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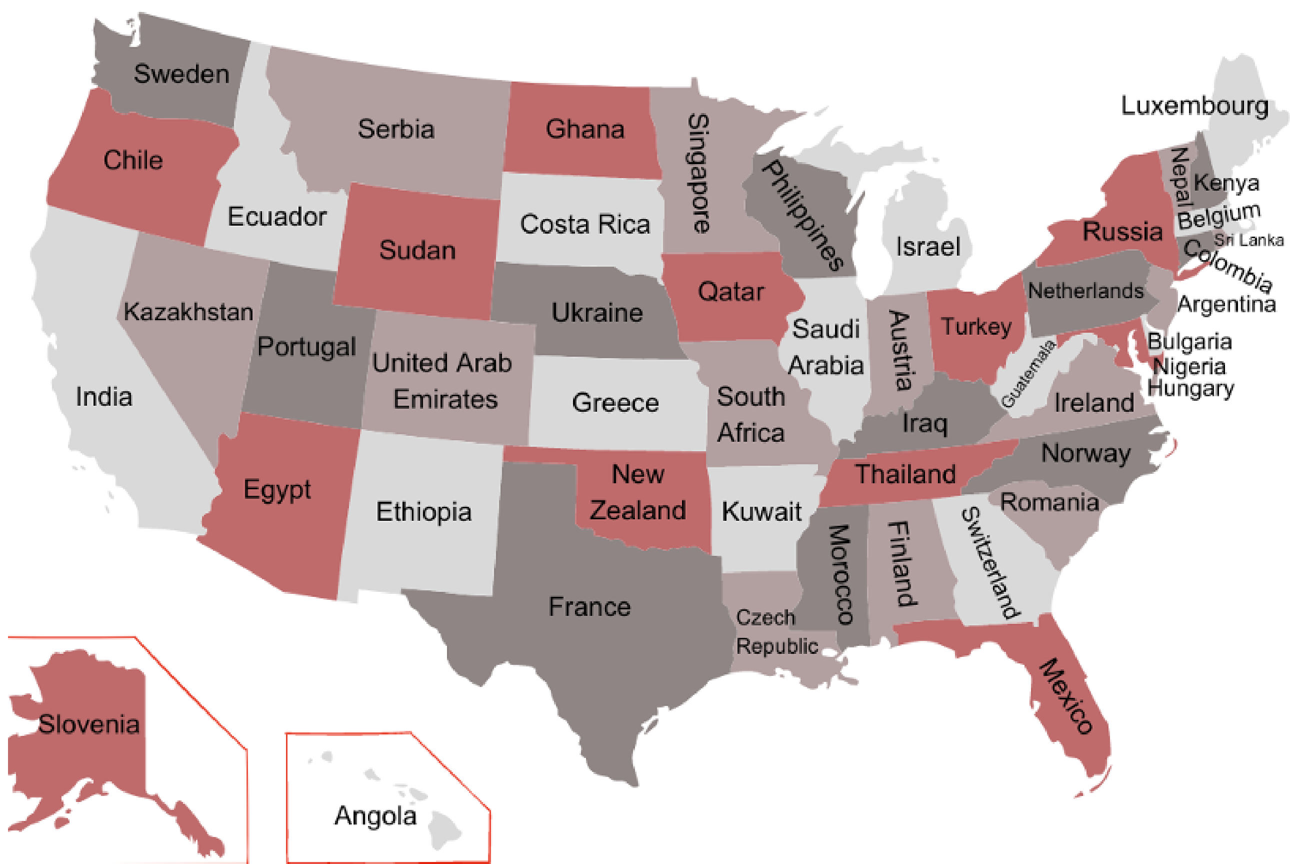
The American Dream

Can Australian companies succeed in the United States?

27 May 2024

A number of Antares portfolio companies have recently acquired businesses with a view to expand their footprint in the United States. The US represents a large market opportunity for Australian companies given the GDP of its individual states rivals that of countries (see Figure 1). We recently spent some time in the US undertaking targeted research on the opportunities for some of our portfolio companies. In this note, we look at key success factors that have historically enabled Australian companies to be successful in the US and present our "on the ground research" findings for three companies - Johns Lyng, Steadfast and Treasury Wine Estates.

Figure 1: US States vs countries with similar GDP (2023)



Source: Antares Equities, World Bank 2023.

The road overseas is paved with skepticism

Ventures offshore by Australian companies are typically met with skepticism in the investment community. This skepticism is well founded as many Australian expansions offshore over the past few decades have ultimately been unsuccessful. There are various reasons commonly cited for failures including: paying too much for acquisitions, poor integration post acquisition, unrealistic synergies, a lack of cultural cohesion and under-reliance on local talent, inadequate operational oversight and misunderstanding the market dynamics or quality of the business. We highlight examples of ASX listed company offshore fails below:

Figure 2: Unsuccessful Australian expansions offshore

Company	Offshore expansion	Years	Reason for failure
Toll Holdings	Global forwarding	2006-2010	Poor integration, culture
Wesfarmers	Bunnings (UK)	2017-2018	Format not replicable
Slater & Gordon	Quindell (UK)	2015	Poor due diligence
Boral	Headwaters (US)	2017-2021	Overestimated market, poor due diligence
A2 Milk	US fresh milk	2015-now	Crowded competitive landscape
Xero	US expansion	2011-now	Underestimated complexity of localization
QBE	US commercial insurance	2007-now	Lack of competitive advantage
Transurban	US toll roads	2006-now	Traffic projections, lower quality assets
Ramsay	French expansion	2010-now	Challenged profitability due to market
Dominos	Japan	2013-now	Aggressive rollout, misread local market
Flight Centre	Liberty & Gogo (US)	2009-2024	Misunderstood US leisure market/consumer
Incitec Pivot	Waggaman (US)	2016-2023	Persistent operational issues
Australian Banks	International expansions	1980'-2010's	Inferior industry positioning, lower ROE
A-REITS	US assets	Mid 2000's	Low quality assets, gearing

Source: Antares Equities; May 2024

Notwithstanding this, a McKinsey study[1] of ASX100 companies over 2010 to 2019 found that companies who successfully grew revenues offshore had the highest shareholder returns. This indicates that there are superior shareholder returns in companies who are able to successfully execute offshore growth strategies.

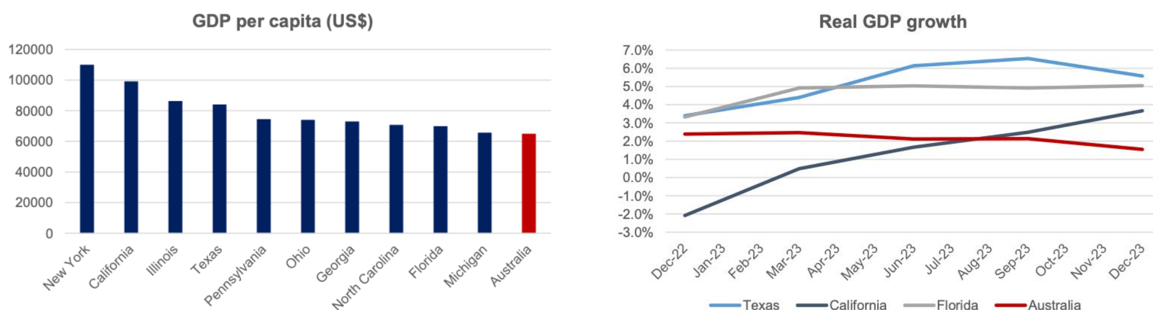
Note 1: McKinsey (2021) Outward bound: *Why Australian companies should look offshore for growth.*

Why Australian companies dare to dream the American dream

With twelve and a half times the population of Australia, the sheer size of the US presents a significant addressable market for Australian companies looking to expand. The United States remains the world's largest economy, and the top 10 US states all have higher GDP per capita than Australia. Population wise, its three largest states California, Texas and Florida are similar in size to Australia, and their real GDP growth is currently well ahead of Australia's.

As such, it is easy to see why many Australian companies see the US as a land of opportunity. But the US market comes with a great deal of complexity with different demographics, consumer preferences, regulations and tax codes across each state. Comedian Trevor Noah has referred to the US as "50 countries masquerading as one", which highlights both the complexity and opportunity of the market.

Figure 3: 2023 GDP per capita and GDP growth: US States vs Australia



Source: US Bureau of Economic Analysis, March 2024.

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At face value, cynics might ask whether Australian companies have the license to expand to the US, particularly given the aforementioned examples of unsuccessful offshore strategies. However, we have observed over time that there are occasionally companies who are able to successfully capture US opportunities. We note these mid-cap (and previously mid cap) companies who are currently successfully executing US strategies in the table below:

Figure 4: Examples of success in the US

Company	US Sector	Entry	Reason for success
CAR Group	Non auto vehicle sales	2021	Specialised niche, excellent execution
PWR Holdings	Thermal mangt for F1 racing	2015	Specialised niche, excellent execution
Macquarie Group	Infrastructure	2004	Specialised niche, excellent execution
Aristocrat Leisure	Gaming	1960s	R&D, innovation and design excellence
Breville Group	Espresso machines	2002	R&D, innovation and design excellence
CSL	Blood collection	2003	R&D, innovation
Cochlear	Hearing implants	1985	R&D, innovation
Resmed	Sleep apnea	1989	R&D, innovation
Lovisa	Fashion jewelry	2018	Unique and scalable, replicable model

Source: Antares Equities; May 2024

Focus and differentiation are key

For Australian companies to succeed in the US we believe there are two key elements.

The first is **focus**. Australian companies that specialise in a niche seem to have a higher chance of success compared to companies that attempt to compete with incumbents more broadly by buying assets with inferior industry positions. We think this is because US incumbents tend to be focused on larger market opportunities, leaving the niches to specialised players. However, for Australian companies these niches can be substantial.

The second is a **differentiated product** or model that resonates with the market. This can take the form of a different manufacturing model, revenue model, retail format, or an innovative product or service offering. Without any competitive advantage Australian companies going to the US are likely to find it hard to penetrate the market.

This is what we are looking for when backing companies who are expanding offshore.

Assessing current opportunities

Our research efforts on our recent US trip were targeted around three mid cap portfolio companies that have US growth strategies and have recently increased their presence there: Johns Lyng Group (JLG), Steadfast (SDF) and Treasury Wine Estates (TWE).

Johns Lyng Group (JLG): Restoring an old approach to a new market

JLG entered the US insurance restoration and reconstruction market via the acquisition of Steamatic Inc. in 2019 and Reconstruction Experts in 2021.

Cultural reinvigoration

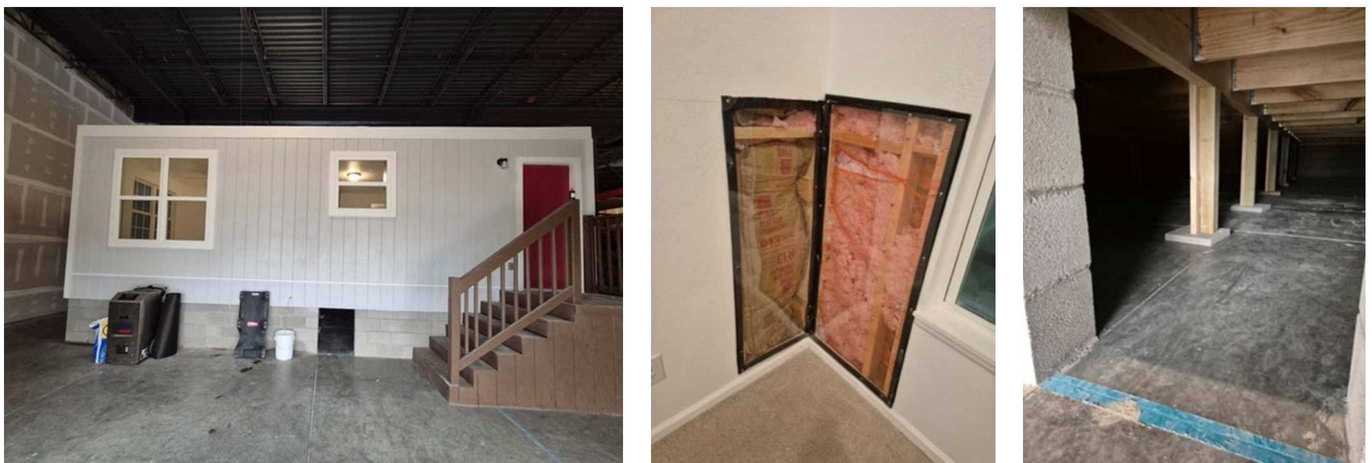
When acquired, Steamatic required a cultural turnaround with the business needing to restore trust and its value proposition with franchisees. Since acquisition JLG management have put in significant work into rebuilding relationships, recruiting talent and investing in training to turn around the culture to position the business to grow. Steamatic possesses some unique talent. For example, we met one of JLG's business partners who has been with Steamatic for 49 years and has been involved in training over 4000 people across 14 countries in the art of restoration. In addition, we observed a strong culture of training and development through meeting several more business partners passionate about skilling JLG's network of restorers.

A unique approach

JLG's approach to restoration is not unique in Australia, but is in the United States. It relates to a philosophy of approaching restoration in the "traditional way" which has become a lost art in the United States. Given private equity's presence in the space, most restoration companies have effectively become glorified demolition companies. A deficit of skills and training means that many restoration jobs require rework and ultimately demolition and rebuild which brings added cost and poor claimant experience for insurance companies. JLG is investing significantly in people and facilities in training its network on restoring – building a physical and chemical understanding of how different materials react to moisture, fire and other elements and events – and then equipping them with the skills and tools on how to restore in an effective way.

This method of restoration gives a cost saving of >30% to the insurer compared to a knock down and rebuild. In addition, the customer experience for the claimant is far better as the time spent out of home is weeks rather than months. Fortunate timing meant we were able to visit one of JLG's newly built training facilities – effectively a house within a warehouse that is built with a composite of materials and is flooded over and over again so that restorers get practical training. JLG is also able to bring in loss adjustors from the insurers for training to educate them on the benefits of true restoration. We believe this is starting to resonate with the market and was a key factor in JLG being appointed to the nationwide Allstate Emergency Response and Mitigation Panel in February this year.

Figure 5: JLG's new restoration training facility in Dallas, Texas



Source: Antares Equities; March 2024

Building foundation and focus

Steamatic is strategically important because it represents the start of the claimant's customer journey. Through the export of Restorx to the US and the acquisition of Reconstruction Experts, JLG is able to offer end to end services now which are being rolled out across five key states identified as key focus areas with a synthetic network of referral partners across the rest of the country. While JLG's US strategy still has a lot of execution ahead of it, we believe the differentiated and focused approach to the market is the right one and post our trip added to existing positions.

Steadfast (SDF): Big opportunities in micro-SME

On our trip we did extensive research on the US insurance industry, meeting with insurers, insurance retail and wholesale brokers, insurtech companies, advisory groups, private equity and venture capital firms in the space.

Putting together the pieces of the puzzle

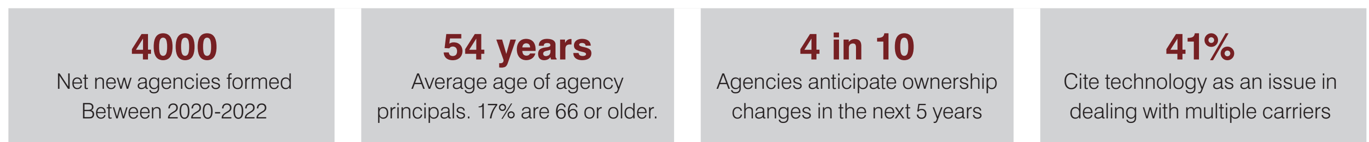
Steadfast acquired US insurance broking network ISU in October 2023. We understand SDF plans to replicate the Australian model of building a network of brokers that can enhance their commissions and access to insurers whilst also driving better efficiency (and profitability) from using SDF's technology solutions. SDF is still at the beginning of its journey in the US with the technology piece of the puzzle still to be unveiled. Our research suggests that there are technology solutions that SDF could partner with (or buy) in both automated bind and quote (similar to the Steadfast Client Trading Platform in Australia) and broking systems (similar to SDF's Insights platform) that could enable SDF to leapfrog developing these systems itself.

Assessing the industry opportunity

Our industry research on Steadfast served as a good reminder of the size of the US market. The large US listed brokers like Aon, Marsh and Brown & Brown all have strategies to push into the US small to medium enterprise (SME) market. Given their presence it is natural to question why SDF would choose to compete in the market. However, our industry research revealed that given the size of the US market, the SME market in the US is more akin to the corporate market in Australia, and the micro-SME market in the US which SDF is targeting, is much more fragmented and not a strategic focus for the large US brokers.

Estimates of the US micro-SME market suggest there are 40,000 independent brokers in the market. In addition, there are a large number of captive agents aligned to one insurer. Structurally the captive market is shrinking with many of these brokers setting up their own independent broking agencies. This has driven significant growth in the number of independent agencies

One complexity of the US market is that while there are a number of national carriers, there are also a large number of state-based insurers with large market shares. To further complicate this, some insurers have excluded themselves from certain lines of business in state markets like Florida and California due to the risks associated with those markets. This complexity amplifies the importance and value of technology solutions to brokers.



Source: 2022 Agency Universe Study

A differentiated sweet spot model for M&A

Brokers are cash generative and economically resilient businesses which can usually improve profitability with scale, making them attractive to groups looking to do M&A rollups. From our meetings, we learnt that there are a number of players active in rolling up the micro-SME market via M&A. They broadly fall into two groups:

- Private equity owned groups who take 100% stakes and generally do not integrate acquisitions
- Network broker platforms (sometimes private equity owned) who do not take stakes in the agencies but enable group buying power and provide business support for the network.

In this context, once SDF has its technology solutions in place, the group is well positioned to be a differentiated consolidator of broking agencies because of its flexible ownership model in taking 0%-100% ownership stakes in brokers. SDF can offer structured succession planning to aging principals by providing them with partial or full liquidity. As a patient partner, SDF receives the economic benefit of owning part of a growing business and can identify new principals (and potentially equity owners) from within or outside the business. We believe SDF's flexible approach coupled with its technology solutions provide a platform for M&A that could meet a sweet spot in a market contending with generational change and rising technology demands.

It is still early days in the US for Steadfast, but following our trip we can see some pieces of the puzzle coming together. SDF has long term opportunity to replicate what SDF has achieved in Australia in the US micro SME market. Absent substantial M&A, we don't expect the US to be a big contributor in the near term given SDF's measured and calculated approach so far, but it is an important pillar of the strategy over the next few years as SDF's model begins to reach maturity in Australia.

Treasury Wine Estates (TWE): Luxury at scale

TWE has been in the US since 2001 but its US business has struggled to generate an adequate return on capital. Industry experts suggest this has been because of a deterioration in some of the acquired brands due to an expansion of volumes, difficulties with distribution and underinvestment in brand and marketing under TWE ownership. In recent years the group has pivoted its strategy to focus on premium and luxury wines, divesting its commercial portfolio and acquiring Frank Family Vineyards for US$315m in 2021 and Daou for e US$900m in December 2023. The market continues to question if TWE can make it work in the US. We travelled through California to speak to industry experts, competitors, and visit Daou to inform our view.

DAOU: A prized new world asset

Daou is a rather unusual winery. It was founded in 2007 by self-taught winemaker George Daou and his brother Daniel as an ultra-luxury brand (Patrimony) and has successfully created three tiers of luxury price points underneath it to serve the broader luxury market. Daou has a strong marketing team and the Daou mountain in Paso Robles is well known for hosting parties and events attracting celebrities and influencers. For a young winery it has been a commercial success, selling 1.1m cases in 2023 and growing sales in excess of 20%.

Figure 6: Daou Mountain, Paso Robles

Source: Antares Equities; March 2024.

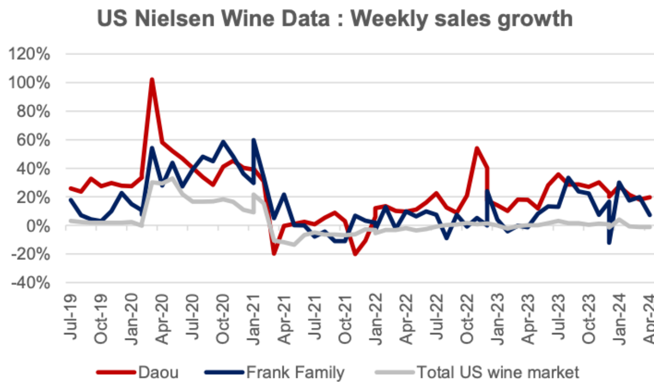
A scientific approach to winemaking

Daou's winemaking philosophy reflects the brothers engineering background, with great attention paid to the science of winemaking. The terroir of Daou Mountain is unique in California with calcareous subsoils providing a minerality to wine akin to growing regions in Bordeaux. The mountain enjoys warm temperate days and cool nights which enables the fruit to achieve the right balance between sugar and acidity, playing into the quality of wine. Industry experts and casual drinkers we have spoken to over the last 18 months agree that Daou's wines are consistently high quality versus competitors at each of its price points. The attention to detail on packaging matches the luxury nature of the brand.

In contrast to the Napa Valley which is becoming increasingly inaccessible to consumers with very expensive tasting room fees and accommodation, Paso Robles has a much more diverse offering for the consumer at accessible price points. With the wine industry struggling to recruit the next generation of consumers, we think Paso Robles is an important region in the biggest luxury wine market in the world.

TWE plans to increase the distribution of Daou across the US, introducing more consumers to a brand. There should also be synergies on the supply side as the company consolidates its existing assets and supply in the region. The key in our view is not to repeat the mistakes of the past. Industry experts we spoke to suggested that a big part of this will be to ensure the pace of expansion is measured such that the brand credentials and price points do not deteriorate. We take some encouragement from TWE's management of the Frank Family acquisition which has thus far managed to achieve this.

Figure 7: US Nielsen Data shows luxury wines Daou and Frank Family Vineyards (Americas Luxury) have consistently grown ahead of the broader wine market.



Source: Nielsen, April 2024

We see significant upside to the current TWE share price based on our sum-of-the-parts valuation that captures a luxury multiple on Penfolds and Americas Luxury. While much market attention is focused on the reopening of the China market, which we also view as an exciting medium-term prospect for TWE, we are not dismissing the potential of the Americas strategy just yet.

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