

25TH ANNUAL

ACCM

**The Largest Conference for Catalog
& Multichannel Merchants**

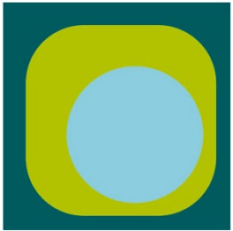
Calculating Lifetime Value for Smarter Allocation of Resources

John Craig, Partner, Windward Group

Ellen Manderfeld, Direct Mail Director, Rockler Woodworking and Hardware

Co-Presented by:

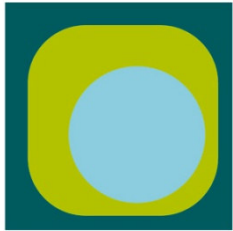




optimist The glass is half full

pessimist The glass is half empty

consultant The glass needs to be RESIZED



LTV

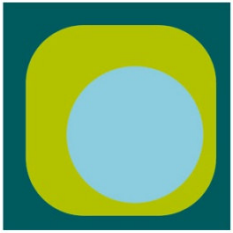
Lifetime Value

CLV

Customer Lifetime Value

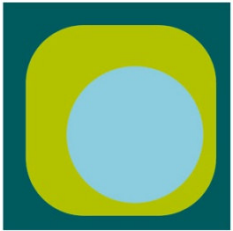
LCV

Lifetime Customer Value



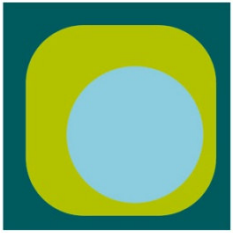
Session Objectives

- Define LTV, why it is important and how it is used
- Provide a planning framework for LTV
- Understand application of LTV to customer acquisition
- Identify how to leverage LTV
- Learn from other companies' LTV examples



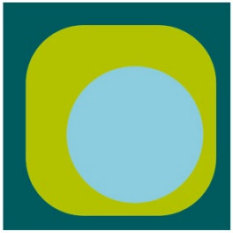
What is Lifetime Value?

- Present value of the profits a company can expect to receive on average from a group of Customers
- Generally three to five year time horizon, beyond that there is too much uncertainty
- Profit flows beyond five years are usually not material due to declining order rate and discount rate



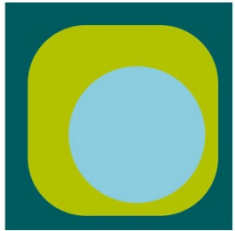
Long Term Value

- Sometimes you will hear the term “Long Tern Value”
- Not much difference in this and Lifetime Value
- Long Term Value carries out the profit streams theoretically to “infinity”
- Exercise rarely adds significantly beyond the Lifetime Value Calculation



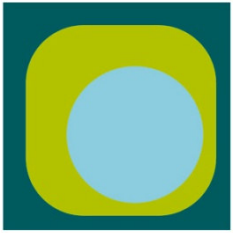
What is Lifetime Value?

- Present value - uses discounted cash flows
- Profits - looks at:
 - Revenues and promotion costs
 - Merchandise costs
 - Fulfillment



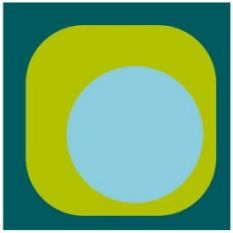
What is Lifetime Value? (contd.)

- Returns
- Refurbishing
- Overhead allocation
- Average - looks at some cohort group of customers with similar characteristics



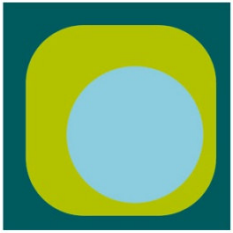
What is Lifetime Value?

- Expressed as a number, for example \$35
- Expressed for multiple groups and overall
- An estimate, hopefully a fairly accurate one



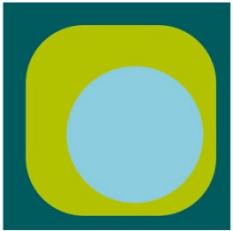
What is Lifetime Value? (contd.)

- A number that can change over time based on marketing actions
- Assumes the future will be the same as the past
- As the future is never the same as the past, indicates the need for conservatism in applying LTV figures



Why Lifetime Value?

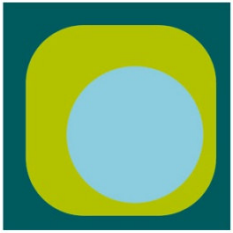
- All customers are \neq
- Why treat them as if they are?
- Customer values are typically increasing or decreasing by segment over time
- Today's marketing actions impact future lifetime value either positively or detrimentally



Lifetime Value

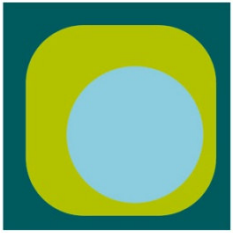


- Benefits and Application
 - Determine how advertising dollars are best allocated
 - Maximize yield from current customers through specific marketing actions
 - Serve as a component of business valuation



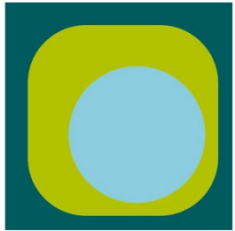
Lifetime Value (contd.)

- Focus customer acquisition efforts on buyers with maximum long term value
- However this focus must be balanced with the cost of customer acquisition



Importance of Planning

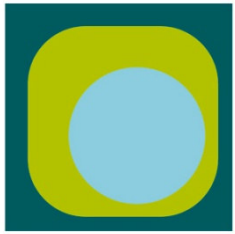
- Need to think deeply about your business before launching a lifetime value project
- Take multiple “views” of the business
- Think strategically: “What would I do differently if I knew this?”
- Consider front end and back end attributes



Initial Order Attributes



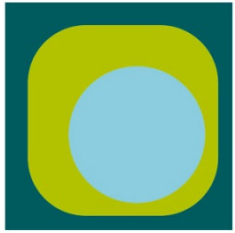
- First order offer
- Single or multiple category purchase
- Seasonality of acquisition (holiday or other)
- Channel of first purchase
- List type
- Specific list
- Buyer type (Business versus Consumer)



Subsequent Orders

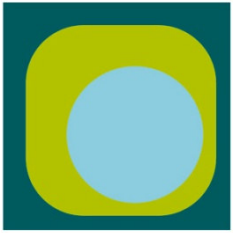
- Single versus multiple buyer
- Web buyer
- Retail buyer
- Catalog buyer
- Two channel buyer
- Three channel buyer





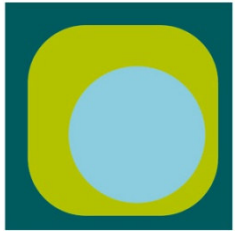
Subsequent Orders (contd.)

- Category A, Category B or Category A and B buyers
- Reactivated versus new to franchise buyer
- Metro versus non-metro area
- Store trading area versus non-store trading area
- “Best Buyers”



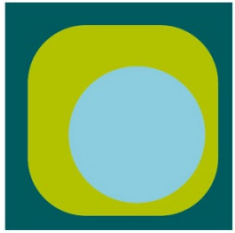
Lifetime Value Calculation

- Takes historical data and projects it to future sales and profits
- Need specific customer data for calculations
- If data is not currently captured:
 - Estimate the values
 - Begin collecting appropriate data



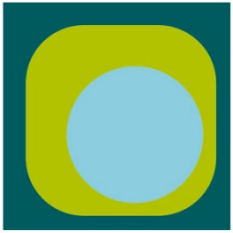
Critical Elements for Calculation

- Catalog promotion costs - various formats
- Customer retention rates
- Real cost of goods
- Return rates (refunds and exchanges)
- Shipping and handling revenues and costs



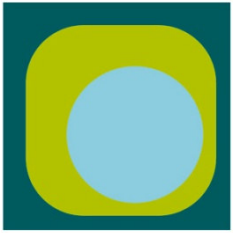
Critical Elements for Calculation

- Average order sizes
- Orders/per year
- Discount rate



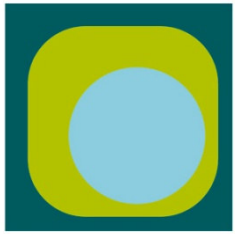
Discount or Hurdle Rate

- Cost of Capital/Time Value of Money
- Used to discount the future customer revenue
- Components
 - Current cost of capital
 - Assumed rate of inflation
 - Some accounting for risk
 - Company breakeven rate of return for business justification



Promotional Coding

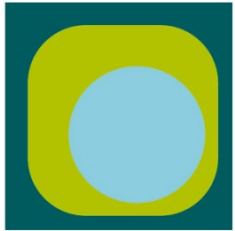
- Record of catalogs and other pieces mailed to a customer and their costs
- Use real contact data
- Tie costs to contacts
- “Average” contacts will not give you an accurate picture of segment lifetime value



Importance of the data



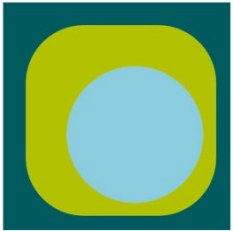
- Availability of actual data is critical
- Data integrity is critical
- Much of the work of lifetime value is data preparation (probably 90%)
- “The devil is in the details”
- Actual computation is a small part of the process



Importance of the data



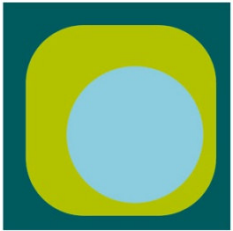
- If you don't get the data right, nothing else matters
- Get the data right and all else will fall into place
- LTV Calculation is streamlined with a marketing database but you can effectively calculate it without a database if data elements exist



Cost Per Name

- Measure of prospecting efficiency on a variable basis
- Components:
- Demand dollars by list or segment
- Apply gross margin
- Account for catalog cost (including real list cost) and fulfillment profit or loss
- Express resulting profit or loss on a per order basis





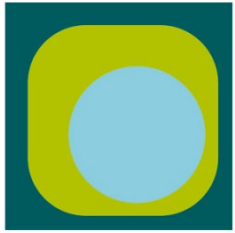
Using LTV in Prospect Planning

Set maximum CPN investment level based on Lifetime Value

Plan annual prospecting investment level based on this CPN at the MARGIN

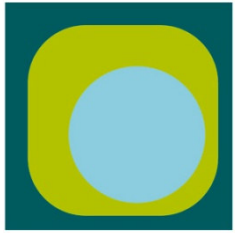
Track actual investment level versus plan to insure maximum is not exceeded

Re-project LTV every 12 to 18 months and recalibrate CPN Maximum



Percentage of Lifetime Value

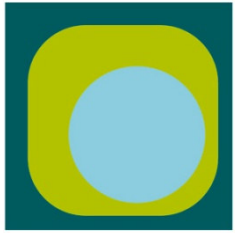
- Investment to get a new customer needs to pay back
- Generally invest 25 to 50% of Lifetime value for acquisition
- Example: LTV of \$35, invest \$9 to \$17 in CPN (Cost Per Name)
- Measure at the margin (last list added) and not based on averages



Time To Payback Investment

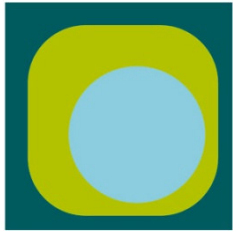
- Example: lifetime value is \$30, Cost per name is \$15
- LTV by six month season
- These are discounted cash flows
- Payback is 12 months

Season 1	Season 2	Season 3	Season 4	Season 5	Season 6
\$8.00	\$7.00	\$6.00	\$4.00	\$3.00	\$2.00

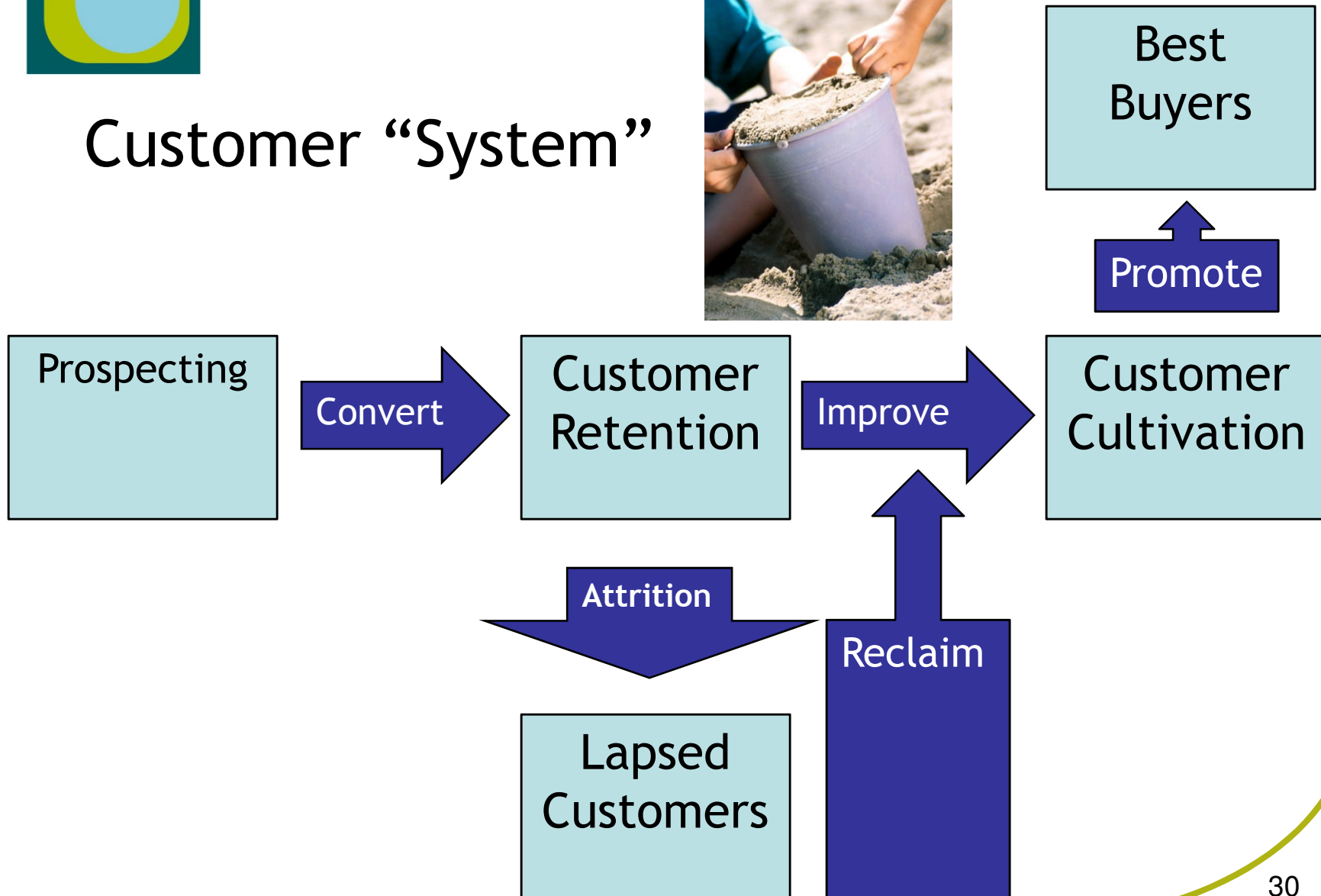


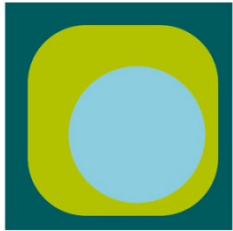
Time to Payback Investment

- Target payback should generally be 12 to 18 months
- Longer paybacks are more risky due to:
 - imprecision inherent in LTV calculation
 - fluctuation in market conditions

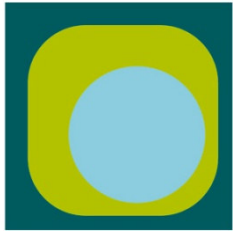


Customer “System”

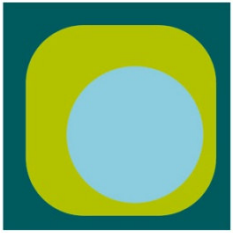




Segment	LTV Question
Prospecting	What method produces the optimum LTV? May be a mix of offers.
Conversion	How much can I afford to invest to convert a single buyer to a multi-buyer?
Reactivation	What is the value of a reclaimed customer versus a new add?



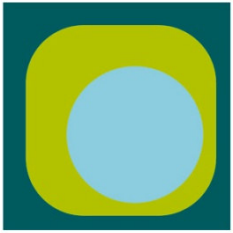
Segment	LTV Question
Retain	What is efficiency of efforts to retain customers and sustain their LTV?
Improve	How much can be spent effectively to improve lifetime value?
Promote	What is the value of a “Best Buyer”?



Strategies to Leverage LTV



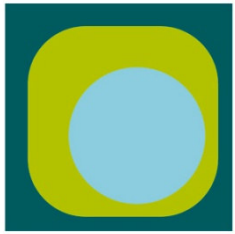
- Instigate or improve new customer treatment
- Offers to “about to lapse” customers
- Frequent buyer card or program
- Affinity credit card
- Rewards and special customer service treatment for “best buyers”



Strategies to Leverage LTV



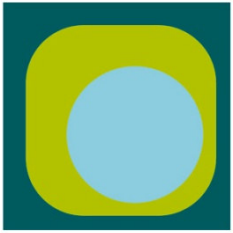
- “Trade Up” offers
- Telephone upsell
- Improved mix of acquisition offers



LTV is a Dynamic Process



- Calculate baseline LTV overall and for key segments
- Target specific strategies by segment to impact (increase) LTV
- Re-calculate LTV on a seasonal or annual basis
- Adjust strategies based on success



One Hanes Place

- Multi-channel marketer
- Selling hosiery, intimate apparel and casualwear
- Selling via catalog and web
- Retail stores as a separate entity

How can I make bra shopping easier and find styles that are right for me?

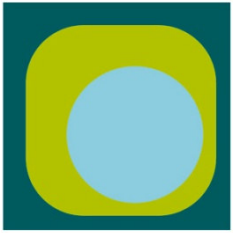
Q&A

We know fit matters. We offer over 90 of USA's best-selling bras in sizes 32A to 46 G! For more, go online & use our Bra Finder to find styles that truly fit & feel fabulous.

As seen on TV!
Hanes™
All-Over Comfort
Hidden Underwire—
no slipping,
no poking,
no kidding!
sold on page 35

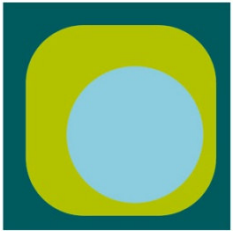
onehanesplace.com

BALI Chantelle barely there wonderbra Hanes Champion



Product Purchase Example

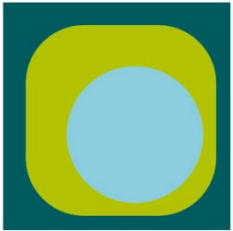
Segment	Description	Behavior	Frequency
AO	Apparel Only	Bought only casualwear or intimate apparel	Lowest
HO	Hosiery Only	Bought only hosiery and no apparel	Higher
HA	Hosiery and Apparel	Bought both hosiery and Apparel products	Highest



Lifetime Value by Product purchase

Segment	Lifetime Value
Apparel Only (AO)	\$8.00
Hosiery Only (HO)	\$25.00
Hosiery and Apparel (HA)	\$35.00

- Knowledge of dramatic variability in lifetime value drove allocation of customer marketing dollars and contact frequency
- Initiated efforts to convert HO to HA



Acquisition Example



- Envelope Mailing
- Hosiery Only
- Save up to 60%

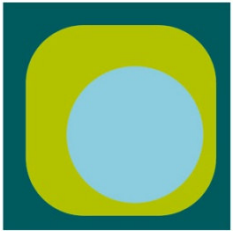
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sold on page 35

onehanesplace.com
BALI Plinkx barely there wonderbra Hanes Champion

- Full Catalog
- Hosiery and Apparel
- Save 35% to 45%

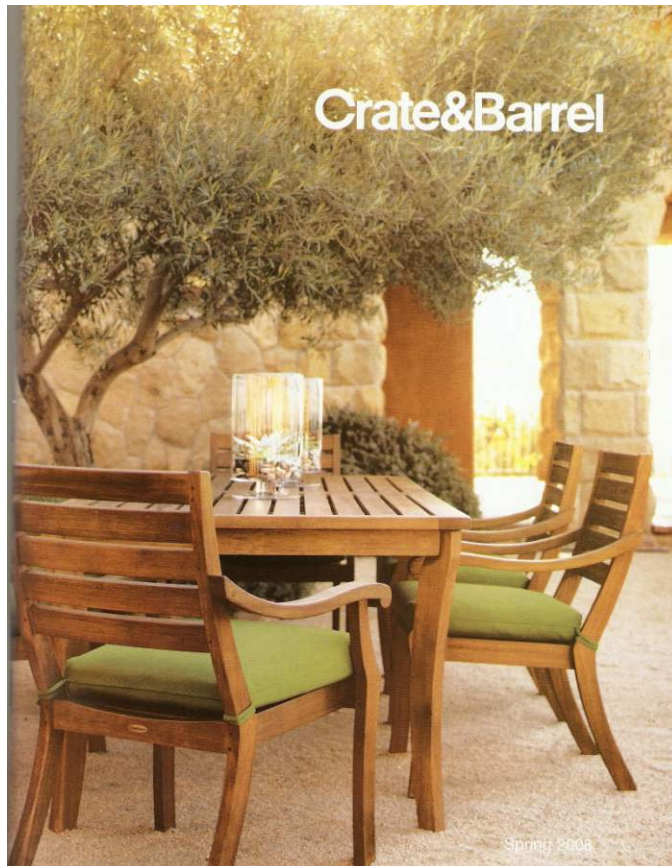


Efficiency Comparisons

Creative	Cost Per Name	Lifetime Value
Sav-A-Gram	(\$2.00)	\$15.00
Full Catalog	(\$9.00)	\$30.00

- Knowledge of investment and lifetime value allows for comparison of different creative and offer approach
- The “right” answer may be some combination of quantity and quality offers for a good customer “mix”

Crate&Barrel Examples

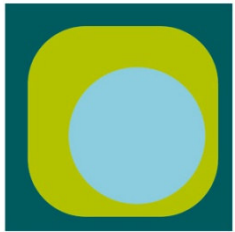


Multi-channel retailer

100+ retail stores

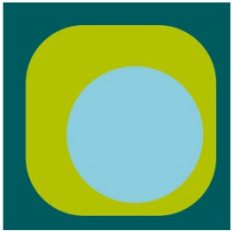
Catalog marketing

Well developed website



Importance of Sales Attribution

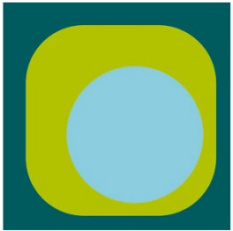
- For multi-channel marketers, sales attribution is critical
- Matchbacks must be conducted to properly attribute sales for prospect promotions
- Allocate back catalog, internet and retail sales to get the complete picture



Example of impact of sales attribution

Sales Channel	Cost Per Name
Catalog	(\$35.00)
Catalog and Internet	(\$15.00)
Catalog, Internet & Retail	\$5.00

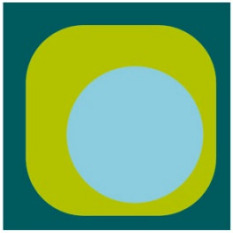
Proper attribution leads to dramatically different assumptions about catalog effectiveness



Acquisition Example

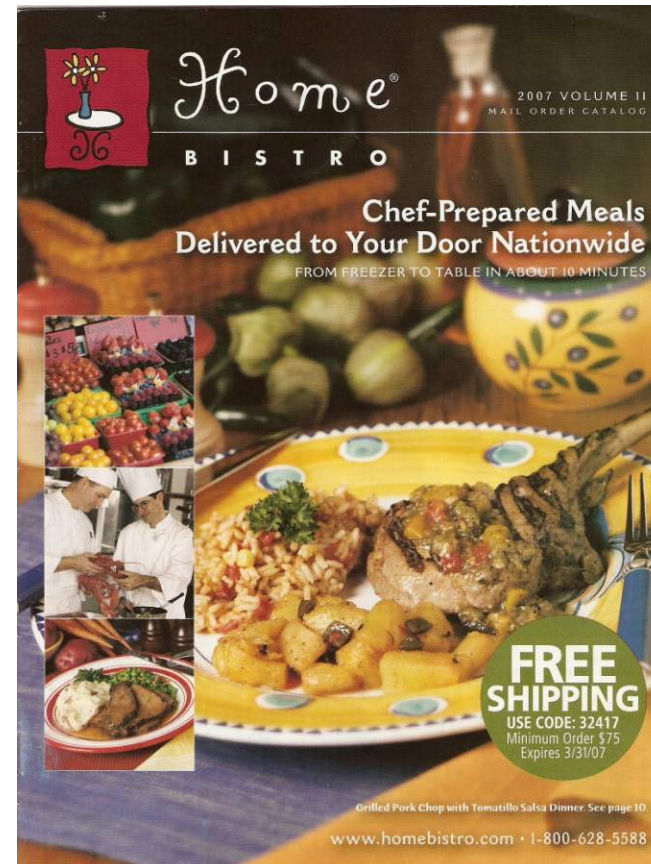
Creative	Sales Index	CPN	LTV
Crate&Barrel Best Buy Catalog (Housewares)	80	Lower	?
Furniture and Housewares Catalog	130	Higher	?

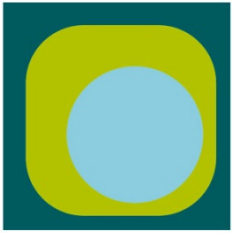
- Recommended calculation of LTV by acquisition offer



Home Bistro

- Direct marketing company
- Chef-prepared meals
- Delivered to your door
- Catalog is primary vehicle





Home Bistro Example

- Four meal sampler for \$19.95
- Normal offer is a catalog
- Normal pricing is \$10-\$14 per entree



Over 100 Different and Fabulous Complete Meals!

Enjoy Chef-Prepared Meals... In about 10 Minutes.

SPECIAL INTRODUCTORY OFFER*

Four Delicious Complete Meals
You're invited to experience extraordinary dining for less than five dollars per meal, delivered to your door nationwide by Home Bistro®.

The Secret to Great Taste
Our European-trained chefs create the most flavorful and inviting entrees with delicious side dishes, vacuum sealed and flash frozen at the precise right moment. You'll enjoy the full flavor and quality you'd expect to find at only the finest restaurants. Simply warm your Home Bistro meal in the specially designed packaging by placing it in simmering water for 10 minutes. No cooking, no cleanup, no hassles.

Home Bistro Executive Chef Scott Stillman preparing another wonderful meal.

YES, send me the meal sampler I've indicated below for only \$19.95
plus \$6.95 Shipping and Handling.

Item #8851 - 4 Complete Meals with Side Dishes: Blackened Chicken Breast with Champagne Sauce, Grilled Salmon with Chili Hollandaise Sauce, Pork Loin in a Reduced Apple Cider Sauce, Shrimp and Garlic Ravioli with Vodka Sauce

Item #8857 - 4 Complete Meals with Side Dishes: Cranberry Stuffed Chicken Breast, Orange-Cashew Shrimp with Fried Rice, Grilled Sliced Steak with Maple Bourbon Sauce, Wild Mushroom Ravioli with Marsala Wine Sauce

I am thrilled with the quality, freshness and delicious taste, not to mention the fantastically easy prep and clean-up.
—Suzanne H.

100% GUARANTEED

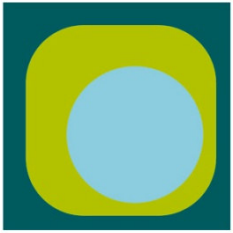
Call 1-800-628-5588 Ext.554
Or fill out the coupon or visit
www.HomeBistro.com/offer554

Home BISTRO

190 Banker Road, Plattsburgh, NY 12901

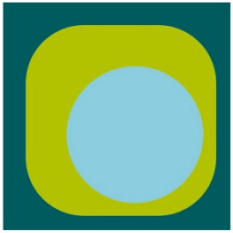
Name _____
Street (No P.O. Boxes) _____
City/State/Zip _____
Phone Number _____
 MasterCard VISA Discover AMEX Exp Date ____/____/____
Credit Card Number _____

All Home Bistro products are shipped in a weatherproof cooler with dry ice to arrive in perfect condition. Offer expires 5/31/07. ©2007 Home Bistro Inc. *New Home Bistro customers only, one per address.



Home Bistro

- Space ads in *New York Times*, *Newsweek*
- Produced lower cost per name than a catalog acquired customer
- Rolled out offer based on favorable front end results, back end was disappointing
- Beware of “the rat in the snake”
- Calculate LTV to know for sure investment allowable and back-end treatment



Lifetime Value

- Calculating Lifetime Value for Smarter Allocation of Resources

John Craig

Partner

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