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The 2014 Consumer Value Creators Series

FASHION AND LUXURY

RIDING A STRONG RECOVERY

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Over the past five years, the global fashion and luxury sector has delivered extremely strong value creation, thanks to improving consumer confidence, an emerging middle class in developing markets, and a willingness among shoppers to trade up to higher-priced goods.

In 2014, as in past years, The Boston Consulting Group conducted an annual study of total shareholder return among 1,620 publicly traded companies in 26 industry sectors, of which 40 were in the fashion and luxury sector.[1] (For the complete analysis of all industry sectors, see *Turnaround: Transforming Value Creation,* the 2014 BCG Value Creators report, July 2014.) Overall, from 2009 through 2013, the fashion and luxury companies in our sample returned an annualized TSR of 35 percent. The sector ranked first among the five groups of consumer companies studied—consumer durables, retail, consumer nondurables, and travel and tourism were the other four—and first among all 26 industry sectors. (For an overview of the performance of the five consumer sectors, see "Rising Volatility, Growing Opportunity," the BCG 2014 Consumer Value Creators Series, December 2014.)

The Drivers of TSR

During the five-year period of our analysis, all of the top ten companies in the fashion and luxury sector generated a significant amount of value through expansion in valuation multiples—more than 20 percentage points of TSR in all cases, which is far more than the contribution from any other component of TSR.[2] (See the exhibit.) This reflects the strong rebound in consumer confidence since the depths of the financial crisis, and it shows that investors have high expectations for the continued performance of fashion and luxury companies in the future.

It is notable that for fashion and luxury, as for two of the other four consumer sectors (retail and consumer durables), changes in the valuation multiple were the major contributor to value creation, followed by sales growth. In fact, several companies in which

The Fashion and Luxury Top Ten, 2009–2013

	Company	Location	Average annual TSR (%)	Market value[2] ($billions)	TSR Disaggregation[1] Sales growth (p.p.)	Margin change (p.p.)	Multiple change[3] (p.p.)	Dividend yield (p.p.)	Share change (p.p.)	Net debt change (p.p.)	2014 YTD TSR[4] (%)
1	Sports Direct	United Kingdom	77.0	7.5	15	3	39	1	–2	22	–3
2	Lululemon Athletica	Canada	71.6	8.6	35	7	30	0	–1	–1	–25
3	L Brands	United States	56.5	18.0	4	12	22	13	2	5	9
4	Signet Jewelers	Bermuda	56.1	6.3	4	12	28	1	1	11	49
5	LPP	Poland	54.4	5.4	20	1	27	3	–1	4	5
6	Hugo Boss	Germany	50.0	9.9	8	7	21	6	0	8	2
7	Burberry	United Kingdom	49.9	11.0	14	8	25	3	0	0	3
8	Under Armour	United States	48.9	9.2	26	0	25	0	–1	–1	54
9	Fossil	United States	48.3	6.6	16	5	28	0	4	–4	–16
10	PVH	United States	47.0	11.2	27	–1	32	0	–9	–3	–7

Sources: S&P Capital IQ; Thomson Reuters Datastream; Bloomberg; annual reports; BCG analysis.
Note: n = 40 global companies with a market valuation greater than $5 billion. The top ten companies on this list differ slightly from the top ten fashion and luxury companies in the 2014 Value Creators report. This list excludes Shenzhou International, a Chinese supplier of garments to brand-name fashion companies, which ranked first in that report.
[1]Contribution of each factor shown in percentage points of five-year average annual TSR; any apparent discrepancies in TSR totals are due to rounding.
[2]As of December 31, 2013.
[3]Change in EBITDA multiple.
[4]As of September 15, 2014.

top-line growth made a relatively small contribution to TSR were still able to create significant value for their investors through a balanced approach. For example, Hugo Boss (which ranked sixth among the top ten) generated just 8 percentage points of annual TSR through sales growth, along with similar contributions from margin expansion, dividend yields, and changes to net debt. As a result, the company returned an annual average of 50 percent to investors from 2009 through 2013. Two other companies—L Brands (which operates Victoria's Secret and ranked third) and Signet Jewelers (which ranked fourth)—posted even lower sales growth than Hugo Boss yet still managed to generate higher overall returns. Both emphasized margins, with L Brands also returning attractive dividends to investors and Signet improving its net debt.

Notable Absences Among the Top Performers

The top-ten list in fashion and luxury is notable for the absence of some of the mass-fashion players that dominated this group in previous years. What's changed? In many cases, those companies created tremendous value during the 1990s and the first years of the 2000s by improving their sourcing and production processes—that is, by siting manufacturing facilities in low-cost countries. They also increased sales by opening new stores en masse. But both approaches may be nearing the point of diminishing returns. Labor costs in Asia are increasing, eroding the margin advantage of companies based in the region. Moreover, many companies have thoroughly covered the most promising cities in developed markets and are now expanding to developing markets, where operations are more costly and sales are not yet large enough to make up the difference. As a result, many mass-fashion companies are seeing their returns begin to plateau.

High-end luxury brands, too, are largely absent from this year's list of top performers, most likely because of slowing growth in China, which represents roughly 30 percent of luxury consumption worldwide. (Prolonged anticorruption and frugality measures by the central government have also affected the performance of fashion and luxury companies that rely heavily on the sale of goods purchased as gifts.) Over the longer term, however, the country still holds tremendous potential for the sector. Of the top ten companies, five are in two segments—the first being premium sports clothes and accessories and the second being designer jewelry, watches, and accessories—that are still growing fast in China.

Three Trends That Will Drive Performance

We believe that three trends will continue to play out in the fashion and luxury sector, driving value creation for the foreseeable future. Of course, these do not apply universally. Like all consumer sectors, fashion and luxury includes companies with a range of business models and core strengths. But we believe that these trends will be of continuing relevance to most fashion and luxury companies.

The first trend is the growing importance of digital. With consumers purchasing more and more goods online—and, increasingly, through mobile platforms—digital sales are growing at double-digit rates across all categories within the sector. To capitalize on e-commerce, companies will need to invest in agile digital architectures, but the rewards are there for those that get it right. For example, top performer Sports Direct makes more sales through digital channels than its competitors, and investors have taken notice, rewarding the company with a higher valuation multiple than any other company among the top ten. Similarly, Burberry has developed a comprehensive digital strategy that spans multiple initiatives. It streams fashion shows live, tweets advance looks at the coming season's lines, and allows customers to buy new pieces online as soon as they appear on the runway (a significant departure for the fashion industry).[3]

The second value-creation trend is the strong performance of premium brands. Over the past several years, the mass-apparel market has been relatively flat, growing at less than 2 percent a year, while the premium market has grown at 3 to 6 percent and the high-end luxury market has performed even better, expanding by 8 to 10 percent a year. Brand profitability follows a similar pattern: it is higher for luxury brands than for mass-fashion brands (where customers are more price sensitive). In some categories, prices have increased much faster than the rate of inflation over the past decade, reinforcing the emphasis on exclusivity rather than mass appeal. At the same time, however, some fashion and luxury players are starting to scale back their reliance on promotions, discounts, and similar strategies intended to drive sales at the expense of profitability. This trend is just beginning, but it is clearly a means for some companies to elevate their brands.

The third, and related, trend is vertical integration, which allows a company to sell through its own single-brand stores rather than through third-party multibrand stores. This strategy offers two clear advantages: it allows fashion and luxury companies to control the entire experience of consumers, from the moment they first set foot in the store. And it allows them to retain a larger percentage of revenue. The industry rule of thumb is that companies shifting from a wholesale approach to their own retail locations can double their revenue with the same sales volume.

Fashion and luxury companies have delivered strong value-creation performance over the past five years. Many of the sector's top performers have achieved this through digitization, premium positioning, and vertical integration—trends that will remain relevant to many companies in the near term. That said, there is no silver bullet. What's most important is that companies understand the levers that are most relevant to their situation and that will allow them to capitalize on a recovering economy and return greater value to their investors.

Notes

1. TSR is a metric that encompasses all sources of value that accrue to shareholders. It includes changes in sales, margins, and valuation multiples, along with all sources of free cash flow to investors and debt holders, such as changes in dividends, net debt, and the number of shares outstanding.

2. The top ten fashion and luxury companies discussed in this article differ slightly from the top

ten in the 2014 Value Creators report. This list excludes Shenzhou International, a Chinese supplier of garments to brand-name fashion companies, which ranked first in that report. The overall performance numbers for the sector include Shenzhou and remain unchanged.

3. Maureen Morrison, "A Focus on Digital Makes Burberry Relevant to a New Generation," *AdAge,* December 10, 2012, http://adage.com/article/cmo-strategy/a-focus-digital-makes-burberry-relevant-a-generation/238671/.

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