

MarketLine Case Study

H.J. Heinz

Merger and diversification offer growth opportunities in a difficult market

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OVERVIEW

Catalyst

H.J Heinz is a producer and marketer of processed food products such as ketchup, sauces, meals, soups, snack and infant nutrition. This case study analyzes key strategies used by Heinz to become one of the leading food manufacturers and also assesses opportunities and threats facing the company.

Summary

- According to Marketline research the food retail industry had total revenues of \$5,848.6bn in 2014. The food retail industry is competitive and Heinz has held its position as a market leader and has built on a strong brand portfolio comprising both international and local brands. Moreover, Heinz has diversified in terms of product offering, the company is not dependent on any particular product segment for generating its revenues. Product diversification has helped the company reach out to a wider consumer base.
- Heinz has been proactive in listening to consumer demand for healthy products and a gluten free range; the company has added a range of low sodium products to its portfolio as well as over 60 gluten-free products. The gluten free market is growing rapidly and provides food manufacturers such as Heinz the opportunity to establish a position in a niche, developing market. Furthermore, Heinz is focusing on expanding its international footprint in a bid to propel growth and aims to generate 25% of its revenues from emerging markets by 2016. ,
- A merger between Heinz and Kraft Food Group was announced in 2015. The new Kraft Heinz Company would be the third-largest food company in America and the fifth-largest worldwide. Whilst it is clear that the merger between Heinz and Kraft will increase both companies' global footprint, in practice this transition may be more complicated than anticipated. Mondelez (an American multinational confectionery, food and beverage conglomerate that comprises the global snack and food brands of the former Kraft Foods Inc) holds the rights to sell many of Kraft's snack brands internationally for the next few years. Therefore, the new Kraft Heinz Company's international expansion will be limited. Moreover, a huge portion of Heinz's revenues comes from sales to Wal-Mart stores. Furthermore, the rise in private label products may adversely affect the company's revenues.

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HEINZ TRANSFORMATION INTO A GLOBAL GIANT

Heinz is a producer and marketer of processed food products such as ketchup, sauces, meals, soups, snacks, and infant nutrition. According to Marketline research the food retail industry had total revenues of \$5,848.6bn in 2014. The food retail industry is competitive and Heinz has held its position as a market leader and has built on a strong brand portfolio comprising both international and local brands. Moreover, Heinz has diversified in terms of product offering, the company is not dependent on any particular product segment for generating its revenues. Product diversification has helped the company reach out to a wider consumer base.

Heinz: A brief history

H. J. Heinz Company (Heinz) manufactures and markets a wide range of food products throughout the world. The company's principal products include ketchup, sauces, meals, soups, snacks, and infant nutrition. The company operates in North America, Europe, Asia-Pacific, Latin America, the Middle East and Africa. It is headquartered in Pittsburgh, Pennsylvania and employs approximately 24,500 people. Heinz was acquired by an investment consortium comprised of Berkshire Hathaway and an investment fund affiliated with 3G Capital in mid-2013. The company's common stock was delisted from the New York Stock Exchange.

Heinz has been able to sustain growth and increase performance through a number of acquisitions.

By acquiring a number of companies, Heinz has entered new markets and product segments, which in turn has increased the company's market share, reduced competition and helped Heinz capture a larger consumer base.

The acquisition and merging of established companies' means that Heinz can enter new geographical markets, which will reduce the risk of market entry barriers; as these players will already have a strong network of suppliers, distributors, and buyers.

This strategy means the threat of competitor retaliation is weakened which Heinz may face if it entered these markets under its own brand name.

The main factors standing driving mergers and acquisitions include economies of scale, and reduction of overheads, as these help increase profit margins. Scale economies in production are important, especially in countries where a consolidated food retail sector means that players are forced to compete intensely on price.

In 1965, Heinz acquired Ore-Ida and transformed a regional business into one of the leading retail frozen potato brands in the US. Heinz also acquired Weight Watchers International in 1978. Weight Watchers offers various products and services to assist weight loss and maintenance; the acquisition of Weight Watchers opened a new target market of weight conscious consumers for Heinz.

The company continued to expand and acquired a large number of companies during 1990s.

Heinz acquired Wattie's (a New Zealand-based food producer of frozen and packaged fruit, vegetables, sauces, baby food, cooking sauces, dressings and pet foods) in 1992 and Borden's food service business in 1994. Borden's sells single-serving packages of foods like sauces and condiments, and also sells bulk amounts of oil-based products such as mayonnaise. This acquisition helped strengthen Heinz's presence in the single-serving food-service market. The following year the company acquired pet food divisions from Quaker Oats; the acquisition allowed Heinz to continue to sustain growth in the pet food business.

Heinz continued to sustain growth and increase its performance in 2001 following further acquisitions. It acquired Poppers retail frozen appetizers business, and its licensing rights to the T.G.I. Friday's brand of retail frozen snacks and appetizers from Anchor Food Products.

Heinz has also acquired a number of brands internationally to increase its presence and global footprint. For example, in 2002; Heinz expanded its presence in China by acquiring three food processing companies Meiweiyuan Food, Meiweiyuan Food Factory and Fanyu Jinmai Food Factory.

Moreover, the company acquired Canadian foodservice sauce and salad-dressing maker, Unifine Richardson, from Royal Cosun Group in 2004. In 2005, Heinz acquired a controlling interest in Petrosoyuz, a Russian maker of ketchup, condiments and sauces. Petrosoyuz's business includes well-known brands such as Pikador, Derevenskoye, Mechta Hoziaiynki, and Moya Sem'ya.

The same year, Heinz acquired HP Foods, HP Foods Holdings and HP Foods International (collectively referred to as HPF). HPF is a manufacturer and marketer of sauces which are primarily sold in the UK, the US and Canada. The company acquired HPF's brands, including HP and Lea & Perrin, and a license to market Asian sauces and products of Amoy brand in Europe. Amoy began producing soy sauce in Xiamen, China in 1908; a license to market these products in Europe allowed Heinz to expand in Europe rapidly with a well-established Asian product. In addition to this, in 2007, Heinz' Australian subsidiary acquired jams, toppings and jellies business in Australia from Cadbury Schweppes. H.J Heinz Company Australia also acquired Golden Circle, a canned fruit and juice producer.

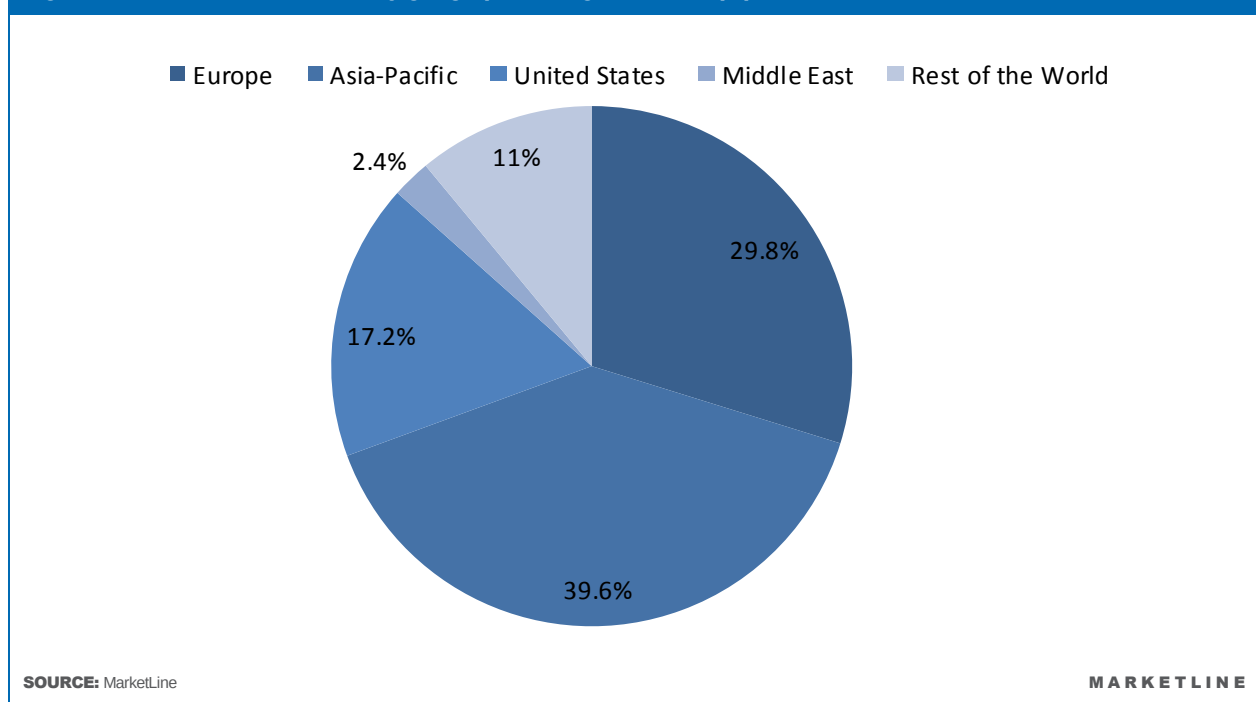
Furthermore, Heinz acquired Benedicta, a French manufacturer of table top sauces, mayonnaises and salad dressings, in 2008. During FY2011, Heinz acquired the remaining 21% interest in Heinz UFE (a subsidiary of the company in China that manufactures infant feeding products). Prior to the transaction, Heinz owned 79% of Heinz UFE.

Heinz has continued to grow and remain profitable, but underperforms the market as a whole

According to MarketLine research, the global food retail industry had total revenues of \$5,848.6bn representing a CAGR of 5.5% over the period 2010-2014. The performance of the industry is forecast to follow a similar pattern with an anticipated CAGR of 4.8% for the five year period 2014-2019; which is expected to drive the market to a value of \$7,408.4bn by the end of 2019.

The geographical segmentation in 2014 was as follows: United States 17.2%, Europe 29.8%, and Asia-Pacific 39.6%. These figures demonstrate that the food retail industry is a truly global business with opportunities on all continents, providing the rationale for Heinz eagerness to expand globally.

Figure 1: Global food retail industry geographical segmentation: (%), 2014



Heinz recorded revenues of \$10,922.3m in FY2014, the operating profit was \$1,568.4m and the net profit was \$657.1m. For FY2014, the US, the company's largest geographic market, accounted for 33.1% of the total revenues; revenues from the US reached \$3,615.3m in FY2014. The UK accounted for 14.2% of the total revenues in FY2014 and revenues from the UK reached \$1,549.5m in FY2014. Revenues from other countries reached \$5,757.4m in FY2014 and accounted for 52.7% of the total revenues in FY2014.

Heinz generates the majority of its revenues from the US and the UK: high dependence on regions or countries can make Heinz's business and operation vulnerable to country-specific trends.

Such geographical concentration increases the risk that should any adverse economic, regulatory, environmental or other development occur in a given country, Heinz business and financial condition will be affected.

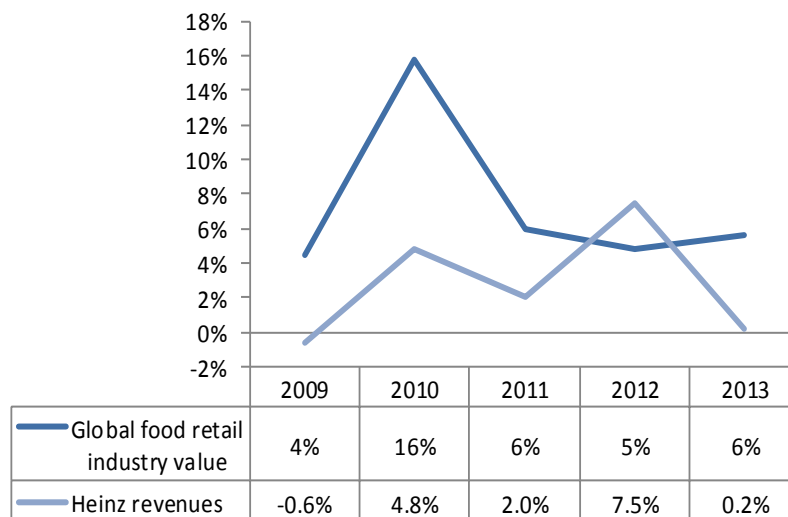
Whilst the economic conditions in the US and UK are improving, with a steady rise in employment rates, consumers are still however wary of their spending.

Heinz has taken a proactive approach to mitigate this risk and has expanded its presence in emerging market through a number of acquisitions and by increasing its brand portfolio.

The company aims to generate 25% of its revenues from emerging markets, where there is an expanding middle class and rising disposable income; by 2016. As demonstrated by the data above Asia provides many opportunities in the food retail industry; establishing its position in this region will allow Heinz to expand its brands further.

Heinz changed its financial year-end date from April 30 to December 31 in 2013, as a results the comparison for the 12-month preceding period are not available. Therefore, financial data from 2013 will be used to compare Heinz performance to the food retail industry as a whole.

Figure 2: Global food retail industry compared to Heinz growth revenues: (%) 2009-2013



SOURCE: MarketLine/ Heinz annual report 2009-2013

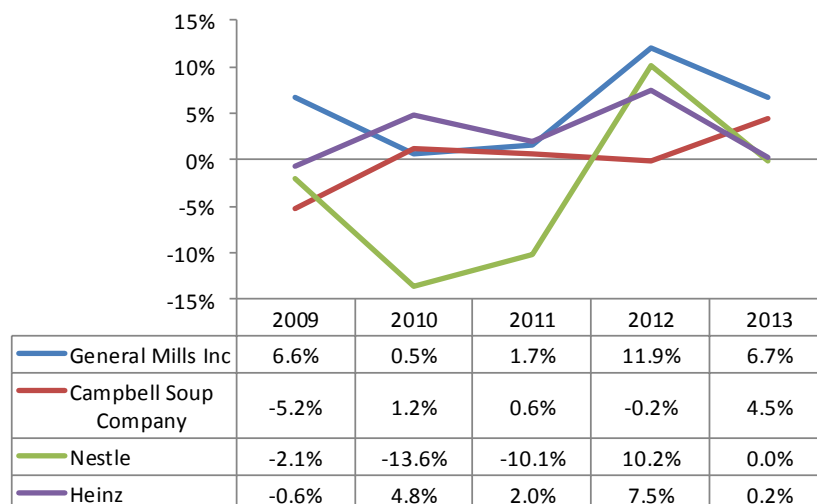
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While it is clear that Heinz has experienced fluctuating levels of growth and decline in recent years, it is important to note that it has remained profitable. During the economic downturn in 2009 Heinz, revenues declined whilst the food retail industry as a whole in fact grew. The company has been growing at a slower rate than the industry; with the notable exception of 2012.

Moreover, Heinz's revenue growth in comparison to the market as a whole demonstrates that the company's performance does not appear to be closely linked to the market's overall performance but is rather more dependent on Heinz's own strategies.

In order to provide a further analysis of Heinz performance it is important to look at the growth of the company's main competitors namely Nestle (which is one of the largest consumer goods companies in the world, operating in the food and beverages sector), Campbell Soup Company (the company manufactures and markets foods and simple meals, including soups and sauces, baked snacks, and healthy beverages) and General Mills, Inc. (a global producer of packaged consumer foods).

Figure 3: Heinz's revenue growth compared with top competitors (%) 2009-2013



SOURCE: General Mills Inc/Campbell Soup Company/ Nestle/ Heinz annual reports

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During the economic downturn all four leading food manufacturers (with the exception of General Mills) reported a decline in revenues. Nestlé's revenues continued to decline until 2012 and Campbell Soup Company reported a decline in 2009 and again in 2012. In comparison Heinz has been posting positive growth since 2009. These figures demonstrate Heinz ability to return to growth following an economic crisis; Nestle on the hand has struggled and went into further decline in 2010 and 2011.

Product diversification means that Heinz can cater for multiple customer types

Heinz has diversified in terms of product offering, the company is not dependent on any particular product segment for generating its revenues. The company's key products and brands include the following: ketchup, condiments, sauces, frozen foods, soups, beans and pasta meals, snacks, infant nutrition and other food.

Its brands include Heinz, Classico, Wyler's, Heinz Bell 'Orto, Chef Francisco, Ore-Ida, Bagel Bites, Poppers, Delimex, Escalon, PPI, Nancy's, Lea & Perrins, Renee's Gourmet, HP, Orlando, Karvan Cevitam, Roosvicee, Farley's, Plasmon, Nipirol, Pudliszki, Honig, De Ruijter, Daddies, Wyko, Benedicta, Wattie's, ABC, Greenseas, Ocean Blue, Ox & Palm, Cottee's, Glucon D, Golden Circle, Original Juice Co., Master, Guanghe, Quero and Complan.

The company's top 15 brands (ABC, Honig, Golden Circle, Wattie's, Master, Ore Ida, Quero, Weight Watchers, Classico, Heinz, Pudliszki, Smart Ones, TGI Friday's, Plasmon and Complan) account for more than two-thirds of its annual sales.

Heinz is well-recognized globally for its ketchups and this has become a household product.

The popularity of the company's ketchup products is indicated by the fact that the company sells around 650 million bottles of Heinz ketchup every year. Heinz dominates the ketchup market in the US and also holds a strong position internationally including the UK, Middle East and Egypt, and Canada.

In addition to this, Heinz has a strong foothold in the baby food and infant formula market. The baby food and infant formula market is growing rapidly and according to data from Datamonitor Consumer, the market had a value of \$12,239.9m in 2014, with Heinz named as one of the leading players with a market share of over 15%.

Heinz offers a range of products for babies, including infant formula, cereals, snacks and jarred products under the Plasmon, Heinz, Farley's, and Farex brands. These brands hold a strong position in Australia, Canada, China, Italy and the UK.

The company's products range includes 4-6 months 'early weaning' products, 7-10 months 'introducing lumps', 10-12 months 'bigger bits' and 12-24 months 'food products for toddlers'. The company's website offers a range of advice on nutrition for babies and also offers a careline for parents. Such factors make a product more appealing.

The growing consumer demand for the baby food products has opened up avenues for companies such as Heinz. In addition to this, many parents are now working and so may not have the time to make meals for their babies; by providing a wide range of nutritional products for babies Heinz is increasing its consumer base and adapting its product offering to suit modern living patterns. Moreover, market growth has been healthy in recent years as demonstrated by data from Datamonitor Consumer; primarily in the emerging economies of China, India, Brazil and Russia; Heinz with its strong brand reputation is therefore well positioned to tap into the growing trends in baby food and infant formula market.

Product diversification means that Heinz can cater for multiple customers and market leadership not only provides a competitive advantage to Heinz but also enhances its bargaining power. Furthermore, a strong brand portfolio lends better visibility and presence in all distribution channels and further enables Heinz to reach a large customer base thereby increasing its market penetration opportunities.

Figure 4: Heinz product range



SOURCE: Heinz.com

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GROWTH OPPORTUNITIES FOR HEINZ

Heinz has been proactive in listening to consumer demand for healthy products and a gluten free range; the company has added a range of low sodium products to its portfolio as well as over 60 gluten-free products. The gluten free market is growing rapidly and provides food manufacturers such as Heinz the opportunity to establish its position in a niche, developing market. Furthermore, Heinz is focusing on expanding its international footprint in a bid to propel growth and aims to generate 25% of its revenues from emerging markets by 2016. In addition to this, a merger between Heinz and Kraft Food Group was announced in 2015. The new Kraft Heinz Company would be the third-largest food company in America and the fifth-largest worldwide.

Growing consumer demand for healthy products

Consumers are becoming increasingly conscious about their health and wellbeing and are now more than ever interested in food products which are healthy and nutritional. Eating too much salt increases the risk of high blood pressure, which can cause heart disease and strokes. Heinz has been criticized in the past for the high salt content its food products contain. Public health ministers have urged food manufacturers including Heinz to reduce the amount of salt in its foods; as a results Heinz has added low sodium products to its portfolio.

The move is part of Heinz's on-going commitment to drive value in the healthy eating category, while also responding to consumer demand for lower salt choices.

Heinz Baked Beans now have 32% less sodium, its Heinz 'healthy beans' have 50% less sugar and 25% less salt than the standard Heinz Beans recipe, and have no artificial sweeteners. Heinz has even introduced Organic Baked Beans which contain organically grown ingredients.

Heinz Pasta now has 31-52% less sodium (depending on variety) and Heinz Cream of Tomato Soup also has 32% less sodium (a can of Heinz tomato soup now contains 0.2g of sodium, down from 0.4g, this amounts to about 0.5g of salt; sugar levels have also fallen from 5.2g to 4.9g, while fat content has dropped from 3.6g to 3g). Heinz Ketchup even comes in a 'no salt added' variety.

Figure 5: Heinz low sodium, healthy beans



nutrition			
Servings per can - 2			
Typical values	Per 100g	Per ½ can	%RI*
Energy	282kJ 67kcal	584kJ 139kcal	7%
Fat	0.2g	0.4g	1%
– of which saturates	Trace	Trace	<1%
Carbohydrate	9.9g	20.5g	8%
– of which sugars	2.3g	4.7g	5%
Fibre	3.7g	7.6g	
Protein	4.5g	9.4g	19%
Salt	0.4g	0.9g	15%
*RI per serving. Reference intake of an average adult (8400 kJ/2000 kcal)			

SOURCE: Heinz.com

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In addition, the company also offers gluten-free products for those who are intolerant to gluten or those that are becoming increasingly health conscious.

By adding gluten free products to its portfolio Heinz is again widening its consumer base. Sufferers from celiac disease would not normally purchase food products from food manufactures that do not offer a gluten free range. Entering the gluten free market gives Heinz a competitive edge over its rivals. The fact that there is a demand for gluten free products and the market is not over saturated means that Heinz does not necessarily need to compete on price and can effectively sell its gluten free products at a considerably higher price. According to the UKs National Health Service (NHS) celiac disease is a digestive and autoimmune disorder in which gluten consumption causes damage to the lining of the small intestine. The consumption of gluten can cause symptoms such as diarrhea and bloating and stomach pain.

Gluten is typically found in wheat, but is also present in cereal grains such as barley and rye. The gluten free market is growing rapidly and provides food manufacturers such as Heinz the opportunity to establish a position in a niche, developing market.

The US gluten-free market is the largest and most mature with a quarter of all product launches having gluten-free claims, followed by Canada and the UK. According to Agriculture and Agri-Food Canada (AAFC), gluten intolerance is the fastest growing intolerance category in Canada. The Canadian Celiac Association says that most consumers (around seven million) are non-medical gluten avoiders, as opposed to 350,000 Canadians with celiac disease and 2.1 million with gluten sensitivity.

In the UK, the gluten-free and wider 'free-from' market have experienced double digit growth between 2013 and 2014, with further strong growth expected in the coming years. UK supermarkets such as Asda (a wholly owned subsidiary of Wal-Mart) and Tesco have also been tapping into the growing demand of gluten free products with 'free from' ranges. The national charity for celiac disease, Coeliac UK, reported in May 2014 that the University of Nottingham had found a fourfold increase in celiac diagnoses over the past two decades, although it is possible that a great deal of these diagnoses are down to increased awareness.

Heinz BiAglut offers a wide range of products and comprises over 60 gluten-free products, including pasta, breads and bread substitutes, flours, cookies, crackers, snacks and desserts.

Figure 6: Heinz gluten free range



SOURCE: Heinz.co.uk/products/gluten-free

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Emerging markets provide expansion opportunities

Heinz maintains a well-balanced geographic portfolio with accelerating growth in emerging markets as well as a strong foundation in the developed markets. Heinz is focusing on expanding its international footprint and aims to generate 25% of its revenues from emerging markets by 2016.

The Asian food retail industry is expected to grow at a rapid rate over the next five years. High GDP growth rates, rising consumer spending, a burgeoning middle class and rising population have contributed to the attractiveness of the Asian market.

Research conducted by MarketLine found the Asia-Pacific food retail industry generated total revenues of \$2,312.2bn in 2014, representing a compound annual growth rate (CAGR) of 9.7% for the period spanning 2010-14; the performance of the industry is forecast to continue growing however, at a slightly decelerating rate with an anticipated CAGR of 6.8%, which is expected to drive the industry to a value of \$3217.9bn by the end of 2019.

Heinz has evidently been increasing its presence in Asian markets due to the growth on offer. For example in 2010, Heinz acquired Foodstar, a leading manufacturer of premium branded soy sauces and fermented bean curd in China, from Transpac Industrial Holdings Ltd., a private equity holding company. The acquisition of Foodstar included four manufacturing sites with 2,500 employees in China. The acquisition of a well-known brand has helped the company establish its position further in China.

Moreover, in December 2014 Heinz announced the opening of the company's largest infant cereal production plant. The 80,000 square meter factory, located in Foshan City, Guangdong Province China will allow Heinz to continue growing and further strengthen its position in China. The company's infant cereals have been available in China for over 30 years and Heinz has a strong brand reputation especially for its baby food products.

However, in China, there is major concern for food safety and quality of products particularly relating to infant products after a 2008 scandal involving melamine-contaminated baby milk powder; in which at least six babies died and thousands more fell ill. For companies such as Heinz this means increased regulation and compliance with safety measures, which can impact margins as often, investment in controls is required.

During June 2014, the China Certificate and Accreditation announced that so far only 94 foreign liquid and powdered infant formula brands, manufactured at 49 separate firms across Europe, Asia and North America have been granted permission to enter the country. The fact that Heinz has production plants in China means that the company does not need permission to enter the country, an immediate advantage over some of its rivals.

In early 2014 Heinz recalled four infant food batches as a precautionary measure after a test found that they exceeded the allowable limit for lead. Following this, Heinz has said that its facility in Foshan City will completely isolate allergens from raw material storage to the production process in order to exceed international standards and its website states 'the new factory integrates the food industry's most advanced infrastructure to uphold the company's relentless focus on quality and safety'.

Heinz has also increased its presence in India; the company acquired the former foods division of Glaxo India and gained the Complan, Glucon D, Glucon C, Sampriti Ghee, and Nycil products and brands.

India is the world's second most populous market and its economy has grown strongly in recent years. The country has a dozen cities with a growing population; this combined with high GDP growth rates, and an increasing middle class means that there is great growth opportunity for Heinz.

Heinz's annual report highlighted sales growth in Asia slowed; partially due to declines in Glucon and Complan branded products in India. Heinz brands have received increasing competition in India. For example, GlaxoSmithKline and its brands Horlicks and Boost, which are similar products to Heinz's Complan brand, have continued to post strong growth in India; whilst Complan has struggled. In addition to this, Dabur's Glucose D has been closing in on Heinz's Glucon D in the powdered glucose drinks category.

In response to this, 2014 saw Heinz give its brand Complan a new look. It changed its packaging, changed its brand ambassadors and included Bollywood star Amitabh Bachan, changed the composition of the products and even widened the products target market to adults as well as children.

India's food retail industry has not reached the point of saturation unlike its western counterparts and therefore, provides many opportunities for retailers such as Heinz. The company however, will have to continue establishing its position in India's competitive market, and strengthen its consumer base.

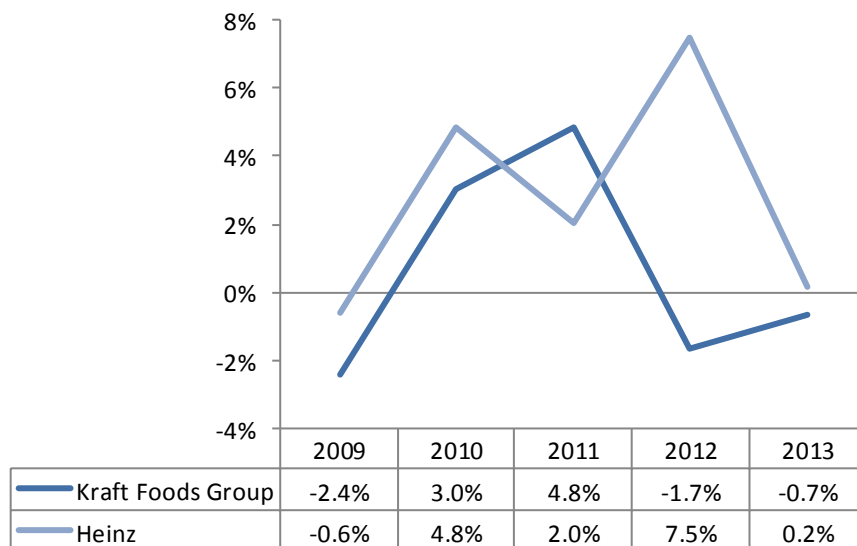
Heinz and Kraft merger creates third largest food company in America and fifth largest worldwide

In 2015, a merger between Heinz and Kraft Food Group was announced. ' Alex Behring, Chairman of Heinz and the Managing Partner at 3G Capital said that by bringing together the two iconic companies, Kraft and Heinz were "creating a strong platform for both US and international growth"

Kraft Foods Group, Inc. is one of North America's largest consumer packaged food and beverage companies. The company manufactures and markets food and beverage products, including refrigerated meals, refreshment beverages, coffee, cheese, and other grocery products. The company's iconic brands include Kraft, Capri Sun, Jell-O, Kool-Aid, Lunchables, Maxwell House, Oscar Mayer, Philadelphia, Planters and Velveeta. Kraft Foods primarily operates in the US and Canada. It is headquartered in Northfield, Illinois.

In FY2013 Kraft recorded revenues of \$18,218 a decline of 0.7% from \$18,339 the previous year. Heinz recorded revenues of \$11,529, an increase of 0.2% from \$11,508 the previous year. (Heinz changed its financial year-end date from April 30 to December 31 in 2013; therefore both companies FY2013 will be compared).

Figure 7: Heinz and Kraft Foods revenue growth 2009-2013 (%)



SOURCE: Heinz annual report/ Kraft Food annual report

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Both companies are large food manufacturers and hold a strong position in the food retail industry. The graph above demonstrates that overall Heinz has been growing at a much faster rate than Kraft Foods and Kraft has also experienced a decline in revenues in recent years.

The new Kraft Heinz Company would be the third-largest food company in America and the fifth-largest worldwide, and the deal has been valued at around \$45bn.

The combined company will have annual sales revenue of approximately \$28bn.

The alliance of these two giant companies means even further consolidation in a market that is already dominated by a small number of corporate players.

Existing Heinz shareholders will have a 51% ownership stake in the combined company, and existing Kraft shareholders will have a 49% ownership stake on a fully diluted basis. Each share of Kraft will be converted into one share of The Kraft Heinz Company.

Kraft and Heinz do not compete head-to-head on many products which means the two companies can continue to expand their leading brands whilst achieving rapid expansion in the food retail industry. Moreover, larger volumes of sales will help the company drive better bargains with clients such as large retail outlets, specialty food stores and restaurants. This will improve operating margins and will also mean the company will get more shelf space in retail outlets.

In addition to this, the two companies can bring together their expertise to expand the company's portfolio further; for example Kraft brings its Philadelphia and Caprisun brands while Heinz comes to the table with its famous ketchup and baked beans.

Figure 8: The Kraft Heinz company brands



SOURCE: kraftheinzcompany.com/brands

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KRAFT'S AGREEMENT WITH MONDELEZ MAY HINDER GROWTH OPPORTUNITIES

Whilst it is clear that the merger between Heinz and Kraft will increase both companies' global footprint, in practice this transition may be more complicated than anticipated. Mondelez (an American multinational confectionery, food and beverage conglomerate, comprises the global snack and food brands of the former Kraft Foods Inc) holds the rights to sell many of Kraft's snack brands internationally for the next few years. Therefore, the new Kraft Heinz Company's international expansion will be limited. Moreover, a huge portion of Heinz's revenues comes from sales to Wal-Mart stores. However, the rise in private labels products may adversely affect the company's revenues.

Mondelez holds the rights to sell many of Kraft's brands internationally

Heinz has a global footprint. It derives 60% of its sales from regions other than North America. Emerging economies contribute 25% of its sales. In comparison, Kraft derives 98% of its sales from North America. This provides scope for the Kraft Heinz Company to sell Kraft's brands in international markets.

However, that opportunity would be limited by Kraft's agreement with Mondelez International. In October 2012 Kraft was renamed Mondelez International, and shortly afterwards spun off Kraft Foods Group, its grocery business; allowing Mondelez to focus on its snacking business.

The firm had effectively split its US and Canadian business from its international business. Kraft Foods Group would be able to focus on tackling the challenges of the American and Canadian markets while Mondelez would refocus on the quickly growing international snack market.

In connection with this, Mondelez International undertook a series of transactions to separate net assets and entities. As a result, Mondelez International currently holds the global snacks business, and Kraft Foods holds the North American grocery business. During the spin-off, Mondelez acquired the rights to sell many of their shared brands in international markets.

Kraft holds a few brands such as A.1., Velveeta, Planters, MiO and Lunchables that it hasn't given to Mondelez. However, Mondelez still holds the rights to sell the majority of Kraft's snack brands internationally for the next few years.

Therefore, the Kraft Heinz Company's international expansion using Kraft's brands will be limited until Mondelez's rights to those brands expire.

Kraft Foods increased product recall may affect Heinz brand reputation

Kraft Foods has been involved in several product recalls in recent years. In June 2014, Kraft Foods voluntarily recalled 260 cases of Velveeta Original Pasteurized Recipe Cheese product due to low levels of preservative ingredient (sorbic acid). Velveeta is one of the brands Kraft holds rights over; any product recalls of this brand will now also affect Heinz.

In October 2013, the company voluntarily recalled some varieties of Kraft and Polly-O string cheese and string cheese twists products due to premature spoilage. These products may spoil before their 'Best When Used By' code dates, leading to product discoloration. Earlier in 2012, Kraft Foods voluntarily recalled the Jalapeno variety of Kraft String Cheese. The precautionary recall was made as a thin layer of plastic film from the package could stick to the cheese and cause a choking hazard. Also in 2012, Kraft Foods voluntarily recalled Planters Cocktail Peanuts sold in 12 oz canisters. The recall was made due to a possibility that the product was exposed to water not intended for use in food during the production process. Considerable numbers of product recalls could affect consumer confidence in the company's products and hurt not only Kraft's brand image but also Heinz.

High reliance on Wal-Mart

A huge portion of Heinz's revenues come from sales to Wal-Mart stores. In FY2014, Wal-Mart contributed 10% of its total revenues. For retailers like Wal-Mart, private-label sales generate a higher profit margin than national brands.

For instance, in the US, private labels account for nearly 25% of Wal-Mart's retail revenues.

During a time of financial crisis and low disposable income, consumers are less likely to buy premium branded food products. The fact that consumers are likely to spend less during an economic downturn; provides supermarkets with the opportunity to entice consumers to purchase supermarkets' own ranges, which are cheaper than branded products.

Private labels now have a similar quality to other renowned brands; although supermarkets distribute and promote them, many of their own brand products are actually manufactured by the top companies in each sector.

Knowledge, or at least perception, as such has aided growth in this sector. If consumers can purchase cheaper products, without compromising on the quality then they may not necessarily revert back to branded products when the economy recovers.

Supermarkets have therefore contributed to closing the perceived quality gap between branded labels and private labels. Originally, supermarket/private brand packaging designs were poor, which made consumers suspicious about the quality of a product, rather than reflecting on lower prices/confirming their good value for money. Supermarkets have now changed their packaging to appeal to more consumers; a good design could contribute to a more appealing value for money proposal and also removes the stigma attached with poor packaging, of 'low quality'.

Supermarkets such as Wal-Mart have even extended their own-label packaging to look very similar to branded products. This is an interesting marketing strategy as consumers may be more willing to purchase items which resemble branded products.

Supermarkets have even used harsh marketing strategies to attract consumers to purchase their products. Comparative advertising for example, involves a particular product being mentioned by a competitor for the express purpose of showing why the competitor is inferior to the product being advertised. Many companies are using this marketing strategy and Heinz products have been no exception. In 2011 Aldi's TV ad campaign compared private label products and branded products. The advertisement features a young girl holding up a bottle of Heinz Tomato Ketchup and a bottle of Aldi's Branwells Tomato Ketchup; she declares that she likes both products, but price flashes show that the 570g Heinz bottle cost £1.95 (approx. \$3.05), while Aldi's 563g bottle is just 69p (approx. \$1.13), 65% less and the ad ends with the strap 'Like Brands, Only Cheaper'. Following this advert, Heinz compacted on this in a statement 'consumers will not be fooled by imitators they know no other ketchup will do'.

By placing the items side by side with similar packaging, consumers are led to wonder why they are paying more for the brand, when the products look almost identical.

Heinz may therefore be forced to reduce the price of its products in order to compete with supermarket brands and retain consumers. However, heavy discounting could damage the company's revenues and profits, and could also damage its brand value.

The introduction of discounting and subsequent pricing pressure exerted by supermarkets such as Wal-Mart on the suppliers, including Heinz, will lead to margin pressure on the company.

Additionally, switching costs for supermarkets such as Wal-Mart which Heinz relies on heavily is not high, which further increases Wal-Mart's buying power. Therefore, any significant change in Heinz's relationship with Wal-Mart, including changes in product prices, sales volume, or contractual terms may adversely impact the company's financial results.

Figure 9: Aldi's comparative advertisement



SOURCE: Aldi.com (TV advertisement)

MARKETLINE

CONCLUSIONS

Heinz success driven by listening to consumer demands and acquiring brands, but threats are present

In a competitive industry Heinz has continued to remain profitable and has also grown at a much more steady rate than many of its competitors, most notably Nestle and Campbell Soup Company. Heinz has sustained growth through a number of strategies such as the acquisition of many international brands. The acquisition and merging of established companies means that Heinz can enter new geographical markets, which will reduce the risk of market entry barriers; as these players will already have a strong network of suppliers, distributors, and buyers.

In addition to this, much of its success is derived from listening to consumer demands and trends; this has been evident through the introduction of low sodium product and gluten free products.

The move is part of Heinz's on-going commitment to drive value in the healthy eating category, while also responding to consumer demand for lower salt/ wheat free choices.

The US gluten-free market is the largest and most mature with the quarter of all product launches having gluten-free claims followed by Canada and the UK. Gluten intolerance is the fastest growing intolerance category in Canada. The Canadian Celiac Association says that most consumers (around seven million) are non-medical gluten avoiders, as opposed to 350,000 Canadians with celiac disease and 2.1 million with gluten sensitivity. Moreover, Coeliac UK, reported in May 2014 that the University of Nottingham had found a fourfold increase in celiac diagnoses over the past two decades. This is a niche, developing market and provides many growth opportunities for Heinz.

Heinz BiAglut offers a wide range of products and comprises over 60 gluten-free products, including pasta, breads and bread substitutes, flours, cookies, crackers, snacks and desserts. By adding gluten free products to its portfolio Heinz is widening its consumer base to customers with gluten intolerance who would not normally buy its products.

In addition to this, the recent merger announced in 2015 between Heinz and Kraft will mean that the new Kraft Heinz Company would be the third-largest food company in America and the fifth-largest worldwide. The alliance of these two giant companies means even further consolidation in a market that is already dominated by a small number of corporate players.

Kraft and Heinz do not compete head-to-head on many products which means the two companies can continue to expand their leading brands whilst achieving rapid expansion in the food retail industry. Moreover, larger volumes of sales will help the company drive better bargains with clients such as large retail outlets, specialty food stores and restaurants. This will improve operating margins of the company and will also mean the company will get more shelf space in retail outlets.

Heinz derives 60% of its sales from regions other than North America. Emerging economies contribute 25% of its sales. In comparison, Kraft derives 98% of its sales from North America. This provides scope for the Kraft Heinz Company, to sell Kraft's brands in international markets. However, Heinz' opportunities to expand Kraft's brands internationally may be limited somewhat by Kraft's agreement with Mondelez. Mondelez holds the rights to sell many of Kraft's snack brands internationally for the next few years.

Therefore the new Kraft Heinz Company's international expansion will be currently limited to a few brands until Mondelez rights to the Kraft's brands expire. Such a restriction will hinder Heinz opportunities to fully expand internationally, but should present an excellent growth opportunity in the longer term.

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