

Frozen Food Fight Helps Consumers, Threatens to Burn Producers

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Published February 26, 2009

SAN FRANCISCO (MarketWatch.com) -- **A bruising battle for market share that has rattled frozen food aisles for months shows no sign of abating.**

This is good news for cash-starved consumers eager to upgrade from Salisbury steak. But it could crimp earnings at H.J. Heinz, ConAgra Foods and Nestle S.A., top sellers of frozen entrees in the U.S., if it goes on much longer.

Heinz, best known for its ketchup, makes Smart Ones, Boston Market and TGI Friday frozen meals. ConAgra sells Healthy Choice, Marie Callender and Banquet, while market leader Nestle owns Lean Cuisine, Hot Pockets and Stouffer's.

Bill Johnson, chief executive at Heinz, said aggressive promotions will squeeze industry margins and devalue the frozen food category if they persist. So far, Heinz has resisted matching the deep discounts of competitors even though this decision has undercut sales.



A promotional battle between food makers is leading to frozen entrée bargains

While Heinz does not break out frozen food sales in its financial statements, the company is the second-largest provider of frozen prepared meals in the U.S. Smart Ones holds a 27% U.S. share, Ore-Ida, 50%, and TGI Friday's, 17%, according to data the company cites from researcher A.C. Nielsen.

"We expect to lose some share rather than chase volume to achieve an end result that could be best described as profitless prosperity," Johnson said at a recent analyst conference in Boca Raton, Fla.

There were plenty of heavy promotions for frozen meals across all categories during a recent trip to a Safeway store in San Francisco.

In the health area, Smart Ones meals were fetching four for \$11, while a comparable Lean Cuisine meal was selling at three for \$10. Both normally go for \$3.79 a piece. A larger Healthy Choice meal was going for two for \$7, below its \$4.29 price.

In the restaurant category, Stouffer Home-Style Selects were being offered at three for \$10, under the \$4.69 price, while Boston Market Home Style Meals were being offered at two for \$5, below the \$4.39 price.

Johnson plans to sit tight for now. He's seen this kind of carnage before. In the mid-1990s, Heinz cut Weight Watchers prices to pump up sales. It worked but at a steep price. Weight Watchers went from being profitable to losing millions of dollars.

"Patience and prudence will be our strategy to a point," Johnson remarked. He said Heinz (HNZ 44.82, -0.23, -0.50%) may be forced to do something by spring to sustain market share.

Food companies have long defended their turf for frozen ready meals using price incentives.

Yet heightened price promotions are "due to the weaker economy as companies seek to compete with not only each other but against consumers cooking from scratch," Virginia Lee, senior research analyst at Euromonitor International, wrote in an e-mail.

Frozen meals are important to ConAgra, making up 14% of the company's total sales for the quarter ended Nov. 23. ConAgra (CAG 24.88, -0.08, -0.32%) has been offering food retailers special promotional deals to help stave off a drop in demand.

"We have had to react somewhat to pricing discounts by competitors. We have done this carefully so we can maintain the margins we need to," spokeswoman Teresa Paulsen said.

Analysts say market-leader Nestle ignited the aggressive price cuts last year after losing market share. They say the world's No. 1 food company, based in Switzerland, is probably taking advantage of the decline of the euro against the dollar and the more value-conscious mentality of U.S. consumers.

"Nestle is trying to get share back . . . they see a quick and easy opportunity," said Ed Roesch, analyst at Soleil Securities.

A spokesman for Nestle (NSRGY 47.12, -0.52, -1.09%) (CH:NESN 54.00, -0.35, -0.64%) declined to comment on the company's pricing strategy. In its Feb. 19 earnings report, Nestle said its frozen foods business has improved over the last six months, notably in Hot Pockets.

The food giant has been promoting products that save families money from eating out at restaurants like its 38-ounce Stouffer Easy Express meals that can feed four for \$7.39.

Given its gigantic stature in the food business, Nestle can make its food at a lower cost than ConAgra or Heinz. This means it can keep discounting as long as its profit margin holds and the U.S. economy stays under duress.

"They will continue to push prices down. There is no incentive for them to stop," said Frost & Sullivan research analyst Chris Shanahan.

Frozen entrees have come a long way since the fish stick was introduced during the household TV boom of the 1950s, and Lean Cuisine and Weight Watchers were unveiled amid a diet craze in the 1960s. The food tastes better and it is healthier. Companies highlight whole grain and fiber-rich ingredients as well as lower sodium and cholesterol levels on the packages.

In the past year, Heinz and ConAgra have been pushing the innovation button, a move that could help stabilize prices in the frozen food aisle and protect their profits. The companies will try to sell newer products at higher price points to counter heavy discounting.

ConAgra has launched Healthy Choice Café Steamers and Marie Callender's Signature Sautés. On the value side, ConAgra re-tooled its Banquet meal line so they can sell for \$1.

Heinz took the wraps off Ore-Ida Steam n' Mash potatoes and expanded its TGI Friday Skillet Meals business, now approaching \$250 million in annual sales.

"It remains unclear how the frozen entree category as a whole will eventually play out, considering Nestle's intent on taking up market share," Deutsche Bank analyst Eric Katzman said in a research note.

One thing is clear: There are better products on the shelf from a decade ago.

Added Roesch: "We won't revert back to days when frozen foods were treated like commodities and whoever gave the best promotion got the volume."