

Moët Hennessy Louis Vuitton – Timeless luxury delivers record sales

Moët Hennessy Louis Vuitton, commonly known as LVMH, produces and sells high-end wine, cognac, perfumes, cosmetics, luggage, watches and jewellery. On 24 April 2023, LVMH became the first European company to reach a valuation of \$500 billion, thanks to demand for its iconic brands including Louis Vuitton, Christian Dior, Hennessy, Moët & Chandon, Tag Heuer, Dom Pérignon, BVLGARI, Sephora and Tiffany & Co, to name a few. The company has an extremely colourful history which is intertwined with the who's who of famous French fashion designers but ultimately, its success and growth have been propelled by current CEO Bernard Arnault's voracious appetite for dealmaking. Alongside this aggressive M&A strategy, economies of scale through vertical integration and a strong family ownership structure have allowed the Group to become the dominant force in the luxury goods industry. Facing a challenging 2024 due to higher inflation pressure and a Chinese consumer under pressure due to the domestic housing crisis, are the recent record revenues under threat?



**Nick
Rogers**

Let's start at the beginning. For the duration of World War II, a young Christian Dior designed dresses for the wives of Nazi officers and French collaborators. In 1946, French entrepreneur, Marcel Boussac, financed Christian Dior's new Paris Maison (fashion house). Dior along with head tailleur, Pierre Cardin, designed the 1947 Bar suit. Dubbed the "New Look" by Americans, it was so different

from the wartime style that it immediately became a success and re-established Paris as the centre of the fashion world. Christian Dior then launched a fragrance, Miss Dior (a tribute to his sister, French resistance fighter Catherine Dior). By 1949, Christian Dior was responsible for 75% of Paris's fashion exports and 5% of France's export revenues. In 1955, 19-year-old Yves Saint Laurent became Dior's design assistant. By the spring of 1957, Christian Dior appeared on the cover of Time magazine but later that year, he tragically suffered a heart attack. After forcing Yves Saint Laurent out in 1960, Boussac's fortunes declined until his company was nationalized in 1978 by the French government. Enter Bernard Arnault who was after one jewel, a diamond in the rough, luxury brand Christian Dior. He managed to raise \$60 million and just a couple of years later, the company was generating over \$100 million per year of free cash flow. In 1987, two of the biggest, most important companies in the country, Moët Hennessy & Louis Vuitton merged to form LVMH (a compromise was made in the order of the lettering).

SPEED READ

- Last year, record revenues helped LVMH become the first European company to reach a market cap of \$500 billion. It is now France's largest private-sector recruiter, yet it was nationalized by the French Government in 1978.
- Christian Dior laid the foundations on which master acquirer, Bernard Arnault's empire of 75 global luxury brands was built. His focus on unrivalled quality, innovation & creativity is core to its success.
- Louis Vuitton & Christian Dior drive profits - the largest Vuitton suitcase may cost you \$12,000 but it takes a master craftsman two hours and eight different operations just to make one handle!
- High-end luxury consumers have no limits. For example, Tag Heuer's latest creation, incorporating lab-grown diamonds, is priced over \$500,000 yet has a 2-year waiting list. What recession?
- Duty-free shopping by Mainland Chinese tourists recovered to 127% & 80% of 2019 levels in Asia Pacific and Europe respectively (by Jan'24) which bodes well for the luxury goods sector, but it is early days as global consumers remain under pressure.

The origins of the word luxury can be traced back to the Latin word ‘luxuria,’ meaning ‘extravagance or excess’. Historically, luxury items were primarily accessible to nobles and royal families, with France’s nobility showing a particular interest in luxury during the Renaissance. France’s dominance in the luxury industry can be attributed to historical factors such as the creation of royal factories and the adoption of protectionist measures. Anyone who has strolled along the Champs-Élysées in Paris can testify to the opulence on display in the seemingly endless rows of luxury boutiques. Arnault’s view of his peers offers an interesting insight into the world of luxury. “I’m not sure that, in this profession, we are really competitors. We are when it comes to buying some business, but not in terms of customers. When a Louis Vuitton store sets up next to a Prada store or a Gucci store, both benefit. It is therefore no coincidence that all these luxury boutiques are generally located in the same places. In fact, the more prestigious brands are concentrated on the same site, the better they work. The notion of competition in luxury is very specific.” Luxury brand consumers have no limits, and place high importance on quality. They want to feel special and unique whilst at the same time being extremely brand conscious, attracted to the age-old association with famous actresses and sports celebrities who endorse luxury perfumes, watches and clothing.

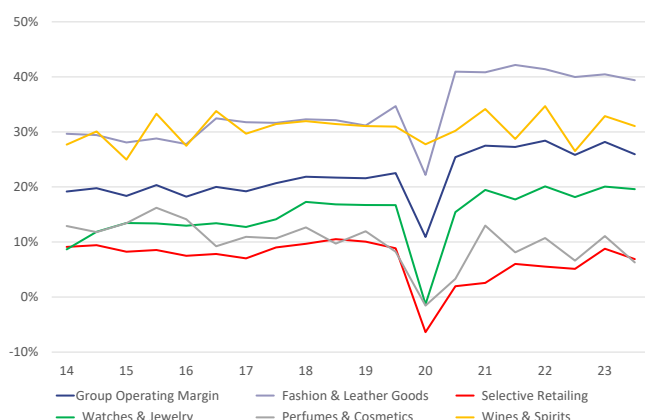
Fascinatingly, CEO Arnault has not founded one of the current 75 brands. Rather, he has relied on his core strength – the ability to identify luxury companies and brands with longevity. He is after brands that will be around 100 years from now, like Dom Pérignon’s vintage champagne. Ensuring consistently high levels of quality across every product is the top priority. “Before we launch a Louis Vuitton suitcase, for example, we put it in a torture machine, where it is opened and closed five

times per minute for three weeks. And that is not all—it is thrown, and shaken, and crushed. You would laugh if you saw what we do, but that is how you build something that becomes an heirloom.” The largest Vuitton suitcase will cost you \$12,000 but it does take a master craftsman two hours and eight different operations just to make one handle. No expense is spared in the pursuit of excellence

How can LVMH manage these high costs of production? Each Maison retains creative control over its own brand/s which leads to high levels of accountability at every level whilst vertical integration ensures that the company can maximize the profit from the entire value chain - from designer to manufacturer, distribution, and sales. In the recent full-year 2023 results, gross margins reached 68.8% whilst the more impactful operating profit margin was maintained above 26% for the third year in a row. This is despite the slowdown in Chinese GDP impacting its largest consumer base. LVMH experienced a record year with sales reaching €86.2 billion. The top performers were:

1. **Fashion & Leather Goods** which contributes 50% to Group sales and 75% of operating profit thanks to strong performances in Louis Vuitton and Christian Dior (+14% organic sales).
2. **Selective Retailing**, the second-largest division, contributed 21% to revenue. Sephora was the leading beauty destination among female US Generation Z consumers in 2022 at 37% market share (Statista) and it continues to deliver.
3. **Perfumes & Cosmetics** contributes a further 10% of revenue. Margins in this division are below 10% at present but could rise into double-digits should there be a further recovery in international travel. 20% of this division’s revenue in 2023 came from products that did not exist the previous year, highlighting the importance of innovation in this industry.

OPERATING MARGIN PER DIVISION



LVMH has achieved a group-wide operating margin above 26% for the third year in a row.

Where is LVMH seeing opportunities in the current tough macro environment? Firstly, the growth in ‘Hard Luxury’ (enduring materials such as precious metals & gemstones) justifies Mr. Arnault’s largest-ever acquisition, the acquisition of Tiffany & Co in 2021 for \$14.5 billion. Secondly, the global luxury watch market is forecast to reach sales of \$30 billion in 2024, rising to \$37 billion by 2032 (IMARC research). LVMH now owns ten watch brands of which TAG Heuer, Hublot, and Zenith together recorded sales of c\$2 billion last year. LVMH is also targeting the fastest-growing segment of luxury watches - women’s watches. Although women’s watches account for only one-third of divisional sales, TAG Heuer’s ability to innovate, using lab-grown diamonds (Yes, it is a thing!) is playing into this growing theme. Its Carrera Plasma Diamant d’Avant-Garde Chronograph Tourbillon is priced

at over \$500,000 and has a 2-year waiting list. This latest example supports LVMH's strategy regarding innovation. Watch sales are following a similar pattern to the broader luxury market, where the wealthiest consumers remain the strongest, highlighting the defensive nature of luxury companies during tough times.

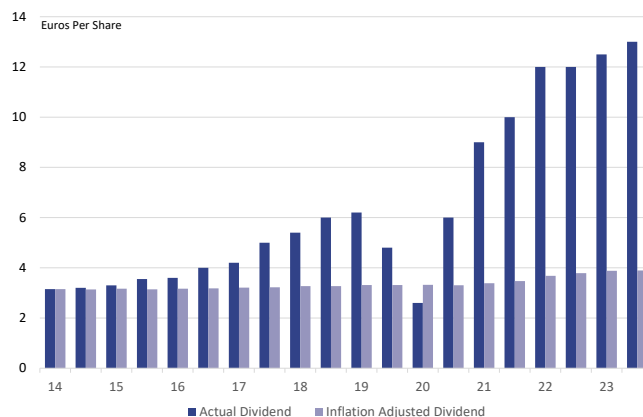
TAG HEUER'S LATEST CREATION



TAG Heuer scored a huge hit with its Carrera Plasma watch encrusted with lab-grown diamonds.

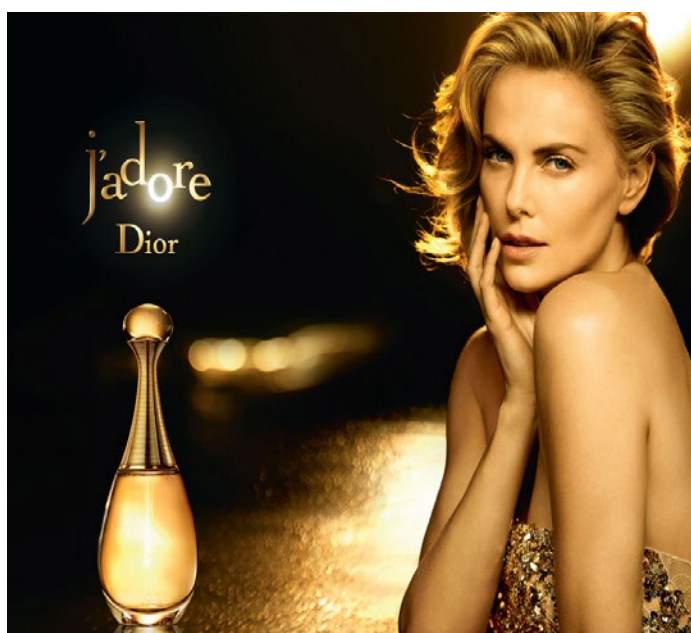
What are the current risks facing LVMH? Despite acquiring 75 brands, there still isn't one that is as good as Louis Vuitton. Fashion and Leather Goods account for 50% of LVMH's total revenues but half of this is Louis Vuitton. Exclusivity via high prices & controlled supply has always been a key strategy in the luxury world, but there is a growing appeal of resale, which allows consumers to bypass these high barriers to entry and buy the product they want second-hand. By 2027, the global second-hand market is projected to double, to a value of \$350 billion (according to Fortune Magazine). Only rarely in Mr. Arnault's extensive history of deal making has he missed out on a prized target. His biggest defeat was in 2001 when François Pinault emerged victorious against him in a long-running and acrimonious battle for control of the Italian luxury brand, Gucci. Mr Pinault subsequently built his own luxury empire, Kering, around Gucci. Given that the Arnault family own 48.6% of the share capital and 64.3% of the voting rights of LVMH, succession planning is paramount to ensure continuity. Although his five children are now entrenched in the business, there is a 'key-man' risk given that Bernhard Arnault is now 74 years old and mortal, unlike his timeless brands.

DIVIDEND GROWTH VS INFLATION



LVMH has delivered superior earnings per share over the years which in turn has allowed its dividend to outperform inflation handsomely.

In conclusion, management is cautious going into 2024 in the face of higher-for-longer inflation that is keeping consumers under pressure. American consumers tend to be more cautious about spending ahead of the presidential elections but then accelerate thereafter. However, with its iconic suite of global brands, there is cause to remain optimistic about the long-term growth potential in emerging markets, particularly China. Duty-free shopping by Mainland Chinese tourists continued to recover, reaching 127% of 2019 levels in Asia Pacific and 80% of 2019 levels in Europe by January 2024. The industry's resilience and growth trajectory hinges on its ability to tap into the rising middle class in emerging economies whilst ensuring that the old wealth continues to enjoy the lavish lifestyles enjoyed by their forefathers. You may not be in the market to afford a Louis Vuitton or Tag Heuer product, but the share and growing dividend stream make a nice alternative.



Christian Dior's legacy lives on – here SA's very own Charlize Theron is the protagonist in an advert for J'Adore Dior fragrance.



Our next Insight seminar will be held in March, and will focus on why our investment philosophy places so much importance on income.



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Topic: **Why our obsession with income?**

Natal Midlands

Date: 14 March 2024

Venue: Oasis Conference Centre,
72 Main Road, Howick

Morning Time: 10am for 10.30am

Evening Time: 5.30pm for 6pm

Johannesburg

Date: 12 March 2024

Venue: Rosebank Union Church, Cnr
William Nichol and St Andrews
Road, Hurlingham

Time: 7am for 7.30am

Cape Town

Date: n/a

Venue: ABRU Motor Studio, Lourensford
Wine Estate, Somerset West

Time: 5.30pm for 6pm

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Performance figures quoted for the portfolio is from Morningstar, as at the date of this document for a lump sum investment, using NAV-NAV with income reinvested and do not take any upfront manager's charge into account. Income distributions are declared on the ex-dividend date. Actual investment performance will differ based on the initial fees charge applicable, the actual investment date, the date of reinvestment and dividend withholding tax. Performance fees do not apply to any funds managed by Harvard House. The manager does not provide any guarantee either with respect to the capital or return of the portfolio. A schedule of fees, charges, and maximum commissions are available on request from the manager.

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