M&A Runway: The Role of Exclusivity in Shaping Streetwear Economics

Mark Leinz
2nd June, 2024

"What began as a largely underground movement rose quickly to main street and unleashed what the fashion world was craving but not finding: a fresh take." – Strategy& and Hypebeast

Overview

In the pulsating heart of contemporary fashion, one trend has emerged as not just a style but a cultural phenomenon — the dynamic world of streetwear (c.f. Oe, 2022). Collectors, enthusiasts, and resellers have become a common sight in European, American, and Asian metropolises, often queuing in lines several hundred meters long to get their hands on the latest Nike Jordan or Adidas Yeezy. At the heart of streetwear are sneakers and apparel, often characterized by limited editions and exclusive distribution channels. Streetwear has evolved from various casual fashion areas, combining elements of sportswear, skatewear and Japanese street styles. In recent years, luxury wear influences have also become increasingly popular (Yotka, 2019).
Within this realm, notable brands such as Supreme, Nike (Jordan), Off-White, and Bape stand as the defining pillars of style and self-expression. Brands such as Vetements and Balenciaga have further blurred the lines between haute couture, luxury, and streetwear, demonstrating a seamless integration of these once disparate areas of fashion.
Beyond its roots in hip-hop and skate culture, streetwear has transcended into a global movement, shaping not only wardrobes but also economies. The global streetwear market is estimated at $185 billion in annual revenue, constituting around 10% of the entire clothing and footwear market (Strategy&, 2019). This evolution in recent years has caught the attention of investors, evidenced by a series of high-profile mergers and acquisitions that have thrust streetwear into the spotlight. For instance, the New York streetwear icon Supreme was acquired by textile conglomerate VF Corporation for approximately $2.4 billion at the end of 2020 (VF Corporation, 2023). However, it is not just brands that command significant valuations; distribution channels also play a crucial role. In addition to the Arklyz Group, which acquired the well-known European streetwear retailer Asphaltgold in 2022, streetwear marketplaces like Grailed and StockX have completed numerous highly valued funding rounds (Bell, 2022; Notice, n.d.). Grailed recently secured $60 million in a Series-B funding round, and StockX raised over $400 million between 2019 and 2021, culminating in a valuation of nearly $4 billion (Bell, 2022; Notice, n.d.). Most recently, at the beginning of 2024, the acquisition of the digital marketplace Farfetch was completed in a deal worth around $500 million, expanding the buyer's portfolio not only with luxury goods but also with numerous streetwear brands (PitchBook, 2024).
These deals raise the question of why this industry is so attractive to invest in. Answering this question is not straightforward and requires an explanation of the unique features of streetwear economics. Ultimately, the article returns to the Farfetch deal and examines the peculiarities of the distribution models in the streetwear sector. This deal also leads to a discussion on the investment risks in this industry.

Decoding Streetwear Economics: Balancing Exclusivity and Demand

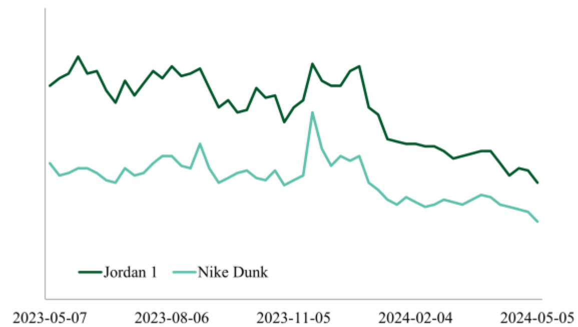
The streetwear market operates on a dual divide: the primary market, where streetwear companies primarily sell their products through direct-to-consumer channels, encompassing physical stores in global metropolises or online platforms; and the secondary market, where products are resold. Platforms such as StockX, Grailed, eBay, specific Facebook groups, or even sneaker conventions serve as avenues for secondary market transactions. This dichotomy represents a fundamental departure from traditional fashion companies due to the concept of drops. While fashion brands typically release collections where all items are available simultaneously, most streetwear firms adopt a strategy known as drops, releasing individual pieces gradually. For instance, Supreme unveils a selection of clothing, footwear, and accessories every Thursday in stores or online at 5 PM. Coupled with the element of exclusivity, these drops are often highly limited and available for a restricted period. Consequently, only a fraction of interested buyers manage to secure the product through mechanisms like first-come-first-serve queues or randomized raffles.
Those who miss out on the drop or arrive late are left empty-handed and must turn to the secondary market. Conversely, those fortunate enough to acquire the exclusive item can sell it at a premium. Ultimately, the streetwear model hinges on a simple equation of supply and demand. Successfully executed, brands leverage drops to strictly limit the supply of a new product below the demand threshold, translating to a fixed supply quantity. In return, the product experiences high resale rates, commands higher prices in the secondary market, engenders greater desire, and augments the brand's value.

The success of this model hinges on maintaining a delicate balance between supply and demand. If supply exceeds demand, the entire system collapses, underscoring the pivotal role of strategic supply management in the streetwear industry's economics.

Why is this industry attractive to investors?

The streetwear industry holds a magnetic allure for investors, driven by a combination of internal and external factors. Internally, the demographics of the customer base are particularly appealing. Research by Strategy& indicates that more than 60% of streetwear consumers are under the age of 25 (Strategy&, 2019). Notably, these customers exhibit strong brand loyalty (Winter, 2017). Their dedication translates into significant spending habits, with streetwear enthusiasts allocating approximately five times more of their monthly budget to streetwear products compared to non-streetwear items (Strategy&, 2019). The products themselves also contribute to the industry's attractiveness to investors. Streetwear items, whether clothing, footwear, or accessories, typically command premium prices, ranging from \$100 to \$300 on average. Remarkably, around two-thirds of consumers perceive these products as timeless, indicating enduring demand beyond transient fashion trends. When considering these factors together, investors anticipate robust recurring revenues, bolstered by the regular drop model characteristic of the industry. Moreover, the high price points of streetwear items translate into favorable profit margins, ensuring relatively stable but probably not the highest cash flows due to the characteristic of limitation (Strategy&, 2019).

Figure 1: Google Popularity Score



Source: Google Trends

Further, investors can capitalize on synergies within the streetwear ecosystem. A prime example is the acquisition of Supreme by VF Corporation, a conglomerate that boasts a portfolio including Timberland, The North Face, and Vans (VF Corporation, 2023). Through collaborations with these affiliated brands, such as exclusive designs for North Face jackets by Supreme, the streetwear giant not only enhances its own reputation but also amplifies the appeal of its partners. This symbiotic relationship generates spillover effects, where the association with streetwear culture drives sales of other products and brands within the conglomerate. The phenomenon is further underscored by the comparison between highly sought-after, limited-edition items like Nike Jordan 1s and more readily available counterparts like Nike Dunks (Figure 1). The fervor surrounding exclusive releases often spills over into less limited products, amplifying demand across the spectrum. Such synergistic effects were likely pivotal considerations for VF Corporation during their acquisition of Supreme, as they sought to leverage the interplay between streetwear and mainstream consumer markets to drive overall growth and profits.

External factors play a pivotal role in making the streetwear market an attractive playground for investors. Unlike the luxury goods sector, where conglomerates like LVMH dominate, the streetwear industry does not yet have a single overarching power. This lack of dominance offers investors ground for establishing strategic partnerships and exploring untapped opportunities. Although giants such as Nike and Adidas are significant players, the recent severance between Adidas and Kanye West's Yeezy brand illustrates that even these relationships are not immutable (Reid & Golden, 2022).

Streetwear Distribution: Strategic Acquisition of Farfetch

In January 2024, the acquisition of Farfetch marked a significant development in the intersection of luxury and streetwear markets. Farfetch, which is an online marketplace, offering high-end luxury and streetwear products by an array of brands, was acquired by Coupang and its investment partner Greenoaks at an undisclosed sum, who contributed a substantial \$500 million in capital, with \$150 million specifically earmarked as new equity. This investment underscores the confidence of players outside the traditional streetwear industry (PitchBook, 2024).
The deal represents a robust strategy aimed at diversifying business operations not only across product lines but also geographically, leveraging Farfetch's strong presence in the UK. The acquisition's strategic motives extend beyond immediate financial gains, aiming to unlock new market potentials and secure long-term revenue growth, which aligns with Coupang's broader business objectives of expanding its global footprint (Schulz, 2023).

Despite this, the financial portrait of Farfetch as an optimal investment in the streetwear and luxury sectors is not entirely rosy. Before the acquisition, Farfetch faced significant financial challenges, as evidenced by Moody's downgrade to Caa2 and the cancellation of its earnings report. These troubles were compounded by a stark decline in revenue growth and persistently negative operational cash flows over recent years, casting a shadow over the attractiveness of the asset. However, the commitment from the buyers leaves the question of whether these issues might stem more from previous management rather than the streetwear industry itself. This scenario underscores a broader interest in capitalizing on the distribution of streetwear and luxury products, despite the limited opportunities in secondary markets. The strategic acquisition thus not only aims to enhance Coupang's existing ecosystem, where its core competencies in logistics and technology can synergize with Farfetch's exclusive brand offerings but also signals a potential turnaround strategy where new management could stabilize and exploit Farfetch's unique market position in the streetwear and luxury segment (PitchBook, 2024).

Potential Risks

As the acquisition of Farfetch illustrates, the streetwear market is not without risks. The financial condition of the online marketplace, nearing insolvency, raises questions about whether streetwear products are also subject to cycles of hype, which complicates long-term planning for businesses and investors. Furthermore, investors in the brand space often grapple with high intangible values. A case in point is the acquisition of Supreme, where out of the $2.4 billion purchase price, approximately $1.2 billion was attributed to the trademark and a further $1.2 billion to goodwill. By 2023, these valuations faced an impairment of around $735 million, suggesting that the hype and name might have commanded an overvaluation (VF Corporation, 2023). It is a reminder that beyond the merely irrelevant tangible assets, what often drives this market is the intangible allure of the brand – a fickle yet powerful force.

Sources

Bell, J. (2022, December 29). The biggest M&A deals in fashion, footwear and retail in 2022. *Footwear News*. https://footwearnews.com/fashion/fashion-news/biggest-retail-deals-end-of-year-review-2022-1203381207/

Notice. (n.d.). *StockX Stock price: $40.30 - Valuation, funding, IPO, how to buy*. https://notice.co/c/stockx

Oe, H. (2022). A discussion of streetwear fashion as a cult: A qualitative approach. *International Journal of Business Management and Economic Review*, *05*(06), 09–28. https://doi.org/10.35409/ijbmer.2022.3433

PitchBook. (2024). Farfetch. https://content.pitchbook.com/share/quick-link/profile/ac5ba61d-8029-44a9-a2c3-756b67f3f681?hash=80d5f8ab289491d9bcb92b1e26f69a44c3f43211a170cbf30c806675bf6f2ac7

Reid, J., & Golden, J. (2022, October 26). Adidas terminates Ye partnership, Gap removes Yeezy items over rapper's antisemitic remarks. CNBC. https://www.cnbc.com/2022/10/25/adidad-terminates-partnership-with-ye-following-rappers-antisemitic-remarks.html

Schulz, M. (2023, December 18). Why Farfetch was acquired by the 'Amazon of Asia.' *Vogue Business*. https://www.voguebusiness.com/story/companies/why-farfetch-was-acquired-by-the-amazon-of-asia

Strategy&. (2019). *Streetwear: the new exclusivity*. https://www.strategyand.pwc.com/de/en/industries/consumer-markets/streetwear/streetwear-the-new-exclusivity.pdf

Strategy& & Hypebeast. (n.d.). *Streetwear Global Market Research*. https://strategyand.hypebeast.com/streetwear-report

VF Corporation. (2023). *Annual Report Fiscal Year 2023*. https://d1io3yog0oux5.cloudfront.net/_c666bcb79637d7946fdfc5abd6c95ce6/vfc/db/409/112817/annual_report/VF_FY2023_Annual_Report-DIGITAL-FINAL.pdf

Winter, M. (2017, March 4). *Supreme customer profile*. Issuu. https://issuu.com/mollywinter/docs/suprsup_c1a9a0e5e86512

Yotka, S. (2019, January 11). Think streetwear is a new phenomenon? Meet Luca Benini who started the hype 30 years ago. *Vogue*. https://www.vogue.com/article/slam-jam-luca-benini-interview-pitti-uomo