M&A DEAL ANALYSIS
Redefining luxury: inside the Kering-Valentino deal

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VALENTINO

KERING

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M&A DEAL ANALYSIS

Acquirer: Kering S.a
Target: Valentino Fashion Group SpA
Deal value: €1,7 bn
Sector: Fashion
Type of M&A: Strategic
Exit multiple: 16.19x
Announced date: 27/07/2023
Completed date: TBC

Acquirer details
Kering S.a
Founding year: 1963
Headquarters: Paris, France
CEO: Francois-Henry Pinault (2005 - Present)
Number of employees: 47,227
Market Cap: €50,16 bn
EV: €58,28 bn

- LTM Revenues: €20.4 bn
- LTM EBITDA: €5.6 bn
- LTM EBITDA margin: 3,65%
- LTM EV/EBITDA: 8,9x
- LTM EV/Sales: 2,4x

(All financial datas as of 15/11/2023)

Description:
Luxury fashion focused investment holding company. Some of Kering's well-known brands include Gucci, Yves Saint Laurent, Balenciaga, Alexander McQueen, Bottega Veneta and many others.

Target details
Valentino S.p.A
Founding year: 1960
Headquarters: Milan, Italy
CEO: Jacopo Venturini (2020 - Present)
Number of employees: 1,512

EV: €5,66 bn

- LTM Revenues: €1.4 bn
- LTM EBITDA: €350 m
- LTM EBITDA margin: 25%
- LTM EV/EBITDA: 16.19x
- LTM EV/Sales: 4.05x

(All financial datas as of 15/11/2023)

Description:
Luxury women's clothing manufacturer
Handbags and accessories manufacturer
Luxury men's clothing manufacturer
Perfumes manufacturer.

Deal Overview

On July 27, 2023, Kering SA, the international luxury group, decided to acquire 30% of the shares of the Italian fashion company Valentino from Mayhoola Investment, a Qatari fund, for a consideration of €1.7 bn, paid entirely in cash. Moreover, the deal also comprised an option for Kering to acquire 100% of the share capital of Valentino no later than 2028.

Kering, founded in 1963, initially operated under the name Pinault SA and only changed its name to Kering in 2013. In the late '90s and early 2000s, the company acquired significant players in the luxury and fashion world. For instance, in 2003, they acquired 42% of the Gucci group for €3 billion and 100% of the Yves Saint Laurent group. In 2000, Kering acquired the leather goods brand Bottega Veneta, followed by Balenciaga in 2001. Throughout the 2000s, the group experienced substantial growth through organic expansion and other acquisitions. Due to the presence of these companies within the group, Kering is considered the second largest international fashion groups in the world after LVMH. In 2022, LVMH revenues grew more than Kering compared to 2021, and this differential even increases if we consider organic growth.

Mayhoola Investments is a private investment firm based in Qatar. It was established by the sovereign wealth fund of the State of Qatar to manage and diversify its investments. Mayhoola has been involved in various acquisitions, particularly in the fashion and luxury retail sector. Indeed, in July 2012, the Qatari fund acquired 100% of Valentino for €700 million from the private equity fund Permira. Valentino is an iconic Italian fashion house founded by Valentino Garavani and Giancarlo Giammetti in 1960. Renowned for its luxurious and sophisticated designs, Valentino specializes in high-end ready-to-wear clothing, accessories, and fragrances. The company during these 11 years thanks to Mayhoola Investments has grown significantly over the years; the revenue soar from €322 million in 2011 to €1.4 billion in 2022.

Industry overview

The global fashion industry is at a crossroads in 2023, grappling with a complex landscape marked by hyperinflation, shifting consumer patterns, and geopolitical uncertainties. After experiencing 18 months of robust growth from early 2021 to mid-2022, the industry is now facing a challenging climate with declining growth rates in the second half of 2022.

The luxury sector, however, is expected to outperform the broader industry. In 2020–21, luxury demonstrated resilience with a 21 percent increase in revenues and doubled EBITDA margins to 12.3 percent. Looking ahead, the luxury sector is projected to grow between 5 and 10 percent in 2023, driven by strong momentum in China (9–14 percent growth) and the United States (5–10 percent growth). Europe, facing challenges from currency rates and an energy crisis, is expected to see modest sales growth for the luxury sector (3–8 percent). In contrast, the non-luxury fashion market is projected to struggle in 2023, with slow sales growth between –2 and +3 percent.
Inflation tops executives' concerns in 2023, with rising costs of goods sold and operating expenses anticipated. Cotton and cashmere prices have surged 45 percent and 30 percent year on year, respectively. Geopolitical uncertainties, such as the war in Ukraine, real estate crises in China, and extreme weather in Asia, further complicate the industry's landscape.

Key trends shaping the industry's response to challenges:

I. Global Economy:
Fashion brands need careful planning to navigate uncertainties and recessionary risks in a volatile global economy. Rising geopolitical uncertainty and uneven economic recoveries pose challenges for deciding where to invest globally.

II. Consumer Shifts:
Economic turbulence affects consumers differently, leading to a two-track spending pattern. Some postpone discretionary purchases, while others seek bargains, driving demand for resale, rental, and off-price products. Gender-fluid fashion gains traction, necessitating a rethink of product design, marketing, and shopping experiences. Rethinking formal wear as workplaces become more casual, with special occasions dominated by statement-making outfits.

III. Fashion System:
Brands reassess the viability of digital direct-to-consumer channels amid rising costs. Diversifying channel mix becomes crucial for growth. Increased scrutiny on sustainability claims requires brands to make meaningful and credible changes while adhering to emerging regulatory requirements. Supply chain disruptions drive a reconfiguration of global production, emphasizing vertical integration, nearshoring, and small-batch production. Changing data rules prompt a new chapter in digital marketing. Brands must embrace creative campaigns and new channels, such as retail media networks and the metaverse.

In addition to Kering's acquisition of Valentino, the luxury fashion sector has experienced a notable uptick in merger and acquisition (M&A) activities in recent times. Some notable deals include the acquisition of Tiffany & Co. by LVMH in 2021 for a staggering $15.8 billion, and the formation of a joint venture between Richemont, Alibaba, and Farfetch in 2023 to strengthen their presence in the Chinese e-commerce market. These deals highlight the growing consolidation within the industry as luxury brands seek to expand their reach and enhance their digital capabilities.

In conclusion, the global fashion industry faces uncertainties and challenges, requiring strategic adaptations to navigate macroeconomic complexities and changing consumer behaviors. The luxury sector is expected to outperform the broader industry, driven by strong momentum in key markets. Fashion companies can position themselves for success by embracing emerging trends, adapting operating models, and prioritizing sustainability and digital strategies in this dynamic and evolving market.

Deal rationale

Valentino is one of the most internationally recognized Italian luxury houses and the acquisition of Kering is in line with the strategy of the group, which owns several other fashion brands, such as Gucci, Saint Laurent and Bottega Veneta and focuses on haute couture houses.

Kering’s growth in revenues has been mostly driven by Gucci expansion over the past years, but this growth has been diminishing. The 2022 Full Year results showed a +8% growth in revenues from the

Gucci segment, which accounted for about 50% of the overall revenues of the group. On a comparable basis and at constant exchange rates, though, Gucci-related revenues had an increase of just +1%, compared to +31% of 2021.

The deal, therefore, comes as Kering is trying to accelerate growth that has lagged that of French rivals LVMH and Hermes. In fact, Kering has also announced the 100% acquisition of the high-end luxury fragrance House Creed on the 26th of June 2023 for €3.5 billion, paying 23 times EBITDA, according to people with knowledge of the details.

In addition, it is important to notice that Kering Group is undergoing several structural changes regarding not only C-Executives, but also Creative Directors. In November 2022, Gucci announced the departure of Alessandro Michele, who had been creative director of the Italian brand since 2015. Last July, the French group also announced the departure of Gucci CEO, Marco Bizzarri, who has been replaced by Jean-François Palus, already present in Kering's Board.

Revenue synergies

Since at the moment Kering has just acquired a 30% stake in Valentino, revenues generated by the Italian house will not be accounted within Kering Group revenues. The French group, though, holds options to acquire the overall firm and if that was the case, around €1.4 billion in revenues would be added. Kering Group revenues would then top almost €23 billion, compared to the 79.2 and the 11.6 billion of LVMH Group and Hermes, respectively. The two main competitor, though, both released strong 2022 Full year results and showed an increase in revenues of more than 20% on a comparable basis. Kering, on the other hand, published a +9% increase and it is continuing to lag behind the competitors also during 2023, based on quarterly results.

Cost synergies

François-Henri Pinault, chairman and CEO of Kering, said Valentino would benefit from synergies deriving from the acquisition and this concept was reiterated also by the CEO of Mayhoola and chairman of Valentino. In particular, Valentino will be able to benefit from the know-how and competencies that Kering Group has acquired in the luxury sector. Furthermore, Bernstein Analyst Luca Solca also highlighted the similarity between Valentino and Yves Saint Laurent, a French company already owned by the French group that had an impressive growth over the past years, also in terms of profitability.

Other synergies

The purchase of Valentino is "part of a broader strategic partnership" between Kering and Mayhoola, as stated in the press release. Mayhoola is the investment vehicle managed and owned by the Qatar royal family and bought Valentino from private equity firm Permira in 2012, for about €700mn. It also bought French family-owned fashion house Balmain in 2016.

The agreement could lead to Mayhoola becoming a shareholder in Kering, strengthening the relationship between the two entities and enabling the exploration of potential joint opportunities. In particular, if Mayhoola was to become a shareholder of Kering, it may provide Kering Group with surplus cash, which might be used for future M&A deals and for the growth of the firm.

Deal structure

The deal is structured in two main parts.

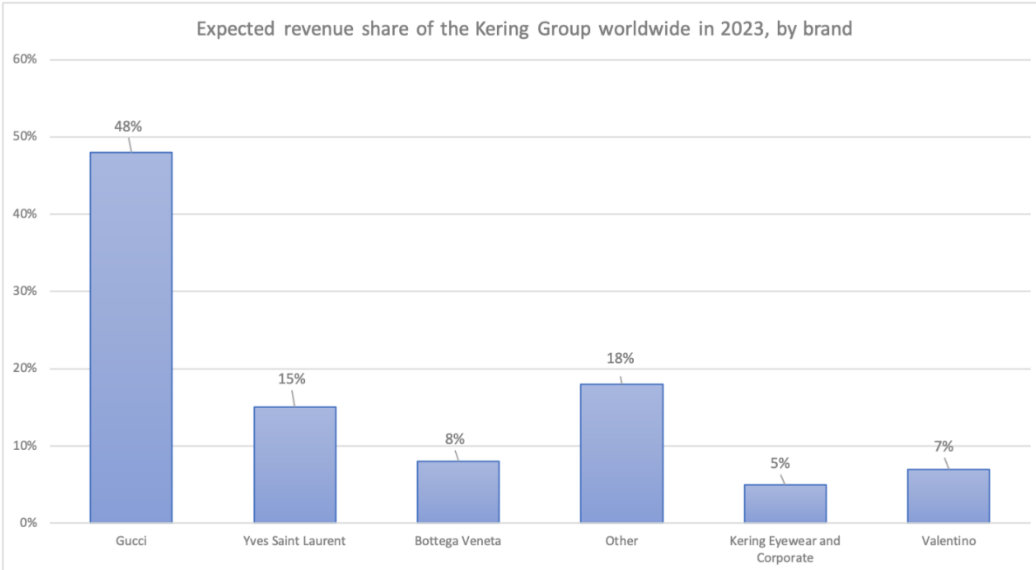
First of all, Kering and Mayhoola have entered into a binding agreement for the acquisition of Kering of a 30% shareholding in Valentino. The price amounted to €1.7 billion and the payment method is set to be paid 100% cash. This price leads to a valuation of the enterprise value of Valentino of around €5.7 billion and a 16x Multiple on EBITDA. Furthermore, Kering will obtain Board representation, while the Mayhoola investment fund will remain the majority shareholder.

Secondly, the agreement also comprised an option for Kering to acquire 100% of the share capital of Valentino no later than 2028. This option would enable the French group to gain full control over the Italian firm, but no news have yet been released on the topic. On the other hand, the French group will be more flexible in its decision about the purchase, having the chance to analyze and deeply evaluate any further move.

Risks and implications

Short term

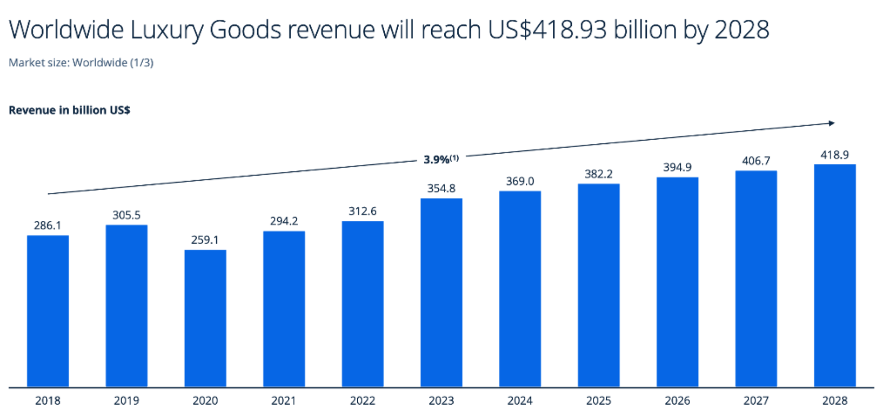
As a result of the Valentino acquisition, Kering's dependence on Gucci's performance will be reduced. Over the last few years, Kering has become exceedingly dependent on Gucci, which represented 52% of the group's global revenue in 2022. With the company being so profitable to the point where outperforming LVMH's Louis Vuitton was a strong possibility, Kering became excessively reliant on Gucci's activity. Market analysts, however, have claimed that the group should stop overworking the brand and help the other labels grow as well, particularly Yves Saint Laurent and Balenciaga. In 2023, with the recent changes in management at Gucci, Kering's "overall sales came in 4.96 billion euros ($5.45 billion), at constant rates, falling below analyst expectations for a 6% increase" in the second quarter, with Gucci sales up only by 1%. Over the same period, competitor LVMH reported a 21% increase in sales. The Valentino deal is, therefore, a strategic move which will refocus Kering's efforts towards new targets, in order to surpass LVMH as the leading luxury fashion company.



One other important aspect that ought to be mentioned is how the investment facilitates Qatari involvement in the euro luxury goods market, which has been traditionally dominated by family-owned European companies. The deal constitutes only the first step towards a broader Kering-Mayhoola strategic partnership and this transaction gives Mayhoola the chance to still play a big role in the sector but as part of a much bigger entity. A Kering holding would mark another important French investment for Qatari firms, another notable one being the Paris-Saint Germain football club. Mayhoola specifically focuses on global investments in the luxury industry with a long-term investment approach and also controls French luxury house Balmain, Italy's small brand Pal Zileri and Turkish luxury department stores Beymen.

Long term

In an attempt to identify the primary risks impacting the luxury industry in the long run, analysts highlight that the prevailing economic and geopolitical uncertainty, coupled with currency fluctuations, pockets of social unrest, and a decelerating Chinese market, pose significant challenges for luxury companies, and therefore Kering. Initial concerns focus on the decline in sales attributed to market saturation in China, leading to operational deleverage and margin compression, ultimately resulting in a contraction of price-to-earnings multiples. Another risk stems from a slowdown in income inequality, which could diminish luxury spending, given that luxury consumption often



Sources: Market Insights by Statista

serves as a public indicator of increasing private wealth. The third identified risk is linked to the austerity climate in the Eurozone and diminishing property values in China, contributing to an overall slowdown in personal luxury goods consumption in China—a substantial danger for luxury enterprises.
Factors such as fluctuating tax rates, currency instability, and apprehensions about travel due to health concerns and the perceived threat of terrorist attacks all significantly impact the luxury goods market. Additionally, the potential closure of Hong Kong's luxury hub to Chinese tourists, following last year's protests, could inflict considerable damage on the industry.
Considering the above, the Valentino acquisition might be viewed as a risky move by Kering. However, the risks impact the luxury market as a whole and, therefore, do not specifically impact Kering position within the industry. In addition, as stated by analysts, despite never having been immune to macro dynamics, the luxury sector is more resilient and is expected to grow annually 3,38% (CAGR 2023-2028).

Market reaction

Despite Valentino's long-term potential for Kering, in the immediate future the M&A deal does not remarkably diminish the impact that Gucci's management changes have on Kering's stock price. It follows that the stock still went down 2.3% the day after the press release announced the investment.

Nevertheless, the Kering-Valentino deal played a major role in reigniting this year's M&A luxury market. Following the acquisition, multiple other investments were made in the industry. Cartier-owned Richemont has acquired a controlling stake in Gianvito Rossi, the renowned Italian shoemaking Maison, in "a private transaction." Tapestry – which owns Coach, Kate Spade, and Stuart Weitzman – will acquire Capri Holdings - whose holdings consist of Versace, Jimmy Choo and Michael Kors - in a deal valued at $8.5 billion. Moreover, Rolex has agreed to acquire Bucherer in what is being characterized as "a major tie-up in the closely held luxury-watch industry that will give it more control over how its watches are sold."
In regards to Kering's next strategic moves, the group is expected to focus on further acquisition targets, particularly in the jewelry space. In terms of geographic coverage, with the U.S. luxury market booming, Kering is considering expanding its store network in second- and third-tier cities such as Atlanta, Charlotte, Nashville and Austin.

Deal advisor

Mayhoola For Investments (QFC) - LLC:
Financial advisors: JP Morgan, Rothschild & Co, IMI – Intesa San Paolo
Legal advisors: White & Case LLP (advising JP Morgan), BonelliErede
Kering SA:
Financial advisors: Centerview
Legal advisors: Darrois Villey Maillot Brochier, Gianni & Origoni, Wolf Theiss Rechtsanwaelte GmbH

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