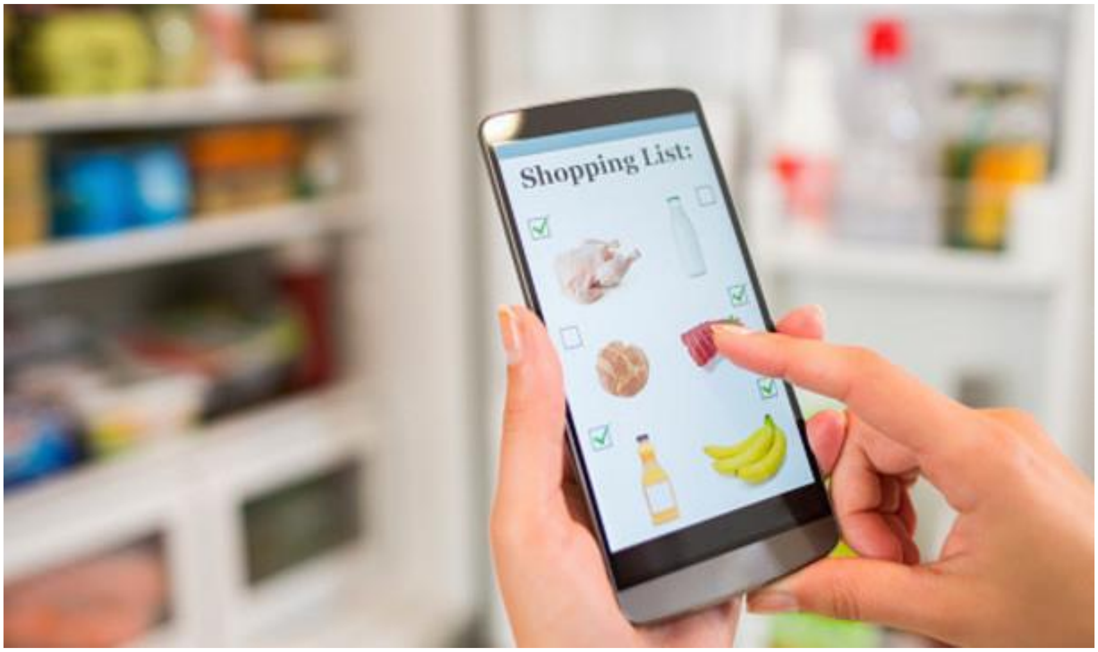

TULLY & HOLLAND FOOD AND BEVERAGE UPDATE

September 2017

TECHNOLOGY IS FUNDAMENTALLY ALTERING CONSUMER BEHAVIOR IN THE FOOD & BEVERAGE SECTOR

TULLY & HOLLAND
INCORPORATED

Food & Beverage Industry Update

How technology is shaking up the F&B Industry

CONTENTS

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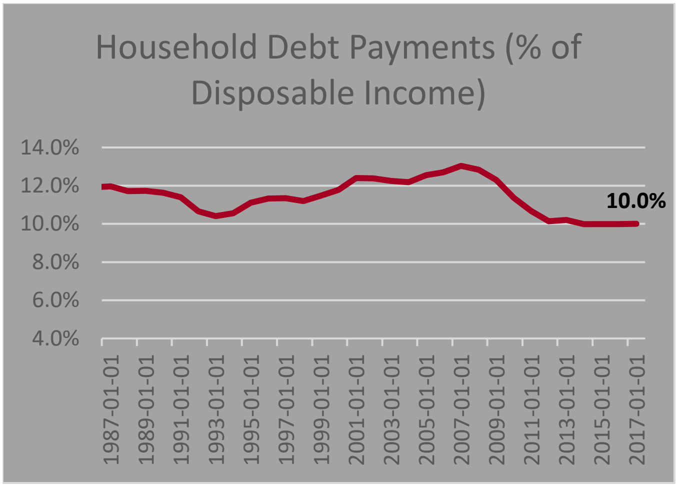
EXECUTIVE SUMMARY

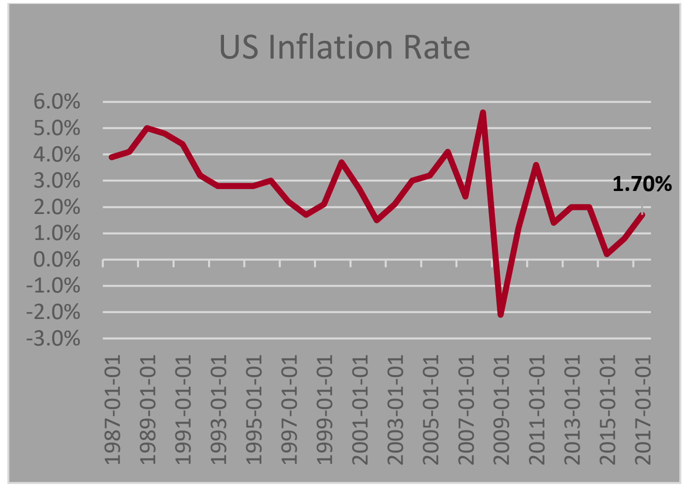
2017 has presented some lasting changes in the Food and Beverage industry which are driven in by macro-economic and broader demographic shifts. These trends are gathering pace and are having a dizzying impact on company performance. Among the most important drivers impacting the F&B space is technology innovation. Technology has changed consumer awareness, behavior and how they choose to shop, eat and spend money and spend time. In this Tully & Holland Food and Beverage update, we will discuss the economy, demographics, technology innovation, and recent and expected M&A activity in the sector.

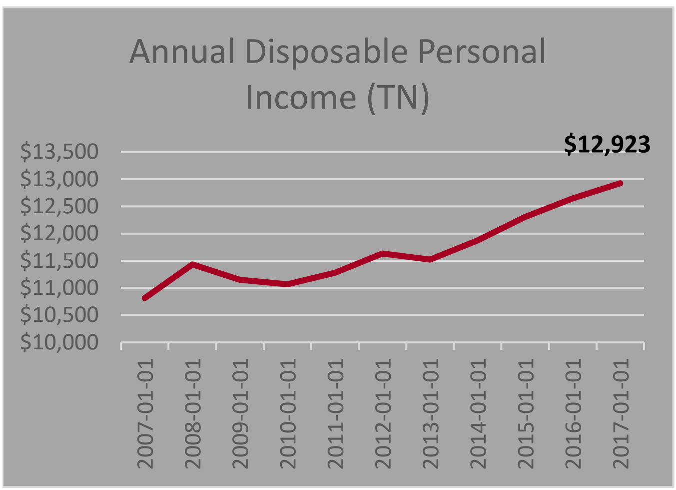
ECONOMIC UPDATE

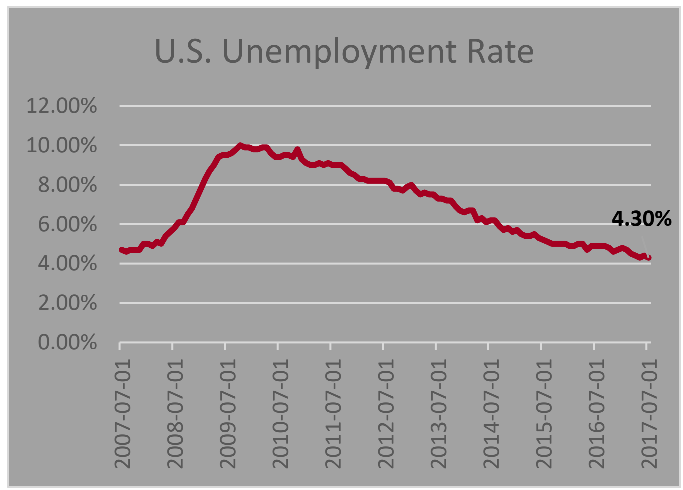
On the surface, the economic outlook in the US looks as bright as ever. U.S. consumer spending and disposable income figures are at all-time highs; household debt payments, as a percentage of disposable income, are at the lowest levels since the Federal Reserve started tracking the data in 1980; the stock market remains in record territory and the unemployment rate is down to pre-recession levels. By these accounts, many consumers are in better financial health and are spending more money on what they perceive as higher quality discretionary products and better tasting better-for-you food.

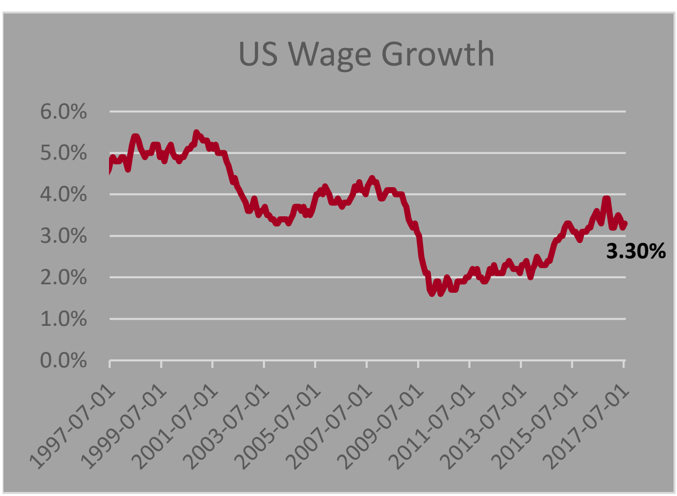
At the same time, a large segment of the population is not feeling these economic gains, is increasingly looking for alternatives at affordable prices and is becoming less loyal to traditionally iconic brands. As the quality of private label products improve, price conscious consumers are switching from the brands that have traditionally been staples in the family home.

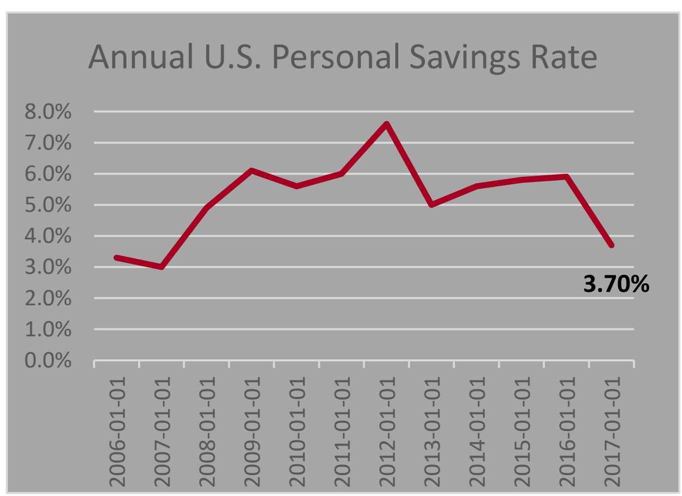












Sources: Federal Reserve and the US Labor Department

Consumer Preferences are Changing:

U.S. consumers are buying fresher, organic, locally produced items with less sugar, artificial food colorings, salt, preservatives and processed ingredients. In a recent report from Deloitte, 23% of consumers said they were willing to pay 10 to 20% more for healthier products in the supermarket and 55% of respondents said they would pay up to 10% more[1]. In sticking with the organic and healthy trend, large food multi-nationals such as Campbell's, are modifying their operations to better meet these shifting consumer desires and in several notable cases are acquiring companies with established organic products which carry a loyal base of customers while their traditional products are being undercut by food retail outlets and changing consumer preferences. Campbell's recent acquisition of Pacific Foods for $700mm is a prime example. Other large food companies are making rapid changes to their product portfolios. Kraft Heinz announced last year that it had removed all artificial dyes from its products. General Mills recently removed all artificial dyes and flavors from its cereals, and Papa Johns announced it would spend more than $100mm a year to remove artificial ingredients from its pizzas. Larger companies are also putting more effort into revitalizing existing brands. Conagra is trying to re-position its Healthy Choice line to appeal to Millennials by launching products such as Power Bowls which is designed to capture the popularity of healthy food bowls. Some companies have failed to shift operations fast enough. Yogurt brands such as Chobani, the Greek-yogurt maker, have taken market share away from General Mills' Yoplait and Danone due to a less than ideal response time.

Consumers are looking for items that check all the boxes in terms of nutrition. If consumers are looking for a snack, brands such as Sahale and Pro Bar offer high protein, better fats, high fiber and good quality grains. This fits well with the high-end consumer palate. When these consumers shop for groceries, they often don't just go to one store anymore. According to Consumer Reports, each month, the average US consumer does their grocery shopping at five or more food retailers[2]. Consumers may go to a nearby farm to buy the fresh eggs, pesticide free fruits and vegetables and then they might drive to a Wegmans to get other organic foods and produce not available at the local farmers market. The retail grocery chains that once were a one-stop-shop for everything are now being utilized more as a source for pantry staple items, pitting them against large wholesalers such as Costco and BJ's who have long been used as sources of bulk items such as laundry detergent, cleaning products, bathroom tissue, etc.

1 https://www2.deloitte.com/us/en/pages/consumer-business/articles/us-food-industry-consumer-trends-report.html

2 https://www.consumerreports.org/grocery-stores-supermarkets/faster-fresher-cheaper-grocery-shopping-revolution/

Grocery chains such as Whole Foods, Wegmans and Trader Joes are appealing to consumers looking for a different shopping experience featuring products that check all of the previously described boxes. Companies that can deliver the above experience including a courteous staff, easy parking access, faster checkout lines, fair-trade goods, fair-labor practices, sustainability and locally farmed goods are the ones that retain the highest customer loyalty and have shown strong sales growth. This month, Aldi announced a partnership with Instacart to compete with Amazon's foray into the grocery business.

During the week, consumers are increasingly on the run and often don't have the time or inclination to shop in a retail store. During the day, consumers are looking to eat out, but when they do, they want convenience, without sacrificing nutrition. They also want an experience and a variety of healthy palate options in the places they go. Fast casual dining establishments such as Sweet Greens and Panera Bread continue to be trendy because they meet these consumer expectations.

At night, some consumers are using meal kit companies such as Blue Apron and Freshly. These companies deliver all the ingredients required in a meal of the consumers' choosing. These companies have been experiencing exponential revenue expansion but have struggled to find a profitable economic model. It was just announced that Amazon will start its own meal kit delivery service and this move may be the start of a bigger trend in the food industry, while pressuring some of the newly formed meal kit providers to consolidate.

On the fast-casual dining front, another success factor has emerged that is important to time starved customers. Not all consumers are just going to the store and ordering fast casual meals the traditional way. They are also using store applications on their phones to place orders before they even get to these establishments. This makes it imperative for fast casual dining and beverage chains to keep up with technology. Companies such as Dunkin Donuts, Starbucks, Panera Bread, Shake Shack and Sweet Greens have successfully incorporated this technology into their businesses.

Resurgence of the Private Label Business

The bifurcated effect that the U.S. economy has had on consumers has had another result – the growth of private label foods. The traditional middle-class consumer has become a generation looking for alternatives. They face stagnant wage growth and as a result are now looking to shop both online and offline for value and convenience.

Price sensitive shoppers are increasingly buying private label and inexpensive store brands versus iconic food brands. Private label product shelf space has grown an estimated 3.5% a year since 2012 according to Credit Suisse[3]. In addition, online stores offering private label options are also starting to gain momentum. Brandless, a website that offers non-perishable grocery store items to beauty and personal care products, charges no more than $3 for everything in its online store. Some of the non-perishable items are organic and freshly made. In addition to already established private label retailers like Trader Joes and Aldi, the U.S. is also starting to see other private label retailers open their own stores and if these stores become trendy, business at larger food retailers may likely suffer. The recent announcement by Lidl, one of the world's largest retailers, involving plans to open 100 new stores by year-end is a perfect example of this trend. Millennials are playing a role in this price sensitive group. According to Retale, a company that specializes in helping consumers obtain local shopping information in cities across the U.S., after surveying 1,000 millennials on what would most likely influence where they purchased groceries, 50% cited lower costs and opportunities to save as their number one motivating factor, while 38% cited availability of locally grown organic products as the second most important factor[4].

T&H believes that stagnant wage growth is a strong driver of this price sensitivity to shopping and even with a strong stock market performance, consumers prefer to hold onto cash for other expenditures such as home improvements rather than spending it on more expensive "branded" food and beverage items. The key takeaway from this consumer analysis is that consumer preferences are becoming increasingly complex, diversified and larger food companies are struggling to defend their brand loyalty while retailers are struggling to find the right product mix and economic model.

Impact of Technology

Social media and the internet: Social media and the internet have lowered the barriers to entry for smaller branded products across the F&B industry. These businesses have grown very efficiently through effective use of social media outlets, while avoiding the heavy marketing costs to create awareness, generating a buzz around their products, and establishing a loyal customer following.

[3] http://www.foxbusiness.com/features/2017/07/06/so-long-hamburger-helper-americas-venerable-2.html

[4] http://www.retale.com/blog/the-retale-millennial-grocery-report/

Platforms such as Twitter, Facebook, Instagram and Pinterest offer businesses ways to gain visibility, remain relevant and collect consumer feedback and data for future and existing product lines.

Consumer feedback can provide a great deal of valuable information - both positive and negative. In addition, a celebrity or someone that has a large social media following can transform a business e.g. George Clooney's association with Casamigos' brand of tequila.

As an example of social media success, Tate's Bake Shop, located in Southampton, N.Y., decided it needed to build out its e-commerce platform. By using Facebook advertising, analyzing social media data and targeting the right audiences, it increased the social media "likes" on two of its brand pages from 1,700 to more than 114,200. By creatively targeting their audience, they acquired these likes at less than 24% of the industry average benchmark cost. After obtaining these social media likes on their page, the company then organized social contests to stay relevant and to keep the Tate's Bake Shop Brand in the mind of consumers. Soon after, Tate's Bake Shop generated more than 87,000 email registrations to their website. By building out its e-commerce platform, it expanded its gluten free product line and saw a threefold increase in gluten free product sales offered through e-commerce[5].

It should also be noted that there have been technological advancements in non-marketing areas that have had an important impact on food and beverage companies. For example, packaging labels and film are now available in much smaller quantities than in prior years and mobile canning lines are enabling beverage companies to minimize their capital costs.

Advances such as these enable small businesses to become more flexible and better able to control costs and minimize inventory levels than in years past. These advancements accelerate the way in which businesses are able to grow their brands and doing so without having to sacrifice significant amounts of working capital is a game changer.

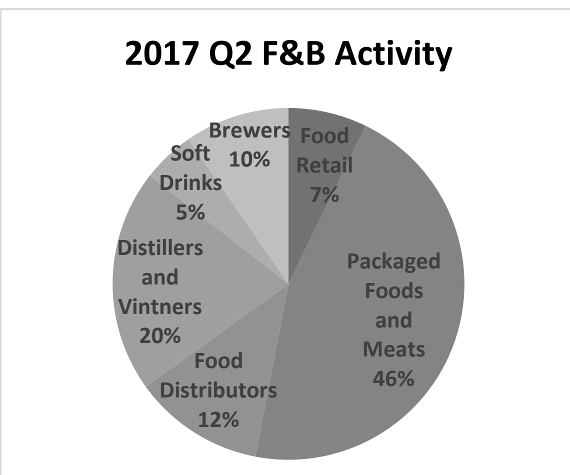
Online Shopping: As we mentioned earlier, the convenience factor of shopping for food using online delivery services such as AmazonFresh is a growing trend. Though many people still like to go to the grocery store themselves to pick out that perfect piece of fruit or a perfect pack of eggs, consumer knowledge that the products delivered by Amazon will be coming from Whole Foods is bound to

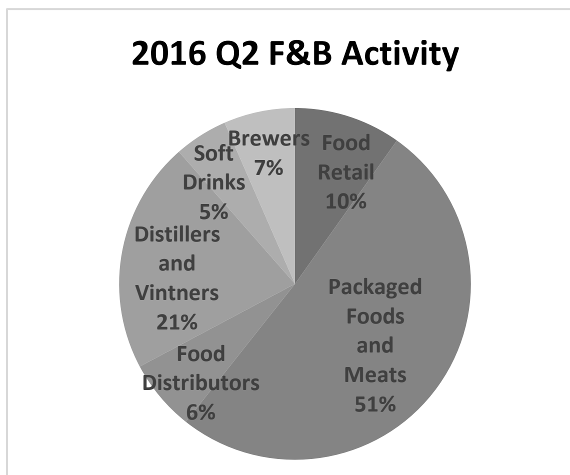
[5] http://socialgoto.com/case-study/tates-bake-shop-social-media/

mitigate some of these concerns. Companies that offer customers convenience and are technologically advanced are better equipped than most to deal with ever-changing consumer tastes. We expect food retail will become a more active M&A sector going forward because of Amazon's foray into grocery business with its acquisition of Whole Foods. As a result, almost all large grocery retailers will be forced to re-examine their business strategy.

T&H Food and Beverage M&A Activity

Q2 2017 Food and Beverage M&A activity is up 33% versus Q2 of last year. With cost cutting measures already pushed to the limit in recent years, larger food and beverage conglomerates are increasingly looking for ways to grow the top line. Though some companies are trying to grow organically and revitalize existing products, many are choosing acquisitions. Campbell's acquisition of Pacific Foods is one recent example of this trend. We have profiled several other similar deals in the last section of this publication. Tully & Holland has also observed that median Enterprise Value / EBITDA and median Enterprise Value / Revenue multiples paid for businesses in the food and beverage sector remain very attractive and have been rising.





Source: Capital IQ

Packaged Foods and Meats remain the most active sector in the F&B space. We are seeing large packaged food companies continue to seek diversification in their food portfolios as they look for growth and as a result, we are seeing consolidation within this sector. In addition, businesses are also divesting less profitable segments and focusing on core operations. The McCormick and Reckitt Benckiser deal is a prime example of this type of activity. McCormick wanted to add more packaged condiments to its brand portfolio (including French's Mustard and Franks Red Hot Sauce), as it looks for additional revenue and Reckitt Benckiser wants to focus on its brands geared towards quality of lifestyle and improving daily routines.

Distillers and Vintners are the second most active space. The tequila market remains hot. Total sales have been growing at an average rate of 5.8% in the U.S. and super premium tequila sales are up 292% in the U.S. since 2002[6]. The Latin American demographic in the U.S. is growing at a fast pace and are among the largest consumers of tequila while other consumers are drawn to improving quality and taste as well as perceived health benefits versus other alcohols. Diageo's purchase of Casamigos (discussed on page 12) indicates the value it sees in the premium tequila space based on the multiple it paid.

Wineries in the US are beginning to operate at full capacity and are looking for expansion opportunities. Gallo, the world's largest family-owned wine company, recently purchased the Stagecoach Vineyard in Napa and Silver Oak Winery recently acquired Ovid, a Napa Valley winery known for Bordeaux and Cabernet for a reported $50 million[7].

Craft Brewers are seeing a slowdown in sales growth in the $23.5B craft beer industry. Sales volume growth that averaged 18% in 2013 and 2014 and 13% in 2015, dropped to 6% in 2016 according to the Brewers Association. The craft beer industry is exhibiting signs of maturation and overall U.S. beer volume sales were down over 1% in the beginning of 2017 and in a recent Goldman Sachs report, the expectation is for overall US beer volume sales to be down in 2017[9]. Sales in the beer segment are declining in part to women drinking more wine and spirits and men turning to a wider range of alcohols including whiskey, tequila and wine. As a result, larger brewers have been losing sales volume and now face over 5,000 brewers fighting for retail shelf space and bar taps. Companies such as Anheuser-Busch InBev have been scooping up craft beer companies (ten published deals) to compete and stay relevant.

6 **Distilled Spirits Council**

7 http://www.cnbc.com/2017/04/21/silver-oak-snags-ovid-as-wine-mergers-are-booming.html

8 https://www.brewbound.com/news/beer-sales-slump-early-2017

9 https://www.washingtonpost.com/news/digger/wp/2017/07/26/beer-sales-are-down-especially-among-the-millennials/?utm_term=.bbdfb10365fa

AB InBev most recently acquired Wicked Weed Brewing, a company that offers a barrel aged and sour beer program. Anheuser-Busch InBev recently announced it is investing $2 Billion in its American breweries over the next four years[10]. The spending will be allocated towards adding capacity. Constellation Brands and Molson Coors have also been active in the craft beer space and we expect these large beer conglomerates to continue the strategic M&A activity in the beer sector.

Valuation of Food & Beverage Companies

Tully & Holland has observed that median Enterprise Value / EBITDA and median Enterprise Value / Revenue multiples paid for businesses in the sector remain very attractive. While this data is somewhat skewed by some particularly elevated multiples, the 17x multiple being paid for businesses is at the highest level since Q4 of 2014. The 20x annual sales multiple Diageo paid for Casamigos tequila and 20x EV/EBITDA multiple McCormick paid for Reckitt Benckiser's food business are but two examples.

Food and Beverage Transaction Multiple Trends	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017 YTD
Median Enterprise Value / EBITDA Transaction Multiples	**8x**	**10x**	**9x**	**8x**	**9x**	**10x**	**11x**	**13x**	**8x**	**12x**	**17x**
Median Enterprise Value / Revenues Transaction Multiples	**0.4x**	**1x**	**1x**	**1x**	**1x**	**1x**	**0.5x**	**1x**	**1x**	**2x**	**3x**

Source: Capital IQ

Competition within in the industry to find high growth businesses with the right product mix and complimentary consumer profile is heating up again. With greater competition and lots of cash sitting on balance sheets, food and beverage multi-nationals are feeling the pressure to invest in growth areas amidst a stable economic backdrop. There is some cyclicality to these valuations, but we believe the current environment will continue for the foreseeable future and as a result, we believe now is a great time to explore a sale of such a business should this be a near term consideration.

[10] http://fortune.com/2017/05/15/anheuser-busch-usa-investment/

About Tully & Holland

Tully & Holland (T&H) is a boutique investment bank that specializes specifically in the consumer products space. Founded over 25 years ago, Tully & Holland has completed dozens of transactions for mid-size food & beverage companies across various sub-sectors. Most recently, T&H assisted Hong Kong based Vitasoy with its divesture of its US subsidiary to Pulmuone Foods, a Seoul, South Korea based food company that produces and markets a broad variety of food products internationally. In addition, T&H recently represented Davidson Specialty Foods in its sale to C&S Wholesale Grocers and Cain Foods in its sale to TreeHouse Foods. In the beverage sector, T&H assisted Independent Brewers, the makers of Magic Hat, in a successful sale to North American Breweries and also advised a wine and spirits company, Geerlings & Wade, in a successful sale to a private strategic buyer. The majority of our assignments involve sell-side clients with an enterprise value between $10mm to $100mm.

T&H is led by a senior management team with significant industry and investment banking experience. Tim Tully, President of T&H, spent almost 20 years advising companies such as Procter & Gamble Co. and General Mills, Inc. and he also held senior management positions with H.J. Heinz Company and RJR Nabisco prior to joining Tully & Holland in 1992.

Tim is joined by his colleagues Jon Pratt and Stuart Rose, who together have a combined more than 85 years of industry and investment banking experience. Tully & Holland brings an unmatched expertise and breadth of knowledge to our clients. This involves imagination and vision, as well as financial acumen. We provide guidance and support to our clients each and every step of the way, from conception to completion.

Notable Recent Deals

- Announced deal valued at $13.7 billion and at a 27% premium on Whole Foods share price
- Distribution capabilities of Amazon and the consumer and food access channels of Whole Foods have potential to reshape the food retail industry
- Currently, most main stream home grocery delivery services from whole foods and other grocers takes ~1-2 days. Amazons technology could provide consumers with grocery delivery service in ~1-2 hours.
- Though Grocery e-Commerce only represents 3% of the $780bn grocery market, we believe the capabilities and products offered by Amazon and Whole foods could change this trend and take away revenues from traditional grocery retailers and increase the demand for M&A in this sector.

- Campbell's announced Pacific Foods has been acquired for $700 million for a revenue multiple of 3.5x
- Pacific Foods makes organic broth and soup and plant based beverages such as almond milk.
- This acquisition really ties into the trend of consumers wanting to eat nutritious products.
- Campbell's looks to find product growth after missing analysts estimates last quarter, a period in which demand was down across its major product lines.

- Diageo's recently acquired super premium tequila maker Casamigos for a record $1bn ($700mm with $300mm in incentives).
- Valuation of 20x annual sales multiple versus a category average of 5x.
- Having the marketing power of Hollywood Actor and Casamigos founder, George Clooney, may help as future international sales driver.
- The three founders of Casamigos plan to continue running the operations of the company.

- Supervalu recently acquired Unified Grocers for $390mm ($114 mm cash) for 100% of outstanding shares.
- Supervalu is one of the largest wholesale food distributors in the United States with annual sales of approximately $13bn.
- The deal is expected to open new avenues for growth at the large wholesaler.

- In a deal valued at $16.6BN, Reckitt Benckiser completed its acquisition of Mead Johnson Nutritionals.
- The valuation is reportedly 17x earnings and is similar in valuation to previous transactions in the infant nutrition market.
- RB CEO, Rakesh Kapoor, cited urbanization and increasing rates of women entering the workforce as reasons for entering the infant nutrition market and he expects the segment to grow 3-5 percent per year in the medium turn.

- McCormick has announced it has acquired Reckitt Benckiser's (RB) food business. RB is known for its French's Mustard and Frank's Red-Hot sauce.
- The deal is for a reported $4.2bn and fetched a 20.4x EBITDA multiple and 6x 2016 Sales Multiple.
- Lawrence Kurzius, chairman and CEO of McCormick, said the acquisition consolidated the groups position as a "one-stop shop for condiment, spice and seasoning needs."

Other Notable Deals (Undisclosed Deal Values)

- The acquisition looks to bolster Anheuser-Busch's versatility in meeting the demands of the craft beer market.
- The company will be added to Anheuser-Busch's operating arm, The High-End Division.
- Felipe Szpigel, president of The High-End Division, mentioned that the Wicked Weed acquisition gives the division new access to the barrel-aged and sour program that Wicked Weed offers.
- The division previously did not own a company that operated in this craft beer segment.
- Craft Brewers sold $23.5bn worth of beer in 2016, over 21% of the U.S. Beer market.

- Capitalizing on the heavy acquisition of west coast wine estates, California based Ponte Family acquired Hawks View Cellars, a company located in Oregon that specializes in high-end Pinot-Noir and Pinot-Gris.
- Valuations for wineries and vineyards on the west coast have risen steadily in recent years due to the need of larger wineries to expand capacity and get ready for the next big trends in the wine sector.

- Constellation brands has acquired Schrader Sellers, a company with one of the most iconic wine portfolios in the world.
- Schrader has the highest-rated Cabernet Sauvignon Portfolio, with 19 100-point ratings from wine advocate.
- Constellation brands looks to expand its foot print in the premium wine segment.