AS SEEN IN SGB JULY 2013

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The *Deal* Makers

When it comes to the history and evolution of the modern sporting goods industry, there may be few people who know as much as Joe Pellegrini and Andrew Martin of Robert W. Baird & Co.

The Deal Makers

"We identify why a particular brand story can generate sustainability and profitable growth. We also know the global strategic buyer universe and private equity buyers and can match sellers and buyers to achieve exceptional outcomes.

BY CHARLIE LUNAN

Pellegrini, since retiring as an NFL offensive lineman in 1989 to go to work for Robertson Stephens, and Martin, since dedicating his career to the industry after a long stint crafting deals for Merrill Lynch and Lehman Brothers, have probably helped more U.S. sporting goods companies raise capital, acquire other companies or be acquired than anyone.

In early 1994, Pellegrini helped bankrupt Odyssey Holdings, Inc. find buyers for The North Face, Sierra Designs and Marmot. Six years later he advised VF Corp. on its acquisition of Vans. In the 2000s, Martin and Pellegrini formed the partnership that survives today, working on transactions such as the IPOs for Under Armour and Zumiez and, in 2012, they advised Wolverine Worldwide on its acquisition of the Sperry, Saucony, Stride Rite and Keds brands from Collective Brands. The partners are among a small group of bankers who have dedicated their practice to the burgeoning active lifestyle and sporting goods space.

Typically, these specialists work both the sell and buy side. In the span of a year, they might help a $50 million-a-year company issue convertible bonds to finance expansion, broker a sale between two private equity funds and help a strategic buyer snap up a brand at a bankruptcy auction. They travel the globe to find buyers and sellers and can be seen prowling the aisles of Outdoor Retailer, ISPO Munich and the SHOT Show for the latest innovations, brands and consumer trends. They are the deal makers.

While the transactions they enable do not always pan out, they have played an important role shaping, reshaping and consolidating the U.S. sporting goods industry to help it lower costs, fund innovation and grow faster than it might have otherwise. In doing so they have helped build American Recreational Products, Cabela's, Inc., Deckers Outdoor Corp., Easton-Bell Sports, Jarden Corp, Wolverine World Wide, Inc. and VF Corp. into global players capable of growing the industry not just at home and in Europe but in Asia, Russia and Latin America.

"When I grew up you went to a fishing shop to buy a fishing rod, you did not go to a mass merchant," recalled Jim D'Aquila, managing partner with Imperial Capital, who helped Dick and Jim Cabela raise their first round of outside capital. "You can now go buy for $40 a beautiful rod and reel combo from Shakespeare that cost $150 when I was a kid and did not have the same quality. These big box retailers have made outdoor recreation more accessible and more top of mind."

The Early Days

Pellegrini was awoken to the potential of the sporting goods industry in the early 1990s, while working as a member of the Consumer and Retail practice for Robertson Stephens.

In 1993, he was assigned the task of helping Odyssey Holdings, Inc. sell off some of its more than 30 outdoor brands as part of a court-supervised bankruptcy proceeding. By the time the liquidation was completed, he had sold Sierra Designs to American Recreation Products, Marmot to a management led buyout group and The North Face to a group backed by J.H. Whitney.

Over the next four years, Pellegrini helped Pacific Sunwear of California, Cannondale Corp. and Rockshox, Inc. raise millions of dollars through IPOs, while also helping Oakley and other rapidly growing companies raise capital, acquire companies or sell themselves to larger corporate buyers or private equity firms. Still, deal flow was sporadic.

"In 1995 there were five or six relevant transactions a year," said Pellegrini. "I used to go to the Outdoor Retailer Show when it was one or two moderate size conference halls. At that time, it was still a small industry dominated by Columbia and Patagonia, which were themselves a fraction of their current sizes and The North Face was under $100 million in sales. There were not enough sizable transactions to generate a profitable investment banking career. Since, the industry has exploded and expanded into multiple, sizable, and rapidly growing categories. Today, my partner (Managing Director, Andy Martin) and our team sometimes struggle to keep up, and there are 3 to 6 transactions in a category each month."

D'Aquila recalls his pivotal deal coming in the early 1990s when he helped raise some of the original outside capital for Dick and Jim Cabela. That experience taught him that the modern logistics and outsourcing Walmart had used to drive down costs was going to spread to the sporting goods industry. As Dick's Sporting Goods and The Sports Authority grew, he figured they would demand better pricing from vendors. To meet this demand and to satisfy retailers' desire to work with fewer vendors, sporting goods' wholesalers and manufacturers would have to consolidate and achieve the scale needed to profitably meet the pricing demands of the key sporting goods retailers.

"I came to this industry because I loved it," said D'Aquila, an avid paddler and cyclist who created Mercanti Group in 2001 to focus on the opportunity. "I started calling on companies whose brands I used, like K2, after it occurred to me that consolidation on the retail side was going to cause consolidation on the vendor side."

One of D'Aquila's first calls was Dick Heckmann, then chairman and CEO of Seattle-based K2. Heckmann was already well known for his $8 billion sale of U.S. Filter, a company he had built through 260 acquisitions. D'Aquila argued K2's underutilized two million-square-foot Chinese factory put it in a unique position to begin consolidating the industry. Over the next five and a half years, D'Aquila helped Heckmann acquire Rawlings Sporting Goods Company and five of the 26 other companies Heckmann bought before selling K2 to Jarden Corp. for $1.2 billion.

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Consolidation Accelerates

Nathan Pund, now a managing director and group head at D.A. Davidson & Co., recognized the consolidation trend while working at RBC Capital Markets in 2003, when he found himself advising Mountain Hardwear on its sale to Columbia Sportswear.

"From the success of that transaction I realized that the outdoor space was poised for growth and consolidation," said Pund, noting that from 2001 to 2003 three of the industry's marquee names – Arc'teryx, Mountain Hardwear and Marmot – had all been sold to strategic buyers. "I thought 'Oh my goodness,' this industry is really changing. That was a watershed moment when the floodgates opened. I tried to convince my boss to open a practice and he disagreed, so I quit and formed Silver Steep Partners in 2005."

At Silver Steep, Pund was joined by Robert Farinholt and Sally McCoy, a former CEO of Sierra Designs and vice president of sales for The North Face who left the firm in 2008 to serve as CEO of

CamelBak. During Silver Steep's existence, from 2005 to 2010, the team closed 18 transactions. Since 2003, Pund has advised on 27 closed deals in the space.

In 2003, after three years at Lehman Brothers, Pellegrini moved to Charlotte, NC to lead Wachovia Corp.'s Retail and Soft Goods investment banking practice. There he teamed up with Martin, who had brought relationships cultivated at Lehman's European corporate finance practice in London. Together the duo took on a variety of high-profile assignments, including helping Under Armor, Volcom and Zumiez go public, advising VF Corp. on its acquisition of Vans and advising SmartWool, Easton Sporting Goods, Brooks Sports, Pearl Izumi and Reef on their sales to Timberland, Riddell-Bell, Russell Corp. (now Fruit of the Loom), Shimano and VF Corp., respectively.

The partners attribute their success to being able to quickly assess whether a brand has the potential to sustain growth.

"We have a really good sniff test and ask some pretty probing questions to figure out the merits and quality of an opportunity," he said. "We identify why a particular brand story can generate sustainability and profitable growth. We also know the global strategic buyer universe and private equity buyer and can match sellers and buyers to achieve exceptional outcomes. We can save people enormous amounts of time without making mistakes. We can help them find that needle in the hay stack."

The Financial Crisis

Deal flow slowed in 2007 as the credit cycle peaked and banks tightened or completely stopped lending to private equity firms, retailers and small businesses. Almost overnight, private equity firms found they could no longer get banks to finance 60 percent of the costs of a deal. By the time Lehman Brothers filed bankruptcy in September, 2008 many PE firms had already shifted their focus from growing companies to stabilizing cash flow. Banks became much more reluctant to finance inventory for retailers because the outlook for consumer spending was so uncertain, making it difficult for vendors to forecast demand. PE firms that had jumped on the active lifestyle bandwagon in the go-go days leading up to the Great Recession retreated from the space.

"A lot of investors perceived a lot of success, specifically in the outdoor world," said Steve Moore, a partner at Brentwood Associates, a Los Angeles private equity firm that has focused on consumer brands since the early 1970s. "There was a sense among some investors that you could do no wrong and it was going to grow no matter what. The 2008/2009 timeframe helped everyone understand whether they had a brand that was important to the consumer."

As valuations dropped, taking on a private equity partner or going public became much less attractive for founders and entrepreneurs. Deal flow suffered.

"For us, the challenge was finding good quality businesses," said Moore. "It was clear those entrepreneurs were not interested in selling their business when people were out looking for a bargain."

In 2008, Pellegrini left Wachovia Corp. to help Robert W. Baird & Co. open its Charlotte investment banking office. Martin joined in 2009 after Wells Fargo acquired Wachovia. In their four years at Baird, Martin and Pellegrini have increased their dedication to the space and, as a result, their deal activity. Notable deals include the sale of Augusta Sportswear to Kelso, the sale of CamelBak to Compass Diversified Trust, the sale of Helly Hansen to Ontario Teachers' Pension Plan, the sale of Peter Millar to Richemont and the sale of Implus Corporation to Trilantic Capital Partners, just to name a few.

"Deal activity clearly softened during the downturn, but the consumer actually held up pretty well as it related to recreational activities," said Martin. "Once the economy started to recover, that buoyancy in the sector - particularly among the stronger brands - allowed for a quick return to deal activity, often at valuations similar or even superior to prior to the downturn."

It did not hurt that Congress was debating whether to restore the 20 percent tax rate on capital gains, said Pund. The debate prompted a flurry of deals as sellers sought to close deals before a widely anticipated December 31, 2012 deadline.

That tailwind, however, became a headwind January 1, 2013, when the tax rate on capital gains increased from 15 to 20 percent. In an era of cheap money, some owners are now simply opting to postpone equity sales.

"There were several companies we expected to come to market in the last few quarters who have instead leveraged up, paid themselves a dividend and decided they will come back later to take another bite at the apple," said D'Aquila of Imperial Capital. "They may be experiencing growth and like their valuation, but they may be thinking 'I don't think performance or value will go down, so I'll leverage up, take out 50 percent of what I'd get if I sold and still own the business.'"

Christy Lowe, an Imperial Capital Managing Partner based in Los Angeles, expects more deals as retailers battered by two disappointing winters and Amazon.com gauge whether to raise more capital or fold.

"It has become more difficult to succeed in brick-and-mortar retailing given the growth in both mobile e-commerce and online retailers, led by Amazon," she said. "If you are a multi-branded online retailer, you are competing on price with Amazon, which is an uphill battle. Brick-and-mortar retailers need to connect with

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their consumers and create a compelling in-store environment in order to survive. Otherwise, their stores are serving as showrooms for cheaper online alternatives."

Strategic Investors Look to Move the Needle

Strategic buyers who fueled much of the deal flow in the 2000s, meanwhile, are keeping their powder dry for acquisitions large enough to affect their bottom line. This focus on "moving the needle" was illustrated in 2012 by VF Corp.'s $2 billion acquisition of Timberland and the more recent bid for Billabong assets and Wolverine Worldwide, Inc.'s $1.23 billion acquisition of the Sperry Top-Sider, Saucony, Stride Rite and Keds brands from Collective Brands. Jarden Corp. has not acquired a sporting goods company since 2007 and sees few investments to rival its own stock.

"We're not very good at auctions and so the best M&A opportunities we've seen so far have been buying back our own equity," Jarden Corp. CEO Jim Lillie told analysts in early 2013. He noted that Jarden may be more inclined to make acquisitions abroad rather than repatriate it's roughly $300 million in European profits at current U.S. tax rates.

"Given their scale now, there is much more of a culture of wanting to see $100 to $150 million in sales," said Brentwood's Moore. "A $50 million business needs a lot more attention to stepping up globally. They want to take something from $200 million to $800 million."

North Castle Partners, a small cap private equity firm that focuses on active and sustainable lifestyles, is bullish. It expects $350 billion in unallocated private equity, strategic buyers' bulging corporate cash reserves and historically low interest rates to fuel strong deal flow and valuations in the next two to three years.

"Global giants across different categories have demonstrated that they are willing to pay premium multiples for strong, high growth brands, both small and large," said Managing Director Alison Minter, noting that deal flow reached record levels at North Castle in 2012. "Our internal data on the transaction history suggests that since 2006, the average multiple of LTM EBITDA paid by strategic acquirers in this space averages 12 times."

Innovation + Passion = Valuable Brands

Moreover, other strategic buyers have emerged, including Compass Diversified Holdings, Inc. A publicly traded equity fund, Compass Diversified became familiar with the sporting goods business from 2004 to 2007, when it owned Crosman Corporation, a maker of recreational air guns and paintball products. Through that experience, Compass Diversified came to appreciate how sporting goods companies could feed off their customers passion for an activity to create a culture of innovation, said CEO Alan Offenberg, who has since helped acquire Fox Factory, Inc. in 2008, Liberty Safe and Security Products, Inc. and Ergo Baby Carrier, Inc. in 2010 and Camelbak Products, LLC in 2011.

"We've been so impressed with many companies in this space and their ability to innovate," said Offenberg. "What's great is they resonate first and foremost with true enthusiasts - the thought leaders in these areas - and have gone on to become aspirational brands for people who are not as hardcore enthusiasts, but simply want the best of the best."

Compass, which had all $290 million of its revolving loan facility available for acquisitions as of mid-2012, is looking to add to its Consumer Brands portfolio, which now generates approximately $550 million in annual sales.

"There are a lot of companies that have really good products, but are hard to differentiate," Offenberg said. "Where we want to be is serving the consumer who says this is a great product and it's better than anything else out there and I want it. We call it "the reason to exist test." If a company were to go away, does anyone care? If they were to disappear would there really be a void in the industry?" ■

Baird is an employee-owned, full-service investment bank that provides a wide range of services to middle market companies, including M&A advisory, equity financing and corporate restructuring.

Martin and Pellegrini teamed up at Wachovia from 2003 to 2006 and have been together ever since. Pellegrini is widely considered the dean of the industry for his long tenure and involvement in several seminal deals. A Harvard graduate who earned his M.B.A. at Columbia University while playing offensive lineman for the New York Jets, he began his career in investment banking in 1989. He worked at Robertson Stephens, Lehman Brothers and Wachovia, before helping open Baird's Charlotte, NC office in 2008. His specialties include branded apparel, footwear and fitness and he recently shed 35 pounds using the P90X program.

After earning an M.B.A. from Wake Forest University, Martin began his career with Merrill Lynch in New York. He worked at Lehman in London, joined Wachovia in 2003 and Baird in 2009. Martin grew up as avid outdoorsman while living near Chesapeake Bay, the Florida Keys and the mountains of West Virginia. He was also a competitive golfer. His specialties include hunting and fishing.

RECENT DEALS IN 2012

- Advised Ontario Teachers' Pension Plan on its acquisition of Plano Molding Company, Inc.;
- Advised LNK Partners on its minority investment in Beachbody, LLC;
- Advised Wolverine World Wide, Inc. on its acquisition of Collective Brands' Performance + Lifestyle Group;
- Advised Helly Hansen Group AS on its sale to Ontario Teachers' Pension Plan;
- Advised Filson Holdings, Inc. on its sale to Bedrock Manufacturing Co.;
- Advised Quad-C Management, Inc. on its sale of Augusta Sportswear Group to Kelso & Co.

SportsOneSource
AS ORIGINALLY PUBLISHED IN SGB JULY 2013 I VOLUME 46 I ISSUE 7