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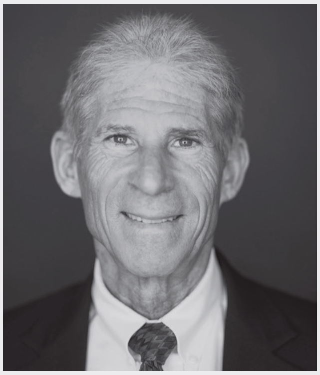
FOOD AND BEVERAGE BRANDS ADOPT D2C TO COMPETE AND THRIVE



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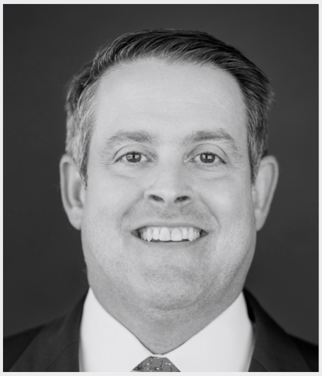

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Jim Freedman is a founding partner and chairman of Intrepid Investment Bankers, a specialty investment bank that provides M&A, capital raising, and strategic advisory services to middle-market companies across various industry sectors. He has more than 35 years of investment banking and corporate finance experience and is an expert on the financial aspects of corporate strategy.

Michael Seccuro is a managing director and head of Food, Beverage, and Agriculture at Intrepid. His experience includes buy-side and sell-side M&A transactions, credit and debt structuring and origination, as well as public and private equity raises. He has represented clients across a variety of industry segments, including packaged food and beverage, produce, protein, seafood, agriculture, grocery retail, and food service.

Today's digitally connected consumers' shopping preferences have changed the way companies sell and market their products. The Food & Beverage industry has experienced a recent surge of startups establishing their brands using eCommerce to sell their products direct-to-consumer (D2C). Some of us remember ordering or receiving food products from a catalog or direct mail based D2C pioneers such as Omaha Steaks, Honey Baked Ham, or Hickory Farms. Since these early pioneers, the volume, importance, and sophistication of the next generation of D2C brands have grown exponentially enabled by new technologies, marketplaces, and business models.

The market has evolved from basic online marketplace models such as Amazon selling third-party products to enablement platforms such as Shopify, which made it possible for brands to make and sell their wares online D2C, and more recently, to today's sophisticated brands that focus on disrupting vertical product lines (e.g., beauty, deodorant, glasses, shoes, etc.). These next-generation brands are building a highly-engaged customer following without putting their products on retail shelves, eliminating the need for middlemen and extra costs associated with brick-and-motor locations.

Forty-nine percent of U.S. consumers shop for Consumer Packaged Goods (CPG) products online and by 2022, the average U.S. household will spend $850 per year online for food and beverages1. We've seen this trend toward increased online purchases in industries like apparel, accessories, and beauty & personal care, which ultimately led to high-profile acquisition by large CPG players such as P&G's acquisition of Intrepid's client, deodorant brand Native, in 2017, and acquisitions in shaving by Unilever in 2016 (Dollar Shave Club), and in 2019 by Edgewell (Harrys).

2019 saw the D2C model achieve greater traction in food and beverage. Fast-growing, innovative D2C food and beverage brands attacking this opportunity are delivering improved products and customer experiences to compete with big corporations across multiple different product categories. Traditional food and beverage manufacturers and retailers have made substantial efforts to go digital, but most have been slow to optimize these channels primarily due to a lack of cohesion with their brick-and-motor operations. Additional factors hampering traditional players include legacy brands that don't resonate with the D2C consumer and younger generations with authenticity, further corporate organizations lack a nimbleness and responsiveness to exploit this rapidly changing environment. This disruption has allowed room for a new breed of D2C to be born online. These companies take a grassroots approach to social media marketing using viral campaigns and micro-influencers to create engaged followers who can be leveraged to compete with much larger companies with multi-million-dollar marketing budgets.

Common Themes of Successful D2C Brands

The D2C delivery model does not work for all product types, such as perishable food items or bulky, low-cost items. Due to shipping considerations, D2C works best for products that are more compact and of higher value. Products are often sold in multi-packs or bundles or are offered as a subscription or auto-ship regular purchase item. Other product form factors that translate well in a D2C model include frozen foods, which have favorable price/value, weight and shipping characteristics, and powder-based products. Wellness supplement brand Moon Juice began as a local LA-based juice business, and the company's sales skyrocketed when the product shifted to powder-based products allowing it to reach new audiences.

A common theme of successful D2C brands is an enthusiast or dietary-specific element that attracts devoted followers. Real Good Foods and Cali'Flour Foods grew from communities who have either diabetes or autoimmune diseases seeking bread alternatives. Another common

QUOTE:

BUDDING DIRECT-TO-CONSUMER BRANDS MAINTAIN COMPLETE CONTROL OF THEIR MARKETING STRATEGIES AND GROW FASTER WITH LESS CAPITAL.

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theme is in products that can leverage detailed education on the benefits of a product or detailed descriptions of formulas based on science or other ingredient specific traits. Several complete nutrition offerings have grown successfully as D2C only brands touting their specific formulations, including Soylent, Organifi, Ka'Chava, and AthleticGreens. Many of these brands start with an influential group of followers with similar interests around the brand, whether that is gamers, developers, tri-athletes, or cross-fit aficionados.

D2C Model Risks and Opportunities

Selling D2C avoids the markup and broker cost of going through traditional channels and protects profit margins. Another factor that helps cash-strapped D2C startups grow quickly is the improved working capital dynamics and faster turnaround of accounts receivable when selling directly to consumers. D2C brands avoid the costly and slow traditional product launches in favor of real-time evolution and tweaking of their R&D with the ability to get instant feedback from customers.

Frozen food disruptor Real Good Foods leverages its more than 500,000 social media followers and heavily engaged D2C customers as an integral part of its product development strategy, enabling the company to bring new products from idea to shelf within months.

Budding digital brands maintain complete control of their marketing strategies, and when paired with the ability to analyze consumer data to recommend products directly to customers, D2C brands have stronger customer connections and brand loyalty. Certain companies are driving increased personalization of products based on the data and customer information which they collect.

Risks to developing a brand online include an insufficient followers base to try products and achieve a level of consumer traction. Traditional retail point of sale provides opportunities for impulse purchases, sampling, and trials that are hard to replicate online, especially for a product that may retail for less than $10.

Aside from selling through a company's own Website, the D2C landscape includes online marketplaces such as Amazon that provide brands with the consumer demand and logistics needed to establish themselves. However, having products available through a third-party puts a brand's vital connection with its customers at risk. Other drawbacks may include additional costs of technology, talent, and marketing. Given the number of eCommerce channels available and the complexity of data, many brands struggle to understand and optimize their digital strategy. Companies often need to hire third-party digital marketing agencies to optimize content, navigation, and load speeds as well as test strategies and analyze customer conversion data.

Additional Growth Avenues Are Key to a Brand's Exit Strategy

The benefits of a purely D2C model begin to diminish as the business reaches a certain scale. Early non-food and beverage D2C success stories such as Casper and Warby Parker selectively opened their own retail stores and companies like Harry's migrated to having their products sold in traditional retail, most notably Target. D2C food and beverage brands have begun to follow the pattern of other verticals with an increased presence in offline channels. Soylent, Real Good Foods, and Perky Jerky all represent challenger brands that enjoy omnichannel success.

The changing retail landscape has allowed brands to experiment with more unconventional retail channels through experiential marketing, store-in-store, and pop-up locations. These types of experiences increase customer engagement by promoting social media sharing through "Instagramable" moments while delivering product education and control of brand communication. Hint (fruit-infused water) opened an experiential store in San Francisco with sampling and an in-house photo booth. Offline channels don't have to be grocery retail. Partnerships with outlets such as fitness studios or office buildings can be useful outlets for certain products.

Fast-growing D2C brands must consider when and how to make the transition to conventional retail channels, especially as it relates to their long-term goals and potential exit strategy. Large strategic acquirers are interested in buying brands that have proven online success with significant growth potential from bringing them into their retail distribution channels. However, there may be a perceived risk from acquirers that products won't translate on retail shelves. Perhaps the best way to move into conventional channels is to enter a select number of retail accounts to prove the model before considering a sale. This strategy can provide a good indicator of the brand's potential and de-risk the transaction from the strategic buyer's perspective.

As millennials become new parents, new households will drive different solutions. Large strategic food and beverage players have generally been on the sidelines, but we expect acquisitions of D2C brands to accelerate as brands prove their ability to succeed online. **END**

1 FMI and Nielson