



May 2008

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Competing in a Transforming Economy *Special Report: Executive Summary*



EXECUTIVE SUMMARY: TURNING INSIGHTS INTO ACTION

INSIGHT

- » Over the past year, consumer change has been faster, more frequent and less predictable than at any other time in recent history
- » Escalating prices have bred exceptionally high price sensitivity, driving declining demand across multiple categories, growth in private label, trial of lower-priced brands and accelerated channel migration
- » Long-standing consumer purchase drivers, including convenience and health and wellness are losing some momentum; consumers are foregoing ultra-convenience, and some shoppers are unable to afford healthier foods
- » Consumers are increasing purchases of basic ingredients and meal components due to reduced restaurant spending but are decreasing purchases of “non-essentials”
- » Changes in consumer shopping and purchase behavior vary widely by segment (eg. income, presence of children, lifestage)

ACTION

- » Step up frequency and granularity of consumer and market assessments; identify and implement required course corrections in brand and store strategies
- » Develop best-in-class marketing, pricing and promotion strategies, which will make or break retailers and brands within this environment; re-evaluate distribution plans to ensure alignment with shopping patterns
- » Re-assess product development priorities and timing, as well as local market assortments in relation to shifting consumer priorities
- » Determine optimal assortment and merchandising focus by market to reflect changes in purchase and consumption habits
- » Develop targeted marketing and merchandising strategies for each high-priority segment



With budgets strained to the breaking point, consumers have been forced to re-evaluate what they buy and where they shop.

“The challenges of growing in this economy are significant, but there are windows of success. This study reveals where those windows are and how to push them wide open.”

Thom Blischok
President, IRI Consulting
and Innovation

THE LANDSCAPE

As the U.S. economy undergoes a transformation, so, too, has the consumer.

While consumer behavior change is notoriously slow and gradual, changes in purchase and shopping behavior over the past year have occurred with remarkable speed and frequency – a testament to the severity of economic hardship many consumers are experiencing.

With budgets strained to the breaking point by rising prices for gas, energy, food and other necessities, consumers have had to continually re-evaluate what they buy and where they shop.

For retailers and manufacturers, go-to-market strategies have become infinitely more complicated. Consumers are highly price-sensitive, but increased commodity and fuel costs necessitate price increases in many categories. Brand equity is losing steam as consumers step up trial of lower-cost alternatives. The “right” assortment is shifting as consumers forego ultra-convenience and get back to basics in meal preparation.

Competing in a transforming economy requires re-assessing nearly every consumer-facing business process, including product development, advertising, pricing, promotion, merchandising and assortment, to ensure alignment with shifting consumer and business priorities – and with far greater frequency than in the past, given the pace of market change.

IRI has conducted an in-depth analysis of the current and projected economic environment and its consumer and market impact to provide industry participants with a foundation for successful strategy development and refinement.

This special edition of *Times & Trends* provides a high-level summary of key findings. The full report explores distinct trends by category, consumer segment, channel and market and identifies emerging opportunities and risks as well as recommended action items. The report was designed to help industry participants:

- » Leverage best practice analysis and insight-driven action plans
- » Build strategies addressing distinct requirements by consumer segment, market and competitive threat
- » Discover strategic pricing and promotion opportunities
- » Understand new assortment, merchandising, and distribution priorities

See page 10 for additional detail regarding full report content and availability.



U.S. ECONOMY IN TRANSFORMATION CONSUMER EXPERIENCE

A “difficult” economy has very real implications for consumers – half of lower-income shoppers are having difficulty buying the groceries they need.

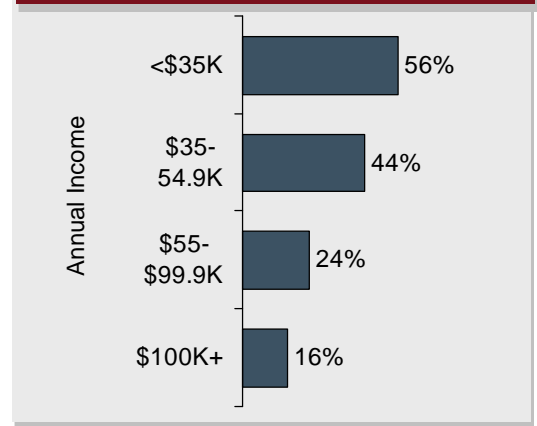
The U.S. consumer experience is dramatically different today than it was just a year ago. Roughly half of U.S. consumers with income under \$55K per year are now having difficulty buying the groceries they need.

Average CPG prices are up 6.6% vs 2006, and pricing on key staples, including eggs, pasta, baby formula and milk, for instance, has risen astronomically, as summarized in the bottom chart.

Additional CPG price increases are inevitable, as manufacturing and distribution costs will continue to rise. While skyrocketing prices for wheat, oats and rice are expected to moderate, the price of corn is likely to remain well above average into 2009, and diesel cost increases are not likely to subside until Q22009.

As a result, we can expect continued belt tightening and behavioral shifts among consumers for at least the next 12 months.

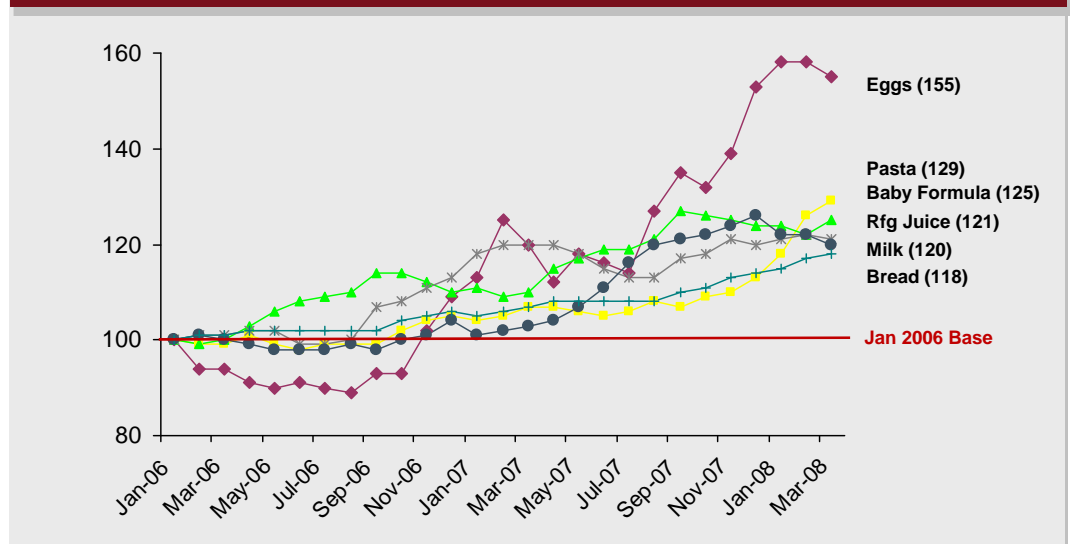
% of Consumers Having Difficulty Buying the Groceries They Need by Income Segment



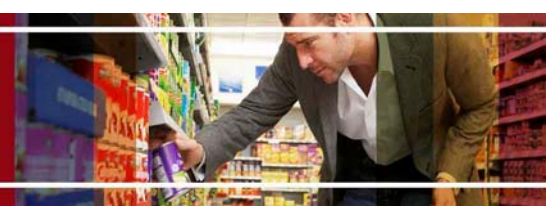
Source: IRI Economic Trend Database™ based on AttitudeLink™ Survey of 1,000 Consumers, May 2008

Rising commodity and fuel costs behind CPG price increases are not expected to ease before Q22009.

Category Price Index vs January 2006 (100) by Month



Source: IRI Economic Purchase Behavior Longitudinal Database™, IRI InfoScan® Reviews, FDMx



CHANGING PURCHASE BEHAVIOR TOTAL CPG PRODUCTS

Hefty price increases hurt CPG demand, but a rebound is underway as recent gas price spikes prompt consumers to eat at home more.

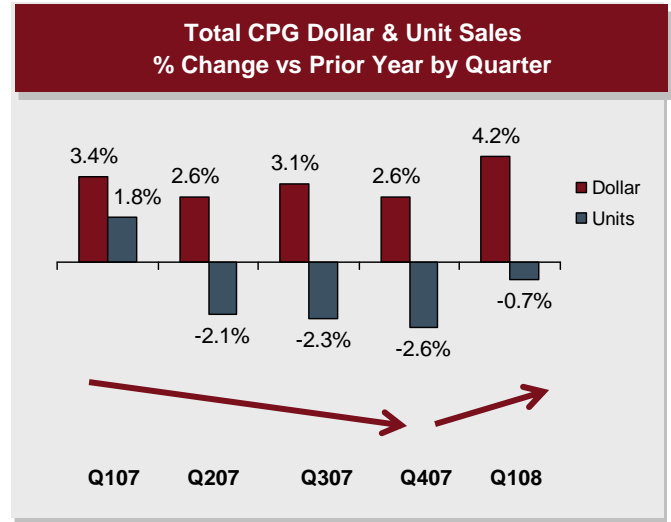
Rising costs have forced consumers to take a hard look at what they buy and make changes to save money. These shifts are reflected in total CPG purchase trends, as highlighted in the top chart.

While CPG dollar growth has remained solid, this growth has been price-driven. Demand slipped sharply in the second quarter of 2007. As detailed in the bottom chart, this is the point at which large CPG price increases took hold across many categories, driving up average prices nearly 5%.

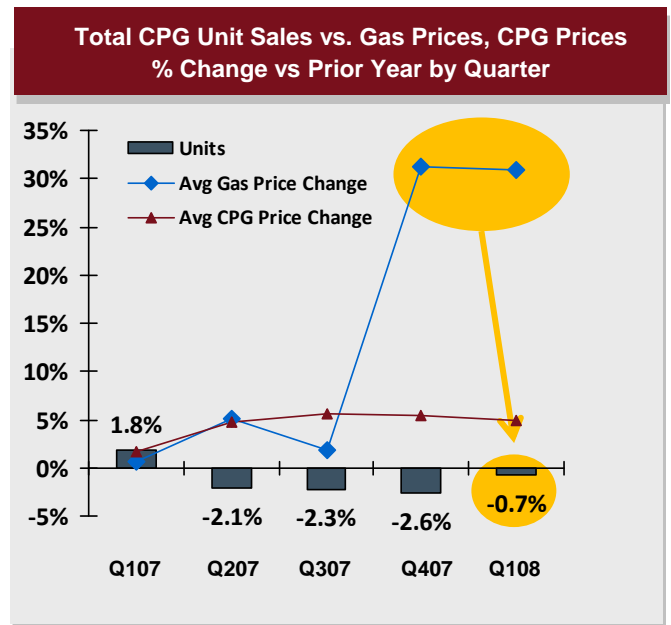
CPG demand continued to steadily decline as prices inched up even further, but began to rebound in the first quarter of 2008. What prompted this turnaround? Gas prices.

Gas prices spiked dramatically in the fourth quarter of 2007, when average prices were 30% above prior year. As this trend continued into the first quarter of 2008, consumers once again shifted spending priorities, eating out less and cooking at home more, driving up demand for meal ingredients and components.

Increased demand has been good news for the industry, but not all categories and channels are benefiting.



Source: IRI Economic Purchase Behavior Longitudinal Database™
IRI InfoScan® Reviews, FDMx



Sources: IRI Economic Purchase Behavior Longitudinal Database™
IRI InfoScan® Reviews, FDMx, U.S. Department of Energy

Times & Trends

A Snapshot of Trends Shaping the CPG and Retail Industries



CHANGING PURCHASE BEHAVIOR DEPARTMENT

Departments providing basic meal preparation essentials are gaining, but “non-essentials” are struggling.

As consumers re-prioritize spending, departments that provide necessities for meal preparation, including frozen foods, perishables and center store, are now gaining. At the category level, basic ingredients are outpacing ultra-convenient frozen and refrigerated meals, marking a turning point in the convenience trend.

By contrast, general merchandise, which includes a high mix of “non-essentials”, felt demand declines as soon as CPG prices began to rise in Q22007. Higher

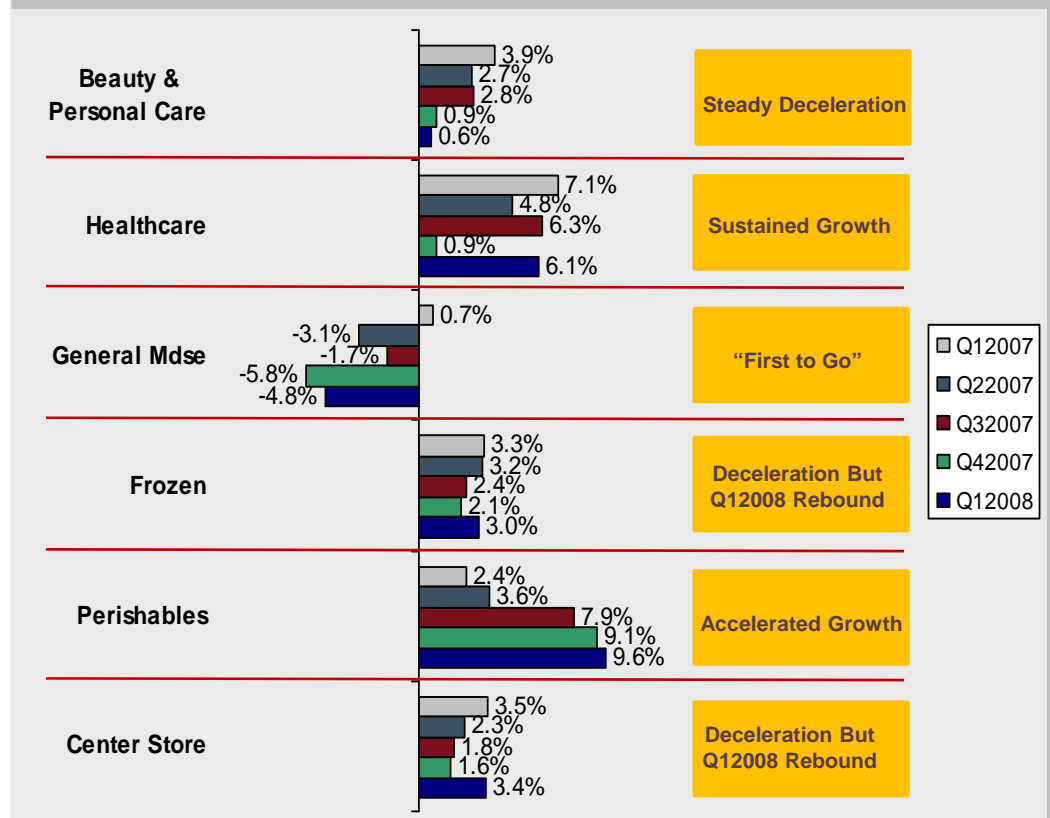
prices among necessities pulled dollars from general merchandise categories.

Beauty and personal care categories, while not declining, have seen a significant slowdown in growth rates. Categories with high price increases have seen the largest demand declines.

Healthcare has been relatively immune to sales lags due to the economy; in fact, consumers are increasingly leveraging self-care products, driving up sales.

53% of consumers report cooking more from scratch now than they did six months ago.

Dollar Sales % Change by Department by Quarter



Source: IRI Economic Purchase Behavior Longitudinal Database™, IRI InfoScan® Reviews, FDMx



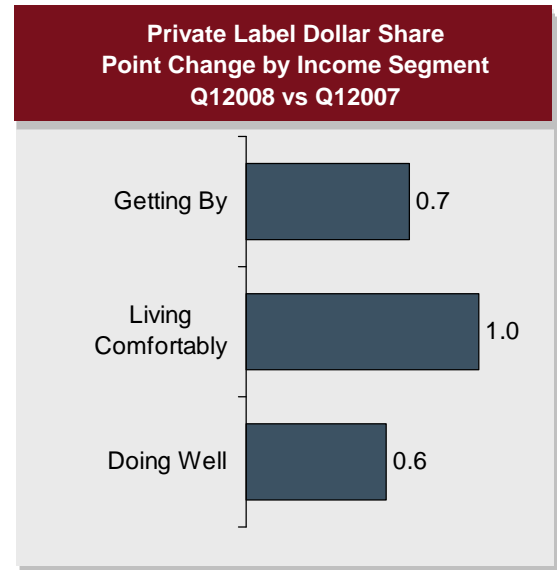
CHANGING PURCHASE BEHAVIOR PRIVATE LABEL

Private label is securing sizable share gains – even among upper-income consumers; however, retailers are missing private label opportunities in center store.

After five years of essentially flat share overall, CPG private label is on the rise, securing sizable gains over the last two quarters.

Rising costs have encouraged consumers across income segments to allocate more of their spending to private label – providing retailers with a unique window of opportunity to extend reach beyond the core lower-income market.

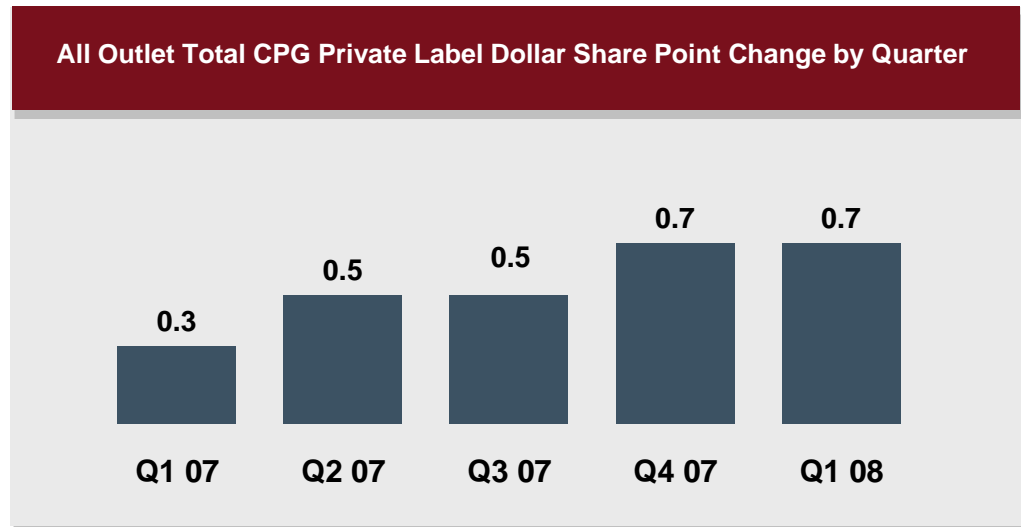
While private label gains have occurred across the store, particularly in high ticket categories and those with high price increases, gains have been relatively modest in center store. With many center store categories revitalized by a shift to at-home meal preparation, retailers appear to be missing further private label growth potential. Manufacturers need to closely watch private label shifts and leverage pricing and promotion to protect and grow share.



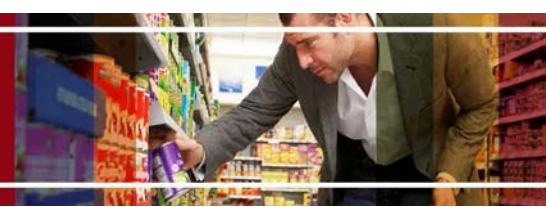
Source: IRI Economic Shopping Behavior Longitudinal Database™, IRI Consumer Network™

“Manufacturers facing increased private label competition need to strategically leverage price and promotion to protect share without damaging long-term sales and margin potential. This is where science meets strategy.”

Sunny Garga
President, IRI Business
and Consumer Insights



Source: IRI Economic Shopping Behavior Longitudinal Database™, IRI Consumer Network™



CHANGING PURCHASE BEHAVIOR CONSUMER TRADEOFFS

Most consumers have been forced to make tradeoffs, but the degree of change required varies markedly by income.

Regardless of income level, a high proportion of consumers report making tradeoffs in response to economic conditions, as summarized in the chart below.

The number of tradeoffs required, however, steadily goes up as income goes down. Nearly half of the lowest-income consumers in the U.S., for instance, are buying less produce because they cannot afford it. A nearly equal number of lower and middle-income consumers are buying fewer healthier foods, as they are more expensive. A much smaller percentage of upper-income consumers has had to make this sacrifice.

Other tradeoffs are more universal. For instance, a high mix of lower and upper-income consumers report foregoing purchases of ultra-convenient products, such as single-serve items and prepared meals, as well as non-essentials.

And, a high percentage of consumers – particularly those with income below \$100K, are putting brand preferences aside to stretch budgets. Tough news for brands that have invested heavily to build brand equity, but good news for lower-priced second and third tier brands and private label. The opportunity to gain trial has perhaps never been better in recent history for lower-priced alternatives – nor has the need for strategic pricing and promotion among leading brands.

Consumers are making difficult choices. Retailers and manufacturers who help to reduce sacrifices by offering competitive pricing and high-quality alternatives will win share and loyalty that will likely last beyond the current economic crisis.

Consumer Tradeoffs: % of Consumers Who Have Made Change Over Past Six Months by Income

	Total	< \$35K	\$35-54.9K	\$55-99.9K	\$100K+
Buy fewer individual serving pkgs as are more expensive	59%	62%	68%	60%	45%
Cut back spending on non-essential groceries	66%	75%	76%	65%	42%
Buy fewer prepared meals at grocery stores	55%	63%	59%	53%	39%
Try lower-priced brands	50%	62%	55%	46%	35%
Buy smaller quantities of favorite treats	55%	69%	58%	54%	34%
Buy fewer organic products, as are more expensive	52%	59%	56%	53%	34%
Buy more private label	50%	58%	58%	47%	31%
Give up favorite brands	42%	58%	52%	38%	19%
Buy fewer healthy products, as are more expensive	32%	45%	42%	28%	11%
Buy less fresh produce, as is more expensive	30%	46%	33%	27%	10%

Source: IRI Economic Trend Database™, based on AttitudeLink™ Survey of 1,000 Consumers, May 2008

Times & Trends

A Snapshot of Trends Shaping the CPG and Retail Industries



CHANGING SHOPPING BEHAVIOR SHOPPING TRIP SHIFTS BY CHANNEL

Channel migration takes a new turn as consumers look to supercenters and drug stores to play a greater role in fulfilling specific trip missions.

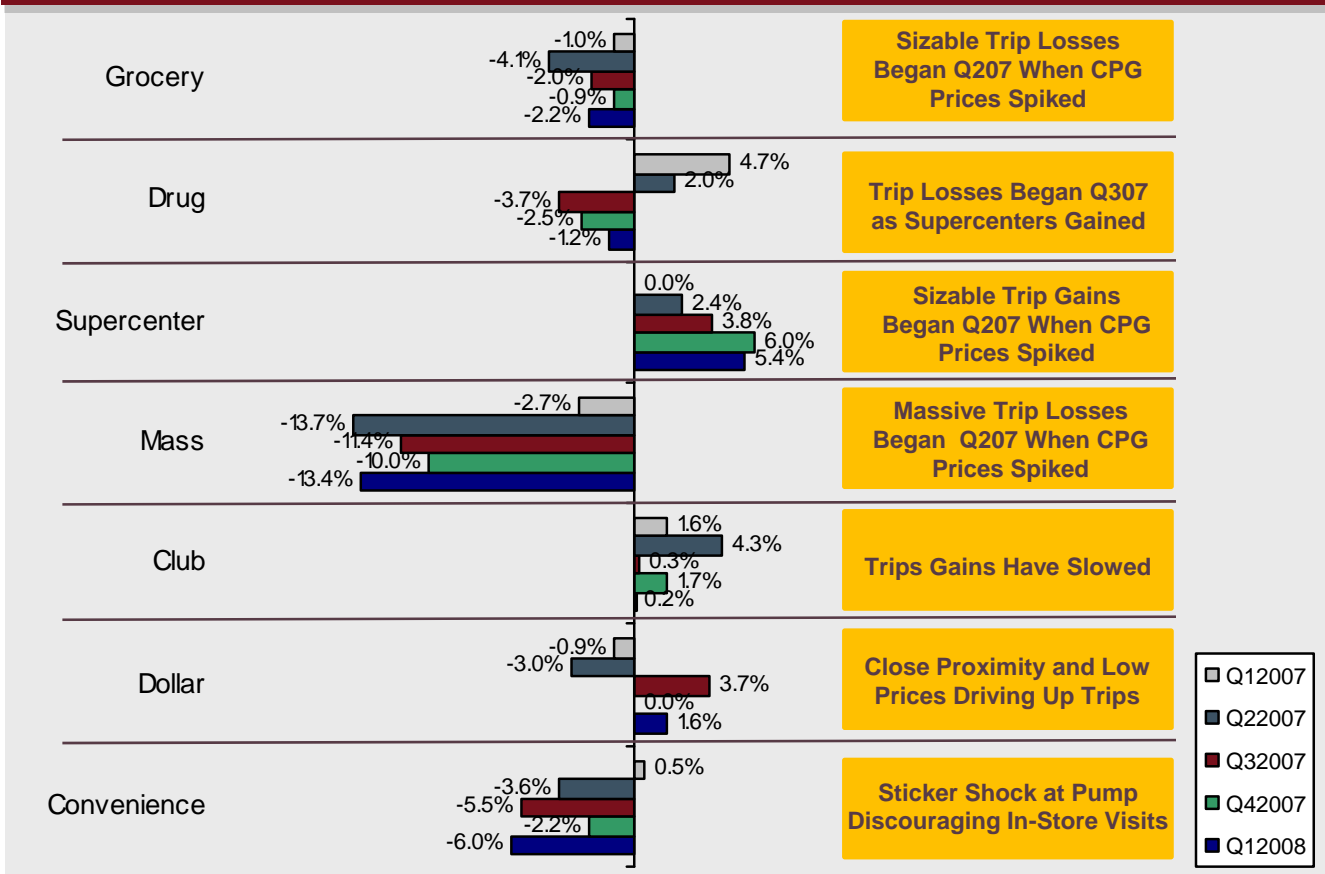
Consumers are revising shopping strategies to maximize savings while minimizing gas consumption. As a result, total trips are down nearly 3%, trips are shifting across channels, and trip mission mix within each channel is evolving.

Supercenters are the big winners, growing total trips and earning share gains across all departments, as consumers step up pantry stocking within the channel.

While total trips are down, drug stores are expanding their role as a 'fill-in' trip destination, securing major share gains across healthcare categories.

The grocery channel's dominance of fresh, frozen and center store food and beverage categories should leave the channel well-positioned as consumers eat in more, but low prices at supercenters are inhibiting grocers from capitalizing on this potential.

CPG Purchase Occasions per Household % Change vs Prior Year by Quarter



Sources: IRI Economic Shopping Behavior Longitudinal Database™, IRI Consumer Network™



COMPETING IN A TRANSFORMING ECONOMY STUDY OVERVIEW

This special edition of *Times & Trends* reveals changes in consumer shopping and purchase behavior in response to economic conditions that will impact every brand and every store to some extent. As behavior shifts vary markedly by category, consumer segment, channel and market, IRI conducted an in-depth assessment cutting across each of these variables to uncover specific opportunities and risks and identify specific action items to address them. And, as changes in consumer behavior and market conditions are faster, more frequent and less predictable than at any other time in recent history, we have developed longitudinal shopping and purchase behavior databases to provide ongoing monthly tracking.

Competing in a Transforming Economy: Study Components

Industry Report

Benefits

- » Leverage best practice analysis and insight-driven action plans
- » Build strategies addressing distinct requirements by consumer segment, market and competitive threat
- » Discover strategic pricing and promotion opportunities
- » Understand new assortment, merchandising, and distribution priorities

Content

- » Demand shifts vs CPG and gas price increases (category and private label)
- » Consumer tradeoffs and changing priorities, based on proprietary IRI AttitudeLink™ survey
- » Share, trips and trip mission mix shifts across channels
- » Analyzed across categories, key consumer segments (Boomer, Hispanic, Kids, Income) and geographies
- » Customization available

Key Indicator Tracking

Benefits

- » Gain competitive advantage through early identification of emerging market shifts
- » Continually assess strategic priorities and identify course correction requirements
- » Identify new risks and opportunities warranting immediate action or further investigation

Content

- » Price and cost indices (CPG, fuel, commodities, packaging)
- » Demand shifts (category and private label)
- » Share, trips and trip mission mix shifts across channels
- » Analyzed across categories, key consumer segments and geographies
- » Monthly and rolling quarter measures
- » Customization available

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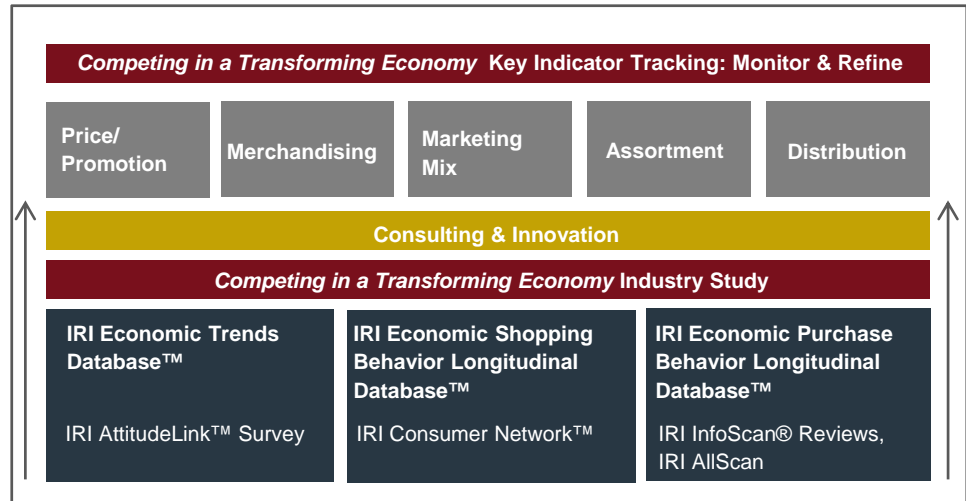
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COMPETING IN A TRANSFORMING ECONOMY STUDY OVERVIEW (CONT'D)

Integrating insights from three extensive new IRI economic databases, the *Competing in a Transforming Economy* report, combined with custom analysis and modeling where warranted, provides the foundation for successful go-to-market strategies during this challenging economic period. The monthly key indicator tracking service delivers the timely information and insights needed to continually monitor and refine consumer-facing strategies as the market continues to transform.

Building a Foundation for Successful Strategy Development and Refinement



About IRI

IRI is the world's leading provider of consumer, shopper, and retail market intelligence and insights supporting 95 percent of the FORTUNE Global 500 consumer packaged goods (CPG), retail and healthcare companies. Only IRI offers the unique combination of integrated market information, automated and predictive analytics, innovative enabling technologies, and domain expertise. With IRI, leading retailers and manufacturers are able to quickly discover breakthrough insights driving smarter decisions and actions across the enterprise for breakthrough results. Companies around the world depend on IRI for improved productivity, stronger brands, and dramatic revenue growth. For more information, visit <http://us.infores.com>

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