

PE Shops For Minority Stakes At Boutique Retailers

BY MATTHEW MONKS

8/20/2007 - As big name retailers like Limited Stores and Barneys New York continue falling into private equity hands, a number of smaller boutique chains are following suit -- but with a twist: they're selling minority stakes rather than executing full-scale buyouts.

In the last year and a half, the owners of closely held retailers like Francesca's Collections Inc., Lululemon Corp., and Steve & Barry's LLC have all partnered with deep-pocketed buyout firms to help them fuel their growth plans. This summer, New York-based upscale women's wear chain Intermix sold a stake to Goode Partners LLC, and Jack Wills, a U.K. retailer of "preppy" clothes, sold a stake to Inflexion Private Equity to raise capital to branch into the U.S. and Japan.

A few years ago, industry experts say, these young chains might have had a harder time finding private equity firms willing to ante up sizable equity commitments without assuming control of their companies. But investors have become more flexible as they look to put money to work in a competitive deal-making environment.

"The quest for proprietary deal flow leads private equity groups to search out earlier-stage deals," according to Matt Polsky, a director with Net Worth Solutions Inc., a New York investment bank that specializes in middle-market consumer and retail businesses. "Principals of such smaller companies are not so quick to yield control, as the valuation hasn't really reached the point of a significant payday."

A minority deal can be a turnoff to PE investors because they often require just as much equity as a traditional buyout, Polsky said. That's because minority deals are often all-equity deals, as entrepreneurs don't want to saddle their companies with a lot of debt. A lot of buyout firms also aren't willing to make a large investment unless they have oversight over a company's day-to-day operations.

"There are still (PE investors) who are uncomfortable with these types of situations because they want to control everything," said Joseph M. Scharfenberger, managing director with Bear Growth Capital Partners, which earlier this year took a minority stake in Francesca's Collections, a specialty retailer of women's clothing and jewelry with 67 locations around the country.

But as the recent blockbuster initial public offering of yoga-wear chain Lululemon shows, a minority investment can deliver stellar returns if a buyout firm backs the right target, specifically, a young company with explosive growth prospects.

Looking for a financial partner to help it to aggressively open new stores, Vancouver-based Lululemon sold a 48% stake to Advent International and Highland Capital Partners in December 2005 for \$93 million in equity.

The chain has been on a tear since then, with revenue soaring 77% in fiscal 2006 as it opened more than a dozen new locations in the U.S. and branched overseas with one shop in Australia and three joint ventures in Japan. Looking for capital to continue expanding into the U.S., the 59-store chain raised \$327.6 million in its initial public offering.

The IPO, which priced at \$18 a share and rose 56% in the first day of trading, was a boon for the company's private equity backers, enabling

them to return all of their equity investment and then some in less than two years.

Advent reaped about \$130 million in the IPO and holds a 26% stake worth some \$575 million, based on Lululemon's mid-day trading price of \$32.68 a share on Friday. Highland took in \$32 million in the offering, with its remaining 6.6% stake valued at \$144 million.

TA Associates is looking to match that success with its minority investment in Steve & Barry's, another fast-growing retailer that has created a buzz by selling affordable, high-quality apparel in inner-city markets.

TA Associates took a minority stake in Steve & Barry's in November, allowing co-founders Steve Shore and Barry Prevor to take some money off the table while bringing in a financial partner to help guide the chain's growth.

Financial details about Steve & Barry's weren't disclosed, although Prevor said the company posts more than \$100 million and annual sales and has achieved a 70% compounded annual growth rate during the last 10 years.

Steve & Barry's aims to undercut Wal-Mart Stores Inc. by selling its blue jeans, sweatshirt and sweatshirts for \$10 and under. It made headlines last year with the success of a \$15 basketball shoe endorsed by NBA star Stephon Marbury. Earlier this year, the chain teamed up with the actress Sarah Jessica Parker to design a line of tank tops, shorts and other items that are sold exclusively at Steve & Barry's locations.

Prevor said the investment from TA Associates enabled the chain to overhaul its stores to showcase the Sarah Jessica Parker line. It also gave it the financial muscle to establish a product development team and boost its store count by 15 locations to the current 200, he said.

Prevor said he and his partner explored going public as well as doing a typical leveraged buyout, but settled on selling a minority stake as it would give them the capital to fuel their growth plans without relinquishing control of the business they founded in 1985.

"We didn't want to sell the company as a whole because we felt there was so much potential in the future and we would be cutting ourselves short," Prevor said.

The company also isn't ready for the public markets, as its growth rate hasn't been steady, he said. Growth has fluctuated heavily from quarter to quarter as the chain opens as many as eight new locations in one month, and four the next, he said.

For its part, TA Associates is content with its position as a minority investor, as half the firm's investments are comprised of non-control deals, said Jeff Barber, managing director of the firm.

He wouldn't give specifics about TA Associates' investment in Steve & Barry's, saying only that it made all equity investment for a stake of less than 50%. The firm had no qualms about including no debt in the deal, given Steve & Barry's growth prospects, he said.

"If a company is growing fast enough you don't need to leverage it to achieve your returns," Barber said.