3Q 2019 CONSUMER PRODUCTS SPOTLIGHT
M&A trends and private equity deal activity
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Kunal Bhatt, Director, Transaction Advisory Services, RSM US LLP
The American consumer has helped to blunt many of the adverse effects on the wider U.S. economy that have arisen from the trade war with China. However, consumer sentiment has started to flag of late and, in addition to the uncertainty ushered into the market from rising tariffs, retailers must also contend with increasing labor costs pressuring margins. At the tail end of the summer, U.S. consumer sentiment declined by its most significant amount since 2012 as concerns around trade disputes with China, and more recently, the European Union, started to take hold. As a result, many clients in the consumer products space are growing rather weary of the continuing developments related to U.S. trade policy. Knowing these changes represent a larger macro event that may unfold over years and hit many aspects of the enterprise, some companies started to revise their sourcing strategies. “These organizations are the ones that have been able to successfully weather the storm,” says Kunal Bhatt, a director with RSM’s transaction advisory services. “Companies exploring a potential sale in the upcoming term should continue to explore vendor diversification out of China and into other areas of Southeast Asia in order to present an attractive asset to the market.” Likewise, players in the consumer space with recurring revenue streams are emerging as attractive assets to financial sponsors and corporate acquirers alike as the prospects of a downturn rise.
Signs have emerged that the American consumer is struggling. More drivers are taking on lengthier auto loans to stay on the road, suggesting that the strength of the consumer backbone keeping the U.S. economy upright may be faltering. According to the RSM U.S. Middle Market Business Index, a potential recession is expected in the latter half of 2020, and recent reports have noted that U.S. consumer debt levels have reached $14 trillion, roughly $1 trillion above levels reached on the eve of the financial crisis. “Consumer businesses will find this data point troubling as we move forward into uncertain waters from a broader economic perspective,” says Bhatt. In addition, student loan debt more than doubled during the decade since the housing market bubble burst to spur the evolution of a younger, asset-light consumer who now rents or shares a whole range of consumer goods, from cars to clothing, all of which were previously purchased outright. Meanwhile, the exceptions to these trends have started to come under pressure from tariffs and disruptions to supply chains, particularly in apparel and footwear. As RSM has noted in The Real Economy Blog, deal-makers in this space already generated more than half of all tariffs collected by the United States while representing just 6% of imports before the trade war.
The year ahead for deal-makers targeting the CP market will hinge on how factors ranging from the trade war and tariffs to a looming economic slowdown and a less robust consumer base affect the market. Collectively, these factors represent a deviation from the patterns that have fueled the strong economic growth of recent years and will force retailers to evolve. In the near-term, however, many companies in the sector are still banking on a resilient consumer to drive holiday spending in the fourth quarter. “As an industry in transition, our retail clients will certainly be hoping for another strong holiday shopping season,” Bhatt observes. “However, consumer sentiment may be waning and could have a direct impact on the upcoming season.” Meanwhile, other trends are reshaping the CP landscape. The demand for ethical sourcing of goods has risen as a primary concern among a growing segment of the consumer base. Confronting this challenge head on, clients in the middle market are finding success addressing the increasingly conscientious consumer. Promotional spending to highlight environmental, social and governance initiatives has been beneficial to many clients, including certifications on vegan and cruelty-free cosmetics. By contrast, middle-market players in the food and beverage sector may suffer at the hands of larger competitors, given their greater ability to leverage economies of scale and quickly adapt to changes in consumer preferences. As RSM has found, a number of complementary resources are already bridging the gap between profitability and sustainability for retailers in the middle market post-adoption. “Blockchain technology can provide consumers with a transparent view of the entire supply chain, resulting in the socially conscious consumer having a view of how the product they purchased is made,” says Bhatt.
M&A activity appears poised to post a fourth consecutive annual decline in completed transactions since peaking in 2015.

Overall deal value fell roughly 50% YOY last quarter to just under $80 billion in total.

With 338 deals representing nearly $50 billion in combined value, North American deal flow improved compared to Europe’s performance.

Completed transactions in both retail and durable goods fell by at least 50% YOY.

Weak completion rates in retail also led aggregate deal value to decline by 50% YOY.

PE firms targeting the consumer space have completed some 930 deals in total, representing $126 billion in aggregate value through Q3.

For a seventh consecutive quarter, financial sponsor activity constituted more than a third of all M&A deals.
M&A ACTIVITY ACROSS CP IN STEEP DECLINE

Despite mergers and acquisitions (M&A) in consumer products turning in another weak quarterly performance, aggregate deal value ticked up slightly in the third quarter of 2019 to nearly $80 billion on the fewest transactions since at least 2013. Completion rates continue to plunge across the space, with dealmakers closing roughly a third fewer transactions, compared to the same period last year. Through the third quarter, European performance across the space continued to drag down figures overall, posting $123 billion—just under half the overall value of North American deals on nearly the same number of completed acquisitions. Nevertheless, medians remain elevated as the competition for the best assets continues between financial sponsors and strategic buyers.
CONSUMER DURABLES BEARING BRUNT OF TARIFFS

The decline in M&A has weighed on CP dealmaking across the board over the past year. But the third quarter proved particularly difficult on acquisition activity in consumer durables, as tariffs on goods such as washing machines from China started complicating supply chains across this sector much earlier than in other industries. Overall M&A volume has fallen by 60% year over year in consumer durables, while aggregate value failed to top $5 billion for the first time since the start of 2013 after topping $17 billion in the third quarter of 2018. Other sectors with less exposure to the trade war, including restaurants, hotels and leisure, have fared far better by contrast. “This is going to be a longer-term macro event, which will affect operations for a significant period of time,” says Bhatt.
FINANCIAL SPONSORS RETAIN SIGNIFICANT SHARE OF M&A

Private equity (PE), looking to deploy record levels of dry powder, continues to target the wider CP space, deploying a buy-and-build strategy to keep add-ons at greater than 50% of all sponsored M&A yet again. Meanwhile, PE firms picked up at least one-third of all M&A for a seventh straight quarter, and they continue to be willing to cut increasingly larger checks in the process. Median deal values for buyouts in the space have more than doubled through the third quarter to almost $130 million for the year, up from $58 million as recently as 2016, even as PE deal flow continues its multiquarter decline. Last quarter, aggregate value represented a decline of 42% year over year to $38 billion across some 250 completed transactions.
THE VALUE OF RSM’S MIDDLE-MARKET LEADERSHIP

Focusing on the middle market, RSM US provides integrated transaction advisory, tax, assurance and consulting services. Our work with 3,900 consumer products companies gives us a deep understanding of the key trends impacting the industry. In addition, we have performed due diligence on nearly 2,600 deals in the past five years, 500 of which were consumer products transactions. This in-depth knowledge provides our private equity and strategic buyer clients with industry-specific due diligence considerations.

METHODOLOGY

M&A is defined as the substantive transfer of control or ownership. The data in this report tracks only completed control transactions. Announced, rumored or canceled deals are not included. Eligible transaction types include but are not limited to control acquisitions, leveraged buyouts (including asset acquisitions), add-on deals, corporate divestitures and reverse mergers. Volume will lag between quarters and will likely be revised upward once more data is collected, often resulting in more robust figures as the result of an ongoing research process to retroactively track down deals.