

## U.S. Cracker Industry Update

### Innovation and Niche Focus Drive Growth

#### MARKET OVERVIEW

Following three years of 3% compound annual dollar growth rate, the cracker market in the U.S. is approaching \$4B in sales dominated by three companies, Kraft, Kellogg and Pepperidge Farm (owned by Campbell Soup).<sup>1</sup> Currently these "big three" control greater than 75% of total cracker sales. However, competition continues to increase as two major marketers, PepsiCo and Procter & Gamble, continue to focus on the segment. With brand extensions for PepsiCo's Lays & Cheetos, and P&G's Pringles, combined with their respective marketing and retail resources, these companies combined have taken 2.4% market share in 2008, representing a 250% increase from two years prior.<sup>2</sup>

With limited unit growth the cracker industry's gains are heavily correlated to both food price inflation and population expansion. Volatile commodity prices are one of the biggest challenges faced by companies competing in the cracker industry resulting in fierce competition as more players push to expand share in a slow growth market.<sup>3</sup>

	Total US FDMx <sup>1</sup> Sales of Crackers in Current Prices (\$MM)		Growth	Total US FDMx <sup>1</sup> Sales of Crackers Inflation-Adjusted Prices (\$MM)		Growth
2004	3.464	(0.9)%		3.947	(3.4)%	
2005	3.503	1.1%		3.860	(2.2)%	
2006	3.671	4.8%		3.919	1.5%	
2007	3.764	2.5%		3.907	(0.3)%	
2008	3.927	4.3%		3.927	0.5%	

(1) FDMx = Food, Drug and Mass Merchandise Sales excluding Wal-Mart  
Source: Mintel based on Information Resources, Inc. InfoScan® Reviews™

The cracker industry is highly fragmented, with the "all other" category being the distinct leader in both sales and growth. The most marketing dollars and new product development resources are committed to the "all other" segment whereas more specific categories, such as saltines and graham crackers, have shown signs of deteriorating appeal with ever increasing options at the consumer's discretion.<sup>4</sup>

Cracker Segment	Sales (MM)		Sales (MM)		% Change 2006 - 2008
	2006	%	2008	%	
"All other" crackers	\$2,651	72.2%	\$2,930	74.6%	10.5%
Saltine crackers	352	9.6%	367	9.3%	4.3%
Crackers with filling	347	9.5%	334	8.5%	(3.7)%
Graham crackers	264	7.2%	241	6.1%	(8.7)%
Breadsticks	32	0.9%	33	0.8%	3.1%
Matzoh crackers	25	0.7%	22	0.6%	(12.0)%
Total	\$3,671	100.0%	\$3,927	100.0%	7.0%

Source: Mintel based on Information Resources, Inc. InfoScan® Reviews™

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## INDUSTRY TRENDS

Major trends in cracker products that have continued to gain momentum over the past several years are private label, consumer health awareness and perception, and niche focused players capable of creating deep customer loyalty.

### PRIVATE LABEL

Recently, private label sales growth in the overall food and beverage industry has outpaced branded sales, growing at 9% in the US from 2008 to 2009.<sup>5</sup> Specifically in the cracker market, private label sales grew 13% in 2008 compared to the overall cracker industry, which grew at 4.5%.<sup>6</sup> With the lingering effects of the economic downturn consumers will continue to trade down to less expensive private label offerings. In addition, private label alternatives have demonstrated that they can compete on more than just price, as supermarkets have committed resources to creating more attractive private label choices such as *Wild Harvest Organic Original Wheat Thins* and *O Organics Rosemary and Garlic Crackers*.<sup>7</sup>

### CONSUMER HEALTH AWARENESS

As the cracker market continues to innovate and expand into the pure play snack segment, brands come into direct competition with other salty snacks.<sup>8</sup> The largest competitors in the snack category in terms of food, drug and mass merchandiser sales excluding Wal-mart ("FDMx") are potato chips and tortilla chips, with \$2.8B and \$2.1B, respectively.<sup>9</sup> Although the sales of these segments combined approximate total sales for the cracker industry, they all benefit from heavy household penetration, thus directly competing for consumer attention and end-user demand. Crackers have a distinct advantage in consumer perception as being inherently healthier, as baked snacks, than traditionally fried potato chips. To further take advantage of this public perception, cracker producers see significant new growth potential within healthy snacks including the proliferation of whole grains, fiber, antioxidants, and 100-calorie packaging combined with continued emphasis on low sodium, low fat offerings.<sup>10</sup>

Top 10 Cracker Brands in FDMx Dollar Sales			
(\$ millions)	2008	2009	% Change
1. Sunshine Cheez-It	310.5	335.7	7.5%
2. Nabisco Ritz	295.1	312.3	5.5%
3. Nabisco Wheat Thins	320.5	284.1	(12.8)%
4. Nabisco Triscuit	229.7	233.0	1.4%
5. Pepperidge Farm Goldfish	209.5	231.5	9.5%
6. Nabisco Premium Saltine	202.5	208.3	2.8%
7. Keebler Club	139.4	138.4	(0.7)%
8. Private Label	109.3	133.6	18.2%
9. Nabisco Honey Maid Graham	109.9	116.9	6.0%
10. Private Label Saltine	82.5	106.3	22.4%
Total Cracker Sales	\$3,927.0	\$3,991.1	1.6%

Source: Information Resources, Inc., Mintel

### INNOVATION & NICHE FOCUS

Focused cracker producers are taking advantage of different trends and creating increased consumer interest in areas such as natural and organic, new flavor varieties and gourmet flavors. The broader food industry theme of natural and organic products has been targeted by leading brands and smaller, more focused brands alike. Currently, brands built on this focused theme, rather than leading brands adding line extensions, have had the most success, examples of which include *Annie's Homegrown Organic Bunny Classics Saltines* and *D'Artagnan Organic Charcuterie Crackers*.<sup>11</sup> New flavor varieties continue to grow in popularity as consumers are receptive to trying new flavors and types of crackers. These innovations are being driven by the leading brands with common themes such as garlic and herbs, and different cheese flavors. Additionally, smaller producers are rolling out more bold flavors such as the *La Panzanella Fieri* line of crackers,

and *Suzie's Naan Bites and Crackers* appealing to both ethnic tastes as well as the more adventurous cracker consumer.<sup>12</sup> The gourmet category, which includes natural and organic, is led by smaller, specifically focused brands looking to differentiate their cracker products from the masses. Such brands include *LU's Herbes de Provence Flatbread Crackers* and *Tucker's Natural Gourmet Crackers*.<sup>13</sup> Additional avenues of innovation not specifically addressed here include: convenience, environmentally friendly production and distribution, crackers that put new twists on familiar forms and new crackers from non-cracker brands.<sup>14</sup>

## PUBLIC COMPARABLES

The following publicly traded companies represent the major brands and sales drivers within the heavily saturated and consolidating cracker industry. As of March 29, 2010 these market leaders were trading last twelve months enterprise value to earnings before interest, taxes, depreciation and amortization at a mean of 10.9x and median of 9.8x.

## T&H Cracker Index

(\$ in millions)	Enterprise Value ("EV") <sup>2</sup>	LTM Revenue	LTM EBITDA	EBITDA Margin	Last Twelve Months <sup>1</sup>	
					EV / Revenue	EV / EBITDA <sup>3</sup>
Procter & Gamble Co.	\$ 212,679.7	\$ 79,117.0	\$ 19,893.0	25.1 %	2.7 x	10.7 x
Pepsico, Inc.	114,249.5	43,232.0	9,596.0	22.2	2.6	11.9
Kraft Foods Inc.	69,702.0	40,386.0	6,503.0	16.1	1.7	10.7
Kellogg Company	24,995.9	12,575.0	2,542.0	20.2	2.0	9.8
Campbell Soup Co.	14,691.9	7,570.0	1,624.0	21.5	1.9	9.0
Ralcorp Holdings Inc.	5,004.9	3,915.6	627.7	16.0	1.3	8.0
Lance, Inc.	852.3	918.2	94.8	10.3	0.9	9.0
<b>Median</b>	<b>\$ 24,995.9</b>	<b>\$ 12,575.0</b>	<b>\$ 2,542.0</b>	<b>20.2 %</b>	<b>1.9 x</b>	<b>9.8 x</b>
<b>Mean</b>	<b>\$ 63,168.0</b>	<b>\$ 26,816.3</b>	<b>\$ 5,840.1</b>	<b>18.8 %</b>	<b>1.9 x</b>	<b>10.9 x</b>

Source: Cap IQ, Tully & Holland

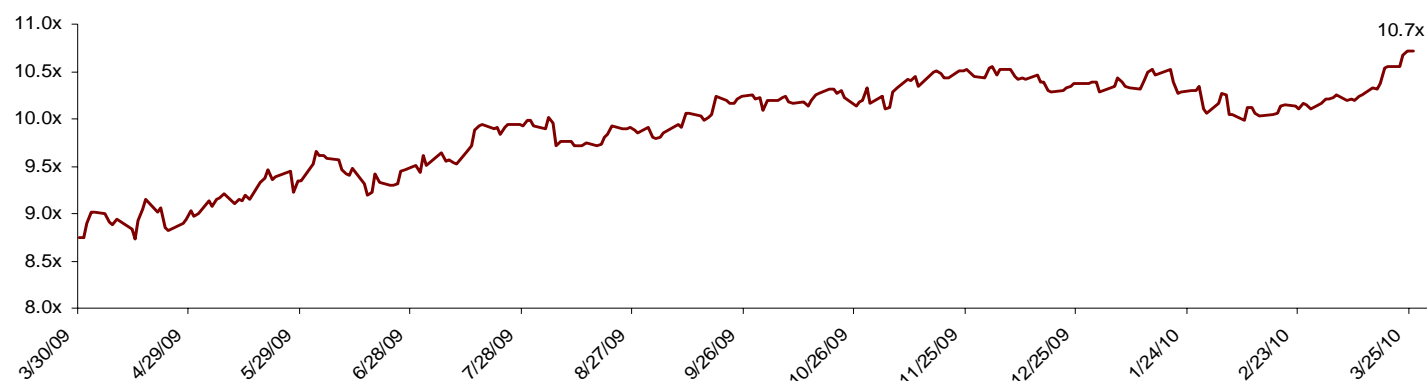
(1) As of 3/29/10

(2) Enterprise value equals market capitalization of equity plus net debt

(3) EV / EBITDA mean represents an EV weighted average of components

T&H Cracker Index Components: PG, PEP, KFT, K, CPB, RAH, LNCE

## Enterprise Value / EBITDA T&H Cracker Index Last Twelve Months



Source: Cap IQ, Tully & Holland as of 3/29/10

EV / EBITDA multiple represents the quotient of the summation of EVs and EBITDAs for each component over LTM

T&H Cracker Index Components: PG, PEP, KFT, K, CPB, RAH, LNCE

## VALUATION

With cracker specific deals often private, involving market leaders adding specialty brands to broaden their product offerings, the best available gauge of valuation is the public equity markets. The major cracker providers are all diversified multi-national food manufacturers so there is no comparable pure play public cracker company. However, we believe that focusing on those companies that have a larger portion of their earnings from cracker products (LNCE, RAH, CPB) realistic valuations are in the 8x – 9x EBITDA band for these large, publicly traded companies. Additionally, smaller niche focused cracker brands will be valued at a premium relative to their size for their innovation and growth prospects with market leading strategics willing to pay up in order to broaden their offerings in product categories providing faster rates of growth.

## Cracker Specific M&A Transactions

Closing Date	Target	Acquiror
1/15/2010	Kraft Foods, Inc. <sup>1</sup>	Pershing Square Capital Management, LP
<b>11/27/2009</b>	<b>Westminster Cracker Company, Inc.<sup>2</sup></b>	<b>Lasalle Capital Group, LP</b>
9/8/2009	Stella D'Oro Holdings, LLC	Lance, Inc.
8/31/2008	Brownie Products Co. and IndyBake Products, LLC	Kellogg Company
3/6/2008	Nonni's Food Company, Inc.	Vivartia S.A.
7/13/2007	Milton's Baking Company, Inc.	GESD Capital Partners
3/5/2007	Bloomfield Bakers	Ralcorp Holdings, Inc.

(1) Pershing Square acquired 2.17% of KFT for \$950MM  
(2) Tully & Holland acted as sole financial advisor to Westminster Cracker Company  
Source: CapIQ

## CONCLUSION

The saturated cracker industry will continue to remain highly competitive. Innovative and specialty focused brands will be able to carve-out growth amongst the established market leaders. Those same, new lucrative opportunities will be sought by the large players, particularly relatively new-comers PepsiCo and Procter & Gamble. As a result, the cracker market will continue to consolidate with the deep resources of top brands paying premiums for smaller niche players that can demonstrate a leadership position in a category that can provide market share growth.

## ABOUT TULLY & HOLLAND

### INVESTMENT BANKING SOLUTIONS FOR CONSUMER PRODUCT COMPANIES

Tully & Holland was the sole financial advisor to Westminster Cracker Company, Inc. in its sale to Lasalle Capital Group in November of 2009. Founded in 1992, Tully & Holland, Inc. is a leading US investment bank that provides merger & acquisition advisory services and private placements to consumer companies with special emphasis on food companies, multi-channel marketers, consumer product manufacturers/distributors, and retailers.

#### Footnotes:

<sup>1,2,4,6,7,8,9,11,13,14</sup> *Mintel*

<sup>3,10</sup> *Doug VanDeVelde's (SVP, US Snacks, Kellogg Co.) interview with Snack Food & Wholesale Bakery 6/8/2009*

<sup>5</sup> *Plunkett Research*

<sup>12</sup> *Snack Food & Wholesale Bakery Journal 11/23/2009*

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