GRAY GROWTH STRATEGIES

Opportunities in Direct to Consumer Frozen Foods

The direct to consumer (DTC) frozen foods business is in the early stages of rapid growth. As many food types are becoming increasingly available on a direct to consumer basis, the share of total purchases allocated to frozen foods is higher in e-commerce than in brick and mortar sales. Frozen food is now one of the Top 10 items to purchase when buying groceries online. An article published on LifeHacker.com noted that respondents favor frozen foods as they are difficult to mess up. They come packaged, branded, and sealed, meaning the consumer does not need to trust a delivery person or personal shopper to choose a quality item.

Gray Growth Strategies examines the state of the DTC temperature-controlled foods market and its prospects for future growth.

THE DTC FROZEN FOOD BUSINESS – PRE-AMAZON ACQUISITION OF WHOLE FOODS

Before the advent of the Internet, the DTC business was called mail order. A few hundred sizeable companies plied the mail order business based on catalog sales, phone calls, and UPS or Postal Service Shipments. FedEx later emerged as an air carrier before expanding into ground service through the acquisition of Roadway Package Service.

With the growing popularity of the internet, e-commerce began to take hold. Over time, smart phones became ubiquitous, the cost of building apps declined, delivery services such as Grub Hub and many others emerged, and supermarkets began to dabble in home delivery through services such as Peapod. Ultimately, Amazon became the 800 lb. gorilla of e-commerce and web services.

Once Amazon, Shopify, and others grew to make e-commerce relatively simple and inexpensive, the frozen foods e-commerce business began to blossom. Third party fulfillment companies, co-manufacturers, and small business e-commerce consultants, including Gray Growth Strategies, emerged to facilitate companies entering the business.

What were once a few hundred sizeable e-commerce companies grew to a significant share of all retail sales. Barriers to market entry fell. Companies no longer needed to consider spending capital on kitchens or distribution centers. And, hundreds of DTC frozen foods companies offered specialty items not generally available in local markets.

AMAZON BUYS WHOLE FOODS – JUNE 2017

Prior to June 2017, e-commerce sales of food products were a modest fraction of all retail food sales. Technology, emerging delivery options, and consumer preferences prompted supermarkets to offer the ability to order at home and pick-up at the store. In some cases, they could even arrange for home delivery without ever visiting the store. The lines between DTC and brick and mortar started to blur. Prior to Amazon's acquisition of Whole Foods, the pace of e-commerce food delivery adoption was largely consumer driven in mostly larger, urban, and suburban communities.

The Amazon acquisition changed the landscape virtually overnight. Amazon brought technology, capital, and millions of Prime customers to the evolving food delivery business. The acquisition of Whole Foods changed the long-range plans of large food retailers and frozen food Consumer Packaged Goods (CPG) companies to immediate attention items.

Recognizing that e-commerce would become a major distribution channel for frozen foods, large companies positioned themselves in the DTC marketplace:

- Tyson Foods formed a partnership with AmazonFresh to sell its Tyson Tastemakers meal kit brand online.
- Unilever partnered with China-based e-commerce firm JD.com to further expand its distribution into the DTC market.
- Rastelli Foods Group launched its own e-commerce division at the start of the frozen foods home delivery movement.
- CPGs such as Talenti, Amy's, Applegate, Beyond Meat, Udi's, Dole, Kellogg's, and others sell frozen products through FreshDirect and other meal delivery channels.

In an interview with Food Dive, Mondelez indicates that it wants its e-commerce business to snag $1 billion by 2020, and said in an email that third-party retailers will make up most of its e-commerce revenue.

In an interview with Food Business News, Jeff Hamilton, president of Nestlé USA's foods division, credits technology as the reason it can now include frozen foods in its e-commerce channel.

In a presentation at the Path to Purchase Summit, Chris Perry, senior director of e-commerce for Kellogg Co., advised CPGs to make online DTC a pillar of their brand strategy.

"D2C models have already been launched or are being planned for launch this year by 44% of CPG companies, and e-commerce is projected to deliver 50% of CPG growth through 2025," he says. "Launch a disruptive model on your own terms that is optimal for long-term leadership, competitive advantage and 'challenger brand out-maneuverability."

TECHNOLOGY TRENDS

Technology has played perhaps the largest role in growing the e-commerce business to date, and its dominant role going forward is virtually guaranteed. High on the list of technology trends is driverless vehicles. These vehicles can be equipped with freezers and customer lockers, and will drive down delivery costs while maintaining the quality of frozen foods in transit.

Virtual reality can allow a consumer to shop in a fraction of the time spent in visiting a store. The consumer can visualize goods on the shelf whether they are physically at the store or in a warehouse. In the virtual reality realm, retailers and large CPG manufacturers can invite consumers to find unusual items that would not be economical to stock in thousands of brick and mortar locations. Long shelf life and transportability make frozen foods natural products for an e-commerce delivery model.

MARKETING

Consumers have rapidly adopted to the time saving and variety expanding options enabled by technology. Next day delivery, once considered fast, has become a norm in many areas while expectations for same day delivery are growing. Companies like FreshDirect and others have created expectations about timely deliveries. Scheduling algorithms have become complex modeling exercises to match anticipated delivery times with the number and location of deliveries on a vehicle.

"Food retail is evolving. The customer is king, and perhaps more than any time in history, the consumers are firmly in control. Competition from multiple channels is unrelenting, and retailers must be creative and innovative in their marketing, product offerings, services and even store designs just to garner even a semblance of consumer loyalty," says David Sprinkle, research director for market research firm Packaged Facts, Rockville, Md.

The once separate worlds of e-commerce and brick and mortar are merging. Customer orders may source from multiple locations and channels. Retailers and supply chain partners will need sophisticated software and many more distribution points than they required to maintain their brick and mortar operations.

KEY FROZEN FOOD SHIPPERS

Gray Growth Strategies considers three key frozen food shippers in the post-Amazon acquisition environment.

Supermarkets

No group will be under more pressure to adopt e-commerce faster than supermarkets.

"Supermarkets face unprecedented competitive pressures today," says Pallab Chatterjee, chairman and CEO for Symphony RetailAI. "In order to compete and win, grocery retailers must transform their outdated store models and become 'stores of the future' that are agile and aligned with today's consumer preferences."

Several industry competitors responded quickly in stepping up their e-commerce game. Kroger and online supermarket Ocado, UK, formed an exclusive U.S. partnership agreement to provide Kroger customers with online ordering, automated fulfillment, and home delivery capabilities. Kroger also began testing grocery deliveries using driverless cars at its Scottsdale, Ariz., location, offering same-day or next-day delivery orders made online or via Kroger's mobile app.

Walmart established a strategic partnership with Microsoft to further accelerate Walmart's digital retail transformation. Danone, Paris, and Lazada Group, Singapore, signed a strategic regional partnership to create a superior online shopping experience for key product categories in Southeast Asia, Indonesia, Malaysia, Singapore, and Thailand.

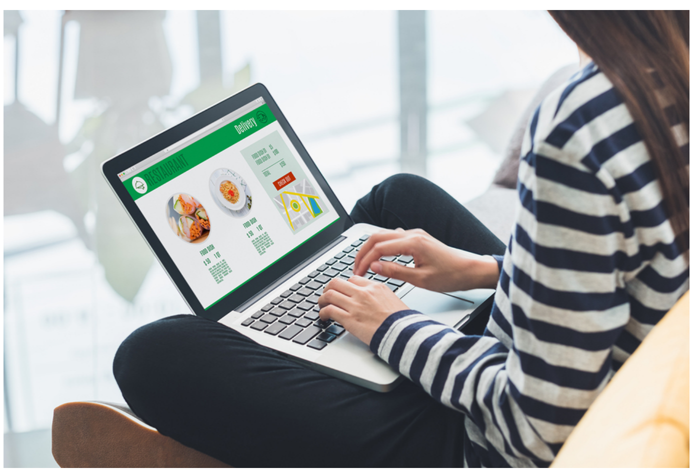
The American supermarket, and those in other countries, are about to undergo a sea change in business strategies and practices. Studies have shown that frozen foods are likely to see a significant fraction of food ordered online for home delivery.

There's no denying online grocery is rapidly growing, but what many may have overlooked is the major effect it is having on the frozen foods industry, according to a column penned by Michelle Cote, vice president of data and insights at MyWebGrocer, Winooski, Vt.

According to MyWebGrocer's research, there is a significant opportunity for frozen food brands to drive even more revenue online. The report found that not only are consumers buying frozen foods online, but they're also spending more on these items online than they are in store.

For example, almost 80% of all online carts included frozen products, making it the fourth most popular e-commerce grocery category. Frozen products are purchased 13% more online than in-store (in terms of dollars spent). With an average basket value of $166, frozen food buyers spend 6% more than average consumers.

"Studies have shown that frozen foods are likely to see a significant fraction of food ordered online for home delivery."



Large CPG companies

Building a DTC model enables large CPG companies to better serve niche markets, communicate directly with their customers and obtain market research on products and how their customers use them. Now more than ever, food and beverage brands have the power to own their customer relationships. Digital platforms, including Facebook, Twitter, LinkedIn, Instagram, Snapchat and others, are empowering brands to open new channels of communication and broaden their customer reach, according to "Going digital, going direct," a report published by Deloitte, New York.

Large CPG companies will be able to offer flavor combinations that would never merit shelf space in a supermarket freezer. With shelf life measured in months, a large CPG can create product variants that appeal to niche tastes. The DTC channel allows CPG companies to easily and inexpensively test market new products. As a result, the DTC channel provides a unique opportunity to build a better relationship with people of similar cultures through food tailored to their tastes.

Smaller CPG Companies

DTC is the preferred distribution method for many start-up and emerging CPG companies. The attractions of the DTC model include the following:

- Ability to develop a supply chain with minimal capital costs, time, and staff.
- Better margins than selling wholesale to retailers
- Outsourced supply chains seamlessly expand and contract with seasonal traffic demands.
- Less capital intensive than selling wholesale – less inventory/sale required and no need to wait for payment post-sale.
- Allows company management to focus on product development, sales, and marketing.
- No need to acquire distributors and shelf space in heavily contested retailer freezers.

Most smaller CPG companies sell products that are either unusual, or appeal to a niche market. Examples of frozen food subscription model companies include premium steak purveyor Butcher Box, healthy home prepared baby food company Raised Real, and premium dog food producer The Farmer's Dog. As few as two distribution points can provide almost 90% coverage of the conti-guous US population via 2-day ground service. For many smaller CPG companies selling a frozen product, DTC is the preferred means of distribution.

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SUPPLY CHAIN PROVIDERS

The universe of DTC supply chain providers includes the following key players:

- Co-Manufacturers (co-mans)
- Third Partly Logistics providers (3PL's).
- Delivery companies
- IT companies
- Industry Consultants

Supermarkets may use **co-mans** for some of their private label products. Large CPG companies probably do not use co-mans today, but may in the future. Co-mans allow a company to create small batch products in facilities appropriately sized for smaller batch processing. For example, large scale CPG firms may not want to run a high-volume processing line for only 45 minutes a month to create a specific flavor variant with small market share. Small CPG's commonly use co-mans for their production needs.

3PL's play the hub role in a hub-and-spoke outsourced supply chain. Frozen foods can be shipped from anywhere in the US (or Canada with proper certification) to strategic locations for DTC distribution. At present, the majority of frozen food 3PL's offering DTC services are smaller firms. As the larger temperature controlled 3PL's receive requests for DTC servicing, one can anticipate that multiple large scale 3PL's will add these services. Two to three strategically located 3PL locations will allow for 1 and 2-day ground delivery of frozen foods to a large percentage of the contiguous US population.

Same day delivery will place a premium on 3PL location. 3PL's located in or around major metropolitan regions can serve as additional distribution points for supermarkets and others who place a high value on same day and one day delivery. Traffic congestion in large metropolitan areas will require considerably more distribution points than many supermarket chains can accommodate internally. Most retail locations do not have the square footage to carry the volume and variety of goods to be sold online.

Delivery companies include FedEx, UPS, and other traditional carriers. New companies are emerging to handle local deliveries and 1 and 2-day ground services in delivery patterns that extend the 1 and 2 day reaches offered by the larger carriers. LaserShip of Vienna, Va. is one such company. LaserShip has expanded its 1- and 2-day ground service for e-commerce deliveries to span 11 states.

IT companies are essential to managing the supply chain network. Fulfillment centers can expect orders to source from multiple retail locations and online access throughout the service region. Sophisticated software will be needed to account for order splitting among multiple fulfillment centers. The same software will need to track inventory levels to keep inventory costs under control while minimizing stock outs on an increased number of sku's.

Most existing temperature controlled 3PL's are smaller operations. They utilize 3rd party software to manage their operations. From a client perspective, the local 3PL software is unlikely to provide a consolidated view of a client's nationwide inventory status. Clients will either need to develop their own software or rely on the larger 3PL's to develop the capability to forecast and maintain proper inventory levels in multiple 3PL's throughout the client's supply chain network.

Finally, **industry consultants** play a critical role in advising new DTC marketplace entrants. As new entrants,

few companies will have the experience to initiate and manage these networks as they grow. Consultants guide companies to adopt the new DTC distribution channel. Many trade-offs should be considered as some segments of the supply chain will adapt to the needs of larger users faster than others. Consultants are needed to evaluate costs, location, IT sophistication, and other factors for their clients.

BUILDING A DTC FROZEN FOOD DISTRIBUTION NETWORK

Companies looking to enter the DTC marketplace have strategic choices to make in their approach to DTC adoption:

- Buy an existing business in the DTC arena to acquire their personnel and knowledge base.
- Build their own network using new hires.
- Work with supply chain consultants.

Supply chain consultants offer the following:

- Save time.
- Minimize mistakes.
- Build a platform for future business.
- Make introductions to major players.
- Offer knowledge of competitors.
- Stay abreast of changing rules and regulations within the supply chain industry.
- Provide fast-to-market scalability, nationwide presence, and 360-degree "turnkey" solutions.

Supply chain consultants also deliver objectivity, focus, experience, skillset, and recommendations for change. They can help companies devise an effective supply chain strategy that identifies and executes the steps needed to grow. Supply chain consultants maintain a network of 3PLs for temperature-controlled products, as well as a network of co-manufacturers for fresh, frozen, and modified atmosphere packaged (MAP) food.

GRAY GROWTH STRATEGIES

Experts at Gray Growth Strategies, New York, work closely with your team to understand business objectives and process flows, identify ways to improve your logistics management and suggest steps to cut your time to market and related costs. They bring a unique set of disciplines–from operational to strategic and marketing–to migrate your company's concept or prototype into a full-fledged commerce-ready service. From DTC meal delivery programs and functional foods to multi-national Fortune 1,000 companies, Gray Growth Strategies maintains all the ingredients necessary to grow your company's supply chain network.

Richard Gray is a leading strategist in global direct-to-consumer marketing and business model development. An expert brand marketer across multi-channel environments, he achieves results quickly and within optimized budgets.

Streamline Your eCommerce Operations Today!

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"I have worked with Richard Gray on multiple projects involving frozen foods and logistics. Richard brings multiple strengths in dealing with the companies he assists. Mr. Gray is highly knowledgeable about all facets of the frozen food supply chain. He has personal contacts with many industry participants.

But even more valuable to many of his clients is his understanding of their perspective and attention to detail in responding to their questions. Richard Gray has the ability to educate and inform his clients without talking below or above their level of understanding. He has this ability to assess how much information is too much and how much is too little.

Richard Silverman, CFO, Fresh Diet"

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