GYMBOREE: AMERICAN CHILDREN FASHION[1]

It was a clear morning in Boston on November 23rd, 2010. The weather forecast announced a high temperature of 63ºF, which was very mild for that time of the year. Jordan Hitch, Managing Director at Bain Capital, was happy. The company he worked for had finally closed a deal to purchase Gymboree, a children's fashion chain that ran more than 1,000 stores in the U.S. and Canada. Bain was originally a consulting company in the Boston area. Some partners at Bain had founded Bain Capital as an investment company in 1984. Since that year Bain Capital had bought and sold hundreds of companies. More than eight hundred employees managed investments with assets under control of almost $70 billion. Bain Capital had been able to reach an agreement to buy Gymboree despite the competition from other well-known Private Equity (P.E.) firms like KKR and Apax Partners.

The purchase price of Gymboree had been $1.76 billion of which Bain had committed $0.52bn in equity and the rest would be financed with debt. The EBITDA multiple was below eight, high but still in line with similar deals in the retail sector in the past three years. Hitch had strong confidence in the management team at Gymboree because it had achieved an outstanding track record in the last five years with Matthew K. McCauley as CEO.

THE RIGHT PURCHASE?

The Bain team had worked hard to close the deal to buy Gymboree. The Company seemed to be in very good shape. It had a strong reputation in the industry, high profitability and a multichain strategy that paved the way for years of growth ahead. Additionally, the company had barely entered international markets, where there was plenty of more room to build the brands. Bain could have targeted any other children's apparel only names in the industry that also offered good potential for growth, for

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example, Carter´s and The Children´s Place (TCP). These followed different strategies from Gymboree: TCP ran just one store chain in the middle-low price range while Carter´s was both wholesaler and retailer with two different chains. The Children's Place's turnover had been flat in the past two years, but Carter´s had delivered specially good growth rates as of late.

Buying Gymboree had been a risky bet because Bain had paid a hefty price for Gymboree and had highly leveraged the company (Appendix 1). Like other P.E. investors, Bain Capital looked forward to making the Company grow quickly and selling it within five to seven years. In order to achieve the selling price that Bain wanted, Gymboree´s management team would have to double the company's turnover and keep its high profitability intact in the next years. In this respect, Hitch also realized that there were many threats out there. First: the industry was very competitive and the players were big. Besides very powerful domestic competitors like Walmart and Target, and retailers like The Gap, some international retailers like H&M of Sweden and Zara of Spain were extending their footprint in the U.S. Second: fast fashion retailers were introducing new fashion trends in shorter lead times in the stores, luring many customers. Additionally: social networks were becoming sources where customers increasingly looked for the latest styles. Finally: new online channels like the Internet were developing quickly and it was difficult to forecast where the market would be in the next years.

Hitch would become a director of the Gymboree Board and he would work closely with the management team. Gymboree´s strategy of running three different chains seemed to be working well so far but Crazy8 (its lower price chain) was competing in a very hotly contested slice of the market. He realized that the company had to execute its strategy impeccably in order to achieve its mid-term goals.

Bain Capital's expectations were high for this operation. It was a difficult challenge for Gymboree´s management team. Would they be able to perform?

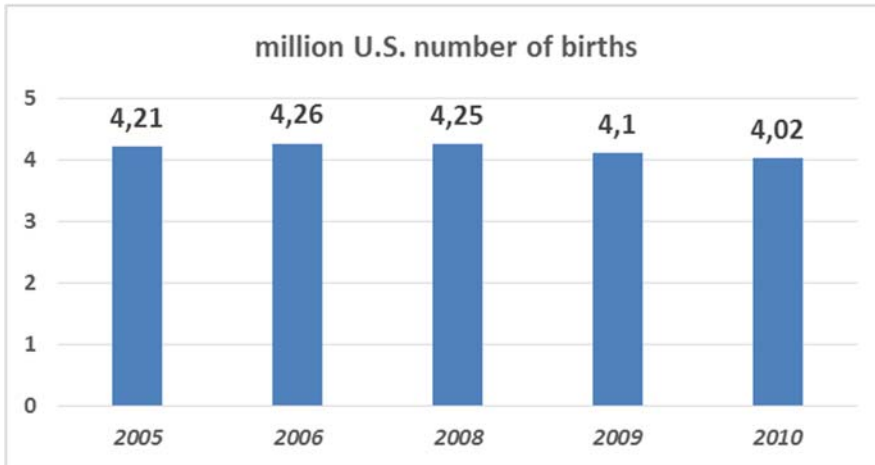
THE MARKET

The U.S. Children´s apparel market was huge. In 2010 it amounted to $23.9 billion, having grown by 3% compared to the previous year. The market went through a dip during 2008-09 due to the financial crisis but it was bouncing back. The forecast for the coming years was a 2-3% CAGR[2], as parents and grandparents spent more money in clothes for kids despite the downward demographic trends.

In 2010 there were 4.02 million births in the U.S., about 4.5% less than in 2005. The forecast trend for the next years was stable around four million though slightly downward. (Graph #1)

[2] Compound average growth rate.

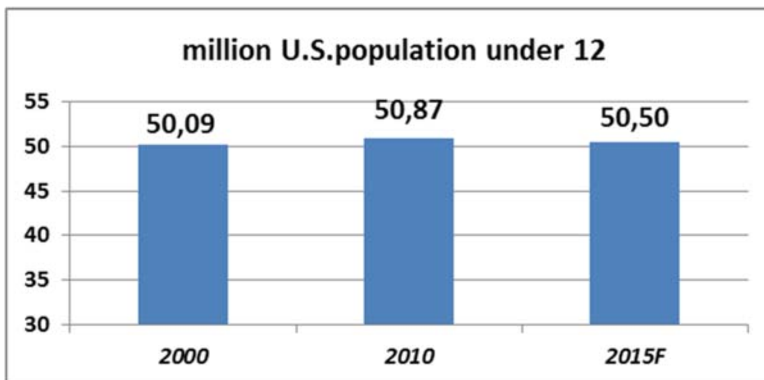
Graph #1



Source: CDC, U.S. Dept. of Health and Human Services.

The total number of consumers (kids under 12) had barely grown 1.5%, from 50.09 million in 2000 to 50.87 in 2010. This trend was to remain fairly stable in the next five years, with a slight decrease to 50.05 million in 2015. (Graph #2). These negative demographic trends meant that children fashion retailers could not rely on a growing number of customers. The only way the market could grow was by increasing the average spending per child.

Graph #2



Source: 2010 U.S. Census and 2014 projections.

Globalization and the development of clothes manufacturing in Asia and other low cost countries had resulted in a strong downward pressure on prices. Graph #3 shows the overall effect on prices in the industry. Prices in the U.S. in general had grown over 63% in twenty years, between 1993 and 2012. During the same period, clothes had actually lowered their prices by 3% in real terms. They were cheaper in 2010 than in 1993!

This price pressure was possible due to the cost advantage that the industry had achieved through low cost sourcing. Companies were switching manufacturing from one