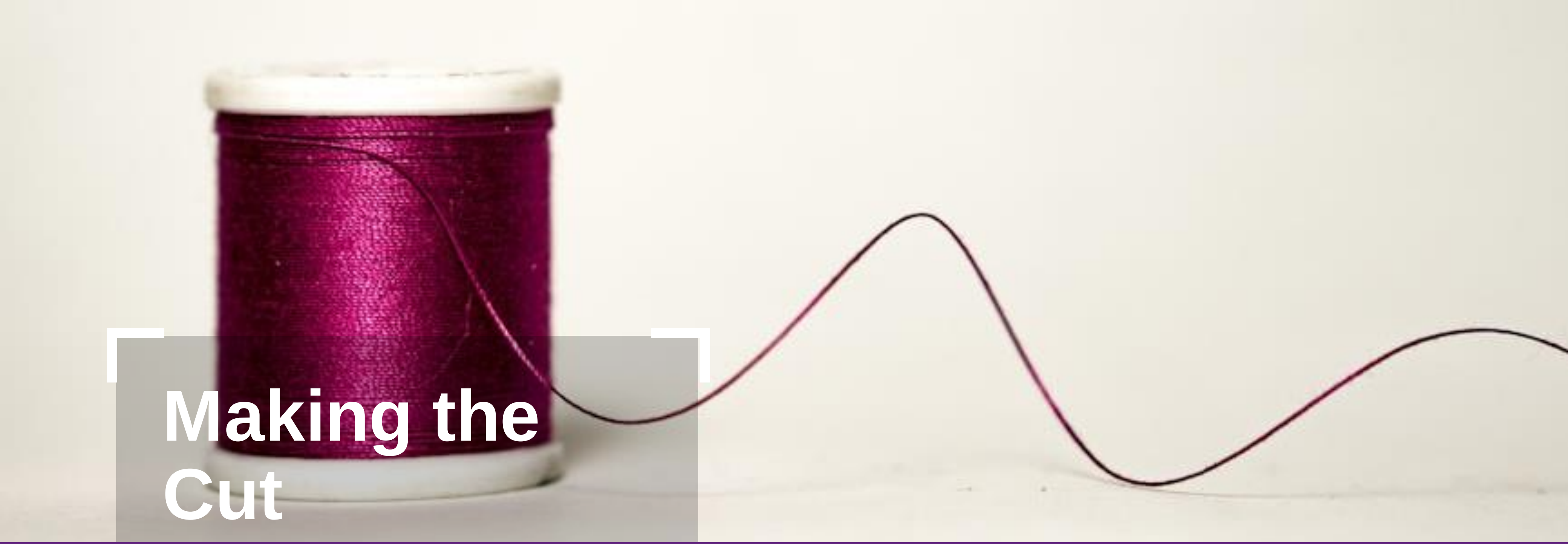


# Making the Cut

Opportunities & Imperatives for Fashion Investments

June 2024

OC&C Strategy consultants

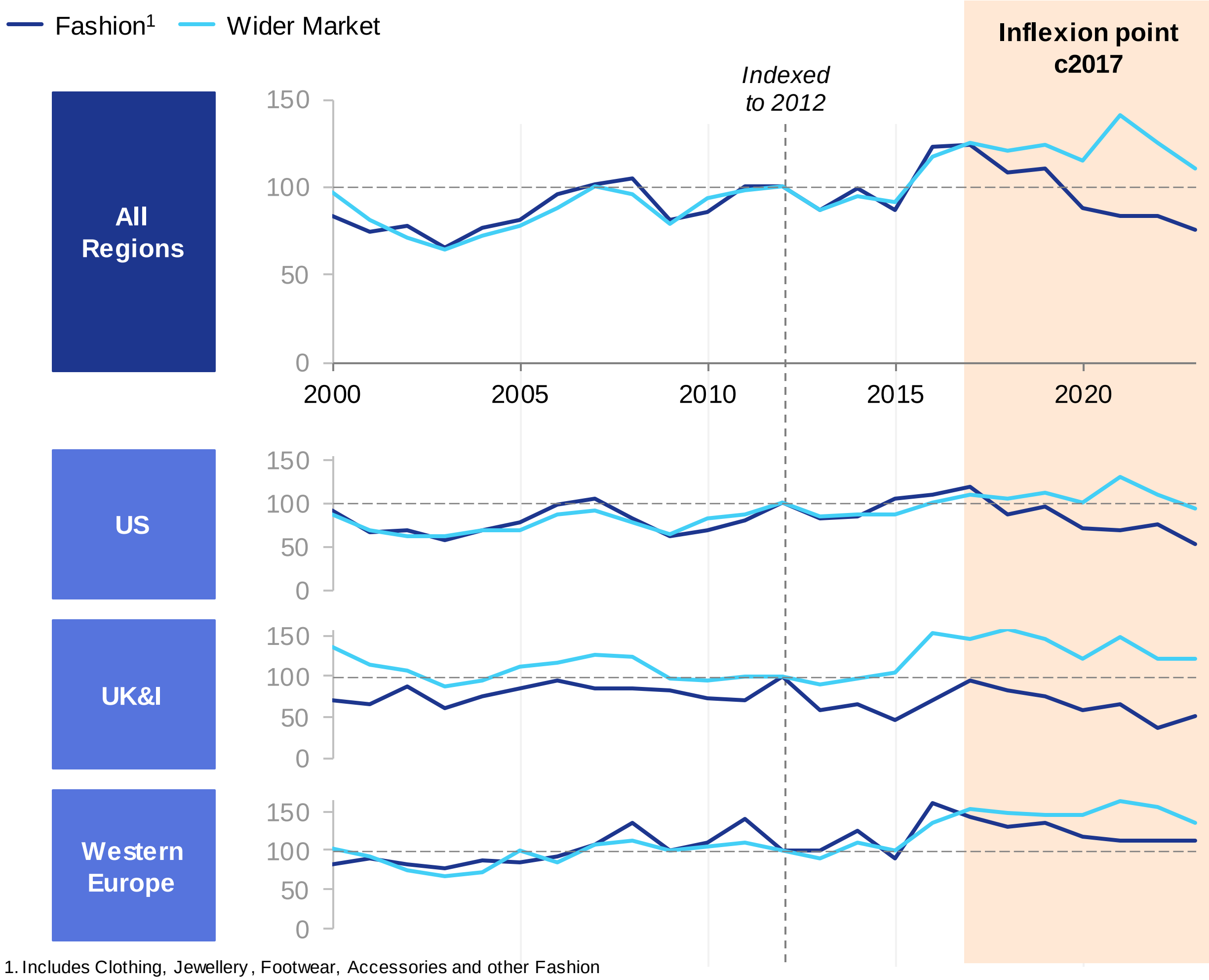
Certified B Corporation

# The Investment Landscape

- **Deal flow in apparel has slowed since 2017, and assets are achieving relatively low multiples vs other categories**
- Selected sub-categories have continued to attract more attention from investors:
  - **In Europe, luxury activity remains higher** driven by perceptions of lower cyclicality, higher margins and availability of trade buyers
  - **In the US, performance/technical assets attract most interest** due to underlying category growth and perception of lower fashion element
- Low apparel activity is despite EBITDA growth, strong (and improving) ROCE and strong underlying customer dynamics
- A key challenge is a more limited pool of exit opportunities and higher burden of proof at investment committee, around fashion risk (amongst other things)
- This environment presents opportunities for investors and imperatives for brands
- **For investors, the right asset can provide solid returns and a less competitive bidder landscape**
  - Finding the right metrics to assess fashion risk is key to success
  - Market dynamics enhance the opportunity: new brands are scaling quickly, and ESG regulation is disrupting established operating models
- **For brands in some categories, it is crucial to prepare the right investor metrics to reduce risk perception:**
  - Articulating brand differentiation and reason for existence.
  - Establishing detailed customer & cohort tracking and product attribution
  - Demonstrating EBITDA stability, growth & sustainability
  - Evidenced long term (10 year) headroom potential
- **All of the above will provide investors confidence in long term exit opportunity**

# Apparel deal flow has been slower in recent years, with successful exits increasingly more difficult to execute

**Deal Volume, 2000-2023**




**Apparel & fashion is not currently seen as a 'must-do' investment, fashion risk is poorly understood**

*"**Lenders are resistant** to investing the category"*

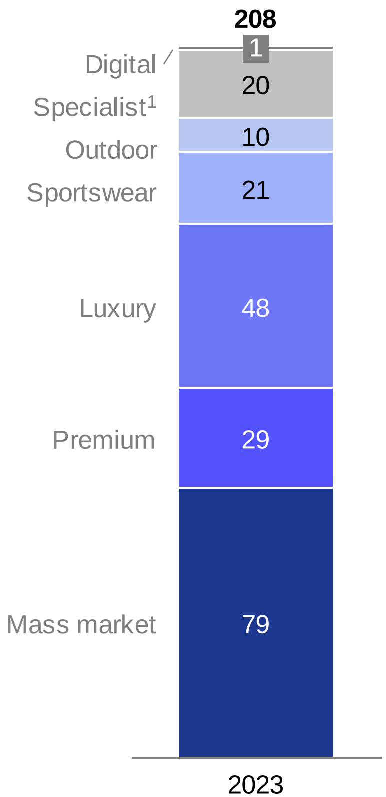
*"**Interest in the sector is at cyclical lows** and won't get any worse in terms of multiples and interest. Interest is likely to shift with a couple of big, profitable exits."*

1. Includes Clothing, Jewellery, Footwear, Accessories and other Fashion

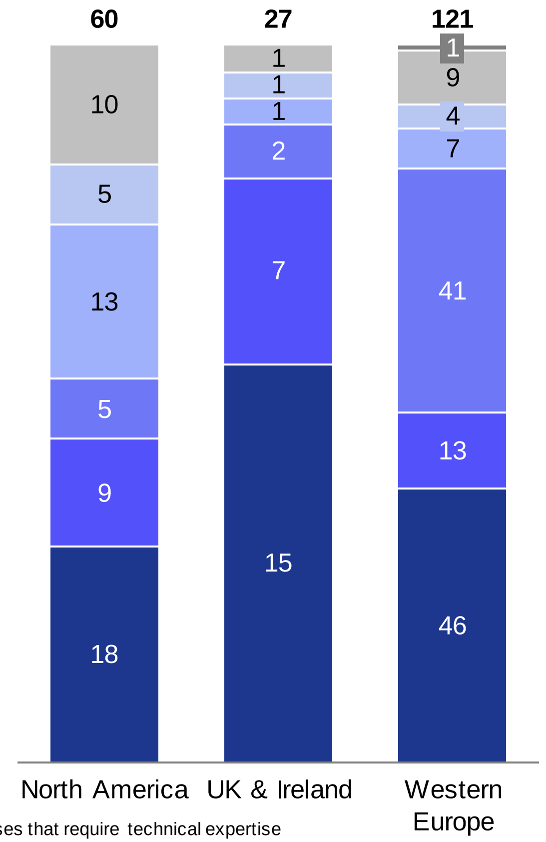
Source: MergerMarket, OC&C analysis

# However, hotspots of deal activity remain within the market – specifically luxury price points and athletic/outdoor

**Sub-Category Deal Volume**
2023




**Sub-Category Deal Volume by Region[2]**
2023




**Focus in Western Europe is mostly on Luxury deals; UK and US deals are more Premium and Sportswear centric**

***"Luxury and premium price points continue to resonate*** *with investors - there is opportunity to push price upwards not downwards. Investors believe margins are better and that consumer spend is more resilient"*

***"There is still lots of interest on the technical side.*** *There are more exit opportunities for those businesses.*

***"Footwear and accessories are getting more interest than apparel"***

*"Authenticity, story telling, content and freshness are now **more important than ever** to differentiate"*

1. Specialist companies offer novel products or manufacturing processes that require technical expertise
2. Geographical location is based on location of target company

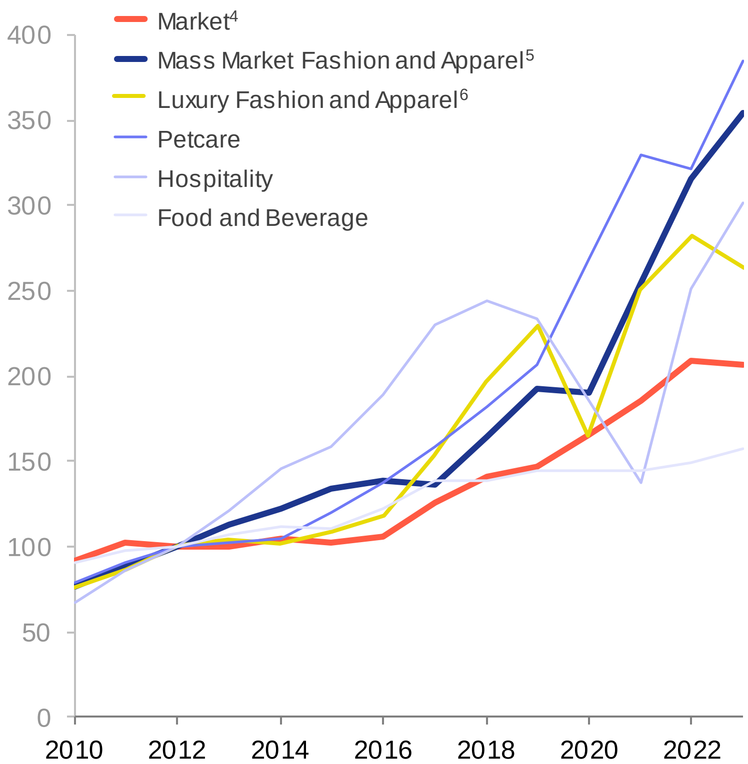
Source: MergerMarket, OC&C analysis

# We believe the opportunity in apparel is undervalued – the sector is more stable and better performing than current investor perception

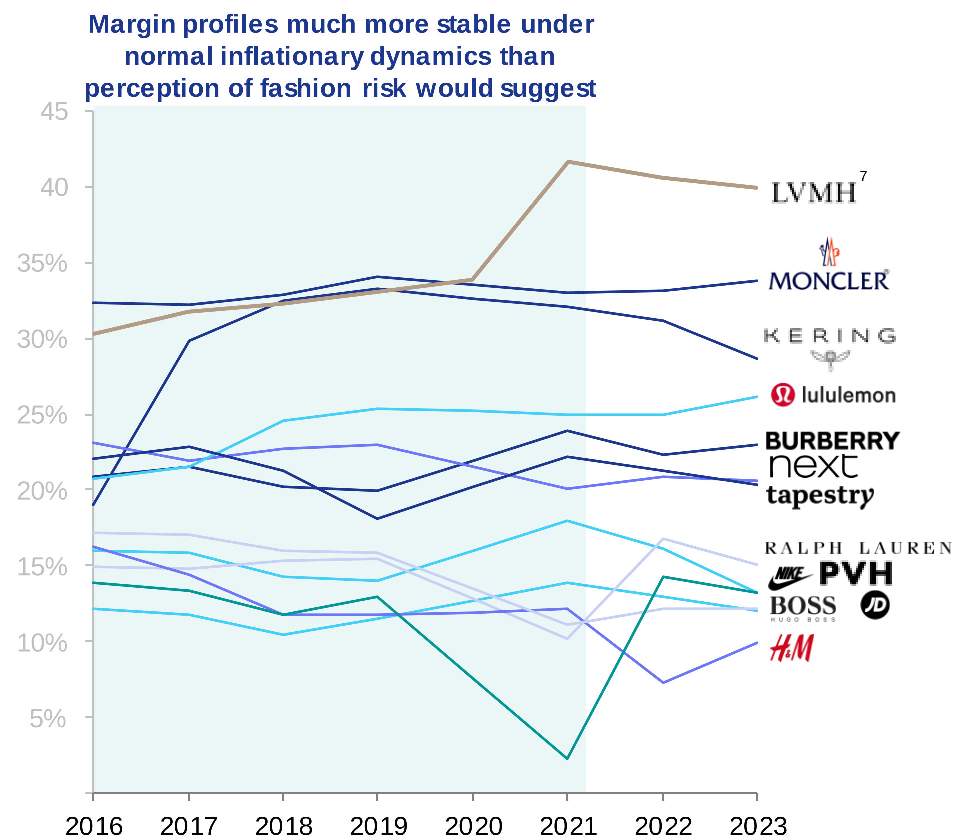
### Indexed Average EBITDA by Industry Segment, 2010-2023[1, 2, 3]

Indexed to 2012

*Includes FTSE100, NASDAQ100 and EuroNext100 companies*




### EBITDA Margin % by Company (2016 – 2023)[3]




1. Indexed to 2012. Yearly data as of 31st December 2. Only includes companies that have data for all relevant years 3. Data omits Covid period (2020) 4. 2023 members of FTSE100, NASDAQ100, & EuroNext100 that have data 2010-23 5. Peer group: JD Sports, NEXT, Frasers Group, Lululemon 6. Peer Group: Kering, Burberry and Moncler 7. LMVH Fashion and Leather Goods business group

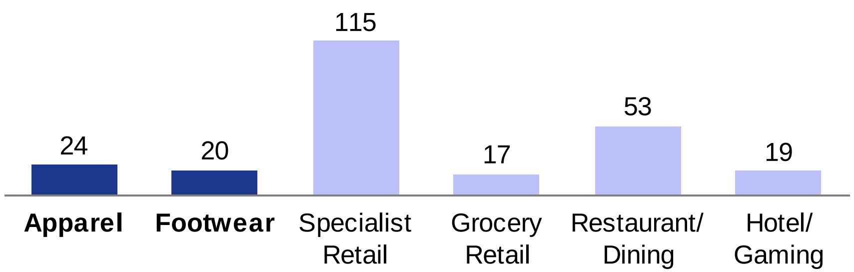
Source: CapIQ, Annual Reports, OC&C analysis

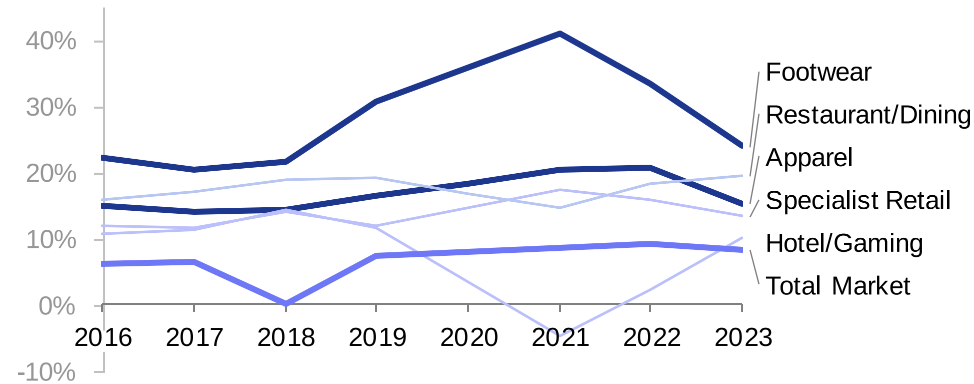
# Current sentiment on the sector could provide opportunity for investors – assets are undervalued and deliver good returns on capital

## Average PE Ratio by Category
2023

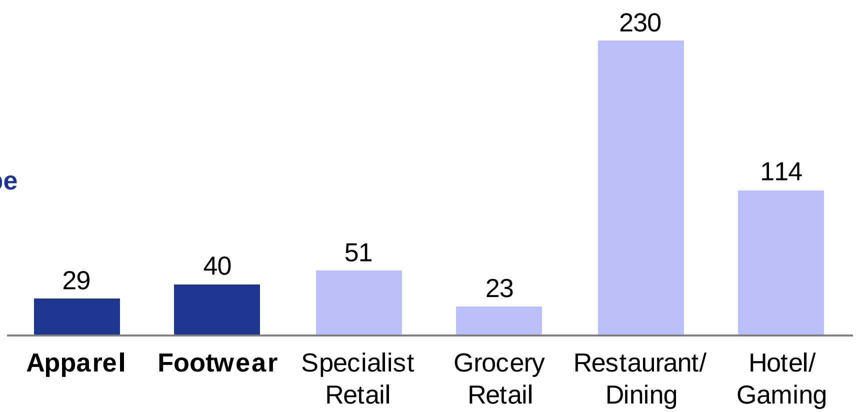
## Average Return on Capital[1] by Category[2]
%, 2016 - 2023

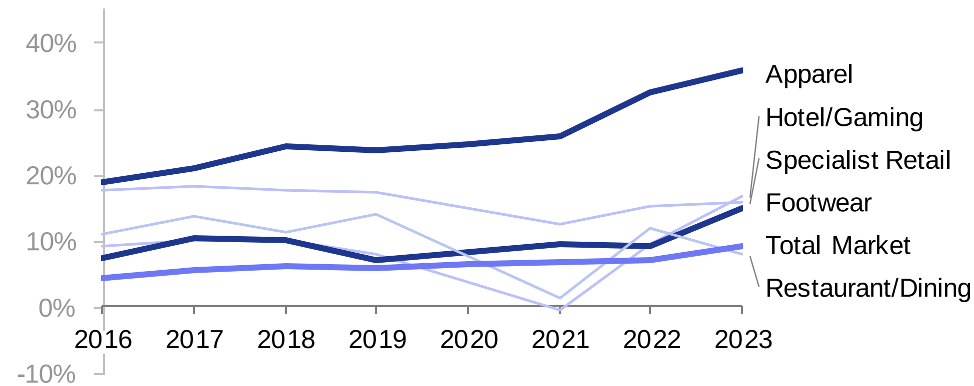
**US**




**Europe**




1. Aggregated after-tax Operating Income, across all firms in group, using trailing 12 month data/ Aggregated Invested Capital, across all firms in group, using most recent balance sheet.
2. Data omits Covid period (2020)

Source: NY Stern, OC&C analysis

# Apparel has much more repeatability of product and customer than is generally recognised

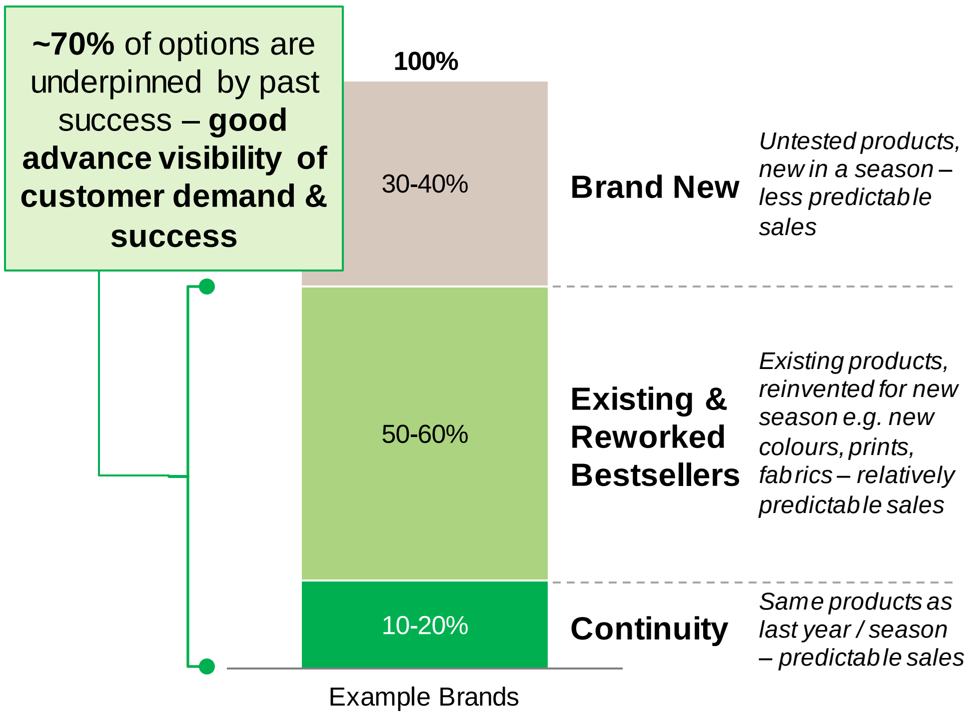
Selecting the Right Asset

**Many fashion businesses have a substantial amount of continuity & predictability across seasons….**

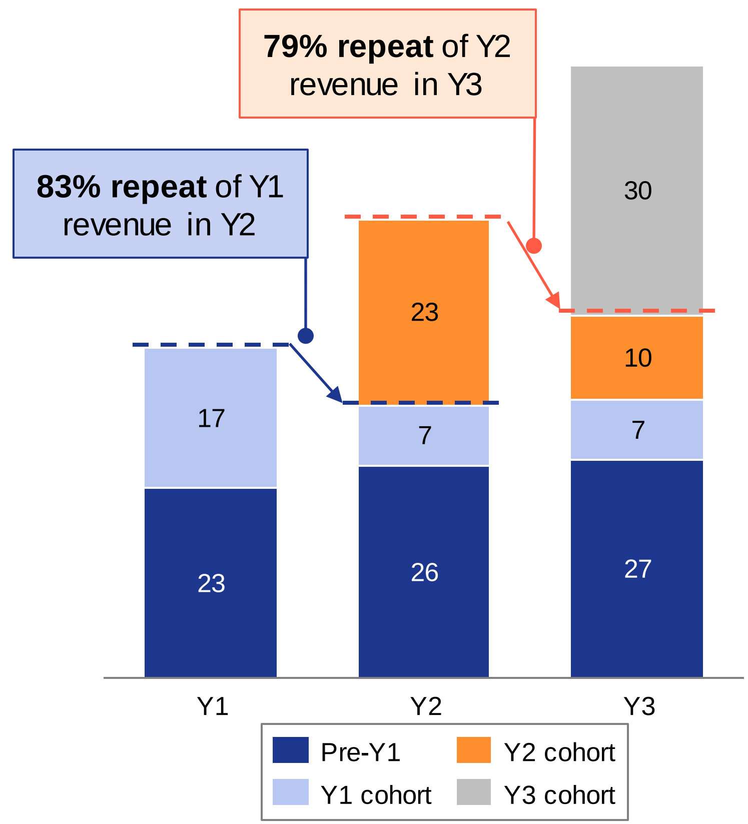
**… And winning brands have loyal customers who return year after year…**

**Example Brand Continuity Pyramid (% of Options)**

*N.B. Revenue % will show even greater skew to continuity*




**Example Apparel Brand:** Revenue by Customer Cohort (Ecomm)




Source: OC&C Experience, OC&C analysis

# A small pool of investors in the category presents opportunities for incoming investors, but challenges for brands/exits

## Investment Landscape

| | | | Example Investors |
|---|---|---|---|
| Primary pool of investors / exit options | Category Confident PE | Knowledgeable on risks & key metrics and are selective on which assets they back. Have a proven brand growth playbook | eurazeo, General Atlantic, TSG Consumer, Highland Europe, Permira, L Catterton, Lion Capital, Great Hill Partners |
| | Family Offices | Willing to take a longer term on growth, and prefer brand-enhancing assets and protecting brands of cultural significance | growth partner, BC CAP Blue Coast Capital, LionRock Capital, Mousse Partners<br>*Fragmented* |
| | Trade Aggregators | Generally reactionary to well-priced assets. They look to leverage existing infrastructure and consider brand fit with rest of portfolio | LVMH, TFG London, next, Frasers Group |
| | IPCo Operators | Buy distressed and discounted brands/IP and then outsource all channel/store operations to create value | authentic Authentic Brands Group, Iconix, Marquee Brands, WHP Global, Bluestar Alliance A Brand Management Company |
| | IPO | Only suitable for assets with sufficient scale | Birkenstock |
| Situational buyers | Interventionist Investors | Specifically look for underperforming & well-priced assets with clear value creation case | Elliott, Sycamore Partners, Alteri Investors, Aurelius |
| | Dormant Trade Buyers | Large international brand groups which currently show limited M&A interest | PVH, VF, GAP |
| | Category Sceptics | Limited current interest in apparel, unless in hotspots (e.g. athleisure, sustainability). Often previously interested | *Fragmented* |

# For investors, picking the right asset is critical – with a set of product, customer and brand attributes which can create advantage

**Key Attributes of Wining Apparel Assets**
With example metrics

**Product / fashion**

- **Stable core product / style which is reliable across seasons** (% continuity)
- **Ability to evolve core product over time** (avg. age of continuity lines)
- **Consistent, data-led seasonal newness** (season success rate, sell-through rate)
- **Identifiable, authentic brand** with significant equity

**Customer**

- **Cross-season customer repeat patterns** (avg. order frequency)
- **Longevity of core active customer base** (avg customer lifespan)
- **Full-price behaviours of core customer** (% of customers buying at full price)
- **Highly engaged customer base and community focus** (social media, event engagement)

**Brand Identity**

- **Clear view of target customer that is not too broad nor niche** (demographics, attitudes, KPCs and needs)
- **Clear articulation for reason to exist** (focus customer, need, occasion)
- **Omnichannel route to market** (optimising use of digital and physical space)
- **Clear content and image** to engage customer base and tell brand story

**Many brands do not track / disclose these as standard**

**This creates potential advantage for well-informed investors**

**Timing & life-stage of the asset** is also important and has a clear implication for headroom, growing pains and exit

# For brands, we see a number of key themes which underpin success/failure at investment committee in the current environment

**Key Themes at Investment Committee**

**Brand strength & trading performance are not enough**
… but remain important: well-performing assets still fall down at Investment Committee

**Fashion risk & repeatability are front of mind for investors**
… but relatively few brands have adequate proof and/or killer metrics to assuage concerns

**Profit growth has become the key metric, replacing topline growth**
Debt cost and availability make financial engineering less viable and future profitability less trusted

**Price flexibility & ability to pass through costs is expected**
Inflationary pressures mean input costs are front of mind – investors want to see rises being absorbed

**Growth should be self-financing**
High cost of debt means sound net working capital structure is seen as critical

**Longer-term growth runways are required**
Investors want 10-year headroom with proven levers – theoretical opportunities are ascribed little value

**Diversified models and operations preferred**
Investors want brands to have a balance of exposure across channels, geographies and categories

**Data accessibility and AI readiness are a barometer for business health**
Metric requirements are higher and good tracking is a sign of operational capabilities

**Digital is attractive but omnichannel is now back in vogue**
Investors no longer ascribe higher valuations on digital alone, and scrutiny of digital metrics/costs is high

**Sustainability is a hygiene factor**
… rather than a USP. Data / traceability expectations continue to rise

**Exits are planned from the start**
… with a view of next likely owners given restricted buyer landscape

# Imperatives for Exit Planning

## Given the investment landscape, brands need to prepare well ahead of the investment process

**Direct Quotes from Banks Operating in the Sector**

### Reassurance on Sector & Asset

- **Build factbase to offset underlying scepticism** on the sector, and ensure credibility on "soft" factors (brand, customer quality, fashion-risk etc) for a financial audience

*"There is lots of scrutiny to understand if there is a fashion component to the brand and how likely to fall away that is"*

### EBITDA Growth & Stability

- **Take action to stabilise and prove growth of EBITDA profile**, with evidence & processes to demonstrate this can continue

*"Growth has been very important, but there is increasing focus on growth in profitability"*

### Pathway to Next Ownership

- **Articulate long-term (<u>10 year</u>) growth vision**, with initiatives in progress and proof points on emerging success

*"Investors want to see that the TAM has opportunity, and growth is not levelling off. They look at 10 years, not 3-5 years"*

# In our experience, there are a set of metrics that help investors understand the strength of a business

Key Investor Metrics

**Not Exhaustive**

| | | | | | | |
|---|---|---|---|---|---|---|
| **Reassurance on Sector & Asset** | **Strength of the Brand** (NPS, awareness etc) | **Number + growth of active customers** | **Customer loyalty** eg repeat rates, frequency | **Core product continuity & evolution** | **Repeatability of success in seasonal / trend product** | **Geographical Diversification** |
| **EBITDA Growth & Stability** | **Product unit economics** (intake & delivered margins) | **Discounting rates** (Markdown %, full-price sell-through) | **Digital & marketing performance** *(incl. CAC, ROAS)* | **First order economics and CLTV** | **Channel operating costs** | |
| **Pathway to Next Ownership** | **Size, penetration & headroom with core market** | **Sized growth / expansion opportunities** | **Success metrics against in-progress growth initiatives** | | | |

# There is a clear set of actions 6+ months before exit for brands to prepare key investor-facing metrics

Actions for Brands: Preparing Key Metrics

## Target Market & Consumer

- ✓ Define **Total Addressable Market** (TAM) & and **target customer**
- ✓ Market-wide **tracking of consumer sentiment** – aligned with target customer

## Customer Performance

- ✓ **Unify view of customer** data - particularly to bridge offline and online transactions
- ✓ Create & track set **of customer repeat metrics**
- ✓ Analyse & track **customer value** and **profitability** across whole ecosystem

## Product Repeatability

- ✓ Attribute and tag product lines including **legacy seasons**
- ✓ **Define & track a metric** to measure season success
- ✓ Increase **traceability** of product development/design process

**Ensure accessibility & quality of standard BAU metrics**

General consumer & customer tracking

Key commercial metrics – sell-though, pricing, promotion, markdown etc

Digital & marketing metrics – CAC, CLTV, ROAS etc

# Brands should also initiate a set of profit driving initiatives – investors will want evidence of success over time to see progression, providing confidence this can continue

**Actions for Brands: Driving / Stabilising EBITDA**

| | Example Value Creation Opportunities | When | Key Proof Points to Prepare | When |
|---|---|---|---|---|
| **Price & Promotions** | • Calibration of GBB price points vs comps<br>• Data-led price increases on continuity lines<br>• Optimise of CRM lifecycles and discounts | 12-36 months ahead | ✓ Historical price increases by line (continuity)<br>✓ Price elasticity of customer base to price increases<br>✓ Discounting %, and impact on reactivation | 12 months ahead |
| **Buying & Stock Clearance** | • Identify intake margin drivers and pursue<br>• Define structure on buying processes, and carefully manage buy depths<br>• Optimise clearance profile and outlet channels | 24+ months ahead | ✓ Intake margin % over time for high volume continuity lines<br>✓ Sell-through rates on seasonal stock<br>✓ Markdown rates by season | 12 months ahead |
| **Marketing & Acquisition Costs** | • Define clear thresholds for ROAS, and monitor performance continuously<br>• Discipline on digital costs at a channel and customer level | 12+ months ahead | ✓ ROAS for brand-level activity<br>✓ CAC over time by channel and market<br>✓ Fully-loaded CLTV – including acquisition, returns and reactivation<br>✓ Cohort performance e.g. retention, AOV, basket size | 6 months ahead |
| **Channel Costs** | • Right-sizing of store estate<br>• Commercially tightening concession relationships and wholesale terms<br>• Unify view of stock & customer across channels | 24+ months ahead | ✓ Store / channel contribution (% and $)<br>✓ Store productivity<br>✓ Footfall<br>✓ Cross-channel customer profitability | 12 months ahead |

# Given focus on headroom, brands should develop and actively pursue a long- term vision to expand the addressable market

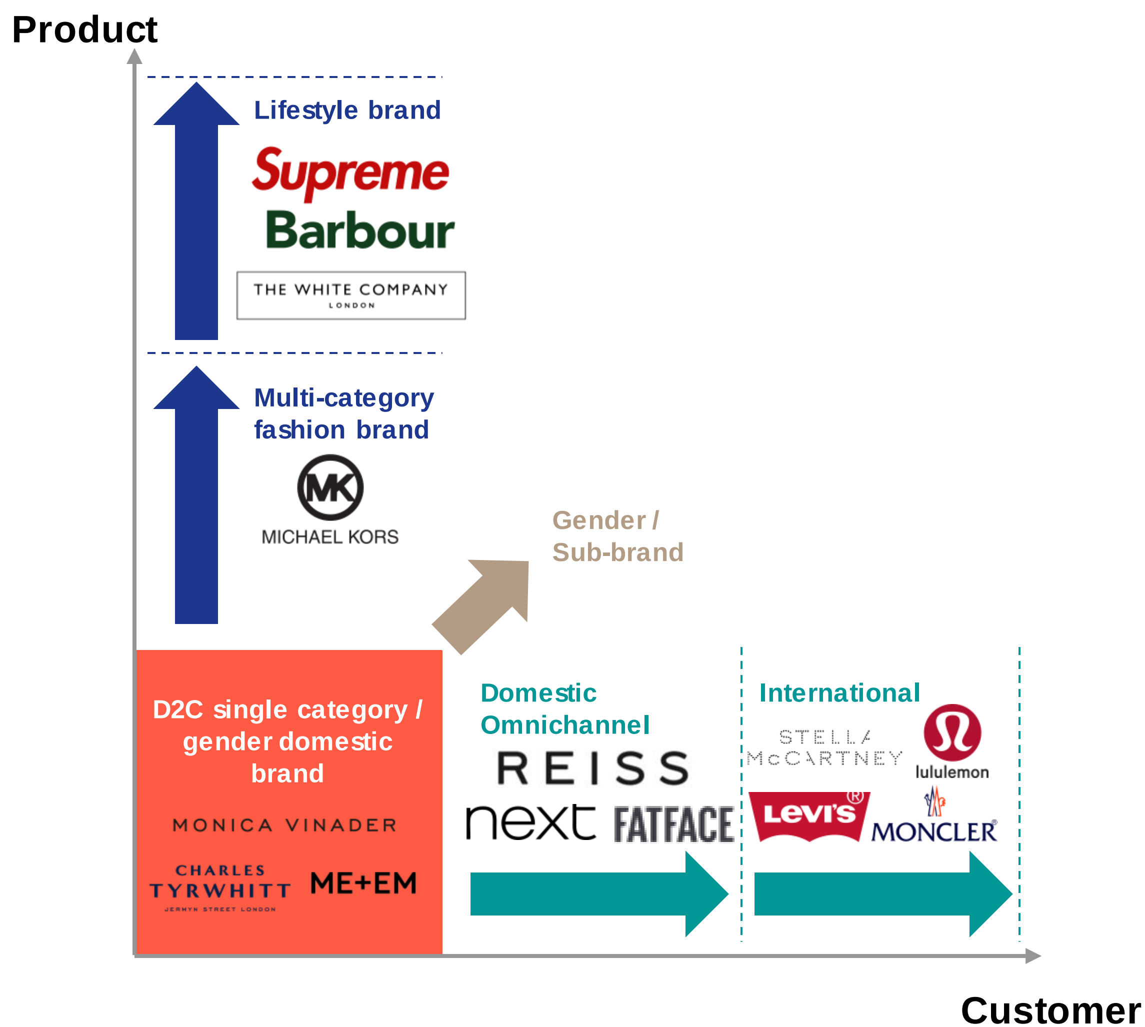
**Actions for Brands: Growing Addressable Headroom**

## Growth headroom is constraint on pathway to next ownership

**Investors are looking for:**

- **Clear vision of long term, 10+ year vision**
  – Additional headroom required to attract the next owner (or enable IPO)
- **Defined set of expansion initiatives at different stages of maturity**
  – A focused, credible list will land better than a comprehensive one
  – Near-term initiatives should already be live / in-progress, with emerging proof points (rather than theoretical)

**Illustrative View: Expanding Addressable Market**



# For brands, there are 5 imperatives in the 12-36 months ahead of exit – beyond BAU trading and execution of near-term strategy

Imperatives for Brands Planning an Exit

**Clearly define the target customer** and implement investor-friendly brand / customer tracking metrics

**Formalise product design function** and ensure good traceability of process and tagging of products

**Optimise for profit early across the value chain** to prove out sustained trajectory of profit growth

**Develop & action a 10 year growth vision** with initiatives at varying degrees of maturity

**Make data core to the operating model**, highly accessible and integrated into BAU decision-making

# OC&C has experience in supporting brands and investors throughout the ownership cycle

**OC&C Transactional Support n Apparel**

**Non exhaustive**

| | **Value Creation**<br>*c. 12-36 months ahead* | **Exit Planning**<br>*c. 6-18 months ahead* | **Exit**<br>*0-12 Months ahead* |
|---|---|---|---|
| **Types of Support** | • Structured projects to drive value, e.g.:<br>– Long term vision & expansion<br>– Product & supply process optimisation<br>– Store & channel efficiency | • Prepare evidence base for exit<br>– Definition & sizing of TAM<br>– Define metric definitions and tracking programmes<br>• Tactical actions to unlock profit<br>– Price & promo optimisation | • Strategy & exit story 'pulse check'<br>• Business plan development<br>• Commercial Vendor Due Diligence<br>• IPO Market Reports (for Long / Short Forms) |
| **What you get** | • Develop and realise strategic vision<br>• Rigorous process to drive commercial and operational improvement<br>• Ensure initiatives land early so there are adequate returns and proof points at exit | • Well-prepared evidence base to offset potential investor concerns on product, customer and headroom<br>• Enhanced profitability profile ahead of the transaction | • A well-developed investment story ahead of the intensity of the exit process<br>• Reduce base case uncertainty and independently validate upsides |

# We have deep experience across all dimensions of the apparel and fashion landscape

## Example OC&C Experience (Non-exhaustive)

| Broad knowledge base across categories & price points… | …Including work with digital led brands and disruptors… | …And extensive M&A experience including IPO |
|---|---|---|
| *Luxury*: Louis Vuitton, Burberry, LVMH, Gucci, Dior, Kering, Yves Saint Laurent | asos, Vinted, fgh, very | *IPO*: Pepco – IPO for Pepco; Watches of Switzerland – IPO by Apollo |
| *Affordable Luxury*: Boss Hugo Boss, AllSaints, Tommy Hilfiger, Reiss, Hobbs London, Victoria's Secret | allbirds, The Hut, Gymshark, Vestiaire Collective, N Brown, Veepee, Castore, END., brands4friends | *Sell-side*: Reiss – Vendor Due Diligence for Warburg Pincus; Masai Clothing Company – Vendor Due Diligence for Rye Family; Poundland / Pepco – Vendor Due Diligence for Steinhoff; Hobbs – Vendor Due Diligence for Sale by 3i; Seraphine – Vendor Due Diligence for Bridgepoint; Zizzi Clothing – Vendor Due Diligence for Fidelio |
| *Fast Fashion/ Mainstream*: Primark, Banana Republic, G-Star, C&A, Gap, Pimkie | M and M Direct, Outfittery, eobuwie.pl, Farfetch, Under Armour, Spartoo, Seraphine, Mos Mosh | *Buy-side*: Footasylum – Commercial Due Diligence for Aurelius; Farfetch – Acquisition of a Stake by IDG; Monica Vinader – Commercial Due Diligence Bridgepoint |
| *Footwear*: Jimmy Choo, Scholl, Crocs, Deichmann, allbirds, Dr. Martens, Salvatore Ferragamo, fitflop, CCC | Dr. Martens, Rapha, Missguided | |
| *Jewellery & Accessories*: Coach, Monica Vinader, Bottega Veneta, Watches of Switzerland | | |