SCOTLAND OF FOOD & DRINK

INDUSTRY PERFORMANCE REVIEW

2017

THE SCOTLAND FOOD & DRINK PARTNERSHIP

CONTENTS

INTRODUCTION

Past, Present, Future

Scotland Food & Drink (SF&D) is the industry leadership organisation tasked with growing the value of the whole industry and building Scotland's reputation as a Land of Food and Drink.

This Industry Performance Review analyses the progress we have made since 2007 when the first strategy, generated by the industry partnership, under the leadership of Scotland Food & Drink, commenced.

In spring 2017, a new industry strategy, with a vision until 2030, will be launched and this report will serve as an ongoing touchstone of our development.

To gauge past performance, we have used the latest official public data to evaluate historic growth against our targets and key performance indicators (KPIs), covering turnover, productivity, research and development (R&D) and exports. Whilst this data is key to tracking our long-term progress its method of collection means it can only take us to 2014 results or 2015 in the case of exports.

Given the pace of change in the UK retail and foodservice markets and the speed at which geopolitical events can unfold we have included two other measures to provide us with more immediate and actionable understanding.

First, industry partners have given us insight into the present and future challenges and opportunities within their sectors, using the extensive knowledge and feedback gleaned from their own members.

In addition, SF&D has undertaken its second annual Business Barometer Survey, conducted within the industry at the start of 2017. This is designed to look into the near future and reflect the confidence levels and investment forecasts of businesses, vital indicators in uncertain times.

Chairman & Chief Executive's view

David Kilshaw
Chairman

James Withers
Chief Executive

By any measurement, events of the last 12 months have been unpredictable. Brexit represents a seismic shift whilst events across the Atlantic have proved just as hard to predict. The old cliché that 'the only constant in life is change' has rarely seemed so apt. So, where does this leave Scotland's food and drink sector as we look back upon another 12 months?

This document gives me real heart about where we are as an industry. A record turnover of £14.4bn has food and drink positioned as the most successful sector of Scotland's economy over recent years. We are in the midst of transforming our sector into one which has a reputation of world renown, is strong locally but increasingly international, is founded upon heritage and provenance but which is embracing innovation.

The success of recent years does not diminish the challenges we face. The last year has seen greater volatility in exchange rates, putting exporters in a more competitive position but driving up our cost base. A furiously competitive home market and inevitable changes to international trade rules mean that we must work on short term challenges as well as the long term opportunity.

Yet, we should move into the next 12 months with confidence in our ability to adapt to whatever opportunities or challenges come our way. An increasingly unpredictable world is no reason to batten down the hatches; rather we should be more ambitious, innovative and collaborative than ever.

Our second Industry Performance Review says a lot about how the industry has performed. Less obvious is the story of why we are seeing such progress. This document is another product of the collaborative partnership that now exists within our industry. The views from each of our major sectors within this document form part of a wider story; a single food and drink industry, comprising individual sectoral strength, but collectively building Scotland's reputation as a Land of Food and Drink.

Our partners across Scotland's public sector landscape – from enterprise and skills agencies to Cabinet Secretaries themselves – have backed the collaborative leadership the industry has shown. Yet, whilst our culture is now defined by collaboration, it needs to be furthered deepened.

The Scotland Food & Drink Partnership has now articulated a new vision; establishing a roadmap to 2030. It is as much about how we work as where the market development priorities and capability-building focus lie. If we want Scotland to be the best place in the world to run a food and drink business – to build on the progress set out in this document and address the challenges too – we need to simplify and streamline the support landscape for businesses. That will be a key focus for us as we take a new 2030 strategy forward; to work better and smarter to support business growth.

Thank you for your support and efforts over the last year and here's to a new, exciting chapter in Scotland's food and drink story.

PAST

Industry Progress 2007-2015

Turnover

2014

Turnover for the Scottish food & drink industry stood at £14.4bn in 2014, up from £14.3bn in 2013.

Turnover for the Scottish food and drink industry stood at £14.4bn in 2014, up from £14.3bn in 2013, an increase of just under 1%. Since 2007 (the start of the Industry Strategy) turnover has risen 44%.

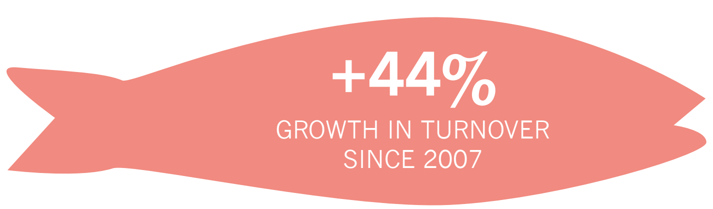
Scotch Whisky has enjoyed strong global growth over the last decade, with total value of exports up 74% since 2004 and Single Malt up 159%. But the Scotch Whisky Association reported challenges in several markets in 2014 with the volume of exports also down slightly by 3% to 1.19bn 70cl bottles. The overall picture, following several years of record-breaking growth, was consolidation in many developed markets and underlying strong growth in most emerging markets. Political volatility affected this picture in places and some fluctuations were driven by changes in stock levels rather than by underlying consumer demand. Weaker economic conditions and political volatility in some markets saw the value of Scotch Whisky exports decline 7% to £3.95bn in 2014 from £4.26bn the previous year.

For Scotland's farmers, 2014 proved to be the biggest cereal harvest ever. Unfortunately, cereal prices were dropping worldwide, as were potato and milk prices, hitting the profitability of farms. The decrease in 2014 income relative to 2013 was linked to lower prices, particularly in cereals, which outweighed changes in volumes.

Scottish livestock producers benefited from lower input costs, increased productivity and better weather conditions in 2014. However, farmgate prices for cattle and pigs averaged significantly lower than in 2013 while sheep prices trailed the prior year's levels through much of the key selling period.

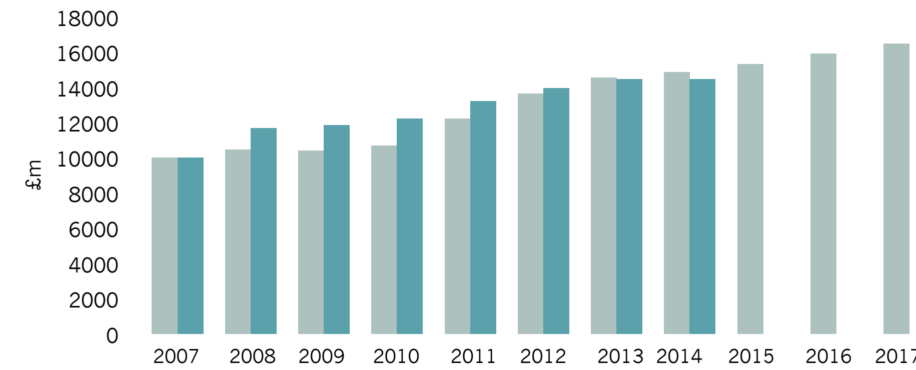
In the processing sector, Scotland's companies benefited from lower raw material prices, having felt a significant squeeze on their margins in 2013. Despite the continued recovery of the British economy, consumption of prime cuts of red meat slipped back.

In aquaculture, the estimated farmgate value of all finfish was £733.4m in 2014, an increase of 6% compared to the previous 12 months. Scottish Salmon exports rose by almost 10% in 2014, to a value close to £500m. The USA remained the top export destination with almost £215m worth of sales, followed by France which grew to near £110m. Exports continued to rise in Far East destinations with significant opportunities from Malaysia and Singapore. Sales to China proved most impressive, growing from virtually nothing in 2010 to almost £65m.



Turnover (£m)

KPI Measurement: 2007 to date

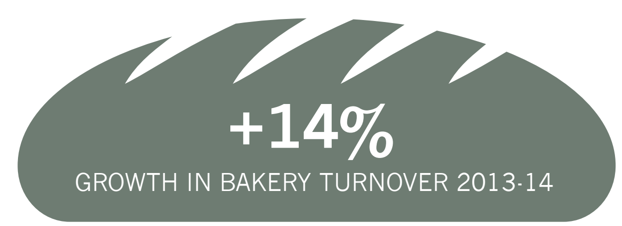


Source: Scottish Annual Business Survey 2014 and Economic Report on Scottish Agriculture 2016

Target Actual

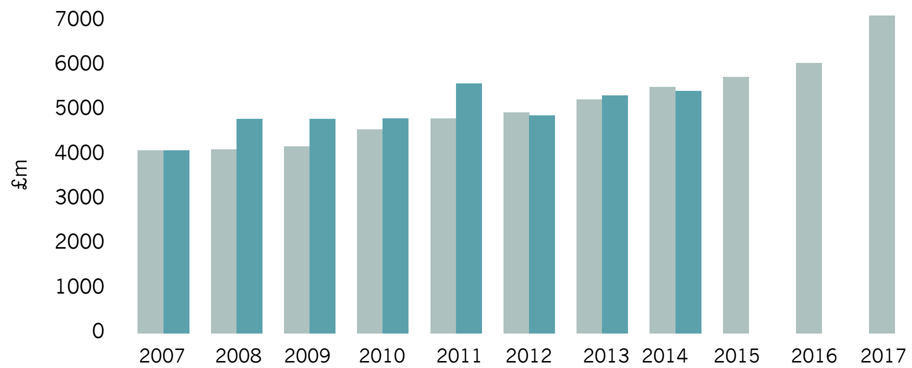
Bakery turnover recovered from a slight decrease in 2013 to end 2014, up 14% year-on-year, with the traditional UK sales channel being complemented by the newly formed Scottish Bakers' Export Group.

Whilst the UK foodservice market rose almost 3% in value sales in 2014 November of that same year saw UK grocery retail sales decline for the first time in at least 20 years as a raging price war and the falling cost of food commodities hit Britain's supermarkets; a deterioration that has only been reversed in late 2016.



Gross Value Added

KPI Measurement: 2007 to date



Source: Scottish Annual Business Survey 2014

Target Actual

In 2014 food and drink made the largest contribution to Scotland's manufacturing GVA, as it has done since 2008.

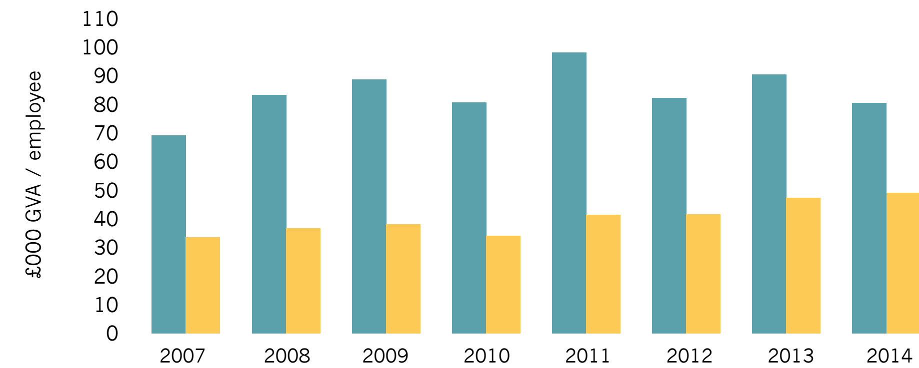
Gross Value Added (GVA) provides a measure for the wealth being generated by the sector and its relative value to Scotland's economy, calculated by the value of the output less the value of inputs used in the production process.

GVA in the food and drink growth sector stood at £5.3bn in 2014, up by 5.1% year-on-year on the consolidated 2013 total. Food and drink were the largest contributors to GVA within Scottish manufacturing, with beverages delivering 15% and food 12%.

The increase in food GVA of 13% compensated for the slight drop in distilled beverages. The sub-sectors driving growth were dairy, up 28%, seafood processing at +20% and in beverages the soft drinks and mineral waters sub-sector also returned a 20% increase.

Productivity

KPI Measurement: 2007 to date



Source: Scottish Annual Business Survey 2014

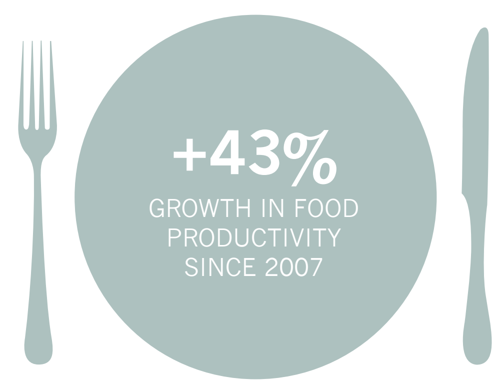
Food and Drink Food only

Generating year-on-year productivity gains is vital to creating increased profitability.

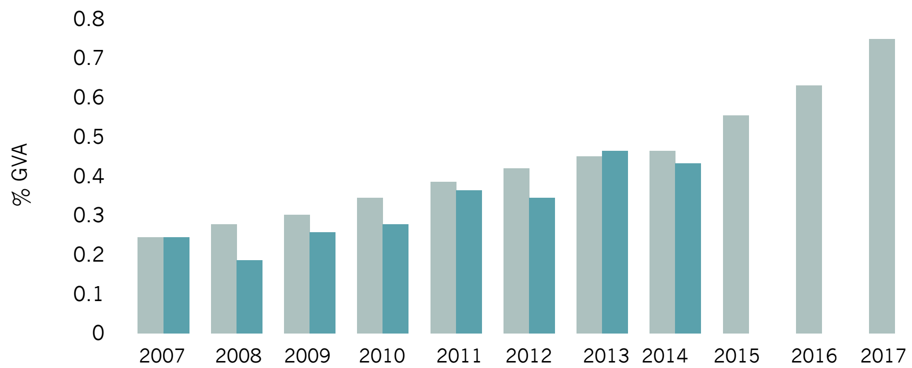
Productivity (measured as £000 GVA/employee) slipped by 12% in the drinks manufacturing sector as Scotch Whisky producers invested in site expansion, reopening mothballed facilities and building new distilleries.

Food manufacturing productivity, on the other hand, increased 5% year-on-year, continuing its steady improvement from 2010, growing 43% above its 2007 level.

Input costs for certain sectors decreased in 2014. Growing concern over a slowdown in the Euro Area and emerging economies, a strong US dollar, a well-supplied oil market and good crop prospects contributed to a weakening of many commodity prices; maize values slumped by around 27% while rice and wheat prices fell 16% and 9% respectively.



Research & Development Spend



Source: ONS, BERD 2014

Target Actual

As competition from elsewhere becomes ever stronger so does our requirement to innovate.

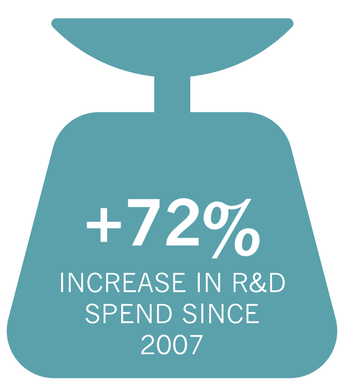
Research and development spend reduced 6% year-on-year, slightly behind target for 2014, but +72% since the start of the current industry strategy in 2007. Initiatives such as the Scottish Aquaculture Innovation Centre and the continued progress of Scottish businesses in creating allergen-free products, from bakery to brewing, is allowing the industry to make further headway towards our stretched 2017 target.

Notes on Industry Progress Data

Turnover and GVA are taken from the annual UK-wide Business Survey (Office of National Statistics) with a boosted Scottish sample to improve the robustness of the Scottish data and published as the Scottish Annual Business Survey (SABS).

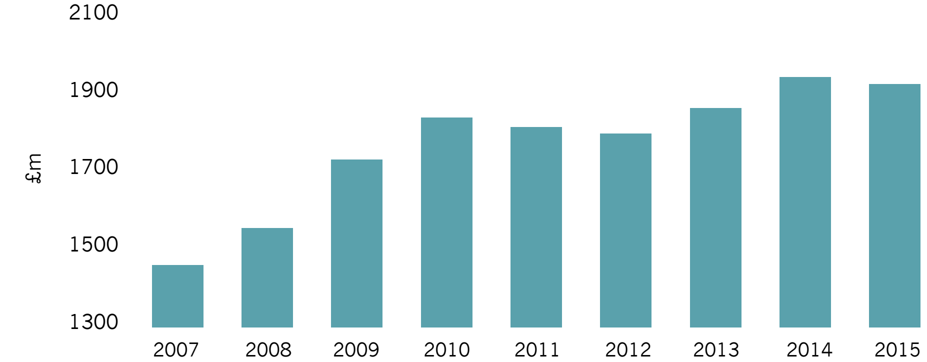
Figures for agriculture are taken from the Economic Report on Scottish Agriculture 2015.

The targets referred to in the commentary were set in the Scotland Food & Drink Industry Strategy Refresh.



UK Market

Estimated Value, Retail Sales, Scottish Food and Drink Brands in UK 2007-15



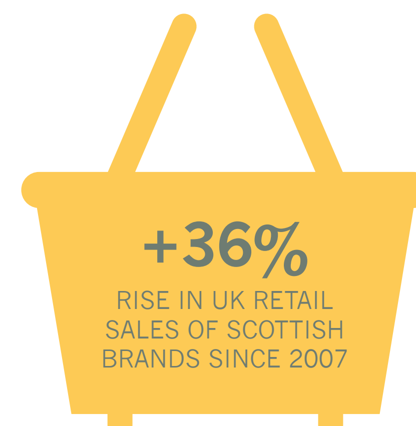
Source: Kantar Worldpanel 2016

In 2014-15 the UK retail market saw a period of record low grocery inflation and fierce supermarket price competition.

As the discount retailers continued to open more stores and win more market share their bigger rivals responded by cutting prices and slashing lesser performing lines from their ranges.

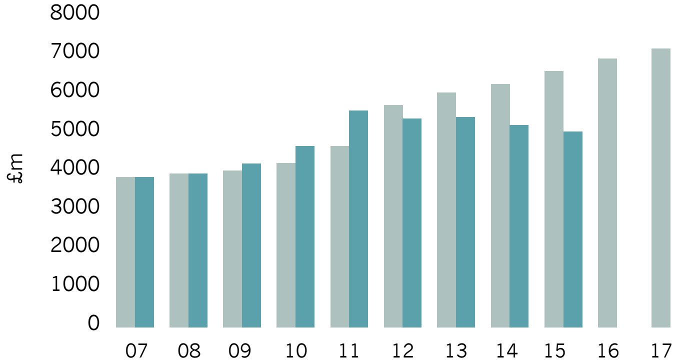
Despite this turbulence, retail sales of Scottish food and drink brands (as captured by Kantar Worldpanel data) in the UK remained around £1.9bn, down marginally from the previous year, but up 36% from 2007. The fall in value was driven by sales declines of a number of top drinks brands competing against some heavy promotions and new ranges from rivals. Retail sales of Scottish food and drink brands in Scotland still account for a larger share (5.5%) of total grocery sales relative to UK (1.8%), a result of wider availability and preference among shoppers in Scotland (source SF&D).

Total spend in the UK Out-of-Home market grew 2.6% in 2015 with total visits up 1.3% to 11.2bn (source MCA). According to the CGA Outlet Index the Scottish hospitality market saw around 500 more food-led openings than closures in 2015 but Scotland is still dominated by drink-led sites; only London and Manchester have more licensed venues than Edinburgh or Glasgow.



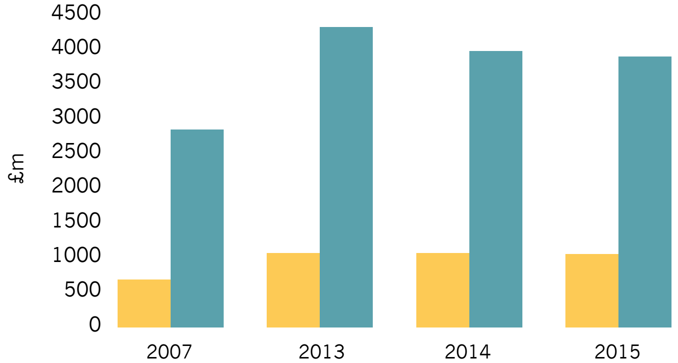
Overseas Exports

Total Food & Drink Exports
KPI Measurement: 2007 to date



Source: HMRC 2016 Target Actual

Exports: Food Vs Drink



Source: HMRC 2016 Food Drink

Food exports again topped the £1bn mark set in 2013.

Overseas food and drink exports from Scotland were valued at £4.9bn, a decline of 3.9%, compared to 2014 and a rise of 31% (£1.2bn) from 2007. Food exports were down marginally from 2014 but again topped the £1bn mark set in 2013.

Scotch Whisky has enjoyed strong global growth over the last decade, with total value of exports up 74% since 2004 and Single Malt up 159%. However, in 2015, exports of Scotch Whisky were valued at £3.9bn, down 2.6% from the previous year. The SWA reported challenges in several markets in 2015 most notably those countries whose economies are driven by oil and other commodities. The slowdown in these economies, for example Brazil, Russia, and some African countries, saw a knock-on effect on Scotch exports.

Overall, the story of Scotch Whisky exports has been the achievement of more value for the same volume, i.e. towards premiumisation. This has been generated through an increased emphasis on, and attractiveness of, single malts and premium blends, as well as additional penetration within regions and markets. The EU is the dominant region for blended Scotch exports (38% by volume, 28% by value). In North America, the value of bottled blend continued to increase, as part of general premiumisation in those markets and the region now accounts for 24% of the total bottled blended value, increasing from 18% in 2011.

In 2015, the main destination for the majority of Single Malt remained the EU (42% by volume, 40% by value). However, EU market share has eroded from around 50% in 2011-12 as North American countries continue the trend for higher volumes of Single Malt.

The largest share of food exports remained with fish and seafood, with international sales dipping 12% year-on-year to £549m. 2015 proved a challenging year for exporters of Farmed Scottish Salmon with exchange rates denting sales values as competitor countries benefited from lower currency values and the glut of salmon on the international markets due to the Russian trade embargo.

PRESENT

A view from the sectors

Scotch Whisky Association

Julie Hesketh-Laird
Acting Chief Executive

Confidence in the future is reflected in the unprecedented level of investment in the Scotch Whisky industry.

The Scotch Whisky industry is feeling positive about the future, with all the signs pointing to continued expansion and a growth in exports, despite the uncertainty and challenges heralded by Brexit.

Scotch Whisky leads the way for the country's food and drink products in overseas markets. We expect demand for our iconic product to increase and we're keen to help other sectors grow their overseas success, for example through our Export Collaboration initiative with Scotland Food & Drink.

Exports of Scotch are starting to grow again after a few years of slowdown caused by economic and political headwinds in some markets. The volume of Scotch exported in the first half of last year was up by just over 3 per cent to the equivalent of 533m 70cl bottles compared to the same period in 2015. While the value of shipments was down slightly by just 1% over the same period to £1.7bn, this drop was much smaller than the decline in value of almost 3% in the first six months of last year.

Turning to Brexit, we're determined to grasp the opportunities, as well as deal with the many challenges this seismic change brings. Scotch will continue to enjoy a 0% tariff in the EU because of World Trade Organisation rules, for example. This will also be the case in certain other major markets, such as the USA.

However, we will need to work with government to secure as open a trade policy as possible in the future, first securing existing EU trade deal benefits, such as reduced tariffs, and then developing an ambitious agenda of new Free Trade Agreements. There will also be work to secure robust legal protection for Scotch Whisky at home and abroad, as well as scope out opportunities where a different UK approach to post-Brexit might better support industry.

Confidence in the future is also reflected in the unprecedented level of investment in the Scotch Whisky industry. There has been record expansion, with 14 distilleries starting production since 2013 and a further eight set to open this year. There are currently up to 40 new distilleries at various stages of planning and development across Scotland from the Borders to Glasgow and Edinburgh to areas clearly associated with whisky distilling, such as Islay and Speyside. We recently signed a Memorandum of Understanding with the Scottish Craft Distillers Association to work in partnership to support the continued success of companies of all sizes in the Scotch Whisky industry and across its supply chain.

As well as new entrants to the industry, existing players have been expanding their sites, for example by increasing distilling capacity to meet demand, upgrading visitor centres or building more maturation warehouses.
An industry of strategic importance to the economy, Scotch Whisky is our global drink. So, let's raise a dram to a bright future.

Seafood Scotland

Iain MacSween
Chairman

With a sustained period of recovery in economic markets, retail sales in seafood have begun to rise.

Seafood remains one of the key food categories in Scotland, growing in importance in both the UK and international markets. It is now exported to over 100 countries across the globe and around £1bn, 540,000 tonnes, of seafood is landed each year.

We continue to export a significant share of the seafood caught in Scottish waters, with figures estimating that around 80% is consumed outwith the UK. The diversity of demand from international markets guarantees that continued supply routes are available for the varied species that we land.

We also maintain a strong presence in local markets, within Scotland and the wider UK. In July 2016, Seafood Scotland, along with delivery partners, was awarded the contract to provide Scotland's advisory service for local food and drink marketing – Connect Local. This contract has secured a dedicated resource to work on with seafood businesses on marketing, business development and supply chain initiatives to ensure they get the best deal for their products in their home markets.

With a sustained period of recovery in economic markets, retail sales in seafood have begun to rise and consumers are choosing to add seafood to their shopping baskets again.

In foodservice, local sourcing has made a big impact and is being increasingly sought by consumers. We are working closely with chefs the length and breadth of the country to promote the quality and diversity of Scottish seafood on their menus.

Our fish farmers and skippers continue to strive for sustainability and traceability of the catch, and are passionate about protecting marine life and future stocks. This is starting to pay dividends in the quality and volumes of fish being caught.

EU quotas have now been increased for cod, hake, whiting and monkfish which has been welcomed by the catching sector. Scottish Government figures on the overall quota increases (16 out of 23 key stocks) amounted to around a £40m boost to the industry.

The most seismic change for the future is the decision to leave the European Union, which for seafood, will affect the general business climate, how our fisheries are governed, production methods, labour and trade tariffs and public funds. The decision by the UK Government to leave the single market means the UK leaving the Common Fisheries Policy and the UK establishing responsibility for the waters under UK jurisdiction.

The mood is optimistic amongst the catching sector following the vote to leave, with a strong belief that the UK will regain control over quotas and fishing rights. There are, however, mixed opinions as to how this will impact on the processing sector and how it will shape existing and upcoming trade deals for Scottish seafood in the future.

The Scottish seafood industry is both resilient and innovative and I am confident that as we move into a new year we can prepare for, and adapt, to the prospects that lie ahead.

Scottish Salmon Producers' Organisation

Scott Landsburgh
Chief Executive

Capital investment by industry continues to be significant, increasing by 16% to £63.1m in 2015.

Scotland's salmon farming industry is buoyant, bringing economic prosperity and social benefits to many parts of rural Scotland. Driven by salmon's position as the UK's favourite fish, and voted as one of Britain's most liked foods, health-conscious consumers are seeking out salmon for its delicious, nutritious and sustainable qualities.

Further afield, salmon was once again sought after in many export markets, winning it the title of Scotland's number one food export for another consecutive year.

Capital investment by industry continues to be significant, increasing by 16% to £63.1m in 2015 demonstrating that Scottish salmon farming's commitment to growth and development is strong and clearly indicating a vote of confidence in the long-term sustainability of the sector.

The launch of the industry's Community Engagement Charter in September received a very warm and welcome response from local and national politicians.

The Charter promotes the ongoing commitment of Scottish salmon producers to the communities where they farm. It highlights the deep-rooted connections developed over the last 40 years and the benefits resulting from wider community engagement.

People are the foundation of salmon farming and the industry provides a diverse range of careers, backed up by qualifications and training. 91 young people undertook Modern Apprenticeships or National Progression Awards in 2015 and the launch of Scottish Vocational Qualification Level 4 Aquaculture Management in 2016 will bring even more opportunities for those keen to progress their careers and for new entrants to the industry.

The number of full-time positions grew by 21, with 93% of all positions in the industry now within this category. Employee pay also grew by 12% last year to £71m with almost 90% going to rural Scotland, a significant income for remote communities.

The publication of the Vision 2030 report in October endorsed a positive future for the sector and highlighted the key challenges to growth which the industry has been working hard to address during the past decade.

The report recommendation for a new Industry Leadership Group (ILG) will bring an additional voice to the growing demands to see aquaculture fully recognised as a strategic part of the Scottish economy.

Planning and consenting reform is vital for the future of the industry and is an area the ILG will focus on to provide a system that is efficient and fit for purpose. The SSPO will take a leading role to represent specific industry concerns on the ILG. Collaboration with communities, regulators and stakeholders is the proven way forward for Scottish salmon farming and will help carve out a successful path for the industry as it develops.

Quality Meat Scotland

Jim McLaren
Chairman

The industry's brands are underpinned by some of the longest-running quality assurance schemes in the world.

Scottish livestock farmers, along with the others who work in the Scottish red meat industry, take a huge pride in the job they do to produce top quality Scotch Beef PGI, Scotch Lamb PGI and Specially Selected Pork.

Our industry contributes around £2bn to Scotland's economy and supports around 50,000 jobs, many of which are in more fragile parts of the country. We also have a great story to tell in terms of environmental sustainability, with grass and rough grazing covering 82% of Scotland's agricultural area. This land is unsuitable for crop, fruit or vegetable production but ideal for the extensive grazing of cattle and sheep. The industry's brands are underpinned by some of the longest-running quality assurance schemes in the world. These schemes – which cover farms, feed, haulage, auction markets and processors – require businesses to meet a range of quality standards, including high levels of animal welfare.

One challenge our industry faces is that, not unlike the process of making Scotch Whisky, the production of quality beef, lamb and pork in Scotland involves a lengthy process of careful management. This requirement for long-term planning means the prevailing uncertainty on a range of issues following recent momentous political developments – from the future of agricultural support to market access and migrant labour – is particularly unwelcome.

Currency movements have also had an impact on competitiveness and trade flows, while intense competition on the UK high streets has created tension in the supply chain. Understandably these issues have made producers and processors wary of making major investment decisions. However, consumers' interest in the provenance and safety of their food, and the health and wellbeing of the livestock used to produce meat, remains strong as does the need to drive productivity and efficiency throughout the supply chain.

Post-Brexit market access to Europe is a key concern as this market takes over 90% of Scottish beef and sheep meat exports. Equally important, though, will be the terms of trade for European and global imports to the UK and Scotland in a post-Brexit era, as the rest of the UK is the destination for around two-thirds of Scottish abattoir output and significant numbers of live animals.

Export markets have been challenging during 2016, but growth has been achieved in some north European markets. New additions to the range of countries that Scottish meat can be exported to will be a key consideration in light of any changed trading arrangement with the European Union. In this regard, developments to open the US market to sheep meat and progress in the EU trade deal with Canada (CETA) have been welcome during 2016.

History has repeatedly shown the Scottish red meat sector's resilience. It is built on very strong foundations and the modern industry features a unique combination of the best of tradition and innovation. These strengths will continue to underpin our industry and form a solid platform from which it will be ready to seize opportunities as they emerge, along with the challenges, in the coming years.

Scottish Bakers

Alan Clarke
Chief Executive

The bakery sector is still enjoying a renaissance and many bakers are using traditional recipes with a modern twist to attract new customers.

2016 saw the passing of music legend David Bowie, his hit song "Changes" with the lyrics, "I watch the ripples change their size, but never leave the stream of warm impermanence," reminds us that nothing is permanent! 2017 will mark the start of the process of the UK leaving the EU, the further introduction of National Living Wage increases, mandatory pension contributions for many small businesses and the introduction of the new training levy tax for large businesses, which will all add to the challenges that bakers currently face.

Bakers have dealt with economic uncertainty on many occasions and will continue to rise to the challenges that this will bring. Since the Brexit announcement, bakers have experienced significant ingredients price increases and it's always a struggle to maintain margins when we are going through a long period of food deflation.

2016 was the 125th anniversary year of Scottish Bakers. We were established in 1891 as the Scottish Association of Master Bakers and we have been working towards our motto "for the good of all" for all this time. In 2016, Scottish Bakers also won Conference of the Year, for the second year in a row, at the UK Association Awards. We were very proud of this and have been delighted that we can now regularly get almost 500 people from our sector to attend our conference weekend which includes the Scottish Baker of the Year Awards. This competition, combined with the World Championship Scotch Pie Awards, gains more than £1m worth of PR for our sector and we have many businesses willing to share the increases in sales and profits that they make as a direct result of winning an award at these competitions.

The bakery sector is still enjoying a renaissance and many bakers are building on their existing customer base and using traditional recipes with a modern twist to attract new ones. The issue of health is still important to our sector with many people realising that sweet treats are a treat and not a substitute for other meals. It's also great to see the many family businesses that make up the sector continuing to develop and innovate. There has been significant multi-million investment by some of our larger members in technology including McGhees in Glasgow, Tunnocks in Uddingston and Nairns in Edinburgh who have made a significant investment in their new, gluten-free site.

Scottish Bakers has made significant contribution to the refresh of the Skills Investment Plan for the food and drink sector and to the new strategy for the food and drink sector led by Scotland Food & Drink. We are highly supportive of ambitious business growth based on assisting companies to develop their products in local, national, UK and international markets. We see this as imperative in assisting our sector to grow and flourish within the wider food and drink sector in Scotland.

National Farmers' Union Scotland

Scott Walker
Chief Executive

The Scottish food and drink industry is built on quality and provenance. These start at the farm or croft.

Now is the time to look forward not back at our past achievements and successes. A momentous decision was taken by the British people when the UK voted to leave the European Union. Brexit has not yet been triggered but it will be shortly. Much change lies ahead and if we are to be the master of our own destiny then much work must be done to ensure that Scottish farmers and crofters can benefit from the growth of Scotland's food and drink sector.

For too long there has been a disconnect between where our food is grown or reared and the supply chain that takes what is produced on Scottish farms and crofts and delivers it to consumers in Scotland, the UK and abroad. Trust and collaboration don't always exist in this supply chain. And too many farmers are having to take an unfair share of risk with little, if any, reward.

There is no doubt that recent times have been hard for many Scottish farmers and crofters. While the growth in the food and drink industry has been spectacular profitability on farms has been hard to come by.

Looking ahead much will now depend on the terms of the UK's exit from the European Union and its future trading relationship with Europe as well as the rest of the world. For the first time in over 40 years there will be the possibility of setting domestic agricultural policy focused on profitable production.

We know that what we produce on our farms and crofts is valued across the length and breadth of the country. NFU Scotland has supported and been involved in dozens of consumer-facing events at supermarkets and farmers' markets where we have been happy to share the fantastic story that Scottish farmers and crofters can tell about the food we produce. The response from shoppers, and their support, has been tremendous. The Scottish food and drink industry is built on quality and provenance. These start at the farm or croft.

As we enter a brave new world post-Brexit, we must set about ensuring that we have a properly functioning supply chain that delivers for everyone. Scotland Food & Drink have a key role in delivering profitable growth for all.

Working together sometimes requires a leap of faith. At its heart is a belief that working together collaboratively will allow each part of the supply chain to achieve so much more than it could hope to do by itself. In order to continue the growth in the food and drinks sector farming needs to become part of this success story.

Scottish Dairy Growth Board

Paul Grant
Chair

With the experiences gained in 2015-2016 and a more competitive currency position for exporting, 2017 is expected to be the year of real, sustained growth.

The Scottish Dairy Growth Board has continued to focus on the priority areas highlighted in my previous annual report. We have been well supported by Scottish Government, SDI and Scotland Food & Drink.

The first area is the mentoring and fast-tracking of processing investment ideas and opportunities. The game-changing investment we had hoped to progress was left pending as another business opportunity was delivered by the company involved. It is still hoped that progress will be made in the forthcoming year. Three other dairy processing investments were prepared for grant support, two being considered favourable and one awaiting a decision in early 2017.

The second is 'The Scottish Dairy Brand'; it has had a very active and eventful year. All leads from the previous year's Anunga were followed up with the USA, the only market with immediate positive action. The relationship with Atalanta, the USA importer, was strengthened by market visits on both sides of the Atlantic. Initial orders were placed at the back end of the year once the elongated process of technical/FDA approval was achieved. 2017 is expected to be the year of real sales development. Detailed market research was undertaken in the Benelux and Scandinavian markets with positive buyer and consumer interest. These markets are the priorities for entry in 2017.

The third area of activity has been dairy business/farm mentoring by me. This has covered new product or brand ideas, farm development and turnaround plans. This has become an important part of the work undertaken and extremely well received by those involved.

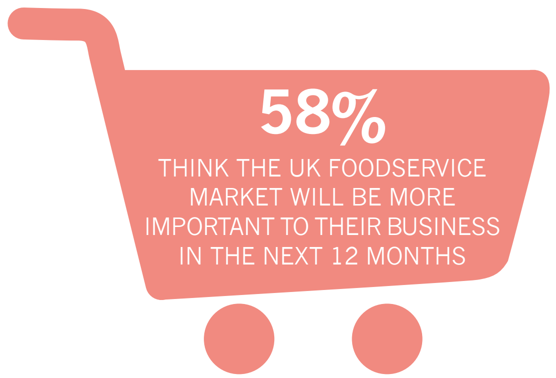
Much of this work comes from 'Hub' referrals. The Scottish Dairy Hub has had an outstanding year, increasing its annual queries by 50% and maintaining the 48hr service response standard. In two and a half years, the Hub has dealt with 800 queries, 70% from dairy farmers. Subjects covered include on farm technical matters, farm costs and efficiency, farm business matters investment ideas, staffing and training.

The year has been very active, the results a little slow in coming, this is more to do with delay rather than rejection. With the experiences gained in 2015-2016 and a more competitive currency position for exporting, 2017 is expected to be the year of real, sustained growth.

FUTURE

2017-2018 Outlook & Business Barometer

2017-2018 Outlook



"A media focus on inflationary pressure is making UK shoppers aware of the threat to their purchasing power."

As the world grapples with major economic and geo-political changes, Rabobank predicts that food prices – which like all commodities are influenced by such forces – will remain low during 2017. While the spectre of inflation stalks some economies, stock levels of food commodities are at record levels, applying some downward pressure to prices. As China and India are responsible for so much of the world's food consumption, so they wield colossal influence over prices. This creates uncertainty in global markets. While demand in China remains buoyant, the demonetisation example in India shows how easily macro-economic or monetary policy can upset the balance between supply and demand.

At the end of 2016, UK food and drink prices were 7% below the February 2014 peak, but the main pressure facing the UK consumer's purchasing power in 2017 will be rising inflation on the back of the pound sterling's depreciation, since June 2016, and the uptick in oil prices. The UK imports one-third of its food and vendors will, at some point, have to start passing on the increased costs of imports, or products made with imported ingredients, to consumers.

Economic forecasters are projecting inflation in the UK to average 2.6% year-on-year across 2017, a considerable increase from the 0.5% year-on-year average seen in 2016. A media focus on inflationary pressure is making UK shoppers aware of the threat to their purchasing power and the first quarter of this year has seen a downward shift in consumer confidence; the value of retail food sales in Scotland in January 2017 was down 2.6% on a year earlier.

According to MCA Insight, considering Brexit-related uncertainties, only 13% of UK-based foodservice industry leaders now expect the trading environment to improve in 2017-18, compared to 43% last year. The prevailing view on UK foodservice market growth is around 2%, but with the prospect of inflation being at least 2%, the underlying volume growth is likely to be minimal and patchy. Rising staff costs, higher input outlays, increasing rents and property prices are all contributing to this air of caution. However, growth is anticipated through premiumisation, particularly in food sales, and non-premium alcoholic drinks are likely to continue to decline.

On a global basis analysts predict grocery retail spend will grow around 4% to 2018 and foodservice around 3% with the US and S.E. Asia the strongest performers.

Figures quoted (pages 22-24) are sourced from the SF&D Business Barometer Survey 2017

Business Barometer Survey 2017

"There may be more cautiousness regarding prospects for the next year but this doesn't seem to have dampened expectations of increased turnover for most food and drink businesses in Scotland."

In early 2017, SF&D conducted its second annual Business Barometer Survey, amongst food and drink producers in Scotland, with the aim of assessing the level of confidence in the prospects for their businesses for the next 12 months. This year we took the opportunity to quiz people on their views about how Brexit might affect their own companies and the wider industry, in the short-to-medium term.

Summary

Unsurprisingly, overall, respondents expressed more cautiousness than we saw in 2016 but this doesn't seem to have dampened belief in the likelihood of increased turnover, the willingness to invest in R&D and staff or to consider new opportunities, both in the UK and overseas.

Whilst half of the respondents felt that Brexit could be negative for their business and around 40% expressed this for the industry as a whole, over a quarter responded with a 'don't know', an insight into the haziness surrounding the future. This was further demonstrated by the 50% who told us they were waiting for more detail before taking any actions specifically related to Brexit. However, around 20% stated they were looking at future business plans based on a range of scenarios.

Respondents agreed that costs of inputs, currency fluctuations and the prospect of UK diners and shoppers spending less would be a challenge to growth. However, their confidence in the short-term appears robust; more than half of respondents forecast up to 10% growth in their company's turnover in the next year and a third believed they would be taking on more staff.

They told us that the UK market will be just as important to them as 2016 and that foodservice in particular will be key in 2017-18. Despite uncertainties about future trading, two thirds of companies that will be exporting overseas in the next year thought that it would even more important to them. Given this ambition it's perhaps not surprising that 64% said they'd be investing more in innovation with NPD, manufacturing processes and packaging as areas of focus.

Business Barometer Findings

Survey conducted online, January 2017
Total Company Sample 63

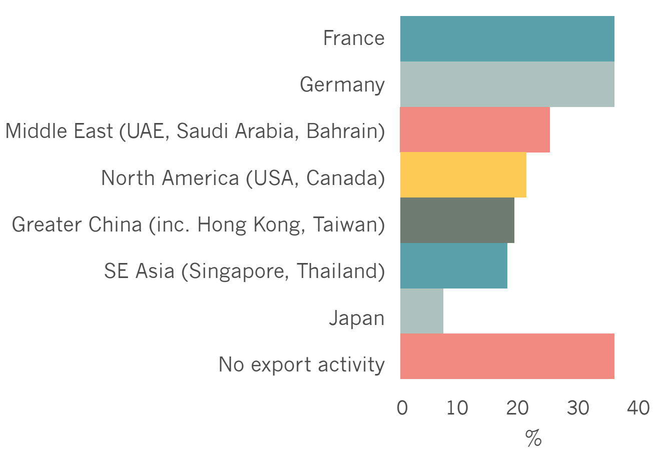
How important will exporting (beyond the UK) be to your business in the next 12 months?

64%
MORE IMPORTANT

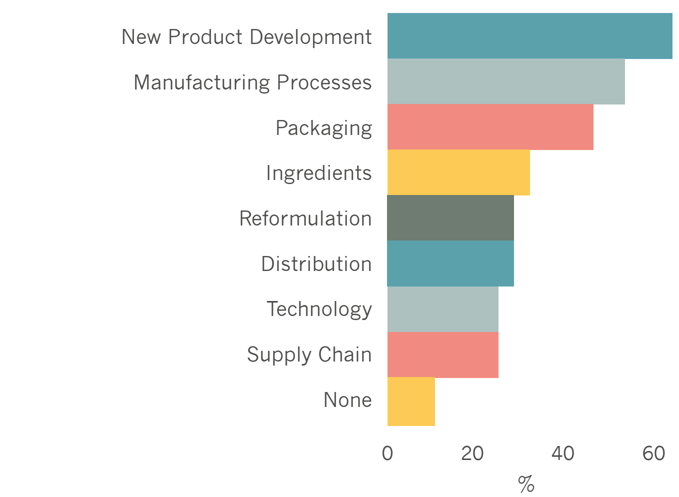
How much more or less will you invest in Innovation (including R&D) in the next 12 months?

32%
A LOT MORE

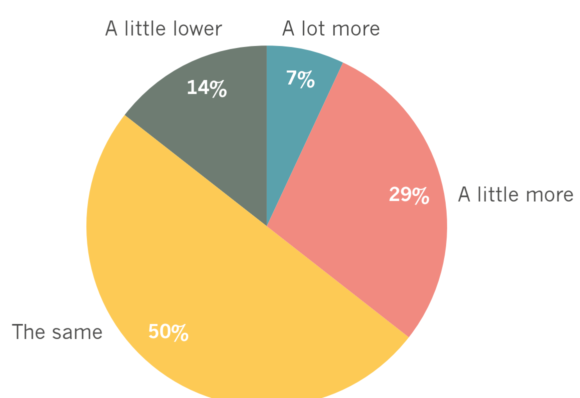
Which export markets will you target in the next 12 months?



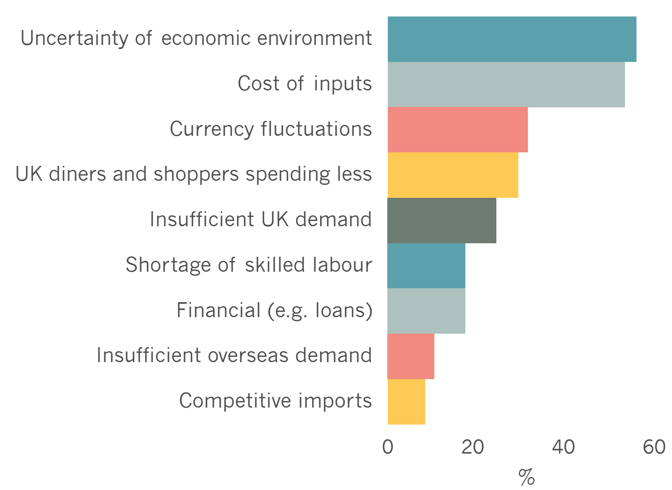
Which areas will be the focus of your innovation investment (including R&D) over the next 12 months?



Excluding seasonal variations what net changes to staff levels do you forecast in the next 12 months?



What factors will limit your ability to increase business activity in the next 12 months?



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