

Published: Wednesday, June 11, 2008

## Credit Crunch Hits Seventh Avenue

By Whitney Beckett

Seventh Avenue is feeling the effects of the macroeconomic credit crunch.

Industry deal makers estimate that 20 percent of mainstream vendors are struggling with credit issues that are forcing them to look for investors or buyers — or even close shop.

"It's a perfect storm," said Allan Ellinger, senior managing partner at Marketing Management Group. "You have more issues contributing to these problems than ever before: Retail business-demand is down, costs are up on the supply side, credit is squeezed from loaners. We're seeing an uptick in people looking to sell businesses, but just because a company is in financial trouble doesn't mean it's salable. People look to acquire companies at advantageous prices, and we'll also see doors closing voluntarily."

Furthermore, as vendors shutter, partner up or simply shave costs to avoid the former two alternatives, layoffs should be expected. For companies that are able to sell themselves to, or merge with, other strategic vendors, jobs will likely be lost as firms look to keep costs down and reduce overlap in the new partnerships. Even companies that choose to stay in business likely will be pruning their staffs.

"You may not be able to control your sales, but you can lower your overhead," Ellinger said. "This will be a defining moment for our industry: Will owners be offensive or defensive?"

Executives of troubled mainstream companies have several options: Invest in the business themselves while cutting costs, get money from venture capitalists, merge with a strategic partner, sell or liquidate. Their decision depends largely on the strength of the balance sheet, the age of the company, the most recent profitability and the distribution channels.

**"If they feel it's only a temporary blip in retail, some will bring money from home," said Jack Hendler, president of Net Worth Solutions Inc., an investment firm which has seen a 50 percent uptick in business. "Others might find that the landscape has gotten so difficult that they will say, 'I've had enough of this' and find a strategic partner or buyer. Some who have just been moderate vendors without a strong position or brand will just liquidate out totally."**

A new type of company is up for grabs: Many hot contemporary firms are waiting out the storm until they can again fetch a higher price, and not-so-hot mainstream businesses are actively looking for financial saviors, according to bankers. Additionally, along with new sellers comes a fresh group of investors, said Bradley I. Dietz and Marc Cooper of

investment bank Peter J. Solomon Co. Traditional private equity interest is ticking down as money in the credit markets becomes less accessible, but hedge funds interested in distressed investments are picking up the pace. Strategic buyers, who couldn't compete with the higher multiples private equity funds were paying, are also reentering the game.

"There's a tremendous uptick in distressed M&A, largely with hedge funds," Dietz said. "They've raised a substantial amount of capital to participate in buying distressed companies that are tapped out from a liquidity standpoint and often entering Chapter 11."

While many of these deals of nearly anonymous middle market companies (for example, a mainstream firm called Sara Max is said to be looking for investments) will be done quietly, the industry has already seen several public examples, including NexCen Brands Inc.'s potential sale of Bill Blass, the new incarnation of which does much of its business at a non-designer level, and the unprofitable brands Liz Claiborne Inc. sold off at discount prices, including several moderate brands — Emma James, Tapemeasure, JH Collectibles and Intuitions — to Li & Fung.

Since it started as a turnaround strategic operation two years ago, Bluestar Alliance, which has bought brands from junior label Hot Kiss to Harvé Benard, has been on the prowl for such opportunistic deals. Schottenstein Stores Corp., which owns a majority of Filene's Basement, DSW Shoe Warehouse and Adrienne Vittadini, had bid on some of Liz Claiborne Inc.'s brands. Schottenstein is also said to be teaming up with Arnold Simon, president and chief executive officer of Designer Licensing Holdings LLC, which has the Bill Blass jeanswear license and owns 10 percent of the Bill Blass trademark, to make a run for Bill Blass. Windsong Brands, which led an investment group to acquire Ellen Tracy earlier this year, is also said to be exploring additional investment opportunities.

**Companies locating buyers are finding multiples have "definitely come down a notch and a half from a year ago," Hendler said. The lower prices, relative to even a year ago, create attractive buying opportunities for longer-term strategic buyers, who are most often buying entry into channels of distribution, is higher than it has been in years. For example, Haresh Tharani, the head of Tharanco Group, which bought better knit label Joseph A. earlier this year, said he is eyeing three high-end accessories labels to take advantage of the lower prices.**

Former Liz Claiborne Inc. ceo Paul Charron, now a senior adviser at Warburg Pincus who recently started his own investment venture through Fidus Partners, said: "If you can buy beachfront property at a moment of market depression, you know that at some point beachfront property will be back on the up."

However, in these hard times, analysts agree that retail Darwinism will be in full effect, and many companies will find themselves no longer fit enough to exist.

"There will be losers that will either be consolidated or go out of business, because lots of people don't have winning strategies," Charron said. "They will be the fashion victims of

this macroeconomic environment."

Several factors are propelling this Seventh Avenue shift. The credit crunch has made lenders extra cautious about risk, leading them to more carefully eye an investment and often requiring additional collateral, possibly leaving vendors with inadequate credit. In addition, retail demand fell in 2007 and the outlook is worse for the rest of 2008, with labor and material costs rising.

As these companies — particularly small to midsize manufacturers in the moderate, better or junior sectors — send 2007 balance sheets to their banks this spring, many are feeling the pressure to produce collateral they may not have or take smaller advances that may not be enough to keep them in business. Several investment groups are also looking to exit the fickle fashion market.

There may be a few ports of refuge, as Charron — a former Navy officer always fond of a seafaring metaphor — puts it. Although traditional banks are pulling credit lines, reducing their advance rates or requiring additional collateral, Seventh Avenue bank Rosenthal & Rosenthal is "dedicated to playing our part" to keep apparel companies in business during the slowdown, said managing director Michael Stanley.

Stanley said Rosenthal & Rosenthal's loans are driven by collateral, which is less affected than sales during downturns, and the bank isn't changing its requirements significantly this year. In fact, Rosenthal & Rosenthal's loan activity is up, which could be explained by its industry-friendly policies relative to other lenders.