AMG STRATEGIC ADVISORS

Cold Facts About Frozen Foods

HOT TOPIC REPORT

October 2012 Update

Ever since Clarence Birdseye first developed a process to freeze and preserve food nutrients and flavor in 1944, the frozen food industry has grown at a healthy rate reaching more than $31 billion in annual retail sales, with over 99% of U.S. households consuming frozen food products. But recently the story has changed. Retailers and frozen food manufacturers are experiencing a sudden and significant decline in frozen food sales.

Over the last 52 weeks (period ending September 29, 2012) frozen food department unit sales declined by more than 3%. Total store unit sales are down, but frozen food unit sales are down more than any other department. In 2011, frozen food unit sales dropped to 2008 levels.

Although most retailers have seen an increase in frozen food dollar sales, unfortunately, nearly all of these dollar sales increases can be attributed to inflation not to increased consumer demand. Shoppers are putting less frozen food into their shopping baskets while purchasing these products at a higher cost.

Frozen foods are being challenged by:

- **Seasonality**
- **Higher prices & reduced package sizing**
- **Competition from substitute products**
- **Shoppers choosing more fresh, doing without**
- **Less product innovation**
- **Fewer younger shoppers**
- **Aisle confusion**

AMG Strategic Advisors launched a proprietary survey of frozen food shoppers and studied the recent shift in frozen food department trends to uncover a number of interesting root causes challenging the frozen food category.

Seasonality

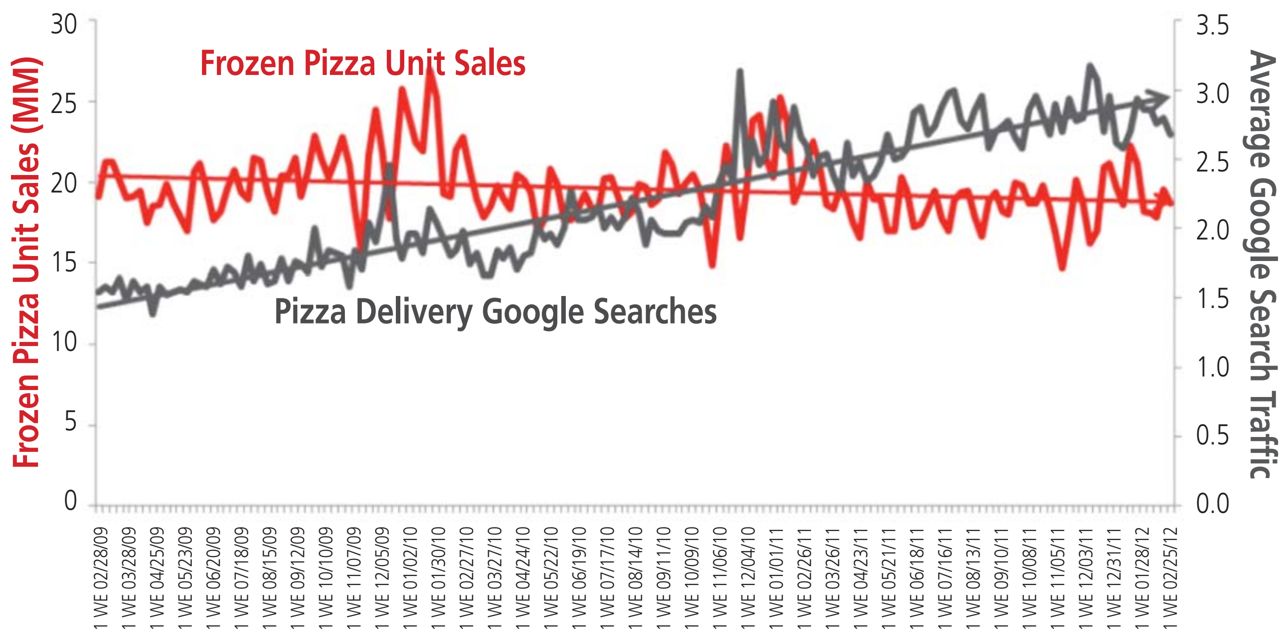
Frozen foods are a seasonal department. The department tends to show some seasonality during the summer months and also in March focused around National Frozen Food Month. Unit sales in March 2012 were down 6% versus the prior year and resulted in the lowest selling March Frozen Food month in the past six years. The 2011 summer season was also soft from a unit sales perspective. Ice cream and frozen novelties, two of the key summer season categories, experienced lower sales levels than the past few years. While never a top month for frozen food, December 2011 was the lowest four-week sales period in the past six years. Perhaps the unusually warm winter impacted consumer demand for frozen foods. The two regions of the country that had the warmest winters, compared with previous years, also had the largest sales decline in frozen foods. With a mild winter in much of the country, shoppers were more likely to eat out.

Not all frozen food categories have been impacted equally. Ice cream, pizza and frozen prepared foods (dinners/entrees) have seen the largest decreases in demand. These three categories alone contribute more than 40% of dollar sales and are key traffic drivers to the department. When shoppers reduce their trips to these categories, it hurts the department overall. Frozen breakfast was the only category that experienced increased unit sales.

Competition

Increased competition from substitute products has also impacted consumer demand for frozen products. For example, the frozen pizza category has been challenged by pizza delivery services. Domino's and others have been discounting heavily. In a review of Google searches for pizza delivery, we find a steady increase in demand while frozen pizza unit sales have slipped.

Frozen Pizza Vs. Pizza Delivery

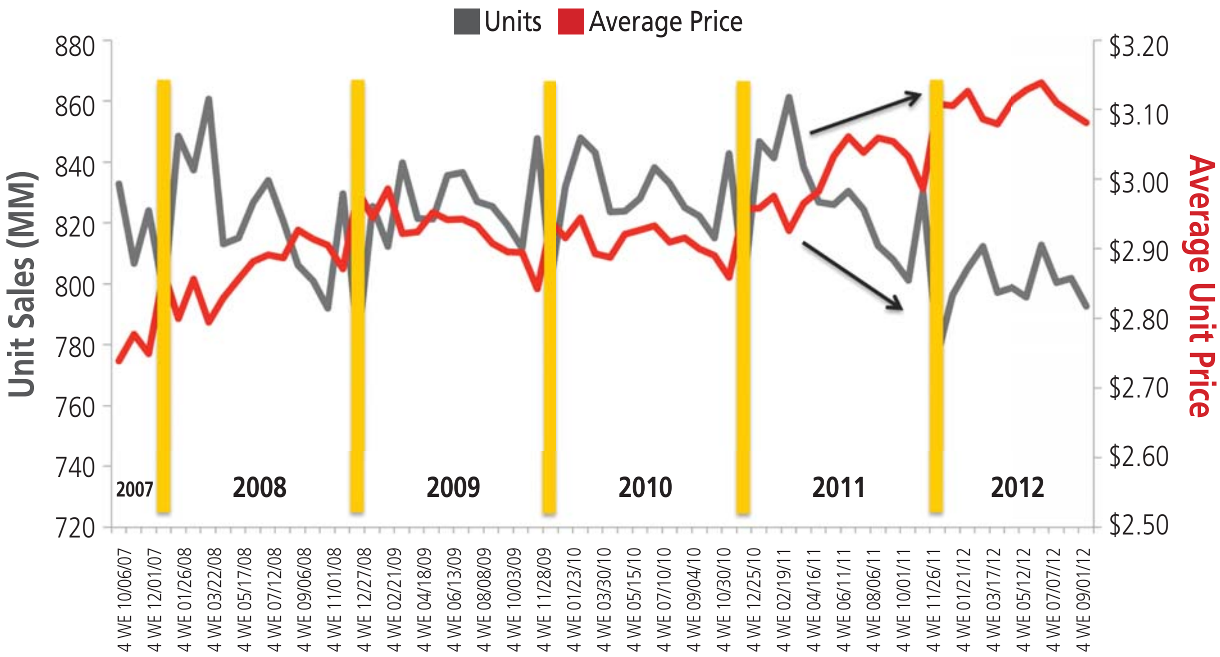


Source: Nielsen L104 WE 3/17/2012. Google Trends "Pizza Delivery"

Pricing

Shoppers cite a variety of reasons for buying less frozen food; however, at the top of the list is unit price. On average prices are up by 7% across the department versus last year.

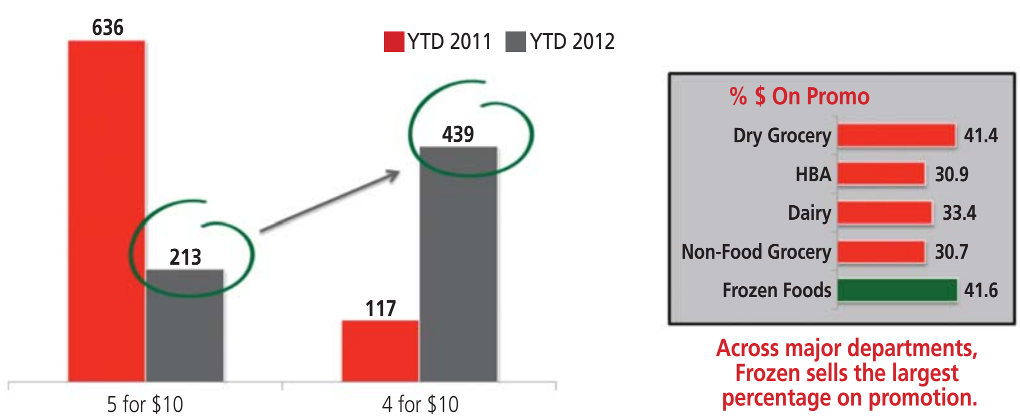
Frozen Food 5 Year Price Trend (FDMx)



Source: Nielsen L66 Quads W/E 9/29/2012

Promotional activity in the department has also changed. With the increase in everyday price, promotional discounts in the frozen food department are not as deep as last year. For example, in frozen dinners 5-for-$10 promotions are now often 4-for-$10 promotions. Consumers are noticing these value changes, and as a result their demand is falling off.

Ad Counts Across Major Food Retailers
(Frozen Self-Serve Dinners / Entrees and Frozen Vegetables)



Source: Feature Vision, YTD 2011, YTD 2012 Selected Retailers

More Fresh & Doing Without

Shoppers are buying more fresh foods and cooking more fresh foods at home. Consumers in certain categories such as frozen desserts cite dietary concerns as a reason for lower demand. Consumers are also trading frozen vegetables for canned and fresh vegetables, and in some frozen categories shoppers are just "doing without."

Why Shoppers Are Buying Less

	Multi Serve Entrees	Single Serve Entrees	Frozen Vegetables	Frozen Pizza	Frozen Snacks	Multi-Serve Ice Cream	Single Serve Ice Cream	Frozen Desserts	Frozen Breakfast	Frozen Meat	Frozen Fish
Higher price/cost	28%	27%	21%	27%	25%	27%	34%	22%	25%	26%	42%
Economy	22%	20%	20%	12%	15%	12%	21%	14%	15%	16%	16%
Not healthy/eating healthier	5%	9%		15%	18%	17%	13%	9%	8%	6%	3%
Dietary	1%	2%		10%	6%	11%	14%	28%	5%	2%	1%
Buy more fresh				4%	1%			3%		19%	15%
Eating less	2%	4%	4%		3%				10%	5%	6%
Buy more fresh/canned			41%								
Change in family size		4%			3%				5%	6%	4%
Doing without						21%	6%	9%			
Cooking more at home	16%	8%		2%					4%		
Making it at home		2%	1%	4%				9%	15%		
Smaller family	6%		4%	5%		5%	2%	1%			
Bored, tired of it	3%	3%	1%	2%	2%				4%		3%
Buy bottled/SS					1%						
Family not asking for it					2%						2%
Special treat				2%	2%	4%	2%	3%			
Don't like the taste		3%	2%	1%	1%						1%
Don't need them		5%			6%				2%	2%	
Cutting back on meat										13%	
Don't like them					6%						5%

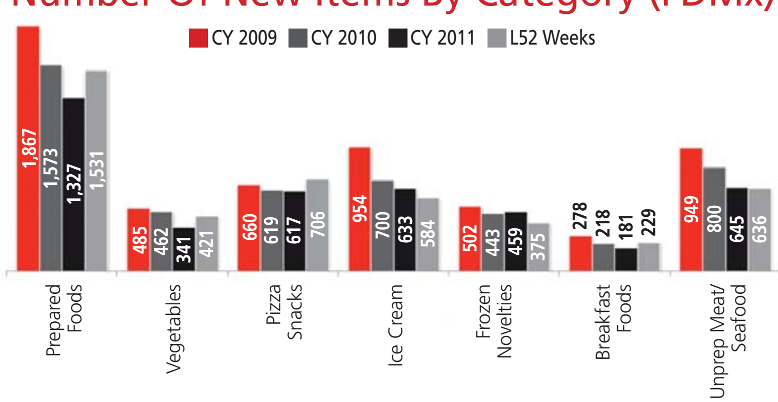
Source: AMG Shopper Community Survey April 2012

Lack of Innovation

Another factor impacting frozen food unit sales is a lack of new item innovation within the frozen food department. In reviewing new item entries into the frozen food categories, manufacturers introduced 22% fewer new items in 2011 than in 2009. In some categories, manufacturers introduced up to 42% fewer new items in the same time period.

There are some exceptions. One frozen category that showed an increase in new item introductions was frozen breakfast. It was the only frozen category showing a unit sales increase versus last year.

Number Of New Items By Category (FDMx)



Source: Nielsen Planners period ending 4/14/2012

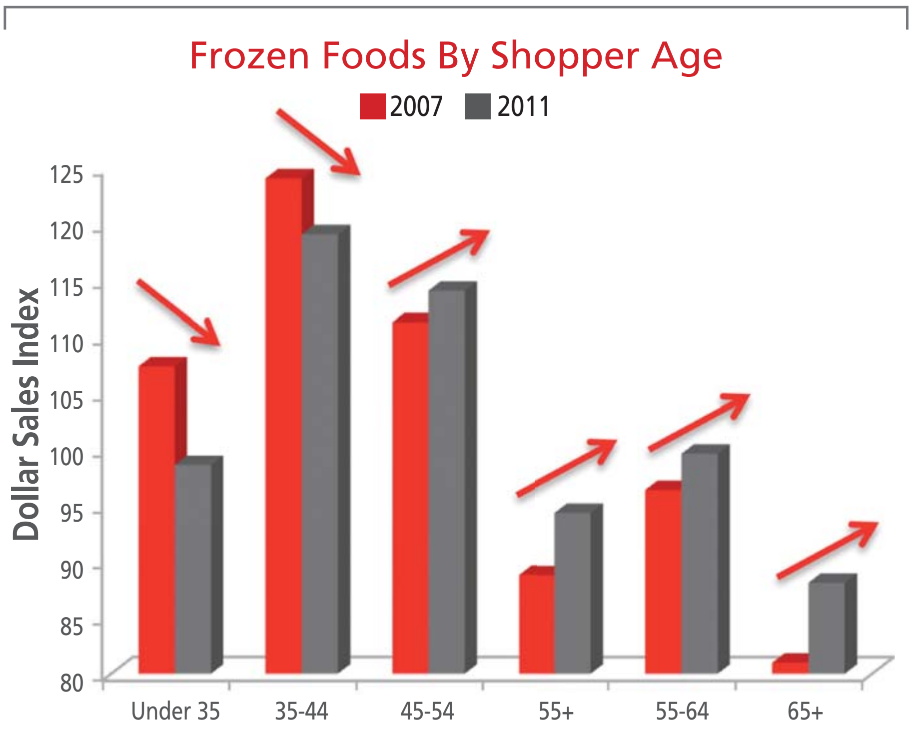
Package Sizes

Packaging changes also explain some of the changes in category demand. The ice cream category has seen large unit sales declines. In addition to increasing prices, manufacturers have also downsized packaging. What used to be a "half gallon" of ice cream is now often a 48-ounce package. This is a 25% reduction in package size. When asked, 33% of all frozen food shoppers indicated they recognized the package size reduction. This ranked highest amongst all other frozen food categories.

Fewer Young Shoppers

Demographics also help explain these recent category trends. Across major frozen categories, more than half of the shoppers are over the age of 45. Shoppers under the age of 45 are leaving the department for other options. Comparing 2007 to 2011, fewer shoppers age 44 and younger are buying frozen foods, while shoppers 45 and older are buying more.

Frozen food categories show significant variance in demographic appeal. For example, about 50% of frozen pizza is purchased by households age 44 and younger while this same group is only responsible for 33% of ice cream sales. Finding ways to entice younger shoppers into the department needs to be a priority for manufacturers and retailers



Source: Nielsen Consumer Facts CY 2007 - 2011

Aisle Confusion

We also learned shoppers find the frozen food department hard to shop and difficult to navigate. Out of 20 major departments or categories surveyed, frozen foods rank amongst the "hardest to shop." The only two categories that ranked harder to shop were personal care and candy. This is a big opportunity for retailers and manufacturers to provide a better shopping experience for frozen food shoppers.

RECOMMENDATIONS: Bringing Shoppers Back

Higher everyday prices and lower promoted price points in the frozen food department have driven shoppers to find other options to feed their families. In particular, younger shoppers are seeking options they perceive as both a better value and a healthier option. They also have been disappointed with the rate of frozen food innovation.

The recession was a key driver in the "eat at home" trend which has continued post-recession. Thus far, frozen food companies have not capitalized on this trend. Following are a variety of suggestions and ideas to help frozen food manufacturers and retailers bring shoppers back to the frozen food department.

Invest in department innovation

- Target younger shoppers to bring them back into the department, capitalizing on their unmet and future needs.
- Address consumer demand for health and wellness as part of the frozen food innovation strategy.
- Consider packaging and portion control innovation.
- Communicate new innovation to shoppers (before they shop) to get on their shopping list.
- Meet the needs of key demographics (multi-cultural, high/low income, younger/older).

Improve the frozen food shopping experience

- Re-evaluate adjacencies and look for ways to simplify the frozen food shopping experience.
- Help shoppers with navigational queues in the store.
- Explore opportunities to bring some "fun" to shopping frozen food.

Redefine "Value" for frozen food shoppers

- Ensure shoppers understand that frozen food offers convenience and nutrition.
- Create complete "solutions" that make meal preparation easy.
- Cross promote inside and outside of the frozen food department.

Leverage March Frozen Food Month

- Invest in promoting frozen food and bringing new shoppers into the department.
- Make March an integrated part of the overall shopper marketing strategy for your brand.

Create a solid price and promotion strategy

- Understand the impact of price gaps and how shoppers will react to price increases.
- Understand key promotional timing, frequency and optimal promoted price points.

About AMG Strategic Advisors

AMG Strategic Advisors is the growth strategy consulting unit of Acosta. AMG Strategic Advisors assists clients in accelerating profitable growth by leveraging insight driven strategies and advanced analytics. AMG Strategic Advisors leverages its seasoned consultants from leading strategy firms with proven industry expertise to provide best-in-class strategy consulting, brand positioning, shopper and marketing insights, and data analysis. For more information, visit www.acosta.com.

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