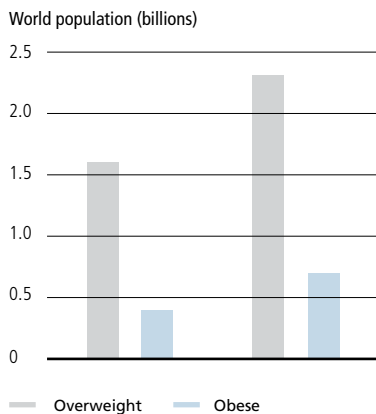


Back to Sustainable Value Creation: Health & Wellness in the Food and Beverage Sector

FB&T and HH&PP Sector Research Paper
March 2009

Obesity, facing the facts



Global Obesity Forecast (WHO, 2005)

The facts are incontestable; the World Health Organisation (WHO) estimates that by 2015 there will be 2.3 billion overweight adults in the world with more than 700 million of them classified as obese. Presently, 28% of the population is overweight with obesity rates at around 7%, and these figures are expected to grow to 40% and 12% respectively by 2020. While developed nations, particularly the US, have traditionally been the focal point of the obesity epidemic, data is increasingly showing that other regions are not immune. The obese population in China is expected to increase 347% between 2005 and 2015. Public health budgets are increasingly feeling the strain, with obesity-related costs accounting for 2-7% of total health costs in wealthier nations. Obesity costs the US approximately \$117 billion in medical costs annually.

While a number of factors for this trend have been cited such as the rise of motorised transport, and the increase in sedentary jobs, the Food & Beverage Sector is typically identified as one of the main antagonists through providing energy-dense foods high in fat and sugars but low in vitamins, minerals and other micro-nutrients. On the back of increased public and governmental concerns over the obesity phenomenon, coupled with the emergence of a new breed of health conscious consumers, the health and wellness trend in the Food & Beverage Sector cannot be ignored.

Healthy eating = healthy growth?

Category	Growth Rate, %
Eggs	19
Stim/Energy/Sports Drinks	19
Ready to Drink Drinks	15
Probiotic Drinks	13
Fruit - Frozen	12
Milk/Cream/Substitutes	12
Baby Infant Formula	12
Dairy/Dairy Sub Drinks	11
Pasta/Noodles	11
Cooking Fats/Oils	10
Overall Global growth	6

Fastest-growing categories/product areas across 38 key markets. Based on sales value increases from 2006 to 2007 (AC Nielsen, 2008)

It is becoming clearer that healthy eating is transitioning from a niche market to the mainstream. Health and wellness-focused products are expanding rapidly, with eight out of ten of the fastest growing food and beverage categories inextricably linked to consumer perceptions of health. In 2006, the market for Health & Nutrition food¹ at retail value was estimated at \$460 billion with a CAGR of 4.4%. This constituted 24% of the total food market which had an average CAGR of 2.8%. More specifically, the global functional food² market is expected to show a CAGR of 5.7% during 2007-2012. Euromonitor (2009) estimates that by 2012 the global health and wellness market is expected to be valued at over €550 billion, with the largest segments being functional foods (€175 billion), naturally healthy foods (€155 billion), 'better-for-you' products (€140 billion), vitamins and food supplements (€60 billion), and organic (€24 billion). Global growth within the beverage segment is attributed to a shift away from carbonated beverages to products like juices, and sports drinks.

From a financial perspective, the business of healthy eating can provide food and beverage manufacturers the opportunity to improve gross margins in a number of ways including

pricing healthy products at a significant premium, lowering COGS through product reformulation, and reducing packaging size while maintaining a similar retail price, thus increasing price per volume unit. However, while consumers seem willing to pay a premium for products perceived as healthy, offering a margin expansion opportunity to the industry, not all segments within the 'healthy eating' business are attractive and gross margin expansion may be somewhat offset by high product development and launch costs. 'Light'/'better-for-you' versions such as mayonnaise, salad dressing, carbonated soft drinks are more likely to be priced at zero premium where producers recognise that health concerns could harm category growth, while in other categories, producers appear able to price their 'light'/'better-for-you' products at a much higher premium (e.g. yoghurt).

How can Food and Beverage companies benefit from this trend?

Food and beverage companies have employed a number of interrelated approaches identified below in varying degrees to position themselves with regard to the health and wellness trend:

Top ten new food and beverage products launched in the US in 2006-2007 were products that helped consumers meet their dietary, disease-fighting, and weight goals, without sacrificing taste (IRI, 2008)

Product	Year 1 Sales, USD million
Campbell's Reduced Sodium Soup	101
Bird's Eye Steam fresh Frozen Vegetables	87
Vault/Vault Zero Regular and Diet Drinks	70
Gatorade A.M. Sports Drink	70
General Mills Fiber One Snack Bars	64
Heineken Premium Light	63
Dannon DanActive Yoghurt	63
Sara Lee Hearty & Delicious Bread	63
Dannone Activa Light Yoghurt	62
Diet Pepsi Jazz Soft Drink	56

By the end of 2008, 1,030 brands across the EU were using Guideline Daily Amount (GDA) labelling

Manufacturer	% Production Volume with GDAs	
	June 08	Dec. 08
Cadbury	-	50%
Campbell	65%	95%
Coca-Cola	89%	100%
Danone	79%	95%
Kellogg	100%	100%
Kraft	30%	52%
Nestlé	60%	100%
PepsiCoBeverages	91%	100%
PepsiCo Snacks	81%	99%
Unilever	50%	90%

CIAA (2008)

Healthy products:

There is growing evidence on the benefits of certain foods – from fruits, vegetables and grains to fish and even chocolate in moderation. Certain product categories are naturally considered as 'healthy' such as fruit and vegetables. Here, Bonduelle is well-positioned through its activity in the processing and distribution of vegetables, which is boosted by data showing that per capita consumption of vegetables are increasing. Beyond this, both functional and weight-management food/beverage products are also considered as healthy. Danone benefits from having a number of blockbuster brands that target specific health issues such as Activia (digestion), Actimel (protection) and Vitalinea (weight management). A number of high-profile healthy product acquisitions can also be highlighted, notably Nestlé of Gerber (medical nutrition), Danone of Numico (infant nutrition) both in 2007, and PepsiCo of Quaker Oats (whole grain oat products) in 2001.

Product reformulation:

Offering healthier versions of existing products has been widely adopted. In the UK, for example, £11 billion worth of products have been reformulated to reduce levels of salt, fat or sugar. Product reformulations range from the very simple to the very complicated. At one end of the spectrum, companies are simply cutting the amount of unhealthy ingredients such as saturated fats in their food. Walker's Crisps (owned by PepsiCo) for instance was praised for switching to sunseed oil in place of standard cooking fat. At the other end, researchers are formulating products which the body processes in quite different ways, taking longer to digest and so keeping consumers full for longer. Overall, product reformulations tend to limit the levels of artificial colours, additives, saturated fats, trans-fatty acids, free sugars and salt in existing products.

Consumer education and awareness:

Providing consumers information on what constitutes a healthy and balanced diet and encouraging responsible consumption of all food and beverage products. One of the key initiatives undertaken by Cadbury, a confectionery company, is 'Be Treatwise', which aims to allow for a more concrete understanding of healthy lifestyles, acknowledging that confections are treats. Concurrently, there has been a growing trend in voluntary nutritional labelling schemes, with an overriding goal to empower consumers. In Europe, the preferred format which has emerged is the Guideline Daily Amount (GDA) nutrition label introduced by the CIAA³. Over 70% of consumers (Millward Brown, April 2008) changed their purchasing decision in favour of a lower calorie or lower salt containing product after having checked GDA values. Additionally, some companies also indicate healthier options in their product mix including Kraft Foods 'Sensible Solutions', PepsiCo's 'Smart Spot' and Unilever's 'My Choice' labels. Specifically for Pepsi, Smart Sport items have consistently outpaced the growth of its regular portfolio. Thus, nutritional information and education, coupled with responsible advertising, assist in supporting informed consumer choices for a balanced diet and healthy lifestyles.

Supporting keep fit initiatives:

The final piece to the obesity-challenge is the promotion of physical activity which can positively impact health and well-being. The WHO estimates that overall, 1.9 million deaths annually are attributable to physical inactivity. While an increasing number of companies are active in participating with organisations, health agencies and governments to promote balanced diets and active lifestyles to good effect, concerns have been raised regarding the authenticity of activity-based offers (e.g. sport) which use less healthy products or a brand that mainly sells less healthy food to promote exercise.

Components of a successful Health & Wellness strategy

While there are clear financial gains to be made from tapping into the growing health and wellness trend, there are some pitfalls to be avoided.

Quick facts: Organic food and beverages

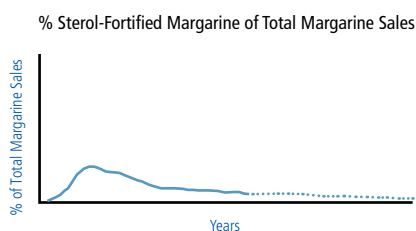
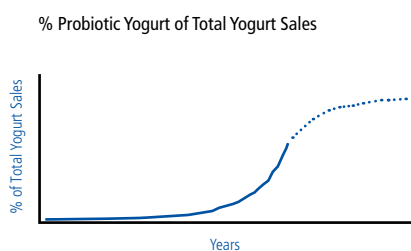
World Organic Food Sales:

- 2002: \$23 billion
- 2006: \$40 billion
(Organic Monitor, 2002-2006)

Understand the market and your consumer:

The ability to identify 'healthy' and/or 'healthier' products with characteristics such as high margin prospects, high growth categories with available market opportunities is crucial. This assessment can be applied to organic baby food. In terms of market size, Euromonitor (2009) estimates that by 2012 the organic products will contribute €24 billion to the estimated €550 billion global health and wellness market. While growth prospects of the overall baby food market are anticipated to be flat through 2011 as a dramatic increase in birth rates are not anticipated, the organic baby food market is still expected to continue to boom; as witnessed by a 60% increase in organic baby food sales between 2000 and 2005. Price premiums are also significant with a 2006 Mintel survey finding that, on average, organic baby foods are priced 69% higher than conventional varieties. This can be translated into higher margins.

Functional food product launches have had differing degrees of success



Scientia Advisors (January 2009)

Generally, consumers ultimately look for specific health solutions with minimal impact on their existing consumption patterns. Results of the latest FDA Health & Diet Survey revealed that while US consumers have good health intentions, this does not carry through to their dietary habits⁴. It is therefore key to differentiate between consumer attitudes and their actual behaviour and to offer products that meet their perceived health requirements. This can be seen in the success of probiotic yoghurt versus sterol-fortified margarine in the US. The former's success can be attributed to a number of reasons including that yoghurt is already accepted as a 'healthy' product; a message of 'digestive health' was developed which avoided reference to bowels, intestines, diarrhoea or other terms which make US shoppers uncomfortable; and a relatively modest price premium. Conversely, sterol⁵-fortified margarines have suffered as margarine is not well-accepted as a 'healthy' product in the US; and the price premium was significant (six to 14 times as much as ordinary margarine).

It is also important for companies to understand local and regional nutritional needs of their consumers, allowing for market specific fortifications of food and beverage products as a key differentiating factor with competitors. For example, Danone's 'Nutripacks' summarises nutritional and health conditions in countries where it operates. This allows Danone to adapt its existing products and identifies the potential for developing new products to satisfy local health and nutrition priorities. As a result Danonino-branded products are adapted to nutritional requirements in 14 different countries.

Ensure product quality remains a priority:

Beyond upholding high product quality standards, striving to ensure marketing material does not give a misleading impression of health benefits of a product is another fundamental element. This ensures consumer confidence and trust in the efficacy of products is maintained, and protects against deleterious consequences. While certain regions, like the EU, have introduced stringent standards on health and nutrition claims, high-profile incidents are still evident. In Q1 2009, Coca-Cola and Nestlé, which launched Enviga in the US as a calorie-burning beverage, agreed to relabel the drink and pay \$650,000 in damages following complaints from the attorneys general and consumer groups. The companies acknowledged

that Enviga alone cannot produce weight loss. In 2004, the £7 million marketing spend for the launch of Coca-Cola's new brand of 'pure' bottled water, Dasani, in the UK was deemed a washout when it was found to be tap water taken from the mains. While nutrition and health claims should result in higher costs they also create an even playing field, and ensure higher transparency for consumers. Manufacturers who have made spurious claims will be penalised, while genuine 'healthy' food producers have the opportunity to build real competitive advantage.

Invest in product innovation:

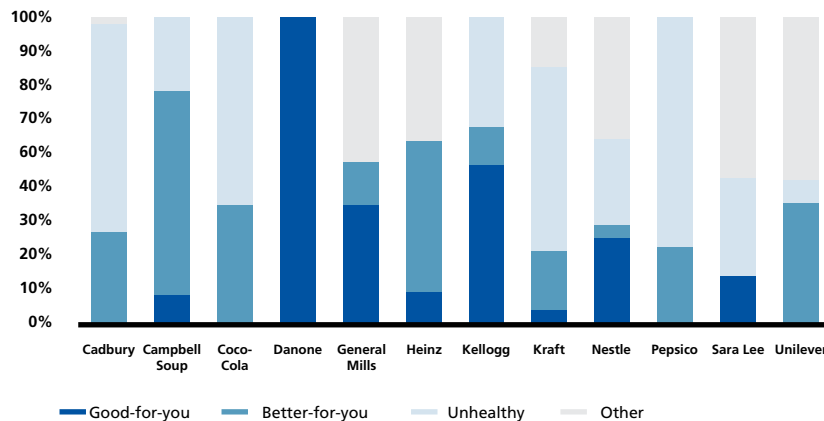
One of the challenges of R&D within the food and beverage industry is to improve the nutritional profiles of products (e.g. reduced portion size, fat, energy, calories, sugar and salt) while maintaining the taste and aroma of the product and delivering these products to consumers at a reasonable price. Unilever states that more than two thirds of the products in its R&D pipeline have 'Vitality' benefits; that is products which display specific nutritional and health benefits. In 2007, Coca-Cola Hellenic Bottling launched over 150 new waters, juices and wellness beverages, representing 73% of all new products introduced and which contributed nearly half of the total volume coming from innovation.

How do companies measure up?

Is a 'healthy' product mix enough?

While a number of strategies have previously been discussed of how companies can gear themselves to the health and wellness trend, a logical starting point is to consider their product mix according to what proportion of revenues are derived from 'Good-for-you', 'Better-for-you', 'Unhealthy', and 'Other' product categories⁶.

Health and wellness attributes of selected companies product portfolio's



Dexia AM estimates 2009

From this, one could conclude that Danone has the 'healthiest' product offer through its offer of yoghurt, water-based beverages, infant nutrition and clinical nutrition. Like Yakult, a Japanese-based company with interests in probiotic milk-like beverages and pharmaceuticals, both companies can be considered a pure health and wellness-focused companies and their overall company strategy and positioning reflects this. For Danone, based on their proven health benefits, blockbuster brands such as Activia and Actimel continue to drive growth with favourable margins and healthy positive volume growth in 2008 which is substantially higher than the divisional average. These two products and others with similar claims generated €4.5 billion in sales in 2007, 35% of Danone's total. Activia alone is expected to achieve more than €2.5 billion in sales in 2009. However, beyond a 100% 'healthy portfolio' approach, there are a number of other strategies which have been employed with success that should not be so hastily discarded.

Making the product portfolio 'better-for-you' through a combination of portfolio rationalisation and reformulations

Some companies have opted for product portfolios with a combination of healthy and unhealthy products, although possibilities are plentiful for making less healthy products healthier. Companies traditionally focused in the provision of convenience and snack foods are also embracing the health and wellness trend by diversifying their portfolios either through acquiring healthy brands (e.g. Coca-Cola's 2007 acquisition of the enhanced-water company Glacéau) and divesting unhealthy brands (e.g. Cadbury's 2008 divestment sale of its US soft drinks division), or by reformulating existing products to make them healthier. At the same time, while they acknowledge that certain products offered may not be considered healthy, they emphasise providing consumer choice and advocate balanced and healthy diets and active lifestyles. Campbell Soup's strategy has been to make its existing portfolio healthier through initiatives such as reducing the sodium (salt) content in its soup. Lower sodium products now total nearly \$600 million at retail. Among other initiatives, Campbell Soup has developed a web-based application that can be used to personalise the US government's dietary recommendations from MyPyramid⁷, a government/science/industry effort to educate the public on balanced eating and physical activity as a way to fight obesity. Coca-Cola Hellenic Bottling's product mix has shifted in recent years with an increased focus on fruit juices, tea and water. Non-carbonated beverages represented 37% of total volume sold in 2007 compared with only 10% in 2001. While not as advanced as peers, Coca-Cola Hellenic Bottling is still active in the promotion of fitness and nutrition education programmes. In 2008, Nestlé total consolidated sales amounted to CHF 109.9 billion, an increase of 2.2% compared to 2007. The main engine of Nestlé's growth cited is the continuous innovation and renovation of its products and brands. Nestlé has removed 34,200 tonnes of trans-fats (Dec 2003-Feb 2007) and 204,000 tonnes of sugar (Jan 2003-Dec 2006) from its products, while providing 1.6 billion additional servings in Europe (2004-2007). In 2008, an additional 15% of Nestlé products were successfully tested for superior nutritional benefits and taste characteristics over competitors' products. Nestlé has also made a number of strategic acquisitions such as medical nutrition company Gerber in 2007, and weight management company Jenny Craig in 2006.

Although inherently unhealthy food and beverage makers are also cashing in

While consumer behaviour is increasingly tending towards healthy food choices, opportunities for growth remain in the overlapping convenience/ snack and indulgence product categories. For example, while the overall confectionery market is generally viewed as unhealthy and does not display especially strong growth rates, the emergence development of healthy confectionery are creating some demand for new products. Mintel reported sales of dark chocolate in the UK, considered a healthier option by consumers because of its high raw cacao content, rose by 96% between 2005 and 2007 to £85 million. Cadbury's is positioned to benefit through its commitment to offer alternative product choices including reduced fat, energy, calories, sugar and salt for core brands. Its well-being products identified as sugar-free chewing gum, dark chocolate and medicated candy account for 30% of their revenue. Both Coca-Cola and its rival PepsiCo have suffered amid an industry-wide slowdown in the North American market as health-conscious consumers avoid carbonated soft drinks in favour of bottled waters, teas and energy drinks. 2007 results for Coca-Cola were driven by the strength of its non-carbonated beverage portfolio like Dasani bottled water, Powerade sports drinks and Minute Maid fruit juices. Its soft drink sales were also bolstered by the introduction of Coca-Cola Zero, a no-calorie cola.

Transparency is key

Thus from a health and wellness point of view, there is no one clear strategy that can guarantee financial success, although the ability to build a well-recognised and trusted brand, regardless of the product category, will ultimately lead to more loyal customers. It is essential that such a strategy is built on transparency.

Is Health & Wellness just a fad or is it here to stay?

In light of current economic downturn a number of trends in the sector have emerged which could hamper the short-term growth and profitability of healthy and healthier food and beverages. The most notable of these trends is downtrading within product channels; consumers are trading down from super and ultra premium brands to premium and value brands. For companies who position their 'healthy' food and beverage products at a premium within their product category there are signs that consumers in some markets are turning away from expensive health food toward simpler products. To a large extent private label products are benefitting, with continued gains market share evident. Within the functional foods category, Danone faces increasing competition from retailers' own cheaper versions, and some commentators have stated that unlike peers, it does not have a broad range of products to provide customers with cheap alternatives as they trade down. This is something that Danone executives contest, insisting that their blockbuster products are not that premium. Nonetheless, it has started making moves towards mass market brands through experimenting with cheaper kinds of yoghurts in a line it calls 'Eco Pack'. On a positive note, downtrading between channels is also being seen from restaurants to takeaway food, or from takeaway food to supermarkets, particularly in the US. Therefore opportunities are rife for manufacturers to provide value products with health benefits as a key differentiating factor.

Other studies have shown that consumers are sacrificing healthier eating at the expense of price in the wake of the looming recession⁸. It is clear that products which deliver real health benefits at a reasonable price have the best chance of success. Products which are fortified with calcium, vitamin D, plant sterols, omega-3 and probiotics, are likely to be considered essential must-haves rather than unnecessary indulgences.

Health and wellness food/beverage categories which currently appear to be resilient to the weakening economic environment include products traditionally viewed as healthy. Chiquita Brands claimed bananas a recession-resistant after analysing its 2008 results. In the meat category, figures are showing that chicken is seeing strong growth compared to other meats, as the perception that it is more healthy and affordable seems to be a winning formula. Niche health markets are also expected to weather the recession with a loyal customer following. While it is clear that the mass market is unwilling to pay a premium, the health conscious niche is. Organic foods are one such niche health product and organisations such as Organic Monitor and UNCTAD have reiterated that organics continue to remain broadly popular among rich-market consumers, especially parents of young children. While positive growth is expected to continue in 2009, slower growth rates are envisaged.

Regardless of the current economic climate, the obesity issue is not going to disappear as rates of obesity and diet-related disease continue to rise, coupled with obesity and health eating rising on the agenda of many government healthcare administrations. While there may be a slight glitch in the health and wellness market in the near-term as price may become the most important differentiating factor, a future with health and wellness is certain.

¹Defined as: Better-for-you, functional foods, allergy-free, herbal, natural, organic, slimming and dietary supplements

²Defined as: Any fresh or processed food claimed to have a health-promoting and/or disease-preventing property beyond the basic nutritional function of supplying nutrients

³The CIAA (Confederation of the Food and Drink Industries of the EU), developed the GDAs nutritional label which is a guide to how much energy and key nutrients are required for a healthy diet, <http://gda.ciaa.eu/asp2/index.asp>

⁴US Food and Drug Administration (FDA), January 2008, 'Health and Diet Survey: Dietary Guidelines Supplement', www.cfsan.fda.gov/~comm/crnutri6.html

⁵Sterols help in lowering cholesterol levels

⁶'Good-for-you': Products that fall into this category tend to be characterised as 'natural', such as dairy, fruits, vegetables, and whole grains. They are nutritious foods, lower in saturated fat, salt and sugar and help to avoid excess energy intake (kilojoules); 'Better-for-you': Products have some nutritional value but which contain moderate amounts of saturated fat, salt and/or sugar. They can contribute to excess energy intake; 'Unhealthy': Foods from this group are high in unhealthy components such as saturated fat, trans-fats, sugar and salt – all of which are associated with an increased risk of developing certain diseases; 'Other':

Food and beverage products which could not be classified, in addition to non-food and beverage products manufactured and/or sold by the company

⁷MyPyramid, www.mypyramid.gov/pyramid/index.html

⁸For example, a 2009 Which? Report found 24% of UK adults feel healthier eating is now less important, with 56% saying price has overtaken as a priority when choosing food

Important information concerning the sustainability analysis

Dexia AM's Sustainability Analysis is based upon different sources of information developed by Dexia AM's SRI team, among others: sector studies and company analyses by Dexia AM's sustainability analysts, "Dexia AM's Sustainability Analysis Research Methodology 2006", "Methodology Guidelines November 2005" by Franca Morroni, "Dexia AM SRI Business Case 2004" and Dexia AM leading SRI principles and multiple research conducted since 1996 as well as data from selected SRI data providers.