gamBIT CORPORATE FINANCE

Quarterly Food & Beverage Review

Food Supplement

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Autumn 2013

Welcome to the Autumn edition of our quarterly food and beverage review, "Food Supplement". Each quarter we comment on some of the latest issues affecting the food and beverage industry along with our review of current M&A activity and any resulting trends that appear.

In this edition we take a look at the response to our recent article about Tesco and their announcement in relation to long-term supplier contracts. We also provide analysis of M&A activity during the third quarter of 2013 and this month's edition also features a guest article from Oliver Wyncoll of Langholm Capital, who recently sold Tyrrells Potato Crisps for a reported £100 million.

Adrian Jones
Partner, Food & Beverage

Hot Topic: Tesco's New Strategic Contracts – The Suppliers Perspective

Tesco is having a tough 2013, particularly following the horsemeat scandal which involved a number of its most popular products. With retailers continually striving to drive prices down further, food and beverage businesses are continually looking to improve efficiencies and source cheaper raw materials to stay competitive and protect their already slim margins. One can argue that there could be a link between the horsemeat crisis and the continual price-cutting nature spearheaded by retailers, driving some producers to extremes in order to survive.

The relationship between suppliers and the major supermarkets is complex. There are the major suppliers of the "must stock" brand that even Tesco cannot do without, where the supplier is able to drive negotiations to some extent. At the other end of the scale, there are the small suppliers who rely on a small number of retail multiples to get their goods to the consumer, with many of these depending on a single retailer for the vast majority of sales.

There appears to be a perception from many of these smaller suppliers that Tesco, in particular, take out a lot more than they put in. But there has to be profit for everyone in the supply chain. Suppliers need to be able to make long-term investments in their businesses and the only way that they can do this is by making a profit that allows for reinvestment in their business.

We have had some interesting responses to our recent article "Tesco – A new regime or just rhetoric?" from a number of companies within the food and beverage sector. The article examined the new long-term strategic supplier agreements Tesco was proposing.

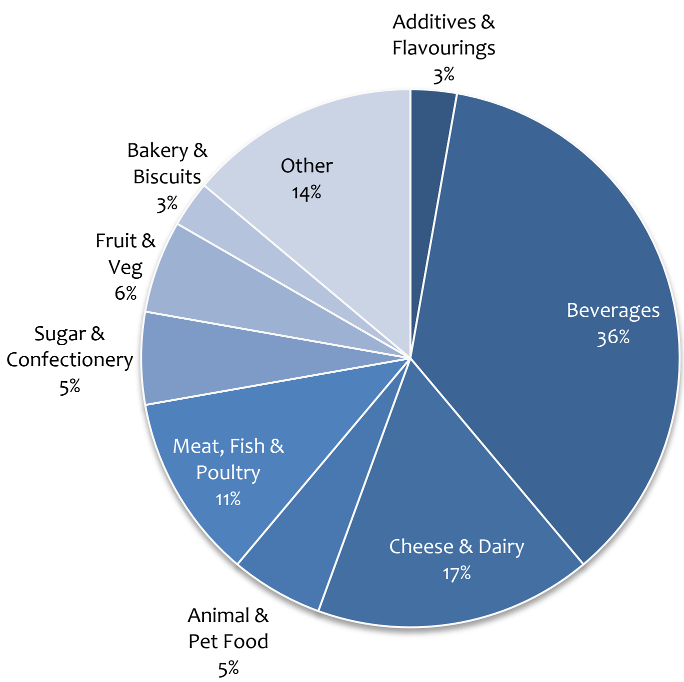
As suggested in our article, there remains a high level of scepticism from the food and beverage sector following Tesco's track record in dealing with its suppliers. Many are expecting "more of the same" rather than a revolution with a number of those that are discussing the new contracts fearing they will be tied to low margin business for longer and thus being exposed to even higher risks which they would be unable to walk away from.

More than one supplier contacted us commenting on the "open book" basis upon which the new future with Tesco is being derived. Whilst it can be seen to be the catalyst to a more open and collaborative way to make everyone in the chain a sensible profit margin, you cannot help but think it only assists Tesco in being able to more easily determine pricing boundaries. Profitability will be based on Tesco's view of acceptable levels of input and direct costs, overheads and wastage. Should actual costs vary from prescribed levels, will Tesco seek to take the benefit from savings but not pay for increases? Given the current volatility of many commodity prices and foreign exchange rates, the question is whether it is sensible for a supplier to be locked into a long-term supply agreement? However, as we have heard more than once, do they really have a choice? The panacea derived from increased volumes, greater overhead recoveries and benefits from economies of scale in purchasing and long-term planning should not be allowed to overrule the inherent risks associated with thin gross margins. To do so will lead to the inevitable consequence of value destruction and thus deny future investment, innovation or expansion into more vibrant markets. To quote one reader we spoke to, "The zombie company syndrome......"

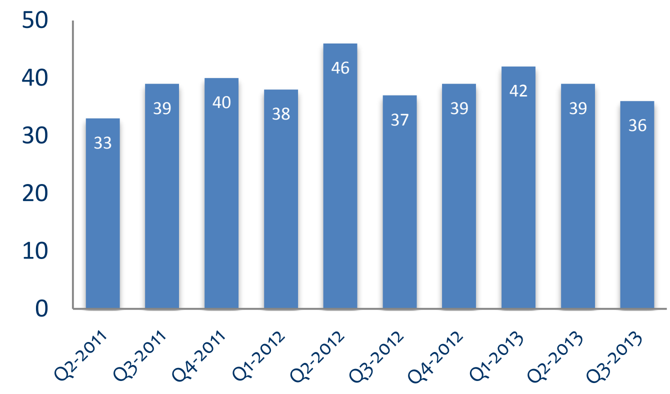
M&A Activity Review

- After an encouraging start to 2013 announced deal volumes in Q3 2013 fell by almost 8% from Q2 2013. Historically deal volumes in this quarter tend to be lower due to the summer holiday period and we would expect to see deal volumes increase in the final quarter of 2013.
- Average deal values fell for the third quarter in a row, down by 22% on the previous quarter.
- There were five private equity deals announced in Q3 2013 at an average deal value of almost £53 million.
- Private equity deals of note include the acquisition of Tyrrells by Investcorp for £100 million and the acquisition of Whitworths by Equistone Partners for £90 million.
- Other deals announced in Q3 2013 worthy of note include:
  - Japanese company Suntory Beverage & Food, which also owns Orangina Schweppes, acquired the Lucozade and Ribena brands from GlaxoSmithKline in a £1.35 billion deal.
  - Muller Dairy acquired Nom Dairy UK including its state-of-the-art £40 million yoghurt production facility in Telford, for an undisclosed fee, as part of a move into the own label yogurt market.
  - Consumer goods group PZ Cussons acquired Australian baby food business Rafferty's Garden for a reported £42 million. This came after the Australian Competition and Consumer Commission blocked H.J. Heinz from buying the company.

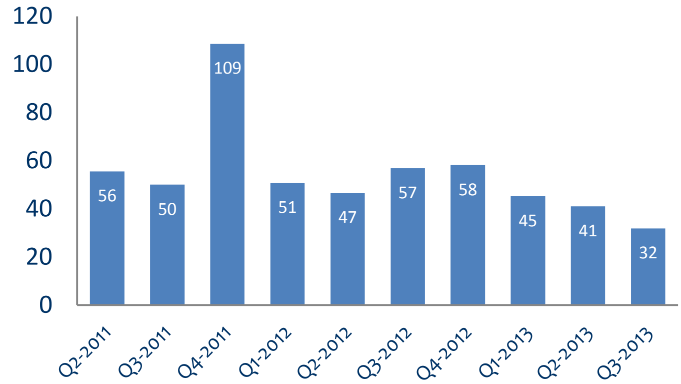
Q3/2013 UK Food & Beverage Deals by Sector



Food & Beverage Deal Volumes



Food & Beverage Average Deal Size (£m)*



*Average transaction value for all deals with disclosed values under £500 million

Valuation Parameters	Q1/2013	Q2/2013	Q3/2013
Food Manufacturers	**EV/EBITDA**	**EV/EBITDA**	**EV/EBITDA**
Associated British Foods	11.17x	9.60x	10.29x
Dairy Crest Group	4.85x	7.27x	7.28x
Finsbury Food Group	4.61x	5.10x	3.99x
Glanbia	13.26x	17.65x	15.84x
Greencore Group	7.85x	8.26x	8.80x
Kerry Group	15.63x	13.53x	13.04x
Unilever	12.85x	12.33x	11.21x
Average	**10.03x**	**10.53x**	**10.06x**
Beverage Manufacturers			
AG BARR	16.25x	14.58x	14.46x
Britvic	10.58x	11.21x	12.16x
C&C Group	13.15x	11.13x	10.49x
Coca-Cola	7.80x	7.90x	7.42x
Diageo	16.57x	15.25x	15.28x
Nichols	15.32x	16.62x	19.64x
SABMiller	20.64x	17.08x	16.64x
Average	**14.33x**	**13.40x**	**13.73x**

Feature Article

Developing new challenger brands – a private equity perspective

Oliver Wyncoll
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Entrepreneurialism has recently become fashionable in the UK in the way it has been in the US for many years. Since the recession started, and with the opening up of new sources of capital such as crowd funding, a new generation of entrepreneurial businesses have been created. For the graduate, starting a business straight from college is now seen as respectable, with far less stigma associated with the possibility of failure.

We are now at a stage of the economic recovery where many so called 'challenger brands' formed since the down-turn, are reaching a phase in their evolution where their business models are proven and they are ready to scale-up. One thinks of a business like Graze.com, with its subscription based snacks in a box model which was started by the former Lovefilm team in September 2008. Only four years later it was sold at a similar price to the recent sale of Whitworths, a 100 year old brand. With the fragmentation of the media world, the advance of social media and use of asset light, out-sourced or e-commerce business models, it is now more possible to scale and challenge the larger sector incumbents than ever before. The Langholm Capital team meets many such businesses in the consumer sector, given our focus and track record.

Our experience is that successful challenger brands often need to add to their innate entrepreneurial flair a more precise and fact based management style. Our formula is to i) develop an ambitious but carefully considered and strategically focused business plan; ii) add to it a deeper, more experienced but still entrepreneurial team; and iii) align and financially incentivise the enlarged management team to deliver the plan.

Using this approach, we have been able to identify and develop several genuine challenger brands over the last decade. The common threads of these businesses are that they all possessed clear product differentiation, operated in scalable high margin, high growth areas and were able to develop "rule-breaking" approaches to their sectors.

One of the most rapidly growing consumer financial services businesses to emerge in the last decade is Just Retirement, a pioneer of enhanced pension annuities and draw-down equity release products. We backed this as a start-up venture in 2004, with just £25 million of equity capital. The business was subsequently sold to Permira in 2009 and has recently launched an IPO at a c.£1 billion plus valuation.

In the case of Dorset Cereals and Tyrrells Crisps, these two businesses had combined revenue of just £20 million when they were acquired by Langholm in 2005 and 2008 respectively. By the time the two businesses were sold in 2008 and 2013 their combined revenue had grown fourfold. Growth was achieved by a combination of new distribution of the core products, genuine innovation into new areas and international expansion, driven by great management .

We are always on the hunt for the next challenger in a fast growth area of the consumer sector. Please contact either myself or a member of the Langholm Capital team if you have an idea you would like to discuss.

Autumn News Reel

- According to consumer researchers IGD, the value of the UK food and groceries market is expected to increase by 21% to £206 billion by 2018, a compound annual growth rate of 3%. The value of online sales is predicted to reach £14.6 billion up by 123% by 2018, convenience up by 30% to £42.2 billion and discounters to reach £18.6 billion, an increase of 96%.
- New research from IGD has also indicated that more than half of all those that they surveyed (56%) wanted to know more about where their food comes from. This is compared to 34% who responded similarly to this question in 2011. Clearly this change in attitude is as a result of the horsemeat scandal earlier this year.
- Supermarket Aldi's latest accounts posted at Companies House shows a surge in UK pre-tax profits of 124% to £157.9 million in 2012, with revenues up 41% to £3.9 billion. Aldi opened 34 new stores during 2012 and has said they are on track to open a further 50 new stores in 2013.
- Research by consumer insight organisation Nielsen has revealed that more than a third of consumers planned to buy more own-label food and drink products as food prices rise, but only 5% planned to buy more branded goods.
- According to figures compiled from HMRC data by the Food and Drink Federation, British food and drink exports grew 2.5% to £6.1 billion in the first half of 2013. This, after falling last year for the first time since 2004.

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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