



# The Other Greek Parmalat?



5/1/18

An in-depth report by QCM Investigative Research Team

Our Investigative Research Team has conducted an in-depth inquiry on **Folli Follie**, the well-known Greek fashion designer and retailer. Our extensive investigation spanned three continents and involved dozens of interviews and on-site visits, a systematic review of Folli Follie's store network and comprehensive analytical work. After reviewing the facts, we struggle to reconcile the company's size, revenue and growth rates with the reality we observed on the ground and we have concerns about the ability of the company's financial statements to portray an accurate view of the company. We worry that the Group could be heading toward serious financial distress and that the stock is correspondingly grossly overvalued.

**QUINTESSENTIAL CAPITAL HAS SHORTED THE STOCK OF  
FOLLI FOLLIE GROUP**

## The Other Greek Parmalat?

### DISCLAIMER

This publication represents the current opinions of Quintessential Capital Management ("QCM") concerning Folli Follie ("FF"). Funds and accounts managed by QCM currently have short positions in FF. Although QCM does not expect to announce in the future any changes in either its opinion concerning or economic interest in FF, both are subject to change. This article is for informational purposes only and does not constitute investment advice or a recommendation to purchase or sell any particular security or to pursue any particular investment or trading strategy. QCM cannot guarantee that any projection or opinion expressed in this publication will be realized. QCM's opinions are based on the sources cited in this article, but QCM cannot and does not provide any representations or warranties with respect to the accuracy of those materials.

### ABOUT QUINTESSENTIAL CAPITAL MANAGEMENT

QCM is a long/short global equity fund. Our short activity focuses on activist short selling, whereby we seek to uncover and expose deeply troubled corporate situations (e.g. frauds, illegal activity, failed business models, etc.) through state-of-the art investigative work.

On the short side, we only act when supremely confident in our thesis and, so far, we enjoy a perfect success rate. Our latest public short, another Greek company named **Globo Plc**, shut down permanently 12 hours following our report<sup>1,2</sup>, with the CEO and CFO of the company resigning their posts and admitting all our allegations. To our knowledge, it was the fastest delisting of a stock following a short report ever. Our previous target, **American Addiction Center**<sup>3</sup>, collapsed 70% within two weeks from the publication of our report<sup>4</sup>. We also performed a number of non-public short-activist operations with an equally high success rate.



**Globo CEO And Finance Chief Resign In Wake Of Quintessential Report**

LONDON (Alliance News) - Globo PLC said Monday Chief Executive Officer Costis Papadimitrakopoulos ...

Alliance News | 26 October, 2015 | 8:35AM | [Facebook](#) [Twitter](#) [LinkedIn](#) [Email](#) [Print](#) [AAA](#)

LONDON (Alliance News) - Globo PLC said Monday Chief Executive Officer Costis Papadimitrakopoulos and Chief Financial Officer Dimitris Gryparis have both resigned, and a board has been set up to "ascertain the true financial position of the company."

Additionally, Chief Operating Officer Gerasimos Bonanos has been suspended from his duties with immediate effect, pending the outcome of appropriate investigations.

This follows a report published by New York-based hedge fund Quintessential Capital Management last week in which it said it had collected "overwhelming evidence suggesting the existence of what appears to us a large-scale conspiracy to deceive investors and creditors through pervasive and systematic accounting manipulation."

<sup>1</sup> <https://uk.reuters.com/article/uk-globo-plc-accounting/globo-plcs-ceo-and-cfo-quit-after-disclosing-irregularities-idUKKCN0SK1QA20151026>

<sup>2</sup> <http://masterinvestor.co.uk/wp-content/uploads/2015/10/GBO-report-super-final.pdf>

<sup>3</sup> <https://blogs.wsj.com/moneybeat/2015/08/05/blog-post-from-college-student-causes-massive-sell-off-in-FF-holdings/>

<sup>4</sup> <https://seekingalpha.com/article/3342015-american-addiction-centers-our-final-opinion-its-a-castle-of-cards>

## Executive Summary

The image we received from reviewing FF's financial statements and official declarations over the year is that of a rapidly-growing multinational fashion company led by double-digit growth in its key segment: Asia. Unfortunately, following an extensive investigative and due diligence work we find it impossible to reconcile that picture with our findings on the ground, which point to an unprofitable, struggling company with materially smaller, and rapidly decreasing revenue, network size and cash balances. The core of the issue seems to be concentrated in FF's Asian and, particularly, Chinese subsidiaries. Our conclusions are well substantiated by the following points that will be reviewed in depth in this report:

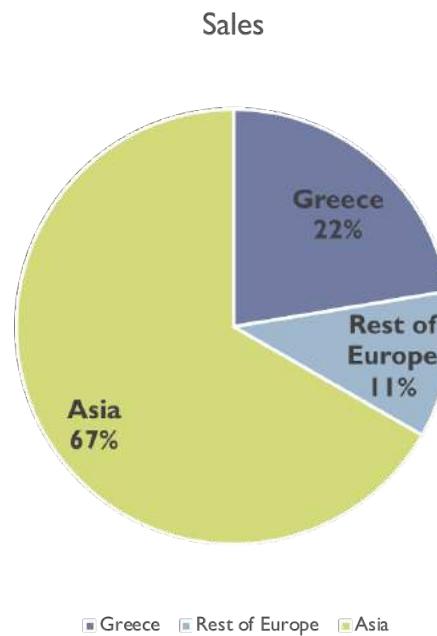
- A. **The network of points of sale (POS) appears materially smaller than expected:** We performed an extensive due diligence and checked each individual POS, often in multiples ways: contrary to the 630 POS mentioned in the 2016 annual report for the FF brand, we found evidence of only 289 operating POS. The majority of the remaining ones appear to have ceased operations.
- B. **Onsite checks:** we personally visited several FF POS in key strategic locations (e.g. New York City and Tokyo, Japan) and can confirm that many critical assets that the company, still appearing on its website (e.g. FF Soho or FF Madison Avenue shops), are indeed closed. We also noticed how a number of POS, including in key locations, appear to be of negligible size (often just a small window) and in the process of liquidation.
- C. **Digital presence:** we ran an audit on FF presence online, checking website traffic and popularity on social media and benchmarking it against FF competitors. Our findings suggest that FF digital presence, especially in Asia, may be indicative of a far smaller company.
- D. **Financial analysis:** FF official figures indicate growing revenue and profit, but constantly negative free cash flow, the bulk of which is explained by large and increasing working capital in its Asian subsidiaries. The amount of account receivables and inventory of FF Asian subsidiaries seems clearly disproportionate compared to its peers.
- E. **Chinese subsidiaries:** FF claims \$1 bn of revenue originating in Asia, of which China has presumably the lion's share (70% of the Asian network would be located there). Surprisingly, we found that the only two mainland Chinese subsidiaries of FF, *Fu Li Fu Lei* and *Binlianyun*, generate only some \$40m of revenue and together count only about 50 POS.
- F. **Concerns about auditors:** after auditing their accounts for several years through Baker Tilly, a 2<sup>nd</sup> or 3<sup>rd</sup>-tier accounting firm, FF recently switched to "Ecovis" a relatively unknown firm. Moreover, the auditors of the entity consolidating FF sales in Asia, totaling approximately \$1 bn, appear to be an obscure firm with a staff of only two people. According to senior Chinese auditors from Big Four firms, this firm may well be inadequate for an audit of this scope (\$1 bn of sales; hundreds of POS in multiple countries).

## I. Company Description

Folli-Follie Commercial Manufacturing and Technical SA operates in the fields of jewelry, department stores, and apparel in Greece and internationally. The Company has three main segments:

- Jewelry-Watches-Accessories: this is the core segment and in 2016 would have generated € 978m of revenue (73% of total).
- **Over 90% of this revenue (€892m) originates in Asia** (mostly China and Japan). FF Asia also generates 100% of the Group's operating income.
- Department Stores: the operation of three "Attica" department stores in Athens, Greece - €181m (14% of total).
- Retail/wholesale: operations of a distribution network in Greece, Romania and Bulgaria - €178m (13% of total).

As management frequently boasts, it is clear from the figures above that **Asian sales constitute the dominant part of FF's activity**. This report will present strong evidence that FF's Asian business, far from growing rapidly, may instead be dramatically shrinking and may be substantially smaller than perceived by the market. Because this is such a large part of FF overall turnover, we are deeply concerned that the financial statements may be incompatible with the facts that we have seen on the ground.



Asia constitutes a dominant part of the overall business<sup>5</sup>.

<sup>5</sup> Source: Capital IQ

## II. Historical Background

The company was established in 1986 in Greece by Dimitris Koutsolioutsos. The first shop was in the commercial district of Athens. Folli Follie started by manufacturing jewelry and in 1994 launched their first watch line. In the mid 1990s the company started expanding aggressively in Asia, first in Japan and later in China and elsewhere.

At first business was good: FF products were esthetically pleasing, creative and affordable. FF enjoyed significant success in Japan, where the brand was extremely popular around 15 years ago. However, in 2008 the Japan business started a slow decline and that does not seem to have changed. The decline was offset until recently by strong growth in China, fueled by the initial popularity of the brand and by the growth in the number of points of sale. However, starting 4/5 years ago, growth peaked in China as well and the brand has been in retreat ever since, with both the number of sales outlet as well as comparable sales decreasing dramatically<sup>6</sup>.

Links of London, a British jewelry brand acquired by FF in 2006, and Attica, a department store with its main outlet in Athens, are non-core businesses accounting for a smaller proportion of sales and possibly unprofitable.

The steady “growth” of Folli Follie’s revenue, has in the last few years generated negative cash, to the extent that FF in 2017 issued a €300m bond repayable in 2021, in addition to another €150m bond issued in 2014.

The company claims rapid growth, investment and expansion. This report will instead suggest a dramatically different picture: a rapidly-shrinking, far smaller company heading toward financial uncertainty.

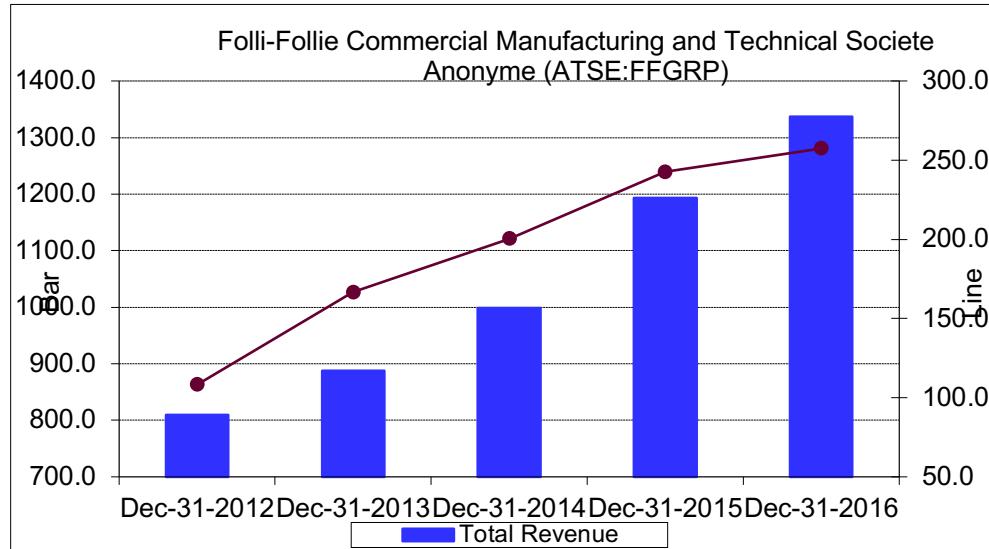
---

<sup>6</sup> This is our interpretation of the evidence we acquired through our field checks.

### III. What the Company claims about itself

The extensive evidence we collected and examined suggests that FF business may be in a precarious situation. This view clearly is in conflict with the image that management tries to portray of a rapidly growing company with a bright future. In order to understand these disturbing inconsistencies, it is important to first look at the official figures, which we view with great skepticism:

a) *Fast Growth in Revenue and Net Profit<sup>7</sup>:*



For the year 2016, FF claimed **total revenue of €1.3b** and **operating income of €257m**, with a healthy 20% operating margin. From 2010, **revenue has been growing at 11% per year on average**; **operating income growth averaged almost 20% per year**.

- b) *Large and Growing Network of points of sale (POS):* the 2016 Annual Report claims **930 points of sales<sup>8</sup>** (up from 568<sup>9</sup> in 2012, implying 362 new POS).
- c) *Growth of the Jewelry-Accessories segment: from €642m (2013) to €977m (2016) (see table below).*

<sup>7</sup> Source: CapitalIQ

<sup>8</sup> 2016 Annual report.

<sup>9</sup> 2012 Annual report (pp. 9, 11) 488 Folli Follie + 80 Links of London.

SALES PER SEGMENT (post eliminations) (Continuing operations)				
in Euro mil	2013	2012	%chng	% of total
Jewellery-Watches-Accessories	642.4	583.8	10.0%	72.4%
Department Stores	136.2	123.8	10.0%	15.3%
Retail/Wholesale	106.3	98.4	8.0%	12.0%
Other Activities	2.5	3.7	-32.4%	0.3%
<b>Total</b>	<b>887.4</b>	<b>809.7</b>	<b>9.6%</b>	<b>100.0%</b>

SALES PER SEGMENT (after eliminations) Continuing Operations				
Ποσά σε € εκατ.	2016	2015	% Δ	% in total
Jewellery-Watches-Accessories	977,8	857,0	14,1%	73,1%
Department Stores	181,4	171,4	5,9%	13,6%
Retail / Wholesale	178,1	164,7	8,1%	13,3%
<b>Total</b>	<b>1.337,3</b>	<b>1.193,0</b>	<b>12,1%</b>	<b>100,0%</b>

Tables implying growth of Jewelry-Accessories segment of 52% in three years (2013-2016)<sup>10</sup>.

*Dear shareholders,*

We look back at an eventful year 2016 influenced by ongoing uncertainties and geopolitical tensions. Despite all this Group managed to reach another excellent performance in 2016 based on an effective diversification in terms of business activities and regional exposure.

We anticipate that 2017 will be another challenging but successful year, while addressing efficiently all global challenges at the same time, we remain focused on creating value to our stakeholders.

All activities exhibited remarkable growth, whereas we expanded our footprint in new markets and we prepared the next stage of the Group development.

Our reported consolidated revenue rose by 12,1% while Group net income increased by almost 22%. These sound results were supported by the resilience of our local activities and an exceptional performance of the affordable luxury division.

Our own brands Folli Follie and Links of London recorded an impressive performance driven by dynamic sales and improved profitability. The continuous demand for affordable luxury confirms our strategy and positioning in an industry which continuously gains customers worldwide.

The performance of our domestic operations demonstrated impressively the resilience of our diversified brand portfolio and benefits of market share gains we experienced throughout the last couple of years.

The Jewellery, Watches and Accessories activity demonstrated its solid performance which accelerated in the last quarter of the year, proving the brands ability to capitalize on the many opportunities available in existing as well as new markets.

The Retail and Wholesale as well as the Department Store activities experienced another year of impressive recovery, translating a growing market share into rising revenues and profitability.

*2016 CEO Annual Letter claiming announcing fast growth.*

<sup>10</sup> Source: FF Annual Reports years 2013, 2016.

#### IV. The Real Picture (according to Quintessential)

Months of painstaking due diligence suggest a radically different picture of FF than what could be inferred from FF official reporting. We came across convincing evidence suggesting an unprofitable, rapidly shrinking business, with **decreasing revenue and negative cash flows**. **We estimate that the real revenue of the Jewelry-Watches-Accessories segment may be only a fraction of the reported revenue.**

We also have a radically different view concerning the size of the FF network and the number of POS: according to our due diligence, **FF-branded points-of-sale may be less than 300** (vs. 630 claimed by the company) with a large number of POS being little more than a small window and selling a few thousand Euros per year. Besides a rapidly shrinking network, same-store-sales in Asia, unlike what the management claims during the conference calls, seem to have been decreasing steadily over a number of years.

What is going on? In our opinion, and based on the extensive evidence we gathered, after the initial success in Asia, particularly in China and Japan, the situation slowly, but steadily went downhill. At first comparable store sales started to drop i.e. each individual store was selling less and less. In Japan, this led to a steady closing of shops that gradually became unprofitable (in Japan there are no franchisees). In China, the company tried to counter this trend by opening new points of sales with new franchisees: this worked for a while, as overall sales increased due to additional shops despite decreasing comp sales. However, soon enough franchisees started closing shops due to disappointments with the achieved levels of sales.

Until about 2013, business was decent in China, the network peaking around 200 POS, half company-owned and half franchisees. At the time, sales were increasing around 10% per year, but driven by new outlets as comp sales were already decreasing. From 2014 onwards, the pace of deterioration accelerated such that a leading FF figure (the Managing Director for China) left the company for a competitor (Montblanc). Apparently, sales quickly fell further after that.

According to our estimates<sup>11</sup>, FF sales in China may be as little as \$40m in 2016 and may have decreased further in 2017.

During the last few years FF appears to have closed most of its Chinese network and 30% of its Japanese one, with more POS planning to shut down soon. We have identified the following reasons for FF catastrophic deterioration in Asia:

- **Sub-optimal management practices:** FF is a family-owned, family-managed business. Most strategic decisions, down to the location of some of the individual stores, are taken directly from Dimitris Koutsolioutsos and there seems to be a lack of organized processes for activities such as merchandising, for example. There have reportedly been disagreements between Mr. Koutsolioutsos and his son, who allegedly would be interested in getting rid of the FF brand altogether.
- **Competition:** when FF first opened in Asia (15 years ago in Japan and later on in China) they found a “greenfield” location and basically had all the market by themselves. The Chinese consumer was far less sophisticated than it is today and eagerly bought FF products that were perceived as quality western luxury goods. Now, however, companies such as Coach, Kate Spade, Furla, Pandora and

<sup>11</sup> Estimates based on the P&L data of one of the two Chinese subsidiaries filed with the Chinese government and confirmed by our digital presence audit. Both sections will be explored further later in this report.

## The Other Greek Parmalat?

Swarovsky started entering the market with arguably far greater resources and better management practices than FF. For example, space productivity (i.e. sales per sqm) for FF was only about 50% of Swarovski or Michael Kors<sup>12</sup>.

- **Products:** In many cases, the FF lines of products received mixed receptions from consumers. For example, the “KK” product line (designed by the founder’s wife, now in her ‘70s) was perceived as “old school” by clients, especially considering that FF seeks to position itself as a “young” brand. There were also concerns about product quality.
- **Key personnel leaving:** as the situation deteriorated, key talent left the company (for ex. the China Managing Director who left for Montblanc). According to our field checks, the departing managing director has been left without a replacement for years. A similar situation seems to have occurred in Japan, with a number of key personnel leaving in frustration.

Given the above, it appears that the entire Asian business, such a dominant part of the Group may be in shambles. Therefore, we are skeptical about FF’s financial statements that claim sales for the Jewelry-Accessories segment increasing over 50% from 2013 to 2016, when FF shut down almost half of its Asian network while suffering decreasing comp sales.

## V. Evidence regarding the number of Points of Sale in the FF network

The size of the FF network and evidence concerning the number of POS is a concerning indication about the health of the FF Group. We have performed a large-scale investigation with the explicit purpose of answering one question: **how many POS does FF really have?** In order to answer the question, we have used a multi-channel approach:

- 1) We have downloaded the relevant POS data from FF own “shop locator” and “global presence” websites, which include phone numbers and addresses.
- 2) We have systematically called almost each individual shop during office hours to check whether it’s open or closed.
- 3) We have checked evidence of the existence of each POS online (e.g. checking whether the site appears on Google Maps, Streetview or on the website of the relevant shopping center).
- 4) In many cases, we have physically visited the POS, checked the facility and took photographs.

We have also used local research teams with the necessary language skills and knowledge of the territory. **Our findings have been remarkable.**

### I. What FF claims about its POS network

We are of the opinion that FF management has been less than transparent about the true size of its network. In fact, different figures appear from different sources, but they all seem to exaggerate the true size of the POS network.

The FF 2016 Annual Report mentions a total of 930 POS, of which **630** for the Folli Follie brand. Out of these, **65** POS in Japan and **240** POS in China<sup>13</sup>:

<sup>12</sup> This insight is the result of field interviews conducted with competitors of FF in Asia.

<sup>13</sup> Source: Folli Follie 2016 Annual Report – pp. 12.

## The Other Greek Parmalat?

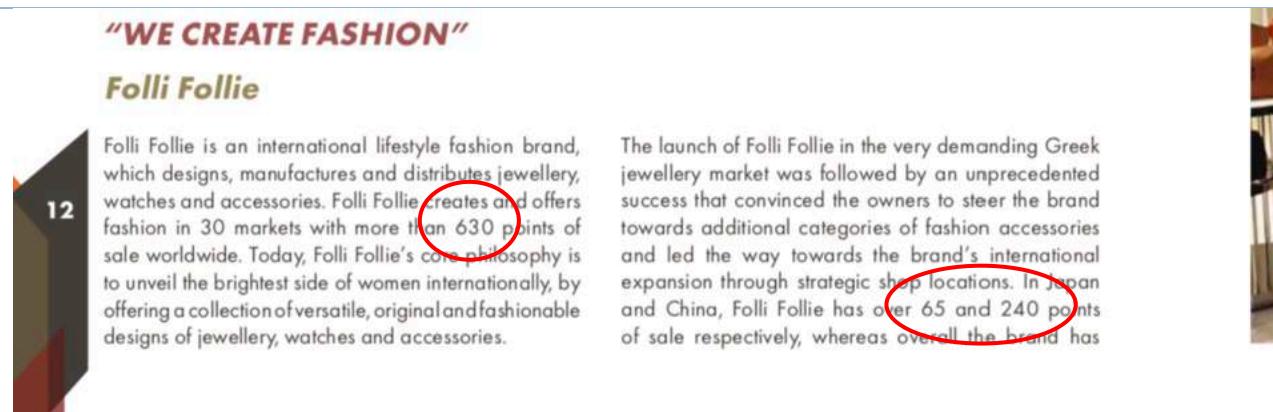
**"WE CREATE FASHION"**

### Folli Follie

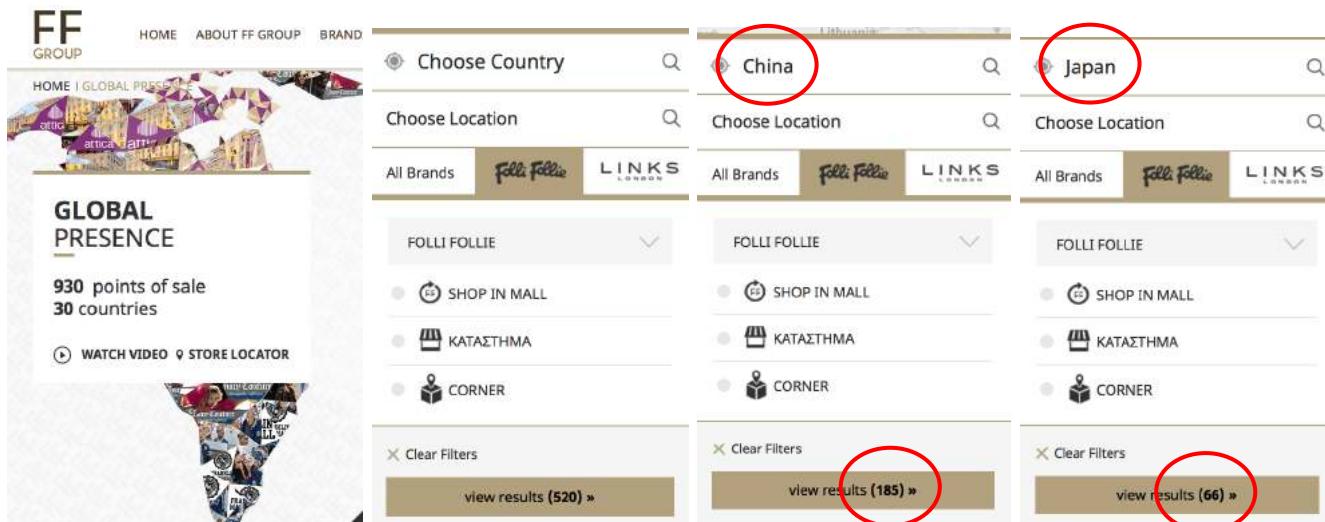
12

Folli Follie is an international lifestyle fashion brand, which designs, manufactures and distributes jewellery, watches and accessories. Folli Follie creates and offers fashion in 30 markets with more than 630 points of sale worldwide. Today, Folli Follie's core philosophy is to unveil the brightest side of women internationally, by offering a collection of versatile, original and fashionable designs of jewellery, watches and accessories.

The launch of Folli Follie in the very demanding Greek jewellery market was followed by an unprecedented success that convinced the owners to steer the brand towards additional categories of fashion accessories and led the way towards the brand's international expansion through strategic shop locations. In Japan and China, Folli Follie has over 65 and 240 points of sale respectively, whereas overall the brand has



2016 FF Annual Report reporting on the number of POS.



The screenshot shows three separate store locator sections. The first section is for China, showing 185 results. The second section is for Japan, showing 66 results. The third section is for the overall group network, showing 520 results. Each section has filters for 'SHOP IN MALL', 'KATASTHIMA', and 'CORNER'.

Screenshots taken from one of two FF store locators.

The screenshots above have been taken from one of the two existing store locators on the FF website.<sup>14</sup> The number for the overall group network corresponds to the one on the annual report (930). However, the store locator claims 520 stores for FF-branded POS (instead of 630 appearing in the 2016 annual report). Also, the store locator lists 185 POS in China (instead of 240 in the annual report). These are the first indications that FF may not have its reporting system in order.

<sup>14</sup> <http://www.ffgroup.com/stores/>

STORE LOCATOR

**Folli Follie**

Search

NEW IN JEWELLERY WATCHES BAGS ACCESSORIES SALES COLLECTIONS

LOGIN TO YOUR ACCOUNT OR CREATE A NEW TO ENJOY 15% OFF

SULTS

## Store Locator

From Athens & Tokyo to Hong Kong, London, New York and beyond, our iconic products are available across the globe. To find a Folli Follie store near you, use the store locator below.

OR **425 stores found**

FF has one more store locator located on its [Follifollie.com](https://www.follifollie.com/cm-en/stores) website,<sup>15</sup> this one claims only 425 POS. We downloaded all the shops listed in the shop locator and, surprisingly, we found some 580 POS, instead of 425.

So, to summarize, FF claims 630 Folli Follie-branded POS, out of which 240 in China and 65 in Japan.

### Our phone and online due diligence

We downloaded the complete information set from the company's store locator and created a full database including, presumably, all of FF network around the world. The screenshots below are examples of the output from the FF store locators<sup>16</sup> we used for our database (the two screenshots refer to the output of the two store locators referring to the same shop). Incidentally, as we shall see later, the shop in question (FF Soho) has been closed for over a year!

**425 stores found**

1 ... 1 OF 36 > SHOW 60 PER PAGE

### SOHO FOLLI FOLLIE

#### FF SHOP

#### ADDRESS

SOHO FOLLI FOLLIE, 133 PRINCE  
STREET  
NEW YORK  
NEW YORK

#### PHONE

212 780 5555

[VIEW MAP & DIRECTIONS](#)

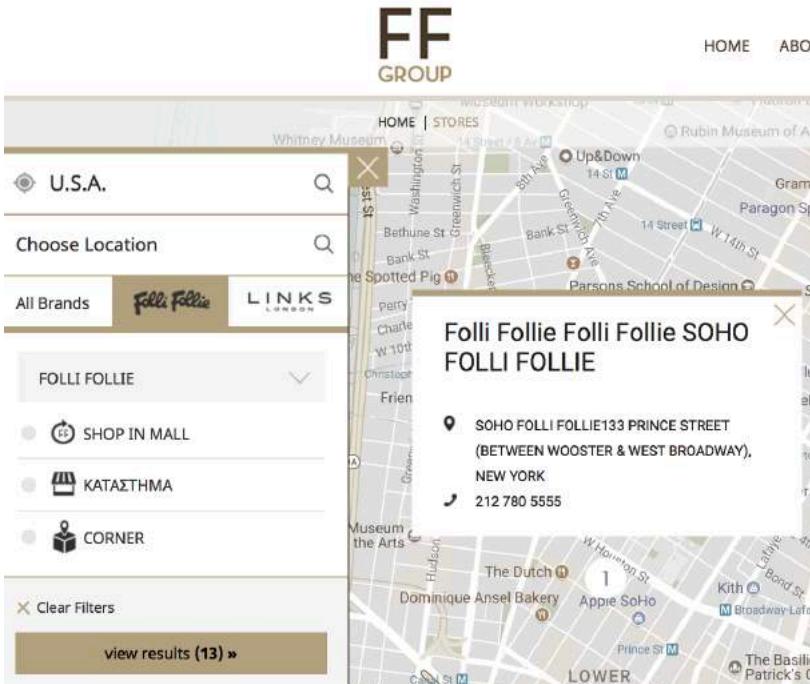


FF Soho, output from [follifollie.com](https://www.follifollie.com/cm-en/stores) store locator

<sup>15</sup> <https://www.follifollie.com/cm-en/stores>

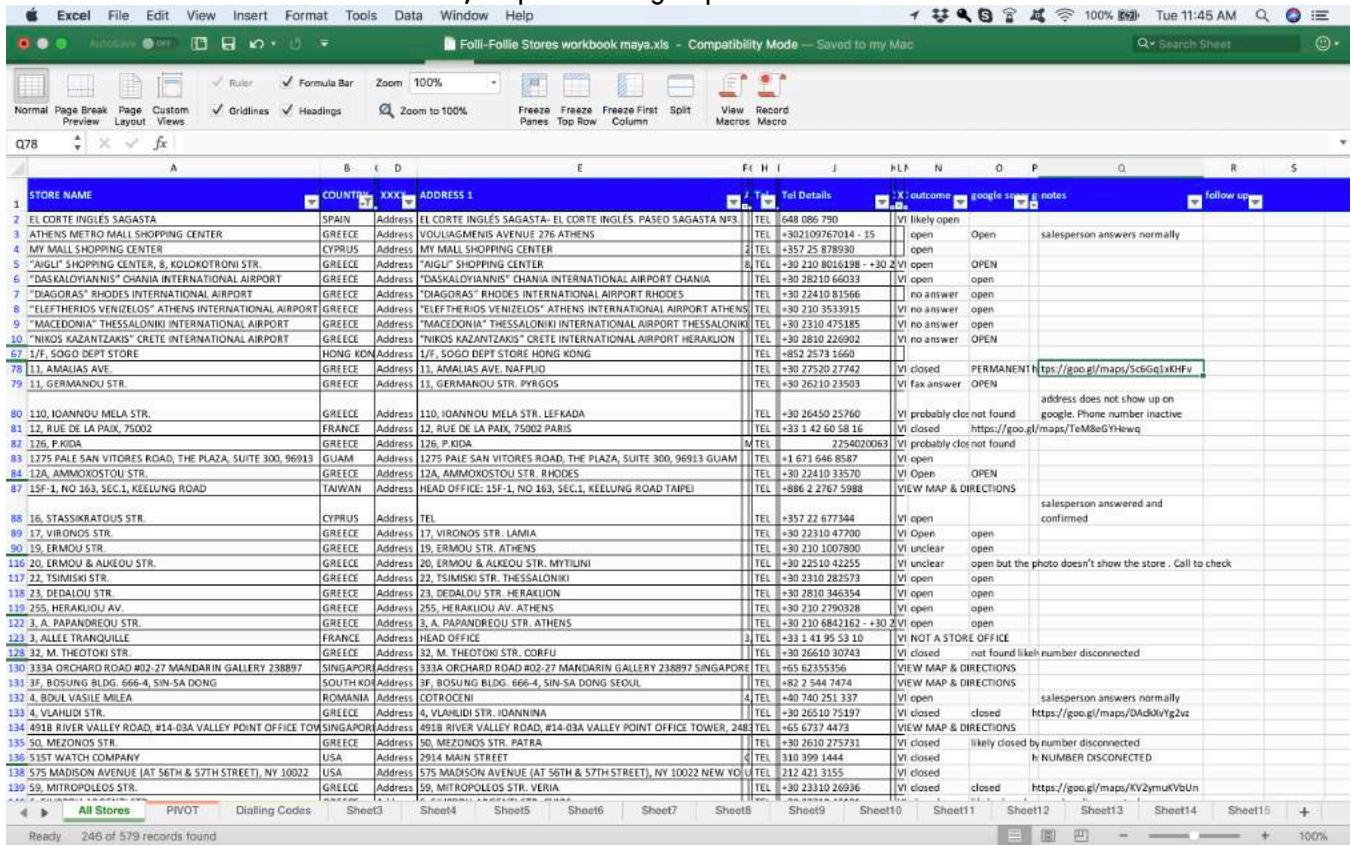
<sup>16</sup> Source: <https://www.follifollie.com/cm-en/stores> and <http://www.ffgroup.com/stores/?countryId=1&manufacturerId=42889>

## The Other Greek Parmalat?



The screenshot shows a map of New York City with a specific location marked in SoHo, New York. The address listed is 133 Prince Street (Between Wooster & West Broadway). The store is identified as "Folli Follie" and "FOLLI FOLLIE". The website interface includes a search bar for "U.S.A.", a "Choose Location" dropdown, and filter options for "SHOP IN MALL", "KATASTHMA", and "CORNER". A "view results (13)" button is visible at the bottom.

FF Soho, output from [ffgroup.com](http://ffgroup.com) store locator



The screenshot shows an Excel spreadsheet with data from 353 stores. The columns include: STORE NAME, COUNTRY, ADDRESS 1, TEL, Tel Details, X: outcome, google score, notes, and follow up. The data spans multiple rows, with some rows showing specific details like address, phone number, and notes about store status (e.g., "likely open", "closed", "no answer"). A "VIEW MAP & DIRECTIONS" link is present in the notes column for many entries. The notes column also contains links to Google Maps for specific store locations.

Screenshot of the database compiled by Quintessential aggregating all the data from FF store locator.

## The Other Greek Parmalat?

Having built our database, we assembled multiple teams of analysts with the necessary language skills and simply checked each individual POS in the database with the intent of determining whether it is closed or in operation. Our teams called each individual POS listed in the database and confirmed their findings with online checks, for example checking whether the shop shows up on Google maps or elsewhere.

The facts: out of the 630 FF-branded POS claimed in the annual report, only about 289 were confirmed open; 154 were confirmed closed and approximately 92 were suspected to be closed<sup>17</sup>. Therefore, we can claim with confidence that the<sup>18</sup> **FF full network size is somewhere between 289 and 381, only** about half of the number claimed. Please note the following:

- Most “closed” and “suspected” closed POS were concentrated in China and Japan. This is particularly worrying considering that management claims that almost 70% of the Group’s revenue and 100% of operating income originate in Asia. Our best estimate for the size of the entire Asian network ranges from 172 to 208 POS.<sup>19</sup>
- A large number of POS we sampled, were not FF shops. Rather they seemed wholesalers selling a large variety of brands, of which FF is likely only a minimal part<sup>20</sup>.
- Many POS we sampled have been closed for a considerable amount of time, sometimes one year or more.
- Many POS appear to be on the verge of closing (e.g. personnel in the shop says the POS will close once inventory is sold out).

COUNTRY	CLOSED	SUSPECT CLOSED	DUPLICATES	OPEN	CLAIMED BY FF	% overrepresented
China	65	92	11	64	240	275%
Japan	22	0	0	46	65	41%
Rest of Asia				62		
Rest of the World	67			117		
Total (FF)				289	630	118%

Summary of phone and online due diligence findings

<sup>17</sup> We considered a shop “suspected closed” if the phone number supplied by FF was invalid and we could not find a relevant confirmation online.

<sup>18</sup> This claim assumes that FF database in its store locator is kept reasonably updated.

<sup>19</sup> 110 confirmed open shops in China and Japan, + 62 in rest of Asia. The upper hand of the estimate adds about 36 suspected closed shops.

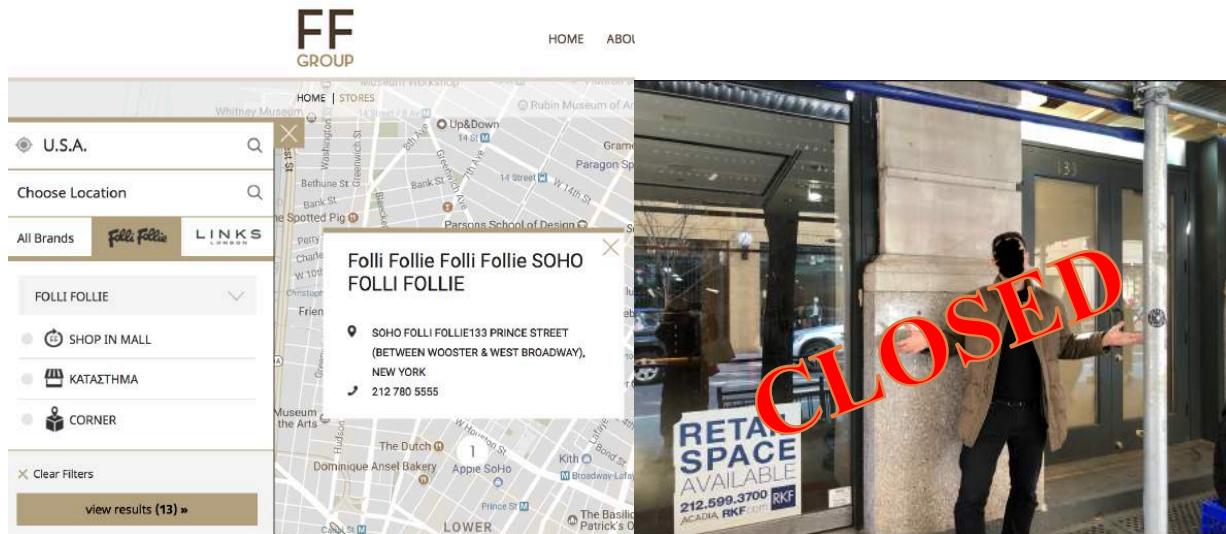
<sup>20</sup> Our field checks revealed that many wholesalers listed in the database may sell as little as \$5,000 of FF products per year or less.

## The Other Greek Parmalat?

### II. Our onsite checks

Intrigued by the stunning outcome of our previous due diligence, we decided to pay a visit a to FF shops in “strategic” locations.

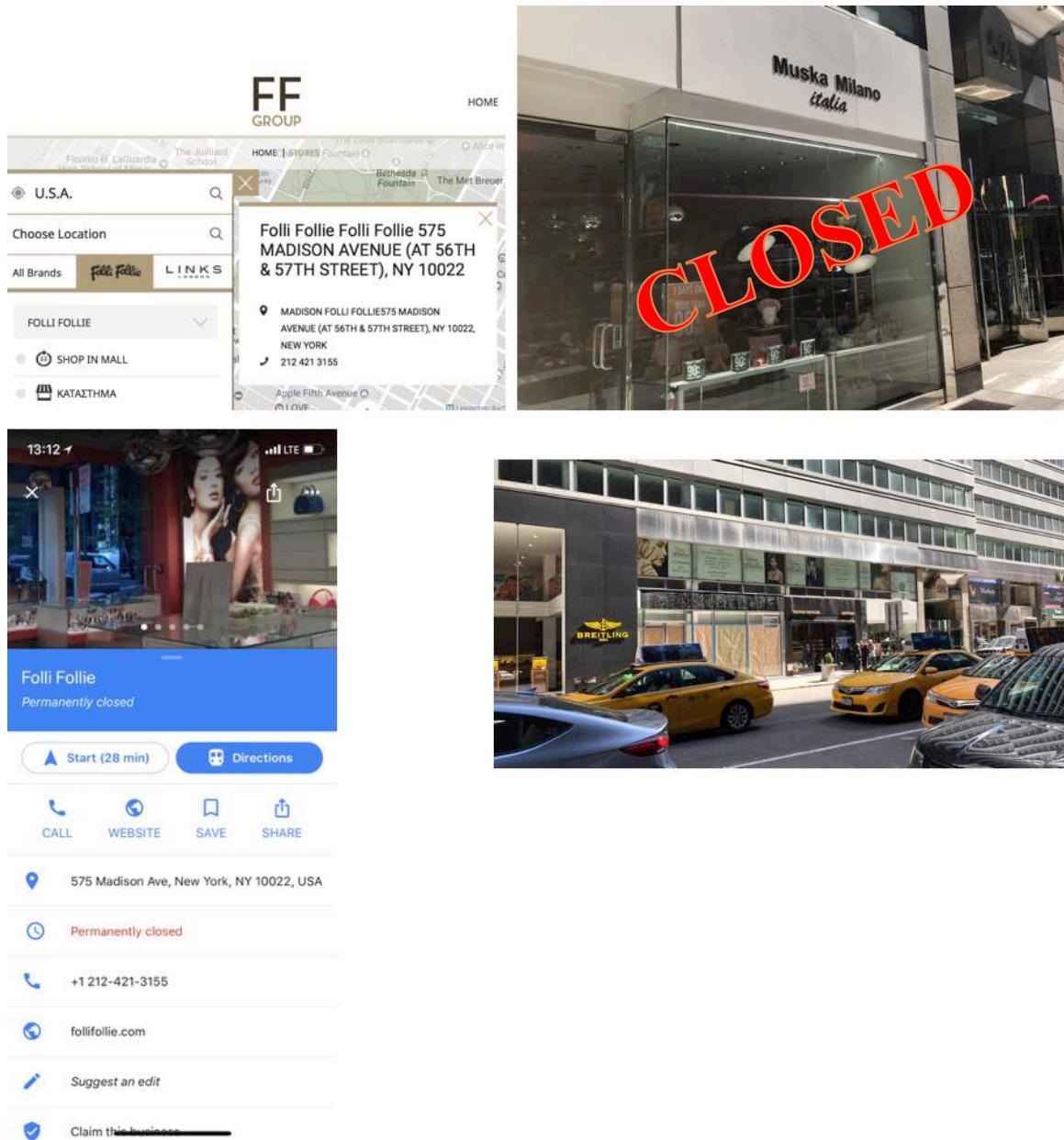
**Folli Follie Soho** (New York, USA): this shop should be located on 133 Prince St., at the heart of the New York trendy Soho area. As you can see below, the shop features prominently on both FF shop locators. We visited on March 24<sup>th</sup>: the shop is **closed**. According to the neighbors we probed, Folli Follie was not even the prior tenant, having left several months before or more. To our knowledge, FF management never disclosed to investors about the closing of this, or any other for that matter, key asset. Indeed, this shop as of today remains on FF-Group store locator.



FF Soho shop on FF store locator (Apr. 17, 2018)

## The Other Greek Parmalat?

a. **Folli Follie Madison Avenue** (New York, USA): this shop should be located on 575 Madison Ave., at the corner with 57<sup>th</sup> street. This is a stone throw from the famous “Tiffany corner” and is one of the most prestigious retail locations in the world. We visited the site on March 24<sup>th</sup> and it was occupied by another tenant (Muska) with no links to FF whatsoever. Our inquiries revealed that FF was indeed there but closed down their location several months ago. This is confirmed by Google Maps that report the store as “Permanently Closed”.

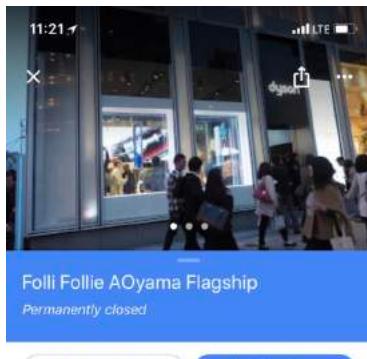


### The Other Greek Parmalat?

b. **Folli Follie Omote Sando** (Tokyo, Japan): this Folli Follie shop used to sit on an exclusive shopping area in Tokyo. QCM visited the site and found a Dyson vacuum cleaners shop in its place. Google Maps confirms that the shop is “permanently closed”. According to our investigations, this shop moved to another, cheaper part of Omote Sando. Apparently FF closed down this second site as well last year (now run by Atmos).



Original Omote Sando FF shop still features on FF store locator.



Google Maps confirms that the FF shop is closed.



Original Omote Sando FF shop, now operated by Dyson.



Subsequent Omote Sando FF shop, now run by Atmos (a snickers company).

### The Other Greek Parmalat?

c. **Folli Follie Shinjuku Isetan and Kawagoe Modi** (Tokyo, Japan): QCM visited these two locations. Isetan is still operational, while Modi will be closed after the (very small) inventory is liquidated. These two points of sale are representative of a significant part of FF network: **many POS are not actual “shops” but little more than a tiny window inside a shopping center**. Compare the FF “window” on the left with the large space used by Coach when we visited Isetan (FF claims a similar level of sales in Asia as Coach, as we shall see later).



FF “shops” in Isetan (Shinjuku) and Modi (Kawagoe).



For comparison: Coach space inside Isetan (Shinjuku).

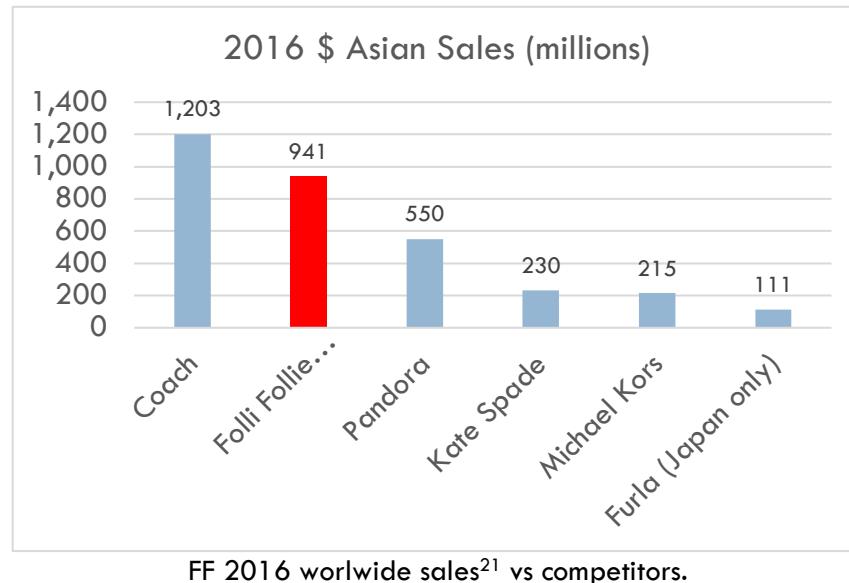
### The Other Greek Parmalat?

## III. Evidence from the analysis of digital sources

It makes intuitive sense to assume a strong correlation between revenue and digital presence for a retailer. In fact, this correlation shows up neatly in all of FF's competitors that we analyzed: In other words, higher digital presence (website traffic, Facebook and Instagram followers) generally means higher sales.

For FF, however, a careful look at **digital presence would suggest a company sized a small fraction of the size it claims to be.**

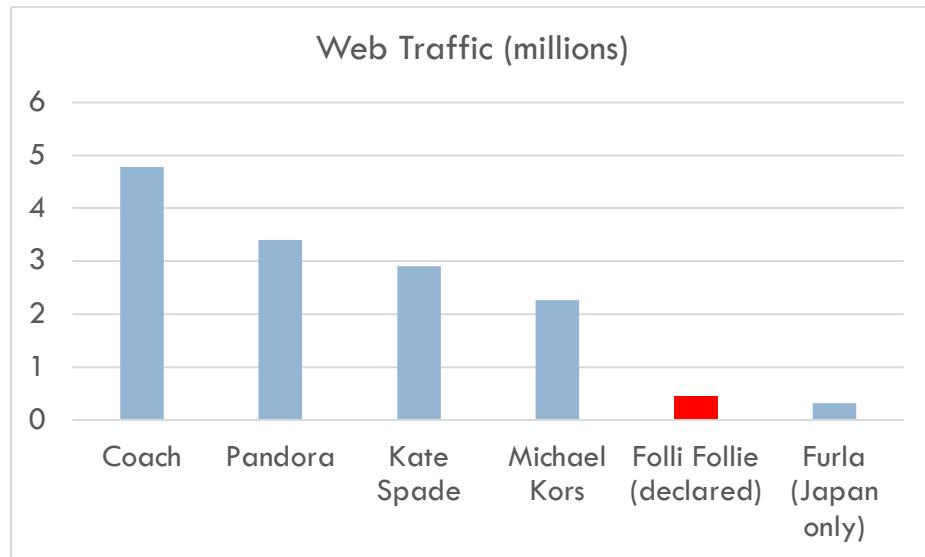
### a. Comparison of Sales with Competitors



The chart above shows 2016 Asian sales for FF and its peers. FF claims Asian sales 8x higher than Furla, 4x higher than Michael Kors and Kate Spade, 2x higher than Pandora and only 20% less than Coach.

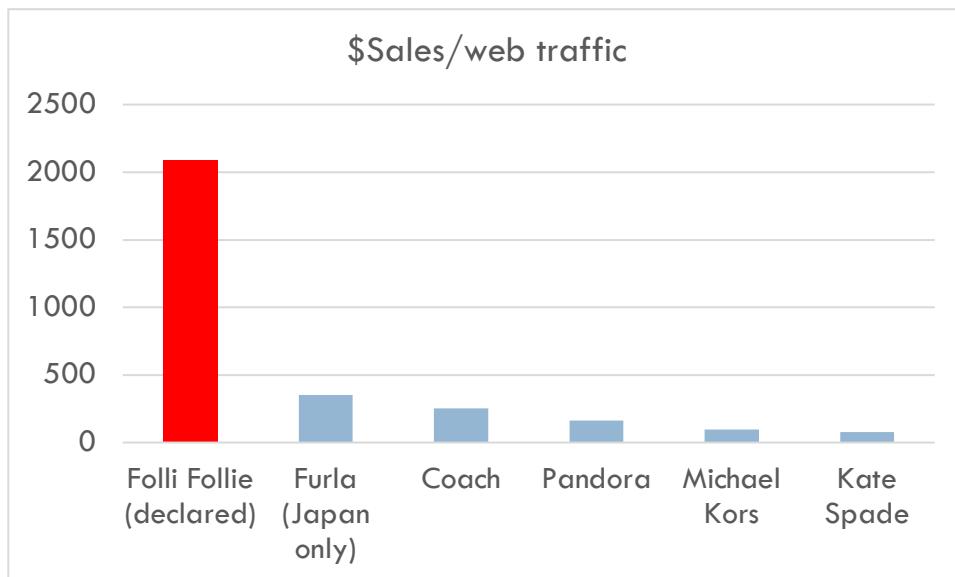
<sup>21</sup> Jewelry-Watches-Accessories

## The Other Greek Parmalat?



2018 Website Traffic originated in Asia\*<sup>22</sup>

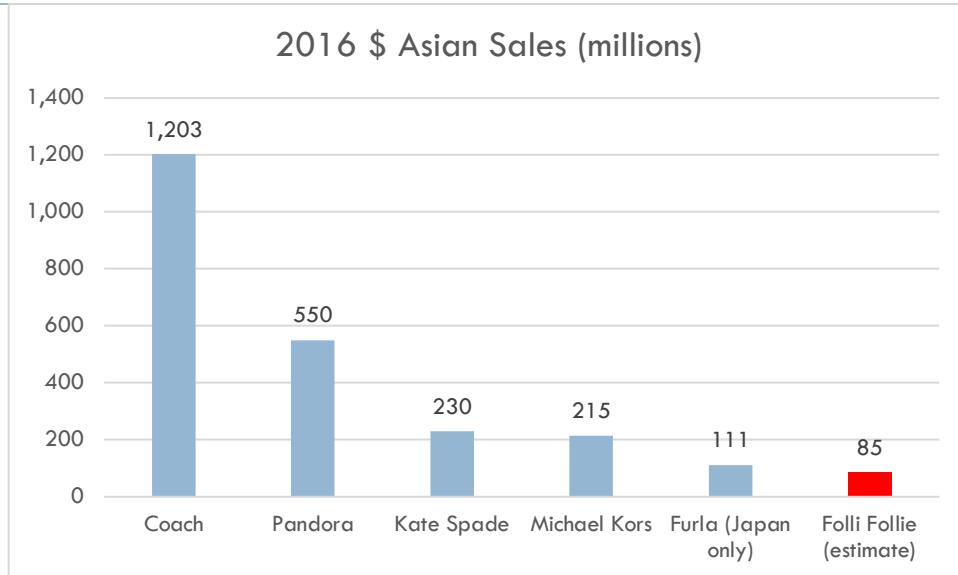
The chart above shows traffic to these brands' websites originated in Asia: for all competitors there is a clear correlation between sales (from the previous graph) and website traffic (above). The only strong outlier is FF: **while claiming sales comparable to Coach (around \$1bn), its web presence instead comparable to that of Furla** (with worldwide sales of only €267m). We have repeated this analysis using Facebook and Instagram followers and considered also worldwide sales and digital presence: the pattern remains.



The oddity of FF official figures is even more staggering by dividing Asian sales by Asian web traffic: as you can see, for all FF peers' sales are approximately \$100-400/website visit, while FF claims an absurd \$2,000. On average, FF peers show sales of \$188/website visit. If we multiply this number by the number of FF website visits we can get a **rough estimate of FF sales in Asia: \$85m**, in contrast to the \$1bn declared.

<sup>22</sup> Source: Similar Web.

### The Other Greek Parmalat?



FF sales implied by digital footprint vs. competitors

## The Other Greek Parmalat?

b. Selected data from digital sources. Notice how FF has a dramatically smaller digital footprint than its peers:



Website traffic<sup>23</sup> comparison (worldwide).

Traffic & Engagement

### Total Visits

Dec 2017 - Feb 2018, Worldwide

Domain

Domain	%	#
follifollie.com	561,345	
furla.com	3.059M	
katespade.com	8.778M	
michaelkors.com	16.00M	
coach.com	15.26M	

Domain	%	#
follifollie.com	561,345	
follifollie.co.jp	396,015	
follifollie.co.uk	205,262	
follifollie.com.cn	60,583	
follifollie.gr	40,949	

FF Website visits (various countries): notice how the Chinese and Japanese FF websites combined have less traffic than the FF.com website. This strongly suggests that Asian sales are inflated<sup>24</sup>.



Website traffic comparison (China).

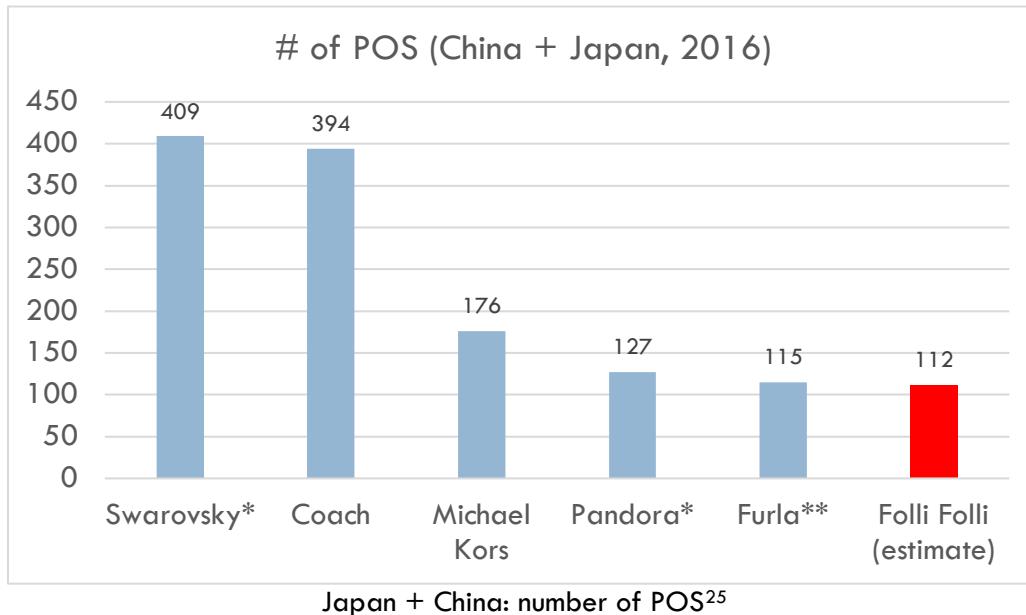
Website traffic comparison (China).

<sup>23</sup> Source: Similar Web

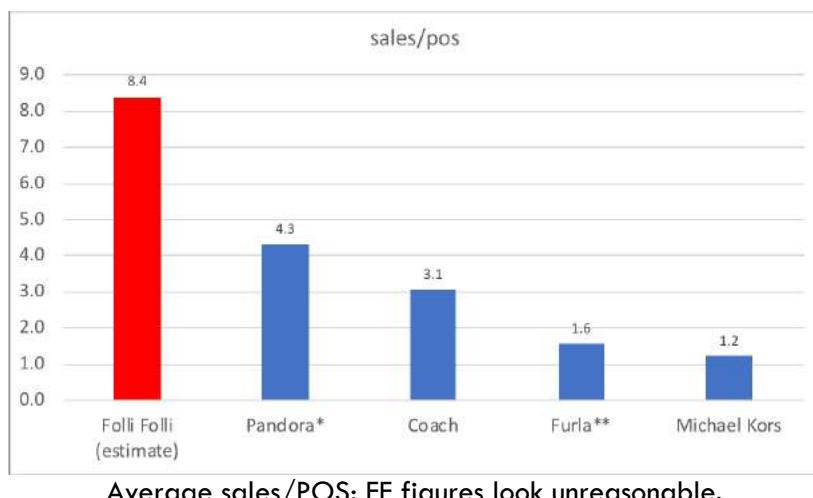
<sup>24</sup> According to reported figures, 88% of the Jewelry- Watches-Accessories segment originates from Asia. If this were indeed the case, we would expect FF Asian website traffic to be higher by the same proportion. This is not the case arguably because Asian sales (audited by local auditors, as we shall see later, are inflated in our opinion).

## The Other Greek Parmalat?

### IV. Evidence from the analysis of competing networks



The analysis of network size and of digital footprint tell the same story: despite claiming Asian sales of \$941mn (more than all peers except for Coach), the FF network<sup>26</sup> is the smallest of the group, with only 112 confirmed POS. These figures imply an absurd average of \$8.4m per POS, which is even more unlikely considering that many of the POS we saw in our due diligence are little more than a window, compared to the much larger, newer stores of competitors, often placed in better locations.



<sup>25</sup> Sources: annual reports, store locators of the various companies mentioned.

<sup>26</sup> We used a network size in China + Japan of 112. This number includes only the stores that we confirmed open in our network due diligence activity described in previous sections. Even assuming a larger network size, the main thesis remains intact: FF network looks too small relative to the sales level it claims in Asia.

## The Other Greek Parmalat?

Comparison of Coach and FF presence (or lack thereof) in prime locations in Tokyo, Japan:

FOLLI FOLLIE



COACH



Shinjuku



Ginza



### The Other Greek Parmalat?

The previous photographs include some of Japan's key locations for every luxury retailer: Isetan Shopping Center at Shinjuku, Omote Sando, Ginza and the Narita airport. In every single comparison, FF seems to come short: either FF does not have a presence or that presence is modest vis-à-vis the competitors we reviewed. Compare Coach's impressive, large corner stores with FF "windows". Please note that, as stated elsewhere, FF claims a comparable level of Asian sales to Coach and revenue per store three times as large<sup>27</sup>. The photographs feature Coach as a comparison, but we could have chosen as well Furla, Pandora, Swarovski or any other brand in FF peer group and the general idea would be the same.

## Opinions of other stakeholders

We approached several parties with knowledge about FF's presence in Asia including:

- Former employees.<sup>28</sup>
- Shopping centers operators hosting FF shops.
- Competitors of Folli Follie.

Without exceptions, every source we approached has confirmed our suspicions and our findings appearing elsewhere in this report. The following insights on FF kept recurring during our interviews:

Opinions by former employees:

1. FF business in Asia is in distress and has been contracting for years:

*"I would say that the Folli Follie brand is not too good. As I said, they had their lucky break in Japan, but that was 15 years ago, where they were the "hot brand" and the business exploded, but from about 10 years ago the sales trajectory of this market has been in slow decline and that hasn't changed. That decline was offset up until 4/5 years ago by strong growth in China with popularity of the brand combined with an expansion of the number of points of sales (in China), but that also peaked in that market probably 4 years ago now so..."<sup>29</sup>.*

*"[...]the China business is going down, it's a fact. Relatively (to Japan and the rest of Asia) the Chinese business is the worst one, because productivity is low. And the stores are not making money and the management team is just a mess."<sup>30</sup>*

*"I would say that the brand is poorly managed and in terminal decline simply due to management."*

<sup>27</sup> Asian network size based on our field due diligence.

<sup>28</sup> For compliance reasons we avoided current employees and former employees who have left the company less than 12 months ago. The information we received was general in nature and the sources we contacted have been asked specifically not to convey any sensitive information or information covered by non-disclosure agreements.

2. Points of Sales (i.e. "shops") are closing (on a net basis):

"We have less than 100 POS in China."

"for the last 10 years they have been slowly closing down points of sale, the smaller ones, as the sales have declined every year. So, as each year sales are getting smaller and smaller."

3. Competition is getting stronger:

"brands like Swarovski and Pandora they have come in and offered the same and better products and better retail offer as well and they have gone and taken the customers."

"our space productivity was low compared to Swarovski and Michael Kors."

"competition is getting stronger and stronger, so they are losing market share."

4. Like-for-Like ("comp") sales are constantly going down:

"[initially FF had] relatively good numbers. But the **growth was managed by new-door and franchise selling business. The comps were not so good, they were negative.**"

Opinions by Distributors:

- We also spoke to a large shopping center operator in China where from where FF runs a few POS. This source claims that **FF is performing poorly** compared to other similar brands in the malls. Given the performance of FF he sees, he **estimates decreasing sales across the country and he expects the company to shrink further.**

Opinions by salespeople:

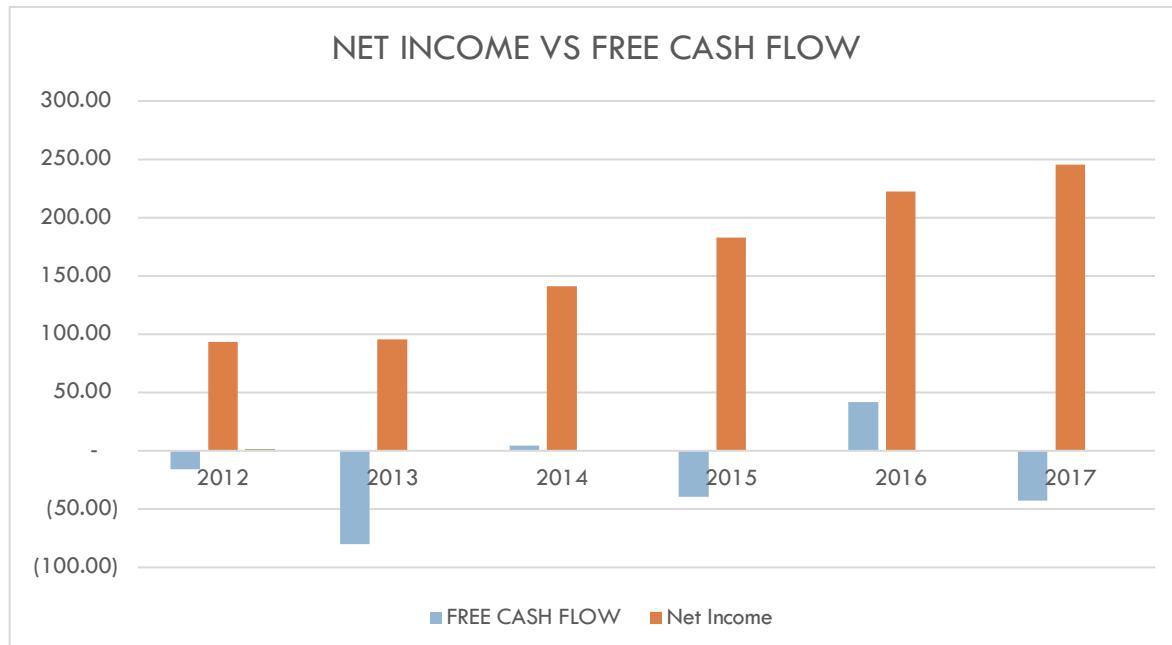
- We received negative feedback from FF shops staff we visited when we enquired whether "business is going well".
- In China, we hired a team to enquire about each individual POS in the country and the feedback received has been universally bad. **Staff complained about slow sales and stores closing.**
- We visited the FF shop at the WTC in New York and the sales staff confirmed that other stores had been closing down and that the WTC one was the only one remaining in continental United States.



## V. Financial Analysis

To any objective observer, FF financial statements should raise eyebrows. We found several worrying red flags consistent with our thesis and with the evidence we examined earlier: FF real Asian business could be much smaller than it appears and is rapidly deteriorating.

- Large discrepancies between income and cash flows<sup>31</sup>:



From the chart above, it is clear that, while claiming positive and rapidly increasing profit, FF Free Cash Flows have been almost constantly negative. From 2012 until recently FF has accumulated a FCF loss of approximately €130m, while claiming approximately €1bn of accumulated earnings. The difference is staggering and should worry any serious investor examining these financial statements.

- Ballooning Working Capital

The €1bn of gap between reported income and cash flows mentioned above is explained almost entirely by a **massive increase in working capital** (€928m) increasing from €611m in 2012 to €1.5bn in 2017. The bulk of the increase is **concentrated in Asia**<sup>32</sup> (85%) and consists in account **receivables and inventory: both seem over the top**, especially if compared to FF competitors: Michael Kors and Tapestry, for example, have receivables around 20 days of sales and 120 days of inventory. Pandora, focusing only on Jewelry, has a slightly larger inventory at 170 days. FF levels are off the chart with 154 days of receivables and 274 days of inventory.

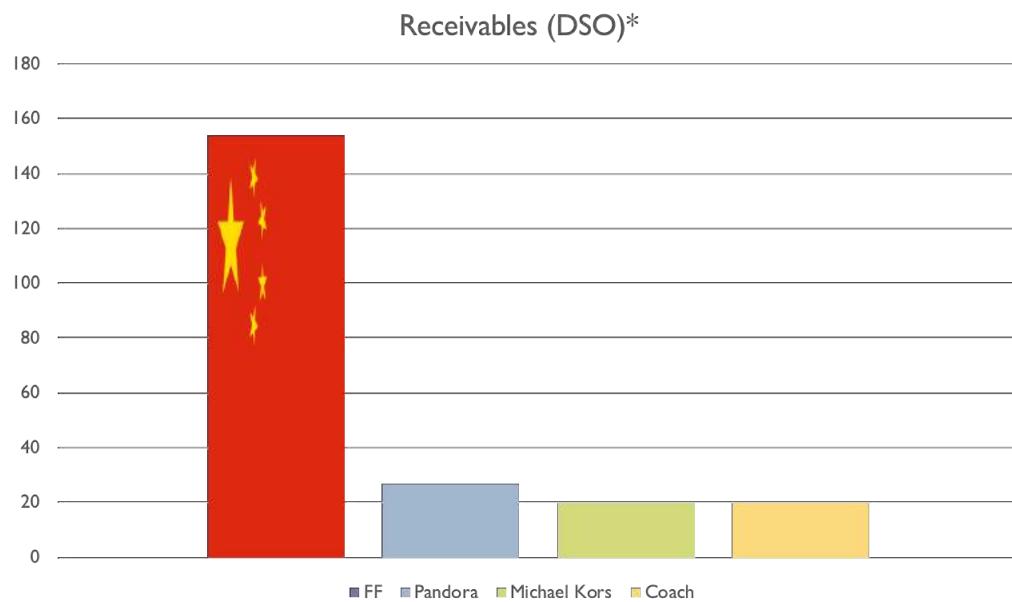
<sup>31</sup> Free Cash Flows have been calculated here as: operating cash flow minus investments. Adjustments have been made to exclude the impact of the 2013 sale of the travel retail business in both net income and FCF calculations.

<sup>32</sup> This statement can be easily confirmed checking the financial statements of FF Group Sourcing Limited, that include working capital for all Asian subsidiaries.

## The Other Greek Parmalat?

Dan McCrum, a reporter on the Financial Times, has written an interesting piece in 2015 concerning this very issue with FF:<sup>33</sup> as of today, the situation has deteriorated much further. Clearly, an abnormally large and **rapidly-increasing inventory at FF should be seen with great concern**, given the results of our due diligence: we saw how FF, far from expanding, appears to be closing points of sales and suffering from diminishing comp sales. A similar situation would be compatible with decreasing, rather than increasing account receivables and inventory.

Furthermore, according to the POS analysis we saw earlier, FF could have only about 208 POS in Asia (many of them are tiny as we saw). Now, total receivables in Asia are approximately €820m<sup>34</sup>, divided by 208 POS we obtain an **absurd €4 millions of receivables per point of sale!**



- **Solvency/liquidity:**

FF has debt of €400m, including a July 2019 bond of €250m and a 2021 bond of €150m. Cash position is €331m. Worryingly, however, **€217m of that cash appears on the financial statements of FF Group Sourcing Limited**, a FF subsidiary whose accounts make us very uncomfortable for reasons that will soon be clear. Should that cash prove not so “available”, FF would be left with about €110m of cash and a cash-flow negative business to repay about €450m of near-term bond maturities.

<sup>33</sup> <https://ftalphaville.ft.com/2015/07/09/2133993/folli-follie-and-the-receivables-question/>.

<sup>34</sup> 2016 Annual Report of FF Group Sourcing Limited.

### The Other Greek Parmalat?

## Big Trouble in Little China: the “smoking gun”?

As we noted previously, the performance of FF Asian division is critical to understand what is going on at the Group level. Asian sales are 70% of total revenue and 100% of EBIT. In other words, without Asian profit the Group as whole would be unprofitable, losing approximately €50m per year.

We are skeptical of FF Asian figures for the reasons mentioned earlier, namely:

- Our due diligence on FF POS shows a small network in Asia counting only about 208 POS, mostly small sites, in Asia.
- The implied amount of sales per POS in Asia is too large, if the Asian network is indeed smaller than it appears.
- Large discrepancies exist between cash flows (negative) and earnings (positive) originates from Asia.
- Stakeholders we interviewed expressed negativity and skepticism about FF presence in Asia.

Clearly, the reality on the ground and the accounting figures are showing a dramatically different picture. How is this possible? Quintessential has investigated in-depth into the Asian structure of the Group. The main reporting entity in Asia is “**FF Group Sourcing Limited**” (FFGS), a company domiciled in Hong Kong and consolidating all the FF Asian subsidiaries. The financials of this company are public and would seem to confirm that FF in Asia indeed sells approximately \$1bn of merchandise.

However, we investigated the only Chinese subsidiaries of FFGS we could find: **Biliyun** and **Fu Li Fu Lei**<sup>35</sup>. We discovered some very interesting information about both companies simply searching through official government files<sup>36</sup>:

- 1) The FF shops owned by these companies are on file with the Chinese government. Official records show **a total of only 48 shops** (33 for Biliyun and 15 for Fu Li Fu Lei).
- 2) Biliyun filed its 2016 annual report. **The findings are staggering:**
  - a. **Sales:** **\$25.5m** (i\$800k per shop).
  - b. **Total Assets:** **\$26.0m** (\$810k per shop).
  - c. **Total Liabilities:** **\$24.3m**
  - d. **Net Profit:** **\$-6.1m**
- 3) Fu Li Fu Lei annual reports are not public, but official records show only 18 shops. If we use the \$800k/shop of revenue we found in Biliyun we can estimate **Fu Li Fu Lei sales of about \$14m**.
- 4) Both Chinese subsidiaries have several negative records and fines with the Chinese government.<sup>37</sup>

<sup>35</sup> We assume these firms correspond to Folli Follie Shanghai (Pilion Ltd.) and Folli Follie Shenzhen Ltd. These are the only FF subsidiaries we found in mainland China. We suspect that the company may have deliberately altered its Chinese name in order to hide the identity of these companies.

<sup>36</sup> This part of our due diligence was performed by expert personnel with Big-4 auditing experience and mother tongue Chinese.

<sup>37</sup> Records mentioned: violation of Law of the People's Republic of China on Product Quality Rule 39. Rule 39 prohibits the seller from selling adulterated, shoddy, unqualified products. In June 2017, it was fined RMB 30,000 (USD 4,762 using exchange rate 6.3) by Market Supervisory Authority of Shanghai Hongkou district resulting from the misleading advertising and marketing of its products. In Jan 2018, it was fined RMB 19,000 (USD 3,015 using exchange rate 6.3) by Market Supervisory Authority of Shanghai Xuhui district in violation of Law of the People's Republic of China on Product Quality Rule 39 again.

## The Other Greek Parmalat?

**According to the official Chinese records we saw, “real” 2016 FF Chinese sales may be as low as \$40m, with only about 50 shops. We assume these 50 shops are company-owned and do not include franchisees. However, any revenue originating from franchisees should be included into one of the two Chinese subsidiaries (since there are apparently no additional Chinese entities). Also, from our phone checks, we found only 66 confirmed open shops so we doubt that the number of shops in franchising is material.**



Screenshot taken from official Chinese records showing the P&L of Binlianyun, FF main Chinese mainland subsidiary<sup>38</sup>: note the financials stated in Chinese RMB.

<sup>38</sup> Based on the number of POS listed in the official records.

## Audits

Obviously, this would beg a question: how can we reconcile the level of Chinese sales we estimated based on our findings (about \$40m) with the Asian sales reported by FF Group Sourcing Limited (about \$1bn)? The short answer is **we can't**. Therefore, we are concerned about the quality of the official financial statements and about the local auditors. We investigated the FF Audit situation and found the following, serious red flags:

1) **Hong Kong Audit Firm, Chung & Partners.**<sup>39</sup>: This is the auditor of FF Group Sourcing Limited.

- The company's website shows only two partners working at this firm.
- We visited the premises in Hong Kong and found a small office hosting about 2 people.
- We spoke to several Big Four auditors and asked their opinion: according to them, this firm may be inadequate to audit an entity such as FF Group Sourcing Limited. This is a \$1bn multinational with operations in several countries. A proper audit would require a much larger team.
- During a 2015 conference call<sup>40</sup>, FF justified using such a small auditing firm in this way:

*"Now with auditors, I mean we're using...no sorry.. even Big Fours ...we are happy with the auditor we have now in Hong Kong, because they do a service that is much more than, you know, what they do in the Big Fours and much less expensive, they even do stock check, accounts in every point of sales, our factories or logistic centers. So you know, we are very happy with them."<sup>41</sup>*

This statement looks suspicious to us because we don't understand how a two-people team in Hong Kong can "do stock checks" and audit the accounts "in every point of sales" when the company operates in multiple Asian countries with hundreds of shops.

2) **Apparent lack of financial controls:** according to FF Investor Relations, in Asia the company uses no digitalized ERP system and no centralized inventory tracking system. "Everything is done via email/spreadsheets".

3) **Change in head auditors:** after having its accounts audited by Baker Tilly for several years in a row, FF changed to a relatively unknown firm, Ecovis. While the partner signing the accounts could be the same person, we are always skeptical of such changes. In some instances (e.g. Globo Plc) companies engaging in creative accounting have dismissed head auditors once they started demanding to audit the company's foreign subsidiaries, instead of relying on local firms.



Photos taken by our local team showing the offices of Chung & Partners.

<sup>39</sup> <http://www.cpl-cpa.com/directors.html>

<sup>40</sup> <https://ftalphaville.ft.com/2015/04/08/2125035/all-that-glitters-at-folli-follie/>

<sup>41</sup> Statement of FF senior management quotes in an FT Alphaville interview, April 2015.

## VI. Questions & Answers and possible replies by FF:

- *So, what is really going on?*

We leave it to our readers to draw conclusions. That said, the solid evidence we presented seems to suggest that FF Asian business may be much smaller than it appears. Our findings in China, including official financials of Chinese subsidiaries are, in our opinion, particularly disturbing.

- *What about the rest of the business?*

It would seem that the Asian business is core to FF. It comprises 70% of sales and 100% of operating income. Therefore, if the Asian business is unprofitable, so is the whole Group.

- *Perhaps the FF store locator is not updated and there are more shops that do not show up?*

We expect the company to claim that the store locator is not updated and that many shops are not included. We are skeptical of this for the following reasons:

- a. The company has a strong incentive to keep the shop locator updated since it is mainly used by consumers to buy their products and generate revenue.
- b. The technology needed to update a database is minimal.
- c. Most of the shops we checked and confirmed as closed, have been closed for several months and, in some cases, years.
- d. The company claims to have “merged” some of their shops, “from multiple locations into one location”<sup>42</sup>. We are puzzled by this statement and believe that closing a shop or merging it with another shop in a faraway location mean exactly the same thing: one shop ceases to operate.
- e. Assuming sales are increasing, or even stable, closing 50% of the POS network would imply doubling like-for-like sales, something that, as we saw earlier, is in conflict with our observations on the field and with the declarations of the people we spoke to.
- f. We challenge the company to publish the updated list of shops which will be, once again, scrutinized thoroughly.

- *What about franchisee shops in Asia?*

- a. To our knowledge, FF does not have franchisee shops in Japan (they are all direct shops). In China the company had until a few years ago, about 90 franchisees. According to our research, most of those shops are now closed. The ones left, almost certainly less than 50 (probably much less), should generate sales that flow into the Chinese subsidiaries we saw earlier and that have total revenue of only \$40m. Our phone due diligence revealed a large number of closed franchisee POS.

- *What about 2017?*

The company has released its 2017 report only a few days ago. We have seen nothing in the figures that would make us change our mind about the situation. If anything, in terms of revenue growth, profitability and cash generation, the situation seems to have deteriorated further.

- *What is the size of the US business?*

To our knowledge, **FF has closed all POS in continental United States** except for a small one in the basement of the "World Trade Center mall, in New York City. This is in conflict with FF declarations in its conference calls claiming that “FF is investing heavily in the US”.

---

<sup>42</sup> This statement by the company was not verbatim, but what we wrote is the general meaning.

## VIII. Conclusion

We believe we have presented a strong case that should generate serious concerns about the health and prospects of the FF Group. Our checks on the true size of the network, digital presence, distributors, other stakeholders and local auditors all seem to point in the same direction: the Asian business may be a fraction of the size it appears to be. **The implication for the stock are clear: in our opinion it may be significantly overvalued.**