Oaklins

CONSUMER & RETAIL

Adapt and evolve in times of crisis

The fashion industry: reinvention required
Federico Giammarusto, Partner, Milan

Beauty care: a rebound in sight
Steven Davis, Managing Director, Los Angeles

Norwegian retail: a reshuffling of the cards
Bjørn Campbell Pedersen, Principal, Oslo

Digital transactions: the new norm
Lutz Becker, Managing Partner, Hamburg

The retail trade: omnichannel presence required
Chris Tait, Managing Director, Melbourne

SHOPPING WILL NEVER BE THE SAME AGAIN

THE COVID CRISIS AND THE RETAIL SECTOR

Worldwide, no sector has been more profoundly affected by the COVID-19 contagion than the consumer and retail industries.

Already under pressure prior to the outbreak from lower margins, the stampede towards online shopping and a growing posse of competitors, the pandemic has thrown many of these trends into hyperdrive. With entire countries slipping in and out of quarantine and consumers shunning human contact, retailers are scrambling to adapt. The further elevation of e-commerce, a growing preference for contactless payments and a new role for brick and mortar stores as delivery destinations are just some of the changes that are likely to outlive the current health crisis.

Needless to say, all of this has had a profound impact on the sector's M&A activity. The following five articles provide snapshots of how this activity has ebbed and flowed during the lockdown and review the key developments that will shape dealmaking going forward.

THE FASHION INDUSTRY: REINVENTION REQUIRED

FEDERICO GIAMMARUSTO, PARTNER, MILAN

Hard hit by the pandemic, the fashion industry has been swamped by this unexpected sea of change. Faced with a dramatic sales plunge, the big global players have been forced to take some extraordinary steps to bail out their businesses. Considering what lies ahead, these may be just the tip of the iceberg.

The impact of e-commerce

Lockdown measures to contain the contagion have brought a new cohort of customers online, including many who had never previously considered e-shopping.

During the pandemic's early days, most of these e-commerce neophytes were focused on buying groceries and other necessities. But as the need for social distancing stretched from days to months, the new way of shopping spread from category to category. That fashion purchases will get caught up in this surge appears inevitable.

The role of geographical exposure

How quickly different fashion brands will recover their sales may depend on their geographical exposure. Those with a greater presence in Asia might benefit from a quicker rebound in consumer confidence. European store openings in May yielded more promising results than expected. In North America, the industry's recovery may take more time, given the coronavirus' outsized impact on the US economy, the upcoming presidential elections and the accompanying rise in social tensions.

A chaotic fashion calendar

Not all of the industry's woes can be laid at the pandemic's doorstep. Some are self-inflicted. Shortly before the contagion took hold, the industry's latest collections hit the stores' shelves, inundating consumers with too many options. Uncertain as to which styles would be in vogue, would-be buyers got anxious and avoided buying anything at all.

A new fashion season calendar — adopted by Michael Kors, Chloé, and Saint Laurent — may help consumers to cope with this overwhelm. For Michael Kors, which initially announced the new calendar, the revised schedule would reduce its number of collections to two per year, putting its spring-summer 2021 collection on the runway in late October or early November rather than during New York Fashion Week in early September. In a similar vein, Saint Laurent and Chloé announced they were moving away from Paris Fashion Week in late September.

New investment KPIs

With the whole industry upended by the lockdown, such traditional key performance indicators as revenue and EBITDA have become less useful as a basis of comparison. Instead, there are some other leading indicators for investors to consider:

- The company's e-commerce dynamic. Fashion houses that managed to ramp up their e-commerce sales and build up their omnichannel capacities in the wake of the pandemic have been able to create more value, compared with those whose e-commerce initiatives have stalled.

- The company's resilience and flexibility. An executive team's ability to act quickly and get the best out of any given circumstances has always been a great asset for any fashion player.

- The company's strategic communications. The first half of 2020 presented many opportunities for companies to express their social and environmental stances, how they were caring for their employees, and their concern for their customers and business partners. Those that did so effectively were able to strengthen their customers' brand loyalty.

The M&A outlook

Given the impact of the lockdown and how the whole industry has suffered, we expect strategic acquisitions to be suspended for some time.

Further clouding the outlook are the challenges facing the private equity funds that traditionally invest in the industry. Those funds that managed to complete their fundraising before the end of February and the widespread onset of the coronavirus have a stronger hand to play. Those that have yet to divest their portfolio companies and distribute the proceeds may need to postpone their exit to avoid a fire sale. And since the raising of new funds is inevitably tied to the distribution of the proceeds from the old ones, these investors may find it difficult to raise new money going forward.

As a result of the above, we also expect some changes in demands for capital and how deals are structured – including a shift towards convertible bonds.

FEDERICO GIAMMARUSTO

BEAUTY CARE: A REBOUND IN SIGHT

STEVEN DAVIS, MANAGING DIRECTOR, LOS ANGELES


STEVEN DAVIS

Year-over-year M&A activity in the beauty care industry dropped a precipitous 39% during the second quarter, but given the global pandemic, this was hardly a surprise. And there was some good news tucked away within the bad. While M&A volume for Q2 2020 fell 23% compared with the previous quarter, 20 transactions closed – only six fewer than in Q1.

In light of all the business closures, the inability of buyers and sellers to meet in person and the general economic uncertainty, these transactions stood out as a sign of the industry's resiliency. Helping to further disperse the gloom, a number of these deals involved high profile companies – such as acquisitions by L'Oréal, Puig, Amorepacific and Coty, as well as private equity investments by KKR, L Catterton, and Main Post Partners. Even more encouraging, three of the transactions each exceeded a total value of US$1 billion.

The 20 deals that were announced certainly benefited from negotiations and momentum that began during Q1, prior to the first wave of stay-at-home orders in mid-March. That tail wind is now spent, and driven by all the pandemic-related disruption and logistical challenges, along with continued market uncertainty overall, we expect dealmaking in the second quarter to dip further during Q3.

At the same time, deal inquiries and exploratory M&A activity by strategic and private equity acquirors are increasing – a sure sign of a rebound. This is particularly true for brands that have either not been strongly impacted by or have benefited from social distancing and stay-at-home orders. Given the timeline of a typical deal, this early-stage activity will likely give rise to a new spate of beauty care M&A announcements during the fourth quarter and early 2021.

Second quarter highlights for beauty care M&A activity include:

- A 39% drop in deal volume from Q2 19. This was down 23% from a strong Q1 20.
- Strategic acquisitions by L'Oréal, Puig, Coty and Amorepacific.
- Continued private equity investment with deals announced by L Catterton Asia, KKR, and Main Post Partners.
- An upswing in M&A activity in the fast-growing beauty ingestibles category, including investments in Vital Proteins, Lashilé Beauty and Sundaily.

NORWEGIAN RETAIL: A RESHUFFLING OF THE CARDS

BJØRN CAMPBELL PEDERSEN, PRINCIPAL, OSLO

Like most countries, Norway experienced a brutal decline in retail consumption from mid-March to mid-May due to the COVID-19 lockdown preventing shoppers from visiting stores. But this coincided with a surge in demand for home improvement products, "hygge" (comfort) products and food to prepare at home.

By mid-May though, confidence in the economy was returning, helped along by governmental support packages. With society slowly reopening, retail consumption began picking up, accelerating even more in June. By the beginning of July, we observed a surprising number of retailers with profits that exceeded their pre-COVID forecasts, especially among the larger retail chains.

For quite some time, the local retail industry has been hammered by the rush to online shopping and the entry of global giants such as Amazon into the Norwegian market. During the second quarter, those retailers who had embraced this change and were ahead of the curve in offering a modern online shopping experience were able to gain market share, as were those who were able to quickly adapt their strategy to new consumer behavior. During the lockdown, for example, Norwegian retailer Match Fashion was forced to close all its stores, which accounted for over 90% of its revenue. But by partnering with the digital marketing firm Precis Digital, the fashion brand was able to rapidly pivot towards online sales.

As the pandemic has proceeded, a record number of customers have switched loyalties, abandoning their previous go-to brands in favor of those with more competitive pricing, an easier shopping experience and the ability to keep the items that they want in stock.

But consumers have also favored those brands that addressed their larger social concerns, especially by supporting their employees during this time of crisis.

These shifts in consumer behavior are reshuffling the cards and creating new opportunities. From an M&A perspective, the time is now for retailers to reshape their portfolios to meet the needs of their future customers. A well-considered transaction can help a business dispose of brands that no longer fit its purpose and bring in product lines that strengthen its appeal.

In one such deal, we recently advised Byggmakker Handel AS on its acquisition of Carlsen Fritzøe Handel AS to strengthen its position in the Norwegian building and home improvement market. This was the latest in a series of strategic moves by Byggmakker and its third acquisition in which we served as the advisor. The company is a good example of how retailers with a dynamic and customer-centered approach to their operations will continue to survive and thrive – even in these challenging times.


BJØRN CAMPBELL PEDERSEN

DIGITAL TRANSACTIONS: THE NEW NORM

LUTZ BECKER, MANAGING PARTNER, HAMBURG

Remember how it used to be? During the good old days, businesses and consumers alike did their shopping and consummated their deals face-to-face with a salesperson – whom they met at either a store, a trade fair or at the customer's location.

But that was then, and this is now. The commercial world has taken a dramatic digital turn and there's no stuffing this genie back in the bottle. Indeed, the pandemic has shattered the bottle, and it is now a given that most transactions will be initiated and closed online.

E-commerce took flight around 25 years ago, but with the onset of the coronavirus it has finally obtained escape velocity. Since it appears extremely likely that all the COVID-related health and safety restrictions will remain in place for at least the next few months – if not years – for the foreseeable future, social distancing will continue to push commerce in a digital direction. This has major implications for the M&A market.

Businesses that were heavily dependent on face-to-face interactions urgently need to find ways of staying close to their customers without physical proximity. In recent years, the shift from brick and mortar to e-tailing and online trading platforms has led to a sharp rise in demand for online companies. While valuation multiples for in-store retailers stagnated and have fallen further during the current crisis, multiples for e-tailers and trading platforms surged and are now surpassing their pre-crisis levels.


LUTZ BECKER

Both of these developments will contribute to an increasing number of deals in the retail, wholesale and trading sector. On one hand, we expect greater consolidation and more rescue transactions among retail chains. On the other, the increasing demand and soaring valuations for digital trading companies will lead to more M&A activity as well.

This is definitely a very dynamic time for the industry! Consumers are changing what they buy, how they shop and where they make their purchases. Retailers need to respond by finding new ways to connect with shoppers both in-store and online.

All this requires careful long-term planning. Business owners and managers in the trading sector need to consider their strategic positioning and unique selling proposition, making continuous adjustments for what has become a highly fluid market environment. Such adjustments can be facilitated by the opportune takeover of an interesting company, a merger or the sale of a business.

THE RETAIL TRADE: OMNICHANNEL PRESENCE REQUIRED

CHRIS TAIT, MANAGING DIRECTOR, MELBOURNE

The death of brick and mortar stores has long been heralded. In this post-COVID era, will their death knell finally ring?

Given the shifts in consumer behavior, retailers limited to in-store networks are struggling with stunning sales losses and high fixed-costs. Yet those with a strong omnichannel or digital-only presence are growing rapidly – as are their valuations. Three examples are Australia's MyDeal, Kogan and Temple & Webster. Their ability to attract new capital for continued investment will give them an imposing strategic advantage in the years ahead.

Businesses still dependent on actual stores need to redefine the purpose of those outlets and rapidly shed their more onerous assets, such as non-core stores and extensive inventory holdings. This will create a fire sale environment, but does not signal the end of in-store shopping. Even Amazon, the world's largest online retailer, is investing in storefronts through Amazon Go, the company's chain of brick and mortar establishments.

But these emporiums will be defined by the new shopping patterns that have emerged out of our currently locked-down, socially-distanced world. With more consumers sheltering in place, the decline in store footfall has increased basket sizes, changing the speed of transactions. Stores that reopen need to serve as pick-up locations and delivery depots for orders placed online. As restrictions ease, great attention must be paid to in-store hygiene and ensuring a safe and clean shopping environment. In particular, heightened health concerns will drive contactless transactions to new levels.

Lockdowns and social distancing have induced consumers to seek out an omnichannel shopping experience. Retailers that act quickly and acquire the necessary facilities will prosper.

Those that fail to make the leap beyond the store-centric model of yesteryear will either become inexpensive acquisition targets or close their doors for good.

The Australian retail sector is seeing high end activity, including the recent sale of online retailer Catch Group to Wesfarmers (ASX:WES) and the current IPO of MyDeal (led by Oaklins, Australia).


CHRIS TAIT

RECENT TRANSACTIONS

has acquired

US$160m
M&A BUY-SIDE
Construction & Engineering Services

has acquired a minority stake in

M&A BUY-SIDE
Consumer & Retail

has acquired

AlphaTheta Corporation

from

KKR and Pioneer Corporation

US$650m
M&A BUY-SIDE
Consumer & Retail

has been acquired by

Private investors

M&A SELL-SIDE
Consumer & Retail/Food & Beverage

has been acquired by

M&A SELL-SIDE
Consumer & Retail

has been acquired by

M&A SELL-SIDE
Consumer & Retail/Private Equity

Margaret Dabbs
LONDON

has been acquired by

US$30m
M&A SELL-SIDE
Consumer & Retail

"It was a great pleasure to work with Margaret Dabbs and her team – Margaret is a remarkable entrepreneur and has pioneered an entirely new category for the sector, building an amazingly resilient business with huge potential. We are excited to have found such a transformational partner for Margaret Dabbs London. The transaction demonstrated the reach of our offices around the world."

JONATHAN BUXTON, LEADER OAKLINS' CONSUMER & RETAIL TEAM

Oaklins

LUTZ BECKER
Managing Partner
Hamburg, Germany
l.becker@de.oaklins.com

FEDERICO GIAMMARUSTO
Partner
Milan, Italy
f.giammarusto@it.oaklins.com

BJØRN CAMPBELL PEDERSEN
Principal
Oslo, Norway
b.campbell@no.oaklins.com

CHRIS TAIT
Managing Director
Melbourne, Australia
ctait@henslow.com

STEVEN DAVIS
Managing Director
Los Angeles, USA
sdavis@intrepidib.com