

**FARRELLY
& MITCHELL**

Food & Agri-Business Specialists



A FARRELLY & MITCHELL REPORT

Food & Beverage Trends: How Changing Consumer Preferences are Influencing M&A

Farrelly & Mitchell examine the changing tastes and expectations of today's consumer and how they influence M&A

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Preface and acknowledgements

Farrelly & Mitchell is pleased to present our report which focuses on identifying evolving consumer tastes and preferences and how these influence M&A in the global and MENA Food and Beverage industry.

We have a distinct understanding of consumer behaviour within the industry thanks to our extensive experience working with clients globally . We put this knowledge to good use in the report to discuss the M&A outlook in the Food and Beverage industry for the near future, and we highlight the importance of some preliminary evaluation steps for investors when pursuing transactions in his space.

We would like to thank all who contributed for their valuable input.

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Contents

At a glance	04
M&A as a pivotal platform to address a new consumer	04
Innovate or get left behind	05
M&A deals in food and beverage: A global overview	06
M&A deals in food and beverage: A MENA overview	08
Closing thoughts	11





At a glance

- Staying relevant to the consumer is becoming the biggest challenge to Food & Beverage (F&B) companies
- Acquiring successful companies with innovative portfolios is becoming a plug-in practice of large, cash-rich companies seeking quick wins
- Consumers are increasingly scrutinising product labels searching for “fresh”, “natural”, and “authentic”. Small to mid-sized companies are actively addressing these needs
- North America and Europe accounted for over 80% of \$365 Billion worth of global consumer product deals in 2017
- Beverages, Agriculture and Protein producers account for almost 50% of the M&A deals in North America
- Telling the right story is now catching consumer attention more than the brand and the price tag
- There were approximately 60 reported transactions in the MENA region in the past 5 years, and the GCC accounts for over 60% of the deals
- Private equity firms are also seeking to invest in high-performing small to medium-sized companies
- The importance of due diligence cannot be overlooked to outline the balance between opportunity and risk, which helps to improve the buyer’s negotiating position

M&A as a pivotal platform to address a new consumer

Consumers have evolved, and so have their purchase decisions. They now expect relevance, innovation and differentiation in favour of traditional factors such as price and brand. Innovative F&B companies are increasingly focusing on these through M&A to stay connected with this new era consumer.



STAYING RELEVANT

We see this is today’s consumer’s attitude to sugar. An overall reduction in sugar intake has become a significant threat to carbonated soft drink manufactures. In an attempt to stay relevant, market leaders Coca Cola and PepsiCo expanded their horizons within the beverages category to retain market shares, leading to business expansions and multiple acquisitions into juices, energy drinks, tea, coffee, bottled water and snacks.

Staying relevant to the consumer is becoming the biggest challenge to Food & Beverage companies.



Innovate or get left behind

Constant innovation is now an essential activity for F&B companies to stay relevant to consumers, but substantial efforts and capital investment in product development still has limitations in success rates of launches. As a result, acquiring successful companies with innovative portfolios is becoming a plug-in practice of cash-rich large companies; outsourcing innovation to lead the next growth wave. Some high-performing small to medium-sized companies are keen to get acquired by a large firm.

For example, Danone acquired WhiteWave which offers plant-based alternatives to dairy and organic dairy products throughout North America and Europe. Although it is a relatively niche space in the dairy category, growing consumer preferences for dairy alternatives and organic dairy has caught the attention of the dairy giant.

In another case, meat giant Tyson Food invested in plant-based protein companies like Beyond Meat and Memphis Meats. For both deals, the underlying theme was to stay relevant to consumers in the respective categories by acquiring innovation.

Acquiring successful companies with innovative portfolios is becoming a plug-in practice of large cash-rich companies.

The need for clear differentiation

Telling the right story to drive business value and connect with consumers is the last leg in successfully recognising the new consumer. Consumers are increasingly scrutinising product labels; trying to understand what makes “Product A” different to “Product B”. Buzz words like **fresh, natural, authentic, locally sourced, hormone-free, no preservatives, gluten-free, alcohol-free** are drawing in this new era consumer. Large F&B companies have traditionally sold these products in more standard formats, while small to mid-sized

companies have started addressing evolving expectations by creating niche segments within each category; a key reason for large companies acquiring them.

The rise of social media as a critical communication channel plays a crucial part in staying connected with the consumer; bringing the story to life when they are online.

Consumers are increasingly scrutinising product labels searching for words like fresh, natural, and authentic. Small to mid-sized companies are actively addressing these needs.





M&A deals in food and beverage: A global overview

GLOBAL CONSUMER PRODUCTS DEAL VALUE OVERVIEW

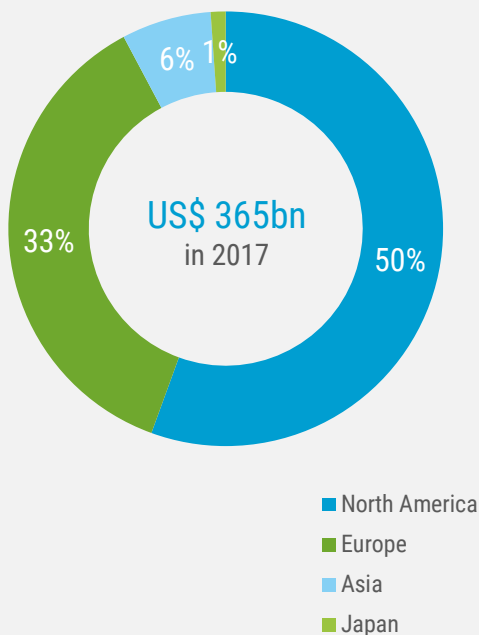
North America and Europe are the most active regions globally for consumer products M&A. Of the total estimated deal value of around \$365 billion in 2017, North America alone accounted for a 50% share, followed by Europe with an approximate 33% share. The presence of global head offices of consumer product companies in these regions is a key reason for these larger shares.

ACTIVE FOOD SEGMENTS FOR DEALS

Beverages (alcoholic and non-alcoholic), Agriculture and Protein Producers attracted higher M&A activity in North America, accounting for almost half of all transactions. Industry consolidation is understood to be the key reason. Although emerging segments like Better-for-you and Specialty Pet are limited at this point, Farrelly & Mitchell expects increased activity over the forecast period due to increased consumer attention in these segments.

Beverages, Agriculture and Protein producers account for almost 50% of consumer product M&A deals in North America.

North America and Europe account over 80% of \$365 billion of global consumer products deals in 2017.



Source: Mergermarket





EBITDA MULTIPLES OF KEY FOOD SEGMENTS IN NORTH AMERICA

- Speciality pet, alcoholic beverages and better-for-you companies commanded higher median EBITDA multiples
- Confectionery and non-alcoholic beverages are in the next league of commanding attractive median EBITDA multiples
- Established commodity segments are offered relatively fewer multiples EV/LTM EBITDA Multiple - 5 years Median (2013-2018)



Share of deals by sub-sectors within F&B in North America, 2017

EV = Enterprise Value (Market Capitalisation + Total Debt + Preferred Equity – Cash and Short-Term Investments)

LTM = last twelve months



OUTLOOK OF M&A IN THE GLOBAL F&B INDUSTRY

Historically, the practice of M&A was deployed by many companies as a way to grow and expand in their home market or intentionally. However, evolving expectations are changing the dynamics in recent years. As for the future, the factors mentioned below will be the key drivers of M&A in the global F&B space.

- Diminishing importance of Brand - Growth of small to medium companies
- Interest beyond core business - To stay relevant, expanding from product segment to product category
- Prominence of Private Equity PE firms - Substantial cash reserves leading to increased investment appetite
- Expand strategic reach - Geographical expansion or strengthening supply chain by acquiring distributors or suppliers

Diminishing importance of brand

There is a growth of small to medium-sized companies addressing different and emerging consumer expectations which have displaced the importance of brand. Instead, telling the right story and keeping the communication focused and simple is attracting more consumer attention. Large firms in the F&B space have begun to realise the shift and are screening quick wins for acquisitions.



Beyond core business

Traditionally, M&A was mostly practised within the product segment. However, companies' business interests have broadened to larger product categories or adjacent businesses to address a more considerable consumer interest. As a result, companies will start to consider acquisitions within their respective categories. For example, Hershey acquired Amplify Snack Brands to become a broader snacking company as opposed to a chocolate company.

Prominence of Private Equity firms

Substantial cash reserves within PE firms and relatively low interest rates have increased the appeal to invest in F&B companies. At the moment, they are one of the strongest investors in the space. Typically, PE investments are strategic; they tend to buy companies at different links in the supply chain and integrate. So even a small company can be acquired if there is a strategic fit to the overall vertical.

Notable deals by PE firms include:

- Unilever's spread business was acquired by private equity firm KKR for \$8 Bn.
- Brynwood Partners acquired Pillsbury and other brands for \$375 Mn.
- More strikingly, major food companies have launched investment vehicles to invest in emerging companies. For example, Danone launched Danone Manifesto Ventures, and Barilla launched Blu1877.

Expand strategic reach

As part of long-term strategic plans, companies are keen to expand geographical reach. Acquiring a company or distributor in the target geography is becoming an easier route to win. For example, Amazon's acquisition of Whole Foods indicates its strategic plan to expand market reach to physical retail stores.

Telling the right story is attracting consumer attention today, more than the brand. PE firms are one of the most active investors in the F&B space.

M&A deals in food and beverage: A MENA overview

M&A activity in the MENA region food industry grew substantially in the past five years, with more than 60 reported transactions. Beverages, Bakery and Protein/Meat are some of the most active categories which accounted for more than 55% of the deals.

UAE and Saudi Arabia are the most active investors, accounting for a 60% share of the total number of deals with a 40% and 20% share respectively.

However, based on limited published available information on the size of some of the deals, Dairy, Protein/Meat and Bakery accounted for over 80% share size. Dairy accounted for over 50% followed by Protein/Meat and Bakery taking a share of around 19% and 13% share respectively.

More than 60 transactions were reported in MENA in the past five years. The GCC accounts over 60% of the deals.





M&A OUTLOOK IN THE MENA FOOD AND BEVERAGE INDUSTRY

M&A activity is expected to intensify further over the next few years in the MENA region. Based on our experience advising numerous clients in transactions and our deep understanding of the Food & Beverage industry in the region, Farrelly & Mitchell foresee a number of aspects driving future F&B transactions in the MENA region:

1. Large companies are looking to consolidate

Due to anticipated changes in subsidy regimes by the local governments and an emphasis on economic diversification, the importance of scale of economies is expected to increase. Large companies are expected to consider acquisitions within their respective business to improve competitiveness.

Key sectors to notice the effect:

- Dairy
- Poultry
- Bottled water
- Processed meat
- Food ingredients and Bakery
- Frozen food

2. Middle market companies are hungry for investments

The economic situation in the MENA region slowed down the influx of investment over the past few years, which impacted both investors and companies seeking investment. Middle market companies, in particular, are affected due to a lack of sufficient funds for business expansions. Conversely, the situation left many PE companies with substantial cash reserves.

As a strategic step to mitigate economic challenges, many PE firms are seeking to take small steps and invest in high-performing medium capped companies.

Private Equity firms are seeking to invest in high-performing medium capped companies.



Key sectors to notice the effect:

- Snacks
- Condiments
- Health & Wellness foods
- Specialty food processing
- Cafes
- Processed meat
- Frozen food

3. Global companies are seeking a local presence

A local presence is increasingly becoming an essential factor for success because of market penetration, proximity to the customer to better understand their needs, strategic location for exports to MENA, among others. Some global F&B companies are seeking to invest or acquire regional companies to gain a local foothold.

Key sectors to notice the effect:

- Dairy ingredients
- Condiments
- Processed meat
- Snacks
- Processed food
- Frozen food
- Canned food

4. Commercial and technical due diligence is seen as crucial in M&A

Due diligence is a critical step in the M&A process to evaluate the opportunity and highlight red flags in investment decisions before finalising the deal. Along with assessing many different areas of the target business, commercial and technical due diligence, in particular, are considered to be essential first steps.



Key evaluation points include:

Commercial due diligence

ASSESSMENT	COVERAGE	KEY POINTS
Existing potential of the target	Market and competition	Typically cover aspects related to target’s position in the market. Drivers and disruptions in the market which could impact target’s business. Competition dynamics and target’s differentiators etc.
Future potential of the target	Value creation	Perhaps the most important part of the commercial due diligence to understand value the target can unlock, assuming possible ways of expansion within the core and adjacent business
Business plan	Business plan	Ratify proposed business plan assumptions and understand how realistic the plan is based on market conditions and industry benchmarks

Technical due diligence

ASSESSMENT	COVERAGE	KEY POINTS
Capability assessment	Operational audit	Mapping the capabilities of the facility and reviewing operational standards
Performance assessment	Technical performance	Evaluating performance based on the capabilities. Remaining life of assets, supply chain assessment etc.
Gaps and improvements	Expansion potential	Performance improvement opportunities and evaluating of proposed expansion plans etc.

5. CDD & TDD should not be overlooked

Commercial and technical due diligence uncovers the hidden upside of deals and highlights the target’s market position. Technical due diligence highlights operational capabilities and gaps, and a combined assessment of these two—factoring in internal and external impact factors—gives a holistic understanding of the potential of the target company. Importantly, it indicates the balance between opportunity and risk, which eventually improves a buyer’s negotiating position.

Commercial and technical due diligence outlines the balance between opportunity and risk, which helps to improve a buyer’s negotiating position.





About us

Farrelly & Mitchell empower some of the world's most ambitious companies and agencies to make the right decisions. With expert insight, local market intelligence and airtight recommendations, we build and implement sustainable strategies that allow our clients to restructure, transform and grow.

We have the hands-on industry experience and expertise, which we combine with local market insight and contacts to help our agribusiness, food and beverage clients to increase profits and improve efficiencies.

What makes us different?

We go above and beyond traditional consultants. As an international management consultancy, we specialise in the global food and agribusiness industry, with a particular focus on the implementation or execution of our recommendations. So we are committed to working with our clients, not just in the development or planning phase of a project, but importantly in its full implementation.

Food an agribusiness specialists

We understand food and agribusiness; we built our experience in this sector, and we employ the best global talent to provide in-depth solutions by addressing real problems sustainably and creating new opportunities for clients.

For the past decade, we have worked with clients across the globe and generated measurable results. We have worked on mandates across every link of the food and agribusiness value chain from large-scale farming operations to food or beverage manufacturing, distribution, retail and hospitality.

Each member of our team of over 200 experienced consultants has worked in industry at an operational and executive level.

We work globally with significant experience in Europe, Middle East and African markets.

Why partner with Farrelly & Mitchell?

Our team has worked at operational and strategic levels all over the European, Middle Eastern, and broader international food, beverage and agribusiness sectors. We have seen projects through from paddock to plate.

We understand the opportunities presented by the growth of the food, beverage and agribusiness sectors, in the Gulf region and across the globe. We work with primary producers, manufacturers, distributors and retailers.

If you are you looking to grow or expand your business, improve efficiency or quality control, or are buying or selling a business, get in touch, and let Farrelly & Mitchell become your project partners.

Farrelly & Mitchell

Global specialists in agribusiness & food



200+
Sector
Specialists



Global
Reach &
Experience



Established
Over 15 years



Clients
Corporate &
Government



Strength
Operational
& Strategic



Value chain
Farm to Fork



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