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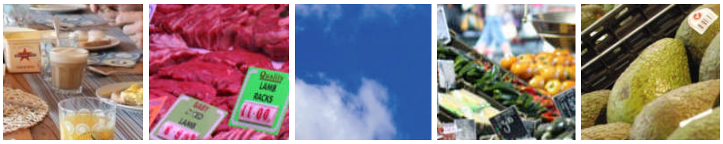


April 2011

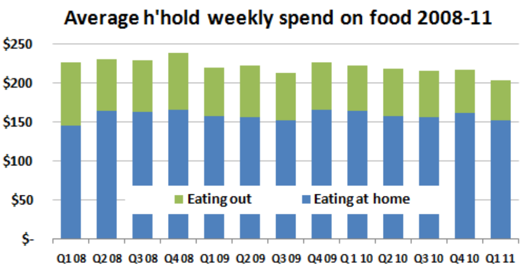
A Freshlogic foodcast on Australian and international trends, innovations and other insights relevant to the Australian food market

In this edition...

What we're seeing

Eating out under further pressure – Freshlogic's tracking of household spending through Mealpulse shows that 'eating at home' continued to grow share of spending, in what is typically the hardest retail quarter of the year, taking three-quarters of total outlays. Compared to this time last year, average weekly spending on eating out declined 13%, while spending on eating at home declined 7%. These figures may differ from reported grocery retail numbers, which include a significant portion of non-food lines, that haven't had the extent of promotional focus as food in recent months.

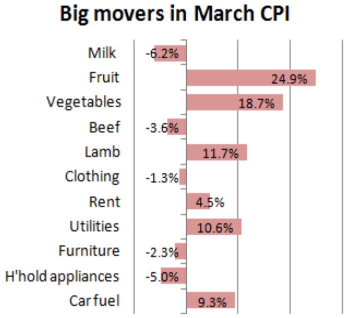
All "eating out" meal occasions lost ground from the corresponding quarter of the previous year, with breakfasts (-38%) and snacking (-16%) the biggest losers – at the same time snacks gained more retailer promotional attention (see below). Specialist food retailers fared best by holding their ground.



✳ *The ongoing trends have different implications for categories within specialist spending and eating-out.*

CPI analysis falls into familiar traps – CPI for food lines suggests the ABS are making another "Cyclone Larry" weighting mistake with the current banana prices. That is, assuming that the same volumes of bananas are purchased at higher prices which have occurred since *Yasi* streamlined the crop. There are divergent measures of food inflation out there. While the ABS suggests food inflation is up 4.3%, Woolworths and Coles continue to service the "value appeal" to shoppers, booking deflation of 3.6% and 1.2% respectively, which has brought the ABS figures into question.

While inflation is often driven by strong consumer demand, at this time food inflation is being driven by shortage of supply. While an interest rate rise is often seen as the remedy for an overheated economy, when supply pressure is causing the problem, this measure would only serve to cause more pain for households.



✳ *We hope the RBA will recognise the impact of the shortage of supply on the inflation results, and not revert to further interest rate rises, which would only frighten householders into deeper caution – something the retail food market doesn't need right now.*

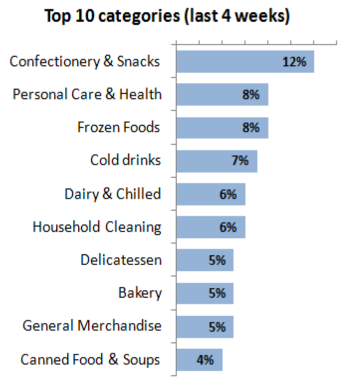
Ethical promises come in various forms – The dimensions of ethical food markets are much wider than suppliers might think. Awareness of ethical food issues is increasing but consumers don't view these concepts through the same filter as those in the food trade. Those in the trade tend to group these benefits together in order to understand underlying 'values', while consumers are treating them quite separately. In addition, consumers are looking for opportunities to act, supported by accessible information that allows them to make a decision. Consumers are embracing "easily comprehended headlines" such as "free range" and "locally grown". This indicates that the challenge in conveying ethical food benefits is as much about how they are "packaged in communication" as the benefits they represent.

✳ *While awareness of this issue may be high, any flow-on changes in buyer behaviour are highly likely to show up where it is most easily understood.*

Independents fight back as Easter snacking gets attention –

Freshlogic's tracking of retailer printed promotional activity using Adwatch showed the "bannered independents" fighting back with heavier investments in lines promoted, as they try to counter the sustained effects of "Down Down" and Price Knockdown".

The **top 10 categories** promoted in the past four weeks showed a strong lift in attention given to the snacking category as Easter promotions took effect. Overall volumes lifted somewhat in this period to levels seen around the "back-to-school" period.

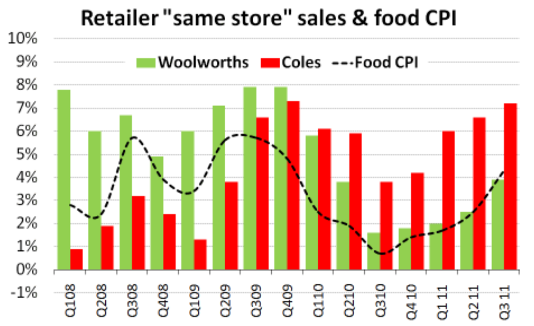


Deeper analysis of the data from Adwatch shows how the change in intensity of promotions affects discount levels, and how promotional activity affects volumes and average unit sales.

What's making news

Share of sales still moving to the majors

– The recent retail sales numbers of the big two grocery retailers suggest they are still taking share of food sales volumes away from smaller players – and from eating-out venues. Each of the chains claimed significant volume gains based on the difference between underlying sales growth and their own measures of deflation.



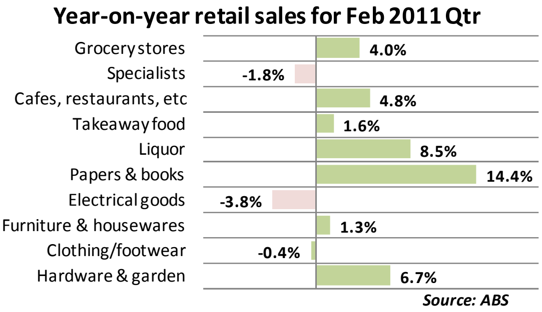
Arguments on measurement aside, the growth in sales numbers are so strong to confirm ongoing shift in volume towards the two majors with undoubted contribution from their escalated discount promotions.

Retail failures – numbers don't add up

– Recent failures in book and clothing retail have given further evidence to tight retailing conditions as well as shifts in consumer preferences and behaviour. The latest retail sales statistics from the ABS back this up – to some extent.

The leakage of sales from bookstores to online sales of e-reader book formats is well chronicled in contributing to the demise of the A&R/Borders franchises, but our national scorekeeper sees sales up nearly 15% in the most recent quarter.

Their published numbers in some sectors of retail defy logic...and industry's own data. Liquor retailer Diageo recently spoke of the liquor trade's own numbers for the three months to February 2011, which reportedly saw a decline of 5%. The ABS numbers posted almost 9% growth!



The problem with poor data coming from official sources is that policy and investment calls may be based on the wrong information. Industry decision-makers simply can't afford to trust it as a lone source.

The consumer

Did you know?

– Recent results harvested from our Mealpulse™ Panel highlight a number of trends in consumer behaviour.

- Established Families (as biggest spenders) have made the biggest savings in food expenditure of our household segments. They now spend on average ***24% less*** than they did this time last year.
- Budgeting Families now spend ***9% less*** than they did this time a year ago.
- ***Quality*** has become a more important driver behind shoppers purchasing products at ***the butcher*** - 71% report this as a key reason for shopping there (up from 66% this time last year). Fewer people look for 'lower regular prices' as a draw card to the butcher.
- Discounting in grocery had led to fewer shoppers buying staples such as milk, soft drinks and bread from ***convenience stores*** compared to 12 months ago. In contrast, more shoppers are buying treats such as sweets and ice cream through this channel .

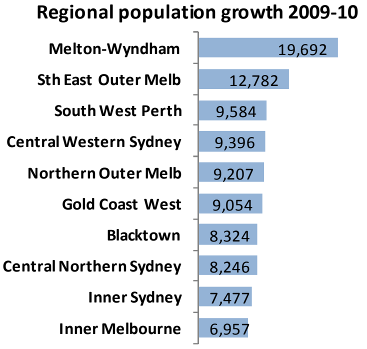
Understanding the pace and nature of changes in consumer purchasing patterns, when value seeking consumers are less forgiving on poor product and service delivery is vital to competing in this food market

Is a mastery of social media essential? – Whatever you pick up and read about the proliferation of social media, marketers are compelled to equip themselves for an engagement with social media of various **forms. Consumers – especially young adu**lts which are a valuable yet impressionable segment - are increasingly tapping into their networks of friends, fans, and followers to discover, discuss and buy. The way that influence manifests itself has been explored by www.trendwatching.com where they identify 5 means which they tag as "F-Factors":

1. F-DISCOVERY: How consumers **discover** products and services relying on social networks.
2. F-RATED: How consumers act on targeted **ratings, recommendations and reviews** from their networks.
3. F-FEEDBACK: How consumers seek input to **improve and validate** their buying decisions.
4. F-TOGETHER: The increasing **socialisation** of shopping, even when consumers and peers are not physically together.
5. F-ME: How consumers' social networks are turned into products and services.

There is no need to make the case for social media's influence – the real question for food suppliers is whether you're exposed to it, and if so, how you credibly manage your presence.

Are you covering the hot spots in population growth? – The latest population growth statistics make interesting reading. Much has been made of the impact of the urban expanse on the infrastructure demands on cities, but for the food market, relative growth in ***absolute numbers of consumers*** is more interesting. The increases in population in urban regions greater than 200,000 in number shows Melbourne's north-west and north easterly fringes have seen the strongest concentrations of growth.



In total, Melbourne recorded 80% of the population gain in Victoria, while Brisbane accounted for only 44% of the Queensland gains. Although easing, Queensland's population is still growing at the fastest rate nationally, while the Gold Coast and Perth are the fastest growing cities.

The expansive fringes of major cities will present retail and distribution opportunities – as will the lifestyle demands of the tightening inner cities in Sydney and Melbourne.

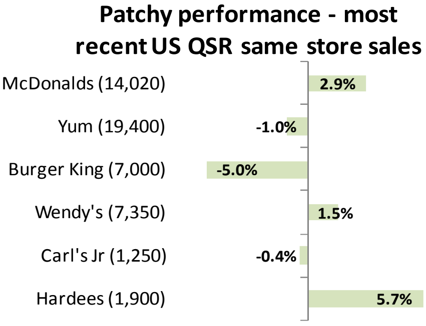
Global retail

Promotion fatigue sets in but habits die hard - A new survey has found that a large number of retailers are suffering from "promotion fatigue", with several looking at other ways to grow business. Promotion management was the number one investment priority in 2009, but was 4th in 2010 and 9th in 2011. The 2011 survey clearly shows that retailers are now prioritising customer knowledge and optimisation of their supply chain and demand forecasting over more promotions. The new competitive edge is enabling customers to buy exactly what they want, when and how they want it and manage the goods flow more efficiently. The survey found that 46% of those surveyed now want to get a "360-degree view" of customers to better understand buying patterns and improve margins.

Surveys are great for posting noble intentions. Actual change away from servicing the need for value will be harder.

In contrast, UK retailers reported in April that they have never sold as much on promotion. The proportion of groceries going through British check-outs on promotion reached 40% - a new all-time high.

Turnaround in US food service? – After a few years in the doldrums, the food service sector in the US is showing signs of improvement. Or is it? The US National Restaurant Association has made much of its *Restaurant Performance Index* (RPI) which tracks the health of and outlook for the restaurant industry. That KPI was 100.7 in February, the fifth time in the last six months that the RPI stood above 100, which to the NRA says signifies expansion of industry activity. It has also spun McDonald's announced plans to hire 50,000 new staff adding about 3% to its US workforce.



But the recovery is patchy. 49% of restaurant operators reported a same-store sales gain in February 2011 over the same month in 2010 (up from 39% in January), while

37% posted a decline in same-store numbers. Looking at recent same-store sales changes for the big players, the performance is anything but uniform.

The better players have moved faster to capitalise on preferences for value, convenience and healthiness while those who kept their feet in clay are still going backwards. This may have an American context, but this has direct implications for the Australian food service market that remains under intense pressure.

Other things of interest...

Single serves catch the premiums – Ready Pac Salad Singles are the latest creation from US-based Ready Pac, the nation's leader in the single-serve packaged salad category. While consumer demand for healthy convenience has always been a focus of Ready Pac's, the recent economic instability has led many shoppers to adopt more cautious spending habits. However, the effective prices of these new convenience lines, at $2.99 for 130-170gms, are actually much higher than the cost of alternative raw and larger packaged salad product, and if successful it indicates that Ready Pac have successfully bundled a combination of attributes that consumers will pay for.

This new product earns a premium by its value-added attributes of portion size and scope to cutting waste levels. This confirms the demand for convenience and suggests that consumers now understand the cost they incur by not using all of the product they buy.

A new twist in protectionism – the battle for control of Italian dairy company Parmalat SpA's (parent of the Australian milk and yoghurt processor) board has taken European protectionism to a new level. After French dairy group Lactalis built a 29% stake in the Italian, Italy Inc went into action. The Berlusconi Government changed a law to allow Parmalat to postpone a decisive shareholders meeting to allow time for rival Italian white knights to amass support against the French incursion. The Government in cahoots with the company were trying to drum up an investment by another food group, backed by state and private bank and private equity groups. The law change was based on the condition that Parmalat was considered a strategic asset to the country.

Lactalis called the bluff of the target and its supporters by announcing a full hostile bid for Parmalat – albeit at a lowball number compared to the cost of its amassed stake.

Ultimate ownership of an Australian dairy subsidiary will be affected by this outcome.

Fresh category profiles

Our newly launched ***Fruit and Vegetable Category Profiles*** outline key supply and market demand features of a single product category, and are designed as a guide in business and category planning.

The profiles draw on a range of data soruces and insights. The key components include:

- Production volumes and share by state
- Volume shares through supply chains, from production to consumer distribution channels
- Retail market value and sales contribution by variety and pack size/type
- Retail range profile, including international comparisons
- Wholesale price per kg relativities and trends
- Key consumer variables, including penetration by household segment average purchase quantities, and popularity ranking

A key design in the Freshlogic analysis is a requirement to reconcile volumes and values through the supply chain, from production output to the household. This approach ensures that these profiles are based on accurate and current market conditions and therefore commercially valid. See our website or contact us for more details.

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Freshlogic is a specialised consulting and analysis business with a strong focus on the food industry. We deliver a range of services to industry and corporate clients, which aim to interpret market and supply chain conditions, or address challenges faced in food supply chains associated with changes in the preferences of consumers, the expectations of the community, international trade and economic settings.

For more information on any of our products and services, please visit www.freshlogic.com.au, or contact us on phone (03) 9818 1588 **or email info@freshlogic.com.au**