ESG
Sustainability Research

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CHEUVREUX
CRÉDIT AGRICOLE GROUP

LUXURY GOODS – Sustainability Sector Profile

The Luxury Goods sector's endorsement of Sustainability is mainly triggered by reputational risk mitigation, in our view. And as one of the least-regulated sectors, it has strong reasons to do so, as it takes decades to build a strong brand capital that can be marred in just a few days. In today's context of meteoric cons-cyclical growth prospects (10% CAGR scenario up to 2020) the need to meet such a demand can lead to risk-taking, overheating, saturation… and unexpected financial consequences. The challenge of sustaining control of reputational risk for 130 major brands while meeting this demand is the reason why we consider raw materials, brand stretching, increased subcontracting, purchasing and producing in Asia as key ESG issues. Overall, the industry has little involvement in sustainable products, is observed by NGOs, and is criticised for its marketing. Brands remain afraid that empowering consumers on sustainable values could reverse the dream and taint the emotional value. We highlight a number of weak signals as well as some seeds of change. On regulation risk, we identify some potential concerns, such as the "made-in" issue.

Sector Sustainability Figures

Untraceable gold	95%
Watches: 2% of units from precious metals	35% of the value
Water to tan a skin	700l
Water for producing 1kg of cotton	From 5,400 to 19,000l
World economy from counterfeiting	From 5% to 10%
People surviving on artisanal small-scale mining	115 million

Source: CA Cheuvreux, Colbert Comitee, Netafim, CTC, ARM

Company Sustainability Performance

Hermès: Best HR & reputational risk management

Burberry: Supply chain reputational risk

Swatch: Lack of transparency

PPR: Advanced supply chain audit system

LVMH: Strong environmental management

Richemont: Leading responsible jewellery initiatives

Strategic Sector Overview

Over the past two years, the luxury sector has experienced remarkable growth, of close to 20% p.a., reaching historical peaks never before seen in terms of sales, far higher than pre-crisis levels.

This hegemony of the luxury market, which is set to continue in 2012 – but at a slower pace – nevertheless raises questions regarding the sustainability of demand, as well as supply.

The strong growth, notably supported by emerging markets (mainly China), will soon also raise questions about a potential saturation of the market, the legitimacy of brands, and the values on which they have been built.

On the production side, even if the volume effect is not the main growth driver, sustainability of quality, supply, and artisanal know-how, as well as the 'made in' factor are day-to-day issues. The current situation of Swiss watch movements and components (dominated by Swatch Group) is a good illustration of the fact that even the biggest global groups do not have fully-secured channels.

Sustainable Drivers & Business Case

Luxury industrialist or purchaser/reseller? A structural differentiation among players, the internalisation level not only determines a part of the margin, but sets the conditions for control of E&S issues. It overexposes players that outsource the majority of their production. Brand stretching amplifies reputational risks.

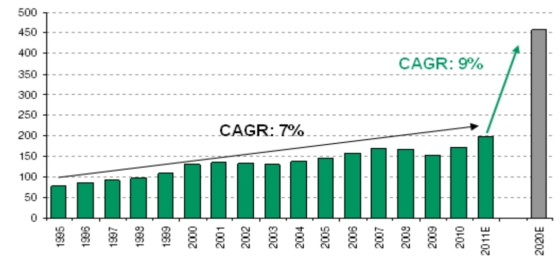
Overheating, saturation? The industry is cons-cyclical and rapid development generates higher exposure to risks in the supply chain, considering brand stretching, increased subcontracting, purchasing and producing in Asia for some, rapid development in implantation and sustained demand. The saturation point (450 DOS) is lurking in the future. And more than 130 brands are moving in the same direction…

Precious materials: Expected raw materials price increases due to physical availability and increasing demand; competition within and outside the sector; major E&S issues and industry initiative starts for better traceability. Much remains to be done and exposes the sector to reputational risks.

Human capital: A threefold challenge, talent wars for top managers and designers, with inflation in wages and benefits; strong issue on replacement of high value added craftsmanship; recruitment and retention of sales advisors to follow the rapid development of outlets.

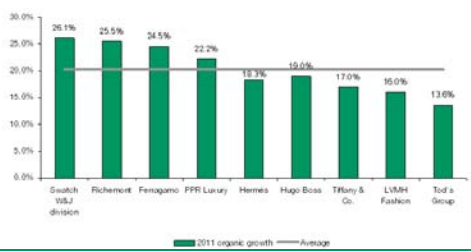
Governance: Often a family story, with inequity of voting rights. The main question is whether minority shareholders, blinded by stock performances, are taking into account the relative weakness of governance structures to mitigate potential disappointment in a context of increased M&A activity.

World luxury goods market in EUR bn



Source: Bain & Co

2011 organic growth for the main luxury groups



Source: CA Cheuvreux

CONTENTS

Part II: Materiality protocol

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Foreword: Industry characteristics and ESG factors

Scope of the study

This study analyses all European stocks covered by Cheuvreux that are in the Luxury goods sub-sector. For multi-activity groups, our bias is to solely analyse activities in the luxury goods sector (e.g. not including Redcats (retail) for PPR, Les Echos (media), Royal Van Lent (shipbuilding) for LVMH, building leases for Ferragamo, etc.). European brands are undoubtedly world leaders.

Company	Market cap (EUR m)	Sector
Burberry	5,106	Luxury goods
Ferragamo	1,940	Luxury goods
Hermès Intl	16,548	Luxury goods
Hugo Boss	1,951	Luxury goods
LVMH	60,294	Luxury goods
PPR	15,077	Luxury goods
Richemont	23,431	Luxury goods
Swatch group	21,171	Luxury goods
Tod's	2,262	Luxury goods

Source: Stock markets, cap at end of 2010

The luxury industry: what is luxury?

From an ESG analytical point of view, Luxury differs from other consumer goods in that is has a threefold value:

- A rational/use value (use value, functionality, durability, real quality, quality of service);
- An emotional/social value (symbolic, aesthetic, perceived quality, recognition);
- A patrimonial value (for hard luxury only: fine materials and precious elements are clearly objective components).

The willingness to pay presupposes a strong brand with a rich, long and unique history, often personalised by its founder. This triple value brings strong pricing power and explains the premium paid for products. This sector profile focuses on some sub-segments, or 11 product ranges.

Product ranges	SSP
Accessories (eyewear, writing, hunting, smoking, etc.)	yes
Champagnes, fine wines and premium spirits	partly
Cosmetics	partly
Fragrances	partly
Haute couture, ready-to-wear clothing, other textiles	yes
Homeware (fabrics, furniture, decoration, etc.)	partly
Jewellery	yes
Leather goods (luggage, small leather goods, riding, etc.)	yes
Shoes	partly
Tableware (ceramic, porcelain, glass, crystal, goldsmith)	partly
Timepieces	yes

Source: CA Cheuvreux, Alta Gamma, Colbert Comitee

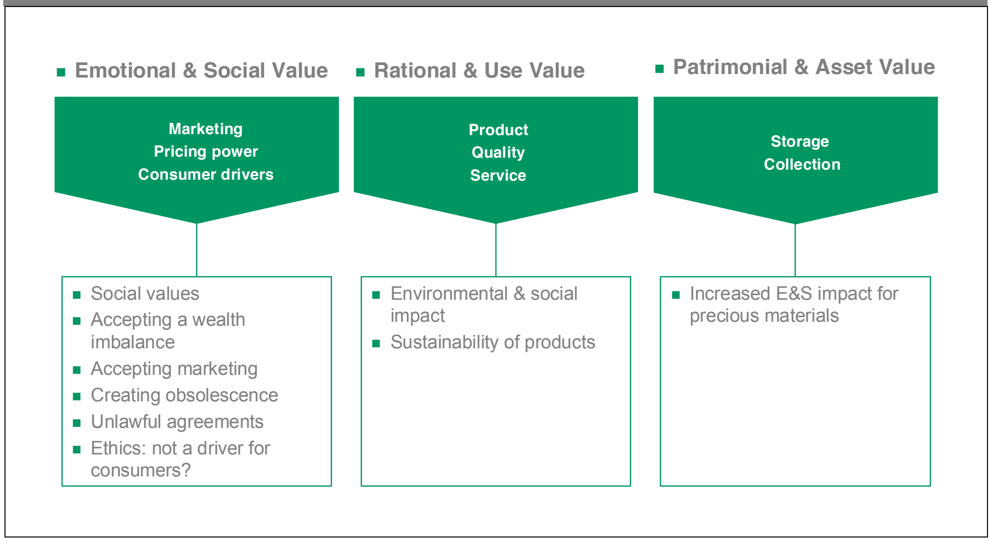
The luxury sector is broader, of course. Some luxury sub-sectors are analysed in other areas (e.g.: luxury cars in the automobile sector). We do not analyse: publishing (books, binders, etc.) – furniture and decoration – luxury cars – luxury hotels and fine gastronomy – luxury real estate (apartments, villas, islands, etc.) – luxury tourism (hotels, cruises, spas, ski, adventures, etc.) – luxury yachts & sailboats – services (concierge, events, limousines, etc.), which are all components of the idea of luxury.
Sector analysis leads us to delve deeper into six industries and about 130 brands:

- Leather (large and small leather goods, shoes)
- Textiles (RtW, Haute couture)
- Cosmetics and fragrances
- Watches and jewellery
- Fine beverages
- Specialist retailers

Values, sub-sectors and ESG analysis

The emotional value refers to values carried by brands, marketing investments, ability to maintain pricing power, and more generally the social acceptance of the sector. The rational dimension raises the question of environmental and social impacts, ecodesign and sustainability of products, even though the sector creates fashion and obsolescence for much of its products. The patrimonial value leads to accumulation, collection or storage. Diversity of the six sub-industries requires specific weighting of each group for risk exposure to raw materials or production process. The snapshots in the appendix will help. Lastly, the power and the value of brands lead to overweight reputational risks.

THE THREE VALUES AND ESG ANALYSIS



Source: CA Cheuvreux

Business cycle and product cyclicality

Cons-cyclicality momentum

In a context of economic crisis in Europe, a tenuous recovery in North America and lower-than-expected but significant growth in EMs and BRIC, the sector shows insolent good health, with growth of up to 10-30% depending on brands.

Cyclicality of product range

In the industry, it is relevant to differentiate "hard luxury" (watches and jewellery) from "soft luxury" (leather goods, cosmetics and fragrances, fashion). "Hard" is more cyclical than "soft". For soft, collection renewal is faster, up to four times a year, except for iconic products.

Cyclicality and ESG analysis

The increasing sales require industrial capacity (capex), sub-contracting, purchasing or licensing. Following demand could lead to more risk-taking on environmental and social issues on the supply chain. Moreover, "soft luxury" raises the issue of product responsibility. We identify a potential bottleneck with more than 130 brands moving in the same direction.

Product and brand segmentations

Portfolio	Companies
Single-brand groups	Burberry, Ferragamo, Hermès, Hugo Boss
Single-activity groups	Swatch (watches, movements, parts)
Multi-activities and multi-brand groups	PPR, LVMH, Richemont, Tod's

Single-brand groups

- Diversification as a "global luxury brand" on all luxury goods product ranges provides development opportunities from the same brand name capital. This is the strategy led for example by Hermès: RtW, textile, shoes, leather goods, small leather goods, accessories, timepieces, jewellery, fragrances, homeware (textiles, tableware, etc.), recreation (riding, beach textiles, games), towards which many brands are moving. This extension outside the "natural" or "historical" field is called "brand stretching". With this in mind, Louis Vuitton will soon (re)launch fragrances: Lab in Grasse, staffing of master perfumer Jacques Cavallier-Belletrud.

- Other possible strategies. Various segmentation strategies are at work: by age (e.g. Hugo Boss: baby, children, teen, man/woman; by lifestyle (e.g. Hugo Boss: Business, Black, Green, Orange, Hugo). Burberry combines price and lifestyle positioning: Prorsum: high-range design wear – London: weekday wear – Brit: weekend wear.

Single-activity groups
Complementary fit between brands is operated through price segmentation.

Multi-brand groups
The search for a complementary fit both in businesses and market price positioning is constant. Price segmentation has two induced effects: create or maintain rarity for a prestige range; achieve economies of scale, industrialise and increase selling volumes for basic ranges.

EXAMPLES OF PRICE SEGMENTATION

Range	LVMH Champagnes	Swatch timepieces
Prestige	Dom Pérignon	Breguet, Blancpain, Jaquet Droz, Glasshütte Original, Léon Hatot
High range	Krug	Longines, Omega, Rado, Tiffany & Co, Union Glasshütte
Mid-range	Veuve Cliquot, Moët & Chandon, Ruinart	Balmain, Certina, Hamilton, Mido, Tissot
“Access products”	Mercier	CK Watch
Non-luxury		Swatch, Flik Flak

Source: CA Cheuvreux

Positioning and ESG analysis

For prestige: the challenge is maintaining exclusivity and scarcity. Down the range, it is to industrialise or subcontract to make volume. Brand stretching requires going out of their "natural" or "historical" core business, either by capacity investments or by sub-contracting. The use of sub-contracting reinforces the need for confidence on audits of the supply chain. Depending of the integration level, confidence should come from a clear vision of audit system: number of suppliers, location, number of audited suppliers per year, type of audits (second-party or third-party) and requirement level of standards used.

Organisational characteristics

The maison structure
Last structural characteristic of the industry, a highly decentralised organisation, with the maisons bearing historical brands. Maisons are most often SMEs of various sizes. Most have a high degree of autonomy, supported by the group's expertise and synergies while the global strategy and complementary fit of brands is determined by headquarters.

Synergies
For multi-brands groups, many synergies are possible: Synergies for conception, sourcing, purchasing, distribution, brand management, business development, HR and management, support functions. Development: R&D, product development platform - Purchasing: media-buying, marketing strategy, indirect purchases - Sourcing: suppliers selection, quality control, audit (social, environment) - Distribution: Logistics platform, information systems, boarding optimization, e-business platform - Retail: real estate, international expansion - HR and Management: Expert knowledge sharing, best practice sharing, talent pool, career path - Branding: brand management, complementary portfolio - Finance: cash pooling and allocation, tax planning, hedging, Management Information System - Legal & Intellectual Property.

Maison structure and ESG analysis
An in-depth analysis of 130 brands is quite impossible or would be ten times longer. We focus on the main ones. However, within the same group, we found maturity differences in ESG stakes. We try to identify the allocation of responsibility between groups and maisons. Moreover, a complex and atomised structure reinforces the need for strong talent management and fine-tuning in human resources.

Here are some structural key factors that are essential to understand, compare and appreciate the performance of luxury goods players on ESG factors. It is not a uniform industry; almost every company is a special case. You will find in the appendix, when needed, snapshots of each one. Let's start!

PART 1: ESG FACTORS

ENVIRONMENT AND SOCIAL: FROM UPSTREAM TO DOWNSTREAM ISSUES FOR THE SUPPLY CHAIN

From upstream to downstream, we focus on four strategic resources: leather, textiles, precious metals and precious gems, in order to discover the specific issues of tension on availability, environmental risks and social impacts, along with strong reputational issues and strategic choices for players such as integration level and supply chain control. We then address production and distribution stakes from an environmental and social point of view.

LEATHER

Leather: natural and renewable, but some sourcing dependence and high environmental risk.

Key takeaways: strategic vision of leather – core business or raw material?
Dependency: Tension is strong on sourcing, resulting in increased prices and availability risks (scarcity, demand growth).

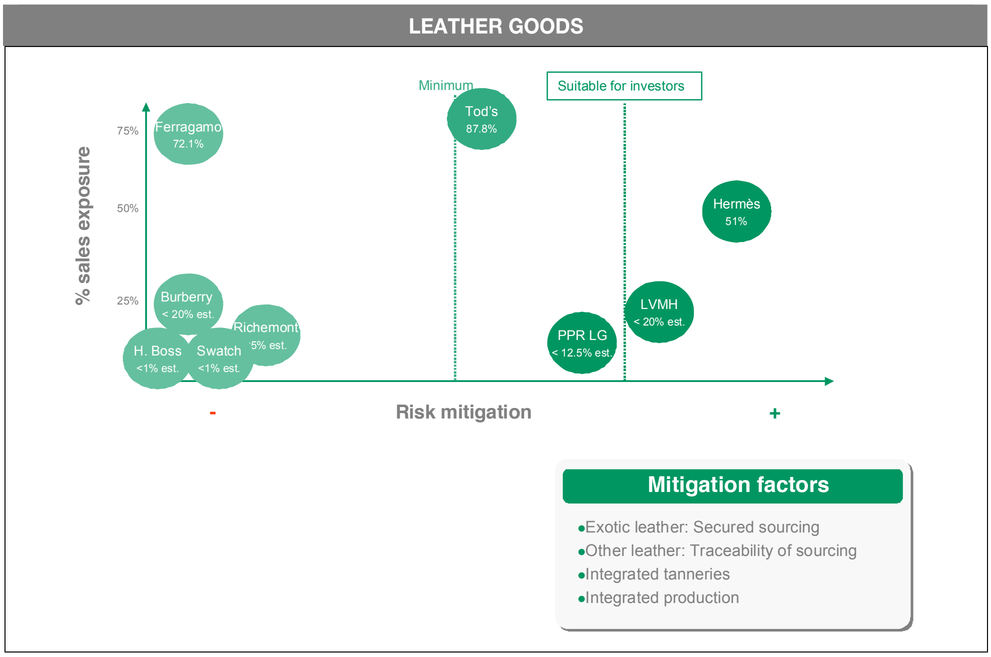
Environment: Tanning is a potentially highly-polluting activity

- In the business model: high cost of remediation
- Outside the business model: need for confidence in traceability and third-party audits

Strategies: For leather, different strategies are implemented:

- Leather as a "core business" activity (e.g. Hermès, Gucci)
- Exotic leather as a strategic resource (e.g. LVMH)
- Exotic leather as a raw material (e.g. Swatch group)

Relative positioning of competitors



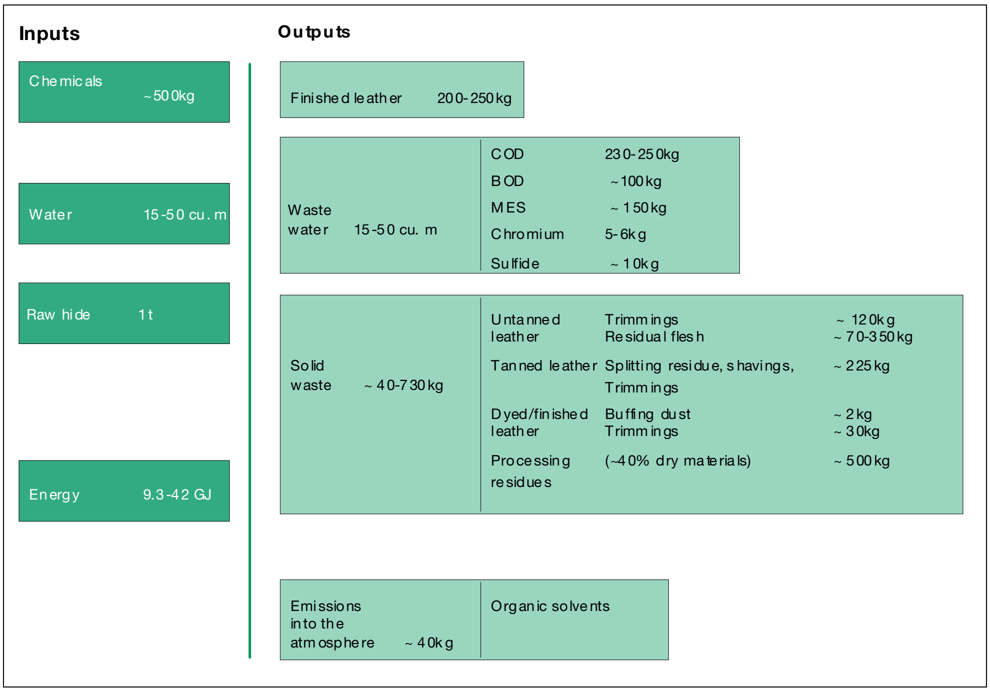
Source: CA Cheuvreux

Leather origin by species:

- Classic leather: bovine / bull / calf (two-thirds of worldwide production), followed by sheep / lamb, goat, deer.
- "Exotic" leathers: crocodilians (crocodile, alligator and cayman) – squamates (lizard, snake, iguana, etc.) – fish (shagreen or "galuchat" from catsharks, sharks, eels, stingrays) – big birds (ostrich, emu and rhea) – kangaroos. Exotic leathers represent a very small share in volume (tonnage / square foot) but a high share in terms of value.

Main uses by the luxury goods industry: The industry is a major consumer for shoes, leather goods (luggage, bags, belts, small leather goods, gloves, etc.) and accessories (organisers, etc.).

Process impacts



Source: EU BTA report on tanneries

Environmental and health risks:

- Chemical tanning: has a potentially high impact on the environment during skin preparation and tanning. Tanning is blamed for polluting rivers and groundwater and requires suitable and expensive effluent treatment (pre-chlorination, ion exchange, activated carbon, and microfiltration). Chrome prevents the skins from rotting. Thresholds: Chrome is an EU REACh substance, from 5 tonnes; tanneries are subject to the Seveso II directive. The IPPC directive on effluent water sets the standard. The EU indicates BAT (Best Available Technologies) for the tanning industry. 700 litres of water with a diluted chrome tanning agent are necessary per tonne of tanned skin (Source: CEA).
- Mineral tanning: tannins are extracted from dwarf birch (Betula nana), or sumac (Rhus), quebracho tree (imported from LATAM) or black wattle. Producers are Ajimoto, Unitan or Silva Team. Effluents must be treated as well.
- Health safety of tanned leather: tests are needed to ensure that leather is without risk for human health, particularly through skin contact. Test standards exist (e.g. level of hexavalent chromium for the German market).

- Protection of species: The CITES (Convention on International Trade in Endangered Species of Wild Fauna and Flora) identify any threatened species. The challenge for the luxury goods sectors is to have full traceability on sensitive species (e.g. Crocs Posorus (Asia, Australia) - Niloticus (Africa) - Mississipiensis (America).

Major producing countries and risks: The EU is the first worldwide producer of tanned skins. In order of importance: Italy, Spain, France, Germany and the UK. Tanneries are mainly SMEs. Sourcing from Tunisia, Bangladesh, India, and China should normally be avoided as traceability is not assured.

Industry initiatives: A few in the green field, private eco-labels (e.g.: la basane (basil) in France - Nordic eco-label for textiles, skins and leather - EU Ecolabel for shoes - Naturleder by IVN. Worldwide, and the Leather Working Group (LWG) focus on environment and rates audits and traceability processes for tanneries. In Europe, Euroleather/Cotance represents the EU Leather industry and sets various policies (code of conduct, social & environmental reporting, training, REACh implementation, etc.).

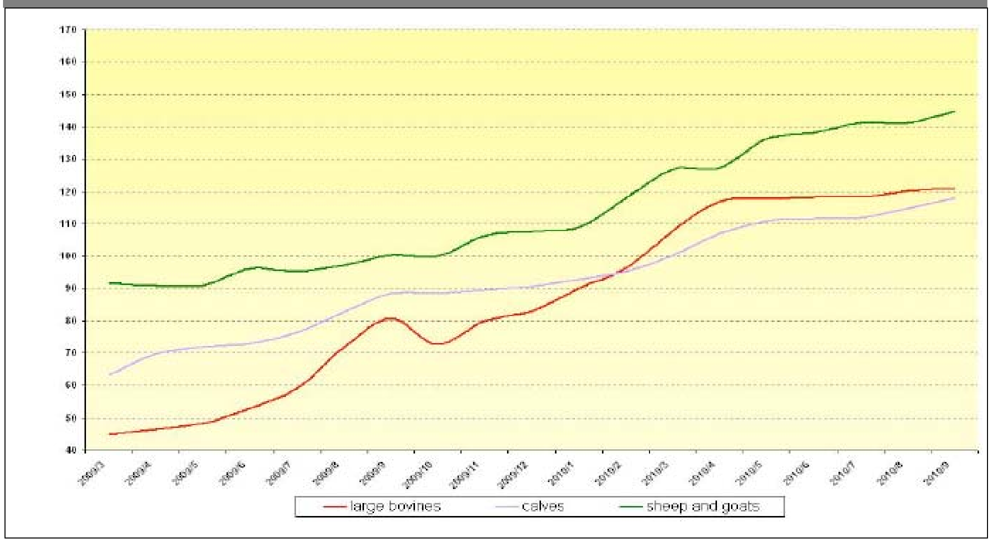
Beyond the environmental impact, securing the sourcing

Increasing sales, particularly in Asia, means having to secure the sourcing, on environmental issues, quality and quantity. For this reason, groups have carried out acquisitions in "exotic skins" and consolidated positioned in tanneries:

- LVMH: bought Heng Long in 2011. 200,000 to 300,000 skins per year, from crocodiles (Posorus) farmed in Asia. Also a joint venture with Tannery Masure (Belgium) specialised in mineral tannery.
- Hermès: started breeding its own crocodiles (Posorus) in Australia in 2009. HCP (Hermès Cuirs Précieux) Asia and France and integrated tanneries (TCIM, Exocuirs Suisse, Reptile Tannery of Louisiana, etc.).
- Gucci group: integrated tanneries in Italy.
- Le Croc (Syferkuil Investments Holdings): Farm and Tannery in South Africa supplies European Companies.
- Padenga Holdings in Zimbabwe provides Hermès (via TCIM/HCP) and is a key supplier of Heng Long (supplier of Richemont, Hermès, Prada, Stefano Rossi and Rolex). Padenga will expand in Australia and the US.

Scarcity and price pressure for all skins

GENERAL MONTHLY INDICES FOR RAW HIDES AND SKIN PRICES



Source: COTANCE

In October 2010, COTANCE (the European Leather Industry body) called on the EU for urgent action regarding the increasing scarcity of hides and skins and worrying price trends (increases of 50% to 170% over the last 18 months). For players, this leads to pre-financing with their own resources. It should strengthen the use of long-term contracts and maybe better traceability on the leather supply chain.

Controversies

Controversies are latent in the leather sector. In its report "Slaughtering the Amazon" (June 2009), Greenpeace International called into question a supplier (Bertin, Brazil, the largest exporter of leather) of a supplier (Rino Mastrotto Group Italy) of renowned brands (Gucci, LV, Prada). Immediately, Bertin joins Greenpeace's fights… Again, traceability deserves a strong commitment, including second-tier suppliers.

TEXTILES

Textiles: poor traceability

Key takeaways: textile sourcing and production, outside the scope?

- The textile industry from upstream to downstream cannot be regarded as "out of the scope" given its multiple social and environmental impacts.
- The least traceable and undisclosed sub-segment. None of the players provide full traceability on textiles, from fibres to apparel. It exposes RTW and other textiles to reputation risk.
- A third-party audit system based on a credible standard is likely to give investors confidence. Gucci and PPR are visibly the most committed to this route

Fibre sourcing

Textile fibres by origin

- Plant fibres: cotton (2.5% of cultivated areas in the world, in 80 countries), linen
- Animal fibres: camelids (llama, vicuna, guanaco, alpaca), goats (pashmina, cashmere, mohair), silkworm (silk), angora (rabbit, yak, goat), sheep (wool), fur
- Synthetic fibres: Dacron, cupric, polyester, aramid, acrylic, nylon, spandex, olefin fibre, Ingeo, Lurex, carbon fibre, etc.

Examples of fibres used in the luxury goods industry (not exhaustive)

- Silk, cotton, cashmere, wool: Hermès (France)
- Vicuna for Brioni (Italy, PPR) cotton, linen: Gucci (Italy, PPR)
- Silk, wool, merinos, cotton, viscose, spandex: Emilio Pucci (Italy, LVHM)
- Silk, wool, cotton, viscose, polyester, cupric: Chloé (France, Richemont)
- Silk, cotton, nylon, rayon, acetate, spandex, viscose, cupric: Burberry (UK)

Producing countries for main fibres

- Cotton: more than 66 countries, China No. 1, US No. 2, India No. 3, Pakistan No. 4, Countries from former USSR No. 5, Brazil No. 6, Turkey No. 7. (Source FAO).
- Silk: more than 20 countries, China No. 1, India No. 2, Brazil No. 3, Thailand No. 4, Uzbekistan No. 5, as well as Bulgaria, Egypt, Madagascar (Source FAO).
- Wool: Australia, China, New Zealand, Iran, the UK, Argentina, India, Turkey.

Potential impacts for fibres

- Vegetable fibres
  - Seedlings: Controversies on GMO seeds (e.g. cotton)
  - Farming: Potential use of hazardous pesticides, insecticides and fungicides (prohibited in EU countries) and overuse.
  - Water use (from 5,000 to 19,000 litres of water for producing one kg of

cotton) and water stress in some producing countries

- Water retting (for linen, hemp) may be water consuming and polluting
- Controversies on labour, in some countries like Uzbekistan (slavery)

■ Animal Fibres

- As for leather, CITES identifies some protected species such as Guanaco or Vicuna (LatAm) whose by-products are textiles. Some countries are signatories of the CITES convention (e.g. Bolivia, Argentina, Chile, Ecuador for export of wool and textile from Vicuna).
- Fur is prohibited for all protected species
- Wool: Prohibited anti-parasitics may remain in fibres, sulphuric acid when cleaning fibres in effluent
- Desertification linked to overgrazing
- Silk worm: Scouring (removing sericin) and charge of fibres with potential hazardous detergents

■ Synthetic fibres

- Thresholds (antimony/polyester, acrylonitrile/acrylic, etc.) and various air emissions (VOC, nitrous oxide, carbon disulfide, etc.)

Spinning, weaving and clothing

Environmental and social impacts

Processes, from fibres to RtW, are many and varied, depending on use of natural or artificial fibres. Quick review of the main risks:

■ Overview of processes: spinning > pre-treatment (desizing, degreasing, washing, bleaching) > dyeing > finishing (printing, fireproofing, coating, sandblasting, easy-care) > weaving and knitting > clothing.

■ Environmental risk: heavy metal use, hazardous chemicals (carcinogenic, reproductive toxicant), air emissions (VOC, etc.), in most cases, water effluent or air emissions require appropriate treatment.

■ Human health risk: sandblasting causes fatal diseases (lung), exposure to solvent, various air emissions and other hazardous chemicals can cause severe diseases.

■ Furthermore, health or environmental issues, clothing sweatshops are strongly denounced all around the world.

Labels or industry initiatives

The traceability of sourcing for either raw materials (fibres) or fabrics cannot be ignored. For companies, there are two routes. Carrying out audits with internal resources, or trusting a textile standard. Initiatives are numerous, but with various levels of confidence.

■ BCI (Better Cotton Initiative): for environmental and social issues for cotton producers.

■ Bluesign standard, with the Bluesign standard substances list including REACh concerns, criteria for textile manufacturers, production sites and chemicals suppliers. It is an Independent Industry Textile standard, which collaborates with SGS, one of the biggest verification and certification companies. Based in Switzerland.

■ Oeko-Tex is an association founded by Öti (Austria) and the Hohenstein Institute (Germany): Oeko-Tek® Standard 100. Includes manufacturing, supplying, H&S, emission thresholds, substances list and customer information criteria with independent certification and controls.

- Many other organic (EKO Sustainable textile, EU Textile Ecolabel, Biogarantie textile, etc.) or fair-trade (FairTrade textile, etc.) certification bodies take fibres into account.

We mention some linked initiatives in the labour field:

- WRAP (Worldwide Responsible Accredited Production) focused on apparel, footwear and the sewn products sectors with compliance with local laws and ILO fundamental conventions.
- CCC (Clean Clothes Campaign) supports working conditions and fundamental rights; the NGO includes other peers and trade unions from 15 EU countries.
- Fair Wear Foundation: dedicated to labour conditions in the garment industry, derived from ILO and UN principles. Not-for-profit organisation. The Fair Wear Foundation brings together 50 brands.
- EJF (Environmental Justice foundation) is active on labour issues for cotton production, denouncing slavery (e.g. Uzbekistan) or hazardous chemicals use (e.g. India)

And finally E&S standards:

- GOTS (Global Organic Textile Standard): the standard adds social responsibility to organic criteria.
- Naturtextil (by IVN International Association of Natural Textile Industry) includes environmental and labour issues (member of GOTS).

Regarding furs, numerous animal welfare organizations are active (e.g. One Voice, PETA). Origin Assured Framed Fur (OA label) provides consumers with information about the source of the fur. The label is framed by the fur industry (International Fur Trade Federation). A few suppliers are involved in "responsible fur" (e.g. SAGA furs, Nordic region).

Countries at risk

60% of apparel exports come from developing countries. Asia accounts for 32% of the total, China 13%. In Asia, there have been three waves. Before 1985, textiles came from sweatshops in Asia: China, Singapore, HK, Taiwan and Korea. The second wave took place in Philippines, Indonesia, and Malaysia. During the third wave, production shifted to lower-cost countries such as Bangladesh, Pakistan, Sri Lanka, and recently Laos, Nepal and Vietnam (source: ILO). Many of these countries are at risk, regarding both the environmental and social stakes. For the luxury industry traceability must be total, with external third-party audits.

Companies at risk

While Burberry declares it manufactures the majority of its products in Europe, it is public knowledge, particularly since the closure of the company Treorchy, that Burberry makes many of its products in Asia, although the company keeps silent about this. Hugo Boss purchases 25% of its manufactured product in Asia without any real visibility for its audit system. From an investor's perspective, manufacturing in Asia or other developing or emerging countries requires strong commitment to working conditions and environmental issues along with a rigorous audit system. Once more, controversies can have a devastating effect on brand image, sales and valuation.

Controversies

Gucci was implicated in sandblasting and working conditions issues before joining the initiative Clean Clothes Campaign (CCC) and building a strong audit management tool. Several luxury goods brands are continuously slammed by CCC. The garment industry is one of the most highly observed industries (Environmental Justice Foundation, Pesticide action network, ITGLWF, Greenpeace, etc.) for abuse in working conditions and repeated pollution. Greenpeace's Dirty Laundry2 "Hung out to dry" report (August 2011) is an illustration.

PRECIOUS METALS

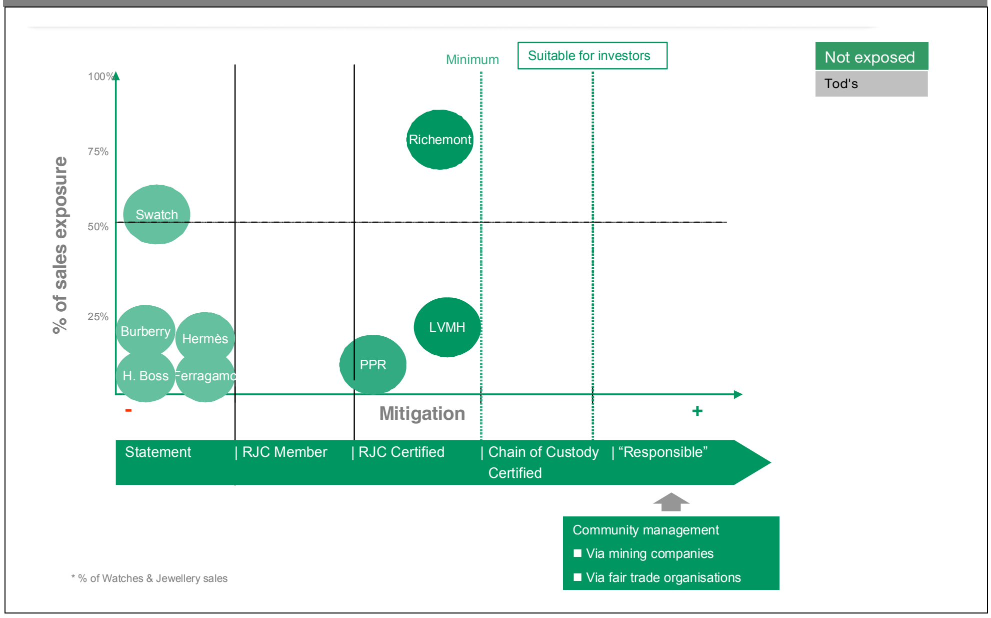
Precious metals: strong competition from emerging technologies, and massive environmental and social impact

Key takeaways: a risk/compliance approach, excluding communities

- Ongoing process, but far from real Responsible Sourcing from mine to finger. Ethical gold exists, but in very limited quantity, which is not sufficient to satisfy industry needs.
- The RJC certification must be regarded as a minimum. The RJC Chain-of-Custody Certification will be the best lever for players to improve in the coming years.
- LVMH and Richemont are leaders, in a risk-mitigation approach. Cartier is the most proactive brand. A sustainable approach would take into account local communities.
- Much remains to be done.

Relative positioning of competitors

WATCHES & JEWELLERY: EXPOSURE AND MITIGATION



Source: CA Cheuvreux

Origins

Precious metals are sourced from repurchases, collection and recycling. But the increase in global demand and competition from other industries (e.g. computers, cell phones) enhance the attractiveness of mining. Moreover, it is sufficient to melt the metal to lose any traceability. The smelter is a key player in the custody chain. Globally, over 100 million people depend on artisanal and small-scale mining (ASM) for simple survival (2$ a day). 15 million ASM miners work in tough and hazardous conditions to produce just 10% to 15% of global gold supplies (source: FairTrade / FairMined, FLA).

Collection and recycling

The collection spinneret is operated by SMEs. Some codes of conduct (e.g. Cadim by Syadim) are beginning to irrigate the area with disclosure requirements, transparency and fairness prior to and during commercial operation and compliance to regulation. For sellers, the crisis, added to the gold price, has increased the appeal. Some high value jewels are purchased by professionals, and even by jewellers for re-use or reshaping.

Mining

Source: ARM

Gold. A large part of the gold mined in the world has no traceability (illegal gold panning). NGOs and countries denounce the strong environmental impact (mercury, etc.) as well as the social impact (working conditions, child labour; violence, funding for crime organizations, etc.). The competition for gold also results from its safe investment aspect.
Platinum. Reserves and production of platinum are concentrated in a very small number of countries, thereby reducing the difficulty of traceability. But for one ounce (28,3g) of platinum, about 10 tonnes of ore need to be extracted. Moreover, the luxury industry is in competition with numerous industries (e.g. automotive, electronics) which increases pressure on price. Thus, the EU defines platinum as a "critical" raw material.
Silver. Silver is also in this list and requests for emerging technologies will triple in the next year.

EXPECTED COMPETITION TREND

Raw material	Production 2006 (t)	Demand from emerging technologies 2006 (t)	Demand from emerging technologies 2030 (t)	2006 indicator*	2030 indicator*
Platinum (PGM)	255	very small	345	0	1.35
Silver	19 051	5 342	15 823	0.28	0.83

Source: European Commission, July 2010

*The indicator measures the share of the demand resulting from driving emerging technologies in today's total demand. We therefore must expect strong tension on prices in the coming years.

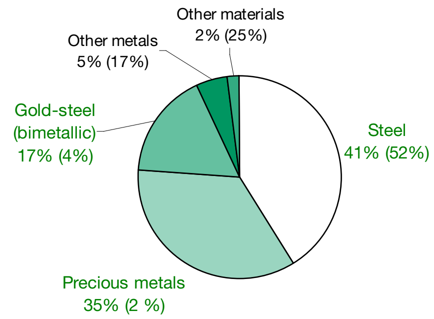
OBSERVED TREND IN PRICES (EUR)

Material	2007	2011	% Chg. 2007-2011
Gold	467	1 250	267.67
Platinum	1 145	1 550	135.37
Silver	10	23	230.00

Source: EU report

Main uses by the luxury goods industry: Watches, jewellery (e.g.: rings, bracelets, necklaces, chains, pendants, cufflinks, brooches) and accessories. Jewellery accounts for 80% of gold use.

VALUE OF WATCHES BY MATERIAL (VS. % OF UNITS)



Source: Federation of the Swiss Watch Industry

Potential impacts on the environment

- Gold: the main environmental impact for gold extraction in artisanal mining is mercury. For every gram of gold, 1.3 to 2 grams of mercury (heavy metal) is released into the environment (water, soil, wildlife bioaccumulation, indirect human ingestion), in addition to mercury vapour (gas) when there is human inhalation and air dissemination and water consumption. Cyanide, a highly toxic substance, is also used.
- Silver: mercury, cyanide.
- Platinum: water consumption, large volume of extract residues.
- For all these minerals, deforestation is another collateral damage.
- Efficient processing solutions exist (e.g.: meadow-chlorination, activated charcoal, filters with sand) but with significant additional costs.

Country risks

- Platinum: South Africa (79% of WW production), Russia (11%), Zimbabwe. EU sources (60% from SA, 32% Russia and 4% Norway).
- Gold: LatAm (Brazil, Columbia, French Guyana, Peru, Surinam), Africa (Burkina Faso, Ghana, South Africa), Indonesia, China. Main producers are China (world's number one producer with 3,408 tonnes in 2010), the US, Australia, South Africa and Canada (2010, source: Goldfacts).
- Silver: Mexico, Columbia, Peru, Russia, China, the Philippines.

Labels or industry initiatives for traceability

- The EITI (Extractive Industries Transparency Initiative) brings together the industry leaders, including AngloGold Ashanti, De Beers, Gold Fields, Gold Corp, Oxus Gold and BHP Billiton.
- The RJC (Responsible Jewellery Council) federates a large part of luxury goods players for their Watches and Jewellery divisions. The RJC integrates both precious metals and gems (see below). RJC developed a certification process with four pillars: codes of practices, auditor accreditation, independent verification and RJC certification. The non-profit organisation has a complaints mechanism.
- **JA** (Jewelers of America) is the trade association for retail jewellers in the US and promotes CSR in the Ethical Initiative Committee.
- The **WGC** (World Gold Council), a market organisation, elaborates the Conflict-Free Gold Standard (conflict, company and commodity assessment) and Chain of Custody Standard (from the mine to end-user) with a certification body.

Multi-stakeholders and independent initiatives

- The Alliance for Responsible Mining (ARM), one of the largest NGOs, develops FairTrade and FairMined standards in Bolivia, Columbia, Ecuador and Peru. They push the Standard Zero for Fair Trade Gold and Associated Silver and Platinum and collaborate with RJC (Responsible Jewellery Council). Fair trade and FairMined are FLA members. The only fully "responsible" source, producing a very small amount of gold, unable to meet the needs of players.
- "No dirty gold" is a campaign launched by Earthworks (US NGO) against the impacts of gold mining on the environment, community, workers and economy.
- CRED jewellery set up an independent standard with Fairtrade and FairMined, working with Oro Verde certification (Columbia).

Questioning the RJC certification

Although a certification process never guarantees 100% traceability. The RJC offers a medium level of assurance and confidence. It forces players to ask questions that did not arise and to consolidate the sourcing process. The next important step will be the ongoing RJC Chain-of-Custody Certification (to be released in March 2012). The RJC is subjected to controversies by NGOs because it only represents industry and is not open to independent third-party NGOs.

RJC: MEMBERS AND CERTIFIED MEMBERS

Companies	Membership of RJC
LVMH	Bulgari* - Chaumet* - De Beers - Christian Dior - Fred* - Hublot - Tag Heuer* - Zenith*
PPR	Bottega Veneta - Boucheron* - Girard-Perregaud - Gucci* - Jean Richard
Richemont	Baume et Mercier*- Cartier* - Jaeger Lecoultre* - Montblanc - Piaget* - Vacheron Constantin – Van Cleef & Arpels
Swatch group	Hamilton* - Tiffany & Co* (ended Sept 2011)

* certified members, Dec. 2011 Source: RJC

Supply chain

Several intermediaries provide brands with gold parts such as Metalor (Switzerland, RJC certified, supplier of Richemont), making the readability of the supply chain useful.

GEMS

Gems: the conflict-diamond process hides corruption, social and environmental issues. No traceability for other gems.

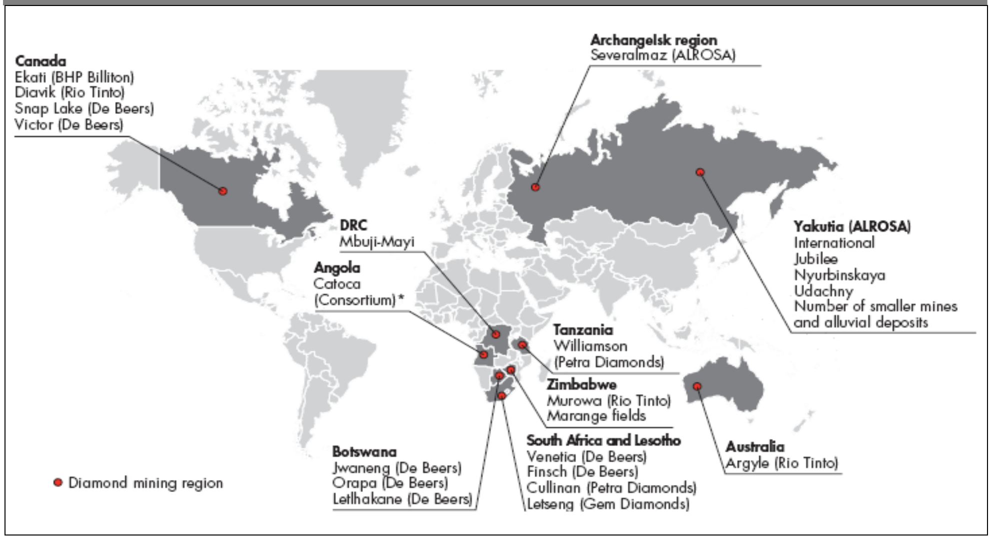
Key takeaways: ongoing story

- Conflict diamonds are like the trees hiding the forest. Corruption, poor working conditions and environmental issues are other huge concerns for all gems. KPCS remains controversial and 4% of diamonds escape from control.
- Sourcing directly with the biggest mining companies with community commitment and long-term contracts could be a threefold solution.
- Dependencies on high-risk countries for supplies.
- The RJC is making headway. The Chain-of-Custody Certification will be a decisive step.
- In connection with precious metals, mainly a risk-based approach for committed competitors with no attention to upstream social and environmental issues.

Type of Gems: Diamonds, rubies, emeralds and sapphires
Mining: Mined diamonds (rough diamonds) are used for industry (abrasives, optical) but jewellery-grade diamonds account for 95% of the total value of natural diamonds. 95% of industrial diamonds are synthetic. From mining, 133M carats were produced worldwide in 2010. Alrosa (Russia, biggest producer worldwide), De Beers (largest supplier, with the Diamond Trading Company, JV with LVMH), Rio Tinto and BHP

Billiton lead the industry. In 2010, 75% of rough-diamond sales were framed by long-term contracts; others are auctions (smaller producer) or spot sales.
Main uses in the luxury goods industry: Watches, jewellery (e.g. diamond engagement rings, rings, bracelets, necklaces, chains, pendants, cufflinks, brooches) and accessories, accessories for leather goods. In the value chain, for a USD12bn value from production (mining), retail generates USD60.2bn, with USD25.2bn in value added.

MAJOR DIAMOND MINES AND MINING INDUSTRY

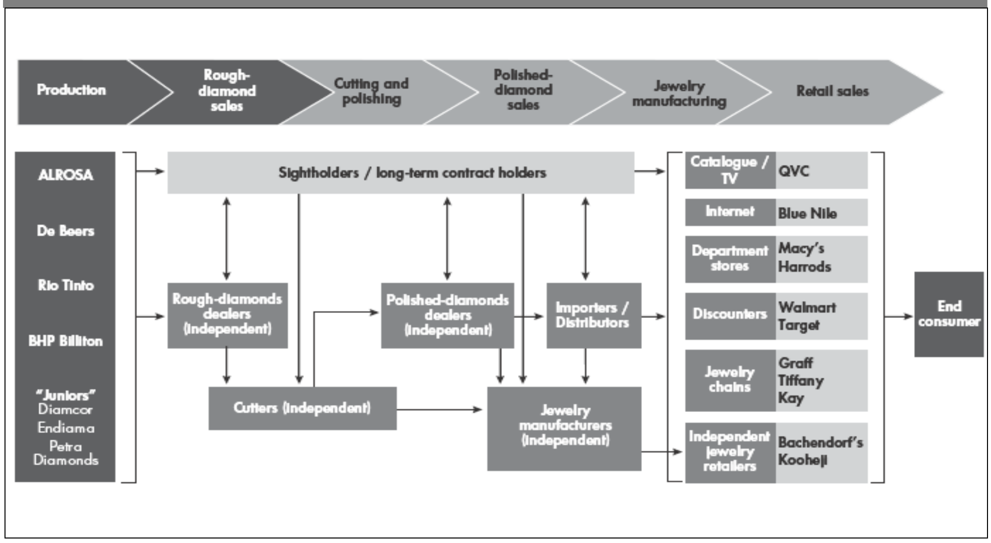


Source: Bain

Country risks

For diamonds, Russia (20%), Botswana (20%), Canada (18%) and South Africa (15%) are the main producers in terms of value. Diamonds also come from Angola, Australia, DRC, Lesotho, Namibia, and many other countries (Sierra Leone, Liberia, China, Ivory Coast, Burma, Guyana, etc). Many countries are the object of special attention regarding the Kimberly process. Burma has faced recurrent controversies for other gems.

FROM MINE TO FINGER: A COMPLEX CHAIN



Source: Bain analysis, Diamond Industry Report 2011

Cutting and polishing take place in a few main centres including Antwerp, Mumbai, New York, China, Thailand and Johannesburg.

Trading places are in Antwerp (Antwerp Diamond Index, London, New York (IDEX index), Tel Aviv and Amsterdam. Antwerp is the largest World Diamond Centre (AWDC) hosting 1,500 diamond companies. Antwerp trades 80% of rough and 50% of polished diamonds worldwide.
The **complexity of the value chain** and the number of players make for even more difficult traceability. As an example, UBS Diamonds inc. (Fullerton, US) operates and trades jewellery, precious stones and metals. UBS identifies "diamond mining and trading: rough diamonds unless Kimberley process certified" as a social risk, without further information.

Industry initiatives

- The Kimberley Process is the most emblematic international initiative. It brings together governments, the World Diamond Council and NGOs and aims to end trading on conflict diamonds, also called "blood diamonds". It concerns only rough diamonds. Through a certification process, it imposes conditions to eliminate the financing of armed conflict. In its progress report of November 3, 2011, the organisation reported non-compliance (statistical or reported non-submission) and strengthened its audits in many countries. A careful reading of the report shows the path that lies ahead… Despite all the initiatives of the profession, the story continues. Indeed, according to the Rapaport group and Human Rights Watch, in 2010, the Kimberley process, with the approval of the World Diamond Council, authorised the release of millions of carats from Marange Diamonds (Zimbabwe). These diamonds are sanctioned by US OFAC and EU regulations and cannot be legally purchased by US or EU entities. This company has been involved in human rights abuses in a context of continuing political violence in Zimbabwe. For experts, 4% of diamonds remain at risk. KPCS only affects conflicts, no other social (corruption, violence) or environmental issues.
- RJC and EITI are active on gems too (see precious metals).

Multi-stakeholders' initiatives

- FJA (Fair Jewelery Action) founded by activist jewellers; promotes social and environmental issues and entails small jewellers, artisans and NGOs.
- IRMA (Initiative for Responsible Mining Assurance) seeks to create independent third-party assurance.

Other gems

For other gemstones, spectroscopic analysis reveals the geological region of origin (which is impossible with diamonds). To date, there is no specific initiative for traceability and controversies in particular about Burma's rubies. Tremendous scope for brands. For sourcing, dependency on high-risk countries (e.g. 90% of rubies produced in Burma, 60% of emeralds in Columbia).

RAW MATERIALS FOR COSMETICS

This subject would merit an in-depth study in a report dedicated to pure cosmetics players. Molecules come from the chemical industry, from natural extracts (plants, flowers, etc.) or from minerals. Some examples. Dyes are synthetic (e.g. mauve) or from minerals. Pigments (iron oxides, titanium dioxide and chromium oxide) are mainly from industrial minerals. In perfume, the main plant extracts are geranium, jasmine, mimosa, rose, tuberose, violet, ylang-ylang, lemongrass, coriander, eucalyptus, iris, patchouli, vetiver, tolu balsam, galbanum, storax-benzoin, cedar, lignum vitae, oak moss, pine, sandalwood and cardamom. Synthetic fragrances are widely used. Generally speaking, cosmetics are chemistry. Fixatives, preservatives, filters, binders, opacifiers, etc. are used. Health issues (tolerability, innocuousness) are considerable.

Many controversial molecules
Paraben, phenoxyethanol (preservatives), phthalates (fixatives), and Triclosan (an antibacterial) are among controversial molecules. Some brands have already banned these molecules to address the concerns of customers or for marketing differentiation. However, in the luxury sector, this ban is only very partial. Moreover, the safety of replacement molecules must be monitored over time.
Nano-cosmetics: ongoing debate and lack of scientific consensus
The debate also concerns nano-cosmetics (e.g. nano-titanium dioxide, nano-particles. of silver, copper, zinc). Some studies (e.g. American Chemical Society) demonstrate a potential negative effect. The lack of scientific consensus is associated with continuing research, and for some industries market placing. The duality between prevention and precaution has never been stronger.

Questioning the cocktail effect
For scientists and some politicians, the question of the "cocktail effect" is still pending.

BIODIVERSITY

Upstream consequences are not explicitly/truly taken into account by the industry. In all cases, raw materials from agriculture, livestock and harvesting impact biodiversity. Leather cannot be considered only as "tannery output", except if tanneries demonstrate a high level of traceability and transparency on environmental management and data. The question arises on leather about the livestock and slaughter phase… or for the agricultural phase for textiles (cotton, linen, etc.) and vineyards. However, LVMH has demonstrated an advance for cosmetics with its seven gardens or "rational way" for vineyards. For others, biodiversity seems to be a matter of philanthropy.

DESIGN

Eco-design and product responsibility

Product durability
For hard luxury (leather goods, watches, jewellery), high quality, materials and assembly make sustainable products. It also benefits from a capital value or high resale value and is sometimes used as an investment. Products are repairable, some with lifetime warranties. After-sales service is provided over a very long time, even over several generations. For example, Vacheron Constantin (Richemont) "undertakes to maintain, repair and restore all watches it has produced since its foundation". The arguments of durability or guarantee are occasionally used in marketing. So far, the ephemeral nature of collections encourages multiple purchases (e.g. bags, shoes) or collecting (e.g. watches). Buyers, particularly HNWIs (high net-worth individuals), rarely own a single product by category.

Soft luxury products (cosmetics, fragrances, RtW, etc.) are inherently short-life products. In fashion, rapid changes in collections (two to four per year: spring, summer, autumn, winter) quickly outmode products.

Durability, often put forward by players is very relative, to say the least. A visible statement of durability (long-term warranty) should objectify this assertion. We must not confuse corporate seniority (sometimes century-old companies) with the ability to last and produce durability.

First steps in eco-design
LCA (Life Cycle Analysis) is largely in place in other areas (e.g. building materials, automotives). The method allows optimisation of costs and impacts. Brands had begun steps to reduce impact from design phases. Some examples: weight reduction of bottles of Champagne (LVMH), refills for cosmetics (Kenzo, LVMH) or 100% recyclable packaging for Gucci, YSL Vintage III collection (recycled fibres), Stella McCartney (Green Me). The challenge is both weight reduction (impact on raw materials consumption, costs, and CO_2 emissions), use of renewable materials, cost reduction and waste. Clearly, the Gucci group and LVMH set up eco-design processes without being able to measure impacts from a global point of view.

Product responsibility
Product performance is another way to assess responsibility and material risk: managing health and safety aspects, reducing environmental impacts and designing products that provide sustainable solutions. Opportunities are numerous: green cosmetics, organic drinks, organic or recycled textiles, responsible gold, etc.
We would mention some emerging and limited initiatives for clothes from recycled fibres (YSL) or The World of Stella McCartney (Green Me) as examples. So far, this route does not seem to be a growth driver for competitors, either via upgrading brand positioning or through M&A.

PRODUCTION

Post tanning: Leather goods manufacturing, a "semi-industrial" activity

Except for Hermès (tanning as core business) and LVMH (shareholdings in tanneries), or Gucci (own tanneries), leather goods most often start from tanned skins for other players. Certainly, brands capitalise on the excellence of the artisans, but actually only a few operate completely manually, including premium brands. While some operations remain manual, more and more are industrial, such as laser cutting or automated stitches.

Cosmetics: Industrial risks and health safety issues

In the production phase, cosmetics require large volumes of water and effluent treatment. Emissions to air come from solvents. The sector is strongly regulated: Cosmetic directive - Animal testing - IPPC Directive - Water directive - and supervised (the so called "Seveso" directive). Ongoing law implementation, with REACh and Animal testing.

Textiles: Outside the scope?

Like for cosmetics, textiles deserve a dedicated report on textile retailers. We report all environmental and social issues (see below). Clothing is partially industrializable for cutting and sewing. In downstream phases, environmental impacts are limited (waste).

Champagnes, fine wines and spirits

Impacts of agricultural or viticulture activities are similar and well known: insecticide, fungicide and herbicide use and their suspected effects on human health, groundwater and biodiversity - water consumption. To ensure high volumes of production, inputs are required (fertilizers). For viticulture, as for agriculture, the GMO debate is open. Pollution of groundwater between the sixties and eighties requires expensive treatment for human use. In the EU, between 1970 and 2010, the number of molecules allowed for professional use decreased from more than 1,400 to about 250 (source UIPP). Requirements for authorization and market placing have hardened significantly (10 to 12 years for development, from a USD120m to a USD200m investment). The most common diseases are botrytis, powdery mildew and iron chlorosis.

Water dependency: watch out for climate change
Climate change is increasing the sensitivity of vineyards and other products (grains) in the Americas and Australia. In a long-term view, French wines are also likely to be affected by a changing climate or migration of insect species, and the risk on water availability weighs on grape volume and quality.

Three production routes are open
There are three production approaches: "intensive agriculture", so-called "rational" agriculture, and organic agriculture. In France, Ecophyto2018 and Certiphyto are government-supported plans to reduce the use of phytosanitary substances, a section of the "rational" way. In Italy, regulations are similar as well as alternative routes.
In organic agriculture, there is (unfortunately, once again) a jungle of labels and initiatives (e.g. Champagne: EU label, French AB, Biodyvin [private], Nature et Progrès [private]). Furthermore, it is important to distinguish organic wine and organic grapes due to wine making and vinification methods. In the Champagne area, only 30 winemakers are certified. There are a few active associations (AIVABC). Furthermore, given a relatively humid climate, grape production in Champagne is not easy without chemicals. Producers indicated that organic means three times as many inspections and more runs for natural treatments.

Real organic momentum

Yet the market for organic wine is experiencing real momentum. In 2010, sales growth in France was 8% (EUR330m). 52,2342 ha in Spain, 52,273 ha in Italy, 50,116 ha in France (6% of total vineyards, +59% in the Champagne region, +28% conversion to organic) and 11,448 ha in the US are producing organic wine. In the fifties and sixties, before the arrival of chemical phytosanitary products, everyone made organic wine, without knowing… But with lower yields per hectare.

Packaging

Waste reduction applies to the design phase. While it can be considered as a secondary environmental impact, it is symbolic and consuming of raw materials. E.g.: LVMH placed 117,597 tonnes of packaging on the market, of which 148,145 for wines and spirits (83.4%), 21,974 tonnes for cosmetics and 5,711 tonnes for fashion and leather goods.

Room for manoeuvre is substantial. Sourcing of renewable raw materials, weight reduction, refills and reduction of overpackaging (packing, packaging, overwrap, shopping bag), and finally separability for waste recycling.

In the sector, packaging is a key component of marketing and customer purchasing. Partly, to change overpackaging, it is necessary to change consumers' attitudes (see consumer shift). Many initiatives for eco-designed packaging are now being implemented (e.g. Gucci, Louis Vuitton).

Climate change

The industry is not considered carbon-intensive but… it generates two major sources of GHG: building/retail and transportation. Growth in production, sales and retail outlets, especially in Asia, automatically leads to increased energy consumption and CO_2 emissions. The share of retailing (scope I) versus wholesale (scope III) amplifies direct consumption. Unlike other industries, there are no comparable relative-intensity KPIs that would effectively measure the efforts of businesses and level of dependency, except for building and retail (CO_2 per square meter). Levers of energy efficiency and emissions reduction are obvious:

- Conception, weight reduction, use / production of renewables
- Production: energy efficiency of processes
- Logistics: shipping by sea instead of air transportation for the Asian and Americas markets, combined rail/road in Europe (split between road, rail, air and sea transportation)
- Retail: energy efficiency of outlets (CO2 per square meter per year)

Three activities are very carbon-intensive: glass (e.g. bottles, perfume packaging, watch glass), crystal (tableware and crystal pieces), and ceramics (watch and jewellery, tableware). They all use fusion (gas furnace).

RETAILING

Logistics: shipping as a way to reduce costs and CO_2 emissions

Production for the main players is mainly based in Europe (France, Germany, Italy, Switzerland), while the proportion of sales is increasing in Asia (Mainland and Greater China, Japan) and is stable in North America and Japan. Luxury goods are not large or heavy, except for drinks. In Europe, road transport is suitable and possible optimisation has been identified (car-boarding, routes, piggyback, last kilometres with e-vehicles, etc.). For export abroad, the traditional means of transport is air, but shipping by sea is a way to optimise costs and reduce CO_2 emissions.

Real estate

Key takeaways: Global coverage is close at hand

- Still a core business and a capital-intensive activity
- Full mastery of environmental issues with "green books"
- The saturation point, 450 directly-operated stores, is looming, with 130 brands moving is that direction

Retail

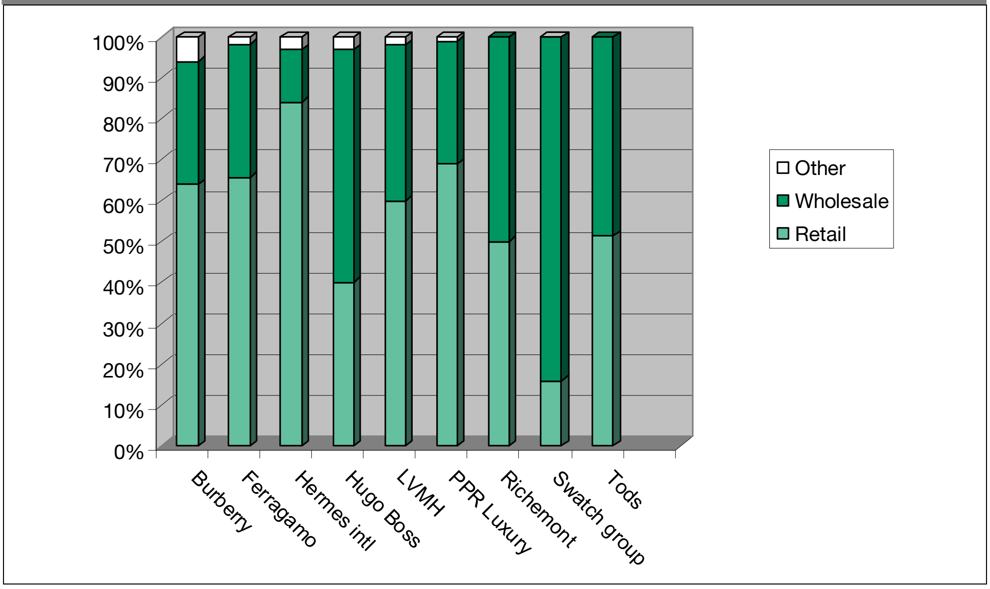
Real estate is at the heart of the business model for luxury goods brands. Indeed, as we pointed out, the maisons wish to control distribution as much as possible, both to keep the distribution margin and to control all components of brand image. Groups wait patiently for years to obtain the best locations. This activity is highly capital consuming (buildings purchased in strategic locations, but mainly commercial leases) and directly enters into the stock valuation. The share of retailing is a major criterion for sector analysis, as is turnover per square metre. Retailers prefer experience with the brand rather than product density per square metre. Products are generally exposed with an emphasis on display, on enhanced racks that are well lit. Insulation, LED lighting, and high-performance cooling systems are a few courses of action.

The design of shops is undoubtedly the issue best addressed by all players, for instance, in Richemont's Green Handbook for building/retail. Systematically, they all set demanding standards (LEED, BREEAM, HQE) for installation or renovation. As part of the experience, showcases tend to be exemplary.

Wholesale

By comparison, wholesale is able to develop the number of outlets faster, and to achieve a higher turnover per square metre, but with a lower level of control of the brand image. Environmental data is more difficult to collect and manage.

REVENUES BY DISTRIBUTION CHANNEL



Source: CA Cheuvreux

RAPID EXPANSION OF THE DISTRIBUTION NETWORK

	# of sales outlets	Opening 2010	Scope
Burberry	441	+ 25	DOS + Concessions + Outlets (end Q3 2011)
Ferragamo	593	not disclosed	DOS + Concessions (TPOS)
Hermes intl	338	+ 11	DOS + concessions
Hugo Boss	537	+99	Owned
LVMH	2545	+122	Owned + Franchised
PPR Luxury	801	+117	Dos (end 2011)
Richemont	1534	+ 66	DOS
Swatch group	not disclosed	not disclosed	Owned multi-brand, mono-brand stores, retail outlets
Tods	230	+3	DOS + Concessions (franchised)

Source: CA Cheuvreux, 2010 annual reports

Environmental impacts and relevant indicators

In our peer comparison, we include CO_2 emissions and energy consumption under Climate Change. In environmental terms (energy, CO_2, water, waste), the impact of wholesale is rarely consolidated in group data and considered to be scope III. Moreover, in assessing performance, we need to have intensity indicators (i.e. CO_2 per square metre). The performances of different groups must be compared with great caution.

Towards saturation?

The "retailisation" trend illustrates that retail is fully a core business, and a prerequisite for customers to have exceptional experience with the brand. This is a capital-intensive activity that must accounted for in terms of both sales points and selling space in square metres. Full mastery of environmental issues but the saturation point is looming. Our view is 450-500 directly-operated stores worldwide for one brand.

Shopping tourism: duty-free boosts GHG emissions

A secondary effect of tourism is CO_2 emissions. While most travel is motivated by a desire to discover countries and cultures, some trips are limited to duty-free bargains. This applies for instance to travel from Mainland China to "Greater China" (Hong Kong, Macao, Taiwan). Depending on the country, taxes in Asia can be as high as 60%. A EUR100 luxury product costs EUR170 in China. A Beijing-Paris or Beijing-Hong Kong return air ticket costs around EUR450. For several purchases, the ticket is quickly profitable. These tax gaps encourage flights and thus raise CO_2 emissions.

Internet sales: The investment boom

The growth of IT helps manage the environmental impact. This is especially true in view of the turn taken by brands in the past three years. Logistics and data servers affect energy consumption and CO_2 emissions. At this stage of luxury brands' development, the impact is not easy to measure and assess. However, given the substantial investments made by brands and the likely consumer shift, this impact is set to be significant in the coming years.

PRODUCT END-OF-LIFE

Waste

Prevention: Waste reduction applies to the design phase. The industry is beginning to implement eco-packaging (materials and recyclability), but has made few steps towards a complete lifecycle analysis of products.

Production: In the industry, fine drinks are the biggest generators of waste. Non-hazardous forms include press waste and empty bottles. Hazardous types include unused chemicals (for vines and vinification) and packaging, batteries and waste oil. Cosmetics generate more hazardous waste: sludge from water treatment plants (from purification of water and effluents), unused chemicals and packaging, by-products from processes, and non-conforming batches.

Collection and recovery: Most manufacturers have set up recovery channels. Mandatory in the industry, these are now extended to retail. Some initiatives to reduce packaging have been made, with client consent (e.g. Louis Vuitton).

Recycling: Different types of waste may find recycling opportunities. Incineration to produce electricity, textile for insulation, organic waste to produce methane or fertilizer, etc.

Recovering to create value?

Hermès's "Petit h" initiative is noteworthy. The company recovers out-takes and raw materials from its main production to design original pieces. Pascale Mussard, a descendant of the founder of Hermès, is behind Petit h. This initiative is symbolic in its environmental impact, and strong in terms of image. However, it demonstrates that one can create value with waste… and ideas.

OVERVIEW OF THE SUPPLY CHAIN, FROM RAW MATERIALS TO DISTRIBUTION: A PEER COMPARISON

Burberry	
Raw materials	**RtW:** In 2009-10, we note that SAGA fur farms were opened up to third-party inspections, the group took membership in the Responsible Cotton network, excluded Uzbek cotton from its supply and supported the Truth in Fur Labelling Act in the US (2010). **Non-apparel:** Far behind peers. In 2009-10, Burberry joined the BLC Leather Working Group to have a clearer understanding of the environmental impact of tanneries and to improve transparency in the leather industry. There have been some statements and management initiatives, but no global, relevant and accurate view. Where does the group source crocodile skins, cashmere, silk, synthetic fibres, timepieces, cotton, etc.?
Supply chain and production	**Supply chain:** Mainly outsourced, the majority (% not disclosed) of Burberry's products are manufactured in Europe using third-party suppliers. The company does not disclose countries or suppliers and manufacture in Asia. In 2009-10, 634 factory visits; 721 "interventions" with various scopes (audits, training, capacity building, hotline programmes) in 2010-11. Supplier assessment includes non-financial performance, the group uses third-party contractors for H&S audits, and states that it respects local environmental laws. There is only one factory within the group's scope (Woodrow-Universal Limited: a UK textile manufacturer). **Environmental management:** Burberry is active on social, with ETI (Ethical Trading Initiative – joined in June 2010) and BSR (Business for Social Responsibility), and has developed a global, but so far basic, environment policy (December 2009). We regret weak disclosure, no quantitative targets or relevant KPIs. With a lack of tangible information, the group can be considered to be exposed to reputational risk on the supply chain.
Distribution	**Retail:** The directly-operated network includes 441 stores (at end Q3 2011; +25). Burberry has enjoyed a rapid expansion in EM, up to 15% of selling space in H2 2011-12. In e-commerce, it launched (in Q4-10) an innovative internet platform (CRM, six languages, 45 countries, iPad version, etc.). Like its peers, Burberry is continuously reorganising its sales area (expansion, renovation, moving to better locations, closure, transfer).
Climate change	**CO_2 and energy efficiency:** Carbon trust certification (a demanding framework) and CDP disclosure show a real commitment. However, the share of maritime transport is declining (12% vs. 88% by air, excluding road transport) and is reflected in air transport CO_2 emissions (3kg CO_2 per GBP1,000 of turnover). Limited data, with no indication of the breakdown between building/production/logistics (road, air and by ship) and retailing. Of course, CO_2 emissions for stores/buildings should be more relevant by square metre… CO_2 emissions intensity (i.e. CO_2 kg per GBP1,000 of turnover) has been virtually stable over the past three years. **Renewables:** Use of renewables in UK activities. Considering the business growth, energy consumption and CO_2 emissions show improvement.

Ferragamo	
Raw materials	**Recently listed (mid-2011).** The company does not currently provide any CSR reporting. Issues on raw materials will be broken down by revenues (2011): shoes & leather goods (74.2% of sales) – RtW (10.4%) – silk and other accessories (7.9%) – fragrances (7.9%).
Supply chain and production	**Supply chain:** Almost 100% of production is outsourced, exclusively in Italy. Moderate risk on the supply chain for environmental (and social issues), to be monitored in the near future. Numerous small Italian manufacturers, and 100% "made in Italy". No controversies identified. No apparent exposure to "Chinese Italy" (Prato – industrial area of Macrolotto). **Audit:** Purchases are covered by a code of conduct, including compliance with current legislation. No audit framework or organisation identified.
Distribution	**Retail** (66.7% of sales): 323 direct-operated stores. **Wholesale** (31.7% of sales): 270 third-party operated stores, and presence in department stores and multi-brand specialty stores.
Climate change	**Impact scope:** 7.3% of revenues from building rentals, mainly in the US, added to retail. No data available in terms of energy efficiency (LEED, BREEAM), logistics and retail (energy consumption and CO_2 emissions). Solar energy at the Osmannoro-Sesto Fiorentino plant (parent company).

Hermès	
Raw materials	**Leather:** Exotic raw hides sourced in the US (*Alligator Mississippiensis* – protected) Australia (the group has its own croc farm, *Crocodylus Posorus* – protected) and Africa (*Crocodylus Niloticus* – protected). Best control of supply chain on leather despite the lack of information on sourcing of classic leather raw hides (bovine). **Textiles:** Cashmere is sourced in Nepal, no disclosure for other fibres. **Precious metals and gems:** Sourcing is not disclosed by the company but relatively low exposure to sourcing risk given the range of products (timepieces 5% of sales; jewellery, part of other businesses, 3% of sales). No disclosure on textile fibres or precious metals.
Supply chain and production	**Supply chain:** High integrated level of production and shareholdings in Tissage Perrin/Textiles (39.5%) and Vaucher Manufacture Fleurier/Timepieces (21%) allows it to secure procurement of strategic resources and to control environmental issues. It is undoubtedly dependent on Swatch for parts despite controlling "La Montre Hermès" (Hermès Watches Assembly and Bracelets) in Biel/Bienne (Switzerland). **Production:** Tanneries (for leather good, small leather, bracelets and riding) are core business for Hermès (HCP, or Hermès Cuirs Précieux), Gordon-Choisy and TCIM in France, Reptile Tannery of Louisiana and HCP Asian Leather started from December 2010. Industrial investment in tanneries for compliance on environmental regulation and water consumption and energy reduction. With 33 manufactures (23 in France, 1 in the UK, 1 in Switzerland, 1 in Italy, 1 in the US), Hermès has total control of manufacturing, in countries where regulations are associated with demanding thresholds and frequent checks. **Environmental management:** Water consumption is stable, despite increased production. Textiles (60.8%) and tanneries (24%) are the most water consuming activities. Effluent treatment is subject to technical advances (e.g. nanofiltration, phytodepuration). No "Seveso" sites in the picture, and a clear organisation for H&S and the environment. **Liabilities:** No provisions or convictions for environmental liabilities. Hermès is the most integrated and transparent player, which leads us to a high level of confidence in the supply chain.
Distribution	**Retail network:** 338 sales points, of which 317 DOS and 21 concessions, +11 vs. 2009 and presence in 57 countries. Transparent view of the distribution network and its control.
Climate change	**Logistics:** Use of maritime transport for tanned skins and air transportation for raw hides (conservation concerns). **CO_2 emissions:** Carbon footprint (Bilan Carbone®) for all production and distribution activities, but not disclosed. **Energy consumption:** Improvement plans (e.g. maritime transport for raw hides instead of air transport, wood heating, transport scheme, etc.) lead to a stabilisation of energy consumption, despite increasing activity. Textile (27.5%) and crystal (34.5%, kilns) are the activities that emit and consume the most. We regret a lack of transparency on CO_2 emissions, despite significant management and actions.

Hugo Boss	
Raw materials	**Exposure to raw materials:** A large range of products (RtW, shoes, accessories and watches) exposes the group to textile, leather and precious raw materials. However, regarding disclosed information, it is impossible to qualify and quantify levels of exposure, mostly for fibres, textiles and fabrics. **Raw materials:** Sourcing includes mainly fabrics, but also components such as linings, buttons, thread and zippers. The majority is sourced in Europe (percentage and suppliers not disclosed). Fabrics predominantly come from long-time suppliers in Italy. For suits, the company also purchases jackets and trousers from manufacturers under contract. For products created in contract processing, the supplier receives the fabrics and other components to be used, as well as the patterns. In contrast, sourcing for casual wear and sportswear is largely based on purchased merchandise. In this case, the merchandise suppliers are given the necessary patterns, but provide the raw materials themselves.
Supply chain and production	**Sourcing breakdown:** 50% of all Hugo Boss products (goods produced in own factories, merchandise and goods sourced in commissioned production) are produced in eastern Europe and the Middle East. Roughly 25% of all products come from Asia. In this region, China is the singly most important sourcing country. The rest of the goods come from RoW, including western Europe (1%), North Africa (9%) and the Americas (2%). Casual wear and sportswear merchandise is primarily sourced from Asia, eastern Europe and North Africa. **Supply chain:** As a prerequisite to starting a business relationship, the group demands strict adherence to social (ILO, UN Human Rights, OECD guidelines) and environmental standards (specific requirements not clear, except the obligation to comply with the REACh restricted substances list). Compliance is ensured through corresponding audit processes along the supply chain. We regret a lack of information about suppliers are controlled regarding sourcing: how many are controlled, by whom (third-party?), when and according to what standards. Also, we do not have any information on how the group manages the sourcing risk for textile (poor working conditions, environment). **Production:** 24% of the full product line is produced in HB's own factories, and 76% is manufactured by independent suppliers in commissioned production and as merchandise. The company's own production sites are in Izmir (Turkey, the largest directly-owned facility), Cleveland (US), Metzingen (Germany), Radom (Poland) and Morrovalle (Italy). The company has worked with 300 suppliers for contract manufacturing and merchandise and made efforts in strengthening long-term partnerships. We found that Hugo Boss reaches a relatively high level of transparency with regard to its production processes, but a lack of comprehensive audit system, from fibres to production. Given its sourcing, Hugo Boss is exposed to reputational risks. **Environmental management:** Apart from some anecdotic measures, Hugo Boss does not disclose any formal and complete programme to target and reduce its environmental footprint, nor is it planning to develop sustainable/eco-design products.
Distribution	**Global coverage:** Hugo Boss sells its products in 124 countries. **Retail:** The number of DOS (directly-operated stores) rose by 99 to 537 in 2010. Franchised stores amount to approximately 1,000. This brings the total number of single-brand stores in the Hugo Boss Group to more than 1,500 in over 80 countries. In 2010, they accounted for 40% of sales. **Wholesale:** the group's products can be found at 6,100 multi-brand points of sale.
Climate change	**Logistics:** Precision planning to avoid overlaps/surpluses, and maritime transport preferred to air transport whenever viable. **Energy consumption:** Savings through "intelligent" architecture and building technologies for the construction of recent administrative complexes in Metzingen and Switzerland (double façade with natural ventilation, cool ceilings and solar panels). At the retail level around the world, use of long-life light bulbs. **CO_2 emissions:** No response to the CDP and no disclosure. This does not seem to be an issue for Hugo Boss.

LVMH	
Raw materials	**Jewellery and watches:** LVMH is the most advanced group in the certification of sourcing via the RJC. All brands are members. Five of eight are certified, and the other three will be certified shortly. Diamond sourcing is secured with DTC (De Beers JV with LVMH). **Leather goods:** Given the scarcity of crocodile skins, the group decided to secure sourcing through the acquisition of Hen Long (2011). For skins, Louis Vuitton depends on external suppliers (Norway, Spain and Italy). A joint venture with Tannerie Masure (a supplier from Belgium) was launched in late 2010. This tannery (Tanneries de la Comète) uses mineral tanning and advanced process treatment for effluents. LVMH intends for Fendi to achieve an equivalent situation. We note that some brands lack a comprehensive view. **Cosmetics and fragrances:** Dry materials, raw materials, chemicals, bottles, closures, etc., are purchased from companies outside the group. **Textiles:** Fibre sourcing does not appear to be a source of concern. **Audits:** The group applies a supplier's code of conduct, with decentralised audits at a maison level for small suppliers and the group level for the largest. We regret a lack of information on key suppliers for raw materials.
Supply chain and production	**Jewellery and watches (10% of sales):** Subcontracting represents 5% of the cost of sales (percent of outsourcing not disclosed) Prototyping activity and purchasing are coordinated for all brands. The group makes almost all assembly operations in its five manufactures. Zenith, Hublot and Tag Heuer also ensure the design and manufacture of their mechanical movements. Cortech, a Swiss subsidiary, manufactures watch cases for Tag Heuer and Zenith. For various non-integrated parts, suppliers are Swiss, except leather bracelets. **Fashion and leather goods (37% of sales):** Overall, 43% of the cost of sales are outsourced. The group owns 15 workshops for Louis Vuitton (11 in France, three in Spain and one in the US) and uses third parties to complete the manufacturing process and gain flexibility. SOFAMA is one supplier; it was recently involved in Lejaby's resumption. Fendi operates workshops in Italy, Loewe in Spain, and Celine in Italy, but these cover only a part of their needs. For textiles, most suppliers are Italian. **Fragrances and cosmetics (14% of sales)**: Production is integrated into the five French production centres (Guerlain, Givenchy, Dior, Kenzo, and Make Up For Ever). US companies (Benefit, Fresh), Acqua di Parma and Loewe outsource production for the most part. To secure its products, LVMH has developed "in vitro" assessment methods in its laboratories and based on large-sized teams and means (technology platform "biological activity" LVMH Research Laboratory, 270 researchers) and partnerships with universities. The laboratory is active in scientific publishing and patenting. Research includes plant extracts (orchids, longoza) and traceable gardens (seven worldwide). Water consumption (-40% in four years) and effluents are controlled. The application of EU Directives is fully taken into account. **Champagnes, fine wines and spirits (17% of sales):** Outsourcing as a percentage of the cost of sales is not disclosed. The group owns 1,979ha in the Champagne region, representing one-quarter of its annual needs. The rest is purchased from winegrowers and cooperatives. Packing materials (bottles, caps, etc.) are purchased. The company shipped 55.8 million bottles in 2010. For Cognacs, 180ha are owned, and most wines and brandy are purchased from 2,500 producers. For vodka, rum, wen jun and whisky, distilleries are operated by the group, but sourcing conditions (cereals, etc.) are not specified. The group is committed to undertake rational means to reduce the use of pesticides, to improve soil quality (erosion, microbiology, protection of water abstraction area) and to carry out testing. A "third way", i.e. mix between use of chemicals and organic phytosanitary products, is implemented. Water consumption (very high in the wine and spirits field) is shrinking (down 35.6% in the past four years). Irrigation is mostly regulated by local authorities. The group is exposed to the risk of changes in the availability of water resources due to climate change and is generalising the use of drop irrigation. **Environmental management:** Clear key issues for the different product ranges. Many maisons are ISO 14001 certified. Mapping of environmental risks, HPR (high protected risk) for fire prevention and HACCP (hazard analysis critical control point) are some of the tools used, confirming a pledge on controlling environmental risks. In 2011, the group increased its production capacity. For 2012, LVMH wishes to accelerate industrial integration likely to limit its dependence on suppliers and ensure sales growth.

Distribution	**Selective retailing (27% of sales):** Includes travel retail (DFS stores, Miami Cruiseline), selective retail (Sephora) and department stores (Le Bon Marché and Franck et Fils, both in Paris). This branch compasses *Les Echos* (media) and Royal Van Lent (yachts). **Retail:** fashion and leather goods: 1,188 DOS (at YE 2010)**.** The total number of outlets is 2,545 (YE 2010, +122 vs. 2009) with store brands (Louis Vuitton, Berluti, etc.). Environmental issues focus on energy (electricity, heating and cooling, escalators), CO_2 emissions and waste recovery generalisation (e.g. Sephora, recycling of fragrance, skincare and makeup testers).
Climate change	**CO_2 and energy efficiency:** Every maison has carried out a carbon footprint (Bilan Carbone®) and most of them have done energy audits. They started from 2002, issuing plans for energy savings with gains (e.g. Le Bon Marché E1, 7GWh from 2008 to 2010) or targets (e.g. Sephora, targeting a 21% reduction from 2009 to 2012). The company is also involved in recognised building environmental certification (e.g. LEED Platinum for Sephora San Francisco, Gold in Santa Monica, HQE under way for La Samaritaine, BREEAM for Glenmorangie). Broad actions are taken in the production phase; some starts in the design phase (e.g. packaging Neverfull by LV, analysis of energy efficiency when purchasing a machine at Guerlain) for reducing the CO_2 impact and cost savings. **Renewables:** Widespread use of photovoltaic panels and membranes. Some thermal panels or geothermal production (three sites). **Logistics:** Measures of CO_2 from upstream to downstream. Heavy goods mainly transported by ship (fine drinks). Ongoing logistics optimisation (e.g.: last-mile logistics with e-vehicles at Sephora, piggyback for Hennessy or river shipping). Mainly air transport for watches and jewellery, fashion and leather goods. Considering the business's growth, energy consumption (844,338 MWh) and CO_2 emissions and estimates have increased significantly in fashion & leather goods and selective distribution, slightly less in fine drinks. Nevertheless, we regret the lack of relevant intensity factors for LVMH (as for peers) to measure efforts and energy dependency. It provides comprehensive management and reporting, ahead its peers.

PPR Luxury	
Raw materials	**Raw materials profile:** For all brands in 2010: leather goods (55%), footwear (14%), RtW (14%), watches and jewellery (8%), and other (9%). For the biggest brands, by sales (H1-11): Gucci (leather goods 57%, apparel 13%, footwear 13% and other 17%); Bottega Veneta (leather goods 83%, apparel 7%, footwear 6% and other 4%); YSL (leather goods 33%, apparel 26%, footwear 22% and other 19%). **Precious metals and gems:** RJC commitment with two certified brands (Boucheron, Gucci) and three memberships (Bottega V, Girard-Perregaux and JeanRichard) and KPC Scheme. Boucheron participation in the "no dirty gold" campaign and assessed "active" by FJA (Fair Jewellery Action). **Leather:** Commitment to the CITES convention for exotic leather. Sourcing from breeding farms and hunt auctions with certificates of legal origin. Cowhide sourced from Europe, principally from France. **Textile:** Acquisition of Brioni (RtW and tailored) generates vicuña and guanaco (protected species) issues. Gucci is associated with the "Clean Clothes Campaign" (multi-stakeholder) for an end to the sandblasting technique. Chic and Ethics collection (New Vintage III) at YSL, with recovered textiles. Despite some best practices, a lack of overview on textile and fibre procurement.
Supply chain and production	**Supply chain**: General Code of Business Conduct and undisclosed Supplier Charter. SA8000 certification (demanding certification standard for working conditions) for leather and jewellery for the Gucci brand. PPR has plans to extend SAI-SA8000 to 100% of the Gucci brand supply chain. Bottega Veneta's main activities are also SAI certified. Joint venture in Italy with local partners. Gucci states that 45,000 people work for Gucci in Italy, 7,000 of which in Tuscany in leather goods. **Audits:** The group claims to have carried out 2,892 social audits of group suppliers in 2010. PPR stands out from competitors thanks to its ambitious audit policy. **Watches and jewellery:** SOWIND takeover (Girard Perregaux & JeanRichard) with manufacture control. **Textiles:** Brioni integrates costume making. **Leather:** ISO 14001 certifications planned for all integrated tanneries of the Gucci group. Bottega Veneta production sites in Italy (Vicenza, Altavilla Vicentina and Vigonza) are already ISO14001 certified. **Environmental management:** Green toolbox for buildings and retail and other activities. The group acknowledges a limited interest in ISO 14001 certification, because its core business is distribution. In our view, this strengthens the need for environmental auditing of the supply chain.
Distribution	**Logistics:** Gucci Luxury Goods platform for logistics optimisation. **Retail:** Continued expansion of own stores for all brands. 728 (up by 75 in 2010 vs. 2009, up by 44 in H1-11) directly-operated stores, contributing 69% of revenues for the luxury division.
Climate change	**CO_2 emissions:** Carbon-neutral target with an undefined timeframe, and targets of a 20% CO_2 emissions reduction for retail. Starts in LEED certification for new openings (e.g. Stella McCartney Milan) and energy savings plans. Transport accounts for more than 50% (269,000 tonnes) of CO_2 emissions, with no apparent dedicated plan. **Energy consumption:** 610GWh, mainly electricity (76.5%) with a target of a 20% reduction over 2009-2014 and a gradual shift to renewables.

Richemont	
Raw materials	**Precious metals and gems:** The group is extensively involved in the RJC, and Cartier is a founding member. For FJA (Fair Jewellery Action, an independent NGO), Cartier is considered "significantly active" regarding sourcing. Through membership in the World Federation for Diamond Bourses (WFDB) and International Diamonds Manufacturers Association (IDMA), Richemont adheres to KPCS (Kimberley Process Certification Scheme). Richemont's supplier code of conduct covers ethical labour, employment practices and human rights. **Leather:** Membership of Euroleather/COTANCE with an ongoing project on traceability of hides and skins (July 2011) and reporting scheme on environmental and social stakes. The group also adheres to the CITES (endangered species). No clear vision of the supply chain for skins. **Textiles:** Seems out of the scope, but low exposure regarding products and sales. **Audits:** The number and kind of audits (external and internal) are not disclosed. Richemont may be considered relatively advanced, with a large set of best practices (e.g. Cartier, Lancel supplier's audits), but lacking a comprehensive, global and detailed view.
Production	**Design:** No evidence of an eco-design process or LCA (life-cycle analysis). **Production:** Watches, jewellery and writing instruments comprise 80% of sales. Manufacturing operations are concentrated in Switzerland, France and Germany: a low risk profile. Richemont states that 86% of production is located in Europe. **Cosmetics/fragrances:** The company states that it complies with the EU Cosmetics Directive on cosmetics and animal testing. Cartier's fragrances are insourced, while other brands are outsourced, referring to the supplier code of conduct. **Environmental management:** Existing but undisclosed "environmental code of conduct" and reporting of water consumption (stable, despite the increase in production), but not for waste and air emissions. **Liabilities:** No fines or convictions for non-compliance with environmental regulation. Assumed risk-based or compliance approach for supply chain with 60 supplier audits carried out in 2010-11, but with no contextual data (number of suppliers, type of risk). The group states that, "Our business does not have major, direct environmental impacts".
Distribution	**Retail:** Store and boutique openings (+66 in 2010) and upgrading/renovations, like peers, with 1,534 boutiques worldwide. Green handbook from Richemont Real Estate deployed for all maisons with energy and waste. **Logistics:** Air transport for light and expensive products, and maritime or road transport for heavy materials.
Climate change	**CO_2 emissions:** The carbon footprint using GHG protocol for all controlled bodies shows a continuous rise in volume due to the increase in business (+24% in 2010-11 vs. 2009-10, with a 33% increase in sales). CDP reporting with details not publicly available and no clear visibility on management to reduce CO_2 emissions. Richemont participates in carbon offsetting programmes, but has not specified projects or offsets achieved. **Energy consumption:** +21% (in 2010-11 vs. 2009-10) and 26% of purchased electricity from renewables. Compared to peers, taking into account activity and acquisitions, results on costs and emissions are set to have stabilised or to grow more slowly.

Swatch Group	
Raw materials	**Supplier selection** with a set of contractual terms regarding safety, environmental protection and socio-political factors. **Diamonds and precious metals:** Each supplier is asked to sign a declaration regarding "ethical rules and the sources of materials". For diamonds, the group reports that sourcing is compatible with the Kimberley Process. **Leather:** Exotic leather comes from controlled breeding sources in the US.
Supply chain and production	**Sourcing:** The most integrated player, focused on timepieces (mechanical and digital) and jewellery. Swatch controls all key businesses: assembly, components with high value added (movements, dials, watchcases, clock hands, jewellery) and all related businesses (high-tech materials components, micromechanical, crowns, oscillating, escapement) and after-sales. The group places many industry players in a situation of dependence, and represents a major barrier to entry. COMCO investigation for abuse of dominant position. **Environmental management:** Corporate risk management system, H&S and environment declared to be a "priority principle". However, Swatch is far from peers in terms of the depth, availability and relevance of data. Water, air, consumables, waste and recycling are taken into account. Compliance with RoHS and WEEE directives. Risk mitigation policy, but with no evidence of implementation of any sustainability model and assumed lack of transparency.
Distribution	**Retail**: Structurally, watch sales are made at both in-store brands, multi-brand stores and wholesale. Basic watches (Swatch, Flik Flak) are distributed in a very diverse network comprised of both single-brand stores and resellers. Tech'Airport (31 retail outlets) targets airports. Tourbillon (20 outlets) is an exclusive prestige brand store. There are also owned single-brand stores: e.g. Omega stores (80 boutiques), Tissot (100 stores). The number of total sales points, as well as the breakdown (by type and brand) of its own network is not disclosed.
Climate change	**Energy consumption:** -12.8% in 2010 for electricity. **CO_2 emissions:** -5.4% in 2010. **Logistics** not considered within this scope. No evidence of climate change as an issue, despite the size of the company.

Tod's	
Raw materials	**Raw material exposure:** From sales, leather (shoes and LG: 77.8%), textiles (12.1% apparel).The company does not disclose any substantial information on its raw material sourcing. However, the company sources 100% of materials (leather, suede, etc.) from western European countries. Skins are already tanned and dyed. Some products are made with exotic leather, but no visibility on sourcing. No specific information on textile sourcing.
Supply chain and production	**Production:** All LG products are crafted in the groups' own factories in Italy, a total of six for shoes and two for leather goods. **Supply chain:** With a limited number of specialised laboratories and suppliers, with long-term business relations, located in Italy. **Supplier audits:** We regret a lack of information on supply chain audits.
Distribution	The group relies mainly on three channels: DOS (directly-operated stores), franchised retail outlets, and a series of selected, independent multi-brand stores. The group's strategy is focused on development of the DOS and franchising networks. **Retail** (51.3% of sales): 159 DOS. **Wholesale** (48.87% of sales): 71 franchised stores, primarily in Europe (especially Italy) and the US. The total number of sales points is 230 (+3 vs. 2010). In 2010, the group expanded its sales up to 10% in Italy, 8.9% in the rest of Europe, 15.9% in the US, and 37.9% in Asia and the rest of the world.
Climate change	CO_2 emissions and energy consumption do not appear to be a concern, as the group does not disclose any information on this subject.

HUMAN CAPITAL

Key people: four strategic resources

Top managers: The battle to attract talent is raging

Bidding to recruit top management: **guarantors of brand image**. Maisons need experienced leaders. They are a key to brand development and the enrichment and preservation of brands. In fact, maisons are SMEs whose strategy is validated by the parent holding company. Top managers have a wide degree of autonomy and rely on the group for its expertise in marketing and procurement. The battle to attract talent is raging, with inflation in salaries and benefits. A brand that wants to grow faster, to reshape or relaunch itself has every interest in poaching talent from renowned rivals. In response to this risk, the groups set up retention plans.

Top designers: relative dependence and cost inflation

While the creator or founder leaves a considerable mark on the company, has moulded the brand's DNA (and is sometimes still living), the designer in charge of the maison has a **key role in the success of a collection,** and thus on sales. This is especially true in the haute couture and ready-to-wear segments, but much less so for timepieces. This dependence requires rigorous crisis management, as demonstrated by the decisions perfectly-timed decisions made by Christian Dior in the John Galliano affair. But above all, preparing for a designer's succession is crucial. The "post-Galliano" collection received mixed reviews, according to experts and the media, and this is likely to have consequences in term of sales. Admittedly, a designer is rarely a good manager. He is sometimes someone difficult to manage with an oversized ego. But for the multinationals of luxury goods, namely **attracting and retaining top talent** is a key strategic issue. And true talent is rare. In this area, as for the leaders of maisons, the battle for talent is raging. With inflation in salaries, benefits and other incentives. And the creative momentum is key for sales. A few examples of top designers:

- LVMH: Marc Jacobs (Louis Vuitton, Marc Jacobs), Phoebe Philo (Céline), Ricardo Tisci (Givenchy), Stuart Vewers (Loewe), Donna Karan (Donna Karan, DKNY), Peter Dundas (Emilio Pucci), Olga Berluti (Berluti).
- PPR: Thomas Maier & Marco Bizzarri (Bottega Veneta), Frida Giannini (Gucci)
- Hermès: Véronique Nichanian (men's RtW), Jean-Paul Gaultier (women's RtW), Gabriele Pezzini (luggage), Laurent Goblet (riding), Karen Petrossian (jewellery accessories), Pierre Hardy (shoes, jewellery), Dimitri Rybaltchenko (silk and textiles), Jean-Michel Franck (furniture), Jean-Claude Ellena (fragrances), Marc Berthier (watches), Pascale Mussard (Petit h).

One illustration of this battle for talent is Hedi Slimane's move from Dior to Yves Saint Laurent (in February 2012), leading to the departure of Stefano Pilati.

Beyond top designers, **creative culture** is *the* key asset for luxury brands. It must permeate all levels, from colours and materials, to marketing and the shopping experience. This is a strong intangible asset.

Handcraft jobs: Apprenticeship to preserve know-how…

The issue is the retirement of baby boomers and **preparing their replacement**, in a context of increased production and sales, mainly for emerging markets. While a number of operations can be automated for basic and mid-range products, for very high-end and prestige lines, manual know-how remains indispensable.

In 2009, Mr Thomas (Hermès) declared: "We are limited by our ability to train new craftsmen". He spoke of the iconic Birkin model (a crocodile skin bag). In watchmaking, training plans and schools have been created and developed in Switzerland on all manual crafts with high added value. Most often, jobs require precision and thoroughness for shaping or assembly. Most players implement plans for apprenticeship with tutoring. As an example, in 2011, LVMH launched a comprehensive plan to prepare for the ageing workforce and retirements.

…and control of small key skill suppliers	We have observed the takeover of small craft businesses with high value added and a lengthy tradition of know-how. For example, for several years now, Chanel has been developing a subsidiary dedicated to art craftsmanship: Paraffection. After buying Desrues (finery maker), Michel (milliner), Massaro (boot maker), Goosens (goldsmith), Guillet (floral finery maker); Lesage (embroidery), Lemarié (feather), it has acquired Montex (crochet hook specialist). In the wake of large maisons, there are still small craft workshops with high value added.
Sales advisors: handling the rapid development in emerging markets	Sales advisors have a key role to play in the brand experience. In Europe (the No. 1 destination for tourism in the world), the issue is the mastery of language and adaptation to different cultures. In EMs, **seniority is key** (e.g. LVMH Asia, 72.8% have less than five years of seniority). The risk is to have inexperienced shop assistants as the sole contact with the brand. The number of locations in both retail and wholesale has grown rapidly over the past five years. Hiring, training, coaching, mentoring and ultimately retaining staff are major issues. So are working conditions. Especially since all brands are growing at the same time. This acceleration has led to controversy and questions about how well growth is controlled. In October 2011, the Shenzhen municipal government began an investigation into poor working conditions at Gucci Shenzhen (limits on staff being allowed to use the lavatory, short rest periods, unpaid overtime). Gucci has fired several managers and promised a review of its practices (source: Beijing information).

Share of value added: are employees pampered?

Sometimes there are more than 12 months in a year	In addition to managers, who are largely incentivised to performance, most employees are pampered through various profit-sharing arrangements: bonus shares, profit-sharing based on the group's performance, contracts providing more than 12 months of pay per year (sometimes up to 15 months), etc. A decisive factor is the number of employees concerned by such programmes. Some groups focus such incentives on top management (e.g. Swatch), some on key people (see above), while others have a clear incentive and profit-sharing plan for all employees (e.g. Hermès). In the first two cases, the conditions are not particularly attractive to other categories of employees, with average wages, use of internships instead of regular work contracts, etc.

Health and safety: an issue under control?

An issue mainly in manufacturing, more acute for cosmetics	Among all occupations, headquarters, design, marketing, retail and support functions are low-risk activities. Only production activities (which are sometimes subcontracted) and cosmetics must be subject to particular attention. However, data provided by the groups does not enable differences to be determined between players or the risks to be assessed accurately.

Job level and location: positive trend on hiring and location in EMs

Sights on Asia, EMs and industrial capacity development

Retail expansion

Development in emerging markets entails a continuous increase in staff, and requires a focus on trained sales staff and marketing, but also purchasing managers, supply chain controllers and retail network expansion.

Development of industrial capacity

Development of industrial capacity to cope with rising demand is a second lever. The sector has low exposure to restructuring risk. Some players have announced an increase in their production capacity (e.g. LVMH). However, to date, for all competitors, we have no information on the location or nature of these investments.

Projected sales trend

In December 2011, our analyst Thomas Mesmin published a sector note entitled "2012: Don't stop the party… just turn down the volume", covering trends and pointing out robust demand in EMs and continuous retail implementation with an expected 10% organic growth. Market contractions, which are projected in Europe and likely in the US and Japan, are not expected to lead to headcount reductions. It should be noted that 10% sales growth does not necessarily correspond to 10% additional volumes produced; the product mix must also be taken into account.

Overview of labour policies: peer comparison

Burberry	
Key people	Programmes highly focused on key people: incentives and specific initiatives to retain key individuals; biannual talent reviews; succession planning; a leadership development programme and various share schemes. Executive compensation includes remuneration in shares and long-term shared-based incentives.
HR policies	We note attention to diversity, health & safety, and employee wellbeing. Far behind peers on disclosure, which does not strengthen confidence.
Job level and location	Positive trend on hiring, as for peers: 6,681 employees in 2011, up 19% vs. 2010. Job locations adapted to growing markets: R. of Europe 2,968 (44.4%), Spain: 430 (6.45%), the Americas 1,385 (20.8%), Asia-Pacific 1,733 (25.9%), RoW 147. Change in location of workforce in R. of Europe (+701), Spain (-462), the Americas (+100), and Asia-Pacific (+677).

Ferragamo	
Key people	Ferragamo declares that it is linking between individual performance and collective performance through its compensation system for a significant portion of its staff.
HR policies	The group was recently listed, and we note a lack of information on labour issues (policy, management, targets and results/data). However, the company claims that it aims to attach great importance to human capital (i.e. equal opportunities, professional development and training programmes, etc.). Otherwise, the company conveys its values through a code of ethics. We credit Ferragamo for its recent arrival on the stock market.
Job level and location	The company has 2,827 employees (at YE 2010) and a net job creation trend of +2% per year for over the past three years. Its international expansion, particularly in Asia, secures its resources.

Hermès	
Key people	Training (and management) is focused on Hermès's culture and sense of belonging: The IFH programme for top managers (60 in 2010), with a zoom on issues and innovation; for managers on behaviour and leadership (160 in 2010); integration scheme for new entrants (200): Hermès continuously shares its values and heritage with its staff. 500 sales people took courses at "L'École des Marchands d'Hermès" (the company's "merchant school") in 2010. We note a share plan for all employees (30 shares per employee for 7,662 people in May 2010), profit-sharing (EUR31m in 2010) with individual and collective variable pay, recognition and team-building events and trips. The tandem programme is dedicated to exchange of know-how for textile and leather goods craftsmanship. Specific training for versatility and excellence for artisans. The most advanced, among peers, on key people and profit and culture sharing gives confidence on strong human capital management.
HR policies	Like its peers, it has an ethics charter. Action plan for integration of differences (disability, diversity, dependence, equal opportunities) and partnership with social institutions (ESAT, support by working for the disabled and underprivileged). Commitment in H&S, particularly for manual workers and more broadly for manufactures.
Job level and location	At YE 2010, the group had 8,336 employees (up 3.8% vs. 2009) with 43% in production, 16% in support functions and 41% in sales, and a geographical split of 60% in France, 10% in the EU (outside France), 9% in Japan, 14% in Asia-Pacific (+17% vs. 2009, +168 employees) and 7% in the Americas.

Hugo Boss	
Key people	Managers: Long-term incentivisation consisting of a multi-year bonus awarded according to delivery on personal targets and fulfilment of pre-defined key figures: EBITDA before exceptionals and trade net working capital. This bonus is calculated conclusively and paid out after the end of FY 2012. If the amount of the outstanding payment in 2013 is negative, this must be repaid to Hugo Boss by the managing board member in question.
HR policies	Promotion of talent, performance-oriented compensation, promotion of work-life balance, support of employees' social involvement – Hugo Boss's HR policy includes a wide array of initiatives. The group also discloses information on diversity: about one in five of its employees in Germany has an international background. Women account for 61% of employees in the group. On a management level, roughly 45% of positions are currently held by women. Detailed reporting on HR policies and management gives confidence that this issue is under control.
Job level and location	At the end of FY 2010, the group had 9,944 employees (up 10% vs. 2009), with 43% (4,269) in industrial activities and 57% (5,675) in commercial and administrative activities – and a geographical split of 21% in Germany, 54% in the rest of Europe, 13% in the Americas, and 12% in Asia-Pacific.

LVMH	
Key people	Top management delegation prepares an Annual Organisational Management Review for mobility, talent development and succession planning. Enhanced plan in 2011 for three key categories of people: top managers, artisans, and sales people, notably in Asia, where seniority is essential. Implementation of an HR office in Asia (LVMH House) to face rapid development and especially to control sales advisors. Incentives plan with E&S criteria for 17,000 managers. In 2011, a mapping of professions, succession planning, and an apprenticeship plan for replacements of key artisans were presented at the top management level (Executive Committee), showing the issue's importance. LVMH reports competitors are seeking to recruit its trained and experienced people, and put out measures for retention. The disclosures on management of key people give a good level of confidence.
HR policies	Broad coverage of HR issues and extensive policies on working conditions and a rigorous code of ethics, and a code of recruitment (recruitment without discrimination, testing), disabled, mobility (between professions, between maisons), training: all the levers of consistent human resource management are activated.
Job level and location	83,542 people (at end 2010), up 8% versus 2009. 23% in France, 21% in the rest of Europe, 23% in the US, 6% in Japan, 22% in the rest of Asia, and 5% in RoW. Breakdown of staff consistent with the location of the production and sales network. The strong dynamics of the sector and the planned opening of sales points will set a positive trend in the next few years.

PPR Luxury	
Key people	Chairmen of group subsidiaries are remunerated based on the achievement of precise objectives, including CSR criteria. Many general initiatives to attract, promote and integrate talent, in particular through training programmes (UniverCity). The group also offers enhanced employee social benefits. Non-managers account for 82% of training undertaken in 2010. No particular visibility on sales people and craftsmen. Redistribution of profits is provided through profit-sharing and incentive schemes. The group wants to develop a leading position through PPR's talent mobility platform, according to its 2020 ambitions. We regret that it has no detailed HR reporting for the luxury branch, making impossible to assess this division separately.
HR policy	The group identifies training as a key CSR priority. It dedicated EUR23m to training in 2010, offering training courses to 38,716 employees for a total of 724,707 hours. The PPR Code of Business Practices also formalises the group's commitment to diversity issues (equal opportunities, employment of disabled people, etc.). Moreover, PPR has carried out internal audits to achieve SA 8000 certification (on working conditions). These factors, along with the usual HR initiatives, lead to a good level of confidence in PPR's HR policy, as it covers many key issues. We emphasise a high staff turnover level, with 28,662 hires group wide and net job creations of 2,793 (in 2010).
Job level and location	PPR employs 38,374 people (YE 2011, average FTE) vs. 35,581 (at YE 2010), with PPR Luxury grew by 1,739 employees from 11,803 in 2010 to 13,542 in 2011 (average FTE). The 2010 geographical split was 35% in France, 26.2% in the rest of western Europe, 19.6% in North America and 11.8% in Asia. In February 2012, the group confirmed strong momentum (25.7% sales growth in 2011) at its luxury division.

Richemont	
Key people	Performance management review and annual individual development plans are considered strategic, with a group performance management process (including compensation and rewards). Specific training programmes for managers. Internal mobility with transfers between maisons for employees. Support of the Creative Academy (Master's in Arts & Design) to facilitate integration of young talent. Training programmes with WOSTEP for securing the next generation of qualified watchmakers. Educational facilities in the US, the UK and Hong Kong (probably for sales people). We regret a lack of data to assess the intensity of the training effort. Likewise for share plans, compensation and benefits for managers and employees. Ageing of the workforce is managed with succession planning.
HR policies	Health and safety and wellbeing are based on OHSAS 18001, with 26 internal audits but data is not disclosed. Diversity (but only one woman on the 17-member board), ethics, equal opportunities and social dialogue are addressed through an Employees Code of Business Conduct. Some good practices in the maisons, but an unclear and imprecise overview and lack of data; despite an assured commitment, this leads to moderate confidence in HR policy.
Job level and location	21,600 employees (at YE 2010-11, March 2011), of which 60% in "Europe" (for the group, this region includes Africa and the Middle East), 26% in the Americas and 8% in the Far East (which includes Japan and the rest of Asia-Pacific), up 13% versus 2010.

Swatch Group	
Key people	Board of directors and senior management are eligible to incentive programmes, including variable compensation linked to performance, a "13th month" of pay, bonuses and stock options. The company encourages skills development and internal promotion. Sourcing for watchmaking and sales talents through Nicolas G. Hayek Watchmaking Schools. It selects students (56 in 2010) for a high level of training. Based on available evidence, Swatch does not have a complete programme for all categories of key people.
HR policies	Very general statement on HR policies as transparency is not Swatch Group's strong point. The group has adjustment capabilities of its activities, notably in Switzerland, developing the versatility of its staff, exchanges and transfers between production factories. Apprenticeships (326 in 2010) are developed to facilitate integration. In Switzerland, an effective network of schools and learning centres and various labour agreements are covered by a collective bargaining agreement for all kinds of watchmaking professions. The group accounts for 25% to 30% of Swiss horology headcount. Swatch fully benefits from its historical and geographical position. Strong competitive advantage through its verticalisation model. However, the apparent lack of transparency in non-financial (and financial) communication (including HR management, targets and data) should trigger a cautious view on Swatch Group.
Job level and location	The group employs 25,000 people, 53% of whom in Switzerland. Headcount was increased by 2,800 in 2011 (according to YE results). The group does not disclose the breakdown by country or worldwide activity. Positive trend, as for peers.

Tod's	
Key people	The lack of information about key people does not allow us to conduct any further analysis.
HR policies	Tod's declares that it is sustaining efforts to offer its employees the best working environment. The company states that it is the first Italian company to build a gym and a day care with qualified staff on its premises for the use of employees. Apart from this anecdotic information, a real lack of data about HR policy.
Job level and location	As of end June 2010, Tod's group had 3,102 employees. Between June 2008 and June 2010, the company created 359 jobs, of which 262 created in H1 2010. Most of these employees were used to build up the group's production structure to better respond to growing demand. The group has been a net employer since 2006 (workforce up 25%) and protected its sales, margins and headcount during the crisis.

SOCIAL ISSUES

Questioning values, social acceptance: Towards a social "licence to operate"

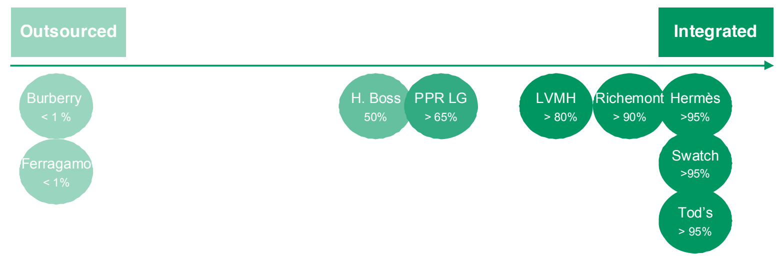
Supply chain, global policies

A key differentiating point between groups is their level of outsourcing. Therefore, this exposes some players to **reputational risks** (pollution, working conditions, etc.), which can severely tarnish their highly valuable brand image. Many NGOs monitor the sector, as demonstrated by recent reports (WWF's Deeper Luxury, FJA's Uplifting the Earth, Clean Clothes Campaign Reports involving luxury brands, etc.). This is **the major risk for the industry**. Increased sales add a requirement to maintain a high level of quality.

The higher the level of outsourcing, the stronger codes of conduct, specifications, clauses in purchasing contracts and overall audits must be. Controls must encompass E&S issues. We have largely developed this point in the supply chain section. From an investor's standpoint, only third-party audits should be considered with confidence.

INTERNALISATION / EXTERNALISATION OF PRODUCTION

Production: Estimated* level of integration



*Estimated input: outsourcing as a % of sales costs, % of production outsourced, industrial/production base

Confidence level: outsourcing

Poor	Poor +	Medium	High
First-party audit or any statement	Second-party audit	Third-party audit	Third-party audit and verification by auditors

Source: CA Cheuvreux

Apart from supply chain risks, we believe that social acceptance of the sector is not complete, and we note some disturbing signals.

Accentuation of the imbalance in wealth sharing exposes the sector to risk

The "Gini coefficient" (developed by Corrado Gini, an Italian statistician) measures the inequality of income distribution in a given country. Over the past 10 to 15 years, inequality has widened in most countries. According to the World Luxury Tracking (BCG and International Luxury Business Association), 40% of the global luxury market is driven by HNWI (high net worth individuals).

While the industry is not responsible for the widening of these gaps, it is a visible sign of the deepening of income disparities. Indirectly, social acceptance of the sector diminishes. Note that HNWI are not the sole clients. Brands have developed many "access products" for middle-class or upper-middle-class customers. Price segmentation of brands (see foreword) is another kind of response. Luxury is not being questioned, but the distribution of wealth is. And luxury can be a symbol of the these widening gaps.

Another possible confusion is respectability. In January 2012, in the basement of a luxury boutique in Italy, tax inspectors discovered goods worth EUR1.6m with no tax documentation. In the minds of many people, tax havens and tax evasion are associated with "rich people", even if they only concern a small minority. Once again, luxury goods businesses must be above reproach in order to avoid guilt by association.

Another notable phenomenon has occurred in China, where the government saw ostentatious displays of luxury as a danger to social stability. In March 2011, the Chinese government moved to ban billboards promoting a luxurious lifestyle due to concerns that endless advertisements are reminding people of the wealth gap. China issued regulations not to encourage a “foreign lifestyle”. Otherwise, the sector’s development in poor countries accentuates the perception of gaps.

Values conveyed by brands through marketing… and questioning reality

After the excesses of the “porn chic” period, (whose effect on sales was substantial), with many ads campaign banned (e.g. Gucci, Tom Ford, YSL, CK, D&G due to sexually explicit content), the sector has regained more public acceptance. There are still occasional ambivalent or sexualized messages. Huge marketing resources and pervasive advertising make people believe that the image is a reflection of society. This may accentuate feelings of frustration or the urge to consume.

Advertising under observation

However, advertising watchdogs are active in some countries. In the UK (July 2011) L'Oréal (Lancôme Brand) was forced to pull an ad campaign because of overly airbrushed images. Jo Swinson (a Liberal Democrat MP) has waged a long-running campaign against “overly perfected and unrealistic images” of women in advertisements and lodged complaints with the ASA (Advertising Standards Authority). L'Oréal admitted that the image had been “digitally retouched to lighten the skin, clean up makeup, reduce dark shadows and shading around the eyes, smooth the lips and darken the eyebrows”.

Any representation of reality?

Nevertheless, there is a more serious risk, as Jo Swinson has complained that images were “not representative of the results the product could achieve”. The same decision was taken (February 2012) in the UK, again regarding a L'Oréal campaign. To face the increased number of complaints and their scientific complexity, the ASA launched (in December 2011) a panel of experts in dermatology to settle disagreement between experts advising different bodies... In 2010, the ASA found that French design house Louis Vuitton was guilty of misleading customers with two advertisements depicting its “craftsmen” because the bags are not actually made by hand. Louis Vuitton argued the ads pay “homage to the craftsmanship” of its employees rather than providing an accurate depiction of the manufacturing process. In October 2011, the ASA issued a statement regarding “sexualised imagery” in outdoor advertising where children are likely to see it.

Complaints are easily filed

In the UK, anyone can complain to the ASA by filling out a very simple online form (according to the ASA’s 2010 Annual Report: 25,000 complaints, 7,000 of which are investigated). The same holds true for Australia or the US (Federal Trade Commission).

Primarily a cultural (or sociological) issue

However, while the UK leads, each country’s body has its own targets (e.g. Sweden and Norway ban outdoor ads targeting children). Anti-ad crusaders (e.g. Adbusters, the Dismantlers, and the Casseurs de Pub in France) have been less active in the recent years. On a sociological level, in her book *No Logo*, Naomi Klein analyses that, “For a growing number of young activists, breaking advertising is the perfect tool to assert their disapproval of multinationals, so aggressively hunted as consumers, and so hurriedly left in the lurch as workers”.

Marketing code of conduct, not an issue?

What is surprising is that none of the players has clearly identified marketing as a risk, despite the repeated controversies and other bans. Apart from local regulatory compliance and local marketing codes of conduct for professional associations, none of the groups have established a code for advertising and marketing. Nevertheless, in our view, **this is the second major issue.** Social/public acceptance of the sector is at stake. The example of China (see above, accentuation of wealth imbalances) reinforces its importance.

Brand enhancement through donations or moral obligation?

There is a definite proximity between luxury, with its prestige, and art. Furthermore, for some, wealth brings with it a form of moral obligation to communities and society, via a commitment to philanthropy.

For a few luxury goods players, this is directly connected to their core business (e.g. Hermès), while for others (e.g. Swatch), the approach is more marketing with the objective of supporting brands. LVMH is strongly committed to art and creation. Lastly, Burberry or PPR have chosen the path of donating to social charities.

These commitments need to be transparent in terms of the proportions and amounts invested (e.g. Burberry) to enhance confidence. Indeed, it is sometimes difficult to assess whether it is a real commitment or mere “window dressing”. But why would anyone be more demanding with this sector than with others? Unconsciously, because wealth is linked to generosity for most people. A rapid overview of initiatives:

- Burberry: 1% of profit before tax given to charitable causes (GBP3m); the Burberry Foundation supports disadvantaged youth via 17 charity organisations, helped by employees’ volunteering.
- Richemont: 1.4% of profit before tax given to the community (charities, sponsorship, education and citizenship).
- Hermès Foundation for the promotion of know-how / education / support for creation and design / and biodiversity (EUR18.45m when established).
- Swatch Group: local action organised by brands to support the brand image, but no overall philanthropic foundation (amount not disclosed).
- PPR Foundation for dignity and women’s rights. Social project with Cooperativa Montana Femminile for Bottega Veneta, for leatherworks and women’s integration, Girard-Perregaux supports the Andréa Bocelli Foundation against poverty or for overcoming barriers caused by illness and disability. The movie Home (produced by the GoodPlanet Foundation, working for sustainability) was funded by the group.

Tourism and shopping: supporting economies in mature markets

When foreign tourists arrive in France or Italy, they come to discover the country, but also plan to go shopping. According to the China Tourism Academy, Chinese tourists are estimated to have spent USD55bn abroad in 2011 (vs. USD48bn in 2010), with 65 million trips to foreign countries, including parts of China not on the Mainland (i.e. Hong Kong, Macao and Taiwan). 100 million Chinese tourists are projected in 2020.

According to Atout France (a French national organisation for promoting tourism), France is the leading European destination for Chinese tourists, ahead of Italy and Germany, with 550,000 visitors in 2009 and 1 million expected in 2015. 60% of their budget is dedicated to shopping, with an average spend of EUR1,200 per person per trip. Their preferred purchases are fragrances, leather goods, fine wines and spirits, and watches. According to another source, the budget for shopping is EUR1,700.

For France, Italy, the UK and Germany, the ability to attract shoppers is essential. Regardless of whether tourists are Americans, Japanese, Chinese, or from other origins, tourism provides strong support to mature economies and sustainable market development for luxury brands.

GOVERNANCE

Family stories… and minority shareholders blinded by stock performance

Almost out of the market's reach

With the exceptions of Hugo Boss and Burberry, luxury businesses are totally out of the market's reach, or at the very least have significantly low exposure to any influence from minority shareholders. Within the luxury goods sector, we can identify two types of control structures for companies: the first are companies with founding families that have maintained their holdings over time (e.g. Ferragamo, Hermès and Della Valle). The second type essentially comprises holding companies formed by a series of takeovers, strategic acquisitions or M&A moves (e.g. LVMH, PPR, Richemont and Swatch).

The luxury goods sector, compared to consumer goods in general, has on average much lower governance, but this is obvious given the type of control structure companies have in this sector, being mainly family controlled with low board independence.

Control within either structure is often maintained via double voting rights, classes of preference shares, or other mechanisms. Furthermore, this control is most often amplified by the lack of independence of board members, and as such, minority shareholders have very little leeway with regard to improving corporate governance.

The role of M&A in sector growth… and governance impact

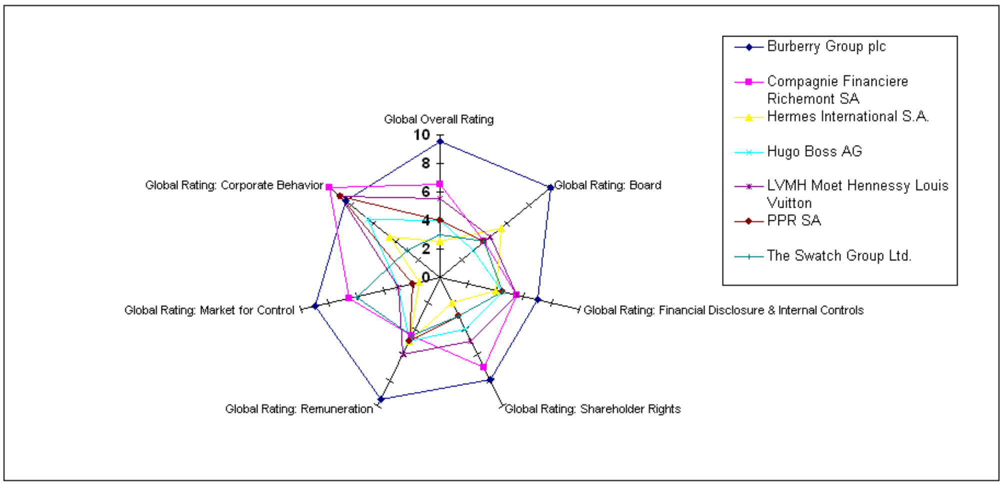
As our estimated sector growth split between organic and M&A points to the latter representing 20-30%, we wonder how this can be achieved while complying with best governance standards. The question of how an M&A scenario within such a controlled sector can be positive for minority investors, and whether they will get a premium for their control becomes paramount.

The entry of LVMH as a shareholder in Hermès in 2010 offers a pertinent example. Through the use of equity swaps, LVMH was able to purchase a 17% stake in Hermès at a significant discount to the share price. This allowed LVMH to out-manoeuvre the Hermès family, which had assumed that their corporate structure protected them from large external investors, while denying minority investors the opportunity to sell their shares at a premium to an investor clearly seeking to build up a strategic stake.

But lack of M&A discipline can lead to short-term value destruction. Over the past ten years, we have seen several acquisitions made after smoky or hostile operations, with high premiums paid. However, the strategic vision behind these M&A deals seems to pay in the medium/long term, with strategic integration into the brand portfolio and operational optimization, in the context of a rarefaction of brands with optimal notoriety and history.

Picking winners

For investors seeking to pick winners in terms of governance and performance, Burberry is the clear choice, significantly outperforming in the seven governance areas measured by GMI, with the only exception being corporate behaviour.



Key figures

For each company, the control mechanisms should be analysed in detail. Here is a simplified overview of key figures.

Company	Fair voting rights	Board independence	Controlling shareholder	Family control (shares / voting rights)	Free float (%)
Burberry	yes	yes	no		100
Ferragamo	yes	yes	yes	Ferragamo (69%)	25
Hermes Intl	no	no	yes	Dumas-Puech-Guerrand (62.8% / 74%)	4.3
Hugo Boss	no	no	yes		12
LVMH	no	no	yes	Arnault (47.64% / 63.66%)	49.9
PPR	no	yes	yes	Pinault (40.7% / 56%)	59.3
Richemont	yes	no	yes	Rupert (9.1% / 50.02%)	90.9
Swatch group	no	yes	yes	Hayek (21.8% / 41.6%)	74.4
Tod's	no	no	yes	Della Valle (56.7% / 56.7%)	34.2

PART II: MATERIALITY PROTOCOL

REGULATION

Hard Law

"Made in": an issue for brands in terms of cost price. Above all, a political issue….

Key takeaways: protectionist temptations can lead to increased costs

- Risk on supply chain (capex) and cost price, if countries decide to implement stricter made-in regulation: there are a few projects in this direction, notably in Italy and Switzerland.
- All countries all affected by "nation branding", few have consistent branding
- The "made-in" issue is mostly related to the idea of origin rather than a customer requirement: brands crush the idea of origin

Does the "Made in" concept nurture brands?
Tradition and history nurture brands, but "made-in" regulation may be a challenge for business. But it is mainly one for countries; it could be a way to preserve or create jobs, or to raise invisible protectionist barriers. Or, for a limited number of countries, it may be a quality label, a support for sales and exports… How might luxury brands be affected? Clearly in terms of cost and sourcing, but, above all, on trust in the brand.

In a May 2010 report for the French President entitled "Stopping anonymous globalisation: traceability to serve consumers", French MP Yves Jégo wrote that, "There is no legal basis in the European Union with regard to this issue. The 'made-in' concept is not defined, it is optional and difficult to control. This imprecision benefits impostors". This quote illustrates the high political sensitivity of the subject. Policies in all countries are driven by the desire to enhance consumer information, encourage consumption of local products, and support local manufacturing. This is further supported by a current sociological backdrop in most European countries, and there has been a growing number of protectionist movements.

Nation branding power
Three examples: 1) Anholt-GfK Roper publishes an annual Nation Brands Index, based on a global survey (20,500 respondents, in 20 countries). It ranks the global image of each country based on various criteria of attractiveness. In 2011, the US is No. 1, Germany No. 2, UK No. 3, France No. 4, Japan No. 5, Canada No. 6, Italy No. 7, Australia No. 8, and Switzerland No. 9. 2) According to the Swiss Federal Institute, the "Swiss made" image can represent 20% of the sales price. 3) A study by the renowned engineering school *École des Mines de Paris* claims that 26% of French exports benefited from their French origins.

Issues and made-in concerns in four countries (Switzerland, France, Italy, Germany) and in EU:

Switzerland: leading made-in concerns
According to the Swiss Watch Industry Employers' Federation (CP), this industry employed 48,000 workers in 2011 (down 1.1% vs. 2009) in 596 companies (down 2.1% vs. 2009). The total industry exports totalled CHF16.2bn in 2010 (CHF17.4bn at 11m-2011, up 19%). Since 1971, a ruling frames the "Swiss made" issue, it is currently subject to much debate. However, Switzerland implements what is called a "nation branding" strategy.

Currently, a watch may carry the indication "Swiss made", "Switzerland" or any other expression containing the word "Swiss" or its translation only if it is Swiss.

- Swiss watches: According to the Swiss Ordinance (Section 1a OSM), a watch is considered as Swiss if it meets the following criteria: the movement is Swiss, the movement is cased up in Switzerland, the final inspection is carried out by the manufacturer in Switzerland.

- Swiss movements: Moreover, in that ruling (Art. 2 OSM) a movement is considered Swiss if it meets the following criteria: that it was assembled in Switzerland, which was controlled by the manufacturer in Switzerland, that is made in Switzerland for 50% or more of the value of all component parts, but without the cost of assembly.
- Swiss assembly: Finally, if the movement fulfils these conditions, but the watch is not assembled in Switzerland, the indication "Swiss" will then be displayed on one of the components of the movement. The outside of the watch will include the inscription "Mouvement Suisse" or "Swiss movement". The ruling (Art. 3 para. OSM 3) requires the word "movement" to appear in full and that it is identical in type, size and colour to that of the name "Swiss".
- Swiss parts: Definitions also govern the "Swiss made" indication for bracelets, boxes, quartz movements, spare parts and clocks.

"If a client learns that French Bordeaux contains Chilean wine, he will feel cheated because the designation of origin will not match anything at all. For the Swiss made, it is the same." The image chosen by François Thiebaud, head of Swatch Group brands Tissot, Certina and Mido is very illustrative. At present, a watch labelled Swiss made might have almost all of its components made in China…

Noting the inadequacy of this ruling, the Swiss government plans to raise the threshold for local integration. Two competing views.

- A new regulation proposed by the government and supported by the Swiss Watch Industry Federation (FH) requires that 60% of the entire production cost of a watch lies in Switzerland. At the same time, designing and prototyping models must be carried out within the Helvetica Confederation. For the FH, this project is seen as an intermediate step to increase this percentage to 80% for mechanical watches. The proposal is supported by prestigious brands such as Bulgari, Dior, Tag Heuer (LVMH); Cartier, Roger Dubuis, Vacheron Constantin (Richemont); Girard-Perregaux, Boucheron, Gucci (PPR); and Balmain, Blancpain, Certina, Mido, Jaquet Droz, and Tissot (Swatch group).
- However, IG Swiss Made comprises 25 watchmakers opposed to the project (Mondaine Watch, others not disclosed) and advocates the status quo. It believes that the project would be counterproductive to medium and low-end watch segments with respect to cost price (a massive increase in costs), damage Switzerland's competitive position, and result in the loss of thousands of jobs. According to IG, it would impact relations with the EU and China. Furthermore, IG calls for compliance with the treaty that was signed with the EU (1971) and never respected in practice by EU authorities.

To compensate for the faulty ruling, the industry has created **three quality labels**:

- The SOCC (Swiss Official Chronometer Control) or COSC (Contrôle Officiel Suisse des Chronomètres). Created in 1973, it measures and controls movement precision.
- The Geneva Seal (*Poinçon de Genève*) is now 125 years old. Featuring three admission criteria and twelve techniques rigorously reworked over the decades in response to changes in the profession (1891, 1931, and 1955), the Geneva Seal is granted only to movements assembled and adjusted in the territory of Geneva and thus by watch companies headquartered in the Geneva Canton.
- The newest label, Fleurier Quality (*Qualité Fleurier*), which was introduced in 2001, attests to global quality criteria.

EU: a framework consistent with WTO rules, but with varying interpretations

According to the Community Customs Code (Art. 24) "Goods whose production involved more than one country shall be deemed to originate in the country where they underwent their last, substantial, economically justified processing or working in an undertaking equipped for that purpose and resulting in the manufacture of a new product or representing an important stage of manufacture." The three criteria used: 1) change of tariff heading (CTH); 2) added value (country with the highest **share of added value, at least 45%,** but varies from one product to another); and 3) specific processing.

France: a heated political debate

In France the debate is essentially political, and fuelled by the upcoming presidential elections. The Jégo report (see above) points out the inaccuracies of current regulation be it French or European. A recent bill adopted by the National Assembly (*Strengthening the rights, protection and consumer information*, Dec. 2011), specifies the conditions for using "origin" and "geographical indications" and "appellations of origin", particularly in the code for industrial property. Remember that the current law set **45% of added value** as a criterion for using "Made in France". A new label "France guaranteed origin" increases the threshold to at least 50% of unit costs + the product gains its essential characteristics in France. But let's be clear, for luxury, "French brand" or "French lifestyle" is more rewarding than "Made in France". For luxury goods, **brands crush the idea of origin**.

Italy

Numerous recent initiatives, including a law (No. 2624, approved by the parliament in March 2010, applicable in October 2010) to mandate the use of a "Made in" indication in the textile, footwear and leather goods sectors. The use of the "Made in Italy" label would be permitted for products for which most of the manufacturing steps took place in Italy, even if raw materials are imported. Note also Law No. 2260 on the traceability of products made with precious materials and Regulation 166/2009 on the “100% Made in Italy” label. Moreover, there are numerous penalty schemes for abuse. Confusion is rampant, but Italy is very committed and consistent with regard to achieving its objectives, protects its "made in" label, and lobbies the European Commission. Many players want decisions to be taken at the European level.

Germany

No local legal definition of "made in", only the EU framework and rules defined by jurisprudence. Example: designed and prototyped in Germany but manufactured abroad can't be labelled "Made in Germany".

The views of professional organizations

The French Colbert Committee argues that 90% of revenues come from exports and therefore that made-in labelling should be mandatory. The Committee considers that to calculate the share manufactured in France (EU rules, 45%), "the specific working" should include research and design. Finally, the Committee estimates that some luxury companies consider that their brand is qualification enough for export and more efficient than a designation of origin.

Italian body Alta Gamma believes that consumer protection is primarily due to the brand and not manufacturing conditions.

Who cheats with the "Made in" label?

Impossible to know. But it is public knowledge that Sellita Watch SA buys its movements in Switzerland, puts together the entire collection of "Made in China" parts in China, and imports them to Switzerland for assembly. This company does not reveal the name of its customers. This would expose those unknown brands and their schemes.

Jewellery

REACh: The European Commission has banned the use of cadmium (heavy metal, carcinogenic) in all jewellery products as of January 2012 (does not apply to articles on the market before 10 January 2012). Cadmium has been used in jewellery for alloys, solder, gold coating, pigment and stabilizer. According to an EU report (*Impact of Restrictions*, April 2010), high concentrations of cadmium appear to be associated with costume jewellery imported from non-EU countries. Based on currently available information, the EU ascertains that regulation would result in higher costs for non-EU jewellery makers compared to EU companies. In the absence of detailed alloys composition data (industrial property) and processes, it is difficult to assess the extra costs and implications for European brands.

Cosmetics

Cosmetics directive: Cosmetics is particularly governed by regulation (Cosmetics directive No. 76/768/CEE and seven amending acts). It defines the banned substances, and gives a list of colouring agents, preservatives and UV filters allowed, as grouped in the EC's Cosing database. The directive also specifies details of packaging information and manuals for consumers.

Animal testing: The ban on animal testing, introduced following pressure from environmental or animal welfare NGOs, is to a certain extent questionable on scientific grounds. Although scientists, industries and regulators have developed alternative methods of testing (EU 2010 report on alternative test methods: *in silico*, *in vitro*, QSPR predictive models, etc.) for toxicokinetics, bioaccumulation, and metabolizing analysis, many experts consider that testing should require the use of animals under controlled conditions. Moreover, animal testing is largely used for REACh substances and continues to expand (e.g. French toxicology research body INERIS is building a animal testing laboratory in Northern France). This is a peculiar paradox related to stakeholder pressure. Many scientists consider that for cosmetics, alternative methods are insufficient in number and coverage.

Starting in 2013, EU Regulation No. 1223/2009 (known as the 8th Amendment) will replace the Cosmetics Directive. With regard to animal testing, the EU will end (on 11 March 2013) a derogation from the ban on placing products on the market in order to test repeated-dose toxicity, the effects of certain substances on reproduction and to study toxicokinetics. This prohibition applies regardless of the availability of alternative test methods. The animal testing issue is sensitive and many NGOs are at work, notably Leaping Bunny (coalition for consumer information on cosmetics) or One Voice (for a planet and animal ethics). Furthermore, the end of animal testing encourages companies to develop alternative methods (in vitro skin), like Episkin (L'Oreal).

LIABILITIES

Concentration in watch industry: a potential capex effect

Swatch's dominant position under scrutiny
Concentration of a limited number of groups heightens the risk of legal action by the competition authorities. Swatch Group has been under scrutiny by the Swiss authorities (the Competition Commision, or COMCO) since June 2011, given its dominant market position in mechanical movements and watch components. Provisional measures ordered by the COMCO require Swatch Group to fully deliver third-party clients. In 2012, Swatch Group will reduce the supply of mechanical movements to 85% of the quantity purchased in 2010 and 95% in assortments. This staggered decision should compel competitors to gradually invest in production capacity to reduce "Swatch dependency", either by acquisitions (e.g. Artecad for LVMH) or by capacity investments.

Dependent on Swatch?
All watch manufacturers are directly or indirectly dependent on Swatch, given its market share (up to 90% on some components). It's difficult to measure to what extent. However, groups are working to master the most strategic parts.

An unlawful agreement to maintain price levels?

Two cases highlight the means used by competitors to maintain high selling prices and margins in an increasingly competitive world, strengthened by brand stretching.

Switzerland: The COMCO opened an investigation (Nov. 2011) into the association of manufacturers, importers and suppliers of cosmetics and perfumery (ASCOPA) and its members following self-denunciation of one of the companies involved. Richemont, LVMH (Dior, Bulgari), PPR (YSL) are implicated. Following the notification, exchange of prevailing information is prohibited. Companies have not been convicted.

France: The Paris Court of Appeal recently confirmed (Jan. 2012) a decision by the French competition authority (2006) on an unlawful agreement between fragrance suppliers and distributors. The latter imposes fines totalling EUR45.4m on 13 companies selling luxury cosmetics or perfume brands through three national distribution channels, notably: LVMH (Guerlain: EUR1.7m - Christian Dior fragrance: EUR2.2m – LVMH fragrance brands (Givenchy, Kenzo) EUR769,000 – Sephora: EUR8.3m); Hermès

(Comptoir nouveau de la parfumerie (Hermès): EUR310,000; and PPR (Yves Saint Laurent fragrance): EURM1.8m.

These two instances illustrates the brands' ability to durably maintain higher prices and margins. This point of view is reinforced by the widespread use of brand stretching. Note that for a major perfume launch, the cost of a marketing campaign (creation, media-buys, POS, tester, etc.), at European scale is estimated at EUR30m to EUR120m.

As an example, in France, according to TNS, amounts spent on recent (2011) media-buy campaigns are estimated as follows: *Dahlia Noir* (Givenchy): EUR9m; *Loverdose* (Diesel): EUR8.5m; *Baiser volé* (Cartier): EUR7.8m; *Cand*y (Prada): EUR6m; *Le parfum* (Elie Saab): EUR5.5m; *Kokorico* (Jean Paul Gaultier): EUR6.5m; *J'adore* (Dior): EUR27m; *Shalimar* (Guerlain): EUR18m; and *Parisienne* (Yves Saint Laurent): EUR14m.

Counterfeiting: A prime target

Counterfeiting accounts for 5-7% of world trade, according to the OECD, while the Colbert Committee estimates it at 10% globally. It concerns many areas of industrial production: pharmaceuticals, autos, aerospace, textile, software, movie, paper, luxury, etc. In a few decades it has shifted from being 'a cottage industry', to industrial, regional and global scale, not just luxury goods but all consumer products. Counterfeiting is now carried out by well-organised criminal networks rather than isolated groups. Counterfeit products are becoming more difficult to spot, and their flow in Europe is constantly increasing, driven in part by the advent of Internet sales.

Multifaceted counterfeiting

Counterfeiting involves numerous products, manifold countries of origin/provenance (goods seized by European authorities in 2008: China 55%, UAE 10%, Taiwan 10%, but also Japan, India, Turkey, Syria, etc.), and all types of distribution channels (the Internet, markets and fairs, on the black market, convenience stores, discounters, private deals, etc.). People buy a counterfeit product for the price (cheap), appearance (a good imitation) and the brand (product I could not buy for myself any other way).

More and more difficult to detect

Tackling counterfeiting is strategic for the luxury goods industry, especially when counterfeit products are more and more difficult to detect and differentiate from genuine items. This struggle requires considerable expenditure.

Direct and indirect costs of tackling counterfeiting

- Direct: house team of lawyers and expenditure, counterfeiting investigators, legal action, destruction, anti-counterfeiting campaigns, integrated traceability systems, discreet and innovative signs of recognition (tags, optical tags), cost of certificates and controls, and of course intellectual and industrial property (trademarks, patents).
- Indirect: impact on sales, on brand image and product renewal cycle.

Does counterfeiting affect sales?

Marginally. According to the players, a customer with purchasing power always prefers the original to a copy. Exceptionally, an "uninformed" customer will be seduced by a vendor who sells him a fake. However, LVMH declares that, "Counterfeiting and parallel distribution has an immediate adverse effect on sales and can gradually damage the image of the products concerned", without being able to quantify the damage precisely.

What are the issues behind counterfeiting?

The first issue relates indirectly to brands. Counterfeiting is associated with poor working conditions, health safety problems, child labour, and the financing of organized crime. Tackling counterfeiting amounts to a fight against illicit financing and the protection of vulnerable people. Brands also don't want their products to become commodities. Finally, it is crucial ensure the products have a warranty certificate, as this is essential to secure investment and the possibility of resale, especially for watches and jewellery. To achieve this, brands have developed expensive and undetectable systems (e.g. nano-optical marking) and various quality labels (e.g. Swiss watch industry) or warranty labels on precious metals (e.g. hallmarks and controls for gold, silver, platinum, gold vermeil etc. from French control bodies and other EU countries).

How effective are public policies?
The OECD leads projects on counterfeiting and piracy. The organization describes the fields of counterfeiting, its networks, consequences and means of action and acts in conjunction with the WTO. The EU recently signed ACTA (anti-counterfeiting trade agreement), which aims to establish international standards for intellectual property rights enforcement and a legal framework for targeting counterfeit goods, and copyright infringement on the Internet. EU national customs authorities have noted that counterfeit goods entering the EU tripled between 2005 and 2010. To date, the trend does not seem be abating. ACTA has been submitted to the European Court of Justice for a ruling as to whether it is compatible with the EU's fundamental rights and freedom.

Players' initiatives

- In France, the biggest brands (e.g. Cartier, Hermès and Louis Vuitton) have formed the Colbert Committee to coordinate their actions and relations with authorities. It is particularly involved in campaigns against counterfeit goods, lobbying national and international regulatory authorities and working with customs authorities, the courts, the French industrial property body (INPI).
- In Italy, Alta Gamma (members are Fendi, Gucci, Ferragamo, Tod's, etc.) endorses a similar role.
- Each maison has established an organisation and resources from detection to destruction. The conviction of eBay, under the impetus of Hermès and Louis Vuitton, is one example of success in this area.

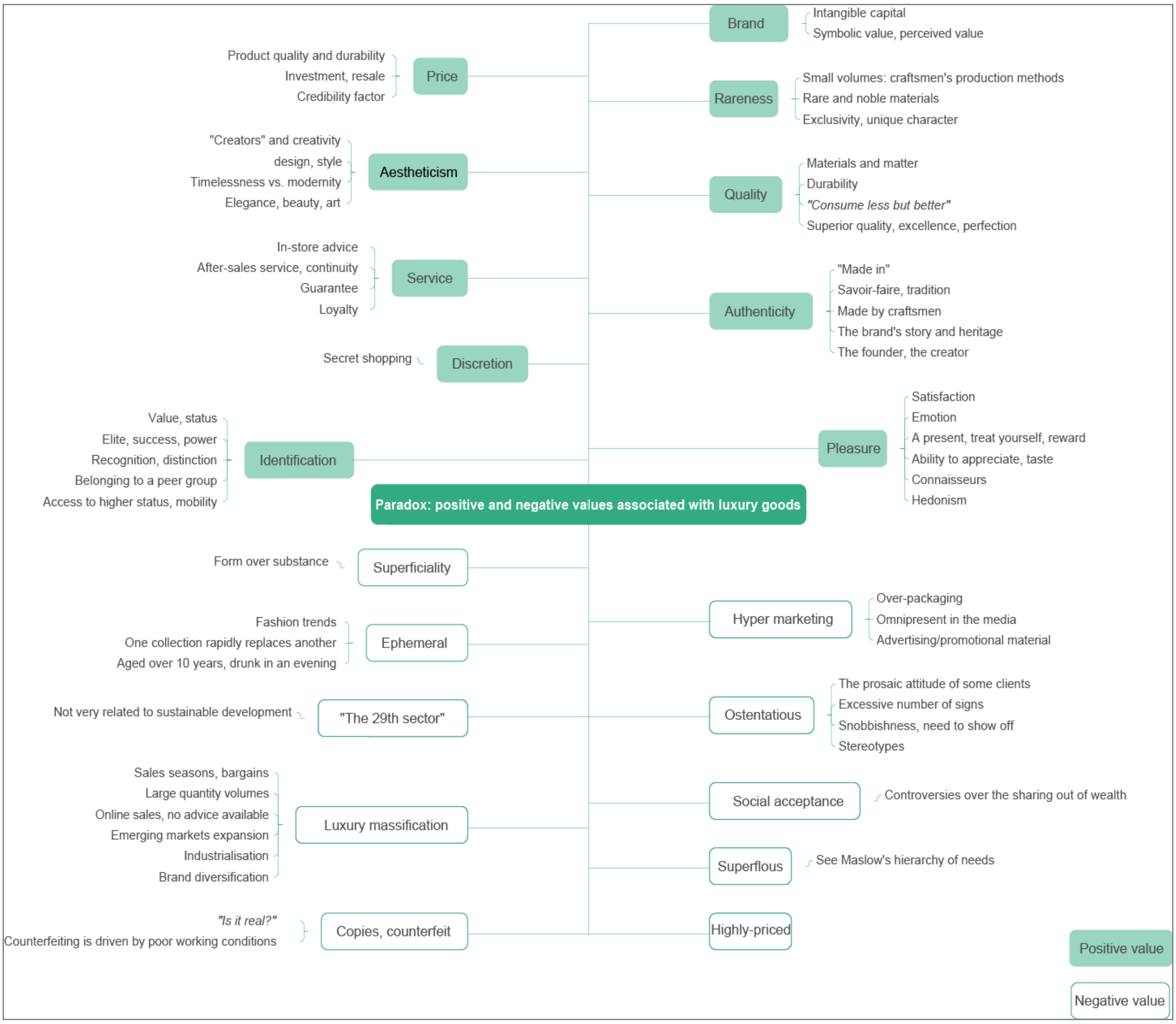
REPUTATION

Luxury brands: a paradoxical paradigm

According to Patrick Thomas, CEO of Hermès, "The luxury industry is built on a paradox: the more desirable the brand becomes, the more it sells. But the more it sells, the less desirable it becomes". For brands, abandoning a high level of product quality, the use of rare materials or an exclusive service would be anathema. Any controversy has to be nipped in the bud. Creating a globally recognized brand takes decades and hefty investment. In most cases, brands are more than fifty years old. Just a few days would be all that's needed to wipe out this heritage.

From a social point of view luxury is not just linked to positive values. In the following mind mapping, we highlight these paradoxes.

POSITIVE AND NEGATIVE VALUES ASSOCIATED WITH THE LUXURY UNIVERSE



So precious brands…

Masstige: many risks but solutions

The main risk faced by the sector is "masstige", or downward brand extension (i.e. prestige for the masses). If volumes are high and there are an increasing number of outlets everywhere, the sector become more like a mass-market industry. The more it is a mass industry, the more it will be exposed to various risks, and be subject to NGO and social pressure. And finally, the more accountable it will become. Groups have several levers:

- Maintain scarcity and exclusivity. At Hermès, for example, orders for the iconic Kelly or Birkin bag will only be taken three days per year and these days are not known in advance. Only at the last moment. Thus is enough to ensure the one-year's production given the level of raw materials and human resources. This scarcity builds high pricing power.
- Portfolios with price brand segmentation. Like LVMH (for Champagne) or Swatch. Indeed, a customer will accept semi-industrial production for entry-level luxury (e.g. EUR250 for watches) but not for a prestige brand (more than EUR10,000).

Brand stretching and ESG factors

Historically, brands are associated with a specific product world. Ferragamo with shoes, Louis Vuitton with luggage, Burberry with gabardine, Omega with watches. Many of them have gradually extended their product lines. Either horizontally (RtW, LG, SLG, Acc, Watches, Jewellery, etc.) or vertically (price segmentation, from prestige to basic ranges). These extensions create strategic risks (loss of identity, commoditisation, etc.). They are all opportunities for brand development, either through integration of production capacity (capex, the least common) or by sub-contracting or purchase/resale, or by licensing (revenues through royalties, without capex or opex). These diversifications are not always successful (e.g.: Omega reworked its fine jewellery strategy in 2010). All brands are moving in the same direction, by strengthening the competition. From an ESG point of view, brand stretching raises questions of mastery of origin and quality: new suppliers, new businesses (expertise), generating new reputation risk. And therefore third-party audits of the supply chain, etc. Note that **integration** can be a risk for small players, as it would require high investment (opex and capex) and could put the business model in danger in the event of a slowdown. It can also reduce the production capacity or adaptability. **Externalisation** can also be a risk when it is not secured on a permanent basis. In all cases, the major question is the safety of the supply and production chain.

The risk of betraying the brand promise: towards overheating or congestion?

While some brands communicate on tradition, country origins and manual skills, they in fact industrialise and relocate production. The industry continues to invest massively in marketing. Several phenomena will be observed in the coming years, including brands' ability to:

- Maintain an image of scarcity, exclusiveness, and handmade goods even though most products are industrially produced and in large quantities;
- Face controversies or bans on marketing (see the section above on social issues, advertising in China, ASA in UK) and maintain their social acceptance;
- Master higher exposure to risks in the supply chain, given brand stretching, increased subcontracting, purchasing and production in Asia, rapid development of footprints and sustained demand;
- Maintain quality (November 2011: controversy in China due to the declining quality of luxury brands, involving Gucci, Burberry, Dior and Louis Vuitton).

One of the risks is to become a brand "like any other" and to find it increasingly difficult to justify price differences, unless it provides high-level guarantees on environmental and social issues. This will become a tougher issue. 130 brands, moving in the same direction, create risks of overheating and congestion. Note the example of Toyota, which, by expanding too rapidly, lost its differentiating criterion: Quality. It will probably take three to five years for the group regain its title as the world's leading carmaker (or it may never do so).

Sustainable development: shatter the dream or nurture the brand?

Could sustainable arguments (e.g. ethics, environment) nurture brands? The influence of brands on consumption patterns and society's values is particularly strong. With huge investments in marketing and advertising, luxury sets the standards for ideal and unattainable beauty (often Photoshopped). It shapes the "must have". Brands have an added responsibility towards society. A rapid look at ads can highlight the arguments used: "Founded in…" harks back to history and tradition; "Fine Jewellery" is a key word for excellence; "Paris, Roma" refers to roots and origin; "Swiss" is a synonym for quality; "Enjoy responsibly" (for Champagne) is a nod to health and safety, etc. But examples are few and far between. Browsing internet sites is a way to measure how brands highlight or use sustainable features.

E&S ARGUMENTS AS SEEN ON BRAND WEBSITES

Group	Brand	Website	Path to CSR
Burberry	Burberry	uk.burberry.com	Foudation / Fourndation & Charity Partners
Hermès	Hermes	usa.hermes.com	No information on CSR
Hugo Boss	Huga Boss	hugoboss.com	Company / Sustainability
LVMH	Chaumet	chaumet.com	Our philosophy / Our committment / RJC cert or A responsible jeweller
LVMH	Bulgari	en.bulgari.com	Philanthropy / Save the chlidren
LVMH	De Beers	debeers.com	Home / Art of Diamond / Beauty of Diamond / Peace of mind / Ethical
LVMH	Moët & Chandon	moet.com	Enjoy responsibly / Above 21years old required
LVMH	Marc Jacobs	marcjacobs.com	No information on CSR
LVMH	Guerlain	guerlain.com	No information on CSR
LVMH	Louis Vuitton	louisvuitton.com	Journeys / Values / Sustainability or Philantropy
PPR	Gucci	gucci.com/int	World of Gucci / Think and act / Foudation or environment or Unicef or arts or philanthropy
PPR	Bottega Veneta	bottegveneta.com	No information on CSR
PPR	Stella Mac Cartney	stellamccartney.co.uk	Stella's World / Charity - Green Me
PPR	YSL	ysl.co.fr	L'Univers YSL / Fondation Pierre Bergé YSL
PPR	Girard-Perregaud	girard-perregaux.ch	No information on CSR
Richemont	Cartier	cartier.co.uk	Tell me / Excellence / Commitment / responsible jeweler or women's intitiative award or foundation
Richemont	Montblanc	montblanc.com/en-US	No information on CSR
Richemont	Dunhill	dunhill.com	No information on CSR
Richemont	Piaget	piaget.com	Ethics and Environment / Raw materials (RJC or KPCS, Cites) or Enviromentaml impact or Good citizen
Salvatore Ferragamo	Ferragamo	ferragamo.com	No information on CSR
Swatch group	Balmain watches	en.balmainwatches.com	No information on CSR
Swatch group	Blancpain	blancpain.com/en/	No information on CSR
Swatch group	Jaquet Droz	jaquet-droz.com	No information on CSR
Swatch group	Longines	longines.com	No information on CSR
Tod's	Tods	tods.com	No information on CSR

Each slash (/) represents the click to the next page — Source: Websites, February 2011

On this point groups often have a "schizophrenic attitude" to developing sustainability. Their reports demonstrate the range of their commitment, as some report on part of this action at group level and say nothing (or very little) at brand level. They probably think that it is not a criterion for the consumer when making a choice, or that it could destroy the vision provoked by the brand or the emotional value when purchasing.

Groups could take a sustainable approach by contributing to consumer empowerment, accountability and awareness on ethics and environment. What could the next steps be for brands? To date, ethical values are most often hidden, not part of marketing argument.

The absolute necessity for total control of the supply chain…

At the risk of repeating ourselves, the first lever to controlling brand reputation is to internalize most of the manufacturing and retailing. We have highlighted environmental and social issues and the remaining risks on precious metals, gemstones, leather, and textiles.

There is a fundamental choice for companies: be a luxury manufacturer or a luxury distributor. In all cases shaped with a high level of control of ESG factors on supply chain and raw materials.

New threats near you?

Some European countries are exposed to new threats. In Italy, the advent of "Chinese Italy" has created controversy. An estimated 40,000 Chinese people, many of which are illegal immigrants, work in the city of Prato in Tuscany. There are about 4,000 Chinese companies there. 152 were controlled by customs police in 2010, and all 152 were in breach of the law. In 2009, 985 illegal workers were questioned by police, and seven were forcibly repatriated. Textiles come from China at very low cost (58 cents per linear metre vs. EUR4.50 for Italian products). It's "Made in Italy". Observers say it's modern day slavery. For local politicians, the area must rid itself of illegal operations. Similar cases are recorded in Spain.

Once again, this reinforces the need for perfect traceability, including in mature countries. Are there any brands exposed to "Chinese Italy"? What will become of "Made in Italy"?

Upcoming saturation?

In terms of worldwide retail implementation, saturation or the end of expansion is on the cards. Brand coverage has already expanded from tier 1 to tier 2 and even tier 3 cities. Profitability in smaller towns is uncertain. We consider that 450 DOS (directly-operated stores) worldwide is the threshold. The most advanced brands are set to have already completed their retail coverage. For others, depending on the maturity of development and the kind of products, it will take five to ten years, with potentially a further five to ten years for sales development. For 130 brands? With brand stretching?

INTANGIBLE CAPITAL

Amazing brand capital

According to specialised agencies (Interbrand, Brandz/MillwardBrown), luxury brands benefit from an amazing reputation and considerable intangible capital. Brand valuation methodologies are grounded in both quantitative customer research and financial analysis. Renown and brand image capital are powerful drivers for development.

	Interbrand*		Millward Brown*		
Brand	WW Rank	Value (M$)	WW Rank	Rank among luxury brands	Value (M$)
Louis Vuitton	16	23,172	26	1	24,312
Gucci	39	8,763		3	7.449
L'Oréal	40	8,699	46	n/a	15,719
Hermès	66	5,356	71	2	11,917
Cartier	70	4,781		5	5,327
Tiffany & Co	73	4,498			
Moët & Chandon	77	4,383		8	4,570
Armani	93	3,794			
Burberry	95	3,732		10	3,379
Chanel				4	6,823
Hennessy				7	4,997
Fendi				9	3,422
Rolex				6	5,269
Hugo Boss					2.445

* 2011 estimates

The methods used are not relevant for financial analysis. In acquisitions, EV multiples are common (EV/EBIT, EV/Sales). However, they qualify the importance of brand equity.
Brands cannot afford any controversy. Brands understand this issue perfectly. Decades are spent building strong brand capital that could be tarnished in just a few days. Preserving brands and reputation is highly strategic, but one must wonder if everything is under control. Nevertheless, controversies are marginal and dealt with immediately. Gucci

understood this when it was challenged by the Clean Clothes Campaign report back in 2008 — the group responded by setting up a comprehensive and ambitious plan for its 2,000 suppliers (more than 2,700 audits for the PPR Group in 2010).

All recent examples show that brands react very rapidly to crises. The **mastery of crisis management** is undoubtedly a strength. Upstream mitigation or elimination of risk is always the best choice.

An attractive "employer brand", but what happens inside?

The four dimensions of the brand must be taken into account: product/brand, and company/institution (corporate). The employer brand is part of the corporate image. One of the strengths of maisons is their ability to draw talent.

Universum issues a series of Ideal Employer Rankings. In its 2011 Student Survey for France (200,000 respondents worldwide), which reveals how students perceive organizations as employers, LVMH holds the No. 1 spot with PPR No. 18. In Italy, Armani was No. 4, LVMH No. 11, and Bulgari No. 15. In Germany, Hugo Boss was No. 29. In all local surveys, brands have once again a strong appeal for new talents. The Trendence Graduate Barometer gives similar results.

Inside view or outside view?

Conversely, no luxury groups have been awarded the "Top Employers" label (in 14 countries, the Dutch CRF institute). In this research, HR management of the participating organisations is assessed. The Dutch Ministry of Economic Affairs states that Top Employers Certification is 100% reliable. No companies appear in the US's "Fortune's 100 best companies to work for" list (ranking with registration), nor on Great Place to Work Institute's 2011 list of "25 Best Multinational Workplaces" for Europe, Italy or its "World's Best Multinational Workplaces list. From an investors' perspective, a released internal survey or a third-party external survey (with registration) would held them understand the internal climate. The luxury sector would benefit from offering assurance on this point.

Sector intangible assets

- Control of brand image
- Complementary nature of the brand portfolio
- Control of the sales network
- Human capital: importance of talent management

Stakeholders' views

- "The 29th sector" in terms of perception sustainability: in marketing studies, for individuals, the luxury sector is the penultimate out of 30. Finance is at the bottom of the list.
- WWF-UK's *Deeper Luxury* report points to poor commitment
- Fair Jewelry Action (FJA)/Lifeworth Consulting's *Uplifting the Earth the ethical performance of luxury Jewellery brands* report shows there is room for progress
- The Clean Clothes Campaign denounces the practices of the garment industry with respect to poor working conditions and calls many brands into question.

CONSUMER SHIFT

Cosmetics

Green products: strong momentum but players watch the trend

Strong momentum

Between 2005 and 2010, green sales in the EU rose 30% p.a. on average (Source: Eurostaf). In 2007, the market for conventional cosmetics represented EUR200bn while bio cosmetics represented EUR4.75bn or 2% of the market. In 2009, bio products totalled EUR2.9bn, and this increased to EUR6.7bn in 2010 (sources: Kline Group, Mintel, TNSwp, Cegma Topo, Organic monitor, Cosmébio). In Europe, Weleda, Logona, Lavera and Dr Hauschka share most of the market (80% in France). Competition increased from 40 brands in 2007 to 235 in mid-2010. Market leader Weleda, a Swiss green cosmetics brand, targeted growth of 12.2% (2008 to 2009) and 11% from 2009 to 2010 (organic growth, excluding currency effects).

Are two out of three consumers interested?

Market researchers agree: natural cosmetics have a great future. This may be due to the unique effect of such products on the person's wellbeing and skin. Some projections indicate that market share for bio cosmetic will rise to 30% in 2015 vs. the current 15%. According to market research firm NPD group, at least two out of every three beauty product users say they are interested in some form of eco-beauty product (source: natural-Organic Trends in Beauty 2008).

From natural to responsible

This is a four segment market: natural products, organic products, eco-friendly products (refills, etc.), and responsible beauty (e.g. Max Havelaar oils, cotton; responsible sourcing and manufacturing conditions). In all cases, questions about research, safety testing and the availability of raw materials are raised. But consumers still need to be better informed. They often confuse natural and organic products, for example. In addition, a natural product may be toxic.

Labelling, profusion equals confusion

The profusion of labels is not good for the industry, for brands or for consumers. Nonetheless it exists. The conflict between standards is an obstacle to development of "green" cosmetics (e.g. Nature and Cosmos). However, over time, consumers become more aware of the content of products and labelling information through the efforts of the most credible brands.

Big players mainly watching the trend

While there is strong market momentum, we note that major luxury brands are taking a wait and see attitude. Two routes: changing the design or marketing of their brands or M&A. Weleda (Switzerland) Logona and Lavera (Germany) are potential targets. To date, no group is developing specific brands or has changed the design, marketing or positioning of their brands.

Chemicals: When consumers influence the game

Some chemical compounds are subject to recurring controversy, notably paraben or triclosan (see E&S/cosmetics). Some brands have de facto banned controversial chemicals (e.g. triclosan for LVMH). But many continue to be used. This practice is likely to spread gradually given the number of brands and major retailers communicating on these issues and accentuating awareness and shifts in consumer behaviour.

Luxury Goods

Seeds of change 1: Appetite for new luxury brands?

Expertise and know-how are available everywhere… Is the time ripe for new entrants? While China is "hungry" for luxury, it also has the know-how.

The foreseeable future could thus belong to new entrants, or reshaped Asian (or other country) brands and sales trends in Europe, the US and Japan. What is clear to all is the ability of Chinese groups to appropriate western know-how and business models with the support of substantial financial wherewithal.

European groups, sensing this risk (or wishing merely to expand), have already taken some positions, notably Hermès with its Shang Xia JV and Richemont with Shanghai Tang . To date, timid starts but with an obvious development potential.

Seeds of change 2: Responsible products starting to emerge

While luxury brands act without revealing their intentions, some designers do not hesitate to get openly involved with sustainable products. This is the case for example of Lolita Lempicka, associated with Ekyog (natural and ethical textile), Stella McCartney (PPR) with The world of Stella McCartney (Green Me, eco-friendly glasses, fragrance charter, etc.), and YSL (PPR) with New Vintage III (recycled textiles).

Dozens of young brands are emerging (EA, Ethic Bag, Pants, NU, Ginger sisters, Slow Motion, Les Fées de Bengale, G=9,8, Jaël a des ailes, Numanu, By Mutation, L'Atelier des Dames, Ignacio Mejia, Iken, Como No, etc.) all driven by convinced designers. Yet, they represent a drop in the ocean compared to the giants. Nevertheless, they are changing minds and consumption patterns. Big players tomorrow? Failure for some? Future M&A targets? In all cases, they are changing attitudes and show one can openly talk of sustainability as a positive value for humanity, and for sales. Gradually, they will certainly force brands to use sustainability to nurture brands.

Is there room for less or better packaging?

Green packaging developments and demand are on the increase in the beauty industry. Weight reduction, renewables (bio plastics, plant fibres, etc.) or recycled materials and refills are three possible paths. As is the collection of used packaging. However, packaging in the luxury industry, more than in any other industry, enhances the product and is an integral part of codes and practices. Some are real works of art, or, at least beautiful creations. If one believes the various initiatives of luxury goods groups, consumers are beginning to be responsive to new packaging. Once again groups are committed, but speaking softly…

Some advances can be observed. LVMH integrates packaging in its eco-conception process (grades on separability, volume, weight, materials, use of refills). Kenzo (Flower by) proposes refillable bottles. In the Champagne segment, the weight of the bottle has been reduced. Guerlain, Louis Vuitton, and Gucci have also significantly reduced the impacts. However, such initiatives are still too recent and limited, often not communicated to consumers, to draw any economic conclusions and appraise the impact on consumers.

The need for discretion for some consumers

While luxury is sometimes associated with showing off, some customers wish to be discreet. There is a nascent but real demand of consumers for “secret” shopping, i.e. unmarked bags for purchases in order to disguise spending from outsiders. In its 2011 Luxury Trend report, marketing research firm IFOP asserts that exuberance is a declining value… Gucci's "no logo" collection is an illustration of this trend.

The voice of the high net-worth: Social responsibility not a purchasing driver?

The Luxury Institute styles itself as the objective and independent global voice of the high net-worth consumer. It is a consulting firm for marketing syndicated research, with clients such as Gucci, Hugo Boss or LVMH, and provides an important perspective on the changing expectations of customers and trends. The firm's *Wealth and Luxury Trends 2012 and Beyond* report confirms one of our views about brand stretching: less is more.

Moreover, its 2009 report 1*2 Rules for the 21st Century Luxury Enterprise* asserts "Rule 12 FROM: Socially disengage, TO: Socially responsible". Influenced by the effects of the crises, conscious of the negative impact of unethical and illegal activities, and the growing awareness of environmental issues, the mindset of high net-worth consumer is changing. According to the Luxury Institute: "*While it may not be a critical purchasing driver for luxury consumers today, a luxury brand’s social conscience will be in plain view, and luxury brands must adapt, or face serious consequences.*"

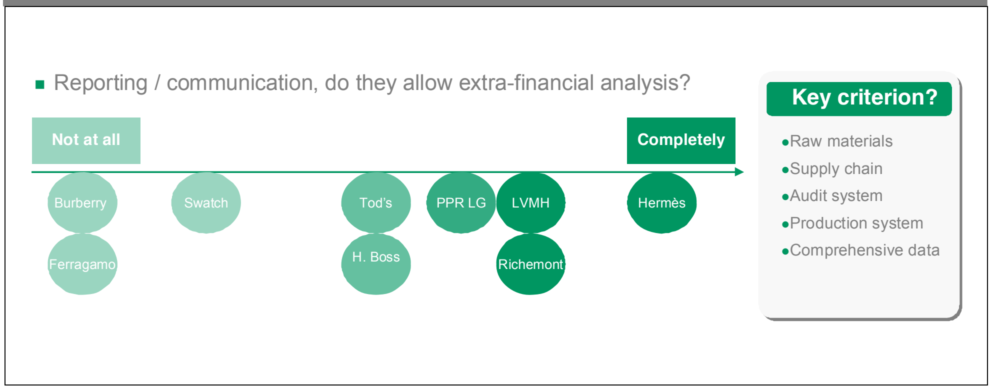
Numerous studies show that customer expectations are changing, be these of marketing companies, sociologists, sector experts. Greendex (by National Geographic) indicates the changing attitudes in BRIC and sensitivity to social and environmental issues. These changes, not clearly quantified in terms of percentage of revenues, are in addition to the urgent need for brands to master reputational risk.
The time will come for "responsible pleasure" or "desirable responsibility".

TRANSPARENCY AND DISCLOSURE

Luxury goods: Do reporting and extra-financial communication allow for complete ESG analysis?

Two dimensions must be assessed: data availability and the relevance of disclosure with regard to investors' expectations. From an investors' point of view, our ESG Grid is: risks and opportunities (contextualization, qualification, assessment, relevance and importance), management (action plan, measures taken, targets), results through data (physical data in volume and in relative terms for environment, quantitative data for social issues), economic impact (revenues, provisions, expenditure, investments and various relevant ratios such as R&D, staff costs per unit of revenue, etc.). For example, to date, we have no P&L accounts on environmental, social, or labour issues. After a full review of the sector, we provide below our own evaluation of investors' expectations and further below Bloomberg's overview on data availability.

TRANSPARENCY / DISCLOSURE: NOT THE STRONGEST POINT OF THE INDUSTRY



Source: CA Cheuvreux

Availability data: Bloomberg Disclosure scores

Bloomberg calculates the following disclosure scores: Total ESG Disclosure Score (Combined scores of the below 3) - Environmental Disclosure Score - Social Disclosure Score - Governance Disclosure Score. This allows users to quickly gauge how transparent a company is in terms of ESG data disclosure. Bloomberg collects more than 100 data points related to ESG. For each company, Bloomberg calculates a score that ranges from 0.1 for companies that disclose minimum number of data points to 100 for those that disclose every data point collected and incorporated into the scoring model by Bloomberg. Score is tailored to different industry sectors to evaluate companies on data points that are relevant to its industry sector.

Name	Tkr & Exch	Mkt Cap	Env Disc Sc	Soc Disc Sc	Gov Disc Sc	ESG Disc Score:Y	CDLI Score
BURBERRY GROUP PLC	BRBY LN	6088.35	6.3	33.3	53.6	26.3	62
CIE FINANCIERE RICHEMON-BR A	CFR VX	21665.01	32.6	42.1	51.8	39.3	83
HERMES INTERNATIONAL	RMS FP	24598.68	11.6	26.3	35.7	20.7	Not available
HUGO BOSS AG -ORD	BOS GR	4505.75	Not available	Not available	Not available	Not available	Not available
LVMH MOET HENNESSY LOUIS VUI	MC FP	53392.70	51.9	45.6	60.7	52.5	64
PPR	PP FP	13536.82	51.6	47.4	57.1	51.7	64
SALVATORE FERRAGAMO			Not available	Not available	Not available	Not available	Not available
SWATCH GROUP AG/THE-BR	UHR VX	14740.91	7.0	17.5	28.6	14.5	Not available
TOD'S SPA	TOD IM	1989.38	Not available	Not available	Not available	Not available	Not available

Source: Bloomberg, 27 February 2012

We clearly think that transparency is not the strongest point of the sector. Three players stand out positively but with very average scores: LVMH, PPR, and Richemont and one slightly lagging this group: Hermès.

For other stocks, it is appropriate to credit Ferragamo for its recent arrival on the stock market. Swatch Group is known for a lack of transparency on financial and extra-financial disclosure. Burberry conveniently "forgets" its environmental impacts and supply chain risks.

Otherwise, based on our ESG grid, weak transparency on the supply chain, given the reputational risk, allows only a medium confidence level. We consider our report as a progress report; encourage cautious views and investors' commitment.

APPENDIX: SNAPSHOTS OF COMPANIES, BRANDS AND ACTIVITIES FOR BETTER WEIGHTING OF STAKES

BURBERRY

	Sales	EBIT	
Womenswear	33%	nd*	Prorsum, London, Brit, Sport ranges
Menswear	23%		Prorsum, London, Brit, Sport ranges
Childrenswear	4%		Girls, Boys, Bags ranges
Non-Apparel	40%		Large Leather goods (50% of the 40% figure), small LG, Shoes, Jewellery, Scarves, Timepieces, Fragrance, Cosmetics, Licences

*not disclosed per activity

Salvatore Ferragamo

	Sales	EBIT	
Shoes	40,9%	nd*	Boots, Moccasins, Pump, Leisure
Leather goods	31,2%		Handbags, Suitcases, Small LG
Apparel	11,5%		RtW
Accessories	9%		Jewellery, Eyewear, Timepieces, Silk, Small Acc
Perfumes	6%		S. Ferragamo, E. Ungaro brands
Licenses	0,9%		Luxottica, Timex, Ungaro fragrance
Property rental	1%		US properties

*not disclosed per activity

HERMÈS PARIS

	Sales	EBIT	
Leathergoods & saddlery	50%	nd*	Shoes, Bags, Small LG, Saddle
Clothing & accessories	19%		RtW, Accessories
Silk & textiles	12%		Scarves, stoles
Perfumes	6%		Perfumes, Cosmetics
Timepieces	5%		Watches
Other businesses	3%		Jewellery, Furniture, Decoration
Other products & Brands	3%		**John Lobb**, Textiles holding, Tanneries, Design, **Petit H**, **Shang Xia**
Tableware	2%		Hermes TW, **Saint Louis**, **Puiforcat**

*not disclosed per activity

HUGO BOSS

	Sales	EBIT	
BOSS Black	68%	nd*	Rtw, shoes, accessories, watches, eyewear, fragrance
BOSS Selection	3%		Rtw, shoes, accessories
Boss Green	5%		Rtw, shoes, accessories
Boss Orange	15%		Rtw, shoes, accessories, watches, eyewear, fragrance
HUGO	9%		Rtw, shoes, accessories, watches, eyewear, fragrance

*not disclosed per activity

LVMH

MOËT HENNESSY. LOUIS VUITTON

	Sales	EBIT		
Fashion & Leather Goods	35%	60%	Louis Vuitton	Trunk, Leat, Sh, W&J, SG
			Loewe	Leat, RtW, silk
			Celine	RtW, Leat, Sh, Acc
			Berluti	Shoes, Leather
			Kenzo	RtW, Leat, Sh, Acc
			Givenchy	HC, RtW, Sh, LG, Acc
			Marc Jacobs	RtW, leat, acc,frag
			Fendi	RtW, leat, acc,frag
			Stefano Bi	Shoes
			Emilio Pucci	RtW, acc, SG, perf
			Thomas Pink	Shirts, ties, acc
			Donna Karan	RtW, childrenswear, acc
			NOWNESS	Web media
Fine Wines & Spirits	15%	22%	Moet & Chandon	Champ
			Dom Perignion	Champ
			Veuve Clicquot	Champ
			Krug	Champ
			Mercier	Champ
			Ruinart	Champ
			Château d'Yquem	Wine
			Hennessy	Cognac
			The Glenmorangie Company	Whisky
			Belvedere	Vodka
			Domaine Chandon California	Wine
			Bodegas Chandon	Wine
			Domaine Chandon Australia	Wine
			Cloudy bay	Wine
			Cape Mentelle	Wine
			Newton	Wine
			Terrazas de los Andes	Wine
			Cheval des Andes	Wine
			10 Cane Rum	Rhum
			Wenjum	ABC
			Numanthia	Wine

	Sales	EBIT		
Selective retailing & Other	26%	8%	DFS	Retail
			Miami Cruiseline	Dut Free
			Sephora	Retail P&C
			Le Bon Marché	Dpt store
			La Samaritaine	Dpt store
			Les Echos	Media
			Royal Van Lent	Yatching
Perfumes & Cosmetics	14%	8%	Parfums Christian Dior	Perf
			Guerlain	Perf + Cosm
			Parfums Givenchy	Perf
			Kenzo Parfums	Perf
			Benefit Cosmetics	Cosm
			Fresh	Cosm
			Make up for ever	Cosm
			Acqua di Parma	Perf
			Perfumes Loewe	Perf
			Emilio Pucci Parfums	Perf
			Fendi Perfumes	Perf
Watches & Jewelry	10%	3%	Tah Heuer	Watch
			Bulgari	Watch + Jew
			Zenith	Watch
			Hublot	Watch
			Dior Wtaches	Watch
			Fred	Jew
			Chaumet	Watch + Jew
			De Beers (JV)	Watch + Jew

PPR

	Sales	EBIT		
Redcats	25%	10%	La Redoute	Mail order
			Daxon	Mail order
			Vertbaudet	Childrenwear
			Cyrillus	Childrenwear
			Somewhere	Mail order
			Ellos	e-shopping
			Castaluna	e-shopping
			Avenue	Mail order
			BrylaneHome	Mail order
			OneStopPlus.com	e-shopping
			Woman Within	e-shopping
			Jessica London	e-shopping
			Roaman's	e-shopping
			KingSize	e-shopping
			The Sportsman's Guide	e-shopping
			The Golf Warehouse	e-shopping

	Sales	EBIT		
PPR Luxury Group	25%	58%	Gucci	RtW, Leat, Sh, Watch, Flag, Bag, SG, Acc
			Botega Veneta	RtW, Leat, Sh, Flag, Bag, Jew, Acc, Perf
			Yves Saint Laurent	HC, Bag, Perf, Eyeswear, Flag, acc
			Balenciaga	RtW, Sh, SLG, Acc
			Alexander Mc Queen	HC
			Boucheron	Jewellery, Watch, Perf
			Sergio Rossi	Shoes, Leather, Acc
			Stella Mc Cartney	RtW, Sh, Acc
		y-e 2010, not consolidated	JeanRichard	Watches
			Girard Perregaux	Watches, Acc
			Brioni	RtW and Tailored
PUMA	18%	21%	Puma	Sport / Street wear
FNAC	32%	12%	Fnac	Books, Music, Games, Hard and Software

RICHEMONT

	Sales	EBIT		
Jewellery Maisons	52%	73%	Cartier	Watch + Jew
			Van Cleef & Arpels	Watch + Jew
Specialist Watchmakers	26%	23%	IWC	Watch
			Jaeger Le Coultre	Watch
			Baume & Mercier	Watch
			Officine Panerai	Watch
			Piaget	Watch
			A. Lange & Sohne	Watch
			Vacheron Constantin	Watch
			Roger Dubuis	Watch
			Ralph Laurent watches (JV)	Watch
Writing instruments	11%	8%	Mont blanc	Writing, Watch, Acc
Other Businesses	11%	-4%	Dunhill	RtW, Lug, Acc
			Chloé	RtW, SG, Gcc
			Lancel	Lug, Acc
			Shangai Tang	RtW
			Alaia	RtW, Sh, Bags, Acc
			Purdey	Shotguns, Acc

SWATCH GROUP

	Sales	EBIT			
Watches	73%	84%	Omega	*Prestige*	*55%*
			Breguet		
			Blancpain		
			Glashütte Original		
			Jaquet Droz		
			Léon Hatot		
			Tiffany & Co.	*High range*	*19%*
			Longines		
			Rado		
			Union Glashütte	*Middle range*	*13%*
			Tissot		
			CK watch & jewelry		
			Certina		
			Mido		
			Hamilton		
			Balmain		
			Swatch	*Basic range*	*13%*
			Flik Flak		
			Endura (Timberland)	*Private Labels*	*0%*

	Sales	EBIT		
Production	21%	12%	Assemti	Movements assembly
			Blancpain Man. & Frederic Piguet	Blancpain, movements
			Comadur	high-tech materials components
			Deutsche Zifferblatt Manufaktur	High-quality dials
			Dress Your Body (DYB)	Jewelers
			ETA	Watches, movements
			Favre et Perret	Lux/prestige watchcase
			Francois Golay (including Valdar)	Micromechanical comp.
			Lascor	Cases, bracelets
			Manufacture Ruedin	Steel, Titanium watch cases
			Meco	Crowns, internal threads
			MOM Le Prélet	Upmarket dials
			Nivarox-FAR	Oscillating, Escapement
			Rubattel & Weyermann	Watch dials
			Swatch Group Assembly	Assembly
			Universo	Watch hands
Electronic Systems	6%	4%	EM Microelectronic	Integrated circuits
			Renata	Micro-batteries
			Micro Crystal	Quartz crystal / oscillator
			Oscilloquartz	Oscillator
			Swiss Timing	Ttiming systems

TOD'S

	Sales	EBIT	
Shoes	72.3%	nd*	Boots, Moccasins, Sneakers, Lace-up shoes **(Tod's, Hogan, Roger Vivier)**
Leather goods	15.5%		Bags, Wallets & Card holders, Bracelets, Belts, Blackberry covers (**Tod's, Roger Vivier**)
Apparel	12.1%		Rtw (**Hogan, Fay**)
Other	0.1%		Eyewear **(Hogan)**

*not disclosed per activity

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