

INVESTING IN DIGITAL

**DIGITAL TRENDS IN UK PRIVATE EQUITY
IN THE RETAIL AND CONSUMER SECTORS**

javelin group

Digital Retail by Accenture Strategy

DIGITAL DRIVES CHANGES IN UK PRIVATE EQUITY INVESTMENT DEALS ACROSS RETAIL AND CONSUMER

We are in the midst of the biggest structural change in consumer spending behaviour since the rise of chain store retailing in the middle of the 20th century. The “offline to online” shift in consumer behaviour generally, and in spending behaviour specifically, has been gathering momentum for 20 years. It is most notable in the Travel sector, and to varying degrees across the whole of the Retail sector from fashion to grocery. Even in experience-led sectors such as Leisure and Bars & Restaurants, enhanced customer engagement, such as booking and ordering through digital platforms, is merging physical and digital experiences.

This structural change in consumer behaviour and spending has been mirrored by a similar change in investment behaviour.

Our assessment of UK private equity (PE) investment activity in the Retail and Consumer sectors (Consumer includes Travel, Bars & Restaurants, Leisure, Food & Beverage, and Consumer Services) finds that deal activity closely follows this consumer spending change with a growing focus on digital assets.

This paper looks at the recent digital trends in UK PE deals in the Retail and Consumer sectors, and what this means for PE firms’ future evaluations of potential investments.

DIGITAL AND OMNI-CHANNEL DEALS ARE FORGING AHEAD

It was over a decade ago when UK PE firms first invested in digital-only (pure-play online) businesses. Since then, digital-only deals have increased substantially to nearly 30% of Retail and Consumer volumes in 2016, a doubling of share from 15% in 2013.

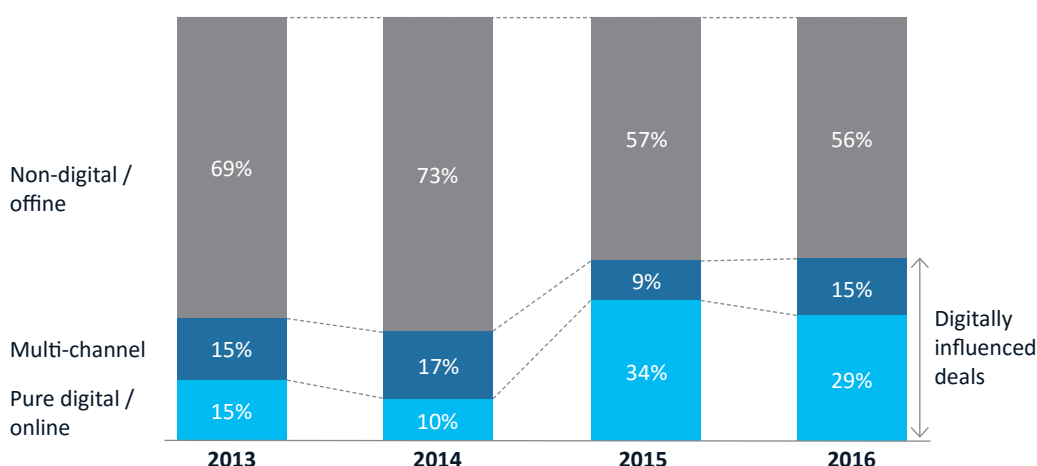
And if we include 'digitally influenced' or 'omni-channel' businesses (where online represents a key pillar of a commercial proposition and the consumer has a choice of how to shop and spend across channels) the scale of digital's impact on the investment landscape is even greater, accounting for over 40% share of investments in the Retail and Consumer sectors in 2016 – up one-third since 2013.

In value terms, deal trends show the same direction of travel. The deal value share of pure-play online businesses grew more than fivefold to more than 20% in 2016, albeit from a low base in 2013. This rapid increase in value share reflects a growing universe of online businesses in the UK reaching sufficient scale and profitability to become interesting investment opportunities for private equity.

Specifically within Retail, nearly half of all transactions involved pure-plays in 2016, up from around a quarter in 2013. Omni-channel retailers (a class which now accounts for the large majority of retailers with stores) accounted for more than half of Retail deal volumes across the years assessed, and for a significantly larger share by value.

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RETAIL AND CONSUMER DEALS INVOLVING ONLINE AND MULTI-CHANNEL BUSINESSES HAVE GROWN AROUND 50% BY VOLUME FROM 2013 TO 2016 TO REACH >40% OF TOTAL B2C DEALS



Source: Javelin Group analysis¹

This is increasingly driven by larger transactions involving traditionally store-based retail businesses, such as New Look and Kurt Geiger, where a growing focus on online and development of an omni-channel proposition is central to the investment thesis.

A dearth of store-only retail deals (averaging around 10% of Retail deal volumes 2013-16), is indicative of the decline of store-only models, with a few notable exceptions such as Poundland demonstrating that a purely physical presence remains the most profitable model for some deep value retail propositions.

As one of the earliest consumer subsectors to feel the impact of digital, Travel had the highest proportion of purely digital deals by volume (80% and value (90% in 2016.

A proliferation of PE deals from 2013 to 2016 involving online travel agents (OTAs), such as Iglu and OnTheBeach, and aggregators, such as Momondo and Trainline, is representative of the continued long-term channel shift to online holiday and travel bookings.

While Travel is highly penetrated by online, offline-led travel models continue to attract capital (over one-third of travel deals by value 2013-2015), with investments clustering around the luxury end reflecting demand for high-touch services and travel tailoring that cannot be provided by transactional online propositions.

Across other subsectors, including experience-led subsectors such as Leisure, Bars & Restaurants and brand-led subsectors such as Food & Beverage, the impact of digital on the investment landscape has of course been less pronounced. However, online aggregator models addressing these subsectors have attracted considerable investment over the last two years, with notable examples being Tastecard (2015), Wowcher (2015) and Leisure Pass Group (2016).

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PATTERNS IN PE INVESTMENTS MIRROR CONSUMER SPENDING BEHAVIOUR

What is clear from this research is that observable patterns in private equity investments over recent years mirror ongoing changes in consumer spending behaviour – and this shift in investment focus has been rapid and is ongoing.

As online penetration continues to grow across the Retail and Consumer subsectors, and disruptive digital business models change how services and products (from leisure activities to food) are consumed, we expect digital to have an increasingly powerful influence on the UK investment landscape over the coming years.

In the Retail and Consumer sectors, more deals will be digital-only, omni-channel deals will increasingly be the norm, and physical space only transactions in the sector will be the exception. We expect the current rate of change to accelerate, with 70%+ deals (by volume) to be digital and omni-channel by 2020, up from 44% in 2016.

We also expect to see a continuation of a couple of trends amongst investors. Firstly, Private Equity investors will face increasing competition from corporates generally and retailers specifically, as management teams look increasingly for both accelerated growth channels/models and to stimulate digital transformation in their own businesses. Secondly, we expect to see growing consolidation of digital skills and experience (both in deal teams and in operating partners and advisors) in PE houses, from mid-market to large cap firms. Investor experience in the digital arena is breeding increased understanding of the opportunities it brings, and the challenges that come with that.

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SO WHAT ARE THE IMPLICATIONS OF THESE TRENDS FOR PE FIRMS?

Digital presents an additional set of investment criteria for PE deal teams evaluating a target, with new skills and experiences required.

Private equity (and competing trade investors in this space) will increasingly need to understand the following:

1

WHAT ARE THE CURRENT KEY PERFORMANCE DRIVERS IN THIS 'DIGITAL' BUSINESS, AND HOW DO THEY RATE VERSUS THE COMPETITION AND BEST OF CLASS?

- Digital marketing capability
- User experience and customer journey mapping
- Digital performance economics
- Customer lifetime value management
- Mobile
- One to one supply chain economics
- Digital technology requirements and enablers
- Management: what are their core competences

These 'digital' issues are of course in addition to fundamentals like product, price, brand, service.

2

WHAT ARE THE GROWTH OPPORTUNITIES AND HOW ACHIEVABLE ARE THEY VERSUS THE MANAGEMENT'S PLAN?

- Performance improvement in the existing business (across the issues above)
- Omni-channel improvement / growth
- International / global expansion
- Product range / service extension
- Partner relationships to strengthen / add in support of the growth plan

3

WHAT ARE THE MAIN RISKS?

- Will the existing technology scale to support management's growth plan?
- Will the existing supply chain scale efficiently to support management's growth plan?
- How do I sustain the competitive advantages I have in this fast-changing space?
- How do I compete against Amazon?

For investors, this means more issues in investment appraisal, some new risks, and opportunities for businesses to differentiate and grow.

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NOTES

¹B2C deals only (excludes B2B businesses operating within Retail and Consumer subsectors). Subsector categorisation of deals defined by Javelin Group on a deal-by-deal basis. Private equity investments > £10m only (does not include trade exits).

ABOUT JAVELIN GROUP

Javelin Group, part of Accenture Strategy, provides strategy consulting and digital transformation services to the world's leading retailers and consumer brands. Javelin Group helps clients improve their competitiveness by anticipating and responding to the rapid changes in customer shopping habits and retail technologies. In 2015, Javelin Group was acquired by Accenture to spearhead digital retail within Accenture Strategy.

The Javelin Group Commercial & Operational Due Diligence practice provides a differentiated approach to investment evaluation in the Retail and Consumer sectors, going beyond the traditional scope of commercial due diligence, to integrate all elements of value creation and operational due diligence, to provide a comprehensive evaluation of a target's or vendor's market, company, growth plans and management teams.

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