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The Value of Long-Term Investing

Investment Insight

LUXURY BRANDS, NFTS AND THE METAVERSE

After two years of absence from museum visits, when a friend suggested that we meet up at the British Museum to see 'Hokusai: The Great Picture Book of Everything' exhibition, I jumped at the opportunity. Hokusai is one of the best-known Japanese artists and printmakers in the West. His breath-taking composition of the woodblock print 'The Great Wave' is said to have inspired the composer Debussy's *La Mer* (The Sea) and the poet Rilke's *Der Berg* (The Mountain). The exhibition itself was fascinating but what also captured my attention was the pop-up store offering NFTs of more than 200 of Hokusai's famous works outside the exhibition.



Source: with permission from the British Museum

Non-fungible tokens, NFTs, are a hot topic and you have likely read about them in recent months. So, what are they? NFTs are unique digital assets that can't be copied and exist in a blockchain, a form of digital ledger. They are traded online and may represent real-world objects like art, music, in-game items and videos. As the [New York Times](#) neatly explains, they act as 'the certificate of authenticity' you might get if you bought an expensive physical painting. NFTs came to prominence in March last year, when a graphic designer, artist and animator known as Beeple, sold his digital work as an NFT at Christie's for more than USD 69 million. The work, called 'Everydays – The First 5000 Days', was a collage of all the images he had posted online since 2007.

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Luxury brands embrace digital assets

NFTs are not unique to the art world. Luxury brand companies are exploring and capitalising on the digital assets boom too. The rationale is simple. Today, Millennials and Gen Z spend more time interacting with their friends on social media or gaming platforms than in real life. As more and more people live their lives on the internet, the demand for digital fashion and branded goods is likely to grow significantly.

In May 2021, Gucci teamed up with various gaming companies to learn how the gaming community responded to its content. To celebrate the brand's 100th anniversary, it opened a virtual Gucci Garden on the popular gaming platform, Roblox. Digital assets (not NFTs) were created, bought and sold on the platform. A digital version of Gucci's Dionysus Bag with Bee was sold for the game's own currency of 475 Robux, (equivalent to USD 6 at the time). Subsequent resale fetched an eyewatering equivalent sum of USD 4,115 (350,000 Robux), almost USD 800 more than the same physical bag in stores at USD 3,400. The event highlighted that digital assets not only have value but also that the value could be very significant. Later that year, Gucci expanded to NFTs by creating a four-minute fashion film based on its Aria collection as an NFT to accompany a runway show. It sold at Christie's for USD 25,000.

Other luxury goods companies have been evaluating NFT opportunities too. In August 2021, Burberry launched an NFT collection entitled Blankos Block Party in partnership with Mythical Games.

Blankos Block Party is a game featuring digital vinyl toys known as Blankos that live on a blockchain that provides players with proof of verified ownership and authenticity. Adorned with Burberry's new TB Summer Monogram, Burberry Blanko, a shark named Sharky B, is a limited-edition and limited-quantity NFT that can be purchased, upgraded, and sold within the Blankos Block Party marketplace. All NFTs were sold out within just 30 seconds of the launch and Burberry made just under USD 400,000 from the sales. In the subsequent secondary market, Blanko fetched as much as four times the original price. These NFTs had a built-in smart contract, such that each time Blanko was sold, Burberry received a royalty.

Are brands and NFTs a marriage made in heaven?

NFTs have unique attributes that match the characteristics of luxury goods.

For luxury goods, authenticity, exclusivity and scarcity, are key features to their desirability and value. NFTs have them all. Authenticity is guaranteed because they exist in blockchains, while the brand can control the number of goods sold to ensure scarcity.

The use of NFTs has further advantages. A luxury goods company can create unique and personalised digital assets that enhance the concept of exclusivity. The cost of creating a



Source: Gucci

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personalised digital product is a fraction of the cost of a physical good. The cost of distribution is also minimal. The typical commission at generalist NFT platforms such as OpenSea (an eBay for NFTs) is about 2.5%. This compares to up to 40% distribution cost for physical items making digital goods much more profitable for luxury goods companies.



Collezione Genesi- Source: UNXD

Creators of NFT's can also get paid royalties on subsequent resales because so-called 'smart contracts' can also be embedded in an NFT. NFTs provide even greater opportunities for luxury goods companies to engage with loyal customers such as inviting them to special events and offering them an

exclusive physical version of the digital asset. Dolce & Gabbana recently did just that. The company sold a nine-piece collection NFT at the auction for USD 6 million (1900 Ether), five of which also came with a physical version alongside the digital assets.

By participating in the digital asset market, luxury brands can engage only not with their existing consumer base, but also a new generation of young consumers and build loyalty around their brands. Some analysts believe the metaverse, gaming and NFTs could be worth USD 50 billion in revenue opportunities by 2030 for the luxury industry representing 10% of the total addressable market. They could contribute even more in terms of profits due to the much lower cost of producing and distributing them.

Is the euphoria for NFTs creating a bubble?

Not all luxury companies are fully on-board with the concept of selling digital assets. At a recent annual results meeting, when asked about his opinion about the metaverse, the CEO of *LVMH*, Bernard Arnault, replied: "We do realise this is a virtual world right now [but] we also have to be wary about bubbles". Arnault has a point. NFTs are mostly traded in cryptocurrencies and as such their value fluctuates with cryptos which could be volatile at times. NFTs, by and large, are traded on unregulated markets and some believe that the exorbitant prices paid for some NFTs were the result of enthusiasm from a handful of crypto experts.

LVMH's caution is also warranted because NFTs in the luxury sector are in their infancy and not without their challenges. Luxury goods must protect their brands; fake products erode sales, profits and brand equity. It is why the protection of intellectual property is paramount. Increasing numbers of companies participating in digital assets are seeking trademark registration to protect their brands. Nike, for example, recently filed trademark applications for its digital products including virtual sneakers and clothing.

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Nike's move is pre-emptive, perhaps not surprising given the emergence of NFTs has already caused controversy on the infringement of intellectual property. American artist, Mason Rothschild, created an NFT artwork entitled 'Baby Birkin', inspired by the Hermès' iconic Birkin bag. The bag, which featured an animation of a baby growing in a bag, was sold at auction for the equivalent of USD 23,500 (13 Ether). Following the success of Baby Birkin, Mason Rothschild created 100 pieces of 'metaBirkin' NFTs. These were initially sold at 0.1 Ether each but the price has since rocketed in the secondary market to a level near to the real Birkin. Both NFTs were created without Hermès' knowledge or permission. In January, Hermès filed a lawsuit against the artist, claiming the infringement of the intellectual property and trademark which subsequently resulted in Rothschild receiving a 'cease and desist' with the metaBirkin NFTs being removed from being on sale on the OpenSea platform. The outcome of the court judgement is still pending.

There is another potential hurdle for NFTs to overcome. While they may offer another avenue for brands to grow their revenues and profits, and engage with more consumers, the environmental impact of selling NFTs is not well defined. NFTs live on a blockchain which requires a lot of energy to mine. A proper assessment is required to ensure the existing environment targets that brand companies have committed to are not derailed. Some platforms offer environment offset such as the sponsorship of planting a tree for every NFT sold offered by LaCollection.

Value and desirability of NFTs in the hands of luxury brands

Back home from the British Museum, I went onto the [LaCollection website](#) to see if I could buy a Hokusai NFT as a souvenir of the first edition of British Museum NFTs. Unsurprisingly, they had already sold out. These NFTs are now trading on the secondary market with some fetching re-sale prices in their thousands.

Following the success of Hokusai NFTs, the British Museum and its partner LaCollection went on to launch their second NFT collection, this time inspired by J.M.W. Turner's artwork, which includes the spectacular A Storm, or The Shipwreck, painted in 1923. The ongoing partnership between the world-renowned British Museum, an old established institution and French start-up LaCollection in itself is telling: Despite their sudden appearance and their lack of physical attributes, it seems that NFTs are not a fad but a real phenomenon that will only grow bigger.

The path of progression, however, may be bumpy and it may take a time for NFTs to move from the early adopter market to the mainstream.

However, it is a sign of their potential that many of those who are cautious on NFTs and the metaverse are gently dipping their toes in this new phenomenon. Only last month LVMH introduced a virtual female avatar as the new face of the group's innovation strategies. Named, Livi, the avatar presented its three-day VivaTech event held this month.



Source: LVMH

As more and more people become aware of and participate in the NFT market, more will be created and competition will likely become fierce. And yet, for luxury brand companies,

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NFTs can be another form of their products having the characteristics of authenticity, exclusivity and scarcity that create desirability and value for younger generations. The winning formula will still lie with brand recognition and brand equity, just as it does now in the physical world.

We believe NFTs can co-exist with physical goods. The ownership of both physical and virtual goods enables luxury customers to move seamlessly between the physical world and the metaverse as we spend more and more time online in the omnichannel world (online and offline) we have been living in over the past few years.

Zhixin Shu, CFA

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