THE DAILY CHECK-IN WITH GOLDMAN SACHS

GUEST: HEATH TERRY, BUSINESS UNIT LEADER FOR THE TECHNOLOGY, MEDIA AND TELECOM GROUP, GOLDMAN SACHS RESEARCH
HOST: LIZ BOWYER, GLOBAL HEAD OF BRAND AND CONTENT STRATEGY
RECORDED: JANUARY 15, 2021

Liz Bowyer: Hi, Heath.

Heath Terry: Hi, Liz.

Liz Bowyer: Heath, you recently initiated coverage of the food delivery industry for Goldman Sachs Research. Food delivery has become much more important in many of our lives during the pandemic. Can you talk about how this sector has fared during these challenging times?

Heath Terry: Online food delivery has obviously been a huge beneficiary during this, you know, with people in lockdown, particularly in major cities but also in the suburbs. We're all taking advantage of whatever convenience that we can get. Restaurants, too, are also taking advantage of these services as well. You know, if you can't do indoor dining or you're dealing with the fact that indoor dining is less safe or you're at reduced capacity as we still are in many parts of the country, this is another way to reach your customers.

Liz Bowyer: But as a lot of these challenges start to lift as more people are vaccinated and lockdown restrictions ease, what do you think that will mean for these companies?

Heath Terry: You know, we think a lot of the habits that are being formed during this pandemic are going to stick. Things like ecommerce and online fitness, online payments. You know, these are all trends that were happening, you know, well before the pandemic. These were growth areas because, for the most part, they all offered some level of convenience, some level of better pricing, some level of better selection, better service that the offline version didn't offer. So we were moving in this direction already.

The pandemic just accelerated it dramatically across all of these categories, including online food delivery. So we think a lot of this is going to be sticky. I mean, if you look at some of the companies, specifically we've gone from sort of three times a month average for their typical customer to five times a month average for their typical customer. We think as we come out of this pandemic probably goes back to four times, not goes back to three times.

Liz Bowyer: So let's talk about the workers at these food deliver companies. What are some of the labor issues and other considerations of this particular workforce?

Heath Terry: Yeah, labor issues have always been major issues for these companies. And it really goes back to well before the pandemic. Early on when we had, you know, 3% unemployment, it was one of supply. These companies were very competitive with each other in terms of trying to find drivers for the platform. You had companies like GrubHub that were paying $1,500 bounties in some markets just to get drivers onto the platforms. You had labor issues in markets like California where regulations like AB-5 were passed and it countered with Proposition 22 to try and find some sort of balance between what was right for the drivers and what was viewed as being right for the market and for the companies.

And so this has always been a very sort of difficult issue for what's obviously a really young industry as it sort of tries to find the, you know, the right balance here. Since the pandemic's started there's obviously been a change in the supply-and-demand dynamic. We've seen a huge increase in demand as people have taken to food delivery and home food delivery as much as they have, especially, you know, across all of these other networks as well that are, you know, that are sort of surging at the same time.

We've also, though, seen a massive increase in supply as we've seen unemployment increase at the level that it has. And so it's changed the dynamic in a way where the companies have been able to see their employment costs come down because of that increase in supply at the same time that we're seeing their regulatory costs or the mandated costs associated with bringing drivers onto the platform increase. So it's going to continue to be an issue for these companies going forward. We're still, you know, at the earliest stages of really addressing this and finding that right balance.

Liz Bowyer: So obviously, Heath, since Goldman Sachs Research has initiated coverage of the food delivery industry there's some real investor interest there. Can you talk about how investors are approaching this space?

Heath Terry: Yeah. You know, I mean, I think investors have always found this space, you know, really challenging. And it's because it is such a competitive, competitive space. Usually in the Internet space, you know, you're dealing with winner-take-all type categories. And that just really hasn't been the case and isn't the case here in the food delivery space. You've got a relatively balanced space or at least a space with sort of one leader but, you know, two really close competitors, especially as we've seen consolidation around that space over the last year or so.

Investors are really, though, I think very optimistic. And you can see it in the share prices for a lot of these companies. Very optimistic about the rate of growth in the category and the potential for these companies to begin to rationalize a lot of their costs and the a lot of the costs that you've seen in growing the category -- marketing costs, the costs of bringing restaurants onto the platform -- so that they can be profitable over time. Something that, you know, prior to the pandemic we really hadn't seen.

Liz Bowyer: So just giving how competitive this industry is, as you've described, does it make it almost impossible for companies to become profitable? What does the model look like?

Heath Terry: Well, I mean, that's the big investor fear and sort of the, you know, the case against these companies that, you know, once we come out of this pandemic where you've seen this surge in demand relative to the costs, you know, the fixed part of these companies' costs that you start to see competition get more severe, and that profitability that we've seen during this pandemic starts to go away as companies get more competitive for that incremental customer or that incremental restaurant relationship. And so there is, you know, real concern that we go back to those lower levels of profitability or, you know, even losses again.

Our view is, you know, you aren't going to see that. We do think that this space has sort of hit a point in its maturation where the companies are being more rational. The kind of hyper competitive competition for customers, the kind of uneconomic exclusive deals with restaurants are largely past us. And so we do think, especially, you know, as the business, as the industry continues to scale for these businesses, that we should see improving profitability.

Liz Bowyer: And what else do you see these companies doing to become profitable over the long term?

Heath Terry: Yeah, I think a big part of that, a big part of that scaling that will drive profitability is going to be moving beyond just food. You know, restaurant delivery, as DoorDash's CEO is fond of saying, if you can deliver ice cream and pizza, you can deliver anything. And I'm paraphrasing there. But that's really true. And, you know, particularly if you have optimized your network to be able to deliver an $8 burrito in 30 minutes then the idea that you could deliver a $100 blender or a $75 sweater on a less urgent time schedule, that certainly makes sense.

And when you look at the logistics networks that are out there that are normally delivering these items, you know, we're at a point where this past holiday season you had, you know, major logistics carriers telling major customers, "We just can't deliver your items during the holiday season. We've got too much demand, too little capacity." You know, these are networks that have been chronically under invested in over the last five-plus years as ecommerce has continued to grow. And largely, you know, the companies that are responsible for this delivery have decided to raise price as opposed to building out their infrastructure and building out the capacity to be able to meet the customer demand.

And so, you know, retailers need alternatives, not just ecommerce retailers but, you know, local retailers who want to be able to get product to consumers quickly. They need alternatives. And, you know, you've already seen some of these companies. DoorDash has a partnership with Macy's and Bloomingdale's. They have a partnership with Walmart. And so we think you'll see these companies go from being food delivery companies to last-mile logistics providers that may not cover everything that the traditional logistics providers do. But, you know, we're near talking about the, you know, now $1.2 trillion worth of ecommerce that's being done in the US alone. There's enough edge cases there that you can build up a very big business just around those cases.

Liz Bowyer: Thanks, Heath.