SOURCING JOURNAL

COVID -19 Will Spark a New Wave of Consolidation – and Not Just From the Usual Players

By Allan Ellinger

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The coronavirus pandemic is accelerating a number of business trends that we've been watching for the past few years.

In the retail and fashion space, one thing the crisis will undoubtedly speed up is the convergence of legacy players with direct-to-consumer (DTC) businesses through mutually beneficial M&A deals. We've already seen interest in opportunistic acquisitions rise sharply among companies with a history of active buying. Experienced serial acquirers will be plying the waters as soon as the end of the second quarter, looking for strategic opportunities to round out their businesses and replace volume they've lost from retailers forced to downsize during the pandemic.

But even companies that have not made acquisitions in the past are now seeing opportunities on the near horizon. Potential acquirers of all types are on the lookout for companies that offer complementary products and distribution channels, DTC components, and technology and marketing strengths that will help them maximize their e-commerce businesses and compete better with online marketplaces such as Amazon and Walmart. A resilient supply chain, a strong senior management team, a compatible corporate culture and a sustainable business are other important assets that will enhance desirability.

The one thing opportunistic buyers must know right now is that speed is key. As we move out of the worst of the crisis, acquirers will have to move quickly to compete in what will surely be a very active M&A environment.

The coronavirus crisis is accelerating trends

Historically, many digitally native DTC brands offered more promise on the technology and marketing fronts than they did on the product front, and their path to profitability could be long and winding. Venture capital and private equity firms were willing to finance losses on these DTC companies, patiently nurturing their growth and hoping for outsize returns on their investments. But much of that VC and PE funding will likely dry up now. There was already a strong argument building against this strategy before the coronavirus pandemic and that argument is now even more persuasive.

That means unprofitable and undercapitalized DTC and emerging brands without adequate cash reserves may be left with only difficult options as they emerge from the crisis. They may be compelled to take a massive cram-down, sell or even file for bankruptcy protection. Cash-strapped privately held businesses may be in an even tougher situation, as their lenders hold personal guarantees as leverage. For companies in these situations, a sale may be the optimal solution.

A wide range of businesses is looking to acquire this time

During the past 30 years, our industry has experienced three major waves of consolidation: one in the late ’80s through the early ’90s, one following the dot-com bubble in the early aughts through 9/11, and one during the Great Recession of 2008–2009.

The coronavirus pandemic will prompt a new surge of M&A activity, but the particulars will be different than what we’ve seen in the past for a number of reasons. For one, this crisis has hit both the demand and supply sides simultaneously, pressuring companies in complex ways they’re not used to dealing with. Also, a whole class of companies and founders this time around is too young to have ever experienced a major downturn in the economy. Consequently, they’ve never managed a business through a crisis.

These factors will position hundreds if not thousands of companies as targets for potential acquisitions, but it won’t be only the well-established players that are looking to buy this time around. All of the following types of buyers are showing increased interest in acquiring businesses that can provide synergistic and strategic benefits:

- **Consolidators:** The post-crisis surge of consolidation activity will likely reveal some new industry leaders. We expect to see the next PVH or VF emerge, whether publicly or privately held. These new leaders will be looking at a range of acquisition targets that simply cannot make it through the post-crisis period on their own, including emerging and established brands and relevant wholesale businesses—particularly those that have a DTC component—as well as stand-alone DTC companies. For consolidators, these businesses will provide defensible market share and technology infrastructure. In return for partnering with consolidators, the emerging brands, wholesalers and DTC brands will gain operational infrastructure and financial stability.

- **Experienced, deal-savvy strategic operators:** These companies have the know-how and teams in place to move quickly on acquisitions. They know how to perform due diligence, negotiate deal terms, close transactions and successfully integrate businesses. Their experience in getting deals done gives them a unique advantage over competing would-be acquirers—speed—which is crucial because retailers and brands will need to salvage as much seasonal business as they possibly can following the full or partial shutdowns they experienced during the first and second quarters.
- **PE portfolio companies:** PE firms will push their portfolio companies to tactically acquire businesses on their own where it makes strategic and economic sense to do so.
- **Privately held businesses that haven't made acquisitions in the past:** Privately held companies that haven't wanted to pay the premiums required to buy overvalued businesses (whether profitable or emerging) in the past will now find more affordable opportunities at discounted values.
- **DTC companies:** DTC names with healthy balance sheets will be looking to buy other DTC companies that will allow them to add complementary products, new customers and volume to their businesses.
- **Vertically integrated businesses:** Whether they sell to retailers or consumers, businesses that own or control their production facilities are able to bypass intermediaries, which typically leads to increased margins. They have better control than many of their industry peers over production lead times, which also positions them at an advantage. However, some of them will be looking for acquisition targets to enhance their marketing or reach new consumer audiences.

For companies seeking acquisition targets as a result of the crisis, a sustainable business model, a reason to exist and the right cultural fit are the most important things to look for. Other factors to consider include a relevant and complementary product, a brand with a strong persona, technology and marketing strengths, diversified distribution, a talented management bench, a strong, flexible supply chain, and solid, maintained margins.

Partnering with or acquiring the right businesses in the coming months can benefit both parties, but target companies will have to be prepared to make tough, objective decisions about their future—and acquirers will need to be prepared to move fast.

Allan Ellinger is co-founder and senior managing partner of MMG Advisors, a boutique investment bank with a 30-year history of successfully managing financial transactions and providing strategic business advisory services to companies across the retail, fashion and consumer sectors. Led by former retail industry senior executives with decades of combined operational experience, the firm has a unique ability to identify and leverage consolidation opportunities that bridge traditional and new retail.