GYMBOREE: AMERICAN CHILDREN FASHION INDUSTRY (B)[1, 2]

In the first few days of March 2016, it was time to face the facts at Gymboree's headquarters in San Francisco. Gymboree's Board had gathered to examine the financials of fiscal 2015, and things did not look good. Gymboree was a children apparel chain that had over 1,000 stores across the U.S.A. and Canada, and it had been acquired by Bain Capital at the end of 2010. Fiscal 2015 had been another disappointing year for the company. Sales had barely grown by 1.5 percent, and despite a slight improvement in margins, profitability was still negative, with losses before tax of USD 3 million (see Exhibit 1 for financial statements).

The excitement of the acquisition in the months leading to the end of 2010 had long dwindled, and with it the bright expectations Bain Capital had of growing the company and selling it after five years with substantial capital gains. It was painful to think that, right after Bain had bought Gymboree with record results, these had begun to fall. The profit and loss accounts started to deteriorate in 2011, and five years later it was far from recovering. It was even more painful to compare Gymboree's results with those of competitors that had also been potential acquisitions in 2010, like Carter's. By contrast with Gymboree's negative performance, Carter's had taken off, and it was currently seeing record sales and profit.

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[1] This case has been published by the Research Division of Instituto Internacional San Telmo, Spain. Written by Mr. Manuel Domínguez de la Maza under the supervision of Professor Jorge Bernal González-Villegas, as a basis for class discussion only and is not intended to illustrate any judgment on the effective of ineffective management of a specific situation.

This case is based on public information; the company has provided no data.

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[2] Please refer to case *DGI-273-E Gymbore: American Children Fashion (A)*, of the Research Division of Instituto Internacional San Telmo, Spain.

The Board needed to take urgent measures to financially support Gymboree because its high debt called for a long overdue restructuring. In the last 2015 fiscal quarter, the company had repurchased USD 135 million of nominal debt at a 70 percent discount. The plan was to offer the repurchase of an additional USD 40 million after the release of the 2015 financials. This was only a small part of the total debt, which amounted to around USD 1.2 billion. The full amount of the debt and in particular the 12 times net debt over EBITDA ratio showed a company unable to repay its debt (see the balance sheet in Exhibit 2).

Jordan Hitch, Senior Advisor at Bain Capital and a member of Gymboree's Board, sat alone at the end of a long table. He needed time to think about the past five years and what they had done wrong.

A DIFFICULT YEAR FOR THE INDUSTRY

It all started after they had acquired the company in November 2010. The following year was very hard for apparel chains. In 2011 there was a bubble in cotton prices, which multiplied by five in less than a year, going from 50 cents per pound to 250 (Exhibit 3). Cotton is the primary raw material in textiles, and this rise forced the entire industry (manufacturers, wholesalers, and retailers) to tighten its margins. All international chains were affected, and their margins fell by five percentage points on average. Among the American chains, Gymboree's gross margin fell by 8 points, Carter's by 6, and TCP only by one point. Over the following four years, Gymboree's margins had continued to decline, and in 2015 they had picked up slightly, but were still 7 points below 2010 figures (Exhibit 4). The Children's Place had followed a similar trend, although not as bad, while Carter's had managed to up its margin by more than 3 points since 2010.

There were a number of reasons that explained such a decline in margins. First: most of the company's new openings had been of Crazy8 stores. The concept these stores sold had a tighter margin than Gymboree and Janie&Jack, the other two chains the company owned. This tighter margin was a consequence of the stiff competition between low-cost chains. Second: market dynamics was also part of the problem. There were more and more discounts and promotions, both on the Internet and in brick and mortar stores. Once the clients had grown used to buying at a discount price, it was hard to get them to buy at full price again. Lastly: Gymboree's chains had cannibalized each other's sales. Gymboree's opening policy had been erratic and had lead to the opening of Gymboree and Crazy8, and in some cases even Gymboree Outlet stores in the same shopping mall.

EXPANSION OF THE NUMBER OF STORES

Gymboree, TCP, and Carter's had followed a clear expansion strategy over these five years, and perhaps Gymboree had been the most aggressive up until 2013. The bad results after that year had brought the openings to a halt. There was a sharp contrast between the 113 net openings of 2012 and the 20 net closings of 2015 (Exhibit 5).

TCP had followed a more cautious opening policy, but its trend was similar to Gymboree's. By 2014, TCP was the first of the three chains to close more stores than they had opened (-10), and again in 2015 when the total number of stores was cut down by 28.

Carter's had expanded its store chain relentlessly because it had started with a smaller number of stores and because its profitability was higher. By the end of 2015, it operated nearly one thousand stores (982), more than doubling the 486 it had in 2010 (Exhibit 6).

Gymboree had focused on opening Crazy8 stores between 2011 and 2015. Out of a total of 241 net openings company-wide, 230 had been Crazy8 (Exhibit 7). These Crazy8 stores had a low productivity that ranged between USD 2,000 and 2,500 per square meter per year. This low productivity was in contrast with Gymboree's high sales (USD 6,000 per m^2 per year) and especially with Janie&Jack (USD 10,000). Crazy8 was dragging the company's average productivity down from its 2007 peak. This drop was already apparent by 2010, when Bain bought Gymboree and average sales had reached USD 4,900 per m^2 per year. Since then, they had plummeted by an additional 14 percent to USD 4,229 (Exhibit 8). Crazy8's weak sales were even worse than those of direct competitors by prize and store size such as TCP, whose sales had dropped by 10 percent in these years and still managed to be over USD 3,000 per m^2 per year.

Carter's was the only one out of the three chains that had managed to maintain its productivity around USD 3,900 per m^2 per year over these years. And yet their sales had plummeted in the last year, probably due to a large number of new stores.

SALES PERFORMANCE

TCP's sales had been stagnant for years, and the company was looking for ways to raise them but, in 2014, the fierce competition in this price segment and other channels such as the Internet, had forced it to start closing stores in the United States. TCP's high online and overseas sales were not enough to overcome this fall. In the past five years, sales had grown a mere 3 percent.

Gymboree's 17 percent sales growth in the years since the acquisition had been greater than TCP's, and yet it was not remarkable. And what was even worse: both chains had sold less in 2015 than three years back.