

HOT M&A TRENDS IN FASHION, APPAREL AND CONSUMER PRODUCTS

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INTRODUCTION

Gibson Dunn’s Fashion, Apparel and Consumer Products Group brings global and comprehensive industry expertise to the complex legal and business issues faced by: fashion designers; apparel, beauty and consumer products companies; retailers; and investors in this sector.

Our offices, strategically located throughout the United States, Europe, Asia and Latin America, provide local market intelligence and legal advice in the major geographic markets for product manufacturing, distribution and sales. We advise a wide range of businesses, from start-up ventures to multinational corporations.

Our areas of industry expertise include:

- Acquisitions and disposition of brands and businesses
- Equity investments, strategic business relationships and financings
- Licensing, manufacturing, distribution, outsourcing and service agreements
- Creation, protection and enforcement of intellectual property, including trademarks, trade names, service marks, trade secrets, copyrights and patents
- Employee benefits
- Real estate
- Commercial litigation and dispute resolution
- Tax planning
- Antitrust
- E-commerce



INTRODUCTION

- This is the first in a series of ongoing briefings and updates on topical issues relevant to the fashion, apparel, retail and consumer products industries.
- In the current environment, many corporations and private equity firms are actively seeking to acquire branded product lines.
- Today's Webcast explores three different strategies for acquiring brands:
 - Acquisitions (stock purchase, asset purchase or merger)
 - Joint ventures/Partnerships
 - Licenses
- And the attendant legal issues related to each approach.



1. ACQUISITIONS

- Several recent high-profile strategic brand acquisitions
 - PVH – Tommy Hilfiger
 - Jones Apparel Group – Stuart Weitzman
 - Robert Rodriguez
- Movement from private equity ownership or designer ownership to corporate ownership
- Reflects difficult global IPO market
- Reflects build up of brand portfolios and industry consolidation



Private/Strategic

- Typically done as asset transactions
- Assets acquired include Marks and other IP, equipment, inventory, WIP, artwork
- Typically leave behind A/R, distribution arrangements and preclosing liabilities
- Many industry-specific reps – IP, trade loading, customers, returns, inventory
- Covenants include ordinary course, noncompetes, transition issues, EIN codes
- Tight indemnities standard



Private/Fund

- On the sell side, P/E transactions have short indemnities with caps as low as 10%
- On the buy side, often not as specific in industry-specific reps/warranties or covenants
- Fund transactions typically include specialized reps and covenants around financing and also allow for walk away for reverse break-up fee
- Escrows and earn outs are playing an increasing role in this area



Public Transactions

- Public transactions in the consumer products/retail vertical look (surprisingly) like public company transactions in any vertical
- Issues handled are generic and include typical public company issues of the day – financing, specific performance, fiduciary outs, reverse break fees and MAE negotiations



Convergence?

- While there is some convergence in the fund and strategic M&A worlds, there seems to be little crossover of industry issues to the public handling of industry M&A
- For example, strategics now negotiate for short indemnities, low caps, reverse break ups and limited escrows in private transactions, but neither strategic nor private equity buyers insist on industry-specific representations/warranties or covenants in public deals





New Direction?


- Use industry-specific reps and covenants
- Public company issues surrounding MAEs should be recognized and handled expressly in private company deals as well as public company deals
- Use specific EBITDA targets for MAE
- Shift burden of proof
- Specify that MAE need not be long term in case of breach of specific reps/covenants, such as customer terminations or trade loading breaches

2. JOINT VENTURES/PARTNERSHIPS

- If a founder desires to retain a significant equity interest in the brand, a joint venture or partnership may be an attractive approach, particularly with a corporate or private equity partner.
- Iconix Brand Group recently formed a joint venture with a mission to leverage Madonna's name and personality in the worldwide development of brands.
 - MG Icon LLC structured as 50-50 joint venture between Iconix and a Madonna/Guy Oseary entity.
 - Iconix paid \$20 million (payable over 4 years) for 50% of the joint venture limited liability company, subject to adjustment.
 - Earn-outs based on achievement of certain milestones (i.e. executed sublicenses for additional trademarks or for women's fragrances).
 - Purchase price reduced by reductions in certain royalties to be paid under license agreements.
 - Entered into direct-to-retail agreement with Macy's for a new Material Girl collection of junior apparel, footwear and accessories to be launched exclusively in Macy's stores and online.

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- Iconix also acquired the Peanuts brand and related assets through a joint venture in which it will own an 80% interest and certain Schulz family trusts will own a 20% interest.
 - Joint ventures require complex negotiations on:
 - governance
 - operations
 - equity and debt funding
 - ownership transfer
 - dispute resolution
 - **Key Issues**
 - Addressing strategic direction
 - Problem if objectives not clear, or purchasers have different objectives
 - Agree on detailed multi-year business plan prior to entering into venture

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- Keeping the talent
 - Employment agreements with non-compete
 - Buyback of employee shares at a discount
 - Royalty payments on sales
 - Creative control
 - Transferring interests
 - No transfers for a specified period (passage of time, achievement of financial milestones)
 - Pre-emptive rights
 - Tags, drags, rights of first refusal
 - Protecting the minority holder
 - Supermajority votes required on key matters

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- Providing for future funding
 - Explicitly provide whether one or more purchasers are committed to provide future funding, what form and on what terms
 - Provide default provisions
 - Resolving disputes/termination
 - Specified termination date
 - Russian roulette
 - Texas shoot-out
 - Modified Dutch auction
 - Penalty
 - Mediation or cooling off period

3. LICENSES


Allows potential acquirer to test the water before committing to acquire the brand

License Agreements typically provide:

- licensor owns the trademarks
- licensee retains the proceeds of sales
- licensee pays a royalty to licensor based on sales (3-15%)
- licensor has approval rights

Additional provisions can create broader rights:

- Renewals
 - can be automatic (if no breach) or conditioned on achievement of specific milestones
- Right of first negotiation/First offer
 - can be geographic and/or product based
- Right of first refusal/Right to match
 - can be geographic and/or product based

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- Put/Call
 - transfer of trademarks and goodwill
 - operative only after specified time period or achievement of specific milestones
 - exercisable only once or at pre-determined intervals
 - formula based on revenue/earnings/other metrics or mechanism (third party determines FMV) for determining price
 - risks



CONCLUSION

- We will continue this series of webcasts with programs on topical issues including e-commerce, intellectual property and regulatory compliance.
- In addition, we will distribute timely email alerts on current legal developments.
- If there are particular topics that you would like us to address, you would like additional contacts to be added to our distribution list, or you would like further information about our practice, please contact us at lherzeca@gibsondunn.com or dwilf@gibsondunn.com.