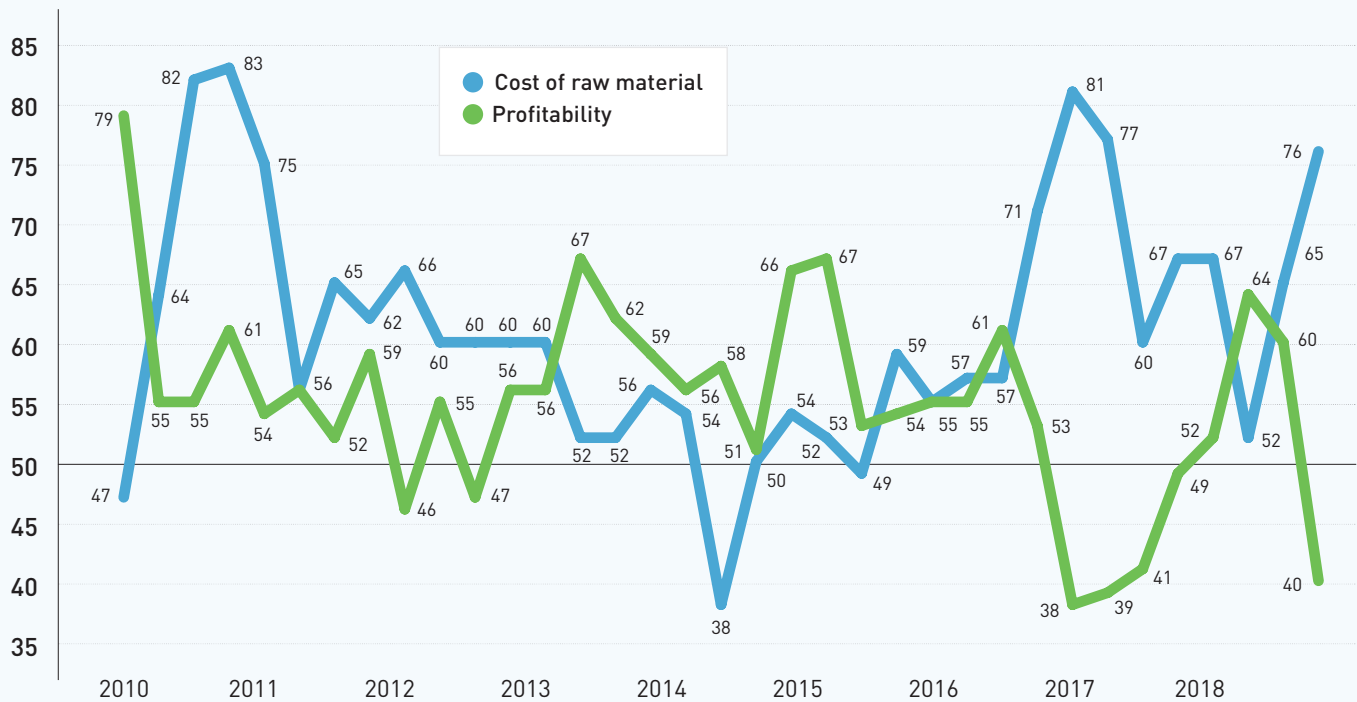


SWEDISH FOOD FEDERATION ECONOMIC REPORT

FIGURE 1. INDEX OF RAW MATERIAL COST AND PROFITABILITY Q1 2010 – Q3 2018.

Index 50 indicates unchanged development compared with the previous year. Source: Swedish Food Federation



The effects of the drought are spreading – the industry is facing difficult times ahead

The main theme currently in the Swedish food economy is, obviously, last summer's record drought and its consequences for the food chain, from farm to fork. According to the Swedish Board of Agriculture, it is now clear that the drought led to the worst Swedish grain harvests since the end of the 1950s. The harvests were halved compared to the previous year, and the consequences for Swedish agriculture are profound. Many farmers have seen significant loss of revenue and losses in operations.

The negative consequences of the drought are becoming increasingly evident also in the processing stage, the Swedish food production industry. The course of events so

far follows expectations, i.e., the costs of raw materials and inputs increased significantly in Q3, affecting the profitability trend negatively. The arrows for purchasing costs point steeply upwards, and the arrows for profitability development point almost as steeply downwards (Figure 1). Sweden's third largest industry is facing hard times ahead.

A 10% COST INCREASE

Purchasing costs are currently increasing significantly on a number of important inputs in the Swedish food production industry. The quarterly survey contained questions about ►

the cost development in eight different product categories, to obtain an up-to-date snapshot of the situation. The snapshot relates to circumstances during the month of October, compared with the same period last year.

Figure 2 shows that few input raw materials have developed in a direction which is favourable to food producers. Sugar has become cheaper to purchase for 35% of companies. For the vast majority of other categories, price increases are noted in varying order of magnitude. Some of the heavy segments such as cereals, meat, dairy, vegetables and fruit and berries showed rapid cost increases.

A total of 97% of companies have experienced increased purchasing costs for cereals, of which 42% report a cost increase of between 10 and 30% and an additional 24% indicate an increase of more than 30%. Nearly one third of the companies have seen huge increases in the cost of meat and 28% have experienced a sharp increase in the cost of fruits and berries. In relation to dairy products, 23% of companies reported significant cost increases.

Naturally, the impact of the price increases of raw materials on individual companies depends on the type of production. An unweighted average of the cost increases of the eight reported inputs in Figure 2 gives an approximate cost increase of 10%, calculated conservatively. Some companies experience far higher cost increases, while others experience lower.

If producers' total cost increases were to be passed on "unfiltered" to consumers via the food retail trade, this would entail an average increase in consumer prices by

just over 5%. A price increase at this level is necessary for producers to be fully compensated for the increased raw material costs. A 5% price increase is a few notches up from the 2.6% price rise of Statistics Sweden's food basket in October, or the 3.1% increase in September.

This is a snapshot of the cost increases Swedish food companies have experienced to date. We have not seen the full spill-over effects of the drought at the cost level of various input raw materials. Most clearly, this is illustrated by the significant increase in the cost of feed in all livestock production, which should ultimately result in added pressure on the costs of (Swedish) meat, poultry and dairy produce.

The picture that is emerging is quite simply a clear cost-increase for the bulk of the input raw materials used in Swedish food production. With a total cost representing 50–60% of turnover spent on purchasing raw materials, a majority of the companies thus notice a clear pressure on profitability, as already noted in the Q3 earnings. Nothing indicates that profitability will improve in the final quarter of the year.

SLUGGISH NEGOTIATION PROCESSES

Obviously, the cost increases will inevitably affect the next stage in the Swedish food chain: wholesalers and grocery stores. As described earlier, however, this is a sluggish process where negotiation is painfully slow. The sluggishness of passing on cost increases to the consumer level varies considerably between different subsectors and companies.

FIGURE 2. HOW HAVE YOUR COSTS OF INPUT RAW MATERIALS CHANGED (OCTOBER, ANNUAL RATE)?

Source : Swedish Food Federation

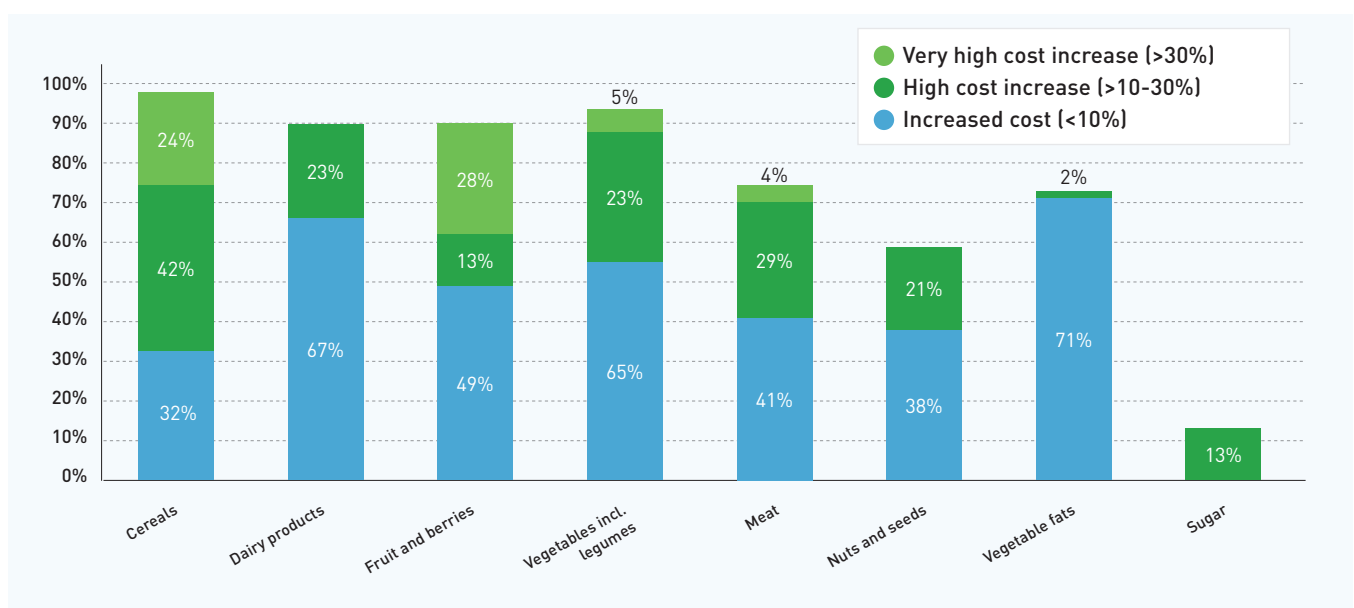
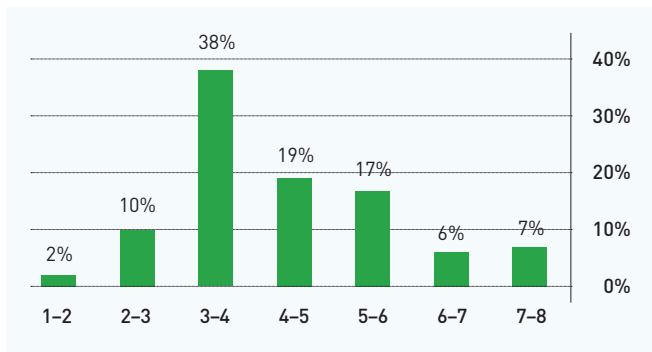


FIG. 3. WHAT IS THE LAG IN RELATION TO YOUR COST INCREASES FOR RAW MATERIALS BEFORE IT IS NOTICED IN THE CONSUMER PRICE? LAG IN NUMBER OF MONTHS.

Source: Swedish Food Federation



Only a small portion of companies, 12%, expect the wholesale/retail trade negotiation process to take less than three months. The vast majority of companies estimate that this will require much more time; 38% of companies expect their cost increases to result in increased delivery/consumer prices only 3-4 months later, 19% indicate 4-5 months and 17% 5-6 months later.

Food producers will therefore be forced to bear the rapidly increased raw material costs for a relatively long period of time. This increases the need for suppliers, once the new supply conditions take effect, to fully cover the new, higher cost levels of raw materials.

NO QUICK FIX OF THE MARGIN

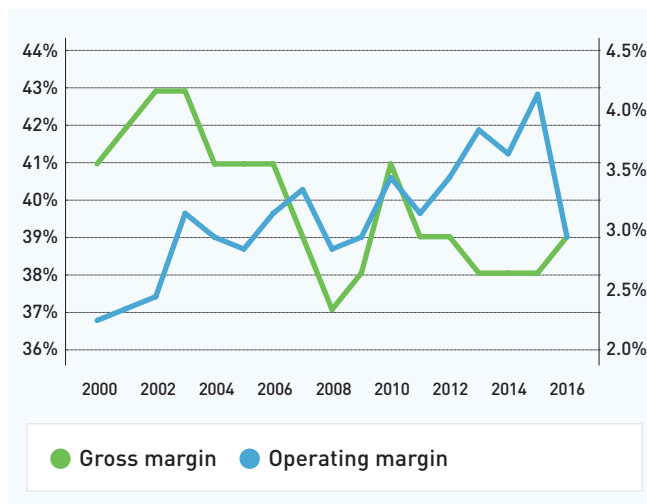
Since the last raw-materials crisis experienced by the Swedish food production industry 2008-09, the pressure on the industry's gross margin has been constant. A decade-long "streamlining programme", including employment cutbacks, has been required for producers to regain lost profitability. Aggregate data from the annual accounts of Swedish food producers clearly show that the ratio between gross and operating margin has been reversed since 2008-09 (see Figure 4). In other words, since the cost crisis of 2008-09 the gross margin has stabilised at a lower level (on average around 39% compared to 41% in the years before the crisis), while the operating margin has nevertheless, through efficiency improvements, managed to recover.

The new cost increase that is broadly affecting Swedish food producers puts further pressure on the gross margin. At the same time, the possibilities of offsetting this by way of streamlining efforts have diminished. The low-hanging efficiency fruits have mostly been picked. There is therefore an imminent risk that the current raw-materials crisis

may hit the Swedish food production industry harder than the crisis of 2008-09.

FIG. 4. DEVELOPMENT OF THE GROSS AND OPERATING MARGIN FOR FOOD COMPANIES 2000 - 2016. INCLUDES ONLY SNI 10 (EXCLUDING BEVERAGES AND TOBACCO).

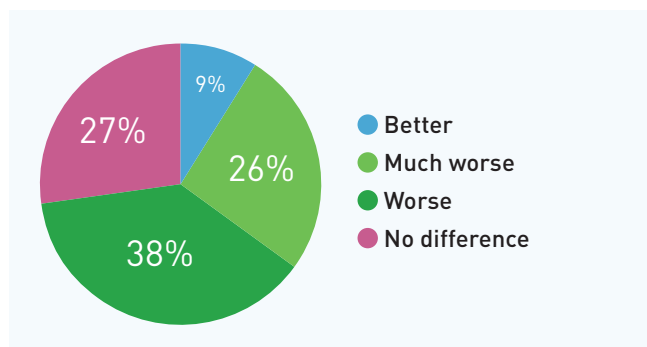
Source: Bisnode and Swedish Food Federation



The seriousness of the current situation is underlined by the member companies' survey responses. Asked how the possibilities of absorbing increased costs have changed since the previous cost crisis, 64% of companies respond that they see less possibilities, of which 26% see much less possibilities. In other words, it is no exaggeration to say that the entire Swedish food chain, and in particular food retail, must assume its share of responsibility to avoid that the cost crisis leads to a large number of closed farms and factories.

FIG. 5. COMPARED TO THE COST CRISIS 2008-09, HOW DO YOU VIEW YOUR COMPANY'S ABILITY TO ABSORB COST INCREASES THROUGH CONTINUED EFFICIENCY IMPROVEMENTS, IN THE CURRENT "COST CRISIS"?

Source: Swedish Food Federation



TRADE SHOWS NEW SIDES

So far, however, we can expect a more pragmatic approach from the Swedish food retail industry when it comes to helping to minimise the negative consequences of the drought. A large majority, 78% of food producers, feel that the food retail industry has shown an increased understanding that they need to charge higher prices after the summer drought. This is an important step in the right direction. It remains to be seen whether this is enough to stabilise the profitability loss at the production stage and thereby to facilitate continued and focused efforts for tomorrow's Swedish food production.

In a Demoskop survey conducted from 15 to 19 November, the Swedish Food Federation asked 1,000 Swedes if they expected their Christmas food to be more expensive this year due to the drought: 30% replied Yes, and 34% replied No. If member companies' forecasts of the lagging effects are correct, the consumer segment should, a few months into 2019, see a clearer correlation between the prices and the record drought, i.e., increased prices for Swedish food.

TABLE 1. ARE YOU SEEING A DIFFERENT UNDERSTANDING FROM FOOD RETAILERS OF THE NEED TO CHARGE HIGHER PRICES?

Source: Swedish Food Federation

We experience no difference in treatment	18%
Yes, an increased understanding	67%
Yes, a much greater understanding	11%
This does not affect our business	4%

THE SWEDISH FOOD FEDERATION'S ECONOMIC REPORT

The Economic Reports of the Swedish Food Federation are published four times a year. Participating companies account for approximately 50% of the industry's turnover. All answers are weighted according to the company's turnover size.



If you have questions relation to the Swedish Food Federation's Economic Report, please contact:

CARL ECKERDAL,
CHIEF ECONOMIST

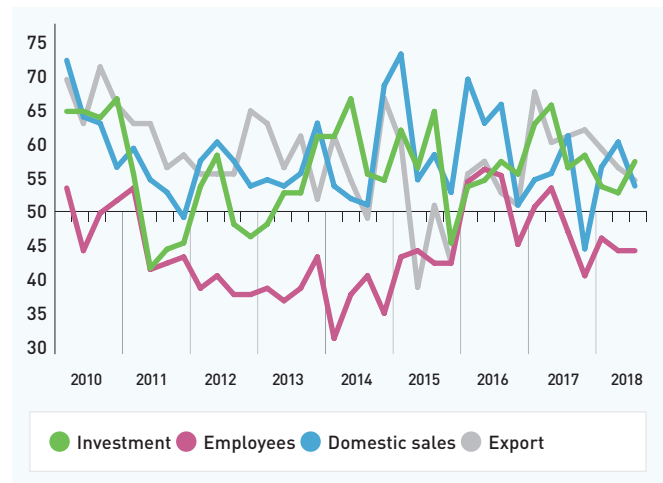
☎ 08-762 61 96
✉ carl.eckerdal@li.se

Three-year increase in investments

The third quarter featured cautious volume increases, both in the domestic and export markets. After a relatively long period 2016-17 with an increased number of employees, the trend is now again slightly negative. However, a notable bright spot in the third quarter, as well as in the last three years, is that corporate investments are increasing slightly (annual rate). Increased investments clearly signal a willingness in the Swedish food production industry to prepare for future challenges.

FIG. 6. THE SWEDISH FOOD FEDERATION'S BUSINESS INDICES OF DOMESTIC SALES AND EXPORTS, AS WELL AS EMPLOYMENT AND INVESTMENT DEVELOPMENT. AN INDEX OF 50 CORRESPONDS TO AN UNCHANGED LEVEL, MEASURED AT ANNUAL RATE.

Source: Swedish Food Federation




LIVSMEDELSFÖRETAGEN
The Swedish Food Federation

Box 556 80
102 15 Stockholm

☎ 08-762 65 00
✉ info@livsmedelsforetagen.se