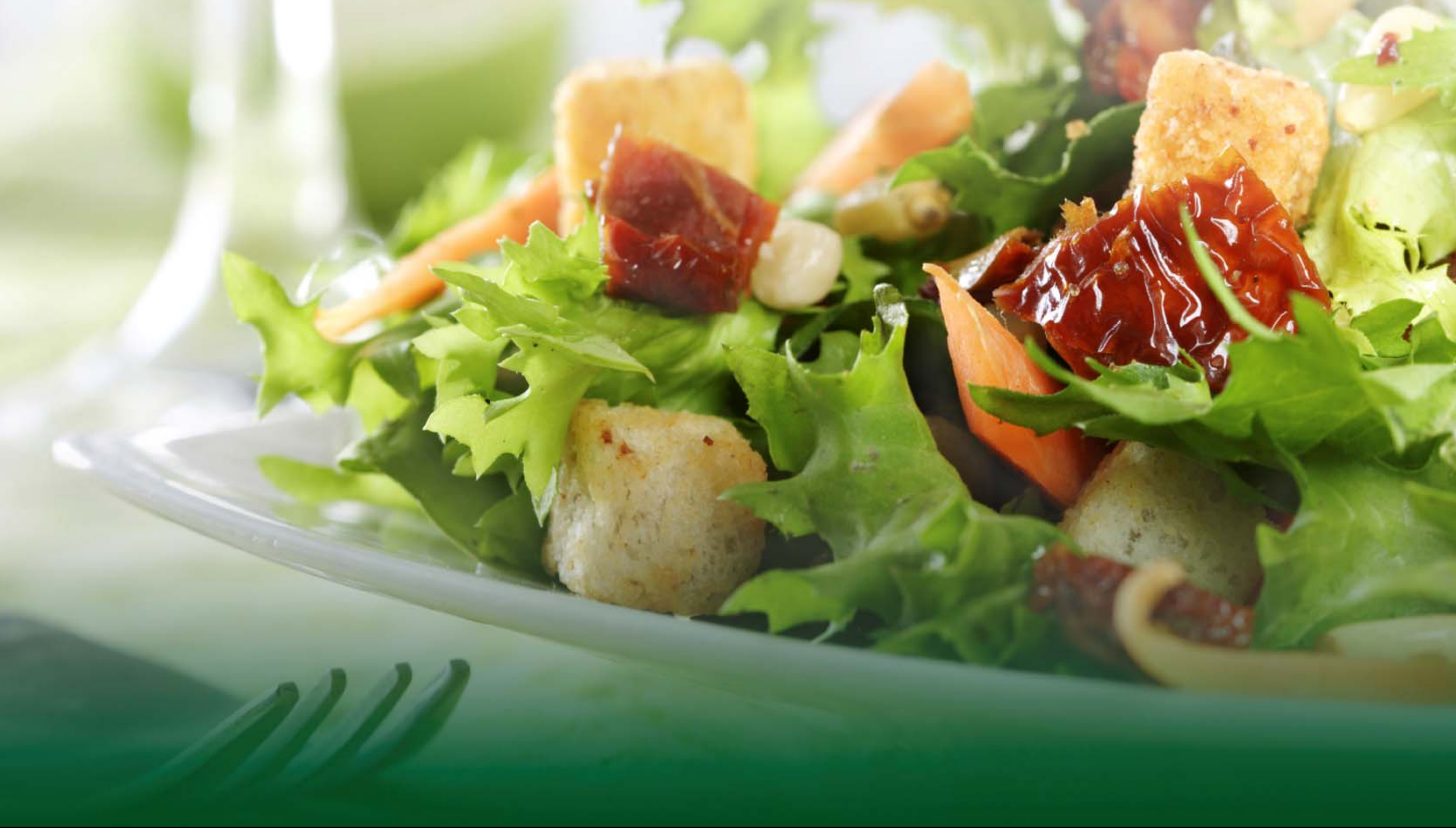
# Agribusiness & Food Processing

## Food & Beverage Industry Middle Market M&A

## Trends & Issues



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# Food & Beverage Industry Middle Market M&A

## Trends & Issues

Nearly three-quarters of the 2011 Food & Beverage Industry M&A transactions reviewed by The McLean Group reported no transaction price and no other financial metrics (revenues, EBITDA, etc.). This would appear to indicate strong middle market M&A activity as acquisitions of larger and public companies routinely include such financial information. Other trends include:

- Strategic Food & Beverage companies comprised of portfolios of brands showed a distinct willingness to sell one or more operations to refocus the overall company while also generating the capital to strengthen balance sheets and broaden strategic options in times of financial uncertainty/capital market constraints.
- Many of the world's most successful and highly-regarded brands have been active throughout 2010 and 2011. These companies are capitalizing on what appears to be a buyer's market to enhance their product portfolios.
- Sellers, on the other hand, should have no fear: when Coke, J.M. Smucker, Sara Lee, Cargill, Nestle, Flowers Bakeries or Diamond Foods come calling with acquisitions in mind, their implicit perception of the quality and potential of said seller suggests that reasonable seller premiums likely will be realized.
- A number of middle market M&A companies and/or their assets were acquired out of bankruptcy – indicating that acquirers with an eye for value were eager to seek out assets in bankruptcy courts.

### Recent Merger & Acquisition Transactions

| Announced | Target/Issuer (& SELLER, where applicable) | Target Description | Acquirer | Value ($ MM) | Acquirer Type |
|---|---|---|---|---|---|
| 8/25/11 | Casa de Oro Foods ***(SELLER: Kansas Venture Capital; Plaza Belmont Management Group; MidStates Capital)*** | Producer and distributor of tortillas, tacos and fajita meal kits. | Gruma S.A.B. de CV (BMV:GRUMA B) | $20.00 | Strategic |
| 8/3/11 | Glutino Food Group ***(SELLER: Claridge)*** | Producer and distributor of gluten-free meals, snacks, breads, mixes, brownie mixes and more. | Smart Balance (NasdaqGS:SMBL) | $65.90 | Strategic |
| 7/11/11 | Starkist ***(SELLER: Dongwon Enterprise)*** | Producer of shelf-stable seafoods (fish filets, seafood entrees, meal kits and canned goods). | - | $90.04 | Unidentified |
| 6/28/11 | Contessa Premium Foods | Producer of frozen seafood and convenience meals in North America, Europe and Asia. | Sun Capital Partners | $51.00 | Financial |
| 6/17/11 | Clement Pappas & Co | Processor of fruits and vegetables into juices, juice cocktails, sports drinks and blends. | Lassonde Industries (TSX:LAS.A) | $400.90 | Strategic |

## Recent Merger & Acquisition Transactions (continued)

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|---|---|---|---|---|---|
| 6/13/11 | Il Fornaio America | Owner/operator of full-service Italian restaurants and bakeries. | Roark Capital Group | - | Financial |
| 6/13/11 | Arby's Restaurant Group | Operator of a chain of roast beef restaurants in the US. | Roark Capital Group | $320.00 | Financial |
| 6/6/11 | Stumptown Coffee Roasters | Oregon-based coffee roaster and distributor. | TSG Consumer Partners | - | Financial |
| 6/2/11 | White Apron, Inc. | Distributor of various meat products. | U.S. Foodservice, Inc. | - | Strategic |
| 5/25/11 | Renaissance Food Group ***(SELLER: The Really Cool Food Company)*** | Producer of fresh fruit platters, veggie snack platters, bean dip and salsa trays. | Calavo Growers (NasdaqGS:CVGW) | $95.62 | Strategic |
| 5/16/11 | Rowland Coffee Roasters | Roaster and producer of espresso coffees for global sales online. | The J. M. Smucker Company (NYSE:SJM) | $360.00 | Strategic |
| 5/12/11 | Border Foods | Processor of green Chile and Jalapeño peppers. | Mizkan Americas | - | Strategic |
| 5/6/11 | Idaho Pacific Holdings ***(SELLER: Varistar Corp.)*** | Producer of dehydrated potato products for industrial food and baking industries. | Novacap Investments | $76.40 | Financial |
| 5/5/11 | Aidells Sausage Company ***(SELLER: Encore Consumer Capital; Geolo Capital)*** | Producer of gourmet sausages, meatballs, sampler packs. | Sara Lee (NYSE:SLE) | $87.00 | Strategic |
| 5/5/11 | Okami | Producer and distributor of sushi. | Fuji Food Products | - | Strategic |
| 5/5/11 | Sweet Leaf Tea Company | Producer and distributor of ready-to-drink canned iced teas. | Nestlé Waters North America | - | Strategic |
| 4/27/11 | Premium Standard Farms, 21,500-Acre Hog Production Site in Dalhart, Texas ***(SELLER: Premium Standard Farms)*** | 21,500 acre hog production site. | Cargill | $33.00 | Strategic |
| 4/10/11 | Tasty Baking | Producer and distributor of single portion cakes, pies, donuts, snack bars, pretzels and brownies. | Flowers Bakeries | $149.65 | Strategic |
| 4/5/11 | Pringles Business of Proctor & Gamble | Producer of potato crisp snacks. | Diamond Foods (NASDAQ: DMND) | $2,517.60 | Strategic |
| 2/16/11 | Townsends | Producer of poultry and chicken products. | Omtron | $24.90 | Strategic |
| 1/31/11 | Chism Hardy Enterprises | Contract manufacturer of carbonated and non-carbonated beverages, teas, beers and more. | City Brewing Company | $30.00 | Strategic |
| 1/26/11 | Colonial Cookies | Manufacturer and marketer of cookies and crackers. | Weston Foods (Canada) | $13.50 | Strategic |
| 1/14/11 | Sun Gro Horticulture ***(SELLER: Premier Tech; Oakwest)*** | Producer/distributor of peat/bark-based growing mixes, and fertilizers for nurseries and consumers. | IKO Enterprises | $201.94 | Strategic |
| 1/11/11 | Veryfine Products ***(SELLER: Sunny Delight Beverages)*** | Producer of juices, juice drinks and nectars for restaurants, schools, hospitals, vending outlets and more. | Angelo, Gordon & Co., Private Equity Group | $15.00 | Financial |
| 1/9/11 | Crumbs Bake Shop | Producer and marketer of cupcakes and caterer of corporate events, weddings, rehearsals and more. | 57th Street General Acquisition (NasdaqCM:CRMB) | $108.34 | Strategic |

## M&A Firmly On The Menu For Food Companies

European food giants seeking to bulk up to drive efficiencies and savings have been active acquirers throughout the economic downturn. Nestle SA (NESN.VX) and French yogurt champion Danone SA (BN.FR) focused on specific, targeted acquisitions and avoided pursuing mega deals as food industry competition intensified and industry players battled for market share. While these deals are driven by the anticipated cost savings that can protect a collapse in margins, such motivations eventually may cause industry players to become less disciplined in their M&A activities than they otherwise would suggest.

Buyers are seeking companies with strong brands in Asia and other emerging markets: this trend warrants close scrutiny. Will acquirers learn how to price and efficiently manage cross-border transactions as they mix and match acquisitions in mature and emerging markets to gain market share while generating cost savings?

## As Food Prices Surge – Food Company Valuations Rise

Growing demand in Asian and other emerging markets is driving up global prices of raw and processed soft commodities alike. Erratic weather, a global push toward biofuels (which consume roughly one-third of the US corn crop annually), food quality concerns worldwide and fears of radioactive exposure arising from Japanese food products following Japan's earthquake, tsunami and resulting nuclear crisis all have exacerbated price pressures significantly. This in turn has increased food-focused mergers and initial public offerings.

Commodity prices significantly influence global agribusiness sales and valuation trends. Higher food prices tend to trigger mergers that strengthen corporate balance sheets while making it easier to meet the demands of a volatile price environment. The IMF's Commodity Food Price Index indicates that global food commodity prices (including cereal, vegetable oils, meat, seafood, sugar, bananas and oranges) rose 32% between March 2010 and March 2011. Higher commodity prices trigger increased agriculture equipment sales and ultimately boost M&A activity.

## Obesity & Health Food Trends

The British Medical Journal "Lancet" reports that half of US adults will be obese by 2030 unless proper nutrition is made a national policy priority with healthful foods becoming cheaper and less-healthful foods more expensive, possibly through tax policy. Lancet's report also recommended changes in how foods are marketed among many other measures. International public health experts argue that the global obesity crisis will worsen significantly, burdening health-care systems and economies unless governments, agencies and other institutions monitor, prevent and control the problem.

It ultimately is up to individuals to decide what to eat and how to live their lives, and on this front, promising trends are emerging. Nielsen reported that in the 12 months through 9/30/10, the three fastest-growing food categories were: yogurt (up 12.8% year over year), trail mixes (up 11.0%) and fresh meat (up 7.5%). A groundswell for more healthful eating is driving growth in healthy foods and organic foods in the US, developed and developing nations and throughout the global food industry. This in turn will drive M&A in years to come.

# Financial & Strategic Buyers

Financial buyers buy and grow private companies for eventual resale to strategic buyers or other financial buyers. Strategic buyers acquire private companies to add new products, markets, technologies and so forth.

Before the 2008/2009 global recession, an average 1,000 M&A transactions valued at $50 million or less closed annually as middle market owners retired or "took their chips off the table." Up until 2008, middle market companies that delivered innovative products and services were prized by prospective acquirers who routinely made offers that could not be refused.

While deal volume declined during the global recession vs. averages realized during the 2004 to 2007 timeframe, this "new normal" arguably reflects a postponement or deferral of hundreds of M&A transactions given prospective sellers' likely disappointment with recession-era valuations for their companies. For baby boomers who comprise a preponderance of middle market business owners, an exit – most likely through an M&A transaction – is all but inevitable. As the economy and valuations recover in one business sector after another, long-deferred M&A sell-side transactions should recover strongly. Middle market M&A transactions involving baby boomer owners will accelerate as baby boomers remain a middle market force to be reckoned with through 2029 when the youngest baby boomers reach age 65.

As baby boomers and other middle market business owners generate an increasing supply of sellers coming to market, will they find a sufficient – and sustainable – pool of buyers? And is there a sufficient – and sustainable – pool of buyers ***today***? There are, in fact, strong indications that the buyers are out there, if only on the sidelines for now. How can these buyers be identified? By the cash they keep. Anecdotal evidence grows stronger every day that thousands of strategic and financial buyers have amassed as much to $3.5 trillion in "dry powder," capital that eventually must be put to work in acquisitions or other reinvestments:

- Since 2008, financial buyers have accumulated un-invested $500 billion in capital (2.5 years of fundraising) that eventually must be invested.
- Strategic buyers also have been hoarding cash, closing out 2010 with more than $1.8 trillion in cash on balance sheets.
- Since 2009, banks have accumulated nearly $1.2 trillion in cash on their balance sheets ($900 billion more than was available to lend to buyers as of year-end 2008).

Deloitte reports that the top 10 publicly-traded US Food & Beverage companies alone are sitting on a reported $30.1 billion that likely will be invested in faster-growing emerging markets and used to increase market share in niche areas and mature markets. These firms can be expected to acquire smaller, more innovative companies and/or brands. Healthy snacks, functional foods, energy drinks, ready-to-drink beverages, dried fruit/nuts and premium teas are especially attractive to strategic and financial buyers alike. Meanwhile, the return of private equity investors is driving up prices because the global food industry sector is expected to realize higher growth rates than most others for years to come. In addition, long term food security and the need to ensure a consistent supply of raw materials also is driving M&A as packaged food manufacturers pursue vertical integration.

This unprecedented $3.5 trillion in cash eventually will fund a wave of company buyouts as private equity buyers team with bank lenders to close private company acquisitions and strategics tap cash reserves to acquire firms meeting their strategic objectives.

# 2011 US Market Deal Volume

**Through the first five months of 2011, PricewaterhouseCoopers, LLP** identified 1,276 announced US M&A transactions with a total value of $454 billion vs. 1,336 transactions worth $327 billion during the first five months of 2010. While this data suggests that fewer, larger deals closed, middle market transactions appear to have been very well represented: in both 2010 and 2011 year to date, more than 36% of deals closed sold for less than $1 billion (ranking them in the middle or lower middle market). During the 2005 to 2007 boom years, on the other hand, 72% to 77% of transactions exceeded $1 billion while middle market transactions accounted for 23% to 28% of transactions.

This upward trend in middle market M&A transactions also was acknowledged in the **National Venture Capital Association's (NVCA)** report on venture investments. Venture backed companies tend to be smaller businesses. The NVCA counted 109 venture-backed M&A deals in the first quarter of 2011. Most of these involved the information technology sector. Information technology increasingly drives not only high tech business sectors but also such realms as Food & Beverage where it often yields disruptive gains by which one market player may overcome entrenched advantages of market leaders. Creative management teams today are using Information Technology and Alternative Technologies not only in core business processes but also to innovate in areas that may burnish their corporate reputations and increase their visibility, enhance their customer bases, and drive operational efficiencies at the same time.

For example, pretzel and snack-food manufacturer **Snyder's-Lance, Inc.** recently completed construction on a 3.5-megawatt solar farm across from its Hanover, PA corporate headquarters (http://www.youtube.com/watch?v=mXNNVbGb_90). In addition to projected energy savings and likely federal, state and local clean energy-related incentives, Snyder's-Lance arguably was motivated by the prospect that its solar farm would generate positive press while also creating a more vibrant, eco-friendly employee workplace.

# The Flip Side of Successful Mergers: Strategic Divestitures

Executing a successful merger or takeover is a highly challenging endeavor. It inevitably involves risks commensurate with its potential rewards because synergies may not be realized, corporate cultures may clash, talented employees may bolt, and expected financial efficiencies may prove elusive. Brand identity and product identity generally drive value, but the merger of two widely recognized – and even highly regarded – brands may prove problematic if one brand thrives while the other falters, or if one brand detracts from the other's ongoing development and long-term success.

When two brands don't work well together post-merger, the time may come when the parent must jettison one brand to preserve the long-term prospects of the other by refocusing on its market segment to maintain and increase its market share. In other words, the flip side of a merger is a divestiture. Successful firms periodically review their corporate portfolios to identify and divest brands/products/divisions that no longer suit their corporate strategies. A judicious divestiture strategy can ensure that firms remain focused on core business models and key objectives. In the absence of a judicious divestiture program, languishing corporate brands and products likely will unduly distract corporate management's focus from successful core brands, often at great expense to those brands, while undermining corporate objectives, profitability and return on investment.

Recent events speak to the importance of periodic corporate divestitures. When Wendy's and Arby's merged in 2008, the combined firm became one of the US' largest fast-food chains with more than 10,000 restaurants in the US, US territories and 24 countries worldwide, $3.4 billion in 2010 sales, and some 67,500 employees. Today there are more than 6,500 Wendy's and more than 3,600 Arby's.

Yet Arby's soon faced increased competition from firms like Panera that offered healthier alternatives to Arby's at comparable price points. Arby's faltered as its brand became indistinct and as cash-strapped Americans cut back on their meal budgets. Wendy's, which has a much more distinctive and successful brand profile along with lower meal price points, did not suffer the same fate but rather has held its own in the enormously competitive hamburger restaurant segment.

Wendy's success throughout the recession of 2008 to 2009 drove corporate decisions to update Wendy's menu and even to open new restaurants in Argentina. Such plans require capital and focus in an era when both are in too-short supply. In Wendy's case, Arby's eventually became an obstacle to success and the combined firm's ownership decided to sell Arby's in order to free up as much as $600 million in capital to reallocate to Wendy's brighter future. Arby's was acquired by Roark Capital Group this past summer for a reported $320 million.

# THE MCLEAN GROUP AGRIBUSINESS & FOOD PROCESSING SERVICES PRACTICE

The McLean Group's Agribusiness & Food Processing practice works with a wide range of agribusiness interests, including food production, farming and contract farming, seed production and supply, agrichemicals, farm machinery, wholesale and distribution, and food processing. Our bankers assist companies operating along all points of the food continuum to develop strategic growth initiatives and keep track of industry trends and technologies. We have provided advisory services to major corporations within this segment, including Kellogg and General Foods.

## Select Agribusiness & Food Processing Engagements

GMA has divested The National Food Lab to acquirer Safe Foods International Holdings, LLC — The McLean Group

KRAFT — Market Intelligence — The McLean Group

GMA SAFE acquired by QMI SAI Global — The McLean Group

Numi Organic Tea — Business Valuation — The McLean Group

Coca-Cola — Market Intelligence — The McLean Group

ABERCO Inc. acquired by Balchem Corporation — The McLean Group

Pillsbury — Market Intelligence — The McLean Group

Amici's East Coast Pizzeria — Business Valuation — The McLean Group

Five Guys Famous Burgers and Fries — Business Valuation — The McLean Group

Bell Winery has been recapitalized by Lindsay Goldberg — Purchase Price Allocation — The McLean Group

# THE MCLEAN GROUP OVERVIEW

The McLean Group is an investment bank providing mergers and acquisitions (M&A), corporate finance, market intelligence and business valuation services to middle market businesses. Headquartered in the Washington, DC metropolitan region, the firm has a presence in more than 30 cities in the US, serving domestic and international clients with a broad resume of successfully consummated financial transactions. Our research staff leverages state-of-the-art, proprietary corporate information and transaction data, providing our clients with unmatched information on which to make transaction decisions.

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Brian Sullivan, Managing Director of The McLean Group's Silicon Valley, CA office, specializes in providing M&A solutions to middle market businesses.