

High-end brands find crisis hard to wear

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At this week's **Milan Global Fashion Summit**, not even the ultra-cool surroundings of Bocconi University's new auditorium could hide the sense of unease gripping the luxury goods industry as the impact of the financial crisis begins seriously to bite.

From designers to trade representatives to store buyers, the message at the annual event was that profits are being squeezed, margins are disappearing and customers are retrenching.

"This is a delicate moment we are living through, and we are all aware of what the conditions are now," says Mario Boselli, chairman of the Camera Nazionale della Moda Italiana, the main lobby group for the Italian fashion industry. Diego Della Valle, chairman and chief executive of Tod's, adds: "This is a crisis that was imposed on us. We are suffering like everyone else."

After riding a wave of consumer splurges in the past few years, when the global stock market boom increased the number of very rich people, luxury goods companies could now be facing a long recession. Not only is wealth shrinking as stock portfolios drop in value; the "feel-good factor" associated with spending money on expensive goods is also drying up. This, analysts and industry figures say, is at least as damaging to luxury goods companies' prospects as disappearing spending power.

As the luxury goods team at HSBC noted in a report yesterday on the watch sector, "we believe the psychological aspect of the 'feel-good' factor has deteriorated even more than the wealth aspects".

This applies even to the very wealthy. As Stephen Sadove, chief executive of Saks, the luxury department store chain, observes: "I don't think any of us anticipated that high-end customers were going to fall off as dramatically as they have."

Darrell Rigby, head of the global retail practice at Bain & Co, says rich people's sudden austerity reflects the fact that the recession and the crisis are hitting their net worth as well as their incomes. "The collapse of the housing market and stock portfolios is having a significant effect on those consumers," he says.

Spending Pulse, which estimates retail spending using receipts from MasterCard credit cards and approximations of other payments, reports that sales of luxury goods fell 21.1 per cent in the first two weeks of November compared with 2007, after falling 20 per cent in October. Luxury goods retailers are responding with some aggressive price-cutting.

Neiman Marcus, the luxury goods retailer, has stepped up price promotions after announcing a 27 per cent fall in comparable store sales in October. It is currently offering savings of up to 40 per cent on designer items at its 42 stores, taking almost \$1,500 off a Bottega Veneta woven leather tote bag that used to retail for \$4,300. Saks is seeking to drive sales with an offer across its 53 stores of 12 months of interest-free credit for customers spending more than \$2,000 in one day.

European outlets have so far not had to resort to such drastic measures. Indeed, anecdotal evidence from Via della Spiga and Via Montenapoleone, the two most exclusive shopping streets in Milan, suggests it is business as usual in the design capital of the world, though there are notably fewer Russian-speaking shoppers now than a year ago.

But tough times are here, nonetheless. LVMH, Burberry, Hermès, Bulgari and Richemont all say trading has been difficult this autumn. Though the US is the worst-hit market, Spain and other parts of Europe have been slowing sharply. There is still strong growth in emerging markets, however, notably China and the Middle East.

Luca Solca, a luxury goods analyst at Bernstein Research, says the real determinant of a company's ability to ride out the recession will be its exposure to emerging markets. The companies operating at the top end of the market – notably LVMH, the world's biggest luxury goods company – are among the most internationally diversified, with sales in emerging markets of between 30 and 50 per cent.

The HSBC report notes that "historically, luxury goods shares have tended to trade at a discount to their long-term fair value when earnings momentum is deteriorating, and at a premium when it is accelerating".

So the sector may be oversold, and likely to stay that way, as the recession cuts deeper into spending power.

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