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Bite Size

Recent activity in the food and beverage sector

Spring 2016

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 2016 and also looks ahead to the trends we believe will shape the market in the coming year.

In this issue we also take a look at some of the key considerations that businesses must address following the introduction of the Union Customs Code, which is the biggest shake up of the EU's customs rules in more than two decades. In addition we present a case study of Casella Wine, Australia's largest wine exporter, which is setting up a new European operation based in the UK.

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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The Union Customs Code – "Don't let the changes eat into your profits"

The Union Customs Code (UCC), implemented on 1 May 2016, represents the biggest change to the EU's customs rules and regulations in more than 20 years. The UCC introduces sweeping changes that apply across the EU, but while the new code has been in preparation for a long time and has been widely reported, a surprising number of companies are only now considering its impact on their businesses.

Mandatory financial guarantees
Many food and beverage companies use procedures such as customs warehousing and processing under customs control to mitigate the impact of duty on imported products on their monthly cash flow. Previously, these procedures have not required a mandatory guarantee. However, under the UCC, unless a company is an Authorised Economic Operator, or meets the criteria applicable to AEO(c), a guarantee will be required. Companies that meet certain of the AEO(c) criteria can benefit from reduced guarantee requirements, while those authorised as AEO(c) will be able to eliminate the guarantee requirement altogether.

Changes to special customs procedures
The UCC also introduces less fundamental, but equally important changes to the special customs procedures regime. Under the UCC, there will only be four types of special customs procedures available, these are:

- Processing (covering inward and outward processing)
- Specific use (temporary admission and end-use)
- Transit (external and internal transit)
- Storage (customs warehousing)

Processing under customs control (PCC) will disappear and be integrated into the processing special procedure, bringing closer alignment between the requirements of inward processing relief (IPR) and PCC. In addition, customs warehouse type D will disappear together with the inward processing drawback system. Existing authorisations will continue until expiry (where they are time-limited) or until they are re-assessed by HMRC, with the re-assessment period running from 1 May 2016 to 30 April 2019.

Increased benefit of the Authorised Economic Operator accreditation
While authorisation as an AEO is not mandatory, the changes introduced by the UCC certainly make it more compelling. AEO accreditation, as detailed above, provides significant advantages in relation to potential duty guarantees. It also provides advantages in relation to the guarantees required for the operation of a duty deferment account (for actual duties) and Simplified Import VAT Accounting (SIVA). In addition, AEO status will eventually provide companies with access to additional benefits introduced, or to be introduced by the UCC such as centralised clearance, self-assessment and entry into records.

If you would be interested in discussing how the changes may affect your business, please contact a member of our Customs and International Trade team.

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CASELLA FAMILY BRANDS

Casella Family Brands' most famous wine, [Yellow Tail] has grown from launch just 15 years ago to become the 5th largest wine brand in the world. Please refer to the back page for the compelling growth story of [Yellow Tail]

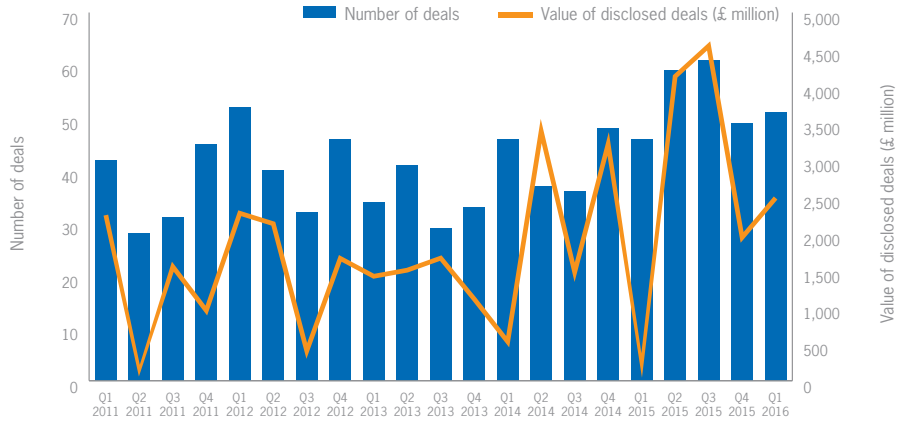
M&A activity – Q1 2016

Building on a strong 2015, the pace of M&A activity [1] in Q1 2016 was similar to the fourth quarter of 2015 (51 deals compared with 49) and was 11% higher than during the same three-month period last year.

Total disclosed deal value in the first quarter was £2.47 billion [2], of which £2.15 billion was accounted for by the sale of Brakes to Sysco, the world's largest foodservice supplier. Excluding the Brakes deal, total disclosed deal value was just £314 million, largely attributable to the limited number of deals with a publically disclosed value (just seven).

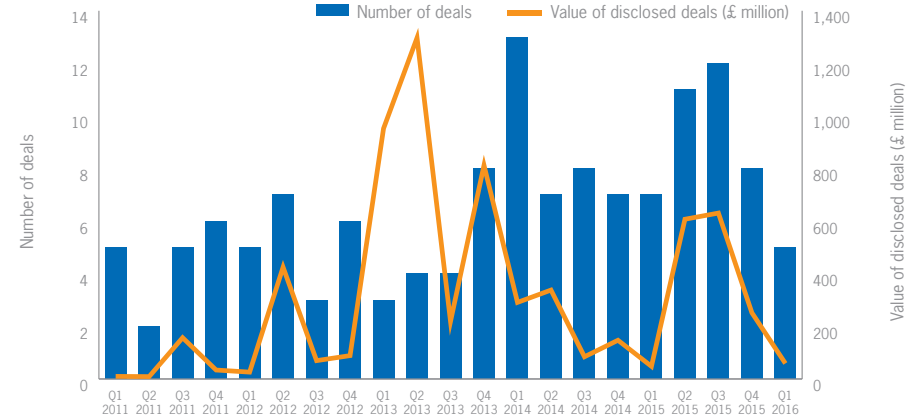
The number of deals involving private equity also declined during Q1 to the lowest quarterly level since 2013. The five private equity transactions consisted of three new investments and two follow-on acquisitions in support of buy-and-build strategies. The level of private equity investment is possibly being affected by the uncertainty created by ongoing changes in the food and drink retailing landscape. Overall, however, we do not believe that there is a lessening of private equity interest to invest in the sector, and we expect activity will pick up as 2016 progresses.

Announced M&A activity in food and beverage - quarterly



The chart above excludes the £71 billion 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 £493 million Euro Cater IBO and £715 million R&R Ice Cream IBO

The Chancellor fires the next salvo in the war on sugar

In the March budget, Chancellor George Osborne announced the introduction of a new sugar tax to be levied on the soft drinks industry. The levy is aimed at high-sugar drinks, with two bands of tax depending on sugar content. Pure fruit juices and milk-based drinks will be excluded and the smallest producers will have an exemption from the scheme.

The Chancellor is hoping to raise £500 million from the tax, but it is likely that manufacturers will reformulate their drinks in order not to be liable for the levy and as a result the tax take may be less than this estimate. However, rather than pure revenue raising, this may be the government's underlying objective in introducing the tax, as it is the statistics on obesity, particularly amongst children, that have been driving the 'war on sugar'.

The UK is the second most obese country in Europe and it is forecast that by 2030 74% of men and 64% of women will be overweight, while 36% of men and 33% of women will be obese. Currently a third of 10-11 year-olds and over a fifth of 4-5 year-olds are overweight or obese.

Diabetes, which has strong links to obesity, costs the NHS more than £1.5 million an hour, or 10% of the NHS budget for England and Wales. The prevalence of diabetes is estimated to rise to 4 million by 2025.

While the obesity crisis is an important issue, there is concern in the beverage sector that the industry is being unfairly targetted. There are a number of factors contributing to the increase in obesity of which sugar intake is only one. The new tax also raises concerns that it may be the thin end of the wedge, with the potential for the UK government to widen the scope of the war on sugar to target other perceived unhealthy food and beverage products. The risk is that this uncertainty weighs on sentiment amongst potential buyers, particularly from overseas and could have a negative impact on deal activity.

M&A activity – Q1 2016

Cross-border deals decline

The number of cross-border deals also fell in Q1, with 32 domestic transactions and 19 cross-border. This equates to a domestic to cross-border ratio of 63:37 compared with 54:46 for 2015 as a whole.

Of the 19 cross-border deals, 12 involved overseas acquirers investing in the UK, with continuing appetite from Asia to acquire western-based businesses. In the midst of McCormick's attempt to acquire Premier Foods and being rebuffed three times, Japanese instant noodle maker Nissin Foods successfully accumulated a stake in the owner of Ambrosia, Oxo, Bisto and Batchelors. Nissin acquired a 17.3% stake for £90 million, which it increased to 19.9% just days later. A partnership with Nissin provides Premier Foods with access to Nissin's innovative products and formats to distribute in the UK market, as well as access to Nissin's international scale to accelerate its own sales in overseas markets.

Other Japanese acquirers were also active during the quarter. Itochu acquired a 20% stake as part of its joint venture with confectionery business Transmar and Nishimoto Trading bought Harro Foods, a full-service importer, wholesaler and distributor of ambient and frozen Japanese foods to restaurants and specialty shops throughout the UK. Moving in the opposite direction, Irish dairy group Ornua acquired Shanghai-based dairy manufacturer, Ambrosia Dairy, which gives Ornua its first manufacturing base in China.

Deals Summary - Q1 2016

Large deals (>£250m deal value)

Sector	Date	Target	Acquirer	Deal value (£ million)
Wholesale and Distribution	Feb-16	Brake Bros Ltd	Sysco Corp. (USA)	2,154

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

Sector	Date	Target	Acquirer	Deal value (£ million)
Diverse	Mar-16	Premier Foods plc (17.3%)	Nissin Foods Holdings Co., Ltd (Japan)	89.9
Pet food	Mar-16	MPM Products Ltd (majority stake)	ECI Partners LLP	50.0
Deli	Jan-16	Bakkavor Group Ltd (50%)	Bakk AL Holdings Ltd	163.0

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

Sector	Date	Target	Acquirer	Deal value (£ million)
Desserts	Mar-16	Waverley Bakery Ltd, The	Idun Industri AS/ Orkla Food Ingredients (Norway)	5.2
Desserts	Feb-16	Chantilly Patisserie	Haydens Bakery Ltd/ Real Good Food plc	1.8
Bakery	Jan-16	Montana Bakery Ltd	Bake & Co NV (Belgium)	17.2

Demand for convenience and foodservice drives deal activity

In line with consumers' ever-growing need for convenience, there was significant M&A activity in Q1 2016 in the prepared food sector, in both chilled and frozen formats.

Amongst the key transactions, in a deal worth £163 million the founders of Bakkavor, the Gudmundsson brothers, joined forces with US-based hedge fund Baupost Group to buy a 51% stake in the UK-based food supplier from a number of Iceland-based institutions. Bakkavor is one of the UK's biggest ready-meal companies, providing prepared foods from salad to pizza and stir-fries to all the major supermarket chains. The deal, in January 2016, coincided with the loss of a contract to supply Tesco with mashed potato, which had put up to 300 jobs at risk.

Also in January, Go2 Foods acquired a majority stake in The Real Yorkshire Pudding Company, which supplies many of the major food retailers and national wholesalers as well as other food manufacturers. The business has recently introduced a gluten-free range, which features both Yorkshire puddings and toad in the hole, and makes 1.6 million Yorkshire puddings each week. Go2 Foods is the latest venture from Paul Simmonds, the former boss of Glisten snack food group.

M&A activity – Q1 2016

In the snacking/food-to-go sector, US-based Diamond Foods acquired a minority stake in premium popcorn brand Metcalfe's Skinny, providing an exit for co-founder Julian Metcalfe, founder of Itsu and Pret a Manger. In turn, Diamond Foods was itself acquired in February by US snack group Snyder's-Lance.

Compared with the under-pressure, contracting retail sector, the foodservice sector is an end market experiencing growing demand, which is underpinning deal activity. During Q1 2016, Real Good Food acquired Chantilly Patisserie, which supplies high quality, hand-made frozen desserts to the foodservice sector and Peter's Food Services bought Surrey-based gourmet hot dog business Mom's Fabulous Foods. Mom's supplies its hot dogs to stadiums, travel hubs, pub groups and fast food outlets across the country. The new deal is set to expand Peter's food-to-go offering while giving the Mom's brand access to Peter's extensive customer base across retail, foodservice, stadiums, caterers and fast food outlets.

Wholesale change

The wholesale and distribution sector was particularly active in the first quarter, with the standout transaction being Sysco's £2.15 billion acquisition of Brakes. Sysco, the world's largest foodservice supplier, agreed the deal following last year's aborted takeover of its biggest domestic rival, US Foods. Brakes supplies food to more than 50,000 customers including restaurants, hospitals and schools, and its acquisition will give Sysco greater access to Europe. Brakes' owner, Bain Capital, had been exploring a sale

Key undisclosed deals

Sector	Date	Target	Acquirer	Deal value (£ million)
Alcohol	Mar-16	Dublin Whiskey Company Ltd	Quintessential Spirits UK Ltd	n.a.
Wholesale & Distribution	Mar-16	Kitwave Ltd (minority stake)	Pricoa Capital Group/ Allstate (USA)	n.a.
Pet food	Mar-16	Tasty Bone Co. Ltd	Pets Choice Ltd	n.a.
Deli	Mar-16	Simpsons Ready Foods Ltd's Goblin and Simpsons business	Malton Foods/ Zwanenberg Food Group BV (Netherlands)	n.a.
Alcohol	Feb-16	The Pogues' Irish whiskey brand (50%)	Halewood International Ltd	n.a.
Alcohol	Feb-16	Beer Hawk Ltd	Anheuser-Busch InBev NV (Belgium)	n.a.
Ingredients	Feb-16	Fuerst Day Lawson Holdings Ltd	IBO - Highlander Partners LP (USA)	n.a.
Fish	Feb-16	Premier Fish Ltd	IBO - Owner Venture Managers	n.a.
Confectionery	Feb-16	Transmar Group (20%)	Itochu Corp. (Japan)	n.a.
Fruit & Veg	Feb-16	Progressive Produce LLC (USA) (65%)	Total Produce plc	n.a.
Wholesale & Distribution	Feb-16	Harro Foods Ltd	Nishimoto Trading Co Ltd (Japan)	n.a.
Catering	Jan-16	Garrets International Ltd	Ove Wrist & Co AS (Denmark)	n.a.
Deli	Jan-16	Mom's Fabulous Foods Ltd	Peter's Food Service Ltd	n.a.
Dairy	Jan-16	Shanghai Ambrosia Fine Foods Company (China)	Ornua Co-operative Ltd (Ireland)	n.a.
Fish	Jan-16	Dawnfresh Seafoods Ltd's stock and scampi business	Whitby Seafoods Ltd	n.a.
Snacks	Jan-16	Metcalfes Skinny Ltd (26%)	Diamond Foods Inc. (USA)	n.a.
Meat	Jan-16	Forza AW Ltd/ Kober Ltd	International Procurement and Logistics/ ASDA	n.a.
Soft drinks	Jan-16	The Noisy Drinks Co Ltd. (51%)	Nichols plc	n.a.
Frozen	Jan-16	Real Yorkshire Pudding Company Ltd (95%)	Go2 Foods Ltd/ Charles Payne	n.a.
Pet food	Jan-16	Nestle Purina PetCare Company (Operations in France, Italy and Spain)	Bob Martin (UK) Ltd	n.a.

[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.

or listing of Brakes since the middle of 2015, but recent stock market turbulence has led many private equity groups to reconsider IPOs as an exit route from investments.

The Brakes deal is an illustration of consolidation in what remains a fragmented sector undergoing significant change. Competition is increasing in wholesale and distribution as the number of routes to market multiply and existing players diversify. There is also an increasing number of specialist operators gaining market share, further fragmenting the market as it consolidates. Logistics groups are also eyeing the market, typified by the five-year joint venture deal struck in Q1 between Compass Group and DHL to provide catering services across a range of industries.

During Q1 NVM Private Equity exited Kitwave Wholesale, selling its minority stake to lead investor Pricoa Capital Group and co-investment partner Allstate, in a refinancing deal that will allow Kitwave to continue pursuing its acquisition strategy. Kitwave, founded in 1988, has transformed itself from a regional confectionery based business into a diversified, national wholesaler through 11 acquisitions since 2006.

Other deals in the wholesale and foodservice sectors include Bidvest Foodservice's acquisition of Caterfood, a foodservice distributor in the south west of the UK; AB InBev's acquisition of Beer Hawk, a specialist beer wholesaler; Musgrave Group's acquisition of foodservice distributor C.J. O'Loughlin Quality Foods, and Fresh to Store's (the owner of Kerryfresh) acquisition of the chilled van sales distribution business Stocked from the Indigo Food Group.

Soft drinks sector M&A undeterred by sugar tax

The soft drinks sector is the target of the new UK sugar tax, but it is interesting to note that there were four deals in just three months in this segment. Nichols acquired the 51% stake it did not already own in The Noisy Drinks Co, the leading supplier of iced drinks to the UK's holiday and leisure industry, but the other deals in the quarter typified broader food and beverage sector trends: health and wellness, provenance and Fairtrade. The Natural Beverage Company acquired Fairtrade cola manufacturer Ubuntu; glo! acquired Bobosjuicery, a manufacturer of cold pressed juices; and 'free-from' coconut milk producer Rebel Kitchen acquired raw coconut water brand Unoco.

In the alcoholic beverage sector, interest continues for niche spirits and craft beer. During the quarter Dublin Whiskey Company was acquired by Quintessential Spirits and Halewood bought a 50% stake in The Pogues Irish whiskey brand.

Pets as people propels M&A

The ongoing trends towards functionality, wellness and premiumisation in the human food sector are also evident in the petfood sector. The majority of pet owners consider their pets to be part of their family and this trend towards humanisation is driving demand for better pet food. The UK spent an estimated £4.6 billion on their pets in 2015 according to Euromonitor, representing a 25% increase since 2010.

Whilst the petfood sector is already heavily consolidated (dominated by Mars and Nestle Purina), the growing niche sector is attracting increasing interest from both private equity and trade consolidators. There is particular interest in the premium and natural niches, which have been gaining market share and are helping to drive market value growth in an otherwise low growth category.

In Q1 2016 alone there were three deals in the petfood sector. In March, ECI acquired a majority stake in MPM, a premium petfood company, which makes its Applaws and Encore pet food and Nature's Calling cat litter using natural ingredients. The deal will help MPM finance its continuing international expansion.

Bob Martin (UK) Ltd, the UK-based producer and distributor of vitamin and mineral powders for dogs and cats worldwide, acquired the France, Italy and Spain-based operations of Nestle Purina PetCare. The acquisition will provide Bob Martin with a broader range of branded, bespoke and private label products across all pet categories, as well as providing access to every major multiple retailer in Europe. Finally, pet food manufacturer Pets Choice acquired Tasty Bone, a manufacturer of niche nylon edible and rubber chew and play toys.

Looking forward

The looming UK referendum on European Union membership – the Brexit vote – has focused attention on June 23rd.

However, regardless of the outcome, the fortunes of the food and beverage sector are likely to be determined more by the detail of subsequent trade negotiations than the simple fact of the 'yes' or 'no' result. If the vote is to stay in, the UK government can be expected to endeavour to support and improve existing trade relationships. Conversely, a 'no' vote would not be a vote for isolation and new trade agreements with non-EU partners would be negotiated. In either case, it will be the detail of the agreements that will be of most importance.

The food and drink industry's concerns about trade are understandable, but it is worth noting that the UK is a net importer of food. In so far as a 'no' vote led to higher imported food costs, this would create an argument for promoting higher consumption of British food – for example, Somerset brie rather than French brie. Whilst the UK food and drink industry would undoubtedly change, it need not necessarily be in ways that would be unequivocally bad news for British producers.

A bigger issue, arguably, would be the impact of a 'no' vote on the use of overseas labour in the food and beverage sector. The proportion of British employees in the industry is low and many segments rely on the availability of competitively priced labour from abroad. It is not obvious whether after a 'no' vote the UK would either ask foreign workers from EU countries to leave or prevent further workers coming in. Clearly, however, there would be increased uncertainty regarding the availability and cost of overseas labour, at a time when the sector is already facing significant upward pressure on wage costs through the introduction of the National Living Wage.

It is the prospect of higher, more uncertain labour costs and other sources of uncertainty that could have the biggest impact on transaction activity. As discussed elsewhere in this issue, the new sugar tax has raised concerns that other parts of the industry as well as drinks could be the target of increased taxation in the future. The need to renegotiate trade deals in the aftermath of the Brexit vote is a further source of uncertainty. Taken together these factors suggest that the food and beverage sector may be more risky than in the recent past. While the flipside of greater risk can be increased return, it is not unreasonable to expect an adverse impact on dealmakers' confidence, particularly amongst overseas buyers. While one quarter's data does not represent a trend, it is plausible that the lower level of interest from overseas buyers in the first three months of the year is in part because of this greater uncertainty and perceived risk.

CASELLA
FAMILY BRANDS

[Yellow Tail], a compelling growth story

Underpinned by highly distinctive brand marketing and a successful commercial strategy, [Yellow Tail], Casella Family Brands' most famous wine, has grown from launch just 15 years ago to become the 5th largest wine brand in the world. Now, with Grant Thornton's help, Casella Family Brands is embarking on the next stage of its UK and European growth story.

Casella is Australia's largest family wine company whose growth has been driven by the global success of [Yellow Tail]. In the USA, its biggest market, [Yellow Tail] has become the number one imported wine brand, selling around 10 million cases. It is very successful in its domestic market as well as in a further 50 countries. In the UK, [Yellow Tail] is the sixth largest and fastest growing wine brand, selling more than 1.2 million cases with a retail value of £85 million.

[Yellow Tail]'s appeal is based on a high quality product, marketed cleverly. Casella's strong relationship with grape growers means its wine is made from the best quality fruit, while its winemaking philosophy produces fruity, smooth and easy drinking wine, which consumers want to return to again and again. The brand's image of a rock wallaby and the bold colouring on its label give [Yellow Tail] a very distinctive look and personality, which makes it easy to find in the wall of wine on supermarket shelves.

The price of wine has been inexorably linked to promotion in the retail space. However, [Yellow Tail] has built a 16% price premium to Australian wines through marketing that delivers high visibility in-store merchandising and a tasting programme that encourages consumers to try before they buy, all supported by a strong Facebook presence.

In support of its marketing strategy Casella has developed a retail distribution network that reaches beyond traditional grocery customers to embrace multiple and independent convenience stores, as well as the pub and restaurant trade. The breadth of distribution allows for greater consumer availability and visibility and, in the on trade, provides the opportunity for trial with programmes such as quarter-size bottles and wine by the glass. The additional benefit of a broad distribution base is that it ensures that the brand is not dependent on any one sector or customer.

In the UK, success to date has been achieved with a distribution partner. Casella now believes the time is right to take control of its own destiny and, with Grant Thornton's help, has established Casella Family Brands (Europe) to take over distribution, initially in the UK and longer-term across Europe. Casella's ambition is for [Yellow Tail] to become the UK's number one brand and, combined with exciting opportunities across Europe, the company remains a compelling growth story.

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