Colliers Food Advisory Services

State of the Food Industry 2021

Insights for the food industry and its real estate partners in a post-COVID-19 world.

It's no secret that the coronavirus pandemic of 2020 has profoundly impacted virtually every industry worldwide. Perhaps one of the most evident and most crucial sectors hit has been the food industry. The effects were quickly apparent as stories ranging from food shortages to food waste and processing plant closures decorated headlines across the United States and worldwide. However, these stories just scratched the surface of a systemic issue throughout the entire food supply chain.

In the ***Colliers Food Advisory Services 2021 State of the Food Industry*** report, we take a look behind-the-scenes to uncover the truth about COVID-19's rippling effects across the entire supply chain. This report will review how the pandemic has affected food consumption and how that, in turn, has affected distribution, third-party logistics companies and more. Conversely, we will review the impact at the early stages of the supply chain and COVID-19's effects on food processors and manufacturers. Lastly, this report will offer insights and recommendations for the food industry and its real estate partners to help them make strategic decisions for a post-COVID-19 world.

Food Consumption in 2020

In the United States, food consumption has been split between two industries: Food away-from-home (Foodservice) and food-at-home (retail). Historically, the two sectors have shared a nearly even (50/50) split in overall consumer spending.

The restaurant industry entered 2020, predicting industry sales to increase 4.0% to nearly $900 billion *(National Restaurant Association, 2020)*. However, 2020 had other plans. As businesses – and disproportionately foodservice businesses – closed their doors to prevent the spread of the coronavirus, the prediction for the restaurant and foodservice industry began to look wildly inaccurate. Instead, single location full-service restaurants experienced an unprecedented -16.9% decrease in revenues and a -3.0% decrease in the number of establishments *(IBISWorld Inc., 2020)*. Perhaps even worse, chain restaurants faced catastrophic declines in revenues and establishments, -39.2% and 15.0%, respectively. The negative impact of coronavirus on the restaurant industry was representative of the foodservice industry as a whole, including foodservice providers for venues, hospitals, schools and other away-from-home eating options. As consumers could no longer patronize foodservice providers, the sector lost nearly 10% of its consumer spending share.

For grocers, the story was quite different. Faced with a wave of demand as consumer spending shifted away from foodservice, food-at-home providers struggled to meet the influx of demand. Before 2020, many grocery stores operated just-in-time (JIT) inventories to curb food waste and guarantee freshness. However, as demand for at-home-food skyrocketed, fueled by mass closures of foodservice providers and panic buying, grocery stores were caught flat-footed with a lack of product. Overnight, grocery store inventories dried up as the JIT supply chain buckled under the pressure of the new wave of demand for consumer food product.

Fueled by anxiety over exposure to the virus and a lack of product on the shelves, consumers began to seek alternative food consumption solutions. While online ordering, delivery and food e-commerce were on the rise before 2020, the pandemic gave way to these sectors' exponential growth. In 2020, online grocery revenues increased 72.7%, nearly three times the previous high set in 2016 of 25.0% *(IBISWorld Inc., 2020)*.

Effects on Foodservice Distribution

Behind the scenes, foodservice distribution companies – business-to-business companies that distribute food for away-from-home consumption – were faced with the unexpected as their downline supply chain dried up overnight.

"The foodservice industry was on a very successful path pre-COVID," stated Bob Stewart, CEO of UniPro Foodservice, Inc. "The impact of COVID on foodservice has been rather significant…" According to Stewart, restaurants and other channel closures - such as the hospitality and live event industries – have caused a significant shift in food consumption.

Following widespread lockdowns and closures of restaurants, schools, venues and hotels in March of 2020, the International Foodservice Distribution Association (IFDA) predicted the industry would lose $24 billion over the second

> ***"The foodservice industry was on a very successful path pre-COVID. The impact of COVID on foodservice has been rather significant…"***
>
> – Bob Stewart, CEO, UniPro Foodservice, Inc.

quarter. This threat of substantial financial contraction for foodservice distributors forced many to explore options to secure the life of their business.

Some companies opted to combat the challenges of 2020 by engaging in mergers and acquisitions. On one side of the spectrum, small, mom and pop operations opted for exit strategies to mitigate losses. On the other side, large, well-capitalized firms acquired these mom and pop operations to diversify revenue streams and reduce risk.

In addition to mergers and acquisitions, foodservice distributors also weathered the uncertainties during the coronavirus pandemic by seeking recapitalizations from private equity and other investment opportunities.

Case Studies

As a result of the global pandemic and its effects on the foodservice distribution industry, in October of 2020, **Quirch Foods, LLC** merged with **Colorado Boxed Beef**. Quirch, owned by affiliates of Palladium Equity Partners, sought the merger to help broaden its core domestic U.S. retail business and expand into new geographies and channels.

In July of 2020, regional foodservice distributor, **Cheney Bros., Inc.** and **Clayton, Dubilier & Rice (CD&R)** announced an investment partnership by CD&R-managed funds in Cheney Bros. The recapitalization effort will help fund the family-owned and operated distributor's efforts to serve the southeastern United States market with more than 50,000 products out of 13 state-of-the-art facilities *(Clayton, 2020)*.

Despite some successes, other foodservice distributors faced, and continue to face, financial uncertainties. Following a period of increasing reliance on local restaurant concepts before COVID-19, many distributors encountered their challenges as their most profitable customer base – independent eateries – shuttered their doors by the thousands.

Caught in the crosshairs, many foodservice distributors are expected to meet the same fate as Maines Paper & Food Service Inc., which announced in May of 2020 that it would close a large portion of its business.

The “big three,” Sysco, US Foods and PFG, all experienced significant declines in demand in the second quarter of 2020. Despite this, all three continue to rebound thanks to their economies of scale. In fact, Sysco, the global leader in foodservice distribution, tapped into its financial might to help its most devastated customers through the pandemic. Leveraging more than $8 billion in cash and available liquidity, Sysco deployed innovative solutions such as creating marketplace pop-up shops, providing solutions to extend the outdoor dining season and improving its digital order entry platform.

CEO of UniPro Foodservice, Inc., Bob Stewart, predicts that the foodservice industry will continue to rebound slowly, expecting the full recovery to take several years to climb back up to pre-COVID levels.

The slow recovery means foodservice distributors will need to seek innovative solutions in the interim to offset the losses of the short-term. Those with flexibility in their operations, product lines and geographies are better positioned to weather the post-COVID recovery, and many are positioning themselves now for the journey.

Like other business-to-business providers affected by the shutdowns, many foodservice distributors have expanded their product offerings into the retail space. With a shift in consumer spending, the grocery and e-commerce supply chain struggled to keep up with the increased demand. The void provided flexible foodservice distributors with an opportunity to quickly pivot their product offerings from foodservice to food retail and give a much-needed boost to supply in the retail sector.

Case Study

In late March of 2020, Food Business News reported that the **Food Industry Association** had partnered with the **International Foodservice Distributors Association** to create a “matching program” to connect foodservice distributors with excess supply and capacity to retailers struggling to meet demand. Both Sysco and US Foods transitioned to the grocery supply chain in late March of 2020.

Others have leveraged the virtual landscape. **Regalis**, an importer of high-end food products like truffles, mushrooms and exotic seafoods, turned to its Instagram followers to offload its product in the early days of the shutdowns and has since deployed an e-commerce platform on its website.

In stark contrast to the effects of COVID-19 on the foodservice industry, traditional food-at-home providers faced their own set of unique challenges brought on by an onslaught of high demand as the foodindustry struggled. The increased demand taxed the just-in-time inventory model of most grocers, bringing it to the brink of collapse in the early days of the pandemic.

As consumers experienced supply shortages, long-lines and concerns over exposure to the virus, traditional grocery was faced with yet another threat: online grocery. As a result, grocers engaged in massive investments to chase the pivot to online ordering, resulting in minimized margins.

The onslaught of demand for food-at-home and e-commerce solutions caused an accelerated takedown of cold storage space and significant labor and recruiting increases to handle the additional business. In some cases, the increased volumes didn't inherently lead to increased profits for grocers and their upstream supply chain, thanks in part to higher costs associated with the increased demand for labor and real estate.

Learning from their early pandemic shortfalls, grocers have begun to replace their skinny inventory and JIT delivery models with broader inventories to handle demand spikes. Additionally, retailers have forced penalties/fees back up the supply chain for

Case Study

While many grocers faced supply shortages in the early onset of the coronavirus pandemic, one food retailer rose above the challenge. **H-E-B**, a San Antonio-based grocer, became a beacon of hope as it quickly implemented policies and procedures to mitigate the risks of the pandemic. H-E-B's preparedness had been long in the works before the COVID-19 outbreak. As early as 2005, when the H5N1 influenza threatened a global pandemic, H-E-B began developing a pandemic and influenza plan.

As part of its plan, H-E-B keeps emergency supplies at nearly all of its warehouses ready to go for when disaster, whether a hurricane or pandemic, hits. When the first wave of news came from China in January, H-E-B's emergency preparedness team, a full-time, year-round group, jumped into action. Learning from countries ahead of the United States in the curve, H-E-B was able to quickly implement its policies and procedures that it had been plotting for over a decade.

empty shelves – from the retailer to third party logistics and distributors up to manufacturers.

In response to the increasing demand for online grocery, grocers are now devoting more of their floor space to fulfill digital orders. Despite movement in this area, the cold chain is hard to break. In 2017, when Amazon acquired Whole Foods, analysts would never have predicted that third party shoppers like Instacart would still be a part of the supply chain model of Whole Foods three years later. However, the development and implementation of facilities and the ability to deliver a chilled product to the consumers' fridges have made the process of effective food delivery services an uphill battle, even for an organization with the vast resources of Amazon.

Effects on Third-Party Logistics (3PLs)

As the latter part of the food supply chain has been taxed by the challenges presented during the coronavirus pandemic, a new interest in cold storage third-party logistics has emerged. The changes downstream from 3PLs are testing the big 3PL model with outdated networks and buildings. Both real estate investors and infrastructure funds have noticed and exhibited massive investment interest in the cold storage 3PL space.

As the effects of COVID-19 carried on through 2020, consolidation within the sector continued. In October of 2020, Americold, a cold storage warehouse owner and operator, purchased Agro Merchants Group for $1.74 billion. Consolidations like this will lead to smaller players raising capital, enabling them to expand their footprint and steal market share with new buildings and an updated supply chain to cater to the changing consumer. However, these consolidations across the sector come at a cost. As a result of consolidations in the cold storage 3PL space, customer service has decreased due to a lack of flexibility, more fees and the requirement of longer-term contracts. Less competition has led to an increase in overall pricing ranging from 8% to 14% and Covid highlighted the 3PL's lack of flexibility with the flux of inventories coupled with additional value add services.

In addition to investments in real estate and consolidations, cold storage 3PLs are investing in massive upgrades to the aging food supply chain. As a result, many cold storage 3PLs are exploring options for infill real estate to supplement the larger distribution centers. However, the industry has yet to see this model come to fruition. Conversely, labor issues are leading many cold storage 3PLs to invest in automation when possible. While this trend is most commonly seen in smaller, last-mile 3PL facilities, even traditional large distribution centers are looking for urban centers to address the need to be closer to consumers.

Effects on Food Processors and Manufacturers

The pandemic has profoundly affected the food processing and manufacturing sector of the food supply chain. Already plagued with labor challenges before COVID-19, which were only compounded by the pandemic, the industry also faced new challenges by the changing landscape of its downstream supply chain industries. Shifts in consumer spending and an uptick in consolidations in 3PLs led to radical changes in the food processing and manufacturing sector.

In the months leading up to the coronavirus pandemic, labor was already more difficult to find and retain for food manufacturers, particularly in the meat and poultry industry. This was due to the job's challenging nature (physically demanding, handling heavy product, repetitive motion) coupled with harsh conditions (cold environment, often shoulder to shoulder crowded environment) and relatively low wage. The virus has exacerbated these challenges. In particular, the crowded nature of facilities led to major COVID outbreaks and shutdowns in meat processing facilities across the United States.

As COVID-19 outbreaks plagued the industry, food manufacturers with just one or two locations took on immense risk as they were forced to shut down 50-100% of operations for two weeks due to confirmed cases. As a result, the need for diversified manufacturing footprints became apparent and demand for new facilities skyrocketed.

While many food processors turned to diversified manufacturing footprints to mitigate production loss risks, others turned to automation. The safety concerns of COVID-19 led some major food processors such as Tyson Foods, Cargill, JBS, Smithfield and others to ramp up automation capabilities to circumvent worker shortages and other labor concerns in general.

In the pandemic's early days, demand for home consumption items surged, and demand for food-away-from-home plummeted. Grocery store shelves were suddenly empty as a result of the rapid shift of demand. However, for manufacturers, the solution was not as easy as the public perceived. Production lines traditionally configured to package large quantity products for foodservice had to be completely reconfigured to package food to be sold at the retail level. As many manufacturers pivoted away from foodservice to protect revenue streams, new production capacity meant for foodservice brought online before the pandemic sat idle.

For foodservice manufacturers who could not quickly pivot their production lines to retail customers, many turned to partnerships with copackers to help handle the growth needs during the pandemic. While this partnership may have resulted in a takedown of expansion space for copackers, the trend is most likely temporary. It could result in the eventual offloading of excess real estate for this sector in the near future.

While the food processing and manufacturing sector has felt pressure from both the rapid changes in consumer behaviors and labor challenges, the massive trend of consolidations in the cold storage 3PL sector has placed another challenge on this sector. With 3PL consolidations resulting in a lack of flexibility, fee increases and labor challenges, many large players in the food processing and manufacturing sector are looking to bring distribution back in-house.

Effects on Real Estate

All of the changes to the food supply chain brought on by the coronavirus pandemic are having - and will continue to have - profound impacts on the food processing and cold storage industrial real estate sector.

Industrial real estate is experiencing a boom in speculative cold storage development on an unprecedented scale. Before the pandemic, there was already a limited supply of existing cold storage space on the market. The pandemic exacerbated this challenge, and now, available cold storage space is nearly non-existent and that which is available is outdated. Developing a cold storage facility can be two-to-four times more expensive than traditional industrial buildings. Due to the high costs, cold storage is usually built-to-suit with consideration for future tenants. However, the economic imbalance of supply and demand for cold storage facilities has now prompted many developers to re-evaluate the risks associated with developing speculative cold storage space.

The onslaught of M&A activity and consolidations across the country for foodservice distributors will lead to older, second-generation facilities coming to market. This trend will continue as companies update their supply chain by shedding excess real estate. As a result of more second-generation space hitting the market, the real estate sector will need to effectively target emerging food companies that can reap the benefits that existing refrigeration infrastructure provides. Some of these benefits include getting up and running in a shorter amount of time and doing it with less upfront capital outlay.

As the third-party logistics (3PLs) sector addressed consolidations and demand for infill space, real estate owners, developers and partners will see significant opportunities for smaller, regional providers to take market share from the larger operators. These emerging 3PLs have quickly raised significant amounts of outside capital and their goal to service the 1,000 to 5,000 pallet customers that are more difficult for the major operators to service. Additionally, 3PLs will begin to partner with their real estate partners such as developers who have entitled land positions in key gateway markets. This partnership will be both a speed-to-market play as well as their ability to execute.

With food manufacturers and processors looking to diversity their footprint and spread the risk of significant losses to production resulting from plant closures, real estate developers and owners will begin to capitalize on the imbalance of supply and demand.

Colliers Food Advisory Services is confident all aspects of the food supply chain will continue to evolve in the coming years. This evolution will profoundly affect the real estate sector and will result in new opportunities for real estate investors in the industrial food and cold storage asset class. These investment opportunities will not be without challenges, namely in terms of underwriting. However, given the success of industrial food real estate assets observed over the past year in an otherwise volatile economic landscape, we believe this asset type can provide investors with an investment opportunity that can be highly resistant to economic changes.* These assets should yield good, long-term value for developers and investors alike.

Citations

Clayton, D. &. (2020, July 23). *Cheney Brothers Announces Partnerhsip Investment from Clayton, Dubilier & Rice*. Cision PR Newswire. Riviera Beach, Florida: PR Newswire.

IBISWorld Inc. (2020). *Online Grocery Sales*. IBISWorld Inc.

IBISWorld Inc. (2020). *Single Location Full-Service Restaurants in the US.*

IBISWorld Inc. (2020). *Supermarkets & Grocery Stores in the US.* IBISWorld Inc.

National Restaurant Association. (2020, February 27). *2020 State of the Restaurant Industry report released.* Retrieved from National Restaurant Association: https://restaurant.org/2020-soi-release

Colliers Food Advisory Services

Colliers International | Atlanta
Promenade | Suite 800
1230 Peachtree Street, NE
Atlanta, Georgia, 30309
+1 404 888 9000
colliers.com/atlanta

Chris Cummings
National Director
+1 404 877 9255
chris.cummings@colliers.com

Turner Wisehart
Vice President
+1 404 574 1008
turner.wisehart@colliers.com

Sam Campbell
Assistant Vice President
+1 404 781 0578
sam.campbell@colliers.com

Cater Corley
Associate
+1 404 317 0930
cater.corley@colliers.com