



INDUSTRY FOCUS

June 2010

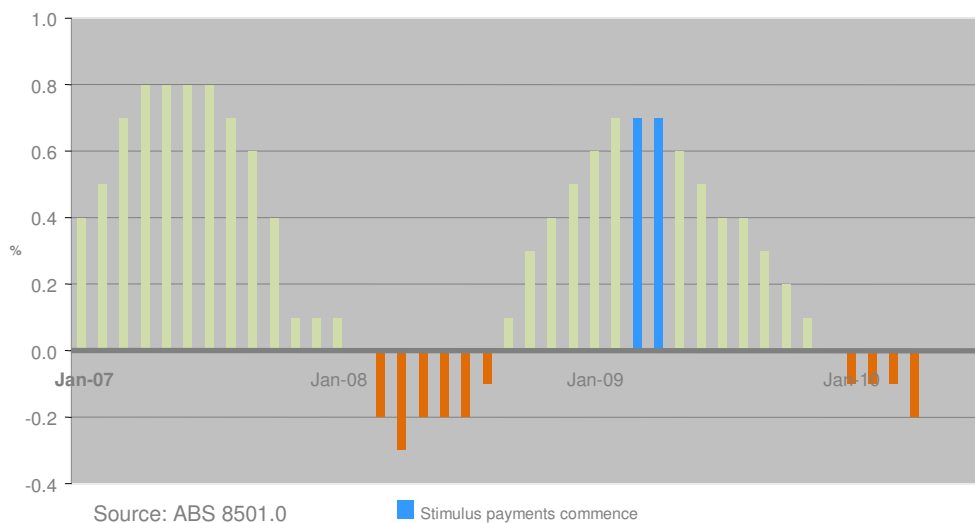
Fashion – Can you wear the exposure?

- Many labels will not survive post-GFC
- Volatility in Australian Dollar creating cost uncertainty
- Some private equity deals have been very profitable, others not so
- Fourth consecutive month of negative trend¹

Overview

For the fashion industry, the release of *Sex and the City 2* is more than just a chance to see the next instalment in the lives of the four now iconic characters. Instead, many fashion designers and retailers will be hoping that its release heralds a return to pre-GFC spending patterns and fashion largesse, where once again consumers place the desire to have the latest designer labels above financial restraint. Taylor Woodings and Turnabout Retail² discuss below key issues facing the industry. An industry that, as per the chart below experienced its fourth consecutive month of trend decline.

Clothing, footwear and personal accessory retailing
% trend growth
2007-Present



More information

For more information please contact:

SYDNEY

Quentin Olde
Partner
(02) 8247 8000
quentin.olde@twcs.com.au

MELBOURNE

Andrew Schwarz
Partner
(03) 9604 0600
andrew.schwarz@twcs.com.au

PERTH

Michael Ryan
Partner
(08) 9321 8533
michael.ryan@twcs.com.au

Source: ABS 8501.0

■ Stimulus payments commence

¹ ABS 8501.0 Trend figures remove unusual influences in the data e.g. the Government stimulus package and therefore reveal a more accurate picture of the underlying growth/decline of an industry

² Turnabout Retail (TR) is a collection of retail experts brought together by their common passion for the retail industry and the opportunities that exist.



Taylor Woodings and Turnabout Retail, stress the need to be diligent in analysing both the financial and creative aspects of a label before becoming financially committed. Several e.g. HMD Partners with Escada, Permira with Valentino etc, may have been seduced by the glamour and “celebrity” of the industry only to find harsh financial realities. Recovery or not, many labels will struggle to adapt to a more austere post-GFC trading environment. It is our view that razor thin margins, an appreciating Australian dollar and the potentially negative effect on the “brand” of sale dependent labels, coupled with sustained economic instability, will inevitably lead to more labels bordering on insolvency before the end of the 2010 calendar year. Recent examples of Australian labels in trouble include:

Ksubi³ Jan 2010	<ul style="list-style-type: none"> Placed into Voluntary Administration Jan 2010 with debts over \$8 million. Struggled to achieve the necessary margin which hindered growth and development. Hit by significantly higher input prices when Australian dollar fell 30%. Exited Administration after developed new business model and restructured operations with manufacturer Bleach.
Morrissey⁴ Feb 2009	<ul style="list-style-type: none"> Shut four stores after battling adverse trading conditions and discontinued clothing line. To date, still has not re-entered clothing market instead focussing on eyewear, gifts, leather goods and luggage.
Mad Cortes⁵ Oct 2008	<ul style="list-style-type: none"> Ceased production shortly after designer Lisa Ho withdrew financial support Very narrow niche market with limited client base.
Peter Alexander⁶	<ul style="list-style-type: none"> Closed all three US stores within months of opening after multi-million dollar losses US recession hit revenues dramatically.
Herringbone⁷ Dec 2008	<ul style="list-style-type: none"> Closed four stores and dismissed 25 staff after entering voluntary administration. Exited Voluntary Administration after sold to German shirtmaker van Laack.

A genuine bargain – where can a label make the quickest gains?

Executive Director of consulting firm Turnabout Retail and former COO of the Oron Group Sydney Michael A. Holtzer, is an industry veteran who has experienced the evolution of retailing and the impact of market trends on modern labels. Michael suggests several rapid improvements that could be pursued by the labels including:

- Liquidate slow moving stock to provide instant cash flow.
- Improve purchase controls and reduce warehouse and administrative costs.
- Control the inflow of raw materials to align with realistic sales expectations.
- Negotiate with landlords who want to avoid empty shops for temporary rent relief during poor trading times.

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 Partner
 (08) 9321 8533
michael.ryan@twcs.com.au

³ <http://www.smartcompany.com.au/retail/20100329-fashion-label-ksubi-emerges-from-administration.html>

⁴ <http://www.theage.com.au/national/morrissey-undone-as-fashionistas-tighten-their-belt-20090214-87pt.html>

⁵ <http://www.fashionreview.com.au/mad-cortes-lisa-ho-split/>

⁶ http://www.peteralexander.com.au/tem/PA_petersworld.tem?Level1Click=hype&Level2Click=news

⁷ <http://www.smartcompany.com.au/retail/collapsed-clothing-chain-herringbone-rescued-from-administration.html>

- Curtail extravagant expenses such as elaborate Christmas parties, under-utilised staff, business class travel, grandiose fit-outs and overly generous staff allowances.
- Adopt modern business practices, systems and disciplines such as cashflow management, inventory management, creditor control, realistic and comprehensive forecasting and supporting IT/Financial systems to achieve significant gains quickly.

Why do labels go broke?

In recent years many labels, both established and up-and-coming, have failed to adapt to the more difficult trading conditions and retail environment. As a result, many have either been forced into administration or have become insolvent. Michael A. Holtzer recommends looking for the following factors when considering the financial performance and sustainability of the business:

Loss of Focus	<ul style="list-style-type: none"> ▪ The line between running a fashion label as a business and an adjunct to a lifestyle can become blurred and priorities can become skewed. ▪ Some labels have survived, even prospered in the last 10 years in spite of having an unrealistic business model and structure. In the past these labels have been able to ride out a downturn, but the duration and magnitude of the GFC has found these labels out. ▪ Instead of focussing on their core business, expansion into new areas have distracted the entrepreneur.
Expansion into New Markets	<ul style="list-style-type: none"> ▪ The desire to open international offices is perhaps a more subtle manifestation of a loss of focus. Many designers will not consider they have “made it” until they successfully open an international outlet that receives critical acclaim e.g. Collette Dinnigan. The desire to achieve peer recognition may run ahead of commercial imperatives, debilitating the labels core business and absorbing a disproportionate amount of resources.
Over Ambitious Growth	<ul style="list-style-type: none"> ▪ Often infrastructure expenditure can run ahead of sales. The stunning marquee store in an expensive part of town may siphon off vital funds which cannot be replaced fast enough to service debt and expenses. ▪ Alternatively, not investing sufficiently to meet growing demand may result in poor channel management and fractured customer relationships due to reliability issues. Being exclusive is one thing, being unable to meet demand is far more serious.
Loss of Key Staff	<ul style="list-style-type: none"> ▪ Often key personnel, both design and organisational, can leave the firm taking valuable corporate knowledge and design flair with them. These skills are often vital to the business and can prove impossible to replace. ▪ This is particularly true for designer-led labels where a certain reluctance to share the limelight can stifle the development and commercialisation of emerging talent.
Obsolete Stock	<ul style="list-style-type: none"> ▪ Often, considerable cash can be tied up in inventory that, in fashion terms, is obsolete i.e. it no longer reflects either the season or the style. After investigation, it may be determined that the stock cannot be sold at any price, making effective recovery zero.
Manufacturing	<ul style="list-style-type: none"> ▪ The rapid movement of the Australian dollar will present upward pressure on raw materials for Australian labels that rely heavily on foreign sourced materials. ▪ Overseas production whilst cheaper, elongates the production process and requires further management oversight.

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Fashion labels and private equity

Many private equity firms have significant experience with fashion labels and retailers. Some of these experiences have been difficult. Situations have arisen where it has been necessary for private equity to hold the asset for several years beyond the usual two to three year horizon e.g. Bally, Valentino, Fila and others.

Equally, there are examples of excellent outcomes, such as in the US, with the recent stellar outcome achieved by Apax Partners selling Tommy Hilfiger for \$US3 billion, quintupling its investment in the American clothier in just four years. Perhaps we will see private equity reconsidering its heavy use of debt to finance their deals. Because of the unpredictability of fashion revenues due to fluctuating trends and fickle consumers, it is hard to make highly leveraged models work, particularly given the issue of reconciling regular debt servicing.

Economic recovery will bring new challenges

Many fashion labels, particularly those in the SME category, will be hoping for a sustained economic rebound to provide a welcome improvement in trading conditions. However, a more attractive trading environment will also likely bring new entrants into the industry, many straight from Design College and all hoping to be the next big thing. The effect will be to not only add competition, but to also disrupt the established stratification of labels.

WHERE DOES THIS LEAVE THE FASHION FINANCIER?

Ultimately, labels that will enjoy long-term success are those that incorporate appropriate amounts of “magic” and “science”. That is, match modern business management tools and techniques with the vital flair and creativity needed to develop the core product. One ingredient cannot sustain or grow a label without the other. There is no doubt that being involved in the fashion industry has enticing elements of glamour and prestige, and some have quickly made considerable profits. However, a loss of focus and an inability, or unwillingness, to confront commercial realities, has led more than one label to fail. Several deals have achieved this balance and have consequently realised massive financial windfalls whereas other linger in unprofitability.

How we assist clients

Taylor Woodings together with Turnaround Retail can assist labels and/or their financial backers to address pressing commercial difficulties. Our combined advice begins with a thorough examination of available options and the development of appropriate mitigation strategies. We can assist businesses with restructuring, transaction services, recovery strategies and where required, “hands on” day-to-day business management that focuses on preserving resources and value.

If you have a restructuring matter you would like to confidentially discuss or are considering investing in a label and would like the reassurance of objective advice, please contact one of Taylor Woodings Partners in Sydney, Perth or Melbourne.

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