

2022 China Consumer & Retail Investment Forum

New Consumer Opportunities in the Post-Pandemic Era

November 2022



Overview of the Forum

The 2022 China Consumer and Retail Investment Forum, hosted by BDA Partners and OC&C Strategy Consultants, was a great success. The Forum focused on Consumer investment opportunities for the post-COVID economy. **65 senior executives attended**, from multinational corporations, state-owned enterprises, publicly-listed companies, and leading private equity firms. We held a series of lively panels discussing market trends, outlook and opportunities coming out of COVID.

Since the outbreak of COVID in 2019, the Consumer and Retail industry has been severely impacted, with investor confidence greatly dampened. COVID was a stress test for enterprises of all sizes, challenging the vision and capability of every player in the industry.

Bringing deep insights into the Consumer sector, BDA and OC&C co-hosted the in-person gathering in Shanghai. The Forum comprised keynote presentations and panel discussions, illuminating the post-COVID macro environment, industry trends and outlook, M&A and capital raising opportunities.



Participants

Keynote speakers



65 attendees from 50 firms: MNCs, SOEs, listed companies and PEs

Corporates



PEs



Capital market and macro environment in 2022

Internal and external challenges slowing down China's economy

The macro environment and market conditions in China have changed dramatically since the pandemic. According to the data from the National Bureau of Statistics and the International Monetary Fund, China's GDP growth rate has fluctuated over the past three years, with growth declining. The market is facing many internal and external challenges in a complex and changing environment.

Internal structural challenges

- **Fading demographic dividend:** declining birth rates, aging population, and rising labor costs
- **Weakened domestic demand:** increased costs of housing, education, and medical care has had a material impact on discretionary income
- **Slowing urbanisation:** Urbanisation rate reaches 65% in 2021, a <1% annual increase for the first time in 25 years, and is expected to hit a 70% ceiling in 2030

External unexpected factors

- **COVID-19 impact:** key sectors such as hospitality, restaurants, and retail have been plagued by uncertainty related to necessary lockdown restrictions
- **Sino-US relationship:** adverse impact on investor sentiment caused by rising geopolitical tension
- **Imported inflation risk:** China's inflation risk has been under control so far, but corporate profit margins could be further squeezed if commodity prices remain high

Effective government policies to drive China's economic growth

In response to the internal and external challenges faced by China's economy, we expect that the Chinese government will employ tailored and effective approaches to stimulate the economy:

- **Stimulate domestic demand** → Maintain and increase the consumption level of the middle-class by stimulating consumer demand and reducing rigid burdens such as housing prices
- **Incentivise growth of lower-tier cities** → Improve the living and consumption standards of lower-tier cities' residents; boost employment, expand consumer base, and develop new regional markets through continued infrastructure development and health insurance coverage
- **Boost the "Big Health" industry** → Employ specific policy initiatives to promote the development of health and wellness, fitness venues and equipment, psychotherapy, and other relevant fields
- **Promote ESG concepts** → Establish administrative goals such as "emissions peak" and "carbon neutrality" to guide social capital investment; set up preferential policies to support company growth while promoting green consumption and raising consumer awareness

C&R investment trends

Given the new macro environment, as well as changes in consumer behaviour, lifestyle, and policies, guests discussed investment themes shaping the consumer market landscape post-pandemic, including:

- 1 Rising personal health awareness drives consumer demand for nutritional food and wearable devices
- 2 Opportunities for and challenges of pre-cooked food in the "single economy"
- 3 Raising focus on price efficiency creates value for discount stores and second-hand luxury goods
- 4 Supply chain companies with stability gain extra market attention in a volatile environment

C&R investment themes

1

Increased focus on personal health drives consumer demand for nutritional supplements and wearable devices

Background

- Aging population: ~50% population will be 45 or over by 2030
- Health issues such as hair loss, obesity, gastrointestinal diseases, and depression are becoming common themes among the younger generation
- Increased consumer focus on health after the continued waves of pandemic
- The “14th Five-Year” national health plan set forth principles such as “health first” to stimulate the “big health” industry

Industry insights

- As nutritional products acquire higher recognition among consumers, product categories started to diversify in order to cater to specific needs among various populations
- The industry landscape for dietary supplements and functional foods varies greatly:
 - Nutritional supplements require stronger R&D capabilities, facing stringent criteria for certification. As a result, the market is relatively concentrated with larger players
 - Functional foods industry has lower entry barriers with more room for innovation. The market includes players from different backgrounds such as start-ups, F&B companies, pharmaceuticals, etc.
- As consumers start to more actively manage their health, demand for health monitoring wearables has surged. We have observed a 20%+ CAGR in the children’s smartwatch sub-segment alone

Investment focus

- Due to the high barrier to entry for nutritional supplements, M&A is an ideal means of entering this industry
- Functional foods industry is in its early stage in China with most capital raises in 2019-2021 occurring as pre-Series A rounds
- In the wearables sector, rehabilitation, health monitoring, and AR/VR wearables are attracting significant investor attention

2

The opportunities for and challenges of pre-cooked food in the “single economy”

Background

- The “single economy” refers to a large, fast-growing single (non-married) population in China
- Pre-cooked food can help retail consumers save time and cost
- Consumers have consistently expressed their desire to eat high-quality yet difficult-to-cook meals at home
- Since food safety and quality is better regulated in a factory than in a restaurant kitchen, pre-cooked solutions can help restaurants save costs while maintaining quality
- The pandemic has accelerated “catering retail”, i.e. selling frozen foods and takeaway at restaurants. The typical 30-minute delivery window makes pre-cooked solutions now a consumer staple in China

Industry insights

- The pre-cooked food industry, including both B2B and DTC segments, is currently in a phase where players are fighting to gain market share with no clear industry leader
- Demand for taste, variation, and differentiation of pre-cooked foods imposes high requirements for product design, R&D, and quality control
- The roadmap to commercialising B2B pre-cooked food business has been relatively clear with strong advocates from both restaurants and regulators
- To commercialise and expand the addressable market of DTC pre-cooked food, companies will need to continue educating consumers on “food quality,” “taste,” and “healthiness” concepts in pre-cooked foods
- Key advice for building and managing a DTC pre-cooked food brand: 1) develop recognisable products in line with consumer preference; 2) earn consumer trust in food safety; 3) build up supply chain barriers; 4) identify and offer a suite of products for various consumption meals and dining scenarios to increase consumption frequency

Investment focus

- Investors currently focus on B2B pre-cooked foods as this segment is larger, more mature, and establish a platform to eventually enter the DTC end-market
- However, restaurant chains are actively exploring opportunities in DTC pre-cooked foods on top of building B2B pre-cooked solutions
- Investors are placing premiums on companies with strong R&D capabilities, well-managed food safety controls, and effective supply chain management

C&R investment themes (cont'd)

3 Increased focus on price efficiency creates value for discount stores and second-hand luxury goods

Background	Industry insights	Investment focus
<ul style="list-style-type: none"> The economic downturn and pandemic led to lower per capita disposable income and consumption, and food discount stores responded by offering attractively priced products to serve changing consumer needs Apart from “value-for-money,” food discount stores also cater to the needs of brands and distributors by handling near-expiry food inventory The rise of new retail technologies and increased IoT adoption has drastically improved efficiency in the delivery of near-expiry foods Luxury goods resale has become a new type of “value-for-money” with China’s vast luxury goods surplus bolstering the market’s development 	<ul style="list-style-type: none"> With digitalisation disrupting the traditional retail grocery industry, even small “mom-and-pop” stores can increase sales and broaden customer reach via apps/mini-programs Food discount stores in smaller formats are becoming popular in the market. Due to the pandemic, customers’ preference and reliance on stores where they can shop anytime has increased Compared to community wholesale businesses, the hard discount model is a more stable & sustainable alternative The luxury resale market is bolstered by consumer’s continued interest in luxury brands and various online marketing strategies; establishment of compliance systems by top resale platforms and supportive government policy that further enhances consumer confidence in the resale market 	<ul style="list-style-type: none"> Food discounters that offer a full range of products and are conveniently located will gain more market share Investors value food discounters with scale, online, and stable supply chain stabilities For luxury resale platforms, marketing capabilities, clear business model, inventory management, and authentication capabilities are key

4 Supply chain companies with stability gain extra market attention in a volatile market environment

Background	Industry insights	Investment focus
<ul style="list-style-type: none"> The previously seen rapid growth of the consumer sector stimulated the expansion of upstream supply chain companies in China As supply chain management is essential towards the operations of consumer companies, more and more companies have started to take actions to exercise control over their supply chain to adapt to changing market conditions While consumer brands are at risk of being replaced, supply chain companies exhibit resilience and stability in a volatile environment given their mission critical nature 	<ul style="list-style-type: none"> Many domestic food-related supply chain companies are actively applying or preparing for IPO, including food ingredient providers, condiments providers, nutrition food ingredient providers, and food packaging companies Some food-ingredient supply chain companies exhibit fast growth and strong profitability. Moreover, low market concentration indicates an abundance of opportunities for further growth and integration Supply chain concentration for certain consumer goods such as sportswear is high, with the athletic shoes sub-sector having the highest concentration as brands typically maintain long-term relationships with suppliers Many downstream companies will invest in self-built supply chains when they reach a certain scale or improve their supply chain through M&A Supply chain companies face challenges such as homogenisation of products, dependence on core customers, low entry barriers to R&D, and high substitutability 	<ul style="list-style-type: none"> Investors focus on sub-sectors with huge market upside such as food ingredients, healthy food raw materials Investors value supply chain players with in-house R&D, scaled production, and strong cash flow. Reliance on core customers and diversification in future developments would also be emphasised

M&A and Capital Raise in Post-Pandemic Era

Post-pandemic capital market overview

The capital market for the C&R industry has been a volatile ride for investors over the past five years, with roller-coaster peaks and troughs. M&A and capital raise volumes in 1H22 plunged compared to 1H21, especially for mega deals. Investment appetite in the C&R industry has also softened, with financial investors behaving cautiously. While overall deal volumes are down, deep-pocketed strategic investors have shown themselves to be opportunistic, with key players taking advantage of market uncertainty to strategically explore M&A opportunities across their value chain.

The forum held a roundtable discussion focusing on the state of post-pandemic capital markets, inviting experienced investors from **Cathay Capital, Goldman Sachs PIA, Tate & Lyle, and Trustrar Capital**. Panelists shared insights on M&A and Capital Raise from financial and strategic investor perspectives, providing suggestions for entrepreneurs looking for financing under the current market environment.



Opportunities and challenges in C&R amid market downturn

- Despite the C&R industry's downturn, there is still considerable investor interest in key sub-sectors. For example, with aging population demographics, an increasing number of consumers pay attention to GI health, which indicates great growth potential for supplements such as dietary fibre. In addition, demand for technology-driven products continues to gain momentum
- For corporates, an increasing number of companies have realised the importance of consolidation, both horizontally and vertically. We expect these consolidation opportunities to continue in the near term
- For investors, as competition eases, valuations in the sector are returning to more investor-friendly multiples. When making investment decisions, valuation benchmarking against listed companies is becoming an increasingly important factor. Primary market investors are also paying more attention to secondary market views



Investors' assessment standards in the post-pandemic market environment

- Post-pandemic, investors will focus more on a target's competitive positioning, business sustainability, profitability, and cash flow generating capabilities going forward, rather than underwriting investments purely on growth potential
- Strategic investors will display a marked focus on immediately accretive or highly synergistic acquisitions that complement existing operations. For financial investors, core metrics for assessing investment opportunities such as IRR and MOIC have not changed, but there will be increased attention paid towards fundamental industry growth drivers and growth sustainability
- New trends in the C&R sector also require investors to learn more about consumer behaviour. New assessment metrics are also considered, including assessing the impact of the pandemic on the company and the industry, reassessment of the business growth logic, and the impact of the evolving policies



Advice to companies looking to finance for their business

- Managers need to comprehensively evaluate each business's growth curve and capital needs to adequately determine the timing, amount, and method of financing most suitable. Potential alternatives to the traditional method of capital raising include convertible bonds or preferred stock. In addition, the companies should be more pragmatic, carefully choosing investment partners that could contribute to the long-term development of the business
- Managers should focus on cash flow and carefully assess policy risks, regularly checking whether the company, the selected industry, and the business model are in line with the relevant policies advocated by the government. When making financial forecasts, the seller should also ensure the reasonableness of forecasts and adjust valuation expectations under the current environment

BDA Contacts

Contact us

The recently concluded 20th CPC National Congress set forth major national goals for the next five years, including “meet the people’s aspirations for a better life” and “common prosperity for all”. We noticed that many C&R investment themes discussed in the forum, such as “rising health awareness”, “focusing on cost-competitiveness”, and “supply chain development”, are closely in line with the spirit of the National Congress. We believe that China’s C&R industry can develop sustainably under the guidance of the policies. Investors should leverage on the opportunities available and act on the ones that fit their strategic goals and financial requirements. BDA will be happy to assist our clients in acquisition, divestiture or capital raising. For further information, please contact us:

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