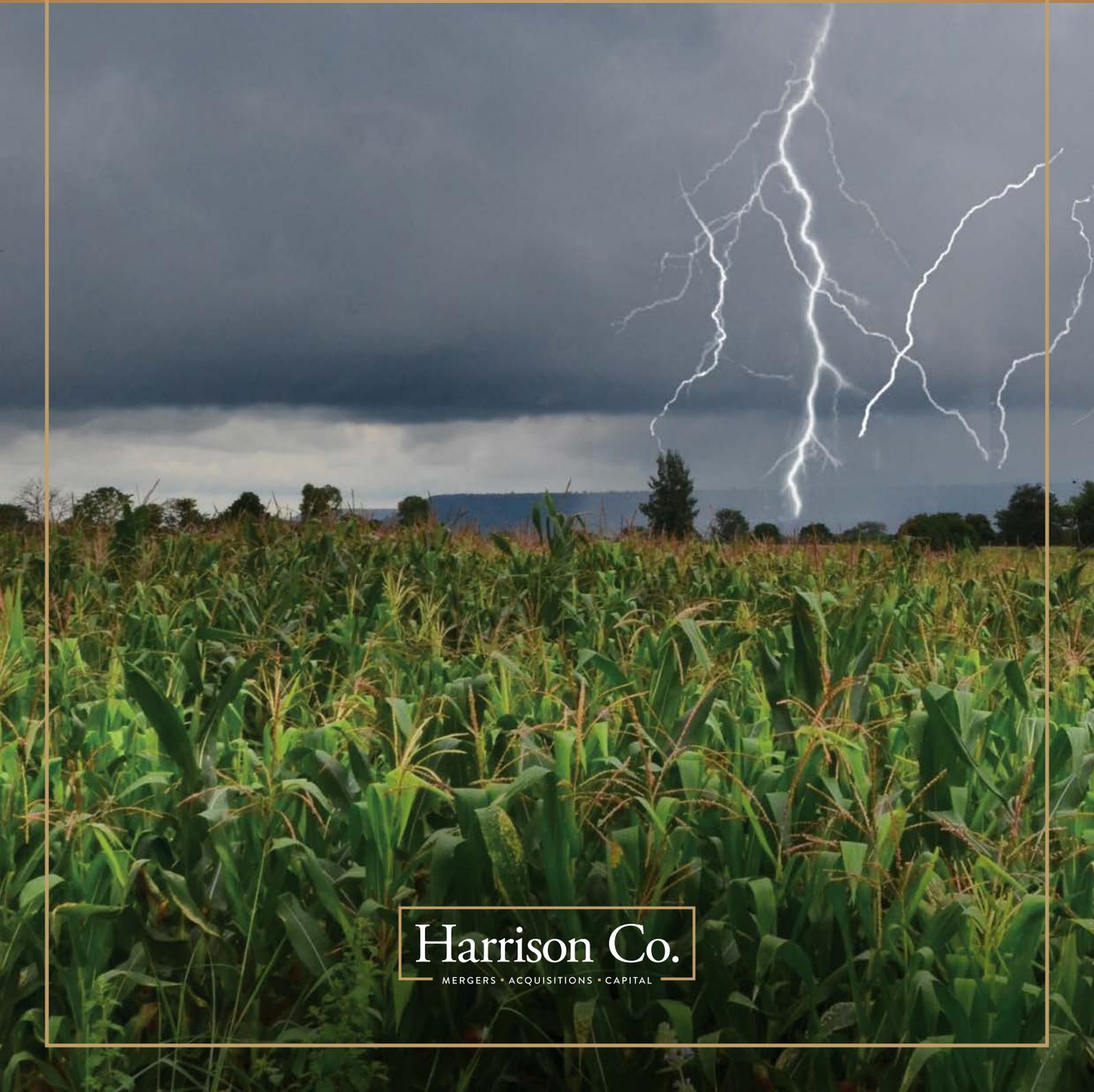


Amazon and Agriculture

Spring 2019

Changing the Landscape of Food Distribution



Harrison Co.

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Amazon and Agriculture: Changing the Landscape of Food Distribution is the first issue of our multi-part Point of View series that analyzes the trends having the greatest impact on the food-supply chain – from farm to table.

Upcoming topics will include water rights, the changing tax code and the impact of immigration on farm labor. We will also explore crucial macro topics such as how AgTech is answering the challenge to feed 9.8 billion people by 2050,⁽¹⁾ how consumer preferences are changing what we grow and eat, and how consolidation is affecting pricing and the industry's balance of power.

We begin with Amazon, the dominant retail force accelerating the pace of change throughout the food-supply chain.

¹ United Nations, *“World Population Projected to Reach 9.8 Billion in 2050, and 11.2 Billion in 2100,”* hyperlink, accessed April 4, 2018.

Amazon Factor

“Your margin is my opportunity”

is a favorite adage of Amazon founder and CEO Jeff Bezos, and a key to understanding the significance of Amazon’s acquisition of Whole Foods.

Industry consolidation may leave some companies watching from the sidelines. Failing to adapt fast enough to the new world order could lead to serious consequences, including margin reductions, declining sales and ultimately, the loss of the business.

We also believe that if current trends continue and Amazon/Whole Foods is successful, we will soon see in-home delivery accounting for a large portion of grocery sales, particularly for shelf-stable products.

We believe Amazon’s aggressive moves in the food industry will lead to significant margin pressure across the entire supply chain, compelling companies to alter business practices, offer more value-added products and services or grow through acquisitions to fight scale with scale.

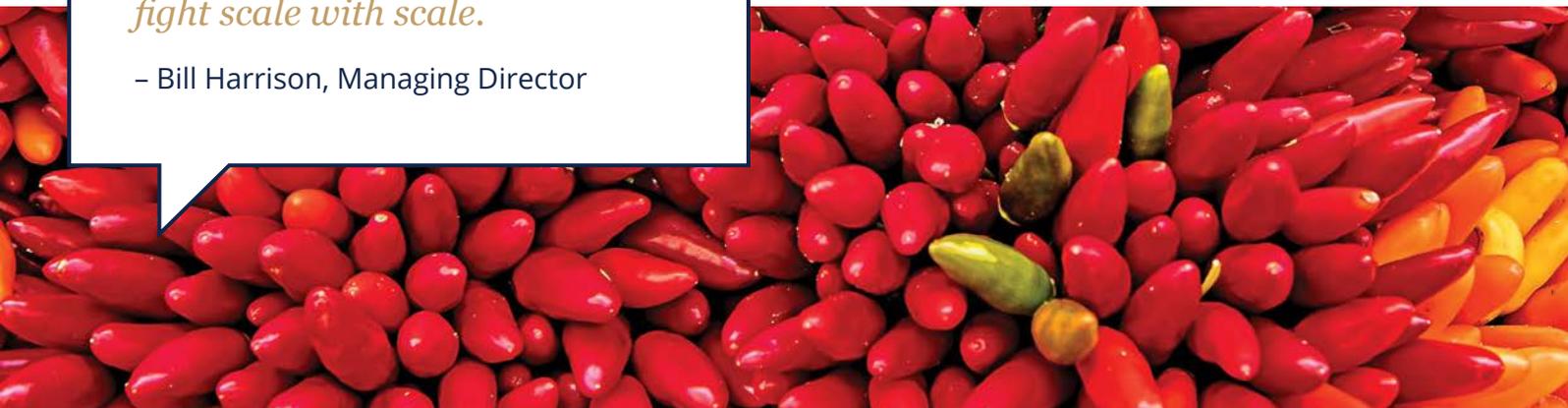
– Bill Harrison, Managing Director

Most supermarkets recognize the need to maintain market share, margins and customer loyalty, and are aggressively ramping up their own in-home delivery services, trying to compete with Amazon.

The long-term potential impact is that Amazon/Whole Foods could control the majority of the food-retail market and in the process, increase the dominance of their own brands.

Doubt us? Less than five years ago, most people questioned Amazon’s ability to become a force in the apparel industry. The consensus was that consumers prefer to touch and try on clothing before buying. Well, today Amazon ranks as the largest US apparel retailer, and which brands are the company’s bestsellers? You guessed it, Amazon brands.

To survive and ideally thrive in the rapidly evolving food-supply chain, and offset the rising and concentrated dominance of Amazon, Albertsons, Kroger, Walmart and other retail giants, every other company in the food industry must become adept at anticipating the changes that lie ahead because the pace of change will be greater than at any other time in history. Those changes include evolving consumer preferences, new industry participants, unprecedented capital and investment, gamechanging technology, and industry consolidation.



Pricing Power

The grocery business is an \$800 billion industry – the largest retail category in the US. It was therefore no surprise that when Amazon purchased Whole Foods, people everywhere took notice.

Industry analysts speculated that the acquisition was “a threat to everyone” and would largely upend the competitive landscape for grocers, food-delivery services and meal-kit companies.⁽²⁾ Headlines even declared “Amazon doesn’t just want to dominate the market – it wants to become the market.”⁽³⁾

Doomsday predictions aside, the truth is...

Amazon’s acquisition of Whole Foods has set off a ripple effect that is permanently impacting every stage in the food-supply chain.

WHY?

Because Amazon can afford to be stingy.

Although aggressive pricing at a single retail store chain is not a revolutionary market shift, it can have a transformative effect when combined with an unprecedented distribution reach.

2 CNBC, “Amazon’s Acquisition of Whole Foods Is a Threat to Everyone, Even Restaurants,” hyperlink, accessed April 2, 2018.

3 The Nation, “Amazon Doesn’t Just Want to Dominate the Market – It Wants to Become the Market,” hyperlink, accessed April 3, 2018.



Amazon has demonstrated time and again its willingness to sacrifice profitability to fund price cuts and while doing so, capture market share. Amazon has earned the support of its public shareholders, so it can afford to sell goods below cost to outlast the competition.

We anticipate Amazon's playbook will be to cut prices, reduce operating costs, put pricing pressure on suppliers & vendors, and continue to drive greater sales of its own brands.

Amazon will then be positioned, as it is in other industries, to dominate while achieving a modest profit. For example, when Amazon purchased Whole Foods, Amazon immediately began lowering prices on organic fruit and other select items, in some cases by as much as 43 percent.⁽⁴⁾

For Whole Foods, there was room for price cuts. Pricing studies showed that on average, Whole Foods was priced at a 15 percent premium compared to its specialty peers.

How was Whole Foods able to sustain higher prices and higher margins? Through a combination of a wide selection of quality products and a strong industry brand. Yet, some change is underway. Increasing natural and organic food options from lower-priced competitors have tipped the scales in competitors' favor.

⁴ Bloomberg, *"Amazon Cuts Whole Foods Prices as Much as 43% on First Day,"* hyperlink, accessed April 3, 2018.

⁵ The Wall Street Journal, *"Produce or Else: Wal-Mart and Kroger Get Tough with Food Suppliers on Delays,"* hyperlink, accessed April 4, 2018.

⁶ The Washington Post, *"It's a Nightmare for Grocery Stores, But It Might Make Your Groceries Cheaper,"* hyperlink, accessed April 7, 2018.

Competitor Response

Pricing pressure is not limited to Amazon and Whole Foods suppliers.

Reuters reports that Walmart met with many of its top food and consumer-product vendors, and demanded they reduce their cost by 15 percent. Kroger is also pressuring its packaged-food suppliers by requiring "on-time and full delivery." Failing to comply results in penalties being levied against suppliers and carriers.

According to The Wall Street Journal, Walmart is fining suppliers 3 percent of the order value for deliveries that do not arrive on time, and Kroger is charging \$500 per missed delivery.⁽⁵⁾

The expansion of Aldi, Lidl and other discount stores, which are primarily private-label retailers, are also challenging traditional grocery stores on cost, with prices, on average, 20 to 30 percent below those offered by competing US stores.⁽⁶⁾ We will address private-label trends in an upcoming report.



Supply Chain Options

Amazon is dominating the broader online market, with nearly one-half of US households subscribing to Amazon Prime. In the food-supply chain, with so much influence concentrated within Amazon and other leading supermarkets, food manufacturers and suppliers have several choices before them:

- 1 **Maintain the status-quo**, which may lead to reduced margins and loss of market share.
- 2 **Seek alternative distribution sources**, such as direct-to-consumer, which will depend on the company's position in the supply chain.
- 3 **Address the growing demands of price reductions**, while identifying ways to lower operating expenses.
- 4 **Give customers a reason to seek them out**, which may include (i) innovative products, (ii) wider product selections than competitors and/or (iii) brand strength driven by product quality and consistency.
- 5 **Increase scale**, which is usually accomplished through consolidation, to offset the dominance of the consolidated supermarket channel.

On one hand, reducing prices can help drive grocery sales. However, history has shown that ongoing price reductions are a race to the bottom because there is no margin remaining for product innovation and brand marketing. For suppliers asked to make concessions year after year, the vendor/customer relationship becomes more and more one-sided, and allows no room for pricing or operational error.

On the other hand...

Retailers, distributors and food manufacturers have more opportunities than ever before to differentiate themselves and rise above the fray.

For example, in an environment where private-label store brands have become more competitive, Chobani, Cuties, POM Wonderful, Halo Top and similar brands can still disrupt an established product category. What makes those companies so agile in the marketplace? Greater product innovation and transparency than their competitors, and a stubborn refusal to be commoditized.

Additional reports in the series will feature in-depth discussions of the specific ways food manufacturers are adapting to the evolving food-supply chain, including product innovation, branding and direct-to-consumer alternatives.

Build, Buy or Divest

We welcome the opportunity to discuss how evolving consumer preferences, new industry participants, unprecedented capital and investment, game-changing technology, and industry consolidation may impact your business, today and in the years ahead.

The following are three strategies to evaluate:

- > Invest in infrastructure to grow organically.
- > Evaluate products and services relative to the competition.
- > Make strategic acquisitions, or consider selling all or part of the company.

Retailers

It is hard to imagine an institution as predictable and more a part of the American lifestyle than the retail grocery store. For most of us, the regular pilgrimage to the local supermarket is an inescapable part of life.

Unless you live on a farm or prefer to dine out, your only option to gather food for the family table is to get in the car, drive to the store, load up a shopping cart and lug everything home.

That was then. This is now.

New Priorities In A Transformed Marketplace

Changing consumer needs and expectations, technology advancements, and a fierce competitive environment are transforming the retail-shopping experience, and will continue to impact the food and ag industries at a faster-than-ever pace.

Well before Amazon purchased Whole Foods, the grocery industry had already begun its rapid and radical change, particularly in consumer priorities. For instance, a convenient location, which has historically been a primary driver for consumers when choosing a grocery store, may not be a leading factor for consumers in the near future, where technology will allow for even greater anytime, anywhere shopping.

A look at how many of the most well-known players in retail food sales have raised their game since Amazon purchased Whole Foods shows the steps being taken to meet, and in some cases exceed, new consumer priorities.



Albertsons acquired Plated for \$187.5 million, marking the first purchase of a prepared-meals company by a supermarket chain.

Bob Miller, chairman and CEO of Albertsons, stated, "Today's consumer is looking for a variety of personalized shopping alternatives... we've found a partner who shares our commitment to delicious, affordable food; superior technology and innovation; and world-class customer service."



Kroger announced the Restock Kroger initiative, which drives more data-driven pricing, personalized customer communication and an across-the-board revamp

of product selections. According to Kroger CEO Rodney McMullen, Restock Kroger is intended to "change the way people eat in the US."



Target expanded its same-day delivery capabilities, which are essential for perishable foods, by acquiring Grand Junction, a transportation technology company, in August 2017

and Shipt, an online grocery delivery company, in December 2017. Target's goal is to provide a same-day delivery option to customers at half of its US stores by early 2018..⁽⁷⁾



Walmart signaled its intention to compete directly with Whole Foods and Amazon by launching Uniquely J, a higher-end grocery line targeted toward millennials. Also, in 2016,

Walmart acquired Jet.com, a fast-growing online retailer, for more than \$3 billion. The new private brand will focus on younger consumers in urban areas, and offer products ranging from select coffee and olive oil to tablets, eReaders and personal-care items.

7 CNET, "[Target Acquires Shipt for \\$550M to Bring You Same-Day Delivery](#)," hyperlink, accessed April 8, 2018.



Rise of Online Shopping

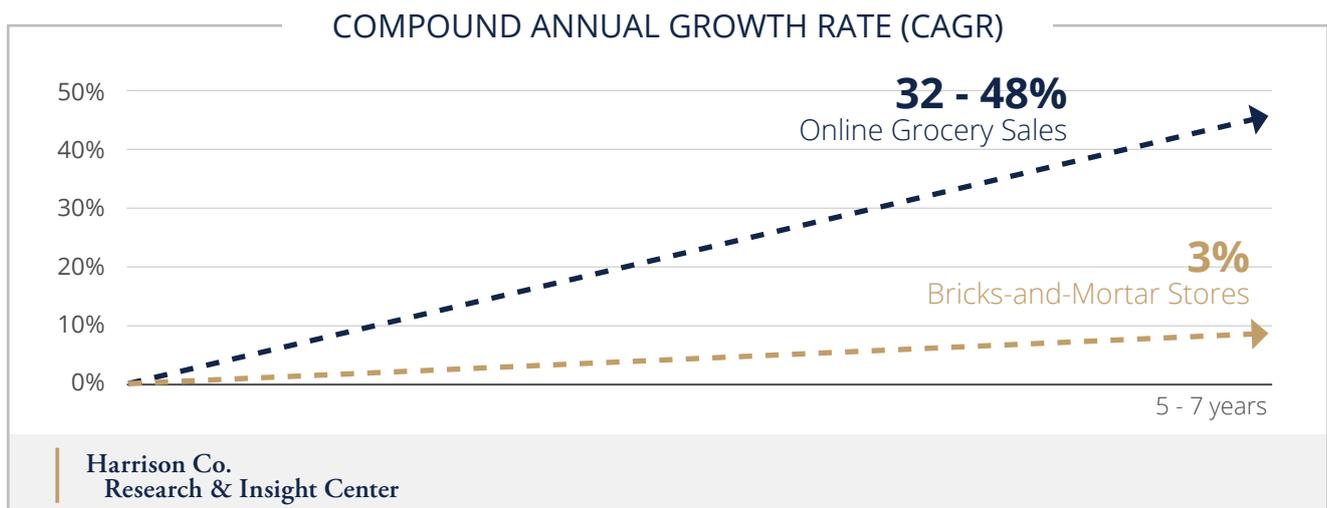
Not since the introduction of electric refrigeration has the retail food sector experienced change as significant as online shopping.

Although modest when compared with overall grocery sales, online shopping is expected to have a stronger position in the grocery-shopping equation as more consumers move online when shopping for ordinary, regularly replenished goods — beverages, paper products, packaged non-perishable food and other household basics.⁽⁸⁾

US online grocery sales totaled approximately \$14.2 billion in 2017,⁽⁹⁾ and there is no slowdown in sight.

Nielsen and Food Marketing Institute (FMI) research reveals that online grocery sales will grow to \$100 billion in the next five to seven years, with 70 percent of consumers purchasing groceries online.

Those findings would translate into a Compound Annual Growth Rate (CAGR) of 32 to 48 percent, compared to approximately 3 percent for bricks-and-mortar stores.



⁸ Food Dive, "7 Trends That Will Define Grocery Retail in 2017," hyperlink, accessed April 5, 2018.

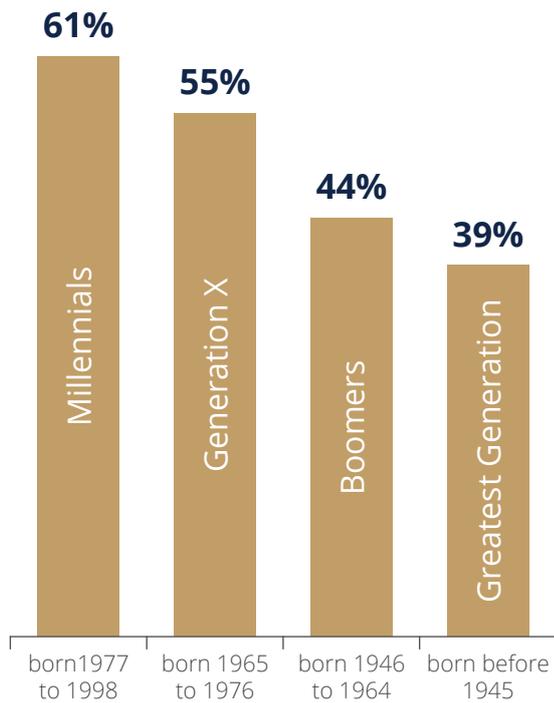
⁹ Statista, "U.S. Consumers: Online Grocery Shopping – Statistics & Facts," hyperlink, accessed April 8, 2018.



How fast does the food industry need to move before it can maximize online shopping opportunities? One of the most reliable guides is the pervasiveness of online shopping across generational and socioeconomic consumers.

Although conventional wisdom has been that millennial and affluent populations purchase the most consumer-packaged goods online, it tells only half the story. While Millennials are in the lead (61 percent are purchasing online), Generation X (55 percent), Boomers (44 percent) and even the Greatest Generation (39 percent) are not far behind, with consumers across all socioeconomic groups now buying into online shopping.¹⁰

ONLINE PURCHASERS OF CONSUMER PACKAGED GOODS



Harrison Co. Research & Insight Center

Source: *The Digitally Engaged Food Shopper: Developing Your Omnichannel Collaboration Model*, The Nielsen Company & Food Marketing Institute (FMI), Jan, 2018

Last Mile Delivery

Fresh produce, meat, dairy and other perishable food may be the last to transfer to online shopping. In the meantime, retailers are scrambling to learn how to best move their products the last mile to customers, without sacrificing freshness or margins.



Walmart's automated 24/7 grocery pickup kiosk located at the Walmart Super Center in Oklahoma City

Round-The-Clock Curb-Side Pickup

Kroger, Walmart, Safeway, Harris Teeter, Albertsons and most other major grocery chains offer in-store or curb-side pickup for their groceries ordered online, with Walmart taking it one step further. The retailer is testing a kiosk in Oklahoma City that allows customers to pick up their online groceries, 24 hours a day, seven days a week. Customers place an order online, which is then retrieved and sorted by Walmart employees, who place the goods in bins inside the temperature-controlled kiosk located in the store's parking lot. All it takes is the customer entering a pickup code at the kiosk, and the groceries can be retrieved automatically.

¹⁰ Nielsen and FMI, "The Digitally Engaged Food Shopper: Developing Your Omnichannel Collaboration Model," hyperlink, accessed April 5, 2018.

Same-Day At-Home Delivery

For consumers who prefer at-home grocery delivery, competitive retailers are identifying new ways to meet this demand. In October 2017, Walmart purchased Parcel, a Brooklyn-based same-day and last-mile delivery company for New York City customers that specializes in delivering perishable products. Routing algorithms that sort and load packages for delivery routes are among the company's technologies.

Next-Generation Services

Companies are already preparing for the next wave of upcoming at-home delivery expectations, which will surpass the same-day standard.

For instance, in February 2018, Amazon introduced free, two-hour home delivery from Whole Foods stores to its Prime members in Austin, Cincinnati, Dallas and Virginia Beach. The service shows how new client expectations can be met quickly, and how an ecommerce giant and a national food chain could together upend the traditional grocery business.¹¹

While other retailers are focusing on the “last mile” delivery, Walmart is working on the “last few inches” of delivery.

¹¹ USA TODAY, “Amazon Starts Free, 2-hour Whole Foods Deliveries in Fresh Test of Grocery Model,” hyperlink, accessed April 7, 2018.

In September 2017, Walmart announced it was testing a service that raises home delivery to a new level of customer convenience. The retailer partnered with August Home, a smart-security company that produces locks that customers can monitor using their phone.

Under the service, which was test marketed in Silicon Valley, if a customer is not home when a delivery arrives, the driver can use a one-time passcode from August Smart Lock to enter the home and stock the groceries in the customer's refrigerator.

Experiential Shopping

If buying products online is a task to be streamlined, then shopping for food in a store is an experience to be savored.

When future generations of food shoppers visit a bricks-and-mortar store, they can expect to be engaged and entertained.

Tomorrow's grocery stores will be integrating experiential features into their design to deepen the personal connection with shoppers, and encourage them to shop longer, spend more and stay loyal.

It is hard to know how successful those approaches will be, though the grocery store of the future will likely look very different than stores of today. It is possible we may see stores that are closer to an interactive farmer's market, featuring fresh foods and healthy meal kits, with most of the shelf-stable food purchased online.

Distributors & Wholesalers

Despite its purchase of Whole Foods, Amazon is, at its core, a logistics and distribution company.

Yet, entering the grocery category presented Amazon with a strategic opportunity to buy into a physical-store presence – the reverse of Walmart’s acquisition of Jet.com for its ecommerce expertise. Amazon not only gained storefronts, but also added 11 food-storage centers to its network of 450-plus distribution centers to support service expansion.⁽¹²⁾

Marketplace Fallout

Gaining access to Whole Foods’ network of food suppliers and distributors is expected by many to strengthen Amazon’s influence in vendor negotiations and drive price concessions from its suppliers, such as United Natural Foods, Inc. (UNFI), the leading distributor of natural and organic grocery products in the US. Those concessions will in turn place pressure on UNFI margins.

Amazon has one of the world’s most robust supply chains, so Whole Foods, under the Amazon umbrella, may self-distribute more product or acquire an established grocery logistics company. A move by Whole Foods toward direct-supplier sourcing would erode the top line for UNFI, who will likely seek pricing concessions from its food and produce suppliers.

As challenges work their way across the food-supply chain, distributors and wholesalers are reacting in a number of ways.



Diversification

Distributors and wholesalers that once specialized in certain foods, such as produce or fresh meats, are adding more SKUs to their product line.

Calavo Growers, which for nearly a century has been synonymous with avocados, has expanded its offering to include chips and salsa as well as other fresh dips.

Other distributors are improving services, including ripening rooms and repacking, to stay relevant and maintain market share.



Consolidation

Sysco, UNFI and other leading food distributors have been actively acquiring local distributors and niche wholesalers, and gaining market share and boosting economies of scale to offset mounting price pressures.



Vertical Integration

Strategies to own the food-distribution chain “down to the earth” are becoming more frequent, with Belgian food distributor Greenyard attempting a takeover in 2017 of Dole Food Company, the world’s largest producer and marketer of fresh fruits and vegetables.

¹² Deloitte, “*The Amazon-Whole Foods Acquisition: Six Competitive Realities for Retailers*,” hyperlink, accessed April 6, 2018.

Opportunities Ahead

The impact of the Amazon-Whole Foods acquisition, and the repercussions that followed across the entire food and ag industries, have yet to be fully realized. However, we know that changes are occurring at an unprecedented pace, which can be challenging, though also ripe with opportunities.



About Harrison Co.



We are an unapologetic advocate for family-owned businesses. We combine intense focus in the consumer industry with a consultative, data-driven approach, to provide private business owners with the advantage they need to make the best possible strategic, M&A, and financing decisions

Contact Us

Nancy Ervin

Partner
+1 559 903 5358
nervin@harrisonco.com

Bill Harrison

Managing Partner
+1 917 596 5533
wharrison@harrisonco.com

Shaun Kalnasy

Partner
+1 404 502 2946
skalnasy@harrisonco.com

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