



Grant Thornton

An instinct for growth™

GLOBAL FOOD AND BEVERAGE STUDY | NOVEMBER 2013

Hunger for growth

Food and Beverage looks to the future

Australian insights



Food and beverage executives in Australia are optimistic. With economies improving around the globe, these leaders expect exports and revenues to rise – along with profits. They're planning aggressive investment programmes to extend the reach of their organisations by category and country.

Yet renewed growth prospects also raise concerns, because rapid expansion can lead to rapid mistakes, as well. Savvy food and beverage executives should carefully weigh their opportunities and implement systems, processes and controls to minimise risk along the way.

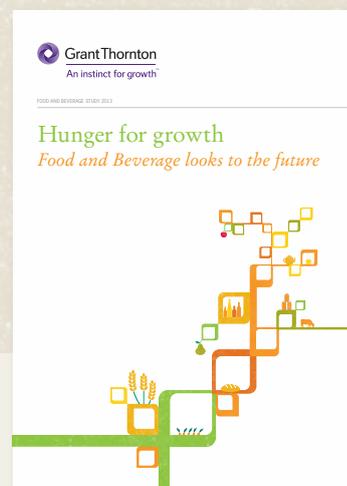
Our global survey *Hunger for growth* examines these trends and more. More importantly, it offers perspectives on how executives can manage change and sustain profitable growth by understanding the new industry landscape, developing strategies that leverage new trends and efficiently executing on their plans.

Australian insights examines these trends from a uniquely Australian perspective.

Tony Pititto
National Head of Food and Beverage

About the study

- Who** 248 food and beverage senior executives
- When** May to July 2013
- Where** Australia, Canada, France, Ireland, New Zealand, UK and US



Australian Economic Outlook

The Food and Beverage Industry



Steven Shepherd | Senior Economic Advisor | Grant Thornton Australia

An examination of the Australian food and beverage industry needs to be treated more than a just a microcosm of the global industry. This is because Australia's position in the global economy is relatively unique from a number of different angles.

This includes Australia's close proximity to the Asia-pacific region, as the population within the region represents some 60 per cent of the world's population, while experiencing a quadrupling in its population during the 20th century. Such a massive population base on Australia's door and with higher than average expenditures on the basic necessities of life, provides a huge opportunity for the Australian food and beverage industry.

Also, the fact that the price of Australia's tradable goods sector with the rest of the world fell by -0.1 per cent over the past year, created a platform of improved international price competitiveness (notwithstanding changes in exchange rates) for the Australian food and beverage industry, within the region.

Moreover, the particular economic configuration facing the Australian economy creates additional opportunities and implications for the Australian food and beverage industry. In terms of cyclical impacts which have impacted on the Australian economy in the post-GFC global economy; Australia has been extremely fortunate to be one of only four O.E.C.D. economies, which has not gone into a GFC induced economic recession. While global factors such as weak world trade and a comparatively

strong Australian dollar in recent times, have not had a particularly disruptive impact on the food and beverage industry from playing its traditional economic stabilising role on the economy. Bearing in mind that it traditionally represents such an important component of consumer expenditure on *necessities*. This structural feature of the industry has also been impacted by the continuation of Australia's population growth which serves as a floor in underpinning growth within this sector.

Sub sector impacts

In terms of the value of manufactured goods from the food, beverages and tobacco sector, it is worth noting that growth in real production rose by a relatively healthy 2.4 per cent over the year to June 2013. This is similar to trends across the entire economy, but significantly higher than the outcome for the rest of the Australian manufacturing sector, which declined by some -0.7 of one per cent.

While in terms of the performance of the food group, in relation to expenditure undertaken by the Australian household consumer, very positive growth of some 3.9 per cent was recorded in the year to June 2013. However, this was offset by the significantly smaller alcoholic beverages sector, whereby consumer expenditure actually fell by -3.4 per cent over the course of the year. As a combined group, food and beverages consumption rose by a still healthy 2.8 per cent over the year and compares favourably with overall consumer expenditure trends across the economy.

Price rises within the food and non-alcoholic sector have also contributed to the sector's relatively favourable performance in recent times. Data released from the September quarter 2013 Consumer Price Index, shows that this sector recorded not only noticeably lower price rises than the rest of the economy, but over the past twelve months, experienced an actual fall in prices of some -0.6 per cent during the period. Discretionary-related goods have recorded relatively higher price rises, thereby providing the opportunity for greater substitution to occur within traditional household expenditure patterns (i.e. in favour of the food and beverage industry, as evidenced by the trends identified above).

Within the food and non-alcoholic beverages sector the most significant price falls in the past year have been recorded in vegetables and meat and seafoods. This arose due to such factors as seasonal conditions (particularly vegetables) and lamb-related prices falling by more than 10 per cent. While at the other end of the spectrum was poultry products which experienced a significant rise of some 4.5 per cent over the past year.

Future outlook

In terms of future expectations for the food and beverage industry, related sectors such as accommodation, cafes and restaurants currently have higher than industry-wide confidence levels involving their business prospects for the year ahead. However, that needs to be tempered somewhat by confidence levels in the more traditional industry sectors of relevance to the food and beverage industry, such as the retail sector.

Capitalise on global market opportunities

Australia's food and beverage industry anticipates significant growth, with a majority of food and beverage executives expecting increases in revenues (84% of executives), profitability before interest and taxes (71%) and employment (61%) in the next 12 months, according to the Grant Thornton Global Food and Beverage Study.





Export driven growth

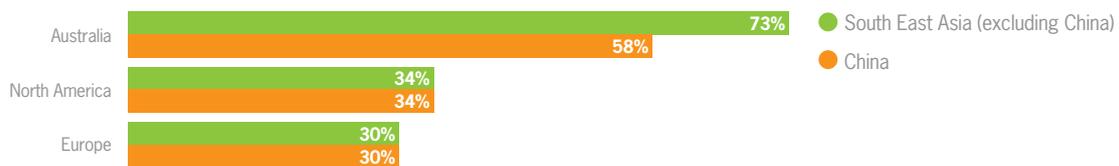
A key driver of growth will be exports for Australian companies, and many plan to pursue that path in coming years. Exports currently account for a median 5.7% of Australia food and beverage sales, expected to rise to 10% within two years. Only 16% of Australian food and beverage study respondents report that exports are not part of their corporate strategy. Food exports from Australia were \$2.03 billion in August 2013, up from \$1.85 billion in August 2012, and \$1.7 billion in August 2011. Beverage exports declined modestly over the same period: \$178 million, \$186 million, and \$195 million, respectively.

Opportunities in Southeast Asia

The top new export markets for Australian companies in the next one to two years are Southeast Asia excluding China (73% of executives) and China (58%). Location offers a huge logistics advantage to Australian firms, as just 34% of North American executives and 30% of European executives indicate that their firms plan near-term movement toward those markets. Advances in management, logistics, and information technology can help Australia food and beverage companies to more efficiently sell into these locations and elsewhere. Yet exports present challenges as well: complex regulations, established competitors, and opaque customs processes.

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Executives near-term movement towards markets



Safeguarding a growth agenda

To manage export risks, executives should conduct rigorous due diligence regarding new trading partners, customers and distribution channels – and in-country expertise in targeted countries can be highly beneficial in getting a firmer grasp on all these factors. When asked what can most help Australian organisations capitalise on Asia export opportunities, specifically, 39% say devaluing the Australia dollar by at least 20%; others cite government support with logistics/distribution costs (16%) and reduced labour costs (16%). However companies with turnover less than \$50 million rate the latter as more important than the high value of the Australian dollar.

Managing costs effectively

A key factor for export success is having quality products correctly priced for overseas markets. Yet Australian Food and beverage companies – like their competitors around the globe – are challenged to keep costs (and prices of their own goods) in check (*Figure 1*). Operations improvements are critical to maintaining competitiveness, and in keeping export-related expenses – logistics, transportation, containers – under control.

Four out of five Australian food and beverage executives (84%) say that controlling costs is a moderate or significant challenge, and one-quarter cite operations capabilities as a constraint on business growth (compared to 18% of all global respondents). “The emphasis remains on efficiency gains and, sometimes, on increasing prices in order to ensure that profitability also increases,” said Tony Pititto, National Head of Food and Beverage, Grant Thornton Australia.

Maintaining robust supply chains

As Australian food and beverage companies expand around the globe, challenges also emerge in monitoring supply chains for quality and safety. Half of Australian food and beverage study respondents (53%) trace goods back through at least the first tier of their supply chains vs. 61% of all global respondents. Three out of five Australian executives believe that their company’s ability to trace goods and ensure product integrity provides a market advantage; 55% said the integrity of the supply chain in Australia differentiates the country’s food and beverage products overseas.

Food and beverage organisations can lose control of their ability to trace goods when products move downstream and into export markets.

Depending on how the supply chain is structured, and when ownership transfers, they can lose the ability to rigorously monitor product. The best traceability programmes will rely upon collaboration among all parties in synchronising compliance practices, risk management, and process-improvement solutions across the entire supply chain.

Tony Pititto
National Head of Food and Beverage
Grant Thornton Australia

Figure 1 – % of respondents anticipating increases in next 12 months

	Global	North America	Europe	Australia
Raw material costs	85%	84%	81%	92%
Utility/energy costs	91%	92%	94%	89%
Transportation/fuel costs	90%	89%	88%	89%
Labour costs	88%	87%	85%	89%
Government regulatory costs	79%	85%	70%	84%
Packaging/container costs	82%	88%	75%	81%
Environmental costs	80%	77%	80%	76%
IT service-provider costs	70%	71%	58%	73%
Service provider costs (not IT)	68%	66%	63%	72%
Sales and marketing costs	84%	88%	83%	70%
Ingredient/flavouring costs	75%	75%	78%	68%
R&D costs	72%	80%	64%	57%

The recent Grant Thornton International Global Food and Beverages Survey provides some very interesting light on the perceptions of businesses within the food and beverage industry.

In particular, the different views of different industries within the Australian food and beverage industry, highlights the different perspectives and touch points with different components of the Australian economy. Some of the most interesting differences in perceptions in terms of their impact on future business performance, by different industries are contained in the following table.

The perceptions of the Australian food and beverages industries on key issues of future business performance

Impact of issue on business performance	Grains/flour Products	Sugar & confectionery Products	Fruit & vegetable Products	Dairy products	Meat & meat products	Seafood products
Devaluation of a\$ would be beneficial	High	High	Medium	High	High	Medium
Reduced labour costs	Low	Low	Low	Medium	Medium	High
Gov't support on logistics & distribution	Medium	High	High	Low	Low	Low
Restructure to produce value-added products	Medium	High	Low	Low	Low	Low

● High
● Medium
● Low



Realise strategic ambitions via innovation

As Australian food and beverage companies assume larger roles on the world stage, they must focus on innovation in both products and processes. Food and beverage trends emerge quickly, requiring companies to rapidly develop new products or risk missing a hot new market – and profits. But innovation requires investment, and Australian companies could be doing more.



Savvy Australian food and beverage executives will align their investments with trends projected to grow in the next 12 months and beyond

Business investment initiatives

Australian food and beverage companies currently spend a median 1.1% of sales on R&D (for comparison, North American food and beverage companies spend 2%). What’s more, just 57% of Australian executives expect to increase R&D investments in the next 12 months (vs. 80% of North American executives). Similarly, 68% of Australian food and beverage executives expect to increase spending on new product development in the next 12 months (vs. 84% of North American executives).

Smarter financing decisions

Savvy Australian food and beverage executives will align their investments with trends projected to grow in the next 12 months and beyond, including healthy/nutritious, premium/luxury and locally sourced food and beverages (Figure 2). It’s important to note that capturing consumer attention with these trends won’t necessarily require new products; some companies may be able to repackage existing products or deliver line extensions. Australian food and beverage companies are most likely to innovate and address trends via new products in the same line/sector (82%), new channels (55%) and new packaging formats (50%).

Many food and beverage companies are also innovating by streamlining operations and updating equipment and information technology applications and systems, in part to minimise the need for new labour hires. Perhaps even more important will be the implementation of new digital and social media marketing tools to inform consumers about new products, offer recipes and suggestions, and establish affinity via unique brand characteristics (e.g., style, corporate citizenship, social responsibility). In today’s food and beverage industry undergoing sales growth, a focus on the “demand chain” is every bit as important as cost-management of the supply chain.

Spend on R&D as a % of sales



Figure 2 – % of respondents expecting positive effect from trend in next 12 months

	Global	North America	Europe	Australia
Healthy/nutritious food and beverages	59%	66%	51%	58%
Premium/luxury food and beverages	60%	63%	59%	53%
Locally sourced food and beverages	49%	46%	49%	50%
Sustainably produced food and beverages	46%	42%	47%	45%
Gluten-free/allergy-free foods	34%	38%	28%	37%
Convenience food and beverages	43%	42%	44%	35%
Organic food and beverages	36%	46%	26%	34%
Ethnic food and beverages	35%	45%	27%	34%
Private-label brands	36%	40%	31%	32%
Whole foods (fruits and vegetables)	22%	27%	15%	24%
Sustainable packaging alternatives	25%	27%	25%	18%
Functional food and beverages	29%	32%	30%	16%
Non-GMO food and beverages	19%	23%	14%	16%
Retailers reducing product range/varieties on shelf	15%	15%	17%	13%

Achieve and sustain growth

Many of the strategies that will help Australian food and beverage companies prosper – from developing overseas distribution channels to expanding product portfolios – can be achieved either via internal growth or through mergers and acquisitions (M&A). Particularly for midsize and large companies, M&A offers opportunities to swiftly broaden product portfolios or to gain foreign-market access.



Avenues for growth

Forty percent of Australian food and beverage executives consider acquisitions a viable strategy: 5% indicate it is likely that their organisation will acquire a company in the next 12 months (vs. 21% of European respondents and 10% of North American respondents), and 11% are likely to acquire a unit or division (vs. 12% of European respondents and 8% of North American respondents).

Other Australian food and beverage organisations will grow and improve capacity by building or expanding a plant, or by investing in new equipment or information technology. (Figure 3).

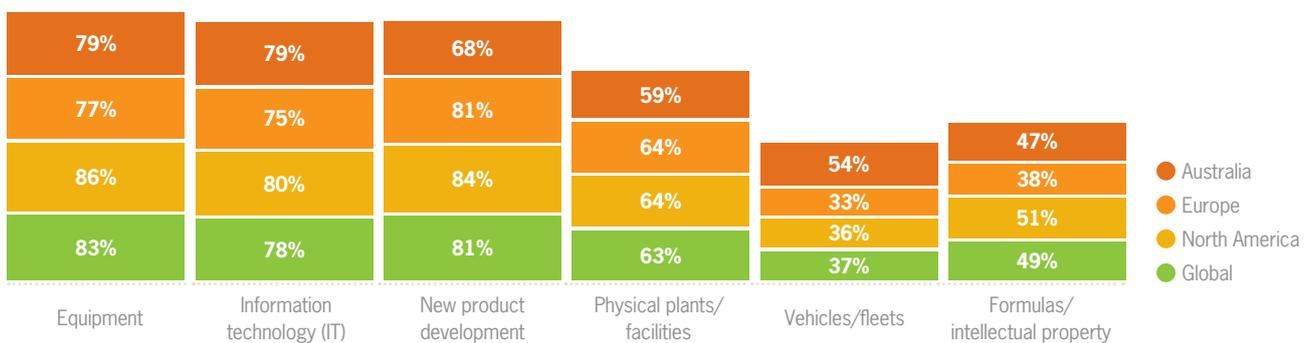
Funding the future

Internal or external growth strategies are likely to require an infusion of capital. Half of Australian food and beverage executives (53%) indicate that their organisations are likely to need additional funding in the next 12 months. Of the one-third of Australian food and beverage organisations likely to acquire a company or unit or to build or expand a plant, 69% are likely to need additional funding in the next 12 months.

Finding capital will be difficult for some. Approximately 16% of the Australian executives indicate that sourcing capital is a constraint on business growth.

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Figure 3 – % of respondents expecting to increase investments



Private label challenge

As Australia food and beverage companies grow, they are likely to keep one eye on the top line and one eye on the bottom line. Australia food and beverage profit percentages before interest and tax are higher than those of global and European competitors (Figure 4).



Profit threat from private labels

This difference likely reflects fewer private-label products (which frequently are less profitable) in Australia than in other regions: Average 17% private-label branded by retailers in Australia vs. 28% in Europe. If private-label increases in Australia, the country’s food and beverage profitability advantage could erode.

Not surprisingly, nearly half of Australian food and beverage executives (46%) indicate that private-label products will have a negative effect on their organisations in the next 12 months vs. 26% in Europe and 16% in North America. Almost two-thirds of Australian executives (63%) also believe that retailers reducing product range/varieties on their shelves will negatively affect their businesses (vs. 45% in North America and 46% in Europe), actions that may reflect a growing private-label trend.

Profit impact of private-label



Figure 4 – Profit before interest and taxes and key costs (median) as a % of sales

	Global	North America	Europe	Australia
Profit before interest and taxes	6.5%	8.0%	5.0%	8.0%
R&D expenses	2.0%	2.0%	1.0%	1.1%
Direct labour costs	11.0%	11.3%	12.0%	10.0%
Raw material costs	45.0%	45.0%	50.0%	42.6%
Marketing expenses	4.0%	5.0%	4.0%	3.0%
Utility costs	3.0%	2.1%	2.5%	3.0%
Transportation costs	5.0%	4.1%	5.0%	5.0%

Almost two-thirds of Australian executives (63%) also believe that retailers reducing product range/varieties on their shelves will negatively affect their businesses.

Australian food and beverage companies compete in a highly competitive global marketplace, one that requires expertise in new strategies and new regions. An outside perspective can help to identify profitable growth opportunities while minimising risks involved as executives:

- 1** expand capacity, acquire competencies, and invest in infrastructure that will deliver the optimal returns
- 2** innovate products that attract new customers and adopt new production, supply-chain and demand-chain processes to meet customer demand more efficiently
- 3** monitor, measure and document compliance at home and abroad to stay ahead of government regulations
- 4** regularly evaluate processes for efficiency improvements and cost control

Key contacts

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If you want to know more, please contact us...

Adelaide

Adam Fisher

T 08 8372 6578

F 08 8372 6677

E adam.fisher@au.gt.com

Melbourne

Tony Pititto

National Head of Food and Beverage

T 03 8663 6204

F 03 8663 6333

E tony.pititto@au.gt.com

Sydney

Peter Woodley

T 02 8297 2659

F 02 9299 4533

E peter.woodley@au.gt.com

Brisbane

Shaun McKinnon

T 07 3222 0336

F 07 3222 0444

E shaun.mckinnon@au.gt.com

Perth

Matthew Donnelly

T 08 9480 2120

F 08 9322 7787

E matthew.donnelly@au.gt.com





Adelaide

Level 1
67 Greenhill Road
Wayville SA 5034
T +61 8 8372 6666
F +61 8 8372 6677
E info.sa@au.gt.com

Brisbane

King George Central
Level 18, 145 Ann Street
Brisbane QLD 4000
T +61 7 3222 0200
F +61 7 3222 0444
E info.qld@au.gt.com

Melbourne

The Rialto, Level 30
525 Collins Street
Melbourne VIC 3000
T +61 3 8320 2222
F +61 3 8320 2200
E info.vic@au.gt.com

Perth

Level 1
10 Kings Park Road
West Perth WA 6005
T +61 8 9480 2000
F +61 8 9322 7787
E info.wa@au.gt.com

Sydney

Level 19
2 Market Street
Sydney NSW 2000
T +61 2 8297 2400
F +61 2 9299 4445
E info.nsw@au.gt.com



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