COMMENTARY

August 17, 2018

Dear clients and colleagues,

As Millennials age and move into executive positions, they will earn more and gain influence in the corporate world. Millennial behavioural habits will also further affect consumer trends. As we all know, Millennials have a high attachment to experiences, and consequently a low attachment to assets. This trait is at the core of important trends and roots the entire social media infrastructure (or maybe vice versa). Social media allows us to compile or value the amount and quality of experiences that go towards building a social status. The status update is a new status symbol.

Wanting to own experiences rather than assets is certainly correlated to the impressive growth of the shared economy. Not owning assets, by will or by choice, has affected homeownership, which has fallen to a 30-year low and only recently started to bottom. The desire to experience what is happening in society requires more of an interactive urban lifestyle, and this has driven urban development to new highs.

The barbell economy is not only about the rich getting richer and the poor getting poorer. It is also about the consumer not gaining any benefit or “experience” from owning middle of the road brands. Brands were important to Generation X because owning them helped define who they were. For example, wearing Nike or Lululemon defined a person as being active. Today, Millennials also need to prove they are active by posting their mountain hike on Instagram. Millennials are attracted to luxury brands, but simply owning a brand doesn’t define them. If they can’t afford or choose not to own a brand name item, they will simply gravitate to a lower cost, better-for-you or greener alternative. This is why regular Coke sales are declining in favour of specialty drinks or carbonated water and why nobody buys a $100 pair of jeans anymore.

According to Matt Britton, a leading consultant on Millennial behaviour, having a business model that adapts to the Millennial consumer will be key to surviving the ongoing transformation of the global economy. Large brands from Proctor & Gamble and Unilever will not survive using conventional marketing practices. Products will need to provide benefits other than brand confidence. We had a chance to attend Matt’s presentation and discuss this issue with him at the Canaccord 2018 Investor Conference in Boston in early August.

Ecosystems

In order to survive, brands will need to create ecosystems. Apple, Amazon and Google have large ecosystems with multiple software and hardware offerings—models that are not easily replaced. Ultimately, ecosystems resemble the old razor and razor blade model. A company like Netflix, which does not make hardware, will experience increasing competition unless they grow a wider ecosystem. A brand like Cascade dishwasher detergent will probably have to team up with a dishwasher manufacturer that will provide small, apartment size dishwashers that can only use Cascade products.

Voice will become a key ecosystem enabler for consumer products. Take the Amazon Alexa for example. If a customer places an order for batteries using Alexa, Amazon could make it harder for consumers to order Duracell batteries than to order the Amazon-preferred brand of battery. Would Duracell even stand a chance?

Global Alpha certainly favours the ecosystem business model in its due diligence process. Sodastream, the leader in home carbonated water systems, is one example of a company with this type of business model. Based in Israel, Sodastream is the leader in the home carbonated water industry. It provides consumers with an inexpensive, healthier and greener substitute for regular carbonated soda. Sodastream sells the equipment and the refillable cartridges—an ecosystem. Sodastream is a Global Alpha holding.

Experiences

Brands are being replaced by influencers. Influencers endorse products by having an experience with them and then sharing that experience on social media. The business of providing experiences continues to grow. This naturally includes the mother of all experiences, the travel industry. Global Alpha is exposed to the travel industry through companies such as Autogrill and Melia Hotels. Autogrill is an Italian company that operates over 4,000 road and airport concessions across the globe. Founded in 1956 in Palma de Mallorca (Spain), Melia Hotels International is one of the largest holiday hotel companies in the world. It currently has more than 370 hotels in 43 countries.

One of the initial signs that experiences were becoming important was the growth of the Festival industry. The industry has been growing rapidly over the last 10 years, and experience-driven venues will continue to emerge. To understand what an experience-driven venue is, try the Museum of Ice Cream, located in various US cities. The store/museum attributes its success to being the perfect place to take a selfie, not a place to eat quality ice cream or learn about the history of ice cream. Selling a service that helps maintain a social status is its business model.

The transformation of our daily experiences offers incredible business opportunities. For example, up-and-coming company Glamsquad, where a team of hairdressers shows up at your home, or Handy, which has an extensive team of home cleaning crews. These companies help to simplify day-to-day life and save time, but they also often replace brick and mortar businesses.

The supermarket experience is certainly at risk of transformation as it is time consuming and requires knowledge and awareness. Self-assembled meals is the Millennial solution. The supermarket industry is a $3 trillion market and is set for disruption. Growing by 20% per year, sales of meal kits are expected to reach $10 billion globally by 2020. Some of the leading players in the US include HelloFresh, Blue Apron, Home Chef, Sun Basket, Purple Carrot and Plated. The industry is experiencing growing pains, as exemplified by the 2015 industry leader, Blue Apron. The company is incapable of increasing margins towards profitability.

Industry experts believe that if delivery is based on the proper production platform and has sufficient volume, a meal kit could be less expensive than buying the ingredients at a supermarket, and it could take only three distribution centres to cover the entire US versus Kroger's 3,000 stores. As this industry evolves and we learn from the Blue Apron debacle, we expect to see investable candidates in the short to mid term.

Most of the shared-economy leaders have long passed the small cap level, Uber and Airbnb for example. One leader remains in small cap territory, IWG, or Regus. IWG provides outsourced workspace in over 120 countries.

IWG's main competitor is WeWork, a unicorn with a $20 billion valuation. IWG is a much larger company with 3,000 centres compared to WeWork's 300 centres. The business models are very similar, and WeWork does not have a true differentiator in comparison to other unicorns and its competitors. This is why Mark Dixon, president, CEO and largest shareholder (25%) of IWG, has contemplated selling the company. Shareholders of IWG, including Mark Dixon, are looking for a fair premium; a valuation that accounts for the positive market dynamics. The spread between the offers received and a valuation comparable to WeWork seems to be too wide for an agreement to be reached. Although we have seen volatility in share price on missed takeover attempts, the Millennial trend continues to support growth at IWG, a core holding at Global Alpha

Have a great weekend.

The Global Alpha team