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MAGAZINE

Action Stations: How 3i Shops for Bargains in the Benelux

Pieter de Jong, head of 3i's Benelux operations, explains how an 'unsexy' discount retail strategy has paid off for the firm

By Ed Ballard

Not many people set foot inside an Action outlet and leave without spending any money.

Asked whether he shops in Action himself, 3i Group PLC partner Pieter de Jong instantly named his most recent purchase at the Netherlands-based discount chain.

"Shaving cream. Actually, it's not shaving cream—it's shower gel," said Mr. De Jong, who oversees 3i's Benelux operations. Enthused, he continued: "I buy my tools there. A screwdriver is 70 to 80 cents or something."

His response encapsulates the qualities that have made Action a knockout investment for 3i. Its pricing is relentless. It generates intense loyalty in its customers. And it appeals to people across the board—shoppers on a budget who need to pick up essential items at rock-bottom prices as well as private-equity professionals with an eye for a bargain. "Low-end retailers are not for poor people; that's an important message," said Frank Quix, managing director of Dutch retail consultancy Q&A. "Poor people need low prices; rich people love low prices."

3i paid £134 million for a 45% stake in Action's holding company in 2011, 18 years after the retailer opened its first store in the city of Enkuizen in the Netherlands. Six years later, 3i has already made £510 million from the investment thanks to four dividend refinancings, and the stake is worth £1.84 billion, according to 3i's June 30 portfolio valuation—fractionally less than the firm's five next-largest investments combined. In June, Morgan Stanley put a value of £3.3 billion on 3i's stake in Action, based on an analysis of the company's expected future cash flows.

Mr. Quix at Q&A helped run due diligence on the company before 3i acquired Action. "We thought it would be a good investment; now it seems to have been a perfect investment," he said.

Action—its growth-rate, its programme of store openings across Europe, the question of how 3i will seek an exit—tends to dominate analysts' discussions of 3i's portfolio. "3i's private-equity business is not only about Action," Morgan Stanley reminded readers in the June report, noting that earnings growth at other portfolio companies had also been impressive. All the same, the investment bank name-checked Action 70 times; 3i's next-most valuable investment, Danish-German ferry operator Scandlines, was mentioned twice.

Aly Jeddy, a senior partner at McKinsey & Co. who heads the firm's private-equity research, said that one-off superstar deals can be "brand-defining for years to come". Without commenting on particular deals, he said such success stories can make a hero of the person who led the deal and may strengthen a firm's hand in future negotiations. On the other hand, the firm may need to take pains to remind investors that it is "a broad-aperture firm", not a specialist in any single type of deal. In the long run, the single triumph matters less to the firm's prospects than the factors that produced it, he said.

Consumer love

Action isn't the whole story of 3i's love-affair with the price-conscious European consumer. It wasn't the first deal 3i had struck in the value-for-money space, or even the first such deal in the Benelux region. That came in 2003 with the acquisition of Rotterdam-based fruit juice producer Refresco. The Refresco deal wasn't an

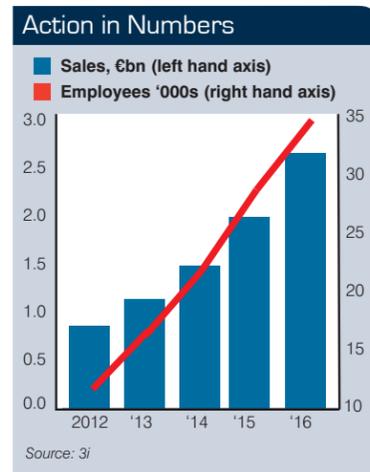
Action-style game-changer, but 3i trebled its money in less than three years when it sold the company for €463 million in 2006.

The juice Refresco makes is sold cheaply in supermarkets under retailers' own brands. After noting the stealthy, decades-long growth of budget retailers such as Aldi and Lidl, 3i was looking for ways to profit from the rise of private-label products, Mr. De Jong said. The Refresco deal "is how the whole value for money theme came on our radar", he said.

Since then, 3i's consumer team in the Benelux has stuck to its guns—not just when it comes to the value-for-money theme, but on Refresco itself. 3i reinvested in the company, now listed in Amsterdam, in 2010 and retains a minority stake.

Refresco last week received a bid from PAI Partners that valued it at about €1.6 billion. In 2010, 3i invested €84 million for a 20% stake in the company, but it has reduced its stake since then and now owns less than 5%, according to exchange disclosures.

(over please)



Basic-Fit (here in Utrecht) is another example of 3i's investment in the discount-price space

'What you see in the consumer space, not only fitness, is a trend of polarisation. People like to buy value for money and or the more luxurious items, and that is coming at the cost of the middle'



Following its initial success with Refresco, 3i was scouting for more ways to emulate the rise of Aldi and Lidl long before they caused high-profile havoc for market-leaders such as Tesco PLC. Mr. De Jong said 3i's Benelux team started following the business after he was alerted about Action's growth trajectory by a former colleague in 2006. It was eventually Robert Van Goethem, 3i's head of consumer and a board director at Action, who led the investment.

"At that time [Action] was a store that was under the radar," Mr. De Jong said. "You might be aware of an Action in your city, but I don't think a lot of people were aware how big it was overall. The founders [Gerard and Boris Deen and Rob Wagemaker] were very low-key operators. They opened the first stores outside of the biggest towns. At that time it was probably not a very sexy store."

Staying unsexy has been foundational to Action's success. Mr. Quix at Q&A, the consultancy, said Action has stayed resolutely committed to stocking only a handful of products, while its pricing policy is so strict that the decision to stock unusually expensive items requires the unanimous endorsement of the company's board.

"They hate complexity; they make everything simple," Mr. Quix said. For each product—a wine-glass, say—other retailers might have a range of glasses, each pitched at a different consumer and priced accordingly. Action, by contrast, buys up a single wine glass in enormous volume and sells it, very cheaply, until none are left.

The "when it's gone, it's gone" mentality is critical to Action's popularity. According to Q&A, of every 10 people that enter an Action store, eight or nine make a purchase. Most non-food retailers would be happy with a conversion rate of 20% or 30%, Mr. Quix said. Action doesn't disclose its conversion rate and a spokeswoman for 3i declined to comment.

Value-for-money

While Action has gone from strength to strength, 3i has continued to back new investments around the value-for-money theme. In 2013 it invested €97 million in

Basic-Fit, a Netherlands-based gym chain, valuing the company at €275 million. 3i made €82 million when Basic Fit was listed in the Netherlands in 2014 and has retained a stake valued at £182 million as of June 30.

Before 3i invested in Basic-Fit, the company's founder Rene Moos had to be convinced that the future lay in growing the discount gym business, rather than the more upmarket gyms he also owned.

"It took a while for him to get used to the idea that maybe discount fitness was the place to be, but the mid-market fitness clubs were coming under pressure from discount fitness clubs," Mr. De Jong said.

"What you see in the consumer space, not only fitness, is a trend of polarisation. People like to buy value for money and or the more luxurious items, and that is coming at the cost of the middle."

Basic-Fit offers family membership for under €20 a month. While the chain offers high-end equipment, spacious facilities and popular group classes, "it does not have the restaurant, the sauna, the bar", Mr. De Jong said. "Those items are very costly but only very few people use them."

Before the investment, 3i's conviction that the low-cost business model could be rolled out internationally was central to the firm's pitch to Mr. Moos, who still owns a majority stake in the company.

"You want the proposition to be as simple as possible, so you can replicate it quite easily," said Mr. De Jong, who sits on the board at Basic-Fit. "He saw that we could scale the business internationally and he liked the roll-out investment thesis we had delivered in the past. When Basic-Fit wanted to enter France we made sure they spoke with the people from Action who entered France a few years earlier."

Action opened its first store in France in 2012; in 2016 it opened its 200th. In that period revenue soared to €2.68 billion, from €873 million. It is close to celebrating the opening of its 1,000th store—a "1000 stores" page has already been created on its homepage, presumably in readiness for the milestone.

Action's prospects from here may hinge

on whether it can maintain the simplicity of its business model and the homogeneity of its ever-changing product range across its stores as it expands rapidly, both geographically and into new product lines such as clothes and sporting goods.

"When you're growing, complexity hits," Mr. Quix said. "Can you keep the business as simple as possible?" He estimated that Action will need to hire 10,000 people to work in its shops, headquarters and distribution centres over the next year. "Finding 10,000 people in Europe, training them and getting them engaged—that's a challenge."

According to its website, Action had 35,000 employees at the end of 2016, an increase of 6,000 year on year.

When laying out the risks that could cause 3i's stock to underperform, Morgan Stanley highlighted the risk that Action's store openings wouldn't keep pace with expectations, or that intensifying competition will squeeze its margins.

Spectacularly profitable

Mr. De Jong declined to comment on 3i's exit strategy for Action. Many analysts expect a stock-market listing in due course. The investment has already proven spectacularly profitable, but for anybody considering 3i's future post-Action, the final return the firm makes from a single investment may be less significant than whether those riches stemmed from blind chance or from an investment process that will continue to deliver in future.

"It's about the process—repeatability, scalability," said Mr. Jeddy at McKinsey. "Process does not create stars; process eliminates dogs. LPs are less interested in the one thing you touched that became gold, than the formula for your alchemy."

For 3i, budget consumer deals in the Benelux look set to remain an important ingredient in that formula. The firm announced its latest investment in April this year, investing €200 million in Hans Anders, a low-cost eyewear retailer. The chain has more than 400 stores in the Netherlands and in neighbouring countries, and has designs on expanding across Europe.