Fashion and Lifestyle Footwear

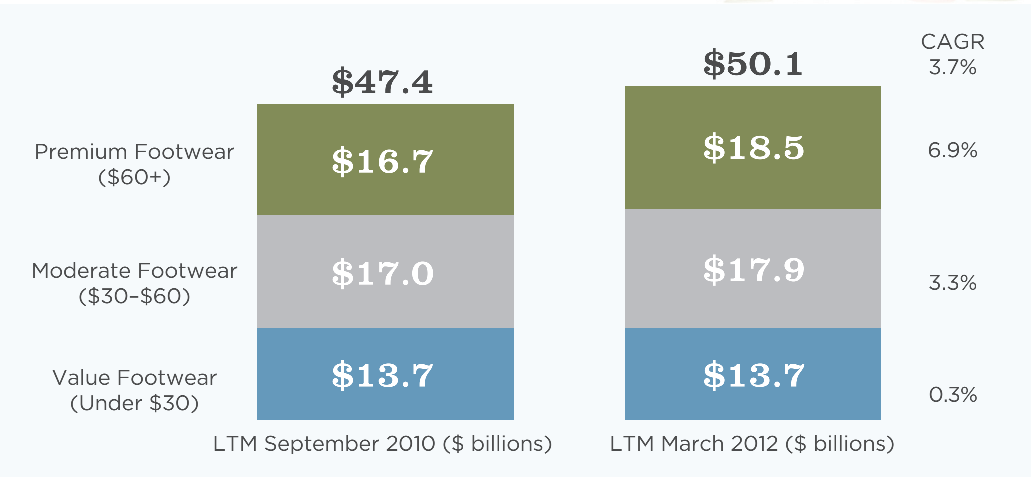
The fashion and lifestyle footwear industry will continue to be an attractive M&A market in the next few years, owing to strong category growth and a highly fragmented landscape.

Footwear sales in general have outpaced apparel sales in recent years, growing at a combined annual growth rate (CAGR) of 2.3% from 2010 to 2012 versus apparel's CAGR of 1.4%.

And within the footwear category, premium footwear has grown faster than more moderately priced and value-priced footwear in the past three years, with premium footwear growing at a CAGR of 6.9% in 2012 versus 0.3% for value footwear. (See Exhibit 1.)

Plus, the footwear market is highly fragmented, with many brands and retail chains ripe for private investment. And we've seen plenty of activity in the sector recently, including:

EXHIBIT 1: U.S. Footwear Retail Sales



Even Amazon recognizes the importance of footwear with its purchase of Zappos.

- > Nike's sale of Cole Haan to Apax Partners for $570 million
- > Deckers Outdoor Corp.'s acquisition of Sanuk
- > Steve Madden's recent acquisitions of Cejon and Topline
- > Golden Gate Capital and Wolverine World-wide's purchase of Collective Brands
- > Goode Partners' purchase of Sneaker Villa
- > South Korean firm E-Land World's acquisition of K-Swiss

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Within the fashion footwear space, we see two particular areas that deserve a second look from investors:

High-growth brands and concepts

These brands may be small now, but they are growing quickly—and can grow even faster with private equity sponsorship.

There are two particularly attractive high-growth categories: youth lifestyle and outdoor. For a youth lifestyle example, take TOMS Shoes, which has an estimated $100 million in sales and has recently expanded into eyewear and apparel and has plans to start selling footwear priced from $100 to $140, a far cry from their typical near-$50 prices. The retailer also plans to open its first flagship store in Venice, California.

Or consider OluKai, the makers of high-end, environmentally conscious, comfort-focused outdoor footwear like sandals and boots. The brand has recently had success selling $200 to $300 shoes at Neiman Marcus while still seeing explosive growth in its shoes closer to the $100 price point.

Another bright spot is Shiekh Shoes, which serves the rapidly growing—but under-served—urban footwear sector. Shiekh benefits from its license to distribute limited-edition Nike and Air Jordan products and has 136 stores across the U.S.

Shoe Palace also caters to the urban footwear and street sector and benefits from its position as a core account for premium street and skate brands. With a growing e-commerce business and 34 stores in California, Texas and Nevada—plus plans to open five more—this retailer could be an attractive target to take nationally.

Road Runner Sports, the self-proclaimed world's largest specialty running store, is also another attractive potential target. The retailer is well positioned to benefit from a running resurgence—running participation grew 18% from 2009 to 2012 versus declines in more traditional team sports—thanks to its deep inventory and technology that helps customers find the right fit. The running shoe market is massive—running shoe sales are about $7 billion and make up 27% of total footwear sales—and Road Runner Sports could continue to grow to serve this market. The retailer currently has 22 stores, mostly located on the West Coast, but could benefit from greater national reach.

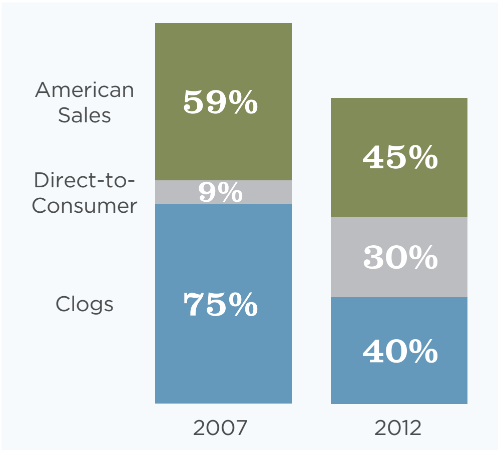
Larger established companies

There are also plenty of brands with strong equity like Crocs and Deckers Outdoor that are currently undervalued by the market and have significant growth potential. For example, Deckers is currently trading at 5.9x EBITDA. But its brands—Teva, Ugg and four others—still have incredible equity and global growth opportunities.

Another brand cashing in on the tremendous growth in the comfort footwear sector, privately owned ECCO claims to be the only major shoe manufacturer in the world that owns every step of the shoe-making process and has about 4,000 branded doors in over 90 countries, including the U.S. *Forbes* estimates the brand is worth about $1.5 billion.

Crocs nearly went bankrupt in 2009 and is now trading at 4.9x EBITDA. It is in the midst of being remade into a lifestyle and casual footwear brand and is expanding internationally. These efforts are beginning to pay off—American sales made up 59% of its total sales in 2007 and now comprise only 45%. Direct-to-consumer now makes up 30% of their sales versus 9% in 2007. And perhaps most significantly, clogs make up 40% of sales now, down from more than 75% in past years, and the proportion of kids' sales has been halved. (See Exhibit 2.) There is still tremendous opportunity for Crocs if they can continue this trend and break out of the clog and kids' spaces and continue to expand internationally.

EXHIBIT 2: The Future of Crocs



These brands could be reinvigorated through aggressive expansion in a private setting. Take a page from Steve Madden's book. The retailer went on an acquisition spree last year, buying accessories company Cejon, footwear company Topline and becoming the exclusive licensee for the athletic-shoe brand Superga, which it then tapped the Olsen twins to design.

Steve Madden is also enlarging its retail footprint. After purchasing its privately held Canadian licensee earlier this year for $29 million, the company expects to add 20 Canadian stores to its current seven within the next five years. A U.K. expansion is also in the works, through retail partners House of Fraser and Topshop. Steve Madden is also growing its off-price outlet division and began selling at Nordstrom in 2012.

Another interesting opportunity is Shoe Carnival, which operates over 400 stores that carry leading brands and cater to a mass audience. After a strong performance in 2012, averaging 5.5% comps in the first three quarters, the retailer plans to open 30 to 35 new stores in 2013. But owing to the hypercompetitive and promotional nature of the space, Shoe Carnival is currently trading at 5.2x EBITDA—likely understating its true growth potential.

The footwear sector promises to be a high-interest M&A area in 2013 and beyond, and investors who explore these opportunities now will be well positioned to benefit as the industry continues to grow. ❖

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