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Bite Size

Food and beverage insights

Sector activity

Spring 2017

Welcome to the latest edition of Bite Size our quarterly overview of activity in the food and beverage sector. This issue provides analysis of M&A activity in the first quarter of 2017 and looks ahead to the trends we believe will shape the market in the coming year.

In this edition, we also take a look issues around leadership, culture and people that boards and management teams may need to grapple with.

In addition, we review the FDF 2017 growth business awards, which are sponsored by Grant Thornton and celebrate some of the success stories in our increasingly challenging sector.

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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Fresh thinking needed from leaders as old game-business meets new rules-technology and millennials

Food, beverages and business have been around a long time. It is an old game with a rich history, but also many entrenched ways of working and ingrained beliefs, rituals and routines. This presents us with a challenge as there is no doubt that we are now at an interesting 'tipping point' in how we do business within the food and beverage industry as well as more broadly and how we operate as leaders.

Historically, the predominant ingrained leadership style has been 'command and control': a low feedback culture where people have done as they were told in exchange for job security and a relatively steady state. In today's business world this approach faces the following issues:

- Low levels of trust between society and business
- Millennial and digital natives who expect to have multiple careers involving meaningful work
- The realisation that resources are finite, but we are consuming 1.6 years' worth of natural resources every year, which will only increase as global population rises

As leaders, these trends present us with a number of challenges, including:

- How do we attract and retain the best talent?
- How do we inspire our people to engage with the organisation and innovate?
- How do we make sure that we, and our people, are listening to the weak signals that warn of imminent change, so that we can stay ahead of the competition?

A new style of leadership

At Grant Thornton we are working with leaders and leadership teams both within the food and beverage industry and across other industries within the UK to help them transition from the 'traditional' leadership style to a more modern pioneering style. One of our food clients has been on this journey for a year now and can't believe how much stronger and better their culture is as a result.

Of course, this sounds easy on paper but in reality involves a big shift in mind-set and beliefs for leaders and leadership teams. However, if leaders are going to attract and retain great talent they need to pay heed to emerging trends, adapt their leadership style and approach and create an open and innovation culture so they can stay ahead and outperform their competitors.

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M&A activity Q1 2017

Deal activity got off to a sluggish start in 2017 with 41[1] transactions in the F&B sector, a 28 per cent decline compared with the same quarter in 2016 (57 deals) and a 15 per cent fall on the last quarter of 2016 (48 deals). Total disclosed deal value was £4.3 billion[2], however this included Tesco's proposed acquisition of Booker. Excluding this deal gives a total disclosed value of £694 million for the quarter.

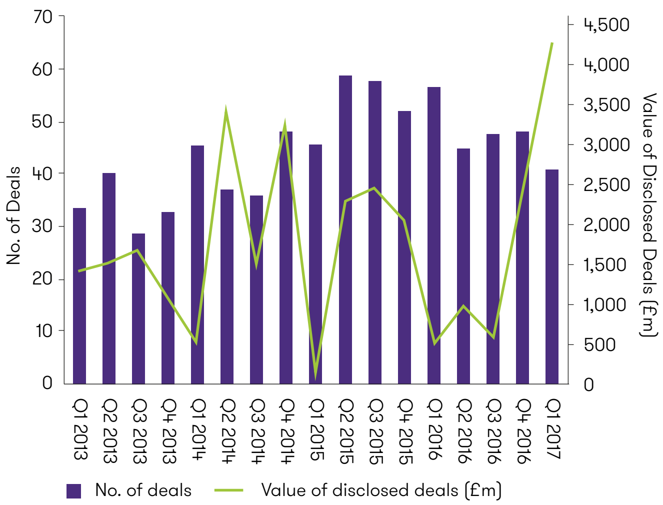
Whilst there was a notable pick-up in 2016 in the number of cross border deals, in Q1 2017 there has been a softening in overseas acquisition activity, with eight transactions with overseas acquirers and eight transactions with UK/ Irish companies buying overseas. Of the first quarter's transactions, 61 per cent were domestic and 39 per cent cross border, compared with a ratio of 56:44 in 2016.

Overseas acquirers of UK businesses included Nippon Suisan of Japan, which bought Sealord Caistor to gain a strategic foothold in the UK seafood processing market; foodservice provider Bidfood (part of South African group Bidcorp), which acquired catering butcher Wyn Lee; and Hain Celestial of the US, which acquired premium soup brand Yorkshire Provender.

Investing overseas, Irish nutrition and ingredients group Glanbia made acquisitions in the Netherlands and the US, and institutional investors including London-based asset management firm Signal Capital Partners rescued German baker Kronenbrot from administration.

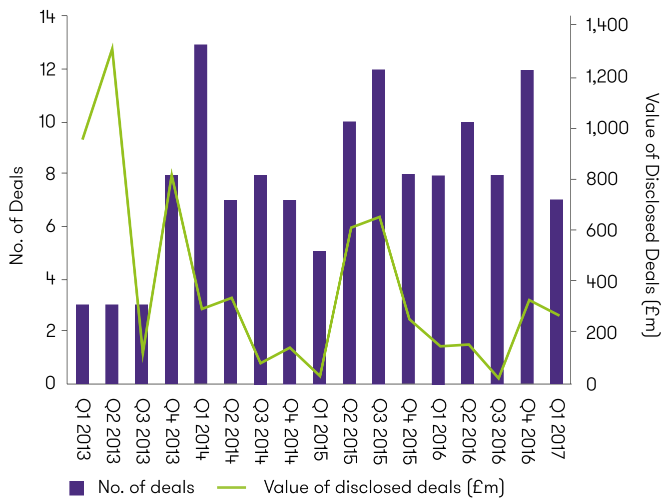
Britvic continued its expansion in the Brazilian market with the £57 million acquisition of juice business Bela Ischia, as part of its ambition to build its presence in the concentrates market, and offset the challenges of the sugar tax, higher input prices and the weaker pound.

Announced M&A activity in food and beverage - quarterly



The chart above excludes the £71bn SAB Miller transaction in Q4 2015

Announced PE activity in food and beverage - quarterly



The spike in Q2 2013 deal value is attributable to the Euro Cater and R&R Ice Cream IBOs

[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 databases including BvD Zephyr, mergermarket and Thomson Reuters Eikon 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.

Large deals (>£250m deal value)

Sector	Date	Target	Acquirer	Deal value (£m)
Wholesale	Jan-17	Booker Group plc	Tesco plc	3,551

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

Sector	Date	Target	Acquirer	Deal value (£m)
Meat	Mar-17	Karro Food Group Ltd	CapVest Ltd	180.0
Functional	Mar-17	Grenade Holdings Ltd (undisclosed majority stake)	Lion Capital LLP	72.0
Functional	Mar-17	H5 Ltd/ Reflex Nutrition Ltd	Associated British Foods plc	60.0
Soft drinks	Mar-17	Bela Ischia Alimentos Ltda (Brazil)	Britvic plc	57.3
Functional	Feb-17	Body & Fit Sportsnutrition BV (Netherlands)/ Grass Advantage LLC (USA)	Glanbia plc (Ireland)	155.0
Dairy	Feb-17	Glanbia Ireland (Ireland) (60%)	Glanbia Co-operative Society Ltd (Ireland)	94.6

Bulking up in sports nutrition

With consumers increasingly health conscious and interested in sports performance, the wellness and sports nutrition space continues to draw trade and private equity acquirers.

In February, Glanbia announced it was investing c. €181 million in its Glanbia Performance Nutrition segment through two acquisitions: plant-based nutrition brand Grass Advantage (trading as "Amazing Grass") in the US, and Body & Fit in the Netherlands, an online branded business focused on performance nutrition.

Addressing the growing importance of wellness, Associated British Foods (ABF) entered the sports nutrition sector with the acquisitions of Reflex Nutrition, an online supplier of protein supplements, and High 5, a producer of energy gel sachets. ABF paid £60 million to gain a foothold in this booming sector.

In the fifth transaction of the quarter, private equity house Lion Capital acquired a majority stake in Grenade, a producer of functional snacking products and supplements, valuing the business at £72 million.

Simplicity versus complexity

Under chief executive Dave Lewis, Tesco has taken steps to streamline its business – disposing of its Harris + Hoole coffee shops and Giraffe restaurants, as well as getting rid of the Dobbies garden centre chain. But the supermarket retailer now faces criticism from some of its major shareholders that it is moving in the opposite direction with the proposed £3.6 billion takeover of wholesaler Booker. Richard Cousins, a former Tesco non-executive director also quit in opposition to the deal, stating that Tesco should make its business simpler, not more complex. For its part, Tesco has defended the takeover as it revealed financial results in early April that showed progress in its turnaround plan, including the first annual increase in underlying sales in its core UK business for seven years.

The proposed deal is the latest example of the large supermarket retailers' efforts to generate growth in a brutally competitive low to no-growth market. While re-thinking some of its diversification attempts, Tesco continues to look for ways to remain competitive, in this instance by pursuing economies of scale with a move up the supply chain into wholesaling. Competition, however, is an issue for the CMA, which is scrutinising the deal. Tesco argues that it will not be adding stores, because Booker operates a franchise model for its Londis, Premier, Budgens and Happy Shopper retail chains, but the CMA is likely to consider levels of influence across the retail supply chain and Tesco's One Stop convenience stores might be an area of contention. When Tesco bought One Stop in 2003 convenience was considered a separate market to supermarkets, but the large retailers have now moved into the sector and the lines are far more blurred.

The Tesco deal follows last year's acquisition of Argos by J Sainsbury, which attracted similar criticism as being a distraction from the core business. Sainsbury's rationale was that consumer behaviour is changing. Its customers want to be able to shop quickly in store, online, or on mobile and want their purchases to be delivered quickly, or be available to be picked up in store, or at a click and collect point.

While still too early to judge the success of these ventures, what is clear is that the supermarkets will continue to evolve to meet changing consumer needs, whether that is the trend towards convenience or online/rapid delivery, and this will underpin transaction activity.

Key undisclosed deals

Sector	Date	Target	Acquirer	Deal value (£m)
Fruit & Veg	Mar-17	Blue Skies Holdings Ltd (undisclosed minority stake)	8 Miles LLP	nd
Seafood	Mar-17	Sealord Caistor Ltd	Nippon Suisan (Europe) BV/ Nippon Suisan Kaisha Ltd (Japan)	nd
Meat	Mar-17	Leivers Brothers Ltd	Danish Crown A/S (Denmark)	nd
Bakery	Mar-17	Park Cakes Acquisition Ltd	MBO team	nd
Foodservice	Feb-17	Wyn Lee Holdings Ltd	Bidfresh Ltd/ Bidcorp (South Africa)	nd
Deli	Feb-17	Yorkshire Provender Ltd	Hain Celestial Group Inc (USA)	nd
Snacks	Feb-17	Portlebay Popcorn Co Ltd (75%)/ Tavern Snacks Ltd	Tayto Group Ltd	nd
Dairy	Jan-17	FJ Need (Foods) Ltd	Ornua Co-operative Ltd (Ireland)	nd
Bakery	Jan-17	Kronenbrot KG Franz Mainz (Germany) (insolvency)	Signal Capital Partners LLP	nd
Confectionery	Jan-17	Dexters Confectionery Ltd	Kervan Gida Sanayi ve Ticaret AS (Turkey)	nd
Desserts	Jan-17	Ministry of Cake Ltd (undisclosed majority stake)	Mademoiselle Desserts SAS (France) / Equistone Partners Europe	nd
Deli	Jan-17	West Cornwall Pasty Co Ltd	Samworth Brothers Ltd	nd

Private equity

Private equity firms were involved in seven transactions in Q1 2017, representing £265 million in disclosed deal value. CapVest added to its food-focused portfolio with the acquisition of UK pork producer Karro Food Group, for a reported £180 million. The deal provided an exit for PE company Endless, which had successfully turned Karro around in its four years of ownership.

Demonstrating their strategy of investing in strong consumer brands, Piper added a second company in the natural pet food space to its portfolio. Piper invested £5 million in Pet Food UK, a producer of premium natural dry pet food whose brands include 'Barking Heads' and 'Meowing Heads'. The investment follows the 2015 acquisition of Forthglade, which focuses on premium natural wet food.

Keeping the spirits up

The alcoholic drinks sector continues to be an important driver for M&A in the F&B market, with six deals in the first quarter, representing 15 per cent of transaction volume. The boom in artisan gin continues, with two deals in the first quarter. Gruppo Campari paid £46 million for Bulldog London Dry Gin, reportedly one of the fastest growing premium gins globally; and Liverpool-based Halewood Wines & Spirits made a strategic investment in The City of London Distillery (COLD), the only working distillery in London's city centre, providing its brands with new routes to market. Halewood also made its first move into the beer sector, purchasing a stake in Lake District-based brewery, Hawkshead.

Looking ahead

One swallow doesn't make a summer and one quarter's M&A numbers don't give the overall picture of deal appetite and trends in the food and beverage sector. While deal volumes were the lowest since the third quarter of 2014, we do not believe this indicates a sharp drop-off in appetite for transactions. The fall in deal numbers is consistent with increased uncertainty, as the currency hedging programmes of many companies will have come to an end in the first quarter, leaving businesses to consider the impact of sterling's large depreciation since last summer.

But our own recent experience is that activity levels remain healthy – Grant Thornton completed four deals for clients in the first week of April alone. Also, the investment themes that have underpinned M&A activity over the last couple of years remain in place and were evident once again in the first quarter's transactions. As discussed earlier, health and wellness is a recurrent theme, as shown by ABF's entry into the sports nutrition market with the acquisition of Reflex Nutrition and High 5; and niche alcohol brands continue to drive deal activity with the large global players acquiring growing brands and the smaller operators building up scale through consolidation.

Food and beverage at their core are non-discretionary spending items. The contents of the consumer basket may change, but there will always be a basket. Of course, the changing composition creates winners and losers as companies try to adapt to shifts in consumer behaviour. For example, polarisation is an ongoing trend in the supermarket sector as consumers move towards either end of the value spectrum, putting those in the middle under pressure.

Cost pressures, too, continue to weigh on margins, with many manufacturers now having to contend with rising input costs because of sterling's depreciation, in addition to the earlier step change in labour costs through the National Living Wage. Some companies are struggling to cope with this pressure from all sides and we expect that there will be an increase in distressed deal activity in the coming months.

With inflation expected to rise, consumer spending may also come under pressure, prompting consumers to reconsider how and where they spend their money. It is difficult to predict ahead of time who the winners and losers will be. For example, during the 2008 downturn in consumer spending, consumers opted to eat out less frequently, which provided a boost for the premium prepared meal segment. What is easier to predict is that changes in consumer behaviour will continue to shape companies' strategies and investment in M&A.

Food and Drink Federation Awards 2017

The awards are fast becoming the industry benchmark of excellence for innovation, competitiveness and talent and for a fifth year running Grant Thornton are proud to sponsor the Regional Growth Business category.

The awards are open to companies and individuals right across the food and drink supply chain from primary producers and growers, manufacturers, retailers, food service, distributors and wholesale and hospitality. The Growth Business award will be split into six regions to give businesses right across the UK the opportunity to earn recognition for their progress, there will be one winner per region plus an overall winner.

Last year's regional winners included Sleaford Quality Foods, The Bread Factory, Clipper Teas, Karro Food Group and Macsween of Edinburgh.

The six regions for 2017 are:

South East England
London, Hertfordshire, Essex, Bedfordshire, Buckinghamshire, Oxfordshire, Berkshire, Surrey, Kent, Sussex, Hampshire and Isle of Wight

South West England
Cornwall, Devon, Dorset, Somerset, Wiltshire, Gloucestershire, Herefordshire, Channel and Scilly Isles

Central England
Norfolk, Suffolk, Cambridgeshire, Worcestershire, Warwickshire, Wales, Northamptonshire, Leicestershire, Rutland, Lincolnshire, Shropshire, Staffordshire

Northern England
Cumbria, Northumberland, Durham, Nottinghamshire, Derbyshire, Yorkshire, Lancashire, Cheshire, Merseyside and Greater Manchester

Wales

Scotland and Northern Ireland

For more information about these awards please visit **www.fdf.org.uk/fdf-awards.aspx**

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