

Food and beverage insights

Sector activity

Summer 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 second quarter of 2017 and looks ahead to the trends we believe will shape the market in the second half of the year.

In this edition, we outline some of the key messages coming out of the report released earlier this month by the Food and Drink Federation (FDF). The report conveys the huge potential of the sector alongside key trends, drivers, opportunities and issues.

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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Untapped potential in the UK food and drink manufacturing industry



Earlier this year, Grant Thornton was commissioned by the Food and Drink Federation (FDF) to undertake research into the food and drink manufacturing sector - exploring the obstacles the industry faces, its unique geographical landscape and its importance to the wider UK economy.

The report, which included analysis of the sector in conjunction with interviews with industry leaders, reveals the untapped potential of the UK food and drink manufacturing sector. The findings also reveal the extent to which exiting the EU may impact the industry's future productivity.

Contributing to a strong UK economy

The UK food and beverage sector accounts for 16% of total UK manufacturing GVA, making it the largest manufacturing subsector in terms of GVA contribution, ahead of transport equipment (14%) and metals (12%). Between 1997 and 2015 the sector's GVA grew by 27%, making it the fourth fastest growing UK manufacturing sector by GVA over that time period. As a whole, the UK manufacturing sector grew by 13% during this time.

One of the interesting observations we made throughout this process is, not only does the sector play an important role on a national basis, it also has a fundamental impact at a local level. The interviews conducted with industry leaders highlighted that the sector's national presence and geographic reach across the length and breadth of the country is one of the sector's defining characteristics. The ability to play a part in the local community, whether through providing employment opportunities, supporting local schools and investing in community initiatives, has become a key role for food and drink manufacturers.

In order to understand how the sector can build on this strong economic contribution the study looked in detail at three specific growth opportunities and the associated barriers that would need to be addressed.



Skills



Innovation



Trade

We will reveal more of the findings of the report later in this edition.

Deals summary

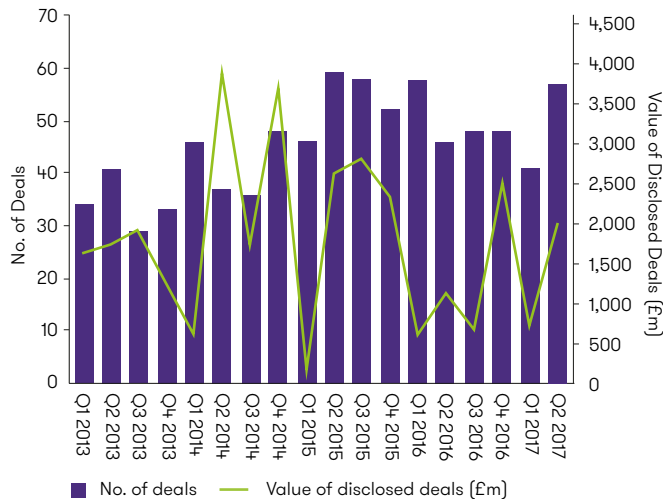
57 deals¹ were announced in Q2 involving a UK/Irish acquirer and/or target – a substantial 39% increase on the 41 transactions recorded in Q1. This brings the deal volume for the first half of 2017 to 98, which compares to a total of 200 for the whole of 2016.

Total disclosed deal value² for Q2 was £3.1bn, compared to Q1's £4.15bn. Both quarters were boosted by a single mega-deal: the sale of Weetabix to Post Holdings valued at £1.4bn in Q2, and the proposed £3.6bn Tesco/Booker deal in Q1. Excluding the respective mega-deals of the quarters, puts Q2 significantly above the preceding quarter with £1.7bn in disclosed deal value compared to £600m.

The first half of 2016 recorded 104 deals – at a time when there was a broad assumption that the vote on June 23rd would have 'a remain' outcome. 98 transactions in the first half of 2017 conveys a clear message that in spite of the uncertain environment following the Referendum, M&A activity in the F&B sector remains resilient. The first half of 2016 resulted in total disclosed deal value of £7.3bn compared to £5.7bn in 2017. Removing the mega-deals of the respective periods brings the like-for-like comparison down to £1.5bn in 2016 and £2.3bn in 2017: again, indicative of the fact that there is still a lot of interest and activity in the sector.

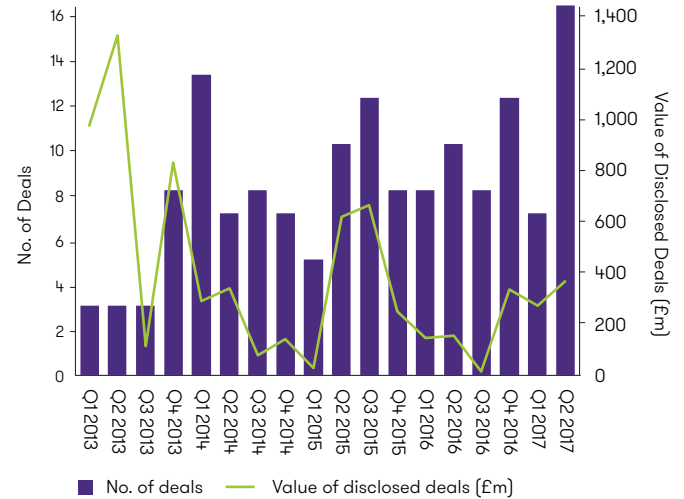
Further analysis of the M&A statistics for Q2 2017 paints a clear picture of the ongoing drivers and trends in the F&B sector, including an increase in inbound and private equity investment.

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



Deals summary - Q2 2017

Large deals (>£250m deal value)

Sector	Date	Target	Acquirer	Deal value (£m)
Alcohol	Jun-2017	Casamigos Tequila LLC (USA)	Diageo plc	792
Cereals	Apr-2017	Weetabix Ltd	Post Holdings Inc. (USA)	1,400

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

Sector	Date	Target	Acquirer	Deal value (£m)
Meat	Jun-2017	Manor Farm (Ireland)	Scandi Standard AB (Sweden)	60.8
Alcohol	May-2017	Charles Wells Ltd's brewing business	Marston's plc	55.0
Alcohol	Apr-2017	BrewDog plc (22.3% stake)	TSG Consumer Partners LLC (USA)	213.0
Condiments	Apr-2017	Kensington & Sons LLC (USA)	Unilever plc	109.5
Deli	Apr-2017	Addo Food Group Ltd	IBO (LDC)	100.0
Confectionery	Apr-2017	Hancocks Confectionery Ltd	Innovative Bites Ltd	100.0
Dairy	Apr-2017	Glanbia plc's Dairy Ireland business (60% stake)	Glanbia Co-operative Society Ltd (Ireland)	98.2
Meat	Apr-2017	Westbridge Food Group Ltd	Charoen Pokphand Foods PCL (Thailand)	60.0
Ingredients	Apr-2017	Tianning Flavour & Fragrance (Jiangsu) Co., Ltd (China) Taste Master Pty Ltd (Australia)	Kerry Group plc (Ireland)	70.1

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

Sector	Date	Target	Acquirer	Deal value (£m)
Fish	Jun-2017	John Ross Jr. (Aberdeen) Ltd/Coln Valley Smokery Ltd (85% stake)	AS PRFoods (Estonia)	13.2
Online delivery	May-2017	Frichti SAS (France) (Undisclosed minority stake)	PE investors including Verlinvest and Felix Capital	25.9
Snacks	May-2017	Whitworths Limited	Anatolia AS (Turkey)	20.0
Snacks	Apr-2017	Brighter Foods Ltd	Real Good Food plc	9.0
Online retail	Apr-2017	Farmdrop Ltd (Undisclosed minority stake)	Group of funders including JamJar Investments LLP and Atomico	7.0
Alcohol	Apr-2017	Renegade Spirits Ireland Ltd (Undisclosed minority stake)	Business Growth Fund plc	5.0

[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.

Private equity

Q2 also brought an increase in private equity investment in the sector. 16 deals in Q2 involved PE investment, equating to 28% of the quarter's deals. This included overseas PE houses investing in the UK, as well as UK houses dipping their toes overseas. The level compares to 38 transactions in 2016 overall, indicating a pick-up in PE investment. LDC were particularly active investors in Q2, investing in savoury pastry product manufacturer Addo Group in a £100million transaction, and backing the MBO of Hill Biscuits. MML Capital supported investee company CH&CO in its bolt-on acquisition of upmarket caterer Harbour & Jones, and CapVest further bolstered Valeo Food Group by bringing Italian cake producer Dolciaria Val d'Enza SpA into the group. Deal activity was also elevated at earlier investment stages, as illustrated by BGF taking a stake in whiskey distillery Renegade Spirits Ireland and Marechale Capital providing funding to coldpress juice producer Coldpress Foods. These deals are also in line with the most active sub-sectors, reflecting the demand for upmarket spirits and wellness products.

Hot sectors

The dominant sectors of activity remain unchanged in Q2. Q2 recorded 11 deals in the alcoholic beverages sector (again dominated by spirits and craft beer), accounting for 19% of deals in the quarter, half of which were cross border transactions. A further six deals took place in the soft drinks sector.

Five deals alone were in the spirits sector, with whiskey especially dominant. Bacardi made its first foray into Irish whiskey with the purchase of a minority stake in The Teeling Whiskey Company, whilst William Grant expanded its presence in the American whiskey distilling market with the acquisition of Tuthilltown Spirits LLC.

The biggest deal in the quarter was Diageo's acquisition of Casamigos, the Tequila brand co-founded by Hollywood actor George Clooney, for up to \$1 billion. Founded in 2013, the brand has grown rapidly to become a premium Tequila brand, and is a clear example of the trend for premium spirit brands.

In the craft brewery sector, the largest deal was BrewDog's sale of a 22.3% stake to US private equity firm TSG Consumer Partners for £213 million, equating to an enterprise value of £1 billion. The transaction allows co-founders James Watt and Martin Dickie to remain controlling shareholders, and the investment will support BrewDog's ongoing global expansion.

Alongside the demand for premium spirit brands and craft beers, the wellness trend continues to thrive and draw M&A investment. DSG Consumer Partners of Singapore invested in all-natural aloe vera fruit juice producer Simplee Aloe, and birch water brand Sibberi was acquired by Westlab Group as the bath mineral salts business seeks to tap into the growing clean living trend.

Inbound investment

The ability to acquire assets at a discounted rate due to sterling's depreciation inevitably played a part in driving an increase in overseas investors in the quarter. 30% deals (17) in Q2 saw UK/Irish targets move to overseas ownership. This compared to 21% of deals in 2015 and 26% in 2016 overall. In line with this increase, the domestic to cross border ratio shifted to 53:47 for the quarter and 57:43 for the first half of 2017. It also meant that 36.2% of deals with UK/Irish targets involved overseas acquirers, compared to 31.7% for 2016 overall. The majority of acquirers continue to be from North America (29%) and Europe (53%).

Q2 saw Weetabix change its overseas parent with a shift after five years from Bright Food of China to Post Holdings of the USA. The acquisition gives Post a manufacturing base in the UK, and unites its own brands including Bran

Flakes, Grape Nuts and Shredded Wheat with those of Weetabix, Alpen and Weetos. The combination of two western companies with complementary brands seems a more compelling strategic proposition than that with Bright Foods, which failed to entice Chinese consumers away from their traditional congee breakfast to a western bowl of Weetabix and milk.

From the Asian continent, Charoen Pokphand Foods PCL of Thailand continued its buy-and-build strategy in the UK and Europe, with the acquisition of Westbridge Food Group for £60 million, following its earlier acquisition of Foodfellas. Westbridge develops, sources and supplies poultry products and prepared foods; the acquisition enhances CPF's distribution network and export opportunities, crucially gaining import quota licences for chicken products to the EU.

European acquirers included Anatolia, a Turkish dried fruits wholesaler, which acquired dried fruit, nut and seed supplier Whitworths. From Scandinavia, Orkla Food Ingredients of Norway continued its buy-and-build strategy in the UK with the acquisition of sweet ingredients supplier Orchard Valley Foods and Scandi Standard of Sweden acquired Irish poultry business Manor Farm. Q2 also saw wine distributor Liberty Wines sell a minority stake to Portugal's Sogrape Vinhos SA, with whom it had formed an initial distribution partnership earlier in the year.

The concept of vertical integration and engaging in M&A with existing trading partners is by no means a new one, but perhaps is likely to grow, as illustrated by a number of recent transactions, as it allows extra familiarity with the acquired asset in a time of change and uncertainty.



Looking forward

At a time when Britain was on a recovery path from the shock of Brexit, political uncertainty triggered by a hung parliament has been thrown into the mix. Just as Brexit caused a number of deals in the pipeline to be put on ice, the outcome of June 8th has inevitably put some deals on hold, especially with regards to outbound investment. There is no doubt that investors are taking a more cautious approach to investments, and there has been some pick up in the number of companies going into administration/liquidation.

On the flip-side and looking forward, there are a number of high-profile transactions in the pipeline: Unilever's auction of its spreads division is due to launch in the autumn, with the estimated £6 billion deal already attracting a long list of big ticket PE houses. Chinese food conglomerate WH Group is the reported front-runner to acquire UK poultry company Moy Park, which is being sold by JBS of Brazil. Already this month we have seen GSK announce plans to sell its consumer brands Horlicks

and MaxiNutrition; and US group McCormick was announced as the acquirer of Reckitt Benckiser's food division in a \$4.2bn deal. Tesco's £3.6 billion acquisition of wholesaler Booker rumbles on, as it faces in-depth investigation by the UK Competition and Markets Authority (CMA), which says that the acquisition of the Londis and Budgens supplier could result in higher prices in 350 areas.

The ongoing weaker pound combined with attractive assets will continue to drive inbound investment in the UK.

Whilst it seems that uncertainty has become the new norm, the route to Brexit is complicated and long. Investor nerves may not become more apparent until there is more clarity and as March 2019 draws nearer and the country inches ever closer to the EU exit door. In the meantime, M&A in the F&B sector continues to perform robustly in spite of the ongoing political and economic uncertainty.

Key findings of the FDF Report

Skills

A modern workforce, for many sectors, is increasingly a matter of balancing the needs of a multi-age workforce as well as the rise in technology-enabled solutions. For the food and beverage manufacturing sector, these issues appear to be especially heightened.

Increased automation has had an impact on the sector for several years now and it was evident in our interviews with industry leaders that this presented both opportunities and challenges. Several interviewees commented that the introduction of automation had lowered the number of workers needed for some operational roles, however, it has also provided opportunities to upskill workers.

For many years, the FDF has drawn attention to the looming skills gap facing the sector: 140,000 new workers are required by 2024.

Our research found that between 10-20% of the food and beverage manufacturing workforce is due to retire over the next ten years. In many cases, these very experienced, loyal employees have adapted to broader changes within the industry. The challenge facing the sector lies in its ability to attract new recruits, as it is clear from our study that the sector faces an image problem and often loses out to other manufacturing sectors, such as automotive and pharmaceutical, which are perceived as being more glamorous and lucrative. Our study demonstrates the huge breadth and variety of roles within food and beverage manufacturing and the clear message from industry leaders was that it is possible to build a great career within it. Another common misconception about the sector is that it has a large proportion of migrant workers doing very low-skilled work.

However, our study revealed that although 38% of EU workers within the sector are working in lower skilled roles, a further 19% are highly educated and doing very specialised roles. For these reasons, the impact of Brexit from a skills perspective could be huge and from a sector perspective, the need to establish a deal that can ensure the rights of EU workers in the UK is vital.

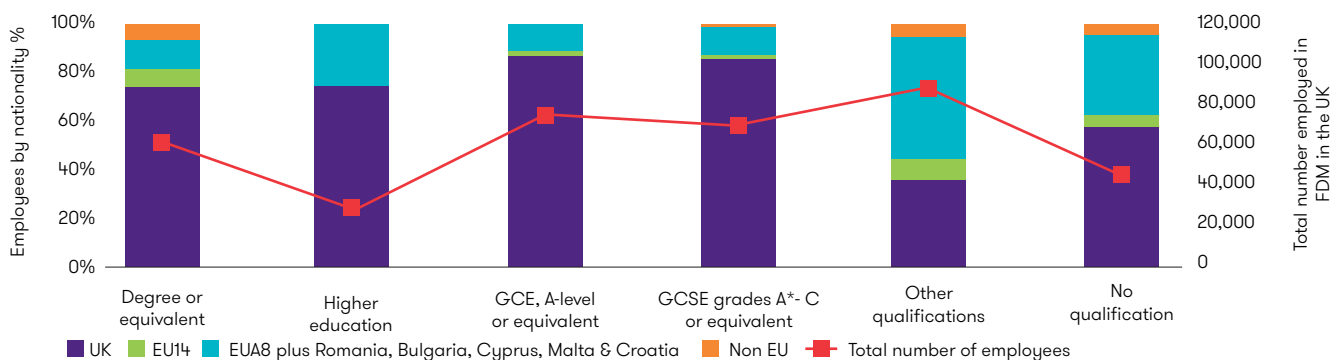
Innovation

When it comes to innovation in the sector, consumer behaviour is one of the main drivers and something that food and beverage manufacturers take a keen interest in. In an era where consumers are time poor, innovation can be seen in new products which are coming to market that reduce cooking time through new packaging or cooking methods.

From the deal activity of this quarter, we can see how consumer behaviour affects this too. Our study found that the alcoholic beverages subsector is the most profitable food and beverage subsector, arguably because of high levels of automation within the manufacturing process. However, the drinking habits of consumers have changed significantly in recent years, with a greater move towards craft beer and spirits and deal activity has followed this trend.

Across the sector, there is a willingness for companies to work collaboratively, both with peers and education institutes, to address some of the big issues both within and outside of the sector. Our survey found that 59% of respondents were involved in some way with pre-competitive initiatives. The most common of which were in relation to food safety (43.9%), authenticity and traceability (43.9%) and health and wellbeing through diet (39%).

Skill level in food and drink manufacturing by nationality



Trade

Our study highlights just how international the UK food and beverage supply chain has become. Brexit could therefore have a serious impact on trade relationships. Although 52% of food consumed in the UK is produced here, 29% comes from the EU, followed by Africa, Asia, North America and South America, all of which have 4% shares respectively. In recent years, the UK has actually increased its reliance on imports, illustrated in the graph (below), showing the increase in imports outstripping exports in real terms.

From an export perspective, the UK is a global player with exports in 2016 reaching an historic high of £20.2bn. Again, recent deals in the sector show the high levels of interest in UK food and beverage manufacturing companies, renowned for their high levels of safety and quality throughout the manufacturing process as well as in the finished product.

From an export perspective, the UK maintained its global food export market share of 2.2% in recent years. Global market shares have been relatively flat in the last five years for most UK comparators, except France who experienced a -0.9% loss in market share down to 4.7% and Poland, which increased its share by 0.4% to 1.9%.

Respondents to our survey said that Europe and USA remain key export markets, although there is a shifting focus towards Asia and Middle East. In terms of the geographies that represent the most potential for future export growth, China, India and the UAE were all named as countries that food and beverage manufacturers would like expand their footprint in.

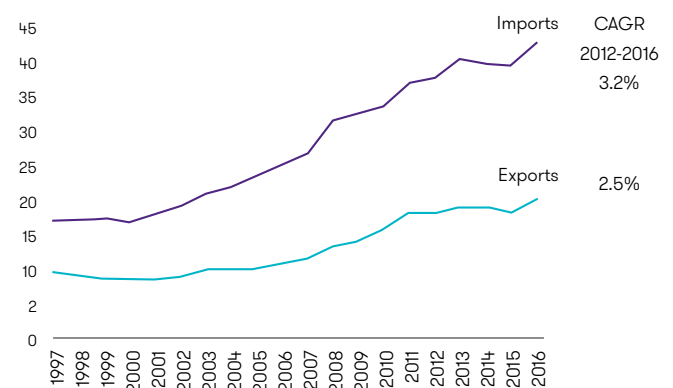
This is largely because of their growing middle classes, who have a taste for western products.

It is vital to harness the growth of the UK's largest manufacturing sector to increase prosperity both now, and in the longterm.

All of these factors highlight not only how strong and dynamic the UK food and beverage manufacturing sector is, but also its huge potential for future growth.

For access to the full report please see: <http://www.fdf.org.uk>

UK trade balance (£million)



Source: HMRC Trade Statistics

“This report really highlights the strength of the UK food and drink manufacturing sector and the important economic contribution that it makes to the UK. It is clear from our analysis that the sector is a truly national sector providing employment opportunities and making a positive economic contribution the length and breadth of the UK. It is this national presence that makes the sector somewhat unique when compared to other manufacturing sectors which tend to be much more geographically focused.

Our analysis also highlights the significant potential that the sector has to drive economic growth in the future. However, we have seen through this analysis and through the regular conversations we have with our clients in this sector that there are a number of external and internal factors that need to be worked through if these growth opportunities are to be realised, not least the uncertainty around the EU Exit. Through this report we have identified the need for clear action both by the sector itself and by Government to ensure that the opportunities are maximised and the risks mitigated.” **Trefor Griffith**



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