2008 Canadian Food Industry Review

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The Canadian food industry was marked by contrasts and extreme volatility in 2008. Changes in commodity prices and the exchange rate made it difficult to interpret pricing performances, and disparity among various segments of the overall food industry precluded generalizations. The following is a review of developments in the Canadian food retail and manufacturing industries with a focus on sales, pricing, and the impact of the exchange rate.

Supermarket Sales

Based on Statistics Canada data through October 2008, it appears that supermarket sales likely increased by at least 4% in 2008. Canadian supermarket sales last year will likely total $69 billion, compared to just under $66 billion in 2007. Total retail sales, not including autos and auto parts will have increased by about 7% in 2008. Figure 1 shows Canadian supermarket sales from 2000 through the estimate for 2008.

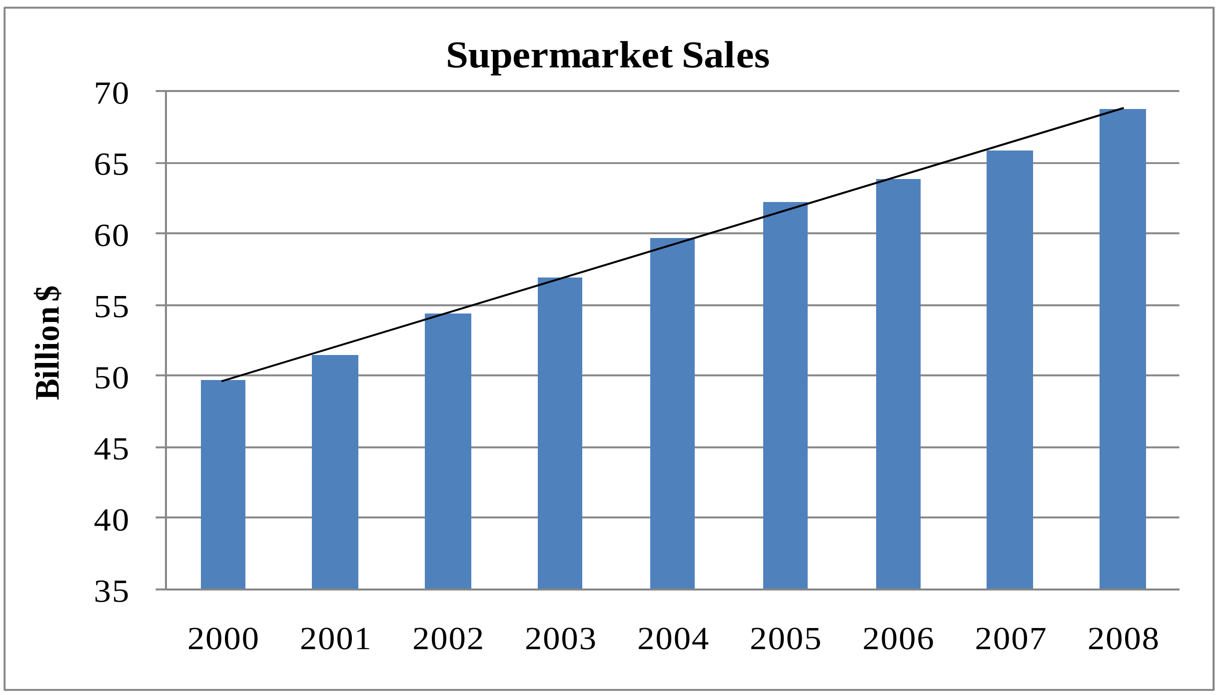

Figure 1

On a year to date basis from January to November, grocery store prices increased by 3.5% compared to January to November 2007. That means that real tonnage through grocery stores will likely have increased by about 1% in 2008. That 1% tonnage growth in 2008 is a modest improvement over 2007.

Retail pricing activity appeared to pick up dramatically at the end of 2008. The average prices of food purchased from grocery stores soared higher in November compared to October.

Figure 2 shows the performance of the Statistics Canada Consumer Price Index from 2006 through November 2008. The StatsCan CPI measures price changes relative to the base year of 2002. The graph shows the price index trends for the following categories: Food from Stores; Food from Restaurants; and All Items Excluding Food.

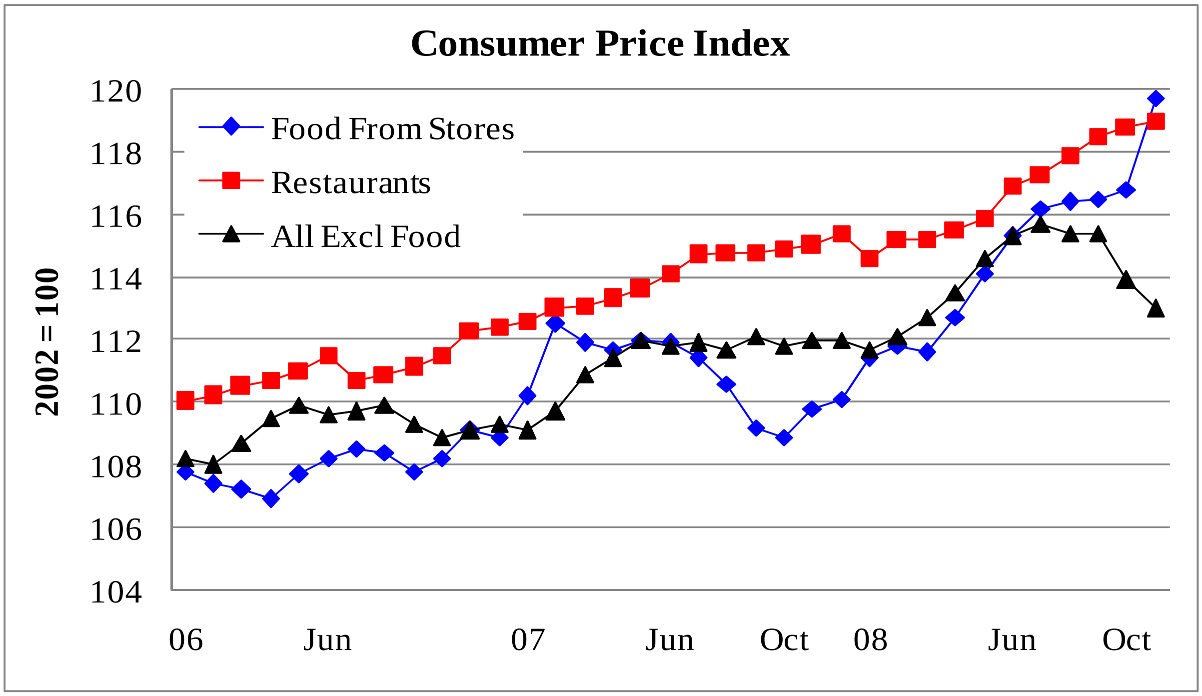

Figure 2

Grocery prices on average increased by 2.5% in November compared to October. November 2008 average grocery prices increased by 9% compared to November 2007. The grocery performance compares to a year to date change of 2.4% for all items, excluding food. Prices for all items excluding food declined 1% from October to November.

Breaking down the November price increases at food stores shows that the major cause of the increase was fresh fruits and vegetables. On a month to month basis, fresh fruits increased by 6% while fresh vegetables increased by 20%. Both of these products comprise significant shares of the overall food CPI and as such, major changes in both lead to changes in the average.

Figure 2 also shows that last year during the first three quarters, the average price of food purchased from stores declined, particularly in the third quarter. Ironically, the main cause of the decline in the grocery CPI at that time was fresh fruits and vegetables, which decreased by 7% and 15% respectively from October 2006 to October 2007. The common factor for the increase in prices this year and the decrease in prices last year was the change in the exchange rate.

Exchange Rate Impact

Figure 3 shows the weekly change in the C$ over 2007 and 2008. As can be seen, the exchange rate appreciated dramatically through most of 2007, peaking in early November. The Canadian dollar depreciated just as dramatically in the fourth quarter 2008. Fresh fruits and vegetables are very sensitive to changes in the exchange rate, especially during fall and winter when Canadian product is not available. The fact that the exchange rate peaked last fall, combined with the fact that the exchange rate dipped most severely this fall, makes year over year food price changes much more noticeable.

As a final point with regard to the pricing situation, it is noted that Canadian price increases have generally been much more modest than U.S. grocery increases in 2008. On a year to date basis through November, U.S. prices of food consumed at home increased by well over 6%. That compares to the Canadian increase of 3.5% as noted earlier.

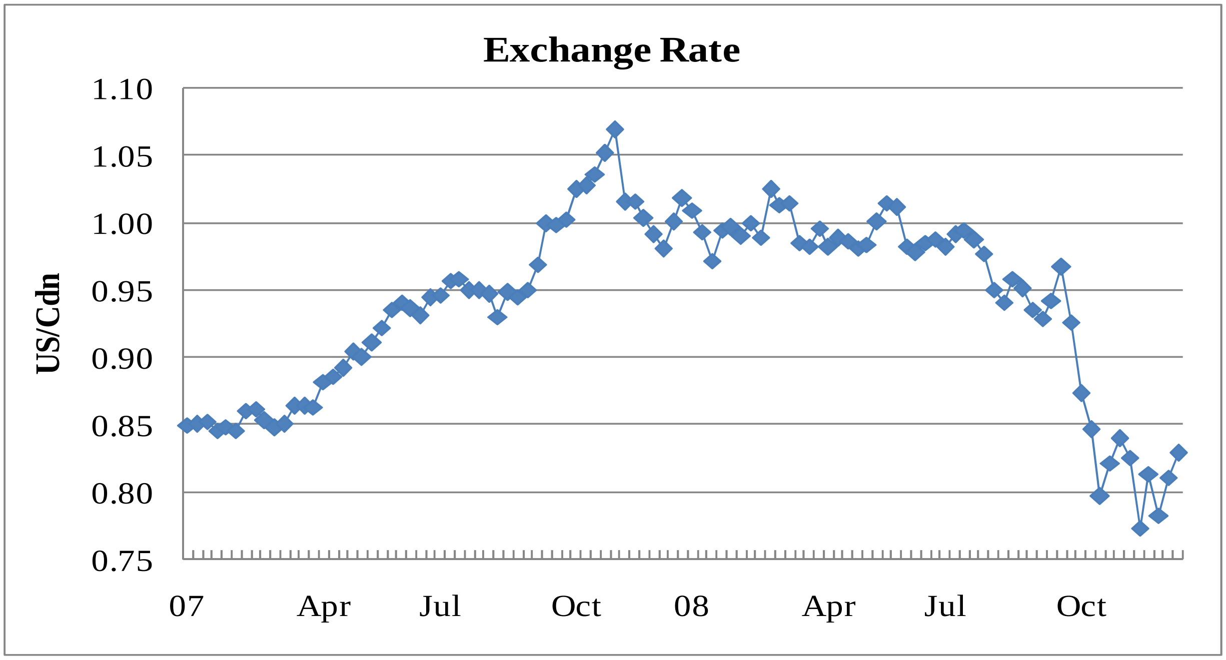

Figure 3

Further to that point, figure 4 shows the CPI for food at home in the U.S. versus the CPI for food from store in Canada, both of which are re-indexed to January 2006 = 100. It is clear that U.S. increases have outpaced Canadian increases in 2008. That is of particular interest, even accounting for the steep C$-induced decline in the third quarter 2007, which would have exaggerated the year over year change in Canada.

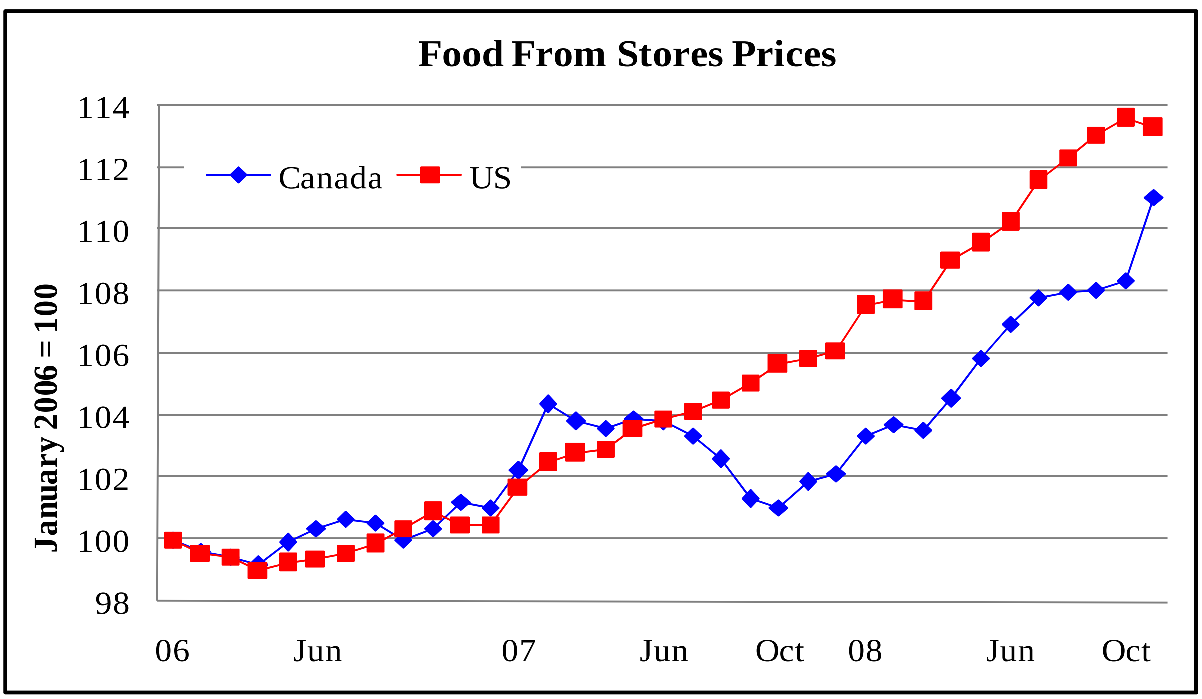

Figure 4

The assertion, therefore, is that while the price of food purchased from stores in Canada did increase dramatically in November, it was due more to exchange rate changes and changes in costs as opposed to margin increases at retail.

Manufacturer Sales

Based on Statistics Canada data through October 2008, it appears that food manufacturer sales are likely to increase by 5% in 2008. That rate of increase means that 2008 food manufacturing sales will hit $77.6 billion, compared to $73.9 billion in 2007. Figure 5 shows food manufacturing sales since 2000.

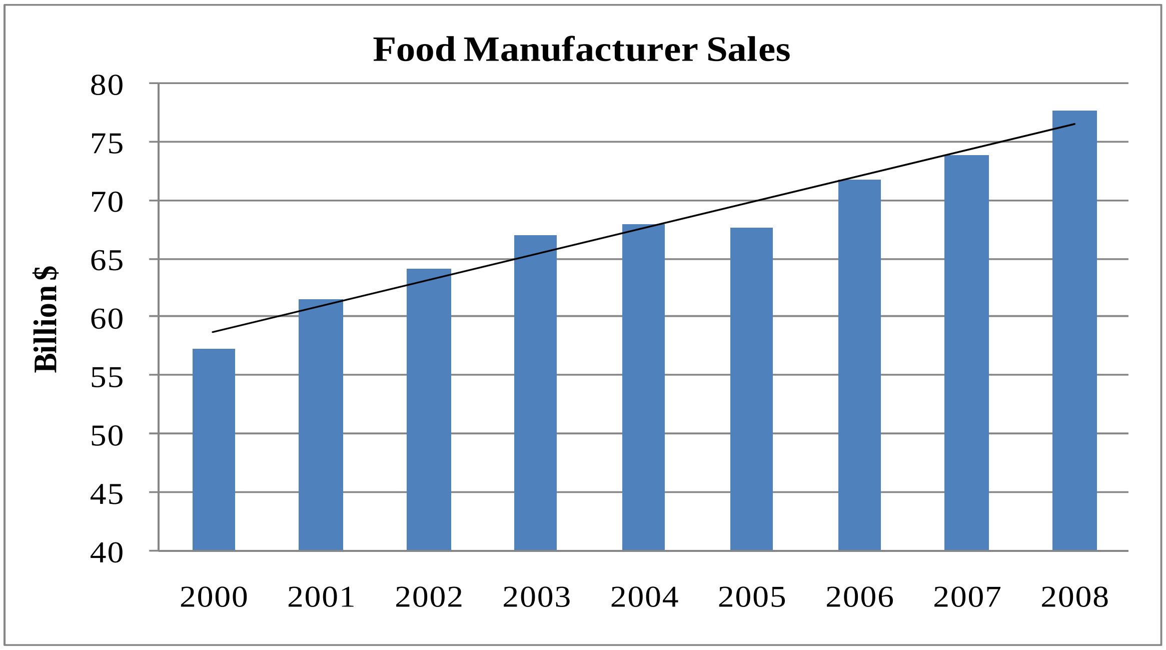

Figure 5

The 5% increase in food sales compares to less than 1% growth in total manufacturing sales. The 1% growth in total manufacturing in 2008 comes after zero growth in 2007. Food manufacturing's share of total manufacturing sales in Canada will be just about 12.6% in 2008, the largest share food has taken since 1993 when it was 13%.

In the United States, total food manufacturer sales are likely going to be up by 8% in 2008 compared to 2007. The U.S. growth was the first year in the last seven that Canadian sales have been slower than U.S. sales in Canadian dollar terms. Figure 6 shows Canadian food sales as a percentage of total Canadian manufacturer sales as well as a percentage of U.S. food manufacturer sales (in Canadian dollars). As can be seen, in recent years Canadian food manufacturer share is generally increasing against both total Canadian manufacturing and U,S, food manufacturing.

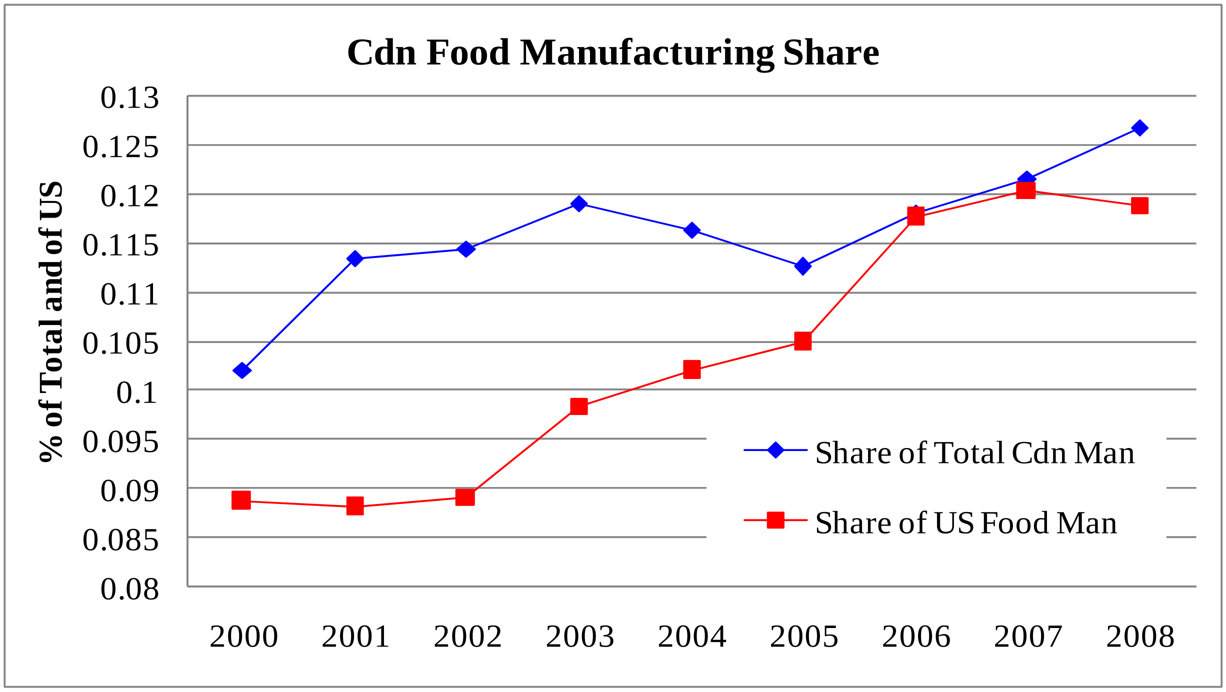

Figure 6

Within the context of a 4-5% overall sales increase, not surprisingly, the individual sectors within the overall food industry have performed very differently in terms of 2008 sales. Figure 7 shows some of the major food manufacturing sales changes, from 2007 to 2008. As can be seen, there has been significant growth in flour milling and vegetable oils sales, while confectionery, meat and cereal sales actually declined last year.

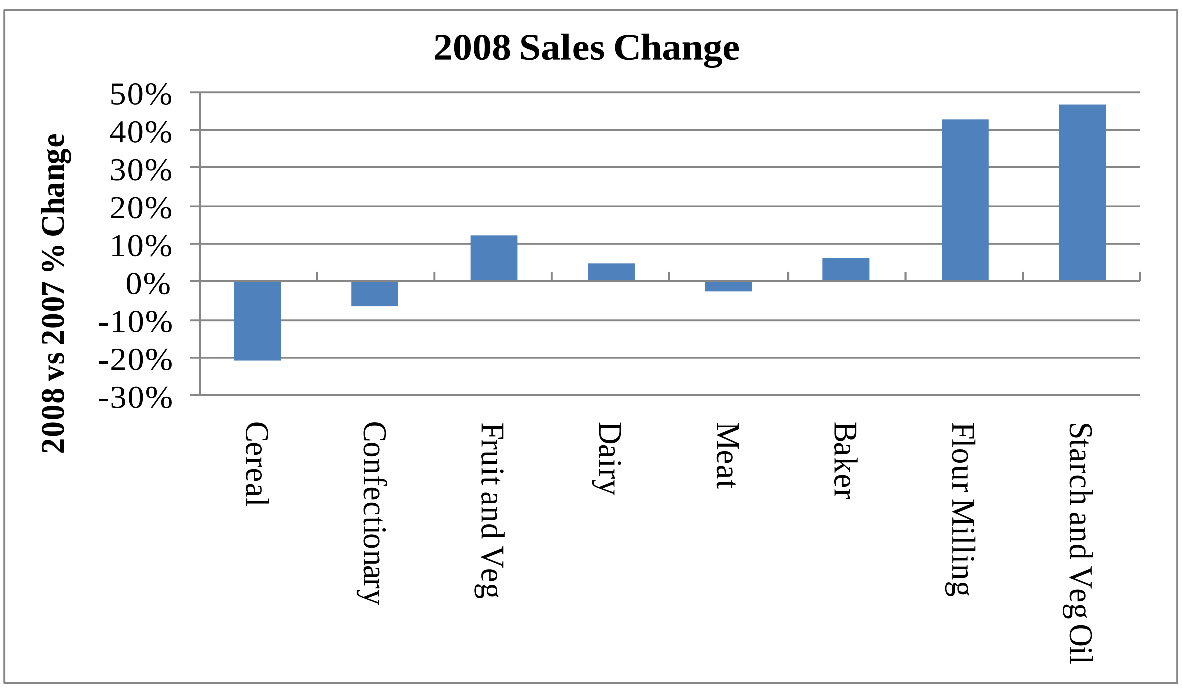

Figure 7

Manufacturer Pricing

The strong showing in food manufacturing sales is due, at least in part, to higher pricing. The Statistics Canada Industry Price Index measures the changes in prices at the manufacturer level. The IPI measures changes in prices for manufactured goods sold to wholesale or retail. The IPI includes discounts and allowances. Figure 8 shows the trend in the IPI for food manufacturing and all manufacturing.

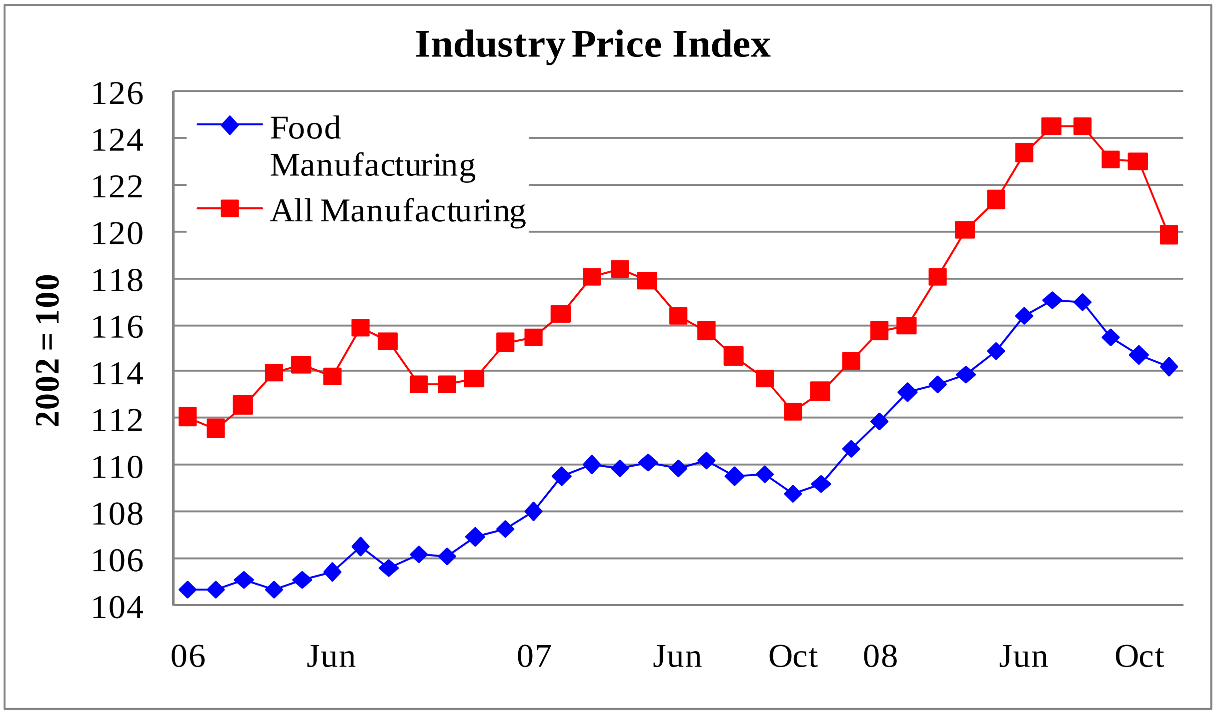

Figure 8

Food manufacturer prices have decreased for three straight months starting in September. Nevertheless, food manufacturer prices have risen significantly on average during 2008. On a year to date basis from January through November, the food manufacturing price index has increased by nearly 5% compared to 2007. November 2008 food manufacturer prices are 4.6% higher than November 2007.

It is of interest to note, however, that most of the increase in food manufacturing is occurring in animal food manufacturing and grain milling. Animal food includes pet food but also livestock feed. Grain milling includes flour milling and oilseed processing. The big price increases are consistent with the huge sales increases noted in figure 7. It is noted that other manufacturer prices for products such as frozen foods, cereal, confectionery, and dairy all saw price increases less than the overall average. Meat prices actually declined in 2008. Bakery products, which increased in price by up to 6%, were one of the few areas in which a basic food product increased materially in 2008.

As such, the biggest increases in food manufacturing have occurred at the primary manufacturing level. That suggests two points:

1. The manufacturing industry is still working through the major commodity cost increases that occurred during the first half of 2008;
2. With the recent declines in commodity prices, manufacturers will have a difficult time pushing through the costs they absorbed in the first half of 2008.

Despite the volatility, it does appear that food manufacturers were able to pass along decent pricing increases in 2008. Retailers, for their part, were also able to move pricing higher in key areas.

Looking forward, economic challenges will result in a more difficult pricing environment. Grocers are always sensitive to their price image and this will heighten in 2009. Manufacturers will not have big increases in commodity prices to use as arguments for pricing increases. Watch for more margin pressures for both manufacturers and retailers in 2009.

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