

POSITION UPDATE

LVMH Moët Hennessy Louis Vuitton

December 20, 2019

As part of our transition into the fee-only registered investment advisor structure, I intend to spend more time educating our clients about what we own. Ideally, I will write a short memo on a company that has had some recent news of interest. My goal will be to both update you on the news event as well as explain the fundamental characteristics of this holding that fit our investment philosophy and justify our ownership.

LVMH is one of the largest luxury goods companies in the world. The company describes its structure as houses, which are general areas of business. The five primary business lines are wines and spirits, leather and fashion, cosmetics and perfume, watches and jewelry, and specialty retail. Across these various houses, LVMH has more than 75 prestigious brands and annual revenue of more than \$50 billion. The businesses range from Sephora that is widely accessible to consumers of all demographics to the high-end jewelry house Bulgari that is clearly oriented to a highly affluent shopper.

On November 25th of this year, LVMH announced the acquisition of Tiffany & Company for \$16 billion in cash. This is their largest acquisition since we initially invested in the company for our discretionary portfolios in 2012. Tiffany is a 180-year old jewelry business that is known for its signature blue box and their diamond engagement rings. This acquisition reminds me of the Bulgari acquisition made by LVMH almost a decade ago. Bernard Arnault, long-time chairman and CEO of LVMH, sees the Tiffany brand as an ideal way to both expand the jewelry and watch division, but also to improve the company's American market share.

Arnault has shown with prior acquisitions that LVMH isn't looking for cost synergies or turnaround stories, but for extremely durable and iconic brands that can be profitably maintained into the foreseeable future. I view his acquisition strategy similarly to that of Warren Buffett at Berkshire Hathaway. LVMH, under the leadership of Arnault, has been a serial acquirer of luxury brands, both large and small, over the past 30 years. Historically, these acquired companies continue to operate as if nothing has changed. While this may seem unique, it makes a lot of sense as the owner of the business. The Arnault family does own nearly half of LVMH's stock after all. I would view their strategy as one of collecting durable brands focused on both wealthy and middle-class consumers from around the world. This strategy seems practical and logical to me.

If you buy a small winery making a premium product, you wouldn't want to damage the value of that brand by attempting to ramp up production at the expense of quality. Likewise, you wouldn't want to acquire a brand like Bulgari or Tiffany at a premium valuation, and then destroy that brand through outlet stores or by mass marketing lower quality products under the same label. Mr. Arnault seems to understand the concept of intangible brand value as well as any CEO that I follow.

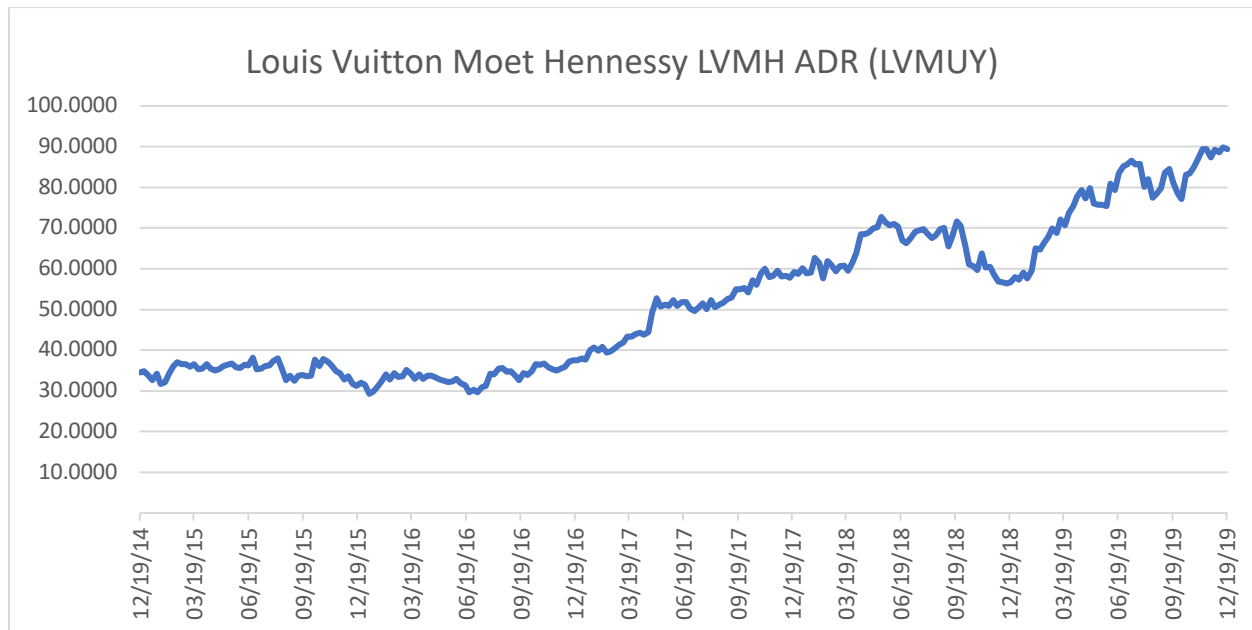
I expect to see him focus on revitalizing the Tiffany brand as LVMH has done previously with Bulgari, focusing on consistent branding with the highest quality merchandising. Mr. Arnault said this about the acquisition "We will plan long-term. Often with American brands traded on the stock market, the emphasis is placed on the results of the quarter. It's not at all the same strategic focus." His comments imply that he saw an opportunity for LVMH to focus on a long-term strategy of restoring the elite Tiffany name to its prior glory without worrying over those quarterly earnings reports. As a long-term shareholder, that sounds like what I would do if I were managing a multi-generational family business.

Absher Wealth Management Analytics:

We consider a range of qualitative and quantitative items when we are buying shares of a company for our clients. We continue to monitor those characteristics as we hold shares in these businesses as well. LVMH stands out in several areas for us:

- **Ownership** – We like to see management teams that are shareholders in the business. Ideally, they have a history of good stewardship. The Arnault Family Group controls 47.2% of the company as of their year-end 2018 annual reporting. Bernard Arnault has been CEO and Chairman of the company for the past 30 years.
- **Free Cash Flow** – We view free cash flow as the funds available to pay shareholders or to invest in future growth. As long-term business owners, free cash flow is a very important metric for us. LVMH generated more than \$25 billion of free cash flow over the past five years and has seen their free cash flow improving by double-digit compound annual growth rates over the past decade.
- **Profitability** – We seek to own companies that have above-average profitability. This can be measured in different ways, but the two numbers that we like to focus upon are Net Margin and Returns on Assets. We look for higher profit margins, because our belief is that may provide us some margin of safety from rising inflation. If costs rise unexpectedly, a more profitable business might still make money even as input costs rise. We focus on return on assets, because that number reflects the quality of the underlying business. We prefer this metric over return on equity, because it is more difficult to manipulate with low-cost borrowing. LVMH has very attractive results on both profitability measures as well as a conservative balance sheet.

Margin of Safety – This is a more intangible metric, but we believe that you can find it in different places. We view the LVMH portfolio of brands (Louis Vuitton, Christian Dior, Moët & Chandon, Hennessy, Sephora, Glenmorangie, Bulgari, TAG Heuer, Fendi, Givenchy, Veuve Cliquot, Loro Piana, Dom Perignon, Celine, etc) and their geographic diversity as both providing a margin of safety for our investment.



Source: Thomson Reuters Charts

“The person who I admire most in business is Warren Buffett. He is a long-term investor and has brilliant ideas, and he sticks to them.”

“What made Louis Vuitton famous was the quality. We don’t do marketing; we just create products that are exceptional in their design and craftsmanship.”

“Can you say that in 20 years people would still use the iPhone? Maybe not. What I can say today is that, in 20 years, I’m quite convinced that people will still drink Dom Perignon.”

~ Bernard Arnault, CEO and Chairman LVMH

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Meet the Team



Pictured from left to right: Kevin Mishoe, Mike Absher, Jennifer Oravsky and Zak Wahdan

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