

Consumer



Food Ingredients: Recipe for Premium Valuations

Buyers have a hearty appetite for value-added ingredient companies, and that craving has only intensified in recent years. The ingredients space is broad and fragmented across the U.S. and globally – leading to an increasing interest from strategic buyers and private equity (PE) investors alike.

The ingredients category ranges from unique flavors and natural preservatives to probiotics providing functional benefits to inclusions that elevate texture and palate. The sector is fragmented with many small, privately owned businesses, yet it is ripe for growth. Elevated consumer expectations, evolving food science and increased customization are at the forefront of growth within the industry.



Many companies in the space have high growth and high valuation potential.

For example, some of Lincoln International's recent transactions have resulted in valuations approaching **20x EBITDA and above.**

Strategic, public acquirers are willing to acquire targets at a premium because they also trade at lofty valuations and see a path to drive continued sales growth with their expanded, international resources. Additionally, strategic acquirers place significant value on innovation capabilities, and they (and their shareholders) view acquiring a proven innovator as safer than building such capabilities. Meanwhile PE has also taken an interest due to the recent tremendous growth, meaningful whitespace and future opportunities for high-value strategic exits.

LINCOLN'S VALUE DRIVERS FOR INGREDIENTS M&A

The food ingredients industry contains many opportunities for both sellers and investors. When we discuss sell-side or buy-side opportunities with clients, we are frequently asked for our perspectives on the business and financial attributes that position an ingredients company for outlier mergers and acquisitions (M&A) outcomes.

Ingredients companies considering a sale should assess the following factors that make targets attractive for investment.

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1. Technical R&D expertise and collaboration with customers

As food manufacturers and foodservice businesses outsource their innovation, the demand for companies with technical R&D expertise has grown meaningfully. Customers rely on their ingredient partner to achieve a specific objective (e.g., unique taste, nutritional benefits, longer shelf life, cleaner label, etc.) that differentiates a finished product and appeals to the end consumer. Ingredients companies offering a greater degree of technical capabilities enjoy more defensible customer relationships and revenue streams.

2. Formula ownership

Ingredients companies providing R&D services should strive to retain ownership of their formulas whenever possible. Formula ownership insulates the ingredient company from competition and replication, further enhancing value.

3. Low cost, high value-add

With differentiation and greater consumer appeal, the food manufacturer or foodservice business is able to charge a higher price for its products. However, the ingredients that provide the differentiation are often only a small fraction of the overall cost of the finished product, leading to a less price sensitive customer. For example, the sauce on your favorite chicken sandwich may be what you remember most from your experience, but is a low cost relative to the other ingredients.

4. "Sticky" customers

The best ingredient companies have very "sticky" customers because of high switching costs. These customers are unlikely to risk upsetting their end consumers by changing the ingredient specifications of a proven and sought after product. Product quality, responsiveness and a history of successful collaboration further solidify the relationship.

5. "Land and expand" opportunities

Once the ingredient company proves its ability to innovate for its customer, the underlying trust and track record of success leads to additional opportunities. Responsive research teams with quick turnaround times, high-service levels and strong first sample win rates are a further driver of account penetration.

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NOTABLE RECENT TRANSACTIONS

Lincoln's food ingredients team—backed by a global network of bankers—has significant experience in the category. We have worked on sell-side and buy-side deals in the U.S. and abroad, as well as many cross-border deals. Recent transactions include the following:

 GRAHAM PARTNERS has sold  GiraffeFoods™ to  symrise Sell-Side 	 criatec has sold its stake in  imeve to private shareholders Sell-Side 
 WOODLAND FOODS has received a majority investment from  GRAHAM PARTNERS Sell-Side 	 FFP FLORIDA FOOD PRODUCTS a portfolio company of  MID OCEAN PARTNERS has acquired  Amelia Bay Acquisition Financing 
 LAKEVIEW EQUITY PARTNERS LLC has sold  UAS Labs The Probiotic Company to  CHR HANSEN Sell-Side 	 DUBILIER & COMPANY has sold  BLUEGRASS Dairy and Food, Inc. to  PPC PUBLIC PENSION CAPITAL Sell-Side 

6. Actionable sales pipeline

In assessing future growth, investors spend considerable time validating the pipeline of the target company. Therefore, owners / entrepreneurs or PE firms that want to sell their business need to show a credible sales pipeline and historical track record of conversion. Furthermore, the company should track the sales pipeline over time to understand and explain critical factors such as seasonality, probability of conversion and expected timing of new business. Successfully demonstrating the certainty of the pipeline increases a buyer's ability to pay a forward-looking multiple reflecting the portion of the projected growth that is already "in the bag".

7. Strong margins

Formula ownership, low cost, high value-add ingredient solutions and customers with high switching costs often provide very attractive margins. EBITDA margins above 20% or significantly higher are not uncommon, driving appeal with investors who are confident of future growth.

8. Available capacity to support growth

Many successful ingredient companies have very high historical growth rates, which naturally lead to discussions about future capacity. To ensure the company can continue to scale, it is prudent to adequately address capacity and expansion plans—preferably prior to M&A discussions.

9. Favorable underlying trends

As described above, notable trends—such as unique flavors and health and wellness priorities—are driving long-term growth in many ingredient categories. Companies that align with those trends are experiencing dramatic growth, often 20% a year or even higher, and deserve higher valuations.

10. Numerous M&A opportunities in adjacent categories

Food ingredient companies with technical differentiation often specialize in a subsegment of the overall category. Savvy investors—realizing the potential to serve food manufacturers and foodservice companies through a spectrum of offerings—often wish to expand customer relationships through M&A. An ingredients company with prior M&A experience and actionable acquisition opportunities will command a premium valuation.

In light of the growth potential and substantial investor interest in the space, ingredients companies should evaluate the above financial and business attributes when determining how to capitalize on recent market trends. If you are considering selling your company, our food ingredients investment banking team can help assess the opportunities available to you.

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