The e-commerce acquisition gold rush: How Amazon aggregators strive to become the digital P&G or Unilever

Introduction

Following the dramatic shift of retail shopping to online channels in the wake of the pandemic, online marketplaces such as Amazon presented enormous opportunities for entrepreneurs to grow an online business. E-commerce roll-up companies or aggregators seek to purchase such successful Amazon third-party sellers, and then use their own resources and capital to help scale the business, boost sales, and maximize profits. Such roll-up funds have raised almost $9bn since April 2020, with US-based Thrasio leading the pack with total funding of $1.7bn. However, it should be noted that most of these companies did not even exist at the beginning of the year 2020.

What is an Amazon FBA business?

Amazon marketplace is the online network for third-party sellers implemented on Amazon's websites, allowing them to sell their products in return for a fee. Consequently, Amazon can offer customers a much wider product choice from thousands of external sellers. In 2020, Amazon's gross merchandise volume was estimated to amount to $475bn. From this, 62% were from products sold through Amazon's third-party sellers. Fulfilment By Amazon (FBA) is a service provided by Amazon to third-party sellers that takes care of storage, packaging, and shipping. This relieves a great burden from sellers and reduces the entry barrier. Furthermore, anyone enrolled in Amazon FBA can also let Amazon manage returns, refunds, and customer service assistance. In many cases, sellers do not even see their own products as they are delivered from manufactures (predominantly based in China) directly to Amazon fulfilment centers. It should be noted that the business model of such e-commerce aggregators is therefore considerably risky as they have little control over their products.

Overall, more than half of all Amazon sales come from third-party sellers, two-thirds of which use Amazon's FBA platform. Merchants on Amazon's marketplace are predicted to make $300bn of sales this year according to Marketplace Pulse – and tens of thousands of them are making revenues of more than $1m a year. However, identifying the successful third-party sellers on the Amazon marketplace is not an easy task. For example, many offer identical goods simply with different labels and some also use fake reviews to inflate ratings.

What is an e-commerce aggregator?

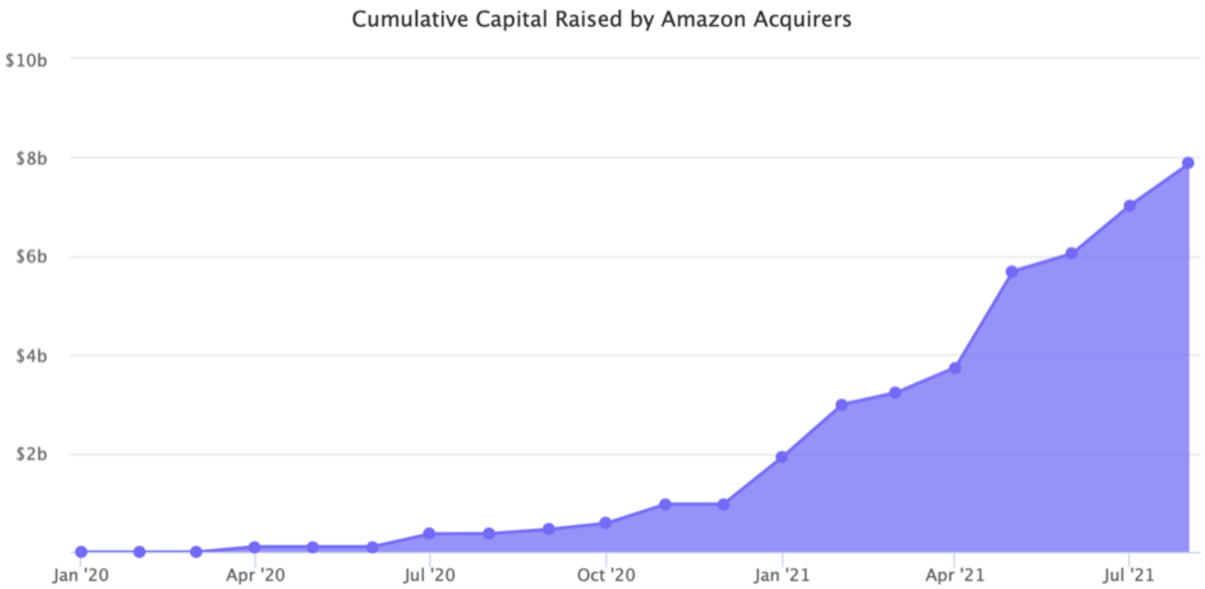
A new type of company has evolved aiming to profit from this e-commerce boom – e-commerce aggregators. These start-ups strive towards becoming the new digital consumer goods conglomerates, imitating the growth story of Procter & Gamble or Unilever. As the pioneer, Thrasio has already bought 150 brands offering over 22,000 products. The businesses targeted make anywhere between $1m to $10m in revenue, have strong reviews, a track record of growth and preferably use FBA. Following the integration of the acquired businesses the aggregator companies reap the benefits from potential synergies as well as greater financial backing, better marketing and greater bargaining power with factories, shipping companies and perhaps even with Amazon. For example, the CEO of UK based e-commerce aggregator Heroes said he was "able to reduce the price per unit for one of its acquired merchants from $7 to $5.50 within days of closing the deal as a result of its supply-chain connections in China."

Amazon aggregators value marketplace businesses on an alternative multiple to EBITDA called multiple of "seller's discretionary earnings" which adjusts for certain costs that the acquiring company expects to operate in-house (e.g., marketing or legal costs). E-commerce aggregators try to buy businesses for lower multiples (in recent months 4x to 5x) and ultimately seek to achieve a higher valuation due to the synergies and diversification.

Major players

Amazon says third-party sales are growing faster than its own retail sales; this is supposed to be an explanation to the booming in the number of aggregators who buy third-party brands. The trend started only in 2018 in the US when Thrasio was founded. The company based in Walpole (Massachusetts) is up to today the largest acquirer of Amazon FBA brands. In July 2020 Thrasio reached a $1bn valuation, becoming the fastest US company ever to get its horn. This success was soon recognized, attracting imitating companies and spreading this roll-up trend to Europe. As of September 2021, the pioneer is still the leader in terms of capital raised with $1.7bn. What's interesting, at this time last year Thrasio was the only aggregator that had raised over $100m, with Perch (Boston) and Razor Group (Berlin) being the only other companies to have raised capital at this time. Twelve months later, the unicorn Perch ($908m) and Razor group ($447m) have now been surpassed by the Berlin Brands Group (BBG) with $1.2bn. On September 1st, the so-called "Thrasio of Europe" raised $700m, making the company Europe's first aggregator unicorn. The company was founded in 2005 under the name Chal-Tec as a traditional e-commerce operator which designed and distributed several products and has now shifted it focus on aggregating Amazon marketplace businesses. In the top ten companies for capital raised, besides other US based companies (Unybrands, Elevate Brands and Heydays), there are SellerX (Berlin; $267m) and Heroes, a London based company founded by two Italian's brothers which has raised $265m.

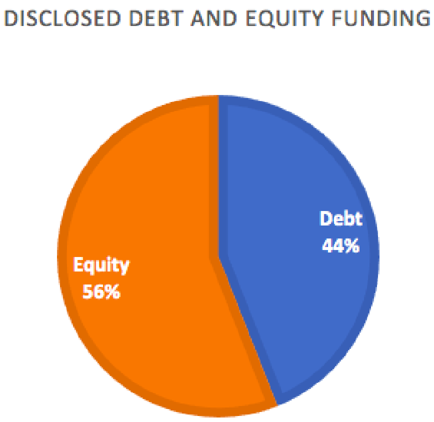
To give an overview, twenty-five different companies acquiring Amazon sellers have now raised at least $100m, a dozen more companies raised less than $100 million, and roughly 30 haven't raised any amount yet or announced it but are active.

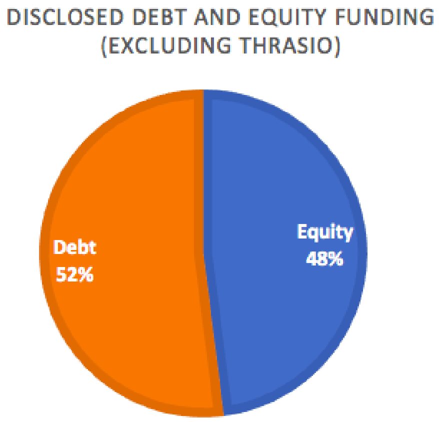


(Source: Market Place)

Funding structure and recent funding rounds

To get into the business, FBA aggregators need to have capital ready to invest and it's not always an easy process, especially speaking of a newly found company. Founder and CEO of Perch Chris Bell said to CNBC : " The first time it was a difficult fundraise because lot of investors were worried about the amazon channel risks". This uncertainty makes the funding more expensive for the aggregators that have to turn also to lenders to raise large sums, rather than only going to venture capitalists who provide capital in the form of equity to high potential companies. As a result, the raise is usually a mixture of debt and equity as the first is needed to have sufficient capital to acquire a large number of target companies. Data shows that debt represents almost 45% of the capital that has been raised in this sector. Interestingly, the debt portion increases significantly if the leader Thrasio is excluded from the analysis.





(Source: Hahnbeck)

During the last two months, some relevant funding rounds occurred.

- As previously mentioned, BBG announced the second funding round this year. In April it announced a debt round of $240m. The latest $700m round, led by Bain Capital, is different in that it includes both an equity and debt component.
- The London-based Olsam Group, which is buying up both consumer and B2B merchants selling on Amazon, has raised $165m in a Series A equity and debt round. The equity investment was led by Apeiron Investment Group and Elevat3 Capital, the debt financing round was led by North Wall Capital.
- Heroes has raised $200m to buy up more Amazon merchants. The raise comes from Crayhill Capital Management and it is mainly in the form of debt.

Transaction process

After raising the capital aggregators have to identify which businesses fit their portfolio. Each buyer has different criteria but almost everyone looks for top-reviewed and bestselling products. When choosing these criteria, buyers must be particularly mindful of certain connected risks, such as the presence of fake reviews and reviews bought through free sampling. The size of the FBA merchants and opportunities of growth are also valuable factors that aggregators consider when searching for a target. The selection process in this fast-growing industry is becoming more and more digitalized as the spread of matchmaking companies like Filippa demonstrate. Platforms like this represent the brokers of the "roll-up era" which aim to match potential seller of Amazon firms and willing buyers. Moreover, bigger players have developed their own algorithm to find target businesses and contact them directly via email, bypassing the brokers. Doing that they reach sellers in a more rapid and less expensive way. Razor Co-Founder and VP Tech/Analytics Shrestha Chowdhury describes the platform she has created as "M&A 2.0": "We have technified the M&A process (…) We do diligence on thousands of sellers every month".

The acquisition process is extremely simplified and standardized, being one of the main reasons that prospective sellers rather deal with an aggregator than approaching individual buyers or private equity groups. Last week Thrasio has announced its three largest acquisitions ever, which include Wise Owl Outfitters. The founder of the hammock firm declared: "We decided to go with Thrasio because of their approach, their infrastructure and the competitiveness of their offer. The deal was fast, and the process from beginning to end was incredibly smooth." As reported on Thrasio website, the transaction takes about 30-40 days and it is the result of good communication between the seller, the diligence division, and the legal team.

Riskiness of business model

Although the trend of booming e-commerce aggregators seems to continue, critics are pointing out the vulnerabilities of the business model. Long-term profitability of aggregators is ongoingly questioned even though the winds are blowing strongly in their favor. One simple reason is that they tend to select already profitable businesses, so the companies are able to generate satisfying profits. Additionally, the transnational capabilities of large aggregators give opportunities to make marketing more efficient, to increase sales by entering new markets, and reduce storage, transportation, and handling costs. Even small but smart changes in delivery go a long way; Perch squeezed silicon straws into smaller packages and shaved 5% off Amazon's shipping fees. Unfair practices such as fake reviews or free product giveaways to boost sales constitute another vulnerability of the business model, making it hard to identify a good target company. Moreover, the products and the business model of the companies are often easy to copy. With external manufacturers and full-service providers such as Amazon FBA, the only challenge is to choose the right marketing method to reach as many potential clients as possible. Furthermore, in many case the negotiations and contracts are only agreed on via WhatsApp and payments are settled via TransferWise with manufacturers in India and China, presenting a major uncertainty. Additionally, some critic also directly targets the aggregators. According to sceptics, caution is specifically necessary, as almost none of the aggregators are more than one year old, so have not proven their efficiency and capability to generate synergies over the long term. Additionally, the need for quick financing pushed aggregators to rely on debt as opposed to equity, which carries higher risk.

Role of Amazon

One of the most crucial points is the role of Amazon itself. The marketplace cannot be seen as a level playing field, as Amazon has superior power to secure its dominance. Even before aggregators became major players, there have been many complaints and accusations that Amazon is misusing its power and distorting the competition. Some third-party sellers alleged that "Amazon basics" and other Amazon brands were stealing ideas from them and Amazon is engaging in predatory pricing. This is possible due to the data collection. A Wall Street Journal investigation uncovered that Amazon uses data collected from third party sellers to develop its own retail operations. Moreover, there have also been an increasing number of cases when sellers were suspended due to a couple of bad reviews, while less fortunate ones were expelled from the site altogether with baseless counterfeiting accusations. One policy that is a huge concern for aggregators is Amazon's inflexibility about moving assets held in their storages. When merging different seller accounts, aggregators are often expected to ship out all inventories and re-register them afterwards, which is a logistical challenge when applied to tens of different brands inventories, distributed across the world.

Despite these problems, the significant advantages of FBA overweight for most merchants. Revenues of businesses in the FBA plan increase considerably faster than Amazon's own sales; in 2020 FBA services, on average, yielded a boost of 50%. Furthermore, there are also successful example of big brands which were built on Amazon. For example, Anker, a Chinese provider of electronical accessories founded in 2011, went public on the Shenzhen stock exchange with an $8bn valuation in August 2020. The stock price soared on the first days, and stabilized over the following weeks, so the IPO was seen as successful. Overall, while Amazon never explicitly opposed the growth of aggregators, its actions show its dominance. Since e-commerce aggregators' business model depends on Amazon, they remain in a delicate position where a few unfriendly decisions may put them in jeopardy.

Conclusion

Although the trajectory of e-commerce aggregators remains unclear, the significant growth it has enjoyed in the last year indicates that a change in the sector is taking place. Challenges for roll-up companies are as numerous as it gets, but there are various ways to overcome them. For example, Thrasio has built a 500-step integration process to successfully control every aspect in an efficient way. Another example for creative thinking is Acquco, a US-based e-commerce aggregator. To overcome the difficulty of finding new, suitable targets, it offers a free Tesla to anyone with a successful referral. To handle the platform risk posed by Amazon, some players are also evaluating the possibility to build their own shop with Shopify while using Amazon as a shop window. The process of aggregation itself is likely to continue: Similar circumstances existed 20 years ago, when the consolidation of gyms, dry cleaners and coffee shops into chains started. From the difficulties of those times, major successful businesses such as LA fitness in the US, McFit in Europe and Illy Caffe emerged or proliferated. As Billy Libby, the CEO of the investment firm Upper90 puts it, "we think that same phenomenon will take place in the digital world" and "I don't think people realize how big this will be."

TAGS: E-commerce, E-commerce aggregators, Amazon, Amazon FBA, Venture Capital, Venture Debt, Start-ups,