HOULIHAN LOKEY

CONSUMER, FOOD, AND RETAIL

CONSUMER PRODUCTS MARKET UPDATE | **COVID-19**

Consumer Products Overview

Houlihan Lokey presents an assessment of the economic impact of COVID-19 on the consumer products industry, including its impact on different consumer segments and valuation trends as well as near- to immediate-term transaction considerations, immediate strategic and financial challenges, priorities for companies and investors, and how Houlihan Lokey can assist in this evolving and dynamic market.

Overview

Over the past month, COVID-19 has sent global shock waves through the markets and captured the attention of the world. Since mid-February the outbreak has accelerated, and infections have become widespread, resulting in significant market volatility that is expected to continue in the near term. The primary responses to COVID-19 have been regulations and restrictions intended to slow the spread of the virus and fiscal and monetary actions aimed at mitigating the impact of such measures on the economy and citizens. Measures intended to slow the spread of the virus, such as social distancing and other restrictions, created substantial disruption to business operations across all sectors of the economy, including the consumer products industry.

As COVID-19 and the resulting economic consequences continue to evolve, we are closely monitoring the capital markets and speaking with business owners across the consumer products industry. The general near-term outlook of the consumer products industry is varied to some degree by subsector. However, one certainty is that volatility will likely persist until the overall impact of COVID-19 and other macroevents can be determined. As industry participants navigate these unprecedented times, there are clearly a number of challenges and opportunities that will arise.

We will continue to be a sounding board for our clients and other market participants as we collectively assess opportunities and challenges in the current environment. We bring to bear a broad range of product and service solutions across the capital structure, and we stand ready to discuss the impact of this crisis on the consumer products industry and your business.

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Real-Time Market Intelligence

Volatile market conditions have created a great deal of uncertainty for businesses, particularly in the consumer products industry. Key market trends and observations are outlined below.

M&A

- Deal volume and pace of execution have slowed dramatically
- Deals may require significant structured solutions to close (stock for stock, structured equity, seller paper, bridge financing, etc.)
- For the few deals that are currently in market, terms are being re-evaluated (i.e., economic and legal terms, particularly MAE/MAC clauses) with extended timelines and financing contingencies
- Many change-of-control transactions will be effectuated through secondary-market purchases of distressed debt

Capital Markets

- Economic implications of COVID-19 continue to manifest in the debt markets in the form of credit rating downgrades and an increase in debt trading at or below distressed levels
- Non-traditional sources of capital are becoming more prevalent (direct lending funds, diversified asset managers, finance companies, insurance companies, family offices, mezzanine funds, mutual funds, pension funds, structured equity providers, and special situations/opportunity funds)
  - Limited dry powder for unlimited opportunities
- Capital providers looking for good companies with bad balance sheets; differentiated and defensible platforms
  - Near-term structured liquidity solutions/rescue financing
  - Opportunistic M&A
  - Private investments in public equities (PIPEs)
- Liability management strategies will be important to evaluate
  - Amendments, consents, repurchases, tenders, exchanges, etc.

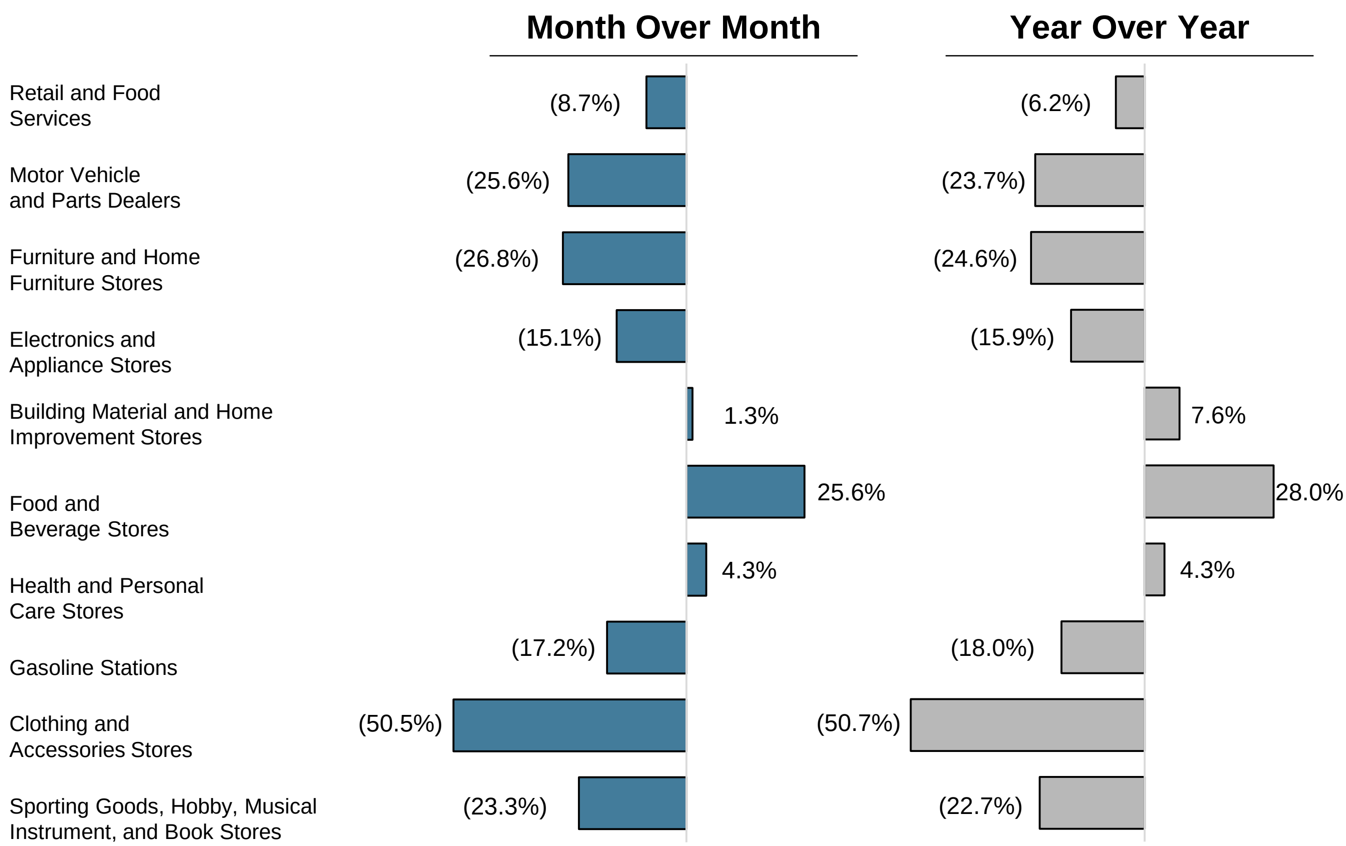
Debt Restructurings

- Expect to see a wave of liability management, liquidity-enhancing transactions, and comprehensive balance sheet restructurings within the near-to-intermediate term
- Capital structure challenges are exacerbated by the unknown length of social distancing measures
  - Liquidity, financial covenant compliance, upcoming debt maturities, and debt capacity are important considerations
- Current market conditions may limit out-of-court solutions, forcing many companies to pursue an in-court process
  - Chapter 11 plan of reorganization, Section 363 sale process, or liquidation
- Optimal solutions will reduce debt service and optimize asset base while positioning for post-reorganization strategic alternatives

Market Perspectives – Retail Sales

The impact of the COVID-19 pandemic and the resulting economic shutdown has had a material impact on consumer product sales in March, with total U.S. retail sales declining nearly 9% from the prior month—although these results were quite mixed across segments.

Key Category Performance: March Retail Sales



Key Considerations

Driven by an unprecedented shift in channel consumption from food away from home to food at home, retail sales at food and beverage retailers were up more than 25% in March. Health and personal care and home improvement retailers also experienced seasonally adjusted month-over-month gains, largely driven by an increase in sales of cleaning, sanitation, personal hygiene, and related products.

Conversely, highly discretionary and/or big-ticket items have seen the most significant immediate declines, as clothing and accessories, furniture, and other specialty retailers experienced month-over-month declines of more than 50%, 26%, and 23%, respectively.

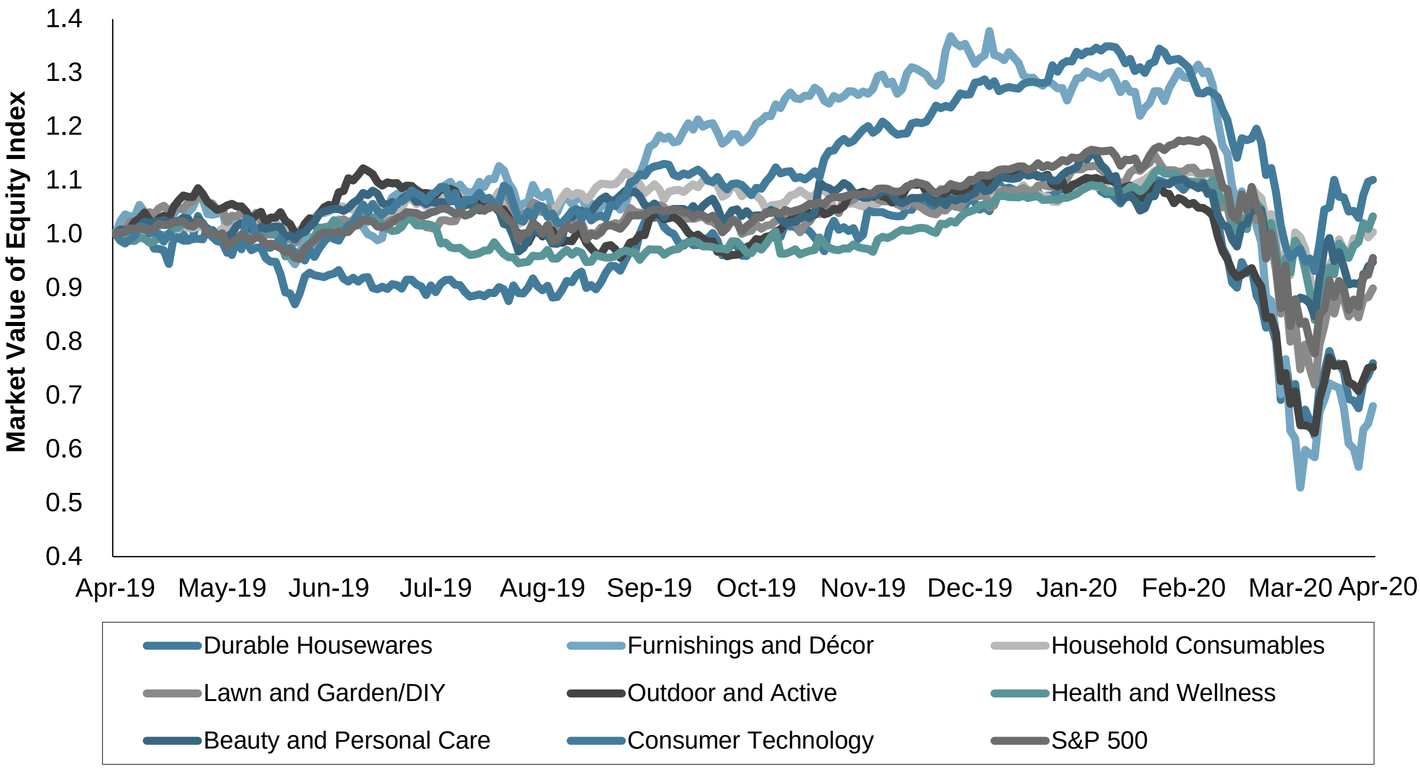
Given the nearly nationwide shutdown of all non-essential retailers, eCommerce and non-store retail spending is serving as the primary growth channel during the crisis, increasing more than 12% in March over the prior year, which accounted for more than half of all retail gains in March.

Source: U.S. Census Bureau Monthly Retail Trade Report

Valuation Perspectives – Recent Performance

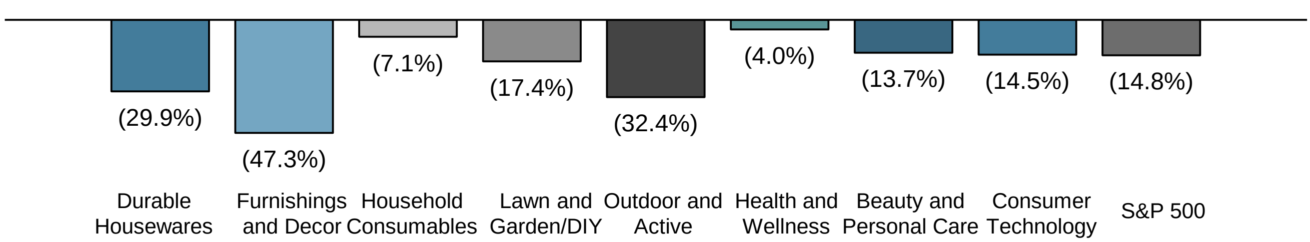
Public Company Market Value of Equity

Houlihan Lokey's Consumer Products Indices vs. S&P 500 During the Past 12 Months

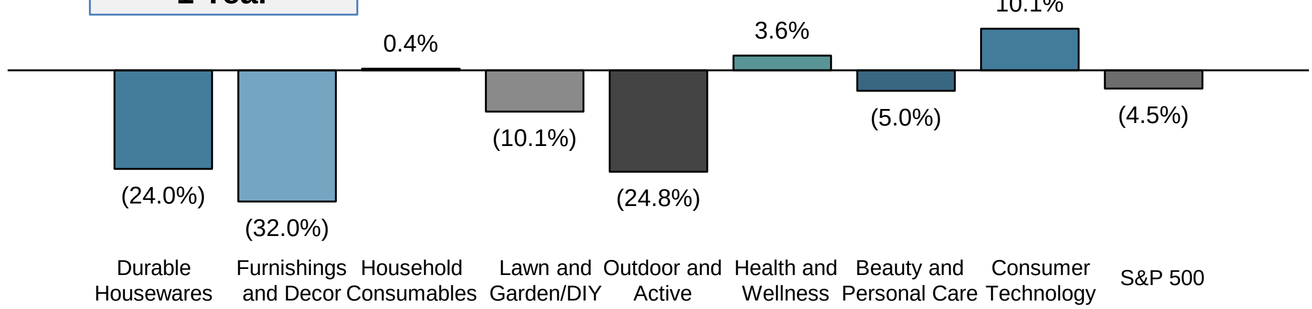


Consumer Products Industry Market Value Indices Performance Relative to S&P 500

Year to Date



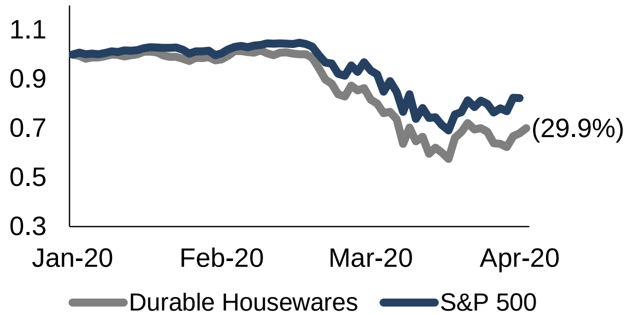
1 Year



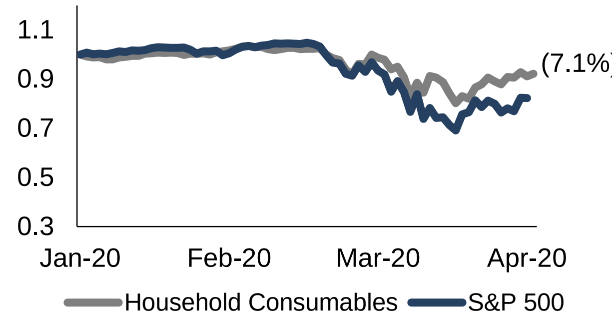
Source: S&P Capital IQ

Valuation Perspectives – Recent Performance (Cont’d)

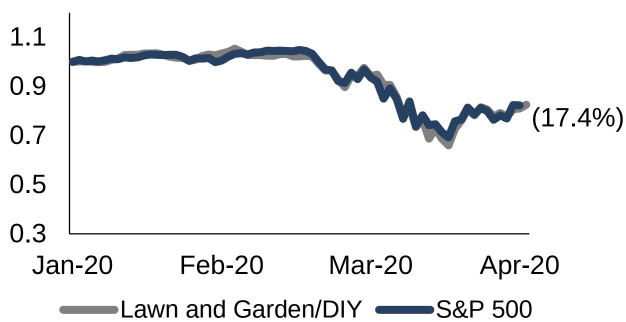
Durable Housewares



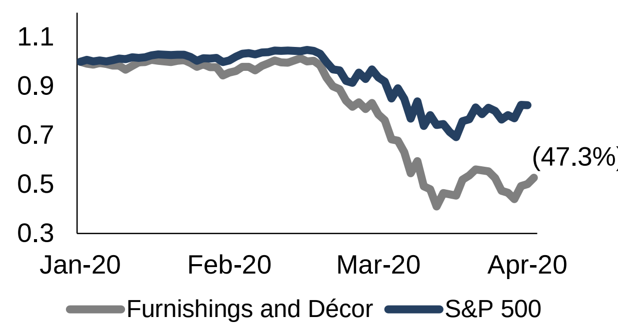
Household Consumables



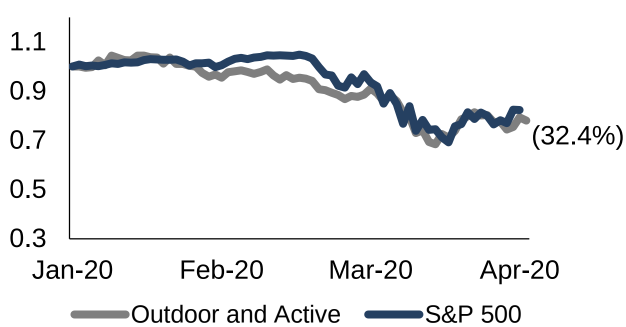
Lawn and Garden/DIY



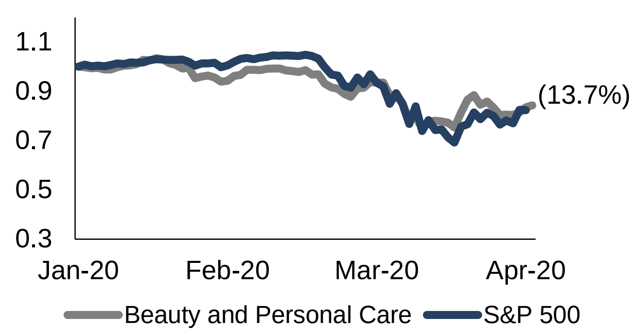
Furnishings and Décor



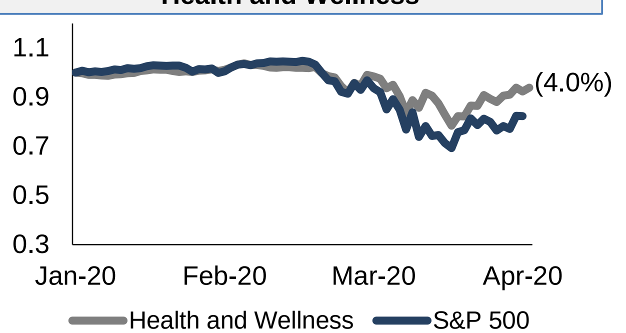
Outdoor and Active



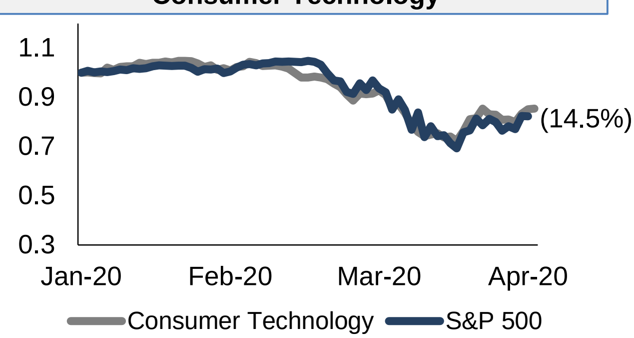
Beauty and Personal Care



Health and Wellness



Consumer Technology



Source: S&P Capital IQ

Capital Markets Update

Recent market volatility has tempered capital markets activity as lenders seek greater visibility.

COVID-19 continues to drive volatility as the economic impact of the virus is felt across markets. Measures taken by the Federal Reserve to stimulate the economy drove Treasury yields and LIBOR to historically low levels, but benchmark rates have since rebounded. While both high-grade and high-yield issuances have resumed at wider terms, many lenders have postponed underwriting new commitments and are approaching today's market with greater scrutiny through the following:

- Delays and revisions for existing commitments and downsized facilities
- Increased focus on stress testing investments, particularly downside forecasts
- Increased portfolio monitoring to understand the medium- and long-term impact of COVID-19

Private debt markets have shown a level of relative resilience over the past several weeks in contrast to the public debt markets. While leveraged loans and high-yield bonds sold off to about 75% of par in mid-March and new issuances have been effectively halted, direct lenders generally remained open for business. Federal Reserve action stabilized the secondary leveraged loan and high-yield markets, with prices returning to the mid-80s by early April. New, federally supported loan programs under the CARES Act are beginning to provide liquidity as well but are limited in flexibility with banks struggling to efficiently deploy funds.

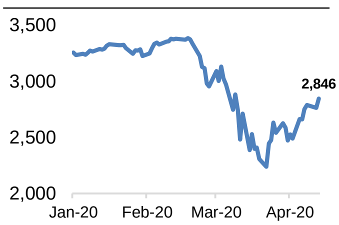
Despite higher costs of capital and greater term structure, opportunities remain abundant in this environment. Corporate players may consider utilizing their "excess" liquidity post-stress testing scenarios or, in the case of sponsors, dedicated pockets of capital for rescue financing or minority investments in cases like these:

- If a transaction has been put on hold, select owners of those assets may still desire some liquidity for their equity and/or debt positions
- Structured investments in situations where lenders are reducing financing availability
- Equity or junior capital investments to appease lenders in situations where the company is currently violating, or will likely violate, covenants and/or where strategic partners can make a valued addition

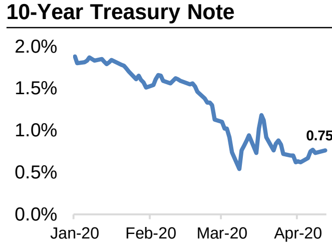
Overall, the credit markets have, at least momentarily, flipped the scale against M&A and created an uphill battle for the sponsor community. While lenders seek stability in the near term, we must employ ingenuity and logic to create a favorable outcome for shareholders.

Below we share various graphics on market performance from January 20, 2020, to April 14, 2020:

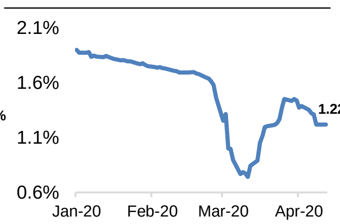
S&P 500



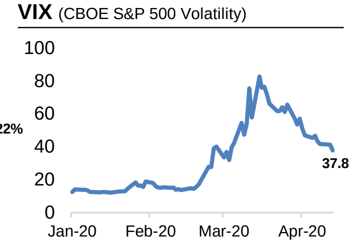
10-Year Treasury Note



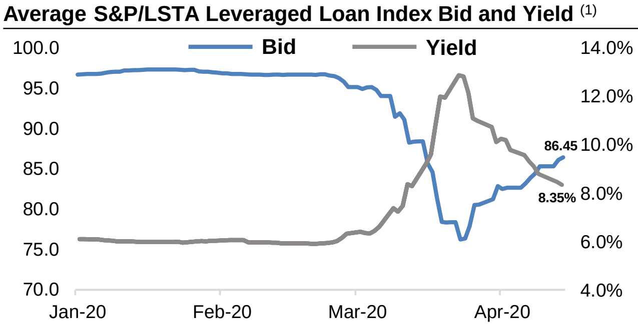
3-Month LIBOR



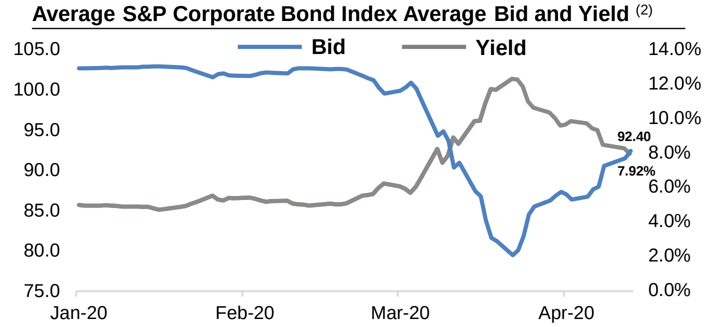
VIX (CBOE S&P 500 Volatility)



U.S. Leveraged Loans:
Average S&P/LSTA Leveraged Loan Index Bid and Yield (1)



U.S. High Yield:
Average S&P Corporate Bond Index Average Bid and Yield (2)



Sources: S&P LCD, LFI Weekly, S&P Capital IQ
Note: Market data as of 4/14/20 market close
1) Daily data, as of 4/14/20
2) Daily data, as of 4/14/20; reflects the single B-rated HY market

Company Checklist

As the COVID-19 crisis continues to unfold and the economic reality of the situation becomes more evident, private equity funds and their portfolio companies, as well as corporates, will need to remain vigilant to ensure the proper steps are being taken to mitigate downside risks.

A detailed financial assessment is of paramount importance during tumultuous times. Companies need to understand their financial situation and be mindful of liquidity constraints in a worst-case scenario. Companies may want to consider the following actions:

- Updating underlying assumptions in financial forecasts, specifically cost of capital
- Stress testing financial forecasts to identify potential covenant breaches (including impact of revolver)
- Scenario analyses to model and monitor potential liquidity levels via 13-week cash flow forecasts and a variety of harsh-to-mild scenarios
- Proactively communicating with significant lenders
- Identifying all available government stimulus packages (e.g., federal loans, tax breaks, etc.)
- In the case of financial sponsor-driven companies, augmenting portfolio companies' financial staff with sponsor personnel to better address the fallout
- In the case of corporate entities, augmenting subsidiaries in greatest need of financial help with corporate, treasury, and other staff to run stress tests

Companies should work hand in hand with customers and suppliers to understand their primary concerns and business risks. An open line of communication with customers and suppliers will allow companies to respond more quickly to challenging circumstances. Below are several actions that can be taken:

- Partnering with critical customers and vendors to address specific business risks
- Monitoring credit risk of customers and suppliers, distinguishing between liquidity and solvency issues
- Considering negotiating payment options with customers and suppliers (i.e., early payment discounts or extensions of receivables/payables) to navigate business risks
- Seeking substitute or alternate suppliers in the event of supply chain disruption

The outbreak may lead to a number of employee-related challenges that managers need to be ready to address. It is imperative that companies find a balance in order to maintain productivity while prioritizing the safety, health, and well-being of employees. We recommend companies consider taking the following actions:

- Identifying critical, on-site employees and establishing protocols for working on site while being mindful of best practices for social distancing to reduce the risk of community transmission
- Developing policies geared toward encouraging working remotely while maximizing productivity

Defensive/Stabilization Priorities

- *Ensuring employee/partner health and safety*
- *Assessing near- to intermediate-term business impact and evaluating downside scenarios*
- *Optimizing the cost structure*
- *Managing liquidity, maturities, and covenants*
- *Evaluating debt restructuring alternatives*
- *Evaluating activist takeover defense considerations*

Offensive/Optimization Priorities

- *Identifying potential new sources of capital*
- *Evaluating value-enhancing liability management strategies*
- *Pursuing opportunistic M&A, including potential consolidation opportunities and strategic add-ons*
- *Evaluating divestiture opportunities, particularly for non-core assets*

How Houlihan Lokey Can Help

Our firm is extremely well equipped to help our clients navigate uncertain times. We respond quickly to challenging situations and are constantly helping clients to analyze, structure, negotiate, and execute the best possible solutions from both a strategic and a financial perspective.

What We Offer

1 Corporate Finance

- Mergers and Acquisitions
- Capital Markets
- Private Funds Advisory
- Board Advisory Services

2 Financial Restructuring

- Company Advisory
- Distressed M&A
- Liability Management
- Creditor Advisory

3 Financial and Valuation Advisory

- Portfolio Valuation and Fund Advisory
- Transaction Opinions
- Corporate Valuation Advisory Services
- Transaction Advisory Services
- Real Estate Valuation and Advisory
- Dispute Resolution Consulting

Corporate Finance

We have been the most active advisor to the consumer products industry for more than a decade and have long-standing relationships with capital providers, including private equity funds, family offices, commercial banks and other senior credit providers, insurance funds, asset managers, and mezzanine fund investors.

Financial Restructuring

We have the largest special situations practice of any global investment bank. Since 1988, we have advised on more than 1,000 such transactions (with aggregate debt claims in excess of $2.5 trillion). We served as an advisor in 12 of the largest 15 bankruptcies from 2000 to 2019.

Financial and Valuation Advisory

Over nearly four decades, we have established ourselves as one of the largest financial and valuation advisory firms. Our transaction expertise and leadership in the field of valuation help inspire confidence in the financial executives, boards of directors, special committees, investors, and business owners we serve.

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