

TULLY & HOLLAND

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U.S. Food Industry Update

‘Good for you’ sector will continue to consolidate in 2016

EXECUTIVE SUMMARY

The U.S. Food industry reported 207 closed M&A transactions in 2015 following a record year in 2014 of 228 transactions. Both years comfortably surpassed the 15-year average of 173. According to IBIS World Report, the industry has been growing at 1% over the last five years and is expected to grow at 1.7% in the next five years owing to an increase in per capita disposal income. Consumers shift towards premium, natural and all-natural brands is intensifying and expected to lift industry revenue. The Kraft-Heinz merger was the biggest story of 2015 creating the fifth largest food-and-beverage company in the world and the third largest in the U.S. Several other big acquisitions also closed in 2015, including that of Hormel Foods and Applegate farms, Mondelez International and Enjoy Life Foods, Hershey and Krave Pure Foods. All these deals were evidence of big corporations acquiring smaller natural and organic companies. These types of acquisitions are likely to continue and the expectation from people in the industry is that food M&A is not declining anytime soon.

KEY TRENDS

Foods and beverages that deliver on both health and convenience will proliferate and gain wider distribution as consumers look for easy ways to incorporate more “good for you” products into their lives.

- **Shift from artificial colors and flavors to natural ingredients:** Manufacturers and producers are pledging to remove artificial ingredients from products. Consumer demand for natural, healthy ingredients and ‘less processed’ food has sky-rocketed, and companies intent on improving the bottom line, are taking notice. Some consumers don't actually need products that are free from gluten, wheat and dairy, but are demanding them anyway, as they consider them to be healthier. Industries have little choice but to respond. According to market research firm Innova Market Insights, the recent surge in mainstream gluten-free

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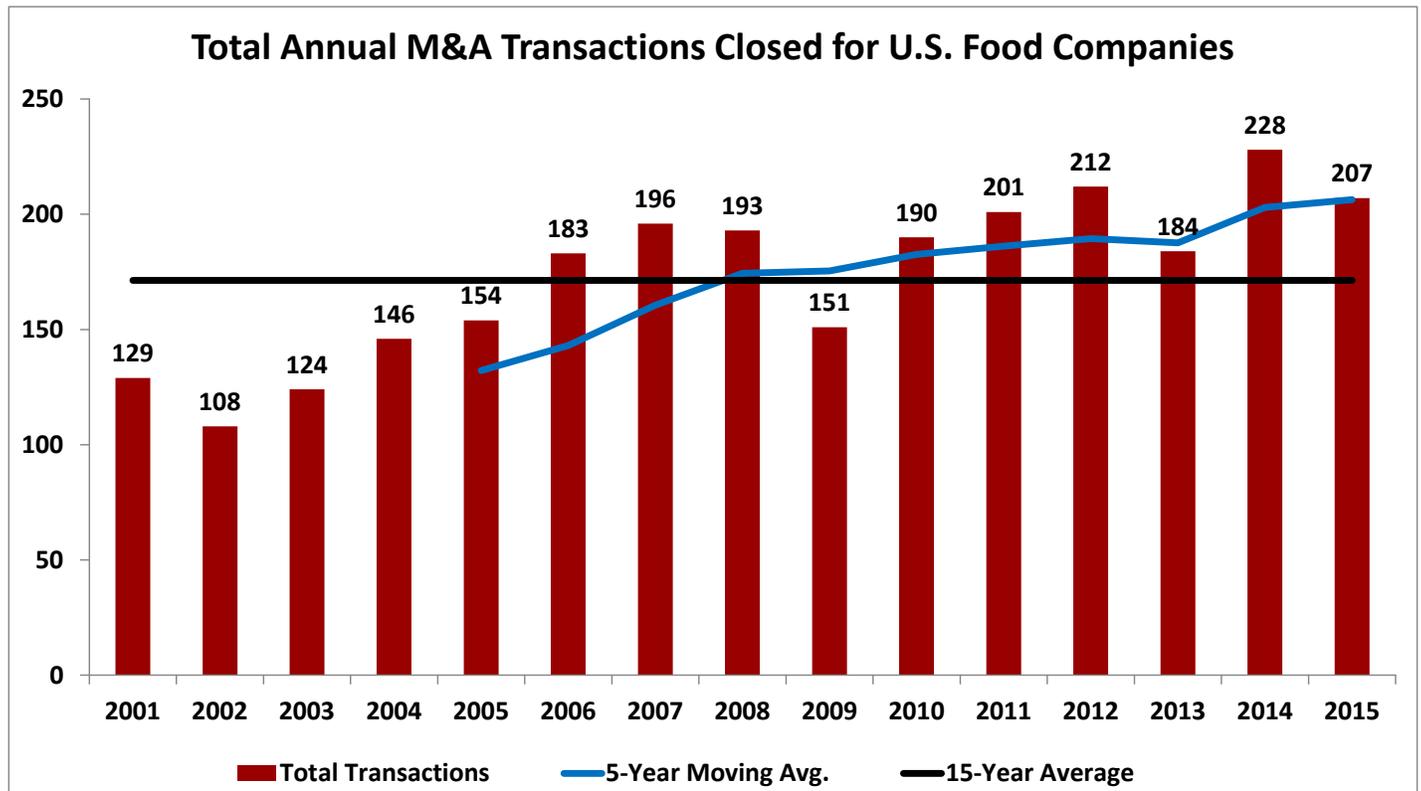
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products has been incredible. This trend could translate to boosts in cereal, candy, and frozen pizza markets, particularly as more natural ingredients get incorporated into these product categories over the next few years.

- **Heightened focus on clear labels:** Food labeling has always been a contentious issue, but food battles are reaching the start of a feverous pitch. “Clear label” established itself as a key trend in 2015, with greater transparency and the focus on simpler products with fewer artificial additives taking “clear label” to the next level. According to a Food Dive report, the biggest surge in new labeling has been reported in organic products, indicating that this will be a key platform going forward in the short term. Another popular category within ‘clear label’ is GMO labeling. The Safe and Accurate Food Labeling Act of 2015, introduced to legislate uniform GMO labelling standards across the country, passed the House but was narrowly defeated in the Senate. However, since Vermont made GMO Labeling mandatory for food companies from July 1 this year, 30 states have followed suit to introduce their own version of the bill. Packaged Facts’ 2015 consumer survey found that almost half (46%) of consumers are looking for foods without genetically modified organisms. Over the last few months, big food companies such as ConAgra Foods Inc., Kellogg Co., General Mills Inc., Mars Inc. and Campbell Soup Co. have committed to GMO labeling on their products nationwide.
- **R&D and Marketing efforts pointed towards “better-for-you” snacks:** Diamond Foods, Nestlé, and others are investing in R&D centers to create products that meet changing consumer needs. Consumption of savory snacks is on the rise across the globe and the main reasons behind the surge according to a report from P&S Market Research, are rising urbanization, increasing per capita income and changing food culture. However, as the Mintel research confirmed, more consumers have changed their definition of what constitutes a snack. These days, packaged healthy snacks include everything from meat and cheese to fruit and yogurt. In 2015, the global savory snacks market totaled \$118 billion, but with an anticipated 7.1% annual growth rate from 2016 to 2020, this segment is expected to reach \$166.6 billion by 2020, according to the P&S report.
- **Increasing emphasis on protein and protein alternatives:** In a survey at the Institute of Food Technologists’ annual meeting and expo, a vast majority of representatives concurred that alternative proteins, ranging from the more commonplace, like chickpeas and quinoa, to the exotic, like seaweed and insects, have the industry’s attention. Packed with protein and nutrients, pulses are elevated when paired with delicious ingredients. In addition, the rise of part-time vegetarians, who have reduced their meat consumption because of health, sustainability and animal welfare concerns, is also having a major impact on new product activity in this category. According to a report from Mintel on the global food and drink market, the growing ranks of novel protein sources and protein replacements is very appealing to the consumer, foreshadowing a profoundly changed market place, where the so-called “alternative” could take over main stream.
- **Healthy living platform:** The benefits of sports nutrition components, such as protein and energy ingredients, can be exploited by all demographic groups and manufacturers, and are therefore diversifying the “healthy living” platform for everyone. Consumers know they need to eat more greens, but shy away because of taste expectations. Children can be encouraged to eat more through hidden vegetable products, while the rise of fusion smoothies and high vegetable pastas indicates that adults also can be encouraged to increase their intake, according to the Innova Market Insights’ report.

M&A TRANSACTIONS

M&A activity for U.S. food companies have been at an all-time high over the last few years. In 2015, there were 207 closed transactions compared to 228 closed transactions in 2014. Although 2015 marked a short-term decline in deal activity for the industry, it remained comfortably above the 15 year average of 174 closed transactions. In terms of transaction size, 25 transactions in both these years were valued above \$100 million. According to Merger Market's Consumer Trend Report, the food sector reported \$80.2 billion in deal value for mergers and acquisitions for the first half of 2015, an increase of 129.9% over H1 2014. This combined with a slight decline in the number of deals during the same period suggests that the 2015 buyers were willing to pay more for valued acquisitions.



Source: Capital IQ

VALUATION ANALYSIS

Reported food enterprise values as a multiple of EBITDA averaged 11.9x in 2015. The Kraft-Heinz deal with an EBITDA of 22.6x had a significant impact on the higher multiple for the year. The EBITDA multiple has remained constant and strong over the last few years owing to continued low cost of capital and increased foreign buyer interest. The 2015 trading multiple is well above the average EBITDA multiple of 9.7x between 2011 and 2013. Enterprise values as a multiple of revenues averaged 1.56x in 2015. This multiple is currently trending slightly above the five year average of 1.54x.

Some of the recently closed M&A transactions in the food sector are highlighted below:

Date	Target/Issuer	Buyers/Investors	Transaction Value (\$mm)
02/29/2016	Diamond Foods, Inc.	Snyder's-Lance, Inc.	1,937.8
02/01/2016	Ralcorp Holdings Inc.	Treehouse Foods, Inc.	2,700.0
01/15/2016	Boulder Brands, Inc.	Pinnacle Foods Inc.	991.4
01/01/2016	US And UK Wine Operations	Treasury Wine Estates Limited	600.0
11/02/2015	Green Giant International, LLC	B&G Foods North America, Inc.	765.0
10/30/2015	Cargill Pork, LLC	JBS USA, LLC	1,450.0
10/16/2015	Archer-Daniels-Midland Company	Olam International Limited	1,300.0
10/09/2015	Sunrise Growers, Inc.	SunOpta Inc.	450.0
09/12/2015	Dave's Killer Bread	Flowers Bakeries, LLC	275.0
08/03/2015	Copper Cane Wines & Provisions,	Constellation Brands Inc.	315.0
07/31/2015	Archer Daniels Midland Company, Global Chocolate Business	Cargill, Incorporated	440.0
07/23/2015	Daybrook Fisheries, Inc.	Oceana Group Ltd.	384.4
07/13/2015	Applegate Farms LLC	Hormel Foods Corporation	775.0
07/02/2015	Kraft Foods Group, Inc.	The Kraft Heinz Company	55,032.0
06/18/2015	Ridley Inc.	Alltech	429.3
05/04/2015	MOM Brands Company	Post Holdings, Inc.	1,151.7
05/02/2015	Sobeys Inc.	Agropur Cooperative	333.6
03/23/2015	Blue Acquisition Group, Inc.	The J. M. Smucker Company	5,769.2

Source: Capital IQ

T & H CONCLUSIONS

In order to adapt to ever-changing consumer preferences, many food and beverage companies have exercised the following options: Change ingredients in current products to make them healthier, develop healthy products, or acquire or merge with a healthy foods company. Not all companies have the desire or resources to make sweeping internal changes to develop healthy products. Most firms see value in offsetting lagging sales of stale brands by acquiring or merging with fast-growing small and mid-sized companies. Recent trends highlight that mergers and acquisitions have proven to be the smart investment in the industry with strong interest from both private equity and strategic buyers.

We expect the middle market will continue to be a strong area of activity as regional banks and larger institutions provide low cost capital. Long term, both international and domestic strategics will continue to seek market share and entrance into new sub-sectors such as natural/organics, offsetting some of the valuation risks for the buyers. This robust M&A activity should result in healthy valuations over the next 12-24 months, particularly for companies focused on the healthy, organic and “good for you” sectors.

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 each client’s needs.

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