In this issue:

Perspectives on The Real Economy 
Consumer products at a glance
M&A deal flow
Private equity deal flow
IPO activity
PERSPECTIVES ON THE REAL ECONOMY

By Joe Brusuelas, RSM Chief Economist

Perspectives on the real economy

The growth path of the U.S. economy late in the business cycle has slowed and the rate of expansion will do well to reach 2 percent on an annual basis even after what is shaping up to be a modest rebound to near 2.5 percent growth in the second quarter. The RSM US Middle Market Business Index rebounded to a cyclical high of 129.8 in the first quarter, a reflection of business optimism related to the possibility of significant corporate tax reform and the Trump administration’s proposed spending plan.

The combination of slowing productivity and demographic headwinds have caused the long-term growth path to ease to 1.5 percent per year, down from 3.3 percent per year growth a decade ago. Despite a fairly bright consumer outlook—our forecast is for household spending to increase at a 3 percent pace this year—there remains the potential for significant retrenchment if policymakers fail to deliver on tax and spending promises.

Mergers and acquisitions

The term structure of interest rates is not yet particularly favorable to mergers and acquisitions (M&A) activity. While we anticipate the Fed will lift rates by a minimum of 50 basis points this year, the combined impact of safe haven moves into dollar-denominated positions and chasing of yield by international investors continues to suppress rates at the long end of the curve. Thus, conditions remain in favor of sellers as opposed to buyers in the market.

OTHER RESOURCES

The Real Economy

A monthly publication to help the middle market anticipate and address the unique issues and challenges facing their businesses and the industries in which they operate. We also release a Global Edition on a semi-annual basis that addresses issues affecting business on a global scale. Read more.

Consumer Products

In a rapidly evolving marketplace, we explore the trends, challenges and ideas directly related to the consumer products industry and offer insights for how to address them and improve business. Read more.

The RSM Middle Market Business Index (MMBI)

The RSM Middle Market Business Index developed in partnership with Moody’s Analytics, is designed to accurately reflect business conditions in the U.S. middle market, while providing a statistically significant measure of the health and outlook for these businesses. Read more.
**Consumer Products**

**B2C AT A GLANCE**

### Consumer sector remains in flux

- Disruptive forces such as e-commerce’s continued inroads into brick-and-mortar stores’ terrain continue to drive considerable change within the consumer products (B2C) sector.
- Businesses with strong brands that can establish a narrative that they are disrupting traditional models and thus are well-placed in the changing sector remain prime targets.
- Across the industry, businesses are looking for more ways to stay competitive in a rising labor market.
- The European labor market still has plenty of slack while the United States may be marked by more optimism, yet important wage growth has yet to truly be realized on both fronts. There is more optimism around wage growth for the United States, however, which could bolster consumer sentiment and prove a boon to the labor force, if not businesses.
- On a global basis, M&A activity actually rose slightly by volume quarter over quarter, although most measures are still significantly down year over year. Worldwide M&A volume in Q1 2017 was down by 40.6 percent relative to Q1 2016, with aggregate value down by nearly 47 percent; in North America, those same figures were 38 percent and 48 percent, respectively; and as for Europe, 42.5 percent and 44 percent.
- Driven in part by shifting demographics and relative real wage growth, consumer tastes remain variable, although in pockets they are decisively shifting toward the experiential.
- Merchants are finding that employing third-party websites such as Amazon to maximize omnichannel strategies on top of enhancing their own direct-to-consumer models can pay off.

---

Source: PitchBook

---

**B2C M&A flow by quarter in North America**

**B2C M&A flow by quarter in Europe**

Source: PitchBook
Significant sub-sector variability

At $14.2 billion, the non-financial consumer services sub-sector saw a greater sum in aggregate deal value than in any other quarter since the start of 2013, excepting Q3 2016. In another atypical shift, the consumer durables sub-sector recorded the second-highest quarterly tally in aggregate value of the past four years, at $10.9 billion. Interestingly, even though valuation-to-EBITDA multiples are quite down to start the year off, the mean and median deal sizes stayed robust, if not toward the higher end of historical tallies. Against a backdrop of declining M&A volume relative to the highs experienced recently, the market still has the potential to be affected by outlier transactions driving overall deal value or contributing to a decline in multiples, or even shifting proportions among sub-sectors.

“We’re starting to see a slight decrease in the quality of companies coming to market,” says Scott Walti, partner with transaction advisory services at RSM US. “The overall number of companies coming to market is down, and I’ve had clients cite the uncertain political environment as a reason for deferring acquisitions.

Deal multiples

<table>
<thead>
<tr>
<th>Year</th>
<th>Debt/EBITDA</th>
<th>Equity/EBITDA</th>
<th>Valuation/EBITDA</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>5.0x</td>
<td>5.1x</td>
<td>5.1x</td>
</tr>
<tr>
<td>2014</td>
<td>4.1x</td>
<td>4.9x</td>
<td>5.1x</td>
</tr>
<tr>
<td>2015</td>
<td>4.2x</td>
<td>4.7x</td>
<td>5.1x</td>
</tr>
<tr>
<td>2016</td>
<td>4.6x</td>
<td>5.1x</td>
<td>7.6x</td>
</tr>
<tr>
<td>2017*</td>
<td>7.6x</td>
<td>5.1x</td>
<td>2.4x</td>
</tr>
</tbody>
</table>

Source: PitchBook. *As of 3/31/17
Is the buyout cycle resetting?

“In the restaurant space, and to a lesser extent retail, one of the issues companies face is declining traffic counts which results in shrinking EBITDA,” says John Nicolopoulos, retail sector lead at RSM US. “What used to be an A- or B+ opportunity is now a C- or D+, and as a result, the multiples are so low that companies aren’t coming out at all or they’re declining the deal.”

This has certainly affected private equity deal flow, yet even more intrinsic factors are likely at play. First, as the consumer industry continues to be transformed by the advent of newer models utilizing advancing technologies more shrewdly, the supply of worthwhile businesses that dwell more firmly within the PE operating purview is a variable in consideration. As can be seen in the steady, quarter-over-quarter decline in top-line PE investment volume since the end of 2015, the supply of quality companies PE buyers are hunting is definitely dwindling, as PE firms haven’t been able to close as many deals. On top of that, even if transaction multiples for overall M&A are down somewhat in Q1 2017, on the whole, valuations remain high.
“Companies that are able to navigate through this environment are able to see an increase in same-store sales,” says David Cho, director with transaction advisory services at RSM US. “They are commanding an even higher premium, in some cases being valued based upon a multiple of revenue rather than historical EBITDA. If you’re able to differentiate as a brand or a concept, and be valued in such a fashion, then strategics and PE sponsors are willing to pay really high multiples.”

As can be seen by the significantly strong median PE buyout size—$74.6 million in Q1 2017, the third-highest tally in PitchBook datasets going back to 2010—PE firms are putting their ample supplies of dry powder to work. By volume, consumer durables and non-durables may still command a plurality of PE investment, yet restaurants still account for a healthy portion.

“We’ve seen much talk about how shifting demographics are affecting the food and beverage space,” says Cristin Singer, food and beverage practice leader at RSM US. “Yet the reality is it’s not all young 20–somethings focused solely on the experiential foods or beverages. By now you have more established, 30–something professionals looking for reliability and convenience.” The upshot of that trend in food and beverage is that it is also reflected in the restaurant space, where new parents are prioritizing healthy and fast-casual dining. Accordingly, continued PE interest in maintaining exposure to such consumer brands and restaurant concepts is likely.
After three elevated years of selling off portfolio companies, PE sponsors were bound to see some reversion to the mean, and with lowering in exit volume across Q4 2016 and Q1 2017, it appears that reversion may be actualizing.

“Some sub-sectors are more exposed to macroeconomic or political issues,” says Walti, “while fund dynamics also come into play. How long have they held the business? Do they need to realize a return, or can they wait?” It is important to note that given the decline in buying on the PE side after recent peaks, the refilling of the pipeline of PE portfolio companies ready to be brought to market may still be underway. Moreover, the appetite of corporate acquirers may also be waning somewhat. PE portfolios don’t often contain the types of relatively cheap, fast-growing, innovative companies that strategic buyers can justify paying high multiples for—some other M&A strategies may not be as effective in the current climate. However, cutting costs always is fashionable: “We’re actually seeing a lot more strategics looking at restaurants than prior because they can maximize the potential of synergies and potentially get some bargains when looking at less productive assets,” says Nicolopoulos.

B2C private equity exits by quarter

2017 off to a slower start

B2C private equity exits by year

B2C private equity exits (count) by sector
Consumer Products

IPO ACTIVITY

U.S. IPOs in the B2C Industry

Median U.S. IPO size ($M)

Outliers spike value

Initial public offerings (IPOs) could make more of a comeback this year in terms of volume should public indices remain favorable, but the recent volatility spikes (or, ironically, complete lack thereof as of late) may spook consumer goods companies more than others, given their exposure to market sentiment and the vagaries of consumers.

“In order to continue to sell products to millennials who would rather spend their money on experiences,” says Carol Lapidus, consumer products practice leader, “you’ve got to get influencers to back your products, which is a focus for many companies.” Beyond the ability to effectively manage social media strategies, there are risks aplenty—particularly in the political arena still—that could dissuade companies from debuting until policies that could have a substantial impact are rendered more concretely.

“Granted, a lot of the administration’s policies haven’t gotten much traction, but, for example, if some of the massive infrastructure projects promised begin to roll out, there will be a massive labor shortage,” says John Nicolopoulos.

U.S. B2C IPO PIPELINE

<table>
<thead>
<tr>
<th>Company name</th>
<th>Sponsor(s)</th>
<th>Sector</th>
<th>Amount ($M)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dole Food Company</td>
<td>N/A</td>
<td>Food Products</td>
<td>$100</td>
</tr>
<tr>
<td>Frontier Airlines</td>
<td>Indigo Partners</td>
<td>Air</td>
<td>$100</td>
</tr>
<tr>
<td>YETI Coolers</td>
<td>Cortec Group, Fifth Street Asset Management</td>
<td>Recreational Goods</td>
<td>$100</td>
</tr>
<tr>
<td>McGraw–Hill Education</td>
<td>Apollo Global Management</td>
<td>Education</td>
<td>$100</td>
</tr>
</tbody>
</table>

Source: PitchBook
PE players retire to the sidelines in Q1

After experiencing a new high in the proportion of overall M&A, PE activity slid to more historically familiar percentages in Q1 2017. As remarked in prior editions of this report series, PE investor rationales can prop up their buying and selling in times when traditional corporate M&A diminishes somewhat. Yet at the same time, the timing inherent in the PE model—especially in a high-priced environment with significant disparity between the multiples certain businesses can command—can lead to anomalous drops before some recovery. The longer-term trend to also notice is the extent to which both PE and M&A activity have slid over the past half year, and to a lesser degree the middle portion of 2016. It has simply been a slow waning of the overall M&A cycle in general as the supply of targets and acquisitive appetite equilibriums adjust within the changing B2C industry—PE players were bound to follow suit at some point.

SELECT B2C Q1 2017 M&A/PE TRANSACTIONS

<table>
<thead>
<tr>
<th>Company name</th>
<th>Buyer</th>
<th>Sector</th>
<th>Amount ($M)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SLV</td>
<td>Ardian Holding</td>
<td>Electronics</td>
<td>€800</td>
</tr>
<tr>
<td>Schustermann &amp; Borenstein</td>
<td>Permira</td>
<td>Internet Retail</td>
<td>€750</td>
</tr>
<tr>
<td>Golden Goose Deluxe Brand</td>
<td>The Carlyle Group</td>
<td>Luxury Goods</td>
<td>€400</td>
</tr>
<tr>
<td>Anova Culinary</td>
<td>Electrolux</td>
<td>Household Appliances</td>
<td>$250</td>
</tr>
<tr>
<td>Arctic Cat</td>
<td>Textron</td>
<td>Automotive</td>
<td>$247</td>
</tr>
</tbody>
</table>

Source: PitchBook
CONTRIBUTORS

Joe Brusuelas
Chief Economist
RSM US LLP
+1 212 372 1506
joe.brusuelas@rsmus.com

Michael Grossman
Partner, Transaction Advisory Services
RSM US LLP
+1 212 372 1570
michael.j.grossman@rsmus.com

Donald A. Lipari
National Practice Leader, Private Equity Sector
RSM US LLP
+1 212 372 1235
don.lipari@rsmus.com

Cristin Singer
Food and Beverage Practice Leader
RSM US LLP
+1 212 372 1184
christin.singer@rsmus.com

Scott Walti
Director, Transaction Advisory Services
RSM US LLP
+1 312 634 5336
scott.walti@rsmus.com

David Cho
Director, Transaction Advisory Services
RSM US LLP
+1 213 330 4834
david.cho@rsmus.com

Carol Lapidus
Consumer Products Practice Leader
RSM US LLP
+1 212 372 1272
carol.lapidus@rsmus.com

John Nicolopoulos
Retail Sector Leader
RSM US LLP
+1 617 241 1299
john.nicolopoulos@rsmus.com

William Spizman
Partner, Transaction Advisory Services
RSM US LLP
+1 312 634 4422
william.spizman@rsmus.com

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 4,000 middle-market consumer products and food and beverage companies gives us a deep understanding of the key trends impacting the industry. In addition, we have performed due diligence on more than 1,850 deals in the past five years, over 300 of which were consumer products and food and beverage transactions. This in-depth knowledge provides our private equity and strategic buyer clients with industry-specific due diligence considerations.

The following list shows a detailed breakdown of the PitchBook industry codes for the B2C industry.

2. CONSUMER PRODUCTS (B2C)

2.1 Apparel and accessories
2.2 Consumer durables
2.3 Consumer nondurables
2.4 Media
2.5 Restaurants, hotels and leisure
2.6 Retail
2.7 Services (non-financial)
2.8 Transportation
2.9 Other consumer products and services