

Food & Beverage State of the Market

Summer 2024



Food & Beverage State of the Market: Summer 2024

As the first half of 2024 comes to a close, the *TM Capital Food & Beverage State of the Market* summarizes the key themes from recent discussions and public earnings calls. F&B brands and manufacturers have faced a myriad of challenges over the past several years, including surging inflation, rising commodity prices, labor shortages, and supply chain disruptions. Concurrently, consumers are dealing with high interest rates, depleted savings, higher housing costs, and mounting credit card debt. Food inflation has moderated over the last several quarters, but prices remain elevated relative to pre-pandemic levels and wage inflation has not kept pace.

This quarter, public F&B company executives highlighted:

- Ongoing pressures on lower-income consumers
- Moderating inflation for at-home food consumption
- Continued strength of private label and the better-for-you category
- A return to more normalized promotional activity levels albeit at higher price points, and
- An increasing pipeline of M&A activity

These dynamics underscore the complex landscape F&B companies continue to navigate to maintain growth and meet evolving consumer needs.

In this edition, we highlight current market perspectives from key food industry leaders, including:

Ryals McMullian
CEO & Chairman
Flowers Foods

Michele Buck
CEO & Chairman
The Hershey Company

Jeff Harmening
CEO & Chairman
General Mills

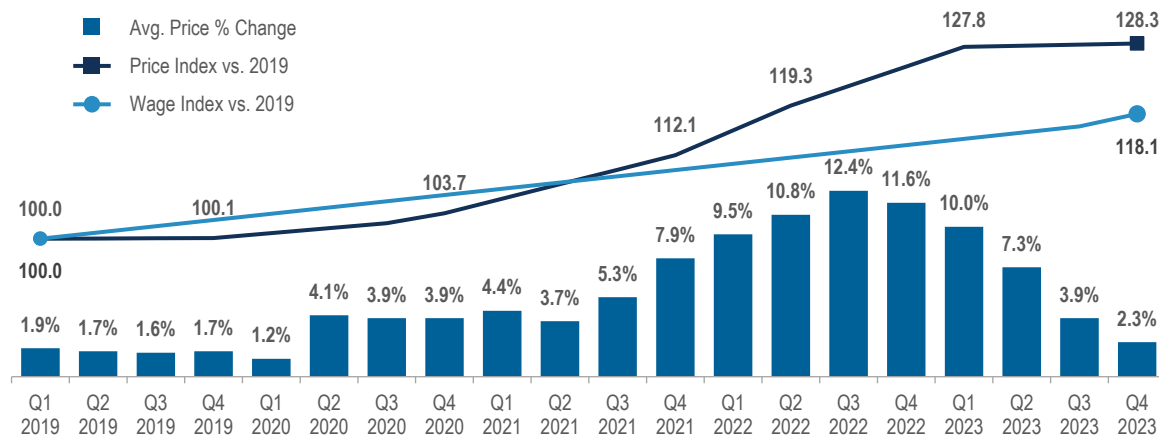
Luca Zaramella
CFO
Mondelez

Bifurcated Consumer Sentiment

During the most recent financial quarter, company executives noted that consumer sentiment has improved, but there is a clear divergence between lower and higher income cohorts, with brands and categories exposed to middle-lower income consumers showing continued weakness. These consumers are impacted by the Supplemental Nutrition Assistance Program (SNAP) benefit reductions last year on top of high interest rates, elevated gas prices, dwindling savings, persistent inflation and wage growth that has not kept pace; these challenges are driving increased trade-down activity, a higher propensity for purchases on promotion and a pullback of spend at restaurants and convenience stores. Campbell's Soup Company CEO, Mark Clouse, noted, **“our snacks business, which has been the most resilient to date, is now facing some short-term pressure, especially among lower and middle-income consumers. We are seeing some modest improvement in the snacking segment in the most recent weeks, with the expectation of more of a full recovery in the first half of fiscal 2025.”**

To address the financial pressure facing lower income consumers, brands are re-evaluating price / pack architecture and identifying ways to make sure entry level price points are accessible. Mondelez CFO, Luca Zaramella, noted, **“We moved price points [over the last couple years], particularly in the bigger sizes above \$4, and we have to get back below \$4 to really get access to those consumers that are price-sensitive. We're going to hit the market with new packs, particularly at entry-level prices like \$3. And so, we will allow consumers to get into a much more stable territory.”** When asked how Hershey's will continue to drive demand despite persistent inflationary pressure on the consumer, CEO Michele Buck responded, **“I think about it as making sure that we look at each occasion, which really comes down to the pack types across the portfolio and ensuring that we have good entry-level prices based on how the consumer perceives value.”**

Food & Beverage Price Realization Year-over-Year and Indexed to Q1 2019



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Consumers are also planning purchases ahead of store visits, sticking to those lists and making fewer impulse purchases. McCormick & Company noted, “**Volumes on the retail side, particularly in the center of store, remained soft. Consumers continue to buy just for what they need and make more frequent trips to the store. On the other hand, they are increasingly shopping the perimeter and continuing to cook at home.**” However, some companies did note early signs that the lower income consumer may be recovering. Flowers Foods’ premium bread brand, Dave’s Killer Bread, typically generates roughly 20% of sales from lower income consumers (earning <\$30k annual income), but this had dipped to 16% over the last couple years. This quarter management observed that the mix of lower income consumers increased back up to 20% this quarter, which may be an early indicator that this consumer segment is coming back.

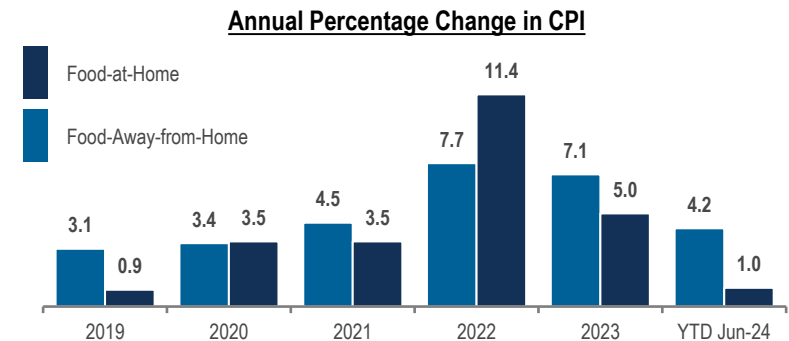
Meanwhile, premium brands targeting higher income consumers continued to exhibit strength. Kraft Heinz noted that, “**there has been a meaningful growth in travel and accordingly, increasing hospitality and entertainment sales, driven by the bounce back among the higher earners.**”

Moderating Inflation and a Resumption of Volume Growth

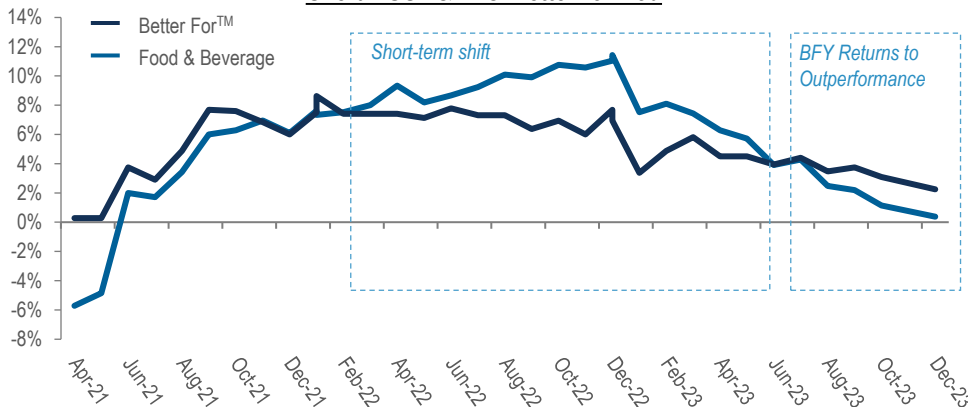
After more than two years of steep cost inflation, F&B manufacturers and brands are finally beginning to experience some relief. While certain commodities are still facing inflationary pressure (notably cocoa and sugar) and several companies noted continued pressure on labor and warehousing costs, the overall inflation rate has stabilized. Some commodities, such as flour and dairy have even experienced deflation. The return to a more stabilized cost environment is a welcome development for brands and manufacturers that have contended with exceptionally elevated costs since early 2021, due to supply chain disruptions, geopolitical events and labor shortages.

Between 2020 and 2023, F&B companies implemented some of the largest annual price hikes seen in the industry since the 1980s, resulting in an over 11% increase in food-at-home prices in 2022. However, price increases have significantly slowed in early 2024, with food-at-home prices rising just 0.8% year-to-date compared to 2023. The USDA forecasts that food-at-home price inflation will remain modest at 1.0% in 2024, although some pressure is expected to continue for food-away-from-home prices, with a projected increase of 4.2%.

As F&B brands begin to lap the substantial price increases of 2022 and 2023 and benefit from a more stable cost environment, they are experiencing a return to healthier volume-driven growth. Flowers Foods management noted, “**Our retail branded volume inflected positively, growing in the quarter for the first time since 2020.**” Similarly, J&J Snack Foods reported volume growth across all three business segments and Kraft Heinz also saw continued sequential volume recovery despite softness in the food-away-from-home category.



Nielsen Percent Change in Sales vs. Prior Year for Overall US F&B vs. Better-for-You



Better-for-You Consumer is a Coveted Demographic Among Many F&B Brands

Growth in the better-for-you category has historically outpaced the broader food and beverage market. As food inflation peaked in 2022, consumers temporarily shifted from premium, better-for-you products to lower-cost conventional alternatives. Over the last year, this trend has reversed, with consumers once again willing to spend more on healthier options and the better-for-you category is back to outperforming the conventional category.

The better-for-you consumer represents an attractive and profitable segment. This category remains a strategic priority for many large F&B brands, both through organic brand investments and M&A. Hain Celestial CEO, Wendy Davidson, commented, “**The core shopper demand in better-for-you continues to be very attractive. [Better-for-you] consumers make more trips and spend nearly twice as much as the average buyer.**” Flowers Foods management noted that better-for-you is a priority for M&A, and they are seeing “**compelling brands that complement our existing portfolio and skew towards a better-for-you nutritional profile.**”

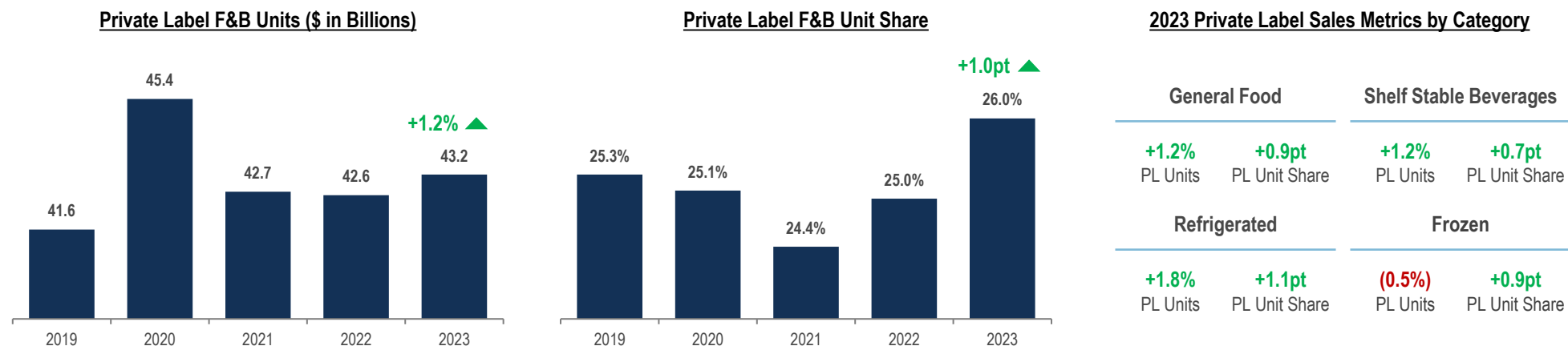
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The snack category, in particular, has experienced a surge in demand for healthy products in recent years. Nielsen data shows the four-year velocity⁽¹⁾ CAGR for better-for-you snacking products outpaced non-better-for-you products across all shopping channels. Consumers are increasingly seeking clean labels, free from artificial additives, preservatives, or allergens, as well as snacks with functional nutritional benefits. Campbell's Soup Company CEO, Mark Clouse, noted, **"I do think health and wellness and better-for-you continues to be an important space, although I think it has continued to evolve beyond absence of negative to more about the presence of positive ingredients and/or the origin of ingredients."**

Private Label Continues to Drive Competition

F&B brands have faced increased competition from private label across most categories over the last couple years, as consumers have sought ways to offset the impacts of inflation and retailers have improved the quality and range of private label offerings. In 2023, private label gained a full percentage point in market share over 2022 and this trend continued into early 2024. However, Flowers Foods CEO, Ryals McMullian, observed that this growth is moderating, noting, **"Although the economic environment has shifted demand toward private label products, which gained 30 basis points of unit share [in the fresh packaged bread category during the quarter], that shift has clearly moderated. In fact, private label actually lost share in the last four weeks of the quarter."**

Interestingly, General Mills highlighted that the return to a more stable supply chain environment, while beneficial to operations, has also improved service levels for private label brands and smaller competitors, creating **"greater competition on the physical and digital shelf."** While private label share gains may have slowed, with consumers paying 30% more for groceries today than they did in 2019, competition from private label brands is likely to persist and remain a strategic focus for retailers.



Increasing Promotional Activity, but Competition Remains Rational

Overall promotional activity has increased, yet executives emphasize that brands remain rational, with promotions generally below or aligned with pre-pandemic levels. General Mills CEO, Jeff Harmening, pointed out, **"if you look at the last 12 months, promotional spending is up, frequency up a little bit and depth of discount is up a little bit relative to the year before. But if you look before the pandemic, it's kind of back to that level of promotional intensity."** B&G Foods similarly noted, **"[promotional activity] is not higher than it was pre pandemic, but it's getting back to kind of a normal cadence of where it was there. And some categories are still a little bit lower than they were pre-pandemic. But we're seeing the resumption of normal promotion activity that's been gradually building over the last 18 to 24 months."**

Notably, Flowers Foods observed that, **"although economic pressure is driving many consumers to seek greater value, lifts from promotion remain below pre-pandemic levels."** Given the sizable price increases experienced over the last few years, it may be that consumers perceive discounts on current prices as less valuable compared to pre-inflationary prices. Also, cash-strained lower income consumers may not be able to afford to stock up on items on promotion in the same way they could a few years ago.

(1) Velocity is the rate of retail sales that a brand or SKU achieves through a particular distribution point over time
Sources: U.S. Bureau of Labor Statistics Consumer Price Indexes; USDA Economic Research Service; Circana MULO+, total US, data ending December 31, 2023; public company earnings call transcripts

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M&A Activity Picks Up

The M&A market is showing signs of improvement and several F&B company executives called out a notable increase in the volume of opportunities in the market. Rob Vitale, CEO of Post Holdings commented that, **“we don’t know if valuations have moved yet because what we’re first seeing is an increase in opportunity flow. We need some more transactions to occur to gain a sense of the market. I think what’s driving it is that there has been a relatively low period of M&A, specifically private equity exits that have aged some of these opportunities, such that I think they will come to market in more of a group.”** Mondelez management remarked that, **“the appetite [for M&A] is high,”** but valuations have been challenging noting that, **“there were a number of deals that we were interested in, but we thought the price ticket was just way too high and we stepped out.”**

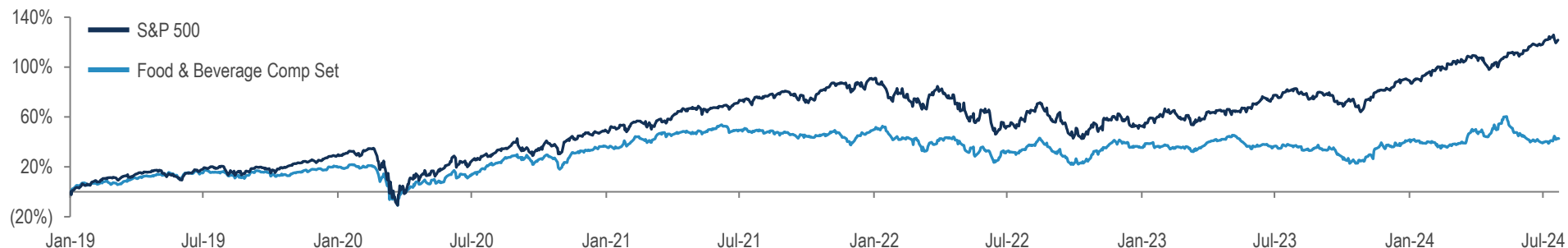
Market Outlook

Looking ahead, F&B company executives are cautiously optimistic. Most management teams maintained guidance this quarter and several brands expect sequential improvement and a return to volume growth as the year progresses. Despite moderating inflation, prices remain much higher than 2019 and executives anticipate that the strength in food consumption at-home will persist, as consumers continue to grapple with stretched budgets. General Mills noted that, **“we expect ongoing macroeconomic uncertainty to result in continued value-seeking behavior by consumers, affecting both the products they buy and the channels they shop.”** Resilience and adaptability will be key over the coming months as brands and manufacturers navigate the evolving economic conditions and seek ways to deliver innovation and value to the consumer.

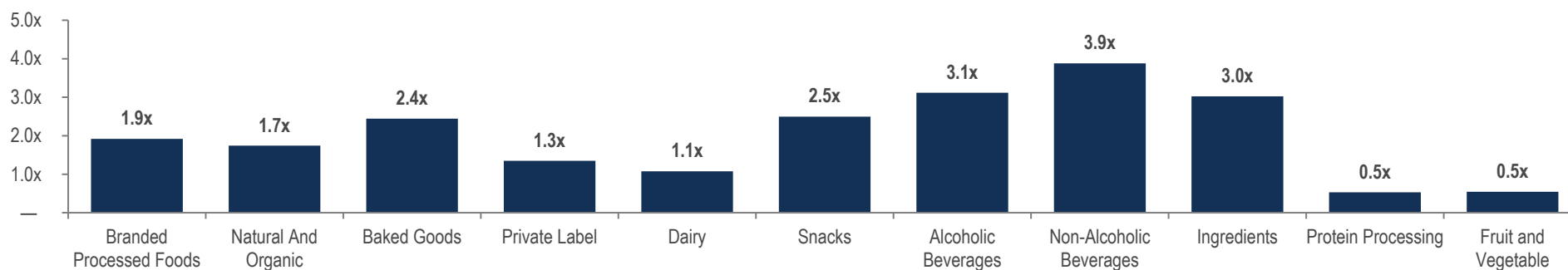


Market Valuations – Stock Price & Multiples

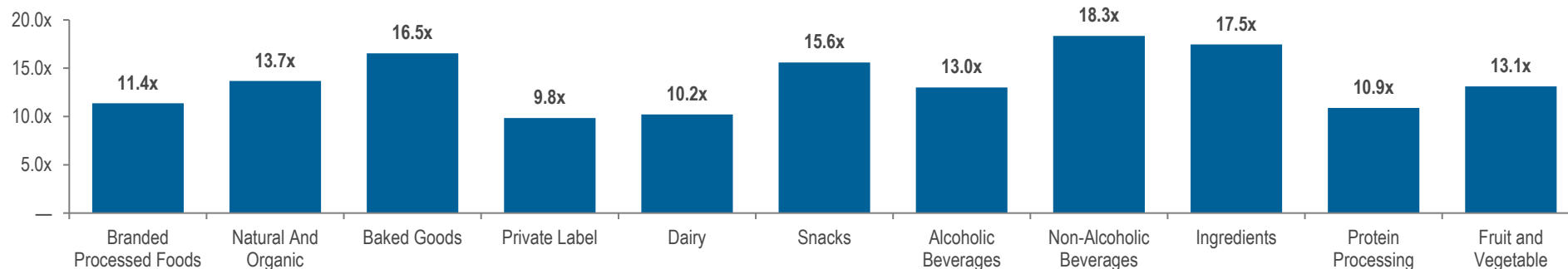
Stock Price Performance (2019 – YTD July 2024)



EV/Revenue Multiples

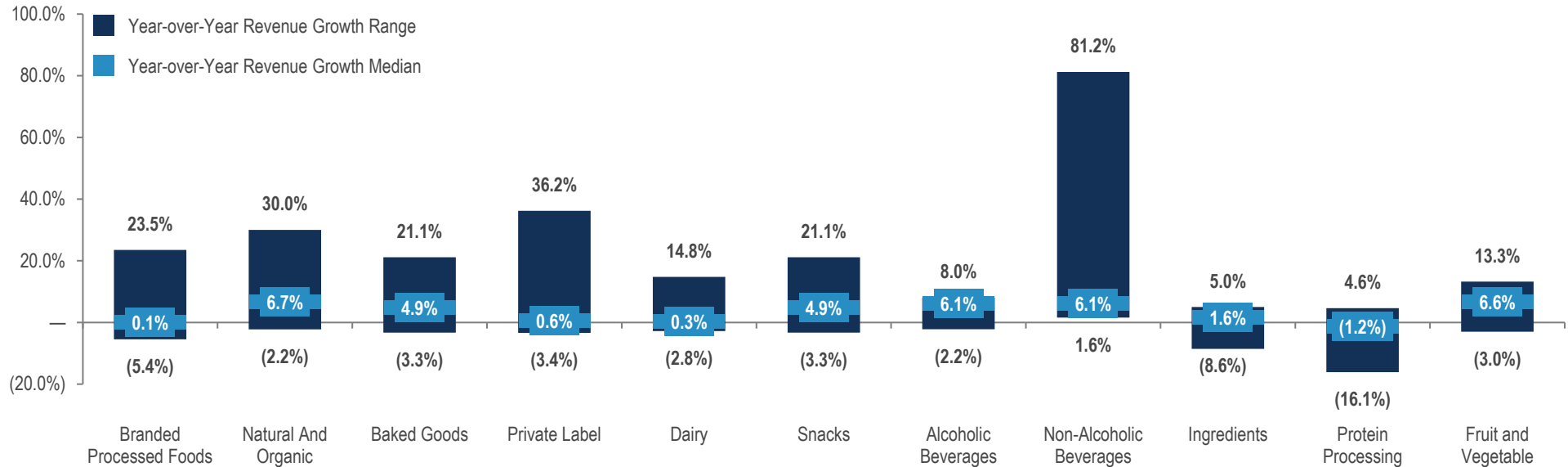


EV/EBITDA Multiples

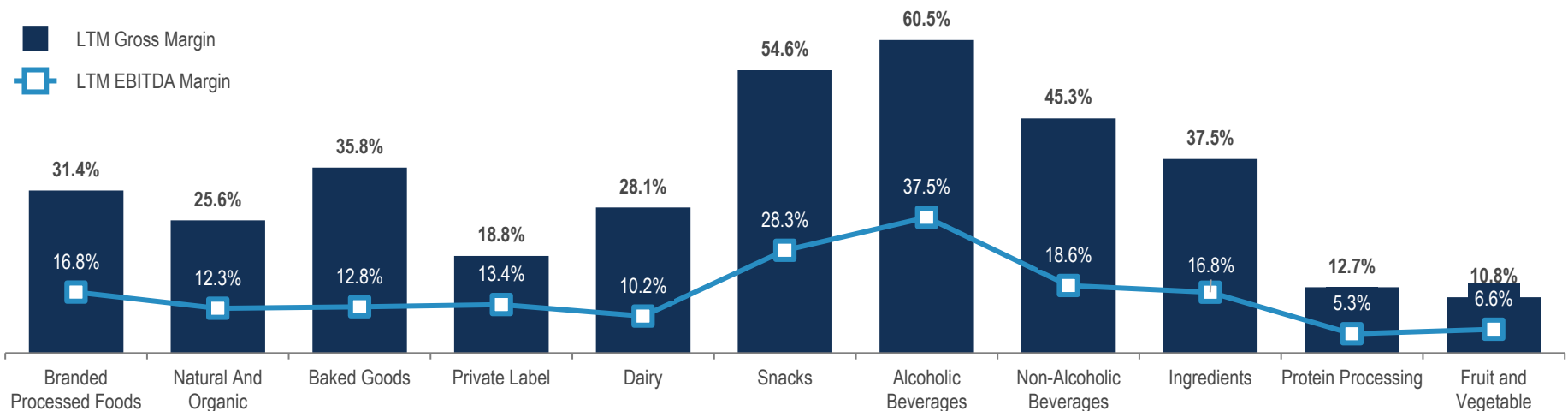


Category Growth & Margins

LTM Revenue Growth (Range and Median)



LTM Gross Margin and EBITDA Margin



TM Capital Food & Beverage Team

TM Capital's Food and Beverage investment banking group has completed many of the marquee transactions across the branded, private-label, ingredient, retail and restaurant landscape. Please feel free to reach out to our leadership team:



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Selected Transactions




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The undersigned served as financial advisor to Tate's Bake Shop, Inc. in connection with this transaction.





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