Grant Thornton

Fast Facts on Food Processing

Grant Thornton Food & Beverage Practice Part 1 of 3 – February 2010

Faring better in 2010

The economic downturn has undoubtedly tested the mettle of the purported "recession-proof" food and beverage industry. Yet after two years of doom and gloom since the recession began in December 2007, the glass is returning to half full for many companies. For some manufacturers, the recession has exposed underlying operational weaknesses. For well-positioned companies, new opportunities have been born of the economic crisis. Although the recovery will not happen overnight, food and beverage manufacturers are positive about their performance in 2009 and optimistic about what 2010 holds.

Audit, tax and advisory firm Grant Thornton LLP is once again collaborating with *Food Processing* magazine on a series of three industry surveys — *Fast Facts on Food Processing* — to offer a perspective on performance trends, challenges and opportunities in the food industry. This first installment, *Faring better in 2010*, examines how food and beverage manufacturers performed in 2009, the factors affecting their performance, and their outlook for 2010. Responses were received from 176 companies (see participant profile at the end of this report) in late November and early December 2009.

FOOD PROCESSING

Revenues and profit growth

Despite the recession, there has been an increase in optimism for food and beverage manufacturers when it comes to revenue projections. In 2009, more than eight in 10 (83%) respondents expected revenues to increase in 2010, jumping from 61% who shared that expectation for 2009 vs. 2008.

Likewise, profit forecasts are positive for the coming year: 81% anticipate net income will increase in 2010 vs. 2009 a sizable jump from the 69% who expected net income growth in 2009 vs. 2008. More than one-quarter (27%) believe net income will increase by more than 10%, a small uptick from last year (22%).

Food and beverage manufacturers are positive about their performance in 2009 and optimistic about what 2010 holds.

Interestingly, a side effect of the recession — more consumers eating at home rather than going to restaurants — may have helped boost optimism and some bottom lines.

"This recession has brought unprecedented changes in the way consumers buy, making it increasingly difficult for food and beverage companies to react," says Dexter Manning, Grant Thornton partner and national Food and Beverage industry leader. "Although more people are eating at home versus dining out, the types of food consumers are purchasing at grocery stores is changing rapidly. Cash is king, and consumers are looking for bargains. The biggest winners have been store and private-label brands that are high-quality but low-cost compared with similar national brands. On the other hand, consumers are more concerned than ever about the origin, quality and caloric content of their food products. Therefore, there is still growth in the organic, healthy and vitamin-enhanced categories, their higher price tags notwithstanding. Value seems to be the rule for consumers these days. The successful food and beverage company must anticipate where consumer tastes will end up once the current economic turmoil ends."

How will your company's revenues change?*

	2010 vs. 2009 (% of respondents)	2009 vs. 2008 (% of respondents)
More than 20% increase	13%	13%
11–20% increase	16%	10%
6–10% increase	26%	20%
1–5% increase	28%	18%
0% change	8%	5%
1–5% decrease	6%	13%
6–10% decrease	0%	10%
11–20% decrease	2%	6%
More than 20% decrease	1%	6%

* May not total 100% due to rounding

How will your company's profits (net income) change*

	2010 vs. 2009 (% of respondents)	2009 vs. 2008 (% of respondents)
More than 20% increase	10%	11%
11–20% increase	17%	11%
6–10% increase	26%	20%
1–5% increase	28%	27%
0% change	11%	9%
1–5% decrease	4%	11%
6–10% decrease	0%	2%
11–20% decrease	1%	4%
More than 20% decrease	3%	6%

* May not total 100% due to rounding

One executive cited a positive impact from this consumer belt-tightening. Others did not find the same silver lining, with one respondent reporting, "[The number of] people going out to eat and ordering out was down, so that greatly affected our bottom line. Things are slowly picking up." In addition, lower commodity pricing (another result of the downturn) has boded well for some food and beverage manufacturers, whereas others report that commodity prices are on the rise.

"When the prices of commodities surged in 2008, food and beverage companies were forced to react in order to survive," adds Manning. "Unfortunately, the number of competitors in the market made raising prices a tricky and sometimes dangerous proposition. Those companies that were highly leveraged quickly found themselves unable to produce enough cash to satisfy the higher input prices and still meet their debt obligations. Many of those companies were forced to either merge or file for Chapter 11 reorganization, thus reducing the number of competitors in the market and opening up the possibility of price increases late in 2009 and early 2010."

Cash is king, and consumers are looking for bargains. The biggest winners have been store and private-label brands that are high-quality but low-cost compared with similar national brands.

Although the downturn has undoubtedly taken a toll on companies, it has not been the sole culprit of poor performance. Respondents have taken a hard look at their own operations, and executives have attributed diminished profits to "production mistakes" and "overproduction of perishable commodities [and the resulting] serious downward impact on prices."

Conversely, strong management has helped stem losses. One executive says, "We as a management team started to work the floor. We are the throughput specialists, so we can contribute incrementally to the operation."

"World-class food and beverage companies devoted substantial attention to the areas they could control, such as internal processes and the supply chain," says Manning. "The work done in 2008 and 2009 to streamline operations, reduce supply chain costs and upgrade operational efficiencies has produced very good results for these companies in 2009 and will continue to improve profitability in 2010."

Staffing and costs

The food and beverage industry has not been immune to staff cuts, but the employment outlook for 2010 is a bit rosier than in past years. More than half (52%) of respondents plan to increase staffing for full-time employees and equivalents, compared with just 34% who expected to increase hiring in 2009. Additionally, there was a significant drop in the number of executives who plan to decrease staffing: Only 10% expect to cut staff in 2010, versus 33% who anticipated doing so in 2009.

Staffing is not the only cost food and beverage manufacturers must shoulder. Most (70%) believed that ingredient pricing would increase in 2009, and 67% expect prices will jump again in 2010.

"Our clients have tweaked their formulas, their ingredients and their packaging to reduce costs," says Danny Goldberger, Grant Thornton Mid-Atlantic partner-in-charge of the Consumer and Industrial Products practice. "They have had some success with choosing less expensive ingredients that do not change the taste or quality of their products."

Cost pressure has also resulted from increased energy prices: 71% of food and beverage manufacturers reported that their total energy costs (across production, distribution, etc.) rose in 2009 vs. 2008. This year is unlikely to offer energy relief, with 76% of companies anticipating that energy costs will increase. Goldberger notes that fuel prices have begun to creep up again, and some food and beverage manufacturers are worried that they may need to once again consider pass-throughs or surcharges to offset the increase.

Many food and beverage manufacturers say the most effective means to control their costs are operations-oriented: using lean manufacturing practices, eliminating unprofitable product lines, implementing long-term waste reduction projects, and reducing the waste of product and process resources (raw materials, labor, energy, etc.).

How will ingredient pricing change?*

	2010 vs. 2009 (% of respondents)	2009 vs. 2008 (% of respondents)
More than 20% increase	3%	4%
11–20% increase	9%	10%
6–10% increase	18%	23%
1–5% increase	37%	33%
0% change	19%	13%
1–5% decrease	10%	10%
6–10% decrease	2%	3%
11–20% decrease	0%	2%
More than 20% decrease	1%	2%

* May not total 100% due to rounding

"Efforts to become more efficient will continue into 2010," says Manning. "Companies will increase capital spending on new technologies, more efficient plants and better sourcing, resulting in a more efficient cost structure. One of my clients has implemented zero-based budgeting internally and for its suppliers, forcing each party to justify any and all spending that affects the company. During this turbulent time, it is also important that food and beverage companies pay attention to the financial health of their suppliers. A successful company should have a backup plan in case its primary suppliers are no longer around."

Although fuel and commodity costs have been the primary cost pressures for food and beverage companies, there are new concerns brewing among executives about the impact of new government legislation. Respondents commented specifically on how health care reform in the United States might affect their company's cost structures. The responses were varied, but several respondents expect higher costs as a result of a new health care bill. In the coming months, the food and beverage industry also faces the potential for unprecedented regulation. Currently, there are a number of bills in Congress that aim to address safety and quality issues, and compliance will come at a higher operating cost for companies.

Outsourcing

Outsourcing continues to be a way for food and beverage manufacturers to manage costs and boost efficiency. Three in five (60%) food and beverage manufacturers report outsourcing some portion of production (based on total dollar sales), while 40% do not outsource any production. Among companies that do outsource, 72% outsource up to 25% of production. Sixty percent of food and beverage manufacturers don't foresee any change in their use of outsourcing in 2010, while 30% expect outsourcing to increase and 10% expect it to decrease.

The major reasons reported for outsourcing are diverse: access to technology/equipment (43%), increased production capacity (33%), lower costs (32%) and distribution advantages (23%).*

"One result of the recession is that many food and beverage companies are revisiting the possibilities offered by outsourcing," says Manning. "As in the past, one motivation of outsourcing is to improve on the core competencies of the business and outsource those activities that are deemed to be outside those core competencies. However, another motivation brought about by this downturn is cost. Is outsourcing more cost-effective or not? Many food and beverage companies believe that it is more economical to outsource activities, including research and development, certain manufacturing functions and logistics. Clients have also experimented with outsourcing IT, internal audit, purchasing and other back-office activities."

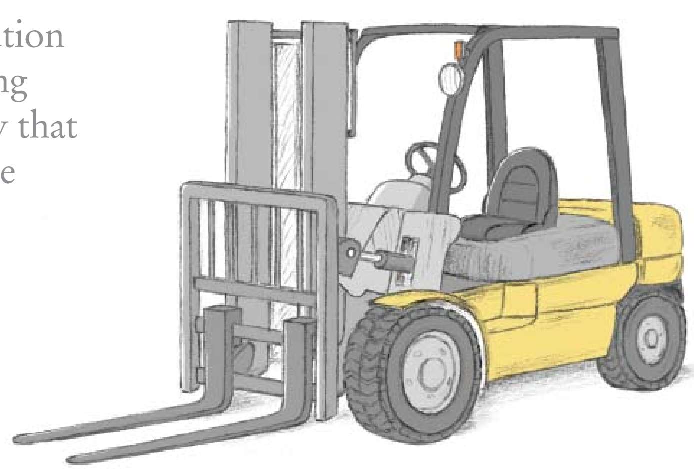
Back to business as usual

Nearly one-third (32%) of food and beverage manufacturers report that their operations and financial performance are already back at pre-recession levels or better. The overwhelming majority (96%) believe those performance levels will return by the end of 2010 or later.

Return to pre-recession performance

	(% of respondents)
They already are	32%
By January 2010	6%
By end of March 2010	9%
By end of June 2010	14%
By end of December 2010 or later	35%
Never	4%

"We became more efficient in distribution and comparison-shopped for packaging materials and supplies. Overall, I'd say that the recession prompted us to pay more attention to details."



* Participants were able to select more than one answer.

“Always be close to your customers and have a true understanding of their needs. Think and act like a service company, regardless of what you manufacture.”

Many food and beverage manufacturers saw the recession as a wake-up call to evaluate what's happening in their companies. “[We] must remain lean and pay attention to the pennies, even during the most prosperous of times,” said one executive. Another noted, “We became more efficient in distribution and comparison-shopped for packaging materials and supplies. Overall, I'd say that the recession prompted us to pay more attention to details.”

Others have seized the opportunity to further differentiate themselves in the marketplace. One executive offers this best practice: “Always be close to your customers and have a true understanding of their needs. Think and act like a service company, regardless of what you manufacture.”

The resurgence of optimism for food and beverage manufacturers may be tempered by ongoing cost pressures. However, companies will benefit from a reduction in commodity prices and an increase in efficiencies gained during the downturn. Those who continue to improve operations and maximize lean manufacturing practices stand to reap significant savings. What's more, companies can take concrete steps to create a more profitable supply chain. Food and beverage manufacturers that are prepared for these challenges and take advantage of emerging opportunities will be ready to take a bite out of the action in the year ahead. •

Profile of participants

A diverse group of food and beverage manufacturers are represented in the results of the *Fast Facts on Food Processing: Faring better in 2010* survey. Approximately three-quarters (72%) of survey participants report annual revenues of less than $100 million, 14% report revenues of $100 million to $500 million, and 14% report revenues of more than $500 million. Approximately 44% of companies produce processed foods, the largest food group represented, followed by beverages (30%); miscellaneous/other (29%); meat, poultry and seafood (27%); and fruits and vegetables (27%).*

* Participants were able to select more than one answer.

For more information

In the coming months, Grant Thornton and *Fast Facts on Food Processing* will continue to offer perspectives on emerging industry events and issues, exploring trends and how they may be affecting your business. For more information about how Grant Thornton can help your organization or to offer comments about this survey, please contact:

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