The Family Expands: LVMH Buys Christian Dior Couture for €12bn

Semyrhamis SA—private investment company
LVMH Moet Hennessy Louis Vuitton SE (MC: PAR)—market cap as of 29/04/2017: €114.85bn
Christian Dior SE (CDI: PAR)—market cap as of 29/04/2017: €45.48bn

Introduction

On April 25, 2017, it was announced that Semyrhamis SA, a company owned by the Arnault family, had made a public takeover offer to acquire the remaining 25.9% stake in Christian Dior SE in a €12.1bn deal.

The transaction would simplify the current cross-ownership structure between Groupe Arnault SAS, Christian Dior and LVMH, while simultaneously strengthening LVMH's fashion and leather goods division. The launch of the offer is expected for June 2017 and completion is expected by the second half of 2017.

About Semyrhamis SA

The investment company, headquartered in Paris and incorporated in 2000, is a subsidiary of Financière Agache within the Groupe Arnault SAS, a company owned by Mr. Bernard Arnault.

Financière Agache is a producer and distributor of luxury goods such as brandy, champagne, beer, couture clothing and accessories. It also operates grocery stores and is engaged in real estate investments.

About LVMH

LVMH Moët Hennessy Louis Vuitton SE is the world's largest luxury conglomerate by revenue. Formed in 1987 through the merger of Moët Hennessy with Louis Vuitton, it is headquartered in Paris and controls a portfolio of 70 brands within 6 different business sectors. Its businesses include wines & spirits, fashion & leather goods, perfumes & cosmetics, watches & jewelry, selective retailing and other activities. Amongst the best-known subsidiaries of LVMH are Dom Pérignon, Fendi, Givenchy, Bulgari, Hublot and Sephora.

LVMH's sales have proved resilient to recent weakness in the global luxury market. Revenues rose by 5% last year, despite terrorist attacks in Europe and the new Chinese legislation aimed at incentivizing Chinese travellers to spend more domestically. In Q1 2017 Sales revenues surged by 15%, beating expectations.

LVMH shares are listed on the Euronext Paris Eurolist, and the company is also included in the EuroStoxx 50 and FTSE Eurotop 100 indices. The stock price has been rising steadily throughout 2016, currently standing at €226.50, up from €144.90 on December 31, 2015. LVMH has a current P/E ratio of 28.6x and reported FY2016 ROE of 15.69%. The strength of LVMH's brands has allowed the firm to command a high operating margin (18.36%) and to reduce financial leverage to 2.25 since 2014.

Christian Dior SE is the main shareholder of LVMH, owning 40.9% of its shares, and 59.01% of voting rights. Bernard Arnault, who is a majority shareholder of Dior, is the Chairman of both companies and CEO of LVMH.

About Christian Dior SE

Christian Dior SE is a holding company headquartered in Paris that specializes in the production and distribution of ready-to-wear clothing, leather goods, fashion accessories, footwear, jewellery, timepieces, fragrance, and cosmetic products. The company operates through Christian Dior Couture, Financière Jean Goujon and LVMH. Christian Dior distributes its products in more than 180 company-owned boutiques and distributors in Europe, the United States, Japan and Asia Pacific.

Christian Dior was founded in 1946 by the homonymous designer. After Mr. Dior's death, Yves Saint-Laurent became the artistic director of the House. In 1984, after the bankruptcy of the Boussac group – controller of Christian Dior – a pool of investors led by Bernard Arnault acquired the company for one franc. In 1988 Christian Dior acquired its first stake in Moët Hennessy Louis Vuitton. In 1990 the firm expanded through upscale flagship stores in Tokyo and New York City and its stake in LVMH rose to 46%. Today, the company has over 210 locations worldwide and reported revenues of €37.9bn in 2016. Christian Dior is listed on the Euronext Paris Eurolist, where the stock has been performing well throughout 2016, with its price rising 27.5% in value. Dior has a relatively high current P/E ratio of 29.1x, partially explained by its operating margin of 17.37% and ROE of 14.7%. The fashion company's Debt to Equity ratio has been fluctuating between 0.37x and 0.85x throughout the past 10 years, and currently stands at 0.49x.

Groupe Arnault SAS is the major shareholder in Christian Dior, holding 69.9% of the stocks and 82.86% of the voting rights.

Industry Overview

The global luxury industry is extremely concentrated – with the top 10 luxury companies owning a combined market share of 47.9. All these players strive to retain and expand their position by putting a wide range of resources at work in terms of capital and of marketing tools. This enormous effort can only be sustained by solid companies that control substantial amounts of the most profitable, fast-growing and iconic brands in the world. Thus, major luxury groups are engaged in a never-ending battle to attract the best companies in their "team" of subsidiaries while pursuing extreme diversification.

During the last five years, the luxury industry has been reshaped by the explosion of social media and by the strong growth of new markets (e.g. Asia) and channels. Luxury companies bear significant risks linked to the uncontrollable effects of the recent technological revolution. In such an era of fast-fashion and short-lived trends, retaining competitive advantage seems almost unrealistic; moreover, the 10 most important luxury companies did not change during 2016, confirming the fact that only well-established luxury giants can compete in the current environment. At the same time, titans such as LVMH and Kering must act in compliance with two main issues: (1) the minimization of reputational risk (i.e. acquisition of the best companies and monitoring of the quality of existing brands); (2) the understanding of the business dynamics (e.g. rising importance of millennials and travellers, dominance of social media marketing, rising complexity of business models).

Despite the overall good performance of the industry, 2016 has hit consumers' confidence: terrorism fear, Brexit and UK elections are likely to impact customers' spending in the luxury sector. The medium-high class individual is expected to cut at least part of his budget for superfluous, "fancy" products.
In order not to be forgotten by consumers, luxury companies cannot stop innovating and promoting their products, renewing transit channels (e.g. airport shops) and seeking to appear in fashion blogs' articles and influencers' pictures.

With total net sales surpassing $200bn and a 4% average CAGR, it is difficult not to recognize the dominance of the French luxury – LVMH, Kering and L'Oréal Luxe combined sales account for c. 78% of the total.

Deal Rationale

The deal has a twofold rationale: it will allow for a simplification of LVMH Group organizational structure, and it will finally regroup Parfums Christian Dior – already owned by LVMH – and Christian Dior Couture under the same roof.

The transaction will strengthen LVMH's Fashion & Leather Goods division thanks to the acquisition of one of the most iconic brands worldwide - Christian Dior Couture, and occurs in a period of recovery for the luxury industry.

Furthermore, the transaction is beneficial to LVMH for two additional reasons. (1) It will add to LVMH portfolio a fast-growing brand characterized by strategic RE assets in high-visibility locations and by a widely appreciated product offer. (2) The newly acquired Couture business will boost the growth of the Fashion division, which is planning to invest in high-potential markets (US, Russia, Japan and China, where Dior has an existent presence with room for improvement).

The takeover clearly demonstrates Mr. Arnault's willingness to intensify LVMH's leadership in the industry. Among other factors, Tte recent outstanding financial results of Kering further motivated Mr. Arnault to strengthen his position through consolidation. Additionally, the offering of Hermès shares will allow the Arnault family to walk away from its controversial relationship with Hermès International. The latter, despite being perceived as the most attractive target of the industry from a strategic and reputational perspective, is not predicted to grow significantly in the future, as it already displays a P/E ratio of 37x against an industry average of 20x (close to LVMH ratio of 23x). Thus, keeping on pushing for an expensive acquisition has been considered not worthwhile.
Simultaneously, the takeover represents a great opportunity for Dior's minority shareholders, who would cash out a profitable investment leveraging on the all-time-high shares trading price.

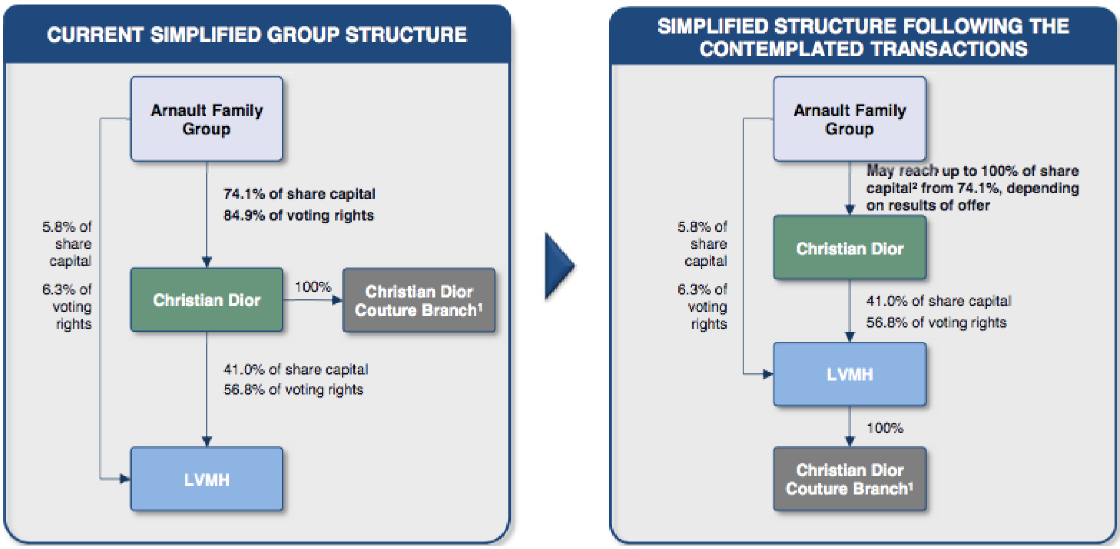
In terms of integration, the long-lasting relationship between the two luxury corporations and their similar positioning towards consumers should facilitate the collaboration between Dior and LVMH. To build on that point, despite Dior's production is said to operate independently, substantial opportunities to develop new solutions arise for the brands thanks to the sharing of design and technical expertise.

Deal Structure

The transaction simplifies the structure linking Dior and LVMH, while selling out the shares of its rival Hermès – whose attempts of acquisition from Mr. Arnault have been a complete failure. LVMH had been slowly increasing its share percentage of Hermès by using equity swaps without declaring them and angering Mr. Thomas, the company's CEO. Finally, Hermès shares declined by 3.9% on April 25, 2017, as they were used by Arnault to finance part of Dior's acquisition.

The buyout increases the Arnault's family stake in LVMH from 36% to 46%.
Groupe Arnault's payment consists in a mix of cash and Hermès shares for the public stake in Dior, valuing the latter at an EV of €6.5bn, with a 15% premium with respect to Monday's closing price. The acquisition is expected to be 2.7% accretive from the first year. Eventually, the Christian Dior Couture business will be sold to LVMH, already owning Dior's fragrance and cosmetics business.

The difference with respect to past acquisitions seems clear: the high premiums paid to acquire businesses such as Bulgari or Hublot (valued at a 60% premium) were driven by the intention of beating rival bids and by the fact that the counterparts were family-owned and not particularly willing to sell. On the contrary, this deal was a matter of acquiring a minority stake not already owned in Christian Dior.



Market Reaction

On April 25, 2017 (day of the announcement), the market seemed to appreciate the deal as both stocks reported a jump in their value. LVMH's shares went up by approximately 5% to a record high of €225, as investors were confident the deal would lead to an increase in EPS. Similarly, Christian Dior shares rose by 13% to a new level of €255 during early trading.

Over the following days, LVMH stock kept on moving up (closing at the peak of €227.45 on April 28 – a 1% improvement since the deal was announced), while Christian Dior stock showed an opposite trend, falling by 1% over the same period.

Advisors

Rotschild & Co. served as financial advisor to Semyrhamis SA.