

The revenue synergy imperative in CPG deals

With deal valuations still high and a potential recession on the horizon, consumer packaged goods companies need to do more than cut costs to drive transaction value.

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Introduction: The revenue synergy imperative

As comfortable as companies have become with finding cost-cutting opportunities in deal transactions, they're less so with uncovering and defining revenue synergies. Valuation expectations and market conditions will change that.

Eliminating redundancies. Consolidating vendors. Closing manufacturing facilities.

These familiar cost reduction M&A strategies in the consumer packaging goods (CPG) sector are mature and, as a result, less effective for organizations that are already running lean and heading into a less-hospitable, lower-profit environment. The results of cost takeout alone can't justify valuations. Revenue synergies, in turn, have become more critical.

Multiples have defied economic worries to date

When KPMG surveyed executives in mid-2022 for their views on the M&A environment, deal appetite was strong and multiples in the CPG sector were high.

Transaction volume remained relatively steady through the top-three barriers to managing inflation identified by industry finance executives: ongoing supply chain disruption, high raw materials costs, and geopolitical risk.ⁱ In the first half of the year, U.S.-focused CPG companies announced 53 deals with a value of \$23.5 billion and an average multiple of 16.2, higher than in 2020 and 2021.ⁱⁱ

Asked to look at the year ahead, 42 percent of executives across the full consumer and retail (C&R) industry said their companies will increase M&A activity over 12 months—but acknowledged that inflation and economic uncertainty could cause them to pull back.ⁱⁱⁱ They are also settling into the idea

that economic disruption could lengthen the due diligence period as investors spend more time looking broadly at drivers and defining the deal's synergy case, and that it could take extra time to realize some of these synergies.

However, 40 percent of C&R executives surveyed still expect valuations to remain stable or increase.^{iv} Asset owners aren't settling for lower multiples yet and don't look to be changing their minds over the short-to-medium term.

Feeling high valuations

CPG deal multiples were **16.2x** through the first half 2022* and **40%** of C&R executives expect valuations to remain stable or increase over the next year.

*KPMG M&A Market Perspectives – Survey Analysis, June 2022;
KPMG Inflation Survey, May 2022*

**Average LTM enterprise value/earnings before interest, tax, depreciation, and amortization (EBITDA)*

ⁱ KPMG Inflation Survey, May 2022.

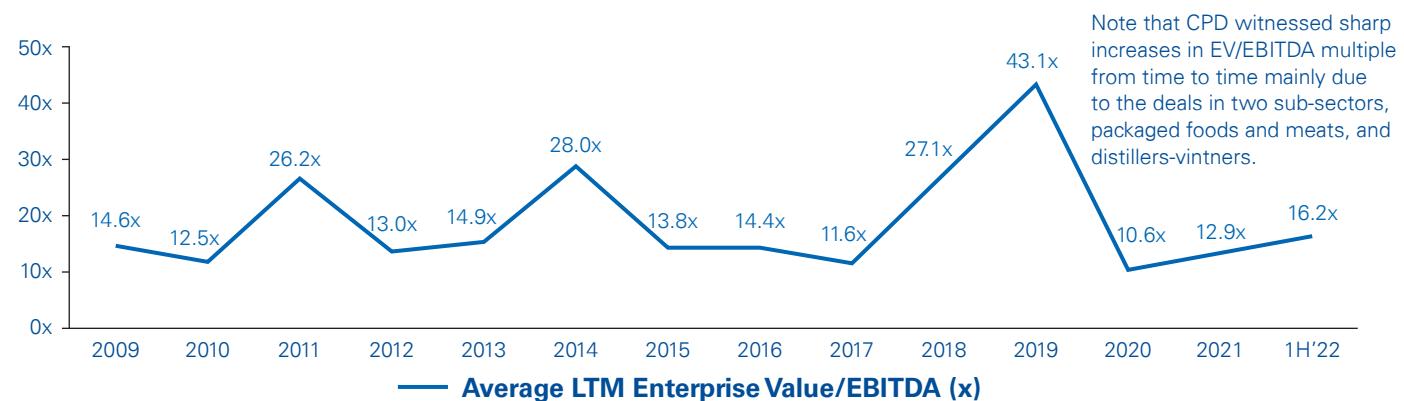
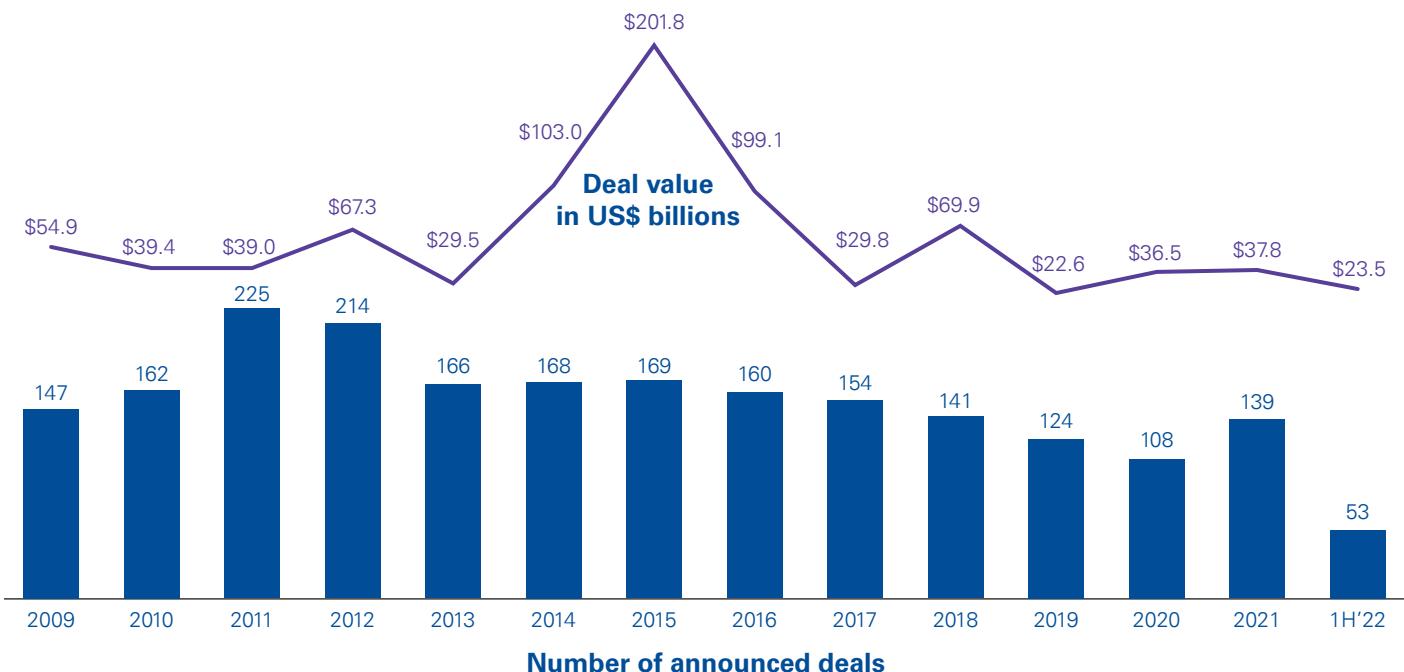
ⁱⁱ Source: S&P Capital IQ, KPMG analysis, June 2022

ⁱⁱⁱ Source: KPMG M&A Market Perspectives – Survey Analysis, June 2022

^{iv} Source: KPMG M&A Market Perspectives – Survey Analysis, June 2022



Annual deal activity by volume and value for top 50 CPG companies 2009 to 1H 2022



Several announced deals contributed higher total values between 2014 and 2016, including Reynolds American Inc. acquisition of Lorillard, Inc. and the merger between Walgreens Boots Alliance and Alliance Boots GmbH in 2014; Anheuser-Busch InBev SA/NV acquisition of SABMiller and the merger of H. J. Heinz Company and Kraft Foods Group, Inc. in 2015; and British American Tobacco's stake in Reynolds American Inc. in 2016.

Source: S&P Capital IQ accessed in August 2022

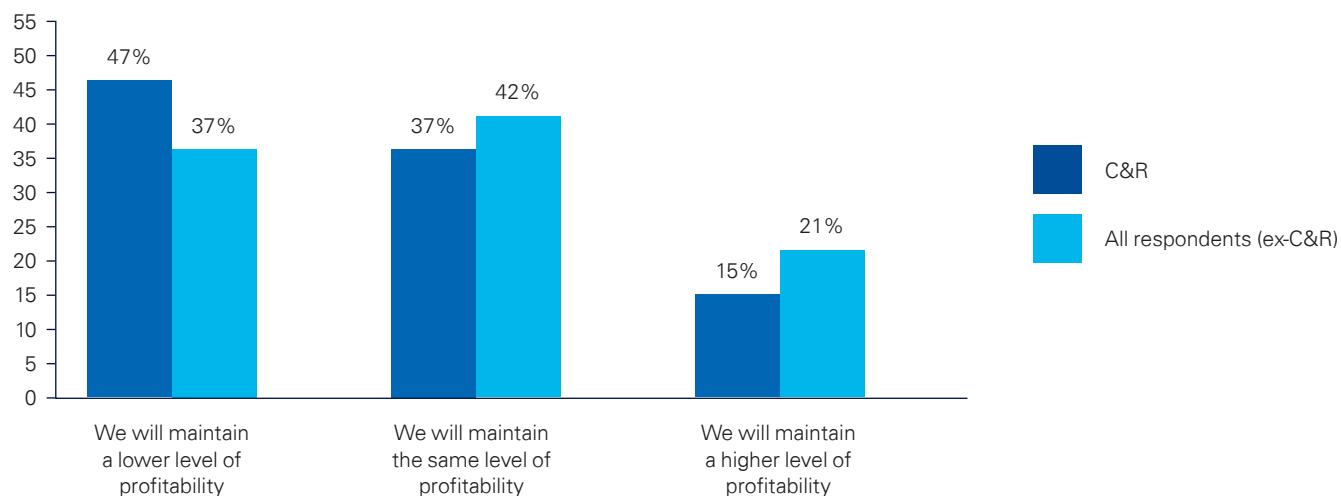
Notes: We considered the top 50 companies in Food and Staples Retailing, and Food, Beverage and Tobacco with the role as buyer; and we included deals undertaken by the companies along with their subsidiaries and excluded private placements, spin-offs, and all asset acquisitions. 1H'22 data is as of 30th Jun 2022.

Deal value justification is about to get more challenging

Valuations have been supported to date by strong, traditionally cost-focused synergies, but it will likely get harder to squeeze efficiencies out of combined entities in a tougher environment. Nearly half of C&R executives, 47 percent, said they don't believe their companies can maintain overall profitability at the same level. A number of C&R companies have already lowered sales expectations and adjusted profit forecasts accordingly.

C&R more than other industries on average anticipates lower profitability as inflation rises

Do companies expect to remain profitable?



KPMG Inflation Survey, May 2022

Consumer spending accelerated in fourth quarter 2022 on lower gas prices. However, prospects heading into 2023 are not as bright.

Lower average hourly earnings further reduced consumer savings, and the Federal Reserve continued to raise rates. Consumer spending will remain somewhat resilient thanks to a cost-of-living adjustment to Social Security.^v However, retail executives surveyed expect higher inflation than leaders in other industries, and they anticipate passing as much as 80 percent of higher costs through to customers.^{vi}

C&R executives already believe that revenue synergy is the most significant M&A value driver after consolidation and cost synergies, according to our survey. But under more difficult market conditions, identifying and then driving revenue synergies in deals has become a strategic necessity. This driving of revenue is key for acquirers to convince the market that companies can continue to be profitable as conditions change.

^v Source: Diane Swonk, Chief Economist, KPMG US, "New Year: Old Challenges – Dealing with the Generation Gap" (January 2023)

^{vi} Source: Diane Swonk, Chief Economist, KPMG US, "KPMG Insights on Inflation Survey" (Q3 2022)

Cost synergies: Important but exhausted

Reducing costs and driving efficiency isn't enough to support the high multiples being paid.

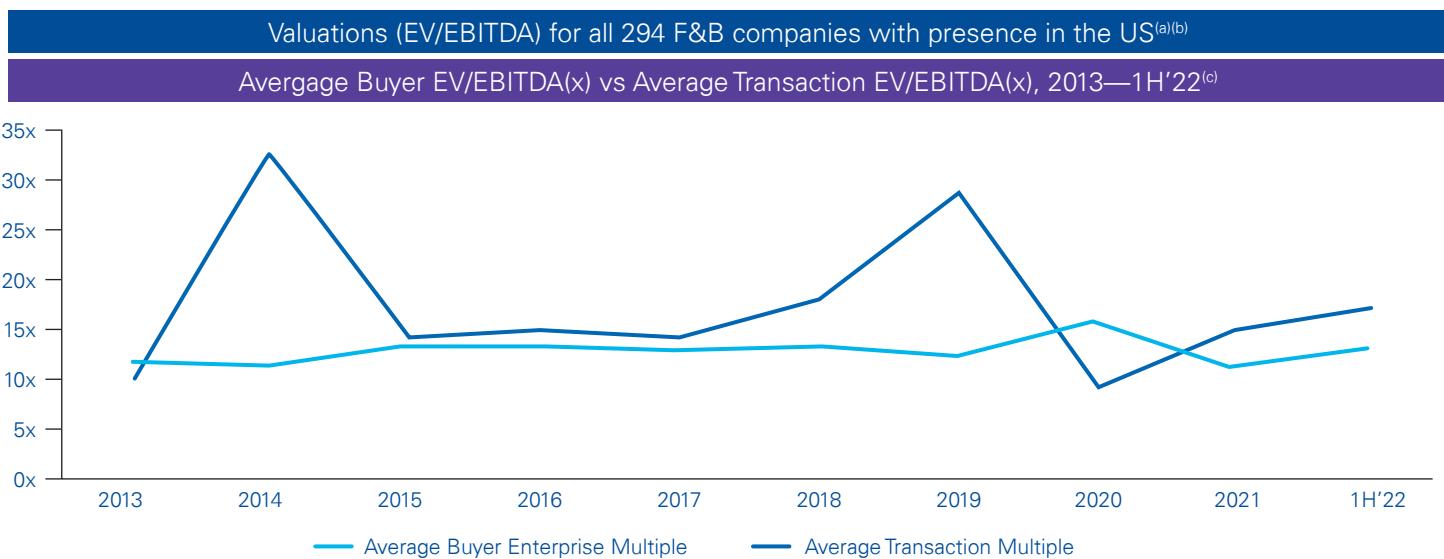
Tried and true cost synergies have successfully boosted multiples, and with the additional tactics discussed in our paper, ["Winning in M&A: Best practices from leading consumer companies"](#), organizations have the opportunity to drive as much value as possible by:

- Announcing the details of synergy expectations and plans before the transaction close;
- Publicly tracking and reporting synergy progress post acquisition; and
- Capturing a significant portion of synergies quickly, usually within the first year.

The challenge of creating value from M&A remains, and the benefits of these tactics applied to cost takeout hold true. But in the current environment, transactions must be accretive to the new parent company in order to support continued high multiples in the consumer and retail space.

Enterprise multiples vs transaction multiples

Except for at the height of the pandemic in 2020, CPG companies have been paying a premium, making acquisitions of targets at multiples higher than their own enterprise values. As exemplified by food and beverage (F&B) deals since 2013 through mid-2022, transaction multiples are higher than buyer multiples for eight out of 10 years. Acquisitions must be significantly accretive to companies to support these high multiples.



KPMG analysis of Capital IQ data: (a) Top 294 companies in the food and beverage industry with the role as buyer; (b) Deals undertaken by the companies along with their subsidiaries, excluding private placements, spin-offs, and all asset acquisitions; (c) 1H'22 as of 30th June 2022.

Revenue synergies: Effective and underutilized

Corporates and private equity are finding that revenue synergies are an increasingly necessary component of value creation, yet they are not as widely leveraged or emphasized in dealmaking as cost synergies.

Most acknowledge revenue synergy benefits

Four out of five C&R executives surveyed now prioritize revenue over cost synergies when considering acquisitions. By including revenue synergies in their valuation models, they can bid more aggressively as well as develop deal rationales that support the industry's high multiples.

Executives also scored revenue synergies as an M&A value driver higher on a one-to-five scale than speedy integration, talent retention, cost synergies, timely closing/minimal disruption, and ESG.

Fewer take advantage

Less than half of C&R companies surveyed have focused on revenue synergies in recent deal announcements. While the percentage rose from 33 percent for announced deals between 2015 and 2017, companies still aren't paying enough attention to revenue synergies given the high multiples acquirers are paying.

"There's always been a focus on cost and efficiency levers to effect value from a transaction. But buyers also have to approach the revenue side correctly," said Gillian Morris, a

principal in Advisory Strategy for KPMG in the U.S. "If they pay high multiples without getting commercial integration right—thereby delivering revenue synergies—the outcome will be poor. That's an open door for activist investors to enter after large transformative acquisitions."

In addition to using the M&A announcement to highlight revenue synergies in sales, product development, and other areas of commercial integration, parties in the deal need to substantiate assertions of competitive positioning and differentiation, and explain how these attributes will help the combined organization become accretive to EBITDA.

Implications for debt financing

In the current environment, private equity investors and potentially some corporates will find it more challenging to line up debt to finance deals. Their deal rationale will need to be solid and detailed to secure that financing, and revenue synergies are an important component for building lender confidence that the deal will deliver on the investment thesis and returns.

80% of C&R executives say that their reliance on revenue synergies has increased relative to cost synergies in their valuation of targets.

Revenue synergies ranks #1 among the most significant M&A value drivers, according to C&R executives.

In deals worth >\$2 billion announced between 2018 and 2021, **only 42%** C&R companies disclosed revenue synergy targets and plans to secure them. When companies don't announce it's because they experience:

- A lack of transparency in the target's operations until deal close (**17%**)
- Poor visibility into data needed for accurate projection (**14%**)
- Fear of being devalued by market if targets are not achieved (**9%**)

KPMG M&A Market Perspectives – Survey Analysis, June 2022

Cautionary tales

Strategic transactions fail for a variety of reasons, and the inability to achieve synergies in the required time period ranks high on that list. Fallout includes goodwill impairment and write-offs as well as shareholder activism.

There are many examples of companies not achieving revenue synergies, and then having to write off the recently acquired assets. Activist investors can move in when transformational acquisitions or mergers secured at high multiples have failed to deliver on profitability, growth, and cost and revenue synergy goals.

That's what happened to one U.S.-based public company shortly after it completed a merger. A prominent activist investor firm took a nearly \$1 billion stake in the company and nominated four directors to the board, demanding that the company take action to improve financial performance and integrate the acquisition smoothly. The share price at the time was lagging competitors after a previous acquisition had turned somewhat sour, resulting in lost customers and a shareholder class action lawsuit.

While the company's share price had surged upon the close of the new merger, the timing of activist investor activity and stock price gains indicated that at least some investors saw value in the intervention. The company staved off broader action by offering a board position to the activist fund's managing partner.

Often, revenue synergies fail when the acquirer does not have a mature understanding of the commercial integration opportunities with the target. In many cases, the parties didn't dedicate time and effort during the due diligence process to develop a well-informed, data-backed perspective on the revenue synergies and instead produced sub-optimized and even simplistic commercial integration strategies. Rather than making a deal that's "better than both," the result was "significantly worse than either."

21% of C&R executives point to **integration/separation** during a large complex deal as the phase with the greatest potential for challenges and risk.

To mitigate such risks, C&R companies tend to lean on **strong internal M&A capabilities (38%) or external support (28%)** through the deal lifecycle.

KPMG M&A Market Perspectives – Survey Analysis, June 2022

Key questions for assessing commercial synergies

Revenue synergy achievement requires a well-thought-out commercial integration plan. Organizations should answer the following questions to uncover the similarities and differences that can contribute to success, or issues that need to be addressed before they lead to trouble.

1. Are there similarities that can be consolidated across both sales teams?
2. Does the acquirer have an inherent bias for the target because the business appears to be similar to its own? Playing devil's advocate, how dissimilar are the businesses?
3. Are there differences where best-of-breed should be taken?
4. What is the revenue synergy potential across products and channels?
5. What is the go-to-market approach of each company?
6. How are the commercial organizations structured?
7. How are the commercial organizations incentivized and how should they think about key differences?
8. Are there special capabilities to be shared from one organization to the other?
9. What is the sales technology integration approach?
10. Are there plans for talent retention?
11. Have perimeters been set up around strategic accounts? What are the defined swim lanes?
12. How are accounts where both companies are active going to be managed?
13. What is the transition plan for pre-close, day one, and 100 days? What is the interim and long-term plan for achieving commercial synergies?

Three key activities to capture synergies

Through our work with CPG companies as well as organizations in other sectors, we have identified three actions that provide the greatest opportunity for achieving revenue synergies.

1) Identify combined go-to-market strategy opportunities

Specifically, companies should undertake a deliberate review of all customers and all markets across both companies. This informs the development of a product portfolio with specifics for each of the six key potential combined customer classes and markets:

- Customers of the acquirer in shared markets
- Customers of the acquiree in shared markets
- Customers of the acquirer in non-shared markets
- Customers of the acquiree in non-shared markets
- Prospects in shared markets
- Prospects in markets where the acquiree was located

A broad-based portfolio tailored to each of these scenarios can drive the highest customer lifetime value. Then, once strategies are defined, the combined entities can develop sales incentives and management systems to drive desired behaviors across unique customer groups.

Case study: A large food service company brings an international specialty distributor into the family

As part of its strategic growth plan, a large food service company acquired a specialty international foods distributor. At that time, the value proposition for the combination was tied up in each company's relationships and product portfolios. But the acquirer wanted to drive revenue synergies as soon as possible.

The specialty distributor had been selling into restaurants, hotels, and other entities seeking their authentic premium and import products. Meanwhile, the food service company was selling less-specialized food as well as non-food products into a number of the international food distributor's customers, but it didn't have relationships with many others.

Prior to closing, KPMG worked with the companies to develop targeted strategies for key customers of each company based on their current product portfolio sold, competitive offer, and the strength of the sales relationships. For example, where the acquirer was already selling non-food items or a limited general portfolio of food products to a gourmet restaurant, a go-to-market approach was developed across both sets of sales representatives that enabled sales of the international product portfolio into that customer as well.

For prospects in shared markets, the organizations developed targeted strategies that identified optimal entry points based on the product portfolio of each customer.

2) Adjust sales accountability and incentive structures

Misaligned incentive structures across organizations that have been combined can lead to internal conflicts that will eventually spill over to the customer experience. Acquirers need to think strategically about how and when to integrate incentive plans, especially if there are major differences between the acquired and the acquirer.

An imperative is to ensure that both commercial organizations do not lose customer focus and momentum in the integration period, which could open the door to competitors.

Case study: Companies satisfy combined sales teams by maintaining incentives

A global public food industry manufacturer agreed to purchase a private company in the same space. But with its smaller size and agility, the acquired was growing faster and had higher profit margins than its new owner.

KPMG designed an interim commercial go-to-market model in which, among other attributes, the incentive structures that helped the newly acquired company expand by double digits before the deal announcement would continue for the first couple of years of ownership. Likewise, the acquirer's customer focus and growth strategies would also continue uninterrupted by immediate changes to incentives.

For the final target go-to-market operating model, the organization introduced newly designed incentive structures which recognized the subtleties of the key business which included "farming" and "hunting" market customer archetypes.

3) Transform sales and distribution capabilities

Initially, guardrails should be in place to ensure sales teams are not stepping on each other as they go to market. Once past the transition, however, the teams will need to integrate and assign responsibility for maintaining and growing individual accounts.

At that time, the combined organization should have access and share sales capabilities, training, and tools. This includes the implementation of best practices and techniques to maximize value across the groups.

Finally, the back office for the selling organization needs to take a continuous improvement approach to support efficient and effective sales for products from both of the original companies to the now-combined customer base.

Case study: Food processor leverages distribution channels and sales expertise

A large food processing company made a couple of acquisitions in the last few years that each had their own revenue synergy opportunities.

The larger of the two acquisitions was of a snack food company that was already lean, so the greater value was in revenue synergies. The target company has relationships and a large and varied footprint throughout convenient stores, gas stations, and other retail outlets outside the acquirer's heavy presence in grocery stores.

With an acquisition, the acquirer had access to sell at the cash register, in the snack aisle, and in other new spaces and to new customers. It also could benefit from the target's trade terms and relationships, such as co-branding promotional activities around the SuperBowl.

The other acquisition was of a premium brand in a similar food processing industry. Whereas in some deals the acquired sales team can be redundant, in this case, the target's sales team was experienced and sophisticated, and could speak to the entire suite of products.

In summary

Tremendous opportunity exists in the CPG sector for exciting and transformative deals. While the M&A and overall market environment is making it more difficult for companies to extract deal value that meets high stakeholder expectations, a deal integration plan that thoughtfully incorporates revenue synergies can help companies attain outcomes that consolidation and cost synergies alone can't produce. A detailed go-to-market strategy, customer-focused sales incentive structure, and fully integrated sales and distribution that all play to strengths of the deal partners will help uncover the valuation they're looking for.



How KPMG can help

Today's complex M&A environment requires dynamic strategies to address disruption, stiff deal competition, faster cycle times, elevated valuations, compounding macro-economic risks, and other market realities. KPMG mobilizes experienced professionals across global markets, industries, and functions to guide companies along every step of the deal lifecycle. By focusing on value identification and outcomes, we can help uncover the cost, revenue, and transformational levers unique to each deal.

For revenue and commercial levers specifically, we work closely with company leaders to uncover growth potential, identify new products and markets, and understand the ecosystems and partners that can help combined organizations drive the greatest deal value. We look for synergies and opportunities for sustained performance improvements across everything from product pricing and cross- and up-selling to customer loyalty, sales and marketing integration, and go-to-market optimization.

With end-to-end capabilities delivered through seamless orchestration, KPMG addresses complex M&A needs to help drive a better overall client experience and long-term deal success.

About the authors



Gillian Morris

Gillian is a principal in the KPMG Strategy practice and has spent more than 25 years supporting corporate and private equity clients with actionable corporate and business unit strategies, many of which have involved acquisitions and divestitures. She works with clients pre-close and post-close to develop coherent and executable commercial integration strategies in the current business climate.



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