

Libey Economic Outlook

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Donald R. Libey, Editor

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Cataloging's Silent Partners

Donald R. Libey

Over the years, the catalog industry has acquired a number of "Silent Partners" who share in our profits but not necessarily in our risks. Perhaps it is time to rethink where this is all going and how we can regain control over our destinies.

What are "Silent Partners?"

A silent partner is a person or entity that exerts some degree of influence over your business which you cannot control. In some cases, it can be a beneficial influence; generally it is not. The cynic in me has often thought of these silent partners as parasites, and a parasite is most often debilitating and unwelcome, running the gamut from eyebrow-dwellers to intestinal blood-suckers; yet, Nature provides the Potato Cod fish with a parasite *remover*—a small fish named the Cleaner Wrasse—that feeds on and removes parasites from the cod's body, mouth and gills, thereby helping to keep the cod healthy and robust, able to feed and grow. Perhaps our catalog industry could use a good Cleaner Wrasse to help rid us of our ectoparasites, or at least keep them to a minimum.

Catalogers historically never felt the pinch of the silent partners because we historically have had such high margins and response rates that their "cut" as a percentage of net sales was negligible. We tended to notice but not get too excited whenever they decided to up their cut of the earnings. In short, over the past 30 years, we've been nickled-and-dimed to death.

The cod does three things: 1) it swims through the water looking for food (prospecting); 2) it eats (sells); and 3) it breeds (survives). In its way, it is a lot like a catalog. A catalog prospects to sell in order to survive. These three functions are the

absolute foundation of survival for a business and for a cod. All other functions are secondary to these three components of existence. Parasites rarely mess around with the key functions; they almost always invade other, less-essential (but important) operations of the body. If a parasite shuts down a key function, it kills the host. That's why they prefer to feed through irritation and portion-control; the host stays alive but becomes weak and anemic.

And so, here we are, our great cod of a catalog industry, lumbering through the water searching for new food, and clinging to our soft filets are our unique parasites, our Silent Partners, and we are looking a little pale. In fact, we may be in danger of dying.

Postageaeus Increasium Absurditus

This is our oldest silent partner and pseudo-beneficial parasite. It has been around for a great many years, dating back to Benjamin Franklin. It unquestionably performs a needed function for the cod-alog industry, but it does exact its pound of flesh, and never as much as it will in the May 2007 feeding frenzy. The absurd postage increase for catalogs (Standard Mail Flats) has catalogers all excited.

There is a danger that we will swim under a rock and avoid hunting for food. That's always what happens whenever the sharks swarm. In the end, though, if we persist in hiding under rocks, we just get weak, waste away and become food for larger marauding predators. That's life: Predation or Prey; it's all about choices. You can go ahead and pull back prospecting and mailing, scale back the catalog pages, eliminate versions and editions—you can hide under the rock—but you won't eat. And you'll get weak and thin and something bigger will swim by and tear you apart.

Here is an important comparative study Kevin Hillstrom did that shows what happens when you retreat due to the postage increase. It is based on a 26 percent overall increase in postage; remember we are faced with anywhere from 12 percent to over 40 percent increases for various classes of flats depending on our catalog sizes, weight, sortations, trim sizes, etc. (See: Kevin Hillstrom: www.minethatdata.blogspot.com).

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The Long Term Impact of Postal Reform

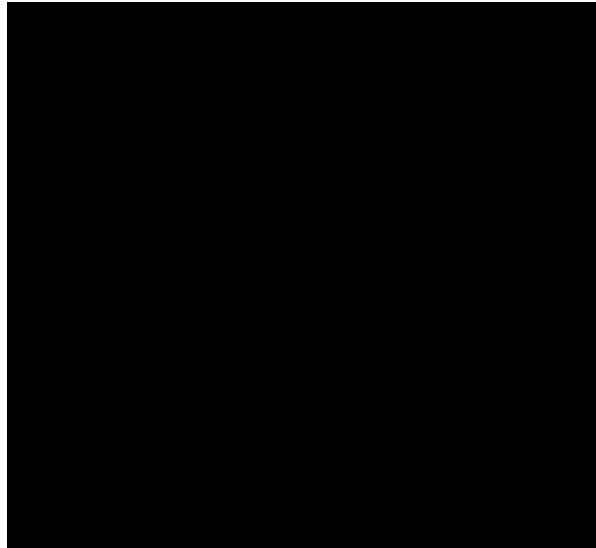
Kevin Hillstrom
President, MineThatData

Catalog-based direct marketers are facing increased postage expenses that threaten the short-term and long-term profitability of our industry.

It is a reasonably straightforward exercise to understand the short-term impact of increased expenses. It is possible to also understand how the long-term growth of a catalog-based business will be impacted by managing expense increases.

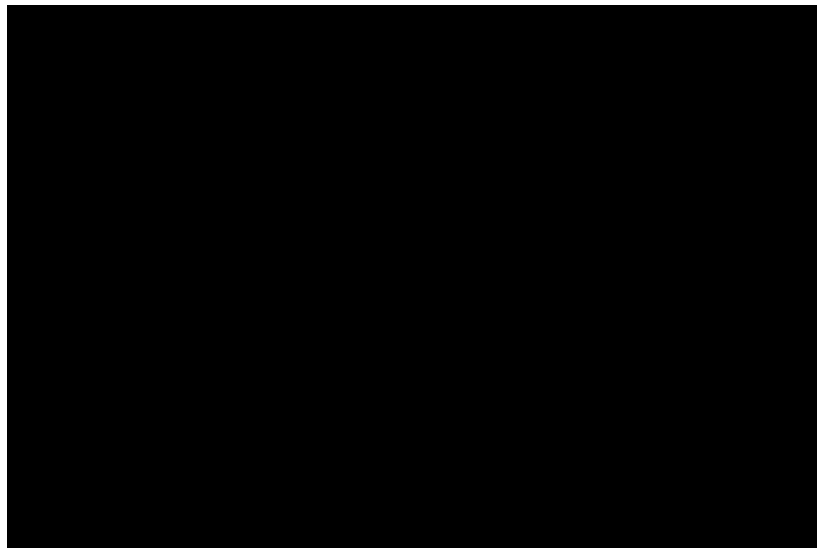
Let's evaluate a catalog-based business that mails approximately one catalog a month, about one hundred pages per drop, to a circulation of about 500,000 prior customers and prospects. This business also has a website that customers choose to purchase from.

In an individual mailing, the profit and loss statement might look something like this:



The catalog-based business mails a half-million catalogs, driving nearly \$1.3 million demand attributed to the catalog/telephone channel, and more than \$0.8 million demand via the website. The individual catalog drove nearly \$90,000 of variable operating profit (not counting general and administrative costs).

Let's assume that the cost of postage increases by twenty-six percent for this catalog-based direct merchant. The profit and loss statement changes, as illustrated below:

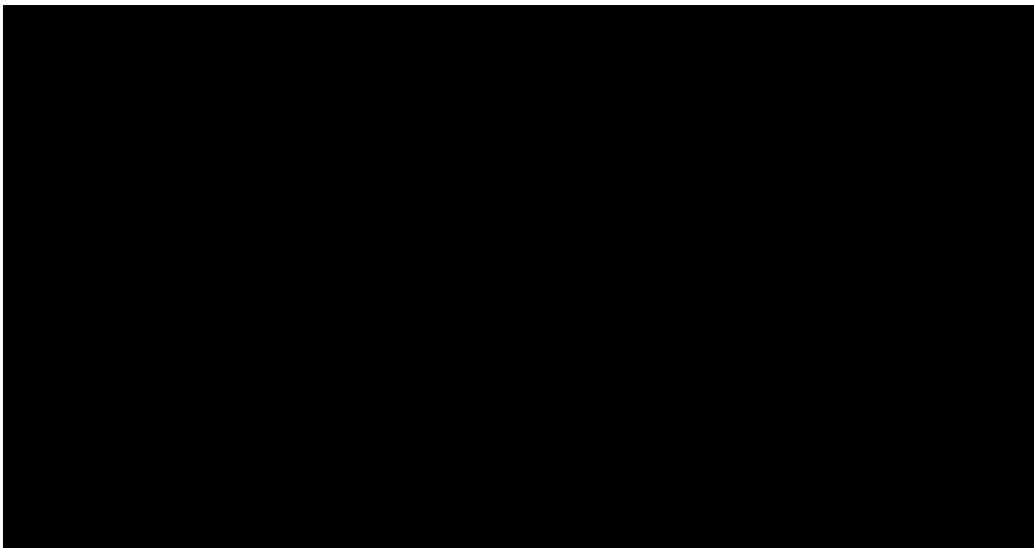


An increase in postage results in a significant reduction in profitability. As long as circulation is held constant, total responders in the catalog remain at 21,000 per drop.

The increase in postage results in more than \$32,000 of incremental expense in this example. Remember, this business mails twelve unique catalogs per year, meaning that more than \$385,000 of annual expense can be anticipated.

The business can choose to accept the increase in expense, and figure out how to better leverage other aspects of the profit and loss statement. The business can attempt to improve the rate at which merchandise is available to the customer (minimizing lost sales), or reduce return rate, or improve gross margin, or lower pick-pack-ship costs, or re-engineer the catalog production process.


It is likely the business will choose to reduce circulation, in an effort to improve profitability and reduce expense. In the next table, observe what happens when circulation is reduced.



The financial folks might support this plan. By reducing circulation (cutting mailings to infrequent customers and prospects who have become unprofitable to mail due to the expense increase), catalog mailing expense actually decreases. Profitability improves marginally, and on an annual basis will be more than \$33,000 better than by not cutting circulation.

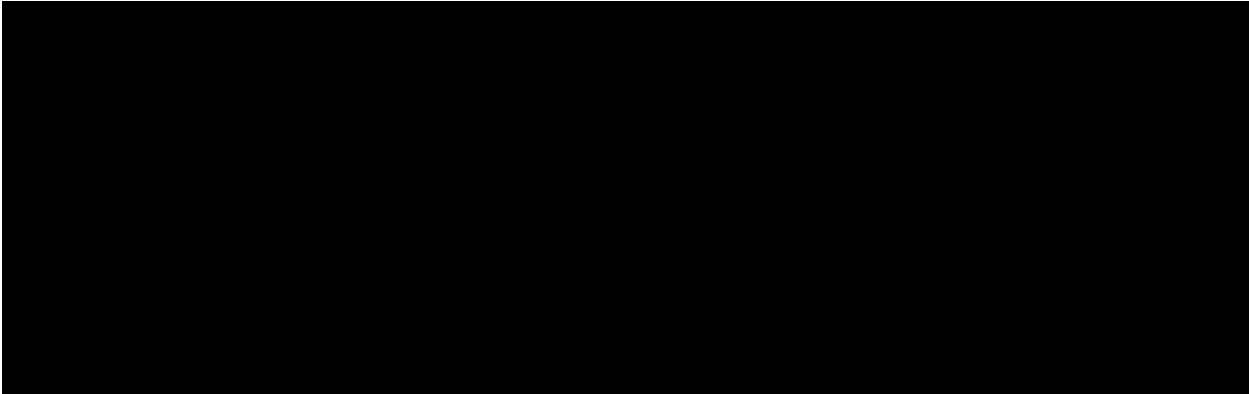
This strategy is likely to be employed by catalog-based direct marketers. There is one problem with this strategy, however. Take a look at the number of responders in this last example. Because circulation decreases, total responders decrease by 1,639. On an annual basis, this results in nearly 20,000 fewer responders. Remember, these customers are not the best customers. Because best customers respond at high rates, they are profitable regardless of an increase in postage.

Before the postage increase, this business had a five-year demand plan that looked something like this:



Demand increases marginally, year after year. Customers are largely acquired via the catalog channel, though some customers are acquired and purchase online.

Now, let's evaluate the five year plan, when between fifteen thousand and twenty thousand fewer responders are added to the business, year-after-year, due to increases in postage that cause reduction in circulation:



At first, there is a \$2.5 million dollar short-term impact, similar to what was illustrated in our catalog circulation example, on an annualized basis. But look what happens over time. The business is starved of about twenty percent of the new buyers the business acquired each year. Fewer inactive buyers purchase as well. After five years, a \$39 million dollar business is reduced to a \$29 million dollar business.

In other words, short-term decisions, made in 2007 and 2008, impact the long-term health of our businesses. The increased cost structure of our catalog-based direct marketing businesses impact profit marginally in the short-term, but throttle our ability to grow our businesses in the long-term.

The long-term growth of our business is the real issue at hand. We can all deal with figuring out how to manage expenses to make the profit and loss statement look acceptable. We have a hard time envisioning the long-term impact of these strategies.

It is likely that within twenty-four months of a postage increase of this nature, catalog-based direct marketers will begin to understand the long-term impact of short-term expense management. This will drive catalog-based direct marketers online, searching for ways to use the online channel to recruit new customers. The push online

could come at the expense of catalog-based marketing. In other words, money spent on catalog-based marketing could be shifted to the online channel, further exacerbating cost pressures in postage, foretelling the collapse of the entire enterprise.

Business leaders are likely to leverage long-term scenario planning and multichannel forensics to better understand what impact postage increases will have on our industry. This paper illustrates the significant impact on our industry, over the next five years. The growth of our industry is likely to be throttled by short-term decisions to reduce expense and to improve short-term profitability. Catalog-based business leaders must forego circulation reductions in the short-term, in order to protect the long-term health of the catalog industry.

* * *

What Kevin brilliantly shows here is that if you pull back prospecting you will be significantly smaller in five years as a result of your decision. This is not *maybe*; this is *mathematic*. It will occur.

Pulling back is giving in to our silent partner, the U.S. Postal Service and its partners, the Postal Regulatory Commission and the U.S. Postal Service Board of Governors. These bodies are attempting to resolve postal rate problems based on new regulations that attempt to balance weight and shapes under the Postal Reform Legislation. There is some who believe that letter-sized mail and catalog-sized mail should share differing postage increase burdens. The letter mailers (banks, credit card companies, etc.) want to limit their postage increase and place additional costs on the catalog mailers. And the letter-size mailers are very well-represented in the lengthy and very confusing process that determines how postage rates are set. Suffice it to say, the process is filled with regulations, lawyers, lobbyists and special interest groups. The catalog industry has never really paid much attention to that stuff. We've been too busy building our businesses and trying to keep customers happy and coming back.

On top of this month's increase in postage, there is potentially *another* rate case to be filed for 2008. The long and short of it all is that you may well have a similar postage increase next year and others as far as you can see in the foreseeable future. Your silent partner has *needs*. Those needs look to require somewhere around 10 to 12 percent of your net sales . . . and climbing.

UPSiasis Packageagita Eternalia

Your second Silent Partner would appear to be United Parcel Service (UPS). Another of our long-time silent partners, UPS has, in the past decade or so, felt an increased need to dip into our collective catalog industry pocket. The annual rate increases are almost a rite, an astrological occurrence that unfailingly takes place every January or February and is often found in the Double-Digit Constellation.

All of us have, at one time or another, sat down with our UPS representative and negotiated our way through another contract. And the end result is that we always pay more; occasionally a senior representative from UPS Regional or—if we are big

enough—UPS national may deign to attend and throw us a small bone of a reduction in the annual increase. Make no mistake, though, you *will* pay more regardless.

Now, just what exactly has Brown done for you lately? As a formidable silent partner, Brown has a litany of fuel surcharges it trots out as necessary; regulations and restrictions; size penalties and size perks; requirements for pricing; lots of rates, tables, factors . . . Actually Brown sounds a lot like the U.S. Post Office, doesn't it?

What has *never* occurred, to my knowledge, is an industry group representing catalogers sitting down with Brown to let them know just what we think, want, need, and expect for the money we are paying. We've never had a Cleaner Wrasse working on the UPS cod. Maybe it's time. Maybe it's way *past* time. Maybe the unionized UPS cod needs to have its gills and scales attended to so that all the little parasites can be exposed and driven away so everybody can get fat and grow.

And don't forget . . . when the Postal Regulatory Commission and the U.S. Postal Service are working on rates for Parcel Post, UPS is in there protecting their interest. Now, would that interest be for a *smaller* Parcel Post increase? Hum?

What pseudo-monopolies don't want is for industries to get organized and present a united front. That interferes with the maximization of profits that have contributed to building such giants as the East India Trading Company, the Hudson Bay Company, Royal Dutch Shell Petroleum, Prudential, Bank of America, the tea and tobacco merchants and so many others who navigate the regulatory and rate-setting currents with such aplomb. They want to negotiate with *individuals* because individuals are weak and have no power. They don't want to negotiate with industry groups with broad-based support because that might screw up the gravy-train. Hey . . . It's all about choices . . . and your Silent Partners aren't giving you any.

FedExium Absolutelias Positiveiansus

When you absolutely, positively need a Silent Partner, FedEx is at least reliable. I was involved in the earliest years of FedEx's foray into the catalog world. This was back in the late 1980s and early 1990s when we worked on a program that FedEx put together to actually offer its services to selected catalog companies. One of the Big Concepts was to feature the FedEx logo on catalog covers and tell customers they could have products overnight. A special price was negotiated for catalog companies to offer this service and, in about one year, the FedEx-catalog industry relationship was up and running. We've never looked back.

But, FedEx has *its* annual price-hike astrological cycle. It *also* likes to only negotiate with individual companies, not industries. It *also* has its arcane rules and regulatory rate-structure. And *it* has a primary interest in feeding from the host.

Again, I don't believe I have ever heard of FedEx sitting down and dealing with an organized, representative body that speaks for, say, half the catalog industry. Take a look inside one of the trucks. We are FedEx.

For that matter . . . *We are* UPS . . . *We are* the U.S. Postal Service. Without us, they would all be very much smaller, weaker, anemic and *hosts*. If we were organized, we might just be able to become *parasites* for a change. Wow! What if?

Googlezonicum Searchalotis

Ah, the Google-zon! Let's see . . . What do we know about Google? Well, they're not evil . . . we know that. And, they want to organize and control access to all human information and knowledge . . . we know that. And, they have more money than the sum total of all the money in the world . . . we know that.

So what's the problem?

Maybe they want to control *all* of our businesses, lives, cultures, minds, and beliefs. Maybe that's a problem . . . Nah!

Best case, they want to be everybody's Silent Partner, controlling access to ecommerce and other channels, too. And charging for that service . . . whatever they want. All alone.

Interestingly, Google *also* only talks with individual companies, not organized industries. While they prefer to talk with aggregators who bring lots of little businesses as a lump into the Google-zon, they do—on rare occasions—actually speak with the great unwashed. They learned that from Amazon.

Google may be your most frightening silent partner in the years ahead. The Post Office is, by and large, benign. It only knows how to increase postage, but it doesn't want to be mayor of your town. UPS and FedEx have a lot of trucks to take care of and, after all, they have the unions to deal with primarily; customers are somewhat of an after-thought. But Google . . . now this is something else. After all, *what is it?* You can't see it or touch it or drive it. It doesn't have a place for a label or a volume control. It's not only a gigantic, engorged Silent Partner, but it's invisible and without form! Do you actually *know* anybody there? Of course not.

But, it's in your pocket. It's a near-monopoly. It's feeding constantly and growing larger by the hour. It almost has control.

Call to Action

We have numerous, excellent associations who look after our broad interests as direct marketers, but what is becoming clear is our need for an organization that specifically focuses on the interest of *catalogers* and our unique relationships with these Silent Partners.

Recently, a number of organizers have come together to form the American Catalog Mailers Association (ACMA). While the initial purpose is to acquire a seat at the postal rates table, the longer-term purpose is to create a large tent in which all catalogers can sit down with Silent Partners and present a solid front that finally tells our story and serves our needs.

ACMA has made great strides in just a little over three weeks. It has been incorporated as a not-for-profit corporation in Washington, D.C., has recruited over 25 member catalog and supplier companies, has formed a board of directors, received significant support in member contributions, hired a small staff, retained a lawyer to represent catalogers' interests in the postage rate case, and is well on its way to defining an important, future role in telling the catalog story and demonstrating the importance of our industry to the national economy.

You can obtain information on how to participate and how to join and support ACMA at its new website, www.catalogmailers.org. It is time for all catalogers to come together; time for all catalogers to put aside a portion of their earnings to assure their future; time for all catalogers to find a common voice that tells our story; time for all catalogers to stand up and be counted, and to sit down at a reserved place at the tables of negotiation with the Silent Partners we support with a portion of our earnings.

It is time to come out from under the rocks. It is time to stop hosting the parasites. It is time to gather together to create strength, influence, and negotiating power. It is time to assure *our* survival.

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The Third Quarter 2007 Economic Outlook

The late April corporate earnings are robust and the stock market is at an all-time historic high. Money is being spent and investments are being made. Banks are consolidating. Private equity groups continue to buy. Strategic buyers are active. This is no time to either pull back or to get crazy. Steady and consistent takes the prize.

There are indications for a further slowing in the economy in the last half; some are predicting economic growth at 2.0 percent. Time will tell. It hinges on the housing market.

My concern is less economic than it is political. There is a growing political angst that could have implications. The global markets and the global political climate either diverge or come together. The outcome will have a business effect.

Oil has once again become problematic. Expect increased costs based on the rising oil prices through the summer and likely beyond. We may have finally reached a whole new \$3 a gallon base for the U.S. It's taken about 18 years to move us from \$.69 a gallon gas to \$3.00 a gallon, but it has worked and it may well be the new constant.

I continue to see a relatively strong economy, but one that is slowing. The manufacturing outlook is mixed, and the increased defense spending maintains stability. The outlook is a 2.5 on a 1 to 4 scale with 4 being robust and positive.

Manage your business for moderate growth; continue to invest in new customer acquisition; focus on new products and merchandising; control costs; and stop any and all leaks that are dripping money away from earnings.

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

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**The Third 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 third quarter of 2007 and the long-term outlook through 2007 remains positive.

Prospect as an Investment

For the second half planning in 2007, even with the signs of second half slowdown in the economy and in overall business, maintain normal to increased strategies for circulation and investment prospecting plans, likely not more than 10 to 15 percent. There are firming signs that the economy is likely to slow but there are no indications or good reasons for reductions in either prospecting or customer circulation, or both, in the last half of the year; businesses and consumers are still spending money. We would remain comfortable with modest increases in prospecting levels, even with the postage increase this month.

Nation at a Glance

We are adamantly continuing our mailing recommendations for third and fourth quarter planning in 2007. In every instance, we caution against decreasing prospecting or customer mailings except for normal hygiene and mailing frequency improvements. Do not be deterred by the postage increase and fall into the trap of reducing mailings; the end result is always a diminished performance.

State	Mailings		
		Missouri—South	Normal
		Montana	Normal
Alabama	Normal	Nebraska	Increase
Alaska	Normal	Nevada	Increase
Arizona	Increase	New Hampshire	Increase
Arkansas	Normal	New Jersey—North	Increase
California	Increase	New Jersey-South	Increase
Colorado	Increase	New Mexico—East	Normal
Connecticut	Increase	New Mexico—West	Normal
Connecticut-Fairfield	Increase	New York	Normal
Delaware	Increase	North Carolina	Increase
District of Columbia	Normal	North Dakota	Increase
Florida	Normal	Ohio	Normal
Georgia	Normal	Oklahoma	Normal
Hawaii	Normal	Oregon	Increase
Idaho	Increase	Pennsylvania—East	Increase
Illinois—North	Increase	Pennsylvania—West	Increase
Illinois—South	Normal	Puerto Rico	Normal
Indiana—North	Normal	Rhode Island	Increase
Indiana—South	Normal	South Carolina	Increase
Iowa	Increase	South Dakota	Increase
Kansas	Increase	Tennessee—East	Normal
Kentucky—East	Normal	Tennessee—West	Normal
Kentucky—West	Normal	Texas	Increase
Louisiana—North	Evaluate locally	Utah	Normal
Louisiana—South	Evaluate locally	Vermont	Increase
Maine	Normal	Virgin Islands	Normal
Maryland	Increase	Virginia	Normal
Massachusetts	Increase	Washington	Increase
Michigan	Normal	West Virginia—East	Normal
Michigan—Up. Pen.	Normal	West Virginia—West	Normal
Minnesota	Increase	Wisconsin—North	Increase
Mississippi—North	Evaluate locally	Wisconsin—South	Increase
Mississippi—South	Evaluate locally	Wyoming	Increase
Missouri—North	Normal		

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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**