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FOCUS: Europe's Food & Drink Cos Counting On Price Rises

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LONDON (Dow Jones)--Europe's cash-strapped consumers will be expected to delve deeper into their pockets to pay for branded food and drink in 2009, as consumer goods makers are relying on price increases for growth.

"We do expect our prices to go up in 2009 and in fact in some markets we have already increased prices in January," Jorgen Buhl Rasmussen, CEO of Carlsberg A/S (CARL-A.KO) told analysts recently.

Carlsberg is not alone. Both Cadbury PLC (CBRY.LN) and Nestle SA (NESN.VX) are set to benefit in 2009 from price increases put through at the end of 2008 while Nestle has guided toward incremental price increases in 2009 as well.

And U.S. giant Procter & Gamble Co. (PG) said in January that pricing and product mix would account for all of its 2%-5% organic sales growth this year, with volumes down by up to 2%.

But with the economic downturn expected to deepen in 2009, volumes and market share could be further put at risk if customers aren't receptive to these higher prices.

"The ability of companies to pass on further price increases to customers in order to mitigate falling volumes will be a key consideration over the next few quarters," Moody's said in a recent report on the beverage sector.

"The economic downturn is likely to make customers less amenable to further price hikes, all the more so now that inflationary pressures are coming down from their high levels in 2008," the report said.

The focus on price is the flip side of expectations that companies will be unable to increase volumes in the current economic environment. Since growth for consumer goods makers depends on either volume or pricing and few European companies expect volumes to rise in 2009, they are left with little choice over strategy.

Volumes are already flat for most food and drink companies, with giants like Unilever PLC (UN UL) and Diageo PLC (DEO) reporting volume falls in their latest quarters.

Likewise, brewers are expecting little benefit from volumes in 2009. Carlsberg and Heineken NV (HEIA.AE) recently said European market volumes would fall during the year, with the previously strong Russian volumes no better than flat.

But these lower volumes are seen as a sacrifice worth making. What matters is sales value and margins; as long as these stay strong, there's no temptation to cut prices in order to boost volumes.

"We are not going to reduce prices," said Pernod Ricard SA's (12069.FR) chief executive Pierre Pringuet at a press briefing recently. "Sometimes we have to sacrifice volumes," he said. "Value is more important than volume."

Associated Foods PLC (ABF.LN) Finance Director John Bason was also adamant margins would not be sacrificed. "Value is paramount," he told Dow Jones Newswires recently.

"You've got to get the value for money equation right," said Swiss-based food industry consultant James Amoroso, "and your first reaction should not be the price."

Equally, Amoroso said it was never a good idea to delay price increases just to snatch a bit of short-term market share, "It's usually the best thing to protect margins and take the volume hit," he said.

Raising prices in the current environment depends on a company's pricing power which, Amoroso, said depends on the category it sells in and the likely competitor reaction.

For example, raising chocolate prices would be much easier for Cadbury than raising laundry powder prices would be for Unilever. Cadbury has very strong positions in most of its markets, suffers from little private label penetration and will know that all of its competitors will have to raise their own prices if they are to offset the high price of cocoa.

In some categories - such as dairy products, where the penetration of private labels is strong - pricing could be quite difficult.

"Retailers may try to fend off hard discounters or get an advantage relative to branded products, by keeping prices low," said Amoroso. "If you're a branded player that's a bit unfortunate.

Even then, Amoroso said the temptation to cut prices should be resisted. "Ultimately things will return to normal," he said.

For distillers like Diageo and Pernod, price rises will also be harder to come by and the trading up to premium brands seen in recent years can't be relied upon to deliver sales growth. The "sales mix" of Diageo and Pernod has improved over recent years as more premium products were sold compared with budget and standard brands.

"Pricing will get tougher and mix could turn negative in some markets," said UBS analyst Melissa Earlam.

"An increasing proportion of Diageo's recent group sales growth has been driven by price and mix, but the positive impact of this is almost certain to be peaking," said Deutsche Bank's Jonathan Fell.

Amoroso said that the challenge for branded goods companies is to highlight the "value" element of "value for money" rather than just the "money."

This can be done through marketing investment and through innovation, he said.

"Unless it's three, four or five times more expensive, consumers are prepared to pay for the quality," he said.

Paul Bulcke, Nestle's chief executive made the same point to analysts recently. "In a downturn it's not a matter of price alone, it's a matter of creating more value and the consumer is not letting down on nutritional interest even in bad times," he said.

"If price is the only driver, there is no price low enough to be successful."

Evidence from Unilever shows the danger of raising prices beyond the tolerance of consumers. Unilever's new chief executive Paul Polman has made stabilizing volumes his first priority after sharp price rises saw volumes slip in 2008.

But despite this new focus on volumes, prices are still expected to rise at Unilever, with Dresdner Kleinwort expecting prices to rise 2.8% in 2009 and Shore Capital forecasting a 2.5% hike.

Cadbury understands this risk as well. "We're aware of the price/volume equation and we're watching it very carefully," Finance Director Ken Hanna told Dow Jones recently.

Amoroso believes the recession could leave the large consumer goods groups in a better position than they entered it.

"Recessions are quite a good thing to have from time to time," he said. "Those companies that haven't worked to differentiate themselves and invested in innovation in recent years are going to have problems," he said.

For these reasons, Amoroso is relaxed about Groupe Danone SA (BN.FR), Nestle and to a lesser extent Unilever's prospects in 2009.

"They've been sharpening their portfolio," he said.

One sub-sector of the consumer goods world is much more upbeat. Tobacco companies have long had to face a sales environment of little volume growth - particularly in the developed world. But persuading smokers to spend a little extra on their habit is rarely a problem.

In fact Altria Inc (MO) - the U.S. tobacco giant - last week raised prices in the U.S. by a full 15%, with rivals expected to quickly follow suit.

But for some companies, especially in the food sector, margins might be increased simply by not passing along the fall in commodity prices that has taken place since last summer.

Amoroso says, however, that while commodity costs have come down, European food companies are unlikely to feel the benefit until at least the second half of the year, as they wait for last year's hedging positions to unwind.

Sanford Bernstein analyst Andrew Wood says the industry is being overcautious about commodity costs for 2009. "We consider it inevitable that the food industry squeals (loudly) as commodity prices go up, but downplays the impact now that they are coming down."

He believes the gross margins for food companies will expand significantly in 2009 as input costs come down. He not only believes pricing can be achieved in 2009 but also expects volume growth.

Food companies will take advantage of the lower commodity costs and the lower cost of media space to increase advertising and promotion - thereby boosting volumes as well, he said.

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