

Food and drink Spring 2023



Sector Overview

While the UK narrowly avoided a recession in February 2023, the widely documented supply chain disruptions, rising inflationary and energy costs and ongoing labour shortages continue to impact adversely on the UK food and drink sector.

After reaching multi-decade highs in 2022, we anticipate global inflation will moderate in response to tightening financial conditions, softening demand and easing supply chain conditions.

Despite supermarkets trying to hold firm on upward pricing, food prices increased at an annual rate of 19% in March 2023. The major retailers continue to demonstrate their value as they are met with increased competition from discount retail chains, including Aldi and Lidl. According to Kantar, Aldi secured a new record market share of 9.9% in March 2023 as consumers continue to shop around.

UK consumers are cutting back on discretionary spend; consumers may choose to dine out less but opt for a higher quality dining experience, while others are trading down and eating at home more frequently.

The quarterly economic survey for Q1 2023 by the British Chamber of Commerce showed that UK hospitality continues to face significant challenges whilst trying to recover from the disruption caused by Covid-19. Rising utilities and ingredient costs compounded by a tight labour market have seen 47% of UK businesses within hospitality report a decline in cash flow during the quarter. To mitigate some operational costs, businesses are looking to reduce operating hours and capacity to operate efficiently.

Notable Insolvency Events

Rising energy bills, food and drink inflation and minimum wage increases coming into force mean there are margin pressures across the supply chain. The UK government reported corporate insolvencies in food production rose 170% to 173 in February 2023, while those in beverage manufacturing rose 136% to 66 in the same period.

At QBE we have seen a notable increase in repayment plans and insolvencies during the period, including the following notable insolvencies:

Troy Foods Ltd (December 2022)

Vale of Mowbray Ltd (December 2022)

Garth Bakery Ltd (December 2022)

Orchard House Foods Ltd (January 2023)

Parrs Foods Ltd (March 2023)

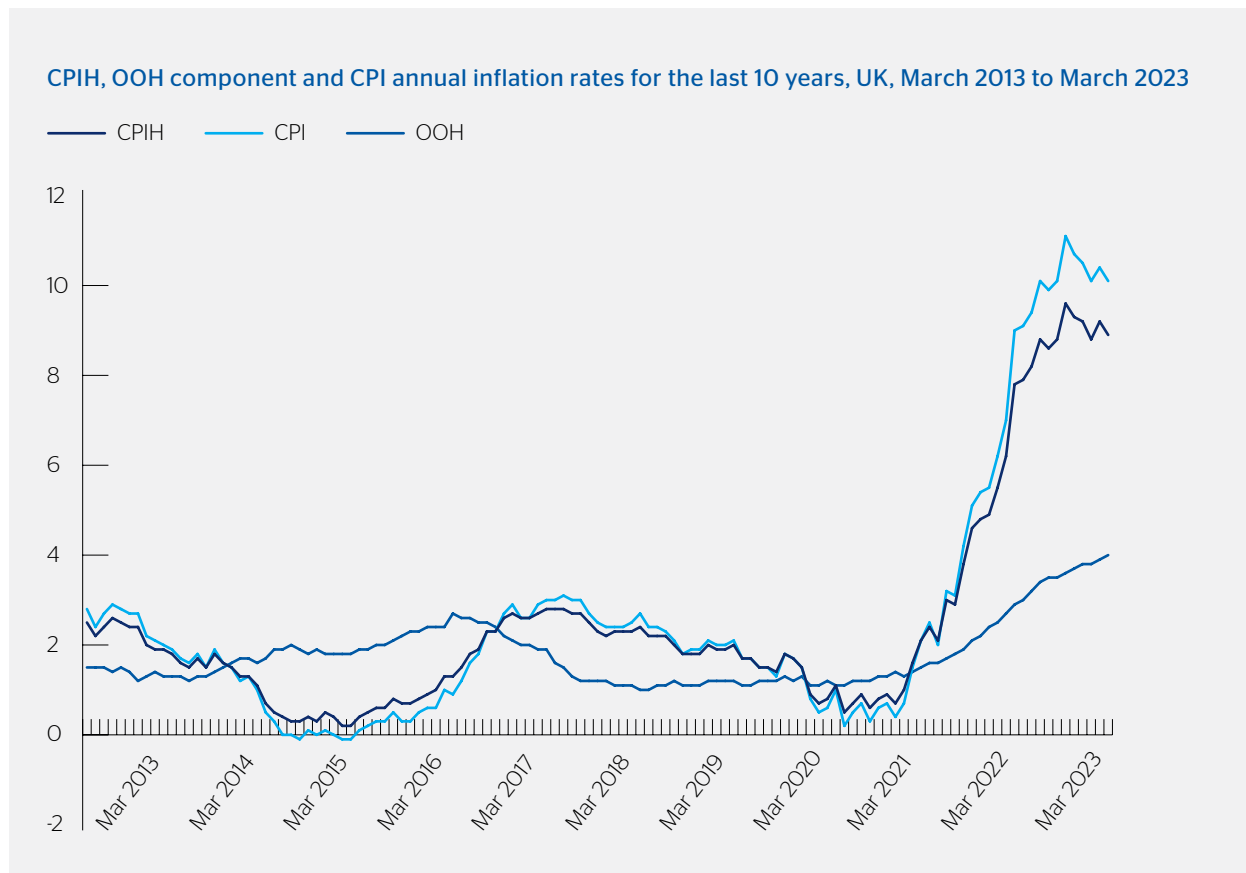
Loscoe Chilled Foods Ltd (April 2023)

Meat Factory Outlet Ltd (April 2023)

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Economic Data

According to the Office of National Statistics, the Consumer Price Index fell to 10.1% in the 12 months to March 2023, from 10.4% in February 2023. The largest upward contributions to the inflation rate were food and non-alcoholic beverages, and this remains at a 45-year high of 19.2%. The inflation rate for restaurants and hotels over the same period reduced 80bps to 11.3% from 12.1% in February 23.



Source: Consumer price inflation from the [Office for National Statistics \(ONS\)](#)

As the Russia-Ukraine conflict continues, the Food and Agriculture Organization of the United Nations has reported a decline in the benchmark index of international food commodity prices for the 12th consecutive month, particularly in cereals and vegetable oils. Russia and Ukraine have agreed to extend the export of grain through the ports in the Black Sea for a further 60 days from 19th March 2023. The agreement to extend exports is vital to global food supply as Ukraine is a major supplier of sunflower oil, corn, barley and wheat.

The UK and EU have formally agreed to a revised Brexit deal under the Northern Ireland protocol which allows for red and green lanes for food and drink hauliers to move through customs more quickly. The system is expected to go live in September 2024. The labelling of UK goods with the words 'Not for EU' on meat and fresh milk will be phased in from October 2023. The framework will allow supermarkets to operate UK-wide rather than moving towards an 'Island of Ireland' model.

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Strengths

- > **Capital investment:** Increased investment in automation/robotics has been noted across the sector throughout every link in the food supply chain (farm to fork) in an attempt to reduce the impact of an increasingly challenging labour market. Artificial intelligence will play a significant role through personalisation such as Chatbots.
- > **Poultry outlook:** While prices have remained under pressure in Q1 23, the outlook is optimistic after the UK government reduced the bird flu risk level to low where good biosecurity is applied. A decline in feed costs has further supported the outlook since poultry meat is the cheapest animal protein compared to beef and pork.
- > **Sustainable food products:** The industry can often endure long and complex supply chains in the traceability of ingredients. A continued demand by consumers to purchase more sustainable food products is supporting the need for a higher standard of environmental and social responsibility through the food supply chain. Plant-based food sales were up 230% and recyclable packaging is leading the way for 2023.
- > **Natural gas prices continue to fall:** Natural gas and fertiliser prices have been declining over the past few months. While volatility is still present in gas markets, fertiliser prices are speculated to return to levels before the Russia-Ukraine conflict. This is positive news for farming.

Challenges

- > **Refinancing** - Some businesses still retain sizeable Covid-related debt levels and refinancing on suitable debt structures may become a challenge, particularly as we see interest rates continuing to rise in the short term.
- > **Price pressures** - We do expect some downward price pressure as commodity price inflation stabilises and the Bank of England expects inflation to fall from mid-2023.
- > **Consumer spending** - While labour markets remain tight, wages have not kept pace with inflation, leading to a decline in real incomes.
- > **Supply chain disruption** - We have seen some improvement from the height of the pandemic, but we expect ongoing disruption as producers scale back production owing to rising inflation and energy costs.
- > **Food manufacturers and food processors** - This is a subsector that has sustained substantial cost increases in what is a typically low margin industry. Manufacturers have stated that costs rose by an average of 21% in 2022 while their selling prices increased by an average of 9%.

Underwriting Approach

- > **Information remains vital:** We remain in regular dialogue with a variety of businesses across the food and drink sector, with closer emphasis on food manufacturing and hospitality. We are seeking to obtain updated management accounts across the food and drink sector to understand fully the trading performance in the current environment and the funding facilities that are being made available to support working capital.
- > **A case-by-case underwriting stance:** Each business is reviewed on its own financial merits.

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