

TIMES & TRENDS

A Snapshot of Trends Shaping the CPG Industry

GAS PRICE IMPACT

HOW SPENDING AT THE PUMP AFFECTS SPENDING AT THE REGISTER



September 2006

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EXECUTIVE SUMMARY

- ▶ Over the past year, while gas price swings have been large relative to historical trends, prices have followed a predictable, cyclical pattern – softening in the fall and winter and climbing in the spring and summer; recent price declines are likely to turn again in the spring
- ▶ Consistent with prior gas price hikes, consumers cut back spending on dining out and entertainment, benefiting CPG food and beverage sales; however, demand growth has been tempered by CPG price increases
- ▶ Gas price spikes this past spring and summer accelerated long-term declines in shopping trip frequency across most CPG channels; the drug channel has grown trips, however, and reaped CPG share gains with strong growth across several health and beauty care categories
- ▶ While the estimated \$535 incremental gas costs per household this year hit lower-income consumers' budgets the hardest, trip conservation was evident across income groups as gas prices increased
- ▶ Despite the fact that Wal-Mart total store sales have been negatively impacted by gas prices (per company statements), the company successfully maintained CPG share as consumers seeking savings -- particularly lower-income consumers -- significantly increased purchases per trip



INTRODUCTION

Rising gas prices appear to have benefited total CPG spending levels but altered consumer shopping patterns.

With an estimated \$535 extra spent on gasoline this past year, coupled with rising CPG product prices due in large part to rising fuel costs, U.S. households have certainly felt their budgets strain.

Yet, as detailed throughout this report, and consistent with findings from IRI's September 2005 gas price assessment, the CPG industry does not appear to have been negatively impacted. In fact, total industry sales actually appear to have benefited as consumers shifted spending from luxuries, such as dining out and entertainment.

What did change, however, is the way in which consumers shop. Across income segments and across channels, consumers significantly reduced shopping trips, accelerating a longer-term trend.

The recent sharp increase in gas prices drove new opportunity, such as strong growth potential among convenient meal solution and entertainment categories, and new challenges, including the need to maximize each store visit as consumers were in stores less often.

In addition to addressing current opportunities and challenges associated with gas prices, CPG marketers should consider planning for future periods of gas price escalation: Consumer reaction is likely to be fairly consistent with current trends, with some variation depending upon the magnitude of price swings. Further, the timing of major price increases is likely to follow a predictable, cyclical pattern, with the largest increases occurring in the late spring and summer.

This report is intended to provide CPG manufacturers and retailers with new insights required to

See new opportunities and risks related to gas price cycles

Act on these insights with speed and confidence and

Win at the shelf.



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GAS PRICE TRENDS AVERAGE PRICES BY PERIOD

An extended dip in gas prices this past winter was followed by sharply escalating prices through the spring and summer.

While gas prices have remained significantly above prior year levels throughout the past year, prices have fluctuated considerably. Consistent with historical trends, prices dropped last winter but then shot up this past spring and summer.

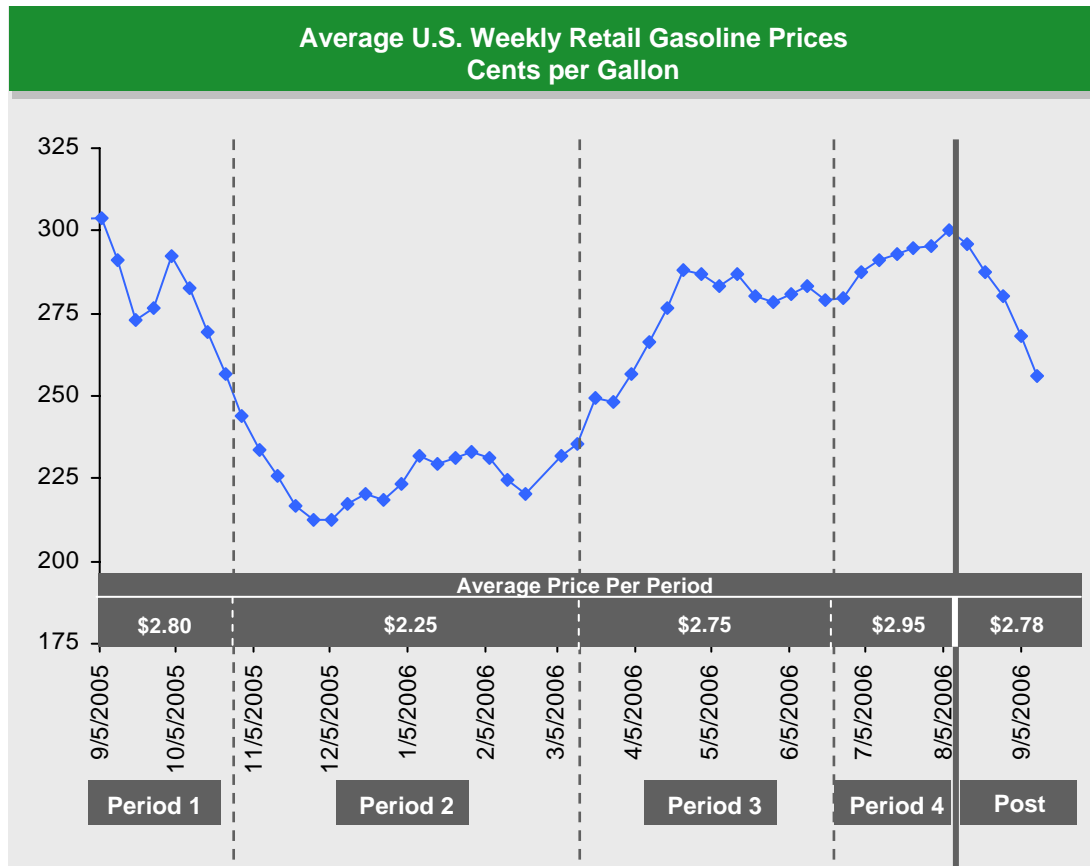
While prices are now coming down again, many analysts believe that trends are simply following the

standard cyclical pattern and will rise again in the spring of 2007.

It is imperative that CPG manufacturers and retailers understand how gas prices impact consumer shopping and purchase behavior across their stores and brands. For many CPG marketers, gas price cycles are an important input into marketing and merchandising plans that is often overlooked in the planning process.

"Gasoline prices have long been seasonally cyclical, rising in late spring and early summer as consumer demand increases with the onset of the summer driving season."

- Federal Trade Commission Report



Source: U.S. Department of Energy

This assessment focuses on gas price impact across four periods over the past year with distinct average gas price levels.



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GAS PRICE TRENDS AREAS OF IMPACT – CONSUMER BUDGETS

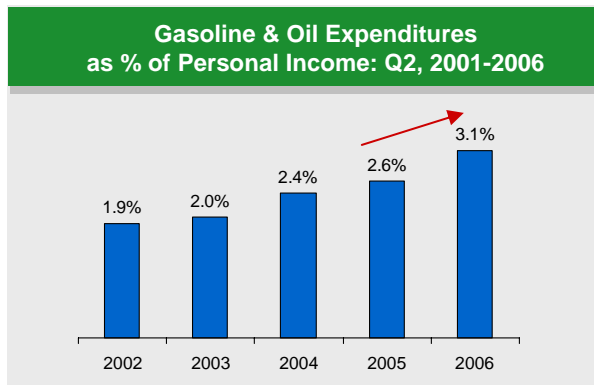
Rising gas prices have strained consumer budgets and driven changes in spending practices.

The average U.S. household spent an estimated \$535 additional on gasoline over the past year vs the prior year.¹ As illustrated in the chart on the upper right, gas and oil costs now represent a significantly greater proportion of personal income than at any other time in recent history.

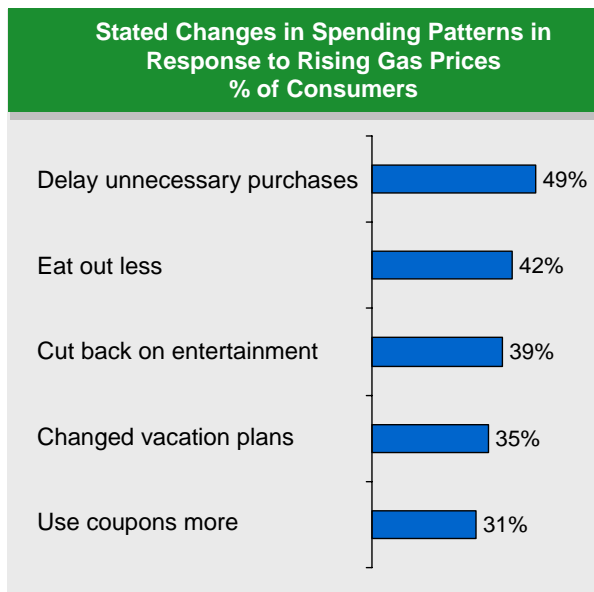
As highlighted in the lower chart, which summarizes findings from a recent Boston Consulting Group survey, a high proportion of consumers have covered this incremental expense by reducing spending on dining out, entertainment and vacation, while delaying unnecessary purchases. In addition, consumers are looking for deals, as nearly one-third report using coupons more.

The findings from IRI's gas price assessment suggest that spending on CPG products does not appear to have been negatively impacted. In fact, there appears to have been a favorable impact on CPG spending as consumers fill the gap left by dining out less often and spending less on entertainment with CPG purchases. As detailed in the next section, it is important to note that this impact has been mitigated by rising CPG prices.

What has changed significantly within CPG, however, is the way in which consumers shop. This report provides insight into shopping trip conservation as consumers conserve gas and the impact on channel performance.



Source: U.S. Department of Commerce



Source: Boston Consulting Group

“Retailers and economists say that many Americans are waiting to buy big-ticket items and are cutting back on frills. Families are dining out less and tightening their budgets.”

– AFX International Focus

1. Consumer Federation of America, IRI Analysis



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GAS PRICE TRENDS

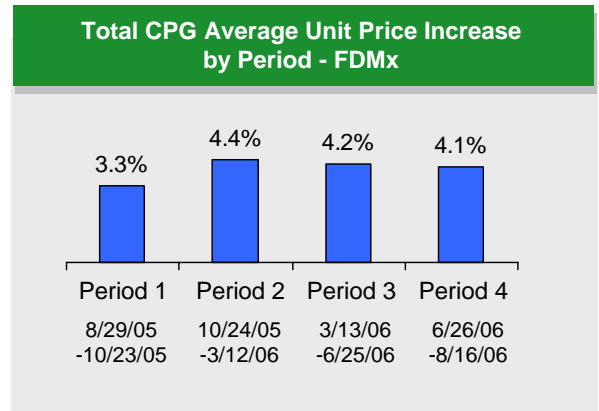
AREAS OF IMPACT – CPG PRICE INCREASES

Sustained high CPG price increases appear to have negatively impacted demand.

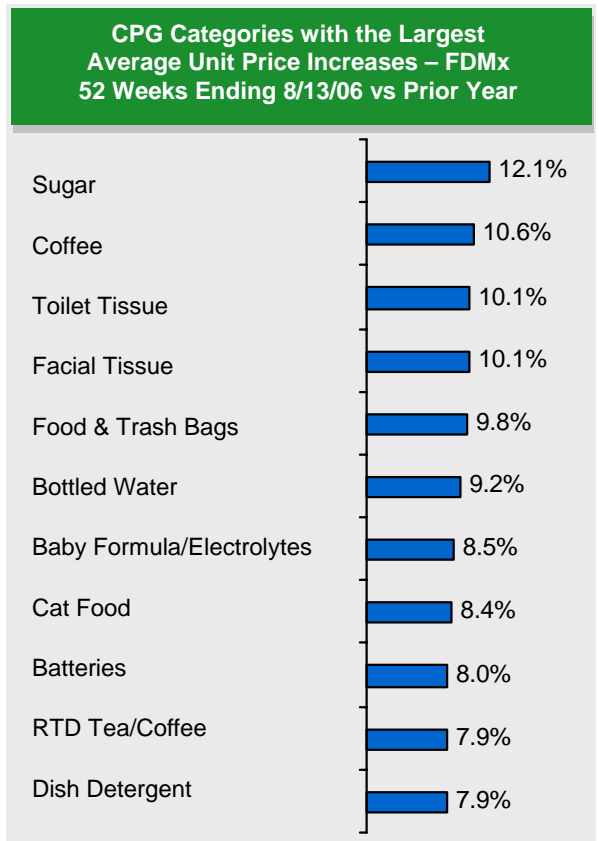
As rising fuel costs drove up distribution and packaging costs, many manufacturers opted to implement price increases. As a result, from the second period of this study forward, average CPG price increases versus prior year exceeded 4%. As will be discussed in more detail later in this report, these price increases appear to have negatively impacted demand, which is now starting to rebound.

Across categories, sugar, coffee and both toilet and facial tissue continue to lead with the highest price increases, as summarized in the lower right chart. In all but two of the eleven categories with the highest increases (high-growth bottled water and ready-to-drink coffee/tea), unit sales declined substantially versus prior year.

If the majority of the fuel-related CPG price increases have been passed through, and average CPG increases begin to stabilize, CPG demand may increase, given consumer cutbacks in other areas discussed on the prior page. However, if gas prices move significantly lower, and consumers shift spending back to dining out and entertainment, the CPG demand increases may not materialize.



Source: IRI InfoScan® Reviews



Source: IRI InfoScan® Reviews



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CPG GROWTH TRENDS TOTAL CPG

CPG industry sales improved as gas prices escalated.

As gas prices changed over the past year, CPG dollar and volume sales have, as well. Clearly, many factors --not gas prices alone -- have influenced CPG sales trends, but gas prices do appear to be a key influencing factor.

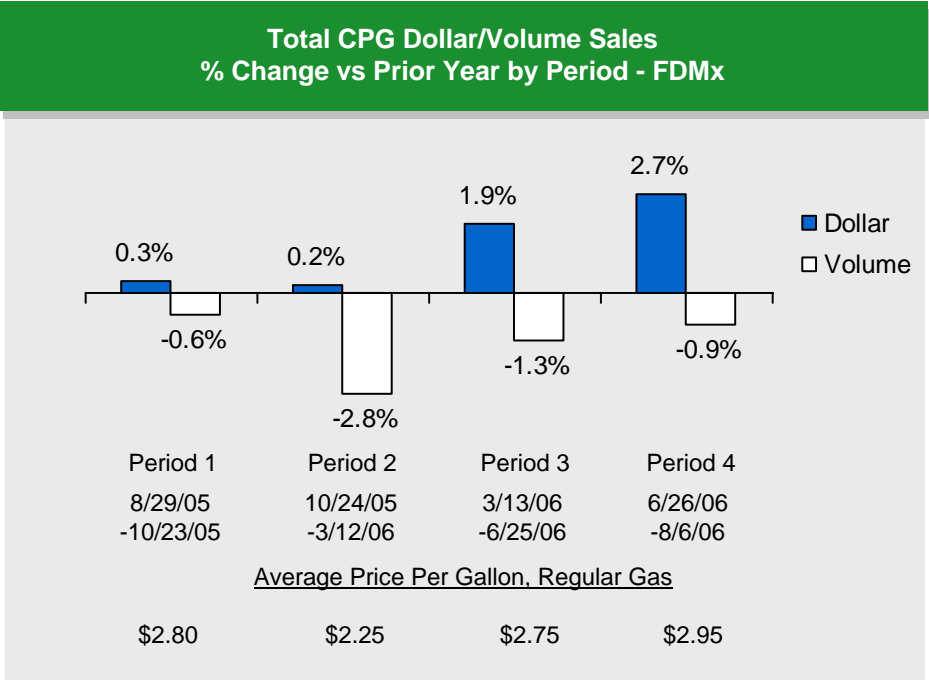
As illustrated in the chart below, as gas prices escalated, total CPG demand improved (although still negative vs prior year), and industry dollar sales growth rates accelerated.

The declining demand in period 2, as average gas prices fell to \$2.25 per gallon, likely reflected the combined impact of two key events: 1) consumers may have returned to prior dining out and

entertainment habits and 2) consumers may have reacted to sizable CPG price increases that were taking effect. The re-emergence of high gas prices in period 3 likely stimulated new CPG demand, as cutbacks in luxuries such as dining out resumed, and consumers may also have become more accustomed to the industry price increases.

If gas prices continue to decline throughout the fall and winter, we may again see reduced CPG demand.

(Note: The \$2.80 gas price in period 1 represented the beginning of a price softening, as prices had exceeded \$3.00 previously.)



Sources: IRI InfoScan® Reviews, U.S. Department of Energy



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CPG GROWTH TRENDS MEAL SOLUTIONS

Reduced restaurant spending created growth opportunity among convenient meal solutions.

Numerous consumer surveys and restaurant company earnings statements have revealed that high gas prices drove reduced restaurant spending.

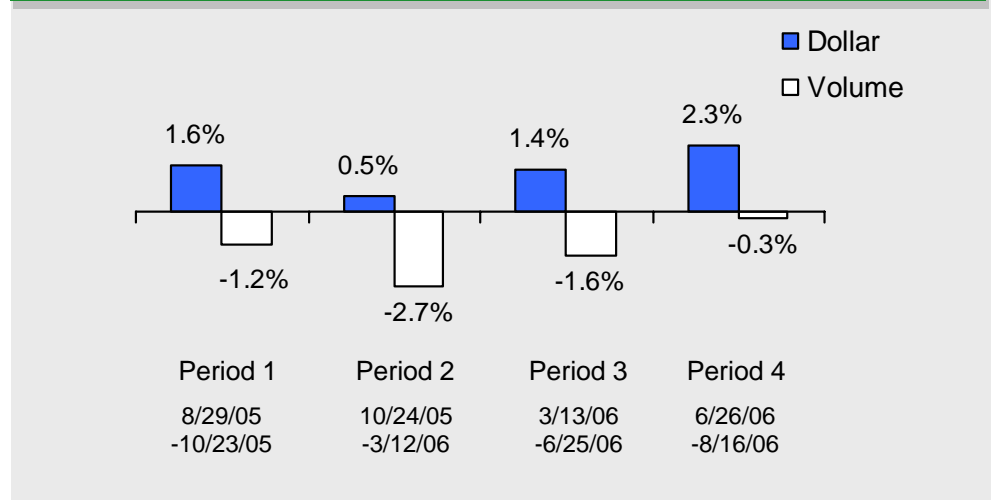
As a result, consumers presumably prepared food at home more, which created increased opportunity across several CPG categories, including frozen and refrigerated convenient meal solutions. IRI's gas price assessment found that dollar sales growth across these categories improved markedly as gas prices increased, and volume sales growth, which was in a negative trend, improved as well.

"Applebee's, KFC and other chains have experienced a major downturn, which they've attributed to high gas prices."
- consumeraffairs.com

"Consumers feeling the gas price pinch have intensified efforts to cut back on restaurants."
- Technomic, Inc.

CPG marketers can tap into this trend during future gas price increase cycles through marketing messages emphasizing the ability to make both quick meals and restaurant-quality meals conveniently and cost-effectively at home.

CONVENIENT MEAL SOLUTIONS*: Dollar/Volume Sales % Change vs Prior Year by Period - FDMx



* "Convenient meal solutions" includes cold cereal, dry packaged dinners, frozen appetizers/snack rolls, frozen dinners/entrees, frozen pizza, frozen pot pies, frozen side dishes, refrigerated lunches, refrigerated entrees, refrigerated salad/coleslaw, refrigerated side dishes, shelf-stable dinners.

Sources: IRI InfoScan® Reviews



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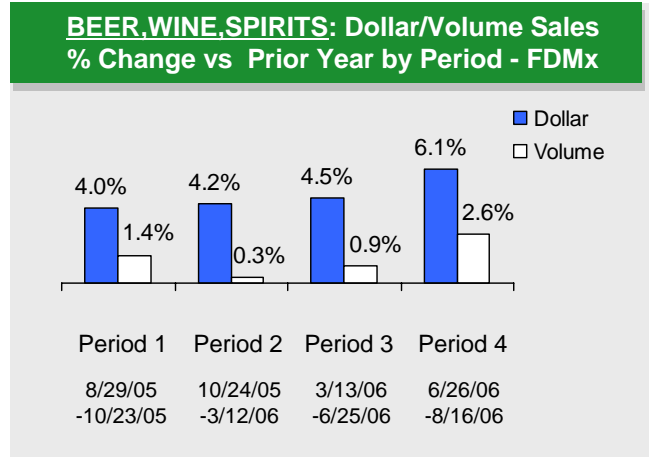
Sales improved across snacks, desserts and beverages as consumers cut back spending on entertainment.

CPG GROWTH TRENDS ENTERTAINMENT

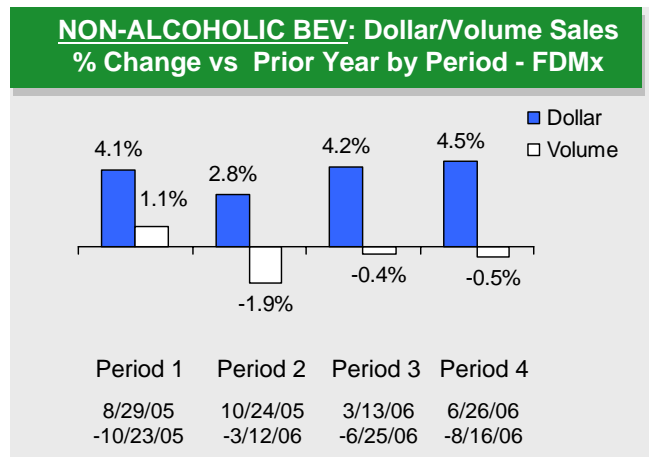
As consumers cut back on entertainment spending due to gas-related budget constraints, they were likely entertaining at home more often. If so, we would expect to see sales growth among food and beverages commonly associated with entertaining.

Indeed, dollar sales growth increased steadily across beer, wine, spirits, non-alcoholic beverages and snacks/desserts from the second period forward, as gas prices climbed. While volume sales remained negative versus prior year among non-alcoholic beverages and snacks/desserts, growth rates did improve as gas prices increased.

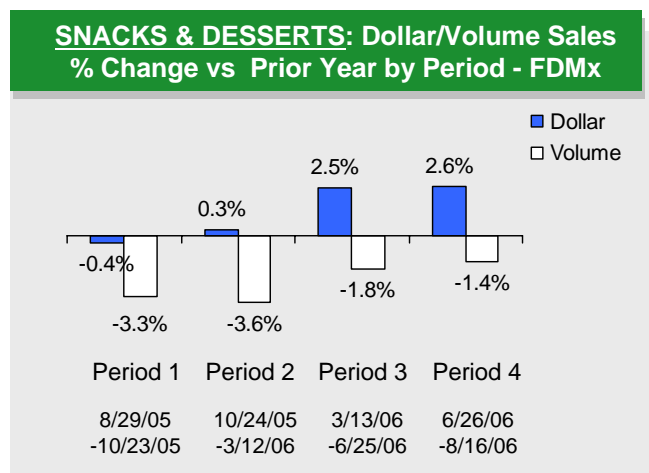
Marketing that stresses the ability to have fun entertaining at home during high gas price periods is likely to resonate with consumers. In addition, manufacturers and retailers should consider stepping up merchandising activity with innovative displays and promotions across these categories.



Source: IRI InfoScan® Reviews



Source: IRI InfoScan® Reviews



Source: IRI InfoScan® Reviews



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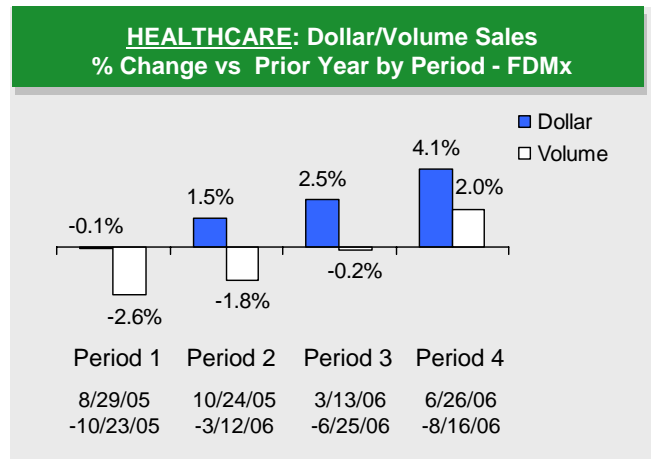
Health and beauty care spending does not appear to be directly tied to gas prices.

CPG GROWTH TRENDS HEALTH & BEAUTY

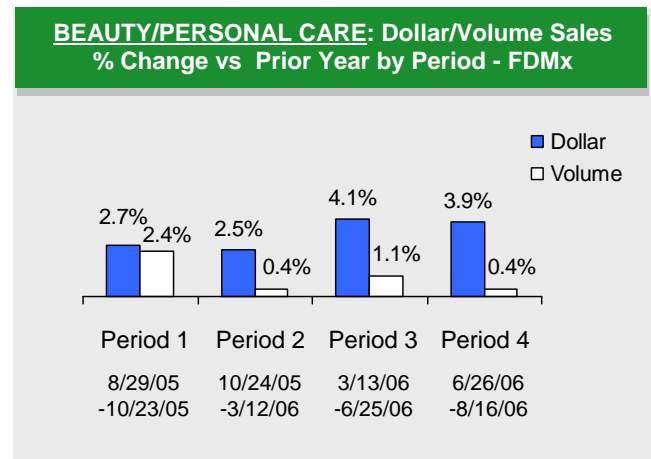
Health and beauty care spending appears to be less tied to gas prices than spending across the food and beverage categories discussed previously.

Healthcare dollar and volume sales growth has steadily improved throughout the year without appearing to respond to fluctuations in gas prices. For instance, sales improved during period 2 when gas prices declined, but continued to improve in period 3 when prices sharply increased. Within these trends, we are likely seeing the influence of Medicare Part D, which delivered prescription insurance to millions of seniors, freeing up an incremental \$1,100 per individual. IRI analysis has shown that Medicare Part D appears to have driven sales increases across numerous categories, including several major healthcare categories.

Beauty and personal care categories provide a good barometer of CPG spending impact: if gas prices led to CPG spending reductions, we would likely see these reductions in beauty and personal care categories – many of which are more discretionary in nature. Instead, as gas prices increased in period 3, we saw increased demand and increased dollar sales.



Source: IRI InfoScan® Reviews



Source: IRI InfoScan® Reviews



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SHOPPING BEHAVIOR TRIPS – ALL OUTLET

Consumers conserved shopping trips in their efforts to conserve gas.

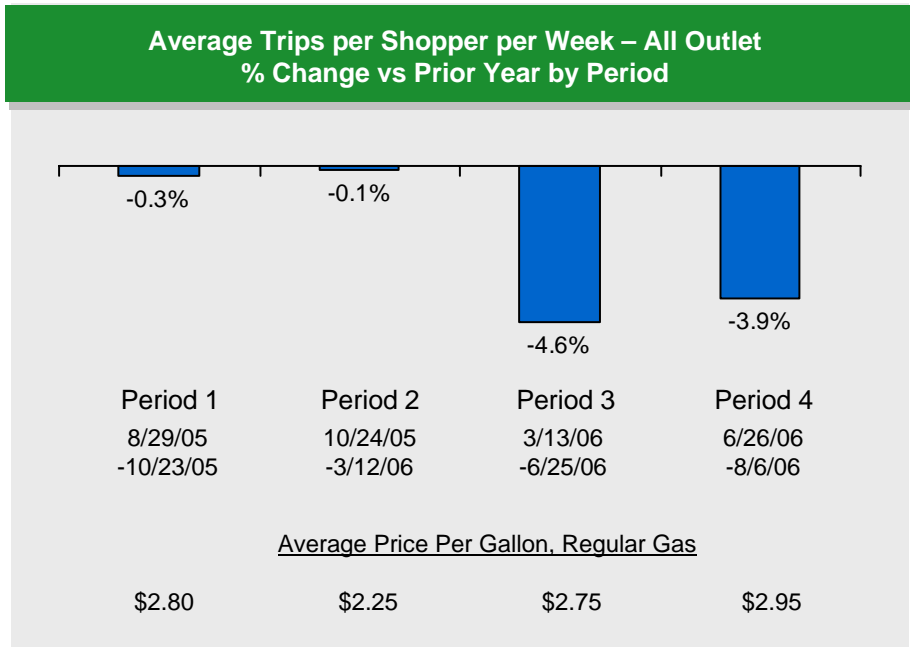
The sustained, steady increase in gas prices beginning in the spring of this year appears to have precipitated significant changes in consumer shopping behavior. When gas prices rose in the third period, consumers began to focus on conserving shopping trips and accomplishing more per trip in their efforts to conserve gas – accelerating a long-term trip reduction trend.

For retailers, securing one of those trips becomes that much more critical – and more challenging. We are likely to see increased ad spending and marketing with more pointed messages regarding how stores can help consumers accomplish multiple tasks with one visit.

Yet, effective in-store marketing and merchandising will be critical, as well, as retailers seek to compensate fewer trips with larger basket rings. And, understanding the specific trip missions that consumers are making within the channel/store and how they are evolving has become increasingly important.

Finally, this trend opens a window of opportunity for “local” retailers - those with locations closest to consumers’ homes - to drive incremental sales.

For manufacturers, there are fewer opportunities to influence product selection in-store, which drives the need for a greater focus on innovative merchandising and promotions to encourage larger package size purchases.



Sources: IRI Consumer Network®, U.S. Department of Energy



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SHOPPING BEHAVIOR TRIPS - BY CHANNEL

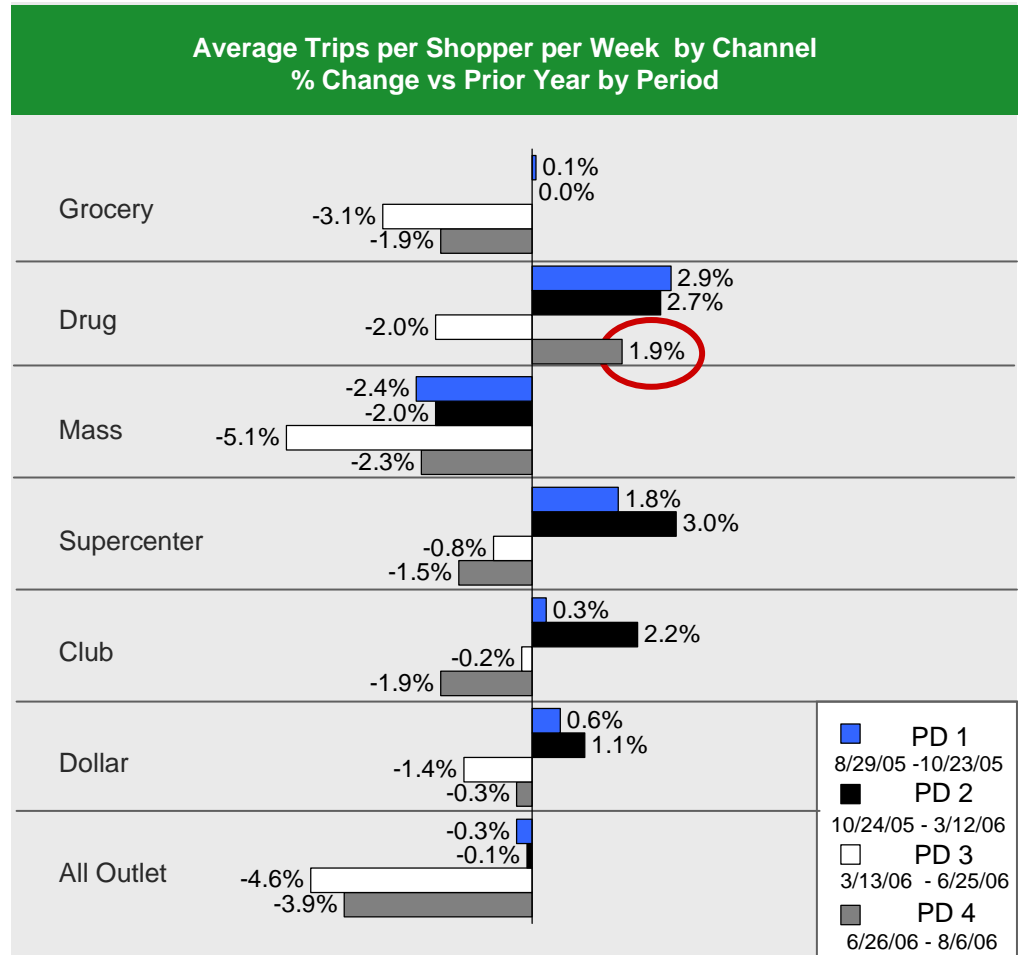
Shopping trip reduction was evident across all channels; however, drug channel trips have rebounded.

When gas prices jumped to an average of \$2.75 in the spring of this year, it seems that consumers made a conscious decision that changes in shopping behavior were required to save gas. We saw fewer trips across the board.

By the summer, when average prices reached \$2.95 per gallon, this new approach to shopping had evolved somewhat: consumers increased trips to local drug stores, presumably to fill

in product needs before the next big shopping trip. And, while the shopping trip decline became more pronounced at supercenters and club stores, it became slightly less pronounced at grocery stores, suggesting that some consumers were sticking closer to home, even for the larger shopping trips.

Distribution and competitive strategies with the agility to address gas-related shifts as they emerge will drive competitive advantage.



Source: IRI Consumer Network®

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SHOPPING BEHAVIOR TRIPS – BY CONSUMER SEGMENT

Consumers across income groups cut back on shopping trips.

Despite the fact that rising gas costs account for a much greater proportion of disposable income among lower vs upper-income consumers, consumers across income brackets appear to have proactively reduced trips after gas prices skyrocketed this spring.

Trip conservation and the resulting marketing and merchandising implications highlighted previously are important considerations for all CPG manufacturers and retailers – whether catering to middle, lower or upper-income consumers.

Getting By

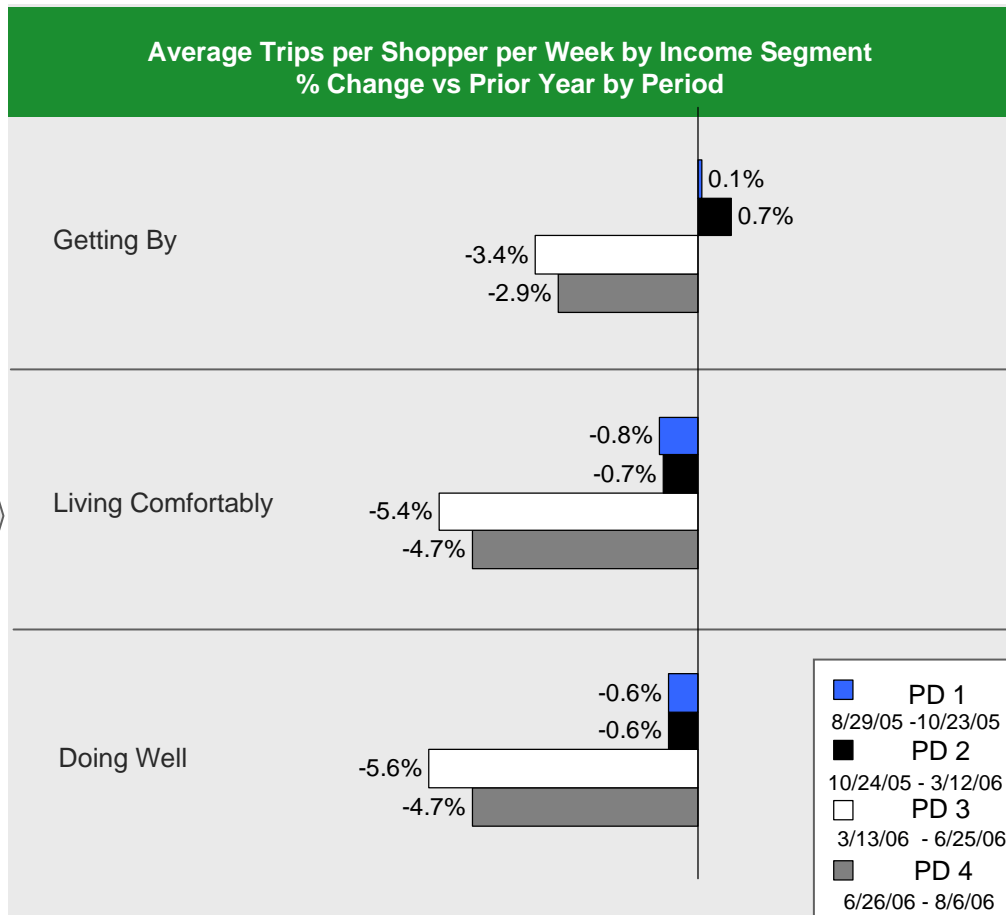
- One member households with income less than or equal to \$19.9K
- Two or more member households with income less than or equal to \$34.9K

Living Comfortably

- One member households with income between \$20K - \$34.9K
- Two or more member households with income between \$35K - \$54.9K

Doing Well

- One member households with income greater than or equal to \$35K
- Two or more member households with income greater than or equal to \$55K



Sources: IRI Consumer Network®



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CHANNEL IMPACT CONVENIENCE STORES

Shifting consumer behavior may be cutting into strong C-store growth trends.

An analysis of growth trends across select snack/dessert and beverage categories within convenience stores suggests that shifting consumer shopping and driving patterns -- rather than increased belt tightening -- may be impacting sales.

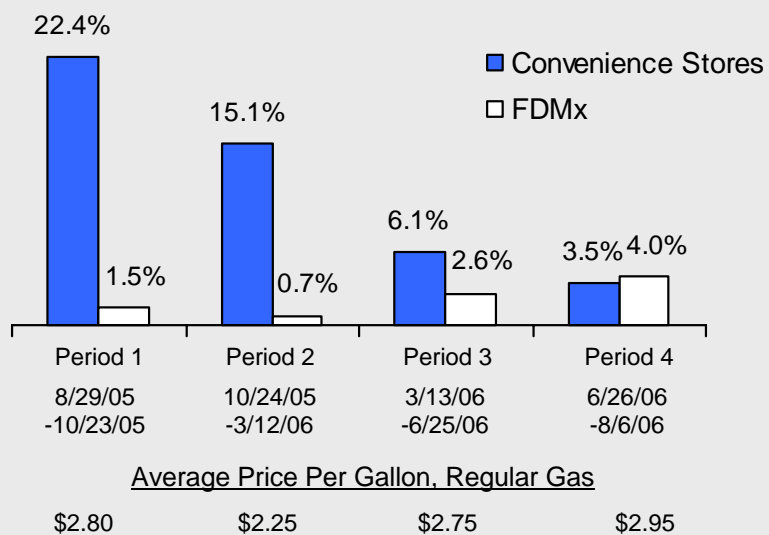
Among these categories, exceptionally high growth rates within convenience stores started to slow as gas prices renewed their climb this past spring. At the same time, however, sales across these

categories began to increase among food, drug, mass channels (excluding Wal-Mart) -- suggesting a shift across channels, rather than category sales declines.

Two factors may be at work here: 1) consumers may be buying more of these products during stock-up shopping trips as they consolidate shopping and/or 2) increased availability of gas at alternate channels (one-third of supermarkets now sell gasoline, vs only 6% just three years ago¹) may be impacting C-store visits.

Among select categories, growth rates across FDMx channels accelerated as growth rates within convenience stores slowed.

Select Snack/Dessert and Beverage Category Sales *
Dollar Sales % Change vs Prior Year by Period



*Reflects dollar sales growth among 36 snack food/dessert and beverage categories (including milk and beer) with coverage across IRI FDMx and Convenience Channel InfoScan® services.

Sources: IRI InfoScan® Convenience Store National Service; IRI InfoScan® Reviews; U.S. Department of Energy



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The combined effect of trip and basket growth drove a sizable drug store share gain in the fourth gas price period.

CHANNEL IMPACT DRUG STORES

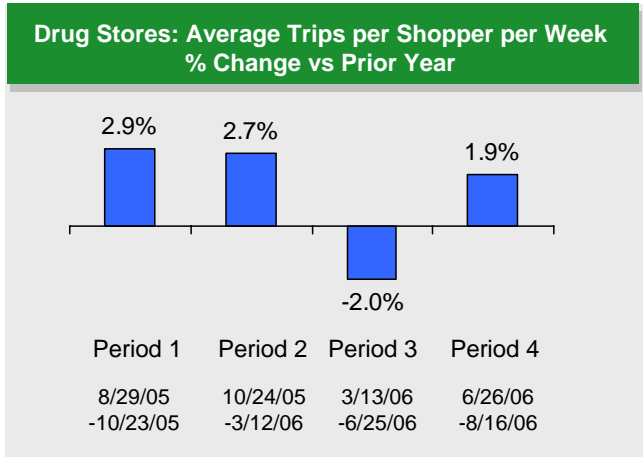
With locations close to home for the majority of consumers, drug stores appear to have reaped significant benefits from escalating gas costs.

As gas prices soared 50 cents per gallon higher in the spring, drug stores took an initial hit in shopping trips, but it appears that consumers soon increased trips to the channel as they decreased trips to other outlets located further from home.

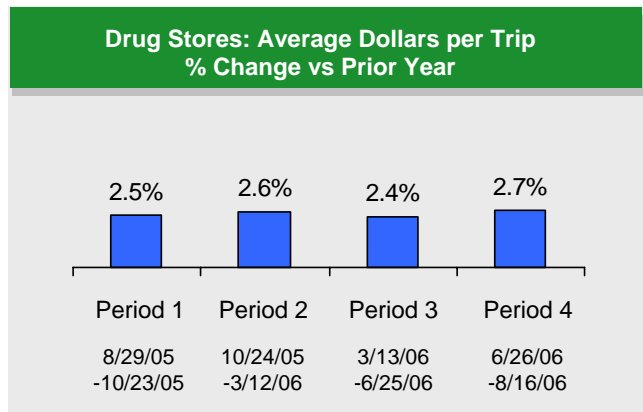
In addition, throughout the entire year included in this study, drug store dollars per trip maintained consistent, steady growth.

As a result, drug store dollar share benefited, increasing a half point in the fourth period of this analysis – one of the largest drug store share increases in several years.

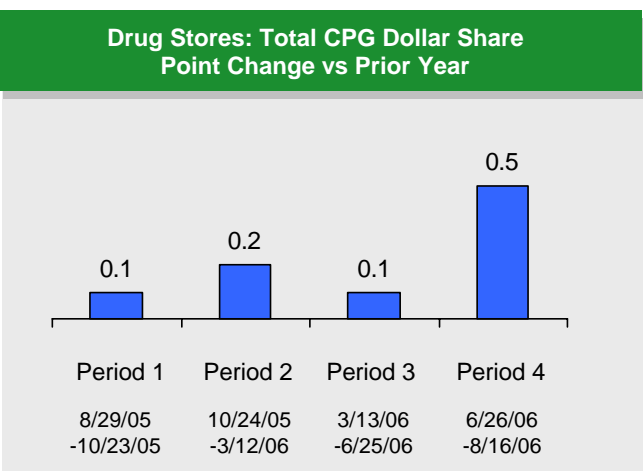
Categories with the largest sales gains within the channel during period 4 were predominantly health and beauty care categories and included suntan products (+20.1%); hair conditioner (+19.7%); cough syrup (+16.0%), shampoo (+14.9%) and eye cosmetics (+11.5%). Drug stores and other “locally-based” retailers should consider promotions on categories in which destination retailers (eg. supercenters) have a high share (such as health & beauty care) to capture sales between large shopping trips.



Source: IRI Consumer Network®



Source: IRI Consumer Network®



Source: IRI Consumer Network®



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CHANNEL IMPACT WAL-MART

While Wal-Mart's total store sales have been negatively impacted by rising gas prices, CPG sales have held strong.

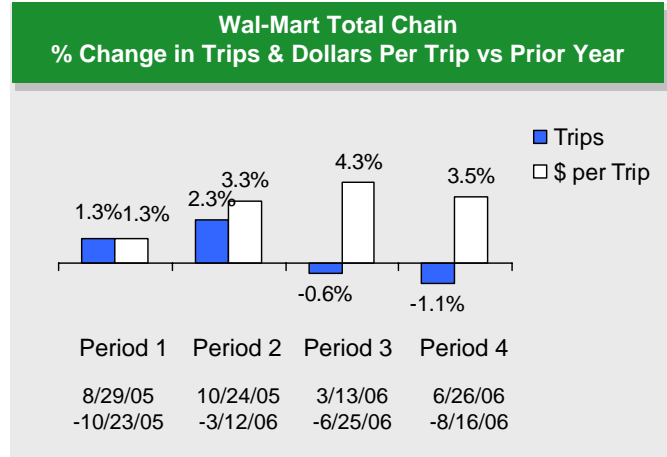
Wal-Mart has made several public statements indicating that total store sales have been hurt by rising gas prices, as core lower-income consumers have been heavily impacted.

There is good news for Wal-Mart within the CPG realm, however. While trips declined as gas prices increased, dollars per trip increased significantly—resulting in modest increases in CPG share.

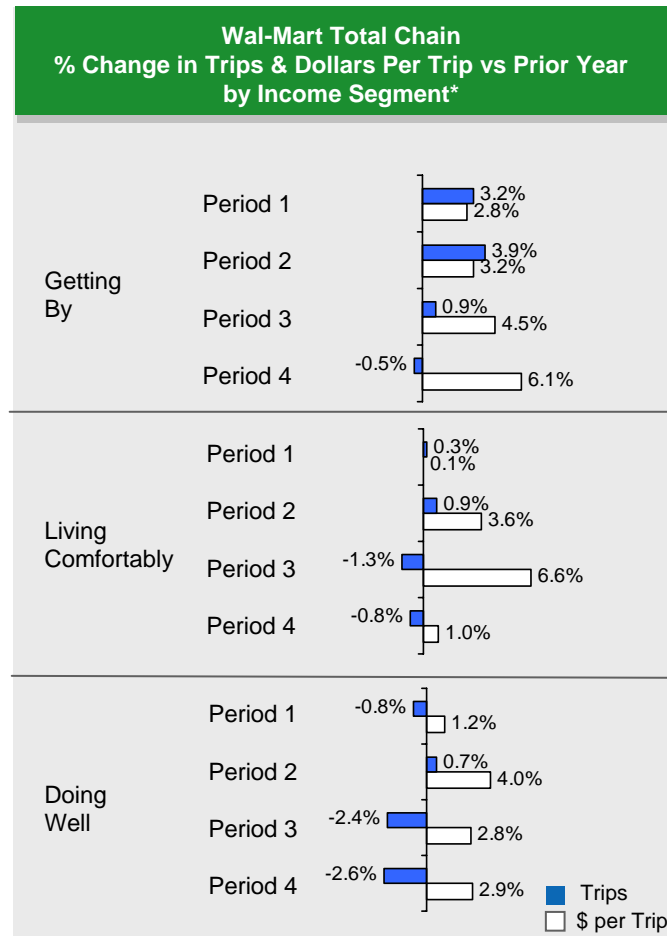
Across consumer segments, the lowest-income group has exhibited only a slight decline in trips balanced by a sizable increase in spending per trip on CPG products. Despite the distance required to travel to Wal-Mart, these consumers are clearly relying on Wal-Mart for lower prices during this time of heavy budget constraints.

To bolster trips and spending, Wal-Mart has announced plans to “re-energize the rollback program to convince consumers that the smart thing to do is to go to Wal-Mart and save more.”¹

The industry can expect increased advertising and in-store marketing around this initiative which will in turn drive increased competition and pricing pressure across retail channels.



Source: IRI Consumer Network®



Source: IRI Consumer Network®

*See page 13 for income group definitions

1 CNNMoney, 9/6/06



CONCLUSIONS CPG MANUFACTURERS

Manufacturers seeking to protect and grow share throughout gas price cycles should consider the following action items:

- ▶ Capture increased growth potential among select food and beverage categories
 - Identify category and brand sales trends throughout gas price cycles -- particularly within meal solution and entertainment categories, including beer/wine/spirits, beverages and snacks/desserts
 - Develop innovative displays and promotions timed with gas price spikes
 - Emphasize convenience, fun and cost savings with at-home dining and entertainment in marketing messages
 - Identify potential share shifts between convenience and food, drug, mass channels and distribution implications
 - Include anticipated gas price trends in the marketing planning process
- ▶ Address declining/shifting shopping trips in promotion and distribution plans
 - Develop volume-building promotions (eg. buy two, get x off; savings on larger package sizes)
 - Explore innovative in-store marketing vehicles
 - Identify modifications required to distribution strategies as a result of trip shifts (eg. drug store gains)
- ▶ Assess product pricing strategies in relation to gas price cycles
 - Consider implementing planned product price increases during gas price downturns, rather than upswings
 - Test/model product price increase impact on brand and category sales
 - Explore price promotion opportunities in stores with a high mix of lower-income consumers during gas price highs



CONCLUSIONS CPG RETAILERS

Retailers seeking to protect and grow share throughout gas price cycles should consider the following action items:

- ▶ Capture increased growth potential among select food and beverage categories
 - Identify category-specific sales trends throughout gas price cycles -- particularly within meal solution and entertainment categories
 - Implement innovative displays, promotions and circular features timed with gas price spikes; tie in several categories, including food & beverage as well as DVDs, music, plates & cups, etc.
 - Emphasize convenience, fun and cost savings with at-home dining and entertainment in advertising and marketing messages
 - Include anticipated gas price trends in the marketing planning process
- ▶ Address declining/shifting shopping trips in marketing and merchandising plans
 - Implement basket-building promotions (eg. buy two, get x off; savings on larger package sizes; cross-category promotions, loyalty-card promotions on under-developed categories, etc.)
 - Explore innovative in-store marketing vehicles
 - Align merchandising with dominant trip missions (which may shift during gas price peaks, eg. more stock-up and less fill-in)
 - “Locally-based” retailers with stores that are close to home for a high proportion of consumers should promote categories (eg. health & beauty) in which supercenters and club stores hold a high share to capture incremental “fill-in” sales
- ▶ Assess pricing strategies in relation to gas price cycles
 - Closely monitor competitor pricing during gas price peaks (particularly as Wal-Mart steps up price rollback initiative)
 - Explore increased price promotion opportunities in stores with a high mix of lower-income consumers during gas price highs



RESOURCES

To gain insight into opportunities to protect and grow sales during gas price cycles, contact your IRI client service representative regarding custom analyses leveraging the following resources:

IRI Consumer Network®	Nationally representative panel of households tracking purchases with hand-held barcode scanners; extensive demographic profiles enable in-depth analysis of purchase behavior across standard or custom-defined consumer segments across channels.
IRI Shopper Insights™	Segments and analyzes stores, shoppers, trip types, and products to uniquely define target markets; this solution integrates IRI panelist demographics with Personix segmentation and panelist purchase behavior.
IRI AttitudeLink	Custom surveys that can be executed via mail, telephone or Internet; the ability to link attitudes with actual purchase behavior enables clients to track sales across custom attitudinal segments.
IRI Price Drivers	Price elasticity analysis that helps CPG marketers make more profitable pricing decisions by quantifying the sales response to base-, promoted-, and cross-price variation of their products. The proprietary methodology is based on store-level data.



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MORE INFORMATION

Please contact Sheila McCusker at sheila.mccusker@infores.com with questions or comments about this report.

ABOUT IRI

Information Resources, Inc. (IRI) is the world's leading provider of enterprise market information solutions and services, empowering its clients to grow their business profitably in a complex marketplace. Driving the transformation of the consumer packaged goods (CPG), retail and healthcare industries, only IRI provides a unique combination of real-time market content, advanced analytics, enterprise performance management software and professional services. The company's portfolio of services, solutions and technology enable leading retailers and their suppliers around the globe to see what they are missing, act faster and with greater confidence and win at the shelf. Ninety-five percent of the FORTUNE Global 500 in CPG and retail leverage IRI to power their business. For more information, visit www.infores.com.



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