North American Consumer Trendspotter: Lackluster end to strong decade amid signs of distress

Analysis

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The consumer sector cooled off last year, after a nearly decade-long M&A hot streak.

According to *Dealogic* data, 2022 saw 35 PE exits in consumer, the lowest number of US financial sponsor exits since 2011, which saw 36 PE exits. By contrast, 2021 saw 71 exits and 2020 — the start of the global COVID-19 pandemic — saw 40 exits. A similar lackluster trend was seen with sponsor buyouts, as the US recorded 70 PE buyouts in 2022 compared with 112 in 2021 and 72 in pandemic-ridden 2020.

Regarding total deal value, 3Q was the strongest period of 2022 with USD 60.5bn worth of deals. In comparison, 2021 saw the most activity in 4Q with USD 96.8bn in total deal value.

“Where we did see M&A last year, they often had the fingerprints of distressed sellers,” said James O’Brien, managing director with GORA Capital. “Large companies with robust balance sheets swallowed up start-up disruptors who faced the dual threat of slowing growth and a dry market for external financing.”

Corporates continue to face rising costs of goods due to inflation and supply chain hurdles as a remnant of the pandemic. This challenge coupled with higher interest rates, recession fears and the war in Ukraine have prompted management teams to take a conservative approach to M&A.

Nevertheless, in the second half of 2022, patient buyers with capital to spend were rewarded with opportunities for some savvy M&A deals.

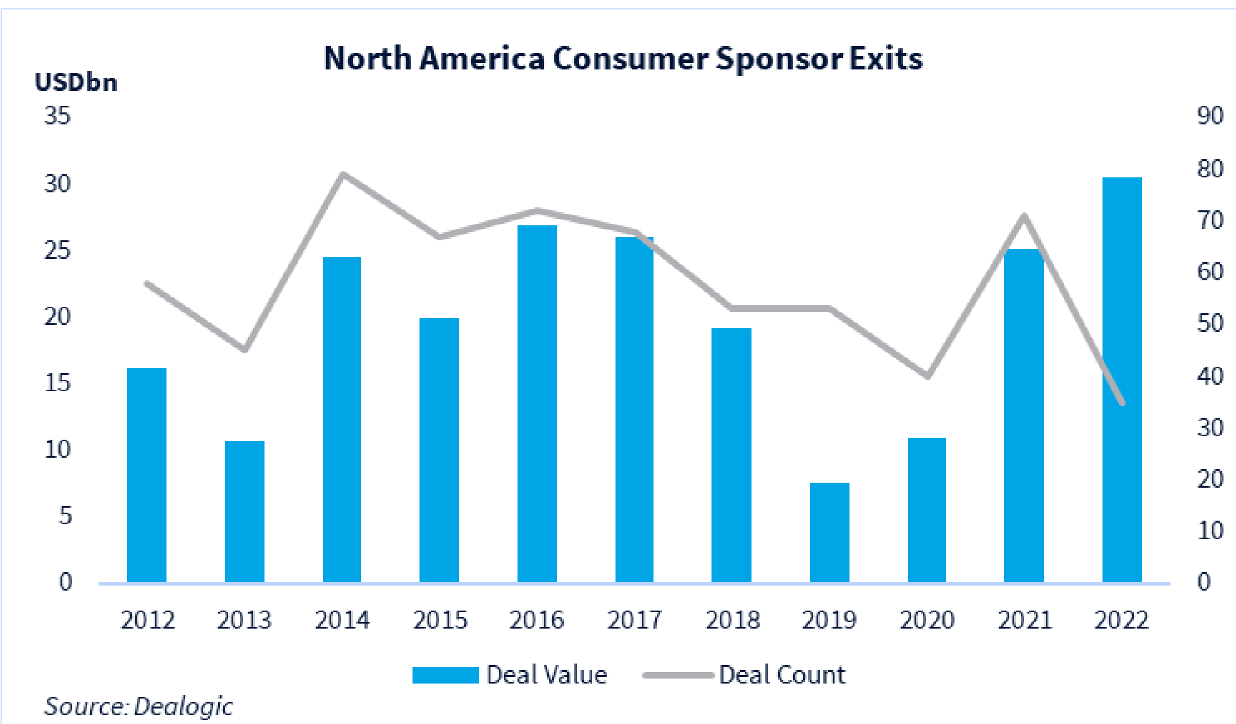
One example is **Dine Brands Global**’s [NYSE:DIN] USD 80m cash offer for **Fuzzy’s Taco Shop**, a 138-unit Mexican restaurant chain, in December. The owner of IHOP and Applebee’s has been publicly looking to acquire a third portfolio brand since 2018—when then-CEO Stephen Joyce said to financial news outlet *TheStreet*, in that bull market, all buyers were subject to overpaying.

Today is a different story, though, as valuations have compressed across the board. With tighter terms on syndicated loans, profitable strategics and private equity firms, with dry powder, will find today is a buyer’s market.

“For the strong performers that have good balance sheets, there is a 20% discount to the high-water mark on average (compared to recent years),” said Euan Rellie, managing partner of New York-based BDA Partners.

Dealmakers are hopeful that interest rates will ease this year. If so, corporate expansion strategies may spur heightened M&A activity by late 2023, sources said.

In the meantime, buyers are seizing the opportunity to consolidate within fragmented verticals.



Checking Out Grocery Deals

The defensive food and beverage segment continued to see mega-deals in 2022, with grocery giant **Kroger** [NYSE:KR] acquiring **Albertsons Companies** for USD 24.7bn in October.

Another huge grocery deal was the majority acquisition of North Carolina-based **The Fresh Market** in May by Chile-based retailer Cencosud from **Apollo Funds** [NYSE:APO] for an enterprise value of USD 1.568bn. The Fresh Market has 160 stores in 22 US states.

More international strategics are eyeing regional and niche grocery chains as a means to enter the US market, said Mark Kelson, a consumer-focused attorney for the law firm Greenberg Traurig. For example, South Korea-based supermarket chain **E-Mart** entered the US in 2018 and in late 2021 was rumored to be in talks with a large California-based food company, according to *The Korea Economic Daily*. Nothing has been announced as yet.

The Hispanic grocery market is particularly ripe for M&A over the next few years, Kelson said. In June, Apollo acquired California-based **Cardenas Markets** from investment fund **KKR**. According to a press release, Cardenas will merge with Chicago-based Tony's Fresh Market "to create a leading Hispanic- and ethnic-focused grocer."

As food products remain attractive amid economic uncertainty, multiples still sit in the solid range of 8X to 10X EBITDA, Kelson said.

Last year's biggest food deals also included **Mondelez**'s [Nasdaq:MDLZ] USD 2.9bn acquisition of privately held energy, health and wellness brand **Clif Bar** in August. In November, **Mars Petcare** bought Canadian pet-food maker **Champion Petfoods**, for undisclosed terms.

PE-backed private-label food manufacturers are also expected to engage in consolidation activity this year as consumers move to buy cheaper off-brand items, said Christopher Nolan, managing director of Dresner Partners, noting inflation bumped food prices by 15% to 30%.

Lower middle market a bright spot

This year, with tighter lending terms, mega-deals in the consumer sector will be harder to fund. However, activity in the lower middle market is expected to remain healthy.

Deals under USD 50m in value are closing at record levels because valuations have eased, according to dealmakers.

Examples of strategics rolling up some smaller game include furniture manufacturer **RH** [NYSE:RH], which late last year acquired both New York-based custom upholsterer **Dmitriy & Co** and Michigan-based boutique **Jeup**. In September last year, **Bassett Furniture** [NASDAQ: BSET] snapped up Canada-based e-retailer **Noa Home**.

As more millennials become homeowners, there is high M&A interest in regional home repair services (plumbing, HVAC and electricity), as seen with **Leonard Green & Partners**-backed **Wrench Group**—which saw TSG Consumer Partners and Oak Hill Capital come in as minority investors late last year.

ACE Hardware, a retailer cooperative, redoubled its bet on at-home services last year by buying Texas-based **Legacy Plumbing** in 3Q22, as reported by *Mergermarket*.

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