The Deal

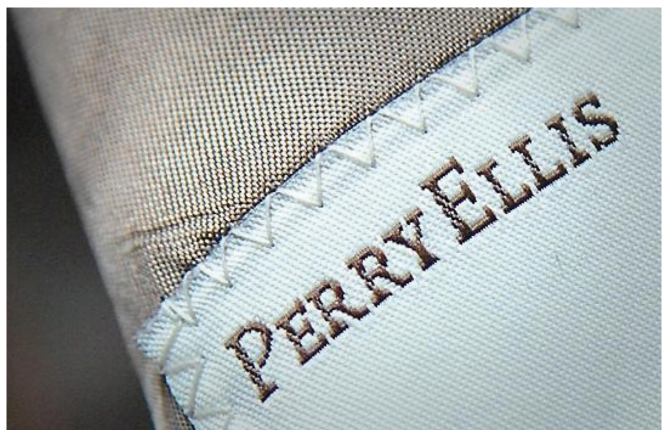
REPRINT FROM NOVEMBER 15, 2018

PERRY ELLIS FOUNDER LEVERAGES IP TO WIN BACK COMPANY

After being pushed out as CEO and chairman at Perry Ellis, George Feldenkreis buys back the company he founded using an innovative financing structure.

BY DAVID MARCUS

The sale of Perry Ellis International Inc. to company founder George Feldenkreis and his son Oscar was the culmination of four years of strife at the Miami-based apparel company. Targeted by an activist in 2014, Miami-based Perry Ellis revamped its board to fend off the approach, but last year the independent directors pushed George Feldenkreis out as chairman even though his son remained CEO. The family teamed with Fortress Investment Group LLC to make a $437 million offer for Perry Ellis and won the company when Randa Accessories couldn't make a firm competing offer—an outcome that shows how family founders facing pressure internally can themselves adopt activist tactics. This account of the deal is based on public documents and interviews with several people familiar with the transaction.



Feldenkreis obtained financing for the deal by splitting the company into three separate corporate entities: one containing Perry Ellis's intellectual property, a second its manufacturing assets and a third its real estate. That structure, perhaps unprecedented, allowed Fortress Credit Advisors LLC to lend against Perry Ellis's brands and real estate, while Wells Fargo Bank financed the manufacturing assets.

The structure stemmed from Perry Ellis's three primary businesses. It owns a number of brands, including Perry Ellis, Original Penguin, Cubavera and Ben Hogan, and can make clothing under those labels or license them to other companies. The company licenses other brands including Callaway Golf, PGA Tour, and Jack Nicklaus for golf apparel and Nike for swimwear and accessories. Most of the apparel Perry Ellis makes it sells wholesale to other retailers, but the company itself owned about 65 stores as of March 18, 2018. Licensing agreements often include provisions that allow the licensee to cancel the deal if there is a change in control at the licensor, which proved a significant stumbling block for Randa in its effort to buy the company.

In April 2014, rumors began to surface that activists were looking at Perry Ellis, and that July 16, Los Angeles-based Legion Partners Asset Management LLC and the California State Teachers' Retirement System revealed a 5.9% stake in the company and told Feldenkreis that he needed to divide his chairman and CEO jobs. Including options, the family owned about 20% of the company and, according to regulatory filings, engaged in a large number of related-party transactions, including leasing office space and a private jet to the company. That day, Perry Ellis stock closed at $17.37 per share.

The next month, two sources floated the possibility that the family was preparing for a sale. Several private equity firms were plausible buyers, including Leonard Green & Partners LP, Golden Gate Capital and Sun Capital Partners Inc., as were apparel companies PVH Corp. and VF Corp. Given the Feldenkreis's stake and the family's deep involvement in the company, it's unclear how realistic rumors of a sale were, though they did reflect the reality that it was becoming increasingly difficult for Perry Ellis to remain an independent public company.

Under activist attack, Perry Ellis set about freshening up its board. In June 2014, it added J. David Scheiner, the former president and chief operating officer of Macy's Florida/Puerto Rico. Six months later, Jane DeFlorio, a former retail investment banker at Deutsche Bank, joined. In May 2015, Perry Ellis averted a proxy contest when Feldenkreis stepped down as CEO in favor of his son Oscar. At the same time, Bruce Klatsky, the CEO of PVH from 1993 to 2007, and Michael Rayden, the former CEO of Tween Brands Inc., joined the board. By the time the family made its offer in

2018, the board had seven members including Joe Arriola, a prominent member of the Miami business community. Legion Partners ended up selling its Perry Ellis stake.

After being forced out as CEO, George Feldenkreis suffered further indignity in September 2017 when the board pressed him to step down as chairman and replaced him with Scheiner. The board formed a special committee of its independent directors to evaluate Oscar Feldenkreis's "employment arrangement with the company," though had he been fired without cause, the company would have incurred a significant severance payment and would have had to find a replacement in a challenging situation.

On Feb. 6, Feldenkreis offered $437 million, or $27.50 a share, to buy Perry Ellis, a 21.6% premium to the target's closing price the day before and a 5.2% premium to its 52-week high. Feldenkreis owned about 11.3% of the company, which had $89 million in debt, while Oscar had another 7.9%. Fortress Investment Group LLC agreed to commit 100% of the cash equity required to complete the transaction, George Feldenkreis said.

He made his offer despite a challenging commercial and financial environment. According to a Perry Ellis presentation filed on Sept. 25 with the SEC, 27% of the company's annual sales came at department stores and 11% at so-called at-risk retailers, those that could well end up going out of business. Like many small public companies, Perry Ellis had trouble attracting investor attention; average daily trading volume fell by 69% between 2012 and 2018, and only two sell-side analysts covered the stock, down from seven in 2015.

On Feb. 26, the special committee announced that it had tapped David Shiffman at PJ Solomon as financial adviser and Robert Schumer and Kelley Parker at Paul, Weiss, Rifkind, Wharton & Garrison LLP in New York along with Stephen Roddenberry and Carl Roston at Akerman LLP in Miami for legal advice. (Perry Ellis is incorporated in Florida.) Oscar Feldenkreis remained as CEO.

The special committee had to generate an auction for the company at the same time as it deferred the launch of a proxy fight by George Feldenkreis, whose choice of Steve Wolosky of Olshan Frome Wolosky LLP, a frequent adviser to activists, portended such a step. Olshan provided M&A legal advice on the deal. Feldenkreis also turned to Daniel Ganitsky and Christopher Bell at Proskauer Rose LLP primarily for financing advice and Scope Advisors LLC, a boutique launched by Guggenheim Securities LLC banker Peter Comisar, for financial advice. Stearns Weaver Miller Weissler Alhadeff & Sitterson was counsel to Oscar Feldenkreis, and David Nemecek and Nisha Kanchanapoomi of Kirkland & Ellis LLP advised Fortress.

According to Perry Ellis's proxy statement, by March PJ Solomon had contacted 9 private equity firms and 9 strategic parties, of which only Feldenkreis and Randa signed confidentiality agreements. In order to encourage Randa to remain in the auction, Perry Ellis's board agreed to reimburse "its reasonable and documented out-of-pocket expenses up to a cap" if Perry Ellis agreed to a deal with anyone else by July 31. Keeping Randa in the auction helped ensure that Feldenkreis didn't lower his price. The board asked him to raise it three times, and each time he refused.

On May 15, the board postponed its director nomination deadline for its 2018 annual meeting to April 12, after Feldenkreis asked for an extension of the nomination window on March 9. He also signed a confidentiality agreement with the company to conduct due diligence. Feldenkreis nominated a dissident slate on May 18, though that seemed a placeholder, since the company had yet to set an annual meeting date.

Feldenkreis and the company signed a deal at $27.50 a share on June 16, and both sides agreed to defer the next annual meeting for the election of directors while the agreement was pending. The Feldenkreis family agreed to roll their stock and some of their performance shares and options into equity in the post-closing company.

The deal was be financed in an unusual way. Feldenkreis planned to split the company into three entities, one containing Perry Ellis's intellectual property, a second its manufacturing assets, and a third its real estate assets. Fortress funded the IPco, as it was called, and the real estate unit, while Wells Fargo provided asset-backed lending to the operating company, or OPco. Fortress also got warrants that would give it 30% of the OPco's equity, which is unencumbered by debt held by the OPco. The structure required not just agreements with the funding sources but cross-licensing agreements between the IPco and the OPco.

The appeal of the split to Fortress was clear; according to a presentation that Perry Ellis filed on Sept. 25, the company's outbound licensing activity, which the IPco would conduct after the buyout closed, accounted for less than 5% of the company's revenues but 45% of its Ebitda.

The IPco/OPco structure is a variant of deals in which a PE buyer would split a retailer's real estate and operating assets in so-called OPco-PROPco structures which have also been used by REITs. Penn National Gaming Inc. employed a similar tactic in 2013. Fortress had more recent—and relevant—experience, since in 2016 it executed a similar deal with Iconix Brand Group Inc. Kirkland advised Fortress on that deal.

On July 2, Randa said Monday it would bid $28 a share, though a month before it told Perry Ellis's board that it wanted to work with one of two other parties, both of which had looked at the company but not signed a non-disclosure agreement. Randa, which licenses brands including Dickies, Tommy Hilfiger, Kenneth Cole, Levi's and Tommy Bahama, tapped Willkie Farr & Gallagher LLP's Steven Gartner and Adam Turteltaub for legal advice and looked to William Susman at Threadstone Partners LP for financial advice.

The special committee rejected the offer because it was non-binding and Randa's debt financing commitments for the deal were "uncertain." Randa's bid also came with a 3% reverse breakup fee if the target's stockholders voted the deal down. The board reiterated its commitment to the Feldenkreis offer on Aug. 3 even after Randa raised its bid $28.90. Randa conditioned its bid on the result of talks with Perry Ellis' largest inbound licensor—reputedly Nike, which refused to negotiate. Nike reportedly didn't agree to the sale to Feldenkreis, but he apparently felt comfortable enough with his relationship with the athletic apparel company to proceed.

Proxy solicitation advisory firms Institutional Shareholder Services Inc. and Glass, Lewis & Co. both advised Perry Ellis stockholders to vote for the deal, advice taken by holders of 75% of the disinterested shares on Oct. 18. That gave Feldenkreis his company back and blunted an effort to block the deal by Water Island Capital LLC, which reported an activist stake of more than 5%. It also may provide a model for other deals in the retail sector, where intellectual property is seen as increasingly valuable and the split Fortress and Feldenkreis engineered is replicable.

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TheDeal.com (ISSN 1547-7584) is published by The Deal.