

Coffee Market Competition Remains Hot



About: SBUX / SJM / KFT / GMCR / SLE / NSRGY.PK /
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Summary:

Americans love their coffee and despite rising prices the love affair continues. Americans consume over \$45 Billion dollars worth of coffee every year. Retail coffee shops like Starbucks drive most consumption but foodservice locations (offices, hotels, schools, restaurants) and the supermarket and grocery channel also drive strong sales. Despite a fickle and price sensitive consumer, coffee consumption continues to grow. As one would expect competition remains intense with ever growing crossover of retail brands (Starbucks, Dunkin Donuts, Caribou, Peets) into the home and foodservice channels.

Analysis:

Let's take a look at the leading coffee companies globally:

- 1) **Starbucks (SBUX):** The largest retail store operator with 8800+ stores. Starbucks also owns and distributes Seattle Best for the foodservice market. Starbucks strongly covets growth in the at home (supermarket channel) segment. Their introduction of Via instant coffee is leading the charge but results are mixed. Starbucks also distributes its Starbucks branded coffee through Kraft's coffee division for the supermarket channel but they are clearly not happy with the overall results and would like direct ownership. Look for them to be more aggressive in the at home space with possibly an acquisition or two.
- 2) **Smucker's (SJM):** Owners of the largest supermarket brand Folgers's along with Millstone and other regional brands and licensing rights for Dunkin Donuts in the supermarket channel. Smucker's owns the dominant share in the grocery channel and has been performing well with their Folgers and Dunkin Donut brands.
- 3) **Kraft (KFT):** Maxwell House, Tassimo (single serve) and licensing from the Starbucks brand makes Kraft the number two supermarket industry coffee company. They continue to struggle with Maxwell House and the licensing arrangement for Starbucks is a cause for concern. However, growth and expansion of the Tassimo brand in the single serve segment from their international base is helping improve overall coffee sales.
- 4) **Green Mountain (GMCR):** Owners of Keurig brewers and K-Cups under numerous brands. Green Mountain leads the fast growing single serve coffee segment. They own many patents for k-cups and the Keurig system that are set to expire between 2012 and 2017. Green Mountain has been a growth leader but faces increased competitive activity in the single serve segment. They remain a likely takeover candidate with only a rich valuation and concern about increased competition deterring potential larger suitors.
- 5) **Sara Lee (SLE):** They distribute coffee internationally and domestically under the Senseo brand primarily through the foodservice channel. It continues to be their second best performing division behind their retail meats segment (Hillshire Farms, Ballpark). They too would like to expand with emphasis on the US market and the single serve segment.

6) **Nestle (NSRGY.PK):** Continued strong international presence with emphasis on their Nescafe and Nespresso brands and their recently announced expansion of Dolce Gusto coffee makers. While their strength is in espressos and cappuccino's they clearly covet improved US expansion and penetration of the base single serve coffee market.

7) **Regional Coffee Shop retailers:** Dunkin Donuts, Caribou, Peets, Tim Hortons all have strong retail presence and are increasingly distributing their coffee brands in Supermarkets. Dunkin Donuts has the strongest supermarket penetration through its agreement with Smuckers.

8) **Other Supermarket Industry Brands:** This includes Zanetti Group (Espressos, Cappuccinos), Eight O Clock, Rowland, Community Coffee and New England Tea and Coffee.

Needless to say the coffee market is crowded with some of the largest, most successful food and beverage companies. Merger and acquisition activity will likely grow in 2011 as companies position themselves for even greater growth in 2012 and beyond. Expect Starbucks to continue to attack the home and foodservice markets. Nestle is rumored to be interested in Green Mountain but they are probably not the only company that covets Green Mountain's Keurig brewing system and k-cup operation. Kraft is said to be dissatisfied with Maxwell House results but finding a buyer is more challenging. Expect smaller players like Eight O Clock to be considered for acquisition or merger.

All in all we expect the coffee market to stay hot with increased merger activity. Higher prices for Arabica beans will only mute growth. Americans need their coffee in the morning and it's clear that the coffee market will remain as hot as ever despite higher prices.

Relevant Subject(s):

Grocery Stores