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In Focus: Business Insights

Think Tank

Beauty M&As See Signs Of Rejuvenation

William Blair's Lindsay Carlson shares insights into the resiliency of the beauty industry.

Skin care has emerged as 2020's version of the "lipstick index," referring to the tendency of consumers to indulge in an affordable way amid recessionary periods.

Photograph by Adobe

For the past several months, consumers have been in a constant state of adjustment when it comes to their beauty, health, and wellness routines as lockdown-induced habits set in and face masks became key fashion accessories. Dealmakers throughout the industry have had to adjust their playbooks in the pandemic as well. Travel bans and social-distancing requirements necessitated a shift from crowded conference rooms to video calls and virtual M&A processes.

While COVID-19 continues to dominate the headlines, we are seeing many beauty, health, and wellness companies regain their footing after pandemic-induced disruptions. This is creating pockets of opportunity for well-positioned companies to revisit strategic discussions and map out their M&A plans, especially for companies with strong brands, digital and social prowess, and attractive financial profiles. Moreover, the broader backdrop is now more favorable, as we have seen the lending market show signs of resurgence and public equities rebound. As we head into the final weeks of the summer, M&A activity is heating up as companies look to test the market amid improving sentiment. This growing momentum comes on the heels of a steady climb in global transaction activity from April's pandemic-induced lows. For all deals ranging from $150 million to $5 billion in enterprise value, July saw 171 deals close totaling $88 billion, compared with only 70 deals totaling $28 billion in April.

We expect this trend to continue with a wave of deal activity to launch or relaunch shortly after Labor Day as companies look to potentially transact ahead of the U.S. presidential election. This insight is derived from our robust pipeline at William Blair, which currently includes more than 100 sell-side engagements. Ongoing conversations with these companies provide us real-time visibility into how buyers and sellers across industries are reengaging and navigating deal processes. These unique, real-time perspectives have given us confidence about the health of the overall M&A market for the remainder of 2020 and provide invaluable market intelligence as we guide clients through the "new normal."

Behind Beauty's Resiliency

Segments of the broader consumer industry have proved to be resilient in past downturns, and beauty remains one of the bright spots in the current environment. Consumer behaviors and preferences have adjusted, but excitement for beauty overall and the important role it plays in our daily lives is here to stay. The pandemic has had significant implications for brands and their dedicated retailers, but the overall beauty category is showing signs of strength – and is now more relevant than ever.

At a time when health is paramount, it is not surprising that the lines between beauty and wellness continue to converge. Brands that offer consumers innovative products are winning in today's environment. Examples include e.l.f. Beauty's new Full Spectrum CBD collection, which serves to refresh, revive and recenter the mind and body. The company, whose IPO William Blair helped underwrite, posted strong results for its first-quarter fiscal 2021 ending June 30, which according to William Blair research analyst Jon Andersen were "aided by highly relevant innovation, stepped-up marketing, and e-commerce investment, and enhanced in-store merchandising." A core growth driver of e.l.f.'s outperformance was its skin-care line, helped by on-trend products such as Holy Hydration face cream, which is a form of self-care today. Skin care has emerged as 2020's version of the "lipstick index," referring to the tendency of consumers to indulge in an affordable way amid recessionary periods.

Skin care is not the only category experiencing robust demand; hair care, bath and body personal-care products, and even vitamins, nutritional supplements, and home fragrances are experiencing a demand surge given the renewed self-care focus. Many companies operating in these segments have been experiencing growth fueled by industry tailwinds, especially companies with authentic stories, safe and transparent ingredient profiles, track records of innovation, and direct-to-consumer capabilities.

Other players benefiting from strong performance across the beauty category are value-added formulators, product developers, and manufacturing partners. William Blair has seen this firsthand, serving as the exclusive financial adviser to Kik Custom Products in connection with the sale of its Personal Care division to Voyant Beauty. Kik Personal Care is a leading North American manufacturing partner and formulator of personal care, prestige beauty, OTC/Rx, and household products for global CPG and fast-growing asset-light brands. The deal closed on Aug. 20.

Leading companies in beauty and other resilient consumer sectors are attracting the attention of venture capital investors, family offices, private equity investors, and strategic acquirers. This broad group of investors and acquirers is focused on the space because of the cyclical resiliency, loyalty from a passionate and engaged customer base, and attractive valuations in recent years.

Signs of Life in the M&A Market

Dealmaking has always been a relationship-driven endeavor, and relationships are more important today than ever. While face-to-face meetings are constrained and other social-distancing measures remain in place, early engagement and counter-party trust are critical to M&A processes. At William Blair, we saw narrower deal processes through the summer – many of which were catalyzed by inbound investor interest or an opportunistic matching of investors and sellers with existing relationships. Now as we head into the fall and bidders get more comfortable with M&A in this environment, we expect broader deal processes to return.

As deals come off pause and activity accelerates, we have also seen an uptick in dialogue with companies that have performed well during the pandemic, have good financial visibility, and are well-positioned to thrive going forward. Given the attractiveness of such companies, we expect investors may be willing to pay a premium for healthy, high-quality assets that can bring stability and scale to a portfolio.

For efficiency and risk-management reasons, many cash-rich strategic acquirers have track records of buying proven brands rather than trying to build them in-house. For these buyers, the pandemic has amplified the importance of acquiring "need to own" assets that add unique capabilities, channel or geography diversification, or some combination of these benefits. As such, the current environment is creating new dealmaking opportunities for strategic acquirers that are already familiar with the industry, a specific business, and its management team. Today's opportunities are particularly ripe if parties are willing to move quickly and be creative around deal structures. Moreover, private equity investors are sitting on record levels of dry powder and face pressure to expeditiously deploy this capital; this pressure is especially acute for funds approaching the ends of their investment periods. These dynamics and the excess capital in the market are facilitating competition for quality assets and can lead to advantageous outcomes in certain situations.

Deals Beget Deals. What Should Sellers Do to Prepare?

For companies contemplating a future sale, it is important to proactively address COVID-19's impact on the business, overall market, and key channels. Investors will be focused on the impact of COVID-19, so sellers need to be prepared with supporting analyses to aid in their situation assessments. Potential sellers will also want to be prepared for key diligence topics such as customer concentration, margin sustainability, barriers to entry, and competitive dynamics. Furthermore, external initiatives from third-party providers, such as data from market analyses, brand studies, and quality of earnings reports, can help sellers prepare for diligence conversations. Lastly, a well-articulated growth plan that outlines value-creation opportunities will be key to building market demand and excitement ahead of a future process.

Lindsay Carlson is a senior member of William Blair's Consumer & Retail Investment Banking Practice.