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Bite Size

Recent activity in the food and beverage sector

Spring 2015

Welcome to the latest edition of 'Bite Size', our quarterly overview of activity in the food and beverage sector. This edition provides analysis of M&A activity in the first quarter of 2015 and looks ahead to the trends we believe will shape the market in the coming months.

In this issue we also take a look at how companies can take advantage of research and development tax credits and present a case study of Bon Bon Buddies, which has successfully grown its business to become Europe's number one provider of character and branded confectionery.

We hope that you find this newsletter useful. If you have any further questions or queries, or would like to know how Grant Thornton can help you and your business please do not hesitate to contact me.

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Food for thought

Research & development (R&D) tax relief means cash – either by saving corporation tax payable or by surrendering tax losses incurred for a valuable cash repayment. From 1 April 2015, it can be worth up to 26% of a company's R&D spend in additional tax relief.

Answer yes to any of the following questions and you may be able to benefit from R&D tax relief. Have you recently or do you continue to:-

- develop new food products?
- invest in new food technology or science to create/maintain competitive advantage?
- undertake studies to understand ingredient interactions or to optimise the shelf life of a product?
- update your food processes to create healthier alternatives to traditional products or to generate cost or time efficiencies?
- develop new or innovative forms of packaging?
- develop/tailor software to improve your IT systems?

Grant Thornton has made successful claims in respect of all of the above. Companies benefitting from the relief range from commercial fish farmers and poultry breeders to whisky distillers and makers of confectionery.

Grant Thornton has extensive experience of working with companies of different sizes in the Food and Beverage sector. As well as having an excellent working relationship with HMRC, we provide robust, practical and tailored advice in order to ensure that claims are maximised.

If the thought of reducing your tax liability whets your appetite, contact us to discuss how our clients have benefitted from our approach and how we can help you to save money.

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bonbon buddies

Bon Bon Buddies has successfully grown its business to become Europe's number one provider of character and branded confectionery, please refer to the back page for the story of their success to date.

M&A activity – Q1 2015

Heinz's £36.5 billion acquisition of Kraft dominated the headlines in the food and beverage sector in Q1 2015[1], but, closer to home, UK M&A activity got off to a robust start to the year with 37 transactions involving UK and Irish targets and/or acquirers. This was a similar level of activity to the deal volume recorded over the previous four quarters, with an average of 41 transactions.

There was, however, a drastic reduction in the number of deals with disclosed values, making quarter-on-quarter value comparisons difficult. Official disclosed deal value for the quarter was just £102 million[2], split across six transactions, compared with £3.2 billion in Q4 2014 (which was bolstered by the £2 billion United Biscuits deal) and £530 million in the first quarter of last year.

Rather than reflecting a precipitous drop in deal value, we believe that it is the level of disclosure that has fallen sharply. Given that deal values for larger transactions tend to be reported publically, it could be inferred that first quarter activity has been dominated by the consolidation of small and medium-sized targets, where there is a tendency for the deal financials to remain behind closed doors.

Though the deal values were not disclosed, there were a few larger transactions in Q1 2015. A number of sources reported that Bright Food Group is acquiring the 40 per cent it does not already own of Weetabix. The 2012 acquisition of a 60 per cent stake from Lion Capital valued the Alpen, Ready Brek and Weetos owner at £1.2 billion. The first quarter also brought the sale of food-to-go manufacturer Adelie to private equity firm HIG Capital Europe for an undisclosed sum. Adelie supplies chilled food-to-go, including sandwiches (and the Urban Eat sandwich brand), salads and quiche to supermarkets, coffee shops and the food service sector. Vendor India Hospitality Corporation (IHC), which acquired Adelie in 2012, has retained a minority shareholding.

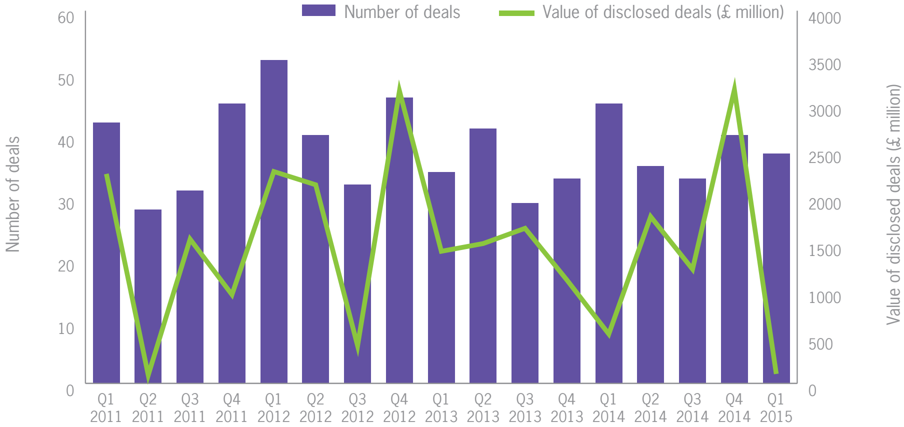
Convenience in demand

The Adelie transaction illustrates the growing consumer appetite for convenience food, which includes food-to-go, deli specialities and snacks, which is being reflected in increasing M&A activity. Transaction volumes in these areas experienced a significant upturn last year, and the trend has continued in Q1 with 13.5 per cent of transactions in the deli/convenience sector.

Following its 2014 acquisition of olive and antipasti manufacturer Alatoni, Winterbotham Darby acquired a majority stake in gourmet dips manufacturer G'Nosh during Q1. Fresh prepared foods maker Bakkavor and Scottish food manufacturer Baxters Food Group both furthered their expansion in the US convenience foods market in Q1. Bakkavor acquired convenience food manufacturer B Robert's Foods, and Baxters acquired Wornick, a leading supplier of convenience foods and military rations to institutional customers.

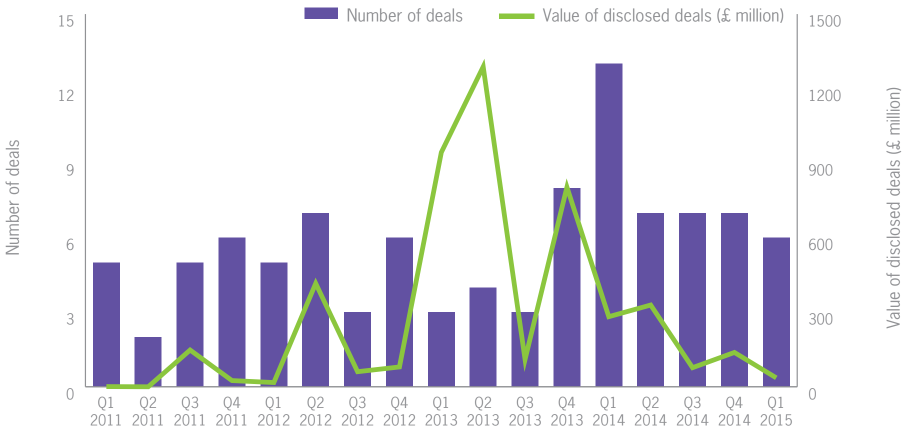
Further transactions are in the pipeline. It has been reported that both Natural Balance Foods,

Announced M&A activity in food and beverage - quarterly



The spike in Q4 2014 deal value is attributable to the £2 billion United Biscuits transaction

Announced PE activity in food and beverage - quarterly



The spike in Q2 2013 deal value is attributable to the £493 million Euro Cater IBO and £715 million R&R Ice Cream IBO; the spike in Q4 2013 deal value is attributable to the £350 million Burton's Biscuit IBO

Portfolio optimisation will continue to be a key deal driver

Portfolio optimisation, which involves companies both rationalising the size of their portfolios and also acquiring new, often faster growing businesses, continues to be one of the key investment themes driving M&A activity in the food and beverage sector.

3G Capital, Kraft's new owners, are expected to use similar cost-cutting techniques as they deployed at Heinz, including zero-based budgeting, which requires managers to evaluate every item in their budgets from scratch each year. The pursuit of cost synergies, however, will very probably also include an assessment of which parts of the business are underperforming or non-core and are therefore suitable candidates for divestment. Kraft's meals and desserts products and Heinz's frozen brands are both considered possible candidates for divestment as the merged entity rationalises its portfolio.

Among the largest global operators, Nestlé is reportedly nearing the sale of frozen food unit Davigel to Brakes, having already divested its Spanish La Cocinera frozen meals business to Findus as part of an ongoing portfolio review. Unilever has said that it is continuing to shape its portfolio with both the sale of non-core assets, including the spin-off of its spreads business, and acquisitions.

Elsewhere in the sector, a number of groups have been selling non-core assets in Q1. For example, Kerry Foods sold Kerryfresh, a direct-to-store supplier of chilled products to its management, as well as its Australian bakery unit, Pinnacle, to Pacific Equity Partners of Australia. The sale of its frozen food unit is pending.

Portfolio optimisation is far from complete and we expect the trend will continue to be an important driver for transaction activity this year.

Deals summary – Q1 2015

which produces the Nākd and Trek range of snack bars and Seabrook Crisps are seeking external investment.

Thirst for alcoholic beverages

M&A activity in the alcoholic beverages sector was healthy in the first quarter across both the product lifecycle and range. Molson Coors sold its UK maltings business, Marston's acquired the trading operations of Daniel Thwaites' beer division, while Quintessential Brands acquired fruit liqueur manufacturer Lafragette & Legier. Also in February 2015, Irn Bru and Tizer maker AG Barr moved into a new sub-category with the £21 million purchase of cocktail mixer company Funkin, paying an EBIT multiple of 10.6 times.

Private equity snapshot

The level of private equity activity was relatively stable in the first quarter with six transactions, compared to seven in each of the preceding three quarters, although this was well below the Q1 2014 peak of 13 deals. While this may suggest the level of activity by financial sponsors has declined, we feel it is more due to timing and asset availability than a reduction in appetite.

There were several notable transactions involving private equity in Q1. In addition to the long-awaited sale of a majority stake of food-to-go specialist Adelie (highlighted above), private equity was active in supporting portfolio companies in buy-and-build strategies. PAI Partners backed R&R Ice Cream's acquisition of Nestlé's South African ice cream business, MML Capital aided portfolio business Nactis Flavours' acquisition of Robertet SA's Belgian division and American Capital Equity supported SMG Europe's acquisition of events caterer CGC.

The latter deal is also indicative of the level of interest in the hot food-to-go and event catering segment. This was further illustrated by Kerry Foods' acquisition of Rollover, which sells over 20 million hotdogs a year from 2,000 stores in stadiums, concert venues and convenience stores.

Looking ahead, Exponent will reportedly be launching a sales process for Quorn later in 2015.

Small deals with disclosed values (<£50 million deal value)

Sector	Date	Target	Acquirer	Deal value (£ million)
Deli	Mar-15	Carroll Cuisine (Ireland)	MBO backed by Carlyle Capital	36.0
Alcohol	Mar-15	Daniel Thwaites plc (beer division)	Marston's plc	25.0
Functional	Mar-15	My Goodness	Aurivo Co-Operative (Ireland)	10.5
Alcohol	Feb-15	Funkin Ltd	AG Barr plc	21.0
Ingredients	Feb-15	FoodBlenders Ltd	Frutarom Industries (Israel)	2.0
Ingredients	Jan-15	Rainbow Dust Colours Ltd	Real Good Food plc	7.5

Key undisclosed deals

Sector	Date	Target	Acquirer	Deal value (£ million)
Deli	Mar-15	Adelie Foods Group	HIG Europe	ND
Dairy / Frozen Foods	Mar-15	Nestle South Africa's ice cream business (South Africa)	R&R Ice Cream backed by PAI Partners	ND
Alcoholic Drinks	Mar-15	Lafragette & Legier SA (France)	Quintessential Brands	ND
Deli	Feb-15	Wornick Company (USA)	Baxters Food Group	ND
Deli	Feb-15	G'Nosh	Winterbotham Darby & Co	ND
Catering	Feb-15	CGC Events	SMG Holdings Inc. backed by American Capital Equity	ND
Fruit & Veg	Feb-15	Gambles Produce (Canada)*	Total Produce plc (Ireland)	ND
Meat/ Catering	Feb-15	Rollover	Kerry Foods (Ireland)	ND
Dairy	Feb-15	Danube Foods Group BV (Netherlands)	Mid Europa Partners LLP	ND
Cereals	Jan-15	Weetabix**	Bright Food Group (China)	ND
Fruit & Veg	Jan-15	Fenmarc Produce	International Procurement & Logistics/ Asda	ND
Alcoholic Drinks/ Dry Grocery	Jan-15	Molson Coors' UK maltings division	Malteries Soufflet SAS (France)	ND
Dairy/ Frozen Foods	Jan-15	Taste Trends	Lakeland Dairies Co-Operative (Ireland)	ND
Deli	Jan-15	B Robert's Foods LLC (USA)	Bakkavor Group	ND
Frozen Foods	Jan-15	Nestle Espana's La Cocinera business unit (Spain)	Findus Group	ND

** acquired a 50% stake*
*** acquired the remaining 40% not already owned*

Notes
[1] All deal activity is based on announced date of the deal and includes deals where there has been any UK or Ireland involvement (target or acquirer). Administrations, liquidations and receiverships are collated but not counted as M&A unless they have subsequently been acquired.

[2] Deal values are primarily sourced from corporate websites, however if no press release is available they are sourced from deal database BvD Zephyr or from press commentary released at the time of the deal. Deal values may subsequently be amended pending earn outs or other finance arrangements and/ or as further detail is released by the acquirer.

Sources: All deal data is gathered as it takes place from numerous sources including trade press, BvD Zephyr and mergermarket.

Recurring themes

Two further recurring themes are worth noting:

The first is continuing interest in the wellbeing and sports nutrition sector. Irish agri-business Aurivo Co-Operative Society acquired London-based sports nutrition company My Goodness (the company behind For Goodness Shakes and energy and hydration brand Nectar) to gain access to the protein drinks market; and gluten-free and wheat-free biscuits manufacturer Kent & Fraser was sold to Honeyrose Bakery.

The second is appetite from overseas acquirers, particularly from Asia, for western targets. Bright Food's acquisition of the outstanding 40 per cent in Weetabix cemented its entry into both the UK and global food markets through the Weetabix brand, supporting its strategy of buying well-known international brands and aiming to establish strong competitive positions in each of its markets. Also during Q1, Israel's Frutarom acquired UK flavours company Foodblenders, and other Asian groups continue to publically voice their interest in pursuing western targets.

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Looking forward

First quarter global M&A activity in the food and beverage sector has been dominated by the mega deal takeover of Kraft by Heinz. While it is not a UK domiciled transaction, and so does not appear in our deal statistics, the takeover clearly illustrates important underlying themes, which we believe will continue to underpin M&A activity this year.

The consequence of intense competition among supermarket retailers is the ongoing squeeze on food and beverage producers. This trend is as evident in the US with supermarket giants such as WalMart putting pressure on their suppliers, as it is in the UK where the big four are reducing the number of SKUs being carried and squeezing producers, especially those in the middle market.

Brands are under pressure and producers are responding by taking a hard look at their businesses, both for the potential to become more efficient, but also to look at new routes to market and whether they have the right mix in their portfolios to be competitive in today's harsh environment.

Kraft Heinz is a good example of this strategic response. Clearly, combining two producers with the scale of Kraft and Heinz will create a better bargaining position with the giant supermarkets and may allow them to resist the pressure on their margins. 3G Capital has already shown its ability to drive out costs at Heinz and the Brazilian private equity group tends to look at targets where there is room for improved efficiency.

Kraft is also a predominantly US-focused business, while Heinz has a far greater international footprint, including a significant emerging market presence. The merged entity will aim to leverage Heinz's global distribution network to increase overseas sales of Kraft's products. As noted above, the merger may well be followed up by subsequent transactions, both as Kraft Heinz disposes of non-core and under-performing businesses and also as the merged entity is used as a platform for further acquisitions.

The impact on the rest of the sector of this activity among the largest global players is likely to be profound. Other producers may look to defensive mergers, or risk becoming targets themselves. By bolting businesses together, companies can create cost synergies and the aggressive cost-cutting techniques being used by 3G Capital are likely to be rolled out more widely across the sector. In a market where margins have already been cut to the bone, this environment will create winners and losers, driving further deal activity as the strong acquire the weak.

Bon Bon Buddies Ltd

Bon Bon Buddies Ltd (BBB) is Europe's number one provider of character and branded confectionery, working with global brands including Disney, Hasbro and Warner Bros. Established in 1993, it now services 40 countries worldwide, with eight dedicated European sales and logistics facilities with further distribution in Central Eastern Europe, China and the Middle East.

In 2013, BBB received The Queen's Award for Enterprise for international trade in recognition of its outstanding achievement in innovation, international trade and sustainable development.

Jo Manfield, Finance Director, explains that BBB positively encourages innovation throughout its business and deploys dedicated, specialist teams from diverse backgrounds to constantly brainstorm and create new ideas, concepts and products – both in confectionery and its packaging. While ensuring that all products comply with stringent health and safety requirements and the company's own ethical beliefs, these innovative teams generate the next core categories of products to successfully and profitably take the business forward.

R&D tax relief has been invaluable, enabling more cash to be re-invested into the business. Jo and the technical project managers worked closely with the Grant Thornton innovation team to maximise the claims made in respect of confectionery, packaging and bespoke IT systems. "Using its experience of making claims for companies within the Food and Beverage sector, the Grant Thornton team provided clear advice and assisted us in identifying the areas of the business where R&D tax relief would be available; devising the best approach to our R&D claims and collating the information in a comprehensive report. The team was proactive and adaptable in its approach to work, ensuring that the claims were prepared as efficiently and promptly as possible. I would recommend that all companies consider whether they could benefit from this important tax relief."

BBB recognises that its future is also dependent on the fantastic team spirit shown by all employees who pull together when necessary to get the job done. Every individual in the company is encouraged to become actively involved by being given responsibility, the tools to develop new skills and the power to innovate.

Ultimately, success comes from understanding the customer. As Jo concludes, "The ultimate goal of the company is to develop products that children love, at market leading prices and with the portion control that parents expect. Seeing a happy face is worth all of the work!"