Exchanges at Goldman Sachs

Why Investors Are Shopping for Consumer Retail

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Allison Nathan: This is Exchanges at Goldman Sachs. And I'm Allison Nathan, a Senior Strategist in Goldman Sachs Research.

The IPO market continues to set new records. And many of the companies going public are making and selling things that we recognize and use in our everyday lives. To better understand why the IPO for consumer startups is stronger than ever, we're speaking with Jen Davis and Vishaal Rana from the Consumer Retail Group within our Investment Banking Division.

Jen, Vishaal, welcome back to the program.

Jen Davis: Thanks for having us, Allison.

Vishaal Rana: Thank you.

Allison Nathan: Jen, we last spoke with you and Vishaal in April when consumer retail companies were really just emerging from the pandemic and just starting to tap the capital markets in a big way to invest in their businesses. Today, we are of course, seeing a slew of consumer-oriented companies going public. Put this all into context for us. How does the activity compare with prior periods? And what's driving the recent surge in activity?

Jen Davis: Yeah. And that's a great question Allison and one we're happy to talk through today because it's an exciting topic. It has been an incredible year in the consumer retail IPO markets. So, thus far, we have seen 14 billion dollars in issuance overall. To put that in context, that is 3½ times last year's level, which itself was a record-setting year. So, really incredible in terms of overall volumes.

In terms of number of consumer retail IPOs, we've seen 28 so far this year. And again, that's higher than the last watermark of 13 consumer retail IPOs, which was back in 2012. So, when you just think about volume of transactions and dollar issuance of transactions, it's been nothing short of incredible. At Goldman Sachs, we were proud to have led Olaplex's $1.8 billion IPO, which itself was the largest US consumer retail IPO in over 20 years.

So, across the sector, it has been an incredible level of activity. I think there are a few things driving that. One, there’s been a lot of investor enthusiasm across the sector. So, when you think about the combination of pent-up consumer demand, high savings rates, and strong wage growth, that all translates into consumer discretionary dollars that need to be put to work and need to be spent. And the consumer retail sector is a great way to play into that dynamic.

And the second thing is across the board, the performance of those IPOs has actually been quite strong across the industry. So, when we look at post IPO performance in terms of day after, month after performance, investors have seen good returns. What has softened in the recent past, however, in the past couple of weeks and months, is some choppier performance during the IPO period. So, that's something that we're continuing to watch carefully.

Allison Nathan: So you mentioned strong activity across the sector. But are there specific areas that the activity has particularly picked up in?

Jen Davis: I would say across all sectors of consumer retail, we've seen interest in activity. So, when you think about apparel, accessories, and footwear, Vishaal led the On Running and the Warby Parker IPOs, which I know he'll talk about, as well as AKA Brands. We've seen it in beauty. I mentioned Olaplex. But you also saw it with European Wax Center. We've seen it in home goods. So, Traeger and Weber in terms of people investing in their homes. We've seen it in fitness and wellness. So, Exponential Fitness, X45, Lifetime Fitness. And then in the food, beverage, and restaurant space there has been a whole host of activity too. So, First Watch, Dutch Brothers, Krispy Kreme, Sovos, Dole, Zevia. Really, it's been very broad based across all consumer and retail sectors.

Allison Nathan: And amid this surge in activity, we're actually seeing consumer retail companies looking at new ways to go public. So, we've had some direct listings.

Warby Parker chose that route last month. Why would some companies choose to pursue that route versus a traditional IPO? Vishaal, maybe you can answer that.

Vishaal Rana: Yeah, sure Allison. Great question. All companies have unique needs. And the IPO, until the last few years, has been somewhat formulaic in how they take companies public. And so, direct listings have had two major factors for the drive in the interest in this style of going public. Number one is the arc of the company. And number two is the specific needs of the company when they're going public.

In an arc, what I mean by that is a lot of companies are staying private for much longer. There are huge amounts of private capital that's out there. There have been public crossover investors like Fidelity and T. Rowe Price, so-called classic public investors who are investing in private companies much earlier. We certainly saw this in the technology sector for many years. We're now sort of seeing it in the consumer sector as well. So, that's the arc.

And the second part, on the needs of a private company, many private companies, because they've been well funded by some of these larger institutions, they may not have the need for a lot of primary capital right now. They may already have a good shareholder base because a name like Fidelity had invested. But what they might have, because they stayed private much longer, is the need for liquidity for some of their shareholders or for their own employees. So, the direct listing comes in in those sorts of scenarios. And the direct listing provides maximum flexibility for shareholders, including employees. There is no lock up. There is an immediate market-based pricing outcome. So, there's no so-called IPO discount. And price discovery led by underwriters is done directly by the market.

So, it tends to work really well, Allison, for, I would say, sophisticated companies because a lot of the work in the direct listing is done by the company itself with the help of a financial advisor, which is what we've been doing. It tends to work well in companies that don't have a need for primary capital. The average cash balance in the direct listings that have occurred has been about a half a billion dollars. And it tends to work well in companies that have a broad shareholder base who already have a real feel of valuations. So, when the company is listed, there's already a sense of where they would sell and what they feel, you know, where the market has been.

And look, Warby Parker, which you reference, is unique in that it's the first consumer company to go public via direct listing. It's also the first public benefit corporation to go public. And they're quite proud of that. And through September of '21, we've had 11 direct listings. And we expect more companies to consider this alternative. Though it will still remain a pretty small percentage of the overall IPO volume going forward.

Allison Nathan: And we've spoken with some of your colleagues on this podcast about the rise of corporate divestitures and strategic transformation. So, why would companies decide to go public at all instead of pursuing a sale today, especially with the prospect of higher taxes down the line?

Jen Davis: That's a great question. Simply put, in the recent past the public markets have been paying outsized multiples relative to the private markets. So, as an illustration for that, right now the S&P is currently trading at about 22 times forward P/E. That's compared to a long-term average of about 17 times. So, a five multiple-point premium to long-term averages in the public markets.

But while the discussion here today has been on the IPO markets, we shouldn't lose sight that the M&A markets have continued to be incredibly strong. So, M&A, both in terms of dollars and deal count, is up over 200 percent year-over-year. So, there still continues to be an incredible amount of activity, I would say, in both products. And what Vishaal and I can attest to for a lot of our clients, there are many dual-track processes being explored. And so, companies, privately going down both paths and exploring one versus the other to maximize optionality and price intention.

Allison Nathan: So, Jen, you talked about some of the drivers behind this surge in activity. We've obviously seen this pent-up savings and economic reopening providing a big boost to the sector. But it's been a bumpy ride. We've had the delta variant spread this fall. We're now seeing more concerns about inflation. How do you expect this sector to hold up among these risks?

Jen Davis: Delta was clearly a huge worry for our sector, especially as first, back to school and now holiday approaches. And so, what was initially a worry around another wave of infection and potential lockdowns has actually quickly pivoted to other related impacts. And I would put those in the bucket of labor shortages, supply chain challenges and the resulting potential inflation that could be more than transitory in nature.

And so, on the supply chain, I would say all of our retail clients are seeing headwinds from supply chain. They're seeing rates from shipping that are 800 to 1,000 percent higher than pre-pandemic levels. GS Research has noted that companies that are better insulated have scaled balance country exposure, more limited import requirements, more negotiated their contracts early.

On the labor side, there is infection-related reluctance to return to work in some cases. And so, that's continued to suppress labor market participation overall and further exacerbated the supply chain challenges. And so, the worry is that the combination of these factors could lead to more than transitory inflation. And that will lead to, potentially, higher prices for consumers. And so, it's something that I would say across the board our consumer and retail clients are watching very, very closely.

Allison Nathan: Vishaal, let me talk to you beyond these near-term cyclical concerns. One of the trends that I think we touch on in so many of our podcasts is technological change and how that is impacting sectors and the economy more broadly. So, you know, obviously, we are seeing a lot of benefits to direct-to-consumer companies. And increasingly, companies with an omnichannel approach, as we've seen technology accelerate during the pandemic. What are the key technological trends that are shaping the retail sector and consumers' experiences?

Vishaal Rana: There’s a lot of different technology changes, trends that are going on. But what I would say the key theme is blurred lines. Meaning customers are shopping online through marketplaces, traditional retailers, directly with brands. But they're also doing it symbiotically with physical stores. So, yes, traffic is down prior to the pandemic. And then further exacerbated by the pandemic. But we sort of see this relationship between the online presence along with the physical store becoming even more relevant to create ubiquity for the customer and allow the customer to shop wherever they want to.

Some of this we addressed on the last podcast we did. But if you look at On Running as an example, which is a very successful IPO from this year, one of the things that's interesting there is they have a split of 60 percent approximately wholesale, 40 percent approximately direct-to-consumer. And the rationale for that is having multiple distribution points to meet the consumer wherever, you know, he or she may be, and driven by technology. And so, you can engage with the product through your mobile device. You can go to the store and have an interactive experience as well. And the technology has made that happen in a way that has brought the product to life.

So, I think most of these blurred lines have tried to meet customer needs. But it's sort of optimized that distribution opportunity, let companies scale, and draw down the cost of acquisition.

And, you know, I'll give you two quick examples like when you look at Nike. Nike in 2010 was 15 percent direct-to-consumer. Today it's approximately 40 percent. Disney Plus didn't exist two years ago and has 115 million subs now. So, the reason you bring those up is that there are two key themes, which is brand and customer experience are what our group is about. So, the customer retail sector cares about brand and customer experience and how technology is a tool to enhance those two things. That's the ultimate theme. Because these are not technology companies, ultimately. They're using technology as a tool to enhance brand and customer experience.

Allison Nathan: So, you both talked about opportunities. You've talked about some risks. Where do you see the outlook from here for 2022 and beyond?

Jen Davis: Maybe I'll start. And I thought Vishaal's characterization of brands and customer experience was a really helpful framework to think about how we're advising our clients. I think the other one that we talk about in terms of megatrends impacting our clients falls in four buckets. One, digitization. And so, the birth of e-commerce is clearly here to stay. And so, how are companies modifying both their front-end and back-end infrastructures to invest into that and make sure they can address that very high, increased demand.

The second is around health and wellness. And again, there's much more of an acute focus. How does that affect our food choices, our fitness choices, how we modify our homes and our offices in terms of addressing that. The third is around ESG. And I think there is a big focus around climate change, sustainability, social equality, and governance. And so, how do companies operate in order to address those needs? And how do consumers make their buying decisions based on that?

And then the fourth related to some of these two is casualization. I think we can all attest that the day of high heels and formal suits is probably day in and day out a thing of the past. Will still exist in some way. But how do we think about our buying choices around that too, both in terms of how we work and live differently.

Vishaal Rana: Yeah. And what I'd add, Jen, to that is when you think about the evolution of capital markets and deal activity in the consumer retail sector, what we're seeing is that increasingly there was a proliferation of companies that have created greater fragmentation and greater specialization. So, customers and consumers want personalization. They would like a product that does X and Y. And that creates fragmentation and specialization. Now, the challenge is for those companies to scale, they either need lots of capital, which could come through an IPO in whatever form, or M&A. And so, our expectation is that as you sort of see this greater fragmentation, greater specialization, a proliferation of companies, and you have a lot of large incumbents that are flush with cash that could engage in M&A, or there's the equity market which, while there's going to be stops and starts as we continue to sort of face macro challenges, ultimately, the linear trend continues to be, in this sector, that the opportunities set for people that want to go public remains quite robust.

Allison Nathan: Well, it will certainly be interesting to see how this space evolves. Thanks for joining us on the program Jen and Vishaal.

Jen Davis: Thanks Allison.

Vishaal Rana: Thanks for having us.

Allison Nathan: That concludes this episode of *Exchanges at Goldman Sachs*. Thanks for listening. And if you enjoyed this show, we hope you subscribe on Apple Podcasts and leave a rating and comment.

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