

OPPORTUNITIES FOR INVESTORS IN LOYALTY

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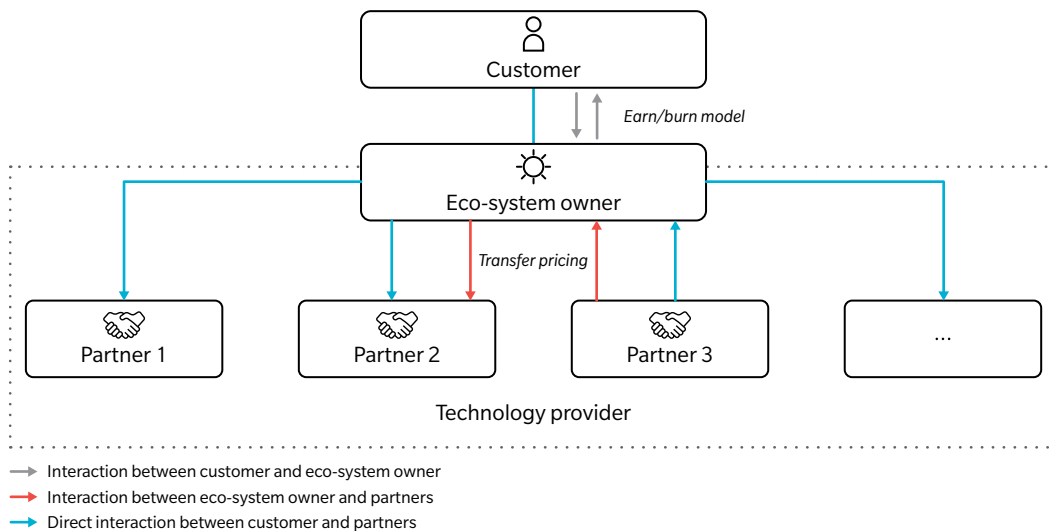
Loyalty programs are often offered by B2C companies (also known as loyalty “partners”) to customers aiming to generate loyalty and ultimately drive greater engagement and higher income from “happy customers”. Spending money typically earns consumers rewards in some form of points that can then be exchange for a variety of rewards such as discounts for the partner’s products/ services or lifestyle rewards (e.g. concert tickets) amongst other offerings.

Loyalty program benefits to companies associated with the program include the following

1. **Strengthen customer relationship:** decrease churn through driving engagement and positive associations with partner and adding another customer hook
2. **Attract new customers:** loyalty programs can provide another source of competitive differentiation/ advantage to a partner, thereby attracting new customers
3. **Increase share of wallet (SOW):** drives engagement and more frequent usage, as well as providing incentives for upsell and cross-sell leading to increased SOW

We consider a number of different players in the loyalty ecosystem, through which we focus on investment opportunities in “loyalty programs” as well as in loyalty technology/service providers. Some players can play both roles through running their own ecosystem and white-labelling the technology as a solution they can then sell to others but for the most part we consider these as separate roles

Exhibit 1: Key elements of the loyalty eco-system

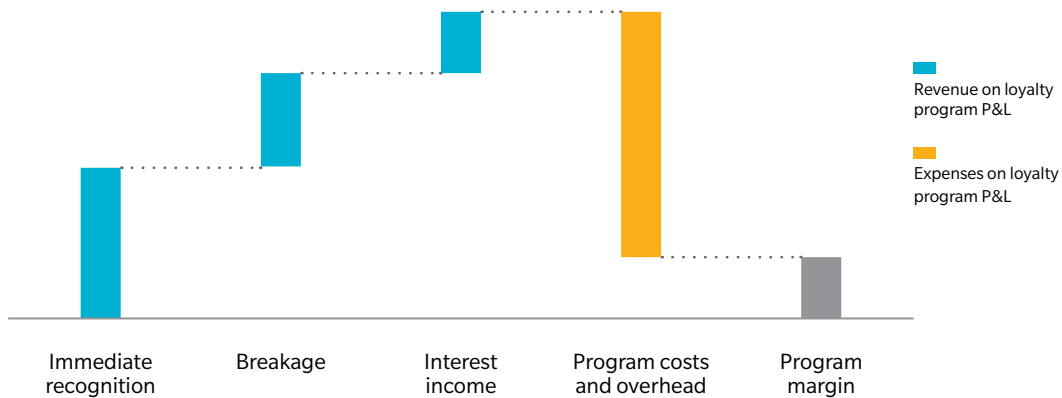


Customer	Partner	Eco-system owner (loyalty program)	Technology/ services provider
Typically consumers, who are customers of both the partner(s) and the eco-system provider	Provides the core products/services against which the customer earns loyalty points	Manages overall scheme and works closely with partners on offering and transfer pricing	Provides technology underlying entire solution, e.g. ability to record transaction and link to points earned, redemption, tailored offerings

ECONOMICS OF LOYALTY PROGRAMS

Loyalty program economics are complex and can vary significantly by industry and program, depending on both partner performance and transfer pricing arrangements. The example shown below is a simplified example of the P&L of the loyalty program, which in this case is a frequent flyer program associated with an airline. The example below also assumes the loyalty program has a separate P&L from the partner although for some loyalty programs that are wholly owned by the partner this may not be the case.

Exhibit 2: Revenue model for airline loyalty program – simplified example



Immediate recognition: Difference between value per mile paid from partner to loyalty program as customer earns airmiles, and cost of redemption of each mile paid from loyalty program to partner as customer redeems airmiles

Breakage: When loyalty program members miles expire these represent the cancellation of a future liability and generate revenue for the loyalty program

Interest income: Loyalty program receives cash as member earns airmiles and holds this on its balance sheet until the member redeems these; during this interim period the loyalty scheme can generate investment income on the cash

Associated cost of running a program: Costs associated with running the program

LOYALTY IN ASIA PACIFIC

While loyalty program offerings may be more developed in some Western markets such as the USA given longer history in these markets we see a number of drivers supporting strong growth in loyalty platforms in Asia-Pacific:

High underlying growth: Loyalty program revenue will be correlated to the partners' revenue and forecast GDP growth across key loyalty sectors (air travel, hospitality, retail including retail fuel, financial services) is ~2-3x higher in APAC than Europe¹

Consumer behavior: We see strong willingness from Asian consumers to support and take advantage of loyalty offerings (although this varies by market)

Ability to drive insights through data: Beyond economic benefits, loyalty programs can provide strategic benefits to partners particularly if the data gathered can be used to derive insights. Technology is now developing to a point where large data sets from different data sources can be combined to generate meaningful insights. In addition, within Asia-Pacific consumers appear to have less resistance to allowing personal data sharing and there are also less regulatory barriers in place

Additional value differentiation: Partners across industries are facing increasing demand for differentiation with a strong offering loyalty considered as one angle

POTENTIAL INVESTMENT STRUCTURES

There are several possible routes for investors to invest in loyalty programs:

Investment structure	Description	Benefits	Disadvantages
Loyalty program carve-out	Carve-out from an existing parent and acquire controlling stake	Ability to participate in full economics/control of program Ability to operate independently of partner(s)	Partners have less incentive for success of loyalty program If tied to 1 partner then success of program dependent on success of partner
Loyalty program minority stake	Invest as a minority shareholder in a loyalty program of an existing parent	Transparent view on the profitability Investors can access a pure loyalty program business when listed	Inability to participate in full economics/control If tied to 1 partner then success of program dependent on success of partner

¹ Oxford Economics, Oliver Wyman analysis

Investment structure	Description	Benefits	Disadvantages
Independent loyalty program	Acquire independents who manage loyalty programs for other companies	<p>Ability to participate in full economics/control of program</p> <p>Greatest freedom from influence of any single partner</p> <p>Success of program less dependent on any one partner (diversification)</p>	Fewer examples of successful independent loyalty programs
Acquire technology/service provider	Invest in companies supporting loyalty programs, e.g. loyalty program software providers, loyalty program platform, etc.	<p>Availability of targets less dependent on partners as typically operated independently of partners</p> <p>Success of program less dependent on any partner (revenue model more linked to stable, recurring fees)</p>	Fewer sustainable competitive advantages, compared with loyalty program where partner access typically sustainable

LOYALTY PROGRAM VALUE CREATION LEVERS

We see a number of levers that loyalty program owners are implementing to derive greater value from the loyalty program and maximise loyalty economics/benefits to the partners:

Customer experience: Enhance customer experience to provide value to customers beyond financial benefits such as:

- Greater focus on lifestyle and status benefits
- Payments integration to allow instantaneous earn and burn/reduce friction
- Expansion of rewards offering across larger ecosystem/increase use cases

Program economics/pricing optimization: Revenue management solution within the constraints of transfer pricing agreements with partners. This could include back-book repricing, re-design of pricing strategy

Targeted customer analytics: Analytics based in understanding of consumer behaviours to understand customer base, e.g. analysis on customer lifetime value (CLV) allowing targeted actions such as targeted marketing to increase cross-sell/reduce churn, e.g. location-based redemption offers, personalized rewards, etc.

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