ANNUAL OUTLOOK

SOLOMON PARTNERS

TRENDS IMPACTING CONSUMER AND RETAIL M&A

2024

INTRODUCTION

Though 2023 was another challenging year for M&A, we are optimistic for a brighter future in 2024 as headwinds begin to fade and positive sentiment takes hold in the boardroom and C-suite.

Before we dive in, we wanted to highlight that in July 2023, we welcomed John LeVert as a Managing Director. John is a proven leader in the consumer sector with 20 years of experience in the food & beverage and pet sectors. As we continue strengthening our consumer franchise, John's extensive sector expertise will help us capitalize on sustained investment in the resilient F&B and pet markets.

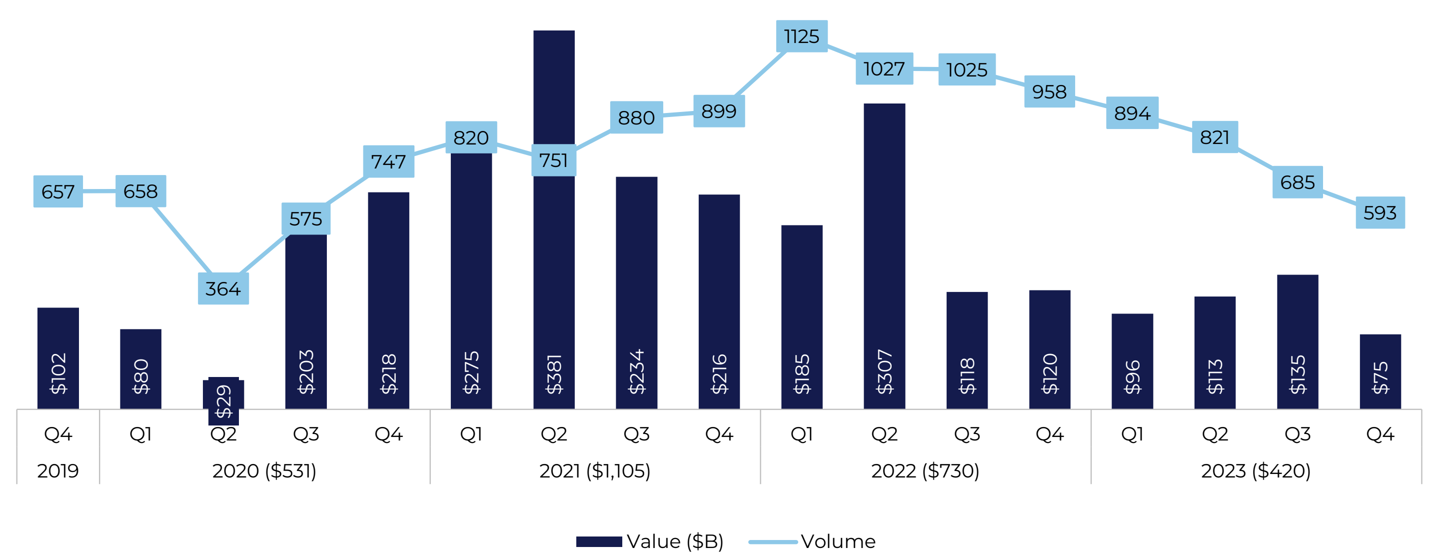
Looking back on the past year, we witnessed heightened inflation and aggressive monetary policy tightening by the Federal Reserve. Sequential rate hikes through July 2023 left companies and investors reluctant to borrow while consumer confidence became unstable amid recession fears, which in turn drove lower sales and profits. The ensuing market volatility resulted in multiple lenders failing, including the second-largest bank collapse in history.

Despite the unfavorable backdrop, we saw investors get creative in their deal-making and capitalize on opportunities by pursuing smaller deals, minority investments, and corporate carveouts while also dipping into their immense dry powder to increase equity checks and avoid over-leveraging in a high-rate environment. Throughout 2023, investors also placed a heightened emphasis on profitability over growth, requiring that potential targets demonstrate stable and increasing revenues and free cash flow. This increased selectivity resulted in a smaller pool of potential companies to invest in, but drove significant interest in top performers.

After a tumultuous first three quarters, pressures finally started to abate, and we have only just begun to see the recovery stabilization that will lead to improved deal-making. As inflation continues its gradual pullback, the Fed has shifted its tone and indicated multiple potential rate cuts in 2024. Retail sales held steady year-to-date through November 2023 and averaged monthly year-over-year growth of 2.1%, with November retail sales beating estimates and growing 3.1% year-over-year.[1] Consumer confidence for December was much better than expected at 110.7 vs. the Street's 104.5 estimate, as psychology around current business conditions and job availability has improved.[2] Multiple market indices have again approached or surpassed all-time highs, and there is growing positive sentiment for both M&A and capital markets activity heading into 2024.

What follows are five themes that we believe will impact deal-making in consumer retail in 2024.

U.S. PRIVATE EQUITY ACTIVITY ($B)



Source: Dealogic; deal volumes and deal counts as of December 29, 2023.

1. U.S. Census Bureau Retail Trade Report, December 2023.
2. Conference Board Consumer Confidence Index, December 2023.

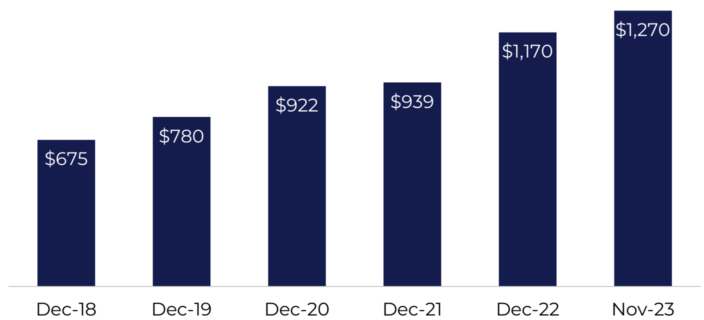
CONTINUED RESILIENCE ACROSS THE FOOD & BEVERAGE LANDSCAPE DESPITE THE CHALLENGING MACRO BACKDROP

The food & beverage sector continues to be attractive due to its resilience through the economic cycle combined with enduring tailwinds, such as consumers' secular shift to "better-for-you" (BFY) and functional products. While the sector demonstrated relative strength vs. its discretionary consumer counterparts, total M&A volume remained down through 2023, extending the ~43% decline experienced in 2022. This reflects a greater abundance of caution amid macroeconomic and geopolitical uncertainties, significantly increased cost of capital, and the corresponding compression in trading multiples. These factors have led acquirors to be highly disciplined, limiting their M&A focus on the few targets that could offer a combination of scale, profitable growth, and runway.

Despite recent easing inflation (and reduced level of pricing increases by F&B corporates), elevated prices continue to pressure organic sales growth across the industry, evidenced by year-over-year volume declines across multiple categories. Consumers have looked to stretch their dollars, selectively traded down to high-quality private label offerings or store led brands, and, for a portion of the population on GLP-1 agonists such as Ozempic, curtailed caloric dietary consumption entirely. Recently, large-cap F&B corporates have been under-performing market indices, with meaningfully more of these companies reporting mixed earnings and missed sales estimates.

To help combat this, strategics with strong balance sheets have been selectively acquiring targets that offer scale, help modernize their portfolios, capture attractive consumer demographics, and enhance their innovation capabilities and growth prospects. This portfolio reshaping is evident across a variety of examples. For starters, Campbell's recently acquired SOVOS Brands, a leader in great-tasting, BFY offerings led by its Rao's brand. Rao's has been the fastest brand in center-of-store over the last few years, and Campbell's brings additional distribution reach and tomato-processing infrastructure to the table. Further rationale for the transaction is that Campbell's mainstream brand Prego had been losing market share to Rao's. Another example is Unilever's acquisition of Yasso, a leader in BFY frozen novelties. This acquisition occurred around the same time as Unilever vocalized a desire to exit certain off-trend frozen treat brands, illustrating the resilience of BFY trends.

U.S. PRIVATE EQUITY DRY POWDER ($B)



Source: Preqin, U.S. PE Dry Powder (Private Equity ex Venture Capital, U.S. Based Fund Managers)

Perhaps the best example is Mars' acquisitions of Kevin's Naturals, TruFru, and Champion Petfoods over the last year. These three transactions proved the long-time candy conglomerate's steadfast focus on its core values and long-term global growth ambitions, with Kevin's filling the void in BFY dinnertime offerings, TruFru filling the void in BFY indulgent snacks while leveraging its Dove infrastructure, and Champion expanding Mars' pet food brand portfolio with Orijen and Acana.

These recent marquee deals all garnered valuation multiples in the high-teens: 20x's EBITDA pre-synergies, underscoring a key theme that buyers are still ascribing premium valuations for high-performing assets. Notably, this extreme selection bias has led to an interesting dynamic whereby transaction multiples appear in line with previous all-time highs due to the lack of offsetting lower multiples associated with more challenged assets not getting to the M&A finish line.

SUPPLY CHAIN SECURITY CONTINUES TO BE A KEY DRIVER OF F&B INVESTMENTS

On another note, improved supply chains and forecasting visibility continue to drive strategic confidence and underscore the importance of securing upstream capabilities. Strategics are perhaps emboldened as supply chains have substantially improved and commodity pressures have generally moderated over the last 18 months. Security of supply remains a high priority, and a preponderance of M&A activity reflects this importance over the last year. For example, Chobani recently announced its acquisition of La Colombe. This transaction provides Chobani with a valuable new growth vector, immediate access to the attractive ready-to-drink coffee category via a leading, scaled brand, and valuable vertical integration (including conscious bean sourcing, roasting, and packing capabilities) on the heels of La Colombe's valuable distribution partnership with (and minority investment by) KDP announced earlier in the year. In another example, Campbell's acquisition of SOVOS Brands (described above) provides scaled tomato sourcing and processing infrastructure.

Private equity has increasingly targeted F&B and pet platforms with scalable capabilities providing contract manufacturing, private-label offerings and/or value-added ingredient solutions. These vertically integrated platforms enable investors to participate in the defensibility, resiliency, and growth of certain categories in a brand-agnostic way and can be well-positioned to weather evolving consumption habits. For example, PAI Partners acquired Alphia, a leader in premium pet food & treats, and Entrepreneurial Equity Partners acquired MBC Companies, a leader in frozen breakfast products.

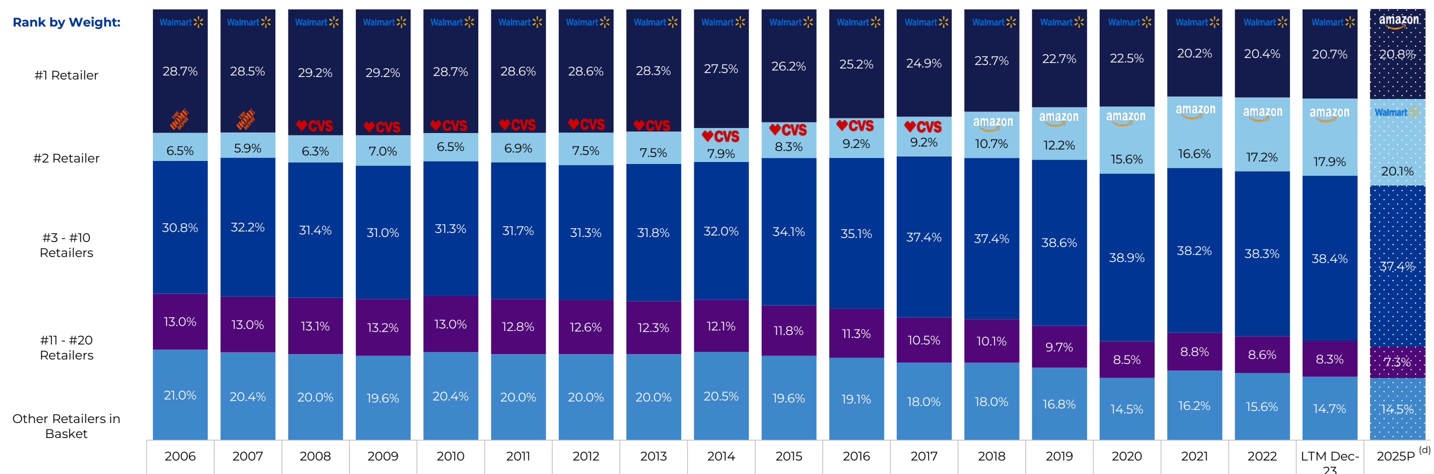
Looking ahead, we anticipate corporates in 2024 will continue to be disciplined in their M&A strategies with a focus on reshaping their portfolios to better align with evolving consumer preferences. This will benefit emerging brands that provide incrementality to their respective categories and the acquirer's portfolio, particularly brands with secure supply chains. This will also lead to select carve-outs of operations deemed non-core. For example, earlier this January Platinum Equity announced the acquisition of Horizon Organic and Wallaby from Danone.

BIGGER RETAILERS GET EVEN BIGGER

Over the past four years, we have covered various topics on scaled retail players and how they continue to influence the industry; our observations have been accurate and our conclusions continue to play out over time. This year, we have delved into the historical data of the top 150 publicly traded retailers, starting from the 2006 launch of the XRT.[3] Our analysis is focused on highlighting the trends associated with the evolving concentration of retail revenue dollars and public investment in market capitalization, specifically for the top two, top 10, and the remaining retailers in this universe.

On a revenue basis, it should be no surprise that Walmart has been the top retailer along with Amazon, which overtook CVS as the second-largest in 2018. By 2025, we project that Amazon will overtake Walmart as the top revenue-generating retailer. In 2006, leading up to the Great Recession, the top two retailers accounted for 35.2% of total retail revenue share while the top 10 claimed a sizeable 66.0%. Fast forward to 2020 and the picture significantly changed amidst the COVID-19 pandemic, with the top two's contributions growing to 38.1% and the top 10 to 77.0%. In 2023, the top two held steady at 38.6% while the top 10 accounted for 77.0%. Over the past decade, Amazon has contributed nearly 34.0% of total revenue growth across the top 150 retailers. Retailers outside of the top 10 have seen their percentage of revenues decline from 32.3% of total in 2013 to 23.0% in 2023.

WEIGHTED TOTAL REVENUE OF SELECT PUBLIC RETAILERS [a][b][c]



	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	LTM Dec-23	2025P [d]
Total Revenue ($B)	$1,216	$1,321	$1,384	$1,396	$1,470	$1,560	$1,639	$1,680	$1,765	$1,841	$1,925	$2,010	$2,167	$2,307	$2,481	$2,832	$2,996	$3,090	$3,427
Total YoY Growth	--	8.7%	4.7%	0.9%	5.2%	6.1%	5.1%	2.5%	5.0%	4.4%	4.5%	4.4%	7.8%	6.4%	7.6%	14.1%	5.8%	3.1%	4.6% [b]
AMZN Growth (% of Total Growth)									17.2%	23.4%	34.8%	49.3%	35.0%	34.1%	60.5%	23.9%	26.9%	42.5%	45.9% [b]

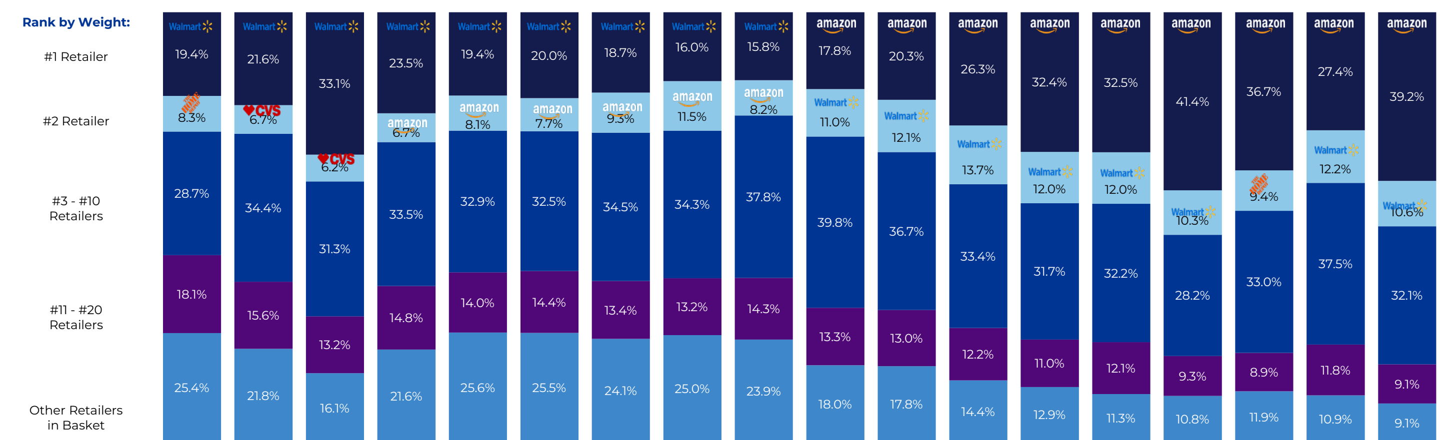
a. Represents a basket of ~150 publicly-traded retailers primarily based on active holdings of the SPDR S&P Retail ETF (XRT) from 2006 to December 2023. The XRT is designed to track the performance of consumer discretionary retailers. Solomon has made adjustments to this index to exclude auto dealers, convenience stores, grocery stores, travel agencies, and other businesses that are not in the primary retailing business; additions include consumer staple retailers, hardline retailers, direct-to-consumer/digitally-native companies with a retail presence, and apparel/footwear companies with a retail presence not included in the XRT. Financial data from Capital IQ.
b. Represents CY Revenue from 2006 to 2023. LTM Revenue is as of December 31, 2023; 2025P YoY Growth Rate represents CAGR from 2022 to 2025P.
c. Represents all AMZN revenue (including AWS, Whole Foods, advertising services, etc.).
d. 2025P based on Wall Street analysts' revenue estimates for the 2022 basket. Select retailers included in "Other Retailers in Basket" do not have coverage through 2025P; however, those retailers' revenue projections have been extrapolated by Solomon using the weighted average CAGR from 2022 to 2025P for retailers within the "Other Retailers in Basket" segment that do have 2025P coverage. Derived CAGR was applied to 2022 actual results to extrapolate projections for 2025P.

3. Solomon has made adjustments to this index to exclude auto dealers, convenience stores, grocery stores, travel agencies, and other businesses that are not in the primary retailing business; additions include consumer-staple retailers, hardline retailers, direct-to-consumer/digitally-native companies with a retail presence, and apparel/footwear companies with a retail presence not included in the XRT.

NUMBER OF U.S. LBOs FINANCED BY PRIVATE CREDIT AND IN THE BROADLY SYNDICATED LOAN MARKET

When viewed from the perspective of investment dollars in market capitalization, these trends become even more amplified. For the past decade, Amazon, Walmart, and Home Depot have consistently ranked as the top three largest retailers by market capitalization. In 2015, Amazon notably overtook Walmart to claim the top spot and now accounts for a staggering 39.2% of total share. At the height of the pandemic, Amazon accounted for 41.4%, amassing an 8.9% gain from 2019 that was accelerated by consumer demand shifting from physical retail to e-commerce platforms. The top 10 retailers have grown from holding 56.5% in 2006 to nearly 82% today, and when omitting Amazon from the analysis, still account for 72.7% of total invested dollars and further highlight the overwhelming dominance exhibited by the top 10. Retailers outside the top 20 have fallen below 10% of total market capitalization (from recent peaks of ~25%).

WEIGHTED MARKET CAPITALIZATION OF SELECT PUBLIC RETAILERS [a][b]



	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Market Capitalization ($B)	$990	$882	$664	$868	$992	$1,025	$1,222	$1,590	$1,754	$1,777	$1,751	$2,142	$2,264	$2,816	$3,948	$4,605	$3,123	$4,009
Total YoY Growth	--	(10.9%)	(24.7%)	30.7%	14.3%	3.3%	19.3%	30.1%	10.3%	1.3%	(1.4%)	22.3%	5.7%	24.4%	40.2%	16.6%	(32.2%)	28.4%[c]
AMZN Growth (% of Total Growth)									(23.7%)	759.1%	(153.9%)	53.1%	140.1%	32.9%	63.4%	8.7%	56.3%	80.5%

a. Represents a basket of ~150 publicly-traded retailers primarily based on active holdings of the SPDR S&P Retail ETF (XRT) from 2006 to December 2023. The XRT is designed to track the performance of consumer discretionary retailers. Solomon has made adjustments to this index to exclude auto dealers, convenience stores, grocery stores, travel agencies and other businesses that are not in the primary retailing business; additions include consumer staple retailers, hardline retailers, direct-to-consumer/digitally-native companies with a retail presence and apparel/footwear companies with a retail presence not included in the XRT. Financial data from Capital IQ.
b. Represents market capitalization as of December 31 from 2006 to 2022. December 2023 market capitalization data is as of December 31, 2023.
c. Growth rate represents growth in total market capitalization from December 31, 2022 to December 31, 2023.

We would be remiss to not acknowledge that several of the top retailers have undergone radical business model transformations in response to technological innovation and shifts in consumer demand. Amazon, for instance, has evolved from an online marketplace to a leading technology provider and global distribution powerhouse, reaching consumers in over 50 countries worldwide. CVS and Walgreens, which both once operated solely as traditional pharmacies, have now repositioned themselves as leading healthcare and insurance providers throughout the United States. Walmart, a once predominantly brick-and-mortar retailer servicing rural American consumers, has undergone momentous change, with its 2016 acquisition of Jet.com serving as a catalyst for its digital movement and broadening its consumer audience. Walmart's recent stakes in Flipkart further underscore its commitment to global technological advancement within the retail sector.

As it relates to our analysis, we believe these trends will continue indefinitely, and for those suppliers to these mega-cap retailers, an argument could be made to strategically concentrate your business efforts on growing with them. On a revenue concentration basis, the number of doors for the top 10 has grown by 21.7% since 2013, even when accounting for the 2018 liquidation of Sears' 2,000+ doors, which was the tenth-largest retailer by revenue in 2013.

THE FUTURE OF DTC

E-commerce continues to win share of retail; however, the digital "land grab" is over. As consumers continue to spend their time online (now in excess of six hours per day), retailers have reoriented both organizational infrastructures and advertising dollars to capture attention online. As mentioned above, established retailers such as Walmart have invested in their digital capabilities, leveraging scale, cost-of-capital, and omnichannel advantages to compete and, in many cases, outperform digitally-native disruptors. Growth continues in digital, with United States e-commerce sales exceeding $1.1T[4] in 2023; however, the composition of this growth has changed, with growth from incumbent brands (+16%) now outpacing growth from digitally-native businesses (+2%).[5]

A more competitive digital environment has spurred an evolution in the digital brand playbook, demanding far more from companies today than targeted performance marketing. Success in digital requires executing on brand-building activities, namely labor- and time-intensive investments in creative and content, personal connectivity to customers, responsive customer service, and other activities that engender long-term customer affinity.

Heightened competition and a reversion to pre-pandemic channel trends have caused dislocation for many digitally-native businesses. Combined with inflationary pressure on the consumer, unfavorable valuations, and limited capital availability, we expect to see continued digital consolidation in 2024, including both strategic combinations and distressed M&A. However, we also anticipate the return of marquee deals for differentiated, scaled brands and the emergence of the next generation of best-in-class, digitally-native businesses which have been informed by both the successes and failures of the first generation of digital disruptors.

4. Fashion United and U.S. Department of Commerce, November 2023.
5. Insider Intelligence and eMarketer, August 2023.

BRAND MANAGEMENT COMPANIES DRIVING M&A IN BRANDED LIFESTYLE & FASHION

Brand management companies have proven to be an influential and expanding force in fashion and lifestyle brands, driving significant M&A activity since 2019. Over the past two years, Authentic Brands Group (ABG) has spearheaded transactions in branded footwear and apparel, completing a series of acquisitions that include Reebok for ~$2.5B in March 2022, Boardriders for ~$1.3B in April 2023 (Quiksilver, Billabong, DC Shoes, etc.) and the Vince IP for ~$77M in April 2023. Though Vince's intellectual property is now owned by ABG, the structure of the transaction allowed Vince's OpCo (NYSE: VNCE) to remain publicly traded on the New York Stock Exchange, attesting to the fact that buyers and sellers alike have been willing to find ways to complete deals in an environment atypical from years prior. Further examples of consolidation include WHP Global's (WHP) $235M investment in an IP JV with Express in December 2022, with the two companies partnering to acquire menswear brand Bonobos from Walmart in April 2023, and WHP's acquisition of global denim brand G-Star RAW in September 2023. Another example is Consortium Brand Partners' acquisition of Draper James in August 2023. Solomon continues to be at the center of this activity, having advised on several of the transactions listed above, as well as most recently having advised PVH on the sale of its intimates brand portfolio to Basic Resources, a large and important licensee to major brands and brand management companies, in November 2023.

We expect this activity to increase in 2024 as brand management companies look to continue acquiring iconic brands across various segments and launching active licensing programs in diverse categories and geographies. Globalization has proven to be a lucrative means of enhancing brands' stature as well as building customer bases. WHP, for example, has been actively pursuing international expansion for its brands. Recently, the company signed long-term licensing deals to introduce the Express brand to new markets such as Indonesia, Paraguay, Mexico and Central America. Marquee Brands also recently announced it will be bringing five of its brands to countries in the Gulf Cooperation Council and India, proving that opportunities continue to exist in new markets. Furthermore, continued IP acquisitions generate additional downstream transaction activity as the IP brand ecosystem expands. Not only are off-take licensee partners to IP companies continuing to grow larger, but they are also co-investing in the IP or buying brand IP on their own. Another opportunity that continues to support lucrative IP M&A activity is category development, as brand management companies look to create value via expansion beyond core product categories. ABG and Reebok recently announced a partnership with Sakar International to manufacture and distribute Reebok-branded basketball, pickleball, baseball, soccer, and football equipment, as well as electronics, including audio, tech, and massage products.

CONCLUSION

We are optimistic about deal-making heading into 2024 despite prolonged macroeconomic headwinds and pressure on consumers, as both buyers and sellers alike continue to exhibit interest and creativity in pursuit of successful transactions. We believe the market has reached equilibrium as the steady retreat of inflation over the past year has resulted in a change in the Fed's rate outlook, with officials soft-signaling the possibility of three rate cuts in 2024. Similar to 2023, M&A activity will continue to be tied to the capital markets, but potential declines in cost of capital have contributed to growing positive sentiment among investors. Stability in the broader market will push boards and management teams to pursue alternatives and will instill greater confidence in buyers to act on strategic decisions that may have been delayed during a challenging 2023.

As always, our experienced consumer and retail advisory team is here to help you think through how to navigate the evolving landscape in 2024 and capitalize on opportunities that may help reshape your business for durable competitive and financial advantage. We wish you success and prosperity in the coming year.

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