

Food Ingredients

M&A update

Autumn 2013



High growth in functional ingredients is driving M&A

The food ingredients sector is characterised by high R&D expenditure, strict regulation and significant growth potential. The health and wellbeing trend and consumer demand for convenience foods are supporting increasing levels of mergers and acquisitions.

The key observations from our research:

■ Focus is shifting from sensory to functional ingredients

Food ingredients companies seeking to take advantage of increasing consumer demand for healthier food and drink products is driving M&A. Developers of functional ingredients that have proven nutritional benefits are attractive acquisition targets.

■ Innovative companies are being targeted

Large food ingredients companies will continue to target niche suppliers that have a proven track record of innovation in order to expand their product portfolios into high growth segments, such as specialty proteins and probiotics.

■ Many sectors are fragmented

There is high potential for consolidation in markets such as proteins, fibres, bakery and savoury ingredients. Health and nutrition is currently fragmented and highly attractive to investors, with Royal DSM making acquisitions worth US\$3.2 billion in the sector in the last three years.

■ High multiples are being paid

Acquirers are willing to pay high multiples to access high growth sectors, established customer relationships and technological expertise. Acquisitions are a critical means of accessing certain markets due to stringent local regulation and the necessity for technical expertise.



“The Food Ingredients Sector constitutes an ongoing source of M&A opportunities as large European and American consolidators are in search of niche players with strong innovation capabilities but which lack the financial resources to grow internationally.”

Fernando Fernández de Santaella
Partner, NORGESTION

Companies are using
M&A to increase
market share

High growth, high margin sector

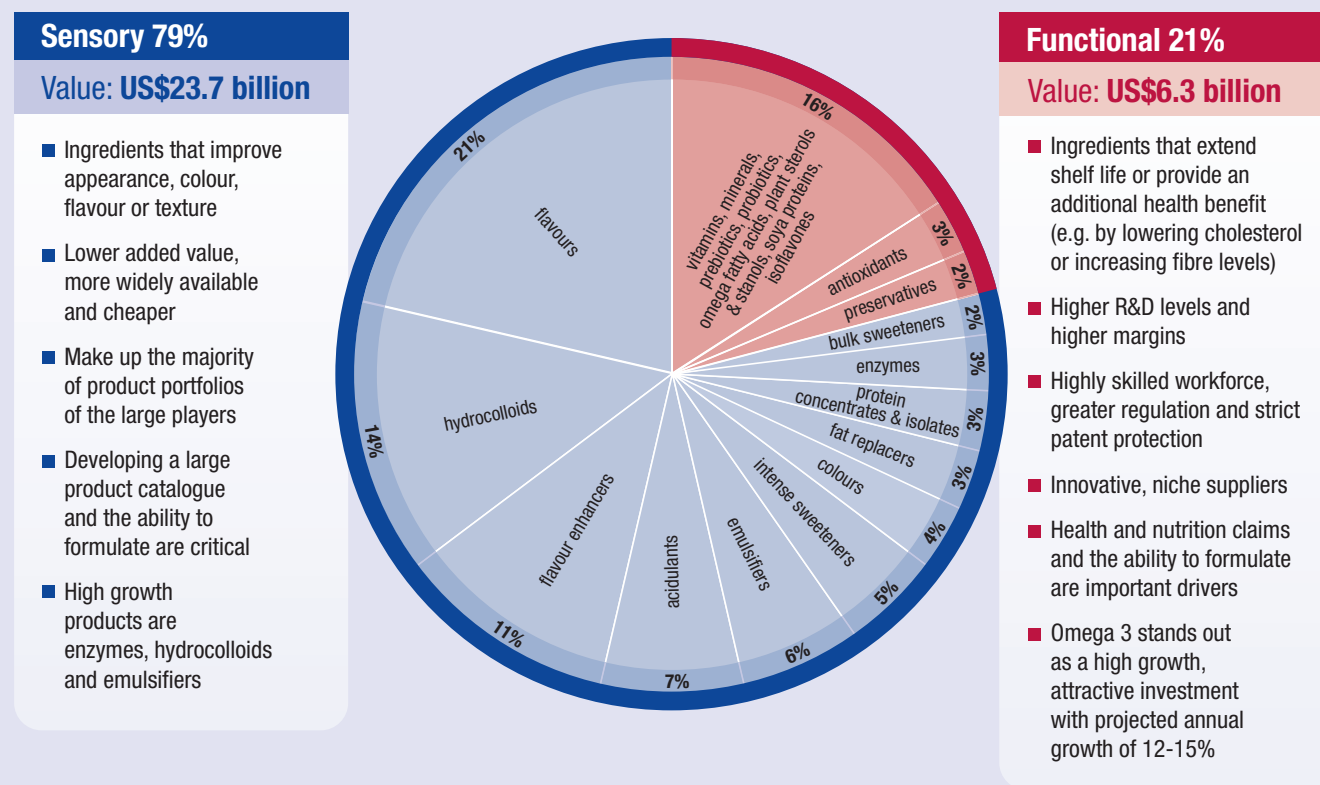
High expenditure on R&D (typically 3-8% of revenue), strict regulatory requirements and high growth underpin the estimated US\$30 billion food ingredients sector, see Figure 1. With a range of end markets, including food and drink processing, cosmetics and pharmaceuticals, the sector is attractive to a range of players.

Major players in the industry (enterprise value greater than US\$1 billion) include specialist ingredient and food producers, such as CSM and market leader Kerry Group, and many large corporates such as Cargill and ADM which have businesses in the food, agricultural, cosmetic, fuel, pharmaceutical and industrial chemicals sectors.

The remainder of the market is predominantly comprised of smaller firms (enterprise value less than US\$200 million) with innovative product portfolios. Niche suppliers such as customised ingredient blend producer Fortitech, recently acquired by Royal DSM, are prime acquisition targets for the big players.

Prior to the global financial crisis, the food ingredients sector saw rapid consolidation, with an average of 40 M&A transactions from 2000 to 2007. The focus subsequently shifted to organic growth, but since 2010 the number and size of deals has continued to rise as firms compete for higher market share, see Figure 2. Major consolidators include Kerry Group (over 70 deals since 2000), Danisco (prior to its acquisition by DuPont), Royal DSM and Frutarom.

Figure 1: Food ingredient subsectors by market value share



Source: Rabobank, Mergers Alliance

Innovation and technology are driving high margins

Technology is the key differentiator of profit margins between sectors and companies. The development of specialty ingredients (such as high intensity sweeteners with margins of 8-15%) requires technical expertise and significant annual R&D investment. Innovation is vital to the industry

as food processors look to reduce costs in the face of rising raw materials prices and cheaper competition from Asian suppliers, as well as the fact that consumers are demanding ever-more healthy, convenient and premium foods.

Fragmented sector
supports consolidation
opportunities

Consolidation of fragmented markets being driven by a number of factors

Long-term success in the food ingredients market is contingent on constant innovation, global presence, negotiating power and the development of substantial production capabilities. The absence of mid-sized players in the industry therefore prompts the numerous smaller companies to seek consolidation as they lack the financial resources and economies of scale necessary to compete with the large corporates.

Smaller enterprises with innovative technology or technical expertise, but which lack the financial resources required for continuous R&D investment, are prime acquisition targets.

Consolidation is also triggered by the necessity for increased negotiation powers with food producers and commodity suppliers, or by M&A activity in the food and beverage industry, as multinationals such as Nestle and Kraft tend to switch supply contracts in favour of suppliers with international production and supply chains.

Increasing consumer health awareness has stimulated growth in the functional ingredients sector, however the rising costs associated with regulatory compliance (such as recent EU legislation requiring nutrition and health claims to be backed up

by scientific evidence) can be prohibitive and is therefore bringing about further market consolidation.

Market leader Givaudan holds a 25% share in the global flavours and fragrances sector. The enzymes, vitamins, minerals and lactic acids segments are also highly consolidated. However, the health and nutrition, proteins, fibres, bakery and savoury ingredients segments remain relatively fragmented and are displaying high-growth potential.

“Food ingredients manufacturers are at the cutting edge of research and innovation. The EU must adopt a holistic approach to the development and implementation of regulation that engages with the market realities of launching new specialty food ingredients.”

Maryse Hervé
Secretary General, ELC - Federation of European Specialty Food Ingredients Industries

Increasing consumer health awareness and changing lifestyles supporting demand for natural ingredients & nutraceuticals

High profile food scares, increasing retailer power and the need for consumer reassurance are together creating significant opportunities for ingredient manufacturers who can support clean label claims and the growing demand for enhanced natural products.

The market has seen a cut in synthetic ingredients, wider use of botanicals, the replacement of emulsifiers with enzymes and other texturisers and a decline in artificial sweeteners as consumers return to natural sweeteners. As a result of these trends, the natural food and drink ingredients market has grown 39% over five years to US\$12.9 billion.

Range of strategic
objectives
supporting M&A

Acquirers have different M&A objectives

Food ingredients companies are using acquisitions to expand into new product categories and markets, strengthen capabilities in existing categories, access technology and R&D, increase their negotiating power with customers and suppliers, access the distribution chain and add higher margin products to their portfolio.

Particularly attractive targets are niche specialists in growth sectors, such as specialty proteins and probiotics. These are often SMEs, based in developed countries, with highly skilled staff and a proven track record of innovation.

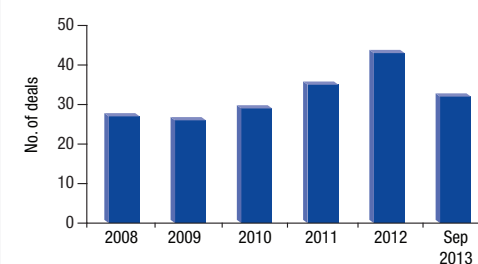
Broadening capabilities in existing markets

■ In November 2012, Netherlands-based Royal DSM broadened its capabilities in the human nutrition and health sector with the acquisition of custom food ingredient premixes and blends business Fortitech for US\$634 million, in line with its strategy to become a full solutions provider in food ingredients blends. The transaction will also expand Royal DSM's supply chain presence, create cost synergies and accelerate product development. This follows the purchase of long-term US collaborator Martek Biosciences for around US\$1 billion (8.5x EBITDA), which develops nutritional products from microbial sources, and is their ninth acquisition in the nutrition sector since September 2010, at a total value of US\$3.2 billion.

■ Omega Protein, the nutritional ingredient company and US leader in Omega 3 fish oil production, acquired Wisconsin Specialty Protein, a producer of organic cow, hormone-free cow and goat whey products, in February 2013 for US\$27 million (2.3x revenue). The deal allows Omega Protein to expand its presence in the specialty protein sector, identifying whey protein as a highly sought-after and differentiated ingredient which complements their existing line of value-added ingredients.

■ FMC, the agricultural, industrial and consumer chemicals producer, predicts rapid growth in the natural colours market to over US\$1 billion by 2015 as a result of growing demand from consumers that favour natural ingredients from renewable and sustainable sources. It strengthened its position in this sector with the acquisition of UK-based producer Phytone (and its natural colour formulation patent) in June 2013, following the purchase of Chilean firm South Pole Biogroup in 2011.

Figure 2: M&A activity



Source: Mergermarket, Mergers Alliance

Accessing new markets and product categories

■ In February 2012, US energy, grain and food cooperative CHS completed the US\$133 million acquisition of Solbar, an Israel-based manufacturer of functional soy proteins which supplies the food, beverage and pharmaceutical industries. The transaction will extend CHS' product portfolio to include specialty soy proteins and soy isoflavones.

■ Wild Flavors, a Swiss natural ingredients producer, acquired the Brazil-based food and beverage flavours, emulsions and colours manufacturer Amazon Flavors in July 2013, marking the latest step in the company's global expansion strategy. The rationale behind the deal was to establish a local production centre to take advantage of Brazil's position as the third largest market in the beverage sector. With a growing middle class and increasing consumer demand for new tastes and flavours, the market still has high growth potential.

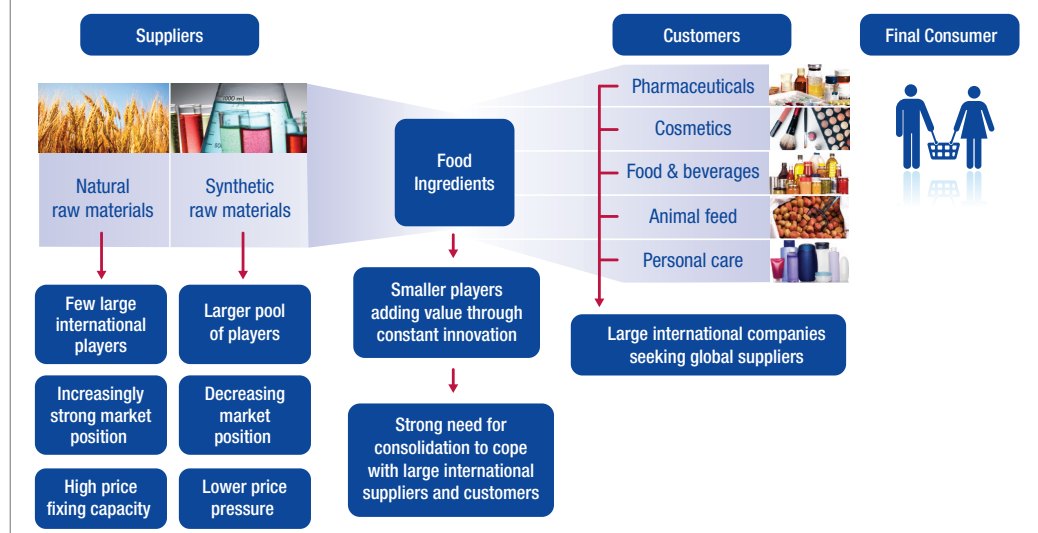
- In line with its strategy to focus on specialty ingredients and expand its portfolio of fibre and wellness products, in May 2013 UK ingredient manufacturer Tate & Lyle acquired Biodelop International, the Sweden-based producer of oat beta glucan for use in the food, beverage, supplement, cosmetic and personal care industries. Tate and Lyle will take control of soluble fibre product PromOat, which is supported by strong scientific health claims and has European Food Safety Authority (EFSA) approval for reducing cholesterol and post-prandial glycaemic response.

M&A volumes for functional ingredients will continue to grow

The shift of emphasis from sensory to functional ingredients in line with the health and wellbeing trend will continue to drive M&A volumes as large companies target innovative small players. An increase in the volume and value of deals will be concentrated in developed countries where there is a highly skilled workforce, regulation and strict patent protection, but will also be seen in emerging economies as consumers become more health conscious.

High quality
companies achieving
attractive valuations

Figure 3: Food ingredients supply chain



Source: Mergers Alliance

High multiples being paid

Average multiples paid (9.4x EBITDA in 2012-13) are among the highest in the food industry. Strict regulatory obligations and a research intensive environment create barriers to entry that make acquisitions vital, with companies willing to pay high multiples to access specific positioning in high growth sectors, technical expertise and strong customer relationships.

- An example of a high value deal was Royal DSM's acquisition of Ocean Nutrition Canada, a manufacturer of Omega 3 EPA/DHA ingredients, for US\$535 million (9.8x EBITDA). This transaction will enhance its product portfolio in the rapidly growing nutritional lipids division. The company has also

acquired the food enzymes and oilseed processing division of Verenium, a US-based developer of high performance enzymes, for US\$37 million (4.9x revenue), which will strengthen its food enzymes innovation pipeline.

- Puleva Biotech, the Spanish company dedicated to the research and commercialisation of products based on natural ingredients, acquired Exxentia Grupo Fitoterapeutico SA, the Spain-based producer of plant extracts, for US\$56 million (19.5x EBITDA). The transaction is in line with the company's strategy to gain market share in the biotechnology food market and develop new dietetic, pharmaceutical and nutrition products.

PE is attracted to high margin, high growth opportunities

Private Equity supports global expansion

Private equity (PE) is targeting food ingredients companies due to their high margins and potential for growth, and can offer financial support to organic growth and buy-and-build strategies.

■ AXA Private Equity bought Diana Group, a French natural sensory ingredients producer, for US\$960 million to support the company's growth through acquisitions. Since then, Diana Group has made four acquisitions, including UK-based Map Technologies and the vegetables, wine and vinegar extracts business of Switzerland-based Givaudan in order to strengthen its position in the natural flavours market.

■ USA-based Arlon Capital Partners acquired a majority stake in Wholesome Sweeteners, the US producer of natural and unrefined sweeteners, for US\$178 million. The company has a strong track record of innovation and is the leading organic sweetener supplier in North America. The deal will enable product portfolio expansion.

■ In 2011, European-based IK Investment acquired Savena, a French manufacturer of aromatic, functional and dietetic ingredients, for US\$224 million with the intention of doubling its size over five years through new product innovation. Savena subsequently merged with Belgian food ingredients manufacturer Sfinx in a transaction that was backed by AXA Private Equity and IK Investment and will enable the companies to enter the nutraceuticals market and expand internationally.

“We are actively looking for targets in the food ingredients sector; the investments required to develop these companies are often not very high in comparison to the growth and cash generation potential.”

Nicola Zambon
Partner, Ergon Capital Advisors - Spain

CASE STUDY: Iberchem

Iberchem is a Spanish manufacturer of flavours and fragrances which has used a series of funding rounds and acquisitions from PE over 15 years to become a multi-national company and grow turnover from €5.9 million to €57 million.

1999 – 2000: Acquisition of Iberchem by Espiga Capital from its three founding partners, with subsequent reinvestment by the management team and funding from regional fund InverMurcia for a total value of €9 million.

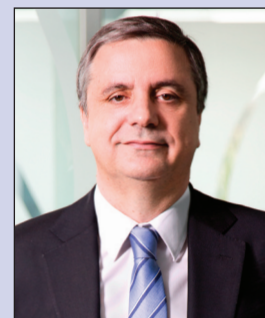
2002: €1.5 million acquisition of a plant in Guangzhou (China) in line with Iberchem's expansion strategy.

2005: Financing round of €1.5 million by Espiga Capital and InverMurcia. The company invested in a new headquarters in Murcia (Spain) with state-of-the-art R&D facilities and a fully automated fragrances production unit, and developed the Indonesian and Tunisian subsidiaries.

2007: Secondary management buy-out (SBO) by Capital Alianza for €35 million with Espiga exiting with an IRR of around 20% and multiple greater than 3x. The company's strategic plan included further expansion in the Middle

Eastern and African markets and the opening of new subsidiaries in India, Colombia and Mexico.

2013: SBO by Magnum Capital, which acquired a majority stake for €80 million (8x EBITDA) with Capital Alianza exiting with an IRR greater than 28% and multiple of around 4x. Iberchem aims to extend its international scope by entering the emerging markets and the USA, opening new factories in Colombia and Dubai and increasing R&D capacity.



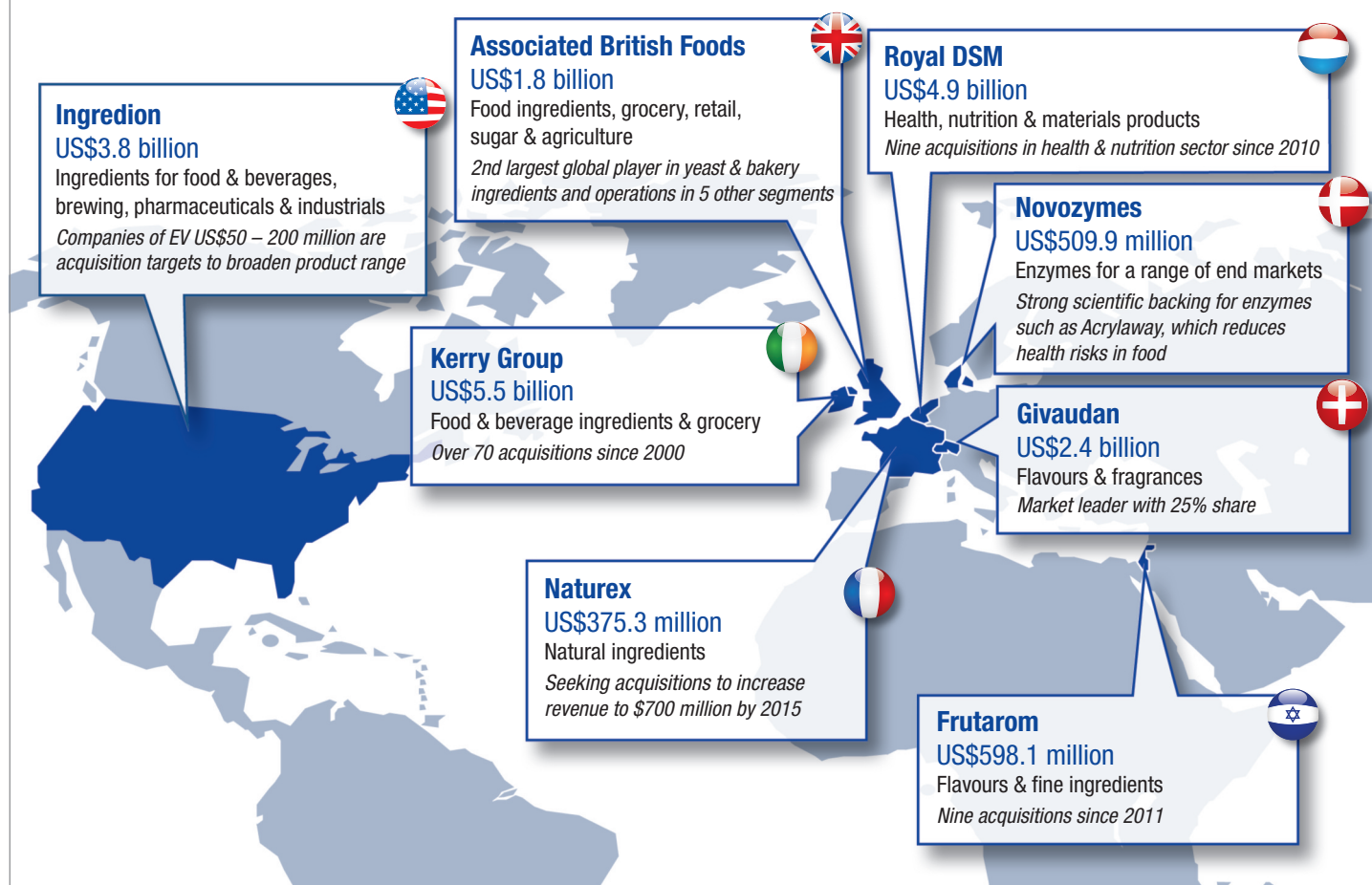
Ramón Fernández
Chief Executive Officer, Iberchem

Figure 4: Selected recent M&A transactions

Date	Target company	Target Country	Target activities	Acquirer	Acquirer Country	Deal Value (US\$m)
Jul-13	Amazon Flavors	Brazil	Flavours, emulsifiers and colours manufacturer	Wild Flavors	Switzerland	nd
Jun-13	Phytone	UK	Natural colour ingredients producer	FMC	USA	nd
May-13	Iberchem	Spain	Manufacturer of flavours and fragrances	Magnum Capital	Spain	104
May-13	Biovelop	Sweden	Oat beta glucan producer	Tate & Lyle	UK	nd
Feb-13	Wisconsin Specialty Protein	USA	Producer of whey products	Omega Protein	USA	27
Nov-12	Fortitech	USA	Custom food ingredient premixes and blends producer	Royal DSM	Netherlands	634
Nov-12	Givaudan	Switz.	Wine and vinegar extracts business	Diana Group	France	nd
May-12	Ocean Nutrition Canada	Canada	Omega 3 manufacturer	Royal DSM	Netherlands	535
Mar-12	Wholesome Sweeteners	USA	Natural and unrefined sweeteners producer	Arlon Capital	USA	178
Mar-12	Verenium	USA	Food enzymes and oilseed processing business	Royal DSM	Netherlands	37
Feb-12	Solbar	Israel	Functional soy proteins manufacturer	CHS	USA	133
Oct-11	South Pole Biogroup	Chile	Manufacturer of natural colours and functional ingredients	FMC	USA	nd
Sep-11	Map Technologies	UK	Food flavours manufacturer	Diana Group	France	nd
Jul-11	Savena	France	Aromatic, functional and dietetic ingredients producer	IK Investment	Europe	224

Source: Mergermarket, Mergers Alliance

Figure 5: Selected food ingredients companies worldwide



Source: Mergers Alliance

Figures denote food ingredients revenue, except Frutarom which includes fragrances sales.

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Specialist advice on call...

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Join in the mergers and acquisitions discussion

With a food ingredients sector team, the Mergers Alliance partners are expertly placed to offer advice.

In particular, we offer:

- Advice on structuring and completing deals in the food ingredients market
- Identifying acquisition opportunities around the world
- Information on sector trends and valuations
- Access to corporate decision-makers and owners