BIZCOMMUNITY

RE:CM warns of luxury goods stock bubble

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The strong financial performance of several local and global luxury goods companies in recent months has re-enforced the perception that this industry is fairly recession proof, however this is not always the case, according to Daniel Malan, Investment Director at asset management company RE:CM.

"With several of these companies currently trading at very inflated prices, the classical signs of a bubble are in place within this industry," he said.

Since the beginning of 2010, the combined share prices of LVMH, Hermes, Richemont and Swatch relative to the market, has increased by 60% - they are currently trading much higher relative to the market than at any point since 1995.

This huge popularity is probably on the back of the 12% rise in sales in 2010 and the predicted 8% rise in sales for 2011, with a further of 5%-6% growth per annum predicted by global management consulting firm, Bain and Company until 2014.

Their positive outlook in turn is based on 30% sales growth in China from 2009 to 2010, with expectations of continued high growth.

"As usual, it seems that the market's focus on short term results and a good story is leading to highly inflated prices, completely ignoring the lessons of history," Malan commented.

He noted that other common signs of a bubble were also appearing, namely acquisitions and new listings when the market was high for the industry.

LVMH paid EUR3.7 billion for Bulgari in March 2011, valuing Bulgari at three times EV/Sales compared to its long term median of 2.5 times at a time when Bulgari's earnings have slumped 67% during the last three years.

Furthermore, Prada exploited the excitement around luxury sales growth in the East by recently listing in Hong Kong.

Malan said that the luxury market may be fairly recession proof, with total sales dropping rarely, and then by fairly small percentages, but the share price of luxury goods companies was clearly not recession proof, sometimes dropping dramatically in response to small drops in sales.

The only two negative growth periods since 1995 were 2002/2003 where sales dropped only 0.7% and 3% respectively and then again in 2008/2009 when sales dropped 2.4% and 7.8% respectively.

In many industries a 3% drop in sales during a recession will be considered minor, and an 8% drop once in 15 years, followed by 12% growth the very next year, a blessing.

However, both these relatively small drops had a huge impact on the share price of the four biggest luxury companies.

In 2003 LVMH lost nearly two thirds of its value, and in 2008/2009 it lost three-quarters of its value, Richemont's value halved during both periods, while Swatch lost a third and nearly two-thirds of its value respectively.

Hermes proved to be the most resilient in both instances, dropping 27% in 2003 and 15% in 2008/2009.

LVMH, which is bigger than the other three combined, was the worst hit in both cases.

According to Malan, many of the classical signs of a bubble are in place, making this a "predictable disaster", as described by James Montier in The Little Black Book of Behavioral Investing.

Earlier this month, Geneva-based Richemont, which owns brands such as Cartier, Alfred Dunhill, Jaeger-LeCoultre and Montblanc, beat analyst forecasts to post a rise in first-half profit of 10%, boosted by robust sales of high-end goods in Asia.

Similarly, maker of Kelly bags and silk scarves, Hermes said third quarter sales jumped 16%, and luxury trench coat and designer handbag retailer Burberry reported a 41% jump in first-half net profit.

In October, French luxury products giant PPR, which counts Yves Saint-Laurent, Balenciaga, Stella McCartney and Alexander McQueen in its stable said third-quarter sales jumped 8%.

According to international credit rating agency Standard & Poor's (S&P), sales of luxury goods are holding steady in developed countries because most affluent shoppers have retained their buying power, despite recent and current global economic woes and a year of unusually extreme natural disasters.