.12
Present Value Stage II	14,212	46.7	25.09
Present Value Stage III	9,372	30.8	16.55
Total Firm Value	30,448	100.0	53.76
Cash and Equivalents	9,099	—	16.07
Debt	-2,477	—	-4.37
Preferred Stock	—	—	—
Other Adjustments	3	—	0.00
Equity Value	37,072	—	65.46
Projected Diluted Shares	566		
Fair Value per Share (CHF)	—		

The data in the table above represent base-case forecasts in the company's reporting currency as of the beginning of the current year. Our fair value estimate may differ from the equity value per share shown above due to our time value of money adjustment and in cases where probability-weighted scenario analysis is performed.

Cie Financiere Richemont SA CFR (XSWX) | ★★★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
59.30 CHF	73.00 CHF	Medium	Wide	Stable	Standard	Retail - Apparel & Specialty

Morningstar Analyst Forecasts

Income Statement (EUR Mil)

Fiscal Year Ends in March

	2014	2015	2016	Forecast	
				2017	2018
Revenue	10,649	10,410	11,076	10,776	11,464
Cost of Goods Sold	3,898	3,534	3,958	3,890	4,070
Gross Profit	6,751	6,876	7,118	6,886	7,394
Selling, General & Administrative Expenses	4,310	4,438	5,035	4,849	5,044
Other Operating Expense (Income)	22	-234	—	—	—
Other Operating Expense (Income)	—	2	22	—	—
Depreciation & Amortization (if reported separately)	—	—	—	—	—
Operating Income (ex charges)	2,419	2,670	2,061	2,037	2,350
Restructuring & Other Cash Charges	—	—	—	—	—
Impairment Charges (if reported separately)	—	—	—	—	—
Other Non-Cash (Income)/Charges	—	—	—	—	—
Operating Income (incl charges)	2,419	2,670	2,061	2,037	2,350
Interest Expense	181	972	166	200	200
Interest Income	245	7	163	175	182
Pre-Tax Income	2,483	1,705	2,058	2,011	2,332
Income Tax Expense	411	369	370	341	396
Other After-Tax Cash Gains (Losses)	—	-2	539	—	—
Other After-Tax Non-Cash Gains (Losses)	—	—	—	—	—
(Minority Interest)	-5	—	—	3	—
(Preferred Dividends)	—	—	—	—	—
Net Income	2,067	1,334	2,227	1,674	1,936
Weighted Average Diluted Shares Outstanding	564	566	566	566	566
Diluted Earnings Per Share	3.67	2.36	3.93	2.96	3.42
Adjusted Net Income	2,067	1,334	2,227	1,674	1,936
Diluted Earnings Per Share (Adjusted)	3.67	2.36	3.93	2.96	3.42
Dividends Per Common Share	—	—	—	—	—
EBITDA	2,850	3,172	2,612	2,565	2,962
Adjusted EBITDA	2,850	3,172	2,612	2,565	2,962

Cie Financiere Richemont SA CFR (XSWX) | ★★★★★

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59.30 CHF	73.00 CHF	Medium	Wide	Stable	Standard	Retail - Apparel & Specialty

Morningstar Analyst Forecasts

Balance Sheet (EUR Mil)

Fiscal Year Ends in March

	2014	2015	2016	Forecast	
				2017	2018
Cash and Equivalents	3,389	5,654	4,569	5,731	6,106
Investments	2,839	3,584	4,530	4,362	4,597
Accounts Receivable	933	1,071	1,021	886	942
Inventory	4,455	5,438	5,345	5,169	5,296
Deferred Tax Assets (Current)	—	—	—	—	—
Other Short Term Assets	210	181	176	171	182
Current Assets	11,826	15,928	15,641	16,319	17,124
Net Property Plant, and Equipment	2,311	2,446	2,476	2,747	2,825
Goodwill	562	320	291	291	291
Other Intangibles	403	461	421	336	296
Deferred Tax Assets (Long-Term)	479	701	700	702	768
Other Long-Term Operating Assets	315	468	589	579	616
Long-Term Non-Operating Assets	22	126	7	7	7
Total Assets	15,918	20,450	20,125	20,982	21,927
Accounts Payable	1,325	1,514	1,526	1,500	1,569
Short-Term Debt	1,251	2,688	2,098	2,203	2,269
Deferred Tax Liabilities (Current)	364	236	268	268	268
Other Short-Term Liabilities	173	650	304	304	304
Current Liabilities	3,113	5,088	4,196	4,275	4,410
Long-Term Debt	318	405	379	379	379
Deferred Tax Liabilities (Long-Term)	60	71	10	10	10
Other Long-Term Operating Liabilities	191	96	79	78	83
Long-Term Non-Operating Liabilities	278	370	414	414	414
Total Liabilities	3,960	6,030	5,078	5,155	5,296
Preferred Stock	—	—	—	—	—
Common Stock	334	334	334	334	334
Additional Paid-in Capital	—	—	—	3	3
Retained Earnings (Deficit)	10,309	10,854	12,111	12,879	13,683
(Treasury Stock)	-326	-364	-412	-412	-412
Other Equity	1,647	3,597	3,014	3,014	3,014
Shareholder's Equity	11,964	14,421	15,047	15,817	16,621
Minority Interest	-6	-1	—	9	9
Total Equity	11,958	14,420	15,047	15,826	16,630

Cie Financiere Richemont SA CFR (XSWX) | ★★★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
59.30 CHF	73.00 CHF	Medium	Wide	Stable	Standard	Retail - Apparel & Specialty

Morningstar Analyst Forecasts

Cash Flow (EUR Mil)

Fiscal Year Ends in March

	2014	2015	2016	Forecast	
				2017	2018
Net Income	2,419	2,670	2,061	1,670	1,936
Depreciation	341	396	456	444	572
Amortization	90	106	95	85	40
Stock-Based Compensation	—	—	—	—	—
Impairment of Goodwill	—	—	—	—	—
Impairment of Other Intangibles	—	—	—	—	—
Deferred Taxes	—	—	—	-2	-66
Other Non-Cash Adjustments	81	-222	-74	—	—
(Increase) Decrease in Accounts Receivable	-53	8	-2	135	-57
(Increase) Decrease in Inventory	-144	-506	-139	176	-127
Change in Other Short-Term Assets	5	-81	-81	5	-11
Increase (Decrease) in Accounts Payable	—	—	—	-26	69
Change in Other Short-Term Liabilities	136	16	103	—	—
Cash From Operations	2,875	2,387	2,419	2,487	2,357
(Capital Expenditures)	-577	-601	-630	-715	-650
Net (Acquisitions), Asset Sales, and Disposals	-43	-31	-131	—	—
Net Sales (Purchases) of Investments	-127	-29	-421	168	-235
Other Investing Cash Flows	-99	318	-105	9	-31
Cash From Investing	-846	-343	-1,287	-538	-916
Common Stock Issuance (or Repurchase)	91	-65	-94	3	0
Common Stock (Dividends)	-452	-650	-854	-906	-1,132
Short-Term Debt Issuance (or Retirement)	-121	-85	-205	105	66
Long-Term Debt Issuance (or Retirement)	58	160	105	—	—
Other Financing Cash Flows	-2	-2	-153	12	—
Cash From Financing	-426	-642	-1,201	-786	-1,066
Exchange Rates, Discontinued Ops, etc. (net)	2	219	-80	—	—
Net Change in Cash	1,605	1,621	-149	1,162	375

Cie Financiere Richemont SA CFR (XSWX) | ★★★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
59.30 CHF	73.00 CHF	Medium	Wide	Stable	Standard	Retail - Apparel & Specialty

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Valuation Analysis

Company/Ticker	Price/Fair Value	Price/Earnings			EV/EBITDA			Price/Free Cash Flow			Price/Book			Price/Sales		
		2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)
LVMH Moet Hennessy Louis Vuitton SE	0.95	18.9	17.4	15.9	9.2	8.9	8.3	17.8	17.2	15.1	2.8	2.6	2.4	2.1	2.0	1.8
The Swatch Group AG UHR CHE	—	591.3	348.7	201.5	13.2	9.9	6.4	119.9	8.9	12.5	1.4	1.4	1.3	1.9	2.0	1.8
Tiffany & Co TIF USA	0.85	—	19.9	17.9	8.9	10.0	9.2	14.4	16.1	28.0	2.8	2.9	2.7	2.0	2.2	2.1
Average		305.1	128.7	78.4	10.4	9.6	8.0	50.7	14.1	18.5	2.3	2.3	2.1	2.0	2.1	1.9
Cie Financiere Richemont SA CFR	0.81	—	20.2	17.4	10.7	9.9	8.6	18.4	17.3	18.0	2.2	1.9	1.8	3.0	2.9	2.7

Returns Analysis

Company/Ticker	Last Historical Year Total Assets (Mil)	ROIC %			Adjusted ROIC %			Return on Equity %			Return on Assets %			Dividend Yield %		
		2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)
LVMH Moet Hennessy Louis Vuitton SE	— EUR	10.4	10.6	11.3	12.6	12.8	13.6	16.6	15.4	15.5	7.5	7.6	7.8	2.4	2.8	3.2
The Swatch Group AG UHR CHE	— CHF	5.0	7.0	11.2	5.0	7.0	11.2	2.5	4.3	7.3	2.1	3.5	6.0	2.7	3.0	3.3
Tiffany & Co TIF USA	5,130 USD	11.3	11.6	12.0	11.3	11.6	12.0	16.2	15.2	15.7	9.0	8.8	9.5	2.5	2.2	2.5
Average		8.9	9.7	11.5	9.6	10.5	12.3	11.8	11.6	12.8	6.2	6.6	7.8	2.5	2.7	3.0
Cie Financiere Richemont SA CFR	20,125 EUR	14.1	13.8	14.9	14.4	14.1	15.2	15.1	10.8	11.9	11.0	8.1	9.0	2.6	3.0	3.7

Growth Analysis

Company/Ticker	Last Historical Year Revenue (Mil)	Revenue Growth %			EBIT Growth %			EPS Growth %			Free Cash Flow Growth %			Dividend/Share Growth %		
		2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)
LVMH Moet Hennessy Louis Vuitton SE	37,075 EUR	4.0	5.2	6.9	9.2	3.0	8.2	13.6	8.5	9.6	41.9	3.7	20.0	—	—	—
The Swatch Group AG UHR CHE	7,775 CHF	-8.0	-2.0	8.0	-52.9	50.3	72.8	-56.0	70.2	72.9	-84.4	NM	-30.1	—	9.9	10.0
Tiffany & Co TIF USA	4,105 USD	-3.4	-1.3	5.5	-15.1	-4.4	9.6	—	—	11.2	44.7	0.3	-39.8	—	—	—
Average		-2.5	0.6	6.8	-19.6	16.3	30.2	-21.2	39.4	31.2	0.7	2.0	-16.6	—	9.9	10.0
Cie Financiere Richemont SA CFR	11,076 EUR	6.4	-2.7	6.4	-22.8	-1.2	15.4	—	—	16.0	15.3	4.8	-6.3	—	—	—

Cie Financiere Richemont SA CFR (XSWX) | ★★★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
59.30 CHF	73.00 CHF	Medium	Wide	Stable	Standard	Retail - Apparel & Specialty

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Profitability Analysis

Company/Ticker	Last Historical Year Net Income (Mil)	Gross Margin %			EBITDA Margin %			Operating Margin %			Net Margin %			Free Cash Flow Margin %		
		2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)
LVMH Moet Hennessy Louis Vuitton SE	4,303 EUR	65.2	64.7	64.8	24.0	23.7	23.9	18.8	18.4	18.6	11.6	11.3	11.6	11.6	11.4	12.2
The Swatch Group AG UHR CHE	277 CHF	69.0	71.0	72.2	13.7	18.7	26.7	8.8	13.5	21.6	3.6	6.2	9.9	1.6	22.4	14.7
Tiffany & Co TIF USA	464 USD	60.7	61.7	61.9	23.2	23.3	24.1	18.5	17.9	18.6	11.3	11.4	11.9	13.7	13.9	7.6
Average		65.0	65.8	66.3	20.3	21.9	24.9	15.4	16.6	19.6	8.8	9.6	11.1	9.0	15.9	11.5
Cie Financiere Richemont SA CFR	2,227 EUR	64.3	63.9	64.5	23.6	23.8	25.8	18.6	18.9	20.5	20.1	15.5	16.9	16.2	16.4	14.9

Leverage Analysis

Company/Ticker	Last Historical Year Total Debt (Mil)	Debt/Equity %			Debt/Total Cap %			EBITDA/Interest Exp.			Total Debt/EBITDA			Assets/Equity		
		2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)
LVMH Moet Hennessy Louis Vuitton SE	4,082 EUR	14.9	12.3	13.3	13.0	10.9	11.7	67.0	69.3	74.8	0.5	0.4	0.4	2.1	2.0	2.0
The Swatch Group AG UHR CHE	100 CHF	0.9	1.6	1.6	0.9	1.6	1.5	1,068.3	863.7	1,045.7	0.1	0.1	0.1	1.2	1.2	1.2
Tiffany & Co TIF USA	1,104 USD	37.9	32.9	26.7	27.5	24.7	21.1	19.5	17.9	29.5	1.2	1.1	0.9	1.8	1.7	1.6
Average		17.9	15.6	13.9	13.8	12.4	11.4	384.9	317.0	383.3	0.6	0.5	0.5	1.7	1.6	1.6
Cie Financiere Richemont SA CFR	2,477 EUR	16.5	16.3	15.9	14.1	14.0	13.7	15.7	12.8	14.8	0.9	1.0	0.9	1.3	1.3	1.3

Liquidity Analysis

Company/Ticker	Market Cap (Mil)	Cash per Share			Current Ratio			Quick Ratio			Cash/Short-Term Debt			Payout Ratio %		
		2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)	2016	2017(E)	2018(E)
LVMH Moet Hennessy Louis Vuitton SE	76,502 EUR	4.51	7.85	15.34	1.83	2.06	2.27	0.77	0.95	1.20	2.39	6.10	5.85	42.5	47.7	50.1
The Swatch Group AG UHR CHE	15,137 CHF	26.38	57.84	60.56	6.58	6.61	6.67	1.82	2.50	2.57	16.01	23.39	24.49	146.9	94.9	60.4
Tiffany & Co TIF USA	9,071 USD	6.49	8.53	8.04	4.81	5.92	6.41	1.76	2.47	2.59	2.76	7.16	10.09	43.9	43.9	44.2
Average		12.46	24.74	27.98	4.41	4.86	5.12	1.45	1.97	2.12	7.05	12.22	13.48	77.8	62.2	51.6
Cie Financiere Richemont SA CFR	33,481 CHF	8.07	10.12	10.79	3.73	3.82	3.88	2.45	2.61	2.68	2.18	2.60	2.69	38.4	54.1	58.5

Overview

At the heart of our valuation system is a detailed projection of a company’s future cash flows, resulting from our analysts’ research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, in-depth competitive advantage analysis, and a variety of other analytical tools to augment this process. Moreover, we think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (e.g., mines), or companies expected to generate negative earnings over the next few years. That said, we don’t dismiss multiples altogether but rather use them as supporting cross-checks for our DCF-based fair value estimates. We also acknowledge that DCF models offer their own challenges (including a potential proliferation of estimated inputs and the possibility that the method may miss short-term market-price movements), but we believe these negatives are mitigated by deep analysis and our long-term approach.

Morningstar, Inc. and its affiliates (“Morningstar”, “we”, “our”) believes that a company’s intrinsic worth results from the future cash flows it can generate. The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk-adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth.

Four key components drive the Morningstar rating: (1) our assessment of the firm’s economic moat, (2) our estimate of the stock’s fair value, (3) our uncertainty around that fair value estimate

and (4) the current market price. This process ultimately culminates in our single-point star rating.

1. Economic Moat

The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm’s long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm’s cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality, no-moat companies will see their normalized returns gravitate toward the firm’s cost of capital more quickly than companies with moats.

To assess the sustainability of excess profits, analysts perform ongoing assessments of the moat trend. A firm’s moat trend is positive in cases where we think its sources of competitive advantage are growing stronger; stable where we don’t anticipate changes to competitive advantages over the next several years; or negative when we see signs of deterioration.

2. Estimated Fair Value

Combining our analysts’ financial forecasts with the firm’s economic moat helps us assess how long returns on invested capital are likely to exceed the firm’s cost of

capital. Returns of firms with a wide economic moat rating are assumed to fade to the perpetuity period over a longer period of time than the returns of narrow-moat firms, and both will fade slower than no-moat firms, increasing our estimate of their intrinsic value.

Our model is divided into three distinct stages:

Stage I: Explicit Forecast

In this stage, which can last five to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in working-capital accounts, and capital spending. Based on these projections, we calculate earnings before interest, after taxes (EBI) and the net new investment (NNI) to derive our annual free cash flow forecast.

Stage II: Fade

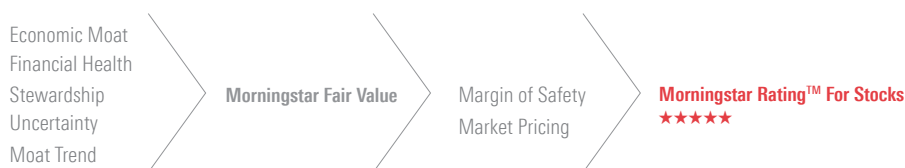
The second stage of our model is the period it will take the company’s return on new invested capital—the return on capital of the next dollar invested (“RONIC”)—to decline (or rise) to its cost of capital. During the Stage II period, we use a formula to approximate cash flows in lieu of explicitly modeling the income statement, balance sheet, and cash flow statement as we do in Stage I. The length of the second stage depends on the strength of the company’s economic moat. We forecast this period to last anywhere from one year (for companies with no economic moat) to 10–15 years or more (for wide-moat companies). During this period, cash flows are forecast using four assumptions: an average growth rate for EBI over the period, a normalized investment rate, average return on new invested capital (RONIC), and the number of years until perpetuity, when excess returns cease. The investment rate and return on new invested capital decline until a perpetuity value is calculated. In the case of firms that do not earn their cost of capital, we assume marginal ROICs rise to the firm’s cost of capital (usually attributable to less reinvestment), and we may truncate the second stage.

Stage III: Perpetuity

Once a company’s marginal ROIC hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys value and that any new investment provides a return in line with estimated WACC.

Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total pres-

Morningstar Research Methodology for Valuing Companies



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ent value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return to all capital providers—we discount future cash flows using the WACC, which is a weighted average of the costs of equity, debt, and preferred stock (and any other funding sources), using expected future proportionate long-term, market-value weights.

3. Uncertainty around that fair value estimate

Morningstar’s Uncertainty Rating captures a range of likely potential intrinsic values for a company and uses it to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating represents the analysts’ ability to bound the estimated value of the shares in a company around the Fair Value Estimate, based on the characteristics of the business underlying the stock, including operating and financial leverage, sales sensitivity to the overall economy, product concentration, pricing power, and other company-specific factors.

Analysts consider at least two scenarios in addition to their base case: a bull case and a bear case. Assumptions are chosen such that the analyst believes there is a 25% probability that the company will perform better than the bull case, and a 25% probability that the company will perform worse than the bear case. The distance between the bull and bear cases is an important indicator of the uncertainty underlying the fair value estimate.

Our recommended margin of safety widens as our uncertainty of the estimated value of the equity increases. The more uncertain we are about the estimated value of the equity, the greater the discount we require relative to our estimate of the value of the firm before we would recommend the purchase of the shares. In addition, the uncertainty rating provides guidance in portfolio construction based on risk tolerance.

Our uncertainty ratings for our qualitative analysis are low, medium, high, very high, and extreme.

► **Low:** margin of safety for 5-star rating is a 20% discount and for 1-star rating is 25% premium.

- **Medium:** margin of safety for 5-star rating is a 30% discount and for 1-star rating is 35% premium.
- **High:** margin of safety for 5-star rating is a 40% discount and for 1-star rating is 55% premium.
- **Very High:** margin of safety for 5-star rating is a 50% discount and for 1-star rating is 75% premium.
- **Extreme:** Stock’s uncertainty exceeds the parameters we have set for assigning the appropriate margin of safety.

4. Market Price

The market prices used in this analysis and noted in the report come from exchange on which the stock is listed which we believe is a reliable source.

For more detail information about our methodology, please go to <http://global.morningstar.com/equitydisclosures>

Morningstar Star Rating for Stocks

Once we determine the fair value estimate of a stock, we compare it with the stock’s current market price on a daily basis, and the star rating is automatically re-calculated at the market close on every day the market on which the stock is listed is open. Our analysts keep close tabs on the companies they follow, and, based on thorough and ongoing analysis, raise or lower their fair value estimates as warranted.

Please note, there is no predefined distribution of stars. That is, the percentage of stocks that earn 5 stars can fluctuate daily, so the star ratings, in the aggregate, can serve as a gauge of the broader market’s valuation. When there are many 5-star stocks, the stock market as

a whole is more undervalued, in our opinion, than when very few companies garner our highest rating.

We expect that if our base-case assumptions are true the market price will converge on our fair value estimate over time, generally within three years (although it is impossible to predict the exact time frame in which market prices may adjust).

Our star ratings are guideposts to a broad audience and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

The Morningstar Star Ratings for stocks are defined below:

Five Stars ★★★★★

We believe appreciation beyond a fair risk-adjusted return is highly likely over a multiyear time frame. Scenario analysis developed by our analysts indicates that the current market price represents an excessively pessimistic outlook, limiting downside risk and maximizing upside potential.

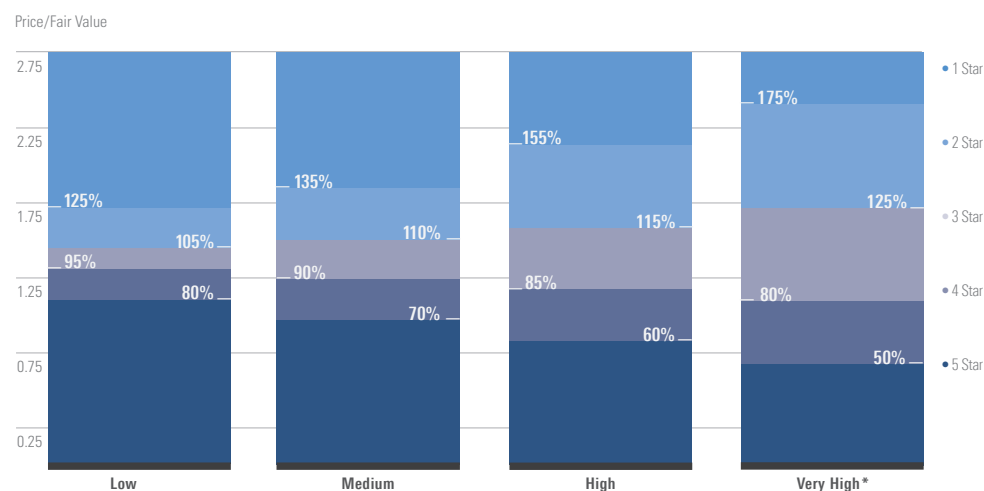
Four Stars ★★★★

We believe appreciation beyond a fair risk-adjusted return is likely.

Three Stars ★★★

Indicates our belief that investors are likely to receive a fair risk-adjusted return (approximately cost of equity).

Morningstar Research Methodology for Valuing Companies



* Occasionally a stock’s uncertainty will be too high for us to estimate, in which case we label it Extreme.

Research Methodology for Valuing Companies



Two Stars ★★

We believe investors are likely to receive a less than fair risk-adjusted return.

One Star ★

Indicates a high probability of undesirable risk-adjusted returns from the current market price over a multiyear time frame, based on our analysis. Scenario analysis by our analysts indicates that the market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to Capital loss.

Other Definitions:

Last Price: Price of the stock as of the close of the market of the last trading day before date of the report.

Stewardship Rating: Represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

Quantitative Valuation: Using the below terms, intended to denote the relationship between the security's Last Price and Morningstar's quantitative fair value estimate for that security.

- ▶ **Undervalued:** Last Price is below Morningstar's quantitative fair value estimate.
- ▶ **Fairly Valued:** Last Price is in line with Morningstar's quantitative fair value estimate.
- ▶ **Overvalued:** Last Price is above Morningstar's quantitative fair value estimate.

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Cie Financiere Richemont SA CFR (XSWX) | ★★★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
59.30 CHF	73.00 CHF	Medium	Wide	Stable	Standard	Retail - Apparel & Specialty



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