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Key Issues In The Global Game Of Luxury M&A

Law360, New York (May 28, 2014, 8:50 PM ET) -- The global market for luxury goods continues to grow, despite cyclical economic downturns in the U.S. and Europe. According to a recent Bain & Company study, the number of worldwide luxury consumers more than tripled over the past 20 years, reaching 330 million at the end of 2013. Going forward, the number of luxury consumers is expected to reach an estimated 400 million by 2020 and 500 million by 2030.[1] This is in large part due to the expansion of the wealthy and upper-middle class populations in emerging markets.[2]

It is not surprising that strategic acquirers and financial sponsors worldwide are actively looking to acquire luxury apparel and accessory brands. Most of the luxury brands are headquartered in France, Italy, Switzerland, Spain, the U.K. and the U.S., and they are rapidly consolidating.[3] Recently, LVMH Moet Hennessy Louis Vuitton SAacquired a majority stake in Nicholas Kirkwood's business and in Loro Piana SpA, and Kering acquired a majority stake in Christopher Kane's business and a minority stake in Altuzarra.

Financial sponsors are also investing in luxury brands. For example, Blackstone Group LP recently acquired a 20 percent interest in Gianni Versace SpA. In general, it is a seller's market with rising valuations for luxury apparel and accessory brands, which are currently achieving valuations in excess of 15 to 18 times earnings before interest, taxes, depreciation and amortization.[4]

Luxury brands may vary in size, heritage and target consumers, but they generally share certain common attributes. Most luxury apparel and accessory brands combine: (1) a unique brand heritage, (2) superior quality and craftsmanship, (3) enhanced customer service and (4) exclusivity and premium pricing. These very factors, however, pose certain unique structural, diligence and legal issues for both buyers and sellers of luxury apparel and accessories brands.

Unique Brand Heritage

Many companies with a single luxury apparel and accessories brand are owned either by a family with a long-standing history or the original creative designer. Such owners are more likely to be quite selective about potential acquirers and investors in order to preserve the image of the brand and are less likely to run a full-auction process. They also may seek to retain a significant portion of their equity and/or enter into employment or consulting agreements in order to maintain the connection with, and continuity of, the brand’s heritage.

Potential acquirers should apply due diligence to all of the intellectual property rights associated with the brand, including not only trademarks, patents and copyrights but also domain names and social media accounts, to confirm that the company, as opposed to the family or other parties, owns those rights and has appropriately protected them in all necessary product categories and foreign jurisdictions.

In addition, in situations where a luxury brand bears the name of an individual designer, the potential acquirer should be diligent as to whether the company owns the rights of publicity for such designer, in order to maximize the company’s ability to use the designer’s name, likeness and other attributes in the future. In the U.S., rights of publicity are governed by state law and vary considerably from state to state as to the nature, extent and transferability of such rights.

Superior Quality

Superior quality and craftsmanship are the hallmarks of luxury goods. Often, luxury brands have operating subsidiaries and/or design offices and use specialized factories in Europe to design and produce their branded goods. A potential acquirer that is contemplating cost savings through a reduction in the company’s European workforce should carefully consider the implications of such actions under existing employment and consulting agreements and under the labor laws of the relevant jurisdictions in the E.U., whose laws tend to be more favorable to employees than those in the U.S.

Moreover, a potential acquirer should consider whether the specialized factories currently used, or intended for use, for production of the branded goods meet the requirements of applicable law and adhere to international human rights standards. It may be difficult, expensive or time consuming to properly address these supply chain issues and/or to find suitable replacement factories. Brands can suffer significant reputational damage from negative media coverage about environmental and human rights issues at factories used by the brand, even where the factories are not owned by the brand.

Enhanced Customer Service

Most luxury brands offer a high level of customer service, as part of the entire brand experience. Luxury brands typically operate their own retail stores and have their own “shop within a shop” in multibrand retail stores, in order to offer consumers a brand-rich environment with knowledgeable and experienced sales assistance. Potential acquirers should review all of the terms of retail leases as well as arrangements with multibrand retailers, not only for the financial terms but also for their flexibility. For example, do the retail leases permit the brand to assign or sublease space if the particular location proves undesirable for the brand (either for financial reasons or due to a changing local business mix)?

Despite the rise of e-commerce, most purchases of high-end luxury goods are still transacted in brick and mortar stores. Few high-end luxury brands operate e-commerce websites that sell their complete product lines and ship worldwide. Luxury brands have been slow to embrace e-commerce in part because brand image is often tied to the customer experience and level of service available in physical stores. Given the increasingly global nature of the consumer base for luxury goods, however, luxury brands are likely to embrace e-commerce, and particularly mobile commerce, to a greater extent in the near future.

To the extent that it is part of a potential acquirer's business model to expand the company's online business, the company may need to make significant investments in e-commerce and mobile commerce. From a legal perspective, this means reviewing and revising data privacy practices to comply with domestic and foreign laws, enhancing data security and developing processes and procedures to deal with potential data security breaches.

Exclusivity and Premium Pricing

Luxury brands typically build their business on the strength and exclusivity of their brand image, rather than by mass merchandizing. The principal elements of this strategy are the high-price points the branded goods are sold at and the exclusivity of the distribution channels through which they are sold.

Increasingly, luxury brands are vertically integrating (i.e., design, sourcing and distribution connected) to better control their brand image and customer experience. For example, in Dubai, which is experiencing a boom in tourism, certain large luxury brands are replacing their franchise and license arrangements with joint ventures with local partners in order to exert more control over their brands.[5] A potential acquirer of a luxury brand should be diligent toward local joint venture partners, with particular attention to the financial and reputational status of the local partner, possible issues under the Foreign Corrupt Practices Act — particularly with respect to the customs and export process — and both the contractual and practical ability to enforce legal rights against the local partner.

To the extent that a luxury brand is not completely vertically integrated, a potential acquirer should closely review the brand's license, distribution and retailer arrangements for compliance with local franchise laws, such as in the Middle East, and for possible resale price restrictions and other vertical restraints on competition that arguably could be antitrust violations under American or foreign law. Notably, E.U. competition law has particularly strict rules in the area of resale price maintenance and territorial and customer restrictions.

M&A transactions involving luxury apparel and accessory brands raise a discrete set of business and legal issues for the parties. An understanding of the unique attributes of luxury brands can lead to more appropriate deal structures and more effective due diligence.

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[1] "Heterogeneous Mix of 330 Million Consumers Purchasing Euro 217 Billion in Luxury Goods Globally, Finds Far-Reaching New Bain & Company Study, Bain & Company," published on Jan. 14, 2014.

[2] "Global Luxury Goods Sector Remains Resilient, Despite Tougher Consumer Market According to Deloitte Report," published by Deloitte LLP on May 13, 2014.

[3] Id.

[4] Astrid Wendlandt, "DEALTALK-High-priced M&A still in vogue despite slowing luxury industry," published by Reuters on Jan. 31, 2014.

[5] Miles Socha, "Luxury Brands Rush to Dubai's New Boom, Women's Wear Daily," May 12, 2014.
