Bite Size

Food and beverage insights

Winter 2017

Welcome to the Winter edition of 'Food and beverage insights', our quarterly review of activity in the F&B sector and – in this issue – of 2017.

With the new year well underway, this issue provides a summary and analysis of M&A activity that took place last year, as well as a look at the factors and emerging consumer trends likely to influence the market in 2018.

In this edition we also report on some of our key initiatives from 2017. 'From ingredients to innovation' captures industry opinions from a recent roundtable dinner held with leaders in the sector. 'Health & wellbeing success in Spain' is a look at our recent trade mission to Madrid, which resulted in an exciting growth opportunity for superfood company Nutrisure.

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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Deals summary

A total of 48 deals were announced in Q4 involving a UK/Irish acquirer and/or target; a very similar volume to Q3's 47 deals.1 Across 2017, there were a total of 206 deals, compared to 202 in 2016. The sale of Unilever's spreads business added £6 billion to a total disclosed deal value of £7.7 billion for Q4.[2] Without this deal, the total disclosed deal value stands at £1.7 billion. This compares to £1.2 billion in Q3, having also excluded the mega-deals that took place in that period.

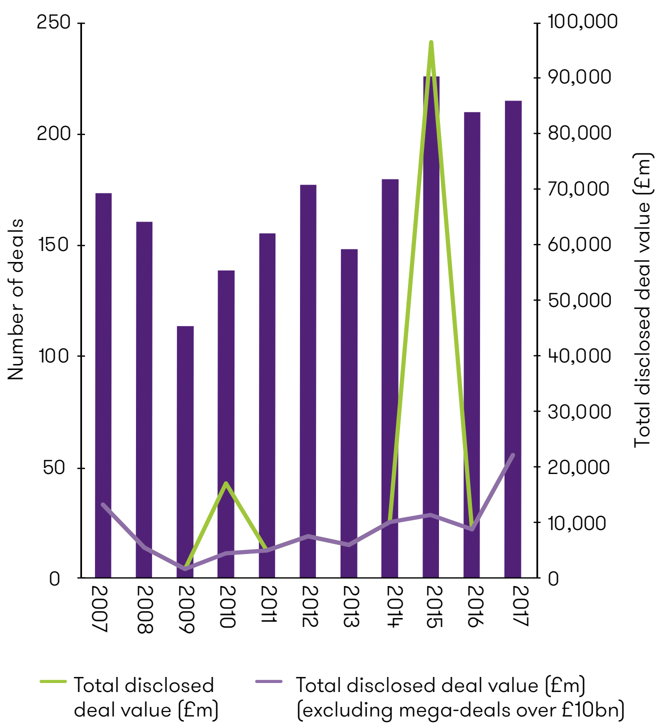
There were several sizeable deals in Q3 and Q4 which contributed to a total disclosed deal value of £21.4 billion for the year, significantly higher than £8.4 billion in 2016 and £10.8 billion in 2015 (excluding the £71 billion SABMiller deal). 2017 was a year of increased deal sizes on the whole, bolstered by those such as Tesco's purchase of Booker and Reckitt Benckiser's sale of its food business to McCormick. Excluding deals over £1 billion, the total value for 2017 comes to £6.2 billion, another increase on 2016's £4.3 billion.

2017 ended with the long-awaited sale of Unilever's global spreads business to US private equity house Kohlberg Kravis Roberts (KKR) for £6 billion. The brands divested include Flora, I Can't Believe It's Not Butter and ProActiv. Following Unilever's rejection of a takeover proposal from US food giant Kraft Heinz, this was its first major action resulting from the company's strategic review of its portfolio.

The last few weeks of December saw a number of other deals announced. Raisio announced the sale of its confectionery business (including brands such as Fox's Glacier Mints and Poppets) to Valeo Foods Group for £89 million. Also in the confectionery sector, Polish group Colian added Irish chocolate manufacturer Lily O'Brien's to its portfolio, following its acquisition of Elizabeth Shaw in 2016.

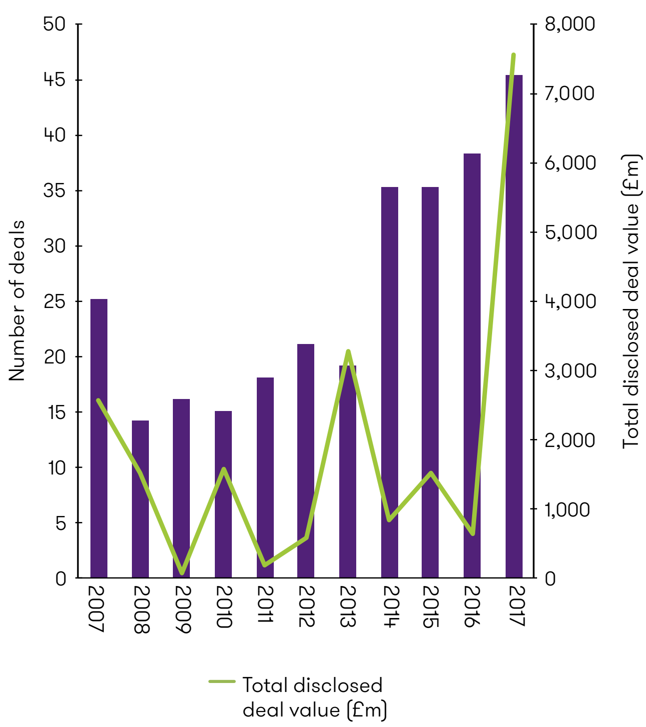
A review of annual M&A statistics demonstrates the sharp rise in total deal value this year.

Announced M&A activity in food and beverage – annually



The chart above excludes the £71 billion SABMiller deal announced in 2015

Announced PE activity in food and beverage – annually



The spike in 2017 deal value is attributable to the IBO of Unilever's spreads business

[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 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 – Q4 2017

Large deals (>£250m deal value)

Sector	Date	Target	Acquirer	Deal value (£m)
Grocery	Dec-2017	Unilever plc (Global spreads business)	IBO (Kohlberg Kravis Roberts & Co. LP) (USA)	6,700.0
Fruit and veg	Oct-2017	Plantas de Navarra SA (Spain) (majority stake)	IBO (Cinven Ltd)	397.0

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

Sector	Date	Target	Acquirer	Deal value (£m)
Confectionery	Dec-2017	Raisio Group plc (Confectionery business)	Valeo Foods Group (Ireland)/ CapVest	88.8
Ingredients	Dec-2017	Kluman and Balter Limited/ A1 Cake Mixes Limited	Brenntag AG (Germany)	72.0
Fruit juice/ Frozen	Nov-2017	Hortex Holding SA (Poland)	IBO (Seventeen Colza Sarl/ Mid Europa Partners LLP)	175.4
Foodservice	Nov-2017	Tyson Foods (Kettle Business) (USA)	Kerry Group plc (Ireland)	95.2
Wholesale/ Retail	Oct-2017	Nisa Retail Ltd	Co-Operative Group Ltd	243.0
Ingredients	Oct-2017	Olivos Naturales SL (Spain) (majority stake)	IBO (ADM Capital Europe LLP)	116.0
Seafood	Oct-2017	Icelandic Group UK Limited t/a Seachill	Hilton Food Group plc	84.0

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

Sector	Date	Target	Acquirer	Deal value (£m)
Confectionery	Dec-2017	Lily O'Brien's UK Ltd (Ireland)	Colian Holding SA (Poland)	35.5
Foodservice	Dec-2017	La Rousse Foods Ltd (Ireland)	Musgrave Group plc (Ireland)	26.4
Alcohol	Dec-2017	Chapel Down Group plc (26.3%)	Consortium of investors	18.5
Bakery	Dec-2017	Coopland & Son (Scarborough) Ltd (minority stake)	Business Growth Fund plc	8.5
Coffee	Nov-2017	Gold Crest Food & Beverages Ltd	Greenbean Roasters Ltd (Ireland)	1.0
Baby food	Nov-2017	Piccolo Foods Ltd (minority stake)	DSG Consumer Partners (Singapore)	0.5
Fruit and veg	Oct-2017	Elst Unlimited Company (Ireland)	Danbywiske Unlimited Company (Ireland)	40.6
Pet food	Oct-2017	Nutriment Limited	Voff AB (Sweden)	7.0

Cross border interest

In 2017 we saw an ongoing, high level of cross border deal activity. A number of European and US firms showed interest in acquiring UK brands, while UK private equity firms shored up their portfolios overseas.

Of the 163 deals in 2017 involving UK/Irish targets, 33.7% had overseas acquirers. This is an increase on the 32% in 2016 and 28% in 2015. Notable deals include the sale of Bart Ingredients to Fuchs Group of Germany, as well as ready meals producer KK Fine Foods being bought by Ter Beke of Belgium.

The uncertainty triggered by the Brexit vote worked as a catalyst to drive up the appetite of overseas buyers. For European investors, guarding or establishing a UK presence has been key; owning a British brand may well ward off the effects of any unfavourable legislation once Britain leaves the Union. UK assets are also around 20% cheaper after the post-referendum currency swing so this has also heightened interest and activity. For those who foresee the pound recovering in 2018, 2017 was an opportune time to acquire, and certainly enabled overseas buyers to take a more competitive stance in auction processes than in previous years.

Private equity picks up

Private equity (PE) activity was particularly strong in 2017. 22% of deals across the year involved PE investment, the highest level in the F&B sector since we have been tracking the data.

The sale of Unilever's spreads business to KKR was by far the largest private equity transaction of the year, following a fiercely contested auction amongst the large buyout groups. Investment in UK firms also originated from overseas PE houses at the smaller end of the scale. Singapore-based DSG Consumer Partners made early-stage investments in baby food brand Piccolo Foods as well as healthy drinks manufacturer Simplee Aloe.

PE investors are highly focused on making smart investments in brands that are genuinely innovative and that will become a sector leader in a short space of time. Examples of those that have undergone explosive growth in recent years include Fevertree tonic water, Dorset cereals, Tyrrells crisps and Nākd snack bars. Mayfair Private Equity, a previous investor in Fevertree, invested in Promise Gluten Free bread in July, expressing hopes that the business has the same potential for exceptional growth. Consumer demand for 'free from' products is expected to continue booming in 2018, as is the demand for vegan and vegetarian products.

Ultimately, investment in the F&B sector has remained strong - and for good reason. While the demand for non-essential items like cars, electronics or luxury goods can fluctuate, the need for food is essential. For PE investors, this makes the F&B sector a less risky investment opportunity compared to other industries, particularly during times of increased uncertainty.

Hot sectors

Alcohol continued to dominate deal activity in 2017. It accounted for 34 acquisitions across the year and 16.5% of activity. This was primarily led by spirits and craft beer.

The most significant deals were purchases of UK brands from US businesses. PE firm L Catterton acquired a 27.9% stake in Scottish craft brewery Innis & Gunn for £15 million, equating to an enterprise value of £58 million. The deal followed fellow US PE house TSG Consumer Partners' acquisition of a 22.3% stake in BrewDog, giving the group an enterprise value of circa £1 billion. Conversely, Diageo committed to a potential $1 billion investment in US-based tequila company Casamigos Spirits Company, in line with its strategy to concentrate on the high growth super-premium segments of the category.

2017 also saw a pick-up in M&A activity in the ingredients sector. Both food manufacturing and off-the-shelf consumer products saw 25 deals across 2017. Big ticket transactions were McCormick's acquisition of Reckitt Benckiser's food business and the sale of Unilever's global spreads business to KKR. Smaller and cross-border transactions included Langholm's sale of Bart Ingredients to Fuchs Group of Germany; Frutarom of Israel's acquisition of food flavours and colours manufacturer Flavours and Essences UK; and Norwegian firm Orkla's purchase of bakery ingredients supplier Orchard Valley Foods.

There was also significant consolidation in the bakery sector in 2017, accounting for 12 deals. Alongside the acquisition of Promise Gluten Free, BGF provided £8.5 million to Coopland & Son, the UK's third largest bakery chain, to accelerate the rollout of its shops across the North of England. Elsewhere, Luxembourg-based holding company, Iberia Industry Capital Group, acquired Cornish baker and pastry maker, W.C.Rowe.

Faced with increased competition and rising costs for raw ingredients, many bakery groups have turned to consolidation as a means of increasing efficiencies and enabling businesses to stay profitable. For example, the price of butter alone went up by 50% in the past 12 months. For some bakery businesses, this has caused a spike in the cost of production that they haven't passed onto customers, so consolidation has been a solution to shore up against these challenges.

Looking forward

The trends that have pervaded 2017 show no sign of slowing down in 2018. Businesses in the health and wellbeing space, as well as those that meet consumers' demand for more convenient and premium products, will continue to drive M&A activity.

One company currently in the M&A spotlight is Graze. The firm has reportedly hired advisors to navigate a sale of the business for current private equity backer Carlyle. Other deals in the pipeline include a potential merger between Burton's Foods and Fox's Biscuits, and ownership changes for Young's Seafood and Maximuscle.

A further catalyst for M&A recently has been the significant level of change in Chief Executives at the helm of some of the biggest groups in the sector. From Nestle at the start of 2017, General Mills in June and Kellogg and Mondelez in the Autumn, this new blood will undoubtedly mean new strategies for growth and investment, alongside a review of portfolios and heritage businesses.

However, it is worth acknowledging the challenges set to continue to impact F&B investment this year. Sector slowdowns and changes in workforces will lead some to focus on defensive consolidation in 2018.

For instance, bread sales have continued to fall across 2017; with total sales reducing by 12% over the past five years. There is still a market for such products but manufacturers are looking to increase their efficiency or otherwise ease their competition.

A need for consolidation is driving the rumoured talks between biscuit makers Burton's Foods and Fox's Biscuits. In a slowing market for their products, merging the two groups would reduce competitive pressure and allow greater economies of scale to protect both businesses.

Another threat comes from the workforce decline across the UK. Of an estimated 400,000 people working in F&B in the UK, a third are EU nationals or otherwise born overseas. This group have been steadily dropping since 2016's Brexit referendum, in part due to the lack of clarity on the future of European workers in the UK.[3] For many, the UK is increasingly seen as a less attractive place to work.

Food manufacturers are already feeling the effect of this, particularly farmers looking for seasonal workers. Those struggling to source staff could see M&A opportunities slip past them as they struggle to achieve sustainable growth.

We will be carefully watching government legislation on EU workers' rights moving through 2018. M&A activity has been strong throughout the past 12 months and a wealth of new decision makers will look to ensure this continues well into the future.

[3] Office for National Statistics

From ingredients to innovation

We all know how important the food and beverage sector is to the UK. It contributes an estimated £28.2 billion to the economy alone and accounts for over 400,000 jobs. Building on this success requires further innovation, agility and a willingness to embrace change.

In November 2017, we held our annual food and beverage dinner. The evening was a great success, and not just because of the delicious sushi on offer at Nobu's newest venture in Shoreditch, London.

Several interesting themes surfaced during the evening, as attendees discussed what is needed to create a vibrant future for the F&B sector.

A healthy mix of product and marketing innovation

The sector continues to thrive as it adapts to changing consumer behaviour, particularly around healthy eating and the demand for convenience. The growth of the 'free from' category, expected to be worth £673 million by 2020, as well as getting products to consumers quicker through 'dash buttons' and meal kit delivery services, are great examples of recent innovations.

The opportunities and challenges lie in continuing to satisfy these trends without sacrificing product taste or quality. Today's consumers want the best of both worlds. As one CEO commented, "it is the industry's challenge to solve".

While we are seeing some progress, product innovation must advance at the same pace as developments in the marketing department. This must move to the top of the industry's agenda.

Time to lead innovation once again

The UK's F&B industry has a track record of leading innovation. From the first Stilton cheese in the 1700's to the UK's first gastro pub in the 1990's, we have a lot to be proud of. Now is the time to ensure that we maintain our lead and global reputation for innovation.

This requires businesses to get back to 'first principles', focusing on what the customer really wants and building from there – using the best ingredients and processes – and amplifying with the best marketing. One guest's company has had great success using the first principles approach in the development of a new type of healthy snack bar.

A CEO's vision is key

The role of the CEO in grabbing these opportunities and propelling the industry forward is crucial. This is particularly true at a time in which we have seen a lot of movement at the top of the sector's biggest businesses.

Having the best people, not just the technology, will separate the winners and losers over the next few years. A CEO with a clear vision and infectious energy will attract the talent that product and marketing teams need to thrive.

Building the right culture and making F&B an attractive career choice is becoming increasingly important. Having a great team in place increases the ability to unlock cash in the balance sheet or take advantage of tax reliefs for research and development projects.

We were lucky enough to have a room of the sector's leaders and innovators and it was clear that this group will not be resting on its laurels. There is a real sense of purpose and determination to embrace change.

The 'free from' category is expected to be worth

£673m by 2020

Emerging consumer trends

Businesses in the sector have always raced to keep up with ever-changing consumer tastes and preferences.

This has proven a challenge for some. For others, these emerging trends have created opportunities for growth. Such brands have been able to adapt their offerings to suit changing consumer tastes, or even rebrand their products entirely.

So what were the key consumer trends to emerge in 2017 which we should have front of mind as we progress through 2018?

Convenience

British consumers are increasingly time poor, as longer working hours and an always-on culture have become commonplace. While not new, this has driven a constantly evolving demand for convenience and 'food-on-the-go.'

As a result, food shopping habits have changed, with many consumers now preferring to do either standalone daily shops, or using them to top up a bigger weekly shop. The benefit of this is that they can adapt consumption to their lifestyle, whilst reducing the likelihood of food going to waste. However, for F&B manufacturers, this has required the development of new products, often in more convenient, easier to cook portions.

The emphasis on matching consumption to lifestyle has also led to a blurring of lines between meal times and snacks, with consumers increasingly seeking snacks that can be eaten on the go. Breakfast is the mealtime where this trend is most prevalent, with the global 'on the go breakfast' market forecast to grow by 46% by 2026, primarily driven by western consumers.

The rise of healthy snacks

Healthy snacking, in particular, has been fuelled in part by the rise of bloggers and social media influencers who focus on diet, nutrition and wellbeing. Consumers now expect more from their snacks, requiring them to provide a range of health benefits, from increasing energy and strength to promoting regular sleep patterns.

This draws upon a preference towards products that promote 'wellness' rather than weight management. Mainstream consumers are becoming less motivated by dieting and counting calories. For many consumers, products that claim to build strength and provide a better sense of wellbeing now resonate far better than those which claim to be low-calorie. Special K is one business that has had to completely transition their branding away from weight-loss to wellbeing and empowerment.

Another area of the snacks sector is the rising popularity of 'raw' products. Such foods avoid affecting their ingredients' nutritional value through the manufacturing process to maintain their purest form. Snack brands like Nākd are tapping into this trend by highlighting 'raw cacao' and other natural ingredients on the packaging of their products.

Priorities other than price

While increasingly time-poor and looking for convenient food and drink choices, consumers are also wary to ensure they choose brands that match their values.

Because of this, many firms are making their ethical and environmental values more visible. When tea and supplement company Pukka Herbs was bought by Unilever in 2017, they continually stressed their commitment to organic, sustainable products to reassure dedicated customers. Meanwhile, brands including HUEL, Divine Chocolate and Origin Coffee have all benefited from wearing their purpose proudly on their sleeves.

For manufacturers and grocers alike, the pressure now isn't to just have an ethical end product on the shelf, but to ensure these standards are met throughout the manufacturing process and product lifecycle as well. The introduction of the Modern Slavery Act and the plastic bag levy have gone some way to ensure greater transparency and responsibility within the supply chain. Meanwhile, consumer awareness has been raised by the popularity of programmes such as Blue Planet II, which gave a very tangible portrayal of the impact of sea plastic on the environment. With attention now turning to the impact of disposable coffee cups, plastic straws and food packaging, the challenge for F&B companies in 2018 will be to ensure that packaging becomes more environmentally friendly without compromising the quality and safety of the product.

Flexibility without fuss

Modern consumers are looking towards plant-based nutrition as a lifestyle choice as opposed to being driven by a specific diet. Alongside the growing demand for alternative sources of protein, the rise of social media and a growing awareness of the impact of meat production on the environment have driven this trend. Celebrities such as Jamie Oliver advocating 'meat-free Monday', is a great example of this. While mainstream consumers may not adopt a meat-free diet on a full time or permanent basis, they are aware of the impact of their choices and are keen to turn to plant-based foods where it fits into their lifestyle. As a result of this demand, there is a current boom in the number of products hitting the shelves being labelled as suitable for vegan diets.

Meat substitute brand Quorn has felt the benefit of the rise in those embracing the concept of 'flexitarianism'. Sales at the company rose 19% in 2017 as more shoppers turn to their products to cook meat-free meals.

The global 'on the go breakfast' market is forecast to grow by

46%

by 2026

27.1%

of adults and one fifth of children eat food from out-of-home food outlets at least once a week

30%

of food-to-go consumers want more vegetarian options, 22% want more dairy free choices and 20% want a broader range of gluten-free products[4]

There has been a

185%

increase in the number of vegan products launched in the UK between 2012 and 2016[5]

[4] IGD
[5] Mintel


DELIGHT

The other side of the chocolate coin

The countertrend to an increase in healthier, more wellness focused food and drink, is an increase in products of a more indulgent nature. While many will choose plant-based, high protein options, the same shoppers may also choose an indulgent and high-sugar product such as a Gü dessert, as an occasional treat. It stems from a change in mentality around these kinds of foods. Those who focus on a healthier lifestyle and food choices may, on occasion, choose snacks that are considered to be a 'guilty pleasure', enjoying these foods in moderation. With continued uncertainty in the UK economy and a widely anticipated squeeze on household budgets expected in 2018, this "affordable treat" segment of the market may do well.

A number of brands have adapted their product ranges to cater to this growing demand. The rise of 'Thins' amongst biscuit and bread manufacturers, offering a slimmer version of an indulgent treat, appeals to consumers who wish to eat healthier but enjoy treats in smaller or leaner portions.

There have been a number of changes to take place in the past twelve months for F&B businesses, driven as always by shifting consumer preferences. The long standing interest in convenience has combined with a desire for healthier options, as well as adopting more plant-based foods on a flexible basis. Meanwhile, at the other end of the scale, growth in indulgent products with smaller portions has become a key current trend for the industry.

We have no doubt that behavioural shifts will continue to challenge F&B producers throughout 2018. Those who can spot them early and adapt accordingly will come out on top.

Health & wellbeing success in Spain

Despite Brexit looming, the European market presents an attractive opportunity for businesses looking to grow. For the F&B sector, there is ample demand for new brands and products.

Take Spain, for example. The country's GDP is growing at a rate of 3%, with less reliance on credit in the market leading to a more stable and controlled economy. Along with an estimated growth of capital goods in 2018 of 6.7%, the country presents fertile ground and an eager market for British brands that can offer something new.

We recently invited a number of health and wellbeing-focused UK F&B companies on a trade mission to Madrid. The two-day initiative – which we led alongside Santander and the Department of International Trade – focused on connecting British brands with some of Spain's largest supermarkets and distributors, who are experiencing rising demand for healthier products from purpose-led brands. Sales of organic products have been growing at 25% per year, well above the European average of 12%.

One business that joined us was Nutrisure, owner of superfoods brand Naturya and Supernutrients. The Naturya brand has a strong presence in the UK and recognised the Spanish market as an opportunity for further growth. However, compared to its growth in Germany, France and Italy, Nutrisure found Spain a challenging market to crack. It is a complex sector split across different players in separate regions, making it difficult to build relationships with prospective partners. Nutrisure joined our trade mission to establish a better foothold in the space.

The company found a very interested market in Spain. With their range of healthy, organic superfoods, they engaged in a number of positive conversations with key Spanish distributors to great effect.

As a result of the mission, Nutrisure has some fantastic prospects lined up for its Naturya products. It has entered into talks with a number of the largest distributors in the region, and is currently refining its options to decide on its preferred partner. These are dramatic steps forward against the challenges the brand faced previously.

As Claudio Stein, international sales manager at Naturya, put it: "The recent trade mission to Madrid has saved our sales teams around two years' worth of work. Grant Thornton's invitation came at the perfect time for us as we were focused on establishing our business across mainland Europe and tapping into the global trend towards health and wellbeing products. The outcomes so far have been fantastic and we look forward to progressing in the region well into 2018."

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