



ELEVATION CAPITAL®



## TOD'S – AN ITALIAN LUXURY FASHION HOUSE

Tod's (TOD.IM, Market Capitalisation €2.0B) Tod's SpA is one of the smaller global luxury players. The Company produces luxury shoes, leather goods, accessories and apparel, and distributes them worldwide through 378 stores (270 Direct-Owned-Stores, 108 Franchised Stores), independent multi-brand stores, its own online stores and third party online stores such as YOOX Net-A-Porter/Mr Porter.

## BRAND PORTFOLIO

- **Tod's** is best known for its shoes and luxury leather goods that represent - Italian tradition, quality and modernity.
- **Hogan** was among the first producers of “luxury” sneakers, one of the most popular product categories today.
- **Fay** was acquired in the late seventies, and developed by Tod's to produce a range of high quality casualwear & coats.
- **Roger Vivier** is famous for its extravagant and luxuriously decorated shoes. The brand now extends its product range to include handbags, small leather goods, jewellery and sunglasses.

## MAJORITY (60.66%) SHAREHOLDER/CHAIRMAN/CEO – DIEGO DELLA VALLE

Diego Della Valle is the grandson of Filippo Della Valle, who started his shoemaking business in the 1920s. After inheriting the business from his father, Diego successfully expanded the business and built the now famous Tod's brand. He also created the Hogan brand. Fay and Roger Vivier are the two brands acquired and developed by Diego Della Valle. The New Yorker (10 May 2004) called him the “Italian Ralph Lauren”.

## VALUE TRAP OR VALUE OPPORTUNITY?

After reaching an all-time high of €142.30 on 23/8/2013, Tod's share price has declined 67% in the last four years to a low of €46.99 on 30/9/2016. It has since recovered to €59.89 as at 20 September 2017. Tod's is currently (as at 20 September 2017) the sixth largest position in Elevation Capital Value Fund. We initiated a position in Tod's in 2014 after the share price declined more than 30% from its all time high in 2013 and the overall luxury sector had seen a sell-off due to anti-graft/anti-corruption policy in China. Tod's represented compelling absolute & relative value then. *The key question is does it now?* While other luxury players have seen recovery in their businesses, and their stock prices. Tod's is currently underperforming due to several company specific issues. *The question again is whether these issues can be resolved in a reasonable and timely fashion?*

## UNDERPERFORMANCE IN RECENT YEARS

Tod's has underperformed in recent years as the strategy of trying to transform Tod's from a shoe brand to a lifestyle/fashion brand was pushed too far from 2013 to 2016 under its then creative director Alessandra Facchinetti. As Management commented that it was “*too much fashion for our old clients and not enough fashion to attract new clients*”. Although Roger Vivier has continued its impressive growth (Compound annual growth rate of +38.3% from 2006 to 2016), both Hogan and Fay have struggled to grow since 2009, this resulted in two designers for Fay leaving the Company in July 2017 after six years working for the brand. Hogan has been particularly disappointing given it really invented the “fashion” sneaker category, but has failed to capitalise on the current global fashion sneaker growth due to its lack of an international expansion strategy, as it continued to focused domestically and wholesale driven.

## TURNAROUND TO BE DRIVEN BY MOTIVATED 60.6% MAJORITY SHAREHOLDER

We believe the specific issues that have plagued the Company in the last few years can be fixed in a reasonable and timely fashion by a motivated 60.6% owner. Management is determined to return to its roots and strength – to create products that reflect the brands' DNA and tradition – Made in Italy, Italian quality and Italian lifestyle. At the same time, Management needs to continue its efforts on improving cost efficiency.

Patience is rewarded if we assume by 2020 EBITDA profitability is restored to €200M (80% of 2012 level, with a Forecast EBITDA Margin of 18.3% vs. 26.0% in 2012) or €250M (100% of 2012 level, with a Forecast EBITDA Margin of 22.9% vs. 26.0% in 2012) and apply the current peer group EV/EBITDA multiple of 14.7x which provides an upside potential of +52.7% or +89.8% (IRR/Annualised Return = +16.5% or +26.0%, assuming an exit in the middle of 2020) - not including dividends. (Tod's has a current gross dividend yield of 2.84% per annum, which is amongst the highest in the sector globally.)

## SECULAR TAILWIND

We believe that Tod's is positioned favourably to execute its turnaround plan as well as the continuation of cost efficiency measures with the following secular tailwinds to assist its efforts:

- Continued Growth in Luxury – The global personal luxury sector is expected to grow at +2% - +3% annually from 2016-2023;



- Shoes/Leather Goods – The two categories that Tod’s generate most of its revenue from are forecast to grow at above average annualised growth rates (Shoes: +5.1%, Leather Goods: +4.5%) versus the broader global personal luxury sector;
- China – Currently, Tod’s has a sizable presence in Greater China – 29.4% of its store count, but only 22.5% of total sales. We believe the recent trend of repatriation of luxury spending and reduced pricing differentials in China should assist the situation; and,
- Casualwear – The increasing appeal of casualwear versus formalwear amongst luxury consumers, and the “luxurisation” of casualwear should further benefit Tod’s core product lines.

#### A POTENTIAL TAKEOVER TARGET

As Diego Della Valle (63) approaches retirement, and with his interests in politics, we see Tod’s as a potential takeover target for:

- LVMH or Kering: two of the largest luxury goods firms in the world, especially LVMH as Bernard Arnault, Chairman and CEO of LVMH, personally owns 3.5% of Tod’s shares, and Diego Della Valle sits on the board of LVMH.
- Coach: The aspiring multi-brand operator with 52% of its revenue generated from North America.
- Burberry: Burberry can remain an UK/European brand operator but with improved diversification.

#### VALUATION – “PRIVATE MARKET VALUE”

We believe based on historical transactions the appropriate multiple ranges to acquire Tod’s would be in the range of 15-17x EV/EBITDA, depending on the potential synergy benefits of the acquisition/merger for the acquirer. Based on FY2017E EBITDA of €170M, we estimate the current “Private Market Value” or Intrinsic Value to be in the range of €75.96 and €86.24, with upside potential of +27.0% and +44.2%. However, we do not believe Mr. Della Valle would sell Tod’s when EBITDA has retreated from €250M in 2012 to a forecast €170M in 2017. Additionally, after Mr. Della Valle sold the Roger Vivier brand to Tod’s, he invested half of the €415M proceeds back into Tod’s at €83.53 per share (versus the current share price of €59.80 as at 20 September 2017).

To be conservative, we assume that Management can improve EBITDA to €200M in 2020 (80% of 2012 level, with a Forecast EBITDA Margin of 18.3% vs. 26.0% in 2012). Based on this assumption, we estimate the Private Market Value range of Tod’s would increase to €93.11 - €105.19 per share. This presents upside potential of +55.7% to +75.9%, with an IRR/Annualised Return range of +17.3% to +22.6% per annum (excluding dividends) assuming an exit in the middle of 2020.

Looking forward with optimism (and motivation of a 60.6% majority shareholder), if EBITDA can return to €250M in 2020 (100% of 2012 level, with a Forecast EBITDA Margin of 22.9% vs. 26.0% in 2012), we estimate the Private Market Value range of Tod’s would increase to €115.77 - €130.88 per share. This presents upside potential of +93.6% to +118.9%, with an IRR/Annualised Return range of +26.9% to +32.6% per annum (excluding dividends) assuming an exit in the middle of 2020.

#### VALUE OPPORTUNITY

We conclude that Tod’s is not a “Value Trap” but it requires patience as the Company restores historical profitability and implements a more targeted expansion programme. We believe investors should be focusing on a return to former profitability levels by 2020 with a potential sale of the Company to a luxury conglomerate thereafter.

#### INVESTMENT THESIS - SUMMARY

Tod’s is one of the leading global players that produces and sells shoes, luxury leather goods and casual wear. It is 60.66% owned by Diego Della Valle. Tod’s has underperformed in recent years due to Management’s poor execution and a failed change in strategic direction that sought to increase the fashion component of Tod’s business.

We expect margins to improve as Management refocuses its efforts on creating products that truly reflect Tod’s core proposition: Made in Italy, Italian quality and Italian lifestyle. We believe the stock is significantly undervalued either; (i) if it remains a standalone company and delivers a turnaround by 2020 that improves EBITDA profitability at/near its FY2012 level of €250M; or, (ii) if Diego Della Valle sells Tod’s (in the price range of 15-17x EV/EBITDA) to a large luxury conglomerate such as LVMH or Kering for family estate planning and succession planning purposes.

Tod’s currently trades at €59.80 per share (as at 20 September 2017), EV/TTM EBITDA multiple of 11.9x. We estimate Tod’s Intrinsic Value to be in a range of €74.42 - €130.88 assuming normal trading conditions and under various valuation scenarios as detailed in our in-depth appraisal/presentation on Tod’s that can be viewed at: <http://www.elevationcapital.co.nz/tods/>. Our valuation/s represent upside potential of between +24.4% to +118.9% from prevailing market prices for the stock.

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*This summary report was written as at 20 September 2017.*

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