M&A and Capital Markets Activity in the North American Consumer and Retail Sector

Corporate and Investment Banking Practice

2021 Update

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Situation Overview

Over the last couple of years, the COVID-19 pandemic has reshaped markets and sectors, especially in terms of consumer behavior. In 2021, the effects of the pandemic became even more evident across the consumer and retail sector in North America. The significant shift in consumer behaviors due to health and safety concerns turned out to be major market drivers. The pandemic also compelled industries, markets, and sectors to adopt and implement technological innovations within a matter of months, which would have taken years, otherwise. The rapid digital acceleration drove companies to change their go-to-market strategies and capabilities to match the changing consumer preferences. Companies are still trying to fine-tune how they segment consumers, prioritize channels, establish product portfolios, position their brands, and deploy service models.

In our previous updates, we had analyzed the North American consumer and retail sector's performance based on various factors, including COVID-19 vaccine deployment, safety restrictions, government stimulus, supply chain constraints, remote working, consumer psychology, and the evolution of new habits. In this update, we have analyzed the sector's performance on an overall basis.

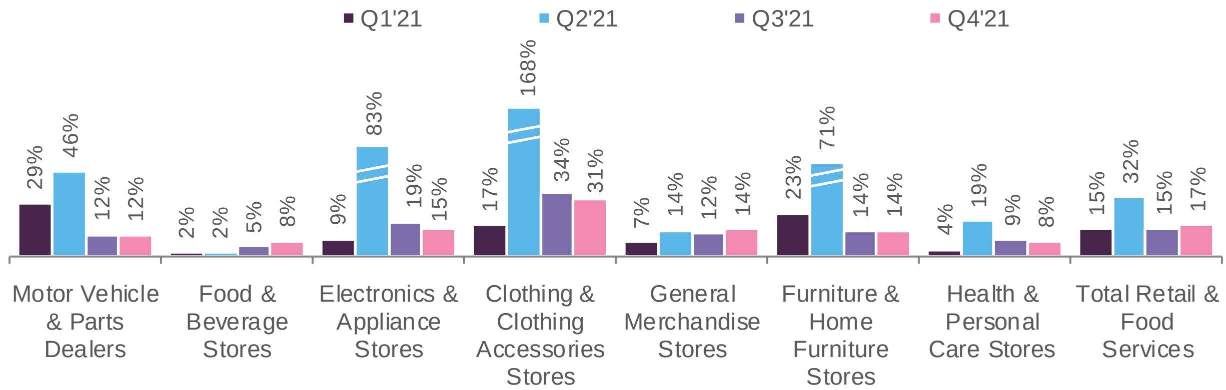
In 2021, the brick-and-mortar retail segment witnessed 21 bankruptcies at a time when internet retailers were garnering bumper earnings. Recovery in the retail segment was uneven, with grocery and Softline players having different market experiences than other players. Overall, retailers were hit harder by COVID-19 than players in other industries; however, they are expecting a faster bounce back.

According to the U.S. Census Bureau's seasonally adjusted data, retail and food services sales grew by 19.4% Y-o-Y to USD 7,402.5 billion in 2021 from USD 6,201.4 billion in 2020. In Q4 2021, U.S. retail sales surged 17.0% to USD 1,904.0 billion, as consumers increased spending despite inflation and COVID-19.

Data suggests that consumers had started their holiday shopping early to avoid any last-minute supply shortage due to the pandemic. However, the heavy spending pattern, particularly on goods rather than services, is intensifying supply chain hiccups and shipping delays, that are pushing up prices. As a result, inflation in the U.S. hit the 7.0% mark, the highest annual rate in almost four decades.

The data represented in Figure 1 shows that U.S. economic activity on a Y-o-Y basis.

Figure 1: U.S. Retail Sales – Y-o-Y Change (in %), Q1 2021 – Q4 2021



Source: U.S. Census Bureau

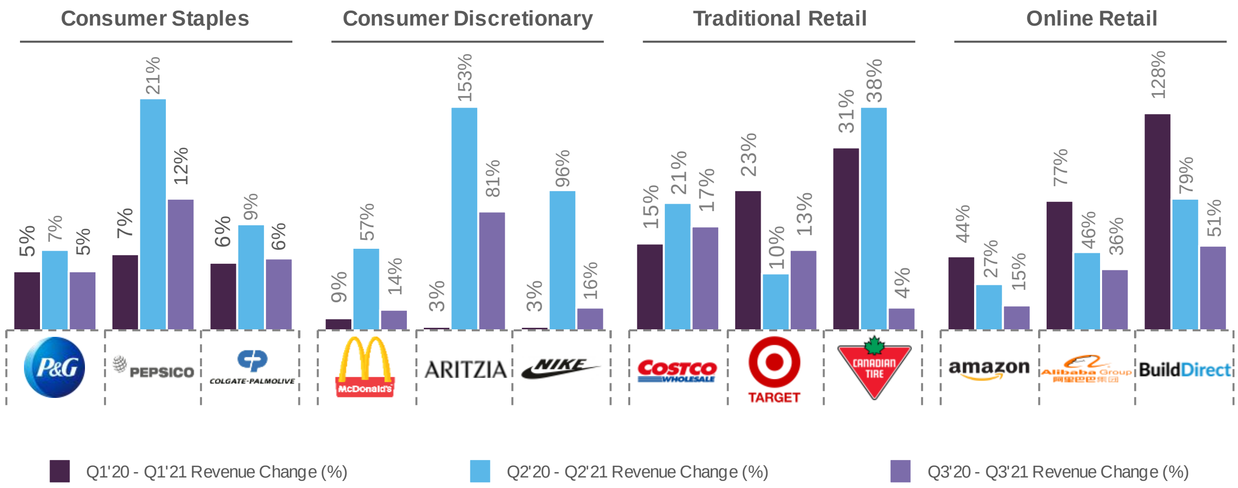
According to a report by the Bureau of Labor Statistics, the unemployment rate in the U.S. declined by 0.3% to 3.9% in December 2021, suggesting a tightening labor market. The number of unemployed people in December 2021 decreased by 483,000 to 6.3 million from November 2021. The employment rate in the consumer and retail sector inched down by 0.01% on an M-o-M basis, primarily due to job losses in clothing, accessories, sporting goods, books, and music stores.

Despite the COVID-19 induced economic uncertainty, U.S. holiday sales grew by 14.1% to USD 886.7 billion from November 1 to December 31. The surge was powered by strong wages, record savings, and soaring e-commerce sales, as reported by the National Retail Federation. Online and other non-store sales also grew by 11.3% to USD 218.9 billion.

Retailers expected shortages and shipping delays during the holiday season and thus encouraged customers to shop earlier. As a result, online sales from Thanksgiving Day through Cyber Monday in the U.S. were down 1.4% Y-o-Y to USD 33.9 billion.

Financial Performance

Figure 2: Revenue Trends – Consumer and Retail Sector



Source: Company Filings

In Q2 2021, retail sales surged by a record 19.6% on a Y-o-Y basis; however, overall retail spending slowed down in the following quarter.

Offline retail sales witnessed strong quarterly results after robust growth in Q2 2021, due to the reopening of physical stores across regions. In Q3 2021, the growth in the online retail segment slowed down by ~3.3%, suggesting moderate growth compared with Q2 2021. The deceleration was expected after witnessing a 30–40% jump in the last four quarters until Q1 2021. In Q3 2021, online penetration dropped to 18.1%, compared with 18.8% during the same time last year, marking the lowest digital penetration since the outbreak of COVID-19 in the U.S.

The consumer discretionary segment registered a strong quarterly result, following a record-breaking second quarter, as consumers exhibited strong optimism driven by higher income. The strong third-quarter results came on the back of significant consumer spending on several categories, including consumer electronics, home improvement, pet supplies, and cosmetics. The consumer staples segment also witnessed continued growth in Q3 2021.

We believe that as the vaccination rate in the U.S. continues to increase and the spread of COVID-19 eases, consumers are likely to continue spending on food services, transportation, and recreation that registered weak performance in 2021.

M&A Activities

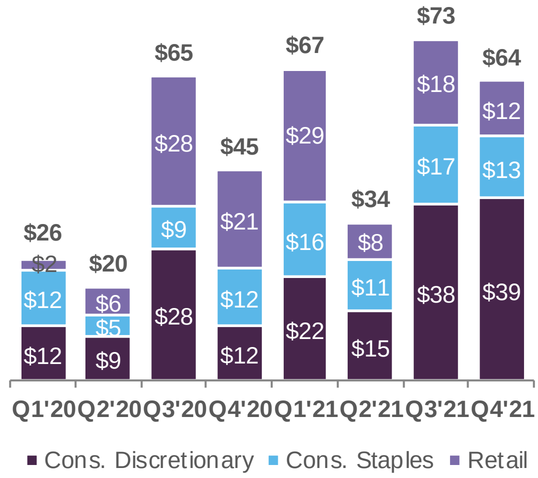
M&A activities in the consumer and retail sector in the Americas (North America, the Caribbean, and Latin America) declined by 12.4% in Q4 2021 to USD 63.8 billion, compared with USD 72.8 billion in Q3 2021. The decline was attributed to a significant dip in M&A activity in the retail and consumer staples segments.

Overall, M&A activities surged a record 52.2% annually in 2021 to USD 236.8 billion, compared with USD 155.6 billion in 2020.

Many companies in the consumer and retail sector were actively looking to increase their footprint in the direct-to-consumer (DTC) and consumer products spaces. We believe these companies are trying to capitalize on the expansion opportunities brought forth over the last two years.

Figure 3: M&A Deal Volume

(Total Deal Value in USD billion)



Source: Refinitiv Deals Intelligence

Furthermore, private equity firms have been showing significant interest in the consumer and retail sector due to the sector's increasingly stable consumer environment, which presents multiple opportunities to invest at attractive valuations.

Retailers are undertaking M&A to explore new growth opportunities. Nordstrom, a luxury department store chain, has announced that it will acquire minority stakes in several brands owned by Asos, an online fashion and cosmetic retailer. Furthermore, Arklyz Group, a sportswear retailer, acquired The Athletes Foot, an athletic-inspired lifestyle and footwear brand.

We believe that the M&A pipeline for private equity firms will remain strong, with continued investments in corporate divestitures and innovative business models. The interest of private equity firms in the sector has risen significantly, with investments directed towards grocery, online, and home improvement retail.

Select M&A Deals in 2021

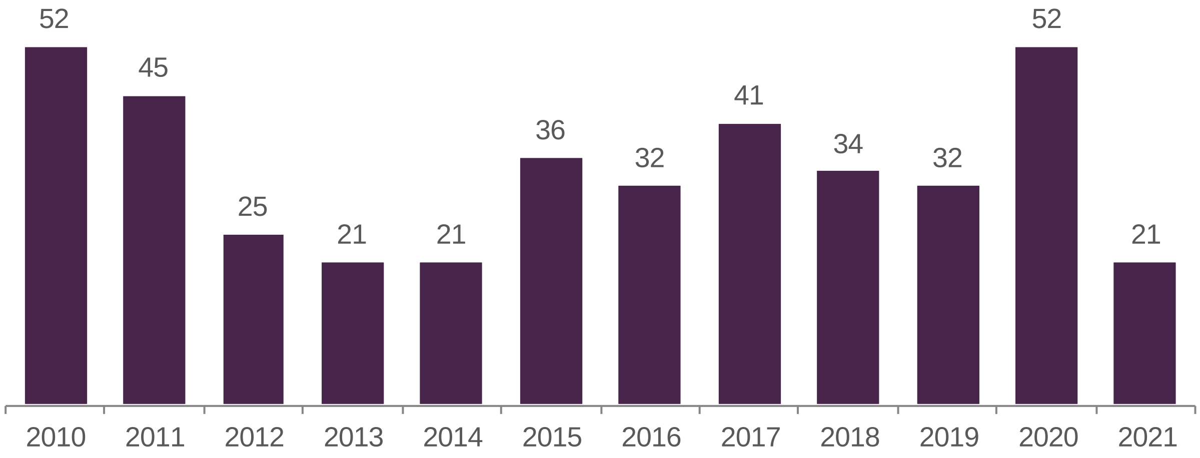
Announced Date	Target	Buyers / Investors	Deal value (USD million)	Target Industry
Dec 14, 2021	Terminix	Rentokil Initial	7,561	Pest Control
Sep 08, 2021	Spectrum Brands' Hardware Business	Assa Abloy	4,300	Home Improvement
Aug 12, 2021	Reebok International	Authentic Brands	2,500	Footwear
Aug 09, 2021	Sanderson Farms	Cargill; Wayne Farms	4,530	Poultry Producer
Aug 03, 2021	PepsiCo's Select Juice Brands	PAI Partners	3,300	Fresh Juices and Beverages
May 26, 2021	Chipita	Mondelez International	2,076	Bakery Products
Apr 30, 2021	The Bountiful Co.- Vitamins Brands	Nestlé Heath Science	5,750	Vitamins and Supplements
Mar 15, 2021	Extended Stay America	Blackstone Group; Starwood Capital	6,008	Hotels, Resorts

Source: Company Filings

Bankruptcies

Bankruptcy filings in the consumer and retail sector came to a halt after a short burst of new filings in late August and the first half of September 2021. As of December 31, 2021, the number of retailers that filed for bankruptcy was lower than half of the number of retailers that filed for bankruptcy in 2020.

Figure 4: Bankruptcies in U.S. Retail Sector (2010–21)



Source: S&P Global Press Releases

Alex and Ani, a jewelry brand, entered into a comprehensive financial and operational restructuring support agreement with its debt holders and equity sponsors in June 2021, citing that it had suffered losses due to adverse macro trends that drove customers away from brick-and-mortar retail. The company has already commenced Chapter 11 proceedings to implement the restructuring process.

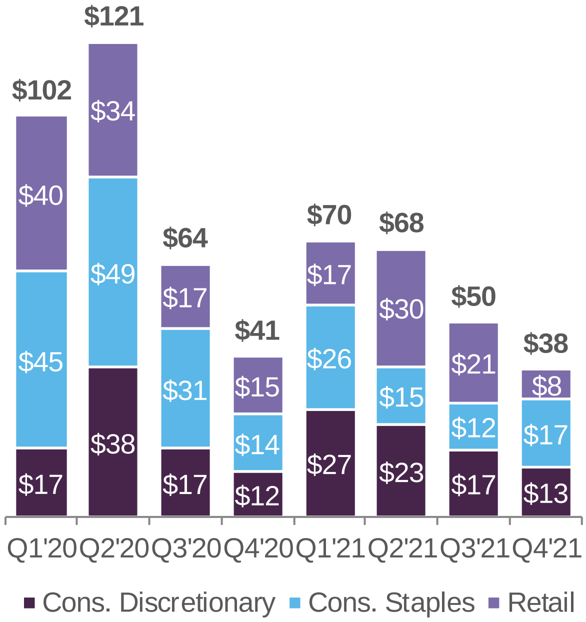
The Collected Group, an apparel and lifestyle retailer, filed for Chapter 11 bankruptcy in April 2021. The company plans to use the bankruptcy process to facilitate store closures and reduce its debt by more than 80%. Going forward, it is expected to completely remove its brick-and-mortar footprint to focus on e-commerce and wholesale.

We believe corporate bankruptcies will pick back up in 2022 after the slowness in 2021, as companies still heavily indebted would be forced to undergo operational and financial restructuring.

Capital Market Activities

Figure 5: DCM Quarterly Deal Volume

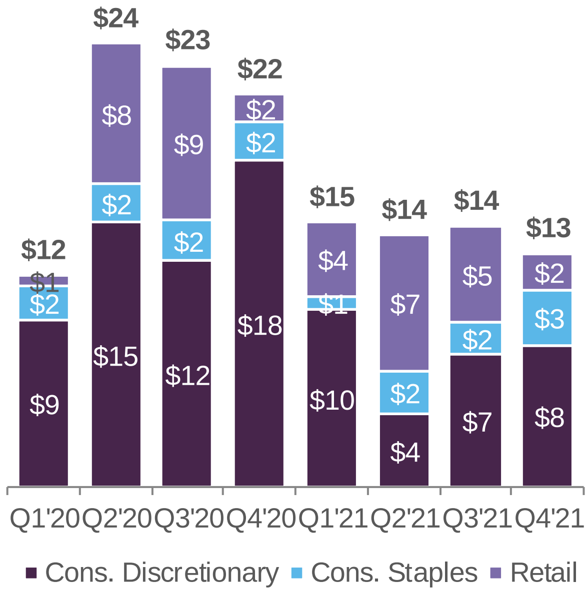
(Total Deal Value in USD billion)



Source: Refinitiv Deals Intelligence

Figure 5: ECM Quarterly Deal Volume

(Total Deal Value in USD billion)



Source: Refinitiv Deals Intelligence

In 2021, debt issuance for M&A and leveraged buyouts (LBOs) continued to grow, suggesting increased activity. Furthermore, dealmakers capitalized on borrower-friendly loans and high-yield bond markets to finance their transactions. The value of debt-raising activities in the Americas, however, declined by 24.1% to USD 37.6 billion in Q4 2021, compared with USD 49.6 billion in Q3 2021.

Private equity firms have largely benefitted from these favorable trends and accessed the market to finance various acquisitions. The Michaels Companies, a leading arts and craft retailer, raised USD 2.2 billion in high-yield bonds as part of its financing arrangements for its USD 5.0 billion take-private deal by Apollo.

The value of equity-raising activities in the Americas decreased by 10.5% in Q4 2021 to USD 12.8 billion, compared with USD 14.3 billion in Q3 2021, primarily due to a significant decrease in equity-raising activities in the retail segment.

Another trend in the market was that many DTC companies and offline retailers started filing for initial public offerings (IPO) in 2021. For instance, Brands, a digital fashion retailer, filed for a USD 110.0 million IPO in September and 1stDibs.com, an online platform that deals in antique furniture, arts, and home décor items, filed for a USD 117.0 million IPO in June 2021. This trend is expected to continue in 2022 as COVID-19 vaccine / booster rollouts continue in North America.

The Road Ahead

The trajectory of the pandemic and vaccine rollouts will undoubtedly define the economic landscape in 2022. Companies will be required to take bold, differentiated actions to stand out from the competition. Retailers will likely explore new revenue models, such as subscriptions or memberships, or form partnerships to create a profitable and digital omnichannel experience. These actions will further allow them to come up with new solutions around third-party logistics, data analytics, and customer acquisition. For example, traditional brick-and-mortar companies could team up with digitally native retailers to gain efficiencies. These partnerships may open cross-channel opportunities and expand customer bases for both parties.

In addition, the current U.S. government's policies on trade, taxes, climate change, and minimum wages will likely prove to be a major catalyst in designing future business strategies and investments. Companies will likely continue to monitor inflation and much-anticipated interest rate hikes to keep a check on operating costs. Equity prices are expected to remain at record highs along with valuations in the M&A market.

Supply chain disruptions are likely to continue to exist and will push companies to invest heavily in developing new contactless technologies for order fulfillment (last-mile delivery, curbside pickup, etc.), warehouse management, and procurement.

We believe the pandemic will continue to reshape consumer behavior and brand strategies; 2022 will certainly be a year of investments and new partnerships, as most brands are expected to reposition their business, marketing, store, and operational strategies to thrive in a post-pandemic world.

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