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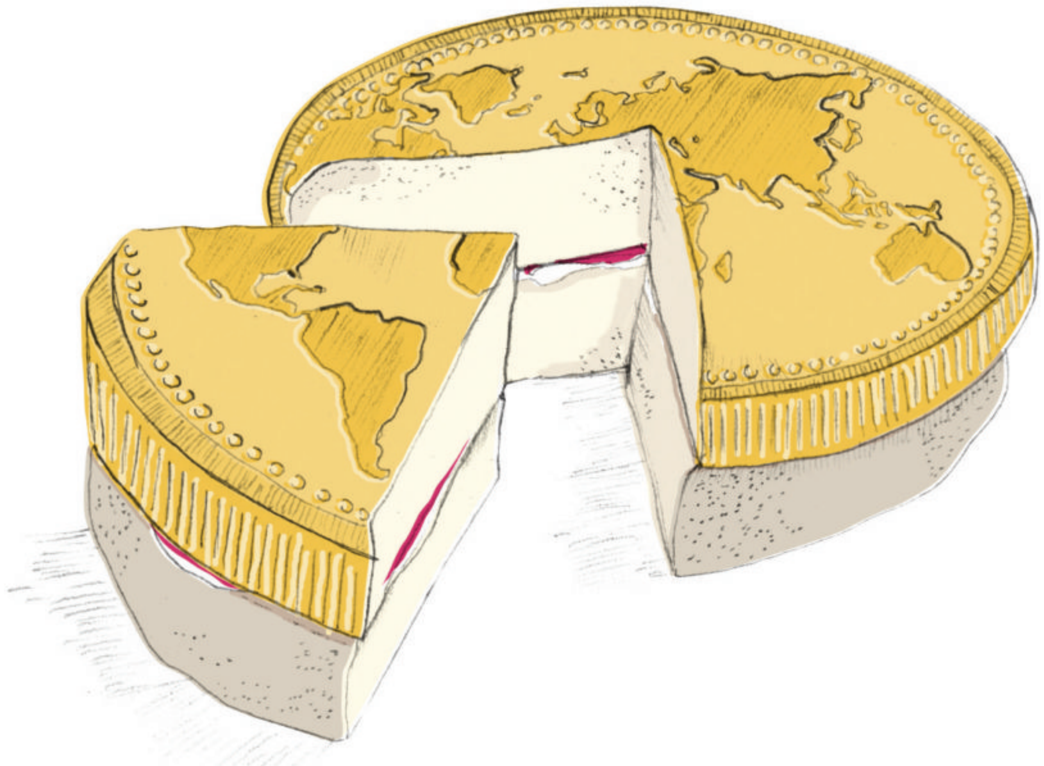
Where is the smart money going in Food & Beverage?



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In the face of continuing economic difficulties and a protracted recovery from the downturn, conditions in the food and beverage (F&B) sector in the UK and Ireland continue to be challenging and in many cases trading is flat. Acquisitive corporates are seeing Mergers and Acquisitions (M&A) as a way of acquiring skills and products and removing costs as a route to growth. Private Equity (PE) investors are seeing opportunities to benefit from the changing dynamics of the sector.

To better understand what is driving investors to get involved in the F&B market, Grant Thornton has commissioned a research project to assess the views of senior representatives from PE houses and companies currently investing in the F&B sector across the UK and Ireland. We would like to thank them sincerely for their invaluable assistance with this project.

In Ireland, the F&B sector is the biggest indigenous export sector, tipping the €9 billion mark in 2011. Ireland, with its population of 4.6 million, produces enough food to feed 36 million people. UK F&B (non alcoholic) exports increased in 2011 by 11.4% to just over £12 billion[1]. In both countries ambitious F&B growth targets have been set. In Ireland the government set a target of 42% growth in exports by 2020[2]. In the UK the Food and Drink Federation (FDF) have set a target of 20% for overall sector growth. Given these targets, future wars may not be fought on battlefields. As the global population continues to grow, demand for food is increasing, consumer preferences are changing and people are living longer, therefore the battles may well become economic.

The key findings from the research are:

- 80% of PE houses plan to do some form of M&A activity in the F&B sector in the next 12 months.
- Acquisition of brands is a route to new products and markets for investors.
- M&A activity is defensive rather than offensive.
- Innovation, Research and Development (R&D) and New Product Development (NPD) are key to stability and growth.
- There is a huge opportunity waiting to be seized in growth markets.
- Mid market PE is mainly focused on niche innovative businesses.
- Corporate acquirers are also keen to add to their offering, as well as consolidating operations and reducing costs.

Our research suggests the time is ripe for M&A activity. While some businesses might still be feeling the pressure, many others have reacted to the downturn by tightening their processes. This philosophy of streamlining is reaping benefits as businesses focus on embedding on-going innovation into their organisational culture in order to deliver from a lower and more productive cost base. Strategies such as re-engineering products, removing waste and cutting out non-value-adding activities are all having an impact. These leaner, battle hardened businesses need to push on now and the M&A markets at home and abroad are the next logical step.

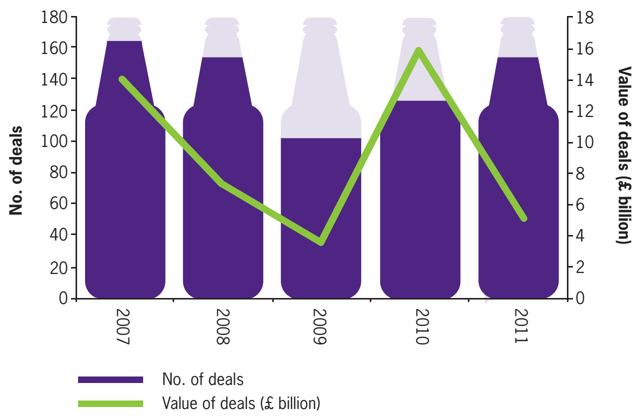
At the same time PE houses are awash with unspent capital and are keen to deploy this to companies that can offer growth, security and sustainability in these uncertain times. Although the incentives to buy among both camps are different, the recent statistics and the forward looking predictions suggest that M&A activity in the F&B sector is set to rise further, irrespective of the global economic worries.

[1] UK Food & Drink performance – Full year 2011 (FDF)
[2] Food Harvest 2020 – A vision for Irish agri-food and fisheries. Department of Agriculture, Fisheries and Food

UK and Ireland Food & Beverage review

Before looking ahead to the prospects for 2012 and beyond, it is worth casting an eye back over M&A activity in the sector over the last five years.

M&A activity in the F&B sector, 2007-2011



The rise and fall of M&A trends over this period demonstrates the context in which businesses today and in the future will have to operate in order to grow. Between 2008 – 2009 tough economic conditions forced a steep decline in M&A activity. In the UK and Ireland, 2009 saw M&A deal volume and value in the F&B sector fall to its lowest point in some time. Since then volume has been climbing steadily buoyed by restructuring and consolidation as businesses seek to strip out dead weight and operate in a more efficient way.

In 2011 overall M&A deal numbers rose 22% on the previous year reaching almost pre-recession levels. Deal value totalled £4.7 billion in 2011. This was down 71% on 2010 value, due to Kraft's acquisition of Cadbury's for £11.9 billion. If the Kraft deal was removed from the equation, deal value in 2011 would be up 6.7% on 2010, a steady improvement since 2009 but still substantially below the £14 billion+ levels witnessed in 2007.

This steady rise in annual deal value can in part be attributed to the activity amongst the large manufacturers that has taken place in 2011, which included:

- Kerry Group's acquisition of the UK flavour technology business of US F&B giant, Cargill, Cargill Flavor Systems (UK). Kerry are believed to have paid around £146 million for the company.
- Ranjit Boparan's BH Acquisitions paid a reported £342 million for Northern Foods which included bakery, chilled and frozen foods, own label foods and also the Fox's biscuit brand and the Goodfella's and San Marco frozen pizza brands.

Trefor Griffith
Head of Food & Beverage, Grant Thornton UK

"A large proportion of the recent transactions were driven by the need to consolidate supply channels and diversify customer bases. The current market conditions and pressures from customers are forcing food manufacturers to think about cost control and reduction as well as effective pricing to maintain margins. Companies can achieve economies of scale through M&A which can then be used to improve control of the distribution process and to expand scale and reach."

- Greencore's acquisition of Uniq, the chilled and frozen food producer for the own label market. Greencore paid in the region of £113 million.
- Hain Celestial's acquisition of Daniels Group from SATS (Ltd). This included New Covent Garden Soup Co, Johnson Juices and also hot pudding company Farmhouse Fare. Hain are believed to have paid around £142 million for the company.
- Premier Foods sold four Irish brands (including Chivers preserves, Erin's soup brands, Gateaux ambient cakes and McDonnells dried noodles) to Boyne Valley. Boyne Valley were reported to have paid £34.5 million.

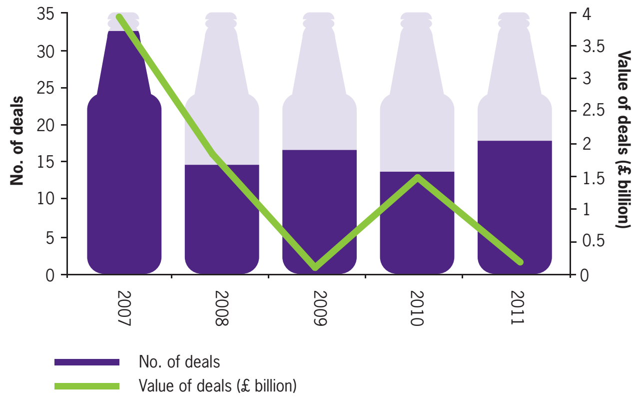
CASE STUDY

Hain Celestial acquired Daniel's Group from SATS (Ltd)

The acquisition has enabled Hain to expand its existing UK portfolio, bolting on strong brands that complement its current offering. New Covent Garden Soup Co. and Johnson's Juice sit well alongside Hain's Daily Bread (which it acquired in April 2004). The chilled foods to go offering and its International Cuisine, ready meals business are a good fit with the Linda McCartney meal range and all products slot comfortably within Hain's strong healthy eating offering, which is currently a highly attractive sector.

In acquiring Daniels, Hain has also consciously moved to broaden its geographic presence. Hain now has a presence in seven countries, up from three countries at the end of 2010, and their intention is to continue to make global acquisitions, looking at Asia, Australia and the Middle East as well as Europe and the US. This strategy is being adopted by many of the larger corporates in order to spread their exposure to fluctuating exchange rates and commodity prices as well as rationalising distribution networks.

Announced PE activity in the F&B sector, 2007-2011



The sector has also suffered from a substantial reduction in PE investment. Since 2007, when 32 PE-backed deals were completed, deal numbers have remained relatively low.

The discrepancy in deal volume vs. deal value is due to economic conditions preventing opportunities for investors to get a lot more for a lot less. The trend of consolidation means companies are more likely to offload parts of their business or brands that are not yielding high returns which represents a great opportunity for savvy PE buyers.

Examples of PE backed deals include:

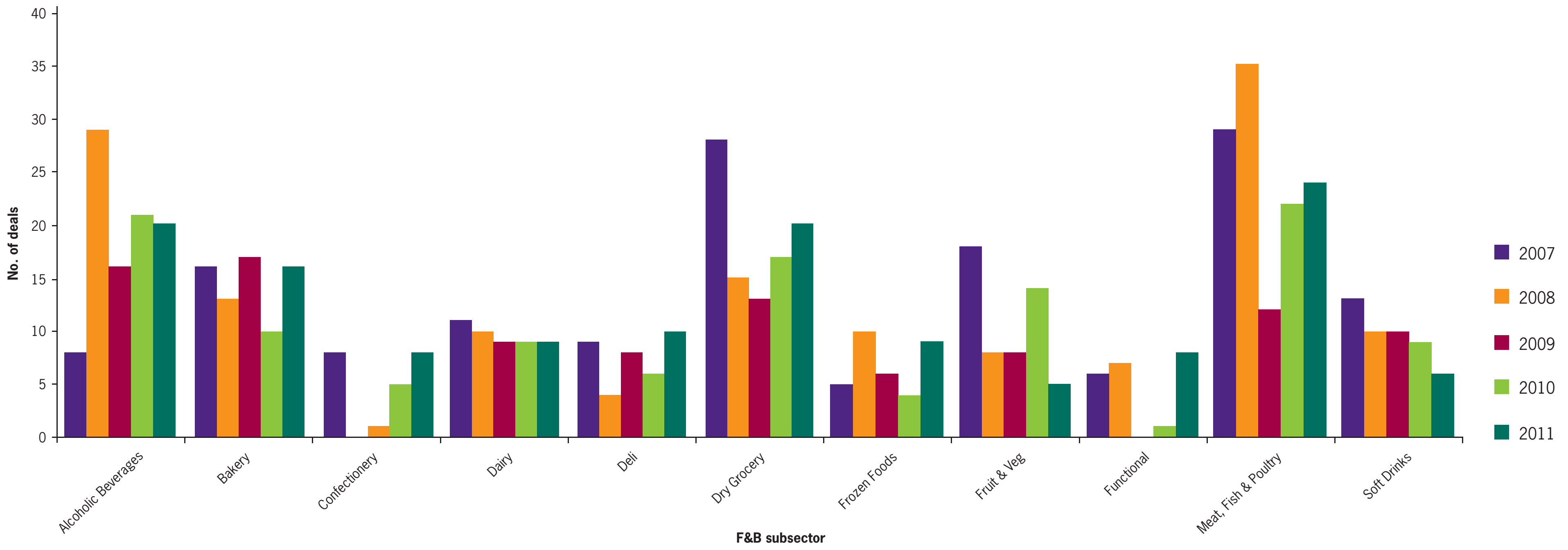
- Blackstone's acquisition of Tangerine Confectionery for a reported £124 million which then acquired the Wham and Highland Toffee brands from Millar McCowan.
- Exponent Private Equity and Intermediate Capital's acquisition of Marlow Foods which produces Quorn and Cauldron, the meat-free businesses which were owned by Premier Foods.
- Change Capital made an investment in McDuff, a Scottish seafood business. Its stated intention was to inject capital to accelerate growth and potentially move into new geographies.
- Piper sold Bottlegreen to SHS Group in 2011 having invested in the company in 2007. It was reported they made 5x money.
- Bridgepoint backed Symington's acquired the 'Chicken Tonight' and 'Ragu' ambient sauce brands from Unilever.
- Risk Capital invested in Bread, a London based specialist bakery.
- Manfield Partners' acquisition of MCM Foods, a canned fish and fruit supplier.

Among the F&B sub-sectors, the main volume areas of Meat, Fish and Poultry, Dry Groceries and Alcoholic Beverages fared relatively well, with modest growth in the last couple of years. More robust growth was seen in the Bakery, Confectionery, and Frozen Foods segments.

Ciara Jackson
Head of Food & Beverage, Grant Thornton Ireland

"With EU milk quotas ending in 2015, Ireland's milk output is expected to increase by 50%. The large Irish corporates are working hard to position themselves to capitalise on this, with Glanbia investing in new plant and Kerry acquiring Newmarket's liquid milk business. Danone have invested €50m in a new plant to expand capacity to produce infant formula. Ireland currently supplies 16% of the world supply of infant formula. Demand in China alone for infant formula is growing at an estimated rate of 20% per annum."

UK and Ireland M&A activity by F&B subsector, 2007-2011



Confectionery

Acquisition activity in the confectionery sector has risen steadily in the last few years as cash rich backers hit the market looking to acquire 'heritage' brands. In July 2011 Blackstone acquired Tangerine Confectionery and followed this up in September 2011 with the acquisition of the Wham and Highland Toffee brands from Millar McCowan and in January 2012 with the acquisition of York Fruits and Smith Kendon, both of which they have bolted onto the Tangerine portfolio. Zetar has also continued its push into the UK confectionery market as has Glisten (via its parent Raisio). This is a sector that is backed by PE and large foreign conglomerates, all with money to spend on building their portfolios. This is supported by our research, which underpins the importance from a buyer's perspective of strong and performing brands.

Dairy

The dairy sector has (and will continue to be) an area of activity. On the one hand acquisitions of branded dairy products will continue as large corporates seek to bolt on to their existing portfolio of brands. And on the other hand it is anticipated that commodity prices will continue to squeeze the liquid milk industry, creating more consolidation opportunity for the few larger players that remain in liquid milk. This is evidenced by the administration of Farmright (Quadra Foods) and Rock Farm Dairies this year as well as Müller acquiring Wiseman Dairies and Connaught Gold acquiring Donegal Creameries liquid milk business. For dairy products there was Uniq's acquisition by Greencore, and the acquisition of Rachel's by Lactalis in May 2010.

Dry Grocery

Activity in this sector has been steadily rising over the last couple of years as corporates seek to acquire brands to bolt on to their portfolios thus reducing expense on Innovation and R&D. They are choosing instead to mix NPD with brand extension and brand reinvention. For example the acquisitions of Unilever's Ragu and Chicken Tonight brands by Symington's, Kellogg's acquisition of the household brand 'Pringles' from Procter & Gamble, Boyne Valley's acquisition of Premier Foods four Irish brands and Baxters acquisition of Fray Bentos (from Princes).

Meat, Fish & Poultry

Activity in the sector has made a recovery since 2009, with activity on the rise again. Here we have seen companies acquire in order to consolidate their supply chain (such as Morrison's acquiring supplier, Farmer's Boy) or to enable diversification into aligned product offering, such as ABP acquiring RWM Group in order to enhance its lamb processing capability. Ireland exports 90% of its beef almost exclusively to the EU. There is speculation in Ireland that America will 're-open' for trading of Irish beef. This is a huge opportunity for the sector, and there is strong demand for grass fed premium quality beef. On the flip side changing consumer demand in the emerging economies is pushing up the price of meat and making it more difficult for some corporates operating in this space.

Alcoholic Beverages

Deal activity in alcoholic beverages remained strong in 2010 and 2011 with branded players selling off non core assets to competitors – such as Heineken selling off its Youngers and McEwan's brands to Wells & Young in October. Conditions have remained difficult due to commodity prices and the reduction in consumer pub spend. In reaction to this the larger brewers have targeted smaller specialist players to enhance differentiation and innovation in their portfolios. An example of such activity is the acquisition of Sharp's brewery by Molson Coors in February 2011.

The recent UK budget has provided no comfort to brewers as beer duty has been raised and large drinks companies will continue to seek acquisitions in order to build their geographic footprint within the UK (and beyond) and diversify their offering. It is anticipated that this trend will continue into 2012.

In Ireland, pubs have experienced a sharp decline in trade, and as a result there is an expectation that this sub-sector is ripe for consolidation. Many pubs are individually owned, but we believe it's likely that a number of 'super pub' groups will emerge.

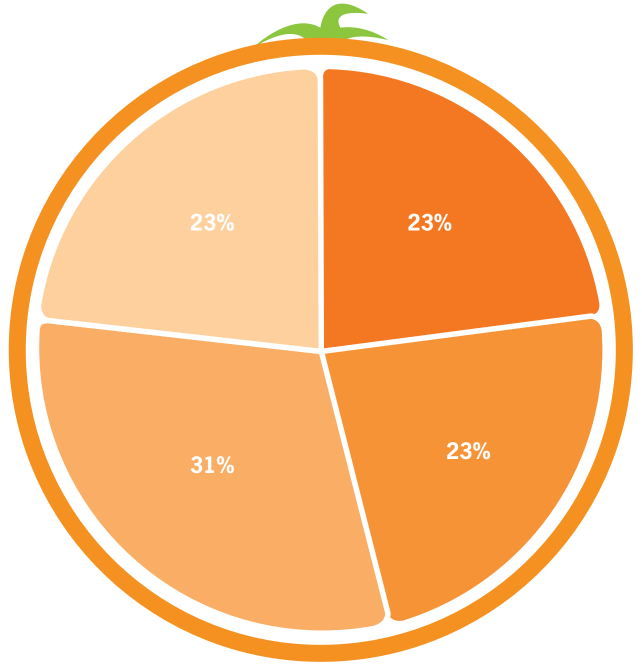
Demand for Irish whisky is growing at a rapid rate (11.5% in 2011), and the large players are positioning themselves well to capitalise on this opportunity. Jim Beam acquired Cooley Distillery for a reported consideration of $95 million. Meanwhile, Irish Distillers Pernod Ricard are due to invest $100 million on its whisky distillery in Cork in 2012.

Investor predictions

What are investors looking for?

Our research shows that PE houses value innovative businesses offering niche services which do not depend entirely on the multiple retailers to survive. The corporate acquirers we spoke to value niche offerings, innovation and R&D just as highly but they are further looking for businesses with a capacity for overseas expansion or to acquire strong consumer brands to add to their stable.

Corporate prediction of investment in the F&B sector over the next 12 months



- Increase significantly
- Increase slightly
- Won't change
- Decrease slightly

Our research indicates that 46% of corporates predict that investment in the F&B sector will increase in 2012. Activity in the early half of the year suggests that this is accurate. For example:

- Kellogg's bought Pringles from Procter & Gamble after Diamond Foods pulled out of the acquisition due to funding problems.
- Robert Wiseman was acquired by Müller.
- Wessanen acquired Clipper Teas.

80% of corporate respondents believe growth will be driven by acquisition, a higher proportion than amongst financial buyers. In days gone by this may have been a sign that the sector was showing aggressive expansionary tendencies, in today's market it is more of an indication that the industry is adapting to survive.

It is clear that a lot of M&A activity is still being driven by the continued trend for restructuring and consolidation but realistically the high volume, low value of these deals is likely to continue. 31% of our corporate respondents believe that nothing will change at all, whilst 23% think investment will in fact decrease. The fact that our respondents' opinions are so evenly divided demonstrates not only the uncertainty driven by current economic conditions but also the widely differing opinions held by the broad spectrum of businesses within this sector.

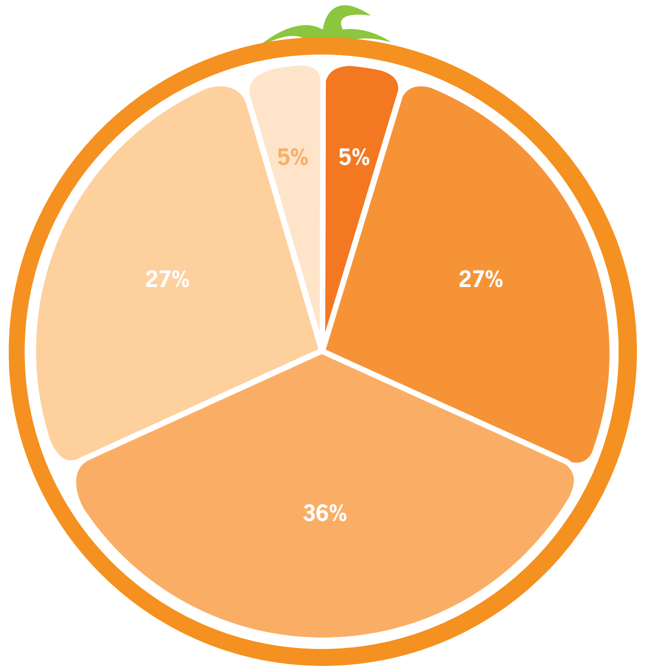
Financial buyers warm to a resilient sector

PE investors do not expect to see a huge amount of change in the levels of investment over the next year. Just 5% of PE investors surveyed expected activity to increase significantly. This is in line with relatively flat investment trends post-recession. The deterioration in the banking environment has hit the PE community harder than the corporate buyers who often fund M&A deals directly from their balance sheets.

Despite this conservative view of future funding, over 80% of the PE investors interviewed did have plans to invest in the F&B sector in the next 12 months.

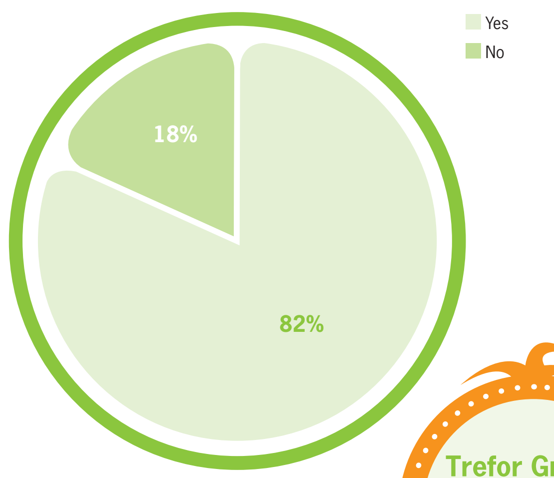
At Grant Thornton, we believe that this sentiment is probably an indication of the strength, safety and potential of the sector.

PE prediction of levels of investment in the F&B sector over the next 12 months



- Increase significantly
- Increase slightly
- Won't change
- Decrease slightly
- Decrease significantly

Does your firm plan to make an investment in the F&B sector over the next 12 months?

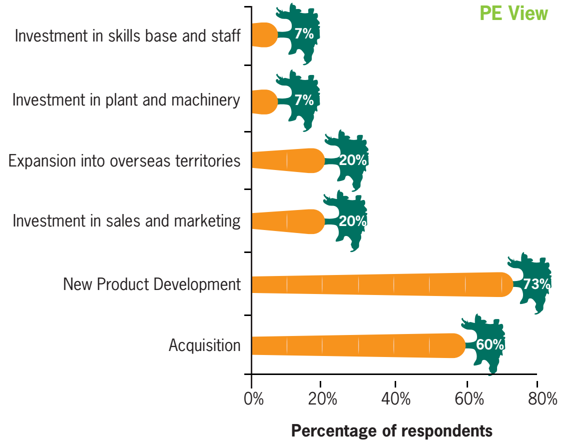


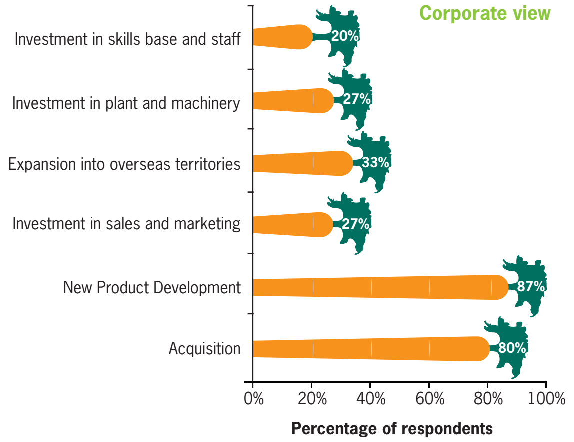
Trefor Griffith
Head of Food & Beverage, Grant Thornton UK

"Only 5% of PE investors expect a significant increase in levels of investment in the sector, yet 80% of those we spoke to plan to make an investment in 2012. It is difficult to see how these two positions reconcile but it is very encouraging to know that PE is committed to further investment in the sector."

Drivers of growth

What will be the main drivers of growth over the next 12 months?





New Product Development

It is clear from our research that both PE and corporate respondents view NPD as the key driver of growth for the sector over the next 12 months, a view supported in a recent Grant Thornton UK report commissioned by the Food & Drink Federation[3] and in the Grant Thornton International Business Report (IBR)[4]. Product development and R&D are huge differentiators and important factors in staying competitive. Consumer tastes are changing and their time is becoming more precious so the emphasis is now to develop new functional and technical ingredients as well as products that have health and nutritional benefits which will meet consumer needs.

However, whilst NPD is vital for survival it also represents significant capital outlay in tough economic times. Consequently some businesses have acquired brands to bolt on to their existing portfolio with a view to adding value to these brands rather than innovating from scratch. This is evidenced by the acquisition of Fray Bentos by Baxters and the recent activity by Symington's which has been acquiring brands such as Chicken Tonight and Ragu. This type of model has recently proved very successful for businesses like Tangerine and Big Bear.

Programmes such as the Manufacturing Advisory Service (MAS), which Grant Thornton UK is delivering on behalf of the Department for Business, Innovation and Skills, are dedicated to helping manufacturers improve any aspect of their manufacturing operations, processes, production or materials technologies and can provide welcome assistance to businesses looking to conduct NPD or R&D. Similarly in Ireland Bord Bia, Enterprise Ireland and Teagasc all provide strong support for F&B businesses.

[3] Sustainable Growth in the Food and Drink Manufacturing Industry, 2011, Grant Thornton report commissioned by the Food and Drink Federation
[4] Managing through uncertainty: Food & Beverage industry in transition, Grant Thornton International Business Report (IBR)

Acquisitions

According to our research the second most popular driver of growth in the sector, as viewed by our respondents, are acquisitions. The last Grant Thornton IBR report, which surveys businesses globally, tells a less optimistic tale with only 17% seeing M&A as an important area of focus (although this is increasing in many countries). The main driver of M&A activity among food businesses in the current market is the on-going process of consolidation, which will be discussed in more detail later. However, a good indicator of whether this appetite turns into significant activity may well come to light in 2012, with the much publicised sell-off of the non-core divisions of debt-laden Premier Foods. With PE buyers likely to be among the most interested parties all eyes are on the process: if Premier succeeds in selling units off at attractive multiples it may encourage other trade vendors to test the water, thereby increasing the flow of opportunities for financial bidders.

Risk management and mitigation is a further driver of M&A activity, as acquisitions can help reduce over dependency on any one customer and maximise potential buying power thus significantly helping to reduce risk. Whatever the motivation, there appears to be real confidence among industry professionals that there will be a plentiful supply of acquisition opportunities over the coming year. Perhaps the only caveat is that obtaining these at the right price may yet be difficult as price expectations on the part of vendors have yet to fall to levels that fully reflect the market realities. One senior Irish respondent explained, there have been relatively few 'tail brands' (typically the large, but not market-leading brands) put on the block so far, but this might change and these could represent attractive opportunities for larger, well-funded UK corporates.

However, as a number of interviewees stressed, speed is of the essence in this rapidly changing M&A landscape. As one respondent explains: "The key to making the most of the opportunities in this environment is to be flexible and prepared to act quickly, both to seize opportunities when they arise and to axe things that aren't working"[5].

Michael Neary
Corporate Finance Partner, Grant Thornton Ireland

"While many well capitalised businesses in the F&B sector are seeking to grow by acquisition, smaller less well capitalised businesses may consider merging to deliver operating synergies and improve performance. In the market today, a key consideration for many F&B businesses is insulating themselves from commodity price fluctuations and we believe M&A can be a key strategic tool in helping to achieve this objective."

[5] UK Food & Drink performance – Full year 2011 (FDF)

Overseas expansion

The third most popular driver of growth for the sector is the expansion into overseas territories. Companies need to diversify their activities abroad and look to both developed and emerging markets to grow their business. Why? Because many businesses are looking to spread their geographic exposure in the face of the Eurozone crisis. Others recognise the advantages of expanding to other potentially lucrative geographies including the emerging economies where consumer tastes are changing in line with their increased spending power. However, due to increasing local and international competition, penetrating these markets is expected to be difficult. Demand for infant formula in China is growing exponentially year on year, and following a food safety crisis a number of years ago, Western brands have gained huge traction. For example, Danone have 70 factories in China, manufacturing a range of products and they aim to be market leader in the infant formula sector. Interestingly in 2011, more than 50% of Danone global revenues have been generated from emerging markets. Dairy Crest have moved into America with the Cathedral City Cheese brand and the Scotch Whisky industry is thriving in Asia due to a rise in the number of affluent middle class consumers, indeed whisky now accounts for 63% of all UK beverage exports (by value).

Anuj Chande
Head of South Asia Group, Grant Thornton UK

"The World Bank forecasts that at the current rate of income growth in emerging markets, the middle class will account for 17% of the total global population in 2030, as opposed to 8% in 2000. This expanding middle class, with increased disposable income is expected to shift diets in emerging markets more towards Western style processed and prepared foods that contain a higher amount of protein. Gondola Holdings' joint venture with the Bharti family to bring Pizza Express to India's middle classes is an example of this trend in action.

Private consumption forecasts suggest that during the coming years UK businesses need to divert attention outside established Western markets – towards BRIC economies and Eastern Europe in particular.

Market entry through M&A or joint venture is an attractive option as in such unfamiliar markets successful foreign players usually have access to local manufacturing operations and product development tailored to local tastes. Ultimately, success hinges on a thoroughly researched and carefully executed long term strategy which involves being visible and working collaboratively with people in the local market."

Jim Moseley
President, Food and Drink Federation

"According to our recent research, many people from Asia and the BRICs, who are increasingly travelling to the West and the UK, are developing a growing appetite for Western premium products. In addition, according to OECD and FAO, consumer demand on a global scale will continue shifting from staple foods towards more processed and prepared food products that contain a higher amount of protein driven by the growing middle class. For UK and Irish business this represents an opportunity to build businesses relationships with emerging market companies wanting to develop top quality manufacturing operations and high standards of food hygiene."

CASE STUDY

Quick Food Products

Quick Food Products, run by Sean Young, is a manufacturer of savoury meat, poultry, fish and vegetable pasties. Having experienced an arson attack seven years ago, production ground to a halt for eight months and competitors quickly filled the gap in the market. Quick Food Products first approached the Manufacturing Advisory Service (MAS) for help with sharpening up their manufacturing control systems. They were keen to develop a new range of patties with flavours aimed at the Nigerian market and to develop patties certified to carry a Halal label.

Their MAS adviser introduced them to an innovation specialist which, with subsidised assistance from MAS, helped them to:

- improve process controls and capacity utilisation which freed up capacity to develop the new range of products
- reduce distribution and packing costs which was of key importance for the Halal market, meeting customer requirements for data content

Sean believes the projects with MAS paid for themselves in a matter of weeks.

For more information about MAS visit www.mymas.org

Peter Kemp-Welch
Partner, Piper Private Equity

"Whilst the sector is facing some challenges and the macroeconomic environment cannot be underestimated, there are still food and drink businesses that continue to grow well. It's a good reminder that this is a large market with shifting segments within it. This creates instability but also opportunities, particularly for smaller businesses.

You have to look at it from the perspective of the consumer: their perception of value is changing and this drives the innovation of new products and new business models and ways of doing things. The restaurant space has some good examples of this: the emergence and strength of 'fast casual' is a good example of how some operators are undercutting traditional restaurants while still providing a restaurant experience. It's a sign of the consumer experimenting because they are under pressure and of entrepreneurs responding with new offerings to meet that need."

Consumer trends

A changing consumer landscape

In the current market, businesses that can fulfil consumer demand for certain niche products are vital for growth. In Ireland, a banking crisis and an economic crisis have ultimately led to the intervention of the Troika. Rising energy costs combined with one of the highest European minimum wage levels continue to provide challenges for the sector. As stated in the Grant Thornton IBR report, UK consumers are simply buying less. In June 2011, food volume in the UK decreased by 4.2%, according to the Office for National Statistics, the steepest drop since record-keeping began in 1988. During the same period, food prices rose 5.8% last year, the biggest increase in two years. With less money to spend and more expensive food prices UK and Irish consumers are changing the way they shop and the type of foods they buy.

Consumer trends driving investment

What are the most attractive niches?

PE investors	Corporate investors
Healthy eating	Branded
Branded	Own label
Premium	Premium

Healthy Eating

Many consumers, whether by choice or doctors' orders, are pursuing healthier lifestyles and healthier food consumption in the form of reduced fat, fewer calories, lower sodium, more fibre, increased nutrients or products free from allergens. The needs of the aging populations in the UK and Ireland also contribute to the popularity of healthy foods. The 'free-from' market is receiving particular attention at present with a number of supermarkets dedicating aisle space exclusively to this category. Successful 'free-from' brands include Rude Health, Hale and Hearty, Alpro, Genius and Mrs Crimble's.

Premium

All the supermarkets have done reasonably well with their high quality, private label products. People are trading up. They cannot afford to go out and eat as many times as they would have in the past, they are eating more at home, which is partly cost driven and partly because of the celebrity chef/cooking at home culture. Consumers will end up buying products of higher quality in the supermarket or in the niche high end retailers, either in the form of ingredients for a recipe or a quality ready meal.

Steven Petrow
Managing Director,
Change Capital

"For us the strategy starts with the analysis of consumer trends. We look at how trends will impact what consumers will be eating and drinking and therefore who might have a real asset. And some of the trends that we are focusing on in particular are to do with healthy eating – all varieties of healthy foods such as cereals, wild seafood and organics. The strong market growth means you may have to pay top dollar for these assets but there are often operational improvements to be made and you can also 'buy-well' by taking opportunity of short-term blips (like the current state of the economy): riding a long term trend, buying well and making operational improvements is a real hat trick."

Trefor Griffith
Head of Food
& Beverage,
Grant Thornton
UK

"The economic climate has created a case of the haves and have nots. Research carried out by our Global F&B team supports this, where we have identified two diverging strands of consumers – the 'budget conscious' and the 'more affluent'. Consumers who have retained employment are in many cases better off due to low interest rates and reduced mortgage commitments, while many other consumers are struggling to make ends meet. This is being reflected in their food shopping habits. The consumers who have fared better may still be concerned about their futures, constraining their spending even as they seek quality foods, especially groceries; those F&B companies that offer quality branded products are faring better and as such are more likely to attract the attention of investors."

Branded vs own label

Certain brands have a stronger position with retailers ie Heinz Baked Beans and Heinz Tomato Ketchup have strong brand equity – 'must stock brands'. The flip side of this is there are not many brands in this position. For own label producers, multiple retailers wield massive power, as they stock a small range of each product, making competition for shelf space fierce. Having said this, own label food and drink sales have risen for the first time in three years[6].

In addition to pressures on consumer spending, it is fair to say that own label brands have become more mainstream and trusted. The emergence of discount retailers such as Lidl and Aldi is indicative of this. In Ireland for example there are currently over 200 Lidl and Aldi stores, from a base of zero in 1999[7]. In the UK over 962 Lidl and Aldi stores have been opened since 1989. Indeed Lidl and Aldi's combined year on year growth stands at 39.2% compared to just 6.8% combined for Tesco and Sainsbury's[8].

Within the leading chain supermarkets, own label complete main meals (ready meals) and own label ice cream have done particularly well – Tesco's Chokablok and Asda's Loaded have challenged premium branded players. However this is not true across the board. In baking and cooking, where strong NPD has been seen from brands like Dr. Oetker, own label sales are in decline[9].

Michael Howard
Group Managing
Director,
SHS Group

"Outside of M&A opportunities, for us it is all about creating the right value proposition and this means different things to different markets. Clearly, if people are not going out to restaurants and are staying in more often, they might be quite happy to treat themselves and trade up. So we would argue that for certain 'indulgences' it is a case of perceived value. But in other areas it might be about product re-engineering and looking at ways of taking the food inflation out of the equation."

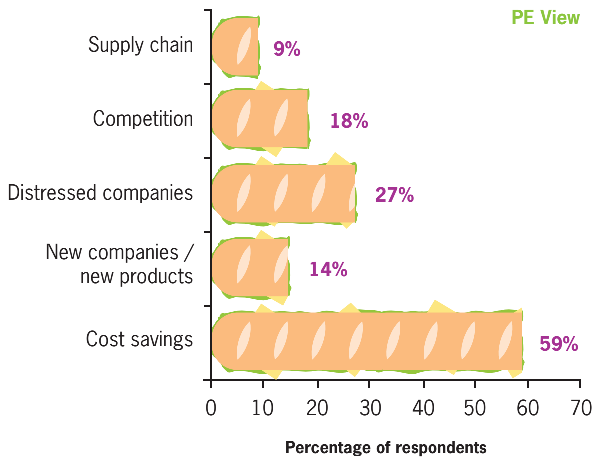
Paul Simmonds
CEO, Glisten Ltd/
Vice President,
Raisio Western
Europe

"Given how tough the market is right now, the key for us is to invest in, and make the best use of our own brands. Brands have been a better place to be during this period in our view. And, now we are part of a larger group with a strong balance sheet, we are also in a better position to manoeuvre in terms of acquisitions. Our philosophy has always been based on being flexible, putting downward pressure on overheads to make sure that we remain fleet of foot, and it is this that has allowed us to find the silver linings that are there. Despite the trading climate we've had a decent year and it's by being fast, flexible and innovative. You have to spot your opportunity, decide quickly and then go for it."

[6] Symphony IRI 2012
[7] Lidl and Aldi corporate websites
[8] Kantar Worldpanel, March 2012 (Year on year growth for the 12 weeks to 20 March 2011 compared to the 12 weeks to 18 March 2012.)
[9] The Grocer

Consolidation

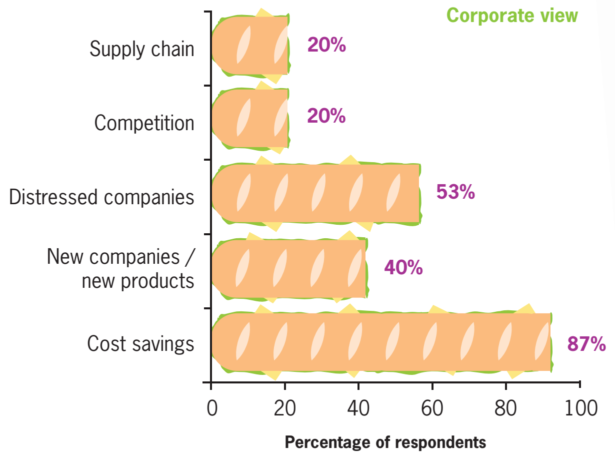
What will be the main drivers of consolidation?



The F&B sector has been in the process of consolidation for many years and this is showing no signs of slowing in the immediate future. Consolidation comes as a by-product of vast change in the market, responding to consumer tastes, demand and buying habits. Both PE and corporate investors agree that consolidation is mainly driven by a need to save costs and a need to revive or offload distressed companies which are under-performing.

For small and medium sized businesses in the F&B sector, growth is often difficult to achieve, so strategic acquisition is one way to move forward. In the bakery market for example, M&A deal numbers have been relatively high but values low, representing a trend of smaller, family owned businesses merging to create stronger, more robust organisations.

Companies can also achieve economies of scale through M&A which can then be used to reduce costs and shed debt. Premier has been a clear example of this trend in action, shedding its Irish brands and own label chilled business, its East Anglian canning operation and its meat-free business in 2011. These types of businesses were snapped up by a mixture of corporates looking to boost competitiveness and market share, and by PE buyers looking to build the business and sell them on.

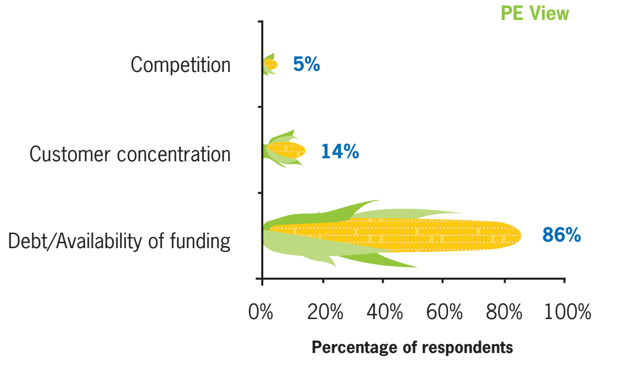


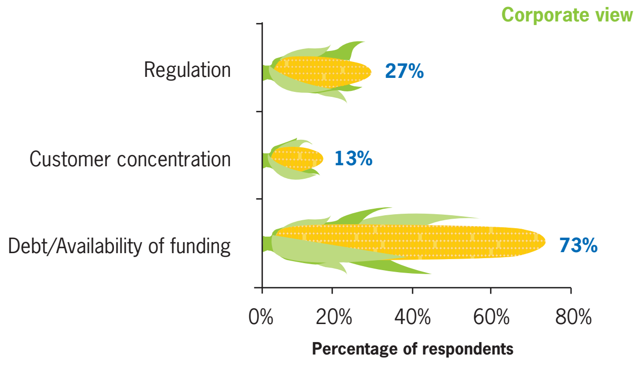
Consolidation is not limited to the UK and Ireland, it is happening across the global F&B industry. The larger deals completed in 2011 and at the start of 2012 indicate a drive, particularly from large corporates, to leverage brands into new product areas and ultimately in to new markets. For example Kellogg's acquisition of Pringles from Procter & Gamble in January 2012 was a strategic purchase of a brand with global appeal and potential.

In terms of inbound investment there has also been activity from foreign entities acquiring UK companies to bolster their presence in Europe. This is driven by a desire to enhance distribution channels and product portfolios, whilst simultaneously spreading any economic risk. Examples of this include Hain Celestial acquiring Daniel's Chilled Foods (see case study on page 3), Wessanen acquiring Clipper Teas, Müller acquiring Robert Wiseman and Jim Beam acquiring Cooley Distillery.

Access to finance

What are the main barriers to consolidation?





Despite the evidence to suggest that M&A volumes in the F&B sector are likely to continue rising, the market is not without its challenges. As potential buyers, both PE and corporate investors identified the main challenge as low availability of debt funding. As one corporate manager states: "It will be a case of cash flow survival for most people in the short term". In addition the capital markets issue extends beyond the provision of acquisition capital and into more operational areas of funding.

This feedback is not surprising as despite government efforts and pledges to loosen the purse strings of the banks, the world is in a completely different place than it was pre credit crunch. In 2007 and before there were far more sources of finance available with more UK and Irish banks in the market as well as a whole host of European and other overseas entities looking to place debt and equity into UK and Irish businesses. Not only did this provide a great deal of choice but increased competition added to the far more aggressive funding environment. All this then meant that it was far easier to borrow money.

This gap has yet to be plugged and some of the remaining banks have had bad experiences with overleveraged businesses in the sector which means that their credit departments are negative around lending more to the sector. This is exacerbated by the current levels of consumer confidence and spending allied to the multiple retailers fighting so hard for every pound spent.

Ciara Jackson
Head of Food & Beverage, Grant Thornton Ireland

"In Ireland the economic and banking crisis hit hard and the effects were felt much earlier than in the UK. In response Irish businesses were forced to adapt more quickly, tightening operating costs and running more efficiently to weather the storm. Feeling this so intensely and with so little warning has been incredibly difficult, but the surviving businesses in Ireland have had to cut costs, improve productivity and shed non core business. Ultimately this means Irish F&B businesses are a smaller leaner group of operators geared toward optimum efficiency with minimum waste – this is true within the F&B sector and beyond."

To an extent Asset Based Lending (ABL) has filled some of the gaps and this is likely to continue as:

1) the mainstream banks are keen to focus on ABL due to their capital requirements
2) it is generally very suitable to the F&B sector given the financial strength of the large customers and the security that it provides
3) there are a number of 'independent' ABL providers who are building up strong portfolios in the sector which is making them more comfortable around some of the issues faced.

Roy Bawden
Director, Food and Consumer, UK Sector Coverage, Royal Bank of Scotland PLC

"We see the F&B sector as an attractive area in which to lend. The fragmented nature of the sector makes it hard to generalise but overall, businesses in this arena have a high level of management skill, show resilience and have good growth potential. There are a wide range of structures to provide finance, ranging from conventional M&A financing for larger corporates and the RBS Manufacturing Fund to schemes such as the Business Growth Fund for equity solutions as well as the Enterprise Finance Guarantee and the National Loan Guarantee that serve the SME market.

On average we accept nine out of every ten loan applications in the SME market of which F&B is a significant contributor. The challenge for many businesses within the sector is concern for sustained economic growth leading to a reluctance to raise debt in the competitive environment in which they operate where managing costs has become a top priority. Both clients and their funders look for assurance on future profitability.

Having said this, there are many successful businesses in the F&B arena with huge potential, more so than in many other sectors. The F&B companies we see achieving the most success tend to have sustained investment in new product development, strong brands and competitive, efficient business models. As the sector is weighted largely with manufacturing businesses there's no shortage of innovation. Ultimately, for those businesses that want it – there are plenty of F&B friendly lenders out there willing to invest."

Graham Barber
Director, PNC Business Credit

"The F&B sector is one that readily lends itself to the use of ABL as a funding solution due to the working capital and investment needs of our clients and the demands of the customers. At PNC Business Credit we continue to look at a number of lending opportunities in the sector, as well as manage our growing portfolio of clients in the F&B sector.

We anticipate continued activity in the sector and will look to provide flexible solutions to clients in order to meet their aspirations for growth."

David Riley
Head of Asset Based Lending, Grant Thornton UK

"Most businesses in the F&B sector accept that they will need to raise funding of some form in the next 12-18 months, even if it is to strengthen capital bases and invest in existing operations. And while the difficulties in raising finance from new sources may mean that many businesses are choosing to 'stick with the devil they know', there is evidence to suggest companies are becoming more proactive and are, instead, investigating alternative sources of capital. There are also signs that new entrants into the funding market may begin to introduce the element of competition that will force the established banks' hands.

Working in the corporate finance arena, Grant Thornton has seen a move towards asset based lending (ABL) solutions, which highlight a shift in strategy among businesses that are finding traditional cash flow based facilities challenging to raise. ABL deal structures typically include revolving facilities based on a company's outstanding accounts receivable and inventory complemented by term loans structured against the value of freehold property, plant and machinery and cash flow generation. With ABL proving to be a viable and flexible alternative funding solution which actively supports businesses planning for growth, the use of more traditional term loans and bank overdrafts is diminishing.

This change in direction reflects the overall trend in the industry, with the clearing banks encouraging customers to move to asset based funding solutions, especially given the lower associated capital holding constraints under Basel III.

Our advice to FDs in the F&B sector, who are considering raising finance to grow their business, is that there has rarely been a more opportune moment to leverage your balance sheet via some form of ABL facility."

Conclusion

It is clear from the findings of the research conducted and from our own experience working closely with F&B businesses that M&A activity in the sector is strong and we fully expect that to continue. At Grant Thornton we are working on a number of transactions that are consistent with the findings of the research and reflective of the drivers mentioned in this report.

The sector is becoming ever more global in its nature as evidenced by the growth targets referred to in the report. This ties in with our approach whereby the F&B sector is one of the key focus sectors for both the UK and Irish firms and also Grant Thornton International. We have a truly global scope and are investing significantly in emerging economies, the UK and Irish firms are working very closely together and this is important given the close relationships between businesses in these markets, not least in terms of M&A activity.

We believe the growth targets set by the Irish government and FDF in the UK, whilst ambitious, are absolutely achievable and we are investing to provide services to help our clients achieve their growth targets. It is important to note that the UK and Ireland are not the only economies that are looking to increase exports and therefore F&B businesses need to continue to up their game to achieve growth, both in terms of innovation and by managing costs to be able to fund the innovation. It is also important to note that whilst exports are important, population is forecast to grow in the UK and this, added to pronounced changes in demographics and consumer requirements also provides significant opportunities for growth. As always amongst the changing landscape there will be winners and losers. Experience tells us that the winners tend to be those businesses with a clearly defined strategy, a strong management team and a sensible financial structure. At Grant Thornton we are helping a number of our clients in the F&B sector to achieve their aims and look forward to doing more of this in the future.

About us

Grant Thornton UK LLP is a leading financial and business adviser, operating out of 27 offices including three staff support sites. Led by more than 200 partners and employing nearly 4,000 of the profession's brightest minds, we provide personalised assurance, tax and specialist advisory services to over 40,000 individuals, privately-held businesses and public interest entities.

Our offer to the market is great depth of expertise, delivered in a distinctive and personal way. Through proactive, client-centric relationships, our teams deliver solutions to problems, not pre-packaged products and services.

Our deep-rooted experience in the issues affecting mid-sized businesses, combined with the true global reach and resources of Grant Thornton International Ltd mean that we're uniquely placed to deliver the best advice, in a seamless way – regardless of service line, regardless of location.

We are a member firm within Grant Thornton International Ltd, one of the world's leading international organisations of independently owned and managed accounting and consulting firms. Clients of member firms can access the knowledge and experience of more than 2,600 partners in over 100 countries and consistently receive a distinctive, high-quality and personalised service wherever they choose to do business.

Grant Thornton Ireland provides assurance, tax and specialist advice to businesses to help them unlock their potential for growth. Grant Thornton has significant experience in the F&B sector from the farm gate through to processing and retail. Our experience means that we can readily identify the critical issues affecting your business and then quickly provide specific solutions. The firm comprises over 400 partners and staff operating from offices in Dublin, Limerick, Kildare and Galway.

Grant Thornton's Food & Beverage sector

The F&B sector is one of Grant Thornton's key focus sectors, not only for the UK and Ireland but also internationally, consisting of experienced industry champions from around the world.

We work together to offer a full range of services to a diverse range of businesses throughout the food and beverage supply chain, from agriculture producers, multinational food and beverage manufacturers through to the major supermarkets. Our expert advice is based on extensive experience in the sector and demonstrable client service, knowledge and contacts, enabling us to readily identify the critical issues affecting businesses and then quickly providing specific solutions across all territories.

Methodology

To gain a balanced and informed view we commissioned the research for this report based on a broad cross section of corporates and PE houses. Over 75% of PE houses that have invested in the sector in the last ten years and a number of high profile acquisitive corporates from both sides of the Irish Sea were surveyed. Respondents were asked to give their opinions on a number of issues including the main drivers of growth in the sector over the next 12 months, changing consumer trends and consolidation as well as their appetite for investment in the sector going forwards and the availability of funding.

All answers were confidential and the results have been reported in aggregate.

The transaction data in this report is as reported and is accurate up to the end of March 2012.

Contact us

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