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# Argentina Food & Drink Report 2008

*Including 5-year industry forecasts*

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Including 5-year industry forecasts by **BMI**

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## Part of **BMI**'s Industry Report & Forecasts Series


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# CONTENTS

# Executive Summary

While the Argentine economy continued to perform strongly throughout 2007, analysts widely agree that a benign external environment has played a pivotal role in this performance, and that 2008 will be a crucial year for the country's medium-term economic outlook. Following her success at the October 2007 presidential elections, Cristina Fernandez de Kirchner is now presented with a narrow window of opportunity to implement a range of necessary policy reforms. The fact that Fernandez has already expressed support for a competitive exchange rate to aid domestic industries and using price controls to stem inflation does, however, not bode well for change.

The 'voluntary' price freezes and reductions on basic foodstuffs, as well as export bans on beef and limits to wheat sales abroad, introduced by president Nestor Kirchner in 2006 with the aim of containing surging inflation have already taken their toll on food manufacturers' and retailers' margins, and Argentine consumers are increasingly faced with food shortages. Milk, meat and other basic foodstuffs were affected in particular during the first nine months of 2007. In several instances, the Center for Consumer Education, a non-governmental watchdog, was unable to carry out its weekly survey of basic food prices because many of the items regularly surveyed were not available in stores.

The shortages are a clear sign that the government's price controls are not working, with food producers holding on to their products rather than selling them at lower prices. In terms of animal-derived products, the price controls might also affect producers' capacity to maintain animal stocks. Representatives at one of **Cencosud**'s Jumbo outlets in Palermo reported that ranchers refuse to sell to the retailer at government-set prices.

In conflicting reports, Miguel Schiariti, head of the Chamber of Meat Industry, stated that retailers refuse to buy meat that is offered to them by wholesalers at the higher prices because they have been instructed not to do so by Argentina's Interior Commerce Secretary. Milk has been another seriously affected product, and the supply of milk and milk derivates has decreased by 30%, according to Miguel Angel Calvete, general manager of the Argentine Chamber of Chinese Supermarkets.

With headline inflation expected to return to double-digit figures in 2008 and distortions and imbalances in the domestic economy growing, the sustainability of Argentina's long-term growth is under serious threat, and in September 2007 buoyant consumer confidence dipped sharply to its lowest level in three years, according to a survey carried out by University Di Tella.

The government, unless it takes urgent action, will continue to undermine the recovery of the Argentine economy of recent years, as well as food and drink manufacturers' efforts and investments.

# Business Environment

## Regional Food & Drink Business Environment Ratings

**BMI**'s new Food and Drink Ratings assess a market's attractiveness to industry investors in comparison with its regional peers. The unique ratings take into account market size, current food and drink consumption levels, future industry growth prospects, the legislative environment and possible barriers to entry, as well as relevant aspects of the economic and political environment. Chile leads the Food and Drink Ratings in Q108 with a score of 72, closely followed by Mexico and Argentina, with scores of 68 and 64 respectively. Ranked fourth and fifth, by some distance, are Peru and Brazil, scoring 53 and 49 respectively, with Colombia and Venezuela bringing up the rear with scores of 45 and 39 respectively.

In terms of the Limits of Potential Returns on investment, Mexico achieved the highest rating in the region, followed by Chile and Argentina. Mexico's leading ranking is based on the country's high food and drink consumption per capita as well as strong per-capita food consumption growth, leading to a high score for Food and Drink Market Structure, as well as its large population and relatively favourable long-term economic structure, which combined to generate a comparatively high score for Country Structure. While Chile performs even better than Mexico in terms of Food and Drink Market Structure, mainly owing to its strong positive food and drink trade balance, it lags behind Mexico in terms of Country Structure owing to its small population, leading to a slightly less favourable overall score for Limits of Potential Returns. Argentina, together with the two leaders in terms of Limits of Potential Returns, stands out from the other markets within the region mainly based on a strong Food and Drink Market Structure score. This is achieved through strong per capita food consumption growth as well as a positive food and drink trade balance. In contrast, Argentina achieved only an average Country Structure score.

While ranked lower in terms of Limits of Potential Returns than Mexico, Chile and Argentina, Brazil and Peru are still well ahead of Colombia and Venezuela as far as this indicator is concerned. Brazil benefits from the highest Country Structure rating within the region based on its vast population and its having the most structurally balanced economy within the region after Chile. Its Food and Drink Market Structure rating is, however, below average, owing to significant income disparities, which lead to low food consumption per capita figures and extremely low per capita food consumption growth. The situation in Peru is exactly opposite – while the country achieves a comparatively low score for Country Structure owing to its small population and low GDP per capita, it has a much more beneficial score in terms of Food and Drink Market Structure owing to comparatively high per capita alcohol consumption and strong per capita food consumption growth.

Venezuela and Colombia come bottom of the Limits of Potential Returns list. Venezuela's low Food and Drink Market Structure score derives predominantly from extremely low per capita food consumption growth and a weak food and drink trade balance, while Colombia suffers from below average scores for per capita food and drink consumption and a weak food and drink trade balance. Both countries also achieve low scores for Country Structure, with Venezuela's rating suffering in particular from a low score for economic structure, while in the case of Colombia, low GDP per capita combines with a low market entry potential.

Aside from the Limits of Potential Returns on investment, a vital consideration for investors is the Risk to the Realisation of Potential Returns. Within the Latin America region Chile offers by far the lowest investment risk, having achieved the highest – most favourable – scores in terms of both Food and Drink Market Risks and Country Risks. The country features low barriers to entry as well as a favourable regulatory environment and achieves above-average scores across all Country Risk indicators with its well-developed infrastructure, skilled labour force and openness to foreign investment and trade, to name just a few.

It is followed in the Risks to Potential Returns ratings by Mexico, which is well ahead of the other countries within the region with its score, again based on low barriers to entry as well as a favourable regulatory environment, which combine to result in a good Food and Drink Market Risk rating. In terms of Country Risk, Mexico falls behind Chile with less developed physical infrastructure, also owing to the size of the country, and a less even income distribution structure, to name just two indicators. It does, however, still perform better than most other markets within the region in terms of short-term economic growth and short-term financial and monetary risks.

Colombia, Argentina, Brazil, and Peru are ranked significantly lower than Chile and Mexico in terms of Risks to Potential Returns, but still ahead of Venezuela, which comes bottom of the list, owing mainly to a weak Food and Drink Market Risk score. The four countries share relatively low barriers to entry and fairly liberal regulatory environments which, although not free from some restrictive legislation and other difficulties, do not present insurmountable problems to potential investors. Peru and Brazil present most challenges in this respect, with Food and Drink Market Risk scores of 50 and 55 respectively, while Argentina and Colombia fare slightly better, with Food and Drink Market Risk scores of 65 and 60 respectively.

In terms of Country Risk, Peru and Colombia come out top within this group of four countries. Peru achieves top scores within the region for strong short-term economic growth and low short-term monetary risk, while Colombia leads where low state control is concerned, as well as achieving above average scores for low short-term finance and monetary risks. In contrast, Argentina in particular suffers from comparatively high short-term monetary risks and risks to business posed by official bureaucracy, the broader legal framework and corruption. In the case of Brazil, the lower Country Risk rating is mainly caused by comparatively high short-term finance risks, low state control and, similar to Argentina, risks to business posed by official bureaucracy, the broader legal framework and corruption.

Venezuela's weak ranking in terms of Risks to Potential Returns is explained by an extremely difficult regulatory environment, in which the government aims to take control of an increasing number of economic sectors, thus severely restricting investors' scope to operate in line with market forces. This has been particularly pertinent in the food and drink sector, with the government interfering with a view to bringing food price inflation under control. Where Country Risk is concerned, Venezuela also comes bottom of the list, albeit with lesser distance to other markets within the region. Its low scores are owing mainly to high short-term monetary risk, the risks posed by official bureaucracy, the broader legal framework and corruption, a low score for openness to foreign investment and trade, and an unfavourable labour infrastructure.

**Table: Latin America Food & Drink Business Environment Ratings – Q108**

| | Limits of Potential Returns | | | Risks to Realisation of Returns | | | | |
|---|---|---|---|---|---|---|---|---|
| | Limits Composite | Food & Drink Market | Country Structure | Risks Composite | Market Risks | Country Risk | Rating | Reg. Rank |
| Chile | **67** | 92 | 43 | **83** | 90 | 78 | **72** | **1** |
| Mexico | **68** | 87 | 48 | **70** | 75 | 67 | **68** | **2** |
| **Argentina** | **65** | **84** | **45** | **61** | **65** | **58** | **64** | **3** |
| Peru | **51** | 56 | 46 | **58** | 50 | 64 | **53** | **4** |
| Brazil | **48** | 41 | 56 | **59** | 55 | 61 | **51** | **5** |
| Colombia | **37** | 32 | 42 | **62** | 60 | 64 | **45** | **6** |
| Venezuela | **35** | 30 | 40 | **48** | 35 | 57 | **39** | **7** |

*Source: BMI. For full explanation of new Food & Drink Business Environment Ratings please see appendix.*

## Argentina's Food & Drink Business Environment Rating

Argentina is ranked third in **BMI**'s Q108 Food & Drink Business Environment Ranking, with the country having achieved a score of 62.5 for Limits of Potential Returns and a score of 62 for Risks to Potential Returns, putting it at rank three for both categories.

Owing to the largely consumption-driven economic boom of recent years, Argentina is leading within the region in terms of per capita soft drinks and alcohol consumption, and per capita food consumption growth. In addition, the food and drink trade balance is strong, based on the export of favourably priced commodities. Thus, despite an average score for per capita food consumption, the country's Food & Drink Market Structure rating is the third highest in the region with a score of 80. Argentina does, however, fare less well where its Country Structure score is concerned, mainly owing to doubts about long-term economic structure, and average scores for population size, GDP per capita, and market entry potential, with the food and drink and MGR sectors already featuring a great number of strong players. Combined, the Food & Drink Market Structure and Country Structure ratings result in Argentina being ranked third where Limits of Potential Returns are concerned.

Argentina's Market Risks rating, at 65, is average in the region. In terms of barriers to entry, a comparatively well-developed infrastructure allows for expansion nationwide, although speed, cost and efficiency can still be a problem. The country's regulatory environment is characterised by increasing government-imposed restrictions, which significantly impact on food and drink manufacturers' decisions.

In terms of Country Risks, Argentina scores below average within the region, with all indicators remaining below optimum levels. This is particularly true for short-term monetary risk, short-term external risk, institutions, and market orientation. Better scores are being achieved for short-term economic growth, short-term finance risk, and physical infrastructure in particular. Combined, Market Risk and Country Risk ratings lead to Argentina being ranked third for Risks to Potential Returns.

# SWOT Analysis

## Mass Grocery Retail

| Argentina Mass Grocery Retail Industry SWOT | |
|---|---|
| **Strengths** | ▪ Argentina has the second-largest retail market in South America, after Brazil. The MGR sector is largely controlled by foreign retailers, operating a combination of supermarkets, hypermarkets, discount stores and convenience stores<br>▪ Modern food retailers account for 40% of food sales by value, with hypermarkets and supermarkets being the most dominant formats |
| **Weaknesses** | ▪ Over recent years, retailers had to undertake significant efforts in order to emerge successfully from the period of economic crisis at the beginning of the century. Store opening programmes thus experienced a setback, and have only slowly started to pick up again, with clear recovery visible in 2007<br>▪ The government, in its fight against inflation, continues to uphold price controls. These measures are placing immense strain on retailers, compromising profit margins and, in the case of small-to-medium-sized operators, threatening their continued existence<br>▪ Income inequality and the large number of people living below the poverty line remain serious social and economic problems – not least because of the inability of one-third of the population to participate in the wider economy, so putting an artificial block on macro economic growth |
| **Opportunities** | ▪ Retailers are starting to expand into the interior of Argentina as the Gran Buenos Aires region becomes increasingly saturated<br>▪ Discount store formats are expected to experience the fastest growth rates over the forecast period, followed by hypermarkets<br>▪ Private label products should experience strong growth rates, helped by outlet expansion outside of Buenos Aires, into regions characterised by a high proportion of low-income consumers<br>▪ A number of cheaper branded products have been re-launched, following the economic crisis, to target the growing lower-end market. Significant growth potential lies in this area, particularly for MGRs that locate new stores in poorer neighbourhoods |
| **Threats** | ▪ Rising inflation could force consumers to cut back on ‘unnecessary’ purchases, constraining sector growth<br>▪ MGRs’ ambitious investment plans, announced over recent months, could be endangered by concerns about the real rate of inflation and fears of returning economic volatility |

# Food and Drink

| Argentina Food And Drink Industry SWOT | |
|---|---|
| **Strengths** | ▪ Argentina is the fifth-largest exporter of food products, with the sector having benefited from vast amounts of FDI in the 1990s. This resulted in increasing consolidation as well as modernisation improvements and production efficiencies, particularly in the dairy, confectionery and edible oil industries<br>▪ Over recent years, food and drink manufacturers have benefited from Argentina's economic recovery, with growth having been largely driven by consumer spending |
| **Weaknesses** | ▪ The government, in its fight against inflation, continues to uphold price controls and export restrictions on beef, poultry and dairy producers in particular<br>▪ The measures are placing immense strain on producers, compromising profit margins and, in the case of small-to-medium-sized producers, threatening their continued existence<br>▪ Income inequality and the large number of people living below the poverty line remain serious social and economic problems – not least because of the inability of one-third of the population to participate in the wider economy, so putting an artificial block on macro economic growth |
| **Opportunities** | ▪ Private label products should experience strong growth rates, helped by mass grocery retailers' increasing expansion to areas outside of Buenos Aires characterised by a greater proportion of low-income consumers<br>▪ The economic recovery of recent years, accompanied by rising disposable incomes, has established a taste for added value processed food products among Argentinean consumers |
| **Threats** | ▪ Manufacturers' export sales have been boosted by high commodity prices and currency depreciation and are vulnerable to any reversal of these factors<br>▪ Argentina's struggle to address its structural problems leads to continuing caution among foreign investors<br>▪ Growing distortions and imbalances in the domestic economy put a strain on short-term economic stability and threaten the sustainability of long-term growth |

# Macroeconomic Outlook

**Powering On**

**BMI View:** *The economy continues to motor ahead of expectations, defying warnings of instability. Given the current momentum, and the pro-growth agenda of the incoming government, we have raised our 2008 growth forecast to 6.0%. We continue to predict a soft economic landing over the five-year forecast period, though remain wary of the downside risks of accelerating inflation and the energy deficit.*

Amid the uncertainty that inevitably surrounds a change of presidency, two features of the economy remain pretty evident as the end of 2007 approaches. Firstly, the rate of economic expansion has exceeded even the most optimistic expectations and is looking increasingly likely to come in around, or perhaps even above, the 8% mark. This matches a trend observed throughout much of South America, as soaring food prices on global markets boost the vital agricultural sectors and domestic consumption remains elevated against a backdrop of growing household confidence. Secondly, the primary objective of the newly-elected administration will be to maintain the high rate of economic expansion, with government policy focussed on trying to contain the symptoms of overheating. In a parting speech, outgoing President Néstor Kirchner implored the new cabinet not to be afraid of strong, consumption-led growth, and his wife and successor Cristina Fernández has stressed that the era of robust growth will continue. On the back of these twin observations, we have upwardly adjusted our short-term growth projections, whilst retaining our soft-landing core view for the medium term, contingent on government policy over the next 12 months.

At the time of writing, official data for Q307 is not yet available. Yet other indicators give a clear guideline of trends in the domestic economy, not least statistics agency INDEC's monthly estimator of economic activity. According to this index, the economy expanded by an average 8.8% y-o-y over the third quarter, which would equal the fastest rate of GDP growth since Q106. Other indices can also provide a useful insight of activity in Q307: industrial output averaged 7.0% y-o-y, unemployment declined to 8.1% in Q307, and retail sales growth at supermarkets (real) and shopping centres (nominal) measured 16.8% y-o-y and 30.4% y-o-y respectively. These data clearly point to a booming economy, and even our upwardly revised full-year target of 7.6% will appear conservative if official Q307 GDP data confirm the suggested development. Indeed, initial estimates of activity at the start of Q407 suggest little in the way of a marked slowdown at the end of the year, and a further adjustment to our forecast, to 8%, is on the cards once GDP data is released.

**More Of The Same In 2008**

What are the implications of this outperformance for 2008? A major surprise in this year's economic tale has been the apparent resilience of domestic activity to rising inflation pressures, a loss of credibility in inflation data, and chronic energy shortages during the winter cold snap. While industrial output slumped to just 2.3% y-o-y in July 2007, when the business sector was forced to accept power rationing as the government diverted energy resources to households, its recovery since then has been dramatic. Consumers have also been undeterred by growing concerns over economic stability and sustainability, and continue to provide the main thrust of growth. While this does suggest a stronger economic foundation than some government critics will argue, we continue to believe that hugely favourable external economic conditions for much of the year, combined with a pre-election impulse that is certainly not sustainable long term, were key forces behind the strong data. Meanwhile, the very fact that the government is in the process of approving an extension to the 'emergency economic law' (which provides the executive with extraordinary control over policy) until the end of 2008 demonstrates that not all is as rosy as the figures suggest. Whether this move implies unease within the government or, as opposition members argue, an unjustifiable grab at power, it is hardly a reassuring decision.

Looking ahead, therefore, we expect that the necessary adjustments to government policy – which will include raising public transport and utilities tariffs, moderating spending in order to restore a fiscal surplus above 3% of GDP, investing heavily in infrastructure and local energy – combined with a deteriorating global economic picture, will ensure some slowdown in GDP growth from the current rates. That said, we expect the new government to continue to tinker with market forces so as to clear the way for ongoing consumption strength, and taking into account the current momentum, we have raised our 2008 growth forecast to 6.0%, from a previous 5.1%.

**Risks, And The Medium-Term Outlook**

Energy and inflation will remain the key downside risks to our economic outlook. Given the government's pro-growth agenda, and the limited slack in the economy, inflation pressures will not subside quickly. As part of the new government's anticipated fiscal tightening, subsidies to the transport and energy sectors will be cut, forcing consumer prices up, albeit at a gradual rate and still far below free market prices. Some private estimates suggest this adjustment alone could add three percentage points to next year's inflation bill, and we expect consumer price growth to end the year in double digits (10.7%). In itself, this could be a manageable and justifiable consequence of rapid expansion, with the government's task centred on preventing the inflation rate from spiraling out of control. That said, resolving the confusion and suspicion surrounding official INDEC price data will also be critical in combating inflation and reassuring investors in the coming year, and despite the forthcoming new index, we expect lingering doubts over the validity of official data in 2008.

As for the energy problems, capacity limits cannot and will not be resolved in the near future, and we expect the import bill to suffer as a result in 2008. There also remains the distinct possibility of further power cuts in the peak summer and winter months, though with the election over, these may be shared more evenly between the commercial and residential sectors. Significant sums of investment into the industry will be required in the next few years, and the success of the new government in attracting this for overseas investors will be critical in determining the medium-term trajectory of economic growth.

All in all, we remain fairly upbeat about the Argentine economy, but are also acutely aware of the potential pitfalls that lie ahead. Our forecasts predict a relatively soft landing for the economy, with annual growth stabilising around the 3.5-4.0% range by the end of the decade. This scenario is highly vulnerable to the policies of the incoming government, which must begin to draw in the investment required for sustainable growth whilst containing the pressures of overheating in the short term. 2008 will therefore be a crucial year for Argentina, in our view. The external economic environment will also play a pivotal role: if conditions remain favourable for domestic industry and agriculture, there will be more scope to implement gradual reform without harming growth, which we see as the fundamental base of the new government's economic plan.

**Table: Economic Activity**

| | 2005 | 2006 | 2007e | 2008f | 2009f | 2010f | 2011f | 2012f |
|---|---|---|---|---|---|---|---|---|
| Nominal GDP, ARSbn [2] | 531.9 | 654.4 | 729.8 | 850.1 | 960.7 | 1066.5 | 1186.2 | 1300.2 |
| Nominal GDP, US$bn [3] | 183.2 | 214.56 | 234.65 | 268.18 | 301.17 | 331.21 | 370.69 | 407.59 |
| Real GDP growth, % change y-o-y [1,2] | 9.2 | 8.5 | 7.6 | 6 | 3.3 | 3.6 | 3.9 | 3.7 |
| GDP per capita, US$ [2] | 4,728 | 5,482 | 5,936 | 6,717 | 7,469 | 8,132 | 9,012 | 9,811 |
| Population, mn [4] | 38.8 | 39.1 | 39.5 | 39.9 | 40.3 | 40.7 | 41.1 | 41.5 |
| Unemployment, % of labour force, eop [2] | 11.6 | 10.2 | 8.4 | 8.2 | 7.8 | 8.1 | 8.4 | 8.5 |

*Notes: f BMI forecasts. 1 *Latest data is a monthly estimate of economic activity. Source: 2 INDEC. 3 BMI calculation; 4 World Bank, INDEC.*

# Retail

## Regional Overview: The Expansion of Mass Grocery Retailing

Latin America today is one of the fastest growing regions for MGR, with many countries featuring highly modern hypermarket and supermarket outlets, which continue to increase in popularity with consumers as spending power rises. This development often masks the fact that MGR development in Latin America did not start until the mid-1980s and, as outlined in research carried out by Michigan State University in co-operation with the Regoverning Markets programme and the International Livestock Research Institute, Latin America experienced a change in grocery retailing in a decade that took the US retail sector 50 years.

**Table: Latin American MGRs' Share In Food Retailing - 2006**

| Country | Population (mn) | MGR share of food retailing (%) | No. of MGR outlets | No. of MGR outlets per million population |
|---|---|---|---|---|
| **Argentina** | **39** | **40** | **7,719** | **197.9** |
| Brazil | 189 | 80 | 126,000 | 666.7 |
| Chile | 16.5 | 58 | 1,393 | 84.4 |
| Colombia | 46.4 | 40 | 1,482 | 31.9 |
| Mexico | 108 | 45 | 8,074 | 74.8 |
| Peru | 27.2 | 25 | 290 | 10.7 |
| Venezuela | 27.3 | 54 | 1,935 | 70.9 |

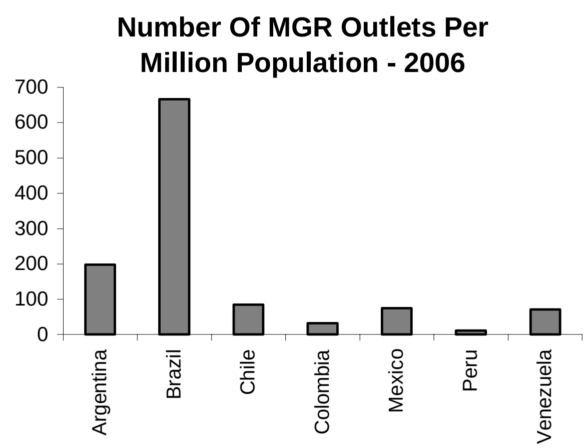
*Source: National statistics offices, BMI*

Post-1985, MGR development started off with a small number of outlets serving high-income sectors of the population, while the bulk of food distribution continued to take place via traditional traders, independent neighbourhood stores, and municipal and open street markets. In terms of supply, wholesale markets had significant influence, which, in some countries, were counterbalanced by government agencies such as CONASUPO (Compañia Nacional de Subsistencias Populares, or National Company of Popular Subsistence) in Mexico, which had a significant influence on distribution and price setting at least for basic consumer products.

This picture had fundamentally changed by 2000, when modern MGR outlets had become major players in the food supply and distribution system, and large numbers of small, independent shops had disappeared. Research carried out in Argentina and Chile, and published in *Development Policy Review* shows that in Argentina 64,198 small shops went out of business between 1984 and 1993, and 5,240 small outlets closed in Chile between 1991 and 1995. In contrast, street markets and greengrocers have in many cases been able to maintain their market positions, owing to consumers' strong preference for fresh products, and the higher prices charged by modern MGR outlets for fresh fruit and vegetables.

Meanwhile, smaller outlets are increasing in importance once more in some countries. Thus in Argentina, while hypermarkets, superstores and warehouse stores remain the most popular retail formats, they are losing market share to small supermarkets, grocery stores and kiosks. Reasons for this change include the increased convenience of smaller stores, and competitive prices.

While modern MGR outlets were initially located in large cities, operators started expanding into easily accessible smaller cities and towns from the mid-1980s, a development that continues today with outlets expanding into smaller population centres. For example, in 2005 **Wal-Mart de México** (Walmex) announced its intention to establish outlets in every Mexican city of more than 100,000 inhabitants. Similarly, in Peru in 2004 **Wong** established stores in Arequipa, Trujillo, Chiclayo and Piura, all of which are medium-sized cities.




*Sources: National Statistical Offices, BMI Research & estimates*

Within individual cities, MGR outlets started to move into middle-class neighbourhoods during the 1990s by opening outlet formats with a focus on low prices. Research carried out by Michigan State University, the Regoverning Markets programme and the International Livestock Research Institute shows that in Peru the biggest growth for MGR outlets has taken place in working class districts such as Cono Norte in Lima. This move has been in response to Lima's expansion into its booming suburbs and surrounding areas, with outlying zones of the capital already comprising around 63% of the city's population. Similarly in Chile, both Cencosud and **Distribución & Servicio** (D&S) have focused store development on middle- and working-class neighbourhoods.

During this process Latin America's leading MGR retailers have grown bigger both through organic growth and a large number of mergers and acquisitions, and multinational operators have, in the majority of countries, established a leading position. Argentine chain **Disco**'s development serves as a prime example for an MGR's path. The company initially started to expand by acquiring a number of small and medium-sized competitors in Argentina until it became the market leader. Disco then started its international expansion by acquiring Chilean MGR **Santa Isabel**, which was also active in Peru and Ecuador. An international MGR, Dutch retailer **Ahold**, became involved in the operation and thus acquired a presence in Argentina, Chile, Peru, Ecuador and Paraguay at the end of the 1990s. In 2001, Ahold bought Disco's share in the joint venture but, owing to the difficulties in which the company became involved, it has since sold on its involvement in the group.

In contrast, over many years leading Chilean MGR Cencosud mainly expanded via organic growth until it modified its strategy in 2003 and started to acquire smaller competitors. The same is true for Walmex as well as other leading Mexican MGR chains.

Both developments have led to consolidation in Latin America's MGR sectors. In Chile, the five main players had a market share of 53% in 2002, which had increased to 82% in 2004. Similar developments could be observed in Brazil, Argentina, and Mexico over recent years. In addition, the market share of multinational MGRs has significantly increased in Latin America over recent years, with the exception of Chile, where local chains dominate.

**Table: Latin America's Top Ten Regional MGRs, 2006**

| MGR | Sales (US$mn) | Country of origin | Market share, % |
|---|---|---|---|
| Wal-Mart | 21,743 | US | 6.9 |
| Casino | 9,685 | France | 3.1 |
| Carrefour | 8,350 | France | 2.7 |
| Cencosud | 5,293 | Chile | 1.7 |
| Soriana | 4,660 | Mexico | 1.5 |
| Falabella | 3,844 | Chile | 1.2 |
| Gigante | 3,258 | Mexico | 1.0 |
| D & S | 3,212 | Chile | 1.0 |
| Comercial Mexicana | 3,099 | Mexico | 1.0 |
| SHV Makro | 2,890 | Netherlands | 0.9 |
| Top 10 | 66,034 | | 21.1 |
| Others | 246,927 | | 78.9 |
| Total | 312,961 | | |

*Source: Planet Retail*

| Table: Latin America: Estimated Concentration And Multinationalisation Of MGRs - 2006 | | | |
|---|---|---|---|
| **Country** | **Share of top five MGRs, %** | **Share of foreign multinationals (full ownership or joint venture), %** | **Share of foreign multinationals in top five chain's sales, %** |
| **Argentina** | **76** | **64** | **84** |
| Brazil | 40 | 45 | 96 |
| Chile | 70 | 0 | 0 |
| Colombia | 72 | 60 | 83 |
| Mexico | 80 | 71 | 89 |
| Peru | 100 | 13 | 13 |
| Venezuela* | 15 | 8 | 30 |

** Excl. Mercal.  Source: BMI*

A number of factors have enabled and supported the rapid expansion of MGRs in Latin America. On the demand side, socio-economic changes, including increasing rates of urbanisation and the higher participation of women in the workforce have meant that concentrated masses of consumers with limited time for shopping and increasing dependency on convenient shopping hours presented strong customer potential for modern MGR outlets.

In Argentina one-third of the population lives in the capital Buenos Aires and the surrounding area, with this region accounting for almost 50% of the country’s food consumption expenditure. In Brazil, 78% of the population live above the poverty line, but only 15% can afford luxury goods and processed foods. Economic disparity in Brazil is particularly pronounced between the heavily populated urban regions of the south, and the rural agricultural regions of the north. In Chile, convenience and ready-to-eat foods are in greatest demand in the metropolitan region of the capital, Santiago.

In addition, households are expected to switch from less to more expensive calorie consumption, such as from coarse grain to meats and fresh fruits and vegetables, as incomes rise, and this is frequently quoted as part of the reason for MGR development. Modern MGR outlets tend to offer a greater variety of processed goods and non-basic foodstuffs than traditional grocery outlets. Finally, rising incomes have also led to increased ownership of consumer durables such as cars, refrigerators and freezers, with families requiring fewer shopping trips and being able to shop outside their immediate neighbourhood. In Argentina, for example, just over 50% of middle- and upper-class households have microwaves, and around 75% have freezers.

The economic crisis that hit Latin America during the 1990s in many cases temporarily reversed the trends towards processed goods and non-basic foodstuffs and, in Argentina, consumers are just beginning to demand more consumer-ready foods, in tandem with the country's economic recovery. At present dry groceries account for 30% of food expenditure, while beverage and dairy product purchases each account for 20% of food spending.

On the supply side, trade liberalisation during the 1980s had a major impact on MGR development in Latin America, together with the increasing flexibility of FDI legislation in the 1990s as part of structural adjustment programmes and regional free trade agreements (FTAs).

In addition to changing the population's consumption and shopping habits and altering the retail infrastructure in many towns and cities, the expansion of modern MGR outlets also had far-reaching consequences for the wholesale and primary production sectors. Local markets and local and regional wholesalers have significantly declined in importance, while nationally-operating specialised wholesalers have become of vital significance for MGRs' product supply. Along with this development, logistics and information and communication networks have had to be established. Research typically identifies the so-called four pillars of MGR procurement systems, which are centralised procurement, specialised wholesalers, preferred suppliers, and private quality and safety standards.

While immediately affecting local and regional product supply systems, there are also more far-reaching effects on small farmers and their income and profits, and thus on Latin America's agri-food systems as a whole. In the majority of cases, a large proportion of agricultural producers are being excluded from modern food supply systems, with those who are poorest and have the least access to physical capital and natural, social, human, and financial assets hit hardest.

In many cases, large proportions of foodstuffs and raw materials are being imported rather than sourced domestically. In Peru, for example, food and beverage imports have increased by more than 10% a year in some years, with local production growth rates of around 4% a year. Overall in Peru, imports increased their share of the market from 16% in 2000 to 22.1% in 2005. In response, the Peruvian government introduced promotional campaigns to encourage the consumption of domestic products. The Ministry of Industry's Buy Peruvian Products campaign was designed to differentiate local products from imports through the application of a distinctive logo and extensive national media advertising, and was supported by the country's main food and beverage producers. In addition, an increase in strategic alliances and vertical integration between industrial and agricultural business segments can be observed in the country, with the aim of ensuring optimum supply of raw materials.

Venezuela also imports a large proportion of its food requirements, despite possessing a rich variety of natural resources for food production, and runs a significant food trade deficit. Although one-quarter of the total land area is devoted to agriculture, two-thirds of food requirements need to be satisfied via imports, with the agricultural sector suffering from state intervention, underinvestment in technology and an over-valued exchange rate. In 2005, agri-food products worth US$2.6bn and fish and seafood products worth US$64.3mn were imported. Growth in the import of consumer-ready products has been held back by import restrictions. In addition, the government is attempting to reduce the country's dependency on wheat imports by encouraging rice consumption, a crop in which Venezuela is self-sufficient.

In Brazil, where the rural agricultural regions of the North suffer from low incomes in general, there are further economic disparities among individual farming regions, with farmers in many areas having no access to fertilisers, seed selection, or crop rotation techniques, and large-scale modernisation and production mechanisation driving agricultural development in other regions.

Similarly, in Mexico large parts of the agricultural sector are characterised by high farm debt and the inability to secure loans to update farm equipment. This has led to a steady decline in the country's agricultural productivity and thus a growing dependence on food imports, especially as the food industry also suffers from under-mechanisation and lack of modernisation. The government is undertaking efforts to make the agricultural sector more competitive. A first step was the opening of the sector to private investment. In addition, the government has launched the Programa de Apoyos Directos al Campo (PROCAMPO), a rural support programme which provides a fixed payment per hectare of cropland to the around 3.5mn farmers who produce basic commodities. In addition, a programme to improve regional wholesale markets and transform them into logistical hubs in order to increase sellers' competitiveness when negotiating with MGRs has been launched.

Thus, some governments in the region are taking a variety of measures to ensure the competitiveness of domestic agri-food production. However, it remains to be seen how far these will be successful, with the MGR sector continuing to expand.

# Industry Forecast Scenario

Driven by the Argentinean economy's strong performance during 2006 and 2007, and encouraged by the fact that growth has largely been driven by strong consumer spending, Argentina's mass grocery retailers appear to have re-found their confidence in the sector's development. Real GDP expansion continued in Q207, increasing 8.7% y-o-y driven by robust household consumption, as rising wealth continued to encourage spending. During the first six months of 2007, average nominal sales at supermarkets and shopping centres in Buenos Aires province increased by 24.8% and 27.4% respectively.

In response, the country's mass grocery retailers announced ambitious expansion plans, with **Casino** for example planning its first new store openings since 2001, in the form of four new hypermarket outlets, and **Carrefour** and **Wal-Mart**, as well as Argentina's domestic operators also having announced their plans for significant investments and outlet expansion, also to areas of the country so far characterised by low mass grocery retailer penetration. New outlet formats, such as Wal-Mart's bodega-style Changomas supermarkets, target the increasing number of well-off Argentineans looking for an upmarket shopping environment and a broad selection of high-quality food and drink products.

Thus, despite the government-imposed price controls, which have led to shortages of basic foodstuffs in many outlets throughout 2007, confidence within the sector appears to be high, with operators, for the time being, discounting the dangers to Argentina's long-term growth outlook should the government fail to undertake the necessary steps towards structural and policy reforms.

For the economy's recovery to be sustained, and sustainable, and thus able to benefit both MGRs and consumers in the long run, the government needs to extend and deepen structural reform processes, bring inflation under control and satisfactorily solve the country's debt issues.

Supermarkets in particular are forecast to experience a reversal of the declining sales observed during the review period, with operators having re-discovered the format's suitability to cater for medium to high-income consumers looking for a broad range of selected high-quality products, as in the case of Wal-Mart's new Changomas supermarket format.

**Table: Sales Value by Format in Argentina's Mass Grocery Retail Sector - Historical Data & Forecasts (US$bn)**

| | 2005 | 2006 | 2007e | 2008f | 2009f | 2010f | 2011f | 2012f |
|---|---|---|---|---|---|---|---|---|
| Supermarkets | 2.64 | 2.59 | 2.51 | 2.57 | 2.64 | 2.71 | 2.78 | 2.85 |
| Hypermarkets | 1.81 | 1.92 | 2.00 | 2.11 | 2.22 | 2.33 | 2.44 | 2.57 |
| Discount Stores | 0.29 | 0.32 | 0.35 | 0.37 | 0.40 | 0.42 | 0.44 | 0.46 |
| Convenience Stores | 0.73 | 0.85 | 0.98 | 1.05 | 1.11 | 1.18 | 1.25 | 1.33 |
| Total Mass Grocery Retailers | 5.57 | 5.68 | 5.84 | 6.11 | 6.38 | 6.65 | 6.92 | 7.21 |

*e/f = BMI estimate/forecast. Source: BMI*

**Table: Sales Breakdown by Retail Format Type - 2006 & 2016**

| | 2006 | 2016f |
|---|---|---|
| Organised/MGR | 40 | 60 |
| Non-organised/Independent | 60 | 40 |

*f = BMI forecast. Source: BMI*

## Industry Developments

- Cencosud announced in October 2007 that Q307 sales and earnings in Argentina have exceeded expectations. 2006 Argentinean same-store sales had increased by 20% y-o-y. In June 2007, the retailer opened the new Portal Tucuman shopping centre in Yerba Buena following an investment of US$29mn. The centre features 90 shops, six cinemas, a car park with a capacity for 1,100 cars, a department store, a food court, an amusement park and a Jumbo hypermarket. Cencosud will also invest into the Disco supermarket chain, with US$647,127 to be spent over coming years for expansion. New outlets are planned for Pinamar and Villa Gesell, and new Super Vea stores are to be opened in Cipolletti, Oran (Salta), and Manzanares. In 2008, Cencosud's Almacenes Paris department store business is to start operations in Argentina. According to banner director Pablo Castillo, US$75mn will be invested into the opening of five stores during 2008, followed by another US$70mn in 2009 in order to open seven further stores.

- In October 2007, **Coto** completed a debt-refinancing scheme for its local and foreign entities following a year of negotiations with creditors. The retailer managed to reduce a debt of

US$175mn by US$23mn and to secure a ten-year payment scheme at Libor plus 3,000 base points and 40% payment in pesos.

- According to statements issued by the Argentinean government in September 2007, Wal-Mart plans to invest US$100mn in the country on top of US$150mn the retailer had pledged in 2006 to invest by 2008. The money, two-thirds of which has been spend already according to the government, will be invested into the opening of new outlets in Buenos Aires as well as in the northern provinces of Santiago del Estero and Salta. Wal-Mart had opened its $16^{th}$ Supercenter in San Fernando in August 2007 and, according to company sources, plans to operate 24 supercentres by the end of 2008. Expansion is also on the cards for the Changomas superstore format and spokespeople have not ruled out acquisitions as an additional means to drive growth. In June 2007, Wal-Mart spokespeople had announced that the retailer aims to launch MoneyCenter units in Latin America.

- In June 2007, Wal-Mart acquired three former **Auchan** hypermarket sites in the Buenos Aires metro area from Spanish construction company **San Jose** for US$30mn. The stores are located in Avellandeda, Quilmes and San Justo. In March, the retailer had launched a new store format in the form of the Changomas superstore, a bodega-style store concept characterised by an extensive product assortment of 25,000 SKUs, excellent quality, competitive prices, strong customer service, and in-store cafeteria, pharmacy and telecoms shops, according to CEO Ezequiel Gomez Berard. The first outlet, with a sales area of 6,500 sqm, was opened in Rioja and further openings are planned for other medium-sized cities throughout the country. A further key feature of the new store format is the 'PyME' programme, under which products sourced from small and medium regional suppliers will be promoted.

- **La Anonima** announced in August 2007 that it plans to open seven new outlets before the end of the year and refurbish the store in Rio Grande (Tierra del Fuego). The new outlets will be located in Junin, Rincon de los Sauces (Neuquen), Ushuaia, Trevelin (Chubut), Bariloche, Puerto Madryn and Rada Tilly (Chubut).

- **SHV Makro**'s Argentinean operation announced in July 2007 that it plans to invest US$32.3mn into the opening of 11 cash & carry stores over the coming three years. In addition, Makro intends to establish a new division in Argentina with the aim to enter food and drinks distribution. Since August 2007, the retailer's store in San Martin in Buenos Aires province, offers a direct delivery service, which is to be rolled out to all stores with the aim to create a direct delivery distribution network in Argentina.

- In July 2007, **Cooperative Obrera** acquired local supermarket chain **Ganador**, which operates five outlets in Centenario, Neuquen. The stores will be rebranded as Cooperativa Obrera.

- Casino announced in May 2007 that it plans to open four hypermarkets in Argentina by the end of 2008. The new outlets would be Casino's first Argentinean store openings since 2001. The first new store will be opened towards the end of 2007 as part of a new shopping centre development in Cordoba.

- Carrefour opened a new hypermarket in Merlo, a suburb of Buenos Aires in April 2007, following an investment of US$5.7mn.Despite the price controls imposed by the Argentinean government, the retailer plans to open a total of 10 new supermarket outlets in the country and has committed to spend a total of US$144.9mn on its Argentinean operations between 2005 and 2008. FY2006 sales reached US$1.4bn, with a core profitability margin of below 1% owing to competitive pricing. In December 2006, Carrefour continued the re-branding of the Norte supermarket outlets to Carrefour Express.

- Government officials agreed in September 2006, to extend price controls through to the end of 2007. 'In this manner we are retaking the path to renew the price accords – as such good results they have given us,' said Internal Commerce Secretary, Guillermo Moreno. The price controls have helped curb inflation.

## Market Overview

Argentina is the world's eighth-largest country in terms of landmass, occupying an area of 2.8mn $km^2$, and covering the majority of the southern half of South America. However, much of this area is unoccupied, since 89% of its estimated 38.9mn people live in urban areas. Buenos Aires has one of the largest populations of any city in the world, with 14.8mn people, and accounts for 41% of Argentina's population.

After years of strong economic growth, the economy suffered a financial and political crisis between 1999 and 2002. The devaluation of the peso in the early part of 2002 led to considerable price increases, which had an impact on the retail trade in general, but, starting in 2003, the MGR sector in particular has recovered.

Argentina is a major South American retail market. Together with Brazil, the country accounts for some 57% of sales through the regional food and grocery trade, which is now largely controlled by foreign retail groups. These include French firms Carrefour and Casino, US giant Wal-Mart, and SHV Makro, from the Netherlands. These firms and other MGRs, operating supermarkets, hypermarkets, discount stores and convenience stores, account for around 40% of sales by value through food retail. While convenience stores dominate in terms of outlet units, supermarkets and hypermarkets accounted for 79.5% of sales by value in 2006.

The large retail chains struggled between 1999 and 2002, in particular, as a result of weaker demand during the economic crisis. Traditional stores were able to regain some market share during this time, as less affluent consumers increasingly moved their purchases to neighbourhood stores offering them credit. In addition, the pace of new store openings decreased, with the exception of warehouse stores addressing low-income consumers.

This trend started to reverse from 2003 onwards, with the leading retail chains having started to expand into the country's interior, as the Buenos Aires region is becoming increasingly saturated. Recent expansion has mainly been focused on the development of discount formats offering lower prices, a high percentage of private-label products and fewer service offerings, while, with the economy recovering, companies' focus has now started to shift towards their hypermarket and supermarket networks.

Furthermore, in line with the more positive economy since 2004, efforts to rebuild credit have been having a positive impact on consumer expenditure and consequently, on retail sales. In an effort to repair consumer confidence, banks and retailers have introduced more favourable terms for issuing consumer credit, and retailers – particularly the larger ones – have established more flexible payment options to encourage expenditure.

In 2006, the Argentine MGR sector totalled 7,699 outlets, representing growth of 13.6% since 2001, while sales reached US$5.675bn.

Carrefour is the market leader, operating a network of hypermarkets, supermarkets and discount stores. It recorded a turnover of US$1.4bn in 2006. The French retailer claims to have a 33.2% share of the MGR market. Next in line, following its purchase of Ahold's Disco supermarket chain, is Cencosud.

Cencosud is followed by Coto, which operates a chain of hypermarkets, supermarkets and convenience stores. The group's other assets include three slaughterhouses and a manufacturing plant. Coto's stores are mainly located in the province of Buenos Aires, although the retailer has recently expanded into Santa Fe and Entre Ríos provinces.

Ranked fifth in the local market, following fourth-ranked domestic chain La Anonima, is Wal-Mart. The multinational entered Argentina in 1995 with the establishment of a Sam's Club warehouse, and now operates 16 supercentres and one Changomas superstore throughout the country.

Ranked sixth is Casino, which entered the Argentine market in 1998. The French retailer operates a chain of hypermarkets (Libertad) and discount stores (Leader Price). The latter format is largely based in the Gran Buenos Aires region, while Libertad hypermarkets are established in medium-sized towns. Casino also operates outlets selling electronic goods (Planet) and office products (Hiper Casa).

Domestic chain La Anonima operates supermarkets in Buenos Aires and Patagonia. Indeed, the group claims to be the market leader in the MGR sector in Patagonia.

It is also important to examine the relative selling power and efficiency of each of the four MGR formats. Hypermarkets, with an average sales value per outlet of US$24.6mn in 2006, are clearly many times more powerful than any other store format.

Shopping centres appear to be ringing up the strongest retail sales in the country. INDEC reports that shopping centre sales have been growing well over and above the country's GDP growth rate since 2003. In that year, shopping centre sales were up 36% on the previous year, which was over four times the annual GDP growth rate of 8%. In 2004 and 2005 the trend continued, if not at the same pace: shopping centre sales rose by 245% and 17% in those years, respectively, against an average annual GDP growth rate of almost 6%. Operators ambitious openings plans for further shopping centres illustrate the outlets' further growth potential.

**Table: Structure of Argentina's Mass Grocery Retail Sector by Estimated Number of Outlets**

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|---|
| Supermarkets | 1,035 | 1,010 | 995 | 1,035 | 1066 | 1,101 |
| Hypermarkets | 61 | 64 | 69 | 72 | 75 | 78 |
| Discount Stores | 458 | 503 | 543 | 563 | 590 | 620 |
| Convenience Stores | 5,222 | 5,410 | 5,620 | 5,680 | 5800 | 5,900 |
| Total mass retailers | 6,776 | 6,987 | 7,227 | 7,350 | 7,531 | 7,699 |

*Source: Official statistics, BMI*

**Table: Structure of Argentina's Mass Grocery Retail Market - Sales by Format (US$bn)**

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|---|
| Supermarkets | 2.93 | 2.84 | 2.76 | 2.689 | 2.639 | 2.588 |
| Hypermarkets | 1.43 | 1.5 | 1.62 | 1.707 | 1.814 | 1.921 |
| Discount stores | 0.14 | 0.185 | 0.23 | 0.255 | 0.286 | 0.319 |
| Convenience stores | 0.5 | 0.52 | 0.54 | 0.625 | 0.727 | 0.848 |
| Total mass retailers | 5 | 5.045 | 5.15 | 5.276 | 5.466 | 5.676 |

*Source: Official statistics, BMI*

**Table: Average Annual Sales Value by Format (US$mn) - 2006**

| | |
|---|---|
| Supermarkets | 2.35 |
| Hypermarkets | 24.6 |
| Discount stores | 0.51 |
| Convenience stores | 0.14 |
| Total mass retailers | 0.74 |

*Source: BMI*

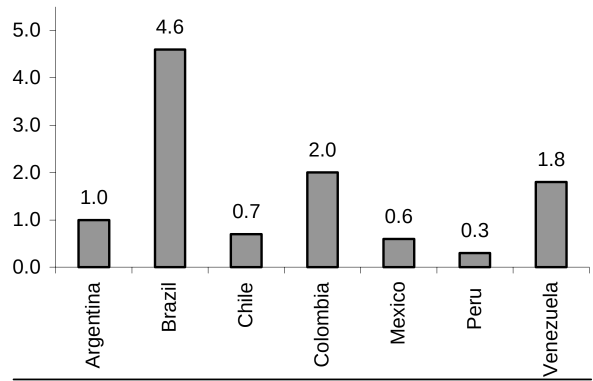
# Food And Drink

## Drink Regional Overview: Coffee Consumption In Latin America

Several Latin American countries, most notably Brazil and Colombia, are among the world's leading coffee producers, exporting significant quantities of what in many cases constitutes one of their key agricultural crops across the globe.

A completely different picture emerges for coffee consumption, as Latin American markets, with the exception of Brazil, are characterised by a lack of an established coffee culture, low per capita consumption, and consumption of predominantly lower grade coffees rejected for export. The situation is, however, beginning to change, driven by local government and industry initiatives, as well as the global expansion of coffee chains such as **Starbucks**, which help to introduce coffee culture and a variety of speciality coffees to the growing segment of Latin American medium to high income consumers. Most successful to date have been initiatives in Brazil, where domestic consumption has almost doubled over the last 15 years.

**Per Capita Coffee Consumption (Kg Per Annum) by Country, 2006**




*Source: ICO; Earth Trends*

The importance of increasing coffee consumption in producer countries was highlighted during the 2006 ExcorCafe conference held in Mexico. Nestór Osoria, Executive Director of the International Coffee Organization (ICO), outlined how the organisation could achieve a balanced global coffee market, provide an alternative market for farmers, increase producer awareness of consumer preferences, lead to a greater appreciation by growers of the value of quality, provide an incentive for foreign direct investment (FDI), and promote the development of small and medium-sized enterprises such as regional roasters and coffee houses. Efforts to increase domestic consumption have been supported by the ICO, which developed a Step By Step Guide to increasing consumption.

Coffee demand is determined by price, the price and availability of substitute drinks, and consumers' tastes and consumption habits. A key feature of the coffee retail market is the fact that coffee demand is largely price inelastic, with consumers not reducing consumption proportionately to increases in price, and falling coffee prices not leading to a proportionate increase in consumption, although of course it does move in line with changing prices. Thus the period of extremely low coffee prices between the

1990s and 2002 did not lead to increased coffee consumption among the low income consumers of Latin America, and the rising prices since then have not led to a reduction in consumption. The availability of coffee substitutes and hot drinks consumption patterns based on alternative products are a reason for low per capita coffee consumption in many Latin American markets. Tea and *yerba mate* in particular are important alternatives, as are other plant-based hot drinks such as coca-based drinks.

The recent increase in per capita consumption of coffee across the region has, in part, been driven by higher disposable incomes, which has led to increasing demand for, and appreciation of, value-added and premium coffee varieties. These include the multitude of coffee varieties offered by coffee shop chains, but also premium roasts, organic and Fairtrade coffees that previously went entirely to export markets but are now available in MGR retail chains across the region. While multinational manufacturers such as Nestlé and **Sara Lee** dominate, local manufacturers have in some cases achieved a strong position in Latin America's domestic coffee markets. An example is provided by **Cafés La Virginia SA** in Argentina, which has achieved a strong market position owing to affordable prices, a broad product range, brand equity, and a strong distribution network. La Virginia's product is tailored to typical Argentine consumption occasions, such as breakfast and *merienda*, an afternoon meal. Similarly, **Santa Clara Indústria e Comércio de Alimentos** has achieved a strong position in the Brazilian market, ranked second after Sara Lee.

**Table: Latin America – Leading Coffee Producers By Country**

| Country | Company |
|---|---|
| **Argentina** | **Nestlé Argentina SA, Cafés La Virgina SA,** |
| Brazil | Sara Lee Cafés do Brasil Ltda, Santa Clara Indústria e Comércio de Alimentos, Melitta do Brasil Indústria e Comercio Ltda, Nestlé Brasil Ltda |
| Chile | Asesorias e Inversiones Santa Victoria Ltda, Corpora Tres Montes SA, ICB SA |
| Colombia | Casa Luker SA, Cia Nacional de Chocolates SA, Indústria Colombiana de Café SA, Torrecafé Aguila Roja y Cia Ltda |
| Mexico | Nestlé, Sara Lee |
| Peru | Altomayo Perú SA, Indústrias Oro Verde SA |
| Venezuela | Nestlé Venezuela SA, Marcelo y Rivero CA, Café Fama de América CA |

*Source: BMI*

**Table: Latin America – Actual And Projected Coffee Production, Exports And Imports**

| | Actual (000 tonnes) | | Projected (000 tonnes) | Growth rates, % per year | |
|---|---|---|---|---|---|
| **Production** | **1988-1990 average** | **1998-2000 average** | **2010** | **1988-1990 to 1998-2000** | **1998-2000 to 2010** |
| Brazil | 1,496 | 2,103 | 1,339 | 3.5 | -4.4 |
| Colombia | 754 | 699 | 747 | -0.8 | 0.7 |
| Costa Rica | 145 | 128 | 194 | -1.2 | 4.2 |
| El Salvador | 135 | 112 | 165 | -1.9 | 3.9 |
| Guatemala | 195 | 293 | 348 | 4.2 | 1.7 |
| Mexico | 315 | 276 | 273 | -1.3 | -0.1 |
| Other Latin America & Caribbean | 538 | 604 | 970 | 1.2 | 4.8 |
| Total Latin America & Caribbean | 3,577 | 4,215 | 4,037 | 1.7 | -0.4 |
| | | | | | |
| **Exports** | | | | | |
| Brazil | 1,064 | 1,217 | 481 | 1.4 | -8.9 |
| Colombia | 724 | 575 | 648 | -2.3 | 1.2 |
| Costa Rica | 139 | 124 | 186 | -1.1 | 4.1 |
| El Salvador | 126 | 120 | 148 | -0.5 | 2.1 |
| Guatemala | 183 | 278 | 339 | 4.3 | 2 |
| Mexico | 233 | 259 | 241 | 1.1 | -0.7 |
| Other Latin America & Caribbean | 392 | 463 | 850 | 1.7 | 6.3 |
| Total Latin America & Caribbean | 2,861 | 3,036 | 2,893 | 0.6 | -0.5 |
| | | | | | |
| **Imports** | | | | | |
| Total Latin America & Caribbean | 38 | 39 | 38 | 0.3 | -0.3 |

*Source: FAO (Agricultural Commodity Projections to 2010)*

Brazil is the exception to the rule of low per capita coffee consumption in Latin America. Coffee is a national beverage and an important part of daily life, accounting for around 75% of hot drinks sales in volume terms. As well as being the world's largest coffee producer, the country ranks second after the US where coffee consumption is concerned, accounting for 14% of world coffee consumption and more than 50% of the coffee consumption of producer countries. Brazil's rise to this position started at the beginning of the 1990s, when the Brazilian Coffee Institute (IBC), which had previously controlled the coffee sector, was abolished and the whole coffee economy was restructured on free market principles. The new market structure allowed roasters to produce a broad variety of coffee products, catering for the whole spectrum of consumers.

In addition, the Brazilian Coffee Industry Association (ABIC) launched a number of programmes to stimulate domestic consumption, including the Coffee Quality Programme (PQC), which aimed to improve processing and roasting techniques. In addition, the ‘Quality Stamp’ was introduced and has since been issued to more than 160 Brazilian coffee brands; the Coffee Purity Programme was launched to ensure consumers that adulterated coffees are not acceptable; and the Coffee and Health programme was unveiled in order to improve the perception that coffee can bring a healthier life. These have been supported by investments into both the ground roasted and soluble industries with the aim to expand capacity, incorporate new technologies, and promote marketing campaigns.

Key for growth is to encourage coffee consumption among younger consumers. This is to a significant degree achieved by the continuous opening of modern and stylish coffee shops. In terms of chain outlets, Starbucks is the main operator present, but some European chains as well as the Colombian **Juan Valdez** chain have reportedly expressed interest in the growing Brazilian market.

Further economic growth and rising disposable incomes will stimulate domestic value sales growth, with demand for premium, speciality and certified coffee currently limited to high income sections of the population. Only around 5% of gourmet coffee produced in Brazil is consumed within the country. Brazil’s MGRs play a key role in making consumers familiar with the full range of coffee varieties available. Pão de Açúcar, for example, runs campaigns to boost consumption of gourmet coffee and, overall, MGRs reserve around 15% of coffee display areas for gourmet coffee, which is the fastest growing coffee segment, with double-digit annual value sales growth.

In other Latin American markets, per capita coffee consumption is significantly lower than in Brazil, and each market has its individual characteristics, presenting both barriers and opportunities to increase domestic coffee consumption.

Chile is a key example of a market where there is a tradition of instant coffee. This is, however, slowly starting to change as consumers increasingly discover ground-roasted higher quality coffee and speciality coffee varieties, partly supported by the increasing penetration of coffee shops, with the capital Santiago having 18 Starbucks outlets. Coffee shops have started to establish out-of-home coffee consumption as a social activity, with young people in particular meeting friends and socialising in the growing number of outlets. Where consumption at home is concerned, MGRs play a vital role in developing premium coffee labels and importing premium brands.

**Table: Latin America – Domestic Coffee Consumption, 2006-2007**

| | Domestic consumption, roasted ground | | Domestic consumption, soluble | | Total domestic consumption | |
|---|---|---|---|---|---|---|
| | **2006** | **2007e** | **2006** | **2007e** | **2006** | **2007e** |
| Brazil | 15,000 | 15,925 | 915 | 940 | 15,915 | 16,865 |
| Colombia | 950 | 950 | 270 | 290 | 1,220 | 1,240 |
| Ecuador | 5 | 6 | 140 | 141 | 145 | 147 |
| Mexico | 1,000 | 956 | 523 | 400 | 1,523 | 1,356 |
| Peru | 70 | 70 | 140 | 140 | 210 | 210 |
| Venezuela | 730 | 750 | 10 | 10 | 740 | 760 |

*e = estimate. Source: FAS USDA*

Colombia produces coffee mainly for export markets but, over recent years, there have been powerful national campaigns to promote domestic consumption, which is low compared to that of other producer countries. A key feature of the market's development are the Juan Valdez-branded coffee stores run by the National Growers' Federation (FEDECAFE). They aim to give Colombians the opportunity to taste high quality 100% Colombian coffee and use the well-established Juan Valdez brand name, which was previously only associated with exported coffee. The brand is described as tapping into strong feelings of Colombian nationalism, and aims to reach premium coffee consumers. New Juan Valdez stores are to be opened, and the brand is also sold via MGRs.

In Mexico, the coffee market is strongly influenced by the fact that growers switched to alternative crops during the period of low coffee prices, leading to the halving of Mexican coffee exports between 2000 and 2006. Rather than returning to the industry's focus on export markets now that prices have recovered, the industry launched a 10-year plan in 2006 with the aim of stimulating domestic consumption. While at present only 30% of domestically produced coffee is consumed in Mexico, the industry aims to increase this share to an ambitious 70%. Marketing campaigns are supported by the Ministry of Agriculture and the government-run Mexican Coffee Council. They are mainly targeted at middle- and lower-middle-income consumers, while the speciality coffee sector focuses on higher-income consumers. 70% of coffee consumed is instant/soluble, with a particular preference for heavily sugared Nescafé.

In addition to targeting consumers, a key focus of efforts is on improving the quality of Mexican coffee. Previously, inappropriate processing techniques such as mixing coffee grains from different altitudes and maturity stages, and mishandling grains during the wet milling process had an impact on quality. During 2007/2008, domestic consumption is expected to have increased by 10%, with the increase expected to be spread fairly evenly across socio-economic classes.

Peru is characterised by a strong tradition of tea and other plant-based hot drinks, such as coca-based drinks. Coffee consumption is the lowest in the region at around 300g per capita per annum, and instant coffee accounts for 75% of consumption. Consumption habits are slowly beginning to change, along with the opening of more cafes and restaurants.

Venezuela, in contrast to other countries in the region, consumes almost 100% of its coffee harvest domestically. The government virtually abolished coffee exports in 2004 due to concerns about domestic availability in the light of falling production. Coffee consumption is widespread, with most grocery stores, and street vendors, selling coffee by the cup.

Consumption has been increasing over recent years, mainly owing to the fact that coffee is included in the basic food basket of products sold via the government-subsidised **Mercal** chain of grocery stores, which has improved access to the product for low-income consumers. Coffee has, however, been subject to price controls since 2003, which has created occasional scarcity in stores. The industry was nevertheless able to sell non-regulated coffee varieties or value-added products at higher prices. This possibility was abolished from January 2006, when the government adjusted the controlled price upwards to avoid further scarcities and the National Institute for the Defence of the Consumer (INDECU) forced roasters to sell all product varieties at the enforced price. For the supply of the Mercal chains, in November 2005 the government established **Café Venezuela**, a state-owned processor.

Thus each country within Latin America has its own opportunities for and barriers to a further increase in domestic coffee consumption. The combined efforts of governments, industry associations, MGRs and international coffee chains can, in most countries, be expected to lead to notable increases in domestic coffee consumption over coming years.

# Food Regional Overview: Confectionery in Latin America

Globally, Western Europe and North America account for two-thirds of confectionery sales, with market growth predominantly driven by growing chocolate confectionery value sales, as the category undergoes a process of premiumisation.

Latin American markets are, however, of key interest to the world's confectionery manufacturers owing to their vast and predominantly young population, rising disposable incomes in many regions, and a growing interest in innovative and high-quality confectionery products, providing strong potential for further category growth.

**Table: Latin America – Estimated Confectionery Sales by Sub-Sector (US$mn)**

| | 2004 | 2005 | 2006 | 2007e | 2008f | 2009f | 2010f | 2011f |
|---|---|---|---|---|---|---|---|---|
| **Argentina** | **940** | **1,006** | **1,126** | **1,296** | **1,490** | **1,669** | **1,869** | **2,093** |
| Brazil | 7,449 | 8259 | 9091 | 9812 | 10570 | 11397 | 12310 | 13196 |
| Chile | 737 | 793 | 856 | 924 | 980 | 1,029 | 1,080 | 1,134 |
| Colombia | 425 | 450 | 478 | 505 | 533 | 565 | 584 | 615 |
| Mexico | 1,979 | 2,122 | 2,274 | 2,405 | 2,530 | 2,661 | 2,755 | 2,851 |
| Peru | 196 | 212 | 230 | 246 | 262 | 280 | 298 | 318 |
| Venezuela | 305 | 336 | 360 | 380 | 399 | 415 | 430 | 445 |

*e/f = BMI estimate/forecast. Source: BMI, Trade press, National statistics authorities, Company data*

With growth in the more mature Western European and North American markets slowing down, Latin America is thus one of manufacturers' focus regions. Growth has been picking up over recent years and can be expected to continue, provided no major economic or financial crises shake the region in coming years. Brazil and Mexico are the largest confectionery markets in the region.

**Table: Latin American Confectionery Producers Ranked Among the World's 100, 2006**

| Company | Head-Quartered | International Rank | No. of Plants | No. of Employees | 2006 Net Sales (US$mn) |
|---|---|---|---|---|---|
| Arcor Group | Buenos Aires, Argentina | 15 | 35 | 18,000 | 1,111 |
| Grupo Bimbo SA de CV | Mexico City, Mexico | 19 | 11 | 83,200 | 799 |
| Colombina SA | Cali, Colombia | 37 | 8 | 5,500 | 320 |
| Grupo Nacional de Chocolates | Medellin, Colombia | 41 | 3 | 16,712 | 255 |
| Empresas Carozzi SA | Santiago, Chile | 43 | 10 | 4,750 | 254 |
| Sabritas SA de CV | Mexico City, Mexico | 47 | na | na | 220 |
| Distribuidora de la Rosa | Guadalajara, Mexico | 52 | 3 | 1,600 | 159 |
| Dulces Vera SA de CV | Guadalajara, Mexico | 68 | 5 | 3,500 | 120 |
| Canel's SA de CV | San Luis Potosi, Mexico | 82 | 3 | 2,000 | 85 |
| Confites Ecuatorianos CA | Quito, Ecuador | 90 | 3 | 1,100 | 70 |
| Riclan SA | Sao Paulo, Brazil | 91 | 1 | 1,000 | 70 |

*na = not available. Source: Candy Industry*

**Key growth factors include:**

- Demographic and lifestyle changes – Latin America's markets are characterised by a large proportion of young people, while busier lifestyles and an increasing number of women working have led to smaller households, urbanisation and informal eating habits, creating demand for portable and convenient treats.

- Global trends towards healthier eating – as a result, functional, fortified and sugar-free confectionery products, which retail at a premium, have increased in popularity among Latin America's more affluent consumers.

- Increasing market segmentation by age, gender and ethnic group – providing manufacturers with more opportunities to market their products to a clear target group, e.g. premium chocolate confectionery products to older consumers with higher purchasing power, or children's confectionery products featuring character licensing from popular movies or cartoon series.

- Further development of premium confectionery products – as disposable incomes across Latin American markets increase, more consumers show interest in premium product varieties.

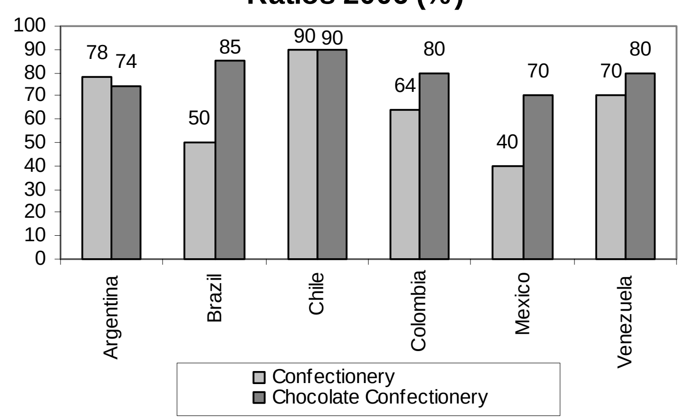
- Growing emphasis on exotic flavours and regional specialities – while multinational confectionery manufacturers benefit from global brands and marketing concepts, over recent years they have also acquired local and regional Latin American players and their brands, and are thus ideally positioned to cater to increasing demand for traditionally popular local and regional specialities.

In value terms, chocolate confectionery accounts for the largest proportion of confectionery markets across the region, while in volume terms, sugar confectionery dominates. Chocolate confectionery sales in many Latin American markets have increased only slowly over recent years and from a small base, with the region having accounted for around 6% of global chocolate confectionery value sales in 2006. In some markets, such as Peru and Venezuela, growth is currently volume rather than value driven, in contrast to many developed North American and Western European markets, where sales growth is mainly being achieved through premiumisation.

Sugar confectionery products have traditionally been more popular in emerging markets, and Latin America is estimated to have accounted for around 9% of global sales in 2006.

Chocolate confectionery production is highly concentrated on the global level, with leading manufacturers including **Nestlé**, **Masterfoods**, **Kraft Foods**, **Cadbury** and **Hershey's**, to name just a few, while sugar confectionery is mainly concentrated at the regional level, with a stronger presence of small and medium-sized players.

**Latin American Confectionery Sector - Top 5 Manufacturers' Concentration Ratios 2006 (%)**




*Source: BMI, Trade Press*

The global chewing gum market is dominated by multinationals **Wrigley** and Cadbury, which together account for around 60% of global chewing gum sales and also have a strong position in Latin America. Wrigley takes the lead with a share of around 35%, and Cadbury holds a share of around 26%. The two companies are followed by **Lotte** (South Korea) with a share of 7%, **Perfetti van Melle** (Italy) with a share of 4%, and Hershey's (US) with a share of 2%. The remainder of the market is made up of around 250 smaller companies of regional or local importance, including **Canel's** and **Natural Gum Chicle** in Mexico.

Global trends, including rising demand for premium chocolate, healthier confectionery products, miniaturisation, exotic flavours and colours, and increased demographic and market segmentation, are also increasingly influencing Latin American markets.

In terms of new product developments in the chocolate confectionery sub-sector, bite-size portions are becoming increasingly popular and product development focus is clearly on adult-oriented indulgence products such as boxed assortments, tablets, and seasonal chocolate, which fulfil manufacturers' need for higher profit margins. Sugar-free product varieties also continue to increase in importance, along with the global trend towards healthier eating and rising concerns about sugar intake.

In the sugar confectionery and gum sub-sectors, a clear trend towards intensely flavoured products can be observed. The further development of sugar-free product varieties is supported by improvements in sugar-free technology. Sugar-free products sell at a higher price and cater to the demands of increasingly health-conscious populations and the rising incidence of diabetes. Sugar-free products' flavour today is as intense as that of sugared gum, and functional products provide consumers with cleaner and whiter teeth and fresher breath.

Competition for the confectionery sector arises from the growing popularity of healthier snacks, with consumers trying to accommodate increasingly busy lifestyles with healthy eating. Thus, while confectionery manufacturers strive to improve the health credentials of their products, producers of healthy snacks aim to reinforce the flavour and tastiness and thus the indulgent nature of their products.

In terms of confectionery manufacturing, Argentina benefited from an influx of foreign direct investment (FDI) and mergers and acquisition (M&A) activity during the 1990s, which has promoted consolidation, technology upgrades and significant productivity gains. The market is dominated by domestic company **Arcor**, one of the world's largest confectionery manufacturers, which is active in all three confectionery sub-sectors. Arcor works in co-operation with Nestlé and has over recent years entered into a number of production and distribution agreements with the multinational.

Arcor's closest competitors are **Cadbury Stani**, which acquired domestic chocolate brand Mantecol in 2001, adding 10% to its market share, and Kraft Foods Inc. Following its 2001 acquisition, Cadbury today controls three of the ten leading Argentinean confectionery brands – Mantecol, a peanut paste and chocolate-based sweet which has no direct competitors and is the sixth most popular confectionery product in the country, Beldent, the country's most popular chewing gum, and Bazooka bubble gum.

The chewing gum sector is led by Cadbury, with a share of around 65%, following its acquisition of Adams, and Arcor, with a share of around 30%. Overall, Argentina's confectionery industry consists of around 120 companies, mainly small and medium-sized players. The five leading operators are, however, dominant, with a combined market share of 78%.

Brazil is not only the most important confectionery sales market in the region, but the country is also the world's third-largest producer of sugar confectionery and the world's fifth-largest producer of chocolate confectionery, according to trade association ABICAB.

Domestic production reached around 500,000 tons of candies and sweets and 350,000 tons of chocolate in 2006. The country's strong position in terms of confectionery production is a result of an influx of foreign manufacturers during the late 1990s, which have set up production facilities to supply both the Brazilian and neighbouring markets. Examples include **FINI** (Spain), Perfetti (Italy), Canel's (Mexico) and Arcor (Argentina). As a result, the market is strongly competitive and profit margins are comparatively low. The industry is predominantly based in the south of the country, with the state of Sao Paulo hosting more than 50% of manufacturing facilities.

The leading player in the overall Brazilian confectionery market is Argentina's Arcor Group. **Arcor do Brasil** operates two production plants, a chocolate facility in Bragancy Paulista and a sugar confectionery and chewing gum facility in Rio das Pedras. The company offers more than 50 brands across product categories in Brazil, with popular brands including Sambapito, Big Big, Poosh, Samba, Blow Up and Tortuguita.

Further important players include **Cadbury Adams**, with a market share of around 14% and main brands such as Trident, Ping Pong Ploc, Clorets and Plets. Cadbury Adams is followed by **Nestlé Brasil Ltda,** with a market share of around 10%, and leading brands including Especialidades Mentex, Nestlé Classic, Alpino, Chokito, Nextle, Galak, Nescau, Seducao, Milkybar, Crunch, Charge and Magic. Ranked third is **Kraft Foods Brasil SA**, with a market share slightly below Nestlé's, with the most popular brands including Bis, Lacta, Sonho de Valsa, Diamante, Negro, Confeti, Ouro Branco, Trakinas, Lancy, Brek and Pascoal. In the chewing gum sub-sector, Cadbury dominates.

Chocolate represents by far the largest sector by value, accounting for more than two-thirds of sales, while sugar confectionery accounts for the bulk of volume sales, with an estimated share of 56%.

In the chocolate confectionery sub-sector, one of the most important companies is **Garoto** which, since 2002, has belonged to Nestlé. Overall, Nestlé is estimated to hold a share of around 62% of Brazil's chocolate confectionery market and also has a strong position in the sugar confectionery sub-sector. Nestlé's closest rival in the chocolate sector is **Lacta**, a division of Kraft Foods, which owns Laka, the country's favourite white chocolate brand and the Sonho de Valsa line of praline products.

These companies' strong position is a result of Brazilian consumers' preference for established brands like Nestlé's Classic and Kraft's Lacta, Sonho de Valsa and Bis. Manufacturers are accommodating this preference by launching brand extensions, as well as new flavours and new categories under popular and established brands.

The Mexican confectionery industry is another interesting regional example. The local industry is characterised by the presence of a number of multinationals, but also features a large number of domestic producers including most prominently **Grupo Bimbo**, and its sister companies **Barcel** and **Ricolino**. The company has invested significantly in its manufacturing facilities over recent years, increasing capacity in San Luis Potosi alone by 35% with a focus on increasing export sales. Ricolino has strategic partnerships with Wrigley's and Argentinean chocolate producer **Bon Bon** and, in 2004, acquired **Joyco de Mexico** and **Alimentos Duval y Lomelin**.

Smaller domestic players include **Montes Group**, and **Chocolatera de Jalisco**. Overall, the industry is estimated to comprise around 1,500 players. However, multinationals Nestlé, Masterfoods and Hershey's account for around 57% of the chocolate confectionery sector, while Cadbury leads the chewing gum category following its acquisition of Adams, with a 60% market share in volume terms. The company is also a strong player in the sugar confectionery sub-sector owing to its range of medicated confectionery brands.

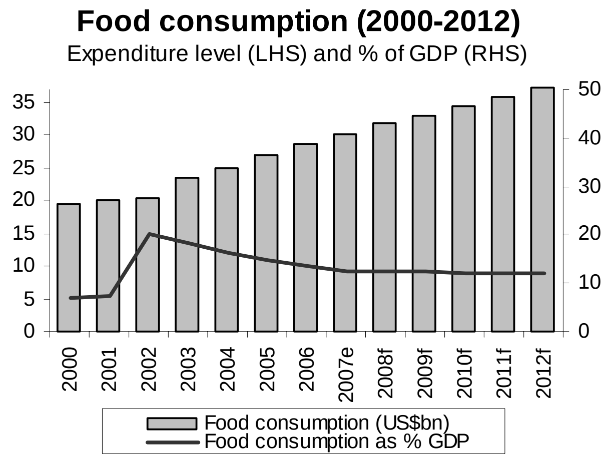
Mexican confectionery producers benefit from strong export sales, particularly to the US, where they cater for the growing number of Hispanic consumers. Examples include: **Dulces Beny**, which exports marshmallows, chewing gum and hard candy lollipops; **Cuanda SA de CV**, which specialises in sugar confectionery and gelatin gummies and exports spicy candies and other sweets; **Dulces de la Rosa**, which supplies marshmallows, tamarind, chocolate, lollipops, gum, hard candies, fruit chews and cookies and wafers; and **Alegro Internacional**, with a focus on lollipops and bubble gum.

Another important Mexican producer with a strong presence in the US is Canel's, which specialises in chewing gum and bubble gum, hard and soft candy, lollipops, marshmallows, jellies, caramel milk lollipops and candy and cough drops.

Exporters benefit from the trend towards exotic confectionery flavours in developed markets, with Latin American products ideally placed to satisfy the growing demand. Examples include candies from fruit pulp, nut pastes or tamarind; chilli, mango, lime and scorched rice flavours; and products that, based on their ingredients, cool, heat, tingle, or trigger salivation.

# Industry Forecast Scenario

## Food




*e/f=BMI estimate/forecast. Sources: Central Bank of the Republic of Argentina, National Institute of Statistics and Census, estimates*

The food and drink industry, similarly to MGR, is benefiting from the Argentine economy's recovery, which has increased the sales of higher quality and premium products in particular. Many manufacturers have, over recent years, increasingly focused on export markets in an attempt to counteract declining domestic demand during recession. While the principal export destinations of Brazil, the US, Chile and China receive almost 50% of Argentina's food and drink exports, new markets in Asia are beginning to buy from the sector in greater quantities. The export destination profile is now gradually moving away from Latin America and the US and more towards China and other Asian countries.

Export sales do, however, remain vulnerable to drops in commodity prices and re-evaluations of the currency, making it vital for manufacturers to take advantage of developing domestic opportunities as the economy continues to recover.

The government's efforts to curb inflation also continue to have an impact on Argentine food and drink producers. While in the domestic market operators such as **Danone** have entered into price-freezing agreements with the government, the beef sector in particular has been subject to more direct government intervention. The government did, for example, impose a 180-day ban on beef exports in order to halt the upward trajectory of beef prices in local markets. These measures, while potentially effective in the short term, do not address the root causes of inflation, and in some instances may contribute to them. With beef, for example, an export ban would reduce the incentives for producers to raise cattle, which could eventually lead to a decrease in production and, therefore, lower supply – potentially generating further inflationary pressures. Moreover, beef accounts for over US$1bn in export revenue. The loss of this revenue thus has a noticeable effect on the export sector, and, in turn, on the economy's growth prospects.

The government's interventionist approach involving export taxes, price controls and export bans will have the largest impact on the country's private sector – the same companies that have been pushing the economic recovery since 2002. Moreover, such moves damage Argentina's attractiveness to domestic and international investors – something that has already been undermined by spiralling inflation.

One sector that has developed well and is forecast to further expand over the forecast period is the confectionery sector. Over the 2000 to 2006 review period, confectionery value sales in Argentina increased by 20%, with sales development between 2000 and 2002 having been negatively influenced by the severe recession of these years. In 2006, 66% of the overall market was accounted for by chocolate confectionery, followed by sugar confectionery and gum with market shares of 26% and 8% respectively. Over the forecast period to 2012, we expect very strong value sales, with sales having recovered rapidly, driven by new product developments and the increasing penetration of multinational brands.

Consumers, encouraged by a more stable economy, are again willing to indulge themselves with premium products and have started to gradually abandon the conservative purchasing habits of the crisis years, during which purchases were often limited to the absolutely necessary. Since 2004, the overall Argentinean food market is influenced by consumers' increasing health consciousness, with a growing preference for organic, low-fat and sugar-free products, and this has also been reflected in sales developments and trends in the confectionery sector.

Similarly, canned food sales can be expected to increase over the forecast period as the economy recovers and disposable incomes start to slowly increase again.

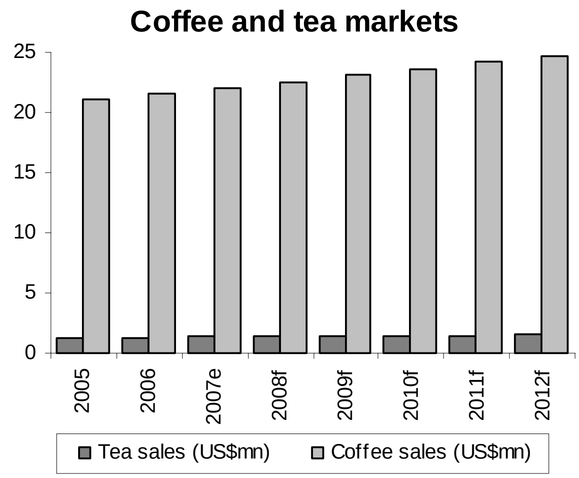
**Table: Argentina Food Consumption, Category Sales & Sector Trade Indicators - Historical Data & Forecasts**

| | 2005 | 2006 | 2007e | 2008f | 2009f | 2010f | 2011f | 2012f |
|---|---|---|---|---|---|---|---|---|
| Food consumption (US$bn) | 26.8 | 28.6 | 30.0 | 31.7 | 33.1 | 34.5 | 35.9 | 37.3 |
| Food consumption (ARSbn) | 77.9 | 87.6 | 94.9 | 104.7 | 113.8 | 123.3 | 132.8 | 143.8 |
| Per capita food consumption (US$) | 692.5 | 731.5 | 760.1 | 794.9 | 820.9 | 846.2 | 871.6 | 898.7 |
| Food consumption as % GDP | 14.6 | 13.5 | 12.6 | 12.3 | 12.3 | 12.2 | 12.1 | 12.0 |
| | | | | | | | | |
| Canned food sales (000 tonnes) | 55.7 | 56.6 | 57.3 | 58.0 | 58.6 | 59.2 | 59.8 | 60.4 |
| Canned food sales (US$mn) | 133.4 | 139.7 | 144.6 | 148.9 | 153.3 | 158.0 | 163.1 | 168.1 |
| | | | | | | | | |
| Confectionery sales (000 tonnes) | 155.9 | 159.7 | 163.0 | 165.4 | 167.8 | 170.2 | 172.5 | 175.0 |
| Confectionery sales (US$mn) | 1,417.5 | 1,606.5 | 1,797.6 | 1,999.4 | 2,221.4 | 2,470.9 | 2,752.4 | 3,061.8 |
| | | | | | | | | |
| Exports (food, drink & tobacco) (US$mn) | 6,054.4 | 6,462.6 | 6,677.2 | 6,692.7 | 6,678.5 | 6,679.1 | 6,678.7 | 6,652.0 |
| Imports (food, drink & tobacco) (US$mn) | 458.8 | 490.9 | 517.0 | 537.8 | 559.6 | 583.2 | 608.6 | 634.2 |
| Balance (US$mn) | 5,595.6 | 5,971.8 | 6,160.2 | 6,155.0 | 6,118.8 | 6,095.9 | 6,070.1 | 6,045.8 |

*e/f=BMI estimate/forecast. Source: Central Bank of the Republic of Argentina, National Institute of Statistics and Census, BMI*

# Drink

Like other product categories, sales of coffee and tea have over recent years been influenced by economic turmoil in Argentina and decreasing disposable incomes. Consumers have been looking for cheaper products, and manufacturers have started to introduce smaller pack sizes. Sales should see modest value growth over the forecast period, as the economy recovers. Retailers' own-label products will benefit here also, as consumers now have a more favourable view of them as economically-priced and of acceptable quality.




*e/f=BMI estimate/forecast. Sources: Central Bank of the Republic of Argentina, National Institute of Statistics and Census, estimates*

Alcoholic drinks sales in 2001 and 2002 suffered from devaluation, recession and changes in consumer habits. In response to these trends, several manufacturers introduced smaller packaging units. With the economy now on a path of recovery, sales – as well as product sizes – can be expected to increase.

The value of soft drink sales during 2001 and 2002 was also influenced by higher prices and, at the same time, consumers trading down to cheaper products. We saw value sales continue to increase during 2007, with consumers increasingly looking for branded products, as the economy recovers and new products, such as **Coca-Cola**'s Dasani bottled water brand, are launched. With price controls for the drinks sector having now been extended through to December 2007, we expect this to continue.

**Table: Argentina Beverage Sectors - Value/Volume Sales - Historical Data & Forecasts**

| | 2005 | 2006 | 2007e | 2008f | 2009f | 2010f | 2011f | 2012f |
|---|---|---|---|---|---|---|---|---|
| Coffee sales (US$mn) | 21.0 | 21.5 | 22.0 | 22.5 | 23.1 | 23.6 | 24.1 | 24.7 |
| Tea sales (US$mn) | 1.3 | 1.3 | 1.3 | 1.4 | 1.4 | 1.4 | 1.5 | 1.5 |
| | | | | | | | | |
| Alcoholic drinks production (mn litres) | 2,873.7 | 3,003.0 | 3,132.2 | 3,257.5 | 3,387.7 | 3,523.2 | 3,664.1 | 3,810.6 |
| Alcoholic drinks sales (mn litres) | 2,420.0 | 2,498.7 | 2,583.4 | 2,663.6 | 2,753.8 | 2,849.6 | 2,947.4 | 3,048.6 |
| Alcoholic drinks sales (US$mn) | 2,684.2 | 2,859.2 | 3,101.1 | 3,284.6 | 3,494.7 | 3,732.0 | 3,978.1 | 4,240.4 |
| Beer sales (mn litres) | 1,356.0 | 1,396.7 | 1,438.6 | 1,467.4 | 1,496.7 | 1,526.3 | 1,556.6 | 1,587.6 |
| Beer sales (US$mn) | 1,925.5 | 2,025.2 | 2,129.1 | 2,215.8 | 2,304.9 | 2,411.6 | 2,515.8 | 2,624.7 |
| Wine sales (mn litres) | 1,040.0 | 1,075.0 | 1,115.0 | 1,165.0 | 1,225.0 | 1,290.0 | 1,357.4 | 1,428.4 |
| Wine sales (US$mn) | 613.6 | 655.8 | 769.4 | 850.5 | 955.5 | 1,070.7 | 1,201.4 | 1,348.0 |
| Spirits sales (mn litres) | 24.0 | 27.0 | 29.8 | 31.2 | 32.1 | 33.3 | 34.4 | 35.5 |
| Spirits sales (US$mn) | 155.0 | 178.2 | 202.6 | 218.4 | 234.3 | 249.8 | 267.1 | 285.6 |
| | | | | | | | | |
| Soft drinks sales (US$mn) | 6,879.7 | 7,204.6 | 7,442.8 | 7,632.7 | 7,810.2 | 8,000.0 | 8,205.7 | 8,406.1 |

*e/f=BMI estimate/forecast. Source: Central Bank of the Republic of Argentina, National Institute of Statistics and Census, BMI*

# Industry Developments

## Food

- In October 2007, Mexican bakery group Grupo Bimbo announced that an attempt by creditors to force **Compania de Alimentos Fargo**, its Argentinean subsidiary, into Chapter 11 bankruptcy has been dismissed by a US bankruptcy court. The Chapter 11 petition had been filed by a group of bondholders, representing around 60% of Fargo bonds, with the Southern District of New York Bankruptcy Court in September 2007. 'Diverse claims and requests against Grupo Bimbo and its affiliates' had also been dismissed. Grupo Bimbo spokespeople did, however, confirm that Fargo remained bound by Argentine 'concurso' bankruptcy proceedings, a status that had commenced in 2002.

- Also in October 2007, dairy producer **Milkaut** announced plans to expand its balanced foods plant in Colonia Nueva in Santa Fe province in co-operation with Dutch company **Alimental**. A new production line will be installed.

- In a report published in late 2006, the OECD contends that an increasing rate of urbanisation in developing countries will create an inflated global demand for meat and processed foods for the next 10 years – with significant consequences for, among other nations, Argentina. The growing market opportunities in certain developing countries will cause the production and export of farm commodities to shift away from developed OECD countries and more towards other developing economies. Argentina's comparative advantages in the beef and cereals (wheat and coarse grains) sectors will stand it in good stead, though it should beware of increasing upcoming competition in the cereals sector in particular – most likely from the Ukraine and Kazakhstan, according to the report. Global yields for wheat will have to rise by at least 1% a year during the period 2006-2015, to meet demand.

## Drink

- According to figures released by **Corporacion Vitivinicola Argentina**, bottled wine exports will have increased 37% y-o-y during 2007, based on the results of the first seven months of the year. Argentina's wine industry was thus on target to have achieved in excess of US$400mn of exports in 2007, compared with US$215mn in 2006. By 2020, the trade association expects export value to reach US$2bn. Export sales growth has been driven by the rising popularity of Argentine wine in the US, the UK, and Canada in particular.

- In May 2007, the European Council of Ministers granted Argentine wine producers a stay of execution over their right to sell wines containing malic acid in the EU, which is banned in EU wine production. Producers and the European Commission (EC) now have until January 2009 to enter into a comprehensive wine agreement, before a sales ban of Argentine wines containing malic acid will, theoretically, come into force. According to industry experts, an agreement is, however, unlikely without the conclusion of a wider deal on food and drink trade restrictions under the WTO's Doha round of trade negotiations.

- The EC agreed in October 2006 to widen EU low-duty quotas for Argentine exporters of wine, vermouth and fruit juices under a new EU-Argentina trade deal. Framed to take account of previously existing trade agreements involving the 10 Eastern and Southern European countries that joined the EU in 2004, the additional annual import quotas include: 40,000 hl of wine at EUR10 per hectolitre (hl) in duties and 20,000 hl of wine at EUR8/hl; 13,810 hl of vermouth at EUR 7/hl; and 7,044 tonnes of fruit juices at a 20% tariff.

- **Quilmes International** (Quinsa)'s 2006 FY operating profit reached US$363.6mn, a y-o-y increase of 32.7%, while sales increased by 21.6% y-o-y to US$1.16bn and net income increased by 24.1% to US$200.5mn. Beer volume sales increased by 8.5% y-o-y to 17.9mn hl, while soft drink and water volume sales reached 10.7mn hl, a y-o-y increase of 25.9%. Quilmes owns Argentina's top-selling beer brand and is responsible for 100% of **PepsiCo** beverage sales in Argentina and Uruguay. For H107, the company reported a 19% y-o-y increase in sales to US$621.2mn, while operating profit for the six months reached US$198.5mn, a y-o-y increase of 24.8%. In Argentina, beer net revenues increased 11% y-o-y to US$231.5mn, while soft drinks net sales reached US$167.3mn during H107, a y-o-y increase of 25.7%. Price increases in the Argentinean market had offset cost increases of certain raw materials, including malt, cans, and energy, and labour.

- During 2007, Argentinean brewer Quilmes Industrial planned to invest US$100mn into increasing production, expanding the sales network, and increasing spending on technological innovation and human resources. US$11mn was to be invested into a soft drinks plant in Zarate near Buenos Aires, which produces PepsiCo brands and, after the investment, would have an annual capacity of 1mn hl.

- In April 2007, **AmBev** gave up further attempts to buy the remaining shares in Quinsa via its subsidiary **Beverage Associates Holding**. The brewer's attempts had been opposed by a number of minority shareholders who claimed that AmBev was not offering a fair price for their shares.

- In July 2007, **Coca-Cola de Argentina** filed a criminal complaint under the country's Unfair Trade Practices statute against executives at **Aguas Danone de Argentina** and **Euro RSCG Buenos Aires**. Coca-Cola claims that the persons named in the suit 'orchestrated and executed a widely circulated two-year internet smear campaign that included the dissemination of false statements against the Dasani water brand'. According to Coca-Cola spokespeople 'these malicious actions, which called into question the quality of Dasani, have misled consumers and negatively impacted the reputation and image of the brand and Coca-Cola de Argentina. Dasani is absolutely safe and meets all quality standards and requirements established by the Argentine government and the WHO'. The spokespeople expressed faith in the Argentine legal system and were confident about a favourable decision.

- **New Patagonia Brewery** teamed up with **Aladdin Beverages** in April 2007 in order to distribute its Antares premium beer brand in the US. The brand is already available in Canada, Germany, Australia, South Africa and Brazil, and a launch in Japan is also planned.

- In October 2006, the Argentinean government extended price controls for the beverage sector until December 2007 with the aim of bringing inflation under control.

# Market Overview

## Agriculture

Based on its strong agricultural sector, Argentina is the world's eighth-largest food producer and the fifth-largest food exporter. The industry benefited substantially from an influx of FDI during the 1990s, leading to consolidation, modernisation and improved production efficiency. Many well-known multinational operators became established in the market as a result. The period was also characterised by a number of mergers and acquisitions, mainly in the dairy, confectionery and edible oil sectors.

At present, around 50% of companies in Argentina are in some way involved in the agri-food sector, and agri-foods account for 59% of exports, 12.4% of GDP and generate 11% of employment. The main export markets are neighbouring countries, the countries of the North American Free Trade Agreement (NAFTA) and the EU.

Argentina is the world's seventh-largest producer of milk and dairy products. Several international players are active on the market, including Denmark's **Arla Foods**, France's Danone, Switzerland's Nestlé and **Fonterra** of New Zealand, which have all signed technology transfer agreements and entered into joint ventures with domestic operators. Most domestic companies have become highly competitive following the currency devaluation of January 1 2002, and have been increasingly focusing on export markets.

Both milk production and dairy exports are expected to reach record highs in 2006, driven by the ongoing recovery in production, competitive production costs and strong international demand, with the latter being influenced by declining EU production and growing demand from Asia in particular. Argentine dairy processors are mainly investing in the expansion of their dry milk production and cheese processing facilities and a further consolidation of the sector is expected for coming years, with multinational operators forecast to take over medium-sized and large domestic companies.

Of particular significance is the meat processing industry, with an estimated annual production value of US$10bn. Most companies in this sub-segment are small to medium sized; the main exporting companies are **CEPA**, **Swift Armour**, **Quickfood**, **ABC**, **Friar** and **Finexcor**. Swift accounts for 75% of Argentina's meat exports to the US, with exports bringing in 70% of group revenues.

In 2006, meat exports were expected to reach record highs of up to 720,000 tonnes, the highest level in history, and Argentine meat exporters were operating close to full capacity. Export growth is driven by the opening up of new markets, such as Russia, and is supported by high sanitary standards and competitive prices. Where domestic demand is concerned, Argentines continue to be the world's largest per capita beef consumers and total domestic consumption is forecast to reach around 2.3mn tonnes for 2006. According to data supplied by the Argentine Beef Promotion Institute (IPCVA), per capita beef consumption is 68kg, with 25 meals a month containing beef. Around 50% of households eat beef between five and seven days a week, with short ribs, ground beef and knuckle being the most popular cuts, and breaded veal, steaks, barbecue and stews being the most popular beef dishes. The strong export demand is expected to lead to higher domestic beef prices, which might alter the composition of beef products purchased domestically, with cheaper cuts and dishes increasing in importance.

Argentine poultry production, consumption and exports have also been increasing over recent years, with production expected to reach around 1.2mn tonnes in 2006 and exports to reach around 150,000 tonnes. Similarly to the beef sector, export growth has been stimulated by the opening up of new markets and competitive prices, and further export growth can be expected once the US market opens for Argentine exports. In preparation, local poultry producers have recently invested significantly in the sector and there are around 43 officially inspected poultry plants operating in the country, mostly under local ownership. Domestic demand has been increasing, especially since the high export demand for beef has led to rising domestic beef prices, but also due to consumers' increasing health consciousness.

The Argentine fisheries sector was of minor importance for the economy until the early 1990s. From then onwards, it has, however, been developing rapidly, with the main focus being on export markets and, in 2000, the United Nations Environment Programme (UNEP) categorised Argentine fisheries as the world's fastest-growing fisheries. This development has led to extensive over-fishing and, following a peak in production between 1995 and 1997, a depletion of many fish stocks in Argentine waters could be observed, reflected in declining production numbers. The sector is characterised by a strong foreign presence for historical reasons. At the beginning of the 1990s charter agreements were signed with fleets from Asian countries for the capture of squid and Argentina agreed to the operation of European companies in the form of nationally registered temporary companies or joint ventures. Further agreements signed with the EU meant that European vessels are now established nationally as local ships and companies. Fish processing is mainly concentrated in the Mar del Plata region of Buenos Aires and in Patagonia, and consists of around 240 mostly small- to medium-sized processing plants and around 80 co-operatives. Fish consumption in Argentina is limited, owing to cultural factors and the comparatively high price of fish, and only accounts for around 10% of production. Middle- and upper-income consumers have, however, increased their fish consumption in recent years.

## Food

Argentina's food processing sector is characterised by the presence of a number of strong domestic and multinational players, with consolidation being comparatively high owing to mergers and acquisitions between domestic players as well as the acquisition of domestic operators by foreign multinationals or financial funds.

During the years of economic crisis, many producers introduced cheaper second and third brands alongside their more expensive flagship brands, and also became increasingly involved in producing private label products for the country's mass grocery retail chains.

While traditionally, domestic producers focused on their home market, the currency devaluation of 2002 encouraged many to expand export sales, which today account for a significant proportion of sales. Domestic consumption started to pick up again in 2004, and during 2006 and 2007 sales growth was mainly driven by the strong spending behaviour of Argentinean consumers, who experienced increasing wealth and rising disposable incomes.

An important food producer is **Molinos Río de la Plata**, which has leading positions in the sub-segments of oils and margarines, flours, baked goods, desserts, jams, processed meats and vegetables, teas, rice and pasta. Molinos produces 600,000 tonnes a year of output, which includes 580 different products. The group's assets include two edible oil production plants; four pasta production plants; one plant producing *yerba mate*, rice and breadcrumbs; a plant producing cake and gelatine premixes; a facility for producing meat products; and one for producing frozen products. In addition, Molinos has a 35% stake in Argentina's leading milling company **Trigalia**, in partnership with US feed mill giant **Cargill**. Trigalia owns milling facilities in the provinces of Buenos Aires, La Pampa, Santa Fe and Chaco. Molinos is also a leading exporter of oils and pasta.

# Drink

The soft drinks sector suffered during the economic crisis, as volume sales have collapsed and many smaller operators have left the market. This was particularly the case in the juice sub-sector, where foreign products hold the largest share and volume decreases were greatest. Competition in the sector is strong, with consumers trading down and becoming less brand-sensitive as they wait for the economy to fully recover.

There are six Coca-Cola bottlers in Argentina – the Mexican owned **Coca-Cola Femsa de Buenos Aires**, **Embotelladora del Atlántico**, **Coca-Cola Polar de Argentina**, **Reginald Lee**, **Juan Bautista Guerrero** and **Formosa Refrescos** – operating 11 plants and 77 distribution centres. Coca-Cola Femsa is the country's largest bottler and holds the licence for the Gran Buenos Aires region.

The leading PepsiCo bottler in Argentina is Quilmes, also the country's leading brewer. Quilmes's subsidiary **FNC** accounts for 84% of PepsiCo beverage sales in Argentina and 100% of sales in neighbouring Uruguay. Quilmes operates soft drink bottling plants in Buenos Aires, Córdoba, Trelew and Tucumán. Quilmes also has an agreement with AmBev of Brazil to bottle and distribute the Brazilian brewer's beverages in Argentina, Bolivia, Chile, Paraguay and Uruguay.

Argentines consumed around 1,350mn litres of beer in 2006, equivalent to 36 litres per capita. Beer volumes grew by 13.8% between 2002-2006. The country's beer market is dominated by Quilmes, which had an approximate 80% market share in 2006. Aside from its six breweries in Argentina, Quilmes also has leading positions in Uruguay, Paraguay and Bolivia. Chile's leading brewer, **Compañía Cervecerias Unidas**, is ranked second, with around 14% of the market. The Chilean brewer's top product is Schneider beer, which accounted for 43% of volume sales in 2006. Other rivals include **Cervecería Argentina Isenbeck**, with an approximate 7% market share and **Cervecería Estrella de Galicia**, with less than 1% of the market.

# Tobacco

## Industry Forecast Scenario

Cigarette sales can be expected to decrease over the forecast period, on the back of increasing health consciousness and the activities of the antismoking lobby. Additionally, further tax increases can be expected, leading to higher cigarette prices for consumers.

**Table: Cigarette Value/Volume Sales - Historical Data & Forecasts**

| | 2005 | 2006 | 2007e | 2008f | 2009f | 2010f | 2011f | 2012f |
|---|---|---|---|---|---|---|---|---|
| Cigarette sales (mn units) | 35,184.5 | 34,913.0 | 34,732.3 | 34,656.6 | 34,600.7 | 34,542.1 | 34,491.1 | 34,456.6 |
| Cigarette sales (US$mn) | 6,799.4 | 7,933.3 | 9,156.0 | 10,538.2 | 10,410.6 | 10,300.1 | 10,206.2 | 9,287.7 |

*e/f=BMI estimate/forecast. Source: Central Bank of the Republic of Argentina, National Institute of Statistics and Census, BMI*

## Industry Developments

- In June 2007, Health Minister Gines Gonzalez Garcia announced a new component of Argentina's Tobacco Control Strategy under the headline 'Homes and Automobiles Free of Tobacco Smoke'. It will feature print, radio and TV advertisements as well as an educational campaign and aims to stop adults smoking in their homes and cars for the benefit of their children. Mr. Garcia called on the Congress, which still has to pass a comprehensive anti-tobacco bill first presented to it in 2005, to act. The provinces of Tucuman, Cordoba, and Santa Fe have already created smoke-free public places.

## Market Overview

Where tobacco production is concerned, Argentina is one of the major producers of both non-manufactured and manufactured tobacco in the Western Hemisphere and the country's cigarette market is the third-largest in Latin America behind Brazil and Mexico, accounting for around 15% of the region's cigarette consumption. Together with Chile and Uruguay, Argentina also has one of the highest per capita cigarette consumption figures in the region.

Since 1984, the Argentine government has been involved in trying to reduce cigarette consumption, including restrictions on tobacco advertisements. A key focus is the reduction of smoking among the young population. In 2003, the government signed the WHO Framework Convention on Tobacco Control.

The legal framework of the tobacco industry is dominated by Law 23.344, enacted in 1986. This established restrictions on advertising tobacco, cigarettes, cigars and other products for smoking. Resolution N° 422 by the Office of the Secretary of Trade, passed in 1984, sets forth the guidelines for cigarette advertising. Law 24.044, enacted in 1991, imposes monetary fines on those who infringe on the provisions of the original law.

The existing laws are considered to be weak and restricted in scope by antismoking campaigners, who claim that the 1986 law essentially codifies the tobacco industry’s ineffective voluntary advertising code and a weak health warning on cigarette packages and misses out on regulation of indoor smoking and second-hand smoke.

Cigarette production is dominated by subsidiaries of the two tobacco multinationals, **British American Tobacco** (BAT) and **Philip Morris**. They are **Nobleza Piccardo SAICF** and **Massalin Particulares** respectively, and together they accounted for around 98% of the market in 2006.

Cigarette smuggling represents a substantial problem to the tobacco industry in Argentina.

# Competitive Landscape

## Key Players

### Mass Grocery Retail

**Table: Key Players in Argentina's Mass Grocery Retail Sector**

| Parent Company | Country of Origin | 2006 Sales US$mn | Fascias | Format | Number of outlets end 2006 | Current number of outlets | Year Est. | No of employees |
|---|---|---|---|---|---|---|---|---|
| Carrefour | France | 1,400 | | | 522 | 522 | 1982 | 24000 |
| | | | Carrefour | Hypermarket | 30 | 30 | | |
| | | | Carrefour Express* | Supermarket | 118 | 118 | | |
| | | | Dia | Discount | 325 | 325 | | |
| | | | Franchises | Discount | 49 | 49 | | |
| Cencosud | Chile | 1,380e | | | 248 | 249 | 1982 | |
| | | | Jumbo | Hypermarkets | 13 | 14 | | |
| | | | Disco** | Supermarkets | 235 | 235 | | |
| Coto | Argentina | 900e | | | 99 | 99 | 1970 | 18000 |
| | | | Coto | Hypermarkets | 11 | 11 | | |
| | | | Coto | Supermarkets | 73 | 73 | | |
| | | | Coto | Convenience | 15 | 15 | | |
| La Anonima | Argentina | 400e | | | 111 | 118 | 1908 | 6000 |
| | | | La Anonima | Supermarkets | 89 | 96 | | |
| | | | Quijote | Supermarkets | 6 | 6 | | |
| | | | Best | Discount | 11 | 11 | | |
| | | | Super Quick | Convenience | 5 | 5 | | |
| Wal-Mart | USA | 300e | | | 15 | 17 | | |
| | | | Wal-Mart | Supercenter | 15 | 16 | 1995 | 6600 |
| | | | Changomas | Superstore | 0 | 1 | | |
| Casino | France | 252 | | | 38 | 38 | 1998 | 3700 |
| | | | Libertad | Hypermarkets | 13 | 13 | | |
| | | | Leader Price | Discount | 25 | 25 | | |
| Makro Argentina | Netherlands | na | Makro | Cash & carry | 15 | 15 | na | na |
| Spar Argentina | Argentina/ Netherlands | na | Spar | Supermarkets | 44 | 44 | na | |

*na = not available, e = estimate, *previously Norte, **acquired from Ahold in 2004. Source: Company information, BMI*

# Food and Drink

**Table: Key Players in Argentina's Food & Drink Sector**

| Company | Sub-sector | 2006 Sales (US$mn) | No of employees | Year Established |
|---|---|---|---|---|
| Arcor Group | Food | 1,529.2 | 13,500 | 1951 |
| SanCor Cooperativas Unidas Ltda | Dairy | 1,215e | na | 1938 |
| CCU | Beverages | 965.2 | na | 1994 |
| Quilmes | Beverages | 1,166.3 | 6,200 | 1890 |
| Nestlé Argentina SA | Food and Beverages | 920e | 2,000 | 1913 |
| Coca-Cola FEMSA | Beverages | 862e | na | 1994 |
| Molinos Rio de la Plata | Food and beverages | 1,356.6 | 3,358 | 1902 |
| Swift Armour | Food | 445e | 2570 | 1907 |
| Parmalat Argentina | Dairy and beverages | 192e | 1,200 | 1992 |
| Finexcor | Food | 141.3e | 1500 | 1960s |
| Molfino Hermanos | Dairy | 125e | 850 | 1921 |

*e = estimate, na = not available, * global figures. Source: BMI, Trade press, Company data*

# Regional Company Case Studies

## Food: Grupo Bimbo in Latin America

Grupo Bimbo, established in Mexico in 1945, is one of the world's leading baking companies and the industry leader in the Americas. It operates 72 plants in three continents, with products including packaged bread, pastries, rolls, cookies, cakes, tortillas, goat milk caramel (*cajeta*), salted snacks, chocolates and candies. Overall, Grupo Bimbo produces 5,000 products under 100 well-known brands and, among the world's largest food manufacturers, is ranked fourth behind **Unilever**, **Sara Lee** and Nestlé. By 2010, the company aims to be the world's largest bread manufacturing company, a goal that is to be achieved, at least partly, by its recent expansion into China.

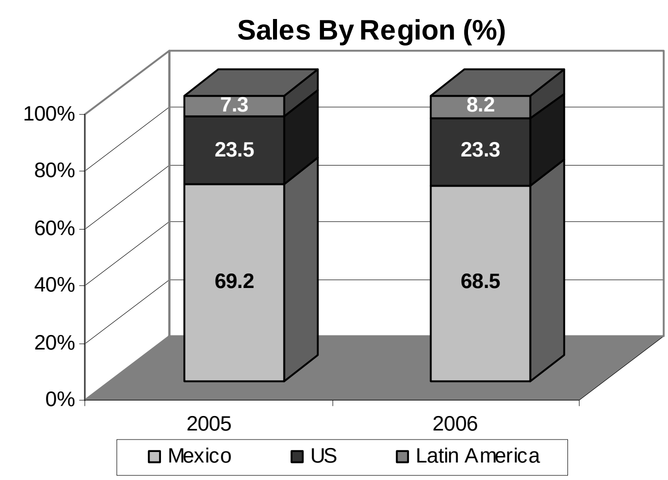
Overall sales during 2006 reached US$6.1bn, with 2007 sales estimates at US$6.5bn. In 2006, Mexico accounted for 67.8% of net sales, followed by the US with a share of 23.6% and Latin America with a share of 8.6%.

**Table: Grupo Bimbo – Net Sales 2005 vs. 2006 (US$mn)**

| | 2005 | 2006 | Growth (%) |
|---|---|---|---|
| Mexico | 3,832.0 | 4,123.8 | 7.6 |
| US | 1,300.9 | 1,404.0 | 7.9 |
| Latin America | 403.7 | 491.7 | 21.8 |
| Total | 5,536.6 | 6,019.5 | 8.7 |

*Source: Grupo Bimbo*

Grupo Bimbo's performance during 2006 was affected by a number of factors. Ongoing growth in consumer demand for healthy and nutritious options has led the company to significantly expand its product portfolio and increase the pace at which it can develop and launch new products. It also invested in brand-building efforts, which resulted in market share gains




*Source: Grupo Bimbo*

across multiple product segments. However, higher raw material costs, due to commodity cycles, speculative pricing, market demand and weather and related environmental factors, resulted in the operating margin remaining virtually unchanged from the previous year at 9.2%.

More than 1,700 new distribution routes were developed in 2006, with particular focus on expansion throughout non-traditional channels in Mexico, the traditional channel in the rest of Latin America, as well as routes for Mexican branded goods in the US.

The company continued the implementation of its ongoing turnaround plan in the US and Latin America, with efforts including optimisation of the sales mix and product portfolio, expansion and segmentation of the distribution network, and investments in manufacturing upgrades, IT systems, and other operational and administrative processes aimed at enhancing the productivity and efficiency of operations in these markets.

Overall, operating improvements are thought to have contributed most to sales growth, with recent acquisitions considered to have had no material impact on results.

Grupo Bimbo's operations are sub-divided into four divisions according to both product-related and geographical criteria and comprise Bimbo S.A. de C.V. (Mexico), Barcel S.A. de C.V. (Mexico), Bimbo Bakeries USA Inc. (US), and Organizacion Latinoamericana (Argentina).

In Latin America, the company is present in Mexico (22 locations), Argentina, Brazil, Chile, Colombia, Peru, Uruguay, Venezuela, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama.

**Table: Grupo Bimbo – Divisions**

| Division | Head-Quartered | Products | Main Brands |
|---|---|---|---|
| Bimbo S.A. de C.V. | Mexico City | packaged bread, pastries, rolls, poundcakes, cupcakes, snack cakes, cookies, packaged tortillas, toasted tortillas, wholegrain cereal bars | Bimbo, Marinela, Tia Rosa, Wonder, Milpa Real, Lara, Suandy, Lonchibon, Del Hogar, Monarca, Breddy, El Globo |
| Barcel S.A. de C.V. | Lerma, State of Mexico | salted snacks, candies, chocolate, goat milk caramel (cajeta), chewing gum, gummy candies | Barcel, Ricolino, Coronado, La Corona, Juicee Gummee, Park Lane |
| Bimbo Bakeries USA Inc. | Fort Worth, Texas, US | packaged bread, pastries, rolls, bagels, English muffins, poundcakes, cupcakes, snack cakes, cookies, packaged tortillas, prepared pizza dough | Oroweat, Mrs Baird's, Bimbo, Entenmann's, Thomas', Tia Rosa, Marinela, Francisco, Old Country, Boboli, Webers' |
| Organizacion Latinoamerica | Buenos Aires, Argentina | packaged bread, pastries, rolls, poundcakes, cookies, snack cakes, sandwich cookies, tortillas, prepared pizza dough | Bimbo, Marinela, Pullman, Plus Vita, Ideal, Holsum, Trigoro, Pyc, Bontrigo, Cena, Fuchs |

*Source: Grupo Bimbo*

**Table: Grupo Bimbo – Plants & Brands in Latin America**

| Market | Plants | Brands |
|---|---|---|
| Mexico | Mexicali & Tijuana (Baja California), Chihuahua (Chihuahua), Gomez Palacio (Durango), Mexico City, Toluca (Estado de Mexico), Irapuato (Guanajuato), Atitalaquia (Hidalgo), Guadalajara (Jalisco), Monterrey (Nueva Leon), Puebla (Puebla), San Luis Potosi (San Luis Potosi), Mazatian (Sinaloa), Hermosillo (Sonora), Villahermosa (Tabasco), Veracruz (Veracruz) | Bimbo, Barcel, Bocadin, CandyMax, Coronado, Del Hogar, Duvalin, Lara, Lunetas, Marinela, Milpa Real, Ricolino, Suandy, Tia Rosa, Wonder |
| Argentina | Buenos Aires | Bimbo, Marinela, Trigoro |
| Brazil | Rio de Janeiro, Sao Paulo, Recife | Ana Maria, Muffs, Plus Vita, Pullman |
| Chile | Santiago de Chile | Cena, Fuchs, Ideal, Marinela |
| Colombia | Bogota, Cali, Medellin, Barranquilla | Bimbo, Bontrigo, Marisela |
| Peru | Callao, Lima | Bimbo, Marinela, Pantodos, Pyc |
| Venezuela | Caucagua, Guarenas | Bimbo, Holsum, Marinela, Ricolino |

*Source: Grupo Bimbo*

In both Mexico and other markets in Latin America, Grupo Bimbo faces the challenge that a significant proportion of grocery retail sales is still via traditional, non-organised independent ‘mom and pop’ style channels. In order to increase market penetration and reach the large number of consumers shopping in these stores, the company has to serve a large number of small and very small points of sale in countries where the infrastructure in remoter regions often remains underdeveloped.

To deal with this challenge, Grupo Bimbo has developed one of the most extensive distribution networks in the world, according to company sources covering more than 1mn points of sale with over 32,000 routes and 38,000 vehicles. The company’s precise approach in each region reflects existing infrastructure and the unique requirements of each market.

A number of initiatives have been undertaken in recent years to further improve distribution. These include the SICOM advanced commercial software system, which focuses on the avoidance of overlapping delivery routes that have increasingly occurred as a result of the expansion of the product portfolio and manufacturing facilities.

In Mexico, the mom and pop channel was further segmented in order to differentiate between high-volume stores and those that carry a more limited product line with less frequent turnover. As a result, service levels could be matched to sales potential, and 100,000 new points of sale could be added in this channel in 2006.

Furthermore, Grupo Bimbo introduced the Enlace concept with the aim of improving efficiency and utilisation of its fleet. The concept consists of docking stations that connect empty trucks with re-stocked trailers, allowing drivers to reach more points of sale without returning to the distribution centre.

An additional distribution challenge is presented by the nature of Grupo Bimbo's products – while the confectionery and snacks products have a long shelf life, bread's shelf life is short and it needs to go from the production line directly to delivery trucks, with stores to be serviced on a daily basis. The improvement of product delivery speed has thus been a key focus of the company's operations over recent years and today retail stores are served through sales reps that manage their accounts individually.

In product terms, market research carried out by Grupo Bimbo confirmed three main trends:

- consumers in all its markets continue to seek products with higher health and nutritional value
- convenience foods that cater to working families are growing in popularity
- youngsters, particularly in Mexico and Central America, are drawn to intense flavours and sensations such as sour and spicy.

The key challenge for Grupo Bimbo is thus to offer consumers tasty, healthy, and innovative choices for every meal and every occasion, while improving the overall nutritional value of the product portfolio. In order to stay ahead of consumer tastes and consumption trends, a continuous innovation process is considered necessary. Thus, in 2006, Bimbo launched around 150 new products. To boost the health value of some products, functional ingredients such as those lowering cholesterol or enhancing mineral absorption have been added. In addition, according to company sources the salt, sugar, and fat content of many products has been lowered without compromising taste. Bimbo also created a range of portion sizes to give consumers more choice about their intake.

In addition to these company-wide initiatives, each of Grupo Bimbo's divisions followed their own strategies to increase sales.

Thus Bimbo S.A. de C.V. saw revenues in both Mexico and Central America increase, driven by higher volume sales – assisted by advertising campaigns – and higher prices, with market share growth in the cookies and bars product segments in particular. Market share in the growing cereal bars segment increased thanks to a number of line extensions, including the Multigrano Nuez Bar, Doble Fibra Bar and the new Bimbo Natura line of bars, and the launch of a new concept in the form of the low-calorie, 100%-natural Fruty Snack apple bar. Other new product launches included Bimbo Bites mini muffins and Lonchibon Stilo salads.

On the production side, a new cookie line was started up in the Toluca plant and the company began to produce bread in Guatemala. In distribution, new routes were opened and productivity in the network was enhanced by leveraging new models such as standalone distribution centres and on-route restocking, further segmentation of the traditional mom & pop channel and strengthening of relationships with supermarkets.

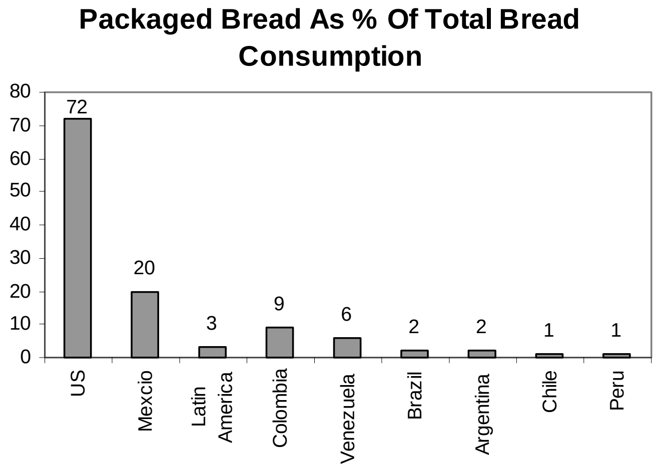
Barcel S.A. de C.V.'s revenue growth during 2006 was driven by good performance in salted snacks and confectionery, with exports to the US having increased significantly. To address the growing demand for healthier snacks, the company launched the Applix fruit snack, Chip's low-sodium, and Nubes baked snacks. Productivity increases were achieved through a consolidation of production facilities by closing two plants, and by inaugurating a new salted snack facility in Hermosillo, Sonora. In addition, the distribution strategy was fine-tuned and new routes were opened, allowing further expansion of reach into the traditional segment and specialised channels.

Organizacion Latinoamerica experienced a significant increase in sales volumes, mainly owing to an expansion of the client base by 35%, achieved through stronger penetration of the traditional mom & pop channels of the individual markets within the region. This was achieved in what the company describes as a cost-effective way – using local distributors and thus benefiting from their local knowledge and relationships.

Bimbo's largest market in the region, Brazil, reached profitability in the second half of the year, with the majority of distribution now outsourced. In Colombia and Uruguay, the focus was on the integration of recent acquisitions. These included Los Sorchantes, a leading regional baking company located in Montevideo, and Productos Roma in Medellin, Colombia, a transaction aimed at extending coverage in the country, where mountainous terrain makes transportation of products by land difficult. Operations in Argentina focused on cutting costs by optimising the product portfolio and controlling distribution costs.

Grupo Bimbo's strategies for the Organizacion Latinoamerica division include the generation of further growth through improved physical distribution, acquisitions, and new product launches, as well as the lowering of distribution costs through accelerating geographic coverage. During 2007, the division continued to pursue double-digit growth through still further penetration of the traditional channel, investments in brand development, and targeted capacity expansion.

A particular challenge to overcome in Latin America is the low per capita consumption of packaged bread, and the low penetration of packaged bread compared to overall bread consumption, as well as distribution difficulties in large markets with underdeveloped infrastructure in remoter regions.




*Source: Grupo Bimbo Analyst Presentation*

Most recently, in September 2007 Grupo Bimbo entered into a strategic alliance with Arcor to create one of the largest confectionery plants in Latin America, the Mundo Dulce plant located in Toluca, State of Mexico. The alliance aims to co-ordinate the two companies' production and distribution expertise in order to meet market demands more efficiently. The plant features 14 production lines with an installed capacity of 35,000 tons per year, and produces more than 150 different confectionery products for the Mexican, US and Central American markets.

In order to meet demand for healthier products, Bimbo also formed a strategic alliance named 'Food Innovation' with **Grupo Lala**, Mexico's leading dairy company. The first product launches in 2006 were Cer Ok! and Cer Ok! Light – packaged cereals with milk products.

Grupo Bimbo looks set for further growth, although H107 profits have been negatively influenced by rising raw material costs in Q207 in particular. Operating profit for the six months reached US$228.7mn, a y-o-y increase of only 1.7%, while earnings from the Mexican business, which accounts for more than 90% of profits, decreased by almost 4% y-o-y owing to higher raw material and distribution costs.

Turnover did, however, increase by 8.7% y-o-y to US$3.2bn, driven by rising sales across markets, with sales in Latin America outside of Mexico having increased in particular.

Overall, Grupo Bimbo plans to carry on the vigorous growth for which it has been known over recent years, both nationally and internationally, through direct investments and new acquisitions.

## Mass Grocery Retail: Falabella In Latin America

The planned merger between Chilean retailers **SACI Falabella** and **Distribución y Servicio SA** (D&S), announced in May 2007, is the culmination of a success story that started in 1889 as a tailor's shop and has since developed into a strong regional player with activities across a number of business segments. The deal, if approved by Chile's competition regulator, will create Latin America's third-largest retail group behind **Walmex** in Mexico and Carrefour's operations in Brazil, Colombia and Argentina, and the region's largest locally-owned retailer in sales terms.

From its humble origins, Falabella first developed into a clothing store and, by 1958, into a department store. From the 1980s onwards, developments sped up, with important milestones being the introduction of the company-own CRM credit card in 1980; the move into the shopping mall sector in 1990; the start of internationalisation, with market entry in Argentina in 1993, Peru, through the acquisition of **Saga**, in 1995, and Colombia, through the merger with **Sodimac**, in 2003; and the creation of travel and insurance divisions from 1997. Today, Falabella's business rests on six pillars: department stores, home improvement, grocery retail, retail finance, banking, and real estate. Recent years have been characterised by efforts to consolidate the six pillars with the aim of developing synergies and integrating best practices between countries and areas of business.

**Table: SACI Falabella – Company Structure**

| | Department stores | Home improvement | Food retail |
|---|---|---|---|
| | Falabella | Sodimac | Tottus San Francisco (supermarkets and hypermarkets) |
| Argentina | 7 | 0 | 0 |
| Chile | 36 | 56 | 16 |
| Peru | 11 | 3 | 4 |
| Colombia | 1 | 10 | 0 |

*NB In addition, Falabella holds real estate in the form of 8 Mall Plaza shopping malls and Sociedad de Rentas and, in the industrial sector, holds 100% of Mavesa, 50% of Italmod, and 20% of FASA. It also operates financial retail businesses. Source: SACI Falabella company presentation, March 2007*

Falabella's move into the grocery retail sector started in 2002, when the first Tottus supermarket was opened in Peru. In its home country, the company had plans to enter the sector via an acquisition but in 2003 was outbid by D&S when trying to acquire Carrefour's seven Chilean hypermarkets. Acquisition talks with the **Montecarlo** supermarket chain in early 2004 were equally unsuccessful, but in July of that year Falabella acquired an 88% stake in superstore chain San Francisco from the Leyton Francione family in a deal worth US$71mn. Through the deal, Falabella acquired eight superstore outlets in the metropolitan region of Santiago, which had achieved 2003 turnover of US$160mn, as well as a hardware specialist store, complementing the existing portfolio of department and DIY stores. The Chilean network was soon joined by the first Tottus hypermarket, opened in December 2005.

As early as 2005 press reports about merger talks between Falabella and leading Chilean grocery retailer D&S emerged, but plans were abandoned and Falabella announced ambitious expansion plans for its grocery retail operation, and a number of new outlets were opened during 2005 and 2006, bringing the total up to four Tottus hypermarkets in Peru, and a total of 16 San Francisco and Tottus supermarkets and hypermarkets in Chile. In February 2006, Falabella announced that the company would invest around US$27mn a year in 2006 and 2007 in order to develop the grocery retail business. Similarly ambitious investment plans were announced across business segments in March 2007, including three new Tottus hypermarkets for Peru and seven Tottus and San Francisco superstores for Chile, with a total of US$1.4bn to be invested between 2007 and 2010.

Overall, the key aim was to strengthen the retailer's presence in all business segments across the region in order to become a major regional player. Progress was, however, slower than initially envisaged and plans to expand Sodimac into Brazil and Mexico were abandoned again.

**Table: SACI Falabella – Financial Indicators (US$mn)**

| | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|
| Revenues | 1,748 | 2,166 | 3,195 | 3,787 | 4,375 |
| Net profit | 144 | 196 | 244 | 309 | 372 |
| EBITDA | 258 | 295 | 393 | 481 | 545 |
| ROE (net income / equity) % | 14.1 | 11.3 | 12.3 | 14.5 | 15.5 |
| Liabilities/equity % | 107.2 | 92.9 | 105.8 | 97.8 | 106.3 |

*Source: SACI Falabella company presentation, March 2007*

In May 2007, Falabella and D&S went public with their merger plans, which aim to create a regional retail powerhouse as well as a retail multinational to compete in a global market. According to a joint statement, the merger will provide the retailers with the critical mass to pursue a more aggressive internationalisation plan across formats and enable them to compete with other multinational MGRs.

Falabella will exchange 0.11 of each of its shares for a share in D&S and thus the merger is, in essence, a US$3.7bn takeover of D&S by Falabella. Together, the companies will have a market capitalisation of US$16bn and 2006 sales of US$7.78bn. Assets will be transferred to a new company, which will be 77% owned by Falabella and 23% by D&S. The impact of the merger is expected to be mostly felt outside of Chile, a country where the grocery retail sector has been going through a process of consolidation and takeovers for more than four years and is already very much consolidated. The two companies are, however, envisaging stronger growth in the more fragmented grocery retail markets in other Latin American countries.

Their combined power, leading to synergies in purchasing and logistics, will enable them to focus on price competitiveness, increasing their appeal with price-conscious consumers across the region. Falabella in particular will be able to further expand its presence in the grocery retail sector, which so far has only contributed around 12% to total revenues. This is of crucial importance in the retailers' strive for a stronger regional presence – successful expansion of the department store and DIY businesses is made difficult by the large income disparities still existing in many markets across the region. Falabella and Sodimac stores' offerings mainly appeal to affluent consumers, while the retailer hopes to be able to capture a broader segment of the population through expansion via the grocery retail format.

While still lagging some way behind leading regional retailer Walmex, with Latin American sales of US$28bn in 2006, Falabella's and D&S's local market knowledge and strong multi-format retail offering could well bring them close to Carrefour, at present the second-largest regional retailer with sales of US$9.5bn in 2006. The merger could, however, yet meet with serious competition commission concerns, with the regulator's decision also likely to be influenced by Cencosud's plans to merge with **Unimarc**, announced in July 2007.

## Mass Grocery Retail: Groupe Casino

French multinational grocery retailer **Groupe Casino** was established in 1898, and now operates in 14 countries worldwide, with over 9,200 outlets and consolidated net sales of EUR24.8bn in 2006. In Latin America, the retailer is active in Argentina, Brazil, Colombia, Uruguay, and Venezuela. Overall, the region accounted for around 11.4% of Casino's 2006 consolidated net sales. In addition, Casino operates 13 Smart & Final supermarkets in Mexico, part of the company's US and Mexican operations. In 2005 Casino undertook an in-depth strategic review of its entire portfolio, with the aim of focusing efforts on the most profitable and value-creating markets. The high-growth markets of Latin America were identified as being of key strategic importance, as one of the two most buoyant strategic regions in Casino's international portfolio, with a population of over 300mn and sustained economic expansion. Over coming years, Latin America is expected to be Casino's leading contributor to international sales.

**Table: Casino Group Latin America, Operations By Country, As At March 31 2007**

| | Year est. | No. of outlets | Retail banners |
|---|---|---|---|
| **Argentina** | **1998** | **61** | **Libertad (13), Leader Price (25), others (Planet consumer electronics stores, Hiper Casa DIY stores) (23)** |
| Brazil | 1999 | 550 | Extra (83), Pão de Açúcar (164), Sendas (62), DIS Barateiro/CompreBem (183), SUP Extra Perto (8), Eletro (50) |
| Colombia | 1999 | 111 | Exito (47), Q'precios (6), Ley, Pomona and others (58) |
| Mexico | 1984 | 13 | Smart & Final |
| Uruguay | 1998 | 49 | Géant (1), Disco (25), Devoto (23) |
| Venezuela | 2000 | 64 | Exito (6), Cada (39), Q'precios (19) |

*Source: Groupe Casino*

**Table: Groupe Casino In Latin America, Sales By Country, 2005**

| | Total banner sales (EURmn) | No. of employees |
|---|---|---|
| **Argentina** | **241** | **3,490** |
| Brazil | 4,853 | 62,925 |
| Colombia | 1,197 | 13,109 |
| Uruguay | 212 | 5,364 |
| Venezuela | 363 | 4,869 |
| Total | 6,866 | 89,757 |

*Source: Groupe Casino*

While the Mexican Smart & Final stores were acquired together with US outlets as early as 1984, expansion into the other Latin American markets only started in 1998, with acquisitions in Argentina and Uruguay, and the development of store networks according to the retailer's international strategy.

In Argentina, Casino acquired 75% of the shares of Argentine hypermarket chain **Libertad**, consisting of seven outlets. At the time, Libertad was the third-biggest hypermarket chain in the country. Casino initially focused on the provincial development of the hypermarket network by opening further outlets in medium-sized towns. Once this was achieved, the retailer started to introduce its Leader Price private-label products into Libertad stores and, when demand for the products had reached a certain threshold, opened the first Leader Price supermarkets in Buenos Aires. Today, there are 13 Libertad and 25 Leader Price outlets in Argentina. Libertad continues to be run as a provincial hypermarket chain, employing locals and forming partnerships with each region's small and medium-sized businesses, which has made it popular with Argentines. The Leader Price supermarkets have continued to focus on the greater Buenos Aires region and operate according to a discount concept under which a comprehensive product range is offered 20-30% cheaper than national brands.

In Uruguay, Casino acquired a 50% share in the country's leading MGR **Disco Group** in 1998 and, in 1999, the two companies opened Uruguay's first hypermarket in the capital, Montevideo, under the Géant banner. This was followed in 2000 by the takeover of the country's leading supermarket chain, **Devoto**, by Disco. All three retail banners offer a range of around 550 Leader Price products.

In Brazil, Casino initially became a minority shareholder in CBD in 1999, but in May 2005, acquired co-control of the retailer, and now owns 34.3% of the share capital, with the stake expected gradually to increase to 39%. Similarly to the market entry in Argentina and Uruguay, Casino chose Brazil's leading MGR as a partner, taking advantage of CBD's local knowledge about social and cultural diversity, and the most appropriate mix of store formats to reach a maximum customer target group. The company operates Extra hypermarkets, Pão de Açúcar and DIS Barateiro/CompreBem supermarkets, Sendas neighbourhood supermarkets, and Extra Eleto electrical household goods stores. More recently, Extra Perto convenience stores have been added to the store network.

In Colombia, Casino also teamed up with the market leader; Exito, similarly to CBD in Brazil, operates a multi-format group, having in the past merged with leading Colombian supermarket operator **Cadenalco**. In January 2006 Casino increased its holding in Exito through a block purchase of 6.3mn shares, representing 3% of Exito's share capital. The transaction represented a total investment of around EUR23mn and brought Casino's holding in Exito to 38.6%. Most recently, Casino announced in May 2007 that it intends to enter into a 30/70 joint venture with Chilean MGR Cencosud to develop a DIY and home improvement retail business in Colombia, setting the stage, potentially, to enter other Latin American markets.

Venezuela was the last Latin American country into which Casino expanded, again by teaming up with the market leader, **Cativen**, by acquiring a 50.01% share in the company. At the time of the acquisition, Cativen operated 48 supermarkets and two hypermarkets, and Casino focused on the further development of the store network, which today consists of six Exito hypermarkets, 39 Cada supermarkets, and 19 Q'Precious discount stores. Casino's Leader Price private-label brand was introduced across store formats, putting the outlets in a leading position where price and quality ranking within Venezuela are concerned.

In Q107 organic growth for Casino's Latin American operations reached 14.2%, with same-store sales up 13.5%. Net sales in the region during the quarter reached EUR678.8mn. Sales growth was mainly driven by the successfully implemented marketing strategy of CBD in Brazil with the aim of improving its price competitiveness, which led to a 5.5% increase in same-store sales since September 2006, and the success of the Extra Perto convenience store format, with four new outlets opened during the quarter. In addition, Colombia's Exito achieved double-digit growth with its assertive expansion strategy, with same-store sales during the quarter having increased by 14.4%.

# Drink: Embotelladora Andina SA

**Embotelladora Andina SA**, established in 1946 in Chile with the licence to distribute Coca-Cola in the country, is today one of Latin America's largest Coca-Cola bottlers. In addition to its country of origin, the company expanded into Brazil in 1994, and into Argentina in 1995/1996. In 2006, net income increased by 30% y-o-y to US$139.7mn. Sales volumes increased by 6.6% y-o-y to 415.1mn unit cases, while sales values experienced a y-o-y increase of 14.8% to US$1.02bn.

Similarly to other soft drinks companies whose business has traditionally focused strongly on the carbonates sector, Embotelladora Andina has, over recent years, increasingly faced the challenge of declining carbonates consumption and the growing popularity of non-carbonated soft drinks, juices, and mineral water. The further development of activities in the non-carbonates sector has thus been a key focus of operations, which overall have been characterised by growing sales volumes and values on the back of economic improvements in the company's three countries of operation.

**Table: Embotelladora Andina SA, Sales Volumes By Country (million unit cases*)**

| | Chile | | Brazil | | Argentina | | Total |
|---|---|---|---|---|---|---|---|
| | Soft drinks | Water and juices | Soft drinks | Water and juices | Soft drinks | Water and juices | |
| 2001 | 98.65 | 20.50 | 133.56 | 5.05 | 78.87 | 2.91 | 339.54 |
| 2002 | 99.65 | 18.21 | 136.19 | 5.50 | 65.93 | 2.28 | 327.76 |
| 2003 | 106.01 | 18.89 | 127.81 | 6.33 | 81.66 | 1.74 | 342.44 |
| 2004 | 109.48 | 19.97 | 133.52 | 6.00 | 93.33 | 1.83 | 364.13 |
| 2005 | 113.61 | 21.87 | 147.69 | 6.05 | 99.25 | 1.35 | 389.82 |
| 2006 | 119.00 | 24.70 | 155.40 | 7.10 | 107.50 | 1.40 | 415.10 |

** One unit case is equivalent to 5.678 litres. Source: Embotelladora Andina*

In Chile, in addition to soft drinks licenced by The Coca-Cola Company, Embotelladora Andina also produces juices and water products licensed by The Coca-Cola Company through its subsidiaries, **Vital SA** and **Vital Aguas SA**. These products are distributed in Chile by the Chilean Coca-Cola bottlers. In 2006, the Chilean market developed against a stable macroeconomic environment, with volume sales growth of 6.1% y-o-y, the best result since 1997, driven by rising private consumption. In addition to its main operations, Embotelladora Andina also produces nectars, fruit juices and energisers in agreement with **Minute Maid Co** and **Coca Cola de Chile SA** under the Vital SA fascia. The company managed to strengthen its market position, despite strong competition from b-brands, owing to a strong brand portfolio and a diversity of product formats, including cans as well as glass and PET bottles, which allow the company to segment the market and thus more effectively serve consumers' needs. Product development in 2006 focused on functional and specific products, including Powerade, Dasani Enhanced (Active and Balance), and Nectars in the 400ml and 1.5l PET formats, in response to increasing consumer demand for health and wellness products. Overall, in line with market trends, non-carbonated products increased in importance within the overall portfolio, with growth rates for water and juices reaching 23% y-o-y and 7.5% y-o-y respectively.

**Table: Embotelladora Andina SA, Operations By Country, 2006**

| | Average volume soft drinks market share (%) | Average value soft drinks market share (%) | No. of production plants | Capacity utilisation (%) | Products sold (licenced by The Coca-Cola Company) |
|---|---|---|---|---|---|
| Chile | 68.0 | 71.0 | 1 | 67.0 | Coca-Cola, Coca-Cola Light, Coca-Cola Light Limón, Fanta Naranja, Fanta Light, Fanta Mandarina, Sprite, Sprite Zero, Sprite Ice, Nordic Mist Agua Tónica, Nordic Mist Ginger Ale, Quatro, Taí, Inca Kola |
| Brazil | 55.6 | 64.7 | 2 | 72.0 | Coca-Cola, Coca-Cola Light, Coca-Cola Light Lemon, Kuat Guaraná, Kuat Guaraná Light, Kuat com Naranja, Fanta Naranja, Fanta Laranja Light, Fanta Mix, Fanta Uva, Fanta Uva Light, Sprite, Sprite Zero, Schweppes Tonica, Schweppes Citrus, Schweppes Soda, Kapo, Burn, Nestea |
| Argentina | 50.6 | 61.4 | 1 | 79.0 | Coca-Cola, Coca-Cola Light, Fanta Naranja, Fanta Naranja Light, Fanta Limón, Sprite, Sprite Zero, Quatro Pomelo Amarillo y Rosado, Soda Kin, Schweppes, Hi – C, Crush Naranja, Crush Lima Limón, Crush Pomelo Rosado |

*Source: Embotelladora Andina*

In Brazil, Embotelladora Andina operates as **Rio de Janeiro Refrescos Ltda**, and in addition to the licenced Coca-Cola soft drinks brands also distributes the Kaiser, Heineken, Bavaria, and Xingu beer brands for **Cervejarias Kaiser**, brands of Minute Maid, and the Bonaqua mineral water brand. In 2006 the company benefited from the fact that a reduction in interest rates and increases in wages led to a more than 4% increase in consumption. Sales growth and an increase in market share of around 2% were achieved through the promotion of multi-serve returnable product formats, as well as increased product availability, coverage, and volume. To ensure sustained growth for the Brazilian operations, the company also implemented a number of strategies aimed at further strengthening its presence, such as market segmentation based on consumption occasion (meals at home, entertainment outside the home, workplace, education, etc) and improved service towards emerging channels.

In Argentina, Embotelladora Andina operates as **Embotelladora del Atlantico SA**. In addition to licenced Coca-Cola soft drinks brands, it distributes Cepita, Carioca and Montefiore juices, and Cepita flavoured waters. While volume sales in the country increased during 2006, driven by an overall expansion of economic activity, margins have come under pressure as a result of union pressure on salary increases above inflation, and government-imposed price controls with the aim of fighting inflation. Sales growth was achieved through a strategy based on geographic, socio-economic, and consumption-occasion segmentation without breaching price restrictions. The company's overall market share was maintained through the use of returnable formats, and a variety of new product lines, such as Dasani.

**Table: Embotelladora Andina SA, Volume Sales By Distribution Channel, 2004 And 2005 (%)**

| | Chile | | Brazil | | Argentina | |
|---|---|---|---|---|---|---|
| | 2004 | 2005 | 2004 | 2005 | 2004 | 2005 |
| Retail establishments for takeout | 45 | 45 | 14 | 17 | 16 | 17 |
| Wholesalers, distributors | 9 | 7 | 28 | 24 | 29 | 30 |
| Supermarkets | 25 | 25 | 33 | 30 | 16 | 15 |
| Restaurants, hotels, bars | 6 | 6 | 21 | 26 | 4 | 4 |
| Convenience stores | 7 | 9 | 4 | 3 | 32 | 30 |
| Other | 8 | 8 | 0 | 0 | 3 | 4 |
| Total | 100 | 100 | 100 | 100 | 100 | 100 |

*Source: Embotelladora Andina*

The company's focus for 2007 will be on further volume growth in its three countries of operation, as well as further development of the non-carbonated product segment.

Most recently, in April 2007, Embotelladora Andina announced investments of US$80mn in the strengthening of its distribution and logistical presence in Latin America. According to a company spokesperson, the funds, of which Chile will receive US$50mn, Brazil US$20mn, and Argentina US$10mn, will be used for 'operational purposes, such as market assets like bottles and cold equipments'. The company has no potential acquisitions in mind in the short term.

# Company Analysis

## Food

| Nestlé Argentina SA | |
|---|---|
| **Company Overview** | Nestlé entered the Argentine market in 1913, when the Nestlé and Anglo Swiss Condensed Milk Company started its operations. The Swiss firm now operates seven production facilities, specialising in the production of key sub-segments such as powdered milk, infant formula, cereals, hot drinks, yoghurts, desserts, cheeses, ice creams, bottled water and pet food. |
| **Strengths** | ▪ A strong multinational player able to make use of synergies and economies of scale<br>▪ Owns a large number of well-known and popular brands |
| **Weaknesses** | ▪ Full sales potential cannot be realised owing to low MGR penetration in some areas<br>▪ A significant proportion of the population is not yet used to purchasing processed food products at modern retail outlets. |
| **Opportunities** | ▪ Significant potential for growing sales and expanding the product portfolio. |
| **Threats** | ▪ Consumers' heightened awareness of the link between food and health<br>▪ Adjustments to product portfolio required in order to include more products with low salt, sugar and fat levels |
| **Strategy** | Nestlé's overall global strategy, which also applies to Argentina, is to enable better performance in the short term, while moving the group to a new dynamic of competitive advantage for the longer term, an advantage more structural than category-focused or geographic. The strategy has four pillars, including operational efficiency (supply chain, manufacturing and administration), innovation and renovation (keep products relevant to the consumer and keep ahead of competitors), evolution in consumer communication (interactive marketing) and product availability (expanding the variety of outlets through which the company's products are available). |
| **Company Data** | • Annual Sales 2006 US$920mn (e)<br>• No. of Employees 2,000<br>• Established 1913 |

| **Grupo Arcor** | |
|---|---|
| **Company Overview** | Arcor is a multinational food group with a core focus on Latin America. The company is one of the world's main confectionery manufacturers, one of the leaders in chocolate manufacturing in Latin America and the main Mercosur confectionery exporter. Arcor manufactures more than 1,500 products, including confectionery, chocolates, cookies and foods (jams, desserts, sauces, frozen foods and corn oil). It produces more than 1.5mn kg of products daily and exports to 117 countries on five continents. Grupo Arcor is made up of 10 businesses, comprising confectionery manufacturing operations, international subsidiaries and packaging, agri-industry and flavours businesses. The manufacturing network comprises 31 plants located in Latin America, 25 of which are in Argentina, two in Brazil, three in Chile and one in Peru. Arcor also operates marketing offices in the US, Canada, Mexico, Colombia, Ecuador, Uruguay, Paraguay and Spain. In Argentina, Arcor has built up more than 160 distributors and a sales force of almost 4,000, which together manage the 250,000 points of sale for its products across the country. |
| **Strengths** | ▪ One of the world's main confectionery manufacturers<br>▪ Broad range of popular brands across product sectors.<br>▪ Powerful domestic and international distribution network<br>▪ Vertical integration allows the company to keep its costs competitive |
| **Weaknesses** | ▪ Argentinean price controls affect domestic margins |
| **Opportunities** | ▪ Argentina's young and rapidly growing population offers significant sales growth potential |
| **Threats** | ▪ Rising commodity and raw material costs |
| **Strategy** | Arcor is present across the region and, over the last few years, has expanded and consolidated its position through internal growth as well as joint ventures and acquisitions. The company has a strong export focus but significant potential for sales growth inside Argentina exists also, owing to the young and rapidly growing population. It was not affected as badly as many other food companies during the recession, as much of its product line is composed of relatively inexpensive chocolate and candy/sweets. Arcor launched the first e-business channels in the Argentine food industry with arcosales.com and arcobuy.com. The B2B portals allow clients to order products directly and facilitate Arcor's export business. |
| **Company Data** | • Annual Sales 2006 US$1,529.2bn (global)<br>• No. of Employees 12,800<br>• Established 1951 |

| **Quickfood SA** | |
|---|---|
| **Company Overview** | Quickfood is one of the leading Argentine manufacturers and marketers of beef and pork products, which has become a leading brand domestically and in Latin America, Europe and the Far East. The company operates five production facilities in Argentina: in San Jorge (Santa Fe), Villa Mercedes (San Luis), Baradero (Buenos Aires) and Martínez (Buenos Aires). It also operates a commercial office in Chile. Brands include Paty, Patynesa, Faty, QF, Patyviena, Barny and Quickfood, and the company is best known for its hamburger products. |
| | |
| **Strengths** | ▪ Portfolio of well known and popular brands, both domestically and around the globe<br>▪ Argentina's largest beef exporter.<br>▪ Reputation for high quality |
| **Weaknesses** | ▪ Argentine beef consumption has recently been declining owing to a combination of lower purchasing power, changing eating habits and higher prices |
| **Opportunities** | ▪ Launch of innovative, value-added products |
| **Threats** | ▪ Rising commodity and raw material costs<br>▪ Outbreak of animal diseases, such as foot and mouth disease |
| | |
| **Strategy** | Based on its reputation for quality and the strength of its brands, Quickfood follows a global strategy that involves the frequent launch of new and innovative products. Quickfood already corners 49% of the Argentine hamburgers market and has said that it seeks to expand its share by 8-10% with the Paty Listo brand. The company's sales have, however, suffered due to Argentina's declining beef consumption – annual beef consumption is now at 60 kg per capita, from its high of 80 kg per capita in 1980, and many breeders are being forced to cut the size of herds that graze the Pampas grasslands. |
| | |
| **Company Data** | • Annual Sales 2006 US$215.4mn<br>• Established 1960 |

| **Molinos Rio de la Plata** | |
|---|---|
| **Company Overview** | Molinos Río de la Plata is Argentina's largest and oldest packaged food manufacturer, with activities ranging across 17 food sectors, including most prominently oils and margarine, flour, baked goods, desserts, jams, processed meats and vegetables, tea, rice and pasta. Since 1999, when it bought a controlling stake in the company from Bunge International, the Pérez family has held 64% of Molinos. |
| **Strengths** | ▪ Argentina's largest packaged food manufacturer<br>▪ Present across a wide variety of product sectors<br>▪ Strong international presence with exports to more than 60 countries worldwide |
| **Weaknesses** | ▪ Vulnerable to fluctuations in commodity and raw material prices |
| **Opportunities** | ▪ Increasing purchasing power in Argentina offers sales growth potential<br>▪ Further expansion of export sales |
| **Threats** | ▪ Rising commodity and raw material costs |
| **Strategy** | Molinos Río de La Plata operates internationally, with products being exported to more than 60 countries worldwide. Over recent years, the company has gone through a number of strategic acquisitions and divestments. In 2001, for example, food manufacturer Lucchetti was acquired in Argentina, while Molinos's milk unit was sold to Saputo in 2003, followed by the sale of the Russian oil unit to Bunge. The group's assets include two edible oil production plants, four pasta production plants, one plant producing yerba mate, rice and breadcrumbs, a plant producing cake and gelatine premixes, a facility for producing meat products and one for producing frozen products. In addition, Molinos has a 35% stake in Argentina's leading milling company Trigalia, in partnership with US feed mill giant Cargill. These assets, together with the activities spread across 17 food sectors, indicate a significant investment potential, with the purchasing power of Argentine consumers increasing and export markets continuing to be strong. Molinos sold its Russian premium bottled oils business Ideal to Bunge for around US$20mn in October 2004. |
| **Company Data** | • Annual Sales 2006 US$1,356.6mn<br>• Established 1902 |

## Molfino Hermanos (Saputo Group)

**Company Overview**

Molfino Hermanos is the third-largest dairy processor in Argentina and was acquired by Canada's largest dairy company Saputo in October 2003. Molfino operates two plants and employs 850 people. The company produces a great variety of cheeses, as well as butter, cream, milk and milk powder. Products are exported to North America, Latin America, Eastern Europe, the Middle East and Africa.

**Strengths**

- Third-largest dairy processor in Argentina
- Strong backing by Saputo
- Strong presence in both Latin America and internationally with a range of strong brands

**Weaknesses**

- Significant investments required if it is to become a major world dairy processor.

**Opportunities**

- Further strengthening of export sales
- Rising disposable incomes in Argentina improve sales opportunities for value-added dairy products

**Threats**

- Commodity and raw material cost increases
- Outbreak of animal diseases

**Strategy**

Within the Saputo group, Molfino Hermanos is responsible for serving the group's international clients. The Rafaela plant in Santa Fe province produces cheese, butter, cream and milk powder. The Villa María plant in Córdoba province, one of the biggest and most modern plants in South America, specialises on cheese production for EU countries, with the plant having been approved by the EU in 2003. Saputo is so far very pleased with its acquisition of Molfino Hermanos in 2003 and believes it has significant potential. The company said in September 2006 that it intends to continue its expansion, both through organic growth and targeted acquisitions in the dairy products sector. In Argentina, the company's intention is to establish a solid base because it believes it can benefit from opportunities on national and international markets in the long term. Close to US$30mn will be spent in controlled and targeted investments over the coming three years with Saputo's overall aim being to become a major world dairy processor.

**Company Data**

- Annual Sales 2006 US$125mn (e)
- No. of Employees 850
- Established 1921

# Drink

| **Quilmes Industrial SA** | |
|---|---|
| **Company Overview** | Headquartered in Luxembourg, Quilmes Industrial is a holding company that, through its subsidiary Quilmes International, distributes beer, soft drinks and bottled water across South America. Quilmes's beer brands are market leaders in Argentina, Bolivia, Chile, Paraguay and Uruguay. Quilmes Industrial holds a stake of 93% in Quilmes International, and AmBev holds 7%. |
| **Strengths** | ▪ Market-leading beer brands<br>▪ Distributor of popular and well-known soft drinks brands<br>▪ Range of strategic alliances and franchise agreements with strong multinational players |
| **Weaknesses** | ▪ Strong focus on carbonates in the soft drinks sector |
| **Opportunities** | ▪ Strong sales growth potential for premium beer brands and non-carbonated soft drinks |
| **Threats** | ▪ Increasing costs of certain raw materials and inputs, including malt, cans and energy<br>▪ Rising labour costs in Argentina |
| **Strategy** | Strategic alliances and distribution and franchise agreements form a vital part of Quilmes's strategy, with the aim to achieve synergies. The company works in a strategic alliance with AmBev and has licensing and distribution agreements to manufacture and distribute AmBev brands in Argentina, Bolivia, Paraguay and Uruguay. In return, AmBev can manufacture and distribute Quilmes's brands in Brazil. In addition, there are bottling and franchise agreements with PepsiCo, with Quilmes accounting for all of PepsiCo's beverage sales in Uruguay and more than 80% in Argentina. Quilmes, for several years, has set itself ambitious growth targets, and has achieved or even exceeded them on the basis of growing beer and soft drinks sales, higher prices and cost savings due to improvements in industrial efficiency. The company has seen rapidly rising beer and soft drink volumes across its key markets of Argentina, Bolivia, Paraguay and Uruguay in 2006 and the first 9 months of 2007. We are forecasting a revenue increase for full-year 2007 of around 12%. In 2007, Quilmes planned to invest US$100mn into increasing production and expanding the sales network. US$11mn was to be invested into a soft drinks plant in Zarate near Buenos Aires for the production of PepsiCo branded drinks, with annual capacity to reach 1mn hl following the investment. |
| **Company Data** | Annual Sales 2006 US$1,166.3mn<br>No. of Employees 6,200<br>Established 1890 |

## Mass Grocery Retail

| **Carrefour** | |
|---|---|
| **Company Overview** | Carrefour's Argentine subsidiary is the leading MGR in Argentina. The company operates three hypermarket and supermarket chains under the banners Carrefour, Carrefour Express (previously Norte) and Dia. This includes 30 hypermarkets, 118 supermarkets and 325 hard discount stores, as well as 49 hard discount franchised stores. Carrefour claims a 33% share of Argentina's supermarket and hypermarket sector. With its expansion plans for 2007 and 2008, we forecast this to rise to close to 40%. |
| **Strengths** | ▪ Market-leading MGR in Argentina<br>▪ Present across three different retail formats and thus able to cater to a variety of customer target groups<br>▪ Store formats adapted to the purchasing power of the respective catchment area |
| **Weaknesses** | ▪ Low profit margins owing to 'price leader' strategy |
| **Opportunities** | ▪ Increase in the number of outlets catering to low-income consumers<br>▪ Low MGR penetration, especially outside of Buenos Aires |
| **Threats** | ▪ Strong competition from Cencosud in particular<br>▪ Government price controls |
| **Strategy** | As Argentina recovers from the economic crisis of 1999 to 2002, Carrefour continues to focus on 'price leader' lines, promising the lowest prices. The company has also introduced club loyalty schemes as part of its strategy for growth. Overall, company development follows a 'cluster' strategy, based on developing formats adapted to the purchasing power of the catchment area. Outlets catering for lower-income groups form a large part of the new batch of stores opened in 2007. Carrefour is continuing its expansion in Argentina, which offers significant potential for further growth for existing MGRs. This is owing to a combination of low penetration in parts of the country and a large proportion of the population that still does not shop in modern outlets. Despite the price controls imposed by the Argentinean government, the retailer plans to open a total of 10 new supermarket outlets in the country and has committed to spend a total of US$144.9mn on its Argentinean operations between 2005 and 2008. FY2006 sales reached US$1.4bn, with a core profitability margin of below 1% owing to competitive pricing. In December 2006, Carrefour continued the re-branding of the Norte outlets to Carrefour Express. |
| **Company Data** | • Annual Sales 2006 US$1,400mn<br>• No. of Employees 24,000<br>• Established 1982 |

| **Cencosud** | |
|---|---|
| **Company Overview** | Cencosud Argentina is a subsidiary of the Chilean MGR Cencosud. It operates 14 Jumbo hypermarket stores, mostly located in the Gran Buenos Aires region, and 235 Disco supermarkets. The hypermarkets have a combined floor space of 110,200m$^2$. Cencosud also operates 21 DIY stores under the Easy Home banner and eight shopping malls in Argentina. |
| **Strengths** | ▪ Strong regional player with a leading position in Chile<br>▪ Present across store formats and thus able to cater to diverse customer target groups |
| **Weaknesses** | ▪ No presence in the discount store sector which caters to the country's low income groups |
| **Opportunities** | ▪ Further outlet expansion outside of Buenos Aires<br>▪ Catering for the increasing number of medium- to high-income consumers |
| **Threats** | ▪ Strong competition from Carrefour Argentina in particular<br>▪ Government price controls |
| **Strategy** | Cencosud has been expanding its presence in Argentina since March 2005, when it formalised its agreement with Dutch retailer Ahold to acquire the Disco supermarket chain for US$315mn. On completion of the deal, Cencosud became the second-largest retailer in Argentina's MGR market, with a 22% market share, and one of the most important retailers in Latin America, with estimated sales of US$3bn and a store network of 329 supermarkets, 39 homecentres, 16 shopping malls and 40,000 employees. During 2006, the company invested almost US$65mn in Argentina, building three shopping malls and six home improvement stores and, up to 2009, it plans to invest more than US$500mn on further expansion in the country. In October 2007, Cencosud announced that Q307 sales and earnings in Argentina had exceeded expectations. In June 2007, the retailer opened the new Portal Tucuman shopping centre in Yerba Buena following an investment of US$29mn. Cencosud will also invest into the Disco supermarket chain. New outlets are planned for Pinamar and Villa Gesell, and new Super Vea stores are to be opened in Cipolletti, Oran (Salta), and Manzanares. In 2008, Cencosud's Almacenes Paris department store business is to start operations in Argentina. According to banner director Pablo Castillo, US$75mn will be invested into the opening of five stores during 2008, followed by another US$70mn in 2009 in order to open seven further stores. |
| **Company Data** | • Annual Sales 2006 US$1,380mn (e)<br>• Established 1982 |

# Food & Drink Ratings Appendix

## Introduction: Revised Methodology

**BMI** has revised the methodology of its Food & Drink Business Environment Rating. Our approach has been threefold. First, we have redefined the risks rated in order to more accurately capture the operational dangers to companies operating in this industry globally. Second, we have attempted, where possible, to identify objective indicators that may serve as proxies for issues/trends that were previously evaluated on a subjective basis. Finally, we have used BMI's proprietary Country Risk Ratings (CRR) in a more nuanced manner in order to ensure that only the aspects most relevant to the industry have been included. Overall, the new ratings system – which now integrates with those of all 16 Industries covered by BMI – offers an industry-leading insight into the prospects/risks for companies across the globe.

## Ratings Overview

## Ratings System

Conceptually, the new ratings system divides into two distinct areas:

*Limits of Potential Returns*: Evaluation of sector's size and growth potential in each state, and also broader industry/state characteristics that may inhibit its development.

*Risks to Realisation of those Returns*: Evaluation of Industry-specific dangers and those emanating from the state's political/economic profile that call into question the likelihood of anticipated returns being realised over the assessed time period.

## Indicators

The following indicators have been used. Overall, the rating uses three subjectively-measured indicators, and 41separate indicators/datasets.

| Table: Limits of Potential Returns | |
|---|---|
| *Food and Drink Market Structure* | |
| Food and drink consumption per capita, US$ | Indicator denotes overall breadth of market. Large markets score higher than smaller ones |
| Soft drink consumption per capita, US$ | Indicator denotes overall breadth of market. Large markets score higher than smaller ones |
| Alcoholic drink consumption per capita, litres | Indicator denotes overall breadth of market. Large markets score higher than smaller ones |
| Per capita food consumption growth (5yr %) | Indicator denotes sector dynamism. Scores are based on total growth over our 5-yr forecast period |
| Food and drink trade balance | Indicator denotes market's natural resources and dependency on imports for food and raw ingredient supply |
| *Country Structure* | |
| Economic structure | Rating from BMI's CRR. It evaluates the structural balance of the economy; evaluating issues such as over-reliance on single sectors/markets as well as past economic volatility |
| Population size | Proxy for potential market size. Large countries are considered more attractive |
| GDP per capita, US$ | A proxy for wealth. Size of population is important, but needs to be considered in relation to spending power. High income states receive better scores than low income states |
| Market entry potential/Maturity | Subjective rating based on the level of industry development and the level and strength of industry competition in a market. Mature and/or competitive markets receive low scores |

*See Business Environment section of report for regional and country-specific ratings explanation*

| Table: Risks to Realisation of Potential Returns | |
|---|---|
| *Food and Drink Market Risks* | |
| Barriers to entry | Subjective rating based on the prevalence of industry-specific barriers that might impede investment and growth. States with many barriers receive low scores |
| Regulatory environment | Subjective rating based on the industry-specific regulatory environment and the presence of potentially restrictive legislation. Low scores reflect a regulatory environment |
| *Country Risks* | |
| Short-term economic growth | Rating from BMI's CRR. It evaluates likely growth trajectory over two-year forecast period, based on BMI's forecasts and projections of business and consumer confidence |
| Short-term financial risk | Rating from BMI's CRR. It denotes risk of currency crisis and stability of banking sector. The former would hit revenues in hard currency; the latter would curtail investment funding |
| Short-term monetary risk | Rating from BMI's CRR. It denotes the risk of inflationary pressures and interest rate fluctuations, while taking into account the position of a country's economic cycle |
| Short-term external risk | Rating from BMI's CRR. It denotes the state's vulnerability to externally-induced economic shock, which tend to be the principal triggers of economic crises |
| Characteristics of society | Rating from BMI's CRR. It evaluates impact of income distribution, poverty and ethnic division on broader stability |
| Scope of state | Rating from BMI's CRR. Low state control markedly increases security risks, thereby increasing costs in certain states |
| Institutions | Rating from BMI's CRR. It evaluates the risks to business posed by official bureaucracy, the broader legal framework and corruption |
| Market orientation | Subjective rating from BMI's CRR to denote predictability of openness to foreign investment and trade |
| Physical infrastructure | Rating from BMI's CRR. Poor power/water/transport infrastructure act as bottlenecks to sector development |
| Labour infrastructure | Rating from BMI's CRR to denote cost/availability of labour. High costs will affect risk-returns calculations |

*See Business Environment section of report for regional and country-specific ratings explanation*

## Weighting

Given the number of indicators/datasets used, it would be wholly inappropriate to give all sub-components equal weight. Consequently, the following weight has been adopted.

| Table: Weighting | |
|---|---|
| **Component** | **Weighting** |
| Limits of Potential Returns | 70% |
| - Food and Drink Market Structure | - 50% |
| - Country Structure | - 50% |
| Risks to Realisation of Potential Returns | 30% |
| - Food and Drink Market Risks | - 40% |
| - Country Risks | - 60% |

*See Business Environment section of report for regional and country-specific ratings explanation*

# BMI Forecast Modelling

## How We Generate Our Industry Forecasts

**BMI**'s industry forecasts are generated using the best-practice techniques of time-series modelling. The precise form of time-series model we use varies from industry to industry, in each case being determined, as per standard practice, by the prevailing features of the industry data being examined. For example, data for some industries may be particularly prone to seasonality, meaning seasonal trends. In other industries, there may be pronounced non-linearity, whereby large recessions, for example, may occur more frequently than cyclical booms.

Our approach varies from industry to industry. Common to our analysis of every industry, however, is the use of vector autoregressions. Vector autoregressions allow us to forecast a variable using more than the variable's own history as explanatory information. For example, when forecasting oil prices, we can include information about oil consumption, supply and capacity.

When forecasting for some of our industry sub-component variables, however, using a variable's own history is often the most desirable method of analysis. Such single-variable analysis is called univariate modelling. We use the most common and versatile form of univariate models: the autoregressive moving average model (ARMA).

In some cases, ARMA techniques are inappropriate because there is insufficient historic data or data quality is poor. In such cases, we use either traditional decomposition methods or smoothing methods as a basis for analysis and forecasting.

It must be remembered that human intervention plays a necessary and desirable part of all our industry forecasting techniques. Intimate knowledge of the data and industry ensures we spot structural breaks, anomalous data, turning points and seasonal features where a purely mechanical forecasting process would not.

# Retail Industry

There are a number of principal criteria that drive our forecasts for each retail variable:

### Mass Grocery Retail Sales

Figures for MGR sales are based, where possible, on primary government/ministry/trade association sources and official data. Where these are unavailable, MGR sales forecasts are based on a range of variables including:

- Company information about past and expected sales and market shares;
- Likely sales development based upon the future development of population, disposable incomes and general macroeconomic climate;
- Political factors (likely changes in legislation affecting the mass grocery retail sector).

### Food Consumption And Expenditure

Criteria used to aid our forecasts for food consumption and expenditure include:

- The growth or otherwise of the population and its disposable incomes, as well as the development of price indices;
- Company results and expansion plans;
- Changes in the industry/new product developments affecting the price level.

### Food, Drink And Tobacco Sales

Figures are forecasted by taking into account:

- The growth or otherwise of the population and its disposable incomes, as well as the development of price indices;
- Changes in lifestyles/general societal trends;
- Likely development of product taxation and other government measures, such as anti-smoking legislation.

### Food, Drink And Tobacco Imports And Exports

Forecasted based on the following criteria:

- The growth or otherwise of the population and its disposable incomes, as well as the development of price indices;
- Developments in domestic food, drink, and tobacco production;

- Currency exchange rate developments;
- Development of bilateral and multilateral trade agreements and negotiations, as well as political developments affecting trade.

## Sources

Sources used in retail reports include local statistics offices, central banks, and government departments, officially released company results and figures, trade associations, multinational organisations, including the OECD, the FAO, and the World Bank, and international and national news agencies.