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Dries Van Noten's texture play.
Photo by Delphine Achard

Proenza Schouler
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It's Only Money

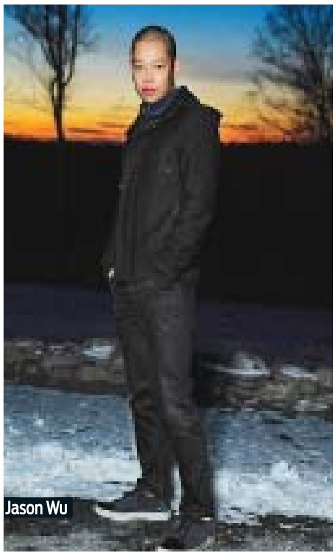
The experience and know-how of a strategic partner can be as important as the checkbook to a young brand.

BY VICKI M. YOUNG AND MILES SOCHA


Prabal Gurung


Rebecca Taylor


Peter Pilotto


Jason Wu

The lure of the so-called "money men" is irresistible—and in many cases indispensable—to independent fashion brands.

But these indie firms, as they evaluate what investment path to take, need to understand that financing is about both dollars and sense.

Firms that do under $15 million in annual volume generally rely on friends and family, but once they are past the $15 million mark, their options can really open up. That's when the business is deemed to have shown some traction, or proof of concept, as financiers like to say.

Traditionally, indie firms have the option of debt or equity. Debt financing includes factors and commercial bank lenders. Equity has typically meant just private equity and strategic buyers.

Lynn Shanahan, chief executive officer of Kellwood Co., which counts Parker and Rebecca Taylor among its contemporary brands, is eyeing up-and-coming designers and labels that have reached at least $30 million in volume to add to its platform.

Strategics, she says, are a great option for incubating the foundation of a brand to take it to the $100 million level. "We can help with the back end of operations, such as accounting functions and distribution, as well as provide advice and help build relationships with retailers," Shanahan notes.

And many designers might be surprised that it's not so easy to open stores, an area where an experienced strategic partner can help.

"Designers don't realize that they have to have enough product categories to engage the consumer experience in the brick-and-mortar format," the ceo says.

According to Ariel Ohana, founder of investment banking firm Ohana & Co., going straight to a strategic partner without a detour to private equity is "getting more traction—for example, Kering taking a 40 percent stake in Joseph Altuzarra last year."

Ohana expects these deals to continue: "Investing in younger brands is a high-return play, but one that comes with high risk, which private equity understandably isn't always prepared to take. They all come with great press books. But there's a difference between having great press coverage and a successful business.

"For strategics, it is a lower risk because of their operational platform and their interest in having a stable of younger designers for when succession issues occur at their mature brands, as was the case for Dior," Ohana says, alluding to the protracted search the French house endured following the 2011 ouster of John Galliano.

And where equity was once narrowly defined, it now has a wider scope that includes high-net-worth individuals, family office and sovereign wealth funds. There's also a newer model developing that involves linkage with an operator that has the financial backing of a private equity firm.

Isabelle Dubern, founder of the Paris-based luxury consultancy 10 Vendôme, outlines another option: "An interesting combination is when a manufacturer invests in a small brand to support it, as happened with hat brand Larose or small fashion brand Le Progrès. In my opinion, this is generally a worthy and healthy combination where support is provided and each party's interests are well understood."

Regardless of what form financing takes, the scenario unfurls along a similar path for indie firms, according to Pierre Mallevays, managing partner of London's Savigny Partners, a mergers and acquisitions firm.

"After the first few million in revenue, the business side starts to feel a lot of strain due to working capital requirements, and often an understrength team," he says. "It's a hard slog, but they can take it into double digits on their own. Beyond that, the brand is generally keen to get investment, particularly if it is considering its own retail or other categories. Remaining independent limits the pace of development and ultimately how far it can go."

A case in point is Jason Wu, who on the day of his New York show, revealed he'd sold a controlling stake in his business to Interluxe, a new investment firm backed by Lee Equity that leans on the fashion expertise of Hilldun Factors' co-ceo Gary Wassner and retail's resident turnaround king Allen Questrom. Wu plans to open a flagship and expand his budding e-commerce and handbag businesses.

New York designer Prabal Gurung and London design duo Peter Pilotto and Christopher De Vos are said among other indie names exploring taking on investors to help grow their businesses to the next level.

Richard Morgan, managing partner of a namesake financial advisory firm in Paris, says it is unlikely that an unproven designer can attract potential investors within the first five years in business. Unless a designer can reach a certain threshold, he or she will be seen as a "start-up with little track record," he says, noting such brands often struggle to reach break-even, struggle for visibility to attract major wholesale clients and rarely are able to finance their own retail.

Winning a fashion prize, or moonlighting at a major brand, can leverage a designer's profile in front of the investment community, he adds. Options for financing for this profile of designer is usually "friends and family," or seed money, as was the case

TAYLOR AND GURUNG PHOTOS BY STEVE EICHNER; PILOTTO BY GIOVANNI GIANNONI; WU BY RODIN BANICA for AMI designer Alexandre Mattiussi, who scored an investment from Mode et Finance in 2012, subsequently winning France's ANDAM.

But even that kind of profile isn't necessarily a guarantee of success.

According to Wassner, "There are a lot of thresholds. It may depend on how many retailers are buying you. If you are a $15 million brand and one retailer has 45 percent of your business, that's not a healthy picture. But it you are a global brand, with more retail accounts, you are speaking to a wider audience. If you are diversified and no one retail account is more than 15 percent of your volume, that tells a lot about the future of the brand."

Robert Burke of Robert Burke Associates says, "The best thing brands can do is grow their business organically without outside investors for as long as they can to get a better valuation when they finally do seek outside investment. If they have a partner take a majority interest at an early stage, the company might not fully realize how much it can achieve."

He explains that sometimes a partner can push to grow in one area, when in fact that avenue ends up being outside the brand's core DNA.

Jeffry Aronsson of the Aronsson Group cautions, "While all money might look the same, the faces behind it are as important as what the money buys. One must be as certain as possible to assure four key ingredients—alignment with a strategy to achieve common goals, clear understanding of mutual expectations, good chemistry and sufficient capital—are present. The absence of any one of the first three threatens a disaster even if there is sufficient capital. Be aware of the face of the money, no matter how [much one is] starving for capital. The consequences of not doing so could be worse than going broke."

> "THE REAL ISSUE IS NOT THE NEED FOR MONEY, BUT THE NEED FOR 'SMART' MONEY."
> — ELSA BERRY

Elsa Berry, founder of luxury-focused investment banking firm Vendôme Global Partners, says, "The real issue is not the need for money, but the need for 'smart' money."

She cites as "smart" money recently formed private equity alliances such as Interluxe, Front Row Partners and Castanea Partners, where there's financial backing coupled with the know-how of an operational specialist.

"They're hands-on and able to provide fashion-specific strategy and operational insights," she says.

One of her concerns is that young companies have an easier time getting brand equity earlier in the cycle due to social media, which can create a huge awareness of the brand very early on.

"Sometimes it comes too early. The business model hasn't kept up with the awareness of the brand, and mistakes can be made. The company may believe it can do certain things, but it really can't because management isn't always deep enough yet and the growth in the cycle of the business hasn't caught up," Berry says.

Understanding the particular peaks and valleys connected with growing pains is where Glen Senk, now chairman and ceo of Front Row and former ceo of David Yurman and Urban Outfitters Inc., might have the advantage over private equity competitors who don't have the benefit of an operating partner.

Senk says as a growth investor, he looks for innovative brands with a point of difference and leaders who are forward-thinking. And the competition to get his attention is keen. "With the inflow we've been getting [since the company launched in March], we're having trouble keeping up with the number of inquiries. There are a lot of interesting investments out there," he says.

Senk's advice to brands looking for an investor: "Spend time on your due diligence. It's not just about getting money. It's not about getting the highest valuation. It's about getting the partner who can create the best value [for the brand] over the long term."

What Are *You* Doing Here?

The finance guys get a front-row perch, but they're not just looking for the latest print or where hemlines hit.

ILLUSTRATION BY MARCELLUS HALL

There in the front row at a slew of shows, rubbing shoulders with the fashion cognoscenti, sat factoring firm Hilldun Corp.'s co-chief executive officer Gary Wassner. And if he wasn't present, Hilldun's executive vice president, Joshua W. Kapelman, was there instead.

So were hedgies and bankers. What gives? Surely critiquing fashion wasn't topmost in their minds.

Hilldun execs check out more than 100 shows each season—including Rodarte, Jason Wu, Derek Lam, Mara Hoffman, Nicholas K, Stella Nolasco and Skingraft. But they're not always the runways of current clients: While Wassner attends some shows to ensure existing clients kept their DNA intact, he's also on the prowl for up-and-coming designers who might need some help in the finance department.

Kapelman looks for "talent and a distinct point of view that resonates with the brand's target customer. I also want to see who's there—friends and family, or buyers and press who can help advance the brand."

Andrew L. Sole, managing member of Esopus Creek Advisors LLC, the adviser to the hedge fund Esopus Creek Value Series Fund, which acquired Loehmann's in a bankruptcy sale in January, said his team checked out show week to glean how the fashion set interacts at live events as it builds out Loehmann's Web site. Some of the shows he took in were Carmen Marc Valvo and Mark and Estel. Esopus shot a street-style video during fashion week that was posted on the off-pricer's site, and "experimented with blogging and social media sites such as Instagram to engage with the customer who couldn't be at Lincoln Center," he says.

For investment bankers, it's about circumstantial evidence. For instance, audience reaction hints at how a brand is received. But who knew that staging a show can be a gauge on the economy?

"I'm looking for the reaction to the designer and the energy in the room," says Gilbert W. Harrison, chairman of Financo Inc., a frequent front-row denizen at such shows as BCBG, Vera Wang and Tommy Hilfiger. "I don't care as much about the attendees or the celebs, although the stars in attendance can say something about a designer's standing. That's necessary to really understand where the product is going."

Triangle Capital's investment banking partner Richard Kestenbaum goes to different shows each season and gets a good read on the economic mood.

"It's always about the product, but the shows also unwittingly send messages about the environment. Is there optimism or concern in the air?" he says, adding that a show where the runway collection is safe and similar to past shows can indicate caution, while a little bit of fashion risk can be interpreted as a sign the financial backdrop is positive.

—V.M.Y.