

Times & Trends Special Report: Impact of Rising Gas Prices

As gas prices soar to levels that consumers never thought possible, consumer packaged goods (CPG) manufacturers and retailers are seeking to understand how the added strain on consumers' budgets is impacting purchase behavior and needs.

This report provides an assessment of CPG spending patterns during three time periods throughout the past year in which average gas prices reached significant new levels (less than \$2.00; \$2.00 - \$2.25; >\$2.25 per gallon.) It is intended to provide manufacturers and retailers with industry benchmarks by which to evaluate their category, brand and store performance, and insights into likely future consumer behavior.

As highlighted below, the CPG industry does not appear to have been negatively impacted, overall, by rising gas prices. In fact, as prices moved into the \$2.00+ per gallon range, growth rates across CPG departments markedly improved. As consumers have reduced spending in other discretionary areas, such as eating out at restaurants and entertainment, CPG retailers and manufacturers have apparently benefited.

A slowing in CPG growth rates over the past few months as prices have exceeded \$2.25 per gallon (reaching an all-time high of over \$3.00 per gallon), however, will need to be carefully watched to determine if sustained gas pricing at this or higher levels will result in a new round of belt-tightening that will lead to CPG spending reductions. Or, once prices plateau, as they are expected to do by the end of the year, consumers may become accustomed to the new levels and maintain current practices or even go back to prior habits such as eating at restaurants more often. IRI will continue to track gas price impact throughout this period of high volatility.

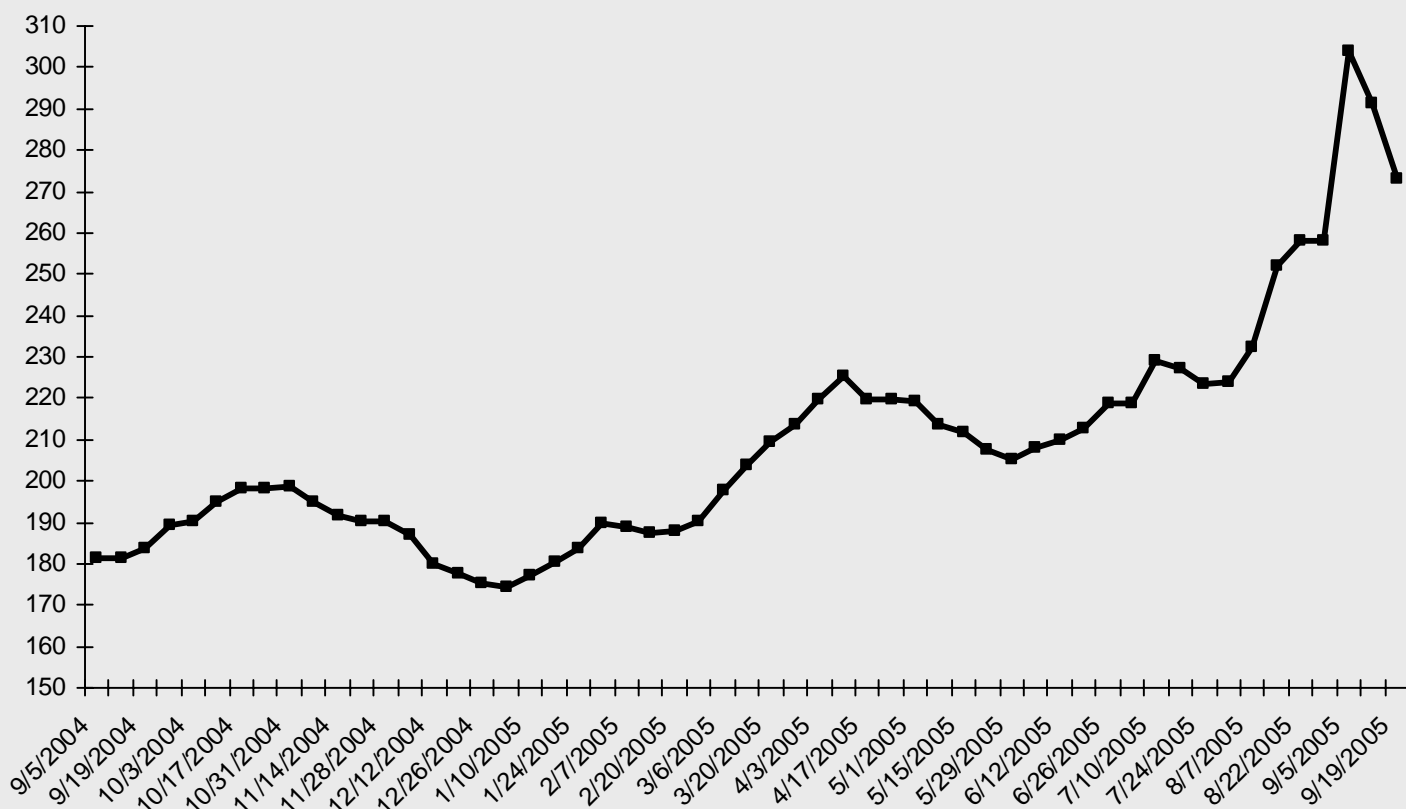
Key Findings

- **CPG sales received a boost when gas prices maintained levels of \$2.00 - \$2.25 per gallon.** During the spring and early summer of this year, as average gas prices held at \$2.00-\$2.25 per gallon, dollar sales growth rates across all major CPG departments (with the exception of general merchandise) accelerated, suggesting that as consumers have reduced discretionary spending in other areas (such as entertainment and restaurants), the CPG industry has benefited. Total industry dollar sales across all outlets increased 2.5% (versus flat sales when average gas prices remained below \$2.00 per gallon.)
- **Growth rates have slowed since average gas prices surpassed \$2.25 per gallon.** Throughout the summer, as average gas prices exceeded \$2.25 per gallon, total CPG industry growth rates slowed to 1.0%. A similar pattern is evident across most departments. While continued analysis will be required to monitor consumer behavior during a longer period of time at these levels, this may signal the emergence of a negative CPG impact.
- **Both club stores and dollar stores have been hit with sales declines.** Neither club stores nor dollar stores experienced the increases evident in other channels at the \$2.00 gas price level, and in fact have experienced sizable declines since prices have gone beyond \$2.25. Dollar store consumers skew lower income and are more likely to be suffering financial hardship due to higher gas prices. While club store core consumers are mid-to-upper income, these highly cost-conscious shoppers may have shifted spending to retailers closer to home who offer one-stop shopping in an effort to conserve gas. Traditional retailers facing strong competition from value competitors may have a window of opportunity to establish relationships with these consumers.

BACKGROUND: GAS PRICE TRENDS

Over the past year, U.S. gas prices have steadily increased, reaching over \$3.00 per gallon the second week in September. The Department of Energy expects gas prices to settle at \$2.60 per gallon by the end of the year and reach an average of \$2.40 next year.

Average Weekly U.S. Retail Regular Gas Prices (Cents per Gallon)
September 5, 2004 – September 19, 2005



Source: IRI InfoScan®; US Department of Energy

CPG INDUSTRY & CHANNEL PERFORMANCE

Massive increases in gas prices do not appear to have negatively impacted the consumer packaged goods (CPG) industry as a whole to date. In fact, when average gasoline prices consistently ran at over \$2.00 per gallon this past spring, industry sales received a boost.

The CPG industry likely benefited from a reduction in expenditures on entertainment and food-away-from-home as consumers tightened discretionary spending. An August 2005 study by Technomic, Inc found that nearly one-in-five consumers have reduced spending at quick-service and full-service restaurants.

Industry growth rates appear to be slowing somewhat, however, as prices rose yet again this summer exceeding \$2.25 per gallon (and recently briefly hitting \$3.00)--suggesting that the strain on budgets may be starting to take its toll on CPG spending. This is a trend that we will carefully monitor.

Across channels, grocery and drug stores benefited from the industry gain this spring, and while supercenters also saw a jump in growth rates (driven in large part by store expansion), fellow value channels club and dollar declined.

Dollar stores' core consumers, who skew low income, have been hit particularly hard, as fuel costs comprise a much higher proportion of their budget versus those with higher income. Although club store core shoppers skew mid-to-upper income and are less likely to feel financial hardship due to rising gas costs, they are highly cost-conscious and may have shifted some spending to other retailers that are closer to home and offer greater one-stop shopping capabilities in an effort to conserve gas.

While Wal-Mart's total chain performance across CPG categories has significantly outpaced the industry, the company has publicly stated that higher gas prices hurt total store sales as spending among their core, lower income consumers was negatively affected.

**Total CPG Dollar Sales Change vs Prior Year by Channel
by Time Period/Average US Regular Gas Price Range**

Time Period	9/27/2004 – 2/20/2005	2/21/2005 – 7/10/2005	7/11/2005 – 9/4/2005
Avg Regular Gas Price	\$1.75 - <\$2.00	\$2.00 - <\$2.25	\$2.25 - \$2.70
Grocery	(0.3%)	+1.7%	+1.4%
Drug Store	(0.8%)	+6.3%	+2.0%
Mass Merchandise	(3.7%)	(0.3%)	(1.8%)
Supercenter	+5.9%	+10.0%	+8.1%
Club	(3.5%)	(1.1%)	(6.1%)
Dollar	+0.7%	(0.2%)	(8.2%)
Wal-Mart Total Chain	+2.7%	+5.2%	+4.1%
All Outlet	(0.3%)	+2.5%	+1.0%

Source: IRI Consumer Network®; US Department of Energy

CPG DEPARTMENT PERFORMANCE

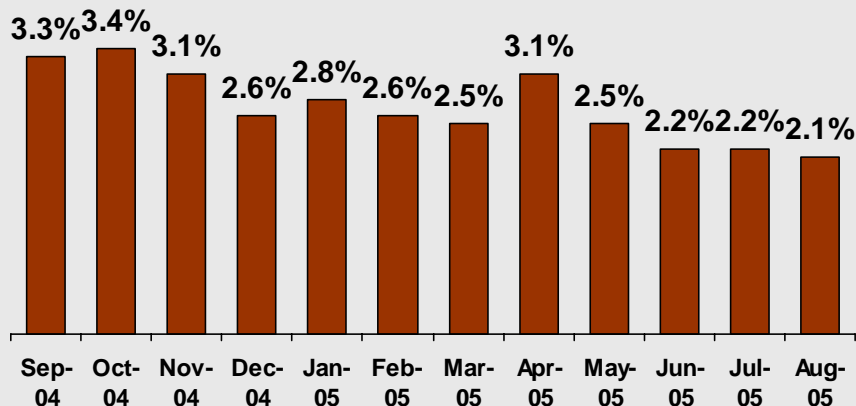
The total industry trends -- improved growth rates as gas prices hit \$2.00 per gallon and subsequent reduction in growth rates after average gas prices hit record new levels this summer -- are evident across all major CPG departments, with the exception of general merchandise. Negative sales trends in the general merchandise category are a continuation of longer term declines.

While gas prices are expected to drive price increases across many product categories due to higher distribution costs, that impact is not yet reflected to a large degree in the sales trends noted below. With the exception of a spike in April, food & beverage CPI has been relatively low and steady since December 2004.

**Department Dollar Sales Change vs Prior Year: All Outlet
by Time Period/Average US Regular Gas Price Range**

Time Period	9/27/2004 – 2/20/2005	2/21/2005 – 7/10/2005	7/11/2005 – 9/4/2005
Avg Regular Gas Price	\$1.75 - <\$2.00	\$2.00 - <\$2.25	\$2.25 - \$2.70
Bakery	+0.5%	+2.5%	+1.2%
Dairy	+2.1%	+3.3%	+1.6%
Deli	+0.9%	+2.6%	+0.1%
Edible	(0.3%)	+2.7%	+2.6%
Frozen	+2.7%	+4.1%	+3.0%
General Merchandise	(7.7%)	(5.1%)	(9.9%)
Health & Beauty Care	(1.0%)	+2.3%	+0.7%
Non-Edibles	(1.3%)	+2.5%	+0.4%
Total CPG	(0.3%)	+2.5%	+1.0%
Total CPG Less Gen Mdse	+0.1%	+2.8%	+1.6%

Food & Beverage Consumer Price Index % Change vs Prior Year



Source: IRI Consumer Network®; US Department of Energy; US Bureau of Labor Statistics

CPG DEPARTMENT PERFORMANCE (CONT'D)

If a proportion of consumers has increased spending on food-at-home in lieu of going to restaurants, we would expect to see increases in sales of convenient meal solutions. Across several leading meal solution categories, sales increases are evident, although declines in frozen pizza and soup following the advent of \$2.25+ gas prices were substantial. If consumer spending shifts towards at-home eating persist, manufacturers of meal solution products and retailers with prepared foods will have a unique opportunity to increase sales through effective positioning.

CONVENIENT MEAL SOLUTIONS - Dollar Sales Change vs Prior Year: All Outlet by Time Period/Average US Regular Gas Price Range

Time Period	9/27/2004 – 2/20/2005	2/21/2005 – 7/10/2005	7/11/2005 – 9/4/2005
Avg Regular Gas Price	\$1.75 - <\$2.00	\$2.00 - <\$2.25	\$2.25 - \$2.70
Cold Cereal	(0.1%)	+3.4%	+6.0%
Frozen Dinner/Entrees	+3.1%	+9.7%	+7.3%
Soup	+0.1%	+0.9%	(2.8%)
Frozen Pizza	+1.3%	+8.4%	(3.3%)
Dry Packaged Dinners	(9.6%)	(4.4%)	(4.8%)

During times of financial difficulties, sales of “small indulgences” typically increase. During this year of consistent gas price increases, however, there have been mixed results across leading snack and dessert categories. While salty snacks and cookies have seen solid sales increases, cracker sales jumped slightly but then declined, and candy sales have remained in the red.

SNACKS & DESSERTS - Dollar Sales Change vs Prior Year: All Outlet by Time Period/Average US Regular Gas Price Range

Time Period	9/27/2004 – 2/20/2005	2/21/2005 – 7/10/2005	7/11/2005 – 9/4/2005
Avg Regular Gas Price	\$1.75 - <\$2.00	\$2.00 - <\$2.25	\$2.25 - \$2.70
Salty Snacks	+1.9%	+4.7%	+3.6%
Cookies	(2.3%)	+4.4%	+3.4%
Crackers	+0.7%	+1.3%	(1.0%)
Chocolate Candy	(2.9%)	(4.6%)	(5.5%)
Non-Chocolate Candy	(0.9%)	(0.5%)	(4.3%)

Source: IRI Consumer Network®; US Department of Energy

CPG DEPARTMENT PERFORMANCE (CONT'D)

While a number of factors have influenced dollar growth rates across beverage categories, the sales boost evident across the CPG industry as a whole after gas prices reached \$2.00 per gallon appear to be playing a role in these categories, as well. Performance in the #1 CPG category, carbonated beverages, is indicative of this general trend. Strong continued high growth within bottled water has been influenced by huge surges in demand resulting from Hurricane Katrina.

Within the beer, wine, spirits segment, consistent with longer term trends in which sales have shifted from beer to wine and spirits, the latter two categories have received greater benefit from increased CPG industry sales than beer. Wine category sales have also been positively impacted by higher pricing and product mix shifts.

BEVERAGES - Dollar Sales Change vs Prior Year: All Outlet by Time Period/Average US Regular Gas Price Range

Time Period	9/27/2004 – 2/20/2005	2/21/2005 – 7/10/2005	7/11/2005 – 9/4/2005
Avg Regular Gas Price	\$1.75 - <\$2.00	\$2.00 - <\$2.25	\$2.25 - \$2.70
Carbonated Beverages	(1.6%)	+2.1%	(0.3%)
Bottled Water	+8.7%	+15.6%	+14.9%
Shelf-Stable Bottled Juices	(3.3%)	+1.5%	+6.8%
Coffee	(2.2%)	+10.0%	+13.7%
Sports Drinks	+8.6%	+15.0%	+18.7%

BEER, WINE, SPIRITS - Dollar Sales Change vs Prior Year: All Outlet by Time Period/Average US Regular Gas Price Range

Time Period	9/27/2004 – 2/20/2005	2/21/2005 – 7/10/2005	7/11/2005 – 9/4/2005
Avg Regular Gas Price	\$1.75 - <\$2.00	\$2.00 - <\$2.25	\$2.25 - \$2.70
Beer	(3.0%)	(1.0%)	+0.3%
Wine	(0.6%)	+6.2%	+10.6%
Spirits	(0.2%)	+4.1%	+2.1%

Source: IRI Consumer Network®; US Department of Energy

CPG DEPARTMENT PERFORMANCE (CONT'D)

Major events within the healthcare industry, including continued impact of Rx-to-OTC switches, legislation and retailer initiatives to place cold/allergy/sinus containing pseudoephedrine behind the counter, and recent safety concerns regarding popular internal analgesics have impacted sales across leading healthcare categories. Nevertheless, the same growth pattern in conjunction with gas price levels seen in the total CPG industry is evident across most leading healthcare categories, as well. It is possible that cuts in other areas of consumer spending have freed up funds for purchases of medications that consumers had previously gone without and/or that consumers have shifted to higher-priced brands.

HEALTHCARE - Dollar Sales Change vs Prior Year: All Outlet by Time Period/Average US Regular Gas Price Range

Time Period	9/27/2004 – 2/20/2005	2/21/2005 – 7/10/2005	7/11/2005 – 9/4/2005
Avg Regular Gas Price	\$1.75 - <\$2.00	\$2.00 - <\$2.25	\$2.25 - \$2.70
Vitamins	+0.5%	+4.0%	+3.1%
Internal Analgesics	+2.0%	+4.7%	(0.7%)
Gastrointestinal Tablets	+1.7%	+11.1%	+6.9%
Cold/Allergy/Sinus Tablets	+2.1%	+12.5%	(1.5%)
Weight Control Liquid/Powder	(16.0%)	(17.9%)	(7.2%)

QUESTIONS ABOUT THIS REPORT

Please forward questions and comments about this report to Sheila McCusker at sheila.mccusker@infores.com.

Source: IRI Consumer Network®; US Department of Energy