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### **M&A Still Happening in Luxury**

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LVMH Moët Hennessy Louis Vuitton recently purchased watch firm Hublot...and yacht-maker Feadship.

Despite a grim economic climate, don't expect mergers and acquisitions in fashion and luxury to come grinding to a halt.

The empires are poised to strike back — if the price is right.

With valuations heading south, and private equity funds stinging from the credit crisis, some of the industry's usual suspects — strategic buyers — are returning to the fore, along with a host of new family-based funds and international buyers from China, India and beyond. If financial buyers have more difficulty structuring a deal, strategic buyers have enough cash on hand to

finance their shopping," said Michel Dyens, principal of Paris-based investment banking firm Michel Dyens & Co. "Luxury groups see acquisitions as part of their business. They constantly monitor the market in search of the right target."

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A host of serial acquirers have bolstered their brand portfolios this year and are on the lookout for more deals, observers said.

Key transactions so far this year include: LVMH Moët Hennessy Louis Vuitton's controlling stake in watch

firm Hublot and yacht-maker Feadship; Compagnie Financière Richemont's purchase of watchmaker

Robert Dubuis; PPR's acquisition of Sowind Group, the Swiss holding company that owns luxury

timepiece manufacturers Girard-Perregaux and JeanRichard; Mariella Burani's purchase of Italy's Finduck

Srl, the parent company of bag specialist Mandarina Duck, and Onward Holdings Co. Ltd.'s acquisition of

Jil Sander.

More realistic valuations and the relative resilience of the high-end segment are driving acquisitions,

despite the glut of grim financial news, observers said.

"The overall M&A market is depressed. But in the fashion and luxury business, it's still pretty active," said

Ariel Ohana, partner at investment firm Ohana & Co. in Paris. "Luxury goods are less affected [by the

slowdown in spending], so they're still a prime target for strategic buyers."

To be sure, the number of deals in 2008 is not expected to be spectacular, especially compared with the

flurry of transactions in 2006 and early 2007, when private equity funds made a splash in the fashion

milieu, observers agreed.

"We know the economic situation is bad and will stay bad for a while. But those who do deals strategically take a longer view, knowing things will improve," said Andrea Ciccoli, a Milan-based partner at consultancy firm Bain & Co. He added, though, that "2008 is not a great year for private equity or strategic buyers. But then we believe that we are going to see a significant pickup in the number of deals."

"I think it's going to be a more active market than ever, especially with the foreign money," said consultant Robert Burke of New York-based Robert Burke Associates, which advises sellers and buyers. "It's more an investors' market now."

Burke predicted toughening market conditions would spur more firms to seek capital injections to survive and grow. Companies are under pressure to invest more in their retail operations as a cushion in increasingly turbulent economic conditions.

"It's very frightening for medium-size entrepreneurs, particularly now," Ciccoli noted. "Extreme market volatility coupled with the need to invest...is a challenging combination. It's not unheard of in other industries, but fashion and luxury goods entrepreneurs are less used to dealing with it. Therefore, there is greater discomfort."

For example, the billionaire Bamford family, whose holdings include luxury goods labels Bamford, Bamford & Sons, and the Daylesford Organic food business, said this week they have hired Blackstone Group to help explore strategic options, including potential partners for the business. The family said they were seeking new partnerships in order to help their brands expand on an international level and into new markets.

Cross-border transactions are also picking up any slack, with private equity funds and private investors now operating on a global scale, Burke added.

Pierre Malleveys, managing partner at London-based Savigny Partners, said the credit crunch has finally

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pushed potential sellers to have realistic expectations. "It will do a lot of good to the M&A market in luxury and branded goods," he said. "[Luxury groups] need the deals to make sense from a strategic and valuation standpoint."

Less competition among private equity players and a deflated stock market have also led to more conservative bidding — much to the consternation of Roberto Cavalli, for example, who called off the auction of his company in July after valuations fell short of his 1.4 billion euro, or \$2.06 billion, asking price.

Rewind the clock about a year or so ago and private equity players were dominating the fashion landscape,

paying top dollar in deals financed with 70 to 80 percent of debt.

"They wanted to go out and buy everything," Ciccoli said. Among companies snapped up by private equity

in recent years were Neiman Marcus Inc., Asprey Holdings Ltd., House of Fraser Ltd., La Perla Fashions

Inc., Samsonite Corp., Lord & Taylor LLC and beauty brands Philosophy, Stila and Burt's Bees.

Today, however, financial institutions are less prepared to take that kind of risk: The cost of debt is higher,

which makes leveraging deals more difficult.

"The private equity debt-fueled bubble has burst," Ciccoli said. "It marks a big change."

Ohana noted prices have come down since mid-2007, when multiples of 10 times EBITDA or more were

common. Single-digit multiples are now the norm, observers agreed.

Strategic buyers, particularly smaller players, are also more comfortable operating in a less-heated

acquisitions climate, when the sale process is slower, Ohana noted. "Strategic buyers find it more

comfortable to get back in the game."

"Lots of groups have money, less debt and they're trying to take advantage of the lower prices in this

period," said Paris-based luxury consultant Concetta Lanciaux, who advises investors and fashion houses.

"It's going to be an easier period....Things are not inflated anymore."

New capital operators like private investors and family funds are also changing the landscape.

"Rich individuals or families from cash-rich countries were not a factor in the past, but they are now part of

the future. They will pick up some of the opportunities. We see them as a new component," said Ciccoli.

With ready access to funds, aspiring empire builders like Labelux Group, for example, the holding

company of the Benckiser family, have been able to out-manuever their private equity peers. Labelux

outbid the competition to buy Swiss fashion company Bally International AG in May.

Other examples include Reig Capital Group, which bought Azzaro; the Herz brothers investing in Escada,

and the French holding company EPI, which owns children's brand Bonpoint and the labels J.M. Weston,

Michel Perry and Alain Figaret.

Malleveys said such "family office" operators "have more appetite, they understand brands, and they have

a long-term view," he said. "Another advantage is [sellers] are more comfortable with this profile than

private equity. They're altogether a more palatable investor than the sharp suits from London and Wall

Street."

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The dire economic environment could also create openings for opportunistic investors, according to

Milan-based M&A consultant Alessio Candi of Pambianco.

Saks Inc., Coach Inc. and Tiffany & Co., for example, have very low price-earnings ratios and are trading

on multiples down by as much as half in some cases by comparison with a few years ago, Candi said.

The world's second richest man, Carlos Slim Helú, took advantage of Saks' low stock price in July, snapping up another 2 million shares and building his stake in the luxe retailer to 15.4 million shares, or 10.9 percent, according to a filing with the Securities and Exchange Commission.

"So, there's definitely an opportunity entering their capital," Candi said. "But there's also a risk, even if

these are fundamentally solid companies with strong EBITDA and net assets."

Photo By: Courtesy Photo

LVMH Moët Hennessy Louis Vuitton recently purchased watch firm Hublot...and yacht-maker Feadship.

Candi predicted that following the recent job losses in the financial sector, "in all likelihood, there will be a slowdown in the coming holiday season and this could impact companies' ability to hit full-year forecasts,"

meaning that share prices could fall further.

"There's also the euro-dollar rate," he added, explaining the U.S. government's \$700 billion market bailout

plan might not be enough to stabilize the dollar, which could return to the lows against the euro seen earlier

this year.

Observers also cite increased interest from investors from China, Russia, India, and the Middle East who

are eyeing the potential of strong brands and high-margin business following the uptick in luxury and

branded consumption in those so-called emerging markets.

The parent company of Italian fashion group IT Holding SpA, for example, is in negotiations to sell a

minority stake to a firm represented by Chinese businessman Billy Ngok to open up the Asian market.

"They are doing due diligence," an IT Holding spokesman said, referring to the unnamed suitor, which is

not Ngok's Hong Kong-based supply chain and retailing group Hembly International Holdings Ltd.

"[IT Holding parent company PA Investments SA has] been courted by private equity funds since April or

May, but they would come in only with financial capital...We want someone who has industrial and

distributive know-how because we have plans for Asia," the spokesman said.

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Dyens said Asian-based investors had ambitions to be more than just industrial partners.

"[They] want to change their image and stop being considered as production logistics facilities only," said

Dyens. "They have the ambition and the financial means to play among the big international

players...through acquisitions of European and American brands."

Besides the Onward-Sander deal, key transactions involving Asian buyers listed by Dyens include Li &

Fung Ltd.'s acquisitions of Peter Black and Van Zeeland; Bombay Rayon Fashions buying Italian denim

brand Guru; and Hembly International Holdings acquiring sportswear brand Sergio Tacchini. And Asian

buyers aren't looking only at the luxury sector: On Tuesday, China sourcing specialist Everbright

Development Overseas Ltd., founded by Guangying Wang, invested \$30 million in troubled U.S. retailer

Gottschalks Inc. and will help it with its sourcing.

Alessandro Pirani of M&A deal origination firm 7A Business Co., which has offices in London and Dubai,

noted the advent of Middle Eastern players is tied to a desire to ensure the survival of ruling families and

the wealth of the region once the oil runs out.

On Monday, the Dubai government revealed it had taken a majority stake in Kuwait-based retailer Villa

Moda, with a view to global expansion. It follows last year's acquisition of Barneys New York by

Dubai-based Istithmar. Also, as reported, an investment vehicle tied to Qatar's ruling family is said to be in

negotiations to take a stake in Paris fashion house Lanvin.

"The value of a deal is tied to status," Pirani said, citing the purchase of 5 percent of Ferrari in 2005 by a

fund in Abu Dhabi as the tipping point for Arab investment in luxury. "[That] was a signal regarding

making investments in Europe from [the United Arab Emirates]," he said.

Ciccoli agreed, saying investors from these markets are often prepared to pay a premium to secure

acquisitions. "It's not just about economic value for them."

Pirani cited strong interest from Dubai investors to buy Italian gold and jewelry companies that have

production facilities and distribution chains, as well as also second-tier fashion brands.

Given the staggering pace of high-end retail development across the Middle East, Pirani predicted such

operators would ultimately seek to become brand owners. "The project is tied to the desire to acquire

fashion brands and take them to Dubai and concentrate them there," he said, adding that \$60 billion had

been earmarked for investment. "They want to internalize as much as possible the potential of production

and consumption they generate in order to keep the money in circulation in the region."

Not that experts are counting private equity out.

Instead, they foresee a shift in which funds are more acclimated to fashion and its longer investment

horizons, evidenced by the fact that some are becoming serial buyers.

"The shift in private equity funds is that now they're asking the companies that they acquired to make

acquisitions in the sector," Ohana said.

He also pointed to the advent of new hybrid players — part private equity, part strategic — such as Dutch

fund FR 2 Capital, managed by former Mexx executives, which last year acquired French swimwear maker

Vilebrequin.

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"It's structured as a fund, but operationally, fashion people are active within it," he said, listing as another

example Phoenix Equity Partners, which bought L.K. Bennett.

"That's a recent trend. Private equity funds tend to be very generally-oriented and not sector-oriented,"

Ohana said.

"Private equity funds continue to be very keen to invest in luxury, and they seem quite good at brand hunting," said Dyens. Among firms recently snapped up by funds include Moncler (Carlyle), Gerard Darel and Technogym (Candover) and Kellwood Co. (Sun Capital Partners). "Private equity funds are very much on the watch — even for big deals." TPG, for example, has recently raised less than \$20 billion and is on the acquisition trail, according to sources.

Ciccoli noted that given the low overall odds of success in creating value through M&As, one might assume the most persistent buyers would be the worst performers. However, in an analysis by Bain of 1,700 public firms and more than 11,000 acquisitions in six industrialized countries from 1986 to 2001, the consultancy found that U.S. frequent acquirers outperformed occasional buyers by a factor of 1.7 and nonbuyers by almost 2 to 1, with similar results in Europe and Japan.

"Frequent acquirers succeed because they tend to be expert acquirers," Ciccoli said. "Deal makers at these companies...prepare carefully to create opportunities. The deal team — and typically there is a permanent, well-supported team of experts — works from an established playbook built on years of deal learning, so the company can efficiently recognize deals that fit strategically, evaluate them, seal the contract and then successfully integrate the acquired business. Winners also tend to have a series of checks and balances in place to kill deal fever and maintain a rational, dispassionate approach."

Observers cited heightened interest in certain categories of business, particularly jewelry — which has outperformed other fashion categories — along with cosmetics, spa brands and luxury yachts.

"During the last few months, private equity funds have been eager to add shipyards to their portfolios," noted Dyens, mentioning L Capital's acquisition of Princess Yachts and other deals for Numarine and Tencomar.

Lanciaux also mentioned "hyper" luxury as a hot category, including haute horology and luxury leather goods.