M&A in Retail

Mergers and Acquisitions are common in retail, but in recent years they have become increasingly high profile. In particular, the acquisition of companies in distress have dominated the headlines. Companies thinking of pursuing a similar route should not neglect properly assessing the value of a target

With the number of distressed retailers on the rise over the past couple of years it is little surprise that M&A activity has risen as well. Retail groups are looking to buy brands out of administration and consolidate their position, but there are also other more strategic motivations for M&A activity. RPC reported a 15% rise in M&As in 2018 from the previous year, however the value of these fell to £3.7bn from £4.3bn during the same period.

The acquisition of distressed brands has been driven, at least publicly, by Mike Ashley. His spate of bids, both successful and unsuccessful, have been targeted at the likes of Patisserie Valerie, House of Fraser, and Evans Cycles. But beyond these we have seen the disposal of Homebase to Hilco for a token £1, JD Sports purchasing a former rival FootAsylum, and HMV purchased by billionaire music mogul Doug Putnam and many more. Not so successful was the Sainsburys – Asda mega merger which was rejected by the CMA earlier this year.

Many of these brands shared a similar theme, all struggling in the current retail climate and facing administration unless they are sold. Though this may be where the commonalities end, what is less clear is the intention behind these acquisitions. Has a genuine turnaround of these distressed businesses been attempted or achieved, are they subject to asset stripping, are they part of a wider strategy, or is little more than a roll of the dice on a business bought on the cheap?

There is a genuine business opportunity surrounding mergers and acquisitions, which explains their seeming popularity at the moment. Corporate restructuring is common and many retail groups periodically go through phases of shedding parts of their business and acquiring others. In this paper I examine why retailers seek to acquire other businesses, whether this represents a sound strategy, and how retailers should react to this increase in M&A opportunities.

M&A Landscape in Retail

Number of M&A deals rose 15% to 37 in 2018

Value of deals fallen to £3.7bn from £4.3bn

53% rise in CVAs for retailers in 2018 from the previous year

Retail administrations in 2018 stood at 43 in total, with 2,594 stores affected

Why are mergers and acquisitions increasing?

Shared Assets and Knowledge: Acquisition targets may have distinct IP, patents, supply chains, or capabilities making them attractive

Bargaining Power: If retailers share suppliers they will look to increase the price pressure they can apply

Cross-Selling: The acquiring company may be intent on widening their reach by selling their products in the acquired businesses stores

Opportunistic: At low prices, some retailers are simply an opportunistic purchase for savvy entrepreneurs

Growth and Restructuring: expanding through other companies can be quicker and more profitable than organically

What is the strategy behind these acquisitions?

The activity of Mike Ashley toward distressed retailers has been interesting. It's hard to see where synergies could be achieved from adding a chain of bakeries to his empire of sports clothing stores beyond adding property to his portfolio. The £8m swoop for Evans Cycles (which was bought for £75m, 3 years previous) shows he is a shrewd opportunist, keen for a bargain and hoping for a lucrative sale a few years down the line. Ashley is acquiring big names with extensive store networks at fire-sale prices, but it seems likely to be little more than a multi-million-pound gamble which he has the considerable financial means to take on.

In contrast to the opportunistic gambles, some acquisitions have been made with the intention of mounting a full turnaround and restructuring the business to make it more viable going forward. Putnam who acquired ailing HMV has just done just this, completely revamping the online store, closing unprofitable stores and changing the inventory and customer experience of those which are staying open. Armed with local music knowledge, extensive vinyl collections and back catalogues HMV will be able to differentiate itself from the likes of Amazon.

Likewise, Homebase is going back its successful roots after a disastrous spell of ownership by Australian Bunning's which axed many of its popular lines and sought to give Homebase a harder 'DIY focused' edge. It has brought back softer home furnishings which were a strong source of revenue as well as shutting its worst loss making stores, and removing inefficiencies from its head office operations.

The failed Sainsburys – Asda mega merger was supposed to bring £1bn in reduced prices thanks to synergies and enhanced buying power. Mike Coupe pledged to pass on some of the enhanced margins to customers but this was given short shrift by the CMA.

Recent High Profile Successful Retail Acquisitions

JACK WILLS

Jack Wills acquired for £12m by Mike Ashley

HOMEBASE

Homebase sold for £1 to Hilco Capital

hmv

HMV bought by Doug Putnam

17 99 GREENE KING BURY ST EDMUNDS

Greene King bought by Hong Kong based CKA

Will it work and what's next?

The most recent acquisitions will take time to see if they are successful, a turnaround is a protracted process therefore determining whether the opportunistic purchases represent a clever strategy is difficult. Evans Cycles at least seems to have stabilised and is reporting a slightly increase in revenue thanks to e-bike demand, but still overall making a small loss in 2018. The early signs from HMV are promising, it has recently overtaken Amazon as the #1 retailer of physical music in the UK.

Homebase is over a year into a 3-year turnaround strategy and is already seeing the benefits of a return to its roots. It has removed £100m from its fixed costs base and reduced its losses 96% to £8.2m in the 6 months to December 2018. It is far from a glowing success story yet, with the distressed retailers still making a loss, but the purchase of Evans and the long-term turnaround strategies of Homebase and HMV already seem to be bearing some fruit.

Distressed retailers will always appear an attractive acquisition target, a set of poor results can send the value of a retailer plummeting meaning they can be bought for a much-reduced sum. A reversal in fortunes whether engineered through a turnaround strategy or more naturally can quickly increase the value of the company making a future sell off a highly profitable venture.

The increase in acquisitions is likely to linked in some extent to the relative success, or failure, of certain brands. While the challenging retail conditions prevail in the UK, M&As will look continue be a preferred strategy for many retailers seeking to reinforce their positions

Opportunist retail bosses and private equity firms will always be keen for a bargain, and down on their luck brands present an attractive opportunity. Those in more serious decline require active intervention in order to save them, therefore the likes of HMV and Homebase, will attract the enthusiasts and turnaround specialists such as Doug Putnam and Hilco Capital who are intent of reviving a struggling brand over the longer term.

Is this a good thing for brands and consumers?

If an ailing, but fundamentally popular, brand is saved from administration via an acquisition then keeping the business as a going concern is good news for the retailer and its customers. High profile victims in recent years such as Jamie's Italian and Toys 'r' Us left thousands of people unemployed and deprived consumers of a brand which was generally well liked.

The recent news that 550 Thomas Cook stores were to be saved by being snapped up Hays Travel was met with widespread joy and relief from not only Thomas Cook staff but also by the public in general who were saddened by the loss of a great British stalwart. The acquisition in this case will be beneficial to the business as well as consumers.

The Competition & Markets Authority took less of a positive attitude towards the proposed mega merger between Sainsbury's and ASDA which was blocked earlier this year on the grounds that it could lead to higher prices in-store, online, and at petrol forecourts despite the two businesses pledging to pass on savings achieved through synergies onto consumers. Clearly the jury is out over whether the recent spate of mergers & acquisitions in the British retail market are overall a good or bad thing.

How should retailers react?

Retail businesses looking to make an acquisition shouldn't forget the fundamentals around making a purchase of another company. As always, the intrinsic value of the company should be fully evaluated to ensure that the purchase represents good value for money. Does the target hold enticing patents, extensive store networks, loyal customer base, supply chain expertise for example? Furthermore are there synergies to be achieved from the acquisition?

Adhering to the principles of corporate due diligence should be of paramount importance to all retailers looking at making an acquisition, and the opportunistic tactics of Mike Ashley are unlikely to be found in any textbook about prudent investing or retail strategy.

Despite this, the turbulent times we are currently experiencing raises the spectre of company values plummeting and low prices will bring out the bargain hunters. The old adage of there being strength in numbers is of special importance in this retail era of CVAs, Brexit, and lower consumer confidence. Consolidating your position, purchasing a rival, and creating synergies between two companies is now very much an item on the agenda at most retailer's board meetings.

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Conor is a an experienced Retail Consultant, having worked with some of best retailers on large scale programmes in the UK and Internationally.