

U.S. Food Industry Update

Millennials, Media, and M&A

EXECUTIVE SUMMARY

The United States Food Industry has been very resilient throughout the past several years despite a difficult and uncertain economic environment and rising commodity costs that have squeezed margins across the industry. We anticipate the recent rise in consumer discretionary spending will benefit the industry in the future if this momentum continues. Increasingly, the Millennial Generation – individuals born between 1978 and 1996 – is expected to drive demand in the industry. The Millennials are more adventurous eaters, active social media users, and health conscious consumers. Obesity remains a major concern in the US – a trend companies can capitalize upon by developing products for more health conscious consumers. One sector that has seen strong growth is the specialty food sector which has boomed to become a \$75 billion industry. The Tully & Holland Food Index companies have consistently traded at a higher multiple than the S&P 500 and Dow Jones Industrial Average (DJIA) due to their steady cash flows and relatively recession-proof nature as a consumer staple. Finally, first-quarter 2012 mergers and acquisitions in the food industry were the highest of the past four years, a trend that correlates to rising commodity costs and smaller margins that are resulting in industry consolidation as companies pursue economies of scale.

KEY INDUSTRY TRENDS

➤ **Millennials Increasingly Drive Demand**

The Millennial Generation, which represents 79 million people born between 1978 and 1996, now outnumber the baby-boomer generation and are increasingly driving demand both directly and indirectly in the food industry. These individuals have indicated that they are more adventurous eaters and are interested in bolder flavors – while retail sales of sauces, dressings, and condiments are expected to decline by 3% between 2011 and 2016, sales of spicy chili/pepper sauces for example, are projected to grow by 12%.¹ The Millennials, which represent 25% of the US population, are also the most ethnically diverse segment of the population and their adventurous palate extends to international brands and foods. Companies must incorporate these global offerings to keep pace with and capitalize on this increasingly important segment of the US population.

➤ **Brands Leverage Social Media**

Food brands are increasingly leveraging social media platforms to attract customers, capitalize on word-of-mouth marketing, and strengthen brand

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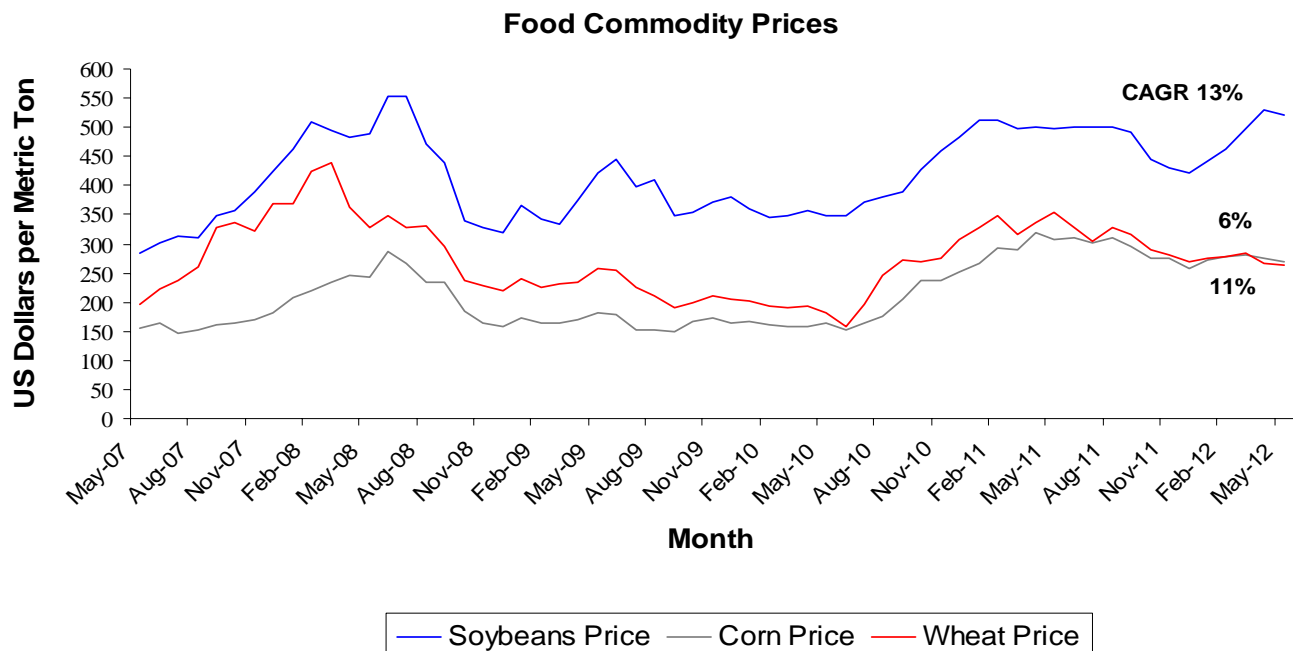
loyalty. Social media will continue to play a significant role in attracting Millennials that are well-versed in technology and hungry to show and tell their friends about their dining out and cooking experiences. Brands with a strong presence on Facebook, Twitter, Foursquare, and Pinterest will be better positioned for growth in the future and will benefit from consumer feedback unheard by their “non-social” competitors. The Chipotle restaurant chain uses social media to interact with their customers and respond to customer suggestions. With over 90,000 followers on Twitter and over 1.8 million Facebook “Likes,” Chipotle is able to listen in on customer conversations enabling the company to design programs and address problems that increase brand loyalty.²

➤ **Booming Growth for the Specialty Food Sector**

Driven by a growing U.S. ethnic population and an increased focus on healthy foods, the specialty food sector has cumulatively grown 20% since 2009 reaching \$75 billion in sales in 2011³. The specialty food sector includes products such as condiments and sauces, ethnic foods, healthy snacks, natural and organic foods, private label and select beverages. Mintel projects that the specialty food market will continue to grow in 2012 – potentially exceeding 10% in sales – while the Consumer Product Index (CPI) for all food categories is expected to increase 2.5% to 3% in 2012. The specialty food sector will benefit from the national trend of individuals increasingly buying locally. However if commodity prices remain high, consumers may shy away from expensive purchases, adjusting down to less expensive items.

➤ **High Commodity Prices**

High commodity prices continue to represent a significant challenge to the U.S. Food Industry. According to the Bureau of Labor Statistics, 2011 figures show that food prices jumped 3.7% from 2010 – the largest annual leap in the past three years. In particular, rising costs of corn, soybeans, and wheat have increased the costs of goods and services and decreased margins where companies cannot pass along cost increases to the consumer.



Source: Index Mundi, Tully & Holland Analysis

➤ **Private Label vs. Brands**

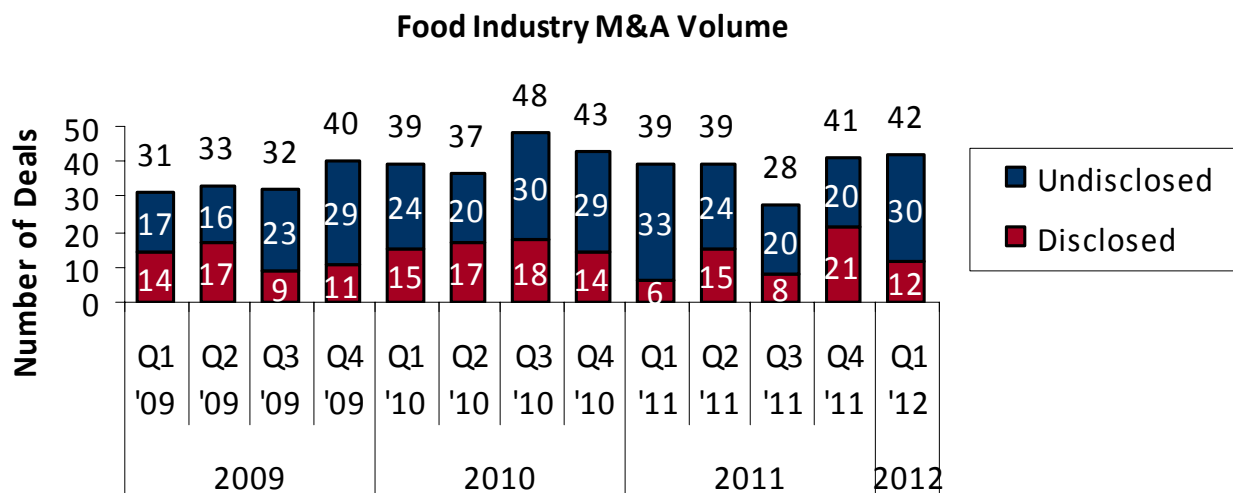
The Private Label Manufacturing Association reports that nearly one of every four products purchased in U.S. supermarkets, drug stores, and discount stores is now a private label brand. According to Nielson Company data for the 52 week period ending December 24th, 2011, private label unit share rose to 23.6% - an all time high. Private labels gained customers during the Great Recession and are now competing to maintain those customers despite intense competition from national brands that are consolidating their costs and lowering their prices.

➤ **Gluten-free Growth**

In the past three years, gluten-free mentions on menus increased 280% illustrating restaurants' push to include a greater number of options for health-conscious consumers. According to Packaged Facts, gluten-free sales grew 30% CAGR between 2006 and 2010 to reach \$2.6 billion and by 2015 sales of gluten-free foods and beverages are projected to grow to \$6 billion. Growth in the gluten-free sector is being driven by factors such as increasing diagnoses of Celiac disease, the rise in popularity of gluten-free diets, and the general "good for you" halo associated with a gluten-free diet.

M&A TRANSACTIONS

Despite a weak third quarter in 2011, the market has posted two consecutive strong quarters of M&A transactions including the greatest number of first quarter M&A transactions in the past four years. Rising commodity costs and shrinking margins will potentially lead to consolidation and greater M&A transaction volumes in the future as companies look to capitalize on economies of scale. In 2012, the largest M&A deals have been dominated by strategic buyers, possibly reflecting the large cash reserves that companies created as a buffer during the recession and are now putting to use to achieve economies of scale. While many private equity firms are still sitting on excess dry powder, food companies remain a key target due to their relatively steady cash flows.



Source: Capital IQ, Tully & Holland analysis

Food Industry Transaction Value By Size

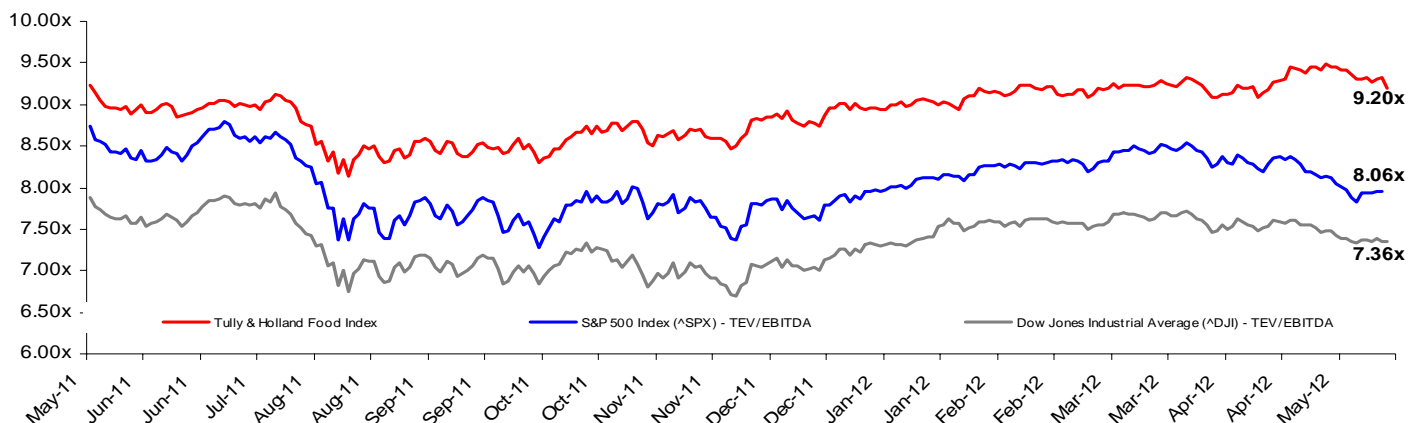
Closed Date	Target	Transaction Value (\$USDmm)	Buyers/Investors
05/01/2012	Solae, LLC	\$ 440.00	E. I. du Pont de Nemours and Company (NYSE:DD)
03/20/2012	Miller Milling Company	\$ 122.00	Nisshin Seifun Group Inc. (TSE:2002); Nisshin Flour Milling, Inc.
03/26/2012	Pilgrim's Corp. (NYSE:PPC)	\$ 107.63	JBS USA Holdings, Inc.
04/23/2012	GreenLine Foods, Inc.	\$ 70.00	Apio, Inc.
03/23/2012	Verenium Corporation, Food Enzymes Business and Key Technology	\$ 35.00	DSM Food Specialties B.V.
04/13/2012	Naturally Fresh, Inc.	\$ 25.00	Treehouse Foods, Inc. (NYSE:THS)
01/31/2012	Silver Springs Citrus, Inc.	\$ 24.00	Sapporo International Inc.
03/02/2012	Mrs. May Naturals, Inc.	\$ 16.00	Dole Packaged Foods, LLC
02/15/2012	St. Hilaire Seed Company, Inc.	\$ 15.02	Legumex Walker Inc. (TSX:LWP)
05/18/2012	Dippin' Dots, LLC	\$ 14.17	---

Source: Capital IQ

PUBLIC COMPARABLES

The following graph illustrates the valuation of companies within the Tully & Holland Food Index which consists of 18 publicly traded food manufacturers. The average trading multiple of the companies within the Tully & Holland Food Index has consistently outperformed both the DJIA and the S&P 500 over the course of the past year. Using a weighted average based on market capitalization the Tully & Holland Food Index is currently trading at an EV/EBITDA multiple of 9.20x versus the 8.06x and 7.36x that the S&P 500 and DJIA are currently trading at, respectively. We anticipate this strong performance will continue in the year ahead, compared to the S&P 500 and DJIA, due to the industry's relatively recession-proof nature and steady cash flows. Additionally, increased revenues from emerging markets are driving growth for large diversified food companies as global consumers trade up to western-style eating habits.

Public Comparables Trading Multiples



Source: Capital IQ, Tully & Holland analysis

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

Tully & Holland Food Index Components: ADM, KFT, BG, TSN, GIS, K, CAG, DF, SFD, SLE, HNZ, HRL, CPB, DOLE, CPO, SJM, DMND, JJSF

VALUATION ANALYSIS

While the greatest number of first-quarter M&A transactions in the past four years was recorded in 2012, the majority of the valuation metrics have not been publicized. In contrast, readily available public equity markets data can be used to provide accurate, relevant, up-to-date valuation guidance. As of June 14, 2012, eighteen of the major sales drivers in the food industry were trading at a mean enterprise value of 9.2x EV/EBITDA. Given that these multiples reflect large publicly traded companies, we would realistically apply size and liquidity discounts to determine valuations of smaller privately held companies. Past Tully & Holland experience suggests a valuation range of 7.0x to 8.5x last twelve months EBITDA, depending upon the size, growth potential, and liquidity of the company.

T&H CONCLUSIONS

Elevated commodity costs that have eroded industry margins and profits will lead to increased M&A activity in the future as companies pursue economies of scale. Some sectors, however, such as the specialty food sector are well positioned for growth in 2012 due to the growing ethnic population in the United States as well as consumers' increased focus on healthy foods. Additionally, companies that tailor products towards the Millennials and leverage social media platforms to strengthen brand loyalty and spread word-of-mouth marketing will be positioned to gain a competitive advantage in the industry.

ABOUT TULLY & HOLLAND

INVESTMENT BANKING SOLUTIONS FOR CONSUMER PRODUCT COMPANIES

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. Tully & Holland's Managing Directors have a combination of deep industry knowledge and sophisticated financial experience enabling them to craft innovative solutions for

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Footnotes

- ¹ Euromonitor International
- ² Mintel
- ³ Mintel