Food and drink update Spring 2022

Economic data

The Food and Agriculture Organizations food price index averaged 140.7 points in February 2022, a rise of 4% from January 2022 and 24.1% up on the prior year. A large portion of food price inflation comes from outside food production, in the form of energy and fertiliser costs.

Russia is a major player in natural gas, and therefore a major input to fertiliser production which is widely used across the supply chain for the food and drink industry. The rising cost for gas, and the disruption in supply has seen nitrogen fertiliser prices increase 200% year-on-year according to the National Farmers Union.

Combined, Russia and Ukraine produce 14% of global wheat, accounting for 14% of worldwide barley production, 17% of world corn exports and 76% of the global sunflower supplies.

The British Retail Consortium has reported food inflation accelerated to 3.3% in March 2022, from 2.7% in February 2022. This is the highest inflation rate since March 2013 and the fifth consecutive month of inflation.

Brexit and the Northern Ireland protocol has created some barriers to trade between Northern Ireland and the rest of the UK. To avoid the hardening of the Irish land border, regulatory and customs checks to the Irish Sea were adopted. Not all checks under the protocol have been fully implemented yet and there is the potential for Article 16 to be triggered. This may see either side suspend part of the agreement which could lead to tariffs being imposed.

Sector overview

The impact of the COVID-19 pandemic over the last 2-years has created challenges throughout the UK food and drink sector. While initially thought to be transitory, it has been exacerbated by the Russia-Ukraine conflict that directly impacts the pricing of world food commodities. It is integrated into the food chain from farming through to consumer consumption. Agricultural commodities such as grains, livestock and diary are being directly impacted by the significant rise in energy and fuel related costs which is putting further pressure on the food and drink supply chain.

Notable insolvency events

Insolvencies have remained low in terms of value as businesses across the sector have been able to adapt over the past 18 months. Since the start of 2022, however, there has been a rise in petitions, receiverships and administrations. We therefore expect insolvencies to rise as all businesses across the supply chain face rising input costs, labour shortages and supply chain disruptions.

- **Dawnfresh Seafoods Ltd** (March) - £72M t/o
- **Speciality Flatbreads Ltd** (March) – £49m t/o
- **Corbin & King Ltd** (January) - £22M t/o

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Strengths

- **Rapid delivery services:** Whist this is not a new concept, the pandemic created a shift in consumer shopping to online delivery apps. There is a strong demand for last mile online delivery with research from IGD suggesting the industry is currently worth £1.4Bn in the UK and is expected to grow to £3.3Bn in the upcoming years. The intense competition is also increasing demand for commercial warehouse space in most of the UK's major cities.
- **Investment:** Increased investment in automation, with robotics affecting every link in the food supply chain from farm to fork to reduce the reliance of labour following the pandemic.
- **Sustainable food products:** There is rising demand by consumers to purchase local and more sustainable food products. A pilot scheme run by Foundation Earth aims to help consumers compare food products for sustainability and push manufacturers to look for more environmentally friendly ways to produce food.

Underwriting approach

- **Information is key:** We remain in regular dialogue with a variety of businesses across the food and drink sector. We seek to obtain updated management accounts to fully understand trading performance in the current environment and funding facilities that are being made available to support working capital.
- **A case-by-case underwriting stance:** Each business is reviewed on their own financial merits.
- **Forward looking levers:** Shifting patterns have accelerated environment, social and corporate governance considerations.

Challenges

- **In agriculture:** Agriculture Price Index is at a current level of 123.86, up from 118.54 last month and up from 104.57 one year ago. This is a change of 18.45% from one year ago according to the World Bank.
- **In transport:** Earlier government initiatives to suspend the number of deliveries EU drivers make in the UK has helped ease the HGV driver shortage but there remains an ongoing shortage of drivers in the UK which has led to wage inflation. Furthermore, shipping costs have risen due to the supply and demand squeeze and ongoing lockdowns in China.
- **In energy:** UK businesses are not covered by the energy price cap and therefore small businesses could see a significant rise in their energy costs. Larger companies may have hedging in place, but this is not likely to be for the longer term.
- **In CO_2:** As a by-product in the production of fertiliser, the gas is critical in the processing of poultry and pork, packaging and in carbonated drinks, which has seen a significant rise in cost.
- **In packaging:** Price increases can be tied to the costs of raw material. There is a strong reliance in food packaging for products such as cardboard, plastic, and aluminium foil.
- **Food manufacturers and food processors:** Likely to be squeezed with the rise of input and distribution costs and their inability to fully pass these on to their customers.
- **Hospitality:** Likely to face ongoing staff shortages, rent increases and the return to 20% VAT in April 22.

Contacts

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