



# TECHNOLOGY, MANUFACTURING & LIFESTYLE PRODUCTS

INDUSTRY REPORT

2020



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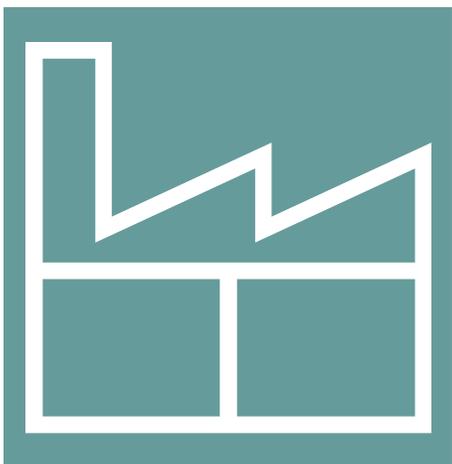
6-8. INDUSTRY ANALYSIS

# EXECUTIVE SUMMARY

July 2020

The Sonoma County Economic Development Board (EDB), in partnership with the Sonoma County Workforce Investment Board (WIB), is pleased to present the 2020 Technology, Manufacturing, and Lifestyle Products Industry Insiders report. Our research partner, Moody's Analytics, provided the research for this report. For additional information, questions, comments, or suggestions please contact us at (707) 565-7170 or visit [www.sonomaedb.org](http://www.sonomaedb.org).

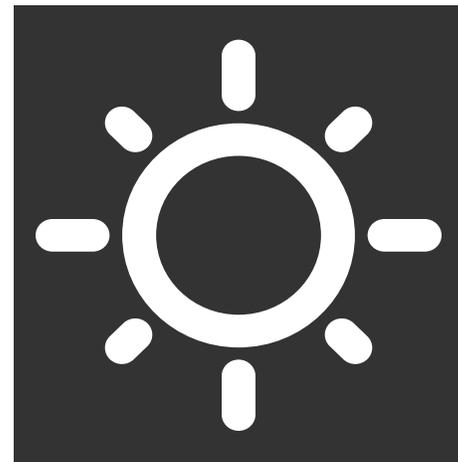
## HIGHLIGHTS



Sonoma County's high tech, manufacturing, and lifestyle industries have been steady drivers of job growth in recent years. The production of non-durable goods, which accounts for nearly two thirds of manufacturing payrolls, have been especially key for this trend. Consumers are purchasing and consuming more organic goods than ever before and as demand for organic and artisanal foods climbs higher, the growth trend has remained healthy and robust. Though conventional offerings generally present cost advantages, consumers are showing willingness to pay a premium for organic goods. During a seventeen week period that ended on June 27, sales of Organic food and drinks skyrocketed upwards of 25%. Consumers' growing preference for organically and locally sourced artisanal food products will play to the advantage of Sonoma-based food and beverage producers.



Sonoma County's manufacturing cluster has still fallen victim to the COVID-19 induced recession; resulting in job losses due to the statewide shelter in place order. However, Sonoma County's manufacturers have burdened the pandemic much better than the rest of the state. During the worst of the damages in April, payrolls had only declined by 7% on an annual bases. This is far better than the California trend of 11% as a whole. The recovery for regional industry has also been a lot quicker than the rest of the state. In May, the same metric showed county payrolls down only 1% in the county compared to 10% statewide. As workers continue to shift towards remote working; local electronic and broadband equipment makers will benefit. Furthermore, comparatively high rents in Marin County may convince more biotech firms to move to Sonoma County. Sonoma County offers strategic advantages that biotech firms are looking for: access to the Bay Area, a talented workforce, and a high quality of life.



Statewide closures of indoor recreation facilities has resulted in greater spending on outdoor recreation. Sales for sports equipment and locally produced recreational goods have spiked. However, this influx of revenue is not expected to last for the long term. As national and regional economies continues to plunge into recession, recreation spending will become much more limited as consumers turn their disposable incomes towards more essential good. Ultimately the lower demand for recreation related goods will decrease revenues for Sonoma County's outdoor equipment and apparel producers. Though the influx of revenue is not expected to sustain, outdoor recreation will manage the pandemic better than other recreation/leisure activities. The resiliency of the industry comes from the foregoing demand present before the spread of COVID-19 and the inherently lower health risks compared to other activities.



**Recent Performance.** Sonoma County's high-tech and specialty manufacturing cluster has been a key source of job gains in recent years. Nondurable manufacturers, which play a larger than average role in the county and comprise nearly two-thirds of total manufacturing payrolls, have been particular standouts. Robust demand for organic and artisanal food products has led to nearly uninterrupted growth over the past few years. Consumers are eating more organic food and using more organic products than ever before, according to the 2020 Organic Industry Survey recently released by the Organic Trade Association. The U.S. organic sector posted a banner year in 2019, with organic sales in the food and non-food markets totaling a record \$55.1 billion, up a solid 5% from the previous year. The shifting national preference toward organic food purveyors has given an outside lift to the county.

Despite the positive momentum moving into 2020, the county's manufacturing cluster fell victim to the COVID-19-induced recession. Manufacturing began bleeding jobs in March as statewide shelter-in-place orders and non-essential business closures forced many firms to furlough and lay off employees, but Sonoma's manufacturing base fared much better than those in much of the rest of the state. A larger than average concentration in food and beverage production helped safeguard payrolls, and at the height of the damage in April, payrolls had declined 7% on an annual basis, compared with more than 11% for California as a whole. The recovery has likewise been quicker than the state and national averages, with payrolls down only 1% on a year-ago basis in May while still down about 10% for the state.

Greater spending on outdoor recreation has spurred sales of sports equipment and Sonoma-designed accessories. The cluster of once-dominant medical device, electronic testing and telecommunications industries is a shadow of its former self, but employment had begun to drift slightly higher prior to the pandemic.

High-tech goods producers still play an integral role in the Sonoma economy, and two of its largest players, Keysight Technologies and Medtronic, anchor what remains a preeminent destination for medical device manufacturers.

**Macro drivers.** The economy has gone sideways since early June as the re-intensification of COVID-19 due to overly rapid business reopenings does damage. States accounting for nearly three-quarters of the nation's GDP have either stopped reopenings or reversed

themselves. Nervous consumers have tightened their self-quarantines and throttled their spending. Google mobility data show travel to retail and recreational destinations has gone nowhere in recent weeks in states suffering the most new COVID-19 infections.

The sputtering economy is also evident in the job market. Initial claims for unemployment insurance, including both regular state UI and the emergency pandemic assistance UI, are averaging 2.4 million each week, more than three times the pre-pandemic record. There has been no meaningful decline in initial claims since the last week of May, though continuing claims are declining slowly, suggesting that hiring has improved. However, with businesses in more and more places required to shut down again or at least pause their reopenings, hiring seems set to slow. Therefore, the economy will not be able to absorb the millions of newly unemployed.

The setback on the virus and the business restart may also be the catalyst for more bankruptcies and failures. Small businesses may have thought they could remain in business if they got up and running quickly and could perhaps buy time with financial help from the Paycheck Protection Program and forbearance on any loan payments. This now looks increasingly iffy, especially in the restaurant, accommodation, travel, recreation and energy industries, which are unlikely to return soon to their pre-pandemic sales levels. According to Cortera, which tracks business-to-business spending performance, more than one-third of B2B payments are already late in these industries and delinquencies are rising quickly.

The venture capital spigot has tightened in the midst of the sharp economic dislocation. Widespread layoffs and small-business failures have cooled investor appetites in riskier early-stage funding. Venture capital funding volumes in the U.S. are down 9% compared with a year earlier, and with tremendous uncertainty regarding the epidemiology of the virus and a potential return to shelter-in-place orders as case counts rise nationwide, funding will likely remain depressed levels for the remainder of this year and early 2021.

**Industry drivers.** Consumers' growing preference for organically and locally sourced artisanal food products will play to the advantage of Sonoma-based food and beverage producers, but the landscape for food and beverage providers has shifted considerably in the wake of the pandemic. Producers are being stung from a pullback in restaurant spending,

but some of this is being offset by increased demand at grocery stores. Early indications suggest that Sonoma's organic producers are reaping the benefits. Despite the cost advantage that conventional offerings hold relative to organic products, consumers are demonstrating a willingness to pay a price premium for organic produce, meat, dairy and snack foods. Many consumers are prioritizing better-quality products over cost as COVID-19 infections continue to rise across the U.S. Sales of organic food and drinks surged 25% for the 17-week period ended June 27, according to Nielsen data. That exceeds the pace of growth in the total food segment.

The near-term outlook for Sonoma's specialty manufacturing cluster is bifurcated. Sellers of food and other necessities—grocery stores, other general merchandise stores, and building supply stores—have seen outside sales growth. These segments have been among the few segments in any industry that have been adding to payrolls in recent months. By contrast, segments that have suffered the deepest sales declines, including apparel stores, restaurants, and appliance and electronics stores, have laid off the largest share of their workers and will likely take the longest for payrolls to recover.

The deterioration of the national and regional economy will limit recreation spending in the coming quarters, which in turn will suppress demand for Sonoma's outdoor equipment and apparel producers. TSA traveler throughput volumes are down more than 60% compared with a year earlier. There is a silver lining, however. Outdoor recreation will fare better given the reduced health risks compared with other leisure activities. Outdoor recreation had been among the fastest-growing industries in the U.S., and direct spending grew by nearly 40% in the last five years, according to the Outdoor Industry Association. Meanwhile, rising demand for ethically sourced clothing will bolster organic apparel producers such as Indigenous and Farm Fresh Clothing.

Sonoma County's technology firms will face a tougher road as business investment pulls back amid continued uncertainty regarding the epidemiology of the virus. However, white-collar jobs in tech have fared better in the initial stages of the recession, with minimal job losses compared with consumer-facing industries. The shift toward more remote work is benefiting local electronic testing and broadband equipment makers. Furthermore, the industry will be backed by strong efforts toward ongoing

modification of the internet infrastructure and demand for smart-home and other household devices that rely on mobile connectivity. Sales at Keysight and broadband equipment maker Calix are on the rise. Rising smartphone penetration globally as well as the incorporation of additional computer and electronic components into automobiles, airplanes, and other transport vehicles will amplify sales of the firm's next-generation signal analyzers and oscilloscopes. Yet automation will limit the need for new labor

The aging of the global population and older workers who remain in the workforce for longer than did previous generations will sustain demand for advanced medical procedures and new medical equipment, including those produced by Medtronic, Claret Medical and Endologix.

**Pricing.** The increasingly competitive organic food product market will hamper pricing power, but Sonoma's reputation for sustainable farming practices and ethically sourced materials will help differentiate county producers. More market offerings, especially as store brands by large supermarkets flood an increasingly saturated market, will force producers to either cut costs or double down on premium offerings. Consumers have demonstrated a desire for ethically sourced materials that should help Sonoma producers retain some pricing power. However, we have already seen price declines in apparel highlight another major development that will continue to pressure prices downward in the months ahead: With major chains entering bankruptcy and others fighting for survival, discretionary product and service prices are likely to keep falling.

Tech firms, on the other hand, will mostly hold on to their pricing power. Semiconductor prices continue their downward trend, and global sales have proven resilient in recent months despite the global recession. The global smart-home and cloud-computing markets continue to grow rapidly, and future catalysts, including the rollout of 5G technology and autonomous vehicles, will ensure sufficient demand for more-advanced chips.

**Operating expenses.** Labor market tightness has abated following the short-lived COVID-19 recession and will decrease wage pressures. Labor costs are the highest share of operating expenses across the county's various high-tech, food and beverage, and specialty manufacturing firms, and slowing wage pressures will ease operating expenses while the labor market heals. Industrial vacancy rates ticked slightly higher in 2019, and will likely tick higher

as small businesses in the county downsize or permanently shut down.

Local research and development facilities have avoided most cost-cutting efforts, but the trend toward lower-cost tech spaces in the South and Mountain West will provide another avenue for firms looking to trim costs. County food and beverage makers will benefit from lower prices for livestock feed and agricultural commodities.

**Profits.** Profit margins are likely to be squeezed for county food and beverage producers. Sales at grocery stores have helped offset the damage from limited restaurant bulk orders, but consumers may begin to pull back once the full extent of the labor market carnage is realized, expanded government assistance related to COVID-19 expires, and layoffs become permanent. Organic and artisanal food producers are in solid shape, as organic sales outpace the overall food market, but fierce competition will provide a speed limit.

Similarly, local sports and outdoor equipment makers will face squeezing profit margins given competition among nationwide retailers and online platforms. Tech producers will likewise grapple with pressure to preserve finances by opting for lower-cost expansions.

**Long-term outlook.** The mainstreaming of the organic food movement will create new opportunities for county producers, especially as consumers prioritize environmental and ethical practices in the production of the food and clothing they purchase. The county's reputation as a haven for sustainable and organic farming practices will help burnish its advantage as organic food sales grow as a share of total food sales, but mass-market organic brands at large food stores will require that Sonoma brands remain ahead of the curve.

Labor-saving technologies such as automation will slow the pace of job additions even as county producers grow their operations. Thus, manufacturing's contribution to job and income growth will be contingent on entrepreneurs' ability to innovate across product lines and to pioneer product segments.

Robust growth of food and beverage manufacturing facilities within the county itself has also cleared some of the inventory of industrial space, and it is imperative that county stakeholders develop new facilities to slow the rise in rents and enable further expansions.

Although Sonoma County will remain a regional hub for high-tech R&D, high-tech services face considerable barriers to growth. High business and living costs relative to those in

emerging tech hubs and a shortage of new engineering graduates are structural challenges that outweigh advantages such as proximity to Bay Area tech centers and a high quality of life. As a result, county-based tech firms will continue to staff up at lower-cost destinations in the U.S. and in other countries.

**Upside risks.** Comparatively high rents in neighboring Marin County could persuade more biotech firms to join the ranks of Sonoma's medical manufacturing cluster, driving growth in high-paying life-sciences research jobs. Rents are jumping in Marin County as vacancy rates dwindle, and firms looking to cut costs while remaining privy to much of the same strategic advantages—proximity to the Bay Area, a talented local workforce, and high quality of life—may incent more biotech firms to expand in Sonoma.

Continued deregulation in the medical device industry and faster-than-expected progress in R&D and successful clinical trials, would accelerate hiring at existing tech firms.

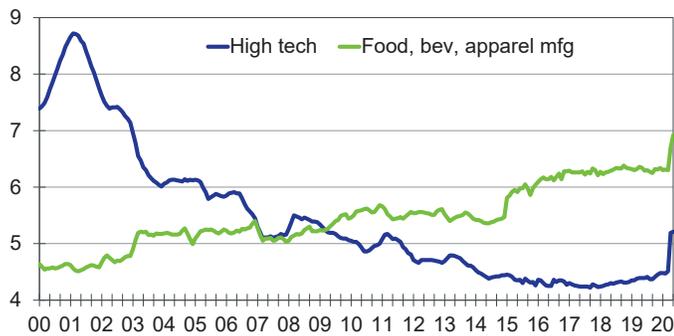
**Downside risks.** COVID-19 and the government's response to the crisis remain the two pertinent downside risks for Sonoma's manufacturing cluster. California reinstated shelter-in-place orders and nonessential business closures for nearly 20 counties in early July, including Sonoma. Sonoma's manufacturing cluster that is considered nonessential may be forced to furlough employees again, and the longer these closures remain in place, the more likely that temporary labor market dislocation becomes permanent as companies burn through their available cash reserves and government support expires at the end of this month. Furthermore, as case counts continue to rise nationally, the likelihood of a slow economic recovery increases and the long recovery for jobs and income will limit the base of consumers for Sonoma's tech and specialty manufacturing goods.

The increased feasibility of conducting R&D overseas could prompt Sonoma firms to expand in more cost-friendly destinations and chip away at the county's base of high-tech service positions. Furthermore, the pandemic has accelerated what has been a gradual shift toward remote working. Should more employers shift to remote work, the high costs of Sonoma and the surrounding Bay Area counties could persuade more firms to set up shop in lower-cost counties while their workforce can work remotely.

*Colin Seitz  
July 2020*

### Manufacturing Base Is Evolving

% of total employment, Sonoma County

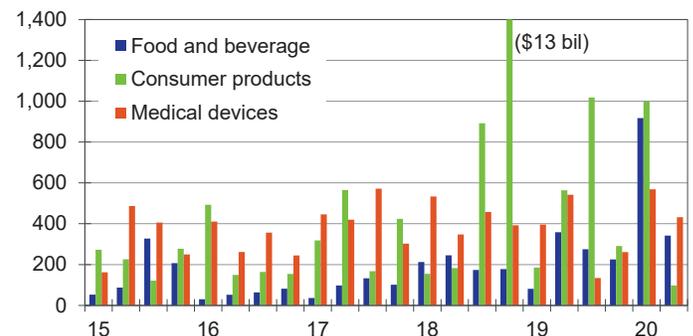


Sources: BLS, Moody's Analytics

Sonoma County's manufacturing base has grown even more bifurcated in recent years. The explosive growth of food and beverage manufacturers stands in contrast to that of high-tech producers, who have only held on to their share of employment. The mainstreaming of the organic food movement will continue to create new opportunities for county producers as consumers prioritize environmental and ethical practices in the production of the food and clothing they purchase.

### Venture Capital Remains Abundant

Venture capital placements, California, \$ mil

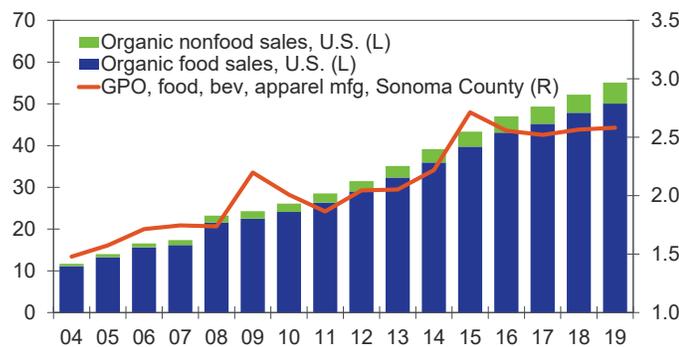


Sources: PwC, Moody's Analytics

Venture capital funding in Sonoma's key clusters has held up despite the COVID-19 recession. While nationwide funding is down 13% on a year-ago basis, venture capital funding in California for medical device, consumer products, and food and beverage products is about 50% higher year to date compared with last year. Investors are likely to pull back in the coming quarters, however. Business and consumer confidence has cratered, and a resurgence in new COVID-19 cases has made prospects of a quick economic recovery slim.

### Organic Sales Command Growing Share

\$ bil

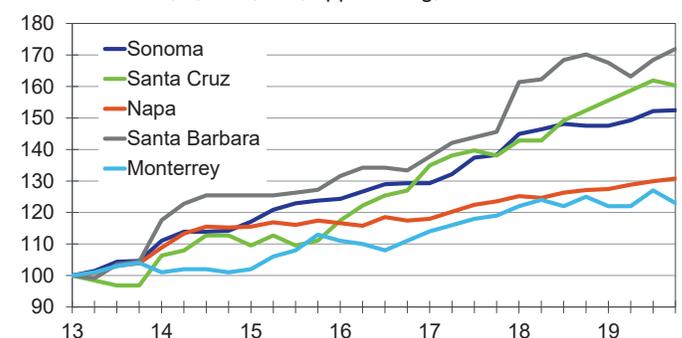


Sources: Organic Trade Assn., BEA, Moody's Analytics

Sales of organic food and nonfood products are rapidly outpacing those of their nonorganic counterparts. Organic products are commanding a growing share of the food and nonfood market, elevating local organic food and clothing makers. Sonoma's early adoption of organic and ethically sourced products has proven valuable in developing a renowned brand, has been crucial to the success of food and beverage producers, and augurs well for local producers.

### Sonoma Near the Top of the Pack

Establishments, #, food, bev, apparel mfg, 2013Q1=100



Sources: BLS, Moody's Analytics

Food and beverage makers are sprouting up in Sonoma County at an impressive rate, with growth in new establishments outperforming that in most California areas other than Santa Barbara and Santa Cruz. Apparel and other specialty lifestyle products have grown less vigorously, but the number of establishments is still ticking higher. By contrast, growth in high-tech firms has stagnated as county tech giants shift manufacturing and research and development to lower-cost centers in the U.S. and overseas.



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707 - 565 - 7170

141 STONY CIRCLE, STE. 110, SANTA ROSA, CA 95401