VENTUREDEAL M&A ANALYSIS

Research and opinion on recent M&A transactions.

Google Acquires Cronologics

Lonza Group Acquires Capsugel

Unilever Acquires Living Proof

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Google Acquires Cronologics For Undisclosed Amount

Quick Take

Search advertising giant Google (GOOGL) has acquired smartwatch platform startup for an undisclosed sum, according to a posting.

The acquisition was likely an 'acqui-hire', bringing Cronologics' cross-platform operating system knowledge in-house.

Expect some upgrades and input from the new team to show up in the next iteration of Android Wear.

Target Company

San Mateo, California-based Cronologics was founded in 2014 by CEO Leor Stern, Lan Roche, and John Lagerling.

The company's mission was to develop a new, cross-platform smartwatch OS (Operating System) that would integrate with a variety of existing platforms such as Android, Apple iOS (AAPL) and Amazon's (AMZN) Alexa system.

To-date, Cronologics had been able to include its Alexa-compatible technology in iMCO Technology's CoWatch, which was called the 'first smartwatch to use Amazon's Alexa voice recognition."

There were no known external or institutional investors in the company; the founders were all ex-Google business development employees.

Acquisition Terms and Rationale

The two companies did not disclose the consideration for the deal.

It is likely Google paid under $10 million for the acquisition due to its very early stage of development.

According to the team at Cronologics, they saw 'strong alignment with Android Wear's mission...to continue pushing the frontier of wearable technology and smartwatches with Android Wear 2.0 and beyond."

The deal has the earmarks of a typical 'acqui-hire'. Google likely saw a talented team with some compelling ideas that it could use to move its wearable technology initiatives forward.

Commentary

Google, along with smartwatch makers Apple, Samsung (005930.KS), Fitbit (FIT), Garmin (GRMN) and others, has made admirable attempts to develop a smartwatch platform that intrigues consumers.

However, like the others, Google has largely failed to make a system compelling enough to be category-defining.

With the acqui-hire of Cronologics, Google is getting another perspective on the smartwatch segment and bringing cross-platform experience in-house.

I believe the major smartwatch players view the smartwatch as the first interface into wearable computing, and as such, are investing in obtaining market knowledge as they attempt to continue product development, miniaturization, and new materials.

Cronologics' competency was in operating systems and interfaces, two important elements in the nascent wearables industry.

Holding a smartphone in your hand is a different proposition than 'wearing' a device on your body and consumer expectations are still being figured out.

I don't expect major breakthroughs from the acquisition, because I believe that wearables will become important when the hardware becomes lighter and form fitting, like Apple's soon-to-ship AirPods.

Rather, expect the next iteration of Android Wear, 3.0, to contain some input and technology from the new incoming team as Google makes incremental improvements to the platform's capabilities.

Lonza Group Acquires Capgugel From KKR

Quick Take

Publicly-held private equity firm KKR (KKR) has agreed to sell its portfolio company Capsugel to Lonza Group AG (LZAGY) for $5.5 billion in cash.

For Lonza, the acquisition fits its strategy of being able to offer a full 'continuum' of services to the biopharma industry worldwide.

Scheduled to close in mid-2017, the deal will provide KKR with a $3 billion return on its original $2.38 billion investment.

Target Company

Morristown, New Jersey-based Capsugel was founded in 1931 and manufactures a variety of two-part capsules that can contain numerous types of drugs and dosages as well as finished dosage forms for oral and inhalable drugs.

The company was previously acquired by Pfizer in 2000 and subsequently sold to current owner KKR in 2011 for $2.38 billion as part of Pfizer's divestiture strategy aimed at reigniting growth in its core business. The deal was priced at a 3.2x multiple of sales.

Since KKR's acquisition, the company has expanded its offerings to include inhalable delivery systems, micro-dosing capabilities for powder-in-capsule evaluations and specialty substances.

Some of this expansion was driven by acquisitions, such as Capsugel's 2015 acquisition of Xcelience and Powdersize. Other expansion initiatives were internally-driven, no doubt supported by KKR's deep pockets.

Acquisition Terms and Rationale

The acquisition was announced for $5.5 billion in cash and the refinancing of Capsugel's $2 billion in debt.

Lonza has obtained commitments for all of the debt financing and plans to raise CHF 3.3 billion ($3.2 billion) to complete the deal.

Lonza said the deal will be accretive to earnings in the first full year after closing, which it expects to occur in 2Q 2017.

The rationale for the buy is that Lonza can now offer a complete family of solutions to its biopharma partners through the entire chain of drug development, and do so on a worldwide scale.

Additionally, drug delivery technologies continue to be at the forefront of new drug development, with particular emphasis on oral delivery which increases patient compliance and improves outcomes.

For KKR, it appears they bought Capsugel for 3.2x sales in 2011 and sold it for over 5x sales, since the company had $750 million revenues in 2010 and likely grew it to under $1 billion in the ensuing five years since then.

Commentary

Lonza wants to provide a 'continuum' of capabilities to its customers through cross-selling Capsugel's solutions and vice versa.

The company believes it will be able to speed up client processes to help them get products to market more efficiently as a result of the integrated approach.

As drug delivery systems continue to evolve through technological advances, Lonza is positioning itself to benefit from its integration strategy.

The question is to what degree Capsugel's R&D advances will be advantaged by access to Lonza's customer base.

An additional question is the price that Lonza is paying for the deal. Analysts at Baader Helvea have indicated that Lonza has not acquired Capsugel for a bargain price and that the subsequent capital raise necessary to consummate the deal will 'weight on Lonza's stock."

Vontobel analyst Carla Baenziger was 'surprised to see an acquisition that has synergies with chemical drug manufacturing rather than biological manufacturing.'

So, it appears the jury is out on the deal for Lonza.

But for KKR, the sale will be a big winner at 2.3x what it paid in 2011, resulting in an approximate average annual return likely exceeding **20%**.

Unilever Acquires Living Proof For Undisclosed Amount

Quick Take

Consumer products giant Unilever (UL) has announced an agreement to acquire hair products company Living Proof for an undisclosed amount.

The acquisition is one of several significant buys this year for Unilever as it tries to remain relevant to Millennial consumers.

If UL can provide its distribution capabilities to these acquisitions and glean product development and marketing knowledge from the upstarts, I'll consider it a long-term net positive for Unilever.

Target Company

Cambridge, Massachusetts-based Living Proof was founded in 2004 by Ward Stegerhoek, Jon Flint, Mitch De Rosa, Daniel Anderson, Amir Nashat and Robert Langer to create improved hair care products from scientific research.

The company says it has 'twenty patents, over 40 products and more than 100 awards'.

It is headed by CEO Grace Ray, who was previously VP Global Marketing at Smashbox Cosmetics, later acquired by Estee Lauder.

Major investors included Polaris Partners (Jon Flint and Amir Nashat) and Leerink Partners, who with others invested a total of $53 million in three financing rounds, with the first round being reported in 2008.

Acquisition Terms and Rationale

The two companies did not disclose the amount paid, nor have there been 'whisper' reports showing up tech blogs.

Earlier in 2016, Unilever paid $1 billion to acquire men's shaving and toiletries supply startup Dollar Shave Club.

Dollar Shave had reached more than $150 million in sales in 2015 and was likely to grow rapidly to $240 million in 2016, so it appears Unilever paid a rather rich 5x sales for that acquisition.

I suspect UL did not pay 5x sales for Living Proof. While the company has no doubt been growing due to its ‘scientific’ approach to better hair care, the 5x multiple paid for Dollar Shave was likely due to its strong brand affinity with young men and its product line expansion from shaving to other men’s care supplies.

Living Proof has shown no such ability or inclination to expand beyond hair care.

The transaction is expected to close in 1Q 2017.

Commentary

Why is Unilever on an acquisition track?

UL appears to be buying brands that have cracked the code in developing new products that Millennials want, and marketing to them in a cost-efficient manner via social networks and influencers combined with traditional advertising.

Another example: Unilever also acquired home products Seventh Generation, which had over $200 million sales in 2015.

The environmentally-focused brand will enhance Unilever’s presence with eco-conscious consumers.

Established CPG companies like Unilever are struggling to sell their products to a new generation of consumers that want to purchase different products than their parents and buy them in different ways.

According to CPG product funding site CEO Ryan Caldbeck, the largest CPG companies are spending only 2% of revenue on R&D and are now “outsourc[ing] R&D and leav[ing] the risk of innovation to the startups that do it best.”

Caldbeck likens the trend to Big Pharma acquiring companies to plug into their ‘vast distribution pipes while they focus on advertising and regulatory issues.’

With the CPG/Big Pharma analogy, I’ll accept that CPG can add distribution capabilities.

More importantly, I imagine UL’s management wants to infuse its traditional brands with DNA from its newly-acquired brands, much in the same way that Amazon (AMZN) acquired Zappos.

Amazon’s founder and CEO Jeff Bezos publicly stated that an important reason for acquiring Zappos was its uniquely customer-centric focus and that he saw “great opportunities for both companies to learn from each other and create even better experiences for our customers.”

If Unilever can bring its distribution capabilities to acquisitions like Living Proof, while learning how to adapt the knowledge gained from these newly-acquired companies in developing and marketing products to Millennials, then the acquisitions will be worth the price paid.