IDEAS | PEOPLE | TRUST

Food and Drink Report 2023

The ingredients for business success in the new normal?

Flexibility and a dash of experimentation

Food and Drink Report 2023

Contents

The industry at a glance

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

THE INDUSTRY HAD A TURNOVER OF **£128 BILLION** IN 2022 (UP 14% ON 2021)

THE INDUSTRY EMPLOYS **456,000** PEOPLE ACROSS EVERY REGION AND NATION OF THE UK

THE FOOD SUPPLY CHAIN EMPLOYS **4.3M PEOPLE**

IN 2022, UK FOOD & DRINK EXPORTS TOPPED **£25BN** (UP 23% ON 2021)

Source: Food and Drink Federation[1]

Introduction

The industry at a glance

There is a sense of optimism in Food and Drink despite the clear headwinds facing the industry. All the metrics in this year's annual BDO Food and Drink survey, which aims to understand current market dynamics and the industry's response to them, are stable or improving.

In the last year there has also been a big jump in optimism across the industry, with 81% of those queried feeling positive about the prospects for the sector, up from 69% in our 2022 survey. This finding likely reflects growing awareness of the sector's resilience.

After enduring Brexit, COVID-19, supply chain challenges and a cost-of-living crisis brought on by a war in Ukraine, Food and Drink leaders could be forgiven for thinking the industry can take pretty much anything the world can throw at it. But this does not mean companies are immune to the challenges.

This year, 70% of respondents said they were positive about the future of their own businesses. That's not a bad figure, but it is down on last year's level of 78% and indicates leaders are now more worried about their own businesses than the sector as a whole. There are certainly some reasons for concern.

While government actions will hopefully bring cost-of-living rises to manageable levels, maintaining margins is hard for Food and Drink companies facing the twin threats of higher costs and constraints on consumer spending.

Meanwhile, the war in Ukraine – with its impacts not only on energy prices but also grain and other markets – does not look set for resolution anytime soon. While energy prices have dipped compared to last year, they still remain above pre-war levels.

These pressures are piling onto UK companies that are already struggling to recruit staff, implement digital technologies, defend against growing cyber threats and adjust to changing consumer preferences while focusing on sustainability.

The long-term nature of many of the threats facing UK Food and Drink companies suggests that leaders will need to stay flexible and think strategically about the future of their businesses. Sticking-plaster measures will not do in an environment where a return to normality – whatever that is – remains elusive.

The good news is that the industry has proved adaptable to the many challenges it has faced since the turn of the decade. Food and Drink companies are used to seeking new formulas and evolving alongside fickle consumer tastes.

If the industry can keep up that spirit of careful experimentation, then the optimism expressed in our survey this year seems justified.

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

Cindy Hrkalovic
Head of Food and Drink
BDO

The state of the industry

The time between this year's industry survey and the one we carried out in 2022 has seen the introduction of a major disruptor to UK Food and Drink supply chains. The war in Ukraine, which broke out after our fieldwork in 2022, has piled pressure onto UK consumers and businesses.

Yet the cost-of-living increases sparked by soaring fuel and grain costs have done little to dampen enthusiasm in a sector that has come out fighting from its encounters with Brexit, COVID-19 and a global supply chain crisis.

Four fifths (81%) of this year's sample were upbeat about the prospects for UK Food and Drink, a 12-point increase on 2022 levels. The percentage feeling positive about their own businesses has dropped, from 78% to 70%, but so has the proportion feeling negative, from 11% to 6%.

Rising performance

Our survey showed net increases over the last 12 months in all of nine key performance indicators (KPIs): operating profit, gross margins, revenue, new orders, headcount, capital expenditure, new product launches, levels of digital automation and focus on sustainability and ESG.

All these indicators are set to remain on a net positive path over the coming year, respondents said. A remarkable 40% of respondents expect gross profit margins to rise and 38% foresee an increase in operating profit. Less than a fifth of the sample expected to see a decrease in any given indicator.

The buoyant mood is encouraging acquisitions, with 24% of companies looking to make a purchase in the next year.

Opportunities and risks

Almost a third (30%) of UK Food and Drink leaders are looking for new products to drive growth in the coming year, while expanding into new, non-European Union (EU) markets is a focus for 29%. The same percentage aims to refresh existing product lines and services.

Attracting and retaining the workforce needed for these goals remains a challenge, although the number one issue mentioned by our sample was changes to VAT, highlighting the scope for government action in supporting the sector. Foreign exchange and competition were also cited as worries.

The big concerns

The Ukraine conflict is still affecting 65% of businesses in the survey, and 28% are taking on higher levels of debt to counteract inflation. Beyond these macro concerns, companies are pushing ahead with digital transformation, with a special focus on the supply chain.

Sustainability is another ongoing focus, with 38% of companies directing research and development (R&D) at the development of more sustainable or plastic-free packaging.



Key findings

From the BDO Food and Drink Survey

70% of respondents are **positive** about the prospects for their business

19% have experienced a **decrease in gross profit margins in the last 12 months**

38% of respondents are expecting profitability to **increase** over the next 12 months

30% say **new product development** will offer sales growth opportunities for their business



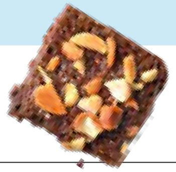

65% say **the Ukraine conflict** is still having an impact on their business

24% are **seeking additional finance** to counter inflation

47% say they are early adopters of **digital technologies**

14% say **VAT changes** are a major challenge



30% are challenged with **protecting increasingly digital systems** from cyber attack

50% are experiencing **difficulties in recruiting** the people they need

39% believe **skills shortages are worse now** than before Brexit and COVID-19

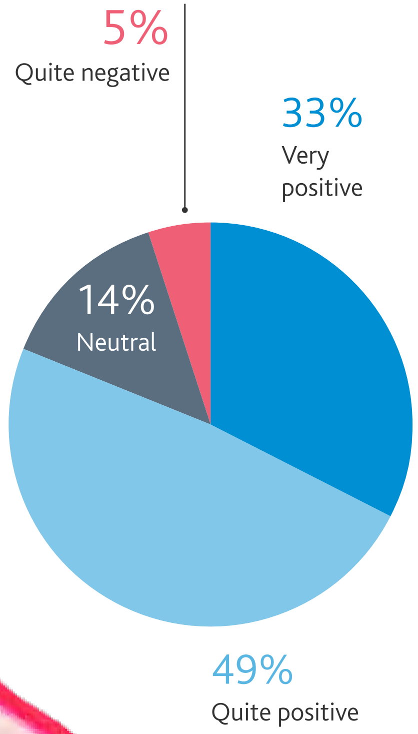
53% have an **environmental, social and governance strategy**

Healthy growth

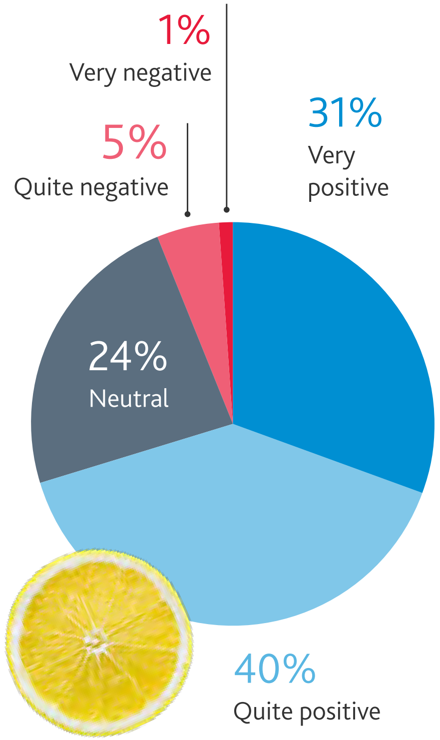
The UK Food and Drink industry is gearing up for growth. Not a single respondent to our survey expressed very negative views on the prospects for the sector, and a third (33%) felt very positive. Only 6% had a quite or very negative view of their own prospects.

These figures, all better than last year, come on the back of outstanding performance given the headwinds facing the industry. Almost half the sample (49%) saw operating profits increasing over the last year, while revenues and profit margins grew for 36%.

How positive or negative do you feel about the future prospects for the Food and Drink industry in the UK?



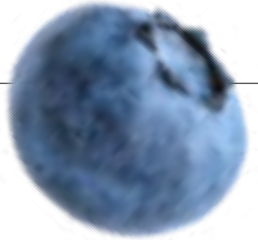
How positive or negative do you feel about the future prospects for your business?



How do you expect your business performance to change over the next 12 months?

	Increase	Stay the same	Decrease	N/A
Operating profit	**38%**	40%	17%	6%
Gross profit margins	**40%**	41%	15%	5%
Revenue	**35%**	44%	18%	4%
New orders	**36%**	44%	17%	4%
Headcount	**34%**	41%	19%	7%
Capital expenditure	**39%**	39%	18%	5%
New product launches/R&D	**39%**	42%	13%	7%
Level of production automation/digital transformation	**33%**	45%	15%	8%
Sustainability/ESG focus	**36%**	50%	11%	4%

There is a sense that this performance could be sustained over the coming months, with 38% of the sample predicting further increases in operating profits and 40% expecting gross margins to grow. Only 18% of respondents expect revenues to drop.



Healthy growth *Continued*

Where do you anticipate most of your sales growth to come from in the next 12 months? Top five options selected

30%
Growth through new product development

29%
Expansion into new export markets outside the EU

29%
Refreshing existing products and services

28%
Growth through mergers and acquisitions

26%
Expansion into new export markets within the EU

Leaders expect growth to come from a range of avenues, including new products (30%), expansion into markets outside the EU (29%), refreshment of existing product and service lines (29%) and growth through mergers and acquisitions (28%).

North America, which is attractive to UK businesses because of business-friendly regulation and a lack of language barriers, emerged as the most popular non-EU market for exports, chosen by 38% of those planning expansion beyond Europe. Australia and New Zealand came second, cited by 31%.

These figures are not dissimilar to those from last year's survey, although in 2022 the main motor for growth was seen as being capital investment in production facilities (cited by 33%, down to 25% this year).

Trade figure's export cheer

Industry insight

A Food & Drink Federation trade snapshot of the first half of 2023 paints a rosy picture for exports, with overseas sales growing 4% over the first six months of the year.[2] This growth is mainly due to healthy trade with the EU, where exports grew 7.6% over the half year.

Ireland was the UK's biggest EU trading partner, seeing sales up almost 10% to £2bn. Non-EU exports were down slightly, but there were some notable exceptions, with sales to Singapore up 53.7%, China growing 23.7% and Taiwan rising 17.2%.

China's figures were buoyed by a 37.6% rise in demand for whiskey, along with soaring appetite for cheese, up 295.7%, protein concentrates (89%) and salmon (57%).

Healthy growth *Continued*

Opportunities in the US for exports and investments

BDO insight

In 2020, UK Food and Drink exports to US alone reached £2bn ($3.2bn), making US the UK's largest single export market for this category. Strong cultural ties, common language, familiarity and positive perception of British brands and products give UK food companies a distinct competitive advantage to maximise that growth potential.

For those UK producers looking to diversify out of Europe, the US market presents a lucrative target for investments as well. First, the US market offers immense potential for innovation, whether that be in emerging sectors such as plant-based food, in transitioning to a low-emission, all-electric delivery fleet, or in novel supply chains such as the meal-kit delivery business. It makes great sense to tap into this growing trend of convenience-driven, health-conscious, sustainable food preference, and the US market provides a fertile ground for such innovations.

Additionally, favourable energy prices and incentives provided by programs like the Inflation Reduction Act make the US an attractive investment destination. From a mergers and acquisitions (M&A) point of view, the current recessionary forces could drive attractive valuations for investors. That could make it a compelling opportunity to expand their brand presence, to get closer to their customers in North America, and integrate new technologies and distribution networks into their supply chains.

Sam Chakraborty
US Food & Beverage Manufacturing Subsegment Leader
BDO USA

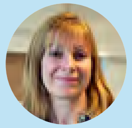
Assessing attractiveness of overseas territories

Industry insight

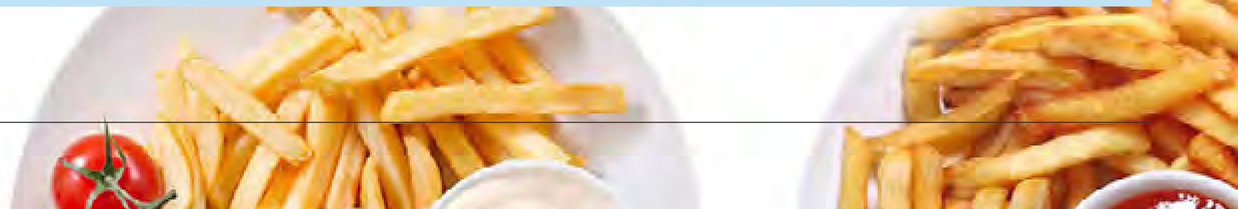
Non-EU markets are important targets for UK Food and Drink companies. Additionally, the UK has or is (re)negotiating free trade agreements to deliver potential benefits such as zero tariffs and frictionless trade.

Nicola Thomas, Director of the Food and Drink Exporters Association, shares five tips on assessing the initial attractiveness of overseas territories:

1. **Population.** The size of the market is a key variable in consumer demand. For mass market products, you need countries with lots of consumers; for niche offers, overall size is less critical.
2. **Consumers with the appetite and money to pay for imported products.** Whilst GDP per capita forecasts offer an indirect measure of purchasing power, wealth inequality tends to be more prevalent in emerging markets. Although the middle classes in these economies are expanding at pace, many consumers have limited access to – and ability to try – new products.
3. **Urbanisation.** Consumers in urban areas tend to be more open to new products and follow trends more closely. Retail and foodservice outlets also tend to be concentrated in cities and towns, which makes it easier and more cost-effective to deliver to points of sale.
4. **Global trends.** If a trend like free-from is reaching maturity in the UK, it may well be turning mainstream in other parts of the world, offering the opportunity to capitalise on new growth channels and extend the lifecycle of your products.
5. **Sales channels.** Online food delivery, for example, is growing rapidly globally, however from a much lower base in many emerging markets than in the UK.



Nicola Thomas
Director
Food and Drink Exporters Association



Appetite for risk

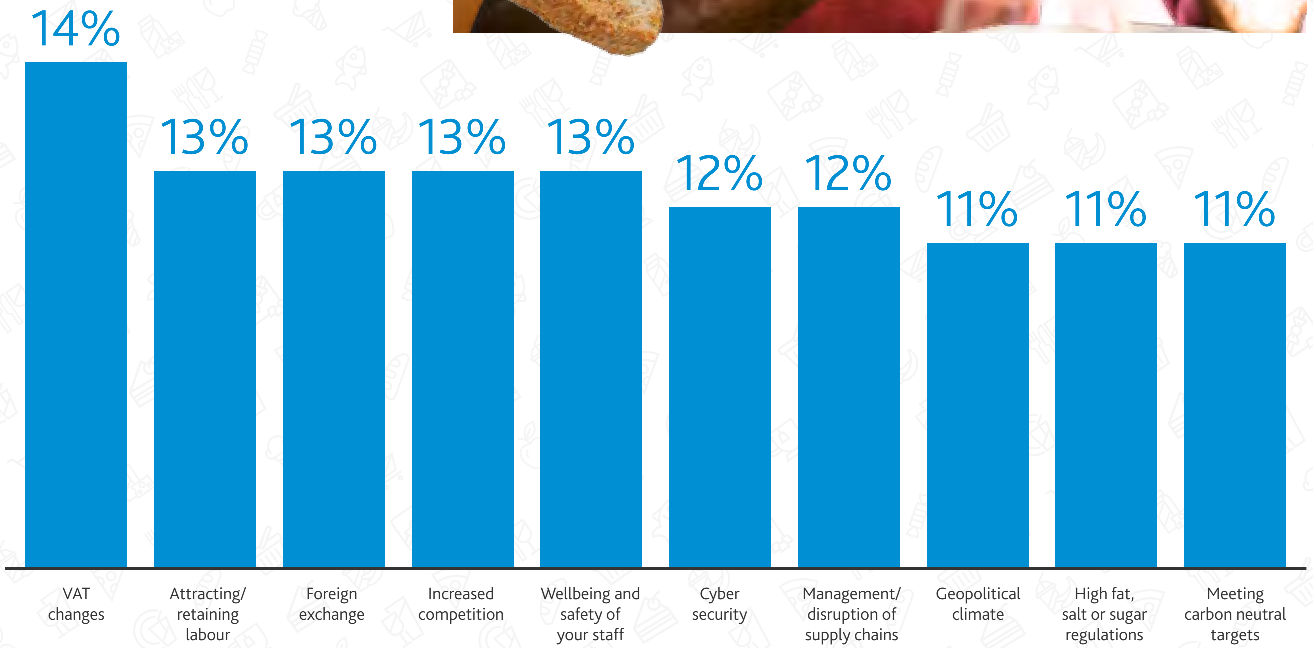
Cost-of-living crisis, conflict in Ukraine, war for talent: there is no getting away from the fact that we live in turbulent times. But when asked about the challenges facing business, the most surprising thing about the responses to our 2023 survey was the paucity of answers.

VAT changes emerged as the top concern for leaders in the survey – but it was cited by a mere 14% of respondents. Attracting labour, a perennial problem for the sector, was cited by 13%, even though half of the sample was finding it hard to get staff.

A further 13% each mentioned foreign exchange, increased competition, and staff security and wellbeing as ongoing issues. Cyber security and supply chain disruption was a worry for 12% of respondents.

But only around one in ten of those surveyed seemed concerned about the geopolitical climate, new regulations, carbon targets, business rates, cash flow or changing consumer habits.

UK Food and Drink's top 10 concerns for the next 12 months



Admittedly, the list of threats to choose from is long and includes risks that range from an over-dependence on key customers (cited by 10% of the sample) to increases in costs linked to the UK's plastic packaging tax (mentioned by 4%).

Companies are exposed to all of them, with not a single respondent saying they were not facing any challenges at all this year. The diversity of risks in today's business environment could itself be seen as a threat, making it harder for leaders to focus on solutions to a given problem.

Certainly, the risk landscape in 2023 is far removed from that of 2022, when 28% of UK Food and Drink leaders were still concerned with the ongoing impact of COVID-19. The pandemic was cited by only 6% of the sample this year.

Appetite for risk *Continued*

Key actions to manage risk

BDO insight

VAT management

As manufacturers develop new products, the VAT treatment of products will be a major concern. Keeping up to date with the latest classification cases on Food and Drink products is vital so you have some certainty over your products' VAT treatment and how it affects your customers and pricing structures.

Lyndon Firth
Tax Partner, North Head of Indirect Tax Services
BDO

Cyber security risks

While going through digital transformation, you'll find a mix of legacy and new technology on your estate. Ensuring your legacy technology remains secured is critical to preventing an attack. Furthermore, if you understand the threats to your business, you can identify which controls directly defend against those threats, optimising return of investment for risk reduction.

Jason Gottschalk
Partner, Cyber Security
BDO

Attracting and retaining staff

Finding and keeping the right staff in your business requires you to articulate two things, very clearly. First, tell them how they can be the most successful version of themselves in their work. Second, tell your people what they get for delivering this success. Their "employee deal" shouldn't be a surprise or a secret.

David Ellis
Partner, Strategic Reward Advisory
BDO

Supply chain disruption

Map your supply chain and that of your suppliers. What alternative routes are there? How many alternative suppliers do you have? Have you got software that can store this information? Can you look at a county, region, shipping route and see what your risks are? And the potential impact on availability? If not, why not?

Fraser Paget
Director, Supply Chain & Logistics Advisory Services
BDO

Meeting carbon reduction targets

While many companies have measured their emissions baseline, set science-based targets and are developing carbon reduction plans, stakeholder scrutiny and expectations are increasing. There is a need to demonstrate commitment and evidence progress through publication of further detail on key initiatives, metrics, timelines and dependencies.

Howard Lungley
Director, Carbon Advisory
BDO

Appetite for risk *Continued*

The Ukraine conflict

Globally, the biggest geopolitical threat to arise since our last survey was the war in Ukraine. While this has affected most UK Food and Drink businesses, with only 35% claiming no impact, less than a quarter (23%) are experiencing significant challenges, mainly in the form of price rises and supply shortages.

Tackling inflation

At national level, the other big change has been inflation. Unlike other major economies, the UK has been slow to shake off inflationary pressures that peaked in October 2022.

In August 2023, the consumer prices index, including owner occupiers' housing costs, stood at 6.3%, a 3.3 percentage point increase over its level from two years previous.[3]

Instead of seeking additional finance or drawing on overdraft facilities, the preferred inflation-busting methods last year (cited by 32% and 30% of the 2022 sample, respectively), Food and Drink companies in 2023 are taking on more debt (28%) and seeking discounts from suppliers (27%).

Inflation on the wane?

Industry insight

After three decades of less-than-5% inflation, a soaring consumer prices index caught businesses off guard in 2022. The good news is that after narrowly missing 10% in October 2022 the cost of living has been on a generally downward curve.

However, inflation in Food and Drink remains uncomfortably high.

The Food & Drink Federation put food and non-alcoholic drink inflation at 13.6% in September 2023, down from 19.1% in April, but with "persistent inflation" in products such as sugar and olive oil.

"The reason inflation has not yet fallen further is because the costs of food production remain high, including ingredients, energy, transport and labour," said the federation.[4]

What measures, if any, is your business taking or planning to counteract the impact of rising inflation? Top five options selected

28% Taking on higher levels of debt

27% Requesting discounts from suppliers for larger orders

26% Changing to cheaper suppliers

25% Implementing new or using existing overdraft services

24% Seeking additional finance

Supply chains and customs

Getting a grip

One thing that companies seem to have learnt from recent years is that it pays to stay close to your supply chain in uncertain times. From sustainable packaging to optimising stock holding, there is a net increase in supply chain resilience spending across all of eight categories polled in our survey.

These investments are largely in response to inflationary pressures, with the highest uplift being in the electrification of transport. Here, investment had increased in 43% of the businesses surveyed, a higher level than for onshoring (41%) or expenditure on supply chain infrastructure (40%).

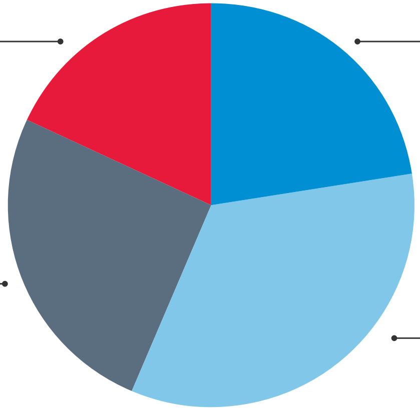
Also, more than three fifths (63%) of respondents said they monitor supply chain KPIs somewhat or very effectively, while only one in ten are not at all effective at monitoring. But one area where further work may be needed is having oversight of customs declarations.

This is key to ensuring the right amount of import tax gets paid, so it is encouraging to see 18% of respondents confirming that they get copies of all customs declarations and check them. While 18% may not sound like a lot, it is twice the level expressed in last year's survey.

At the same time, though, the proportion of respondents leaving things entirely up to their freight forwarders has also risen, by 23%, compared to just 7% last year. The proportion of companies retaining their customs declarations for HMRC audits has meanwhile fallen from 46% in 2022 to 26% this year.

Perhaps unsurprisingly, approval for and operation of customs duty reliefs – including the ability to gain approval for warehousing, inward processing and so on – was said to be challenging by 64% of this year's sample. But that is not the only problem facing supply chain administration.

How thorough is your oversight of the customs declarations your freight forwarder submits to HMRC in your name?



18%
We receive copies of all customs declarations, retain and check them to ensure we are paying the right amount of tax at import.

26%
We receive copies of all customs declarations and retain these for HMRC audits.

23%
We leave all this to the freight forwarder and do not have oversight of duty and import VAT incurred

34%
We sometimes see copies of customs declarations

Supply chains and customs *Continued*

Multiple challenges

Another four core supply chain processes, including valuing and classifying imported goods in accordance with current rules, were all deemed more challenging than not by the respondents in the sample.

The most problematic issue for importers, cited by 69% of respondents, was the application of preferential origin arrangements under UK free trade agreements with trading blocs such as the EU and within the Generalized System of Preferences in developing nations.

While not stated explicitly in the survey, there is an implication that supply chain efficiency has not been helped by the UK's departure from the EU.

Further evidence for this comes from the finding that 63% of businesses surveyed are finding it hard to trade with Northern Ireland via the Trader Support Service, and only 5% are not having any problems at all.

For UK policymakers, these findings should send a strong signal regarding the need for simpler import-export rules and greater help in navigating the red tape hampering supply chain efficiency.

Tech's key supply chain role

BDO insight

Food and Drinks companies are taking five steps to make their supply chains more resilient:

- Introducing dual sourcing of raw materials
- Regionalising supply chains and nearshoring production
- Introducing technology for supply chain data analytics
- Increasing inventories of critical components
- Hiring additional digital talent to inform decision making.

The picture is a complex one, with overlapping supply chain challenges. Some of these are hard to manage, but there are others where businesses can take direct control. The role technology plays is essential, regardless of whether it's being driven by efficiency gains, digitally informed decision making or a desire to improve supply chain transparency, particularly in an era where visibility is more important than ever.

Two main risks caused by poor supply chain transparency are a growing reputational risk for businesses from suppliers that do not meet the high ethical standards consumers are demanding and knock-on effects when businesses do not understand regional challenges faced by suppliers. But where does technology come in? Its role is multi-pronged.

- Leveraging data is essential to improve transparency and visibility. Accessing data in real time can deliver smart, fast decisions, meaning investment in technology is now a 'need to have' rather than a 'nice to have'.
- Leading-edge technological solutions for improved transparency make the most of advances in artificial intelligence (AI) and machine learning, to ensure data about supply chain challenges, such as delays and shortages, is readily available, while processing and analysing data to aid decision-making.
- Cloud-based solutions enable people across different regions and countries to see supply chain activity in real time.

There's little doubt from our survey that those businesses that have taken a proactive approach to building supply chain resilience, with a focus on sustainability, will be in a strong position to weather future storms, whatever they may be, in the years ahead.

Fraser Paget
Head of Supply Chain and Logistics Advisory Services
BDO

Supply chains and customs *Continued*

Can Food and Drinks companies comply and compete in the supply chain?

BDO insight

Customs duty remains high on everyone's agenda, with the post-Brexit trade landscape being administratively complex and introducing additional cost into the international supply chain.

Is it possible to meet the customs obligations laid down by HMRC and remain competitive?

Yes – if Food and Drinks companies can meet the following three criteria:

- **Understand their responsibilities to HMRC.** A customs declaration is a tax return. Would companies outsource their corporate tax returns process to third parties without checking them? Probably not.
- **Use a smart approach to manage customs compliance.** How does a company ensure it is submitting accurate customs declarations with limited customs resource? It is often not practical or even possible to check every customs declaration that has been submitted in a company's name, and for which the company is legally responsible, by hand. But data analytics and technology can allow that process to be automated, freeing up resources to focus only on those declarations containing a flagged potential risk.
- **Invest in knowledge.** There are several ways duty costs can be reduced for Food and Drinks companies. But many companies miss out because they lack the knowledge and awareness of these opportunities. Taking time to bring that knowledge into the company, for example through customs training or appropriate resourcing, can pay dividends in the future.

Matthew Clark
Partner, Customs, Excise and International Trade Services
BDO

Digital dreams

A quarter of those surveyed expected investments in automation and digitisation to contribute to bottom-line growth in the coming year. There are plenty of other investments, for example in new product development, that leaders said could have a greater impact.

Yet the 25% level, which is consistent with the 27% result obtained last year, still highlights the importance of digital transformation in maintaining competition. Digital enterprises can achieve higher levels of productivity than their analogue peers and can cope better with skills shortages.

Leaders were keen to burnish their digital credentials in the survey, with 47% claiming to be early technology adopters and only 5% belonging to the 'late majority' of risk-averse tech followers. Only one company identified as being a technology laggard.

Building on the technology-is-key-theme, 66% of respondents said their executive teams recognised the importance of digital transformation and 67% agreed their businesses could become obsolete if they did not transform digitally. Seven in ten said transformation would open new revenue streams.

Respondents see digital transformation potentially touching a wide range of business functions, from production and procurement (each cited by 24%) to recruitment and finance (16% and 14% respectively).

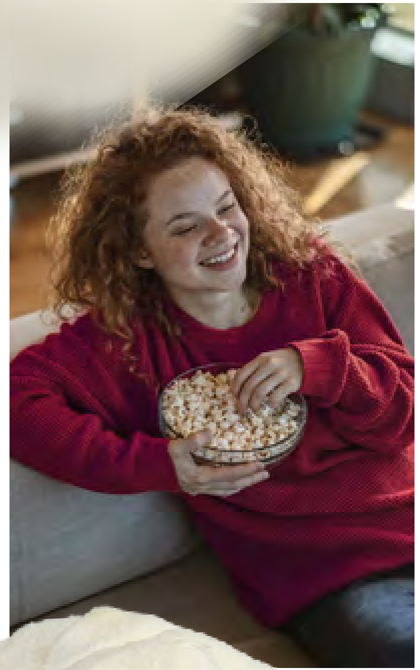
Digital dreams *Continued*

Falling behind

Accordingly, 30% of Food and Drink manufacturers have increased their focus on automation and digital transformation in the last 12 months. A third of the sample planned to increase their focus in the coming year.

Sadly, however, 60% of respondents also confessed their businesses were falling behind in their digital transformation journeys.

The biggest problem with staying on track involved ensuring new systems were compliant with privacy and data protection laws (cited by 43% of the sample), followed by finding the resources to fund a transformation (31%).



What are the biggest challenges your business has faced while undergoing digital transformation?

Ensuring new digital systems are compliant with regulations around privacy laws and data protection	43%
Finding the resources to fund digital transformation	31%
Protecting increasingly digital systems from cyber attack	30%
An internal culture resistance to digital transformation	30%
The slow pace of digital transformation and roll out	29%
Lack of digital transformation talent	24%
Integrating new digital & old legacy systems	18%

Protecting systems from cyber attacks was cited by 30%, which while still qualifying as a top-three concern is perhaps unusually low given the proliferation of high-profile breaches in recent months.

Wiltshire Farm Foods and its parent Apetito suffered a cyber attack in June 2022[5] and in January 2023 a ransomware hit closed almost 300 UK fast food restaurants – including KFC and Pizza Hut franchises – run by Yum! Brands.[6]

Manufacturers are particularly susceptible to cybercrime, according to industry body Make UK, with almost half of all UK manufacturing businesses being hit last year and more than a quarter suffering financial loss.[7]

Digital dreams *Continued*

Digital dos and don'ts

BDO insight

This year's survey shows most Food and Drink manufacturers recognise the importance of digital transformation. As these companies move forwards in their journey it is critical that they step back from point solutions to individual problems and consider their whole IT architecture. Value will be realised through solutions that coherently fit together, with well governed data that can flow easily across the organisation. In the short-term this will help break down internal silos and empower employees with more immediate information from their peers. In the long-term it will enable companies to respond more quickly, and with accuracy, to advances in data science and AI.

Increasing levels of intelligent automation can also help address a high level of concern regarding compliance and regulation. Companies will want to delegate more decision making to AI but need to reflect on requirements to be fair and equitable with customers and to protect customers' personal data. Companies will need to combat unintentional bias to prevent Food and Drink products being targeted based on race, sex or other such characteristics. In the short-term, most companies will likely realise they need to use the latest technology as a helping hand rather than a self-regulating, independent resource.

Andrew Souyave
Director, Digital
BDO

Importance of developing a clear vision and roadmap

Industry insight

We typically find Food and Drink manufacturers to be in one of three stages in a digitalisation journey: innovators pushing the boundaries of the latest technology; companies that have wide use of digital technology but siloed with limited integration; and businesses with basic systems at an early stage of digital maturity.

A common major barrier for the latter two stages is understanding how to integrate digital solutions to understand process and product. Significant value can be unlocked if the insights from the data can be used to support decision making and ultimately automate the processes. Typical benefits include reduced product development times, improved process control and quality as well as overall equipment efficiency.

Developing a clear vision and roadmap for the business are critical. As is ensuring your operational teams are actively engaged with the programme of change. Digital transformation requires cultural and organisational alignment as well as selecting the right technology to support your enterprise architecture and business processes.

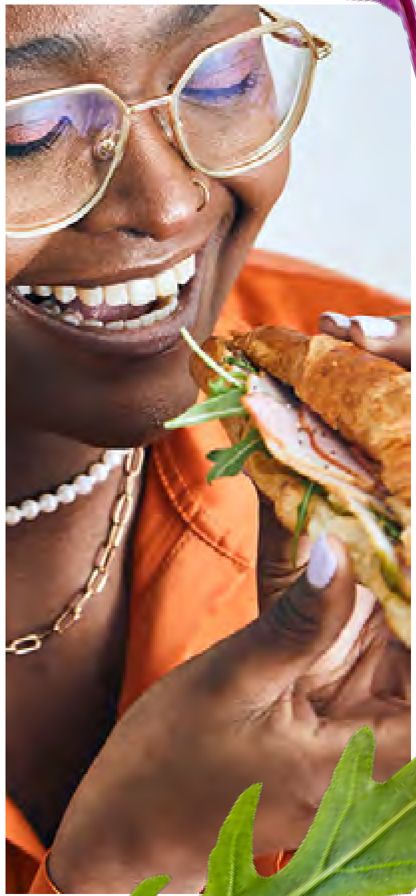
Bhavnita Patel
AgriFood Sector Development Manager
MTC

You just can't get the staff

There is no getting away from the UK Food and Drink industry's people problem. One in two Food and Drink manufacturers are struggling to find the workers they need, according to this year's survey, and a further 19% were unsure.

These figures represent a small improvement on last year, when 62% of survey respondents said they were having problems with recruitment, but it is hard to see the issue getting much better as companies step up recruitment efforts.

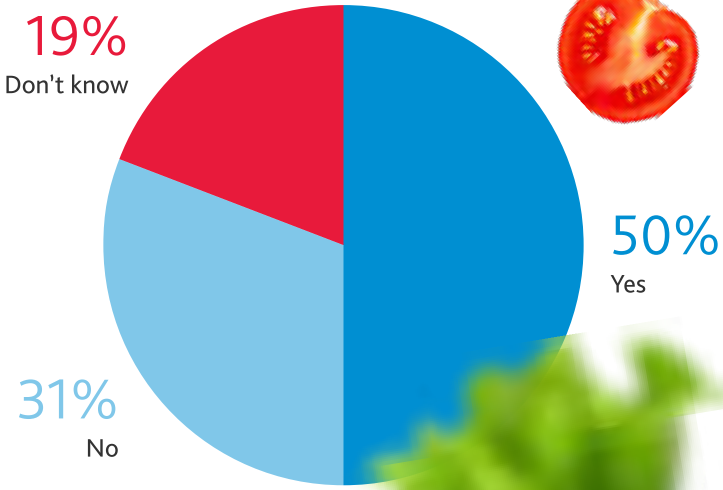
A third (34%) of Food and Drink businesses are planning to increase their headcount in the next 12 months, compared to the 19% that are planning to trim their staff. A shortage of skilled workers is not a new phenomenon for UK Food and Drink, but it has not been helped by recent events.



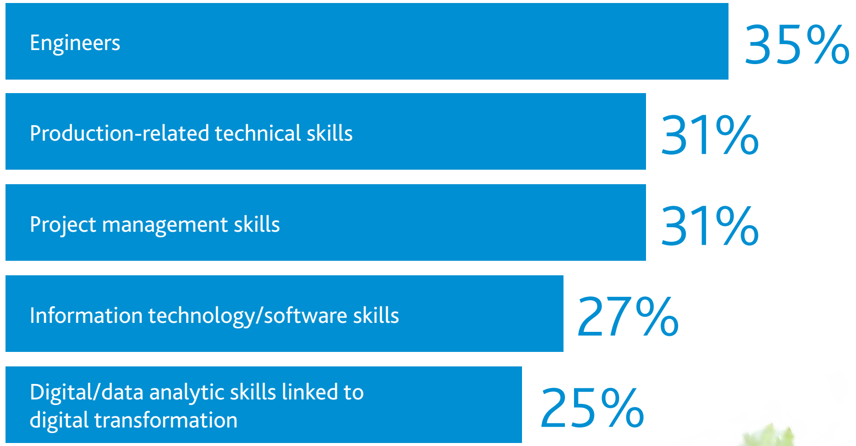
Almost two fifths (39%) of the companies experiencing recruitment challenges said they were suffering more from staff shortages now than before COVID-19 and Brexit. This is ten percentage points higher than the number of respondents saying recruitment had improved since COVID-19 and Brexit.

The biggest need is for engineers, cited by 35% of those facing hiring issues, followed by workers with project management or production-related technical skills (31% each).

Is your business experiencing difficulties in recruiting the people and skills it requires?



Top five skills businesses are struggling to recruit



These figures show a shift with respect to last year, when the top two asks were for people with IT or software skills (34%) followed by digital transformation capabilities (32%).

You just can't get the staff *Continued*

Skills demand

However, demand remains high for skill sets across the board, with a quarter (24%) of companies this year looking for people with design skills and a fifth (20%) each seeking technicians, labourers or researchers.

The need to find and retain skilled employees is leading to a growing focus on health and welfare, with staff wellbeing and safety emerging as the fifth most important challenge that company leaders said they faced in the coming year.

Organisation culture

Organisation culture plays an important role in retaining staff. In 34% of the companies surveyed this year, employees had been involved in co-creating culture change aspirations, and in a further 32% the desired values and behaviours of staff had already been defined.

Three in ten leaders said they had a clear path to embedding a desired culture and values across their organisations, and 29% claimed to have effective methods in place to check the alignment between actual and desired cultures.

Finally, a quarter (24%) of those surveyed said they had a clear focus on key initiatives that are seen as pivotal to achieving corporate ambitions.

Sector's ten-point plan to overcome labour shortages

Industry insight

June 2023 saw ten recommendations emerging from an independent review of workforce needs in England's food supply chain, chaired by G's Fresh chairman John Shropshire.[8]

The report called for a comprehensive strategy to enhance sector attractiveness and a 'moonshot' approach to innovation in the sector, while providing incentives for and advancing knowledge of automation.

Other recommendations included improving access to migrant labour, investing in domestic workers, reforming the Apprenticeship Levy, building on skills supply collaboration, supporting the delivery of food career curricula and producing a workforce data strategy.

Food and Drink Federation chief executive Karen Betts said the report "rightly focuses on the unprecedented challenges the Food and Drink industry faces in recruiting talent, upskilling our workforce and investing in technology, while maintaining a sustainable and resilient supply chain."[9]

Following publication of the report, Farming Minister Mark Spencer announced £12.5m in research and development funding for automation and robotics.[10]

You just can't get the staff *Continued*

Why culture is key

BDO insight

An organisation's culture is manifested through its values, attitudes and behaviours. It has far-reaching impacts on how employees feel, perform and make decisions and how resilient the organisation is in times of change and uncertainty. Numerous studies have shown that the most ethical companies' share price can outperform others by up to 25%. An organisation's products, services and strategy can be copied, but organisational culture cannot. Your culture and your employees are your true differentiators and sources of competitive advantage.

The Food and Drink sector is facing multiple disruptive challenges, as you can read in this report. Culture can act as a general enabler, helping to respond to your challenges in a more consistent and cohesive way. But it might also help to anticipate changes and prepare for further disruptions. Whatever your unique culture is, you can leverage it by understanding it, benchmarking it against competitors, making brave choices and pursuing focused changes with tracked business impact. Our survey identified that less than a third of respondents have defined the culture they are trying to achieve and their desired values and behaviours, with over two thirds of organisations also lacking a clear plan to embed the desired culture, values and behaviours across the organisation.

Ian Bennington
Partner, National Leader for Governance, Risk and Compliance Services
BDO

Why Food and Drink organisations should be acting now

- An organisation's culture has far-reaching impacts in terms of how employees feel, perform and make decisions, and how resilient the organisation is in times of change and uncertainty
- Culture is often the root cause of high-profile ethics and compliance issues and company failures
- As Warrant Buffett famously said, "It takes 20 years to build a reputation and five minutes to ruin it"
- Organisations need to have robust ethics and compliance frameworks and strong company cultures to drive high standards of ethical decision-making and to protect the business from the risk of ethical breaches causing reputational and financial damage
- Corporate culture is under significant scrutiny from external stakeholders
- UK governance codes recognise the importance of organisational culture, require organisations to align culture with purpose and strategy and encourage sound ethical values and behaviours throughout a company.

Zsolt Szelecki
Head of People Advisory Services
BDO

The sustainability and ESG outlook

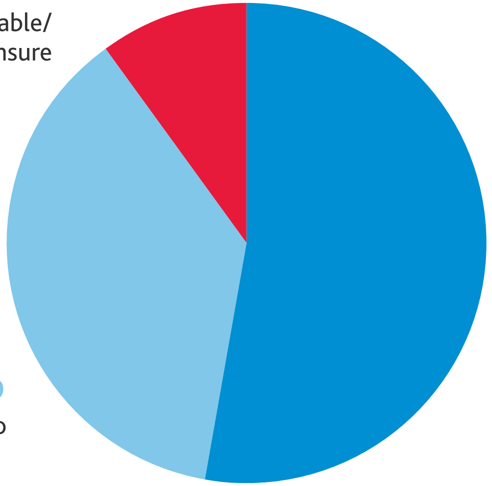
Despite other priorities and sustainability becoming part of business as usual, ESG continues to have a place in corporate agendas across the Food and Drink industry.

A robust 27% of the sample said their ESG focus had increased in the last 12 months, compared to 15% where it had decreased, and 53% of businesses claimed to have an ESG strategy.

Meanwhile 46% of respondents claimed ESG accountability had been assigned to a specific individual or team, 38% said their businesses had set targets, 44% were linking executive pay to ESG-related performance and 48% had systems in place to capture or monitor relevant data sets.

Elsewhere, 41% of businesses claimed to be identifying ESG-related risks and opportunities and 35% of businesses had set net-zero targets.

Does your business have an ESG strategy with defined objectives across the environmental, social and governance pillars?



Businesses appear to be seeking assistance in this important mission, with 43% claiming to have independent assurance in ESG reporting matters and 46% using artificial intelligence tools to reach sustainable objectives.

The quest for sustainability extends to corporate structures, with 44% of leaders saying they would consider acquiring a business or divesting non-core assets to meet ESG goals.

Pursuing decarbonisation

Nine in ten (91%) of companies with a net-zero target have one that is science based, 80% have a plan in place to achieve it, 71% are including Scope 3 (supply chain and product lifecycle) emissions and a similar percentage is on track to meet their objectives.

Furthermore, 50% of respondents said their businesses were collaborating with their supply chains on emissions reductions. Elsewhere, three quarters of the sample expressed confidence in having business processes that provided adequate risk coverage for plastic packaging tax filings.

This still means one in four companies is unprepared for the new regulations, with 3% saying they were “not confident at all” in having the business processes and procedures that could provide adequate risk coverage for the filings needed.

The sustainability and ESG outlook *Continued*

Moving forward on sustainability

BDO insight

Despite the combined challenges of climate impacts, geopolitical instability and the cost-of-living crisis, our data shows that commitment to the ESG agenda remains robust across the sector. A distinct emphasis is placed on the need for supply chain resilience and transparency. As the industry combats rising inflation, vigilance when seeking alternative suppliers is crucial to maintaining business reputation and long-term stability.

The industry is also facing increased pressure to improve the sustainability of its operations across its value chain, from customers and employees to investors and financial institutions. Scope 3 emissions comprise up to 95% of the industry's total carbon footprint and regulators are increasingly aware of this issue, incorporating Scope 3 into ESG disclosure requirements. It is encouraging to see the quality of decarbonisation plans across the industry, with strong efforts being made to meet science-based targets. Those that deprioritise progress towards net zero risk regulatory and reputational damage as the world shifts to a low-carbon economy.

Digital infrastructure and artificial intelligence provide efficient solutions to the complex sustainability challenges faced by the industry, from smart data processing and factory production to inventory management. With nearly 50% of businesses reporting to have used AI to reach their ESG objectives, it is important to not get left behind.

Simon Pringle
Head of Sustainability and ESG Advisory
BDO

Innovation's plastic focus

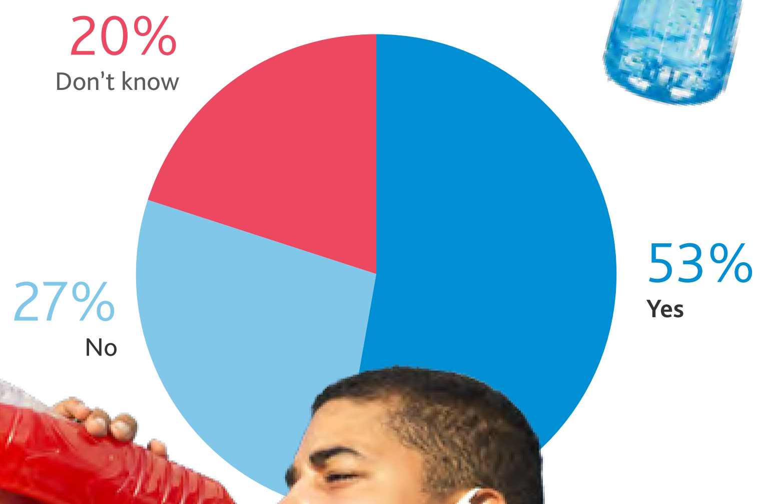
The UK Food and Drink industry's acclaimed capacity for innovation is being brought to bear on the plastic packaging tax. In this year's survey, the development of sustainable packaging emerged as the top priority for product R&D in 2023.

R&D, under the guise of innovation, process improvement or new product development, was cited as a key focus for 53% of respondents in this year's survey, a significant drop on the 79% level registered last year – but still an important figure.

This activity spans a wide range of issues and business functions, but reductions in plastic packaging and the development of sustainable alternatives was the top area. It was mentioned by 38% of respondents, a major uplift from the 24% response obtained last year.

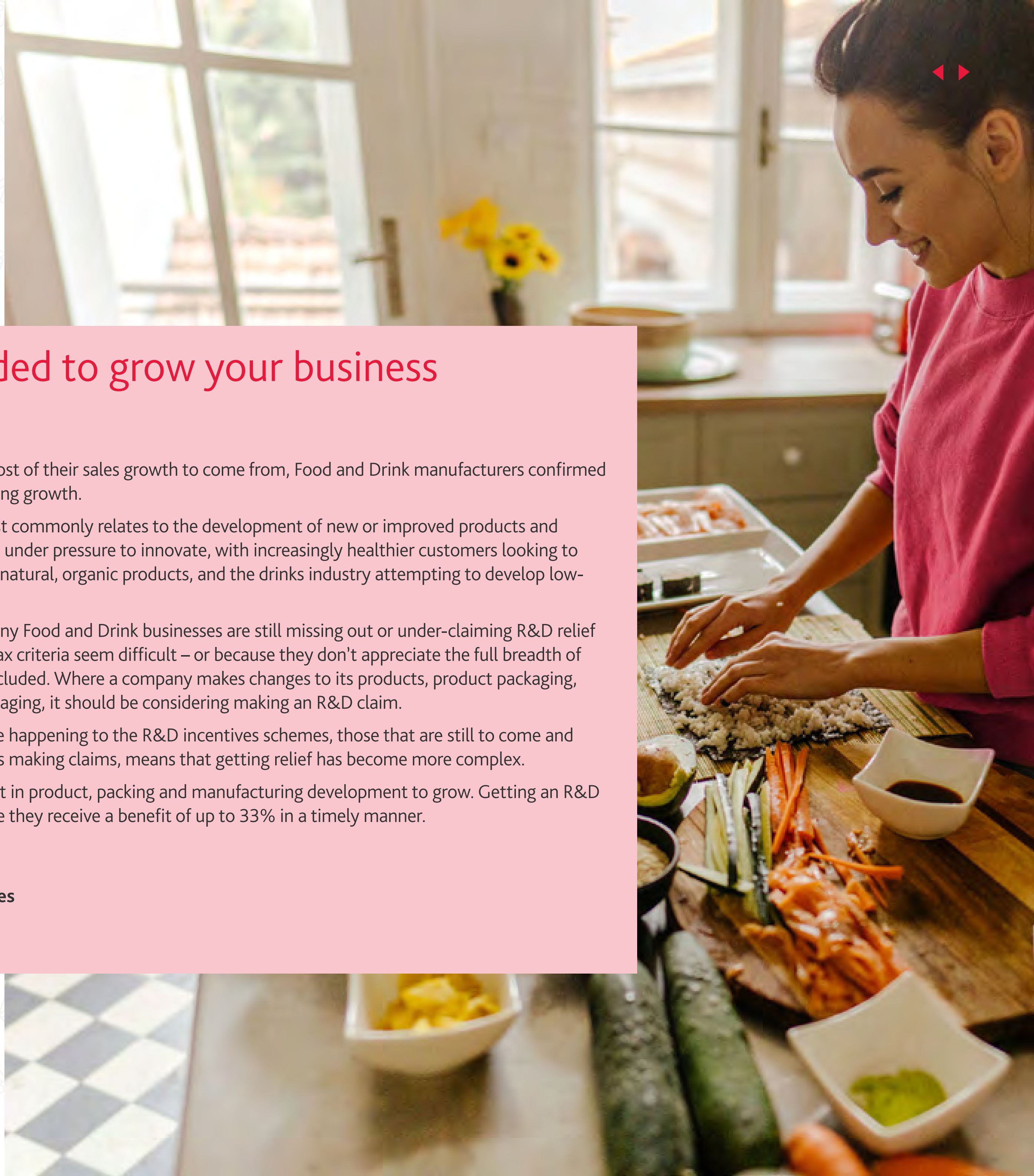
Other major R&D focus areas this year included back-office systems, mentioned by 36% of the sample, plus convenience and reduced sugar or fat products, cited by 34% apiece. New product development is seen as the biggest motor for growth in the industry this year, according to 30% of those questioned.

Is new product development, process improvement, R&D and innovation a key focus for your business?



Which areas are your new product development/R&D teams mainly focused on?

Innovation's plastic focus *Continued*



Government support

Companies involved in product R&D should be aware of changes to incentive schemes that came into effect in 2023. Positively, this was the case for 78% of this year's sample.

Two fifths (41%) of the companies aware of the incentive scheme changes viewed them as positive, versus 25% that expected to see a negative impact.

The highest level of incentive scheme awareness was related to proposed HMRC legislation for a merged R&D tax regime for all company sizes.

While the government has not yet taken a decision on whether to merge the regimes, and intends to keep the option of doing so, Westminster says a merger would be "a significant opportunity for tax simplification, provide more clarity and certainty... and help to drive innovation in the UK."[11]

More than nine in ten (92%) of companies were clear about the impact that this might have on their operations, with 49% believing it would be positive and 17% bracing for negative repercussions.

Innovation is needed to grow your business

BDO insight

When asked where businesses expect most of their sales growth to come from, Food and Drink manufacturers confirmed that new product development was driving growth.

R&D in the Food and Drink industry most commonly relates to the development of new or improved products and manufacturing processes. The industry is under pressure to innovate, with increasingly healthier customers looking to reduce sugar, salt and fat or adopt more natural, organic products, and the drinks industry attempting to develop low- and no-alcohol alternatives.

With that in mind, it's a surprise that many Food and Drink businesses are still missing out or under-claiming R&D relief because the definitions and associated tax criteria seem difficult – or because they don't appreciate the full breadth of activities and expenditure that can be included. Where a company makes changes to its products, product packaging, manufacturing process or transport packaging, it should be considering making an R&D claim.

This, combined with the changes that are happening to the R&D incentives schemes, those that are still to come and HMRC's increased scrutiny on companies making claims, means that getting relief has become more complex.

Food and Drink companies need to invest in product, packing and manufacturing development to grow. Getting an R&D incentive claim right first time will ensure they receive a benefit of up to 33% in a timely manner.

Ece Akser
Director, R&D Incentives
BDO

Hunger for M&A

Economic uncertainty has slowed the mergers and acquisitions (M&A) activity that gripped the UK Food and Drink industry following COVID-19, but the appetite for deals remains, suggests this year's survey. M&A was the fourth most popular avenue for sales growth in the survey, cited by 28% of businesses.

While 30% of companies are putting investment decisions on hold for the foreseeable future, with 23% pausing M&A activity to counteract the impact of inflation, 24% are looking to make acquisitions in the next year and 25% are planning to acquire other businesses within three to five years.

A fifth of the leaders surveyed said they already had experience of acquisitions. The research also suggested acquisitive companies could be rewarded with suitable targets.

A quarter of respondents said they were considering strategic options including the sale of all or part of their business within the next year, and 35% said they could be seeking buyers within three to five years. In addition, 21% of those queried said they would consider divestments to focus on growth in core operations.

24%

of Food and Drink manufacturers are looking to make an acquisition in the next year

Likely reflecting a growing share of private equity (PE)-led transactions in the sector, 12% of respondents said they were seeking PE investment in the next year and 14% said they might do so in the coming three to five years. Almost a fifth (18%) already had experience of PE investment and 27% agreed it was good for businesses in the sector.

M&A drivers

As for the drivers for M&A, the top three reasons were enhancing ESG propositions (39%) and accessing new products (38%) or customers (38%); other important motivations were to scale up operations (34%) and expand geographic coverage (27%).

The hunt for ESG-related targets could in part be explained by a need for improved support to reduce carbon emissions and invest in the circular economy, which is seen as a top priority for the industry, cited by 25% of respondents.

The quest for acquisitions to bulk up product portfolios, meanwhile, is for the most part driven by a thirst for free-from and allergy friendly recipes, convenience and grab-and-go options and products with reduced fat and sugar content, the survey found.

39%

say the key driver for M&A is to enhance ESG propositions

These drivers were each cited by 39% of the companies looking to access new products through M&A, or around 15% of the total sample. A further 26% of the M&A subset, and 10% of the overall sample, claimed to be looking for meat-free, vegan and plant-based products.

Hunger for M&A *Continued*

Is the perfect storm lifting?

BDO insight

Deal volumes fell by 30% in the opening half of 2023, compared to 2022 H2, as rising inflation and interest rates, coupled with geopolitical uncertainty, continued to erode confidence. The annual rate of UK Food and Drink inflation increased to an eye-watering 19.1% in the 12 months to March 2023, its fastest pace for over 40 years.

Supply disruptions have been the main contributor to inflation over the last 18 months, with a major factor being the Russian invasion of Ukraine, which had a major impact on the global supply of grains and fertilisers, and on European energy prices. Other key factors include labour shortages, which left some crops unharvested, alongside droughts and cold snaps in Europe and North Africa, which led to higher imported food prices. The UK is heavily reliant on food imports, and the price of imported food materials has been rising at twice the rate of domestic food materials.

However, deals have been completing despite the challenging backdrop, with a number of high-profile transactions to note. Examples include SoftBank and Grosvenor Group's £50m investment in Gousto, and Leprino Foods' acquisition of Glanbia Cheese for £204m. Outside of premium deals, transaction processes have taken a cautious approach as buyers navigate a volatile economic climate and forecast future benefits to gain comfort around valuations.

Capital from private equity and trade buyers continues to be available for assets in growing markets, such as alcoholic beverages, health foods, plant-based and free-from, and pet and animal food, as well as core categories such as meat and fish. But the split between private equity and trade transactions has swung towards trade, which represented 82% of deals for the period.

For many, recovery from the economic 'perfect storm' may be on the horizon, as the Consumer Price Index predicts inflation is starting to fall.[12] As our survey reveals, there is high appetite for M&A as a means of scaling up operations, accessing new products, customers or geographies, and enhancing ESG propositions. Assuming economic stability materialises, the next six to 12 months could be a busy time for building revenue and margins in preparation for releasing a pent-up demand for investment and exits.

Continues next page

Hunger for M&A *Continued*

Is the perfect storm lifting?

BDO insight

Key deals throughout 2022 and 2023 H1 include:

Alcoholic Beverages

- Diageo went on a 'branded' shopping spree, picking up 21Seeds, Balcones Whisky, Mr Black Spirits, East African Breweries and Don Papa Rum, in line with a "*strategy to acquire high-growth brands with attractive margins*," as reported by its European President. This activity illustrates investors and buyers capitalising on a growing consumer trend to buy less but buy premium.[13]

Health Foods

- Huel, a meal replacement retailer focused on supporting healthy, low-carbon footprint diets along with agricultural development in Sierra Leone, received a £20m investment from investors led by Highland Europe and including A-list celebrities.[14]
- Virgin Active's acquisition of the Real Foods nutrition business for £28.6m allowed it to capitalise on demand for a healthier diet.[15]

Plant-based

Our previous report noted investment in the plant-based, free-from category was 'rocketing' in 2021, whereas activity reduced to 6% of all Food and Drink deals in 2022 and to 4% in H1 2023. This was due to challenges including reduced profitability and health questions raised against certain products. The rationale for deals in this category is a mixture of growth investment and the acquisition of food tech knowledge as the category experiences a period of consolidation and operational optimisation.

- Lightjump Acquisition Corp merged with Moolec Science, a food tech company which genetically modifies plants to produce animal proteins. This transaction values Moolec at £422m and will make it the first molecular farming food-tech company to trade in public markets.[16]

Pet and Animal Food

- Anikin, trading as KatKin, a UK-based fresh cat food and healthtech platform, raised £18.2m in a Series A funding round led by Verlinvest and Perwyn.
- AB Agri's £42.3m acquisition of Greencoat, a manufacturer and distributor of specialised animal feed and supplements, was a "*key step in our strategic goal to expand our international animal nutrition and technology business*," said AB Agri's CEO.[17]
- Cranswick made a £32.2m acquisition of Grove Pet Products. The CEO of Cranswick plc commented: "*The move into pet food is an exciting one as the category continues to grow and consumers are increasingly looking to premiumise the diet of their pets.*"[18]

Meat and Fish

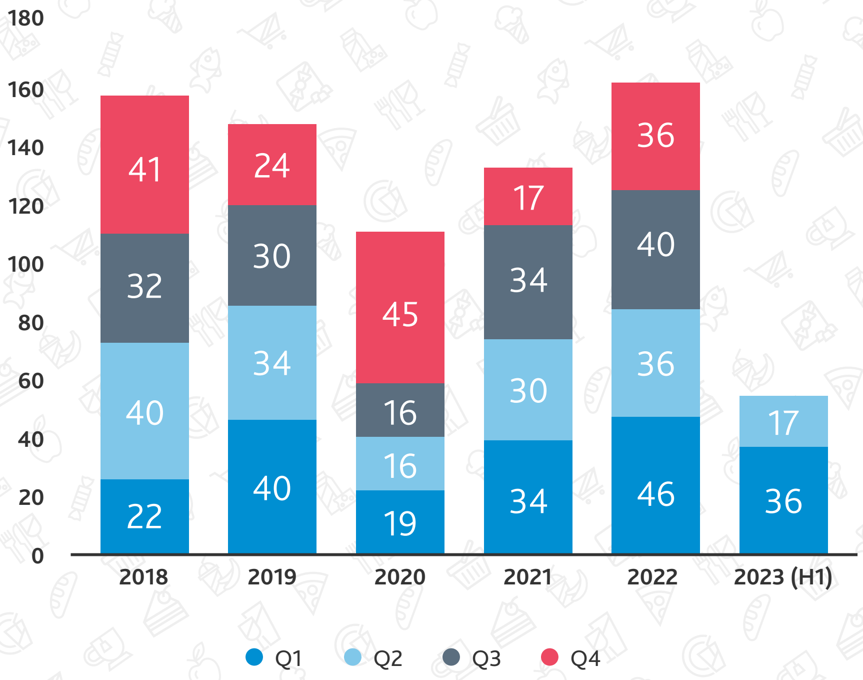
- Devro plc's £667m sale to SARIA, a service provider for agricultural and food sectors, represented a 10.9x EBITDA multiple. SARIA's CEO stated: "*The combined businesses are ideally placed to capture growth in both mature and emerging markets.*"[19]

Roger Buckley
Partner, Corporate Finance
BDO

Eleanor Fearne
Senior Manager, Corporate Finance
BDO

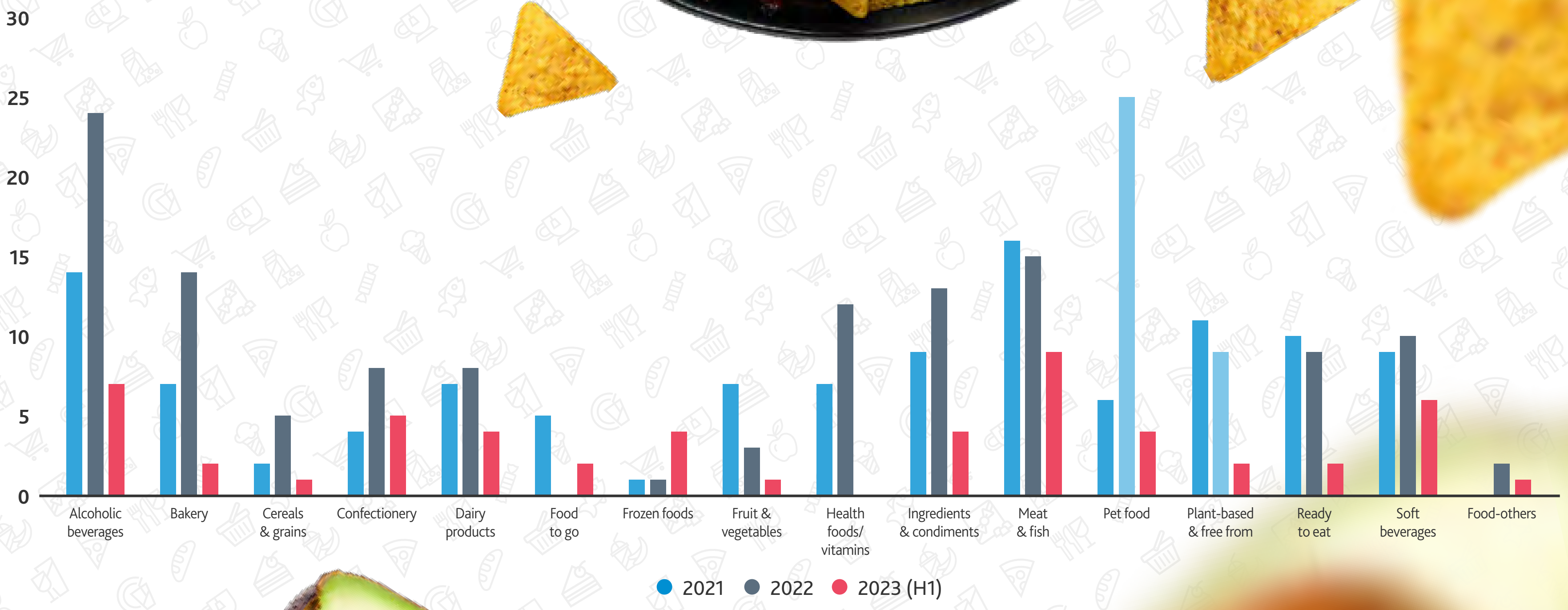
Hunger for M&A *Continued*

Food and Drink manufacturing transactions volumes 2018 to 2023 (H1)



Source: BDO analysis

2021, 2022, 2023 (H1) deal volumes by category



Source: BDO analysis

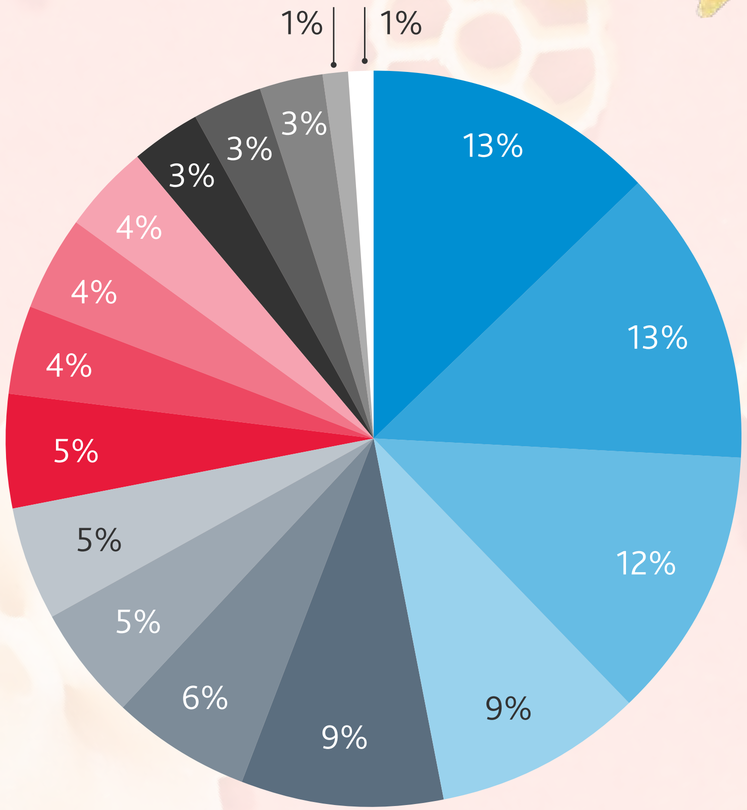
The survey

This report is based on a survey of 101 directors of UK Food and Drink manufacturing companies with a turnover of between £10m and £300m. The research was carried out by market analysis company Censuswide on behalf of BDO in August 2023.

The companies surveyed covered a wide range of industry subsectors, from frozen produce to equipment manufacturing, with some businesses operating in more than one market niche.

The most highly represented subsectors were food-to-go and fruit and vegetables, each with 13% of the total, followed by bread, bakery, biscuits, cakes and crisps, with 12%.

Industry subsector*

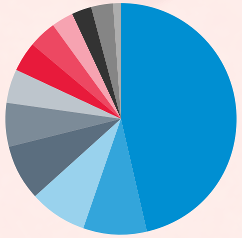


- Food-to-go
- Fruit & vegetables
- Break, bakery, biscuits, cakes, crisps
- Dairy & cheese
- Frozen produce
- Animal food
- Meat & poultry
- Plant-based/meat alternative
- Seasonings/spices/condiments
- Soft drinks & bottled water
- Seafood/fish
- Sugar & confectionery
- Alcoholic beverages (breweries, wineries & distilleries)
- Primary products & agriculture
- Tea/coffee
- Equipment manufacturing
- Packaging

*All charts in this section show percentages. Note that some companies operate in more than one subsector

Location

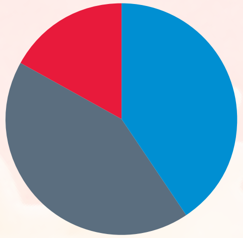
Almost half (47%) of those surveyed hailed from Greater London, and a further 9% from the East of England. Other significant regions in terms of respondents included the West Midlands (8%), the South West (8%) and Wales (9%).



Greater London	46%	West Midlands	4%
Wales	9%	North East	4%
East Midlands	8%	Scotland	3%
East of England	8%	South West	3%
North West	6%	Yorkshire & The Humber	3%
Northern Ireland	5%	South East	1%

Company size

Most of the companies surveyed had turnovers of less than £100m, with 41% in the £10m to £50m range and 43% earning between £50m and £100m.



£10m – £49.9m	41%
£50m – £99.9m	43%
£100m – £300m	17%

BDO would like to thank all the directors who took part in this survey, along with the other professionals who have contributed to this report.

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23-09-3646