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Troubled California Brands Figuring Out How to Survive in the New Apparel World

By Deborah Belgum | Thursday, October 6, 2016

A rash of recent layoffs at big prestigious Los Angeles labels noted for their superb fabric, cutting-edge styles and trendsetting ways is a sign that traditional brands are facing tough competition from e-commerce sites and fast-fashion retailers and faced with the added challenge of a millennial mindset that shuns department-store merchandise in favor of fashion blogger recommendations.

Particularly hard hit is the premium-denim category, where private-equity firms and investment groups in recent years bought out the founders of such well-regarded labels asTrue Religion, J Brand, 7 For All Mankind, Joe's Jeans and Hudson Jeans.

True Religion, acquired in 2013 by TowerBrook Capital Partners for $824 million, is in high risk of going bankrupt, according to a recent Fitch Ratings report. The company's revenues are down to $408 million after coming in at $420 million five years ago. Its institutional term loans amount to $485 million.

There are reports that True Religion is looking for a turnaround expert after having brought in John Ermatinger last year as the company's chief executive.

"True Religion has fallen on very difficult times and mostly for their own home-made reasons, making the already tough market situation much worse for them," said Andreas Kurz, a former chief executive of 7 For All Mankind and now president of Akari Enterprises, an international business consultant. "The premium-denim market has contracted. People are working with an old recipe where they import Italian or Japanese fabric, but now they are manufacturing in China or Mexico and trying to sell a jean for $200 to $250. That doesn't work anymore. Consumers are more price-conscious."

The Internet and new technology are turning the apparel industry and the retail world on their heads—with many trying to conjure up the latest magic formula.

On top of this, department-store shoppers have been trained to hunt for bargains, while younger consumers shun the majors to search for uniqueness in their clothing mix.

"The consumer is being trained to be more frugal and to expect more for less, and that is tough on brands" said Lloyd Greif, president and chief executive of Greif & Co., a downtown Los Angeles investment banking firm. "This is an industry under assault."

Three Los Angeles labels hard hit recently are 7 For All Mankind, Splendid and Ella Moss, sold to Israeli company Delta Galil earlier this year for $120 million by VF Corp., which bought the contemporary labels for more than $1 billion several years ago and saw revenues from the three drop several years in a row.

With its new purchase, Delta Galil is laying off more than 100 people at the three labels and combining the headquarters of all three into one Los Angeles location.

"There was a perception that these brands were once on fire and now they are just smoldering," Greif said, noting that Delta Galil is known for selling down-market goods. “This is a clear sign that these brands are well into their maturity and are on a downhill slope. Whether Delta Galil turns them around or milks them until there is nothing left remains to be seen.”

J Brand is also struggling. Japanese giant Fast Retailing Co., parent company of Uniqlo, acquired an 80 percent share of the denim label in late 2012 for $290 million.

J Brand has been under performing in recent years, forcing Fast Retailing to take a $145.8 million impairment loss during fiscal 2016.

Premium denim is not the only category taking major hits. Other California brands, particularly those catering to department stores, are being squeezed.

BCBGMaxAzria is laying off 123 people as it tries to come out from under a load of debt that is owned principally by Guggenheim Partners, the company’s major shareholder.

The new frontier

Financial experts catering to the apparel industry point out that these problems are not unique to California companies but to the apparel industry across the country.

U.S. specialty stores have been shrinking in the last two years as many go out of business or have low credit ratings, making it difficult for clothing manufacturers to get financing from factors and banks to sell to these retailers.

“The same thing that is going on in California is going on in New York,” said Paul Zaffaroni, managing director at Roth Capital Partners. “These are problems that are more of the industry.”

Rob Greenspan, president of Greenspan Consult, points out that it is the nature of the fashion business that things change, going up and down like a roller coaster. A savvy businessperson lays off people when sales are down and hires when revenues are up.

“When business gets bad, the smart business has to do the smart thing to survive,” he noted.

But financial experts caution that other survival techniques have to be put into place and a whole new business strategy developed to keep up with modern times.

“The brands that are growing quickly are the hot brands that go direct to the Internet and reach the consumer by social media and online,” Zaffaroni said. “We have seen brands come out of nowhere and go from zero to $30 million in sales in two or three years—all online. The old way of opening independent stores and department stores—that model is broken.”

But good products still reign supreme. Thomas Knapp, an assistant professor of clinical entrepreneurship at the University of Southern California’s Marshall School of Business and the founder of California action-sports brand Honolua Surf Co., said you have to continue to provide fashion hits.

“They have to fit with what is happening in the world at the time and maintain a core position,” he said.

Catering to the customer is also important.

“Nobody woke up and said there is nothing in my closet,” Knapp said. “It is really getting people to make the decision that they will choose you over other offerings.”

That is why many in the premium-denim market, which is starting to see some momentum after years of sluggish sales, are tweaking their merchandise mix to compete with the athleisure movement. Denim companies are offering denim pants with spandex to make them more comfortable—even making jog jeans that have the feel of a knit but the look of denim.

“The athleisure movement is not about to stop. People want more-functional and -technical garments,” said Kurz of Akari Enterprises.

Kurz noted that in the past it was taboo to introduce spandex to men’s jeans because men preferred traditional rigid denim.

“Now, even in men’s denim, the introduction of stretch fabric has found a great audience because it is just more comfortable,” he said.

Product and price are two things most apparel companies can deal with. But the one cumbersome hurdle for many clothing companies and retailers is getting a handle on how to market and sell clothes online, which is key to surviving. During the first eight months of this year, department-store sales tanked 5 percent compared to the same period last year, while online sales jumped a staggering 15.8 percent, according to the U.S. Census Bureau.

“It is hard to figure out this digital strategy, but everyone knows they need to do it,” Zaffaroni said.