Rabobank

# Talking Points: 22 Months and Counting

## *Evolving Themes*

*RaboResearch*
Food & Agribusiness
far.rabobank.com

Nicholas Fereday
Executive Director
+1 347 215 4158

**Contents**

1. Remember When? – Some of Those Pre-Covid Drivers Remain Highly Relevant 1
2. Three Enduring Habits – Food E-commerce, Working (and Eating More) From Home, and ESG Issues Are All Pandemic 'Winners' 2
3. Myriad Macro Pressures – Inflation, Labor, and Supply Chains Are Adding Another Layer of Complexity to Our World 3
4. The Future of Packaged Foods – Reasons to Be Optimistic 3

## Summary

In this end-of-year note, let me share some of the recurring topics that my colleagues and I have been discussing with our clients and networks. The themes will be familiar to you all, and like something else we know, have evolved (mutated?) over the past 22 months of this pandemic.

1. Remember When? – Some of Those Pre-Covid Drivers Remain Highly Relevant
2. Three Enduring Habits – Food E-commerce, Working (and Eating More) From Home, and ESG Issues Are All Pandemic 'Winners'
3. Myriad Macro Pressures – Inflation, Labor, and Supply Chains are Adding Another Layer of Complexity to Our World
4. The Future of Packaged Food – Reasons to Be Optimistic

## 1. Remember When? – Some of Those Pre-Covid Drivers Remain Highly Relevant

Let's not get too teary eyed here, but often in many of our discussions this year, it didn't hurt to begin with a little reflection and perspective. Back in those carefree pre-Covid days of 2019, some of the issues were:

- the rapid pace of change, such as the rise of all those fast-growing emerging brands stealing market share from big food companies;
- the changing retail landscape – from Amazon to omnichannel – as retailers explored new routes to the consumer;
- the changing tastes of consumers looking for fresh, natural, gluten-free, more snacking options, more personalization, more convenience, and let's not forget clean labels;
- and the way that all of these were accelerated by the rise of social media, from Facebook to Instagram to TikTok.

We also talked about how the future was going to be flexitarian as many (especially the media and billionaires) fell in love with plant-based foods, with companies such as Impossible Foods, Beyond Meat, and Oatly leading the charge. At the time, we also reflected on how many of these developments were bad news for the large US food companies who had been struggling to reconnect with consumers for some time. After an expedition into private-equity-inspired cost cutting, the big players had returned to focusing on growing the business. We talked about how some companies – as part of their attempts to reconnect – were focusing on their purpose, their mission.

When you look back, it is interesting to see how some of these talking points now look out of date. It is almost quaint to think we thought the food universe was changing rapidly in 2019, compared to the acceleration in change we have witnessed in the last two years. Similarly, the excitement of all things plant-based has, in recent months, fallen flat and left companies scratching their heads as to what is going wrong. Consumer interest appears to be more fickle than first thought, even at a time when sustainability issues are top of mind for many consumers. But some trends have remained relevant and accelerated, as we show in the next section.

## 2. Three Enduring Habits – Food E-commerce, Working (and Eating More) From Home, and ESG Issues Are All Pandemic 'Winners'

Fast forwarding, let's focus on three food-related pandemic trends that appear to have some stickiness to them, a question that food companies continue to obsess about. While many consumers have regretted some of those pandemic purchases – from Pelotons to bread makers to hot tubs – here are three food-related trends that will outlive the pandemic.

First, **food has finally found its relevance in e-commerce.** Once a laggard, food has had a step-change increase in demand where the pandemic accelerated the adoption curve of food e-commerce. We believe the genie likely won't go back in the bottle. In the UK, for example, Covid led to a doubling in food sales, from 5% to 10%. And in the US, according to Brick Meets Click, we are averaging about USD 8bn sales/month compared to just USD 2bn/month back in 2019. The latest development in the reinvention of grocery shopping has been the rise in 10- to 15-minute grocery delivery for the 'I want it now crowd' by cool-sounding companies such as Getir, Jokr, Gorillas, and Fridge No More. These new upstarts with billion-dollar valuations aim to replace convenience stores with delivery drivers and dark stores. It's a far cry from the start of the pandemic when we were all pantry stocking so we would never run out of anything ever again!

And it's not just how we shop and purchase food. The second winning habit is home-centricity: how the **center of gravity of where we consume food has shifted back toward the home**. We hear lots of justifications from food companies using arguments about how millions of us have learned to cook; how we have just been through the mother of all sampling events; how it is way more affordable (eating out is typically two to three times more expensive); and how we're doing all that Netflix snacking. But of course, the big one is that many white-collar workers will continue to have the flexibility to work from home. Occupancy rates in offices in the major US cities are still at about one-third pre-pandemic levels and a recent Gallup survey found that 45% of full-time workers were remote for at least some of the week. Yes, we are out and about more, and back eating at restaurants, but some of those Covid habits around 'healthier' home cooking, home delivery, and Netflix snacking have proven more convenient that we thought. In short, we are not just spending our food dollar like we did before: over half of it is now being consumed back in the home. Even just one day working from home is, what, a 20% drop in volume? One day of not getting your coffee to go, one trip less to the sandwich shop or canteen. I don't think many of us expected to be largely remote 21 months into this pandemic.

The third point is how **ESG issues such as sustainability and environmental impact have remained center stage for consumers**. The continued focus on purpose-related themes such as ESG issues is despite, or perhaps because of, impossible-to-ignore catalytic events like the global pandemic and Black Lives Matter. Major food companies are increasingly placing importance on ESG practices – with corporations like Nestlé, Danone, and McDonald's deeming them necessary to meet the demands of today's consumers and workers. For many companies, it is the right thing to do from a societal perspective. But it is increasingly also a license to operate and even a competitive advantage, an opportunity. However, as more companies commit to similar aims such as net-zero targets (typically, 2050), how do you stand out? Is it just, as has always been the case, by your company's performance? Companies are, after all, at pains to stress to their shareholders that such goals are compatible with growth. Laurent Freixe, Head of Zone Americas at Nestlé, has talked about "transforming as we are performing" by focusing on key growth areas where sustainability was integral to their growth strategy. Public companies need to walk the talk on both mission and profits.

## 3. Myriad Macro Pressures – Inflation, Labor, and Supply Chains Are Adding Another Layer of Complexity to Our World

A third area of discussion my colleagues and I have spoken a lot about is the wider macro environment that has (in addition to the ESG concerns mentioned above) increasingly encroached into the world of food in a way we haven't witnessed in a long time. Or to put it another way, there are a whole host of issues that were to varying degrees taken for granted, and are now increasingly taking up management's time, adding more pressure and further layers of complexity to their decision making. These include issues such as supply chain bottlenecks and labor shortages. These topics have consumed big food companies and their CEOs (with mentions of supply chain issues by chief executives jumping 412% from 2020 to 2021, according to Reuters) and been on full display for consumers. 'Striketober' morphed into 'Strikesgiving' as consumers questioned major food companies' practices on worker safety and well-being.

And then there is inflation, which is currently at a four-decade high, almost touching 7% over the last year, and has been a talking point throughout. Recall, this time last year the Fed was forecasting 1.8% inflation for 2021, then upped it to 2.4% in March. We are now shy of triple that level. While we can argue about what supply and demand factors are driving this, it is equally important to think about where consumers' heads are right now. After all, consumer expenditure drives almost 70% of GDP in the US: USD 16 trillion out of USD 23 trillion. Inflation is having, and will continue to have, a massive effect on consumer confidence and what they choose to do with their pocketbooks and wallets.

According to the University of Michigan, consumer sentiment has been stuck for the last few months at levels comparable to the pandemic lows of April 2020 where "higher income and receding covid has been offset by higher rates of inflation and falling confidence in government policy." A recent Gallup poll found 68% of people said they felt the economy was getting worse. But perhaps Bloomberg captured it best: "Why are Americans so grumpy about their economic boom?" For now, consumers continue to spend, but if they do pull back, demand will be sucked out of the economy. It is hardly surprising that food companies have been talking about input cost inflation (from freight, labor, energy, and commodity prices) and expecting it to remain in the mid to high single digits and squeeze their margins. And companies are raising prices (repeatedly) and passing costs on to consumers when they cannot absorb them themselves. We saw consumers embrace legacy comfort brands (a boon to big food) throughout the pandemic, and that trend may continue as wallets remain squeezed and they choose price over other product attributes.

## 4. The Future of Packaged Foods – Reasons to Be Optimistic

Let's end with a biggie. Ever the optimist(s), during our discussions this year, we argued that the future of packaged food and beverages looks a lot less gloomy than it did back in 2019. The pandemic has provided companies a unique opportunity to reimagine their future. Let's acknowledge that for packaged food companies 2020 was like nothing they had experienced in a decade. Recall at the start of 2020, before the pandemic began: the three-year-average sales growth of the largest-of-the-large publicly traded food companies in North America had been hovering at around zero.

Although none came close to the 38% growth in sales that Amazon experienced last year, looking back over the past decade, given that the sales of the US packaged food industry grew by about 10% last year, many of these companies have never had it so good. And to varying degrees, even by their latest quarterly results in 2021, many of the big CPGs are reporting results in Wallstreetese as, 'better than expected.' The latest grocery scanner data puts US packaged food sales up about 4% YOY, and up 6% where they were two years ago, with volume gains accounting for almost half of this growth. Through elevated consumer demand, food companies have reassessed the opportunities for many of their mainstream brands that they previously thought had little prospects for growth or relevance for consumers.

And let's not forget about emerging companies – like the ones we see at FoodBytes! These challenger brands have in the past chipped away at the bigger players' market share. For a host of reasons, including their speed to market, challengers have helped create new mainstream opportunities for packaged foods and beverages. Look at hard seltzers, for example. In less than five years, they have stolen 10% of the beer market's drinking occasions, proving there are still mainstream unmet needs out there. Turns out not everyone likes beer! Although the market has cooled somewhat, my colleague Jim Watson reminds me that, "the market will continue to be one of the strongest growth segments because the more gender-neutral and premium image need state that seltzers fulfil for non-beer drinkers are very much in play." See also the rediscovery of frozen foods propelled in part by the move of restaurant brands into the supermarket. And we already get a sense of where the next innovations are likely to come from as consumers look for less plastic and packaging in their foods, for example, or for foods that benefit the microbiome.

# Imprint

***RaboResearch***
Food & Agribusiness
far.rabobank.com

| | | |
|---|---|---|
| Nicholas Fereday | Executive Director | nicholas.fereday@rabobank.com<br>+1 347 215 4158 |