WWD

Retail M&A Update: Is It Time to Sell?

Andrew D. Postal, managing partner of MMG Advisors Inc., discusses the state of M&A trends in the retail and fashion apparel market.

By Arthur Zaczkiewicz on October 21, 2020

Andrew Postal says sellers need to "professionally articulate the strategic and financial attributes" of a business and be able to present a "forward plan that validates the value propositions."
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While cash flow and profits have stalled for many retailers and brands this year, due to COVID-19, a flurry of acquisitions has not yet materialized. Still, industry experts say it is a "sellers' market."

Andrew D. Postal, managing partner at MMG Advisors, an investment bank focused on middle-market retail and fashion companies, represents parties on both sides of the table with clients that have included Vince Camuto, John Varvatos, Hampton Industries, the Northwest Company, Milly, New Holland Apparel, Jazwares, Haskell Jewels, Planet Sox, Kids Headquarters and Waterbury Garment, among others.

Here, as part of a two-part series on buying and selling fashion apparel or retail brands, Postal shares his insights into market trends in mergers and acquisitions and what brands need to know when considering a sale.

WWD: Would you describe current conditions as a sellers' market?

Andrew Postal: We believe this is more of a sellers' market than people might believe. While liquidity and profitability have been constrained as a result of disruptions from COVID-19, the avalanche of sellers that many forecasted has not come to pass. Numerous potential buyers with financial capability are looking for opportunities, and the dearth of companies for sale is keeping valuations and demand higher than might be expected.

External market factors may also affect demand. Trade and tax policies going into 2021 could have an impact on timing and valuations. The fate of retailers and suppliers are also factors.

Certainly there is a broad spectrum of outcomes because there is a broad range of circumstances for many potential sellers. Smart buyers are going to consider transactions earlier in a recovery cycle to take advantage of the restoration of value. Potential sellers need to be well prepared for a transaction and should be affirmatively preparing their companies to maximize a successful outcome. Sellers should seek advice on transaction structures, valuation and tax efficiency to insure the best possible results.

WWD: Why should you sell your business? And what value proposition does your company offer for today's buyer?

A.P.: There are many reasons why a business owner should consider selling his or her business in the disrupted economy occasioned by COVID-19. Many businesses have been badly wounded by recent events and may find consolidation with another operating company the way to a sustainable future. Many companies are facing credit constraints in their business or credit problems in their customer base. Some businesses have reengineered operating economics by cutting overhead and may offer greater value to a range of buyers. Many digital companies have actually flourished during COVID-19, and ownership may see an opportunity to achieve high valuations based on 2020 results.

Andrew D. Postal Courtesy image

Regardless of the reason, there are certain basic factors that buyers will want to consider. Does your company have a brand? Does your company have an attractive distribution? Does your company have complementary product expertise? Do you have a secure and dependable supply chain? How has COVID-19 affected your company's economics?

Most importantly, every seller will need to professionally articulate the strategic and financial attributes of your business and be able to present a forward plan that validates the value propositions. The plan must address factors such as: How much of overhead savings are sustainable? Will the company's top line return to pre-COVID-19 levels? What is the growth trajectory for your brand? How has the competitive landscape changed for your business?

WWD: In the context of the pandemic, how do you determine valuations? How should a company think about 2020 sales and profits and normalized valuation?

A.P.: Surprisingly, valuations are not depressed for many types of sale transactions. COVID-19 slowed the M&A market for all but bankruptcies. As we enter a new normal, there is a great deal of pent-up demand for transactions. Public companies need add-on acquisitions to augment organic growth and support their multiples. Private equity firms have funds they have raised that must be deployed. Many private strategics with available capital have been waiting for opportunities for accretive deals. Brand accumulators remain very aggressive, and SPACs [special purpose acquisition corporations] may become a factor.

As a consequence, multiples for good opportunities have not declined. However, sellers should expect deal structures designed to tie consideration to forward performance. Buyers recognize that 2020 may well be an aberration deviating from the past trend of performance. Of paramount importance will be the forecast of 2021 and beyond, with defensible assumptions and performance indicators to demonstrate that the company will return to positive performance. The lessons learned and changes made to the business model resulting from COVID-19 may actually enhance forward valuations.

WWD: What type of buyers are in the market?

A.P.: Buyers today run the gamut from strategics to private equity to brand accumulators and to family offices. Recently, SPACs are being formed to make acquisitions. Each of these classes have different criteria and perspectives on valuation metrics. Strategic buyers are operating companies. Larger strategics, often publicly traded, generally seek brands and are willing to pay premiums for long-term investments. Private operating companies are likely to be more value buyers and will entertain branded, licensed and private label businesses that are accretive to their bottom lines.

Private equity companies typically pursue brands and range from premium buyers to more value buyers. Many private equity firms will consider smaller acquisitions where they are add-ons to an existing portfolio company. Private equity buyers have time horizons for their investments of typically from three to five years. Most private equity firms seek control investments. Family offices are private investment vehicles that favor branded companies and long-term investments.

In considering a sale, owners should be sure to have a carefully curated list of buyers and understand their criteria.

WWD: What are the various deal structures for the sale of your business?

A.P.: Most strategic deals are asset transactions for 100 percent of the company. Strategic deals will generally contain a portion of the value in an earn-out or other features designed to tie value to future performance and incentivize ownership to stay with the business. Earn-outs are structured to be based on metrics ranging from gross margin to contribution margin, EBITDA [earnings before interest, taxes, depreciation and amortization or pretax profits. Negotiating how these post-closing features work is vital to the success of any transaction.

In the case of financial buyers, the transaction is likely to be for less than 100 percent of the company. While these transactions may have a higher percentage of the purchase price paid at close, in today's economy it is likely there will be post-closing contingent consideration. In such cases, the company will be governed by an operating agreement, the terms of which will control how the business is to be operated and the respective rights of the shareholders. The operating agreement will determine how future liquidity events are to be handled and may include put and call features governing future sales between the parties.

WWD: Is it advantageous for our company to run a broad or focused process? What are the considerations?

A.P.: The type of process depends on the ownership's agenda and circumstances.

If an entrepreneur or the family is critical to the business and will have to stay with the business, the culture and character of the buyer may be of utmost importance. If circumstances permit, a focused process aiming for acquirers with whom there is a cultural and synergistic fit may be preferable. In such a case, there may be great sensitivity to customers or employees knowing the company is for sale. This may differ if the company is under financial stress and the need for a quick process overcomes the need for confidentiality.

If the seller's value rests in a brand, or the company is owned by a public company or equity sponsor, there will be less sensitivity to the confidentiality of the process. In such a case, a broad process including strategic and financial buyers will be the best way to maximize value. The better the brand the more likely that the process may be driven by brand accumulators, in which case the process may conclude with linked transactions separating brand equity from the operating company.

WWD: What should you be doing to prepare your company for a successful transaction outcome?

A.P.: Preparation for a sale should start with an assessment of what are the seller's objectives. Next, a business owner must be willing to take a hard look at the business and recognize what assets or lines of business represent value to a buyer. Company capital and overhead should be deployed to support the brands or profitable segments, while unprofitable or unsustainable segments should be de-emphasized.

The company will need to develop a pro-forma model of the go-forward business, including synergies and add-backs that could result from a transaction. The model will need to be accompanied by identifying potential growth drivers, as growth potential will be a key factor in determining value. The company’s balance sheet will need to be considered, particularly liabilities that buyers may reject such as leases, benefit plans, and facilities such as warehouses.

If a digital business or division is involved, KPIs [key performance indicators] will need to be reviewed. Buyers will want to assess whether customer acquisition costs [CAC] have been artificially lowered during COVID-19 and whether marketing spend will escalate as demand for media increases in 2021 and beyond thus increasing CAC. Increasingly, digital businesses need to show profitability or a credible path to profitability within a reasonable period.