

December, 2021



▶ 2022: CONSUMER RESET OR RETRENCHMENT



▶ Q4 EARNINGS WILL BE KEY



▶ THE CONSUMER "YEAH, BUT..." IS LOSING SWAY

Tully & Holland

Topics and Trends

GOAL-ORIENTED ADVICE

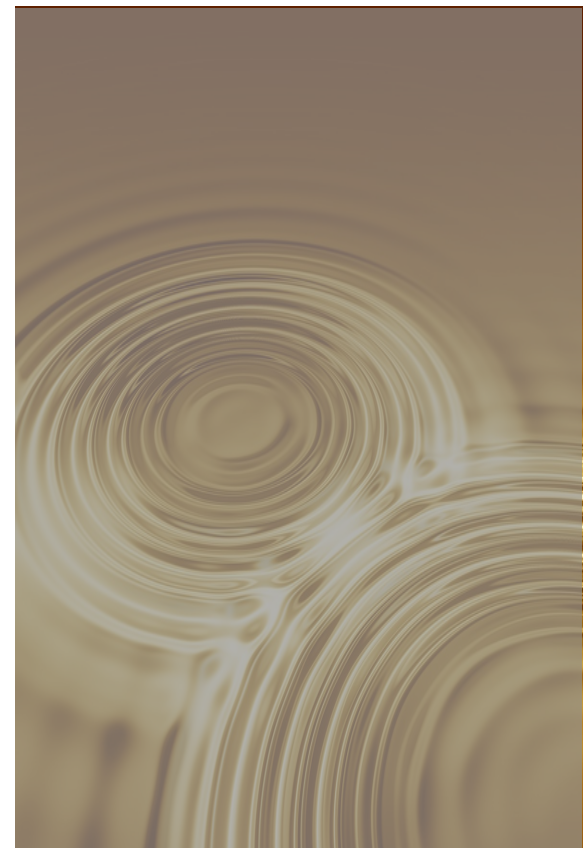
INVESTMENT BANKING FOR CONSUMER COMPANIES

2022 – Will Anticipated Consumer Reset Become Retrenchment?

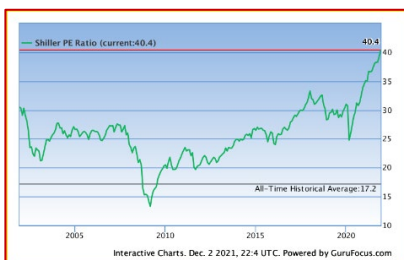
A year ago, as we prepared to enter 2021, uncertainty around COVID-19 remained but it seemed more a question of when, not if, the societal reset button would be pressed. Vaccines were arriving, kids were increasingly back to school in some form, retail establishments were expected to be “back to normal” by end of Q2, and corporations were debating if they should mandate full workforce returns by July 4th or Labor Day. Throughout it all, the consumer drove a demand-based economy that kept us all both afloat and excited about

a soft-landing return to normalcy.

Now, twelve months later, while progress has been made on many fronts, uncertainty around COVID-19 variants exacerbate the broader economic turbulence we face in supply chain backlogs, labor force imbalances, and inflationary pressures across all metrics. Indeed, the question we now must face is whether the very consumer demand that buoyed us will reverse to become an anchor? Only time will tell, but certain topics and trends warrant focus.



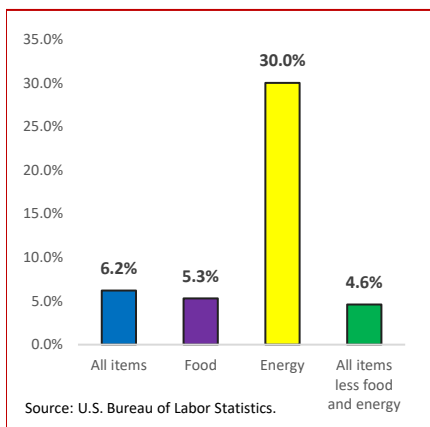
The 20 Year Shiller PE Ratio Shows Just How Close To Perfection Markets Are Priced.



Q4 EARNINGS WILL SET THE TONE

Markets are jittery as we begin the final month of 2021, and while some sectors may prove resilient, the Consumer and Retail Sector is not likely to be as profitable. More to the point, while it can often lift corporate results to see shelves depleting over the holidays, the fact that sellers are having to wait longer, and pay more, to slowly re-stock their shelves with ghostly manpower, does not bode well. Pressure on COGS, SG&A, Inventory, and Working Capital metrics will all work against bottom line results. And while some inflation will be passed on in the form of price, the magnitude and lag effect of the gap may be larger than many imagine. Q4 earnings will provide a first look at how well companies are balancing the tightrope walk.

Consumer Price Index, 12-month percentage change, selected categories, October 2021, not seasonally adjusted.



“Yeah, but...” is likely to lose psychological sway

The “Yeah but...” rationalization of the consumer has likely reached a tipping point. Rising inflation, an idling to reversing housing market, turbulent equity markets, and a more hawkish FED make it much harder for Mr. and Ms. Mainstreet to justify discretionary purchases through the cocktail talk of “Yeah, but my 401(k) is up a ton!”, “Yeah, but the equity in my house is a safety net!” “Yeah, but my used car is worth more than it was new!”

Looking to the most recent Consumer Price Index data (see chart above) the “All items” index rose 6.2% for the 12 months ending October. This represents the largest 12 month increase since November 1990. The subcategory of Food, where we at T&H do a lot of work, was up 5.3%. And as much as one would like to believe a righting of the supply chain will normalize prices, it’s never that simple.

First, the righting of the supply chain is not an overnight matter and likely will not occur in full until at least 2023, and that assumes some help on the COVID front. Second, the need to incentivize labor through increased wages will not

slow in the near term, likely exacerbating CPI in the next two quarters. Third, no retailer is going to “take back” the price increases once passed on; the best we are all hoping for is a return to normalized rates of inflation in 18 months or so.

Agree or disagree with the timeline, resilience of markets, whether we go into recession, etc. - What is undeniable is the consumer is feeling the hit at the same time sellers and suppliers are beginning to lose a zero-sum game on the profitability line. Something has to give, and the most logical next place for that to occur is on the consumer demand side.

So what does that mean for our clients, and the potential effect of M&A in the Consumer space? Happily, the answer is not as dire for many lower-middle market companies as the set-up might suggest. More specific, those companies that can provide consistency, efficiency, and value, while simultaneously focusing on quality, will benefit most.

At Tully & Holland we work with companies that range in Enterprise Value from \$10M-\$200M, and the trends described above are prevalent throughout our client base. Indeed, we represent a leading food distributor that focuses on fresher, faster; and we are launching in January on a large global sourcing and virtual

manufacturer of private label foods that gives clubs and grocery higher margin sales on best quality and value goods. Clients in the sleep tech, organic coffee, vitamin and supplements, and fresh-juice space have already demonstrated their resilience and the customer loyalty that accrues to “better for you” trends. As consumers become more frugal they will also become pickier about share of wallet going to those that share their “moral” values while simultaneously providing “economic” value. We expect Strategic acquirers and PE firms to look for much the same.

Tully & Holland – Trailing 12 Months Completed Transactions

 Vermont Coffee Company has been acquired by Stonewall Kitchen Financial Advisor to Seller	 David DelCurto has been acquired by Hancock Natural Resource Group Financial Advisor to Acquirer	 Mariner Seafood LLC has been acquired by True North Seafood, Inc a part of Cooke Inc. Financial Advisor to Seller	 Aqua Leisure Industries, Inc. has been acquired by Blackford Capital Financial Advisor to Seller	 Rocket Innovations, Inc. has been acquired by SociÉTÉ Bc S.A. Financial Advisor to Seller
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Tully & Holland – Live Engagements

Sell-Side: Leading Fresh Food Distributor	Sell-Side: Specialty Craft Coffee Company	Sell-Side: Category-Leading Sleep Technology Company	Sell-Side: Vitamin & Supplements Contract Manufacturer	Sell-Side: Clean-Label Branded Beverage Company	Sell-Side: Supplier/Virtual Manufacturer of Private Label Foods	Buy-Side: Food & Beverage Conglomerate
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