

COVID-19:

Impact on Consumer and Retail Sector



North American Consumer and Retail Sector: Situation Overview

COVID-19 has infected more than 11 million people globally. To control the pandemic, countries were forced to impose lockdowns and social distancing measures. Although several countries have re-started economic activities, the crisis has had a significant impact on the world economy. As per IMF estimates, global economy is expected to shrink by 4.9% in 2020.

The impact on the consumer and retail sector is varied across segments due to dynamic consumer behavior. Demand for consumer staples, especially food, beverage, medication, toiletries, and home care products has increased. On the other hand, consumer discretionary spending has declined significantly, as consumers are avoiding spending on furniture, hotels and resorts, fashion, and restaurants.

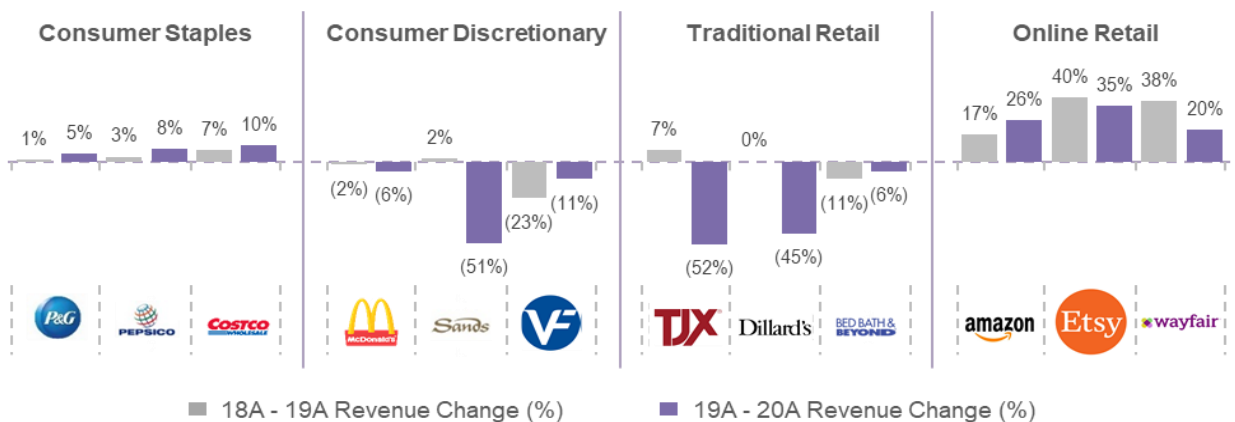
In addition, consumers have shifted from traditional brick-and-mortar retailers to online sellers due to restricted movement during the lockdowns. While this has resulted in growth for online retailers, traditional companies are faced with a survival challenge.

Companies worldwide are brainstorming as to how the post-pandemic world would look like and are redefining their strategies. We believe that the consumer and retail sector will be shaped by the following emerging trends:

- Consumer spending trends witnessed during the lockdown period will continue and may become a norm in many cases, such as the switch to digital shopping, demand for preventive essentials, and cooking at home.
- When the pandemic ends, consumers will experience a new economic reality, such as less dependence on cash, more value-oriented shopping, and stockpiling of several product categories, including essential and hygiene products.
- Significant consolidation of retailers will completely change the competitive landscape, leaving a few well-positioned retailers.

North American Consumer and Retail Industry: Financial Performance

Figure 1: Revenue Trends of Consumer and Retail Sub-sectors



Source: Company Filings

Online retail and consumer staples segments have performed well, driven by the demand for consumer essentials. Consumer discretionary and traditional retail segments have been hit hard. While discretionary companies are experiencing subdued profitability, many traditional retailers are incurring heavy losses

and are on the verge of going bankrupt. It is anticipated that only a few large traditional retailers would be able to survive this changing landscape. Large e-commerce players could also seize this opportunity to increase their market share by acquiring small online retailers.

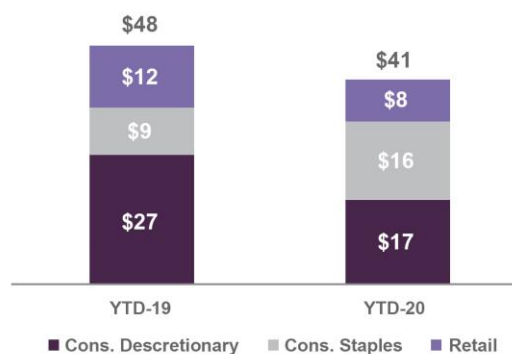
Impact on North American Consumer and Retail M&A Activity

M&A activity in the Americas (North America, Caribbean, and Latin America) has recorded a massive year-to-date decline of 21% to \$41 billion, as of June 18, 2020, and will most likely continue declining during the rest of 2020. The consumer discretionary segment is the most affected, followed by the retail segment (online as well as traditional). Consumer staples is the only segment that has shown an increase among them.

Given the uncertainty and related volatility, buyers are looking for ways to terminate transactions they have already entered into. Furthermore, pending M&A discussions have slowed down to allow for the market / economic situation to become stable.

M&A Deal Volume (YTD)

(Total Deal Value in \$bn)



Source: Refinitiv Deals Intelligence

Below is a list of Selected Announced M&A deals on a year-to-date basis.

Announced Date	Target	Buyers / Investors	Deal value (US\$m)	Target's Industry
06/29/2020	Kim Kardashian West Beauty, Inc.	Coty Inc.	200	Personal Products
06/25/2020	Constellation Brands (Select Brands)	Sazerac Company, Inc.	255	Distillers and Vintners
06/24/2020	GNC Holdings, Inc.	Harbin Pharmaceutical Group	760	Specialty Retailers
06/16/2020	Borden Dairy Company	KKR & Co.; Capitol Peak Partners	340	Packaged Foods and Meats
06/11/2020	Seven Aces Limited	Trive Capital Management	132	Casinos and Gaming
06/10/2020	Grubhub Inc.	Just Eat Takeaway.com	7,300	Online Food Retail
06/1/2020	Vision Healthcare N.V.	Avista Capital; Vision Consumer Health	336	Online / DTC Healthcare Retail
05/11/2020	Coty's Professional & Retail Hair business	KKR & Co. Inc.	2,580	Personal Products
02/18/2020	PersonalizationMall.com, LLC	800-Flowers, Inc.	252	Online Retail
01/28/2020	Delphi Technologies	BorgWarner Inc.	3,300	Auto Parts and Equipment

Source: Company Filings

M&A deal cancellations in the consumer and retail sector have increased substantially on a year-to-date basis.

Many potential transactions have fallen through due to the current market volatility, as sellers and acquirers wait for a stable market.

Below is a list of Selected Cancelled M&A deals on a year-to-date basis.

Cancelled Date	Target	Buyers / Investors	Deal value (US\$m)	Target's Industry
4/24/2020	Eldorado Casino Shreveport JV	Maverick Casinos	230	Casinos and Gaming
4/17/2020	Renaissance Austin Hotel, Inc.	Undisclosed Buyer	101	Hotels, Resorts & Cruise Lines
4/16/2020	Stein Mart, Inc.	Kingswood Capital	45	Apparel Retail
4/10/2020	Vectorply Corporation	Neenah Composites	155	Textiles
3/24/2020	Park Place Motorcars Ltd.	Asbury Automotive Group	1,030	Automotive Retail
2/9/2020	Harry's, Inc.	Edgewell Personal Care	1,370	Personal Products
2/4/2020	AQUAhydrate, Inc.	The Alkaline Water	43	Soft Drinks
1/3/2020	Hudson's Bay Company	The Catalyst Capital	1,500	Department Stores

Source: Company Filings

Limited access to debt financing and equity market volatility are hampering deal execution. However, the lack of financing options is also providing an opportunity for corporates with high cash reserves and private equity firms with ample dry powder. Private equity firms are looking to infuse capital in both take-private opportunities and private investment in public companies. Cash-backed corporates are well-positioned to enter into transformational acquisitions at a distressed valuation, as sellers are likely to accept all cash at a lower valuation.

This trend has been prevalent since March 2020. On March 11, 2020, PepsiCo acquired Rockstar Energy Beverages for ~\$3.9 billion in an all-cash transaction. PepsiCo has a history of making all-cash deals and recently reported \$11.0 billion in cash and cash equivalents in its Q1 20 filings. On May 27, 2020, Axar Capital Management announced the acquisition of the remaining 48% stake in StoneMor Inc. in a going-private transaction. In another private placement transaction, US Foods issued \$500 million in convertible preferred equity to KKR to fund the Smart Foodservice acquisition on April 21, 2020.

Stressed valuations, limited access to financing, and stringent due diligence are some of the key challenges buyers and sellers could face in the current market conditions.

North American Consumer and Retail Industry: Rising Debt and Bankruptcies

The pandemic has wreaked havoc in the retail industry, which is struggling due to significant changes such as the rise of e-retailers and decreasing brick-and-mortar traffic. Many companies are taking multiple measures to improve their financial position and flexibility, while trying to avoid severe consequences such as bankruptcy by suspending quarterly dividends, deferring capital spend, and drawing down credit facilities.

Macy's, the largest department store chain in the US, plans to raise ~\$5.0 billion in debt to survive the current crisis. In April, Nordstrom issued \$600 million in secured debt financing, in addition to drawing down \$800 million on its revolving line of credit.

The pandemic has compelled traditional retailers to close stores due to stalling demand. As a result, many traditional retailers have been forced to file for Chapter 11 bankruptcy protection. In May 2020, five major brick-and-mortar retailers – Tuesday Morning, J. Crew, Neiman Marcus, Stage Stores, and JCPenney – filed for bankruptcy.

Companies selling consumer staples and discretionary products are also raising debt for general corporate purposes and to meet working capital requirements. These companies are more likely to get financial assistance than brick-and-mortar retailers, as they are still attracting enough demand and are less likely to go bankrupt.

North American Consumer and Retail Industry: Outlook

As economies recover from the aftermath of the pandemic, consumer and retail companies need to anticipate new consumer behaviors as well as buying trends.

Also, once this crisis is over, brands, distributors, and retailers should focus on the below-mentioned points to deal with future health emergencies:

- **Optimizing supply chain and manufacturing operations:** Firms should lay out a plan and have additional suppliers in place for all their products to ensure smooth sourcing in the event of a similar situation in the future. Manufacturers should also be prepared to balance diminished capacity (due to employee safety) with increased demand.
- **Optimizing delivery logistics:** Transportation capacity should be flexible enough to accommodate a sudden increase in volume during the crisis.
- **Realigning production with a change in product assortment:** Many FMCG companies have the opportunity to repurpose their production and supply chain to focus on addressing shortages in certain categories, such as preventive essentials, toiletries, and personal protective equipment. Recently, the U.S. FDA announced that it will not take action against manufacturers that have begun the production of hand sanitizers without proper FDA approval. These include many unconventional manufacturers, such as luxury goods maker LVMH, which have modified their production lines to address the shortage of sanitizers.
- **Rethinking e-commerce strategy:** The pandemic is compelling consumers to shift to online retail channels, thus, retailers should re-consider their e-commerce strategies and use this opportunity to reach a broader consumer base.

- **Dynamic pricing:** The surge in demand in many categories could encourage manufacturers to increase their list pricing. Retailers need to monitor supply chain constraints, as well as order backlog. Prices should be derived after considering all these factors. The industry also needs to have some checks and balances in place to measure the maximum pricing threshold and avoid negative customer sentiment.

There is still a significant amount of uncertainty around losses incurred by sectors in the US and Canada due to the pandemic. However, we believe this recession will be short-lived, as the US and Canadian governments are taking proactive action to support their economies. Recovery in the consumer and retail sector, as well as the US and Canadian economies will depend on how fast these countries can emerge from the crisis.



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