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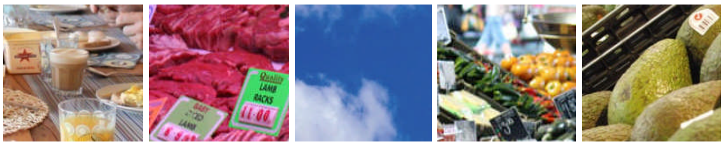


May 2011

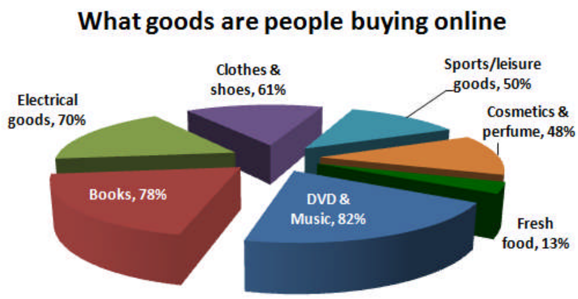
A Freshlogic foodcast on Australian and international trends, innovations and other insights relevant to the Australian food market

In this edition...

What we're seeing

Online grocery: this time the real deal? – Bigger investments in hardware by major grocers indicate there is a push underway in earnest for a greater share of online business. Coles' new fleet of 250 trucks and customer pick-up facilities at petrol stations display serious commitment. The online prize can't be ignored, and the reasons that efforts by food retailers were retired several years ago no longer hold. Shopper appetite is stronger:

- Consumers are ***increasing their use*** of online applications across a widening range of categories – Research by the Australia Institute shows high participation, and strengthening rationales based on value, range and convenience. The use of "services" including booking travel, arranging home services, bill-paying and banking, etc have already changed the landscapes in those sectors;
- They are having ***positive experiences***, including in international online stores. Trust and reliability is growing, and for many, it takes away a marginal 'in store' experience;
- Online shopping allows ***ready capture and comparison of value***, the advantages from which have gained increasing profile. The recent PR fiasco arising from the complaint by "bricks and mortar" retailers about the advantage gained by online retailers selling into this country only served to make more aware of the savings they could be making by using the internet.

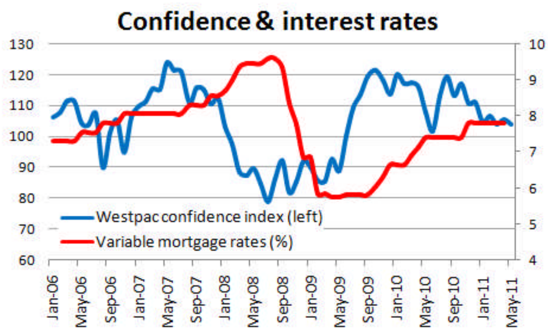


Source: The Australia Institute

The digital shift is supported by the era of tight economic conditons, more sophisticated search technology, and greater use of targeted loyalty programs.

While we are already seeing strong in-roads in other channels, growth in online food sales will depend on ease of delivery. The time has never been better – this will be about how well it is executed.

Talking ourselves into tighter times – With the variable conditions in different segments of the Australian economy, we have a strong incidence of people being made to believe that times are tough, and getting tougher. We have been watching over the past month how comments about the state of the economy and the impact on householders, are increasingly "talking things down". Media and politicians are doing a good job of convincing people that the risk of higher interest rates; a weaker housing market; and the possible impact of a carbon tax – all add-up to deepen the gloom, and in turn, draw out a weaker sentiment. Westpac's sentiment gauge obliged with a dip in the reading.



It begs the question whether we really need an interest rate rise to quell inflation. Talk alone may do the job.

Growth in alternate channels – Despite tight times for retail good spending, alternate food retail channels continue to grow their physical footprint and share of the food dollar. Examples include:

- ***Lite & Easy*** – ready meals are expanding in the sizeable market

Freshlogic at Fresh Connections 2011

Freshlogic will have an active presence at the PMA's Fresh Connections convention at the Brisbane Convention & Exhibition Centre on 8-10 June. Martin Kneebone will speak on the issue of ***Using Market and Consumer Data to Grow Your Business***, and we will have a stall in the Trade Show. If you are there, come and see us!

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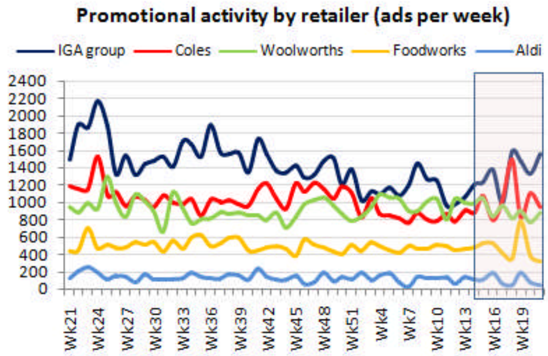
for prepared meals, which major retailers have missed;

- ***Dinners made simple*** – recipe ingredients delivered to order, to cut out waste and boost convenience;
- ***Fruit in a box*** – now well over 100 providers service this doorstep delivery market, directly responding to the AFD offer;
- ***Aussie Farmers Direct*** – boasting $100m in sales, now widening the regional coverage, and now with their own milk plant;
- ***Costco*** – a wholesaler specialising in bulk SKUs, catering for small retailers but also value-conscious households;
- ***Farmers markets*** – creating an online presence through www.efarmersmarket.com.au.

While none of these channels is so big in its own right, combined they are adding up to represent a significant share of the overall food market, and – more importantly – they are "stealing" growth niches from those retailers that pay rent and have a fixed network infrastructure. Their innovations will spark a response in several grocery categories.

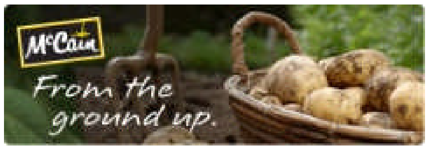
The more diverse food markets not only create challenges for the established, but provide growth avenues for nimble suppliers.



Grocers push the message harder – Freshlogic's tracking of retailer printed promotional activity using Adwatch showed retailer volumes have picked up 5% on average in the past 4 weeks, with Coles, IGA and FoodWorks lifting their presence sharply for short periods. The **top 10 categories** promoted in the past four weeks showed a return to form with personal care and frozen foods going back to the top of the list. In terms of the promotion of brands, Coles remains the most promoted brand in the promotional space, with a large surge in the middle of May.

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

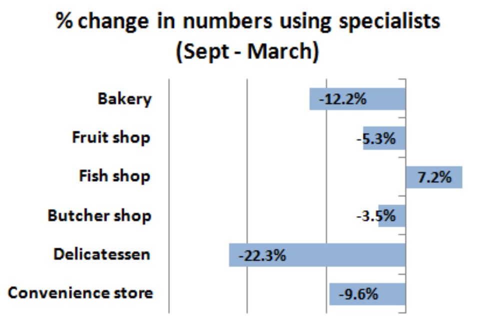
Sustaining health: McCain's pitches a reformulation plan – McCain Foods ANZ has announced a revamp of product formulations as part of a pitch to healthy eating, based on a new "overarching global company philosophy", pledging to spread the goodness. It will reformulate to eliminate additives or preservatives, emphasise its School Veggie Patches campaigns and highlight the benefits of fresh-frozen foods, and increase product transparency – allowing shoppers to see what's used and choose what they would like included.



One of the major enterprises in processed vegetables is building the strength and value of their brand. The pitch takes sustainability at its widest definition – human health, through to the impact of its production and packaging systems.

The consumer

Leakage increases as price stays in focus – Recent results harvested from our Mealpulse™ Panel highlight a number of trends in consumer behaviour.



- Between September quarter 2010 and March quarter this year, the leakage of shoppers from their preferred major supermarket chains to specialist retailers – butchers, greengrocers, bakeries etc – had reduced. The shifts in patterns weren't consistent, but enough to incur some pain. Butchers did well to hold traffic as the focus of price competition went away from meat with rising beef and lamb prices.
- The reasons behind the support of specialists didn't change a great deal. People still value their delis due to location, range and quality – they are just not going there as often! Butchers held ground on convenience and range.

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.

List shopping in focus – We recently explored the use of lists in shopping, to get an insight into what extent of planning is being used and what it might mean for those trying to get into the attention-span of the target audience. We drew out the following findings:

- Overall, in March 2011, almost two-thirds 'always' or 'often' use a list.
- The driver of the need to use a list varies among shoppers but generally includes recipe sourcing, time pressure, personal organisation and memory foibles etc.
- Considering responses over the past 12 months, there is variation in the use of lists between states, genders, and household segment. Lists are used more frequently in Queensland – a growing destination for forgetful retirees perhaps. Female shoppers are much more likely to rely on a list. Those more cost conscious – low-income young and old couples are most likely to use a list.

The increasing use of technology and tools that allow shoppers to readily identify the food purchase need from the kitchen (including recipe apps) to the store, present an opportunity to get products into pre-set lists or reminders.

Global food retail

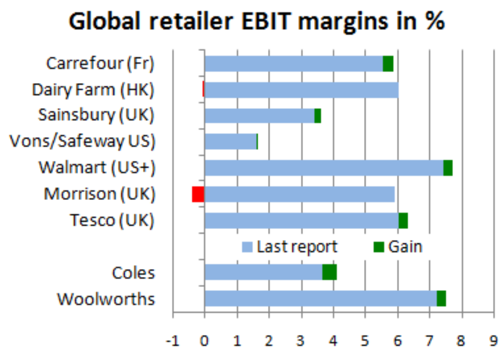
Discounters flying in the UK – The UK's deep discounters in food have given the best evidence of the response of the UK consumer to rising food inflation at a time when that country is heading back into a downturn. A leading UK retail-sales index fell for the first time in three months in May and retailers generally expect growth to slow in June. The UK consumer confidence slid in April and unemployment claims rose at their fastest rate in 15 months, underlining the fragility of the economy as government spending cuts and inflation erodes household finances.

The total UK grocery market grew sales by 4.8% during the 12 weeks to 15 May, but that was mostly inflation, as rising food prices fed their way onto retail shelves. The big players (ASDA, Tesco, Morrison, Sainsbury) each booked like-for-like sales below that level, indicative of loss of volume and/or weak data. Only premium grocer Waitrose bettered the CPI number. The deep discounters – the duo of Aldi and Lidl – grew at double digit rates, and Aldi said it posted its best market share.

It's an about face for those once taking the lead in the discounting war. Walmart's UK child ASDA has been beaten at its own game – it led the price wars between majors as the UK slowed into its current lengthy malaise. ASDA this month posted like-for-like sales that were barely positive.

Big players will have to dig deeper to find other forms of reinvention as the economic gloom in the UK gets worse.

Room to move? – There's plenty of speculation in the food industry about whether we will see a deepening of the discount war with share moving to Coles. Relative profitability of the majors suggests there is room to move. By global comparisons, Woolworths is a relatively healthy business and investment destination as its counterparts are all struggling in tough markets. But the chart on the right shows that our retailers aren't clear and away the most profitable on the globe.



Latest same-store or like-for-like sales improvements may give Woolworths encouragement to chip away and protect margins, boosting ROCE where they have a large perceived advantage for investors.

Revamping private label – What do you do when a private label offering gets a little tired? Simply add a word and boost your ethical premise. The major UK grocery retailer spent most of 2010 climbing off the floor after a poor run of results. As part of what seems like a strong recovery, it is revamping its mid-range private label brand from *Sainsbury's* to *by Sainsbury's*. The revamp affecting over 6,500 products, will take two years, and two-thirds of their lines will be "new or improved", which includes the reduction in packaging weight, removal of "bad food" ingredients and the reduction of greenhouse footprints associated with their production and delivery systems.

While the approach to a revamp might seem cute, there are some interesting parallels in Sainsbury's plan. Linking private label values to a range of higher-cost ethical promises has been a recent play by local retailers.

Waitrose takes convenience further – The premium UK retailer is going after more convenience sales. Waitrose (with like-for-like sales way ahead of the market average) has launched a new range “Good To Go”, in order to enhance its foray into the convenience market. The new label includes 150 lines designed to be eaten on the move. Different salad bowls with meat, fish, eggs, or dressings as well as salad leaf boats with prawns are some of the new innovations, together with the more standard sandwiches and smoothies. This product expansion reflects the retailer’s plans to open 300 convenience branches over the next 10 years, as it makes a bid to double its share of the convenience market.

The move by a mainstream retailer signals their view that food on the go is market worthy of new product investment. This innovation is being applied in a very tough market – we’ll be keeping an eye on what it says of its experience.

Speeding up the fast food experience – We reported to you earlier about the “tipping point” in the use of touch screens in food. A further development is the major move by McDonalds to roll out POS technologies into its restaurants outside the US, offering touch screens and swipe card transactions to speed up the customer response. The burger chain intends to reduce the number of cashiers working in its outlets and the volume of banknotes and coins it has to handle, with plans to implement the changes across its 7,000 outlets in Europe. It says no jobs will be shed. People will be transferred to other roles to deal with the expected higher traffic! More than 15,000 new jobs under the Golden Arches will be created in Europe this year.

Expect the roll-out to reach these shores any time soon. The QSR segment in this market is reported to be experiencing some heavy weather, so it’ll need innovation to provide a shot in the arm.

The faster speed of the fast food experience will help the chain take advantage by being ahead of the recovery of foodservice in Europe. We’ve seen consumers hold onto convenience values in the gloomiest of times, and this allows the burger chain to stay ahead of the pack.

Other things of interest...

China’s tough trade-off – Drought is gripping much of China’s rural food production regions, reducing stocks of grain which are already heading for greater stress given the unfolding drought in Europe which is pushing up grain prices and will help stabilise dairy commodity prices as well.

Shortages of water give China further headaches at a time when it is dealing with growing unrest from its people about the cost of living in the Chinese miracle. Water is not only critical to drinking supplies but also to the country’s hydro-electric schemes – emptying dams to irrigate wheat and rice paddocks will cut power production. Rampant food inflation, blackouts and no drinking water make a potent cocktail.

The pressures on food commodity prices affecting food manufacturers and consumers globally may intensify if this drought gets a lot worse. The bigger challenge for China’s government though, is how it best spends from its vast financial resources to quell consumer unrest.

We are seeking analysts

Freshlogic is keen to recruit analysts with experience in agribusiness and/or food. Drop us a line if you:

- Have full time experience from a role in food, whether in a corporate, consulting or industry role.
- Have market research experience.
- Have strong report writing, presentation skills and communication skills and the ability to relate well with clients and colleagues.
- Have the energy for a challenging and varied role in an exciting and dynamic field on the happening issues relevant to food markets and supply chains.

If you would like to discuss this opportunity to work – or know of someone you think might be interested in this – please send an email to info@freshlogic.com.au.

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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**