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RETAIL

Who is winning the race to become America's leading luxury group?

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Digging heels in: Tapestry-owned Stuart Weitzman's global spokeswoman Yang Mi in Katrina boots. Image credit: Stuart Weitzman

By Limei Hoang

At a time when consolidation in the luxury market is at the forefront of investors' minds, two companies in the United States have been steadily building up a collection of brands in an attempt to become America's leading luxury conglomerate.

On the one hand, there is Tapestry, made up of Coach, Kate Spade and Stuart Weitzman. On the other is Capri Holdings, which consists of Michael Kors, Versace and Jimmy Choo. Over the past few years, both companies have embarked on rapid acquisition sprees, adding new dimensions to their core offering in a bid to expand their global reach and customer base.

As their efforts begin to gain momentum, which brand is best placed to take the lead to become America's leading luxury group and could they potentially gain enough scale to compete with Europe's heavy-hitting luxury conglomerates?

"With Tapestry and Capri Holdings, I think what they are attempting to do is very interesting," Robert Burke, chairman and chief executive of the consultancy Robert Burke Associates told Luxury Society. "Both American groups are headed by very seasoned executives, so there's no reason that America couldn't have strong conglomerates, but I don't think that they are competing yet, that doesn't mean that they won't."

If you look at both companies, continued Mr. Burke, they understand how to grow businesses.

"The approach of Kering and LVMH are probably very much focused on craftsmanship, heritage and exclusivity, and that's innate to the European houses," Mr. Burke said. "American houses and or these two groups, I think, in a very valid and refreshing way, have a very different approach to the business.

"I think they will be very aggressive and strategic in how they grow these businesses," he said. "Clearly, they have the infrastructure, they have the expertise, they have knowledge of the global market. But they are at two very different evolutions, the U.S. and Europe."

Michael Kors' autumn/winter 2019 campaign. Image credit: Michael Kors

Historically, American mega-brands such as Coach and Michael Kors were managed to grow as fast as possible through all channels and were not too fussy about discounts, Luca Solca, managing director of Luxury Goods at Sanford C. Bernstein, wrote in an analyst note. Yet in doing so, they produced materially lower return on invested capital (ROIC) over time.

"Given the different growth profiles of European mega-brands and U.S. conglomerates, it is not surprising to see the U.S. stocks trade at lower multiples than the European," Mr. Solca said in his note.

"However, in recent months, valuations of U.S. names have gapped materially lower, as execution issues at Tapestry and Capri have caused investors to question whether multi-brand strategies are more of a liability than an asset," he said.

Capri and Tapestry both went through very similar issues a few years ago, Neil Saunders, managing director and retail analyst at GlobalData Retail, told Luxury Society.

"Those issues were really around ubiquity and the fact that they had both expanded their core brands in quite a dramatic way," Mr. Saunders said.

"They had undervalued their brand and they're really pushed them very hard into the market, often using strategies of discounting, which it had eroded some of the brand image they ended up having to really retrench and pull back on the discounting," he said.

"But they managed to rebuild some brand equity, they both then seemed to turn their attention to expansion through the acquisition of new assets."

For certain, the path for both groups has not been as smooth as they might have hoped.

Earlier this year, Tapestry's chief executive, Victor Luis, left his role at no notice and its chairman, Jide Zeitlin, took over as its interim chief executive. A search for Mr. Luis' replacement is still ongoing.

And while the Coach brand is performing well, the same cannot be said for the Kate Spade brand, where sales are continuing to decline.

Likewise, at Capri Holdings, its core brand Michael Kors is still struggling.

"Management at Michael Kors has not been so willing to materially reduce exposure to wholesale and, as a result, has made less progress on rebuilding brand equity," Mr. Solca said.

In spite of their challenges, both companies represent an opportunity for an American luxury group to build up further scale, particularly as further consolidation in the luxury market seems imminent.

A few weeks ago, LVMH confirmed that it was in preliminary talks with U.S. jeweler Tiffany & Co., estimated to be worth around $14.5 billion (13 billion).

While it is still in the early stages, the interest from LVMH in Tiffany highlights the importance of the United States as geographical market to luxury companies.

However, it is important to note that while both companies are growing, they are not even close to the scale of European luxury conglomerates.

"American conglomerates are very pale imitations of the European versions," Mr. Saunders said.

"The European versions are very mature, I think that they are very well-established, and I actually think that they have a really balanced portfolio of brands under their various houses," he said.

"Comparatively, American luxury groups really are fairly small. They tend to have a couple of brands that are reasonably good but probably a bit American-centric in some cases. And they are nowhere near as mature or established.

"Therefore, they are groups now, but they are just not the same scale as something like an LVMH. They are just not on that level yet. And they just don't have an overall cachet as groups as some of the European groups do."

"I really don't think that they are trying to emulate, meaning Capri Holdings and Tapestry, LVMH and Kering," Mr. Burke said. "I think that is a very different proposition.

"It's probably a little premature to be comparing them to an LVMH or a Kering or even a Richemont at this point, because really two or three brands doesn't make a conglomerate."

"They're more broadly distributed, I don't think that they are going after the high, high luxury from what I can tell. I mean, Versace would be. And what I think is perhaps good to look at, is that I think that they might be more diversified."

Looking forward, Mr. Saunders believes both groups will eventually make further acquisitions to continue to build up scale.

"That is really the aim of both companies," Mr. Saunders said. "I think it may be a little bit of time before that happens because Capri is still absorbing Versace and I think Tapestry still has issues with Kate Spade. But I think that they would quite like to absorb some other brands.

"They are probably going to be in adjacent segments in something like jewelry or something like that, or they might look in the case of Tapestry, at an apparel brand which fill some gaps in the segments they don't cover as well," he said.

"Making further acquisitions would make the groups more significant, but really, I think the priority at the moment is to get the core part of the business working.

"They really need to get those parts of the business motoring well in order to be successful and be comfortable in making those future acquisitions. So, there is a bit of internal work to do and I think it's looking externally to try to build up more expertise."

So, who is winning the race to become America's leading luxury group?

"That's a difficult question to answer," Mr. Saunders said. "In terms of scale and significance, it probably is Capri because I think that Versace is a big international well-known brand.

"Michael Kors is far more of an international brand than some of Tapestry's brands and Jimmy Choo has a lot of potential and has a fairly good international footing as well. So, in some ways, scale and significance, it's Capri," he said.

"However, from the point of view of a well-run business, and brand coherence, it errs towards Tapestry because I think Coach is a much more tightly defined brand.

"Its turnaround has been more successful than Michael Kors because I think that they have done a better job. But they don't necessarily, and they have a lot of potential for Kate Spade, but they don't necessarily quite have the reach that Michael Kors or Capri does.

"It depends on which way you look at it, but definitely in terms of size and scale and influence, it has to be Capri at the moment."

It is a view shared by Mr. Burke.

"Well, it's evolving and what I say today may be different in six months or a year, but I'm particularly interested to watch what Capri Holdings does, and greatly because of the experience of the team there," Mr. Burke said. "And particularly also because of Versace, which I think has great opportunity."

HOWEVER, MR. SOLCA believes that Tapestry might have a winning advantage.

"In the end, your conglomerate is as good as your core brand," Mr. Solca said.

"For example, the key to Kering's success was buying Gucci," he said. "We believe that Coach is a healthier core brand than Michael Kors and more is being done by Tapestry to leverage the scale benefits than a multi-brand strategy can bring."

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