The evolution of an investment thesis

NB Private Equity Partners explain why they think a key advantage of private equity is the ability to magnify potential growth via well timed business decisions...

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Private equity investors like NB Private Equity Partners (LSE: NBPE) seek out companies with the potential to accelerate growth. However, one of the advantages of private equity is the ability for this very potential to grow significantly through bold but well-timed business decisions...

Private equity investors target businesses with the potential to achieve greater growth, on top of their established business operations. This can be realised through a range of means: often private equity investors are heavily involved with their investee companies, working closely with them to improve margins, explore new revenue streams and even contemplate acquisitions.

Typically, these improvements occur gradually over time, with a business seeing greater growth over a three-to-five-year time horizon. However, occasionally, a single decision or strategy can have a more immediate impact.

A distinctive feature of private companies versus their public counterparts is their ability to take big and complex business decisions that can massively transform businesses without consulting a broad church of, often relatively conservative, shareholders. While this has been criticised in some quarters, it can enable companies to make bold moves that significantly improve their growth trajectory. These transformations are difficult, take considerable expertise and time, and as a result are ideal for private equity investment – where private equity managers can make changes over many quarters, outside of public markets, and without the focus on "quarterly earnings".

For the managers of NBPE, these kinds of game-changing business decisions have emerged within their portfolio a couple of times in recent years, to marked success. Together, they demonstrate the strengths of investing in quality businesses, with able management teams and alongside strong private equity backers that are willing to endorse and drive bold business decisions where appropriate.

BCA improves its prospects in a Cinch

BCA Marketplace, now named Constellation Automotive Group, was taken private by a private equity fund in 2019. As Europe's largest business-to-business used car marketplace, it was already an attractive proposition, operating in a relatively defensive sector.

NBPE invested alongside TDR, a UK-based private equity manager, as NB knew TDR well and felt they offered an attractive value-add through their skillset and expertise in growing market leading businesses in Europe, including in terms of shifting the company's operating model towards digitalisation. This thesis was proved correct in 2020, when subsidiary BCA Marketplace quickly and nimbly responded to the constraints of the Covid 19 pandemic, accelerating its digitisation to move 100% of its re-marketing online.

At the same time, the company had been exploring options in the business-to-consumer market. With a reduction in household spending being driven by the economic lockdowns of early 2020, while fiscal interventions protected incomes, demand for cars dramatically rose through the second quarter of 2020. As a result, in July the company launched its consumer marketplace Cinch into an already feverish market.

This was a nascent opportunity that had been identified by TDR at the time of its investment. With only an estimated 1% of used car sales currently happening digitally, Cinch may offer significant growth potential for the business. While the digital transformation of BCA has itself improved the group's value, the launch of Cinch has only accelerated the potential for this investment – a thesis that has already borne fruit with the value of NBPE's stake in Constellation being written up in June 2021 from c.$22m to $101m, making it NBPE's largest portfolio company.

Petsmart chows down on Chewy.com

Petsmart is the US equivalent of Pets At Home and has a similar investment thesis. It is the market-leading pet store within the US, has strongly performing well-located physical shops and offers services alongside products within its stores.

It is also exposed to the resilient pet market, with its private equity backers, BC Partners, making the increasing humanisation of pets (and therefore increasing spend on them) a cornerstone of the investment thesis. Indeed, in 2015 at the point of its private equity buyout, the primary thesis was the attractive end market which was growing but also expected to be relatively stable in a downturn, coupled with the opportunity for company specific earnings growth.

Another key thesis of the buyout was to drive growth of the online business. During this same time period, Chewy.com was building a rapidly-growing online pet retailer that differentiated itself through its customer service, comprehensive product offering and loyal customer base.

Seeing this success and rapid growth, Petsmart's private equity manager, BC Partners, opted to acquire Chewy, while keeping it an entirely separate business. While Chewy was loss making at the time, the rapid revenue growth justified the price paid, which at the time was a record amount for an online retailer.

Chewy continued to grow rapidly, to the extent that it was logical to list the business publicly. Two years after acquiring it, Petsmart and its private equity owners listed Chewy at nearly $9bn, an uplift on the $3bn it acquired it for in 2017, and the company's stock price has continued to appreciate in value since then. At the same time, Petsmart defended its own business by investing further into its services offering and using its physical store presence as an advantage, meaning both components of the business have created value in the investment to date. The share price of Chewy has risen by over 250% since it listed and NBPE's stake in the combined business is now valued at approximately $38 million as of 30 June 2021.

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