2022 Shareholder Letter

Cheers Health, Inc.

Preface.

Dear Cheers shareholders,

I am excited to report to you through my, and Cheers', second ever shareholder letter. As you may know, Cheers is based in Texas, and so… it is with great honor that when it comes to this endeavor, I can now say: "This isn't my first rodeo."

The responsibility of reporting through an annual shareholder letter falls squarely on the shoulders of the CEO. It is no small task, as I am reporting to over 1,500 Cheers investors about the state of a business that they own. Whether you invested a few hundred dollars in this recent round, or a few hundred thousand dollars in previous rounds, you are a part-owner in this business and your management team feels the full weight of that responsibility.

In my first shareholder letter, I explained what I thought made a good letter after studying some of the great CEO's annual letters over the past decades—Buffett, Bezos, Kelleher, etc. This included them being clear, candid, insightful, full of personality, telling a story, and getting better through the years. I even remarked on how most letters aren't short—then proceeded to write a lengthy letter myself. This year, I'm going to invoke Cicero's famous quip again at the end: "If I had more time, I would have written a shorter letter."

I invite you to reread last year's letter for a refresher. As well as to make a determination on whether this second letter is better than the first. In rereading that letter myself, my only comment is that I wish I would have not done such a good job the first time around, so that this year it would have been easier to show improvement. This is a long journey, and I need to learn to pace myself… as such, there are many big things we are up to that I haven't included in this letter and would instead prefer to let you know about them when they're finalized in the future.

Last year I also laid out some ground rules for these letters. They are summarized as follows:

- 1) We will not give away any information that we believe could help our competition.
- 2) We will not give away any information that we believe is legally risky.
- 3) Everything we say is our current best guess and will probably change as we encounter additional information.

Reasons for why we have each of these rules are included in the original letter. But here's an overarching explanation:

The beautiful thing about shareholder letters is that they are neither regulated nor required—and yet are given freely to the public… investors and non-investors alike. Similarly, the ugly thing about shareholder letters is that they are given freely to the public… investors and non-investors alike. And I would wager that people who wish to do us no good (e.g., competition) study these letters closer than any well-meaning shareholder.

I must also say: All information and opinions herein are that of management, specifically me, and views may differ. I don't claim to be right—no one is right about everything. I'm rather trying to explain my current understanding of everything and give our reasons behind our current strategy.

Every year I start preparing this letter around Easter. That famous Galilean man said two millennia ago: “Whoever can be trusted with very little can also be trusted with much, and whoever is dishonest with very little will also be dishonest with much.” I believe that this statement about the human condition regarding responsibility and stewardship is still true. And therefore, I and my team strive to uphold the highest of standards no matter the size of our business or what has been entrusted to us.

Thank you for throwing your lot in with us and joining us on this journey! I hope you will find this letter both insightful and fun.

“Cheers,”

Brooks Powell, Founder & CEO

To the Shareholders of Cheers Health, Inc.

In 2022, Cheers generated $7.9m in revenue with $0.8m of net income. For reference, in 2021 Cheers generated $8.7m in revenue with $0.9m of net income. This means that from last year Cheers' revenue is down 10% and Cheers' net income is down 11%. This, of course, is significantly down from Cheers' watermark year in 2020 when the business generated $10.4m in revenue with $1.7m in net income. That year we also had minimal corporate taxes due to carried losses from the years prior as well as other unusual income—such as restitution from Amazon when they lost a load of our inventory.

When it comes to comparing apples-to-apples for these 3 years, a good metric to look at is Net Operating Income (which I'll refer to as "operating income" hereforward). 2020 had an operating income of $1.4m (13.7% operating margin), 2021 had an operating income of $1.2m (13.8% operating margin), and 2022 had an operating income of $1.2m (15.4% operating margin). Those two years' operating income round to the same number, but Cheers actually had $8,964.80 more in operating income in 2022 than 2021… but who's counting?

As we have seen in the public markets with startups that have IPO'd in the last few years, we believe the days of people foolishly valuing revenue growth at all costs are (mostly) behind us, and now we're moving back to a world where we believe people (generally) care about the fundamentals again. I believe that this is a good trend for Cheers, as the growth-at-all-cost strategies of our peers was causing us to look quite contrarian for several years there. We would prefer the market to value what we value so that there is alignment.

One of my goals as CEO is always to maximize the long-term future free cash flow of the business. The reason I'm using operating income as the metric in this letter is one of practicality. I believe yearly net cash flows tend to be lumpy due to the timing of things like inventory purchases and investment decisions, whereas operating income offers a smoother and more representative view into the health and trajectory of the business year-to-year.

Maximizing Cheers' ability to reliably create increasing cash flow long-term, I believe, is what maximizes the value of Cheers' shares. As I will explain later in this letter, I believe we have a very good shot of adding significantly to our ability to produce more cash and operating income in the future based on our current playbook. In other words, I believe that we are embarking on a strategy that gives us a good chance of increasing this operating income significantly beyond our 2020 watermark year.

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We're trying to build Cheers to last.

One thing that I have learned from watching a decade of acquisitions is that the golfing phrase "it's better to be lucky than good" is sometimes painfully true. Golfers often say this after hitting a prosperous, but accidental shot… such as when someone goes for the island green on a par 5 with a 3 wood, comes up short, and the ball skips off the water and right up near the flag for a tap-in eagle. In all probability, if that ball doesn't skip—which it rarely does—the golfer is going to be writing down a bogey 6 on their score card. Instead… the golfer is writing down an eagle 3. He's happy and everyone else is jealous at his sheer, dumb luck.

Of course, a good golfer knows when they get lucky or unlucky. They play the odds, execute good swings, and hope for some luck—sometimes it goes their way, sometimes it doesn't. As the famous golfer, Bobby Jones, once said: "*Golf is the closest game to the game we call life. You get bad breaks from good shots; you get good breaks from bad shots, but you have to play the ball where it lies.*"

Business is no different. I believe acquisition prices are often more the result of the market environment—and the companies doing the acquiring—than the companies getting acquired themselves!

As an example, consider how my Shark Tank nemesis, Mark Cuban, made his first billion. He sold his company, Broadcast.com to Yahoo! for $5.7b in in 1999. The "Dot-Com Bubble" ran from about 1995 to early-2000 before it popped. Mark sold right at the top. By 2002, just 3 years later, Yahoo! had virtually all but discontinued the product—meaning it was already becoming worthless—and making it arguably one of the worst acquisitions of all time for the buyer… and conversely, one of the best for the seller. Mark himself has admitted that he thinks that if he had to do it all over again, he could probably make himself worth $10m, but not $1b. Why? Because him becoming a billionaire involved a high degree of luck. Had Mark sold just a few years later… he probably would have received next to nothing for his company.

The problem with relying on luck is that you never know when luck is going to come your way. When it comes to luck with acquisitions, you're fundamentally relying on something outside of your control. Who knows when the market is going to get hot on cryptocurrencies, or fintech, or self-driving, or videoconferencing, or alcohol-related health. The truth is… you can't! You may be able to skate to where the puck is going—but you can't time the market.

Therefore, it is my belief as CEO of Cheers that the smartest way to build is in a way that is self-sustaining and can last forever without an over-reliance on luck when it comes to funding or exiting. Then, if you get lucky, and the market gets really excited about whatever you're building, great! You can then take advantage of it. But it makes no sense building in a way that either must raise more money or die, or must be acquired or die. To do so is to rely on the market environment… which you have no control over.

I have seen many cases where a company wasn't sexy for a decade or two, then all of the sudden the market gets hot on their industry and they get to enjoy their time in the limelight—whether through acquisition, investment, IPO, or increased demand. As they say: "*It takes about 10 years to become an overnight success.*" In my opinion, if everyone is already bullish on a category, you're probably too late. You need to be there building before everyone is excited about the category—so when the wind does shift your way, your sails are already in position to take full advantage.

Since my last shareholder letter, many startup CPG brands have gotten themselves in trouble. They have continued to spend money like it's 2015 and there is ample venture capital money looking to fund the next generation of high-growth brands.

The problem with the market downturn, and the crash of most publicly traded direct-to-consumer companies, is that the venture money is long gone for most CPG brands… and many startups haven't been willing or able to flip to internally generated cashflows to fund their business. Now there are likely a lot of balance sheets out there that are looking quite precarious. This is precisely why one should never build in such a way that relies on the kindness of strangers for future financing needs.

I'm proud to report this is not the case with Cheers. We have kept ourselves disciplined and have continued to build our balance sheet. At the end of 2022, Cheers had $6.2m in total assets, with only $.3m in debt. More than $4m of those assets are held in cash and short-term US treasuries, which, for context, is more than double our current annual overhead. While by no means an infinite storehouse full of grain—in reference to the parable of the rich fool in Luke 12 who said to himself "You have plenty of grain laid up for many years. Take life easy; eat, drink and be merry."—it is a healthy balance sheet that gives us some rest at night during turbulent times. (For a full picture of our financial health, please see our audited financial statements which can be found on our 2022 annual report.)

I am often asked by other entrepreneurs why Cheers doesn't spend more money. We have enjoyed consistent profits and built a solid balance sheet, so why not hire more people, spend more money on marketing, and do other things with the capital? In other words… "If you have it, why not spend it?"

I've indirectly answered this question at length through a blog article titled: "ROI in "Brand Awareness" Matters." It is a fiery piece that goes on to conclude how ***every*** expenditure in a business must be viewed as an investment. And how making sure your investments are generating positive returns is the key to financial discipline when it comes to running a business. It doesn't matter whether that expense is marketing, an employee, or your office space—everything is an investment.

Tom Murphy, the CEO of Capital Cities, once said: "I get paid not just to make deals, but to make good deals." I see my job the same way. Cheers isn't going to be a squirrel—doing things for the sake of doing things. No, the animal we should emulate is a crocodile, which patiently waits for opportunities where the odds are overwhelmingly favorable and then acts with blinding speed.

It's true, we have built up a nice balance sheet relative to the size of our business. And the past few years we've been looking for the right thing to pounce on. I believe we have finally found it and that the time is right.

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Refining our brick & mortar vision.

What is one of the most iconic dietary supplement brands that you can think of? For me, it's Emergen-C. They did one thing, very well. They were synonymous with immune health. They were usually sold in the vitamin aisle. They did a lot of seasonal advertising, promotion, and merchandising. And they ended up becoming the #1 seller of Vitamin C in the US. You couldn't walk into a drugstore during flu season and not see Emergen-C. I believe that this is what Cheers needs to become for alcohol-related health.

Pfizer ended up acquiring Emergen-C back in 2012 when it was producing around 500m packets annually. Likewise, Schiff Nutrition acquired their competitor, Airborne, for $150m cash that same year.

In my last letter I spoke a lot about alcohol brands, such as Casamigos, and how they reached such a profitable exit. While Cheers is clearly a dietary supplement, I geared the business to operate like an alcohol brand. We attended alcohol trade shows, targeted alcohol merchants, talked with alcohol distributors, and even made a beverage form of our product to appease their desired form factor. While the margin on our beverage product didn't meet our standards, we had a straightforward plan—we were going to use the beverage as a "trojan horse" to get our more popular capsules products placed in the alcohol aisle. As one of our employees cleverly coined: "The beverage is the leverage, but the pills pay the bills."

We believe are two glaring problems with this strategy: 1) Alcohol merchants and alcohol distributors speak the language of beverages and want nothing to do with pills. And 2) alcohol companies that could allow us to scale and could one day become an acquirer want nothing to do with something that has the optics of making their products look poisonous. As you will soon see, "optics" is probably my least favorite word in the English language.

On the first matter, we had no idea how powerful industry norms and status quo are—both among alcohol merchants and alcohol distributors. You are fighting a long, uphill battle trying to get alcohol merchants to put pills on their shelves and alcohol distributors to put them on their trucks. We believe the form factor just doesn't work with their warehousing, palleting, shelving, and ride to the store. One distributor told us our products are going to get crushed, and lost, and that his guys aren't very careful and will destroy them. One large alcohol retailer told us they are removing all small, non-beverage products from their stores due to them getting lost and disappearing.

Add in the fact that the alcohol industry is highly fragmented and you find yourself with a business that is going to take a long time to build. We interviewed a potential VP of Sales who had a similar role at a California beer brewer that does close to $100m in annual revenue. He told us that just for the state of California that they had to sew together a patchwork of 27 different distributors to get across the whole state. Imagine how many distributors you would need to get across the US… And with each conversation being like pulling teeth, you become Sisyphus—forced by Hades to roll a large boulder up a hill, only for it to roll back down when you get to the top, for all eternity.

On the second matter, you already know my opinion about building a company to sell. I think it's a foolish strategy that relies largely on luck. However, it's also foolish to build a company in such a way that it cannot sell. If you want the flexibility to one day sell to a strategic group when the market is right, then the company your building must be able to fit into the normal operations of the potential acquiring company. Thus, we acted like an alcohol brand since we though the most likely acquiring company would be an alcohol company.

As a general rule of thumb, to get into the alcohol aisle of a store, you need to first convince a retailer's alcohol merchant to bring in your products to their stores. Because alcohol is such a fragmented industry, these merchants often only have jurisdiction over a small territory, such as the city of Houston—even if they're part of a national grocery chain. Then, because the alcohol aisle of a store is only fulfilled via direct-store-delivery (DSD), you can't just ship your product to the retailer's warehouse and have them then drive the product to each store and put it on the shelf—something called "warehouse direct"… no, you instead have to then go make a deal with an alcohol distributor that services that territory to fulfill the product for you.

This means that for each new territory, you're selling twice—first to retail merchant who wants to know which distributor is carrying you, and then to the distributor who wants to know what retailers are carrying you. And, of course, both are fighting to not be first—a classic chicken-and-egg scenario. In Houston alone we found we would have to use multiple distributors to get across the city. Again, that's a lot of deal making… which is problematic when industry norms are stacked against you.

To solve for this, we thought: "Well, if we can prove out the metrics in one territory, then we could pitch it to a large alcohol manufacturer who could then use their distribution clout to make it happen nationally." That's how we could scale the business and create a potential acquisition at the same time. It was a good thought. And why wouldn't someone who sells alcohol not want to also sell something that could make people feel better from said alcohol?

So, I networked my way into a conversation with one of the largest beer manufacturers in the world. In that meeting, I was told that this investment/acquisition team had been looking at our space for a decade now, and that every time it has been brought up to executive management it has been forcefully shot down because of "optics".

When I asked for them to explain, they said: "Well, investing in Cheers would make it look like our company sells poison that needs recovering from." I replied: "But your company does sell poison, doesn't it?" To which they said something along the lines of: "Well, of course alcohol is poisonous, but we don't want to draw attention to that!" Evidently, if you're a big alcohol company, you don't want to admit that your products are poisonous… even if they are poisonous and everyone already knows that.

Frankly, I don't get the big deal. I believe consumers know alcohol is bad for them and they drink it anyways. And, a brand like Cheers, which tries to show the world what it looks like to be a responsible, health-conscious drinker should be exciting to an alcohol conglomerate—not terrifying. But they told me that executive management didn't want to do anything that put their core business of selling beer at risk. These companies are far more interested in checking the box by saying "please drink responsibly" than they are of actually making any meaningful changes to promote health-conscious alcohol consumption.

From a consumer perspective, we believe putting Cheers next to alcohol makes all the sense in the world. It's a wonderful product-market fit. The problem, however, is in our opinion that it is perceived as an awful product-market fit for the alcohol merchants, alcohol distributors, and alcohol manufacturers—and in the vast majority of circumstances, buy-in from these groups are all necessary to get the product onto the shelf near alcohol and be successful.

At the end of the day, it feels a lot like trying to cram a square peg into a round hole. Does this mean that this strategy is impossible? Absolutely not. In fact, we may have a few tricks up our sleeves still. It's just my opinion that when it comes to getting pills near alcohol—there is a lot of resistance. And I would prefer tailwinds to headwinds where we can find them.

As such, we have decided to slowly transition away from our beverage, to instead focus all of our efforts on our capsule products and distributing them in a manner similar to Emergen-C—in vitamin aisles and through a warehouse direct strategy. For the same reason, we're also phasing out our use of CBD, as the vast majority of retailers, Amazon.com included, will not accept products containing this ingredient. Our new strategy, while not without challenges or blind spots, I believe solves for both the problem of 1) finding a collective product-market fit between manufacturer, retailer, and consumer, and 2) finding product-market fit between startup and potential industry partners or acquirers.

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The mechanics of the vitamin aisle.

To understand our refined strategy, you have to understand how this world works. I believe that taking the time to explain how this part of the store operates will serve as a foundation for future letters. As a first order of business I must point out that to my knowledge there isn't a book or "cheat sheet" for all this information. There are probably a few good ones out there—but I haven't found them yet. And things are always changing. Our lawyer, when editing my letter, kept writing "source?" after every paragraph where I explained the above and below ways that I believe retailers operate, and I kept thinking: "I don't have a source other than this is what our advisors, mentors, and retail merchants have explained to me and what I have gathered from hundreds of conversations with people in this industry over the past year." This isn't school anymore where you must cite everything—but I understand the need to put a legal disclaimer here. Everything above and below is my current best understanding of how this whole world works. I'm bound to be wrong, and things are also bound to change. So read what I say with this understanding. (You'll also now understand why I must write "we believe", "in my opinion", and other qualifiers so often!)

Given the title of this section, I must point out that the "vitamin aisle" is my shorthand for a lot of different categories that we fit into at different retailers, these include: "health & wellness" (H+W), "health & beauty care" (HBC), "health, beauty, and accessories" (HBA), "vitamins & minerals" (VMS), "over-the-counter medications" (OTC), "cough & cold", "stomach remedies", "adult/sports nutrition", and more.

We have found that the bigger the retailer the more defined their sets and the more merchants they have managing each. The smaller the retailer—such as a 15-store regional grocery chain—the less categories and merchants they have. For example, Walmart is so big (i.e., the biggest) that they even divide their VMS set into two—one for functional supplements and one for "A-to-Z", which is codename for standard, non-formula based vitamins, such as Vitamin A through Zinc. And of course, Walmart has a ton of merchants managing all the sets within this larger health & wellness category—with each merchant's desk often having a number of associate merchants to help manage the load. On the other hand, a small retailer may just have one category manager for all of health & wellness. Remember… merchants cost overhead, so the number of merchants a retailer might have is proportional to the size of the retailer.

Generally speaking, you can breakup all HBC sales into two main channels—Food, Drug, Mass, Club (or "FDMC" for short) and Convenience (which is often written as "C-store"). Of course, there are others, such as liquor stores, hotels shops, specialty stores, and more… but it's a tiny slice of the entire HBC pie. For this letter, I will focus on FDMC. And I will often use Walmart as the example. Why? Because no one sells more HBC product volume in the world than Walmart. And when it comes to scale, complexity, and efficiency, Walmart is king.

Have you ever noticed that not all Walmart locations carry the same products? This then begs the question: "how does Walmart decide which products should go into which stores?" Well, it all comes down to "modulars" or "mods". A mod is simply planogramed shelf area of different sizes to fit different stores. For example, a Walmart Supercenter may have the full 900 sku ("stock keeping unit"—industry lingo for unique products) VMS modular whereas a regular Walmart may have half of that (e.g., 450 skus), and a Walmart Neighborhood Market may then have half of that (e.g., 225 skus). Walmart as a company has several different modulars for their different formats and stores across the country. Some products, such as Emergen-C's top skus, have enough proven demand that they go into all 4500 Walmart mods across the country whereas others may just go into 100 Walmart mods as a test. Each individual store is given a "planogram" reflecting this modular that the store managers and their team are then supposed to adhere to with the best of their abilities—refilling shelves, putting stuff in the right place, keeping things tidy and clean, etc.

Thankfully, this part of the store is typically maintained by the retailer itself and is fulfilled by the brand via "warehouse direct". In other words, instead of the "direct store delivery" common in the alcohol world where a brand ships product to a 3rd party distributor, who then delivers the product to the store and puts the product on the shelf according to the planogram, giving the store free labor in the process… this is executed by the brand shipping product to the retailer's own warehouses, and then the retailer is responsible for bringing it to the stores and putting it on the shelf themselves.

One can only imagine the complexity of managing 900 skus across 4500 different stores all containing different modular assortment types. It's also not hard to imagine the challenge of changing these modulars to incorporate new products or remove old products… and the amount of planning and labor it requires.

Because of the size of this undertaking, most large retailers only make these decisions once a year. This is called a "category review", which is when the merchant and their team decide which products had good enough performance the prior year to stay in the category, which products didn't perform well enough to stay, and which new products they are going to bring into the upcoming year. This category review, once decided, is followed a few months later by a "planogram reset"—which is where all the stores in a chain execute these changes to the planogram on the shelves of the store. Obviously… changing the store all at once would be quite disruptive, so chains typically stagger different category reviews for different months.

From the brands perspective, this gives you one shot per category, per retailer, per year.

Of course, there are all kinds of exceptions and caveats to this rule… for example, you can really only have a sku in one category per retailer—e.g., you usually can't have the same sku in both the VMS set and the OTC set—because then those merchants would have to somehow share the sales. And… some retailers don't have yearly reviews, and instead do them on a "rolling basis" whereas other retailers only review some categories every two years, or on some different cadence. And sometimes, some retailers may do small mid-year revisions if one of the products in their mod is really tanking or has some other issue, such as being out of stock due to supply chain problems.

In my opinion, if you look at the calendar, this ends up posing quite the problem for a startup that needs to move quickly. Let's say today is May 1, 2023 and Cheers decided to pursue distribution at the fictional chain "Powell's". So, we reach out to that retailer, network around until we get to the right person, and find out that they just completed their review in April, they reset 6 months later in October, and they only review the category once per two years. That would mean that the earliest Cheers could get on their shelf is October 2025, a whopping 2.5 years from now. Not to mention, rarely does a retailer put all of your skus in all of their stores the first review/reset. Instead, they start a new vendor with 1–2 skus in a subset of their stores to test the performance among their customers—then add more skus and stores with each review/reset. This means that it could be the end of 2027 by the time this chain is giving meaningful revenue to Cheers. Maybe end of 2029 if things don't go swimmingly. That's a long time!

This may sound farfetched, but that's similar to a real situation we're experiencing with a regional grocery chain that we have all kinds of ties to and one would think we'd be able to find a shortcut at. This sounds very negative… so let's talk positive. Let's talk about how a brand could build a valuable business through this distribution channel.

To do this, let's make an example scenario using a fictional mass retailer called Targmart. Targmart, of course, is similar to Target/Walmart. Let's say that this category has a "threshold", the amount each sku needs to sell per store per week to stay on shelf, of $20. Let's also say there are 2,000 Targmart locations that are a good fit for this brand's products. And finally, let's say the brand's products are priced at $20 at Targmart, and Targmart takes 40% margin, and the brand has 33% margin on its list cost to Targmart of $20 * (1 – 0.4) = $12.

This means that for every unit sold, the company makes $12 * 33% = $4 as gross margin. Or, in other words, the brand gets 20% of retail sales as gross margin. And then, can use that gross margin to pay for salaries, marketing, legal, branding, R&D, etc… of which, anything leftover becomes operating income, which then pays taxes, and then finally becomes net income. (There sure are a lot of mouths to feed, aren't there?!)

In year 1, Targmart gives the brand test distribution of 1 sku in 100 stores. The brand sells right at threshold. 1 * 100 * $20 * 52 = $104,000 retail sales. Multiply that by .2 and you can see the brand gets $20,800 as gross profit. Not much…

In year 2, Targmart is happy that the brand met threshold, and decides to give the brand distribution of 2 skus in 1000 stores. The brand hits threshold again. 2 * 1000 * $20 * 52 = $2,080,000. Multiply that by .2 and you get $416,000 as gross profit. Ok… now we're getting somewhere and can pay a few salaries.

In year 3, Targmart is very happy with all the incremental sales and performance and decides to go all in, giving the brand distribution of 5 skus in all 2000 stores. The brand continues to hit threshold. 5 * 2000 * 20 * 52 = $10,400,000. Multiply that by .2 and you get $2,080,000 as gross profit. That's a sizable amount of money… one which can feed a lot of mouths and still have some left over.

Now the above is fictional, but the math isn't too dissimilar from what is possible for a CPG brand such as Cheers. The big question is how much money the brand will have to pay for salaries and marketing to ensure that its products are surpassing threshold at these stores and keeping their retail partners happy. Generally, as distribution increases, so should marketing. And all distribution comes with complexity, and complexity requires humans, and humans require salaries and payroll.

At the beginning of this letter, I stated that I wouldn't pursue this strategy if Cheers wasn't already a profitable business and had a healthy balance sheet. Why? Because look at the time it takes!

Assuming a brand took 2 tries to get into Targmart in the above scenario, that would be 3-4 years from the beginning of their efforts until Targmart was giving them enough distribution to actually pay any salaries. Not to mention, the tradeshows, trade marketing, and other B2B expenses necessary to get the attention of Targmart—which may or may not decide to ever bring you in. Targmart doesn't just bring any brand in… they're looking for the best. This means that this process not only takes a long time and a lot of investment before it pays out, but it's woefully unpredictable. Trying to model scenarios or make projections varies *wildly* based on the timing, sku count, and door count of a few large retailers.

But, for a brand like Cheers, which is currently profitable from its eCommerce business alone, has a healthy balance sheet, and has the benefit of time and being able to take a few bites at the apple… one can see how landing large brick & mortar retail distribution could be a profitable business strategy. This strategy isn't fitting for everyone, but for us, I believe the juice could be well worth the squeeze.

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Getting through the gate—and its keeper.

Getting into any institution typically involves dealing with a gatekeeper of some sort. If you're trying to get into an Ivy League college, you have to convince the admissions office you're worthy. If you're trying to raise money for your company, you have to get convince the investment committee it's a good deal. And if you're trying to get into a retailer, you have to convince the merchant it's a smart move.

For better or worse, gatekeepers are humans. And as such… subjectivity, gut feels, personal tastes, selfish ambition, and even internal politics come into play.

We're biased, but we believe that Cheers is a slam dunk. It's incremental—it adds new, additional revenue to the vitamin aisle's pie rather simply cutting a new slice, such as a 14th brand of fish oil would. It's white space—no one's really doing anything like it and it represents a completely new opportunity for the retailer. And it serves a clear need state—that is, it fixes a defined problem for the consumer that they're willing to pay for.

Some merchants see the merits of Cheers right away. For example, at one trade show, we were approached by the CEO of regional grocery chain of a few hundred stores who decided to make a 6-figure initial pipeline order of Cheers within 10 minutes. This order was for semi-permanent floor displays that held $1k of merchandise each. Oh, and he wanted it delivered in just a few weeks. So far, the program has been successful and reorders have been placed.

However, some vitamin merchants have had a knee jerk reaction to the fact that Cheers is alcohol related. We have experienced situations where a VMS merchant shot down our products because they believed their category was for "health and wellness"… and that because our products were alcohol related they therefore could not also be health related. We have even been challenged by a merchant who said that she doesn't drink much, and doesn't really know anyone who drinks, so our products are niche. When I told her that the statistics are that over 1/2 of Americans drink monthly, she said, "that doesn't sound right" and then wasn't willing to look at the evidence.

For what it's worth, these challenges aren't new to us. In 2017, when I had just graduated from Princeton University, Cheers was promised a $100k investment from Princeton alumni through a program called the Alumni Entrepreneurs Fund (AEF). Because the money was donated by alumni to the university for investment, the provost's office had to sign the final check—something about "their non-profit status" and "which account the money was coming from". Well, the AEF investment committee approved our deal, told us we were getting the money, and then checks started getting handed out to all the Princeton startups in our 2017 cohort. Except… Cheers' check never came.

We were later informed that for the first time since the beginning of the program—about 5 years and 20 deals total—the provost was refusing to sign a check the AEF investment committee had approved and committed. Why? Well, as was explained to us: "It would be bad 'optics' for Princeton to invest in anything alcohol related." (There's my least favorite word again!)

We did some background digging and found out the provost, a career academic, was anti-alcohol and spent much of her career writing academic articles on how to reduce drinking on campus, the danger of alcohol, and other anti-alcohol-related topics. Unfortunately… she refused to even take a 30-minute meeting with me so I could explain that we both ultimately wanted the same thing—for people to be healthier and smarter when it comes to alcohol. She just had a knee-jerk reaction to the idea, was afraid of how it might be perceived, and so never gave it the time of day.

It was a big deal to us. Shelby and I were a young married couple, fresh out of college, and had no savings. At the time, Cheers was doing $50k a year in revenue and wasn't profitable—so there was no cash flow to pay ourselves anywhere close to enough for rent, food, or gas. Along with the promised $100k from AEF, we raised $100k from an angel investor with a tranche for another $100k that would be released if we could get to the milestone of a little more than $150k in revenue per quarter. In total, that was to be $300k for our first round of funding.

We had earmarked $100k for a year's worth of salaries to be split between me, Shelby, and our first hire, Hank. Then the other $100k would go to advertising to get us to the revenue level necessary to hit the tranche milestone that would release the 3rd and final $100k, which could then support the additional inventory needs. From that first $100k from the angel investor, we unexpectedly had to spend about $15k in legal fees and due diligence so that Princeton could invest into Cheers, as the first $100k was to be paired with the $100k from AEF.

When Princeton's provost blocked the deal, it made it really hard for us to release that tranche for the 3rd $100k. In a matter of weeks… my excel model went from us having $300k in available funds to just $85k. Cheers was close to death. We had no choice but to roll up our sleeves and figure out how to make ends meet—such as by cutting our salaries, which weren't much to begin with! It wasn't pretty… but we eventually were able to release the tranche, just in time for our airing on the season finale of Shark Tank.

In hindsight, it's hard for me to believe we pulled it off and got through it. It's something I'm proud of… and we're better for it, but I hope to never go through such financial difficulties again. They put gray hairs on my then 24-year-old head! After the ordeal, AEF changed the entire process to prevent this from happening again. Now startups applying for AEF are first run through the provost's office to see if there are any potential deals the provost is opposed to, then it goes back to the AEF investment committee to decide who they're actually going to give the money to. It took me about 5 years and the provost leaving before I was able to get back into the Tiger spirit! In hindsight, it's a good reminder about the role of luck in business—and the importance of optics to large institutions.

We later had similar experiences among the venture capital community who thought having something hangover-related in their portfolio would look bad to their mission of "doing good"—even if, in actuality, we were doing good. I asked one investor: "Does perception trump reality?" And they said, without a second's pause: "Yes." At least this investor was honest. In my near decade as CEO of Cheers, I have found that perceived "optics" is almost always a more powerful force than critical thought. Corporations want the appearance of doing good more than they actually want to do good. If they can do both at the same time, great. But if they can only pick between one or the other, 9 times out of 10, corporations are going to pick the appearance of doing good.

One would have thought that given these experiences that I would have invested more into fixing this problem of "optics" so that we wouldn't have any issues in the future. Well, the truth is, we haven't needed to until recently. Instead of investing in our B2B storytelling over the past 6 years, I avoided this expense by bypassing institutions and their gatekeepers almost entirely and instead appealed directly to consumers. Instead of making our case with gate keepers, the rebel in me said: "Who needs them? We can build Cheers without them."

And, as time has shown, we were quite successful with this strategy: In my opinion, Cheers is now indeed popular with consumers. If it wasn't, we wouldn't have been able to build the DTC business that we have today. And if we weren't popular with consumers, we also wouldn't have then been able successfully raise $1.75m through regulation crowdfunding—which, as the name suggests, I believe requires being quite popular with a crowd!

Now, however, Cheers is pursuing brick & mortar retail distribution. And the world's best retailers are large institutions which share many of the same concerns of those investors that have turned us down in the past. For the first time, as much as a former me would hate to say it, Cheers needs to invest in its B2B storytelling. We need to show the retailer world how Cheers is a force for good that customers not only want, but is also good for them, and society at large. In other words, we need to start winning the war of "optics".

Over the coming year, you will see Cheers start investing much more time and energy to explaining what we're all about to other businesses—and how we're a force for good in American society. You may have even seen me start these efforts through Linkedin, which I really started ramping up late last year. While helpful, no efforts are more powerful than personal relationships and face-to-face meetings.

As such, we're investing a lot of money and time to become an active member of the HBC brick & mortar community. We need to be a thought leader for alcohol-related health and champion its merits to this small world of people that ultimately decides which products end up on the HBC shelves of major retailers. This includes getting to know the merchants, the press, the service providers, and the other suppliers in this industry. Because, at the end of the day, word tends to travel… and we have great products, an awesome story, and an even better mission. Cheers is an objectively good thing that ought to be on store shelves for customers to have access to. (If you're reading this letter, you're likely an investor and already know all of this, so I'll spare you the rehash for now. But, if you are looking for some examples of our for-good motivations behind our company, I invite you to spend some time reading the articles on Cheers' blog.)

I have likened this to getting a snowball rolling down a hill. At the beginning, there isn't much there. But as time goes on, more and more snow collects to the ball and the momentum increases exponentially. A finicky merchant who doesn't drink, and won't look at data, likely won't change their mind by anything we say to them. But… if all of their peers get behind the idea, and the product proves itself as a performer on shelf, only then does it become a no-brainer—even if begrudgingly. It's hard to overemphasize how strong the stigma of alcohol/hangovers can be among some people! Especially when we have ample competitors who are, in fact, pushing a binge-drinking focused messaging and poisoning the well. As Jesus pointed out two millennia ago, people ultimately see what they want to see, regardless of what is said. And examples of our binge drinking competition only emphasize a finicky merchant's knee-jerk reaction, forcing us to try to explain how we're different ***after*** they have already made up their mind. (And yes, the often-cited factoid that it takes 20 more encounters to overturn a first impression does indeed feel true here.)

One thing to point out is that many retailers play musical chairs with their merchants. Every 2–5 years a retailer will take a merchant off their current category desk and put them onto a different, oftentimes completely unrelated desk. It's not uncommon for a merchant to be the frozen pizza category manager one year and then the VMS category manager the next. Sometimes, when a merchant really understands the brand and supports you… you're praying for them not to leave their desk. Other times, if a merchant just doesn't get the brand and is blocking you at every turn… then them changing desks becomes a blessing. It cuts both ways.

This dynamic ultimately means that the process never ends, a brand must continually be working to be to a thought leader and create in-roads to their industry. Cheers must constantly be in contact and listening to our retail partners and consumers alike so that we can provide good, innovative, product-market fit that our customers want, and our retail partners want to sell.

This year, Cheers will spend a few hundred thousand dollars on these efforts between attending trade shows, trade advertising, other marketing campaigns, and the employees necessary to manage these efforts. You will see us start investing far more time and energy into optics. These initiatives will take a bite out of our P&L. But it's an investment we can afford and the timing is right. With the downturn in the market, many companies are looking to save money and are pulling back on spend. Well, we've been saving for the past few years, and us zigging while everyone else is zagging makes it easier for Cheers to make a splash in this industry and make a stronger first impression.

Unlike DTC, it's hard to measure the ROI of these activities. Last year we met with a retailer at one trade show and the meeting didn't go so well. One would be inclined to think that the investment necessary to get that meeting was a waste. But then, a few trade shows later, we had the opportunity to meet with that retailer again. This time we were able to address that merchant's fears from the previous discussion and the meeting went so positively well that it looks like that they are going to bring 2 of our skus into 75% of their stores. Was the first meeting a waste? No, it was ultimately necessary to make the second meeting a success. Sometimes you have to keep the faith and just keep showing up!

These things take repetitions, and due to the annual nature of trade shows and line reviews, these repetitions take years… and years take a lot of time and money. If Cheers, didn't have a lot of time or money, I wouldn't pursue this strategy. Thankfully, that's not the case, and I believe we are in an optimal financial position to invest what's necessary to build ourselves into a household name in this category.

If we're right, and this strategy works as planned, we could build a future with a lot of operating income. And that would make us quite an attractive addition to a CPG conglomerate that has a portfolio of VMS brands. But it all starts with getting the snowball rolling and making those initial investments, even if the returns are years later. When the lag between investment and returns spans more than a calendar year, its return ends up being something that doesn't get reflected on a present-day P&L. Cheers has come a long way from 5 years ago, and I'm optimistic that 5 years from now that we'll be looking back and saying the same thing.

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Miscellaneous.

Last year I gave big shoutouts to Hank and Dalia. This year major credit needs to go to Seth and Shelby.

Seth:

We started attending our first trade show with our vitamin strategy in Q3 of last year, and since then, things have been like being shot out of a cannon. In many ways, getting into brick & mortar is like starting a completely new business. Sometimes I think the only link between our eCommerce operations and our brick & mortar operations is that they happen to share the same brand name and the same bank account.

We had to figure out our warehouse direct supply chain, different pricing and skus for different types of retailers, different packaging, different case sizes, different manufacturing processes, and more. There is still a lot to do—but we have come lightyears in a short amount of time. To help us figure this all out, we were blessed to be able to bring on two new equity holding advisors from the HBC / FDMC world. Both are industry veterans and are well known by their peers and have decades of knowledge they are transferring to us. Beyond that, we have been utilizing a number of helpful other mentors—some paid, some not paid enough, and some not paid at all and who are just happy to help.

Seth, our VP of Operations, is my other half when it comes to the operations of Cheers. One of the best articles that I've read on the relationship between a CEO and their key operator is "Second in Command: The Misunderstood Role of the Chief Operating Officer". Seth would be a combination of "The Executor" and "The Other Half". Here's an excerpt from the article:

"*Back in the 1990s, people in organizations jokingly picked up on a phrase from the television series* Star Trek: The Next Generation*. In it, starship captain Jean-Luc Picard, having settled on a course of action, would simply instruct his crew to 'make it so.' CEOs in general can't quite get away with that, but to the extent that they are focused on strategy, they rely on COOs to oversee much of the implementation. They must be able to trust that they can afford to address longer-term and bigger-picture issues because their second in command will maintain a focus on the here and now.*"

The reason I have been successful in my job so far is because of Seth. I have always joked that I have the ability to get ourselves into opportunities, but Seth is the one who actually figures out how to make them work. He is the chief architect behind pretty much everything you see at Cheers. I may get the idea for something and set up the meetings and get the deal made, but he's the one who turns any of my effort into something valuable. He is our implementor, and with the new retail side of our business, this has involved twice the implementation.

Seth joined Cheers a few months after our airing on Shark Tank and just a few weeks after Cheers raised a $2.1m seed round from VC investors. When he stepped off the plane from NYC to Houston, he entered a war-torn disaster. I, Shelby, and Hank had got the business to over $5m in annualized revenue with only $200k in equity financing. Things were falling through the cracks left and right. We needed someone organized to start building the team and figuring out how to manage this company. Seth was our guy to wrangle that chaos into something coherent.

That's the world Seth was thrown into, and it hasn't changed since. He has performed brilliantly as an operator. I create the chaos by getting the business some opportunity… then he figures out how to control the chaos and make good on the opportunity. Normal math is 1+1=2. But when it comes to me and Seth, 1+1=100. We complement each other very well and the two of us together are worth far more than our separate halves!

Behind every good CEO there is a better operator, and that's Seth.

Shelby:

Behind every good man there is a better woman, and that's Shelby.

Shelby and I first started dating our freshman year of high school in 2008 when we were both just 15 years old. Boyfriends/girlfriends break up all the time in high school. Why else would people celebrate their first month anniversary? I don't think either of us realized when we started dating that we would one day get married. By the end of high school, we were "that high school sweetheart couple" that everyone loved. Neither of us were that popular individually, but everyone loved "Brooks & Shelby". How else could you explain a nerdy swimmer (me) and a girl who raised pigs for Future Farmers of America (Shelby) winning homecoming king & queen?

I was a good student, but a phenomenal swimmer, so I was recruited to swim at Princeton. Shelby also decided to leave Texas and went to the University of Oklahoma. We set our minds to make long distance work. Of course, everyone at college was quick to make fun of us, explaining how long distance never works. But we proved them wrong. While previously attached at the hip, that first year we went from June to November without being able to see each other.

By the end of our sophomore year, 2 things happened: 1) I had started working on Cheers and 2) we were sick of doing long distance. So that summer we devised a plan.

I would take a year off between the fall and spring of my junior year to officially get Cheers off the ground and Shelby would take extra classes so that she could graduate a semester early. We would get engaged at the beginning of my year off and then married at the end, shortly after her graduation. Then she would move back to Princeton with me while I finished my junior and senior year, and we would figure it out from there.

So, we did that. We got engaged. I moved back in with my parents for a year and got Cheers further off the ground. And we got married at the beginning of 2016, just in time for us to get in a honeymoon and drive from Houston up to Princeton.

The plan wasn't for Shelby to get involved with Cheers, but from us being together for so long, she knew everything about Cheers from our nightly phone calls and pillow talks. While in Princeton, Shelby decided to start her own photography/videography business around the time that I was also dabbling in digital advertising.

Very quickly, Shelby started getting sucked into the Cheers universe. It started with: "Hey, can you do a video shoot for me that I can use for ads on Facebook?" Then it became: "Hey, can you also edit the videos, then put them into Facebook Ads Manager? I'll show you how." Until finally, it exploded into: "Hey, can you help deal with these customer service tickets? Help ship out these orders while I'm in class? And do our next product shoot?" By my graduation, Shelby was essentially a co-founder of Cheers and we decided to make a full-time go at it upon my graduation. I've always joked that it's a good thing Shelby and I work together, because if we didn't, I don't think we'd ever see each other!

One of my business professors, a trusted mentor to me and Shelby, sat me aside one day and explained that the VC community is weary of family businesses, and that if we wanted to raise VC, us being a husband/wife team is not something we should be shouting from the rooftops.

Evidently, the belief is that startups are stressful, and there's too much emotional spillover between the business and the personal. So, from that point on, we always kind of downplayed it.

Shelby was phenomenal at her role as Director of Marketing. She made all of Cheers' content, edited them for Facebook/Instagram, and spent millions of dollars a year on digital advertising. One only needs to look at our 2020 financials to see how good she was at her job. She was one of the best in the nation, and 3 times we tested her performance against the best digital advertising firms in the country and she beat them handily.

Of course, as discussed last year, iOS 14 sucked a lot of wind out of the sails of digital advertising and Shelby needed to reinvent herself. At the start of Q3 last year, Shelby decided to throw herself into Cheers' brick & mortar efforts. She planned all of the tradeshows, made all of the sales materials, set up the meetings, mapped out the plan, and became one of the best representatives of the Cheers brand I've ever seen.

The funniest thing started happening at trade shows. At these events everyone wears an official lanyard with a name badge on it. This badge is required for entrance onto the show floors and you're required to wear it the whole time. Well, Shelby and I would sit down to have a meeting with a retailer, and the merchant would look down at our tags and see that both of our names ended in "Powell". Very quickly, after a number of puzzled looks, we realized the retailer was trying to figure out if we were brother/sister or husband/wife. So, for the first time, there was no hiding the fact that Cheers was run by a husband/wife team.

We decided to lean into it because we didn't really have a choice, and as it turns out just like in high school, we are a whole lot more likable together than apart. Or maybe Shelby is just really likable and I get the benefit of it. I'm still trying to figure that one out. Any of the success you're now seeing in our retail efforts is because Shelby decided to get involved. And so, she's since been given the title of "VP of Sales & Marketing".

It's been a lot of fun for us building the brick & mortar side of our business together. We've always had to downplay the relationship when meeting with VC investors, but in the retail world, there are still a lot of family owned and/or operated businesses and it's not a negative, but likely a positive. In many ways… family-owned businesses can signal stability and a genuine care for the mission. For the first time, we feel like we get to be our true selves publicly, which has been a big blessing to both our marriage and our business.

On that note… I am also very proud to report that Shelby is pregnant, and we're expecting our first child—a ***son***!!!!!!—in Q4 2023. If merchants like the combination of Brooks & Shelby more than both of us individually… I expect they will like the 3 of us even more.

You may be worried that us having a child will make business more difficult for us. But don't, as you know I'm a capitalist, and you have my word that I'm already thinking of ways to best use this child to drive sales on your behalf! I can't wait to have Shelby sitting down with retail merchants while 30 weeks pregnant and pitching the future of Cheers on their shelves. And who better to explain to retailers the appeal of Cheers to millennial mothers than a millennial mother herself? We’re not ones to let a good sales opportunity pass us by… babies are expensive, and as such, we’re expecting it to deliver ROI!

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Closing thanks.

If you made it to the bottom of this 10,000+ word letter, kudos to you! I have quoted the Roman philosopher and statesman Marcus Tullius Cicero before, and I will quote him again: “If I had more time, I would have written a shorter letter.” This letter has explained a lot of concepts unique to Cheers, many of which can be referred to in future letters, ideally making them shorter. But let’s be honest, probably not! Because I will end up going deep on some new subject next year.

I hope that this letter helps you understand how we think about Cheers and how we are being faithful to steward your support. There are many people that are deserving of gratitude that were not included in the body of this letter. Throughout the years, I hope to highlight more of them that make up the DNA of Cheers’ team. Two more that stand out this year include Kelsey Mathews and Leah Nguyen.

Kelsey, our Operations Manager, is the right hand of Seth Hazleton. She actually predates Seth in her Cheers tenure by a few months, but she is the best supporter in the planet and knows the ins-and-outs of every aspect of the Cheers business. I believe she’s the glue that holds this organization together and I’ve been around long enough to know that Kelsey is probably the most valuable asset we have. She works behind the scenes to make this business a success in ways that I know I don’t even see. I don’t think Seth could do what Seth does without Kelsey. And I definitely can’t do what I do without either of them.

Leah, our Design Manager, as you will notice is a repeat offender on this list… she stepped up and for the period of a few months was able to hold down the entire design department of Cheers on her back while Dalia was on leave. I wish I could say these were an easy few months with a lighter workload… but no. Murphy’s law occurred, and it ended up being a period where we had to do a ton of design because of our retail efforts, and so it involved a lot of late nights at the office. But she handled the hours and stress wonderfully, and even found energy to remodel parts of our office—with self-apply wallpaper, DIY painting, led lights, and more. We’ve told her she needs to take a vacation… But one thing is for certain, if you cut her open, she bleeds blurple.

Sam Swidensky is our team’s new guy and he has been fighting alongside me and Shelby in the trenches on our retail efforts. So far, we like what we see, and I hope to write about him next year!

On behalf of Cheers' management team, I sincerely thank all the shareholders for their support of this company and its future.

¡Salud! ("good health" in Spanish—my favorite way of saying "cheers"),

Brooks Powell (Founder & CEO)

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