Bakery bites: Looking back and looking ahead

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With the holiday season officially over, we look back at the main developments in US bakery in 2023 and speculate on what to expect in the new year. We see the industry is in better shape now than a year ago, mostly due to lower commodities prices, restored margins, and boosted knowledge of how to navigate a volatile environment. The recent drop in volume remains worrisome and is likely to be the main point of attention for bakeries in the new year. On a positive note, we expect a more stable environment for commodities and limited supply chain constraints in the year ahead that, in addition to improved margins, should create room for promotional activity to restore volumes.

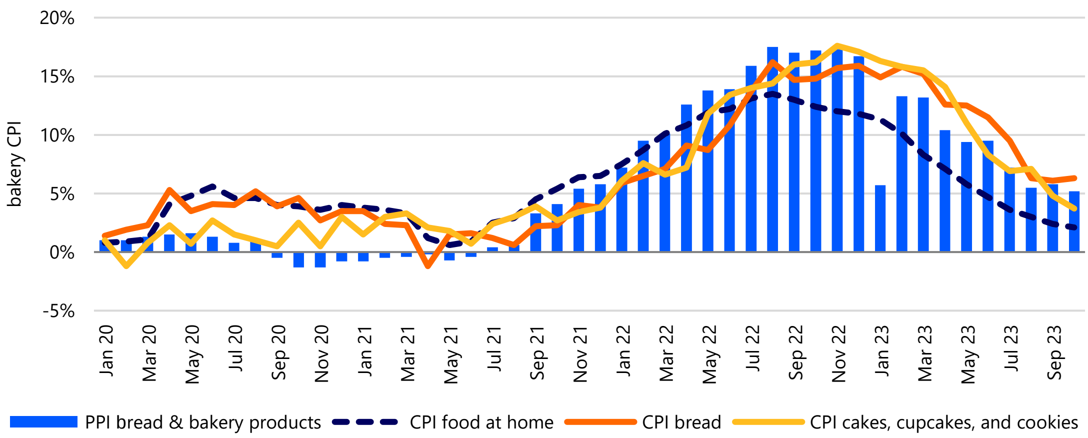
Prices up, volume down

Volume in most bakery retail categories is lower than it was in the previous year. This is somewhat expected, as 2023 was the true post-pandemic year with a fully open economy and no major new Covid variant affecting Americans' traveling and eating-out routines. Moreover, a sharp increase in prices is likely to have contributed to lower total demanded volumes.

Volume contractions have been a reality throughout most consumer goods categories, from food to cleaning supplies. Bakery inflation reached double digits in the second half of 2022 and has stayed materially above the food consumer price index (CPI) since then. However, as bakery is a basic-need product, we should expect a reduced impact on the final demand. According to Circana, volumes for selected bakery categories in the retail channel were down 2.7% YOY in the first 11 months of 2023, with average prices 10.6% higher.

The following graph shows a fair correlation between the bakery CPI and producer price index (PPI), making the case that raising prices was a necessary measure to catch up with increasing costs, especially after February 2022 when the war in Ukraine led to a surge in wheat and energy prices.

Figure 1: Bakery inflation (CPI) has stayed materially above food-at-home inflation and correlated with PPI



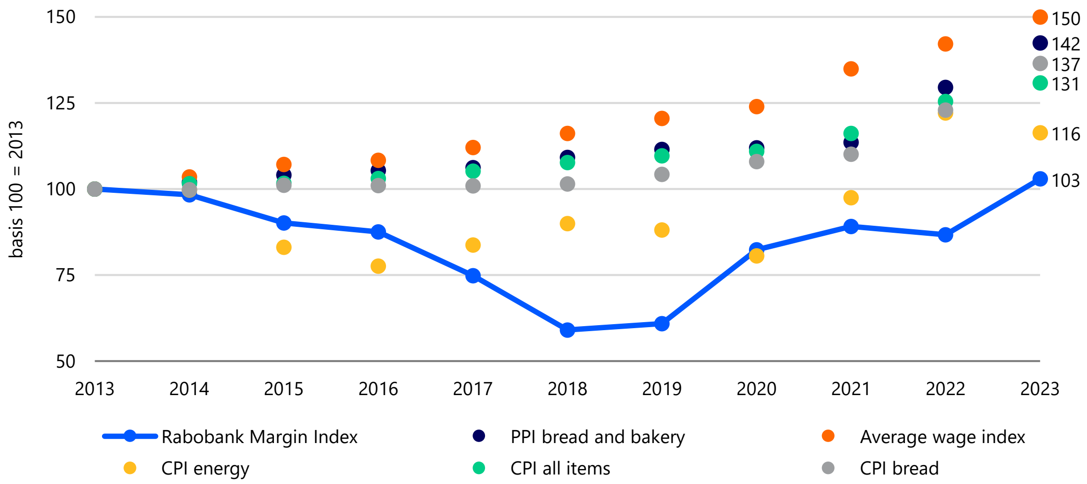
Source: US Bureau of Labor Statistics, Rabobank 2023

Margins restored

Recent price increases have likely helped restore historical EBITDA margins for breadmaking, despite loss in volumes and overall efficiency. Pressure on margins didn't start when the first Russian missile hit Ukrainian soil. Bakeries suffered from rising costs and difficulty in adjusting prices accordingly for many years before the war and the pandemic. Looking back at the past 10 years, we see that margins have consistently dropped following natural price increases in main inputs – most notably labor in the post-financial crisis economic boom. Bread CPI remained missing in action vis-à-vis input increases, as volumes were flattish. There was not much room for price increases in an environment where retail volume was flat and consumers were shifting more spending toward food away from home. Most bakeries focused then on value-adding to contour dropping margins and sluggish volumes.

Besides boosting demand, the Covid-19 pandemic also represented a major change on the operational side, by improving running rates and reducing merchandise returns that contributed positively to the bottom line. Margins partially gave back as volumes returned to more normal levels and following a surge in main bakery commodities prices in 2022. Higher pricing activity since mid-2022 has allowed a catch-up with increasing costs and restored margins to 10-year highs, as estimated in the RaboBakery Margin Index[1] below.

Figure 2: RaboBakery Margin Index: Pricing has restored breadmaking margins as most inputs continued to rise



Source: Rabobank's own calculation using a variety of publicly available sources, including US Bureau of Labor Statistics and US Social Security.

Happier new year!

We can say we enter 2024 in a better shape as an industry. Wheat and energy prices have eased, and consumers have taken higher pricing, which has supported COGS and restored margins. But equally important is that the industry has learned its lessons. The last comparable inflation event took place over 40 years ago, which means a whole new generation had to face successive price renegotiations and uncertainties for the first time in their lives and careers.

[1] The RaboBakery Margin Index considers historical bread volume and average selling prices. It is not representative of the performance of any company and cannot be related to specific players, as portfolios, pricing, cost structure, geographies, and client base vary enormously. It is meant to illustrate year-over-year changes in cost and rentability on an average basis for reference purposes only.

Throughout the many conversations we had with bakers and at conferences we attended this year, it became noticeable that there was a consistent easing of supply chain issues – namely, the availability of packaging, ingredients, and truck drivers – that used to be the main talking point at bakery forums in the past two years. After a turbulent 2020-2023 period, we now see bakeries talking about the future and planning ahead.

There are still many challenges out there, from labor availability to changeable consumer preferences for baked goods and brands. They say a smooth sea doesn't make skilled sailors; in that same vein, bakers now benefit from hands-on expertise to navigate upcoming storms, as the past struggles and price volatility have made bakers even better at planning production and procurement.

Looking at 2024, bakers have likely listed restoring volumes while keeping current pricing and margins as one of their New Year's resolutions. Improved margins and dropping commodities prices are likely to allow promotional activity aimed at the bargain-focused shopper – a group that has only expanded. Even as inflation eases, compressed discretionary income remains, and high consumer debt and the grim economy are likely to keep consumers cautious with spending in the year ahead.

Still, on the macroeconomic side, upcoming developments remain uncertain, as high interest rates have started doing their job of slowing economic activity down, with effects from the higher cost of borrowing still to be felt along the new year. Resilient economic indicators in the US (namely, gross domestic product, employment, consumer spending) and, more recently, the end of the interest rates hiking cycle (even cuts forecast in 2024[2]) dispel fears of a massive or abrupt economic slowdown to the point it could materially affect demand for food staples such as baked goods. Tighter discretionary spending could drive up demand by favoring food at home at the expense of eating out.

The effects of a slower global economy are already being felt positively on the cost side. Our 2024 outlook for agricultural commodity markets estimates that food commodity prices – namely, sugar, coffee, corn, and soybeans – will normalize somewhat in 2024 as strong supply meets weak demand from international markets. For wheat, it remains a bit more unclear, as it will depend on the developments of the war in Ukraine and Russian export restrictions; it is unlikely, though, that we will go back to the highs seen in the past years. We recommend listening to our latest Consumer Foods-to-Go podcast episode with Rabobank's Head of Agri Commodity Markets Research to discuss the outlook for key crops in 2024.

Over the past 12 months, the performance of different agri commodity markets has been extreme, with wheat down ~24% in the past year, while soft commodities – namely, sugar, cocoa, and coffee – were 26% to 96% higher in the same period (see breakdown in figure 3). These soft commodities are associated with higher-value products, which might feel some relief in an economic slowdown, positively impacting sweet baked goods producers from a cost perspective (assuming no major weather impact in crucial producing areas). The main takeaway is that volatility is likely to be lower – also helped by higher final stocks of commodities – allowing better cost management, strategic pricing, and promotional activities.

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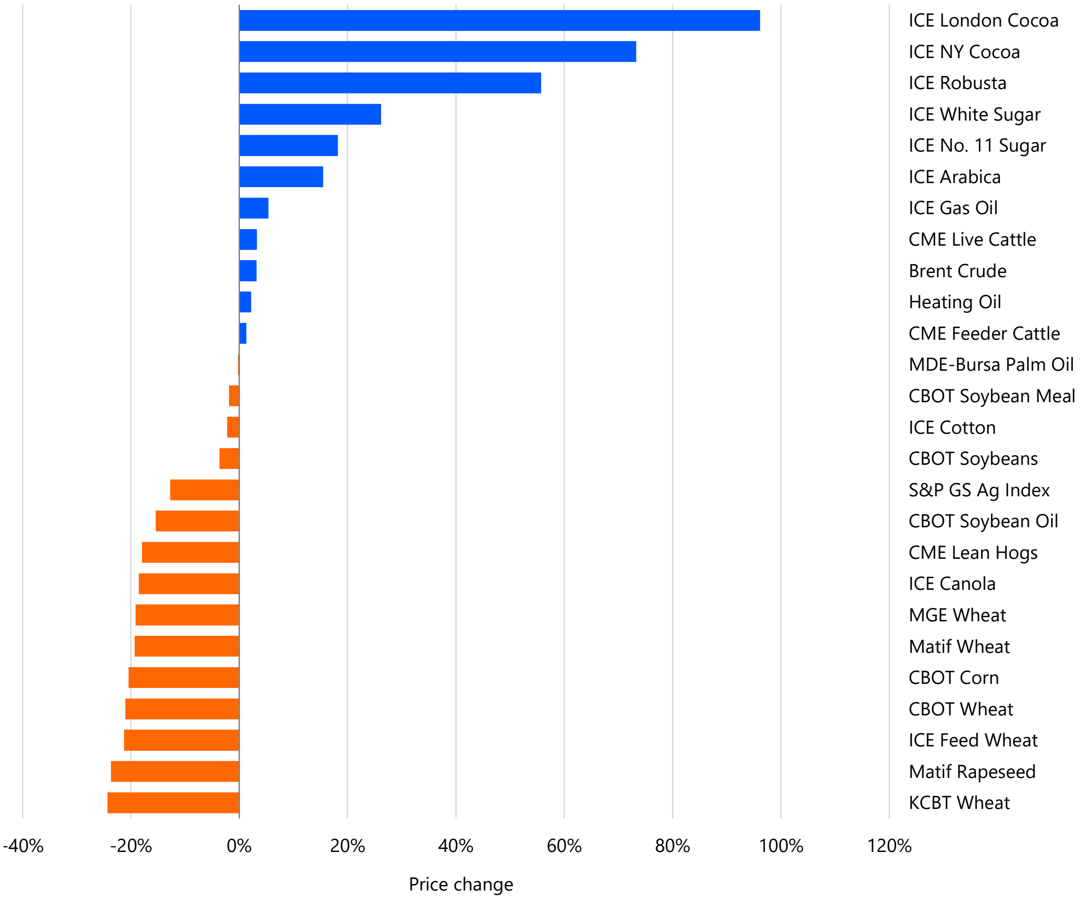
[2] Rabobank estimates the Federal Reserve will start cutting rates by mid-2024 as a reaction to mild recession, reducing policy rates by 75bp before the end of the year.

Figure 3: Price changes, Dec 18, 2023 vs. Dec 18, 2022



Source: Bloomberg, Rabobank 2023

Besides agri commodities, other relevant costs for bakeries, including wages, transportation, and real estate, remain on the rise, with no sign of easing forecast. An economic slowdown might also help to relieve pressures on the labor and energy fronts.

Besides pricing and costs, bakeries should remain attentive to new consumer preferences. Consumers have tried private label and different brands in search of value; in some cases, they have upgraded to premium products – such as brioche and artisan bread – to offset less frequent dining out. Bakery-savvy and indulgence-seeking consumers will continue to search for the next greatest thing and pay the extra dollar for it. Recent M&A activity from top US bakeries in the field of premium products and foodservice, in addition to overall footprint expansion – adding things like brioches or Uncrustables – supports the trend of value-adding strategies remaining in place despite the uncertain economic scenario.

Consumers have also changed where and when they shop. The saving spree has favored discounters (such as Aldi and Lidl), wholesale clubs (Costco and Sam's Club, for instance), and – more surprisingly – online groceries. We believe these trends – that received tailwinds from the pandemic and inflation but proved not to be a pandemic fad – are poised to gain further market share and re-shift the retail landscape permanently, resulting in increased consumer exposure to private label and impacting shopping frequency and impulsive buying.

All those factors are already shaping the bakery business of 2024, which is far from being a return to pre-pandemic preferences or cost structures. As we remain optimistic about a more normal environment than the turbulent 2020-2023 period, bakeries will be able to focus further on business opportunities and plan for the longer term with (a bit) more certainty.

Imprint

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