

Research @ Citi Podcast, Episode 31: Snack Attack — The U.S. Migration to a Healthier Diet

Recorded: April 8, 2025

Published: April 23, 2025

Host: Lucy Baldwin, Head of Citi Research

Guest: Thomas Palmer, Food Products & Producers Analyst

Transcript:

Thomas Palmer (00:01)

I'm frankly a little surprised we haven't seen a big uptick in M&A activity here in the past couple of years. We've seen a little bit, but we have a lot of companies, I think, that— you look at their balance sheets, they're in a good enough place where they can start pursuing M&A. You look at their sales growth, it would seem like, you know, they could use something to kind of stimulate that growth given some of the ongoing volume challenges. And so maybe as we look at the coming year, we'll see a bit more than we've seen in recent years.

Lucy Baldwin (00:32)

Hello and welcome to the Research @ Citi Podcast. I'm your host, Lucy Baldwin, Head of Research at Citi. Today, I'm delighted to be joined by our packaged food analyst Tom Palmer. Tom, welcome to the podcast.

Thomas Palmer (00:46)

Thanks for having me.

Lucy Baldwin (00:47)

Well, look, there's plenty to get through today, Tom, but maybe we can just take a little bit of a step back. I mean, obviously the sector has been in focus for many clients in the recent past, partly as a result of some structural challenges candidly that it's faced even pre the development of GLP-1s. But let's have a little bit of a think about the sector, maybe, Tom, just to kick us all off, with what the space has been through really since COVID. I know myself that during COVID, me, like many people, probably spent far too much time racing to the fridge and into the cupboard whilst working from home with the sort of snacking/eating regime. I can imagine that was pretty positive for the sector during those COVID years from 2020 to '23. And then I imagine many of those benefits started to unwind, and I think today it's fair to say that one of the big challenges for the sector isn't just the challenges around being able to fully pass on price inflation, but also this inability in many cases to really drive volume, Tom. How would you frame this for us?

Thomas Palmer (01:46)

Thanks, Lucy. And the way you framed it really at a high level kind of captures it. I mean, what we've seen, especially at the onset of the pandemic, was not just a surge in food at home consumption, but it was market share gains for large companies that had much more resilient supply chains and were able to continue manufacturing in a way that some smaller competitors and even private label products were not able to. And as those pandemic tailwinds faded and you saw supply chains normalize, we saw a migration not just back to eating away from home, but to share losses for large food companies as smaller companies were better able to stock product on shelf as was private label. As we came kind of to that transition period

for volume, inflation really ticked up for food companies and they passed on a significant amount of pricing to combat that and one challenge that the industry really began to face, but not maybe as bad as feared, was volume declines in response to that higher pricing. And that brings us to kind of about a year and a half ago or so as that pricing really started to fade, companies tried to pivot and incent volume growth once again and just as we had relative inelasticity when prices were so high, we just haven't seen the same response for consumers in terms of purchasing as that pricing has tailed off and we've seen companies try increased promotional activity, outright prices being lowered and increased marketing. Most of it really just hasn't gotten the traction that these companies had hoped for. And we continue to see large food companies losing market share and in many cases, reporting negative organic sales growth in recent quarters.

Lucy Baldwin (03:33)

Got it, Tom. And what's behind that? Is that a real step change in consumers' eating habits? Is this a drive for health and wellness? I'm sure we'll talk about "Make America Healthy Again," too. Is it really GLP-1s and that's rapidly changing how people are buying and what they're buying? What do you think the big drivers are, or is it more fundamental and reflecting a slowing in the economy for certain cohorts of the consumer?

Thomas Palmer (04:00)

It's almost an "all of the above," and I think that's one of the challenges these companies are facing today. So one, if we look at income ranges, we have seen a pullback, especially by low-income consumers. So \$25,000-and-under households have pulled back in a pretty meaningful way over the last, call it, you know, 15 or so months in terms of food at home purchase activity. This is dollars. Whereas high income, we haven't seen that same pullback. And so that's been one challenge. We have seen healthier eating trends, and so if we look total food sales, they still continue to grow 3–4% year over year as measured by Nielsen. But the share in terms of departments that we're seeing is shifting more towards fresh categories. That would be meats, dairy, produce, and you're seeing categories like frozen and categories like dry grocery, which most of these large packaged food companies focus on more, so losing share relative to those other fresh departments. That's been a challenge these companies have faced. For years, these companies pivoted their portfolios in terms of acquisitions and divestitures to be more exposed to snacking. And we've seen a bit of a pivot. I think GLP-1 is a factor for this, where snacking growth has been very challenged, and we've seen meals doing a bit better. But again, that meal side has been more concentrated in scratch cooking versus the prepared meals that many of these companies focus on in their portfolios.

And then, kind of, we found a new headwind. And that has been much more recent with just the "Make America Healthy Again" agenda and having someone very vocally point out that certain products might not be healthy for them with things like dyes in them or other additives. And that's been also an issue, I think, for— in a disproportionate way for some of these large food companies, and they're caught in a tough position where if they make these changes — and ultimately we can go into how they probably will have to at some point — they will effectively fire a subset of their customers if private label doesn't follow, right, because they're buying the product and will be priced out. Or they kind of have their situation today where you have this continued migration towards healthier products that really has emerged in a bigger way over the past three or four months.

Lucy Baldwin (06:36)

Okay, Tom, so there's quite a bit to dig into there. Just to dig into the meat and dairy on the fresh side, right, and the growth you've seen there relative to the declines in frozen and dry, is

that particularly focused around certain cohorts of consumer or is that a very widespread and, would you say, sort of enduring structural trend on the back of health and wellness themes?

Thomas Palmer (06:59)

So the argument that we've seen over time for scratch cooking, right, there is always the argument of, is this cheaper and if you have the time, won't you do it and maybe there's an element of: coming out of the pandemic, people learned more through the time they had to cook and have stuck to some of those habits. But I think one of the bigger transitions that we've seen recently is the emergence of GLP-1 and how— our work has shown that users that are using GLP-1 drugs, in terms of behavior, mirror — although maybe it's stickier, right? — mirror people that are using other diet methods. And one thing that you see when people diet is they make a conscious decision to eat healthier and they tend to have more scratch cooking. And it has broader impacts, I think, than just looking at GLP-1 penetration because you also have families that end up changing diets around meals, right, when one member of the household, especially if it is the primary cook, is using or on a diet. And so that has, I think, maybe had broader impact. But then also in the younger generation, we have seen general, right, healthier trends. Alcohol consumption tends to be lower and we are seeing, I think, more of a migration towards scratch cooking. So it's not just one thing, but I do think GLP-1 is important with other contributors as well.

Lucy Baldwin (08:23)

And when you layer in, then, the sort of “Make America Healthy Again,” you know, talk us through how big food companies would think about this. Do they really want more regulation because actually it just pushes up the barriers to entry? I imagine in parts of the sector, maybe such as snacking bars, historically, the barriers to entry have been relatively low and actually if there's, you know, more regulation, it can be a good thing from a market share perspective for some of the bigger names?

Thomas Palmer (08:51)

Yeah, this has really been one of the debates, I think, that has emerged in recent months is the “Make America Healthy” agenda has gotten more traction. And ultimately, if changes are mandated, our view has been that large food companies are likely to have an easier time making these changes. In many cases, these companies have global operations and are manufacturing products overseas without certain additives already. There's a couple of reasons, but one of the reasons you might opt not to do it in the United States would be cost reasons, right? An ingredient could be cheaper. And then secondarily, and we've seen this with some companies, if you remove certain food dyes for, let's say, a kid's product, it now is visually less attractive and less likely to be purchased. And so there have been companies, including in, like, the cereal category, right, where they'll remove additives — dyes, mainly — see sales fall, and then add them back because that consumer base historically did not really mind that the dye was in there. That was part of the appeal of buying the product. And so by now changing consumer perception, the hit is really happening today where people are being told in a very visible way, these products are not good for you and we're starting to see disproportionate share losses for certain types of products such as kids' cereal. And that's— I think that's the headwind.

If we look out a couple of years, if mandates are ultimately enacted where these additives can't be used, it's going to be large food companies who are better positioned to make those changes. They might have the formulas in place already. They're going to have an easier time sourcing and pivoting. Again, the challenge today is if you make those changes in isolation, you have increased your cost structure, you probably need to take pricing and your

competitors, if they don't follow — in many cases, especially private label, they would be unlikely to — you could face some added share losses. So I think today is more the challenge when I think about those headwinds more so than when we look out when actual product changes could potentially be mandated.

Lucy Baldwin (10:56)

And then just to pivot into perhaps pricing, you know, what are we seeing there? You know, is it certain categories like coffee, like chocolate, or where are we with the broader premiumization across the sector? Are we sort of maxed out and at the limits or are there still a number of trendy categories out there, Tom, where you can continue to push that price architecture further? What's the sense?

Thomas Palmer (11:20)

So in the case of cocoa and coffee, which both are very inflationary today and likely to get worse given tariffs, which we can touch on, we're likely to see continued price increases. I think one difference that maybe we've seen with coffee versus cocoa is coffee is very much a pass-through. And companies broadly have been very clear that as much dollar inflation as they're seeing on coffee, that's kind of what's going to translate on shelf. And there is hedging to allow it to happen kind of concurrently where it might take, you know, 60 or 90 days to increase, implement a price increase, and that's also— the hedging will allow companies to make those changes without it impacting their profitability in a meaningful way.

In the case of cocoa, one of the challenges that companies have faced, especially in the U.S., more so the U.S. than other parts of the world, has just been some of these healthier eating trends and less snacking have hurt the chocolate category broadly, and so companies have maybe shown a bit less of a willingness to pass on the full magnitude of cocoa inflation and pricing, and so that's something now that we've got kind of another leg up potentially in cocoa coming just with the tariffs that companies are going to have to grapple with how they want to kind of address that if they'll pass it on in full or absorb some of the hit. And look, we don't at this point really have an answer. In terms of other parts of the store, I'd say we're seeing less in terms of price increases. Again, this could change a little bit with certain tariff considerations such as packaging, but it's more likely to be recently more price investment and companies trying to kind of combat some of their share losses, and they tend to be the industry leaders, right, these large companies I'm referring to. So they are the more proactive companies taking pricing action, and then sometimes the industry follows, sometimes not.

Lucy Baldwin (13:18)

Got it. Well, Tom, given we've just gone through Liberation Day, it's probably worth talking about tariffs, and talk us through what you're expecting to see in terms of the impact for your sector and if there's any sort of meaningful supply chain reconfiguration that needs to happen on the back of what we've heard so far.

Thomas Palmer (13:38)

Relative to other consumer categories, food comes out relatively unscathed. Most companies have supply chains that are more at least North America-centric and manufacturing footprints that are very U.S.-centric. So there's not a lot of manufacturing on another continent and then shipping the product finished goods into the U.S. Where we will see some pressure is going to be certain agricultural products that cannot be grown in North America or the U.S. given climate considerations and the two major ones are going to be, and we just talked about how they're already inflationary, cocoa and coffee, and then secondarily, you could see things like

spices and seasonings that are hard to source. So that's on the ingredient side, and then on packaging, that's where you'll see more overseas exposure, especially when considering like canned goods and the packaging for that. We don't have an answer yet on kind of how these companies will handle it. But ultimately, I don't think there's much optionality to start sourcing those products on a more localized basis. I think it's more there'll just be a higher cost of procuring them that these companies will have to kind of grapple with. I'll just note on kind of the Mexico–Canada dynamic because there is a lot more flow from both of those countries in terms of food. At this point, most companies believe that those products will fall under exemptions from tariffs. And so at this point, and this could change, it seems more about overseas versus those two countries in terms of tariffs.

Lucy Baldwin (15:16)

That's helpful, Tom. And then when you think about the group of companies that you look at, you know, what proportion roughly of their business tends to be outside of the United States and presumably in the new environment that we're entering from a world order perspective, growth outside of the United States maybe becomes more complex, less of a priority for a whole host of regions. Is there a need and a pressure to create local brands in local markets for those companies operating outside of the U.S.? Be just great to get a sense of the sort of growth dynamics that you see going ahead outside the U.S.

Thomas Palmer (15:52)

So the majority of the food companies that I cover tend to be more U.S.-centric in terms of their operations, and then they might sell those same brands overseas. Often, it could be exports, often, we're talking, you know, 85, 90% of sales coming from the U.S. and so very U.S.-centric. Now, there are going to be a few companies that I cover, so Mondelez, which—Oreo is an iconic product, that have very global operations, only 25% of Mondelez's sales come from the U.S. And that's a company that has done— they go around buying up, over a series of time, a lot of large regional brands, and so there's some very large U.S. ones, but also more diversified. And you'll see that also from McCormick, right, the leader in spices and seasonings, where there's the McCormick label that's sold in many parts of the world, but they've also acquired a lot of more localized brands. I think most others, you're not going to see that same breadth of product. It's going to be— or manufacturing, right? These two companies operate in terms of manufacturing around the world. You tend to see with most others more of this U.S. footprint and taking U.S. brands and trying to expand those abroad.

Lucy Baldwin (17:10)

No, that's pretty clear. Thanks, Tom. And I suppose that leads me to almost like the final part of my questioning, which is around the roadmap for portfolio transformation. Because I think historically, you know, over the last few decades, your companies have been pretty successful in shifting their business models to where they see the structural growth and where they see, you know, new categories, new trends emerging. What do you see the outlook for continued portfolio optimization, transformation as? Does that mean we're going to see a rise in perhaps M&A to combat some of the challenges and the headwinds that we've been talking about today? And maybe for context, like, who today structurally has got the best hand of cards, the right starting point in terms of the best portfolio right now based on the trends that are evident in today's world?

Thomas Palmer (18:01)

Yeah. Maybe it's just some perspective on that M&A landscape. For a lot of years, what we saw from companies was trying to pivot portfolios more towards snacking, which was seen as

higher growth than meals or some other, you know, legacy type categories. And traditionally, that growth would come from maybe smaller-scale acquisitions that were under-penetrated in terms of their distribution footprints, typically emerging brands that were still growing, and then you could get some operational synergies or, you know, cost savings from maybe taking some of that manufacturing in-house instead of using co-packers. And so that was a strategy, I'd say a lot of companies used in terms of maybe success stories. I think Mondelez has done a very good job with that. I just noted this is a company that is very global in its footprint, 25% of sales come from the U.S. and they have in different regions of the world, they'll acquire emerging brands and then use their kind of broad distribution platform to really scale up the presence of those brands in different places. We saw it with General Mills in a big way. They bought into the pet food category, an area they had not really operated in previously. I think it was seven years ago now with the acquisition of Blue Buffalo at the time, it was very—it was a well-regarded brand, but sold mainly in pet specialty stores. And then they were able to take that brand and really expand it broadly across grocery stores and mass retailers where they already sold other products. Um, so those tend to be, I'd say, the most effective M&A we've seen.

I think if you go back kind of pre-pandemic, there was some more transformational M&A that companies tried where you take kind of a large food company and then a midsize food company, both are a little bit more of a diverse set of brands, and try to combine the two and just get operational synergies without maybe the same growth path in terms of distribution. And looking back, maybe those were a little bit tougher to see as clear benefits where we sit now. I'm frankly a little surprised we haven't seen a big uptick in M&A activity here in the past couple of years. We've seen a little bit, but we have a lot of companies, I think, that—you look at their balance sheets, they're in a good enough place where they can start pursuing M&A. You look at their sales growth, it would seem like, you know, they could use something to kind of stimulate that growth given some of the ongoing volume challenges. And so maybe as we look at the coming year, we'll see a bit more than we've seen in recent years.

Lucy Baldwin (20:38)

Tom, fantastic. That's a great run-through of all the trends you're seeing in your sector. Thank you so much for joining me today.

Thomas Palmer (20:45)

Thank you, Lucy. Happy to be here.

Lucy Baldwin (20:47)

This episode of Research @ Citi was recorded on Tuesday, April the 8th, 2025. I'm your host, Lucy Baldwin. Do join us next time as we sit down with Kate Moore, CIO of Citi Wealth.

[Disclaimer] (21:02)

This podcast contains thematic content and is not intended to be investment research, nor does it constitute financial, economic, legal, tax or accounting advice. This podcast is provided for information purposes only and does not constitute an offer or solicitation to purchase or sell any financial instruments. The contents of this podcast are not based on your individual circumstances and should not be relied upon as an assessment of suitability for you of a particular product, security or transaction. The information in this podcast is based on generally available information, and although obtained from sources believed by Citi to be reliable, its accuracy and completeness are not guaranteed. Past performance is not a guarantee or indication of future results. This podcast may not be copied or distributed, in

whole or in part, without the express written consent of Citi. ©2025 Citigroup Global Markets Inc. Member SIPC. All rights reserved. Citi and Citi and Arc Design are trademarks and service marks of Citigroup Inc. or its affiliates and are used and registered throughout the world.