

“Alexa, Buy Me Whole Foods”



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The grocery and retail sectors were shook up last week with the news that Amazon has agreed to a \$13.7 Bill (US) all-cash deal to buy Whole Foods Market, the high-end US organic grocery chain*. While we wrote up a quick reaction immediately following the news release, we had an opportunity to think through the online retail and grocery space in the time since then.

We are all aware that e-Commerce has had a slow and steady impact on our shopping habits over the last two decades. We are less reticent in sharing our credit cards to buy books, shoes and electronic gadgets online. We buy music and apps on our mobile devices. We search more web properties for incrementally better pricing and user reviews. We buy travel online more than we buy offline from travel agents. But there also happens to be categories where physical presence is necessary - to appreciate the feel and fit of high end apparel, the trailing of brand name make-up/perfumes and to test the ripeness of a Washington apple or gauge the freshness of a bundle of parsley.

The grocery business is a hard nut to crack. It is part of the social milieu. In Asian countries, people bargain for fish and cabbage at bazaars. Grocers have low margins and are susceptible to a time sensitive supply chain. Shopping at grocery stores is time consuming and in-efficient. In other words, the grocery business feels like the perfect "nut" for Jeff Bezos.

"There are two kinds of companies, those that work to try to charge more and those that work to charge less. We will be the second". Jeff Bezos.

To be clear, we did not see this deal coming. But upon hindsight there has been several clues as to Bezos's interest in groceries. Amazon's Fresh (grocery delivery) initiative in 20 US cities has just garnered it less than 1% market share so far. The grocery business today is not that different than what it used to be a decade ago. Overall changes in this industry has been incremental with the additions of kiosks, loyalty and "tap n go", but there is potentially much more disruptive change on the way. Amazon has been testing no-checkout technology at its Seattle stores called "Amazon Go" that would allow shoppers to pay via their Prime membership (linked to a credit card) without ever seeing a cashier or a checkout kiosk.

Why Whole Foods? While Amazon's management team has not articulated their specific thinking behind the acquisition, the company's entire value proposition is based on reducing cost and increasing convenience. Delivery of groceries today is costly and inefficient. Whole Foods offers 440 great real estate location in urban markets and brings to bear refrigerated access to major markets that Amazon

¹Does not make investment recommendations

*Source: Bloomberg, as of June 16, 2016

Fresh had not yet accessed. Whole Foods as a brand resonates well with millennials and plays to the trend towards organic foods. The storefronts could augment an already best-in-class logistics infrastructure. Do you want your farm fresh eggs, kale and chemical-free chicken delivered within the hour? How about your fidget spinner, Vitamix and Michael Lewis's latest book by 4 pm today?

Jeff Bezos follows the puck to where it is going to, unlike any other CEO we know. What stands out after reading his biography is his laser-like focus on improving the present reality as seen through his customer's lens. His culture is along the lines of – “let us try stuff and if we fail, we fail, and if we succeed we will double down”. This leads to a driven culture at Amazon that is supportive of bold experiments some of which have been successful including Amazon Web Services that pioneered cloud computing and smart home appliances (Echo/Alexa), while other experiments have been less successful like their Fire Android smartphones and tablets.

There may be a Bezos grand plan that is being in the process of being unveiled. Or maybe not. Maybe this is another experiment to be tinkered with - like pondering Amazon branded-labels for foods (just like Amazon media content) so as to reduce prices at Whole Foods. Amazon already knows what we as consumers tend to buy, what we crave (wish lists) and now they will know what we consume.

We do not yet know if the Department of Justice and the FTC will voice their opposition to this acquisition. We do not yet know if there will be another buyer. What we do know is consumers are going digital, consumers crave the convenience of shopping in their sleep wear and Amazon has made it clear their interest in the grocery business. What we saw in the market Friday with the value destruction in the grocery and retail industry maybe be just the rumblings before the tsunami.

As of May 31, 2017, Amazon was the top holding in AGF American Growth Class.

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Publication date: June 19, 2017