The Grocer

Eat... or be eaten

A new report predicts unprecedented levels of consolidation in the food and drink industry over the next two to three years, Liz Hamson reports.

The credit crunch may have put the kibosh on the big private equity deals in UK food and drink, but it hasn't reduced the number of mergers and acquisitions - or business failures. Rather the reverse, reveals new research.

The figures in the Food Consolidation Index 2008 report, produced by Axis Management Consulting for Grant Thornton and Barclays, make for uncomfortable reading. In 2006 and 2007, 450 food and drink manufacturers went out of business triple the number in 2004 and2005 and 260 were bought compared with 200 in the previous two years.

Of course, the credit crunch has been largely irrelevant to the surge in business failures, most happened before the economy started to nosedive, says Jonathan Smith, MD of Axis Management Consulting.

"One of the main constants is the pressure to meet the demands of the major retailers," he explains. But "that pressure is intensifying. The total number of failures and acquisitions is markedly higher than in our previous report. Most of the commodity price increases came relatively late in the day, so I would attribute the increase in company failures to the fact companies are not positioned right to meet the needs of the retailers."

The report predicts an unprecedented number of mergers, acquisitions and, more worryingly, outright failures over the next two to three years as poorer access to finance and soaring raw material costs hit home. With retailers rationalising their supply bases, suppliers have become embroiled in a dangerous game of Russian roulette, it suggests. But though certain sectors will be particularly prone to consolidation according to the index, there are steps businesses can take to ensure they survive - even thrive.

As predicted in the previous survey, the sectors that have so far undergone the highest levels of consolidation have been fruit and veg; meat, fish & poultry; snacks and crisps; and frozen savoury. Activity in frozen was even higher than expected as a raft of major manufacturers followed Nestle's example by exiting the sector.

Significantly, the sectors that have had the highest levels of inflation - and by definition are coming under most pressure to consolidate - tend to be those dealing in commodity foodstuffs. Many are dominated by own label, making it even harder for suppliers to pass cost increases on.

MAKE YOURSELF INDISPENSABLE BY...

1 Ensuring at the front edge of exploiting consumer understanding

2 Ensuring you are the best at providing category-building initiatives to the retailers

3 Optimising NPD to balance proactiveness and customer responsiveness.

4 Systematically measuring and evaluating how you add value to your key customer relationships

5 Aggressively and proactively driving down costs throughout supply chain.

OR STRENGTHEN YOUR POSITION WITH THE MULTIPLES BY...

1 Identifying acquisition opportunities that can reduce costs through integration

2 Acquiring businesses that broaden your company's product offering to the multiple retailers.

3 Finding acquisitions that build your position in attractive niches such as healthy eating

Source: Axis Management Consulting

Portfolio adjustment has been another key driver of consolidation as larger companies seek to extend their presence in new markets and categories, and has led to an increased level of cross-border food industry mergers at a European level, according to the report.

The environment is only going to get more challenging. As Asda boss Andy Bond said earlier this year: “I don’t think it is acceptable to say that if you demonstrate as a supplier that costs have gone up, we will accept increases. I think our vendors have to do their own restructuring so they are not passing on cost increases.”

Those that have already stripped out costs may be forced to dispose of underperforming parts of the business or those not considered core. Others will take the opportunity to bolster their businesses through acquisitions.

This month, Associated British Foods announced it was merging its Ryvita business with cereal business Jordans following its acquisition of a 20% stake last September. There’s more to come.

Bread and morning goods is one of the sectors likely to be most susceptible to consolidation over the next couple of years, suggests the report. It accounted for a whopping 17% of failures and 13% of mergers in 2006 and 2007, even though it represents just 7% of total grocery sales. As wheat costs continue to rise, high levels of consolidation seem inevitable.

Functional soft drinks such as sports mixers, energy and dairy drinks is another sector in which heavy consolidation is expected, this time because of the prevalence of innovative smaller players that are attractive acquisition prospects.

Though very high levels of activity have already been seen in fruit and veg, there’s still much further to go in yet another sector that is highly fragmented and dominated by smaller players. Retailers now want suppliers who can provide all-year-round supply of multiple products, a trend only partially offset by interest in local suppliers.

It’s a similar story with meat, fish and poultry. A whopping 42% of the failures noted in the report were in this sector, even though it only accounts for 15% of the total grocery market.

“Looking ahead, it is hard to see this pattern changing, with smaller suppliers continuing to be squeezed out and failing and larger suppliers operating on tighter margins but using scale to survive,” says the report.

Though private equity’s ability to pull off big highly leveraged deals may have been hampered by the credit crunch, the appetite for smaller deals is as strong as ever, both among trade and private equity buyers, experts agree.

“The number of deals beyond the £250m mark is a lot more limited,” confirms Neil Sutton, head of corporate finance at PricewaterhouseCoopers. “But in the mid market of £30m to £150m deals, things are significantly better. The trade is still there even if private equity at the large end has reduced its activity.

“Consolidation will happen for good reasons... and bad,” he adds. Whether in the market to buy or be bought, manufacturers dealing with the multiples should do their best to make themselves indispensable (see boxout). “They need to be proactive in two areas: how they do their day-to-day business and how they handle mergers and acquisitions,” says Smith. “When a retailer says ‘why should this supplier be supplying us in five years time?’ there has to be a dear, compelling answer. The player that’s been highly collaborative, innovative in NPD and on the front foot in terms of driving down costs is going to win every time.”

The biggest mistake would be to scale back on NPD as the going gets tough, agrees Phil Jackson, head of food M&A at Grant Thomton. “Standing still is not an option. Innovation and growth are two features customers and potential acquirers are attracted to,” he says. “Strive to maintain and improve gross margins by passing on price increases, sourcing raw materials efficiently, creating manufacturing efficiencies and currency hedging effectively.”

The message is that even the mid-sized players, who are likely to feel the heat most, can protect themselves. It’ll be about survival of the fittest - not the biggest.

FOOD CONSOLIDATION INDEX	VALUE £	YR-ON-YR VALUE SALES CHANGE %	INDEX
Meat, fish & poultry	9.3bn	5.2	1
Fruit and Vegetables	7.9bn	6.6	1
Bread and Morning Goods	2.8bn	9.1	1
Other soft drinks	200m	24.0	1
Chocolate confectionsry	3.0bn	6.8	2
Milk	2.9bn	10.1	2
Cheese	2.1bn	3.0	2
Snacks and Crisps	1.9bn	4.6	2
Cereals	1.7bn	5.4	2
Biscuits & Crackers	1.7bn	3.2	2
Chilled ready meals	1.7bn	1.6	2
Ambient cakes	1.0bn	5.7	2
Sandwiches	931m	7.2	2
Frozen vegetables	844m	6.0	2
Water	609m	-5.8	2
Chilled pies, quiches and pasties	5.2bn	4.3	3
Froxen desserts	270m	0.5	3
Carbonates	2.0bn	1.1	3
Fruit Joices/drinks	1.9bn	5.4	3
hot beverages	1.4bn	3.5	3
Sugar confectionary	1.2bn	5.3	3
Frozen savoury	1.1bn	-0.3	3
Prepared salads	866m	4.0	3
Ice cream	702m	-4.4	3
Cookng sauces	547m	6.4	3
fresh cakes	148m	12.0	3
Chilled pot desserts/yogurts/fromage frais	1.8bn	4.3	4
Canned pies, meat, fish & soups	1.2bn	3.5	4
Canned fruit, veg & pasta	1.0bn	3.4	4
Butter and spreads	963m	6.6	4
Eggs	632m	19.0	4
Rice & Pasta	501m	12.4	4
Squashes	433m	-6.5	4
Preserves	279m	6.7	4
Sugar & sweeteners	264m	2.1	4

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