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M&A and Capital Markets Activity in North American Consumer and Retail Sector: Q1 2022 Update

Corporate and Investment Banking Practice

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Sector Overview

After witnessing record growth and a strong M&A environment in the consumer and retail sector in 2021, a series of macroeconomic headwinds weighed on the sector's growth in Q1 2022.

- Macro headwinds include rising inflation, higher interest rates, supply chain disruptions, and uncertainties triggered by the Russia-Ukraine conflict.

Amid a tight labor market and rising incomes, inflation is increasing the prices of consumer essentials, including gasoline and food, leaving less disposable income for consumers.

- According to the University of Michigan Consumer Sentiment Index, consumer confidence has declined to 59.4 in March 2022 – the lowest since 2011

The US Federal Reserve's aggressive approach to curb the rising inflation has resulted in the highest increase in interest rates in two decades.

- The interest rate hike is part of the Fed's efforts to contain rising household costs; however, it has increased the cost of capital for dealmakers.

Sustainability has become a predominant factor when choosing M&A opportunities.

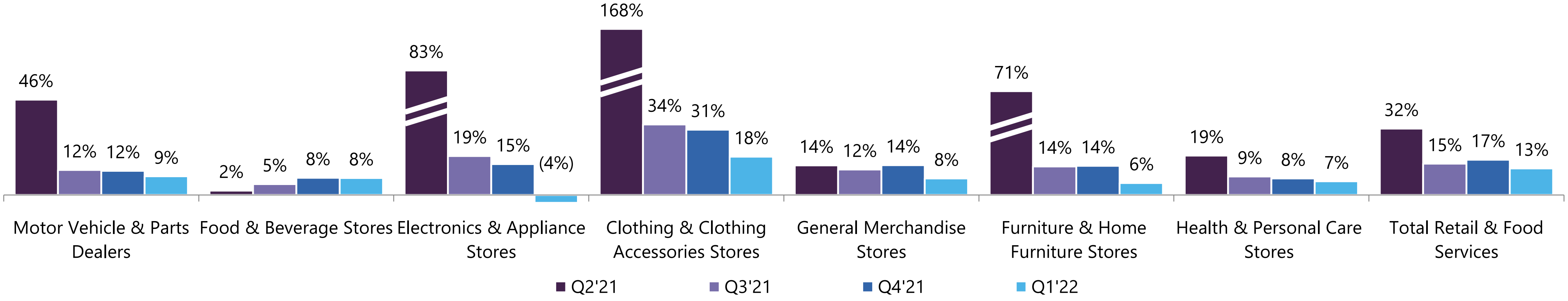
- Large companies are looking to get rid of asset portfolios that do not support their environmental, social and governance (ESG) agenda.

According to a recent report by the Bureau of Labor Statistics, the overall unemployment rate in the US remained at 3.6% in April 2022. So far, this is the lowest rate of unemployment in the US during the pandemic.

- Retail trade added 29,000 jobs in April 2022; the food and beverage and general merchandise categories were the primary contributors to the upside in the sector.

Sector Performance

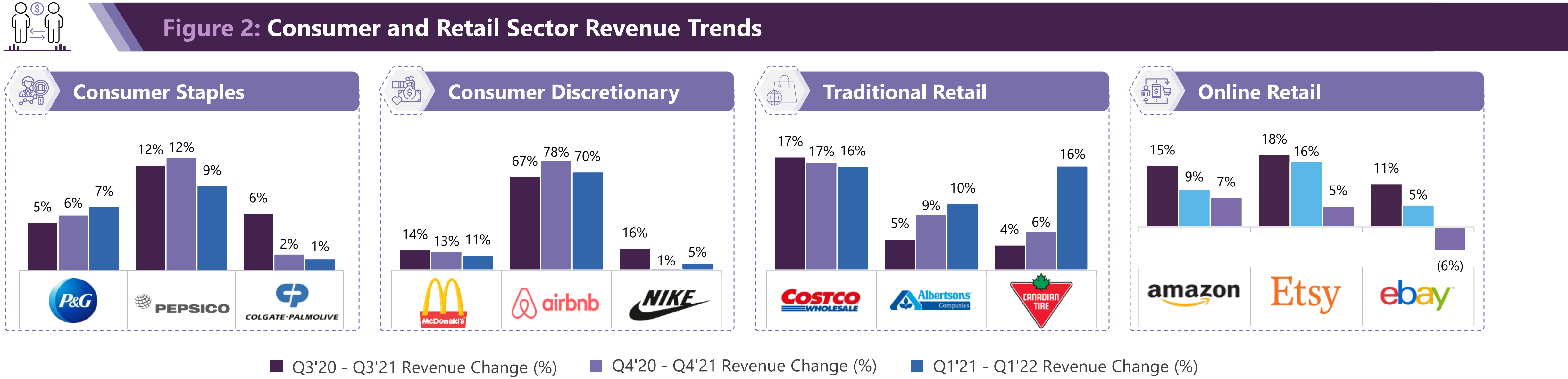
Figure 1: US Retail Sales – Y-o-Y Change (%)



- According to the US Census Bureau's seasonally adjusted data, total retail and food services sales grew marginally by 12.8% Y-o-Y to $1,985.4 billion in Q1 2022, compared with $1,759.9 billion in Q1 2021.
  - All segments across the retail and food service started to feel the heat due to high inflation in Q1 2022, however, the electronics & appliance and clothing & clothing accessories segments were significantly impacted in the last quarter.
- The pandemic-driven e-commerce surge has slowed, as consumers have returned to in-store shopping and service-sector spending.
  - Online store sales fell by 6.4% in March 2022 after falling 3.5% in February 2022, the first back-to-back decline since the last two months of 2020.
  - Amazon posted a decline in online retail sales of 3.0% Y-o-Y to $51.1 billion in Q1 2022, while physical store sales rose 17% to $4.6 billion.
- We believe sales in consumer non-essentials categories will remain under pressure for some more time, until inflation eases.

Source: U.S. Census Bureau

Financial Performance

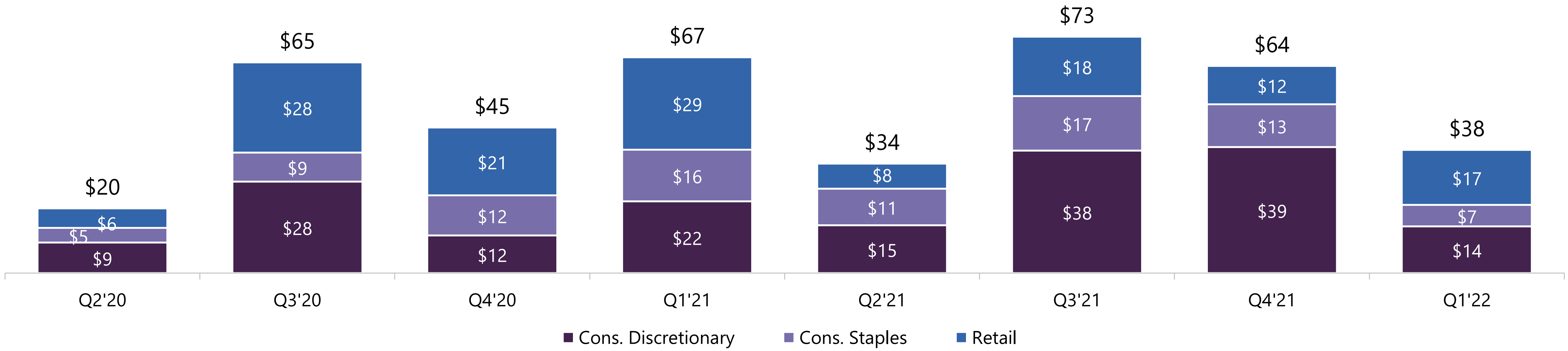


- As illustrated in Figure 2, consumer staples sales started declining in Q1 2022, as consumers had overstocked essential items during the pandemic.
- The consumer discretionary segment has continued showing a positive trend, as consumers started to spend on non-essential items, driven by easing of physical restrictions and lockdowns.
  - However, sales in the consumer discretionary segment faced certain headwinds in the last quarter due to the emergence of new COVID-19 variants, including Omicron, and rising inflation
- The traditional retail space witnessed the highest jump in sales as it witnessed a revenue surge driven by growing foot traffic and the reopening of physical stores.
- The online retail space witnessed a continued decline in Q1 2022 due to a shift in channel preference.

Source: Company Filings

M&A Activity (1/2)

Figure 3: M&A Deal Volume (Total Deal Value in $ billion)



- M&A activity in the consumer and retail sector in the Americas declined by 41% in Q1 2022 to $38 billion, compared with $64 billion in Q4 2021.
  - The downside can be attributed to a drop in M&A activity across the discretionary, staples, and retail segments.
  - M&A performance in the current quarter indicates a stark reversal from recent trends, as the deal volume within the consumer and retail sector nearly matched the pre-pandemic levels.
- In 2022, we expect to see more acquisitions lined up in health and nutrition, direct-to-consumer focused assets, and going-green business categories.
  - Portfolio reshaping, along with new market entrants, and rising investment in healthier options are the driving forces in the US.
  - Acquirers are looking to expand their portfolios to meet changing consumer expectations.

Source: Refinitiv Deals Intelligence

M&A Activity (2/2)

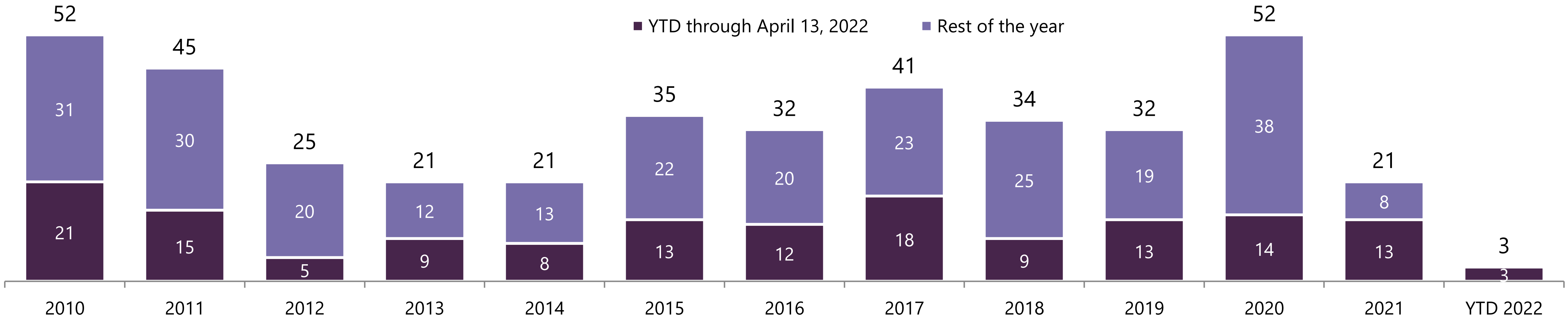
Select M&A Deals in YTD 2022

Announced Date	Target	Buyers / Investors	Deal value ($ million)	Target Industry
May 11, 2022	The Fresh Market	Cencosud SA	1,568	Food Retail
May 09, 2022	Points.com	Plusgrade	375	Internet and Direct Retail
May 05, 2022	PANTHERx Rare	Nautic Partners; General Atlantic; The Vistria Group	1,450	Drug Retail
May 04, 2022	Varroc Lighting Systems	Compagnie Plastic Omnium SE	634	Auto Parts and Equipment
Apr 25, 2022	Grupo Bimbo: Confectionery Business	Mondelez International	1,300	Packaged Foods and Meats
Apr 06, 2022	Main Event Entertainment	Dave & Buster's Entertainment	835	Leisure Facilities
Mar 11, 2022	Dainese Group	The Carlyle Group	691	Equipment and Apparel
Feb 23, 2022	Tenneco	Apollo Global Management	7,100	Auto Parts and Equipment
Feb 22, 2022	Peninsula Pacific Entertainment’s Assets	Churchill Downs	3,335	Casinos and Gaming
Jan 26, 2022	Gavilon Agriculture Investment	Viterra	1,125	Food Distributors
Jan 24, 2022	Accell Group NV	KKR; Teslin Participaties Coöperatief	1,764	Leisure Products

Source: Company News, Press Releases

Bankruptcies

Figure 4: Bankruptcies in US Retail Sector (2010–YTD 2022)

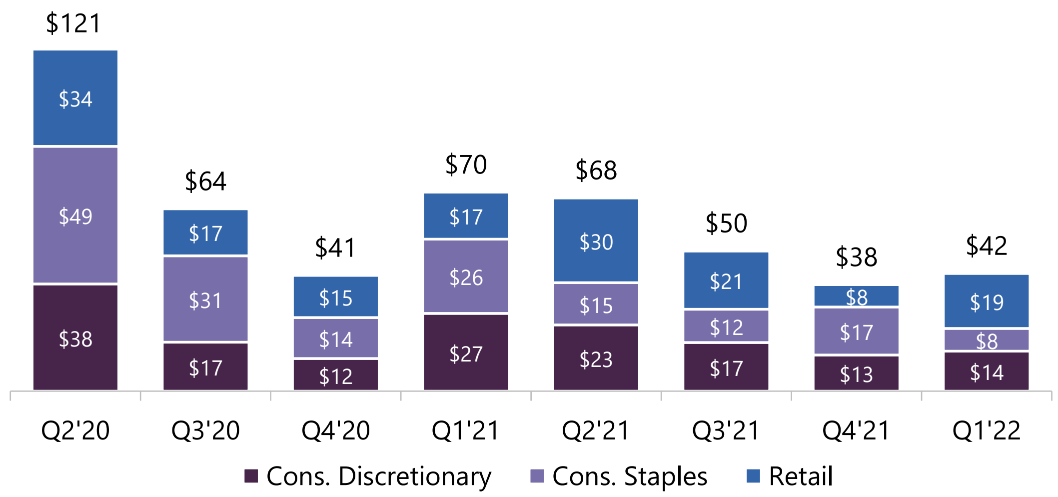


- Only three retailers filed for bankruptcy in the US in Q1 2022 – the lowest number of first-quarter filings in the last 13 years.
  - Both federal stimulus and private credit had kept companies afloat by providing financial flexibility amid the pandemic.
  - On March 25, Top Line Granite Design, a company specializing in quartz, marble, and granite fabrication of kitchen countertops, bathroom vanity, and fireplaces, filed for Chapter 11 bankruptcy.
- There were more store openings than closing announcements, as many struggling retailers had already right-sized their store footprint.
- We expect retail bankruptcy filings to remain low in H1 2022, as long as lenders maintain flexibility and interest rates stay relatively low, even as the Federal Reserve has begun to raise interest rates this year.
- We also believe that retail bankruptcies could increase in H2 2022 after their historic low due to federal stimulus and low interest rates.
  - Many retail companies, however, will seek to renegotiate leases and refinance debt to avoid bankruptcy.

Source: S&P Global Press Releases

Debt and Equity Capital Markets Activities

Figure 5: DCM Quarterly Deal Volume

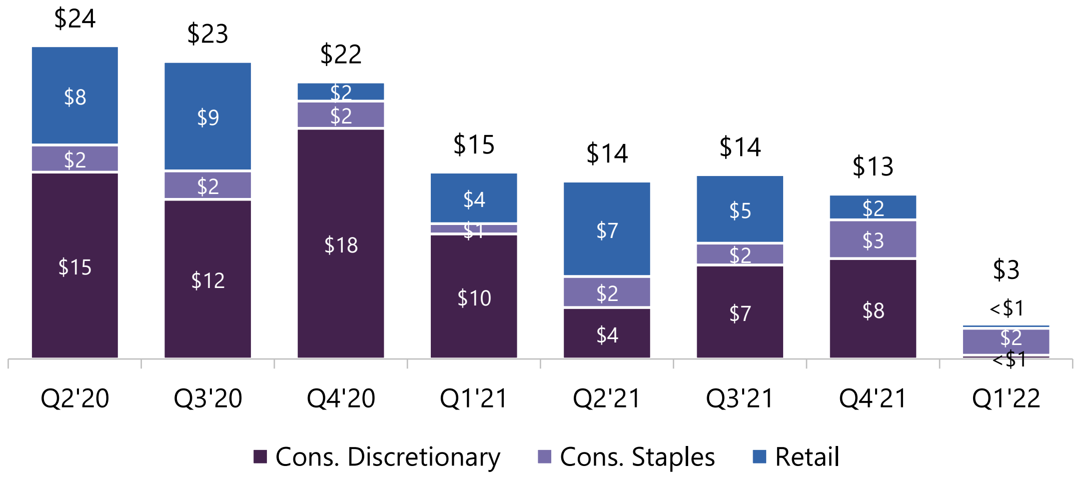


The value of bond-issuance activities in the US consumer and retail sector was $42 billion in Q1 2022, compared with $38 billion in Q4 2021.

- The upside was primarily driven by the retail segment, which grew 148.2%.
- On the other hand, the consumer staples segment witnessed a 52.8% decline in bond issuances.

In January 2022, Fertitta Entertainment, a.k.a. Golden Nugget, a diversified gaming, restaurant, and entertainment company owned by Tillman J. Fertitta, closed a $2.25 billion senior notes offering.

Figure 6: ECM Quarterly Deal Volume



The value of equity-raising activities in the US declined by 79% in Q1 2022 to just $3 billion, compared with $13 billion in Q4 2021.

- ECM activity is positively correlated with M&A activity.
- Rising inflation and higher interest rates almost froze the initial public offering (IPO) market.

In April 2022, Steinway Musical Instruments, a piano maker, filed for an IPO to raise $100.0 million.

- The shares will trade on the NYSE under the ticker STWY.

Source: Refinitiv Deals Intelligence

The Road Ahead

Outlook for 2022

Supply chain crises are likely to become even more intense, as the current lockdowns in China could add to sourcing problems for many businesses.

- Companies are reconsidering their supply chains due to the Russia-Ukraine conflict.
- They are either shifting their supply chains in factories / facilities in countries closer to the US or back-shoring them to local factories where labor cost is very high.

Consumer spending on services will likely increase, as public health returns to normal and consumers are allowed to go out without masks or vaccination in many states.

- We see consumers resuming activities such as dining out, going out for recreation, and traveling, which were halted due to COVID-19.

Despite the current slowness in e-commerce, businesses will keep investing in technologies that help them to improve their omni-channel presence and performance, order fulfillment, online sales, and overall marketing efforts.

We believe the M&A pipeline in the consumer and retail sector is relatively robust.

- Deal activity would pick up pace, once companies have more clarity around the Federal Reserve's interest rates increase program and a better assessment of global trade in a post-war situation.

We expect a further slowdown in consumer demand for the remainder of 2022, due to rising oil prices and the Federal Reserve's efforts to contain record inflation.

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