

SPRING/SUMMER 2016

FOOD & BEVERAGE NEWSLETTER



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WELCOME TO OUR NEWSLETTER!



Welcome to the Spring / Summer 2016 edition of our Food & Beverage newsletter.

Our first article, *"5 Keys to a Successful Succession Plan"* highlights important aspects of succession planning in the food and beverage industry. Most business owners do not consider planning for an exit strategy until their pending retirement, when the issue becomes urgent and critical. Establishing a sound exit strategy—well in advance—is a vital part of the business planning process, and may substantially reduce uncertainties within the family regarding the future direction of the business.

Another area that needs greater attention by business owners is fraud prevention and detection. Fraud is becoming more sophisticated and is a growing problem in many food and beverage businesses. According to the Association of Certified Fraud Examiners *"2014 Global Fraud Study"*, survey participants estimated that the typical organization loses 5% of revenues each year to fraud. The median loss caused by fraudulent activities was \$145,000 and in 22% of the cases, losses of at least \$1 million were incurred. Our second article titled *"Warning Signs of Employee Fraud"*

illustrates red flags of employee fraud and practical measures that can be taken in each case to help reduce the incidence of fraud.

In the Road to Success section of our newsletter, we share the story of the growth of Italian Home Bakery. Discover how the Rossetti brothers successfully grew their business and ultimately sold it to a strategic buyer.

The Fast Facts, Trends and Recent News section of our newsletter sets out selected food and beverage market transactions in Canada and the United States. According to the *"2016 Food Report"* prepared by Blake, Cassels & Graydon LLP, the total value of food, beverage and agribusiness M&A deals in Canada was \$4.8 billion for the four quarters ending September 30, 2015. This compares to \$19.9 billion in the year earlier, which spiked due to the merger of Tim Hortons and Burger King.

In recent years, there has been tremendous growth in Canada's craft beer market. One of Canada's major beer producers, Labatt Breweries, was active in the fall of 2015 acquiring Toronto-based craft beer maker Mill Street Brewery. Mill Street is Canada's largest producer of certified organic beer. In another 2015 transaction, Labatt also acquired a number of craft beer brands owned by the Mark Anthony Group.

In March 2016, Canadian drug store chain Rexall was acquired by public healthcare company McKesson Corporation in a \$3 billion deal. Rexall operates 470 pharmacies and in recent years has built larger stores offering grocery and private label product lines. The acquisition of Rexall was widely anticipated following Loblaw's purchase of Shoppers Drug Mart in 2013.

There were several recent notable U.S. transactions in the grocery sector including Kroger's purchase of Roundy's Supermarkets for USD \$835 million and private equity firm, Apollo Global Management's acquisition of grocer The Fresh Market for USD \$1.3 billion.

We appreciate the opportunity to share these articles, best practices, market activity and trends in the food and beverage sector. Thank you for your readership and we hope you enjoy the newsletter!

A handwritten signature in black ink, appearing to read 'Ellis Orlan'.

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FIVE KEYS TO A SUCCESSFUL SUCCESSION PLAN



It's no secret that building a successful food or beverage business requires persistence, dedication and personal sacrifices. As a business owner, you will likely want to reap the benefits of your hard work by retiring at some point in the future. But how do you ensure that the business will thrive once you leave? And how do you maintain the legacy of your business and protect the future for both your family and employees?

A succession plan enables you to identify and develop top talent to assume senior positions, with a long term objective of eventually running your company. It's a tool to protect all your hard work and sacrifices, while maximizing your proceeds in the event of retirement, illness, disability or death. If you plan well, you'll rest easy at night knowing that the business will continue to thrive beyond your departure.

While most business leaders understand the importance of succession planning, they can fall victim to human nature and fail to devote the time and resources to make it happen, instead, giving priority to other, more seemingly urgent priorities. As a result, they place the business at risk by not having a strong team in place who can step in, when required, to assume corporate leadership. It is far better to make proactive decisions than to scramble last-minute for situations that should have been planned well in advance.

Part of the problem is that many owners feel overwhelmed with the sheer scope of the task, and uneasy with the idea of extracting themselves from a business they've worked so long and hard to build. At Fuller Landau, we share our vast experience to work closely with you and your family in developing a comprehensive and effective succession plan to help you transition out of the business, while maximizing your proceeds.

Below are five key considerations to take into account when embarking on this critical process:

1. OUTLINE YOUR OBJECTIVES FOR YOUR SUCCESSION PLAN

Do you want a complete exit from the business without any continuing day-to-day responsibilities? Or would you prefer to transition your involvement over a period of time? This decision will impact the timeframe for the plan and how you execute it.

2. DETERMINE WHAT YOUR BUSINESS IS WORTH

A Chartered Business Valuator (CBV) will help you determine the fair market value of your business and give you a benchmark of what your business is worth. They can also help you maximize the value of your business by increasing sales, reducing costs, and ensuring the balance sheet is optimized for the eventual sale.



BY PHIL SMITH, CPA, CA

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3. IDENTIFY LIKELY SUCCESSORS

Family members, employees, and external third parties are all possible successors of your business. Special attention should be given to situations where some, but not all, of your children are identified as the likely successors. There is an increased risk of failure for succession plans when injustices, whether actual or perceived, arise from the transition of a business to one child and not another. Carefully consider the emotional consequences of these decisions as they can affect how smoothly the transition occurs. In the event that you decide your business is better suited for a sale to a third party, create a list of possible purchasers who may wish to acquire your company. Be sure to include any competitors on this list who may be willing to pay a premium to acquire your company's assets and, in particular, your customers.

4. UNDERSTAND THE LEGAL AND TAX IMPLICATIONS OF YOUR PLAN

It is important to seek the assistance of tax and legal professionals in order to ensure your tax bill is minimized on the disposition of a major asset, and that no unforeseen legal complications arise when you want to end your involvement with the business. This is a crucial part of the succession planning process. If you overlook this consideration, you may be leaving a lot on the table.

5. DO NOT DELAY

It is highly advisable to start planning early, as a thorough and effective business succession plan usually takes a few years to implement. In our experience, five years is good – ten is better.

The key objective in an effective succession plan is to ensure the smooth transition of your business. In order to maximize the value of your company, focus on how your departure will impact relationships with your family, your customers, suppliers and employees, and leave the valuation and tax planning issues that are integral to a succession plan to your trusted professional advisors.

WARNING SIGNS OF EMPLOYEE FRAUD

Fraud is a growing problem in many food and beverage businesses. Most organizations only take steps to improve their controls after a fraud has been discovered and the damage has been done. But the good news is that you can reduce the risk of fraud by being aware of the red flags to look out for.

This article will illustrate three warning signs of employee fraud and what measures you can take to minimize the opportunities for fraud in each case.

RED FLAG #1

One warning sign of employee fraud is a supplier who insists on dealing with one specific employee. Some purchasing frauds are committed by inflating supplier invoice amounts. A corrupt purchasing agent may be receiving a kickback payment from a supplier for goods purchased. The kickback will often be paid directly by the supplier to the employee. Alternatively, the employee may establish a fictitious purchasing company which then submits invoices for payment.

In order to detect this type of fraud:

- Have an employee outside of the purchasing department check supplier invoice prices against documented price lists and quotes obtained.
- Review contracts that were issued without competitive bids.
- Require two signatures on all cheques with careful scrutiny of invoices and supporting documentation. Be suspicious of invoices that indicate a post office box as the address.
- Compare all addresses and telephone numbers recorded for employees to the master file of suppliers.

RED FLAG #2

When an employee does not take annual vacation time, it could indicate that the he or she does not want their responsibilities taken over by other employees who may detect fraudulent acts. An employee who is over-protective of their work activities and processes may have something to hide.

In order to detect this type of fraud:

- Consider insisting that employees take annual vacations and have other employees perform their duties during their absence.
- Implement a policy of rotating job responsibilities and cross-training employees to perform different functions.

RED FLAG #3

Another warning sign of employee fraud is a sudden or drastic change in lifestyle. Management should be suspicious if an employee exhibits significant changes in lifestyle or if they appear to be living beyond their means. In many cases, fraud occurs because an employee is desperate or greedy for funds beyond the income earned from employment.

In order to detect this type of fraud:

- Be vigilant and keep your eyes open for suspicious activity.
- Follow through by further investigating any activities that seem irregular or out of the ordinary.

WHAT YOU CAN DO

One of the most important internal controls that can be easily implemented is a "segregation of duties." For example, be sure to separate the purchasing/receiving functions from the invoicing/cash/payables and general ledger functions. Further, all bank accounts should be reconciled by someone other than those responsible for cash receipts and disbursements. Restricting access to records and databases depending on the employee's position and responsibilities is another effective internal control that can help prevent fraud.

In today's uncertain economic climate, employees may be more motivated or tempted to perpetrate a fraud. Protect yourself and minimize the risk! Your business advisor can be a valuable resource for evaluating the state of your internal controls, recommending best practices, and implementing improved fraud risk management strategies, policies, procedures and internal controls.



BY BRUCE ROHER, CPA, CA-IFA, CBV, CFE

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ROAD TO SUCCESS

ITALIAN HOME BAKERY: FINDING A STRATEGIC BUYER

Since 1955, Italian Home Bakery has been an active and highly-respected member of the Toronto baking community. In 1999, the business was acquired by two brothers, Dennis Rossetti and John Rossetti. Dennis was Italian Home Bakery's co-CEO and COO, and John was the company's co-CEO and CFO.

In the beginning, Italian Home Bakery was in the fresh bakery business, primarily supplying artisanal breads to major retailers including Loblaws, Sobeys and Metro. About a decade ago, however; the retailers shifted from selling daily fresh product to frozen product. In order to remain relevant and competitive, Italian Home Bakery had to adapt by developing a new frozen baked goods line. That's when Dennis' bakery experience came into play. He developed a frozen, thaw-and-serve or quick-to-refresh program. The products developed were fully baked and frozen. Retailers have the option of keeping the product frozen or refreshing it – which means baking it in an oven for five minutes, and it would be ready to serve.

The new products were a success. In 2011, the Rossetti brothers realized in order to expand, they needed to secure capital. There was interest from private equity firms, however, the firms did not share the brothers' vision for the future of the company. The private equity firms were looking for rapid growth/rapid exit.

In 2015, the brothers found their strategic buyer in Grupo Bimbo, a Mexican multinational bakery product manufacturing company. Grupo Bimbo had recently purchased Canada Bread and an artisan bread manufacturing plant in California, and was looking for a similar artisan bread plant in the north-east to service the New York, Massachusetts, Quebec and Ontario markets. Talks began in April 2015 and a final agreement was concluded in July 2015, a relatively short time frame for completing an acquisition.

John claimed the actual search for a strategic buyer began long before 2015. He explains: "This process started back in 2011 when we realized we needed to expand through acquisition or by selling to a strategic buyer.

You have to be ready early on in the process. It is critical that your financial records and forecasting processes are in order. The company's cash position has to be monitored regularly and internal controls have to be in place. The quality and tenure of the management team is also very important. Your production facility must operate efficiently, and you need excellent relationships with a solid base of customers to establish continuity of business."

John credits their success in finding a strategic buyer for their business to adhering to a well-defined business plan, and then moving through all the appropriate phases of the plan. He says they were supported by a strong team, particularly Italian Home Bakery's comptroller, who was involved every step of the way. From the beginning, the brothers brought in advisors to ensure their vision for the company was unified. John explains: "From a long-term planning perspective, it was important that our decisions were based on strategic initiatives rather than operational efficiencies. We retained a consultant to coach us in addressing the strategic direction of the business and implementing the plan."

John says it all comes down to being honest with yourself. "The most important thing is documenting your strategic plan in terms of where you see your company in two to three years. And be honest with yourself to say you are capable of bringing your company there. If you and your team are not capable of this, then you must make a decision. That's the toughest part. You have to be in that frame of mind to say: I'm ready for the next move."

John says any business should always be prepared for sale. "That phrase is commonly used, but misunderstood. When I say to an entrepreneur you have to get your company ready for sale, the entrepreneur says: "My company is not for sale." I say, your company has to be for sale at all times. You're either creating value for a potential buyer or you're creating value for your own company. And if you're not doing this, then you're not operating a successful business."



FAST FACTS, TRENDS AND RECENT TRANSACTIONS (AS AT MARCH 31, 2016)



Enterprise value/EBITDA multiples of selected food manufacturers, distributors, grocery and super centres ranged from 7.1 to 18.5 with a median of 12.7 as at March 31, 2016.

Selected Food Manufacturers, Distributors, Grocery and Super Centres	Industry Classification	Last 12 Months Revenue (Millions)*	Enterprise Value (Millions)*		EV/ EBITDA*
Loblaw Companies Limited (TSX:L)	Grocery Stores (Primary)	45,394.0	40,683.0	CAD	13.2
Alimentation Couche-Tard Inc. (TSX:ATD.B)	Grocery Stores (Primary)	47,913.0	35,991.8	CAD	12.2
Saputo, Inc. (TSX:SAP)	Food Products (Primary)	10,771.4	18,037.3	CAD	16.5
Empire Company Limited (TSX:EMPA)	Grocery Stores (Primary)	24,222.4	8,263.7	CAD	7.1
Metro Inc. (TSX:MRU)	Grocery Stores (Primary)	12,344.9	12,529.0	CAD	13.1
Maple Leaf Foods Inc. (TSX:MFI)	Food Products (Primary)	3,292.9	3,407.6	CAD	18.5
Lassonde Industries Inc. (TSX:LAS.A)	Food Products (Primary)	1,449.3	1,514.5	CAD	9.8
High Liner Foods Inc. (TSX:HLF)	Food Products (Primary)	1,385.8	884.1	CAD	8.1
Premium Brands Holdings Corporation (TSX:PBH)	Food Products (Primary)	1,484.6	1,866.9	CAD	16.7
SunOpta Inc. (TSX:SOY)	Food Products (Primary)	1,584.5	1,167.5	CAD	18.1
Clearwater Seafoods Incorporated (TSX:CLR)	Food Products (Primary)	504.9	1,228.3	CAD	10.7
Whole Foods Market, Inc (NasdaqGS:WFM)**	Food Retail	15,547.0	10,344.9	USD	7.4
Costco Wholesale Corporation (NasdaqGS:COST)**	Hypermarkets and Super Centers	117,269.0	69,537.1	USD	14.6
Wal-Mart Stores Inc. (NYSE:WMT)**	Hypermarkets and Super Centers	482,130.0	259,749.5	USD	7.7
Median					12.7

*Source: Capital IQ **U.S. Public Company

DISCLAIMER: The information in this section has been provided by external sources and is subject to change. Fuller Landau LLP is not responsible for the accuracy, reliability or timeliness of the information supplied by external sources. Readers wishing to rely upon this information should consult directly with the source of the information.

SELECTED CANADIAN TRANSACTIONS

Announced Date	Target/Issuer	Total Transaction Value (\$ millions)	Buyers/Investors	Sellers
October 9, 2015	Mill Street Brewery	Not disclosed	Labatt Brewing Company Limited	HMW Capital Inc., Investment Arm and others
October 29, 2015	Pete's Fine Foods	Not disclosed	Sobey's Capital Inc.	Pete Luckett
November 10, 2015	Ready-to-Drink, Cider and Craft Beer Brands	350	Labatt Brewing Company Limited	Mark Anthony Group, Inc.
November 12, 2015	Club Coffee L.P. (25.1% stake)	25	Massimo Zanetti Beverage USA, Inc.	Morrison Lamothe Inc.
November 18, 2015	Organic Meadow Inc.	Not disclosed	Meadowfresh Dairy Corporation	Organic Meadow Co-operative, Inc. and Avrio Capital Inc.
November 25, 2015	French Creek Seafood Ltd. (70% stake)	8	ShangHai Kaichuang Marine International Co., Ltd. (SHSE: 600097)	Brad McLean Family
November 30, 2015	The Original Cakerie, Ltd. (majority stake)	Not disclosed	Gryphon Investors	The Original Cakerie, Ltd.
December 4, 2015	Nixx Wine & Spirits	Not disclosed	Buzz Buddy Liquor	Nixx Wine & Spirits
December 15, 2015	Continental Ingredients Canada Inc (43% stake)	Not disclosed	Trident Brands Incorporated (OTCPK: TDNT)	Donald MacPhee, Robert Campbell and others
December 15, 2015	Hemp Oil Canada Inc.	42	Compass Diversified Holdings (NYSE: CODI)	Hemp Oil Canada Inc.
December 16, 2015	Centra Roast Inc.	11	GreenSpace Brands Inc. (TSVX: JTR)	Centra Roast Inc.
January 7, 2016	Biodroga Inc.	15	Neptune Technologies & Bioresources, Inc.	Goerlich Pharma International GmbH
January 12, 2016	Marketwest Food Group Limited Partnerships	Not disclosed	Dot Foods, Inc.	Primeline Food Partners Ltd
January 19, 2016	Mariposa Dairy Ltd. (minority stake)	Not disclosed	Gay Lea Foods Co-operative Ltd.	Unknown
February 2, 2016	Sauces and condiments business from Wing's Food Products	Not disclosed	Ventura Foods, LLC	Wing Hing Lung Ltd.
February 10, 2016	L.B. Maple Treat, Inc.	Not disclosed	Champlain Financial Corporation	Bedford Fund IV, LP
March 2, 2016	ReXall Pharma Plus Ltd.	3,000	McKesson Canada Corporation	Katz Group Pharmacies Inc.

SELECTED US TRANSACTIONS

October 28, 2015	Diamond Foods, Inc.	USD 1,938	Snyder's-Lance, Inc. (NasdaqGS: LNCE)	BlackRock Fund Advisors, Oaktree Capital Management, L.P. and others
November 2, 2015	Ralcorp Holdings Inc.	USD 2,700	TreeHouse Foods, Inc. (NYSE: THS)	ConAgra Foods, Inc. (NYSE: CAG)
November 3, 2015	Covington Foods Inc.	Not disclosed	Niemann Foods Inc.	Covington Foods Inc.
November 3, 2015	Maui Wowi Franchising, Inc.	Not disclosed	Kahala Corp. (OTCPK: KAHL)	Maui Wowi Franchising, Inc.
November 4, 2015	Crossings Fine Foods Corp.	Not disclosed	Saint-Germain	Crossings Fine Foods Corp.
November 11, 2015	Roundy's, Inc.	USD 835	The Kroger Co. (NYSE: KR)	Willis, Stein & Partners III, L.P. and others
November 19, 2015	Suntree, LLC (unknown majority stake)	USD 20	Satori Capital, LLC	Suntree, LLC
November 24, 2015	Boulder Brands, Inc.	USD 991	Pinnacle Foods Inc (NYSE: PF)	Alyeska Investment Group LP, Engaged Capital LLC, and The Litchfield Fund
December 1, 2015	Suntava, Inc.		Healthy Food Ingredients, LLC	
December 7, 2015	Keurig Green Mountain, Inc.	USD 14,253	Acorn Holdings B.V.	Multiple investors
December 14, 2015	Pinkberry, Inc.	Not disclosed	Kahala Corp. (OTCPK: KAHL)	Sherpalo Ventures, Maveron LLC, Highland Capital Partners and others
December 21, 2015	Fully Cooked facility	USD 11	O.K.Foods, Inc.	American Foods Group
January 14, 2016	Southern Comfort and Tuaca brands	USD 542	Sazerac Company, Inc.	Brown-Forman Corporation (NYSE: BF.B)
January 14, 2016	Sunny Delight Beverages Co.	Not disclosed	Brynwood Partners VII L.P.	Winter Street Opportunited Fund, L.P.
February 16, 2016	Pacific Paradise Foods, Inc.	USD 572	Asrapport Dining Co., Ltd. (JASDAQ:3069)	Pacific Paradise Foods, Inc.
February 23, 2016	American Fruits and Flavors	USD 690	Monster Beverage Corporation (NasdaqGS: MNST)	American Fruits and Flavors
February 25, 2016	North Star Seafood, LLC	Not disclosed	Sysco Corporation (NYSE: SYY)	Trivest Fund V, L.P., Trivest Partners, L.P.
March 14, 2016	The Fresh Market, Inc. (NasdaqGS: TFM)	USD 1,340	Apollo Global Management, LLC (NYSE: APO)	Ray Berry, Brett Berry and others



QUESTIONS? COMMENTS?

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OUR FOOD & BEVERAGE PRACTICE

Fuller Landau LLP is a leading mid-sized accounting, tax and advisory firm. We are committed to helping owner-managers and entrepreneurs build value and grow their business. We are uniquely positioned to do just that because, as business advisors and entrepreneurs ourselves, we know first-hand what it takes to meet those challenges and succeed in any business environment.

We know that being in business within the food & beverage industry presents a unique set of challenges: customers' tastes and needs are constantly changing, margins are under pressure, and inventory and logistics need to be managed effectively. Our team has the expertise and experience to advise on a wide range of business issues.



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