ROBECO
The Investment Engineers

Global Consumer Trends

Online meal delivery: Growth potential intact despite Covid headwinds

- Online meal delivery market set to grow by 20% per year until 2022
- Profitability of main players now at an inflexion point
- Merger and acquisitions activity poised to continue

The digitalization of consumption is one of the structural changes our Global Consumer Trends strategy focuses on. A major development in this area has been the advent of online meal delivery. After a period of heavy investment, this relatively young market is now quickly consolidating, thus offering both strong growth and improved profitability prospects, despite the short-term challenges raised by the Covid-19 crisis.

The market

Article
For professional investors
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The online meal ordering and delivery market has been growing strongly over the past few years and is expected to continue doing so in the near term. The size of the online meal delivery market is currently estimated to be around USD 270 billion globally. Researchers expect the global market value to grow by 20% per year, on average, over the 2019-2022 period.

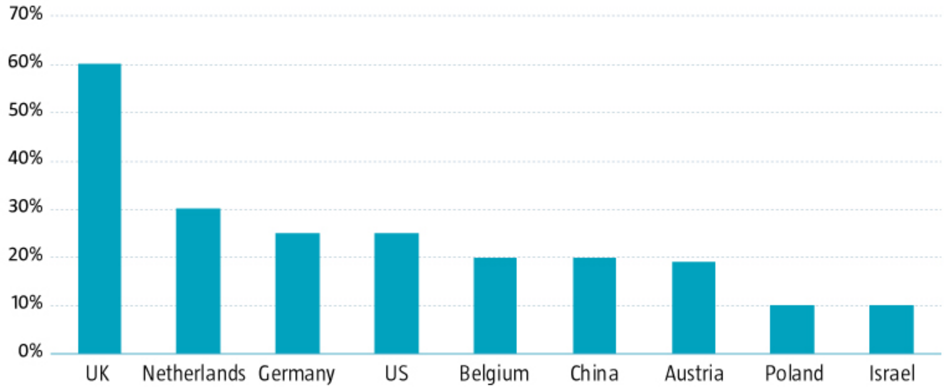
These developments are consistent with broader trends in consumer spending. While the structural shift towards online shopping started mainly with physical goods, such as books or consumer electronics, it has gradually moved into services as well. Meal delivery is a very good example of a type of service that is now increasingly being provided online.

Revenues generated by online meal delivery players mostly depend on the commissions paid by restaurants on each order. Additional sources of revenues arise from other types of fees, such as card-payment fees or placement fees (fees paid to rank higher in search results). These revenues can grow with the number of orders handled, as new customers sign up and order frequency from existing customers rises, but also depending on each company's ability to increase take-rates.

Replacing phone ordering
More broadly, however, the main driver behind the rise of online takeaway overall is not so much an increase in the total number of meals delivered, but rather a shift away from more traditional food ordering by phone. Currently, online penetration is only estimated to be around 20% of the total food takeaway market, for the main markets around the world.

However, there are sharp differences from one country to another, even among developed countries, as the graph below illustrates.

Figure 1 | Online penetration of delivered meals



Source: Takeaway.com and Delivery Hero reports, JPMorgan estimates. February 2020.

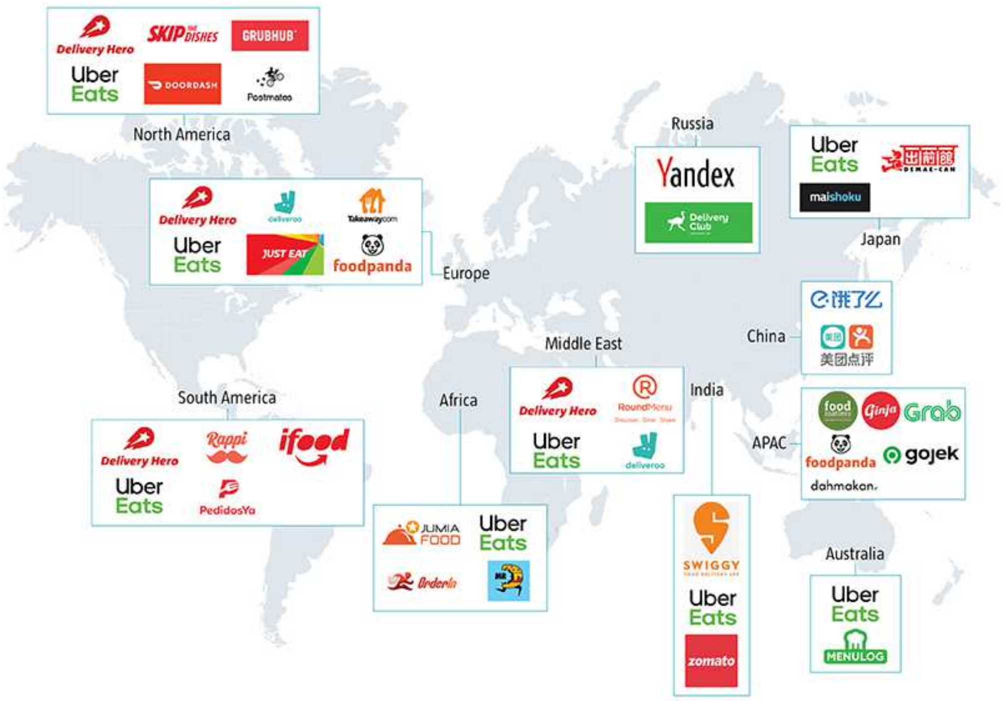
The UK's close to 60% penetration rate makes it by far the most advanced market in this field. This is partly due to the population's fondness of restaurant chains that tend to offer meal delivery on a more systematic basis. Still, the high penetration rate in the UK suggests that other countries, such as the Netherlands, Germany or the US, could see the share of online delivery rise substantially in the coming years.

The curious case of the Chinese market
In emerging markets, penetration remains significantly lower, between 1% and 5% in most countries. There is, however, one important exception: China, where penetration is closer to levels seen in the developed world, around 20%. This makes China by far the largest market with over 400 million active users of online meal delivery services, which means that approximately two out of three users worldwide are Chinese.

The players

Despite pertaining to very local businesses, the online meal delivery market is dominated by only a dozen players. These companies divide the global market amongst themselves. Most have grown their operations in their home market organically and have expanded geographically through acquisitions. The figure below shows the main players in a number of selected markets.

Figure 2 | Main players in selected online meal delivery markets



Source: Frost & Sullivan, Robeco

Broadly speaking, these players can be classified into two different categories, depending on their business models.[1]

The marketplace model

Marketplace companies connect restaurants with users but remain only an intermediary and do not perform the delivery. The fee they charge on each order is usually between 10% to 15%. This model has proved to be very successful as it requires only limited investments. Just Eat Takeaway is a good example of a marketplace player. The company was already the dominant player in the Netherlands and Germany and has now also become a leader in the UK after the recent acquisition of Just Eat.

The logistics model

Logistics companies contact restaurants through a platform and handle both ordering and delivery. They take a much larger fee, which can go up to 30%, but also have to bear the cost of delivery. This is a very popular business model in many markets. An obvious example of this model is Uber Eats. Other players include Deliveroo or Doordash.

Until recently, these firms benefited from benign funding conditions and raised billions of dollars from private equity investors. This money enabled them to expand rapidly, as they raced for market share at the expense of short-term profitability. Delivery operations have higher fixed costs than marketplaces, which are just business facilitators. Delivery players therefore need sufficiently dense networks to cover their costs.

Blended models

Lately, the boundaries between both types of players have become more blurred. Some marketplaces have ventured into delivery to fend off fierce competition from logistics players, while some logistics players opened their platforms for

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marketplace restaurants to increase scale. For example, Just Eat Takeaway.com, initially a marketplace, now also offers delivery for interested restaurants.

Recent developments

The past few years have been marked by very aggressive expansion strategies from the large logistics players, including Uber Eats and Deliveroo. In this race for market share, often at the expense of more established marketplace players, these companies have completely sacrificed profits. Doing so, they have also hurt the profitability of the marketplaces they were trying to overtake.

More rational competition

More recently however, the ongoing price war seems to have de-escalated, as the very favorable funding conditions these large logistics players had been enjoying have become more constrained. As a result, these companies have shifted their focus from growth to profitability. And although most of them remain unprofitable, they have become more rational and less aggressive.

Consolidation

Another key recent development has been a massive consolidation move around the strongest players. Mergers and acquisitions (M&A) activity has been particularly intense in countries such as Germany (see box), the UK, and South Korea. In South Korea, the number two player, Delivery Hero, recently made a bid for Woowa Brothers, the market leader in this large Asian food delivery market.

The recent exit of Uber Eats from the very competitive Indian market by selling their business to Zomato is also a good illustration of this trend toward more consolidation. In an industry with barely room for one or two profitable players per country, M&A is really needed to improve the sector's overall financial viability.

Box 1: The German consolidation case

The German market has been through one of the most spectacular consolidation waves seen in the online meal delivery sector. In just a few months, the number of competing players went from four down to just one, Just Eat Takeaway.com, as other companies either sold themselves or exited the country altogether.

Thanks to a unique IT platform, higher efficiency and strong execution, the Netherlands-based company managed to replicate its model in a market almost five times larger than its home country. Doing so, the company was able to gradually gain market share at the expense of other already well-established players.

Within a few months Just Eat Takeaway.com was able to acquire two of their competitors – Pizza.de and Lieferheld – and force the fourth player, Deliveroo, to withdraw from the market. Currently, the company has a market share of over 95% in a fast-growing market and can now focus on scaling up its operations in order to improve profitability.

The combination of strong growth and improving profitability, helped by more rational competitor behavior and intense M&A activity, has turned the online meal delivery sector into a much more compelling investment theme. Further consolidation and increased focus on profitability should lead to a few dominant players able to generate high and robust profit margins in the long run.

Yet some pitfalls remain, in particular on the regulatory front. One clear example of these pitfalls are labor regulations, which vary from one country to another and also tend to change over time. These moving regulations could mean delivery staff may have to be considered as employees instead of so-called gig workers. This could change the financial picture materially and could thus lead to additional scrutiny from investors.

Box 2: Meal delivery in times of coronavirus

While the trends we focus on in our investment strategies are structural transformations expected to play out over the long term, the scope and intensity of the crisis triggered by the Covid-19 pandemic obviously raise concerns. Furthermore, the health and safety measures to contain the spread of the virus may require us to change our long-term expectations.

In China, for instance, leading player Meituan Dianping has already acknowledged significant disruptions to the daily operations of the restaurants they serve. With most restaurants being closed and many delivery riders staying at home, the impact on their business is obvious. However, demand for online meal delivery has rebounded strongly over the last few weeks, as most consumers stay home. Since many restaurants are keeping their premises closed, meal takeaway is the only way for many of them to generate any revenues.

For now, we are inclined to believe the Covid-19 crisis will only have temporary negative consequences for the sector. The drivers underpinning its expansion, such as the reduction of time available for cooking at home, the rising use of smartphones and shifting consumer behavior towards takeaway food, all remain intact. Finally, since many new consumers will try online food delivery during this crisis, as confinement measures force them to stay home, a likely outcome could actually be an accelerated growth for the online meal delivery industry in a medium term.

Conclusion

The online meal delivery market has been growing strongly over the past few years and is expected to continue to do so. More recently, the price war started by logistics players with very aggressive expansion plans seems to have de-escalated. The main reason for this is that the favorable funding conditions these companies enjoyed has become constrained.

The more rational behavior of existing players and the important consolidation into a number of strong players with local dominance have improved the sector's financial prospects. Despite the short-term headwinds provided by the Covid-19 crisis, we are convinced the drivers of growth remain intact for the sector and continue to see compelling long-term investment opportunities.

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