

Libey Economic Outlook

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Donald R. Libey, Editor

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What's Good?

Donald R. Libey

In this issue I will attempt to comment on what is good about the future of catalogs. As we rush to embrace multichannel evolution, let's not lose sight of what got us here and what sustains upwards of 80 percent of our businesses.

Good is Relative

Because we are so close to the daily Sturm und Drang, we seldom see all of the good things that surround our businesses. Some become focused on the bad things; some seem almost oblivious to both; a few lead from a position of positivism.

Good is a relative concept; it describes different things for different people. I know several veteran circulation pros who think a 2 percent prospecting response rate is "good," and they are right, for their company and circumstances; for others it might be a 4 percent response. We try to benchmark metrics and analytics that will prove our performance is good, but there is no all-around definition of good; it varies for every company and across every channel and product line. Clients always want me to benchmark specific areas of performance and, when I give them industry norms, they immediately refute those norms and say their business is different. Of course, it is. What is difficult to understand is that the idea of good performance is relative only to your business and its unique performance history. The key is to get to the point where you *know* what is good and what is bad, where you can objectively evaluate good from bad as it uniquely applies to your business. At the end of all analyses is one ultimate question: Is there adequate profit?

Catalog Good

Even though more and more catalogers now define their business as “multichannel” rather than “cataloger,” the primary element that makes the paper catalog good is control. *You* control the catalog circulation, not Google or Yahoo. You do. You say how many and at what cost. You pick and choose—proactively—who will receive your catalog. You control the offer and the price. Search engine marketing controls you. It tends to dictate the rules and—sometimes one might think—the results. Search term auctions and bids have you at their mercy. It’s “pay to play” and there’s no guarantee.

Not so with the paper catalog. When you carefully construct a prospecting plan based on known performance of known cells from known lists from known merchants, you have a *basis of tested knowledge* through which you control your efforts and your expenditures. Search is still a bit of the Wild West frontier without absolute metrics; and let’s be straight forward: metrics is how we got where we are. For my money, control is affordable in the form of a paper catalog with a tested mail plan to top performing lists.

The second thing about good catalogs is the fact that they *do* create online sales; at least 70-80 percent of the online sales begin with the paper catalog catalyst. That seems to be an innate attribute of catalog and the purchasing process. They are also good at bringing people into retail settings, whether industrial supplies or office products, or computer peripherals. Catalogs are truly *catalytic*. I’m not sure I’m ready to give that up in favor of Google entirely.

The third fascinating thing about catalog goodness is the simplicity. It isn’t difficult to put them together and track them. There’s really not a lot of ambiguity about catalog performance. Oh, I know, they’re old fashioned and don’t have a lot of “neo-channel” appeal anymore, but I can usually track the absolute source of about 85 percent of the orders at almost no cost for the knowledge. And, if I can drive those orders well-enough, I can keep upwards of 60 percent of those people who will buy from another catalog and another catalog and another catalog. With all the popular “speak” about being “channel agnostic” I really don’t mind customers who prefer to buy from catalogs over and over. Let’s see . . . we’re really good at order entry and fulfillment and service . . . the products are good . . . the price is right . . . so . . . all I have to do is keep sending interesting catalogs with new stuff and the customer stays happy. Maybe . . . just maybe that is what is keeping that buyer from running off with a Google search competitor, or switching to a product aggregator, or a dodgy “net gnat.” Maybe it’s the old familiar catalog that is a touchstone of reliability and trust. Maybe the catalog actually *drives* retention.

Catalog Cost

I suppose I am a heretic—especially this month after the USPS catalog postage rate revelation that seems to have caught the entire industry off guard—but with what other media can you make a lingering sales call and get people to browse your store for less than \$.70 a pop? Only with a paper catalog. Even if half the cost is to deliver it from Wisconsin to California, the postage is cheap. And it really isn’t about the postage cost anyway; it’s really about both the response rate and the sales per catalog, and those are *really* about the quality of the *merchandising*.

What is concerning, is that a \$.70 catalog from one cataloger can do well and a \$.70 catalog from another does poorly. The postage is the same. The paper is the same. The ink is the same. *It’s all about the merchandising*, and we have become lax, soft and

sloppy in our merchandising skills. We thought it was all about databases marketing. Then we thought it was all about Abacus and co-ops. Then we thought it was all about search terms. NO. *It has always been—and always will be—about the product, the offer and the customer’s needs at the moment.*

So, if you want to compete with your \$.70 paper catalog, invest in merchandising. It will benefit *any* channel you use.

Cost is relative. For a small catalog, it might be \$.70. For a big catalog, it might be \$2.70. It doesn’t matter because it is relative. Merchandising, however, is not relative. It is competitive and objective. We can all whinge and whine about tough online competition, or we can do something innovative, unique and fresh with products, offers and concepts. We can do something creative with photography rather than just using manufacturers’ pick-ups. We can *tell a product story* with fresh applications. If you want the \$.70 to return more to your bottom line, *give it something to work with.*

Controlled Simplicity or Random Chaos

Stop for a day or two and take a good look around. We’re beginning to analyze systems that analyze systems that analyze. We have more data and bits and bobs than we’ve ever had before and frankly, from what I see, most multichannel marketers don’t know what to do with it all or what it all means. And we’ve got more third-party Internet and search vendors telling us to do even more analyses and to build even more models that we are slowly slipping into the ooze of the Great Grimpen Mire and will soon sink into the smothering oblivion of random chaos. And it’s *really* expensive.

But the catalog has the attraction of controlled, understood simplicity. It’s a steady track in an otherwise uncharted online world. We know *how* to catalog. We know how to investment prospect for future growth and profits. We know how to paginate. We know how to create creative. We know how to get it into hands that want to hold it. And we do that pretty much all by ourselves.

No, I am not returning to my pre-1992 Luddite period. I understand the importance of the online evolution. I simply don’t want it to get too far out of control and destroy the needed balance of our—still—most significant and important channel: the catalog.

Look to the Smart Money for Channel Strategy

In differing countries, I see differing strategies and differing emphases. On two boards on which I serve, there are very smart, very wealthy, very strategic minds leading the way. These individuals would have to be among the very best minds in the multichannel/catalog industry. Both of these brilliant people are increasing their *catalog* circulation by as much as 40 percent in 2007. They figure 75 percent of those catalogs will drive online orders, and they really don’t care. The catalog is the best vehicle for obtaining *customers* and for *retaining* customers. They see paper catalogs as inexpensive, efficient, controllable and effective. They can turn on and off the spigot of circulation as they wish, and the demands of paper catalog merchandising makes them better merchants, regardless of the channel. These two brilliant people are investing in *merchandising and circulation* while all those around them are investing in multichannel complexity. They are also acquiring other businesses, customer lists, affiliates and catalogs.

The Plea for Balance

As we become increasingly immersed in social marketing, YouTube and MySpace, and the bottomless Google, this small article is, at its heart, a plea for balance. Keep your eyes on *all* of the multichannel milieu, but keep *one* eye totally on your catalog expansion, performance and circulation strategy. Avoid the Siren Song luring you fully to the shoals of the pure online world with its writhing chaos. There is safety, comfort and profit in the backwater of the paper catalog, there in the deep waters where the big fish feed and the *haul* is assured. At least for the intermediate future. Adapt slowly; it's a Darwinian industry.

The Guideposts

Here are a few ballpark guideposts to help you evaluate where you are relative to a broad cross-section of multichannel marketers. These are not absolute, but they are reasonable. Your individual performance will vary.

1. Business to Business Costs (percentage of net sales).

Cost of goods sold	47.1%
Gross margin	52.9%
Marketing expenses (catalog)	22.5%
Online expenses	6.0%
Operating expenses	7.0%
G&A expenses	10.5%
Operating income	6.9%
List rental income	1.0%
Income (EBIT)	7.9%

Any one percent improvement in gross margin or any expense category produces significant benefit to EBIT. This is where there is *good* to be harvested from a good catalog business.

2. Business to business salaries (7+ years of experience).

Marketing director	\$100,000 to \$125,000
Merchandising director	\$100,000 to \$130,000
Ecommerce director	\$120,000 to \$150,000
Circulation director	\$ 75,000 to \$ 95,000
Creative director	\$ 90,000 to \$ 110,000

Regional variances are common and may be above or below these salary ranges. This describes what *good* people are being paid this year.

3. Sales per employee.

2007	\$365,000
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This is my arbitrary benchmark for sales per employee based on a running score of the companies I review. This number has been increasing over the past 10 years due to

productivity increases from systems. This is highly variable, however, and is determined by many factors. Yet, poor performing companies are usually below this number and excellent companies are usually above this number, often substantially. The key is knowing your company's trend; only up is good.

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The Second Quarter 2007 Economic Outlook

The February stock market decline may be a signal of difficulty ahead; however, growth may slow further to 2.2% through the end of 2007 and a soft-landing may be the result, especially if the housing market has bottomed out. The slowdown will cause the unemployment rate to drift up, probably from 4.5% to 4.8%.

The Fed will likely try to keep things balanced by interest rates. Greenspan's comments still move markets as we have seen, and he is clearly less optimistic. We sense a continuing period of pressure, but not an out and out recession—yet. It is very true, however, that the long bull market has to come to an end at some point, and the jitters are palpable. The repeated offsetting outlook remains that slower growth would cause core inflation, which excludes energy and food, to moderate. Fed policy easing will perhaps restore a flatter yield curve, offsetting a bit the lengthy inverted yield curve we have had for some time now, which is almost always a precursor to economic slowdowns. Profits will stabilize at a slower single-digit pace. The overheated private equity investment pace may cool, and that might not be a bad thing. Overall, this is a cautious outlook and, increasingly, it can be influenced by the increased saber-rattling over Iran and the complex problems in almost all of the Middle-east.

I continue to see a strong economy, albeit one that is slowing. The manufacturing outlook is mixed, but defense spending keeps it stable. The real power right now is the investment being made in business consolidation by massive private equity binging; everything from power plants to dairies is being consolidated, kick-started for growth, and flipped for return to investors. At some point, that has to stop, but for now it is driving a reasonable economic outlook.

Signs of Regional Stability or Status Quo

Region One (CT, ME, MA, NH, RI, VT)

Region Two (NY, NJ, CT, PR, VI)

Region Four (OH, KY, PA, WV)

Region Six (GA, AL, FL, LA, MS, TN)

Region Seven (IL, IN, MI, WI, IA)

Region Eight (MO, IL, IN, KY, TN, LA, AR)

Region Nine (MN, WI, ND, SD, MT, MI)

Region Ten (KS, CO, MO, NE, NM, OK, WY)

Region Eleven (TX, LA, NM)

Region Twelve (CA, UT, AZ, NM, OR, WA)

Slower (Individual states)
 Region Three (PA, NJ, DE)
 Region Five (KY, MD, TN, VA, NC, SC)
Louisiana
Mississippi

The Second Quarter 2007

Circulation and Prospecting Outlook and Recommendations

Synopsis

The short-term economic outlook for the catalog industry remains positive. The intermediate-term outlook remains positive for the second quarter of 2007 and the long-term outlook through 2007 remains positive.

Prospect as an Investment

For the first half planning in 2007, even with the apparent slowdowns in the markets and in overall business, continue with normal to slightly increased strategies for circulation and investment prospecting plans. It would require caution to increase prospecting presently by more than 10 to 15 percent. There are early signs that may signal economic reasons for reductions in either prospecting or customer circulation, or both, in the last half of the year, but this is not the time to pull back in my estimation. We would be comfortable with modest increases in prospecting levels.

Nation at a Glance

We have revised mailing recommendations in several states for the second quarter planning in 2007. In all areas in **bold**, we have shifted to normal mailings from increased mailings.

State	Mailings		
		Illinois—North	Increase
		Illinois—South	Normal
Alabama	Normal	Indiana—North	Normal
Alaska	Normal	Indiana—South	Normal
Arizona	Increase	Iowa	Increase
Arkansas	Normal	Kansas	Increase
California	Increase	Kentucky—East	Normal
Colorado	Increase	Kentucky—West	Normal
Connecticut	Increase	Louisiana—North	Evaluate locally
Connecticut-Fairfield	Increase	Louisiana—South	Evaluate locally
Delaware	Increase	Maine	Normal
District of Columbia	Normal	Maryland	Increase
Florida	Normal	Massachusetts	Increase
Georgia	Normal	Michigan	Normal
Hawaii	Normal	Michigan—Up. Pen.	Normal
Idaho	Increase	Minnesota	Increase

Mississippi—North	Evaluate locally	Pennsylvania—West	Increase
Mississippi—South	Evaluate locally	Puerto Rico	Normal
Missouri—North	Normal	Rhode Island	Increase
Missouri—South	Normal	South Carolina	Increase
Montana	Normal	South Dakota	Increase
Nebraska	Increase	Tennessee—East	Normal
Nevada	Increase	Tennessee—West	Normal
New Hampshire	Increase	Texas	Increase
New Jersey—North	Increase	Utah	Normal
New Jersey—South	Increase	Vermont	Increase
New Mexico—East	Normal	Virgin Islands	Normal
New Mexico—West	Normal	Virginia	Normal
New York	Normal	Washington	Increase
North Carolina	Increase	West Virginia—East	Normal
North Dakota	Increase	West Virginia—West	Normal
Ohio	Normal	Wisconsin—North	Increase
Oklahoma	Normal	Wisconsin—South	Increase
Oregon	Increase	Wyoming	Increase
Pennsylvania—East	Increase		

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Business to Business Growth by Medium

The following highlights a variety of business to business media and the compounded projected annual growth for each through 2009. Perhaps this will assist you in focusing on possible growth initiatives and logical allocations of marketing resources.

Media	Projected Annual Growth Through 2009
Catalog	4.6%
Non-catalog (envelope/flyer)	6.2%
Telemarketing	5.5%
Internet	11.6%
Email	11.6%
Insert media	6.2%

What I think this indicates is that you have a need to rationalize your media by triangulating dollars, response and projected growth. The key is to get to *your* logical annual growth and logical media. While these are broad industry numbers, your numbers will likely be very different. The point: Do you know? Does your marketing team know?

The other thing that becomes very clear is that we are *still and will remain* a list-based industry for the future. Don't lose sight of the value of a name versus the value of a search term. We do business with *people*.

I believe the next 2-3 years will require a far more analytic and accurate determination of where marketing dollars are to be spent. We are in the very early years of gaining experience with multiple channels. Previously, we only had to rationalize mail and telephone, by and large. Now, we have added online, email, search, and other media to the mix. Most companies do not, as yet, have a solid grasp on the relationship between these expenditures and are exploring how to measure and plan for future optimal advertising allocations.

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Catalog Production 2007-2020

The paper industry experiences exceptionally long lead times for manufacturing paper capacity and constantly studies demand for catalogs very carefully. In my experience they are the best “crystal ball gazers” to predict the future of the catalog. Here are their numbers for all catalogs expressed in Thousands Short Tons.

Year	Total Catalog Paper Consumption
2007	3,876,000
2008	3,973,000
2010	4,136,000
2015	4,749,000
2020	5,232,000

Conclusion: This is a compounded 35 percent increase over 13 years. The paper industry is expecting catalog growth to continue to grow at these rates the intermediate future. Cheaper grades and lighter weight grades of paper will be used by catalogers, a shift from coated #4 and #5 grades. What this tells us is the next 15 years have a strong catalog component to the multichannel industry.

Perhaps you have found the various benchmarks and comparisons throughout this issue to be of interest and of some help to evaluating where you are relative to other companies. All of these are, as I have stated, different for every company; only you can determine where you should be, but these are reasonable indicators on a map for you to read and use as you see fit.

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Ecommerce Systems

Netconcepts

Reasonableness has to be considered in all systems purchases, especially those for ecommerce platforms and search engine optimization. For me, the definition of reasonableness is whether something will work and is priced somewhere below the cost of a small nation. In full disclosure, I have no relationship of any kind with the company mentioned; I just like its premise and its reputation.

Netconcepts has been around about 12 years now. Located in Madison, Wisconsin, they number among their clients companies such as Northern Tool + Equipment, Cabela's, Home Shopping Network, REI, Discovery Communications, Inc. and many others. None of these are small operations; most are complex with lots of SKUs.

Netconcepts has two primary ecommerce entry-level products: GarvityStream for search engine optimization; and GravityMarket, a suite of open source code-based solutions for the ecommerce platform.

I am a believer in open source code. It is not proprietary. It's not "owned" by somebody. The code is not stored in someone's garage.

I am also a believer in reasonable cost. The entry price for the search engine optimization package is about \$8,000. The entry price for the ecommerce platform is about \$25,000. Kind of like buying a Ford Focus and a Ford 500. Reasonable.

GravityMarket is a suite that enables merchants to set up a shopping cart, offer gift certificates, feature select products, optimize search engine marketing and offer up best sellers. Netconcepts is expanding the capacity for GravityMarket to help retailers improve their web site, as well as their online marketing and merchandising across all sales channels, thereby helping shoppers make more informed purchasing decisions.

GravityStream, the SEO package, helps catalogers build a more keyword friendly site search engine and a stronger online brand identity. It can also assist in improving customer loyalty through an intuitive and user friendly shopping experience. GravityStream can create more effective cross- and up-sell strategies, such as programming the shopping cart to bring up best-selling items once a product is placed in the cart, along with add-ons and gift cards. It's also Web 2.0 technology.

Not bad: open source code; solid company; good clients; reasonable cost. Probably worth looking at. Plus, there is just something good about companies that are based in Madison, Wisconsin. Madison is a center of Midwestern direct marketing and the talent and work ethic in Madison is special. Also (and not trying to be a snob or anything) Madison and, indeed, the Midwest, has a lot of very bright and innovative people.

Systems Spending

Overall in the catalog and online direct marketing industry, technology replacements or upgrades for 2007 are broadly estimated to be as follows:

Replacement Priority	Percent Catalogs
Ecommerce platform	42%
Order entry/management system	34%
Site search system	42%
Web analytics package	30%
Website performance monitoring	25%
Shopping cart package	30%

Interestingly, given the costs and the talent required to make these replacements and to upgrade online technologies, only about 30 percent of the catalog and online companies plan to hire outside vendors to assist them with the technology projects or use outside third-party vendors. That means that about 70 percent of the catalog and online companies are choosing to handle their technology implementation internally.

Similarly, online marketing is a significant cost center, yet only about 30 percent of the catalog and online companies use a third party vendor for managing their search programs. Roughly 70 percent run these initiatives in-house.

It would appear, as the industry matures and gains sophistication, we believe that we can do it better for less cost in-house than as an outsourced function.

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The China Connection

Undoubtedly you saw DMNews' announcement about FedEx:

DMNews; March 2, 2007: FedEx Corp.'s FedEx Express unit has completed the purchase of Tianjin Datian W. Group Co. Ltd.'s 50 percent share of the FedEx-DTW International Priority express joint venture and DTW Group's domestic express network in China for about \$400 million in cash. Memphis-based FedEx said China continues to be one of the fastest-growing markets in the express industry and a key to its international growth and profitability. The acquisition will allow the company to solidify its leading position and ensure its global customers continued access to China. As a result of the acquisition, FedEx will employ more than 6,000 people in China. DTW Group will continue to operate international freight forwarding, general cargo transport and merchandise distribution businesses.

Now, let's think about what this means. FedEx is a global brand with, I believe, the largest fleet of airplanes of any earthly entity; larger even than the U.S. Air Force. FedEx has a huge stake in distribution in China. FedEx specializes in moving "stuff" in boxes from point A to point B.

The article above states, "The acquisition will allow the company to solidify its leading position and ensure its global customers continued access to China." What it doesn't say, but what is implicit in the acquisition is that 'The acquisition will allow the company to solidify its leading position and assure its Chinese customers access to the global market.'

In short, I have been saying for about a year that we have been slowly but relentlessly teaching China about direct marketing. When they learn to become catalog and online merchants, selling and fulfilling ones and twos rather than container loads, we will have a formidable competitor with a price structure that will make even Wal-Mart go all nuts.

What lies behind this is an inevitable market force that will not allow for the costly double movement of a good from point A (China) to point B (your warehouse in Atlanta) and then from Point B to Point C (an end-consumer in California). Trucking the product across country *twice* is not efficient.

When China is able to sell the same product online—*at China's cost to produce*—and ship it directly to the end consumer, the U.S. merchant has a new competitor. What we possess now is the barrier to entry: direct marketing and online marketing knowledge and assets (lists, niche markets, customer base). Perhaps it is time for us to be a bit more possessive of our knowledge.

It looks to me like FedEx has hedged its future bets and is setting itself up to be the package delivery company of record for the new China direct marketing industry. You heard it here first.

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A Final Word

If business for you softened in the first quarter, don't go getting all crazy and cutting back and reducing mailings and prospecting. It seems to have softened for a *lot* of companies and my guess is that the weird weather had as much to do with it as the state of the economy.

Every time we see a dip—whether due to disasters, weather, anthrax scares or whatever—the meek rush to pull back and they spend the next two years trying to catch up. Sorry, but the meek *do not* inherit the earth.

Don't panic. Use solid logic and common sense and manage the business rationally with a consistent but growth-oriented look to the future.

If you look at the very long view—say, 1970 to today—you see a business that has “octupled” its size. If we had not invested and pushed the edges, we would be where we were then. It will expand. It will grow. It will be ten times larger in another 30 years and none of us will be around. But, pulling back . . .? “*There's no pulling back in baseball!*”

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Libey Incorporated
Consultants & Recruiters to Direct Marketing

**811 Church Road Suite 105
Cherry Hill, New Jersey 08002
Tel: (877) 903-9448 Fax: (866) 221-8346**

Tel: (515) 537 2307 (Don Libey's Direct Number)

**E-mail: libey@libey.com
www.libey.com**