Milk weathers the economic storm in 2009

Euromonitor International

28 October 2009

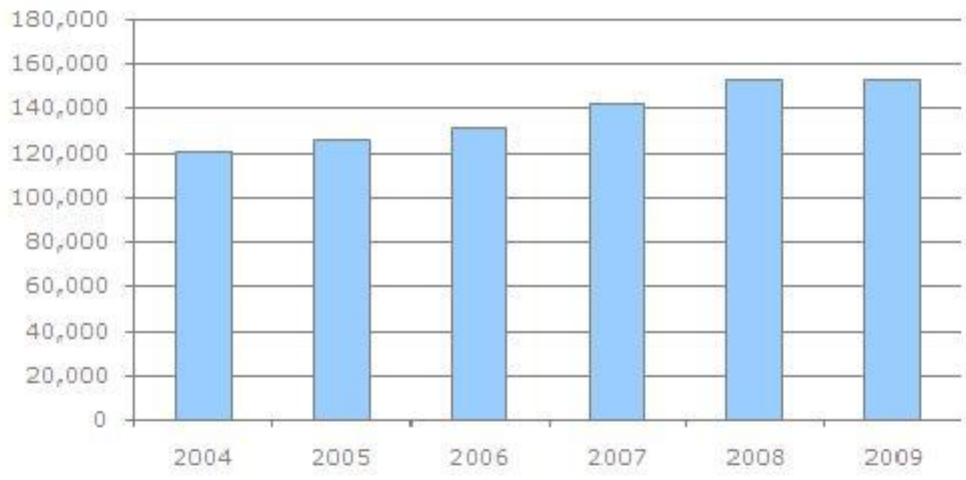
Despite the current recession, drinking milk products are set to witness positive growth in 2009. Lower commodity prices, the staple status of these products in many countries and steady investment in functional properties have all contributed to the relatively strong performance of the category at global level.

Global market performance

Euromonitor International estimates that global retail sales of drinking milk products are set to decline by 0.2% in retail value in 2009. This decline has mainly been prompted by a moderate drop in milk prices as a result of lower demand and large production stocks. When milk prices peaked in early 2008, farmers increased production, which, as a result of weaker demand during the second half of 2008 and into 2009, prompted a fall in prices (3% at global level).

Retail volume sales in 2009, however, are set to rise by 2% as a result of relatively low prices and the staple commodity status of milk in most countries. In countries like Ukraine, for instance, chocolate confectionery sales are set to decline by over 13% in retail volume as consumers cut down their expenditure on non-essential food products. Demand for milk products, on the other hand, will decline by a mere 1% as Ukrainians focus on affordable staple products consumed on a day-to-day basis. The share of private label grew by over one percentage point to 23% by the end of 2008 and is expected to continue to grow throughout 2009 as price gains increasing relevance among cash-strapped consumers.

Chart 1 Global drinking milk products retail value sales. US$ 2009 fixed exchange rates



Euromonitor International

Crisis impact

Research shows that drinking milk products are regarded as a staple in the diet of many countries. This, along with relatively low prices, makes these products quite resilient to recession as consumers tend to cut down on other non-essential items such as indulgence products.

Sales of drinking milk products are set to grow by 2% in retail volume in 2009, 0.5 percentage points up on the previous year. Demand for drinking milk products is being underpinned by lower global milk prices, which makes this commodity largely affordable to consumers. Despite this reduction in prices only partially being passed on from retailers to consumers, the latter have seen a cost reduction in milk products across the regions.

Emerging markets continue to drive growth despite the recession

Despite recessionary pressures, sales growth of drinking milk products has continued to be robust in some parts of Asia-Pacific and the Middle East and Africa over 2009. Algeria and Tunisia, which are set to witness 11% retail volume growth in 2009, are valid examples of this trend. This is because despite the slowdown in economic growth, middle-class consumers in urban areas have continued to trade up from fresh to packaged milk products, which are considered safer than 'untreated milk'. Furthermore, strong population growth has underpinned demand for staple products in these countries, including milk.

Within Asia-Pacific India has been one of the fastest growing countries in terms of drinking milk products. Unlike other dairy products, the economic slowdown that has hit India has not constrained the growth of drinking milk products in 2009. Milk is a staple product regarded as essential by many Indian consumers, who buy it on a daily basis. Furthermore, the hot weather makes the storage of fresh milk unsafe and is prompting a trade up from fresh to packaged lines. Furthermore, the decline in milk prices witnessed in 2009 has allowed a larger number of lower-middle class consumers to consume these products, thus contributing to the growth of drinking milk product sales across the country.

Retail value growth of drinking milk products in Eastern Europe has been underpinned by high inflation levels rather than strong consumer demand. In contrast, retail volume sales have remained fairly stable and are expected to increase by a mere 0.3% in 2009. Despite the intensity of the recession in countries like Ukraine and Hungary, the staple status of milk has allowed drinking milk products to remain fairly stable in volume. Consumers in these countries are reducing their expenditure on non-essential food items such as chocolate confectionery and chips/crisps, which have posted a drop in sales in 2009.

Lower milk prices in Latin America are slowing the value performance of drinking milk products in 2009. This deflationary trend has been particularly intense in markets like Brazil, which has seen milk unit prices decline by 13% in constant value terms during 2009. In contrast, demand for healthier low-calorie alternatives has continued to fuel growth of soy beverages in the region, with the category set to grow by 6% in retail volume in 2009.

North America's negative value performance has been driven by the strong decline in domestic milk prices, which were passed on almost entirely from manufacturers to final consumers in 2009.

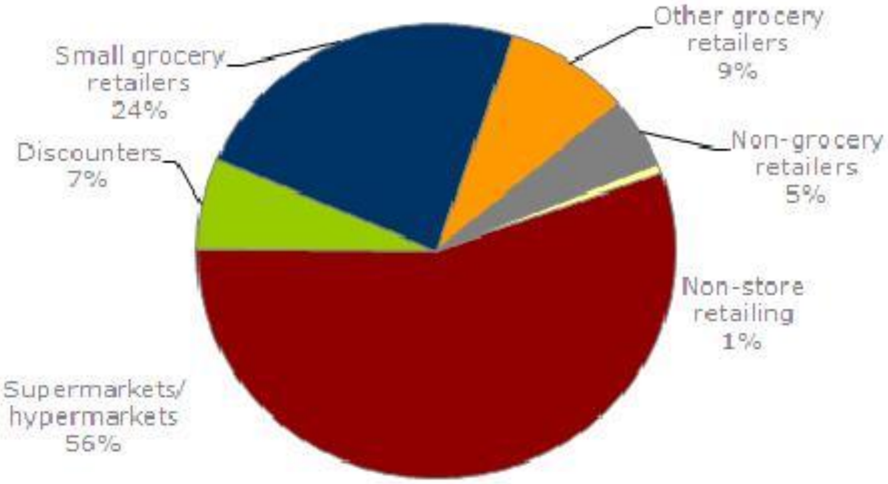
Distribution

Supermarkets/hypermarkets remain the most important retail outlets and command the largest share of drinking milk product sales, according to Euromonitor International. These outlets are particularly important in developed regions like North America, where they are set to account for around 75% of total retail value sales in 2009.

Small grocery retailers is the second most important channel, set to command a 24% share of retail global value in 2009. These outlets are particularly important in less developed regions such as Latin America and Eastern Europe, where the presence of corner shops is more widespread.

Discounters remain small in terms of relative importance, set to account for just 6% of global retail value in 2009. Discounters have seen their sales remain fairly steady since 2004. Overall, these outlets have failed to gain significant ground on supermarkets and hypermarkets, which offer a more balanced portfolio of economy and premium milk and flavoured milk drink brands. These outlets, however, carry greater importance in Western Europe, a region where they are widely present and account for around 17% of retail value sales (2009).

Chart 2 **Drinking milk products. Global retail value sales by distribution outlet (2009)**



Euromonitor International

Key trends and developments in 2009

The addition of health properties to add value is playing a key role in the industry's strategy to maintain consumer interest and increase differentiation from private label offerings. Drinking milk products are regarded as staples and the inclusion of additional nutritional properties is maintaining demand for these products even in highly mature markets.

Other than traditional fortification through the addition of vitamins and calcium, manufacturers are increasingly focusing on the development of 'multipurpose' lines containing a wide range of functional properties instead of just a single one. The result is the emergence of a 'super-healthy' category that satisfies more than one consumer need. Interestingly, some of these lines have been seen in private label products, a trend that is putting additional pressure on mainstream brands to increase even further the health orientation of their products.

Another key trend driving growth at global level is the progressive expansion of low-fat milk lines in developing markets. Population growth in these countries is resulting in a middle-class increasingly concerned about dietary and health issues and willing to pay a higher price for staple products formulated to address these concerns.

Increasing health awareness continues to be the main driver of new product development in developed drinking milk product markets. In an increasingly saturated market, organic and functional niches offer higher margins (around 50% and 15-20% in the US market, respectively) than the increasingly commoditised mainstream market (typically no more than 10%). However, margins on organic milk products are coming under pressure as inelastic supply begins to catch up with demand. In Germany, for instance, discounters are beginning to infiltrate the organic space by offering higher added-value products.

One of the key trends in 2009 has been the increasing shelf space allocated by retailers to organic offerings, with some of them clearly labelling the organic content of the brands displayed. US supermarket group Publix, for instance, has recently introduced shelf tags in its stores to make it easier for shoppers to find natural, organic and earth-friendly products. The organic tags contain the information icon 'USDA Organic', which means the item contains 95-100% organic ingredients. A 'Made with organic ingredients' tag means the item is made with 70-94% organic ingredients and the 'natural' or 'earth-friendly' tags have no information icon. The tan colour is meant to inform customers that the item is minimally processed and contains no artificial colours, flavours, preservatives or sweeteners.

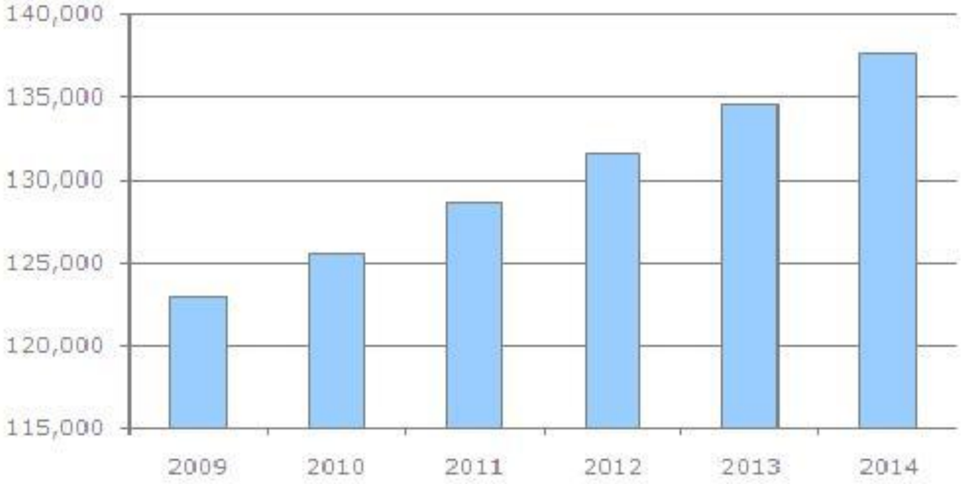
Global prospects

The drinking milk products category is predicted to grow by 12% in retail volume over the 2009-2014 period, according to Euromonitor International's projections. This is a performance in line with the moderate but steady growth registered in previous years.

Sales will be driven by the strong demand expected in emerging economies in Asia-Pacific and the Middle East and Africa as economic growth allows consumers in these regions to trade up from unpackaged/artisanal staple foods to more expensive but nutritional milk.

Sales in more developed regions like Western Europe and North America are predicted to be driven by value rather than volume, with unit prices forecast to grow by 18% and 27% respectively over the 2009-2014 period. Other than a predicted moderate increase in milk commodity prices, new functional properties in UHT milk and flavoured milk drinks are set to increase the added value of drinking milk products as a whole, enhancing the category's appeal among health-conscious consumers. Interestingly, sophistication in private label offerings is likely to increase over the medium term, encouraging manufacturers to enhance the indulgence/functionality of their products further to increase differentiation from more economical retail brands.

Chart 3 Global drinking milk products sales forecast ('000 tonnes)



Euromonitor International

Future direction

Euromonitor International forecasts that robust growth in the Middle East and Africa and Asia- Pacific will continue beyond 2009, particularly in markets such as China and India. Manufacturers should adapt their long-term strategies accordingly, prioritising those markets where organic growth will be strongest. International manufacturers should therefore adopt a dual strategy in order to maximise growth at global level.

On the one hand, they should extend standard-priced packaged milk lines to developing markets, using where possible local inputs to minimise costs and final retail prices. Manufacturers should not overlook the fact that maintaining relatively low prices is crucial to allow middle-class consumers to trade up from fresh to packaged milk in emerging economies. Innovation should focus on vitamin-enrichment and the introduction of low-fat lines targeting middle-class consumers in fast growing urban areas.

On the other hand, manufacturers should enhance the premium content of their brands in more mature markets through additional health properties. The development of hybrid 'super-premium brands' combining indulgence, health, organic and fairtrade properties will be crucial to expand the consumer base of drinking milk products in more mature markets, in which health, social or organic properties are no longer enough to expand sales when marketed separately.