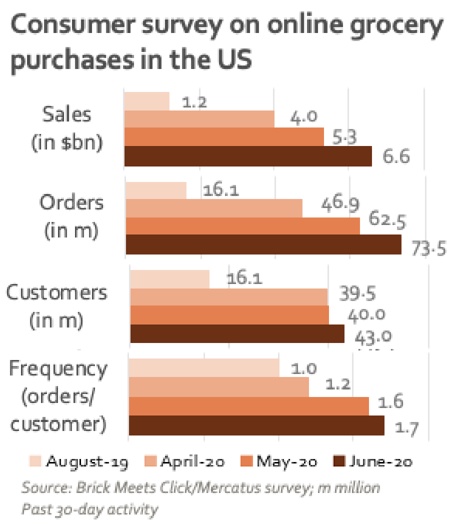
US Food Market

Unigrains' opinion on the key events of recent months

Headline news: US e-commerce gets a boost



Amazon's takeover of Whole Foods in 2017 was a turning point in food e-commerce in the United States. The coronavirus crisis is another, as shown by the Brick Meets Click/Mercatus surveys. The health crisis is speeding up the adoption of this channel by new consumers and the roll-out of services and infrastructure. Several approaches coexist, as illustrated here in food product sales.

Traditionally, home delivery is the main channel. Many traditional retailers have opted to partner with a company specializing in food delivery and many of them have turned to the leader, Instacart. This company has been one of the major beneficiaries of the coronavirus crisis thanks to its business model, which consists of joining forces with retailers of all sizes, from local chains to major players such as Kroger, Albertsons or Costco, to deliver from their stores. According to the *Second Measure* barometer, which records the number of credit card transactions in food e-commerce, Instacart reached a peak market share of 57% in April, well ahead of Walmart (down to 25%) and Amazon.

Restaurant meal delivery specialists are now drawn by the success of food delivery: DoorDash (which has signed up with convenience store chains, as well as with Wegmans and Hy-Vee), Postmates (with Walgreens) and more recently Uber, which announced in July that it was keen to develop this service in the United States via its Uber and Uber Eats platforms. DoorDash has gone one step further with the launch of DashMart, a virtual convenience store concept offering thirty-minute delivery from directly-owned warehouses.

A few leading retailers have opted for developing an in-house delivery service by acquiring skills. Cases in point are Walmart, with the purchase of Jet.com, Target with Shipt, HEB with Favor, and Ahold Delhaize with Peapod. During the coronavirus crisis, Walmart and HEB stood out with their venture into express delivery (a service pioneered by Amazon Prime), each choosing a different option: a very wide offering for Walmart (160,000 food and non-food products), an offering limited to essential products for HEB. The positions are shifting, however. In mid-August, Walmart ended up signing up with Instacart to take advantage of its expertise in express delivery and strengthen its position against Amazon, starting in four pilot areas.

The other approach, pickup, is more recent but has grown beyond expectations, even surpassing home delivery in terms of number of orders in June (54% vs. 46% in June 2020 according to Brick Meets Click). During the lockdown, not only were some stores converted into pick-up locations (dark stores), but several players announced a large-scale roll-out of this service (Target, Albertsons, Ahold Delhaize, Aldi, amongst others). Hy-Vee stood out with the launch of an express pickup option in May. Another recent movement is the development of this service by e-merchants specialising in home delivery: Instacart, in partnership with retailers (Sprout Farmers, Aldi), as well as FreshDirect.

Ultimately, the short-term challenge is to support the growth of food e-commerce and gain market share. The big players in the retail industry are banking on both pickup and home delivery, with a few exceptions (for instance, Costco does not offer a pickup service). We can expect to see a raft of initiatives in the coming months. But the challenge is also to ensure service level, as consumers are more demanding than at the onset of the crisis, and to make these sales channels profitable, especially for home delivery. Managing the product range, inventories, last mile logistics, etc. – the equation is complex and competition between e-commerce players is set to intensify, putting pressure on prices and service charges.

Charles Sweat, Managing Principal at Sweat Equities, LLC, an investment firm based in Dallas, specializing in the food & beverage and consumer goods sectors

"For food manufacturers, one of the biggest challenges created by the development of online sales will be the pricing strategy"

The coronavirus crisis has been the biggest disruption in food consumption for years, triggering a major displacement of food sales and a lasting shift in consumer behaviour towards online purchases. All players on the market (retailers, restaurants, online platforms…) have moved or accelerated their transition towards e-commerce.

When focusing on online grocery, both curbside pickup and home delivery have soared since the Covid-19 outbreak. When the epidemic is finally under control, consumers can be expected to come back more frequently to brick & mortar shops, but online buying will remain at a higher level than before the crisis and will continue to grow. With the prevailing deteriorated economic

Date of Publication: September 2020

conditions, pickup might benefit most from this trend in the short-term as it is a lower-cost solution compared to delivering. But some consumers will be willing to pay a higher price for home delivery, which will continue to develop and at the same time become more affordable thanks to economies of scale (and intense competition between players). Lower delivery rates will in turn accelerate growth. In the future, brick & mortar shops' role as a showroom might become much more prevalent with more purchases being completed online, including on pure players' platforms.

For food companies, distribution channels will diversify combining traditional brick & mortar retail and online sales through retailers' websites or specialized platforms such as Amazon, but also through their own websites. Although an 'all under one roof' approach is likely to appear more convenient to consumers, there is a growth potential for direct sales from manufacturers to consumers, in particular for products purchased on a routine basis and for well-established brands. Implementing direct sales will require from companies that they internalize the order preparation activities, subcontract transport to carriers such as UPS or Fedex (able to deal with perishable goods) and manage delivery issues by reshipping (which is anticipated by carriers in their rates).

This is a major change for food manufacturers. For some of Sweat Equity's portfolio companies, online sales might increase and account up to 50% of their total sales within five years. But they will have to manage the pricing complexity to ensure an appropriate balance between sales channels. Setting up too low online prices to attract consumers might cannibalize brick & mortar sales, with the risk of being delisted by retailers. The pricing strategy will be one of the biggest challenges to be addressed.

Key events of recent months

Consumption

The coronavirus crisis has made private label brands even more popular with consumers

Even before the crisis, market research specialist IRI predicted that private labels would outperform brands for the fourth consecutive year in 2020. With the deterioration of the economic context following the health crisis, private labels have become even more attractive and this trend is accelerating.

According to new estimates provided by IRI to the *Food Dive* website, private label food and beverage sales in supermarkets, hypermarkets and club stores (stores accessible via a membership system) could increase by $10-12 billion in 2020, compared with an increase of $2.5 billion in 2019, to reach $93-95 billion. In these channels, their market share looks set to increase by 0.4 points compared with 2019 to reach 19.2%.

Orange juice consumption back on the rise

After two decades of decline, retail sales of orange juice have been boosted by the coronavirus crisis. According to Nielsen data released by the Florida Department of Citrus, sales, which were still down 2.5% in volume at the beginning of 2020 compared with the same period in 2019, soared 46% in the four weeks ending 11 April. Since then, growth has slowed but remains high, above 20% in early July.

With its high vitamin C content, orange juice benefits from a positive image as an immune system booster. It remains to be seen whether this rebound will be long-lasting.

Retail

Disappointing IPO for Albertsons

Controlled by a pool of investors led by the Cerberus fund, Albertsons is the fourth-largest food retailer in the United States (source: Supermarket News 2018/19) with the brands Albertsons, Safeway, Vons, Shaw's, Acme, Tom Thumb, Randalls, United Supermarkets, Pavilions, Jewel-Osco, Star Market, Carrs and Haggen. The supermarket operator had already staged two attempts to go public in the last few years. It decided to go ahead with its IPO on the New York Stock Exchange at a time when the retail sector was performing very well, benefiting from a shift of purchases from foodservice due to the coronavirus crisis.

But the IPO fell far short of the retailer's expectations, with 50 million shares sold at $16 per share, raising a total of $800 million, when Albertsons was hoping to sell 65.8 million shares at $18 to $20 per share. A disappointing result that reflects investor uncertainty about what the future will hold post-Covid-19.

Food Lion acquires 62 stores from Southeastern Grocers

Food Lion, a subsidiary of the Ahold Delhaize group, announced in early June the acquisition of 62 supermarkets (46 BI-LO and 16 Harveys) in Georgia and North and South Carolina from its competitor Southeastern Grocers. The brand is already well established in these three states with 630 points of sale and is therefore strengthening its position.

Southeastern Grocers has experienced serious difficulties in recent years and has filed for Chapter 11 protection, a procedure from which it emerged two years ago. The company is continuing its strategic repositioning by investing in its Harveys and Winn-Dixie brands and in the Fresco y Mas Hispanic supermarket chain. The store sales are continuing: the retailer has indicated that it wants to divest the BI-LO brand entirely and sell the remaining stores that were not included in the deal with Food Lion.

Lidl reaches 100-store mark in the United States and announces 50 openings by the end of 2021

Having entered the US market in 2017, Lidl opened its 100th supermarket in Suwanee, Georgia, at the end of May. After a difficult start (the 100-store mark was reached two years behind the initial plan) and a series of management changes, the German retailer has readjusted its strategy, notably with the acquisition of Best Market and a shift towards smaller and cheaper stores. The brand is now announcing an acceleration in the roll-out of its network with plans to open 50 stores by the end of 2021 (€500 million investment), focusing on nine East Coast states.

That said, Lidl is still a small player in the market. Its compatriot and competitor Aldi passed the 2,000-store mark in June (in 36 states) and plans to open 70 stores by the end of 2020, also targeting the East Coast. In the discounter segment, competition also comes from chains such as Dollar Stores.

7-Eleven acquires Speedway convenience store chain

This is the largest acquisition project in 7-Eleven's history. The company, owned by the Japanese group Seven & I Holdings, finalised its discussions with Marathon Petroleum Corporation for the purchase of its network of Speedway petrol stations and stores for $21 billion in August. With this deal, 7-Eleven, which already has 9,000 points of sale in the United States, is acquiring around 3,900 convenience stores.

The deal is expected to be finalised in early 2021. The announcement comes as the coronavirus crisis is leading to a fall in prices and fuel consumption. 7-Eleven is looking further ahead, however, and did not want to miss this opportunity. Canadian chain Couche-Tard also had its eye on Speedway. If Couche-Tard had clinched the deal, it would have overtaken 7-Eleven to become the leader in convenience stores in the United States.

Agri-food industry

Auction of Dean Foods' assets challenged

Following its filing for Chapter 11 bankruptcy protection in November 2019, Dean Foods' assets were auctioned off and the cooperative Dairy Farmers of America (DFA, of which Dean Foods is the main customer) acquired a substantial portion of these assets, 44 sites for $433 million, while Prairie Farms acquired eight plants. A total of 57 sites were sold for $530 million.

Although the US Department of Justice validated the deal, two lawsuits have been filed against DFA. The first, filed on 19 May in North Carolina by the retailer Food Lion and the dairy cooperatives of Virginia and Maryland, is part of an antitrust lawsuit. The plaintiffs are seeking a suspension of the sale and the divestiture of at least one Dean Foods production facility in North or South Carolina to an independent player. The second lawsuit, filed on 2 July by a former Dean Foods shareholder, 17 farmers and a supplier, accuses DFA of having operated a "milk cartel" and of having "unfairly expanded its scope with the takeover of the majority of Dean Foods' assets".

Borden Dairy acquired by Capitol Peak and KKR funds

Another struggling dairy group, Borden Dairy, controlled by the Acon Investments fund since 2017, filed for Chapter 11 bankruptcy protection in January 2020, two months after Dean Foods. Like the latter, Borden has been hurt by the fall in milk consumption (54 litres per head in 2019 compared with 70 litres in 2010 according to Euromonitor) and competition from plant-based drinks and distributor brands.

Borden was acquired by the Capitol Peak (majority) and KKR funds for $340 million on 26 June. Both funds are familiar with the dairy sector. KKR had already acquired Borden in 1995 for $2 billion and remained a lender to the company. Capitol Peak was founded by Gregg Engles, who ran Dean Foods for 18 years and is now taking over Borden.

Nestlé is divesting its pasta business in North America and is considering doing the same with its bottled water brands

Nestlé Good food, Good life

Continuing the portfolio streamlining process started in 2017, Nestlé announced the sale to the Brynwood Partners fund of its Buitoni branded pasta business in the United States, Canada and the Caribbean ($130 million in revenue in 2019). Buitoni was regularly losing ground to the competition. The transaction is being carried out while sales are benefiting from the coronavirus effect.

Nestlé had already sold its US confectionery business to Ferrero in 2018 and its ice cream business to Froneri in 2019. The group is now focusing on bottled water, a fiercely competitive business exposed to increasing plastic bashing. Consideration is currently being given to a possible sale of the majority of this business in North America ($3.6 billion in sales in 2019) to refocus on its iconic international brands (Perrier, San Pellegrino, amongst others) and switch to so-called functional water (water that provides health benefits).

Regulation

FDA issues food safety policy framework

Published in mid-July, this strategic framework, as reported by Business France, aims to create a safer food system by relying on modern digital technologies. It addresses issues of traceability, epidemic prevention and response, new products and marketing methods, and food safety promotion and training.

For more details, please refer to: *https://www.fda.gov/food/new-era-smarter-food-safety?utm_campaign=FDA%20Launches%20New%20Era%20of%20Smarter%20Food%20Safety%20Initiative&utm_medium=email&utm_source=Eloqua*

Main deals in the 2nd quarter of 2020

Main deals involving targets in the United States; deal value in €m

Sector	Date	Deal	Value
Pastry & bakery Pasta products	08/06/2020	**Brynwood** fund acquires **Buitoni's North American activities** (pasta) from Nestlé	102
	07/05/2020	**Mayfair** fund acquires **Rudi's Organic Bakery** (bread, bagels, muffins)	n/a
	07/05/2020	**Mayfair** fund acquires its partner's stake in **Three Bakers Gluten Free Bakery**	n/a
	30/04/2020	**Philadelphia Macarony Company** acquires dry pasta manufacturer **Zerega's Sons**	n/a
Snacks	05/06/2020	**Collier Creek** fund acquires savoury snacks manufacturer **UTZ**	1,378
Meat Delicatessen	22/05/2020	Canadian pork producer **Hylife** acquires 75% of US company **Prime Pork**	n/a
	04/05/2020	**The Hershey Company** sells **Krave** jerky (meat snacks) to **Sonoma Foods** fund	n/a
Dairy products	22/04/2020	Australian fund **MGD** acquires **Meadow Gold Dairies,** Dean Foods' Hilo plant	n/a
Plant alternatives	12/06/2020	Acquisition company **Forum Merger II Corporation** acquires **Itella International**	372
	25/04/2020	**Danone** invests $10 million in **Laird Superfood** (vegan creams)	9
	07/04/2020	**Entrepreneurial Equity Partners** (e2p) acquires **Grecian Delight Foods** (Greek products)	n/a
Sauces, condiments	05/05/2020	**Highland** fund sells **Chicago Custom** (seasoning) to **Sauer Brands** (Falfurrias fund)	n/a
Beverages	25/06/2020	**Constellation Brands** sells Paul Masson Grande Amber Brandy (spirits) to **Sazerac** group	227
	10/06/2020	**PV Brewing Partners** fund acquires **Kona Brewing's operations in Hawaii**	n/a
	09/06/2020	**Foley Family Farms** acquires wine producer **Ferrari-Carano**	221
Ingredients	10/06/2020	**Nestlé** takes over the US collagen manufacturer **Vital Proteins**	616
	19/05/2020	**The Firmanent Group, Sweat Equities** and investors acquire **Citrus Extract**	n/a
	09/04/2020	**Ingredion** acquires 75% of PureCircle, a manufacturer of stevia-based sweeteners	288
Other	27/04/2020	**Altair** fund acquires **Wildtree,** a meal replacement specialist	n/a

Source: Unigrains based on Merger Market and press; the dates provided are the dates on which transactions were announced

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