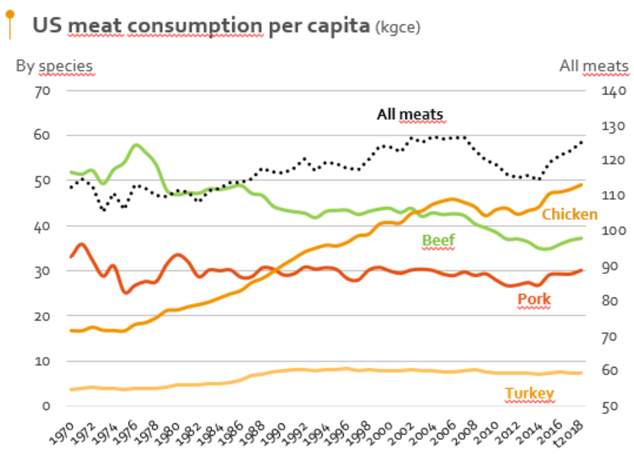
US food market

Unigrains' point of view on the quarter's key events

In focus: meat consumption back on the rise



Source : Unigrains based on USDA ; kgce : kg carcass equivalent
USDA forecast for 2018 at 18/09/18

While more and more initiatives are being taken to offer consumers alternatives to animal proteins, US meat consumption per capita has bounced back since 2015. The US Department of Agriculture (USDA) expects consumption to reach 125 kg/inhabitant (carcass equivalent) in 2018, i.e. a level very close to that of the historical highs of the mid-2000s.

Chicken meat, which recorded continuous growth until the mid-2000s, is the biggest contributor to this rebound, but there is also a rise in pork and a recovery in beef consumption.

This rebound is part of a positive trend for protein consumption, in a context of high production. US meat production is set to top 100m lb (454 Mt) for the first time in 2018.

Fabrice Pasquinelli, Senior Adviser, Unigrains North America

"Meat consumption is driven by rising purchasing power and good consumer perception in terms of health benefits"

The US meat market is currently in a traditional cycle of abundant supply and low prices. Regarding consumption, three important points are worth noting:

1- The correlation between GDP and meat consumption. The United States are currently enjoying strong growth and full employment, translating into greater household purchasing power.

2- American consumers' perception of meat in terms of health benefits. Poultry has a good image and chicken consumption has been rising constantly for several years. Regarding beef, the perception of a an unhealthy or even carcinogenic meat is increasingly questioned by new scientific studies.

3- The meat sector is getting ready to address the new trends for "plant-based protein" and "clean meat" (laboratory-grown meat). Both of these sectors have come under criticism for risking to generate confusion about products. Back on 28 August, Missouri was the first US state to pass a law prohibiting the use of the term "meat" on the packaging of plant- or laboratory-based food products, under penalty of fines. The packaging must indicate that the product is "made from plants" or "grown in a lab".

Ben Zaitz, President of B. Zaitz & Sons, LLC, US family office specialised in agribusiness

"The meat sector continues to be seen as a stable place to find growth and returns here in the US"

On the supply side, there has been a lot of activity in the bovine meat sector. A significant portion of the conventional cattle finishing business has changed hands since 2017 to ownership outside the cattle industry.

Green Plains Ethanol has bought Cargill's feedlots and Bartlet Grain feedyards. Also JBS feedlots has been acquired by Pinnacle Asset Management. These sales likely indicate that cattle feeding offers stable reasonable returns for investors.

The "all natural" (without artificial additives) and "grass fed" sectors continue to grow at over 5% per year as consumers shift towards more sustainable - humane production practices and seek healthy meat alternatives. Further several small private equity deals in the "all natural" space have been closed as well.

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B. Zaitz & Sons has invested in Greenhaven Cattle. Whereas virtually all of the cattle born on the East Coast are shipped 1,500 miles West to be finished in the feedlots of the high plains (notably Texas, Kansas and Oklahoma), and then shipped back to the East Coast population centres, this company decided to base its activities in Georgia. In doing so, Greenhaven not only created a logistical advantage, but benefits from the moderate Southeastern climate and plentiful water for irrigation. Greenhaven is able to feed cattle on grass 12 months of the year, producing high quality grass-fed beef.

Key events of the last quarter

Consumption

Meat products, eggs and butter among the biggest increases in US retail sales

Recently released IRI data on retail food sales in the United States illustrate two current trends, towards animal protein and towards less-processed foods. These data also confirm robust butter consumption.

Results in value over 12 months at 20/05/18 (all channels combined):

- Animal products: +11.8% for eggs in shell, +9.4% for fresh and frozen meat, +7.9% for breakfast meat products and +6.4% for butter.
- Other categories stood out for their strong performances: frozen soups (+18%), meal trays (+13.5%), dips (+13%), starters (+12.7%), tea/coffee (+11.4%), rice cakes and popcorn (+9.5%) and bottled water (+5.9%).

Conversely, the categories that recorded the sharpest declines were frozen infant nutrition products (-61%), food supplements for weight loss (-14%), speciality nutritional bars (-12%) and meal replacement bars (-10%).

The growth rates as reported need however to be put into perspective with the size of the market and price effects.

Retail sales of vegetable meat substitutes are on the rise, but remain very limited

Meat substitutes recorded significant growth: retail sales were up 17% over the 12 months to 11 August 2018 (source: Nielsen/The Good Food Institute), but only accounted for 1% of meat sales, with sales of $3.7 billion. In order to win over more customers, manufacturers are increasingly using the term "plant-based" instead of "vegan" or "vegetarian".

By company, Beyond Meat recorded the strongest growth (+70% over one year), ahead of Field Roast (+68%), Gardein (+51%), Dr. Praeger's (+44%) and Quorn (31%).

Booming demand for craft spirits

The vogue for craft drinks started with beer, which now accounts for one quarter of sales in value in this market. The trend is also spreading to spirits. Technavio expects the US market for craft spirits (mainly whisky, gin and vodka) to grow 26% per annum between 2018 and 2022 to $11 billion. These markets are driven by demand from millennials (Generation Y, birth years ranging between 1980 and 2000) and Generation Xers (birth years ranging between the mid-1960s and the end of the 1970s).

Retail

Walmart: 25% market share in the US food market

In its last quarter to 31 July, Walmart recorded its sharpest revenue growth in nine years. The brand achieves 25% of retail food sales in the United States (an $800 billion market), compared with 2% for Amazon. Food products accounted for 56% of Walmart's sales in 2017.

Walmart is moving into home delivery and pick-up points

In parallel, Walmart is accelerating the development of its home delivery service and now covers 100 cities, compared with 50 for Target, 30 for Amazon Fresh and 10 for Whole Foods (for Prime customers). Walmart is also developing store pick-up for orders placed online: 1,800 stores with pick-up points to date, against 1,000 for Kroger. Amazon has just launched this service in two Whole Foods stores. Aldi is also setting up in this segment.

Amazon: 18% of online grocery sales in the US

Amazon remains the clear leader in online grocery sales in the United States. According to One Click Retail, its market share reached 18% in the second quarter of 2018 with sales of $650 million (+40% over one year). Amazon's market share is double that of Walmart, the number two.

Sales are dominated by coffee ($135 million over the period), ahead of Soylent food substitutes. Bottled water sales were up 65%, outstripping energy drinks. Sales reached $75 million for snacks (+45%), $50 million for bakery and pastry (+41%), $40 million for confectionery (+36%), $35 million for hot drinks excluding coffee (+58%), and $35 million for baby food (+20%).

One year after the takeover by Amazon, what has changed at Whole Foods?

The transformations carried out at Whole Foods (WF) had three main objectives:

- Improve the efficiency of the supply chain: re-centralisation of purchases, reduction in supplier numbers.
- Restore pricing image: mainly via mega-promotions on selected bestsellers.That said, WF is still more expensive than its competitors on the whole.
- Develop synergies with Amazon: roll-out of Prime loyalty programme at WF, *365 Everyday Value* private label products listed on Amazon. Also in terms of logistics: Amazon uses WF stores as a basis for pick-up lockers and to roll out its express delivery service (still limited to a few cities at this stage).

Amazon’s takeover of WF also led to a significant acceleration of the digital transformation of physical retail leaders (Walmart, Kroger, amongst others).

Aldi is gaining ground in the war between retailers

Another trend worth noting in US retail is hard discount. Aldi stands out by its dynamism and is attracting consumers. Almost one in every five Americans who recently changed to a different retailer reportedly chose Aldi (Morgan Stanley study). Aldi only has a market share of 2% to 3%, but it is putting pressure on prices.

Aldi has an ambitious growth plan for its supermarket network (+700 outlets over 4 years to 2,500 stores). The product range, which comprises 90% of private label products, will be extended by 20% (to include more organic and vegetarian products). Aldi is also stepping up the roll-out of its home delivery service in partnership with Instacart (35 states/75 major cities will be covered in time for Thanksgiving).

Industry

Soft drink giants are investing in beverages that are more in line with consumer trends

In the United States, retail sales for soft drinks have been declining for 13 years and have been overtaken by mineral water (in volume) since 2016. This situation is driving soft drink giants to reposition themselves in beverages that are more in tune with consumer trends.

On 20 August, PepsiCo announced it was acquiring SodaStream, the manufacturer of a home sparkling water maker. The group paid $3.2 billion for this acquisition, a very high valuation of 30.6x 2017 EBITDA.

Right after, on 31 August, Coca Cola announced its acquisition of British chain Costa Coffee for £3.9 billion; Costa Coffee is the world 2nd-largest global coffeehouse chain behind Starbucks, but is not yet present in North America.

The most recent transaction was Keurig Dr Pepper’s takeover of premium water brand Core for $525 million. Dr Pepper already managed two thirds of the distribution of Core products in the US.

Tyson acquires Keystone (processed poultry products for the fast food industry)

The Brazilian meat group Marfrig had announced the sale of its subsidiary Keystone, and Tyson looked to be one of the most serious candidates. The transaction was announced on 20 August, for an enterprise value of $2.5 billion (11x EBITDA).

Based in Pennsylvania, Keystone supplies processed products (mainly poultry) to the fast food industry, notably McDonald's. It has industrial presence in the United States, China, South Korea, Malaysia, Thailand and Australia. Keystone’s revenue reached $2.5 billion in 2017/18, 65% of which was generated in the US.

With this deal, Tyson is strengthening its presence in Asia-Pacific and its positioning in fast food, while Marfrig is refocusing on beef, in which it has become the world number two (in terms of slaughter capacity) since its acquisition of 51% of US producer National Beef in June 2018.

Campbell's Soup sells fresh produce division

Campbell's Soup announces strategic shift. The group is selling its fresh produce division (Bolthouse Farms, Garden Fresh Gourmet) and its international brands Arnott's and Kelsen, representing $2.1 billion in revenue (FY 2018) for consolidated revenue of $8.67 billion.

These brands were part of the group's strategy to reposition itself in products with a healthier image. The results deteriorated, however, leading to the ousting of Campbell's CEO in May and the announcement of a thorough review of the strategy. The group is now refocusing its business on canned soups and snacks.

Regulation

Draft regulation on the labelling of plant alternatives to dairy products

The FDA announced that it would review the labelling of products positioned as alternatives to dairy products. The agency initially launched a public consultation to evaluate consumers' level of understanding and assess the risks of confusion that could lead to a public health problem.

Draft regulation on labelling GMOs as an ingredient

The USDA is working on a regulation on labelling GMOs as an ingredient.

Back in May, the agency published a draft and issued a request for public comments, which ended in early July.

Main deals of the last quarter

Main transactions involving targets in the United States in the last three months
Transaction value expressed in €m and in EBITDA multiples

Sector	Date	Transaction	Value
Bakery products	09/08/2018	**Tyson** sells **TNT Crust** (pizza dough) to US private equity firm Peak Rock Capital	n/a
	09/08/2018	**Olympus Partners** fund acquires **Rise Baking Company** from Arbor Private Invest fund	n/a
	01/08/2018	**San Francisco Equity Partners** fund acquires **Brazi Bites** (Brazilian cheese bread)	n/a
	09/07/2018	**Brynwood** (US fund) acquires **JM Smucker**'s pastry & bakery business (except Canada)	n/a
	06/08/2018	**C.H. Guenther & Son** acquires cookie manufacturer **Cookietree**	n/a
	20/07/2018	**Krispy Kreme Doughnut** acquires cookie manufacturer **Insomnia Cookies**	n/a
Snacks	12/09/2018	**Hershey** acquires snack manufacturer **Pirate Brands** from B&G Foods	362
Pasta	02/08/2018	**THL Equity** fund acquires **Dakota Growers Pasta Company** (dried pasta)	215
Meat	20/08/2018	**Tyson** acquires **Keystone** (processed poultry products for foodservice)	2,100 (11x)
		Indiana Packers Corp (Mitsubishi) acquires **Specialty FoodsGroup** (delicatessen)	23
Beverages	20/08/2018	**PespsiCo** acquires **SodaStream** (manufacturer of home sparkling water maker)	2,774 (30.6x)
	14/08/2018	**Coca Cola** acquires stake in **Bodyarmor** (sports drinks)	n/a
	27/09/2018	**Keurig Dr Pepper** acquires premium water brand **Core**	449
Foodservice	02/07/2018	**Elior** acquires **Bateman Community Living** (ready-made meals), US subsidiary of Compass	n/a
Retail	26/07/2018	Wholesaler **UNFI** acquires **Supervalu** (wholesaler and supermarket chain)	2,409 (7.2x)

Source: Unigrains from MergerMarket and press

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