Hogan Lovells

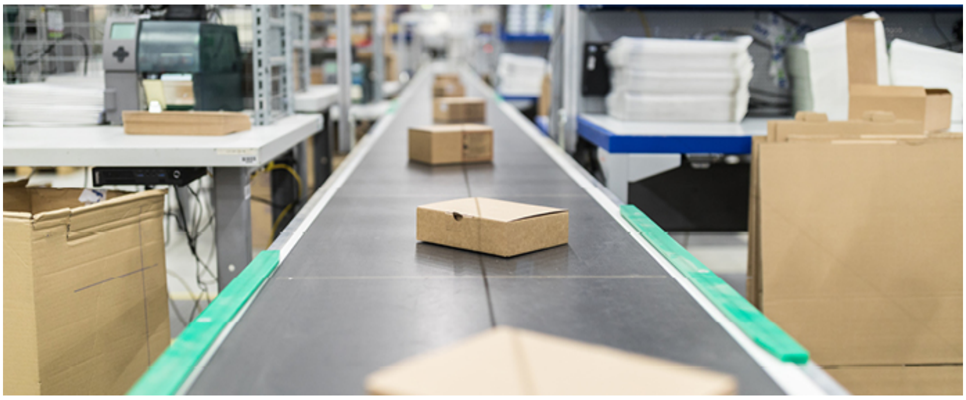
Deal Dynamics
Insights on cross-border M&A

In association with
Mergermarket
An Acuris company

10 Jan 2019 > Insight

Consumer & retail sector deal value rises as companies pursue new business models and growing markets

- Cross-border consumer sector M&A increased 39% quarter on quarter (US$39.4bn)
- Consumer brands turn to M&A to access online sales channels
- Higher trade tariffs expected to put higher pressure on consumer sector than other sectors



Times are changing in the consumer sector. And so are the strategies behind the cross-border deals in the industry. While the underlying motivation for all deals is growth, recent transactions reflect a host of different strategies. Companies are investing for exposure to faster-growing regions, such as China and other Asia Pacific countries. Others are buying digital capabilities with an emphasis on direct-to-consumer, or moving into increasingly trendy categories such as healthy food and drink and all-natural products.

It is these strategies that have been behind many of the major consumer deals in Q4 and throughout 2018. Total cross-border consumer M&A deal value in Q4 2018 came to an estimated US$39.4 billion, a 39% jump from Q3 2018 but a small fall from the last quarter of 2017, which saw US$44.2 billion worth of deals.

Looking at the year as a whole, cross-border consumer M&A value came to US$137.4 billion. While this represents a year-on-year decline of 44.3%, it is not indicative of a steady downward trend in this space, as 2017 was a banner year for the consumer sector. That year, British American Tobacco completed the US$49.4 billion takeover of its U.S. rival Reynolds American, creating the world's biggest listed tobacco company, for example.

China's demand for premium products

The end of 2018 witnessed a strong presence of attractive Asia Pacific acquisition targets. The highest value transaction of Q4 involved Heineken taking a 40% holding in China's largest brewer, China Resources Beer (CR Beer), for US$3.1 billion.

Facing stalling organic growth in their home markets, many consumer goods companies are turning to cross-border M&A opportunities to access expanding markets. The Heineken/CR Beer tie-up gives the Dutch brewer a strategic foothold in China, with CR Beer now owning exclusive distribution rights to the iconic brand. Not only that, European brands and their rich heritage are seen as premium goods and are therefore in high demand among aspirational consumers.

This contrasts with a highly competitive beer market in mature markets such as the United States and the UK, where craft beer has exploded in recent years. This prompted Heineken to acquire stakes in two London-based craft breweries in 2018: Brixton Brewery and Beavertown. However, determining which of the many emerging microbreweries to back is a far more piecemeal and, arguably, speculative strategy than accessing China, the world's largest beer market where long-term demand is likely to rise in tandem with a growing middle class.

Going directly to consumers

Access to still-growing markets is not the only strategy Western consumer brands are pursuing. Many are turning to new sales channels. Swiss group Richemont – the owner of Cartier and Montblanc – upped its stake in luxury online retailer YOOX Net-A-Porter, from 49% to 90%, for €2.6 billion in Q2. Richemont plans to use the platform as a conduit for its own online sales, and in October signed a joint venture agreement with Alibaba to better reach Chinese consumers under the YOOX Net-A-Porter brand.

Within the cosmetics industry, the Asia Pacific region represents both an opportunity for growth, as well as a potential consolidation play. It has been widely reported in the past four years that companies such as L'Oreal and Unilever, among others, have invested in Asia Pacific cosmetics brands. The region not only is the largest skincare market in the world, but relatively fragmented. According to research firm GlobalData, the top five brands – L'Oreal, Kose Corporation, Shiseido Company, Amorepacific Corporation, and Kao – hold no more than a combined value share of 14.2%. Potential growth areas include men's skincare, as well as products made from natural ingredients as consumers become more conscious about what they put on, and in, their bodies.

Health consciousness

The shift towards healthy, organic alternatives clearly extends to the consumer staples segment of food and drink. Younger consumers are steering away from traditional foods and are interested in innovative healthier options.

This was the reported motivation behind PepsiCo acquiring Israel-based Sodastream in Q3 for US$3.2 billion. Sodastream has since successfully repositioned itself as a sparkling water maker. Just as people are shunning fizzy soft drinks, the bottled water market grew by 7% in 2017, and sparkling water sales surged by 38%, according to Beverage Marketing Corp, a clear sign of the shift in tastes.

Challenges on the horizon

The consumer sector, however, is bracing itself for the effects of a number of political and economic developments. Ongoing trade protectionism between the United States and China is expected to increase the cost of products, from bicycles to refrigerators. In addition to 25% of the goods hit by recent tariffs being consumer, the increased prices on the remaining industrial-related goods will raise companies' input costs, which will be passed on to the consumer. Ultimately, this inflation will erode people's disposable incomes.

Another concern in the United States is the tightening of monetary policy. As the Federal Reserve raises interest rates to curb inflation, a fourth hike in 2018 to 2.5% made in December, consumer credit and spending is likely to dip in favor of saving. Moreover, the cost of financing acquisitions is rising, which could dampen M&A activity across all industries. Economic warning signs in the last weeks of 2018 also signal a potential pullback from dealmaking this year.

The bright spot is that any pressure on revenues from consumers reining in their spending, while slowing organic growth, makes the case for highly strategic M&A even stronger. And with new tariffs in place, there is more impetus for U.S. companies to establish a presence in Asia Pacific, and vice versa, rather than rely on costly exports.

Key contacts

Kelly Tubman Hardy
Partner
Washington, D.C., Baltimore

Matthew Johnson
Partner
Perth