2004 INDUSTRY OUTLOOK FOR PROCESSED FOODS

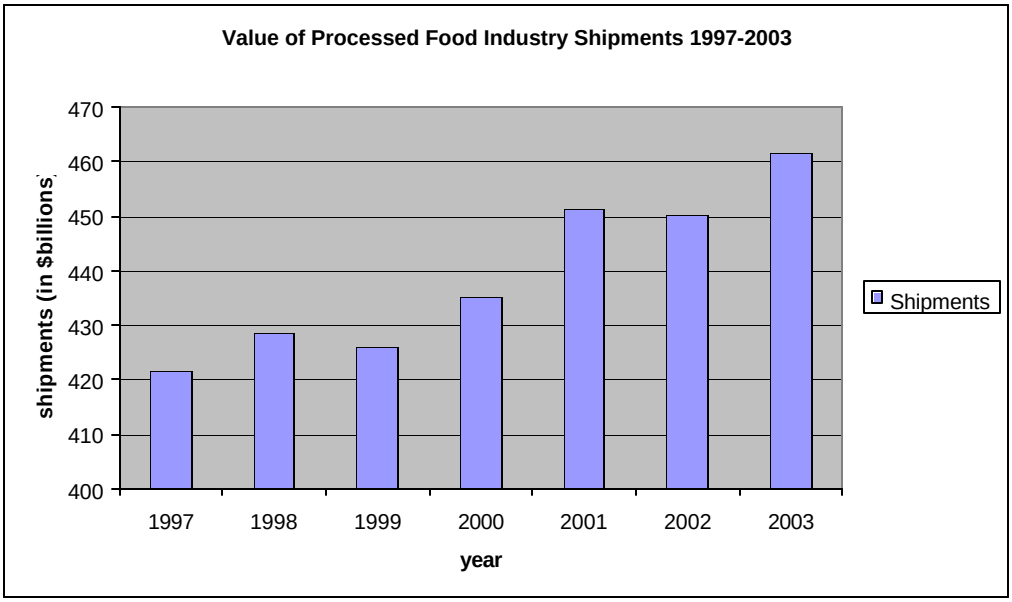
Food Manufacturing Industry Definition

The food manufacturing industry (NAICS 311) transforms livestock and agricultural products into products for intermediate or final consumption. Subsectors in this category include animal food manufacturing (NAICS 3111), grain and oilseed milling (NAICS 3112), sugar and confectionary product manufacturing (NAICS 3113), fruit and vegetable preserving and specialty food manufacturing (NAICS 3114), dairy product manufacturing (NAICS 3115), meat product manufacturing (NAICS 3116), seafood product preparation and packaging (NAICS 3117), bakeries and tortilla manufacturing (NAICS 3118), and other food manufacturing (NAICS 3119).

Establishments primarily engaged in manufacturing beverages and tobacco are classified separately in Subsector 312, Beverage and Tobacco Product Manufacturing and are not covered in this chapter.

U.S. Domestic Industry Overview

The food manufacturing industry is one of the United States' largest manufacturing sectors, accounting for more than 10 percent of all manufacturing shipments. The processed food industry has experienced steady growth over the 1997-2003 period. In 2003, the value of food shipments was $461.6 billion, an increase of 9 percent from 1997 shipments of $421.7 billion (see chart).[1] In 2003, the ten largest U.S. companies in this sector were Altria (Kraft Foods), ConAgra, PepsiCo, Archer Daniels Midland, Cargill, Coca-Cola, Mars, Anheuser-Busch, Tyson Foods, and Dean Foods.



[1] This chart reflects growth in current dollars, not real dollars and does not account for changes in inflation.

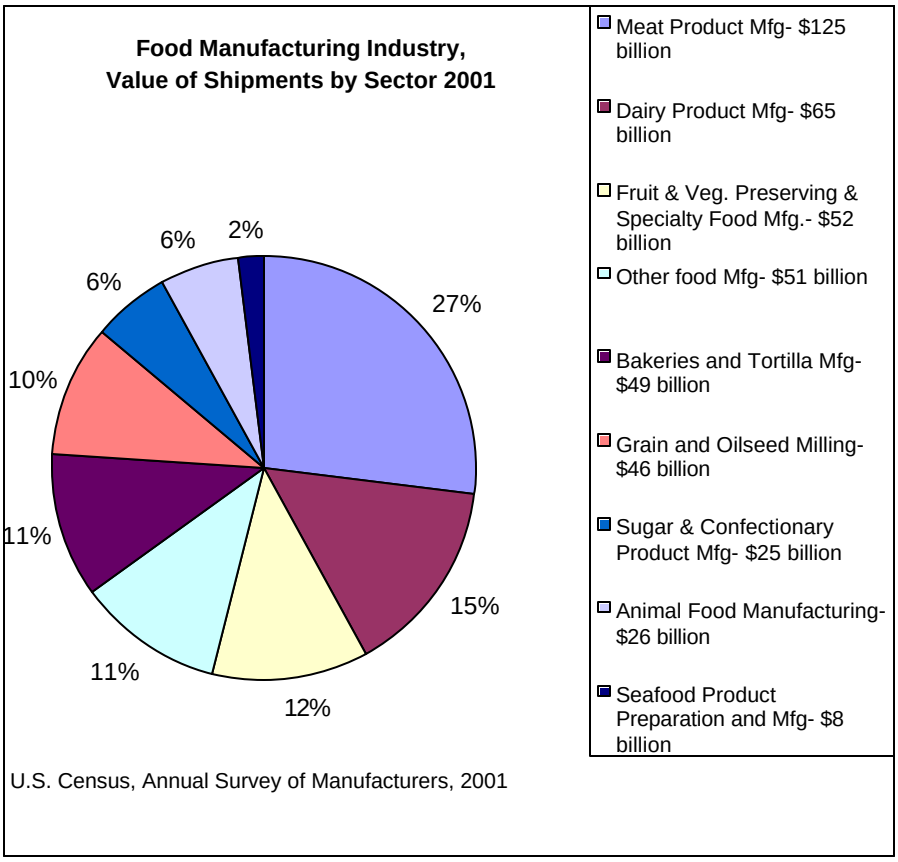
Demand for processed food products is less affected by economic upswings and downswings than other industries since food is a necessary purchase. Historically, the industry has had a high level of merger and acquisition activity and consolidation and reorganization have continued, although at a slower pace than in the past. The processed food industry has become increasingly global, as companies in the industry have expanded production and distribution into foreign markets.

Technological change has played an important role as production becomes increasingly automated and companies invest in new technology. Productivity gains from automation have increased output while leaving employment levels relatively stable. Investment in advertising and new product development is also significant.

Nature of the Industry

Processed foods are "value-added" products, referring to the fact that a raw commodity or commodities are transformed into a processed product through use of materials, labor, and technology. Any product that requires some degree of processing is referred to as a processed product, regardless of whether the amount of processing is minor, such as for canned fruit, or more complex, such as for snack foods.

Of the subsectors that make up the food manufacturing industry, the largest four: meat products; dairy products; fruit and vegetable preserving and specialty food; and other food, made up 65 percent of total industry shipment values of $451 billion in 2001. Other sectors included bakeries and tortilla manufacturing, which accounted for 11 percent, grain and oilseed milling (10 percent), sugar and confectionary (6 percent), animal food manufacturing (6 percent) and seafood products (2 percent).



Employment

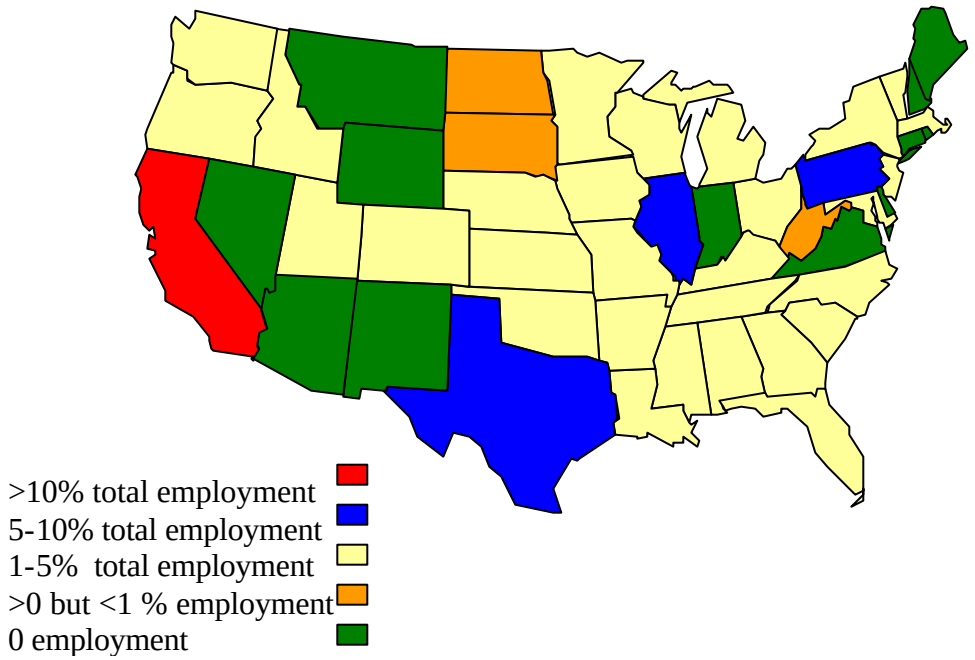
Employment in the industry increased slightly from 1.50 million in 1990 to 1.51 million in 2003. Better technology and increasing automation allowed companies to increase production while holding employment steady. The meat industry employed the largest number of workers in 2003 employing 34 percent of total industry workers.

Industry	**Employment 2003 (thousands)**	**%**
Food Manufacturing	1518.7	100.0
Animal Slaughtering and Processing	515.4	33.9
Bakeries and Tortilla Mfg	292.5	19.2
Fruit & Veg Preserving and specialty	183.8	12.1
Other Food Products	152.8	10.0
Dairy Products	136.3	8.9
Sugar and Confectionary	83.8	5.5
Grain and Oilseed Milling	61.8	4.0
Animal Food	49.7	3.2
Seafood product prep and pkging	42.6	2.8

Source: Bureau of Labor Statistics

Geographically, the largest percentage of workers in the industry is concentrated in California, making up 11 percent of the food processing industry workforce in 2003. Texas, Illinois, and Pennsylvania employed significant percentages of the food processing workforce at 6 percent, 6 percent, and 5 percent respectively with the rest of the workforce fairly evenly distributed across the United States (see chart).

2003 Employment in Processed Food Industry by State



Source: U.S. Department of Labor, Bureau of Labor Statistics, 2003 State Employment for Food Manufacturing

Consolidation is Slowing

According to the Food Institute, there were 415 mergers and acquisitions in the food manufacturing industry in 2003, which reflects the fact that the industry continues to consolidate. The slow economy resulted in less activity than in past years, down from a high of 813 mergers in 1998. The Economic Research Service of the United State Department of Agriculture (USDA) notes that consolidation or mergers can be in a company's interest in order to take advantage of more efficient manufacturing plants and close inefficient ones, or quickly expand a firm's product lines by acquiring market share in a mature domestic market.

Consolidation among food retailers increased from 27 mergers and acquisitions in 2002 to 42 in 2003. Despite increased consolidation, prices have remained low due to discount retailers such as Costco and Wal-Mart that sell large volume food products. Also, more consumers are buying from restaurants and take out establishments, which compete with food retailers. According to USDA, in 2002, 46 percent of the food dollar was spent on

food away from home while spending for food at home was 54 percent. Competition between warehouse clubs, traditional retailers, and restaurants has kept the rise in food prices below inflation levels.

Food Prices

According to USDA, in 2002, families spent only 10 percent of their household disposable income on food; 6 percent on food consumed at home and 4 percent on food consumed away from home. The consumer price index (CPI) for food rose 2.2 percent in 2003. Due to sustained economic growth, consumer demand for food is expected to increase with rising disposable personal income. Consumer demand, marketing costs, and commodity prices can have an effect on food prices.

Consumer Trends

Demographic factors affect demand for processed food products in the U.S. market. The Hispanic population continues to grow rapidly and processed food companies are developing new products for this population. Convenience products and snack foods are also popular and cater to double income households and consumers who are generally short on time. Frozen foods are doing particularly well due to their convenient and quick preparation. Snack bars that are positioned as portable meals are in demand by consumers with little time for a sit down meal.

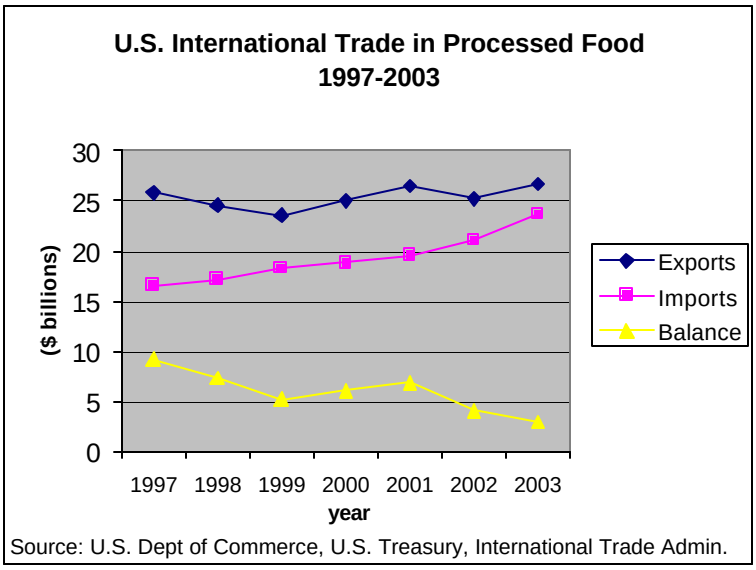
Other factors affecting demand for processed food in the U.S. market include concern about dieting and obesity, which are generating interest in weight-loss food products and low-carbohydrate options due to the popularity of the Atkins diet. The sports and fitness market is growing, and products that offer nutrition and energy benefits are popular.

Organic food is another market segment that is growing rapidly due to increased consumer interest in healthy products. Organic food can now be found in traditional supermarkets, natural food stores, and other retail markets. According to DataMonitor, the U.S. organic market is projected to reach a value of $30.7 billion by 2007 with a five-year annual compound growth rate of 21.4 percent between 2002 and 2007. USDA estimates that organic product sales were more than $11 billion in 2003 and will reach almost $22 billion in sales in 2010. Although USDA and DataMonitor figures differ, both indicate the rapid growth of this segment of the processed food industry. Popular organic products include fresh produce, nondairy beverages, breads and grains, packaged foods, and dairy products. In response to rapid growth in the industry, USDA issued new Federal standards for organic food in October 2002. In accord with the new standards, a certified organic processed product must use at least 95 percent organic ingredients to be labeled or represented as organic.

U.S. Processed Food Trade

The U.S. processed food industry is a major participant in the global economy, active in both exporting and foreign direct investment. In 2003, the U.S. processed food industry

exported $26.7 billion of product and imported $23.7 billion. Weakness of the U.S. dollar contributed to the growth of food exports. The processed food industry's trade surplus has been narrowing over the last several years and in 2003, dropped to about $3 billion.[2]



Almost half of the world's top 50 food processing firms are headquartered in the United States (21 out of 50 in 2003 according to Prepared Foods). Acquisitions and mergers have resulted in consolidation of some of the largest companies in the industry. In 2003, 15 of the top 25 food and beverage companies worldwide were U.S. companies. Major foreign competitors were Nestle (Switzerland), Unilever (England), Diageo (England), Groupe Danone (France), Kirin Brewery (Japan), Asahi Breweries (Japan), Snow Brand Milk Products (Japan), Heineken (Netherlands), Cadbury Schweppes (England), and Nippon Meat Packers (Japan).

According to USDA, global food consumption patterns are changing, leading to increased trade and demand for processed food products. Improvements in transportation, higher income, and consumer perceptions of quality and safety are important factors affecting sales of processed food. Income growth in developing countries has resulted in increased demand for meat products which may in turn drive demand for imports of products such as animal feed. In countries with low-income levels, consumers need to meet basic calorie requirements and any increases in income lead to consumption of carbohydrates, which are high in calories. In higher income countries, consumers are able to meet their basic calorie needs and, thus, demand for food is driven by taste, cultural trends, quality, and convenience. In developed countries, higher income growth has led to more demand for high value added and better quality processed food products. Increased demand for these items can be met domestically and/or by increasing imports.

[2] This chart reflects growth in current dollars, not real dollars and does not account for changes in inflation

Standards for food safety vary across countries with wealthier countries often having stricter food safety regulations. Consumers in these countries are willing to pay more for increased food safety. Differing standards for food safety can affect trade patterns since producers may find adhering to an exporting country's regulations costly. Alternatively, when domestic regulations are strict, domestic producers may face increased costs of production relative to importers and thus have an interest in applying the same sets of standards to their competitors. In response, countries are working within international organizations and multilateral trade agreements to move towards mutual recognition of systems and harmonization of standards.

Top International Markets for Processed Food Products

In 2003, five foreign countries accounted for 62 percent of U.S. processed food exports: Canada (21%), Japan (15%), Mexico (15%), Korea (7%), and China (4%).

In 2003, five countries accounted for 53 percent of U.S. imports of processed food products: Canada (31%), Mexico (7%), Australia (6%), New Zealand (5%), and Italy (4%).

The 1994 North American Free Trade Agreement (NAFTA) is one factor that spurred trade growth and foreign direct investment in processed food between Canada, the U.S., and Mexico. The United States is the largest source of foreign direct investment in Mexico's processed food industry. Because U.S. food processing affiliates in Mexico export only about 25 percent of their sales to the U.S., demand is dependent on the status of the Mexican economy. Increased trade and foreign direct investment between Mexico, Canada, and the United States, due to NAFTA, have created a regional food market and can mean more efficiency in providing food to consumers due to extended growing seasons, expanded consumer choice, and increased food quality.

U.S. Trade Patterns in Food Manufacturing (NAICS 311) in 2003
(millions of dollars; percent)

Exports

Region	Value	Share, %
NAFTA	9,608	36
Latin America	2,192	8
Western Europe	2,464	9
Japan/Chinese Economic Area	6,566	25
Other Asia	3,193	12
Rest of World	2,677	10
Total	**26,700**	**100**

Top 5 Countries	Value	Share, %
Canada	5,561	20
Japan	4,129	15
Mexico	4,046	15
Korea	1,862	7
China	1,116	4

Imports

Region	Value	Share, %
NAFTA	8,869	37
Latin America	2,682	11
Western Europe	4,726	20
Japan/Chinese Economic Area	1,464	6
Other Asia	2,781	12
Rest of World	3,178	13
Total	**23,700**	**100**

Top 5 Countries	Value	Share, %
Canada	7,319	30
Mexico	1,549	6
Australia	1,375	5
New Zealand	1,101	4
Italy	1,068	4

Values may not sum to total due to rounding

Source: U.S. Department of Commerce, Bureau of the Census

According to the U.S. Department of Agriculture, the best markets for processed food exports in the top five countries are the following:

Canada: Snack foods, organic foods, seafood, pet food, processed meat

Japan: Pork, beef, tuna, crab, pet food, cheese, flatfish, prepared whole tomatoes, chocolate confectionary, fresh and frozen berries, frozen desserts, frozen pizzas

Mexico: Meat, fish and seafood, frozen desserts, sauces, snack foods, healthy foods, and food ingredients

Korea: Red meat, poultry meat, seafood, processed potatoes, frozen vegetables, sauces, confectionary, bakery products, pet food, processed fruits and vegetables

China: Red meat, poultry meat, dairy products, processed fruit and vegetables, snack foods, salmon, crab and crabmeat, tree nuts, fish paste, roe and urchin, egg products, pet food

Major Trade Shows for the Processed Food Industry

The following are major processed food trade shows supported by the U.S. Department of Agriculture. To search for future events, go to USDA's website at: http://www.fas.usda.gov/scripts/agexport/EventQuery.asp

- **U.S. Food Export Showcase & Food Marketing Institute's (FMI) Annual Exposition (Processed Foods)**

  May 3-5, 2005
  Chicago, Illinois
  Number of visitors: 30000

USDA Contact: Sharon Cook
USDA Trade Show Office
1400 Independence Ave. SW
Stop 1052
Room 4939-South Building
Washington, DC 20250
Phone: 202-720-3425
Fax: 202-690-4374
Email: Sharon.Cook@usda.gov

- **Taipei International FoodShow 2004**

  June 17-20, 2004

  Khaliaka Meardry
  USDA Trade Show Office
  1400 Independence Avenue, SW
  Washington, DC 20250-1052
  Phone: 202-720-3065
  Fax: 202-690-4374
  Email: Khaliaka.Meardry@fas.usda.gov

- **Abastur 2004**

  September 29- October 1, 2004

  Teresina Chin
  Room 4642-South Bldg
  14th Street & Independence Ave., S.W.
  Washington, D.C. 20250-1052
  Phone: 202-720-9423
  Fax: 202-690-4374
  Email: Teresina.Chin@fas.usda.gov

- **Foodex Japan 2004**

  March 8-11, 2005
  Tokyo, Japan
  Number of visitors: 93637

  Khaliaka Meardry
  USDA Trade Show Office
  1400 Independence Avenue, SW
  Washington, DC 20250-1052
  Phone: 202-720-3065

Fax: 202-690-4374
Email: Khaliaka.Meardry@fas.usda.gov

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