Salvatore Ferragamo

When one hears the phrase "Made in Italy", chances are the name Salvatore Ferragamo will come up when discussing luxury fashion. Salvatore Ferragamo (BIT:SFER, Market Capitalisation: €3.37Bn) is an iconic brand well-known for its finely crafted fashion apparel and accessories. Rising to fame as a shoemaker for movie stars in Hollywood such as Marilyn Monroe; Salvatore Ferragamo has grown from a small presence in Florence, Italy to being one of the most respected fashion brands in the world. Ferragamo has a strong heritage in the art of craftsmanship, creativity and elegance of leather goods; with Salvatore himself leaving 20,000 models and 350 patents. Taking into account the entire distribution structure, the Ferragamo Group is present in over 90 countries all over the world.

Since Salvatore Ferragamo passed away in 1960, the company has been managed by his wife Wanda, his daughter Fiamma and son Ferruccio, who became CEO in 1984. In 2006, former CEO Michele Norsa was recruited from the Valentino Fashion Group, and while at Ferragamo he managed the acceleration of the retail expansion and the development of the travel retail network. Under his leadership, in the period 2009-2014 Salvatore Ferragamo recorded a brilliant operating performance with revenues growing at a 16.5% Compound Annual Growth Rate (CAGR). The increase was extremely consistent across all of the different business lines and regions (only Japan remained flat but Asia-Pacific including Japan stayed above 45% of total revenues). However, since 2015 the Group has lost momentum and 2015-2019 CAGR was -1% with declining revenues in Europe (where wholesale is the dominant channel) and in apparel and accessories. Since 2016, the attempts to relaunch the brand passed through three changes of CEOs, increasing costs of communication, marketing and investments in the store network which boosted distribution and selling costs. We arrive at Ferragamo today, with a troubled business outlook and several underperforming divisions, in need of a new direction and focus.

Company Highlights

1923 Salvatore Ferragamo opens the Hollywood Boot Shop marking the start of his career as “shoemaker to the stars”.

1938 Ferragamo makes the famous Rainbow model for Judy Garland, the year after having invented and patented the cork wedge heel.

1950s Launch of the women’s leather goods and women’s ready-to-wear lines, endorsed by celebrities such as Audrey Hepburn.

1960s After the death of the founder, his widow Wanda took over the reins of the company. In 1965 the production of bags starts.

1970s Launch of the first men’s RTW collections, men’s footwear, silk and accessories.

1978 Creation of Vara, one of the most famous shoes by Salvatore Ferragamo.

1990 Creation of the bag with the famous Gancini decorative symbol.

1998 Launch of the Salvatore Ferragamo Fragrances and Eyewear lines.

2003 Realisation of the first Salvatore Ferragamo watches.

2011 Salvatore Ferragamo S.p.A. is listed on the Mercato Telematico Azionario organised and managed by Borsa Italiana S.p.A.

2019 Appointment of Paul Andrew as Salvatore Ferragamo’s Creative Director.

2019 Appointment of Marco Gobbetti as CEO.

Product Offering

Ferragamo began as a maker of women's shoes, yet since the 1950s has transformed into a well-diversified company operating in the creation, manufacture and sale of footwear, leather goods and ready-to-wear clothing, covering all range of use (from formal to casual). In the 70s, the company entered the menswear business, which now accounts for approximately 40% of total revenues, and launched silk products and other accessories. In 1998, Ferragamo added a range of perfumes for both the male and female markets and an eyewear line (under license with Marchon). Ferragamo's product range was expanded in 2003 with the realisation of their first watch (under license with Timex).

Salvatore Ferragamo is a monobrand group and is mainly focused on shoes (41% of FY20 sales mix) and leather goods (42% of FY20 sales mix). Its collections are marked by iconic and original designs. Iconic elements from Salvatore Ferragamo's brand heritage are the "Gancini" bag clip (created in 1990), "Vara" shoes (launched in 1978) and signature prints. Below is an outline of Salvatore Ferragamo's product range:

Footwear
(41% of revenue)

The historical product of the brand; featuring original designs, perfect fits and top-quality materials. It features an extensive range of men's and women's footwear.

Leather Goods
(42% of revenue)

This comprises of handbags, suitcases, belts, wallets and other leather accessories. Features hand-made details such as embroidery, and highly recognisable metal accessories.

Accessories
(10% of revenue)

The types of product that most identify the "Salvatore Ferragamo" brand. This category includes the iconic silk accessories (ties, scarves) and others such as shawls and gloves.

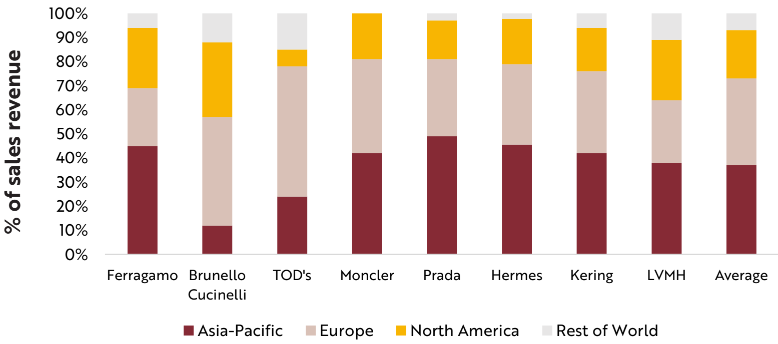
Jewellery
(6% of revenue)

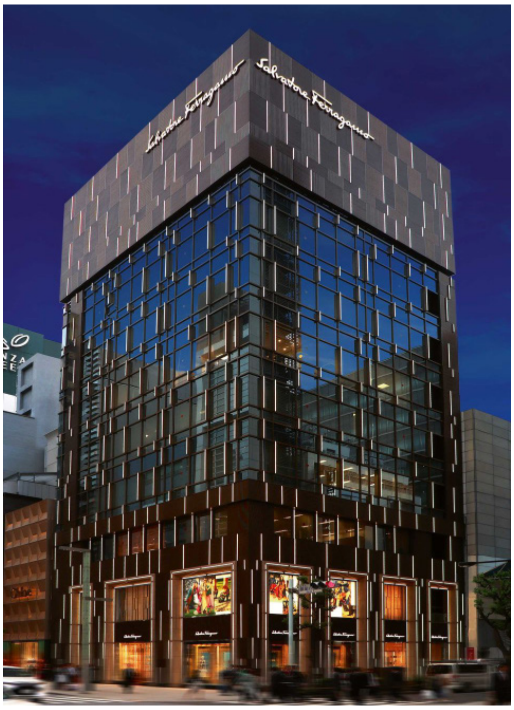
Offers a range of jewels in gold, diamonds, gemstones and silver. Uses the brand's most celebrated symbols and icons for earrings, necklaces, watches, and other jewellery.

Distinguished exposure to Asia-Pacific

Ferragamo has a higher than average exposure to Asia-Pacific (APAC), it represents ~45% of sales compared to an industry average of 38% in the region. The APAC market is experiencing a growing middle class with greater economic prosperity, and Chinese consumers are set to contribute almost two-thirds to global luxury spending. Luxury holds significant social capital in Asia, with young consumers viewing luxury as a means to differentiate themselves from their peers. Ferragamo's standing as a leader amongst their peers within the APAC region leaves them in a prime position to capitalise on this growing target market.

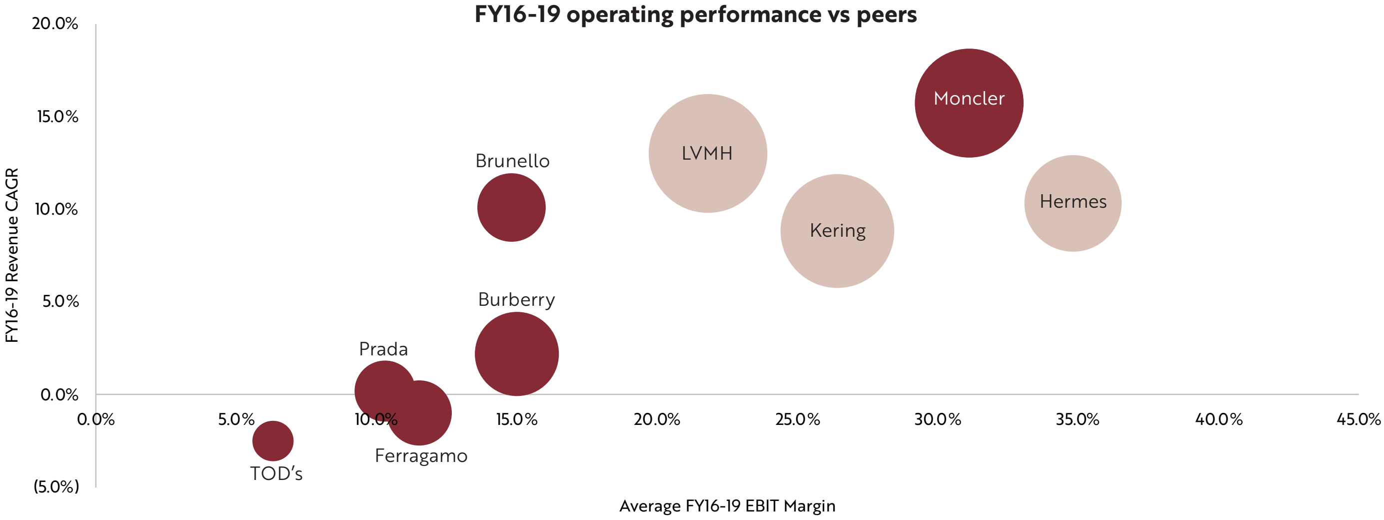
Geographic exposure vs peers in FY20





Italian monobrands trailing French conglomerates

Over the last few years, Ferragamo has suffered a loss in momentum resulting in -1% revenue CAGR growth from FY16-19 vs an industry average of +6%, and an 11.8% average EBIT margin for FY16-19 vs an industry average of 18.8%. This underperformance isn't just characteristic of Ferragamo, but of many of the Italian fashion houses. Overall, the major Italian houses haven't kept up with the French houses. The French are over-weighted on accessories; while Italian brands are more focused on ready-to-wear. Accessories have outperformed, delivering the highest gross margin amongst product types, which has provided a significant competitive advantage to the French conglomerates. The French have also used bolt-on acquisitions to grow inorganically, and the impact of this increased scale and consolidation cannot be understated. For a conglomerate in a fixed-cost industry such as fashion, advantages of scale are significant in creating efficiencies. The most important synergies come from location and rental cost negotiations, as well as negotiations with publishers and organisations on advertising. Another advantage is having all of the brands synced to your digital presence — and a deeper bench when it comes to talent along with better access to the financial markets. Those who champion the Italian industry have long dreamt that a multibrand conglomerate would emerge to rival what French giants such as LVMH, Hermès and Kering have forged in recent decades. Unfortunately, that window has closed - due to the lack of available large core brands to build a conglomerate around - and in the next few years, instead of being consolidators within the market, Italian brands will be targets from the big global groups outside of it. At the heart of any of the French groups, you will find Italian brands with strong prestige and history, with LVMH and Kering now owning four major Italian brands each with €9Bn+ market values.



The influence of Gen Z and Millennials on *haute couture*

According to Bain & Company, millennials are poised to be luxury customer leaders and will represent 45% of the total market by 2025. Furthermore, younger millennials (aged 14-24) contribute the most both in the US and China, with 52% and 70% in value respectively. Millennials value shopping experiences to a greater extent relative to the product itself; which is why delivering customisation, collaboration, and unique collections will propel the demand of the luxury market onwards, and is a key priority for luxury firms. Growing up with environmental and social issues such as climate change, exploitation of workers in developing countries and pollution from textile waste have all contributed to the way millennials consume goods. 'Sustainability' and 'ethical' are key words influencing both consumer and brand, as a trend towards conscious purchases continues to emerge. Organic fabrics, fair-trade certifications, responsible supply chains and locally produced goods are more than the product, it is a luxury good. It is also about experiences and aligning with the emotional need to be a decent human being. Some luxury companies are awake to the wants and needs of this group, catering to this demographic and creating a brand culture that better aligns with millennial values.

Ferragamo poaches Burberry heavyweight

Warren Buffett & Charlie Munger like to find century-scoring batters and not tell them how to swing. We can't think of an industry where management is as important as it is to fashion. The margins in fashion are notoriously razor-thin and the number of fashion houses which declare bankruptcy, go off track, or dilute their brand must number in the thousands. Even esteemed houses such as that of Yohji Yamamoto have gone bankrupt due to mismanagement.

Pierre Bergé managed Yves Saint Laurent with great success, while Patrizio Bertelli has taken Prada to the heights of Italian industry. Sidney Toledano has been at the helm of Dior since 2015 and overseen its revival after the dismissal of John Galliano (Renzo Rosso, the owner of Diesel which owns Maison Margiela, had the foresight to hire Galliano to design Margiela). In the larger landscape of fashion, Tadashi Yanai has been an outstanding manager of Uniqlo. We cannot overstate the importance of good management in any business but especially fashion and luxury. Gobbetti has a strong track record. His roster of successes are diverse and unparalleled. As CEO of Celine he oversaw the visionary collections of Phoebe Philo, which revived Celine to such an extent the Philo-designed Celine is particularly collectible. Growth at Celine was reportedly in the double digits under Philo and Gobetti's tenure. Prior to Celine, Gobbetti revived Givenchy alongside the designer Ricardo Tisci. Both Celine and Givenchy are owned by Louis Vuitton Moët Hennessy (LVMH). The controlling shareholder of LVMH, Bernard Arnault, has a famously brutal disposition towards bad management -- it says everything that Gobbetti oversaw not one but two revitalisations at LVMH.

The revival at Burberry is Gobbetti's latest project; it must be said he is leaving earlier than expected. In 2016, when Gobbetti was appointed Burberry stock was down 35% from its all-time high and Christopher Bailey (Gobbetti's predecessor) had taken a 75% pay cut. Worse was that Burberry was fast becoming divorced from luxury; at the end of Bailey's tenure it was closer to Coach or Guess than a prestige brand. Under Gobbetti operating income per quarter increased from GBP 66.9 million (Q2 2016) to GBP 158.7 million in the same year (Q4). More importantly Burberry started to regain its reputation as a luxury brand which is reflected in its enterprise value -- from GBP 4.14 billion at the start of 2016 to GBP 8.92 billion as of the most recent quarter. It's clear that Gobbetti creates significant value for the brands he operates.

MOSCHINO	GIVENCHY	CELINE	BURBERRY LONDON ENGLAND
CEO, 1993-2004	**CEO, 2004-2008**	**CEO, 2008-2016**	**CEO, 2016-2021**

Rooted in heritage, yearning for revitalisation

Ferragamo has a remarkable history; differentiated from most Italian fashion houses which were formed after WWII, and the majority after 1970, Ferragamo has a long and rich heritage filled with iconic designs for truly iconic people. Some of their most illustrious clients include Audrey Hepburn, Sophia Loren, Princess Diana, and more recently Kendall Jenner. Throughout their history they have created new designs which have shaped the agenda of fashion; in particular steel reinforced stilettos, the ballet pump, the sock-shoe and a vast archive of patterns rivaling that of Hermes. Ferragamo also has street appeal -- 90s Ferragamo is popular among 'tastemakers' in France -- when asked why? They responded it was *the* brand to own growing up.

However, the company has found itself in the doldrums in recent years. Prior to COVID-19, the company's revenue was shrinking, albeit at a relatively modest pace of ~3% per annum; on the whole revenue has remained stagnant. This may be due to the classic case of overextending itself without really saying anything; the company includes a vast portfolio of goods ranging from sunglasses to giftware for perfumes. The company may already be engaging in a turnaround with the licensing of their perfume business (previously made in-house) to Interparfums. Ferragamo's problem is that of a heritage company with no real point of view. The most successful houses take a point of view: perhaps the most successful heritage house as of writing in terms of cultural capital is Balenciaga. Cultural capital translates into tangible value when selling bags, shoes, t-shirts, perfumes and the like. This is the great paradox of fashion. For example, Marc Jacobs' clothing designs while at Louis Vuitton were critical darlings; but it was the bags that sold. On the other hand, Ferragamo has been prudently run for a number of years, which is so often the case with a family owned business; it is why often our perennial preference is to own a business which is still family-controlled, they have 'skin in the game'. Ferragamo has often generated a net income margin of c.7%, which is perfectly respectable for a fashion business but not particularly best in class (Burberry's under Gobbetti was around 12%). Its debt is well managed and it has survived sensibly. The task at hand is creating cultural capital. This is an act of alchemy. The most obvious alchemy comes from appointing a designer who will take the history of the brand and make it relevant to the zeitgeist. The single most remarkable occurrence of this alchemy is no doubt the reign of Karl Lagerfeld at Chanel -- when Lagerfeld took over Chanel, it was a forgotten fashion house with cheaply licensed out clothes that no one wore. Lagerfeld created the blueprint for revitalising a house; play with the logo, play with the tropes of the house style, don't respect it too much. The big question mark -- and frankly, the biggest risk -- is who is appointed. Gobetti has a stellar history in appointments.

The strength of a fashion house, and its future sustainability, can often be measured by the frequency of legacy products and designs in its catalogs. UBI Banca estimates that ~50% of Ferragamo's sales come from evergeen products; items which hold everlasting appeal and have no off-season. The benefit of this is that they have solid recurring revenue without having to allocate funds towards the design process and other research and development, inevitably flowing through positively to margins. This increases the value of the Ferragamo brand, as their value is derived from the intellectual property of their most recognisable designs and features, rather than being overweight on their current crop of talent or recent fashion trends.

Audrey Hepburn
(with founder, Salvatore Ferragamo)

Diana, Princess of Wales

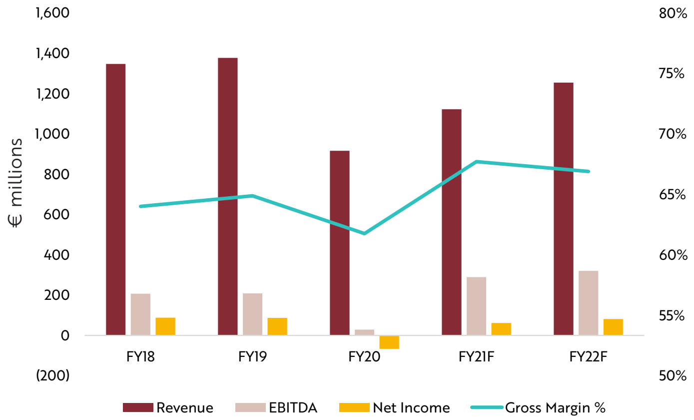
Kendall Jenner

Financial Analysis

Ferragamo's fundamentals are not particularly inspiring, neither are they particular cause for concern. Ferragamo's debt sits at around €1Bn which is perfectly serviceable and in most years prior to the Pandemic the company made a modest profit. Their compounded revenue growth rate over five years dropped significantly after 2017; prior it was c.3.7%. Covid cannot be blamed entirely here, in Q3 2019 it was (0.5%) and in Q4 of the same year it was 0.4%. This is evidence of sleepy management -- a company shrinking is hardly a guarantee to sleep well at night. However, Ferragamo has improved its cash-generation over the last decade, from a free-cash-flow yield of 7% in FY11 to 15% in FY20, demonstrating an ability to generate reliable funds in challenging times.

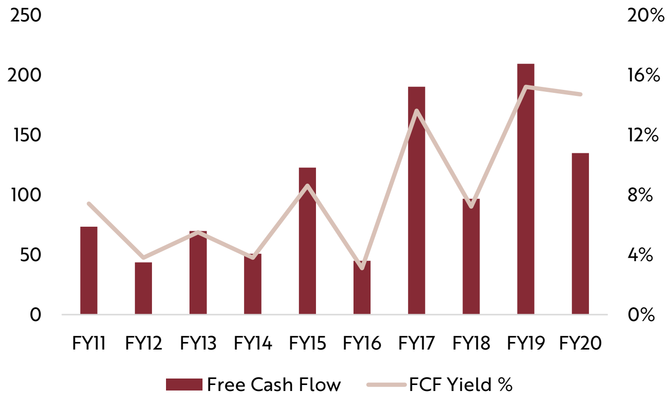
The value of Ferragamo is in its archive and Gobetti's management. For instance, Burberry's stock price on 8 July 2016, just prior to his appointment, was GBP 1,162. The price as of writing is GBP 2,092. Gobetti delivered a +57% (+12% IRR) increase in value from when he became CEO of Burberry up until leaving. The power of incentives, as Charlie Munger says, should not be underestimated; Gobetti was signed up to Burberry with performance-based incentivisation of double his salary, as well as share-based compensation worth 3.25 times his annual salary. In 2020 - the year of the Pandemic - Gobetti was still paid GBP 4 million, signalling strong performance even in tough times. Ferragamo, on the other hand, does not have a tarnished reputation. It has an underutilised brand and archive. It is closer in kinship to its Italian brethren than to Burberry. This is important as a tarnished reputation is incredibly difficult to recover, even for a CEO such as Gobetti, as Warren Buffett explains below:

Earnings Performance, FY18-FY22F



Source: Capital IQ

Free Cash Flow, FY11-FY20



Source: Capital IQ

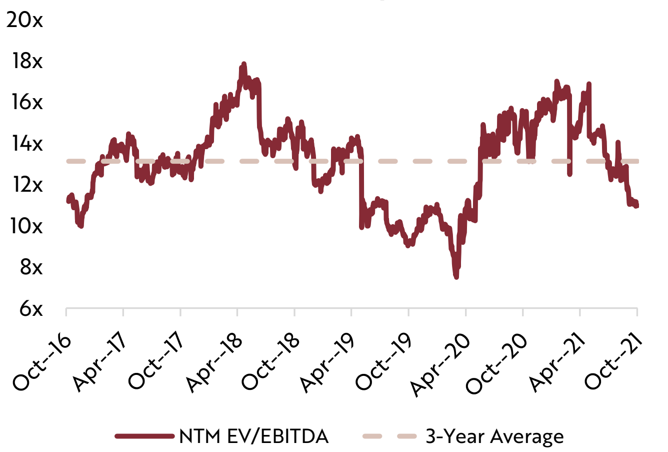
"Our conclusion is that, with few exceptions, when a management with a reputation for excellence tackles a business with a reputation for poor fundamental economics, its the reputation of the business that remains intact."

- WARREN BUFFETT, BERKSHIRE HATHAWAY 1980 LETTER TO SHAREHOLDERS

Ferragamo is currently trading at a 16.3% discount to its average 3-year next-twelve-months (NTM) EV/EBITDA multiple of 13.1x. The undervaluation began in September after the company reported its 2021 H1 results, with forward EBITDA receiving revisions from analysts after exceeding expectations.

The downward momentum in the share price has been a result of cooled expectations of a potential sale. Gobbetti's arrival clearly delays a potential sale of Ferragamo, allowing the executive to engineer and execute a turnaround plan, after years of a slowdown at the brand. Speculation about a possible sale of Ferragamo has swirled for years, and has always been denied by the family, which has been easing out of top roles and hiring outside managers to take the business forward.

3-Year NTM EV/EBITDA



Source: Capital IQ

Remains an attractive acquisition target

The COVID-19 pandemic has added to the pressure with demand shifting in a very concentrated manner to a small number of luxury brands. Therefore, we expect a 'Darwinian shakeout' to occur; where the crisis will further unnerve the weak, embolden the strong, and accelerate the decline of companies that were already struggling pre-pandemic. We expect the outcome of this shakeout to result in further industry consolidation. As government support schemes are wound back in a post-pandemic world, weaker brands will come under pressure. To secure their future, companies must adapt to the new market environment by evaluating divestment and acquisition opportunities to strengthen their core and capture whitespaces that emerge. This creates conditions that are favourable for those seeking to sell to others, merging with others or joining forces to be able to scale, but also to leverage expertise / talent. Borrowing costs remain extremely low by historical standards, to the advantage of companies in a strong financial position seeking to invest. Lower valuations, due to stunted recent growth rates, will create more opportunities for those that have cash flow to fund acquisitions; and for the targets, the performance benefits of being part of a larger group will become enticing.

Due to Ferragamo's strong heritage, large archive and solid position within the Chinese market, the brand would certainly be an attractive asset to a large conglomerate in the luxury sector. Its mediocre recent performance makes it ideal for a conglomerate, who can acquire at a lower valuation than a high-performing single brand such as Moncler. Houses such as Ferragamo offer a heritage and *je ne sais quoi* which cannot be replicated, and the cash-rich conglomerates would better facilitate the turnaround story Gobbetti is currently writing.

M&A in the luxury fashion industry has been at pace recently, with further activity expected. In 2020, LVMH agreed to pay a slightly reduced (due to the pandemic) US$15.8 billion for US jewellery brand Tiffany, the luxury sector's biggest ever deal. VF Corporation, owner of Timberland, Vans and The North Face, acquired streetwear brand Supreme for US$2.1 billion. And finally, Moncler acquired menswear brand Stone Island for US$1.4 billion. In 2021, luxury M&A has included LVMH acquiring 60% of Virgil Abloh's 'Off-White' trademark, Chanel took a majority stake in Italian knitwear business, Paima, and both Birkenstock and Etro sold stakes to private equity firm, L Catterton.

Expect more of the same in 2022. Analysts estimate that after the Tiffany deal, LVMH still possesses up to US$34 billion in acquisition firepower, Kering has up to US$21 billion, while Richemont has capacity to spend about US$11 billion or more on future acquisitions. The most likely targets are the few remaining independent luxury fashion brands, including Burberry, Prada and Ferragamo. Following Kering Group's failed bid to snap up Moncler, there are suggestions that the group may make a play for Ferragamo, which is a slightly smaller company featuring an attractive focus on leather goods and shoes as opposed to the more volatile ready-to-wear segment.

Key Luxury Fashion M&A Deals, 2011-2021

Acquirer	Target	Year	Deal Value (US$Bn)	EV / TTM EBITDA (x)
LVMH	Bulgari	2011	5.20	25.0
LVMH	Hermes	2011	2.00	15.5
PPR	Brioni	2011	0.41	30.0
Eurazeo	Moncler	2011	0.61	11.8
Central Retail Corp	La Rinascente	2011	0.37	11.0
Mayhoola	Valentino	2012	0.86	20.0
LVMH	Loro Piana	2013	2.57	18.0
Swatch	Harry Winston	2013	1.00	23.0
Signet	Zale	2014	1.46	15.0
Samsonite	Tumi	2016	1.81	14.5
Coach	Kate Spade	2017	2.38	10.4
Michael Kors	Jimmy Choo	2017	1.17	15.7
LVMH	Christian Dior	2017	13.1	15.6
Essilor	Luxottica	2017	23.9	12.7
Richemont	Yoox Net-a-Porter	2018	3.31	30.4
Michael Kors	Versace	2018	2.12	22.1
LVMH	Belmond	2019	3.20	14.5
LVMH	Tiffany & Co	2020	15.8	16.6
VF Corp	Supreme	2020	2.10	14.9
Moncler	Stone Island	2020	1.40	16.6
L Catterton	Etro	2021	0.59	11.1
Authentic Brands	Reebok	2021	2.50	7.6
Average Multiple				**16.9x**

Valuation

We believe as Ferragamo starts to deliver results consistent with a company offering a growth profile, not only will the stock re-rate to levels above peer group averages, it will also make the company a more attractive acquisition target for the big multibrand luxury players in the market (e.g., LVMH, Richemont, Kering) who could pay up for quality, growth and brand heritage. Industry consolidation has been rampant in the industry, with the top 10 players accounting for more than 50% of sales, and other monobrand operators evolving into multibrand businesses.

Accordingly, we have utilised industry average EV/EBITDA transaction multiples, and have derived valuations utilising FY21 forecasts and analyst estimates of the earnings growth present in FY23. As such we arrive at a valuation range for Salvatore Ferragamo of €25.40 to €31.57, presenting upside of between +27.49% to +58.49% from the 22 November 2021 share price and +49.65% to +86.04% from the Elevation Capital Global Shares Fund cost basis (as at 22 November 2021).

The forecast increase in EBITDA is consistent across analyst coverage, with a renewed sense of optimism on the street following the appointment of Gobbetti. This growth can be considered modest compared to his performances at Celine and Burberry, and there is significant upside to be had from resurrecting the brand's creative direction, while the prestige and history is something that can't be recreated. This heritage is why we are confident Ferragamo can provide investors with attractive returns over a 3-5 year period.

Salvatore Ferragamo Valuation Summary

EBITDA		FY21E	FY23E
EBITDA (€m)*		304	367
EV/EBITDA Peers Multiple (x)		16.9	16.9
Implied Enterprise Value		**€ 5,133**	**€ 6,195**
Minority Interests (€m)		20	20
Net Debt (€m)		303	303
Leases (€m)		568	568
Total Equity Value		**€ 4,283**	**€ 5,324**
Shares Outstanding (m)		169	169
Implied SOTP Share Price		**€ 25.40**	**€ 31.57**
Current Share Price	€ 19.92		
Implied Upside		+27.49%	+58.49%
Global Shares Fund Cost Basis	€ 16.97		
Implied Upside		+49.65%	+86.04%

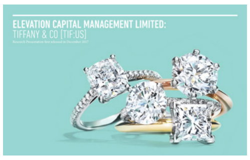
*Société Générale Equity Research Estimates

EV/FY21F EBITDA Trading Peers Comparison

Source: Capital IQ

Conclusion

Salvatore Ferragamo (SFER) is currently trading at a discount to its intrinsic value, and offers attractive upside in the medium-term to the patient investor. The investment case for Ferragamo is quite simple. It is the revival of a sleepy house with an incredible archive and brand identity predicated on hiring a superstar manager who has repeatedly done exactly "what it says on the tin". The macro case is similar; as a whole the luxury market is poised for growth in a post-Covid world - especially as global travel resumes. We also like the opportunity presented by a potential change in control considering the large number of heirs and the strong brand heritage makes Ferragamo a potential attractive prey within the luxury sector. Ferragamo's history of iconic designs worn by famous celebrities means its brand offers significant heritage value for potential acquirers, and the respect and focus shown towards its hallmark designs is exemplified through their focus on leather goods and shoes (>40% of sales each) and low exposure to ready-to-wear products (5.5% of sales) also makes them an attractive target for the French conglomerates in our opinion. Elevation Capital has a successful history of investing in brands which have been ignored or considered tarnished, such as Adidas (+54.5% return per annum, over 1.5 year holding period) and Tiffany & Co (+19% return per annum, over 7.5 year holding period).



We believe Salvatore Ferragamo to be a similar story.

Salvatore Ferragamo

This summary report was written in October-November 2021.

Any data not referenced was sourced from Salvatore Ferragamo SpA Annual Reports, Investor Briefings & Earnings Conference Calls.

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ELEVATION CAPITAL
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Independent Thinking
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[In-de-pend-ent Think-ing] indəˈpendənt THiNkiNG verb
Is essential to long-term investment success. We are often contrarian and do not pay attention to index compositions when making investment decisions. We believe that when you're several thousand miles away from Wall Street in a different nation, it's easier to be independent and buy the things that other people are selling, and sell the things that other people are buying.

[Dis-ci-plined In-vest-ing] disciplinəd invesˈting verb
The market presents opportunities every day, but disciplined investing is as much about the opportunities you do not take. We also believe that cash is sometimes the most attractive investment.

MORNINGSTAR INTERNATIONAL EQUITIES CATEGORY FUND MANAGER OF THE YEAR 2017, NEW ZEALAND

NOMINEE - FUNDSOURCE INTERNATIONAL EQUITY SECTOR FUND MANAGER OF THE YEAR 2013, NEW ZEALAND

NOMINEE - MORNINGSTAR INTERNATIONAL EQUITIES CATEGORY FUND MANAGER OF THE YEAR 2012, NEW ZEALAND

NOMINEE - FUNDSOURCE INTERNATIONAL EQUITY SECTOR FUND MANAGER OF THE YEAR 2012, NEW ZEALAND

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