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Increasing nationalism to drive more domestic M&A activity in 2017

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Image source Coach

By SARAH JONES

Factors such as slowed growth and accessible capital that contributed to strong gains in merger and acquisition activity during 2016 are set to continue to propel increases in deals this year, according to a new report from A.T. Kearney.

"Off to New Peaks in Uncertain Times" found that throughout 2016, there were 58 "megadeals" valued at $1 billion or more, and overall deal value rose 30 percent over the year prior, surpassing $450 billion for the first time since the recession. Luxury itself has not been immune to blockbuster deals and consolidation in recent history, as independent labels are scooped up in an effort to perform better together than alone.

"The primary drivers of M&A are slow organic growth, consolidation, plentiful capital and strong balance sheets," said Bahige El-Rayes, co-author of the report and a principal in the consumer and retail practice of A.T. Kearney, New York.

"With no sign of a pickup in organic growth, consolidation will be a primary investment theme in consumer/retail M&A again this year," he said. "About 25 percent of executives surveyed believed the trend will continuethe highest endorsement rate among all themes presented.

"We observe record amounts of dry powder at private equity firms and strategic buyers, up 15 percent and 7 percent (for S&P 500 companies), respectively. Possible cash repatriation and reduction in corporate tax rates under the Trump administration may push this trend even further.

"In addition, the environment overall is ripe for disruption and companies are using M&A as a tool to do that. For example, in U.S. retailing, price deflation and online competition are trying to re-ignite growth by acquiring innovative and specialized businesses. Valuations in this space have corrected in 2016, making a range of acquisitions more attractive to potential buyers and contributing to executives' overall optimism regarding M&A."

Coming together

A.T. Kearney's report notes that private equity players and financial buyers slowed down their investing in 2016, accounting for only 16 percent of all M&A activity. For private equity firms, high interest rates made taking on debt to finance acquisitions unappealing, while sovereign wealth funds waited to move amid falling oil prices.

This wait-and-see approach has left investors with capital to spend and the research expects them to be more active buyers this year.

While financial buyers were out of the picture, large companies bought up other players as they looked to spur growth amid slowing organic increases.

Last fall, Este Lauder Companies made its largest acquisition to-date, scooping up premium millennial-centric label Too Faced in a $1.45 billion deal (see story). Earlier in the year, the group also acquired prestige fragrance house By Kilian (see story).

Kilian Hennessy

Competitor L'Oreal Group has also been acquiring more niche labels, adding Atelier Cologne in 2016 (see story).

Meanwhile, conglomerate Mot Hennessy Louis Vuitton acquired luggage maker Rimowa (see story).

As in 2015, the United States and Europe represented about three-quarters of the total deal value. However, with the strength of the dollar against the euro and the pound, Europe came out on top, with 45 percent of all deal value and 44 percent of all transactions during the year.

Image source Rimowa

On the whole, valuations softened in 2016, as buyers avoided risky gambles amid a market with high interest rates. Outside of the outlier megadeals, valuations were closer to rates seen earlier, getting back to the norm.

However, valuations appear to be rebounding in established markets such as the United States, Japan and Europe, pointing to a possible return of growing valuations in the coming year.

"We are witnessing a fundamental shift in consumption behaviors," Mr. El-Rayes said. "Consumers are moving away from affluence value, transaction and one size fits all brands to influence: values, personalized offering and trust based. As a result, we are witnessing a lot of growth of personalized offering and startups that align to consumer expectations.

"Large brands see this as an opportunity and are using M&A as an ingredient to drive growth," he said. "The large strategic corporations are increasingly setting up venture capital funds to screen, identify, acquire and grow startups that allow them to more closely align to consumers."

Acquisition outlook

Polling executives in the retail and consumer goods sectors, A.T. Kearney found that only 1 percent anticipated a slowdown in M&A activity for 2017.

Already in 2017, a number of blockbuster luxury deals have been announced.

For instance, Coach acquired its accessible rival Kate Spade for $2.4 billion. While the newly multi-brand company was also rumored to be buying brands such as Jimmy Choo, its large price tag for Kate Spade has left it doubting any similarly sized transactions in the near future (see story).

Eyewear maker Luxottica also got into the consolidation game, merging with lens producer Essilor to the tune of $49 billion (see story).

Lottie Moss for Chanel eyewear spring/summer 2017

With earnings still lagging, consolidation is expected to remain a key tactic to promote growth.

Often, companies will use an acquisition as a means of extending their reach to new markets. Given the current political uncertainty in the U.S. and some European nations, cross-border transactions may face new regulations.

Only about one in five of those surveyed anticipate a rise in international M&A deals. Coupled with the 67 percent who expect greater global consolidation, A.T. Kearney predicts an increased interest in domestic transactions.

Personal luxury goods are the most attractive sector for mergers and acquisitions, according to Deloitte.

Deloitte's head of merger and acquisition advisory, speaking during the "Investment and Private Equity in the Fashion & Luxury World" session at FT's Business of Luxury Summit May 16, shared new findings on M&A trends between 2015 and 2016, and looking forward to 2018. Forecasting the investment habits of luxury conglomerates and private equity underscores the health of the market (see story).

"We expect strong growth in the luxury M&A industry in 2017 coupled with an increase in multiples," Mr. El-Rayes said.

"After analyzing the strategic drivers of the major M&A transactions in our study, we looked at the acquirers' ability to create value through these transactions," he said. "Our research shows that frequent buyersthose that completed on average two transactions per year or moreincrease value faster than infrequent buyers.

"Whether companies benefit directly from inorganic growth or use acquisitions to fuel organic growth, the enterprise value (EV) growth rate of the frequent buyers is higher than for companies that did not engage in transactions as often during the same period."