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Bite Size

Recent activity in the food and beverage sector

Winter 2014/15

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 last quarter of 2014 as well as the year in review and also looks ahead to the trends we believe will shape the market in 2015.

In this issue we also take a look at the issue of creditworthiness and alternative sources of funding. 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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Have you thought about your credit worthiness?

Following poor trading over Christmas, the departure of Morrisons CEO Dalton Philips might not be seen as a surprise. But is all the recent press on supply chain pressures and supermarket strategies prompting other people to look at your business differently?

Grant Thornton recently advised a leading food producer on securing £35 million of debt facilities to refinance existing debt and finance two acquisitions. The company is a market leader in their sector and a key supplier to major supermarkets. The fundraise allows the business to bolster its existing product offering, further expand its customer base (to include additional major supermarkets) and consolidate its market leading position.

With rapidly changing market dynamics as price pressure increases, challenges arise for many businesses and it raises the question of was expanding at the current time the right decision?

We would argue that these market dynamics create significant opportunity for agile, well managed businesses. Capitalising on these opportunities often, as in the case outlined above, requires additional financing and ensuring that your business is in the best position to navigate this process is key.

So what do you need to consider ahead of a pre-lending review which will be carried out by any potential investors? And how do you prepare for that conversation?

Key questions to consider include:

- What is your stakeholders' perception of your credit worthiness? Who is taking a view on your credit worthiness? Your lenders? Potential investors? Suppliers? Landlord? Trade insurers? Your customer(s)? The answer is 'all of the above and probably a handful more'
- Have you got a robust financial forecast that supports your strategic ambitions and demonstrates how you can gain from the turbulent market dynamics?
- Have you calculated the correct quantum of capital required to support your growth and avoid over-indebtedness, particularly in light of recent pressures?

There are some practical steps that you and your team can take to better manage your credit worthiness profile ensuring that messages to market are clear and accurate.

We talk to hundreds of business leaders and stakeholders about credit worthiness and the pre-lend review process. We'd be happy to share our knowledge with you. For more information please contact:

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M&A activity – Q4 and full year 2014

The fourth quarter provided a solid finish to a positive year for food and beverage M&A activity[1]. Deal volume increased by 21% to 40 transactions in Q4 2014 compared with the third quarter. Whilst total disclosed deal value for the last quarter of 2014, at £3.15 billion, was 157% higher than Q3, this was heavily skewed by the £2 billion United Biscuits transaction. Taking this deal out of the equation, there was a 6% fall in deal value compared with the prior quarter. However, looking at the wider picture across the year, Q4's 40 deals brought the total number of transactions for 2014 to 153, a 13.3% improvement on 2013's 135 deals.

Total disclosed deal value for 2014 was £6.7 billion compared with £5.8 billion in 2013. Both totals were inflated by large deals: last year by the £2 billion sale of United Biscuits and by the £1.35 billion sale of GlaxoSmithKline plc's Lucozade and Ribena brands in 2013. Excluding the two mega deals in the respective periods, total disclosed deal value increased by a modest 4.4% to £4.7 billion from £4.5 billion.

The volume of distressed M&A deals also maintained the downward trajectory that started in 2011, recording a further decline of 12% on the 2013 level[2]. However, whilst the overall number of company liquidations fell in 2014, there was an increase in the number of food companies entering insolvency, impacted by the supermarkets' price war and resultant ongoing squeeze on the already-challenged margins of suppliers.

Overseas appetite for iconic UK brands

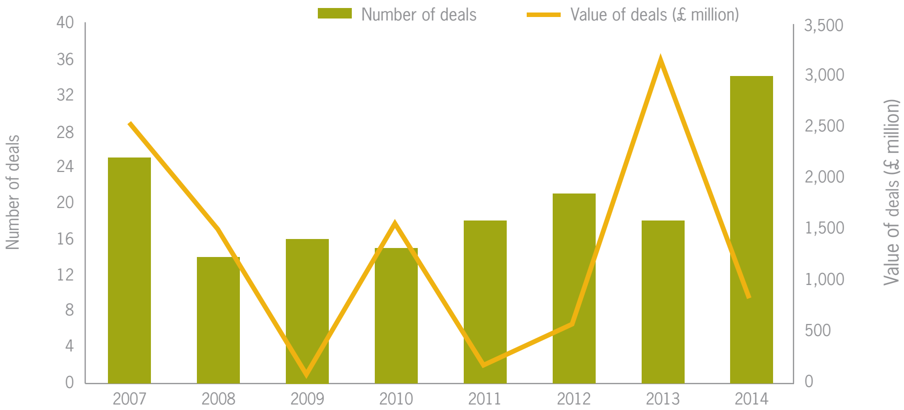
The fourth quarter's largest deals provided further examples of the continuing interest of buyers from emerging markets in acquiring well-established western brands. In November, private equity groups Blackstone and PAI announced the long-awaited sale of United Biscuits to Yildiz Holdings of Turkey for £2 billion. Yildiz, whose brands include Ülker and Godiva chocolate, fought off rival bidders including Burton's Biscuits and Kellogg's, to take ownership of brands such as Jaffa Cakes, McVitie's and Penguin, to create the world's third largest biscuit manufacturer. Yildiz plans to drive United Biscuits' growth using its own global distribution network and promote further growth of the British brands in overseas markets.

Also in November, Diageo agreed to sell its Bushmills Irish Whiskey brand to Mexico's Grupo Cuervo. The deal was structured as an asset swap, with Diageo in return receiving circa $400 million in cash and the 50% of Cuervo's Don Julio tequila brand, which it did not already own. Diageo, which had failed in an attempt to take over Grupo Cuervo in 2012, is pursuing a portfolio optimisation strategy,

Announced M&A activity in food and beverage - annually

NB: the spike in 2010 deal values is attributable to the acquisition of Cadbury by Kraft for £11.9 billion

Announced PE activity in food and beverage - annually



Healthy eating and the war on sugar

After the festive season, the New Year traditionally brings with it increased media coverage of health and diet issues and 2015 has been no different. However, consumers' awareness of health and well-being issues around food and drink is an ongoing trend, while the healthier eating lobby's more aggressive campaigning is not just a post-Christmas phenomenon.

A war has been declared on sugar, which has become the new dietary evil, with some critics calling it the next tobacco. Consensus Action on Salt & Health (CASH), for example, which previously concentrated on reducing salt intake has switched its focus to sugar and 'Action on Sugar' proposed a 'sugar tax' to incentivise healthier food. Last year's report from the UK Scientific Advisory Committee on Nutrition called on the government to halve recommended sugar intake on obesity grounds.

This trend is already having a noticeable impact on the food and beverage sector, most notably on juices and smoothies, which were previously seen as part of the 'five a day', but are now in the firing line for their sugar content.

In December the Grocer's annual Top Products Survey showed that sales of juices and smoothies had fallen by 3.5%, with market leaders Innocent and Tropicana hardest hit. The manufacturers are fighting back with their own media campaign to challenge the anti-sugar lobby, which will include commissioning research to highlight the nutritional benefits of the products, but the war's impact can already be seen in new product development.

Last April, Innocent launched a range of 'super smoothies' supplemented with vitamins, minerals, seeds and botanicals, and in October expanded into cold-pressed drinks, which is a growing market segment. Also, healthier, less calorie-rich alternatives to juices, such as coconut water brand Vita Coco, have been growing rapidly.

The impact of consumers' health awareness can also be seen among more traditional producers. Bakery chain Greggs enjoyed a strong performance in 2014, with revised recipes and a push towards healthier products. Its 'Balanced Choice' range - containing less than 400 calories - performed particularly well.

All of these health-driven trends, from gluten-free through to diet management and sports nutrition, are set to continue and will underpin M&A as new niche producers emerge and mainstream manufacturers look to tap into the healthier eating trends.

Deals summary – Q4 2014

focusing on fast-growing premium spirits. Portfolio rationalisation will continue to be an M&A driver in 2015 with deals in the pipeline including the spin-off of Unilever's spreads business and the divestment of Kerry Group's frozen foods arm.

Other brands moving into overseas ownership in 2014 included Unilever's Peperami migrating to Link Snacks Inc. of the US, Japan's Mizkan Group acquiring Unilever's Ragú & Bertolli pasta sauces, and Tilda rice shifting to serial acquirer Hain Celestial, also of the US. However, whilst overseas purchasers acquired a number of notable UK food and beverage businesses, the level of domestic versus cross-border activity has remained fairly constant in the past few years. In 2014 there was a slight uptick in foreign investment, with 33% of deals having an overseas investor.

Private equity takes a bigger bite

The food and beverage sector remains fragmented and ripe for consolidation, offering private equity ample opportunity to acquire both niche and well-known brands and pursue buy-and-build strategies. Private equity was involved in 34 deals last year, either acquiring a new investment or supporting an existing portfolio company in a follow-on acquisition, representing an 89% increase on 2013. Total disclosed deal value, however, fell 74% to £826 million from 2013's £3.15 billion and average disclosed deal value dropped from £315 million to just £59 million. The significant decline is largely accounted for by the number of large deals in 2013, with the five largest deals accounting for 91% of value.

Private equity continued to be highly supportive of buy-and-build strategies in 2014. Langholm Capital, for example, supported investee companies Bart Ingredients and Purity Soft Drinks with acquisitions; with Bart diversifying into the wet ingredients market with the acquisition of OTP Food, and Purity acquiring niche competitor Firefly Tonics.

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] Business failure data includes administrations, receiverships and liquidations. For the purposes of collating failure statistics, all 'failures' are counted irrespective of whether they were subsequently acquired. Only business failures announced in the press are included in the count for years 2007-2011. For 2012 onwards London Gazette data will also be included

[3] 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.

Large deals with disclosed values (>£250m deal value) [3]

Sector	Date	Target	Acquirer	Deal value (£ million)
Dry Grocery	Nov-14	United Biscuits	Yildiz Holding AS (Turkey)	2,000.0
Alcoholic Drinks	Nov-14	Tequila Don Julio SA de CV*	Diageo plc	370.0 (est)
Alcoholic Drinks	Nov-14	The Old Bushmills Distillery Company	Tequila Cuervo La Rojena SA de CV (Mexico)	255.5 (est)

acquired the remaining 50% not already owned

Mid market deals with disclosed values (£50 million - £250 million deal value)

Sector	Date	Target	Acquirer	Deal value (£ million)
Dairy	Nov-14	Dairy Crest Group plc's dairies operations	Muller UK & Ireland	80.0
Wholesale and Distribution	Nov-14	Logismose/ Claus Meyer Holding A/S*	MBO backed by IP Investment Partners and Dansk Vakstkapital	74.2 (est)
Dairy	Nov-14	Cilag GmbH International (Benecol business in the UK, Ireland and Belgium)	Raisio Group plc (Finland)	71.0
Soft Drinks	Oct-14	Fevertree Drinks plc	IPO	93.3
Bakery	Oct-14	Fletchers Group of Bakeries	Finsbury Food Group plc	56.0

estimated deal value for both assets

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

Sector	Date	Target	Acquirer	Deal value (£ million)
Catering	Dec-14	Waterfall Services	MBO backed by LDC	20.0
Meat, Fish & Poultry	Nov-14	Stofnfiskur HF (Iceland)*	Benchmark Holdings plc	29.0
Meat, Fish & Poultry	Nov-14	SalmoBreed AS (Norway)	Benchmark Holdings plc	22.4
Functional	Nov-14	PhD Nutrition	B&B Investment Partners LLP	20.0
Soft Drinks	Oct-14	Pfunda Tea Company Sarl (Rwanda)**	Borelli Tea Holdings	12.1

*acquired 81.8% **acquired 90%*

Key undisclosed deals

Sector	Date	Target	Acquirer	Deal value (£ million)
Dairy/Frozen	Dec-14	Talenti I LLC (US)	Unilever plc	ND
Bakery/Frozen	Dec-14	The Handmade Cake Company	Européenne des Desserts (France) backed by Equistone	ND
Functional	Dec-14	Cambridge Weight Plan*	Cambridge Weight Plan's Employee Ownership Trust	ND
Wholesale and Distribution	Dec-14	Elveden Food Hub	Thomas Ridley	ND
Deli	Nov-14	Kings Biltong	New World Foods Europe	ND
Meat, Fish & Poultry/Deli	Nov-14	Castellano's Charcuterie	Tulip	ND
Catering	Nov-14	Inn or Out	Bartlett Mitchell Services	ND
Meat, Fish & Poultry	Oct-14	Benson Park	Cranswick plc	ND
Deli	Oct-14	Tanfield Foods	Symington's	ND
Deli	Oct-14	Alatoni	Winterbotham Darby & Co	ND
Catering	Oct-14	Lexington Catering	Elior SA (France)	ND

acquired the remaining 50% not already owned

'Food to go' in demand

Demand is increasing for 'food to go' and convenience products, as well as a growing appetite for premium deli products and snacks. In 2014, 6.5% of deals were in this sector, a 150% increase on 2013. The last quarter of 2014 alone provided four deals: Symington's acquired convenience meals producer Tanfield Foods, whose ranges include 'Look What We Found' and free-from brand 'Ilumi'; and there were three deals in the meat snacks sector including Winterbotham Darby's purchase of olive and antipasti company Alatoni. Other notable transactions in 2014 included Edward Billington and Sons' acquisition of TSC Foods, best known for its Glorious! soup brand, from Key Capital Partners.

The snacks market has changed significantly in recent years, with a whole raft of new crisps and snack brands (including Tyrrells, Burts, Piper Crisp Company and Salty Dog), taking market share from the traditional dominant players, such as Walkers, Pringles and McCoy's. The market is also being driven by a trend towards premium brands, healthier snacking and ethnic flavours. Further consolidation will occur in the coming years in the snacks sector, where press rumours have recently circulated regarding a potential sales process for Seabrooks Crisps, which is likely to attract a healthy level of interest from both trade and private equity buyers.

A great British bake off

Irrespective of the push towards healthy eating, the appetite for bakery products and bakery M&A was upheld in 2014. Q4 2014 saw Européenne des Desserts of France, backed by Equistone Private Equity, enter the UK market with the acquisition of The Handmade Cake Company. It has said that it plans to increase production capacity for high growth markets such as gluten-free product ranges, and is also targeting further acquisitions in the UK bakery sector, which remains highly fragmented.

Other bakery deals in 2014 included the sale of muffins, cupcakes and flapjacks manufacturer Fabulous Bakin' Boys to Netherlands-based Daelmans; the sale of malt loaf maker Soreen to Samworth Brothers, and the sale of Ministry of Cake, manufacturer of desserts and cakes for the food service industry, from Greencore to an MBO team backed by LDC.

Securing the seafood supply chain

The seafood sector both globally and in the UK witnessed a high level of M&A activity in 2014, and is forecast to continue into 2015. Acquisitions are being driven by the need for vertical integration throughout the supply chain, a global footprint, and reduced exposure to restricted farming licences and constrained supply.

Last year's activity included the £856 million acquisition of Norway-based fish farm and fish feed producer Cermaq, by Mitsubishi Corporation via its wholly-owned UK subsidiary MC Ocean Holdings. Other deals of note in the period include the acquisition of UK salmon farm operator Meridian Salmon Farms by Canada's Cooke Aquaculture and Whitby Seafood's move into Scotland with the acquisition of Galloway Seafoods, which boosted its share of the UK retail scampi market.

Looking forward

A predominant theme driving M&A activity in the food and beverage sector is the ongoing intense competition in the UK grocery market, which continues to have profound effects on businesses selling to supermarket retailers. As 2015 gets underway, there is fresh evidence of both renewed price competition among the big supermarkets and the impact it is having on their businesses.

Tesco has announced that it will be 'selectively investing in price' to offer everyday low prices on essentials rather than focusing on promotions. Other cost saving strategies being implemented by CEO Dave Lewis include the closure of 43 unprofitable stores across the UK and shelving plans to open a further 49 new very large stores. Tesco also plans to reduce the number of SKUs it carries. Morrisons has said that it will match the discounters on price, but also announced in January that chief executive Dalton Philips is to leave the company and that it would be closing 10 loss-making stores. Price discounter Aldi, however, in November said it plans to invest £600 million in UK expansion, opening 550 new stores over the next eight years, more than doubling its UK presence. At the other end of the market Waitrose has also announced that it will be opening 14 new stores in 2015.

With stores closing at the big four and a reduction in the number of lines being carried, the squeeze on the middle of the market is set to continue. At the value end of the market, the discounters' growing market share will be good for business. Premium brand producers also know that the supermarkets want their products to drive footfall and they may benefit from increased shelf space allocation as the overall number of SKUs is reduced. It will be tough going for mid-range suppliers.

This unfavourable environment of winners and losers will drive further consolidation, underpinning M&A volumes. Strong companies will seek to diversify their portfolios, while those under pressure may look to defensive mergers to reduce overheads in a market where margins have already been cut to the bone. Diversification strategies from dependency on supplying the major multiple retailers could include seeking alternative routes to market such as the food service market or export channel. However, this switch requires investment in export infrastructure and businesses already on the back foot may not have the capital to invest, making them vulnerable to acquisition or financial issues.

It remains to be seen if the impending general election will hamper M&A activity due to market uncertainty and greater scrutiny into any mega transactions. Alternatively, the threat of a rise in taxes post the election could serve as a catalyst for deals. Nevertheless, the current trends and drivers in the food and beverage sector should see the growth trajectory in M&A activity continue this year. A number of companies have stronger balance sheets than in previous years and M&A will always provide a faster means of achieving growth than organic expansion.

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