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Bite Size

Recent activity in the food and beverage sector

Winter 2016/17

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 2016 and the year overall and looks ahead to the trends we believe will influence the market in the coming year.

Unsurprisingly, the UK's decision to leave the European Union continues to be a dominant theme and with the shape of the negotiations and the post-Brexit landscape still unknown, the only real certainty is more uncertainty.

Against this backdrop, in this issue we take a look at the potential increased costs arising from customs duty in the worst-case scenario where the UK has no free access to the EU market and tariffs are also imposed by the UK on imports from the EU. In addition, we provide details of this year's FDF Awards, where for a fifth year running Grant Thornton are proud to sponsor the Regional Growth Business category.

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.

Trefor Griffith
Head of Food and Beverage, UK
T +44 (0)20 7728 2537
E trefor.a.griffith@uk.gt.com

Brexit … spilling the beans on additional customs duty costs

With the prospect of a 'hard Brexit' increasingly becoming a reality, have you considered how much additional Customs Duty your business might have to pay on products sourced from the EU?

Work we have done for one of our clients, which imports approximately £60 million of produce from the EU each year, suggests the additional customs duty cost could be as much as £9.5 million per annum, an uplift of over 15%. And it doesn't stop there! As import VAT is calculated on the customs duty inclusive value of goods imported, there could also be an adverse impact on working capital, as businesses are forced to fund the additional VAT cost until such time as it can be reclaimed from HMRC (if at all). That's an additional VAT cash flow cost of £475k per quarter!

What do we know now?

The International Trade Secretary, Liam Fox, has indicated to Parliament that the UK will look to apply the existing EU customs duty rates to imports into the UK, after Brexit. In practice this means that UK businesses importing produce grown in the EU will be required to pay customs duty when that produce arrives in the UK.

Much has been made of the low rates which often apply to goods imported into the EU, with many commentators citing an average rate of around 2%. However, this does not necessarily apply to food and drink imports. As these products are a basic necessity to the population, governments usually look to ensure that local producers are protected by adopting high customs duty rates, which ensure the sustainability of the local industry. Consequently, EU duty rates for such products tend to be higher and the UK is set to adopt those rates….which is not good news for the sector.

A typical example of the additional duty liability that importers could face is tinned tuna, which attracts a duty rate of 24%.

Clearly, then, importers of food products should prepare to face high tariffs when buying from European suppliers, if the Prime Minister's hopes of achieving a good trade deal with the EU are misguided.

What should you do now?

We have conducted a number of supply-chain reviews for our clients helping them to quantify the potential duty liability post-Brexit, as well as looking at potential options to manage and mitigate these costs.

Please contact us if you would like to know more or to discuss your own review in more detail.

Louise Scholey
Associate Director – Indirect Taxes
T 020 7865 2194
E louise.scholey@uk.gt.com

Michael Alexander
Executive – Customs Duty
T 020 7728 2532
E Michael.d.alexander@uk.gt.com

fdf AWARDS food and drink federation 2017

Grant Thornton are proud to sponsor the Regional Growth Business category as part of the FDF Awards 2017. These awards are an opportunity for dynamic businesses to gain the recognition they deserve and to celebrate some of the success stories in our increasingly challenging sector. Please refer to the back page for details of how to enter.

M&A activity – Q4 and full year 2016

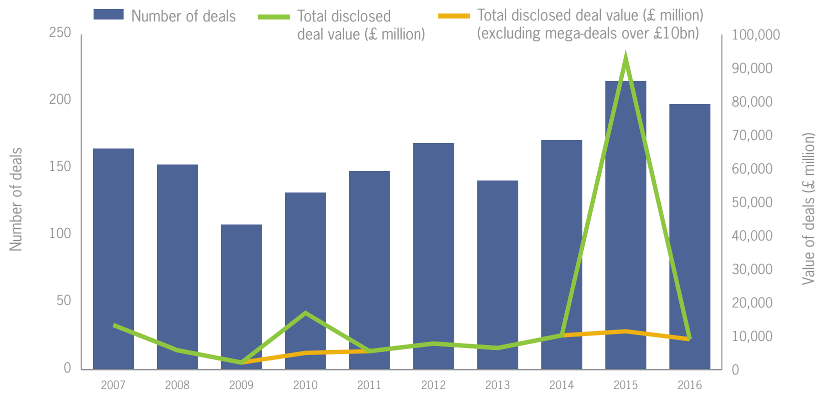
Despite the uncertainty both ahead of, and in the aftermath of the Brexit vote, deal activity in 2016 in the F&B sector remained solid. There were 48[1] food and beverage transactions in Q4, bringing the total for the year to 198, compared with 215 for 2015, a fall of 8%. However, these figures should be put into context: 2015 was a particularly active year in terms of both deal volume and value and 2016 was still the second busiest year for sector M&A activity since 2007. It appears that Brexit prompted a short-term slowdown in transactional activity – Q2 was the softest quarter of the year – rather than a sustained reduction in deal appetite.

Total disclosed deal value[2] for Q4 2016 was £2.2 billion, a significant increase on the prior quarter, which recorded £576 million. Total disclosed deal value for 2016 stood at £8.4 billion, which compares with £10.8 billion for 2015 (after excluding AB InBev's £81 billion acquisition of SABMiller announced at the end of 2015). This represents a decline of 22% compared with the previous (adjusted) year.

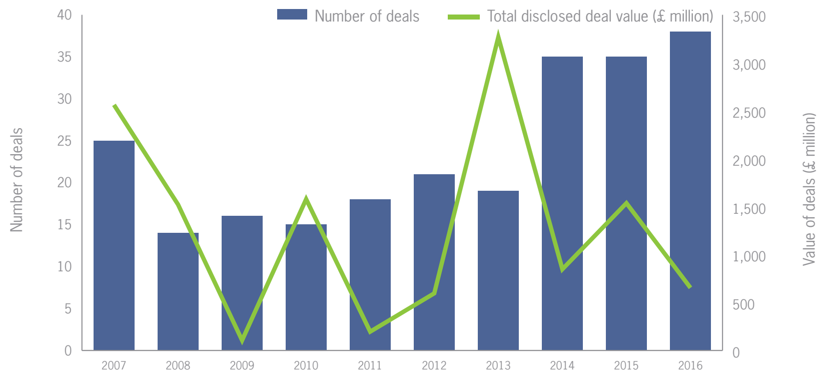
The largest transaction in Q4 was Japanese conglomerate Sumitomo's approach to acquire Irish fruit distributor Fyffes, offering £716 million for the London-listed company in a transaction that will allow Sumitomo, already a leading fruit distributor in Asia, to significantly expand its European food footprint.

A significant trend in the data is the increasing number of overseas acquirers for UK/ Irish targets. In 2014, overseas buyers accounted for 20% of transactions with UK/Irish targets. In 2015 this rose to 28% and increased further in 2016 to reach a level of 32%. North American and European groups continue to account for the majority of overseas appetite for UK/ Irish targets, but there has also been a steady rise in interest from Asian buyers for western assets. Asian acquirers represented 11% of overseas buyers of UK/ Irish targets in 2014, growing to 13% in 2015 and 19% in 2016. There was particular appetite from Japanese acquirers in 2016, with three deals in Q4 alone: Sumitomo's approach to Fyffes, Nagatanien Holdings' acquisition of fellow freeze-dried ingredients producer Chaucer Food Group, and agricultural co-operative ZEN-NOH's acquisition of ethnic food supplier Scotch Frost of Glasgow.

Announced M&A activity in food and beverage - annually



Announced PE activity in food and beverage - annually



The spike in 2013 deal value is attributable to three significant IBOs with total deal value of £1.6 billion

Hot sectors

The areas of the sector drawing the most activity in Q4 were consistent with the previous quarters.

Convenience cravings increasing

The demand for convenience was one of the drivers behind a number of deals in the crisps and snacks, as well as the food-to-go sectors. The trends for healthy snacking and gluten-free products also drew M&A activity. During Q4 Apax-backed Europe Snacks of France acquired Kolak Snack Foods, and fruit and vegetable crisp maker Emily Crisps sold a significant minority stake to private-equity firm Inverleith and investor club Hothouse Brands. In total, there were 10 deals in the crisps and snacks sector in 2016. Other key snacking transactions included the sale of Tyrrells to Amplify Snack Brands of the US, Kettle Foods' acquisition of the remaining stake in Metcalfe's Skinny Popcorn and the sale of Stream Foods, a maker of natural and healthy fruit snacks under the Fruit Bowl brand.

Greencore progressed its strategy of focusing on the food-to-go/ convenience market with its Q4 £597 million acquisition of Peacock Foods in the US, a manufacturer of ambient,

Deals summary – Q4 2016

chilled and frozen food products, which followed its earlier acquisition in 2016 of The Sandwich Factory for £15 million. Also in food-to-go, Sun Capital acquired Fresh-Pak Chilled Food, a supplier of fresh sandwich fillings, pate, dips and cooked egg products into the UK retail, foodservice and food manufacturing markets.

The pull of protein

The protein sector remained an active sector for M&A in 2016. Q4 transactions included the acquisition of Netherlands-based Group of Butchers by Equistone and Cranswick's acquisition of Dunbia's pork processing business, building on its earlier £40 million acquisition of Crown Chicken. Ranjit Boparan continued to build his meat empire in 2016, sealing the acquisitions of both turkey processor Grove Park and Bernard Matthews in a pre-pack administration deal, and reportedly fending off competition from Moy Park/JBS and UK chicken processor Faccenda. With UK demand for meat running ahead of domestic production capacity, we expect continued interest in the sector from the world's largest players, which will support deal activity.

Alcohol acquisitions

Consumer demand for craft beer and artisan spirits continues to increase, and is reflected in the high level of M&A in the alcoholic beverages sector. The artisan gin sector, in particular, has undergone an unprecedented boom in the past year or so. During Q4 Beam Suntory acquired a minority stake in upmarket brand Sipsmith and Stock Spirits Group acquired Bohemia Sekt SRO's Prazska vodka, Nordic Ice and Dynybyl gin brands.

There were a raft of transactions in all areas of alcoholic beverages in 2016, from craft beer and ale (Bath Ales, Inveralmond Brewery, Woodfordes) through to spirits (The Pogues' Irish whiskey brand, Spencerfield Spirit, Benriach Distillery etc.) and at the larger end of the scale, AB InBev's acquisition of SABMiller completed in Q3 of 2016.

Large deals (>£250m deal value)

Sector	Date	Target	Acquirer	Deal value (£ million)
Fruit & Veg	Dec-16	Fyffes plc (Ireland)	Sumitomo Corporation (Japan)	715.6
Fruit & Veg	Nov-16	MP Evans Group plc	Kuala Lumpur Kepong Berhad (Malaysia)	422.1
Deli	Nov-16	Peacock Foods Inc. (USA)	Greencore Group plc (Ireland)	597.0
Frozen	Nov-16	Optima Srl (Italy)	IBO (Charterhouse Capital Partners LLP)	302.6

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

Sector	Date	Target	Acquirer	Deal value (£ million)
Ingredients	Dec-16	Chaucer Foods Ltd	Nagatanien Holdings Co., Ltd (Japan)	103

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

Sector	Date	Target	Acquirer	Deal value (£ million)
Wholesale/ Frozen	Nov-16	SFG Holdings Ltd (t/a Scotch Frost of Glasgow Ltd)	ZEN-NOH/The Norinchukin Bank (Japan)	7.7
Dairy/ Ingredients	Nov-16	CoreFX Ingredients LLC (USA)	Ornua Co-operative Ltd (Ireland)	4.5
Wholesale/ Foodservice	Oct-16	Foodfellas Ltd, The (60%)	Charoen Pokphand Foods Public Company Ltd (Thailand)	12.3
Alcohol	Oct-16	Bohemia Sekt SRO's vodka, and gin brands (Czech Republic)	Stock Spirits Group plc	4.5
Catering	Oct-16	Journey Group plc (70.1%)	IBO (Jaguar Holdings Ltd/ Harwood Capital LLP)	17.3
Wholesale/ Foodservice	Oct-16	Vegetarian Express Ltd (majority stake)	IBO (Bridges Ventures LLP)	5.6

[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.

Spotlight on Private Equity

There were 12 transactions involving private equity groups in Q4, bringing the total for the year to 38, a robust performance, just ahead of the 35 transactions recorded in each of the previous two years. Q4 transactions included Livingbridge winning the auction for caterer Rhubarb and Apax Partners-backed French desserts group La Compagnie des Desserts acquiring Destiny Foods in the UK.

A number of UK-based private equity groups continue to invest in European assets. In Q4, deals included Equistone supporting the MBO of Group of Butchers, a Netherlands-based manufacturer of premium meat products and Bridgepoint Development Capital acquiring a majority stake in Sweden-based functional drinks business Vitamin Well AB. Whilst there remains some discussion over whether some PE houses will increasingly shift their focus from UK assets to the continent, PE appetite clearly remains strong in the UK, and continues to draw overseas PE investors too.

Looking forward

Reviewing the year's transactions data, one striking feature is the continuing upward trend for overseas buyers to acquire UK/Irish food and drink businesses. On a rising path since 2014, this trend is likely to be influenced by two additional drivers following the Brexit decision and its impact on the value of sterling. The first driver clearly supports the growing trend: the depreciation of the pound means that UK assets are now about 20% cheaper for overseas buyers. As 2017 gets under way, the pound remains under pressure as financial markets factor in the possibility of a "hard Brexit".

The potential for the UK to no longer be part of the common market after Brexit is likely to have a more ambiguous impact on M&A activity. Some overseas buyers, considering an investment in the UK as a gateway to Europe, might be deterred by the risk of more restricted access to EU markets. Conversely, potential buyers assessing how to access UK customers in the post-Brexit world may now consider a direct investment in the UK, given that a base in continental Europe may no longer guarantee free access to British customers. The net impact on deal activity is hard to determine at this early stage of the exit process.

The sharp fall in sterling since the Brexit decision is also a major factor for UK food and drink manufacturers. A weaker pound makes UK exports more competitive and creates potential for companies to increase their growth. The UK government is putting greater focus on promoting food and drink exports, with Defra publishing a five-year international action plan during 2016. Whilst increased exports are clearly positive for the sector and the wider economy, it is worth highlighting that not all food and drink products are suitable for export, either because of different consumer preferences overseas, or the limited shelf life of perishable goods. However, products focused on the domestic market could also benefit from the weakness of sterling, which makes imported alternatives more expensive. As well as boosting exports, a weaker pound increases the potential for import substitution and using more UK-produced foodstuffs.

With the price of imported goods and raw materials rising, manufacturers face further upward pressure on costs, which will be difficult to pass on to their supermarket customers, who will always seek to resist price increases. Margin pressures will lead some businesses to struggle and there is scope for further consolidation as the sector polarises between the winners and losers. There remains a wall of money interested in investing in UK food and drink businesses, but greater risk about where that money is invested within the sector.

Food and Drink Federation Awards 2017

fdf AWARDS food and drink federation 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, 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**

The winners will be chosen based on achievement relative to company size so both large and small companies stand an equal chance of claiming this prestigious award. Sustainability and ambition of growth will also be considered.

Growth can be through increased sales, capacity and resource expansion, developing new and innovative product lines or even impressive first-year achievements after starting from scratch. In short, if you think your business is fabulous, enter and illustrate why.

For more information about these awards and how to enter please visit - www.fdf.org.uk/fdf-awards.aspx