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TM CAPITAL
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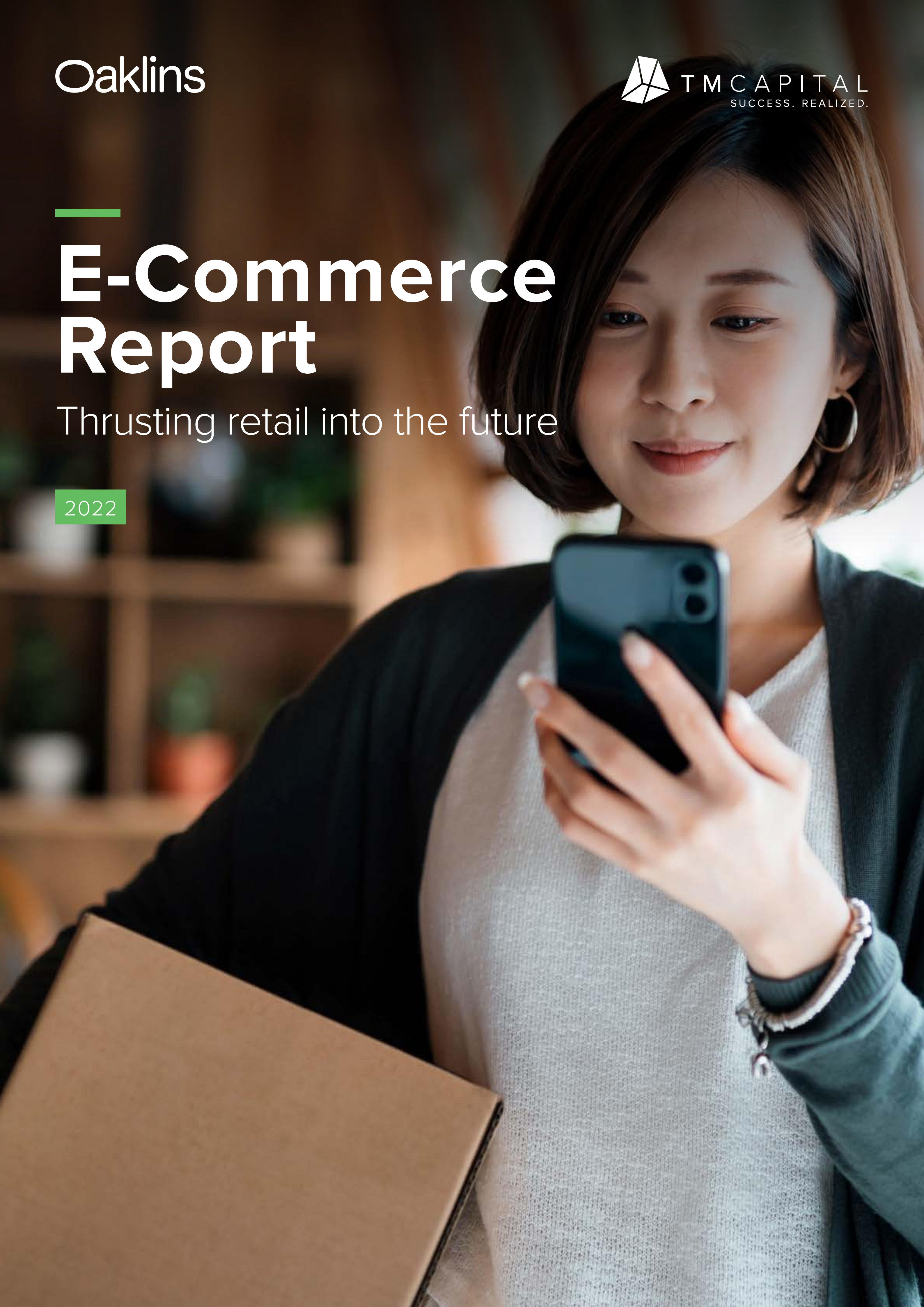
E-Commerce Report

Thrusting retail into the future

2022



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About TM Capital

TM Capital is a founding member of Oaklins, the world's most experienced mid-market M&A advisor, with over 850 professionals globally and dedicated industry teams in more than 45 countries. Our dedicated teams across the USA have a wide range of expertise in a number of sectors. Founded in 1989, TM Capital is the client-first investment banking team advising industry-leading companies across North America and around the world. In everything we do, our professionals share a relentless commitment to engineering extraordinary outcomes with an unmatched standard of client care. Over the last three decades, we have completed more than 350 transactions with a combined value in excess of US$25 billion. With offices in Atlanta, Boston and New York, our mission-critical capabilities include: complex mergers and acquisitions; debt and equity financings; minority and majority recapitalizations; restructurings; and board advisory services.

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Overview

As Jeff Bezos goes, so goes e-commerce. Maybe it is no coincidence then, that Bezos literally launched himself through the stratosphere and into space in the summer of 2021.

As anybody following the digital consumer ecosystem will attest, trends in the evolution of consumer behavior, technology and business practices, which already favored e-commerce, have accelerated in dramatic fashion as a result of the global pandemic.

Our recent experience confirms this trend, which echoes the age-old maxim, "luck is when preparation meets opportunity." We've had a front row seat over the last year, observing our digitally native, omnichannel and "digitally transforming" clients reap substantial rewards in the form of rapidly accelerating e-commerce revenue. In almost all cases, these companies had been investing methodically in their online capabilities in the years preceding the pandemic. We expect those operators that pulled ahead in the digital race to continue to gain ground in the years ahead, primarily at the expense of legacy players that are yet to execute substantively on their own digital strategies.

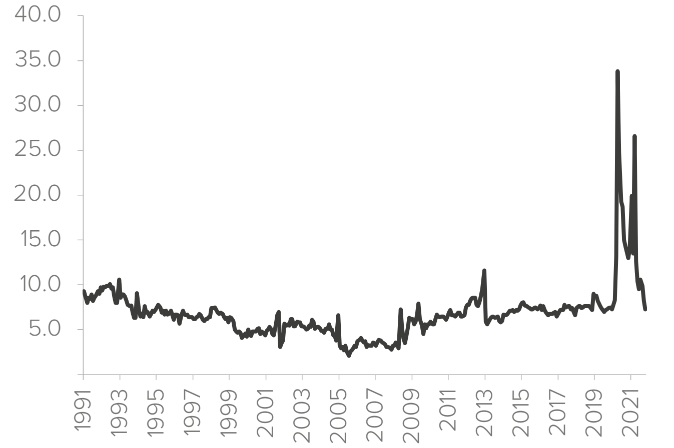
However, new momentum breeds new issues. Exhibit A: Apple's gigantic shot across the bow via its 2021 iOS update. We'll explore that further below, but the synopsis is that we believe this to be Apple's first strike in a long war to stake a claim on some of Facebook's and Google's spectacularly profitable online advertising market share. Despite the fact that such factors are likely to create some bumps in the road, we believe that they also enhance opportunities for businesses that evolve and execute nimbly.

In this report, we will analyze the implied opportunities and associated risks in the evolving retail sector, and how, as a result, entrepreneurs, operators, strategic acquirors, and investors can capitalize and capture value. Importantly, we will explore how the pandemic has propelled e-commerce onto the fast track, and identify the trends and technologies that are likely to continue to shape e-commerce (and commerce more broadly) in the coming years.

The post-pandemic consumer

The pandemic upended many pre-existing consumer behaviors and accelerated others. As we all experienced, the onset of lockdowns induced mass panic as consumers hoarded essentials and hit the brakes on discretionary spending. As the pandemic proved persistent, consumers re-evaluated their spending habits and priorities. Unprecedented fiscal stimuli, paired with fewer social gatherings and reduced travel/dining spend, resulted in a personal savings rate of over 30% — the highest since measurement began back in the 1960s. According to the Federal Reserve Bank of New York, consumers accumulated nearly US$1.6 trillion in excess liquidity they would not have been able to save pre-pandemic. As vaccines have become universally available and leisure travel has rebounded, the savings rate has begun to normalize — however, consumers remain cautious, and do not appear interested in depleting their overflowing piggy banks any time soon.

US personal savings rate



Source: St. Louis Fed — Personal Savings Rate Data

RISE OF THE DIGITAL BOOMER

More than ever, consumers flocked to digital media and communication platforms to engage with friends and family. While it was no surprise that Gen Z and Millennial digital natives were highly active on such platforms, the less intuitive consumer shift happened within the Boomer (and, to a lesser extent, older Gen X) cohort. These consumers did not grow up with the internet but were forced to adopt its technology during the pandemic.

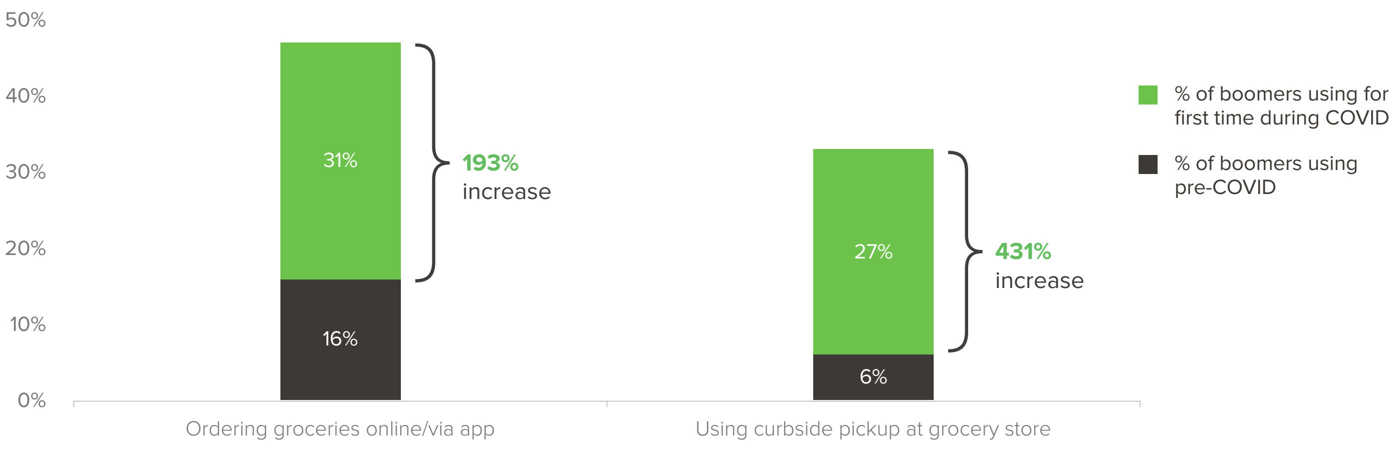
A Mobiquity report on the rise of digital adoption among Boomers evidences a step change in technology usage for grocery delivery and curbside service (illustrated below), which we believe is indicative of other online habits as well.

This new display of technological savvy presents an unexpected opportunity for businesses to reach these older consumers through digital channels. Having captured these cohorts for the first time, it is now incumbent on brands and marketers to retain them.

88%

of Boomers say they will continue to use digital technology to make life easier post-pandemic

Baby boomer adoption of digital technology



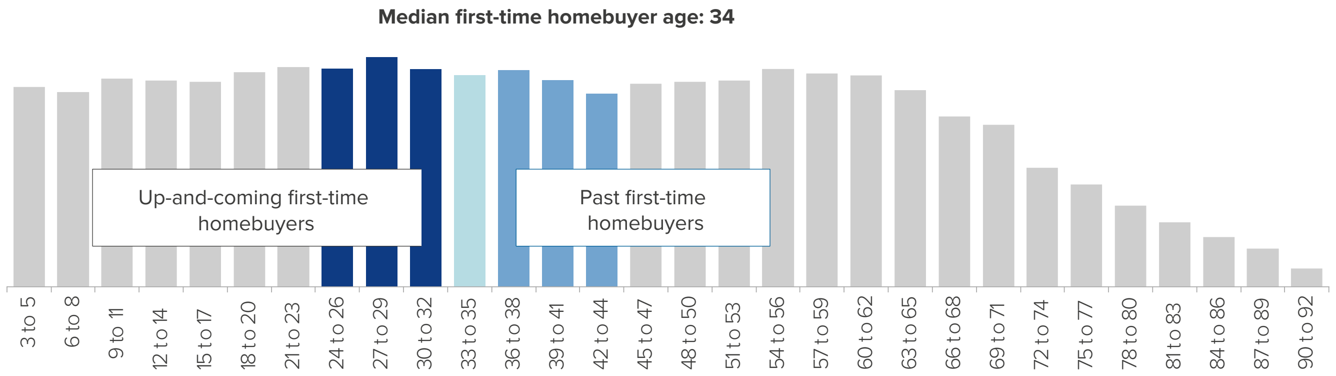
Source: Mobiquity

THE AT-HOME ECONOMY

With more time at home, record low interest rates and rising home prices, a growing number of consumers are migrating from urban centers to suburban areas (with Sun Belt states a key beneficiary of this trend). Widespread adoption of remote work introduced greater flexibility when it comes to choosing home location, and a heightened preference for homes with larger footprints and remote workspace.

Demand for entry-level housing has never been higher, driven by a collision of Millennial household formation and Boomers trading down for retirement.

Millennial housing trends: entering peak home buying years



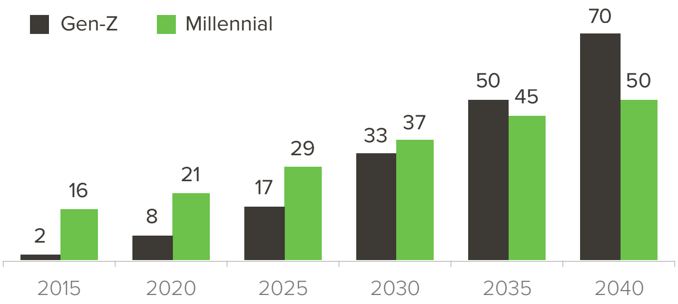
Source: US Census Bureau — Population Demographic Data

As the largest generational cohort of the US economy, we believe Millennial-driven "mega-trends" will continue to shape the housing market (and, as such, will be a critical driver for sales and digital transformation in the décor and renovation markets) over the next decade. Millennials comprised the largest share of homebuyers in 2020; and with home ownership levels of only 43%, compared to 67% and 77% for Gen X and Boomers, there is plenty of running room for Millennial home purchasing activity. Growth in home ownership among digitally native generations is fueling substantial and growing e-commerce demand for indoor and outdoor home décor and furnishings, renovation-oriented products, lawn and garden care, and more.

GROWING POWER OF DIGITALLY NATIVE GENERATIONS

As the pandemic has been influencing consumer behavior, several other independent dynamics are also impacting the consumer sector, including macrodemographic trends and heightened consumer focus on ESG (Environmental, Social and Governance). These factors further contribute to some of the Millennial-driven mega-trends mentioned above, as the Millennial cohort enters its peak consumption years and Gen Z begins to flex its own economic muscle. An interesting outgrowth of this is the "B Corp" – a certification held by over 4,000 businesses (including companies like Allbirds and Bombas) affirming a commitment to consider the impact of their decisions on workers, customers, suppliers, the community and the environment. The B Corp designation is often highly influential to customers as they direct their own purchasing. According to McKinsey, the digitally native Millennial and Gen Z cohorts wield over US$350 billion in combined spending power in the US alone, and Gen Z represents approximately 40% of global consumers.[1] Euromonitor estimates that Gen Z income will eclipse Millennial income by the early 2030s, increasing 140% over the next five years.[2] While we often joke about our collective need to understand TikTok, the ability to effectively communicate with and market to Gen Z will be an important differentiator for direct-to-consumer (DTC) brands in the coming years.

Generational income (in US$ trillions)



Source: St. Louis Fed — Generational and Age Household Wealth Trends

[1] McKinsey: McKinsey on Consumer and Retail
[2] Euromonitor: Generation Z: The Next Wave of Consumers

What's a COVID bump?

As the US economy and population continue to battle variants of COVID, consumer behavior and spending patterns continue to evolve and adjust. This is one common element we've witnessed across nearly every sell-side process we've run over the last 18 months; together with our clients we have spent a lot of time analyzing and answering questions regarding sustainable revenue and margin trends — i.e. is there a COVID bump?

In our collective experience, the realities around the COVID bump are highly nuanced – much more so than the standard "people were home, they spent more on comfort items, renovation and hobbies" response. Broadly speaking, many of our clients' COVID bump experiences fall into one or more of the following buckets:

Companies taking market share. As online activity spiked in mid-2020, consumers were introduced and reintroduced to new DTC brands and services. While not all these new customers were retained, many were, and this represents a permanent shift of market share from an offline brand to an online alternative. Further, based on the substantial influx of online eyeballs, e-commerce brands well equipped to service these new customers (via tech backbone, inventory availability, customer service staffing, etc.) gained substantial ground from both their offline peers and less sophisticated online competitors.

Companies developing lifetime value (LTV). LTV-driven DTC businesses are unique animals. These businesses build value over time by developing robust cohorts of repeat customers. We call this "stacking layers of sediment." For instance, if a business generally converts 30% of new customer acquisitions to recurring relationships, a one-time influx of new customer acquisitions (as seen in 2020) will pay long-term dividends as the LTV of returning customers continues to accumulate. We observed a number of LTV-driven businesses taking advantage of this dynamic, by investing heavily in acquiring future market share, and this was further compounded by lower customer acquisition costs driven by temporarily depressed online advertising rates in 2020.

Sustained behavioral shifts. In certain hobby, enthusiast and home-oriented categories, consumer behavior is undergoing what we believe is a sustained shift, driven at least partially by increased work-from-home dynamics creating "found time" for what had been a generation of commuters. For instance, an August 2020 Lawn and Garden Survey showed that nearly 90% of consumers who participated in gardening in 2020 acknowledged plans to maintain or increase their gardening activity in 2021 and beyond.[3]

Likewise, the DTC auto aftermarket continues to be hot, as illustrated by recent investments in Rough Country (TSG), Enthusiast Auto Holdings and Z1 Motorsports (Cortec Group), and T-Sportsline (Kian Capital). Similarly, we are firm believers that the Millennial mega-trends, in combination with shortages in the housing market, will continue to drive long-term tailwinds in any categories related to décor and renovation.

COVID impacted customer acquisition costs. While 2020 saw a temporary decline in advertising costs, this reversed in 2021. According to Revealbot, the CPM (cost per thousand impressions) to advertise on Facebook and Instagram, grew between March and August 2021 by 17.9% and 16.5%, respectively, in comparison to the same period in 2020.[4]
In essence, all but the most efficient advertisers were forced to grapple with increased marketing costs as big advertisers found their way back into the market after pulling back due to the uncertainty of the pandemic. This was further compounded by "measurement noise" created by Apple's release of iOS 14.5 and its impact on advertisers' ability to track, measure and attribute activity driven by Facebook across platforms.

COVID impacted promotional cadence. While most of the COVID bump conversation has centered around sustainability of revenue, certain dynamics during 2020 and into 2021 impacted company margins. For instance, the influx of eyeballs in mid-2020 enabled some DTC businesses to offer fewer discounts or promotions than they may have in a typical year (in a circle-of-life story, many brick-and-mortar retailers are now experiencing similar dynamics). While some businesses will be able to maintain a less frequent promotional cadence, as a result of enhanced market share and brand awareness, others will inevitably return to historical norms.

> "We're confident we benefited from higher overall participation [in 2021] as one-third of all consumers said they increased participation this spring."
>
> **JIM HAGEDORN**
> CEO, SCOTTS MIRACLE GRO

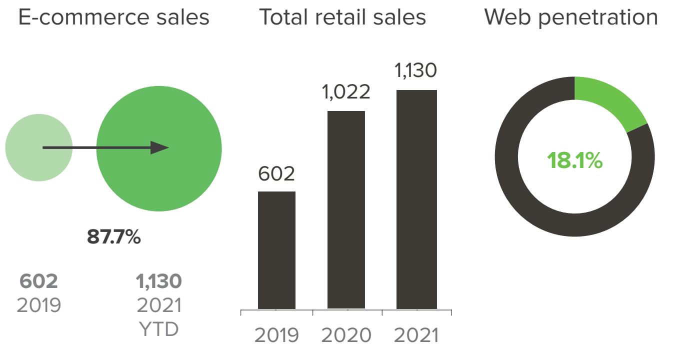
[3] Garden Research August 2020 Garden Survey
[4] Revealbot Instagram Advertising Costs by CPM

State of large market e-commerce today

Pre-COVID, there was no denying the structural shift toward e-commerce. Online retail sales had been growing more than three times faster than overall retail sales. In 2020, e-commerce penetration, excluding gas and auto sales, jumped to 20% compared to 15.2% the previous year.[5]

The pandemic has accelerated underlying trends in e-commerce adoption. A recent PwC consumer insights survey[6] noted that 68% of consumers said COVID-19 was elevating their digital purchasing expectations.

US retail landscape during 3Q2021 (in US$ billions)



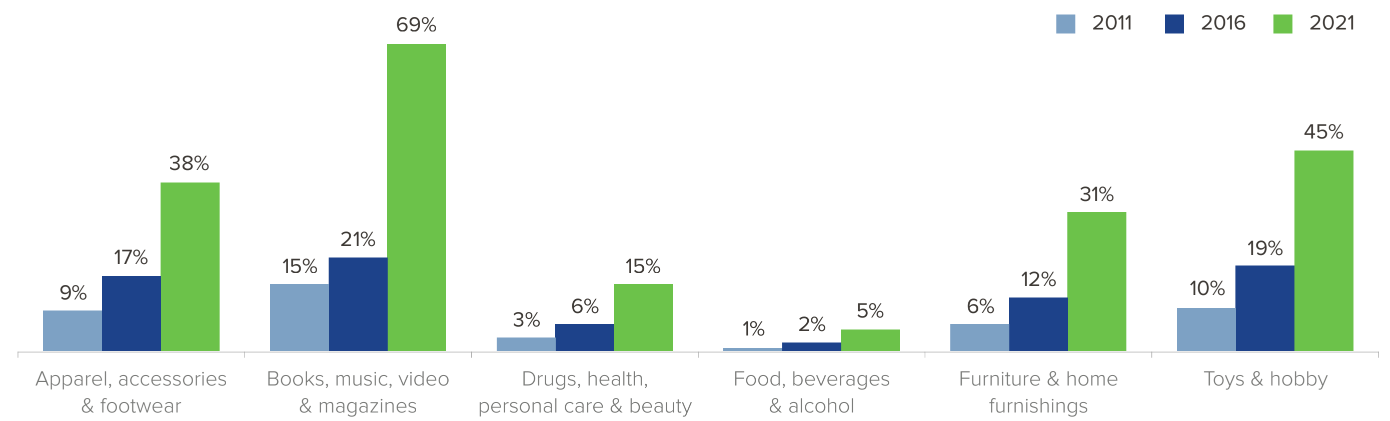
Source: DigitalCommerce360 — Quarterly Online Sales

> "Our e-commerce and omnichannel penetration continue to rise, accelerating trends by two to three years in some cases. We're convinced that most of the behavior change will persist beyond the pandemic, and that our combination of strong stores and emerging digital capabilities will be a winning formula."
>
> **DOUG MCMILLON**
> CEO, WALMART

E-COMMERCE PENETRATION IS NOT ONE-SIZE-FITS-ALL!

While overall online sales have grown rapidly since 2011 across market segments, absolute e-commerce penetration still varies widely. Penetration in segments subject to meaningful regulatory and delivery/logistics constraints (e.g. food, beverages & alcohol) remains relatively low. At the other end of the spectrum, nearly 70% of music and video content is purchased online. Both apparel and furnishings – two categories that fall somewhere in the middle – have grown from <10% penetration to >30% penetration since 2011. As a result, it's no surprise that these segments have attracted substantial investment and M&A activity, particularly as penetration accelerated during the pandemic.

US retail e-commerce sales by product category: % of total retail sales



Source: eMarketer — US E-commerce by Category 2021

[5] eMarketer: US E-commerce by Category 2020
[6] PwC Consumer Insights Pulse Survey

NOT AN AMAZON-TAKES-ALL GAME

Amazon has been a dominant force in e-commerce for the better part of two decades, and has accounted for the largest share of e-commerce growth each year. That trend continued in 2020 and 2021, with Amazon generating nearly a third of US e-commerce sales. Amazon's still formidable overall share is seeing steady encroachment. In 2021, Amazon's share of growth was down notably at 41% versus 47% in 2019.[7]

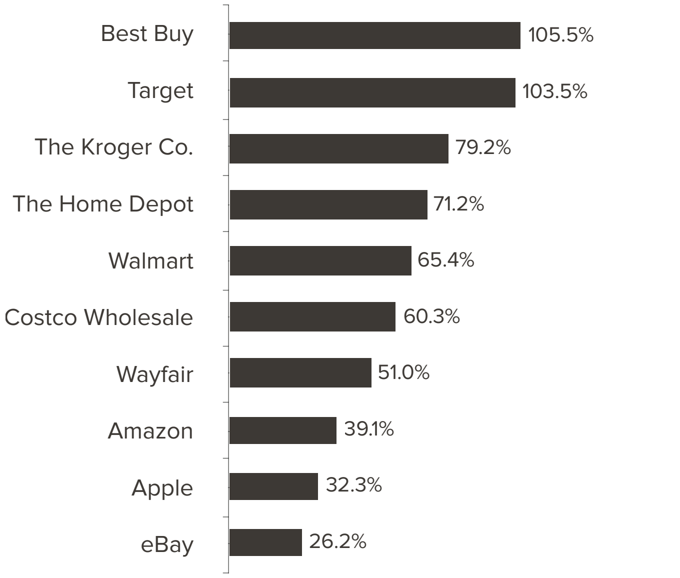
As the pandemic forced consumers to adopt online shopping alternatives, retailers that had most aggressively invested in digital capabilities gained ground. Walmart surpassed Apple and eBay to become number 2 in e-commerce sales. And, while many criticize Walmart's 2016 acquisition of Jet.com and subsequent discontinuation of the site in 2020 (followed by Mark Lore's exit), the infusion of Jet.com's DNA unquestionably accelerated Walmart's e-commerce capabilities substantially.

US web sales leaders by % of e-commerce sales

Retailer	2019	2020	YTD OCT 2021
Amazon	47.0%	39.1%	41.4%
Walmart	4.6%	5.8%	6.6%
eBay	6.1%	4.9%	4.2%
Apple	3.8%	3.5%	4.0%
The Home Depot	1.7%	2.1%	2.2%
Target	-	1.7%	2.0%
Best Buy	1.3%	2.0%	1.8%
Costco	1.3%	1.4%	1.6%
Kroger	-	1.4%	1.4%
Wayfair	1.3%	1.5%	1.3%

Source: Statista — Market Share of Leading Retail E-commerce Companies

Top 10 US companies by 2020 retail e-commerce sales growth



Source: eMarketer Annual 3Q Forecast

Target, which we view as a leading omnichannel innovator, generated an astounding 103.5% growth in e-commerce sales in 2020, breaking into the top 10 e-commerce revenue list for the first time. As Brian Cornell, Target's CEO, said on a recent earnings call, "The team's ability to react in 2020 was years in the making."

The retail giant, with nearly 2,000 stores throughout the US, began a rapid acceleration of its digital investments five years ago. Target was aggressive about merchandizing digitally native brands in its stores, and prioritized omnichannel investments such as click and collect, delivery and smaller store formats.

Ultimately, the company hit its previously stated 2025 goal of US$10 billion in digital sales in 2020, partially driven by 235% year-over-year growth in the company's same-day pick up and delivery sales.

Although Amazon remains a formidable e-commerce competitor, 2020 and 2021 provide further evidence that e-commerce is far from a winner-takes-all market.

"The team's ability to react in 2020 was years in the making."

BRIAN CORNELL
CEO, TARGET

[7] eMarketer: Amazon Will Corner the US Retail E-commerce Market

What we learned from Black Friday/Cyber Monday (BFCM)

As discussed above, the last two years have been strange ones for many e-commerce businesses. Due to rapid, material shifts in demand and supply throughout the early stages of the pandemic, companies couldn't easily compare their 2020 or 2021 sales on a seasonal basis against previous years. As a result, it was only following the 2021 holiday shopping season that many businesses began to gain a clearer sense of normalized demand trends relative to pre-pandemic levels.

DECIPHERING A SURFACE-LEVEL DOWNTURN IN ONLINE SALES

According to the Wall Street Journal, online retail sales for the 2021 Thanksgiving holiday weekend failed to surpass the previous year's sales for the first time in memory, despite overall retail sales (including offline) rising 14% in comparison to 2020 and 5.8% compared to 2019. This has been attributed to a combination of both fewer discounts, less in-stock inventory and higher offline sales than in previous years. Consumers impacted by 18 months of cabin fever were excited to return to stores (mall foot traffic grew by 83%), while overall online sales remained relatively flat.

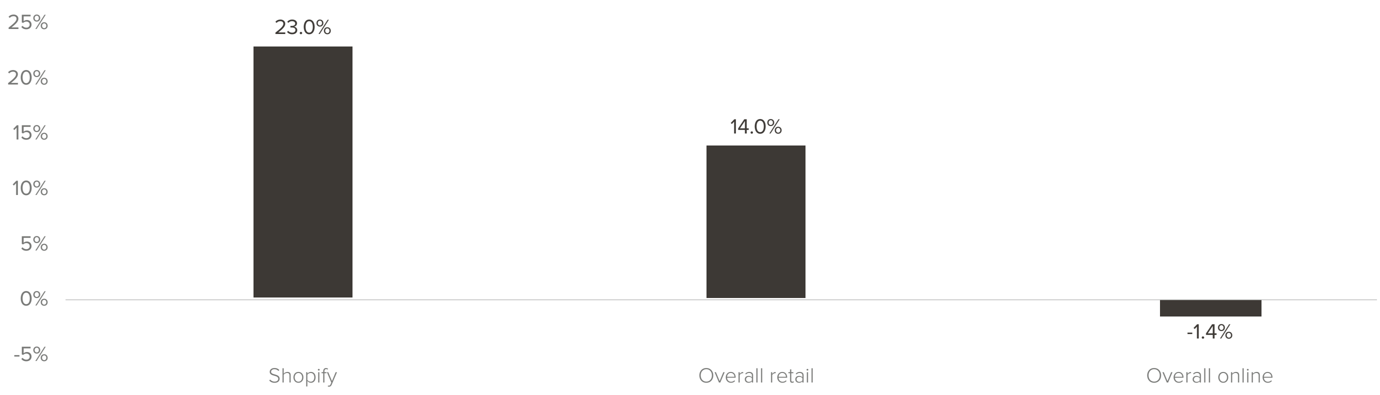
WHO AND WHAT BUCKED THE TREND?

While these headline numbers may have caused heartburn, the reality is more nuanced. First, the Shopify ecosystem materially bucked the overall trend, with businesses supported by Shopify generating US$6.3 billion throughout BFCM globally, representing 23% growth over 2020. Our anecdotal observations confirm this. Ultimately, we believe that companies with the right combination of brand recognition and inventory (a tall task given ubiquitous supply chain challenges) performed well, driving growth above 2020 high-water marks. Consumers filled online inventory gaps by shopping in stores, where they were guaranteed to leave with something to put under the tree.

As supply chains normalize, we believe that the macro trends discussed herein will result in a return to growth for online retail, overall. Further, we believe that businesses that managed to stock up on inventory in 2021 are differentiating themselves in the marketplace and will continue gaining share.

> "From in-store retailers to online and even viral TikTok must-haves, Black Friday sales show that independent businesses are having a massive impact on global commerce. Consumer support of independent brands is at an all-time high."
>
> **HARLEY FINKELSTEIN**
> CEO, SHOPIFY

2021 BFCM sales growth compared to previous year



Source: Shopify — Black Friday Cyber Monday 2021: Data on US$6.3 billion in sales

Trends in DTC/e-commerce M&A and investment activity

Less than a decade ago, with relatively few exceptions, venture capital was the primary source of funding for DTC and e-commerce-driven businesses.

This created a gap in the market for businesses seeking shareholder liquidity (rather than simply growth funding). It has been interesting to observe as a variety of investor genres seek to fill this gap, ranging from traditional private equity (PE) with newly developed e-commerce-specific capabilities, to strategic buyers and specifically formed "aggregators".

PRIVATE EQUITY JOINS THE PARTY

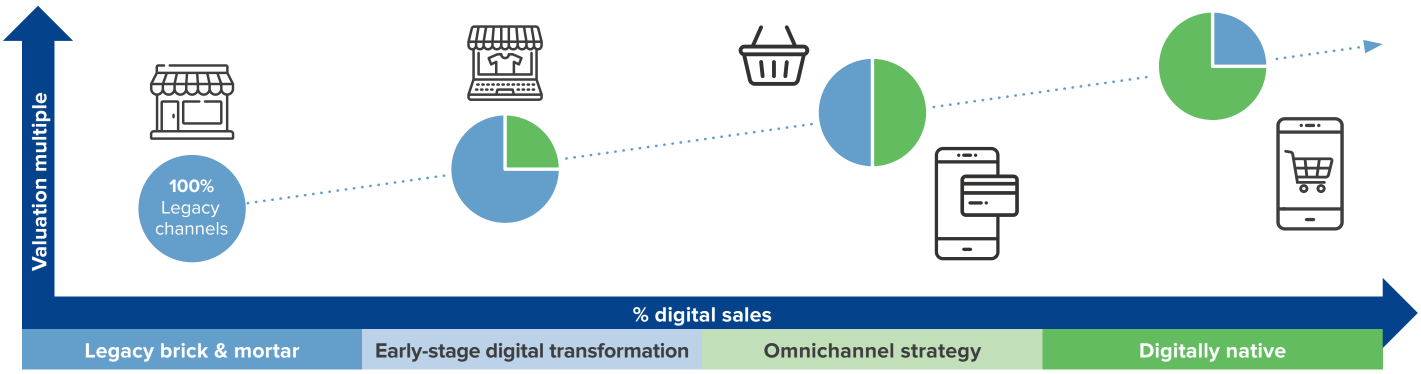
As the e-commerce category has begun to mature, many traditional private equity groups have invested resources to develop in-house teams of experienced e-commerce professionals, ranging from data scientists and marketing experts to professionals with sourcing and e-commerce logistics expertise. This expertise enables firms to develop conviction in their ability to impact the trajectory of investments in what are frequently digitally native businesses. We believe that the proliferation of firms with true expertise in these functions is resulting in more competition among investors, and thereby helping to drive increasing valuations in the category.

Select private equity firms with value-added e-commerce expertise

PRIVATE EQUITY AND THE IMPORTANCE OF NAVIGATING DIGITAL TRANSFORMATION

It is increasingly important that even investors without a dedicated e-commerce focus understand how to operate in the category. Beyond digitally native businesses, there are a growing number of consumer, building products and B2B businesses that find themselves (or their industries) in the midst of digital transformation. For those owned by founders or private equity, and are currently selling primarily through legacy channels and with the intent to exit in the foreseeable future (i.e. many), it is critical to invest in an actionable e-commerce strategy.

For some, that may mean beginning to generate some percentage of sales via third-party marketplaces (e.g. Amazon, Wayfair or Ferguson.com), investing in development of their own "direct-to" sites (targeting consumers and/or trade professionals), or developing some form of online-driven lead generation. For these businesses to exit at attractive valuations in the coming years, it will be important to tell a credible and actionable story to the market around the evolution of this transformation. For those who are able to move beyond "proof of concept" on this front, the opportunity for multiple expansion (and thereby value creation) is enormous. Along these lines, we believe private equity firms that develop a proven playbook for accelerating digital transformation have the opportunity to achieve outsized returns on their investments over the next few years.



Strategic buyer M&A and investment activity

Much of the prognostication in TM Capital's 2019 e-commerce Spotlight Report has proven prescient. M&A for strategic buyers continues to act as a way to both create and stand up against disruption. At the same time, disruptive talent remains difficult to recruit, primarily because many who truly possess "hypergrowth e-commerce abilities" are applying that talent toward building their own businesses.

There are a number of examples illustrated on page 13. For instance, Walmart's acquisition of Zeekit enhances the retail giant's digital shopping experience, while Levi's acquisition of fast-growing, digitally native activewear brand Beyond Yoga marks the classic American brand's attempt to tap into the DTC channel.

THE AGGREGATORS

In addition to traditional strategic buyers acquiring e-commerce-oriented businesses, a few new categories of strategic buyers have come onto the scene. For instance, cohorts of buyers focused on high volumes of often smaller acquisitions have formed, including those mining the Amazon ecosystem (e.g. Thrasio) as well as the Shopify ecosystem (e.g. OpenStore). This set of acquirors targets controlling stakes (typically 100%) in founder-owned businesses, and leverages their platforms and processes to drive operational efficiencies.

Thrasio has raised over US$3 billion since its founding and acquired more than 200 Amazon sellers, with Advent International and Silver Lake as its largest shareholders.

Likewise, OpenStore recent venture capital raise valued the business at US$750 million, and the company has set its sights on acquiring one new Shopify-based business per day.[8]

Our experience suggests that, while many of these buyers may provide speed and certainty to sellers seeking a full exit, they may not represent the path to maximizing value in a transaction.

THE COMING RACE TO DEVELOP (AND EXIT) MULTI-BRAND DTC PLATFORMS

Notwithstanding the aggregator platforms profiled above, to date, there have not been many traditional private equity platforms targeting multi-brand DTC roll-ups. That said, we continue to hear chatter in the market from a number of firms speculating about the benefits of doing so, and believe that the market is in the early stages of a sea shift in this direction. Unquestionably, some of this momentum is being driven by a few recent notable wins. For example, Summit Partners formed and took public AKA Brands (NYSE:AKA), a multi-brand apparel platform, and not long thereafter, Solo Brands (NYSE:DTC). The Solo Brands public offering came after Summit acquired a majority stake in Solo Stoves from Bertram Capital and then quickly bolted on additional DTC brands, Chubbies Shorts, Oru Kayak and ISLE.

Ultimately, the logic underpinning these platform formations appears sound. Catalog retailers (the original DTC) recognized the benefits of scale in customer acquisition decades ago, and have since largely consolidated, sharing customer data among sister brands in the name of building a data-driven marketing edge.

As a result, it is no surprise to see that there is a more modern wave of DTC consolidation trending in a similar direction. Additionally, after seeing how AKA Brands and Solo Brands debuted in the public markets (well into the double digits on EBITDA multiples), we fully expect to see other PE firms aggressively embrace this strategy with an eye toward near-term public market exits. In turn, this should continue to drive downstream e-commerce M&A activity in the private markets.

[8] Forbes: "OpenStore Raises US$75 Million To Acquire More Shopify Sellers, Reaches US$750 Million Valuation In Eight Months"

Recent transactions

AQUA CAPITAL
has sold its portfolio company
Grand Cru
to
(evino)
M&A SELL-SIDE
Consumer & Retail/Food & Beverage/Private Equity

babymoov
has been acquired by
initiative & finance
M&A SELL-SIDE
Consumer & Retail

BIG BLANKET
has completed a recapitalization with
ALTACREST CAPITAL
M&A SELL-SIDE
Consumer & Retail

BigGreen smile .com
has received a significant investment from Future Business Partnership
FUNDING, DEBT ADVISORY & ECM
Consumer & Retail

BIOSYNEX
has acquired
PARA'KITO
M&A BUY-SIDE
Healthcare

cameranu.nl
has been acquired by
EUROPEAN IMAGING GROUP
M&A SELL-SIDE
Consumer & Retail

CAPZA
has acquired a minority stake in
WSHOP
M&A BUY-SIDE
Private Equity/TMT

COCOLITA
has been acquired by
BurdaInternational PL
M&A SELL-SIDE
Consumer & Retail

cpap.com
has been acquired by
CATHAYCAPITAL 凯辉基金
M&A SELL-SIDE
Healthcare/Private Equity

FAST
has been acquired by
a consortium backed by
EC Investments, PPF and Rockaway
M&A SELL-SIDE
Consumer & Retail

GLOBAL BRANDS GROUP
has been acquired by
Alpha Vista Investment Co., Ltd
M&A SELL-SIDE
Consumer & Retail

highroad CAPITAL PARTNERS
has sold
CALI
to
VICTORIA PLC
M&A SELL-SIDE
Construction & Engineering Services/Private Equity

kelkoogroup
has completed a recapitalization
FUNDING, DEBT ADVISORY & ECM
Consumer & Retail

MICHEL DESIGN WORKS
has been acquired by
STONEWALL KITCHEN
M&A SELL-SIDE
Consumer & Retail/Private Equity

R·A·F INDUSTRIES INC
has sold
STEAMIST
to
MASCO
M&A SELL-SIDE
Construction & Engineering Services/Private Equity

SHOE STATION
has been acquired by
SHOE CARNIVAL
M&A SELL-SIDE
Consumer & Retail

The future of the advertising market

MARKETING TECHNOLOGY: DATA AVAILABILITY (OR LACK THEREOF) AND EVOLVING TECHNOLOGIES

In sales and marketing, big data is one of the key advantages e-commerce holds over traditional retail and is much more than a buzzword. Harnessing big data enables companies to better target the right audiences. For the most forward-thinking consumer companies, data-driven marketing has become a key differentiator.

Proper harnessing of data facilitates better targeting of current and prospective customers with promotions, product recommendations and service. It paves the way for enticing consumers with products they perhaps did not even know they wanted, with customers spending an estimated 48% more when their shopping experience is personalized, according to Janrain.[9]

APPLE'S SHOT ACROSS THE BOW

Over the last decade, many DTC companies have built their businesses on the strength and rapid evolution of Facebook's consumer data engine and advertising attribution technology. In May 2021, Apple threw those businesses into disarray overnight with the release of iOS 14.5. While we'll spare our readers the technical explanation, the short story is that as iPhone users received the system update, they were provided with a prompt to opt in to data sharing across apps and platforms. With the bulk of users choosing NOT to opt in, Facebook's ability to provide valuable attribution data to advertisers declined materially. For the less technically inclined, just know that weaker attribution generally results in higher customer acquisition costs.

The slightly longer explanation, as expertly articulated by Common Thread Collective (a respected digital agency and e-commerce thought leader): Facebook's proprietary tracking tool, Pixel, previously had the ability to tie users' in-app ad views to off-app activity (such as site visits, shopping cart adds, purchases and more), ultimately enabling sophisticated advertisers to granularly segment their audiences and efficiently target their advertising. Post iOS 14.5 launch, when it comes to users who have not opted in, advertisers lose the vast bulk of this data, and instead of tying ad views to the previously rich set of nuanced activities can now only tie these ad views to a direct purchase.

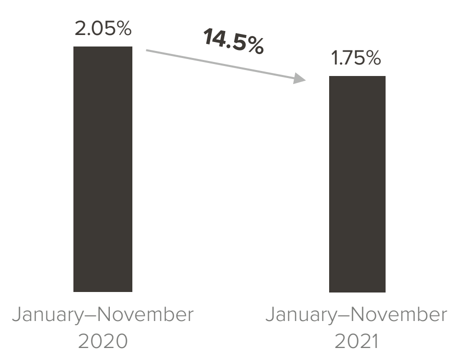
> "Our key differentiator in this competitive landscape is that we're a marketing and data company, and we know how to acquire customers in a very cost-efficient way."
>
> **GIL EFRATI**
> CMO, RESIDENT HOME

IMPERFECT SOLUTIONS AND THE IMPACT ON ADVERTISERS

Facebook has responded to Apple's privacy changes by making several adjustments to its own reporting to advertisers, attempting to use its own access to data and illustrative modeling to provide attribution estimates. However, Facebook's workaround continues to prove challenging, in comparison to the previously perfected data link.

The impact of "Apple's shot" is real, and goes above and beyond the impact of prior Facebook or Google algorithm shifts. For instance, reported Facebook return on advertising spend (ROAS) declined to 1.75 % in the period from January through November 2021, from 2.05 % for the same period in 2020 (an approximately 14.5% decline). While this decline in ROAS may have been driven by factors beyond the iOS rollout (for instance, more expensive advertising compared to peak pandemic), the impact magnified from June 2021, with the gap between the two years widening materially following the iOS 14.5 rollout.

Facebook ROAS



Source: Common Thread Collective Blog — Facebook Ads, iOS 14 Changes & E-commerce Data

[9] Janrain: Online Personal Experience Study; Common Thread Collective Blog — Facebook Ads, iOS 14 Changes & E-commerce Data

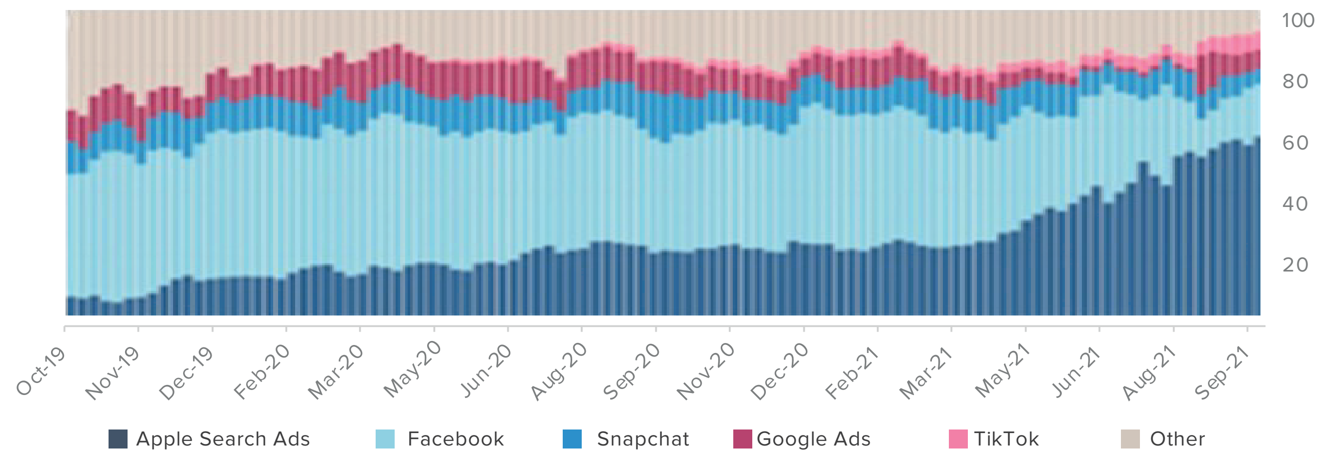
THE AD PLATFORM SHAKE-UP

We believe that the stunning decreases in ad efficiency will prove transitory over time. Ultimately, companies will only advertise on Facebook (or through other mediums) if they are achieving appropriate returns on their investment. And, until companies figure out which forms of advertising are profitable, they will experiment. In the end, the market for clicks on Facebook is like any other,and if advertising efficiency decreases for a large enough swath of advertisers then the cost will come down accordingly and other mediums will become more cost effective. The iOS 14.5 rollout drove many advertisers to accelerate their experimentation with other platforms such as TikTok and Snapchat, and is motivating increasing adoption of influencer marketing. As the market, in response to demand, develops better attribution and measurement tools, these platforms are likely to capture a larger portion of ad spend.

APPLE'S END GAME

It will be interesting to observe how Apple's end goal in all this evolves. While positioned to the market as an altruistic focus on consumer privacy, we believe it is more likely to be Apple's first step in a plan to capture a portion of the valuable advertising market for itself. We would not be surprised to see Apple evolve into a major player in online advertising in the coming years, utilizing a "walled garden" approach to consumer data that is positioned to iPhone users as more trustworthy than Facebook or Google. In fact, since introducing its privacy changes, Apple's advertising business (which today offers only sponsored slots in its App Store) has more than tripled its market share in this advertising arena.

Share of total installs



Source: Financial Times — How Apple's iOS 14.5 update is shaking up the app economy

HOW SHOULD E-COMMERCE BUSINESSES ADAPT?

The ultimate win for an e-commerce business would be to eliminate reliance on the "online advertising gods" by developing its own first-party data sources. Many brands are striving to build content and community-driven customer acquisition engines. For example, this approach has helped enthusiast-driven e-commerce businesses (where members gather online/offline and have a genuine affinity for a company's products) achieve attractive market valuations. Ostensibly, enthusiasm drives community and content, which drives commerce, thereby materially reducing the need for paid advertising. Web Smith (co-founder of Mizzen & Main and a respected e-commerce thought leader) has championed this concept, dubbing it "Linear Commerce." Brands that embrace robust content development engines as a core competency will build highly engaged audiences that can be more efficiently converted to sales, ultimately translating to low customer acquisition costs and higher lifetime value (the holy grail of e-commerce). The Linear Commerce hypothesis is that this trend will drive elements of convergence between e-commerce and media organizations in the coming years, so that their respective first-party data can be leveraged to target their audiences.

While completely eliminating reliance on Facebook and Google is not a realistic goal for the vast majority of e-commerce businesses, finding ways to reduce this reliance can be highly valuable. Examples include providing customers with more valuable content through effective email marketing, collecting proprietary demographic data on customers, and implementing tools that enable personalization of the shopping experience. Additionally, it is increasingly important for business leaders to be nimble, abreast of the latest advertising, data capture and attribution trends, and always learning. Currently, that likely means considering implementing a reliable set of third-party attribution tools, thereby eliminating or reducing reliance on the native tools provided by Facebook and Google.

B2B/direct-to-pro

DIRECT-TO-PRO E-COMMERCE GAINS SHARE

The B2B e-commerce paradigm continues to shift rapidly, driven, in particular, by the increasing digital literacy evidenced by trade professionals (pros) throughout the commercial world. We attribute this to a rising cohort of pros (including Millennials) for which smartphones and e-commerce have become second nature at home. As is true across the consumer landscape, as digitally native generations grow more influential in their fields, these pros are apt to demand similar conveniences in the workplace. Over the last few years this shift has accelerated, as even long-tenured pros previously resistant to adopting technology have been forced to embrace digital channels in more aspects of their lives.

As a result, although often lower in profile than many high-flying DTC businesses, B2B e-commerce opportunities are quite promising. Broadly, the North American market for B2B e-commerce is approximately US$1,494 billion, nearly twice as large as the B2C e-commerce market.

TABLE STAKES IN HOME IMPROVEMENT

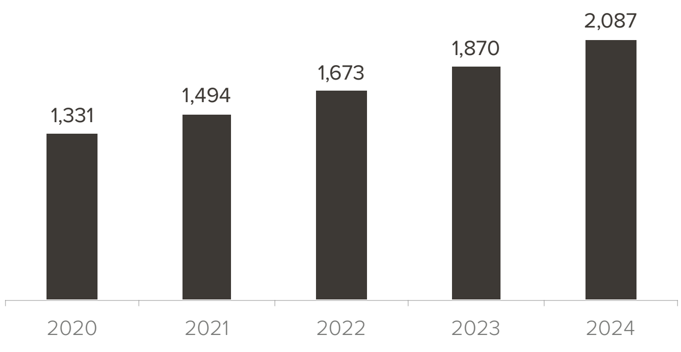
Ferguson's 2017 acquisition of TM Capital client Supply.com was a canary in the coal mine, signaling that "direct-to-pro" was the way of the future. At the time, part of Ferguson's rationale for the acquisition was to disrupt itself, rather than awaiting disruption by others. Today, the most successful home renovation products companies must have digital capabilities to serve both B2C and B2B customers, thereby beginning to circumvent (or supplement) traditional two-step distribution. A few good examples include TM Capital clients, Cali Brands (acquired by Victoria plc) and Steamist (acquired by Masco Corporation). Additionally, private equity firms are increasingly targeting the B2B market. Notable recent investments include DecksDirect (Harbour Group), Renovation Brands (Comvest and Digital Fuel) and Fireclay Tile (Provenance).

Successful B2B e-commerce businesses are bringing together a combination of strong brand, attractive product assortment and white-glove customer service comparable to that provided by terrestrial suppliers. More specifically, factors like 100% overnight or two-day availability with flexible or direct-to-jobsite delivery, efficient custom estimates, and creative customer engagement models are driving accelerated adoption. Not limited to building products, these dynamics are emerging throughout the B2B world.

> "Millennials are highly engaged with The Home Depot. Our B2B website is seeing record volumes and engagement."
>
> **TED DECKER**
> INCOMING CEO, THE HOME DEPOT

The best direct-to-pro e-commerce operators are effective in acquiring highly valuable pro customers (who often generate customer lifetime value worth many multiples that of a typical consumer) through a combination of (i) digital-first lead generation, and (ii) highly competent, technically oriented inside sales and customer service efforts. Best-in-class, direct-to-pro e-commerce businesses effectively gather data throughout the marketing funnel, linking together online and offline customer interactions. Ultimately, the goal is to reduce purchasing friction, enhance loyalty and drive repeat business. While some of the businesses noted above have established a clear head start (as many of their competitors have not yet invested in substantial digital capabilities), we believe that a B2B capability set is likely to become fundamental in the coming years. Investors who develop a strong playbook to drive digital transition in the B2B universe stand to reap substantial rewards.

US B2B e-commerce trends (in US$ billions)



Source: Insider Intelligence — E-commerce Statistics: Industry Benchmarks & Growth

Select B2B e-commerce companies

SUPPLY.com | CALI BAMBOO & MORE | STEAMIST | RENOVATION BRANDS

Conclusion

Ultimately, we expect the pandemic-induced supply and demand imbalances will normalize, and many businesses will emerge with rosters of new customer relationships and more flexible supply chains. Rapidly evolving technology and consumer preferences will continue to be driving forces, especially as digitally native generations grow in purchasing power and influence. We expect the DTC/e-commerce M&A landscape will also continue to evolve as investors take note of the opportunity to aggregate digital brands and help digitally transitioning operators keep pace. All of these forces combine to create opportunities (and risks) for operators competing for consumers' and pros' wallets. We believe that fortune will continue to favor the prepared — those companies willing to invest in, test and continually evolve digital capabilities to meet customers where, when and how they want to shop.

Public market indicators & valuation drivers

TM Capital DTC index composition

FIGS, allbirds, WARBY PARKER, solo brands, FARFETCH, REVOLVE, BRILLIANT EARTH, THREDUP, hims & hers, RTR, PELOTON, a.k.a.

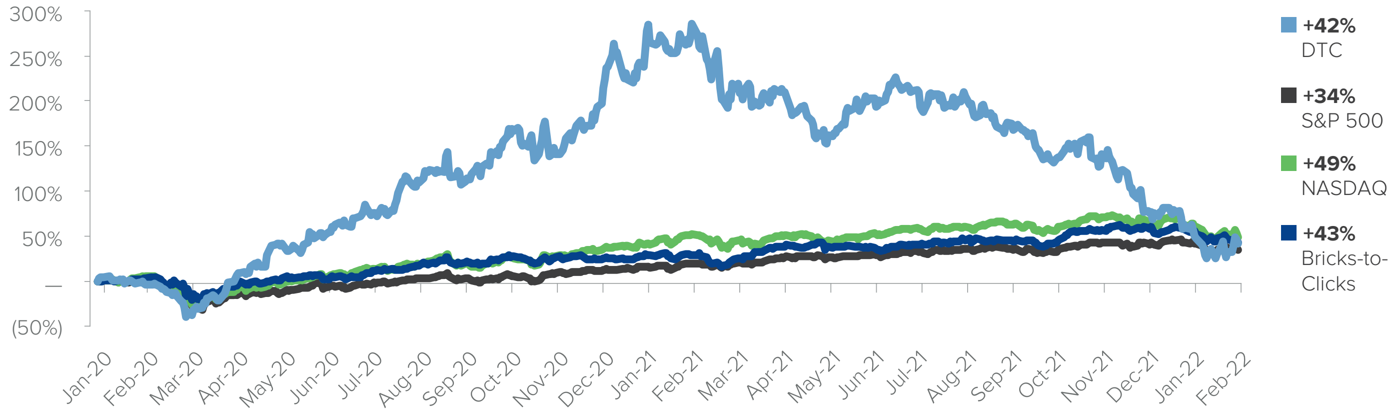
chewy, LOVESAC, TheRealReal, smile DIRECT CLUB, HONEST, lulus, wayfair, 1-800 petMeds, bark, purple, STITCH FIX, 1800 flowers.com, Blue Apron

TM Capital Bricks-to-Clicks index composition

BED BATH & BEYOND, THE HOME DEPOT, KOHL'S, LOWE'S

macy's, NORDSTROM, TARGET, TJX, Walmart

TM Capital indices – historical stock price (as of 11/02/2022)



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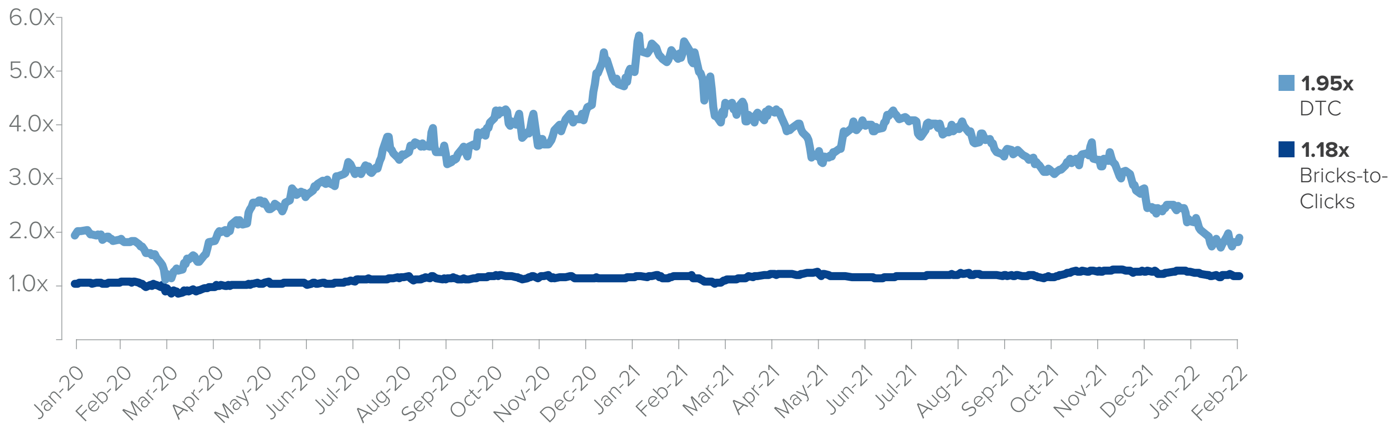

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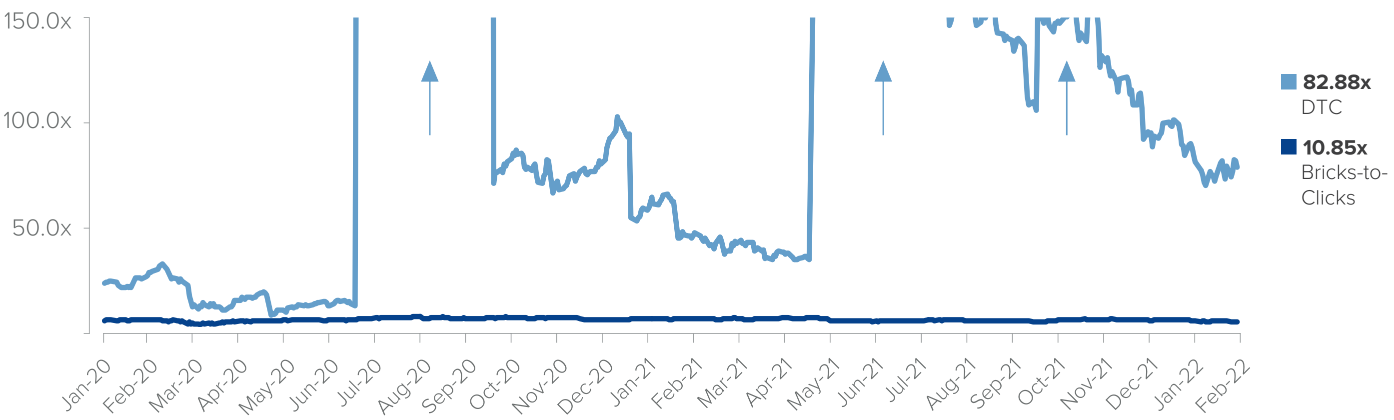
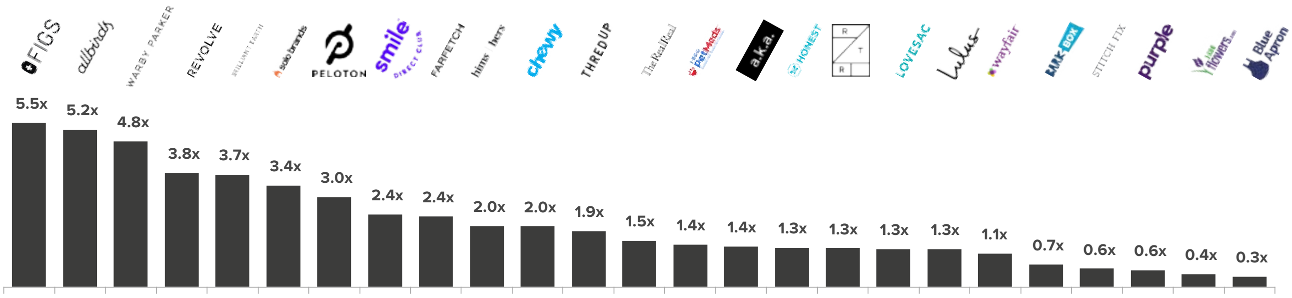
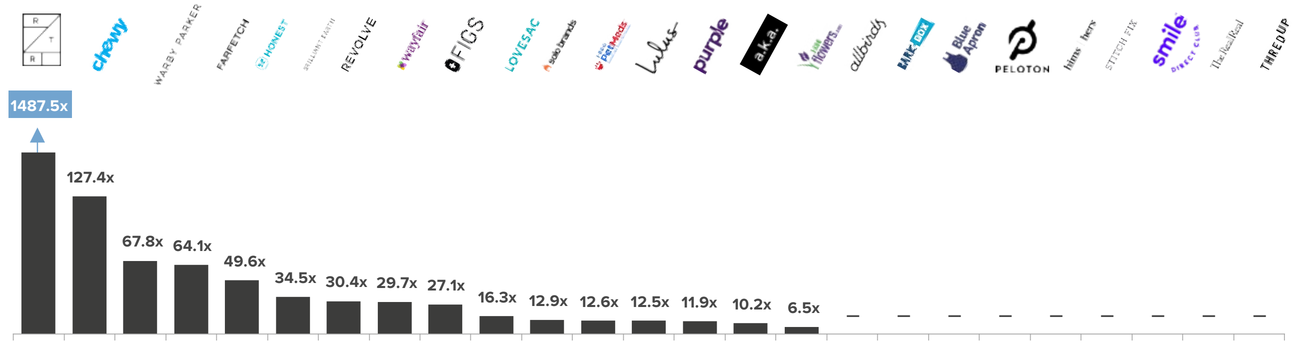


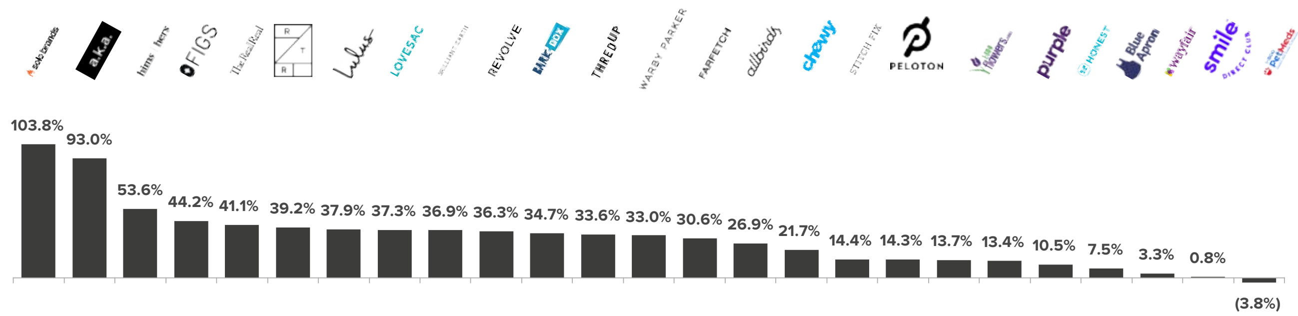
Enterprise value to 2022 (CY+1) revenue multiples for online-first guideline companies



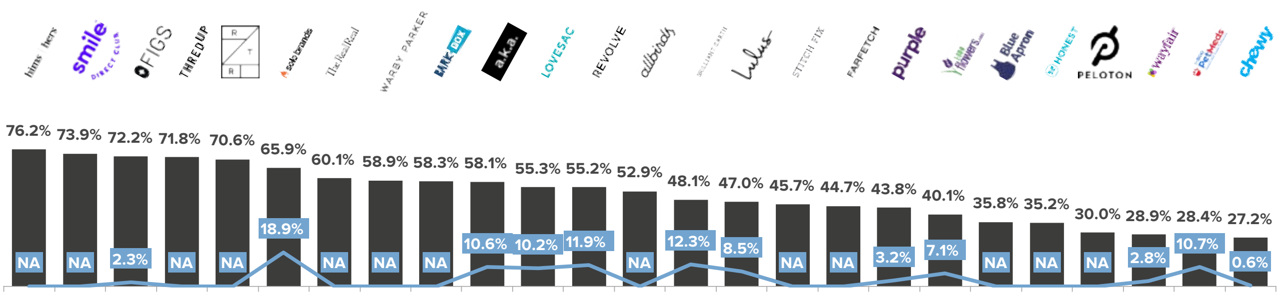
Enterprise value to 2022 (CY+1) EBITDA multiples for online-first guideline companies



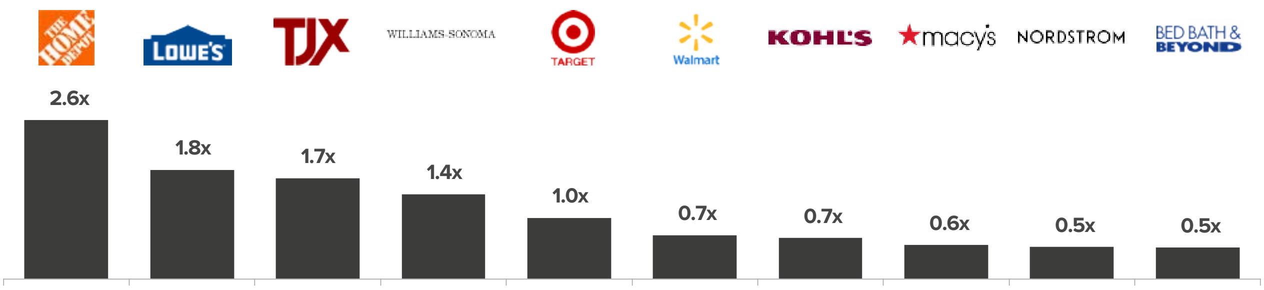
Two-year revenue growth rate for online-first guideline companies (2022–2022E)



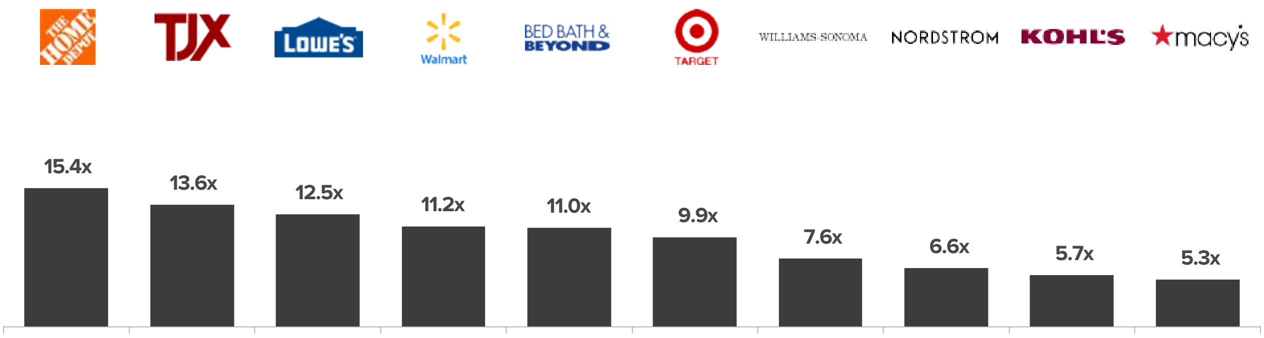
LTM gross margin and EBITDA margin for online-first guideline companies (as of 11/02/2022)



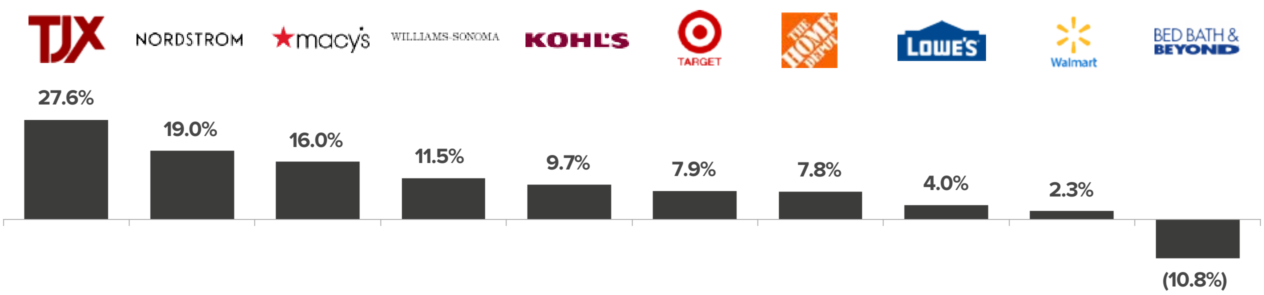
Enterprise value to 2022 (CY+1) revenue multiples for bricks-to-clicks guideline companies



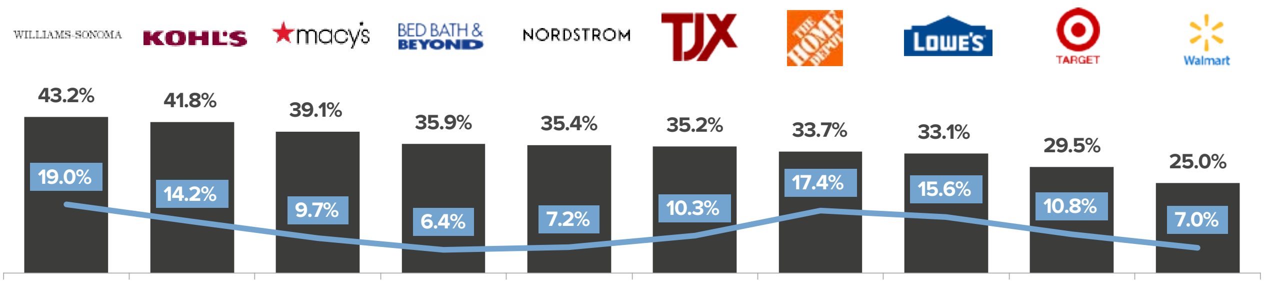
Enterprise value to 2022 (CY+1) for bricks-to-clicks guideline companies



Two-year revenue growth rate for online-first guideline companies (2022–2022E)



LTM gross margin and EBITDA margin for bricks-to-clicks guideline companies (as of 11/02/2022)



Testimonials

"We hired TM Capital to work with us on the sale of Cali Brands — a disruptive, rapidly growing, online-first/omnichannel provider of branded flooring products — based on our prior experience as a buyer of TM's effective process management, and the combination of its deep understanding of the flooring market and its proven success positioning direct-to-consumer businesses. Our experience with the entire TM team, from top to bottom, was exceptional, and it delivered on its promise of senior-led, white-glove attention from the beginning to the end of the process. We and the Cali team could not be more pleased with the outcome."

BEN SCHNAKENBERG
FORMER CHAIRMAN, CALI

"Our relationship began several years ago, at a time when our pro e-commerce strategy was in formation. Throughout our years of collaboration, TM leveraged its deep building products distribution and e-commerce expertise, along with its senior-level industry relationships to help us envision what it calls "the art of the possible." When the time came to complete a transaction, TM thoughtfully positioned our business to resonate with strategic buyers, built a fantastic set of marketing materials, and then led us through a very efficient process that culminated in an incredible outcome. My team is excited to take our business to the next level with our new partner, and we could not have gotten here without the help of the entire TM team."

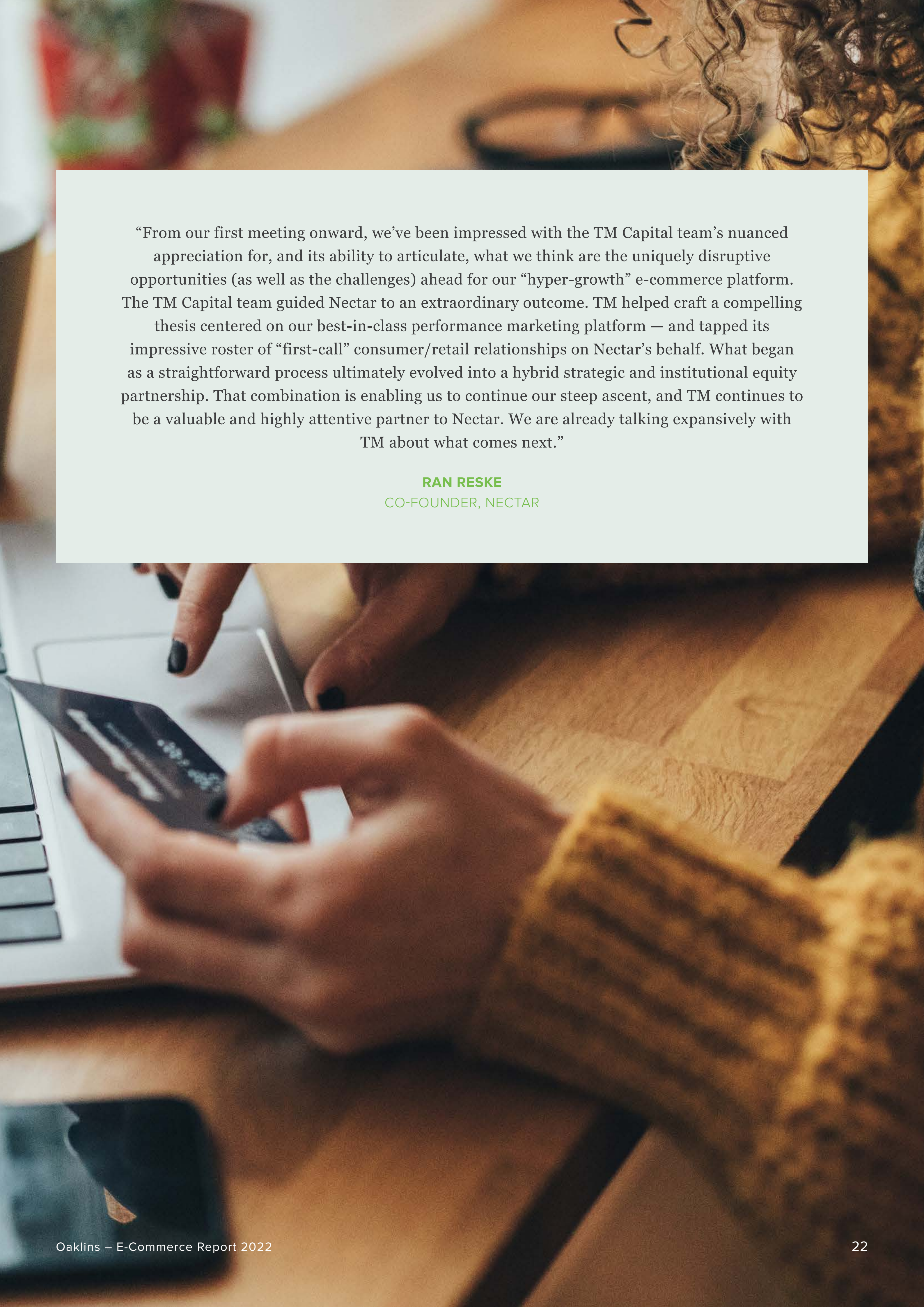
MARCUS MORGAN
CO-FOUNDER & CEO, SUPPLY.COM

"I go into every engagement with a hint of cynicism — that there's no way they can deliver on all that has been promised. TM Capital is a rare breed. From the beginning, TM has exceeded all of my expectations. Going forward, I will be a champion for TM Capital whenever I can."

BRYAN SIMPSON
FOUNDER & CEO, BIG BLANKET

"To realize our vision for CPAP.com, we sought an advisor with deep insight into both the healthcare markets we serve and the DTC e-commerce engine driving our success. As a founder-owned business, we also needed our advisor to be sensitive to our goals for the CPAP.com team. TM Capital delivered on all fronts, with the ideal combination of sector expertise, valuable relationships, and the senior partner focus required to engineer an outstanding outcome. We're excited to begin our next chapter with a world-class partner in Cathay Capital."

JOHNNY AND CAROLYN GOODMAN
CEO & CFO, CPAP.COM



"From our first meeting onward, we've been impressed with the TM Capital team's nuanced appreciation for, and its ability to articulate, what we think are the uniquely disruptive opportunities (as well as the challenges) ahead for our "hyper-growth" e-commerce platform. The TM Capital team guided Nectar to an extraordinary outcome. TM helped craft a compelling thesis centered on our best-in-class performance marketing platform — and tapped its impressive roster of "first-call" consumer/retail relationships on Nectar's behalf. What began as a straightforward process ultimately evolved into a hybrid strategic and institutional equity partnership. That combination is enabling us to continue our steep ascent, and TM continues to be a valuable and highly attentive partner to Nectar. We are already talking expansively with TM about what comes next."

RAN RESKE
CO-FOUNDER, NECTAR

Oaklins

TM CAPITAL
SUCCESS. REALIZED.

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