ATKearney

Fortifying Before the Storm

2019 Consumer and Retail M&A Report

Consumer and retail companies are looking to M&A to strengthen their portfolios and capabilities ahead of a potential slowdown in the economy.

Introduction

Significant merger and acquisition (M&A) activity in the consumer packaged goods (CPG) and retail sectors will characterize 2019. Companies are addressing years of anemic growth and changing consumer demands by fortifying themselves with new capabilities that build efficiency and agility while facilitating deeper ownership of the consumer experience.

Fortifying Before the Storm, the fourth edition of the A.T. Kearney Consumer & Retail M&A Report, is based on a proprietary analysis of M&A transactional data and more than 100 C-level CPG, retail, and private equity (PE) executives' answers to crucial strategic and financial questions.

Despite a drop in M&A activity in 2018, caused mainly by a reduced number of large transactions, the opportunities for deal-making are not drying up yet. Investors are refocusing attention from scale deals to scope deals and allocating their capital to assets that give them access to key competencies and geographies instead of just building scale or market share.

> Despite a drop in M&A activity in 2018, the opportunities for deal-making are not drying up yet.

We see three key takeaways for this year:

- **Sustained M&A activity.** This trend will be driven by multiple factors, including a large supply of dry powder, falling asset prices, divestiture of non-core assets of strategic companies, and a continuous search for growth through category expansion and investment in adjacencies.
- **Taking ownership of the customer experience.** Companies will aim at taking more ownership of key capabilities such as digital and supply chain and invest in adjacencies to own the consumer experience.
- **M&A as a tool for localization.** This year's cross-border M&A will look to expand the portfolio with local assets, allowing customer proximity in growth markets, without pushing a global model. International corporations are becoming more multi-local.

2018 in Review: Smaller Companies in the Spotlight, Sustained Multiples, and Increased Political Uncertainty

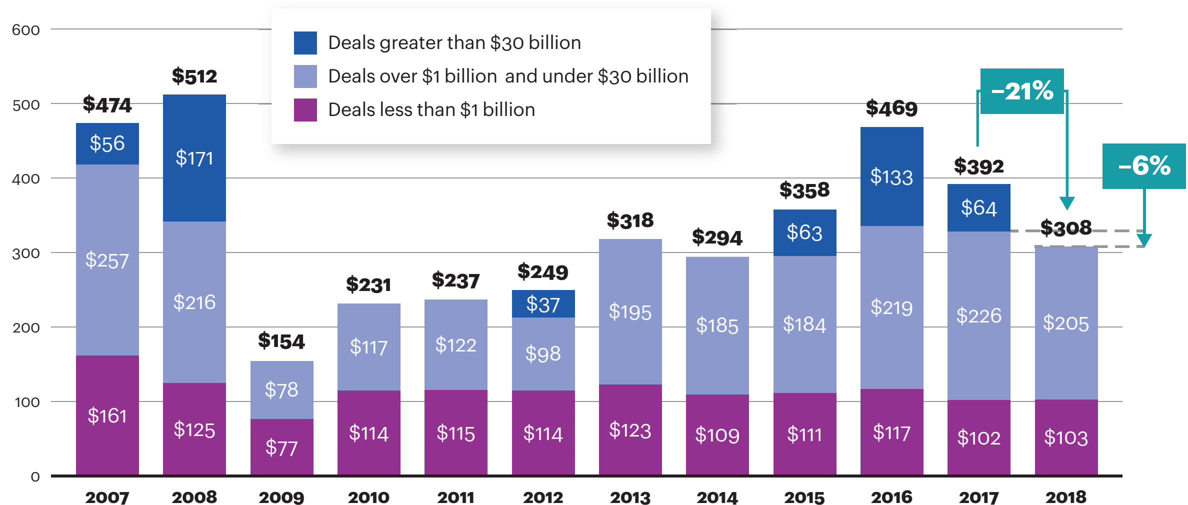
Overall CPG and retail M&A activity dropped from $392 billion in 2017 to $308 billion in 2018, primarily due to the absence of megadeals last year (see figure 1 on page 2).[1] The opportunity pipeline for larger deals has narrowed as CPG and retail assets are in much better shape than they were a few years ago.

[1] Editor's note: For the purposes of this report, we are using the following criteria to determine M&A size: small (<$100 million), midsize ($100 million–$1 billion), large ($1–$30 billion), mega (>$30 billion).

Figure 1

There was no CPG or retail M&A activity over $30 billion in 2018, while deals under $30 billion remained steady

Consumer and retail M&A activity level
(US$ billion)



YoY growth (excludes deals >$30 billion)	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
M&A deal volume	7%	–3%	–22%	11%	–1%	–6%	–9%	–2%	–12%	9%	–6%	–18%
M&A deal value	57%	–18%	–55%	50%	2%	–10%	50%	–8%	0%	14%	–2%	–6%
Median EV/EBITDA	8%	–24%	–16%	16%	14%	2%	18%	–6%	12%	–14%	3%	2%

Note: Numbers may not resolve due to rounding.
Sources: Dealogic 1/1/2000 to 12/31/2018; A.T. Kearney analysis

Smaller companies are becoming primary takeover targets

Investors are increasingly focusing on strategic deals aimed at building legacy companies' capabilities through the acquisition of smaller, disruptive companies. While the volume of midsize deals fell 4 percent, the value increased 6 percent as investors looked to opportunities with bold, challenger retailers to integrate change agents—in the form of new brands, new customers, new concepts, new capabilities, and new talent—at lower cost and risk.

A clear example of this trend is Macy's acquisition of Rachel Shechtman's Story, a single-concept store operating in Manhattan's High Line neighborhood that approaches retailing through storytelling as if the store was a magazine, offering customers an entirely different curated experience every month. The acquisition, announced in May 2018, was essentially a way to acquire Shechtman's formidable team and talents as storyteller, innovator, retailer, and marketer, in order to radically transform Macy's consumer experience.

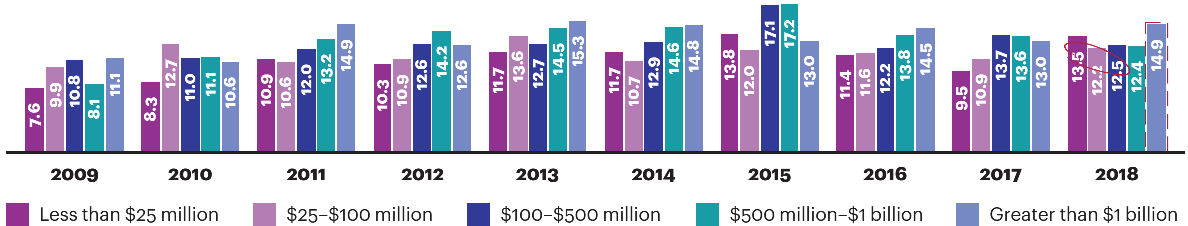
In an investment market where capabilities are the strongest valuation driver, and size and market share mean less and less, small companies are, on average, valued at higher multiples than midsize ones (see figure 2 on page 3).

Figure 2

Small targets (below $25 million) have now overtaken midsize ones in multiples, while investors continue to pay a premium for large targets

Multiples by company size[1]

(median EV/EBITDA multiples, 2009–2018)



[1] 2018 sample sizes for deal value, used as a proxy for company size: <$25 million n=38; $25–$100 million n=50; $100–$500 million n=67; $500 million–$1 billion n=18; >$1 billion n=29

Sources: Dealogic 1/1/2000 to 12/31/2018; A.T. Kearney analysis

Large CPG transactions can remain relevant if they are targeting new routes to market, exploring adjacencies and new capabilities. This was the case of the Keurig (JAB Holdings)/Dr Pepper merger that created a diversified brand portfolio by marrying a strong "in-home" brand with a leader in the "ready-to-drink" market that represents the third-largest nonalcoholic beverage company in the world.

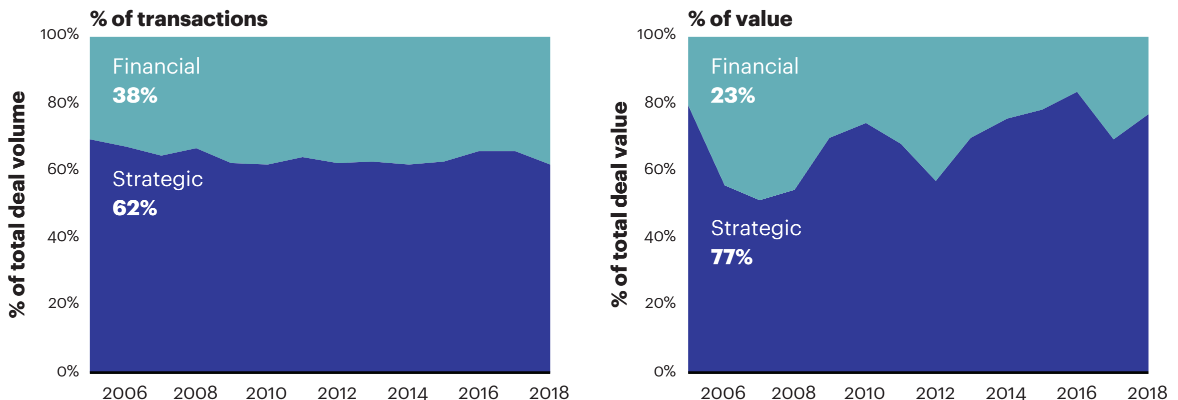
Strategic investors continue leading the market, and multiples remain high

Strategic investors continued to hold the lion's share of CPG and retail M&A deals in 2018, representing 62 percent of transactions in volume and 77 percent in value, despite the higher share of media attention PE transactions often get (see figure 3).

Figure 3

Strategic investors still have the lion's share of the M&A market, representing 62% of deal volume and 77% of deal value

Share of consumer and retail deals by investor type



Sources: Dealogic 1/1/2000 to 12/31/2018; A.T. Kearney analysis

The spread between CPG and retail multiples is shrinking, going from 33 percent in 2017 to 4 percent last year (see figure 4). This is mainly driven by a resurgence of retail as a hot M&A investment in 2018, driven by companies' search to be closer to the customer.

PE firms are still paying a premium compared to strategic investors (15.1 versus 12.4 EV/ EBITDA) as competition is intensifying on finding quality assets (see figure 5). PE firms are increasingly looking at smaller deals or new concepts or brands at an earlier stage than they have typically done.

PE funds also still have plenty of cash on hand to invest. At $858 billion, the current amount of PE dry powder remains 8 percent above the 2005–2018 average (see figure 6 on page 5).

Figure 4

Retail has closed the gap in multiples versus CPG, ending a historical trend

Consumer and retail deal multiples versus major benchmarks[1]

Deal multiples	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
CPG M&A	10.9	11.8	14.0	11.3	9.0	10.0	11.2	11.1	14.3	14.7	14.2	13.8	13.8	13.0
Retail M&A	12.9	13.0	13.0	9.1	8.0	9.9	11.4	12.4	11.3	11.5	14.5	11.4	10.4	12.6
S&P 500	9.4	9.1	10.1	7.0	7.9	7.9	7.1	7.4	8.9	9.6	9.7	9.9	10.8	9.6

[1] Median per year; benchmark based on median multiples of top 25 holdings within XRT (retail) and IYK (CPG) ETFs

[2] EV / forward EBITDA at year end

Sources: Dealogic 1/1/2000 to 12/31/2018, Capital IQ; A.T. Kearney analysis

Figure 5

Financial buyers continue to pay higher premiums

Multiples by buyer type[1]

(Median per year)

[1] Financial acquirers: n=59; strategic acquirers: n=144

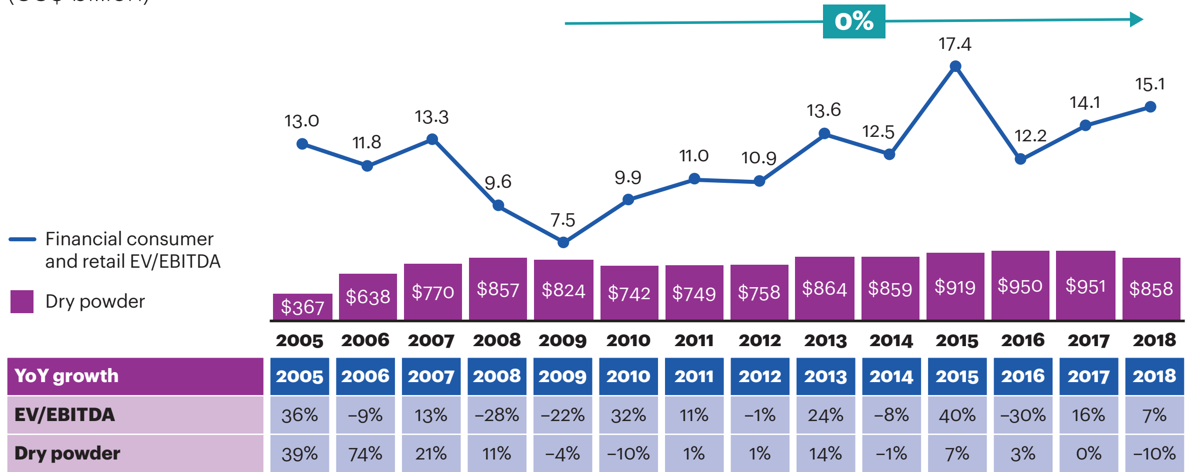
Sources: Dealogic 1/1/2000 to 12/31/2018; A.T. Kearney analysis

Figure 6

Dry powder is stabilizing, but still remains high, similar to 2008 and 2009 recession levels

Financial investors' dry powder at year end and multiples

(US$ billion)



YoY growth	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
EV/EBITDA	36%	–9%	13%	–28%	–22%	32%	11%	–1%	24%	–8%	40%	–30%	16%	7%
Dry powder	39%	74%	21%	11%	–4%	–10%	1%	1%	14%	–1%	7%	3%	0%	–10%

Sources: Dealogic 1/1/2000 to 12/31/2018; A.T. Kearney analysis

PE funds have also adapted to sustained high valuations and pressure on fund-raising by starting to extend the lifespan of their funds and holding assets longer, leading to fewer annual exits than ever before (see figure 7).

Industry-leading private equity houses, such as The Carlyle Group, Apollo Global Management, Blackstone, and CVC Capital Partners, have recently started to offer long-term funds (15 or more years); successful newcomers such as Core Equity Holdings and Cove Hill Partners continue to position their strategy around longer-term investments.

Political and economic uncertainty: the bottom line

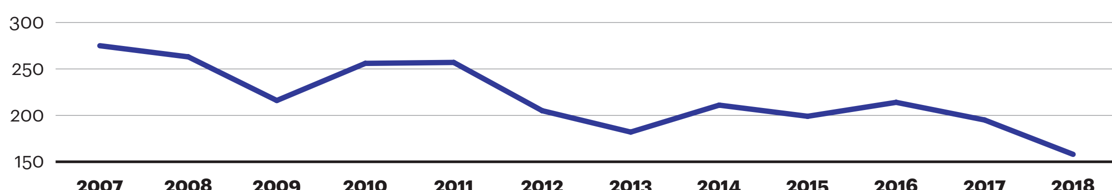
The disruptive nature of the 2016 US elections, growing global political tensions, Brexit, the risk of long-term trade wars, the potential looming recession (or at least significant market correction), and fear of rising interest rates have created a perfect storm of uncertainty for 2018's investment community that has benefited domestic deals over international M&As. In

Figure 7

PE deal exits are at a 12-year low

CPG and retail PE deal exits

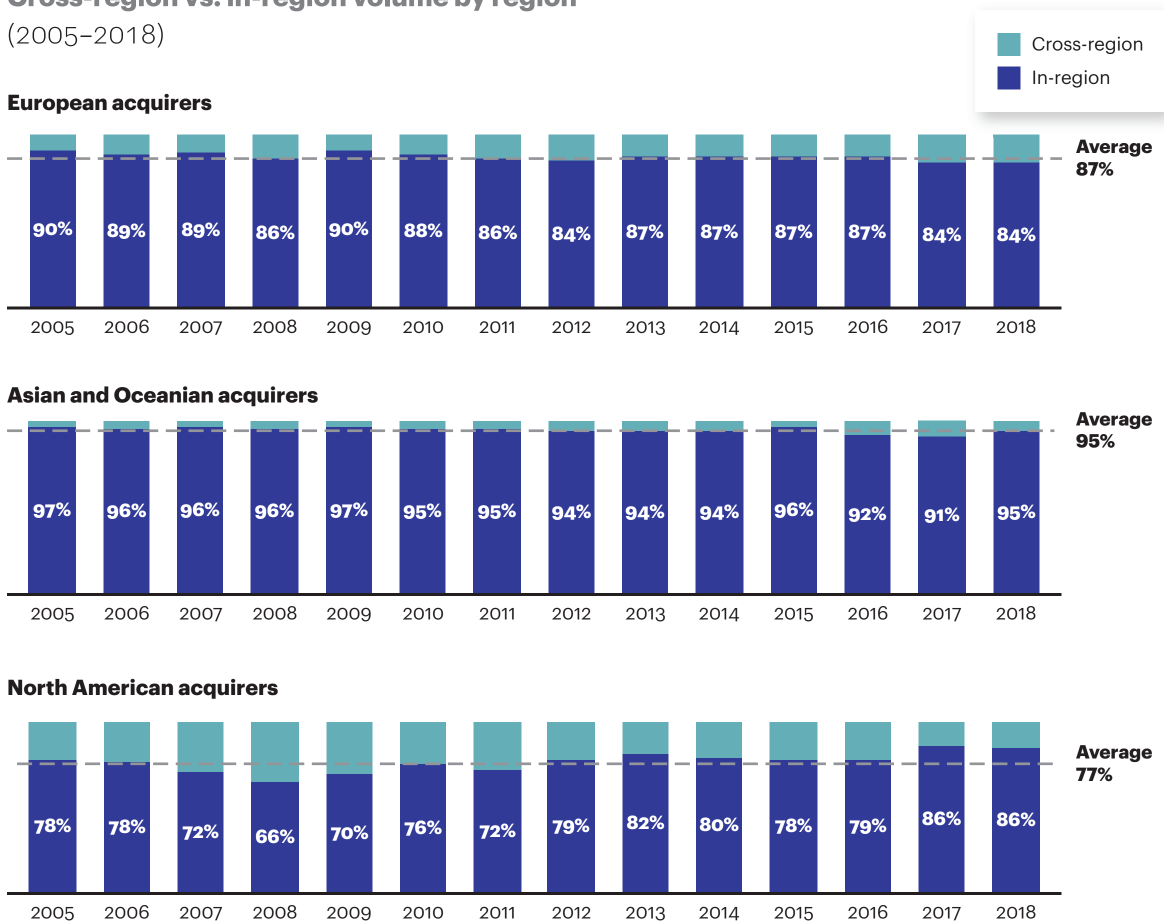
(# deals, 2007–2018)



Sources: Dealogic 1/1/2000 to 12/31/2018; A.T. Kearney analysis

North America, CPG and retail cross-border deals have hit a 14-year low, down to 14 percent of M&A volumes (see figure 8).

Figure 8
In-region deal volume in North America remains higher than the 14-year average



Sources: Dealogic 1/1/2000 to 12/31/2018; A.T. Kearney analysis

Key Drivers for 2019

Global growth is clearly slowing down. Economists generally agree on a dip in growth this year and a return closer to historical averages, with a low 2 percent growth rate in the US and mid to high 2 percent global growth. More bearish observers, including Nobel Prize winner Paul Krugman, point to a possible recession in the fourth quarter of 2019 or the first quarter of 2020—effectively making 2019 the "last good year" of the current economic cycle.

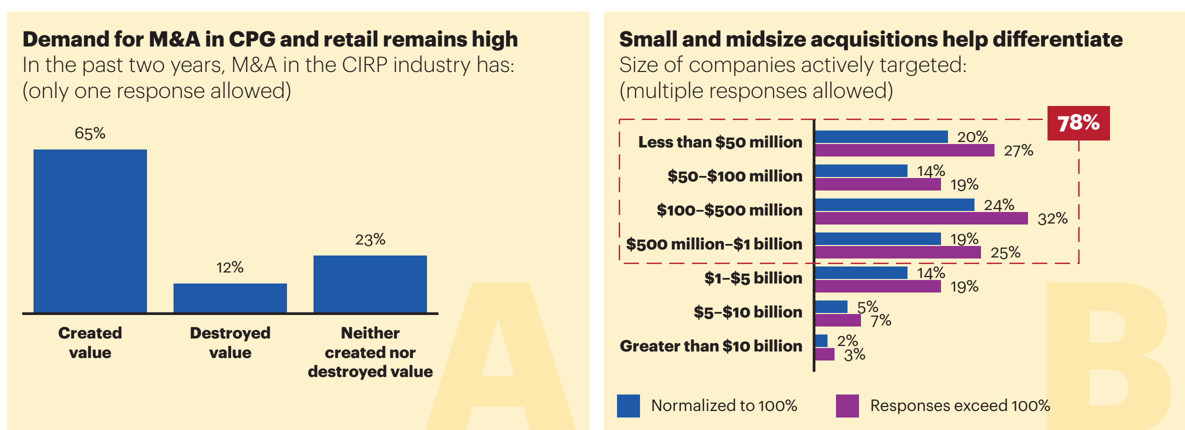
Despite these economic uncertainties, M&A remains an accretive strategy for CPG and retail companies. Sixty-five percent of respondents believe M&As will continue creating value this year, and the resilience of the CPG industry to market conditions makes such companies strong investment candidates.

As highlighted by our executive survey, the top three factors driving M&As in CPG and retail are:

1. Accessing new customers
2. Broadening geographic reach, and
3. Expanding product portfolios.

We also have reason to believe the trend toward smaller companies will remain: 80 percent of responding executives believe that companies under $1 billion will be the most sought-after M&A targets (see figure 9).

Figure 9
Key drivers for 2019: demand for M&A activity remains high although macro uncertainty continues



Source: A.T. Kearney analysis

2019: The A.T. Kearney Outlook

A.T. Kearney is bullish as we look to the consumer and retail M&A market in 2019, and so are the executives surveyed for this report. Armed with significant capital resources and realizing the need to rapidly integrate key capabilities into legacy companies, investors will be on the lookout for deals that can help them both remain competitive in the short term and grow over the long term.

This year's three most crucial M&A trends will be:

1. Sustained M&A activity

Eighty-eight percent of the C-level executives surveyed expect 2019 M&A activity to be equal or better than 2018 levels. Ideal takeover targets will be smaller companies—easy to integrate and bringing some disruptive elements to legacy businesses.

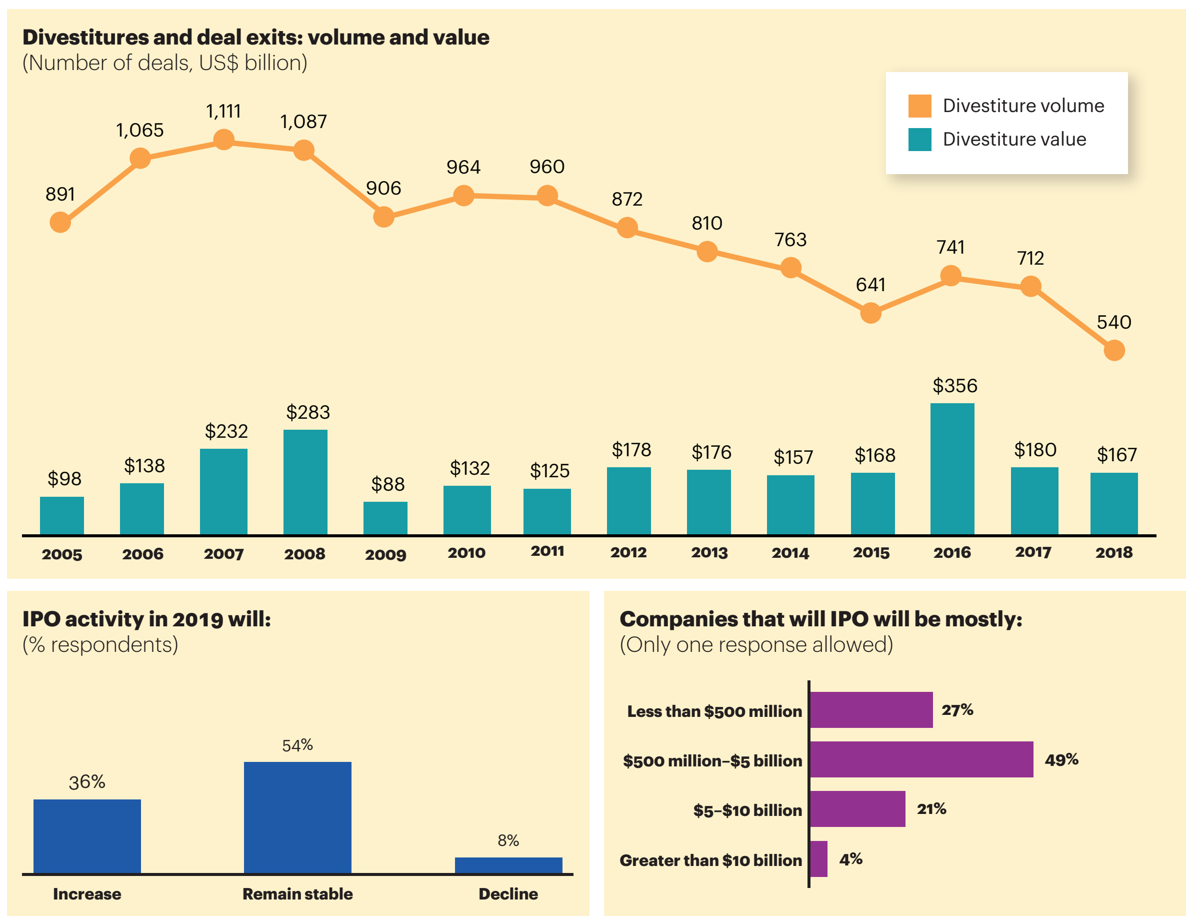
Sellers will be primed to let go of non-core assets this year ahead of an anticipated economic correction. Many strategic investors have followed the same trend as PE funds and held onto their assets for longer than ever; they will recognize 2019 may be the last good year to cash in and reallocate capital.

This same line of thinking may trigger a round of IPOs, especially for small and midsize firms. More than 90 percent of responding CPG, retail, and PE executives expect IPO activity to remain stable at the very least, while 36 percent expect increases over 2018 IPO activities (see figure 10).

> Eighty-eight percent of executives surveyed expect 2019 M&A activity to be equal or better than 2018.

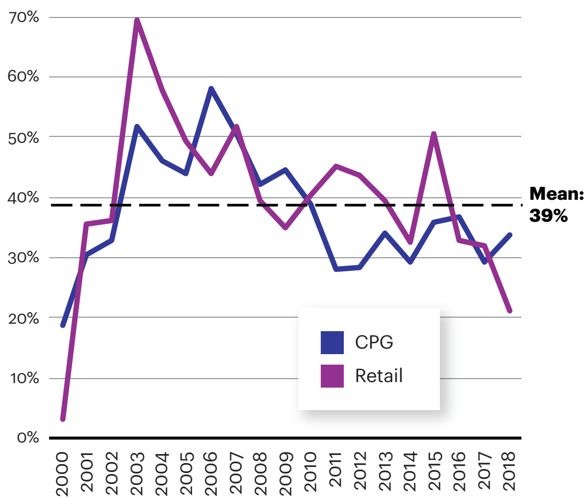
CPG and retail transactions are expected to support strong PE performance in 2019, as these less-cyclical-demand industries are seen as safe harbors for investment. A.T. Kearney research indicates that PE executives believe both CPG and retail investments will maintain returns on par with, or higher than, their portfolio average in 2019 (see figure 11 on page 9).

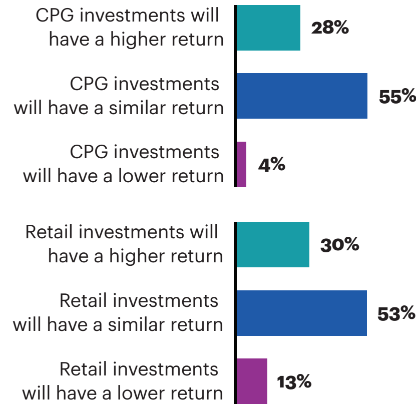
Figure 10
M&A activity will sustain, more than 90% of respondents believe IPO activity will remain stable or increase



Sources: Dealogic; A.T. Kearney analysis

Figure 11
CPG and retail PE performance will hold in 2019





Note: PE and finance respondents only

Sources: Dealogic 1/1/2000 to 12/31/2018; A.T. Kearney analysis

2. Taking ownership of the customer experience

The first area of focus for legacy businesses will be to acquire the key competencies they are still missing, such as digital and analytics, e-commerce, and supply chain and operations—the three core capabilities highlighted by executives as the main reasons to perform M&As in 2019 (see figure 12 on page 10).

The interfaces between these three capabilities (digital, e-commerce, and supply chain) are strong; as corporates have come to realize, the digital revolution is affecting both the top- and bottom-line sides of their business, with strong implications for customer experience along the way.

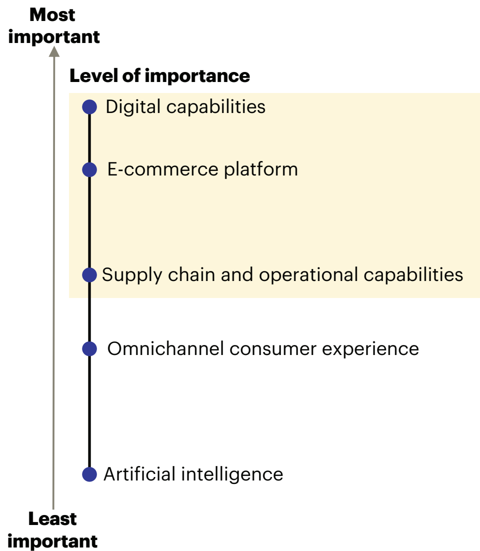
E-commerce and mobile shopping platforms are a key driver of customer experience and have become table stakes to succeed in retail. Independent research from IDC points out that competition is evolving fast in the field, with more than 50 percent of online shoppers reporting that the web or mobile platform of their favorite retailers are improving significantly every year. Innovation cycles are getting shorter; organizations must develop agility and speed to avoid being left behind.

The next step after online and omnichannel capabilities is the development of advanced analytics to enable a truly customized and dynamic user experience, as well as extract more insights out of proprietary data to generate unique customer perspectives. Furthermore, customer adoption and satisfaction remain low for personalized online services (for example, tailored clothes fitted online, augmented and virtual reality, subscription retail); we see an opportunity to differentiate in this space for the most sophisticated retailers.

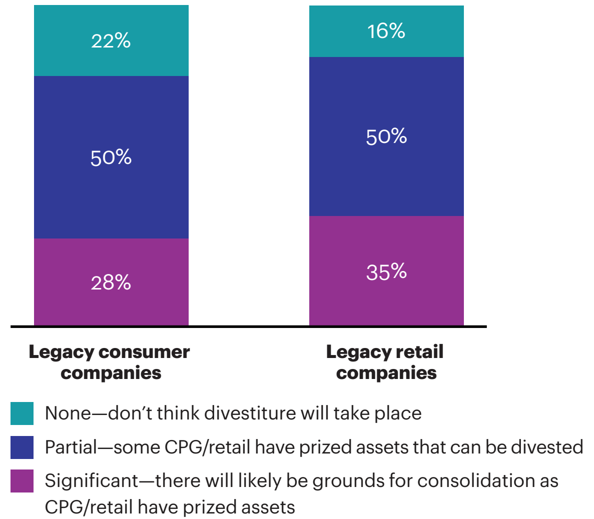
Beyond competencies, the ability to create or curate experiences has become a key differentiator in CPG and retail, and companies are using M&As to take control of a greater part

Figure 12
Legacy companies will look to divest some portion of their asset base

Most important new capabilities:
(Ranked 1-5, most important to least)



Legacy companies' views on divestitures
(Only one response allowed)



Note: Numbers may not resolve due to rounding.
Source: A.T. Kearney analysis

of the consumer journey and to widen their interface with consumers. Mobile and omnichannel is one side of the equation to reach the ever-connected future consumers, but customer proximity is also more than ever a key success factor to generate an intimate and relatable experience and ensure loyalty.[2]

> More than 80 percent of executives surveyed expect to see divestitures increasing in the next 12 months.

This trend is driving the convergence of CPG and retail, and the blurring distribution channels between brick-and-mortar and e-commerce, and food and pharmacy. This blurring of the CPG and retail segments is expected to create new growth segments for the M&A activity. The beverage sector, for example, provides several case studies of the convergence of beverage at home and away from home:

- **Nestlé–Blue Bottle Coffee**
  - Announced date: July 2017
  - Deal value: $500 million for 68 percent stake

[2] A.T. Kearney defines future consumers as consumers born after 1997; they will account for close to 50 percent of the global consumer base by 2030.

- Deal rationale: Nestlé acquired the artisanal coffee retailer to enter the "third-wave specialty coffee" market, a higher-margin consumer experience-based sector which accounted for 15–20 percent of US coffee consumption.

- **Nestlé–Starbucks**
  - Announcement date: May 6, 2018
  - Completion date: August 28, 2018
  - Deal value: $330 million
  - Details: Nestlé acquired perpetual rights to market Starbucks Consumer Packaged Goods and Foodservice products globally, excluding products that are sold within Starbucks coffee shops.
  - Deal rationale: For Nestlé, the new brands in its portfolio help the business work on innovation to enhance consumer experience for coffee lovers.
- **Pepsi–SodaStream**
  - Announcement date: August 20, 2018
  - Completion date: December 5, 2018
  - Deal value: $3.4 billion at 26.0 EV/EBITDA
  - Deal rationale: The deal gives Pepsi a presence in the at-home market, offers healthier options, and provides a new "razor-and-blades" revenue stream with syrup and CO2 gas refill sales.
- **Coca Cola–Costa Coffee (the leading coffee company in the UK, owned by Whitbread PLC)**
  - Announcement date: August 30, 2018
  - Completion date: January 3, 2019
  - Deal value: $5.0 billion at 16.4 EV/EBITDA
  - Deal rationale: The deal expands Coca-Cola's addressable coffee market from $0.8 trillion (ready-to-drink nonalcoholic coffee and tea) to $1.5 trillion (adding the $485 billion hot-beverages market).

Of course, not all capabilities acquisitions will be M&A-driven. Partnerships also enable CPG companies and retailers to rapidly acquire competencies, especially in the field of analytics. Examples of this include Valentino's partnering with IBM, through Yoox-Net-a-Porter, to improve omnichannel and inventory and fulfillment capabilities, and Zara's partnerships with Jetlore, an AI start-up, to predict consumer behavior across channels and platforms, and Fetch Robotics, to introduce robot-handled stock inventory.

3. M&A as a tool for localization

While the domestic market will remain the primary focus of CPG and retail companies in 2019, and despite global trade uncertainties, international M&A deals are expected to grow. Executive respondents confirmed that using M&As to drive geographic expansion remains among their top three growth strategies.

Major CPG and retail companies realize the value of "must-win" markets, notably Asia Pacific, China, and India. In order to win in these markets, they need local capabilities not only in sales, marketing, and e-commerce, but also increasingly in supply chain and operations.

Some large corporations will also use M&A in an effort to circumvent trade wars and integrate production rather than outsourcing it. Local market observers confirm this trend; according to Baker McKenzie, "Chinese domestic M&A cooled off due to tighter credit conditions, but inbound M&A has gathered pace as overseas firms move to protect access to Chinese markets in the event of future trade barriers."

We see continuing evidence of companies driving more local focus, as in the case of Walmart's sale of 80 percent of its stake in its Brazilian operations to Advent PE.

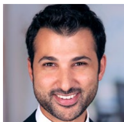
Conclusion

Strategic focus in CPG and retail companies has shifted gradually—but definitely—from building market share and economies of scale to offering a differentiating customer experience. Legacy companies understand that Millennial and Gen Z shoppers comprise a new, more sophisticated consumer base, one that needs to be approached through a new set of skills. For many companies, M&A is the right vehicle to acquire such capabilities.

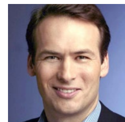
Some of the most successful consumer and retail companies are serial acquirers. They understand the value of acquisitions to support long-term strategy in any market, and have the resources to find and integrate deals.

One word of caution: investing before a downturn is risky, as companies may overpay as valuation softens and growth stumbles. However, no one can predict the exact time line of a downturn in the economy. Waiting too long may delay both the integration of strategic capabilities and the benefit to the core business.

Authors



Bahige El-Rayes, partner, New York
bahige.elrayes@atkearney.com



Bob Haas, partner, New York
robert.haas@atkearney.com

Alexandre Terseleer, consultant, San Francisco
alexandre.terseleer@atkearney.com

The authors wish to thank Avishee Gupta for her valuable contributions to this paper.

A.T. Kearney is a leading global management consulting firm with offices in more than 40 countries. Since 1926, we have been trusted advisors to the world's foremost organizations. A.T. Kearney is a partner-owned firm, committed to helping clients achieve immediate impact and growing advantage on their most mission-critical issues. For more information, visit www.atkearney.com.

Americas	Atlanta Bogotá Boston Calgary Chicago	Dallas Detroit Houston Mexico City New York	San Francisco São Paulo Toronto Washington, D.C.
Asia Pacific	Bangalore Bangkok Beijing Brisbane Hong Kong Jakarta	Kuala Lumpur Melbourne Mumbai New Delhi Perth Seoul	Shanghai Singapore Sydney Tokyo
Europe	Amsterdam Berlin Brussels Bucharest Copenhagen Düsseldorf Lisbon	Ljubljana London Madrid Milan Moscow Munich Oslo	Paris Prague Rome Stockholm Vienna Warsaw Zurich
Middle East and Africa	Abu Dhabi Doha	Dubai Istanbul	Johannesburg Riyadh

For more information, permission to reprint or translate this work, and all other correspondence, please email: insight@atkearney.com.

The signature of our namesake and founder, Andrew Thomas Kearney, on the cover of this document represents our pledge to live the values he instilled in our firm and uphold his commitment to ensuring "essential rightness" in all that we do.

A.T. Kearney Korea LLC is a separate and independent legal entity operating under the A.T. Kearney name in Korea.

A.T. Kearney operates in India as A.T. Kearney Limited (Branch Office), a branch office of A.T. Kearney Limited, a company organized under the laws of England and Wales.

© 2019, A.T. Kearney, Inc. All rights reserved.