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Bite Size

Food and beverage insights

Sector activity

Autumn 2017

The nights have drawn in and Christmas decorations are already on store shelves. Which can only mean it's time to welcome you to the Autumn edition of 'Food and beverage insights', our quarterly overview of activity in the food and beverage sector.

This issue provides analysis on M&A activity in the third quarter of 2017 and looks ahead to some of the big trends for the new year.

In this edition we also take a look at some of the major challenges facing the industry. 'Calculating the indirect impact of Brexit' highlights the need for businesses to plan for the potential increase in import duties and tax. While 'Minimum wage reviews: are you HMRC ready?' points to areas of National Minimum Wage compliance which businesses are falling foul to. Finally, there is a bit of a teaser to our upcoming 'Boosting the balance sheet in your food and beverage business' report which looks at untapped opportunities to release cash within your business.

We hope you find this edition useful. As ever, please do get in contact if you have any questions about these issues or how Grant Thornton can help you and your business.

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Boosting the balance sheet in your food and beverage business - exclusive preview

The food and beverage (F&B) sector contributes an estimated £28.2 billion in value and 400,000 jobs to the UK economy directly. A further £100 billion in value and 4 million jobs are provided from the supply chain. The importance of the sector to the UK cannot be understated.

The F&B sector also provides a global showcase for the best of British branding and creativity. From household names such as Mr Kipling and Sharwood's, to relatively new entrants like The Saucy Fish Co and Brewdog that are taking the world by storm.

All these successes should be celebrated, but we cannot be complacent. There's no denying that the sector faces significant emerging economic and regulatory uncertainty. The as yet undetermined impact of Brexit is a key driver, of course. Developments in technology are also playing an important role, while changing consumer habits and tastes are driving rapid change and creating room for new players to disrupt.

It is with these external changes in mind that we will soon be publishing a new report, '*Boosting the balance sheet in your food and beverage business*'. This report looks at how food and drink businesses can unlock cash in their businesses to prepare financially for the potential challenges and opportunities ahead.

In the report we estimate there's a further £7.3 billion of cash that F&B companies across the UK could access by improving their management of working capital. The benefits of doing so include cost reduction, better access to finance and greater flexibility when investing for growth.

The report also looks at how many F&B businesses are not fully aware of the opportunities open to them through R&D tax relief. Whether it's improving the understanding of what qualifies as R&D, or putting processes in place to ensure a systematic approach to applying for relief, we discuss how firms can maximise these opportunities.

We're looking forward to sharing '*Boosting the Balance Sheet in your food and beverage business*' with you in due course and we hope you find it insightful.

Deals summary

Continued interest from international acquirers and three mega-deals resulted in a busy summer for the industry. A total of 43 deals[1] were announced in Q3 involving a UK/Irish acquirer and/or target. Whilst this represents a decline on the volume of deals in the previous quarter, which saw 62 deals take place, deal activity for the year is similar to the corresponding period in 2016. There have been 146 deals in 2017 to date compared to 152 for the equivalent period last year.

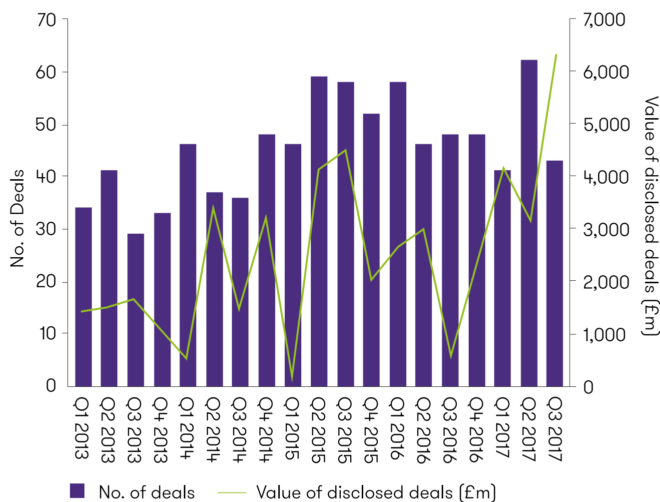
Three mega-deals contributed to a total disclosed deal value[2] of £6.4 billion during Q3, which is double that of Q2. Excluding the mega-deals the quarter's total disclosed deal value was £1.2 billion, compared to £1.7 billion for Q2, excluding the Weetabix transaction.

The biggest deal of this quarter was McCormick's acquisition of Reckitt Benckiser's non-core food business for £3.2 billion. The acquisition strengthens McCormick's leadership in the condiments category by adding brands including French's Mustard and Frank's RedHot sauce and allows Reckitt Benckiser to focus on its consumer health and domestic brands.

The long-awaited sale of UK poultry producer Moy Park to US based Pilgrim's Pride added £1 billion to the quarter's disclosed deal total. This was closely followed in value by the sale of Cott's bottling activities in the UK, US and Mexico to Refresco for £963 million.

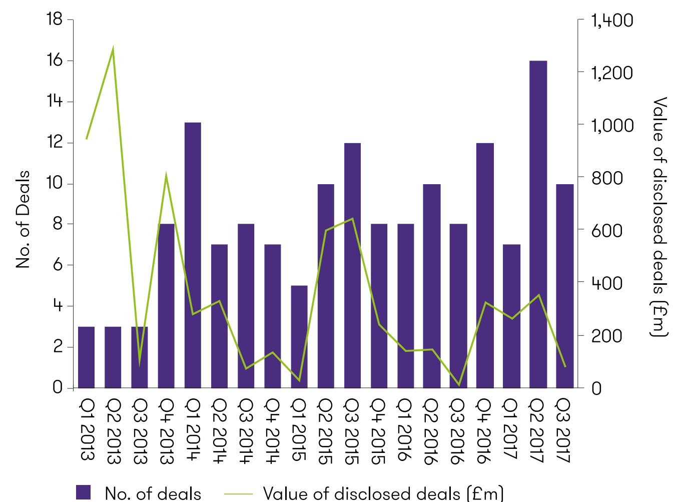
With the domestic to cross-border ratio heavily weighted in favour of overseas acquirers at 40:60, this quarter has seen no let-up in the appetite of international acquirers. Of the 34 deals involving UK/Irish targets, 48.5% of the acquirers were overseas – this compares to 31% for the first half of 2017, and a similar level on average for the whole of 2016.

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 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, and mergermarket 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.

Deals summary – Q3 2017

Large deals (>£250m deal value)

Sector	Date	Target	Acquirer	Deal value (£m)
Meat	Sep-2017	Moy Park Group	Pilgrim's Pride Corporation (USA)	1,000
Condiments	Sep-2017	Acetum SpA (Italy)	Associated British Foods plc	273.0
Diverse	Sep-2017	Unilever South Africa Holdings (Pty) Ltd (South Africa)	Unilever plc	271.7
Condiments	Jul-2017	Reckitt Benckiser Group plc (Food businesses)	McCormick & Company Inc. (USA)	3,218
Soft drinks	Jul-2017	Cott Corporation (bottling activities) (USA, Mexico and UK)	Refresco Gerber BV (Netherlands)	963.0

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

Sector	Date	Target	Acquirer	Deal value (£m)
Ready meals	Aug-2017	Preferred Brands International Inc. (USA)/Tasty Bite Eatables Ltd (India)	Effem Holdings Ltd/Mars Inc. (UK/USA)	158.0
Meat	Aug-2017	Cherry Valley Farms Ltd	CITIC Group Corporation/Beijing Capital Agribusiness Group (China)	138.5
Agriculture	Aug-2017	Sunrich Plantations Pte Ltd (Singapore)	MP Evans Group plc	83.5
Alcohol	Jul-2017	TJ Carolan & Son Ltd (Ireland)	Heaven Hill Distilleries Inc. (USA)	126.7

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

Sector	Date	Target	Acquirer	Deal value (£m)
Ready meals	Sep-2017	Healthy Kids Ltd t/a Little Dish (Undisclosed majority stake)	Profile Capital Management LLC (USA)	17.0
Alcohol	Sep-2017	Innis and Gunn Brewing Company Ltd (Minority stake 27.9%)	L Catterton LLC (USA)	15.0
Agriculture	Aug-2017	Bridge Farm Nurseries Ltd	MBO (Northedge Capital LLP)	30.0
Ingredients	Aug-2017	Flavours and Essences UK Ltd	Frutarom Industries Ltd (Israel)	15.0
Deli	Jul-2017	Montalbano Industria Agroalimentare SpA (Italy) (51% stake)	Oxy Capital – Sociedade de Capital de Risco SA (Portugal)/ Attestor Capital LLP	20.5
Alcohol	Jul-2017	Quintessential Brands Ireland Whiskey Ltd (Minority stake 25%)	Stock Spirits Group plc	16.2
Agriculture	Jul-2017	Donegal Investment Group plc (Grianan Estate and associated assets) (Ireland)	Glenmore Estate Farms Limited (Ireland)	15.3
Alcohol	Jul-2017	London Fields Brewery Ltd	Carlsberg A/S (Denmark)	4.0

Private equity

There was a drop in the number of private equity (PE) investments in the sector during Q3. Ten of the 43 deals in the quarter involved private equity investment, compared to 16 deals in the preceding quarter. However, the total number of deals involving PE investment in the year to date is now 33, compared to 26 for the same period last year.

Overseas PE houses continued to invest in UK brands this quarter. US investment firm Profile Capital acquired healthy baby food group Little Dish in a £17 million deal, providing a second windfall for food entrepreneur John Stapleton, co-founder of the New Covent Garden Soup company. Elsewhere, Scottish craft brewer Innis & Gunn accepted £15 million investment from US private equity firm L Catterton, in exchange for a 27.9% stake in the business.

Other PE deals in the sector were focused on the booming pet food and 'free from' markets.

Protein power

Whilst the alcoholic beverages sector continued to be a steady driver of deal activity in Q3, it was the protein market that continues to dominate deal activity and value. The four key deals this quarter were led by the £1 billion acquisition of poultry processor Moy Park, which saw its ownership change hands for the third time in the past ten years.

Elsewhere in the protein sector, pig processing company Tulip, part of the Danish Crown group, announced its acquisition of UK pig producer Easey Holdings. The Competition and Markets Authority (CMA) has launched an investigation into the deal so this remains one to watch.

Cherry Valley Farms, a leading supplier of Peking ducks has been acquired by two Chinese companies, Beijing Capital Agribusiness Group and CITIC Modern Agriculture Investment Company. With an overall market share of over 75%, Cherry Valley Farms sells its ducks to more than 60 countries and regions around the world.

Most recently, Cargill of the US and Faccenda Foods, announced a joint venture in the UK (subject to clearance by the relevant regulatory authorities) focused on their chicken, turkey and duck businesses.

It would be remiss to comment on this sector without mentioning the investigation at 2 Sisters Food Group, which unmasked poor hygiene standards and the altering of food labels. Ranjit Boparan, owner of the Group which produces a third of all poultry products eaten in the UK, recently appeared before a parliamentary committee to address the allegations.

A niche opportunity

The UK 'free from' market continues to grow at a pace and is expected to be worth £673 million by 2020. The PE community is clearly aware of this potential - a standout deal in Q3 was Mayfair Private Equity's acquisition of a majority stake in Promise Gluten Free. The Donegal-based company exports its gluten-free loaves to over 1,000 stores in Australia and 10,000 outlets in the US and Canada, as well as supplying Tesco, Sainsbury's and Marks & Spencer in the UK.

Separately, the Soil Association has said that the sale of organic products is due to reach a record £2.2 billion in the UK by end of this year. Unilever jumped in on that trend last quarter adding organic herbal tea business, Pukka Herbs, to its portfolio. Unilever has vowed to adhere to Pukka's ethical heritage whilst helping it expand its global footprint as demand for upmarket organic beverages increases.

At the smaller end of the scale, Pembroke VCT made a further investment in cold-pressed juice producer Plenish. Life Health Foods UK, owner of breakfast brands Up & Go and Nutri-Brex, added premium breakfast smoothie, Nosh, to its growing portfolio.

It was also interesting to see Diageo, the world's largest distiller, take a minority stake in Seedlip, a British company which produces non-alcoholic distilled drinks. The investment was made via Distill Ventures, the company's funded accelerator programme for entrepreneurs. With the number of drinkers in the UK falling and millions of people taking part in initiatives such as 'Dry January' and Macmillan Cancer Support's 'Go Sober for October', it wouldn't be surprising to see more drinks brands moving into this area.

It's not only humans fuelling interest in more niche ranges and brands. The continued 'humanisation' of pets, which sees consumers opting for premium and natural food offerings for their four-legged friends, led to a number of deals over the summer. PE firm Endless' SME fund, Enact, invested in Kennelpak, a wholesale supplier of own-brand and third party branded pet food and associated pet products. The quarter also saw Rutland Partners acquire Armitage, a leading manufacturer and supplier of premium branded pet treats and accessories. Interest in the premium end of this market was also evident on our TV screens, with Dragons Den's Jenny Campbell and Tej Lalvani investing £50,000 in Huxley Hound's organic and vegetarian pet treats.

Looking ahead

Amazon sent shock waves through the food and beverage sector over the summer when it bought Whole Foods. The e-commerce giant's move is one of the most obvious examples of how traditional routes to consumers and brand choice are being upended.

The deal not only gives Amazon access to a bricks and mortar format but also provides it with vital consumer shopping data and allows them to access 365 own-label products. This, combined with the growth of voice search, could have a huge impact on the food and beverage market. When you ask Alexa to add butter to your cart, whose brand is likely to go in there?

Continuing to find new ways to reach consumers directly and adapt their portfolios to embrace fast-moving trends will remain at the forefront of FMCG's minds. It will be interesting to see what niche and nascent sectors the global food and beverage groups target and we expect we will see further interesting announcements from their accelerator programmes throughout the next twelve months.

The auction for Unilever's spreads business is now well underway this Autumn. Other key assets coming to market include healthy snack supplier Graze, whose private equity owner The Carlyle Group has appointed advisers; and coffee and food chain Pret a Manger which is the subject of talk around a possible IPO in the US and takeover approaches.

The impact of the UK Competition and Markets Authority verdict on Tesco's acquisition of wholesaler Booker is also likely to have wider ramifications for the market.

Despite political and economic uncertainty, M&A activity in the food and beverage sector remains strong. However, businesses and investors will no doubt be looking for further clarity from the government as the details of a Brexit deal are hammered out and we head into a new year of investment and growth decisions.

Calculating the indirect impact of Brexit

The figure for UK imports of food and non-alcoholic drinks stands at £35 billion, of which approximately 70% originates from the EU. For this reason the effects of Brexit on the F&B industry can already be seen, most notably through currency shifts which are driving up the price of ingredients, finished goods and packaging imported from abroad. We are also seeing increased pressure on workforces due to the potential restriction of labour movement in the future.

Looking forward, businesses in the sector should be preparing themselves for paying more tax on imports too. Below is an explanation of what will change and what impact it could have on your business.

What will change?

While the outcomes from the Brexit negotiation table are still unknown, in almost all scenarios businesses that currently acquire or despatch goods to the EU will be required to treat these as imports and exports. While this may open up additional opportunities for exporting which go beyond the benefits of a weaker currency, when it comes to imports, both Customs Duty and Import VAT are potentially payable.

This matters because Customs Duty, a cost which is not reclaimable, will either need to be absorbed by businesses or passed on to customers. Import VAT, on the other hand, will be payable at point of entry into the UK, and while it can be reclaimed, this could take up to four or more months, typing up important working capital.

The UK currently has access to more than 50 free trade agreements with countries around the world that were negotiated by the EU – entry to these may be lost as a result of Brexit, with a knock-on effect on import and export duties.

There will also be additional administrative costs arising from the need to process import and export declarations and instruct handling agents where necessary. This introduction of customs reporting requirements after Brexit will bring in the region of 180,000 previously unaffected UK traders within the customs net, potentially costing them over £4 billion a year, according to a paper from the Institute of Government.

Businesses who don't buy their ingredients or goods directly from the EU or other markets are not immune. UK wholesalers and suppliers will need to pass on increased costs to someone. Meanwhile, marketing and sales departments will need to prepare early for communicating and reacting to increases in the price of items on the shelf. In other words, the indirect tax impact of Brexit requires a cross-functional approach to assessing and planning for these potential changes. It should be a boardroom issue, if it isn't already.

To help businesses understand the possible Customs Duty, VAT costs and develop contingency plans, we have developed 'Brexit Indirect Tax Impact Analysis', a data analytics platform.

Using duty rates and real import and export data, the Brexit Indirect Tax Impact Analysis tool assesses the impact of a range of possible scenarios, providing a personalised analysis of the potential changes in duty and Import VAT.

To get started, all we need is your Instrastat and import data (MSS data). If you are interested in collaborating with us to create your own dashboards, please contact Louise Scholey - T: 0207 8652194 or E: louise.scholey@uk.gt.com.

A very real impact

Let's take an example of a business we have been working with to better understand the impact of these changes.

Working with our client, an importer of approximately £60 million of food and beverage products from the EU each year, we found that the additional Customs Duty cost posed by Brexit could be as much as £10 million per annum. This represented a cost of sales increase of over 15%.

In addition, as Import VAT is calculated on the Customs Duty inclusive value of goods imported, we also identified a possible adverse impact on working capital. The business would need to fund the additional Import VAT cost until it could be reclaimed from HMRC, a potential cash flow cost of £475,000 per quarter.

Minimum wage reviews: are you HMRC ready?

This summer Argos was named as one of 233 employers who faced a record £1.9 million in fines following a large-scale National Minimum Wage (NMW) and National Living Wage (NLW) review by HMRC. Debenhams and John Lewis have also been named and shamed in the press this year.

The government's tax collector is making National Minimum Wage (NMW) and National Living Wage (NLW) audits a bigger priority and is investing in manpower.

Underpaying staff can come at significant financial cost, starting with having to make up the difference through back-pay. With an additional penalty fine of up to £20,000 per worker and HMRC authorised to audit the previous six years, the cost of non-compliance can quickly add up for larger employers.

The more worrying aspect for many businesses, however, is the significant risk of reputational fallout that results from being named and shamed. The cost to a brand, from a customer, employee or investor perception point of view, may be harder to quantify but could dwarf any liabilities due. An additional concern is that many businesses are inadvertently defaulting on payments despite what appear to be legitimate reasons and processes.

While no-one is safe - small businesses have been named and shamed for a total underpayment of less than £100 - we know that HMRC is focusing on industries where there is a good chance of success. Food and beverage, especially producers and manufacturers who often have large workforces at the lower end of the pay scale, is one of the sectors that HMRC are investigating.

Here's what you need to know about the audit process and how to protect your business.

Avoiding accidental underpayment

It is rare for reputable businesses to knowingly pay less than the minimum wage. Instead, it is more common for firms to have inadvertently failed to pay at least the minimum wage in what is known as a 'technical' breach. As recent cases show, these 'technical' breaches can occur legitimately.

It could happen when an employee's quoted hourly rate is in line with the NMW. But once averaged out over a longer time frame (say, 12 months), the amount they receive compared to the total time worked takes the actual rate below the NMW.

It may also happen due to legitimate deductions being made from their gross salary (eg salary sacrifice schemes like pensions and childcare) or where there might be a discrepancy in the period that counts as paid work time. A common example of the latter in food manufacturing would be time spent changing into protective clothing and meeting cleanliness standards before starting a shift.

Technical breaches might also occur because of ambiguity in staff contract terms. HMRC recognises four categories of work:

- paid by the hour ('time work')
- paid an annual salary, under a contract for a basic number of hours each year ('salaried hours')
- paid by the piece - eg items made or tasks completed ('output work')
- paid in other ways - eg commission, fixed price for a project ('unmeasured work').

A common pitfall is for an employer to consider their employees to be 'salaried workers' but fail to include a precise number of hours in their records. HMRC will then argue that the employee is an 'unmeasured worker', which can make the resulting NMW calculation less favourable.

Getting HMRC ready

The best way to limit your exposure is to be proactive. This starts with ensuring all employees under contract have some sort of hours agreement with you in writing. You must be able to prove that the agreed amount is realistic. You may also want to consider reviewing your existing policies for clocking in and out.

In the event that you suspect you may have underpaid staff at some point in the last six years, our advice is to initiate a 'self-review'. If you can provide evidence of the review and that any money owed has been paid to staff, you should not be subject to HMRC penalties even if they decide to carry out their own investigation. Don't forget former employees either - make sure your HR department is consistently capturing forwarding contact information for anyone leaving the business.

The fallout from being named and shamed impacts the very core of an organisation and any doubt should be acted upon urgently.

Our employment tax team have already supported a number of successful self-reviews and are always on hand should you have any questions about minimum wage compliance.

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