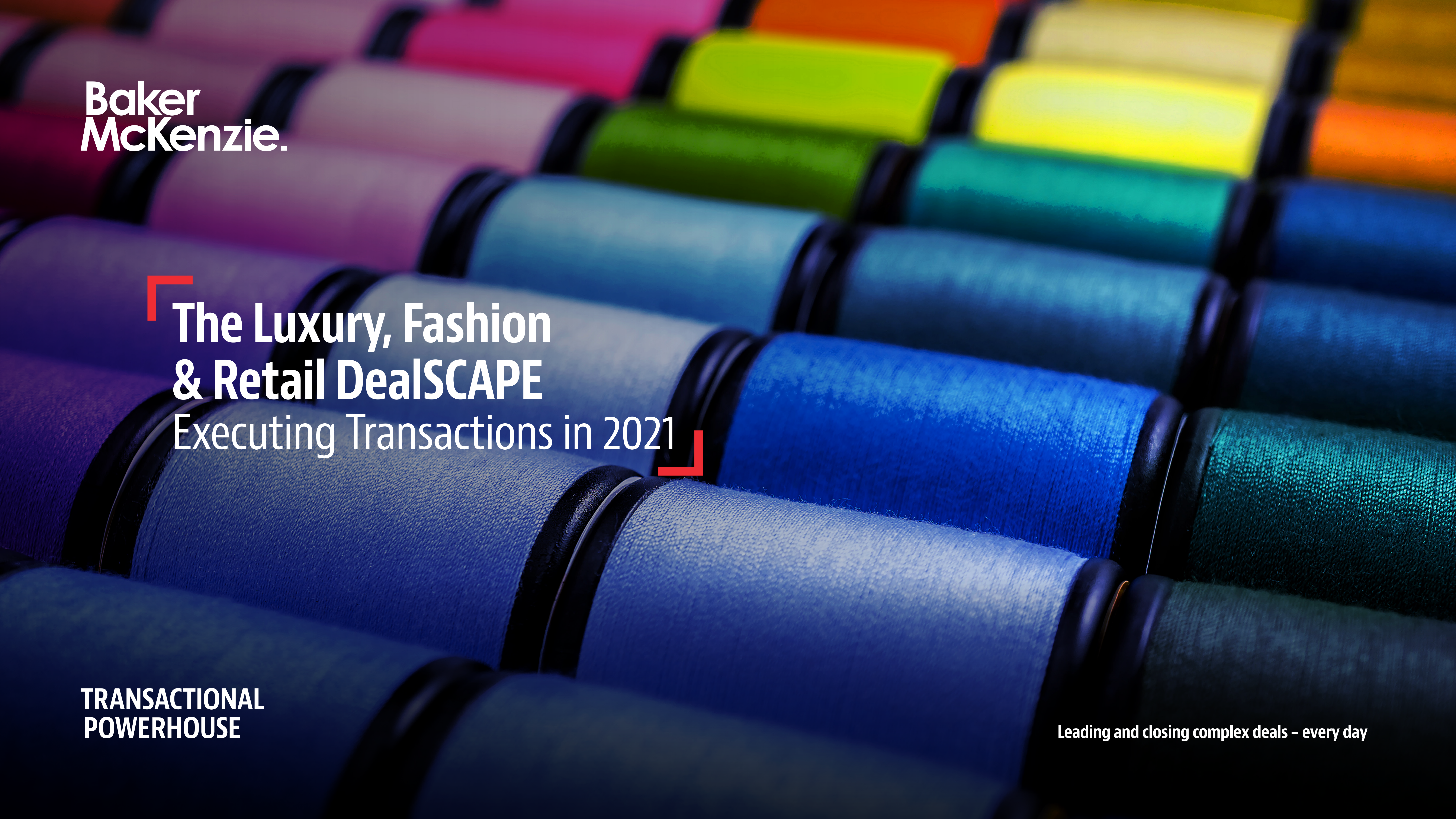


Baker McKenzie.

The Luxury, Fashion & Retail DealSCAPE

Executing Transactions in 2021

TRANSACTIONAL POWERHOUSE

Leading and closing complex deals – every day

Opportunity for Recovery & Reinvention

The new dealSCAPE

A bold vision of the future is redefining corporate strategy in the Luxury, Fashion & Retail (LFR) sector, with new opportunities arising from disruption. For many organizations, the fastest route to reinvention is through acquisitions and/or disposals — creating new customer bases rapidly, divesting to access liquidity, building digital direct-to-consumer channels and changing the scale and focus of operations to accommodate new consumer demands. Retailers of "non-essential" items are expected to accelerate digitalization arising from changing consumer lifestyles during the pandemic, and the development of online communities and loyalty program platforms.

It is both more important and more difficult to execute business critical transactions now. The imperative to transform sustainably is in sharper focus, but routes to executing viable deals are less clear. Competition for consumer attention and must-have digital assets is high,. Operating costs are rising, ESG (environmental, social and governance) issues are front of mind, and many brands are finding it challenging to predict the shape and tenor of their recovery. Despite these challenges, companies have a unique opportunity to regroup and expand their customer base.

In this briefing, we explore the defining characteristics of LFR transactions in 2021 and introduce a framework to understand legal complexity in a fast evolving sector and at a uniquely opportunistic time.

LFR DealSCAPE Trends

Strategy

Meet customers where they are now

Consumer brands are pivoting M&A strategies in response to surging domestic demand in APAC and focusing on digitalization for a deeper online presence to foster consumer engagement and retention.

Competition

Winner takes all deal market

Cash-rich conglomerates, highly capitalized groups and private equity will drive deal activity for the most desirable assets, triggering further industry consolidation with a particular interest in smaller, newer names and brands that resonate with a growing class of younger consumers.

Assets

Opportunities near and far

Making choice investments in digital transformation, distressed assets and focusing on key domestic markets are top priorities.

Process

Optimize networks across borders

Retailers and their suppliers will become more connected as vertical integration creates economies of scale. Strengthening supply chains and diversifying offerings are of particular interest.

Environment, Social & Governance

Raise the bar on sustainability

Consumers are increasingly savvy about ESG issues and are channeling their considerable spending power to responsible brands, leading to new scrutiny in deal making. There is an increasing focus on sustainability to attract and increase appeal to a more diverse consumer base.

Luxury, Fashion & Retail APAC Market Factfile

- Over recent months, the companies that have performed the best have a strong presence on the digital market, with stock prices up **76%** for internet retailers according to McKinsey & Company.
- China is a digital leader in consumer-facing industries. Before COVID-19, the Chinese market accounted for **45% of global e-commerce transactions** — a trend which has been accelerated by the pandemic.
- Millennials account for almost half of one of the region's leading consumer financing platform's user base, according to iiMedia. There is no shortage of consumer credit available in the region.
- While deal activity at the end of 2020 focused on big names, Deloitte predicts that M&A in 2021 will be powered by young, contemporary fashion brands that appeal to the social media generation.
- Consumers in South-East Asia are a driving force behind the digitalization trend, spending approximately eight hours a day online according to McKinsey & Company. Companies with strong and structured digital platforms were, on average, trading **35% higher** in December 2020 than in December 2019.

1 Strategy | Meet consumers where they are now

Trend

Luxury brands anticipate that a freeze in international travel because of the pandemic will compromise growth and are pivoting to attract domestic consumption amongst cash-rich millennials in their own countries.

Opportunity

Acquisitions that provide instant access to younger buyers in buoyant Asian markets — China, in particular — offer more immediate returns.

Legal considerations

It is important to identify early on what the scope of the transaction will be and how it will be structured. In multi-brand businesses, transactions may target only one (or a few) selected brands (a brand acquisition) and therefore be structured as an asset sale. Hybrid asset/share sale structures are common where particular assets (including intellectual property (IP) relevant to the brands being sold are held by one or more special purpose or brand exclusive vehicles in order to protect the proprietary rights attached to valuable IP.

Strategically, the use of licenses rather than transferring ownership to the operating entity using the brand is preferred to ensure the asset is protected in the event of solvency issues. On the buy-side, different purchasing companies will often be used for different asset classes. Consideration should be given to the life-span of the particular asset investment and how it should be held, to mininise disruption on investments. Tax planning is also an important factor, as may be merger control considerations.

Assessing the resilience, particularly of "hot property" targets will also be key. Targets should have unique propositions and sales pipelines, with the potential for a sustainable brand currency. Linked to this is an increase in regulation in certain areas, e.g. with respect to how companies engage and deal with people who are paid to act as "influencers" to promote products on social media.

Trend

Urgent action is required to respond to changing consumer behavior. Digitization is critical to building expanding share of wallet.

Opportunity

Luxury brands and conglomerates are accelerating their digital transformation strategies, and many are looking to acquire technology to create direct-to-consumer platforms and Omni channel purchasing experiences. With the cost of sales rising, brands are seeking more efficient and unique ways to target consumers using digital tools and social selling techniques.

Legal considerations

Pre-pandemic, real estate was more crucial to the success of a LFR brand with success often hinging on the quality of the retail portfolio such as flagship stores within major cities. The pandemic and acceleration of digital transformation requires particular due diligence to risks, liabilities and opportunities associated with real estate portfolios. In large portfolios, we often see a form of 'triaging' being carried out where the real estate portfolio is divided into categories of importance and a different commercial/contractual approach adopted for each.

2 Competition | Winner takes all deal market

Trend

Acquiring independent brands with a loyal customer base of cash-rich millennials can provide fast returns for strategic buyers.

Opportunity

Investment-ready assets providing access to consumers are hotly contested and are likely to command exceptionally high valuations. This presents a more efficient route to customer acquisition while complementing digital marketing, branding and logistics.

Legal considerations

Authenticity is key to independent brands and their discerning customers. A buyer will need to strategically craft long-term plans for the organization as part of a winning bid. For example, prioritizing efforts to retain key talent post-merger using scale and portfolio synergy, and preserving cultural fit.

Trend

APAC's mega-platforms are consolidating their positions as the gateway to the region for many international brands.

Opportunity

We have seen APAC's mega-platforms invest in retail platforms. This trend is flipping the conversation about retail in China from counterfeit goods to new consumer markets and platforms.

Legal considerations

Merger control issues require careful consideration. Various types of transactions other than mergers and acquisitions can trigger (often mandatory) filings, irrespective of their actual impact on competition. They are of particular importance on LFR deals because the consumer-facing nature of the sector lends itself to close scrutiny from regulators.

A buyer's concerns may include:

- the need to make merger control filings, and whether the estimated time to obtain clearance, will put it at a competitive disadvantage in an auction process;
- whether relevant authorities will require remedies (either behavioural or structural) as a condition to granting clearance and how those remedies would impact value; and
- whether the timetable for obtaining clearance may be so long as to erode value.

Companies may be able to rely on the "failing firm" defence when seeking merger control approvals for acquisitions of distressed assets. However, temporary measures put into place to respond to global disruptions in the supply chain, will be subject to usual competition rules, unless specifically exempted by regulators.

Breach of merger control provisions may attract infringement proceedings with far-reaching consequences. Regulators are keen to boost competition. Insights into antitrust enforcement and key target areas will be critical to deal certainty. Enforcement of payments interoperability for example (use of payment services owned by retailers across platforms) could be scrutinized. It will be key to define the appropriate "market" as digital businesses from outside LFR encroach on the industry. These blurred boundaries will need to be weighed up when analysing antitrust risk.. With the proliferation of online shopping, we expect increased scrutiny of digital platforms, including the use of pricing algorithms by suppliers to facilitate collusion, and imposition of price parity/most-favoured nation clauses and exclusivity clauses on suppliers in the digital context.

3 Assets | Opportunities near and far

Trend

Incorporating digital platforms and technologies into sales and distribution channels will be a constant theme for the LFR sector — balancing personalized customer experience in physical stores and online.

Opportunity

The pandemic has altered consumer behaviors, value and mindset. Digital technology has become an irreversible component of consumer consumption patterns. Strategic partnerships and minority investments in emerging technology will accelerate digitization strategies, with organizations favouring strategic cooperation to advance innovation. Companies that offer social and mobile commerce capability, AI and data analytics competency will be particularly attractive.

LFR companies will expand into new retail architecture mixing the lines of social media and ecommerce. 'Social commerce' will create deal opportunity in live-streaming, social networking and short-form video, involving media and celebrity influencers.

LFR companies will look to technology as enablers to drive employee and customer communication and engagement. This period will represent an existential opportunity to arrest complacency by more traditional retailers. The use of robotics in warehousing to speed delivery and use of apps and cashless payment technology to harness valuable customer data will be key.

Legal considerations

Growth strategies could involve licensing, franchising or participating with a local business in a joint venture, which may be more suitable depending on a company's appetite for risk and control, desire for speed and the local regulatory environment (e.g. where foreign ownership restrictions may apply). Strategic alliances possibly combined with distressed asset acquisitions can be an efficient and effective way to enhance market position.

More mature brands will look to bring back control of their distribution channels to the brand owner, by buying out licensees, franchisees or joint venture partners once they are established in a market. Some transactions (including joint ventures and minority shareholdings) can trigger merger control laws; dealings/collaborations with competitors (including interactions connected to a transaction e.g. sharing information and joint initiatives) should also be subject to a competition law assessment.

With the proliferation of online shopping, we expect increased scrutiny of digital platforms. This may include the use of pricing algorithms by suppliers to facilitate collusion, and imposition of price parity/ most-favoured nation clauses and exclusivity clauses on suppliers in the digital context.

Exit mechanisms, clearly defined processes for the valuation of assets and other key terms will need careful consideration when the joint venture is established to prevent potential disputes at the time of enforcement.

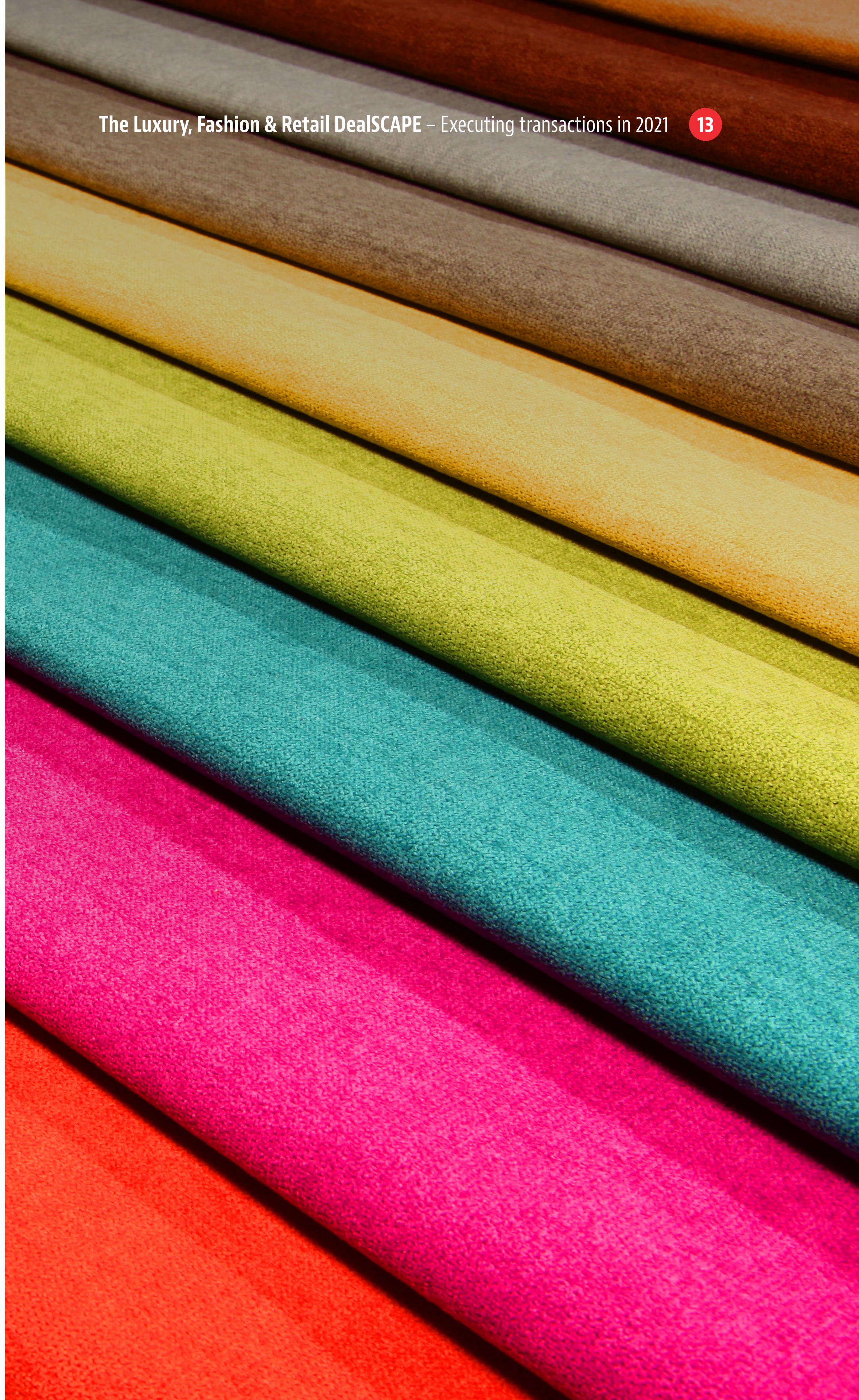
Trend	Opportunity	Legal considerations
Cash flow remains an issue for LFR companies — especially those that were running large inventories before the pandemic.	We expect to see a rise in distressed assets offering opportunities for financial and strategic investors.	Attention should be paid to the resilience of distressed targets (including across their supply chain). Pricing structures are generally dictated by deal structures, with IP usually the key value driver. Innovative pricing structures, such as loan-to-own and options-based arrangements, can also assist to mitigate risk in target distressed businesses. Careful due diligence is required early on in the process and up to the time of acquisition to assess the risks with pursuing the transaction in view of country specific insolvency processes and stipulations which may automatically apply in certain circumstances.
China's economic recovery post-pandemic is accelerating while Europe and the US continue to manage a patchier recovery.	APAC investors are likely to target distressed LFR assets in recovering markets — maximizing their cash position to expand.	Many LFR companies operate with a cross-border supply chain, meaning that currency fluctuations and wider socio, political, economic and regulatory changes can have a major impact on production and operating costs and capability. Investors must be mindful of FDI restrictions and merger control requirements (highlighted above).

4 Process | Optimize networks across borders

Trend	Opportunity	Legal considerations
Serving consumers in-store and online is placing significant pressure on logistical operations, globally and in local markets. Customers have increasingly high expectations in relation to speed of fulfilment and customer service, leading brands to critically assess their supply chains.	Stepping up vertical integration is a key strategy to improve supply chain performance, resilience and competitive advantage. Organizations operating in LFR must be careful to remain agile.	Supply chain arrangements tend to receive a great deal of attention on LFR deals. In practice, supply chains are likely to be complex and span multiple jurisdictions. Transitional arrangements will be needed to ensure continuity of supply while the buyer integrates the products into its existing arrangements and/or builds up new ones. Responding to volatile geo-political environments, transactional activity may also be driven by nearshoring and insourcing fixed assets. Alternative arrangements and careful crafting of contract terms should be considered to minimize business disruption following unforeseen events impacting the supply chain.
Manufacture-on-demand is where the consumer's desire for bespoke services, meets sustainability.	The trend for dynamic manufacturing based on individual preferences and measurements will grow as a result of innovative new production processes. Light on waste and heavy on choice, it taps into current priorities — especially among millennial customers.	Given the significant value attributable to IP in a LFR deal, the buyer's legal due diligence will be more IP focused than may be customary in other sectors. For example, a buyer will often want to assess whether or not a brand can be expanded into new markets. Where the product formulation itself is important, due diligence is required to ascertain the existence or extent of protectable rights in respect of formulae and manufacturing process. In some LFR sectors, such as consumer electronics, technical patents will be the cornerstone of the business. It will be important to trace through contractual terms agreed with suppliers and consultants (particularly where third-party formulators are used in the supply chain) as well as ensuring that any current or former employees in the research and development function have properly transferred relevant IP rights to the target business. Sellers should prepare for heavy scrutiny of IP rights and commercial agreements in any deal negotiation.

5 Environment, Social & Governance | Raise the bar on sustainability

Trend	Opportunity	Legal considerations
LFR industries are facing more conscious and attentive consumers than ever before. The trend toward sustainability and the desire for more responsible consumption will continue to intensify.	Addressing consumer interest in ESG is mandatory for deal activity. Investors want to ensure brands are diverse, inclusive and responsible. The ability to understand and properly address key ESG factors is increasingly considered a significant risk mitigation factor in deal making.	In addition to standard due diligence, brands should expect and be prepared for more in-depth sustainability reviews — providing clear, detailed information about their processes, products and entire supply chain. Transparency and accountability is key. Regulators and end consumers are increasingly focused on accountability, sustainability and ethical behaviour in the supply chain. Gaps between public promises and legal disclosures on ESG expose organizations and their acquirers to litigation risk.
Circular retail is heavily influencing the market and future brand strategies, with pre-loved retail and consignment sites transitioning from niche to mass-market propositions.	Brands with circular supply chain strategies and the capability to navigate environmental, financial and social issues will attract investors.	Production, sourcing, labor inequalities, responsible recycling and disposal of stock are measured, monitored and reported on with greater attention in the course of M&A due diligence. The negative brand impact of failings in the way a company does business (including through its non-owned supply chain) is enormous.
ESG issues are not equally acknowledged and managed across APAC. This, combined with the global divergence of ESG rules, can be problematic when it comes to deal execution in LFR.	Timely and successful deal completion will increasingly require the alignment of sellers and buyers who may have different attitudes towards and priorities for ESG.	To avoid derailing business critical transactions, acquirers can seek contractual protection in acquisition agreements where material ESG gaps and risks have been identified or information is limited. Insurance can provide additional reassurance although the impact of policy exclusions should be carefully considered.



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