



# Luxury is about *sexiness*

The Luxury and Cosmetics Financial  
Factbook 2018 Edition





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# Introduction

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# Introduction



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## Luxury is about *sexiness*

### EY-Parthenon vision for the future of the luxury industry and the challenges of the Italian system

The luxury goods industry has entered a new cycle in the last two to three years, characterized by moderate growth (plus 3% to 4% per year) and a greater heterogeneity of performance among major brands. This new cycle has affected all product categories, from personal luxury goods to high-end wine and experiential luxury goods.

The strong growth in casualization, the reduction in the opportunities to use traditional formalwear, the extreme attention to the experiential component of purchasing, and the propensity to mix and match by all types of consumers are manifestations of a deeper evolution of taste and expectations.

Today, the key word behind all of the great growth stories, with the exception (still) of one or two French luxury brands who occupy a timeless position away from fashions and

trends is *sexiness*. *Sexiness* is the ability to express a new sensuality that is imaginative, intimate and delicate, and the ability to do this with a clear break from the canons used in the past 20 years – a clear break that may sometimes be provocative, able to capture the imagination of consumers and bring new ones closer to the brand.

The brands that understood how to ride this evolution first have seen their like-for-like performance grow by double digits, especially thanks to the increased number of consumers of their brands. This formidable growth has not required expensive revision of store concepts, restructuring or large retail openings, but finds its own push in the product and the way of communicating it.

In fact, as far as product is concerned, *sexiness* is the ability to leverage iconic pop products once not considered in the high-end world, such as sneakers, T-shirts and backpacks, making them the platform for the new concept of luxury. *Sexiness* also is the ability to develop new and unconventional shapes capable of provoking and intriguing thanks to the use of researched materials, finishes and creative effects.

Communication has shifted from traditional media to digital and includes more immediate, flexible and tantalizing forms of communication able to put the consumer and the community at the center, instead of the brand and the product.

Today, more than 60% of purchases are influenced by digital, whether consumers are looking online and buying in a physical store or directly online. Word of mouth continues to be the first lever of influence for the luxury consumer and today occurs for two-thirds through digital platforms, and more than 70% of consumers connect to their favorite brands through social platforms.

This digital revolution not only allows luxury companies to amplify their vision and message but contributes substantially to the sexiness effect of the intimate and personal nature with which it takes place. Today, the relationship with the brand must be increasingly transformed from a simple "transaction" to an appointment – a love affair that takes place in a fluid way between physical and digital channels.

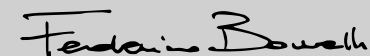
Companies less receptive to these changes have seen their performance worsen and, in some cases, witnessed a contraction of turnover despite their historical heritage and a product of absolute quality supported by a strict "made in" label and major investments to support communication and sales channels. It is clear now that being a well-known brand with high-quality products is no longer enough to succeed.

Over 85% of high-end consumers are aware and informed about where the product they purchase is produced. Italy is perceived as the number one country producing luxury goods, especially leather goods and clothing, and the "made in Italy" branding and value proposition of the country as a production center remains important. However, this alone is no longer enough to sustain the growth of Italian luxury companies.

The key question for the sector institutions, for the supply chain and for Italian luxury companies, on which the future of the country is based, therefore becomes:  
**how can we make "made in Italy" sexy again?**



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## Index evolution

The EY luxury and cosmetics index (represented by the companies included in *The Luxury and Cosmetics Financial Factbook 2018 Edition*) has outperformed the market over the last 10 years with a total return of 137%, corresponding to a significant average yearly return of 8.6%.

During the last year (from March 2017 to March 2018), the Standard & Poor (S&P) index performed very similar to the EY index. However, the total return of the EY luxury and cosmetics index is higher, with a total yearly return of 15.8% (compared with 11.8% for the S&P and a negative return of 2.7% for the STOXX index).

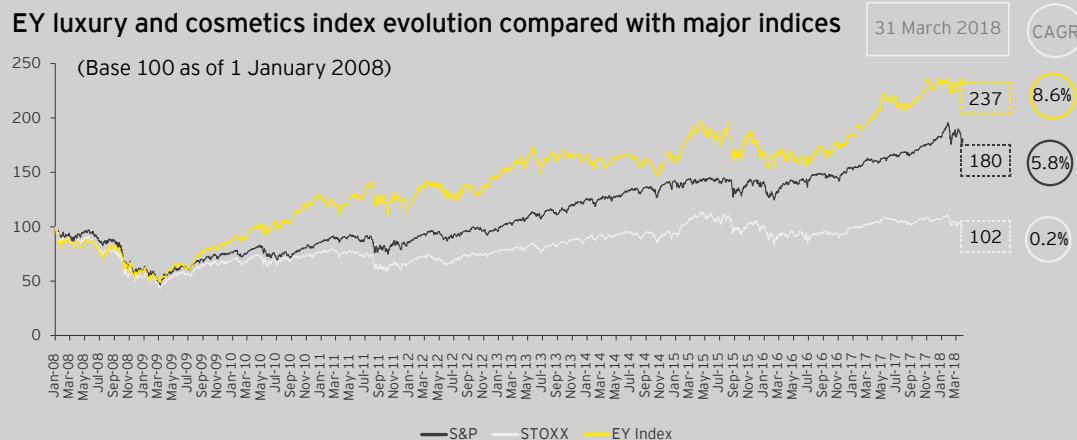
Both in the luxury and cosmetics sectors, growth is mainly driven by consumer spending in emerging luxury markets, such as China, Russia and the United Arab Emirates (UAE). Following is some insight about the most significant companies included in the index in terms of the size and market capitalization increase compared with 2017.

- ▶ Louis Vuitton Moët Hennessy (LVMH) achieved a record year. All business groups recorded double-digit organic growth, with the exception of wines and spirits, whose growth in the second half was limited by supply constraints. Accordingly, it increased its market capitalization by more than 24% (compared with 31 March 2017), reaching €123,362m.
- ▶ Michael Kors has increased its market capitalization from €5,656m on 31 March 2017,

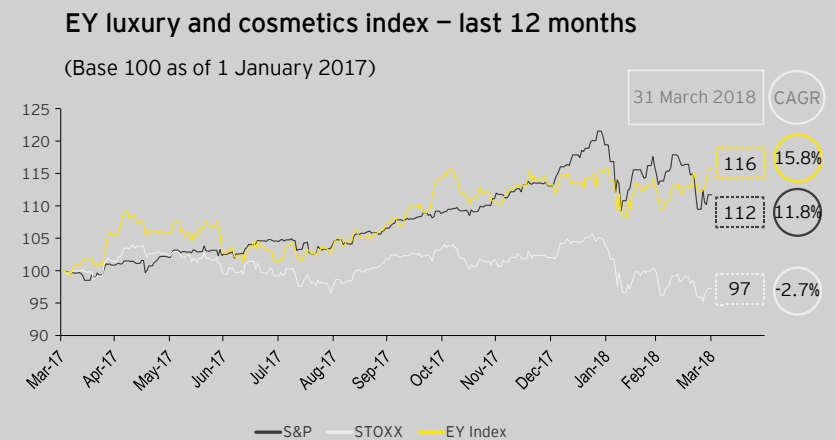
to €7,629m on 31 March 2018, following the acquisition of Jimmy Choo in November 2017, which also contributed to improving the company's prestige.

- ▶ L'Oréal confirms its leadership position among cosmetics companies, taking advantage of the rapid growth of the makeup sector at a global level, thus achieving a market capitalization of €99,881m (up 1.1% compared with 31 March 2017).
- ▶ Estée Lauder has increased its market capitalization from €29,105m on 31 March 2017, to €43,270m on 31 March 2018, by profiting from higher demand for fragrances and premium cosmetics and capitalizing on a growing Chinese market. Its acquisition of millennial-friendly brands (Deciem Inc.) and quick adaptation of digital technology have boosted online performance and accelerated revenue growth.
- ▶ Shiseido has doubled its market capitalization from €9,914m on 31 March 2017A (actual), to €19,683m as a result of the restructuring processes and a new long-term strategy announced and implemented since the appointment of Masahiko Uotani as CEO in 2014A. The new CEO has invested in and put a focus on the travel retail business and having a cross-border marketing team, while taking advantage of the growth of the market in Asia, where it is based. Long-term growth prospects and market capitalization growth are supported by the creation of a platform backed by cutting-edge technology (consolidated through the acquisition of MATCHCo), which will be key, especially if personalized cosmetics become mainstream.

EY luxury and cosmetics index evolution compared with major indices



EY luxury and cosmetics index – last 12 months



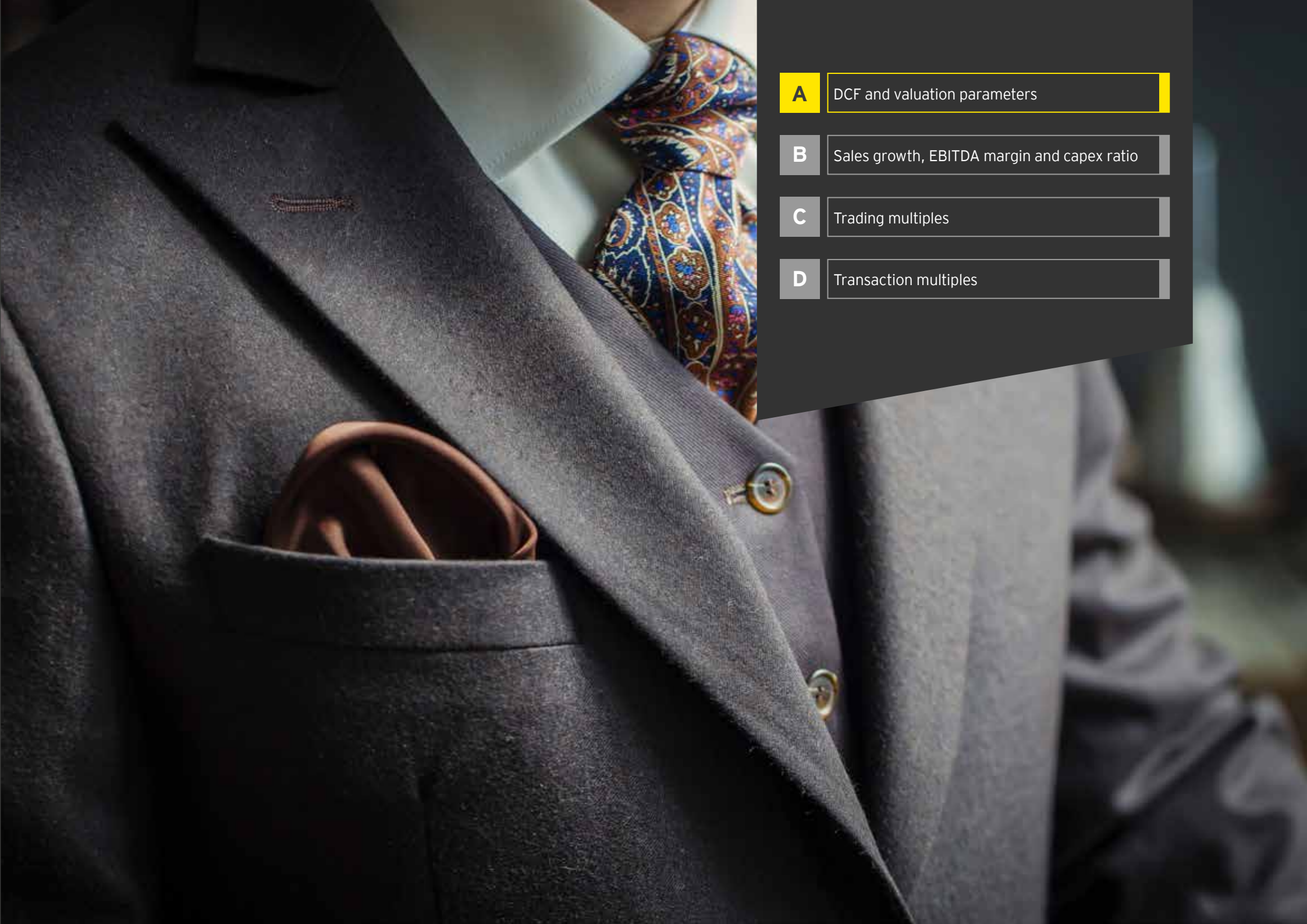
**Note:** The EY index is a representation of the luxury and cosmetics companies analyzed within the factbook. A specific weight has been attributed to each company included in the EY index based on its market capitalization and revenues (both of these two parameters are weighted equally as a half). The relative weights have been revised for each company's inclusion after its initial public offering (IPO) and after eventual delisting. Finally, the evolution of the EY index has been compared with those of the S&P 500 and STOXX Europe 600 indexes using 1 January 2008, as a starting date (rebased to 100). CAGR is the compounded average growth rate.





# Financial parameters

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**A**

DCF and valuation parameters

**B**

Sales growth, EBITDA margin and capex ratio

**C**

Trading multiples

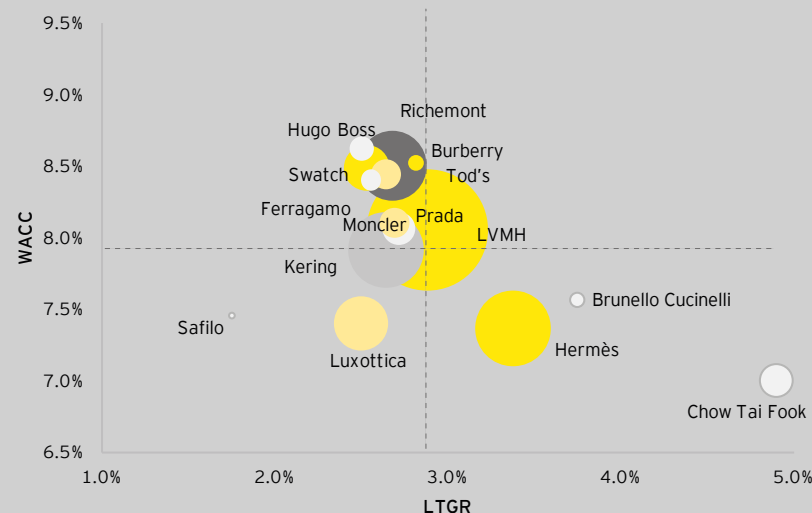
**D**

Transaction multiples

## A DCF and valuation parameters

### Market capitalization of almost all luxury companies has increased. On average, it has increased by 8% compared with 2017, mainly driven by the jump of more than 20% of LVMH

- ▶ Market capitalization of almost all luxury companies has increased. The average increase has been 8% compared with last year, with LVMH surpassing the €100b threshold.
- ▶ The weighted average cost of capital (WACC) ranges from 6.7% (Tiffany) to 8.6% (Ralph Lauren), influenced particularly by geographic exposure (companies that operate principally in developed countries have, on average, lower rates) and gearing ratios (a higher gearing ratio gives a premium on the cost of capital and the cost of debt).
- ▶ Luxury companies are on average debt free with an average indebtedness of 0.8%, lower compared with last year due to a slowdown in capital investments for the relevant period (4.7% of capex over sales in 2017A vs. 5.3% in 2016A), especially relative to a slowdown in retail store openings.
- ▶ The long-term growth rate (LTGR) is in line with last year's figure (2.9% in 2018 compared with 2.7% in 2017), thus, confirming the expectations of growth in the sector.



**Note:** The bubble size reflects market capitalization. Dotted lines represent average values. Please note that Michael Kors is not represented as WACC is not available.

#### Sources:

- ▶ WACC and LTGR: based on consensus of several brokers' reports for each company.
- ▶ Market capitalization and beta: EY elaboration based on "S&P Capital IQ," *Capital IQ website*, <https://www.capitaliq.com>, accessed 31 March 2018.
- ▶ Gearing: EY elaboration based on companies' FY17 financial statements.

Luxury companies	Market capitalization (€m)	WACC	Gearing	Beta	LTGR
LVMH	€123,362	8.1%	6.3%	1.04	2.9%
Kering	€48,497	7.9%	5.8%	1.07	2.6%
Hermès	€47,471	7.4%	(6.2)%	0.52	3.4%
Richemont	€40,736	8.5%	(14.6)%	0.65	2.7%
Luxottica	€24,345	7.4%	3.4%	0.26	2.5%
Swatch	€17,739	8.5%	(8.0)%	0.76	2.5%
Tapestry*	€12,076	7.5%	3.9%	0.65	n/a
Tiffany	€10,038	6.7%	0.1%	0.67	n/a
Chow Tai Fook	€9,208	7.0%	5.8%	0.55	4.9%
Prada	€9,204	8.1%	1.6%	0.35	2.7%
Burberry	€7,758	8.4%	(14.9)%	1.11	2.6%
Michael Kors	€7,629	n/a	7.0%	0.10	n/a
Moncler	€7,544	8.1%	(4.1)%	0.44	2.7%
Ralph Lauren	€7,123	8.6%	(19.0)%	0.96	n/a
Hugo Boss	€4,908	8.6%	0.3%	0.71	2.5%
Ferragamo	€3,734	8.4%	(3.3)%	0.67	2.6%
Tod's	€1,980	8.5%	0.2%	0.74	2.8%
Brunello Cucinelli	€1,757	7.6%	1.1%	0.50	3.8%
Safilo	€267	7.5%	37.6%	0.49	1.8%
<b>Average</b>		7.9%	0.2%	0.64	2.9%
<b>Median</b>		8.1%	0.3%	0.65	2.7%
<b>Maximum</b>		8.6%	37.6%	1.11	4.9%
<b>Minimum</b>		6.7%	(19.0)%	0.10	1.8%

\* Tapestry: Coach Inc. changed its name to Tapestry in 2017 and includes Coach, Kate Spade and Stuart Weitzman.

#### Notes:

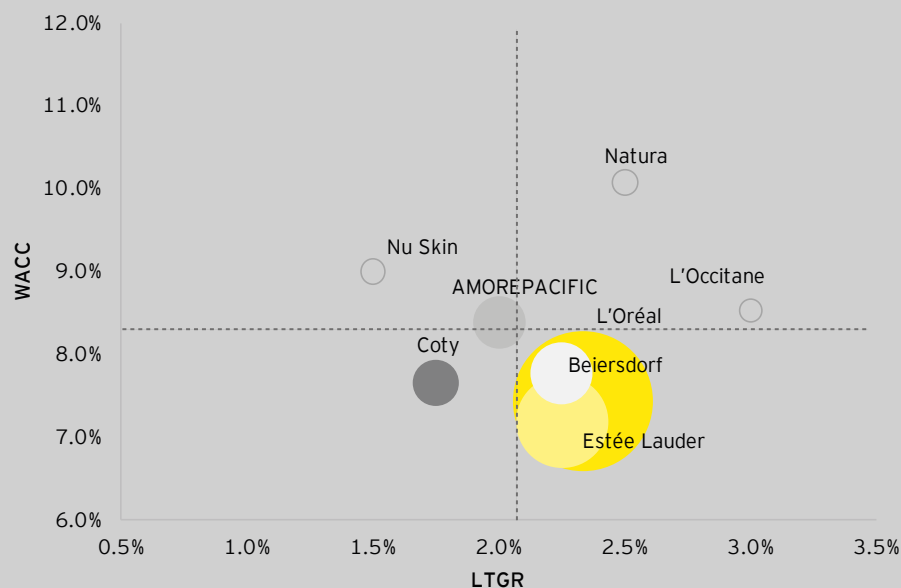
- ▶ Companies are sorted by decreasing order based on the market capitalization in euros observed as of 31 March 2018 (one-month average).
- ▶ Gearing is defined as the ratio between the net financial position and enterprise value (EV).
- ▶ Beta corresponds to levered beta measured on a weekly basis over a two-year period.
- ▶ Data points denoted as n/a represent information not available.

## A DCF and valuation parameters

### Market capitalization of cosmetics companies has increased on average by 18% compared with 2017, mainly due to the increases of more than 40% of Estée Lauder and Shiseido

- ▶ The average WACC declined from 8.7% to 8.3% with Natura's WACC remaining an outlier, notwithstanding the improvement to 10.1% (vs. 13.0% last year). Being based in Brazil, Natura's WACC is also affected by local valuation parameters.
- ▶ Cosmetics companies show a higher average gearing ratio compared with luxury companies, with Natura and Coty raising the average. Both have had a structurally high gearing ratio, despite the deleveraging efforts. In fact, the gearing ratio further increased after the acquisitions carried out in recent years (The Body Shop was acquired by Natura in 2017 and the 43 brands of Procter & Gamble (P&G) were acquired by Coty in 2016).

- ▶ The average LTGR has decreased slightly, 2.2% in 2018 vs. 2.4% in 2017, due to milder investor expectations following the current geopolitical tensions.
- ▶ The top three companies maintain their lead: Estée Lauder acquired Deciem Inc. (a fast-growing, vertically integrated multi-brand company) in June 2017; Shiseido improved its market capitalization ranking due to the effects of the multiple restructuring measures introduced by Masahiko Uotani (appointed CEO in 2014A) and through the acquisition of MATCHCo in 2017; and L'Oréal achieved almost €100b of market capitalization after the acquisition of Valeant Pharmaceuticals' skin care business (€1.3b EV) and the Bellissima brand in 2017.



**Note:** The bubble size reflects market capitalization. Dotted lines represent average values. Please note that Shiseido is not represented as WACC is not available.

#### Sources:

- ▶ WACC and LTGR: based on consensus of several brokers' reports for each company.
- ▶ Market capitalization and beta: EY elaboration based on "S&P Capital IQ," *Capital IQ website*, <https://www.capitaliq.com>, accessed 31 March 2018.
- ▶ Gearing: EY elaboration based on companies' FY17 financial statements.

Cosmetics companies	Market capitalization (€m)	WACC	Gearing	Beta	LTGR
L'Oréal	€99,881	7.4%	(1.6)%	0.68	2.3%
Estée Lauder	€43,270	7.2%	3.0%	0.63	2.3%
Beiersdorf	€19,867	7.8%	(5.6)%	0.62	2.3%
Shiseido	€19,683	n/a	(0.8)%	0.61	n/a
AMOREPACIFIC	€14,398	8.4%	(2.9)%	1.20	2.0%
Coty	€11,424	7.7%	35.0%	0.37	1.8%
Natura	€3,492	10.1%	47.3%	0.83	2.5%
Nu Skin	€3,207	9.0%	(1.1)%	1.37	1.5%
L'Occitane	€2,208	8.5%	(12.5)%	0.52	3.0%
<b>Average</b>		8.3%	6.8%	0.74	2.2%
<b>Median</b>		8.1%	(1.1)%	0.62	2.3%
<b>Maximum</b>		10.1%	47.5%	1.27	3.0%
<b>Minimum</b>		7.2%	(12.5)%	0.47	1.5%

#### Notes:

- ▶ Companies are sorted by decreasing order based on the market capitalization in euros observed as of 31 March 2018 (one-month average).
- ▶ Gearing is defined as the ratio between the net financial position and the EV.
- ▶ Beta corresponds to levered beta measured on a weekly basis over a two-year period.
- ▶ Data points denoted as n/a represent information not available.



**A**

DCF and valuation parameters

**B**

Sales growth, EBITDA margin and capex ratio

**C**

Trading multiples

**D**

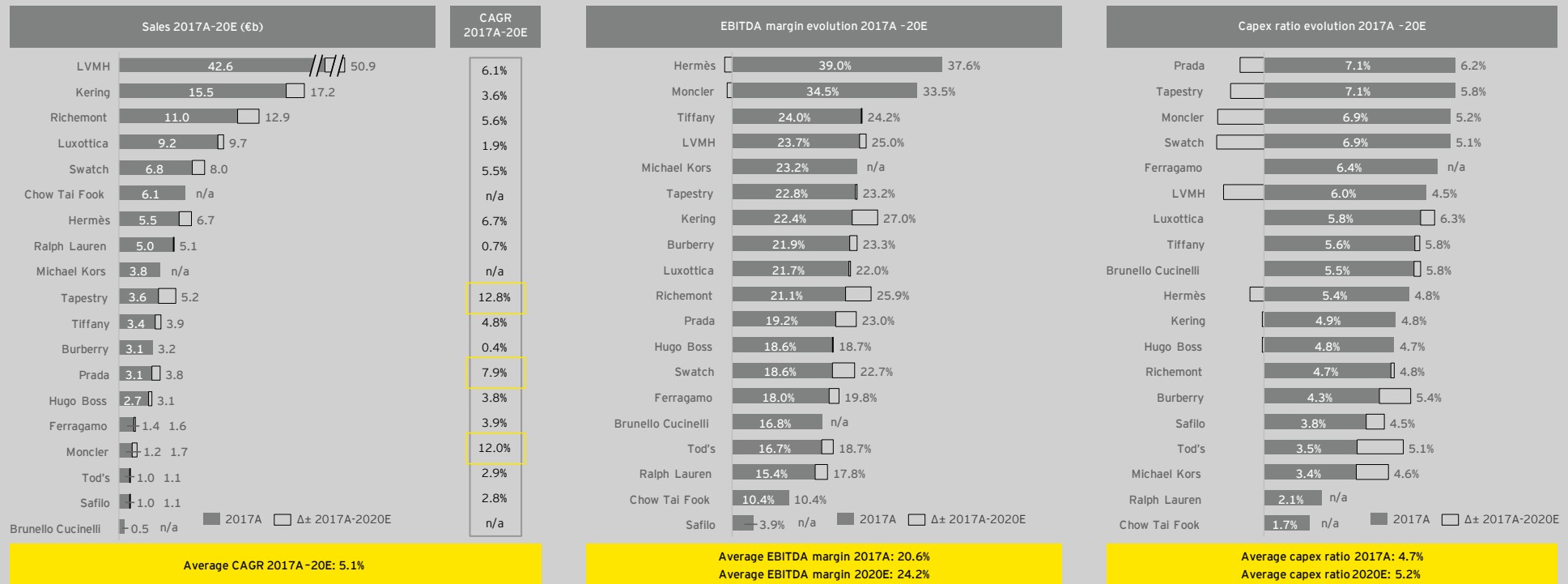
Transaction multiples

**B**

Sales growth, EBITDA margin and capex ratio

**Emerging markets and a change of the essence of luxury toward a digital experience and personalization of goods will drive growth in the following years**

- ▶ Notwithstanding the higher competition, the geopolitical and macroeconomic uncertainties, and the Western market saturation, the luxury sector should continue an interesting trend of growth of sales for the next three years. This will be driven by consumer spending in emerging markets, the change of the essence of luxury toward a digital experience and the personalization of products. Tapestry is number one in sales growth expectations, as a result of the investments starting in 2014 to transition the company to a “modern luxury” concept. The hard work is almost done and included investments in marketing to strengthen the brand, improve the customer experience and renew the store format to include digital innovation in the supply chain.
- ▶ Margins are also expected to be higher in 2020E (2020 expected) than in 2017A for almost all panel companies, with relevant increases in profitability expected for Richemont (up 4.8 percentage points in its EBITDA margin, estimated at 25.9% in 2020E) thanks to integrating synergies after the YOOX NET-A-PORTER GROUP (YNAP) deal and a strong operating leverage resulting from the increase in sales driven by the boost in consumer spending in the watch category; and Kering up 4.6 percentage points in its EBITDA margin, estimated at 27% in 2020E.
- ▶ Capex ratios, on the contrary, are showing a general stabilization for many of the major luxury groups. In recent years, there has been a shift in budget allocations from capex in retail openings to other expenses tied to the digitalization of the industry.



Average CAGR 2017A -20E: 5.1%

Average EBITDA margin 2017A: 20.6%  
Average EBITDA margin 2020E: 24.2%

Average capex ratio 2017A: 4.7%  
Average capex ratio 2020E: 5.2%

B

Sales growth, EBITDA margin and capex ratio

## A historical analysis of luxury's KPIs and a forward-looking view of 2018E



- ▶ The growth in 2015-16 was weaker, mainly due to the underperformance of key markets and a shift to global pricing derived from the increase in the popularity of the digital channel. However, due to the implementation of omnichannel strategies by the main companies in the luxury market, sales growth rebounded in 2016-17 and 2018E should confirm the positive trend.
- ▶ In the upcoming years, luxury companies will continue leveraging the digital strategies that have been successfully implemented, the growth in emerging markets and the importance of millennials as new consumers of luxury. Millennials have specific needs to be fulfilled, such as the attractiveness of the casual style. The latter leads to the rise of affordable luxury and numerous collaborations between classic and streetwear brands. Additionally, customization is a growing request and a purchase driver (especially in apparel), which main players in the sector are already tackling.
- ▶ The average EBITDA margin of the panel is fairly stable at around 20%, slightly decreasing from 23.5% in 2014A due to the shift of budget allocations in the past years.
- ▶ The average capex ratio has slightly decreased in recent years due to the slowdown of monobrand store traffic and sales and the consequent slowdown in retail store openings. In the upcoming years, the mix of store formats will shift toward off-price stores and airport stores, to the detriment of monobrand stores, department stores and specialty stores. Prada is the company with the highest capex (ranging from 10.2% in 2014A to 7.1% in 2017A), due in part to the investments in the new automated logistic hub in Osmannoro carried out in 2017 and 2018 (which will be fully operational in 2019).
- ▶ Advertising expenses have remained stable during the last few years, but with a high focus on digital advertising because true luxury consumers heavily engage with media. However, for high-end luxury, the importance of printed and traditional advertising is higher than in other sectors, such as cosmetics.

**Note:** The analysis has been performed like for like for the historical period. As a consequence, the averages may differ from previous editions of the factbook since the panel has changed. In particular, in 2018, Hengdeli has been removed due to discontinuation of several business lines and Jimmy Choo has been acquired by Michael Kors.

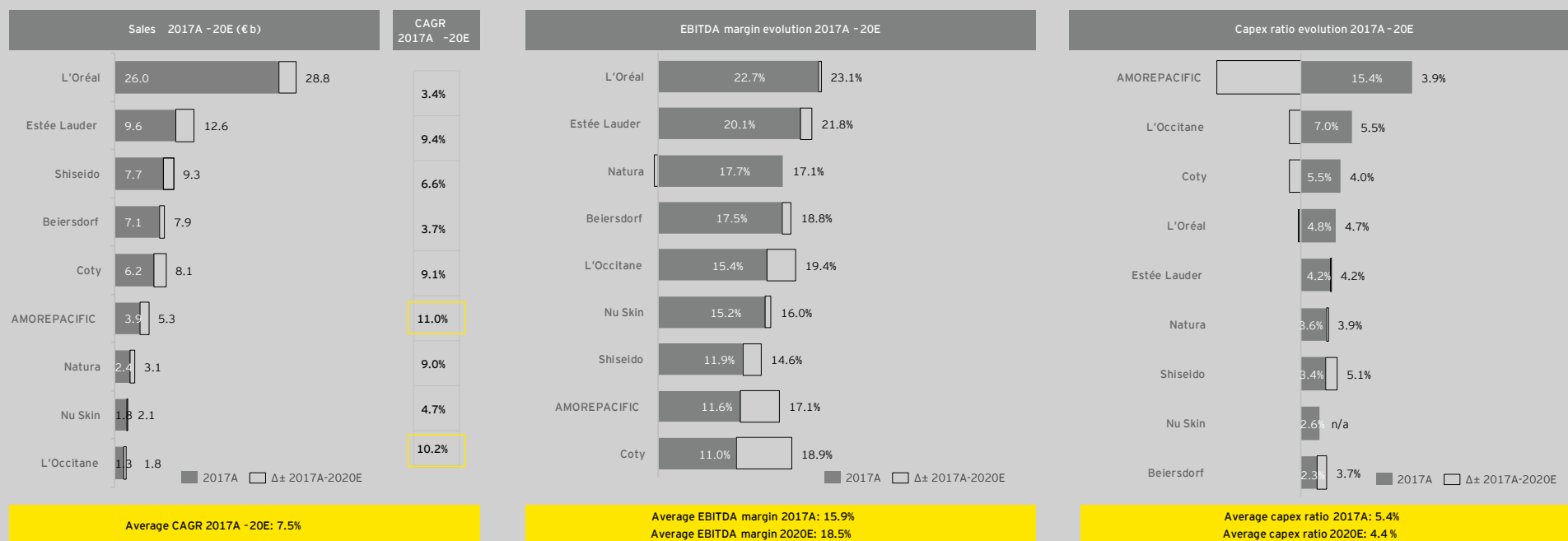


**B**

Sales growth, EBITDA margin and capex ratio

### Sales growth for cosmetics companies in the next three years will come mostly from a digital-first mindset, which increases the consumer engagement and omnichannel commerce

- ▶ Cosmetics companies are expected to register high growth in the next three years (average CAGR between 2017A-20E of 7.5% compared with expectations last year between 2016A-19E of 6.2%) by leveraging a digital-first mindset, which allows for increased consumer engagement and omnichannel commerce.
- ▶ Margins are expected to increase in future years partly with a positive effect from (i) acquisitions carried out in recent years by certain top players; (ii) the accretive impact on margins of the integration of the new brands, such as Estée Lauder’s acquisition of Deciem Inc. in June 2017 and Coty’s acquisition of the 43 brands of P&G; and (iii) partly through a product “premiumization” and (iv) new geography mix.
- ▶ Capex, on average, is expected to decrease (5.4% in 2017A and expected to stabilize at 4.4% in 2020E), although with different specific trends for each company. AMOREPACIFIC has the highest capex as a percentage of revenue in 2017A due to restructuring capex. L’Occitane has the highest level of capex after AMOREPACIFIC and has a very different business model, which sees topline development through store openings. The capex trends also depend on each company’s strategy going forward and on the brand-building efforts envisaged for future years.



**Sources:**

- ▶ EY analysis on actual data from companies’ financial statements and expected data based on consensus of several brokers’ reports for each company

**B**

Sales growth, EBITDA margin and capex ratio

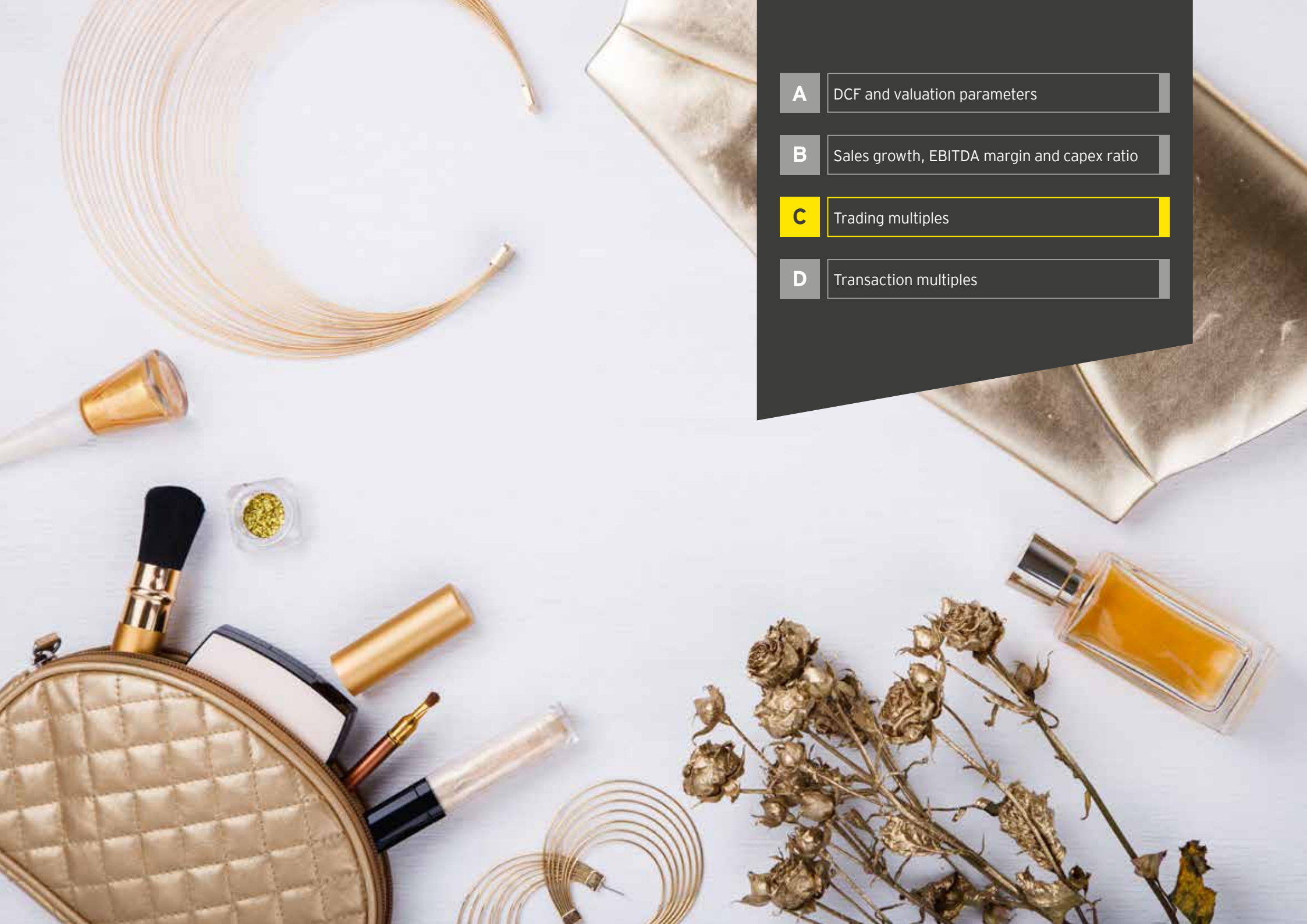
**A historical analysis of cosmetics' KPIs and a forward-looking view of 2018E**



- ▶ The cosmetics market is constantly growing and has seen a boom in the last few years, driven by the expansion of the high-income class and the increase in the number of Chinese consumers traveling worldwide, and raising their spending in cosmetics.
- ▶ In the cosmetics sector on average, YoY sales growth has been high, ranging from 4.6% to 5.8%, and is expected to register an all-time high YoY in 2017A-18E (6.1%).
- ▶ All global beauty care players are expanding in the emerging markets of Asia-Pacific and Latin America due to consumers' rising income levels. In the coming years, an increasingly attractive channel mix will support growth through e-commerce, directly operated stores (DOS) and travel retail channels.
- ▶ In the upcoming years, cosmetics companies will leverage the digitalization of the sector and enhance consumer engagement through omnichannel commerce.
- ▶ The average EBITDA margin of the panel is fairly stable at around 17%, slightly less than luxury companies due to the higher advertising spending and the elevated number of sales representatives needed to promote products in stores.
- ▶ The average capex ratio is slightly less than for luxury companies, except for companies such as L'Occitane and AMOREPACIFIC. This is because, except for L'Occitane and AMOREPACIFIC, cosmetics companies do not have investments related to store openings.
- ▶ The cosmetics sector is a big spender in the advertising industry because the product itself hardly has the means to strongly differentiate itself from what competitors produce and has to create a lasting perception and image for consumers to dominate the competing products. In fact, advertising expenses are well above 21% on average.

**Note to YoY sales growth:** Coty is excluded from the average of 2017A and 2018E YoY sales growth as fiscal 2017A financials have consolidated numbers for the acquisitions of the P&G beauty business as of 1 October 2016, which impact 2017 YoY sales.

**Note to advertising expenses:** Nu Skin is excluded from the average of advertising expenses as they are lower than average due to a different business model. Additionally, Shiseido has been removed from the average in 2014A and 2015A since information for 2016A and 2017A is not available. The difference from 2016A to 2017A is due to a restatement of costs in Natura's annual accounts.



**A** DCF and valuation parameters

**B** Sales growth, EBITDA margin and capex ratio

**C** Trading multiples

**D** Transaction multiples

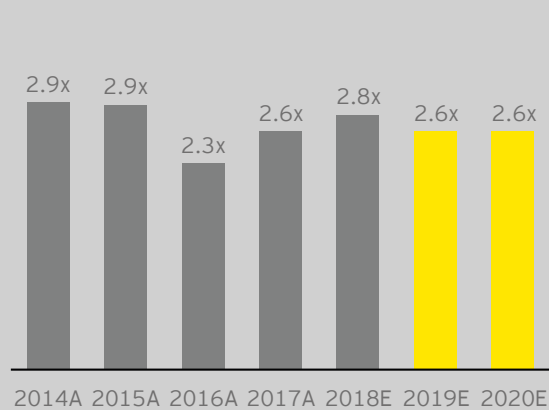
## C

## Trading multiples

## Luxury multiples are further rebounding in 2018E

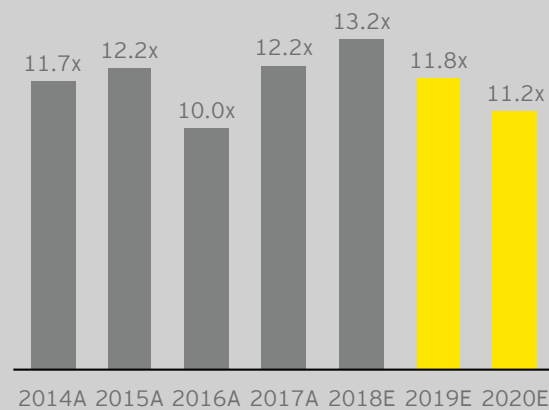
- ▶ The charts below analyze the evolution of the trading multiples of the luxury companies in our current panel on 31 March of each year from 2014A to 2017A, and the expected average multiples for 2018E, 2019E and 2020E.
- ▶ After the decrease in sales suffered by the luxury market in 2016, due to the negative trend in sales of key markets and the abovementioned shift to global pricing implied from the rise of digitalization, multiples follow the rebounding trend of 2017A. This is mainly driven by the accomplishment of omnichannel strategies, which have been recently implemented by the main companies in the luxury market.
- ▶ Best practices in the luxury market include tailoring strategies to specific categories and developing brand stories by creating an ecosystem where every interaction with the customer has a great impact. Additionally, a reinterpretation of streetwear by luxury brands in an attempt to enlarge the customer base by appealing to young customers has also positively impacted the industry.

## EV/sales



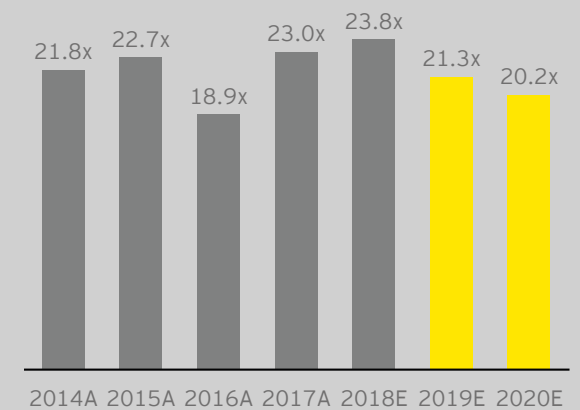
Average 2014A-18E: 2.7x

## EV/EBITDA



Average 2014A-18E: 11.9x

## Price to earnings



Average 2014A-18E: 22.0x

**Note:** Each year, the multiple is calculated as the ratio between EV as of 31 March of that year and forecast sales, EBITDA and earnings for that year. The information for 2018E-19E and 2020E represents the forward multiple analysis for the factbook launch in 2018, calculated as the ratio between the EV as of 31 March 2018, and the sales, EBITDA and earnings expected for 2018, 2019 and 2020.

**Source:** Data based on consensus of several brokers' reports for each company. Please note that Tumi was removed from the luxury and cosmetics factbook panel in 2017 and Jimmy Choo, Hengdeli and YNAP have been removed in 2018's edition. To make the analysis more meaningful, they have been removed from the panel in previous years as well.

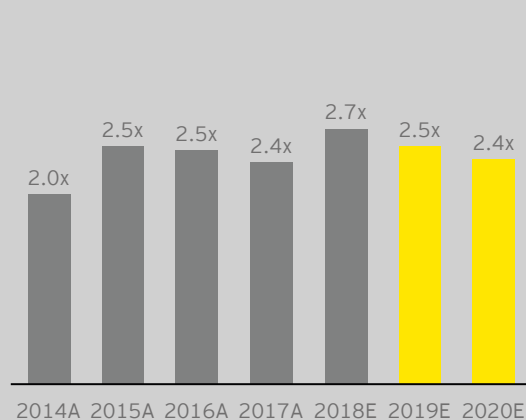
C

Trading multiples

## Cosmetics multiples are further rebounding in 2018

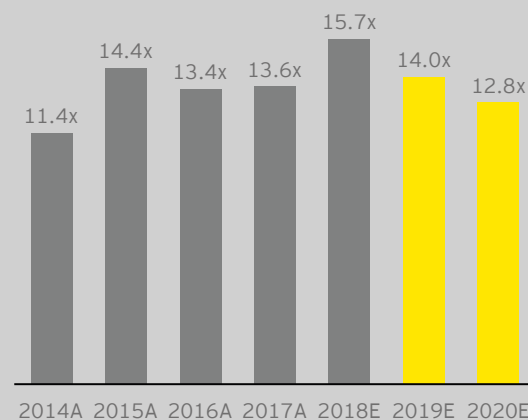
- ▶ The charts below show the evolution of the expected trading multiples of cosmetics companies in our current panel on 31 March of each year from 2014A to 2017A, and the expected average multiples for 2018E, 2019E and 2020E.
- ▶ Cosmetics companies followed a similar path as luxury companies with an increasing trend in multiples from 2017 to 2018. Trends such as premiumization, higher use of makeup among millennials and Generation Z consumers, beauty bloggers and celebrity-backed brands, an increased rate of women in emerging markets entering the workforce, more people traveling internationally, and a proliferation of new products and niche brands should see cosmetics sales grow in the mid to high single digits going forward, with the premium category growing even faster. Additionally, the beauty industry is known to be resistant to economic downturns, even faring well during the Great Recession of 2008. Though consumers tend to be more price conscious during those times, they do not stop spending. It is clear that in today's environment of rising per capita incomes the beauty business is booming.
- ▶ It is worth mentioning that the higher EV of Estée Lauder and Shiseido has an impact on increased EV/sales and EV/EBITDA multiples in 2018E. The reason for the increase in EV is the acquisition of Deciem Inc. by Estée Lauder in June, together with the success in targeting millennials and the effects of multiple measures introduced by the new CEO of Shiseido, which helped increase its market capitalization.

### EV/sales



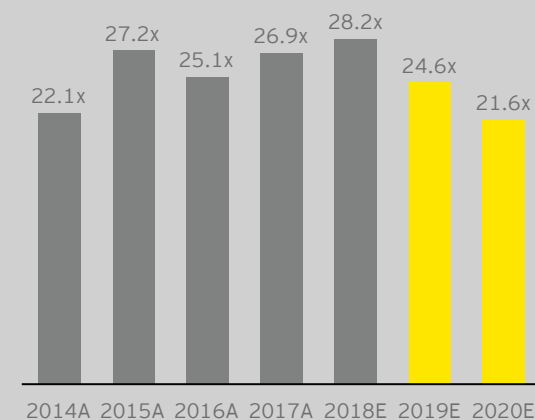
Average 2014A-18E: 2.4x

### EV/EBITDA



Average 2014A-18E: 13.7x

### Price to earnings



Average 2014A-18E: 25.9x

**Note:** Each year, the multiple is calculated as the ratio between EV as of 31 March that year and forecast sales, EBITDA and earnings for that year. The information for 2018E-19E and 2020E represents the forward multiple analysis for the factbook launch in 2018, calculated as the ratio between EV as of 31 March 2018, and sales, EBITDA and earnings expected for 2018, 2019 and 2020.

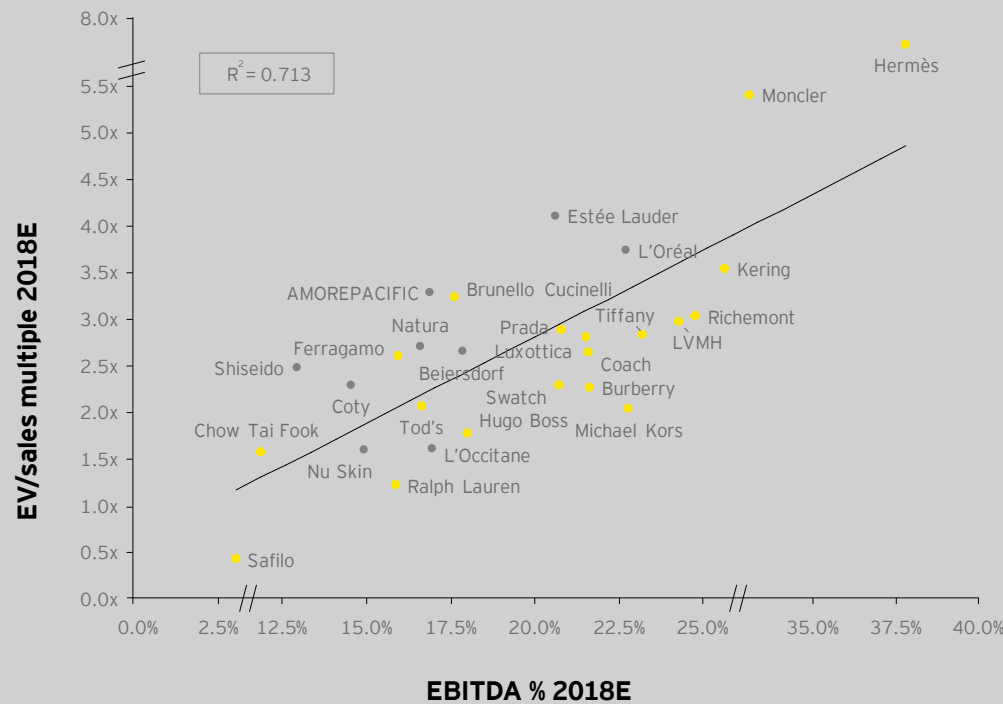
**Source:** Data is based on consensus of several brokers' reports for each company. Please note that AMOREPACIFIC and Nu Skin were added in the factbook panel in 2017. To make our analysis more meaningful, we have added them to the panel in previous years as well. In 2014-16 for these two companies, multiples are calculated with Capital IQ data. For this reason, the average may vary.

**C** Trading multiples

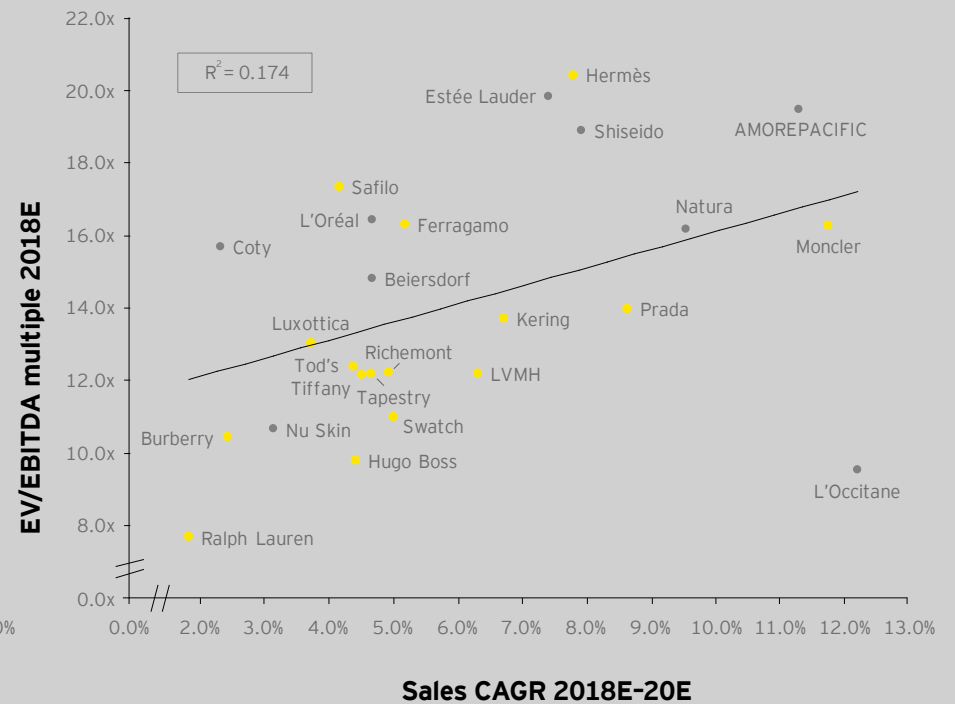
**In 2018, investors seem to focus more on profitability than growth, confirming a historical trend**

- ▶ A regression analysis shows a strong correlation between EV/sales levels and profitability. High profitability levels of a luxury company are, in general, associated with the strength of the brand and its capacity to command premium prices compared with its competitors. This makes its revenues more “valuable,” with a direct relevant effect on the EV/sales multiple. The reason is that the luxury industry is based on margin turnover, rather than volume. Thus, high margins are achievable and sustainable over time.
- ▶ The correlation between EV/EBITDA and sales growth is less robust (and less than last year), showing that investors seem to focus more on profitability than growth. Exclusivity brand loyalty and stable demand are some of the key factors to ensure sustainable business development and secure the strong financial conditions of companies in the luxury sector. Consequently, these companies have achieved strong pricing power and higher levels of profitability.

**Regression analysis: EV/sales 2018E multiple vs. EBITDA margin 2018**



**Regression analysis: EV/EBITDA 2018E multiple vs. sales CAGR 2018E-20E**



**Note:** Please note that Brunello Cucinelli, Chow Tai Fook and Michael Kors do not have consensus available for 2020E sales and are, therefore, not represented in the regression analysis between EV/EBITDA for 2018E and sales CAGR for 2018E-20E.



**A** DCF and valuation parameters

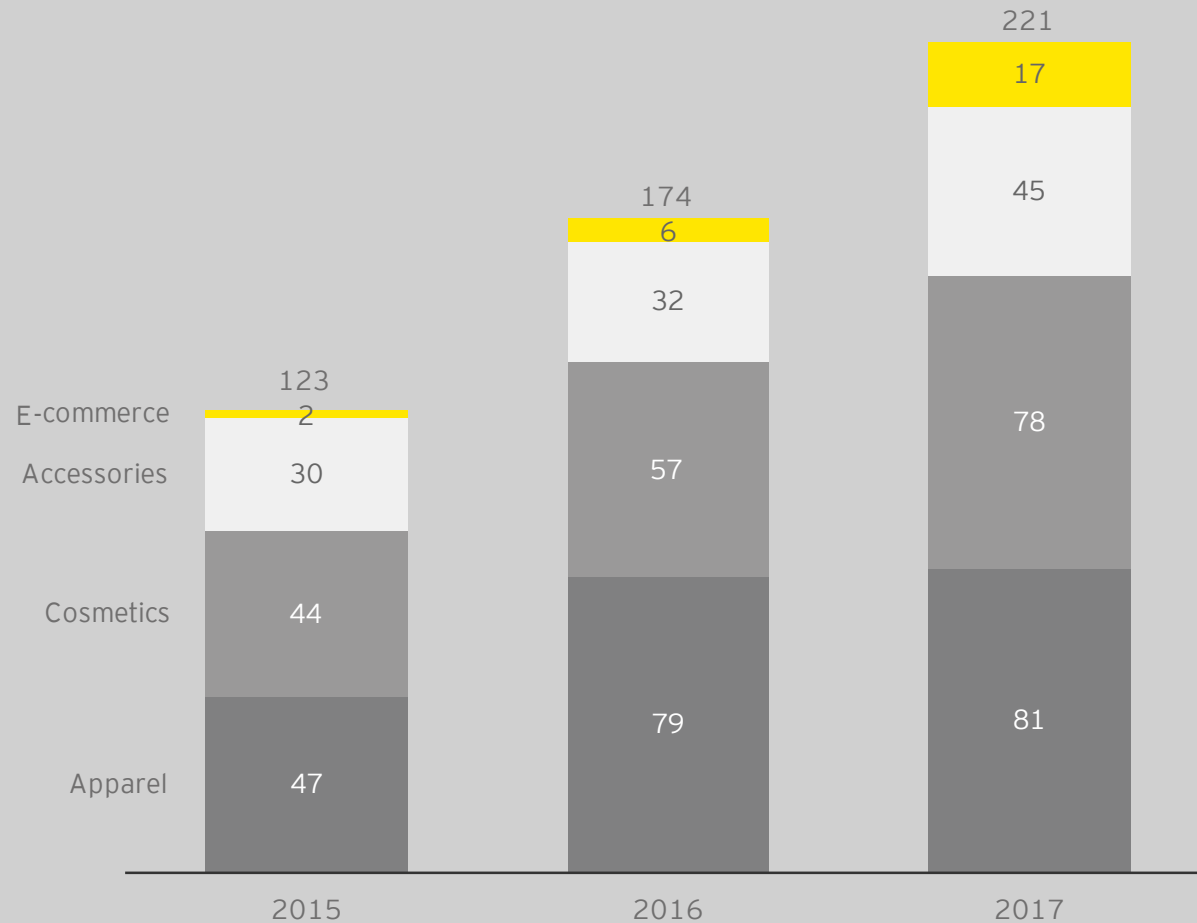
**B** Sales growth, EBITDA margin and capex ratio

**C** Trading multiples

**D** Transaction multiples

**D** Transaction multiples

**Accessories and cosmetics were the hottest sectors in 2017, with investors attracted by the growth potential of digital, which is currently driving consumer spending, especially in these product categories**



**Selected global 2017 transactions**

Coach/Kate Spade	
BC Partners/Pronovias	PHI Partners/Boglioli
Shandong Ruyi/Aquascutum	Goldwin/Woolrich

Natura/The Body Shop	
Unilever/Carver Korea	L'Oréal/Valeant (skin care)
Coty/Younique	Coty/Burberry Group

CVC Capital Partners/Breitling SA	
Essilor/Luxottica	Michael Kors/Jimmy Choo
Onward Luxury Group/Charlotte Olympia	Carlyle/Golden Goose

Conforama/Showroomprive.com	
Apax Partners/Matchesfashion.com	Apax Partners/Moda Operandi
JD.com/Farfetch.com	Showroomprive.com/Beauteprimee

**Notes:**

- ▶ Apparel includes transactions related to apparel, sportswear and lingerie.
- ▶ Cosmetics includes transactions related to cosmetics, dermocosmetics and third-party producers.
- ▶ Accessories include transactions related to accessories, jewelry and watches, and shoes.
- ▶ E-commerce includes transactions related to e-commerce for both luxury and cosmetics companies.

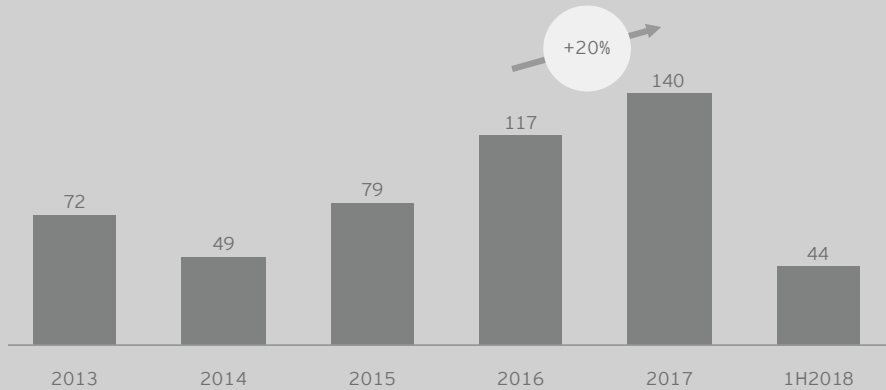
**Source:** EY analysis on Mergermarket data.



**D** Transaction multiples

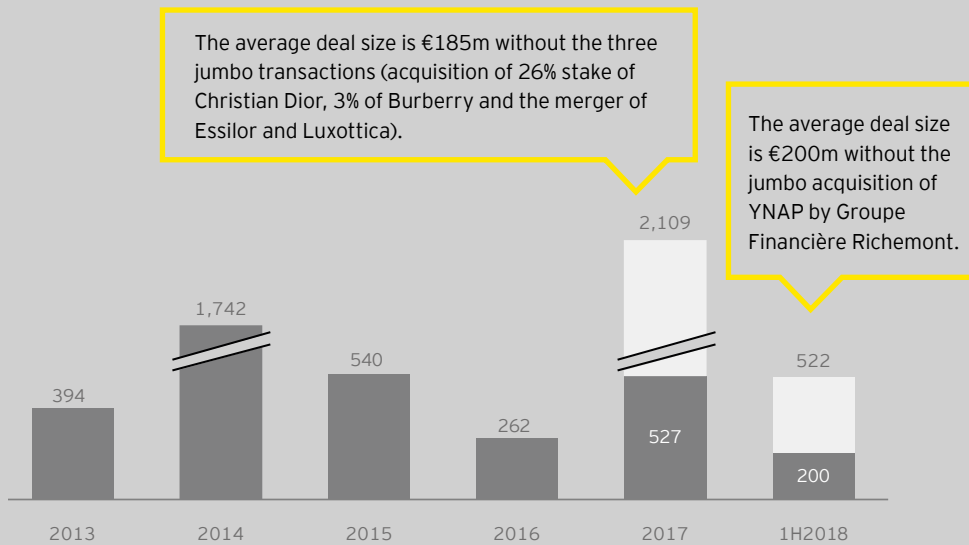
**In 2017, M&A activity in the fashion and luxury arena reached all-time highs with 140 transactions, with accessories and e-commerce being the hottest sectors**

**Number of completed deals**



- ▶ In 2017 there was a 20% increase in transactions compared with 2016, confirming the positive investor expectations of the potential in the luxury market.
- ▶ The interest has been in middle-market companies; however, the year was also characterized by large transactions that saw the establishment of new fashion platforms such as Tapestry (Coach and Stuart Weitzman in 2015, Kate Spade in 2017) and Michael Kors, which began creating the platform with the acquisition of Jimmy Choo.

**Average deal size (€m)**



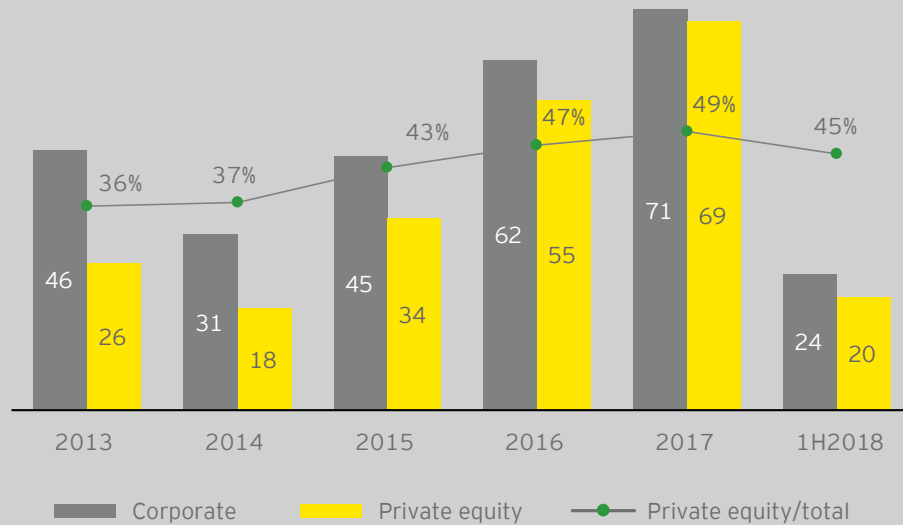
- ▶ In 2017, many transactions were led by private equity funds, which are showing interest in middle-market companies in the premium and entry-to-luxury sector.
- ▶ In the current scenario, investors are also showing growing interest in the e-commerce sector, a trend that is most likely going to continue in the coming year given the upsurge in digital. Players are moving to consolidate leadership in this distribution channel by acquiring smaller platforms. For example, Apax Partners acquired Matchesfashion.com and Moda Operandi to create an interesting e-commerce platform, and JD.com acquired Farfetch.com with the same goal.
- ▶ The year 2018 commenced with smaller acquisitions compared with 2017, but of very well-known brands, such as the acquisition of La Perla by Sapinda Holding, Bally by Shandong Ruyi and MSGM by Style Capital. The only large transaction is the acquisition of YNAP by Groupe Financière Richemont.

Source: EY analysis of Mergermarket data. 1H stands for first half.

**D** Transaction multiples

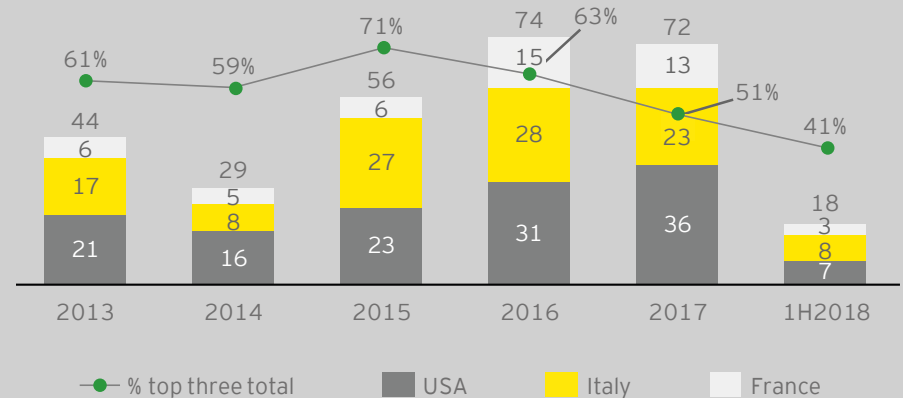
**Private equity activity fueled by dry powder reached 49% of total M&A activity in the fashion and luxury sector in 2017**

Number of completed deals by type of buyer



- ▶ The luxury sector has always been of interest to financial investors given the high growth potential and profitability.
- ▶ Private equity activity in the sector has risen remarkably in the past year, reaching 49% of the total activity in 2017, fueled by the dry powder of funds and credit availability.
- ▶ E-commerce is the emerging sector where private equity funds are investing, showing interest in online premium and entry-to-luxury distribution platforms. These are expected to lead growth in fashion and luxury distribution in future years, especially for product categories such as bags, shoes and other accessories.

Number of completed deals sorted by top three geographies of target



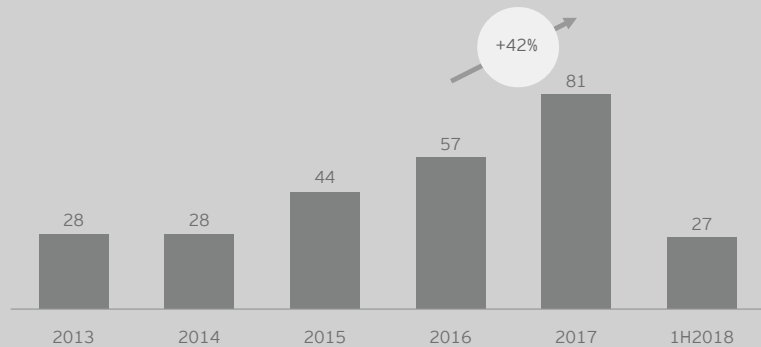
- ▶ Italy, the US and France are historically the top countries attracting the interest of buyers in the fashion and luxury arena. In 2017, the UK was also attractive to investors, beating France in deal count with 18 transactions.
- ▶ Chinese buyers have been very active, acquiring worldwide renowned brands to relaunch in the top three target countries. For example, Shandong Ruyi acquired in 2017 and 2018 Lycra, Aquascutum, Trinity and Bally.
- ▶ The US is targeted especially for sportswear and casual brands, while Italy and France have been targeted for brands with heritage, mostly in the entry-to-luxury and high-end luxury arenas.

Source: EY analysis of Mergermarket data.

**D** Transaction multiples

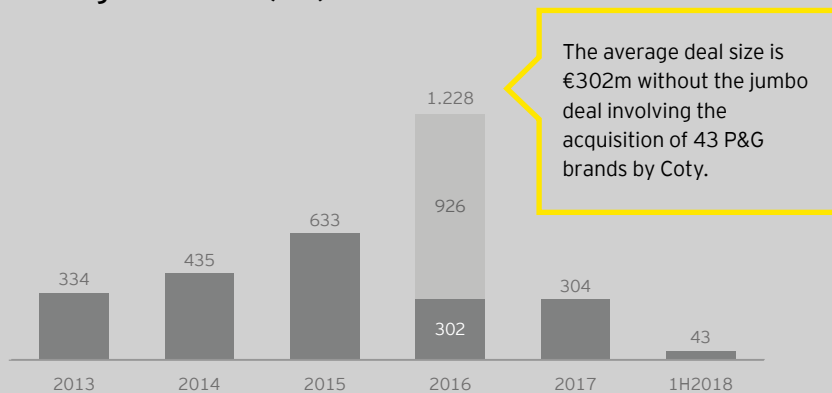
**M&A activity in cosmetics is rising, drawing the appetite of investors who see opportunities for high returns with lower risk compared with investments in fashion and luxury brands**

**Number of completed deals**



- ▶ The cosmetics industry witnessed impressive growth of 42%, with 81 transactions (the highest in the last five years) in 2017, compared with 57 in 2016.
- ▶ The year 2017 marked major transactions by leading corporate groups such as the acquisition of The Body Shop by Natura, Younique by Coty and Carver Korea by Unilever.
- ▶ In 2017 investors showed a rising preference for cosmetics, but also toward dermocosmetics (for example, L'Oréal acquiring the skin care division of Valeant Pharmaceuticals), as well as the e-commerce sector (for example, the acquisition of Beautéprivee by Showroomprivé).
- ▶ Acquisition of top-tier brands with a preference for dermocosmetics has been the response of large groups to consumer preferences, which are shifting from mass products to premium products (for example, Colgate acquired EltaMD and PCA Skin, Gruppo Sodalis acquired Icim International and Maeco Group acquired Rougj).

**Average deal size (€m)**



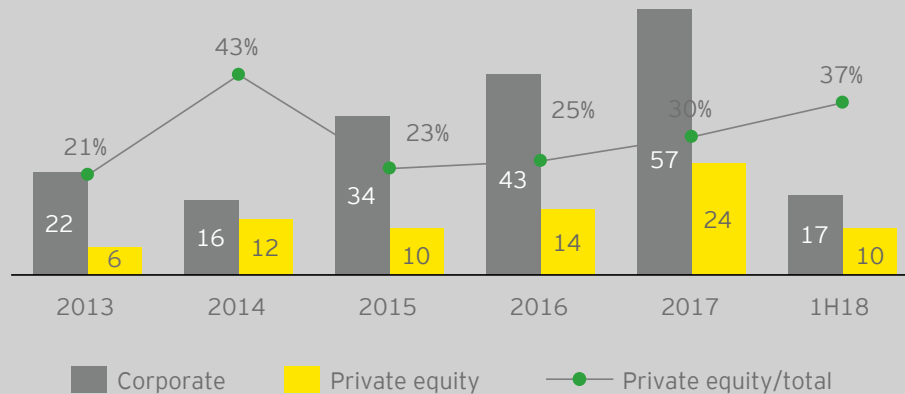
- ▶ The average deal size for 2017 is in line with 2016 if the jumbo deal involving the acquisition of 43 P&G brands by Coty is excluded.
- ▶ In general, smaller acquisitions are carried out when there is a very innovative product involved or an initiative with a relevant technology component (for example, the acquisition by Shiseido of MATCHCo, a company that launched a revolutionary technology and innovative digital tools to provide consumers with individual, customized foundations at scale).

Source: EY analysis on Mergermarket data.

**D** Transaction multiples

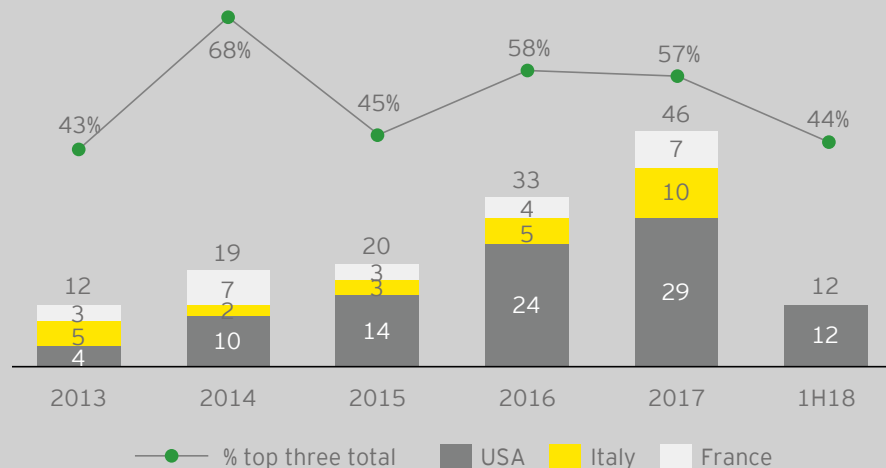
**Notwithstanding the usual predominance of trade buyers, the sector has attracted more interest from private equity funds in 2017, which accounted for 30% of the total deals versus 25% in previous years**

Number of completed deals by type of buyer



- ▶ Historically, cosmetics have been of interest just to the leading cosmetics groups; however, in recent years, private equity funds have started to look at the sector to leverage (i) the opportunity for a trade sale exit given the aggregation strategy carried out by large cosmetics groups and (ii) the lower risk compared with the fashion and luxury sector.
- ▶ As mentioned, the growing consumer awareness of ingredients is fueling growth in natural and organic products, which has driven investment toward dermocosmetics companies.
- ▶ Investors have positive expectations since the underlying market is strong, with some categories growing more than others (men’s grooming and skin care) and with markets such as Asia-Pacific just starting to pick up the pace with an expectation it will represent around 60% of the total market by 2020.

Number of completed deals sorted by top three geography of target



- ▶ The US is the main target for investors, due to it leading the way in industry innovation.
- ▶ Italy and France follow the US with a significantly lower number of transactions. These countries are characterized by a large quantity of very small companies, which, in some cases, did not raise the interest of the large trade players and were considered smaller than the critical size required.

Source: EY analysis of Mergermarket data; Euromonitor; EY analysis.

**D** Transaction multiples

**Transaction multiples in the luxury and cosmetics industry are rebounding**

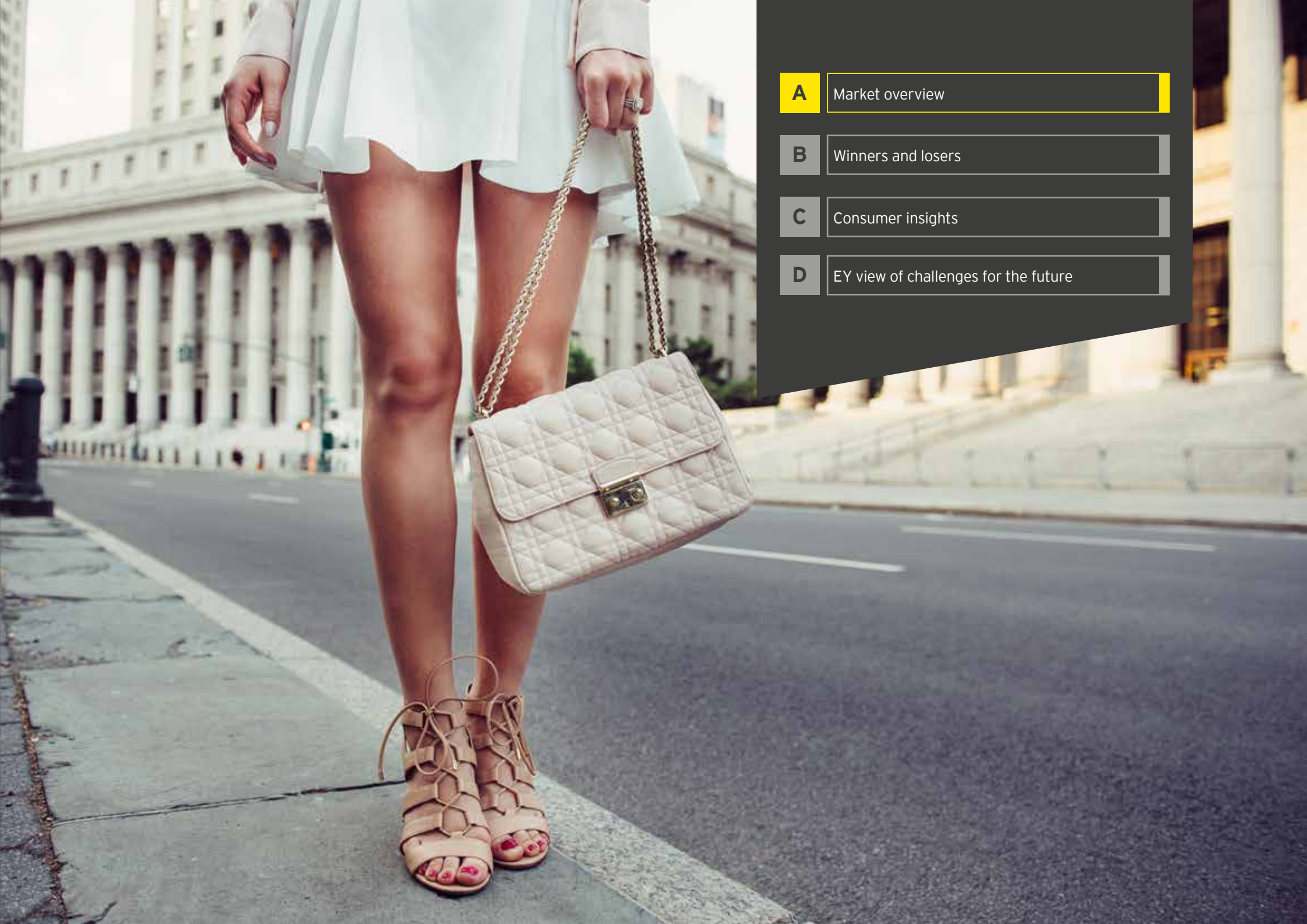

**Source:** EY analysis of Mergermarket data.

M&A luxury multiples in 2017 were slightly higher compared with previous years. However, they could have been higher, if not for the nature of some specific transactions carried out in 2017. For example, there was the acquisition of the minority stake (25.9%) of Christian Dior by LVMH that was aimed at simplifying the ownership structure and had an EV/EBITDA of 6.0x, and the acquisition of 33% of Grupo Cortefiel acquired by CVC Capital Partners Limited, which had a low EV/EBITDA multiple since it was underperforming with more than four years of negative results. Moreover, the acquisition of Belle International Holdings by Consortium had an EV/EBITDA multiple of 6.6x because it is a low-end luxury company located in Asia. However, the remaining multiples available are above the average of previous years. The average, excluding these transactions, would be 14.3x and includes transactions such as the merger between Luxottica and Essilor, Coach and Kate Spade, Michael Kors and Jimmy Choo, Breitling SA and CVC Capital Partners, and Pronovias and BC Partners.

In the case of cosmetics companies, M&A multiples in 2017 increased compared with previous years, mainly due to major transactions such as the acquisition of The Body Shop by Natura and the acquisition of Carver Korea by Unilever (which was performing at a 43% EBITDA margin).

# Luxury industry overview

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**A**

Market overview

**B**

Winners and losers

**C**

Consumer insights

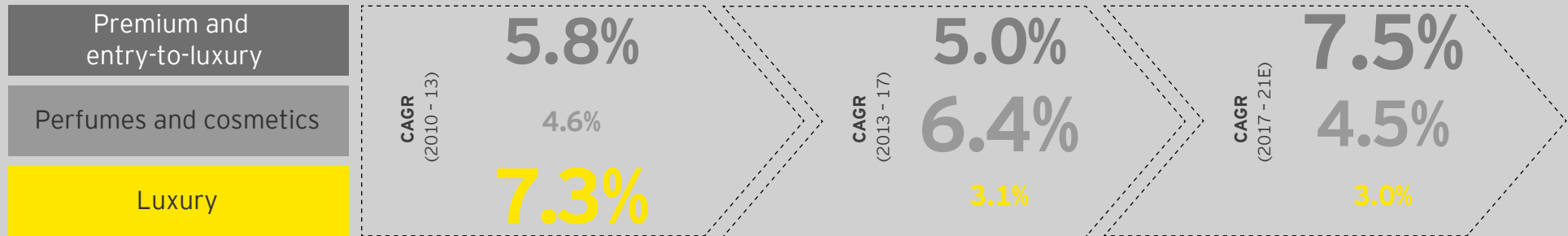
**D**

EY view of challenges for the future

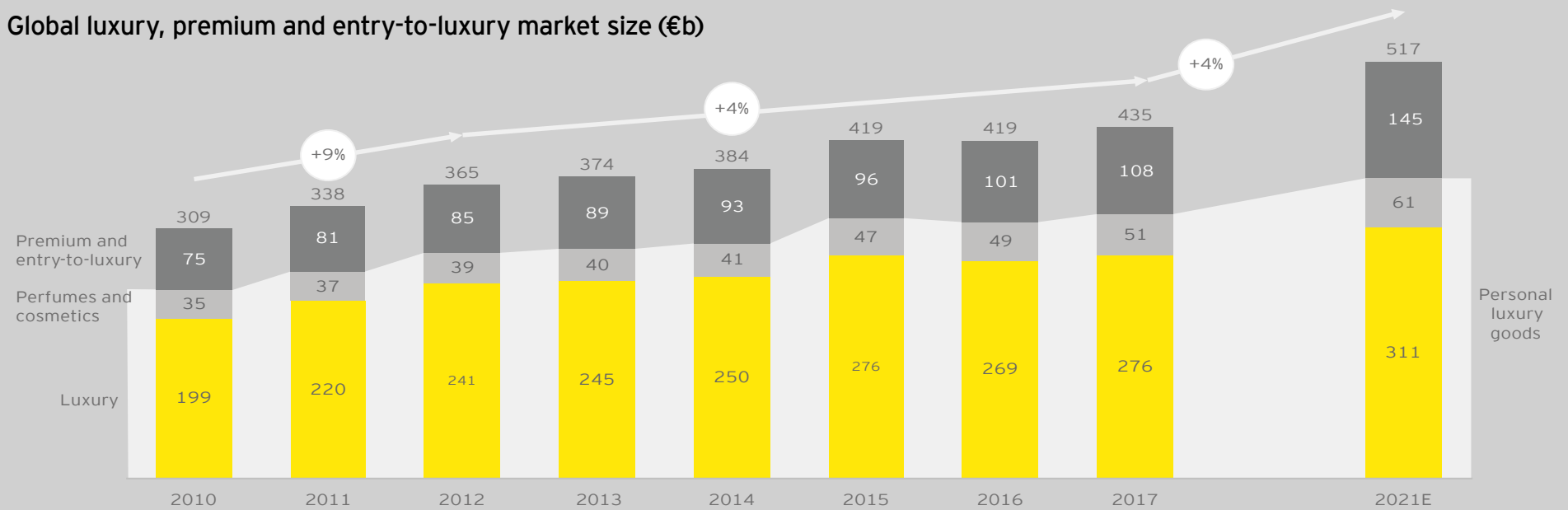
**A** Market overview

Premium and entry-to-luxury segments are expected to grow by 7.5% CAGR, while luxury market will decrease its historical fast pace (CAGR 3.0%)

Luxury, premium and entry-to-luxury market growth (%)



Global luxury, premium and entry-to-luxury market size (€b)



**Note:** Experiential luxury (e.g., hotels, wine and spirits, exclusive vacations), yachts, cars, design, lighting and smartphones are excluded.

**Source:** EY analysis on Fondazione Altagamma data.



A

Market overview

Luxury shoes still remain the object of desire, leading the segment growth. Premium clothes will increase their pace and reach the same market value of the luxury segment in 2021

	Luxury		Premium and entry-to-luxury	
	2017	2021E	2017	2021E
 Shoes	€18b +6% CAGR	€25b +10% CAGR	€19b +5% CAGR	€24b +6% CAGR
 Accessories	€66b +7% CAGR	€80b +5% CAGR	€11b +9% CAGR	€16b +9% CAGR
 Watches and jewelry	€123b +2% CAGR	€122b -1% CAGR	€16b +7% CAGR	€21b +8% CAGR
 Apparel	€69b +4% CAGR	€84b +5% CAGR	€62b +4% CAGR	€84b +8% CAGR

**Notes:**

- ▶ 2017: CAGR is calculated for the period between 2011 and 2017.
- ▶ 2021: CAGR is calculated for the period between 2017 and 2021E.
- ▶ Experiential luxury (e.g., hotels, wine and spirits, exclusive vacations), yachts, cars, design, lighting and smartphones are excluded.

**Source:** EY analysis on Fondazione Altagamma data.

A

Market overview

The premium segment is growing quickly in the leading geographies, even in China, despite the recent slowdown

	Luxury*		Premium and entry-to-luxury	
	2017	2021E	2017	2021E
	€24b** +6% CAGR	€26b +3% CAGR	€8b +7% CAGR	€11b +8% CAGR
	€109b +8% CAGR	€127b +4% CAGR	€28b +6% CAGR	€39b +8% CAGR
	€79b +2% CAGR	€89b +3% CAGR	€35b +2% CAGR	€40b +4% CAGR
	€115b +3% CAGR	€129b +3% CAGR	€37b +8% CAGR	€55b +10% CAGR

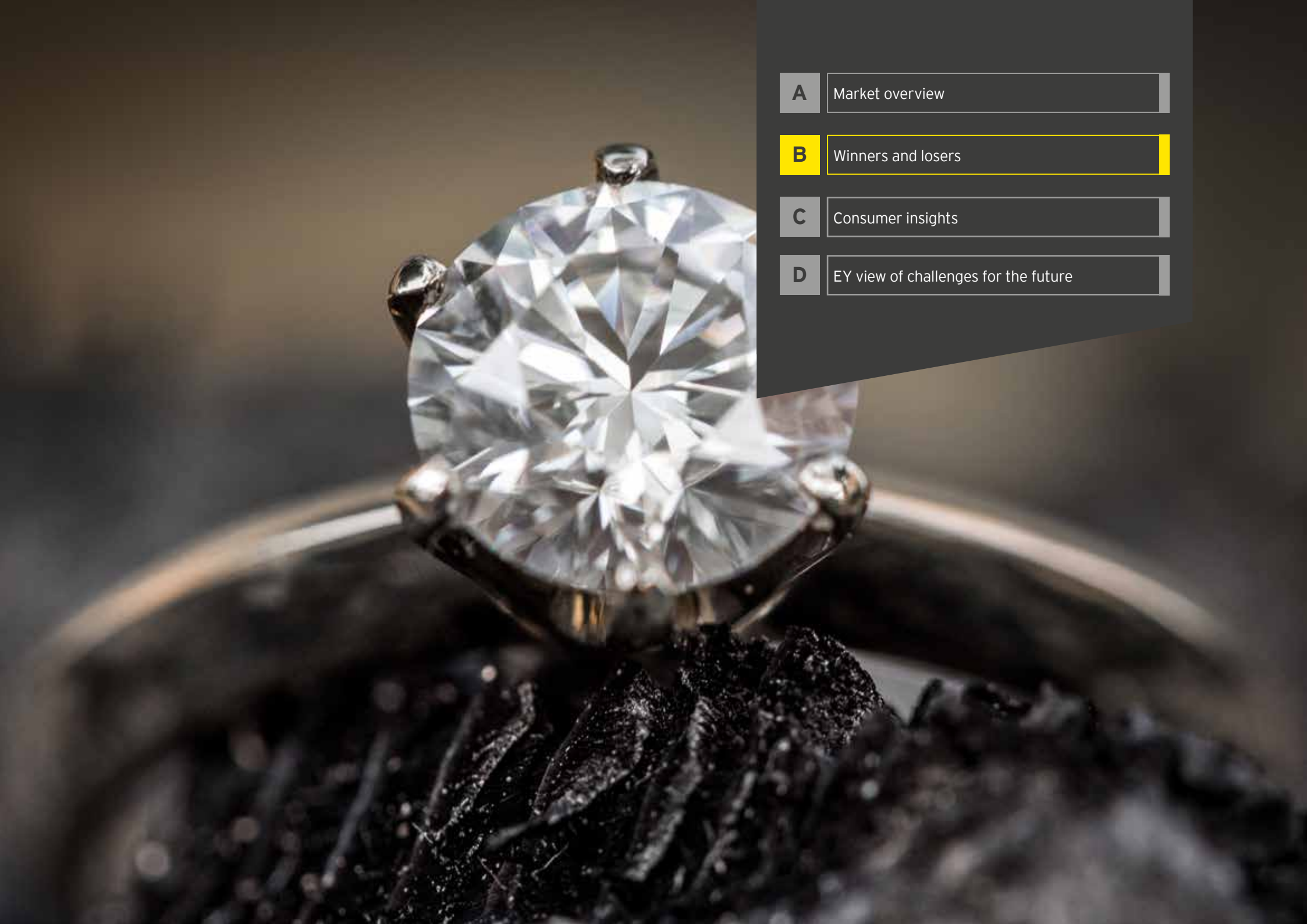
\* Includes perfumes and cosmetics.

\*\* The Chinese luxury consumer shops worldwide. Only €24b of sales are generated in the Chinese domestic market, while the Chinese consumer accounts for more than €100b (circa 30% of the global luxury market) if purchases in the rest of the world are taken into account (especially in Europe and the US).

**Note:**

- ▶ 2017 CAGR: The CAGR is calculated for the period between 2011 and 2017.
- ▶ 2021 CAGR: The CAGR is calculated for the period between 2017 and 2021E.
- ▶ Experiential luxury (e.g., hotels, wine and spirits, exclusive vacations), yachts, cars, design, lighting and smartphones are excluded.

**Source:** EY analysis on Fondazione Altgamma data.



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EY view of challenges for the future

**B**

Winners and losers

**The idea of sexiness is related to iconic details of the brand but also to communication style and unconventionality of the brand**

What sexiness means:

Expressing a new **sensuality that is imaginative, intimate** and delicate that may sometimes be provocative and, able to capture the imagination of consumers and bring new ones closer to the brand

Developing new and **unconventional shapes** capable of provoking and intriguing thanks to the use of researched materials, finishes and creative effects

Creating more **immediate, flexible and tantalizing forms of communication** able to put the consumer and the community at the center, instead of the brand and the product



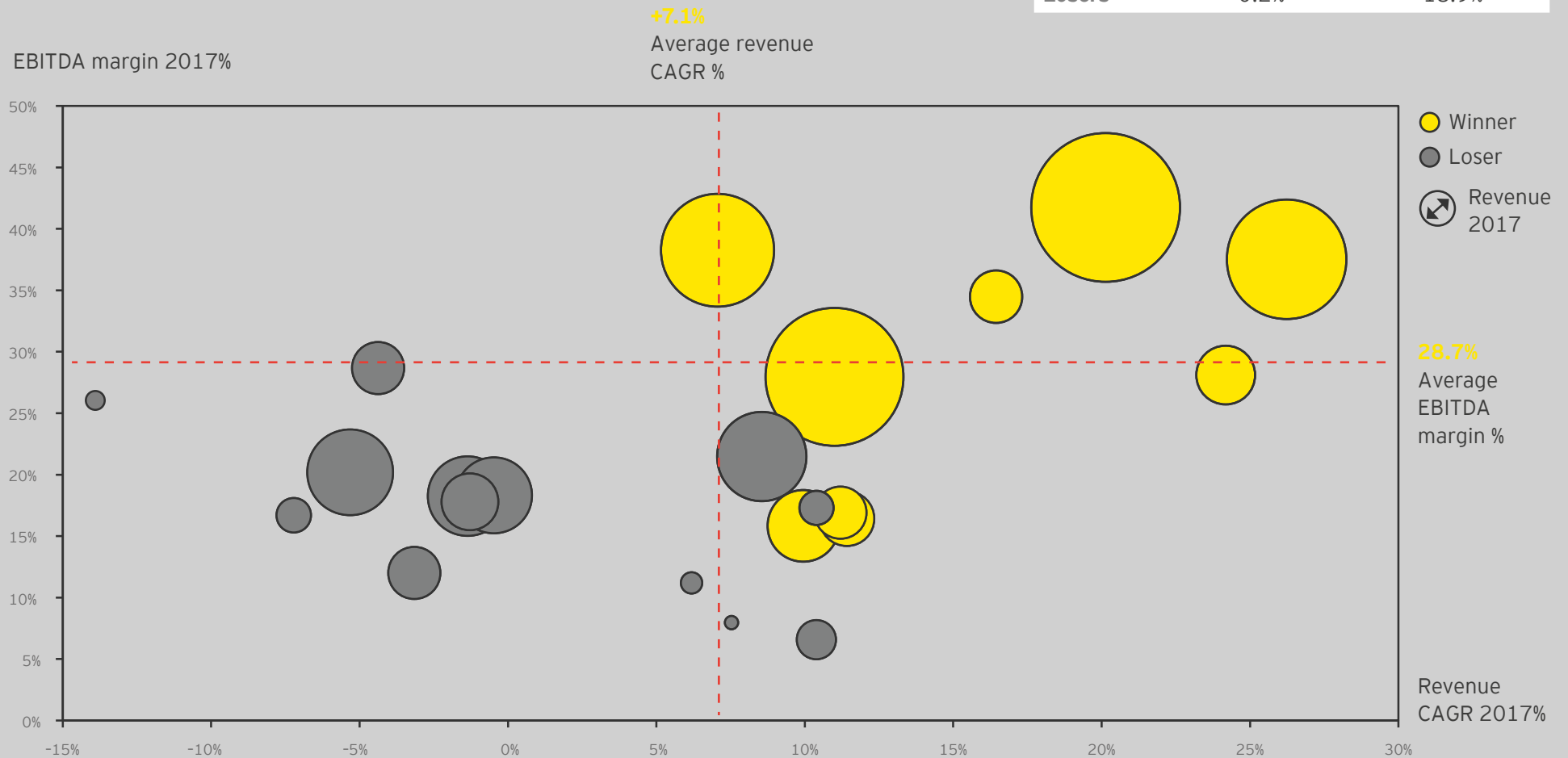
**B**

Winners and losers

In a world where market growth is slowing down, if all other factors are equal (quality, made in, distribution, etc.), understanding the key to sexiness can make the difference between losing or winning

Benchmarking analysis of key players – Revenue CAGR and EBITDA margin

	Revenue CAGR %	EBITDA margin %
<b>Winners</b>	+11.1%	33.4%
<b>Losers</b>	-0.2%	18.9%



**Note:** 2017 CAGR: The CAGR is calculated for the period between 2011 and 2017 for the brands whose financial statements are available.

**Source:** EY analysis on companies' financial statements.

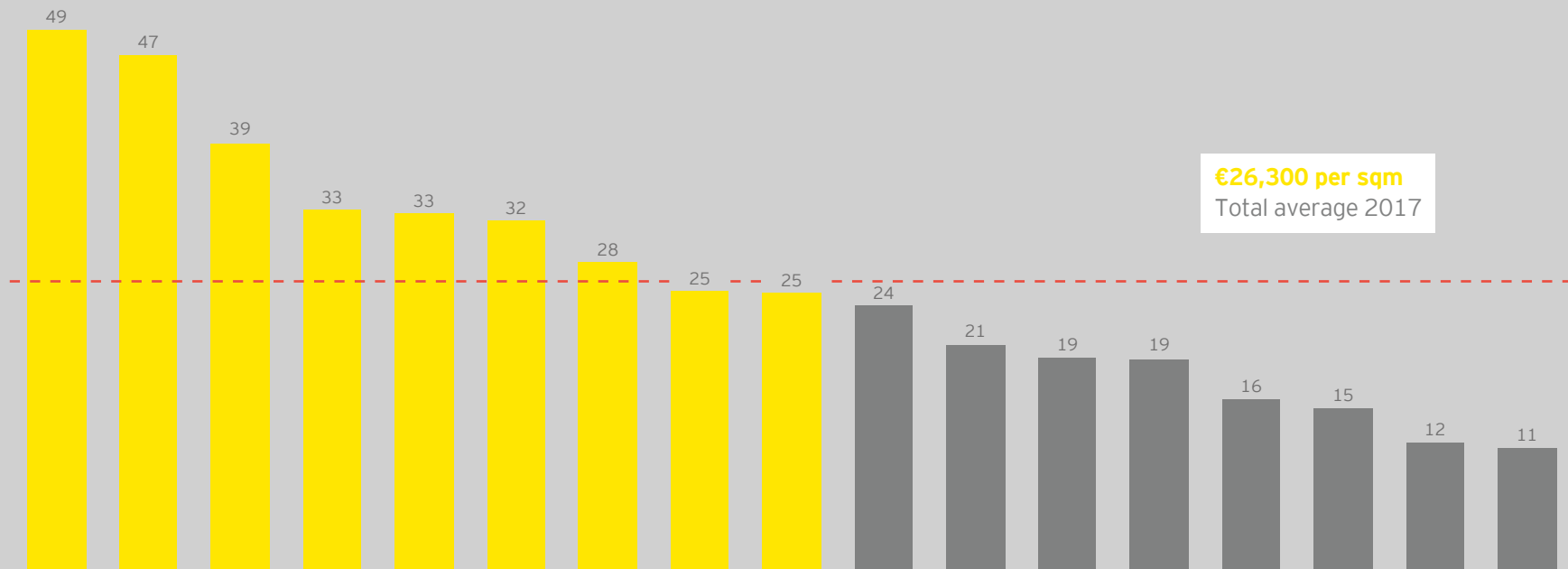
**B** Winners and losers

In the market there are winners and losers, despite all brands having superior quality, heritage and premium store location. The difference seems to be the ability to respond to consumer demand for "sexiness"

Benchmarking analysis of key players – Revenue per square meter

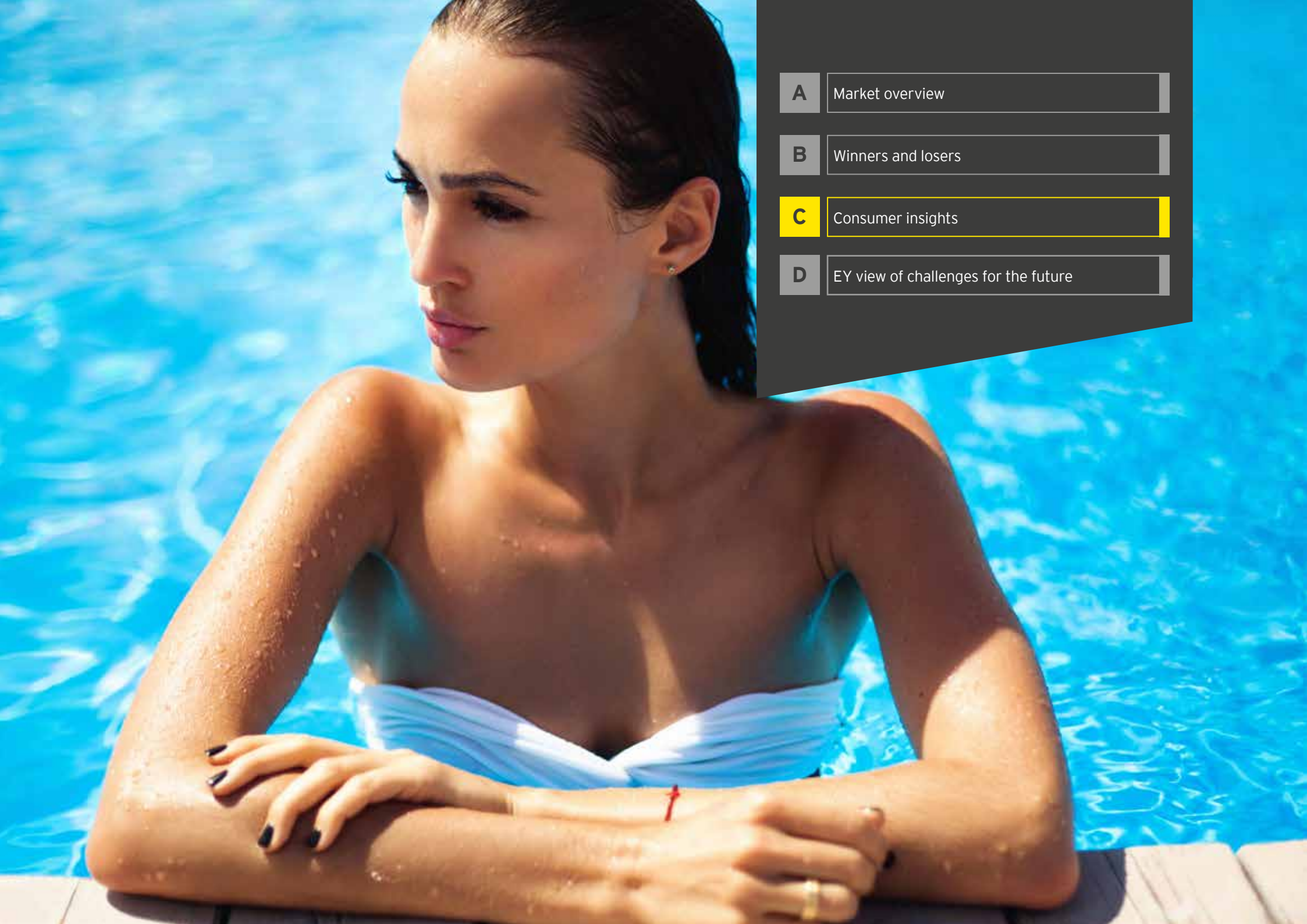
Revenue per square meter (sqm)

<b>Winners</b>	€32,700 per sqm
<b>Losers</b>	€20,600 per sqm



**Note:** Total average 2017: The average of revenue per sqm in 2017 is calculated for the brands whose financial statements are available.

**Source:** RBC Luxury Retail Productivity Study, RBC Capital Markets, 2018.



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EY view of challenges for the future

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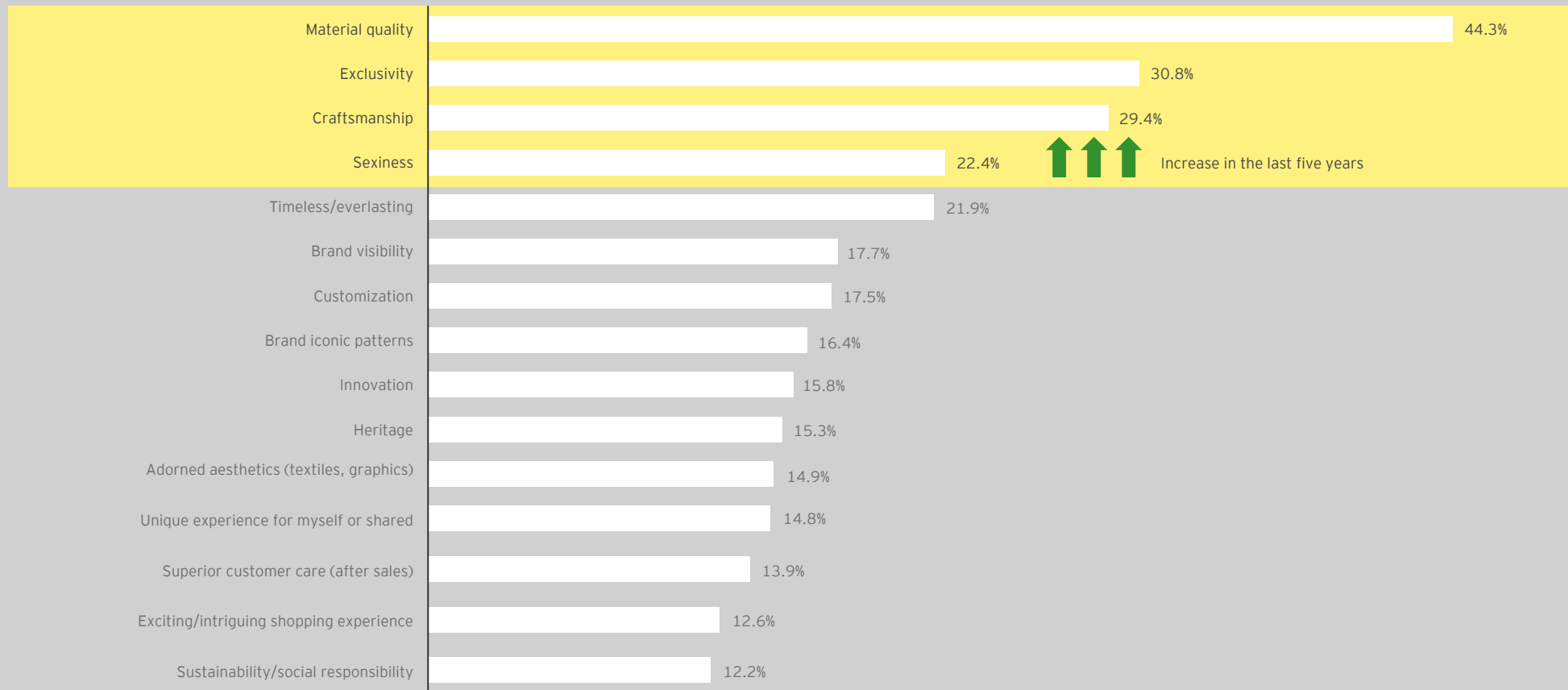
Consumer insights

**Sexiness today is one of the first factors representing luxury for customers, a change after many years in which material quality, exclusivity and craftsmanship were the key factors**

What is luxury to me?

**Customer luxury value\***

(% of respondents' answers)



**Note:** Experiential luxury (e.g., hotels, wine and spirits, exclusive vacations), yachts, cars, design, lighting and smartphones are excluded.

**Source:** EY analysis; *True-Luxury Global Consumer Insight*, Fondazione Altagamma, 2018. Interviews of 12,000 true luxury consumers. Each consumer expressed three characteristics so the total adds up to 300%.



C

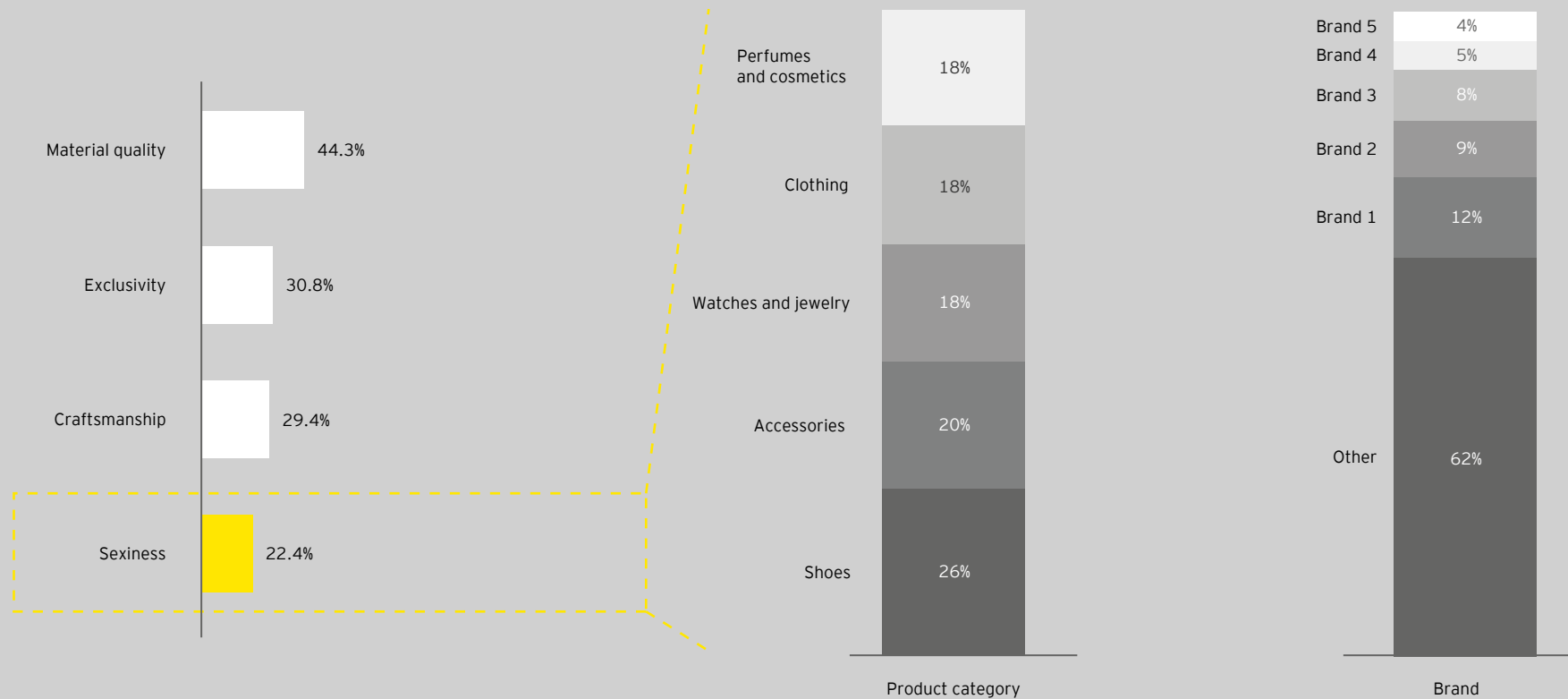
Consumer insights

## Almost half of customers associate sexiness with shoes and accessories from the top luxury brands

### What is luxury to me? *Categories and brands*

#### Customer luxury value\*

(% of respondents' answers)



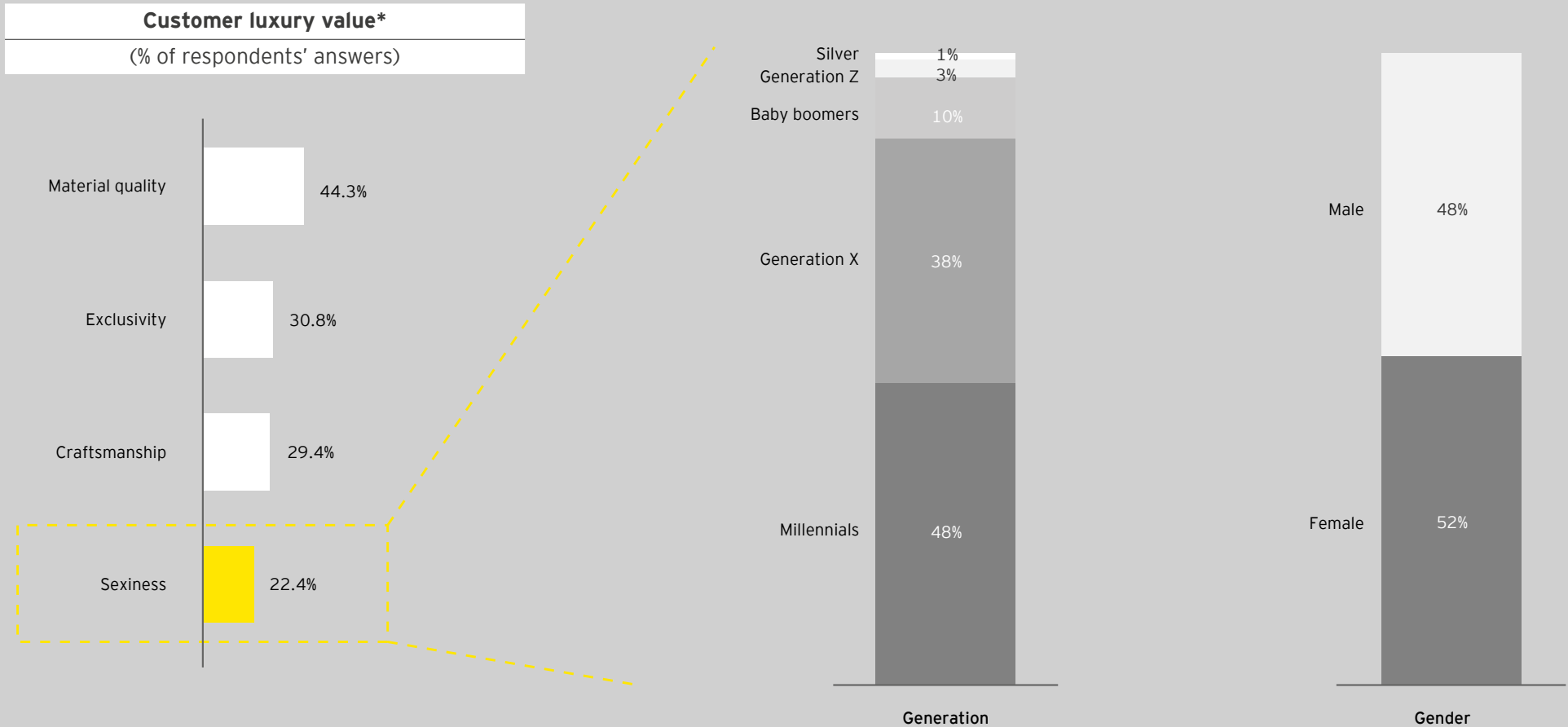
**Note:** Experiential luxury (e.g., hotels, wine and spirits, exclusive vacations), yachts, cars, design, lighting and smartphones are excluded.

**Source:** EY analysis; *True-Luxury Global Consumer Insight*, Fondazione Altgamma, 2018. Interviews of 12,000 true luxury consumers. Each consumer expressed three characteristics so the total adds up to 300%.

**C** Consumer insights

**Consumers seeking sexiness are mainly millennials or under 50, and equally distributed by gender**

**What is luxury to me? Age and gender**



**Note:** Experiential luxury (e.g., hotels, wine and spirits, exclusive vacations), yachts, cars, design, lighting and smartphones are excluded.

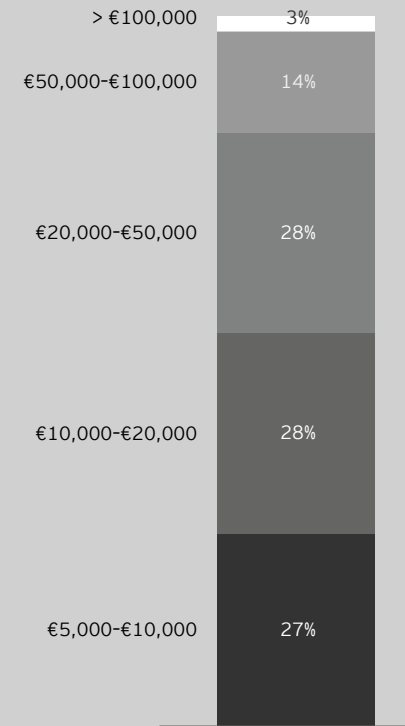
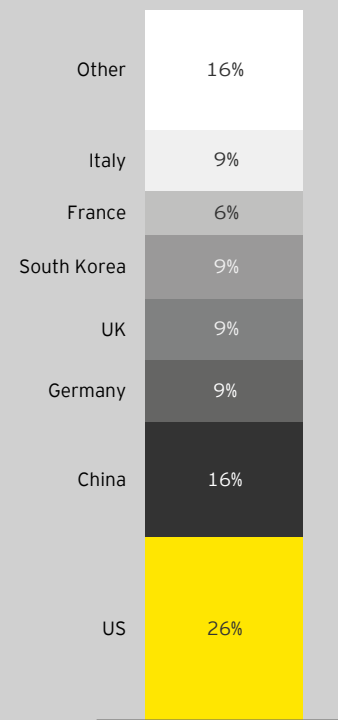
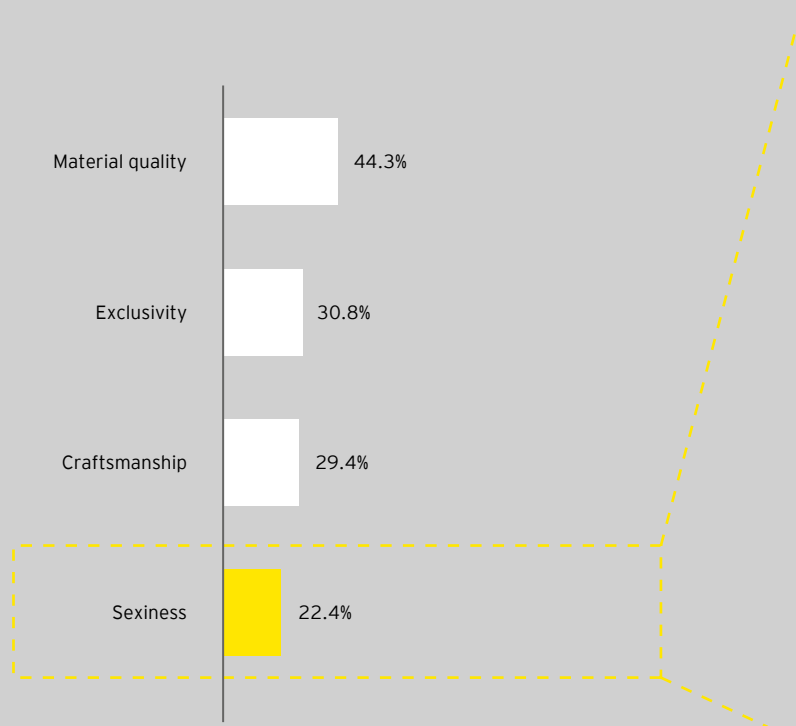
**Source:** EY analysis; *True-Luxury Global Consumer Insight*, Fondazione Altagamma, 2018. Interviews of 12,000 true luxury consumers. Each consumer expressed three characteristics so the total adds up to 300%.

**C** Consumer insights **Sexiness hunters are mostly located in the US and China and spend an average of between €5,000 and €20,000 on luxury**

What is luxury to me? *Country and amount of spending*

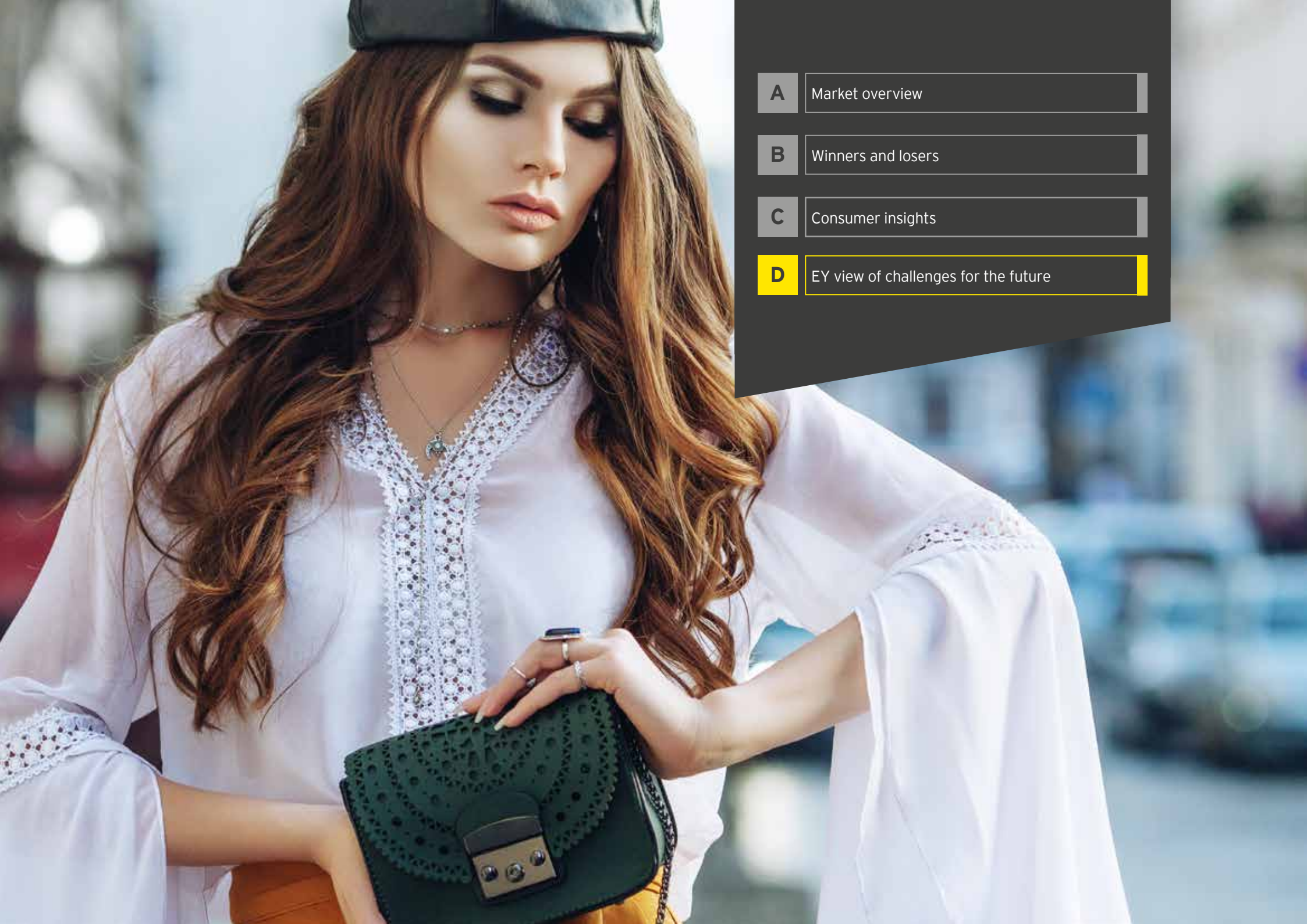
**Customer luxury value\***

(% of respondents' answers)



**Note:** Experiential luxury (e.g., hotels, wine and spirits, exclusive vacations), yachts, cars, design, lighting and smartphones are excluded.

**Source:** EY analysis; *True-Luxury Global Consumer Insight*, Fondazione Altgamma, 2018. Interviews of 12,000 true luxury consumers. Each consumer expressed three characteristics so the total adds up to 300%.



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EY view of challenges for the future

**D**

EY view of challenges for the future

**The challenge for the future lies in creativity and business excellence. Business excellence must focus on three pillars: buying and merchandising, customer relationship management and improvement of the retail machine**

Key challenges for the future



**Creativity**

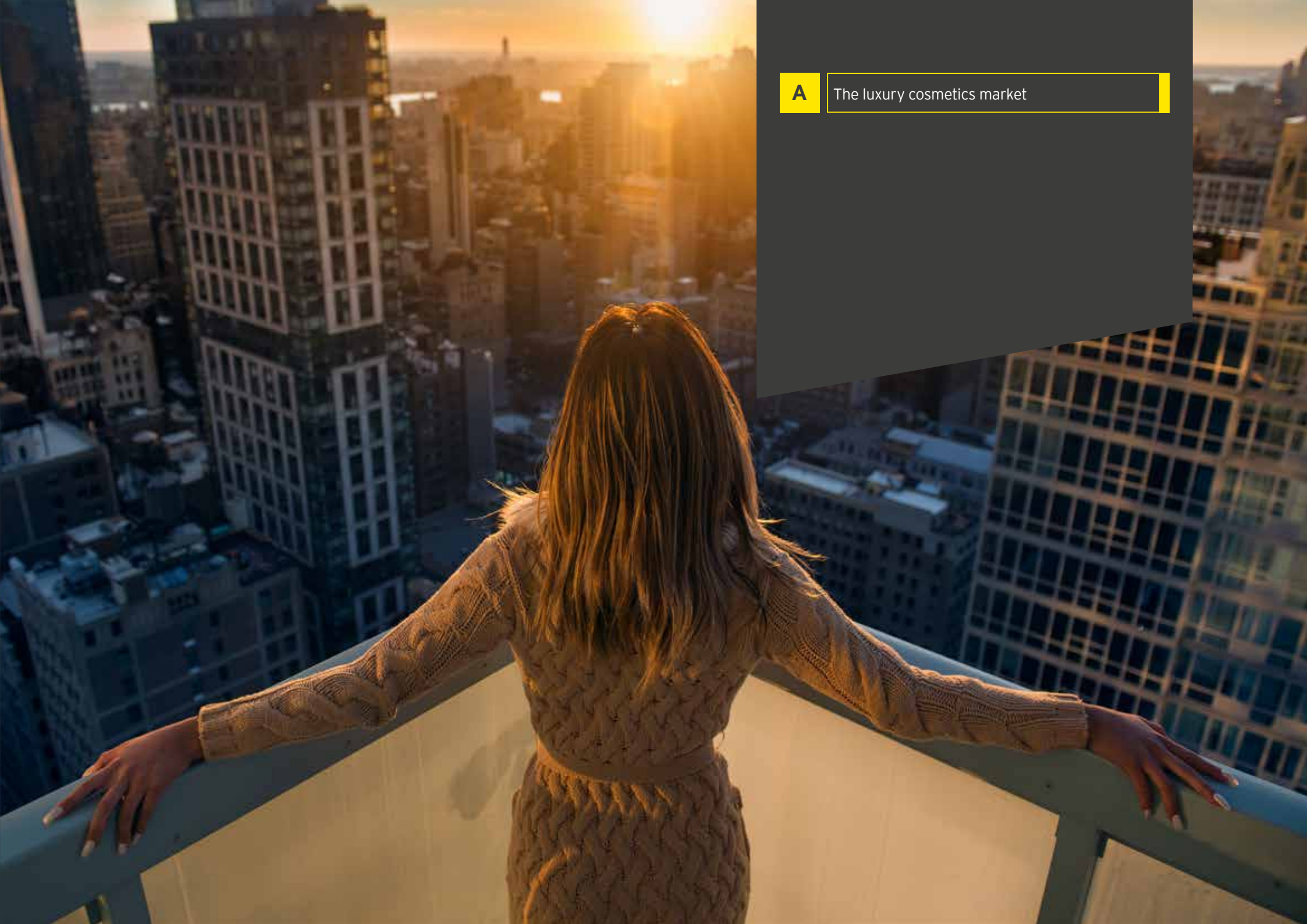
**Business excellence**

<b>Buying and merchandising</b>	<b>Customer relationship management</b>	<b>Improvement of the retail machine</b>
<ul style="list-style-type: none"> <li>▶ Performance analysis per category and SKU</li> <li>▶ Review merchandising grids for each category, price range and occasion</li> <li>▶ Reduction of collection complexity</li> </ul>	<ul style="list-style-type: none"> <li>▶ Deep customer segmentation to define a one-to-one approach to each cluster</li> <li>▶ Ensure coherent approach among channels and maximize customer redemption for the single activities</li> </ul>	<ul style="list-style-type: none"> <li>▶ Offering analysis per single DOS at category and SKU level</li> <li>▶ Definition of a set of solutions based on door clustering:                             <ul style="list-style-type: none"> <li>▶ Must buy and open to buy review</li> <li>▶ New visual merchandising approach</li> <li>▶ Review of the services (e.g., replenishment)</li> </ul> </li> </ul>

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# Cosmetics market overview

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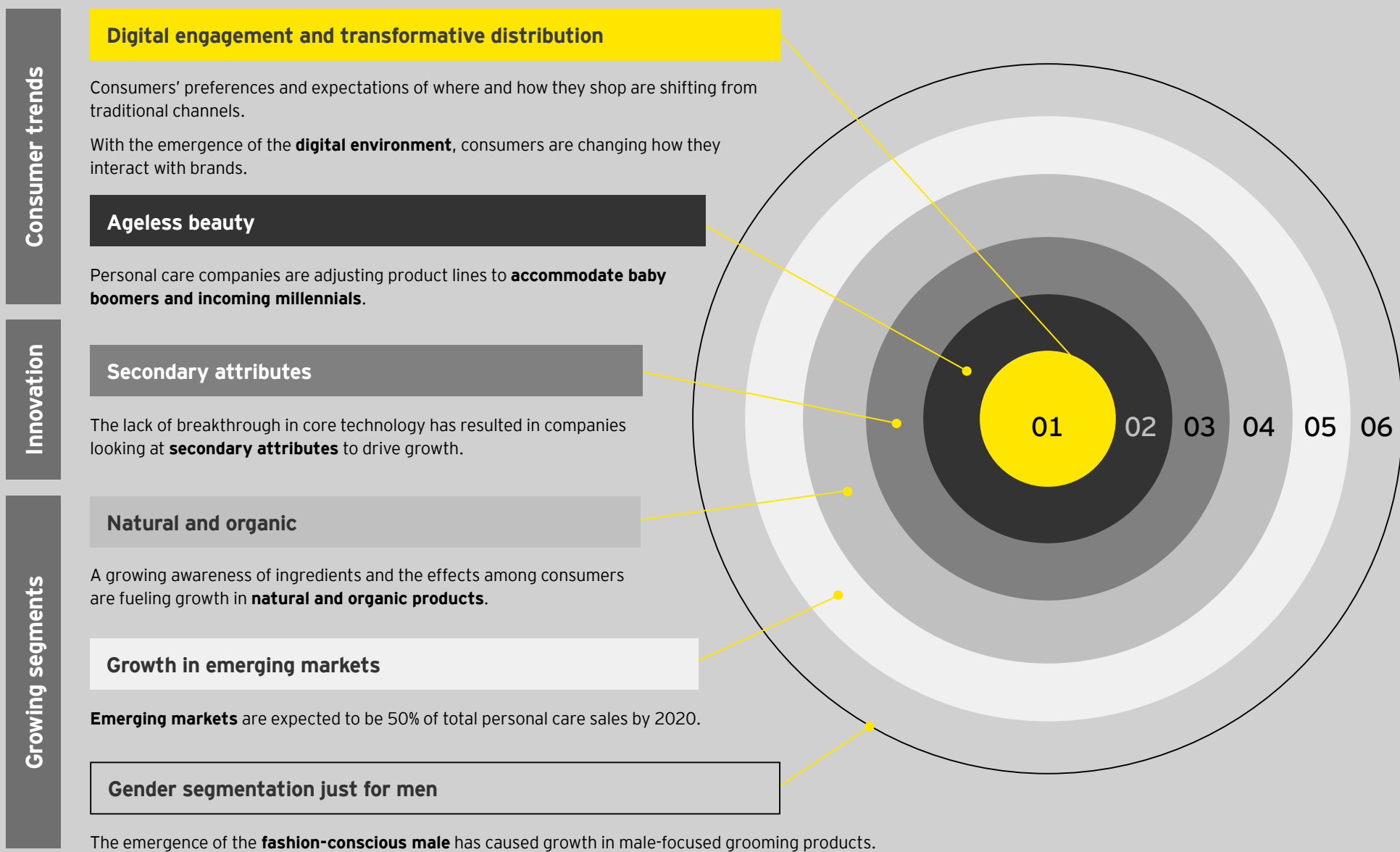


A

The luxury cosmetics market

**A** The luxury cosmetics market

**Key themes driving the new luxury in beauty**





**A**

The luxury cosmetics market

**Digital engagement and transformative distribution**



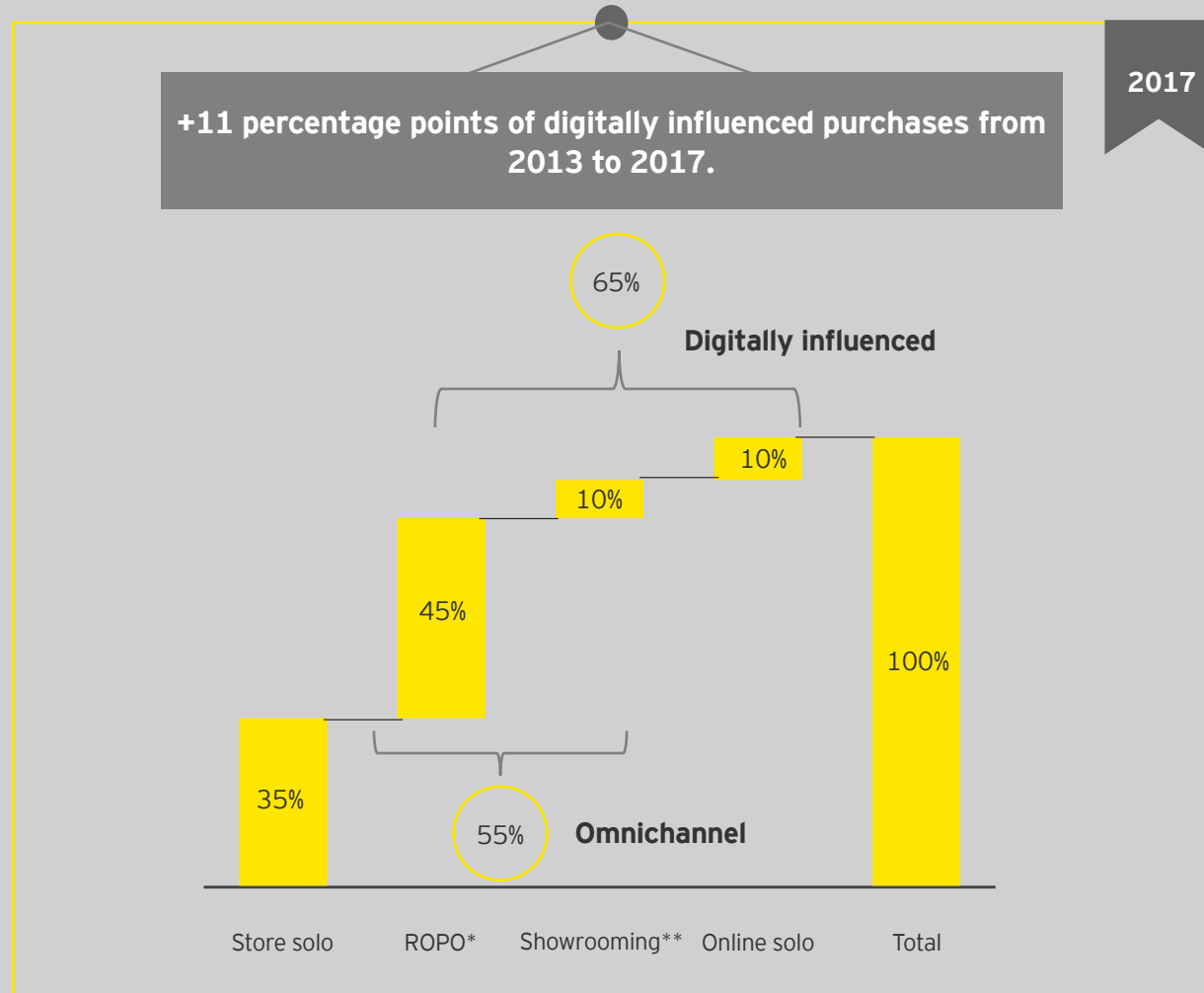
When asked: **Where did you buy your last luxury cosmetics product? Where did you research it?**

Consumers answer showing how, even when they purchase offline, often they have researched online and when they purchase online, they sometimes search offline. In fact, even when purchased in store, a product can be digitally influenced.

\* Researched online, purchased offline.

\*\* Researched offline, purchased online.

Source: EY analysis on Fondazione Altagamma data.



A

The luxury cosmetics market

## Antiaging is an important beauty interest for people of all ages

### Why is each age group looking at antiaging products?

#### < 24 years

- ▶ Delay the aging process
- ▶ Reactivate skin's natural moisturization and protection processes
- ▶ Easier to prevent fine lines
- ▶ Anti-agers good for treating acne, spots and pores

#### 25-39 years

- ▶ Focus on preventing fine lines and skin discoloration due to sun damage, as well as treating adult acne
- ▶ Lifestyle-driven aging



#### 40-59 years

- ▶ Lifestyle-driven aging
- ▶ Desire for skin smoothing and removal and reduction of fine lines
- ▶ Desire for hydrating, nourishing formulas to comfort drier skin and restore luminosity and keep stay-put makeup from the creases

#### 60+ years

- ▶ Healthy appearance and hydrated and healthy skin
- ▶ Specific solutions\*, such as lifting and firming or improving texture

**With the increased inclination of millennials toward the healthier routine of maintaining their youth, there are category and generational shifts in the antiaging products category.**



\*Sixty-three percent of Euromonitor's Beauty Survey respondents over 60 years old selected moisturizing and hydrating as the most desired product feature in their skin care products; 38% of them sought out antiaging claims.

**Source:** EY analysis on Euromonitor data.

A

The luxury cosmetics market

## Secondary attributes are becoming increasingly important

- ▶ Most personal care products have not had any recent breakthroughs in the core technology (i.e., those that affect the primary benefit of the product).
- ▶ This has resulted in consumers looking toward secondary attributes, including package coloring and dispensing methods, among others, to drive brand choice.



### Fragrance

- ▶ Personal care companies are increasingly using innovations in fragrances to drive differentiation.
- ▶ Consumers are seeing greater variety in scents and technology that improves the longevity or potency.

### Packaging

- ▶ Packaging innovations drive differentiation through visual appeal of the exterior of the product.
- ▶ The packaging can now target differing consumer bases, affect product dispensing or even appear to be more prestigious.

A

The luxury cosmetics market

## Natural and organic

+9.6% CAGR

(17A-21E) of the global natural and organic personal care market

## Why the preference for organic and natural personal care products?

1

Increasing awareness of the hazards posed by synthetic chemicals in personal care products

2

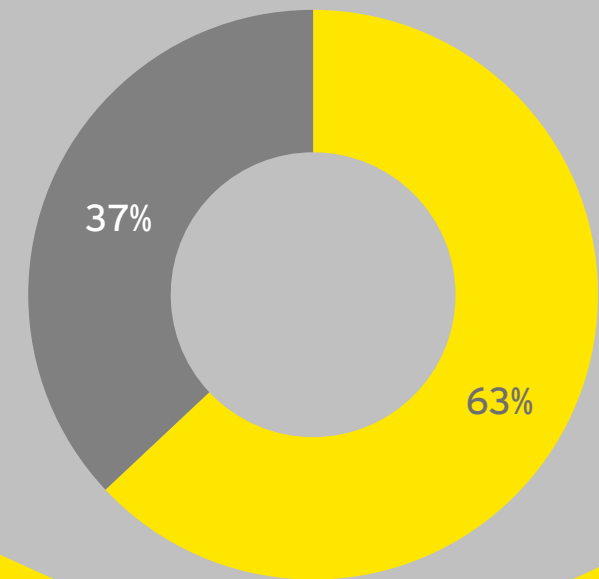
Consumers continually and increasingly moving toward a greener lifestyle

3

Rising incidence of allergies, increasing demand for organic and natural cosmetics

4

Consumers increasingly becoming focused on missions of companies (e.g., sourcing their ingredients ethically, using biodegradable packaging, ethical testing practices)



Researchers have found **63% of millennial women** believe it's "very important" to buy natural skin care products, and women actively seek them out.

Source: EY analysis on Euromonitor data and secondary sources.

A

The luxury cosmetics market

## Growth in emerging markets

## Emerging markets growth (17A-21E)

7.1%

7.4%

## Developed markets growth (17A-21E)

2.4%

3.6%

Key factors driving growth in emerging markets

## Fragrances

- ▶ The Middle East and Africa region dominates the fragrance category with 55% of the emerging market growth, which is expected to continue through 2020.
- ▶ The popularity of aspirational Western lifestyles includes acceptance of fragrance as part of a daily personal care regimen.
- ▶ Companies are adopting a tailored approach toward individual cultures and release fragrances based on regions.

## Men's grooming

- ▶ The male grooming space in global emerging markets is expected to grow on the back of rising urbanization, disposable incomes, and the tendency toward "individualism" versus more traditional and family centric lifestyles.

## Color cosmetics

- ▶ An increased demand from emerging markets is being driven by rising consumer spending and urbanization. The key drivers include:
  - ▶ Rising demand for natural ingredients-based cosmetics;
  - ▶ Developing fashion trends and rising interest in grooming, driven by selfie concept and social media emergence.

Source: EY analysis on Euromonitor data and secondary sources.

**A** The luxury cosmetics market

**Gender segmentation just for men**



Source: EY analysis on Euromonitor data and secondary sources.









**A**

Why does luxury require a “haute couture” digital approach?

**B**

Innovate your innovation: leveraging a startup playbook in luxury beauty

**C**

Sustainability in the fashion industry

**D**

How can luxury fashion embrace digital?

A

Why does luxury require a “haute couture” digital approach?

## Why does luxury require a “haute couture” digital approach?



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Digital is no longer just an option, it is key to survival. In fact, digital distribution channels widen the playing field for luxury brands, allowing them to increase their client base by engaging with customers online in geographies where a brand has no stores.

Technology is disrupting business models. The challenge is to define the right mix between physical and online. Where to start? What is the right balance? What new talents and investments are required? How fast should one go? Digital allows for democratization and easy access when luxury is, in essence, elitist. Therefore, how do brands maintain that idea of exclusivity in terms of the quality of service and the customer experience at the same time as expanding their client base and opening up to more customers.

These are some of the many questions raised when considering the idea of digital in the sector. This report aims to answer those, considering customers and operations, and future innovations.

#### Protecting brand image and customer experience

Most luxury houses, until very recently, shied away from digital as they feared that it would be unable to evoke the same emotional response from customers as walking through a historic flagship store would. Digital for them was often seen as cold and impersonal as opposed to the in-store experience.

Luxury is all about storytelling and conveying an idea of exclusivity. How do you do this consistently online and offline, across geographies and cultures? How can brands keep control of their image when social media increasingly is an influencer?

The answer is osmosis between digital and physical. Digital must remain true to the brand image and universe. Digital must be as exclusive as the in-store experience.

Hermès pioneered the concept of “digital flagship.” In addition to being an online store, the platform also aims to be informative and playful to be as rich as the in-store experience.

Conversely, leading cosmetics and jewelry brands propose enriching the in-store experience with further opportunities to customize products via the digital interface, while offering personal assistance from the store staff. That way, the brand protects its identity through real exclusive service.

In light of the above, one can see that physical and online blur into “phygital,” and that the challenge is wider than omnichannel. In a world where speed is of the essence and 70% of sales are influenced by online touch points, the key is to understand customers and remain in permanent “personal” contact with them to provide them what they want, when and where they decide.

#### How does digital impact operations?

##### A radical shift of mindset

Speed is of the essence in an increasingly digital world. What does this mean operationally? It means that digital thinking and actions must be woven into the structure and processes of the company. It also means that the mindset has to shift from knowing to learning and trying. Digital is not in addition to, it is an integral part of how things are done. This drives talent recruitment, training, management and retention.

A

Why does luxury require a “haute couture” digital approach?

## Why does luxury require a “haute couture” digital approach?

### A reset of operating models

Online selling and social network selling lead to click-to-store and click-and-collect sales, all impacting inventory management and product flow. New collections often sell faster, but that triggers new complexities in terms of logistics, accounting and systems. Getting those right is a key to avoiding any damage to the brand image because when it comes to luxury products, clients expect a flawless experience – be it online or in store.

To do so, management must rethink operating models. Design, advanced analytics, artificial intelligence, production, inventories and the supply chain all need to be fully integrated to quickly adapt to customer needs. Pressure to get this right quickly is higher than ever. To stay in the race, most brands will have to strike the right partnerships to complement their skill sets.

The tone from the top is key to shaping a new culture encompassing all business functions and employees.

### Data: the new black gold

Luxury brands have always collected a wealth of information about their customers' habits and tastes. However, most brands until recently have not really leveraged the data since they were mostly unaware of its valuable impact. But this is changing, as highlighted by

*The Economist*, which said, “The new economy is now about analyzing rapid real-time flows of mostly unstructured data.”<sup>1</sup> Brands combining their online customer data with offline information are in a position to grow.

To understand and engage better with their customers, luxury brands have to gather data from the web and social media platforms, before analyzing it carefully. Then it is critical for them to have the capacity to make sense of the data through analytics. Such critical insight is essential to improve and personalize the customer experience online, as well as offline. Marketing professionals must also harness the power of predictive models to better understand when a customer is likely to make their next purchase, or how much a customer is willing to spend on a type of product.

### More revolutions ahead!

New shopping trends, a new mindset and developments in technologies are expected to further impact the luxury industry in the coming months.

### Multi-brand platforms or a new growth channel

Multi-brand stores and platforms, until recently were considered potentially harmful to a luxury brand's image. However, new players have proven themselves.

Farfetch and YNAP have shown that multi-brand platforms, far from deterring customers, can actually open a new horizon of growth for the luxury industry.

### Multi-brand platforms and brand alliances

In collaboration with Gucci, Farfetch launched the “Store of the Future.” The platform helped the luxury brand collect and analyze its online and offline customer data. Farfetch then brought in-store technology, allowing customers to log in using their smartphones and receive tailored recommendations. At the same time, the staff could access their customers' profiles to better guide them.

### Augmented reality to enhance retail experience

Luxury brands are expected to increasingly adopt augmented reality in their flagship stores to enhance the shopping experience. “Smart mirrors,” which are large indoor displays, already allow clients to gather the price, components or origin of any product. This technology also allows customers to try products, such as apparel, jewelry and cosmetics, at home before they make any purchase.

<sup>1</sup> “Data is giving rise to a new economy,” *The Economist*, May 2017.

**A**

Why does luxury require a “haute couture” digital approach?

## Why does luxury require a “haute couture” digital approach?

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### Conclusion

Digital is an additional tool, but not the grail itself.

The human factor remains essential as luxury requires creativity, permanent reinvention and storytelling to stay in the race.

Digital does not change the importance of client relationships, as anticipation, tailored offerings and a personal touch remain key to customer loyalty. The difference lies in the magnitude of that capability through advanced analytics and digital channels. Yesterday, luxury was for the happy few. Tomorrow, thanks to digital, it will extend its reach. The next challenge is to maintain prestige and exclusivity while extending the customer base and improving accessibility.



15:27



**A**

Why does luxury require a “haute couture” digital approach?

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**D**

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B

Innovate your innovation: leveraging a startup playbook in luxury beauty

## Innovate your innovation: leveraging a startup playbook in luxury beauty



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*Innovation is the driving force behind growth, and global luxury brands have had difficulty bringing innovation to market quickly. Their global scale and expert workmanship, long a competitive advantage, now often serve to hamper the ideation and execution of product and service transformation with the speed and agility required by the modern consumer. Learning from innovative and early stage companies can help global luxury brands bring innovation to market at a pace that resonates with modern consumers.*

Heritage beauty houses have long built their success on prestige, craftsmanship, design, premium packaging and materials, and exclusivity. While these qualities are synonymous with luxury, they are no longer sufficient to drive sustainable growth. Consumer preferences are dynamically shifting, and brands are evolving quickly to meet those needs. Today's consumer expects rapid developments of new products, inclusive and expansive color ranges, and quality ingredients. In tandem, social media and the influx of influencers via blogs, vlogs and the rise of e-commerce have facilitated the quick discovery and adoption of niche companies that seemingly are born overnight to address consumer preferences. Modern consumers expect multichannel, tech-enabled engagement and interaction with their beauty brands. They expect a proliferation of products, have increased the demand for on-trend products, and have altered expectations around the degree of innovation and the time to market.

As such, and more than ever, companies must innovate to stay relevant and drive growth; they can no longer rest on their (impressive) laurels. By looking to earlier stage companies that have led the market in innovation, we see that these breakthrough stars are built on a product or concept development that expands existing lines, creates new categories and improves efficacy, disrupting the market and driving category growth.

B

Innovate your innovation: leveraging a startup playbook in luxury beauty

## Innovate your innovation: leveraging a startup playbook in luxury beauty

### Today's key success criteria for innovation in luxury beauty brands

Key success criteria	Why it's so important	How being more agile with innovation can help a luxury brand stand out	What some successful beauty innovators did well
<b>Speed of new product validation</b> <i>(proof of concept, business plan)</i>	Thanks to digital marketing, consumers are aware of and adopt trends earlier and faster.	The most nimble brands can conduct in-market proof-of-concept testing in a fraction of the time required by luxury brands.	<ul style="list-style-type: none"> <li>▶ Reducing the timeline from product conception to shelf from the traditional development cycle</li> <li>▶ Using prelaunch product samples with influencers to gauge excitement and consumer demand</li> <li>▶ Engaging with consumers directly through social and digital footprints to allow for real-time market feedback</li> <li>▶ Testing product launches in select channels (owned e-commerce, owned brick and mortar) before supporting full product launch, providing opportunity to course correct or accelerate production depending on tested outcome</li> </ul>
<b>Focus on product breath and inclusivity</b>	Customers now expect brands to offer a wide range of inclusive color tones and product shades at every launch, thus bringing to market cosmetics that adapt to every skin shade.	Having sharper control of both the product development process and a focus specifically on product inclusivity allows brands to quickly develop highly curated product lines.	<ul style="list-style-type: none"> <li>▶ Products with wide range of base color tones to adapt to multiple skin shades</li> <li>▶ Color collections with colors that flatter a wider range of skin tones</li> <li>▶ Intentionally and specifically leveraging marketing copy demonstrating product inclusivity, either by models wearing product or "swatches" on different skin tones</li> </ul>
<b>Focus on trend</b>	The nature of beauty trends has shifted to one of rapid change, constant evolution, and wider experimentation with products and look.	Brands that have focused on trends (product types, product formats, colors) have quickly been able to bring relevant products to market.	<ul style="list-style-type: none"> <li>▶ Incremental innovation that rapidly brings one new item to market rather than an entire season of color</li> <li>▶ Focusing on product type or format only, for example, highlighters or pallets</li> </ul>



B

Innovate your innovation: leveraging a startup playbook in luxury beauty

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Key success criteria	Why it's so important	How being more agile with innovation can help a luxury brand stand out	What some successful beauty innovators did well
<b>Supply chain</b>	Traditional processes take too long to capitalize on quick-to-market trend products.	Technology-enabled innovations in sourcing and logistics are increasingly shifting the time and reaction to go to market faster.	<ul style="list-style-type: none"> <li>▶ Contracting with efficient third-party suppliers on trend items and prioritizing internal supply chain for core product production</li> </ul>
<b>Product marketing</b>	E-commerce brands tend to dominate the most impactful communication channels, such as social media.	Brands can reach consumers wherever they consume content. Marketing channels are becoming immediate (e.g., evolution from Facebook to Snapchat) and use multimedia.	<ul style="list-style-type: none"> <li>▶ Leveraging viral marketing instead of traditional channels</li> <li>▶ Investing in end-to-end digital strategy taking into account multimedia content across channels, including owned site and social media</li> <li>▶ Starting consumer conversations through digital marketing ahead of launch to perfect positioning prior to rollout to retailers</li> </ul>
<b>Customer activation</b> <i>(Inducing trial)</i>	Brands are competing for consumer mindshare across the retail environment, not just the subsector for that particular brand.	Efficiently identifying and leading emerging opportunities for brand reinforcement in out-of-the-box ways that resonate with luxury consumers.	<ul style="list-style-type: none"> <li>▶ Partnering with retailers to engage shoppers wherever they are in the store, e.g., in-store displays, travel-size section, product sampling</li> </ul>
<b>Global access</b>	Given the impact of a global social media network, consumers are learning about and demanding product launches on a global scale.	Brands that are able to innovate products that fit a global market and launch simultaneously (or at least multinationally) will win consumer loyalty.	<ul style="list-style-type: none"> <li>▶ Simultaneously launching limited product collections, but with inclusive shades, globally</li> <li>▶ Partnering with retailers or retail networks with a global reach</li> <li>▶ Having global e-commerce capabilities from day one</li> </ul>

**B**

Innovate your innovation: leveraging a startup playbook in luxury beauty

## Innovate your innovation: leveraging a startup playbook in luxury beauty

By studying several large global luxury beauty brands and their innovation processes, EY-Parthenon found launch execution and internal launch processes were typically areas that hampered the ability to get disruptive products to market expediently. These steps affect the entire production process and often are the culprits in failed innovation over time. In contrast, smaller companies have been winning in the market by introducing well-executed launches with speed.

The value of speed to market with luxury goods first became apparent in the apparel sector with the rise of Zara. Inditex leveraged innovations in design capability and the supply chain to express on-trend copycat looks from couture runways into Zara's stores in a matter of weeks. Major beauty brands typically require one to two years to launch new products and release products on a seasonal schedule. But there's an emerging wave of "fast beauty" companies that have introduced trend-inspired products in a few months, and sometimes even a few weeks. e.l.f. Cosmetics, for example, copied this model and is now known for its rapid production and trend-focused product launches. Many of the major recent innovations in beauty, such as ethnic beauty, limited ingredient formulations, novel packaging, and tech-enabled matching

or customization, have been introduced by upstart players. These mass or "masstige" brands have gained an advantage over the slower pace of innovation in the luxury market, but it is one that can be adopted and leveraged.

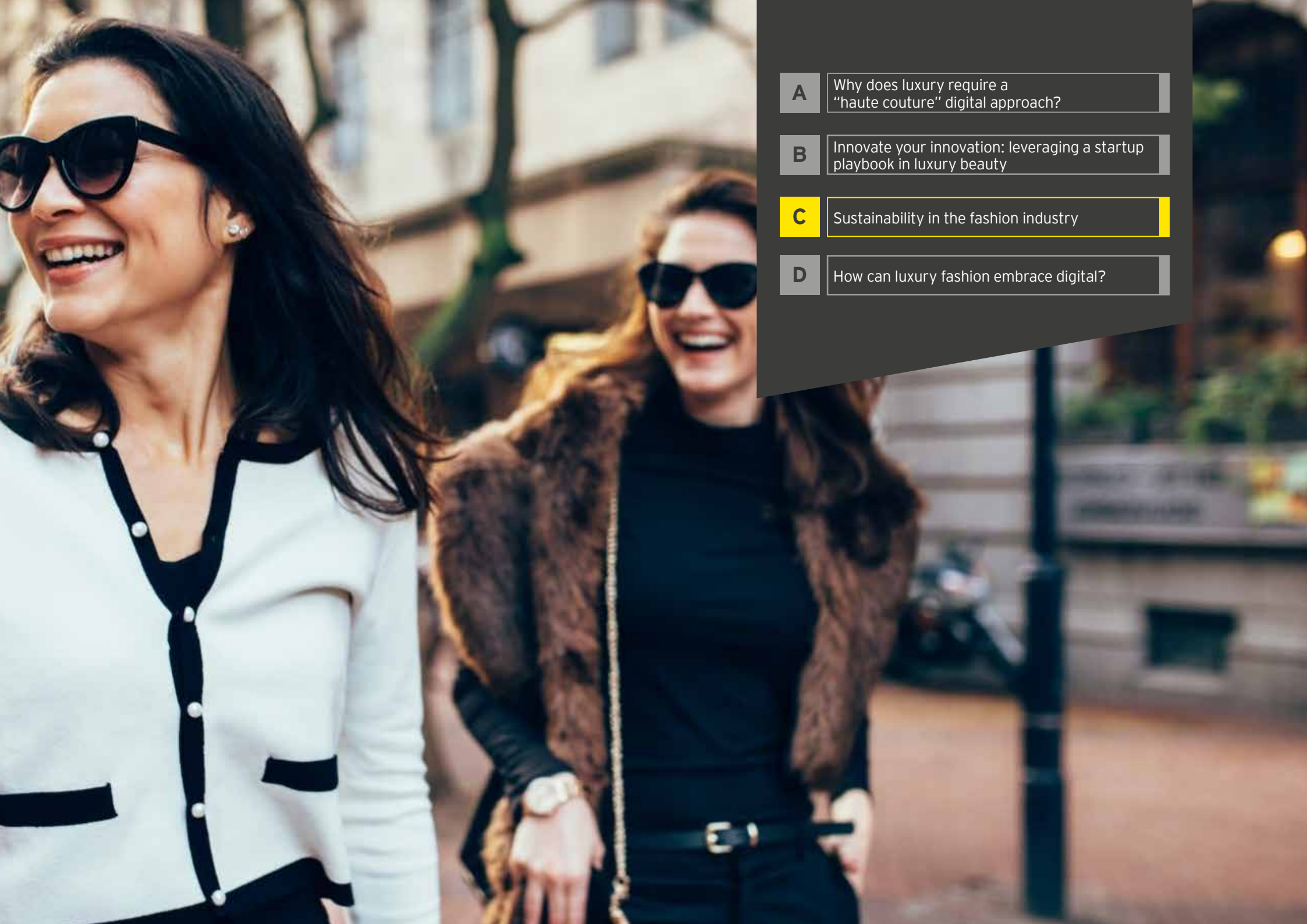
Additionally, consumers will not hesitate to substitute on-trend luxury beauty products with "beauty dupes" in the case of stock outages (recall Kylie Jenner's Kylie Lip Kit selling out within minutes of launch), leading to further leakage of the value of being early to market. Given the beauty market's focus on trends right now, customers want a trial at a low price point before committing. Legacy brands that can accelerate and invest in rich marketing and trial are more likely to win these consumers early by providing a higher quality offering before the customer has a chance to commit to a lower-tier brand. Unsurprisingly, smaller brands are more agile and can react to trends: this is a strong competitive advantage given the importance of speed to market in luxury beauty, and heritage brands must not be left behind.

Beauty upstarts that are winning in the market can be defined both by their production process and strategic focus. A "digital-first" strategy is a hallmark of recent winners and a foundation for success. This approach

encompasses everything from the obvious (marketing) to not-so-obvious aspects, such as the launch calendar and cycle, production and inventory planning, and even the product mix, all taking into account a constant stream of consumer engagement and interaction. These entrants also rely more heavily on e-commerce, with destination sites and channels that help educate the consumer about relevant and evolving authentic brand identity. Lastly, smaller companies also are able to take advantage of their more compact and less complicated manufacturing and distribution, with the ability to directly manage a smaller number of manufacturers and vendors and more highly leverage international distributors.

While some luxury beauty brands have used mergers and acquisitions to increase the agility and speed of innovation, others have successfully co-opted the key success factors that fueled growth at small upstart brands. A self-assessment of existing innovation processes and agility enables companies to identify gaps and begin to create solutions that will overcome strategic and organizational vestigial issues, and allow luxury brands to capitalize on quick-moving trends.

Source: EY-Parthenon analysis



**A** Why does luxury require a “haute couture” digital approach?

**B** Innovate your innovation: leveraging a startup playbook in luxury beauty

**C** Sustainability in the fashion industry

**D** How can luxury fashion embrace digital?

## C

## Sustainability in the fashion industry

## Sustainability in the fashion industry



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Investors are no longer what they used to be. This statement summarizes, with a little irony, the transformation currently under way in financial circles. Those working in financial circles are becoming more and more inclined to evaluate corporate performances in a holistic manner, and not only from a mere economic standpoint.



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In recent years, investors have demonstrated a growing interest in nonfinancial information to evaluate potential investment opportunities. The social and environmental impacts of a company and the way in which these aspects are managed and kept under control influence the decision to invest or not in that company. The reason for this progressive change has a precise name: "risk management." The increasing demand of data and qualitative elements and the corresponding analytics activities respond to investors' need to gain a deeper knowledge of the possible risks associated with an investment. Recent examples of investments in which such risks actually produced negative outcomes teach us that poor management of social and environmental impacts can have direct repercussions on the economic value of a company, often as a consequence of a deterioration of its reputation. Therefore, for investors, it is better to weigh these aspects before becoming subject to a financial risk exposure.



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Research conducted by EY on 320 institutional investors across the globe clearly confirms this trend. The channels and documents through which companies communicate the environmental, social and governance risks that can affect their business model are considered less and less sufficient, while the cases in which nonfinancial factors have a substantial impact on investment decisions are increasing.



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Similarly, stock exchanges across the world are increasingly attentive to the sustainability performance of listed companies and use ESG indices (environmental, social and governance), based on the management of ESG aspects.

## C

## Sustainability in the fashion industry

## Sustainability in the fashion industry

Among the main instruments adopted by the stock exchanges emerges the publication of guidelines for reporting of nonfinancial information. For example, *Your Guide to ESG Reporting*, published in 2017 by the London Stock Exchange Group, guides companies in developing reports tailored to investor requests. As stated in the guide, “ESG reporting is not only dedicated to large companies, it is intended for all organizations, regardless of size, in order to represent information relevant to investors and allow them to make more transparent decision-making processes.”

For many years now, an increasing number of companies from different sectors have published a sustainability report to respond to investor requests, but also, more generally, to communicate transparently with all of their stakeholders. A sustainability report is a document that describes the identity of the organization, its business, its values, its governance model, its relations with the main interlocutors, and the initiatives implemented to listen to their needs and to know their opinions. Furthermore, the sustainability report presents the management approach to the main economic, social and environmental aspects, reflecting the most significant impacts generated by the company or those that can influence the decisions of the stakeholders. For example, in this type of document, we can find out more about greenhouse gas emissions, water consumption, labor relations, equal opportunities and the fight against corruption.

To date, the most widespread methodological references at an international level for the preparation of a sustainability report are the Global Reporting Initiative Standards.

In 2018, EY carried out an analysis of the fashion industry, taking into consideration 41 listed companies, or those belonging to groups listed, on regulated markets. More than half of those have prepared a sustainability report (subject to limited revision in 70% of the cases) and included a section dedicated to sustainability on their websites. More specifically, 17 published a sustainability report (15 following the Global Reporting Initiative Standards methodological indications) and 5 included a section within their annual report dedicated to their sustainability performance. Nineteen companies did not publish any documents related to their sustainability performance.

The most recurring topics deal with the aspects that fall into the following areas:

- ▶ **Environmental:** energy consumption, greenhouse gas emissions, waste management
- ▶ **Social:** assessment of suppliers from a social point of view, attention to local communities, consumers' health and safety
- ▶ **Human resources:** employment levels, training, health and safety at work
- ▶ **Human rights:** forced and child labor, equal opportunities
- ▶ **Regulatory compliance:** contrast of corruption, compliance with environmental and social laws

In 2017, the Global Fashion Agenda published the *Pulse of the Fashion Industry* report, prepared in collaboration with the Boston Consulting Group, which highlights the urgent need for the fashion industry to change the paradigm and

reduce the important negative impacts generated at the environmental and social levels, but without renouncing profits and corporate growth.

The earth's resources are increasingly scarce and the fashion industry, given that its business model has a very short product life cycle, certainly has great responsibility when it comes to environmental impact. At a social level, the most critical aspects concern the working conditions to which workers are subject, which often are very misaligned from those foreseen by the United Nations Sustainable Development Goals.

Considering the current production and consumption trends, it is foreseeable that these environmental and social conditions will lead to an increase in costs, which could significantly erode fashion companies' economic margins and reduce their profitability by 2030 unless such companies put in place immediate changes. This change would bring environmental and social benefits, while protecting the profitability of the business.

Unfortunately, today fashion companies' commitment in this direction is still rather weak; the fashion industry could, and should, do more to become increasingly sustainable. The “pioneers” in this area are the largest and most established companies, while smaller companies are proportionally less active in sustainability terms.

The biggest players, already on the right path, will surpass their competitors with innovative business models and efficient production techniques, which minimize the use of water, energy, soil and hazardous chemicals. By achieving better working conditions and improving worker safety, they will minimize operational and reputational risks and create significant value for themselves and the global

## C

## Sustainability in the fashion industry

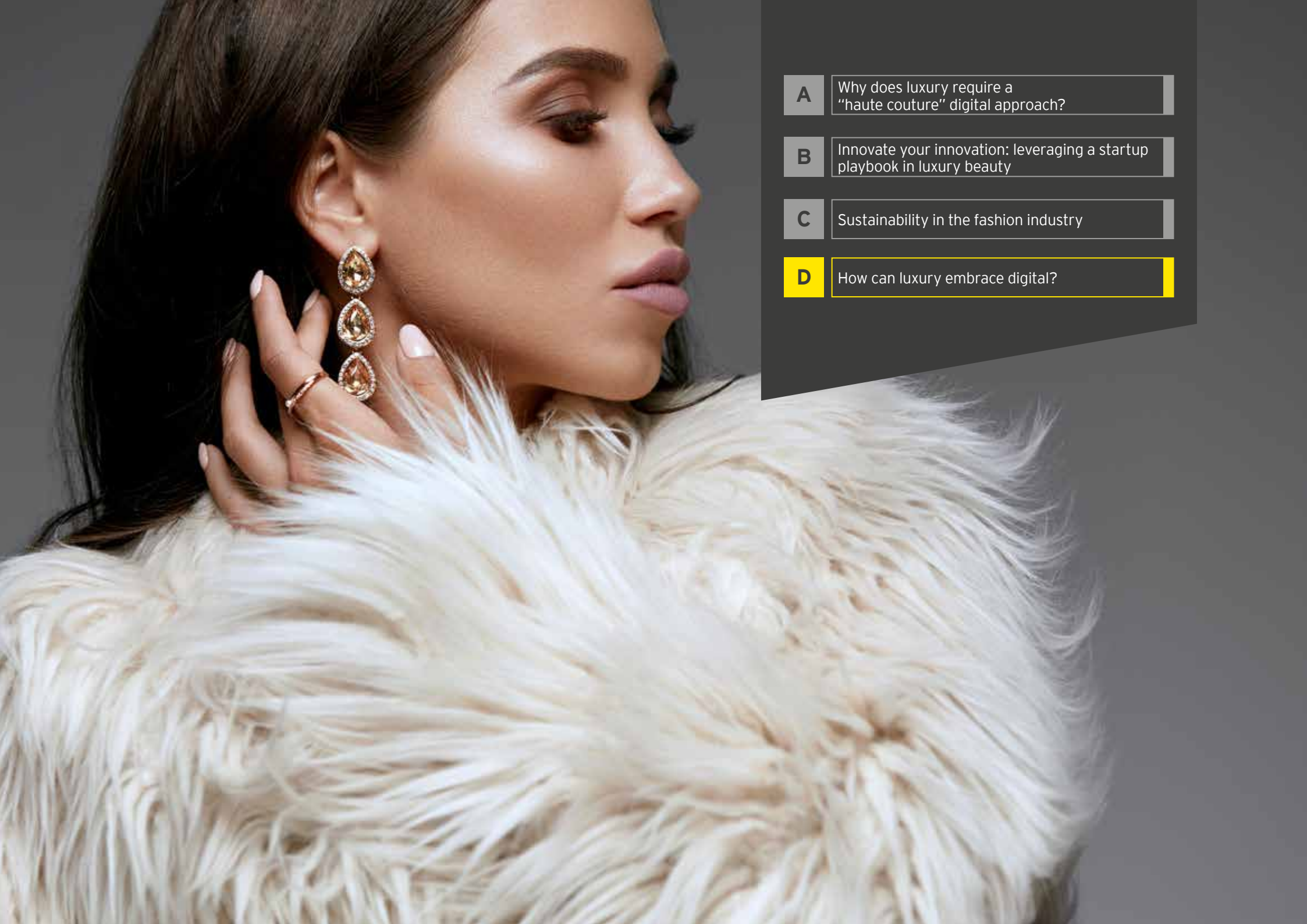
## Sustainability in the fashion industry

economy. Their example will inspire other companies in the sector, which will progressively adapt to new market standards, though the speed with which this change will take place appears to be too slow. For this reason, coordination and pulse actions of the whole sector are necessary to favor a rapid and effective transition toward more sustainable fashion. It is a call to action addressed to a plurality of actors involving different roles and responsibilities, not only companies, but NGOs, industrial associations and consortiums also are called to intervene by coordinating and guiding cross-sector and inter-functional collaborations intended to promote change. Regulators can amplify this change through the design and implementation of incentives and sanctions.

The current scenario is certainly complex and challenging, but the fashion industry can count on many resources – above all, creativity – but also the technologies, skills, relationships and financial resources that can be exploited to face this phase successfully.

In 2018, *The State of Fashion* study by McKinsey & Company and Business of Fashion identified the 10 main trends that will define the fashion agenda in 2018. Among these, one is explicitly related to sustainability. Indeed, the authors envisage that sectorial efforts in the sustainability field will be concentrated on the identification of circular economy solutions at all levels of the value chain.

In conclusion, we can see that the fashion industry has started addressing sustainability issues and the related reporting activities later than other industries, mainly for historical reasons related to the type of impacts generated. Today, however, it seems that external demands and a more mature awareness in managing relations with stakeholders are making the gap between fashion and other industries shrink quickly. It is an unstoppable positive process. It will be interesting to observe how it will evolve in the coming years.



**A** Why does luxury require a “haute couture” digital approach?

**B** Innovate your innovation: leveraging a startup playbook in luxury beauty

**C** Sustainability in the fashion industry

**D** How can luxury embrace digital?

D

How can luxury fashion embrace digital?

## Four primary technologies are revolutionizing the industry



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### Digital disrupters

There are four primary technologies that are revolutionizing how we work, collaborate, and ultimately, deliver engaging and impactful customer experiences. Each of these is unique in its own right, and has the potential to combine high fashion and high tech.

#### Machine learning



*Automate  
transactional activity*

#### Machine learning

A subfield of artificial intelligence focused on the ability of machines to receive a set of data and learn for themselves, evolving algorithms or analytics as they learn more about the information they are processing in an effort to optimize outcomes.

#### Big data and predictive analytics



*Expose data to drive deeper learning*

#### Big data and analytics

Companies are using big data to compile, integrate and utilize data from multiple sources (internal and external) to extract insights and drive better decision-making, including:

- ▶ Descriptive analytics
- ▶ Predictive analytics
- ▶ Prescriptive analytics
- ▶ Forensic analytics



D

How can luxury fashion embrace digital?

## How can luxury fashion embrace digital?

### Next-generation e-commerce



*Deliver an enriching online experience*

#### **E-commerce**

E-commerce is now the lifeblood of most consumer products companies. Consumers strongly prefer the convenience and variety of products offered by online platforms over traditional “brick-and-mortar” operations. This is especially true in strategic growth markets (e.g., China).

### Blockchain



*Digitize the business value chain*

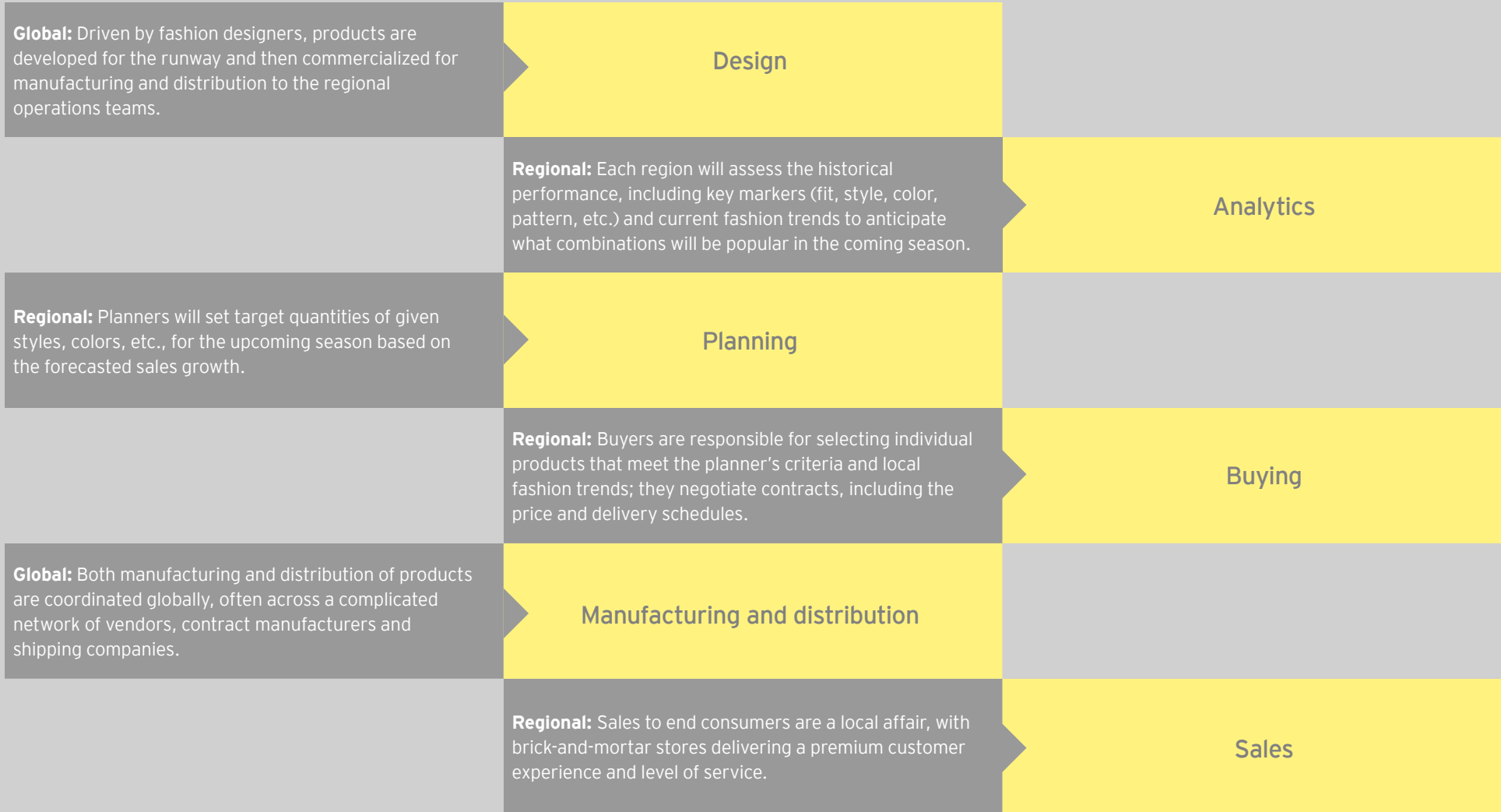
#### **Blockchain**

Blockchain is a distributed infrastructure technology that is both a database and a network. It is a decentralized ledger that shares a record of all transactions with all parties. Its benefits are derived from the transparent sharing of data, smart contracting and consensus algorithms to promote data security.

**D** How can luxury fashion embrace digital?

**The luxury industry value chain incorporates both global and regional input**

**Luxury industry value chain**



**D** How can luxury fashion embrace digital?

**How can luxury fashion embrace digital?**

**Luxury industry value chain**

Luxury fashion in China has been growing rapidly, with millennials as the major drivers of increased sales. Historically, China was seen as a “loss leader” in the market, wherein operations were not expected to turn a profit, but instead serve as an avenue for advertising products and driving “shopping tourism” to companies’

home locations (New York, Milan and Paris, among others).

This is no longer the norm; China’s stores are now expected to be profitable, contributing to global growth and profitability.

To achieve this, luxury fashion companies are expanding their footprint from offline to online. Stores are increasingly in competition for local sales and are more aggressively pushing products. Consumers are responding well, appreciating that they can buy trusted products locally. But profitable growth remains an elusive challenge.

There are a number of challenges luxury fashion companies are currently navigating in China, primarily:

<p><b>1. Limited data and analytics tools</b></p>	<ul style="list-style-type: none"> <li>▶ Fashion trends change quickly, but the tools used to analyze historical performance haven’t kept up.</li> <li>▶ Many fashion companies are still leveraging simple software and reporting capabilities; they have not adopted advanced analytics techniques.</li> </ul>
<p><b>2. Limited use of external data</b></p>	<ul style="list-style-type: none"> <li>▶ While historical analytics set a valuable benchmark, luxury fashion is deeply rooted in “what’s next.”</li> <li>▶ To gather intelligence and understand where the taste of a company’s target market may turn most luxury companies are still relying on manual data gathering and personal intuition.</li> </ul>
<p><b>3. Disconnected planning information across regions</b></p>	<ul style="list-style-type: none"> <li>▶ Plans are not coordinated across different regions. They are developed independently by each market and then shared with the global organization for confirmation or correction.</li> <li>▶ This creates inefficiencies wherein China struggles to understand what the New York, Paris and Milan (fashion trendsetters) markets are buying.</li> <li>▶ Smaller markets in Asia don’t know what China is buying. Often, products won’t be commercialized for the region unless China commits to buying them.</li> </ul>
<p><b>4. Operational processes very often manual</b></p>	<ul style="list-style-type: none"> <li>▶ Compared with fast fashion or other fast-moving consumer goods companies, luxury fashion is low volume and often leverages older or outdated systems and manual processes to manage accounting, HR, procurement and distribution.</li> </ul>
<p><b>5. Engaging e-commerce as a new distribution channel</b></p>	<ul style="list-style-type: none"> <li>▶ Luxury fashion globally has been slow to adopt e-commerce and has been disrupted by startups embracing purely digital operating models.</li> <li>▶ In China especially, e-commerce is the way forward, with consumers demanding products online and many luxury fashion retailers beginning to explore e-commerce.</li> <li>▶ However, fake products are still a challenge, which will require careful and thoughtful policies and practices enabled by technology.</li> </ul>
<p><b>6. Long lead time to go to market</b></p>	<p>Collectively, these issues create a long lead time for product development and, ultimately, sales.</p> <ul style="list-style-type: none"> <li>▶ On average, it takes more than six months for a new design to be sold in regional markets due to multiple factors.</li> <li>▶ Competitors in other types of fashion are achieving 90 days to market (or less, with some getting to market in as few as 60 days).</li> </ul>

D

How can luxury fashion embrace digital?

## How can luxury fashion embrace digital?

### 1. Limited data and analytics tools

#### Current situation:

- ▶ Many luxury brands have not yet advanced in predictive data analytics, particularly as it relates to design. Design is an art, not a science.
- ▶ This is especially true when it comes to local planning and buying decisions, for example:
  - ▶ For luxury items with a longer life-span (e.g., handbags), buying decisions are made based on 70% historical data and 30% “fashion sense.”
  - ▶ By contrast, for items with a shorter life-span (e.g., seasonal, read-to-wear fashion), there is limited data available and buying decisions are based on 30% historical data and 70% fashion sense.

#### Which digital platform can help?

EY teams suggests using big data and advanced data analytics tools to deliver greater insights and accelerate the analysis and planning cycles.

- ▶ Big data technology can integrate and harmonize data across a broad base of source systems.
- ▶ Data visualization tools can make analytics engaging, enticing buyers to better leverage the information.
- ▶ Shifting toward “data-driven buying decisions” will optimize product mixes, thus, driving better sales and increasing profitability.

### 2. Limited use of external data

#### Current situation:

- ▶ For most luxury brands, having a good fashion sense is valued more than having insightful data.
- ▶ Nowhere is this clearer than looking at how luxury brands scan the market, anticipate trends, and make multimillion-dollar design and buying decisions.
- ▶ Today, this is entirely done by people studying magazines, high design, trendsetters, fashion blogs or any other available source of information.

#### Which digital platform can help?

Artificial intelligence technologies can further create insights when coupled with advanced data analytics.

- ▶ Natural language processing can scan blogs, magazines and other digital data sources to gather feedback and analyze customer sentiment toward certain styles or future designs.
- ▶ Image processing can be used to scan competitors’ product ensembles and relay critical feedback during the design and buying season to make products that do or do not resemble those of a competitor.
- ▶ Facial recognition products can be used to gauge emotion and product reactions as consumers shop in the store. This can be taken one step further by connecting offline to online data to profile individual customers and deliver more tailored experiences.
- ▶ Integrating these external data sources with traditional internal data sources will provide a more holistic picture of the market and increase data-driven decision-making over the more traditional approach of an individual buyer’s fashion sense.

### 3. Disconnected planning information across regions

#### Current situation:

- ▶ Planning and buying decisions are made independently by each region with all coordination and feedback done via the global headquarters. There is no “peer-to-peer” sharing of planning.
- ▶ This creates inefficiencies in that feedback is one-dimensional and extremely iterative as planning for all geographies evolves.
- ▶ There is a clear case for sharing the planning and buying:
  - ▶ The China market is very keen to understand the buying decisions being made in key trendsetting markets, namely New York, Paris, Tokyo and Milan, so that China’s consumers can buy the same fashions available there.
  - ▶ At the same time, smaller Asia-Pacific markets want to know what China is buying because it is increasingly the trendsetter in the region. Often, if China doesn’t buy a given product, then the headquarters will cancel the manufacturing altogether.

#### Which digital platform can help?

Blockchain offers a promising platform to promote transparent (peer-to-peer) sharing of information to streamline and accelerate the process.

- ▶ At its core, blockchain is a distributed database. Its magic comes from equally sharing the data between all parties in the network.

D

How can luxury fashion embrace digital?

## How can luxury fashion embrace digital?

- ▶ Planning and buying data could be stored inside of the blockchain and transparently shared with all regions in real time so that each market could see what the other intends to buy.
- ▶ Buying decisions then could be optimized based on what the entire network of buyers is most interested in selling in their respective markets, thus, eliminating last-minute iterations to the buying plan.

### 4. Operational processes very often manual

#### Current situation:

- ▶ Many luxury fashion brands are challenged with the same day-to-day manual operational challenges seen across industries.
- ▶ Traditional improvement levers remain a challenge, including:
  - ▶ Disparate processes
  - ▶ Duplicate or manual reporting
  - ▶ Inconsistent design and application of controls
  - ▶ Skills gaps, particularly related to continuous improvement and adoption of new technologies

#### Which digital platform can help?

- ▶ Next-generation improvement levers can drive autonomous automation of key processes.
- ▶ Digitalization of processes with enablers such as customer resource management, HR information systems, account reconciliation tools, optical character recognition and fapiao scanning solutions among others

- ▶ Desktop automation of local processes
- ▶ Full (unattended) automation with robotic process automation
- ▶ Chatbots for employee self-service and Q&A

### 5. Engaging e-commerce as a new distribution channel

#### Current situation:

- ▶ Luxury companies have been adopting e-commerce to expand their sales channel; however, this is often product advertising only and online sales are not yet supported.
- ▶ Consumers (especially in China) are increasingly interested in buying luxury products online.
- ▶ Fast-fashion companies have been quick to adopt e-commerce business models with engaging platforms (including mobile) with one- to three-day product delivery and generous return policies.

#### Which digital platform can help?

- ▶ EY teams suggests that luxury brands implement e-commerce as another sales channel to grow their sales and better serve customers. Product verification can be managed with blockchain and chatbots and can create a premium customer experience within the e-commerce platform.

#### Case study: ecommerce

A leading global jewelry and luxury fashion brand currently is implementing a new e-commerce business model.

#### Solution: product guarantee

A leading global Chinese baijiu producer created a mobile app based on blockchain in which a user scans the QR code on a bottle of baijiu during checkout and can view the full manufacturing, distribution and retail history of the individual bottle to verify the authenticity and guarantee the product safety. Blockchain empowers data gathering and sharing between all parties, including the end consumer.

D

How can luxury fashion embrace digital?

## How can luxury fashion embrace digital?

### 6. Long lead time to go to market

#### Current situation:

All of the above challenges ultimately lead to an increased timeline from design to planning, buying, manufacturing, distribution and, ultimately, sales.

- ▶ On average, it takes more than six months for a design to reach the market, mainly because:
  - ▶ There's reliance on a linear value chain, often with multiple iterations between the design, planning, buying and sourcing.
  - ▶ Each step has its own unique inefficiencies with limited adoption of automation.
  - ▶ Complicated designs with high-quality goods take time to source and manufacture.
  - ▶ Luxury brands are looking for ways to catch up with the likes of Zara and Bershka, and reducing their time to market to 60 days.

#### Which digital solutions can help?

This is a multivariable problem with multiple solutions required to tackle each. Each of the solutions introduced here will drive measurable improvements in the luxury fashion value chain and create opportunities to accelerate product planning, buying and, ultimately, sales.

To get started, luxury brands can initiate this journey by 1) creating a detailed map of their entire value chain, 2) assessing the greatest challenges of their current operations and 3) aligning the solutions introduced here to each of those prioritized challenges. Then luxury truly will be able to excel in a digital world.

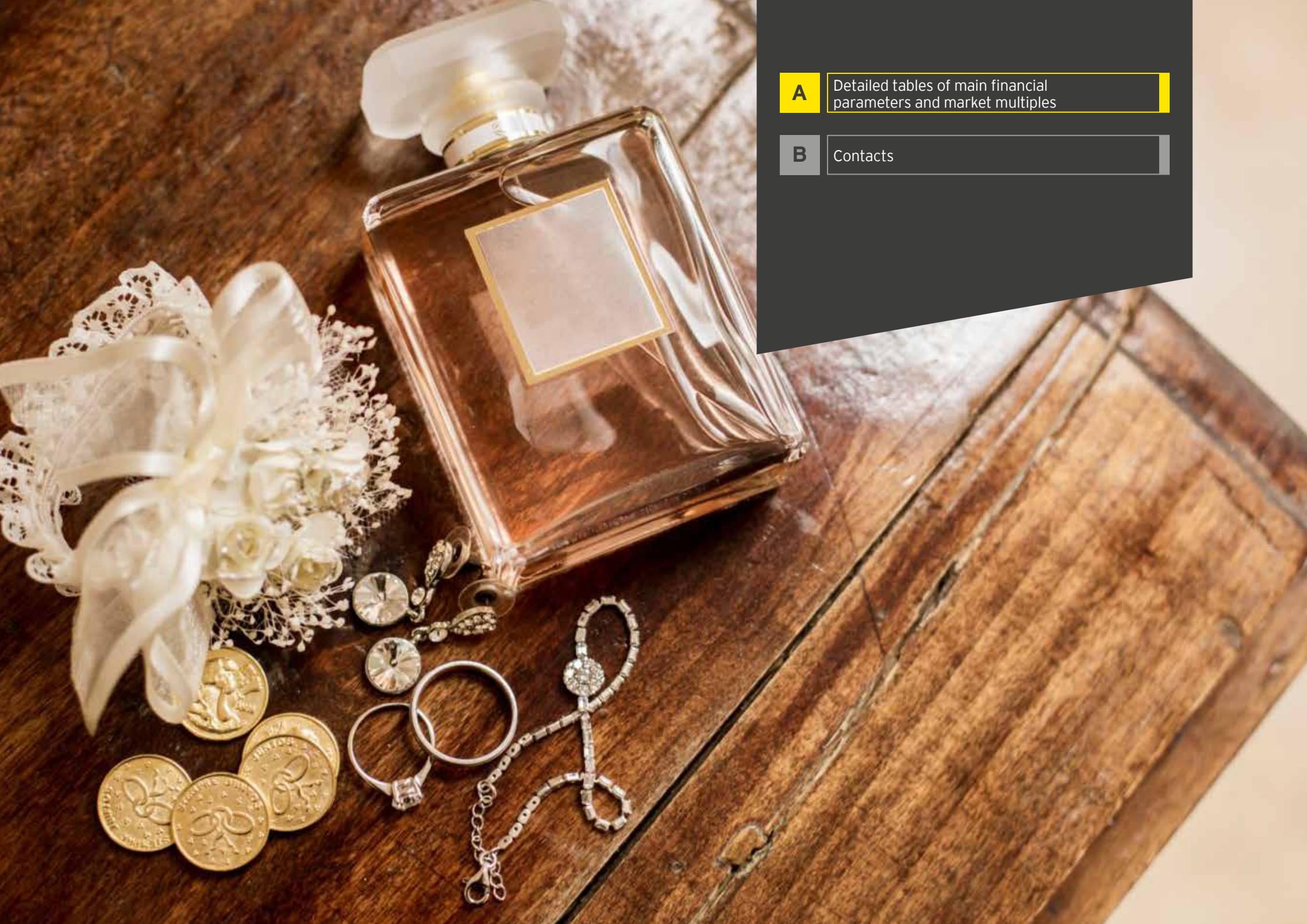




# Appendix

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**A** Detailed tables of main financial parameters and market multiples

**B** Contacts

**A** Detailed tables of main financial parameters and market multiples

**Luxury and cosmetics sample of companies and associated operating aggregates (sales and EBITDA margin)**

Luxury	Sales (€b)	2017A	2018E	2019E	2020E	EBITDA margin	2017A	2018E	2019E	2020E
	Brunello Cucinelli	0.5	0.6	n/a	n/a	Safilo	3.9%	3.1%	5.1%	n/a
	Safilo	1.0	1.0	1.1	1.1	Chow Tai Fook	10.4%	11.9%	n/a	n/a
	Tod's	1.0	1.0	1.0	1.1	Ralph Lauren	15.4%	15.9%	16.5%	17.8%
	Moncler	1.2	1.3	1.5	1.7	Tod's	16.7%	16.7%	17.5%	18.7%
	Ferragamo	1.4	1.4	1.5	1.6	Brunello Cucinelli	16.8%	17.6%	n/a	n/a
	Hugo Boss	2.7	2.8	2.9	3.1	Ferragamo	18.0%	16.0%	17.7%	19.8%
	Prada	3.1	3.2	3.5	3.8	Swatch	18.6%	20.8%	21.9%	22.7%
	Burberry	3.1	3.0	3.1	3.2	Hugo Boss	18.6%	18.0%	18.6%	18.7%
	Tiffany	3.4	3.6	3.7	3.9	Prada	19.2%	20.8%	22.1%	23.0%
Tapestry	3.6	4.8	5.0	5.2	Richemont	21.1%	24.8%	25.5%	25.9%	
Michael Kors	3.8	4.0	4.1	n/a	Luxottica	21.7%	21.6%	21.8%	22.0%	
Ralph Lauren	5.0	4.9	5.0	5.1	Burberry	21.9%	21.7%	22.0%	23.3%	
Hermès	5.5	5.8	6.2	6.7	Kering	22.4%	25.7%	26.3%	27.0%	
Chow Tai Fook	6.1	6.3	n/a	n/a	Tapestry	22.8%	21.6%	22.6%	23.2%	
Swatch	6.8	7.2	7.6	8.0	Michael Kors	23.2%	22.8%	23.7%	n/a	
Luxottica	9.2	9.0	9.4	9.7	LVMH	23.7%	24.3%	24.7%	25.0%	
Richemont	11.0	11.8	12.4	12.9	Tiffany	24.0%	23.3%	23.2%	24.2%	
Kering	15.5	15.1	16.2	17.2	Moncler	34.5%	33.2%	33.4%	33.5%	
LVMH	42.6	45.0	47.9	50.9	Hermès	39.0%	37.8%	37.5%	37.6%	
<b>Total</b>	<b>126.6</b>	<b>131.9</b>	<b>132.1</b>	<b>135.2</b>	<b>Average</b>	<b>20.6%</b>	<b>20.9%</b>	<b>22.4%</b>	<b>24.2%</b>	

Cosmetics	Sales (€m)	2017A	2018E	2019E	2020E	EBITDA margin	2017A	2018E	2019E	2020E
	L'Occitane	1.3	1.4	1.5	1.8	Coty	11.0%	14.6%	17.3%	18.9%
	Nu Skin	1.8	2.0	2.1	2.1	AMOREPACIFIC	11.6%	16.9%	17.8%	17.1%
	Natura	2.4	2.6	3.0	3.1	Shiseido	11.9%	13.0%	13.7%	14.6%
	AMOREPACIFIC	3.9	4.3	4.9	5.3	Nu Skin	15.2%	15.0%	15.5%	16.0%
	Coty	6.2	7.7	7.8	8.1	L'Occitane	15.4%	17.0%	17.5%	19.4%
	Beiersdorf	7.1	7.2	7.5	7.9	Beiersdorf	17.5%	17.9%	18.4%	18.8%
	Shiseido	7.7	8.0	8.5	9.3	Natura	17.7%	16.6%	16.9%	17.1%
	Estée Lauder	9.6	10.9	11.8	12.6	Estée Lauder	20.1%	20.7%	21.1%	21.8%
	L'Oréal	26.0	26.2	27.4	28.8	L'Oréal	22.7%	22.8%	22.9%	23.1%
<b>Total</b>	<b>66.0</b>	<b>70.3</b>	<b>74.6</b>	<b>79.0</b>	<b>Average</b>	<b>15.9%</b>	<b>17.2%</b>	<b>17.9%</b>	<b>18.5%</b>	

**Source:** EY analysis on actual data from companies' financial statements and expected data based on consensus of several brokers' reports for each company.

A

## Detailed tables of main financial parameters and market multiples

## Luxury and cosmetics multiple analysis

Trading multiples	EV/sales			EV/EBITDA			Price to earnings		
	2018E	2019E	2020E	2018E	2019E	2020E	2018E	2019E	2020E
LVMH	3.0x	2.8x	2.6x	12.2x	11.3x	10.5x	21.8x	20.1x	18.3x
Richemont	3.0x	2.9x	2.7x	12.2x	11.3x	10.6x	21.5x	19.5x	18.9x
Swatch	2.3x	2.2x	2.1x	11.0x	9.9x	9.1x	21.6x	19.0x	17.1x
Hermès	7.7x	7.2x	6.6x	20.4x	19.1x	17.7x	36.8x	34.6x	31.5x
Kering	3.5x	3.3x	3.1x	13.7x	12.5x	11.4x	21.0x	18.9x	17.2x
Tapestry	2.6x	2.5x	2.4x	12.2x	11.1x	10.4x	20.3x	18.0x	16.6x
Luxottica	2.8x	2.7x	2.6x	13.0x	12.3x	11.8x	25.0x	23.3x	22.7x
Ralph Lauren	1.2x	1.2x	1.2x	7.6x	7.2x	6.6x	17.1x	15.9x	13.7x
Tiffany	2.8x	2.7x	2.6x	12.1x	11.7x	10.7x	22.5x	20.6x	18.8x
Burberry	2.3x	2.2x	2.2x	10.4x	10.1x	9.3x	21.2x	20.1x	18.6x
Hugo Boss	1.8x	1.7x	1.6x	9.8x	9.2x	8.7x	19.7x	18.0x	16.6x
Safilo	0.4x	0.4x	n/a	17.3x	9.5x	n/a	n/a	n/a	n/a
Tod's	2.1x	2.0x	1.9x	12.3x	11.3x	10.1x	26.9x	23.5x	21.5x
Prada	2.9x	2.6x	2.4x	13.9x	12.2x	10.9x	27.4x	24.0x	19.7x
Ferragamo	2.6x	2.5x	2.4x	16.3x	14.0x	11.9x	31.7x	26.0x	21.6x
Brunello Cucinelli	3.2x	2.9x	2.7x	18.3x	16.6x	15.0x	35.0x	30.4x	29.8x
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Chow Tai Fook	1.6x	1.5x	1.5x	13.3x	11.9x	12.8x	18.2x	16.2x	18.6x
Moncler	5.4x	4.8x	4.3x	16.3x	14.4x	12.9x	28.3x	23.9x	22.2x
Average	2.8x	2.6x	2.6x	13.2x	11.8x	11.2x	23.8x	21.3x	20.2x

Trading multiples	EV/sales			EV/EBITDA			Price to earnings		
	2018E	2019E	2020E	2018E	2019E	2020E	2018E	2019E	2020E
L'Oréal	3.7x	3.6x	3.4x	16.4x	15.6x	14.7x	26.0x	24.4x	22.9x
Estée Lauder	4.1x	3.8x	3.5x	19.8x	17.9x	16.3x	32.6x	28.8x	25.8x
Beiersdorf	2.6x	2.5x	2.4x	14.8x	13.7x	12.8x	26.1x	24.2x	22.4x
Natura	2.7x	2.4x	2.4x	16.2x	13.9x	14.1x	24.0x	19.7x	16.9x
Shiseido	2.5x	2.3x	2.1x	18.9x	16.8x	14.5x	42.8x	39.1x	31.4x
L'Occitane	1.6x	1.5x	1.3x	9.5x	8.7x	6.5x	21.0x	18.8x	13.6x
Coty	2.3x	2.2x	2.2x	15.7x	13.0x	11.6x	25.6x	20.1x	16.9x
AMOREPACIFIC	3.3x	2.9x	2.6x	19.5x	16.0x	15.5x	35.2x	28.0x	26.3x
Nu Skin	1.6x	1.5x	1.5x	10.6x	9.9x	9.4x	20.2x	18.5x	17.9x
Average	2.7x	2.5x	2.4x	15.7x	14.0x	12.8x	28.2x	24.6x	21.6x

Source: EY analysis on actual data from companies' financial statements and expected data based on consensus of several brokers' reports for each company.



**A**

Detailed tables of main financial parameters and market multiples

**B**

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B

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