A.T. Kearney

hartman GROUP

Is Big Food in Trouble?

The industry's major players are struggling as smaller companies gain a competitive edge. Staying on top will require shifting the focus toward consumers' preference for "real" food.

Small Firms Taking a Bite Out of Market Share

Large food manufacturers are losing the growth game. The top 25 food manufacturers in the United States have ceded 300 basis points to small and medium-size competitors since 2012 and have grown revenue at 1.8 percent compared with 11 to 15 percent growth for the smaller companies. US consumers are voting with their wallets to leave the established large food companies. Changes in consumers' core values—amplified by social media, celebrity chefs, and a myriad of food experts—are rewarding small and medium-size companies with above-average growth and slowing the growth of the top 25 food and beverage (F&B) companies.[1]

The top 25 food manufacturers in the United States have grown revenue at **1.8 percent compared to 11–15 percent growth** for the smaller companies.

After decades of making food safer, more accessible, and more affordable, some of these large companies might not survive in this new "real" food marketplace. Forward-thinking firms will change direction to recapture lost share and return to a profitable growth trajectory.

Consumers' Growing Influence on Food

Today's consumers are more passionate about the food they eat, and their appetites are creating dynamic shifts in the grocery aisle. Viewpoints and products that once were the domain of co-ops and local health food stores have gone mainstream. The market has shifted from previous decades' focus on diet foods to a focus on real food as a way to maintain health. Most people now view food—particularly food with benefits—as the key to good health.[2] More foods are being launched that go beyond basic nutrition to support heart health, digestive health, and higher energy levels. Consumers are rewarding retailers that, by investing heavily in private-label lines, offer high-value products at lower prices than branded alternatives. They are embracing free-from segments (non-genetically modified, organic, and gluten-free), which collectively have a projected growth rate at a CAGR of 21 percent over the next five years. Fresh food departments and formats are growing in popularity at the expense of center store and processed foods. Locally sourced foods with a direct-to-consumer model are becoming more attractive; the demand for transparency in food sourcing, production, and labeling is gaining traction; and consumers are discovering novel, foreign ingredients such as quinoa. Figure 1 on page 2 highlights the trends that are roiling the branded marketplace.

A 2015 study by The Hartman Group indicates that for the first time, consumers believe their purchasing decisions have a much greater impact on society than their voting decisions or

[1] Food and beverage companies with annual revenue of more than $4 billion

[2] *Shopping for Health* study, *Organic Life* magazine, 2016

Figure 1

Changes in core consumer values are impacting the food landscape

Key trends to watch

Trend	Trend description	2015 size (billion)	CAGR	Threat
Functional	Demand for foods with added health benefits is increasing	**$98.0** (Global market)	**7%**[1]	
Private label	Private label sales are trending upward, particularly those with increased retailer investment	**$85.1** (US retail sales)	**5%**[2]	
Free-from	There is high growth in free-from market segments	**$61.8** (Sum of US non-GMO, organic, gluten-free)	**~21%**[3]	
Fresh	Demand for fresh foods is outpacing center store and processed foods	**$18.6** (Fresh format)	**12%**[4] (Fresh format)	

Trends for awareness

Trend	Trend description	2015 size (billion)	CAGR	Threat
Local	Local foods are seeing market growth, strong consumer preference, and increased investment	**$11.7** (US 2014)	**9%**[5]	
Transpa-rency	Consumers are demanding increased transparency into food production for safety, ethical, and religious reasons	**N/A**	**N/A**	
Discovery	Seeking new food experiences, consumers show increased demand for global ingredients and foods	**N/A**	**N/A**	

Note: CAGR values are from 2014–2019, except for Functional (2012–2017) and Local (2014–2018).

[1] Ken Research

[2] Statista

[3] Food Dive, Specialty Food Association, Nutrition Business Journal, Food Navigator, Statista

[4] Willard Bishop

[5] A.T. Kearney

Source: A.T. Kearney analysis

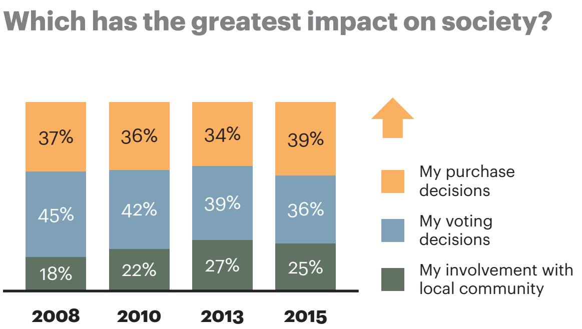
their involvement in their local community (see figure 2 on page 3).[3] Millennials and Gen Xers—significant consumers for future grocery sales—have especially strong feelings about the impact of their purchasing decisions.

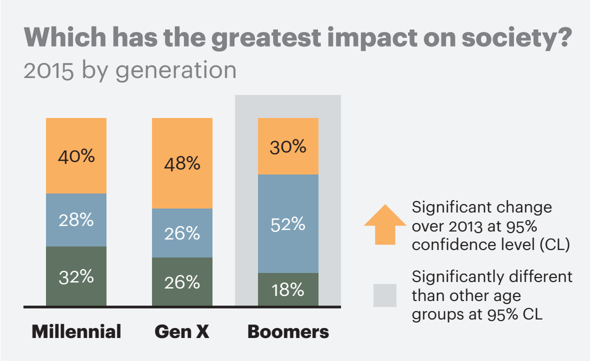
As consumers—led by Millennials and Gen Xers—continue the shift from a traditional production-driven food culture to a more modern demand-driven food culture, they will continue to press companies and retailers for more information and accountability about how ingredients are sourced and processed, how "real" their food products are, and how responsive they are to consumers' desire for choice and customization. This growing influence has major ramifications for the future of big food.

[3] Transparency 2015, The Hartman Group

Figure 2

Consumers now believe their purchasing decisions have a greater impact on society than their voting decisions





Base: All consumers, 2013 (n=1,841); 2015 (n=1,779); Core (n=243); Inner Mid-level (n=552); Outer Mid-level (n=490); Periphery (n=262); Millennial (n=480); Gen X (n=401); Boomers (n=898).

Source: A.T. Kearney analysis

Big Food: Bigger Issues

As a result of these trends, the top 25 US food manufacturers' share of US food and beverage retail sales has declined from 66 percent in 2012 to 63 percent in 2015.[4] While the overall market has grown 3.4 percent, the top 25 have shown a CAGR of only 1.8 percent over the past three years. Meanwhile, medium and small companies have driven market growth with 11 to 15 percent CAGR from 2012 to 2015 and $14 billion of added revenue, catching up with the big food companies that grew their total revenue by $16 billion over the same period (see figure 3 on page 4).[5]

Big food companies have been evaluating strategies, **improving their core businesses to accelerate growth.**

In addition to big food's loss of market share to small and medium-size companies, big-food earnings growth slowed to 4.8 percent from 2012 to 2015. During this same period, market capitalization has grown by 8.1 percent—begging the question of whether current valuations are sustainable and implying that the large food manufacturers need to step up top-line and earnings growth from current trajectories (see figure 4 on page 5). For many larger food companies, the declines are coming from their core businesses. With the market betting on future growth, big food companies have been evaluating strategies to improve their core businesses along with other options to accelerate growth.

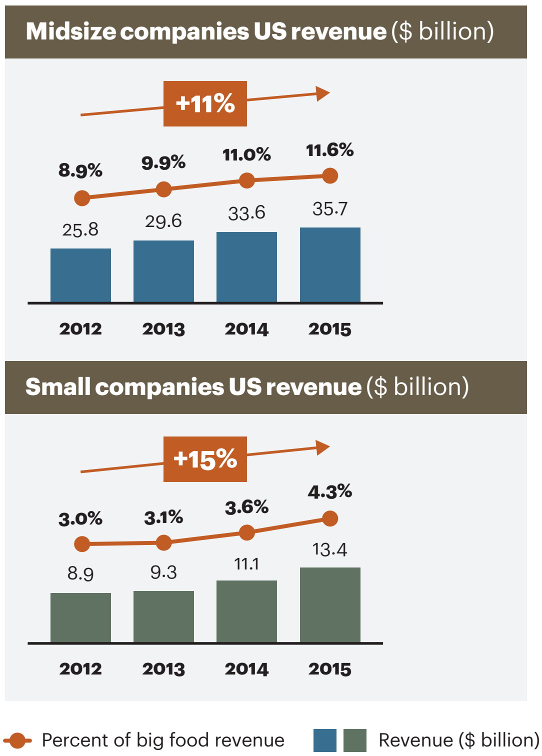
[4] Top 25 is based on revenue.

[5] Medium-size companies have $1 billion to $4 billion in annual revenue; small companies have $0.5 to $1 billion.

Figure 3

Small and midsize companies grew at 11–15 percent CAGR and added $14 billion in revenue over the past three years

Food manufacturer revenue ($ billion), ratio vs. big food by segment[1]



Additional notes

- Size definitions:
  - Small: Greater than $50 million and less than or equal to $1 billion in 2012 net sales (15 companies)
  - Midsize: Greater than $1 billion and less than or equal to $4 billion in 2012 net sales (12 companies)[2]
  - Big food: Greater than $4 billion in 2012 net sales (25 companies)
- Other:
  - 52 food and non-alcoholic beverage manufacturing companies have been sampled (25 big, 12 midsize, 15 small)
  - Between 2012 and 2015, sampled small and midsize companies captured $11 billion in market share from big food

[1] Data set consists of 12 midsize and 15 small food and non-alcoholic beverage companies.

[2] Foodprocessing.com Top 100 lists about 50 midsize companies, indicating about 24% coverage in sample.

Sources: Company annual reports and SEC Filings, Foodprocessing.com; A.T. Kearney analysis

Campaign for Sustainable Growth

Based on industry projections, big food can tap into a $70 billion opportunity in overall F&B market growth over the next three years. Recognizing slow growth in their core businesses and mounting pressure to align their brands with consumer tastes, big food companies need a systematic campaign to rebuild loyalty and win back consumers. They need to rigorously evaluate their portfolios, create strategies to reduce costs and enable investment in growth activities, pursue expansion into trending categories, and participate in joint ventures to nurture potential acquisitions. Recapturing profitable growth will hinge on finding the right mix of three strategies.

Strategy 1: Take advantage of cost take-out and divesture to enable investments in growth activities

In 2008, 3G Capital purchased Anheuser-Busch for $52 billion and used an aggressive approach to remove unnecessary costs. Some of the measures included slashing 1,400 jobs (75 percent of which were at the St. Louis headquarters), replacing existing management with external people,

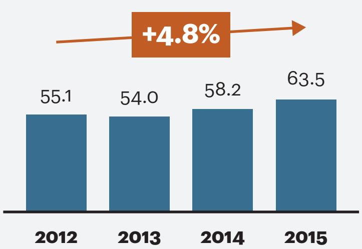
Figure 4

Market cap exceeded earnings growth for the top 25 producers, indicating overvaluation by investors

Food manufacturer EBITDA vs. market cap by segment[1]

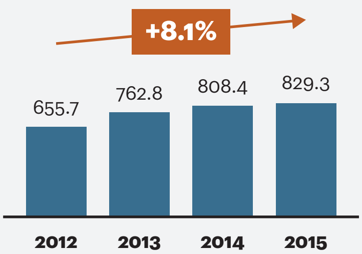
Top 25 Q1 EBITDA ($ billion) **segment**

Modest EBITDA growth of Top 25 at 4.8% does not justify growth in value



Top 25 Q1 market cap ($ billion) **segment[1]**

The Top 25 producers saw a corresponding 8.1% annual growth in value



[1] Does not include currently private companies (Mars, Bimbo Bakeries, Land O' Lakes, HJ Heinz, Kraft, Smithfield Foods) included in Top 25 sample

Sources: Yahoo Finance, annual reports; A.T. Kearney analysis

bringing in talent from 3G, implementing zero-based budgeting, and instilling a merit-based payment system that rewarded promising young people. The turnaround proved successful: Anheuser-Busch InBev's EBITDA increased by 31 percent, margins reached 39 percent (while SAB Miller was at 23 percent), and stock prices shot up by 150 percent.[6]

Venture funds allow F&B companies **to engage with entrepreneurs.**

Selected divestitures have enabled big food to refocus capital on promising growth opportunities. ConAgra, for example, divested its private-label business because of stagnant sales, which helped consolidate 32 manufacturing facilities, and the company will focus more on higher-margin businesses. General Mills divested Green Giant, a frozen and canned vegetable producer out of step with accelerating trends toward fresh foods and produce, and J.M. Smucker divested canned milk because of stagnant sales.

Strategy 2: Use controlled acquisitions of smaller, established players and external venture capital development to add trending categories to a portfolio

Controlled acquisitions could include one or two small public competitors with about $550 million in 2015 revenue and 7 percent CAGR until 2019, or two to three companies each with $250 million to $350 million in 2015 revenue and 13 percent CAGR until 2019. Examples include Kraft, Hillshire Brands, MOM Brands, Krave Jerky, and Applegate. Alternatively, companies can launch four

[6] EBITDA is earnings before interest, tax, depreciation, and amortization.

or five high-growth products (equivalent to $100 million valued start-up) with potential for 100 percent CAGR until 2019. Examples include Soylent, Quinn Popcorn, and WikiFoods.

Early this year, General Mills acquired EPIC Provisions, a two-year-old maker of bars and other snacks with meat in them. Prior to that, General Mills acquired Annie's for $820 million to expand its US natural and organic food category. In addition, the company has a new business development and venturing unit called 301 INC to provide capital, knowledge, and expertise to entrepreneurs and early-stage food companies. Investments have been focused on natural and organic foods. As a result, General Mills achieved 4.3 percent CAGR from 2011 to 2015, which is significantly above the big-food average. Today, the company has seven organic or natural brands with net sales that exceeded $570 million in fiscal 2015.

Strategy 3: Create venture funds to invest, seed, and grow nascent brands, products, and technologies that could position companies to take advantage of consumer trends with a lower entry cost

By creating a venture fund, F&B companies can engage with entrepreneurs whose ideas may be too risky for acquisition or who are uninterested in giving up complete control of their business. This also allows F&B companies to invest in promising start-ups early on rather than paying a hefty acquisition cost later. One good example is General Mill's acquisition of Annie's at a multiple of 27 times EBITDA where the industry norm is between eight and 10 times. Figure 5 shows the key start-up investments by large F&B companies' venture funds.

Figure 5

In efforts to create small-company growth prospects, many companies are looking to invest in new business models

Non-exhaustive

- Multiple food and beverage companies have created "venture funds" to invest, seed, and grow nascent brands, products, and technologies that could take advantage of trends
- Venture funds provide the opportunity to engage with an entrepreneur whose idea may be too risky for acquisition, or who is uninterested in giving up complete control of his or her business

	General Mills	Unilever	Coca-Cola
	301 Inc.	**Unilever ventures**	**Venture and emerging brands**
Investments	• **Rhythm Superfoods:** Nutrient-dense, real-food snacks (for example, Beet Chips, Broccoli Bites) • **Good Culture:** Organic cottage cheese • **Beyond Meat:** Plant-based protein snacks • **Tio Gazpacho:** Low-calorie, convenient cold soups	• **Froosh:** Leading premium smoothie brand in the Nordics • **Snog:** Premium frozen yogurt brand in UK • **HangYo (Indirect):** Regional ice cream and dairy in India • **SoBe V Water (Indirect):** UK's first natural vitamin water	• **Honest Tea:** Organic tea, lemonade, and sparkling soda • **Zico:** Coconut water • **Core Power:** High-protein milkshake with real filtered milk • **Suja:** Organic, non-GMO pressed juices • **Fairlife:** Ultra-filtered milk with 50% more protein than natural milk

Sources: General Mills, Unilever, Coca-Cola; A.T. Kearney analysis

Winning with Big Food

Over the past decade, acquisitions have been the primary means by which many F&B companies have attracted and retained consumers and quickly created value for shareholders (see figure 6).

Although many of these acquisitions have driven some top-line growth, they expanded large food manufacturers' scale in stagnant categories, not emerging ones. This relentless search for sustainable market-share growth will have winners and losers. Ultimately, the landscape of big food will change as there will not be enough large acquisition opportunities to keep investors happy. To succeed, larger F&B manufacturers need a focused acquisition strategy to expand into growth categories paired with a more robust internal innovation model.

With a focused strategy, big food can convince consumers to stay.

Along with M&A-driven growth, larger companies need to build their internal competencies in two ways. A **culture of innovation** enables a willingness to take risks and enter new categories or pursue novel ideas at leadership levels as well as throughout the organization.

Figure 6

Benchmarking accretive impact of acquisitions on earnings per share (EPS)

Acquirer	Target	Date	Expected EPS increase	Expected EPS accretive date	Acquisition type
Hormel	Applegate	July 2015	2015: Neutral 2016: +$0.07-0.08	FY 2016 (Year 2)	**Scope expansion**
Hershey's	Krave Jerky	January 2015	Likely short-term dilutive[1]	–	**Scope expansion**
Post	MOM Brands	January 2015	–	Immediate	**Scale expansion**
Heinz	Kraft	July 2015	2015: Neutral 2016: Neutral 2017: +$0.28[2]	FY 2017 (Year 2)	**Scale expansion**
General Mills	Annie's	September 2014	2014: Neutral 2015: +$0.01	FY 2015 (Year 1)	**Scope expansion**
Tyson	Hillshire Brands	August 2014	2014: Neutral 2015: +$0.17	FY 2015 (Year 1)	**Scale expansion**
ConAgra Foods	Bertolli	July 2012	2012: Neutral 2013: Neutral 2014: $0.05-0.07	FY 2014 (Year 2)	**Scale expansion**

[1] Estimated impact of acquisitions (Krave, Allan, Golden Monkey) is –$0.03-0.05

[2] EPS estimated to increase from 3.32 (FY 16) to 3.60 (FY 17) with accretive value being generated due to the merger

Sources: Broker reports, press releases; A.T. Kearney analysis

Financial forward-thinking helps build budgets based on future needs versus historical ones in order to cut unnecessary costs and drive growth along with willingness to sacrifice short-term high margins and return on investment to maintain share.

To win in this space, the large established food manufacturers will need to give consumers real reasons to remain loyal. This includes providing innovative products that meet consumers' needs, delivered when and where they shop and with transparency in sourcing, production, and marketing. With a focused strategy that balances strategic acquisitions and forward-thinking investments, big food can convince consumers to stay.

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About A.T. Kearney

A.T. Kearney is a leading global management consulting firm with offices in more than 40 countries. Since 1926, we have been trusted advisors to the world's foremost organizations. A.T. Kearney is a partner-owned firm, committed to helping clients achieve immediate impact and growing advantage on their most mission-critical issues. For more information, visit www.atkearney.com.

About The Hartman Group

For over 25 years, The Hartman Group has been a recognized thought leader on demand-side trends in the food industry. Our expertise ranges from how the smallest nuances of product design affect your product's ability to grow to devising portfolio strategies that maximize sustainable, demand-led growth. We have advised some of the world's largest food and beverage companies on issues of portfolio management, brand renovation, consumer insights and innovation. Our approach is always highly customized to each client's strategic interests and corporate culture.
For more information, visit www.hartman-group.com.

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