SOLOMON PARTNERS

unrivaled wisdom

RETAIL OUTLOOK 2022

TRENDS IMPACTING RETAIL M&A

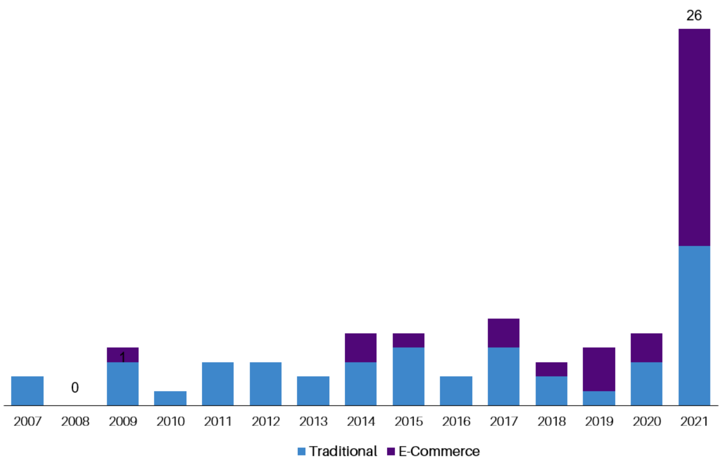
THE REOPENING & RESURGENCE

2021 was an extraordinary year on many levels. We witnessed the reopening of the economy after the earlier phases of the pandemic and substantial pent-up consumer demand. Aided by government monetary policies, credit and equity markets reached new heights and retailers were direct beneficiaries. This was a market that lifted many transactions out of the M&A market and into the capital markets. Look no further than the resurgent retail IPO market, bolstered by the emergence of consumer retail SPACs. We witnessed the return of private equity firms and family offices to retail via LBOs, as well as a higher level of strategic deal-making.

On an operational level, the pressing issues faced by our clients' boards and management teams included labor shortages, global supply chain congestion and disruption, and inflation, and these issues are continuing into 2022. However, as we've noted in the past, those with scale can press their advantages – with larger balance sheets, lower costs of capital and healthy stock prices – allowing them to take greater market share, both via organic means and acquisitions.

As is our tradition, we use this opportunity in the new year to look forward, rather than back. What follows are four critical themes we believe are going to impact retailing – and retail deal-making – in 2022.

REOPENING OF THE PUBLIC EQUITY MARKETS FOR NEW RETAIL ENTRANTS



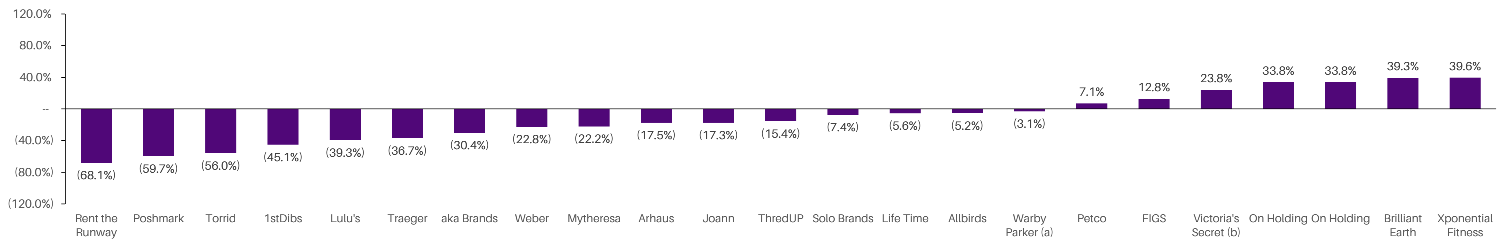
Source: Capital IQ a/o 1/11/22; excludes beauty / personal care and companies with valuations less than $100M

In the years following the Great Recession, the retail sector experienced stagnant public market activity. From 2008 through 2020, IPO markets averaged a mere three traditional retail and e-commerce offerings a year. In 2021, we witnessed the renewed willingness of IPO investors to back digitally native retailers, new management teams and/or repositioned legacy brands. The remarkable return of SPACs also presented an alternative path to being publicly traded. These factors resulted in an explosion of public equity market new issue activity, with 26 retail companies (comprised of 11 traditional and 15 e-commerce retailers) IPO'ing or de-SPAC'ing in 2021. There is also a robust IPO pipeline with six companies having filed confidentially with the SEC and over a dozen companies rumored to follow suit, as of the time of publication of this letter.

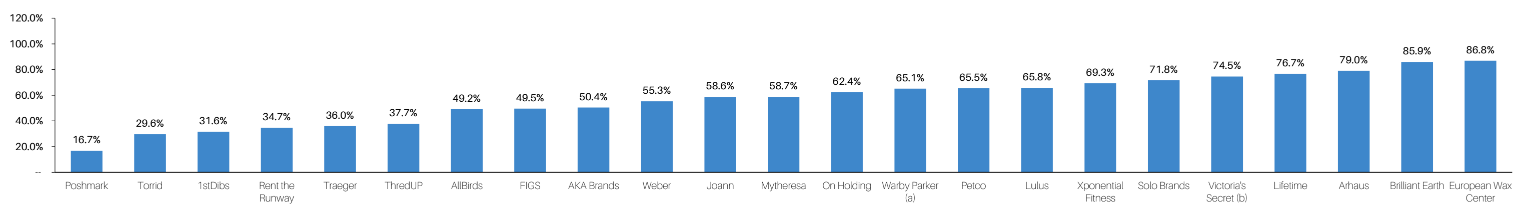
Notwithstanding public markets investors' initial appetite, time will tell how well this cohort of newly minted public companies performs over the long term. Initial market reception to the 2021 class of traditional IPOs was largely positive. 16 of the 23 IPOs entered at or above the high end of their filing range, and the average percentage change from IPO price to opening price was 21%. However, wind has come out of the sails and now just 7 of these 23 companies are trading at or above their IPO price.

This latest public cohort is comprised of direct-to-consumer startups, re-IPO'ed retailers from the last decade and companies in sectors that have benefited from the impact of Covid, including home-related goods and health and wellness products. The digitally native retailers and those with established omnichannel capabilities were best positioned for the pandemic and therefore reaped the benefits when first entering the public markets. However, many of the digital-first retailers have traded down after strong debuts, often as a result of the inability to live up to market expectations. Average stock price performance of digital first retailers since IPO is inferior to that of traditional retailers that have IPO'ed. While some digital-first retailers are now settled into lower trading levels, they are still generally trading at premiums to traditional retail peers as the market ascribes greater long-term growth expectations to those companies enjoying channel shift tailwinds.

% CHANGE SINCE IPO



% OF 52-WEEK HIGH



Note: As of January 11, 2022. a) Direct listing.
b) Victoria's Secret was spun-off from L Brands and listed separately under the ticker NYSE:VSCO in August 2021.

After restructuring through the pandemic, Claire's, Mattress Firm and Guitar Center join a group of more traditional retail companies that plan to capitalize on public investors' positive sentiment and tap the public markets. The IPO markets represent a new start for those private equity-owned companies previously hobbled by debt or unable to find a new home with new private owners. A number of the 30+ major retailers that went bankrupt during the pandemic (including large retailers such as Neiman Marcus, Tailored Brands, and J. Crew) may look to follow suit.

With strong consumer spending trends contributing to continued positive investor sentiment, we anticipate a healthy queue of retailers looking to join the public markets in 2022.

RESURGENCE OF RETAIL M&A

In our January 2021 Retail Outlook we asserted that private equity had rotated away from retail. In particular, PE had heightened concerns around specialty softlines retailers, multi-banner specialty retailers and trends in the mall. At the time, store closures were 3.5 times greater than store openings and mall traffic was ~76% lower than in the year prior[1]. Companies were focused on portfolio optimization. Some looked to spin-offs to accomplish the optimization (for instance VF's spin-off of Kontoor Brands and the planned separation of Torrid from Hot Topic — later completed via IPO). Others turned to sale dispositions of non-core brands (for

1 The Daily on Retail, Placer.ai (https://www.placer.ai/the-square/industry-trends/)

instance, Ascena, L Brands (ultimately resulted in a 100% spinoff of Victoria's Secret), HBC and Tailored Brands all completed divisional sales). Traditional retail LBOs and IPOs had all but disappeared, making it difficult for financial investors to underwrite retail investments to unpredictable exits. We had seen a building backlog of failed retail sales in 2015 through 2019 and our thesis was that only the best-of-breed omnichannel companies could break through and be sold at premium valuations.

Today's market looks very different. The Covid-driven retail dislocation accelerated previous trends, leaving stronger, omnichannel retailers thriving after a further "shakeout" of weaker competitors through bankruptcies and store closures. As larger retail companies explore growth and category expansion opportunities, small to midsize assets are once again in their sights. Improved visibility on future company earnings and stronger consumer spending are giving CEOs and boards of directors the confidence to acquire. Elevated corporate cash levels and record profits further embolden company decision makers.

Financial sponsor interest in the consumer retail space has also been revived with buyout firms noting the more stable consumer backdrop and opportunities to invest at attractive valuations. Sponsors also have more confidence that both the IPO and M&A markets provide viable exit alternatives. The At Home and Michaels take-privates represent harbingers for the return of the traditional retail LBO. As funds eagerly look to deploy their collective $2 trillion war chests and strategics build scale and drive growth, we expect retail M&A to continue at a healthy pace in 2022. Activism is also likely to play a role in catalyzing deal activity.

Within the overall increase in M&A activity, certain sub-sectors are clearly in favor. Investors are flooding into categories with durable Covid tailwinds. The post-pandemic focus on health and wellness, active and outdoor, as well as continuing work-from-home trends and general casualization, are driving sales of functional and comfortable apparel and footwear. As examples, Wolverine World Wide paid $410 million to acquire global fitness and lifestyle brand Sweaty Betty and Levi Strauss bought yoga apparel brand Beyond Yoga. The aforementioned Michaels and At Home LBOs are also evidence of the race to deploy capital toward businesses indexed to people spending more of their post-pandemic lives in and around their homes.

It remains a "seller's market" in these early days of 2022. We believe strategic buyers will continue to drive growth through brand, channel and customer– and often turn to acquisitions to accomplish this. Financial buyers have massive amounts of existing dry powder and access to additional financing on favorable terms. These factors — combined with a limited supply of quality targets — are supporting near record-level valuations. Assuming companies can navigate current supply chain disruptions (discussed below), handle inflationary pressures, and have access to historically cheap credit (despite planned interest rate hikes this year), we expect this robust environment to stretch well into 2022 (and possibly beyond).

DIGITAL ACCELERATION, DIGITAL SHAKEOUT

For many digital-first retailers, the early days of Covid created a highly attractive growth environment: customer acquisition costs decreased (for the first time in years) as a result of brick-and-mortar store shutdowns and mass retailers prioritizing essentials. Simultaneously, government stimulus supported elevated discretionary spending while social distancing drove investment in home, wellness and comforts. However, as we enter year three of Covid, a more normalized digital operating environment has emerged. We'll be tracking these five emerging themes:

1. *Increased Scrutiny on Public Market Pricing for DTC Assets:* despite initial positive receptivity for last year's cohort of digitally native IPOs — and stratospheric growth multiples in a number of instances (see Allbirds, FIGS, Poshmark) — the majority of these now-public companies trade below their offering prices. As DTC businesses consider strategic alternatives in 2022, they will have to contend with market skepticism based on their 2021 IPO predecessors. As a result, we expect increased scrutiny on business fundamentals.

2. *Heightened Focus on Customer Economics:* unlike in traditional brick-and-mortar retail or wholesale channels, digital retailers have unique insights into customer and transactional data. Increasingly, these metrics are becoming foundational to investment decisions. As a result, we expect to see increased transparency around DTC metrics, including disclosures on contribution-based lifetime value and customer acquisition costs. Given the disappointment surrounding former high-flyers like Casper and Wish, customer behavior as observed via these metrics will become a key determinant of corporate value in 2022.

3. *Competition and Privacy Challenges to Digital Customer Acquisition:* long-run customer acquisition inflation has returned as we re-enter a normalized digital advertising market. Increased competition has combined with policy changes designed to protect customer data (notably Apple's App Transparency and Google's move to limit cookies) to create an environment which demands differentiated content and execution to succeed.

4. *Evolution in Channel Strategies:* the customer acquisition arbitrage available to DTC pioneers has largely disappeared. Seminal digitally native brands like Warby Parker and Allbirds have increasingly leveraged brick-and-mortar retail, while companies like FIGS and REVOLVE have validated the growth potential of pure-play digital. Increasingly, we expect customer profitability to drive channel strategies, as businesses lean into the opportunities that offer the highest return-on-marketing investment. Ultimately, the ability to be tactical across channels (wholesale and brick-and-mortar) and within channels (Facebook, Instagram, TikTok, Google) will drive outperformance.

5. *Continued M&A Activity, Including Consolidation:* We expect continued momentum in both private and public market DTC M&A in 2022. 2021 saw strategics re-enter the digital acquisition arena (Levi's / Beyond Yoga, Edgewell / Billie, Best Buy / Yardbird), continued sponsor activity (Carlyle / End., Freeman Spogli / Brooklinen) as well as a number of SPAC transactions (Boxed, BarkBox, Grove). More recently, we have seen DTC rollups gaining momentum, with successful public market execution by a.k.a. and Solo Brands, and announced deals from Harry's (Lumē), Cerberus (Helix and Brooklyn Bedding) and Win Brands (Gravity), amongst others. We expect continued consolidation throughout 2022 as scale, diversification and operational leverage help mitigate a more competitive digital environment.

SUPPLY CHAIN DISRUPTION AND IMPACT ON DEAL-MAKING

The second half of 2021 brought a new crisis: massive supply chain disruption created a virtual chokehold on global commerce, ensnaring nearly every industry in every region and putting M&A activity at risk for companies with vulnerable supply chains. Accelerated freight costs, lack of container availability, scarce labor and uncertainty of delivery timing, have resulted in unprecedented challenges for business leaders and disappointed end-consumers around the world.

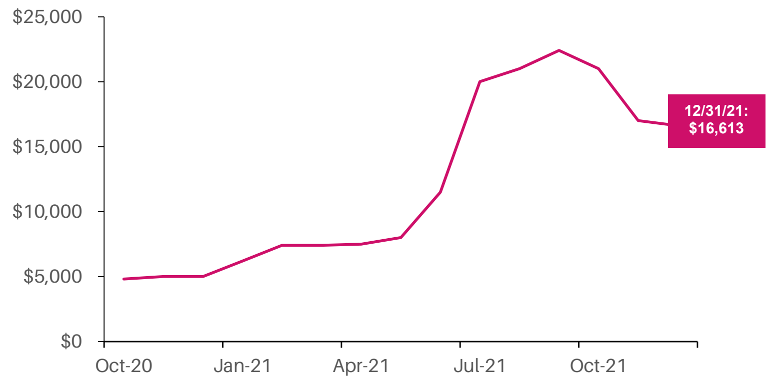
Key factors contributing to the crisis include:

1. *Covid infrastructure cutbacks and a resurgent consumer:* consumers are spending at above average levels and deploying more to goods than services. Consumer spending as measured by the personal consumption expenditures (PCE) index increased 11.4% in the first quarter of 2021 and 12.0% in the second quarter of 2021 compared to the previous year[2]. Container shipping had to juggle elevated consumer demand for goods on the heels of having slashed capacity during initial lockdowns. We also note the heightened demand for shipping containers heading into Chinese New Year in February 2022.

2. *Unpredictable production capacity:* Covid variants have continued to disrupt factories around the world, with notable impact across Southeast Asia's and Latin America's manufacturing centers. The countries in the IHS Markit ASEAN manufacturing PMI saw factory conditions decline due to elevated Covid cases and restrictive lockdown measures across southeast Asia in August 2021[3]. Since then, manufacturing has improved gradually as Asian countries have begun to recover from peak disruption in mid-2021.

3. *An overtaxed shipping and port ecosystem:* with about 90% of world trade moving by sea, congestion at major ports stuck with aging infrastructures and persistent labor shortages, combined with increased shipping volumes, have put massive strain on many major shipping routes and doubled shipping times from China to the United States[4]. With the top four container shipping companies accounting for approximately 58% of global market share[5], increased demand has driven an enormous rise in container prices. At its peak, container rates from China to the United States exceeded $20,000 per container; as of December 2021, average container prices remain elevated at ~$16,000 per container[6].

CHINA / EAST ASIA TO NORTH AMERICAN EAST COAST CONTAINER PRICE



Source: Freightos

4. *Raw materials and component parts in increasingly scarce supply:* this has resulted in sharp price increases throughout the supply chain. For example, from May 2020 to September 2021 fuel prices tripled, and food and metal prices are forecasted to remain at higher than pre-pandemic levels[7].

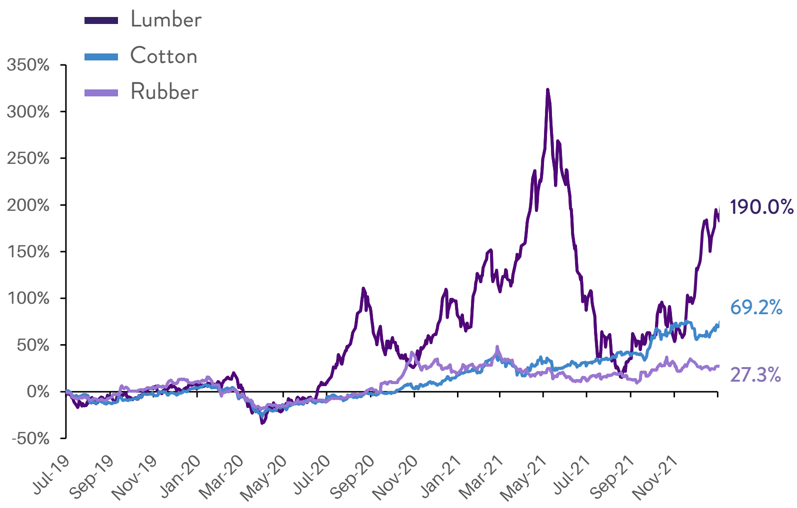
5. *Microcontrollers ("chips") have also been in short supply:* as more everyday goods embed technology, manufacturing capacity cannot keep up. This has led to unfinished goods piling up in upstream manufacturers' factories – or even products shipped lacking key features.

2 Bureau of Economic Analysis
3 https://ihsmarkit.com/research-analysis/asean-economies-hit-hard-by-escalating-covid-delta-waves-sep21.html
4 https://www.bloomberg.com/graphics/2021-congestion-at-americas-busiest-port-strains-global-supply-chain/
5 https://www.freightwaves.com/news/top-10-liners-control-85-of-market-and-theyre-not-done-yet
6 https://www.reuters.com/business/china-us-container-shipping-rates-sail-past-20000-record-2021-08-05/
7 https://www.euromonitor.com/article/three-charts-on-surging-input-costs-in-manufacturing

6. *Labor markets continue to tighten:* fewer people have been willing or able to work on factory floors to produce goods or get behind the wheel of tractor-trailers to deliver those goods. The US trucking industry currently faces a major shortage, which has been exacerbated by the pandemic, with 80,000 drivers needed in 2021 compared to 61,500 needed pre-pandemic, a 30% increase[8]. Covid flareups continue to further pressure the ability to rely on the availability of labor – particularly for densely packed factories and distribution centers.

COMMODITY INDEX CHART

Source: S&P Capital IQ



A concerning byproduct of these factors is inflation, which reached 7.0% in December 2021, the highest rate since 1982. While many market observers expect inflation pressures will abate with supply chain normalization, there is no such guarantee and many consumers are become increasingly aware of the impact on their wallets in the interim.

As previously noted, CEO confidence is a major factor supporting M&A volume. To date, supply chain and inflationary pressures do not seem to be impacting deal volumes, but this could change if there is not a clear path to resolution. Prior to the pandemic, understanding the supply chain was largely a confirmatory diligence workstream in an acquisition process. Today, supply chain is a headline issue for buyers, both in terms of underwriting "normalized" historical financial performance and in risk assessing 2022 financial performance.

The upside, however, is that strong operational infrastructure has evolved as a strategic weapon for the companies that can legitimately lay claim to having better sourcing mousetraps. More businesses that possess resilient sourcing infrastructures are highlighting this attribute as a core investment consideration in marketing materials for sale processes. These companies are also in the enviable position of being able to secure market share from competitors unable to meet demand. We believe buyers will attach incremental enterprise value to such better-positioned companies in 2022 deal-making.

CONCLUSION

We anticipate a busy first half of 2022 that will challenge the peak periods of deal-making that we experienced throughout 2021. We believe we will see an increase in private equity and family office retail investing, we will continue to see more DTC businesses and traditional retailers transact, and we will receive more clarity on how investors are going to value DTC businesses (many of which are evolving over time to look more and more like omnichannel retailers).

As always, our experienced advisory team stands at the ready to help you think through the impact of these trends on your business, and how you may best capitalize on the opportunities the trends present. We wish you a happy and productive 2022.

8 https://www.cnn.com/2021/10/19/economy/trucking-short-drivers/index.html

SOLOMON CONSUMER RETAIL TEAM

Cathy Leonhardt
Managing Director
Co-Head of Consumer Retail
+1.212.508.1660
cathy.leonhardt@solomonpartners.com

David A. Shiffman
Managing Director
Co-Head of Consumer Retail
+1.212.508.1642
david.shiffman@solomonpartners.com

Jeff Derman
Managing Director
Consumer Retail
+1.212.508.1625
jeff.derman@solomonpartners.com

Irina Adler
Managing Director
Consumer Retail
+1.212.508.1658
irina.adler@solomonpartners.com

Patrick Furlong
Director
Consumer Retail
+1.212.508.1643
patrick.furlong@solomonpartners.com

Flore Gimello
Director
Consumer Retail
+1.212.508.1645
flore.gimello@solomonpartners.com