M&A Market Review

Food & Beverage

gambit CORPORATE FINANCE

Food Supplement

Q2 2014

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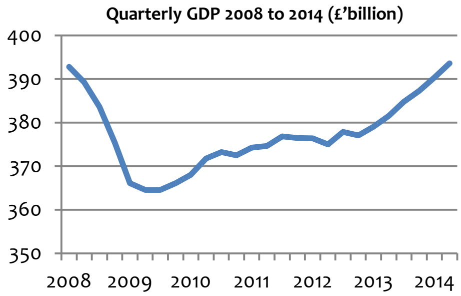
Content Summary:

M&A Market Review	Overall deal volumes fell by 15% in Q2 compared with the first quarter of 2014. However, there was a significant increase in average deal value in Q2 compared with the first quarter of the year. The average deal value for Q2 2014 was £107 million compared to an average of £63 million in Q1.
Public Comparables	Amongst the food and beverage companies monitored by Gambit, average EV/EBITDA valuation multiples have increased noticeably post-recession in all areas other than food retailing .
Commodity Prices	With the exception of a few commodities, most notably meat, agricultural prices continued to fall due to favourable supply prospects.
Guest Article	This edition: Ed Garner, Director at Kantar Worldpanel, addresses the issue of the mounting pressure on the mainstream grocery retailers.

Macro Outlook

In August the Bank of England upgraded its growth forecast for 2014 from 3.4% to 3.5% and for next year from 2.9% to 3.0%. The Bank expects the robust economic recovery of the past year to continue. On an annual basis the UK economy grew 3.2% in the second quarter, up from an initial estimate of 3.1% in July 2014. The Office for National Statistics' figures confirmed the UK economy saw its best economic performance for six years and passed its 2008 peak. The International Monetary Fund has forecast that the UK will have the strongest growth in 2014 of any of the G7 countries.



Source: ONS

Despite continued strong growth in the UK economy, the Bank of England said in its quarterly Inflation Report that the level of slack in the economy had been larger than it initially believed suggesting interest rates do not need to rise imminently to avoid fuelling inflation. This led to the financial markets pushing back the expected timing of the first interest rate rise with the consensus being that the Monetary Committee will not vote for a rate rise until the early months of 2015. The rise in sterling over the past 18 months has put pressure on UK exporters and is equivalent to a tightening of monetary policy which further adds to the case against premature rises in interest rates. However, two members of the Monetary Committee did vote for an increase.

Summary: Favourable M&A conditions in place for mid-market Food and Beverage companies

- ***To sell:*** With currently strong valuations within the food and beverage sector, corporate M&A activity is increasing and with a favourable tax environment, this represents a good time for those considering an exit.
- ***Private equity:*** The UK food and beverage sector remains attractive to private equity. The benefits of well established markets and predictable returns in food and beverage means that private equity houses are repeatedly looking to invest in the sector.
- ***Financing:*** With interest rates remaining at all-time lows and the availability of debt continuing to gather momentum, suitable finance is available for businesses adopting a growth strategy, be that investment in new facilities or strategic acquisitions.

Public Comparables Q2/2014

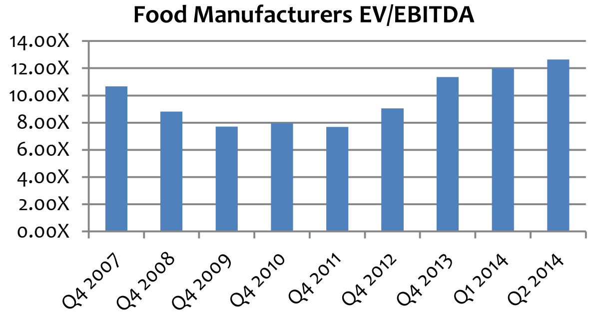
- Amongst the food and beverage companies monitored by Gambit, average EV/EBITDA valuation multiples have increased noticeably post-recession in all areas other than food retailing, reflecting the general strength of the pubic markets.
- The average EV/EBITDA valuation multiple of the food manufacturers has risen consistently since 2011 and is currently at a high of approximately 12.63x, well above pre-recession levels.
- EV/EBITDA multiples for non-alcoholic beverage companies have risen by over 55% between 2007 and 2014. There has been a slight decline in recent quarters but the majority of this is due to the falling share price of Nichols since March 2014 after a litigation claim was filed against the company, which it subsequently lost in July 2014.
- The average EV/EBITDA multiple of the food retailers has decreased by 42% between 2007 and Q2 2014. The rise of discount retailers such as Aldi and Lidl and premium retailers such as M&S and Waitrose, has hit the "big four" hard in terms of market share. They have also become embroiled in a price war to try to win back market share which is further impacting profitability.

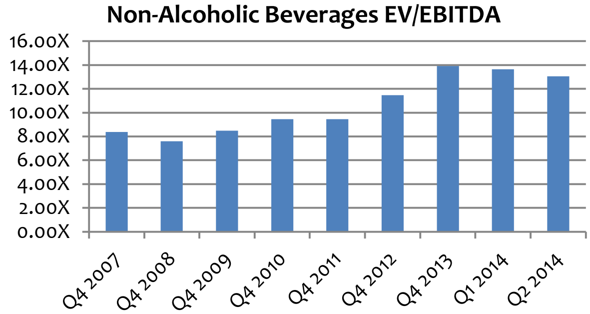
Food Manufacturers	Enterprise Value (£m)	EV/EBITDA
Associated British Foods	25,204	15.76X
Dairy Crest Group	782	9.20X
Finsbury Food Group	50	4.62X
Glanbia	2,907	16.78X
Greencore Group	1,346	13.21X
Kerry Group	8,582	15.42X
Premier Foods	1,275	13.34X
Unilever	82,797	12.73X
Food Manufacturers Average		***12.63X***

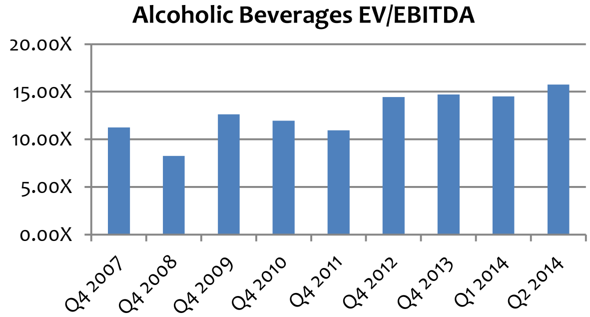
Non-Alcoholic Beverages		
A.G.Barr	737	16.26X
Britvic	2,315	12.91X
Coca-Cola	704	9.49X
Nichols	321	13.55X
Non-Alcoholic Beverages Average		***13.05X***

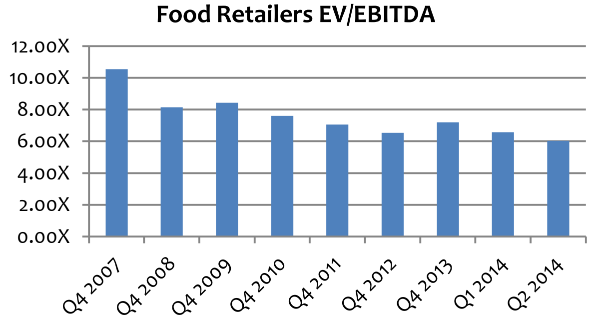
Alcoholic Beverages		
C&C Group	1,351	11.07X
Diageo	56,658	16.64X
SABMiller	63,910	19.56X
Alcoholic Beverages Average		***15.76X***

Food Retailers		
Tesco	31,269	6.92X
Wm. Morrison	7,097	6.14X
J. Sainsbury	7,285	5.02X
Food Retailers Average		***6.03X***









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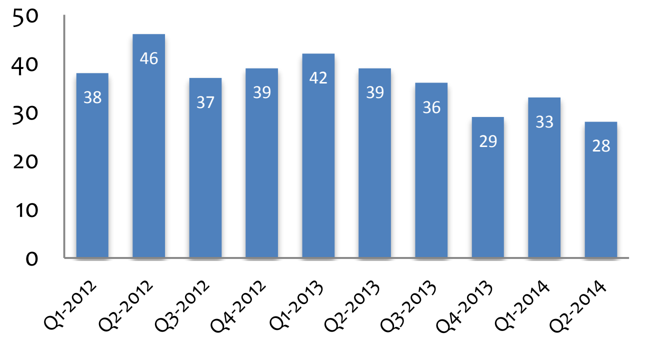
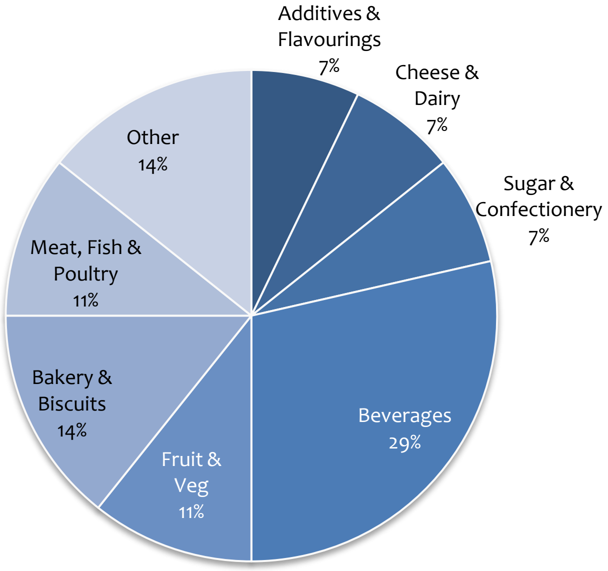
M&A Market Review

- Overall deal volumes fell by 15% in Q2 compared with the first quarter of 2014 reflecting a lack of supply rather than acquisition appetite. However, there was a significant increase in the average deal values compared with the first quarter of the year. The average deal value for Q2 2014 was £107 million compared to £63 million in Q1.
- The beverage sector was the most active during Q2 with eight deals announced. The most notable transaction being the sale of Scotch whisky distiller Whyte & Mackay to the Philippines-based maker of Emperador brandy for £430 million.
- Private equity deal volume fell by 50% in Q2 compared with the first quarter of the year with four deals completed in Q2, a direct impact of constrained supply of quality businesses seeking investment.
- Following the sale of its Peperami meat snack brand in the first quarter of 2014, Unilever has continued the theme of portfolio optimisation among the larger industry players with the £1.3 billion sale of its Ragu and Bertolli pasta sauce brands to Japan's Mizkan Group.
- It is reported that United Biscuits and Moy Park look likely to be heading for IPOs before the end of this year, whilst The Grocer has also speculated on a number of other well-known IPO candidates including Quorn, Weetabix, R&R and Adelie amongst others. The IPO market offers private company owners an increasingly attractive alternative exit option.

UK Food & Beverage Deal Volumes

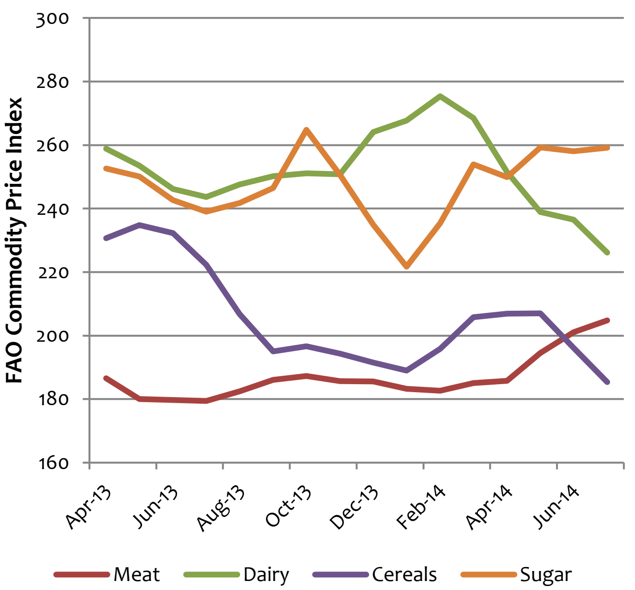


Q2/2014 UK Food & Beverage Deals by Sector



Commodity Prices

- With the exception of a few commodities, most notably meat, agricultural prices continued to fall due to favourable supply prospects.
- There was a 10% decrease in the FAO Cereal Price Index between March 2014 and July 2014 in reaction to the favourable production prospects in the major producing countries.
- The FAO Dairy Index fell by almost 16% between March 2014 and July 2014, reflecting both reduced import demand and abundant export availability.
- Meat prices rose sharply in Q2 mainly due to herd rebuilding in Australia and also a continued strong import demand for bovine meat from Asia.
- According to the IMF futures markets, most agricultural commodity prices are expected to increase over the next 12 months. Ongoing tension in Eastern Europe has led to an expectation that wheat prices will increase by 12% over the next 12 months. In contrast energy prices are predicted to fall.



Like Eggs in a Vice: Pressures Mount On Mainstream Grocery Retailers

Ed Garner

Director, Kantar Worldpanel

Let's start with macro trends at the total grocery level. The striking feature is that grocery price inflation has effectively disappeared. Our latest 12 week data has it standing at 0.2%. Naturally this has fed through to the overall market performance which at 0.8% value growth is the lowest for 10 years. So, barring future harvest disasters or oil-price shocks, this zero-inflation world will continue. The flattering effect of inflation on balance sheets can no longer be assumed.

Why has this happened? Deflation in vegetables, milk and bread will have undoubtedly helped. But of course the lower prices put into the market by Aldi and Lidl, together with the competitive reaction from other retailers, has driven inflation sharply down.

It's not only lower prices from Aldi and Lidl - it's how those prices are expressed. On average, across the "Big 4" (Tesco, Asda, Sainsbury's, Morrisons), 45% of sales are on deal. The equivalent figure for Aldi is 4% so in effect they do not promote. There are no 'smoke and mirrors' or 'here today gone tomorrow' deals – simply, here is the price and full-stop. This is increasingly appealing to consumers, even before we consider the transformative effect on supply chain efficiency, inventory and therefore costs.

> *"On average, across the "Big 4", 45% of sales are on deal. The equivalent figure for Aldi is 4%"*

It's no surprise that phrases like "Prices down and staying down" and "Everyday low prices" are starting to be used by the Big 4. Maybe promotions won't disappear completely but pricing clarity will certainly grow in importance, together with pressure on margins.

How can retailers compete in this brave new world? In my view there are two choices. Either compete on price (difficult given the fundamental low-cost DNA of the discounters – think Ryanair). Asda is probably best-placed to do this given their scale and consistent low-price positioning over the years. Or, be "everything the discounters are not" as stated by Mark Price of Waitrose. In other words: differentiation; quality and provenance; the story behind the food rather than just the price. This also applies to Marks & Spencer food and, to a lesser extent, Sainsbury's with their market leading positions in Fair Trade, Organic and Free Range.

One way of quantifying the problem for the Big 4 is that Aldi, Lidl and Waitrose together have siphoned off 4.0 points of market share over the last three years – equivalent to nearly £5 billion annual sales.

What of the future? Well quite a large chunk of it is probably in the hands of Dave Lewis as he starts his 'Tesco Challenge'.

Many commentators think that the discount sector could peak at double its current size of 8.4%. The bullish annual store opening plans for Aldi and Lidl, and a modest toe-in-the-water from Netto, certainly bear this out.

The convenience category also has further to go although it has historically been driven by store openings from Tesco and Sainsbury's. Little Waitrose and Morrisons Local will provide further medium-term growth. Dave Lewis could take a hard look at the Express estate and cull some of the poorer performers so a bit of uncertainty there I'm afraid.

There is no uncertainty with the online market, although only 6% of the market is growing at 20% per year. This will continue if shopper groups take their buying habits with them as they age, rather than saying "I can't stand all this online excitement – I'm off to the corner shop." The growth of 4G, click-and-collect, smart phones and tablets will provide continuing tailwinds to help ecommerce become m-commerce: mobile, whenever and wherever.

In the words of the apocryphal Chinese curse "May you live in interesting times".

Gambit's Food and Beverage Team

Gambit has a dedicated food and beverage team with a demonstrable track record in the sector. We maintain ongoing contact and relationships with a wide range of knowledgeable sources to stay abreast of the issues and trends that impact the industry's M&A activity or otherwise influence our clients' businesses.

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Our team would be delighted to meet with you to discuss our experiences in the sector and to answer any questions you may have on the current M&A market.

About us

Gambit is an independent corporate finance advisory firm specialising in advising private and public companies on mid-market transactions in the UK and overseas.

We are widely recognised as a market leader in M&A advice in the food and beverage industry having built up detailed industry knowledge and an enviable track record in deal origination and execution.

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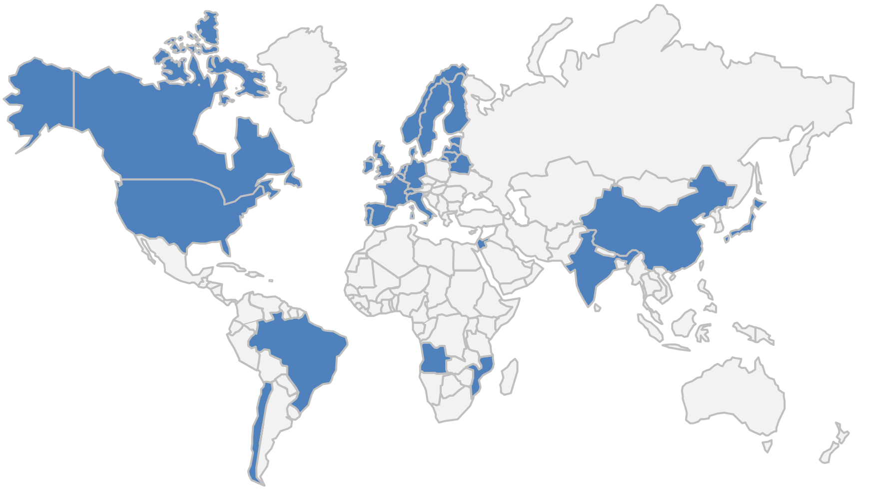

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