

CONSUMER GOODS

THE CURRENT CONSUMER GOODS & RETAIL LANDSCAPE

To take a closer look at how the consumer goods and retail sector works, we asked Andrew Apfelberg, Co-Chair of the Branded Consumer Products Industry Practice Group at Greenberg Glusker; and Ron Friedman, Co-Leader of the Retail and Consumer Products group at Marcum LLP, to weigh in for a discussion.



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◆ What do you anticipate is ahead for retail in the US?

FRIEDMAN: Retail has been weak for many years, but we finally saw some light at the end of last year. Sales for the holiday season were stronger than they've been in a while, as consumer confidence continues to improve. Nonetheless, retailers need to change with the times -- their survival will depend on it. We can expect that of the 900 malls in the United States, 300 will be gone in the next five years. The remaining 600 malls are being reconceived, or will be, to create a new kind of destination venue that is completely different from the retail malls of today. The Westfield Century City Mall is a great example of what is ahead for retail. Malls that were once apparel-centric will be replaced with a different variety of stores and experiences for shoppers. We can expect to see more restaurants, health clubs, movie theaters, bowling alleys, bars, clubs, concert halls, and even health care centers.

◆ How would you describe 2018's overall climate for retail in Southern California?

APFELBERG: 2018 will continue the evolution of retail from a traditional brick-and-mortar experience to an in-person/on-line hybrid. I expect on-line sales to expand as manufacturers are increasing their direct-to-consumer emphasis and the delivery cycle is being shortened each day. Traditional stores will likely pivot to more of a "showroom" model (as Restoration Hardware has done) or a "concierge" model (as Nordstrom has done). I am not bullish on shopping malls but think that neighborhood retail centers will flourish (as will stores like ULTA that built a strategy around them).

◆ How will the Trump administration impact the consumer goods landscape moving forward?

FRIEDMAN: The tax cut will give the average American more money in their pockets starting with their payroll checks in February 2018. These additional funds will be used to lower individuals' debt or to be spent on purchasing more consumer goods. Consumer confidence is increasing. With all of this, more money will be spent on entertainment and consumer goods. Early indicators are that businesses have been expanding which is a good sign for future growth in the economy.

◆ What are the main challenges and opportunities facing retailers and manufacturers of consumer goods doing business in California compared to other states?

APFELBERG: The main challenge is, in actuality, the main opportunity. California is long known for its employee-friendly environment, consumer protection and push towards transparency (in ingredients, animal testing, manufacturing methods or otherwise). This certainly increases the costs of production which can be a challenge to a new product being developed or

an existing product maintaining healthy margins. However, it is exactly this sort of product that the consumer (especially the upper-middle class parent of young kids and the millennial) is embracing and seeking out. Therein lies the opportunity. If a manufacturer can legitimately position its product as being in alignment with the organic, non-GMO, Fair Trade, cruelty-free type sensibilities of this customer base, they will have a loyal following that is willing to pay a premium. A perfect example of this is COOLA, which puts out an amazing sun protection product and is based in Southern California.

FRIEDMAN: California is a vibrant state with a GNP that is the sixth largest in the world. That all sounds good, but there are major challenges that we face as a state. We have one of the highest state income taxes in the country, and with state taxes no longer deductible on your Federal Income Tax Returns, the cost of doing business in the state is going up. The minimum wage for our workers is also amongst the highest in the country. One question every business will need to answer is whether they want to stay in California or relocate to a state with more favorable tax rates and minimum wages? On the positive side, California is a great state to live in, with great weather, beaches, mountains, recreation and lifestyle. My bet is that people and businesses will stay, work hard, and become more efficient in order to stay successful. As I tell all manufacturers and retailers, we face many challenges doing business in California, but if you are not having fun doing, then do something else.

◆ What sectors within consumer products are performing particularly well and why?

APFELBERG: Luxury brands and prestige products continue to do well. With more disposable income than at periods in the past and more product information at their fingertips, the consumer is willing to spend more to get a better product. The smart manufacturers are making these more accessible (whether by making smaller sizes or through different distribution methods). These brands tend to better understand the impact of consumer knowledge about their products and real-life product reviews. In that kind of universe, the consumer can get validation that the money being spent is worth it. Hourglass Cosmetics has done a particularly good job with this. The future trend is going to favor luxury products where consumers continue to spend money but focus that spend on a few products that matter rather than a lot of products that don't. Another sector that may surprise people is automotive. This spans from aftermarket parts to car care products. Autos are continuing to be a form of personal expression and identity (especially in places like Southern California). As such, consumers are willing to spend real dollars to craft such expression or identity. As with other sectors, the products need to be high quality, well branded and readily accessible. I really like what Smartwax and Chemical Guys have done in this space.

◆ Are there other sectors bubbling up under the surface that you think will see a surge in the near future?

FRIEDMAN: Online retailers have been growing in excess of 15% per year, and they represent about 12% of all retail sales of consumer products. This is the fastest growing segment of retail, and we are seeing at Marcum that online furniture retailers, in particular, are performing very well. The Millennials are big purchasers of online products because they do not have the time available for shopping at brick-and-mortar stores, and because they grew up with technology. They prefer to use their iPhones and iPads to do their shopping. This generation wants to be entertained when they go out on the town, and with the pressures on them from work, purchasing furniture online saves them time.

APFELBERG: One of the sectors I am most optimistic about is what I would characterize as the "wellness movement." By that, I mean a product that helps a person to be healthier physically, emotionally, in appearance or all of the above. In the past, there was a focus only on that last factor and, in a sense, beauty was only skin deep (whether we are talking about apparel, beauty or food/beverage). In contrast, today's consumer recognizes that things don't work in isolation. By that I mean that what one eats and drinks is interrelated with what one uses as a topical on their skin and what they wear. When all those sync up, it can be a powerful and highly effective combination. Add on top of that a charismatic founder who is knowledgeable and leads by example and you have a real exciting opportunity. One of my favorites in this space is MoonJuice. Another sector that people don't often talk about in public but which already is a massive business is cannabis related products. There has been strong demand for hemp-based food/beverage products and apparel as well as CBD topicals. I am proud to have helped the Bob Marley estate establish one of the first branded cannabis strains and accessories in the world as well as their forays into the beverage and consumer electronics spaces. With the recent legalization of cannabis in California and a handful of other states, I see this area expanding rapidly, especially for higher-end products.

◆ How have recent trends in consumer behavior and purchasing habits affected the consumer goods industry?

APFELBERG: People are strongly preferring to shop from home or in neighborhood centers rather than shopping malls. This has led to a sharp increase in direct-to-consumer strategies and the development of high quality products that are easy to ship. Additionally, I am seeing more product specialization and associated branding to carve out a "niche" in the market. Companies are increasingly trying to be best-in-class at a more narrow type of product category instead of being all things to all people. In fact, some forward-thinking companies (such as First Lite) have moved almost entirely in that direction.

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◆ What advice would you offer to an early stage manufacturer seeking growth capital?

FRIEDMAN: The early-stage manufacturer has a real challenge in raising money. At Marcum, we are realistic that start-up companies need to look for initial funding from family and friends. Most outside investors do not want to provide the capital to launch a new venture. The exception that we have seen is the entrepreneur who has been in the business and is launching a new company. The early-stage company can work with a factor for accounts receivable and inventory financing and also use purchase order financing for production against customer orders. Once the line has been through a successful season or two, outside capital may become a possibility.

◆ What are we seeing on the M&A front?

APFELBERG: There is significant demand for high-quality companies. They are finding themselves with many suitors, premium valuations and seller-favorable terms. Private equity funds are increasingly looking to establish a relationship with premium brands earlier in their lifecycle. Strategic buyers are willing to come in with strong offers to get companies that bolster their product offerings, have strong brand recognition and for which there are potential synergies to enhance profitability. Both types of buyers are placing increasing importance on a company's social media presence and proprietary "content" and related media. As a result of these and other factors (such as increased consumer spending), branded products are doing better than non-branded. In my time as an investment banker and as an attorney I don't think I have ever seen such vibrant M&A activity for consumer products.

◆ How do you think tax reform will affect the consumer goods landscape in the near future?

FRIEDMAN: Consumers will shop where the entertainment is. Tax reform will put more money in the pocket of the average American Millennial. We saw an improvement in retail sales during the fourth quarter of 2017 as Congress was working on the final version of the tax bill. This country has too many retail stores, and tax reform is not going to change that. We have more than 25

square feet of retail per person in the United States, while Europe and Japan have less than 10 square feet per person. Until we get right-sized, the landscape will continue to be difficult, as we have too many stores competing for the same dollars.

◆ What are some of the best ways for a retailer to build its brand and elevate itself from the competition?

APFELBERG: Using a public figure for a license, endorsement or brand ambassador is an incredibly powerful way to differentiate a brand. The company immediately announces to the world who it's demographic is and what it stands for. If done right, there is instant credibility with a significant sector of the buying community and a sense that the purchase will help the admired celebrity or athlete. It also can give the product increased exposure into aspirational demographics through the personal promotional efforts of the celebrity. Consumers increasingly want to directly associate with their favorite public figure or to emulate in this way the life led by such public figure. Companies increasingly want to co-opt the image and loyal following of the public figure to build goodwill and drive almost immediate sales. Celebrities and athletes with strong social media presence are among the most desirable. I helped OPI establish and run such a program and it worked very well both in the eyes of the consumer and potential acquirers (including COTY who ultimately did buy them). Just as important, due to the exclusivity provisions contained in these agreements, it is one of the very few times there are real barriers to competition. During the exclusivity period, none of the competitors can get the brand association with such public figure. Interestingly, many of the deals with public figures have included them making financial or other investments which has further closely tied their interests with that of the manufacturer.

FRIEDMAN: The definition of insanity is to do the same thing over and over again and expect different results. Retailers must change with the buying habits of their customers, and we are not seeing enough change at retail. The retailer must ask who are the customers they want shopping in their stores and how to get them there. Shoppers are looking for an experience, so give them one. Create events such as evening entertainment with wine and cheese, private parties for special customers, personal shopping

with your best customers. Be creative and think of ways to be different from everyone else.

◆ What are some of the best practices for a branding or endorsement campaign promoting a consumer product?

APFELBERG: The single most important thing is having true alignment between the public figure and the product/manufacturer. Unless the association is authentic and about more than money, it will not resonate with the public. In fact, it will likely backfire. The second more important thing is for both sides to be clear in their expectations and desires over the length of the campaign and take into account all the different ways that such expectations could get frustrated. If the public figure and the manufacturer have a close working relationship and goals of mutual benefit, you can overcome almost any obstacle and, in fact, will find opportunities that were not apparent at the time of signing the contract. A last thing to consider is for the company and the celebrity to be open and transparent with one another and bring the other "inside the tent." By so doing, each side will better understand the other's objectives, concerns and ways of doing things and be able to adapt or encourage innovation or additional partnership opportunities.

◆ What kinds of trusted advisors should growing retailers and consumer goods companies seek out?

FRIEDMAN: Everybody in business needs someone they can talk to. I have always had the attitude that I want to work with people who are smarter than I am. Surround yourself with people inside and outside your company that meet this criteria. We all know that you need a good CPA, attorney, and banker to work with, but just being good is not enough. You have to develop a strong partnership with this group and listen their advice. Inside your company, develop a team that you trust and can listen to. As a young accountant, I learned that if I always agreed with my boss, then one of us was not needed. Make sure your team will challenge you, and everyone will be better off.

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