

## Small M&A Deals Changing Seventh Avenue

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Some Seventh Avenue vendors are looking for investors.

Major acquisitions by public companies and private equity firms have slowed to a trickle, but smaller strategic deals are reshaping Seventh Avenue.

Vendors are being squeezed at both ends: Creditors are cutting their debt-to-equity ratios in half, and retailers are reducing orders and demanding sky-high markdown rebates — together forcing an estimated one-quarter of privately held apparel vendors to search for a capital investor, a strategic merger or a buyer, according to sources.

The primary buyers in these deals are neighbors and sometimes competitors of the sellers, but with stronger balance sheets and stronger stomachs for the volatile economy.

**“There are financially distressed companies, but there are also companies that are just emotionally stressed because people have yet to get spring orders and they realize their balance sheets won’t sustain another year of soft sales,” said Jack Hendler, president of investment banking firm Net Worth Solutions Inc.**

**Hendler said Net Worth Solutions is busier than ever, with distressed deals making up half of his business, compared with about one-third normally. But strategic deals in which companies, primarily those between \$30 million and \$80 million in wholesale volume, look to combine with complementary companies to increase their sales and market share and reduce back office costs are also increasingly popular.**

**For example, Hendler just sold Ardmore Blouse Inc., a \$50 million company whose main label was moderate-priced top brand Anxiety, to Hong Kong-based knit supplier KBL Knitwear. Terms were not disclosed.**

**“This was a classic case of four partners who’d been in business for 35 years and said ‘We’ve had enough,’” Hendler said. “Their business was healthy, but they just didn’t want to fight the fight of this economy. On the other hand, we had an Asian vendor that wanted to get closer to retailers.”**

**Net Worth Solutions is working on another transaction in which a \$90 million better-priced dress company is acquiring a \$40 million better-priced dress company with minimal distribution overlap.**

**“Neither is distressed, but they felt vulnerable not having distribution throughout all channels,” Hendler said. “This gives them the size and clout necessary to stand up to the surviving retailers without being pushed around, and when things improve in a few years, it positions them big enough to be attractive to a private equity buyout.”**

Cerberus-owned Rafaella Group is looking for strategic acquisitions to round out its distribution, said Christa Michalaros, chief executive officer. Republic Clothing Co. has been approached by several competitors in need of capital, and has said it could be interested in acquiring a business if the price and opportunity is right. Brand Matter and Fashionology Group LLC, the parent companies of Ellen Tracy and Caribbean Joe, are also still looking for branded companies at a bargain and are eyeing a few men's brands.

According to M&A sources, Ed Hardy, Joseph Abboud and Charles Nolan are among the designers looking for either a buyer or capital infusion. Representatives from Ed Hardy and Joseph Abboud did not return calls. Jewel Kesberg, chief executive officer and president of Charles Nolan, denied that the company was on the market.

"The principal Asian investor remains very committed to the company," Kesberg said. "The worldwide impact of the financial situation is expanding our market reach much more quickly than initially envisioned, and to fully capitalize on this enlarged market opportunity, we would be amenable to discussing additional investments, but by no means do we require additional investors."

Kellwood Co. said it is still exploring strategic alternatives and searching for a buyer for Hollywould, the contemporary sportswear, dress and accessories company, which it announced it would sell last month.

Sources said interest has been restoked for a 30 percent stake in Tory Burch because the asking price has declined since the initial self-valuation of almost \$1 billion. No deal is on the table, but private equity firm Oak Hill Capital Partners is said to have entered the due diligence process, joining TSG Consumer Partners and Irving Place Capital (formerly Bear Stearns Merchant Bank). All declined comment.

"Very few quality companies are putting themselves for sale," said Marc Cooper, managing director of investment bank Peter J. Solomon Co. "The one people are talking about is Tory Burch, and who knows if it will get done or not. There's a considerable amount of interest in the company, but the question is whether Tory Burch accepts the kind of multiple she can get right now."

**Hendler said although multiples have fallen at least a point, deals often use 2007 earnings in addition to the dismal 2008. Terms also are shifting for earn-outs that typically run three years to skip 2009, assuming it will be a lost year, and instead evaluating performance in 2010-2012.**

Because of additional due diligence (one private equity investor said he did calculations based on scenarios of various retailers folding to create a valuation that included the risk), nondistressed deals are taking about 40 percent longer, sources said.

But the price is certainly right. Valuations of apparel vendors are lower than they've been in years. Earnings multiples have dropped one or two full notches, at the same times earnings have slumped.

"Companies appear cheap by any standard, but you just don't know," said Paul Charron, a senior adviser at Warburg Pincus with his own investment venture through Fidus Partners. "A lot of companies aren't making any money, so what's an evaluation on a company losing money? Multiples go out the window when the prices are what they are."

Charron said private equity's resistance to enter the market in a sizable way is twofold. First, lenders aren't lending because they are securing their own balance sheets. Second, the outlook for apparel companies is uncertain, between consumer confidence and retail security.

"I know some private equity firms that are looking," said Sharon Zackfia, a retail analyst for William Blair & Co. "There's obviously a problem in the debt markets, which limits the size of the deal. In general, transactions under a couple hundred million are much more likely than transactions over that."

Private equity firms may still be dabbling in deals for companies less than \$200 million, but getting leverage financing for bigger deals is near impossible. Of the public arena M&A deals in the apparel industry tracked by Factset Mergerstat LLC, only one was done in September and another in October — down from an average of nearly five deals a month in 2007.

So far this year, 35 public deals have been consummated in the apparel sector for a total disclosed price of \$2.4 billion — on track to be about half of last year's \$5.4 billion disclosed value on 58 total deals, according to Factset Mergerstat. If the pace from the last few months continues through the end of the year, 2008 will record the fewest M&A deals in the apparel sector completed since 2002, when 23 were done for \$1.7 billion of disclosed value.

"There's not a tremendous amount of strategic growth-oriented M&A now," Cooper said. "We probably did the last deal, selling Athleta to Gap. Most of the [public] strategic buyers are out of the market at the moment because, first, they are concerned about credit and having the cash to operate their business. Second, the private company marketplace hasn't adjusted to the same degree as the public markets, and public companies don't want to buy at higher multiples than they are trading at themselves. Companies that are great growth businesses haven't accepted they will take only the two to four times EBITDA that public companies are trading at."

With both the biggest buyers and biggest sellers taking a break, the smaller players — the building blocks of Seventh Avenue — are dividing themselves into two groups: stressed sellers and opportunistic buyers. Between those groups, work is being done that will change how vendors emerge from the downturn.

"When you take the publics off the table, privately held companies in a market like this are very cautious in how they will deploy their assets, because it is usually their personal assets," said Allan Ellinger, senior managing partner at Marketing Management Group. "So they don't want to take big risks, but they are searching for smaller, accretive deals, gross margin contributors, which they can immediately plug into their businesses and leverage off their back ends."  
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