Consumer and Retail M&A in 2017

Off to New Peaks in Uncertain Times

Expect new M&A records driven by global growth, consolidation, and private equity.
Large, strategic transactions lifted consumer and retail M&A activity to another post-recession record in 2016, even as deal pricing retreated from the frothy levels of 2015. We expect deal-making to rise again in 2017, accompanied by a rebound in valuations.

In 2016, consolidation among major players seeking an antidote to sluggish organic growth sparked 58 megadeals valued at more than $1 billion. Consumer goods and food companies led the overall increase in M&A, posting a 46 percent jump. Europe was the most active region, capturing nearly half the total deal value. But valuations cooled, with retail multiples down 21 percent from 2015. Private equity (PE) and other financial buyers kept mostly to the sidelines, struggling to compete with strategic buyers while accumulating large capital reserves.

Based on our research, we foresee more growth in the consumer and retail M&A market this year, driven by acquirers’ strong balance sheets and easy access to capital. We also expect deal multiples to rise on growing global optimism and a strong US dollar. Consolidation remains a key investment theme as economies around the world grind along in low gear. But rising political uncertainty and nationalism require a more cautious and strategic M&A approach.

This report analyzes major trends in consumer and retail M&A during 2016, and presents a multidimensional outlook for 2017. In this context, we offer three specific predictions for the year ahead:

- **Value at the extremes.** Higher-value M&A activity will migrate to the far ends of the innovation-to-efficiency spectrum, lifting both megadeals and smaller buyouts.

- **Increased activity from private equity and other financial buyers.** PE and other financial buyers will move off the sidelines, deploying vast supplies of “dry powder” to acquire consumer or retail companies that offer synergies with their existing portfolio businesses.

- **Growth across markets.** The consumer retail M&A market will grow across geographies, reflecting rising consumer and investor confidence.

Please see the appendix for our research approach to generating the insights here.

2016: Post-Recession Highs, Corrected Valuations, Reduced Retail Multiples

Several trends, largely in line with the predictions of our 2016 outlook report, marked last year’s consumer and retail M&A market.

**Consumer and retail M&A reaches post-recession heights, fueled by megadeals.** As shown in figure 1 on page 2, global M&A deal value among consumer and retail companies crossed the $450 billion mark for the first time since 2008, a 30 percent increase over 2015 (see sidebar: 3G Capital’s Role in Consumer and Retail M&A Growth on page 2). Deal volume climbed 9 percent, the first increase since 2010. It was another big year for megadeals: acquisitions worth more than $1 billion climbed by 12 percent to 58, the highest level since 2008 (see figure 2 on page 3). In line with this overall trend, average deal value in 2016 jumped about 35 percent over 2015 levels, and the 10 largest transactions represented more than 50 percent of total deal value. The priciest deal, AB InBev’s $107 billion acquisition of SABMiller, accounted for nearly a quarter of 2016’s total deal value.
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Sources: Dealogic /one.old//one.old/ /two.old/zero.old/zero.old/zero.old to /one.old/two.old / /three.old/one.old/ /two.old/zero.old/one.old/six.old; A.T. Kearney analysis

Figure 1
2016 was a near-record year with $469 billion in deals

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

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Sources: Dealogic 1/1/2000 to 12/31/2016; A.T. Kearney analysis

3G Capital’s Role in Consumer and Retail M&A Growth

The consumer and retail M&A growth discussed in this report is part of a broader post-recession trend, with annual growth of about 12% since 2010. But a single player—global investment firm 3G Capital—has played an outsized role in the rise.

As a direct acquirer, investor, or divestor, 3G has been behind close to $300 billion in deals since 2010—or almost 15% of all consumer and retail M&A during that period (see figure). Without 3G-backed deals, M&A in the sector would have increased by a more-modest 7% annually since 2010. Subtract 3G from 2016’s total and the increase drops from a torrid 30% to a robust 16%.

Looking ahead, the executives we surveyed were bullish on consumer and retail M&A in 2017, and generally expect deal values to increase. But keep in mind that one “mega-megadeal” worth more than $100 billion (AB Inbev’s acquisition of SAB Miller) closed in 2016, boosting overall deal values and prompting two questions: Will a new 3G-backed mega-megadeal be forthcoming? And can the market keep climbing without a massive 3G deal?

Figure
3G Capital has played a major role in consumer and retail M&A activity over the past five years

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

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Sources: Dealogic 1/1/2000 to 12/31/2016; A.T. Kearney analysis
Europe steals the show. As figure 3 shows, Europe and North America accounted for about 75 percent of total deal value, in line with 2015 figures. But Europe attracted the most capital, with 45 percent of the total, thanks largely to the AB InBev/SAB Miller acquisition. That “mega megadeal” drove total EU-based transaction value up 150 percent to a record $208 billion—9 percent above the previous high set in 2007. Foreign exchange also played a role, as the US dollar’s rise against the euro and pound—especially after the June Brexit vote—made European targets more attractive than US opportunities.

Europe accounted for 44% of the M&A transactions in 2016, its highest total in over a decade
Valuations cool. The consumer and retail M&A market lost some froth in 2016, as deal multiples dropped from 2015’s near-record levels. More specifically, the median deal multiple (EV/EBITDA) fell 14 percent to 12.2, the lowest level since 2012. Multiples declined across all geographies and almost every deal size, for both financial and strategic buyers. However, decreases were far more pronounced in retail, where the median multiple plunged 21 percent to 11.4, outstripping a 2 percent drop to 13.8 for non-retail deals (see figure 4). The broad pullback likely reflects both a natural correction and a retreat from risk, especially in early 2016 when high-yield interest rates spiked. Current multiples are more in line with historical trends, with lower-risk targets fetching higher multiples. Megadeals stand out as the lone exception to the declining-multiples trend. The median multiple for those outsized deals rose to 14.4 from 13.0 in 2015, likely reflecting buyers’ willingness to pay acquisition premiums for large publicly traded companies. Spinoffs and carve-outs climbed as private-equity exits continued—though at a slower pace than 2015 and 2014—while companies strategically divested ancillary assets to focus on core businesses.

Financial buyers on the sidelines. PE and other financial-firm buyers accounted for only about 16 percent of total M&A activity last year, their lowest share since 2005 (see figure 5 on page 5). A combination of factors kept financial players out of the action. Continued low oil prices held back sovereign wealth funds. Rising interest rates early in 2016 drove up the cost of high-yield debt, which PE firms rely on to finance many acquisitions. More generally, financial buyers gave way to strategic acquirers with strong balance sheets and synergy with target companies. Keep in mind, however, that capital is piling up at PE firms as they wait for deal-making conditions to improve. Their “dry powder” climbed to a record $1.5 trillion last year, an immense sum that will make its presence felt before too long.

With these 2016 trends in mind, here’s our big-picture outlook for consumer and retail M&A in 2017.
Our analysis suggests consumer and retail M&A in 2017 will resemble 2016 in some ways, and diverge in others. The primary drivers of M&A—slow growth, consolidation, plentiful capital, and strong balance sheets—remain in place, foreshadowing another increase in deal-making. On the other hand, we foresee a rise in deal values, and a more complex political environment for cross-border M&A.

What Will Stay the Same

**More growth in consumer and retail M&A.** Only 1 percent of the consumer and retail executives we surveyed predicted a decrease in M&A activity this year, while 67 percent anticipated an increase. Some $200 billion in pending transactions announced in 2016 support their outlook. Several megadeals have already been announced in 2017, including the approximately $50 billion Essilor/Luxottica merger. But optimism isn’t the only force propelling M&A. In US retailing, established chains beset by slumping sales, price deflation, and online competition are trying to re-ignite growth by acquiring innovative and specialized businesses. As noted earlier, valuations in this space have corrected, making a range of acquisitions more attractive to potential buyers and contributing to executives’ overall optimism regarding M&A.

**Consolidation remains key.** With no sign of a pickup in organic growth, consolidation will be a primary investment theme in consumer and retail M&A again this year (keeping in mind our cautionary note above). About 25 percent of executives surveyed believed the trend will continue—the highest endorsement rate among all themes presented. Large deals announced so far in 2017, including Essilor/Luxottica and Reckitt Benckiser/Church & Dwight, extend a pattern of consolidation that drove six of the top 10 deals in 2016.
Steady or increasing capital access and balance sheet strength. As noted above, we observe record amounts of dry powder at PE firms and rising cash reserves at strategic buyers, up 15 percent and 7 percent (for S&P 500 companies), respectively. Possible cash repatriation and reduction in corporate tax rates under the Trump administration may push this trend even further.

What Will Change

A potential return to sky-high multiples. Valuations are up significantly in the US, Japan, and most European markets. High multiples in developed countries will open the door for more balanced growth across markets. For example, multiples in China and Latin America dropped in 2016 but economic prospects in those regions have since improved, reflecting strong global optimism. Still, US retail stocks have been down in 2017, amidst ongoing volatility driven by political uncertainty.

While it’s clear that consumer and retail M&A will continue growing in 2017, shifts in market dynamics and political conditions raise new challenges for companies seeking growth through acquisition.

Political uncertainty and rising nationalism require careful M&A strategy. Players in the US and EU markets will walk a fine line between respecting the rise of nationalism and pursuing global deals to reach new markets and customers. For example, new tax policies, revised trade agreements, and border adjustment taxes are likely to favor domestic deals over cross-border combinations. Until these and other relevant policies are finalized, the path forward will be unclear for companies seeking global growth.

Increasing pressure on consumer companies. The early 2017 stock market rally lifted share valuations for consumer companies, creating pressure to justify higher stock prices by increasing profits. This could lead to even higher levels of M&A activity in the consumer sector, particularly in the US, where an expected rise in interest rates may fuel economic optimism while potentially diminishing valuations. However, unsettled geopolitical conditions make predictions difficult.

A.T. Kearney’s Strategic Insights for Consumer and Retail M&A in 2017

While it’s clear that consumer and retail M&A will continue growing in 2017—potentially breaking records set in 2008 on key market metrics—significant shifts in market dynamics and political conditions raise new challenges for companies seeking growth through acquisitions. To help companies navigate these cross-currents we have developed three strategic insights for the year ahead.
Value at the extremes: mega and small M&A deals

We expect higher-value M&A activity on the far ends of the innovation-to-efficiency spectrum, boosting valuations for megadeals and smaller acquisitions.

Large deals driven by consolidation. As earnings growth remains subdued, consolidation will be critical to improving bottom-line results, suggesting more large M&A deals in 2017. As noted earlier, high-profile megadeals expected to close this year—such as Essilor/Luxottica and Walgreens/Rite Aid—reflect the consolidation theme. Consolidation advances two primary strategic objectives for consumer and retail companies. They can expand in premium market tiers by acquiring natural, organic, and “free from” products that command higher prices from consumers willing to pay more for healthier offerings. Acquirers also can reap value by capturing merger synergies through zero-based budgeting and optimization of networks, sourcing, and assortments.

With strong capital on hand, buyers will primarily target thriving companies, in part because there have been several failed large acquisitions in consumer packaged goods. In line with this, we expect less reliance on distressed assets and leverage for growth, an expectation shared by the executives we surveyed (see figure 6).

Small deals focused on new growth horizons and nimble innovators. In-house venture capital funds tend to focus on new growth opportunities, with many deals coming from the food and beverage sector. Among the most active is Unilever Ventures, which targeted Internet and mobile technologies in the 18 deals it has funded over the past five years. Innovative food and beverage companies accounted for four of eight investments since 2012 by Coke Ventures, which acquired stakes in Rani soda drinks, Barbican malt beverage, Suja Juice in California, and Nigeria-based Chi.
We expect this activity to increase in 2017: about 40 percent of the executives we surveyed said they will emphasize M&A deals under $100 million, up seven-fold from 6 percent in 2016. In line with this, we foresee greater reliance on new technologies and customers over organic strategies. This will be especially true for big food players, as they will likely pursue smaller businesses with the healthier, more-convenient products consumers want.

Finally, local “nimble innovators” stand to benefit from rising nationalism. Large acquirers contending with populist economic policies may seek buyout targets that produce locally—especially if government incentives reward domestic M&A. Along with “made here” bona fides, these nimble innovators can provide new aligned-to-trends brands, technologies, and R&D capabilities that acquirers have struggled to build in-house.

**Increased activity from PE and other financial buyers**

We expect financial buyers to come off the sidelines in 2017, as forces that drove their retreat recede and reasons to re-engage increase. A full 92 percent of the PE executives we surveyed expect greater or equal M&A activity in 2017; only 8 percent expect further declines. A key factor in their optimism is the decline of high-yield interest rates from the peak levels of early 2016, which drove up acquisition costs for PE firms. By early March 2017, high-yield rates had dropped to historic lows, while the spread between those rates and treasury bond yields also had narrowed to unprecedented levels.

**We expect high deal values in all geographies, but a greater emphasis on domestic M&A.**

Lower rates will drive down acquisition costs at a time when PE firms are sitting on record levels of capital, a potent mix likely to drive PE activity even as asset prices remain relatively high and global economic uncertainty continues. As an additional incentive, publicly traded PE firms need to boost their underperforming shares, which lagged as the firms made fewer acquisitions.

In consumer and retail deal-making, PE firms will look to develop “platform” companies, create synergies with their existing businesses, and leverage operational skills across their portfolios. That’s because competition from strategic buyers is not likely to diminish—we expect it to increase—and resurgent deal multiples will make it difficult to find attractively priced assets. Thus PE firms can win by playing a game similar to strategic buyers—seeking synergistic acquisitions and relying on operational diligence to identify the right opportunities.

**Growth across markets**

As in 2016, consumer and retail companies need to diversify geographically. Last year, our consumer and retail M&A report showed capital largely moving west to developed countries. This year, while buyers remain optimistic about cross-border trades, political uncertainty in the US and key EU markets complicates global expansion strategies.
Therefore, we expect high deal values in all geographies, but a greater emphasis on domestic M&A. The executives we surveyed overwhelmingly predicted rising consumer and retail M&A in all regions of the world, but just one in five forecasted more cross-border deals (see figure 7). Nevertheless, major consumer and retail companies cited global reach as a key objective in a recent analyst presentation.¹

Of note, while regional brands are giving large national brands a run for their money and even beating them in many categories (including food and personal care), we expect this trend to reverse as younger population segments spur greater homogenization of demand. This will give international brands greater incentive to acquire regional players, and to consider keeping the acquired regional brands as they are.

Against that backdrop, we present our consumer and retail M&A outlooks for all major global regions:

**North America.** Despite the strong US dollar, we expect North America to capture a large share of consumer and retail M&A in 2017. The region accounted for more than 60 percent of pending deal value at 2016’s end. US companies are sitting on record levels of cash, deal momentum is gathering steam, and consumer confidence is rising (and has returned to 2007 levels). Our survey results show that 92 percent of executives expect equal or greater deal activity in North America compared to 2016. Still, we expect domestic deals to dominate North American M&A; in line with this, 54 percent of executives we surveyed foresee decreasing inbound M&A. The strong US dollar will remain a headwind for inbound deals, while the Trump administration’s nationalist economic agenda encourages domestic acquisitions, in support of “made in USA” offerings and capabilities.

**Western Europe.** Our outlook suggests that Europe will maintain a large share of consumer and retail M&A activity overall, partly because developed markets offer “safe havens” for investments in uncertain times. But deal value is likely to drop from 2016’s record level, which was due largely

¹ CAGNY
to the closing of AB InBev’s massive SAB Miller acquisition. Rising US interest rates should keep EU currency exchange rates high, making European targets more desirable and extending the post-Brexit trend that doubled capital movement from North America to the EU last year. In line with this, executives surveyed agreed that Brexit won’t depress consumer and retail M&A in the UK—if anything, UK targets should become even more desirable as the pound declines. But deal values could fall if upcoming EU elections intensify political uncertainty, eroding the bargaining power of European sellers.

**Latin America.** This region shows increasing promise in consumer and retail M&A. Despite an approximately 11 percent year-over-year drop in deal values, Latin America appears to have found its footing. In fact, 96 percent of executives surveyed foresee growing or stable markets—a sharp contrast to 2016, when only 35 percent expected consumer and retail M&A growth there. Even Brazil, wracked by economic turmoil and diminished consumer spending in recent years, is poised for a rebound. Some 77 percent of survey respondents based in Brazil predicted consumer and retail M&A activity will accelerate; a more-stable macroeconomic and political environment, along with declining inflation and interest rates in South America’s largest country, will likely fuel this optimism. Attitudes toward Colombia are also very positive, with 100 percent of executives interviewed expecting stable or increased M&A activity in 2017. In general, with a positive economic outlook and valuations down about 39 percent to a median EV/EBITDA multiple of 10.3 in 2016, Latin America offers potentially attractive geographic diversification opportunities, especially relative to North America. In fact, inbound M&A from North America to Latin America in 2016 was at the lowest level since at least 2005. A strong US dollar and attractive valuations should make this market even more appealing to potential buyers. On a cautionary note, executives worry about unstable politics and interest rates in Latin America.

**Asia.** 2016 brought record consumer and retail M&A activity to Asia, where deal value surged 40 percent to nearly $100 billion. China led the rally with a 52 percent surge powered in part by a 40 percent decline in multiples. We expect another strong year for consumer and retail M&A across Asia, supported by executives’ optimism about this region. China should see more inward investment in 2017, as westbound capital flows reverse somewhat. In March, China’s commerce minister announced formal curbs on outbound investments, which will promote the inward-investment trend. Consumer and retail M&A also appears likely to rise in India, where intense local competition makes organic growth difficult to achieve. Many companies opt for inorganic expansion through deals such as Unilever’s purchase of Indulekha to enter the naturals segment. A run-up in Indian stock markets since state-level election victories by the Narendra Modi government could accelerate M&A as companies scramble to close the gap between their fundamental performance and their rising share valuations.

**Middle East and Africa.** In 2016, the Middle East and Africa saw a 15 percent rise in consumer and retail M&A from 2015 levels. For 2017, these regions have positive outlooks overall, with some qualifications. Three-quarters of executives surveyed expect consumer and retail M&A to increase in these regions. This optimism was reflected recently in Amazon’s $650 million acquisition of Souq.com, an e-commerce marketplace serving the Middle East from Dubai. But the ongoing oil-price slump, along with political uncertainty and unrest, are likely drags on M&A growth.
Looking Forward to 2017, Cautiously

We conclude on a partly cautious note. Global trade is at risk as more companies embrace economic nationalism. A recent study by A.T. Kearney outlined multiple regulatory scenarios companies should prepare for strategically in this context.

In addition, we highlight a universal truth: many M&A deals won’t create value in the long run. Fully half of the executives we surveyed acknowledged that their transactions over the past one to two years created less value than expected.

Yet even in this uncertain environment, we believe buyers with a long-term horizon and healthy risk tolerance will succeed. On the other hand, companies in the middle market—where growth and margins are lower—should become more nimble if they hope to remain independent.

To maximize results, consumer and retail players of all sizes need to plan for changing regulations and other variables, while focusing on synergistic acquisitions and strong execution.

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Appendix: Research Approach

To generate the insights in this article, we analyzed more than 100,000 consumer and retail transactions from 2005 to 2016, spanning the food and beverage, grocery, pharmacy, personal care, and other subsectors. We also surveyed more than 100 C-level executives of private equity firms and consumer and retail companies, seeking their perspective on key trends in consumer and retail sectors and future M&A activity. For purposes of this report, deals are credited to the year in which they closed, not the year they were announced.
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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.

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