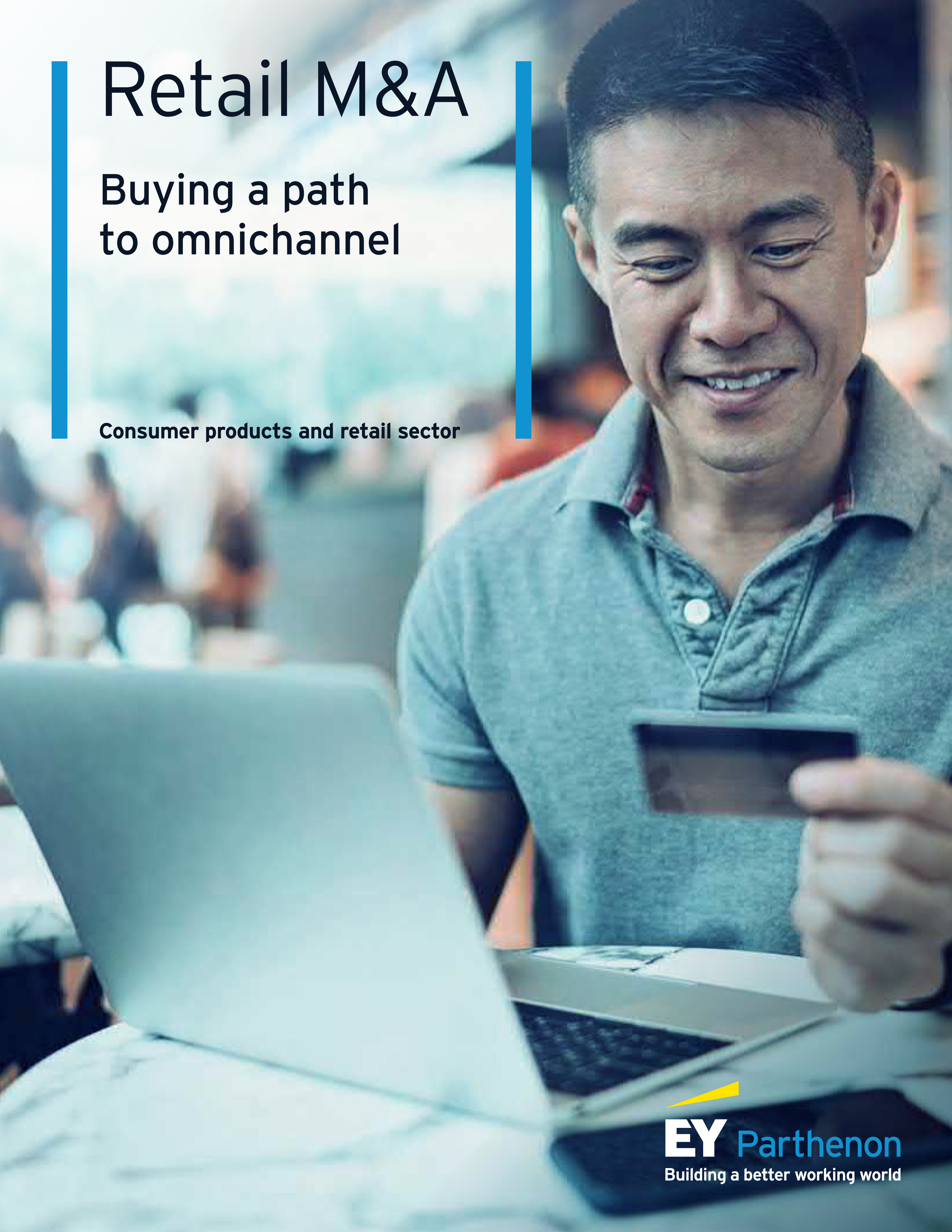
Retail M&A

Buying a path to omnichannel

Consumer products and retail sector



EY Parthenon
Building a better working world

Introduction

It's no secret that retailers are scrambling to develop future-ready businesses and operating models that fit consumers' expectations for a seamless shopping experience across all physical and digital touch points. For many, the road to internal capability development has proven to be arduous, with daunting challenges that puzzle even the largest retailers, including:

- Laying out a long-range plan with a clear road map
- Identifying the most important capabilities to develop
- Freeing up resources to fund development of the identified capabilities
- Attracting the right talent to create those capabilities
- Getting to appropriate scale
- Integrating new capabilities into existing operations

Meanwhile, the consumer, the competitive context and the technology environment are evolving rapidly, resulting in the perpetual whiplash that leaves many retail executives feeling as though a path to omnichannel is impossible to forge.

The journey from concept to scaled, meaningful operations requires a pace, a focus and a way of thinking with which many retailers struggle. These dynamics can result in vulnerability, as single-minded competitors that approach old retail challenges from different angles fight for share in the market. Even unprofitable challengers can be disruptive by giving consumers a taste of what might be possible, raising expectations for all. As a result, many retailers, recognizing the complexity of building differentiated capabilities quickly, have looked to acquisitions to ramp up omnichannel capabilities and allow them to be competitive in today's pressurized retail market.

Profiling recent omnichannel acquisitions

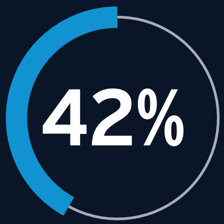
Such analysis begs the question: for what objectives and under what circumstances should retailers pursue acquisitions for the sake of omnichannel development? To answer that question, EY-Parthenon analyzed 60 deals completed by the top 100 US retailers in the past five years that warrant classification as an omnichannel-enhancing deal (see Appendix). More specifically, we looked at deals initiated by the top 100 retailers (as defined by 2017 US revenue) that met one or more of the following criteria:

- A store-based retailer acquiring an operating e-commerce company
- An e-commerce-centric company buying a store-based retailer
- A retailer (store or e-commerce-centric) acquiring a company whose primary functional capability would enhance the acquirer's omnichannel operations, which can include anything from marketing technologies, to logistics to advanced analytics.

These deals ranged from small tuck-in deals up to Amazon's acquisition of Whole Foods Market in 2017 and Walmart's acquisition of Jet.com. In each case, the deals fulfill some combination of the following strategic objectives initially surveyed:

- Expanded offering
- Customer experience transformation/ enhancement
- Technology/intellectual property procurement
- Talent acquisition

Consumer products and retail statistics

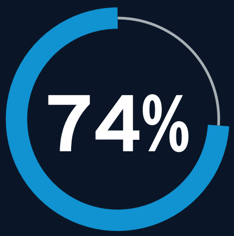


of consumer products and retail-focused executives intend to pursue acquisitions in the next year.

Source: EY Digital Deal Economy Study January 2018

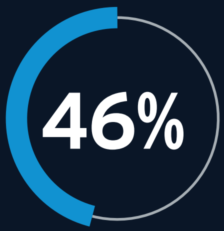
of companies are considering digital capital allocation planning.

Source: EY Digital Deal Economy Study January 2018



of companies take an inorganic approach to digital growth, up 7% since 2017.

Source: EY Digital Deal Economy Study January 2018



say their M&A due diligence processes are not highly effective for digital acquisitions.

Source: EY Digital Deal Economy Study January 2018

For example, Signet's acquisition of James Allen enhanced Signet's e-commerce offering, a key executive and shareholder priority. But James Allen also offered Signet access to novel 360-degree diamond imaging technology and online visualization that could contribute to the sophistication of Signet's platform more broadly. Likewise, Target's acquisition of Ship't builds a presence in grocery while advancing last-mile delivery capabilities. Other examples include PetSmart's acquisition of Pet360, which hosts an online platform for veterinary health information and care advice. Pet360 does not necessarily represent share gain, but does broaden the "community" of PetSmart's customers — thus strengthening the omnichannel customer experience with relevant intellectual property. Overall, the deals we believe are most poised for success are those that fulfill more than one strategic objective, and specifically for those deals undertaken for share gain, that the target can enhance the omnichannel offering beyond mere portfolio expansion.

Of the **60 deals** we analyzed, **75% fulfill more than one** of the deal criteria. Many notable deals simultaneously expand e-commerce share and strengthen omnichannel presence through improvements to customer experience, technology or talent.

The seven steps to pursuing omnichannel in retail

Based on our research, EY-Parthenon teams have identified seven steps to consider when pursuing omnichannel acquisitions in retail.

01

Strategic alignment

First, a company should lay out a clear long-range omnichannel vision and strategy. This process, which by definition is cross-functional, prioritizes the capabilities required to fulfill the company's vision. This basic building block is often overlooked and can therefore reflect a problematic absence of a common definition of "omnichannel" among the senior leadership.

02

Capability and CX road map

Second, the omnichannel strategy should identify the capabilities and consumer experiences needed to enable the omnichannel strategy. This discrete road map should specify key enabling capabilities and channels, their relative priorities and the timeframe in which the company wants to enable them. In addition to pure share gain, these enablers should represent tangible advancements and innovation against baseline e-commerce capabilities.

03

Execution assessment

Third, it's important to a) decide whether each capability or channel requires speed to market in order to create a sustainable advantage and b) determine the size and risk profile of an effort to develop it organically. This typically requires a high level of coordination across multiple internal functions to create a well-informed assessment, and an evaluation of the possibility of achieving similar outcomes via acquisition or via partnership/joint venture.

04

Talent assessment

Fourth, companies need to assess whether they have the talent to reliably develop the desired capabilities in-house or if supplemental talent is needed. This is often the Achilles' heel of this process, as retailers can both under- and overestimate their internal talent pools, especially as it relates to new and emerging capabilities. According to the EY Capital Confidence Barometer, over half of consumer products and retail executives struggle to identify and hire people with the right skills.

05

Target identification

Fifth, an industry screening process will identify viable acquisition targets that can provide the capabilities needed to achieve the omnichannel strategic objectives. Through this process, a company can also discover potential targets that have additional, valuable assets they could leverage beyond a customer and revenue base: for example, are there patents, unique workflows, customer databases, technology skills, innovation and analytics capabilities, relationships, and other intellectual property that would enhance the acquirer's seamless delivery of a great customer experience?

As convergence between the retail and technology sectors continues to increase, a rigorous target screen should not only identify intuitively viable acquisition targets, it should identify hidden disruptors as well. Tools such as EY Embryonic can enrich the screening process and inform M&A decisions by leveraging data analytics to identify overlooked players that are likely to have a meaningful impact on a given company or industry in the future.

06

Enhanced value assessment

Sixth, a company needs an articulated perspective on the size (and sources) of enhanced value to be expected from the new omnichannel skills, and a plan for measuring the added value. This could include defensive value, in which buying the asset could deprive competitors of unique omnichannel capabilities that consumers value.

07

Implementation rating

The final consideration should be a reflection on a company's track record of successful integrations. Sporadic acquirers have a spottier record of creating and sustaining value from acquisitions than serial acquirers, as they lack successful models of effectively integrating new companies at a strategic and operating level. Is there a clear deal thesis and vision of the post-acquisition operating model? Omnichannel acquisitions can be tricky given their value is most often tied to multiple drivers, not one strategic dimension, and often bring on board very different cultures, capabilities and technologies. And they generally require significant integration activities, since keeping them as stand-alone entities defeats the underlying purpose of capability enhancement.

Conclusion

Given the rate of change in retail and the migration to consumer behavior that rewards superior omnichannel execution, we have little doubt that the pace of acquisition of these kinds of companies will continue for some time. Retail leaders will be those that are prepared, pick the right assets and successfully handle the integration of new channels, capabilities and talents.

Appendix

Below is a list of 60 deals that were analyzed by EY-Parthenon consumer teams. These deals have been initiated by top 100 US retailers (as defined by 2017 US revenue) in the past five years that warrant classification as an omnichannel-enhancing deal.

The deals fulfill some combination of the following strategic objectives initially surveyed:

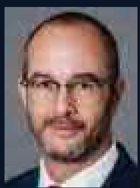
- Expanded offering
- Customer experience transformation/enhancement
- Technology/intellectual property procurement
- Talent acquisition

Acquirer	Target	Technology/ IP	Expanded offering	Transformation/ enhancement	Talent acquisition
Ace Hardware	The Grommet	x	x		
Albertsons	Plated		x		
Amazon	Colis Privé			x	
Amazon	Evi Technologies	x			
Amazon	Goodreads	x		x	
Amazon	Graphiq	x			
Amazon	Shoefitr	x			
Amazon	Body Labs	x		x	
Amazon	Orbeus	x			
Amazon	Whole Foods Market		x	x	
Amazon	Souq		x		
Amazon	EMVANTAGE Payments	x			
Amazon	GoPago	x			
Apple	BookLamp	x		x	
Apple	Ottocat	x			
Apple	Beats Electronics		x		x
Bed Bath & Beyond	Indie Designers		x		
CVS Health	Drogarias Pacheco		x		
Dick's Sporting Goods	Affinity Sports	x		x	
Dick's Sporting Goods	GameChanger Media	x		x	
Gamestop	Geeknet		x		
Gamestop	Simply Mac		x		
Gap	Weddington Way	x	x	x	
HEB Grocery Company	Favor	x		x	
Hudson's Bay	Gilt		x		

Acquirer	Target	Technology/ IP	Expanded offering	Transformation/ enhancement	Talent acquisition
IKEA Group	TaskRabbit	x	x		
Kroger	dunnhumbyUSA				x
Macy's	Bluemercury		x		
Nordstrom	BevyUp	x		x	
Nordstrom	MessageYes	x		x	
Nordstrom	Trunk Club		x	x	
Office Depot	CompuCom	x	x		
PetSmart	Pet360			x	
Rite Aid	Envision Pharmaceutical Services	x			
Rite Aid	Health Dialog Services		x	x	
Sears Holdings	SNUPI Technologies (WallyHome Sensor Technology)	x	x		
Signet Jewelers	James Allen	x	x	x	
Staples	PNI Digital Media	x	x		
Staples	Happy Studio		x	x	
Staples	Runa	x			
Staples	Accolade Promotion Group		x		
Target	Ingredient 1	x	x	x	
Target	PoweredAnalytics	x			x
Target	Zettata	x			x
Target	Grand Junction (application software)	x		x	
Target	Cooking.com		x		
Target	Shipt	x	x	x	
The Home Depot	Global Custom Commerce		x		
The Home Depot	The Company Store		x		
Walgreens Boots Alliance	Consumer Health Services		x		
Walgreens Boots Alliance	Sleek MakeUP		x		
Walmart	Parcel			x	
Walmart	SCM			x	
Walmart	TEDI Translogic Express Dedicated			x	
Walmart	Jet	x	x		x
Walmart	Simplexity	x			
Walmart	Bonobos		x	x	x
Walmart	Moosejaw Mountaineering and Backcountry Travel		x		
Williams-Sonoma	Outward			x	

Contacts

Joshua Chernoff
Managing Director
EY-Parthenon
Ernst & Young LLP
+1 312 879 6848
joshua.chernoff@parthenon.ey.com



Chehab Wahby
Managing Director
EY-Parthenon GmbH
+49 211 9352 17873
chehab.wahby@parthenon.ey.com

For more information, please visit ey.com/parthenon.

EY | Assurance | Tax | Strategy and Transactions | Consulting

About EY

EY is a global leader in assurance, tax, strategy, transaction and consulting services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. For more information about our organization, please visit ey.com.

About EY-Parthenon

EY-Parthenon teams work with clients to navigate complexity by helping them to reimagine their eco-systems, reshape their portfolios and reinvent themselves for a better future. With global connectivity and scale, EY-Parthenon teams focus on Strategy Realized — helping CEOs design and deliver strategies to better manage challenges while maximizing opportunities as they look to transform their businesses. From idea to implementation, EY-Parthenon teams help organizations to build a better working world by fostering long-term value. EY-Parthenon is a brand under which a number of EY member firms across the globe provide strategy consulting services. For more information, please visit ey.com/parthenon.

EYG No. 012641-18Gbl
CSG No. 2005-3491326
ED None

ey.com