[WHITE PAPER]

THE IMPACT OF THE RECESSION ON THE UK OTC MARKET

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EXECUTIVE SUMMARY

The recent recession has caused some surprising changes to the dynamics of the UK OTC market.

- A strong growth in sales of Own Label products in categories dominated by well-known brands.
- A slump in volume sales in some categories which had previously seen steady sales growth, particularly those associated with travel and categories relating to stress.
- Pricing has shown some unprecedented volatility and change.

Another factor influencing OTC sales in 2009 was the launch of Alli, this biggest OTC launch by value in the last ten years. The impact of Swine Flu is NOT significant in IRI sales data in Q2 2009 although sales grew in July and a second peak is expected from Q4.

These are important implications for **manufacturers and indeed retailers**

What does this mean?

INSIGHT 1 - Consumers are increasingly prepared to save money where they can be confident in buying on ingredient rather than trusting a familiar brand.

ACTION – Manufacturers need to reassess urgently their strategy and tactics for OTC brands where Own Label is making fast inroads. Consumer messaging and benefit proposition, pricing, promotion and availability are all key sales drivers where changing circumstances require reassessment.

INSIGHT 2 - The recession has caused people to cut back on purchasing, probably using up existing household stocks rather than buying ahead – we have seen this in toiletries too.

ACTION – Whilst this trend is probably short term in impact and will recover, manufacturers need to consider ways of stimulating consumers to purchase ahead of incidence. Irrespective of any changes, manufacturers should NOT assume that these negative trends will continue. A greater understanding of Income Elasticity of Demand will assist in refining sales forecasts.

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INSIGHT 3 - With increasing unemployment, patients have more time and less money, and with free prescriptions have less reason to buy OTC especially for more expensive lines.

INSIGHT 4 - Even in a recession, it is possible to launch an exciting new OTC product successfully with the correct marketing and launch execution.

ACTION – Manufacturers should consult with both IRI and IMS Consumer Health who, as partners together are best placed to advise on the interrelationship between prescription and OTC sales.

ACTION – OTC Manufacturers should focus more clearly on understanding the opportunities for growth via innovation – new categories, applications, indications, positioning. All can give real benefits to consumers which they will be prepared to pay for. Innovation is a fundamental feature of how IRI works.

These are important implications for manufacturers and indeed retailers. IRI believes that many common-held theories about how consumers behave with OTC products have been blown away and much more analysis is needed to understand what has changed and why, and how consumers will respond in the future.

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BACKGROUND – THE PAST TEN YEARS OF OTC MARKET TRENDS

Volumes have been rising in the noughties

The UK OTC Market has shown strong steady volume growth in terms of number of packs sold during the past decade. The principal drivers of this absolute growth have been:

- A trend toward increased responsibility for self-medication by consumers, encouraged by government, manufacturer and retail initiatives, and facilitated by improved medical information available on the internet.
- An increasing population, through immigration.
- Cheaper prices for the best-selling OTC lines making OTC medicines relatively more affordable.
- More cash-rich, time poor people who are prepared to pay for OTC products for convenience, rather than get a prescription.
- Greater availability of OTC products through deregulation of status, making former prescription-only products available over-the-counter in pharmacies (POM to P switching), and making more products generally available outside pharmacy in supermarkets and impulse outlets (P to GSL switching).
- Growth in term of packs sold has partly been due to consumers buying smaller packs more frequently.

The value of the OTC market has grown even faster than volume since 2000

This is because:

- Consumers have been buying new products typically at higher prices – whether new improved or enhanced versions of well known medicine brands like "Nurofen Express", or completely new products such as heat patches for pain relief.
- Those categories in the greatest growth over the past decade have had products with higher price points – such as Smoking Cessation.

Yet pricing trends since 2001 have been downward

Prices for the best selling OTC lines have been falling since the UK Government abolished Resale Price Maintenance in 2001. Furthermore sales of unbranded own label and generic products have also grown ahead of the market which has acted as a brake on overall value growth as consumers pay less for these products than for well-known brands.

And Own Label share (with products at lower prices) has been growing overall for a number of years

This has been driven by some categories in particular, such as Adult Oral Analgesics, Vitamins and Minerals, and Hayfever Remedies. For the most part, OTC brands exhibit strong brand values based on trust, reliability and efficacy, making it difficult for Own Label variants to make inroads.

The prime determinant of short term and year on year market variance continued to be the incidence of colds and flu and its impact on sales of winter remedies.

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BACKGROUND – THE IMPACT OF THE RECENT RECESSION IN THE UK RETAIL SPACE

Since the beginning of 2008 the end of the global economic boom has been anticipated although for the first six months of 2008 consumer behaviour itself was largely unchanged, with the exception of house price inflation. Certainly there was no impact on sales of health products and medicines. In the summer of 2008 this point the credit crunch became more tangible with a reduced availability of retail credit, the sudden instability of the banking sector and increasing unemployment. This, and the accompanying media comment, started to have a discernable impact on consumer confidence and behaviour from September 2008 onwards.

Within FMCG the impact of the increases in world commodity prices during 2007 and 2008, and the deterioration in the value of the £Sterling on world currency markets had a bigger impact on the UK food market in particular by driving producer costs up sharply and forcing retail prices upward.

In summary the broad trends discernable in the UK retail space since September 2008 have been:

- A shift in UK consumer spending TOWARDS foodstuffs caused by two things: an increase in home eating at the expense of out-of-home eating which drove up volumes, and the increase in shop prices described above.
- Given that overall household expenditure on FOOD has increased, consumers have sought to cut costs within that by employing a number of changed behaviours:
  - A small proportion of consumers have switched their weekly shop to discounters such as Aldi and Lidl, and away from more expensive retailers like Waitrose (NB this is the net effect of a complex set of consumer switching patterns).
  - Consumers have bought LESS of some products and categories by simply deferring purchases and running down household stocks. The partial replacement of MULTIBUY promotions with PRICE REDUCTION OFFERS has encouraged this trend. This is of importance to Toiletries and repertoire categories.
  - Finally some consumers have switched (within the same store) to buying LESS EXPENSIVE PRODUCTS in some cases.

It is this final aspect of changing consumer behaviour which is most interesting as it has a number of manifestations: -

- Generally, the switching has been from expensive Own Label products to either cheaper Own Label products or to cheaper brands. In Tesco in particular the development of cheap discounter-style brands (with a big fanfare in the Summer of 2008) led to a haemorrhage of sales of standard and premium Tesco Own Label sales. This phenomenon has largely been restricted to food. The net effect on Own Label sales has been that overall these sales have remained surprisingly flat in volume terms and in value have seen some declines.
- In toiletries and some food categories where Own Label is historically weak, we have not seen any growth in Own Label share as consumers continue to buy brands albeit sometimes in smaller quantities/less frequently, and often at heavily discounted promotional prices.
- It is worth mentioning that the impact of increased cost prices has had a disproportionate effect on Own Label pricing in all categories as manufacturing cost accounts for a higher proportion of the selling price.

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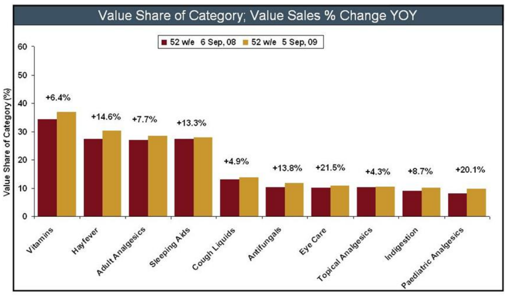
THE RECESSION AND SALES TO DATE OF OTC PRODUCTS IN 2009

Own Label products are the recent winners in OTC

Since the start of the “recession” in mid-2008, and particularly since the start of 2009, sales of Own Label products in most OTC categories have grown whether expressed in absolute year on year value or unit sales or in share terms.

Own Label Value Shares and growth in various OTC categories



Source: IRI All Outlets; Value Share of Category; Value Sales % change 52 w/e 5th Sept 2009.

To a certain extent this is simply an extension of the growth of Own Label in OTC which has been evident for the past decade and before, with a steady rate of growth in the categories most susceptible to Own Label sales, and no discernable growth in the bulk of OTC categories.

However what is new and different is the recent strong growth of Own Label share in categories hitherto notable for a low Own Label share and a strong dominance by key brands. Good examples are Paediatric Analgesics, dominated by Calpol, and Indigestion Remedies with a number of big brands led by Gaviscon and Rennie. And even within the traditionally strong Own Label categories, the share of Own Label has jumped up sharply.

What is driving this? There are a number of hypotheses:

> The multiple grocers have advertised specifically, since mid 2008, that consumers can save money by switching to Own Label products, and OTC products have featured heavily, partly because the savings in some cases are relatively large.

> There have been in-store displays featuring own label products from Boots, which highlight their Own Label brand.

> There has been an increase (undocumented) in the amount of press, radio and TV coverage given to features on how to save money in a recession, and many of these have mentioned switching from OTC brands to Own Label.

> The combined effect of all the above may not be enough in itself to affect sales, but at a time when a greater proportion of consumers are particularly prone to reassessing budgets and changing behaviour they may have had an identifiable impact.

> There have been some price increases to a number of key branded SKUs in the OTC sector, driven by cost price inflation occurring at the same time.

> Store-switching has benefited stores which typically have a higher share of Own Label sales, and hit stores which typically sell more brands. Store-switching does not necessarily affect the Own Label consumer dynamic itself, but there may be a distribution effect where the new store has greater Own Label choices.

> The recession may have disproportionately affected NPD of premium branded products both in terms of number of launches and impact of those launches on the market.

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Where's the growth and where's the decline?

Comparing the first six months of 2009 with the same period in 2008 is the best way of comparing sales before and after the recession hit, whilst removing the effect of seasonality which is so strong in OTC.

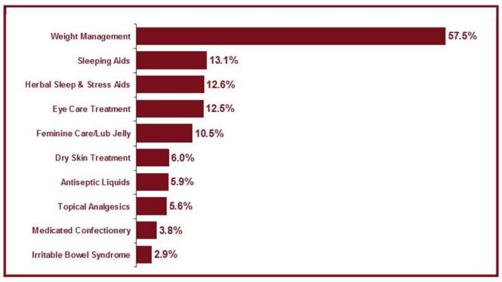
We have seen winners and losers in the first six months of 2009. Before analysing volume decline it is worth pointing out some winners.

The biggest single driver of growth within OTC has been the launch of the weight management drug Orlistat under the brand name Alli, from GSK. With sales during the first two months of launch alone of over £6M it has contributed to growth of over 50% in the Weight Management category over a six month period.

However the recession has triggered growth too. In particular some categories associated with stress such as Sleeping Aids, whether "P" category sleeping pills or herbal Sleep and Stress Aids. Other categories which have seen strong growth are Sex Accessories and Lubricants. This may or may not have anything to do with a trend towards more in-home entertainment.

Top 10 Fastest Growing OTC Categories First Half 09

Value % Sales Change v Year Ago

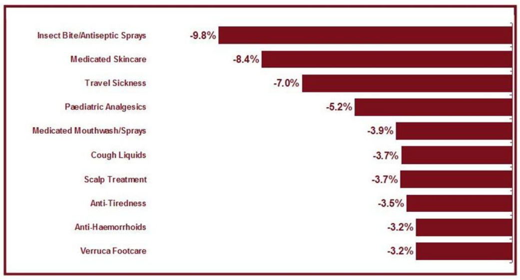


Source: IRI All Outlets; Value Sales % Change vs Yr ago; 24 w/e 13th June 2009

Of greater impact on the overall market however is a noticeable decline in sales in a number of OTC categories.

Top 10 Fastest Declining OTC Categories First Half 09

Value Sales % Change v Year Ago



Source: IRI All Outlets; Value Sales % Change vs Yr ago; 24 w/e 13th June 2009

Each category has to be assessed individually. But Insect Bites and Travel Sickness are closely linked with foreign travel in the winter months. For the other categories the biggest single driver of negative value is the move from brands to Own Label.

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OTHER OTC EVENTS IN EARLY 2009

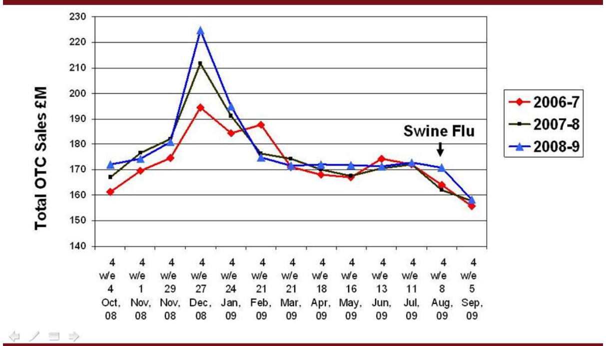
The launch of Alli

In the context of all this recessionary “crisis” it’s very interesting to note that this period has seen the most successful OTC launch of the past 20 years, when measured by standard criteria of sales and share levels, promotional profile and distribution build in the weeks after launch. Clearly account also needs to be taken of the high levels of advertising and other support in the context of the absolute sales figures. Similarly it is early days and time will tell whether the high rates of sale at launch will be continued if the repeat purchase rate is low.

The Winter Season 2008-09 and the impact of Swine Flu

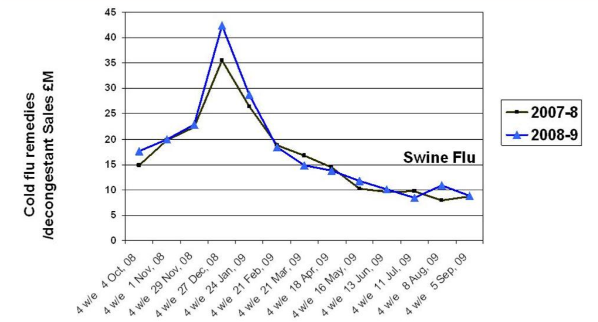
Overall the winter season in 2008/09 was strong in terms of sales of winter remedies (being cold/flu relief, decongestants, cough liquids and medicated confectionery), and broadly similar in overall impact to the previous year 2007/08 and with a more pronounced peak month in December 2008. Overall this meant sales were not markedly different year on year, permitting the impact of other factors on the market to be identified more easily.

OTC £ sales – winter season peak and Swine Flu peak



Swine Flu, whilst making an impact on the media and public consciousness, was confined to isolated areas in the UK for the most part during the first six months of 2009, and never spreading widely enough to impact significantly on total OTC sales. Mild outbreaks spread more rapidly in July as demonstrated by increased sales of Cold Flu treatments and Decongestants.

Winter Flu season and the first Swine Flu peak 09



However the four-weekly variation in sales compared with the corresponding period four weeks a year ago are not significantly out of line with normal variation, and in comparison to a normal winter season sales are still very low. A truly big epidemic is expected to have a greater effect on the market and the coming winter may see sales rise strongly.

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CONCLUSIONS AND RECOMMENDATIONS FOR MANUFACTURERS AND RETAILERS

The recent recession has caused some surprising changes to the dynamics of the UK OTC market which run counter to some of the trends observable in the market over previous years. This leads to some new insights with differing consequences for Manufacturers and Retailers, and it is worth addressing these consequences and necessary actions separately.

INSIGHT 1 - Consumers are increasingly prepared to save money where they can be confident in buying on ingredient rather than trusting a familiar brand.

MANUFACTURER ACTION – Manufacturers need to reassess urgently their strategy and tactics for OTC brands where Own Label is making fast inroads. Consumer messaging and benefit proposition, pricing, promotion and availability are all key sales drivers where changing circumstances require reassessment. Value may need to be incorporated into the product proposition.

RETAILER ACTION – Retailers need to understand the rapidly changing dynamics within this sector – profitability may be being sacrificed in order to drive basket share or footfall, especially where Own Label pricing is very low such as Adult Oral Analgesics. Price elasticities for most OTC products have historically been relatively inelastic whether Own Label or brands. Retailers should keep abreast of any changes to elasticities in these changing market conditions in order to maximise the opportunity of growing categories and brands and increasing market share. If branded skus become more price-elastic in a recession, then if consumers switch to Own Label there will be missed opportunities for driving growth through price changes within brands.

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INSIGHT 2 - the recession has caused people to cut back on purchasing, probably using up existing household stocks rather than buying ahead – we have seen this in toiletries too.

MANUFACTURER ACTION – Whilst this trend is probably short term in impact and will recover, manufacturers need to consider ways of stimulating consumers to purchase ahead of incidence. Irrespective of any changes, manufacturers should NOT assume that these negative trends will continue. A greater understanding of Income elasticity of demand will assist in refining sales forecasts.

RETAILER ACTION – There is an opportunity to position the category overall in preventative terms. Selective promotions around the Medicine Cabinet as a way of incentivising consumers to be ready for a Swine Flu epidemic may be a way of bringing forward purchases.

INSIGHT 3 - with increasing unemployment, patients have more time and less money, and with free prescriptions have less reason to buy OTC especially for more expensive lines.

MANUFACTURER AND RETAILER ACTION – Manufacturers and Retailers alike should consult with both IRI and IMS Consumer Health who, as partners together are best placed to advise on the interrelationship between prescription and OTC sales.

INSIGHT 4 – Even in a recession, it is possible to launch an exciting new OTC product successfully with the correct marketing and launch execution.

MANUFACTURER ACTION – OTC Manufacturers should focus more clearly on understanding the opportunities for growth via innovation – new categories, applications, indications, positioning. All can give real benefits to consumers which they will be prepared to pay for.

RETAILER ACTION – Pharmacy retailers have done a fantastic job of making the launch of Alli work successfully. Learnings from this can be analysed in conjunction with IRI to assess how future launches can be best managed.

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These are important implications for manufacturers and retailers. IRI believes that many common-held theories about how consumers behave with OTC products have been blown away and much more analysis is needed to understand what has changed and why, and how consumers will respond in the future.

Appendix: SOURCE OF DATA

IRI InfoScan

IRI InfoScan promotion

IRI Price Advantage (price elasticity modelling)

TNS Worldpanel

About IRI
IRI is the world's leading provider of consumer, shopper, and retail market intelligence and insights supporting 95 percent of the FORTUNE Global 500 consumer packaged goods (CPG), retail and healthcare companies. Only IRI offers the unique combination of integrated market information, automated and predictive analytics, innovative enabling technologies, and domain expertise. With IRI, leading retailers and manufacturers are able to quickly discover breakthrough insights driving smarter decisions and actions across the enterprise for breakthrough results. Companies around the world depend on IRI for improved productivity, stronger brands, and dramatic revenue growth. For more information, visit www.infores.co.uk.

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