

PERSPECTIVES

Insights on Healthy Living & Aging

Purity in Personal Care:

Avalon Natural Products



An Interview with Gil Pritchard CEO of Avalon Natural Products and Ellen Marram, NCP Managing Director



The natural personal care products industry reached \$5 billion in 2004, reflecting three straight years of double-digit gains and a 50% increase since 2000, according to a new report from Packaged Facts. Organic personal care, a subsegment of natural, has been growing even faster. The strength of the natural personal care segment reflects the impact of the aging baby boomers and their search for health and well being, as well as the growing interest from consumers of all ages in effective products that are safe and less processed. For North Castle, the leading private equity business addressing healthy living and aging trends, an investment in Avalon Natural Products, a leader in the natural and organic personal care segment, fit squarely in the firm's area of focus.

Gil Pritchard, the CEO of Avalon, is an experienced leader who has worked in the mass-market personal care industry and has successfully led two private equity backed natural food companies. Ellen Marram and Rich Gersten are the two North Castle managing directors directly responsible for the Avalon investment. "Based on our research" says Ellen, "it was clear that the natural personal care industry was poised for continued strong growth. We believed that Avalon had the

right brands to lead that growth and that North Castle, with its focus, knowledge and network was the right firm to make that happen."

We recently talked with Gil and Ellen about the company's progress and future growth plans.

How did North Castle's investment in Avalon come about?

Ellen: In early 2002, Rich Gersten and I began studying the personal care industry to identify growth opportunities. One segment that was growing significantly was natural and organic personal care products, so we began to research the companies in that segment. At about the same time, Mark and Stacey Egide, the founders and owners of Avalon, decided that it was time for them to bring in outside investors. The Egides were attracted to North Castle because of our focus on healthy living and our familiarity with natural products and consumer packaged goods.

From our perspective, Avalon was a leadership company that had introduced the very first line of organic personal care products. Our due diligence confirmed that Avalon and its major brands had an excellent reputation with retailers and consumers. The company also had strong operating margins. The team agreed on an operating blueprint, that is, the key growth strategies for profitably building the business and its two primary brands. In August 2002, North Castle bought Avalon.

Why do you think the natural personal care business is growing?

Gil: It's growing for the same reasons that the natural and organic food business is growing.

People are concerned about health and product safety issues, and many are also concerned about the environment.

There's some concern that mass products have become too commercialized and include lots of ingredients we know little about. Increasingly people view things that come from nature, that are minimally processed, grown without pesticides, as being inherently safer for them, their families, and their children.

What did North Castle do first at Avalon?

Ellen: It all begins with people. One of the first things we did was bring in "value added" board members and build a capable management team. We added Peter Roy, one of our North Castle advisors, who is well-known and respected within the natural products community, to our board. Shortly thereafter, Gil, who had experience in both the personal care and natural products category, also became a director. We also added Gale Bensussen, the president of Leiner (another North Castle company), who was familiar with several of the retail accounts we were interested in reaching. In terms of management, we brought in several financial folks, a new V.P. of sales as well as a V.P. of operations.

When we first bought the business, we agreed with the Egides that, after about 18 months, we would transition to a new CEO. Early last year, that time came, and Gil became the new CEO, bringing the knowledge of Avalon that came from being a board member.

Gil, why did you decide to become the CEO of Avalon?

Gil: For me, it was a homecoming of sorts. I started my business career as the marketing manager for Oil of Olay where we went through some pretty explosive growth back in the late 70s and early 80s. When I departed Olay, I went on to natural food where I spent the next 20 some years. But I always loved the personal care products category. It's a fun place to be, and the natural personal care products section is poised for explosive growth, has excellent margins and offers an opportunity to build some good brands. Also, I had an opportunity to work with some people that I knew, Peter Roy and I have known each other for many years, as well as the other board members whom I had come to admire and respect. I thought it would be a good partnership.

Was North Castle's focus important to you?

Gil: Yes. North Castle's focus on health and wellness was appealing to me, because it suggested that they understood the market and the consumer that we were trying to reach. They also owned businesses that shared retail customers and consumers with Avalon.

What are some of the key things that you've accomplished in your first year?

Gil: The Egides did a wonderful job of creating a platform from which to grow a couple of key brands, but it was an entrepreneurially run business. What we had to do was put in some of the professional disciplines that would allow us to grow and sustain growth over time. First, we completed the management team by bringing in a new V.P. of marketing. Second, we had to clearly communicate our vision and our key strategies to all our employees. Third, we continued to focus on just two brands, Avalon Organics and Alba Botanica, and to divest the smaller brands that we owned. We've been able to prove to ourselves that less is more. Our

growth rate at the end of last year was 15% on the top line. This year, we're looking for a comparable growth number. So far, we've been able to achieve it. Our share and market position have also continued to grow.

Would you talk a little bit more about some of your key marketing initiatives over the last year?

Gil: Well, Avalon Organics was the first organic personal care brand and we wanted to continue to strengthen its leadership posi-



“Avalon introduced the first line of organic personal care products.”

tion. While we were exploring how best to do that, we became aware of a European Union initiative, Directive 76, which banned a number of frequently used chemicals from personal care products. The EU decided that those ingredients, which were either untested or not thoroughly tested, raised some safety questions.

While the U.S. industry has not yet moved in this direction, we think that eventually they will at least consider it. In the meantime, we believe that there is an opportunity for us to build our leadership by complying with the tougher European regulations.

So we spent the last half of 2004 putting our Avalon Organic shampoos, conditioners,

body lotions, bath gels and hand soaps through a ladder of improvements that actually increased the organic content and improved the performance characteristics while making them EU compliant.

Coincidentally, the Breast Cancer Fund announced an initiative, called the Campaign for Safe Cosmetics, to try to get U.S. companies to voluntarily comply with the European Union directive. We were the first company to sign their compact. Since then, another 87 companies have, but to the best of our knowledge, we're the only company that is fully compliant with EU directive 76. That initiative paved the way for us to go to our key customers, such as Whole Foods and Wild Oats, and work with them to try and change some of the standards for the products in the industry.

What about new products?

Gil: Last April, we introduced the Alba Hawaiian line, which was the most successful new product launch in the last 10 years in the natural personal care business. It immediately garnered a #1 share in the segments that it's in and it has an almost unheard of nearly perfect distribution among the 900 larger

health food stores. It has been strongly accepted, not only by retailers, but also by consumers. We've also introduced five new soaps, four new Alba items, two new shave creams, and a couple of other items. We've got a number of things in the new product pipeline that will launch over the next six to 24 months.

Where are Avalon's products sold?

Gil: Avalon sells primarily in the health food channel. Whole Foods and Wild Oats are two chains that everyone's probably familiar with, but there are a number of other chains and individual stores as well. There are about 900 stores that do in excess of five million dollars a year in retail sales. We have pretty good presence in those

stores as well as another 1,000 or so smaller stores in the channel.

We also have some selected distribution in places like Trader Joe's, Target and CVS. You'll also find us in some leading grocery stores, such as Wegman's.

What are your priorities in terms of channels?

Gil: First, we want to take our two primary brands, Avalon Organics and Alba Botanica, and perfect our distribution and sales in the health food channel. Even though we are the #1 brand there, we only have a 12.1% share. We could double our business just by focusing on the health food channel over the next two to three years. That doesn't mean that we're not interested in some of the other channel opportunities out there, but we plan to be appropriately selective.

Why do you see such strong opportunity for growth in the health food channel?

Gil: Today, only 7% or one out of 14 shoppers in health food stores buy any personal care products there. Contrast that to conventional grocery stores where well over 50% are buying personal care items. So the health food store is underdeveloped in personal care.

Is that because those stores carry too few brands or give less space to personal care products?

Gil: Actually, I think you'd find if you walked into a Whole Foods, personal care might be overspaced. The problem is that we haven't done a very good job as an industry differentiating our products and telling our consumers why that differentiation is better for them — how that delivers additional health benefits. They're doing a wonderful job over in the cereal aisle, in the beverage aisle, and in the dairy aisle communicating the benefits of those food products, both natural and organic. We have not had a marketing program or initiative from either the manufacturers or the retailers, which communicates as well for personal care items.

Ellen: From a consumer perspective, I think that people first think about the things they ingest, like food or supplements. It takes slightly longer for people to recognize that the shampoos they put in their hair or the skin creams they put on their face also get absorbed into the body. So, if people are worried about certain kinds of chemicals or ingredients when they eat, it gradually dawns on them that they ought to start having similar concerns about products they don't eat but use topically, because often those products get into the body.

Gil: I was watching TV the other night, and they now have a birth control patch for women, which is topically applied. Makes you think, if topicals can by design, change reproductive systems, maybe other products used on the body have more impact than we have traditionally thought.

How important do you think it is that people that are selling Avalon's products have experience in these kinds of health food channels?

Gil: Well, this is primarily a push business. The first person you have to convince to sell these products are the retailers. They are the ultimate gatekeepers. They decide what they're going to take in, and what they're going to sell. We rely on them very heavily. It's almost mandatory that you have relationships with them and those relationships don't come overnight. They are built over a long period of time. Among our key sales executives, there is well over 220 years of experience in dealing with the health food channel.

Ellen: To underline Gil's point, it's important to understand that a key difference between the health food channel and the mass market channel is that the health food channel retailers play a more impactful role because when consumers go to health food outlets they search out store personnel in the aisle and ask them for advice. The whole relationship between the retailer and the manufacturer as well as the role of education within a store is very different from what happens in traditional channels.

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personal care facts

- During 2002 just 350 new organic non-food products were launched world-wide, but by 2004 840 new products were introduced, almost double the number launched in 2002.
- For the all-natural non-food market, the rate of new introductions has increased at an even greater speed, from 615 product launches in 2002 to 1,475 in 2004. This means that on average six new organic or all-natural non-food products hit our supermarket shelves every day of the year.
- By 2009, Packaged Facts projects that the natural personal care market will climb to \$7.9 billion.
- Parabens are a class of preservatives widely used in cosmetics and personal care products. A report published in the Journal of the American College of Toxicology in 1984 estimated that parabens could be found in over 13,000 cosmetics products, including shampoos, conditioners, deodorants and sunscreens. That's in addition to food and pharmaceutical products.
- A 2004 UK study detected traces of five parabens in the breast cancer tumors of 19 out of 20 women studied. This small study does not prove a causal relationship between parabens and breast cancer, but does highlight the need for more research on the potential link between products containing parabens and increased breast cancer risk.

Going back to Avalon, we've talked about what you've done with the products and brands, but what about the infrastructure? What changes have you made?

Gil: I think any company really starts with the people. We already talked about making sure we had the right people in the right positions. Secondly, we felt the need to focus our energies against the things, which made a difference. So we reduced the number of brands from six to two and the number of SKUs from a little over 400 down to 180. We figured out what had the most upside potential, and put our energies against those.

We also put in an off the shelf computer system that will allow us to grow. We now have management reports, sales reports. We're able to do customer business reviews. Any way we want to cut the data, we can. It allows us to partner with businesses and download customer information from key customers with whom we have alliances.

Avalon already outsourced its manufacturing but we looked for other outsourcing opportunities. For example, we outsourced customer fulfillment service for internet sales to allow our warehouse personnel to focus on distributor and retailer orders.

What about NCP? How does the partnership work?

Gil: We are all aligned on the strategies that we'll follow to grow the business. The North Castle team itself, as well as the board as a whole, has a relevant and varied mix of skills and experience. They provide me, and other members of the management team, advice and good counsel on various programs and initiatives that we are considering. The North Castle team has also helped us work with some of our sister companies. As one example, we get the CoQ10 that we use in one of our top skin care lines through Leiner and that saves us both time and money. We've shared some sales information and leads with Enzymatic Therapy and, through them, we've also been able to source some essential oils and herbs that can be difficult to find. It really is an advantage having an

equity partner who's focused and can bring both experience and tangible benefits.

I understand that the management team has recently made their own significant investments in the company. Why do you think they did that?

Gil: I think the management team's belief in North Castle and in Avalon and the brands we're building stimulated management's interest. We believe that it's the right partnership and,

“It really is an advantage having an equity partner who's focused and can bring both experience and tangible benefits.”

quite frankly, it seemed to us to be a much better investment than investing in a mutual fund.

Speaking of investments, Burts Bees just sold for pretty high multiples to a financial sponsor. Hain just bought Jason's and Zia. Why do you think that there is so much activity in this category?

Ellen: I don't think there are very many category segments out there that have had consis-

tent double-digit growth rates over the last decade and also have the attractive margins and earnings that natural personal care products do. Also, I think that strategies are gaining interest in these products because they see the opportunity to distribute them more broadly and because these brands represent a way for larger companies to establish a beachhead in the fast growing health food channel.

Gil: Additionally, these brands — the natural and organic brands — offer higher retail margin opportunities for participating retailers than do the conventional brands.

How do you think about exit?

Ellen: We think that we can significantly grow both sales and earnings within the next two to three years. We'll continue to build two very strong, profitable brands, which is fundamental to exit. The metrics should be very attractive.

We believe we're much more likely to exit to a strategic buyer. But it's interesting to note that financial buyers have also come into this category. North Castle was one of the first private equity businesses to identify organic personal care as an opportunity for investment. There have been a number of financial sponsors that have bought businesses subsequent to our purchase, and without exception, they have paid higher multiples, which reflects the recognition of the growth potential in this category. So, we feel very good about the brands that we're building, about the management team and our alignment around building the business.

We certainly think that there will be excellent exit opportunities; we think we've got the right plan and people in place. It's working.

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