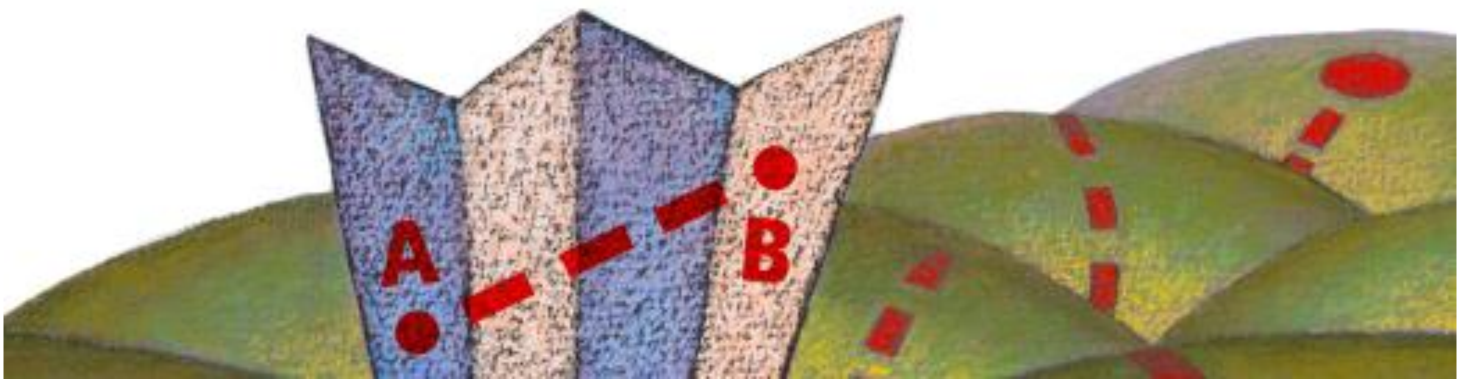
The Hale Group

Strategic Initiatives

Mapping Success in the Food System
Discover. Analyze. Strategize. Implement. Measure.



IFMA'S FOODSERVICE 2020 STRATEGIC ISSUES SERIES:

Foodservice Distributors of the Future — The Evolution of the Foodservice Distributor Sector

The Hale Group
8 Cherry Street, Danvers, MA 01923 ■ 800.229.4253 ■ www.halegroup.com

Background

In 2009 The Hale Group published a white paper titled ***Foodservice 2020: Global, Consolidated & Structured.*** The conclusions were as follows: consumers will focus on value, operators will respond to consumers with stronger value propositions, stronger value propositions will cause operators to look to their supply chain partners for better value and this will drive foodservice supply chains to be global; operator purchase power will be significantly further consolidated; and, operator- manufacturer relationships will be more formally structured and governed. This white paper was first presented at IFMA /IFDA 2010 President's Conference.

Since the white paper was developed, The Hale Group created —in partnership with IFMA— the *Strategic Issues Series* to further explore and understand the implications of *Foodservice 2020* for IFMA members. The first drill down was GPOs and this time the drill down focuses on the Foodservice Distributors of the Future.

The Hale Group's outlook concerning the likely evolution of the foodservice distributor and strategic implications for foodservice manufacturers is divided into six sections:

- *Foodservice 2020: Global, Consolidated and Structured*
- *Historical review of the foodservice distributor*
- *Closer Look at Top 10 Broadline Foodservice Distributors*
- *Forces of change shaping the Distributor of the Future*
- *Implications for the Distributors P&L*
- *Summary of Distributor Issues and Priorities*
- *Sysco as a MODEL of the Distributor of the Future*
- *Restaurant Depot: a Model for Alternative Distributors*
- *Success Model Elements for Distributor of the Future*
- *Strategic Imperatives for Foodservice Manufacturers*

Foodservice 2020: Global, Consolidated and Structures

One of the major conclusions developed in the Foodservice 2020 outlook was foodservice operators will focus on their value proposition so they can deliver compelling value to consumers. This in turn will result in these operators looking to their supply chain partners to assist them in pursuit of value. One of the ways operators will search for value will be to aggregate or consolidate their purchases of goods and services with other operators. The operator is well aware of the benefits they can derive from making bigger purchases from their supply chain partners. Essentially, the more they buy from a manufacturer or distributor, the lower the prices they pay.

As shown in Exhibit 1, The Hale Group expects that 79% of all operator purchases will be made through a centralized purchasing organization. This pertains to both goods and services. The consolidation of purchasing power by the operators will have a profound effect on the distributor community.

The consolidation of operator level purchasing facilitated by a number of different types of organization as noted in Exhibit 2.

This consolidation of foodservice manufacturers' sales and operators' consolidation of purchasing power impacts the distribution industry as well. These are organizations that have aggregated the operator level demand for products and have also done the same in acquiring distribution and logistics-related services. Thus, the distributor community is realizing the pressure that flows from bigger operator customers seeking economic benefits associated with "big purchasing power".

Exhibit 1. Consolidation of Operator's Purchases Through Contralized Purchasing Organization

	Share Controlled by Consolidated Operator Purchasing	
Segments	**2009**	**2020 (P)**
Restaurants	58%	72%
Lodging	70%	85%
Retail Foodservice	80%	90%
Recreation	55%	70%
Airlines	100%	100%
Business & Industry	75%	85%
Colleges & Universities	57%	65%
K-12	65%	85%
Healthcare	80%	95%
Others: Government, Agencies, Institutions	70%	80%
Total	**62%**	**79%**

Source: The Hale Group's Estimates

Exhibit 2. Manufacturer's Concentration of Sales 2010 and Projected to 2020

	Manufacturer Sales 2010 [1]		Share of Manufacturer Sales 2020 (P)	
	Sales ($B)	Share (%)	Consensus [2]	Foodservice 2020 [2]
Top 250 Chains	$58	35%	37%	39%
GPOs	17	10	15	18
Top 25 FSMs	12	8	10	11
Other Contracted	15	9	10	11
Total Contracted	$102	62%	72%	79%
Street	63	38	28	21
Total	***$165***	***100%***	***100%***	***100%***

Sources: 1. Technomic 2. Feedback from Foodservice 2020 Audiences
3. The Hale Group's Foodservice 2020

Historical Review of the Foodservice Distributor

Perhaps the best place to start in gaining insights into the future structure and operating practices of the distributor industry 2020 is to first understand the segmentation of the distributor industry. A historical view of distributor's segmentation is presented in Exhibit 3. The broadline distributors emerged in the early 1970s offering the ultimate concept of a "one-stop-shop" distributor, i.e., everything you need on one truck. Today they account for nearly 60% of all distributor sales to operators. The system distributor services major chain / multi-unit operators with a streamlined and tailored set of services valued by these large operators. System distributors too had their roots in the 1970s. Specialty distributors provide value by offering a set of specific categories of products that they assemble or manufacturer and then distribute to the operator. For the most part these are product category specialists which represent approximately 20% of operator purchases and have been declining over the past as broadliners grew. The alternative distributors are most often "Cash & Carry-like" distributors or wholesalers. This includes club format outlets, classic cash & carries and the new breed of Restaurant Depots and similar formats. This breed of distributor is not new, but their formats are evolving to be more attractive and more popular with the small operator not purchasing through a centralized purchasing organization.

While this is a snap shot of the distributor industry in 2010, the structure of the distributor industry will change over the decade as shown in Exhibit 4 below. The broadliner remains the largest segment, while the product specialists lose share to broadliners and even more so to the alternative distributors. The alternative channels grow as the broadline distributors continue to seek efficiencies through rationalizing their customer portfolios to more efficient customers and as they dictate large drop sizes.

Exhibit 3. The Foodservice Disrtributor Segmentation Landscape

Distributors	Estimated Sales 2010	Classes of Trade Served
Broadline Distributors	**$101.5**	All Classes
• National (2)	*$54.6*	
• Super Regional (8)	*$32.9*	
• All Others	*$14.0*	
System Distributors McClane, Sygma, MBM, etc.	**$19.2**	Multi-unit operator
Specialty Distributors Dairy, Produce, Meats, Beverage	**$33.0**	Focus on non-multi-unit
Alternative Distributors / Cash & Carry Restaurant Depot, Costco	**$20.3**	Small foodservice operators
TOTAL	**$175.0**	
Redistribution : Dot, Honor, Green	**$10.0**	Distributors and Jobbers

Source: ID Update, Technomic, The Hale Group estimates

It is significant that the business nature and operating practices between broadline and system distributors will continue to blur as the broadliners service more of the large multi-unit operators / chains and GPO's. Furthermore, the alternative formats will increasingly capture independent operators.

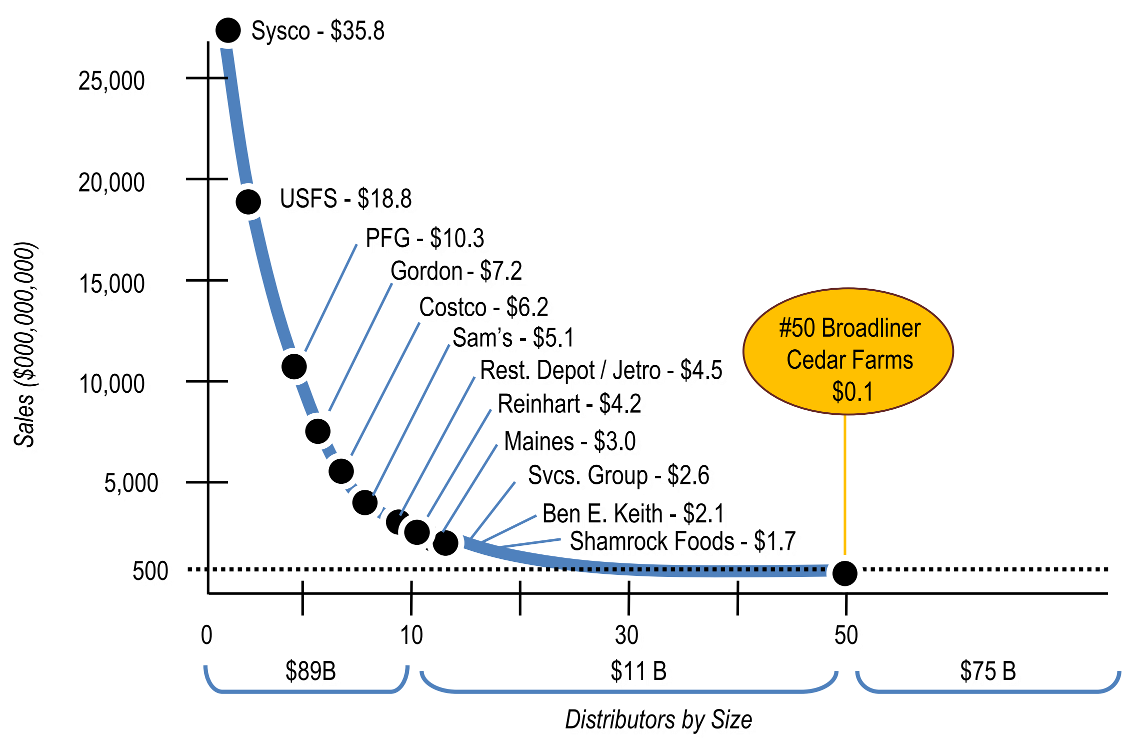
Exhibit 4. Historic and Projected Sales of Foodservice Distributors by Segment

	Share of Total Sales (%)					
Type of Distribution	1995	2000	2005	2010 (F)	2020 (P)	Comments
Broadline	45%	50%	53%	58%	59%	Adding categories & systems business to Increase share
System	14%	17%	15%	11%	11%	Broadliners are competing for this business
Product Specialist	38%	30%	27%	20%	16%	Have high service levels & specialty products
Alternative Format Specialist	2%	3%	5%	11%	14%	Capturing the independent
Total Percent	100%	100%	100%	100%	100%	
Total Sales ($Billion)	$103	$132	$159	$175	$203	

Source: ID Magazine and Newsletters Top 50 , Technomic and The Hale Group estimates (excludes alcohol and non-food equipment))
1. Alternative formats include Restaurant Depot, Warehouse Clubs and Cash and Carry

Closer Look at the Top 10 Broadline Foodservice Distributors

Exhibit 5. 2010 Ranking of Selected Foodservice Distributors by Sales



Source: The Hale Group, Ltd., ID Report, Technomic. (1) Estimate based upon US sales only

While broadline distributors represent nearly 60% of all foodservice distributor sales, within this segment consolidation among the players is taking place at a rapid rate. The largest foodservice distributor in 2010 was Sysco with sales of $38.4 billion, and the 50th largest distributor had sales of approximately $100 million, as shown Exhibit 5.

What is noteworthy is the Top 10 broadline distributors captured all foodservice growth between 2003 – 2010 (see Exhibit 6). The incremental foodservice industry grew by $31 billion between 2003 and 2010; in that same period, the Top 10 grew by $31 billion as well. This reflects the resources and understanding that consolidation is underway again at a rapid rate and the time is now to be the consolidator rather than the consolidated.

Exhibit 6. Top 10 Broadline Distributor's Growth versus the Foodservice Industry Growth 2003 to 2010

Company	2003	2010	AACGR 2003-2010	Δ 2003-2010		Growth Drivers
	Sales (in billions $)		*Share of Growth*			
Sysco	$24.700	$35,800	5.4%	$11,100	36%	Fold outs, acquisitions, organic
U.S. Foods	17.500	18,961	1.1%	1,461	5	Organic
PFG	3.600	9,720	15.2%	6,120	20	Acquisitions, chains, organic
GFS	3.000	7,200	13.3%	4,200	13	Geographic expansions and organic
Reinhart	1.400	4,205	17.0%	2,805	9	Acquisitions, chains
Maines	1.100	3,000	15.4%	1,900	6	New accounts
FSA/Services Group	1.350	2,600	9.8%	1,250	4	New structured accounts, organic
BEK Foods	.810	2,100	14.6%	1,290	4	Organic, specialty acquisition
Shamrock	1.050	1,650	6.7%	600	2	Expansion and organic
Labatt	.380	.909	13.3%	529	2	Organic, new account
Total Top 10	**$54,890**	**$86,145**	**6.6%**	**$31,246**	**100%**	**Top 10 captured 99% of growth**
Total Foodservice	**$143,793**	**$175,356**	**2.8%**	**$31,563**	**n/a**	

Source: ID Update, Technomic and The Hale Group estimates

One of the growth drivers of the Top 10 broadline distributor has been increasing the amount of business they are doing with chains, GPOs and other multi-unit operators. Conversely, this same set of distributors' share of business conducted with independent operators or street accounts is declining. This has a major impact on the P&L as margins on the larger accounts is far less than street accounts. Exhibit 7 illustrates this shift in the distributor's customer portfolio. This shift is not completed as yet, in our opinion; the portfolios will continue to skew toward larger operators and purchasing groups.

Exhibit 7. Top 10 Broadliner's Customer Portfolio and the Share of Their Business Generated by Independent Operators Street Business

Street Business Share of Top 10 Broadline Distributors

		1995	2000	2005	2007	2010 (P)	Comments
1.	Sysco	55%	55%	43%	41%	39%	50 50 portfolio
2.	U.S. Foods	71%	55%	55%	55%	40%	Significant Chain and GPO business
3.	Performance Food Group	20%	23%	40%	42%	40%	Acquisitions increased street business
4.	Gordon Foodservice	75%	70%	58%	57%	50%	Chains a bigger piece of portfolio
5.	FSA/Services Group	95%	65%	50%	50%	47%	Major shift towards chains
6.	Reinhart	78%	65%	57%	56%	42%	Becoming a systems distributor
7.	Maines Paper	40%	12%	10%	10%	9%	Becoming a systems distributor
8.	BEK Foods	68%	68%	60%	61%	55%	Holding at pre-set mix
9.	Shamrock	70%	66%	60%	58%	55%	Slow drift toward chains
10.	Labatt	65%	70%	80%	90%	90%	Focus on contracted business
	Average	**64%**	**55%**	**51%**	**52%**	**47%**	**Continued shrinkage of street**

Source: ID Update's Top 50, Technomic and The Hale Group estimates

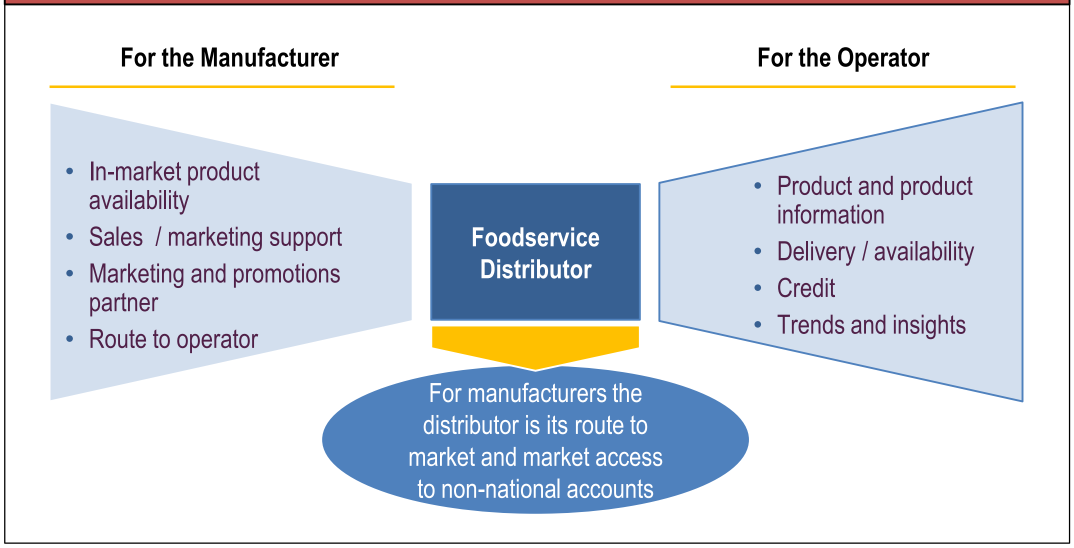
The Hale Group forecasts further growth of the Top 10 with their access to capital, utilization of scale, the ability to acquire and / or develop talent in the areas of technology, logistics, finance, business intelligence and leadership. Those distributors not in the Top 10 that have a valued area of specialization will also be winners. The distributors without scale or specialization, i.e., caught in the middle, will have difficulty surviving through the decade.

The Distributor's Role and Importance

In the past, the distributor was viewed by many manufacturers as a partner, but also the "Gatekeeper." As the Gatekeeper, distributors determined what products would be stocked, which were the product and company priorities with the sales force, and established pricing of products to the operators.

As the customer base shifts, so does the Gatekeeper's role. The distributor as Gatekeeper is now changing as the mix in their customer portfolio changes to more contracted business, changing industry practices – unbundling products and logistics services and changing technology enables on-line services and information. While many aspects of the distributor's business models are changing as a result of changing customer mix and the economic pressures that generates, the distributor's role for most manufacturers is their route-to-market and for the operator their critical supply chain partner. Foodservice distributors have and will continue to play significant roles for the manufacturer and the operator.

Exhibit 8. Distributors Play Critical Role for Manufacturers and Operators



Forces of Change: Shaping the Distributor of the Future

There are essentially three forces shaping change in the distributor community,

- Changing customer mix with more multi-unit operators and buying groups that want a low cost/high efficiency and reliable supply-chain / logistics partner – *extreme margin pressure*

- Trade income under pressure as the manufacturer trade dollars are now shared among distributors, buying groups, operators and soon to be consumers – *margin relief is going away*

- Bigger customers with multi-regional footprints want one distribution vender versus a patchwork – *streamlined, efficient, one touch distribution network*

Changing customer mix and the resulting economic pressures are at the center of the forces shaping the future distribution community.

The distributors' customer mix has been changing for at least the past two decades. Serving the independent operator, or "street" customer, was the basis upon which the current broadline business model was established. This independent operator looked no further in the supply chain for support and answers than their distributor. But as the independent operator becomes a smaller part of the distributor's customer portfolio, the economics driven by the customer mix becomes key to distributor profitability. Exhibit 9 tracks the changing nature of the broadline distributor's customer portfolio over time.

Exhibit 9. The Changing Nature of the Broadline Distributor's Customer Portfolio

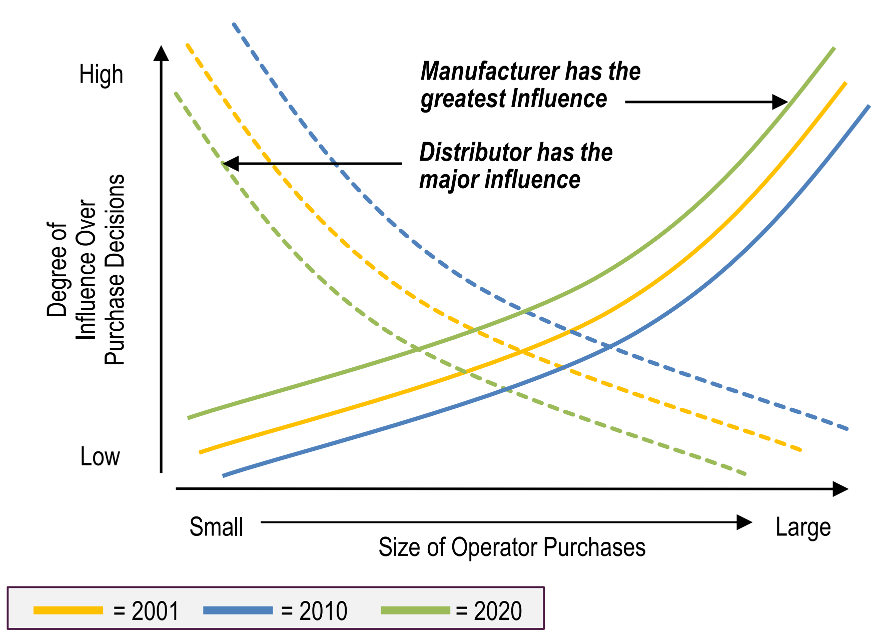
Types of Customers	1990	2000	2010	Promotional Dollars generated (as of % of sales)	Comments
Street • Independents	54%	43%	38%	6-8%	Full margin Full trade income
Bid • School, Government	8	8	8	2-3%	Fewer but larger bids due to bundling
Large Leveraged Operators • Major independents • Institutions	4	5	7	3-5%	Growth in response to GPO option
Contract Management Firms & GPOs	9	12	18	1-2%	Growth of GPO's, the real news here
Chain Accounts	25	32	38	0-1%	Chain dictates operating practices
TOTAL	**100%**	**100%**	**100%**	—	

Source: The Hale Group estimates

The distributor's customer mix reflects the fact that the highly profitable business, the "street" customer, is shrinking while lower margin business, chains, GPOs and bid accounts, begins to dominate the portfolio. It appears that the growth of these large accounts at the expense of the "street" customers has come to the "tipping point" and the force for changes in the business models.

The changes in the distributor's customer portfolio reflect the changing nature of the market's structure and configuration. The growth of chains, GPOs and other aggregators of operators' purchasing demand, has moved the operator's product purchase decisions to a centralized organization, most likely not located in the geographic market being served by the distributor. Therefore, the operator's product purchase decision is less influenced by the distributor and influenced to a greater degree by the manufacturer.

Exhibit 10. Degree of Influence on the Operator Purchase Decision



Source: IFMA Winning Business Models; The Hale Group, Ltd.

Over time the manufacturer has gained influence over the operator's purchase decision. Aggregation of operator demand into fewer decision points tends to shift influence to manufacturers.

The reduced influence of the distributor on the product purchased by the operator also affects the trade and rebate income that is available to them. Increasingly the foodservice manufacturers will spend the trade dollars on where they get the most impact. This means trade spending, or as The Hale Group views it trade investment, will flow to where it is most effective and drive the product purchase. Data shows that the operators are gaining a larger share of this trade investment since they increasingly control the purchase decision. As we look to the future, more of the trade investment will flow to operators and over time to the consumer. Early indications are that technology and business intelligence will allow the manufacturing partnership with their key operator customers to target the consumers and drive demand for special menu items and menu categories and thus drive demand for the manufacturer's product. The net result of this shift is where manufacturers make the trade dollar investment, distributors will be disadvantaged in gaining further trade dollars and even holding the trade income they currently realize.

Implications for the Distributor's P&L

It is increasingly apparent that economics —at the end of the day— will continue to drive the reshaping of the distributor of the future. Changing customer mix, what the larger operator customers' value from their distributor supply-chain partners, and changing trade income plays out on the distributor's P&L. The P&L below in Exhibit 11 is a composite picture reflecting the broadline distributors' customer portfolio. The P&L is not specific to any one distributor, but is illustrative of the economic impact of operator consolidation and the margins associated with the various segments of the business.

Exhibit 11. Conceptual View of a Broadline Distributor's P&L

	Street	LLOs	National Account	Overall
Sales	100%	100%	100%	100%
Cost of Goods	82%	86%	90%	86%
Gross Profit Margin	18%	14%	10%	14%
Operating Expense				
Selling Experience	5%	4%	2%	4%
Warehousing	5%	3%	2%	3%
Transportation	4%	3%	3%	3%
G&A	3%	3%	4%	3%
Total Operating Expense	15%	13%	10%	13%
Operating Margin	3%	1%	0%	1%
Promotional Income	4%	2%	1%	2%
Operating Profit with Shelter	7%	3%	1%	3%
Share of Distributors Customer Portfolio	30%	30%	40%	100%

Source: The Hale Group's Estimates

The street business is the most profitable for it has both an attractive gross profit margin and promotional income. While street customers are also more costly to serve, the higher total income generated by this set of customers more than offsets those costs.

The large leverage operators (LLOs), consisting of self-operated hospitals, colleges and universities, bid business, and other sizeable operators able to negotiate lower pricing from distributors, generate lower gross profit margins and promotional income. This set of operators captures some of the promotional income directly from the manufacturer, or in some cases, the distributor passes the promotional income through to these operators.

The most problematic customer segment for the distributor is the national account and GPO. The customers negotiate lower gross margins, 10% gross profit or lower, and yet expect the distributor to pass on all promotional monies generated on their purchases. The net of the low gross profit and no promotion (or minimal) is an operating profit of 1% or less.

As can be seen in the P&L, as the distributor's customer portfolio reflects the growth of national accounts, GPOs, coops and bid business, the financial pressure are significant. If the distributors do not finds ways to improve the productivity and efficiency of their business model, the traditional broadline economic business model implodes. Therefore we witness the reinvention and transformation of the broadline distributor's business model.

Summary of Distributor Issues and Priorities

There are many issues that are shaping the "foodservice distributor of the future," some of which have been called out in this white paper and some are for another day. The overarching issue for distributors will be the need to make significant changes to their traditional business model.

So these shaping issues are:

1. Distributors are witnessing a change in their customer portfolios and associated customer profitability.

2. Broadline distributors will be either big with scale and address a wide range of segments, or specialized / targeted by segment, product or geography.

3. Trade spend provided by the distributor's trading partners provides the difference between profits or losses; this is under pressure.

    - Trade spending provides an income generated for distributors of 3 – 8% as a percentage of sales

    - Should there be a change in trade spending behavior, it will be critical to distributors to create alternative business models.

4. The large national distributors are challenged to deliver top-line growth and attractive profits, given their ownership.

    - Sysco, a public company; USF and PFG, private equity owned

5. The role of distributor brands continues to be a key weapon in the battle to control the operator relationship, but perhaps the role of distributor brands will diminish as large group purchasing organizations enter the market reducing the differential between manufacturer brand's pricing and the distributor brand's prices. It is conceivable that GPOs and chains will develop their own brand strategies. (Note: Novation and Amerinet have private-label and/or co-label brands with customers)

6. Distributor strategy of higher order minimums are helping to fuel the growth of the Cash & Carry / Club channel.

7. The top 10 broadline distributors have been – and are likely to continue to be – market/share growth leaders.

8. Consolidation will continue in the distributor community.

    - Historically, growth has largely been driven by acquisition.

Sysco as a Model of the Distributor of the Future

Sysco Corporation is the largest foodservice broadline distributor and has undertaken a transformational initiative. It is bold in its goal and timely in responding to the changing operating environment. While not all distributors will seek to model the Sysco transformation, there are insights and lessons to be learned from the Sysco direction and efforts.

Currently, Sysco has a number of operating units within the overall enterprise. Each addresses a unique segment of operators and their unique needs.

Sysco is changing its business model to be in line with future market landscape realities which include more contracted business, lower cost-to-serve multi-unit operators, a competitive set of highly efficient system distributors, and less influence on operators' product selection.

Sysco Corp (2011)

	Sysco *Broadline*	Sygma *Systems*	Product Specific *Meat, Produce*	Guest Services *Hospitality*
% of Sales	81.2%	13.6%	5.6%	
% of Profit	93.0%	2.4%	4.6%	
# of DCs	90	21	48	14

Plus: 2 Completed Redistribution Centers (VA & FL)
1 Under construction (IN)
Plus: 1 Call Center (TX)
Plus: 5 Regional Pods

It is noteworthy that Sysco has decided that when targeting a major segment of the business, the business model, or value chain, must be designed to assemble those, and only those, unique set of activities valued by the target customers. This recognizes that a blended model which attempts to have "one size fit all" is suboptimal.

Sysco's financial information published in their annual report demonstrates the changing margin structure in the industry as a whole. Sysco's gross profit margin has realized constant pressure and decline over the past while operating expenses remain essentially the same; that is, until recently. Exhibit 12 tracks the P&L of Sysco from 2001 to present. The gross profit margin has declined. The operating expense remained the same until 2011. Perhaps this is an early sign of the success of the transformation.

Exhibit 12. Sysco Profit and Loss Statements 2001, 2006 and 2011

	2001		2006		2011	
	$ (B)	%	$ (B)	%	$ (B)	%
Sales	$21.8	100.0%	$32.6	100.0%	$39.3	100.0%
Cost of Goods	17.5	80.0	26.3	80.6	32.0	81.4
Gross Profit	$ 4.3	20.0%	$ 6.3	19.3%	$ 7.3	18.6%
Operating Exp.	3.2	14.7	4.8	14.7	5.4	**13.7**
Operating Inc.	$1.1	5.0%	$ 1.5	4.6%	$ 1.9	4.8%

Source: Sysco's Annual Report 2011

Given the changing operating environment, Sysco's stated strategic priorities are:

Exhibit 13. Sysco's Stated Strategic Priorities

Strategies	Outcomes
1. Invest in Core Business	Distributor Marketer
2. Increase Customer Retention	Price, Reach, and Service Satisfaction
3. Transform Business Systems	SAP to Have Abundant and Accurate Information
4. Reduce Operating Costs	Streamline on Multiple Fronts
5. Execute Fold-ins and Acquisitions	Buy Market Share
6. Deliver Better Value Proposition	Clear Recognized and Demonstrable Value

Source: Sysco's Annual Report 2011

Clearly, the strategic thrust growing out of these identified priorities is to be highly efficient, with better and more consistent execution against clear value proposition and promise.

The elements of the transformational strategy are beginning to show themselves in the marketplace with a few beta test sites. The initiatives associated with these transformations are identified in Exhibit 14.

Exhibit 14. Initiatives Associated With Sysco's Transformational Strategy

Initiative	Implications for Manufacturers
▪ Introduce Redistribution Centers • To improve efficiencies and logistics	▪ Both large and small manufacturers can ship full truck loads ▪ Increased interest in rail shipment
▪ Introduce a Call Center • To improve efficiency with technology, be one-touch with the customer and customer friendly	▪ Less impact on manufacturers
▪ Introduce a New Order System • "One click away," fewer DSRs and shift to category specialists	▪ Must provide order system information ▪ Must take more responsibility for operator development
▪ Introduce Improved Information Capture • Information for national account customers and better marketing information	▪ Will be viewed on national performance ▪ Will be challenged on performance and pricing. "Sysco can now see it all"

Source: Sysco Corp.'s Annual Reports and The Hale Group Field Reports

Studying Sysco as it transforms will provide clues to the nature of the real life distributor of the future.

Exhibit 15. Selected Alternative Foodservice Distributors Sales 2000 to 2010

Channel	2000 Sales ($M)	2005 Sales ($M)	2010 Sales ($M)	2000-10 CAGR (%)
Clubs				
Estimated Foodservice	$6,800	$9,600	$11,800	5.7%
Cash & Carry				
GFS Marketplace	$700	$900	$1,500	7.9%
Jetro / Restaurant Depot	$1,400	$3,300	4,500	12.4%
Smart Foodservice	$1,700	$2,000	1,800	0.6%
A / O Cash & Carry	$500	$600	700	3.4%
TOTAL Cash & Carry	**$4,300**	**$6,800**	**$8,500**	**7.1%**
GRAND TOTAL FS	**$11,100**	**$16,400**	**$20,300**	**6.2%**

Source: ID Updates, Technomic, The Hale Group estimates

Restaurant Depot: A Model for Alternative Distributors

As mentioned earlier in this paper, as broadline distributor drive for efficiencies, they will increase the minimum purchase size per delivery and that will cause smaller operators to be unable to meet this requirement. Also, operators will realize alterative distributors offer lower prices for products because the alternative distribution outlet have a different business model and part of this model is lower gross profit margins. Exhibit 15 identifies some of these alternative distributors serving the foodservice operators.

The growth achieve by this set of distributors is well above industry growth rates because operators are increasingly recognizing the value provided by these distributors

Restaurant Depot has been a leader in this category of distributors. They have, and continue to achieve, a high growth rate as they build new outlets and generate increased same store sales. Currently, Restaurant Depot has 72 stores; 7 are Jetros and 65 are Restaurant Depot stores. Their stores are 70,000-75,000 square feet with high ceilings and their sales are between $4.5 and $5.0 billion. Restaurant Depot generates $1-$1.5 million sales / week and Jetro generates $2-$2.5 million sales / week. They are growing at 10% per year through unit expansion which is 7 or more stores a year. Restaurant Depot is privately owned and expansion is self-funded. They are well financed and there appears to be little debt. A key difference in this business model is collection of funds at point of purchase. Operator financing is through credit cards, not their broadline distributor's terms.

Exhibit 16. Restaurant Depot's Customer Demographics

Customer Demographics	
Restaurants	43%
Deli (Independent)	9%
Non-Profit (Fire houses, Religious Organizations, American Legions, Union Halls)	7%
Bars	4%
Bagel Shops	5%
Coffee Shops	2%
Hotels	1%
B& I	1%
Other (Ice Cream Parlors, Meat Markets, Pizza Shops, Jobber Trade, Latino various formats and Halal)	23%

Source: Restaurant Depot

Restaurant Depot's management has stated their strategy as Everyday Low Price (ELP). Margin expectations have been 8-10% over cost with focus on independent operators only, with no consumer sales. They have a highly ethnic customer group; large components are Hispanics and Asians. It is Restaurant Depot's wish to purchase at the lowest possible price and in most markets they are as large as the major distributor houses. Simplicity is a part of Restaurant Depot's strategy when it comes to barcodes, freight, etc. They are selling units, not just cases. Information is important and they expect brokers and manufacturers to help train and provide support. Restaurant Depot is a combination distributor and store. Demonstrations and audits need to be visible in-store.

Buying Offices are in New York – New England – Baltimore / Washington, Chicago – Midwest, Florida, California – California, Texas – Southwest. Restaurant Depot needs to treat each one as an independent sales effort and over time they will begin to communicate and centralize their purchasing. Merchandised products are branded and private label.

Success Model Elements for Distributor of the Future

A theme that will run through the shaping of the "Foodservice Distributor of the Future" is that distributors will be aggressively looking for ways to reduce costs of business and improve efficiencies. Five areas will be the focus of exploration.

1. ***Sales force reduction*** is being explored to reduce the number of DSRs and remaining DSRs in an effort to have broader coverage and apply technology-based solutions to sales tasks.

2. ***Automated order and information retrieval*** would be a web-based technology solution. To reduce functional management at DCs they will centralize back-office and non-customer facing activities.

3. ***Rationalize product offerings*** by employing category management and using redistribution to a greater extent

4. ***Warehouse and delivery efficiencies*** and cost reduction by having improved order selection, automation, larger drops, better route efficiency and night drops.

5. ***Improved people skills and competency***, use of technology and better work processes.

These efficiency focus areas will be one aspect of the changes that will be witnessed in the distributor community. However, the strategies winning distributors of the future will deploy will be more focused. There are four characteristics of a winning distributor of the future.

1. The first is a business model and ***value proposition designed to meet a specific segment*** of operators and their unique need state with clarity of positioning; the generalist will no longer be viable.

2. Also important to the success model are ***business processes and systems*** that provide their customers with real time and highly accurate information on products, trends, usage and customer specific order-to-fulfillment information; i.e. the distributor as an extension of the customer.

3. The third element of the success model is to have a ***product and service portfolio*** that reflects the targeted segment needs and expectations and appropriate vendor support with relevant and efficient product /services portfolio.

4. The last key element to the success model is to have in place ***highly efficient operational practices, processes and systems*** in order to achieve market-accepted pricing and yet sufficient owner profitability and highly competitive performance for the customers.

Strategic Imperatives for Foodservice Manufacturers

For foodservice manufacturers a set of strategic imperatives are associated with the evolution of the distributor of the future and these imperatives provide the basis to frame a manufacturer's distributor strategy.

1. ***Distributors are your route-to-market and supply chain partners***. The vast majority of manufacturers cannot get their products to an operator without a distributor. Therefore, a healthy distributor is as important to the manufacturer as it is to the distributor. You must determine the distributors that are strategically important to achieve ok goals and objectives and then define the role you want the distributor and network to play and assist them to achieve that role.

2. The second part involves increasingly ***centralized operator purchasing entities, i.e. chains, FSMs, GPOs, etc., will align and contract with distributors*** as their supply-chain partners. Manufacturers must recognize the distributors being selected and work on supply chains to enable efficiencies for all the distributors and operators. Supply-chain excellence will become even more of a basis of competition than it is today. It is important to work with distributors to remove inefficiencies and work to use the efficiency lever to lower cost-to-serve. Supply-chain efficiencies should be part of the distributor / collaborative planning in conjunction with the operator customer.

3. Operator level contracts will become more prevalent in the foodservice channel and distributors' customer portfolios reflect this fact. ***Distributors will have "fewer feet on the street," therefore manufacturers must take more responsibility*** for demand creation at the operator level. They must create and capture demand in local markets in ways that are low cost, high impact and highly targeted. Establishing compliance and building consumption are the manufacturer's responsibility on contracted business.

4. ***Trade income is as important to distributors as it is to manufacturers***. Both parties should view this income as an investment to achieve pre-established objectives. Manufacturers must work with their strategic distributors (their route-to-market and market access) to invest, execute, measure and adjust so the desired outcome is realized. To ensure the ideal outcome, trade spend must be recognized as an investment and have objectives / expectation on outcomes. The program should be win-win, benefiting both parties.

5. ***Distributors other than the Top 10 (or so) will migrate to become either segment or product specialists*** in order to achieve penetration and the efficiencies required to have a sustainable business model. Manufacturers should, based on their product portfolios and segment focus, identify and align with a relevant set of distributors to form a network to reach the relevant markets. Manufacturers should target based on the segment "sweet spots," and allocate their resources with a bias toward those selected distributors to form your network.

The distributors of the future will continue to play a central role in the foodservice channel. For the manufacturer, they are the route to market and a key supply chain partner. Therefore, the success of the manufacturer in the foodservice business will be dependent on having a healthy and collaborative working relationship with distributor trading partners.

Manufacturer Roundtables

On June 19th IFMA conducted a **Strategic Issues Series** meeting to present the "Distributor of the Future". After the presentation by Bill Hale, the manufacturers in attendance were organized into four roundtables to discuss: Opportunities, and Challenges they associated with the "Distributor of the Future" operating environment. The following are two of the themes that emerged from those roundtable discussions.

Trade / Promotional Income

The manufacturer roundtables thought the trade spending will become a major challenge and opportunity for the distributor of the future. All recognize its importance in making the distributor financially whole as lower gross profit business begins to overtake the high gross profit business. Therefore, manufacturers and distributors must have tough but thoughtful dialogue around trade income. This income must be viewed as an investment to provide mutual performance based benefits for both parties.

To have these tough conversations the roundtables suggested:

- Do your homework before sitting down for that discussion; conduct a thorough situation analysis and plan of action going forward;
- Find ways to have greater visibility into the actual performance of the trade investment; and,
- Develop an annual plan with key distributor partners so everyone is aligned around the initiatives, responsibilities and metrics of performance

Alternative Distributors as a Growth Opportunity

One of the big opportunities identified by a couple of the roundtables was alternative distributors. Restaurant Depot was used as the model but the findings and recommendations were relevant to all distributors that fall into this genre. While these types of distributors are growing 3 to 6 times the industry growth, there are challenges. Among these challenges are:

- Need to develop a fair and coherent pricing strategy for these alternative distributors that fits with the overall distributor marketplace; the cost to serve and financial models are so different throughout the broader distribution community the prices at a Restaurant Depot or Costco can be very different for a street customer than the same street account buying from a broadline distributor;
- Packaging and merchandising needs of the alternative channel are very different from a broadline distributor so SKUs must be added by manufacturers; this adds cost and complexity to the foodservice offering of manufacturers;
- Gaining internal alignment within manufacturer's organization to the fact that alternative distributor have different needs and different sales and marketing responses can be a challenge; and
- Understanding the nature of these types of outlets and what works and what does not is still a challenge; "we are still in the discovery mode".

But, there was a consensus that the alternative channel will grow, and is worthy of greater attention from the manufacturer community.

Overview of The Hale Group

The Hale Group provides strategic counsel to the food system focusing on mapping and navigating opportunities for profitable growth – discover, analyze, strategize, implement, measure. Founded in 1986, its client base is global in nature and progressive in thoughts and action. The underlying philosophy of the firm's efforts on behalf of its clients, and in collaboration with them, is to formulate strategies that enable clients to break through the market clutter and identify platforms for growth.