PPR - Gucci -LVMH

Background Readings

Exhibit A

THE FINANCIAL TIMES

MARCH 5, 2003

INSIDE TRACK: FROM LUMBER TO THE LAP OF LUXURY:

INTERVIEW SERGE WEINBERG, PINAULT-PRINTEMPS-REDOUTE: Reshaping the French group to focus on retail and luxury business has been a tough and public task for its chief, writes Paul Betts

Serge Weinberg describes himself as an "active pessimist". Clinching the biggest deal of his career on September 10 2001, the day before the terrorist attacks in the US, did little to help his disconsolate disposition.

The softly spoken 52-year-oldis chief executive of Pinault- Printemps-Redoute (PPR), the French retail and fashion conglomerate founded more than four decades ago on a small lumber business by a self-made entrepreneur Francois Pinault. Mr Weinberg has been orchestrating one of the country's most radical corporate restructurings with the decision to shed businesses with total sales of Dollars 12bn (Pounds 7.6bn), nearly 45 per cent of the group turnover.

Once a darling of the stock market, PPR has seen its capitalisation more than halved to about Euros 8bn (Pounds 5.5bn) during the past two years. Its management - previously revered as one of the most successful teams in the retail industry - has come under fire. Sentiment has been further undermined by the group's complex structure and what many consider to be an opaque relationship with its controlling founding shareholder - Mr Pinault's family holding, Artemis, owns 42.2 per cent of the company. PPR also has high debt and there are fears of a deteriorating trading outlook.

Above all, however, it has been PPR's costly foray into luxury goods that has tarnished rather than embellished the group's image and its share price. Four years ago, Mr Pinault rushed to the rescue of Gucci by acquiring 44 per cent of the Italian fashion house for about

Dollars 3bn to thwart a hostile takeover attempt by Bernard Arnault, the head of French luxury goods conglomerate LVMH. He acquired at the same time the Yves Saint Laurent fashion and fragrance business which has since been absorbed by Gucci.

What followed has been called "the war of the handbags", "the battle of big egos", and in France "la guerre du chiffon" or the "war of rags". An armistice was reached on September 10 2001. Just as the world was about to change, PPR agreed to buy nearly half of LVMH's 20 per cent stake in Gucci, raising its stake in the Italian group to 53 per cent, and promised to buy out minority shareholders at Dollars 101.50 per share in March 2004.

Mr Weinberg, who will announce today the company's annual results, is the first to admit that life has not been easy. Yet PPR, he says, was preparing its strategic redeployment even before the events of September 11 and the challenges they brought. The plan is to dispose of activities with low organic growth potential such as the Guilbert office equipment maker, the Rexel electrical equipment distributor and the group's original lumber business. The disposals are designed to fund the luxury goods investments and refocus the group around two core businesses: retail and luxury.

"The shift in the balance of the group's businesses occurred at a special moment," he says. "A lot suddenly changed (after September 11): stock markets, the real economy were all under pressure. . . markets very rapidly focused exclusively on balance sheet issues. All companies were affected but it was perhaps more acute in our case," he says.

The group has raised more than Dollars 3bn from disposals, helping it reduce debt, as well as acquiring Gucci shares on the open market to lift its stake to 58.2 per cent. The shares of the Italian luxury goods company are currently trading at about Dollars 86. Under the LVMH truce, PPR can build up its Gucci stake to 70 per cent through open market purchases. It will have to offer Dollars 101.50 for the remaining 30 per cent.

By far PPR's biggest disposal has been the recent sale of its highly profitable Finaref consumer finance business to Credit Agricole and BNP-Paribas, two of France's biggest banks. Some analysts question the wisdom of selling such a successful high-margin business, but Mr Weinberg says he felt the time was right to sell the financial service activities to strengthen the group without touching the core retail and luxury goods operations.

"We did a good job in building up this business in the last six to seven years," he explains. Although its long-term prospects were "very sound", the business raised a number of issues. "In terms of value, we felt 2002/03 were peak years in terms of interest rate spreads with high lending rates and low borrowing rates," he says, adding that French banks, until recently inefficient in the consumer credit sector, were becoming more active in this area.

"The competitive landscape was changing and the banks were gaining ground. EU directives also risked making life more difficult for stores' consumer credit operations," he explains. And although PPR has shed this activity, it has kept control of the marketing operations connected to the credit business.

The group carefully avoiding being sucked into the internet bubble - Mr Weinberg says he never believed in it, adding that "paradoxically we are now one of the largest internet players in France, owning two of the top five sites". But investors now worry it may have been sucked into the tempting but fickle world of luxury at a time when western economies are in a prolonged tailspin.

One Paris investment banker asks if it was wise for a successful retailer such as PPR to diversify into luxury; in the same way he criticises its arch-rival LVMH for diversifying into retail.

Mr Weinberg vigorously defends the move. "We felt there were strong links between retail and luxury: people don't often realise that we already manufacture most of our apparel products for our Redoute mail catalogue business," he says.

Luxury offered two big attractions. "First the organic growth rate of luxury has been consistently very high during the last 15 years: from 1985 to 2001 it has grown more than 10 per cent a year except in 1991-92 when it grew by only 3.5 per cent.

"Second, it gives us the ability to go global. When you are a retailer you can become international," he says, explaining that the Conforama furniture chain earns 32 per cent of revenues outside France, the Redcats mail order firm 58 per cent, and the electronics, records and books Fnac stores more than 25 per cent.

"These operations are now in several countries but they are not global," Mr Weinberg says. "Our vision was that Europe would have lower growth than some other regions so we needed global brands enabling us to seize opportunities in countries such as China and Russia."

He also believes that investors will realise next year that the price paid for Gucci was "reasonable". Although the last tranche of the acquisition involves Dollars 101.50 a share, "it is highly possible that the overall value of the investment will be around Dollars 83-Dollars 84 a share".

Mr Weinberg recalls how PPR was criticised for paying too much for the Fnac electronic store business in 1994. "I also thought the price was too high but Francois Pinault had an intuition and Fnac has since seen its profits increase five times," he says.

The luxury goods market is under pressure. Although Mr Weinberg acknowledges the threat of war in Iraq and the economic slowdown are hurting perceptions, he sees the sector coming back because "there is no reason to believe that buying pleasures will disappear".

The luxury business continues to hold up "pretty well", he says, and the group has continued to invest counter-cyclically for an eventual upturn.

The Gucci group invested Euros 350m last year opening 66 stores. It has been working to restore the YSL brand and, although YSL breaking even may be delayed until 2005, this would affect PPR's operating profits by less than 1 per cent, he claims.

Investors have also been worried that the two architects of Gucci's success - Domenico De Sole, the Gucci chief executive, and designer Tom Ford - may leave next year. "We do hope they will stay on board and continue to help build Gucci for the future," Mr Weinberg says. But he adds: "We are living a certain paradox for the group has lots of designers and brands and one of Domenico De Sole's and Tom Ford's strengths is that they have been able to attract very strong talents." Other brands and designers include the Balenciaga fashion house, the Boucheron jewellery business, Sergio Rossi shoes, Bottega Veneta leather goods, and designers Stella McCartney and Alexander McQueen.

Mr Weinberg admits the guerrilla war that still goes on despite the Gucci/LVMH truce is a "nuisance".

"At the end of the day I have to manage this group and must avoid being diverted on a matter I consider not important."

Managing has also involved making PPR more transparent. He concedes the company until recently did not communicate well enough. "But we also needed secrecy because we did not want to hurt the value of our businesses we wanted to sell," he explains.

As for the relationship with Mr Pinault and Artemis, his family holding, Mr Weinberg insists it is quite clear. "No transactions have taken place between PPR and Artemis except for one case when YSL was resold to the Gucci group at a loss to Artemis," he says. "We are not involved in competing activities."

Mr Pinault is also in "100 per cent agreement" on PPR's strategy, although Mr Weinberg admits the founder is not "indifferent" on the sale of the group's original businesses.

Mr Weinberg appears confident that his radical strategy of refocusing the group on retail and luxury will pay off, but also admits 2003 will be another tough year. "There are no real reasons to be optimistic this year," he says - an "active pessimist" to the last.

Exhibit B

The Wall Street Journal

12 February 2003

Purse Strings: Pinault's Win in 'Handbag War' Is Proving Costly to His Empire

In Besting LVMH for Gucci, He Promised Lofty Price To Minority Stockholders

Will 'Dom and Tom' Stay Put?

PARIS – When Francois Pinault, a high-school dropout who got his start selling lumber, won a long struggle with rival French billionaire Bernard Arnault for control of Gucci, fashion insiders hailed him for winning the "war of the handbags."

Now they are wondering if France's most daring entrepreneur might instead become a fashion victim. The gamble Mr. Pinault took when he jumped into the volatile luxury-goods business, and the onerous terms of a truce he made with his foe, threaten the empire he built over four decades.

Gucci, one of fashion's biggest success stories in the 1990s, has hit a rough patch. Reduced global travel at a time of economic stagnation, terrorism and war talk has hammered an industry that counts on free-spending tourists for much of its sales.

What makes this so tough for Mr. Pinault is that to end the battle over Gucci, he promised its minority stockholders that if their shares weren't worth at least $101.50 in March 2004, he would buy them for that price. Gucci now trades for $94. The potential tab for Mr. Pinault's publicly traded company, Pinault-Printemps-Redoute SA: $4.27 billion. PPR has had to sell some of its most profitable assets to raise cash to honor the commitment – which it knows will probably force it to overpay for the rest of Gucci.

On top of that, PPR faces a risk of losing the architects of Gucci's 1990s comeback. Designer Tom Ford and Chief Executive Domenico De Sole are already rich from Gucci stock, and their contracts expire in 2004. Moreover, they want full managerial independence, a goal hard to square with Mr. Pinault's desire to exercise more control over Gucci. The loss of Mr. Ford would be a particular setback, as the charismatic Texan is such a star that many investors identify him with Gucci's fortunes.

Mr. Pinault bought into Gucci in 1999 at the top of the boom. Fashion and luxury goods had exploded into a $100 billion industry, triple its size in 1992. Those heady times transformed the business as small, family-owned firms gave way to conglomerates such as Mr.

Arnault's 70-brand LVMH Moet Hennessy Louis Vuitton SA. However, those big companies remain highly dependent on the talents of their designers. How Mr. Pinault handles the personnel issues at Gucci could hold broader lessons for the rest of the industry as it copes with the downturn.

In a rare interview, Mr. Pinault says he took "a calculated risk" when he invested in Gucci. Even though the Gucci investment has helped cut the value of his PPR stock to about $3.5 billion from $12 billion two years ago, he says he doesn't regret it and is confident it will pan out.

He says he would like to see Messrs. Ford and De Sole stay but that Gucci "shouldn't shake in its boots at the thought that they might someday leave." The brand is strong enough, he says, "that a change of management shouldn't put the company in peril."

Mr. Pinault has dodged danger before. A rare self-made man in France's business elite, Mr. Pinault got his start in business more than 40 years ago by buying a two-man sawmill with $91,000 borrowed from his first wife's father. "I didn't have a diploma, a network of contacts or money, and I came from a family of peasants," says the tycoon, now 66. "Today, I've got a bit of a network, a bit of money, but still no diploma."

After building the sawmill into a large lumber company, he started branching into other businesses, ranging from an African shipping company to France's largest electronics-store chain, building PPR into the conglomerate it is today.

Mr. Pinault did several deals in the early 1990s that stirred controversy. One of them, PPR's 1992 takeover of the Paris department store Le Printemps, gave such short shrift to minority shareholders that it helped prompt a reform of French takeover rules. Citing the new protections they won, Mr. Pinault quips that "minority shareholders should give me a medal instead of criticizing me."

His biggest killing came in late 1992, when he bought depressed U.S. junk bonds that troubled California insurer Executive Life had to unload. He earned an estimated $2.5 billion on the bonds. But the deal and Mr. Pinault's later acquisition of Executive Life itself have since become the subject of a probe by federal prosecutors in California and a lawsuit by California's insurance regulator. At issue is whether French bank Credit Lyonnais illegally "parked" the bonds and the insurer with a group of companies before selling them to Mr. Pinault, and whether Mr. Pinault knew about the scheme. The bank declines to comment. Mr. Pinault says he's "not worried, because I did nothing wrong."

PPR then began to buy up glamour assets, such as the Chateau Latour vineyard and Christie's auction house. By early 1999, Mr. Pinault says, he "had been looking for 20 years to get into a business where the hunting grounds are Europe and the world, rather than just France." Luxury goods provided the chance. After LVMH built up a stake in Gucci, the fashion house's Mr. De Sole sought a white knight, not wanting Gucci to become just another cog in the big LVMH machine.

Mr. Pinault took on the role. He spent $3 billion to buy enough newly issued Gucci shares for a 44

The share issuance diluted LVMH's 34became personal. Announcing the investment in Gucci, Mr. Pinault said his goal was to be No. 1 in luxury goods, and added that as for Mr. Arnault, "there's always room for a No. 2."

The billionaires were soon trading defamation lawsuits and vying to buy independent fashion houses. Gucci used the cash injection from PPR to acquire couture house Yves Saint Laurent and jeweler Boucheron, among others.

LVMH then revealed that Gucci had made a huge stock-option grant to Messrs. Ford and De Sole. LVMH accused PPR of having promised the grant to "bribe" the men to back PPR's investment in Gucci. PPR and Gucci shot back that LVMH had found out about the options by rummaging through Gucci's trash for a memo. During a pause at a court hearing in January 2001, Mr. De Sole caught sight of an LVMH spokesman and bellowed, "Watch out for your coats! There are thieves among us." LVMH said it didn't get the memo from the trash but from an anonymous mailing.

Messrs. Pinault and Arnault finally brought their nasty fight to a close in the fall of 2001. PPR agreed to buy nearly half of LVMH's 20minority stockholders got a put option entitling them to force PPR to buy their shares at $101.50 in March 2004 if they are then trading below that level.

The deal was inked on Sept. 10, 2001. The terrorist attacks in the U.S. the next day roiled world markets, and Gucci stock soon fell. A lawyer for Mr. Pinault, Jean-Michel Darrois, says he looked into backing out of the deal, but Mr. Pinault ruled that out, fearing it would destroy his credibility with investors.

Gucci's shares, which trade in Amsterdam and New York, recovered. But they began a new slide last spring as it became clear fewer consumers were splurging on $800 handbags and $350 shoes. Gucci's earnings for the first nine months of 2002 were off 40for as little as $35.

In April, Standard & Poor's downgraded PPR's debt to just above a junk rating, citing its exposure to the costly put. PPR's stock, traded on the Paris exchange and in the U.S. through American depositary receipts, tumbled as investors worried anew about the put. By last summer PPR's slide was posing a threat to Mr. Pinault's 100vehicle, called Artemis.

The problem was that its 42margin calls from its lenders. So Mr. Pinault had to get

PPR's stock moving back up. That meant PPR had to start raising the cash to cover the cost of honoring the put.

The biggest asset PPR has sold is its highly profitable consumer-finance arm, Finaref. PPR has also sold part of its big office-equipment business. It has plans to shed an electrical-equipment distributor, the African shipping company and even the lumber company from which Mr. Pinault built his empire.

The sales have raised about three billion euros after taxes so far, two billion of which PPR used to whittle its heavy debt load to about five billion euros. Most of the rest it spent buying Gucci shares on the open market. Every share it acquires today at $94 or so is one it won't have to buy in 13 months at $101.50. PPR has now raised its stake in Gucci to 58.2build its Gucci stake to no more than 70

Mr. Pinault is confident he can raise the money to honor the put in 13 months. He has less control, he acknowledges, over what Messrs. Ford and De Sole do.

The two rescued Gucci from near bankruptcy in the 1990s. They bought back thousands of product licenses from manufacturers who were sullying the brand by plastering its logo on key chains and umbrellas. They opened Gucci-owned stores, for which Mr. Ford created a common look, going so far as cutting decorative flowers to exactly the same height.

In 1995, Mr. Ford unveiled a breakthrough collection. Gone were Gucci's traditional loafers. The new Gucci woman wore tight-fitting, hip-riding pants and a peacock-colored shirt unbuttoned to the navel. The look catapulted Gucci back into the fashion columns.

These days, the star wattage of the "Dom and Tom" duo is such that PPR shareholders worry they've become indispensable to the fashion house. A Gucci Securities and Exchange Commission filing warns that the company's "success depends to a significant degree upon the efforts and abilities" of the two, and that the loss of their services "could have a material adverse effect."

Fanning fears they might leave are the March and June 2004 expiration dates of their contracts – and the ample fortunes they already have. Mr. De Sole has earned $15.5 million from option exercises since 1999, and still holds many more options that he can cash in before or when the buyout occurs. Mr. Ford has done even better, earning $144.5 million by exercising Gucci stock options over the past three years, according to Dutch securities filings. Before 1999, he made tens of millions of dollars more that he didn't have to disclose. And he can pocket an additional $52 million from his remaining options if PPR has to buy the rest of Gucci in 13 months. So he has both the money and the fame to form his own fashion house if he chooses.

Mr. Ford declined to be interviewed. Mr. De Sole said that "it's objectively possible" he and Mr. Ford would leave in 2004, "but I don't think so because we have an emotional attachment to this company." Yet he added: "We want to manage the company independently."

That could be a problem. Mr. De Sole, an Italian-born, U.S.-trained lawyer, has had tense relations with PPR Chief Executive Serge Weinberg, who says Mr. De Sole should report to him. Mr. De Sole contends he is accountable only to Gucci's board. "It's normal that personalities as strong as Serge Weinberg and Domenico De Sole should clash about certain things," Mr. Pinault says.

Mr. Pinault has said in the past that once PPR had acquired all of Gucci, it would put some of the shares back in public hands. That would help Mr. De Sole keep his independence because Gucci would retain independent board members not named by PPR. But now Mr. Pinault may have changed his mind. Although a final decision hasn't been made, he says that "we're not obligated to re-float Gucci" shares.

Should Mr. Ford leave, some PPR executives say privately, other talented designers in the Gucci group could take his place. "Did Dior survive the departure of Christian Dior? Yes. Did Chanel survive the departure of Coco Chanel? Yes," says one PPR executive. "To say that if Tom Ford leaves, Gucci is done for is to give too much credit to one guy, albeit a very talented one."

In a sign that PPR is trying to distance the brand from its star designer, it recently asked Mr. Ford to stop using the editorial credit "Tom Ford for Gucci," instead of just "Gucci," on photos in fashion magazines. He did so. Putting Mr. Ford's name alongside the brand wasn't a good idea, Mr. Pinault says.

Though the fashion house has cost him dearly, Mr. Pinault says he doesn't regret the Gucci gamble. "If you don't take risks," he shrugs, "you can't call yourself an entrepreneur."

Corrections & Amplifications

LEHMAN BROTHERS estimates that, if it weren't for Pinault-Printemps-Redoute's promise to buy out Gucci's minority stockholders at $101.50 a share in March 2004, Gucci shares might trade for as little as $39. A page-one article yesterday incorrectly said Lehman's worst-case estimate was $35.

(WSJ Feb. 13, 2003)

Teri Agins contributed to this article.

Exhibit C

WWD

25 February 2003

PPR Adds to Gucci Holdings

MILAN - Put another point on the board for PPR. French retail giant Pinault-Printemps-Redoute acquired another 1.17 million shares of Gucci Group stock between Jan. 28 and this past Thursday, boosting its stake in the luxury house to 59.33 percent from 58.2 percent.

As reported, PPR has pledged to buy all shares of Gucci it doesn't own in 2004 for $101.50 each. Any purchases made for less than that amount at current market prices represent savings to PPR. Through an affiliate, PPR most recently spent $110.2 million for 1.17 million shares of Gucci, an average of $94 a share. Acquired at $101.50 a share in 2004, those same shares would have cost $119 million, $8.8 million more.

PPR said Monday in a filing with the U.S. Securities and Exchange Commission that it bought 719,973 shares on the Amsterdam exchange at prices between $91.96 and $94.86 a share for a total of $67.3 million. Dollar figures have been converted from the euro at a current exchange rate of about $1.08 per euro. During the same period, PPR bought 452,474 shares on the New York Stock Exchange at prices between $93.17 and $94.38 a share for a total of $42.5 million. PPR said last month it would continue to buy Gucci shares on the market and eventually lift its stake to more than 61 percent. Prior to next year's deadline, PPR can lift its stake to as high as 70 percent by buying shares on the market. The purchases were made through PPR's Societe Civile de Gestion Financiere Marothi subsidiary and Marothi's Scholefield Goodmann subsidiary.