

Ensemble Capital's Investment Thesis Update on Tiffany & Co.

This article is excerpted from a conference call with MOI Global instructor Todd Wenning, a senior investment analyst at Ensemble Capital Management, based in Burlingame, CA.

When we think about luxury goods, two things tend to come to mind. First, we tend to think of European brands like Louis Vuitton, Chanel, and Cartier. In fact, according to the consulting firm Deloitte, French, Italian, and Swiss companies together accounted for just under half of global luxury good sales in 2017. Second, we tend to recognize a luxury brand when we see one. A Ferrari, for example, is unmistakable, as are Louis Vuitton handbags with their ubiquitous LV insignias. That's largely the point in purchasing a luxury item, of course - to communicate status to others.

Curiously, Tiffany does not fall into either of those buckets. It's one of just a few global American luxury brands and the casual observer cannot tell a Tiffany diamond engagement ring from one purchased elsewhere. There's no room on a diamond for logo placement.

So how does Tiffany do it? Like its European luxury counterparts, Tiffany is draped in a wonderful narrative and history. You might be as surprised as I was to learn, for instance, that Tiffany has been around since 1837 and has been in the diamond business since 1848, when Charles Lewis Tiffany opportunistically purchased diamonds from fleeing French aristocrats in the French Revolution of 1848. His timing couldn't have been better, as new American millionaires clamored for royal jewelry to show off their recently achieved status. That's what got the ball rolling.

As a company, Tiffany is older than Cartier (founded in 1847), Louis Vuitton (founded in 1854), and Burberry (founded in 1856). This durability matters in luxury because it communicates a brand's ability to endure all kinds of major socioeconomic changes and remain relevant over successive generations. It also communicates a certain timelessness of core products that remain in fashion despite intermittent fads and trends.

Tiffany is one of the few brands in the world that can be identified by a color alone. Its trademarked robin egg blue provides instant recognition, from near or far. And that color communicates elegance, exclusivity, and sophistication. To be sure, more than one would-be suitor has tried his hand at putting a non-Tiffany item in a Tiffany Blue Box to achieve the desired effect. It's a risky move, of course, for if the ring doesn't fit, you have some explaining to do when the recipient needs it to be resized. But that speaks to the power of the Tiffany brand - that the color of the box can multiply the value of what's inside it. Assuming the item was properly acquired, a Tiffany ring in a Tiffany Blue Box communicates to the recipient that you're worth the extra money.

Tiffany's narrative has been carried forward into the modern era by popular media, such as the classic movie *Breakfast at Tiffany's* starring Audrey Hepburn, and more recent movies like *Sweet Home Alabama* and *The Great Gatsby*. The most recent advertising campaigns feature millennial celebrities like Zoe Kravitz, Lady Gaga, and Elle Fanning.

To be sure, the Tiffany brand has been mismanaged at various points in its history. However, we think current CEO Alessandro Bogliolo, who joined the company at the end of 2017, has been a fantastic brand steward and is executing well in the areas the company can control. Notably, we are encouraged by his focus on "informal" luxury to better resonate with the Millennial generation. Last year, for instance, Tiffany opened a "style studio" in London's Covent Garden, about a mile away from

its ritzy high-end storefront on Old Bond Street. The “style studio” format is more informal than the main store, with barstool seating, fragrance dispensers, and opportunities to interact with and customize Tiffany-branded jewelry. We think this is a healthy way for Tiffany to reach out to new consumers without diluting the core brand value.

Like other luxury brands, Tiffany is seeing growth in emerging Asian economies, some of which are adopting Western-style engagement ring culture. In August, Tiffany announced a partnership with India-based luxury retailer Reliance Brands Limited to open new stores in Delhi and Mumbai. As the CEO of Reliance Brands put it in the press release announcing the deal, “Tiffany needs no introduction in India – it is iconic and timeless.”

That quote brings up an important point about Tiffany’s brand-driven moat. It’s extremely challenging to attach a brand (and command a related price markup) to a piece of jewelry that from a distance cannot be differentiated from a similar item. Given its rich heritage and place in popular culture, Tiffany, as the Reliance Brands CEO put it, “needs no introduction.” This is a huge advantage against would-be upstart competitors.

In many other areas of the luxury goods market, we’ve seen direct-to-consumer brand startups leverage social media to take on incumbents. But it’s far more difficult to start and scale high-end jewelry, as the product doesn’t outwardly advertise the brand. It takes decades, if not generations, to be considered “iconic and timeless.” And this says nothing about the expensive input costs – gold, platinum, diamonds, skilled artisan wages – that would go into a high-end jewelry operation.

In summary, we’re confident in Tiffany’s moat and have growing confidence in Tiffany’s management. The company is set up well for continued relevance in future generations.

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