

## BAKERY PRODUCT MANUFACTURING

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### OVERVIEW

Companies in this industry make fresh and frozen bread as well as cakes, pies, and doughnuts. Major companies include Dawn Foods, Flowers Foods, McKee Foods, and United States Bakery (all based in the U.S.), along with Allied Bakeries (UK), ARYZTA (Switzerland), Grupo Bimbo (Mexico), Weston Foods (Canada), and Yamazaki Baking (Japan).

The U.S. bakery products industry includes more than 2,800 commercial bakeries with a combined annual revenue of about \$30 billion, along with about 6,700 retail bakeries with an annual revenue of about \$3 billion.

### UPDATES

The United Kingdom's in June 2016 vote to leave the European Union could increase operating costs for the nation's bakery product manufacturers. Analysts have predicted that new import duties and other taxes resulting from Brexit will limit trade between the UK and EU member countries. Because bread is a staple that is mostly produced and consumed locally, it is more insulated from trade policy changes compared to internationally distributed packaged food items, especially discretionary purchases like candy and snack foods, Bakery and Snacks reports. However, costs of imported ingredients and other raw materials from key trading partners such as France and Germany will likely be more volatile in the short term due to the fluctuating value of the British pound and uncertainty about potential tariffs. Some manufacturers are



also concerned that a weaker pound will make it more expensive to invest in capital improvements, which would be a setback to baked goods producers that frequently upgrade machinery and equipment to keep up with evolving consumer tastes. Labor costs are another major concern, as changes in immigration policy could limit the amount of available migrant workers, which make up a large portion of the bakery workforce. Volatile ingredient, capital, and labor costs could make it challenging for U.K. bakery product manufacturers to develop reliable long-term business strategies over the next several years. Working with local suppliers and focusing on regional growth could help companies insulate themselves from Brexit-related disruptions.

### TRENDS

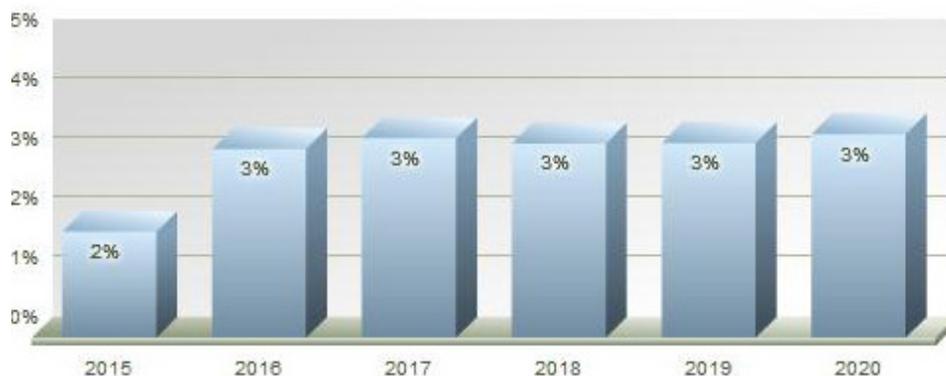
The consumer price index for food, an indicator of bakery product values, rose 0.2% in July 2016 compared to the same month in 2015. U.S. nondurable goods manufacturers' shipments of food products, an indicator of demand for bakery goods, rose 0.3% year-to-date in June 2016 compared to the same period in 2015. The spot price of crude oil, which affects energy-intensive baking operations, fell 0.2% in the week ending August 12, 2016, compared to the same week in 2015. Total U.S. wholesale sales of nondurable goods, a potential measure of bakery products demand, fell 2.6% in June 2016 compared to the same month in 2015.

Many larger bakeries increase revenues by introducing product items, often through mergers or acquisitions.



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Industry Output Forecast



Revenue (in current dollars) for U.S. bakery products manufacturing is forecasted to grow at an annual compounded rate of 3% between 2016 and 2020, based on changes in physical volume and unit prices.

Large bakers have grown mainly through acquisitions, and the industry is consolidating. Because automation is costly and margins tend to be low, many small operators cannot make the capital investments necessary to lower operating costs.

More highly automated bakery facilities allow bakers to produce a more consistent product with higher quality. To compete with giants like Flowers Foods, some small bakeries are upgrading facilities using automation and robot technology. Although costly, automation upgrades allow small bakeries to produce more goods in a shorter time. Automated bakeries are often safer for workers, because the likelihood of accidents, like burns from touching industrial ovens or hot pans, is reduced.

### CHALLENGES

The costs of major raw materials, such as wheat, vegetable oils, fuel for delivery fleets, and natural gas for ovens, can change rapidly. Producer prices for wheat and vegetable oil can vary more than 40% during a year; commercial customer natural gas prices can vary by more than 25%. To protect against sharp increases in raw material costs, many bakers use futures contracts.

Commercial bakeries operate in a mature industry and consumption trends are largely dictated by population growth. The success of individual bakers often comes at the expense of others. As customers like supermarket

chains and mass-merchandisers including Wal-Mart get bigger and have greater leverage with suppliers, small bakers find themselves squeezed by bigger producers that can negotiate nationwide contracts.

Recalls of foods containing allergy-provoking ingredients have increased, due primarily to inadequately cleaned food equipment. The Food and Drug Administration (FDA) inspects many bakeries and other food processors that supply restaurants and supermarkets to ensure that allergy-causing ingredients are not getting into processed foods. As a result of growing concern by consumer groups, the FDA has strengthened manufacturing and labeling guidelines.

### OPPORTUNITIES

Bakery products companies could reduce production costs by using alternative energy sources and investing in more efficient equipment. Bakeries can invest in solar energy systems and other alternative energy sources to supply the electricity needed to power modern production facilities. Energy efficient ovens could reduce the amount of natural gas needed for the baking process. Companies with a delivery fleet might also invest in converting their trucks from conventional gasoline or diesel fuel to natural gas or propane to cut exhaust emissions.

Connecting with the growing number of users of social media platforms and mobile apps could help retail bakeries

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market themselves. About two-thirds of American adults own a smartphone, and that number is still rising, according to Pew Research. Retail bakery operators can promote themselves through those channels by offering special deals to people who interact with their social media accounts or check in at their stores using location-based services. Social review services like Yelp have become very popular as a means of discovering new restaurants or other businesses.

Changing consumer tastes have given rise to artisan or gourmet breads. Smaller bakers with flexible production facilities can capitalize on such developments and on

differences in regional and local tastes to produce and deliver a wider variety of products, often at higher margins, than larger bakers.

Bakeries are marketing par-baked products to grocery stores and restaurants as a faster and more cost-effective alternative to baking from scratch. In par-baking, products are baked until approximately 80% cooked, then immediately flash-frozen. By buying frozen par-baked products from wholesale bakeries, grocery stores and restaurants do not have to hire highly skilled bakers or worry about products spoiling quickly.

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