

# Food & Beverage Industry Snapshot

Grant Thornton Corporate Finance Winter 2011

## Food and beverage industry: 2010 in review

Grant Thornton Corporate Finance LLC (GTCF) is pleased to present the winter 2011 issue of its semiannual *Food & Beverage Industry Snapshot*. This edition contains commentary on key factors that affected the food and beverage industry in 2010 and an overview of M&A trends, including a summary of industry stock market performance. Also featured in this publication is an outlook for 2011 highlighting anticipated developments within the industry.

With offices in more than 100 countries, the partners and employees of Grant Thornton International Ltd member and correspondent firms serve hundreds of food and beverage industry clients ranging from global conglomerates to middle-market companies in all sectors of the industry. GTCF teams have advised more than 50 food and beverage industry M&A transactions over the past three years.

### Overview

This past year was significantly better than 2009 for companies throughout the food and beverage industry. Changes in regulations, increases in commodity prices, and shifts in consumer preferences affected industry participants in varying ways and will eventually change the industry's landscape. M&A volume, transaction value and multiples climbed during 2010 as the economy expanded, lending markets loosened and consumer confidence rose. As we enter 2011, it is helpful to evaluate this past year in order to highlight milestones and key trends within the food and beverage market.

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## Food Safety Modernization Act

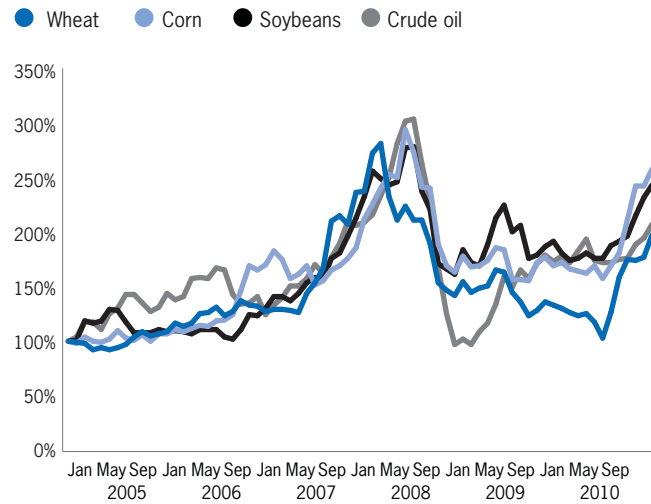
Food safety has been a hot topic for some time now, but it is gaining even more attention with the recent signing of the Food Safety Modernization Act (FSMA), which is regarded as the most comprehensive reform of food supply oversight since the late 1930s. The FSMA, signed into law on Jan. 4, 2011, focuses heavily on prevention rather than reaction and is designed to reduce the incidence of food-related illnesses in the United States. Additionally, the Food and Drug Administration (FDA) now has extensive authority over food and beverage companies, excluding USDA regulated meat, poultry and dairy producers, and small companies (under \$500,000 in sales).

Some of the most important aspects of the bill are summarized below:

- Food production facilities are required to develop written food safety plans and a strategy for implementing corrective actions. Plans also must include consideration of suppliers and an understanding of their ingredients' origins. Companies have 18 months after enactment to have these plans in place.
- The FSMA mandates more inspections and the FDA is now required to inspect high risk facilities every three years (starting within five years of enactment) and non-high risk facilities every five years (starting seven years after enactment). Moreover, the FDA now has the authority to issue direct food recalls, rather than rely on producers' voluntary recalls.
- Although there were already some controls in place, the new law heightens the FDA's ability to verify the safety of imported foods. The FDA has the ability to reject food coming into the United States if the facility has refused U.S. inspection. Moreover, importers will be required to implement supplier verification programs, including activities such as periodic testing, lot certification, on-site inspections and analysis of food safety and production controls.

To a certain extent, companies are already performing a majority of these actions, but the FSMA will force businesses to take an even closer look into their food safety plans, product originations, and quality of goods. It remains to be seen how the new regulations will impact food and beverage companies financially. If the cost of compliance becomes significant, companies with tenuous financial situations could decide that teaming up with a more financially sound player, with significant compliance standards already in place, might make more sense than going it alone. This could lead to additional deal activity in the food and beverage industry.

## Commodity Price Index



Source: International Monetary Fund

## Commodity prices rise

As illustrated in the commodity price index chart above, prices of commodities rallied in the second half of 2010 due to an increased demand coupled with decreased supply.

The spike in commodity prices was driven by China's persistent demand for raw materials and agricultural produce. As the top importer of crops such as cotton and soybeans, China — with its escalating economy and strong yuan — was able to buy commodities at relatively cheap prices. Rapid industrialization, along with a growing population, drove demand.

At the same time, severe weather conditions around the globe cut into commodity supplies. The combination of higher demand and weaker supply naturally pushed up commodity prices. Global wheat prices soared, increasing by 95% in the last six months of 2010 as drought and wildfires ravaged wheat crops in Russia. Supply reductions coupled with the country's self-imposed ban on wheat exports put further pressure on prices. Corn and soybean prices also climbed as adverse weather conditions in the United States led to smaller-than-expected harvests. As depicted in the chart, corn and soybean prices rose by 64% and 39%, respectively, in the last half of 2010.

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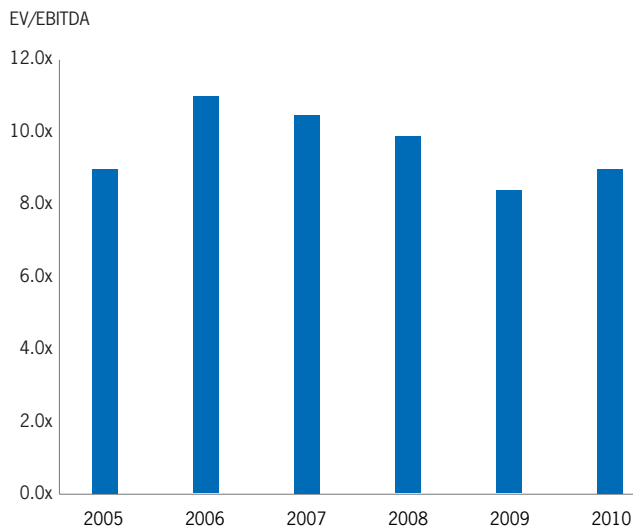
**Global wheat prices soared, increasing by 95% in the last six months of 2010 as drought and wildfires ravaged wheat crops in Russia.**

## Changing consumer preferences

Given the rise in consumer awareness regarding a healthier lifestyle, there has been a surge in innovation from food and beverage companies to meet rising demand. This direction is exemplified by PepsiCo's focus on its good-for-you product line, which currently generates \$10 billion in sales through brands such as Tropicana, Naked Juice, Aquafina and Quaker Oats, among others. PepsiCo's strategic plan is to grow its nutrition business to \$30 billion by 2020. The company has already started making strides toward its goal by agreeing to acquire, pending required government approvals, 66% of Wimm-Bill-Dann Foods OJSC (NYSE: WBD), which is Russia's leading dairy and juice company. PepsiCo plans to target more acquisitions in an effort to build its good-for-you product line.

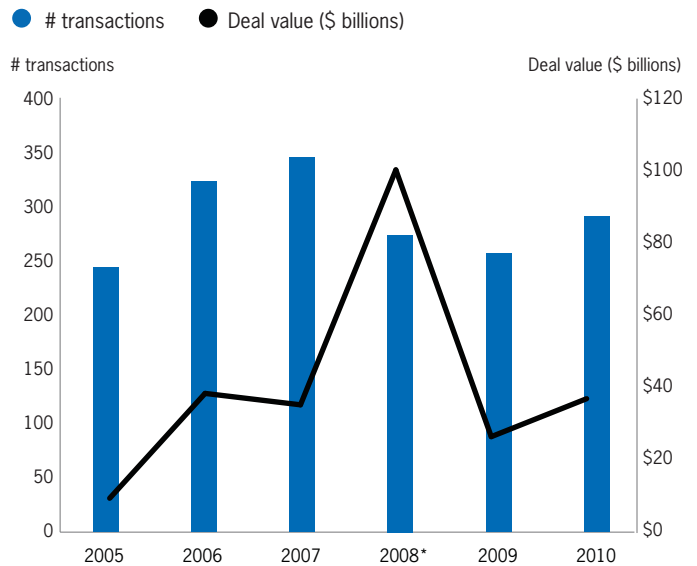
Products labeled organic or natural are generating more and more demand as consumers look for healthier food items. The White House has furthered this trend by enacting the Healthy, Hunger-Free Kids Act of 2010 (HHFKA). Among the HHFKA's provisions are new nutritional standards for all foods sold in schools, including food items sold in vending machines. This act will undoubtedly bolster the already rising trend of replacing vending machines that offer soda, candy and cookies with machines that offer juice, fruits and granola bars.

## Median EV/EBITDA multiples



Sources: GTCF research; certain financial information provided by Capital IQ, Inc.

## Food and beverage industry M&A activity



Sources: GTCF research; certain financial information provided by Capital IQ, Inc.

\*Deal value in 2008 was significantly high as a result of two large transactions – Mars' acquisition of Wrigley and InBev's purchase of Anheuser-Busch Cos. Inc.

## M&A activity

Although the number of announced food and beverage transactions remained significantly below 2007 levels, it was still higher in 2010 than in the previous two years. The number of food and beverage transactions showed a 13% rise from 255 in 2009 to 289 in 2010. This uptick in activity is not surprising, given the improving economic outlook and loosening credit markets. Deal value increased more sharply, rising by almost 42% in 2010; there were 14 transactions valued above \$500 million announced in 2010, compared with only eight such transactions in 2009.

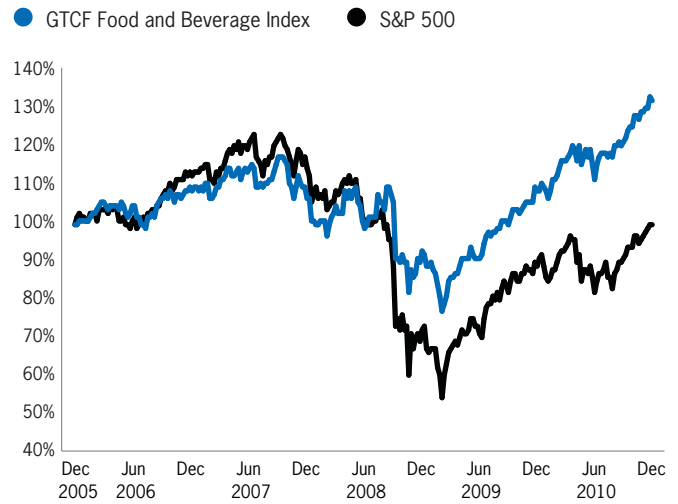
In addition, according to GTCF analysis of food and beverage valuation trends, median valuation levels rose from 8.4x EBITDA in 2009 to 9.0x EBITDA in 2010. Perhaps not surprisingly, as credit markets have loosened, additional competition for acquisition targets has taken place in terms of both the number of bidders for attractive targets and the price acquirers are able to afford, with the end result being higher multiples.

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An expanding economy and the desire to grow led to a number of significant M&A transactions in 2010. Following are a few of the most notable deals:

- In February, PepsiCo completed the acquisition of two of its bottling companies — PepsiAmericas and Pepsi Bottling Group — in an effort to integrate its supply chain more fully. The company now manages nearly 80% of its total North American beverage volume distribution.
- Rival Coca-Cola followed suit in October as it acquired the North American business of Coca-Cola Enterprises (CCE) while simultaneously folding its bottling operations in Norway and Sweden into CCE. The deal gives CCE the option to purchase an 83% stake in its German bottler and gives Coca-Cola 90% control over its North American bottling. Coca-Cola believes that this deal strengthens its competitive position and allows it to benefit from shared synergies.
- GTCF's winter 2010 *Food & Beverage Industry Snapshot* discussed the high-profile pending merger of Kraft Foods and Cadbury. Since then, the two companies have come together; Kraft acquired Cadbury for almost \$22 billion, or 11.4x EBITDA. Kraft now has an estimated 15% of the global market share for chocolate and candy, and the company controls more than one-quarter of the global gum market.

#### Grant Thornton Corporate Finance Food and Beverage Index



Sources: Public company filings; certain financial information provided by Capital IQ, Inc.

#### Stock market performance

The GTCF Food and Beverage Index shown above reflects data from industry participants that are broadly categorized as food processors, food distributors, food retailers and beverage companies. Public market information indicates that the GTCF Food and Beverage Index is up by more than 10% from its October 2007 highs, while the S&P 500 has not yet reached those levels. The food and beverage industry is relatively stable because consumers use it, on average, three times a day. Food and Beverage Index companies have outpaced the broader market since 2008 as a result of the industry's ability to tailor its products easily to consumers' wants and needs.

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## Food and beverage EBITDA multiples

Category	Average metrics					Historical metrics
	% of 52-week high	Enterprise value (\$mm)	LTM EBITDA %	EV/EBIT	LTM EV/EBITDA	12/31/09 EV/EBITDA
Food distributors	94.1%	\$5,948	4.6%	9.9x	8.0x	7.3x
Food retailers	94.8%	\$23,261	14.8%	14.2x	9.7x	8.4x
Food processors	93.9%	\$47,983	16.5%	13.0x	10.3x	9.3x
Beverage companies	94.4%	\$35,619	22.8%	14.6x	10.8x	10.5x
<b>Average</b>	<b>94.3%</b>	<b>\$28,203</b>	<b>14.7%</b>	<b>12.9x</b>	<b>9.7x</b>	<b>8.9x</b>

As of 12/31/2010

Sources: Public company filings; certain financial information provided by Capital IQ, Inc.

As shown in the chart above, EBITDA multiples have mirrored GTCF Food and Beverage Index company performance. Multiples in each of the four categories increased from 2009 to 2010. As of Dec. 31, 2010, food distributors traded at approximately 8.0x EBITDA, food retailers traded at about 9.7x EBITDA, food processors traded at nearly 10.3x EBITDA, and beverage companies traded at 10.8x EBITDA.



## 2011 outlook

Even though food and beverage companies will have to face new challenges in 2011, there is great optimism for the new year. The FSMA will have major effects on food and beverage companies as it redefines the way the industry does business. Consumer preferences will also affect the industry as rising awareness of obesity, diabetes and other health problems prompts individuals to improve their eating habits. But the No. 1 cause for concern in the industry is commodity prices. Drastic rises in commodity prices could kill the nation's economic recovery and significantly affect food and beverage companies in a very negative way. However, if commodity price increases taper off and the economy continues to improve, we will likely see further credit market loosening and heightened deal activity. •

### About Grant Thornton Corporate Finance LLC

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