INSIGHTS ON THE FOOD & BEVERAGE INDUSTRY IN 2023

The **Food & Beverage Roundtable** panel is produced by the L.A. Times B2B Publishing team in conjunction with Cathay Bank; Citrin Cooperman; Greenberg Glusker LLP; and GHJ.

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With the unprecedented operational changes that businesses in every sector have had to make over the last few years, a whole new landscape has emerged in the food and beverage sector in terms of social, cultural, environmental, financial, legal, employment, marketing and supply chain issues. Even the most seasoned industry pros have found themselves having to get creative to determine solutions over the past year.

Are the changes, protocols and best practices that have emerged trend-driven or here to stay? What should restaurants, manufacturers, distributors and vendors be focusing on in terms of new trends and standards?

To address these issues, as well as many other topics, the Los Angeles Times B2B Publishing team turned to four leading food and beverage industry experts for their thoughts and insights and to get their assessments regarding the current state of the industry and the various trends that they have been observing.

Q: AS A TRUSTED ADVISOR, WHAT ARE SOME OF THE KEY PIECES OF ADVICE YOU HAVE PROVIDED TO THE BUSINESSES YOU WORK WITH IN TERMS OF MANAGING SUPPLY CHAIN ISSUES IN THE CURRENT CLIMATE?

A: Fagan

Before making a significant change to your supply chain, make sure the decision is based on verifiable data which considers both intended and unintended consequences. Shipping prices and lead times continue to fall so, at this point, there may not be a need for a drastic pivot. However, if the data shows sourcing struggles into the foreseeable future, remember there are multiple ways to manage and improve supply chain efficiency. Some, like onshoring or reshoring, may have an appeal of something shiny and new – but buyer beware of the risk and complexity that come with them. Other changes, like relationship management (creating a true partnership with your supplier) and supply chain illumination via technology improvements, add incremental value with less risk.

> ***"Over the past few years, the industry has accepted, and in some cases embraced, the fact that more and more customers prefer to shop, buy and consume products at home instead of the traditional brick-and-mortar locations."***
>
> – Andrew Apfelberg

A: Pearman

A healthy supply chain means that all inputs are available when needed. Vendor relationships are important investments, and such relationships should be diversified to mitigate risk, just as an investor would diversify financial investments. Have multiple suppliers for inputs so there is not a disruption if one supplier has logistics issues. Think of the many port logistics challenges that we experienced during COVID. If a critical supplier is overseas, consider having a second relationship with a domestic supplier. Another example is the aluminum can shortage in 2021, in which some suppliers put limits on order sizes. Having good relationships with multiple vendors could reduce the impact of a shortage. Also, ensure adequate coverage in business interruption insurance. This can serve as the financial safety net if a company cannot get its product to market due to supply chain issues.

Q: WHAT CHANGES MADE DURING THE LAST FEW YEARS DO YOU THINK WILL REMAIN IN PLACE GOING FORWARD?

A: Apfelberg

Over the past few years the industry has accepted, and in some cases embraced, the fact that more and more customers prefer to shop, buy and consume products at home instead of the traditional brick-and-mortar locations. As a result, the approach to packaging, marketing and distribution needed to change. So did the legal advice we provided our clients. We had an increase in the review of packaging, websites and social media to guard against false claims and for compliance with "influencer" and similar laws, negotiation of third-party-logistics contracts, analysis of the legal requirements for direct distribution in multiple states and taking a fresh look at product warranties.

A: Haney

In addition to outdoor dining, I think we'll continue to see food home delivery from more sources – including alcohol delivery, a first that has been very popular – as well as the growing diversity of supply sources. Adversity certainly takes its toll, but it also breeds success and innovation.

A: Fagan

Food and beverage companies will continue to deliver their products in smaller units than they were accustomed to prior to the pandemic due to the hybrid work environment and shifts in consumer shopping habits that emerged. While food distribution will always have large retail outlets and restaurants, Amazon has forever changed food distribution. However, two elements may disrupt the popularity of the direct-to-consumer business model – inflation and environmental, social, and governance (ESG) concerns. We all know the most expensive part of a supply chain is the last mile, and it's getting more expensive with the current inflationary pressures. Environmental regulations and initiatives may also affect transportation in the future. Consumers constantly assess the price of convenience and, more recently, the price of a purchase with a low carbon footprint. Expect these factors, along with technology, to add some disruption to current methods.

Q: WHAT ARE SOME OF THE KEY CONSUMER TRENDS THAT FOOD AND BEVERAGE INDUSTRY ORGANIZATIONS CAN CAPITALIZE ON TODAY?

A: Pearman

There is a significant opportunity for any manufacturing operation – and food and beverage in particular – to leverage technology. This may come through automating the production line, collecting data about their consumers or changing the go-to-market strategy. The power of big data has yet to be harnessed by the food and beverage industry. I think industry organizations can play a key role in collecting and organizing this data and sharing it with companies within the industry – whether that be manufacturers, distributors, retailers or investors. Another key consumer trend is the desire to have on-demand home delivery of goods. Retailers are also increasingly wanting inventory on demand. There is a great opportunity for food distributors to innovate when and how products get to retailers.

Q: FROM YOUR PERSPECTIVE, HOW RESILIENT HAS THE FOOD & BEVERAGE INDUSTRY BEEN AFTER THREE YEARS OF THE COVID-19 PANDEMIC?

A: Haney

I think it's been incredibly resilient. Supply chain issues felt early in the pandemic have resulted in a more resilient supply chain. Another change has been for some restaurants to continue outdoor dining, which became quite popular during the pandemic. Many restaurants have begun to seek permanent rezoning to accommodate it. It never ceases to amaze me how resilient business owners are, regardless of the obstacles they face.

A: Fagan

Resilience is an appropriate word, in addition to agile and creative. Top performers were able to communicate changes to their customers efficiently, had leadership teams who took calculated risks based on timely data and started the pandemic with a strong balance sheet. Besides the requirements for COVID-19 safety measures and adapting to supply chain disruptions, manufacturers and distributors were forced to change their business models. The new at-home or hybrid work environment created an increase in demand for packaged and shelf-stable foods. Many food and beverage companies had their recurring customer bases eliminated due to COVID but pivoted to delivering products to new customers at smaller quantities with higher gross margins, offset by increased distribution costs. Lastly, innovations in the areas of plant-based functional foods have forced manufacturers to change production methods. Significant headwinds, including inflation and interest rates, will require more resilience in 2023.

> ***"In addition to food, the value proposition of a restaurant may be the experience, the convenience, the service, etc., in addition to serving good food."***
>
> – Jim Haney

Q: WHAT ARE SOME OF THE HOTTEST TRENDS IN THE RESTAURANT SPACE?

A: Apfelberg

Where previously people wanted colorful food that looked great on an Instagram post, now they want an "experience" when they eat out. They want an environment that transports them to another place and time or makes them feel "cool." They want to be able to get into a place that all of their friends still long to go. Chefs are now celebrities and interaction with them is a big deal. The ultimate for me, though, is the "pop up" by a renowned chef within a beloved restaurant or a "smash up" where two chefs or two restaurants collaborate on dishes for a limited amount of time. One restaurant held monthly wine dinners with a 'meet the maker' event.

Q: IN TIMES OF GLOBAL STRIFE, HOW HAVE ISSUES SUCH AS THE CONFLICT IN UKRAINE AFFECTED THE FOOD AND BEVERAGE INDUSTRY?

A: Haney

It can have a significant effect over time. Although Ukraine is a major breadbasket, it produces less than 5% of the world's wheat, so in time, there should be enough capacity to make up for shortages now. What is extremely unfortunate is that it might take several crop cycles for supply and supply chains to adjust to where the need is.

Q: WHAT IMPACT IS THE EMERGING FOCUS ON DIVERSITY AND INCLUSION HAVING ON THE INDUSTRY?

A: Pearman

Today, there are more platforms to promote emerging brands that are owned by minorities. This comes in the form of incubator groups, grants and promotional highlights because the topic of diversity, equity, inclusion and accessibility (DEIA) has greater awareness across most media outlets. The rising tide of DEIA is lifting the boats of minority-owned food and beverage companies.

Q: WHAT ARE CONSUMERS SEEKING FROM FOOD & BEVERAGE COMPANIES TODAY?

A: Fagan

Overall, consumers are seeking products which are healthy, convenient, sustainable, transparent, and personalized. The forthcoming 2023 Citrin Cooperman Pulse Survey revealed that product availability and range of product offerings are most important to customers, followed by customer service, and lastly pricing. A positive consumer experience includes best-in-class e-commerce solutions which are user-friendly and offer products that are tailored to their specific needs and preferences. Consumers are increasingly looking for healthier food and beverage products that are low in sugar, fat, and calories, as well as those that are organic, gluten-free, and free from artificial ingredients. This includes products sold in smaller units which are pre-packaged, pre-cooked, or ready-to-eat. Finally, consumers want to feel good about their choices and often seek products that are produced with minimal waste and have a low carbon footprint.

Q: WHAT'S THE GREATEST OPPORTUNITY YOU'RE CURRENTLY SEEING FOR THE INDUSTRY?

A: Haney

An unfortunate situation is that when some businesses don't survive tough times, it creates opportunities for others to step into the void that was left. I see this happening particularly in the restaurant sector and among businesses seeking to exploit niche markets to a greater degree.

A: Pearman

There is a major opportunity for companies selling liquid products to innovate their delivery to the consumer. Many beverages could be repackaged so that it is sold to the consumer in a concentrated form – some type of pod (such as Keurig-type coffee pods). The consumer then combines the concentrate with water and makes an instant beverage. The advantage to the producer is reduced cost; they now are significantly cutting back on water, packaging, carbon dioxide and freight. This also puts the onus on the consumer to source their own expensive materials (water and CO_2), which will become more of an issue as resources continue to become scarce in certain geographical areas. Additionally, this shift would drastically reduce single-use plastics.

> ***"The new at-home or hybrid work environment created an increase in demand for packaged and shelf-stable foods."***
>
> – Mark Fagan

Q: WHAT ARE SOME OF THE BIGGEST MISTAKES THAT FOOD AND BEVERAGE COMPANIES MADE DURING THE LAST FEW YEARS?

A: Apfelberg

The biggest mistake made was getting so immersed in the day-to-day operations that companies lost focus on their current business plan and future goals, thus failing to take steps to best position themselves for the years to come. This was necessary during peak COVID times; survival was all that mattered. However, we are now on the tail end of that, and the changes it brought to what, how and where items are consumed are here to stay. I strongly recommend companies work "on the business" instead of "in the business" and convene a team of trusted advisors to provide their perspectives and guidance. Start the discussion with a description of where you want to be in three to five years so the target is clear. Then utilize all of the brainpower in the room to determine the optimal way or ways to get there.

Q: HOW HAS THE INDUSTRY'S APPROACH TO PACKAGING CHANGED IN THE LAST DECADE?

A: Haney

We're seeing a growing shift to biodegradable, environmentally friendly packaging due to consumer demand, especially in California. Styrofoam – which does a great job of preserving freshness but can be devastating to the environment – is significantly down. There has been a move away from plastic, and the two alternative options have significant drawbacks: Glass is more expensive and heavier (not to mention breakable), and aluminum cans take a lot of energy to make, and some people – including me – don't think food in them tastes as good. Plastic bag use has also come under fire. However, unlike paper bags, they provide a moisture barrier and are more sanitary than multi-use bags.

Q: ARE THERE ACCOUNTING AND TAX-RELATED ISSUES THAT BUSINESSES MAY BE OVERLOOKING?

A: Fagan

Twenty years of low-interest rates have caused companies to become lax with their cash cycle and levels of working capital. Rising interest rates, inflation, and supply chain issues have increased working capital for most companies. In addition, increases in the cash cycle (the number of days between paying for the procurement of inventory and collection of cash from customer sales) have forced companies to increase their borrowings at a time when borrowing money is at its highest level in 20 years. Recent tax legislation has limited the amount of interest expense a company can deduct. These factors make it necessary for CFOs to take a hard look at cost management accounting and the finance portion of their operations for cash leakage. Between inflation, interest rates, increased effective tax rates, and supply chain disruptions, companies may see profit erosion in 2023.

Q: HOW IS THE INVESTMENT CLIMATE TODAY FOR FOOD & BEVERAGE COMPANIES WANTING TO RAISE CAPITAL OR ATTRACT INVESTORS?

A: Haney

In relative terms, given the state of the economy, it's very strong – since food is largely recession-resistant. People always have to eat. There is plenty of capital, and money is pretty abundant for food products that have mass appeal, are affordable, and fall into the "flavor of the day" category, being attractive in terms of health benefits, convenience, and/or taste. The restaurant sector is a different animal because restaurants can be trendy, and a restaurant's value proposition is usually more than just the food it serves. In addition to food, the value proposition of a restaurant may be the experience, the convenience, the service, etc., in addition to serving good food.

A: Apfelberg

There is no question that the market for financing and acquisitions has tightened or slowed. This makes obtaining growth capital or achieving a liquidity event for a business more difficult than in the past. To be able to achieve that, companies need to have products with an almost cult-like following, an experienced management team, a clearly articulated growth strategy and identifiable, concrete steps to achieve their business plan. There is a noticeable "flight to quality" when deals get evaluated. Companies need to do whatever it takes to put themselves into that category. We are seeing an increase in transactions for less than 50% of a company so that the founders/early investors can have a "second bite at the apple" in a few years when multiples and other deal terms are more seller-favorable. Transactions are also much more highly structured or complex than in the past. It is critical to understand the "real life" impact of all of this and "stress test" it under varying potential economic and operational future circumstances.

A: Pearman

The investment climate is active, but it is not as hot as it was in 2021 or the first half of 2022. Macroeconomic conditions are felt in the industry: Higher interest rates lead to a contraction of cash or a tightening of the belt, and indications of a recession lead to cold feet from investors. However, there is still a good deal of flow in the sector. Emerging companies continue to drive disruption in food and beverage, and investors take notice. Many of my food and beverage clients are successfully closing capital raises. These years are important building years for emerging companies. Series A or B rounds will be closed, and companies will continue to build momentum and demonstrate solid performance in the market, which will tee them up for a transaction as we enter a more expansive phase of our economic cycle.

Q: WHAT ARE THE PROS AND CONS OF BEING BASED IN LOS ANGELES IN 2023?

A: Apfelberg

Let me start out by saying that the pros outweigh the cons. Some of the negatives include higher costs for employees and real estate as well as increased health and safety regulations as compared to companies located elsewhere. Being in a big city, there is also more competition, especially when first starting out and trying to find distribution and retail opportunities. Some of the positives, though, are the more open and accepting attitudes, willingness to try new things and diverse tastes to accompany diverse backgrounds and lifestyles. Los Angeles attracts creative people who are willing to take risks. There is also the "Hollywood" factor that can be a huge opportunity to building brand awareness and loyalty.

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>
> – Maria Pearman

A: Haney

I see mostly pros. In my opinion, L.A. is the most vibrant business community on the planet. It would rank as the 10th largest economy in the world by itself. If you need it, you can get it here. Restaurant trends are set here, and given our diverse population, L.A. is a microcosm of the world where you can find any type of food. Many suppliers are here because importing is supported by our location next to the West Coast's largest port and close proximity to farmers, dairies, and ranches. We also have a more creative base of workers than most other places. The cons I can see are the travel distances since the city is so spread out, the cost of living is high, and the regulatory environment can be challenging in Los Angeles.

Q: WHAT KEEPS FOOD AND BEVERAGE MANUFACTURERS AND DISTRIBUTORS UP AT NIGHT?

A: Pearman

Access to labor continues to be a major concern. Hiring is still very challenging today. Compressed margins continue to linger and present further challenges. During the pandemic, costs of direct inputs soared, and prices could not increase enough to preserve margins. Costs are coming down, but margins are not where they were pre-pandemic. Many food and beverage companies have great top-line performance, but they still struggle to make ends meet. Leaders are looking for innovative ways to drive efficiency in their operating expenses.

A: Fagan

Respondents from the forthcoming 2023 Citrin Cooperman Pulse Survey report that supply chain disruption, rising inflation, and interest rates are the top issues of concern. Following closely behind is the worry that their employees do not have the appropriate technology skills to maximize the current software being run by their enterprise resource planning (ERP) system. Besides the factors that were at least partially caused by COVID-19, the Fourth Industrial Revolution continues in the food and beverage industry. Artificial intelligence (AI) and machine learning (ML) continue to revolutionize the industry. Algorithms are advancing beyond predictive maintenance and quality control. Manufacturers with heavy assets and complex production apply AI to reduce their reliance on experience, intuition, and judgment. Since variations in operators' qualifications can affect efficiency, AI's ability to preserve, improve, and standardize knowledge has become a game changer.

Q: LOOKING TO THE FUTURE, HOW DO YOU SEE THE INDUSTRY EVOLVING OVER THE NEXT FIVE YEARS?

A: Pearman

Categories that have been stagnant for years are being revitalized by innovative new brands. Companies are bringing life and zest to canned food and other pantry staples with new flavor profiles and formulations. Who would have imagined that canned beans could be exciting? Some companies have introduced contemporary flavors, high quality, and attractive branding to an aisle of the grocery store that has been stagnant for decades. Emerging food and beverage companies will continue to find pockets of the market that sorely need innovation, which will drive continued acquisition and disruption of sleeper categories.

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