Can online take-away businesses deliver for investors?

By Kevin Murphy

23 Aug 2017

A queasy mix of excitement, hope and cash has for some years now been mixing together in the food delivery sector and that rarely proves to be a recipe for success.

©pavel shlykov via 123RF

Investors are showing little sign of losing their appetite for low-margin food delivery businesses even though there is now plenty to suggest it would be well worth pausing for breath before tucking into yet another helping. There are some obvious dangers of investing in exciting but poorly understood technologies, such as Bitcoin, yet deceptively simple ideas people think they have grasped can be just as risky.

That goes for supposed experts too as venture capitalist investors seem to find food delivery startups curiously hard to resist. According to data from tech market intelligence platform CB Insights, for example, food delivery startups backed by the top 25 venture capital firms raised $815m in 2016 – up a third on the year before. In the first five months of 2017, meanwhile, the equivalent figure was already approaching $450m.

The food delivery sector is 'imploding'

And yet, as noted recently in the *Financial Times*' Lex column, the sector is "imploding". Noting the travails of a string of colourfully named food delivery businesses – DoorDash, Maple, Postmates, SpoonRocket, Sprig – it continues: "So many venture capitalists have backed so many startups offering such similar services – many of them expensive and unreliable – that mass failure is inevitable."

It turns out venture capitalists have had a taste for food delivery startups for some years now. The current giant of US food delivery 'GrubHub' floated in April 2014. On its first day of trading after this its share price jumped 30% – a time when venture capital deals within the sector had hit a five-year high, so notes a CB Insights blog.

Since then, there has been no shortage of food delivery businesses having to scale back or close their operations – one issue being the very low 'barriers to entry' so that, in effect, pretty much anyone can have a go. Even for investors in GrubHub – despite that encouraging first day of trading – the ride has been anything but smooth and yet the flow of investor money into the sector shows little sign of abating.
Success is still some distance away

Nor is it as if there is the example of any runaway success that might be encouraging people to put up their cash. Even GrubHub, with its eight million-plus customers and 300,000-odd orders a day is trading at a pretty stomach-churning level – the company's $3.5bn valuation, notes Lex, is more than five times this year's expected sales and 19 times earnings before interest, tax, depreciation and amortisation.

In other words – and with the benefit of hindsight to boot – out of all the hundreds of food delivery startups people could have picked to invest in, even the 'winner' is going to have to expand like microwaved popcorn to grow into its valuation. These businesses have provoked much excitement – overexcitement, even – and, it would appear, a significant degree of 'herding' among supposedly canny investors.

Mix in the high hopes and huge amounts of money sloshing around the sector and surely the key, ahem, takeaway must be that investors should, as ever, be very wary about following the crowd.

Schroders is presenting at the Allan Gray Investment Summit on 31 August 2017.

ABOUT THE AUTHOR

Kevin Murphy, fund manager, equity value, Schroders.