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Kellwood Takes Sun Offer

By Whitney Beckett

Recognizing the majority of shareholders will likely accept Sun Capital Securities Group LLC's \$762 million takeover bid, Kellwood Co. on Monday surrendered and entered into a merger agreement with the private equity fund.

In an about-face, the \$1.6 billion St. Louis-based vendor encouraged shareholders to tender their shares on Monday, before tonight's deadline.

According to sources close to the deal, by Monday night Sun had already reached the necessary majority, including the 11.4 percent Sun holds.

"As a strong, private company, Kellwood will continue to execute on its strategic priorities to position the company as a brand-focused marketing enterprise," Robert C. Skinner Jr., Kellwood chairman, president and chief executive officer, said.

After opposing Sun's offer since September, Kellwood said the absence of a higher bid and the belief that the majority of the company's shareholders planned to accept the bid inspired the agreement, which provides "for a prompt merger if Sun Capital's tender offer is successful." Kellwood also is terminating its cash tender offer for \$60 million of its 7.875 percent notes due 2009, a move Sun had insisted on, saying it hurt the vendor's equity.

In a note released Monday, Jody Kevin Kane, an analyst for Sidoti & Co. LLC, offered additional reasons for Kellwood's change of heart, which he considers positive for shareholders. "We view the change in the board's stance toward the Sun Capital offer as intriguing given that initially, Kellwood wanted nothing to do with the proposed deal," Kane said.

"We think the board's change stems from continued weakness in the industry and the likelihood that Kellwood will lower its guidance when reporting fourth-quarter earnings, with the stock price, minus the Sun offer, suffering as a result. We think if Kellwood does lower guidance and if Sun walks away from the deal, the stock will retreat to the \$12 to \$13 range; we therefore view \$21 as an attractive offering price."

Contingent on a majority of shareholders accepting the bid by tonight's deadline, Monday's agreement (which sources called a face-saving acceptance of the takeover, not a merger) ensures that all Kellwood shareholders will get the \$21 price. However, shareholders who didn't accept the offer by the deadline won't receive payment until the merger is completed, which could take months. Last week, Sun sent a letter to shareholders warning them that the \$21 price was promised only to those who tendered their shares by the deadline.

Sun will assume control of the Kellwood board upon the completion of the offer. The question is: What will the fund do with its new subsidiary?

"We look forward to working collaboratively with Kellwood to ensure a smooth and expeditious transition and urge all shareholders to tender their shares to guarantee they receive prompt payment for their holdings," Jason Bernzweig, Sun Capital vice president, said. "As we have said before, we are prepared to commit substantial resources beyond the purchase price to build Kellwood's business, and we will work closely with management and employees at Kellwood to strengthen the company and develop its branded portfolio."

Kellwood and Sun Capital declined further comment.

Members of the investment community said they are perplexed by Sun Capital's interest in the vendor and curious to see the fund's turnaround plans for the largely moderate manufacturer. Traditionally, Sun Capital invests in companies it considers undermanaged, and after acquiring them, leverages the fund's operational capabilities to streamline areas including sourcing and supply chain management — dramatic cuts that are easier to make as a private company. Founded in 1995, Sun Capital affiliates have invested in and managed more than 180 companies worldwide, including Mervyns and Limited Brands Inc., with combined sales of more than \$35 billion.

But what attracted Sun to Kellwood, which it has railed publicly for missing earnings for several years now? Sources suggest that getting the company for a relative bargain, seeing clear areas in which the vendor underperforms its competitors, and the ability to make future apparel acquisitions motivated the private equity group.

"The only reason they are doing this is to make other acquisitions," said Andrew Jassin, managing director of the New York consulting firm Jassin-O'Rourke Group. "They will have to either acquire companies with better DNA or with a retail component."

Added Brad Stephens, a retail analyst for Morgan Keegan & Co. Inc.: "As poor as Kellwood's earnings have been, the business has great cash flow and not much capital expense. On the apparel side, the problem is not with the management as much as with the brands."

Though Sun typically keeps management teams on at companies it acquires, many speculate the fund will let go of Kellwood's top management, although some believe Skinner could be spared.

"I expect a full housecleaning of management, because if it had confidence in the management, it wouldn't be doing this," said Jack L. Hendler, president of Net Worth Solutions Inc. "It's possible, though, that Skinner has been handcuffed at the board level and with a new board, if they give him enough leeway, he'll have the capacity to make the change."

Hendler added the recent restructuring at Kellwood competitors Liz Claiborne Inc. and Jones Apparel Group Inc. may have motivated the buy. "Kellwood has always been the follower of Jones and Liz, and Sun believes that if Jones and Liz can do it, Kellwood could benefit from the same plans. The moderate brands will either be sold or closed, or if they're smart, with everyone getting out of moderate, maybe they will keep them and even acquire more."

Although moderate makes up the bulk of Kellwood's business, outsiders have long speculated that it was the company's higher-end recent acquisitions that made it an acquisition target, and the real question may be what Sun decides to do with those brands.

"Sun obviously has a gameplan and a strategy, and it will be interesting to see what that is," said Paul Charron, former chairman and ceo of Liz Claiborne and a senior adviser at equity firm Warburg Pincus. "They will either try to spin off the brands with good value — like Hollywood, Hanna Anderssen and Vince — or they will invest in them."

But in changing hands, Kellwood could lose some of its key licenses. Kellwood holds licenses for O Oscar, Calvin Klein white label, ck bridge line and Gerber, and those deals often have change-of-ownership exit clauses. Sources said the O Oscar and Calvin Klein lines have been underperforming, and Phillips-Van Heusen Corp. could choose to give the Calvin Klein licenses to a higher-performing licensee, like G-III. Losing those higher market lines could hurt Kellwood's portfolio.

Although sources predict the majority of Kellwood shareholders will accept Sun's bid today, the verdict won't be known until Wednesday. Some shareholders are still deciding whether to tender their shares.

"CtW is pleased with the board's recent about-face, especially the redemption of the poison pill and willingness to honor tender results," said Michael Garland, a director at CtW Investment Group, which represents an estimated six million union members who own about 198,000 shares of Kellwood common stock, or less than 1 percent. "We are still evaluating today's news about the board actually endorsing the deal. We are not yet recommending the tender, as we had hoped for a higher price."

Kellwood's stock closed up 41 cents, or 2 percent, at \$20.94.