TAG® TELSEY ADVISORY GROUP

INDUSTRY UPDATE

SEPTEMBER 18, 2020

KEY TAKEAWAYS

- On September 17, we hosted a conference call with LJM Group, a consultant that helps shippers save time and improve profitability with expert FedEx and UPS auditing, as well as shipping consulting services focused on cost management and recovery since 1998.
- Carriers are controlling the market by selecting package sizes, increasing prices, and adding surcharges.
- Peak volumes in the holiday season will likely lead to delays in shipments.
- In 2021, shipping expenses are expected to rise 6%-7%.
- Strong e-commerce growth has served as a headwind to profitability, partially offset by physical retail presence (e.g., BOPIS) and supply chain efficiencies.
- Dark stores should continue to be utilized as DCs, as they help deliver goods faster and cheaper.

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TAG'S CONFERENCE CALL SERIES

Shipping & Logistics Update with LJM Group

On Thursday, September 17, we hosted a conference call with LJM Group, including Thomas Andersen, Partner, VP of Supply Chain Services, and Kenneth Moyer, Partner, VP of Supply Chain Strategies, to discuss the current and future shipping and logistics environment. LJM services customers across multiple industries and specializes in supply chain management.

It's A Carriers' Market: LJM Consultants indicated that FedEx and UPS have the upper hand right now, given the significant surge in online orders, which seems unlikely to slow in the near term. Carriers are leveraging the trend by dictating terms, such as selecting package sizes, increasing prices, and adding surcharges. This structural increase in online demand is forcing carriers to rapidly expand delivery capacity, but it takes time to meet the strong demand. Looking ahead, LJM expects shipping expenses to rise 6%-7% in 2021, which is a fairly standard annual increase. Note, FedEx recently announced a rate hike of 4.9% in 2021, but it often ends a little higher.

Holiday Season: Looking at the holiday season, LJM expects a new peak in volumes, which tend to increase by 100% between the end of November and December. This year, it will likely prove challenging for retailers to meet the surge in demand and satisfy customers. Large retailers, which are expected to ship massive volumes, could be most impacted from capacity constraints, given that carriers are limiting volume capacities allocated to each retailer to serve as many retailers as possible. LJM believes retailers should not overpromise tight delivery windows, but expect delays from carriers, given the difficulty adding more labor, vehicles, and infrastructure. Higher volumes also should result in higher returns and, thus, higher shipping costs.

E-commerce Profitability: E-commerce has grown 30%-40% over the past few months, due to COVID-19, well ahead of its historic growth rate of 10%-20%. The surge in online demand is pressuring e-commerce profitability for retailers, given higher rates from carriers and higher returns. However, these headwinds are partially offset by economies of scale and efficiencies in DCs and supply chain related to accelerated investments in technology, resources, and labor. According to LJM, retailers can improve e-commerce profitability by optimizing picking and packing and maximizing space in trailers, which helps retailers to have more negotiating power. The companies with a physical presence have the advantage of offering BOPIS, curbside pickup, and ship-from-store, which is a more profitable way to deliver goods than from centralized DCs, despite higher picking and packing costs. That said, for this advantage to work, retailers need a solid inventory management system to have the right product at the right location at the right time.

Role of Dark Stores: LJM believes, and we agree, that dark stores are essentially an extension of the ship-from-store model. Typically, dark stores are located closer to consumers than a regular DC and can fulfill orders within a few hours during peak demand periods at lower costs. Online retailers, such as Amazon.com, and several physical retailers with high volumes, are experimenting with the model to quickly meet customer demand. The use of last mile delivery providers, such as Walmart Spark, Target Shipt, and Instacart, support the growth of dark stores.

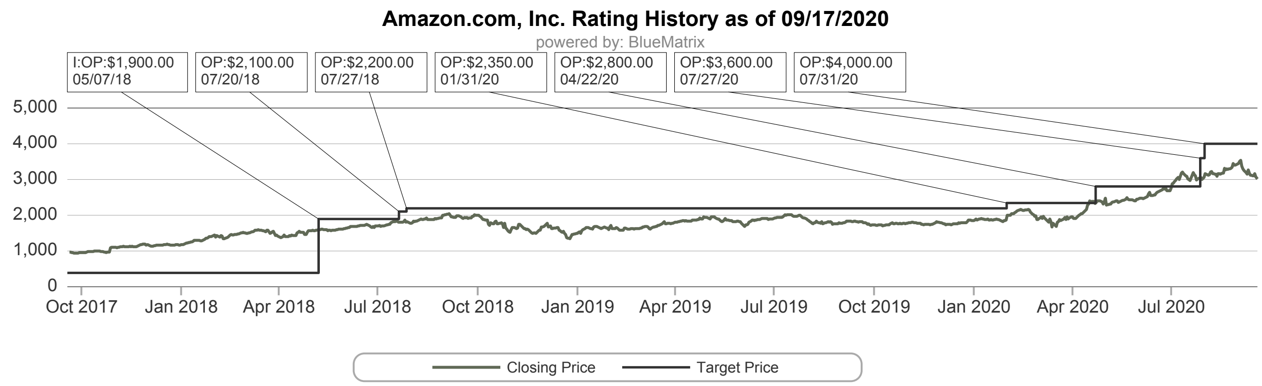
ADDENDUM
Important Disclosures:

Valuation Method for Target Price: Price-to-Earnings, enterprise-value-to-EBITDA, P/E to growth, price to free cash flow, and discounted cash flow analysis.

Investment Risks: Telsey Advisory Group's (TAG's) equity research department covers consumer-focused sectors including apparel manufacturers, cannabis, children's and teen retailers, consumer electronics retailers, cosmetics, department stores, discounters, footwear, home furnishings retailers, home improvement retailers, internet, luxury goods, office supply retailers, off-price retailers, restaurants, specialty apparel retailers, sporting goods retailers, and supermarkets. Risks across or specific to one or more of these sectors include volatility of commodity costs, consumer spending, currency, rising interest rates, weaker consumer confidence and unemployment rates. Additionally, access to capital, supply chain disruptions, commodity costs, private label distribution, currency, geopolitical uncertainty, unfavorable government regulations, lack of appropriate real estate sites, and the use of the World Wide Web to sell merchandise represent unique industry risks.

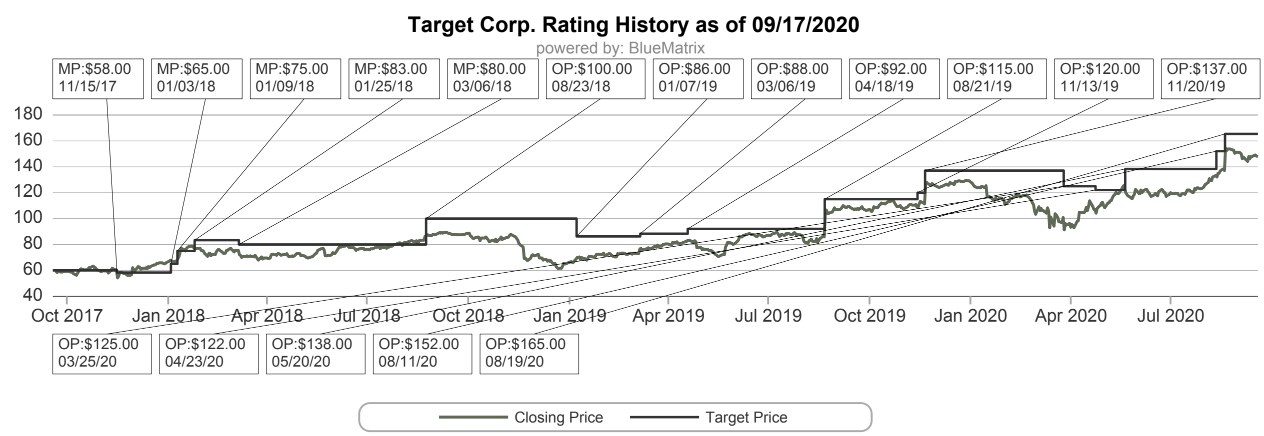
Analyst Certification
The Research Analysts, Joseph Feldman, Cristina Fernández, CPA, Sarang Vora, CFA and Zeyn Burak, who prepared the research report hereby certify that the views expressed in this report accurately reflect the Analyst(s) personal views about the subject companies and their securities. The Research Analyst(s) also certify that the Analyst(s) have not been, are not, and will not be receiving direct or indirect compensation for expressing the specific recommendation(s) or view(s) in this report.

Company Specific Disclosures



On September 16, 2012 TAG completed a transition from price target ranges to specific price targets. All price target changes prior to September 16, 2012, are displayed as price target averages.

* Telsey with ratings are effective as of 09/11/14



On September 16, 2012 TAG completed a transition from price target ranges to specific price targets. All price target changes prior to September 16, 2012, are displayed as price target averages. Exception listed for 08/16/2012

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Ratings Distribution & Investment Banking Disclosure

Rating	Count	Ratings Distribution	Count	*Investment Banking
OUTPERFORM	**40**	**51.95%**	**4**	**10.00%**
MARKET PERFORM	**37**	**48.05%**	**0**	**0.00%**
UNDERPERFORM	**0**	**0.00%**	**0**	**0.00%**

On 09-11-2014 TAG launched a three-tiered rating system of Outperform, Market Perform, and Underperform to evaluate its stocks under coverage. Price targets continue to be used in conjunction with the new rating system.

Ratings Definition and Distribution

Our recommendation system is based on a stock's expected total return relative to the industry universe over the next 12 months.

We divide stocks under coverage into three categories, each defined by a prospective rate of return:

Outperform – the stock is expected to outperform the average total return of the industry universe over the next 12 months.

Market Perform – the stock is expected to perform in line with the average total return of the industry universe over the next 12 months.

Underperform – the stock is expected to underperform the average total return of the industry universe over the next 12 months.

Disclosures required by United States laws and regulations

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