MASTER THESIS

FINANCE MAJOR

THE BRAND IMPACT ON VALUE CREATION IN A TRANSACTIONAL CONTEXT

A case study on the luxury industry

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Introduction

Brands govern consumption. The most influential companies today are those that distinguish themselves through their brand image. Brands like Apple are renowned for their design and technology, while others like Coca-Cola stand out with their flagship product or iconic . Chanel, on the other hand, is synonymous with prestige and luxury.

These companies have successfully capitalized on the intangible asset of their brands. The question now is how to quantify this value: what is the worth of a brand? The academic literature on this subject is thriving, especially as brands have become the sole justification for transactions such as mergers and acquisitions. Therefore, the aim of our master's thesis is to establish a taxonomy of brand valuation methods while evaluating their robustness. However, the acquisition price is not the only factor in creating value in a brand merger:

> « Firms often turn to the market to acquire or sell brands. However, this exchange process can be impaired by two related problems: an inability to **estimate the economic value** of brands and inappropriate **management of brands when transferred**. Brands often are tied to the routines, systems, and cultures of specific firms, which indicates high organizational complexity[1]. »

As highlighted by Laurence Capron and John Hulland in this excerpt from the Journal of Marketing, brand mergers are intrinsically linked to valuation and brand integration.

The success of a transaction lies in the integration of the target company. Corporate cultures and post-merger integration processes are often underestimated. It is essential to move beyond a purely quantitative perspective and consider brand strategy and management, brand portfolio construction, and corporate culture. Therefore, our thesis will present frameworks to guide decision-makers in overseeing brand integration.

For our case study, we selected the luxury goods industry, specifically **the acquisition of Tiffany & Co by LVMH**, which exemplifies the immense power of brands. Brands play a pivotal role in the luxury goods sector, as they alone justify the premium prices charged. Customer attachment often stems from both social and emotional reasons.

Hence, it seemed appropriate to study the value creation of this high-profile acquisition by examining the financial valuation of Tiffany & Co and subsequently discussing the integration of the brand within the French luxury goods group.

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[1] Capron, Hulland, 1999

1. Literature review

1.1. Value creation in deals

Value creation is often perceived as the primary goal of any M&A transaction, as it is central to company management and shareholders' wealth[2]. The topic of whether M&A generate value for shareholders and companies is extensively discussed in academia, but empirical outcomes vary intensively[3]. This divergence can be attributed to the varying definitions of M&A performance and company performance among academics. This section aims to provide a literature review on the creation of value through M&A. We will first define value creation, then enumerate its different drivers, and finally we will examine the most important measures of value creation in M&A.

i. Definition of value creation

To begin, we need to define value creation. The value of a business can be understood as the total wealth obtained from selling that particular company. Determining the value of a company involves various methodologies, leading to two different types of value: Enterprise Value, available to the stakeholders of the firm, and Equity Value, only available to shareholders, representing cash flows after debt interests and repayment. Value is created when an increase in the deemed value affects the company and the shareholders. Value creation can be broken down into two principles:

- The "core of value" principle, where value creation is measured by an increase in returns on capital and growth,
- The "conservation of value" principle, which states that value creation comes from enhanced cash flows rather than financial engineering[4].

Consequently, value creation can be defined as improvements in the firm's future cash flows and higher returns on capital.

ii. Drivers of value creation

Value creation varies depending on the perspective adopted, either that of the company or the shareholders. However, the underlying processes are largely comparable, and ideally, businesses and investors should have a shared objective of creating value within the realm of mergers and acquisitions. Therefore, in this section, we do not differentiate the mechanisms of value creation but rather focus on its drivers.

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[2] Walter, Barney, 1990
[3] Das, Kapil, 2012
[4] McKinsey of Finance, 2011

Synergies

In traditional M&A deals, synergies are the main sought-after source of value creation. Synergies come in different forms and correspond to future cash flows that can be generated by the combined acquirer and target, which could not have been generated by either one alone.

- Revenue / Growth Synergies

Revenue synergies are rooted in economies of scope. They create stronger and/or longer-lasting competitive advantages through higher pricing power, reduced competition, increased switching costs, leveraging brand equity through new products and services, cross-selling products with customer relationships and distribution networks, and expanding into new markets and geographies.

Assessing the margin realized on revenue synergies is necessary to measure value creation, as it determines the impact on pre-tax earnings. Combination of forces can lead to higher ROCE on future projects vs. existing ones. However, investors often do not fully incorporate these synergies into their calculations due to the difficulties in quantifying and verifying them. According to a 2016 Deloitte survey in the United States[5], only 24% of firms achieved more than 80% of their revenue synergy goals, indicating the challenges in effectively realizing such types of synergies.

- Cost Synergies

Cost synergies stem from economies of scale. They arise when costs are saved on current operations, resulting in higher EBIT margins. Cost synergies can be achieved through better group purchasing terms, improved coordination in vertical M&A, elimination of duplicated costs (e.g., headquarters, administrative functions, IT), asset synergies, improved capital efficiency, rationalization of capacity, reduction of capex per unit sold, decreased working capital, disposal of redundant assets, divestiture of non-core assets, and operating improvements through better management of the target.

Cost-based synergies are often regarded as more effective in generating value for both shareholders and the company. Utilizing industry-specific scalability is particularly effective in M&A strategies for value creation.

- Financial/Tax Synergies

Financial synergies arise from tax optimization or the reduction of funding costs. Tax optimizations are linked to the target's tax losses carried forward, lower corporate rates of the target, or tax benefits from asset write-ups in the case of asset deals. Funding costs are lowered when access to more liquid and cheaper financial markets is obtained, the target's capital structure is changed to reach optimal gearing, or larger firms with stable operating cash flows are perceived as safer, leading to lower costs of debt, increased ability to leverage

[5] Deloitte M&A trends 2016

safely, and a reduction in weighted average cost of capital (WACC). However, these synergies will only increase value if the free cash flow for the firm profile remains the same.
Such financing synergies are very difficult to quantify and should be approached with caution by investors. The extent to which they are considered a source of value creation in mergers remains contentiously debated.

In summary, academic literature strongly indicates that M&A deals driven by cost synergies are value-creating. However, when it comes to transactions motivated by revenue or financial synergies, the findings in academic research are more varied and inconclusive. From a valuation perspective, this is the net present value of synergies that is utilized. Although it is customary to express this value as a multiple of projected annual synergies (using metrics like price-to-earnings ratios), acquirers cannot avoid conducting a comprehensive evaluation of the complete potential for synergy. Evaluating the extent of synergies during negotiation of deal terms is a crucial milestone in solidifying future value generation. If the evaluation is inaccurate and excessively high, the anticipated value creation becomes uncertain, and transactions fail to deliver value or even result in value destruction.

Undervaluation

Value creation can come from an undervalued target, as well as from the perception of an overvaluation of an acquirer versus a target in the case of a share exchange. Undervaluation encompasses the value that an acquiring entity believes is not adequately recognized by the market before taking synergy into account. The presence of information asymmetry, or at least the perception of such asymmetry, plays a crucial role in explaining why an acquirer might be willing to pay a higher price based on undervaluation. Accurately assessing undervaluation is challenging and susceptible to erroneous estimations. Similar to other distinct M&A scenarios, shedding light on value can be relevant.

Internationalization

Internationalization, which refers to expanding into new geographical markets, is a common motive for conducting acquisitions, as a form of horizontal growth. Indeed, internationalization through M&A appears to be a fast mean to expand, with relatively few risks. Such transactions are particularly successful in generating value for both shareholders and the firm. Some empirical studies show that companies expanding into countries in which they had no historical operations achieve significant positive abnormal returns. This is the case of Doukas and Travolos (1988)[6] who examined a sample of 301 foreign acquisitions made by US companies, and Cakici et al. (1996)[7] who studied 195 international firms that acquired US targets. However, several more recent studies contradict these results. For instance, Moeller and Schlingemann (2005)[8] demonstrated that companies engaging in cross-border acquisitions experienced lower returns on the announcement day of approximately 1% in comparison to domestic acquisitions. In the end, the evidence supporting the hypothesis that

[6] Doukas, Travolos, 1988
[7] Cakici et al., 1996
[8] Moeller, Schlingemann, 2005

M&A strategies based on international expansion are particularly effective at creating value is mixed, with some studies supporting the hypothesis while others contradict it.

iii. Measure of value creation

It is valuable to be able to assess whether value has been generated to determine the success of a transaction retrospectively or predict its success beforehand. This gives rise to the crucial question of how value creation can be measured. The range of measures includes accounting-based and financial approaches, market criteria, and managerial assessments of a transaction.

Accounting-based valuation

- Earnings Per Share

One widely used indicator are the Earnings Per Share (EPS) because EPS accretive deals are highly valued by many investors, and as a result, managers are particularly motivated to pursue transactions that result in EPS accretion. However, the indicator can be misleading for several reasons. Firstly, it does not factor in the cost of equity, which represents the level of risk. Secondly, the accounting methodologies used to calculate EPS have no actual impact on the firm's value. Lastly, an increase in EPS does not imply that the Price-to-Earnings (P/E) ratio, as assessed by investors, remains unchanged. These misconceptions often lead to the mistaken belief that EPS dilution is synonymous with value destruction. In reality, EPS growth indicates value creation only if the financial decision, such as a transaction, does not alter the fundamental risk of the business, earnings growth, and the capital structure. EPS growth implies value creation if and only if these precedent conditions are met. In the end, while EPS accretion/dilution analysis cannot serve as a standalone measure of value creation, it continues to be widely used by financial analysts and remains crucial in the financial realm, serving as important tools for both investors and managers.

- Rates of Return

The return on investment is usually compared to the required rate of return, such as Return on Equity (ROE) compared to the cost of equity for shareholders or Return on Capital Employed (ROCE) compared to the cost of capital employed for firms.

The ROE measures the return generated on the equity provided to a company by its shareholders. It directly relates to the company's performance from the view of the shareholders.

$$\text{ROE} = \frac{\text{Net Income}}{\text{Average Shareholders' Equity}}$$

The ROCE measures the efficiency with which all of a company's capital is used to generate operating profit.

$$\text{ROCE} = \frac{\text{NOPAT}}{\text{Average Capital Employed}}$$

The positive spread between the return and the required rate is generally seen as an indicator of value creation. One main disadvantage of indicators like Return on Equity (ROE) or Return on Capital Employed (ROCE) is that they are based on accounting measures, making them susceptible to manipulation and not necessarily indicative of value creation or destruction. For instance, the ROE is not only derived from improved profitability or operational efficiency. Changes in capital structure can also contribute to an increase in the ROE. By leveraging the company, management can achieve a higher return on equity without implementing any changes to the underlying business operations, assuming the cost of debt remains stable.

- Equity Per Share

Equity Per Share, commonly known as the P/B ratio, shares a similar drawback as EPS. Changes in the P/E ratio are unpredictable after each financial decision. This ratio is commonly used for financial firms, for which P/B < 1 suggests that the expected return on equity is lower than the return required by shareholders.

To conclude, accounting criteria, although they provide a snapshot of a company's financial position, can be easily manipulated and do not consider the time value of money or the opportunity cost of capital. Boosting these indicators does not necessarily lead to value creation and fails to represent the risks undertaken by the company.

Financial valuation

- Net Present Value

Net Present Value (NPV) is considered one of the most reliable financial indicators for measuring value creation or destruction. It calculates the present value of cash flows by applying a discount rate that captures the time-value of money. The discount rate reflects the investors' required rate of return. Investments or projects with a positive NPV should be pursued, while those with a negative NPV should be rejected.

- Economic Value Added

Economic Value Added (EVA) measures value creation based on the excess return of ROCE over WACC, times capital employed. It can be expressed as:

$$\text{EVA} \ = \ \text{Net Operating Profit After Tax (NOPAT)} \ - \ \text{WACC} \ * \ \text{Capital Employed.}$$

EVA is related to NPV through the equality: $NPV = \sum_{i=0}^{\infty} {EVA_i}/{(1+WACC)^i}$

However, calculating EVA requires adopting an economic perspective and adjusting reflect the actual economic value in capital employed. It can be challenging to perform, and there is a management bias if they are solely incentivized based on EVA, as they may prioritize reducing invested capital and favour short-term EVA at the expense of value creation and long-term growth.

- Cash Flow Return on Investment

Cash Flow Return on Investment (CFROI) is an accounting measure calculated as:

$$\text{CFROI} = \frac{\text{EBITDA}}{\text{Capital Employed}}$$

This measure can also represent the average internal rate of return (IRR) of a company's existing investments. It differs from traditional IRR as it does not assume constant future cash flows over time and is compared to the WACC. If CFROI is higher than the WACC, the company is considered to be creating value, and vice versa. However, calculating CFROI in this case can be complex and non-intuitive for managers.

Market criteria

Assessing the success of a transaction often involves considering the increase in a company's stock price, as it is regarded as the most immediate and tangible manifestation of value creation. Consequently, stock price performance becomes a natural choice for evaluating the outcome of a transaction.

- Cumulative Abnormal Return

The Cumulative Abnormal Return (CAR) is the difference between the expected and the actual return on a stock, which is the reflection of the market’s expectation regarding the value creation resulting from the deal, benefiting both the acquirer and the target. As the likelihood of a deal's success increases, the target's share price tends to move closer to the offer price.

- Market Value Added

MVA is calculated as:

$$\begin{aligned}\text{MVA} \ = \ &\text{Market Capitalization} + \ \text{Market Value of Net Debt} \\ &- \text{Book Value of Capital Employed}\end{aligned}$$

If the Market Value of Net Debt equals the Book Value of Net Debt, the equation simplifies into:

$$\text{MVA} \ = \text{Market Capitalization} - \ \text{Book Value of Equity}$$

Market Value Added (MVA) is considered a more relevant indicator than simple share price movements, but its usefulness relies on market efficiency theories. It questions whether the market capitalization truly reflects the company's value or is influenced by market speculation. However, MVA is not applicable to non-listed companies.

- Total Shareholder Return

Total Shareholder Return (TSR) measures the annual return, including dividends and capital appreciation, earned by buying shares at the start and selling them at the end of a specified period, usually 5-10 years. The indicator is used to measure shareholder value creation, as it is directly linked to their wealth.

$$\mathrm{TSR}_t = \frac{\mathrm{P}_t - \mathrm{P}_{t-1} + \mathrm{D}_t}{\mathrm{P}_{t-1}}$$

Where:

P = Stock price at the end of period t t

P = Stock price at the beginning of period t $t-1$

D_t = Dividends paid during period t

TSR may not be directly correlated with value creation as it does not measure the change in the actual accounting or financial economic performance of a company. It can be influenced by market speculation and contextual factors like economic booms or recessions and does not take into account a company's capital structure. Despite its limitations, TSR remains a highly relevant metric for measuring value creation, due to its simplicity and wide applicability, particularly for stockholders.

Synergies vs. Control Premium Paid

Assuming the target is fairly priced and a 100% cash transaction, the acquiring firm will pay the fair value of the target in addition with a premium and will receive assets worth the target's fair value plus the capacity to generate additional cash flows, namely synergies.

The amount paid for the target can be calculated as follow:

$$\text{Amount Paid} = Target's\ Pre\ bid\ Market\ Capitalization + Acquisition\ premium$$

And the value acquired:

$$\text{Value Acquired} = Target's\ Value\ pre\ acquisition\ premium + PV(Synergies)$$

If we assume that the target's pre-bid market capitalization equals its stand-alone value, the value acquired exceeds the amount paid if, and only if $PV(Synergies)$ > $Acquisition\ Premium$.

The method of measuring value creation by comparing the acquisition premium to the present value of synergies is theoretically and intuitively solid. However, the estimation of synergies poses several challenges, leading to a high degree of uncertainty. Firstly, estimating synergies themselves is very difficult, and it is impossible to arrive at a number that can be defended with absolute certainty. Secondly, not all estimated synergies at the announcement of a transaction materialize. Thirdly, multiple approaches to valuing synergies exist, which can yield different results, such as the use of P/E multiples, discounted cash flow methods, real options valuation, etc. Despite these challenges, this method remains efficient for assessing value creation and should be applied whenever possible.

To conclude, various numerical measures exist for assessing value creation, each with its own strengths and weaknesses. However, no single measure can adequately capture value creation on its own, and non-financial aspects should be incorporated into the assessment of value creation. For example, managers can discuss the impact on corporate culture, talent acquisition, brand awareness, and other qualitative factors resulting from a merger. It is not advisable to rely solely on a unique measure of value. It is recommended to combine it with other analyses to gain a more comprehensive perspective on value creation. In the end, there is no perfect indicator for assessing value creation, and companies tend to use the ones that portray them favourably.

iv. Potential impact of higher interest rates on M&A Value Creation

The increase in interest rates can have both positive and negative effects on M&A value creation.

On one hand, higher interest rates can increase the cost of capital, making it more expensive for acquiring firms to finance their acquisitions. Indeed, the cost of borrowing increases as a consequence of rising interest rates, making it more expensive to finance acquisitions through debt. This can result in reduced deal activity and potentially result in lower premiums paid for target companies, as potential acquirers may be more cautious and selective in pursuing M&A opportunities.
In addition, higher interest rates can affect the valuation of target companies. The Discounted Cash Flow (DCF) method takes into account the cost of capital, which is influenced by interest rates. As interest rates rise, higher discount rates are used in valuation models, leading to lower valuations and reduced deal premiums.
Moreover, higher interest rates can also impact the attractiveness of alternative investment options. When interest rates are higher, investors may opt for fixed-income investments that offer more attractive returns with lower risk, diverting funds away from M&A activities.

On the other hand, some research suggests that higher interest rates can enhance value creation in M&A transactions. Higher interest rates can help mitigate the risk of overpaying for acquisitions, as they provide a higher hurdle rate for expected returns on investment. This can encourage more disciplined decision-making and result in improved post-acquisition performance.

Overall, the impact of higher interest rates on M&A value creation is complex and depends on various factors, including the overall economic conditions, industry dynamics, and the specific characteristics of the transactions. It is crucial for acquirers to carefully assess the potential impact of interest rates on the cost of financing, valuation models, and investment opportunities to make informed decisions and maximize value creation in M&A transactions.

1.2. Estimate the economic value of a brand

i. Definition of a brand

Different definitions of a brand coexist, and their usage varies depending on the context and stakeholders involved. Generally, a brand is referred to as the reputation and visual identity of a firm. This definition aligns with the one provided by Haigh and Knowles[9], who state that a brand possesses one of the following elements:

- A logo and visuals that carry “associated goodwill” in customers’ minds,
- Associated intellectual property rights.
- A holistic company or organizational brand.

Kotler[10] adds an important dimension in his definition: the competitive advantage that a brand is designed to bring when facing competition in a market. According to Kotler, a brand is “a name, term, sign, symbol, or design, or a combination of them, [that] is intended to identify the goods and services of one seller […] to differentiate them from those of competitors”. Numerous papers have highlighted that a brand increases consumer expected utility. Therefore, determining the fair value of a branded business and monitoring its competitive advantage post-transaction is essential.

Considering the financial scope of this study, the accounting perspective is also important to consider. The accounting perspective aims to address the issue of asset recognition for intangible assets, such as patents, trademarks, or brands. According to IAS 38:

> “An intangible asset is an identifiable non-monetary asset without physical substance.” However, a distinction is made for internally generated intangible assets as opposed to acquired assets, e.g., through government grant or asset exchange. Internally generated assets are not recognizable on the firm balance sheet but acquired intangibles are recognized as distinct from goodwill” [11]

Hence, in a transaction, the buyer needs to determine the fair value of the acquired brand and recognize it on its financial statements.
Let's consider the acquisition of Costa Coffee by the Coca-Cola Company in 2018 as an illustration. The notes to the financial statements in the quarterly report depict how intangible assets are recognized:

> “As of June 28, 2019, $2.4 billion of the purchase price was preliminarily allocated to the Costa trademark and $2.5 billion was preliminarily allocated to goodwill. The goodwill recognized as part of this acquisition is primarily related to synergistic value created from the opportunity for additional expansion as well as our ability to market and distribute Costa in ready-to-drink form throughout our bottling system. It also

[9] Haigh, Knowles, 2004
[10] Kotler, 2006
[11] IFRS 3

includes certain other intangible assets that do not qualify for separate recognition, such as an assembled workforce."[12]

However, this accounting definition is not the most common one in the corporate world, which favours a business angle. As explained by Gabriela Salinas[13], the accounting definition can be seen as opposed to the economic perspective, which considers a brand as an asset, even outside an acquisition context. This asset is a "Vital form of corporate equity, a measurable asset whose value is as important to a business as its capital infrastructure and staff" underlines Pr David Aaker[14], academic at UC Berkeley.

ii. <u>Distinction between brand equity and brand value</u>

Secondly, it is important to distinguish between brand equity and brand value. Brand equity is a term primarily used by marketing teams to refer to the value of a brand, which is linked to its name and symbol. Synonymous with brand strength, brand equity encompasses customer loyalty, brand awareness, and brand associations, such as copyrights. Academics use the following three criteria to qualify brand equity:

- Customer mindset, measured by awareness and attitude.
- Product market outcome, measured by the price premium paid by customers.
- Financial market outcome, measured by the incorporation of brand value in the stock price, which depends on whether it's a consumer or industrial brand.

Natalie Mizik and Robert Jacobson explain in Valuing branded businesses[15] that there is a correlation between brand awareness and customer loyalty, which impacts future consumption patterns. Indeed, a high-quality brand leads to a higher perception of the value of its products, resulting in increased sales and margins. In What's in a Name? Lessons from the Demise of the Nokia Brand, Efrat Kasznik[16] mentions two value drivers of a brand:

- The underlying products, correlated with the brand strength and identified by the trends in market share.
- Marketing investment, maintaining innovation and a strong brand identity, depicted by investments.

As a result, brand equity is closely linked to the firm's performance, making it necessary to quantify and incorporate the value of brand equity in the valuation process, considering the characteristics of the sector and industry. The numerical value assigned to brand equity is called the brand value and is also defined as the replacement price of a brand.

[12] 10Q Coca Cola Company, June 2019
[13] Salinas, 2009
[14] Cal Alumni Association, 2014
[15] Mizik, Jacobson, 2009
[16] Kasznik, 2014

Consequently, financial brand valuation frameworks have been developed to address various purposes, including trading brands, justifying a firm's market capitalization, measuring marketing performance, or managing taxes.

iii. Financial valuation of a brand

Although many methodology providers and associated valuation frameworks exist, this thesis focuses on assessing the financial value of a brand using the most popular methods. We will detail three methods: the cost approach, the market approach, and the income approach, as described in "A Taxonomy of Brand Valuation Practice: Methodologies and Purposes" by Gabriela Salinas and Tim Ambler[17].

The cost approach is similar to the patrimonial method for firm valuation. It aims to value the brand based on its historical cost or the cost to recreate the brand. The first perspective relies on taking into account all investments realized to grow the brand. For instance, Coca Cola would need to sum up all advertising expenses which participated in building the brand value. A second perspective is to quantify the cost as if a company would invest today to build the exact same brand.
The cost-based methods generally provide a minimum value as it does not consider the brand's earning potential but focuses on past values.
Obviously, this approach is also disconnected from the intangible and unique nature of a brand. Indeed, it seems impossible to quantify all investments or even determine which investments had an impact on a brand value and in which proportions. But cost-based approaches are easier to compute since they are founded on past data.

The market approach is similar to the comparable multiples method for firm valuation, as it relies on comparing recent transactions involving similar brands. The core principle is to gather a benchmark, with similar brands, and determine the multiple paid to acquire those brands, based on recent transactions. This method is limited by the availability of comparable transactions and their data. Besides, comparing brands is in nature contradictory with the uniqueness of brands…

The income approach follows the same logic as the Discounted Cash Flow (DCF) method, as it determines the future cash flows or income attributable to the brand. Future cash flows can be determined through two main approaches:

- Capitalising annual sustainable earnings, which relies on past data,
- The Royalty Relief method based on determining a licensing fee as if the company had to pay if it was not the brand owner. This method relies on future assumptions and the royalty rate, often derived from market values. Valuation experts often determine this royalty rate based on their knowledge of a particular sector which makes it less accurate and precise.

[17] Salinas, Ambler, 2009

The main weakness of the income approach is its reliance on future assumptions, which can introduce valuation errors.

In conclusion, companies and experts have several methods at their disposal to value brands. Choosing the right approach is critical for maximizing the value creation associated with an M&A transaction. Selecting the valuation method that maximizes the value of a brand can prevent a potential bidder from overestimating the target, overpaying, and failing to achieve value creation.

1.3. Brand management and integration throughout the M&A process

This thesis also focuses on the value creation linked to the post-merger integration of the target's brand. We will, therefore, explore brand synergies and the choice of brand architecture within the new entity.

i. Monitoring brand synergies

The acquisition of a brand can present an opportunity for additional synergies, but these are contingent on the post-merger integration process, which begins well before the transaction. It involves anticipating and assessing brand compatibility and associated risks through thorough due diligence. Bringing two brands together can result in cannibalization, irrelevant marketing expenses, but also opportunities for value creation through a precise integration plan. Hence, it is crucial to monitor and evaluate the brand value post-M&A through measurable KPIs, such as customer retention.

ii. Defining the best brand outcome of the merger

Defining the brand outcome of a merger is crucial as it has implications for every stakeholder. A brand contributes to the image and reputation of a business among its partners, including suppliers and customers, and also plays a role in fostering a sense of community among employees. Academics have identified three pillars driving the merger of brands: brand strength, product branding strategy and identity, and group architecture.

- The brand strength

Regardless of the specific circumstances of each deal, there are four possible scenarios for integrating a brand post-M&A, as illustrated in Figure 1. We will provide an example and the associated M&A rationale for each scenario.

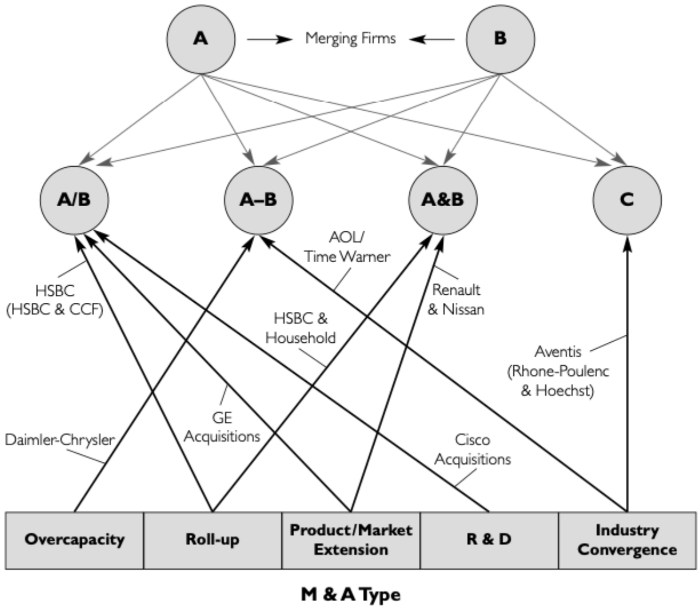


Figure 1 Scenarios of Brand Integration[22]

- **Keep only one brand, either the bidder's or the target's**
  This integration strategy is often referred to as "Backing the stronger horse," meaning that the combined entity typically adopts the name and logo of the leading company. Contrary to common assumptions, it can favor the target's brand if it is better suited for niche markets or geographic expansion, for example. The decision heavily depends on the context and future strategy of the entity, such as acquiring new customers through geographical expansion or gaining specific market access and improving R&D capabilities. The multiple acquisitions made by the diversified conglomerate General Electric perfectly illustrate this rationale. For instance, Converteam was acquired in 2011 to enhance GE's renewable energy solutions and acquire new customers through innovation[18].

- **Keep the two existing brands**
  This strategy involves keeping the brands' offerings separate or selecting one brand based on the context. The main advantage is maintaining a status quo, which can bring peace in a high-pressure transactional context.
  Let's consider an example in the pharmaceutical industry, a highly competitive and consolidating sector. When Sanofi and Aventis merged in 2004 to maintain a leading position in the market, they faced a challenging merger process. To ease tensions between the two firms, especially the highly diluted German counterpart, both brands were retained[19].

- **Build a joint brand**
  If the individual brands are iconic and have a strong customer reach, it can be beneficial to anticipate a new market phase and create new products before the

[18] La Tribune, 2011
[19] Les Échos, 2004

competition. This often occurs in sectors where the motive for M&A is industry rationalization or when dealing with strong national icons.
For instance, the merger between AOL and Time Warner faced significant pressure from competition authorities, who were concerned about the emergence of a communication behemoth. At the time, both companies had a loyal customer base, which justified maintaining the two corporate brands and leveraging the alliance to enhance the product offering ahead of competitors[20].

- **Create a new brand**
  This strategy signifies the management's strong signal of building a new culture and potentially a new product mix. For example, Aventis was born from the merger of Rhone-Poulenc and Hoechst, where a complete renewal of corporate culture, product offerings, and brand was chosen.

Each strategy has its advantages and disadvantages, and the decision-making process takes into account various factors, such as gaps in the vision of top management, differences in cultures and brand image, and the capabilities and resources of each entity.

- The product branding strategy

As explained by Kunal Basu in the California Management Review[21], there is a distinction between corporate brands, like Pepsico, and product brands, such as Pepsi. These concepts are often mistaken for each other, but it should be noted that a diversified group with multiple products has as many product brands as products. The associated strategy and identity can vary significantly depending on the presence of organizational and/or value linkages between them.

Following an M&A, management must decide whether to target every existing customer segment or narrow down the positioning. Based on this decision, the brand strategy is developed, taking into account the offering (internal decision of one or several products for specific customer segments) and the message, which conveys a market position. The resulting brand identity "provides direction, purpose, and meaning for the brand."

Figure 2 illustrates different approaches to product branding strategies:

[20] Les Échos, 2001
[21] Basu, 2006

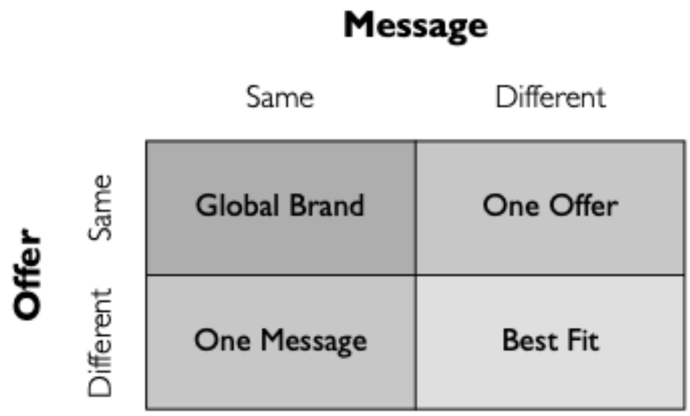


Figure 2 Product branding strategies[21]

- **Global brand strategy**
  A single offering and message are used for every customer, contributing to the creation of a universal identity. It is essential to establish a symbol, particularly after a merger process, to communicate a clear message to customers. The flagship product, such as the cola drink for Pepsi, is often chosen as it represents the associated brand at first glance.
  With a standardized offering, the company can benefit from economies of scale and/or scope throughout the supply chain (product development, manufacturing, communication, etc.).

- **Best fit**
  This strategy emphasizes differentiation at all levels, which inevitably leads to increased costs, but balances with the benefits of customer reach and total flexibility. In this case, the organization's brand identity cannot be associated with a single product since customer preferences are diverse. However, the values and culture of the organization should reflect common customer features to appeal to all.

- **One offer**
  This strategy involves selling a single product with different communication arguments based on customer features. For example, tire manufacturers may allow their salesmen to promote discounts or highlight premium characteristics while offering very similar products. The challenge is to maintain clarity and prevent customers from confusing the different messages.

- **One message**
  This strategy is adopted by brands whose identity markers are strong and appealing to all segments, such as HSBC in the banking industry. The brand identity often relies on a human-like personality that is recognizable and prominent.

To sum up, the brand identity at both the product and corporate levels is crucial for the success of post-merger brand integration.

- <u>The firm architecture</u>

The final step is to design the firm architecture, as shown in Figure 3, according to the brand identity, as the relationships among brands are crucial in a merged portfolio. While some firms may prefer no connection between their brands, others may benefit from inter-brand linkages.

Product Branding Strategy	Brand Identity	Brand Architecture	Example (Postmerger branding)
Global Brand	Symbol	Island	PepsiCo holds Pepsi, Quaker, Doritos, and Lipton Tea product brands in isolation of each other in an **Island** portfolio.
One Message	Person	Umbrella	HSBC uses its corporate **Umbrella** brand over individual product brands such as FirstDirect, CCF, and HFC.
One Offer	Product	Ladder	Bridgestone offers Bridgestone, Firestone, Dayton, Europa, and Lassa product brands, ordered in a price/quality **Ladder** portfolio.
Best Fit	Organization	Network	BMW, Mini, and Rolls Royce are independent product brands linked in a **Network** of luxury autos owned by BMW.

Figure 3 Brand architecture[21]

- **Island architecture:** if each product addresses a distinct customer need and requires a dedicated and specific strategy, there is no benefit in promoting other brands within the portfolio.

- **Umbrella architecture:** the advantage lies in the credibility brought by promoting a unifying corporate culture and core values.

- **Ladder architecture:** it establishes a clear hierarchy among products based on factors such as willingness-to-pay.
- **Network architecture:** if there is no clear and unique corporate message, but the consumption of multiple brands can be encouraged by building inter-brand connections.

To conclude, it is crucial to define the merged group's strategy for each brand in its portfolio, considering both customer reach and product mix.

iii. <u>Tackling the corporate culture</u>

The final challenge in integrating a brand is, in fact, the major challenge of any M&A transaction: integrating corporate cultures, as depicted by the major failure of the Amazon-Whole Foods merger.

Amazon, as the number one retailer with a significant e-commerce business, has core values that include customer focus and offering the best price. Whole Foods Market, on the other hand, is a supermarket chain known for offering organic food and upholding strong ethical values towards the planet and people, including employees.

The merger between Amazon and Whole Foods took place in 2017 as a vertical integration move for Amazon to acquire additional distribution capabilities and expand into offline retail. Despite Amazon's attempts to adopt some attributes of Whole Foods' culture, customers perceived this attempt as a failure. The clash of cultures created a tense environment within the merged entity, with Amazon's standards being implemented to stay competitive. However, higher flexibility and autonomy should have been implemented to maintain the high-quality customer contact that Whole Foods had.

This example demonstrates the importance of not underestimating the impact of corporate culture on a transaction. To understand the cultural gap between two entities, it is crucial to estimate their compatibility beforehand[22]. Several frameworks have been developed for this purpose.

The first integration scoring approach, presented in the PMI course[23] by Pr P. Legland (Figure 4), involves calculating a score based on the cultural similarity between two entities in terms of culture, processes, and management. A high score indicates a low risk of culture shock.

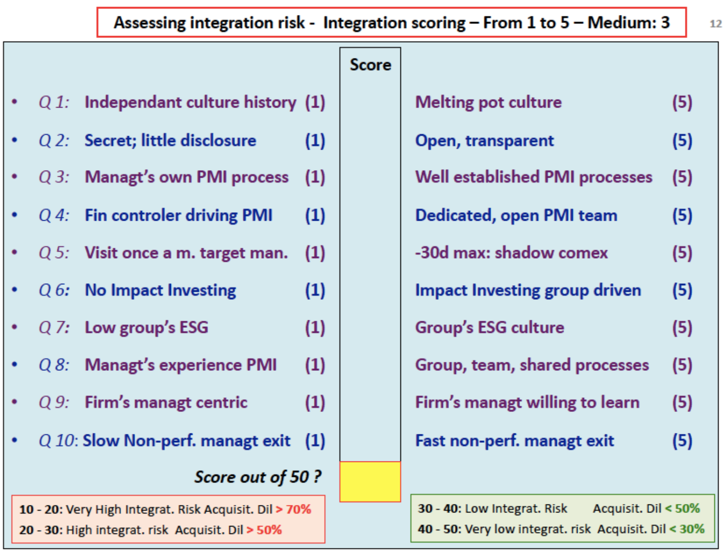


Figure 4 Integration score framework[23]

McKinsey published a report[24] in 2010 stressing how managers became aware of culture repercussions in a merger: "50% said that cultural fit lies at the heart of a value-enhancing merger". A culture clash is indeed conducive to a conflict-ridden atmosphere, leading to the loss of the best employees, as well as an unfavorable environment to achieve synergies and the expected value creation.

[22] Yang, Davis, Robertson, 2011
[23] Legland, 2023
[24] McKinsey&Company, 2010

Then, the report shares a practical framework to discuss culture throughout a robust and rational approach.

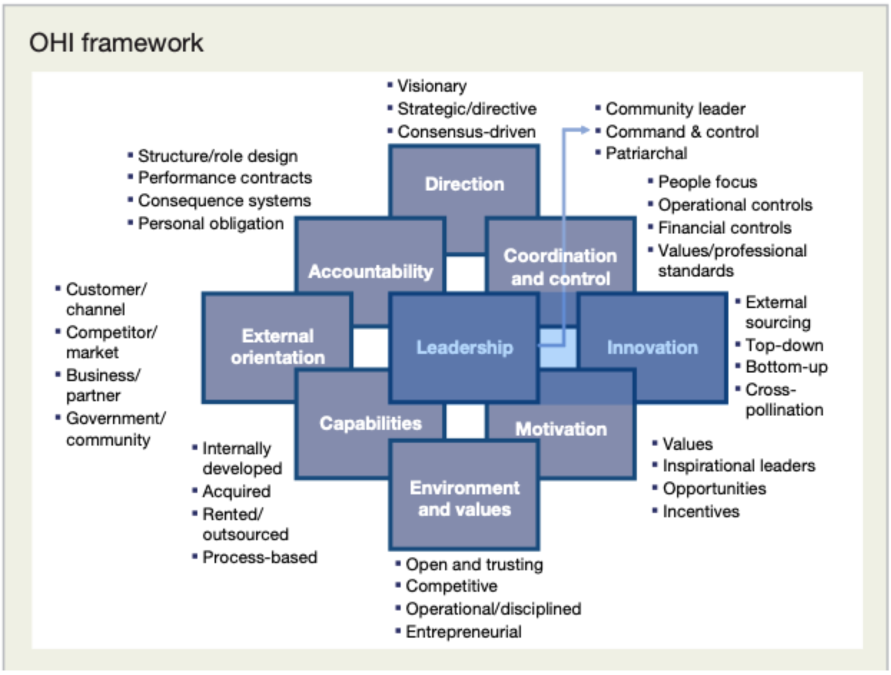


Figure 5 OHI framework[24]

The goal is to assess each counterpart based on public information, such as company websites, annual reports, filings, etc. Cultural frictions are then highlighted by categories, such as leadership style, innovation, or capabilities. The points of convergence also enable the identification of strengths on which integration should be based to promote value creation. In both cases, it's management practices that have an impact on culture and help resolve cultural conflicts.

In Stretch for Change[25] the culture consultant Gustavo Razzetti depicts a different step-by-step approach:

- **Identify the type of organizational culture**, such as tribal (family-like environment, people-oriented like Airbnb), fearful (top-down management with strong control processes), aggressive (result-oriented and competitive environment like Amazon), and fearless (importance of experimentation and creativity, like Pixar).
  In the Amazon-Whole Foods transaction we mentioned earlier, the gap between Amazon's aggressive culture and Whole Foods' fearless culture is quite obvious.

- **Determine if alignment is possible** between the entities. Even if they operate in the same industry, entities like AOL and Time Warner can be at opposite extremes in terms of their purpose. AOL focuses on short-term opportunities and maintains an aggressive business posture, while Warner focuses on building long-term value.

[25] Razzetti, 2017

- **Agree on the merger narrative** driving communication on both sides to alleviate anxiety arising from the merger. The notion of a "Merger of Equals" is a myth; there is always one side that has the advantage. Whether the "weaker" entity undergoes a significant identity transformation through a name change or both entities were former competitors, the merger narrative needs to unite the teams.

- **Assess compatibility of emotional and functional cultures** (see figure 6). Team rituals, decision-making processes, and psychological safety are at the core of a firm's culture. Culture Due Diligence is therefore a crucial phase for gathering key information for a successful, value-creating transaction.

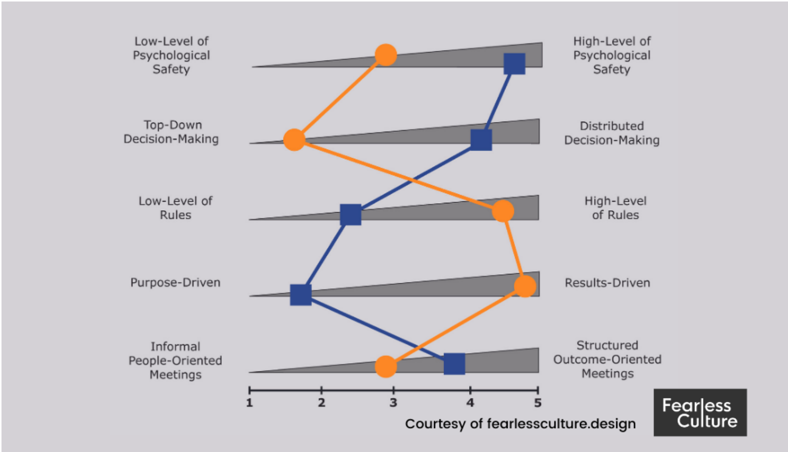


Figure 6 Culture compatibility assessment[25]

In the second part of this thesis, we will examine the convergence between these different frameworks for assessing the cultural compatibility of a merger.

2. Case study: the acquisition of Tiffany & Co. by LVMH group

2.1. The choice of the luxury industry and the LVMH-Tiffany & Co. transaction

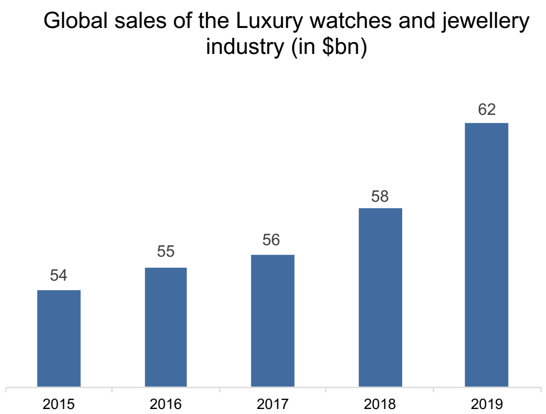
The luxury industry is an interesting subject to study due to its unique characteristics. The cost of production does not serve as a limiting factor, and demand is driven by the vision of artistic directors. The industry thrives on constantly renewing itself, as it sells dreams and a sense of belonging. It exhibits high resilience to crises since experiences and emotions are sold rather than essential goods. Furthermore, price elasticity is negative, as lowering prices diminishes the crucial sentiment of "uniqueness." Therefore, the brand becomes one of the most critical assets in this industry, as its power is central to attracting customers and makes luxury an important aspect to consider when studying brand valuation.

The decision to acquire Tiffany & Co. by LVMH was based on the understanding that the brand is the most valuable asset of Tiffany. The iconic blue boxes of Tiffany represent a significant intangible asset known as the "*Tiffany brand*". Valuing the company ultimately boils down to evaluating the brand itself.

2.2. Rationale and context

i. <u>Overview of the industry: the luxury industry is a stable well-performing sector dominated by few players</u>

Luxury watches and jewelry, also known as "hard luxury," are a sub-category within the luxury industry, distinct from "soft luxury" products such as clothing and perfumes. In 2019, the total revenue of the luxury goods market reached $313.5 billion. Luxury watches and jewelry accounted for 20% of the market, generating $61.9 billion in global revenues. This sub-category is projected to maintain a stable Compound Annual Growth Rate (CAGR) of 2.5%-3% in the coming years. Asia is the largest market for the industry, contributing 50% of the revenues in 2019, followed by Europe (26%) and the Americas (22%).



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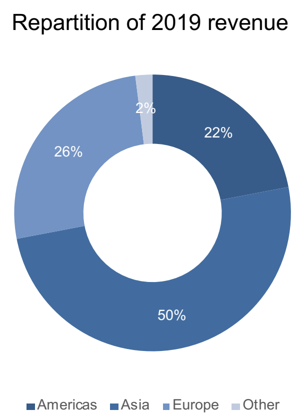


(b)

Figure 7 (a) Global sales of the Luxury watches and jewellery industry (in $bn) and (b) Geographic repartition of sales in 2019

The competitive landscape of this industry is largely dominated by a few key players. In 2019, Richemont (which owns brands such as Van Cleef & Arpels, Chloé, Cartier, Mont Blanc, etc.) held a 14.8% market share, Tiffany & Co. held 10.8%, and LVMH (owner of brands like Louis Vuitton, Bulgari, Céline, Dior, etc.) held 7.5%. While there is significant competition from both specialized and multi-product companies, brand reputation remains a primary driver, along with factors such as pricing and promotion, in which Tiffany does not actively engage[26].

ii. Overview of the companies

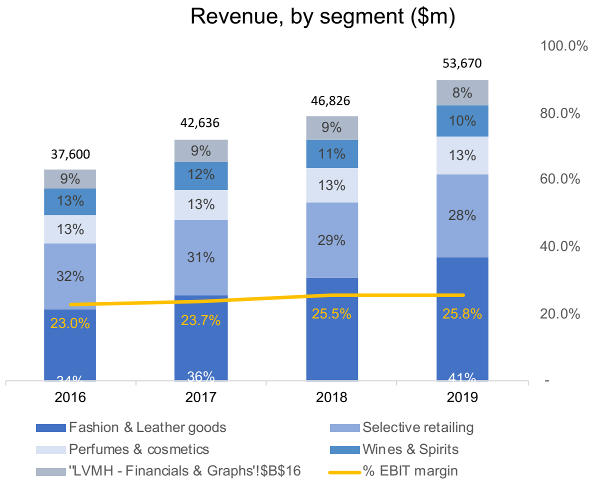
External growth has played a significant role in the expansion of LVMH within the luxury industry.

LVMH is a French luxury goods holding company that was established in 1987 through the merger of Moët-Hennessy and Louis Vuitton. It is headquartered on Avenue Montaigne in Paris, France. The company, which is still controlled by the Arnault family, including CEO Bernard Arnault, is among the French international titans and has been part of the CAC40 market index since its inception.

Since its establishment, LVMH has heavily relied on acquisitions as a major driver of its geographic and, more importantly, industrial expansion. Through a series of key acquisitions, LVMH has achieved dominance in all segments of the luxury industry. The company owns a wide range of well-known brands, including Tag Heuer, Bulgari, Hublot, Christian Dior, and others.

Between 2015 and 2019, LVMH made several notable acquisitions, including Le Parisien, Belmond, Christian Dior, and Fenty Beauty. The company has a strong presence in Asia, accounting for 36% of its 2018 revenue, and Europe, accounting for 29% of its 2018 revenue. LVMH is actively expanding into the US and Canadian markets, where its presence is relatively weak. The watches and jewelry segment represents only 9% of the company's total sales in 2018, making it the smallest division.

[26] 10K Tiffany&Co



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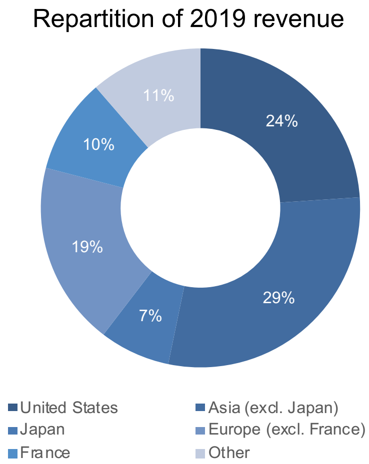

(b)

Figure 8 (a) LVMH sales by product segment and (b) Geographic repartition of sales in 2018[27]

After facing a series of scandals, Tiffany is seeking to revitalize its business and expand into new markets.

Tiffany & Co. is a luxury jewellery and fine tableware design house founded in 1837 by Charles Lewis Tiffany. The company is headquartered on Fifth Avenue in Manhattan, New York City, USA. Tiffany is known for selling exquisite jewellery and gained popularity through the movie "Breakfast at Tiffany's" featuring Audrey Hepburn, which helped establish the brand as a symbol of elegance and glamour. In 1887, Tiffany purchased a third of the French Crown Jewels, solidifying its reputation as a high-end jeweller with expertise in diamonds. In 1984, Tiffany was acquired by the Registrant and completed its IPO in 1987. It is now one of the major players in the global luxury jewellery industry, with a market capitalization of $11,324 million as of July 27, 2019.

Tiffany's primary focus is on jewellery, which is divided into categories such as Jewellery Collection, Engagement Jewellery, and Designer Jewellery. The company offers high-quality products that attract affluent customers, featuring diamonds, platinum, and gold. In 2019, Tiffany reported total revenue of $4.2 billion and generated earnings of $586 million. The Jewellery Collection segment accounted for 54% of total sales, and accessories, fragrances, and watches contributed 8% of sales. The company's largest market is the Americas, representing 44% of its 2019 revenues, followed by Asia-Pacific (28%), Japan (15%), and Europe (11%).

[27] LVMH Financial reports

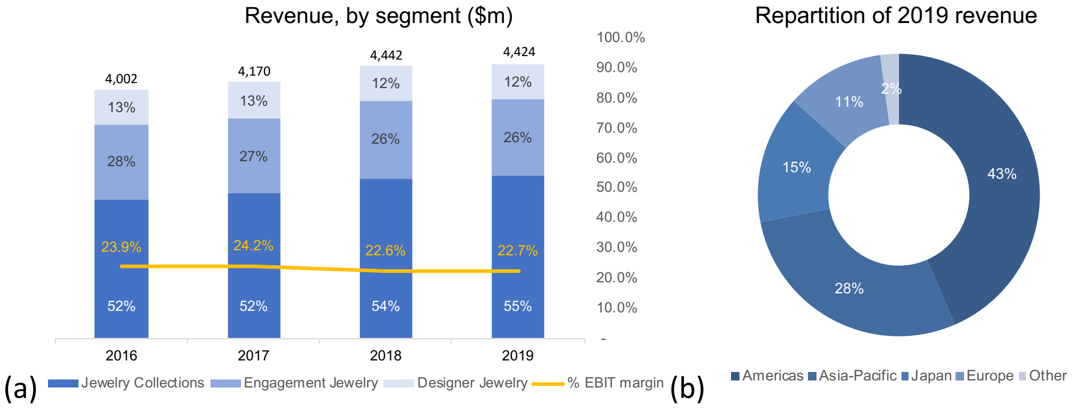

Figure 9 (a) Tiffany & Co sales by product segment and (b) Geographic repartition of sales in 2019 [28]

After a few years of inconsistent revenues and CEO scandals, Tiffany & Co.'s main strategy consists of updating its brand message and products to strengthen its position among competitors, particularly in new markets such as the Asia-Pacific region, although its historical market is the USA. Sales in Europe accounted for only 11% of revenue in 2019. The Tiffany brand is the company's most important asset, and it has traditionally invested heavily in its single brand, marketing it through cinema and individual ambassadors. It has become iconic and is associated with high-quality gemstone jewellery, romance, and excellent customer service in elegant stores. In 2019, 788.2m€ (18% of revenue) was spent on advertising, marketing, and public and media relations. This figure includes costs for media, production, catalogs, internet, visual merchandising, and marketing events. To enhance the brand, the company also engages in charitable sponsorships, grants, and donations.

Figure 10 Tiffany & Co's strong and iconic brand image

Regarding their strategy, Tiffany & Co. has faced a series of scandals and financial underperformance in recent years. They are now seeking business deals to recover from recent losses and turn their operations around. In addition to financial recovery, Tiffany is also

[28] Tiffany&Co Financial Reports

looking for opportunities to strengthen its brand in new markets, particularly in the Asia-Pacific region.

iii. Financial analysis of Tiffany & Co.

Table 1 Key financial figures of Tiffany & Co., preceding the acquisition (in $m) [29]

Income statement (figures in $m)	**2015**	**2016**	**2017**	**2018**	**2019**
Net sales	**4,104.9**	**4,001.8**	**4,169.8**	**4,442.1**	**4,424.0**
Increase from prior year (%)	-	*(2.5%)*	*4.2%*	*6.5%*	*(0.4%)*
Gross profit	2,491.3	2,499.0	2,610.7	2,811.0	2,762.9
As a percentage of net sales	*60.7%*	*62.4%*	*62.6%*	*63.3%*	*62.5%*
EBITDA		**955.0**	**1,011.0**	**1,005.0**	**1,004.0**
As a percentage of net sales	-	*23.9%*	*24.2%*	*22.6%*	*22.7%*
Depreciation & Amortization		(208.5)	(206.9)	(229.0)	(259.7)
As a percentage of net sales	-	*(5.2%)*	*(5.0%)*	*(5.2%)*	*(5.9%)*
Operating Income	**768.9**	**746.6**	**804.5**	**775.5**	**744.0**
As a percentage of net sales	*18.7%*	*18.7%*	*19.3%*	*17.5%*	*16.8%*
Net Interest Expenses	(49.0)	(46.0)	(42.0)	(39.7)	(44.6)
As a percentage of net sales	*(1.2%)*	*(1.1%)*	*(1.0%)*	*(0.9%)*	*(1.0%)*
Net Income to Company	**446.1**	**446.1**	**370.1**	**586.4**	**541.1**
As a percentage of net sales	*10.9%*	*11.1%*	*8.9%*	*13.2%*	*12.2%*
Number of diluted common shares (weighted average)	125.5	125.5	125.1	123.5	121.6
Net Income per diluted shares	3.6	3.6	3.0	4.7	4.4
Cash flow from operating activities	705.7	705.7	932.2	531.8	670.9
Free cash flow	**482.9**	**482.9**	**629.9**	**249.7**	**350.3**
Total debt-to-equity ratio	***36.6%***	***36.6%***	***30.9%***	***31.8%***	***30.9%***
Cash dividends paid per share	**1.8**	**1.8**	**2.0**	**2.2**	**2.3**
Company-operated Tiffany & Co. Stores	313	313	315	321	326
Number of employees	11,900	11,900	13,100	14,200	14,100

Before the acquisition, Tiffany & Co.'s revenue remained relatively stable, with a slight increase in 2017 and 2018. However, there was no significant growth in revenue from 2015 to 2019. Additionally, the company suffered greatly from the COVID crisis, resulting in the closure of its shops in 2019, leading to a decline in revenues and a 45% drop in Q1 2020 revenues. Tiffany & Co.'s EBITDA margin remained fairly stable, amounting to 22.7% in 2019. However, an increase in depreciation and amortization expenses led to a decline in operating income over the years, and Tiffany & Co.'s net income experienced fluctuations during this period.

iv. Share Price analysis of Tiffany & Co.

Tiffany & Co.'s share price experienced fluctuations during this period. There was a moderate increase from 2016 to 2018, followed by a decline in 2019. At the time of the deal, the comparison of cumulative 5-year total return shows that Tiffany & Co.'s share price had been struggling and underperforming the S&P 500 Index and the S&P 500 Consumer Discretionary Index since 2015. The price only improved when the deal was announced.

[29] Tiffany&Co Financial Reports

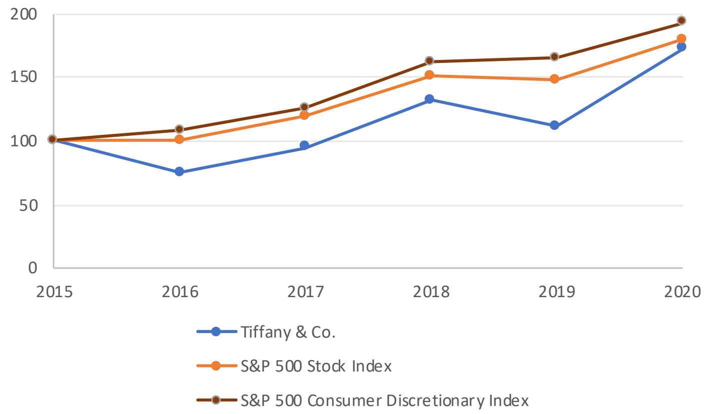

Figure 11 Comparison of cumulative 5-year total return of Tiffany & Co and the S&P 500 Index[30]

Figure 12_Evolution of Tiffany & Co'.s Share Price at the time of the announcement [30]

Overall, the financial analysis reveals that Tiffany & Co. experienced relatively stable revenue, with modest growth in certain years. Net income fluctuated, with a significant increase in 2017 but a decrease in 2018. The EBITDA margin showed some variability, indicating fluctuations in operating profitability. The share price also experienced fluctuations, with periods of moderate growth and decline.

v. Rationale for the deal: Tiffany & Co's acquisition is driven by LVMH geographic expansion strategy

From LVMH's perspective, the deal is a way to secure Tiffany & Co., a major player in the industry. It will double the size of LVMH's "Watches and Jewellery" division, making the company the market leader and surpassing its biggest competitor, Richemont. It will also allow LVMH to establish a strong presence in the Americas, which is Tiffany's main market, while maintaining high standards of elegance and luxury. Bernard Arnault's hesitation in letting LVMH develop its American market presence stems from concerns about the "low standards" in the US luxury retail industry that could potentially harm the LVMH brand.

[30] Capital IQ

From Tiffany's perspective, the deal provides the opportunity to expand internationally on a much larger scale and address their revenue generation challenges by leveraging the support of a large and experienced group's structure and processes.

vi. Acquisition timeline

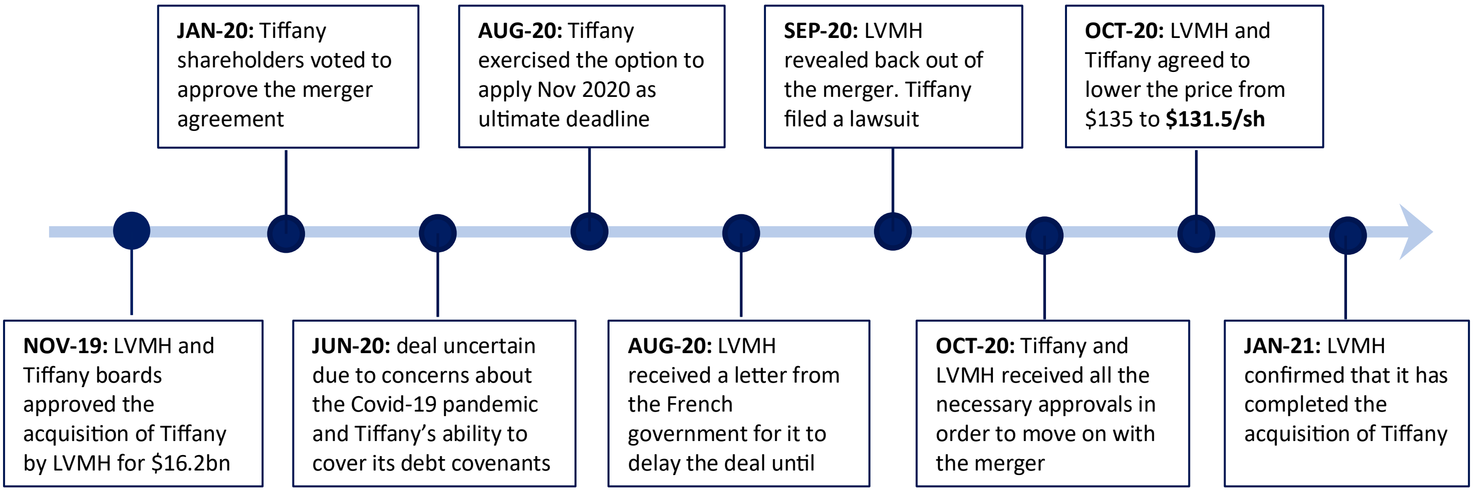

Figure 13 Timeline of the acquisition

The deal was announced in November 2019. Initially, LVMH planned to acquire publicly traded Tiffany's for $135 per share in cash, totalling $16.2 billion, with a closing date set for mid-2020. The initial offer was $120 per share but was revised. The announcement received a positive response from the markets and government. However, due to the COVID crisis, the deal was halted in September 2020. Eventually, discussions resumed in October 2020 after legal threats and government intervention, and an agreement was reached at $131.5 per share, with another positive market reaction. The deal was officially closed on January 7th, 2021.

2.3. Financial valuation

The valuation of Tiffany & Co. revolves around assessing its brand, which is the company's most important asset, including strong consumer perceptions and the value of its trademarks29. Tiffany & Co.'s iconic blue colour exemplifies this point. A research study demonstrated that almost 80% of respondents directly associated the colour Pantone 1837 with the Tiffany & Co. brand. Now, we will value Tiffany & Co. using the different methods previously mentioned: cost approach, market approach, and royalty relief approach.

i. Main assumptions and preliminary analysis

We use data from Capital IQ:

- Latest financial statements: from 2016 to 2019
- Financial statement from 1990 to account for historical costs

We make the following assumptions:

- Sales: 5% annual growth rate until 2025. Tiffany & Co. should benefit from LVMH's customer base and marketing strategy.
- Sales: 4% perpetual growth rate, reflecting the growth of the luxury industry and its resilience to crises.
- EBITDA: We assume that the EBITDA margin will align with LVMH's levels in the future, reaching 25% by 2025. We model a constant improvement of the margin to this level.
- Depreciation & Amortization: Constant at 5.5% of net sales.
- Interest rates: We assume that interest rates are high due to inflation forecasts, using the highest interest rate over the past four years.
- For currency exchange gains or losses and other non-operating incomes or expenses, we apply the average percentage of revenues from the previous 4 years.

ii. Cost-based method: historical cost of creation and cost to recreate

The first method we apply to value Tiffany & Co. is the historical cost of creation method, which suggests that the value of a brand is the sum of the costs that have been incurred to create the asset. We use data from Capital IQ, where we find the expenses of the brand from 1992 to 2019. Global marketing expenses, including advertising expenses, marketing expenses, selling & marketing expenses, and global rental expenses, including net rental expenses, imputed operating lease interest expenses, and imputed operating lease depreciation, are the ones we select for the analysis. Marketing and rental expenses appear to be a good representation of the expenses Tiffany & Co. incurred to create the brand image it benefits from today, as Tiffany benefits greatly from advertising and its iconic selling points.

To compute the historical cost of creation of the Tiffany & Co. brand, we gather the aforementioned data and attribute a rate of participation in building the brand image. Considering that Tiffany & Co. is an old brand, we assume a significant portion of expenses was used to build the brand at the beginning of its activity. However, we split expenses between developing and maintaining brand strength. We only account for expenses related to building brand strength when valuing the brand.

We make the following assumptions:

- 90% of marketing expenses are attributable to building brand strength for the first fifteen years of data.
- 40% of marketing expenses are attributable to building brand strength for the following years of data. The rest aims to maintain the already built brand reputation.
- 55% of rental expenses are attributable to building brand strength.

Table 2 Tiffany & Co.'s historical cost of creation valuation[31]

Tiffany - Historical cost of creation

Assumptions	
Marketing cost attributable to building brand strength - first fifteen years (%)	90%
Marketing cost attributable to building brand strength - years after (%)	40%
Rental cost attributable to building brand strength (%)	55%

Cost Analysis (figures in $m)	**1992**	**1993**
Marketing expenses incl. advertising expenses, selling & marketing expenses	19.2	19.4
Marketing expenses attributable to building brand strength (%)	17.3	17.5
Rental expenses incl. net rental expenses, imputed operating lease interest expenses and depreciation	38.8	48.0
Rental expenses attributable to building brand strength (%)	21.3	26.4
Brand expenses	**38.6**	**43.9**

Cost Analysis (figures in $m)	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**
Marketing expenses incl. advertising expenses, selling & marketing expenses	18.1	31.0	37.2	43.9	51.8	52.5	57.3	84.2	86.4
Marketing expenses attributable to building brand strength (%)	16.3	27.9	33.5	39.5	46.6	47.3	51.6	75.8	77.7
Rental expenses incl. net rental expenses, imputed operating lease interest expenses and depreciation	53.1	58.1	65.4	74.2	78.5	96.9	113.6	117.0	117.0
Rental expenses attributable to building brand strength (%)	29.2	32.0	36.0	40.8	43.2	53.3	62.5	64.3	64.4
Brand expenses	**45.5**	**59.9**	**69.4**	**80.3**	**89.8**	**100.5**	**114.0**	**140.1**	**142.1**

Cost Analysis (figures in $m)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Marketing expenses incl. advertising expenses, selling & marketing expenses	101.9	122.4	135.0	273.0	323.4	376.7	408.5	319.8	395.2
Marketing expenses attributable to building brand strength (%)	91.7	110.1	121.5	245.7	129.4	150.7	163.4	127.9	158.1
Rental expenses incl. net rental expenses, imputed operating lease interest expenses and depreciation	133.2	173.9	198.6	212.3	236.7	272.9	290.6	452.1	517.4
Rental expenses attributable to building brand strength (%)	73.3	95.6	109.2	116.7	130.2	150.1	159.8	248.6	284.6
Brand expenses	**165.0**	**205.8**	**230.7**	**362.5**	**259.5**	**300.8**	**323.2**	**376.6**	**442.7**

Cost Analysis (figures in $m)	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Marketing expenses incl. advertising expenses, selling & marketing expenses	468.1	500.6	506.4	568.0	604.0	598.0	629.8	788.2
Marketing expenses attributable to building brand strength (%)	187.2	200.2	202.6	227.2	241.6	239.2	251.9	315.3
Rental expenses incl. net rental expenses, imputed operating lease interest expenses and depreciation	601.3	636.6	684.0	692.6	707.0	748.8	797.0	863.2
Rental expenses attributable to building brand strength (%)	330.7	350.1	376.2	380.9	388.9	411.8	438.4	474.8
Brand expenses	**517.9**	**550.4**	**578.8**	**608.1**	**630.5**	**651.0**	**690.3**	**790.0**

Valuation	**8,608**

[31] Capital IQ

Table 3 Tiffany & Co.'s historical cost of creation valuation – Sensitivity analysis

Rental cost attributable to building brand strength (%)	Marketing cost attributable to building brand strength - first fifteen years (%)				
	20%	30%	40%	50%	60%
40%	5,949	6,597	7,246	7,895	8,543
45%	6,403	7,051	7,700	8,349	8,997
50%	6,856	7,505	8,154	8,802	9,451
55%	7,310	7,959	**8,608**	9,256	9,905
60%	7,764	8,413	9,062	9,710	10,359
65%	8,218	8,867	9,516	10,164	10,813
70%	8,672	9,321	9,970	10,618	11,267

According to the historical cost of creation method, Tiffany & Co.'s brand value is estimated at $8.608 million.

This method, which is very easy to apply, is simple and requires no assumptions. However, it doesn't seem to be very reliable as it is highly sensitive to the number of years of expenses integrated into the computation and our assumptions regarding the weight of each expense attributable to building and maintaining brand strength. Furthermore, this method doesn't take into account inflation and the time value of money, thereby distorting historical expenses.

To address this issue, we use the cost-to-recreate method. We consider the same expenses used to calculate the historical cost of creation, but we add an inflation factor and discount the expenses. Thus, we treat past expenses as cash flows and bring them to their present value using a discount rate. We used the previously computed Weighted Average Cost of Capital (WACC) as the discount rate, and inflation rates are sourced from the World Bank database, specifically the rates of the United States.

Table 4 Tiffany & Co.'s cost to recreate valuation[32]

Tiffany - Cost to recreate

Assumptions	
Marketing cost attributable to building brand strength - first fifteen years (%)	90%
Marketing cost attributable to building brand strength - years after (%)	40%
Rental cost attributable to building brand strength (%)	55%

[32] Capital IQ

Cost Analysis (figures in $m)	**1992**	**1993**
Marketing expenses incl. advertising expenses, selling & marketing expenses	19.2	19.4
Marketing expenses attributable to building brand strength (%)	17.3	17.5
Rental expenses incl. net rental expenses, imputed operating lease interest expenses and depreciation	38.8	48.0
Rental expenses attributable to building brand strength (%)	21.3	26.4
Brand expenses	**38.6**	**43.9**
Inflation rate (annual US rate *from the World Bank Database*)	3.0%	3.0%
Annual inflation factor	1.030	1.030
Compounded inflation factor	2.238	2.130
Brand expenses adjusted for inflation	**86.4**	**93.5**
Discounting factor	9.3	8.5
Discounted(Brand expenses)	**9.3**	**10.9**

Cost Analysis (figures in $m)	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**
Marketing expenses incl. advertising expenses, selling & marketing expenses	18.1	31.0	37.2	43.9	51.8	52.5	57.3	84.2	86.4
Marketing expenses attributable to building brand strength (%)	16.3	27.9	33.5	39.5	46.6	47.3	51.6	75.8	77.7
Rental expenses incl. net rental expenses, imputed operating lease interest expenses and depreciation	53.1	58.1	65.4	74.2	78.5	96.9	113.6	117.0	117.0
Rental expenses attributable to building brand strength (%)	29.2	32.0	36.0	40.8	43.2	53.3	62.5	64.3	64.4
Brand expenses	**45.5**	**59.9**	**69.4**	**80.3**	**89.8**	**100.5**	**114.0**	**140.1**	**142.1**
Inflation rate (annual US rate *from the World Bank Database*)	2.6%	2.8%	2.9%	2.3%	1.6%	2.2%	3.4%	2.8%	1.6%
Annual inflation factor	1.026	1.028	1.029	1.023	1.016	1.022	1.034	1.028	1.016
Compounded inflation factor	1.903	1.943	1.943	1.663	1.382	1.542	1.880	1.651	1.307
Brand expenses adjusted for inflation	**86.6**	**116.3**	**134.9**	**133.5**	**124.1**	**155.0**	**214.3**	**231.3**	**185.7**
Discounting factor	7.9	7.2	6.7	6.1	5.7	5.2	4.8	4.4	4.1
Discounted(Brand expenses)	**11.0**	**16.1**	**20.2**	**21.7**	**21.9**	**29.8**	**44.7**	**52.4**	**45.7**

Cost Analysis (figures in $m)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Marketing expenses incl. advertising expenses, selling & marketing expenses	101.9	122.4	135.0	273.0	323.4	376.7	408.5	319.8	395.2
Marketing expenses attributable to building brand strength (%)	91.7	110.1	121.5	245.7	129.4	150.7	163.4	127.9	158.1
Rental expenses incl. net rental expenses, imputed operating lease interest expenses and depreciation	133.2	173.9	198.6	212.3	236.7	272.9	290.6	452.1	517.4
Rental expenses attributable to building brand strength (%)	73.3	95.6	109.2	116.7	130.2	150.1	159.8	248.6	284.6
Brand expenses	**165.0**	**205.8**	**230.7**	**362.5**	**259.5**	**300.8**	**323.2**	**376.6**	**442.7**
Inflation rate (annual US rate *from the World Bank Database*)	2.3%	2.7%	3.4%	3.2%	2.9%	3.8%	(0.4%)	1.6%	3.2%
Annual inflation factor	1.023	1.027	1.034	1.032	1.029	1.038	0.996	1.016	1.032
Compounded inflation factor	1.432	1.486	1.595	1.511	1.401	1.513	0.965	1.158	1.282
Brand expenses adjusted for inflation	**236.2**	**305.9**	**368.0**	**547.7**	**363.7**	**455.2**	**311.9**	**435.9**	**567.6**
Discounting factor	3.7	3.4	3.2	2.9	2.7	2.5	2.3	2.1	1.9
Discounted(Brand expenses)	**63.1**	**88.8**	**116.0**	**187.4**	**135.2**	**183.7**	**136.7**	**207.5**	**293.4**

Cost Analysis (figures in $m)	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Marketing expenses incl. advertising expenses, selling & marketing expenses	468.1	500.6	506.4	568.0	604.0	598.0	629.8	788.2
Marketing expenses attributable to building brand strength (%)	187.2	200.2	202.6	227.2	241.6	239.2	251.9	315.3
Rental expenses incl. net rental expenses, imputed operating lease interest expenses and depreciation	601.3	636.6	684.0	692.6	707.0	748.8	797.0	863.2
Rental expenses attributable to building brand strength (%)	330.7	350.1	376.2	380.9	388.9	411.8	438.4	474.8
Brand expenses	**517.9**	**550.4**	**578.8**	**608.1**	**630.5**	**651.0**	**690.3**	**790.0**
Inflation rate (annual US rate *from the World Bank Database*)	2.1%	1.5%	1.6%	0.1%	1.3%	2.1%	2.4%	1.8%
Annual inflation factor	1.021	1.015	1.016	1.001	1.013	1.021	1.024	1.018
Compounded inflation factor	1.154	1.091	1.084	1.005	1.038	1.043	1.024	1.000
Brand expenses adjusted for inflation	**597.8**	**600.6**	**627.3**	**611.0**	**654.6**	**679.1**	**707.1**	**790.0**
Discounting factor	1.8	1.6	1.5	1.4	1.3	1.2	1.1	1.0
Discounted(Brand expenses)	**335.6**	**366.1**	**415.3**	**439.3**	**511.1**	**575.8**	**651.1**	**790.0**

Valuation		**5,780**
WACC	*8.6%*	

Table 5 Tiffany & Co.'s historical cost to recreate valuation – Sensitivity analysis

Rental cost attributable to building brand strength (%)	Marketing cost attributable to building brand strength - first fifteen years (%)				
	20%	30%	40%	50%	60%
40%	3,877	4,359	4,841	5,323	5,805
45%	4,190	4,672	5,154	5,636	6,118
50%	4,503	4,985	5,467	5,949	6,431
55%	4,816	5,298	**5,780**	6,262	6,744
60%	5,129	5,611	6,093	6,575	7,057
65%	5,442	5,924	6,406	6,888	7,370
70%	5,755	6,237	6,719	7,201	7,683

WACC	Valuation
8.6%	5,780
7.6%	6,102
8.1%	5,936
8.4%	5,936
8.6%	**5,936**
8.8%	5,936
9.1%	5,936
9.6%	5,936

According to the cost to recreate method, Tiffany & Co.'s brand value is estimated at $5.780 million.

This value is lower than the previous one and appears to be more accurate. Past expenses carry less weight than more recent ones. As before, we provide a sensitivity analysis of the result, considering the weight given to marketing and rental expenses in building brand strength, as well as the discount rate. The valuation depends heavily on our assumptions and the discount rate. Increasing the discount rate by 1% reduces the brand value by 5%. Therefore, this method has limitations due to its high dependence on general assumptions.

iii. <u>Income-based method: royalty relief method</u>

The third method we apply to value Tiffany & Co. is the Royalty relief approach. It consists in multiplying potential future sales (net of taxes) of the company its royalty rate and then discounting them at the WACC, like if the brand would pay royalties to her owning company.

The third method we apply to value Tiffany & Co. is the Royalty Relief approach. It involves multiplying potential future sales (net of taxes) of the company by its royalty rate and then discounting them at the WACC, as if the brand would pay royalties to its owning company.

Finding and evaluating the royalty rate is challenging. To address this issue, we utilize the fact that Tiffany & Co. has been paying a royalty to Elsa Peretti, one of the brand designers. Since 1974, Tiffany has been the sole licensee for the intellectual property rights necessary to make and sell jewelry and other products designed by Elsa Peretti and bearing her trademarks. Tiffany and Ms. Peretti completed the "Peretti Agreement," which reflects the long-standing rights and marketing and royalty obligations of the parties:

- Tiffany agrees to pay Peretti a basic royalty (the "Basic Royalty") of Four Hundred and Fifty Thousand Dollars ($450,000) per Fiscal Year during the Term.
- In addition to the Basic Royalty, Tiffany agrees to pay Peretti a royalty of Five Percent (5%) of Net Peretti Sales (the "Sales Royalty") during the Term.

The designs of Ms. Peretti accounted for 7% of Tiffany & Co.'s worldwide net sales in 2019. Using the Knoppe formula, as presented by Salinas (2009), which states that the royalty rate should be around 1/3 of the licensed product profit divided by its sales, we can compute Tiffany & Co.'s royalty rate:

Table 6 Tiffany & Co.'s royalty rate computation [33]

Tiffany - Royalty Relief

Royalty rate computation (in $m)	
Basic Royalty (per yr)	450
Sales Royalty (% of net Peretti sales)	5.0%
Peretti sales (% Tiffany & Co.'s net sales)	7.0%
Net sales in 2019	4,424
Total royalty sales	310
Net operating income in 2019	744
Total royalty operating income	52
Royalty rate	5.6%

The royalty rate is 5.6%, which falls within the range of royalty rates in the luxury industry, typically between 5% to 8%. The royalty rate is multiplied by the projected branded net sales, which are then discounted to their present value, to obtain the brand value.

Table 7 Tiffany & Co.'s royalty relief valuation

Assumptions	
Brand Strength Index (%)	90%

Income statement (figures in $m)		2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Net Sales		4,689	4,971	4,420	4,685	4,966	5,264	5,269	5,585	5,920	6,216
Branded Sales		4,220	4,474	3,978	4,217	4,470	4,738	4,742	5,027	5,328	5,595
Royalty Revenue	5.6%	237	251	223	236	251	266	266	282	299	314
Tax rate		22%	22%	22%	22%	22%	22%	22%	22%	22%	22%
Royalty Revenue After Taxes		**185**	**196**	**174**	**184**	**195**	**207**	**207**	**220**	**233**	**245**
Discounting factor		1.1	1.2	1.3	1.4	1.5	1.6	1.8	1.9	2.1	2.3
PV(Royalty Revenue)		170	166	136	133	129	126	116	114	111	107
Perpetual growth rate	5.0%										
Terminal value											**6,475**
PV(TV)											2,838
Valuation											**4,146**
WACC	*8.6%*										

[33] Amended and restated agreement between Tiffany & Co. and Elsa Peretti

Table 8 Tiffany & Co.'s historical royalty relief valuation – Sensitivity analysis

WACC	Royalty rate 4.6%	5.1%	5.6%	6.1%	6.6%
7.6%	4,660	5,166	5,673	6,179	6,686
8.1%	3,929	4,356	4,783	5,210	5,637
8.4%	3,593	3,984	4,374	4,765	5,156
8.6%	3,400	3,770	**4,140**	4,509	4,879
8.8%	3,228	3,579	3,929	4,280	4,631
9.1%	3,000	3,326	3,652	3,979	4,305
9.6%	2,687	2,979	3,271	3,563	3,855

According to the royalty relief method, Tiffany & Co.'s brand value is estimated at $4.288 billion. The impact of the royalty rate and the discount rate is analyzed through a sensitivity analysis. The valuation heavily depends on these factors. Increasing the discount rate by 1% reduces the brand value by 21%, while increasing the royalty rate by 1% increases the brand value by 18%. Determining the royalty rate is subjective but crucial in this method. It is limited due to its high dependence on general assumptions.

iv. Market-based method: transaction multiple method

The market approach involves comparing the deal of interest to other recent transaction values. The acquisition of Tiffany & Co. by LVMH was a significant transaction in the luxury retail industry. While finding exact comparable transactions is challenging due to the unique characteristics of each deal, there have been several notable M&A transactions in the luxury goods sector that can provide some points of comparison. Here are the selected transactions that share similarities with the acquisition of Tiffany & Co. by LVMH in terms of their impact on the luxury goods industry and strategic motivations behind the deals:

- **Richemont's acquisition of YOOX Net-a-Porter**: In 2018, Swiss luxury goods group Richemont acquired YOOX Net-a-Porter, an online luxury fashion retailer. The deal allowed Richemont to expand its digital presence and tap into the growing e-commerce market for luxury goods.

- **LVMH's acquisition of Christian Dior**: In 2017, LVMH acquired the remaining minority stake in Christian Dior that it did not already own. This transaction consolidated LVMH's control over the iconic fashion brand and demonstrated the company's commitment to expanding its luxury portfolio.

- **Estée Lauder's acquisition of Too Faced Cosmetics**: In 2016, Estée Lauder, a multinational beauty company, acquired Too Faced Cosmetics, a popular makeup brand known for its quirky and trendy products. The acquisition allowed Estée Lauder to expand its presence in the high-growth makeup segment and tap into Too Faced's loyal customer base.

Table 9 Tiffany & Co.'s transaction multiple valuation[34]

Tiffany - Comparable Analysis

Target	Acquiror	Date	Transaction Price (€m)	Currency	Acquisition stake	Brand Price at Transaction Time	Estimated % Attributable to Brand	Target Sales at Acquisition (€m)	Implied Multiple
YOOX Net-a-Porter	Richemont	2018	2,800	EUR	45.99%	1,400	23%	2,091	0.7x
Christian Dior	LVMH	2017	6,500	EUR	100%	4,900	75%	43,683	0.1x
Too Faced Cosmetics	Estée Lauder	2016	1,500	USD	100%	607	40%	270	2.2x
Average multiple									**1.0x**
Tiffany & Co. Sales in 2019									4424
Brand valuation									**4,468**

Table 10 Tiffany & Co.'s transaction multiple valuation – Sensitivity Analysis

Average multiple	Valuation
1.0x	4,468
0.4x	1,770
0.6x	2,654
0.8x	3,539
1.0x	**4,424**
1.2x	5,309
1.4x	6,194
1.6x	7,078

V. Conclusion and comparison with consensus

- General overview of our results

In order to enhance our understanding of the distribution of these results, we gathered the results from different valuation methods in Table 11 and utilized a football field analogy to create a clearer perspective.

[34] Companies' Financial Reports

Table 11 Tiffany & Co.'s results summary and comparison to benchmark

Tiffany - Values comparison (€m)

Method	Low	High	Base
Cost-based approach			
Cost to recreate	4,816	6,744	5,780
Income-based approach			
Royalty relief	3,400	4,879	4,140
Market-based approach			
Comparable transactions	1,770	7,078	4,424
Average - Valuation methods	**3,329**	**6,234**	**4,781**
Median	**3,400**	**6,744**	**4,424**
Benchmark			
Crédit Suisse			6,334
Deutsche Bank			5,881
HSBC			6,107
Jefferies			6,334
Morning Star			5,429
Average			**6,017**
Methods valuation vs. benchmark average			**(21%)**
LVMH			
LVMH Brand valuation *(financial report 2021)*			**5,949**
Methods valuation vs. LMVH	**(44%)**	**5%**	**(20%)**

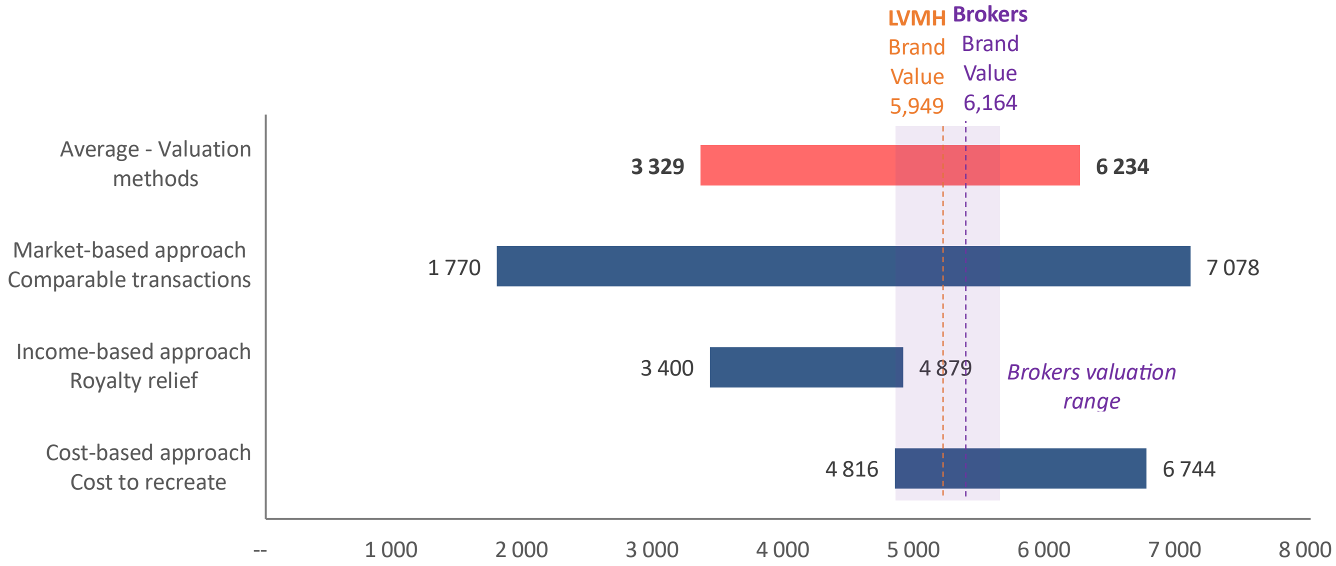

Figure 14 Football field and brand valuation summary

It is important to note the disparities in these results as brand valuation is subjective and computation varies among companies. The selection of a valuation method based on a brand's characteristics and business strategy or taking an average of all methods remains unclear in academic papers.

The average value of Tiffany & Co.'s brand, based on the different valuation methods used, is approximately €4.8 billion, within a range of €3.3 billion to €6.2 billion. When comparing this value to LVMH's estimation of €5.9 billion in their financial reports, it falls within our estimated range and is 20% higher than our average.

Furthermore, we compared our estimation to different benchmarks. By gathering the share price estimated in brokers' notes and applying the ratio of brand valuation calculated using LVMH's brand valuation computation divided by the total equity value at the acquisition, the average value is on the higher range of our valuations, 21% higher than our average, and above LVMH's brand valuation.

- Sensitivity of our results

As mentioned earlier, brand valuation heavily relies on various assumptions. Therefore, it is important to exercise caution when considering our forecasts, especially those based on market comparison, as finding comparable transactions can be challenging. These difficulties arise due to the nature of the luxury industry itself and its underlying purpose. Luxury brands are characterized by their ability to drive consumption beyond necessity, practicality, or economic value, making direct comparisons quite challenging.

Additionally, the luxury industry operates within a highly concentrated market structure, with only a few dominant players. Hence, when attempting to compare Tiffany & Co.'s intangible assets with those of other comparable entities, benchmarking against leading luxury conglomerates such as Richemont or LVMH proved problematic and inadequate. As a result, we found only a limited number of public comparables for evaluating Tiffany's brand value.only a limited number of public comparables for evaluating Tiffany's brand value.

- Conclusion on the different valuation methods

<u>Conclusion on the historical cost of creation method:</u>

The historical cost of creation method is relatively easy to apply and is often used to compute a floor value for the brand, particularly for young brands where market power is not yet determined.

However, this method has significant simplifications that make it less reliable. It does not account for inflation and gives the same weight to each year, ignoring the time value of money. For old brands like Tiffany & Co., this becomes a major issue as it inflates the value of the brand. Moreover, isolating costs specific to building the brand is challenging due to a lack of information, especially for older brands where it's unclear which expenses contribute to building brand strength and which ones are meant to maintain the brand value and artificially increase valuation. Finally, the method only aggregates past expenses without assessing their efficiency and ignores potential future expenses that a buyer would be interested in.

Conclusion on the cost to recreate method:

The cost to recreate method considers the time value of money and inflation, adding to the advantages of the historical cost approach. This method is more suitable for old brands like Tiffany & Co. as it reduces the weight of very old expenses and provides a more reliable value.

However, the cost to recreate method shares the disadvantages of the historical cost method and is not considered a good future indicator of brand value. It fails to identify management failures, the costs and time spent that could have been avoided to develop the brand, and relies on assumptions regarding the split of costs between brand-building and brand-maintaining expenses, as well as the discount rate applied to those costs.

Conclusion on the royalty relief method:

The royalty relief method allows for the isolation of the brand itself from the rest of the company by defining a royalty rate that rewards only the profit generated by the brand. The royalty rate takes into account the dynamics of the industry and the brand strength. Moreover, the valuation can be computed using publicly available information, and the method is easy to implement and understand.

However, this method heavily depends on general assumptions, particularly the royalty rate. When the brand is licensed, the royalty rate is easily accessible and reliable. In the absence of a licensing agreement, estimating the royalty rate becomes subjective. Finding comparable licensing agreements can be challenging, especially considering the uniqueness of brands as intangible assets. Additionally, royalty rates might include components beyond the right to use the brand or exclude rights on the brand that are not transferred from the owner to the licensee but should be included in the valuation. In such cases, further analysis may be necessary.

Conclusion on the comparable transactions method:

One advantage of the comparable transactions method is that it relies on a "fair" value comparison.

However, for this method to be reliable, the market from which transactions are extracted must possess sufficient liquidity, which is currently not the case for brand-only transactions. Determining the portion of the transaction price related to the brand in branded-company transactions is a challenging task, as transaction prices are often disclosed with limited details.

Additionally, this method shares the limitations of comparative approaches, as finding truly comparable assets for a brand, which is inherently unique, can be difficult or subjective. Lastly, the choice of the multiple used in this method significantly impacts the resulting valuation, highlighting its importance in the analysis.

- What is a good valuation model?

It is important to define what constitutes a good valuation model. This case study demonstrates that a robust valuation methodology should yield reasonable results in relation to the overall firm value. To achieve accurate estimations, it is beneficial to employ a straightforward and transparent gross brand valuation methodology. The availability of comprehensive data to incorporate various brand valuation parameters is crucial for enhancing the accuracy of the approach. Therefore, data accessibility and ease of calculation are major criteria.

Furthermore, brand valuation should always consider both the financial value of the brand, derived from measurable intangible assets, and the perception of consumers, as well as other economic entities such as investors, competitors, resellers, or suppliers. Integrating brand equity into brand valuation is crucial but challenging.

Finally, a good brand valuation methodology should be understandable to a wide range of stakeholders and replicable. The financial and social values of brands are too significant to be left to subjective choices in methodology, highlighting the importance of reliable and objective brand valuation practices.

2.4. Brand integration

i. Brand synergies between Tiffany & Co. and LVMH

Let's focus first on LVMH's viewpoint on achieving value creation with this acquisition. LVMH's 33% premium was significant. As for the strategic outlook, the vision includes:

- Increasing LVMH's market share in jewelry to 18.4% to better compete with Richemont.
- Expanding the geographical footprint, as some regions like North America are less attracted to LVMH brands.
- Increasing customer reach by diversifying the product mix with lower-priced products that are attractive to younger customers.

LVMH plans to leverage its omnichannel capabilities, such as Tiffany's heritage, through heavy investments in marketing and retail expansion. They also aim to apply their own experience in creating value from acquisitions, as demonstrated by their acquisition of Bulgari in 2011. Operational savings and efficient integration of Tiffany's back-office functions, such as finance and logistics, will also help in creating value.

Additionally, a leadership transition is necessary to maintain the motivation of Tiffany teams. This explains why Michael Burke and Anthony Ledru, both from Louis Vuitton, were appointed to Tiffany's senior management, along with positioning the most experienced top executives in Tiffany to transfer cultural values and managerial know-how. Therefore, synergies were sought to achieve value creation, and they extend to many dimensions as summarized in Table 12.

Table 12 Tiffany LVMH synergies

	Cost	Assets	Revenue
Transformational opportunities	▪ Reduce less-expensive silver jewellery with lower margins	▪ Increase financial resources ▪ Use existing assets e.g., facilities ▪ Invest in online and digital sales ▪ Spiff up Tiffany's retail stores	▪ Mitigate Tiffany's over-dependency on the bridal product segment ▪ Limit product ranges e.g., focus on high-end jewellery line ▪ Expand European and Asian sales ▪ Broaden the customer base e.g., target younger customers (GenZ) ▪ Boost Tiffany's marketing budget
Combinational synergies	▪ Merge overlapping back-office functions: financial, logistics and digital	▪ Share of knowledge and experience: LMVH expertise in luxury brands vs Tiffany expertise in customer relationship	▪ Cross-product selling ▪ Merge of digital force
Protect core business	▪ Keep traditional processes ▪ Vertical integration of Tiffany	▪ Retain Tiffany assets e.g., creative teams, diamond-finishing facilities ▪ Retain key organizational knowledge of Tiffany's managers	▪ Keep and develop high-end jewellery lines ▪ Keep focusing on existing customer base

The core target of LVMH's integration plan is to implement a balanced strategy between increasing Tiffany sales and maintaining the brand value. LVMH's ultimate goal is to lock Tiffany's market shares in different segments. To achieve this, the merger functions as a collusive alliance with a high preservation strategy. It aims to maintain the target's peculiarity by giving it autonomy and ensuring little interdependence. Inter-brand synergies with LVMH's jewelry portfolio, which includes Chaumet, Bulgari, Fred, and Repossi, are minor, as are the risks of cannibalization.

ii. Integration of Tiffany&Co. in the portfolio of LVMH jewellery brands

Brand strength

As explained above, LVMH acquisition is based on a geographic roll-up in North America as it aims to increase its sales in this region.

Table 13 shows that prior to the Tiffany acquisition, LVMH's jewelry segment generated only 8% of total sales. By 2021, the date of the acquisition, sales in North America reached 25%, or 2,241 million euros, thanks to Tiffany's geographical footprint.

Table 13 Sales data for LVMH Watches & Jewellery, years 2019 to 2022[35]

In € millions	**2019**	**2020**	**2021**	**2022**
Revenue	4,405	3,356	8,964	10,581
Revenue by Geography (%)				
France	*5*	*4*	*2*	*3*
Europe (excl. France)	*23*	*20*	*15*	*15*
United States	***8***	***8***	***25***	***26***
Japan	*12*	*12*	*11*	*11*
Asia (excl. Japan)	*38*	*43*	*36*	*32*
Other Markets	*14*	*13*	*11*	*13*
Profit from recurring operations	736	302	1,679	2,017
Operating margin (%)	16.7	9.0	18.7	19.1

To benefit from Tiffany's American customer base, LVMH must integrate the brand while maintaining its visibility with its customers. The brand must keep its identity, visual signals, and communication to remain attractive to its customers. There are therefore two options for

[35] LVMH Annual Report

the corporate brand: either leave Tiffany completely autonomous and independent or build a joint brand that relies on Tiffany's new affiliation with the French luxury goods group.

The choice is easy for LVMH, whose website[36] underlines its vocation "to ensure the development of each of its Maisons while respecting their identity and autonomy." This scenario is also conducive to a smooth integration where both teams of employees are confident about continuing their jobs.

Product branding strategy

LVMH brands offer a diversified product mix thanks to Tiffany & Co. and its four other jewelry brands: Bulgari, Chaumet, Fred, and Repossi. It should also be pointed out that the jewelry segment has been built up through acquisitions, with Tiffany being the most recent.


Bulgari


Fred


Chaumet


Repossi

This product branding strategy is consistent with LVMH's ambition for ultra-customization. As the pinnacle of luxury is made-to-measure, the group's portfolio aims for maximum differentiation, giving its Maisons carte blanche to choose their design and communication policies. This corresponds to the Best Fit strategy with a specific message and product offer for each brand and weak inter-brand linkages, as summarized in Table 14.

Nevertheless, the brands benefit from being part of the LVMH group, which provides the resources they need to expand. The distribution network, diamond workshops, and technical collaboration are real advantages over their competitors. However, the vision of each Maison remains independent to differentiate the brands, with a strong attachment to their customers.

[36] LVMH website

Table 14 Product branding strategy of LVMH Jewellery portfolio

	Bulgari	Chaumet	Fred	Repossi	Tiffany&Co
Message	▪ History of Italian excellence ▪ Mix of classicism and modernity	▪ Jeweler of royal families ▪ Footprint in cinema (César, Cannes)	▪ Modern and exuberant ▪ Artists	▪ Creativity and entrepreneurial spirit ▪ Avant-garde and family-spirit	▪ Icon of love and weddings
Offer	▪ Color gemstones ▪ Iconic lines worn by stars (Elizabeth Taylor)	▪ High-end jewelry ▪ Vegetal inspiration	▪ Mixed and for all ages ▪ Bold materials (steel)	▪ Discretion and elegance, details ▪ Diamonds	▪ Diamonds for young generations

Firm architecture

The Best Fit strategy implies an organizational architecture that favors brand autonomy. Indeed, apart from the values of excellence and prestige shared by the brands in the LVMH portfolio, there is no clear unique corporate message. LVMH has therefore opted for a network-type architecture. The advantage of this strategy is also that it avoids intra-portfolio cannibalization. As the product mix is different for each brand, customers are even encouraged to buy from several Maisons, unlike the Island architecture.

In conclusion, the integration of Tiffany was carried out in perfect harmony with the corporate brand and product brand strategies. Management's choices in terms of architecture favor value creation through this acquisition.

The only remark we could make is that LVMH fueled a highly political and confrontational communication that conflicted with the successful implementation of this fully mastered strategy (see Figure 15).

As mentioned above, LVMH launched a number of rumors that disrupted the transaction process, which was already slowed by anti-competitive concerns. The group even went so far as to file a complaint against Tiffany.

In our view, this conflict-ridden atmosphere is not the key to a successful integration. Furthermore, LVMH's strategy is precisely to give Tiffany its autonomy and full trust, which is radically at odds with the initial exchanges between the parties...

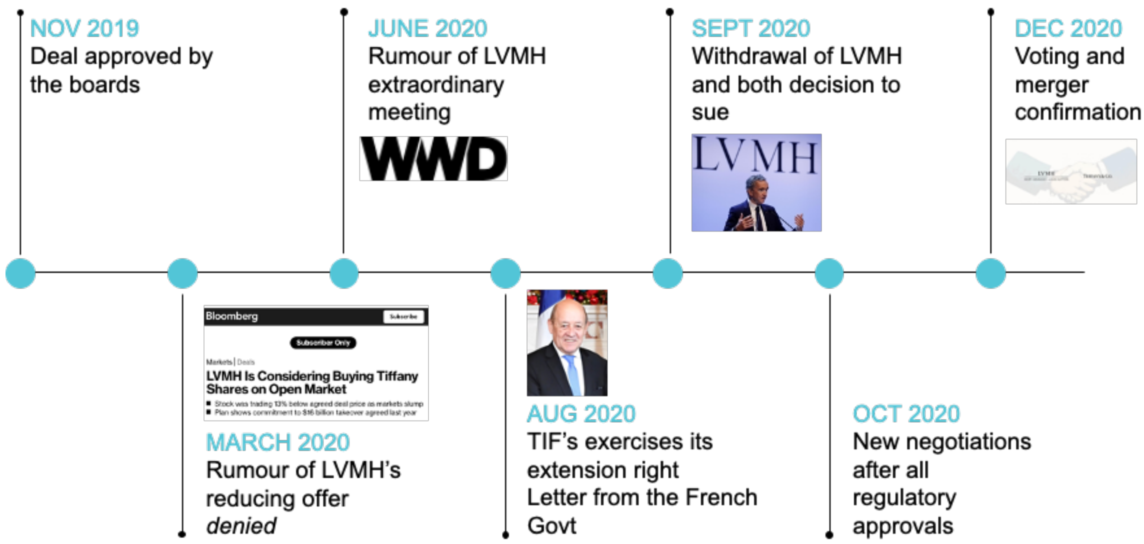

Figure 15 Acquisition timeframe

iii. Compatibility of Tiffany&Co. and LVMH corporate cultures

Let's focus now on the cultural compatibility of LVMH and Tiffany, determined using the three frameworks presented in the literature review.

Integration scoring

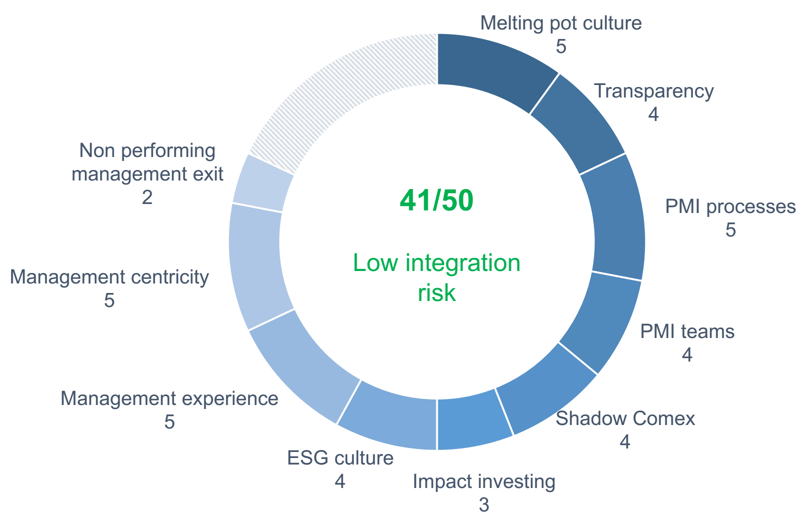

Figure 16 Tiffany LVMH integration score

- LVMH's **melting pot culture** is strong, since the Group relies on its ability to develop flexible processes with standards of excellence that guarantee the individuality and independence of its brands.

- As both companies are publicly traded, they must comply with disclosure requirements that promote **transparency**.
- In all its business sectors, LVMH has strengthened its position through external growth. The group's numerous acquisitions are proof of the expertise of its **PMI teams and processes**.
- Although the luxury sector is not closely tied with **ESG concerns**, LVMH is ambitious in terms of its environmental actions but remains cautious about impact investing (no green bonds issued for instance).
- The family of LVMH CEO Bernard Arnault has divided up the management of the major Maisons, guaranteeing management continuity and promoting **management centricity**. Tiffany top executives are also renowned for their expertise and their control on the firm.

To sum up, LVMH and Tiffany have similar corporate cultures, which lowers the integration risk.

Outside-in analysis

Table 15 Tiffany LVMH outside-in analysis

Dimensions	LVMH cultural practices	Tiffany cultural practices
Leadership	Patriarchal leadership, driven by managers	More community-like style
Direction	Top-down, clear guidance	Top-down
Values/environment	Excellence, competitive environment, customer-oriented	Customer-oriented
Accountability	Clear roles and responsibilities, performance culture	Clear roles and responsibilities
Capabilities	Organic growth and strong external growth	Organic growth
Motivation	Company values and leaders	Company products and reputation
External orientation	Strong customer focus	Strong customer focus
Innovation	Employee-driven	Employee-driven

Caption
Strong alignment
Clear challenges

As presented in Table 17 based on McKinsey's framework, the main cultural frictions between Tiffany and LVMH deal with their leadership styles and capabilities. LVMH is known as a family-driven group, with a strong cult surrounding the Arnault family. Employees are emotionally attached to the brands they work for, a result of years of work experience and strong brand identities. Tiffany, on the other hand, has a less patriarchal, more community-oriented culture, which may contradict the strong commitment of LVMH teams to their Maisons.

The second challenge is linked to the growth models of the two companies. While LVMH relies heavily on acquisitions to expand, Tiffany prides itself on organic growth. However, the independent culture of LVMH Maisons should help resolve this issue.

On the other hand, the companies align with each other in certain cultural characteristics, such as customer service and employee-driven innovation. These cultural connections are real assets in creating value and ensuring the success of this acquisition.

Culture compatibility

We now apply Gustavo Razzetti's framework, starting with the type of organizational culture. LVMH values a people-oriented mindset where employee satisfaction and talent retention are as important as expertise and creativity. However, innovation is slowed down by the high standards of excellence, which come with risk aversion and increased control. Hence, LVMH seems to be at a crossroads between a fearful culture with top-down management and strong control processes and a tribal environment. Tiffany, on the other hand, puts the spotlight on innovation, making it a combination of fearless culture characterized by experimentation and creativity, as well as a fearful culture with elements of top-down management and strong control.

As a result, there is a strong opportunity for cultural alignment. The biggest challenge, however, is to balance LVMH's risk aversion with Tiffany's agility and entrepreneurial spirit. In addition to operating in the same industry, both companies also share a similar purpose of achieving excellence and providing the best to their customers while leveraging the brands' heritage.

The merger narrative is a weak point, given the communication debacle surrounding the process, as mentioned in part 2.4.ii. However, the culture compatibility assessment presented in Figure 17 shows close emotional and functional cultures.

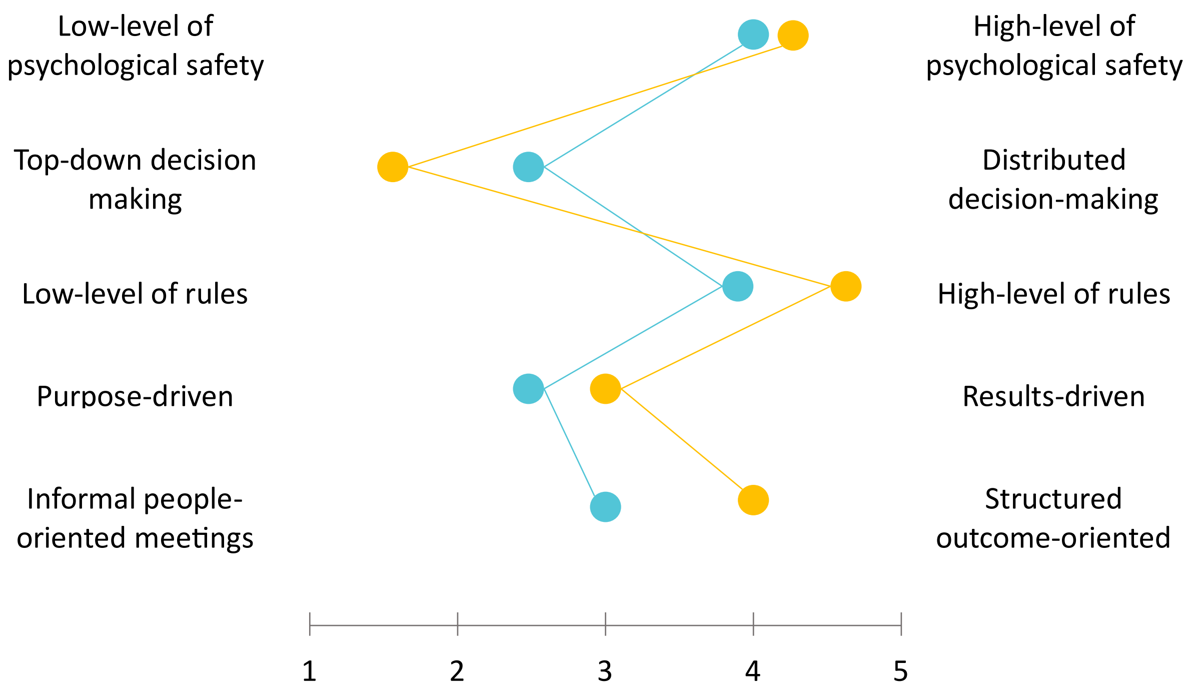

Figure 17 Tiffany LVMH culture compatibility assessment

Conclusion

In conclusion, the three frameworks converge in their diagnosis: the corporate cultures of LVMH and Tiffany are similar and have the potential to be aligned. Nevertheless, there are risks of cultural clashes that need to be anticipated and mitigated during integration. For instance, in the luxury goods sector, surpassing competitors has made secrecy the norm for protecting know-how and brand uniqueness. This specificity of the industry, true for Tiffany as well as other LVMH Maisons, must not become an obstacle to the integration of the New York jeweler.

iv. Conclusion on brand integration

Creating value and generating synergies in a brand merger requires greater vigilance regarding brand integration and the corporate culture of the parties involved.

Traditional acquisitions often consider cost-cutting as an easy way to achieve synergies and balance a high premium paid. However, this way of thinking is not applicable in brand merging since marketing and communication expenses are vital to build a leading market position. Similarly, creative functions like product design are crucial, as the Watches & Jewellery industry segment thrives on innovation and singularity, which are major assets for the brands.

Nonetheless, synergies can be found in support functions such as distribution or manufacturing. This implies having resources and expertise in these areas, which is what LVMH has built over the years. Since 1996, when LVMH owned just one jewelry house, the group has continuously acquired the most prestigious jewelry houses, illustrating LVMH's ambition to expand in this segment both geographically and in terms of customer segments. LVMH's attractiveness is correlated with its capabilities, which becomes a selling point for targets that are often family-owned and lack a high-performance distribution network.

The second challenge of integrating jewelry brands lies in their strong identities and often family inheritance. That's why LVMH has built its model around autonomy, aiming to preserve the DNA of each Maison while nourishing it with its resources. It also implies that some common ground on values must exist. For instance, being people-oriented is crucial as family-owned companies often rely on a founder's cult, and employees are their most precious asset, possessing the savoir-faire essential to the brands. Hence, LVMH's position is a delicate balance between having a strong hand in the acquisition and depending on keeping the target satisfied and its employees motivated. This balance is strongly supported by LVMH's network architecture, as explained in part 2.4.ii.

Finding a balance between creativity and control is another challenge in brand integration. Customers expect uniqueness, which means brands must continuously surpass themselves. However, the demand for customer service and excellence often creates a rigorous environment where innovation struggles to find a place. This is a constant challenge for LVMH, as its size necessitates the establishment of standards and procedures for efficiency.

Furthermore, LVMH's repeated acquisitions go hand in hand with a thorough review of the positioning of the targets within the existing portfolio. Bernard Arnault's remarkable skill lies in having built this consortium of luxury brands to encourage customers to consume from each brand, rather than generating internal competition and cannibalization.

In conclusion, this case study of Tiffany and LVMH proves the importance of brand integration and brand due diligence. The potential for value creation between two brands can be unparalleled, but corporate culture and integration can become insurmountable obstacles if not carefully considered and understood. Academic literature is beginning to develop on this subject, providing us with the tools and frameworks needed to implement a process as rational and methodical as the valuation process.

Conclusion

This study aims to explain why many firms are highly valued thanks to their brand names by investigating the various approaches used for brand valuation and linking them to value creation in a transactional context. We first conducted a literature review on value creation in deals and the estimation of the economic value of a brand, and then applied our findings to a real-life case study: the brand valuation of Tiffany & Co. in the context of its acquisition by the LVMH group.

Throughout the case study, we applied different valuation methods based on literature sources to determine the worth of the brand. This allowed us to examine the advantages and disadvantages of each method and identify the most accurate ones. Subsequently, we connected our findings to the evaluation of the value generated through the transaction, delving deeper into the process of brand integration.

As a result, we discovered that brand valuation is often perceived as ambiguous and subjective, as evidenced by the diverse range of results obtained for Tiffany & Co. Several factors highlighted as major in the literature were ultimately not feasible to assess using public information, such as the breakdown of royalty rates. However, despite these challenges, we were able to establish a reasonable valuation range for the brand, which was relatively close to the one reported by LVMH in its financial reports. Ultimately, this part of the study enabled us to draw conclusions regarding the definition of an effective valuation model. A robust valuation methodology should produce reasonable outcomes in relation to the overall value of the company and should be both comprehensible to a wide range of stakeholders and replicable. To ensure accurate estimations, it is advantageous to employ a straightforward approach to gross brand valuation, and the availability of comprehensive data is a major criterion. Finally, the case study showed that the financial and social values associated with brands are too significant to be left to subjective choices in methodology, highlighting the importance of trustworthy and objective brand valuation practices.

The second part of the study showed that, although brand valuation remains essential in a transactional context, it is not the main source of value creation. Creating value and generating synergies in a brand merger requires greater vigilance with regard to brand integration and the corporate culture of the parties involved. The case study of Tiffany and LVMH proved beyond doubt the importance of brand integration and brand due diligence. The potential for value creation between two brands can be unparalleled, but corporate culture and integration can be insurmountable obstacles if not thought through and understood.

In conclusion, brand valuation and integration remain areas that require further research. While more advanced models may be developed in the future, the primary challenge lies in designing models that are both academically supported and practically applicable, striking a balance between accuracy and efficiency.

List of figures

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