

SPARKLING PERFORMANCE BOOSTS LUXURY GOODS



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- Luxury has benefited from global growth, with French brands outperforming Italian
- Volume recovery could stimulate pricing power
- Kering, LVMH and Moncler outperforming

The past two years has seen a pick-up in luxury goods, as the global economy continues to expand. Chinese sales are trending upwards and growth has rebounded in Japan and Europe. Valuations are also attractive: the sector is on a price/earnings (PE) ratio of about 23 times – although excluding Hermès, whose high PE of 40.53¹ distorts the picture, the PE is 20-21. This compares with an historic range of 18-20 times.

BEST IN CLASS

Within the luxury goods sector there have been winners and losers. Jewellery has outperformed watches and, by and large, French brands have outperformed Italian, with some exceptions.

The outstanding performer of the past year was Kering, headed by François-Henri Pinault. Its success is largely down to the new CEO for Gucci, Marco Bizzari, and a new creative director, Alessandro Michele. The team have rebranded the company and launched new products, resulting in impressive sales growth.

LVMH, with best-in-class management and 70 brands, has continued to perform well. The CEO, Bernard Arnault, and CFO, Jean-Jacques Guiony, have pushed the group to expand through successful, performance-enhancing acquisitions to produce consistent performance, even when cynics have said those acquisitions were over-expensive.

The performance of the sector shows this area of retail has seen volume recovery. Volume precedes price – so if economic stability continues and geopolitical events do not derail the trend we should see some pricing power returning. For example, how much would someone pay for a handbag? Press reports recently show a second-hand handbag sold for \$380,000 at Christies in Hong Kong. So perhaps pricing power is already here.

¹ Bloomberg, 21 March, 2018.

KEY RISKS

There are three key risks to future growth in the sector. First is China. In 2012 when President Xi Jinping banned extravagant gift-giving during business transactions, watch sales suffered – in some areas this so-called ‘gifting’ accounted for around 30% of the market. Since the ban the market has normalised, but is unlikely to return to previous highs. A repeat of this in China would have similarly damaging effects. However, given that the government in China is more consumer-focused, this seems unlikely.

Second, there is a shift towards experience over ownership. The travel sector is a particular beneficiary, a trend that could threaten luxury goods sales. However, travel is more at risk from geo-political destabilisation or health scares.

Third, fashions change. The fear for luxury goods manufacturers is that the consumer no longer favours a brand’s products. Thankfully, such shifts are well signposted and the fashion cycle is reasonably long.

M&As

Kering, LVMH and others have shown that aggregating brands in one business gives scale, boosting sales and profitability. So, we expect some of the minnows to sell out – and a consolidating industry is healthy and ripe for successful investment.

GOING FORWARD

We have seen some firms expanding into lucrative areas of fashion, such as Moncler entering knitwear, and this is a trend worth watching. New management bringing new ideas may also benefit some companies. For example, Moncler’s ‘Genius’ collection, unveiled at the Milan Fashion Week, eschews the industry-standard twice-yearly release rhythm by rolling out collections once a month.

We believe jewellery will continue to outperform watches, and see promising signs of innovation in this area. Pandora, famed for its silver charms and bracelets, is poised to bring out its new ‘Shine’ collection of gold-plated jewellery, which might attract new buyers as well as existing customers. Finally, we are also seeing soft luxury goods – high-end apparel and leather goods – enjoying strong and continuing momentum.

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