



market monitor

Focus on food sector performance and outlook

December 2013

Food for thought

While the food sector reports in this edition of Market Monitor may reinforce perceptions – some might say national stereotypes – others may come as something of a surprise.

For instance, France has a justifiable reputation for the excellence of its wine and cheese – and this is evident in the success of its exports of those products. However, while the USA is often harshly characterised as the originator of ‘fast food’ outlets, one of its success stories is the organic food sector, especially organic fruit and vegetables.

For the markets we observe, exports clearly play an essential role in the profitability of the food sector: sometimes compensating for less positive results in the home market. Spain is one such example. But its excellent export performance is nothing new: achieving a competitive edge in food exports has been a long-term process, with exports growing steadily since the 1990s.

Growth in exports is often most marked by demand from regions beyond Europe. Dutch beer producers have seen their best export results in Africa, Latin America and Asia Pacific. And, even though most Polish food exports still go to EU member states, they too are seeing significant growth in markets such as China and Saudi Arabia. For Denmark as well, China is now a key export market. Brazil however is experiencing some export problems because of the current embargo of its meat products by several non-European countries.

Belgium’s export focus is still on its immediate neighbours, but it is finding that real growth opportunities lie further afield, in the US, Japan and the BRIC nations, where sales of Belgian chocolate and beer are on the rise.

Belgium



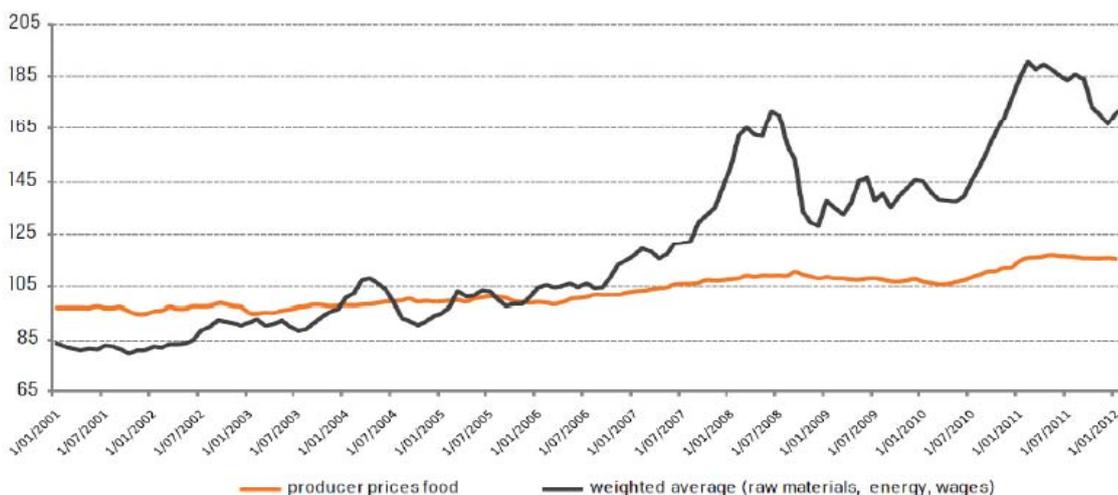
- Margins remain under pressure as input prices rise
- Payment delays and insolvencies increase
- Growth opportunities in some overseas markets

The Belgian food sector, which accounts for more than 89,000 jobs, recorded modest 1.8% growth in turnover in 2012, to EUR 46.6 billion, driven mainly by exports. Indeed, exports are becoming increasingly important for the sector, accounting for 5% of growth and 52% of total turnover, while domestic turnover is decreasing. The industry's primary subsectors are meat, dairy, chocolate, sugar, fruit & vegetables and beverages. The region of Flanders accounts for 75% of turnover, 81% of national investment, 72% of employment and 65% of the companies in the sector.

Exports remain mainly focused on the European Union, with an emphasis on Belgium's direct neighbours: the Netherlands, France and Germany. Exports (mainly of chocolate and alcoholic beverages) to distant export markets like the US, Japan and the BRIC countries are on the rise, and it is especially in these distant export markets that Belgium can find growth opportunities.

The biggest challenge for Belgian food companies is coping with the volatile, upward trends in input prices. The aggregated index of the three most important input factors (raw materials, energy and wages) has risen faster than the selling prices that food producers can charge their distributors. As a result, the competitiveness of Belgian food producers, in both domestic and foreign markets, continues to be under pressure. However, investments ensure that the sector can partly cope with the increasing price pressure. In 2012, investments in the food sector increased 12.4% after an already sharp increase of 16.3% in 2011.

Margins are under pressure as input costs grow much faster than producer prices



Source: Fevia

Like 2009, 2013 has been a very difficult year for the food industry. Growth in turnover slowed considerably in the second half of 2012 and we have seen a worrying decline in domestic consumption. If and when domestic consumption will pick up again is questionable, as consumer confidence has decreased sharply since March 2013 because of a wave of announcements of business closures. As a result, pessimism about unemployment rose to its highest level in three years. Business confidence is also persistently negative.

We are currently receiving a higher number of notifications of non-payment in this sector. The industry faces an increasing number of insolvencies, a trend which was already evident in 2012 and which has been reinforced in 2013, with 230 insolvency cases between January and October 2013 compared to 170 cases in the same period of 2012. Overall, we expect Belgian business insolvencies to increase 9% in 2013, followed by a levelling off in 2014.

Given the current problems, our underwriting stance towards the Belgian food sector remains cautious, especially for the frozen food, fruit & vegetables and meat subsectors. We seek the most recent financial information available for buyer companies, and if possible interim figures, and closely monitor stock levels, trade creditors, debts, turnover, margins, payment delays and social security default. We also pay attention to the direction of raw material prices, which may increase because of adverse weather conditions. Also important is the possibility of further incidents of infection and contamination, such as mad cow disease, salmonella or dioxins in food. Seasonality effects are noticed in most of the food subsectors and this allows Atradius to manage credit exposure by agreeing time-limited cover.

Despite an overall cautious stance, we always try to find ways to agree cover by obtaining additional information about things such as good payment experiences or guarantees from a stronger parent company.

Belgian food sector

STRENGTHS	WEAKNESSES
Geographic location in the centre of Western Europe	Lack of large players
Quality food products	High input costs
	Subdued domestic demand

Brazil



- **Food retail expected to perform well**
- **Government subsidies provide support**
- **Retailers adapt to changing customer behaviour**

With real private consumption growth expanding just 2.1% year-on-year in the first quarter of 2013, and continuing headwinds in the form of high inflation and interest rate hikes on the horizon, Brazil's private consumption will grow slower in 2013 than previously expected: 1.8% instead of 2.2% expected at the beginning of the year. That said, food retail is likely to outperform other items of private consumption and generally sales growth is robust for the main companies in the sector. Moreover, moderating input prices (grains) could improve margins and help companies recover in the coming months. While persistently high inflation is eroding the average purchasing power of middle-class families, this will have an impact mainly on food imports and non-primary goods.

Meat

Brazil is a large producer and exporter of several qualities of meat and the industry has grown significantly as quality improves: in the case of pork through genetic research, and by a focus on religious prescriptions such as Halal certification for chicken. However, in the beef subsector market confidence has to be restored after a single case of alleged 'mad cow disease' in December 2012, which has hit exports. Although the risk has been said not to pose a threat, Japan, China, South Korea, Peru, South Africa, Saudi Arabia and Taiwan have banned any meat import from Brazil. This should not have severe consequences for Brazil, which is appealing the case with the WTO, as those countries have a weak case and, apart from Saudi Arabia, account for only a small share of Brazil's total meat exports.

One potential harmful factor could be the increase in refrigerated cargo costs: possibly by as much as 60%. However, the Ministry of Agriculture has announced measures to support the industry, including subsidies and the creation of additional credit lines.

Fruit and vegetables

Brazil is the world's third largest fruit producer, growing many tropical, subtropical and temperate fruits. Production has increased in volume by 24% over the past ten years, while the actual cultivated areas have reduced: showing that productivity and sustainability have been boosted by improvements in cultivation techniques. Currently Brazil produces 43 million tons of a wide variety of fruits, most notably oranges, mangoes, papayas, grapes, apples and melons. It exported 693 thousand tons of fresh fruit in 2012, valued at US\$ 619 million, and the European Union is still the main export destination.

Brazil is also the largest producer and exporter of sugar, coffee (30% of the market), and orange juice, and is ranked second (after the US), for soybeans, third for corn (after the US and China) and sixth as a cocoa grower (after Côte d'Ivoire, Ghana, Indonesia, Cameroon and Nigeria). Like almost every large farming country, Brazil is divided between productive giant operations and inefficient hobby farms. Half the country's 5 million farms earn less than Real 10,000 a year and produce just 7% of total farm output, while its 1.6 million large commercial operations produce 76% of the output.

Retail

In Brazil, retail sales of packaged food reached US\$ 113.7 billion in 2012. By 2017, this figure is expected to reach US\$ 143.4 billion: growth of more than 26%. This expectation is based on Brazil's current economic stability and social welfare programmes such as 'bolsa familia', which have helped to increase consumer purchasing power.

Retailers have also adopted new marketing and financial solutions, such as own-brand credit cards, to attract more customers, while consumers have expanded their choice of grocery purchases. The typical family shape has changed too, with fewer family members, and this has led to changes in consumer behaviour. The focus is now on the increasing number of supermarkets, while hypermarkets are adapted for wholesale use. Those families seeking a wide selection of products at low prices are buying from 'atacarejos' – the Brazilian equivalent of 'Cash and Carry'.

Internet retailing of groceries is still in its infancy. The greatest challenge is to change cultural habits as Brazilians feel more comfortable buying food and drink in person than online. There are many retail chains and, particularly in the food sector, these are performing well. But, while the growing use of credit cards has increased consumers' instant access to many products, the recent rise in inflation has proved a barrier. The Brazilian grocery market is currently worth US\$ 329 billion and is set to become the fourth largest in the world by 2016, valued at US\$ 468 billion. With its large population and growing middle class, Brazil's food retailing sector is an attractive market for both foreign and local investors.

On average, payments in the food industry take 60 days, and our experience with the sector's payment behaviour over the past two years has been good. The level of payment delays and insolvencies has been stable over recent months and we expect this trend to continue into 2014. As a prudent measure, when underwriting buyer risk, we contact buyers to seek their latest financial figures and take into consideration the trading experience of our insured customers. We also take into account any local factors that can positively affect a buyer's financial capabilities: in particular their access to credit lines that offer more favourable conditions than the high level of interest applied from banks.

Brazilian food sector

STRENGTHS	WEAKNESSES
Large domestic market	Lack of infrastructure
Strong position in the global food market	High debt level of businesses
Growing customer base	

France



- **Decreasing gross margins**
- **Increased pressure from foreign competition**
- **Rising insolvencies in the meat subsector**

According to the National Association of Food Industries (ANIA), turnover of the French agri-food industry increased 2.3% year-on-year in 2012 to EUR 160.9 billion. The sector still benefits from its reputation for products such as wine, champagne and cheese, and it can claim some genuine global brands within the food sector: for instance Pernod Ricard, Lactalis and Danone. However, most of the 13,000 French food businesses are small: with 75% of them employing fewer than 20 people. The sector has proven resilient so far, but currently market conditions are more difficult for several reasons:

- raw material price fluctuations
- strained relations between agri-food firms and the major retail chains: agri-food companies face problems in passing increased costs on retailers
- increase in the unemployment rate has led to a drop in household consumption, with consumers focusing more on price
- tax increases, such as in the beverage subsector

Under these difficult market conditions, agri-food production volumes increased just 0.3% in 2012 with 3,900 lost jobs. As businesses struggle with rising production costs, gross margins have decreased 14.3 points since 2008: reaching a low of 22.4% last year, according to ANIA.

As a result, French food companies are often unable to invest enough, and this has a negative effect on their competitiveness with other European food firms and on their ability to develop a presence abroad. In 2012 France dropped one place in the table of the world's largest food exporters, and now ranks fifth behind the USA, Germany, the Netherlands and Brazil.

According to AGRESTE (the French Ministry of Food and Agriculture), the value of exported processed food products (excluding agriculture) was EUR 43 billion in 2012, generating a trade surplus of EUR 7.9 billion (compared to EUR 6.9 billion in 2011). This is driven largely by exports of dairy products and beverages. The surplus derived from European markets fell but was offset to a great extent by healthy demand from the USA and Asia. However, it is important to note that, without beverages, the trade balance would be negative.

During the first eight months of 2013, the French agri-food industry recorded a lower trade surplus - EUR 4.3 billion - than in the same period last year - EUR 5 billion - as the imports of dairy products rose while exports decreased. Turnover growth will level off or increase only modestly (by around 1%) in 2013. Faced with these challenges, the sector is pursuing a strategy of reorganisation and concentration, with several mergers and partnerships, especially in the milk and meat subsectors. The aim is for companies to reach a critical size to strengthen their negotiating power with distributors, develop their sales abroad and focus on core-business or fewer segments.

Meat

With a 21% share of French food sales and 28% of employees in the industry, meat is by far the largest subsector. However, like much of the sector overall, it is composed mainly of small businesses and even French groups are quite small compared to foreign competitors. Meat has been most affected by the general difficulties already mentioned - in particular rising feed costs (cereal prices), the difficulty of passing on increased production costs to supermarkets, and flat or even decreasing demand. Production prices reached a record level in 2012, affecting the whole subsector: livestock farmers, slaughterhouses and food processors.

The combination of rising raw material prices, insufficient investments and high labour costs made French meat more expensive than that of European competitors, mainly in Germany and the Netherlands. As a result, imports continue to rise and the trade balance, which had already been in the red since 2005, worsened in 2012 and has deteriorated even further in 2013. Production fell 2.4% in 2012 and by another 2.1% in the first seven months of 2013, especially for beef and pork. However, turnover increased 5.3% in 2013 as price rose, while lower cereal prices should enable production costs to fall in 2014.

Dairy products

The dairy products industry represents 17% of total food sales, with two French groups - Lactalis and Danone - enjoying worldwide status. Production remained stable in 2012 (up 0.5%) after two successive years of growth. Sales increased 1.8% between January and July 2013. After lengthy negotiations with supermarkets and the intervention of the French government, milk prices increased in 2013. By August the price of milk was 14% higher than in 2012, reaching its highest level since 2010, and should remain so in 2014. The overall trade balance has stayed positive in 2013, thanks to steady demand from emerging countries. The sector has intensified its reorganisation efforts, with many partnerships and mergers in preparation for the ending of EU milk quotas in 2015.

Fruit and vegetables

Developments in this subsector depend largely on weather conditions, which have an impact on the fruit and vegetable harvest and a direct effect on both purchase and sales prices. Wholesalers are mainly small firms, which tend to group together to increase their national presence and which usually have both low equity and low margins. Indeed, gross margins are falling as these companies cannot pass on all of their increased costs to supermarkets or to caterers, especially as consumption has remained flat since the 2000s. The rainy spring in 2013 also affected production, with the poor harvest leading to a price increase, mainly for fruit (up 11%).

Beverages

The drinks industry represents 16% of total food sales, with exports accounting for 30% of sales. Globally beverage sales are growing and prices are rising. The positive trade balance reached a record level in 2012, boosted by strong demand for wine, champagne and spirits, mainly from the US and emerging markets. According to Agreste, wine production is expected to increase by 7% in 2013 and champagne production by 40-50%. Production of beer increased 5.3% in 2012, mainly during the second half of the year, as the sector anticipated the tax increase which came into effect in January 2013. As a result, production fell in 2013: down 6.7% by July.

Overall, French food businesses are highly dependent on bank finance, and, especially in the fruit and vegetables subsector, many companies have high short-term debt. Payment behaviour has been stable for the past six months but we

expect to see more notifications of non-payment over the next six months in the meat sector, especially poultry. The suspension in July 2013 of poultry meat export restitutions will impact French exports and may jeopardise the whole sector: bringing uncertainty about the future level of production. Moreover, the drop in prices is cascading down the production chain. This could lead to more insolvencies in the coming months and force this subsector to speed up its reorganisation or create new partnerships.

Although the food sector's insolvency level is still lower than in other industries, the more difficult market conditions led to an increase in agri-food insolvencies last year (see chart below).

Insolvencies in the agri-food sector since 2006



Source: Ania / Les Echos

We expect such insolvencies to increase further in the coming months: about 5%, especially in the meat sector.

Therefore, while our underwriting stance towards this sector remains generally relaxed, we are keeping a closer eye on troubled subsectors, especially meat. We contact buyers for their latest financial accounts and forecasts, and monitor their working capital requirement, cash situation, debt repayment, investment and financing plans, and assess the support they receive from financial partners.

It helps greatly if our customers do not ask for more cover than they need, and also let us know if that need is temporary – as is often the case in the fruit and vegetable subsector. Of course, our customers' own trading experience with the buyer is invaluable: their current outstanding balance, annual sales, orders in hand and payment history.

We try to meet our customers' requests whenever possible: and indeed, where our assessment of the buyer or subsector is particularly positive, we encourage the customer to extend further credit. If the buyer's financial strength does not merit the full cover requested, we will try to give a partial approval, perhaps by setting a time limit on the approval or by establishing a parent or bank guarantee. Whatever our decision, the reasoning behind it will be fully explained to the customer and this in itself will give a clear picture of the buyer's financial strength.

French food sector

STRENGTHS	WEAKNESSES
A non-cyclical industry	Too many small companies: need for concentration
Several French global players/leadership in wine and spirits	Shrinking margins and lower investment
Noted for high quality products	High labour costs affect international competitiveness

The Netherlands



- **Domestic sales under pressure**
- **Consumers turn to online purchasing**
- **Ending of EU milk quotas may have an impact**

As last year, domestic sales in the food industry remain under pressure because of gloomy consumer sentiment, with households continuing to be cautious with their purchases in the face of rising unemployment and government austerity measures. Total food consumption in 2012 amounted to EUR 56.6 billion. The market share of food services (hotels, restaurants, catering and convenience) fell to 31.7%. As ready-prepared food grows in popularity and supermarkets promote their fresh food, their share of the market has grown further - to 49.8% - at the expense of speciality stores.

The three biggest buying organisations/wholesalers - Maxxam, Sligro and Supertrade - have an 80% share of the market and they are the major outlet for foodstuffs like drinks, snacks and confectionery.

Supermarkets' turnover is expected to increase 2.8% in 2013 and 2% in 2014, as a result of rising prices rather than volume. Supermarkets' online sales will increase as more consumers turn to this way of buying. For supermarkets, variety of choice is an important distinguishing factor. While margins in the food service subsector are larger than those of food retailers, they remain under pressure because of increased costs and growing consumer price sensitivity.

Beverages

The development of the beverage industry is generally positive. Around two thirds of all food exports are of alcoholic drinks, of which beer is the most important. Beer producers' turnover has risen as the result of higher exports to non-EU regions like Africa, Latin America and Asia Pacific, while there is no growth in the European markets.

Dairy

The dairy sector is one of the largest and most vital agriculture sectors in the Netherlands. In 2012 the export value of dairy products was EUR 5.9 billion: up 4.5% year-on-year. With a trade surplus of EUR 3.6 billion, the dairy market constitutes 9% of the entire Dutch trade surplus. 65% of dairy exports go to the EU (mainly Germany, Belgium and France) while the main export destinations outside the EU are Russia, Saudi Arabia and Nigeria. Cheese is by far the most important dairy product produced in the Netherlands, accounting for almost 56.3% of domestically processed milk.

Despite this, there are some problems on the horizon. In 2015 the EU's milk quota will expire, leading to an increase in milk supply. This will depress prices and possibly create a surplus of milk on the market. Nevertheless, the good reputation of Dutch dairy products will also lead to increased demand from Asia, where hygiene issues with domestic products have already led to higher imports. However, increasing price pressure from wholesale and retail could result in growing problems for some producers. In our experience, payment behaviour in the Dutch dairy sector is good, and we have received few credit insurance claims on the sector.

Animal feed

The Dutch compound feed industry produces feed for farm animals – around 13.5 million tons of animal feed a year. It operates under challenging conditions and, through mergers and acquisitions, the subsector is concentrated with just a small number of export oriented companies whose market share and margins are quite slim.

The industry’s problem on the domestic market is that the amount of Dutch livestock is limited by regulations to protect both animal welfare and the environmental. That means that there is no room to grow animal feed volumes in the Netherlands. In addition, there is upward pressure on agricultural commodity prices as global demand grows. As animal feed costs are 55% to 75% of the final cost price, this has an immense impact on farmers’ results. However, in the last 12 months we have not received any credit insurance claims on buyers in this sector.

Meat

Major subsectors within the meat sector are beef, veal, pork and poultry. Total domestic meat consumption remained stable in 2012, with 59% of meat distributed via supermarkets, 35% sold by the catering industry and 6% through specialist retail butchers. The share of pre-packaged meat in the household market increased from 72.4% in 2000 to 92.5% last year.

Fish

This sector covers everything from catching the fish to selling it to the consumer. Around 20,000 people in the Netherlands work in the industry and the Dutch trawler fleet is among the most modern in Europe. By far the majority of the catch - 90% - is destined for export to more than 70 countries. Major export markets include West Africa, Egypt, China, Philippines, Japan and Eastern Europe. 2012 was a good year for Dutch fishing companies, due to the high prices fetched by pelagic fish: those living near the surface of open seas. Fish processing involves a wide range of companies - wholesale, processing and handling fish – and the number of such companies remains fairly stable. In 2012, the domestic market for fish and fish products shrank, but is expected to increase again in the coming years as fish has a healthy image, there is wide availability and choice, and prices are attractive. We have received few claims or notifications of non-payment over the last 12 months although payment disputes sometimes arise over incorrect deliveries or contaminated products.

In general our experience of the food sector has been good over the past two years. We expect no major increase in late payments or insolvencies in the months ahead and therefore our underwriting stance remains relaxed. However, we are more cautious in the meat sector, especially concerning wholesalers and traders. At present, to assess a buyer’s creditworthiness accurately, our minimum requirement is sight of 2012’s balance sheets. For large credit limit applications we also need to see details of our customers’ previous trading experience with the buyer.

Dutch food sector

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

Spain



- **On of Spain's economic engines**
- **Stable payment behaviour and default levels**
- **Further efforts needed to cope with the challenges of internationalisation**

Since the beginning of the economic problems in Spain, the agri-food sector has shown its resilience, strengthening its position as a strategic sector for the national economy. The industry carries considerable weight and exports have grown since the mid 1990s, indicating that globalisation has been an ongoing and long-term process in the industry - not just a reaction to the recent effects of the recession on domestic demand. Spanish agri-food sector production amounted to EUR 86.3 billion in 2012, accounting for about 7.5% of GDP. The sector comprises around 30,000 companies of which 96% are small and medium-sized enterprises, and half a million employees. This represents 2.5% of total employment in Spain. It is worth noting that the unemployment rate in the food sector is about half that of Spain's overall unemployment rate.

Agri-food companies play a key role in Spain's export success. In 2012 food and beverage exports increased 9.4% year-on-year, to EUR 22 billion, accounting for nearly 10% of Spain's total exports and providing a trade surplus of EUR 3 billion. Exports have continued to grow in 2013, by about 4% in the period of January-August 2013.

The growth and modernisation of the Spanish agri-food industry have paved the way for (mainly) larger companies to compete internationally. As international sales have grown in importance, the industry has been forced to become more efficient. Now Spain's agri-food industry can claim to be more competitive than the European average throughout the value chain - from production to retail distribution. In addition, the need to be competitive has led the industry to become highly innovative. Revenue from new and improved products has doubled over the last decade.

However, domestically the sector has shown signs of weakness due to falling disposable incomes and thus purchasing powers. This is compounded by a VAT increase in September 2012 which has hit spending on food. Overall last year domestic food sales decreased 2.7% year-on-year.

Meat, alcoholic beverages and dairy industries constitute 45% of total agri-food output. All subsectors contributed to increased exports in 2012, especially meat (up 18.6%) which also accounts for 23% of the industry's employment and 14% of all agri-food companies. Indeed, the meat subsector remains a key segment for the total industry. While the domestic situation remains complicated by the pressure on margins, as vendors seek to maintain sales in an environment of low consumption, exports sales improved significantly in all meat categories. However, higher commodity prices and energy bills continue to affect the sector's profitability, especially for those companies with low export activity.

After Italy, Spain is Europe's second largest fruit and vegetable producer. One of the main challenges for these producers is to create larger companies with more leverage to negotiate: not just with retailers but also with finance providers. The downward trend of the Spanish alcoholic beverages subsector continues because of lower domestic demand. However, exports increased 15% in 2012.

Since the start of the economic downturn the dairy subsector has fared worst within the agri-food industry, with extensive rationalisation of capacity and output reduction continuing. Two major problems are 'downtrading', i.e. that consumers choose distributors' cheaper private labels, and the difficulty of passing on rising costs.

Indeed, in the food retail subsector as a whole, price has become the most important factor in purchasing decisions, because of increased VAT and reduced consumer purchasing power, and this is likely to persist in 2014. Supermarkets continue to be the most important and powerful sales channels at the expense of hypermarkets. Discounters are benefiting from the current situation and are adjusting to the new reality, offering a wider range of products, selling local brands and opening stores in city centres.

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

- Developing larger companies and promoting integration into cooperatives to modernise, internationalise, and improve capacity and competitiveness. It is clear that small-scale entities don't have the powerful trade structures needed for successful export.
- Improving the efficiency of the supply chain will to increase competitiveness.
- Reducing existing imbalances in trade relations between the different operators in the value chain by enhancing the ability of producers to manage supply, take on the transformation of their own products and compete on a level playing field with those industries that buy their products.
- Improving the quality of business management - especially in strategic planning, cost management and quality marketing

In the food sector, except for production, margins are quite slim. The final price breaks down as follows: 46% for production, 21% for transformation, 11% for supply chain management and 22% for retail distribution. Retail margins have remained largely unchanged since 2000.

Companies operating in this industry generally have acceptable balance sheet structures with solvency ratios usually above the average. Like other Spanish companies, food operators - especially SMEs - suffer from the lack of credit and liquidity flows in the economy. However, dependency on bank finance is lower than in other sectors.

Average payment terms have remained unchanged since last year: at about 80 days, while in some subsectors, such as fruits and vegetables, payment terms are higher: 100-120 days. During 2012 and into 2013 the generally good payment behaviour remained stable, unlike many other industries, and we do not foresee any significant change in the coming months. Insolvencies are also at good levels and are expected to remain so.

Because of its resilience and the stable trend in our credit insurance claims experience, our underwriters are generally supportive of this industry. However, while there has been a significant improvement in the transparency of buyers, we remain cautious in cases where there is little positive trading experience or up-to-date financial information available. Within the food sector, we closely monitor those subsectors facing decreasing domestic demand and tighter margins, i.e.

meat products, beverages and frozen seafood. We also conduct special reviews of subsectors facing high raw material prices and which have little room to pass on costs: such as poultry farmers, the flour industry and animal nutrition.

We aim to anticipate risks by collecting financial data and interim figures on the weakest companies, and by maintaining close contact with buyers in regular face-to-face meetings. This is valuable to our customers as it helps to maintain a satisfactory level of cover. We will continue to pay particular attention to the underlying trends that could signal potential future difficulties: such as high leverage, adverse performance against budget and erosion of profit margins.

Spanish food sector

STRENGTHS	WEAKNESSES
Resilient to current economic problems	Pressure on margins
Positive trade balance	Volatile input costs
Highly innovative	Low concentration and regulatory limitations

United States



- **Sales of organic food boosted by health awareness**
- **Meat sales led by a boom in exports**
- **Record milk production expected**

Fruit and vegetables

The growth of protected agriculture in the fresh vegetable market has taken much of the volatility out of production and turned it into more of a commodity business than ever before. Large growers can take advantage of economies to scale and survive on their shrinking margins. However, there is still a high level of risk in this industry. We are likely to see a reduction in the traditional production of many fruits and vegetables as the risks associated with growing fresh produce result in higher production costs and yield volatility for those who do not grow in protected environments.

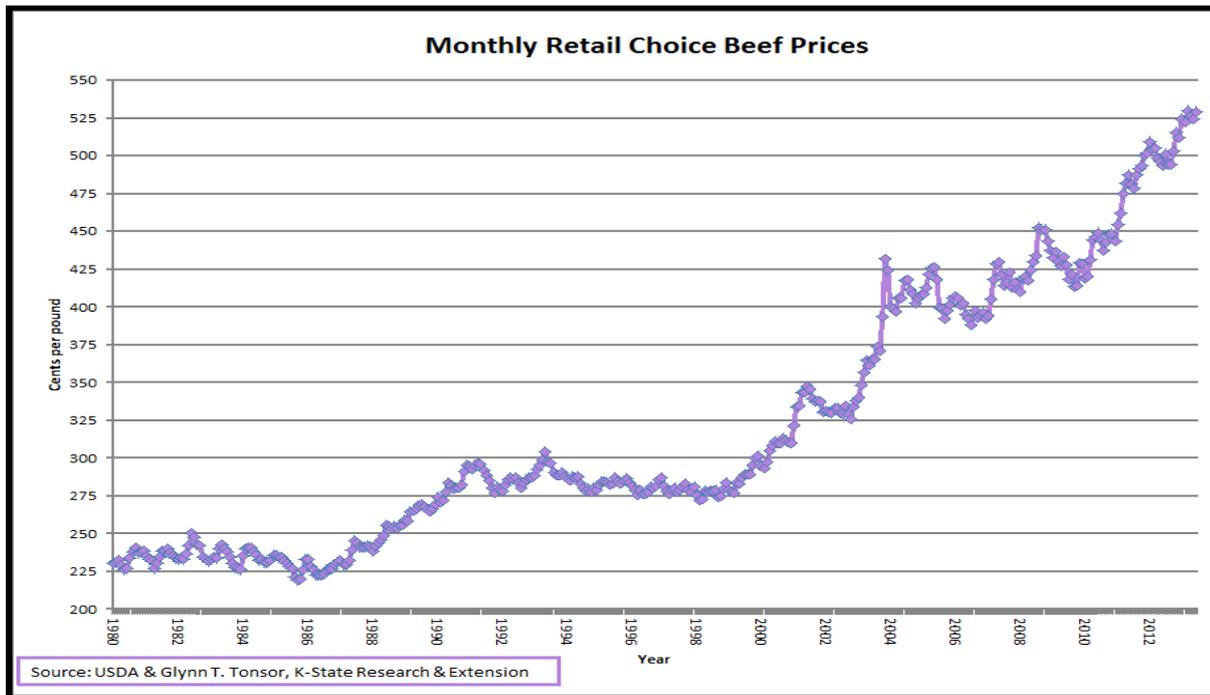
Vegetable output is expected to rise faster than population growth over the next decade because of the emphasis on health and nutrition that has led to expanding consumer demand. Moreover, organic food has grown in popularity in the US, with a heightening awareness of health benefits, environment protection, food safety, and animal welfare reforms. Even during the challenging economic slowdown, the organic sector posted 5.1% year-on-year growth in 2009: well ahead of overall food industry growth. In light of current and predicted market trends, the organic food industry is likely to see a 12% Compound Annual Growth Rate (CAGR) during the period 2010–2014. Research shows fruits and vegetables to be the most dominant of the organic food segments in the US.

Other farmed commodities

Following recent declines, the prices of corn, wheat, oilseeds and many other crops remain historically high, and the value of US agricultural exports and farm cash receipts (the cash income received from the sale of agricultural commodities) are expected to rise through the rest of the decade. Production costs are also expected to rise beyond 2015, but net farm income will remain historically high.

Meat

Meat consumption in the US has fluctuated over the past decade, but there has been a boom in exports. Production of red meat and poultry has increased by 10% over the last 10 years and, even though per capita consumption in the US itself has declined, exports of these products are forecast to reach 7.3 billion kilos in 2014, compared to just 4.4 billion kilos in 2003. Although domestic beef demand remains uncertain, with consumers deterred by high prices, that foreign demand is enough to support beef production in the coming years. Moreover, cattle producers can expect corn prices to fall, easing the heavy burden of high feed costs that they have had to carry throughout years of drought.



Dairy

The US Department of Agriculture (USDA) anticipates record levels of US milk production in 2013 and 2014, helped by lower feed prices. This year’s milk output is expected to reach 91.7 billion kilos, up from 90.9 billion kilos in 2012 and 89 billion kilos in 2011. Next year, production is forecast to rise again: to 92.8 billion kilos. USDA predicts all-milk price for 2013 to be US\$ 19.60 to US\$ 19.80 per hundredweight (cwt), and, for 2014, US\$ 18.65 to US\$ 19.65 per cwt.

Food retail and wholesale/distribution

According to the Private Label Manufacturers Association (PLMA), in 2012 sales of private label food products exceeded US\$ 108 billion. Over the past two decades, sales of these private labels have grown steadily and often compete directly with national brands for market share. In supermarkets, private label sales reached an all-time high of US\$ 59 billion in 2012, despite slow growth overall for all brands. From 2009 to 2012, private label sales increased at an average annual rate of 2.6%, compared to an average of just 0.9% for national brands. Indeed, sales gains of private label brands constituted 40% of all sales gains in supermarkets during that period, according to PLMA.

For most food distributors, business has slowed because of rising food prices and a drop in restaurant traffic. With wholesale food prices in the US following an upward trend, the Food Institute predicts that retail food prices will also rise, but only moderately. According to the Food Institute, the increase in wholesale food prices has exceeded that of retail for the 13 months to May 2013. Indications are that the food-at-home price index will move up as well, into the 1.0% to 1.5% range. This is still an extremely moderate inflation level and means that the nation’s grocers will have to work harder to increase their top line sales compared to a year ago.

Virtually all distributors now offer value added services to customers, but the industry as a whole is still focused on products to drive revenue. Distributors will increase their investment in process improvements to reduce costs and improve quality, customer satisfaction and speed of service. Information technology is critical as distributors grow in size and broaden their supply chains.

Despite the ongoing economic uncertainty, the tight US and global commodity market supply and demand conditions - due largely to poor growing conditions during 2012 - were expected to keep US food price inflation in the range 1.5% to 2.5% throughout 2013 and slightly higher (2.5% to 3.5%) in 2014. That would be closer to the historical norm. However, inflationary pressures are expected to be moderate, given the outlook for commodity prices, animal inventories and ongoing export trends. While this forecast assumes normal weather conditions, a resurgence of the drought or severe weather conditions in key agricultural areas could drive up food prices beyond the current forecasts.

On average, payments in the US food industry take 30 days. While payment delays and insolvencies have increased over the last six months, we expect this trend to stabilise into 2014. For the food sector overall, our underwriting policy is relaxed, although we take extra care with subsectors that may feel the impact of commodity prices on their production costs, as this will determine the price paid by consumers and consequently the level of demand. We also take account of one-off events such as a spike in feed prices for meat producers or the Gulf oil spill which had a significant impact on seafood producers in that region.

While we have our own reliable sources of financial information on privately held companies in the food sector, we also encourage our customers to share their direct experience of the sector and their trading history. When we approach a buyer directly to obtain financial information, it also helps if our customer has agreed to be named as the insured supplier.

US food sector

STRENGTHS	WEAKNESSES
Good long-term growth prospects	Pressure on margins
Strong export performance	Volatile commodity prices
	Low concentration and regulatory limitations

Market performance at a glance

Denmark

- **Two thirds of food production exported**
- **Some SME exporters are vulnerable**
- **Discounting challenges traditional supermarkets**



More than two thirds of Danish food production is exported and altogether the agro-industrial sector accounts for 20% of Danish commodity exports. The improvements in 2012 and 2013 have been driven mainly by demand from emerging markets: China has now joined Germany and the UK as Denmark's most important export markets. Production of meat, mainly pig meat, is one of the most important subsectors, with around 90% exported. This subsector is generally resilient and positive results in recent years have also resulted from acquisitions and mergers abroad. The 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. In 2013 Danish dairies have generally performed well in the global market, with prices rising as milk production has been unable to match the growth in demand. The relatively small Danish greenhouse production of fruits and vegetables has for several years incurred higher production costs than foreign competitors. However, in the spring of 2013 the Danish Government passed a bill to reduce or abolish a range of taxes and levies on businesses.

Large Danish food businesses have generally performed well during the past couple of years, and this trend has continued into 2013. Among small and medium-sized enterprises, performance has varied from subsector to subsector. Meat manufacturers and wholesalers, 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. Furthermore, a number of Danish fish smokehouses have suffered – and a few have failed – from the high and still increasing price of salmon. In the Danish fast moving consumer goods sector competition is fierce, and in 2012 and 2013 the discount business has continued to grow at the expense of both traditional supermarkets and speciality stores: almost 50% of Danish retail stores are now discounters. Food retail prices have continued to fall in recent months as the increasing demand for low cost, private label products reflects cautious consumer confidence.

On average, payment terms in the food sector are 30 days: unchanged since 2012. In the last six month we have seen a stable or marginally improving trend in insolvencies in the food manufacturing sector as well as in retail and wholesale. Compared to other industries, we have received relatively few credit insurance claims relating to the food sector, and both the number and value of those claims have fallen in the past six months. The expected improvement in global growth in 2014 will have a positive impact on Danish food export. 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. Fierce competition, pressure on margins, and structural changes will continue to put pressure on traditional grocers, speciality stores, and their suppliers.

Poland



- **Good outlook as domestic consumption will grow**
- **Payment duration of 45 days in general**
- **Good payment experience over the last two years**

The Polish food sector performs well, and sales are expected to increase considerably until 2017, as rising disposable incomes mean that Polish consumers can spend more on food. Another positive factor is food exports, which increased 13.8% year-on-year in the first half of 2013. Although traditionally most Polish food exports go to key EU members such as Germany and the UK, exports to countries outside Europe, including China and Saudi Arabia have increased significantly. In fact, Polish exports to China quadrupled in the first six months of the year, propelled by high demand for pork. The robust nature of the Polish food sector has attracted private equity, as investors show their eagerness to profit from the agricultural and food industry.

The meat sector is constantly growing, due to high domestic consumption (75-80 kg per head: among the highest levels in Central and Eastern Europe) and thriving exports, with meat products account for more than 25% of exported food. Meat businesses have invested significantly to increase production capacity and to meet the highest quality standards. Those investments have in the main been financed externally, as a result of which companies are highly indebted. This may become an issue in the event of a drop in profitability or sales volumes. Milk production accounts for around 15% of total agricultural production and dairy products for 11% of Polish food exports. The Polish dairy industry has consolidated in recent years, especially following EU accession, with the leaders being privately held cooperatives established in 1990s.

The Polish food retail sector is currently dominated by discount stores like Biedronka (Jeronimo Martins), Lidl, and Netto. Market leader Biedronka had a 15% market share in 2012. The grocery retailing market increased 4% year-on-year in 2012: to Zloty 166.8 billion (EUR 39.9 billion), driven by steady demand for basic products and increasing interest in private labels.

With considerable pressure for low prices and the prominent market position of discounters, small and independent shops are finding it hard to survive. To avoid bankruptcy, these businesses are cooperating with, or are being taken over by big convenience store chains such as Zabka, Carrefour Express and Sloneczko.

The food sector's leverage is high, with substantial reliance on bank financing. However, at least banks are willing to lend. On average, payments in this sector take 45 days and our experience has been good over the last two years, with few notifications of non-payment. There are few insolvencies and we expect this to remain the case as the outlook for the sector is positive. As a result, our underwriting stance remains relaxed. To provide our customers with their requested cover, we will ask buyers to provide their previous year's annual financial statements plus interim data for the current year. In more complex cases, forecasts, trading experience and information of ageing debts are required. Because of its high indebtedness, we are generally more cautious when underwriting the meat subsector.

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