

Food & Beverage Industry

M&A Market Update

At A Glance...

- In a special guest column in this issue, Michael Waks of CST Consulting and former VP Global External Development at Kraft Foods shares insights from his novel new statistical study of profitability levels across 80+ food categories.

Mr. Waks makes a strong case of the inherent value to corporate strategists and investors in developing a deep understanding of specific food industry categories and relevant competitors by examining the underlying profitability levels of those categories.

[See inside for more detail on this topic](#)



HT Capital's M&A Market Observations

Over the past half year, HT Capital has observed the following transaction pricing and volume trends based on relevant market data and interactions with domestic and multinational companies, along with family offices and private equity firms that focus on the food and beverage industry:

- Valuations based on EBITDA multiples remained near historically high levels. The average Total Enterprise Value-to-EBITDA multiple for food and beverage transactions in the second and third quarters of 2018 (for which data was disclosed in our selected sample set) was 13.1x. The average revenue multiple during the period was 2.0x.
- Food and beverage M&A transaction volume held steady over the previous two quarters. According to Capital IQ, the second and third quarters of 2018 had 196 announced industry transactions in North America compared to 197 announced transactions in the fourth quarter of 2017 and first quarter of 2018.

Guest Column

By Michael Waks, CST Consulting LLC

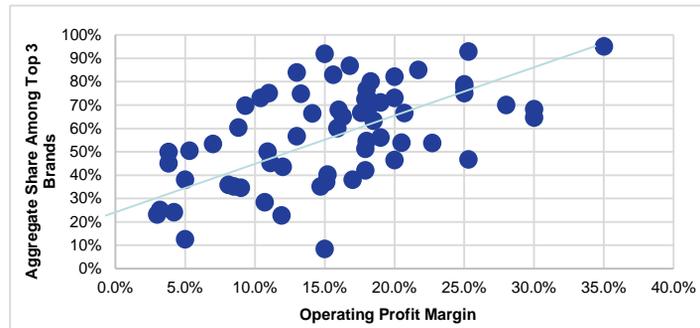
➤ Category Profitability – Lessons Learned

We looked at over 200 profitability figures for branded products across 80 US Food and Beverage categories to see what drives superior performance. Our data came from publicly available company and segment reporting over the past 15 years. Beyond 10-Ks and 10-Qs we looked at exhibits with fairness opinions, material acquisition and divestiture agreements, and litigation by private firms where profits were disclosed (e.g. Arizona Tea). Reported operating profits were “normalized” to adjust for one-time charges such as reserves for litigation, goodwill impairment write-offs, and non-recurring corporate restructuring costs.

It’s nice to have a resource with profitability for 80 categories. Looking back, that would have helped screen the multiple acquisition ideas and proposals my team received each day at Kraft. To think about resource allocation for new product development outside our existing categories. To consider the chances our strategic plans would improve the future profitability of our various businesses. And to inform our competitor analyses and modeling of their sources of cash flow.

Beyond these benefits, the most important finding from our study was that category characteristics determine the level of profitability a firm can be expected to realize. The lowest category profitability in our review was fresh and canned fruits and vegetables with 3-5% operating profit margins. The most attractive categories were energy drinks (28%) and baby formula (25%). Differences in profitability between branded firms competing in a category were modest in comparison and largely fall within three and seven percentage points.

The research (we used statistical experts) found the key drivers of category profitability were:



- Market size. The larger the retail market, the lower the operating profit margin for firms competing in the category. It turns out market size is a good proxy for increased competition. Barriers to entry are low from a manufacturing perspective (e.g. bread, with 12+ firms over \$100M in retail sales) and these large markets can support regional brands as well as national brands.
- Concentration of competition. Higher share among the top three brands/firms supports higher profitability. These firms have sufficient scale to spread fixed costs (SMG&A) and achieve enough profitability to reinvest in innovation. In turn, innovative products leave few gaps for new entrants.
- Private label share. The greater the share held by private label, the lower the profitability level reported by brands. The presence of an advantaged (shelf space is controlled by the retailer), low-cost competitor puts pressure on branded firms to manage price gaps. Branded firms then price lower (and realize lower margins) than would have in the absence of these visible discounters.
- Market growth. Here the positive correlation between growth and profitability was comparatively weak, and only just barely statistically significant. We are likely seeing two counter-balancing forces at work. High growth allows firms to achieve revenue and profit increases without engaging in costly discounting tactics to take share. The offset can be investments in advertising and innovation to spur the topline.

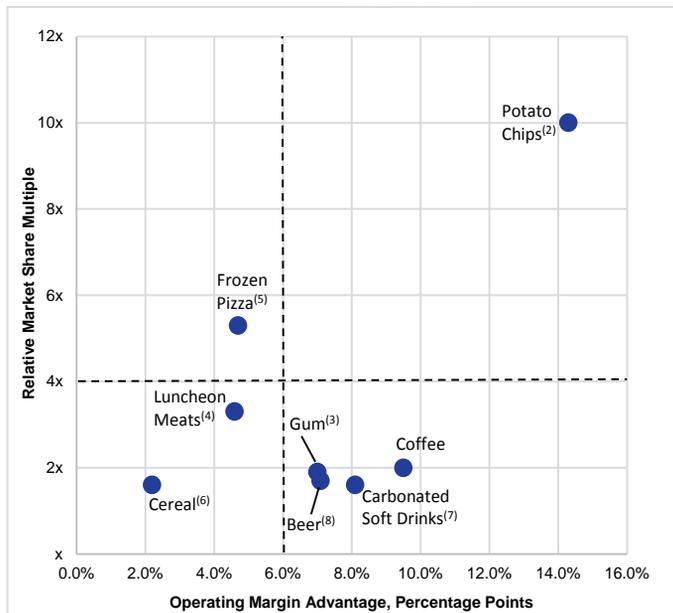
Guest Column (continued)

Corporate strategists and investors will consider these structural aspects, and how the category of interest will change over time, to assess whether current levels of profitability are likely to be maintained, increase, or decline. Savvy private equity investors in search of stable cash flow have long targeted mid-to-small categories with high share concentration and low private label participation. And not prioritized growth. Our data says private equity firms are, generally, considering the right category characteristics to achieve reliability of cash flow.

Some corporations, such as B&G Foods, have taken a similar approach. B&G has been a serial acquirer of niche businesses in categories with low levels of private label share and high branded concentration. They now own 50 brands. Their niche business acquisitions include Polaner jam (1999), Cream of Wheat hot cereal (2007), Mrs. Dash seasoning (2011), and McCann’s Irish Oatmeal (2018).

A riskier approach is betting on growth. Nonetheless, there are a number of private equity firms which have developed expertise in identifying innovative, smaller brands with a meaningful source of competitive differentiation. The private equity firms can attract the right management team and provide growth resources to develop these brands into national prominence. Examples include TSG and their stewardship of Glaceau Vitamin Water and PopChips.

When we look within categories, most of the spread observed in operating profit margins can be explained by the relative market share of the competing brands/companies in a given category. The ability to spread fixed costs over greater revenue/share can readily provide a boost of four to seven percentage points.



For every “rule” there are exceptions. The +20 percentage point difference between Frito Lay in salted snacks (38% operating profit margin) and Kettle Chips (18%), J&J Snacks (11%) and Snyder Lance (7%) is clearly an outlier. Frito Lay has an extreme relative share advantage of 10X. Frito Lay leverages their scale, and defends their share, with the broadest product range, superior store-door delivery system, and extensive advertising. Another outlier is Starbucks. The nearly 20 percentage point difference achieved by Starbucks (38% operating profit margin) in ground coffee versus the competitive average (19%) reflects their brand premium/“Coffee House” credentials, supported by over 8,200 outlets in the US.

For questions concerning this study (available for purchase in January 2019), please contact:

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Mike has 30+ years in M&A and strategy posts in consumer products firms including Unilever, United Brands, Altria, and Kraft.

M&A Transaction Roster

Food & Beverage
Notable Transactions – Second and Third Quarters 2018

Date	Target Company	Buyer	Transaction Size (\$m)	TEV / Revenue	TEV / EBITDA
9/27/2018	Core Nutrition, LLC	Keurig Dr Pepper Inc. (NYSE:KDP)	\$ 453.3	2.3x	-
9/25/2018	All the Assets of Desi Natural Dahi	Raymundo's Food Group, LLC.	-	-	-
9/24/2018	Frozen Soup Business of NORPAC Foods Inc.	Kettle Cuisine, LLC	-	-	-
9/17/2018	Tea Manufacturing Assets Of Redco Foods	Harris Freeman & Company (Harris Tea Company)	-	-	-
9/12/2018	Pirate Brands, LLC [Seller: B&G Foods, Inc. (NYSE:BGS)]	The Hershey Company NYSE:HSY (Amplify Snack Brands, Inc.)	\$ 420.0	4.3x	-
9/11/2018	Florida Food Products, Inc.	MidOcean Partners	-	-	-
9/11/2018	Ciao Bella Gelato Company, Inc.	High Road Craft Ice Cream, Inc.	-	-	-
8/31/2018	Costa Limited	The Coca-Cola Company (NYSE:KO)	\$ 5,100.0	3.0x	16.3x
8/25/2018	Kahiki Foods, Inc.	CJ Cheiljedang Corporation KOSE:A097950 (CJ America, Inc.)	-	-	-
8/20/2018	MFG (USA) Holdings , Inc. and McKey Luxembourg Holdings S.a.r.l.	Tyson Foods, Inc. (NYSE:TSN)	\$ 2,400.0	1.0x	11.4x
8/13/2018	Sandwich Manufacturing Business of Select Foods Products, LLC & Yorkshire Valley Farms Ltd.	Premium Brands Holdings Corporation (TSX:PBH)	\$ 46.2	0.7x	-
8/9/2018	TNT Crust, Inc. [Seller: Tyson Foods, Inc. (NYSE:TSN)]	Peak Rock Capital	-	-	-
8/6/2018	Cookietree, Inc.	C.H. Guenther & Son, Inc.	-	-	-
7/31/2018	Brazi Bites, LLC	San Francisco Equity Partners	-	-	-
7/30/2018	Food Group of Companies of Services Group of America	US Foods Holding Corp. NYSE:USFD (US Foods, Inc.)	\$ 1,800.0	0.6x	14.6x
7/26/2018	AGT Food and Ingredients Inc. (TSX:AGT)	Current Management Team (Led by Pres. & CEO, Murad Al-Katib)	\$ 735.9	0.6x	13.4x
7/20/2018	Insomnia Cookies, LLC	JAB Holdings B.V. (Krispy Kreme)	\$ 500.0	-	-
7/20/2018	Rise Baking Company	Olympus Partners	-	-	-
7/9/2018	U.S. Baking Business Of The J. M. Smucker Company	Brynwood Partners	\$ 375.0	1.0x	-
7/6/2018	Substantially All the Assets of Queen City Candy, Inc.	Highlander Partners, L.P.	-	-	-
7/2/2018	Good Karma Foods, Inc.	Dean Foods Company (NYSE:DF)	\$ 15.0	-	-
6/28/2018	Chobani, LLC (20% Minority Interest)	Healthcare of Ontario Pension Plan	-	-	-
6/27/2018	Pinnacle Foods Inc. (NYSE:PF)	Conagra Brands, Inc. (NYSE:CAG)	\$ 10,986.8	3.4x	15.8x
6/6/2018	Bhakti Chai LLC	Molson Coors Brewing Company (NYSE:TAP)	-	-	-
6/4/2018	Tecumseh Poultry, LLC	Tyson Foods, Inc. (NYSE:TSN)	\$ 382.0	-	10.0x
5/25/2018	Bare Foods Co.	PepsiCo, Inc. NasdaqGS:PEP (Frito-Lay North America, Inc.)	-	-	-
5/23/2018	Shepherd Gourmet Dairy (Ontario) Inc.	Saputo Inc. (TSX:SAP)	\$ 78.2	1.8x	-
5/18/2018	Rogue Creamery	Savencia SA (ENXTPA:SAVE)	-	-	-
5/15/2018	Poultry Rendering and Blending Assets of American Proteins, Inc. and AMPRO Products, Inc.	Tyson Foods, Inc. (NYSE:TSN)	\$ 850.0	1.5x	-
5/6/2018	Tate's Bake Shop, Inc.	Mondelez International, Inc. (NasdaqGS:MDLZ)	\$ 528.0	5.0x	-
4/26/2018	Old Orchard Brands, LLC	Lassonde Industries Inc. (TSX:LAS.A)	\$ 160.0	1.5x	10.1x
Median				1.5x	13.4x
Mean				2.0x	13.1x

Notes:

- Transactions in green are pending
- TEV = Total Enterprise Value
- ND = Not Disclosed
- Estimates based on approximated data are italicized
- *Total consideration may include contingent payments

Sources: MergerMarket, Capital IQ, and HT Capital research

Select Industry Transaction Activity

- **Conagra Brands (NYSE: CAG)** announced in June and completed in October the acquisition of **Pinnacle Foods (NYSE: PF)** or \$10.9 billion in cash and stock. The purchase price represented an adjusted EBITDA multiple of 15.8x based on Pinnacle's estimated FY18 results excluding synergies, and 12.1x adjusted EBITDA inclusive of run rate cost synergies. The acquisition brings together two portfolios of iconic brands, and increases Conagra's share of the faster growing snack and frozen food segments of the packaged food industry.

With over half a century of experience, HT Capital is uniquely qualified to assist you in achieving your strategic objectives. For more information on subjects in this newsletter including the transaction environment or to have a confidential discussion on how HT Capital might be of assistance, please contact our practice leaders Tom Girardi at (212) 319-3701 or tgirardi@htcapital.com or Steve Tardio at (440) 571-1330 or stardio@htcapital.com

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