Is it Back to the Future for Consumer & Retail M&A?

BY: SCOTT WINSHIP

It would be challenging to argue that we're back to the halcyon days of 2005-2007 for Consumer and Retail investing and M&A, but it is safe to say that deal chatter and strategic dialogues are running at very high levels, as several compelling forces exert their influence on the current marketplace. As such, GulfStar is anticipating an active transaction environment in Retail and Consumer for 2013, with deal activity being stimulated almost equally by Corporate Acquirers and Private Equity buyers.

One of the many themes we have detected over the last several quarters is a resumption of intellectual interest in earlier-stage businesses, where highly differentiated product, branding and/or service delivery models generate tangible separation from the crowd and re-ignite the "innovation" value creation thesis - which was essentially left for dead as the broader markets crumbled in late 2008.

Again, recalling the 2005-2007, the transaction slate at the time reflected a meaningful acceleration of activity whereby large, established but historically slower-moving acquirers were increasingly purchasing nimble upstarts as a means to (1) outsource R&D and stoke more contemporary strategic development efforts, and (2) attempt to stay in front of a rapidly changing consumer messaging paradigm that was shifting from traditional TV and print media to the Internet and Social Media. This "sub-era" gave rise to a seismic awakening in the Consumer sector when brand owners suddenly realized that they didn't need a $100 million yearly media spend to reach and influence consumers and get products to move off of the shelf. Conversely, it was a wake-up call for the majors who saw the rules of engagement literally changing before their very eyes and started doing something about it by investing in, and acquiring the fast moving, buzz-generating assets.

Make no mistake about it, the present environment does not have the same unbridled optimism that existed as recently as late 2007/early 2008, in part because the whipsaw of the 2008-2010 market knocked a large population of would-be contenders to their knees, and then ultimately out to sea, as the capital markets made a long and ugly retreat. That said, as we stand here today on the starting line of 2013, growth is squarely back on the agenda for strategic acquirers, as many of the larger market participants across the consumer spectrum are flush with cash that is earning nothing sitting on the Balance Sheet, and are coincidentally facing an increasing level of pressure to create near-term value or put cash back into the hands of the Shareholder via dividends or share repurchases.

In addition, the reasonable capital markets stability seen over the last 24 months has enabled the upstarts and earlier-stage competitors to once again regain their footing and aggressively pursue the consumer, often at the expense of the more established players. It's happening across the spectrum from grocery retail to restaurants to packaged goods and, as this competitive pressure continues to build from below, we expect that "defense as offense" will make a more mainstream appearance with strategics in 2013, driving deal activity right alongside.

Similar to the Balance Sheet pressure at the corporate level, Private Equity buyers face their own equity deployment pressure. Depending on the data you choose to examine, somewhere between $400 billion and $550 billion is currently available to go to work via PE investment, with some tangible front-end deployment pressure on capital raised in earlier vintage funds. In a "use it or lose it" scenario there is absolutely no doubt that Private Equity interest in broad-spectrum transactions is at, or near, cycle highs. Moreover, the debt capital markets remain highly receptive to new deal activity, so a key element of the PE return profile continues to flash a color that is undeniably green. As long as there is "technical excess" in the Fund pipe and friendly, full-range (i.e. Senior and Junior) financing available to support transactions, we will see strong activity and healthy competition for quality companies.

The cocktail that comprises all of the above strongly suggests that we're in for an active and interesting year in 2013. The confluence capital pressure and the re-emergence of the innovation agenda further lead us to believe that the transaction size spectrum could be wider than years past. Of course, there will always be a size bias in the middle market, and there is no doubt that more scaled assets showing $5-$15 million in trailing EBITDA will continue to attract a larger audience of potential buyers for a myriad of technical and psychological reasons. However, in Retail/Consumer, we wouldn't be surprised to see a handful of industry influencing transactions that involve large and established players looking to attach the next leg of growth by partnering with creative, earlier stage companies that can deliver that elusive acceleration element that is oftentimes best written on a cleaner sheet of paper.

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Scott joined GulfStar in 2010 and brings over 17 years of experience advising clients in the Consumer Products and Information Technology industries. He has successfully closed over 50 transactions with an aggregate value in excess of $18 billion across a broad range of public and private market equity and debt financings, mergers and acquisitions, and strategic advisory assignments. Previously, Scott was a Managing Director at 6Pacific Partners in Los Angeles where he advised clients in the food, beverage and branded consumer products industries. Prior to that, Scott led the Packaged Food and Beverage group at BMO Capital Markets in Chicago and held senior positions in the Technology industry groups at JPMorgan Chase & Co. and at Cowen & Company in San Francisco. Scott received a Bachelor of Arts from the University of California, Davis, where he graduated with Honors.