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Recent Mergers & Acquisitions Trends in the Apparel Industry

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1. Introduction

In this essay, we will discuss recent trends in the apparel industry in regards to mergers and acquisitions. We will begin with an overview of the concept of mergers and acquisitions, discussing basic differences and reasons why companies may or may not want to take part in M&A. We will then discuss the pros and cons of mergers and acquisitions for society as a whole, and their larger ramifications. After, we will provide a closer look at the apparel industry itself and then discuss specific M&A deals since the start of 2017. After careful research and consideration of recent deals, we have found large companies have been on the defensive, investing in new geographic and client markets, ecommerce retailers, strong brands and client-focused platforms in order to withstand 'The Amazon Effect'.

2. Mergers & Acquisitions Background

2.1 Mergers & Acquisitions Definitions

In simple terms, a merger or acquisition occurs when one company 'buys' another company, thus combining them into one entity. In reality, there are nuances as to how this purchase takes place, what becomes of each company, and whether it is considered a merger, acquisition, or something entirely different. These differences are largely technical and legal, but basic distinctions can be made. In a merger, two companies, usually of similar size, combine to form a joint organization. Typically, the acquired company either ceases to exist and operates as a part of the acquiring company, or the two companies 'merge' to create an entirely new company, sometimes with a new name. In an acquisition, normally a smaller company is purchased by a larger one. The acquiring company typically purchases a majority stake in the acquired company, and the acquired company remains intact, but operates as a segment of and under the control of, the acquirer. Other 'types' of mergers and acquisitions include consolidations, tender offers and asset acquisitions, which are typical in bankruptcy auctions. While the distinction between a merger and and an acquisition used to be important, recently, the two terms are commonly used in conjunction, and thus have become conflated. Hence, the increasing popularity of term 'M&A'.

2.2 Why M&A?

Why would a company want purchase or merge with another company? There are many reasons, but perhaps the most important is the idea that upon combining the companies certain synergies will be realized. Synergies are benefits that can only exist by having two companies merge. The premise is that both the buyer and the seller are better off when their assets, management teams and brands are combined. Typically, synergies are broken down into revenue synergies and cost synergies. Revenue synergies are benefits that are seen in an increase in top-line sales, often resulting from cross selling or increased brand influence. Cost synergies are benefits that are realized from being able to cut costs in the combined company, commonly by reducing input prices or firing redundant workers. For example, if a large ice cream company buys a cone manufacturing company, the ice cream company can potentially increase revenues by cross advertising ice cream and cones and can cut costs by paying less for cones for their stores. Aside from synergies, a company may decide to purchase another company for strategic reasons. A company may want to directly buy out its competitor, or simply purchase a smaller promising company before their competitor does so. A company may also use an acquisition as a way to invest in new technology, or get their hands into new client markets or geographic locations.

The benefits of purchasing another company are somewhat straightforward, but the advantages of selling your company are slightly more complicated. Probably most common, a company will put itself up for sale if it is in significant financial trouble. Trouble may stem from poor financial management, excessive debt burden, or issues with the underlying viability of the business. In all cases, the company is hoping that the buyer will be able to either infuse much needed cash into the business or improve management and operations in order to salvage operations and hopefully return profits to shareholders. A company need not be doing poorly, however, to want to sell. Sometimes, a firm may be looking to put itself up for sale to gain the many advantages of scale. By being bought out by a firm with larger cash reserves, a better brand name, international distribution networks, or greater bargaining power, for example, a smaller company may be able to expand its sales and boost profits. Occasionally, a company may even be sold without ever putting itself up for sale. A company can receive a private bid from a company looking to purchase them without ever soliciting offers. Even if management had not seriously considered selling the company prior to receiving the offer, under certain circumstances including a particularly high offer price, an attractive big-name buyer or a bearish market, the company may decide to sell itself. Also important are non-strategic considerations for selling. A company may decide to sell itself if, for example, its owners are looking to cash-out and get out of the business. Especially if the original founder or his or her family is still the owner of the company, the owners may simply want to reclaim their investment and retire.

2.3 M&A Downsides and Alternatives

While M&A may seem very attractive, it can also have negative impacts on both the buyer and the seller if not properly thought-through. As mentioned above, if the synergies are realized, both companies can reap many benefits. Some synergies, however, may go unrealized, causing the stock price of the combined company to fall. While synergies sound very nice on paper, in reality it is very hard to put them into practice as it requires meticulous planning and execution and the cooperation of the employees of the newly combined company, often down to lowest level of employee. Employee dissatisfaction can also be a large problem, as many employees worry about the immediate or long term security of their jobs, especially if the company cultures of the two firms are not compatible, or the acquisition was hostile. Firings are also commonplace as some business units and departments are typically redundant upon the closure of the deal. Another reason why an M&A transactions may go awry is if the decision to do the deal in the first made was made for poor reasons. Sometimes, a company is purchased simply because an overly confident management team pushes through a deal so that they can 'make their mark' on the company, resulting in a poor match once the deal is complete. Similarly, as mentioned above, sometimes company is only purchased because the target company is wanted by a competitor or is perceived to be a strong potential competitor itself. This phenomenon can result in panic and a sub-par rushed deal. In certain circumstances, an M&A deal will actually fail to go through or be fully completed. This can happen if the acquirer runs short of cash or cannot obtain the necessary funds to complete the deal, or if the transaction is not approved by state or federal oversight committees due to antitrust laws.

Aside from M&A, companies do have many other options to improve their financial and strategic positioning. Alternatives for a potential acquirer include sell-offs, share buybacks, investments in research and development and dividend payments. Instead of looking to buy a company, a potential acquirer could instead sell a weak part of their current business and use the cash to invest in other areas. If a company already has a large amount of cash-on-hand they could increase shareholder value by investing in internal research in a an up-and-coming sector, or decide to increase dividend payments, or payout special dividends. A particularly common financial strategy recently has been share repurchases. In this process, the company allocates a certain sum of money to purchasing its own shares, thus hoping to lower dilution and increase the value of its shares. For a potential seller, the options are slightly more limited. If owners or founders are looking to cash out the company could consider an initial public offering, or an equity private placement. If they are strapped for cash, they could consider taking on more debt, however, debt markets are typically more limited for smaller companies.

3. Social Pros and Cons of M&A

3.1 Pros

The benefits of mergers and acquisitions extend well beyond the direct advantages conferred upon the firms engaged in the transaction. Often times, the effects of a merger yields benefits to the rest of society as well. One of the primary benefits which mergers can provide to the public is decreased prices. In particular, many companies argue that their companies have cost synergies which will allow them to be more productive. This increase in productivity will, in turn, allow them to lower prices for their consumers, conferring a benefit on the rest of the public.

In addition, another social benefit is increased investment, jobs, and philanthropy to the surrounding community. When a merger or acquisition occurs, oftentimes the headquarters of the companies is consolidated into a single location, bringing more jobs and investment to that community. On top of providing more jobs, this increase in people within the community will spur investment and increased spending within the economy, providing a benefit for years after the merger goes through.

On top of increasing investment, mergers and acquisitions can also benefit consumers by providing a wider range of products to them, allowing them to better optimize the preferences with the increase in choices of products. By bringing two companies together which previously offered different products, the companies would then be able to make each other's products available at their locations, expanding the number of consumers each product can reach. One particular instance where this has occurred is the merger between Bank of America and Merrill Lynch. In this merger, the two companies offered different services to the customers; however, after they combined, they were able to expand the product base for their consumers by broadening the financial services that they offered at their locations. By expanding their product base, consumers from these two firms were then able to access a wider range of financial services.

Finally, mergers and acquisitions have the potential to actually increase competition within the marketplace and this happens two different ways. First, through a vertical merger, a larger company can expand its business into a previously untapped market, allowing it to use its synergies to compete with the leading companies within the industry. One particular example of this is the AT&T and Time Warner merger which happened earlier this year. Through this merger, AT&T could help them compete with companies like Netflix and Amazon who have both started creating and distributing their own content. By combining these companies, AT&T could bring a challenge to Netflix's supremacy in the market and possibly lower prices for consumers. In addition, we can also see an increase in competition through horizontal mergers as well. If two smaller competitors are able to join within a highly concentrated industry, they can provide a challenge to larger companies in the market by both increasing their market share and also increasing their productivity through the economies of scale. One particular example that we see of this is the proposed merger between T-mobile and Sprint. If these two companies were to merge, the combined company would be able to provide a third national carrier to challenge the dominance of AT&T and Verizon in the wireless network market, providing a benefit to other consumers through decreased prices (via more competition).

3.2 Cons

On the flipside, although mergers have the potential to benefit society, they can also be detrimental. One of the negative social impacts from a merger is the possibility of a price increase. There is a strong possibility of a price increase in the economy since mergers (especially in the case of horizontal mergers) can decrease competition in the marketplace. By decreasing competition, it would be significantly easier for companies to raise prices since they now have more market share and less competitors after the merger. In addition, in the case of an acquisition, companies have an incentive to increase prices after purchasing a company so that they can recoup the money that the firm spent to acquire the company, showing the stakeholders that the investment will be a profitable one.

In addition, although some communities will benefit from a merger through the consolidation of headquarters, the opposite is true of the area which lost the headquarters within their city. For this community, they will typically see a decrease in jobs (from people leaving the city), investment (due to less corporate activity in the region) and philanthropy (due to the loss of corporate and private donations). One particular example of this was through the merger of Internorth and Houston Natural Gas. Internorth had become a fixture within their Omaha, Nebraska, and people relied on the business's contributions to the community for both investment and philanthropy; however, after the merger, the members of Houston Natural Gas slowly took over the seats of the board and decided to move the headquarters back to Houston, devastating the economy and the people within the local community.

Although mergers can be used to expand the product selection available to consumers, it has also been noted that the opposite can be true as well. In particular, a company, especially in vertical mergers, can use its market power in the upstream market to affect players in the downstream market, forcing them to pay monopoly prices for their goods. This issue was of particular concern during the AT&T and Time Warner merger when the Department of Justice argued that AT&T would be able to use its market power in content to cut off other distributors from using Time Warner's programming. This would force consumers to switch to AT&T if they wanted to continue to enjoy these programs.

4. Understanding the Apparel Industry

4.1 Important Players

The first step to understanding the apparel industry is knowing who its big players are, and what categories they fall into. Traditionally, the types of companies in the apparel space consists of clothing and accessory brands, retailers, and manufacturers each of which falls into either the luxury, non-luxury or off-price category. The emergence of ecommerce has dramatically changed the face of the space, with both large and small ecommerce retailers and technology retail startups becoming major players. The traditional bulwark of the apparel space is international conglomerate Walmart, which falls into the off-price category, and dominates the space. Other important discount retailers include TJX Companies, owner of TJ Maxx and Marshalls, and Ross Stores, owner of Ross Dress For Less. Also very active and influential in the space are the sizable luxury fashion houses Moet Hennessy Louis Vuitton (LVMH), Kering and Richemont, which have all taken M&A focused strategies to grow their businesses, and which collectively now own almost all prominent high fashion brands. New trends have also created newly minted bulwarks such as fast fashion firm Inditex, owner of Zara, and Nike, which has capitalized on the growth in casual sportswear. Last but not least, it is important to mention Amazon, which in the last decade has become by far the most influential company in the retail space. Amazon's rapid growth and investment into almost every industry has disrupted retail and commerce. 'The Amazon Effect' looms large in the mind of all apparel retailers, and its existence has spurred rapid defensive acquisitions and investments in new technology.

4.2 Recent Changes and Trends

Before analyzing specific deals, it will be helpful to review some common trends in the apparel space and also the consumer and retail space more broadly. As mentioned above, technological advancement and the advent of Amazon has spurred rapid change. Large companies are more focused on technology and defensive investment, as brick and mortar sales, even if on a bounceback, still remain largely uncertain. Overall, the consumer and retail market is still trying to bounce back from the recession and post-recession slow down in order to eclipse pre-recession sales highs. Since 2009, firms have also had to combat fickle consumer preferences, which seem to be changing at lightning speed. One strategy to deal with consumer preferences has been intense diversification, with many firms even expanding into completely new sectors, mimicking Amazon. Global markets have also become far more important for apparel companies than ever before. American and Western European markets are highly saturated, but Asian markets and to a lesser extent South American and Eastern European markets are emerging as gigantic potential customer bases. The drive into new geographic markets has been a substantial driver behind recent M&A. In addition, private equity firms have also become more active in recent years, both as purchasers and sellers of firms. Private equity funds are currently sitting on large amounts of cash due to the economic uptick since the recession, so their activity is only expecting to increase in the coming year. Before moving on to discuss specific apparel deals, it is interesting to look at the historical volume of recent consumer and retail M&A more broadly.

Table 1: Consumer and Retail M&A Activity

Source: A.T. Kearney 2018 Consumer and Retail Report

As can be seen in the chart, since the recession M&A activity has only been slowly making its way back to pre-recession levels. The most important year thus far has been 2016, which saw a spike in both regular M&A and megadeals, defined here as deals greater than thirty billion dollars. Deal values in 2017 were not quite able to eclipse 2016 levels, but they did keep pace, especially without the consideration of often erratic megadeals. While not pictured here, 2018 was also a very large year in M&A with dealflow keeping pace and also seeing a significant amount of megadeals.

5. Recent Apparel M&A Deals

5.1 Walmart

By far the leader in apparel M&A in the past two years has been Walmart. Since August 2016, Walmart has made seven acquisitions, making it deserving of its very own section here. The first acquisition was their $3.3 billion acquisition of Amazon competitor Jet.com. Jet.com is an online retailer just like Amazon and the company was bought with the purpose of directly competing with Amazon's increasing presence. This acquisition was very important to the competitiveness of Walmart's portfolio. Further, Walmart actually made two other smaller e-commerce acquisition right after, ShoeBuy and ModCloth, technically making the purchases through the Jet.com business. ShoeBuy is a direct competitor of Amazon owned Zappos, and ModCloth is an online retailer of 'Indie' style clothing, providing Walmart access to another niche market. Both companies were purchased for around $70 million. Walmart next purchased men's fashion brand Bonobos, which has both brick and mortar and online stores, and began to sell the brand on Jet.com. In May 2018, after a bidding war directly with Amazon, Walmart purchased Flipkart an Indian e-commerce giant. Giving them both access to a new market and the revenues of a company that could, like Jet.com, legitimately compete with Amazon. In October of 2018 Walmart purchased both ELOQUII, an online brand for plus size woman and Bare Necessities, an online lingerie retailer. In sum, Walmart's strategy has been to compete with Amazon through large ecommerce investments and investments in new geographic and client markets.

5.2 Accessible Luxury Brands

Aside from Walmart, the sector in retail that has seen the most M&A action in the past two years is accessible luxury. Recently, accessible luxury brands have been re-evaluating their sales strategies and gearing up to compete either in the non-luxury and discount categories in the pure-luxury category. The most important player in this category has been Michael Kors, which acquired Jimmy Choo in July of 2017 and Versace in September 2018. These acquisitions are in-line with Kors' strategy to boost sales by elevating the brand from accessible-luxury to luxury. The acquisitions were also part of a larger plan to make Kors a luxury fashion house comparable to an

LVMH. Notable in this respect was the renaming of the company from Michael Kors Holdings Limited to Capri Holdings following the Versace Acquisition. Also taking on this strategy is Coach, which acquired Kate Spade in May 2017 and renamed the combined company Tapestry. Coach is looking be a 'fashion house', but has also been relying on discount sales far more than Michael Kors, and does not plan to change this strategy. Also notable, is PVH Corporation's March 2017 acquisition of True&Co. True&Co is an e-commerce intimates brand, that gives PVH, which owns brands known for in-store sales, a better foothold in e-commerce.

5.3 Department Stores

The next biggest players in M&A have been department stores. These large retailers have been struggling with brick-and-mortar sales recently and have each pursued different strategies to combat this issue. In May 2018 Macy's opted to purchase STORY, an industry leader in experiential shopping. STORY is a clothing store based around creating a customized in-store shopping experience, which is increasingly what shoppers are looking for rather than a run-of-the-mill department store experience. Nordstrom, on the other hand, decided to go the start-up route with their purchases of BevyUp and MessageYes. BevyUp is a back-end technology that will help Nordstrom in-store employees and MessageYes is a service brands can use to send certain notifications to customers while they online-shop. Both brands will allow Nordstrom to become more technologically efficient brand. Taking a different route, DSW decided to partner with Authentic Brands to purchase Camuto Group, owner of luxury brand Vince Camuto in October 2018. The deal comes after shoe chain Aldo called off its acquisition of Camuto Group earlier in the year. The acquisition is a huge step for DSW as it vastly expands their portfolio and helps them reach into the elusive luxury market.

5. Conclusion

In conclusion, throughout the past decade, the fashion industry has been dramatically altered through recent M&A. In particular, companies have been utilizing M&A deals to expand their product lines, acquire more market share, and diversify their consumer experience. For the e-commerce behemoths, Amazon and Walmart, these two companies have been expanding their product lines by purchasing up-and-coming brands which offer different products than themselves and appeal to different consumers. Not only are they able to diversify their products this way (and thus protect themselves from the fickle preferences of consumers), they are also able to protect themselves from startup companies who could compete for a piece of the e-commerce pie. In addition to expanding their e-commerce presence, we also see companies utilizing mergers to expand their market share and compete in new markets worldwide. This allows fashion companies to expand beyond the saturated markets of Western Europe and the United States and move to emerging fashion markets (like South America and Asia). Finally, some companies have been utilizing M&A to diversify their customer experience. In particular, brick-and-mortar stores have been purchasing companies to change their consumer experience, so they can stand out amongst the crowded space (like Macy's purchasing STORY). Thus, over the past few years, M&A deals in the fashion industry have been slowly returning back to pre-financial crisis levels and these deals have been used to increase companies' product lines (mainly through e-commerce), expand their companies into new markets, and change their customer experience to help them diversify within a crowded market.

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