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Title: Retail Meals-to-Go and the Battle for Dinner

Retail Meals-to-Go

and the Battle for Dinner

Supermarket retailers are facing new pressures as consumers increasingly seek alternatives to traditional shopping, meal preparation and dining practices. Economic, cultural and generational forces are combining to push food retailers toward offering their customers new solutions to their needs. In many cases, supermarket chains are not just competing with one another, but with whole other categories of food providers.

CHART E.1: CHANNELS USED REGULARLY

Source: FMI U.S. Grocery Shopper Trends, 2014. Regularly = at least "fairly often"

Of all grocery shopping channels available to consumers, the vast majority (85%)[1] still shop at supermarkets as their primary store in 2014. But within that majority trend, another preference has developed over recent years. Actually, it might be more accurate to say that a lack of preference for any one store is taking

[1] Grocery shopping channels include supermarkets, supercenters, discount stores, warehouse club stores, low-price no-frills grocery stores, drug stores, natural and organic food stores, and convenience stores. Source: FMI *U.S. Grocery Shopper Trends, 2014* p.10

precedence. Shoppers are exercising choice more than they have at any point in the past dozen years. The good news for retailers is that at this point the proportion of shoppers without a preference is still relatively small, only 9% according to FMI's most recent survey data. The bad news is that lack of preference appears to be spreading.

This ongoing change in shopping habits is likely due to a number of factors and there are steps retailers can take to reverse the trend while at the same time leveraging off of those very factors to maintain shopper loyalty and even increase sales. But in order to understand how some of those measures can work, it's worth knowing something about the forces that are driving this change.

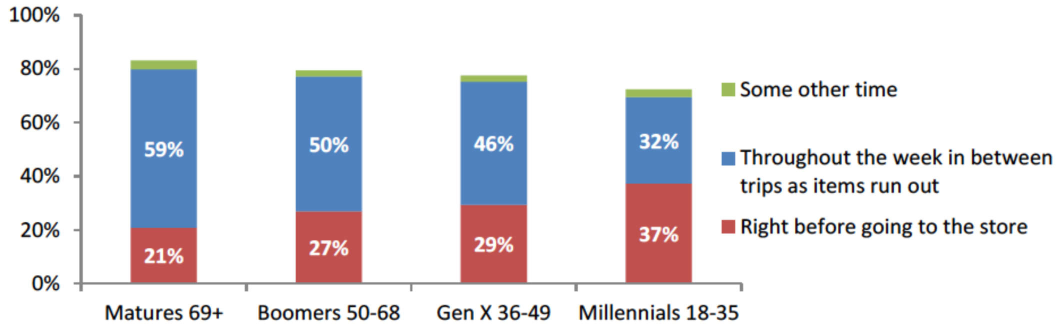
The Changing Food Retail Environment

First and foremost among these factors effecting shoppers' preference, along with the current economic conditions, is generational transformation. This shift is widespread and pervasive change across large sectors of the economy. Although homeownership among the youngest generation of buyers, commonly referred to as Millennials, has been flat coming out of the recession,[2] it hasn't been growing either. Likewise, a generational trend in auto ownership has also developed. Millennials are less likely than prior generations to own cars.[3]

Today, we have six living generations all with different likes and dislikes, collective experiences and habits. As a result, these diverse generational groups shop differently which poses additional challenges for retailers. More than half of Seniors (age 69 and older) plan their trips to the supermarket with shopping lists. This holds true for half of the next oldest generation, Baby Boomers (age 50 to 68). Generation X uses shopping lists about 46% percent of the time, and Millennials even less. This group of shoppers is more apt to make their purchases based on what they want to eat when they want to eat it.

[2] The Recession's Lost Generation Of Homeowners Isn't Millennials -- It's The Middle-Aged. Source: forbes.com/sites/trulia/2014/08/15/the-recessions-lost-generation-of-homeowners-isnt-millennials-its-the-middle-aged/
[3] The Cheapest Generation, Why Millennials aren't buying cars or houses, and what that means for the economy. Source: theatlantic.com/magazine/archive/2012/09/the-cheapest-generation/309060/

CHART E.5: WHEN GENERATIONS MAKE THEIR SHOPPING LISTS

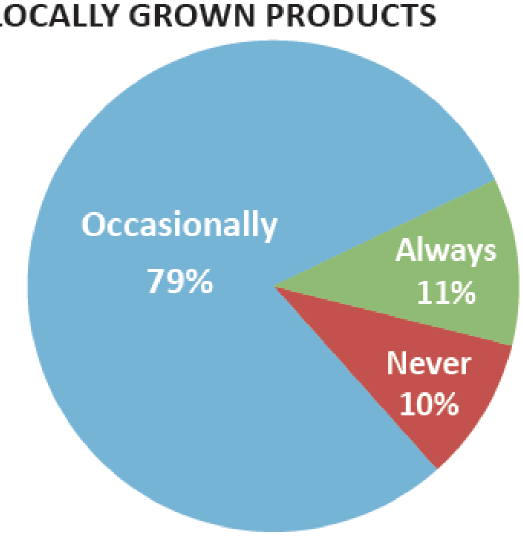


Source: FMI U.S. Grocery Shopper Trends, 2014.

Some millennials, according to research from FMI, do occasionally put together shopping lists but only after jotting down the ingredients for different recipes they want to try.

At the same time, as this generational shift is happening, another trend is occurring. Consumers overall are more concerned about wellness and healthy eating than ever before. As they become more and more savvy readers of nutritional labels, shoppers are increasingly favoring fresh foods over processed ones. *Approximately one in four shoppers say that they value minimally processed foods with the shortest list of recognizable ingredients, and if those foods are locally grown or produced, all the better.*

CHART E.9: FREQUENCY PURCHASING LOCALLY GROWN PRODUCTS

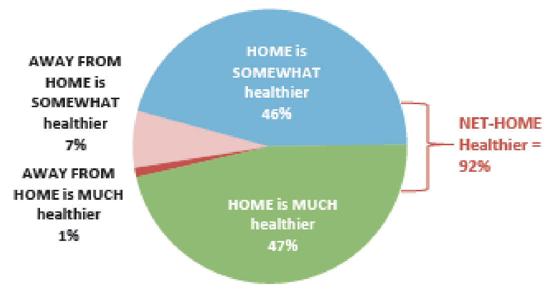


Source: FMI U.S. Grocery Shopper Trends, 2014

Two other growing trends are for locally grown foods and eating out. The first of these is easy to understand. Shoppers by and large equate locally sourced products with freshness, better taste and nutrition. These two trends, however, would seem to contradict one another. Over the past twenty years, per capita spending on food eaten at home has remained virtually flat while, at the same time, the amount consumers have spent on eating food outside of the home has risen dramatically.[4] And all this is occurring while the vast majority of consumers believe eating at home is healthier than eating elsewhere.

Almost everyone thinks eating at home is healthier—a full 92% of adults survived feel that having the control they do in the home over ingredients, nutrition and portions provides greater benefits than do restaurants and other foodservice providers.[5]

CHART E.10: ADULTS BELIEVE EATING AT HOME IS HEALTHIER THAN EATING OUT



Source: FMI U.S. Grocery Shopper Trends, 2014.

Answers to Consumer Trends

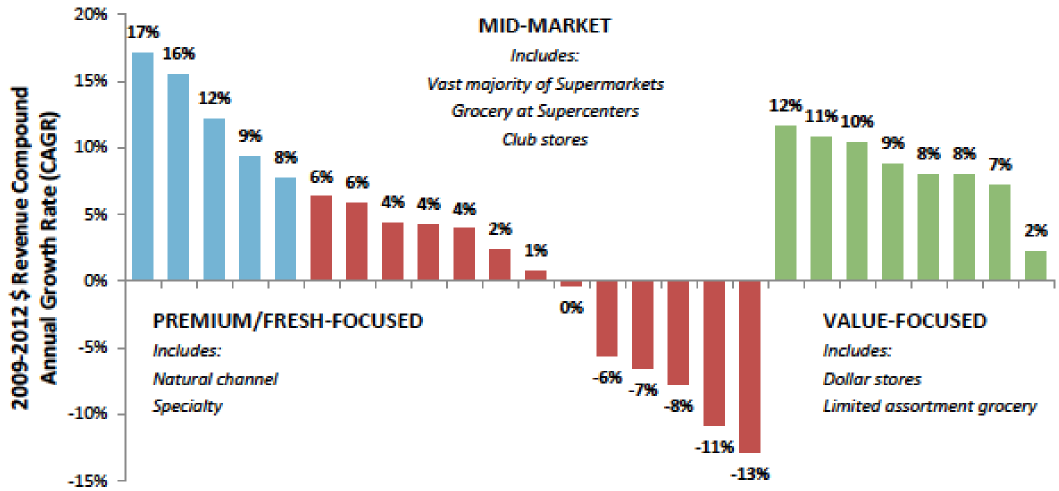
All of these factors together combine to both challenge and present an opportunity for retailers to capitalize on how consumers shop for food. One of those opportunities is lunch time. More than half of all meals eaten away from home are at lunch. Many supermarkets already provide shoppers with options for their midday meals with salad bars, sushi and deli offerings such as sandwiches and chicken.

But another more general approach has been to focus a store's value proposition on one of two different strategies. Within the grocery sector, the most successful retailers have either adopted a premium/fresh approach or a value/savings one. The former approach heavily emphasizes the fresh foods perimeter of the store and ready-to-eat foods while the latter concentrates on marketing to value-focused consumers. As it turns out, these two tracks tend to delineate the opposite ends of the retail market.

[4] Annual per capita spending in 2012 dollars on eating at home hardly moved at all from $2,213 in 1984 to $2,215 in 20212, while over the same period the amount spent on eating away from home rose dramatically from $1,560 to $2,167. Source: USDA sector estimates as reported in FMI *U.S. Grocery Shopper Trends, 2014* p.15

[5] Source: FMI *U.S. Grocery Shopper Trends, 2014* p.46

CHART 1.2: ANNUAL REVENUE GROWTH OF LEADING U.S. FOOD RETAILERS, 2009-2012



Source: U.S. Sales data for 26 food retailers from Stores.org, "Annual Top 100 Retailers," 2 additional upmarket retailers from 2013 8-K and 10-K reports, Calculations and analysis by The Hartman Group.

Between 2009 and 2012, the amount of revenue growth in these two segments has been substantial (as much as 17% for premium/fresh and 12% for value/savings) while over the same period, the non-differentiated approach taken by the majority of retailers (so-called mid-market chains including supercenters and club stores) has declined.[6]

Dramatic shifts in eating over the past 25 years have presented resourceful retailers with new opportunities to more successfully serve their customers' needs.[7]

In order for mid-market retailers to begin to see growth, the need to redefine their strategy is more crucial than ever. One way is for those stores, and others, to focus on capturing a greater proportion of today's shoppers by more effectively catering to their needs for readily available foods and recipe ingredients.

As previously mentioned, despite consumers' growing concern for healthy eating, coupled with their certainty about the home being the healthiest place to eat, an ever-increasing number of Americans have outsourced their cooking. People on average eat dinner at home less than five times a week.[8] However, the data suggests that many would be willing to eat in more often if only there were more convenient, cost-effective ways to do so.

[6] Source: U.S. sales data for 26 food retailers from Stores.org as reported in FMI *U.S. Grocery Shopper Trends, 2014* p.20
[7] Source: FMI *U.S. Grocery Shopper Trends, 2014* p.34
[8] Source: FMI *U.S. Grocery Shopper Trends, 2014* p.50

Many of the meals that are consumed at home already come from different sources. Over a third of them, for instance, come from takeout or delivery. Roughly another quarter of meals eaten in but prepared outside the home, come from fast-food outlets. The remainder of non-home prepared meals eaten at home comes from a variety of other sources including supermarkets. [9]

Freshly prepared offerings from grocers typically take either of two forms—**Ready-to-Eat** such as rotisserie and fried chicken, sandwiches, sushi, etc.; and **Heat-and-Serve** items like fresh pizza, casseroles and soups. Ready-to-Eat items tend to outsell Heat-and-Serve by 57% to 44%.[10]

Shoppers consume 15% of food purchases within an hour after they're bought.

Supermarkets can also provide consumers another convenient option for eating at home through meal solutions that place items for an entire dinner in and around a single display case. When combined with easy-to-make recipes that all together cost under $10, retailers find that shoppers, especially younger ones, are enticed.[11]

In-store cooking demonstrations (Food Theater) that feature recipes with ingredients merchandised at or around cooking stations, can highlight featured items that play to (especially younger) consumers' sense of discovery and desire for variety in their eating choices.

Retailers have a genuine opportunity to capitalize on a countervailing trend against eating out by offering consumers healthy, convenient choices. Half of all consumers express the desire to save money by eating out less.[12] Fresh prepared items from supermarkets provide shoppers a value that goes beyond just quality and convenience — they can offer customers real savings.

Supermarkets are starting to get the message. As sales for frozen and refrigerated packaged goods have declined, the growth of fresh prepared foods has accelerated into a $26 billion market over the past five years.[13]

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[9] Source: FMI *U.S. Grocery Shopper Trends, 2014* p.50
[10] Source: FMI *U.S. Grocery Shopper Trends, 2014* p.51
[11] Source: FMI *U.S. Grocery Shopper Trends, 2014* p.52
[12] Source: FMI *U.S. Grocery Shopper Trends, 2014* p.78
(FMI *U.S. Grocery Shopper Trends, 2014 – Full Report*)
[13] Source: *Fresh Prepared Foods: A Growth Driver for Your Company,* ATKearney and Technomic, 2013 p.2

So far, beyond segment-leading Whole Foods, small, regional players have achieved the greatest results in this arena. But succeeding with fresh prepared foods is by no means off-limits to others.

Implementing Successful Fresh Prepared Programs

A successful fresh prepared foods program hinges on three key factors: an **effective product mix**, a **merchandising strategy** that genuinely delivers on claims of freshness, healthfulness and value, and an **efficient supply chain** that effectively scales to shopper demand.

Effective Product Mix - By effectively changing consumer habits over the past several years, other outlets have successively eroded supermarkets' share of providing meal items throughout the day. More and more people, for instance, buy coffee ready to go than brew it at home. Likewise, fast food and quick-service restaurants have even longer-ago supplanted brown-bagging lunch. That leaves dinner as the best meal for which supermarkets can still keep from losing customers.

Consumer tastes are changing, and it's not simply enough to offer prepared ingredients for home-cooked meals in order to compete. Along with fresh and healthy options at an affordable price, shoppers want variety and selection that fulfills their sense of discovery and desire to try new dishes and cuisines. Successful players in this space have provided upscale formats that range from unique twists on comfort foods, to progressive ethnic fare that features healthy options often comparable to high-end restaurants.

For most supermarkets, however, a more widely appealing orientation toward an "elevated homestyle" will be a better fit. This approach would be one that, regardless of location, improves on the menu items customers are used to preparing themselves by offering variety and superior ingredients.

Merchandising Strategy - Beyond offering a compelling product mix, a fresh prepared meals program must have an effective merchandising strategy. The ubiquitous labeling of foods as "fresh" has rendered the term all but meaningless. In marketing their fresh prepared foods, retailers must clearly define for shoppers why the term has meaning.

The merchandising tactics available are many and well known: dish customization, attractive packaging and display, a "made-on-premises" look, aroma, evidence of frequent rotation or replenishment, appropriate signage, suggestive selling, see-through packaging and labeling that indicates when an item was made rather than when it will expire.[14]

Cooking demonstrations in high-traffic areas and merchandising complete menu ingredients, either along with them or featuring them in single-island display cases, for instance, can aid in attracting shoppers.

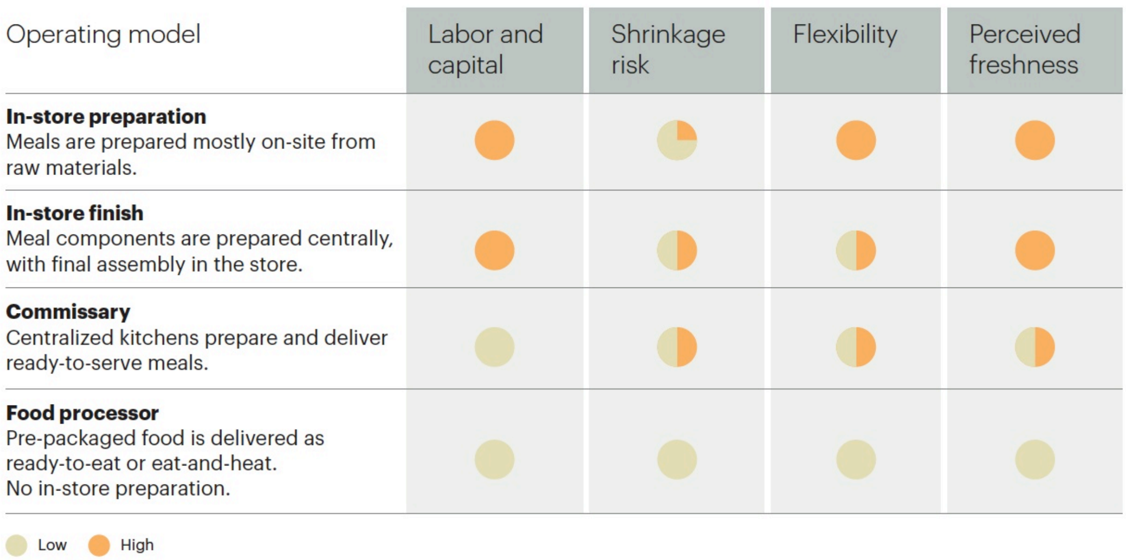
Efficient Supply Chains - A fresh prepared foods program imposes a unique set of challenges on supermarkets with which they wouldn't have to normally contend. Short shelf life with unsellable product is a big risk, for instance, if spoilage is not controlled. Food manufacturers have found ways around this particular obstacle but only after extensive effort.[15]

The supply chains supermarkets use to support fresh prepared meal programs must be attuned to not just short shelf life, but product turnover, varied assortment and target pricing. A delicate balance between having enough product on hand and reducing shrinkage has to be maintained.

One other key consideration is for food safety. Conventional supermarket suppliers may not always be setup to optimize and maintain fresh foods with short shelf lives. Doing so for many retailers will require going beyond their traditional supply chains to work with other producers and suppliers who can meet the challenges of fresh food distribution.

[14] Source: *Fresh Prepared Foods: A Growth Driver for Your Company,* ATKearney and Technomic, 2013 p.5
[15] Fresh Express took several years to perfect their bag salad product by optimizing their supply chain as reported in *Fresh Prepared Foods: A Growth Driver for Your Company,* ATKearney and Technomic, 2013 p.5

Each fresh foods operating model implies trade-offs



Source: A.T. Kearney analysis

Successful retailers have benefited from pursuing one of four different approaches to supplying their fresh prepared meal programs: in-store preparation, in-store finish, commissary production and food processors.

The on-site production of fresh prepared meals provides numerous benefits, but at the same time, presents significant challenges. By adopting an *in-store preparation* approach, supermarkets can offer consumers a clear value proposition that allows shoppers to actually see the food being produced. On the other hand, labor costs, inventory management, the need to maintain quality and food safety combined with low economies of scale can discourage retailers from taking this route.

Another avenue some retailers have taken to offering prepared-fresh foods might actually be better called frozen-fresh delivery. This approach relies on a retailer's traditional frozen product supply chain and manufacturing sources to provide the ingredients for menu items that are then prepared in the store. Many of the challenges that in-store preparation pose are overcome by *in-store finish* resulting in improved economies of scale.

By establishing centralized production facilities, supermarkets can leverage a number of advantages to maximize quality standards and economies of scale. This model of *commissary production*, when successfully implemented, allows retailers to achieve a balance between differentiated products and pricing leverage.

Going beyond a reliance on either their own facilities or frozen food suppliers, some retailers have developed arrangements with large food processors that can use their facilities to produce fresh prepared foods. The only real challenge for the retailer in adopting the *food processor* approach is in establishing an efficient supply chain and having packaging that maintains food safety.

None of these approaches is necessarily better for any one retailer than another. Supermarkets have to carefully assess the pros and cons of each one in order to determine which best align to their overall customer value proposition and enable them to achieve their strategic goals.

But whichever the route path they choose, it’s clear that in order for supermarkets to reverse the declines in loyalty and patronage the industry is facing, a fresh prepared meals program is a key, if not absolutely mandatory, solution.

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