Fashion's M&A Scene Heating Up

by EVAN CLARK
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Fashion’s game of deal or no deal is heating up for 2010 and it seems almost everyone is looking to play a part.

And although no one is predicting a return to the go-go days of 2006 and 2007 when buyers bid hot properties up into the stratosphere, experts said a steadier economy, easing credit markets and more realistic price tags could bring some sizzle to fashion’s mergers and acquisitions scene this year.

“If we have a more benign, let’s say slowly improving, environment, you’re going to see a meaningful increase in the deal flow,” predicted Joe Pellegrini, managing director of Robert W. Baird & Co.’s consumer retail team. “You’ll see a lot of activity in that $200 million to $500 million zone.”

The tenor of the market will recall the dealmaking of the earlier part of the last decade, said Pellegrini, pointing to such strategic buys as VF Corp.’s acquisitions of The North Face and then Vans and Nike Inc.’s purchase of Converse.

And many of those same companies — with cash, cash equivalents and short-term investments on their balance sheets or the ability to borrow enough for a purchase — are headed back out on the hunt.

Among the companies publicly scouting or said to be on the prowl with at least some capital to be put to use are Nike ($3.63 billion in cash, cash equivalents and short-term investments on hand), PPR (1.27 billion euros, or $1.83 billion at current exchange), Li & Fung Ltd. ($1 billion), VF ($379.1 million), Phillips-Van Heusen Corp. ($356.6 million), Iconix Brand Group Inc. ($233.4 million), The Warnaco Group Inc. ($229.3 million) and Jones Apparel Group Inc. ($156.9 million).

Not everyone will use their cash to bulk up with new brands, though. Polo Ralph Lauren Corp., has cash and short-term investments of $925.7 million, but observers don’t expect the firm to cut a deal anytime soon.

In general, companies are looking for brands and businesses that are strong enough to have power and meaning, but not so big that they don’t have room to grow. Among the businesses and brands that could attract interest, even if they aren’t necessarily for sale, are Under Armour and Lululemon Athletica, both publicly held; VF’s Nautica and John Varvatos units; Liz Claiborne’s Lucky Brand division; Patagonia, and New Balance, according to observers.

Wish lists are company-specific, though, as can be seen from hints given during quarterly conference calls with Wall Street where:

• Thomas Chubb 3rd, president of Oxford Industries Inc., said the company would pursue “a brand that’s such that it can have its own retail operation.”

• Chris Vieth, chief operating officer and chief financial officer of Maidenform Brands Inc., expressed interest in “an international intimates company or a domestic shapewear company.”

• Glen Senk, chief executive officer of Urban Outfitters Inc., said he wouldn’t overextend: “If we were to do an acquisition, it would likely be relatively small.”

• Lawrence Rutkowski, executive vice president and cfo of Warnaco, said, “First and foremost, we’ll look at areas where we want to expand our distribution rights, add additional Calvin businesses and go direct-to-consumer.”

Kellwood Co., which itself was acquired by Sun Capital in February 2008, has acknowledged its interest in acquisitions, saying it has signed two letters of intent and has two other offers on the table. Last month, Michael W. Kramer, Kellwood’s president and ceo, said the company was keeping its eye on competitive brands in the juniors and women’s sportswear categories. Kramer wants “plug-and-play” acquisitions, which add to the company’s profits relatively quickly.

It is strategic players looking for a business to complement their existing portfolio that are expected to take the lead, although investment firms could also make their mark.

Ajay Khaitan, chairman and ceo of Emerisque Brands, said last month he was in discussions with brand owners, bankers and private equity groups. Last year, Emerisque and SKNL North America B.V. bought Hartmarx Corp. out of bankruptcy.

Khaitan is looking for opportunities with underperforming "heritage brands," with wholesale volume between $75 million and $750 million. "Our vision is to buy and build a multibrand, multiproduct position with a number of investments," he said.

So far, M&A action in the fashion world has been relatively tepid even as big deals have been struck in other sectors, from food to transportation to technology. Retail deals last year were valued at $34.84 billion globally, a fraction of 2007's total of $156.39 billion, according to a Dealogic tally through mid-December. Apparel and shoe deals dropped off to $3.25 billion from $17.19 billion.

The falloff, while dramatic and indicative of the cautious climate pervading the industry, tells only part of the story. Deals that are still in the works have been, in at least some cases, a long time coming.

"We, right now, are in the process of working actively at five different transactions," said Gilbert Harrison, chairman and ceo of Financo. "Three of them we thought were going to close [last] year. People are being much more cautious. Banks have been impossible to work with."

And sellers have yet to adjust their expectations. "A lot of people are still thinking pricing that is 2007 as opposed to pricing that is 2010," Harrison said. "The days of having deals being done at eight-, nine-, 10-times EBITDA are gone for the time being."

Larger, more powerful firms have worked hard to cut costs, improve efficiency and stockpile cash and they're not about to overpay to take over competitors. The growing divide between the strong and the weak could be one of the most pronounced changes to come out of the financial crisis, the recession and the increasingly ultrathrifty consumer.

"The pie is smaller out there and only the best are going to get it," said Marc Cooper, managing director at Peter J. Solomon Co.

Many recent deals have involved companies in some degree of financial stress. But once healthy companies start to "hit the bid" and establish a new price range, more deals could come, Cooper said.

"The ice will break shortly," he said. "Over the next six months, you're going to see trades. You are moving to a consensus, a buyer-seller consensus."

The financial players that are still in the market for retail could be on the lookout for what Cooper described as "fallen angels," or good brands that have been floundering. He cited TPG Capital's 1997 acquisition of the now high-flying J. Crew Group Inc. — although it was an investment that appeared to be problematic until Millard "Mickey" Drexler became chairman and ceo in 2003 and turned the chain around. J. Crew subsequently had one of the most successful retail initial public offerings in history.

"You'll see financial types coupled with management teams potentially buying some of the fallen angels, like we've seen already, and attempting to reinvigorate them," Cooper said.

Some recent examples include Golden Gate Capital's takeover of Eddie Bauer and Advent International Corp.'s acquisition of Charlotte Russe.

For strong strategic players, the right deal is a chance to scoop up competitors and solidify their market share and grow even as consumers cut back.

"The winners are now winning even bigger and the laggards will continue to struggle," said David Shiffman, managing director, head of retail and consumer at Miller Buckfire & Co.

Some companies that had been snatched up by investment firms in leveraged buyouts could be returned to public markets with IPOs.

“You’ll see continued IPO activity next year, including some of the bigger, older vintage LBOs where you will need the liquidity in the equity markets in order to deleverage the balance sheet,” Shiffman said. “Most of these big LBOs don’t have big natural strategic buyers.”

Neiman Marcus Inc., which TPG and Warburg Pincus bought for $5.1 billion in 2005, could eventually issue new stock. In 2007, Wall Street sources said the owners were gauging investment interest for a possible Neiman’s IPO, but an offering never materialized and the market went south. But retail stocks rebounded with a strong 47.2 percent increase last year.

This also could be the year for international players to make their move. Already the lion’s share of production is overseas and those manufacturers increasingly want to control their own destinies with brands of their own.

Li & Fung has been active and promises to remain busy this year. Last year, the sourcing agent acquired U.K.-based footwear maker Shubiz, gloves producer JMI and Kids Headquarters.

“The pipeline of deals is strong and it’s almost unprecedented that we’ve seen so many great opportunities,” said Bruce Rockowitz, president of Li & Fung.

Jeffry Aronsson, who cofounded Aronsson Group, which has stakes in Matthew Williamson, Ginny H. and Casall, said he traveled to Asia recently and met with “several large, fast-growing and highly profitable vertically integrated apparel companies looking for strategic investments if not outright acquisitions of European and American retail brands.”

Aronsson, former ceo of Donna Karan International and Marc Jacobs, said there will be an increasing number of cross-border transactions as Chinese apparel firms look to differentiate with design and branding and South Korean companies look to expand internationally and at home.

“The China market promises enormous opportunities to raise cash from strategic partners for struggling European and American fashion businesses,” he said.

Like the economic recovery — which had fueled a lot of hopes, but has yet to prove its authenticity — it remains to be seen if buyers and sellers will really be able to connect in a meaningful way. There are certainly plenty of obstacles, from reticent banks to skittish consumers. Even the fashion industry, which is known for its glitz and bravado, has turned contemplative and cautious in the wake of the downturn.

“I don’t think that [deal-making] is going to be really heating up anytime soon,” said Esteban Bowles, a principal in the retail practice of A.T. Kearney.

“Companies are still focused on their recovery and focused on their fundamentals,” he said. “I think that is the right move, honestly. Companies still, a lot of them, have major changes to their strategies and their assortments and they’re still working through those issues.”

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