Private Equity Funds Get Taste for Fashion

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PARIS - An entrepreneurial spirit, plenty of capital, connections galore and a real sense of urgency.

Those are among the virtues ascribed to private equity funds, which are emerging as key players in fashion and luxury as they continue to snap up brands in the current buoyant acquisitions climate.

Investment executives say brands moldering within conglomerates or cash-starved independents can get a new lease on life under more driven and flexible owners ‹ even as detractors warn there are few quick fixes in fashion.

"One of the key features of private equity is they're able to apply focus and professional management to their investments," said Pierre Mallevays, managing director of Savigny Partners LLP, a corporate finance and mergers and acquisitions firm in London. "If you have a large group, there will often be isolated assets that get less attention from senior management."

"For any brand that needs to be revitalized, new ownership helps," agreed William Smith, managing partner of Global Reach Capital, a fund that has invested in fashion house Tory Burch and has signed letters of intent to acquire two other "big well-known" brands. "The private equity guys are very sophisticated. They hook up with new operators and merchants. We're very focused and we can add value from sourcing and brand building."

To that end, Smith works in collaboration with luxury consultant Robert Burke, who offers his retail and merchandising expertise.

"Our point of view is that we want to buy businesses and build them up, and we have the resources to get there. We have a history of being retail operators on an international scale," said Gunnar Sigurdsson, managing director of U.K. investments for Icelandic investment firm Baugur Group, which owns a range of British fashion chains, from Karen Millen to Whistles.

"Depending on the brand, the growth potential can be quite significant," said Sigurdsson, citing Baugur's Jane Norman young women's chain as an example, which posted double-digit like-for-like sales last year.

Recent months have seen several headline deals involving private equity players, including Change Capital Partners buying Jil Sander, Sun Capital Partners Inc. taking on Stila Cosmetics and Sciens Capital Management LLC and Plainfield Asset Management LLC teaming up for Asprey. (For more on Asprey, see pages 10 and 11.) Then, of course, there was last year's $5 billion acquisition of Neiman Marcus Group by private equity players led by Texas Pacific Group.

"We will look at luxury investments based on their own merits," said Roger Holmes, a managing director at the London-based Change Capital who worked with its head, Luc Vandevelde, at Marks & Spencer plc. Change tends to target European businesses with annual revenues of about 75 million euros, or $92.3 million, to 300 million euros, or $369 million, and in which it can take a majority stake and leverage its retail expertise. Holmes acknowledged that "fashion risk" and the cyclical nature of the fashion business can discourage private equity investors from the industry, but he's confident this won't be the case with Jil Sander given its high-quality allure.

A bullish market for luxury is paramount among the factors that are attracting a new crop of financial bidders, rather than more familiar strategic buyers.

Mallevays of Savigny Partners said private equity firms have become more interested in luxury goods and fashion as some of the perceived "negative connotations" have disappeared in their estimation. Principal among these are the high multiples luxury brands command, unease with fashion and luxury goods' reliance on the creative process and a perception that management resources are slim. To the latter point, Mallevays countered: "People have realized there's a pool of management talent that is very significant."

Meanwhile, growth has roared ahead for the major luxury conglomerates ‹ LVMH Moët Hennessy Louis Vuitton (which on Thursday reported its first-quarter sales leaped 15 percent), Gucci Group and Compagnie Financière Richemont ‹ that have demonstrated impressive resilience through all sorts of economic and sociopolitical gyrations.

"This interest shown by private equity funds to invest in fashion brands ...
means that the luxury industry is in good shape and is healthy," said Armando Branchini, vice president of Intercorporate.

What's more, the funds see more growth potential for luxury and fashion now that "China is open for business and India is opening up for business. These are going to be huge markets," Mallevays noted.

Burke said he also spies major upside in the fast-growing United States.

"Luxury is absolutely going to continue to grow and aspirational luxury is going to grow even more," he said, citing such disparate examples as Coach, Juicy Couture, Jet Blue and Starbucks as bright lights in the latter category. "Good taste and good fashion are becoming more democratic than ever."

To be sure, observers cited a litany of examples where a change of ownership ‹ often to private equity ‹ changed a brand's fortunes and notoriety.

Perhaps the most frequently cited success is Gucci, which was acquired by Bahrain-based investment fund Investcorp and revitalized in the Nineties in spectacular fashion by Domenico De Sole and Tom Ford.

But plenty of others followed. Karine Ohana, partner in Ohana & Co., lauded Vestar Capital Partners' "beautiful turnaround" of Polo Jeans Co. and two British brands involving private equity, Jimmy Choo and Molton Brown.

In her view, the entrance of these players is positive for the industry because it increases management motivation and efficiencies, which ultimately benefits consumers. "Most of the time the management is financially involved and is undertaking an entrepreneurial challenge, which they are often deprived of in big luxury groups," Ohana noted.

Added a luxury goods executive, who requested anonymity, "I think this is only good for fashion and luxury because when private equity companies take over, they look for specialized managers. Right now is a good opportunity for managers to advance. Also, the private equity companies are very, very generous with giving managers equity in the company as part of the pay package, so there is money to be made, too."

"I think it can be positive, taking these people to work in an entrepreneurial setting rather than a conglomerate setting," agreed Gilbert Harrison, chairman and chief executive officer of New York-based Financo Inc. "The apparel business is entrepreneurial by nature. ... Some of these funds can be much more intuitive and they have much more flexibility."

Harrison noted, for example, that a takeover by a private equity fund inevitably brings forth lots of cost-saving initiatives.

Smith agreed funds are driven to enact a turnaround "in a reasonable time frame. They are more likely to figure out what are the opportunities and if there's a fix, do it quickly."

And like conglomerates, larger funds with multiple holdings are keen to extract synergies and leverage their connections.

For example, when Baugur acquired British fashion retailer Oasis in 2003, it detected an infrastructure capable of taking on more banners. To wit: Baugur helped Oasis acquire Karen Millen and ultimately assemble a multibrand group that "gives an insulation from the fashion cycle," Sigurdsson said.

Also, Baugur's Jane Norman chain just made the leap outside of the U.K. with an outlet in the Danish department store Illum, also a Baugur property. "If it works out well, we'll go some other places," Sigurdsson noted.

Fendi, Lanvin, Bottega Veneta, the luxury watch brand Officine Panerai and Aéropostale are other examples of brands that benefited from a change of ownership, observers noted, although in the cases of the first three, they were bought by luxury conglomerates.

Mallevays also cited a succession of private equity deals in the Nineties involving Ferretti, a maker of luxury yachts. It signaled the depth of the market for high-end products as Ferretti's expansion sailed far beyond original expectations. "That was a big eye-opener," he said. Another brand in the same vein was TPG's purchase of Ducatti motorcycles, shares of which zoomed when it went public.

Franco Pene, chairman of Gibò, cited L Capital's minority stake in Mariella Burani Group's leather goods business, Antichi Pelletieri SpA, as a success story. Antichi Pelletieri, which bought the Coccinelle brand earlier this year, is heading to the stock market this year via an initial public offer.

"The luxury goods industry has two positive characteristics. It can have both very fast growth levels and strong margins," he said.

Branchini noted that Coraline's purchase of home linens brand Frette seems to be working well under ceo Enrico Marinelli, but the industry lacks success stories since private equity's entry to the fashion world is so recent.

"A fund has to provide more than just money. It has to provide strategic marketing, a product identity and a brand identity," Branchini said.

On the cautionary side, several observers mentioned Bally as an example of a private equity investment that's had a rocky time on the road to rejuvenation, although TPG has had more luck lately with Bally and another holding, J. Crew, which has become one of the fastest-growing retailers in the U.S. under the reign of Millard "Mickey" Drexler and may go for an IPO later this year.

To be sure, skeptics question whether private equity firms will carve a major and successful path in fashion and luxury in the long run. And the luxury goods executives pointed out that the sector is only one of many private equity players are investing in, given the "huge amount of money in these funds right now; they're looking everywhere."

Antoine Colonna, head of the luxury goods research team at Merrill Lynch in Paris, said funds remain "marginal" in the sector, although there is speculation the champagne brand Taittinger, recently put on the block by Starwood Capital, could land in private equity hands. Press reports, citing sources, have said the field of bidders has narrowed to six and include private equity firm CVC Capital Partners and the Taittinger family.

"We're still missing a big deal," Colonna said in an interview. "The major issue with luxury goods is it's not easy to get a quick return. [Funds] may not have the patience required to succeed."

Mallevays agreed the investment horizon of private equity funds ‹ typically three to five years ‹ is "not necessarily compatible" with the time it takes to turn around fashion brands. That's why he predicted hedge funds would likely start playing a bigger role in fashion deals, with Asprey being a watershed because they can have a longer horizon for a return.

According to one fund manager who requested anonymity, the key with a fashion or luxury asset is an attractive entry price, which is rare in today's heated M&A environment.

"You have to be very selective," the executive said. "This is an industry where you have no certainty of a turnaround of a brand. There's an element of risk. But people tend to believe in miracles, especially in this industry."

According to another European source involved in private equity investments, funds are turning to fashion out of desperation.

"All of the conventional private equity deals are getting increasingly competitive, and over the last five years more and more funds have been getting into the game," the source said. "Today, when potential targets come up there's an auction for them; the prizes come at a high price and the deals are fewer. Don't forget that private equity raises money from investors on the basis that investors will get a return on their investment."

One analyst at a London bank agreed.

"There are no longer a lot of private equity investment opportunities out there in the classic, very stable sectors ‹ like cement companies, for instance ‹ which is why investors have turned to fashion, which they perceive as less obvious," the analyst said. "But it's risky for them. I think what you're going to be seeing is a natural selection of successful companies. The winners will be investors who have actually done their homework, and done a deal that makes sense for them. I think a lot of investors fall in love with the idea of owning a luxury brand, so they pay over the odds. Then reality hits and they see what sort of business they're dealing with, and the risk is that they kill off the golden goose."

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