



Waiting for recession

M&A trends in consumer & retail

Q3'22

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Introduction
p.2

By the numbers
p.3

Notable trends
p.5

Deep dive
p.6

Outlook
p.7

Introduction

Ready but unwilling

C&R sector investors face a paradox: while many firms have money ready to invest in M&A, the Federal Reserve's relentless tightening and the increasing chances for a recession have reduced appetites for deals. This dynamic caused the number of announced C&R deals to fall by 20.7 percent in Q3'22 compared with the previous quarter.

The value of deals in C&R also declined, from \$28.6 billion in Q2'22 to \$16.8 billion. The largest deal in Q3'22 was Amazon's announced acquisition of One Medical, a West Coast-based primary care platform. Amazon has been expanding its footprint in the medical field, buying PillPack in 2019, which has become Amazon Pharmacy, and Health Navigator, which became part of Amazon Care, a health benefit manager based in the Seattle area. Other big retailers also are pushing into healthcare services, such as Walmart's purchase of telehealth provider MeMD in 2021.

With a recession looming, investors may be holding off making deals until 2023 when valuations are likely to be lower as stock prices continue to fall and future Fed interest rate policy is clearer. With many retailers like Target and Walmart acknowledging they have too much unsold inventory and what they have is no longer top of mind for consumers, the holiday selling season could have a critical impact on company finances and determine which firms become viable M&A targets.

The KPMG Consumer Pulse Survey: Holiday 2022¹ found that while consumers intend to spend about 6 percent more

this year than last year, they remain overwhelmingly concerned about the impact of high inflation and products running out of stock. More than half of respondents said they intend to shop at discount stores this year, and only 18 percent said they would be buying gifts at luxury retailers.

Despite those worries, retailers are significantly bullish about end-of-year sales, both for in-store merchandise and e-commerce. According to the KPMG Retail Executive Outlook: Holiday report 2022,² more than half of the executives

surveyed believe sales in physical stores will increase, while a similar number think online sales will also grow. Notably, 71 percent of respondents said they expect a recession in the next year. To address those issues, they plan on cutting indirect expenses like travel, but only a quarter said they plan on cutting store workforce—a reflection of the persistent difficulty in finding qualified staff.

Key statistics

-21% decrease in total C&R deal volume from Q2'22 to Q3'22 (673 to 534)

-41% decrease in total C&R deal value from Q2'22 to Q3'22 (\$28.6 billion to \$16.8 billion)

17% PE share of C&R deals in Q3'22. PE buyers accounted for 6.2 percent of total value

Julia Wilson on C&R M&A outlook:

While there are more headwinds than earlier with inflation, continued conflict in Ukraine and aggressive monetary action by the fed, I expect C&R companies will continue to engage in M&A to shape their portfolios and orient their companies towards the most profitable consumers, product segments and channels.

¹ See KPMG, [Consumer pulse survey: Holiday report](#), October 2022

² See KPMG, [Retail executive outlook: Holiday report 2022](#), September 2022

By the numbers

Uncertainty reigns

Uncertainty about the likely contours of a recession and dipping consumer sentiment caused many C&R firms to pause or slow their M&A activity in Q3'22. Deals declined from 673 in Q2'22 to 534 in Q3'22, a 20.7 percent drop. The one bright spot was a series of deals by Amazon, which bought One Medical and robot vacuum cleaner company iRobot.




Private equity deals declined to 90 in Q3'22 from 144 in the previous quarter, a substantial 37.5 percent decline. The value of PE deals plummeted even more, falling 93 percent from \$15 billion in Q2'22 to just \$1 billion in Q3'22. One explanation for the decline may be that the sharp rise in interest rates has made leveraged buyout much more expensive.

In contrast, strategic deals fell from 525 in Q2'22 to 442 in Q3'22, a drop of 15.8 percent.

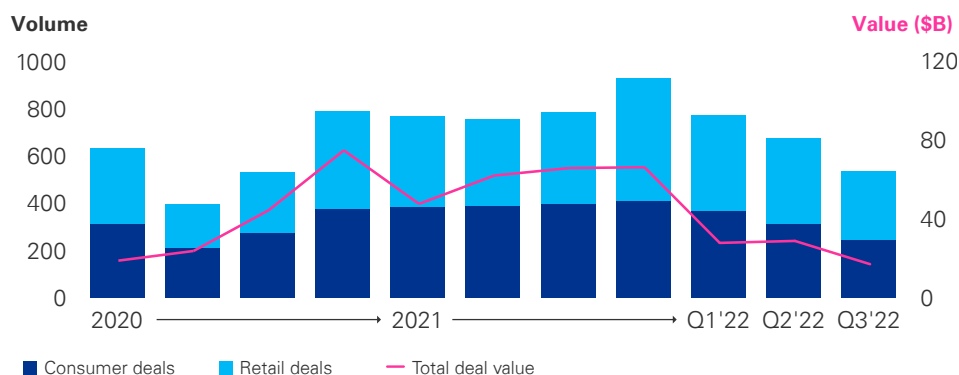
Despite the changed environment, the value of strategic M&A showed some strength, with deal values rising from \$11.8 billion in Q2'22 to \$15.6 billion in Q3'22, thanks to those Amazon acquisitions and washing machine maker Whirlpool buying a garbage disposal firm.

PE values fell from \$15 billion in Q2'22 to just \$1 billion in Q3'22. The top deal involving a C&R sector firm was the purchase of parts of Treehouse Foods, a U.S. maker of private label goods, by InvestIndustrial, a European PE firm, for \$950 million.

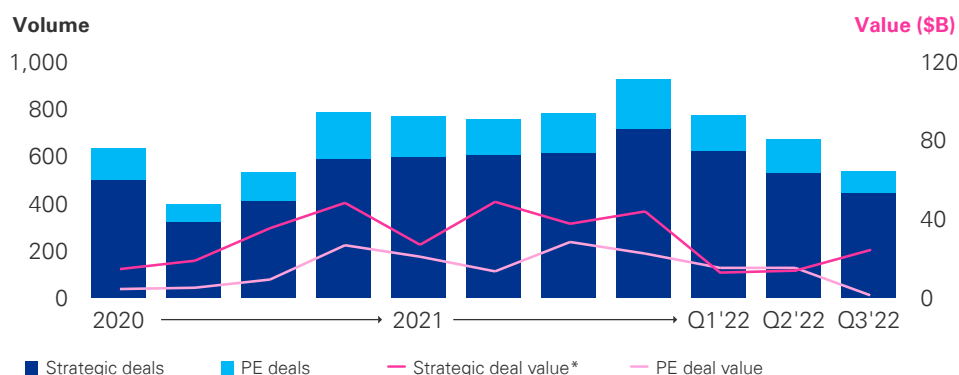
Top C&R deals Q3'22

 Acquirer	 Target	 Value (billions)
Amazon.com, Inc.	One Medical	\$3.9
Whirlpool Corporation	InSinkErator, Inc.	\$3.0
Amazon.com, Inc.	iRobot Corporation	\$1.7
Investindustrial	Treehouse Foods (meal preparation division)	\$1.0

U.S. C&R activity by sector



Strategic and PE C&R deals



*Includes SPAC deal volume and value

About the data: Data was sourced from CapitalIQ, Refinitiv, Pitchbook, and KPMG analysis. The values and volumes data cited are for U.S. deals announced during each quarter. Previously published statistics may be restated to incorporate new data and/or changes in deal outcomes.

By the numbers



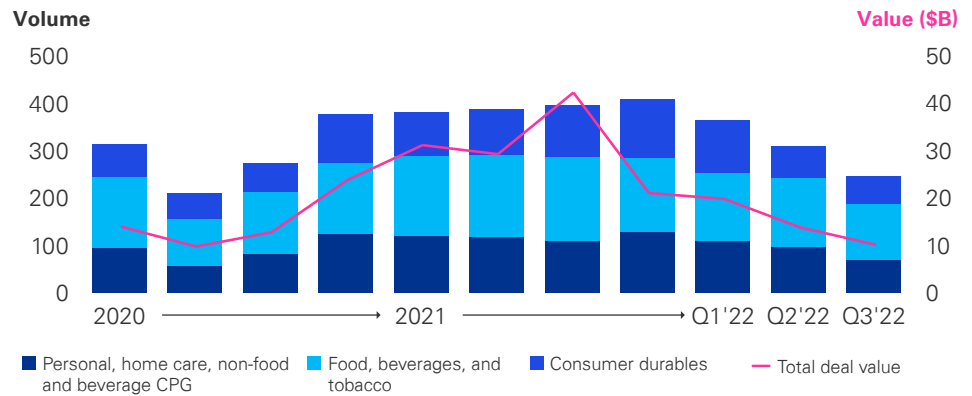
Consumer and retail overview

Consumer deals declined from 310 in Q2'22 to 245 in Q3'22, off 21 percent from the previous quarter, with the value of consumer deals down from \$13.8 billion to \$10.1 billion. Consumer deal volume dropped 38.1 percent compared with a year ago.

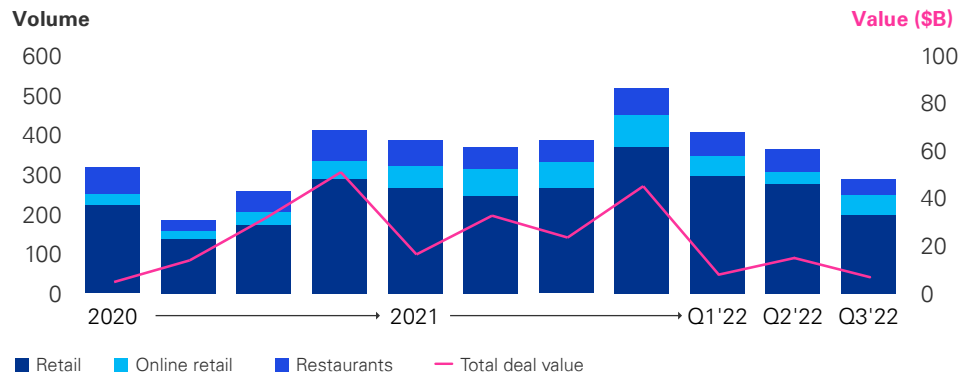
Retail mergers declined from 363 to 289, down about 20.4 percent, while the value of retail deals fell to \$6.7 billion from \$14.8 billion, a sharp 54.6 percent fall. Retail M&A volume was off by 25.3 percent compared with Q3'21.

Private equity deals declined from 144 in Q2'22 to 90 in Q3'22. The value of PE deals fell dramatically, from \$15 billion in Q2'22 to just \$1 billion in Q3'22, a fall of 93 percent. The reasons for the decline are not entirely clear, but the sharp rise in interest rates may make leveraged buyouts, the preferred financing mechanism for PE firms, more expensive.

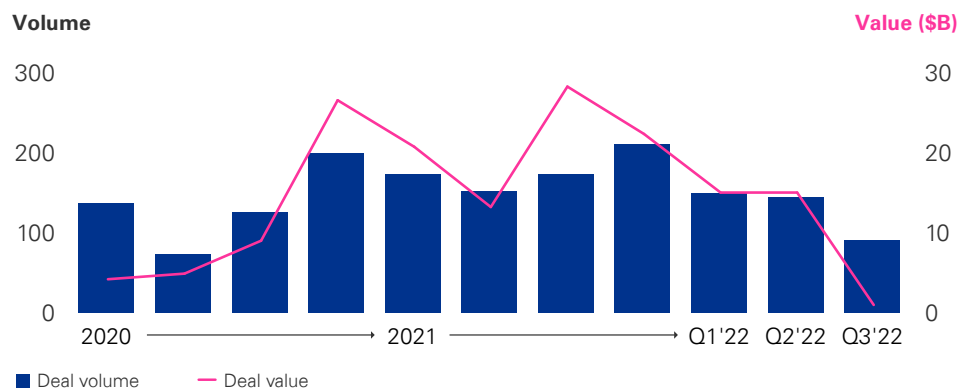
Consumer deal value and volume by subsector



Retail deal value and volume



PE deal value and volume



About the data: Data was sourced from CapitalIQ, Refinitiv, Pitchbook, and KPMG analysis. The values and volumes data cited are for U.S. deals announced during each quarter. Previously published statistics may be restated to incorporate new data and/or changes in deal outcomes.

Notable trends



Fast casual dining is driving deals

While dining out has receded as inflation spikes, fast casual has managed to grow revenue despite the downturn.

And the growing popularity of the concept is driving M&A deals. The latest deal involving fast casual was the August 9 announcement by Los Angeles-based PE firm Butterfly Equity that it had reached

agreement to acquire Qdoba, a burrito chain with 750 outlets, from Apollo Capital. No price was disclosed. Butterfly said it would merge the restaurants with its existing Modern Restaurant Concepts, which was formed with the 2019 merger of Modern Market and Lemonade. Qdoba was originally owned by the Jack in the Box chain, but it was sold to Apollo in

2017 when the firm came under activist pressure to divest it.³

Another fast casual target was Bellagreen, which operates restaurants in Dallas and Houston. Richardson, Texas-based Ampex Brands, which acquired the Au Bon Pain chain in 2021, announced the acquisition in July but did not disclose details.



Alcoholic beverages thrive

Although the COVID-19 pandemic inspired many consumers to adopt a healthier lifestyle, it hasn't dampened alcohol sales. According to research firm Future Market Insights, the premium alcoholic beverages market is set to grow at a CAGR of 9.3 percent in the next decade, reaching \$1.7 trillion by 2032.⁵

That growth is helping drive industry consolidation. Pittsburgh Spirits announced August 11 that it has acquired

craft distillery Wigle Whiskey, which produces whiskey, gin, and other spirits, as well as hard cider and mead under the Threadbare brand. Terms of the deal were not disclosed.⁶

On August 7, Domaine Drouhin Oregon, a burgundy winemaker, announced the acquisition of Methven Family Vineyards, gaining a winery, visitor space, and 85 acres of planted vineyards. Terms were not announced.⁸

In late June, Texas-based Milestone Brands, maker of Dulce Vida Tequila, announced the acquisition of Canada's Victoria Distillers, producer of Empress Gin, for an undisclosed sum. The deal is expected to double the company's volume to 400,000 cases a year.⁹



A taste for sweets

The health food trend has also not dented M&A interest in candy and other sweets.

French restaurant conglomerate Groupe Le Duff, seeking to expand its presence in the U.S. and Canadian markets, announced the purchase of Connecticut-

based Lecoq Cuisine Corp., a producer of Viennese and French pastries. Terms of the transaction were not disclosed.¹⁰

Chocolate Works, a maker of private label specialty chocolates, announced July 1 it is acquiring Oregon-based Moonstruck

Chocolate LLC for an undisclosed amount. The purchase will give the New York-based Chocolate Works a presence on the West Coast.¹¹

³ Jonathan Maze, "Butterfly Equity to acquire Qdoba," restaurantbusiness.com, Aug. 9, 2022.

⁴ Ron Ruggless, "Founders sell Slapfish interest to Mac Haik investment group," www.nrn.com, July 6, 2022.

⁵ "Premium Alcoholic Beverages Market Outlook (2022 – 2032)," futuremarketinsights.com, July 2022.

⁶ Ryan Deto, "Pirates owner Bob Nutting to buy Wigle Whiskey, Threadbare Cider & Mead," [Triblive.com](https://triblive.com), Aug. 11.

⁷ "Anora acquires Globus Wine, the leading wine company in Denmark, to further strengthen its position as the leading Nordic wine and spirits group," cision.com, June 22, 2022.

⁸ L.M. Archer, "Domaine Drouhin Oregon Acquires Methven Family Vineyards in Willamette Valley's Eola-Amity Hills AVA," winebusiness.com, Aug. 7, 2022.

⁹ "Milestone Brands Gains Fast-Rising Gin Label In Acquisition Of Victoria Distillers," [shankednewsdaily](https://shankednewsdaily.com), June 22, 2022.



Engineering value

Consumer companies are grappling with the worst inflation in four decades, sparking an unprecedented surge in prices that has significantly transformed shopper behavior across retail channels. According to the U.S. Department of Agriculture, grocery store food prices rose 13.5 percent on an annual basis in August.¹²

One example of how higher input costs have impacted CPG companies is Beyond Meat, one of the primary producers of plant-based alternatives to animal protein. The company estimates its cost of goods in the last year rose by \$1.20 a pound, a 30 percent increase. This is now changing the relationship between the cost of Beyond Meat plant-based alternatives and the cost of meat. The result is that a meaningful portion of flexitarian consumers, who are leaning in to plant-based alternatives in an effort to eat less animal protein, are switching back to animal protein. And that move is forcing the company to slash its sales forecasts from \$560–\$620 million to \$470–\$520 million.¹³

In an effort to maintain volumes and dollar sales, CPG companies are deploying what's known as price elasticity of

demand statistical modelling to determine which products are more sensitive to higher prices on supermarket shelves. For example, a bakery products company that passed on a 25-percent price increase found that its sales volumes were declining because consumers had limits to what they would pay for baked goods. On the other hand, sugar-free chocolate prices increased by 27 percent, but sales didn't suffer, because these confections were seen as a permissible indulgence by consumers.

Companies that find product sales negatively affected by inflation have been forced to pivot and re-engineer their products to maintain consumer loyalty. One method gaining ground is described as "value engineering." For example, Pepsi reduced the contents of its Gatorade from 32 to 28 ounces, while ice cream maker Tillamook cut the size of its containers from 56 to 48 ounces, but kept the price the same.¹⁴ Some firms refer to making these smaller sizes as "down-ouncing."

Further, companies that are well positioned in recessionary periods are those that have a broad portfolio across

price tiers such as Hormel, as well as those with a meaningful part of their portfolio comprised by frozen food such as Conagra brands. The frozen aisle typically outperforms other parts of the store in a recession due to price per volume gaps vs non-frozen products. Further, companies that have a broad portfolio spanning across day-parts and eating occasions are better positioned in recessionary periods. Hormel CEO Jim Snee said the company has been making "numerous strategic acquisitions focused on snacking and entertaining" to accomplish the transformation. In recognition of their strategic portfolio shift, the company announced a corporate restructuring with three new lines of business: retail, food service, and international.¹⁵



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Sunder Ramakrishnan on passing inflation on to consumers

Consumer companies can try to pass on higher prices because of inflation, but there is a trade off because consumers might then shift to less expensive private label goods or leave the category completely.

¹² "Summary Findings Food Price Outlook, 2022 and 2023," usda.gov, Sept. 23, 2022

¹³ Deena Shanker, "Beyond Meat Cuts Sales Forecast as Shoppers Trade Down," bloomberg.com, Aug. 4, 2022

¹⁴ Christopher Doering, "PepsiCo considers more price hikes and product mix changes to combat inflation," fooddive.com, July 13, 2022

¹⁵ "Hormel Foods Corporation (HRL) Q3 2022 Earnings Call Transcript," seekingalpha.com, Sept. 1, 2022

Outlook

Dealing with uncertainty

The outlook for the consumer goods and retail (C&R) sectors hinges on how well consumer spending holds up in light of record levels of inflation and higher interest rates. KPMG Economics now expects the U.S. economy to enter a recession in Q4 2022 and persist for the first half of 2023. The recession is still expected to be mild, but more abrupt and deeper than previously forecast. KPMG expects the unemployment rate to rise to 6 percent versus 5.5 percent in an earlier forecast, but this is still mild when compared to the COVID-19 jobless rate of 14.7 percent and the Great Recession's 10 percent.

By focusing on raising unemployment as the primary way to reduce demand, the Fed is likely to slow overall economic activity, although persistently strong hiring numbers mean that many consumers still have money to spend. With overall consumer sentiment dropping, however, households are watching their spending and switching from branded products to private label goods. Sales of discretionary goods like clothing and big-ticket items like washing machines and electronics are getting hit.

KPMG analysts believe that C&R sector health will depend significantly on the results of the 2022 holiday season shopping, with many retailers warning they have excess inventory they cannot sell. As a result, the first two quarters of 2023 could be brutal for these companies.

In terms of M&A, both strategic buyers and private equity firms are telling KPMG that while they have capital to deploy for good assets, the uncertainty in the macro environment is serving as a brake on possible new deals. Once it is clear that a recession has started and the

uncertainty is better understood, many larger consumer companies are well placed to make acquisitions because they have solid balance sheets from their booming sales over the past two years. In addition, valuations of target companies are coming down along with the rest of the stock market.

Private equity firms also have plenty of dry powder to deploy but they face the

headwind of much higher interest rates because many of their deals are leveraged buyouts. Many PE firms are telling KPMG they are adopting more conservative leverage terms. Nonetheless, they have a limited time to deploy their capital or return it to their limited partners so they cannot wait until the recession is over before investing.

Key considerations as we look ahead

In pursuing M&A in an economic downturn, C&R deal makers will need to recalibrate their focus to ensure success:

- 1 Focus on the portfolio** Revisit the capital agenda to better understand allocation strategies to strengthen the core as well as categories and brands that perform more strongly in a recession. Also consider divesting underperforming businesses.
- 2 Evaluate transactions** Unique opportunities may exist at lower valuations to expand into new markets or to bolster product offerings, with the potential to acquire key competitors that were unprepared for a slowdown.
- 3 Perform detailed commercial and financial due diligence** Understand the impact a potential slowdown may have on brand performance and sustainability of demand across company portfolios, key financial metrics and the ability to navigate battered markets.
- 4 Consider scenario** Model macroeconomic impacts to top line growth and bottom line profitability, and consider ways to mitigate risks.

Robert Gaida on good assets

Competition from strategics and financial sponsors for good assets in the market is still high which may keep multiples at fairly robust levels.

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With a C&R specialization, our teams bring both transactional and operational experience, delivering rapid results and value creation.

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