Top Deal: Digital Brands Group Continues To Be Strong Investment

https://www.seedinvest.com/dbg/series.a3

Key Deal Stats

- Raising Platform: SeedInvest
- Valuation Cap: $35M
- Security Type: Preferred Equity
- To date and as of 12/20/2018, Digital Brands Group has raised $1.9M

In July, we covered a company called Denim.LA and its brand DSTLD. Short for “Distilled”, the brand is built with the concept of selling staple high-end clothing products direct to consumer.

Their products, like t-shirts, leather jackets, and jeans, are all fashion essentials immune to the cyclicality of the fashion industry and therefore do not contribute to the wastefulness of fast-fashion.

Even more, by selling their products online, their average selling price is often between 60-80% of comparable luxury products, despite being verifiably sweatshop-free and environmentally friendly.

At the time, we rated the company a Top Deal, citing their strong financials and their traction at market penetration in a high barriers-to-entry market like fashion. Today, we are reiterating this Top Deal rating, reserved for the top 10% of all deals across the market.

You can also check out our discussion with Co-Founder Mark Lynn HERE that was conducted as part of our due diligence.

Digital Brands Group

Since July, Denim.LA has seen some changes and many successes with their operational capability. First off, their company is now called Digital Brands Group (DBG), a portfolio company of digital-first lifestyle brands.

The company's initiative to place showrooms and limited inventory storefronts has also turned out wildly successful. In major metropolitan areas like New York City and Los Angeles where showrooms have been concentrated, customer lifetime value has grown by 12%. This success is also reflected in their digital marketing efforts consistently generated strong returns, often achieving 2-3x ROA.

Their performance also continues to be very strong by other metrics. While in July, DSTLD was estimated to have a CAC of ~$40 with a 1.5x payback in 12 months, DSTLD now has a marginally higher CAC of ~$43 with a 2.1x payback in the same time frame.

This has been made possible by their healthy average order value of $117 and their robust repeat purchase rate of 37%. For comparison, the fashion industry generally has an average order value of $97 and a repeat purchase rate of about 10% - 20%.

Considering this, alongside their dramatically lower return rate, the company's acceptance among consumers is definitely on the rise, positioning it for a strong 2019. DSTLD already boasts 71.9K+ lifetime customers and this number is sure to rise in the coming years.

Business Model

DBG's strong emphasis on building new brands this early on is well-founded. A holding company has the added advantage of economies of scale in aspects like logistics, manufacturing, and customer service, all central factors in what drives costs higher for a digitally native company.

Controlling these specific costs is particularly important for DBG. Their target market, Millennials and Gen X consumers, heavily values an omnichannel experience. To meet the expectations of their target consumers, the company needs to invest heavily to provide such an experience, which can prove to be incredibly expensive.

Their efforts at launching showrooms around the country is a good example of their predicament. While showrooms ensure that Millennials can interact with the physical product that they plan on purchasing and thus lower the chance of dissatisfied customers, showrooms are expensive to maintain, requiring attendants and, most importantly, rent expenses.

An effective omnichannel experience extends to every aspect of the business as well. Companies are increasingly pressured into providing their customers multiple ways to contact their customer support team.

DSTLD does a good job of this: their “Contact Us” page features an email to contact, live chat, and text message. Supporting such a comprehensive customer support effort is important for appealing to its target market, but also incurs heavy staffing costs.

Showrooms and customer support are two of many aspects where the omnichannel experience helps attract new customers but are fairly expensive to maintain. But, DBG shines the most in this aspect: by consolidating these costs under one parent company, each brand is able to benefit from stronger cash-flow generation, as well as lower total costs.

For example, while showrooms are an essential customer acquisition and retention strategy, the rent expense associated with maintaining physical locations is inhibiting. But, if DBG manages multiple brands, one showroom could display articles of clothing from a number of different brands.

Customers that walk into the store looking for items from one brand are then also exposed to all of DBG’s different brands, which generates additional value in the form of brand awareness while taking on the same fixed expenses.

Considering that DBG’s brands are all founded on similar values of environmentally sustainable, low-cost high-quality items, a customer that comes into a storefront for DSTLD products has a good chance of becoming a customer of the company’s other brands. Their comprehensive customer support initiative is similarly able to enjoy efficiencies related to economies of scale.

Product Roadmap

The primary purpose of this round of fundraising is to launch DBG’s second brand, ACE Studios. ACE has the same core values as DSTLD, meant to sell luxury men’s clothing at discounted prices, made possible by the same low overhead costs and operational efficiencies that DSTLD has managed. ACE is planned to launch in the next few weeks, starting with a product line of performance tees, dress shirts, suits, and slacks.

The company works with established Italian clothing mills and factories based in Europe, placing a heavy emphasis on high-quality raw materials. Their products use “Impact Zero” fabric, which is water-repellent, wrinkle resistant, odor-free, and thermoregulated. Clothing with these features have proven to be widely in demand, demonstrated by Lululemon’s success with their products. Impact Zero fabric has the added feature of environmental sustainability, requiring only one third the water normally used when creating traditional wool-based frabric, and does not use any harmful chemicals throughout the process.

The Recommendation

1. Strong Brand Identity

The fashion industry is notoriously centered around brand recognition. Luxury brands like Gucci and Louis Vuitton derive much of their value from their branding and have capitalized heavily on consumer perceptions of their products. Consumers who enjoy the luxury status that comes along with owning LV or Gucci products purchase these products because of the brand’s identity as a fashion icon.

DBG can capitalize on their brand identity as well, but in a different way. Though their products are made with the same standards of quality and luxury in mind, DBG is not meant to be a product that consumers need to save six months of salary to indulge in. Rather, their brand identity is strong in their commitment to environmental sustainability.

Though DSTLD can be seen as a company that sells quality items at a discount, the core value that drives its products is really the promise of creating high-quality staple products that consumers can wear any day of any year without being labeled “unfashionable”.

Fashion trends are cyclical by nature and are intended to drive consumers to need to update their wardrobe constantly. While this definitely boosts revenues for clothing retailers, the waste produced by this cycle is immense and producers often rely on unethical cheap labor to offset the additional costs levied by always needing to change their production line.

DSTLD’s emphasis on breaking this cycle with fashion constants like jeans and tees is aimed at breaking this cycle, to balance out consumerist trends and limit their impact on the environment. ACE’s Impact Zero fabrics with its water conservation efforts are even more directly environmentally sustainable.

Market trends have continuously indicated that consumers are increasingly willing to spend more money to purchase environmentally sustainable products. Presented with an opportunity to purchase environmentally sustainable products at a discount, most consumers would be more than happy to purchase products, especially knowing that the company they buy from has sustainability in mind. At this point, DBG can also leverage its brand identity to keep its consumers shopping with its other brands like in our example of the showroom.

2. Historical Success

The biggest risk associated with DBG at this moment would be the failure of ACE Studios. The company revenues have largely flown to creating this second brand, and lack of penetration would set the company back for a few quarters.

However, this failure is exceedingly unlikely. Their successful launch of DSTLD is a testament to management's ability to identify qualities that its end consumer value. Fashion magazines like Vogue, GQ and Elle have all praised DSTLD's products. The low return rate, high repurchase rate, and increasing customer LTV and AOV all point toward happy customers as well.

Purely judging on their success in managing DSTLD's launch, DBG's management seems to know how to best manage ACE's release.

3. Underutilized Synergies

A major part of DBG's business model is to capitalize on the synergies in maintaining multiple direct to consumer clothing companies.

At this moment, the company has only one brand - DSTLD. So, many of the synergistic efficiencies that DBG promises are not even maximized as of this moment. Their launch of ACE just four years after DSTLD's success shows that DBG is serious about expanding the number of brands under its control. Similarly, the company is in talks with several potential acquisition targets and could be adding more brands to their company in the near future.

The Rating: Top Deal

I would argue that until DBG has a couple of brands under its control, the economies of scale that their business model promises are not yet fully engaged. At this moment, DBG has a hefty valuation of $35M, but once the company capitalizes its efficiencies to their maximum potential, their profit margin can be much higher than it is right now.

Especially considering that the company already has $15M+ lifetime sales throughout its four years, purely through DSTLD, I would argue that the company is still a Top Deal, acting under the assumption that ACE and it’s acquisitions are successfully managed. Be sure to invest HERE.