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The Great Grocery Grab of 2020 and the Ongoing Impact to U.S. Animal Protein

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Inside…

Key Points:

- 2020 was the most volatile and, for many, the most challenging year in U.S. animal protein history. The COVID-19 pandemic drove a historic shift to eating at home, temporarily closed nearly half of U.S. red meat capacity in the spring, and lifted retail meat prices to record highs.
- In spring of 2020, U.S. food consumption reverted to a level of at home food consumption not seen since the early 1980s, and with that, the greatest and most rapid shift in meat and food supplies the industry has ever seen.
- While 2020 may be over and U.S. protein supplies are back to normal, the foodservice sector has lost one in five restaurants nationally during the pandemic. It could be the back-half of 2022 before foodservice sales return to pre-pandemic levels as the restaurant industry rebuilds.
- As U.S. animal protein consumption slowly returns to normal, the food service sector will still lag. That means a challenging outlook for food service-focused animal proteins including high-value beef cuts, poultry produced for foodservice specs, and labor-intensive processed meat products that are in short supply.

Introduction

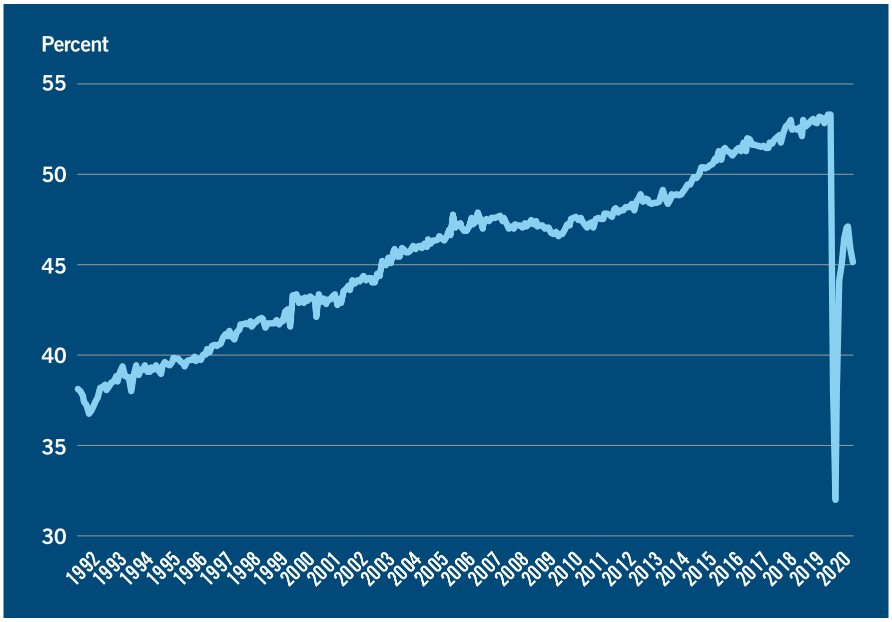
As COVID-19 spread around the world in the spring of 2020 and restaurants across the country closed, the pandemic caused a historic shift in the U.S. to eating at home. It upset the long-held U.S. food consumption trend toward restaurants and other away-from-home outlets. Foodservice sales declined by more than half in April 2020 as cities and states across the country ordered or requested their citizens to stay home. This drove consumers to empty the shelves and meat cases in grocery stores to fill their home pantries. During this time, away-from-home food consumption fell to just one-third of total food expenditures – a level not seen in the U.S. since the early 1980s. Ultimately, this led to one of the largest shifts in the U.S. food supply chain as food distributors, processors, and retailers diverted massive portions of meat and other food originally intended for restaurants into retail distribution channels and grocery stores around the country.

Since spring 2020, foodservice sales have improved but remain well below 2019 levels, and its proportion of total food consumption is similar to the early 2000s *(Exhibit 1).* This prolonged period of reduced restaurant foot traffic will cost the restaurant industry over $240 billion in lost sales and nearly 2.5 million in lost jobs in 2020 alone according to the National Restaurant Association. Possibly more significant to the outlook for foodservice demand is the estimated one in five restaurants that have closed. Making matters worse, foodservice sales this fall have only worsened as COVID-19 cases have risen, which is a trend that will likely only continue through the winter *(Exhibit 2).* As we look ahead in 2021 as the availability of vaccines improves over the course of the year, the hole left by the closing of the thousands of restaurants will mean that foodservice demand will take far longer to normalize.

An Uneven Recovery

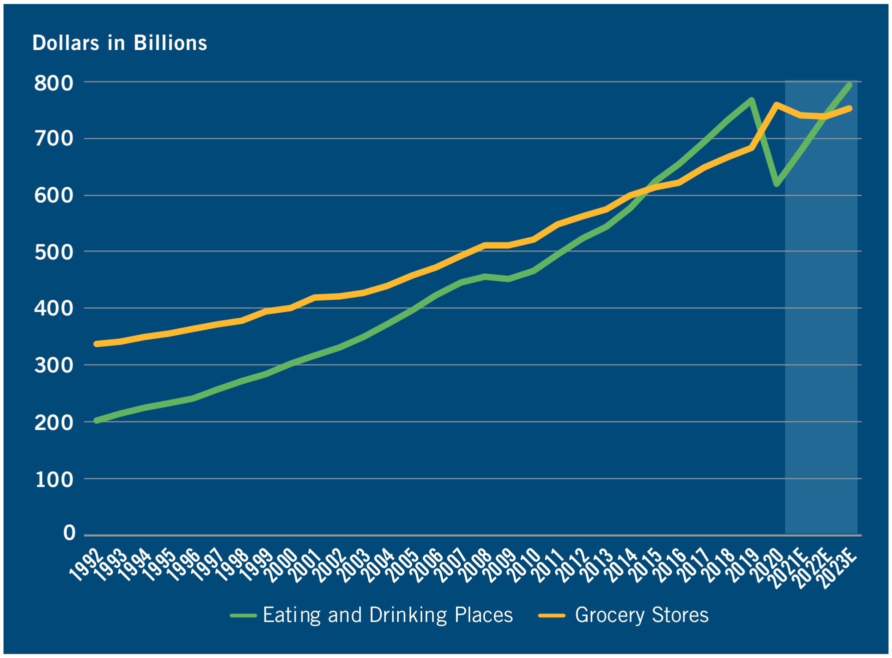
The importance of individual foodservice channels varies greatly by animal protein species and by producer *(Exhibit 3).* Some foodservice channels have rebounded from spring 2020 lows to actually achieve sales growth, as indicated by positive comparable-store sales since the summer for a number of fast-casual and quick-service restaurants (QSR). Meanwhile, full-service restaurants continue to face double-digit declines in sales. In November, full-service restaurant sales were down 36% versus last year while total

EXHIBIT 1: Percent of U.S. Food Consumption Away From Home



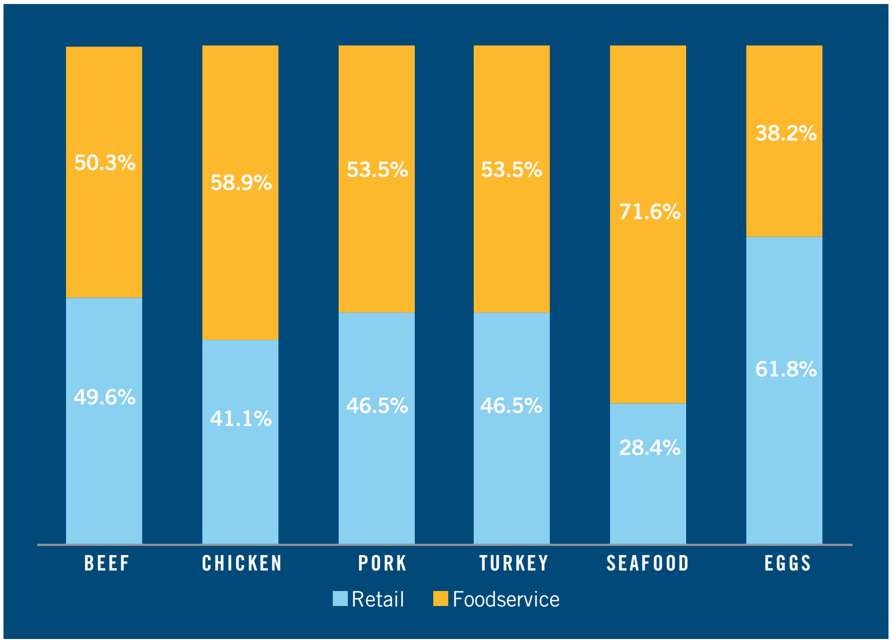
Source: U.S. Census

EXHIBIT 2: U.S. Food Spending



Source: U.S. Census

EXHIBIT 3: U.S. Animal Protein Foodservice vs. Retail Volume in 2019



Source: Urner Barry Consulting

foodservice sales were down 17%. In-restaurant dining will be vulnerable as long as consumers remain wary of dining indoors and many cities and states restrict or prevent indoor dining this fall and winter while COVID-19 cases remain elevated.

These differences in the performance of the various foodservice channels is especially evident in U.S. beef consumption. While ground beef makes up the majority of beef volume through foodservice, it makes up only about one-third of the value due to its low price point. Ground beef in the limited-service restaurant channels has performed quite well, but the beef sector continues to be hurt by the full-service, hotels, and education channels that remain depressed. The high-value steaks and roasts that are primarily sold in these channels only make up a quarter of the volume of beef sold through foodservice but nearly half of beef sales. Many fine dining establishments – especially those that are independent and privately owned – closed during 2020, and in the months to come will leave a significant hole in beef demand.

As a result, approximately a quarter of the high-value steaks and roasts for full-service is finding its way to retail. This is the primary reason consumers have found a significant increase in the amount of prime graded beef available at retail. At points during the summer when full-service restaurants were especially stressed, the spread between prime and choice graded beef contracted to unusual levels. We view this as not only evidence of the challenges in the industry but also the flexibility available in certain areas of U.S. animal protein.

An Inconvenient Lack of Convenience

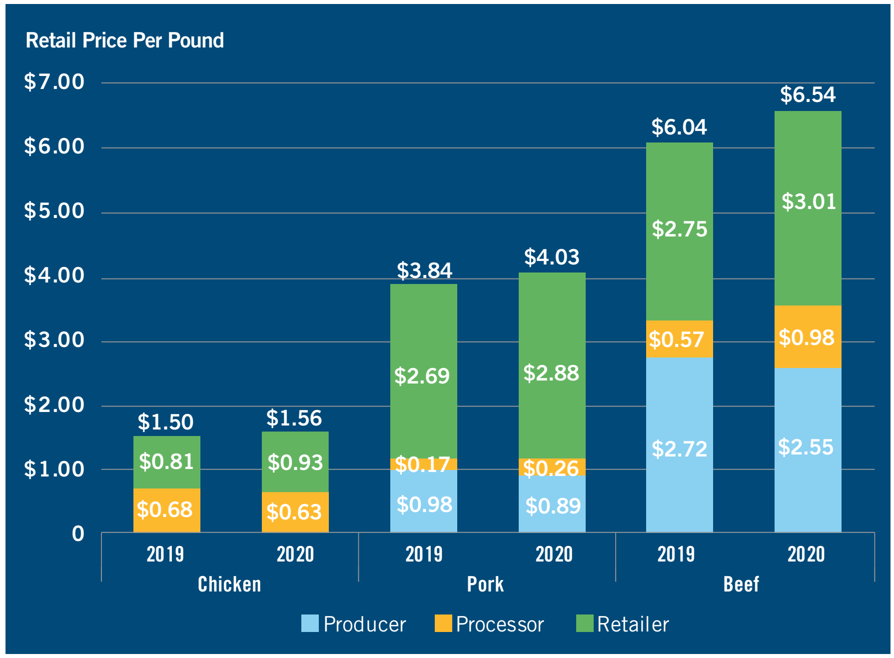
As consumers have shifted to an unusual level of at-home food consumption, they have also found fewer value-added and convenient meat products at grocery stores. This is especially true in the value-added meat products that are manually processed by hand. Since last spring, meat plants have experienced significantly higher rates of employee absenteeism, which has continued throughout the year. Weekly livestock slaughter has returned to at or above year-ago levels, which has been accomplished by shifting the meat plant workforce out of secondary processing (where these value-add and convenience products are produced) and into primary processing.

This shift in meat plant workforce has been especially felt in the pork sector where the vast majority of its products sold at foodservice are value-added and further processed items. Items like bacon, breakfast sausage, deboned (boneless) hams and others make up the bulk of pork at foodservice. The more stable prices of bone-in ham over the course of 2020 reflect the ebbs and flows of pork exports to Mexico and China where the majority of bone-in hams are exported. Meanwhile boneless ham values have shot up and held a historically large premium over the bone-in product.

The lack of these convenience products has impacted the profitability of pork processors as these products are

generally more profitable than the basic whole muscle cuts that the industry has had to focus on during the pandemic. The labor environment since last spring is far from normal, and in some cases, has become more challenging for the U.S. animal protein industry this fall and winter. It may be many months before convenience meat product prices and availability are what meat processors and consumers have come to expect.

EXHIBIT 4: Retail Share of Revenue Per Pound of U.S. Animal Protein



Source: USDA AMS, CoBank Estimates

Flexibility is Key

The beef and pork sectors have flexibility because major packers sell their products to a variety of retail, foodservice and export customers. In the poultry sector, however, many poultry integrators and poultry plants focus either on retail or foodservice, not necessarily both. Under normal market conditions, the retail channel accounts for approximately 40% of U.S. chicken volume but is 60% to even 80% for some U.S. chicken companies. This was a fortunate channel mix during the COVID-19 pandemic, but it made for a very challenging year for those producers who sold their products with just as much focus on foodservice.

Making matters more complicated is that the chicken grown for one channel is very different than for the other, and that can also be said for the plant where it is processed. The smaller bird needed for the chicken sandwiches that have become the must-have menu items at QSR is quite different than the big birds processed in other plants. As many of the foodservice channels that big bird producers focus on have been pressured in 2020, many of these companies are looking to cut costs and supply until foodservice demand returns and possibly shift their business models for the long-term.

Margin Shift to Retailers

The historic shift in food consumption during the COVID-19 pandemic lifted margins for grocery retailers as they have been able to increase prices of animal protein and other food products over the course of the last year *(Exhibit 4).* In 2020, retail beef prices climbed by 8.1%, pork by 4.8% and chicken by 4.5% according to the USDA. This isn't the highest level of retail meat price inflation U.S. consumers have seen, but as livestock prices were overall lower in 2020 it does indicate that grocery retailers are seeing higher returns in the meat case than before. With the foodservice sector expected to experience a continued uphill battle in 2021 and for years to come, grocery retailers look to be in a favorable position to capture margin and pricing.

Some packers and processors, especially beef packers, realized higher margins in the last year due to their limited processing capacity. But for all animal protein processors, costs of livestock harvesting increased significantly during

the pandemic as processors increased wages, invested heavily in personal protective equipment, and experienced significant idle time in the spring. As a result, while there are examples where price spreads for processors have increased relative to 2019, the bottom line profitability has not increased to the same degree.

Conclusion

The trends in U.S. consumer demand for at-home and away-from-home consumption are central to the profitability and viability of the animal protein supply chain. As the U.S. foodservice sector climbs out of the hole left by 2020, the U.S. animal protein sector will need to realign itself with the survivors of the last year. In many cases that includes the large, publicly traded, franchise and multi-location limited-service restaurants. For beef, that could very well mean a long-term shift in high-value steak consumption to retail as the upscale restaurants have been especially hard hit and seen a significant number of closures. The pork sector will need to bring back the value-added meat products that not only provide convenience for their retail and foodservice consumers, but also boost processors' bottom lines – but they will need to invest in automated processing equipment. Poultry producers that focus on retail and fast-food chains have fared reasonably well during the pandemic but others will need to continue their focus on cost and supply reduction until foodservice demand normalizes, which may very well be one or two years away.

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