Hungry for deal flow in the food and beverage industry
Preparation and due diligence key for seller and buyer

Prepared by:
Bill Spizman, Partner, McGladrey LLP
312.634.4422, william.spizman@mcgladrey.com

April 2015

Food and beverage (F&B) industry leaders gathered recently for a McGladrey-sponsored executives’ round table, and the discussion was ripe with deal flow—active deal flow. According to many there, it’s the best it has been in a long time, and things continue to look up for the industry.

One of the reasons for positive deal flow: it appears the F&B industry has been immune to a number of issues, such as credit problems and volatile commodity costs in recent years. But while there is substantial capital available to acquire F&B companies, there seems to be a shortage of desirable companies to buy. It is clearly a seller’s market.

With that in mind, interest has carried over to smaller F&B companies that have the potential for fast growth or provide an opportunity for expanded products and new categories or markets. Related to this idea, it is becoming more efficient for some companies wanting to expand, to acquire rather than develop internally through traditional Research and development methods.

The 2014 McGladrey Manufacturing and Distribution Monitor: Food and Beverage Report, which surveyed F&B executives about industry business issues, has followed the expansion trend and fortifies what was discussed at the recent round table. The report indicated that overall, more than 40 percent of the surveyed F&B executives say their organization plans to acquire a company in the same business or will acquire a company in a complementary business. Executives state the top reasons for mergers and acquisitions are to expand product lines to reach new customers, to create cost synergies and improve margins - and to improve current market conditions.

There were other trends cited from the round table discussion and the F&B landscape as a whole. For instance, it is a challenge for some financial buyers to compete with strategic buyers right now because of the synergies that strategics have. To win those deals, strategics are pushing multiples higher than many private equity firms are willing to pay. Strategics are less hindered by certain financial requirements than private equity firms - and aren’t constrained by limited timeframes on their investments. However, despite the pricy multiples, private equity firms are actively competing in the industry. Plenty of debt is available to finance transactions and the cost of money is cheap. Private equity firms are willing to pay the high multiples because the market is pushing...
them to do it. Otherwise, someone else will step in and buy. For sellers, it is an ideal time to exit. Prices are currently high and buyers will keep coming up with ways to justify deals.

Sales-ready considerations
For F&B companies looking to sell, being attractive to the buyer is essential, and there needs to be a clear understanding of how the company manages cash flow and, at the same time, shows a consistent sales trend and record of profitability. In addition, a history of controlling expenses and possibly hedging commodity costs are key contributors to demonstrating an attractive deal, as are differentiation and other unique product characteristics.

Also, selling companies should be mindful that consolidation in brand sectors is popular with buyers. Private equity firms love branded products, as they can make brand extensions, launch international lines and open new channels. If a potential selling company has a product that can add to a larger company’s single-product expansion, a buyer’s interest is swayed. At the same time, however, the seller must make sure company financials and profitability reporting are in shape and can stand the test of a vigorous due diligence process.

Key buyer concerns
Product differentiation, strong brand recognition and market are most important to the buyer of an F&B company. In addition, private-label is often considered by buyers where there is a unique factor, such as low-cost production facilities that are too costly to replicate at today’s prices. Buyers must weigh, “what is the potential to broaden distribution or leverage the brand franchise?” Also, the qualitative and quantitative aspects of reported revenues, costs and EBITDA need to be analyzed.

The advantage goes to the buyer that performs a concerted and phased due diligence process to vet out the good deals from the undesirable ones. Triggers to explore during due diligence include:

- High customer concentration – Do few customers make up a large proportion of the company’s net revenue?
- Rebate accounting – What’s accounted for, and what’s expected?
- Product recalls – Who is responsible for the recall, the supplier or processor?
- Seasonality – Any trends that will impact projections and future budgets?
- Vendor commitment – Are there pre-existing contracts and commitments?
- Spoilage – Are there noteworthy adjustments?
- Commodity pricing – Are there contracts that will impact EBITDA?
- Price increases – Could this be an issue with customer concentration?
- Competitive bidding – Is this an issue, particularly in relation with potential suppliers?
- Sales commission – What’s the trend of sales commissions within the company, and how does it correspond with the company’s true growth?

There is much to consider, but one thing is certain. F&B deal making is hot. Winners will be those sellers that know what the market is looking for in terms of brands and deal price - and those buyers who are efficient and diligent in their deal pursuits. For more information about this topic, contact your local McGladrey representative.