MARKET RESEARCH REPORT

Retail

The Retail Reset

C3 Solutions

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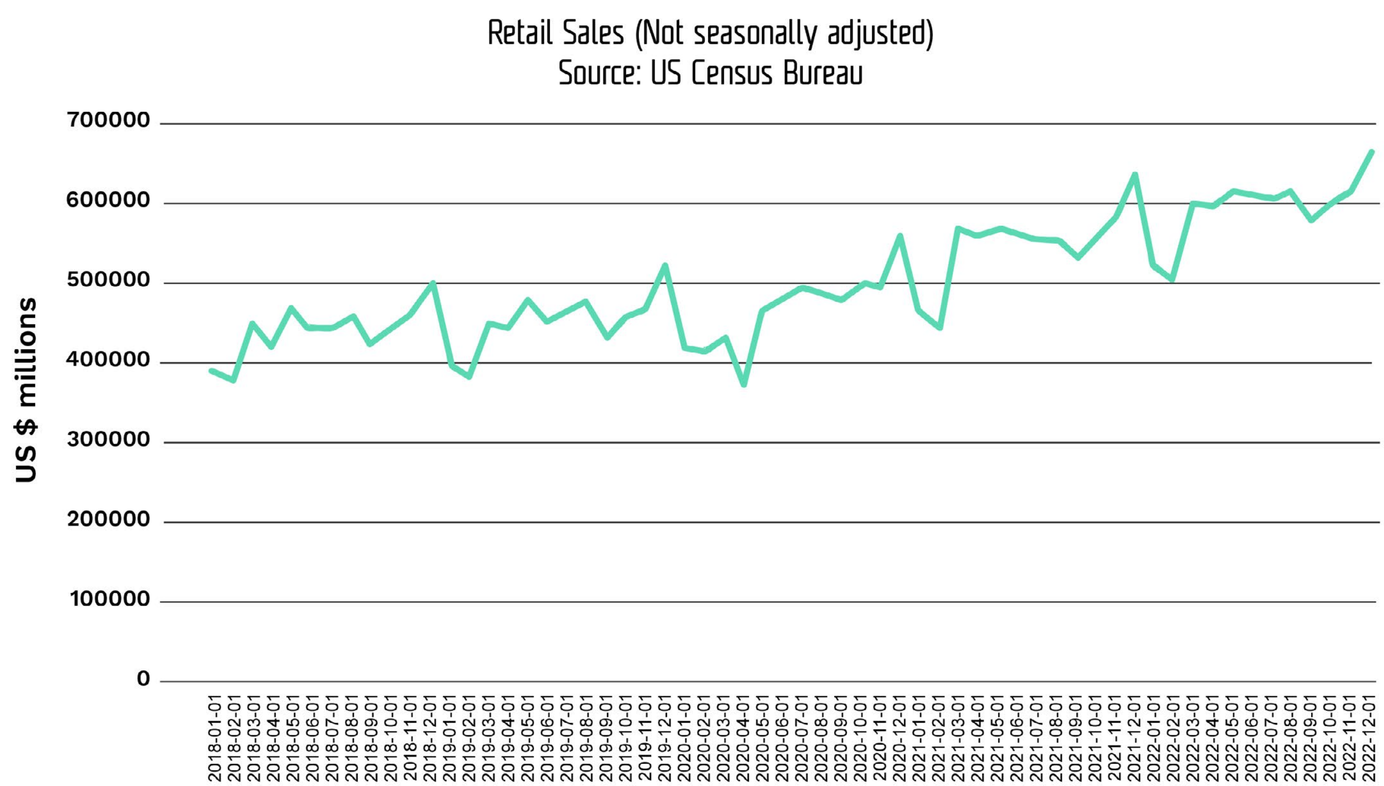

The retail industry has undergone a profound change in just a matter of only a few years. From an emphasis on brick & mortar retail stores to one of an integrated, omnichannel approach, it took a global pandemic for the industry to accelerate technology investments linking physical stores with virtual stores and to strengthen supply chains to gain visibility, maintain the flow of inventories and to position them closer to consumers for faster last-mile delivery service.

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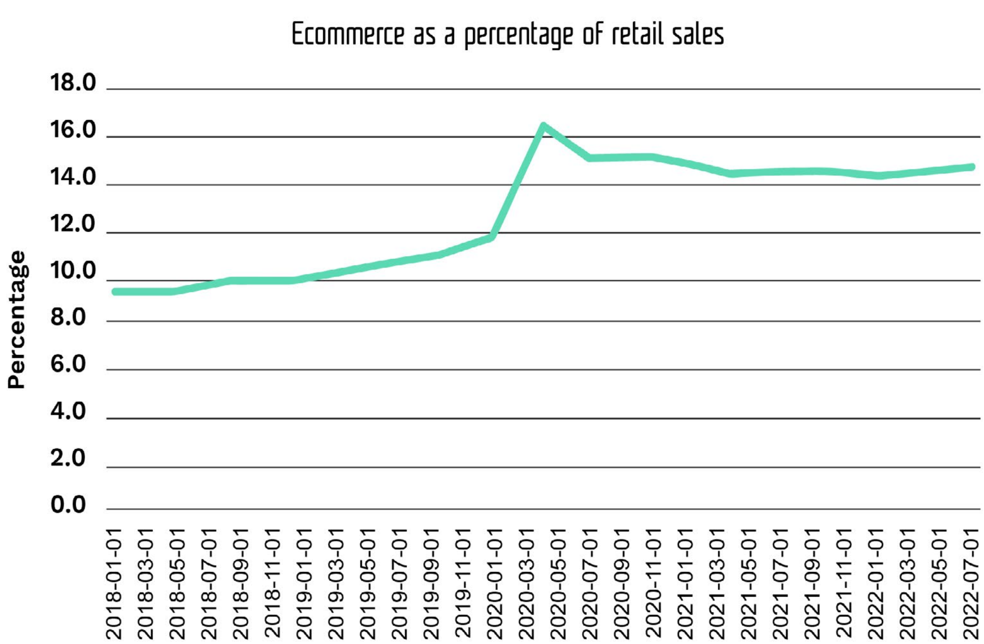
E-Commerce

Much of the retail sales jump was attributed to e-commerce and those retailers with existing omnichannel capabilities benefited as well.



Prior to the global pandemic, e-commerce was slowly ticking upward as a percentage of retail sales, and many retailers were following Amazon's lead by offering free two-day deliveries prior to the pandemic.

In 2019, e-commerce represented 11.1% of total US retail sales but when the pandemic hit in 2020, it peaked at 16.4% of total US retail sales before settling to around 15% once retail stores began to reopen and vaccines became available.

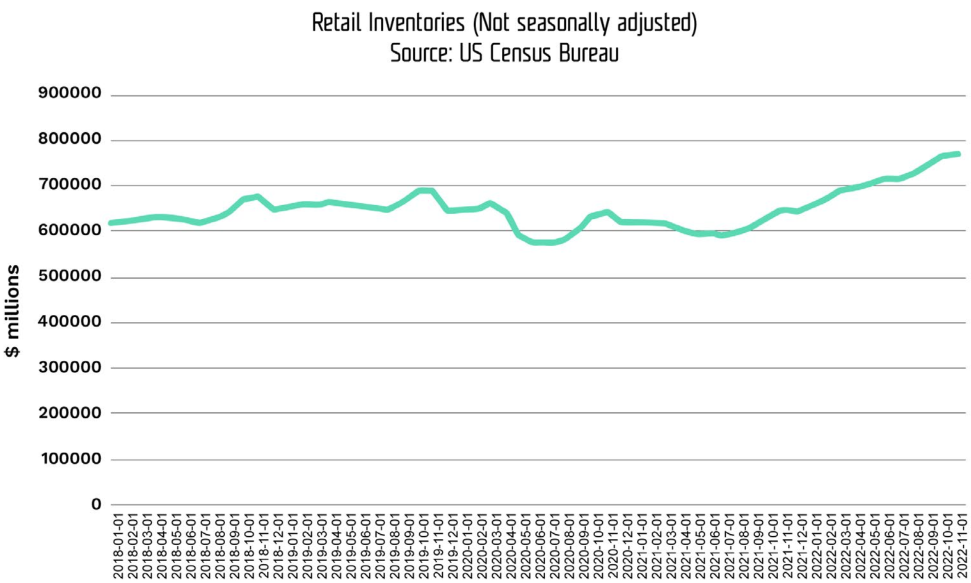
As such, a sense of urgency occurred for those retailers that had been slow to invest in technology prior to the pandemic as they quickly ramped up investments to link their ecommerce platforms to their physical stores and to the rest of their supply chains, including business intelligence tools and analytics.

The Pandemic - Supply Chain Disruptions

The global pandemic led to inventory shortages, delivery delays, and **higher supply chain costs**. In addition, the need for visibility became apparent as retailers spent valuable time looking for and obtaining transportation, tracking freight, and diversifying suppliers.

Many retailers began to shift away from just-in-time strategies that had worked for years to one of just-in-case as they ordered extra inventory to compensate for the delays in supply chains. However, this strategy backfired on some retailers as economic and geopolitical concerns resulted in consumers slowing down their spending in 2022.

As a result, warehouses became bloated. Logistics real estate developer and provider, Prologis noted that average occupancy during the fourth quarter 2022, was 98% and retention stood at 82.4%. “With regard to our markets and leasing activity, the bottom line is that conditions remain healthy and there is little we see across our results or proprietary metrics that point to a meaningful slowdown,” Prologis CFO, Tim Arndt told analysts in January. “We see a normalization of demand and when combined with low vacancy, it continues to translate to a meaningful increase in rents. Across our markets, rent growth was nearly 5% during the quarter, driving the full year to 28%. Arndt said.



As a result of excess inventory, retailers turned to markdowns and promotions to help clear out warehouses and to entice consumers to spend. Among the retailers to focus on reducing inventories was Target which **announced its plan in June 2022** “to right-size its inventory for the balance of the year and create additional flexibility to focus on serving guests in a rapidly changing environment.” Included in this plan was additional markdowns, removing excess inventory and canceling orders, adding incremental holding capacity near U.S. ports to add flexibility and speed in the portions of the supply chain most affected by external volatility; price adjustments to address the impact of unusually high transportation and fuel costs; and working with suppliers to shorten distances and lead times in the supply chain.

By Q3 2022, Target’s inventories improved despite some inventory arriving earlier than expected during the quarter. “Our inventory is in a much healthier position than earlier in the year because of the heaviness you’re seeing today is due to the early arrival of fresh inventory we are planning to sell. For example, by early November of this year, nearly 90% of our key Q4 programs had already moved into our distribution centers and stores. In contrast, last year, just over half our key programs were in the network as of the same time frame,” Target’s COO, John **Mulligan told analysts** in November, 2022.

Target’s inventory dilemma is similar to many other retailers.

From January 2022 to November 2022, retail inventories in terms of dollars, increased 17.5% according to US Census data.

Consumers responded positively to retail sales during the 2022 holiday season. According to **the National Retail Federation**, U.S. holiday sales rose by 5.3%. Including e-commerce, holiday sales which is not adjusted for inflation jumped to $936.3 billion during November and December.

The Retail Industry - 2023

The January Logistics Management Index suggests that firms were able to run down inventories over the holiday season. “We see evidence in January’s numbers that firms are now working to replenish them,” according to the **February press release**.

But **retailers continue to face market challenges** this year while at the same time the need to continue their supply chain technology investments, and network redesigns to ensure they are flexible and resilient for the next potential supply chain shock.

According to a **Deloitte survey**, nearly all retail executives surveyed expect inflation to pressure their profit margins. Six in 10 respondents expect inflation to raise operating costs, and while passing higher prices on to consumers has been the norm, many question how long they can continue the trend. These retail executives are also predicting hard times for consumers, with nearly all anticipating diminished consumption in 2023, resulting from rising financial concerns.

While inflation has eased since Deloitte first surveyed retail executives, recession fears have replaced inflation concerns.

Nearly all executives in Deloitte’s survey say consumers will expect a seamless shopping experience across channels this year. But executives expect consumers to be significantly more price-conscious, making consumers more likely to shift from source to source, powered by peer recommendations and price comparison shopping as they go.

So, it’s no surprise that this year that executives will focus on advancements created during the pandemic: to drive more profit from the curated experiences, last-mile options, and conveniences that retailers introduced all at a time when the purse strings may need to tighten.

However, retailers do not expect a one-size-fits-all solution to uncovering profitable growth in this environment.

Overall, retailers will focus on a number of long-term strategic initiatives to create efficiencies such as:

- Investing in fulfillment capabilities
- Heightened focus on **the customer experience** and tapping into loyalty programs
- Improving the margin profile of their e-commerce capabilities

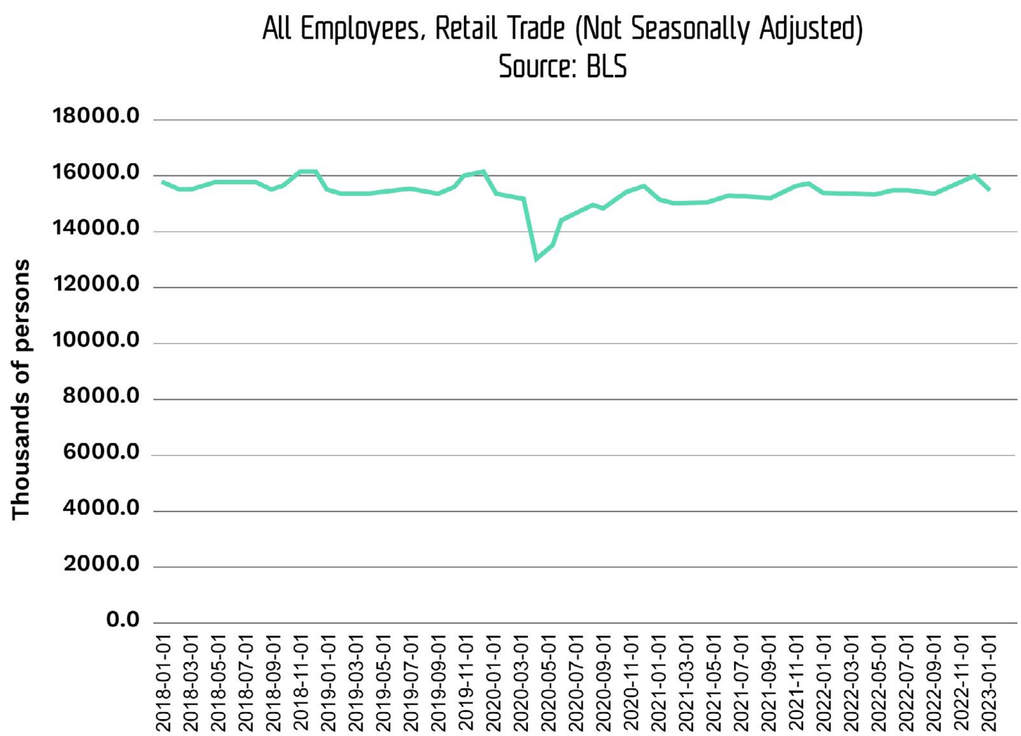
Eight in 10 executives surveyed by Deloitte said they plan to make moderate to major investments to modernize their supply chain in 2023.

Labor Concerns Continue

In addition, seven in 10 executives surveyed said labor is the number one challenge. As of November 30, 2022, 879,000 retail jobs remained unfilled. Hiring and retaining employees has been an ongoing issue, and competition for hourly workers remains fierce, with retailers forced to offer higher wages and more flexibility.

According to the US Bureau of Labor Statistics, the number of retail employees in January 2023 was about the same as January 2020, up 2.3% compared to January 2021 and up 0.5% compared to January 2022. However, the number of employees has not kept pace with the increase in retail sales.

In addition, the growth of e-commerce has created a shortage of warehouse workers. According to the US Bureau of Labor Statistics, the number of warehouse employees in January 2023 was up 48.8% compared to January 2020, up 22.3% compared to January 2021 and up 3.1% compared to January 2022. The US Bureau of Labor Statistics estimates the average annual warehouse turnover rate is 43%.



What Retailers are Saying...

"We see clearly that customers want to shop both online and in store and we are continuing to grow with omni-channel sales. This once again shows the value of having both physical and digital channels, which strengthen and complement each other. We are therefore continuing the integration of our sales channels to offer customers a convenience and inspiring experience. We also continue to invest in other areas, particularly within tech AI and supply chain. An important part of our supply chain is our logistics systems.

We currently have several global initiatives involving new highly automated logistics centers with a focus on innovation," H&M CEO, Helena Helmersson, **Q4 earnings transcript** for the period ending Nov 30, reported on January 27, 2023.

Helena Helmersson
CEO **at** H&M

"We definitely have seen that the promotional environment went a little bit deeper and we believe it's going to go a little bit longer. And a lot of that has to do with some of the building inventories that are out there with all the brands. And that is something that all of the retailers are going to need to work through in the coming quarters," Under Armour CFO Dave Bergman, Q3 earnings transcript for the period ending Dec 31, reported on Feb 8, 2023.

Matt Puckett
CFO **at** VF Corporation

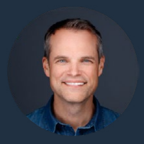
"As we move into 2023, we are encouraged by healthier inventories in the channel and the work we have done to improve our own inventory dynamics and actions to improve capacity at our U.S. distribution centers,"
Levi Strauss President and CEO, Chip Bergh, **Q4 earnings transcript** for the period ending Nov 27, reported on January 25, 2023.

Chip Bergh
President and CEO at
Levi Strauss

"We recognize and embrace that our customer shops differently today. They visit stores less frequently and have higher expectations when they do visit around service, engagement and assortment. They want an omni experience that we are committed to deliver. Ease of shopping is critical, and we are committed to delivering such services as BOPIS and same-day shipping, Bed, Bath & Beyond President and CEO, Sue Gove, **Q3 earnings transcript**, for the period ending Nov 30, reported on January 10, 2023.

Sue Gove
President and CEO at
Bed, Bath & Beyond

"We continue to see higher lead times across the supply chain during the quarter impact the business. In addition, higher volatility on the distribution and logistics side of things, particularly in the Americas, coupled with the higher volumes of the quarter and event driven spikes in demand, led to inconsistent on-time delivery performance to our wholesale partners and inefficiencies in support of our direct-to-consumer business in the US during parts of the quarter," VF Corporation CFO, Matt Puckett, Q3 earnings transcript for the period ending Dec. 31, reported on Feb 7, 2023.



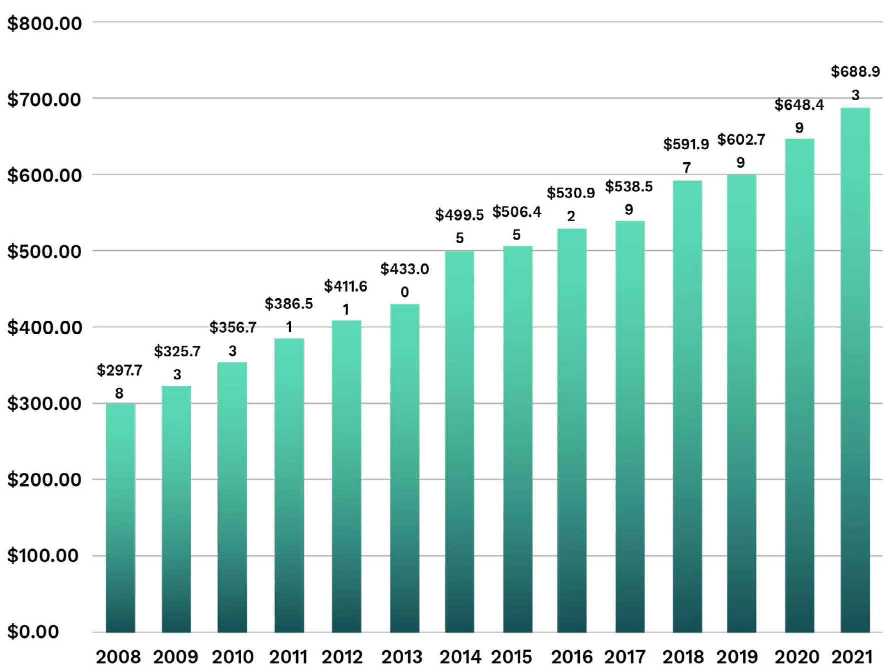
Dave Bergman
CFO at Under Armour

Secondary market/ Discount Stores

Due to the sharp rise in inventories in 2022, shifting consumer expectations and the growth in e-commerce, companies have turned to secondary market channels to unload excess inventories and returns.

According to Assistant Professor at Colorado State University, Dr. Zach Rogers, the value of goods moving through secondary market retailers has more than doubled, from $297.8 billion in 2008, to $688.9 billion in 2021, the equivalent to 3% of U.S. GDP. Rogers' estimate of the secondary market is made up by eight components: salvage dealers, online auction houses, value retailers, dollar stores, factory outlets, flea markets, pawn shops, and charities.

Size of U.S Secondary Market (In $ Billions)



Value retailers such as TJ Maxx, Ross, Burlington, Ollie's and Five Below have experienced significant growth over the last few years. Value retailers follow a strategy of taking overstocks from primary retailers and using low prices to turn goods over quickly, thus it's important to keep the flow of goods moving throughout these retailers' supply chain. A **disruption** could mean the loss in revenue.

"We plan to flow fresh product to our stores and online multiple times a week, which is a key differentiator of our business compared to many other retailers," TJX Companies CEO, Ernie Herrman **told analysts** in November.

"We now have the capability to reach approximately 90% of our stores within two days and the network is expected to provide efficiencies and keep our stores well stocked," Five Below CEO, Joel Anderson **told analysts** in November.

Dollar stores also are recipients of overstocks. These types of stores have grown dramatically. Rogers notes that there is a dollar store within five miles of 75% of the U.S. population.

"We are seeing more customers come into our segment. The majority of these customers average $80,000 and higher in regards to household income.When they are inside the store, we are seeing shifts in their behavior in which they are very consumable and needs-based focused to try and make that budget work and stretch it over the month. For 39 weeks in a row, we're also seeing private brands outpace national brands," Dollar Tree CEO, Mike Wytinski **told analysts** in November.

As one can imagine, growth in this retail sector has outpaced the need for optimized supply chains. "...More than $40 million in additional supply chain costs in Q3 compared to what we had previously expected. These costs included retention fees incurred for delays in returning shipping containers. Costs associated with inefficiencies in moving freight within our distribution centers and higher transportation costs as a result of servicing stores from less-than-optimal distribution center alignments," Dollar General CEO, Jeff Owen told analysts in December.

Owen noted that the company had opened two new permanent regional distribution hubs in Georgia and Texas, which will serve as intermediary facilities between import points and the rest of its distribution centers. Additionally, a distribution center in Nebraska, Arkansas, Colorado, and Oregon are expected to come online over the next 18 months. Collectively, these new distribution centers will result in a more than 20% increase in total capacity.

In addition, Ollie's Bargain Outlet plans to expand its distribution facility in York, Pennsylvania, and open a fourth distribution center in the Midwest in the first half of 2023 to meet continued high consumer demand.

"We think we're going to continue to see momentum," John Swygert, Ollie's president and CEO told analysts in December. "With the overall inventory challenges that people are facing, a lot of goods are sitting in warehouses."

Outlook

Consumers will likely be more cautious in their spending this year due to economic concerns. As such, retail sales will rise by less than 3% this year, reaching over $7.3 trillion according to eMarketer.

Despite a possible slowdown in retail spending, retailers will use this year to optimize their supply chains. Brendan Witcher, Vice President, Principal Analyst for Forrester **wrote in his 2023 outlook**, "the elite among those [retailers] will leverage technology that enables their company to quickly reconfigure business structures and capabilities to meet future customer and employee needs with adaptivity, creativity, and resilience."

In addition, to address worker shortages, retailers will also automate functions that historically have been labor-intensive. Witcher notes that a critical component of these investments will be technologies that utilize AI… "to make mundane but critical and traditionally time-consuming operations such as receiving, customer service, and task management far more efficient."

Salesforce also identifies some interesting retail trends for this year:

Retailers will use data to expand into new industries such as health, technology, logistics, and media.

Store associates are expanding their roles, taking on areas such as personal stylists, fulfillment experts, and service agents. Given this, Salesforce predict 60% of digital sales will be influenced by physical stores and associates, regardless of where demand is generated or fulfilled.

Nearly every retailer is looking for new ways to manage fulfillment and returns. Approaches will include using brick-and-mortar locations, partnering with other brands, using last-mile carriers, and even taking advantage of resale platforms.

To achieve succss, retailers will need to embrace flexible, resilient supply chains and utilize data analytics to achieve efficiencies and growth opportunities.

C3 Solutions's dock scheduling and yard management system has been helping retailers' distribution centers optimize the flow of live and drop shipments for the past 22 years. Retailers benefit from the platform's visibility and process efficiency, particularly true during these volatile times. Due to a complete web API offering, they have demonstrated to be a valuable partner by easily integrating with retailers' TMS, WMS, and ERP systems, providing best-in-class supply chain efficiencies.

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