Grant Thornton

Food & Beverage Industry Snapshot

Grant Thornton Corporate Finance Summer 2010

Milk does a market good

Grant Thornton Corporate Finance LLC (GTCF) is pleased to present its semiannual *Food & Beverage Industry Snapshot.* This snapshot contains timely commentary on key factors affecting the food and beverage industry, an overview of trends in mergers and acquisitions (M&A), and a summary of industry stock market performance. Each issue also includes a sector focus section discussing trends, M&A activity and public market information for a selected industry subgroup. This issue features the dairy sector.

Through 110 worldwide offices, the partners and employees of Grant Thornton International Ltd member and correspondent firms serve several hundred food and beverage industry clients ranging from global conglomerates to middle-market companies in all sectors of the industry. GTCF teams have advised on more than 50 food and beverage industry M&A transactions over the past three years.

Overview

In the first half of 2010, food and beverage industry performance mirrored that of the overall U.S. economy, improving at a measured pace. This more optimistic climate has benefited many industry participants, as consumer spending on luxury items has increased relative to 2009. Gains have been unevenly distributed though, as consumer behaviors and preferences continue to change the shape of the U.S. food and beverage industry:

- Consumer spending on luxury items such as dining out has increased relative to 2009, and that increase is expected to continue. According to the National Restaurant Association, restaurant revenue is expected to increase 2.5% during 2010 (compared with a 0.7% year-over-year decline in 2009). Operators are encouraging this trend by offering special menu items, partial-order options and discounts to entice guests.

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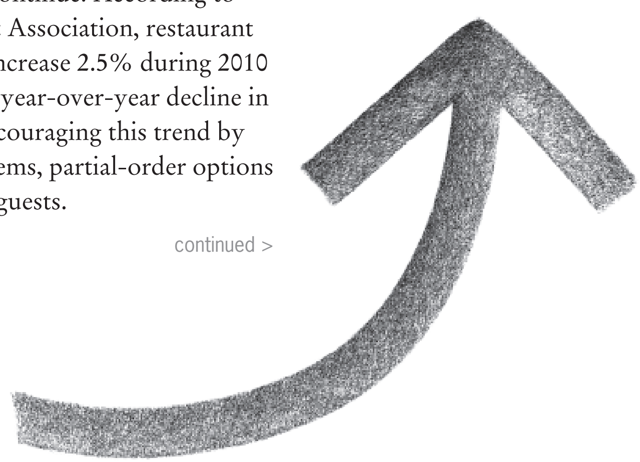

Further increases in M&A activity are expected as the credit markets continue to loosen.

- Similarly, after a temporary slowdown to 5.1% growth during 2009, the organic food niche is expected to bounce back during 2010, though it is not expected to reach its former double-digit growth pace. Relative price concerns compared with other non-organic food items is less of a factor in an improving economy, and the continued focus on healthy lifestyles and healthy eating is fueling demand.

- The healthy lifestyle trend in the United States has had a corresponding effect on less-healthy food options. Purveyors of items considered to be unhealthy — high-fat, high-cholesterol and sugar-laden snack foods and drinks — are bearing the brunt of consumer sentiment increasingly favoring healthier alternatives. Consumer awareness of topics such as childhood obesity and diabetes has grown with increased media coverage. Even the White House has entered the fray with its Anti-Childhood Obesity Action Plan, which, among other things, pushes for reduced availability of these types of snacks in schools.

- Concurrent with the marketing problems for unhealthy food items, several states have enacted a so-called "sin tax" on sweet drinks in an effort to limit consumption and promote healthier living. Further legislative action along these lines is expected.

Trends in the metrics

The measured improvement in the overall economy and in food and beverage industry performance has translated into a slight increase in M&A activity. Through the first half of 2010, 136 U.S.-based M&A transactions were announced, compared with 110 in the first half of 2009. Valuation levels are also improving, as the average multiple on announced transactions ticked up slightly over one quarter of a point.

Further increases in M&A activity are expected as the credit markets continue to loosen. Private equity firms, historically very active participants in food and beverage sector M&A, have an enormous amount of dry powder available for deals and have become increasingly active in the sector during the past six months. Assuming the economic recovery continues, look for increased demand for food and beverage companies from the private equity sector.

Despite the overall economic improvements, many food and beverage industry players have been forced into distressed transaction processes such as bankruptcy or even liquidation. While painful for those involved, these activities do provide opportunities for more financially stable players to gain market share, acquire attractive assets and strengthen their own operations. Further, a bankruptcy may not be the end for some of these companies, as some businesses successfully use the bankruptcy code to shed liabilities and unprofitable operations, emerging stronger than before.

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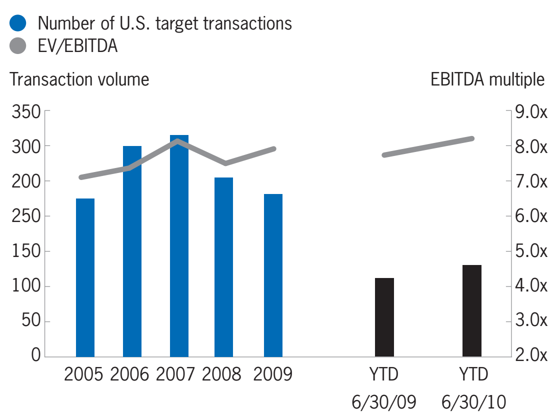
Food and beverage industry M&A activity



Sources: Grant Thornton Corporate Finance LLC; certain information taken from Capital IQ

Public market performance

GTCF monitors a large, diverse set of food and beverage industry participants that are publicly traded on various U.S. stock exchanges. Reviewing the relative performance of these companies in the aggregate against a benchmark such as the S&P 500 can provide insight into how the industry is perceived by well-informed investors and what is expected in terms of future performance.

Since June 2007, both the GTCF Food and Beverage Index and the S&P 500 have dropped dramatically and recovered, with the food and beverage industry even rising above its June 2007 level. Meanwhile, the broader market has yet to fully recover and has been showing some signs of weakening in recent weeks.

From a relative valuation perspective, a multiple comparing enterprise value (the market value of equity plus debt minus cash) with EBITDA (earnings before interest, taxes, depreciation and amortization) is commonly used. The terms of the equation include the total value of the company for all stakeholders (equity and debt holders) compared with an earnings figure that is capital structure-neutral and closer to true cash flow than a term such as net income would be. Other earnings and revenue metrics are also used, though to a lesser extent.

As shown in the chart below, EBITDA multiples for three out of four food-related categories have increased relative to 2009, while multiples for beverage companies have remained stable. Improving multiples in the food sector are attributable to a steady return to profitability and growth expectations in the near term. Conversely, beverage companies — a category dominated by Coke and Pepsi — are under increasing pressure from the healthy lifestyle trend. Growth in the near term is expected to slow while participants re-engineer offerings to address the new paradigm.

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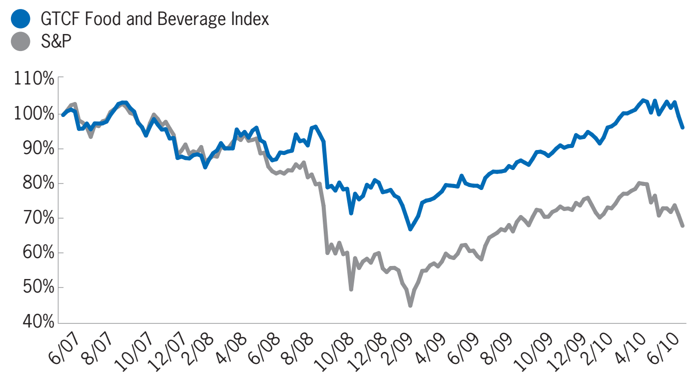
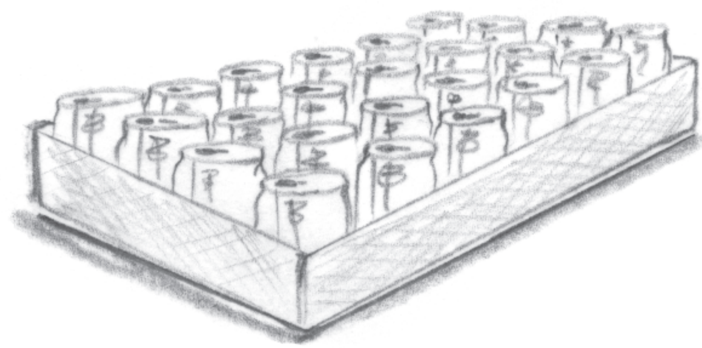
Three-year comparison: GTCF Food and Beverage Index vs. S&P 500



Sources: Public company filings; certain information taken from Capital IQ



Food and beverage EBITDA multiples

	Average metrics				Historical metrics
Category	Enterprise value ($mm)	LTM EBITDA %	EV/EBIT	LTM EV/ EBITDA	6/30/09 EV/EBITDA
Food distributors	$6,398	5.1%	9.7x	8.1x	8.0x
Food retailers	$19,420	14.6%	12.0x	8.1x	7.5x
Food processors	$41,258	16.8%	11.3x	9.3x	9.1x
Beverage companies	$30,618	22.6%	13.2x	9.9x	9.9x
Average	**$24,424**	**14.8%**	**11.5x**	**8.8x**	**8.6x**

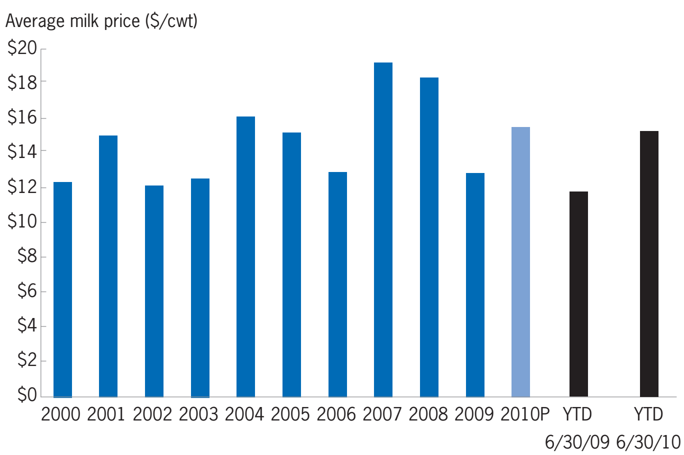
As of 6/30/10
Sources: Public company filings; certain information taken from Capital IQ

Sector focus — dairy

Dairy products are ubiquitous in the United States. They are a staple of the American diet and a critical sector in the food and beverage industry. The $90 billion dairy industry includes more than 1,200 companies, with four very large players: Dean Foods, Dairy Farmers of America, Land O'Lakes and Kraft Foods. Even though industry performance has fluctuated significantly over the past few years, the outlook is increasingly optimistic.

U.S. dairy prices reached record highs in 2007, averaging $19 per cwt (cwt = 100 pounds) for the year, as shown in the "Historical and forecasted all-milk price" chart. Dry weather conditions forced a decline in supply from two chief dairy export nations, Australia and New Zealand, which put upward pressure on prices as U.S. production was absorbed by the global marketplace. However, by mid- to late 2008, foreign demand for U.S. dairy products had declined as the global economic recession coupled with the strengthening U.S. dollar made exports less appealing. This led to oversupply and the inevitable decrease in prices. As producers' profits are tied closely to milk prices, fluctuations severely affected earnings. Conversely, dairy processors benefited from falling raw-milk prices (input costs), while keeping retail prices high.

Historical and forecasted all-milk price



Source: USDA National Agricultural Statistics Service

In fact, the U.S. Department of Justice has filed a civil lawsuit against Dean Foods, the largest dairy processor in the United States. This lawsuit seeks to overturn Dean's April 2009 acquisition of Foremost Farms USA's consumer products divisions. The federal government claims that this acquisition reduces competition in the sale of milk products to schools and other retailers in and around Michigan, Illinois and Wisconsin. Dean contests this allegation and believes the merger is legally compliant and even benefits certain farmers, since it provides them with a reliable channel to sell their milk. This lawsuit is ongoing.

Nevertheless, 2009 had its share of bright spots as the dairy industry started to make some positive strides. Although debt levels remain high, performance of companies in the market is improving, and the worst appears to be over:

- The administration has helped alleviate pressure on the dairy market by appropriating $290 million in direct federal aid to support dairy farmers and another $60 million to help diminish the surplus by purchasing cheese products for food banks. Prior to that, the U.S. Department of Agriculture (USDA) raised the price it paid for milk and cheese in an attempt to increase dairy farmers' collective revenue by an estimated $243 million in 2009. However, some groups feel that the government has not done enough and should support the market to a much greater extent.

- As illustrated in the "Historical and forecasted all-milk price" chart, milk prices in June 2010 reached $15.80 per cwt, a 40% increase from June 2009 levels, but still below 2008 levels. Even though milk prices have declined since the beginning of 2010, the USDA predicts that the all-milk price will again reach $15.80 per cwt by December 2010.

- Expanding economies of net importing countries, such as China and Japan, and lower than expected production from New Zealand and Australia have supported and will continue to support U.S. export sales. Sales to overseas markets are expected to increase on average during 2010 but are not expected to reach 2008 levels.

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The following public company analysis represents a cross-section of publicly traded domestic and foreign companies in the dairy space. As depicted in the chart, the median trading multiple — defined as EV/EBITDA for this purpose — was 5.7x. On average, earnings have increased over the past 12 months, as companies have generated greater net sales due to the positive impact from acquisitions and improved marketing designs.

Public company analysis ($ millions)

Company name	Revenue	Enterprise value	EBITDA	EV/ EBITDA
Bongrain S.A.	$4,700	$1,415	$309	4.6x
Dairy Crest Group plc	$2,473	$1,292	$209	6.2x
Danone	$19,434	$41,487	$3,661	11.3x
Dean Foods Co.	$11,713	$6,116	$835	7.3x
Emmi AG	$2,530	$1,087	$201	5.4x
Fromageries Bel S.A.	$3,183	$1,667	$414	4.0x
Morinaga Milk Industry Co. Ltd	$6,260	$2,207	$364	6.1x
Parmalat SpA	$5,122	$2,419	$445	5.4x
Robert Wiseman Dairies plc	$1,346	$546	$112	4.9x
Saputo Inc.	$5,467	$6,312	$690	9.1x
Unibel S.A.	$3,183	$1,464	$413	3.5x
Wimm-Bill-Dann Foods OJSC	$2,280	$3,235	$307	10.5x
Median	**$3,941**	**$1,937**	**$389**	**5.7x**
Mean	**$5,641**	**$5,771**	**$663**	**6.5x**

As of 6/30/10
Sources: Public company filings; certain information taken from Capital IQ

More than 200 transactions have been announced within the global dairy market since the beginning of 2008. For purposes of this snapshot, 11 of these deals with reported multiples have been highlighted below. The recent dairy M&A market can be characterized as companies completing strategic acquisitions in an effort to grow the business and expand market share.

Although industry participants can be optimistic about improved future performance, significant strides toward improvement must occur within the overall economy before pressure is wholly alleviated. This market was hammered during 2009, and dairy prices will have to increase significantly for farmers to break even. Producers lost substantial equity in 2009, and it will take time to recoup those losses. Fortunately, recent news suggests a positive outlook for the dairy industry. As demand from foreign countries rises, supply and demand will eventually reach equilibrium, which will help stabilize the market and allow participants to grow their business and improve their operations. •

Select dairy sector M&A transactions

Closing Date	Target	Buyer	Enterprise value (in $mm)	EV/ revenue	EV/ EBITDA
N/A	Puleva Food S.L.	Groupe Lactalis S.A.	$858	1.4x	9.4x
08/14/09	Synnøve Finden AS	Scandza AS	$110	0.8x	8.3x
07/20/09	F & A Dairy of California Inc.	Saputo Inc.	$45	0.3x	N/A
10/11/09	SBM Dairies Inc.	Dean Foods Co.	$88	0.9x	N/A
02/06/09	Fresh Made Inc.	Lifeway Foods Inc.	$11	1.1x	16.2x[1]
10/01/09	Nippon Milk Community Co. Ltd	Snow Brand Milk Products Co. Ltd	$214	0.1x	N/A
12/01/08	William Neilson Ltd	Saputo Inc.	$372	0.8x	9.3x
02/25/09	S.A. Fabrica de Productos Alimentícíos vigor	Bertin Ltda	$181	0.5x	6.4x
04/14/08	Laticinios Morrinhos Industria e Comercio Ltda	GP Capital Investors IV L.P.; GP Investments	$198	N/A	4.9x
03/19/08	Fromageries Paul-Renard S.A. (nka:Altareit)	Groupe ALTAREA	$23	0.3x	5.8x
04/01/08	Alto Dairy Cooperative	Saputo Cheese USA Inc.	$160	0.4x	8.2x
		Median	**$160**	**0.6x**	**8.2x**
		Mean	**$205**	**0.7x**	**7.5x**

[1]Data point removed as an outlier
Sources: Public company filings; certain information taken from Capital IQ