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**"VALUE CREATION THROUGH M&AS IN THE LUXURY  
INDUSTRY. EVIDENCE FROM CASE STUDIES"**

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# Abstract

The heightened mergers and acquisitions activity that characterized the last decade is in contrast with the traditionally recognized corporate finance theory that links M&As to value destruction, especially for the acquirer's shareholders. To shed more light on the apparent dilemma and further the literature on the matter, this thesis studied the transactions and deal strategy of various companies operating within the luxury industry. Even though this study came across some adverse returns, the large majority of the results were satisfactory, demonstrating a more optimistic deal success rate with respect to the ones normally cited in the literature. Firms making frequent acquisitions between 2010 and 2019 were found to create more value both in the short and the long-term compared to rare acquirers. Their superior performance was due to a better understanding and exploitation of acquirer-specific as well as deal-specific factors affecting the transactions. Additionally, the alignment of M&A and corporate strategy and the use of deals as an enduring capability rather than an occasional project were found to be important drivers of value creation.



*To my father.*





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# Introduction

Value creation is the primary purpose of any business entity. Creating value for customers helps sell products and services, while creating value for shareholders, in the form of increases in stock price, ensures the future availability of investment capital to fund operations (Hillstrom, 2020).

Challenges such as globalization, income inequality, climate change, and the growing power of technology titans have shaken public confidence in large organizations and stimulated a reflection on the virtues and vices of capitalism. In such a tumultuous context it's critical that managers and board of directors have a clear understanding of what value creation means. For today's executives, creating value cannot be limited to simply maximizing today's share price. Rather, the evidence points to a better objective: maximizing a company's value to its shareholders, now and in the future (Goedhart and Koller, 2020). To ensure their survivability and prosperity, firms need to take a more holistic approach and create value by growing in a way that is profitable whilst bringing forward a strong environmental, social and governance (ESG) proposition.

Managers can choose to grow organically or inorganically. Organic growth is developed through overall expansion in the market segments represented in its portfolio (portfolio momentum) or by gaining share in any particular market (market share performance). Inorganic growth is achieved through mergers and acquisitions (M&As).

While executives typically strive for high growth, the highest growth will not necessarily create the most value. Traditional corporate finance literature scrupulously describes the value destroying power of mergers and acquisitions of listed companies, especially for the acquiring firm shareholders (Mueller, 1997; Coffee, Lowenstein et al., 1988; Damodaran, 2005). Nonetheless, the last decade has been characterized by a heightened M&A deal activity which peaked in 2018 counting around 52.626 worldwide transactions for a total value of \$ 4,13 trn (IMAA, 2020). These two facts seem to be in contrast with one another, as it would seem irrational to undertake a deal that is quite likely to be value destroying.

This study aims to answer the question on whether mergers and acquisitions create value for the acquiring firm's shareholders both in the short and long-term. To that purpose evidence was gathered from case studies of thriving companies within the luxury industry so that their growth

strategy and their market performance could be compared to answer the previously exposed dilemma.

The research is organised as followed. Firstly, a theoretical background is presented, displaying the literature finding on the subject matter, its discrepancies and its deficiencies. Specifically, new and traditional studies on the value creation power of M&As are assessed and some of the main factors affecting deal performance are exposed. Then, to allow for a clear understanding of the study, the methodology used as well as an overview of the luxury industry is offered to the reader. Following, the thesis dives deep into the individual case studies. In particular, each company's strategic choices regarding growth and its use of M&As is observed. Also, market performance is evaluated for value creation both at M&A announcement and on a longer time frame. Ultimately, the results obtained as well as the strategies employed by the different companies are confronted and final considerations are drawn.

# PART I

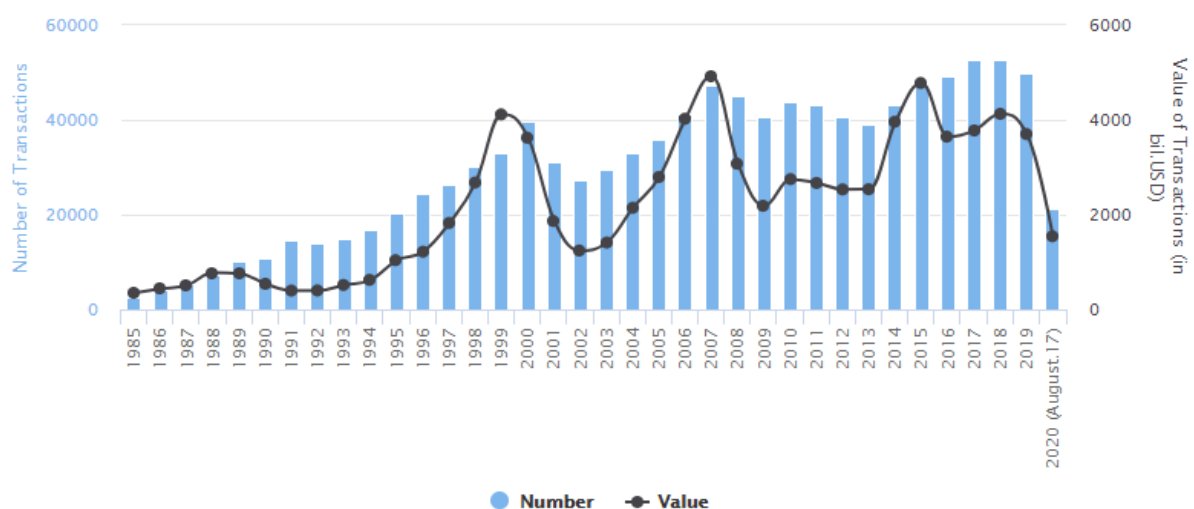
## 1 Value creation or value destruction?

The empirical literature is unanimous in concluding that M&As are expected to create value for the target and bidder shareholders combined (as reflected in the announcement abnormal returns), with the majority of the gains accruing to the target shareholders. Instead, evidence on the wealth effects for the bidder shareholders is mixed: some realize small positive abnormal returns whereas others suffer (small) losses (Martynova et al., 2008). This chapter starts by presenting some data on M&A activity, then it deals with the literature contrasts regarding bidder returns. Lastly, it highlights the most popular causes of failure and suggests some factors that could help improve deal performance.

### 1.1 M&A activity

Firms seem to believe they can benefit from M&As, in fact, the number of deals as well as the deal value has grown in the last decade. In the period 2010-2019 the number of deals moved from 43.940 to 49.849 (with a compounded annual growth rate of 1,41%), the higher level being 52.740 in 2017. Moreover, the value of those transactions increased from \$ 2,75 trn in 2010 to \$ 3,7 trn in 2019, with a peak of \$ 4,78 trn in 2015.

*Figure 1. Mergers and acquisitions worldwide*



Source: IMAA, 2020

Additionally, the last few years have seen a steep rise in mega deals that have almost doubled with respect to 2009 as corporate executives have taken advantage of record stock prices,

buoyant consumer confidence and relatively low borrowing costs to update their companies in the face of sweeping technological changes (Platt, 2018; IMAA, 2020).

M&A activity is expected to continue at an active pace throughout 2020, thereby extending the boom that resulted in more than \$ 10 trn in US transactions since 2013. Even though some stabilization and moderation are predicted, M&A activity has not reached the end of its cycle yet. Deloitte seventh M&A trend report (2020) survey respondents noted that even an economic downturn should not have a negative effect on M&A transactions, but actually boost M&A activity. In such a case, firms may decide to be strategic about using downturns to buy assets at a cheaper cost, especially private equity investors that often have large cash reserves. Moreover, divestitures could become a very important tool for companies to raise cash or shed underperforming units (Deloitte, 2020).

Despite a strong deal environment, some transactions continue to fall short of generating the expected value or return on investments.

## 1.2 M&A Performance

According to traditional literature, many mergers and acquisitions carry the potential for both financial and operational synergies. However, the majority of the deals fail to realize them (Bruner, 2014).

### 1.1.1 Short-term results

Traditional studies have had slightly different results in terms of short-run performance of M&As depending on the period selected or the country analyzed. However, the majority of them converges toward the belief that a large chunk of the deals undertaken are either destroying value or yielding insignificant results (Damodaran, 2005; Martynova et al., 2008; Bruner, 2014). Researchers confirmed that the M&A activity pertaining to the late 1970s and the 1980s reported negative abnormal returns ranging from 1,2% to 0,7% at deal announcement. Instead, mixed results were obtained when looking at the 1990s wave with various studies being split almost evenly between positive and negative returns at announcement (Martynova et al., 2008). Moreover, for almost half of the 58 acquisitions inspected by McKinsey and Co. in the period 1972-1983 neither the return obtained exceeded the cost of capital nor the acquisitions helped the parent companies outperform the competition. Also, KPMG examined 700 of the most expensive deals between 1996 and 1998 and compared the post-deal stock price performance of the combined firm to the performance of the relevant industry segment a year after the deal



was completed. It concluded that only 17% created value for the combined firm, 30% were value neutral and 53% destroyed value (Damodaran, 2005). Similar views are found expressed by Grubb and Lamb (2000) that states: “[...] *The sobering reality is that only about 20 percent of all mergers and acquisitions really succeed*“.

This seems to set a very grim picture for managers wanting to undertake mergers or acquisitions.

Contrary to traditional corporate finance literature, newer studies have shown that recent M&As have been delivering higher value at deal announcement with respect to the past.

By comparing the results obtained in the 2003-2007 merger boom with the ones relative to the previous 1997-2000 wave, Dobbs et al. (2006) concluded that the former was characterized by larger value creation and higher value appropriation by the acquirer firm. In particular, both cash and share deals performed better in recent years and their results in terms of deal value added (DVA) progressively improved, opposed to the previous period that was characterised by a deal performance deterioration. Even if cash deals still delivered on average more DVA, for the first time in 2003 share deals did not on average destroy value. The main element reflecting these differences is a lower premium paid on deals in the 2000s. While in the 1990s the typical deal premium hovered around 30% that decreased to just above 20% in the following decade, showing increased management caution with respect to overpayment. At the same time, in the first period of the 2000s cash deals grew in proportion with respect to pure-share deals (associated with higher percentage of overpayment and lower performance). This illustrates how avoiding overpayment is a critical success factor in an M&A.

Moreover, Alexandris et al. (2017) showed that after the 2008 financial crisis M&A deals experienced positive effects on their value creation. The aftermath of the crisis brought a surge in shareholder activism and litigation cases, as well as the introduction of new regulations and voluntary practices that led to an evolution in corporate finance. At the same time, the combination of historically low borrowing costs and challenging operating conditions that had many companies struggle to increase sales, made acquisitions an attractive way to enhance top line growth. These factors materialized in a change in investment behaviour toward more optimal investment allocation. Notably, CEO over-optimism decreased, executives paid more attention to synergy measurement and started to quote synergistic benefits within M&A announcements, hence, under- and over-investment dropped. The effects on deal performance have been significant: during the period 2010-2015 the average acquirer gained an abnormal return of approximately 1,05% around deal announcement, a huge shift from the average loss

of -1,08% of the previous two decades. The average deal benefited from a 4,51% combined gain for acquiring and target companies, thanks to the improvement of synergetic fit.

Additionally, during that period 54% of public deals were associated with positive abnormal return relative to only 39% in the previous decade. Alexandris et al. (2017) argued that the shift in return was so significant that public acquisitions generated comparable gains to private ones, contrary to traditional knowledge (Koller et al., 2015). In fact, improvements in deal quality were focused on listed targets characterized by larger size, heightened media attention and reputational exposure, which were historically more susceptible to value destruction. Although continuing to generate significant gain, private deals did not benefit from the same peak in performance. On the other hand, mega-deals' results, normally linked with large scale losses for acquirer shareholders (Moeller et al., 2004; Koller et al., 2015), have improved enormously post-2009 with the average acquirer earning a 2,54% abnormal return or \$ 62 mln gains (Alexandris et al., 2017). This is in line with the 2010-2020 surge of mega deals highlighted in the previous section.

Traditional studies may understate average acquirer return because they employ problematic methodologies, fail to capture the pre-announcement rise in acquirer share prices (especially in emerging markets) (Cornett et al., 2011; Cai et al., 2011; Yılmaz et al., 2016) and fail to adjust for distortion of a few large transactions (DePamphilis, 2017). Consequently, recent studies are not only better at mirroring the volume of M&A activity but are also more advanced from an empirical point of view.

### 1.1.2 Long-term results

The majority of the available research is focused on the DVA and return to shareholders at announcement assuming that investors can accurately assess potential synergy, even though they often lack access to the knowledge necessary to make an informed decision. Consequently, said research is affected by the significant shortcoming of not viewing M&As in the context of a larger integrated business strategy. However, among the studies that have analysed the long-term impact of M&A activity the evidence found is still conflicting (DePamphilis, 2017).

Traditional long-term studies converge toward the belief that firms experience under-performance over a one to three years period following mergers and positive, but insignificant, performance following tender offers (Agrawal et al., 1999). However, these empirical studies have been openly criticised by various scholars, because they employed sub-par methodology

choices, are based on overlapping datasets and suffer from data mining biases. Additionally, they fail to distinguish among different situations in which M&As occur and do not divide transactions into subsamples by type of target firm, bid status (friendly or hostile), transaction type and means of payment. (Fama, 1998; Barber et al., 1997; Martynova et al., 2008; Dutta et al., 2009). Therefore, the research often produced insignificant long-term return or anomalies, which may tend to disappear with reasonable changes in the measurement technique (Fama, 1998).

The M&As long-term wealth effects are contradictory even with more recent studies (DePamphilis, 2017; Bruner, 2004). Martynova et al.'s (2008) literature review suggests that takeover lead to a decline in share prices over several years following the transaction. However, an analysis of the Canadian market by Dutta and Jog (2009) shows no significant negative abnormal returns once accounted for methodological discrepancies.

Post-merger operating profitability does not fare any better. In fact, most of the available literature is in contradiction with one another. Generally, studies employing earnings-based measures of operating performance have shown a decline in post-merger profitability, while the ones analysing cash flow performance measures presented merger gains. Target relatedness has proven not to be a factor affecting operating performance, but the same cannot be said for means of payment. In fact, cash bids obtain a significantly better operating performance with respect to all-equity acquisitions (Martynova et al., 2008).

A matter that needs to be considered when dealing with stock-for-stock acquisitions is that they are influenced by upward earning management (up to six months prior to the deal announcement). In such deals, the shares exchange ratio is determined using the market price of the acquirer shares at the time of the deal. By inflating reported earnings within the legal boundaries and managerial discretion, acquiring firms try to increase their share price so that target firm's shareholders would receive less shares. Even if the phenomenon has a non-significant negative reaction in the short-term, the market tries to revert the effect on share price in a longer time frame. In fact, the practice creates a highly significant negative reaction during the first year after the announcement and a negative trend up to three years following the deal announcement for an average share-for-share acquirer. As a consequence, acquirers engaging in earnings management prior to a deal announcement are more likely to have a poor post-merger performance. The post-merger effect was found to be more pronounced in publicly traded targets (Alsharairi et al., 2015).

There are various issues that make long-term M&A results so difficult to unequivocally establish. Firstly, when the event window is extended over several years after announcement, the magnitude of the M&A effect on the share prices strongly depends on the estimation method used to predict the benchmark return (Martynova et al., 2008). Secondly, when analysing a long post-merger period, it is difficult to isolate the takeover effect (DePamphilis, 2017). In fact, there is a high likelihood that factors unrelated to the merger, such as strategic and operational decisions or changes in the environment (for instance financial policies variations, industry shocks or overvalued stocks), will affect financial performance (Bruner, 2004). Moreover, longer-term studies cannot compare how well the acquirer would have done without the acquisition (DePamphilis, 2017). Furthermore, long-term returns vary significantly by industry and deal pattern. In fact, companies with the right capabilities can succeed with a pattern of small deals, but in large deals industry structure plays a role comparable to firm capability and leadership in guaranteeing deal success (Rehm et al., 2012).

### 1.1.3 Factors affecting M&A

Given the uncertain ground surrounding acquisition performance, it is a necessity for managers to have a clear understanding of the factors that may hinder the success of merger activity so that they can actively work on avoiding them. At the same time, executives should keep in mind the key successful factors of M&As and exploit them to increase deal performance.

#### 1.1.3.1 *Determinants of failure*

Some of the principal reasons of mergers failure, highlighted by various scholars, are: overpayment and poor integration due to lack of resources, cultural conflicts or inadequate processes (Macdonald, 2005).

CEOs consistently overestimate the value of synergy, while simultaneously underestimating the time needed to deliver them (Damodaran, 2005). Overpaying for synergies in most acquisitions, acquiring firm shareholders tend to end up obtaining none of the benefits of the increased value. The risk is larger when directors believe they are immune to the common mistakes that led to value destruction in M&A deals; as such, in multiple occasions managerial pride and overconfidence has been the root of overpayment (Roll, 1986). Overconfident CEOs are frequent acquirers that benefited from positive experience in past acquisitions, but blinded by self-attribution bias cannot see that they are paying more than the target is worth (Billet et

al., 2008). Such acquirers are associated with higher likelihood of conducting M&A transactions as well as higher premium paid and worse performance on those deals (measured by bid announcement results) (Malmendier et al., 2008). They may feel remorse from having overpaid, hence, experiencing what has been referred to as the “winner’s curse” (Kagel et al., 1986; DePamphilis, 2017). The negative results connected to CEOs hubris are true for both target and acquirer firms. By analyzing a sample of 2.130 firms, Kose et al. (2010) found that the acquiring firms experienced a drop-in market price of no less than 10-12% on average on deal announcement if both target and acquirer firms were governed by overconfident executives. Additional roots of overpayment are biased evaluation processes and failure to plan for synergy attainment. Often, a deal assessment is made by an investment bank (hired by the acquiring firm), whose fee rests on the deal being completed. As such, the bank may continue to promote and suggest a deal even if non-profitable for the acquiring shareholders because the investment bank itself will gain from it. If we combine this assumption with the fact that at that point managers of most acquiring firms have already decided that they want to pursue the deal at any price, it is not surprising that CEOs overpay for synergy and control (Damodaran, 2005).

As many aspects of corporate finance, M&As are affected by agency problems. In particular, managers may decide to undertake acquisitions to increase their compensation, add to their prestige, build spheres of influence or for self-pervations. Unlike overconfident executives that believe their actions will maximize value, CEOs with empire-building preferences consciously disregard shareholders’ interests (Malmendier et al., 2008). Therefore, they may pursue value destroying transactions because they are self-beneficial. Such mismanagement may persist when shares are widely held, as is in the majority of public firms, because the cost of such negligence is spread across many shareholders (DePamphilis, 2017).

An additional issue highlighted by the literature is an increasingly complicated organizational structure resulting from mergers and acquisitions. Especially by merging two unrelated companies, as was the case during the conglomerate era (1965-1969), the firm structure may become too complex and hamper managerial problem-solving. In various instances, these obstacles were so serious that it became a necessity to transition back to simpler and more manageable organizational forms rendering the M&A efforts futile (Coffee et al., 1988). In this regard, Bruner (2014) showed that while diversification has been known for destroying value, focus conserves it. By focusing on both activity and geography, mergers are able to enhance acquirer stockholders’ share value by 2% to 3%.

At the beginning of the section, it was briefly explained that poor integration is a major reason for M&A failure. In fact, without an effective and adequate integration the expected value to be derived from an acquisition is elusive.

While a lack of integration may result in the loss of the expected synergy, too much integration could be detrimental and result in considerable cultural clashes. Moreover, the extent of integration required to obtain synergies may ultimately result in the destruction of the acquired company's knowledge-based resources because of employee turnover, disruption of organizational routines and destruction of ties embedded in the target organization. As a consequence, it is important to note that even though finding the right integration extent is key to extract synergies there is no fixed amount of integration that is successful throughout all M&As. Instead, as M&A are undertaken within different contexts and for different reasons, integration strategies need to adapt to reflect these differences (Gomes et al., 2013).

A similar argument surrounds integration speed. If on one hand a slow process helps in reducing the conflicts between the parties involved, on the other it may cause uncertainty and rumours to thrive affecting both employees and customers. Nonetheless, the cost of losing the momentum of a business is much greater than the one associated with mistakes made through quick decisions. Hence, scholar's advice managers to move rapidly and consistently throughout the whole integration process (Gomes et al., 2013). Successful acquirers tend to capture between 70 and 75% of the expected synergies within the first year after the deal and try to go after the biggest synergies as soon as possible to make sure they do not miss their window of opportunity (Ficery et al., 2007).

While integration is often perceived as a determinant of failure in M&A strategies, if properly executed it could easily translate into a key success factor (KSF).

#### 1.1.3.2 *Critical success factors*

Regardless of the general results of M&A activity, there are some factors that could be used by acquirers' CEOs to increase the likelihood of success.

Communication is a significant KSF when a firm is pursuing an acquisition.

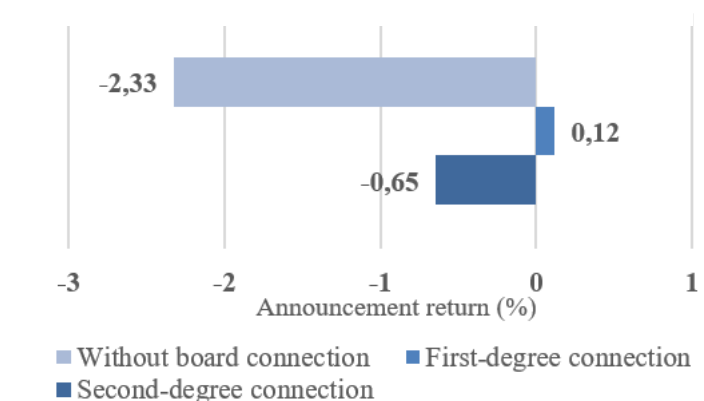
It starts early on with internal communication with the board, integration team and associates at large; and it is necessary to align the views of associates with the ones of shareholders (Macdonald, 2005). To reach an effective communication, managers ought to set appropriate levels of expectations and correspond fairly and accurately. Especially, to be successful, deal makers must have a simple, transparent and disciplined approach to measuring value creation.

Otherwise, they risk being penalized by shareholders at inception with higher discount rates, which may result in a lower probability of entering a transaction or a lower stock price if the deal is undertaken. Additionally, if the process of internal communication and M&A valuation are poor, it is likely that communication will not improve with external communications to analysts, vendors, and all other external constituents (Macdonald, 2005). Also, the way in which the acquirer communicates its future intentions toward the acquired entity is an important aspect of managing stakeholder expectations. An information vacuum leads to uncertainty that can result in loss of confidence from key stakeholders and in extreme cases cause fear, dysfunctional actions, and industrial unrest (Gomes et al., 2013).

Having a trusted information channel in the form of a board connection between the two firms involved in the transaction has the power to improve deal making significantly. In fact, according to Cai et al. (2011) having a board connection may improve information flow and communication, therefore, increasing each firm's knowledge and understanding about the other's culture and operations. Acquirers with a board connection to the target enjoy a bargaining advantage in deal negotiations due to their private information about the target with respect to outside bidders with no connection to the target. Consequently, the information advantage allows not only for better M&A transactions, but also affects premium paid by acquirer shareholders and the price of the deal. In fact, first-degree connections (in which the two firms share a common director before the deal announcement) limit competition from outside less-informed bidders, as competitors fear the winner's curse more due to the presence of an informed bidder, reducing the acquirer's incentive to offer a higher premium to deter competitors. Moreover, greater communication diminishes the need for advisory services and fairness opinion, thereby decreasing investment bank fees (measured as a percentage of deal size) and the transaction cost of a deal. Second-degree connections

are characterized by the presence of one director from the acquirer and one from the target company that have been part of a third firm's board before the deal announcement. In this case, the connected directors are more likely to undertake deals when they lead

*Figure 2. Benefit of board connections*



Source: Cai et al, 2011

to combined announced returns. Both types experience higher average acquirer abnormal return with respect to a deal without any connection (in the sample studied the differential was +2,45% for first-degree and +1,84% for second-degree connections). Additionally, the post-deal operating performance of the combined firm is better for transactions with a second-degree connection.

The importance of communication between transacting firms has been highlighted also for cross-country deals, normally known for performing better (at announcement) with respect to domestic deals (Reinhard and Röhrle, 2016). Such transactions must be handled with particular care because they are affected by greater information asymmetry with respect to domestic deals, which could have negative effects on the deal. Moreover, if not overcome, larger cultural gaps, typical for cross-country deals, could decrease the success in intercultural business relations. These risks can be avoided or reduced when firms have multiple interactions. In fact, the establishment of trust and confidence from prior interactions can allow realistic action planning, effective communication, and appropriate bargaining styles. It may also enable both parties to become more sensitive to interorganizational cultural differences that otherwise can lead to misperceptions, misunderstandings, conflicts, and lack of trust. A pre-merger “courtship period”, a time when companies get to know each other before deciding to merge, could be ideal in these situations. This form of engagement may range from having a prior formal arrangement, such as a joint venture or working on a specific project, to an arm’s-length relationship, like a trading partner, board-interlocks, or active shareholder with board representation (Gomes and Angwin, 2013). By obtaining accurate information and overcoming potential tensions and conflicts between parties, they improve the acquisition process, especially negotiation and integration phases, and set themselves up for success.

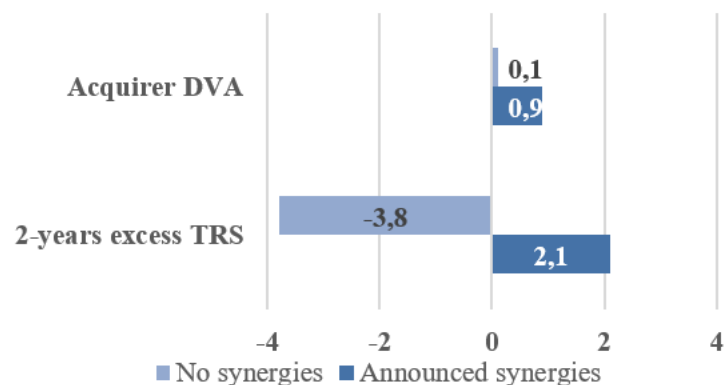
Furthermore, a strong and clear communication toward investors through synergy announcements will result in obtaining a more favourable market reception, especially for cost-reduction synergies that are often assigned a smaller discount rate with respect to revenue-enhancing synergies (Bruner, 2014).



Since 2010, only around 20% of the acquirers publicly disclosed the synergies they expected to capture (Agrawal et al., 2017). The main deterrents of disclosing synergy values are lack of precise information and shareholder litigation risk (Dutordoir et al., 2014). Moreover, executives retain information because they feel compelled to move too quickly to compile the data or because they fear overpromising. However, when companies aren't forthcoming, investors may interpret it as a sign that managers don't know how they'll make a deal work. Instead, when companies announce synergies, they give investors a deeper understanding of the deal rationale. Even though

Figure 3. Benefits of announced synergies

managers do not always execute transactions for synergistic reasons; when they do and disclose the source of value of such synergies at deal announcement, investors reward them with higher share prices. Albeit, on average, firms that announce synergies end up



Source: Agrawal et al, 2017

paying slightly higher premiums, they also benefit from higher DVA around announcement date and a 6% boost in two-year excess total return to shareholders (TRS) compared with those that didn't mention synergies. Moreover, if directors update investors on progress during integration, they build trust and confidence in their skills as stewards of investors' resources. As a consequence, they are more likely to maintain the positive price effect earned at synergy announcements. In particular, even deals that initially received a muted market reaction often see significantly higher excess TRS two years after the transaction when investors were provided synergy updates. This reflects successes in cultural integration and the ability to maintain a deal's business momentum—which lead to synergies (Agrawal et al., 2017).

The Securities and Exchange Commission (SEC) recognized the need for an improved information flow to investors about acquired or disposed businesses. In fact, on May 21, 2020, it amended the financial statement and other disclosure requirements that apply when public companies acquire or dispose of a business. Among other things, the amendments allowed for "Management's Adjustments" to pro forma financials, permitting companies to address reasonably estimable synergies and dis-synergies of the transaction, largely in response to criticism that pro forma financials do not always communicate useful information. While the

changes are not effective until January 1, 2021, voluntary early compliance is permitted if the amendments are applied in their entirety from the date of early compliance (SEC, 2020; Cantone et al., 2020).

Also, having strong and performing operations is a determinant of success in mergers and acquisitions. In fact, empirical research showed that acquirers whose earnings and share price grew at a rate above industry average for three years before the acquisition earned statistically significant positive returns on announcement. Similar results were found when using market-to-book ratio as a measure of corporate performance (Koller et al., 2015; Morck et al., 1990).

To sum up, it is still unclear whether M&A are profitable for acquiring shareholder, especially in the long run. While various mergers are able to obtain good results for the bidder others still turn out to be value destroying. Nonetheless, recent studies have shown a much more positive picture with respect to the one described by traditional literature. Given the uncertain environment surrounding M&A it is up to managers to avoid the common mistakes made in bad deals and exploit the critical success factors to achieve a favourable outcome.

## 2 Analysis's presentation

The next few chapters analyse the strategic choices regarding the use of mergers and acquisitions made by some of the most prominent companies within the European luxury industry. To clearly understand them, the following sections introduce the methodology used when analysing these cases and the environment surrounding them.

### 2.1 Methodology

#### 2.1.1 The firms' selection

Within the process of selecting the companies on which to focus this study on, listed firms seemed to be the perfect candidate. In fact, one of their main characteristics is the availability to the general public of a large quantity of information regarding them, such as their value in term of share price, their financial statements, press releases and various others.

Geographically, the choice was restricted within the confines of the European Union luxury market, as it presented a significantly greater number of deals to be analysed compared to other regions (as showed below). Additionally, the presence of various conglomerates makes it an interesting study topic. In fact, literature always depicted M&As aimed at differentiation to be value destroying, thereby discouraging the developing of this type of organizational form, which instead seems to be flourishing in this environment.

Lastly, this academic work targeted mainly the luxury goods segment and the ones annexed to it. Top European companies within the industry built themselves into large conglomerates involved in various businesses, for instance putting together personal luxury and wine and spirits and/or home and furniture as well as many others. However, the car manufacturing business seems to have mostly kept itself separated and so in that logic it was excluded and considered to be non-pertinent. Firms involved in the luxury car segments differ substantially to the ones involved in all the others and would not have allowed for an effective final comparability of their results because they face different challenges and obstacles.

LVMH was a clear first choice as it is the undisputed leader within the market in term of both revenue generation and market capitalization. Moreover, its extended use of mergers and acquisitions made it a perfect target for this type of analysis. Then, Kering and Hermès were chosen among the top performers in the industry because of their high comparability with LVMH and their singular use of M&As. Each of these corporations includes in its portfolio one

of the top three most valuable luxury brands in 2019 (once Chanel is excluded<sup>1</sup>): Louis Vuitton worth \$ 47,21 bln, Hermès esteemed \$ 30,97 bln and Gucci at \$ 25,27 (Taplin, 2019). These three organizations were analysed extensively because their growth strategy presented tough-provoking peculiarities.

Lastly, the Italian luxury leader Prada and Richemont, the third-largest luxury goods company, were chosen due to the different acquisition choices they employed during the decade. Their examination was computed in a briefer view, while still being attentively assessed.

The carefully chosen cases, which are presented in details in the following chapters, are structured as follows.

### 2.1.2 Approach

Each of the cases that were analysed present an introductory section regarding the firm, its history and achievements. That is necessary to give an overview to the reader of its general position to allow for a deeper understanding of the core of the inquiry. Then, an important part of the case study consists in identifying and outlining the growth strategy utilized by the firm and, in particular, its reference to M&As.

It was previously shown how value creation should entail maximizing a company's value to its shareholders without focusing of short-termism, but with a view to the future.

To measure a firm's value creation ability this study relies on the use of a company's market performance and more specifically to its return to shareholders (TRS). Within a given period of time TRS shows the sum total of what a stock has returned to those who invested in it. Stockholders' earnings from their share ownership are capital gains and capital income. The former represents the difference in market price from the moment the stock was bought to the date in which it was sold or current price if it is still owned. The latter refers to the dividends paid by the company to the investor because of its ownership of the stock. TRS is computed as follow:

$$TRS = \frac{(Current\ price - purchase\ price) + dividends}{Purchase\ price}$$

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<sup>1</sup> For clarity, the Chanel brand was not included within this analysis because its parent, the namesake company, is a private firm.

Though in different ways this measure was used both when assessing long and short-term M&A value creation.

#### *2.1.2.1 Short-term performance*

The short-term value creation ability was evaluated individually for each deal in a period going from two days before to two days after the announcement date. The rationale is that by looking at the change in the acquirer's share price in such a short period the only factor affecting its value is the M&A itself.

Within this context TRS was not used on its own, instead the cost of equity pertaining to the period was removed from the individual announcement return to obtain the TRS in excess of equity costs (ETRS on cost of equity). Thus, the derived amount represents the return exceeding the basic compensation required by shareholders for owning the asset and bearing the risk of ownership.

$$ETRS \text{ (cost of equity)} = TRS - \text{cost of equity}$$

This quantify shows whether investors were able offset for the risk undertaken and at the same time indicating if a significant return on top of it was earned. To have an overall view of the general short-term value creation obtained by a corporation average and median values of excess TRS were obtained.

The cost of equity used to compute excess TRS was calculated by applying the CAPM model (see in the appendix). According it, the cost of shareholders equity can be calculated as the product of the beta of the asset ( $\beta_i$ ) and the equity risk premium (ERP, which is the difference between the expected market return and the risk-free rate) plus the risk-free rate of return.

$$\text{Cost of equity} = R_f + \beta_i * ERP$$

Cost of shareholders' equity was computed annually. For its use in the short-term analysis the values were adjusted to reflect the announcement time frame. From that, an average value was taken into account and applied to all of the deals' TRS regardless of the years in which they were made.

It would have been extremely interesting to see the weight of the deals undertaken on each firm market capitalization and to find out the value of excess TRS on the target price to have a clear grasp of the exact significant of the transactions and their performance. However, that was not possible, in fact, this type of analysis was hindered by the inability to obtain information such as the price paid for many of the M&As completed.

Market performance at announcement was used also to evaluate if specific features relating to the deals were yielding favourable outcomes and which led to the highest results.

Firstly, the transactions were divided according to the objective that the company aimed to achieve when undertaking them. For instance, they were differentiated for being vertical integrations (either forward or backward), portfolio expansions through new brand acquisitions or others. The average and median excess TRS obtained by the deals falling within a particular strategy were compared to understand which was best perceived by the market, hence, creating more value around the announcement date. The same process was used to understand whether domestic or cross-country deals worked better for each organization by yielding on average higher excess TRS at announcement.

Lastly, some considerations were drawn regarding the impact of factors that according to the literature aid or hinder value creation in M&As, for instance overpayment and communication were taken into account.

#### *2.1.2.2 Long-term performance*

Differently from the examination of short-term value creation for which every deal completed was examined separately, in order to estimate long-run performance it is necessary to take a more general view.

While it would have been interesting to assess the outcomes of the target companies and to determine the actual synergies formed with the acquirer, that is unfeasible. Most organizations disregard the results of each individual subsidiary, opting to present the aggregated performance per division or only the outcomes of a few of the main brands along with the consolidated results in their financial statements. By looking solely at the Group performance, it is impossible to single out the long-term impact of each M&A as too many factors affect an organization when a broader horizon is taken into account. To that purpose, TRS is computed annually over a period of ten years and some adjustments are made to present results that are as pure as possible.

As what was previously done for assessing short-term M&As value creation, TRS in excess of cost of equity was computed annually to assess whether over a longer period of time the firm was able to earn a return for its shareholders higher than the one required to cover for the ownership risk.

It is important to remember that while the results obtained in the short-term are completely attributable to mergers and acquisitions thanks to the very brief period analysed, the same

cannot be said for the long-run. In fact, by taking in consideration annual performance what we obtain is the result of every action and decision taken by the corporation jointed with the outcomes of all the elements that affecting it from its environment.

In an effort to remove the influence of external factor on the shareholder return achieved, TRS was computed in excess of an industry index return.

$$ETRS (industry\ return) = TRS - industry\ TRS$$

The index chosen was the MSCI Europe Textiles, Apparel and Luxury Goods Index, which is composed of large and mid-cap stocks across fifteen Developed Markets countries and comprises a total of twelve constituents (such as LVMH, Adidas, Kering, Richemont, Hermès, EssilorLuxottica and Moncler). The index was used as a proxy for industry performance and as a way to isolate the industry effect and achieve an excess TRS that is only affected by the firm's choices. Also, by showing the performance of the average firm in the industry, this measure acts as a benchmark on which to compare the results obtained by the cases selected.

The study is panned out over a period of ten years, hence, the shareholder's investment is assumed to be compounded over multiple periods. To take into account this factor and obtain an average measure of value creation throughout 2010 to 2019, geometric averages was calculated for both ETRS.

Additionally, each company's compounded return was multiplied by its market capitalization to compute the value created over ten years. By considering the impact of the return on market capitalization, this study takes into account the fact that creating value for a very big company is harder than for a small one. Moreover, even a small average TRS if earned by a company with a large capitalization is bound to have a significant impact.

#### *2.1.2.3 Comparison of strategies and results*

To avert the inherent limitations that affect every M&A's value creation study (especially the ones focused on long-term), the organizations analysed were separated depending on the growth strategies used. In particular, the ones that chose to make a wide use of M&As were divided from the ones that opted for a path more oriented toward organic growth. In that setting, the results previously presented for each case were combined per strategy and compared. From that, considerations were drawn regarding the capability and efficacy of value creation though mergers and acquisitions.

## 2.2 Overview of the luxury market

The luxury market is a significant economic force and, especially for Europe, a substantial driver of GDP and competitive advantage (BCG, 2020).

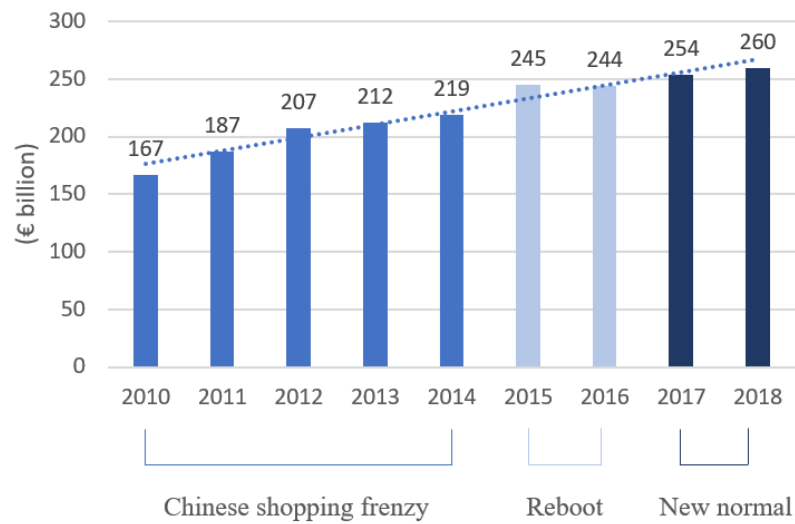
Overall, its nine segments (luxury cars, personal luxury goods, luxury hospitality, fine wines and spirits, gourmet food and fine dining, fine art, high-end furniture and housewares, private jets and yachts, and luxury cruises) were estimated to be worth about € 1,2 trn in 2018. During the same year, most of them showed positive performance and real term growth. Luxury cars, hospitality and personal luxury goods together accounted for more than 80% of the total market. Even though sales of luxury cars continued to dominate the market, in 2018 personal luxury goods outperformed the overall market, rising 6% to reach a record high of € 260 bln (D'Arpizio et al., 2019). According to a survey by McKinsey between 2015-2019 personal luxury showed a positive growth of +5,7% (CAGR) and stable EBITDA%. Other luxury sectors are growing less (+4,1% CAGR in 2015-2019) and with a slight decrease in profitability. Watches and jewellery had been the most attractive sectors within 2010 and 2015 combining the highest sales growth and margins. Between 2015 and 2019, they relinquished their lead position to cosmetics and cruises. Solely in terms of marginality, apparel and accessories are still the top performing category (Deloitte, 2020a and 2017).

Specifically, the Eurozone continues to experience growth albeit at a slow pace. In 2018, local consumption was positive overall, helping to boost retail sales 3% to € 84 bln. However, a strong Euro value limited tourists' purchasing power leading to a deceleration in tourist spending that had a major impact across European markets (D'Arpizio et al., 2019; Deloitte, 2019). In the meantime, according to the McKinsey Global Fashion Index, Asia-Pacific and Latin America emerging-market countries saw growth between 5 and 7.5% (Ramirez, 2019).

In fact, during the last decades various emerging countries experienced extensive increase in luxury demand. The highest sales were registered mainly in China and Japan, bringing Asia to the forefront of luxury consumption and revenue generation. During fiscal year 2018, 35 percent of total revenue of European luxury conglomerates LVMH and Kering was originated in Asia and 11% from other markets. Also, Prada's revenues from regions other than Europe and Americas was over 47% (Ramirez, 2019; Fashionbi, 2019).



*Figure 4. Value of the personal luxury good market*



Source: D'Arpizio et al., 2019

From 2008-2014, the number of Chinese households purchasing luxury products doubled, fuelled by greater access to luxury goods and growing incomes. Since 2015, the primary driver of increases in luxury spending has shifted from consumers making their first purchases of luxury goods, to the incremental spending from existing luxury consumers (McKinsey, 2017). According to McKinsey China Luxury Report (2017) between 2008 and 2016 more than 75% of the total growth in global luxury spending, over \$ 65 bln, could be attributed to purchases made by Chinese consumers, either at home or abroad.

The increasing importance of non-western markets for the entire industry has been supported by supply chain leadership, technological innovation and international investments. These factors helped promote growth also in the European and American markets. Mergers and acquisitions have played a large role in the matter (Fashionbi, 2019).

The fashion and luxury industry has increasingly trended toward consolidation of its key players. Last year, for the first time, the Top 10 luxury companies contributed more than half of the \$ 281 bln total luxury goods sales of the Top 100 companies (Deloitte, 2019; Deloitte, 2020b).

Historically, European luxury holding companies have been a constant of the market for the past half century. Even nowadays, the three major players in the consolidated luxury market are all based in Europe. Francois Pinault's Kering (which can count on brands such as Gucci, Saint Laurent, Alexander McQueen, Balenciaga etc.) was the first to employ the method of large-

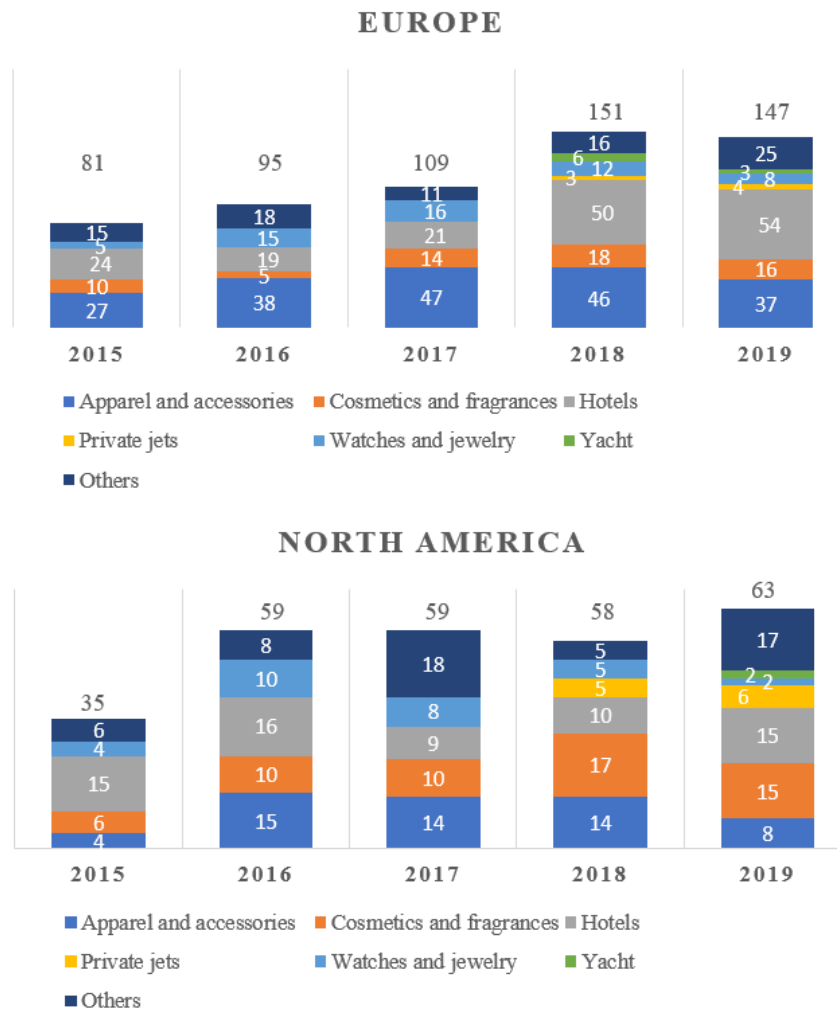
scale luxury holdings (Fashionbi, 2019). Shortly after, LVMH followed thanks to the merger of Louis Vuitton and Moët Hennessy (already the result of the union between Moët & Chandon and Hennessy in 1971). In 1986, LVMH was already a conglomerate dealing with leather goods, wine and spirits, perfumes (Parfums Christian Dior and Parfums Givenchy) and cosmetics. Also, at the time of its foundation (1988), Richemont already owned various luxury brands among which Cartier, Dunhill, Chloë, Yves-Saint-Laurent and Montblanc. The European luxury industry promotes consolidation, which gives financial advantages to the conglomerates. Hence, various independent companies followed development strategies characterized by the takeover of other companies and the expansion of the retail network (Fashionbi, 2019; Donzè et al., 2017).

On the contrary, without being able to lean on the longstanding heritage of European conglomerates, American companies have struggled to brand themselves as fashion houses (e.g. Ralph Lauren and Calvin Klein) (Fashionbi, 2019).

The European model preserves individual brand value because large holding companies do not have a brand of their own which can distort the one they acquire. Instead, American companies, with already established customer perceptions, are increasingly acquiring direct competitors. Nonetheless, some American firms have emulated the European strategy. For instance, the recent acquisition of Versace by Michel Kors established what might be the first US luxury conglomerate, Capri Holding (Fashionbi, 2019).

During the last five years European companies have completed more than twice the number of deals that were executed in North America during the same time period. Nonetheless, in both regions the number of M&As being concluded is rising steadily with a compounded annual growth rate of respectively 12,7% and 12,5%. In Europe, the apparel and accessories sector has been the recipient of a large quantity of deals. In 2017, it reached its height when 43% of the total deals involved the apparel and accessories sector. In the last two years, instead, the luxury hotels deals have dominated the European market. A different trend was developed in North America. While in 2015-2016 there was the predominance of the hotel sector, during the past three years cosmetics and fragrances have had a larger reach. All the other geographical regions experienced an increasing number of transactions, that remain notably lower compared to Europe and North America (Deloitte, 2020a; Deloitte, 2017).

Figure 5. Number of deals completed per luxury sector in Europe and North America



Sources: Deloitte, 2020a; Deloitte, 2017

As per characteristics, most of the buyers chose small sized targets (which accounted for 49% of deals in 2016 and 62% in 2019) delivering medium-high average multiples. Moreover, most bidders, 75% in 2016, aim to obtain majority stakes in the target. Investor profile varies largely depending on the year considered, but in 2016, 68% of investors were strategic buyers, mainly active in apparel and accessories, hotels, and watches and jewellery (Deloitte, 2020a and 2017).



## PART II

### 3 LVMH

#### 3.1 Introduction to the case

LVMH was founded in 1987 in Paris when two small family companies, Louis Vuitton and Moët Hennessy, decided to merge in order to pursue their growth and expansions on global markets. In only a few decades these firms became what is now a multinational corporation and the world's leading luxury goods group. In the 2019 fiscal year, the conglomerate recorded € 53,7 bln of revenues, € 11,5 bln of operating income and € 7,2 bln of net income (figures that faced growth of 15%, 15% and 13% respectively with respect to the previous year). The group is present in 70 countries through 4.915 stores, over 163 thousand employees and 75 maisons. Its sixty subsidiaries are often managed independently, under the umbrellas of six branches: Fashion and Leather Goods, Wines and Spirits, Perfumes and Cosmetics, Watches and Jewellery, Selective Retailing, and Other Activities (Donzè et al., 2017; LVMH, 2020).

The transformation from a small firm to an established luxury conglomerate was in large part due to the M&As that the company undertook through the years. Such deals became an integral part of the growth strategy of the group.

In 1989, Bernard Arnault became the group's majority shareholder, and chairman and Chief Executive Officer. From then onwards he pursued its vision to make LVMH a leader in the luxury industry. In an interview for CNBC (2018) he said: *"In the 90s, I had the idea of a luxury group and at the time I was very much criticized for it. I remember people telling me it doesn't make sense to put together so many brands. And it was a success ... And for the last 10 years now, every competitor is trying to imitate, which is very rewarding for us."* (LVMH, 2020; Handley, 2018).

While in its origins LVMH was a purely French luxury group, in the 90s the acquisitions of the Japanese designer Kenzo (1993), the Italian shoemaker Berlutti (1996), the Spanish high quality leather company Loewe (1996) and the firm of the New York designer Marc Jacobs (1997) started a process of internationalization. In this time period, the assets of the company were multiplied fourfold, rising from € 4.8 bln in 1989 to 20.7 bln in 1999.

However, as a result of this expansion the debt levels started to increase. Hence, in the 2000s LVMH decided to employ a more focused strategy. The group divested its unrelated businesses

to focus exclusively on luxury. The sale of Hard Candy, Urban Decay, Pury & Luxembourg and Philipps were the result of this new approach. Nonetheless, the use of M&As as an expansion strategy in the worldwide luxury industry continued and LVMH was able to incorporate brands such as Rossimoda, Fendi, Emilio Pucci, La Samaritaine, Fresh, Donna Karan and various others (Donzè et al., 2017; The Fashion Law, 2020; Dominic-Madori, 2020).

## 3.2 Strategy and M&As

LVMH has deployed a business model marked by dynamic growth since its creation in 1987. This model, which drives the success of our Group and ensures its promising future, is anchored in a long-term vision that builds on the heritage of our Houses and stimulates excellence. In line with this strategic thinking, the conglomerate perfectly integrates a strong M&A activity with the organic growth of its Houses.

LVMH acquisition strategy includes identifying brands with strong, long-term potential and helping them to capitalize on it. For many of them, that constitutes using LVMH resources to grow from small entrepreneur managed firms to internationally established brands. To do so, the group chooses to purchase majority or control stakes in its targets. However, it normally allows the firms to develop individually maintaining their own identity, while being supported by its large holding. As a consequence, the pre-acquisition management is often re-confirmed after the transaction is concluded, allowing entrepreneurs and designers to be active participants in the development of their firm within LVMH. While selecting its target companies, the group places a lot of importance on their culture, making sure that the new companies will fit seamlessly within the group. In particular, it desires to include firms that strive for creativity and innovation. Thanks to these acquisition features the group was able to gain the reputation of a good acquirer. By selling their firms to LVMH, entrepreneurs know that the conglomerate will continue to respect the values and individuality of its target. Hence, they often are willing to sell to LVMH that has hardly used hostile takeovers within its strategy (Elliot, 2011). Also, to ensure the high quality and excellence of its products LVMH invested heavily in vertical integration, which the company considers one of six pillars of its unique operating model (the other being decentralized organization, organic growth, creating synergies, sustaining savoir-faire and balance across business segments and geographies) (LVMH, 2018).

During the last decade LVMH completed 41 deals and announced the acquisition of Tiffany (completed later on), which was referred by The Guardian as the biggest-ever deal in the luxury

sector (Capital IQ, 2020; The Guardian, 2020). The total transactions made were divided into: 33 M&As and 9 divestitures.

While most of the M&As (22) focused on the acquisition of new firms to add to LVMH's already wide brand portfolio, the conglomerate also aggregated a few of its suppliers (6) in an effort to integrate the production chain of its luxury goods.

Large investments were made to reinforce the Watches and Jewellery segment, among them we can find the acquisitions of the Italian jewellery brands Bulgari and Repossi as well as the producer of Swiss watches dials ArteCad.

Also, LVMH strengthened its major segment, fashion and leather goods, which moved from earning 37% of total revenue to 41% in 2010-2019. LVMH acquired designer brand Marco de Vincenzo and Demibell, as well as minority ownership of designers MHS, JW Anderson and Stella McCartney. Moreover, it vertically integrated various suppliers of leather such as Masoni Industria Conciaria and The Roux Tanneries. Exclusively for their crocodile leather production it bought Australian Johnstone River Crocodile Farm and reached an agreement for a 51% stake in Heng Long. Important was the acquisition of 80% of Italian Loro Piana, already an essential LVMH supplier as well as an established brand within the leather goods sector.

The hospitality and travel sector were furthered with the acquisitions of Hôtel La Maison Blanche, Hotel Saint-Barth Isle de France, Société Anonyme des Bains de Mer et du Cercle des Étrangers à Monaco and Belmond.

The addition of La Samaritaine was the only example of forward integration. LVMH *modus operandi* normally involves selling its individual brands within flagship stores, hence does not normally employ forward as much as backward integration. This exception was a highly strategic move from Arnault which decided to buy the department store both to locate new stores for its brands, such as Sephora and Kenzo, and to contrast its competitor Kering. The acquisition was an investment to increase LVMH already owned shares to full control (100%) of the company.

The group also completed two M&As in the publishing industry. The media business falls outside of the group luxury focus, however the deals further a segment which was already experiencing positive results from Les Echos. While only a minority interest was acquired in Éditions Gallimard, the group decided to add to its portfolio a 100% stake in SNC Le Parisien Libere. The market responded with mixed reactions from analysts and investors (which were reflected on the deal performance at announcement date as shown in the following section). Various of them insisted that if Les Echos could be associated with LVMH since it focuses on

*Table 1. LVMH mergers and acquisitions (2010-2019)*

Target	% Acquired	Business	Strategy
Masoni Industria Conciaria S.p.A.	Minority	Leather production	Backward integration
Tiffany & Co.	100%	Watches and jewellery	Brand portfolio expansion
Stella McCartney Ltd	10%	Fashion design	Brand portfolio expansion
Repossi Diffusion SAM	27%	Jewellery	Brand portfolio expansion
Château du Galoupet SAS	100%	Wine and spirits	Brand portfolio expansion
Belmond Ltd.	100%	Hospitality and travels	Brand portfolio expansion
Colgin Cellars Inc.	60%	Wine and spirits	Brand portfolio expansion
Demibell S.A.C.I.F.I.	100%	Fashion design	Brand portfolio expansion
Grandville SA	100%	Fashion and leather goods, wines and spirits, perfumes and cosmetics, and watches and jewellery	Brand portfolio expansion (within an Arnault family group redistribution strategy)
Parfum Francis Kurkdjian	61%	Perfumes and fragrances	Brand portfolio expansion
Rimowa GmbH	80%	Suitcases and luggage bags	Strategic acquisition
Repossi Diffusion SAM	42%	Jewellery	Brand portfolio expansion
Société Anonyme des Bains de Mer et du Cercle des Étrangers à Monaco	5%	Casino and gaming, hospitality and travels	Brand portfolio expansion
SNC Le Parisien Libere	100%	Publishing	Unrelated acquisition
Société du Domaine des Lambrays Sàrl	100%	Wine and spirits	Brand portfolio expansion
Marco de Vincenzo S.R.L.	45%	Fashion design	Brand portfolio expansion



Éditions Gallimard S.A.	9,50%	Publishing	Unrelated acquisition
JW Anderson Limited	Minority	Fashion design	Brand portfolio expansion
Nicholas Kirkwood Limited	52%	Footwear	Brand portfolio expansion
Johnstone River Crocodile Farm	100%	Crocodile leather production	Backward integration
Hotel Saint-Barth Isle de France	100%	Hospitality and cruises	Brand portfolio expansion
Loro Piana S.p.A.	80%	Leather apparel	Brand portfolio expansion and backward integration
Cova Montenapoleone s.r.l.	80%	Food services	Strategic acquisition
Société MHS SAS	Minority	Fashion design	Brand portfolio expansion
The Roux Tanneries SAS	100%	Leather production	Backward integration
Heng Long	51%	Crocodile leather production	Backward integration
Hôtel La Maison Blanche SA	100%	Hospitality and travels	Brand portfolio expansion
Hermès International	0,55% (reaching 20,2%)	Apparel and accessories	Strategic acquisition
ArteCad SA	100%	Swiss watch dials production	Backward integration
Bulgari SpA	100%	Watches and jewellery	Brand portfolio expansion
NUDE brands LTD	70%	Skin care	Brand portfolio expansion
Ole Henriksen of Denmark, Inc.	100%	Skin care	Brand portfolio expansion
Grands Magasins de la Samaritaine Maison Ernest Cognacq S.A.	41% (+55% acquired in 2001)	Department stores	Forward integration

Source: Capital IQ, 2020.

the business world, Le Parisien is a secondary investment and would have been better acquired by Arnault directly then by the conglomerate. Others argued that Paris and its newspaper are at the center of the luxury world and could be used by the group as an influential, networking and advertising channel (L'Express, 2015).

Only for twelve M&As LVMH decided to release numerical details such as price paid, deal size and financing details. Moreover, even though synergies were announced for almost all transactions they were never quantified, only explained. From the available data, five of the M&As completed were megadeals: Bulgari in 2011 (€ 3,7 bln); Loro Piana in 2013 (€ 2 bln), Grandville in 2017 (€ 6,5 bln), Belmont in 2018-2019 (€ 3 bln) and Tiffany in 2019-2021 (€ 14,3 bln). The remaining were deals of smaller or undefined dimensions.

### 3.3 M&As and value creation

#### 3.3.1 Short-term market performance

The analysis of total return to shareholders at announcement was computed considering all M&As completed and the Tiffany deal (only announced in the time period considered). While a few negative returns were ascertained, for about two thirds the excess return was positive (see next-page table 2.).

The excess returns were distributed between a top value of 10,33% and a lowest of -2,51%. An average ETRS of 1,48% and a median one of 0,87% were observed.

*Figure 6. Excess return to shareholders distribution*

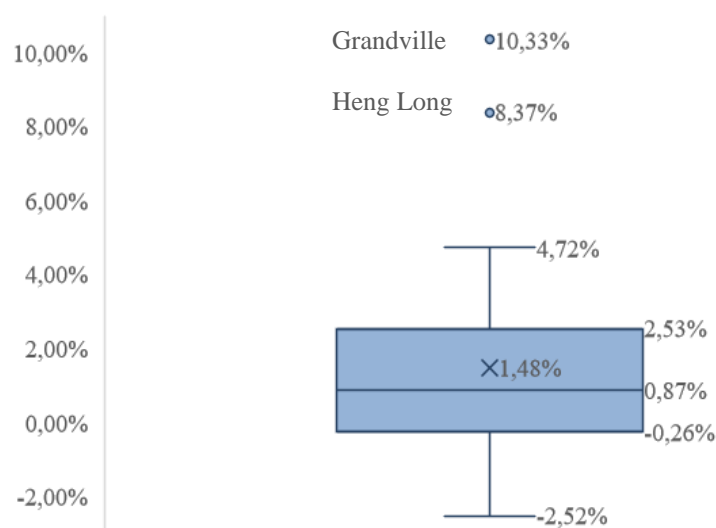


Table 2. LVMH's ETRS at announcement per M&A deal

Target	Announcement date	Price 2 days prior (€)	Price 2 days after (€)	Dividend (€)	Excess TRS at announcement
Masoni Industria Conciaria S.p.A.	23/12/2019	402,25	414,10		2,83%
Tiffany & Co.	28/10/2019	377,05	384,45		1,85%
Stella McCartney Ltd	15/07/2019	383,10	382,60		-0,24%
Repossi Diffusion SAM	22/05/2019	330,05	336,50		1,84%
Château du Galoupet	20/05/2019	341,20	336,30		-1,55%
Belmond Ltd.	14/12/2018	254,35	252,00		-1,03%
Colgin Cellars Inc.	21/11/2017	246,60	248,80		0,78%
Demibell S.A.C.I.F.I.	04/10/2017	233,25	230,40		-1,33%
Grandville SA	25/04/2017	206,90	225,90	2,6	10,33%
Parfum Francis Kurkdjian	20/03/2017	198,75	199,60		0,32%
Rimowa GmbH	04/10/2016	151,80	155,00		2,00%
Repossi Diffusion SAM	30/11/2015	159,10	158,45		-0,52%
Société Anonyme des Bains de Mer	25/07/2015	167,20	165,80		-0,95%
SNC Le Parisien Libere	27/05/2015	163,60	164,15		0,23%
Société du Domaine des Lambrays	14/04/2014	140,85	142,95	1,9	2,73%
Marco de Vincenzo S.R.L.	24/02/2014	137,15	135,15		-1,57%
Éditions Gallimard S.A.	30/10/2013	139,60	141,20		1,04%
JW Anderson Limited	25/09/2013	146,30	146,05		-0,28%
Nicholas Kirkwood Limited	20/09/2013	145,80	148,50		1,72%
Johnstone River Crocodile Farm	23/08/2013	139,15	135,80		-2,52%
Hotel Saint-Barth Isle de France	31/07/2013	134,45	140,65		4,50%
Loro Piana S.p.A.	08/07/2013	126,30	132,40		4,72%
Cova Montenapoleone s.r.l.	27/06/2013	122,00	127,35		4,28%
Société MHS SAS	20/02/2013	132,35	132,45		-0,03%
The Roux Tanneries SAS	03/05/2012	125,15	127,50		1,77%
Heng Long	07/10/2011	101,95	110,60		8,37%
Hôtel La Maison Blanche SA	30/12/2011	107,00	112,15		4,70%
Hermès International	20/12/2011	104,10	106,65		2,34%
ArteCad SA	10/11/2011	115,95	116,75		0,58%
Bulgari SpA	06/03/2011	112,95	114,30		1,09%
NUDE brands LTD	11/02/2011	118,05	118,05		-0,11%
Ole Henriksen of Denmark, Inc.	07/02/2011	116,90	118,05		0,87%
Grands Magasins de la Samaritaine	25/11/2010	116,80	117,05		0,10%
<b>Average excess TRS at announcement</b>					<b>1,48%</b>
<b>Median excess TRS at announcement</b>					<b>0,87%</b>

The considerable difference between the average and median values is attributable to the fluctuations that were present in the data and affected only the former. In particular, the presence of two extremely positive outliers helped driving the average ETRS at announcement upward but did not affect the median one.

The two outliers that outperformed greatly all of the other transactions were Grandville and Heng Long. They experienced an excess return of 10,33% and 8,37% respectively. The next paragraph analyses their drivers and characteristics in more detail.

Having invested heavily to open shops around the world, notably in emerging markets, luxury leaders had been competing to control the supply lines behind their sales. In this environment, they had been racing to lock in rare skills as well as raw materials and ingredients vital to their brands' survival (Wendlandt, 2013). Already in 2011, LVMH realized the need to have guaranteed a steady supply of exotic reptile skins to continue creating limited edition or custom-made handbags and accessories as part of its long-term strategy. Heng Long, one of the top five firms dealing with crocodile leather worldwide, was acquired to satisfy this need. The market positively reacted to this M&A, which resulted in a high return at announcement. It is possible that the sizable return was partly due to the perfect timing of the acquisition. In fact, the transaction was announced in 2011, during the early stages of the run for raw materials. In 2013 (just one and a half years later), crocodile farm owners stated that they had been approached by many foreign investors wanting to purchase their business (Kim et al., 2013). The higher demand might have raised the acquisitions prices, making the M&As less profitable. This would be confirmed considering that the acquisition of Johnstone River Crocodile Farm (2013) during the hype of the "skin frenzy" period experienced a -2,52% of excess TRS at announcement. Additionally, just a couple of years after the acquisition of the farm, PETA (People for Ethical Treatment of Animal, 2016) published an exposé on the cruelties inflicted by the luxury industry on exotic animals raised for their skin, showing that maybe the general opinion on the matter had turned more animal friendly.

Grandville's acquisition is peculiar because it is part of a re-organization of the Arnault family group (major LVMH shareholder) in an attempt to increase its value by simplifying its structure. Part of Arnault strategy involved the addition of Grandville and its subsidiary Cristian Dior Couture (often referred to as the Cristian Dior Couture Branch) to LVMH portfolio. The move, which was considered an important milestone in LVMH history, was made to strengthen the Fashion and Leather division. In fact, the target is an iconic fashion house and one of the

most prestigious brands worldwide, counting on an unparalleled position within the luxury industry. As LVMH, the couture house has a global network of directly operated stores that ensures comprehensive control over distribution and brand image. The company had high growing prospects, with revenues doubling between 2011-2016 (pre-acquisition) and investments in place to accelerate its growth in non-European markets, and possessed unique strategic assets such as real estate in Paris, London, Tokyo and Seoul. The transaction was also a way to strategically re-group the entire Cristian Dior brand within LVMH, which already owned Cristian Dior Parfums. The deal was positively viewed by various analysts. The presence of a common major shareholder between target and bidder ensured the agreement was beneficial for both parties. Moreover, such a strong board connection allowed to avoid any issues in term of trust and communication between the two firms involved and as literature has proven also provides greater announcement returns. Financially, the deal was accretive from the first year, with an expected increase in earnings per share of 2,7%. Moreover, the vendor loan raised had a maximum maturity of 24 months, allowing time and flexibility for refinancing, and limited impact on the financial structure of the firm as the (gearing ratio post transaction was expected to be 35%). According to Unicredit and S&P, the transaction strengthened the business-risk profile of the Fashion and Leather segment and was a source of improved cash flow to the conglomerate. In conclusion, the market strongly believed in the success of the deal, in fact, on the day of the announcement LVMH share price experienced a boost of +11,09% leading to the highest return at announcement (Crivelli, 2017; Unicredit, 2017; LVMH, 2017; Serafino et al., 2017).

Overall, the excess TRS is significant and positive, but not remarkable (with the exception of the two previously exposed acquisitions). In fact, the average return is in line with the one presented by other literature studies analysing M&As' market performance around announcement date (Aktas et al., 2009). This is of course a good outcome and it sheds light on the ability of the Group to generate positive short term excess returns. In fact, on average investors recognized the value created by the transactions undertaken and steered an increase in the Group share price.

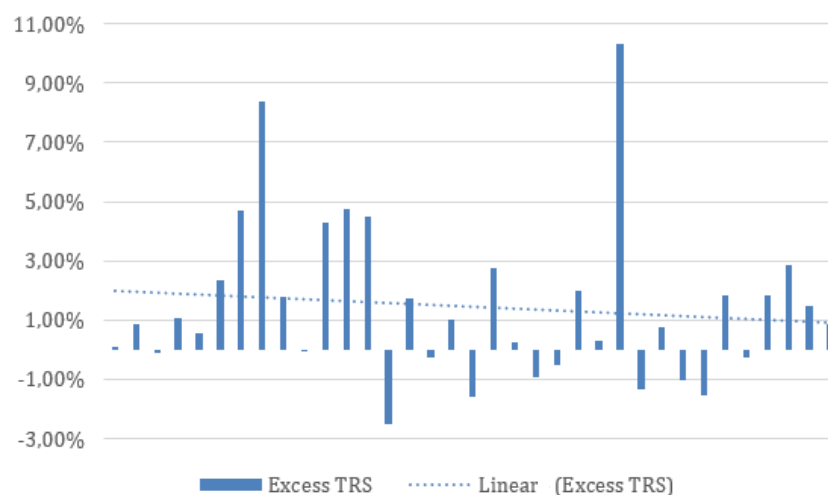
Considering that the period studied is very brief the results obtained within such a short timeframe can be deemed substantially profitable. However, it is surprising that LVMH, the luxury market leader and the first organization in the industry that decided to build itself as a conglomerate, did not raise higher confidence in its deals by the market and the investors. The

Group made wide use of mergers and acquisitions through the last thirty years of the organization's history, during which it was able to transform itself from a small company involved in spirits and apparels into the largest luxury house. It would therefore be expected that the accumulated experience and the developed capability to manage acquisitions would appease investors allowing them to feel secure when valuing the firm's transactions favourably.

Recent literature states that companies that regularly and systematically pursue moderately sized M&A deliver better long-term TRS with respect to any other approach (Rudnicki et al., 2019). Similarly, innovative studies focusing on short-term performance have rejected the previously accepted belief that associated serial acquisitions to negative returns bringing forward the notion that companies making repetitive deals are able to gain either significant positive or insignificant abnormal return at announcement (Aktas et al., 2009; Galpin, 2014). However, in doing so they discovered that short-term returns for serial acquirers decline from deal to deal both at firm and CEO level. While most researchers explained this phenomenon through CEO hubris and overpayment, according to Aktas et. al. (2009) rational managers able to learn from deal to deal are actually the most effected. In fact, economically motivated risk averse rational CEOs who learn from investor reactions to past deal announcements and are more accurate their forecasting abilities, bid more aggressively over time. This behaviour leads to higher acquisition prices that are at the same time the cause of a reduction in the time between successive acquisitions but also of a lower return.

The following figure presents the excess TRS earned by LVMH per deal in chronological order. It is possible to notice how the tendency line is actually declining depicting a reduction

*Figure 7. ETRS' decreasing trend*



of excess return over time. This is in accordance with the exposed theory and could explain why a firm such as LVMH that has a steady experience in securing and carrying out M&As as well as a solid acquisition strategy was not able to obtain more outstanding returns for its shareholders.

Even though during the period considered the outcomes yielded are satisfactory, this empirically ascertained trend could lead to issues in the future if not reversed.

#### *3.3.1.1 M&A strategy and market performance*

In term of strategy pursued, backward integration gave mixed results creating value at announcement only for some of the firms involved. It yielded the widest return distribution among all the strategies, even compared to portfolio expansion that counted on a much larger number of M&As and would therefore be expected to be more dispersed. Nonetheless, the average result for this strategy was quite satisfying and was only topped by the strategic acquisition method and the successful combination of backward integration and portfolio expansion in the Loro Piana transaction.

One of the most selected M&A method by LVMH has been the acquisitions of new brands to add to its portfolio. However, it was not blessed with the best performance in term of value creation at announcement. For instance, a large part of the returns obtained through this strategy were zero or negative (see Stella McCartney, Demibell, Marco de Vincenzo and so on) and only about half of the transactions yielded a positive return in excess of cost of equity. This outcome, which may seem appalling, is actually in agreement with the theory that at announcement markets favour cost-reduction synergies with respect to revenue-enhancing ones. It is important to keep in mind that this does not mean that the strategy is ineffective, but only that it is not the best from an announcement performance point of view.

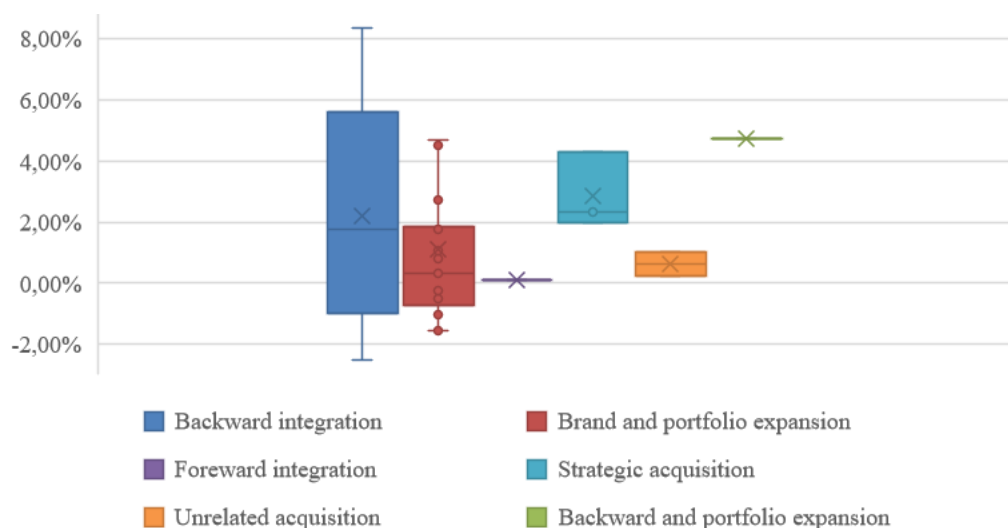
With the exception of the Loro Piana deal, strategic transactions (Hermès, Rimowa and Cova Montenapoleone) were the ones that achieved best performances, earning TRS well above the average short-term return. These M&As satisfied specific needs in term of increasing control over key competitors (in the case of Hermès) or gaining access to a complementary products (Rimowa and Cova). For the latter the main objective of the acquisitions has been the ability to cross sell the new brands with already established products. For instance, Cova Montenapoleone is an historical café and patisserie in the centre of Milan fashion hub and one of the most expensive shopping throughfares, favoured destination for Asian tourists. So, LVMH acquired not only a brand, but also an essential real estate and a window through which it could advertise its own wares (Sanderson, 2013). Similarly, the addition of Rimowa's high

quality suitcases to the Group's portfolio allowed it to offer a complete range of services related to the hospitality sector. The typical LVMH tourist can travel to one of its hotels, shop at its many flagship stores and buy a new travel bag to bring home the results of his shopping spree all within LVMH array of brands. The market showed more interest in these well thought strategic M&A with respect to the simple addition of another hotel or fashion label and has rewarded them with significant short-term excess returns: 2,34%; 4,28% and 2,00% for Hermès, Cova and Rimowa respectively.

As expected, the two unrelated acquisitions belonging to the publishing industry had both results below the average. Not pertaining to the usual LVMH *modus operandi* regarding acquisitions, their deals lack of fundamental key success factors that conglomerates normally ensure to exploit. Both of the targets were French companies (domestic acquisitions, often associated with lower announcement returns) with no previous relation with LVMH and nurturing dissimilar cultures.

Similarly, the forward integration was not met by a very accepting market and showed the worst average return among all the strategies employed. In fact, it earned only a slightly positive return of 0,1% of excess return. It is possible that investors were more hesitant in evaluating a deal seemingly out of scope of the normal LVMH sought out acquisitions. While the absence of detailed and quantitative synergy announcement may have generally hurt LVMH short term deal returns, this is especially true for La Samaritaine. In fact, more information to investors might have allowed the market a better understanding of the conglomerate plan leading to an higher announcement return.

*Figure 8. ETRS per strategy*





Domestic and cross-country deals were divided<sup>2</sup> and their results were compared. Differently from the predominant literature theory, which considers foreign targets' acquisitions more profitable at announcement, in LVMH case the opposite was true. In fact, domestic deals had a better average short-term return with respect to cross country deals (1,75% versus 1,28%), even though showing a larger interquartile range of distribution. This is unexpected. In fact, cross-country M&As are facilitated by the Group's M&A process which is characterized by similar-cultured targets and partial integration, as subsidiaries tends to operate on an almost independent fashion. These factors limit the risk of cultural clash and failed communication that are often typical of dealing with foreign targets. It is possible however that these positive features will have a more significant impact on the medium or long-term as they are more pertinent to the latest phases of the M&A process.

In the first chapter it was shown that the decade has been characterized by a surge in mega deals, whose performance improved enormously post-2009 with the average acquirer earning a considerable announcement return. The findings connected to the LVMH case go beyond that by showing that there is a significant discrepancy between the announcement excess TRS yielded by megadeals with respect to smaller or undefined ones, with the results being in favour of the former. In fact, LVMH's megadeals experienced on average a 3,39% of short-term ETRS while smaller deals yielded only a 1,17% excess return, accounting for a 2,2% differential.

### *3.3.1.2 Overpayment*

The literature describes overpayment as one of the main causes of failed mergers and acquisitions. It is however difficult to analyse overpayment for the LVMH case. Firstly, the conglomerate, and in general the luxury industry, acquires mostly private firms. So, pre-acquisitions data on the targets are mostly lacking. Moreover, the prices paid to complete the transactions are often not disclosed by the bidder that prefers to avoid divulging the details of the deals made.

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<sup>2</sup> Cross country transactions were: Masoni Industria Conciaria; Johnstone River Crocodile Farm; Heng Long; ArteCad; Tiffany; Stella McCartney; Repossi Diffusion; Colgin Cellars; Demibell; Repossi Diffusion; Marco de Vincenzo; JW Anderson; Nicholas Kirkwood; Bulgari; NUDE brands; Ole Henriksen of Denmark; Loro Piana; Rimowa and Cova Montenapoleone.

Domestic deals were: The Roux Tanneries; Château du Galoupet; Belmond; Société Anonyme des Bains de Mer; Société du Domaine des Lambrays; Hotel Saint-Barth Isle de France; Société MHS; Hôtel La Maison Blanche; Grandville; Grands Magasins de la Samaritaine; Hermès; SNC Le Parisien Libere; Éditions Gallimard and Parfum Francis Kurkdjian.

Only in a few selected cases there was the availability of the necessary information to determine whether LVMH overpaid for its targets: Bulgari, Loro Piana and Tiffany. (A few years passed between the initial agreement and the closing of the Tiffany deal, during which the price was re-discussed. For this reason, the analysis is computed twice considering the price paid firstly as to be the one the firms initially agreed on, which was communicated to the public at deal announcement, and then as the definite one actually paid). Prior to the acquisition, Bulgari and Tiffany were public firm. Hence, their premiums are computed considering their fair value to be reflected in the share price. Different premia were found when comparing the price paid to the share price one day, one week and one month prior to the announcement.

*Table 3. Premiums*

Target	Price paid	Premium – one day prior	Premium – one week prior	Premium – one month prior
Tiffany (first)	\$ 120	21,8%	34,0%	30,6%
Tiffany (last)	\$ 131,5	33,4%	46,8%	43,1%
Bulgari	€ 12,25	59,0%	58,9%	60,3%

Source: Capital IQ, 2020.

Instead, Loro Piana was private so the premium could not be computed analysing the share prices, but it was possible to look at the reports available on the transaction. Out of the € 1.987 mln paid by LVMH for the acquisition only € 940 mln were considered as net assets belonging to the controlling interests (only 80% was purchased), while the remainder € 1.047 mln was attributed to goodwill. That is an unproportionate and much larger sum than the € 9 mln attributed to the non-controlling interests at consolidation. Moreover, the fair value recognized by experts to the 20% that stayed in the hand of the original entrepreneurs was € 244 mln, less than half of the value that would have originated from the proportional attribution of the price paid to the non-controlling interests, hinting at a substantial premium paid by LVMH. In fact, only 49% of the charge transferred to initial owners covered the fair value of the net assets acquired, the residual 51% was a premium.

In all three of the cases analysed, the actual premiums paid have been significant. They ranged from a low of 43,1% for Tiffany to a heigh of 60,3% for Bulgari (considering share prices one month prior to the deal announcement date). Loro Piana with its 51% paid on top of fair value of net assets was situated in the middle. The decrease in premium paid throughout the years would suggest that LVMH has been increasingly sensitive to the extra amount used

in mergers and acquisitions. There is no clear connection between the premium paid and the value obtained in the short term, but considering the limited number of elements available for the evaluation that is not surprising. Bulgari, which had the largest premium, was assigned the lowest return (below the average announcement return). Tiffany with its lower premium fared better in term of TRS. However, it didn't match the over 4% short term return of Loro Piana regardless of the higher premium paid by the latter.

To sum up, aside from a couple of exceptional cases LVMH did not experienced extremely high short-term return. However, most of its results are significantly positive, a fact that was confirmed by a 1,48% of average excess return. Looking at target origin, domestic acquisitions earned better returns with respect to cross-country M&As, a fact that was in disagreement with the literature. Among the type of M&A, the union of backward integration and portfolio expansion that was pursued with Loro Piana as well as strategic M&As aiming for product complementarity were the most profitable from an announcement point of view.

### 3.3.2 Long-term market performance

So far it was shown that the market responded positively to the announcement of the mergers and acquisitions undertook by LVMH. This section tries to assess whether the M&A strategy employed was successful also in the long-run and whether the firm was able to create value.

*Table 4. Long-term ETRS and value created*

	2010-2019	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Price per share at year-end (€)		78,38	123,35	109,40	137,80	132,60	132,25	147,15	181,40	245,40	258,20	414,2
Dividends per share (€)			2,10	2,60	2,90	3,10	3,20	3,55	4,00	5,00	6,00	4,80
Return to shareholders	21%		60%	-9%	29%	-2%	2%	14%	26%	38%	8%	62%
ETRS on cost of equity	14%		53%	-16%	22%	-8%	-5%	7%	19%	31%	1%	56%
ETRS on MSCI luxury goods index	5%		6%	3%	-9%	-23%	15%	17%	12%	-4%	16%	21%
Value created (TRS) (€Bln)	205											
Value created (ETRS in Ke) (€Bln)	97											
Value created (ETRS on MSCI) (€Bln)	21											

The price of LVMH shares increased more than five times within the end of 2009 and 2019, a positive result for the conglomerate.

While in the first part of the decade share values experienced more fluctuations, which caused the price to suffer slight drops for a few years (mainly 2011 and 2013), during the last period growth has been positive and increasing. In fact, LVMH share price faced a steep rise between fiscal year 2018 and 2019, when it moved from a value of € 258,2 to a final one of €

414,2. Following this pattern, annual return to shareholders have been mostly positive, with the exception of years 2011 and 2013 where slightly negative values were found (-9% and -2% respectively).

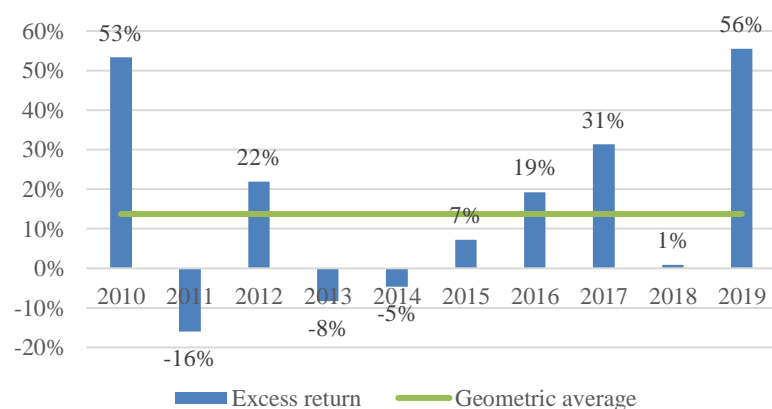
Overall, the success of the intertwined use of organic growth and significant M&As efforts has been recognized by the market and its investors. In fact, the strategy used by LVMH was rewarded with excellent results in term both arithmetic and geometric average return to shareholders, 23% and 21% respectively. Not only the compounded annual growth rate is extremely high, but once that is accounted in relation to the large LVMH's market capitalization, then value creation is outstanding. Between the beginning of 2010 and the end of 2019 the Group was able to raise € 205 bln in value for its shareholders.

### 3.3.2.1 ETRS on cost of equity

From a shareholder perspective, investing in LVMH has given very positive results. In fact, for the large majority of the years considered the conglomerate was able not only to compensate investors for the ownership risk undertaken, but also to yield a significant return on top.

Over the years, ETRS values varied from a low of -16% in 2011 to a high of 56% in 2019. The exceptional growth of 2010 and 2019 was slightly dampened by the reduction of cost of equity, but still resulted in exceptionally excellent excess returns for the investors, namely 53% and 56% respectively. Throughout the remaining years the measure experienced mostly favourable and often double-digit results, with a few exceptions. In 2011 and 2013 negative return to shareholders were only worsened when considering ETRS, instead, in 2014 the moderate annual return to shareholders obtained was not able to fully offset ownership risk leading to a slightly negative ETRS.

*Figure 9. ETRS - Excess on cost of equity*



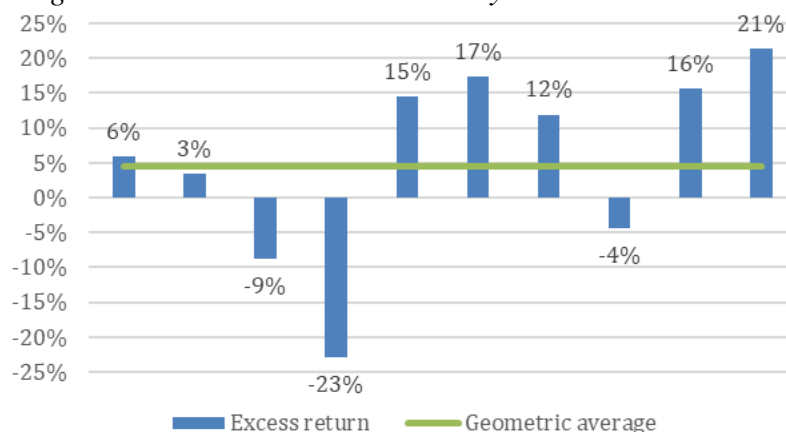
Average ETRS of 16% (arithmetic) and 14% (geometric) were computed, showing that even though some occasional undesirable annual excess returns were obtained the positive values more than overcome them on a ten years' time frame. It is impressive for LVMH to obtain such a high average ETRS, which determines the Group as a significantly profitable investment from a shareholder point of view. In fact, over the long-term stockholders are not only assured the base return to compensate for the investment risk undertaken, but were also attributed a 14% additional return on top of it. When TRS in excess of cost of equity is taken into account as a measure for value creation it is possible to show that LVMH generated € 97 bln within the ten years considered, a demonstration of the successful implementation of a pertinent, powerful and efficient strategy.

### 3.3.2.2 ETRS on MSCI luxury goods index

Over the period analysed ETRS on MSCI experienced mostly positive results, various of which were double-digit, indicating favourable long-term accomplishments and an overall industry overperformance.

In particular, ETRS fluctuated between a low -23% in 2013, when the Group performed poorly regardless of favourable industry conditions, and a top value of 21% in 2019.

Figure 10. ETRS - Excess on industry index



2013 was a significantly bad year for the conglomerate performance. Not only returns to shareholders was negative but it also suffered the highest discrepancy with respect to the index, which earned an extremely positive return. During the first part of the year LVMH share prices moved in synchrony with the upward trend of the market thanks to the improvement of the economic situation, especially in Europe. However, in the last quarter slowdown in the Chinese economy led to a dramatic reduction in the conglomerate's share price. Moreover, earnings

remained stable facing a 0% growth and the effects of the multiple M&As performed during the same year were not yet observed in revenue generation. As a consequence, ETRS suffered its highest drop (the only negative result apart from a -9% excess return in 2012 and a -4% in 2017).

Oppositely, the poor return to shareholders of 2011 was connected with unfavourable industry conditions and general decreases in share prices due to the effect of the economic uncertainty on the markets. Nonetheless, LVMH reported slightly better results than the MSCI Europe Textiles, Apparel and Luxury Goods Index demonstrating the ability of the conglomerate to raise above the negative performance of the average firm in the industry. While the changes in consolidation that were enacted from the beginning of 2009 contributed negatively (-0,4%) to the rise in revenues of fiscal year 2010 (only slightly dampening its excellent results), in 2011 the consolidation efforts drove a 4% revenue increment. Seemingly, the consolidation of the jewellery branch, cosmetic sector and LVMH only forward integration had positive results and may have helped in gaining the results that outperformed the index at a time of adverse industry conditions.

By comparing annual returns with the MSCI ones it is clear that a significant part of the results attained by the conglomerate is attributable to general factors affecting the whole industry. Nonetheless, during most of the years considered LVMH return to shareholder was not only positive, but also outperformed the results achieved by the industry. This indicates that the overall growth strategy of the Group, which included mainly inorganic approach designed to simultaneously acquire new brands and grow them by building operational synergies, has been successful. It is actually rare for a company to implement efficiently such a strategy and many firms tend to opt for either organic development with rare use of M&As or less intense inorganic growth. Even a conglomerate like Kering which during the decade utilized both expansion method, did it by separating them in two different phases: the first characterized by M&As and the second focused solely on growth of its own brands.

Big corporations are often associated to struggles with innovation and more difficulties to growth, instead LVMH proved this theory wrong by not fearing new ideas and applying them to its firm fruitfully regardless of its large conglomerate structure. In particular, the Group's ability to anticipate, create and establish strategic trends in the industry to then carry them out in the most efficient way, has brought the Group at a superior position with respect to others in the luxury industry. Hence, ETRS on MSCI index averaged to a total of 5% of both arithmetic

and the geometric mean. Having a 5% average return for shareholders in excess of the one obtained by the MSCI Europe Textiles, Apparel and Luxury Goods Index is a sizable accomplishment for LVMH, especially if that is applied to its very large market capitalization. In fact, the conglomerate was able to raise € 21 bln of value in excess of the base one originated by the average luxury firm, which can definitely be considered an outstanding long-term market performance for LVMH.

In conclusion, the result secured by the conglomerate have been positive from a short-term perspective, but especially from a long term one. In fact, around announcement date the deals undertaken obtained moderate favourable results, possibly reduced by the payment of significant premiums. On the other hand, when given a larger time frame the firm was able to grow the brands it acquired thereby exploiting fully the benefits of the M&As completed. In fact, the ETRS earned (both with respect to industry TRS and cost of equity) was extremely good and confirmed that in the long run LVMH strategy brought both growth and profitability to the conglomerate and its shareholders. Particularly, the corporation was able to completely repay the ownership risk undertaken by shareholders investing in LVMH and earn them a 14% return on top of it. Moreover, through the decade the company considerably outperformed the industry, proving its leadership status within it was well earned.





## 4 Kering

### 4.1 Introduction to the case

In 2019, Kering was one of the leaders in the luxury industry, managing the development of a series of renowned Houses in Fashion, Leather Goods, Jewellery and Watches. Some examples are Gucci, Saint Laurent, Bottega Veneta, Balenciaga, Alexander McQueen, Brioni, Boucheron, Pomellato, DoDo, Qeelin, Ulysse Nardin, Girard-Perregaux, as well as Kering Eyewear. The group employed over 38 thousands workers and it raised nearly € 16 bln of revenues, € 5 bln of operating profits and € 2,3 bln of net income (Kering, 2020).

The company was founded in 1963 when François Pinault (father of the current CEO, François-Henri Pinault) established the Pinault group specializing in international trading of lumber and construction materials. In the 1990s, it acquired Compagnie Française d'Afrique occidentale (CFAO), specialized in the distribution of electrical material and in general trade with Africa, and the furniture retailer Conforama. Moreover, the group took over discs and books chain store Fnac and Au Printemps SA, owner of the Printemps department stores in Paris. These transactions made Kering (at the time named Pinault-Printemps-Redoute, PPR) a leader in retail distribution (Kering, 2020; Donzè, 2018).

The move into the luxury sector was not until the 1999 when the group acquired a 42% stake in the Italian firm Gucci, number which almost doubled within five years making Kering the 99,4% shareholder of what is still its primary brand. The cash provided to Gucci was used to build an international multi-brand luxury group through the acquisition of various companies: the French couturiers Yves-Saint-Laurent (1999) and Balenciaga (2001), the Italian shoemaker Sergio Rossi (1999), the French jeweller Boucheron (2000), the Swiss watch company Bedat & Co. (2000), the British fashion designers Alexander McQueen (2000) and Stella McCartney (2001), and the Italian leather goods manufacturer Bottega Veneta (2001). (Kering, 2019 and 2020; Donzè, 2018). While the sales of the luxury branch were only a small percentage of the total group sales they had much better results in term of profitability. As a consequence, Pinault decided to restructure the group refocusing it on luxury. The company disinvested from general distribution and used its funds to invest in a new Lifestyle and Sport division build by acquiring Puma (2007), Dobotex International (2009), Brandon (2009), Cobra (2010) and Volcom (2011). The redefinition of the group solely into the luxury industry was accompanied by the change of its name from PPR into Kering in 2013 (Harvard Business Review, 2014; Donzè, 2018).

## 4.2 Strategies and M&As

Differently from other firms that had mixed approaches, Kering focused its acquisition strategy on adding new brands to its portfolio through the acquisition of majority stakes. The process is based on the key assumption that a brand cannot cover all segments in terms of price or style, hence, the group chooses to follow multiple brands that complement, rather than compete with, one another. To be selected targets need to fulfil a clear mission within the acquirer and cover a distinct segment of the market. Similarly to LVMH, Kering offers to its target brands the possibility to grow organically and to scale thanks to the resources that it has at its disposal. An important part of the new firm growth resides in Kering helping it develop a retail strategy, so when a young brand joins Kering it gains access to a worldwide real estate team. The Group's employees have the know-how and the connections that small brands lack and can secure the best locations for flagship stores at the right prices. The stores are essential to a brand as they have the dual function of attracting customers and serving as advertisement. While each brand is completely in control of its sourcing strategy, supply chain and production, being part of a bigger company enables them to find new suppliers easily around the globe. Additionally, with its two product development centres, Kering is able to speed up product development for its brands. Lastly, the expansion strategy ensures that new brands' strategic and creative vision are aligned by assigning a strong CEO to complement the 360 degrees vision of the previous creative director, which is normally reconfirmed even after the M&A (Harvard Business Review, 2014).

Part of Kering's strategic process regarding mergers and acquisitions involves deciding whether to purchase its target directly or through its subsidiaries. When external growth opportunities are targeted bolt-on acquisitions that complement existing brands or product category as it is often the case, they are made by one of the Group's units. Instead, if the transaction is expected to involve assets that change the Group's configuration, the investment is made directly. For instance, the acquisition of Cobra Golf was done through Puma as an effort to reinforce the sports business performance and strengthening the growing success in the Golf category (Kering, 2010 and 2011).

In the timeframe considered, Kering acquisition strategy was split in two. The period between 2010 and 2014 was characterized by ample deal activity: fourteen firms were acquired and four were sold. During the next five years, the conglomerate implemented a strategy which was exactly the opposite. It opted to push for huge internal growth, deciding to make no

acquisitions at all and focusing mainly on China. Moreover, it dismissed brands which were deemed less relevant. Some of the disposals (in total four firms and two real estate properties) were the result of acquisitions in the previous decade such as Stella McCartney, and Puma. Volcom was purchased and sold in only eight years (2011-2019), its sale determining the end of the Sport & Lifestyle branch within the group.

*Table 5. Kering's mergers and acquisitions 2010-2019*

Target	Announcement Date	Closing Date	% acquisition	Business	Strategy
Ulysse Nardin	30/07/2014	01/11/2014	100%	Watches	Brand portfolio expansion
TMAP	19/11/2013	19/11/2013	51%	Apparel and accessories	Brand portfolio expansion
Altuzarra	06/09/2013	05/09/2013	Minority	Fashion design (womenswear)	Brand portfolio expansion
Pomellato	24/04/2013	05/07/2013	81%	Jewellery	Brand portfolio expansion
France Croco	25/05/2013	25/05/2013	Majority	Crocodile leather production	Backward integration
Christopher Kane Limited	14/01/2013	14/01/2013	51%	Fashion design	Brand portfolio expansion
Abbey Reinsurance	11/12/2012	11/12/2012	100%	Reinsurance	Unrelated acquisition
Qeelin Limited	12/10/2012	30/11/2012	Majority	Jewellery	Brand portfolio expansion
Wildlife Works Carbon	27/04/2012	27/04/2012	5%	Environmental services	Unrelated acquisition
Brioni	08/11/2011	11/01/2012	100%	Menswear	Brand portfolio expansion
Sowind Group	04/07/2011	24/11/2011	27,01% (up to 50,01%)	Watches	Brand portfolio expansion
Volcom	02/05/2011	22/06/2011	100%	Sportswear and accessories	Brand portfolio expansion
Wilderness Holdings Limited	08/04/2010	08/04/2010	20.1%	Ecotourism	Unrelated acquisition
Cobra Golf	10/03/2010	16/04/2010	100%	Sportswear and accessories	Brand portfolio expansion

Source: Capital IQ, 2020.

With the acquisition of Puma in 2007 Kering entered the sport market. In 2009, 18% of revenues and 23% of recurring operating income were originated by that single brand (Kering, 2011b). However, Puma was still lacking behind competitors such as Nike and Adidas. As a consequence, the following year the Group decided to further invest in the what became the Sport & Lifestyle division of the company. To that purpose, Puma purchased golf equipment brand Cobra Golf (2010) and Kering made a direct investment to acquire Costa Mesa surf-and-

skate brand Volcom (2011). Both of the US brands complemented Puma's offering in term of sport related products and clothing and opened up new horizons in the fields of golf and surf, skate and snowboard. Additionally, Volcom helped Puma in speeding up the development of its sportswear brand (Chang 2011). In just a couple of years the acquisitions made as well as the growth in the segment allowed the division to earn almost 40% of total Group's revenues (Kering, 2012). During the following years, however the division suffered from the high volatility of the sport market and faced difficulties in growing their sales levels. Only in the beginning of 2017 Puma's price peaked and sales faced a double-digit growth, showing a highly favourable outlook. Nonetheless, Kering decided to focus completely on becoming a pure luxury player, and, between 2017 and 2019, it sold both Puma and Volcom thereby putting an end to its Sport & Lifestyle division (Paton, 2018; Guyot et al., 2017).

In term of apparel and accessories, Kering introduced the Italian tailor Brioni in 2011 and participations in three designer brands, Christopher Kane, Altuzarra and Tomas Maier, in 2013. Brioni was a family-owned company that specialized in male formalwear. At the time the market for men's fashion was booming and, especially in Asia, males were the primary source of industry's growth. So, the major players looked-for men's-only stores. Albeit being in a good market, the brand not only faced difficulties in recovering from the economic downturn and competing with large conglomerates, but was also weakened by disputes between descendants of the founders. Kering, which did not own a top men's wear brand yet, did not waste the opportunity to snatch the company and add it to its portfolio (Passariello, 2011; Kering, 2011c; The Economist, 2011). The Group also felt the need to include in its product offering classic yet subtly daring designs by Scottish fashion designer Christopher Kane; subversive and fiercely feminine ready-to-wear by French- American Altuzarra and simple swimwear and knitwear by Tomas Maier (also creative director of Bottega Veneta from 2001). However, these designers did not have a long life within the conglomerate, in fact, Altuzarra is the only one still remains. While Tomas Maier closed its brand, Christopher Kane's was sold back to the designer after a 5-year partnership partly because the it did not experience significant growth after the acquisition (Chitrakorn, 2018). The decision to sell out some of the designers (among which we find also Stella McCartney) is part of a new strategy that allows Kering to focus its the most profitable brands (Muret, 2018).

The Watches divisions was furthered through the acquisitions of two important players in the industry: Sowind Group (2011), in which the Group's interest reached the control stake of

50,01%, and Ulysse Nardin (2014). The former controlled the established Swiss fine watchmaking manufacturer Girard-Perregaux and Swiss luxury watches pioneer JeanRichard, both of which have been included in Kering's brand portfolio. This acquisition helps position Kering's luxury group within the high-end watchmaking segment where it had not been present. Also, it allowed to form strong synergies with its high-end jeweller Boucheron and the leather goods houses Bottega Veneta and Gucci, as Sowind had already been collaborating with those brands before the transaction (Kolesnikov-Jessop, 2011). The latter not only possessed a very strong brand identity and an historical expertise, but it was one of the most innovative and independent watchmakers. Being a pioneer in new technologies and materials (such as silicon), ensured Ulysse Nardin was one of the few Swiss watchmakers that had in house know-how and capacity to produce its own components. In particular, the deployment of the numerous synergies linked to Ulysse Nardin's technical and industrial expertise and its excellent distribution network contributed to accelerate the growth of the whole division (Kering, 2014; Swissarma, 2016).

Kering increased its presence in the jewellery segment by adding to its portfolio of houses the Chinese Qeelin (2012) and the Italian Pomellato (2013). As the appetite for high-end products evolved in China, so did Kering need to satisfy more and more its Asian customers. Founded by a French expat and a Chinese designer, Qeelin blends French craftsmanship with inspiration from China. In a similar approach to Hermès's Shang Xia, Qeelin's product offering is infused with characteristics, symbols and meanings from the Chinese culture and therefore of more interest for its population (Week in China, 2012; Masidlover, 2012). Oppositely, the Pomellato group is a perfect representation of the Italian style. Its two brands Pomellato and Dodo rank among the most beautiful and innovative jewellery brands worldwide, while covering respectively the fine jewellery and the accessible jewellery segments (Kering, 2013). Both acquisitions, complementary to Kering's existing brand, aimed at extending and reinforcing the Group's position of luxury brands in the high growth jewellery market both in the Western and Eastern countries.

The purchase of France Croco during the "crocodile skin frenzy" was the only backward integration and served to secure its raw material supply. Additionally, three unrelated M&A were completed when reinsurance firm Abbey Reinsurance and minority stakes in Wildlife Works Carbon and Wilderness Holding Limited were bought.

## 4.3 M&As and value creation

### 4.3.1 Short-term market performance

Kering experienced positive results in term of return at announcement date, showing that the markets and its investors were confident in the deals undertaken by the company. Out of a total of fourteen M&As completed only one had a significantly negative return while the wide majority had TRS greater than 1%.

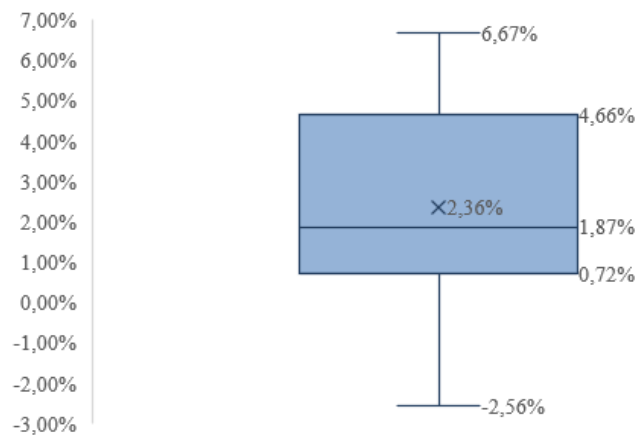
Differently from the previous case, Kering did not issue dividend within the period comprised between two days prior and two days after the announcement date for any of the carried out M&As, as such none was accounted for in the following calculations.

*Table 6. Kering's ETRS at announcement per M&A deal*

Target	Announcement date	Price 2 days prior (€)	Price 2 days after (€)	Excess TRS at announcement
Ulysse Nardin	30/07/2014	142,25	147,55	3,61%
TMAP	19/11/2013	150,48	152,48	1,21%
Altuzarra	06/09/2013	160,79	162,61	1,01%
Pomellato	24/04/2013	153,03	154,75	1,01%
France Croco	25/05/2013	161,77	157,82	-2,56%
Christopher Kane	14/01/2013	136,68	143,6	4,94%
Abbey Reinsurance	11/12/2012	131,98	131,98	-0,12%
Qilin Limited	12/10/2012	119,15	123,99	3,94%
Wildlife Works	27/04/2012	111,25	116,46	4,56%
Brioni	08/11/2011	121,11	116,55	-0,16%
Sowind Group	04/07/2011	114,14	115,58	1,14%
Volcom, Inc.	02/05/2011	112,28	119,9	6,67%
Wilderness Holding	08/04/2010	94,57	97,08	2,54%
Cobra Golf	10/03/2010	83,58	88,09	5,28%
<b>Average ETRS at announcement</b>				<b>2,36%</b>
<b>Median ETRS at announcement</b>				<b>1,87%</b>

Overall, an average excess return of 2,36% was observed along with a median value of 1,87% showing that from a short-term perspective the deals were generally very successful. However, the distribution was quite dispersed ranging from a lowest excess TRS of -2,56% for the acquisition of France Croco to a highest excess return of 6,67% belonging to the Volcom transaction. Also, the interquartile range was 3,94%, a fairly wide number considering that the mergers and acquisitions completed during the period studied were not so many. The discrepancy between mean and median values can be attributable to this volatility.

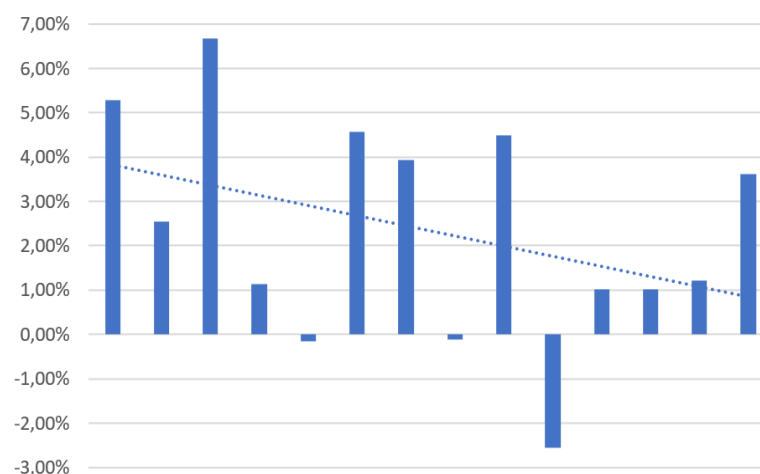
*Figure 11. Excess return to shareholders distribution*



By looking at the excess TRS achieved it is clear that the market was confident in the successful implementation of the deals pursued by Kering and awarded most of them with significant increase in share price around announcement date. Hence, the carefully planned use of mergers and acquisitions resulted in considerable value creation in the short-term.

Over the first five years Kering can be considered a frequent acquirer as it made extensive use of inorganic growth and M&As deals to build itself into a luxury conglomerate. Within this context, the Group was able to obtain higher announcement excess TRS with respect to the ones presented for the average serial acquirer by the literature. However, it was not immune to the obstacles affecting the category. While its results demonstrate great capability to generate value from the deal undertook, the value created for shareholders in term of excess TRS decreased over time.

*Figure 12. ETRS' decreasing trend*



Considering this, the choice made to pursue M&As intensely in the first five years to redefine itself in the market, whilst allowing for a period of organic growth next was wise. By doing so Kering avoided the decrease of short-term returns to shareholders to undesirable levels at the same time benefitting from a strong phase of acquisitions.

#### *4.3.1.1 M&As strategies and market performance*

The acquisition of new brands makes up for the majority of the M&As completed (ten). All of its deals targeted cross-country firms and required the investment in a majority interest (the only exception being a minority stake in Altuzarra). This specific type of transaction had very positive results and its average excess TRS outperformed the mean obtained by all of the M&As. In term of average return, brand portfolio expansion finds itself on second place below the environmental acquisitions, but much better positioned with respect to the backward integration and the unrelated acquisition. While the results obtained have been dispersed, it is noticeable that, except for a slightly negative return belonging to Brioni, all of them are above 0. As such, the broad distribution is only indicative of the fact that this strategy yielded various positive excess returns, some of which have reached significantly beneficial outcomes for Kering.

There is no clear pattern that characterises the performance of this strategy in a particular business (for example watches) as better than another (e.g. fashion). The only evident finding is that the market and its investors felt more optimistically when valuating mergers and acquisitions in Kering Sport & Lifestyle business. In fact, Cobra Golf and Volcom's excess TRS were the highest among all the transactions and amounted between two to three times of the general average return. At the time of the acquisitions Kering was slowly transitioning from retail to sport and luxury, though the latter was still a limited business within the conglomerate. Puma earned a significant part of the Group's revenues and an even higher share of operating profits. Moreover, it was the focus of a series of investments aiming to develop further the brand and its division. As a consequence, it is easy to understand why analysts might have been confident in the addition of new complementary brands from which significant synergies could have been drawn.

Even though they might be overlooked both because of the small share acquired and the different business in which they operate, the acquisitions of Wilderness Holding and especially Wildlife Works Carbon gave excellent results in term of excess TRS at announcement. Even though unrelated to Kering's main business, the transactions were part of an important social



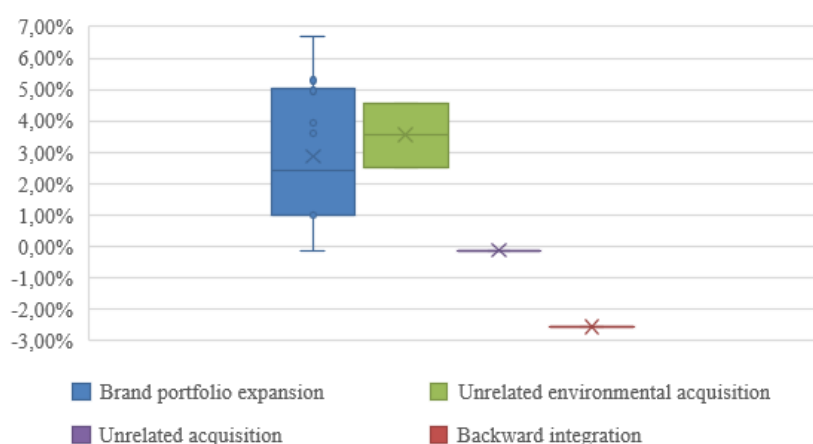
and environmental brand strategy. In fact, the conglomerate considers the promotion of sustainable designs and the reduction of environmental footprint one of its pillar: Care (the others being Collaboration and Create). The corporation is considered to be a pioneer in the introduction of sustainability initiatives in the luxury industry and Pinault considers operating on a more sustainable level across all business areas integral to Kering's business plan and to its longevity (Martin Roll, 2020). In accordance with the different function and aim they were expected to carry out, Kering decided to invest in minority stakes only in these specific instances. The move seems to have played out well since, the two environmental deals were very successful and displayed the highest average result when confronted with the other M&A strategies. Also, their performance exhibits a much smaller distribution with respect to the one achieved through brand portfolio expansion. However, it is hard to compare them since the latter's dispersion may be easily attributable to the larger number of transaction belonging to that approach. Nonetheless, it is undeniable that in the short-term environmental acquisitions have been well received by the market; the proof being that both deals earned excess returns above the average: 2,54% by Wilderness Holding Limited and 4,56% by Wildlife Works Carbon versus an overall average result of 2,36%. The outcomes obtained by these acquisitions confirmed the importance of taking a wider view when approaching value creation for which strong environmental, social and governance (ESG) proposition are essential.

It is crucial to notice that Kering's participation within Wildlife Works is not that of a simple passive shareholder, but it is actively involved in its ventures. Being aware of the negative ecological impact of the fashion and luxury industry, Kering actively tries to offset its greenhouse emissions. To this purpose, carbon credits were purchased from Wildlife Works' leading REDD offsetting project in Kenya (the first Voluntary Carbon Standard validated and verified Reduced Emissions from Deforestation and Degradation program). The program reduces greenhouse gas emissions by protecting threatened forests that are essential in mitigating climate change, improves the quality of life for local communities and conserves endangered wildlife. Moreover, Kering took on an active role in supporting Wildlife Works' aim to secure 5 mln hectares of native forest over the three years following the acquisition and to protect them for a minimum of twenty years with an expected 25 mln tonnes of CO<sub>2</sub> emissions mitigated annually. The voluntary carbon market was placed for growth and potential for return could exceed the original investment by multiple times (Kering, 2011a; Briancon, 2019). Pinault believes a sustainable business model provides competitive advantage, leads to value creation and fuels growth; at least in the short-run this acquisition proved him right.

The fully unrelated acquisition of Abbey Reinsurance was completely overlooked and did not cause any variation in Kering share price.

France Croco was the only deal that experienced important negative TRS result (with Brioni and Abbey Reinsurance showing only slightly negative excess returns). In terms of deal characteristics, it is clear that there are some substantial differences from all of the other mergers and acquisitions examined. In fact, only in this instance Kering chose to use a backward integration strategy and to target a domestic firm. Given the uniqueness of the case it is impossible to draw evident conclusion of whether these factors in general would be beneficial or detrimental to the short-term performance of a transaction. However, it is undeniable that they did not lead a satisfactory accomplishment for France Croco. While the transaction was crucial to secure raw materials and ensure the production of crocodile leather items, the market did not reward it on the short-term. It is possible that investors might have been diffident in front of a change in Kering's acquisition method. Also, it is noticeable how its purchase was made during the same period of LVMH's Johnstone River Crocodile Farm deal, which also had a similarly negative announcement return. Hence, it is likely that both transactions had been affected by onerous acquisition prices caused by being completed during the period of greatest demand for exotic skin farms and tanneries.

*Figure 13. ETRS per M&A strategy*



#### 4.3.1.2 Overpayment and communication

As for the LVMH case, it was difficult to determine the premia paid as the vast majority of the mergers and acquisitions examined did not disclosed financial information on the deal or the target. Only one public firm was acquired in the period considered and as a consequence was forthcoming with details on the transaction: Volcom.

Under the terms of the transaction, Kering made a cash tender offer to acquire all the shares and in the money options of Volcom for a price of \$ 24,5 per share. The consideration paid reflects a premium of 32,9% with respect to the target's share value one month before the deal was announced. While the premium evaluated is significant it is not extremely high. In fact, it is very close to the 30% average premium for corporate control described by the literature (Koller et al., 2015). Smaller premiums were found when shortening the time analysed to one week or one day.

*Table 7. Premium*

Target	Price paid	Price - one day prior	Price - one week prior	Price - one month prior	Premium - one day prior	Premium - one week prior	Premium - one month prior
Volcom	\$ 24,50	\$ 19,73	\$ 18,57	\$ 18,43	24,2%	31,9%	32,9%

Source: ADVFN, 2021.

The avoidance of extreme premiums and overpayment levels may be a factor that contributed to prevent the decrease in the short-term return of the transaction which in turn was rewarded with the highest results at announcement.

Additionally, the availability of more information on this deal with respect to all of the others might have been had a positive effect. It is important to notice that even though more facts were disclosed synergies were never shown from a quantitative point of view, but only briefly described. Offering the market a deeper understanding of the deal rationale might have helped further the announcement return and in particular the medium-term performance of the transaction.

All in all, the M&As completed have been profitable from a short-term point of view both individually, as only one deal experienced a significantly negative result, and collectively. The average excess return at announcement was 2,36% and it showed that Kering followed a successful strategy in pursuing its acquisitions. The vast majority of the transactions concerned the purchase of majority stakes in cross-country brands to be added to the Group's portfolio. Noticeably, the inclusion of minority stakes in companies offering eco-friendly services carried out as part of an environmental and social strategy were well received from the market. Oppositely, the only domestic backward integration did not perform well showing that skewing from the normally applied strategic approach to M&A is risky for Kering. The use of moderate premium and the disclosure of additional information paid out for the Volcom deal, but further

conclusions or generalisations on the matter cannot be drawn given the availability of similar data for other transactions.

### 4.3.2 Long-term market performance

Kering short-run performance was encouraging, however, as the literature often stresses that does not necessarily imply the achievement of successful results also on a longer term. The following section analyses Kering market returns throughout the years 2010-2019 and compares them with industry returns for the same period and equity costs.

*Table 8. Kering's ETRS and value creation*

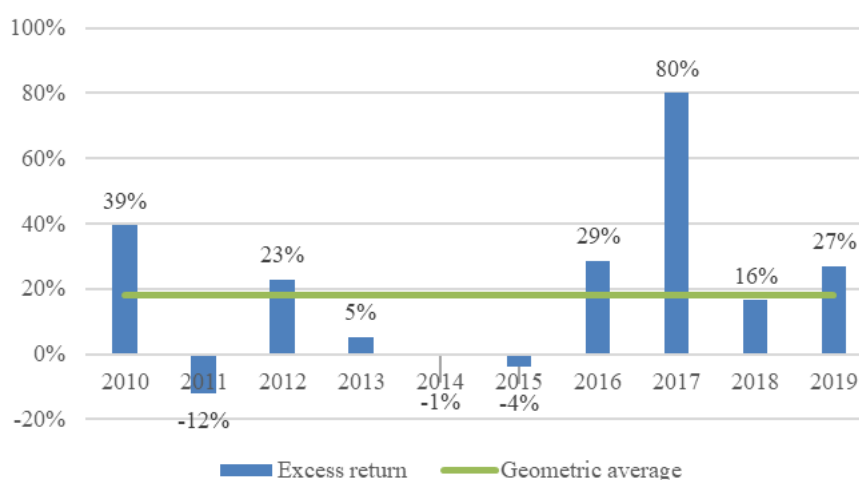
	2010-2019	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Price per share at year-end (€)		78,30	111,44	102,84	130,22	142,81	148,25	149,13	198,25	365,27	441,60	585,2
Dividends per share (€)			3,50	3,50	3,75	3,75	4,00	4,00	4,60	6,00	10,50	8,00
Return to shareholders	25%		47%	-5%	30%	13%	7%	3%	36%	87%	24%	34%
ETRS on cost of equity	18%		39%	-12%	23%	5%	-1%	-4%	29%	80%	16%	27%
ETRS on MSCI luxury goods index	9%		-7%	8%	-7%	-9%	19%	7%	22%	45%	32%	-7%
Value created (TRS) (€Bln)	85											
Value created (ETRS in Ke) (€Bln)	41											
Value created (ETRS on MSCI) (€Bln)	13											

The yearly returns obtained by Kering were mostly positive, but subject to intense fluctuations. Even though annual TRS fell below 0 only once in 2011, during the remaining years performance varied widely: between 2013 and 2015, low level of decreasing results culminated in the lowest positive TRS of 3%; oppositely, only a couple of years later, in 2017 the same measure peaked into the exceptionally high value of 87%. Unsurprisingly, Kering's share price and its movements had a major impact on the oscillations affecting the annual returns. In fact, the dividend paid out to the conglomerate's shareholders remained stable during the first part of the decade and its moderate increase in the following years was not comparable to the important growth experienced by price per share in the same period.

#### 4.3.2.1 TRS in excess of cost of equity

The average cost of equity subtracted to compute annual excess TRS was 7,34% (see appendix table 2). Since the same rate was applied to all of the years considered the resulting pattern is similar to the one highlighted by the annual return, only slightly reduced. As such, two additional negative returns were presented for years 2014 and 2015 in which cost of equity was greater than the return earned. Regardless, both figures are only marginally negative and yielded an excess TRS of -1% and -4% respectively.

Figure 14. ETRS - Excess on cost of equity



The only drastically adverse excess TRS (-12%) was found in 2011, where the already negative TRS was only worsened when decreased by the cost of equity. Instead, 2010 and 2017 had outstanding results earning them TRS in excess of equity costs of 39% and 80% respectively.

2017 was a record-breaking year for the conglomerate. Revenues increased by 25%, particularly in the Western Europe and Asia Pacific regions (Japan excluded), and recurring operating income grew by 56% with respect to the previous year (Kering, 2018).

Many of the action plans implemented during previous years yielded positive results in 2017. Since early 2015, Gucci undertook a major transformation programme to overhaul its creative drive, organisation and collections. The efforts paid out as just two years later the brand had an exceptional year marked by a revenue growth of 42%, demonstrating its to reinvent itself and rapidly return to the forefront of the luxury goods industry. Puma, under the direction of a new management team since 2013, continued to roll out its strategic plan aimed at renewing and streamlining its product line-up and refocusing its positioning around Sport Performance. Moreover, in 2017, Puma found itself in the perfect position to fully capitalise on the

partnerships and alliances it had entered or renewed in previous years, such as the ones with famous athletes and football clubs as well as the ones in the fashion world. The results of these initiatives had been apparent in the brand's robust top-line growth between 2014 and 2017, but only in the latter they were combined with significant profitability gains (Kering, 2018).

Definitely, part of the exceptional return achieved by the firm is due to factors that affected the industry as a whole. In fact, in 2017, the worldwide Luxury Goods picked up sharply, growing 5% after having contracted slightly in 2016. Moreover, in line with the gradual upward pattern observed during the course of 2016, spending by Chinese customers on Luxury Goods rose considerably in 2017, which lifted not only the domestic market, but also markets in tourist destinations. In addition, the year saw an acceleration of e-commerce as well as Millennials increasingly becoming customers of Luxury Goods brands and contributing to an overall 30% to the industry's revenue. However, not all players benefited from this dynamics. Performances across the sector varied widely, with some groups, in particular multi-brand groups as Kering, considerably outperforming mono-brand players.

It is possible to notice that the average industry result of 42% in 2017 makes up for only half of the total return achieved by the conglomerate which was 87% during the same year. As a consequence, not only Kering overperformed the average firm in the luxury industry but also more than doubled the return. As it was previously said, 2017 was outstanding for the Group not only when taken on its own, but also when compared to the market (see the next section for more details). In this instance, Kering was able to demonstrate the relevance of its strategy and multi-brand model.

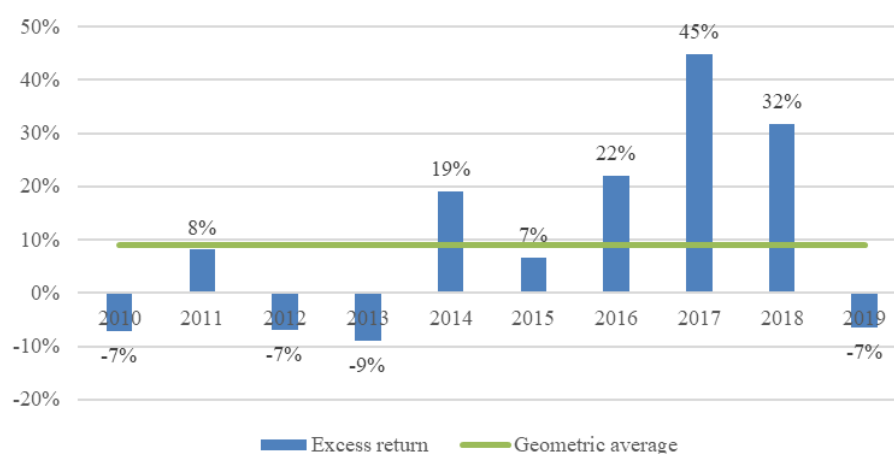
Overall, the TRS in excess of cost of equity was encouraging. In particular, the presence of a couple of very positive results in 2010 and 2017 more than balanced out the few undesirable returns obtained by Kering. As a consequence, the excess TRS was blessed with considerably high average values that amounted to 20% of arithmetic and 18% of geometric mean.

It is clear that the strategy utilized by the Group was extremely successful as it was able to compensate completely the cost of capital and ownership risks undertaken by shareholder at the same time earning them considerable returns on top of it. In fact, over the whole period analysed a cumulative excess return of 418% was obtained which accounted for more than € 41 bln in value creation.

#### 4.3.2.2 TRS in excess of MSCI

TRS in excess of cost of equity was subject to very wide fluctuations. Compared to it, returns to shareholders in excess of MSCI results were generally less dispersed, but displayed a lower value distribution. Kering fared very well for some of the years considered in which it significantly outperformed the average firm in the industry. For instance, 2014 and the period between 2016 and 2018 had industry excess TRS varying from a low of 19% to a highest value of 45%. However, out of the ten years analysed four presented an undesirable performance, with the same figure amounting to -7% in 2010, 2012, 2019 and -9% in 2013.

Figure 15. ETRS - Excess on industry index



2014 and 2018 were particularly exceptional not only because Kering outperformed the average industry results, but especially due to the different path taken by the two. During both years the market experienced negative growth that placed the average firm in the industry at a lower position with respect to the previous years. Instead, the conglomerate was able to rise above the negative trends and gain positive and in 2018 very high returns.

In 2014 the luxury industry saw a slowdown in growth, mainly due to weaker consumer spending on Luxury Goods in emerging markets and Western and Eastern Europe (D'Arpizio et al., 2015). Despite the overall market context, the Group's Luxury division achieved considerable sales growth in 2014 and was able to compensate the less upbeat results obtained by Sport & Lifestyle. This performance at the end of the M&A spree seem to highlight the strength and appeal of the Group's luxury brands as well as the success and complementary nature of the strategies put in place for each one in terms of positioning, product categories, distribution channels and geographic footprint. Overall, revenue generated by the Luxury Division totaled € 6.759 mln, up 6,0% on 2013. Regardless of the considerable number of new

brands acquired it is important to highlight that Gucci was still the main Kering revenue generator and contributed to 51,7% of total luxury sales (Kering, 2015).

Similarly, in 2018 the MSCI index scored a -8% showing how an average firm in the luxury business would have suffered throughout the year. Instead, Kering came out on top counting on significant growth in sales as well profitability improvements with respect to the previous year. In fact, the Group gained € 13.665 mln of revenues, up 26,3%, and recurring operating margin benefitted from an increase of 4%<sup>3</sup>. Throughout the year, Stella McCartney, Tomas Maier, Christopher Kane as well as the brands belonging to the Sport & Lifestyle divisions were sold in an effort to create a conglomerate completely focused on luxury. At the same time, the remaining brands continued their progress with individual and targeted strategies for growth. The result show clearly that the direction taken by Kering was a successful one.

Overall, TRS in excess of industry index was positive and accounted for an arithmetic mean of 10% and a geometric one of 9%. The outcomes show that on average Kering was able to outperform the industry and earn higher returns for its shareholders. This is an excellent result for the Group and positions the firm as one of the top value creators in the luxury industry. In fact throughout the period analysed, the organization yielded a cumulative excess return of 135%, which led to a creation of about € 13 bln of value to shareholders.

#### 4.3.2.3 *Measure's comparison*

The comparison between TRS in excess of cost of equity and Kering's return after the industry effect was removed gave peculiar results in various years considered. For instance, in 2010 Kering had one of the highest returns after of equity cost, but displayed a negative industry excess TRS. At that time, the average firm involved in luxury had exceptionally high results thanks to favourable market conditions and worldwide growth driven especially by Asian countries such as China (Fondazione Altagamma, 2010). Nonetheless, the conglomerate's result did not match the ones of its peers, but it was found to be underperforming. A similar discrepancy was experienced also in 2012, 2013 and 2019 even if with a smaller magnitude.

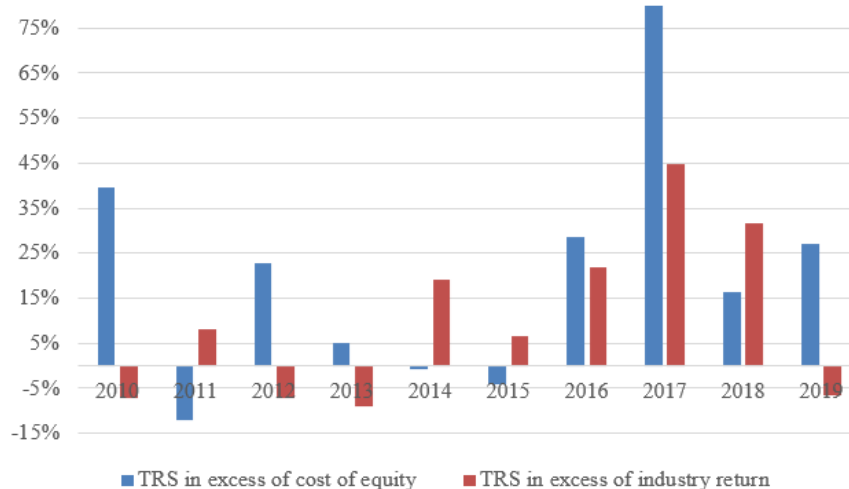
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<sup>3</sup> In 2018 PUMA, Stella McCartney, Volcom and Christopher Kane were sold, hence, their results were included within discontinued operations as per requirement of IFRS 5. So, strictly to allow a proper comparison between the years, data from 2017 were restated to account for figures from the same brands within discontinued operations. This operation was not completed on any graph or table above as their aim is to deliver precise yearly performance regardless of the Group's organizational structure.



Oppositely, during 2011 the Group was unable to obtain a return large enough to compensate the risks taken on by shareholders and experienced its lowest return in excess of equity costs. However, when its performance was compared to other firms in the market, it was superior. The same phenomenon was shown in the results from years 2014 and 2015.

*Figure 16. ETRS - Comparison*



While still showing significantly positive results, TRS in excess of industry return tampers down the picture perfect performance depicted by returns in excess of cost of equity. The former highlighted that while in some years the results accomplished might have been relevant, they were still less than the one obtained by the average industry firm.

Regardless, during the decade both measures of value creation earned outstanding results and indicated great capability of the firm to raise returns for its shareholders thanks to a solid growth strategy.

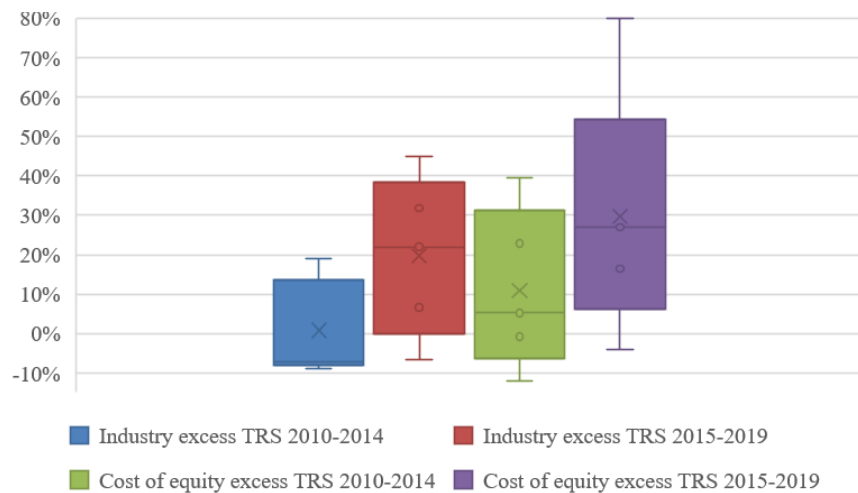
## 4.4 Considerations

It is important to notice that while so far all the results were considered and analyzed together, for the scope of this research it would be relevant to separate and comment on the differences experienced between the first and last five years. In fact, Kering's acquisition strategy was clearly separated into two phases. The first one lasted between 2010 and 2014 and involved actively buying luxury brands; the second one was comprised between 2015 and 2019 during which the Group decided to focus on the organic growth of their most promising labels. According to an interview released by Barron's, Pinault, recently named into Barron's 2019 list of the World's Best CEOs, stated that Kering did not need acquisition to grow. While having had the financial capability to seize opportunities if they presented themselves, Pinault argued

that the conglomerate already possessed many brands with great potential that needed investing to reach their next phase of development (Briancon, 2019).

A similar phase evaluation was not completed for the previous case as it presented a conglomerate, LVMH, that was continuously involved in M&A activity throughout all ten years without experiencing any gaps or breaks. In fact, its strategy involved the simultaneous research for new compatible target and growth of already acquired firm.

*Figure 17. Distribution of ETRS per phase*



The graph above shows the distribution of industry excess TRS as well as return in excess of cost of equity separating them in their two acquisition phases: 2010-2014 mergers and acquisitions; 2015-2019 solely organic growth.

It is clearly visible that for both measures of return the second period considered experienced a wider dispersion of results, not only in term of interquartile range but also when looking at the general value distribution. Most importantly, the outcomes pertaining to the second phases were able to obtain higher positioning in both methods of accounting for return.

As expected, the first two columns (the ones depicting TRS in excess of industry return) had lower results and less discrepancies between the phases with respect to the last two. This confirms what previously stated regarding a significant part of the return to shareholders as being affected by industry wide factors. Moreover, having removed any influence from the market industry excess returns are less prone to fluctuations.

Focusing exclusively on industry excess return it is noticeable that mean and median values are exceptionally improved in the period between 2015 and 2019 with respect to the first part of the decade. Precisely, their values amounted to 20% and 22% respectively within the organic

growth phase and only 1% and -7% during period of M&A activity in 2010-2014. Additionally, the former is mostly distributed above 0% with the full interquartile range being made up of positive values. Instead, the first five years are characterised by a significant presence of negative results as a substantial part of their IQR is positioned below zero.

The data above would suggest that, for Kering, focusing solely on internal growth has been a much better choice with respect to embarking on the path of M&As activity and, as such, hinting to the use of purely organic growth in its business plan. However, what these figures do not take into account is the business repositioning strategy that constitutes the underlying logic of the acquisitions made. In fact, it cannot be ignored that Kering was initially founded as a timber and building materials business, which afterwards successfully breached the retail market and only years later, at the beginning of the century, began its rise within the luxury sector. Hence, the period considered in this study has been crucial for Kering to shift completely into the luxury business and get rid of all the brands belonging to other industries. In fact, during 2010 only 27% of its revenues was originated from luxury an amount that increased up to 100% in 2019. While organic growth has undoubtedly given superior results, they would not have been achievable without the acquisitions made in the previous years. In conclusion, the shortened time-frame might conceal the value of the underlying strategy that characterized the M&A phase, which instead is incorporated when taking in consideration the full-time span of ten years.

It stands to say that, regardless of the general performance in the industry, having a stage that focused exclusively on growing the brands already present within its portfolio has helped Kering achieve a period of higher returns. Even if these results are undisputable for the conglomerate its conclusion cannot be extended to other cases. In fact, its peculiar history and, in particular, the recent shift into the luxury business makes it an exception with respect to its peers.

In conclusion, Kering implemented strategy was found to be successful. In fact, the returns experienced by the Group both in the short and long-term were outstanding.

Kering chose to acquire cross country targets focusing mostly on new brands to add to its portfolio in its effort to shift to a pure luxury conglomerate. These M&As as well as the purchase of a couple of firms involved in environmental services (part of a carefully planned social and environmental strategy) helped drive upward the excess TRS around announcement date, which averaged at 2,36%. Oppositely, both of the acquisitions falling outside this precise

modus operandi experienced negative returns showing how the market did not perceive the deals as to be value creators.

Positive performances were realized also when looking at a longer time frame. As a matter of fact, return in excess of cost of equity as well as TRS exceeding industry return showed positive results for most of the years considered and totalled geometric averages of 18% and 9% respectively. In particular, the period comprised between 2016 and 2018 had exceptional results thanks to favourable market conditions. Simultaneously, effective decision making and investments made in the previous years allowed Kering to rise on top of the average market performance.

While in term of industry excess TRS the Group fared much better when using solely organic growth (2015-2019), it is impossible to dismiss the M&As undergone as let-downs. In fact, they were essential for Kering to reposition as the pure luxury conglomerates everyone is nowadays familiar with.

## 5 Hermès

### 5.1 Introduction to the case

Thierry Hermès founded his namesake company in 1837 as a harness workshop in Paris. Originally, his intent was to serve the needs of European noblemen by providing saddles, bridles and other leather riding gear. During the interwar years, changes in lifestyle led to the need for innovation and Hermès leveraged its mastery of raw materials and its culture of craftsmanship to expand in other métiers. While remaining loyal to the equestrian world, the House started producing additional leather goods, such as belts and bags, and gained exclusive rights to the zipper that was used for luggage and clothing. Currently, the range of products under the Hermès brand name includes leather goods, lifestyle accessories, furniture, fragrances, watches, jewellery, ready-to-wear and saddlery. During 2019, the company operated mostly within the leather goods and saddlery category which contributed to half of the company's revenues; ready-to-wear and accessories followed by raising 23% of sales, and then silk and textiles with a 9%. The remaining product categories are still minor within the Group and made up for only 7% or less of the firm's revenues (Hermès, 2020; Martin Roll, 2020a).

Hermès is a well-known luxury goods manufacturer with an iconic brand. As of 2019, it employs 15.417 people worldwide and has 311 exclusive Hermès stores, 223 of which are directly operated. Its most important markets are Asia-Pacific, especially Japan which alone generated 13% of revenues, and Europe that generated 30% of sales (of which 13% only in France). Although it achieved international stature, the company has never lost its human touch and tradition. By offering its customers a combination of rich heritage, exquisite craftsmanship, eye for detail and high levels of quality through the entire manufacturing process, Hermès obtained a position of superiority in the competitive luxury sector. In fact, the company has been consistently ranked by leading consultancies among the most valuable luxury brands (Hermès, 2020; Martin Roll, 2020a).

The stellar performance of the brand throughout its 183-year history is largely credited to its drive for strategic consistency, combining excellent creativity with craftsmanship as well as an unrelenting focus on the long-term against short-term benefits. That culminated with exceptionally positive results in fiscal year 2019 when Hermès generated € 6,9 bln in sales, € 2,3 bln of operating income and a final figure of € 1,5 bln of consolidated net income (Hermès, 2020; Martin Roll, 2020a).

Hermès continues to assert its independence, which is one of the firm's strategic pillars, underpinned by a strong family-based shareholding structure. In fact, the House is still controlled by the founding household and its two co-chairmen are two cousins Axel Dumas, the actual CEO, and Pierre-Alexis Dumas, the creative director, that represent the six generation of the Hermès-Dumas family (Gebel, 2019). Hermès's long-lasting history, tradition and heritage are key factor that characterises it and affects many of its core features, differentiating it from its peers. In an interview to *Corriere della Sera* Mr. A. Dumas explained that Hermès' product rarity comes from the firm desire to manufacture as much as possible without sacrificing quality; to do so, every year the House hires four hundred new artisans. In that sense, he states that Hermès can be considered more an artisan company than a luxury maison (Montefiori, 2016). Furthermore, the controlling shareholders are still committed to their roots and have decided to retain most of the company's production in France. To that purpose, the Group is pursuing a sustainable, responsible and social value-based growth model, with commitment to regions where there is a high level of manufacturing savoir-faire to create quality jobs (Hermès, 2021).

## 5.2 Strategy: organic growth aided by collaborations

Hermès is not a conglomerate in the real sense of the word and does not own a portfolio of brands like its key competitors: LVMH, Kering and Richemont. Instead, it preferred to use a mix of organic growth and strategic collaborations (Martin Roll, 2020a).

Although LVMH, Kering and Richemont started out as small family firms like Hermès itself, throughout the years they used mergers and acquisitions to leverage their global presence and develop multi-sectoral brands to enhance their market power. Instead, Hermès chose a slower, organic growth strategy, preferring to develop new lines alongside the existing ones, but always under the umbrella of the original brand. As such, the House's approach revolves around two pillars: craftsmanship activities and exclusive distribution network.

The firm's less aggressive strategy did not lead to the sales volume enjoyed by the increasingly larger conglomerates typical of the top firms in the luxury sector. Nonetheless, it has enabled the company to retain control of the high value, integrity, and status of its brand, along with the loyalty of the customers who believe that its quality surpasses that of most others (Taplin, 2019).

A very strong and distinctive element of Hermès brand strategy is the concept of collaboration. In the continuation of a strategy that was adopted by the first generation of the founding family, the company regularly invites new artists, carefully selected by senior Hermès artistic directors, to design iconic products in the company's portfolio. Collaborations with designers are a mainstay of the House, whose objective is for both the designer and the brand to benefit from each other's reputations. Nowadays, collaborations are not only limited to scarfs as it was originally, but occur in all product categories and within portfolios (Gouveia, 2020).

Hermès has extended its reputation also by entering into strategic collaborations with labels outside the Hermès brand portfolio, specifically particular players and suppliers in the ultra-luxury segment (Gouveia, 2020; Martin Roll, 2020a). Generally, these endeavors may entailed the acquisition of a minority stake in the partner firm by Hermès, such as the case of the Maison Pierre Hardy, but they also may be simply partnership agreements between two firms aiming for the joined realization of new and innovative products.

A perfect example of a partnership seeking to produce innovative items is the one signed between Hermès and Apple in 2015 for their joint effort in a new collection called Apple Watch Hermès. Together the two brands were able to expand the definition of luxury by creating a smartwatch that mixes the groundbreaking technology of the Apple watch with the craftsmanship typical of Hermès. The mutually beneficial relationship allowed Apple to breach the luxury industry by positioning and marketing its product not only to high-tech savvy, but also to all of the affluent Hermès customers, normally after a more traditional touch. At the same time, the luxury House got access to a flagship product of one of the world's biggest companies, was able to re-design it freely, sell it in its own stores and benefit from the significant effort Apple put in its promotional campaign (Cook, 2015; Gouveia, 2020; Huen 2015; Passariello, 2015; Ritson, 2015). The collaboration was limited to the collection co-produced and did not require equity investments in the partner, so the brands remained completely independent from one another in all other instances.

Moreover, Hermès is not new to the use of joint ventures in its expansion strategy and has used them frequently (Malani, 2007). For instance, in 2010, the collaboration between the world-famous designer Jiang Qiong Er and Hermès led to the creation of the jointly own Shang Xia that proposes handicraft items with a strong component of Chinese design (AFP, 2010).

Additionally, at the beginning of the decade Hermès was trying to expand its home division by offering an increasingly wider range of products alongside its collection for the table and the

art of living. To do so, in 2011, it decided to collaborate with the Dedar. The Italian brand specializes in the production of high-end fabric and a key brand in the upholstery fabric and wallpaper sector, in which it controls international distribution. Thanks to the similar values and cultures shared by both firms, the House decided to employ a joint venture form of collaboration from which a newco, Faubourg, was born. Faubourg creates, manufactures and distributes wallpaper as well as décor and home fabric by mixing the high-quality Made in Italy manufacturing process ensured by Dedar and Hermès' design attentiveness. The joint venture allowed to increase the selling point to include not only the Group's boutiques, but also a net of specialized distributors contacted by Dedar (Barone, 2011; Fashion Magazine, 2011; Hermès, 2012 and 2014).

Hermès was not only interest in building collaborations for the design and creation of new luxury good, but it also aimed at strengthening its control on the chain of production. To that purpose, it decided to undertake a few strategic collaborations in which it actively invested in its partners. The acquisitions fell in a period when crisis-defying demand for luxury goods, coming mainly from Asia, had put pressure on production capacity of all of the major brands in the industry that responded by rushing to secure their supplies of raw materials. In addition, the House continuous strive to create flawless products led to the need for only the best suppliers, able to provide items of the highest quality. In fact, Hermès is infamous for burning its own bags if they presented even a minor imperfection. Within such a unsettled environment and severe requirement for superior raw materials, the Group, which bases about half of its revenues on leather goods and saddlery, felt like it could not afford any problem and preferred to incorporate a few of its suppliers (Leitch, 2012; Reuters, 2013).

Within the strategic choice to preserve and develop sources of supplies and know-how related to them, Hermès bought two of its calf leather suppliers: Tannery d'Annonay in 2013 and Tanneries du Puy in 2015 (at the time facing financial difficulties). Both companies, located respectively in the Rhône Valley and in the Auvergne-Rhône regions of France, supply high-end brands all over the world and export a large part of their production. Luxury brands require large-size hides of cowhide of consistent thickness, without stains or marks for their handbags and favour single-tone cowhide, which is easier to dye. Tannery d'Annonay and Tanneries du Puy serve this need. In fact, the brands are recognized worldwide for the quality of their expertise in cowhide and especially the "box" calf, one of Hermès' iconic materials used in the



fabrication of its Birkin and Kelly bags (AFP, 2015; Beyer, 2015; Guilbault, 2015; World Footwear, 2015; France info, 2013).

Moreover, in 2013 Hermès purchased 30% of J3L, a long-standing French supplier of the Group which specializes in the manufacture of metal parts destined principally for leather goods and fashion accessories. J3L was one of Hermès' key suppliers and it provided many essential pieces such as the steel lock for its famous Kelly handbag. In 2020, the integration of the company was completed when the Group acquired the remaining 70% equity interest and took the full control of the player (La Conceria, 2020; Hermès, 2014).

Furthermore, in the fiscal year 2014 Hermès proceeded to acquire 40% of Bettina. The latter, already a partner of the fashion House, focuses in the production of knitwear for the high-end luxury sector (with customers including Cartier and LVMH) and operates in various segments, such as ready-to-wear, silk and textiles and art of living. Of particular interest to the Group and the reason for such a strong collaboration is Bettina's twillaine, widely used in Hermès products and one of its distinctive features (Le Point, 2013; Hermès, 2015). While the percentage acquired does not guarantee Hermès direct control, it still allows it a certain sway in all of the decisions made. As a consequence, the Group is able to protect its interests and strengthen its relationship with Bettina, thereby ensuring continuous collaboration.

Last on the acquisition series and only one not concerned with vertical integration is the decision of Hermès to further strengthened the link between the Group and the designer Pierre Hardy. A creative collaboration allowed Mr. Hardy to designing various items for the luxury House, firstly shoes from 1990 and then also jewellery from 2001. Following their success Hermès named him creative director of shoes and jewellery. In the meantime Pierre Hardy founded its own company Maison Pierre Hardy in which he held the position of artistic director. The firm, which focuses on the design and production of shoes and fashion accessories for man and women, sells its products internationally through retailers, online and in its boutiques in Paris, Tokyo and New York. In July 2016, Hermès decided to seal the alliance between the two by acquiring a minority (33%) equity stake in the Maison. The agreement highlights Hermès' ambition to contribute to the label's global growth dynamic and confirms the close and prolific relationship that has developed over the years between Hermès and Mr. Hardy (Hermès, 2016a and 2017; Il Sole 24 Ore, 2016; Capital IQ, 2020; Bolelli, 2016)

In the previous paragraphs it was shown how Hermès does not use mergers and acquisitions as its base strategy for growth. Instead, it prefers to grow organically and sometimes uses

strategic partnerships and collaborations to boost innovation in its products or luxury concepts. In the few instances when M&As were actually used they were mostly undertaken to vertically integrate and have deeper control in the chain of production. In that case only backward integrations were used to secure high-quality supply of raw materials. No forward integration was employed confirming that the brand prefers to present itself in its own selling points as most of the Hermès stores are directly operated. All of the companies that were integrated (partly or fully) in the luxury House were domestic companies originated in France with the only exception of Bettina based in the Principality of Monaco. This falls into the Hermès-Dumas family desire to safeguard the excellence of local artisan and retain the Group's production in France. The totality of the transactions was made with private companies and no financial details were disclosed with the public. In fact, the company preferred to conclude its deals with the outmost confidentiality leading to the lack of significant information necessary for further analysis.

Only two out of the five acquisitions completed concerned firms in which Hermès bought a 100% equity stake. Instead, the Group seemed to favour minority investments pursued to strengthen relationship with its stakeholders and not to add new brands to its portfolio as its peers (e.g. LVMH). The M&As undertaken by Hermès' competitors lead to a post-acquisition independence of the target, which is offered resources from the acquiring group, but is allowed full creative and artistic liberty. On the other hand, Hermès strategy aims to build stronger connection and interdependencies with the companies acquired with the final objective of bettering and enhancing the original brand.

*Table 9. Hermès' mergers and acquisitions 2010-2019*

Target	Acquisition Date	% acquisition	Business	Strategy
Maison Pierre Hardy	13/07/2016	33%	Shoes and accessories	Creative collaboration
Tanneries du Puy	24/11/2015	100%	Cowhide	Backward integration
Bettina	2014	40%	Knitwear	Backward integration
J3L	2013	30%	Metal pieces for bags	Backward integration
Tannerie D'Annonay	10/01/2013	100%	Calf leather	Backward integration

Source: Capital IQ, 2020.

## 5.3 M&As and value creation

### 5.3.1 Short-term market performance

For Hermès specific case, the analysis of its short-term return is limited. Not only the deals made were rare, amounting to only five in the selected period, but for two of them the information regarding the date in which the contract was signed and the intended announcement was not disclosed.

The transactions with Bettina and J3L were only mentioned briefly in the Group's financial statement at the end of the fiscal year. As a consequence, it is impossible to compute a short-term return for such deals given no precise announcement date.

Since Hermès paid no dividend within two days prior to two days after the announcement date of any of the M&As considered, dividends were not accounted in the calculation of the short-term excess TRS.

The mergers and acquisitions studied presented sub-par announcement excess return that averaged at -0,02% with a median value of -0,20%.

The single positive result (1,04%) was achieved by the acquisition of Maison Pierre Hardy, which was the only minority M&A among the three selected and sole creative collaboration. Oppositely, both of the efforts made by Hermès to vertically integrate its supply chain by fully purchasing tanneries earned negative excess TRS at announcement, -0,20% and -0,78% for Tannery du Puy and D'Annonay respectively.

*Table 10. Hermès' ETRS at announcement per M&A deal*

Target	Announcement date	Price 2 days prior (€)	Price 2 days after (€)	Excess TRS at announcement
Maison Pierre Hardy	13/07/2016	344,50	348,30	1,04%
Tanneries du Puy	24/11/2015	331,30	330,85	-0,20%
Tannerie D'Annonay	10/01/2013	231,25	229,60	-0,78%
<b>Average excess TRS at announcement</b>				<b>0,02%</b>
<b>Median excess TRS at announcement</b>				<b>-0,20%</b>

Hermès main competitors and peers in the luxury industry built as conglomerates and used M&As to add new brands to their portfolios. The acquisition of Pierre Hardy's label by Hermès follows a similar path, even if the logic behind it was that of a creative collaboration and the strengthening of the bond with the designer. It is possible that investors felt more confident and rewarded this portfolio expansion with a higher return at announcement with respect to the other M&As because they already observed the profitability of such a strategy in other firms within

the industry. Similarly, the backward integration of suppliers has been a relevant part of the general industry strategy, but led to a smaller number of deal comparatively and mixed announcement returns. As such, the market might have been more sceptical when evaluating the same type of deal for Hermès leading to negative excess TRS.

Another reason that may have hindered Hermès short-term return causing them to be so unfavourable is that the Group decided to acquire only France-based companies. Traditional literature has shown that M&As involving domestic firms as their target tend to experience lower results with respect to cross-country deals. While this fact has not been confirmed for all of the cases previously examined in this study of the luxury industry it is still something that should be taken in consideration as a negative impact factor.

On the other hand, a study by Bruner (2014) demonstrated how deals that did not diversify but chose to focus on both activity and geography, such as the ones undertaken by Hermès, created value for the acquiring shareholders. Also, the establishment of conglomerates, common especially between 1965 and 1969 but a prevalent practice in the main player of the European luxury industry, has been widely criticized by the literature because of their negative effects on organizational structure and prompt problem-solving. On that note, a company such as Hermès whose sales derived mainly by leather goods, ready-to-wear and accessories and that undertook M&As with the objective of strengthening its core business should find itself with an advantage with respect to its competitors. However, the announcement results did not corroborate that and were found to be disappointing.

The market might have been wary about the relative inexperience of Hermès in undertaking mergers and acquisition and therefore penalized them. In addition, the refusal of the Group to disclose to the public any of the specifics regarding the transactions, such as price paid, payment method and in particular expected synergies, might have increased the hesitancy of the investors, hence reducing deal announcement profitability.

While the short-term returns evaluated do not paint a positive picture of Hermès M&A's profitability around the announcement date, that does not necessarily mean for the long-run results to be sub-par too, as many other factors tend to affect the latter.

### 5.3.2 Long-term market performance

Hermès experienced a positive long-term market performance and was able to create significant value for all of the measures analysed.

*Table 11. Hermès' ETRS and value creation*

	2010-2019	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Price per share at year-end (€)		93,31	157,55	230,35	223,80	263,50	294,80	314,50	390,00	446,25	484,80	666,2
Dividends per share (€)			1,50	7,00	2,50	2,70	7,95	3,35	3,75	9,10	4,55	4,55
Return to shareholders	23%		70%	51%	-2%	19%	15%	8%	25%	17%	10%	38%
ETRS on cost of equity	19%		66%	47%	-6%	15%	11%	4%	21%	13%	6%	34%
ETRS on MSCI luxury goods index	4%		16%	63%	-39%	-2%	27%	11%	11%	-26%	18%	-2%
Value created (TRS) (€Bln)	71											
Value created (ETRS in Ke) (€Bln)	48											
Value created (ETRS on MSCI) (€Bln)	5											

Since stock prices are significantly larger than dividends, the annual returns to shareholders tended to reflect their path, with only minor changes being caused by the latter. Hermès' price per share followed an upward direction and experienced significant growth throughout the whole decade moving from a starting point of approximately € 93 at the end of 2009 to a value of around € 666 at the end of 2019.

In particular, the outer fiscal years (2010, 2011 and 2019) were all affected by extreme increase in the Group's share price that rose more than 35% each period. As such, return to shareholders experienced its highest peak in 2010 (70%) followed by lower but still outstanding results in 2011 and 2019. Oppositely, the worst drop was obtained in 2012, only year in which annual return turned to a negative yield (-2%), due to adverse growth albeit small in its share price. The central part of the decade was more stable and faced an almost constant double digit growth in prices that was reflected in optimal return to shareholders.

Throughout the decade, TRS experienced a considerably positive performance that ended up generating a 23% compounded annual rate of return. When that was considered in relation to Hermès' market capitalization it was shown that the House was able to create € 71 bln of value from market performance for its shareholders.

#### *5.3.2.1 ETRS on cost of equity*

ETRS on cost of equity experienced significantly optimal results pointing out the potential of investing in Hermès' shares.

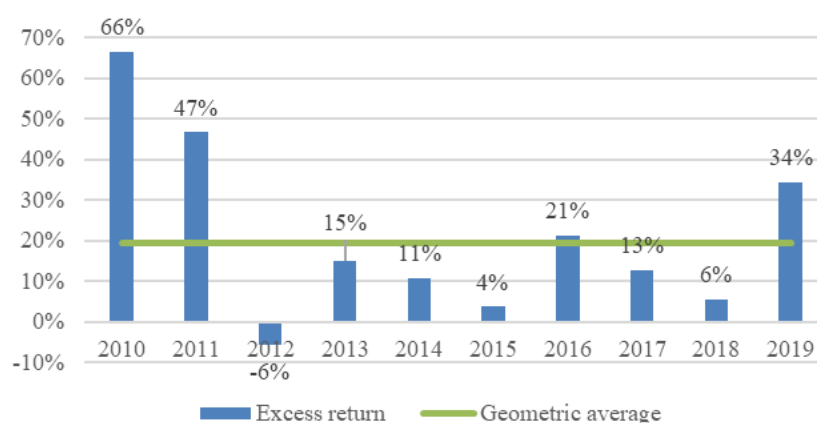
Given the same cost of equity reduction was applied to every year's return to shareholders, the ETRS' patter is the same as the one detailed above only slightly reduced.

As expected, 2010, 2011 and 2019 experienced outstanding results, most likely aided by the union of strong organic growth and favourable market conditions. None of the M&As were undertook before 2013 so they cannot explain the exceptional results obtained before. Regardless, considering how little Hermès bases its strategy on mergers and acquisition it is

questionable whether even the Pierre Hardy deal in mid-2016 was able to be a significant driver of the remarkable ETRS of 2019. Instead, it was Hermès continued effort to create new collection and to improve the quality of its distribution network, with store openings, renovation and extension, that drove such profitable market performances.

Overall, TRS in excess of cost of equity obtained good and often significantly positive results

*Figure 18. ETRS – Excess on cost of equity*



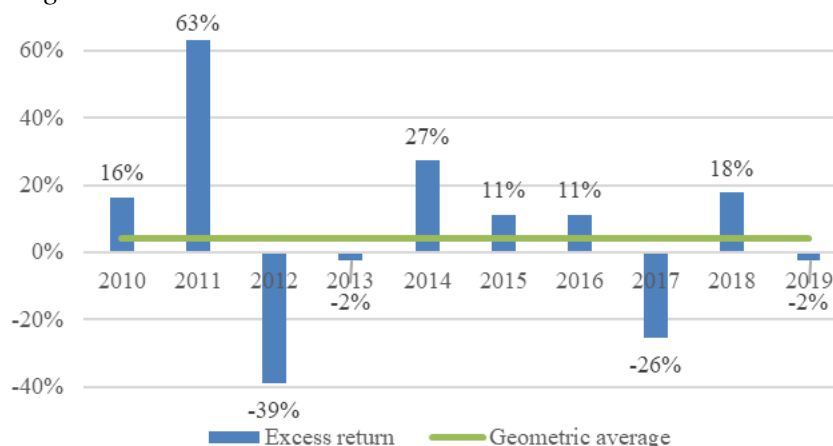
that allowed it to gain an arithmetic average result as high as 21% and a geometric mean only slightly lower at 19%. This shows how shareholders are not only compensated for the ownership risk attached to the shares they purchased, but they are able to secure a considerable profit from them. As a consequence, Hermès can be deemed an attractive investment thanks to its continuous growth and its rewarding capital (as well as income) gains. Between 2010 and 2019, return to shareholders in excess of cost of equity generated € 48 bln of value realizing a significant accomplishment for the House.

#### 5.3.2.2 ETRS on MSCI luxury goods index

ETRS on MSCI shows that Hermès was able to outperform the industry in the long-run, hence confirming the validity and efficacy of its business strategy.

In all of the instances when the index supplied a negative results Hermès was able to completely counteract the effect and earn its shareholder positive returns, thereby showing great resilience. However, when the luxury sector faced strongly positive performance the Group was neither able to surpass it nor to match it. As a consequence, the results obtained after the industry impact was accounted for are more modest with respect to the once previously seen, as expected for any firm.

Figure 19. ETRS - Excess on MSCI



The House was able to significantly outperform the industry and earn exceedingly positive results twice: in 2011 when a 63% industry excess TRS obtained and in 2014 when the same measure was 27% (during both years the average luxury firm experienced negative double digit TRS). Oppositely, four of the years considered, 2012, 2013, 2017 and 2019, held negative ETRS because the Group did not flourish as much as the industry. In particular, 2012 and 2017 were characterized by very troubling results as Hermès fell drastically behind the sector's stellar performance earning -39% and -26% of excess return. 2010, 2015 and 2016, and 2018 were characterized by mild, but successful results with industry excess return ranging between 11% and 18%.

Comparatively, 2011 can be said to be Hermès best year as the company was able to raise above the double-digit negative return that the average firm in the industry obtained and earn a sizeable positive result. In fact, during the year the Group managed to yield the highest mismatch between its performance and the index leading to the greatest industry excess TRS within the period considered.

During the year Hermès raised € 2.841 mln in revenues an increase of 18.3% on the previous year in particular thanks to the American and Asian (Japan excluded) regions where sales grew 26% and 29% respectively. While all of the segments participated to the growth of the company, an especially excellent performance was awarded by the Ready-to-wear & Fashion accessories division (+30%) due to the success of new ready-to-wear collections as well as the innovation and diversity of the fashion accessories offer. It has to be noted that Hermès made a significant increase in advertising expenses (that represented 5% of sales) with respect to the previous year thereby aiding sales collection. The revenue boost was significant, but not exceptional as similar if not better results were experienced by the Group also in other years within the decade. What

made 2011 unique in its performance was the fact that the rise in sales was not matched by a similar increase in expenses. Therefore, the firm was able to reach € 885 mln in operating income, a 32,5% growth with respect to the €668 mln earned in 2010. As a consequence, the operating margin gained 3,4 points and reached 31,2% of sales, marking the best performance recorded by the group since it was first listed on the stock market in 1993. Return on capital employed increased appreciably from 32% to 42%, owing to a strong earnings growth and decrease in working capital requirements. Additionally, Hermès benefitted from a positive net financial income of € 12 mln, thanks to the sale of its stake in Jean Paul Gaultier, which alone generated € 29.5 mln in gross capital gain. The Group estimated that in 2011 it elevated economic value added by € 131 mln up to € 464 mln, an incredible achievement in a moment of unfavourable environmental conditions (Capital IQ, 2020; Hermès, 2012).

Oppositely, just one year later, in 2012, Hermès had the biggest adverse discrepancy between its performance and the one of the market. It is not that the Group accomplishments were scarce during the year, but it seemed like the company was unable to fully benefit from the general encouraging conditions within the industry.

The House's revenues increased by 23%, a record within the period considered. Moreover, while sales cost and selling general and administrative expenses grew accordingly, operating income still experienced a significant growth (26%). However, there were also elements that determined negatively on the firm and its statement. For instance, against an exceptionally positive financial income obtained during the previous year, in 2012 the same figured resulted in an expense of € 18 mln. Also, income tax increased to 20.5% leading to a € 60 mln additional expense (Hermès, 2013). Ultimately, the Group's raised a net income of € 730 mln; the figure experienced a significant growth, 24%, but much lower than the one matured during 2011.

Even if Hermès stated that during 2012 it created an economic value added of € 628,5 mln, up 35% with respect to the previous period, this value was not reflected in the Group's share price at year-end that actually faced a minor drop. The decrease interrupted the continuous growth path the company's share prices experienced during the decade leading to the only negative annual return and to the worst TRS in excess of industry return.

Generally, TRS in excess of industry have been lower than annual returns hinting that a part of the performance earned was due to factors that affected the whole industry. However, it is normal for any firm to be affected by the environment surrounding it. Hermès ability to secure a return exceeding the one obtained by the average firm in the industry, confirmed by a



geometric average ETRS of 4%, showed that the House secured a dependable competitive advantage within the luxury sector allowing it to consistently outperform the industry. Between 2010 and 2019 ETRS determined a values creation ability of € 5 bln, positioning Hermès at the forefront of the luxury industry.

To sum up, while Hermès earned close to zero short-term performance, on the long-run the success of Hermès' organic growth strategy bloomed as confirmed by consistent rise in share prices and value creation.

Short-term performance for the deals completed led to mixed individual results. On the aggregate level, excess return was very close to 0% with the average outcome being slightly positive and the median one slightly negative. The results, which highlighted market reluctance to positively evaluate the deals completed, were probably hurt by limited M&A experience and lack of information released. Additionally, Hermès devotion to keep production in France led to the majority of the deals being domestic ones, usually considered less profitable by the literature.

The long term showed extremely good results in term of return to shareholders in excess of cost of equity, emphasizing how Hermès's prices have been constantly subjected to strong growth that allow shareholders' profits to amply exceed the ownership cost. While the House's results were tampered when taking in consideration its ETRS on MSCI, on average the firm was able to outperform the industry and rise on top of most of its constituents. This demonstrates the high potentiality and capability to succeed of the company, backed by strong strategic choices. In particular, Hermès' scarce involvement in M&As allowed the House to focus on the main factors that set its brands up for success: preserving its traditional roots while at the same time offering its clients innovative product lines that respect stringent standards for quality.



## 6 Prada

### 6.1 Introduction to the case

The Prada brand dates back to the beginning of the last century. In 1913, Mario Prada opened an exclusive store in Galleria Vittorio Emanuele II, Milan, selling handbags, travel trunks, beauty cases, tasteful accessories, jewellery and other luxury items. Thanks to the innovative design of its goods, created using fine materials and sophisticated techniques, Prada rapidly acquired wide popularity across Europe. The turning point for the Group came at the end of the 1970s when Miuccia Prada, the founder's granddaughter, partnered with Tuscan entrepreneur Patrizio Bertelli (now co-CEO of the Group along with Miuccia) combining her innovative creative ideas with his business acumen and deep capability to manage the luxury production cycles. After a few years, this union led to the merger between Bertelli's IPI S.p.A. and Prada and laid the foundations for the ensuing international expansion (Prada, 2020).

Now, the Prada Group, synonymous with innovation, transformation and independence, is one of the world's leaders in the design, production and distribution of luxury handbags, leather goods, footwear, ready-to-wear apparel, accessories, eyewear and fragrances. The organization owns some of the most prestigious international brands: Prada, Miu Miu, Car Shoe, Church's and Marchesi 1824. The Group, which employs 13.779 people worldwide, operates in 70 countries through franchise stores, a network of selected high-end multi-brand stores and luxury department stores. One of its most important assets are the 641 directly operated stores located in the most prestigious locations of the major international shopping destinations, consistent with the image, heritage and exclusivity of each brand.

Prada's distinctive features and prestige derive from its particular industrial process management which allows it to offer its customers products of unequalled quality, creativity and exclusivity. The individual heritage and identity of each brand is rigorously defended by the company's designers and craftsmen being constantly challenged to keep tradition alive through a continuous process of re-invention and innovation (Prada, 2011 and 2020).

Between 2010 and 2019, the Prada Group was able to double its total revenues that reached € 3,2 bln (from sales and royalties) at the end of fiscal year 2019, a significant part of it was originated from the leather good segment which was the most sought out by customers. Similarly to the other luxury groups, Prada's main markets are the European and Asia Pacific ones with the Americas, Middle East and Africa together gaining only about 17% of total sales.

In fiscal year 2019, the organization earned almost € 1 bln of EBITDA and a final amount of € 256 mln of net income (Prada, 2011 and 2020)

## 6.2 Strategy and M&As

Differently from some of its competitors such as Kering and LVMH, Prada's transition from a small firm to a luxury leader did not change it intrinsically. In fact, it maintained its status of a family-owned firm and decided to expand following mostly an intrinsic growth strategy. Throughout the years the company grew its original brand, Prada, which remained the main revenue generator (earning 83% of sales in 2019), and created Miu Miu, inspired by Miuccia's free-spirited creativity. The few brands acquired, Church's (1999), Car Shoe (2004) and Marchesi 1824 (2014), had a minor impact on the whole Group and in 2019 accounted only for 2,8% of consolidated net sales (Prada, 2020).

Along with pursuing organic growth, Prada did not shy away from partnerships and collaborations that were employed when the organization needed capability and know-how that it did not possess internally. For instance, in 2015 the union between the Group and Coty created the first Miu Miu fragrance. Similarly, in accordance with an agreement signed in 2019 from 1<sup>st</sup> January 2021 Prada licenced the production and distribution of its brand of cosmetics to L'Oréal. Also, important partnerships with leading technology suppliers were established to assist the marketing and merchandising processes (Prada, 2020).

At the beginning of the period considered, Prada's organic growth strategy consisted mostly in improving its control over distribution and the expansion of its retail channel. The decision was made because the Group considered its retail network an effective platform to showcase new collections and an essential point of contact with customers, through which portray a strong and consistent brand image worldwide. Between 2011 and 2014 the firm was able to almost double its directly operated stores. While this choice had proven its worth in the past by being able to counteract the effects of the worldwide economic downturn of 2008-2009, it did not lead to the desired results later on. As a consequence, from 2017 Prada decided to support its sales plan through various marketing initiatives and bold actions on the digital front even as physical retail remained at the centre of its omnichannel strategy. To this purpose, the Group created new partnerships with top online retailers, such as Net-a-Porter and Highsnobity (Prada, 2011, 2015, 2018 and 2020; CCPLuxury, 2017; The Local, 2018; Yiasoumi, 2019).

As presented before, Prada mostly utilized organic growth as a mean to expand its business. Hence, it rarely undertook any mergers and acquisitions. Between 2010 and 2019 the firm acquired three companies: food retailer Marchesi (2014); lambskin specialized Tannerie Megisserie Hervy (2014), renamed Tannerie Limoges afterwards, and the luxury retailer Fratelli Prada (2019). All of the firms purchased were majority acquisitions, but they each referred to a different M&A strategy related to the precise reason for which they were bought. Differently from other luxury companies that often preferred to use acquisitions to expand their portfolio of brands, Prada's M&As were only undertaken when needed to complement its organic growth efforts.

*Table 12. Prada's mergers and acquisitions 2010-2019*

Target	Announcement Date	Closing Date	% acquisition	Business	Strategy
Fratelli Prada	31/10/2019	31/10/2019	100%	Luxury retail	Forward integration
Tannerie Megisserie Hervy (Tannerie Limoges SAS)	08/10/2014	08/10/2014	100%	Leather tannery	Backward acquisition
Marchesi Angelo S.r.l.	14/03/2014	14/03/2014	80%	Food retail	Unrelated acquisition

Source: Capital IQ, 2020.

Marchesi Angelo S.r.l. is the owner of an historical and renowned patisserie in Milan, especially well-known for its chocolates and panettone. Prada decided to buy an 80% stake in it in 2014, a year after the Group lost the auction for the acquisition of the famous pastry shop Cova to its competitor LVMH. In a similar fashion to Arnault's conglomerate, the deal aimed to the strategic strengthening of the brand both in Milan, within the development project of the newly obtained spaces in Galleria Vittorio Emanuele II, and internationally. While target and acquirer fall within a different business, thereby rendering this an unrelated acquisitions, both share similar values: tradition, quality and excellence (Matarrese, 2014; Sacchi, 2014).

During the same year, Prada completed the acquisition of Tannerie Megisserie Hervy as a joint venture with its long time industrial partner Conceria Superior. For over 70 years, the French firm has been a beacon of excellence in the tanning of lambskin, in particular plongé nappa leathers; a local traditional technique at risk of extinction. The purpose of the deal was to introduce the tannery into Prada's direct supply chain, allowing it to rely on a stable production. An important process of requalification of the existent structures and renovation of manufacturing facilities contributed to the full recovery of the activity of the Tannerie. That ensured the preservation of valuable artisanal know-how as several specialized workers with a

valuable ten to twenty -year experience in the field were reemployed (Consigliere, 2014; Prada, 2014 and 2021).

At the end of 2019, the Group obtained full control of the retail network through the acquisition of Fratelli Prada, the company responsible for operating the Prada mono-brand shops under a franchising agreement effective for more than ten years. The deal, which was worth € 66 mln, ensured the luxury house secured four historical stores in the shopping hub of Milan, including the one opened by the founder in 1913, (Ferraro, 2019; Prada, 2020).

## 6.3 M&As and value creation

### 6.3.1 Short-term market performance

Short-term market performance was satisfying overall. Out of the three deals undertaken, two of them were positive and only one (Marchesi) obtained a negative ETRS.

*Table 13. Prada's ETRS at announcement per M&A deal*

Target	Announcement date	Price 2 days before announcement	Price 2 days after announcement	Excess TRS at announcement
Fratelli Prada	31/10/2019	24,25 HKD	25,50 HKD	5,03%
Tannerie Megisserie Hervy (Tannerie Limoges SAS)	08/10/2014	48,15 HKD	49,05 HKD	1,75%
Marchesi Angelo S.r.l.	14/03/2014	58,05 HKD	56,45 HKD	-2,88%
<b>Average excess TRS at announcement</b>				<b>1,30%</b>
<b>Median excess TRS at announcement</b>				<b>1,75%</b>

According to a study by Rehm et. al. (2012) companies pursuing organic growth strategy within the largest industry of consumer discretionary tend to earn the lowest excess return to shareholders. Oppositely, firms deciding to take on many a large quantity of small deals (together making up a significant part of market capitalization) had the best results (Goedhart et al., 2020). In particular, in the long-term a discrepancy of 8,4% was found when choosing one strategy instead of the other and organic growth was linked with significant negative excess TRS. It would be rational to expect that such value creation deficiencies experienced by organizations opting to pursue organic growth were reflected on the market response to their M&As around announcement. However, this is not the case for Prada. The market reaction to

the acquisitions undertaken by Prada is considerably positive. The announcement ETRS was on average 1,30%; the median value fared even better, earning a 1,75% excess return.

It is appalling for such significant ETRS to be earned by a firm that does not have a special strategy and a precise approach toward mergers and acquisitions such as the ones developed by LVMH and Kering. Additionally, the lack of experience and know-how, attributable to the rare use of M&As, puts Prada at a disadvantage which should decrease investors' confidence in the deals made. It is possible for the exceptional announcement performance to be positively influenced by the accurate integration of the organic growth strategy and the transactions pursued, especially Prada's efforts in vertical integration. For instance, the purchase of Fratelli Prada was the last step in the multi-year strategy employed by Prada to obtain full control of its retail distribution. Also, the incorporation of Tannerie Limoges was aimed to the improvement of one of Prada's most important assets: a high-quality and excellence seeking industrial and manufacturing process. The deal satisfies at the same time the need to ensure the availability of first-class raw materials and to preserve valuable artisanal know-how. To confirm the relevance of the interconnections between the M&As and Prada's general strategy, both the backward and, especially, the forward integration had optimal ETRS that amounted to 1,75% and 5,03% respectively.

Oppositely, the unrelated acquisition of Marchesi, involved in food retail, was not well-received from the market that assigned it a -2,88% of excess return at announcement. That is not surprising as the literature has documented for some time that focus should be preferred to differentiation and that unrelated acquisitions often bear unsatisfactory performances (Coffee et al., 1988; Bruner, 2014). For complete transparency, it should be said that differentiation has worked well for some of Prada's competitors within the limit of the luxury industry. However, differently from the Italian brand, they aimed to reach a conglomerate structure that could group a multitude of brands. Regardless, unrelated M&As have been known to lead to damaging results and the Marchesi deal was not an exception.

#### *6.3.1.1 The impact of efficient communication*

An efficient communication both toward investors and between the acquirer and its target have been known for their impact on the returns earned by mergers and acquisitions. The deals involving Marchesi and Fratelli Prada are two examples of this.

The exceptional result obtained with the acquisition of Fratelli Prada can be at least partly attributed to its connection with the Prada Group. Various studies depict the importance of

board connections to improve information flow and communication, therefore, increasing each firm's knowledge and understanding about the other. Acquirers sharing one member of the board with the target were found to experience on average a higher return of 0,12% at announcement. The main reason is that they can benefit from bargaining advantage in deal negotiations, that allows them to pay lower premiums, and from reduced transaction costs thanks to a lesser need for costly advisory services (Cai et al., 2011). All those factors are heightened when taking in consideration the firms in question. In fact, both companies originated from the same founder and were passed on to his family. The family ties between the firms were still strong, in fact, the ownership of Fratelli Prada was conducive to Miuccia (who had the majority of the shares) and her siblings Alberto and Marina Prada Bianchi (Sacchi, 2019). Miuccia's head position in both corporations and her deep knowledge of the business made sure that the deal signed could be balanced and beneficial to the acquirer as well as the target. That was recognized by the market and its investors that rewarded the transaction with remarkable short-term excess TRS.

This aspect of the transaction makes it quite similar to the Grandville one by LVMH which experienced exceptional short-term market performance as well, confirming the relevance of communication and ties between target and acquirer on announcement TRS.

Communication is essential not only between bidder and target, but also toward investors, the Marchesi and Cova deals are perfect examples of that.

The deals in question present strong similarities between the acquirers as well as the targets. Cova and Marchesi are renowned patisseries located in the shopping hub of Milan and famous for their product excellence, impeccable service and fascinating interiors. The bidders, LVMH and Prada, are both prominent companies operating in the luxury goods market and not involved in food retail prior the deal. However, the way they decided to communicate and share information about the transaction to investors differed highly. Prada gave a brief statement explaining that the deal's objective was to expand the Marchesi brand nationally and internationally. Instead, LVMH explained that its investment in Cova was not limited to adding a flourishing brand to its portfolio aiming to further expand it internationally (as the Italian firm was already present in the Eastern countries and on luxury cruises). The conglomerate made sure to highlight to investors that Cova was also a great real estate and a window through which advertise its own wares and cross-sell its products. Just a few additional information regarding the benefits that both LVMH and Cova could draw each other through the transaction are



incredibly useful to look at the deal in a different way, not as an unrelated acquisition but as a strategic one (strategy to which was attributed the second-best average announcement excess return in LVMH's case). Comparing the short-term performance, LVMH obtained a 4,28% ETRS versus a -2,88% earned by Prada on their respective deals. The 7,16% ETRS gap between the two similar deals cannot be fully attributable to Prada's scarce communication as LVMH's conglomerate form and it being a serial acquirer helped obtain higher investors' confidence. However, it is highly probable that a more thorough synergy announcement would have helped to reduce the negative impact of the current excess return to shareholders earned by Marchesi's deal.

### 6.3.2 Long-term market performance

Prada's short-term market performance was considerably optimal as the firm was able to raise investors' confidence in its deals regardless of its rare use of M&As. However, the same positivity was not observed in the long-term when the Group obtained sup-par and highly unsatisfying results.

During the period considered, Prada's growth strategy proved to be lacking.

Its initial strategy involving the opening of many directly operated stores had worked well at the beginning of the decade as the luxury industry faced an expansion phase thanks to the increased consumption by Chinese and Asian customers. However, by the end of 2015 Prada's revenue growth had stopped and sales began to drop. The Group's main setback was its resistance to change, particularly when it came to engaging in e-commerce and strengthening their digital presence. Also, Prada hesitated in acknowledging the importance of the new generation for its future and in adapting its products accordingly, by including more leisure wear and sneakers for its younger buyers. By the time Prada started to embrace these new tendencies and fighting back by developing digital technologies and revamping its product lines, it was well behind most of its competitors, especially conglomerates such as Kering and LVMH (The Local, 2018).

In 2017, Prada's direction change toward a more updated strategy was still penalised by its previous moves, in fact, the Group had to reform its retail channel by closing underperforming stores and renovating the others (CCP Luxury, 2017). Additionally, some time was needed for the new strategy to give significant results. In fact, even if by the end of 2017 sales through the e-commerce channel grew, Prada's total revenues were still falling. Finally, 2018 and 2019

showed positive growth in total sales, which in 2019, after four years of decline, led to an increase in net income.

If a company decides to grow organically then it is necessary for its survivability and profitability for it to have an innovative strategy and to be conscious of the continuous changes occurring in its environment. Prada's failure to do that and its use of an outdated approach to revenue generation resulted in the overall poor long-term market performance shown below.

*Table 14. Long-term ETRS and value creation*

	2012-2019	2011	2012	2013	2014	2015	2016	2017	2018	2019
Price per share at year-end (HKD)		35,15	73,15	69,00	43,95	24,10	26,30	28,30	25,80	32,20
Dividends per share (HKD)			0,05	0,09	0,11	0,92	0,95	1,03	0,82	0,52
Return to shareholders	1%		108%	-6%	-36%	-43%	13%	12%	-6%	27%
ETRS on cost of equity	-7%		101%	-13%	-43%	-50%	6%	4%	-13%	19%
ETRS on MSCI luxury goods index	-12%		71%	-27%	-24%	-40%	-1%	-31%	2%	-14%
Value created (TRS) (HKDBln)	7									
Value created (ETRS in Ke) (HKDBln)	-40									
Value created (ETRS on MSCI) (HKDBln)	-59									

Prada became public in mid-2011 when it made an initial public offering at the Hong Kong stock exchange. As a consequence, differently from the previously exposed cases, the period considered when evaluating long-term market performance does not comprise the entire decade, but only the eight years between 2012 and 2019. Regardless, the period was believed to be extended enough to be able to draw the results needed for this analysis without affecting its quality.

At the end of 2012, Prada's share prices experienced a significant jump as they more than doubled with respect to the end of the previous fiscal year, reaching HKD 73,15. TRS highly benefitted from this outcome, which in turn led to a yearly return to shareholders of 108%. The outstanding result obtained during the first year analysed drove overall TRS upwards and allowed to compensate for some of the adverse returns experienced afterwards. In fact, from then onward share prices started a decreasing path and more or less stabilized at HKD 26 per share. Only in 2019 Prada's shares were able to grow their price by approximately 25% to HKD 32,20. As a consequence, the TRS values earned annually have been mixed and included some significantly negative returns.

Overall, Prada yielded an average (geometric) return for its shareholders of 1% over the period analysed, which in turn created a total value of HKD 7 bln. Even if this is demonstrating a positive performance it is important to be mindful that without accounting for the exceptional

TRS obtained in 2012 the conclusion would have been considerably different. In fact, over a period of seven years going between 2013 and 2019, Prada registered a geometric mean of -9% of return to shareholders, thereby implying a value destruction of HKD 1,2 bln.

#### *6.3.2.1 TRS in excess of cost of equity*

Only during half of the multiple time periods considered Prada was able to compensate its shareholders for the risk undertaken when investing in its shares. With the exception of year 2012 that experienced an extraordinary ETRS, the positive excess returns were all quite moderate demonstrating that only a small shareholders' return was obtained on top of cost of equity. Oppositely, the negative ETRS were always double digits and in half of the cases larger than 40%. This depicts a worrying picture of Prada's long-term accomplishment as its performance was much more prominent when the company was unable to reimburse shareholders' risk than when it was.

Differently from the measure discussed in the previous section, the exceptional ETRS earned in 2012 was not able to compensate the less-than-optimal performance yielded throughout the rest of the period. As a consequence, the TRS in excess of cost of equity showed an overall a geometric mean of -7% implying that shareholders on average obtained a return of 7% lower than minimum one expected in order to offset their ownership risk. Additionally, if ETRS on cost of equity is considered as a measure of value creation it is possible to notice how a negative cumulative excess return of -44% led to a total value destruction of HDK 40 bln.

#### *6.3.2.2 TRS in excess of MSCI*

Comparing Prada's TRS with the one of the MSCI index selected, it is clear that the firm was not able to match the industry performance. Most of the times the Group was found to have returns to shareholders significantly below those earned by the average firm involved in the luxury good market. Only twice Prada managed to outperform the index. Firstly, in 2012 while luxury consumption was rising, Prada's bullish store-opening strategy ensured the Group a return almost three times the one earned by the MSCI. Then, in 2018 the industry experienced a more adverse market performance than Prada's. In fact, luxury firms' sales, including the Group's, were affected by limited tourist purchasing power caused by a strong euro currency. Nonetheless, during the year the effects of Prada's digital and youth-oriented strategy guaranteed its shareholders a comparably higher return. This remarks the importance of creating a strategy that takes into consideration the environment in which the firm is placed in. Prada's failure to take into account the new challenges and trends that affected the whole industry

caused it to plod along behind its competitors a fact that was clearly visible by its TRS in excess of MSCI.

Both geometric and arithmetic ETRS mean demonstrate a considerable average industry underperformance that amounted to -12% and -8% respectively, which account for a HKD 59 bln of value lost over the eight years analysed due to the missed opportunity to develop a solid strategy able to match if not outperform the index.

Differently from what was expected from a firm rarely undertaking M&As, the deal announcements made were well received by the market and its investors that on average rewarded Prada with a positive and considerable short-term return. The best results were ascertained relatively to the Group's vertical integration effort, especially forward integration. Oppositely, as anticipated, the one unrelated acquisition was penalized by the market and yielded a considerably negative ETRS, but not enough to offset the positive market performance created by the other two.

The limited use of mergers and acquisitions was unable to counteract the damages created by a conservative long-term strategy. As such, in the long-term total return to shareholders was the only measure of value that gave a positive average result even though quite small. Oppositely, both ETRS on cost of equity and ETRS on industry index experienced significant negative performances, demonstrating an overall value destruction throughout the period analysed. In fact, Prada was unable to match the minimum return expected by investors and at the same time faced considerable underperformance with respect to the average firm in the luxury goods industry.

## 7 Richemont

### 7.1 Introduction to the case

In the 1940s South African entrepreneur and investor Anton Rupert founded Rembrandt Group Limited of South Africa (now known as Remgro Limited), which owned significant interests in the tobacco, financial services, wines and spirits, gold and diamond mining industries, and some luxury goods investments. In 1988 after meeting with French entrepreneurs Robert Hocq and Joseph Kanoui the Rupert family invested in Cartier. During the same year, Johann Rupert decided to manage its foreign investments separately, so he created Compagnie Financière Richemont (hereafter “Richemont”) through the spin-off of the international assets owned by Rembrandt. At inception, Richemont owned two companies engaged in the luxury business, Cartier and Dunhill which themselves controlled other brands such as Yves-Saint-Laurent, Montblanc and Chloé, but was also involved in the tobacco and media industries. Over the 1990s Richemont almost doubled its assets thanks to the acquisition of a series of European firms (Donzè, 2018; Richemont, 2021).

Through the 2000s, the conglomerate operated a strategic change characterized by a more intense focus on luxury. The company exited the television, natural resources and financial services businesses, it sold the British garment company Hackett (2005) as well as other diversified consumer goods firms and it transferred its engagement in tobacco to Reinet Investments (2008), a newly founded financial holding company controlled by Rupert (Donzè, 2018; Richemont, 2020).

Now, Richemont is one of the most important players in the luxury industry and a leading luxury goods group. As of 2019, the conglomerate is the third-largest luxury goods company in Europe (fourth in the world after the US Estée Lauder) in term of revenues. The corporation is listed and publicly traded on the SIX Swiss Exchange (on which the following research is based) from 2000 and the JSE Securities exchange (Deloitte, 2020b and Richemont, 2020).

The Group contains twenty five brands, such as Cartier, Buccellati, Panerai, Yoox and Cloè, divided into four businesses: Jewellery Maisons, Specialist Watchmakers, Online Distributors Fashion and Accessories/Other. In 2019 the Group with its 35.000 employees and 2.186 boutiques created almost € 14 bln of revenues, of which more than half pertaining to the Jewellery Maisons. Asia, particularly China, Hong Kong and Macau, was the prime geographical segment and generated 46% of the total sales of the conglomerate. During the

same year, Richemont raised € 1,9 bln in operating profit and a final net income of € 2,8 bln (Richemont, 2020).

## 7.2 Strategy and M&As

Richemont growth and expansion strategy is based on a marriage of organic growth, which is fundamental for all of its brands, and inorganic growth, through the acquisitions of “hidden treasures”.

Since a sense of luxury builds on scarcity, companies run the risk of their brands being considered less luxurious when they increase their market penetration. In this respect, Richemont prioritized organic growth preferring to trade up its maisons instead of pursuing the continuous addition of new brands to its portfolio. Nonetheless, the good profit situation that the Group found itself in at the beginning of the decade allowed it to at the same time grow its in-house brands and also acquire other ones. When undertaking mergers and acquisitions Richemont decided to look for targets solely within the personal luxury industry (or its vertical integration) avoiding to diversify outside of its core business. This is a characteristic that differentiates Richemont from various of its competitors and peers, for instance LVMH has been increasing its presence within the luxury hospitality business and Hermès entered the high-end furniture and housewares one (Richemont, 2021b and c; Müller-Stewens, 2013).

Richemont aims to achieve long-term value creation for its stakeholders through the profitable and responsible growth of its existing and newly acquired Maisons and businesses. In order to do that, the Group helps them in designing unique and timeless creations and memorable experiences, and by continuing to protect their heritage in quality and craftsmanship, while driving innovation. Also, the conglomerate support its subsidiaries by helping them thrive in existing and new markets, if there is scope for international diversification.

In order to preserve their distinctiveness, each Maison has a certain degree of independence granted by having its own management team to lead design, product development, manufacturing, marketing, communication, distribution, and customer services. Richemont’s corporate level focuses on a few central global functions that provide the overall framework for the group and controls coordinative tasks with respect to multi-channel distribution topics. The Maisons’ high degree of autonomy is seen as a crucial factor to preserve each brand’s innovative strength and perceived independence, two essential drivers of competitive strength in this

industry. Synergies are only pursued step-by-step by, for example, simultaneously purchasing similar watch components, or coordinating the market positioning and market entrance across the Maisons. High efficiency gains are made through the joint control and management of all the brands' distribution platforms (Richemont, 2021b and c; Müller-Stewens, 2013).

Throughout the period ranging from 2010 to 2019 Richemont undertook and completed the following twelve mergers and acquisitions.

*Table 15. Richemont's mergers and acquisitions 2010-2019*

Target	Announcement Date	Closing Date	% acquisition	Business	Strategy
Buccellati Holding	27/09/2019	26/09/2019	100%	Jewellery, watches and silverwear	Brand portfolio expansion
Watchfinder.co.uk	01/06/2018	01/06/2018	100%	Online retail of pre-owned watches	Strategic acquisition
YOOX Net-a-Porter	22/01/2018	10/05/2018	50% (+ pre-owned 50%)	Online retail	Strategic forward acquisition
Stefano Serapian	13/11/2017	13/07/2017	100%	Handbags and briefcases	Brand portfolio expansion
Kering Eyewear	21/03/2017	01/06/2017	30%	Eyewear	Strategic acquisition
Manufacture Roger Dubius	21/01/2016	21/01/2016	40% (+ pre-owned 60%)	Watches	Brand portfolio expansion
RLG Retail	05/05/2015	29/07/2015	49% (+ pre-owned 51%)	Cartier retail	Forward integration
YOOX Net-a-Porter	31/03/2015	05/10/2015	50%	Online retail	Horizontal merger
Antica Ditta Marchisio	31/01/2013	08/01/2013	100%	Jewellery	Backward integration
Varin-Etampage and Varinor (VVSA)	02/10/2012	02/10/2012	100%	Metals manufacture	Backward integration
Peter Millar	21/09/2012	19/10/2012	100%	Apparel and accessories	Brand portfolio expansion
NET-A-PORTER	01/04/2010	01/04/2010	67% (+ pre-owned 33%)	Online fashion retail	Strategic forward acquisition

Source: Capital IQ, 2020.

It is clear that Richemont preferred to avoid minority acquisitions in favour of obtaining 100% stakes, in fact complete control acquisitions made up half of all of the M&As undertaken. Additionally, four of the transactions above involved targets in which the Group already possessed a minority stake and decided further invested in to have a full participation. With the only exception of the merger between YOOX and Net-a-porter, none of the M&As involved public firms, remarking the tendency to acquire small and private companies. As such, no megadeals were completed. The majority of the transactions were cross-country with only two cases of domestic acquisitions (Varin-Etampage and Varinor or "VVSA" and Roger Dubius).

Among all of the cases analysed Richemont's is the one presenting the most varied strategic approach to the deals along with LVMH, even though the latter made twice as many transactions. The M&As included: four brand portfolio expansions; five vertical integrations (of which one simple forward, two strategic forward and two backward acquisitions); one horizontal merger and two strategic acquisitions. Regardless, the conglomerate renovated its efforts on remaining focused on furthering its already present businesses and did not undertake any unrelated acquisitions.

To support the growth of what has constantly been the most important division for the Group, jewellery, Richemont made investments for integrating its business chain. In particular, it undertook the forward integration of RLG Retail to re-appropriate itself of its Cartier retail channel in India (2015) and the backward assimilation of Italian jewellery producer Marchisio (2013) and metal manufacturer VVSA (2012). The latter, an historical partner of Richemont's, has been of strategic relevance due to its specialization as a gold refiner and producer of semi-finished precious metal products destined for the jewellery but also the watch industry, for which it also manufactures high-end stamped exterior components (Richemont, 2012). Synergies were created because its products and services are applicable and useful not only for the jewellers Cartier and Van Cleef & Arpels but also for a significant number of additional Maisons involved in the watches business. Lastly, Richemont acquired Buccellati in 2019 because it believed its brand to be one of the few in the jewellery market that was complementary in term of style, origins and craftsmanship with the Group's existing Maisons. Even though the deal mainly target Buccellati as a jeweller, the brand is actually involved also into silverware and watches (Richemont, 2019; Capital IQ, 2020).

In addition to the previously mentioned deals that also strengthened the Specialist Watchmakers division, the conglomerate also acquired the remaining 40% interest in the Roger Dubious brand thereby obtaining its full control.

One of the most significant accomplishments obtained by Richemont through the use of mergers and acquisitions is the creation and establishment of its Online Distributor division, which in 2019 raised 15% of total Group's sales. The conglomerate has been a pioneer in luxury e-commerce, first as a minority shareholder of online fashion retailer NET-A-PORTER in its infancy (2008) and then as a controlling shareholder since 2010, when the firm was fully acquired. In 2015, just a few years after the acquisition the conglomerate decided to horizontally merge NET-A-PORTER with its Italian competitor YOOX thereby creating YOOX Net-a-



Porter (“YNAP”) of which Richemont held 50% of the shares and only 25% of voting rights (to preserve its independence) (Richemont, 2015, 2020). Three years after, in 2018, the Group purchased the remaining shares and obtained full control of the world leading online luxury retailer.

Lastly on its digital strategy, the corporation acquired Watchfinder. Differently from NET-A-PORTER and YOOX Net-a-Porter that are simply involved in e-commerce of new luxury items, the target is a leading pre-owned premium watch specialist online and offline retailer. By selling already owned watches Watchfinder opened Richemont to a new market comprised of enthusiasts and collectionists that the Group would not have reached without it (Richemont, 2018). The resale market was previously shunned by luxury fashion houses, who are wary of ceding control of the distribution, price and perception of their items (Sina, 2021). However, second-hand online retail, especially of high-end items, has been booming in the recent years proving its worth even to companies in the luxury sector as a real and deeply rooted trend. Watchfinder’s acquisition demonstrate once again Richemont’s ability to be aware of the changes in its environment and its willingness to be a pioneer and a first-mover in the many segments of the digital luxury sector.

To build the foundations for a stronger apparel and accessories division Richemont acquired two new brands to add to its portfolio: the US-based apparel label Peter Millar and the Italian leather goods manufacturer and designer Stefano Serapian, already Richemont supplier of leather for Cartier and Dunhill collections (Bolelli, 2017). Moreover, in 2017 it signed a partnership between its Cartier Maison and Kering Eyewear by taking on a minority interest in it. The collaboration was aimed at bringing their operations together to create a stronger platform for the development, manufacturing and worldwide distribution of Cartier eyewear collections. For that purpose, Kering Eyewear integrated Manufacture Cartier Lunettes in its activities (Sacchi, 2017). At the time, the Maison was well established in the jewellery and watches segments, but had some difficulties with its eyewear items, among the priciest in the market (worth twice as much as the average Gucci’s sunglasses). Kering’s specialized subsidiary was able to offer its experience and know-how in this growing luxury segment.

## 7.3 M&As and value creation

### 7.3.1 Short-term market performance

Richemont achieved a slightly negative short-term market performance caused by adverse market reactions around announcement date in three quarters of its transactions.

*Table 16. Richemont's ETRS at announcement per M&A deal*

Target	Announcement date	Price 2 days prior (CHF)	Price 2 days after (CHF)	Excess TRS at announcement
Buccellati Holding	27/09/2019	72,20	71,54	-1,07%
Watchfinder.co.uk	01/06/2018	90,60	92,06	1,46%
Yoox Net-a-Porter	22/01/2018	88,66	88,70	-0,11%
Stefano Serapian	13/11/2017	90,25	85,25	-5,70%
Kering Eyewear	21/03/2017	77,80	78,20	0,36%
Manufacture Roger Dubius	21/01/2016	63,75	63,75	-0,16%
RLG Retail	05/05/2015	83,65	80,40	-4,04%
Yoox Net-a-Porter	31/03/2015	79,90	78,95	-1,35%
Antica Ditta Marchisio	31/01/2013	76,45	75,80	-1,01%
Varin-Etampage and Varinor	02/10/2012	56,40	58,30	3,21%
Peter Millar	21/09/2012	61,15	59,50	-2,85%
NET-A-PORTER	01/04/2010	40,73	41,21	1,02%
<b>Average excess TRS at announcement</b>				<b>-0,85%</b>
<b>Median excess TRS at announcement</b>				<b>-0,58%</b>

Excess return to shareholders at announcement ranged from a top value of 3,21% obtained through the VVSA deal to a bottom one -5,70% by the Stefano Serapian transaction. With the exception of the highest ETRS which was encouraging, very few other positive values (specifically yielded by Net-a-porter, Kering Eyewear and Watchfinder) are actually more modest and position between 0,36% and 1,46%. The remaining eight deals undertook were all distributed below zero, with many of them earning significantly negative short-term excess returns.

Throughout the complete period, Richemont short-term market performance around deal announcement had been sub-par and obtained poor average and median values of ETRS, namely -0,85% and -0,58% respectively. These results hint at a general lack of confidence by the market and its investors in the mergers and acquisitions took by Richemont.

One of the possible issues explaining the short-term performance fiasco is that Richemont lacks a general vision and clear strategy to unite its M&As. For instance, Kering's deal were all pursued under the plan of transforming the firm from a large diversified business into a luxury focused conglomerate. Richemont acted in a similar way with respect to its Online Distributor division that was assembled thanks to mergers and acquisitions, but not for the remaining cases that followed a more random path and were pursued only when Richemont found some hidden treasures. When dividing deals by division, this is demonstrated as the transactions grouped in the Online Distributor category were the only ones that obtained an average positive short-term excess return, even if quite moderate (namely, 0,26%). For every other division the transactions

made experienced an excess return that averaged from slightly adverse for jewelery and watchmakers to significantly negative for the accessories and other classification. It is not unexpected for investors to assign lower values to deal relating to apparel and accessories as that is the least developed segment by Richemont, so there is a smaller number of similar firms from which distribution and/or production synergies can be originated. Also, during the years the division yielded dubious results, for instance, operating losses were stated the year before both Stefano Serapian and Peter Millar's acquisitions.

Moreover, M&A announcements' press releases never mentioned synergies neither in a quantitative fashion nor in a qualitative one, with the only exception of the rare "international diversification" prospect for the newly acquired firm. This leaves investors blind to the plans made for the target after integration and to the value the conglomerate expects to obtain from the transaction. By not allowing full clarity about deals and their details, it is hard for investors to develop strong confidence about the M&As pursued as they may doubt whether the acquirer made a knowledgeable choice as well as the transactions' profitability.

#### *7.3.1.1 Deal characteristics and market performance*

Richemont used a variety of strategies when undertaking its mergers and acquisitions and did not bring forward a standard approach to the transactions.

In term of strategies employed, the expansion of the conglomerate's portfolio through the addition of new brands was found to be the worst strategy in term announcement excess TRS. In fact, all of the four acquisitions that reflected this approach caused considerable drops in Richemont's share price (with the exception Roger Dubius' deal that had no impact on stock's value) and yielded significant negative ETRS, regardless of the business they were involved in.

The only horizontal merger of equals was also negatively valued by the market and obtained a -1,35% short-term ETRS. This type of transactions were rare in the industry compared to others and Richemont was the only firm among the ones analyzed that employed it. Not having other similar deals in the industry that could act as a benchmark might have increased the uncertainty surrounding the deal swaying investors sentiment toward a more adverse opinion.

Oppositely, the strategic acquisitions of Kering Eyewear and Watchfinder experienced the best average result by strategy and obtained positive excess returns for both of the deals involved (0,36% and 1,46% respectively). It is clear that the market appreciated the logic behind

the deal, that was not focused on increasing its presence in existing markets, but aimed at opening up new segments and market niches for its existing brands.

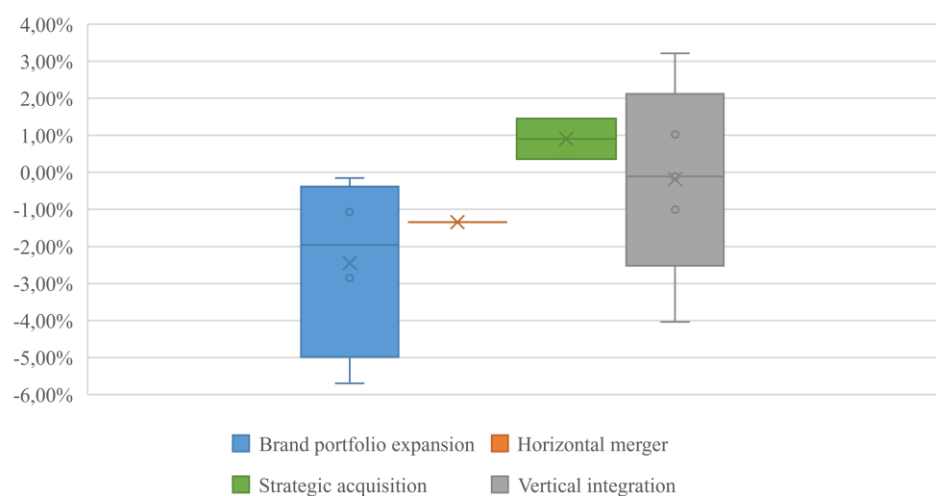
Lastly, Richemont's vertical integration effort yielded mixed results that spanned from significantly negative to considerably positive announcement ETRS, but when further differentiated into the specific types of transaction more precise trends were exposed.

Backward integration worked well for the conglomerate and its average performance determined this individual strategy as the best among the one applied by Richemont. In particular, its results were driven upwards by the VVSA deal, whose production capability and know-how were employable for every jewellery and watchmaker maison.

Within all of the deals that followed a forward integration logic opposite results were found between RLG Retail deal, which represented the traditional forward integration of the Cartier Indian retail channel, and the strategic forward acquisition of online distributors NET-A-PORTER and YOOX Net-a-Porter. While the first strategy earned the worst excess TRS, the second one obtained on average a slightly positive ETRS.

The relevance of the strategic acquisitions and of the strategic forward integration highlighted the importance to the market and its investors of a clear and well-thought logic supporting the transactions. In fact, it is by being on top of the trends affecting the personal luxury industry and creating new spaces and niches in the market that Richemont earned three out of its four positive short-term excess returns to shareholders.

*Figure 20. ETRS per strategy*



Short-term ETRS of cross-country and domestic deals was compared and it was shown that on average the latter obtained higher average excess contradicting the traditional theory that

investment in targets located in foreign country were more profitable. However, Richemont actually made only a couple of domestic acquisitions and focused mostly on acquiring companies based abroad. This may have been another factor that negatively affected its overall short-term performance leading to the unsatisfactory results detailed above.

### 7.3.2 Long-term market performance

M&A short-term market performance is not an exact indicator of the long-term success of the deal. Nonetheless, in Richemont's case the negative market performance obtained around announcement date was confirmed and reinforced with long-run unsatisfactory results.

*Table 17. Long-term ETRS and value creation*

	2010-2019	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Price per share at year-end (CHF)		34,93	55,00	47,51	71,40	88,80	88,80	72,10	67,45	88,30	63,00	76,06
Dividends per share (CHF)			0,35	0,45	0,55	1,00	1,40	1,60	1,70	1,80	1,90	2,00
Return to shareholders	10%		58%	-13%	51%	26%	2%	-17%	-4%	34%	-27%	24%
ETRS on cost of equity	0%		49%	-23%	42%	16%	-8%	-27%	-14%	24%	-36%	14%
ETRS on MSCI	-5%		4%	0%	14%	4%	14%	-14%	-18%	-9%	-18%	-17%
Value created (TRS) (CHF Bln)	31											
Value created (ETRS in Ke) (CHFBln)	-1											
Value created (ETRS on MSCI) (CHFBln)	-7											

Between the beginning on 2010 and the end of 2013 Richemont's share price more than doubled moving from a low of CHF 34,93 to a top value of CHF 88,80. This is a considerable growth to be accomplished in only four years. However, from then onwards Richemont's prices fluctuated on lower ranges and never actually passed nor even reached that value again. Regardless over the whole decade the stock price actually experienced a compounded annual growth rate of about 8%. At the same time, dividends followed an upward path even though remaining quite moderate.

As a function of the two previously described measure, total return to shareholder experienced mixed results throughout the years yielding various significantly positive outcomes as well as some considerably negative ones. TRS peaked in 2010 when it achieved its highest value, 58%; oppositely in 2018 it was at its lowest: -27%. There seems to be no clear path or direction followed by return to shareholders, which often fluctuated between positive to negative values from year to year. Nonetheless, by ignoring individual annual performances and taking into consideration the TRS achieved throughout the full decade it is demonstrated that Richemont were able to earn a compounded annual rate of return of 10% on its share price. Applying that

to the Group's market capitalization at the end of 2009, which was CHF 553,7 mln, in ten years the company was able to create about CHF 31 bln in value to its shareholders.

#### *7.3.2.1 ETRS on cost of equity*

ETRS on cost of equity fluctuated on a similar but lower path than the one described above for return to shareholders. During exactly half of the years analysed, the measure was negative and in most of the cases double digit, highlighting the fact that the return yielded was considerably lower than the one required to compensate for investors' ownership risk. Oppositely, the remaining half achieved significantly positive ETRS showing that at the time Richemont market performance surpassed the minimum one required to match its cost of capital.

Individual results were varied, but positive excess return often earned higher absolute values with respect to the negative ones, thereby obtaining an arithmetic average of +4% of ETRS on cost of equity. Nonetheless, by considering the multiple compounded time periods that changed, demonstrating that overall Richemont's TRS seemed to match its cost of equity, if not yield slightly lower results. In fact, the compounded annual ETRS was only slightly lower than zero at -0,28%. This shows that the Group was unable to meet the minimum return set by cost of equity for its investors, which caused them a total value loss of CHF -542 mln.

#### *7.3.2.2 ETRS on MSCI luxury goods index*

Total return to shareholders on excess of industry index was mostly modest as it fluctuated between a low of -18% to a high of 14%. Over the years its values were separated in two phases. During the first half of the decade, Richemont was able to earn positive ETRS demonstrating its ability to either outperform the industry or matched it like in 2011. Oppositely, between 2015 and 2019 the Group consistently underperformed the average company in the personal luxury sector yielding double-digit negative annual excess returns. During that period the conglomerate faced significant increases in its selling, general and administrative expenses as well as other operating expenses, which in turn drove a consistent decrease in its EBITDA margin. The rise in operating expenses reflected the accelerated renovation of Richemont's global distribution network and the opening of new boutiques, but in 2019 was largely attributable to the consolidation of online distributors YNAP and Watchfinder.

In 2019, one year after Richemont obtained full control of YNAP and Watchfinders the two drove a 19% increase in sales (with the reimaging brands of the group only growing by 8%). However, the simultaneous increase in expenses added to a € 165 million amortisation of

intangible assets recognised on acquisition led to a € 264 million operating loss being recorded by Online Distributors.

Overall, ETRS on MSCI experienced a geometric average of -5% showing a general underperformance with respect to the industry. This shows that while Richemont's strategy might be valid from a shareholder's point of view it is not enough to confirm its leadership position in the industry that will inevitably alter if things will remain the same. In fact, when compared to the luxury goods sector the Group's value creation end up short of CHF 7 bln for its investors.

In conclusion, Richemont's slightly negative short-term performance was confirmed in the long term when the firm could be said to have on average matched cost of equity, without offering them any additional return and obtaining an industry underperformance.

The acquisition of hidden treasure that not necessarily were part of a specific vision for the firm hurt short-term performance especially when forward integration, brand portfolio expansion and horizontal mergers were involved. Oppositely, the strategic acquisitions of targets which could open up new markets or segments for Richemont received higher investors' confidence and announcement excess returns.

In the long-run, TRS and ETRS on cost of equity experienced overall positive or slightly negative results showing that investors did not face losses when purchasing Richemont's shares, even if they were not rewarded any exceptional return over the repayment of ownership risk. Additionally, Richemont's found its market performance lacking behind that of the average firm in the industry hence yielding a negative ETRS on MSCI. While its strategy is similar to some of its competitors it seems like the conglomerate might have found some difficulties in its realization as the Group did not grow the companies acquired enough or incurred in expenses large enough to offset various of the synergies built.





## PART III

### 8 Comparison and discussion

When considering each organization on its own it is quite hard to determine whether one's growth choices had a direct effect on the long-term performance. As M&As are not the only factor in place affecting the firm's accomplishments and its profitability in the long-run, an analysis solely as the one completed so far is not sufficient to determine cause effects. Also, the evaluation of short-term performance is hindered by not having a benchmark of comparison. This chapter aims to shed some light and allow to derive more precise notions by comparing all of the case studies that were individually analysed above. In order to do that, the companies were separated depending on their policies and decisions regarding growth as well as mergers and acquisition.

#### 8.1 Comparability

##### 8.1.1 Comparability

The firms analysed are competitors in the luxury goods industry and, even though they present some individual peculiarities due to their history and vision, they are comparable.

At the beginning of the period considered they were represented by the following financial and market data, which shows each firm starting point before the influence of their strategic choice was analysed (in 2010-2019).<sup>4</sup>

*Table 18. Multiples, market and financial data per company*

Company	Market data			Financial data				Multiples			
	Price (p.s.)	Market cap (Mln)	TEV (Mln)	Sales (Mln)	EBITDA (Mln)	EBIT (Mln)	Earnings (Mln)	EV/Sales	EV/EBITDA	EV/EBIT	P/E
LVMH	78,38 €	37.178 €	40.998 €	17.053 €	4.055 €	3.352 €	1.755 €	2,4 x	10,1 x	12,2 x	21,2 x
Kering	78,30 €	9.904 €	17.683 €	13.584 €	1.647 €	1.240 €	951 €	1,3 x	10,7 x	14,3 x	10,4 x
Richemont	23,54 €	13.034 €	10.833 €	5.418 €	1.172 €	972 €	1.075 €	2,0 x	9,2 x	11,1 x	12,1 x
Hermès	93,31 €	9.811 €	10.079 €	1.914 €	547 €	466 €	289 €	5,3 x	18,4 x	21,6 x	34,0 x
Prada	3,50 €	8.956 €	8.844 €	2.047 €	527 €	424 €	251 €	4,3 x	16,8 x	20,8 x	35,7 x

Source: Capital IQ, 2020.

The multiple analysis suggests that the market has valued Hermès and Prada at much higher multiples with respect to the other companies. For instance, LVMH, Kering and Richemont

<sup>4</sup>The data exposed is dated to 31/12/2009 with the exception of Prada whose figures refers to 31/12/2011 due to the firm completing its IPO in mid-2011. All the data are in Euro to allow for better comparison, to do so conversion rates were applied to the data for Prada as well as Richemont.

obtained EV/EBITDA of about 10x while Hermès and Prada were assigned 18,4x and 16,8x for the same multiple. That is not a sign of overvaluation, instead it likely shows that investors believed for future performance of these firms to greatly grow and improve.

It is possible to determine that while the market has valued these firms in a somewhat similar way, they still do present intrinsic differences based on their chosen strategic development and organizational structure, which are reflected in their financial data.

### 8.1.2 Strategy and grouping

There is clear strategic division on the use of mergers and acquisitions between organizations that chose to develop as luxury conglomerates uniting many maisons under their portfolios and others that preferred to grow organically by building a solid and well-recognized unique brand. They are divided into two groups to help further analysis.

To the first category belong LVMH, Kering and Richemont. Even if with different intensities, they all chose to apply an inorganic tactic aimed at undertaking various acquisitions and growing the targets thanks to the large resources at their availability and the synergies they could create with other brands in their portfolios. They are included in Group 1.

Hermès and Prada chose the second approach deciding to create value through the continuous improvement of their main brand. They strived for excellence throughout their business chain and focused on building a strong distribution network as well as high-quality production manufacturing. Also, their efforts were directed in creating appealing designs for their product lines that mixed traditional and innovative touches that could satisfy their customers and be at the forefront of the luxury sector. They made rare use of mergers and acquisitions in their strategy and, in such occasions, they were mostly employed for vertical integration. These organizations belong in Group 2.

## 8.2 M&A value creation

### 8.2.1 Short-term market performance

As the previous chapters explained, returns to acquirer shareholders are largely situational, varying according to the size of the acquirer, the type and size of the target, the form of payment, firm-specific characteristics and investor sentiment. This section aims to firstly answer the short-term value creation dilemma that surrounds M&As and then to identify general factors

within the luxury industry which could be useful to obtain better market performance at announcement in mergers and acquisitions.

#### 8.2.1.1 *Success and profitability*

Some of the cases detailed, namely Richemont and Hermès, presented slightly negative short-term market performances hinting at the possibility that mergers and acquisitions could destroy value instead of creating it, at least in the short-term. Nonetheless, when considering the results obtained by the deals of all of the organisations analysed this adversity is contrasted leading to generally satisfying outcomes. This indicates that, in Richemont's and Hermès' cases, strategy as well as firm-specific and deal-specific considerations may have hindered otherwise successful M&As.

Study after study reported average failure rates of M&As between 40 and 60 per cent, with some research even obtaining rates as high as 70 to 90 per cent (Bauer et al., 2015; Christensen et al., 2011). This thesis proposes more optimistic findings. In particular, over a total of sixty-five transactions completed by the companies assessed, forty yielded positive acquirer excess returns at announcement and only fifteen displayed negative ones, driving a failure ratio of 38%. The 62% success rate demonstrates that M&As are not necessarily value destroying transactions as traditionally thought. Instead, the data showed that within the luxury industry more than half of the cases were well received by the market which assigned them favourable short-term market performance.

A mean short-term excess return to shareholders of 1,17% was computed demonstrating that in the brief period surrounding announcement date mergers and acquisitions have a desirable effect on the acquirer market price. In fact, on average stockholders were able to have their cost of equity fully repaid and also gain a considerable return on top of it. The median ETRS calculated was marginally lower, at 1,01%, due to the effect of a couple of positive outliers only affecting the mean. Even so, the value itself is encouraging confirming overall M&As' short-term profitability within the luxury goods industry.

*Table 19. Overall announcement ETRS*

Announcement ETRS	Group 1.	Group 2.	Total
Mean	1,22%	0,66%	1,17%
Median	1,01%	0,42%	1,01%

When separating the two types of acquirers, the results indicated that the market assigned privileged M&A valuations to the deals made by Group 1, thereby leading to higher profits due

to share price gains to shareholders of frequent acquirers at announcement. Precisely, the average and median short-term excess return to shareholders for Group 1 was 1,8 and 2,4 times larger than Group 2 respectively.

#### 8.2.1.2 *Acquirer-specific factors*

The literature illustrates that acquirer characteristics may explain to a greater extent than deal specific-factors the variation in financial return to bidders (Gulubov et al., 2015; DePamphilis, 2018). With this rational LVMH in particular, but also Kering, and even Richemont in a smaller extent, find themselves at an advantage thanks to their corporate structure, specific organizational traits and attributes. By building themselves as conglomerates they created in-house corporate development teams charged with screening deals, performing due diligence and undertaking most of the analysis underlying acquisitions decisions, which allowed them to develop deal making skills and knowledge. Additionally, the nature of their assets allowed for bidder-specific synergies, which were especially focused on the joint distribution and delivery, but also on shared resources regarding network and organizational system and processes. Successful acquirers tend to internalize the M&A process such that continuing and persistent success is not dependent on the leadership at the top not the deal structure employed, LVMH, Kering and Richemont did just that.

The accumulated M&As experience and their peculiar post-merger integration process which involved a large degree of independence to the targets are also favourable factors. Conglomerates are, in fact, considered good acquirers by entrepreneurs that are reassured their companies' core values will be preserved and are often willing to transfer ownership and remain within the firm in managerial positions. For instance, LVMH repeatedly specifies in its deal announcements that its targets top executives are going to be re-confirmed post-acquisition to allow not only for a smoother transition but also because they are valued as key talents and as bearer of the corporate long-term vision. Additionally, by allowing considerable target autonomy post-merger these organisations reduce degree of desired integration and as such also the issues that it typically comports (loss of knowledge and know-how; lack of clear responsibilities; conflicts and so on) (Cartwright, 2002; McDonald, 2005) and that are often the main cause of M&A value destruction (Bauer et al., 2015).

On the other hand, the large size that characterizes all of the conglomerates might not have played in their favour. In fact, it is recognized that smaller acquirers tend to realize higher M&A returns (DePamphilis, 2018). This argument would position smaller firms, such as the ones in

Group 2 especially Prada, at an advantage. However, some of the reasons that are cited in the literature do not apply to the firms in Group 1 thanks to peculiar factors, such as them being family-owned.

For instance, the commonly applied skewed compensation system, which reflects more the overall size of the company than its ongoing profitability often leading to managers making larger and more risky investments, is not an issue for both LVMH and Kering cases. In fact, by having CEOs that are majority shareholders with strong family ties to the organization they evade the type of agency problems that hinder value creation in mergers and acquisitions. Richemont had been in a similar situation up to 2013 when the founder of the Group Johann Rupert left its managerial position to Stanislas de Quercize <sup>5</sup>. This management change led to the emergence of the agency issue in the corporation, which could have therefore found itself at a disadvantage and earning lower returns for its shareholders (note that Richemont achieved the lowest short-term performance among all of the companies analysed). The Group tried to counteract this negative effect by offering a mixed of fixed and variable compensation, mainly based on short-term cash incentive and share options, to its senior executives (Richemont, 2021a).

By being involved in many mergers and acquisitions throughout the decade LVMH, Kering and Richemont have been exposed to the unavoidable issue of overconfidence. CEO hubris is one of the most cited causes of M&A losses; while it is a widespread factor that can affect any firm, frequent acquirers tend to be the most affected because the phenomenon increases its intensity over multiple deals. This was confirmed empirically as all of the companies belonging to the first group (frequent acquirers) experienced decreasing short-term excess returns to shareholder values over time. Oppositely, both Hermès and Prada that made rare use of M&As showed upward paths in their excess returns around deal announcement. This leads to the inference that rare acquirers (Group 2) were not as affected by increases in CEO hubris and if they even marginally were the benefits they drew from the additional experience gained in previous deals was more than able to overcome it. In this setting Kering's idea of having a first phase of intense M&A activity and a following one focused on the growth of the acquired firms paid out. In fact, the company not only obtained the highest short-term excess return, but it also created a deal gap that may reduce the impact of overconfidence in future deals. Instead, LVMH

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<sup>5</sup> The position of CEO was abolished by Richemont between 2016 and 2018 when the board of directors thought it was unfair for a single CEO to be responsible for the whole Group, leaving the head of each branch to report directly to the board. Then, Jérôme Lambert was appointed and as of now still fills the position.

continuous target purchase strategy may risk leading unsatisfactory future short-term market performances if no action will be taken to contrast this effect.

The importance of communication not only internal or between target and acquirer, but also with investors was highlighted in the first chapter of this work. Investors' sentiment and in particular the way they perceive mergers and acquisitions is a relevant factor when considering not only short-term return but also its persistence over time.

Investor sentiment in the form of optimistic investors around deal announcement result in the overestimation of potential synergies and underestimation of the risks leading to higher returns to acquirer shareholder. The impact of this effect varies by sophistication of bidder shareholders, whether the bidder is public or private, and the size of the target firm compared to the bidder. In particular, the optimism tends to be greatest when deals receive extensive media attention around the announcement date, which is especially the case with large publicly traded firms as the ones analysed. In this aspect there was no difference between frequent or rare acquirers as most of the companies tried to create public visibility for their deals, the only exception is Hermès. The House only communicated with the market for the acquisitions of three targets (Maison Pierre Hardy and the tanneries du Puy and D'Annonay), while choosing to only mention the purchase of the other two firms (Bettina and J3L) in the year-end financial statements. It was impossible to establish the direct effect of the missed-communication in the latter, as Bettina and J3L short-term performance was not evaluated due to the absence of an announcement date. However, it is possible that this might have affected other transaction in the form of reduced investors' confidence in all of the firm's deals.

Another significant element to consider when analysing investor-acquirer communication is the disclosure of synergies. According to a study by Agrawal et al. (2017) on average firms that announce synergies end up paying slightly higher premiums, but they benefit from higher deal value added around announcement date and a 6% boost in two-year excess total return to shareholders compared with those that didn't mention synergies. While none of the companies analysed actually quantified synergies, most of them decided to disclose them in a qualitative way. Kering had definitely been the organization with the best track record in this regard, in fact, it always stated clearly what the acquirer and the target could bring into the deal as well as a brief vision for the newly purchased entity within the Group. Additionally, even in its strategy Kering communicates its desire to grow each of its brand individually backed by the Group, which coordinates all the shared resources and strategic functions such as logistics, IT,

marketing, real estate and so on. LVMH followed closely with clear but less extensive disclosures. Among the conglomerates Richemont was the one that shied away the most from synergy declaration only occasionally citing international expansion as its plan to develop the newly acquired entity. Prada's deal announcements were mixed. The company was open about some transactions such as Fratelli Prada's in which both synergies and price paid were disclosed and for which experienced exceptionally positive market response, but in the remaining case it chose to communicate only one or the other. It goes without saying that omitting even one factor within its synergy disclosure did not go as well in term of announcement return for Prada's shareholders, as no other deal matched Fratelli Prada's short-term market performance. Lastly, Hermès displayed limited desire to disclose synergies except for the backward integration of two tanneries that was said to be aimed at the preservation and development of sources of supplies and know-how.

#### *8.2.1.3 Deal-specific factors*

Various deal-specific characteristics influencing M&As have been widely present in the literature, such as target organizational form and method of payment. After their brief overview, the following section focuses on the factors that have been either more overlooked (strategic approach) or that presented a few contrasting results (domestic vs. cross-country).

In term of organisational form, it was shown that thanks to the limited number of bidders as well as the limited information availability acquirers tend to pay less for privately owned or subsidiary targets thereby obtaining higher short-term returns (DePamphilis, 2018). Throughout all of the deals previously analysed the vast majority represented privately owned target that were always preferred by every acquirer within the industry, probably due to this specific reason. A few exceptions were the acquisition of Tiffany by LVMH and that of Volcom by Kering, which nonetheless yielded positive and, in the latter, even exceptional announcement returns.

The method of payment chosen by the acquirer also has an effect on deal performance. In particular, the study of the impact of equity and cash payment has shown differing results in term of market characteristics. In the USA, negative returns are linked to publicly traded firm paying stock as investors recognise this payment type as a signal that shares are overvalued and so decide to sell them, thereby lowering their value. Oppositely, in Europe the existence of large block shareholders actively monitoring activity reduce this issue and allows equity payment to obtain higher announcement returns (DePamphilis, 2018). Regardless stock payment was rare

in the deals analysed and used only in special occasions such as the need to have deeper partnership with minority targets by LVMH or Richemont's horizontal merger.

When an organization decides to undertake an M&A deal an important decision regards the stake it wants to invest in its target. By separating majority and minority transactions it was shown that either are more appropriate, hence more profitable, when they fall within the entity *modus operandi* regarding mergers and acquisitions. On one hand, for conglomerates, which built their strategy by fully acquiring a substantial number of brands to add to their portfolio and by achieving vertical integration, majority acquisitions were a better fit. In fact, such deals achieved an average short-term ETRS of 1,51% compared the 0,56% obtained by minority investments, showing a considerable differential of almost 1%. On the other hand, minority acquisitions were better valued by investors when they involved luxury houses, which preferred to focus on the growth of their main brand and only take a small interest in other entities. As such, for Hermès and Prada minority acquisitions yielded better shareholders excess returns amounting to 1,04% versus a 0,59% earned by majority investments.

When taking a more general point of view, both majority and minority deals involved a positive short-term market performance. Majority deals were found to be the most profitable within the luxury goods sector in which being vertically integrated as well as having a portfolio of brands allows to recover more swiftly from negative industry conditions. An average overall ETRS of 1,41% was found for majority investments and a smaller one of 0,58% for transactions involving only minority stakes.

*Table 20. Announcement ETRS per type of M&A and no.*

Announcement ETRS	Group 1		Group 2		Total	
	No.	ETRS	No.	ETRS	No.	ETRS
Minority	18	0,56%	1	1,04%	19	0,58%
Majority	41	1,51%	5	0,59%	46	1,41%
Domestic	17	1,47%	5	0,44%	22	1,24%
Cross-country	42	1,11%	1	1,75%	43	1,13%

The literature often depicts cross-country mergers and acquisitions as being originator of more value with respect to domestic deals (Danbolt and Maciver, 2012; Reinhard and Röhrle, 2016), but there is also some evidence that the opposite is true (Conn et al., 2005). DePamphilis (2018) brings forward the theory that this difference may be due to the nature of the acquirer. He infers that cross-border deals yield positive returns for acquirer shareholders except if they involve large public bidders.



While all of the entities analysed are large public companies, they did not seem to be hindered in neither domestic nor cross-country acquisitions that managed to earn their shareholders an average announcement excess return of 1,24% and 1,13% respectively. By looking at the overall data, domestic acquisition demonstrated a slightly higher short-term market performance with respect to cross country ones. This finding is in contrast with the most recognized theory within the literature that states the opposite to be true. However, by separating the returns per acquirer group it is possible to notice two separate trends: frequent acquirers experienced higher results from domestic deals while rare acquirers faced better performances with cross-country transactions. Domestic acquisitions generated average announcement excess returns of 1,47% to the conglomerates' shareholders and only 0,44% to those of Hermès and Prada. Oppositely, cross-country deals yielded an average short-term ETRS of 1,11% for companies in Group 1 and 1,75% for those in Group 2. It is noticeable that the differential is greater when its Group 1 outperforming Group 2 and not vice versa, that is mainly due to the acquirer-specific factors shown before that allowed the overperformance of conglomerates on single brands.

Even though as was mentioned above all of the companies are comparable, the organizational structure of the conglomerates implies that they are somewhat larger in size. In accordance with DePamphilis idea, the organizations belonging to Group 1 might have faced slightly lower profitability in cross-country deals because of their bigger size. In this light, the presence of a substantially wider number of mergers and acquisitions belonging to Group 1's acquirers had an impact on the overall results and might have been the reason for the higher returns being derived from domestic deals.

Lastly, various strategic approaches to mergers and acquisitions were analysed to understand which one could be chosen to maximise short-term shareholders returns and which was more likely to obtain only moderate market reception. In particular, the transactions were divided in

*Table 21. Announcement ETRS per M&A strategy*

Announcement ETRS	Group 1		Group 2		Total	
	No.	ETRS	No.	ETRS	No.	ETRS
Brand portfolio expansion	35	1,20%	0	-	35	1,20%
Backward integration	8	1,34%	3	0,26%	11	1,04%
Forward integration	2	-1,97%	1	5,03%	3	0,37%
Strategic acquisition	10	2,32%	1	1,04%	11	2,20%
Horizontal merger	1	-1,35%	0	-	1	-1,35%
Unrelated acquisition	3	0,38%	1	-2,88%	4	-0,43%

the following categories: brand portfolio expansion, vertical integration (backward and forward), strategic acquisition, horizontal merger and unrelated acquisition.

In accordance with the strategy undertaken by the companies examined brand portfolio expansions were employed only by the conglomerates and were by far the most utilized type of M&A present in 35 cases over a total of 65 analysed. Their announcement performance was satisfying, with an average ETRS of 1,20%.

According to Bruner (2014) revenue-enhancing synergies are often assigned a larger discount rate with respect to cost-reduction synergies. This would lead to lower deal valuation for this category with respect to both backward integration, which often allows for economies of scale and margin improvement, and strategic acquisition, that create economies of scope. However, this is confirmed only for the latter. In fact, among all the strategies brand portfolio expansion was ranked in the second place after strategic acquisition, but before backward integration. The reason for this theoretical and empirical discrepancy may be due to the fact that the vertical integrations were undertaken not only by conglomerates, but also by firms in Group 2. Group 2 was in general linked with lower announcement results and as such reduced the profitability of the strategy with respect to the acquisition of new brands. In fact, when comparing the results obtained by two approaches solely for Group 1, backward integration shows higher valuations confirming Bruner's theory.

Vertical integration was widely practiced within the industry, especially to secure high-quality raw material and essential manufacturing know-how, but also to obtain high-visibility real estate located in shopping hubs.

Backward integration was the second strategy in term of volume of deals (equally to strategic acquisition) and third for the short-term ETRS yielded to shareholders, which amounted to 1,04%. More values were assigned by the market to this type of deals when they were undertaken by conglomerates which could apply the newly acquired competences and machinery to multiple brands creating economies of scope and have more possibilities to create synergies. In fact, while still having an average positive return the luxury houses experienced poorer market performance on backward integration obtaining a result of only 0,26% (compared to the 1,34% yielded by Group 1).

Forward integration was less frequent in the industry due to companies preferring to acquire boutique space and real estate directly and not through mergers and acquisitions. Overall, the strategy obtains a slightly positive result (0,37%), but experienced considerable differences and

fluctuations in individual deal performance. Differently from backward integration which favoured companies with a conglomerate type of structure, the data indicates that forward integration was better valued by the market when undertaken by single-brand organisations. In particular, while Group 1 obtained a significantly negative excess return on deals aimed to forward integrate targets, namely -1,97%, Group 2 could boast an exceptional result of 5,03%. However, it is difficult to draw solid conclusion on the matter as there was only a limited number of deals on which to base this assessment. For instance, the only forward acquisition completed by Group 2 was the transaction between Prada and Fratelli Prada whose enormous success is also attributable to other factors especially the strong family ties between the two firms.

Strategic acquisitions were rewarded the highest performance among all the strategies considered and yielded an extremely high average excess return of 2,20% at announcement. Companies undertaking strategic acquisitions do so to enter new market segments and/or exploit the economies of scope product complementarity allows, which the market recognized as value creation activities and rewarded appropriately.

The single case of horizontal merger by Richemont was assigned a negative and significant excess return of -1,35%. The results should not have been hindered by the payment method as it was shown that European markets are more receptive and optimistic toward equity payment with respect to the USA ones (DePamphilis, 2018). However, it is possible that factors such as the unicity of the deal and the lack of comparability with similar transactions in the industry might have led investors to take a more cautious approach leading to the unsatisfactory excess return shown.

Unrelated investments drove the second worst average excess return, -0,43%, only followed by the single case of horizontal merger. That was to be expected since the literature had been in agreement in defining focus on both geography and activity as a source of value creation or at least conservation, while diversification has been known for destroying it (Bruner; 2014). It is impossible to say that geographical differentiation has been detrimental in this industry as many brands acquired and various vertical integration involved firms in foreign countries (and it was shown above that cross-country acquisition actually dominated domestic ones). However, the same cannot be said for activity differentiation that was not recognized by the market as something able to bring the acquirer an added value. Differently from strategic acquisitions that

allow the opening up of new segments of markets in which the company is already present, unrelated acquisition refer to the immediate entrance for the acquirer into completely new markets. That was not appreciated by bidders' investors leading to the unfavourable results obtained by unrelated acquisitions compared to other strategies. It goes without saying that this type of M&As was rare and selected only four times by the companies examined over the period considered.

It has to be noted that among all of the deal-specific factors that were studied none yielded negative performances with the only exception of the use of horizontal mergers and unrelated acquisitions as M&A strategic type. Forward integration experienced adverse results only for frequent acquirers, but when looking at the overall return the exceptionally optimistic valuation assigned to the only deal made by Prada (grouped within rare acquirers) more than compensated leading to favourable total excess return for the strategic type. Regardless, only a minority of the deals made pertained to those categories demonstrating the ability of every company to have a considerable understanding of the factors affecting negative deal performance as to avoid undertaking value destruction M&As.

At last, all the deal-specific factors analysed were examined together to obtain more clarity on their combined effect on announcement ETRS (see appendix). There were clear differences on the type of M&As undertaken by companies belonging to Group 1 or 2 as well as on how the factors affected them, which caused the results of this profitability analysis to be clearly divided between one or the other type of acquirer.

Firstly, the single majority forward integration of a domestic firm resulted in the best strategy overall with its 5,03% excess return to shareholders. However as explained before the acquisition of Fratelli Prada by Prada (Group 2) itself was a very peculiar transaction characterised by strong family ties between target and acquirer. The undertaking of majority domestic brand portfolio expansions by Group 1 offered the second-best results achieving on average a 2,86% short-term ETRS. It has to be noted that the same strategy applied to different target geographical provenance and/or stake invested resulted in considerable performance differences even leading to negative excess returns when the deal involved minority stakes in domestic firms. Strategic acquisitions of minority interests in cross-country companies (employed solely by the conglomerates) yielded the following highest value to shareholders, namely of 2,49%.

Oppositely, majority domestic unrelated acquisitions and the individual cases of majority cross-country horizontal merger and minority cross-country forward integration resulted in the worst short-term performance fluctuating between -4,04% for the latter and -1,32% for the former.

As was introduced above, frequent acquirers experienced a better short-term market performance with respect to exceptional bidders. Their overperformance is due not only to the effect of favourable acquirer characteristics typical of their conglomerate nature but also to a better understanding and exploitation of deal-specific factors affecting M&As.

For instance, Group 1 companies focused the majority of their transactions, namely the 90%, in the top three performing strategies (strategic acquisition, brand portfolio expansion and backward integration) with only the remaining 10% following the lower profitability ones (unrelated acquisition, forward integration and horizontal merger) against the same measures accounting for 67% and 33% for firms in Group 2. Similarly, both type of acquirers preferred to take on majority stakes in their targets even though controlling interests are especially beneficial only for frequent acquirers and rare bidders obtained better results in minority M&As. Instead, in term of geographical location both groups undertook deals that were less than optimal for them. On one hand, the two luxury houses favoured domestic transaction that yielded their shareholders only mildly positive returns with respect to foreign investments. On the other hand, the conglomerates opted for a considerable number of cross-country M&As which were not as profitable to them as the domestic ones.

Even in term of the combined power of the previously considered deal-specific factors, frequent acquirers were able to recognised some of the most efficient choices and exploit them whenever they made a deal, while rare acquirers did not. In particular, frequent acquirers took on a significant number of investments in expanding their portfolio of brand with majority stakes in domestic companies and either majority or minority ones in foreign targets, all of which were combination that created considerable value for the bidder's shareholders. Additionally, a significant number of deals involved the strategic acquisition of controlling stakes in cross-country firm, which yielded optimal results in term of announcement ETRS. Rare acquirers experienced the highest deal concentration in majority investments for the backward integration of domestic firms, which were characterised by negative short-term market performance.

It is clear that the inefficient exploitation of deal-specific factors affecting M&As by luxury houses compared to the conglomerates only increased the performance differential between the two types of acquirers.

#### 8.2.1.4 Intragroup performance

Performance was not completely homogeneous even within the previously designated groups of acquirers and some strategic and performance differences emerged.

*Table 22. Mean and median announcement ETRS per acquirer*

Announcement ETRS		Group 1		Group 2	
	LVMH	Kering	Richemont	Hermès	Prada
Mean	1,48%	2,36%	-0,85%	0,02%	1,30%
Median	0,87%	1,87%	-0,58%	-0,20%	1,75%

Within Group 1, LVMH and Kering earned optimal short-term excess returns to shareholders, while Richemont experienced negative announcement performance.

Individual deals specifics aside, Richemont did not fully benefit from the previously exposed factors affecting M&As leading to a worst overall market reception of its transactions. In term of acquirer-specific factors all the conglomerates displayed well thought-out M&A process with limited post-merger integration. However, there were significant differences in the intent behind their deal activity. Kering aimed at a core business transformation (from a retail to a luxury centred group), instead LVMH and Richemont's objective was mainly growth and expansion. If LVMH pursued it continuously making a large number of deals, Richemont preferred to do so in a less systematic and more occasional way by only integrating "hidden treasures", its less programmatic approach might have caused investors to be more sceptical. Additionally, The Swiss-based organization tended to shy away from synergy declaration and detailed deal description when communicating with the market thereby hindering positive investors sentiment. Also, differently from the others the absence of a majority shareholder-CEO caused Richemont to be affected by more agency issues and possibly CEO hubris. In term deal-specific factors, it was found that within Group 1 Richemont had the highest deal concentration in the three worst strategies as 17% of its deals referred to forward integration or horizontal merger (no unrelated acquisition was made) with the same measure being only 7% and 9% for Kering and LVMH respectively. Moreover, Rupert's company performed better in domestic acquisitions, but it made rare use of them focussing instead on cross-country deal. The other conglomerates were more conscious of their deal choices made and invested more in transactions profitable to them. What is appalling is that Richemont's performance was the worst among all the companies analysed, rare acquirers included, even though compared to them it was clearly advantaged by its deal-making experience and defined transaction process.

The discrepancy observed between LVMH and Kering performance is certainly lower than the one shown in comparison to Richemont, but nonetheless significant. That could be attributable to the phenomenon of decreasing returns over time. In fact, LVMH has based a considerable part of its strategy on M&As from its establishment. As a consequence, it is possible for its short-term performance to have decreased over time thereby reaching a lower level with respect to Kering that concentrated most of its deal activity between 2006 and 2015. Regardless, it has to be noted that the drop in return was much steeper for Kering indicating that if it had continued making deal in the same way it would have probably obtained a lower short-term performance, instead its period of organic growth (2015-2019) prevented the issue entirely.

Similarly, rare acquirers experienced differing results in term of short-term market performance created by the M&As undertook. In particular, the deals made by Prada have been better valued by the market with respect to Hermès', which only gained close to zero average excess returns. The former has definitely been aided by its exceptionally profitable deal with Fratelli Prada, but it is undeniable that it has paid more attention to its communication with the market and its investors allowing for more media attention as well as more detailed information about its transactions to transpire to the public. As per deal-specific factors both would have been in better luck if they choose to make more minority cross-country transaction, instead of opting for the opposite.

## 8.2.2 Long-term market performance

Long-term M&A performance has been one of the most controversial topics for researchers due to the contradicting findings in different studies. The next section aims to clarify the dilemma on long-term market profitability of mergers and acquisitions on their own as well as per M&A strategy within the luxury industry. It also assesses the intragroup discrepancies and analyses the long-term performance power of predictability of announcement results and valuation.

### 8.2.2.1 *ETRS and value creation*

By looking at the joint results obtained by all of the firms analysed it is clear that they presented positive returns for shareholders as well as significant value creation between 2010 and 2019. In fact, even though there were firms experiencing some adverse measures of value creation, namely Richemont and Prada, the majority yielded favourable and promising results

completely overcoming the exceptions. In particular, an average 16% return to shareholders generated an overall value of € 78 bln. In term of ETRS on cost of equity the luxury goods organisations were able to yield shareholders a 9% return after compensating for investors' ownership risk, thereby earning them € 36 bln in value. Lastly, return in excess of MSCI luxury goods index was 0% on average due to positive and negative returns from different firm cancelling each other out and matching perfectly the performance achieved by the industry. However, when taking in consideration value creation, the impact of large market capitalisations of firms experiencing positive ETRS on MSCI (especially LVMH) allowed to still generate considerable value on top of the industry: € 5 bln.<sup>6</sup>

*Table 23. Total, per group and individual average annual ETRS and 2010-2019 value creation*

Value creation 2010-2019	Total	Group 1	Group 2	LVMH	Kering	Richemont	Hermès	Prada
Return to shareholders	16%	19%	12%	21%	25%	10%	23%	1%
ETRS on ke	9%	10%	6%	14%	18%	0%	19%	-7%
ETRS on MSCI	0%	3%	-4%	5%	9%	-5%	4%	-12%
Value created (TRS) (€Bln)	78	106	36	205	85	28	71	1
Value created (ETRS on Ke) (€Bln)	36	46	22	97	41	0	48	-5
Value created (ETRS on MSCI) (€Bln)	5	9	-1	21	13	-7	5	-7

This indicates that, overall, the firms considered experienced good outcomes from their strategies regardless of whether that entailed a significant use of mergers and acquisition. However, when looking into more detail at the different performance obtained by the two groups of acquirers it is clear that there is substantial difference between them, with the best results belonging to Group 1.

#### 8.2.2.2 *Group performance and the impact of numerous deals*

As previously introduced, frequent acquirers experienced on average higher results in term of every measure considered for both ETRS and value creation with respect to rare acquirers. In particular, there was an additional 6% to 7% for each measure of return achieved by Group 1 with respect to Group 2. This difference was exacerbated when considering value creation due to the conglomerates all having a larger market capitalization, that is especially true when looking at TRS as frequent acquirer obtained on average € 70 bln more than rare acquirers.

<sup>6</sup> Prada's and Richemont's value creation data described in the text as well as on the following table originally in HKD and CHF, are presented in EUR to allow for better comparison. The exchange rate applied was the one of the end of-the period considered.



The same discrepancy was presented in the short-term as well. However, if around announcement both groups experienced positive excess returns with the conglomerates only experiencing higher price increases, between 2010 and 2019 single-brands actually yielded negative ETRS on MSCI values showing an average industry underperformance.

The reasons for this performance differentials are difficult to explain by looking at the literature as only a reduced number of researchers took into consideration the long-term effects of M&As and even those who did could not find matching or conclusive results mainly due to methodological issues and the failure to incorporate other strategical elements impacting a firm performance (as shown in chapter one). In addition, long-term returns vary substantially by industry and deal pattern (Rehm et al., 2012), which most studies failed to separately recognise.

Rehm et al. (2012) incorporated the importance of the deals pattern made by separating firms according to their growth strategy and to their specific industry and studying their returns over the period between December 1999 and 2010. They determined among their sample of firms five different strategies, namely programmatic, selective, tactical, large deals and purely organic. A company employing a programmatic strategy completes many acquisitions that together make up for a material level of investment as a percentage of the firm market capitalization. Oppositely, a tactical approach involves numerous small deals though not making up a large part of the company market cap. Selective deal making refers to the occasional undertaking of deal by organisations that do not have an M&A capability or a proactive M&A strategy; in this case return to shareholders are mostly driven by organic growth with only marginal relevance of the inorganic approach. Lastly, firms may choose to undertake large deals that represent more than 30% of their market cap. It was found that organisations using programmatic strategies are generally the most successful. When looking precisely at the consumer discretionary industry, in fact, programmatic strategies achieved the highest excess returns followed by the selective and tactical approaches. Instead, both large deals and pure organic growth were related to negative long-term ETRS. As a consequence, a growth strategy built around many small deals can actually be less risky than avoiding M&A altogether.

Unfortunately, due to the lack of detailed data on the deals analysed (in particular prices paid that were often undisclosed) this study found it impossible to clearly differentiate frequent acquirers between those following a tactical and those using a programmatic approach. Nonetheless it is clear that this research confirms that within the luxury goods industry frequent acquirers which made a large quantity of mergers and acquisitions (regardless of its percentage

on market capitalization) achieved on average better performance than rare acquirers, which undertook the occasional deal to aid organic growth (selective strategy according to Rehm et al.). What is interesting is that the literature actually assigns selective approaches a 2% ETRS of the global consumer discretionary index, showing the strategy led to peer overperformance. However, this thesis finds strategies pursuing the occasional M&A along with a focus on organic growth to have a considerable industry underperformance resulting in value losses. According to a more updated study by Rudnicki et al. (2019) the uncertain and fast-moving environment that characterized the period between 2007 and 2017 led to alternative approaches to the top performing programmatic strategy, including the selective one, to under-deliver and actually show ETRS losses relative to peers. This is in line with the previously exposed findings about rare acquirers and highlights the relevance of the firm environment not only as a general influence, but as a significant force able to drive otherwise profitable M&A strategy to failing to deliver positive results.

The main reasons for the long-term success of frequent acquirers that systematically and programmatically use M&As is that they define the program and treat mergers and acquisitions as an enduring capability rather than an occasional event or project. According to the literature, they are more likely to estimate revenues and cost-synergies at various stages of the deal-making process as well as more likely to have designated clear personnel for each stage. Additionally, they are rewarded for their efforts in building up organisational infrastructure and establishing best practices across all stages of the M&A process (from strategy and sourcing to due diligence and integration planning to establishing the operating model). By aligning M&A strategy with corporate strategy frequent acquirers allocate M&A capital to business units that align with strategic objectives and make buy-sell choices on their firm's aspirations. Perfect examples of this practice are Kering's re-organisation into a luxury group and LVMH's decision to build as a luxury conglomerates with multiple brands and full vertical integration. Another KSF fundamental for frequent acquirers is the development of a defined vision for the new company during the integration process as well as clear measures and performance indicators to ensure everything is done correctly and according to the plan. This ensures not only a smooth integration, but also guarantees the correct development of the target to match the project and objectives determined by its acquirer (McCurdy et al., 2019; Rudnicki et al., 2019).

According to Rehm et al. (2012) larger companies tend to rely much more on inorganic growth with respect to smaller ones. This leads to programmatic approaches to M&As being

selected by mostly large firms, while smaller companies employ less profitable strategies. This is confirmed for all of the cases analysed. In fact, companies choosing to make a significant number of M&A as part of their corporate strategy (LVMH, Kering and Richemont) were shown to be slightly larger than those (Prada and Hermès) pursuing organic growth with the occasional deal. Even though this is not necessarily an issue it still drives an important reflection about the difficulty that small firms do or will encounter in reaching or surpassing the performance of their larger competitors. Additionally, due to the specific characteristic of frequent acquirers it is very challenging for individual companies to transition from any other approach to the systematic use of M&As (Rudnicki et al., 2019). This may lead to a substantial performance differential over a longer time frame between large companies that decided to pursue the use of programmatic acquisitions and smaller ones which did not. A considerable difference between frequent acquirers and rare acquirers was already assessed so far, but these arguments suggest that the disparity will only worsen in the future if the organizations continue to pursue their chosen strategy.

A volume effect affecting firms choosing a programmatic strategy was discovered by Rehm et al. (2012) that suggested that the more deals a company does the higher the probability it will earn excess returns. This argument is in accordance with previous research as well. For instance, Amburgey and Miner (1992) showed that when a firm engages in multiple acquisitions over time, it may create a strategic momentum lasting for several years and according to recent practitioner (Frick and Torres, 2002; Rovit and Lemire, 2003) create substantial value for its shareholders (Laamanen et al., 2008). Within this thesis, the volume effect in the long-term was exhibited when comparing between Group 1 and 2 as shown above, but not actually within frequent acquirers themselves as suggested by Rehm et al. (2012). By looking solely at Richemont's and LVMH cases it might seem for the volume effect to be confirmed as LVMH displayed a higher number of deals as well as higher ETRS on industry index. However, by taking in consideration data from Kering's performance it is clear that is not the case. In fact, even though LVMH made more than twice the number of deals with respect to Kering during the same period, the latter was still able to draw higher average ETRS values. As a consequence, it is not possible to make clear conclusions on whether a larger number of deals actually has an effect on long-term performance on its own on companies making numerous M&As, but the data seem to indicate that the strategy behind it may play a more significant role.

#### 8.2.2.3 *Intragroup performance*

In the previous section the long-term market performance superiority of frequent acquirers with respect to rare acquirer was shown. However, by looking at the table presented above it is noticeable that the groups considered are not fully homogeneous and different trends are discerned according to the individual acquirer.

The heterogeneity demonstrated among classes of acquirers is common to both groups, but is especially present for rare acquirers. In fact, the companies within Group 2 have been characterized by substantial performance disparities and often demonstrated opposing direction as one yielded optimal result, while the other simultaneously obtained unsatisfactory ones.

The only measure that showed positive results for both Hermès and Prada is return to shareholders, which amounted to 23% for the former and just 1% for the latter. This discrepancy was only heightened when considering the value created by it, for which an additional € 70 bln was attributed solely to Hermès. Instead, when taking in consideration excess returns they showed opposite direction. Hermès obtained a 19% ETRS on cost of equity, the highest among all of the companies analysed including LVMH and Kering hence realising a € 48 bln of value, while Prada was unable to compensate its investors for their ownership risk leading to a € 5 bln of value destruction. Similarly, if Hermès showed considerable outperformance of its peers by yielding a 4% ETRS on MSCI, thus creating € 5 bln of value, Prada's returns were about 12% behind those of its competitors thereby leading to a negative value of € -7 bln. It is clear that Prada's impact of each measure of return on value was limited compared to its peers by its smaller market cap as well as the smaller period of computation (eight years instead of ten). This has been particularly beneficial for the company as to reduce the impact of its negative market performance leading to smaller value destruction than it otherwise would have achieved and reducing its discrepancy with respect to Hermès' results.

The reason for this difference is shown by looking at the pertinence and efficacy of the diverse organic growth model and corporate strategy applied. On one hand, Hermès thrived thanks to its ability to systematically retain an aura of exclusivity through references to its history and tradition as well as relentlessly building brand awareness through global marketing. In doing so, the House achieved resilience and continued profitability which allowed it to prosper in the long-term. On the other hand, for a long time Prada's corporate strategy was not mindful of the forces and the new trends characterising its environment. The Italian company resisted the changes happening in the industry for many years as it did not realise the importance

of young customers as well as the need for digital transformation. By the time this trend was corrected it was already late for the new strategy to have a significant positive impact able to counteract the consequence of its previous choices within the period considered in this study.

Group 1 has also showed some differences within its constituents, but on a more limited scale with respect to Group 2. In particular, out of the three companies involved two (Kering and LVMH) demonstrated the ability to earn significant return to their shareholders and only one (Richemont) struggled to yield positive results.

Between 2010 and 2019 both Kering and LVMH prospered and competed for the leadership position within the European luxury industry. Kering actually obtained higher values for every measure of return with respect to LVMH, for instance it accounted for an average yearly 9% of industry overperformance. That is on its own an incredibly outstanding result, but it also defined an additional 4% against the 5% earned by the competitor. However, when considering Kering's value creation, it is clear how it did not even slightly match what LVMH achieved, as its much larger market capitalization allowed it to make the most of the returns yielded. Regardless of the fact that Kering overperformed LVMH with respect to all measures of return by 4%, the latter demonstrated larger value creation ability. For instance, ETRS on MSCI generated a value differential of € 8 bln between the two competitors, but even more relevant is the additional € 120 bln in favour of LVMH of value created by return to shareholders.

Oppositely, Richemont fell strongly behind the other frequent acquirers as it struggled to yield its shareholders returns on top of cost of equity, while also showing considerable industry underperformance. The Swiss-based conglomerate obtained an average annual positive TRS, but that only amounted to 10% versus the 25% and 21% of Kering and LVMH respectively, hence determining clear difference in the value created by TRS, which on average was €117 bln less than its peers. Also, while other firms yielded positive ETRS, Richemont only had a 0% for return in excess of cost of equity and -5% on the industry index, showing that the strategic approach employed did not work as well for it as for the other Group 1 constituents.

For frequent acquirers the disparity was mostly generated by the intent and the commitment put into the M&A activity as well as the realignment of deal effort and corporate strategy.

Richemont and LVMH chose a similar approach to mergers and acquisitions by at the same time making various acquisitions and growing organically the firms already present (or newly acquired) within their portfolios. However, the intensity with which they were pursued were different. LVMH committed fully to the systematic and programmatic use of M&As as it

acquired about thirty-three companies within the period selected, with an average of more than three deals per year, and it was able to develop and expand them according to its strategy allowing for synergies in internationalization, distribution, advertising. This represents more than twice the number of firms bought by Richemont, which instead chose to focus on organic growth of its companies while at the same time pursuing acquisition of hidden treasures to help expand nationally and internationally. So, even though it decided to build as a conglomerate, Richemont did not undertake such concentrated M&A activity and chose only making bids when it found itself in front of a “jewel”. This less structured approach might have contributed to the scarce performance obtained by the Swiss firm, but it is not the only factor.

Another relevant issue to discuss is the intent that every company followed when pursuing its deals. In fact, if Kering and LVMH aligned the M&A pursued with their strategy very well, Richemont was less accurate. Kering, which was the top performing firm, enforced two separate and concentrated phases, during its first five years it purchased as many companies as Richemont did in ten, then proceeded to expand them rigorously and thoroughly. Differently from the other two it seemingly divided its organic and inorganic growth into different periods in order to fit its corporate strategy. In fact, at the beginning the firm faced the need to structure itself into a luxury group by removing all the other unrelated business in which it was involved and acquiring new ones pertaining to the industry. Then, even though it could have continued to make acquisitions it preferred to focus on its portfolio and improve its performance by expanding its newly acquired and existing brands thanks to shared resources and synergies. LVMH combined its deal and corporate strategy by pursuing many transactions in order to build as one of the top luxury conglomerates and definitely the most diversified. Richemont, instead, was less efficient in using M&As to reach its strategic goals. During the period considered the Swiss company reorganised part of its group by establishing the Online Distributor division mainly through the purchase of specialized firms. That allowed it to not only face the trend of industry digitalization, but also to find a way to be a pioneer in the niche. However, the remaining acquisitions did not follow a precise intent if not that of occasionally adding new brands or vertically integrate.

As a consequence, the importance of the intent behind mergers and acquisitions as well as the commitment to aligning deal and corporate strategy was confirmed as a key fundamental factor to create long-term performance. In fact, even though Richemont pursued the use of frequent acquisition, which are normally linked with superior long-run market performance, its less than efficient use of the M&As made led to the unsatisfactory results presented above.

#### 8.2.2.4 *Does M&A short-term performance actually reflect the long-term one?*

The literature often discusses short-term M&A performance as a source of value and returns to the acquirer shareholders. It is however dubious whether the effects of deals around announcement are reliable indicators of long-term performances. The next paragraphs show this study's findings on the matter.

According to Koller et al. (2015) even though it is natural for companies and their investors to be happy when share prices rise, that is not necessarily a sign of good performance (or vice versa). They state that even though there's nothing wrong with rising share prices, they don't necessarily indicate whether a company is fundamentally healthy, in the sense of being able to sustain its current performance and to build profitable businesses in the future.

Koller assessment might suggest for short-term M&A market performance not to be a dependable and trustworthy indicator of the firm long-term profitability. However, this research found that in some specific case the opposite may be true. In fact, while both the companies in Group 2 (Hermès and Prada) displayed high discrepancy between long-term and short-term performance, for the companies in Group 1 the wider time period considered mainly confirmed the announcement results. That is to be expected as M&As made up a significant part of the strategy employed by the conglomerates, but they had only a marginal effect on single brands organisations.

In detail, frequent acquirers experienced a performance consistency as Kering yielded the best results in term of both long-term and short-term, followed closely by LVMH. Instead, Richemont's adverse announcement returns were linked to an unsatisfactory long-run that showed important industry underperformance.

Of more interest are rare acquirers and the discrepancy they presented in the different time period considered. In particular, Prada obtained sizable good results around announcement date for its deals, however it achieved the worst long-term accomplishment as it failed to compensate shareholders for their ownership risk and displayed considerable industry underperformance. As a consequence of the implementation of an outdated strategy that was not mindful of the continuously changing environment surrounding it, Prada found itself behind its competitors and failed to generate value for various years. The optimistic announcement results that the firm achieved suggest that the deals undertook might have had a positive effect on long-term performance, but only marginally due to the firm's choice to develop through organic growth, as such not able to contrast the negative impacts of its strategy. Oppositely, Hermès was unable

to yield share price increases around announcement date, in fact it experienced an average short-term ETRS very close to 0. However, during the ten years studied it obtained very optimistic performance with significant value creation and the best result among all companies considered in term of ETRS on cost of equity. This shows that even though Hermès did not communicate efficiently with its investors when announcing its M&A activity, in a longer time frame the market still recognised not only the efficacy of its strategy, but also the efficiency with which it was implemented.

This shows that long-term acquirer performance may be reflected within announcement deal results, but only if M&A make up a significant part of the firm's corporate strategy. Instead, for firms that do not strongly rely on mergers and acquisition to grow, announcement returns may have an effect on long-term performance, but only marginal as the efficiency of the organic strategic approach undertook becomes the main determining factor.



## Conclusion

This thesis has provided evidence of the importance of mergers and acquisitions as a mean for value creation within the luxury industry. In particular, the analysis of both the short and long-term market performance of the cases considered led to overall positive results being connected with M&A activity thereby contrasting the traditional belief that linked those type of transaction to the destruction of value. In addition, the separation of different classes of acquirers based on their M&A approach allowed to define the strategy and best practices which ensured frequent acquirers overperformance on rare acquirers.

Within the short-term, this research found a more optimistic deal success rate with respect to the ones normally cited in the literature. Hence, even though this study came across some adverse announcement excess returns, the large majority of the results were satisfactory, demonstrating that 62% of the times the market positively valued the transactions made. Moreover, the positive results were able to completely overcome the few negative ones leading to an optimal average deal short-term market performance of 1,17%.

Companies making frequent acquisitions with a methodical and systematic approach to deal-making were able to obtain almost twice the announcement ETRS yielded by rare acquirers, which used M&As only occasionally. Thanks to their conglomerate nature, frequent acquirers were advantaged by acquirer-specific factors such as the presence of in-house corporate development teams, the accumulated experience from past M&A, the existence of bidder-specific synergies and their peculiar post-merger integration process. Moreover, they had a better understanding of the deal-specific factors affecting transactions, which they were able to recognise and exploit as to obtain better results and higher value creation. In fact, frequent acquirers deals concerned mainly majority stakes in small companies accomplished according to the three top-performing strategies: strategic acquisition, brand portfolio expansion and backward integration. Oppositely, rare acquirers undertook various deals with characteristics linked to lower profitability to them, thereby worsening their ETRS differential with the conglomerates.

This study avoids the main methodological issues faced by traditional literature by assessing the long-term performance per classes of acquirers and not per M&A. It shows that frequent acquirers obtained on average positive and optimal results in term of value creation as well as the various measures of return and even more importantly they overperformed luxury goods

industry index. Industry consolidation has enabled firms to pool common resources (especially in centralized distribution and delivery, but also in IT, marketing, real estate and so on) and realize economies of scope and scale. As a result, conglomerates making frequent use of M&As have been able to strengthen their industry position. Instead, single-brand companies that made rare use of mergers and acquisitions were able to compensate shareholders for their cost of equity, but experienced considerable industry underperformance.

Frequent acquirers were successful because they treat mergers and acquisitions as an enduring capability rather than an occasional event or project. They are able to align M&A and corporate strategy and make buy-sell choices based on their firm's aspirations demonstrating a clear intent behind their deals. Additionally, they were rewarded for their efforts in building up organisational infrastructure and establishing best practices across all stages of the M&A process (from strategy and sourcing to due diligence and integration planning to establishing the operating model).

Starting from a general theoretical point of view, this study developed with a focus limited to the luxury industry and its performance within the period ranging between 2010 and 2019. Additionally, it was developed with a case study approach which is meant to assess specific companies and derive observation on them. There is still much to uncover regarding M&As, especially their long-term effect on acquirers on which further studies could be useful to give executives a clearer picture on the matter in order to make the most of their investments.

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# Appendix

*Table 24. Cost of equity - LVMH*

Cost of equity - LVMH	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Average
Risk free rate (%)	3,3	3,15	1,83	1,62	1,57	0,27	0,27	0,44	0,64	0,1	
Beta	0,82	0,82	0,82	0,82	0,82	0,82	0,82	0,82	0,82	0,82	
Expected market risk premium (%)	5,4	6,15	8,26	7,01	6,62	6,37	6,98	6,23	5,61	7,49	
Cost of Equity – annual (%)	7,72	8,19	8,60	7,36	6,99	5,49	5,99	5,54	5,24	6,24	6,74
Cost of equity – daily (%)	0,03	0,03	0,03	0,03	0,03	0,02	0,02	0,02	0,02	0,02	0,03
Cost of equity–announcement(%)	0,12	0,13	0,14	0,12	0,11	0,09	0,09	0,09	0,08	0,10	0,11

Source: Zacks, 2021; Fenebris, 2021.

*Table 25. Long-term value creation - LVMH*

Long-term value creation - LVMH	2010-2019	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Price per share at year-end (€)	78,38	123,35	109,40	137,80	132,60	132,25	147,15	181,40	245,40	258,20	414,20	
Dividends per share (€)	1,65	2,10	2,60	2,90	3,10	3,20	3,55	4,00	5,00	6,00	4,80	
Return to shareholders	60%	-9%	29%	-2%	2%	14%	26%	38%	8%	62%		
Arithmetic average rate of return	23%											
(Return + 1)	160%	91%	129%	98%	102%	114%	126%	138%	108%	162%		
Cumulative return	551%											
Geometric average rate of return	21%											
Cost of equity (annual)	6,74%	6,74%	6,74%	6,74%	6,74%	6,74%	6,74%	6,74%	6,74%	6,74%	6,74%	
ETRS on cost of equity	53%	-16%	22%	-8%	-5%	7%	19%	31%	1%	56%		
Arithmetic average excess return	16%											
(ETRS + 1)	153%	84%	122%	92%	95%	107%	119%	131%	101%	156%		
Cumulative excess return	262%											
Geometric average excess return	14%											
MSCI index return	54%	-13%	37%	21%	-12%	-3%	14%	42%	-8%	41%		
ETRS on MSCI	6%	3%	-9%	-23%	15%	17%	12%	-4%	16%	21%		
Arithmetic average ETRS	5%											
(ETRS + 1)	106%	103%	91%	77%	115%	117%	112%	96%	116%	121%		
Cumulative excess return	56%											
Geometric average ETRS	5%											
Market capitalization (€Bln)	37											
Value created by TRS (€Bln)	205											
Value created (ETRS on Ke) (€Bln)	97											
Value created (ETRS on MSCI) (€Bln)	21											

Source: MSCI, 2021.

*Table 26. Cost of equity – Kering*

Cost of equity - Kering	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Average
Risk free rate (%)	3,3	3,15	1,83	1,62	1,57	0,27	0,27	0,44	0,64	0,1	
Beta	0,91	0,91	0,91	0,91	0,91	0,91	0,91	0,91	0,91	0,91	
Expected market risk premium (%)	5,4	6,15	8,26	7,01	6,62	6,37	6,98	6,23	5,61	7,49	
Cost of equity – annual (%)	8,21	8,75	9,35	8,00	7,59	6,07	6,62	6,10	5,75	6,92	7,34
Cost of equity – daily (%)	0,03	0,03	0,04	0,03	0,03	0,02	0,03	0,02	0,02	0,03	0,03
Cost of equity–announcement(%)	0,13	0,14	0,15	0,13	0,12	0,10	0,10	0,10	0,09	0,11	0,12

Source: Reuters, 2021; Fenebris, 2021.

*Table 27. Long-term value creation - Kering*

Long-term value creation - Kering	2010-2019	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Price per share at year-end (€)	78,3	111,4	102,8	130,2	142,8	148,3	149,1	198,3	365,3	441,6	585,2	
Dividends per share (€)		3,5	3,5	3,75	3,75	4	4	4,6	6	10,5	8	
Return to shareholders		47%	-5%	30%	13%	7%	3%	36%	87%	24%	34%	
Arithmetic average rate of return	28%											
(Return + 1)		147%	95%	130%	113%	107%	103%	136%	187%	124%	134%	
Cumulative return	858%											
Geometric average rate of return	25%											
Cost of equity (annual)		7,34%	7,34%	7,34%	7,34%	7,34%	7,34%	7,34%	7,34%	7,34%	7,34%	7,34%
ETRS on cost of equity		39%	-12%	23%	5%	-1%	-4%	29%	80%	16%	27%	
Arithmetic average excess return	20%											
(ETRS + 1)		139%	88%	123%	105%	99%	96%	129%	180%	116%	127%	
Cumulative excess return	418%											
Geometric average excess return	18%											
MSCI index return		54%	-13%	37%	21%	-12%	-3%	14%	42%	-8%	41%	
ETRS on MSCI		-7%	8%	-7%	-9%	19%	7%	22%	45%	32%	-7%	
Arithmetic average ETRS	10%											
(ETRS + 1)		93%	108%	93%	91%	119%	107%	122%	145%	132%	93%	
Cumulative excess return	135%											
Geometric average ETRS	9%											
Market capitalization (€Bln)	10											
Value created by TRS (€Bln)	85											
Value created (ETRS on Ke) (€Bln)	41											
Value created (ETRS on MSCI) (€Bln)	13											

Source: MSCI, 2021.

*Table 28. Cost of equity - Hermès*

Cost of equity - Hermès	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Average
Risk free rate (%)	3,3	3,15	1,83	1,62	1,57	0,27	0,27	0,44	0,64	0,1	
Beta	0,41	0,41	0,41	0,41	0,41	0,41	0,41	0,41	0,41	0,41	
Expected market risk premium (%)	5,4	6,15	8,26	7,01	6,62	6,37	6,98	6,23	5,61	7,49	
Cost of equity – annual (%)	5,51	5,67	5,22	4,49	4,28	2,88	3,13	2,99	2,94	3,17	4,03
Cost of equity – daily (%)	0,02	0,02	0,02	0,02	0,02	0,01	0,01	0,01	0,01	0,01	0,02
Cost of equity–announcement(%)	0,09	0,09	0,08	0,07	0,07	0,05	0,05	0,05	0,05	0,05	0,06

Source: Reuters, 2021; Fenebris, 2021.

*Table 29. Long-term value creation - Hermès*

Long-term value creation - Hermès	2010-2019	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Price per share at year-end (€)		93,31	157,55	230,35	223,80	263,50	294,80	314,50	390,00	446,25	484,80	666,20
Dividends per share (€)		1,05	1,50	7,00	2,50	2,70	7,95	3,35	3,75	9,10	4,55	4,55
Return to shareholders			70%	51%	-2%	19%	15%	8%	25%	17%	10%	38%
Arithmetic average rate of return	25%											
(Return + 1)			170%	151%	98%	119%	115%	108%	125%	117%	110%	138%
Cumulative return	724%											
Geometric average rate of return	23%											
Cost of equity (annual)			4,03%	4,03%	4,03%	4,03%	4,03%	4,03%	4,03%	4,03%	4,03%	4,03%
ETRS on cost of equity			66%	47%	-6%	15%	11%	4%	21%	13%	6%	34%
Arithmetic average excess return	21%											
(ETRS + 1)			166%	147%	94%	115%	111%	104%	121%	113%	106%	134%
Cumulative excess return	489%											
Geometric average excess return	19%											
MSCI index return			54%	-13%	37%	21%	-12%	-3%	14%	42%	-8%	41%
ETRS on MSCI			16%	63%	-39%	-2%	27%	11%	11%	-26%	18%	-2%
Arithmetic average ETRS	8%											
(ETRS + 1)			116%	163%	61%	98%	127%	111%	111%	74%	118%	98%
Cumulative excess return	52%											
Geometric average ETRS	4%											
Market capitalization (€Bln)	10											
Value created by TRS (€Bln)	71											
Value created (ETRS on Ke) (€Bln)	48											
Value created (ETRS on MSCI) (€Bln)	5											

Source: MSCI, 2021.

*Table 30. Cost of equity - Prada*

Cost of equity - Prada	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Average
Risk free rate (%)	3,3	3,15	1,83	1,62	1,57	0,27	0,27	0,44	0,64	0,1	
Beta	0,91	0,91	0,91	0,91	0,91	0,91	0,91	0,91	0,91	0,91	
Expected market risk premium (%)	5,4	6,15	8,26	7,01	6,62	6,37	6,98	6,23	5,61	7,49	
Cost of equity – annual (%)	8,21	8,75	9,35	8,00	7,59	6,07	6,62	6,10	5,75	6,92	7,34
Cost of equity – daily (%)	0,03	0,03	0,04	0,03	0,03	0,02	0,03	0,02	0,02	0,03	0,03
Cost of equity–announcement(%)	0,13	0,14	0,15	0,13	0,12	0,10	0,10	0,10	0,09	0,11	0,12

Source: Reuters, 2021; Fenebris, 2021.

*Table 31. Long-term value creation - Prada*

Long-term value creation - Prada	2012-2019	2011	2012	2013	2014	2015	2016	2017	2018	2019
Price per share at year-end (HKD)		35,15	73,15	69	43,95	24,1	26,3	28,3	25,8	32,2
Dividends per share (HKD)			0,05	0,09	0,11	0,92	0,95	1,03	0,82	0,52
Return to shareholders			108%	-6%	-36%	-43%	13%	12%	-6%	27%
Arithmetic average rate of return	9%									
(Return + 1)			208%	94%	64%	57%	113%	112%	94%	127%
Cumulative return	8%									
Geometric average rate of return	1%									
Cost of equity (annual)			7,34%	7,34%	7,34%	7,34%	7,34%	7,34%	7,34%	7,34%
ETRS on cost of equity			101%	-13%	-43%	-50%	6%	4%	-13%	19%
Arithmetic average excess return	1%									
(ETRS + 1)			201%	87%	57%	50%	106%	104%	87%	119%
Cumulative excess return	-44%									
Geometric average excess return	-7%									
MSCI index return			37%	21%	-12%	-3%	14%	42%	-8%	41%
ETRS on MSCI luxury			71%	-27%	-24%	-40%	-1%	-31%	2%	-14%
Arithmetic average ETRS	-8%									
(ETRS + 1)			171%	73%	76%	60%	99%	69%	102%	86%
Cumulative excess return	-66%									
Geometric average ETRS	-12%									
Market capitalization (HKDBln)		90								
Value created by TRS (HKDBln)	7									
Value created (ETRS on Ke) (HKDBln)	-40									
Value created (ETRS on MSCI) (HKDBln)	-59									

Source: MSCI, 2021.

*Table 32. Cost of equity - Richemont*

Cost of equity - Richemont	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Average
Risk free rate (%)	3,3	3,15	1,83	1,62	1,57	0,27	0,27	0,44	0,64	0,1	
Beta	1,3	1,3	1,3	1,3	1,3	1,3	1,3	1,3	1,3	1,3	
Expected market risk premium (%)	5,4	6,15	8,26	7,01	6,62	6,37	6,98	6,23	5,61	7,49	
Cost of equity – annual (%)	10,32	11,15	12,57	10,73	10,18	8,55	9,34	8,54	7,93	9,84	9,91
Cost of equity – daily (%)	0,04	0,04	0,05	0,04	0,04	0,03	0,04	0,03	0,03	0,04	0,04
Cost of equity–announcement(%)	0,16	0,18	0,20	0,17	0,16	0,13	0,15	0,13	0,12	0,15	0,16

Source: Reuters, 2021; Fenebris, 2021.

*Table 33. Long-term value creation - Richemont*

Long-term value creation - Richemont	2010-2019	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Price per share at year-end (CHF)		34,93	55,00	47,51	71,40	88,80	88,80	72,10	67,45	88,30	63,00	76,06
Dividends per share (CHF)			0,35	0,45	0,55	1,00	1,40	1,60	1,70	1,80	1,90	2,00
Return to shareholders			58%	-13%	51%	26%	2%	-17%	-4%	34%	-27%	24%
Arithmetic average rate of return	13%											
(Return + 1)			158%	87%	151%	126%	102%	83%	96%	134%	73%	124%
Cumulative return	159%											
Geometric average rate of return	10%											
Cost of equity (annual)			9,91%	9,91%	9,91%	9,91%	9,91%	9,91%	9,91%	9,91%	9,91%	9,91%
ETRS on cost of equity			49%	-23%	42%	16%	-8%	-27%	-14%	24%	-36%	14%
Arithmetic average excess return	4%											
(ETRS + 1)			149%	77%	142%	116%	92%	73%	86%	124%	64%	114%
Cumulative excess return	-3%											
Geometric average excess return	0%											
MSCI index return			54%	-13%	37%	21%	-12%	-3%	14%	42%	-8%	41%
ETRS on MSCI			4%	0%	14%	4%	14%	-14%	-18%	-9%	-18%	-17%
Arithmetic average ETRS	-4%											
(ETRS + 1)			104%	100%	114%	104%	114%	86%	82%	91%	82%	83%
Cumulative excess return	-38%											
Geometric average ETRS	-5%											
Market capitalization (CHFBln)	19											
Value created by TRS (CHFBln)	31											
Value created (ETRS on Ke) (CHFBln)	-1											
Value created (ETRS on MSCI) (CHFBln)	-7											

Source: MSCI, 2021.

Table 34. Number of deals and announcement ETRS per deal-specific factor

Announcement ETRS per type of M&A		Domestic				Cross-country			
		Maj.		Min.		Maj.		Min.	
		No.	ETRS	No.	ETRS	No.	ETRS	No.	ETRS
Group 1	Brand portfolio expansion	7	2,86%	3	-0,38%	18	1,21%	7	0,20%
	Backward integration	3	0,81%	0	-	4	1,36%	1	2,84%
	Forward integration	0	-	1	0,11%	0	-	1	-4,04%
	Strategic acquisition	0	-	1	2,34%	6	2,23%	3	2,49%
	Horizontal merger	0	-	0	-	1	-1,35%	0	-
	Unrelated acquisition	1	0,23%	1	1,04%	1	-0,12%	0	-
Group 2	Brand portfolio expansion	0	-	0	-	0	-	0	-
	Backward integration	2	-0,49%	0	-	1	1,75%	0	-
	Forward integration	1	5,03%	0	-	0	-	0	-
	Strategic acquisition	0	-	1	1,04%	0	-	0	-
	Horizontal merger	0	-	0	-	0	-	0	-
	Unrelated acquisition	1	-2,88%	0	-	0	-	0	-
Total	Brand portfolio expansion	7	2,86%	3	-0,38%	18	1,21%	7	0,20%
	Backward integration	5	0,29%	0	-	5	1,44%	1	2,84%
	Forward integration	1	5,03%	1	0,11%	0	-	1	-4,04%
	Strategic acquisition	0	-	2	1,69%	6	2,23%	3	2,49%
	Horizontal merger	0	-	0	-	1	-1,35%	0	-
	Unrelated acquisition	2	-1,32%	1	1,04%	1	-0,12%	0	-