CONSUMER AND RETAIL GROUP

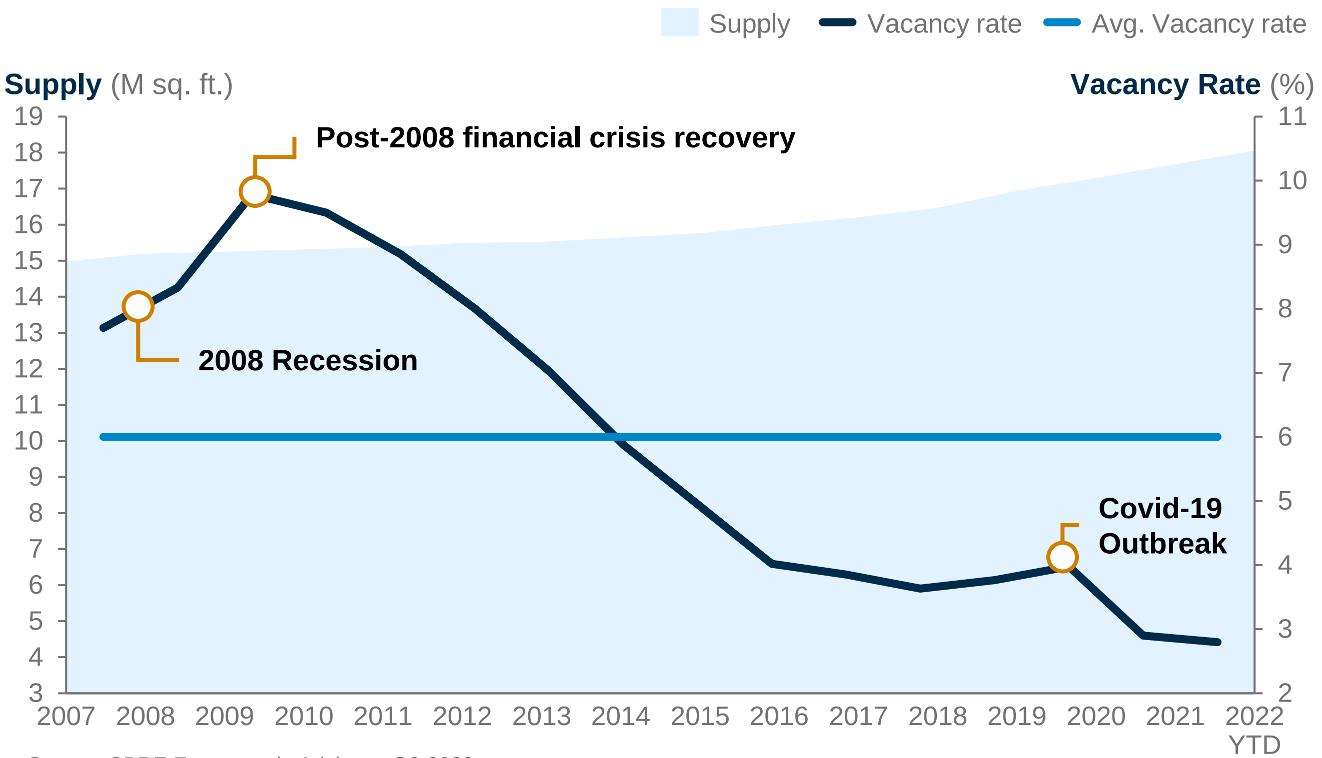
Operating impacts of excess inventory

Warehouse space availability in the US is at historic lows.

The US is "full".

Retailers in search of warehousing space are faced with a supply-constrained market, and historically low vacancy rates. CBRE Research shows that the vacancy rate for US industrial space is 2.9%. This vacancy rate means companies will be extremely challenged to find additional storage space, even more so as the peak holiday season approaches.

> **"The "land grab" in warehousing space is unlike anything we have ever seen… "** – 3PL Division President



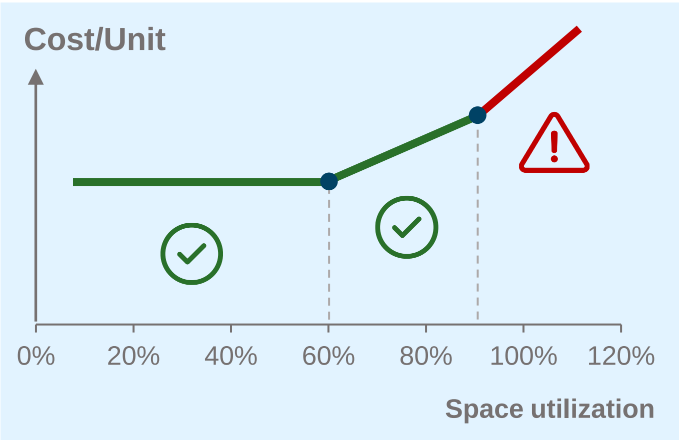
Source: CBRE Econometric Advisors, Q2 2022

In this operating environment, Supply Chain costs can erode quickly, and changes are required

Operating change is required when the warehouse is full.

Retailers are entering the 2023 Holiday season with inventories 40 – 60% above the levels of 2022. Retailers are making plans to try and “clear the shelves” during the critical Holiday sales period. Not all will succeed. Beyond the sales and margin risk of this excess inventory, the negative impact on operating costs will come out as companies report Q3 earnings.

The cost impact of excess inventory on distribution is not “linear”. When warehouses are full, operating costs erode rapidly. When the United States is “full”, the impact on operating costs will be dramatic.



> **As we ran out of space, we took our eye off the ball of operating efficiency. Space challenges made training and staffing even more challenging”**
>
> ***– Senior Supply Chain Operator***

It is not just space that will get more expensive.

- ***Management Focus*** on productivity and service will decline as solutions to space challenges become key focus and debates about the forecast expand.
- ***Distribution Labor*** will become unproductive as workers spend more time finding a place to put something away and constantly shuffling and reshuffling inventory.
- ***Shipping departments*** will be pressured to ship in tighter windows as retailer defer inventory decisions as late as they can.
- ***Labor spikes*** will be dramatic as retailers drive promotions in order to liquidate inventory.

Actions to reduce excess inventory in the short term

In this challenging environment, what can companies do to mitigate these cost increases?

Understand your operating costs

Model what will happen to your costs when you run out of capacity. Leverage this information to drive pricing, promotions or investments to mitigate costs NOW. Avoid the conversation at the end of the quarter about how you missed shipping targets or budgeted distribution costs because “the warehouse was too full”.

- Impact on allocation / planning – Customer will defer allocation but DCs need them ASAP.
- Impact Training & on-boarding labor when standard operating disciplines are lost.
- Cost of space and transportation to/from – Drivers, Fuel.

Develop sales forecasts with action triggers

Critical to gain Management alignment on sales forecast and decision points. Allow time for planners, operators and finance teams to develop contingency plans.

- When space it tight, you can not “kick the can down the road”.
- Operating with “no space” require a different approach to forecasting.
- Accept that all partners will be challenged – Vendors, Internal, Customer, and you must think differently.

Develop operating plans, not just financial plans

Monthly & quarterly sales targets will not cut it. Daily & weekly plans for receipts, allocations, shipments are critical when managing operations without space.

- ***Inventory plans*:** Detailed plans of what inventory will move so that operators can take action on slow moving inventory in order to optimize the space they have.
- ***Total company plan***: Customer service, Allocations, Credit, Marketing, etc. all play a role when managing in a capacity constrained environment.
- ***IT*:** Can your technology solutions support inventory moving to new locations, maximum utilization of all available facilities.

Opportunities to leverage as you reduce excess inventory

With all these challenges, there are opportunities that companies may miss while resources are focused on getting units out the door.

Reduced demand and market place challenges provide opportunity to negotiate lower Ocean, OTR and parcel costs

Be aggressive with the Ocean providers on detention and storage charges. COVID rates can be challenged in today's environment

Supplies costs are falling – Corrugate, pallets, etc. markets faced with decreased demand and costs are failing from COVID peaks and costs must be reviewed quickly

If you are lucky enough to have space, monetize it. Many partners or services can help you get value out of your space on a short-term basis.

Here in the Alvarez & Marsal Consumer and Retail Group, we are helping retailers and consumer products companies be on the front-end of disruption and achieve their highest level of potential impact.

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