Green Hasson Janks

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Outlook and Opportunities for Growth in the California Food and Beverage Industry

In the extremely competitive food and beverage industry, companies are changing the way they do business. With a continuing sluggish economic climate, executives are revamping traditional sales models, focusing on innovation, packaging, and generating new products. Further, they are evaluating new market strategies and seeking acquisition opportunities as a vehicle for growth. While sales are on the rise, gross profit margins struggle to remain stable or perhaps reflect small declines, and companies will likely need to focus on streamlining infrastructures, improving efficiency, and reducing costs where possible. Further, increased concern over labor costs looms in the shadow of the Affordable Care Act. Yet, in spite of the challenges, the industry is optimistic, predicting continued increased sales and workforces as well as an economy rebound within 18 months.

Green Hasson Janks recently conducted its annual Food and Beverage Industry Survey with west-coast business owners and executives. A follow-up to the 2012 survey, this year's results reveal that the industry continues to make modest improvements with an overwhelming majority of respondents reporting increases in sales for 2012. Even more executives predict continued growth for 2013.

While the industry is experiencing high growth, companies are struggling to grow profitability. More than half of executives report an increased workforce in 2012, yet they plan to add fewer employees in 2013. On a positive note, more than half indicated sales increases of more than 10 percent and the same number predict double-digit growth again this year.

While sales and revenues are on the rise, gross profit margins continue to be tight. More than half of respondents report that last year's gross profit margins were flat compared with the prior year or grew by less than five percent. Three-quarters expect the trend to continue through 2013. Respondents cite raw material costs and pricing as key concerns and recognize new-product development, pricing strategies, and geographic expansion as keys to rising

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above competitors and the economy. In response to increased costs and flat gross profits, more companies are turning to social media to bolster traditional marketing efforts. Additionally, executives exhibit an increased interest in company or product-line acquisitions while interest in a company merger decreased notably from 2012 to 2013.

This year's respondents demonstrate growing concern over labor costs and employee retention, likely in response to regulations surrounding the Patient Protection and Affordable Care Act. Additional regulatory concerns include The Food Safety Modernization Act and its implications on infrastructure and costs. Angst over financing and cash flow continues to burden executives and logistical concerns over fuel costs add additional pressures. While companies are turning their focus inward to infrastructure and cost reduction, more than one-third report a lack of a succession plan for their companies.

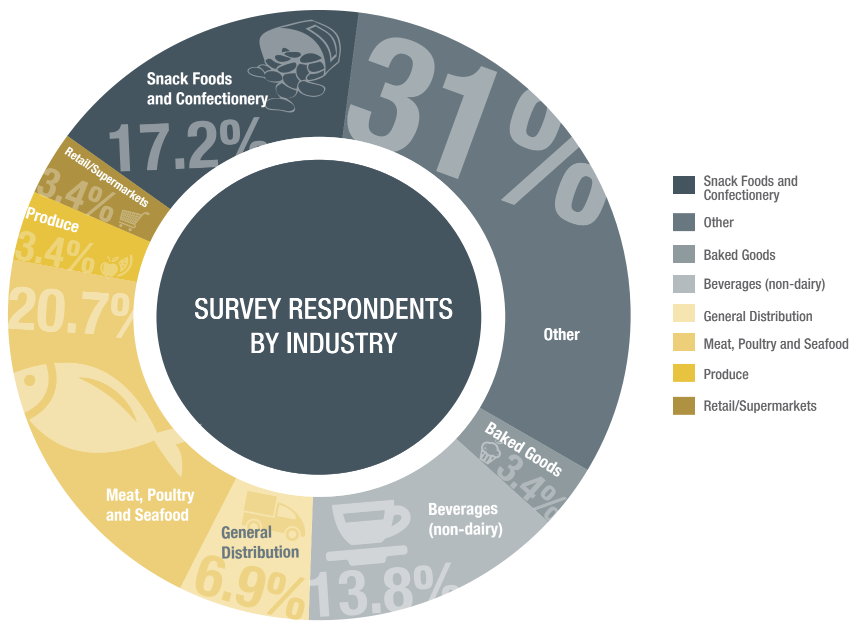
Looking forward, the majority of industry executives plan to invest in organic company growth over the next 24 months, focusing on new-product development, pricing strategies, and geographic expansion. A focus on operational and financial technology also tops the list of key management initiatives through 2014. Nearly two-thirds of respondents don't anticipate an economic rebound before the end of 2014, with the majority predicting late 2015 and beyond.

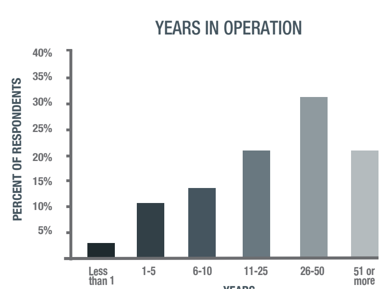
Food and beverage executives will need to take strong measures to ensure their growth in this tumultuous economic climate. Careful financial analysis, strategic planning, and a commitment to innovation are keys to ensuring the industry's success. This report presents key factors that affected the industry in 2012 as well as a providing an outlook on the industry for 2013 and beyond. Green Hasson Janks, LLP, would like to extend its sincere thanks to those who participated in the 2013 Food and Beverage Industry Survey.

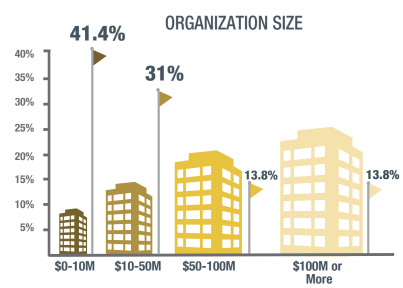
ABOUT THE RESPONDENTS

Green Hasson Janks' 2013 Food and Beverage Industry Survey Respondents represent more than 10 industry categories with the overwhelming majority of companies based in Southern California. All of the respondents were C-Suite executives or above with the majority representing CEOs and presidents.

Nearly one-third of companies are family-owned with half reporting third and fourth generation leadership. Respondents cite impressive corporate longevity with the majority having been in business for more than 10 years. Notably, more than half have been in operation for 25 years or more with 20 percent reporting durability of







a half-century or more. Approximately 40 percent of respondents report 2012 gross annual sales of less than $10 million while approximately 14 percent indicated gross sales above $100 million.

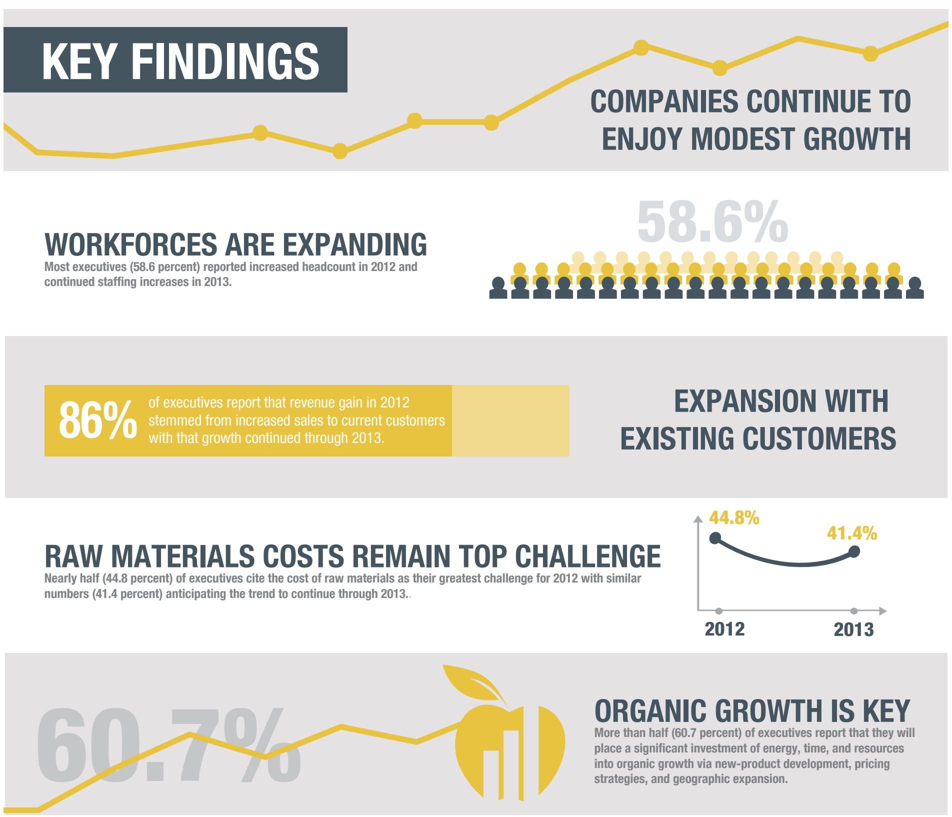
BACKGROUND INFORMATION

Experts estimate the annual revenue of the U.S. retail food and beverage industry between $1.75 and 1.85 trillion (Plunkett Research Ltd.). Typically divided into segments, the food and beverage industry consists of production and distribution. While the economy continues to present challenges and concerns for most Americans, the food and beverage industry may be one area that continues to maintain or increase market share. In fact, the Bureau of Labor Statistics reports that food and drink services jobs increased by 38,000, reflecting a shift in consumer spending habits. Further, industry experts predict a modest yet encouraging compound annual growth rate (CAGR) of 3.5 percent by 2014.

INDUSTRY TRENDS

1. ***Rising raw material costs are a major factor to the food and beverage industry.*** As commodity prices rise, food companies are forced to increase pricing. However, if the market can't bear increased prices, revenue remains level and profits decrease. 2012 brought the worst drought in 50 years, creating havoc on more than 60 percent of U.S. farmland. The USDA predicts that consumers will decrease spending as food prices increase.
2. ***Increased competition in the food and beverage industry directly impacts sales and profitability.*** With the competition keeping sales prices in check, product innovation becomes an essential corporate initiative. Survey respondent Todd DeMann, CEO and chairman of Freshology Inc., a gourmet health-conscious meal-delivery program, says that competition has increased in the California market. "With increased competition, there is a lot of pricing pressure," DeMann says. He asserts that when companies respond by offering promotional savings, "the consumer becomes conditioned to sales and that's a problem for all companies." DeMann is also seeing competitors respond to pricing competition by limiting production expenses and can "see where they are cutting costs in portion size and quality of raw materials." Bob Hermanns, director of food industry programs for University of Southern California's Marshall School of Business, says that competition is especially difficult for retailers. "Almost every retail format is offering food in some form or fashion," Hermanns says. "The squeeze on retailers is incredible and a differentiation from your competition" is critical to retailer success, according to Hermanns.
3. ***Emerging markets offer areas for innovation and increased market penetration.*** For example, the Hispanic sector is the fastest growing demographic in the country, expected to represent 30.2 percent of the U.S. population by 2050. Additionally, the epidemic levels of obesity in America continue to impact the food and beverage industry through an increased demand for healthy foods companies that support healthy lifestyles. Hermanns also advises companies to consider the Asian and Indian markets as well. "They are small in size but growing rapidly, especially in Southern California," Hermanns says. The Asian and Indian demographics present unique opportunities for new-market penetration for smaller companies, according to Hermanns. "The major chains have been able to nibble around the edges of these markets, but haven't been able to penetrate the true ethnic offering for those groups," he reports.

4. ***Consumers are demanding organic, natural, and local foods.*** Shoppers are more interested than ever about where their food comes from and are spending time reading food packages and researching food sources. The number of farmers markets has increased nearly 20 percent in the last year, demonstrating an expanded consumer desire in farm-to-table foods. Encouragingly, industry experts report that 53 percent of consumers are willing to pay more for local food. While a relationship with a local grower may offer a positive differentiation from competitors, Hermanns cautions that local growers may have less-stringent quality control measures than larger producers.
5. ***Portable foods satisfy busy consumers.*** Busy schedules mean that more meals are eaten away from home. Brands and products that offer portable, convenient, and single-serve packaging are in great demand. With the frequency of snacking up by 30 percent from just three years ago, consumers are increasingly depending on snack foods, especially healthy varieties. "Consumer product manufacturers have stepped up their offerings that appeals to the trend of portable foods," Hermanns says, "and retailers are now offering more grab-and-go selections as a result."
6. ***Social media offers cost-effective marketing options.*** Food and beverage executives are recognizing the significant impact that digital, social, and mobile technologies have on growth. Research shows that the industry's top-performing companies have an active and integrated social-media presence. While building brand recognition is the primary strategy, companies also use social media to build local communities, collect customer feedback, and solicit new product ideas. Hermanns agrees that social-media marketing efforts help "establish one-on-one connection with customers that you can't get through print, television, or radio marketing. However, he cautions companies have systems in place to address problems immediately. "Social media can be your best friend in terms of getting your message to consumers," he advises, "but it can also be your worst enemy if you don't handle it correctly and immediately." According to Hermanns, "the luxury of time" in the face of a problem "has vanished" as a result of social media.



KEY FINDINGS

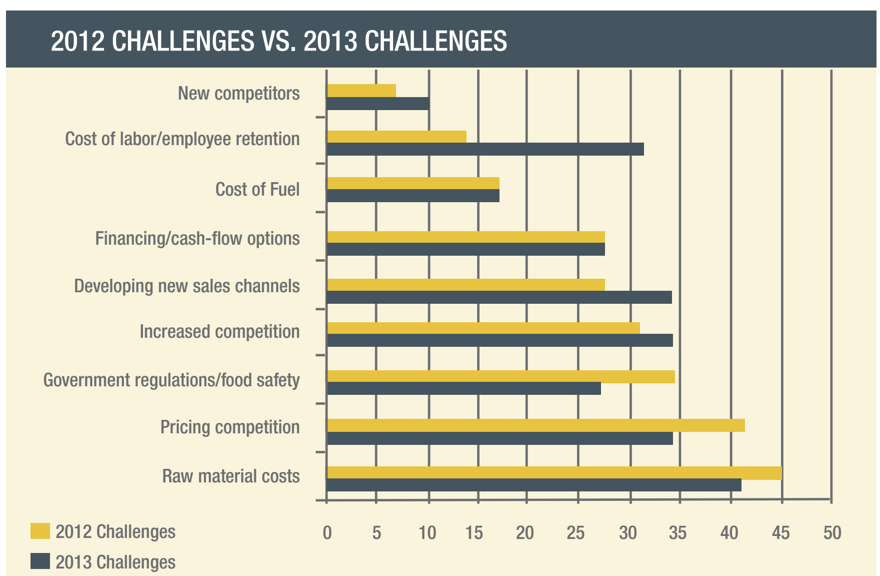
Companies continue to enjoy modest growth. Demonstrating the strength of the food and beverage industry, 85 percent of executives report increased sales between 2011 and 2012 with 88 percent anticipating continued increases in 2013. More than half (57.1 percent) of respondents indicated that sales were up by 10 percent in 2012 and the same number anticipates continued double-digit growth for 2013. While sales and revenues are on the rise, gross profit margins continue to be tight. More than half (55.5 percent) of executives saw gross profit margins stay the same or increase by less than 5 percent in 2012. Three-quarters anticipate the trend to continue in 2013. Hermanns warns that only those manufacturers and retailers who are innovating, creating opportunities, using all the tools at their disposal, and offering a differentiated message to their consumer will succeed. "If you don't have something specific and significant about your brand, you'll simply fall into the mix of all the companies offering the same thing you are," he says.

Workforces are expanding but concerns over the Patient Protection and Affordable Care Act (PPACA) may limit growth. Most executives (58.6 percent) reported increased headcount in 2012 and continued staffing increases in 2013. However, they are cautiously optimistic, planning to add fewer people in 2013 than they did in 2012. With 41.4 percent of companies reporting staffs of less than 25 full-time equivalent employees, more than half (52.2 percent) of respondents say they will keep employee numbers below 50 to avoid PPACA regulations. Most (56.5 percent) have plans in place to change benefits coverage to comply with PPACA requirements. Nearly 20 percent of executives are considering modifying work hours of part-time employees to meet safe-harbor rules and avoid full-time classification. DeMann admits that his company is concerned about the impact of PPACA. "Thankfully, the government has put PPACA compliance on the back burner for companies like ours," DeMann says, "however the Act will ultimately pose a financial stress on our company that we will, unfortunately, have to pass on to the consumer." DeMann also anticipates additional government regulation in coming years. "I believe that health-care costs are going to drive some political change against the food companies, requiring them to offer much more healthful foods."

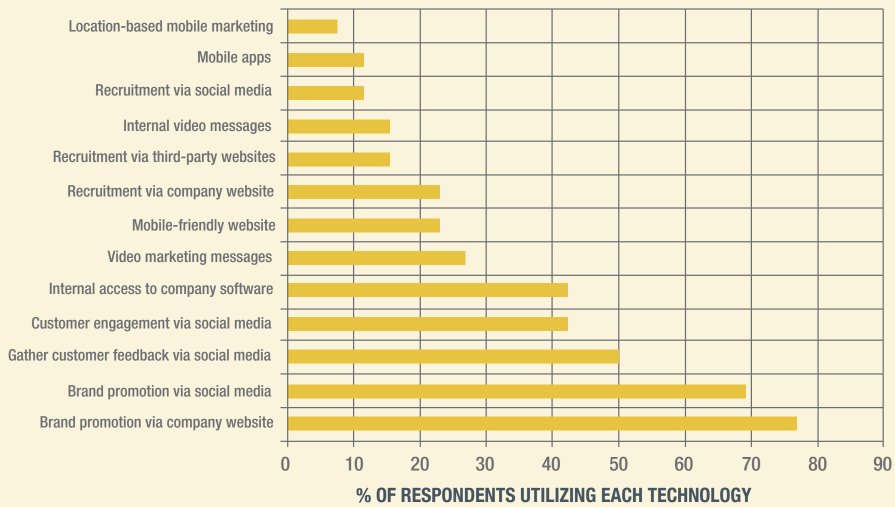
Expansion with existing customers and new products top revenue sources. More than 86 percent of executives report that revenue gain in 2012 stemmed from increased sales to current customers with that growth continued through 2013. Half of respondents cite new product offerings as a promising source of revenue. Executives continue to seek out new customers in their current marketplaces while seeking expansion in new market sectors. Hermanns agrees that maintaining a loyal customer base is critical to success. "When you lose a customer, the cost of getting that customer back is far more than it cost to get the customer in the first place," he says.

Raw-material costs continue to top list of challenges. Nearly half (44.8 percent) of executives cite the cost of raw materials as their greatest challenge for 2012 with similar numbers (41.4 percent) anticipating the trend to continue through 2013. Survey respondent Matt Kiene, President, of Homemade harvey, reports that because his products are essentially crop-based, raw-material costs will always be an area of concern. "I never really imagine a time when ingredient prices will go down," Kiene says, "but we do shift to larger commodities that are less price sensitive and less weather sensitive." While the climate can certainly affect the cost of certain ingredients, international exports, especially to China, can also drive up prices, according to DeMann.

Organic growth is a key initiative for 2013 and 2014. More than half (60.7 percent) of executives report that they will place a significant investment of energy, time, and resources into organic growth via new-product development, pricing strategies, and geographic expansion. Kiene reports that innovation and future growth will come via expansion within his current product offerings of pouch-packaged fresh fruit. "We'll stick with pouches," Kiene reports, "but plan to add products with additional functional benefits such as protein, chia, or calcium." Additional initiatives will include significant improvement in operational and financial processes, including related technology.



MARKETING TECHNOLOGY TRANSFORMING THE INDUSTRY



Merger and acquisition activity is expected to slow for the next five years. More than half (57.1 percent) of respondents do not anticipate acquiring another company or brand in the next five years. Nearly two-thirds (64.3 percent) do not anticipate the sale or merger or their company within the same timeframe.

Companies lack formal succession plans. Nearly one-third (31 percent) of the companies surveyed are family-owned business, and the same number plan to transfer the company to a family member or key employee. A striking number (35.7 percent) of respondents have no formal succession plan.

Technology is transforming the way companies operate. More than three-quarters (78.9 percent) of executives report that social media is having a significant impact on their businesses. Email campaigns and online shopping help companies drive revenue. In addition to developing a brand presence, 50 percent of companies are using social media to gather customer feedback and engage consumers. Corporate websites continue to dominate and executives are recognizing the importance of mobile-friendly pages. Kiene reports that social media and a website are Homemade harvey's only form of marketing promotion. Kiene reports that the company uses Google Analytics to "see who visited the website, when, where they are located, and how they came to us." Social media is a key tool in customer engagement, DeMann reports. "We use social media to try to create engagement of customers amongst themselves and also as a platform to ask us questions and provide suggestions," he says. For Freshology, a sales platform is critical to the bottom line. Also, "a sophisticated suite of data analytics evaluates website traffic, provides feedback about how and how often users use the website, and collects important information about our customers and prospects," DeMann says.

STRATEGIES FOR SUCCESS

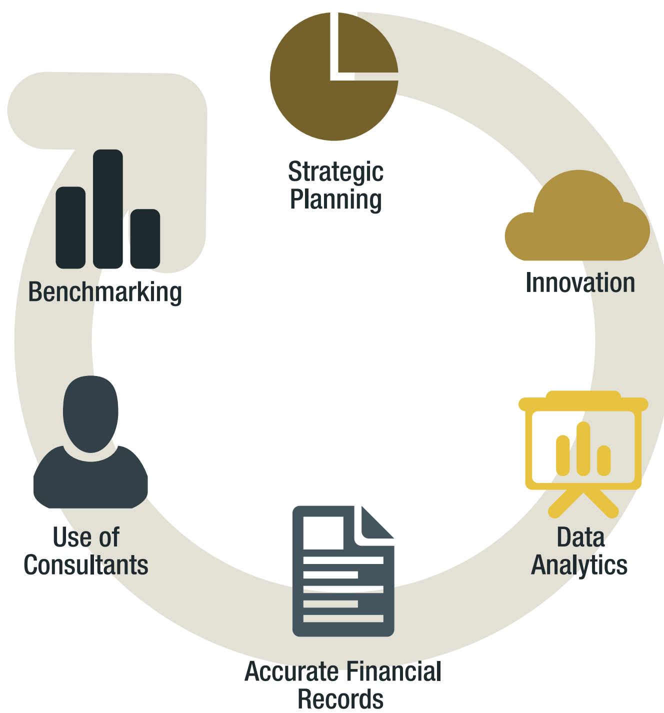
Companies that want to thrive in a struggling economy and beyond need to commit to four key strategies. While these strategies may require additional resources in terms of time and finances, companies can expect success when they: ***1) commit to planning for the future; 2) develop innovative products and services; 3) measure and monitor data; 4) carefully evaluate their finances; 5) obtain outside help when it is appropriate; 6) look to others within their industry to benchmark performance.***

1. **Strategic planning.** It is essential to create short-term (six months) and long-term (three to five years) plans. In addition to defining a company's purpose and vision, a strategic plan identifies specific corporate objectives and resources as they relate to the marketplace. While the specifics of a strategic plan may be dynamic, adjusted as situations change, the plan should address high-level initiatives that drive every division of the company. Plans should be reviewed regularly to ensure compliance and allow adjustments as needed.
2. **Innovation.** Increased competition and pinched profit margins are causing companies to be more innovative in areas of products, pricing, packaging, and promotion. The need to differentiate has never been greater. Innovation may take the form of improved quality, additional products, or more efficient manufacturing processes. In addition to tapping into growing or emerging markets, companies are recognizing the critical role that technology can play in innovation. Hermanns advises that smaller companies may find success by following the lead of other innovators who "put their toe

in the water first" and demonstrate a consumer demand for a new product. He also suggests that smaller producers should not be intimidated by competing against larger companies. "Smaller companies can offer a quality or differential" that bigger brands may not offer, according to Hermanns.

3. **Data analytics.** The food and beverage industry is entering an era of rapid technological development. Data analytics allows companies to increase productivity, improve decision-making, predict trends, and gain a competitive edge. Information may reveal that a particular product should be retired. Alternatively, data can demonstrate a need for expansion in a certain area. A strategic evaluation of data can reveal a goldmine of information about customers, suppliers, employees, finances, and the marketplace.
4. **Accurate financial records.** The 2012 survey revealed that the majority (73 percent) of executives prepared annual budgets or forecasts and nearly 90 percent reviewed financial statements on a monthly basis. However, incomplete or inaccurate financial statements can lead to decisions that may detrimentally affect the bottom line. In addition to providing critical operational information, accurate statements are essential for financing.
5. **Use consultants where appropriate.** The use of experts when and where appropriate can help organizations reach their goals. Technology consultants can aid in website development, social media integration, and data analytics. Marketing consultants can help develop strategies for branding and advertising. Logistical experts provide advice on operational issues including supply chain, distribution and warehousing. Financial consultants can assist with strategic planning, budgeting, risk management, financial reporting, and taxes. Additional information on government compliance, including PPACA requirements, will be essential to industry executives over the next year. Tax experts may provide cost-saving advice on maximizing tax credits for research and development as well as hiring from a variety of qualified groups.
6. **Benchmark against others.** Benchmarking enables companies to compare business processes and performance, recognizing best practices from success stories or failures. Benchmarking may take place during a seminar, conference or smaller peer-group gatherings. Information may also be garnered by reading trade periodicals. An open dialogue with competitors can help expose emerging trends, underserved markets. Areas benchmarked may include processes, finances, performance, products, strategy, and operations.

GREEN HASSON JANKS STRATEGIES FOR SUCCESS



SUMMARY AND CONCLUSION

Industry executives believe that the primary challenges for 2013 include the volatility of raw-material costs, increased competition including pricing, and the development of new sales channels. The marketplace continues to be plagued by a lack of consumer confidence in the struggling economy, limited availability of funding, and increased government regulation including Affordable Care Act initiatives. Unfortunately, food and beverage executives don't see an economic turnaround coming anytime before late 2014. Yet they are confident that sales will continue to grow at a modest rate. However, strategic planning and careful analysis will be essential to maximizing profit gain. While there is an emphasis on organic growth via new product development, pricing strategy, and geographic expansion, companies are also considering inorganic growth via acquisitions. Successful companies will be proactive with product development and strategic financial planning. They will also align with the appropriate professional services organizations to address wide-reaching challenges and financial goals.

[1] (http://www.imap.com/imap/media/article_documents/AnnualReport_Innenseiten_WEB_RZ_D2689417397E4.pdf)

About the Author

Donald J. Snyder is a partner at Green Hasson Janks and heads the firm's food and beverage division. Donald has more than 25 years experience in public accounting and chairs the firm's Accounting and Auditing Department, as well as the Quality Control Department. He provides audit, accounting and consulting service to clients in numerous industries, including manufacturing, wholesale/distribution, restaurant, food and beverage, nonprofit and technology. He is a well-known business consultant in the food distribution, food processing and manufacturing industries. A popular industry speaker, Donald also writes for the firm's quarterly Food Digest newsletter and hosts a number of food and beverage networking groups.

Donald is involved in assisting clients with designing and assessing their internal accounting controls and has been a frequent lecturer in this area. He has also written several articles on the subject of fraud prevention and detection in the work place.

Donald holds a Bachelor of Science degree in Administration with emphasis in Accounting from the University of Colorado. He is a member of the California Society of Certified Public Accountants and the American Institute of CPAs.

About Green Hasson Janks

Founded in 1953, Green Hasson Janks is one of the oldest independent accounting firms on the west side of Los Angeles. Ranked as a top-20 largest accounting firm on the Los Angeles Business Journal's Book of Lists, the firm has 13 partners and approximately 100 staff members that serve over 3,000 clients.

The firm is a member of the American Institute of Certified Public Accountants (AICPA), the AICPA Governmental Audit Quality Center (GAQC), the California Society of CPAs and the California Association of Nonprofits (CAN) and the Public Company Accounting Oversight Board (PCAOB).

Green Hasson Janks is also an independent member of HLB International, a worldwide organization of professional accounting firms and business advisors represented in over 100 countries. This affiliation provides access to the subject-matter experts of other member firms in most major cities around the world. Green Hasson Janks is the exclusive member firm of HLB in Los Angeles County.

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