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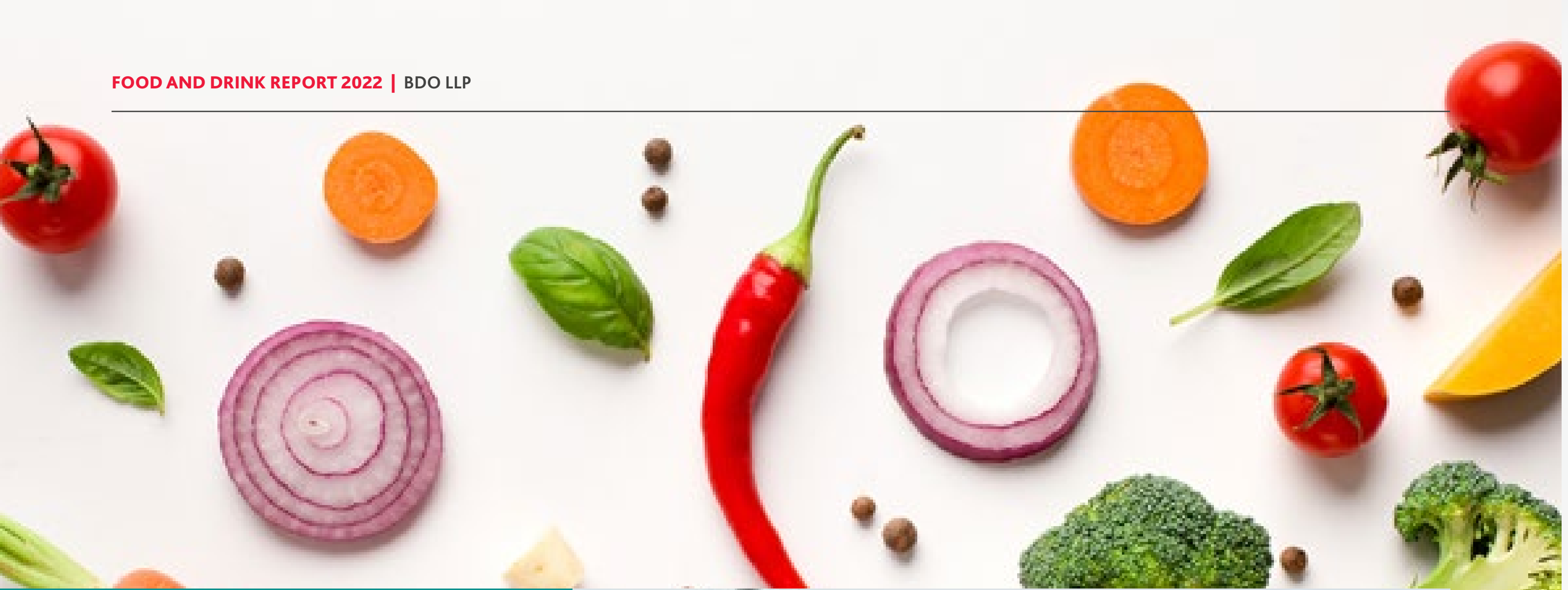
FOOD AND DRINK REPORT 2022

RESILIENCE IN THE FACE OF ADVERSITY



CONTENTS

THE FOOD AND DRINK INDUSTRY AT A GLANCE[1]

FOOD AND DRINK IS THE **BIGGEST MANUFACTURING INDUSTRY** IN THE UK

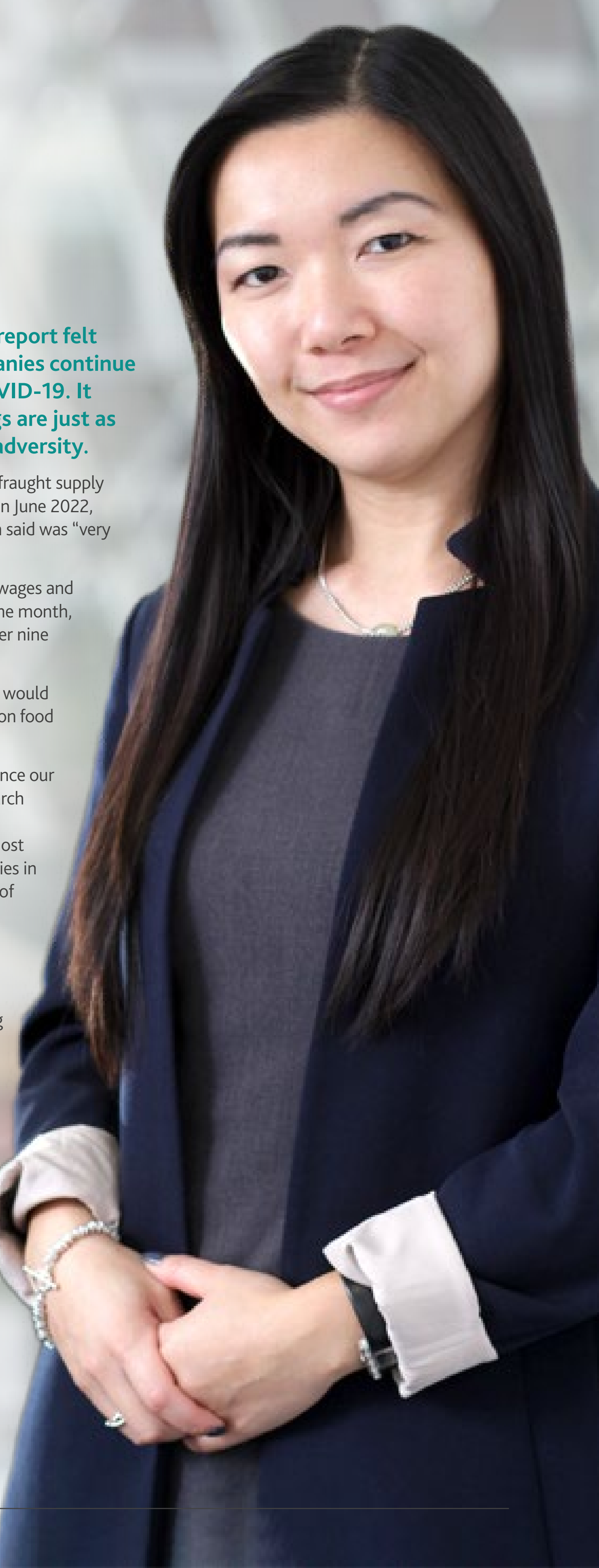
THE INDUSTRY HAD A TURNOVER OF **£112** BILLION IN 2021

THE INDUSTRY EMPLOYS **468,000** PEOPLE ACROSS EVERY REGION AND NATION OF THE UK

THE FOOD SUPPLY CHAIN EMPLOYS **4.2M PEOPLE**

IN 2021 UK FOOD & DRINK EXPORTS TOPPED **£20** BILLION

INTRODUCTION



CINDY HRKALOVIC
HEAD OF FOOD AND DRINK, BDO LLP

Seven out of ten leaders polled in our April survey for this report felt positive about the industry. As of June, the reality is companies continue to face economic headwinds after surviving Brexit and COVID-19. It has been a tough few years for Food and Drink — and things are just as challenging, but businesses remain resilient in the face of adversity.

Russia's invasion of Ukraine in February has increased the pressure on already fraught supply chains and fuelled levels of inflation that have not been seen in four decades. In June 2022, UK food inflation hit 8.7%, a development that the Food and Drink Federation said was "very concerning."

The situation was compounded by a tight labour market, putting pressure on wages and causing some manufacturers to slow production, the Federation said[1]. The same month, a report by Lloyds Bank found UK Food and Drink output had fallen in May after nine consecutive months of expansion.[2]

Elsewhere, market research firm Kantar predicted average annual grocery bills would rise by £380 this year and supermarket Asda reported shoppers setting limits on food spending and switching to budget ranges.[3]

Clearly, the industry's fundamentals have worsened significantly in the time since our fieldwork was done, which means some of the optimism reflected in our research will have waned slightly. However, it is evident from our survey that Food and Drink manufacturers have taken steps to build resilience in their operations. Most businesses have diversified their supply chains, in-shored or near-shored supplies in and outside of the European Union and the industry now has greater visibility of contracts and better tools to monitor supplies.

The industry is also focusing on automation, digitalisation and new product development, with a third of companies planning capital expenditure in production this year. This is the industry's top focus for growth, ahead of expansion into new markets and new product development. However, making these investments will not be easy as increasing costs eat into margins.

At the same time, a similar proportion of companies is seeking additional finance, and maybe one in four businesses are looking for cost savings that might come as part of a digital transformation journey.

It remains the case that Food and Drink is still the UK's biggest manufacturing industry and a major source of employment and economic growth.

It is also true that the industry has exhibited remarkable levels of strength in recent years and its products are a prime necessity that could warrant government support if things get too tough.

That said, there is no getting away from the fact that the outlook for Food and Drink companies is mixed and the industry will have to continue to demonstrate its resilience as it seeks ways to navigate the current challenges.

We would like to thank all respondents to our survey whose views have informed our report. We hope you find this report interesting and useful for your business.

EXECUTIVE SUMMARY

UK Food and Drink manufacturers had reasons to be quite optimistic when we carried out our survey. The economic rebound from COVID-19 boosted profits for 49% of those surveyed, with only 17% seeing a drop in the bottom line. Orders were also up in 55% of cases, and profit margins increased for 50%.

While recent events may have dampened the mood, in April the industry expected this good fortune to continue over the next 12 months, with most respondents anticipating increases in operating profit, gross margins, revenue, orders, product launches and levels of production automation and digital transformation.

Continuing pandemic uncertainty and challenges such as inflation and geopolitical instability are encouraging players to invest in measures that add resilience to operations, with 56% planning to boost research and development (R&D) and 51% increasing production automation in the coming year.

GROWTH IN ALL DIRECTIONS

More than half (53%) of respondents expect to see an increase in orders over the coming year. A third of respondents see investment in production as the key driver, but geographical expansion comes close behind for many companies.

Thus, 31% of respondents expected to grow in non-European markets such as the Middle East and North and South America. A further 29% expected growth to come from the UK and a similar percentage (28%) were looking to new markets in the European Union, Brexit notwithstanding.

Finally, new product development continues to be an important source of growth for 29% of respondents. Only 17% of respondents foresee reducing R&D expenditure in the next 12 months, compared to 19% that have cut expenditure in the last year.

A COMPLEX RISK LANDSCAPE

Food and Drink companies face a range of risks and challenges in 2022, although no single issue is of overwhelming concern. The biggest worry is the ongoing impact of COVID-19, cited by 28% of our sample. Sustaining new product development was seen as a challenge by 20%.

Beyond this, increased competition, the effects of cheap imports, cyber security and wage inflation were all seen as problems for between 16% and 18% of those surveyed. Although not expressly considered a threat, it is clear the acquisition and retention of skilled labour is a challenge.

More than two fifths of companies increased headcount in the last year and a similar proportion expects to do so in the coming 12 months, but 61% of respondents report having difficulty in recruiting the people they need.

Reflecting growing levels of digitalisation in the sector, IT and software skills are the hardest to find.

INFLATION ENTERS THE PICTURE

Another growing source of business unease in 2022 is rising levels of inflation. Companies are adopting a wide range of strategies to deal with price rises: 32% of respondents said they were seeking additional finance and 30% were looking to use new or existing overdrafts.

In addition, 27% of companies were looking to raise prices, 26% were planning redundancies, 25% were changing to cheaper suppliers, 23% were reducing profit expectations and 19% were preparing to take on higher levels of debt.

GROWING SUPPLY CHAIN RESILIENCE

Brexit and COVID-19 lockdowns have made the Food and Drink industry mindful of supply chain issues, with 88% of respondents saying they are aware of the commercial leverage they have with key contracts and 66% embedding tools and systems to monitor suppliers.

These resilience measures are expected to play a growing role in the industry as Russia's invasion of Ukraine puts further pressure on supply chains in 2022.

A CONTINUING FOCUS ON SUSTAINABILITY

Sustainability remains high on the industry agenda and there is a suggestion it is now becoming part of business as usual, with 69% of businesses identifying specific environmental, social and governance risks and opportunities.

RESULTS HIGHLIGHTS

FROM THE BDO FOOD AND DRINK SURVEY 2022

78%
of respondents are **positive** about the prospects for their business

18%
have experienced a **decrease in operating margins**

51%
of respondents are expecting profitability to **increase** over the next 12 months

33%
say **investment in production** will offer sales growth opportunities for their business

28%
think the **ongoing impact of COVID-19 is the biggest threat** to their business

32%
are **seeking additional finance** to counter inflation

88%
are aware of the **commercial leverage** they have with key suppliers and contracts

Only 9%
receive copies of all customs declarations to ensure the right amount of import tax is paid

52%
believe **cyber threats** are a significant risk to their business

61%
are experiencing **difficulties in recruiting the people** they need

64%
have **considered flexing reward packages** to attract and retain workers

55%
have **an environmental, social and governance** strategy

GROWTH AND PROSPECTS

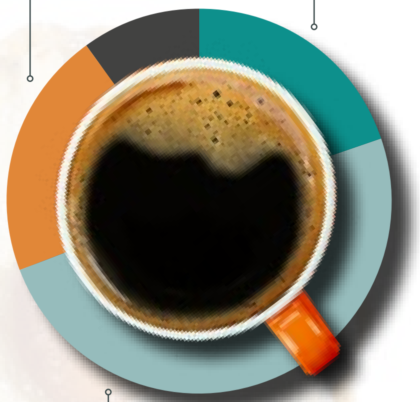
At the time of our survey, the mood among Food and Drink manufacturers was buoyant as Brexit dwindled in the rear view mirror and COVID-19 was getting under control. Only one in ten survey respondents had a 'quite negative' view of prospects for the industry. Not a single leader voiced a very negative perspective.

And 69% were very or quite positive. Levels of optimism were even more significant when it came to respondents' businesses, with 78% voicing a positive opinion. Levels of pessimism tallied with the industry forecast, with 8% and 3% offering 'quite' and 'very' negative outlooks, respectively.

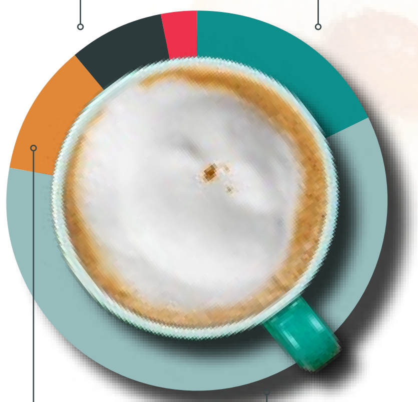
This confidence makes sense given the industry's financial performance over the last 12 months. Operating profitability increased or stayed the same for 80% of the sample, and gross profit margins were similar or up for 75%. Revenues rose or remained equal in 86% of cases.

There was a general expectation that the industry would continue to experience continued improvements in performance over the coming 12 months, with 51% of respondents forecasting further increases in operating profitability and 57% anticipating growth in gross profit margins.

HOW DO YOU FEEL ABOUT THE PROSPECTS OF THE INDUSTRY IN THE UK?



HOW DO YOU FEEL ABOUT THE PROSPECTS FOR YOUR BUSINESS?



HOW DO YOU ANTICIPATE YOUR BUSINESS PERFORMANCE TO CHANGE OVER THE NEXT 12 MONTHS, IF AT ALL?

	INCREASE	STAY THE SAME	DECREASE
Operating profit	**51%**	29%	17%
Gross profit margins	**57%**	25%	13%
Revenue	**55%**	25%	19%
New orders	**53%**	34%	11%
Headcount	**42%**	39%	15%
Capital expenditure	**41%**	32%	25%
New product launches/R&D	**56%**	24%	17%
Level of production automation/digital transformation	**51%**	30%	16%

55% of companies surveyed expected revenue to go up and 53% were looking forward to increased orders. Based on this outlook in April, 42% of businesses were looking to grow headcount, versus 15% planning a decrease, and 73% were due to maintain or increase capital expenditure.

Much of this money seems destined for new product development and digital transformation.

More than half (56%) of the sample expected to increase the level of product launches and research and development (R&D) in the coming 12 months, while 51% planned to up levels of production automation and digital transformation.

INDUSTRY INSIGHT
EXPORTS BOOM AFTER COVID

"Following significant COVID-related impacts, markets in Asia, North America and Africa are now showing very encouraging signs of recovery," says the **Food & Drink Exporters Association** in its *2021 Trade Snapshot.*[5]

Figures show trade increases of nearly 10% in the £3.7bn Asian market, 6% in the £2.6bn North American region and a striking 63% in the £534m Central and South America territories helped offset an 11% drop in Europe, which remains the UK's largest trading partner, worth £12bn in 2021.

GROWTH AND PROSPECTS
CONTINUED

ROUTES TO GROWTH

Indeed, investment in production was seen as the biggest potential contributor to sales growth in the coming year, cited by 33% of the sample. A further 27% were looking to invest further in automation and digital transformation, like the 29% planning growth through new product development.

Market expansion was also on the cards for many, with 29% looking to grow in the UK, 28% eyeing European Union territories and 31% aiming to conquer markets beyond Europe. Of these, North America is a clear favourite, selected by 42% of companies looking to expand outside Europe.

The Middle East and South America, meanwhile, were each seen as attractive for 32%. Asia only appealed to 25% and Australia and New Zealand (10%), despite becoming more attractive with recent changes in regulations, trailed Africa (13%).

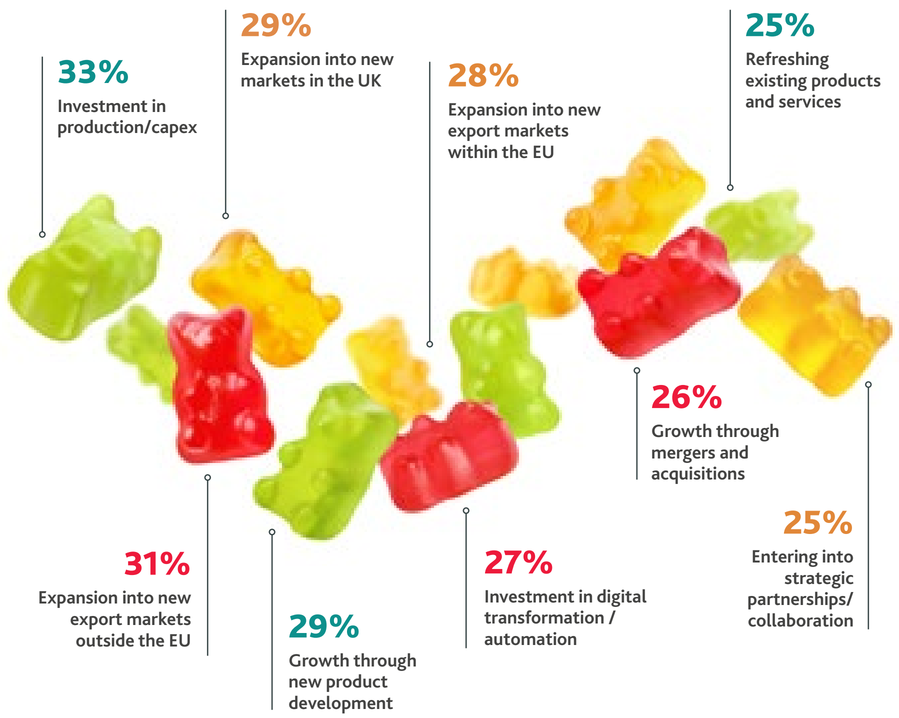
BDO INSIGHT
SUPER-DEDUCTION AND SPECIAL RATE FIRST YEAR ALLOWANCE

With any current or planned investment, it is important that, where possible, Food and Drink companies schedule their spending to qualify for the temporary first year allowances on plant and machinery available before 31 March 2023. As announced in the Spring Statement, the Government is looking to replace the super deduction and SR allowance to maintain a strong incentive for businesses to invest beyond March 2023. A further announcement on new incentives to invest is expected in the Autumn Budget.

More information on capital allowances can be found here.

STEVE WATTS
PARTNER, TAX

WHERE DO YOU ANTICIPATE MOST OF YOUR SALES GROWTH TO COME FROM IN THE NEXT 12 MONTHS?



RISKS AND CHALLENGES

The Food and Drink risk landscape is evolving quickly. When our fieldwork was carried out it was clear that the lingering impact of COVID-19 was still a concern, cited by 28% of respondents—more than any other worry.

Yet scarcely a few weeks later, Russia's invasion of Ukraine was giving rise to a very different threat. By May, shortages of grain and fertiliser caused by the war prompted United Nations Secretary General António Guterres to warn of a global food crisis.

The shortages could "tip tens of millions of people over the edge into food insecurity," he said.[6]

Wheat prices hit record highs in May[7], creating problems even for well-off economies. Tesco chairman John Allan warned that Britons were experiencing real food poverty for the first time in a generation.[8]

INDUSTRY INSIGHT
COMMODITY MARKETS SPIKE OVER UKRAINE

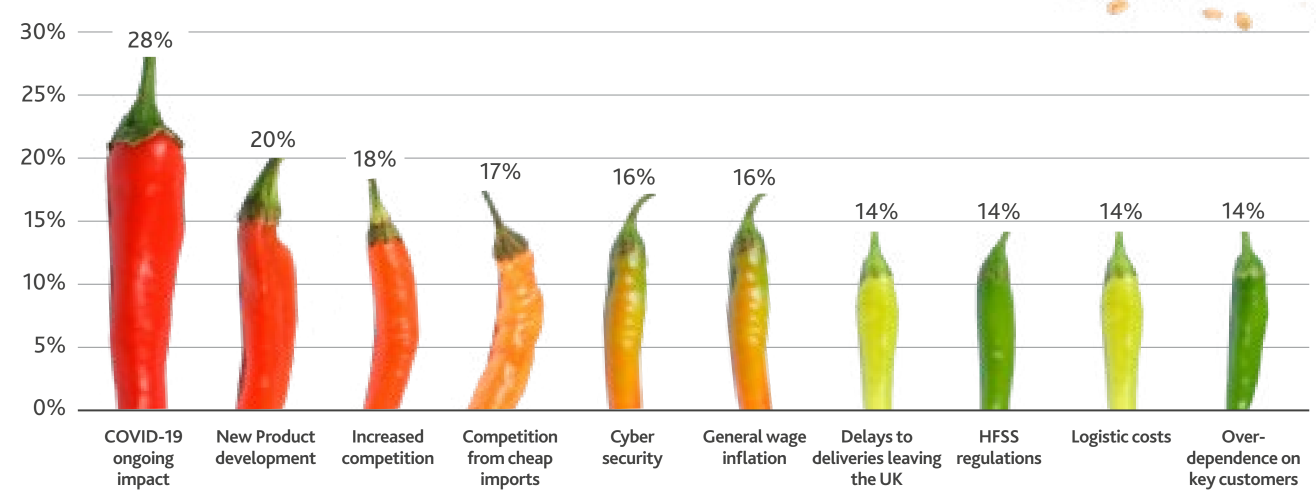
Global commodity prices are soaring because of events in Ukraine, with Brent crude up 42% on 2021 levels and non-energy prices expected to rise 20%. Particularly hard-hit will be grain, since Russia and Ukraine account for around a quarter of global wheat supplies, the World Bank says.[9]

The Bank's April 2022 Commodity Markets Outlook predicts wheat prices will go up more than 40% this year, reaching an all-time high in nominal terms. Already trading at $315 a tonne last year, it is expected to hit $450 in 2022 before falling to around $380 in 2023.

"While prices generally are expected to peak in 2022, they are to remain much higher than previously forecast," says the report.

However, it adds: "The outlook for commodity markets depends heavily on the duration of the war in Ukraine and the severity of disruptions to commodity flows, with a key risk that commodity prices could be higher for longer."[10]

WHAT ARE THE TOP RISKS/CHALLENGES FACING YOUR BUSINESS IN THE NEXT YEAR?
TOP TEN OPTIONS SELECTED



RISKS AND CHALLENGES *CONTINUED*

DEALING WITH INFLATION

For UK Food and Drink manufacturers, the soaring cost of basic products is likely to aggravate tensions caused by general wage inflation, cited by 16% of respondents in our survey, and logistics costs, mentioned by 14%.

In the normal course of events, some of these price increases might be passed onto customers. This is what 27% of companies in our study were planning to do. But with UK consumers feeling the pinch on all fronts, companies that pass on costs too assiduously might expect to lose market share.

Competition from cheap imports was a concern for 17% of our sample, while 18% are worried about increased competition overall. If passing on price increases is not an option, what else can companies do to cope with inflation? The most obvious answer, according to our survey, is to seek additional finance.

This was mentioned by 32% of respondents, while 30% said they would be taking out new overdrafts or using existing ones and 19% were preparing to take on higher levels of debt.

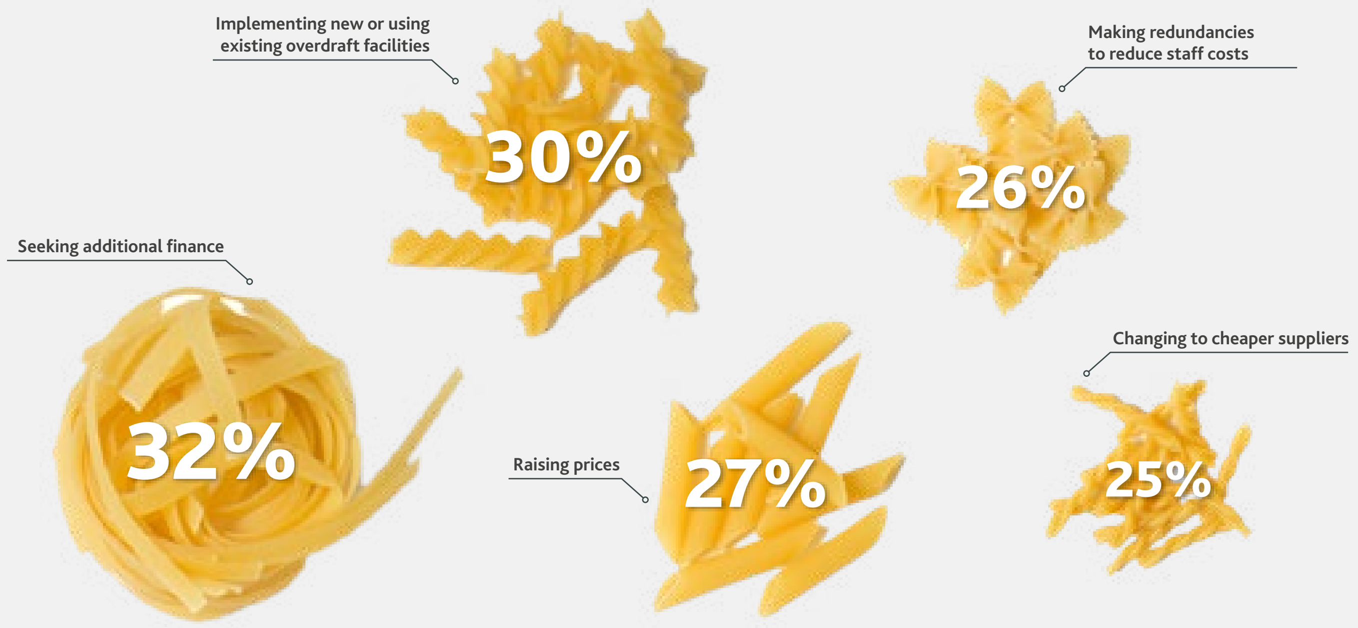
Reducing staff costs through redundancies is also a relatively popular course of action, being pondered by 26% of those surveyed.

Since this is higher than the percentage of respondents citing concerns over wage inflation, it would appear some manufacturers are looking to fight inflation with investments in automation that would allow for the release of lower-skilled employees.

Elsewhere, 18% of respondents were requesting supplier discounts in exchange for larger orders, and 17% were pausing investment in the business. At the time of the fieldwork, many of these measures were based on the assumption that cost inflation would be short-lived. However, UK inflation has continued to rise at it fastest rate in 40 years to 9.1% in the 12 months to May.[11]

Nor are rising costs the only thing that the industry is worried about. Another important concern was cyber security, cited by 16% of respondents.

WHAT MEASURES, IF ANY, IS YOUR BUSINESS TAKING OR PLANNING TO TAKE TO COUNTERACT THE IMPACT OF RISING LEVELS OF INFLATION? TOP FIVE OPTIONS SELECTED



GROWING CYBER THREATS

Although Food and Drink companies may not have been unduly targeted by hackers in the past, the picture changed dramatically in May 2021 when Brazilian meat processing giant JBS suffered a major cyberattack. The attack knocked out all JBS's American facilities as well as operations in Australia.[12]

JBS restored its services after paying an $11m ransom in Bitcoin, which Food and Drinks companies might believe could serve as an incentive for further attacks on the industry.

While cyberattacks could affect Food and Drink manufacturers directly or through their supply chains, our research also revealed concerns in downstream areas. Almost 14% of respondents faced delays in deliveries leaving the UK and a similar percentage cited over-dependence on key customers as a risk.

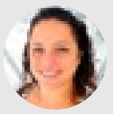
BDO INSIGHT
PRODUCT DEVELOPMENT CONCERNS

One unusual finding from our research was that one in five respondents listed new product development as a challenge. This seems an unusually high level of concern – coming second only to COVID-19 – for something that is more often viewed as an opportunity.

Apprehension over new product development may be related to a growing need for products that address regulations around high fat, salt and sugar (HFSS) content.

HFSS regulations were a headache for 14% of those surveyed, although the restrictions have now been pushed back a year which gives manufacturers more time to prepare for the changes.[13]

The craze for healthier lifestyles ushered in by COVID-19 might be creating problems for some companies in terms of new product development. Plus, with greater competition overall, it is harder to develop a differentiator in the market.



ECE AKSER
DIRECTOR, R&D INCENTIVES

SUPPLY CHAINS

WATCHING OUT FOR THE WEAKEST LINK

If the last couple of years had left any doubt about the importance of supply chains, then 2022 is making sure leaders take note. Supplier issues that have been mounting since Brexit are now being compounded by supply shortages arising from Russia's invasion of Ukraine.

In April 2022, the Office for National Statistics reported that the UK Food and Drink industry was being hit harder than others by supply chain shortages and price increases.[14]

The government body cited a March survey that showed 60% of companies in the industry had been affected by rising energy prices, compared to an average of 38% across all industries.

And "Food and beverage businesses were approximately twice as likely to report additional transportation costs," it added. "Food and beverage businesses were more likely than other sectors to have changed supply chains due to the end of the EU transition period in the first three months of 2022.

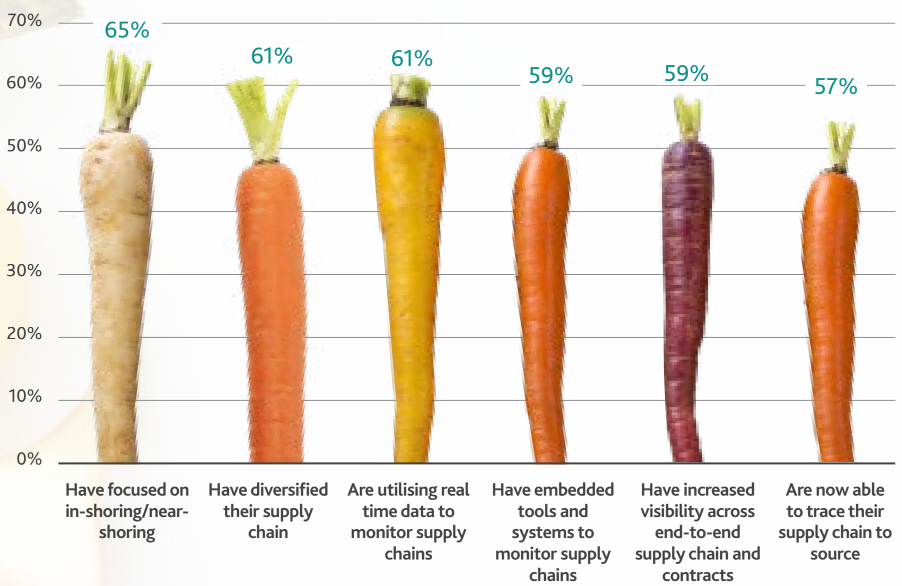
"Food and beverage businesses are more likely to have reported price rises for materials, goods and services."

BUILDING RESILIENCE

These ongoing challenges have forced most of the companies in the industry to improve their knowledge of suppliers and build resilience into the supply chain, according to our survey.

For example, 66% of companies in our survey have deployed tools and systems that can help improve oversight of supply chains, with 61% using real-time data monitoring and 59% increasing end-to-end visibility. Leaders in 57% of companies say they can now trace supplies to their source.

FOOD AND DRINK MANUFACTURERS' APPROACH TO SUPPLY CHAINS AND CONTRACTS STRATEGY



Three-fifths of companies have adapted their supply chain and contracts strategies to the new environment and almost nine out of ten (88%) say they have at least some awareness of the commercial leverage they have with key suppliers.

A third of those surveyed said they were "completely aware" of the extent of commercial leverage.

88%

of companies say they are somewhat aware or completely aware of the commercial leverage they have with suppliers and contracts

The effort involved in adapting supply chains is a mixed bag, with 46% of respondents saying the process has gone smoothly versus 43% reporting difficulties in adjusting supplier and contract strategies.

Meanwhile, with shipping costs on the rise and containers in short supply, 65% of companies surveyed say they have focused on in-shoring or near-shoring suppliers in recent months, and 61% have diversified their supply chain.

For 59%, that diversification has meant looking to new markets in the European Union, while a similar proportion (57%) has diversified beyond Europe. Overall, 56% of leaders surveyed say they are investing time in forming strong relationships with suppliers.

CUSTOMS CONTROL

Despite this clear trend towards understanding and managing the supply chain, there still appears to be little control over customs declarations.

Less than half (46%) of those surveyed say they receive copies of all customs declarations and retain them for HMRC, and only 9% check them to make sure the company is paying the right amount of import tax.

A scant 39% say they "sometimes" see copies of customs declarations while 7% leave matters entirely to their freight forwarder. At a time when moving goods around is already more costly than usual, risking import tax overpayments does not seem like a good idea.

BDO INSIGHT

WHAT CAN BUSINESSES DO TO MANAGE SUPPLY CHAINS?

Food and Drink companies may hope supply chain pressures will be short-lived but in practice it is key to safeguard supplies for the long term.

Speed of reaction to events can be a basis for competitive advantage. Comprehensive mapping of the key elements of the supply chain is becoming a baseline necessity. This is complemented by improving customer demand forecasts. Forecasting customer demand is challenging; putting effort into forecasting accurately will support meaningful conversations with suppliers. In the trade-off between efficient and resilient supply chains we are seeing a move to resilience.

While efficient processes such as just-in-time purchasing might help the bottom line, today it makes sense to sacrifice profits for predictability and opt for more resilient procurement strategies, for instance buying goods in bulk as a hedge against shortages. This is easier said than done with lead times of natural ingredients often being lengthy, consumption profiles changing and variety of shelf-life limits influencing planning, amongst other factors. Managing the associated risks also comes at a cost but is the cost less than being unprepared for a disruption.

The sustainability agenda is driving innovation and regulation. It is increasingly becoming part of branding and informing consumer choice. An ability to report accurately will support gaining visibility of the supply chain which in turn can contribute to understanding and responding to events, including those driven by climate change, both as single events and as longer-term trends.

Finally, in the long term it will be important to incorporate a greater sustainability dimension into supply chains, adapting them to climate change. We are already seeing supplies being affected by severe weather events and that trend is set to continue in the coming decades.

Extreme is becoming the new normal, and supply chains had better be ready for it.

NICK EGGETT
SENIOR MANAGER, RISK ADVISORY SERVICES

BDO INSIGHT

CUSTOMS DUTY – ANYTHING TO DECLARE?

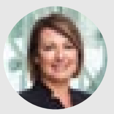
Customs duty issues should be high on everyone's agenda since Brexit. In our survey of Food and Drink companies, we asked about the level of oversight businesses have of the customs declarations submitted by their freight forwarders.

While 46% of respondents said their businesses retain all customs declarations, only 9% of them check the declarations have been completed correctly. Nearly 40% don't see all their declarations and, worryingly, 7% just leave everything to their freight forwarders.

This is important because even though you may have contracted out the customs declaration process to a third party, when your goods are imported and exported your business retains legal liability to HMRC for errors made in its name.

So, if you are not checking your declarations, you could be building up a history of non-compliance and facing growing risk. How confident would you be if HMRC turned up to undertake a customs audit?

More information about customs duty processes can be found **on our website**.



JULIET WALLWORK
DIRECTOR, CUSTOMS DUTIES

CYBER SECURITY

ATTACK OF THE CYBER MEN

The rush to digitise and automate production in the Food and Drink industry carries a hidden risk. Every new device that is connected to an IT network is a potential gateway for hackers—and cyber criminals are attacking manufacturers like never before.

The manufacturing sector endured more cyber-attacks last year than any other industry, even coming ahead of traditional targets such as financial services and government, according to IBM's annual X-Force Threat Intelligence Index, released in February.[15]

Ransomware is the top cyber threat for manufacturers, it says.

"Experiencing more ransomware attacks than any other industry, attackers wagered on the ripple effect that disruption on manufacturing organisations would cause their downstream supply chains to pressure them into paying the ransom," said IBM.

RANSOMWARE RISK

This technique was used to devastating effect in the case of JBS last year (see 'Risks and Challenges'), sparking concern about copycat attacks in the UK. In our survey, 52% of companies said cyber threats were a significant risk to their business and 44% of companies admitted to having been attacked.

This is almost certainly an underestimate, since many companies are reluctant to admit to being hacked and many more may not be aware that they have been compromised. Hackers can lurk on a corporate IT system for an average of six months before being detected.[16]

Most companies surveyed are taking the threat seriously, with 55% stating that cyber security was a strategic priority. Even more—69%—include IT security in their key performance indicators and 58% have upped spending on cyber defences.

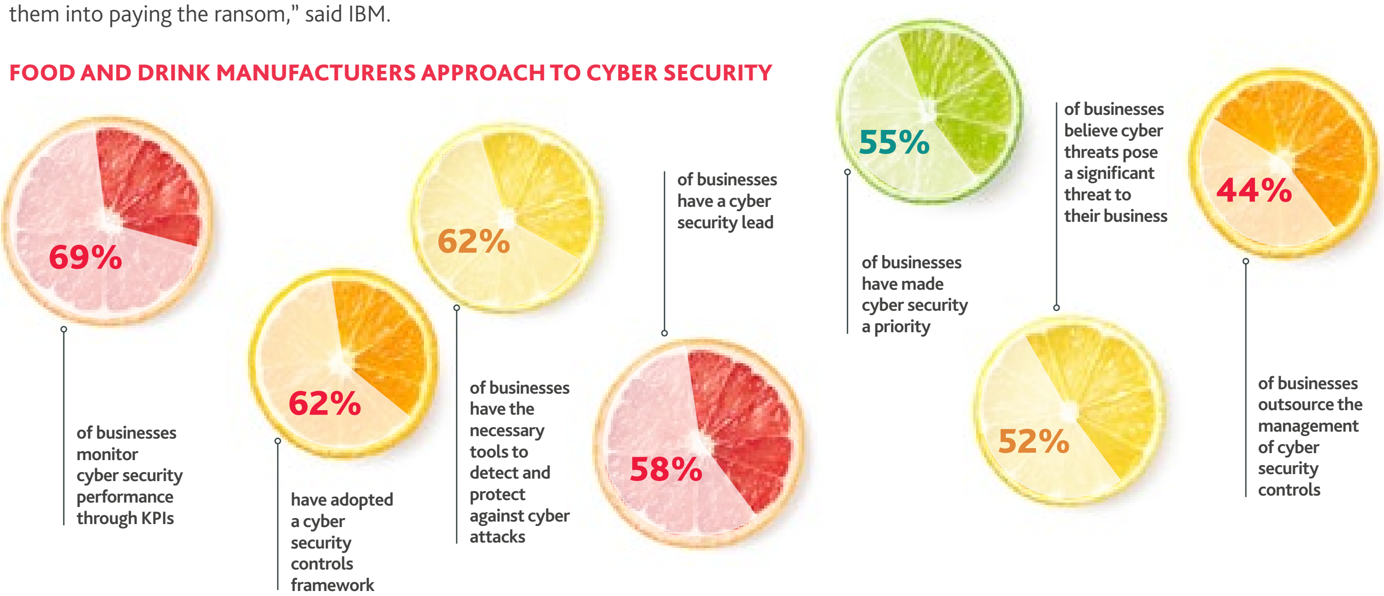
TAKING THE LEAD

An identical percentage has nominated a cyber security lead for the business, while 62% have adopted a framework to deal with threats.

At the same time, the research unveiled quite high levels of confidence in dealing with threats, with 65% of respondents claiming their businesses had sufficient capacity to address cyber security risks and 62% believing they had the right tools for threat detection and protection.

Given the magnitude of cyber risks today and the constantly evolving nature of the threat landscape, it is hard to tell if this confidence is well founded or simply reflects ignorance of the challenge. Let's hope it is the former.

FOOD AND DRINK MANUFACTURERS APPROACH TO CYBER SECURITY



BDO INSIGHT

DIGITAL TRANSFORMATION COMES WITH RISK

Digital transformation remains an area of focus for most organisations within the industry, with 51% of respondents of our survey reporting an increase in the level of production automation or digital transformation within their organisation and 27% reporting this as a top-five area of growth.

This is not unique to the Food and Drink industry. Many organisations are using technology to streamline or scale operations, connect with customers or to remain competitive.

In many instances, digital transformation has moved from an area of innovation or source of competitive advantage to a requirement for organisations to keep pace with competitors.

This was particularly relevant during the pandemic as organisations without a digital presence struggled to compete while those that had once reaped the rewards of an easy transition to remote working or the ability to continue servicing customers with reduced physical contact.

While there are numerous benefits, a digital transformation strategy does not come without risk. Cyber risk is increasingly relevant to organisations adopting a digital transformation strategy, as the reliability of systems and data is critical to support the new way of doing business.

Cyber risk was rated fifth in the top ten risks in the Food and Drink survey. A further 52% of respondents believed cyber threats pose a significant risk to their business. And 55% have made cyber security a strategic priority going forward.

ONE SIZE DOES NOT FIT ALL

Cyber threats will continue to evolve as organisations place more reliance on technology and malicious threat actors stand to profit from disrupting business or exploiting vulnerabilities for financial gain.

This has been demonstrated through numerous examples of system compromises, data breaches and disruption of operations, and 44% of respondents within the Food and Drink industry indicated that they have been subject to an attack.

There are frameworks and sources of guidance organisations can follow but there is no one size fits all. We find that understanding one's threat exposure through a threat assessment is key to building an effective cyber security strategy.

This will help you balance or prioritise cost or protection with the risk of being a target as well as the impact of a cyber breach.

A CYBER STRATEGY IS KEY TO MANAGE THE RISK

Developing a cyber strategy and operating an effective control environment can be challenging given the pace at which technologies and controls change, and with the scarcity of skills in this area remaining a challenge.

This has been shown by 35% of respondents indicating that they do not have sufficient capacity to address their cyber risks, 44% outsourcing this responsibility and 62% believing they have the necessary tools to detect and protect against attacks.

A cyber strategy is key to effectively managing the level of risk exposure and reducing this to acceptable levels. This strategy should balance the following:

- Alignment with the business and other enterprise risk management processes
- Threats facing your organisation and the potential impact to the business
- Prevention, detection, response and recovery capabilities
- Effectively resourcing your capability to sustainably manage your cyber control environment (in-sourcing versus outsourcing).

JASON GOTTSCHALK
PARTNER, CYBER SECURITY

SKILLS

ISSUES WITH THE RUSH TO DIGITAL

UK Food and Drink company leaders know their businesses must embrace digital technologies.

They know automation can improve efficiency and help reduce the need for unskilled labour at a time when inflation is posing a real risk to margins, and digital tools can help make up for creaking supply chains. There is just one catch. Implementing digital programmes is not something anyone can do.

It requires a very specific set of skills and experience. And those skills and experience are in short supply, our research shows. Three fifths (61%) of respondents said they were having difficulties recruiting the people and skills their companies needed.

The skills they need are digital ones, with 34% of those surveyed listing information technology and software abilities as the job profiles they were most struggling to fill.

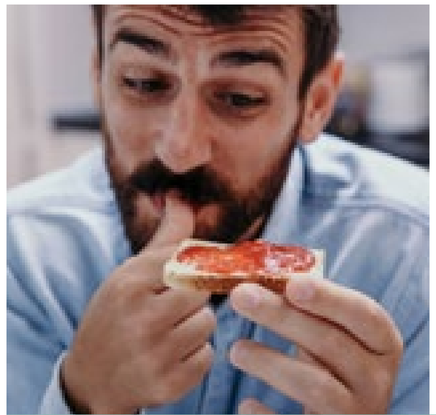
Close behind this was a shortage of data analytics and other skills linked to digital transformation, mentioned by 32% of the survey. Design skills were also a recruitment headache for 27% of those surveyed.

Beyond this, just under a quarter of the survey cited skills that again are often linked to digital transformation, with 24% each mentioning project management and technical research and development and 23% mentioning difficulties in recruiting engineers.

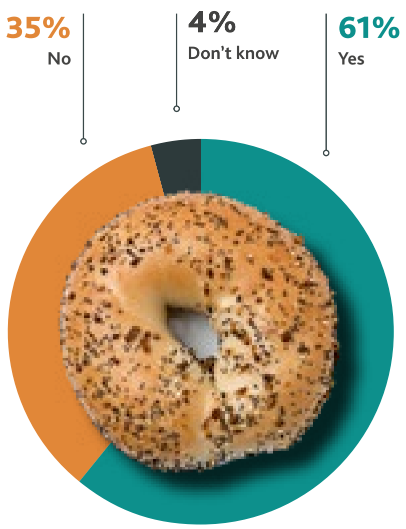
In contrast, a lack of unskilled manual workers, listed by 23% of the survey, and craft skills, listed by 18%, did not even make it into the top five recruitment challenges listed.

Finally, finding people with production-related technical skills was an issue for 16% of respondents and a similar percentage mentioned difficulties in recruiting sales and marketing professionals.

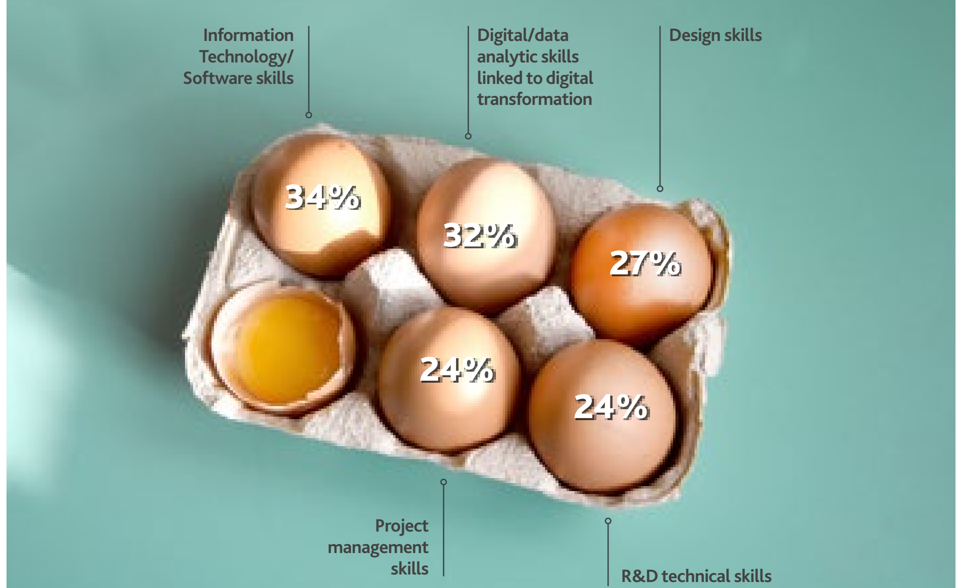
Meeting the need for digital skills will likely remain a challenge because competition for these professionals is not just a matter for Food and Drinks companies.



IS YOUR BUSINESS EXPERIENCING DIFFICULTIES IN RECRUITING THE PEOPLE AND SKILLS IT REQUIRES?



TOP FIVE SKILLS BUSINESSES ARE STRUGGLING TO RECRUIT



UPDATING REWARD SCHEMES

Most industries in the UK are embracing digital transformation, leading to intense competition for professionals with data and IT backgrounds. Against this backdrop, Food and Drinks companies are rushing to update reward schemes and make them more attractive for key staff.

In our survey, 57% of respondents said their businesses had evaluated their reward structures and 63% of those that had not were looking to do so in the future.

Even though 58% of leaders said they have systems in place to measure employee satisfaction, 47% believed they would need to improve remuneration structures such as salaries and bonuses; 53% were paying staff more to attract and retain talent.

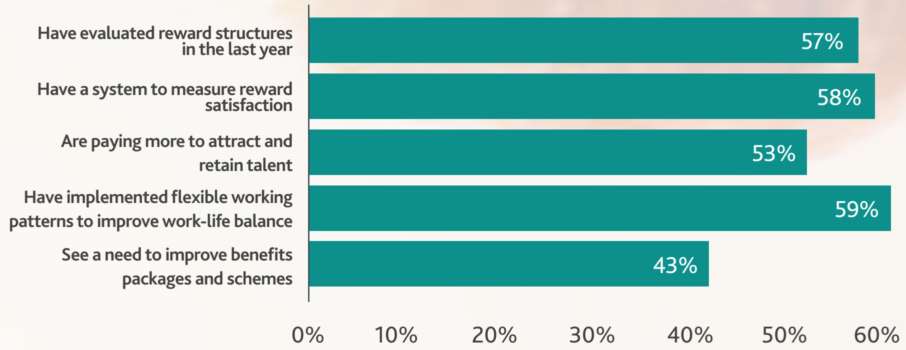
And 60% had optimised pension offerings to ensure they remained attractive. A significant minority (43%) also see a need to improve business benefits packages and schemes covering areas such as healthcare, childcare support and company cars.

Notably, 64% of businesses are considering rewards linked to environmental, social and governance measures. Flexible working has also become standard practice in the industry, with 59% of respondents saying their companies have implemented schemes to improve employee work-life balance.

A relatively high proportion (46%) is also considering employee ownership or share schemes. When it comes to recruitment, apprentice schemes remain a popular route, with 54% of companies using the government programme.

Businesses are also working to tackle gender pay gaps and improve diversity, with 58% of respondents saying they had achieved the outcomes they wanted in these areas. In addition, 64% of businesses have considered flexing their reward packages to attract and retain workers of all ages.

FOOD AND DRINK MANUFACTURERS APPROACH TO PAY AND REWARD



BDO INSIGHT

RETHINKING REWARD PRACTICES TO ATTRACT TECH TALENT

The competition for tech talent is intense with a third of our survey participants reporting that they are struggling to recruit tech and digital talent. How can the industry compete successfully for the skills it desperately needs?

The survey responses this year suggest Food and Drink companies are deploying a range of tools to support the acquisition of tech talent. Over half of our survey participants are paying more to attract and retain talent and many believe they need to improve further their base salary and bonus offering.

We also see a focus on offering improved benefits packages (43% of participants) and flexible working (59% of participants). While these individual measures may be occasionally helpful, they come at a considerable cost and may not necessarily be sufficient to shift the dial.

Our experience suggests that the following interventions can make the most difference:

- **Design total reward strategies that can be differentiated for different employee groups.** This allows companies to provide targeted rewards that better meet employee needs and expectations; for example, by anchoring hot skills to higher market percentiles or offering a skills-based pay premium
- **Put your purpose at the fore. People want to work for businesses that do good.** You can steal a competitive advantage by focussing on the positive impact you make in your communities and markets
- **Adopt an 'employee deal' mindset.** Total reward nowadays extends beyond competitive salary and benefits packages to include broader employee wellbeing, skills development and career progression.

There are two aspects of this employee deal mindset that can reap great benefits for companies. One is to create clear career paths for key talent, offering meaningful work opportunities, progression and experience.

The other relates to hybrid working. Remote working is not new. In fact, before the global pandemic forced everyone to work from home, it was a common practice in many sectors. Keep your offer flexible, since failing to do so is a barrier to attracting and keeping the people you need.

More information about pay and reward can be found on our website.

DAVID ELLIS
PARTNER, STRATEGIC REWARD ADVISORY

SUSTAINABILITY

GREEN IS GOOD

Environmental, social and governance (ESG) issues continue to be a concern for Food and Drink companies, with 53% of leaders surveyed saying ESG and sustainability is a key focus for their business in 2022.

55% of companies surveyed claim to have an ESG strategy and 57% say the strategy is linked to a specific individual.

IS ESG/SUSTAINABILITY A KEY FOCUS FOR YOUR BUSINESS IN 2022?

Furthermore, 63% of companies surveyed have ESG objectives linked to the business strategy and 69% have identified ESG-related risks and opportunities.

Almost three fifths (59%) have set ESG targets or key performance indicators, and a similar proportion (60%) have linked executive pay to ESG performance.

It is clear social and environmental performance is seen as a competitive differentiator, with 57% of companies applying ESG considerations when going to market and deciding which suppliers to work with.

Three in five companies have set a net-zero emissions target and 93% of those businesses have a plan in place to achieve it. To stay on track, 63% of businesses have systems that capture or monitor key ESG data sets and 60% get independent assurance on ESG reporting.

Data and reporting cover a wide range of targets and frameworks, starting with the United Nations Sustainable Development goals, used as a framework by 62% of companies surveyed.

Other popular metrics and frameworks include the Task Force on Climate-Related Financial Disclosures, mentioned by 58% of the sample, the World Economic Forum International Business Council index (57%), the European Union Taxonomy (56%) and the Sustainability Accounting Standards Board (54%).

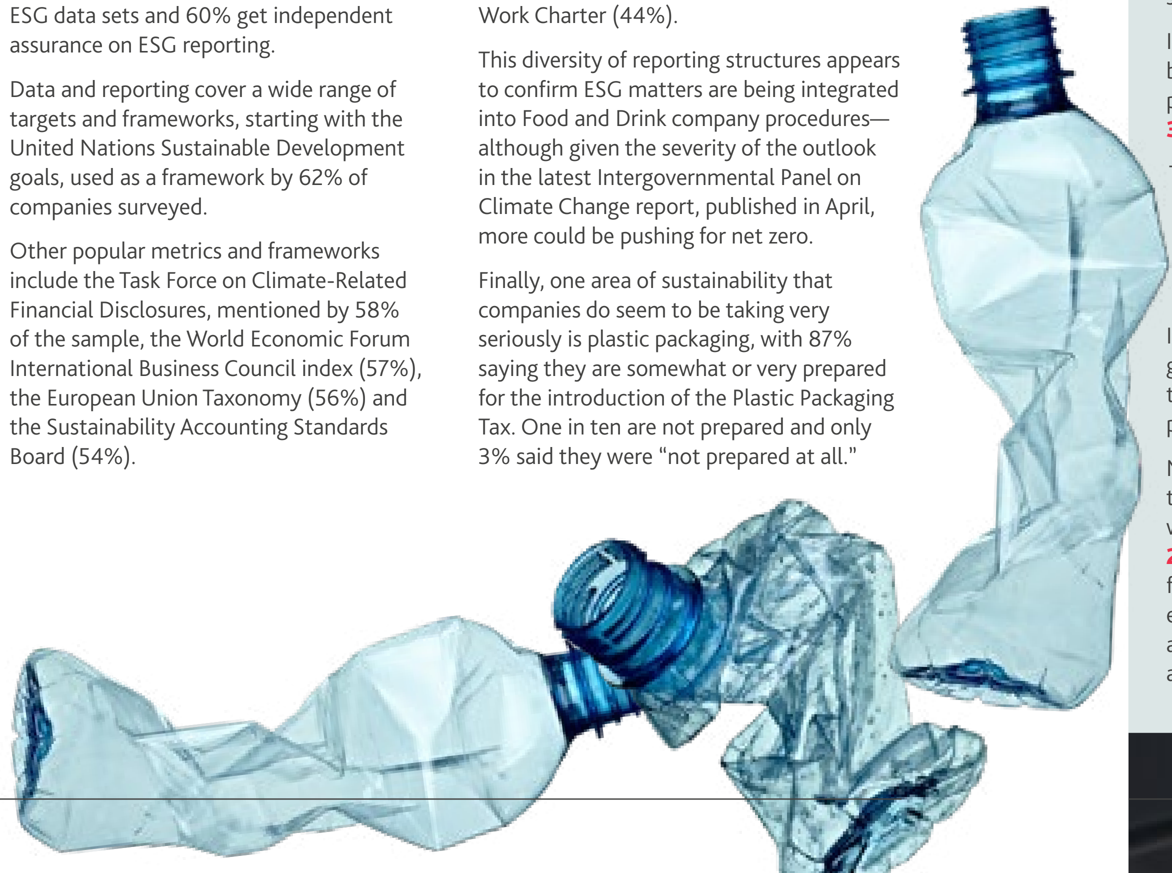
36%

of business leaders called for more help in reducing carbon emissions and investing in the circular economy

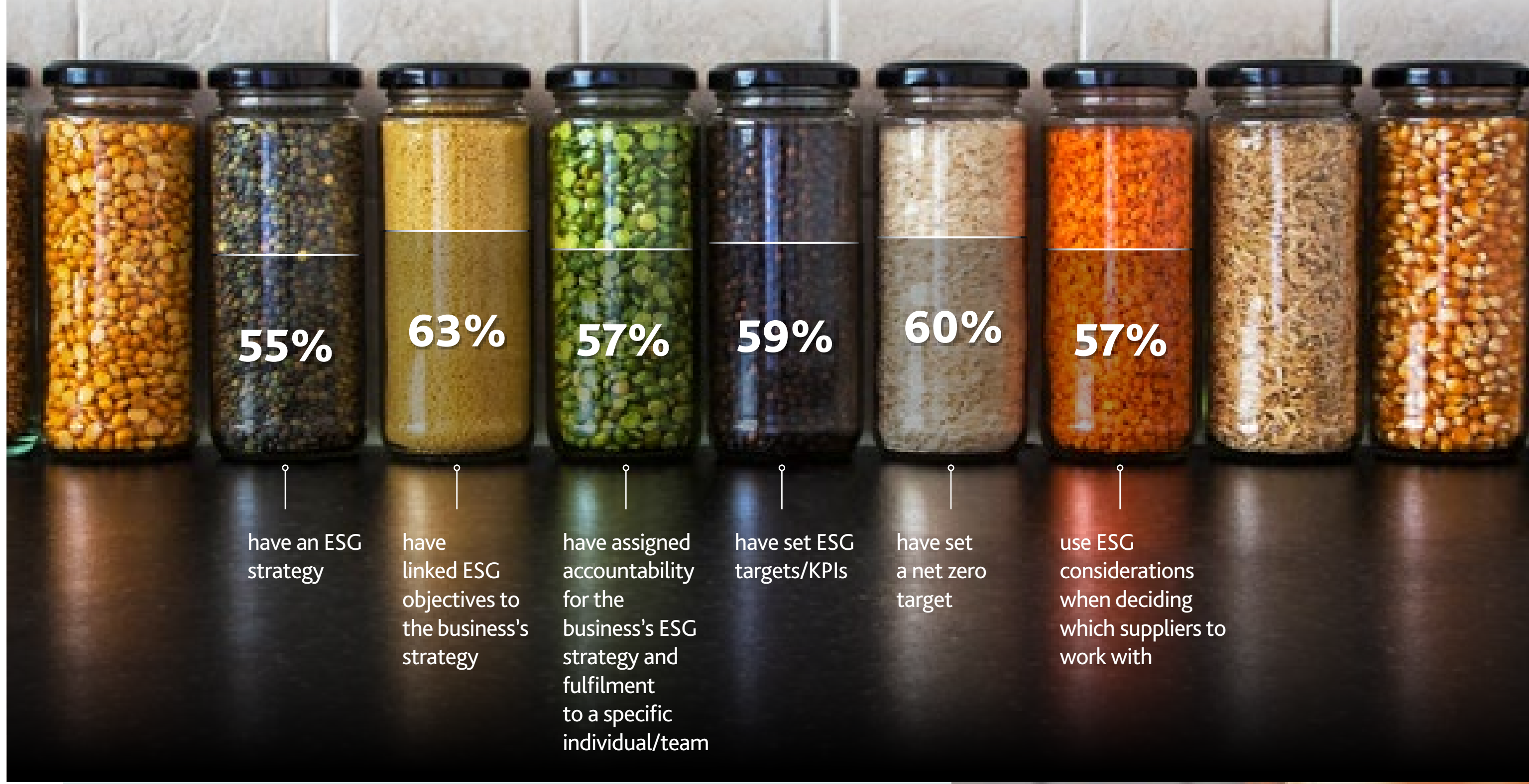
Exactly half of the sample used Streamlined Energy Carbon Reporting, and for social reporting popular measures included board diversity, mentioned by 59% of the sample, the gender pay gap (52%), the Modern Slavery Statement (45%) and the Race at Work Charter (44%).

This diversity of reporting structures appears to confirm ESG matters are being integrated into Food and Drink company procedures—although given the severity of the outlook in the latest Intergovernmental Panel on Climate Change report, published in April, more could be pushing for net zero.

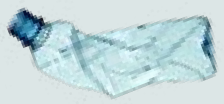
Finally, one area of sustainability that companies do seem to be taking very seriously is plastic packaging, with 87% saying they are somewhat or very prepared for the introduction of the Plastic Packaging Tax. One in ten are not prepared and only 3% said they were "not prepared at all."



FOOD AND DRINK MANUFACTURERS APPROACH TO ESG/SUSTAINABILITY



BDO INSIGHT
PLASTIC PACKAGING TAX UNDERWAY



April 2022 saw the start of the UK's new Plastic Packaging Tax (PPT) regime and, like many others, companies in the Food and Drink industry were at various stages of readiness.

In our survey of Food and Drink businesses, while **87%** said they were prepared for the PPT in some way, only **30%** said they felt well prepared.

The majority (**57%**) described their company as "somewhat prepared," emphasising that 2022 will be an interesting year as companies get to grips with the new rules in practice.

Indeed, with HMRC still issuing guidance on the new rules, it is likely that those businesses that feel well prepared still face reporting challenges.

More encouragingly, there are signs that the aim of the new tax, reducing plastic waste, is being achieved to some extent: **24%** of companies say they were now focusing research and development efforts on reduction in plastic packaging and development of sustainable alternatives.

Once their PPT administration is under control, we would expect businesses to focus greater efforts on reducing costs by increasing recycled plastic content or switching to other packaging materials.

More information about PPT can be found **on our website**.

CHRIS MORGAN
DIRECTOR, VAT

SUSTAINABILITY *CONTINUED*

GREEN IS GOOD

CASE STUDY

DEALING WITH ESG INNOCENTLY

Innocent Drinks has built its brand on goodness. And that ethos spreads to its approach to ESG. The company's first factory, in Rotterdam, Netherlands, is built on three key principles. It is a great place for people to work, it is planet-friendly, and it helps innocent be a better business while helping others to be better, too.

The factory's 100% electric blender operates solely using renewable energy from on-site solar panels and wind turbines, making it fully carbon neutral.

The factory also includes a cleaning system that reduces water usage by 50%, and innocent worked with several companies to recycle the construction waste and reach recycling rates of around 90%.

To save water, "we have some kit that creates mini tornadoes to clean pipes rather than just flushing," says Chief Operating Officer James Davenport.

The location of the factory is designed to reduce transport emissions by minimising the distance that trucks need to travel in getting to key markets. Innocent has also taken delivery of the world's first 50-tonne electric lorries, to take care of distribution.

Because nobody has built a factory like this before, there was a lot for innocent to learn. Starting from scratch was a great opportunity to embed sustainable ways of operating from the start.

Innocent worked to Building Research Establishment Environmental Assessment Method-certified standards and "we are proud to be the first-ever factory to be following the WELL Certification that recognises sustainability and wellbeing best practices, making it a really good place for people to work," Davenport says.

"We want to share all the learnings we have with anyone interested, including our competitors," he adds.

"What we are doing is better for the environment, so we want to encourage more people to do the same."

BDO INSIGHT

ESG STRATEGY

We can see from the survey results businesses are still grappling with what ESG means for them. The importance of this agenda is continuing to grow, with consumers, governments and investors taking an ever-greater interest in business practices.

EVOLVING STAKEHOLDER DEMANDS

The pandemic has brought significant opportunity for many Food and Drink producers, but it has also sharpened the focus on the ESG agenda. While the top ESG themes—resource usage, supply chain, waste and health and safety—remain similar, stakeholder demand for increased, transparent and measurable reporting is growing.

Business leaders find themselves with consumers that don't just want goods in their hands but also want to know that the companies they support are spending, planning and producing with ESG top of mind. There is now greater scrutiny placed on reducing our environmental impact while focusing on the social agenda.

INCREASING REGULATORY DEMANDS

This has increased the speed at which regulation is being brought in, for example to assist organisations in reducing packaging or using sustainable producers and supply chains.

Businesses need to make sure they can meet these changes, which are becoming increasingly mandatory, with greater employee and financial resources. In addition, there is an increasing drive for organisations to set a net zero target that has been ratified by the Science Based Targets initiative (SBTi).

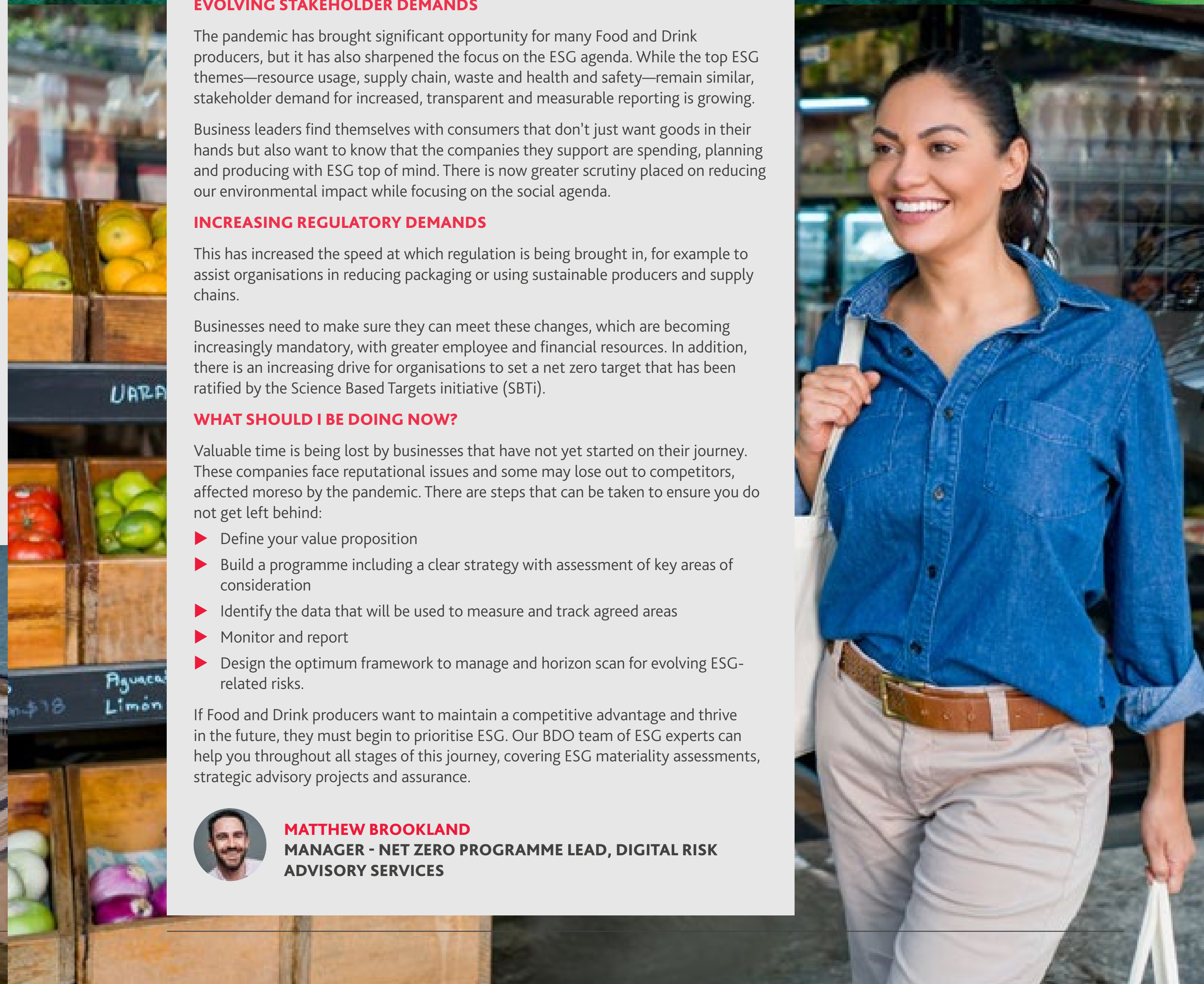
WHAT SHOULD I BE DOING NOW?

Valuable time is being lost by businesses that have not yet started on their journey. These companies face reputational issues and some may lose out to competitors, affected moreso by the pandemic. There are steps that can be taken to ensure you do not get left behind:

- Define your value proposition
- Build a programme including a clear strategy with assessment of key areas of consideration
- Identify the data that will be used to measure and track agreed areas
- Monitor and report
- Design the optimum framework to manage and horizon scan for evolving ESG-related risks.

If Food and Drink producers want to maintain a competitive advantage and thrive in the future, they must begin to prioritise ESG. Our BDO team of ESG experts can help you throughout all stages of this journey, covering ESG materiality assessments, strategic advisory projects and assurance.

MATTHEW BROOKLAND
MANAGER - NET ZERO PROGRAMME LEAD, DIGITAL RISK ADVISORY SERVICES



INNOVATION

SEARCHING FOR THE NEXT BIG THING

Research and development (R&D) have long been an important issue for UK Food and Drinks companies – and it is no less so in 2022.

As margins dwindle, competition toughens and new regulations bite, 79% of leaders surveyed said new product development, R&D and innovation were key focus areas. These efforts are spread evenly across a range of fields, however.

To begin with, there is traditional new product development, with 32% of companies looking to innovate in terms of convenience or grab-and-go offerings and 30% developing meat-free, vegan and plant-based products.

Then there is product development of the type that might not be immediately obvious to consumers, such as extending the shelf life of products (a goal for 29% of the sample) or reducing their sugar or fat content to comply with regulations (also being pursued by 29%).

Finally, there is innovation in terms of systems and processes. Three out of ten companies are investing R&D effort into manufacturing processes and the same proportion is looking to strengthen back-office systems.

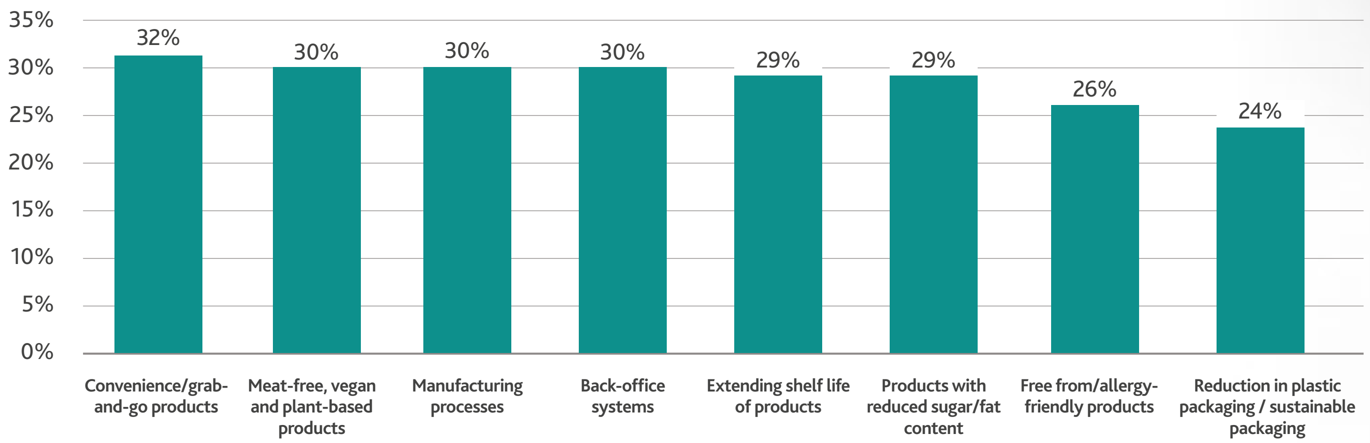
With innovation so high on the corporate agenda, it is important for Food and Drink companies to be aware of the changes to R&D tax allowances announced in the Chancellor's spring statement. Most businesses surveyed (88%) said they were aware of the reforms.

ARE NEW PRODUCT DEVELOPMENT, RESEARCH AND DEVELOPMENT AND INNOVATION A KEY FOCUS FOR YOUR BUSINESS?

88%

of business leaders are clear about the changes announced in the recent R&D Reforms and Spring Statement 2022

WHICH TRENDS/AREAS, IF ANY, ARE YOUR NEW PRODUCT DEVELOPMENT AND RESEARCH AND DEVELOPMENT TEAMS FOCUSED ON?



BDO INSIGHT

WHY INNOVATION IS A MUST FOR GROWTH

R&D in the Food and Drink industry most commonly relates to the development of new or improved products and manufacturing processes.

With an increasingly healthier customer, the industry is under pressure to continually innovate, looking to reduce sugar, salt or fat, adopt more natural, organic products or, in the drinks industry, develop low- and no-alcohol alternatives.

When asked about the top risks and challenges facing their business, Food and Drink manufacturers confirmed that new product development was listed as the second highest challenge, with the ongoing impact of COVID-19 being listed as number one.

With that in mind, it is a surprise that many Food and Drink businesses are still missing out or under-claiming R&D relief because the definition and the associated tax criteria seem difficult or because they do not appreciate the full breadth of activities and expenditure that can be included.

Moreover, they still believe R&D incentives are only available for new product development activities.

In fact, activities that meet the definition of R&D, for the purposes of incentives, can exist throughout the supply chain, from the moment an idea is generated to the point the product gets delivered to the customer. Additionally, the motivation for the change does not impact a company's ability to claim.

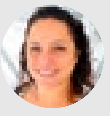
R&D activities can arise from:

- Appreciably enhancing existing manufacturing capability (which can subsequently lead to the product having to be reformulated)
- Reformulations of an existing product or packaging to use new materials
- Manufacturing processes to produce new or existing products
- New products or packaging to increase market share
- Purchasing identifying cheaper, alternative sources of materials
- Legislative-driven changes.

Where a company makes changes to its products, packaging, manufacturing process or transport packing, it should consider making an R&D claim.

Post COVID-19, cash flow continues to be important, and to grow companies must continually invest in innovation activities.

Food and Drink companies need to invest in product, packing and manufacturing development to grow and exploring R&D incentives—which can generate up to a 33% benefit—could generate the cash needed to drive this.



ECE AKSER
DIRECTOR, R&D INCENTIVES

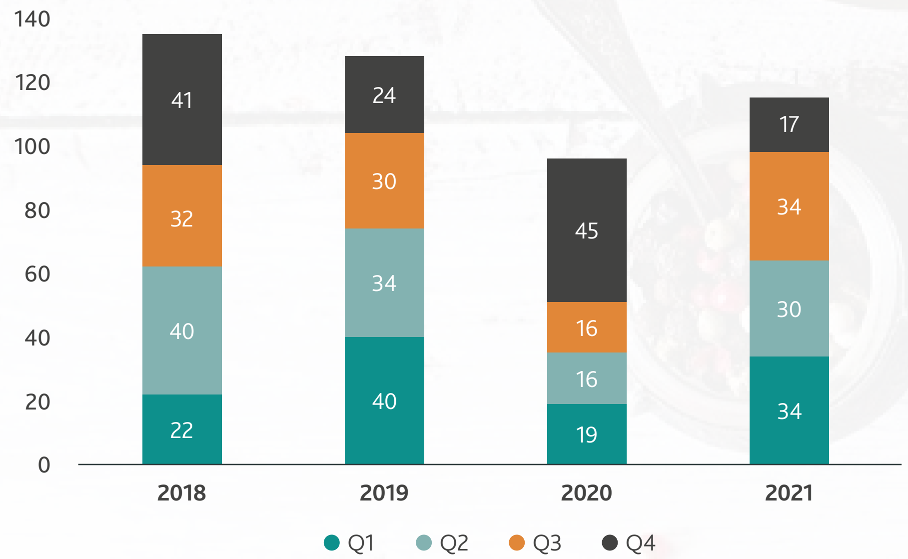
DEAL VOLUMES BOUNCING BACK

Mergers and acquisitions (M&A) are back on the agenda for operators in the Food and Drink industry following a brief pause for COVID-19. That is clear in the survey results, with over a quarter of businesses looking to acquisitions as a source of growth in the next 12 months.

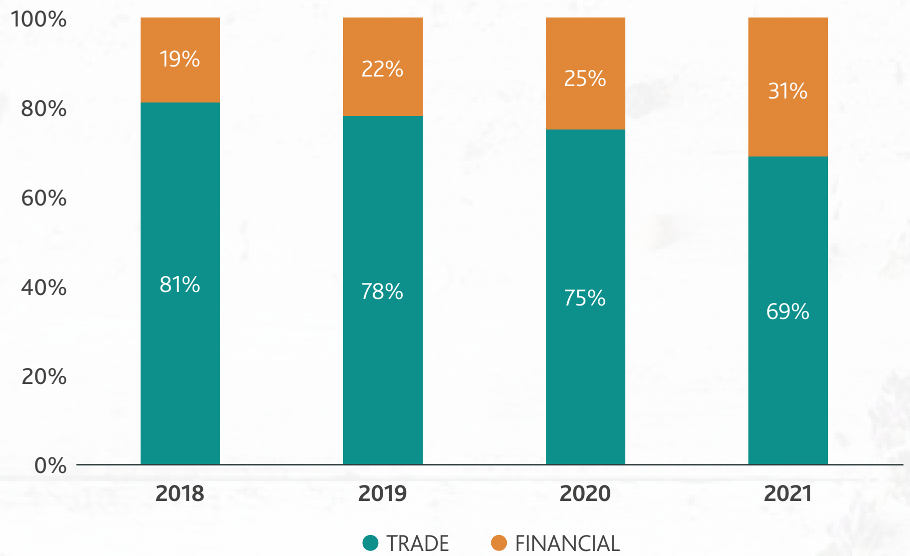
Despite the multitude of challenges faced by the industry, the industry has remained resilient, not least in the M&A market, where deal volumes increased by 20% over 2020, and now stand only 10% lower than pre-pandemic levels.

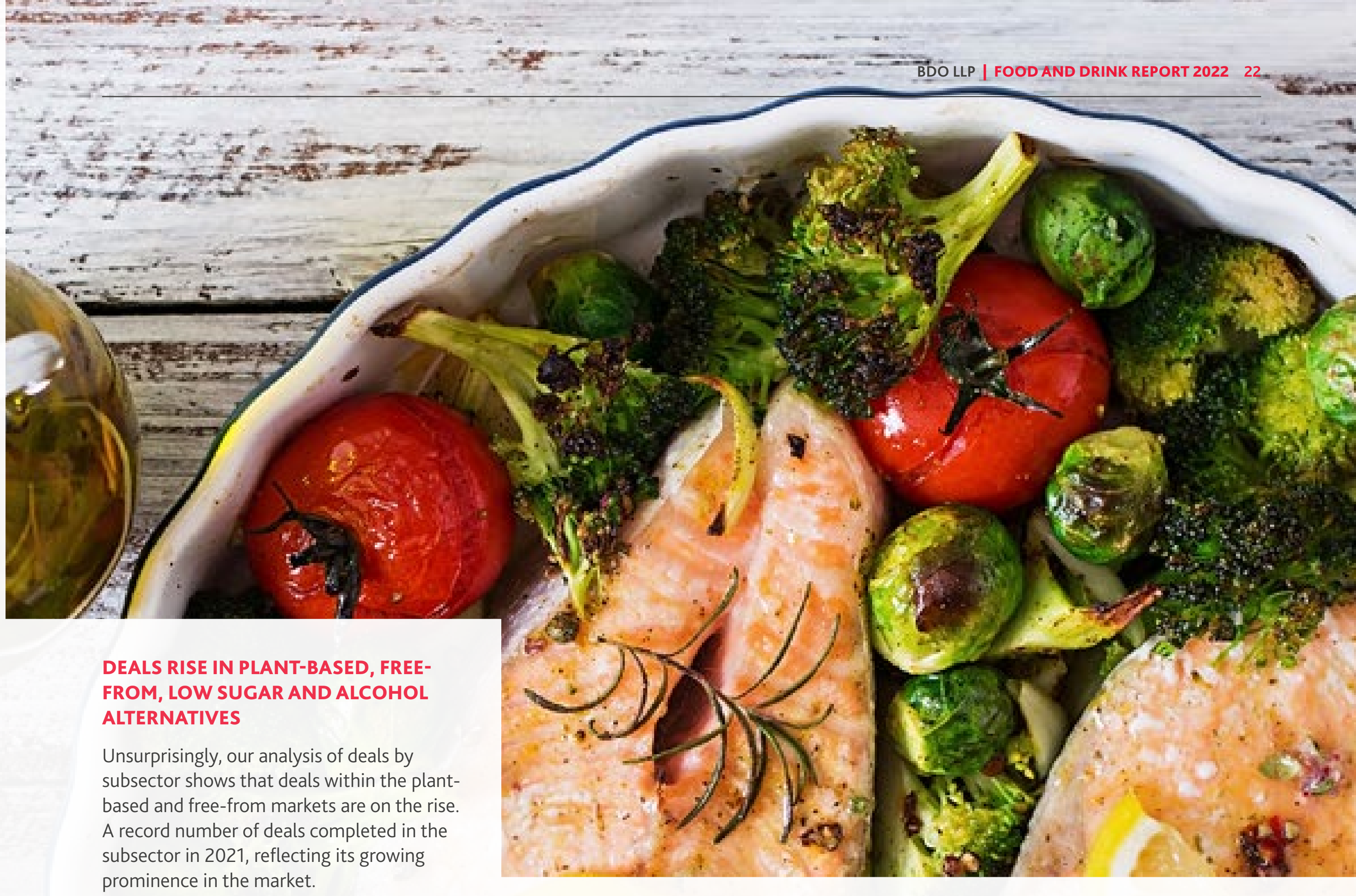
The rise in 2021 volumes can be attributed to improving market sentiment, strategic positioning, pent-up demand following an uncertain year and rumoured changes to capital gains tax.

FOOD AND DRINK MANUFACTURING TRANSACTIONS VOLUMES 2018 TO 2021



SPLIT OF TRANSACTIONS BETWEEN PRIVATE EQUITY AND TRADE





DEALS RISE IN PLANT-BASED, FREE-FROM, LOW SUGAR AND ALCOHOL ALTERNATIVES

Unsurprisingly, our analysis of deals by subsector shows that deals within the plant-based and free-from markets are on the rise. A record number of deals completed in the subsector in 2021, reflecting its growing prominence in the market.

Although the number of transactions remains high compared to other subsectors, activity within alcoholic beverages remains subdued, while 'low and no' and premium soft drink markets continue to grow.

Confectionery, frozen foods and 'food to go' saw a significant decline in activity through 2020 and 2021, perhaps reflecting the COVID-19 pandemic impacts and increasing numbers of people working from home.

PLANT-BASED AND FREE-FROM

While plant-based, free-from and sustainable Food and Drink have been upward trending for the past few years, it is clear this subsector is now entering a new stage of growth, with M&A transaction volumes rocketing in 2021.

One such high-profile deal was the acquisition of vegan and free-from brand Gosh! by Portugal-based Sonae for £64m.

More than nine in ten (91%) of deals that completed in this subsector in 2021 were acquisitions by corporates, showing the desire for existing operators to be active in the plant-based and free-from markets.

Start-ups and growing businesses in this subsector continue to attract significant investment, with private equity seeking to fund innovative businesses in this space both in the UK and overseas.

As an example, Plant Meat Limited (trading as THIS) secured £11m of Series A funding co-led by Business Growth Fund and Lever VC.[17]

LOW-SUGAR AND HEALTHY OPTIONS

Transactions in healthier and low-sugar options were also prevalent in 2021. Since the announcement of the Soft Drink Industry Levy, or more commonly 'sugar tax', 50% of manufacturers have reduced sugar content of drinks; the equivalent of 45 million kilos of sugar each year.

One recent deal of note is the acquisition of Sneak Energy, manufacturer of zero-sugar energy drinks, by private equity firm True Capital.

LOW AND NO

Investments in the 'low and no' alcohol space and premium drink market continue to thrive, in line with the International Wines and Spirits Record's prediction that consumption is expected to grow 31% by 2024.

Sample deals include Zero Proof UK Ltd (trading as Lyre's) closing a £20m equity financing led by D Squared Capital, and Clean Liquor Co Ltd, a producer of low- and no-alcohol drinks, receiving funding of £7m.

ON THE DECLINE

The food-to-go subsector has seen transaction volumes decline year on year, reflecting the impact of COVID-19 and increased working from home. Of the transactions that have completed, 80% are branded as healthier snack options.

Confectionery deals have also declined in 2020 and 2021 as trends continue to point towards healthier food and drink options being attractive to consumers.

The subsector will continue to innovate or diversify with the introduction of new regulations that restrict unhealthy food promotions in stores.

Transactions in frozen foods have also fallen. A notable deal recorded in the subsector this year was the carveout of Croatian Fortenova Group's frozen foods business, which it sold to Nomad Foods Limited for £525m.

For our full assessment of the M&A market in the industry, please refer to our **2022 Food and Drink Manufacturing Review** **on our website**.

ROGER BUCKLEY
CORPORATE FINANCE PARTNER

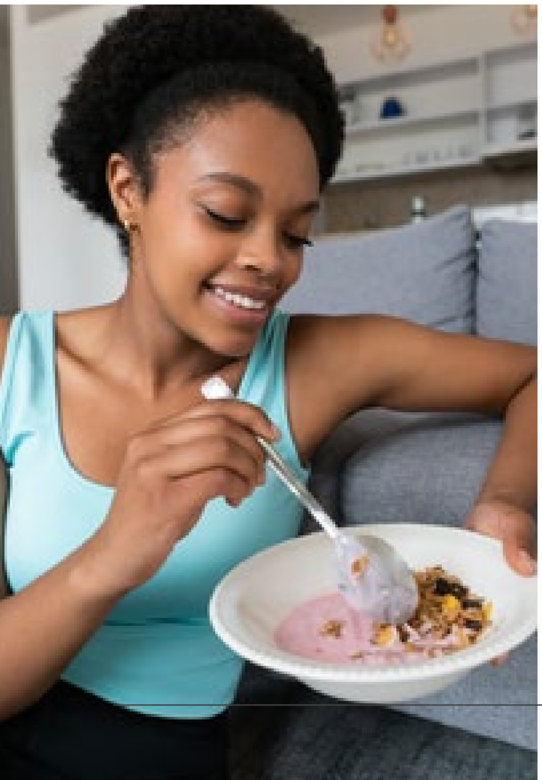
MARC HUTCHINSON
CORPORATE FINANCE DIRECTOR

THE SURVEY

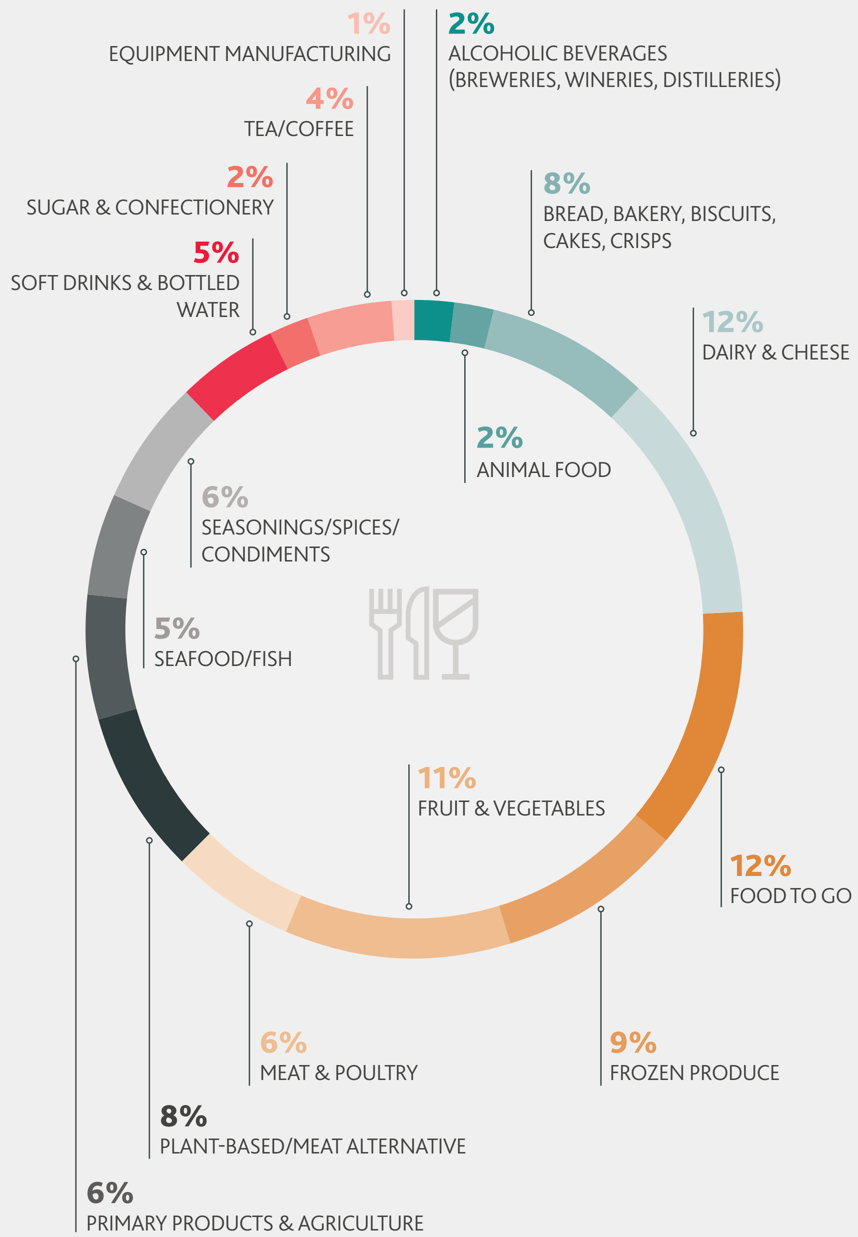
This report is based on a survey of 101 directors of Food and Drink manufacturing companies with a turnover of between £10m and £300m, carried out by market analysis company Censuswide on behalf of BDO in April 2022.

The sample was skewed towards larger businesses, with 61% having a turnover of £201m or more. Most (54%) hailed from the south of England, with 38% from the north, four each from the east and from Northern Ireland, and one from Scotland.

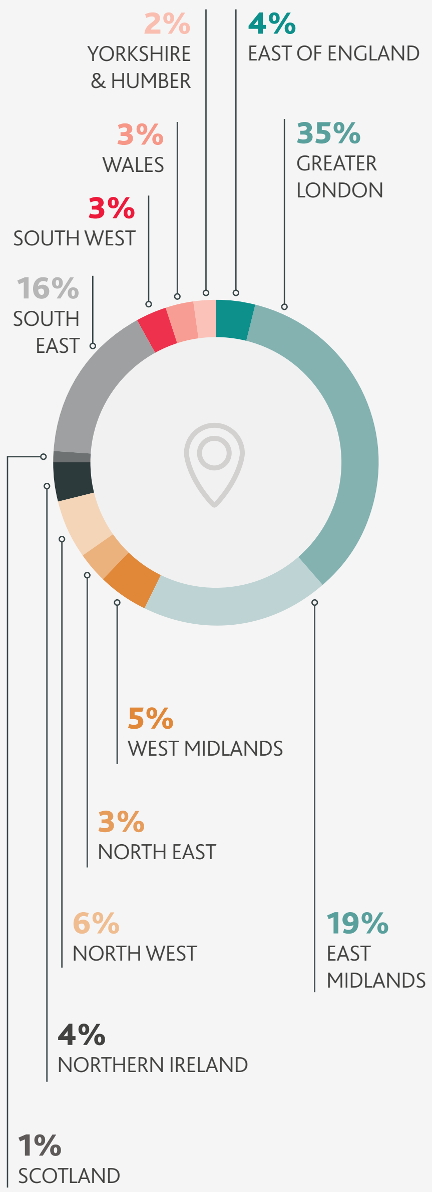
The most highly represented subsectors were dairy and cheese, which 30 companies were active in, food to go (29 companies), fruit and vegetables (27) and frozen produce (9). Some companies were active in more than one subsector.



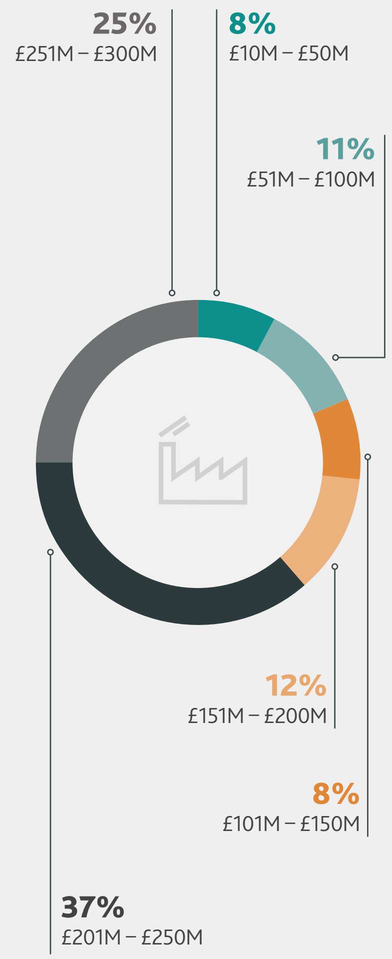
INDUSTRY SUBSECTOR



LOCATION



COMPANY SIZE



BDO WOULD LIKE TO THANK ALL THE DIRECTORS WHO TOOK PART IN THE SURVEY, ALONG WITH THE OTHER PROFESSIONALS WHO HAVE CONTRIBUTED TO THIS REPORT.

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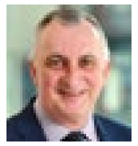

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SOURCES

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