The Consumer Opportunity
An executive summary of the Privcap thought-leadership series on private equity opportunities in the consumer sector

Plus:
Expert Q&A with Michael J. Grossman, Principal, McGladrey

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1. **GPs must help their portfolio companies get the Internet right**

Any CEO worth his or her salt knows the importance of the Internet for sales and brand reputation. But this doesn’t always mean they have the capacity to take a bricks-and-mortar business online. This is where an experienced and well-resourced private equity partner can help transform a consumer-facing business. It often requires a new perspective—and new investment—to design a system that will enhance a company’s operations. Says Michael J. Grossman of McGladrey, “A lot of management teams try and develop it themselves, and don’t really do it successfully.”

And some companies forget that even if their product isn’t particularly attractive for online retail—like value-brand shampoo—reputation and brand identity is still shaped via social media. Those who fail to realize that will see their sales suffer, says Joan McCabe of Brynwood Partners. “So even if it’s not the front end—you’re not selling on the Internet—you do have to have what I call the ‘back end,’ the social media awareness.”

Timothy Mayhew of Fenway Partners is fascinated by...
how companies are monetizing things like Facebook “likes” and other social media branding opportunities. He joined the board of a social media marketing business to better understand how companies can leverage those opportunities. “If you’re not focused on it, you’re dead,” he said.

2. Invest in better customer service
One of Mayhew’s favorite examples of transformational consumer products investment is Fenway’s recent experience with 1-800-CONTACTS, an online seller of contact lenses. Fenway knew that contact lenses had become a commodity product, and decided to focus entirely on the company’s direct-to-consumer value and customer service. Fenway sold off the company’s manufacturing plant and beefed up its call center and website. By increasing call response times and streamlining the order process, Fenway focused on reducing the “friction” in the buying experience.

The firm also made sure its mobile-device storefront was actually suited to mobile devices. “You can’t just take a web site and put it on a portable device,” he says. “It just doesn’t work. So we created a whole new team and invested in that.” Two years ago, the company generated no revenue from mobile sales. Today, mobile accounts for 20 percent of the business, Mayhew said.

But satisfying customers doesn’t just mean taking them to the Internet. Fenway also led the company in the opposite direction—to the bricks-and-mortar confines of WalMart. By doing so, they put themselves in direct contact with the largest population of physical shoppers in the world.

3. Consumer companies must grow faster than GDP to produce attractive private equity returns
Success in the consumer products business requires an expansive view of potential areas of growth. While everyone is focused on the Internet, superior distribution channels aren’t the only factor in producing profit and capturing value.

Take the trend toward “good-for-you” products like energy bars. By identifying and capitalizing on such opportunities, private equity firms can generate good returns regardless of where the product is sold. Likewise, demographic groups or entire countries figure prominently in growth rates for consumer businesses. “Either way, you’ve got to figure out how you’re going
EXPERT TAKEAWAYS /

4. Orphaned brands can be great starting points

Not surprisingly, investors often shun declining businesses. But sometimes, at the center of declining businesses are brands that can be repotted with new management and operating infrastructure and turned into success stories. McCabe’s Brynwood specializes in such deals. The firm recently picked up the U.S. business of Zest, the “Zestfully-clean” soap brand that had all but been abandoned by then-owner Proctor & Gamble. “They had no brand managers, no one was working on it,” she explains. Brynwood changed manufacturing methods and reduced cost-of-goods-sold. The even lowered the price of each bar of soap to put it firmly in the value category.

Part of a private equity firm’s advantage in revitalizing a consumer brand is its ability, and motivation, to focus. “We have 100 percent of our time on one SKU, not on 30 brands. [Zest was] the last thing that came out of the bag of a P&G salesman, not because it was a bad brand, but just because he was spending his time on Old Spice and Oil of Olay,” Brynwood has taken the same approach with dusty brands like Alberto Vo5 shampoo, Brylcreem and Aqua Velva.

Delighted with decline

Joan McCabe, managing partner at Brynwood Partners, sees value where others see a has-been consumer brand. Her approach is to take a declining business, slow the downward trend or reverse it, and to capture the otherwise foregone profits that result.

“We don’t buy growth businesses,” she explains. “We look back instead of forward. So where you stand depends on where you sit. Many of the brands that we buy are declining double-digit. So to us, to get to zero is a success.”

The key to success, in McCabe’s view, is gaining control. Minority deals are anathema. “For better or worse, we make the decisions,” McCabe said. “We don’t want to be in a position where we’re fighting at the board level.”

to grow double digit,” Mayhew said. “It’s either got to be the sector, it’s got to be the channel, or it’s got to be the region. It’s got to be something along those lines.”
Michael Grossman says he is seeing new interest in the orphaned brand revitalization strategy. By his estimation, such brand or division carve-out deals tripled in the past year. Management can successfully make the transition to private equity ownership, he explains. “You get them to roll some equity or give them new equity in the business,” Grossman says. “And you get a real good opportunity there.”

5. Think customers, not corporate

Back to that all-important person—the customer. Retailers must be everywhere their customers want to be, and know them when they get there.

Mayhew likes to use a personal example—buying t-shirts at J.Crew. “J.Crew has 15 different types of t-shirts, and I buy a specific type of t-shirt online,” he explains. “So when I go into a J.Crew store it’s unclear to me why, when I go to the salesperson and say ‘Where are the t-shirts?’ they don’t say, ‘What’s your name?’”

“I don’t know why they don’t know me equally in all these channels... It’s a level of good, old-fashioned service. It doesn’t matter what channel you’re in.”

McCabe of Brynwood Partners says those are the types of exchanges that a private equity partner with a fresh perspective can help a company create. She says that an infusion of cash helps, but it can also require changing a corporate culture. “We find that’s the most difficult thing—training people, educating people to think differently,” she said. “A lot of companies are just too big to be at the cutting edge of that.”

A desire to be cutting-edge is pushing a lot of reluctant sellers into the market, says Grossman of McGladrey. “They need some working capital to get to the next level because they know they’re going to get crushed in the market if they don’t get to that level.”

Don’t fear the founder

Turning a consumer products company around doesn’t necessarily require putting existing management out on the street, says Timothy Mayhew, a managing director at Fenway Partners. “We tend to like to work with founders,” he said. “And so that founder can remain a consistent presence...It’s only a failure for us, I think, if we actually completely swept the culture.”

But he works hard to find the right kind of founder, one who’s open to—and enthusiastic about—making the necessary changes. He suggests finding businesses that show small indications of potential, some forward momentum that could use the bigger shove private equity can provide. “Then maybe there’s going to be a little extra tweak or a little extra push or a little extra change that’s going to take it from a single-digit to a double-digit,” he says.
What services does McGladrey offer to private equity clients?

We've got a lot of experience with buy- and sell-side due diligence. But we also do tax structuring and M&A tax advice. Technology is also a big piece of our business. We have a whole consulting practice built around technology and areas like performance improvement. And then, of course, there are portfolio and fund audits.

For due diligence, margins are very important to our private equity clients. In the middle market, you really need to make sure your margins are appropriate.

What has been an important trend in the consumer-products private equity space?

We see more minority interest deals. This started back in 2009 when there weren’t really a lot of deals going on. You get companies that don’t necessarily want to sell 100 percent or 80 percent of their business, but yet they needed some working capital, growth equity. And so they were able to get those deals done.

For more information, please contact Michael Grossman at michael.j.grossman@mcgladrey.com • www.mcgladrey.com

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We provide a single point of contact for all service teams working with you domestically and globally, whether your needs involve portfolio and fund-level management, transaction support, fundraising or exit strategy. When new tax laws or regulations in areas such as health care affect your investments, we bring together professionals with functional and industry expertise to help you navigate these changes.
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