market monitor

Focus on agriculture/food performance and outlook

December 2012

In this issue…

On the following pages we indicate the general outlook for each sector featured using these symbols:

Excellent **Good** **Fair** **Poor** **Bleak**

Size does matter

Food. It's essential, but it can also be one of life's pleasures: the vast array of celebrity cookbooks and TV chefs testify to that.

But while we may conjure up a romantic notion of quaint French patisseries, Spanish tapas or Italian pasta, the truth is that, to survive in today's tough economic environment, many small food producers and purveyors are being 'consumed' by larger groups in order to survive.

Take one example featured in this month's Market Monitor. The French agri-food industry consists of over 10,000 companies – most of which employ fewer than 20 people. There's no denying the well earned reputation and appeal of French food, but, in Europe as well as across the globe, it is losing market share. Many of its foreign competitors, such as those in Denmark, have already achieved economies of scale through a process of concentration, giving them increased bargaining power in a sector where rising costs such as animal feed and energy, can cut deeply into profits.

It's a similar story elsewhere: as in Italy, where the larger operators are faring reasonably well, while the many smaller firms are struggling with falling demand, price-sensitive consumers and foreign competition.

The word 'resilient' appears several times throughout our reports. Despite the many external and internal problems facing the food industry, those operators that can adapt to a changing marketplace are staying profitable. In Spain, for instance, though it still has a long way to go, the industry is beginning to transform itself to meet the challenges of changing global demand and shifting consumer habits. Meanwhile, the German food industry has latched on to the opportunities of growth in burgeoning markets like China.

We also review the closely related agricultural sector. While again input costs such as volatile commodity prices can prove a real burden, increased global demand can also have the positive effect of allowing prices to rise.

Overall, it's a mixed picture with both winners and losers. But the clear message is that, to prosper in today's agri-food industry, size really does matter.

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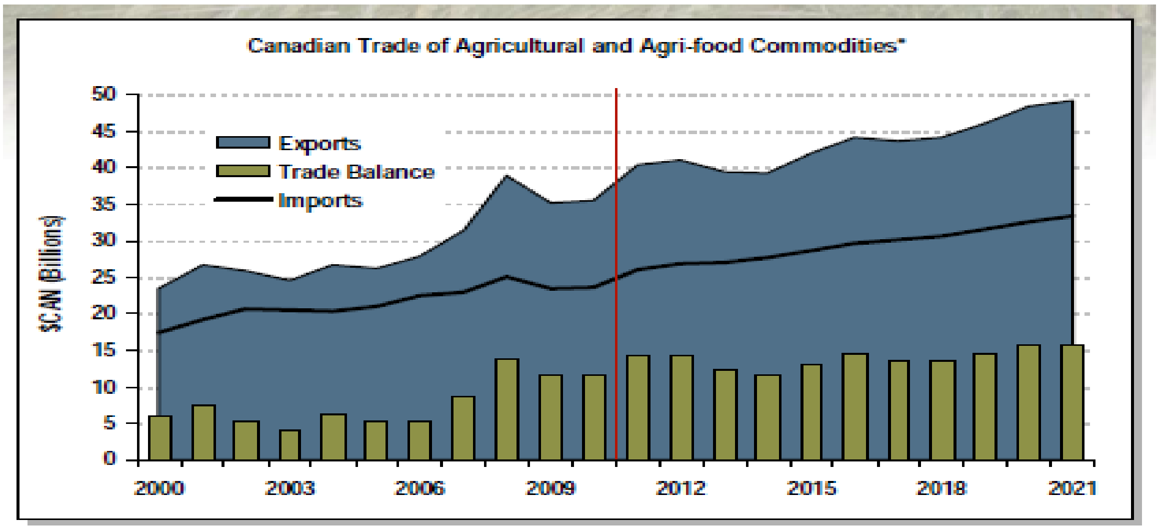
Canada

The strong performance continues

Agri-business in Canada provides one in eight jobs, employing over 2 million people. In addition, the industry indirectly generates employment in transportation and other economic sectors. In 2011, agriculture accounted for over 3.7% of total Canadian GDP, or approximately C$ 47 billion, with Ontario, Quebec and Alberta accounting for 80% of total Canadian agriculture and agri-food sector GDP.

Domestic demand for grain and oilseed continues to be driven by world prices, the strength of the Canadian dollar and modest growth in the domestic red meat industry. The 2011/12 crop year has shown some recovery after a very challenging spring for many Western Canadian producers. Cool, wet weather and excess soil moisture in some regions delayed seeding. Fortunately, a late autumn frost in many regions extended the opportunity to harvest late seeded crops.

The overall Canadian trade balance for agriculture and agri-food commodities is expected to continue to remain positive (see chart below).



* Excludes Fish and Seafood and their products. Exports in the graphic represent the domestic values. Exports, Imports and Trade balance are in current dollars.

Source: Statistics Canada

Grain, oilseed and related products represent around half of the export value of Canada's agricultural sector while live animals, red meat and other animal products make up about 20% of trade.

In the medium term, prices for grain, oilseed and special crops are expected to decline from the recent price peaks but to remain well above historical levels. In response to these higher prices, the total harvested area is projected to increase 4% in 2012 compared to the average achieved between 2006 and 2010. The largest area increases are expected for canola in Western Canada, and corn and soybeans in Eastern Canada.

So far, the sector has performed well in 2012, as a result of which we have seen no increase in payment delays and do not expect any change to this in the coming months.

For the 12 months to 31 August 2012, the total number of Canadian insolvencies (bankruptcies and proposals) decreased 5.1% compared to the previous 12 months, with business insolvencies decreasing 5.8%. The three sectors that saw the biggest decrease were transportation and warehousing; retail trade; and manufacturing. The agriculture sector also recorded a decrease (see chart below).

	Volume			**% Change**	**12-Month Period Ending**		
	August 2012	**July 2012**	**August 2011**	**August 2011 to August 2012**	**08-31-2012**	**08-31-2011**	**% Change**
Agriculture, forestry, fishing and hunting	12	5	14	-14.3	124	133	-6.8
Bankruptcies	8	4	11	-27.3	95	87	9.2
Proposals	4	1	3	33.3	29	46	-37.0

Source: BankruptcyCanada.com

Because of its good domestic and export performance, we do not foresee any increase in insolvencies in the sector in the short-term. Our underwriting stance will remain open. However, we continue to monitor the sector closely because of currency issues (i.e. the strength of the Canadian dollar) and volatile input costs such as fuel, in case producers have any problems passing these costs along. When underwriting the risk of a company that belongs to a group, our decision will take into account information relating to the parent/group strategy.

Canadian agriculture sector

STRENGTHS	WEAKNESSES
Sophisticated operations	Government market controls
Innovative producers	Climate issues
Geography- arable land	Volatile inputs: fuel, fertilizer etc.

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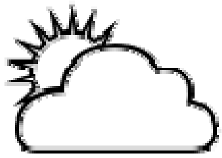


Canada

Food: good payment behaviour and low insolvencies

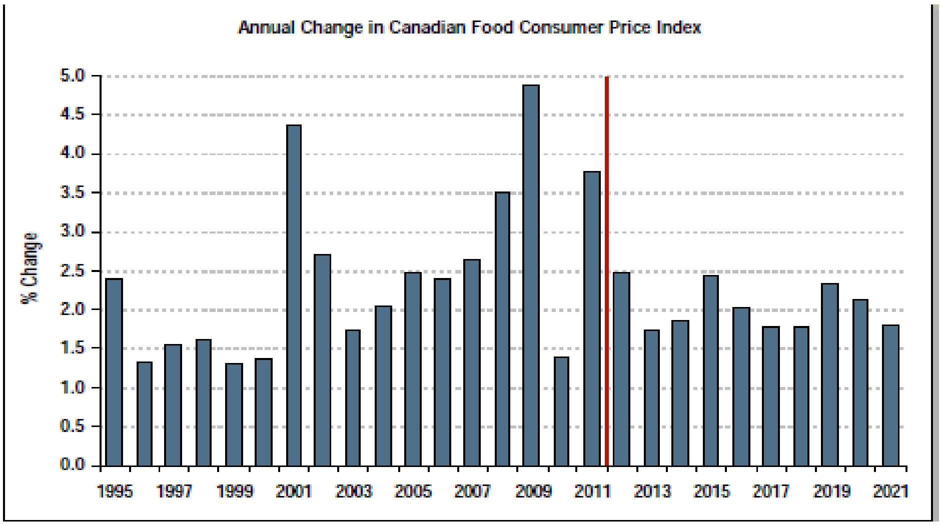
According to Statistics Canada, food, beverage and tobacco (FBT) processing is the second largest contributor to total manufacturing GDP in Canada, following transportation equipment manufacturing. FBT processing's share of manufacturing GDP is approximately 15% (C$ 23.8 billion), with food processing accounting for C$19.4 billion of the total. The largest FBT processing industries are meat products manufacturing followed by dairy products manufacturing. Most food processing industries have experienced a slowdown in average annual growth relative to the late 1990s: notable exceptions are sugar/confectionary, seafood, dairy, bakery and tortilla manufacturing.

There are around 3,300 FBT processing businesses across Canada, each generating at least C$ 25,000 in sales. Large FBT processing businesses produce the bulk of output: while they comprise only 10% of the total number of enterprises, they account for approximately 50% of the shipments. In contrast, small businesses make up 70% of the total number of firms but account for only 15% of the total value of shipments. Many of the food processing subsector industries have high concentration ratios, with the top four firms accounting for up to 80% of total industry sales. On a regional basis, the concentration can be higher than the national ratios.

About 75% of all FBT processing shipments are destined for Canadian consumers: the rest are exported. However, some subsectors are more export-oriented than others. For example, while nearly 75% of seafood products are exported, only 4% of dairy products are. Canadian processed products are exported to over 180 countries, with 75% of the total going to just two markets: the U.S. (65%) and Japan (10%). Domestically, FBT processors compete for sales with imports. On average, FBT product imports have a 20% share of the domestic market.

Alcoholic beverage and tobacco processing has consistently had substantially higher profit margins than general manufacturing, while food processing has slightly lower profit margins. Food and soft drink processing has a higher return on equity ratio than general manufacturing. FBT processing tends to be more highly leveraged (i.e. the debt to equity ratio) than the general manufacturing sector.

The annual Canadian food consumer price index is expected to increase 2% in the medium term. Events in 2010 put upward pressure on Canadian food prices in 2011 but far less so than in 2009, when prices were also affected by the depreciation of the Canadian dollar. Among the highest price increases in 2011 were fresh or frozen meat (6.8%), bakery products (5.8%), eggs (7.1%), fresh vegetables (9.2%), coffee (9.4%) and sugar (10.9%). In 2011, prices rose more for food purchased in grocery stores (4.3%) than in restaurants (2.8%). In general, those price increases have had a negative effect on consumer demand.



Source: Statistics Canada

In 2011, retail trade for food & beverages grew 3% to over C$ 110 billion: consistent with average growth since 2005. Competition in the retail sector is high, leading to price wars. This is likely to result in consolidations.

Payment behaviour in this sector has remained unchanged throughout 2012 and we do not expect any increase in payment delays in the coming months. On average, compared to other Canadian industries, the food sector's default/ insolvency rate is good and we expect this to continue. The only risks we see are potential issues arising from contamination/recall actions (e.g. due to listeria or e-coli).

As in the agriculture sector, our underwriting stance remains open. However, we continue to monitor the sector closely because of the strength of the Canadian dollar and volatile input costs such as fuel, in case food businesses have problems passing these costs along. When underwriting the risk on a buyer that belongs to a group, we also take into account the parent/group strategy.

Canadian food sector

STRENGTHS	WEAKNESSES
Sophisticated operations	Health and safety compliance issues
Integrated manufacturers	Volatile input costs

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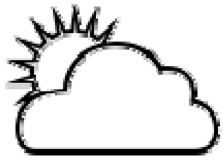


France

Agriculture: the animal/meat sector faces more problems

France is Europe's largest agricultural producer, accounting for 18.6% of total production. Currently there are about 500,000 French farms in this sector. While their average size has increased: from 42 hectares in 2000 to 55 hectares in 2011, about a quarter of these farms cover as little as 6 hectares or less. The number of farms has reduced by around 3% a year as farmers retire and their business is absorbed by others. Since 2000, the number of farms has decreased by 26% and this trend is set to continue.

Despite the difficult economic environment, in 2011 French agricultural production increased 6.7%, to EUR 71.4 billion, with vegetable production up 5% and animal products up 10.6%, thanks to a 1% increase in household consumption and dynamic exports. However, the industry was hit by rising production costs resulting from more expensive fertilizers and livestock feed, as commodity and oil prices increased.

Production value 2011	**(EUR billion)**
Vegetable products	42.2
Cereals	11.8
Industrial plants	4.7
Fruits, vegetables and potatoes	7.1
Wines	10.9
Flowers and plants	7.7
Animal products	25.4
Cattle (bovine, ovine, pork…)	10.9
Poultry, eggs	4.6
Milk and dairy products	9.9

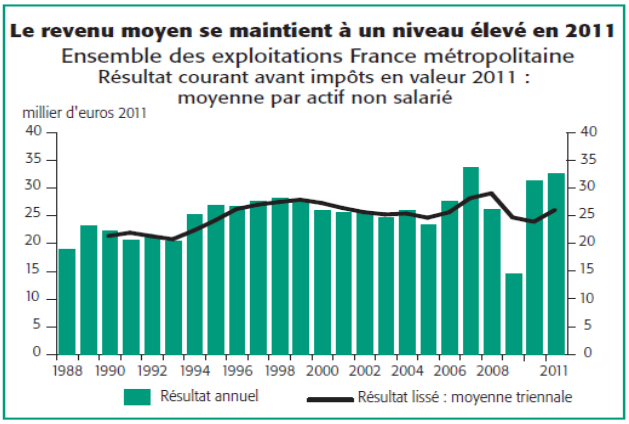
Source: INSEE, ANIA

Profit margins in the agriculture sector differ from one subsector to another and from year to year, depending on production, quality and price, but livestock farmers often record lower margins than cereal farmers: one third of livestock farmers even record losses and serious indebtedness.

Because activity in this sector is seasonal, solvency and liquidity can change markedly from month to month, but farms can benefit from seasonal loans to finance their inventories. As already mentioned, livestock farmers report more difficulties than cereal farmers, and this is especially the case in 2012. For instance, pork producers are struggling with raw material price increases and the investment needed to comply with new EU legislations. Consequently many pork producers may have to 'close shop' in 2013 and some farmers may decide to change production from livestock or milk production to cereals when profitability is too low.

In 2011, the average result before tax of agricultural businesses increased 3.8%: to EUR 32,500. However, there was significant variance between subsectors, with wine and dairy breeding seeing their revenue grow to EUR 58,000 and 29,900 respectively while cereal farmers saw a decline in revenue to EUR 41,700 as production decreased.

Evolution of result before tax of agricultural businesses (average for the sector)



Source: ANIA

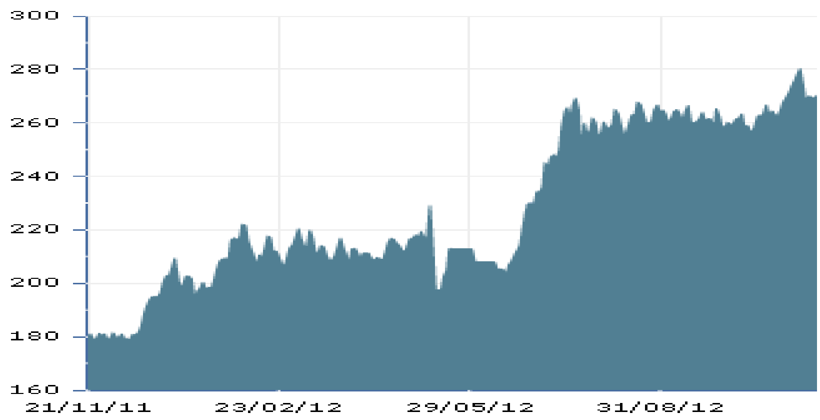
Agricultural businesses are not required to register financial accounts. According to Alim'agri, in 2010 the average indebtedness of farms was around EUR 160,000, of which two thirds was medium to long-term debt needed to acquire assets such as buildings and materials.

On average, payments in the French agriculture industry take 45 days. In the coming months, payment delays may increase in those subsectors hit hard by rising raw material prices and production costs (e.g. animal products). However, compared to other French industries, the insolvency rate in the agriculture sector is very good, although insolvencies could increase in the coming months, especially in animal breeding and flowers & plants: these experience above- sector-average insolvencies as they suffer most from increased commodity prices.

The outlook remains generally good

The US and Russia were affected by drought last summer and worldwide cereal production is expected to decrease 2.7% this year from its record level in 2011. Since this will leave demand outstripping supply, with a weak wheat and corn harvest in 2012, there will be a further increase in cereal prices. Fortunately, France has benefited in 2012 from good weather conditions, so its wheat harvest is expected to be 36.1 million tons (up from 34 million tons in 2011) and of good quality. Half of this is destined for export.

The evolution of wheat prices at the Paris Stock Exchange (EUR/tonne): +33% since January 2012.



Source: Franceagrimer

As a result, cereal farmers should record healthy revenues in 2012, boosted by the good production and high prices. However, livestock farmers will be penalized further by increasing raw material prices and production costs. Pork production is expected to decrease 3% this year and, coupled with an increase in production costs, this will lead to a sharp increase in price. French milk production decreased 4% between August 2011 and August 2012 and the profitability of dairy farms is expected to decline in 2012. The cost of milk production is likely to increase around 5% this year because of higher feed prices and energy costs, with increasing competition worldwide decreasing milk prices.

The grape harvest will be exceptionally small in 2012 because of the bad weather and is expected to yield only 41.7 million hectolitres of wine compared to 51 million hectolitres last year: a 20% drop. The Beaujolais and Champagne regions are worst hit, with production down by 37%.

The fate of French agriculture in the coming years will also depend on the support afforded by the EU's Common Agricultural Policy (CAP). France is currently the largest beneficiary of the CAP: receiving around EUR 9 billion a year. In October 2012, the European Commission published its draft proposals for the future Common Agricultural Policy for the period 2014-2020 but France has rejected some points. The new EU budget due to be passed early next year may have a negative impact on French agriculture. That said, the insolvency rate in this sector remains quite low and therefore our underwriting stance is quite relaxed. However, we are more cautious on the animal breeding sector.

French agriculture sector

STRENGTHS	WEAKNESSES
Leadership in wine	Many small farms
EU subsidies (France is the largest beneficiary)	Volatility of output
French State support	Low margins and low investments in assets in several sectors

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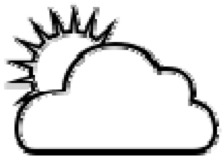


France

Food: Generally resilient – decreasing domestic demand

The French food sector demonstrated its resilience throughout the economic crisis of 2008-2009. The industry employed around 500,000 people in 2011 and consisted of more than 10,000 companies, almost all of which were small and medium-sized enterprises (SME) with fewer than 250 employees – and almost three quarters employed fewer than 20 people.

The largest food subsectors in 2011 (by revenues) were:

Meat processing: EUR 30.7 billion
Manufacture of other food stuff: EUR 25.9 billion
Manufacture of dairy products: EUR 25.5 billion
Beverages: EUR 23.6 billion
Manufacture of livestock feed: EUR 10.9 billion
Manufacture of bakery products and pasta: EUR 10 billion
Processing of fruit and vegetables: EUR 7.6 billion
Grain milling and starch production: EUR 6.4 billion

According to INSEE, the industry's turnover increased 1.5% in real terms - to EUR 157.2 billion in 2011 - due mainly to higher exports and increased sales prices. The export of processed products amounted to EUR 56.7 billion, generating a surplus trade balance of EUR 6.8 billion in 2011 (up 23% year-on-year). This development was boosted by exports of beverages and dairy products. However, French food continues to lose both European and world market share.

Beverages

A third of the growth in the food industry comes from the beverage sector, thanks to vibrant exports. Nevertheless, the beverage industry has already been hit by EUR 800 million of higher taxes on sodas and spirits in 2011 and the French government has recently proposed a law to raise taxes on beer in 2013.

Volumes remain

Meat

ed quite stable in 2011, with healthy exports. The sector saw growth in value of around 5% resulting from the increase of production costs (i.e. cereal prices).

Dairy products

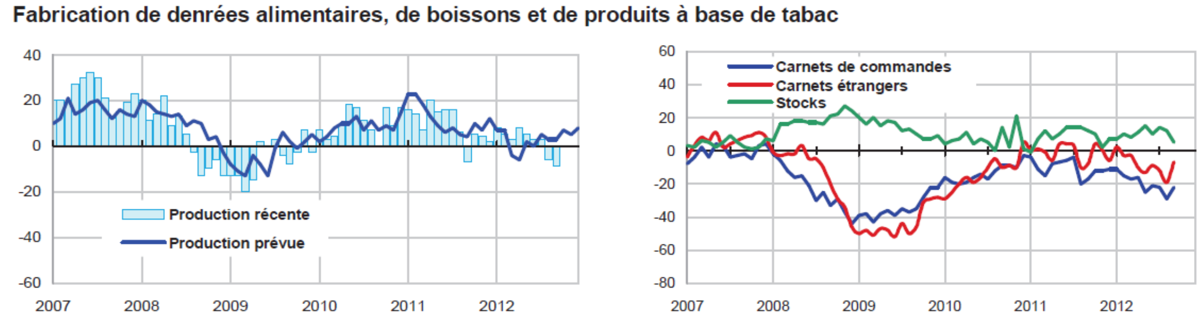
In 2011, volumes increased 1% and prices 7%, thanks to increased global demand for dairy products.

Fruit and vegetables

Fruit juices saw growth in 2011 while stewed fruits declined in both volume and price. During the summer of 2012, fruit prices increased because of lower domestic production. Production of apples is expected to decrease 27% in 2012 due to bad weather conditions, which should lead to a price increase of 10-15%.

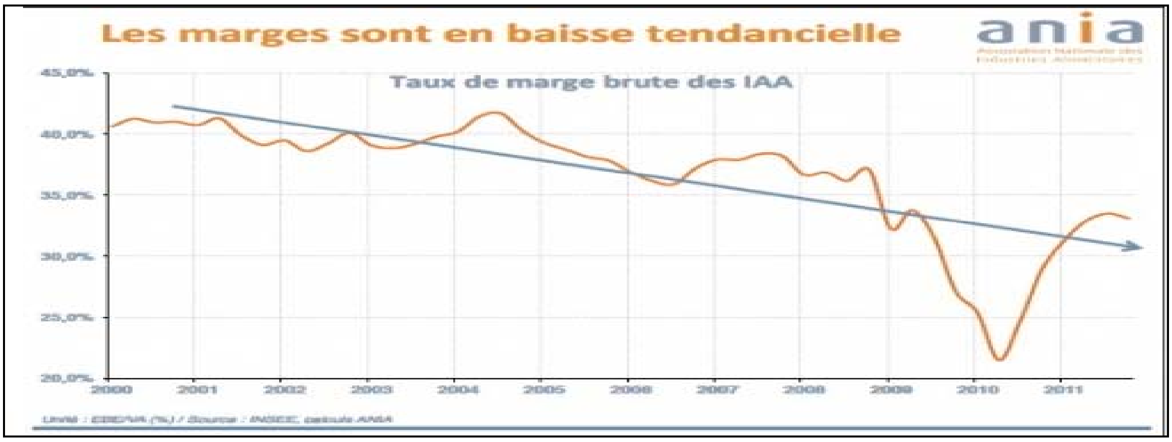
According to INSEE, order book decreased in 2012 but activity should remain stable in the coming months, except for bakery products.

Evolution of production **Evolution of order book (blue line)**



Increasing cereal prices and higher energy costs have affected the margins of several subsectors such as meat and poultry manufacture, bakery and dairy products, which have been unable to pass these costs on. Relations between agri-food firms and the major retail chains are often strained and recently the pork industry has asked the French state for support as it is struggling with increasing production costs. The financial strength of food businesses depends on the subsector and/or location in the value chain (manufacturers, wholesalers and retailers). Usually cooperatives have a lower solvency than private groups.

Evolution of gross margin in Agri food industry between 2000 and 2011



Source: Ania

According to ANIA (the National Association of Food Industries), the sector recorded an increase in agricultural raw material prices of 31% in 2011and this trend has continued into 2012, with an increase in the prices of cereal (wheat +33% since January at the Paris Stock Exchange, corn +28%) and animal feed (soy bean meal +36%). This impacts several subsectors (meat, pasta, and bakery). Pasta and bakery/pastry have also been affected by the sharp rise in egg prices following new legislation in January 2012 relating to egg production: as a result of which production decreased and egg prices more than doubled in a single year.

Food producers and processors are finding it hard to pass on increased production costs to the powerful supermarket chains, which are engaged in an ongoing price war as unemployment increases, forcing households to reduce their spending. In recent years we have seen a concentration process, especially in meat and diary subsectors, to reach critical size and focus on core-business or a few segments. However, foreign competition (e.g. from Denmark) is leading the race in the food sector to achieve economies of scale and market power from such concentration. This is important, as international competition accelerates the shift of the European food sector landscape, moving it from a local or national scale to a European - and even a global - one.

Rising insolvencies in some subsectors

On average, payments in the French food industry take 45 days, and payment behaviour has remained unchanged over the last couple of months. However, in the coming months we expect payment delays to increase, especially in those subsectors that have been worst affected by rising commodity prices. On average, compared to other French industries, the food sector's default/insolvency rate is good. However, we have seen an increase in the number and value of credit insurance claims in Q2 and Q3 of 2012, due mainly to the insolvency, in early June, of Doux. Doux was Europe's largest producer of poultry and poultry-based processed products, generating 1.1 billion of revenues and employing 10,000 people worldwide. Its demise has had a major impact in France. We have also seen more insolvencies in the meat subsector, which currently faces difficult market conditions, as the increase in raw material prices leads to higher production costs and demand for meat stagnates or even decreases.

According to the Banque de France, in the first eight months of 2012 the French agri-food industry recorded a higher trade surplus than in the same period last year. Overall, the industry had planned growth in activity of 1.5% for 2012 but French food production will slow down year-on-year, as rising unemployment reduces household consumption. Increasing raw material prices will further impact the industry's operating margins, especially in the meat and pastry subsectors, where there are too many companies. Competition will remain strong in the dairy subsector. We expect to see more insolvencies in the meat subsectors in the coming months, as operating margins shrink and the financial situation of many businesses deteriorates further. The same goes for smaller businesses in the fruit & vegetables subsector.

Despite the recent increase in insolvencies in the food industry, the rate remains quite low compared to other industries. Therefore, our underwriting stance remains quite relaxed, although we are more cautious about the troubled subsectors. In view of the food sector's concentration process of recent years, we pay particular attention to larger businesses´ level of short-term indebtedness (compared to the level of turnover and short-term authorizations) and medium-term indebtedness (compared to cash flow) as some groups have important short-term financial needs due to seasonal activity.

French food sector

STRENGTHS	WEAKNESSES
Several French global leaders	Too many small firms
The world's 4th largest exporter	Low margins and investments in assets
French state support	May businesses still too focused on the domestic market

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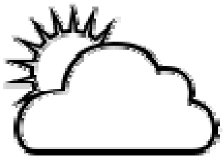

Germany

Agriculture: ongoing consolidation

Naturally, agriculture plays an essential role in ensuring the supply of raw materials to the food processing industry. But in 2011 the German agriculture sector was burdened by higher energy costs, lower proceeds from arable farming and poor harvest yields, which together led to lower earnings.

The most important players in this sector are cooperative and former cooperative retailing/purchasing societies, which increased turnover by 5% last year: to EUR 1.2 billion. The main driver of sales was the merchandise sector, followed by dairy and meat. The high sales generated by merchandise cooperative societies were thanks largely to the increased price of crop and oil seeds, triggered by the rising demand for renewable energy. Cooperative societies in the fruit & vegetables subsector increased their turnover 8.6% in 2011: to EUR 3.3 billion, while the animal feed sector also saw their sales increase.

There are more than 2,500 of these societies in Germany, but just five major ones. Over the last three years a process of consolidation has given the larger societies more market power, as those in financial difficulties have been absorbed by or merged with stronger societies. But, because of those mergers and acquisitions, insolvencies are rare in this kind of business.

As the agriculture sector is basically a strong performer with few insolvencies our underwriting stance is generally relaxed. However, we usually do not provide cover for buyers that have operated for less than one year.

German agriculture sector

STRENGTHS	WEAKNESSES
Non-cyclical industry	Price volatility
Generally strong business	

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Germany

Food: pressure on margins continues to increase

The German food industry continued to grow in the first half of 2012, although to a lesser extent than in 2011: according to the German Food Association BVE, turnover increased 3.8% year-on-year, to EUR 83 billion, with domestic sales rising 3.8%, to EUR 59.2 billion, and exports 3.7%, to EUR 23.8 million.

	2011	2010
Total turnover	163,3 bn. € (+7,6%)	151,8 bn. € (+2,8%)
Domestic turnover	115,4 bn. € (+5,9%)	109,0 bn. € (+0,5%)
Exports	48,0 bn. € (+12,1%)	42,8 bn. € (+9,0%)
Real sales trend	+0,8%	+0,6%
Share of exports in total turnover	29,5%	28%
Companies	5.960 (+1,0%)	5.900 (+0,6%)
Employees	550.000 (+1,4%)	542.000 (+1,0%)
Consumer prices (total)	+2,3%	+1,1%
thereof food and beverages (non-alcoholic)	+2,8%	+1,4%
Producer prices of the food and drink industry		
Domestic	+6,1%	+0,9%
Export	+8,4%	+5,3%

Source: BVE

Generally, equity strength is good in the food sector, but larger groups and producing companies are usually better capitalised than wholesale or retail businesses. In terms of solvency and liquidity, larger companies are normally better financed than smaller ones.

Domestically, there is fierce competition in the German food sector, because of the market power of the large German food retailers and discounters which have increased their market shares over the last couple of years. The overwhelming market power of these companies and the tough competition and price wars in the food retail sector, mean that the food producers, processors and suppliers have found it difficult to pass on increasing raw material, energy and other costs. As a result, their profit margins have continued to decline: especially for those focused on the often non-essential private label products and those dependent on just a few powerful retailers. In the last couple of years food discounters in particular have changed their supplying partner structure, with an increasing number of companies becoming exclusive suppliers. However, in many cases supply contracts are short-term or even non-existent, causing the suppliers real problems if those large retailers decide to cancel the supply arrangement.

Nevertheless, despite the problems in the industry, many companies in all food subsectors are doing well, for a number of reasons. Firstly, the food sector is non-cyclical, so that business development is less volatile than in sectors like construction, machines metals or transport. Secondly, the export share of this sector has almost doubled since the mid-1990s, providing business opportunities abroad: with 6.1% share of the global export value of food and beverages, the German food industry is the third largest exporter behind the USA (10.0%) and the Netherlands (6.8%).

Meat/meat processing

With a 23% share of total German food sales, meat/meat products is by far the largest subsector, and is controlled mainly by a few market-leading meat processors who, over the last few years, have created more or less fully vertically integrated groups. Besides those large players, there are many mid-sized or small market participants with just a minor market share. Small and mid-sized meat processing companies in particular have suffered from increasing raw material prices which often cannot be passed on to the retailers or consumers.

In response to increasing meat purchase prices – the result of increased food consumption and higher demand from countries like China - meat businesses have negotiated price increases with the retail industry. However, as there is usually a time lag between sales price and purchase price rises, profitability generally remains unsatisfactory. On the other hand, the increasing demand for meat worldwide has provided business opportunities, so that the German meat industry has significantly increased its export ratio, with a positive effect on the profit margins of those businesses with the largest export share. On a less positive note, overcapacity in the German meat and meat processing sector means that suppliers of non-essential products and companies that do not export are in danger of being squeezed out of the market sooner or later.

Milk/dairy

This subsector accounts for 16% of German food sales. Milk processing enterprises increased their turnover by 13%, to EUR 23.23 billion, in 2011, with butter and milk powder performing particularly well. Higher demand meant that consumers were prepared to pay higher prices and the milk fees paid to farmers rose by around 14% compared to 2011: to 35 cent/kg. Exports of German dairy products also developed positively. Exports of milk powder increased 30%, to 290,000 tons, and exports of yoghurt and butter milk rose 36% year-on-year. However, in the first half of 2012, sales prices again fell because of high capacity and, together with the higher price of animal feed, this has led to lower profits.

Fruit & vegetables

The fruit & vegetables subsector is also experiencing declining profit margins. Sales prices are stagnating or even falling because of the market power of the large German retailers. The fruit & vegetables segment is characterised by regionally operating mid-sized wholesalers - which often join specialised purchasing companies so that they can benefit from lower purchase prices – and by many small businesses. Despite generally declining margins, there is still a significant number of well established and successfully operating companies in this subsector. The development in this business segment depends largely on weather conditions, which have an impact on fruit and vegetable harvesting and a direct effect on both purchase and sales prices.

Beverages

Sales prices in the German beverage industry (beer, mineral water, soft drinks etc.) are falling because of lower consumption, increasing consumers' price awareness and discounting, combined with a significant rise in the price of raw materials like cereals and sugar.

The German beer sector suffers from an ongoing market concentration and consolidation, changing consumer behaviour and by the smoking ban in bars and restaurants. The number of breweries still seems to be too high and many of them are too small to be competitive. In an attempt to reverse the industry-wide declining sales of beer, many German breweries have begun to offer innovative beer-mix drinks with lower alcohol level. However, with many competing products, there is less profit to be had from such innovations.

In the fruit juice industry, increasing raw material prices (mainly fruit juice concentrates and sugar) have resulted in declining profit margins. A slight but persistent fall in the consumption of fruit juice and replacement by cheaper or low calorie drinks has led to significant overcapacity. Smaller fruit juice producers in particular have suffered from difficult market conditions, as they do not have the means to make adequate investment in necessary production facilities. As a result, several companies have been squeezed out of the market by insolvency, takeover or liquidation.

A rise in insolvencies cannot be ruled out

On average, payments in the food industry take around 30 days (in the food retail sector around 45 days). We have seen an increase in the number of notified non-payments in the last couple of months and expect this to continue. The generally more difficult economic environment, rising commodity prices and a competitive landscape have had an adverse effect on payment behaviour. With food processing companies and retailers demanding longer payment terms from their immediate suppliers to improve their working capital, a wave of longer terms is being created along the whole supply chain. Increasing costs and continued pressure on profit margins may lead to an increase in insolvencies in the medium term.

As the food sector is still robust, our underwriting stance remains generally relaxed for the time being. However, we usually do not provide cover for buyers who have operated for less than a year, unless they are affiliated to well-established companies or groups. As a rule, we request financial information annually (e.g. balance sheet, profit & loss accounts, interim statements, budget figures and liquidity status). There is closer monitoring of businesses with deteriorating financials, e.g. quarterly reviews and payment experience reports.

This sector has seen quite a lot of fraud cases and so we pay close attention to the number of credit limits that are applied for within a short period, especially where the buyers are recently established and where management and/or shareholders have recently changed or the buyer's business sector does not match with the goods ordered (e.g. a steel company ordering food items).

German food sector

STRENGTHS	WEAKNESSES
Non-cyclical industry	Partial overcapacity
Profits from increasing export business	Shrinking margins
Internationally very competitive	Low price level due to strong discount sector; branded products are replaced by white label articles

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Italy

Agriculture: some subsectors continue to deteriorate

The agriculture sector has always been exposed to commodity price volatility and climatic conditions, with several ups and downs over the years. Since mid 2011, the sector has been put under pressure by lower consumption and higher commodity and energy prices - with an evident deterioration this year. Agricultural and food processing businesses face pressure from both ends: at the top, an uncertain trend of prices and, at the bottom, the bargaining power of large scale retailers which cuts into margins. Last year, raw materials prices increased sharply for all subsectors (dairies, meat and cereals) while this year we have seen a slowdown, with the exception of cereal prices which remain persistently high.

Historically, Italian companies in this sector have been poorly capitalised. The larger operators have a reasonable level of liquidity while small and medium sized companies with poor cash flow generation and heavy investments in working capital are experiencing some problems.

Live animal farming is suffering most from the economic cycle, with the greatest threats to its liquidity. Manufacturing and distribution of meat, dairy products and cereals are affected by high fragmentation of the industry and competitive pressures.

DAIRIES			
	2011	2010	Δ
AGGREGATED TURNOVER *in euro/000*	15,717,899	10,467,853	*50%*
GROSS MARGIN	12.08	12.04	*0%*
OPERATING MARGIN	2.86	2.56	*12%*
NET INT / SALES	-0.45	-0.41	*10%*
DSO	88.43	87.30	*1.1*
STOCK DAYS	45.91	46.44	*-0.5*
DPO	87.18	85.19	*2.0*
GEARING	201.07	203.95	*-1%*
SOLVABILITY	28.95	28.72	*0.2*

MEAT						
	DISTRIBUTION			HAMS AND SALAMI		
	2011	2010	Δ	2011	2010	Δ
AGGREGATED TURNOVER *in euro/000*	10,733,429	9,539,560	*13%*	2,347,947	2,270,074	*3%*
GROSS MARGIN	9.98	10.54	*-5%*	13.91	14.97	*-7%*
OPERATING MARGIN	1.65	2.04	*-19%*	2.88	3.41	*-16%*
NET INT / SALES	-0.42	-0.61	*-32%*	-1.00	-0.92	*8%*
DSO	77.99	76.17	*1.8*	95.87	94.47	*1.4*
STOCK DAYS	22.62	20.82	*1.8*	116.66	115.60	*1.1*
DPO	62.60	58.19	*4.4*	87.74	87.39	*0.3*
GEARING	213.70	230.66	*-7%*	376.00	196.82	*91%*
SOLVABILITY	25.16	25.62	*-0.5*	28.34	28.38	*0.0*

Source: Atradius

More payment delays and insolvencies expected

On average, payments in the agriculture industry take 85 days. Payment delays differ by subsector, with those businesses faced by high commodity prices more likely to delay payments. Weaker businesses with a more fragile financial structure and poor management of key business risks are most exposed to payment delays. The Government has approved a new law, effective from 24 October 2012, which imposes shorter payment terms - of 30 to 60 days – on agriculture/food deliveries in Italy. The upshot is that companies can no longer alleviate low liquidity by seeking longer credit terms from suppliers and, as a result, weaker businesses may find that pressures on their liquidity become a real burden. However, most companies in the industry welcome this new law, which should limit the bargaining power of large scale retailers and allow the injection of new liquidity in the system.

For the last few years, wholesalers, retailers and live animal farmers have experienced financial tensions and insolvencies above the sector average, exposed as they are to changes in economic trends. Other factors that can lead to insolvency are unexpected climatic conditions, high fragmentation, historical slow payments and poor capital investment. We expect insolvencies to increase further in 2013 as these problems persist, with weaker operators leaving the industry. In the current uncertain environment, performance will depend mainly on management skills, good credit management and a focus on core business to reinvest the cash generated into the company.

However, demand is expected to remain stable for those export driven businesses whose reputation is based on the perceived value and quality of Italian food.

With the obvious problems in the sector, our underwriting stance is cautious. We take into account the management of working capital, especially in view of the new law on credit terms, cash flow generation, investments, the sustainability of the net financial position and repayment capacity.

Other information relevant to our underwriting decisions includes the skills of shareholders, the management of key risks (credit, financial, governance) and the strategy for business development.

Italian agriculture sector

STRENGTHS	WEAKNESSES
Inelastic demand	Fragile capitalisation and margins
Good international reputation	Increasing competition and price volatility
Export performance	Low consumption dynamics

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Italy

Food: mounting difficulties

Despite its generally non-cyclical nature, the Italian food sector has been affected by lower private consumption and poor consumer confidence, which has put some pressure on profit margins. Structural weaknesses are high fragmentation, poor profits, low earning retention and a modest equity base. The larger operators show a reasonable level of liquidity while small to medium-sized companies, with poor cash flow generation and heavy investments in working capital, are experiencing some problems.

In the past two years Italy has experienced the same kind of challenging economic environment that it did in 2008 and 2009. The weaker players in the food industry are already in financial distress - not only in the historically poorer Southern regions but also in the North. In addition, leading foreign brands are fuelling competition and price wars. In this mature market, the most successful companies can maintain growth through acquisition from and a careful focus on their commercial strategy.

With their market power, larger food retailers are generally faring better than smaller firms and food processing businesses.

Larger food retail sector

RATIOS GDO based on bs 2011	
AGGREGATED TURNOVER *in euro/000*	50,060,072
GROSS MARGIN	9%
OPERATING MARGIN	2%
NET INT / SALES	0.4%
DSO	16
STOCK DAYS	80
DPO	32
GEARING	78%
SOLVABILITY	29%

Source: Atradius

This sample comprises 50 large scale retailers, representing EUR 50 billion turnover: according to Federdistribuzione, this represents around 60% of the total value of the industry (EUR 83.7 billion).

On average, payments in the food industry take 80 days. In large scale retail, payment behaviour remains similar to previous years, while a partial deterioration can be detected in the medium-sized distributors segment. We expect payment delays in the food sector to increase in the coming months.

In recent years – and particularly this year – many small- and medium-sized food retailers have experienced financial distress and insolvency. Common issues are the quality of the assets (credit, stocks, fixed assets), conflict of interests with associates, slow payment habit and poor cash flow generation, and reliance on bank credits rather than on self financing. By contrast, large scale retailers have a low and even decreasing insolvency ratio.

In the current uncertain market environment, performance will depend mainly on management skills, good credit management and a focus on core business to preserve enough of cash generation to reinvest in the company. Demand is expected to remain stable for the food industry, for both private labels and brands with perceived value added. Despite its problems, the food sector can benefit from its anti-cyclical trend and large and differentiated base of clients.

The overall deterioration in the economy demands higher attention to key risks, in order to anticipate and react rapidly to potential liquidity problems. Therefore, when underwriting businesses in this sector, we monitor the management of working capital, cash flow generation, investments, the sustainability of the net financial position and repayment capacity.

Italian food sector

STRENGTHS	WEAKNESSES
Inelastic demand	Fragile capitalisation and tight margins
Good international reputation	Businesses are small on average
Export performance	Low consumption dynamics

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The Netherlands

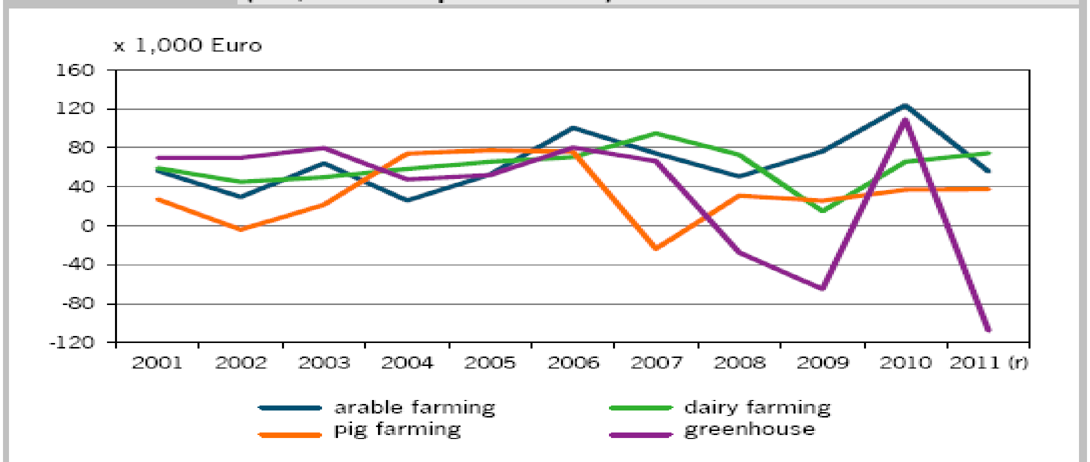
Agriculture: high energy and commodity prices mean lower incomes

The contribution of the agricultural sector to the Dutch economy, in terms of added value and employment, is currently around 10%. Besides the primary agriculture industry, the sector also includes trade and processing, the distribution of agricultural products, and commodity and related services. As the sector is less cyclical than many others, it is also less affected by the current troubles in the Dutch economy – although there are still some consequences for the industry.

Dutch agriculture generally saw further expansion in 2011. After growth of 7% in 2010, production increased 2.5% in value last year. The value of exports increased 9%, from EUR 66.6 billion to EUR 72.8 billion, while import value grew by a substantial 18%. This increase in trade value, particularly imports, came mainly from a steep rise in prices, especially for grain and oilseed, but the volume increase (7%) also contributed to the growth in value. The net agricultural trade surplus amounted to EUR 24.5 billion. The export value of vegetables was much lower than in 2010, with prices depressed by the EHEC (E-coli) crisis.

While Dutch agricultural trade is strongly oriented towards EU markets, Russia is also an important customer and more than 9% of total Dutch agricultural exports go to countries outside the EU. The consequences for the Dutch agricultural sector of the current situation in Greece, Italy, Portugal and Spain are limited, as the proportion of exports to those countries is relatively low, at 12%. Since 2011, the exchange rate of the euro against the dollar has had a favourable impact on exports to countries outside the Eurozone. However, agricultural sectors that rely heavily on imports of energy, fertilizers and commodities have been disadvantaged and saw their income fall in 2011 after a robust recovery in 2010.

Figure S.1 **Recent developments in the results and incomes realised in the agricultural and horticultural sectors, 2011 (x 1,000 Euro per business)**



Source: Farm Accountancy Data Network.

In the broad spectrum of independents in the small and medium-sized enterprise segment, the income of agricultural businesses remained at the low end of the scale in 2011, as it had been in the two years before the boom seen in 2010. The fall in agricultural income in the Netherlands in 2011 was in sharp contrast to other countries in the European Union, many of which saw their incomes rise, in part due to higher grain revenues. In greenhouse horticulture, incomes have fallen in all segments last year. Greenhouse vegetable growers have been hit very hard by the EHEC crisis, while the incomes of growers of flowers, pot plants and bedding plants were also much lower in 2011 - and were insufficient to accumulate any savings. In the open-air growing sector, three segments - vegetables, fruit and flower bulbs - faced a considerable drop in income due to lower product prices. Only flower growers could count on a relatively constant income in 2011, despite falling sales of their products.

The bulb cultivation subsector

The Netherlands is the world's largest producer of bulb cultivation and the controlled production of ornamental plants, with a global market share of 80%. But the overall number of farms has decreased 52% since 2000. The bulb cultivation subsector consists of several dozen breeding companies and other suppliers who deliver material to the 1,660 growers. The export value is approximately EUR 600 million (6.5 billion bulbs, of which 3 billion are tulip bulbs). However, this subsector is facing structurally tough trading conditions, and in the coming years the number of growers will shrink about 25%, as a result of ongoing consolidation. Increasingly, growers are changing their sales structure by taking over the role of the wholesaler.

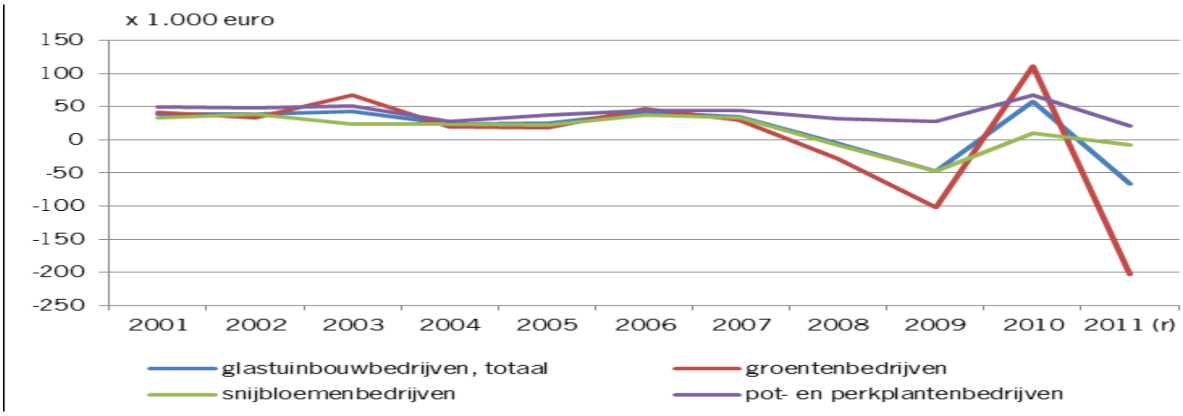
Arable farming

In the arable farming segment, after a fairly solid 2010, lower prices brought down the incomes of potato and onion farmers, while farmers of starch potatoes have managed to keep their incomes generally stable.

The greenhouse vegetable industry

The number of greenhouse growers halved between 2000 and 2011. Last year the profitability of the greenhouse vegetable companies had returned to the low level seen in 2009. Once again, the EHEC crisis was the prime reason.

Average net income per grower in the greenhouse industry



The blue line represents the whole greenhouse industry and the red line just the vegetable growers.

Source: Farm Accountancy Data Network

The wholesale trade in agricultural products is a substantial part of the agricultural complex, with more than 13,000 businesses and 100,000 employees. It includes companies that service retailers, institutional customers, catering companies and the food processing industry. The concentrations in the fresh fruit and vegetable supply chain heighten the already tough competition and aggressive pricing, affecting returns throughout the supply chain.

Excluding arable farming, the increase in debt incurred by businesses in the agriculture sector accelerated between 2001 and 2010. Notably, the solvency ratio dropped in all subsectors except for arable farming, which has increased sharply and now stands at an estimated average of 80%. The reason for the robust solvency of arable farms is the appreciation of assets - mainly land - and, of course, good operating results. Greenhouse vegetable growers saw a significant fall in solvency - of 34% - over the past three years, due to bad net results and low property prices: the percentage now stands at an average of around 40%.

Most of the 141 companies in the agricultural sector that went bankrupt in 2011 were vegetable, mushroom and flower growers. This number was a slight increase from 2009 and 2010, but rose sharply in the fourth quarter of 2011. Banks are no longer willing to finance investments if solvency percentages fall below 25%. Profits are increasingly used as a financial buffer rather than to re-invest.

Growth has again accelerated

Thanks to positive price developments, the combined outlook for the agriculture and horticulture sector is rather good. An increase in gross production value of more than 5%, to EUR 26.75 billion, should be possible this year. So far in 2012, the weaker euro exchange rate has boosted Dutch agricultural exports significantly and the continuing and growing demand for agricultural products worldwide will mean that prices remain fairly high. That said, the Netherlands' current economic woes are having a negative effect on some subsectors, with falling demand hitting those segments with a relatively high value added (meat, dairy, flowers and plants), just as it did in 2009. The wholesale subsector's growth in 2012 is expected to stagnate at 0.5%, after an average annual growth of 5% over the past 20 years: again a reflection of the Netherlands' economic problems.

Our underwriting stance remains generally relaxed, but some subsectors require special attention. The wholesale trade sector shows obvious overcapacity and requires ongoing close monitoring. Domestic investment in the horticultural industry has fallen to a very low level, affecting the creditworthiness of greenhouses construction – a sector that also required frequent monitoring.

Dutch agriculture sector

STRENGTHS	WEAKNESSES
Modern infrastructure	Restricted access to external financing
Highly efficient in producing and trading	

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The Netherlands

Food: suffering from lower domestic demand

The Dutch food sector is affected by the current economic troubles, with sales under pressure because of gloomy consumer sentiment and decreasing purchasing power, both of which have led to lower spending on food. Private consumption contracted in 2011 and 2012, and is expected to rebound only 0.4% year-on-year in 2013. Expectations for food sector sales are also muted as turnover growth this year and last year has been due mainly to price increases rather than higher volumes. Supermarkets have benefited from the rise in popularity of ready-prepared food: their market share has risen from 48.4% in 2010 to 49% in 2011 at the expense of food service businesses, whose 2011 market share is just 32%.

Tabel 1: Raming Foodomzet in Foodretail en -service

	Omzet 2011 (mld. €)	2011	2012	2013
Foodretail	**36,9**	**1,9%**	**1,4%**	**1,3%**
Supermarkten	32,2	2,4%	2,0%	1,8%
Foodspeciaalzaken	4,7	-2,2%	-2,5%	-2,5%
Foodservice	**18,1**	**0,6%**	**-0,6%**	*****
Horeca	11,4	-0,1%	-0,1%	*
Catering	3,4	-0,1%	-3,9%	*
Gemak	3,4	4,8%	2,7%	*

Bron: Cijfers Foodretail - CBS, Gfk en Raming ING Economisch Bureau. Cijfers Foodservice - FSIN

There are winners and losers among entrepreneurs. The winners are operating well on a tighter budget and are catering to consumers' busy lifestyles. But possibilities for growth are limited and the battle for the consumers' Euros is getting tougher. In addition, food retail and food service are 'fishing in the same pool'. The only way that companies can improve their performance is by winning customers from their competitors and streamlining their processes.

Large food retailers, i.e. supermarket chains, are forcing their suppliers to accept longer payment terms: as much as 90 days. This is purely cash driven and has nothing to do with the retailers' financial strength. But the problem is that the longer payment terms are cascading down in the production chain, although it is the retailers' direct suppliers that are hardest hit. Production costs are rising faster than selling prices and, as a result, margins are falling. This is the general threat to the Dutch food sector.

Meat

The major segments within the meat sector are beef, calves, pigs and poultry, and in 2010, 75% of meat production was destined for export. Total domestic meat consumption remained stable. 59% of meat is distributed via supermarkets, 35% is sold by the catering industry and 6% through specialist retail butchers. The share of pre-packed meat bought by households increased from 72.4% in 2000 to 92% in 2011.

Beef

Dutch beef is highly valued, thanks to its reputation for nutritional quality and controlled production processes. Tracking and tracing methods and independent quality inspections allow meat to be traced from the point of sale back to its source. Because of the tight supply on the European beef market, prices increased by 15% in 2011. Export volumes increased by 2% - to kg 229 million - with Germany and France the most important destinations.

Pigs

The Dutch pig trade sector has a good reputation. Export of pigs increased to a new high of 6.8 million in 2011. While deliveries to Germany increased, exports to Poland, Spain and Italy declined.

Poultry

Dutch poultry is of a very high quality because of strict control. Export of poultry increased 4% to 1.1 million tonnes last year. In particular, exports to Germany, the UK, some African countries and the Middle East increased.

Dairy

The dairy sector is one of the largest and most vital food sectors in the Netherlands. In 2011 milk production reached 11.9 billion kg, of which 35% was for the domestic market, 45% for EU and 20% for outside the EU. Throughout 2011 the dairy market was positive, thanks to a combination of limited availability and higher demand. Increased demand from Asia ensured that selling prices increased and remained stable.

In 2011, Dutch export of dairy products decreased in volume, but price increases meant that export value increased: 17% year-on-year, to almost EUR 5.4 billion. The importance of the dairy market can be seen in the Netherlands' trade balance with a trade surplus of EUR 3.1 billion: 8% of the entire Dutch trade surplus. The largest share of exports went to Germany, Belgium and France.

In the first half of 2012, milk production increased further, but that put downward pressure on the prices of butter and milk powder because of excess capacity coupled with lower demand. Production and export of Dutch cheese increased slightly. In the second half of 2012 production has decreased again, which could effect prices. With limited availability of milk its price will increase, as will the cost of producing cheese, while the price to consumers falls. This will result in pressure on dairy manufacturers' margins.

Dutch food sector

STRENGTHS	WEAKNESSES
Modern infrastructure	Subdued domestic demand
Highly efficient in producing and trading	Fierce competition in retail

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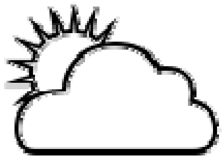

Spain

Food: a strong sector with strategic importance

Spain has one of the most important agri-food sectors in Europe. In virtually all the categories, Spain lies among the top four European producers of animal and plant crop derivatives. Taken together, production, transformation, supply and distribution in the Spanish agri-food sector represent almost 8% of GDP and account for almost 1,800,000 jobs (direct and indirect) - 10% of total employment in Spain. The industry contributes around 15% to Spanish exports, thereby helping to reduce the trade deficit. In 2011, the sector comprised 29,334 companies (30,261 in 2010) with 446,300 directly employed (+0.41%). 96% of companies are small and medium enterprises, with fewer than 50 employees, of which 80% have fewer than 10.

Despite Spain's economic weakness, the food and beverage sector recorded a 1.77% sales increase in 2011 - to EUR 83,773 million - due mainly to rising exports (+12%), while Spanish household expense on food and drink decreased by 0.68%. In times of rising unemployment, the workforce has remained stable. With its resilience, the industry has underlined its position as a strategic sector for the national economy.

Meat

The meat subsector accounts for 21.3% of the food sector's output, about 14% of its businesses and 23% of its employment. It shows the best export/import ratio (300.48%) of the total food sector (105.87%) which is already substantially ahead of the national ratio of 82.23%. Clearly therefore, the meat subsector is a key segment within the food industry. While, in 2011, there was pressure in margins to maintain domestic sales in an environment of low consumption, export markets showed significant increases in all meat categories: with a total year-on-year increase of 8%. However, rising commodity prices and higher energy bills are damaging the sector's profitability, especially for those companies with low export activity. The capacity to pass on costs to consumers is severely reduced for those operating in the price-sensitive domestic market.

Fruit and vegetables

Spain is the second largest European fruit & vegetable producer after Italy, accounting for 43% of total Spanish food exports.

Beverages

The Spanish alcoholic beverage subsector has seen four consecutive years of a downward trend. In 2011 the year-on-year slowdown of 6% was the result of low domestic demand. However, last year exports increased by 15%. In the short term, domestic demand will remain subdued because of low private consumption.

Dairy

Since the start of the economic crisis, the dairy sector has experienced the worst evolution in the food industry. This has triggered a profound rationalisation of industrial capacity and a significant reduction in output. The subsector's main problems are 'downtrading', i.e. with consumers choosing the distributor's cheaper own brands, and the poor capacity for passing on costs into the final prices.

Food retail

In 2011, food-based retail sales increased 0.22%. Mercadona, a 100% Spanish company, strengthened its leading position with a market share of 23.8%: 12 percentage points above the second leading operator, Carrefour. The market is still price-oriented because of falling domestic demand. The hypermarket format is losing the battle with smaller and local formats such as supermarkets and even traditional stores. Own-brands continue to gain market penetration and now represent 31% of total sales.

Challenges ahead

The industry is undergoing a transformation for several reasons:

- As it is a very fragmented sector, continued concentration in the industry
- Decreasing private consumption
- High sensitivity to the volatility of international prices
- Poor capacity for passing on costs to final prices
- Consumers are price conscious. Price is the main driver of the shopping list
- Consumers are more demanding and more sophisticated
- Supply of healthier products and products that are easy to use
- Lifestyle changes have generated new families of products
- Introduction of functional foodstuffs
- Increasing weight of own-brand products.

The Spanish agri-food sector must make an effort to meet the challenges of a globalised economy with its open markets, volatile commodity prices, and changing global demand for food due to population growth and shifting food habits. A number of strategic priorities are needed to alleviate the problems in the sector and make it stronger, more competitive and innovative, increase exports and give it greater capacity to pass on costs to consumers:

- The development of larger companies and the promotion of the integration of cooperatives so that they grow in size and capacity, and become more competitive. There are more than 4,000 cooperatives in Spain but their average turnover is very low: less than EUR 5 million. It is a very fragmented, small-scale sector, with little market power. No Spanish cooperative is among the 25 largest cooperatives in the European Union, and two cooperatives in the Netherlands invoice as much as 4,000 Spanish cooperatives invoice between them. The sector needs to foster integration processes that allow them to be re-scaled, modernized, internationalized and made more competitive as their current small-scale cannot hope to have enough power to compete internationally.
- The improvement of the operation of the food chain: this will increase both the efficiency and competitiveness of the sector
- An improvement in the quality of business management, and especially in strategic planning, cost management and quality marketing.

No payment increases seen

Companies operating in the food industry show acceptable balance sheet structures, with solvency ratios usually above the average. However, like other Spanish companies, food operators are also suffering from the lack of credit and liquidity flows in the economy.

According to industry sources, average payment terms in the food industry are 79 days. However, in the case of fruit & vegetables, payment terms increase to 100 and 120 days.

During the first nine months of 2012, the sector has not shown any deterioration in payment practices and we do not foresee any significant change in the coming months. Insolvencies are also at good levels and forecasts are for this trend to be maintained. Thus, on average and compared to other industries, the food sector shows a good default/insolvency rate that is expected to remain stable in the coming months.

Spanish food sector

STRENGTHS	WEAKNESSES
Key industrial sector of the Spanish economy	Pressure on margins
Resilience to the current crisis	Very fragmented, small scale sector
Positive trade balance	Poor capacity for passing on costs
Highly innovative	High sensitiveness to the volatility of international price developments

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Snapshots

Market performance at a glance

Belgium

Food: some subsectors are troubled

Food, after chemicals, is the second most important sector in the Belgian processing industry: accounting for more than 5,500 companies. Its primary subsectors are meat, dairy, chocolate, sugar, fruit & vegetables and beverages. Most activity is situated in Flanders, which represents 80% of turnover, 75% of the national investments, 70% of employment, and 66% of companies in the food sector.

The turnover of the Belgian food retail industry in 2011 is estimated at EUR 22.8 billion, with a 2.5% increase expected in 2012. In the current difficult economic climate, we have noted a reduction in both domestic and export consumption. However, the food industry has fared better than other sectors, as the reduction of purchasing power is having a greater impact on secondary goods.

Results in the food industry are quite divergent, depending on the subsector. Those recording difficulties are fruit & vegetables, meat and bakery operations, while beverages, dairy and food retail are seeing more positive results. Beverages and food retail are better able than others, such as meat and bakeries, to pass on price increases resulting from higher commodity prices. Constant price wars embattle the retail subsector, while the labour intensive and thus relatively expensive Belgian meat sector has to contend with the automated processes of German and Dutch competitors.

On average, payments in the Belgian food industry take between 1 and 30 days, and payment behaviour in the sector has generally remained stable. However, we have registered an increase in notified non-payments in the meat, fruit & vegetables and frozen food subsectors, and this is set to continue in the coming months.

We have also seen an increase in insolvencies in the sector, although the numbers are better than in other industries such as construction, catering and transport. Those mainly affected are meat and fruit & vegetables, which face fierce competition and increased raw material prices. With persistent high commodity prices and the current economic environment, we expect the rise in insolvencies to continue.

For the time being, our underwriting stance towards the Belgian food sector remains cautious, especially for the meat and fruit & vegetables subsectors. We seek the most recent figures and closely monitor stock levels, trade creditors, debts, turnover, margins and payment delays. We pay attention to the further development of raw material prices, which may increase because of adverse weather conditions. We also remain vigilant to the possibility of further incidents of infection and contamination, such as mad cow disease, salmonella or dioxins in food.

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Czech Republic

Food: meat subsector under increasing pressure

Between January and September 2012, sales of food and beverages in the Czech Republic decreased 2.7% year-on-year (at constant prices) and increased 0.2% (at current prices). Currently, the Czech meat sector is facing the challenge of considerable imports of low quality products which are competing on price. Input prices for producers have risen sharply, and as it is difficult to pass these on to customers, many producers are posting losses. In the beverage sector, September's scandal, in which many people were killed by methanol-tainted 'bootleg' spirits, has hit the alcoholic beverage market significantly, including exports. The food retail market is facing falling sales and profit margins because of the slowdown in economic growth (GDP is estimated to contract 0.6% in 2012) and lower consumer confidence. Average real wages and salaries decreased 1.1% in real terms in Q2 of 2012, while food price inflation increased 7.3% year-on-year in September – much higher than overall consumer prices, which rose by 3.4%.

While the Czech food sector's equity strength, solvency and liquidity are on a par with other industries, the profit margins of many food businesses are decreasing, due mainly to higher input costs. However, after peaks in 2011 and early 2012, general commodity prices were 1.7% lower year-on-year in Q2. Crop prices decreased 7%, but prices for animal products increased 5.8%.

On average, payments in the food industry take 30 days and for retail chains up to 60-90 days. Payment delays have increased in the last six months and, with lower demand and increasing price pressure, we may see more payment problems in the future. We also expect insolvencies to increase, especially in the meat subsector, due to increasing input prices, decreasing disposable consumer income and the amount of imported meat. All this will put pressure on businesses to cut their margins and costs even more.

To maintain profitability in the current uncertain economic environment, food producers and retailers will try to lower fixed costs by postponing capital expenditure and reducing employee numbers. The food retail sector will try to keep their sales prices low, even though this is achievable only by using cheaper substitutes and EU imports. This will impact further on the already falling number of live animals bred for meat in the Czech Republic. A possible rise in VAT in 2013 - from 14% to 15% - would also diminish demand and reduce margins.

Our underwriting approach in the food sector is cautious and our main criteria are the subject company's equity ratio, liquidity and turnover.

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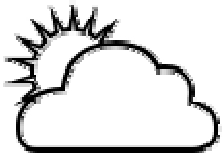
Denmark



Food: resilient – but not immune – to a slowing economy

The Danish agriculture and food sectors are closely related. The main food producing companies are farmers' cooperatives whose collective turnover is close to 10% of Danish GDP. In 2011 the sector benefited from higher sales prices due to increased global demand, while the weak euro and low interest rates have strengthened Danish food competitiveness. Farmers' production costs rose 11% year-on-year in 2011, but this was more than outweighed by increasing prices of almost all crop and livestock products.

More than two thirds of total production is exported: the value of Danish food exports reached EUR 10 billion in 2011, with Germany, the UK, Sweden and now China being the most important markets. Production of meat, mainly pig meat, is one of the most important subsectors. Around 90% is exported, with pig meat accounting for almost half of all agricultural exports and for more than 5% of Denmark's total exports. This subsector is generally resilient: positive results in recent years have also been driven by acquisitions and mergers abroad. However, the outlook is not that bright for Danish pig farmers as increasing pork prices are not sufficient to cover higher feed prices. Combined with high debts, this means that a number of pig farmers will post losses in their 2012 accounts.

The Danish dairy industry consists of the international dairy group Arla Foods and 30 smaller dairy companies, which together handle more than 20% of all Danish agricultural exports. The Arla group processes more than 90% of the Danish milk pool, while the other 30 dairies specialise in various product areas (cheese, butter and liquid milk production). Generally, the milk market is volatile but, as a basic source of nutrition, milk-based products have shown resilience to the downturn in the economy. The relatively small Danish greenhouse production of fruit & vegetables has for several years incurred higher production costs than foreign competitors. On top of that, the E. coli crisis hit the sector in the summer of 2011 at the peak of the harvest season. The impact was profound for producers, with some going bankrupt.

Overall, larger Danish food businesses have performed well during the economic crisis and generally saw good results in 2011. Among small and medium-sized enterprises (SME), performance has varied from subsector to subsector. Manufacturers and wholesalers of meat (including catering companies) have performed quite well. Among the most vulnerable SME companies are exporters to Southern Europe and suppliers/sub-suppliers to hotels, restaurants and private canteens, including some wholesalers and small fruit retailers.

Nearly 90% of the Danish FMCG sector is controlled by three large players, which operate traditional supermarkets, mini markets and discount stores. Other players are mainly foreign based discounters. Competition is fierce and in 2011 the discount business continued to grow at the expense of both traditional supermarkets and speciality stores: almost 50% of Danish retail stores are now discounters. The increasing demand for low cost, private label products reflects cautious consumer spending.

On average, payments in the food sector take 30 days. In the last six month we have seen no increase in insolvency in the manufacturing sector, while there was a small increase in retail and wholesale. We have received relatively few credit insurance claims relating to the food sector, compared to other industries, and both the number and value of those claims has fallen in the past six months.

Much uncertainty remains about how 2013 will evolve – especially as the Eurozone crisis lingers on. However, the Danish food sector has so far proved to be resilient. Our underwriting approach remains positive across all subsectors. However, we will continue to closely monitor smaller companies in subsectors with challenging market conditions, e.g. fruit traders and small meat/catering and seafood companies. The FMCG market conditions - fierce competition and structural changes, the expected flat market development in 2013 and a relaxing of the law on shop closure times - will continue to put pressure on traditional grocers and speciality stores and their suppliers. We will monitor progress through regular contact with buyers and review up to date management accounts where necessary.

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