

Published: December 5, 2007

## **Markdown Demands May Force Mergers**

By Whitney Beckett

The dismal retail numbers reported this season — alleviated only by early sales — mean one thing to vendors: markdown money.

Facing these profit-eating demands come January, many midsize moderate and better manufacturers are turning to the M&A community looking for a strategic solution, including merging with other companies in similar situations with which they could share back-office costs.

**"Except at the very upper tier, everything that is being sold at retail is all promotional, and those markdowns at retail revert to the vendor," said Jack L. Hendler, president of Net Worth Solutions Inc., a New York-based mergers and acquisitions firm. "Everyone is anticipating that what is asked for in January 2008, before retailers give orders, will be a substantial increase in markdown money, making a fair amount of vendors very vulnerable."**

**Although companies build kitties into their cost sheets that anticipate 3 to 10 percent dilution at retail, those numbers could double this year, Hendler said. "Probably only half the companies have the substantial wherewithal to withstand hits like this before considering finding a strategic partner or simply going out of business," he said.**

**Net Worth Solutions has seen more than a 50 percent increase in inquiries from vendors looking to be either acquired or merged, Hendler added. He said healthy companies "who want to get out while they still can with value" are looking for buyers, while more troubled companies — particularly those doing less than \$50 million in volume — are looking for strategic partners with which they can grow sales while sharing costs.**

For the latter category, the M&A community sees two types of partners. First, a small or midsize vendor can merge with a similar company — as long as it has either a different product category or different distribution. For example, a pants company with moderate distribution might look for either a similar company with better distribution or a top company with moderate distribution — so long as it does not cannibalize itself. The second type of merger involves a foreign investor — most often from China, India or Pakistan — with production capabilities looking for a vendor that has marketing, sales and design arms.

**"We're very busy advising and consulting these under-\$50 million companies," said John Henderson, a director at Net Worth Solutions, who for years worked at**

**Kellwood Co. "Those companies always wanted to get in the major leagues so they could get protected by the strength of numbers with the retailers, but the public companies are pruning out those types of companies. They're still looking for the protection of someone, so by two coming together they can equal three."**

With the traditional consolidators instead turning into liquidators, there are fewer strategic buyers — particularly for the long-suffering moderate and better vendors. While these public companies focus on top-line growth, privately held firms focus more on the bottom line, so these firms — which are becoming the primary strategic buyers in the industry — are less likely to write big premium checks. As a result, many companies whose profitability has been suffering are finding they aren't salable. But to survive in a marketplace plagued by retail consolidation and markdown money requirements, these companies must increase profitability. One way to cut costs without cutting sales is merging with another apparel firm with similar needs — warehousing, distribution, accounting, production, sourcing — to share the back-end costs.

"Underfinanced, undercapitalized companies in the moderate zone — which may be good in design and sales individually, but need to leverage on a single overhead — should be combined together, similar to what Liz and Jones had originally done or like what Li & Fung is doing now," said Andrew Jassin, managing director of the New York consulting firm Jassin-O'Rourke Group. "Most companies make their money through good sourcing more than through good design."

Allan Ellinger, senior managing director of Marketing Management Group, proposed that although the M&A game has traditionally been dominated by acquisitions, mergers may emerge as an alternate solution in today's challenging retail climate. "Mergers are another option to selling one's business outright," Ellinger said. "You can build revenue, increase profitability and create a larger company that ultimately is more marketable, plus be able to sustain itself in a marketplace where everyone is under pressure."

"But merging two companies is more difficult than an entity buying or selling a business," Ellinger continued. "The difficulty in merging is melding the two cultures with two owner-operators and who is ultimately the boss?"

But as consultant Emanuel Weintraub noted, "Merger is a stealth term for acquisition. There is rarely a merger of equals: One partner is always superior to the other."

Although perhaps in a preferable position compared with the plight of private companies considering going out of business or frantically looking for a partner, public companies will also face their own challenges come the new year. Jeffrey Knopman, principal at Profit Solutions Group Inc., an outsource accounts receivable firm or "chargeback recovery company," expects markdowns will be worse across the board this year. Profit Solutions represents vendors of \$50 million in size to public companies that do billions of dollars in volume.

"For a \$60 million company, a 10 percent charge is a \$6 million loss, which can mean the

difference between profit and loss for that size company," Knopman said. "But it's not just the privately owned firms — the chargebacks are across the board. Our public company clients have another cross to bear: stock owners and Wall Street."