

Focus on: Food and beverage

International Business Report 2010 – Sector focus series

The Grant Thornton International Business Report (IBR) 2010 reveals that privately held businesses (PHBs) in the food and beverage sector are one of the least confident about their economic prospects for the year; a balance¹ of just +7 per cent are optimistic this year. Businesses, on average across all sectors, are more optimistic this year (+24 per cent) than they were in 2009 (-16 per cent).

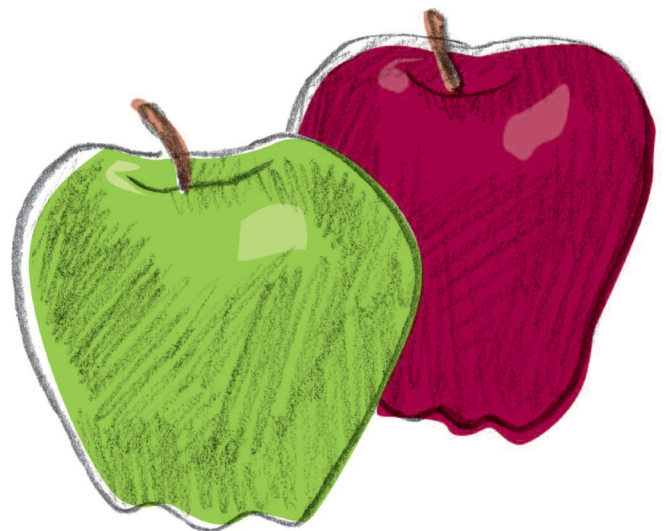
Of the ten sectors considered in the 2010 sector focus series, financial services is the most buoyant at +42 per cent; ahead of technology (+40 per cent), cleantech (+34 per cent), hospitality (+32 per cent), retail (+31 per cent), manufacturing (+25 per cent), construction and real estate (+13 per cent), food and beverage (+7 per cent), transport (+5 per cent) and healthcare (-18 per cent).

The food and beverage sector

The food and beverage sector did not escape the financial turmoil of the past 12 months, although some sub-sectors suffered more than others. As credit dried up and consumers tightened their belts, higher end restaurant sales plummeted, but the subsequent increase in people eating at home has been a boon for supermarkets. Sales of private label products as well as nutritional and healthy lifestyle ranges have been especially profitable.

Commodity food and beverage prices peaked in July 2008, but had lost almost a third by the end of 2009, to finish at their lowest since May 2007. Prices remained fairly volatile over the course of 2009, but finished the year at around the same level as 24 months previously.

Mergers and acquisitions (M&A) activity in the industry dropped significantly in 2009 as banks became more risk averse. The total number of deals fell by just three per cent – from 3036 to 2949 – but the value of these transactions declined by a staggering 52 per cent from the previous year.² In an attempt to prevent stagnation, many businesses in more mature economies have looked to expand their operations in the emerging markets, which have, by and large, held up better during the downturn.



¹ the balance is the proportion of companies reporting they are optimistic less those reporting they are pessimistic

² source: Zephyr 'Annual M&A report 2009'

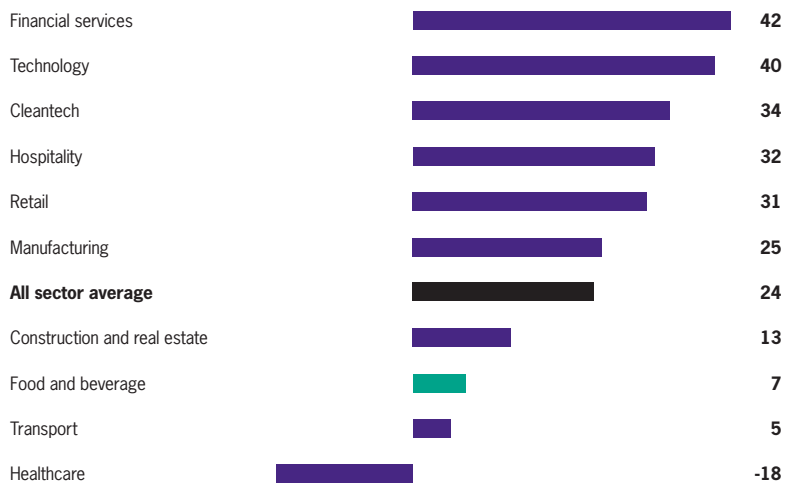
The state of the sector

Optimism/pessimism

- a balance of just seven per cent of businesses in the food and beverage sector are optimistic about their respective countries' economic outlook this year (+7 per cent)
- only businesses in the transport (+5 per cent) and healthcare (-18 per cent) sectors are less optimistic about the economic outlook this year
- across all sectors, the balance indicating optimism for the year ahead has risen by 40 per cent this year, from -16 per cent in 2009 to +24 per cent.

Figure 1: Outlook for the economy over the next 12 months

Percentage balance of businesses indicating optimism against those indicating pessimism



Source: Grant Thornton IBR 2010



Trefor Griffith
Grant Thornton, United Kingdom

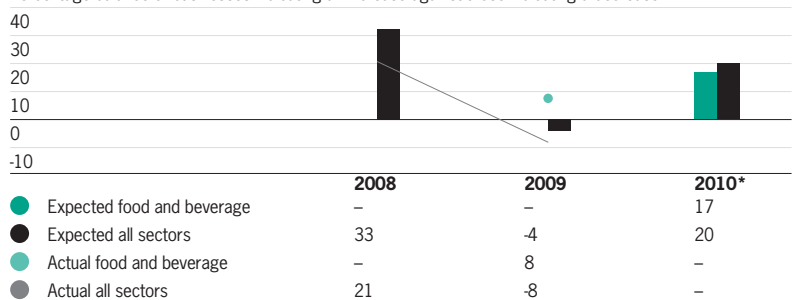
“The green agenda is continuing to gather momentum despite the economic downturn; this is again affecting the architecture of businesses and the way in which they take products to market and source raw materials.”

Employment

- a balance of +17 per cent of businesses in the food and beverage sector expect to expand the size of their workforce in 2010, below the all sector average of +20 per cent
- actual employment growth reported on average across all sectors in 2009 (-8 per cent) was even worse than expected 12 months previously (-4 per cent).

Figure 2: Employment history: 2008-2010

Percentage balance of businesses indicating an increase against those indicating a decrease



*actual 2010 data will be documented in IBR 2011

Note: the food and beverage expected data for 2008 and 2009 as well as the actual data for 2008 are not available as this sector has not been covered in the survey previously.

Source: Grant Thornton IBR 2010

Revenue expectations

- a balance of +40 per cent of businesses in the food and beverage sector expect their revenue to increase across 2010
- only businesses in the transport (+25 per cent) and construction and real estate (+22 per cent) sectors are less optimistic about increasing revenue in 2010
- on average across all sectors, revenue expectations have rebounded to +40 per cent this year, up from just +11 per cent in 2009.

Figure 3: Revenue expectations over the next 12 months

Percentage balance of businesses indicating an increase against those indicating a decrease



Source: Grant Thornton IBR 2010



Jim Softsis
Grant Thornton, Australia

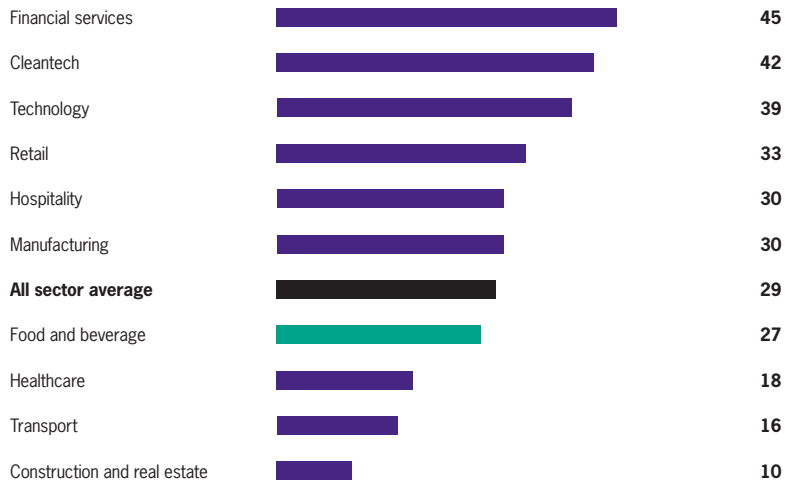
“Businesses have tried to control their margins and their costs to the best of their ability but the combination of the fall in tourism as a result of the financial crisis and the fall or the tightening of corporate style expenditure has had a huge impact.”

Profitability expectations

- the balance of businesses in the food and beverage sector expecting to increase profits in 2010 is +27 per cent, similar to the all sectors average of 29 per cent
- the all sectors average has increased by 34 per cent, from -5 per cent in 2009 to +29 per cent this year.

Figure 4: Profitability expectations over the next 12 months

Percentage balance of businesses indicating an increase against those indicating a decrease



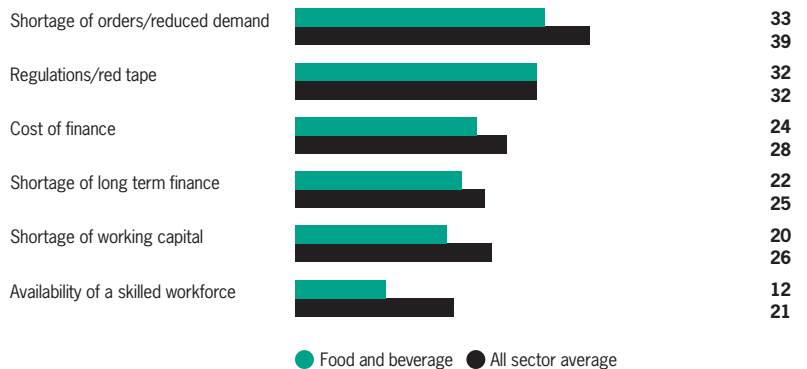
Source: Grant Thornton IBR 2010

Constraints

- a shortage of orders/reduced demand is the most pressing concern for businesses in the food and beverage sector, 33 per cent compared to 39 per cent on average across all sectors
- identical to the all sector average, regulations/red tape is cited as the second biggest constraint by businesses in the food and beverage sector (both 32 per cent)
- the availability of a skilled workforce is of considerably lesser concern within the food and beverage sector (12 per cent), than it is on average across all sectors (21 per cent).

Figure 5: Constraints on expansion

Percentage of businesses rating constraint 4 or 5 on a scale of 1 to 5 where 1 is not a constraint and 5 is a major constraint



Source: Grant Thornton IBR 2010



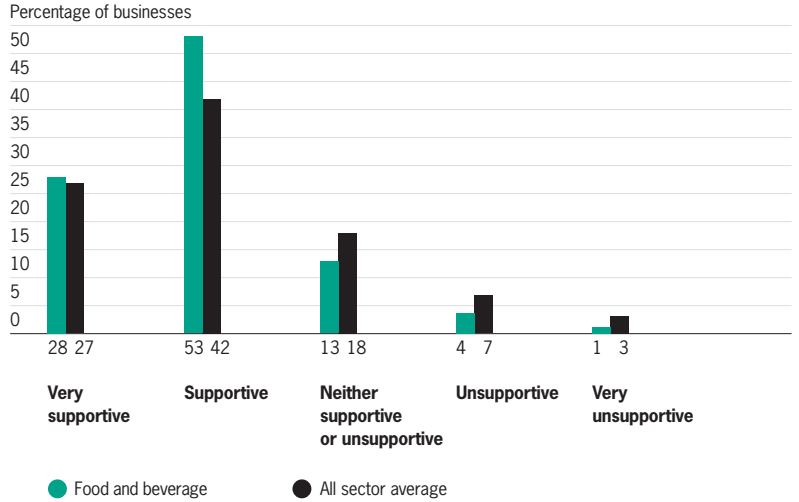
Dexter Manning
Grant Thornton, United States

“More and more companies are investing in expanding their plants or in technology that will help them control costs going forward. Having made it through the recession, they are looking to position themselves so that, if there is an increase in commodity prices going forward or other things, they can be as efficient as possible in their production.”

Support of lender

- 81 per cent of businesses in the food and beverage sector are happy with the level of support provided by lenders, compared with 69 per cent on average across all sectors
- just five per cent of businesses in the sector believe that lenders are unsupportive or very unsupportive of their business, compared to ten per cent on average across all sectors.

Figure 6: Level of support provided by lenders



Source: Grant Thornton IBR 2010

Mergers & acquisitions

- the proportion of businesses in the food and beverage sector planning to grow through acquisition is 16 per cent, ahead only of healthcare (11 per cent)
- the all sector average has fallen steadily over the past three years from 44 per cent in 2007 to 26 per cent this year.

Figure 7: Plans to grow through acquisition in the next three years



Source: Grant Thornton IBR 2010

Consumer trends

- healthy eating (69 per cent) and price awareness (64 per cent) are the trends that most businesses in the food and beverages sector believe have increased
- a balance of just six per cent believe that alcohol sales have increased
- whilst impulse spend is the only trend believed to have decreased (-31 per cent).

Figure 8: What is the current trend for the following consumer behaviour?

Percentage balance of businesses indicating increased against those indicating decreased



Source: Grant Thornton IBR 2010

Large supermarket dominance

- actively targeting new customers is the most popular action to counteract the dominance of large supermarkets in the food and beverage sector (34 per cent)
- followed closely by pricing, with 31 per cent of businesses in the sector adopting this strategy
- the least popular options are acquiring competitors (seven per cent) and moving into new overseas locations (four per cent).

Figure 9: What are you doing to counteract the dominance of the large supermarkets on your business?

Percentage of businesses



Source: Grant Thornton IBR 2010

Outlook for the sector

The takeover of British confectionary giant Cadbury by American firm Kraft in January 2010 is one indication of renewed confidence in the sector, now that credit lines are easing and markets are becoming less volatile. Indeed, the valuations of many businesses have dropped rapidly over the past 18 months, making them attractive propositions for businesses with healthy balance sheets. The developing world should remain an appealing investment opportunity, especially China where M&A regulations were relaxed last year, in an effort to attract foreign direct investment.

As the global economy improves, and consumer demand recovers, so too should the food and beverage sector. However many challenges remain, such as the volatility of commodity prices and the need to be ever more creative with deals and packaging to attract customers, who themselves are questioning the nutritional benefits of products more than ever before. Higher-end food service businesses will rely on improving consumer confidence and innovative pricing strategies to drive performance over the next 12 months.



Jim Menzies
Grant Thornton, Canada

“Environmental initiatives are a ‘must’ for food and beverage companies. They impact all aspects of their operations, from purchasing to producing to packaging. There is no choice but to get on board with these green initiatives, as they are not going to go away.”

Sector's perspective

“The trend regarding organics is increasing but I believe part of the reason is that there is no real standard of what it takes to be organic.”

A Canadian chain of restaurants employing around 7,500 staff.

Lessons learned from the downturn

“Restaurant's competition in particular has been aggressive, in terms of value to consumers. People are watching their pockets in the economic crisis and we need to offer value to get them in and spending; the value proposition for customers. Consumers have greater information these days so you have to make sure that restaurant guests are serviced especially well. With new communication methods and new social media, networking word is spreading much faster. In Canada, there are so many different internet sites for consumers to leave reviews; they can be their own critic. You have to be aware that there are so many more communication channels available now.”

Major risks for the year ahead

“In this market, competition is always the risk; it's intense in this market place. There are new entrants and they are raising the bar in terms of standards, food quality, the overall experience and salesmanship.

In Vancouver, a harmonised sales tax, rather like the UK's VAT, has been introduced. Specifically for us, as in restaurants, it will affect us as restaurant meals are to be taxed an additional seven per cent. Unique to the industry, rather than just our chain, is the government's growing involvement in healthy foods and eating. Reforms are to be introduced for restaurants to publish the nutritional information of their meals; this will affect everybody in the restaurant industry. These are the risks specific to our industry but we also have the broader major risks to contend with. But as with any business we are also concerned about and affected by competition, the economy and the cost of products.”

Planning for the future

“We are looking at new locations in the domestic market as well as in other regions outside of Canada, potentially international. So the plan for moving forward is to perfect the development and execution of new restaurants. And as always, to ensure that we continue to offer good customer satisfaction and salesmanship in existing and new restaurants, to ensure we uphold our image. Internally there is always room for improvement. That is, improvement in standards, the customer experience, salesmanship and higher turnover. Internally we are also looking at methods of moving the business forward; that may be through additional training, the renovation of restaurants, new product development and technological changes. We have just launched an online take out service for customers to place orders over the internet.”

Rise of healthy eating

“Healthy eating is definitely something that is important but people also want taste, especially in our market place. Highly flavoured Asian/ethnic food has really caught on here so people may want healthy food but they are not willing to forfeit taste and flavour. People are definitely more price aware in the current situation. I also agree the trend regarding organics is increasing, but I believe part of the reason is that there is no real standard of what it takes to be organic. It makes sense that impulse buying is decreasing as consumers are looking for value. They have the knowledge nowadays; they know different companies have different value points. And they know how to target that avenue rather than buying on impulse.”

“It is very tricky to balance fixed costs with flexible pricing for customers.”



Archeon – Netherlands

The company provides food and beverage service activities, employing around 100 staff.

Lessons learned from the downturn

“We have learnt to be careful, to check all our costs and expenses and to think twice before making any purchase or investments. We have also learnt to be flexible on price as customers like discounts; with private businesses especially, flexibility is required to ensure loyalty.”

Major risks for the year ahead

“The risks are also linked to pricing: customers want flexible prices but a lot of our costs are fixed. The essentials such as gas, water and electricity are fixed and prices inflexible. So it is very tricky to balance fixed costs with flexible pricing for customers. The government needs to look elsewhere to generate the extra income that they require, rather than through taxing businesses. Compared to ten years ago it is much more expensive to set up a business, there is a lot of legislation.”

Planning for the future

“We do serve both businesses and private parties but the focus will be more on private parties and visitors. We also have to look into pricing at peak times, for example, altering prices during the busy 6pm – 7pm dinner slot. As this has become the norm we need to follow suit, we have to be more flexible as it provides more opportunities. Also, with environmental power and energy, the way forward is positive thinking and advances in technological solution and not through taxation/legislation by the government.”

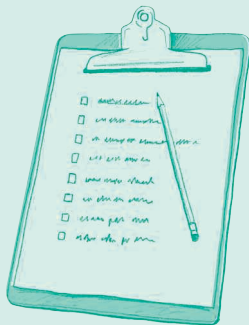
Rise of healthy eating

“I agree that the trend in healthy eating is increasing, as is price awareness. We have seen that consumers are looking more at price; they want a fair price for fair products, but they don't want to pay more for fairtrade products. Just as they are using 'price dump' stores more now, they expect the same in our sector. Impulse spending has reduced, we see that through the peak time pricing (6pm-7pm), and private parties expect prices to be more negotiable.”

View from Grant Thornton

Lessons learned from the downturn

- **consumers have started to shop for value:** a large proportion of shoppers have altered spending habits in a bid to save money
- **value of price promotions:** discounts, promotions and loyalty cards in supermarkets have boomed in a bid to retain customers
- **demand for 'ethical' and 'healthy' goods remains robust:** sales of fairtrade, green, health and free range goods have remained stable despite the downturn, although consumers are prepared to shop around for value
- **staying close to your banker:** indebted businesses need to stay in close contact with their banker to avoid hitting them with nasty surprises
- **dangers of being over-leveraged:** cash flow became an issue for many highly-leveraged businesses when commodity process spiked
- **importance of monitoring financial health of supply chains:** businesses need to keep up to speed with their supply chains in order to safeguard their own production capabilities.



Major risks for the year ahead

- **food safety:** most large food producers are becoming increasingly aware of health and safety processes within their supply chains, and are increasing their ability to recall products
- **commodity price spikes:** there are concerns around prices of certain raw materials which could impact on 2010 business plans
- **consumer confidence:** high levels of personal debt combined with increased levels of taxation will continue to put downward pressure on prices, impacting on research and development spend
- **currency fluctuations:** the sector is also a victim of that and whether or not any currency fluctuations will bring back tourists
- **energy costs:** if the price of oil continues to rise, it will have a significant impact on the cost of transporting goods.



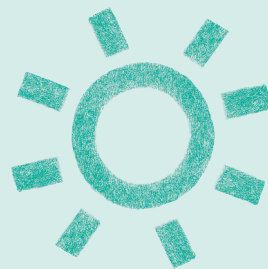
Planning for the future

- **investment in efficiency:** businesses are expanding their plants or investing in technology; that will help them control costs going forward
- **balance sheet control:** many businesses are looking to deleverage and some large organisations are looking to sell non-core assets to reduce debts
- **consolidation:** manufacturers are looking to create greater scale in order to protect their business from further pressure from the retailers
- **search for capital:** businesses in emerging markets are looking to increase capacity ahead of expected increases in consumption
- **understanding consumer preference:** businesses are increasingly trying to tailor their offer to consumer demand
- **demand for 'green packaging':** many businesses in the sector need to consider new packaging innovations to make sure it becomes more environmentally friendly.



Implications of increasing demand for 'healthy eating' products

- **pressure on cash:** larger producers will be looking to buy smaller producers of the specialised products to be able to increase their product offering, but production volume will remain relatively low and logistics costs increase
- **difficulty of balancing value with consumer preference:** consumers are demanding healthy eating products but at low prices, which is a tough balancing act for the sector
- **increasing awareness of consumer:** consumers are prepared to shop around to see their preferences and expectations in terms of price met
- **trend set to increase:** younger generations are becoming increasingly aware of the health and environmental impact of products and businesses with the foresight to prepare for this should prosper.

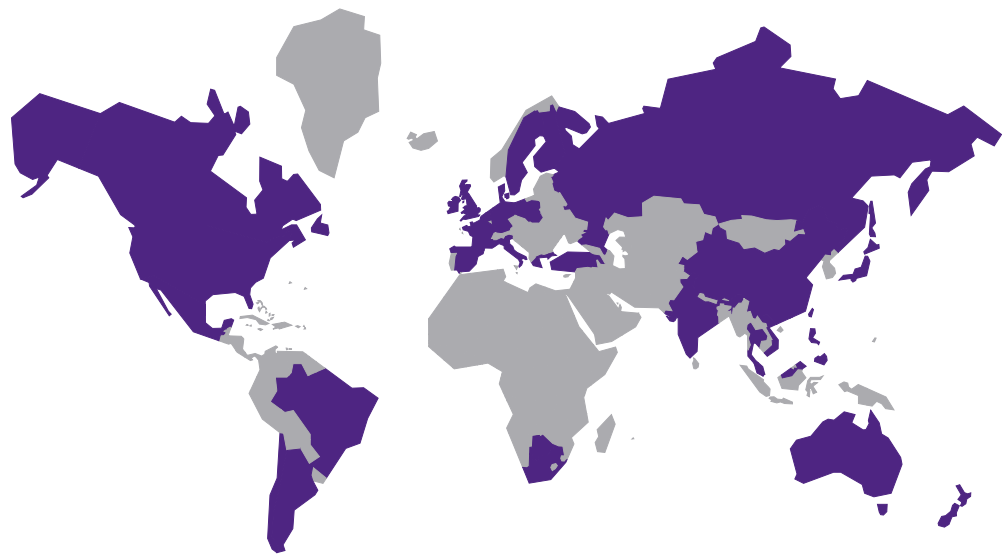


The Grant Thornton International Business Report (IBR) is an annual survey of the views of senior executives in privately held businesses (PHBs) all over the world. Launched in 1992 in nine European countries the report now surveys over 7,400 PHBs in 36 economies providing insights on the economic and commercial issues affecting a segment often described as the 'engine' of the world's economy. In the food and beverage sector, 390 businesses were interviewed, 47 per cent from manufacture of food products, 18 per cent from retail sale of food, beverages and tobacco in specialised stores, ten per cent from food and beverage service activities, eight per cent from manufacture of beverages and 17 per cent from other food and beverage.

To find out more about IBR and to obtain copies of reports and summaries visit: www.internationalbusinessreport.com. The site also allows users to complete the survey and benchmark their results against all other respondents by territory, industry type and size of business.

Participating economies

- | | |
|----------------|----------------|
| Argentina | Japan |
| Armenia | Malaysia |
| Australia | Mexico |
| Belgium | Netherlands |
| Botswana | New Zealand |
| Brazil | Philippines |
| Canada | Poland |
| Chile | Russia |
| Mainland China | Singapore |
| Denmark | South Africa |
| Finland | Spain |
| France | Sweden |
| Germany | Taiwan |
| Greece | Thailand |
| Hong Kong | Turkey |
| India | United Kingdom |
| Ireland | United States |
| Italy | Vietnam |



www.gti.org
www.internationalbusinessreport.com

© 2010 Grant Thornton International Ltd. All rights reserved.
 Grant Thornton International Ltd (Grant Thornton International) and the member firms are not a worldwide partnership. Services are delivered independently by the member firms.