EVALUESERVE

M&A and Capital Market Activity in Consumer and Retail Sector in North America

Corporate and Investment Banking Practice

Q2 2023 Update

August 10, 2023

Overview

Q2 2023 ended with mixed results for the North American consumer and retail sector. The worries stemming from regional banks were addressed, and headline inflation dipped to 4%. Moreover, the potentially unsettling US debt ceiling concern, looming over the sector throughout Q2 2023, was finally resolved by June's end – just days before the government could have run out of funds. The resolution came just in time, preventing what could have resulted in significant market turbulence.

According to the University of Michigan, consumer sentiment jumped to the highest level in July 2023, after nearly two years (since September 2021), due to the receding inflation and a strong labor market. The preliminary consumer sentiment index skyrocketed by 12.7% to 72.6 in July 2023, from 64.4 in June 2023.

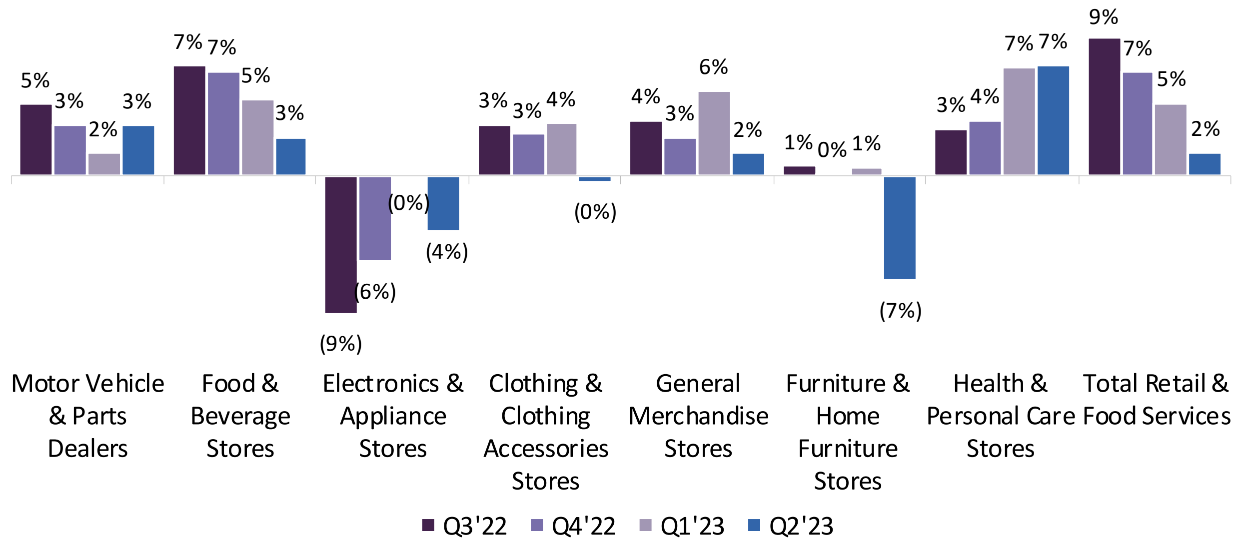
However, sentiment remained subdued for low-income consumers who cut back on discretionary spending due to cost-of-living pressures. Overall, this boost in sentiment further drove confidence in the consumers' purchasing behavior and positively impacted the sector's performance.

Despite challenges, such as high-interest rates, ongoing geopolitical tensions, tightening labor markets, and increasing raw material costs, the sector displayed mixed resilience, showing moderate spending growth and maintaining the positive financial market in Q2 2023.

According to the US Census Bureau's seasonally adjusted data, the retail and food services sales grew by 1.6% Y-o-Y to USD2,062.3 billion in Q2 2023, from USD2,030.2 billion in Q2 2022. The upside was primarily driven by key segments such as healthcare and personal care; motor vehicle and parts dealers; and food and beverages. However, the upside was partially offset by a decrease in the furniture and home furnishing segment and the electronics and appliance store segment.

However, the retail and food services sales performed below expectations in June, up only by 0.2% on an M-o-M basis to USD689.5 billion. Although service stations and building material stores experienced declines, consumers boosted or maintained spending elsewhere, contributing to a stable economic trajectory.

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



Source: U.S. Census Bureau

According to the US Bureau of Labor Statistics, the unemployment rate in the US remained unchanged at 3.5% in July 2023, compared with June 2023. The number of unemployed people declined by 187,000, a modest gain from 185,000 in June 2023, to 5.8 million. However, the retail sector added 8,500 jobs mostly across motor vehicle and parts dealers; food and beverage retailers; and building material stores. As the labor market remains tight, we believe wages will continue to increase, albeit at a moderate pace. The purchasing power of consumers would also gradually increase as inflation subsides.

M&A Activity

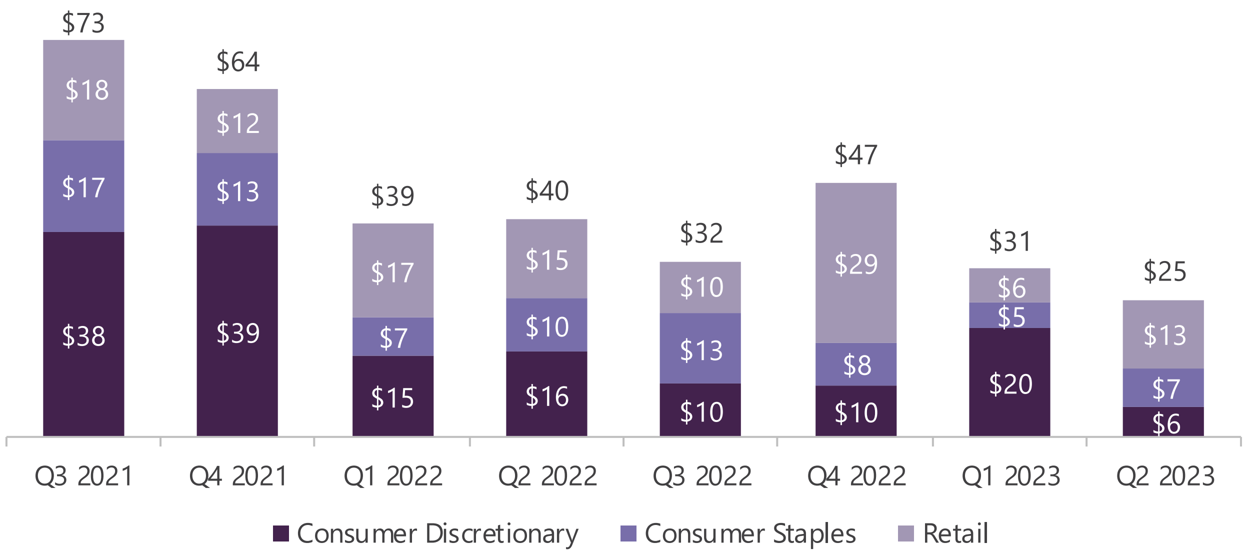
M&A activities in the consumer and retail sector in the Americas (North America, the Caribbean, and Latin America) encountered a persistently weak trend and declined by 17.9% to USD25.3 billion in Q2 2023, from USD30.8 billion in Q1 2023. The downside was due to a substantial drop in M&A activities in the consumer discretionary segment.

Global uncertainty, a stand-off over the US debt ceiling, high-interest rates, and the possibility of a US recession were among the major factors that kept the dealmakers on the edge in Q2 2023. The adverse environment has also made leveraged buyouts difficult for private equity firms, further contributing to the slump in the activity.

We anticipate that M&A activities will likely remain subdued in the consumer and retail sector until the end of 2023, primarily due to a struggling global economy.

Figure 2: M&A Deal Value

(USD billion)



Source: Refinitiv Deals Intelligence

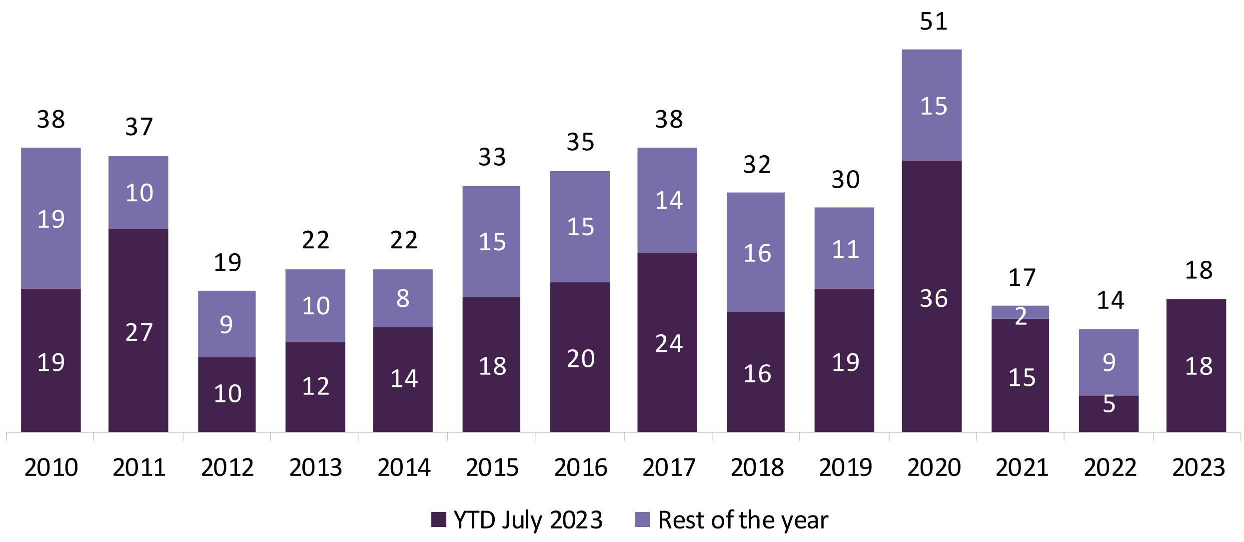
Bankruptcies

Until July 18, 2023, 18 retailers declared bankruptcy in the US. This number is nearly on par with the combined total of bankruptcies filed during the same period in 2021 and 2022.

iiRcade (a home arcade machine seller), iMedia Brands (a media company), and Golden Developing Solutions (a health and wellness retailer) filed for bankruptcy during June 18, 2023–July 18, 2023. What is worth noting is that all three of these businesses were operating in the online marketplace.

With rising debt loads due to high-interest rates, inflation, and soaring borrowing costs, we believe more retailers will likely file for bankruptcy protection in the coming months.

Figure 3: Number of Bankruptcies in US Retail Sector (2010 – YTD 2023)



*Source: S&P Global Press Releases**

**Due to a change in the Global Industry Classification Standard in March 2023, as well as a methodology change to exclude distributors, results starting with the April 2023 publication will not match prior publications.*

Capital Market Activity

Capital-raising activities continued to show resilience in the Americas even during the largest interest-rate rise campaign since the 1970s and 1980s. Although credit conditions and lending standards were tightened further, borrowing activity was largely confined to refinancing near-term maturities. Despite inflation, high-interest rates, and geopolitical uncertainties, issuers were able to extend near-term maturities this year.

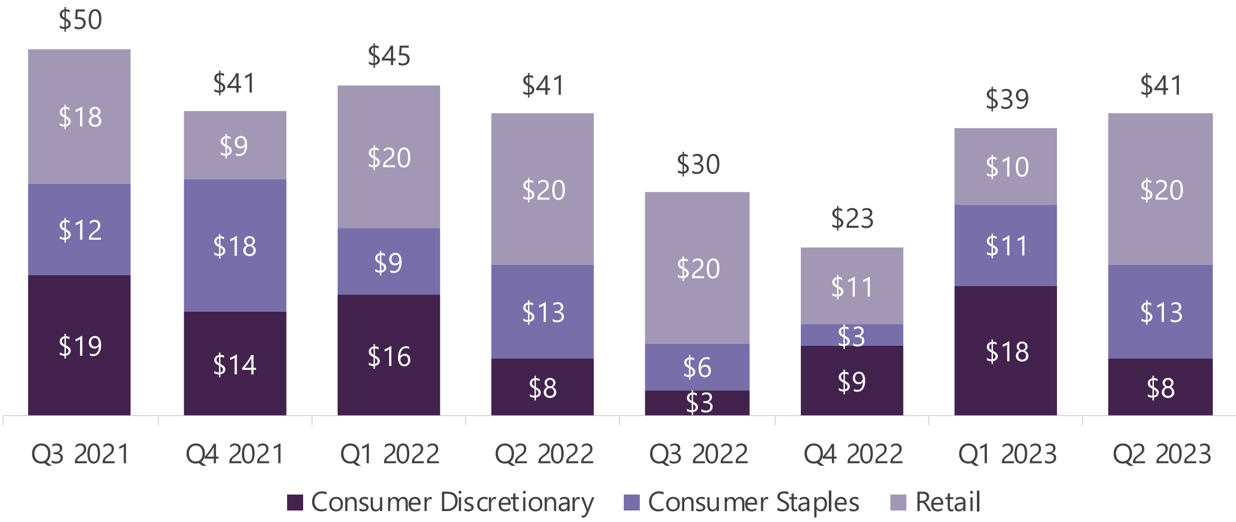
The value of debt-raising activities increased by 4.8% to USD40.8 billion in the Americas in Q2 2023, from USD 38.9 billion in Q1 2023. This growth was mainly fueled by debt-raising and refinancing efforts within the retail and consumer staples segments.

A dynamic interplay was observed between broadly syndicated and private credit players. Although private credit remained supportive, the broadly syndicated markets have started fighting back, even reclaiming certain deals from private credit players. This tug-of-war shapes the evolving lending landscape.

Despite positive signals that brightened the outlook for H2 2023, the prevalent challenges of a high-interest environment and economic uncertainty persisted. These factors continue to define the path forward, underscoring the intricacies that market participants need to navigate.

Figure 4: DCM Quarterly Deal Volume

(USD billion)



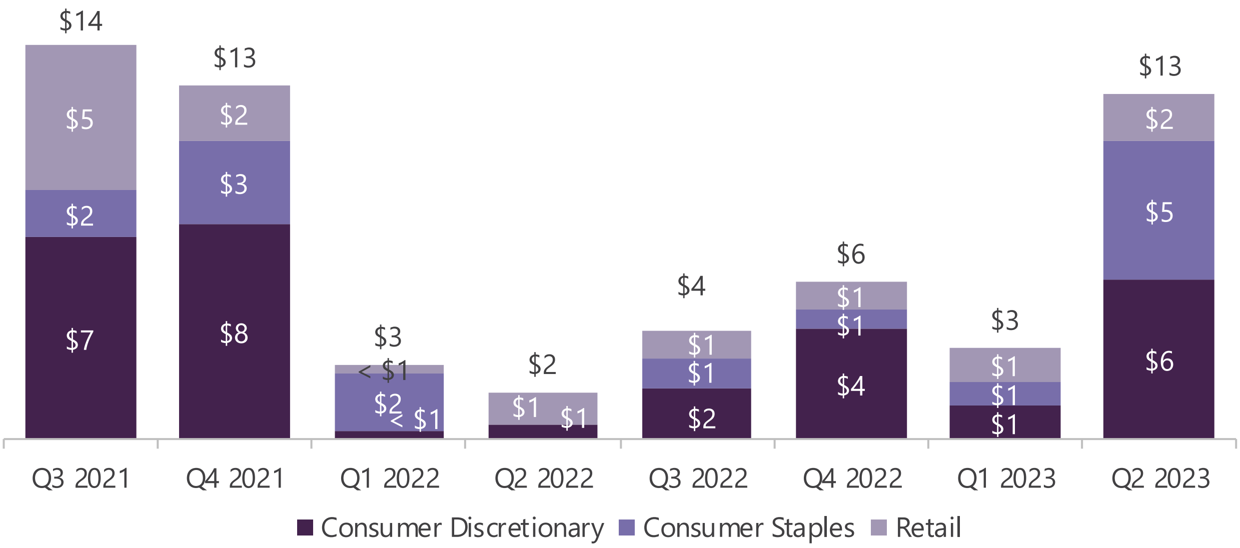
Source: Refinitiv Deals Intelligence

The value of equity-raising activities surged by a whopping 278.8% to USD12.5 billion in the Americas in Q2 2023, from USD3.3 billion in Q1 2023. This notable increase was primarily driven by a robust equity-raising performance in the consumer staples and consumer discretionary segments.

Despite a robust quarter marked by strong equity-raising endeavors, we believe that the recovery of IPO markets will likely unfold gradually. While companies armed with compelling equity narratives and reasonable valuation expectations are poised to access the market, sentiment in the investment community suggests that deal activity will only start picking up in 2024.

Figure 5: ECM Quarterly Deal Value

(USD billion)



Source: Refinitiv Deals Intelligence

The Road Ahead

Despite stringent monetary policies, which were aimed at curbing inflation, the consumer and retail sector witnessed strong performance. Although consumer spending maintained its steady trajectory, we anticipate a softer and potentially uneven pace for consumer spending in H2 2023.

As per the National Retail Federation, the outlook for retail sales growth is between 4% and 6%, reaching between $5.1 trillion and $5.2 trillion in 2023. While online shopping continues to shape consumer behavior, a significant portion of this surge is propelled by multichannel sales, underscoring the pivotal role that physical stores play in the fulfillment process. Notably, brick-and-mortar establishments are set to retain their status as the primary point of purchase, accounting for ~70% of total retail sales.

Amid resilient labor market conditions, job growth is expected to decelerate in the upcoming months due to sluggish economic activity and the prospect of tighter credit conditions. This trajectory could take the unemployment rate to surpass the 4% mark before the next calendar year.

As economic conditions gradually brighten and market sentiment improves, an impending resurgence in IPO activity is on the horizon and is expected to be visible by the end of 2023. Large-scale corporate spin-offs and carve-out listings, which were dormant for some time, are also poised to reemerge. Established companies are exhibiting enduring resilience, while growth narratives grounded in realistic and acceptable valuations are steadily gaining traction. In this evolving landscape, businesses aspiring to go public should be primed to seize the opportunity during any forthcoming window.

M&A and leveraged buyout (LBO) activities are more likely to thrive within resilient subsectors such as consumer health, beauty, pet retail, and pet services. Specific scenarios driven by refinancing needs or transformation agendas may also drive these markets.

Looking ahead, 2024 will likely bring about a return to normal interest rates. With a clearer understanding of global geopolitics and economic prospects, the market is expected to gain more clarity. This anticipated shift sets the stage for increased issuance in various areas, particularly in M&A and LBO offering domains, driving a comprehensive escalation in overall market activities.

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