ELEVATION CAPITAL
GLOBAL SHARES FUND

HERMÈS PARIS

Hermès International SA (RMS: ENXTPA, Market Capitalisation: US$105.11B), was founded in 1837 by Thierry Hermès as a saddle workshop serving the needs of European noblemen. Thierry's steady hand created some of the finest harnesses and bridles for the carriage trade, and saw Hermès emerge as one of the most famous saddlery retailers of the 20th Century. Thierry's son relocated the company to 24 Rue Du Faubourg Saint-Honore in Paris and the company product offering has expanded over the years introducing accessories and clothing in the 1920's. Its leather travel and handbags launched in mid 1920's were global successes. In the 1930's Hermès introduced the Kelly Bag named after actress Grace Kelly, which remains one of the most sought after handbags in the world. The Birkin Bag which has ranged in price between USD$2,000 and USD$300,000 was introduced in 1984 and is the exquisite work of a single craftsman who takes between 18-25 hours to complete the job by hand. Hermès is infamously known to burn imperfect Birkins, highlighting their dedication to the finest quality.

One of the most prestigious family run business in the luxury sector, Hermès has reigned supreme for six generations operating 306 exclusive stores and employing 15,000 artisans. Hermès has consistently been ranked among the worlds most valuable luxury fashion brands and 28th most valuable brand in 2020, enjoying iconic status in the world of luxury through its prestigious heritage and exquisite craftsmanship. Under the guidance of the current CEO Alex Dumas, top line revenue has grown at CAGR +14.45% since 2016, and consistently produced outstanding results across a broad range of financial metrics. By all accounts Hermès results in 2021 were exceptional in nature, with revenues up +77% from 2020 as Hermès affluent client base spent on luxury goods during the pandemic. While the luxury goods industry has only grown in the mid single digits over the past decade, Hermès has outperformed the sector by a wide margin.

Company Highlights

1837 Thierry Hermès founds the company as a harness workshop providing saddles bridles and other leather riding gear.

1990 Hermès starts selling the "Haut a Courroies" bags for use by riders to carry their saddles in.

1918 Hermès introduces the first leather golf jacket for the Prince of Wales.

1920's A pivotal moment in the companies history, Hermès introduces accessories and a range of luggage and handbags to much fanfare.

1930's Hermès introduces products that have entered the annals of fashion, the Kelly Bag and the Hermès carres (scarf).

1950 Hermès introduces their now iconic orange boxes complete with the duc-carriage and house logo.

1980's The Birkin Bag is introduced after a chance meeting between then CEO Jean-Louis Dumas and singer Jane Birkin, on a flight from Paris to London.

1993 Hermès goes public on the Paris Bourse under the ticker RMS at €5.95 per share.

1990's Hermès embarks on a strategy of buying out franchise stores and closing them, increasing exclusivity.

2014 An extremely rare Himalyan Nilo crocodile Birkin sells for USD$185,000 becoming the second most expensive bag sold at auction.

2015 Apple and Hermès partner together on the "Apple Watch Hermès". In a landmark partnership.

2021 Hermès stock price reaches an all time high at EUR$1,678 up +21,866% from 1993.

2022 Hermès stock price declines ~35% from its all time high, presenting an opportune entry point for the Elevation Capital Global Shares Fund.

Product Offering

Hermès began purely as a producer of leather goods but has diversified its offering over time to include a broad range of products. Hermès designs and manufactures luxury products including leather goods, silk goods, perfumes, watches clothing and also generates revenue in furniture, wallpaper, tableware and interior fabrics. Hermès is active in 14 different categories, but discloses its activities in four business segments. During the 1970s, new materials like polyester and plastic emerged which prompted Hermès to develop new items in a bid to win over consumers. By the 1990s, Hermès was offering over 30,000 products. In 2014, new launches included the Oxer Bag, the Nautilus pen, the Faubourg watch, the La Parfum de la Maison, the H-Deco tea and dessert service and the lighting collection. Former CEO Jean-Louis Dumas best summarises Hermès' brand philosophy with the quote - *"We don't have a policy of image, we have a policy of product".* It is for these very principles that the brand has always shunned mass production, manufacturing lines and outsourcing, and adhered to a mindset that everything Hemès touches should be singular, the product of years of training from the hands of dedicated artisans.

Leather Goods and Saddlery

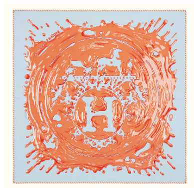
Hermès original business is still responsible for 50% of its revenues, selling handbags. luggage, clutches and small leather goods for men and women.

Ready-to-wear and Fashion Accesories

Ready-to-wear comprises 23% of Hermès revenues and includes coats and jackets, polo shirts, trousers and shorts, sandals, belts and hats etc.

Silk and Textiles

Hermès sells silk scarfs and ties for men and women, this sector contributes 9% of global revenue.

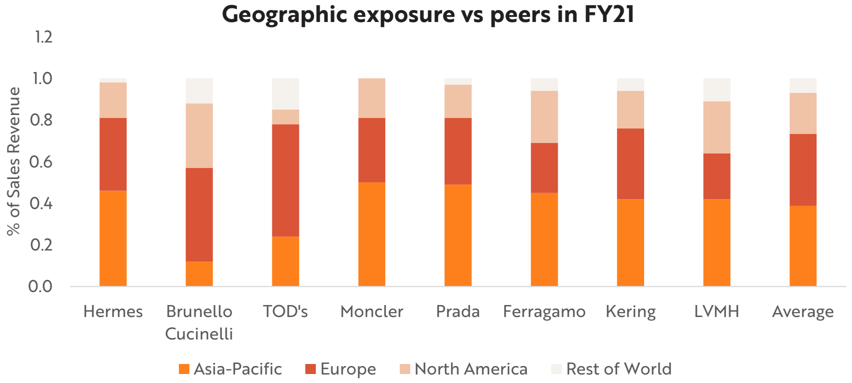


Watches, Perfumes and Other Sectors

Jewellery and tableware comprise 7% of revenues while perfumes come in at 5%, and watches at only 3%. The remaining 3% is made up of Hermès stake in other brands.

Increased Asia-Pacific Focus

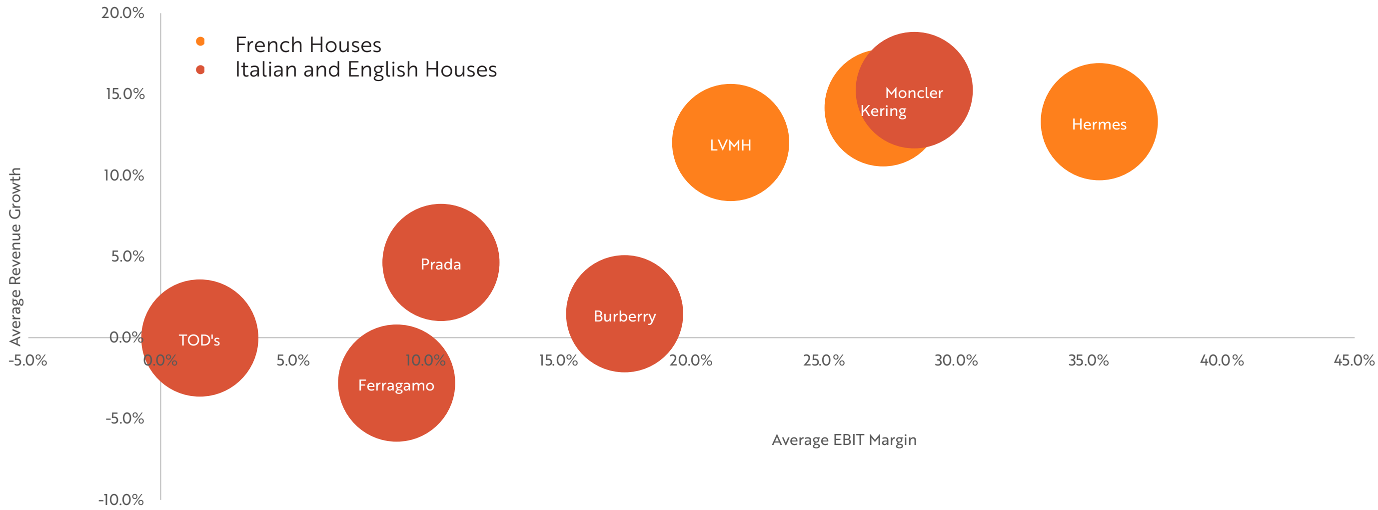
Hermès derives around 46% of its revenues from the APAC region, amounting to EUR2.9B in revenues in 2021 when including Japan this amounts to 59% of overall revenues. The APAC market has been experiencing a growing middle class with greater economic prosperity, and Chinese consumers are set to contribute 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. Hermès standing as a leader amongst peers within the APAC region has put them in prime position to capitalise on this growing target market.



French houses dominate luxury.

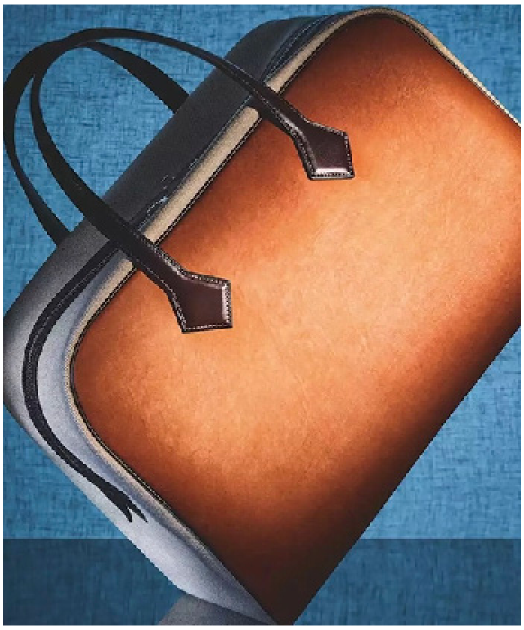
Hermès results over the last few years have been exemplary, averaging revenue growth of +13.31% and an industry leading EBIT margin of +35.38% from 2017 - 2021. This is in strong contrast to industry averages of +6.41% and +16.5%, respectively. This out-performance has been characteristic of the three main French houses Hermès, LVMH and Kering, while the Italian brands have lagged behind on the whole. This out-performance is in part due to the strong performance accessories have seen over the last decade, with the French houses benefiting from greater exposure to this category. Accessories such as handbags have increased the most in recent years, receiving the highest gross margin amongst product types, which has afforded significant competitive advantage to the French companies. In Paris the fusion of the old and new, art and commerce, for sources of creative inspiration is unmatched and explains the allure of Parisian brands in the luxury landscape. While other countries and cultures will have a strong influence on luxury, spearheaded by Chinese preferences, the uniqueness of Paris will continue to be a breeding ground for the creativity and craftsmanship that is so critical to luxury. Recently the sector has been plagued by the highest inflation in 40 years, crackdowns on ostentatious displays of wealth and further lock-downs in several Chinese provinces. This has prompted luxury houses to raise prices and it is worth noting that while LVMH has raised prices above inflation, Hermès has only passed on costs due to the rising price of leathers and textiles, and still maintained and even grown margins in some cases.

Fashion Industry FY17-21 Operating Performance



The influence of Gen Z and Millennials

According to Bain & Company, millennials are poised to be the 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 remain 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. Hermès has come under pressure for the use of exotic leathers in its products, leading expansion into more sustainable leathers such as "Sylvana", derived from mushrooms pictured on the right. '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, as is a luxury good. It is also about experience, perceptions and aligning with the emotional need to be a decent human.



The Sadlers Spirit

Brands are valuable if they increase the willingness of customers to pay more. Quality is certainly an important aspect in arriving at a price and Hermès produces products of the highest quality, but the price of these products exceeds by far, the functional value these goods would command. At Hermès, any lasting premium derives from mystique. After all, selling a commodity ultimately boils down to one thing: price. But selling beautiful objects that people don't inherently need? That requires a more complicated formula that Hermès has mastered.

Hermès celebrates the quality of its products, more so than most fashion houses. All Hermès artisans must go through a mandatory two-year training program before they can start work on any leather product in the Hermès portfolio. This slows down production time but also adds an element of rarity, with this scarcity creating long waiting lines which act as a self-fulfilling feedback loop of exclusivity. An integral part of almost every luxury brand is its heritage, most often leveraged as a marketing mainstay. Hermès frequently mentions its illustrious heritage, the exquisite craftsmanship as well as the culture that is attached to the brand. It is almost impossible for new companies to talk about tradition and heritage like Hermès can. Timeless products enhance the brand's heritage and can be passed on to the next generation in an ever-going cycle. Hermès tightly controls the supply and distribution of its products, and some are only made available at a select few stores, which are usually located at the most expensive and prestigious locations in cities all over the world. When entering the stores, everything is designed to telegraph the rarity and exclusivity of the products.

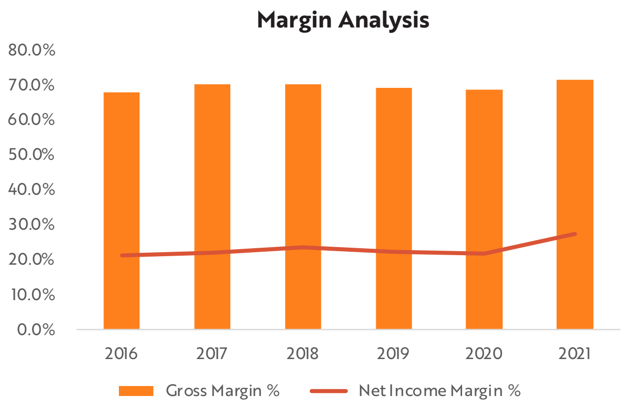
The demonstration of wealth, success, and exclusivity, is the heart of Hermès' economic moat. Hermès clients purchase their products to demonstrate they are wealthy enough to afford them and that they are worthy of attaching themselves to the heritage of Hermès, demonstrating their social status through the public perception of positional value. This is only possible if the brand is well-known and there is general social consensus that the brand symbolises exclusivity, success, and power. If someone is buying a Handbag for $10,000 but nobody has ever heard of the brand it is useless as the symbolism is missing, unless it is a Birkin or a Kelly. As long as Hermès is held up as the epitome of luxury, it doesn't matter what the individual thinks, only that a wide majority of people associate Hermès with power, wealth, and success. Before Hermès' economic moat can be successfully attacked, that social consensus has to break down, however, social consensus can last for centuries, and Hermès' economic moat continues to grow stronger.

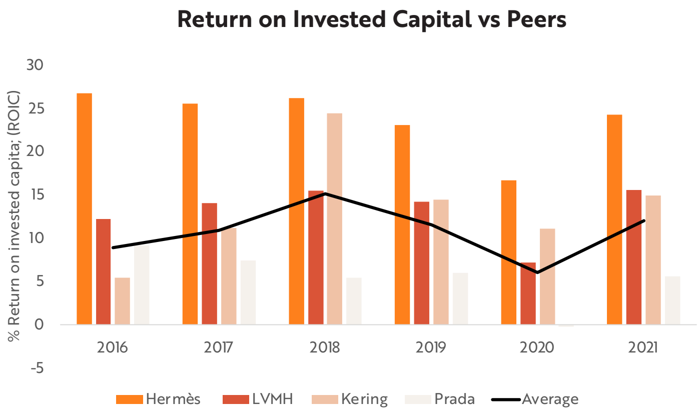
Grace Kelly with the Kelly Bag

Jane Birkin with the Birkin Bag

An Enduring Legacy

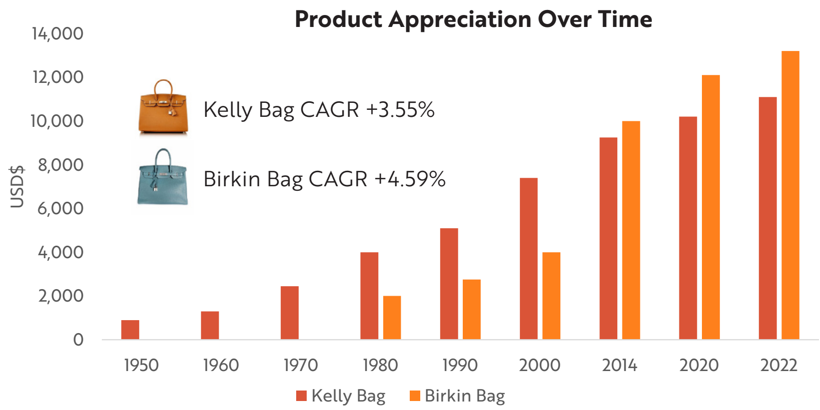
The incredible legacy Hermès has built around its products and its dominant market position has cemented its place in the industry with incredible pricing power. Hermès has industry leading margins, which sit in excess of 40% within its Asia-Pacific business where Hermès has the greatest revenue exposure. Pricing power enables Hermès to pass on the rising costs of metals, leathers and textiles to a willing customer base. As with several great fashion houses, Hermès' products exhibit the characteristics of a Veblen good, (a high quality product with few substitutes that exhibits increasing demand as its price increases). The ability for Hermès to increase its prices steadily in a high inflation environment, which simultaneously increases demand cannot be understated. Over its 185 year history Hermès has built a reputation as one of the best run family businesses in all of Europe. Under the current CEO Axel Dumas, Hermès Return on Invested Capital (ROIC) has been extraordinary, consistently outperforming its peers. Since 2016, Hermès has maintained an average ROIC of ~+24%, this turns Hermès into **a compounding machine**, a key reason behind Hermès meteoric share price growth. Through its various facets, the descendants of Thierry Hermès control ~73% of the company to date, and have collectively agreed not to sell their majority stake until **2041.** This highlights the faith the family has in Hermès current CEO Axel Dumas, who has seen Hermès share price grow five fold since his tenure began in 2013. With more than half of Herme's shares locked up until at least 2041 the family has an extraordinary amount of skin in the game, the age old solution to the problem of agency. With such a heavy price to pay for poor management, the descendants of Thierry Hermès have a strong incentive not to rest on their laurels. At Elevation Capital we like family run businesses, especially those that are run as well as Hermès. We anticipate similar exceptional capital management from Hermès for years to come with strong consumer demand despite the headwinds of an inflationary cycle in the global economy.





Evergreen brand loyalty

Nowhere is Hermès pricing power more evident than in the two handbags that built the brand. Over time the price of the Kelly and Birken Bag have grown at CAGR +3.55% and +4.59% respectively, which would have outperformed several staple asset classes over the same period. Hermes has recently done away with their waiting list which used to last up to six years, making it even harder to get your hands on a bag. Just getting on the waiting list in the first place required customers to have built up a reputation with the company, buying several of Hermès' other products, a practice know as *peihuo* in China. This pent up demand creates massive spillover effects into Hermès other product lines, which only serves to grow revenues.

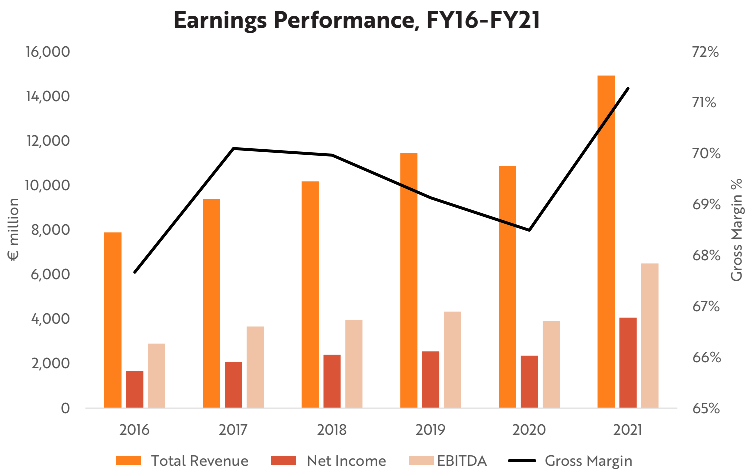


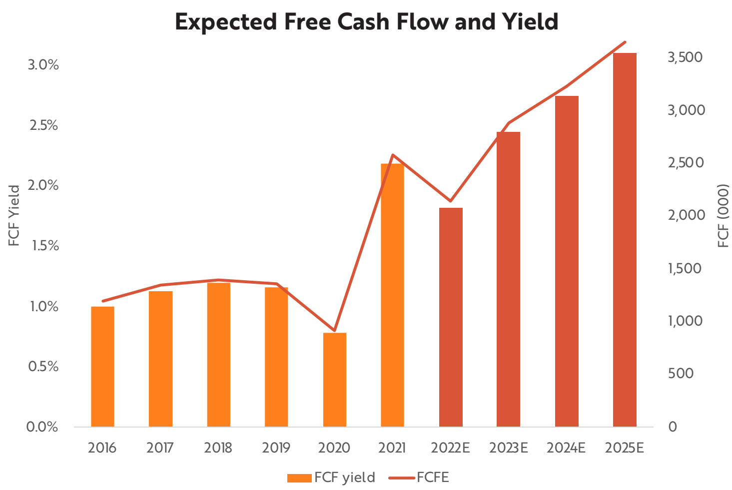
Hermès is well prepared for a recession

Most metrics would suggest that the economy is headed for a period of economic slowdown, if not a recessionary environment. Conflict in Europe and China's relentless pursuit of a "Zero Covid" strategy are stoking the flames of the highest inflation rates in 40 years, stemming from massive fiscal expansionary policy in the wake of the Covid-19 Pandemic. This would be the third global recession to occur since the turn of the century (and the Covid-19 induced recession at the start of 2020). The GFC of 2008-2009 was the most significant contraction in the global economy since WWII and saw a massive sell-off in luxury stocks along with most other sectors. From May 2007 the Savigny Luxury Index (SLI) lost ~62% of its value, however over this same period the financial performance of the SLI constituents was vastly different, growing sales at an average rate of +5.7% in 2007 and +6.5% in 2008, and +2.2% in 2009. Sales recovered strongly in 2010 +17% and 2011 +21% and the SLI rallied +218% from March 2009 to year-end 2010. Given the nature of the Covid-19 crisis, it is somewhat more difficult to draw comparisons with the GFC however the comparison is particularly insightful in light of current luxury trading multiples, which have just come off historic highs, reaching an average EV/EBITDA multiple of 21.9x in June 2021 buoyed by optimism for the entire sector. History has demonstrated that heritage brands with strong leather goods offerings fare best during periods of economic slowdown, this is followed by makeup, with "affordable luxury" taking the bottom of the leader board. Hermès and LVMH followed by Estèe Lauder were the clear winners of the GFC recession and post-GFC boom that impacted the entire luxury sector. This is hardly a surprise as both sub-sectors are considered a safe bet, especially in times of downturn. In this aspect, the French luxury powerhouses have used the GFC and the more recent recession as an opportunity to expand their desirability through bold local moves in China, solidifying their leadership positions among Chinese Gen Zer's. There is a mass of studies on consumer behaviour during recessionary periods, many of which point to an increased appetite for escapism, leading to irrational purchases. A 2008 study found that consumers with more than $10 Million in assets planned to increase their total spending on luxury goods despite the GFC. These affluent consumers tend to gravitate towards the top end of the luxury triangle; towards LVMH and Hermès, however, the dynamics of consumer spending are more complicated than the well-off continue spending while the rest of the world tightens its belt. Typically people try to hide their wealth during an economic recession, with anecdotes of shoppers leaving high-end shops with their purchases in brown paper bags to avoid detection. Although a 2010 study did away with this hypothesis, the particular case of Hermès in China is of interest here. The subdued, underplayed and highly exclusive positioning of its brand matches seamlessly with the current regime's drive for "common prosperity" cracking down on ostentatious displays of wealth and logos. Hermès avoids the overt display of logos and the complete absence of any form of celebrity endorsement, leaving them well placed to appeal to the changing definitions and perceptions of luxury among the Chinese consumer. French culture enables a long-term vision for brands, focusing on brand equity building. Unlike the many short-term profit-driven approaches in the US, French brands strive to build long-term brand equity, balancing traditional craft and disruptive execution. This gives French luxury brands, especially leading ones, a competitive advantage that is difficult to match. Every crisis defines the leaders of the future, as it looks now, French brands, at least those with excellent management, such as Hermes will have an edge. Should a global recession hit we anticipate polarising valuations, with strong leather heritage brands continuing to dominate the sector and affordable luxury names continuing to lag.

Earnings Performance

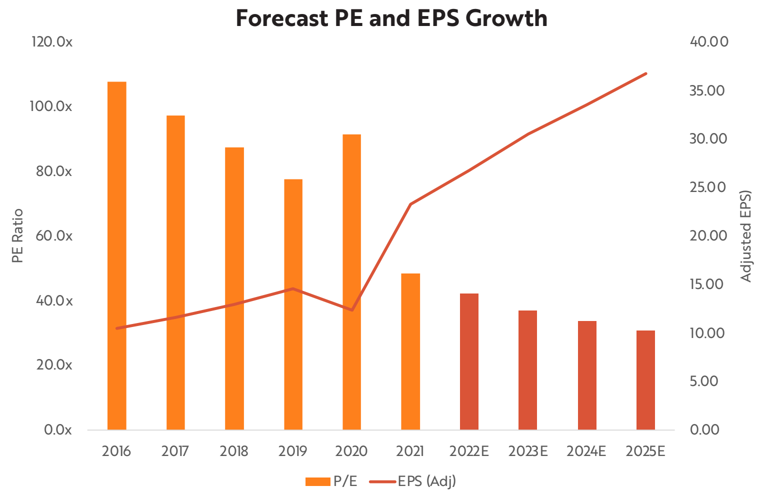
As expected, Hermès fundamentals are exemplary, consistently growing revenues, which reached their highest level yet in FY2021. Hermès has a fortress balance sheet, with a net cash balance of ~€3.7 Billion. This is characteristic of many family run business, who are extremely prudent with debt, ever focused on retaining control of the firm for the next generation. Hermès is not a particularly capital intensive business, spending an average 6% of sales as CAPEX. Recently CAPEX has focused on vertically integrating workshops and suppliers, resulting in cost reductions, improving margins as well as ESG efforts for lowering machinery energy consumption and tannery waste management. Free cash flow more than doubled in FY2021 as recurring revenue grew +78% from FY2021 supported by strong Asian demand in addition to the Americas area with a +44% increase. The majority of free cash flow has been paid out as dividends, however Hermès has engaged in share buy backs and small scale bolt on acquisitions. Headwinds due to rising inflation and prolonged lock downs in China do present several challenges for FY2022 growth, and we see revenue growth declining from its FY2021 high. Despite these headwinds Q1 2022 has started strongly with revenue up +27% from Q1 2021, slightly below managements' lofty target of +30%. Hermès has the luxury of being in a position where they can focus on storytelling, and selling to the consumer. Demand is so strong that price hikes are negligible, we can look to Chanel's +50% handbag price hike in FY2021 as an example. We anticipate strong pricing power, pent up demand, outstanding capital management and a fortress balance sheet will see Hermès continue to deliver on its exceptional performance for many years yet.

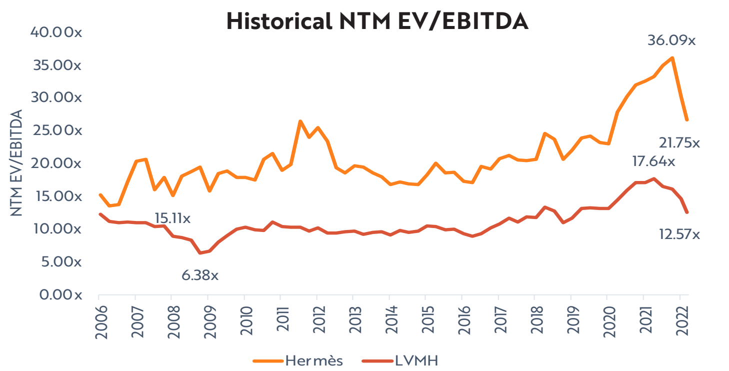


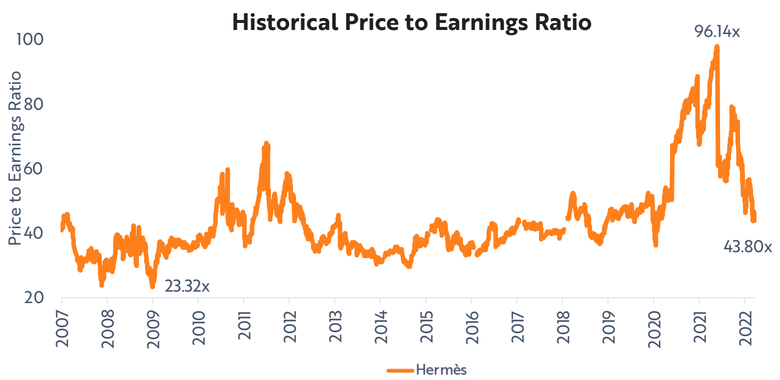


Valuation

Hermès ability to consistently grow revenues, expand margins and compound its invested capital at an extraordinary rate will continue to see it lead its peers in the luxury industry for decades to come. Hermès trades at higher multiples than almost every one of its competitors, however we believe this premium is more than justified, and does not fully reflect the compounding nature of the business. Additionally, we can observe that as Hermès grows its forecast EPS into 2025, we will see its PE ratio decrease dramatically to levels more consistent with peer group averages. We have utilised three valuation methodologies to assess Hermès fair value. (1) **Discounted Cash Flow** (**DCF**); (2) **Historical PE**; and, (3) **Historical NTM EV/EBITDA**. **Our weighted valuation for Hermès is €1,480 per share, implying a median discount of ~45% based on the closing share price of €1,020 as at 25 May 2022.**







"Over the long term, it's hard for a stock to earn a much better return than the business which underlies it earns. If the business earns 6% on capital over 40 years and you hold it for that 40 years, you're not going to make much different than a 6% return—even if you originally buy it at a huge discount. Conversely, if a business earns 18% on capital over 20 or 30 years, even if you pay an expensive looking price, you'll end up with a fine result." - Charlie Munger

Our weighted average valuation range indicates ~45% undervaluation...

Valuation range is assessed by the following weights: 50% DCF, 25% Historical PE, 25% Historical NTM EV/EBITDA.

Conclusion

Hermès has all the hallmarks of a high quality business, dominating its niche market position in the premium luxury goods sector. Hermès unassailable brand gives credence to the companies immense pricing power, and its management team continues to demonstrate excellent capital allocation. With the descendants of Thierry Hermes controlling ~77% of the business, we can be sure that the company will continue to place long term growth over short term unsustainable gains.

We currently believe this exceptional business is trading below its intrinsic value, and its premium to its peers is justified through its robust global business model. Hermes share price has declined ~40% from its all time high in November 2021. This has been mainly due to macro factors that have plagued the global economy rather than any internal issues as Q1 revenue continued to grow ~+20% yoy and management indicate further margin expansion into 2022. We believe current market conditions present an opportune entry point into this exceptional company, for investors in the Elevation Capital Global Shares Fund.

Any data not referenced was sourced from Hermès International, Investor Briefings & Earnings Conference Calls.

1 Capital IQ as at 6 May 2022
2 Refinitiv as at 9 May 2022
3 Bain & Company (2021). The Future of Luxury: Bouncing Back from COVID-19.
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5 BOF *Is Luxury Recession Proof?* (2022).
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This investment summary report was written in May 2022

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Independent Thinking Disciplined Investing

[In-de-pend-ent Think-ing] ində́pendənt 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 inves'ting 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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