

June 2007



Food Sector Report

A mergermarket report on M&A trends and activities in the Food Sector



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Introduction

Welcome to mergermarket's second Food Sector Report in association with CMS. This report comes on the back of 18 months of strong M&A deal flow in the European food sector. This is a landscape in which many corporates continue to innovate and reshape product lines to accommodate ever shifting consumer appetites. From a product-side, according to our survey, key developments in the industry centre around healthy convenience foods, organic, sustainable and chilled foods.

According to many of the respondents we spoke to, pursuing these strategies will drive corporates to continue to pursue both organic growth strategies and M&A. At the same time, further demerger and rationalisation moves in a similar vein to Unilever's sale of its frozen food division cannot be ruled out. In addition, fully funded private equity funds are expected to remain active buyers in the sector.

We would like to thank the participating advisers, CMS, Langholm Capital and Rabobank International for their support in producing this report.

Methodology

mergermarket canvassed the opinions of 50 senior level executives from the European Food industry in the first quarter of 2007, gaining an insight into their views on the market and current major issues and trends; the factors influencing their opinions and decision making; and an exploration of their future strategic intentions and expectations.

Respondents were split across food manufacturers and food retailers from corporate firms with an annual turnover of between €50m and €500m. The job titles of those surveyed included CEO, President, Finance Director, Vice President and Managing Director. Respondents were drawn from a range of geographies including Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Norway, the Netherlands, Portugal, Spain and the UK.



Mergermarket

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- **Executive Dinner Debate;** London, UK, 12 September 2007
- **Italian M&A Forum;** Lake Como, Italy, 8 November 2007
- **Private Equity Forum;** London, UK, 20 November 2007
- **Japanese M&A and Private Equity Forum;** Tokyo, 2007
- **Global Hedge Funds Awards;** London, UK, 2007
- **Iberian M&A Forum;** Madrid, Spain, 2008
- **North American Energy Forum;** Calgary, Canada, 2008
- **Nordic M&A Forum;** Stockholm, Sweden, 2008

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Executive Summary

Optimism that growth prospects will at least remain constant

Respondents appear to be relatively bullish regarding the Food sector's growth prospects over the next 12 months. 62% believe growth prospects in 2007 will be as good as they were in 2006. A further 30% believe they will be better.

Innovation will be the key growth driver

The majority (88%) of respondents believe that increased levels of innovation in value-added food areas will be the key drivers of sector growth.

Rationalisation of overcapacity will be key driver of efficiencies

Further rationalisation of overcapacity emerged as the principal factor likely to increase efficiencies in the sector – 90% rated it at least a likely driver of growth in the Food sector. 78% believe the increased use of technology in the supply chain is at least a likely driver of efficiencies.

Price competition and Retailer consolidation are major threats

42% of respondents believe that price competition is the major threat to future growth and profitability in the Food sector. Retailer consolidation was ranked a close second with 40% share.

Respondents identify increased emphasis on fresh produce, organic foods, and convenience foods

Following the shift in consumer attitudes towards healthy eating in recent times, it is unsurprising that 50% of respondents believe fresh produce goods will enjoy the best growth opportunities over the next 12 months. Similarly, the expected increased emphasis on healthy foods is reinforced by the fact that organic foods (48%) and nutraceuticals (26%) were also cited.

Respondents back organic growth and growth by M&A

Respondents typically picked more than one source of growth for their company in the coming years. A sizeable 62% of respondents expect their company to grow by organic growth. A combined 68% of respondents expect their company to expand its operations via a merger or acquisition.

Bank financing is the chief source of finance for acquisitions

A dominant 84% of respondents would consider using bank financing for making acquisitions. 49% would predominantly use internal resources while 33% of respondents would consider using leveraged finance.

Forward M&A confidence is high

Respondents appear to be very confident regarding M&A prospects in the next 12 months. Nearly two thirds of respondents (64%) anticipate an increase in M&A activity, while 32% expect M&A levels to remain the same in the coming 12 months.

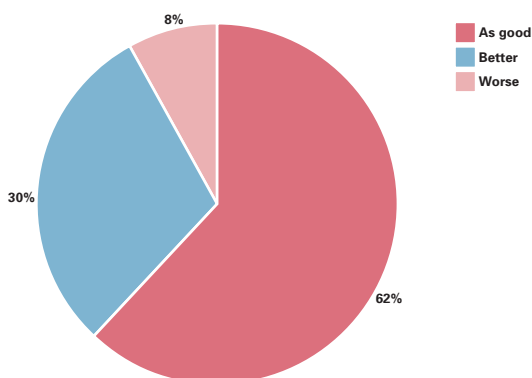
56% back private equity buyouts in the sector to increase

After the recent high profile buyouts of United Biscuits and Unilever's frozen food division, it is perhaps predictable that 56% of respondents expect to see increased levels of private equity activity within the sector. 40% expect the level of deal making from private equity funds in the sector to remain the same in the next 12 months.

Survey Findings

Sector Overview

Compared to 12 months ago, what do you believe growth prospects for the sector are over the next 12 months?

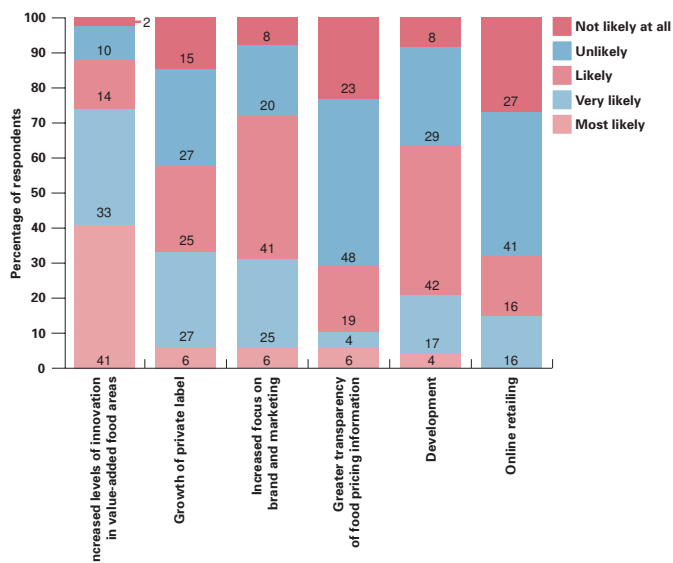


Respondents appear to be relatively bullish regarding the Food Sector's growth prospects over the next 12 months. 62% believe growth prospects in 2007 are as good as they were in 2006, with 30% believing the next 12 months will provide increased growth opportunities for the Food Sector generally. Moreover, only 8% of respondents believe that growth prospects in the next 12 months are worse than they were 12 months ago.

“Against the recent backdrop of constant retailer led deflationary pressures, there is a strong need for both manufacturers and retailers to invest in and encourage innovation in the Food Sector. Similarly branded players must reverse the trend of shifting funds from short term below the line activities to brand building.”

Oliver Wyncoll, Langholm Capital

Which of the following do you think is most likely to spur growth in the sector?



The majority of respondents believe that increased levels of innovation in value-added food areas will be the principal driver of growth in the Food Sector. A significant 41% of respondents rated this factor as the most likely driver while a further 47% considered it to be at least a likely stimulant of growth in the sector. Elsewhere, 72% of respondents expect an increase in the focus on brands and marketing to be at least likely to spur growth in the sector. Online retailing and greater transparency of food pricing information emerged as the least likely drivers of growth in the Food Sector in the eyes of respondents.

It is noteworthy that a significant minority of respondents named factors other than those listed as potential determinants of growth in the sector. The issue of healthy foods was identified by respondents as likely to be a high growth area as well as eco-labelling, organic and fair trade products. One respondent predicted that the next 12 months will see an increase in the number of food manufacturers looking to specialise in premium foods in order to take advantage of predicted growth in this segment.

“ The increasing interest in Health and Wellbeing has undoubtedly accelerated over the last 12 months. It is less clear as to whether this media-led interest will be translated into sustainable changes in consumer behaviour, with taste usually the default selection criteria. Manufacturers have the challenge of innovating with new products that are consistent with Health and Wellbeing, but without sacrificing on taste or convenience.

Oliver Wyncoll, Langholm Capital

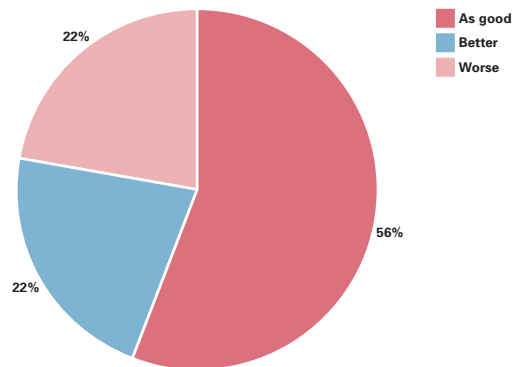
“ Increased consumer awareness offers healthy growth opportunities to those in the market able to leverage premium brand names and, either through organic growth or acquisition, offer products that satisfy consumers’ appetite for nutritious, environmentally friendly and premium quality products. As well as delivery of such products, proper management and protection of brand or label portfolios and compliance with regulatory/consumer bodies’ labelling requirements will be vital.”

Louise Wallace, Head of Consumer Products,
CMS Cameron McKenna

“ The recent consumer trends towards premiumisation, natural, organic, fairtrade, provenance and local sourcing are a challenge for large brands. Branded manufacturers are exploiting well the growth in health platforms, and retailers are beginning to catch up, but it is as yet too early to tell if they will be able to compete effectively with the likes of Actimel and Flora Pro Active.”

Oliver Wyncoll, Langholm Capital

Compared to 12 months ago, what do you believe the profit prospects for the sector are over the next 12 months?



Respondents appear to be cautiously optimistic regarding the profit prospects for the Food Sector over the next 12 months. Over half of respondents (56%) rate the sector’s profit prospects as likely to be as good as last year while 22% of respondents consider them to be better, with one respondent justifying their opinion by commenting, “ 2006 was a rough year for the industry. Consequently, I expect an improvement now which will bring the profit levels back to normal” . However, a not insignificant 22% of respondents believe that the sector’s profit prospects are actually worse this year.

“ Whilst respondents are bullish about growth in the overall sector, the more cautious view of profit prospects indicate that the focus for the next twelve months may well be on investment in development of brands, innovation and increasing efficiencies, all of which should provide longer term sustainable growth in the sector.”

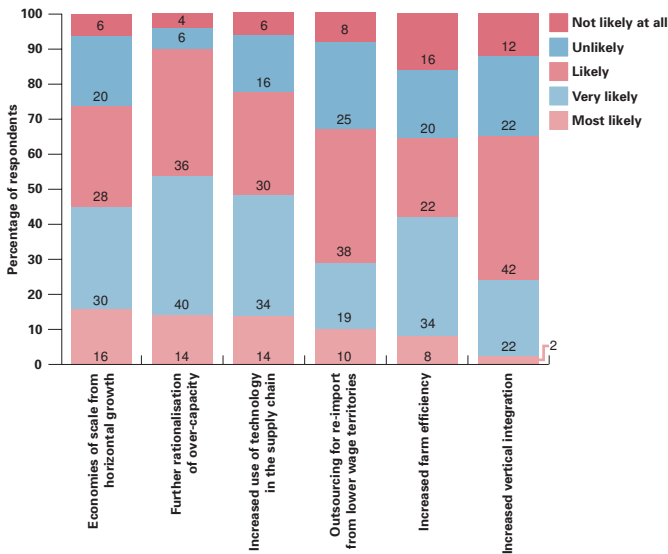
Sarah Hanson, Commercial Partner - Consumer Products, CMS Cameron McKenna

“ In the food sector, the ever-increasing retail consolidation is affecting margins, which is having a knock-on effect on producers. Consolidation amongst food producers to counter retail pressure and excess liquidity is currently driving M&A transactions in the European food market.”

Maarten ter Haar, Rabobank International

Sector Overview

Which of the following is most likely to increase efficiencies in the Food Sector in the future?



“Increasing efficiency by way of rationalisation of capacity and better use of technology is a proven strategy for growth in strong and profitable parts of the business – if such measures are carried out properly. This will also make finance easier and cheaper to obtain and enhance possibilities for successful acquisitions and mergers – private equity investors have played a key role in supporting businesses through such processes.”

Louise Wallace, Head of Consumer Products, CMS Cameron McKenna

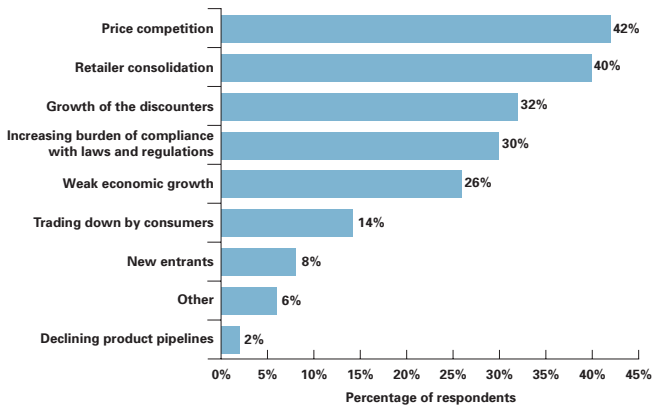
“Whilst economies of scale are likely to increase efficiencies, should a contamination occur, it is possible that a much wider range of products and markets may be affected (such as occurred with the Para Red and Sudan 1 recalls). Crisis management plans should recognise this risk and evolve accordingly.”

Jessica Burt, Food Law Specialist – Consumer Products group, CMS Cameron McKenna

The majority of respondents considered that most of the above factors are likely to increase efficiencies in the sector in the future. Further rationalisation of overcapacity emerged as the principal factor with only 10% deeming it unlikely or not likely at all to increase the level of efficiency. Additionally, 14% of respondents rated this factor as most likely and 40% considered it to be a very likely driver of efficiency within the sector.

Increased use of technology in the supply chain was cited by a resounding 78% of respondents as likely, very likely or the most likely factor to improve efficiency. Similarly, the development of economies of scale from horizontal growth was considered by 74% of respondents to be at least likely to increase efficiency. Increasing farm efficiency appeared the least likely driver of efficiency in the Food Sector in the eyes of respondents with 36% considering it unlikely or not likely at all to encourage overall efficiency gains.

What do you see as the major threats to future growth and profitability in the Food Sector?



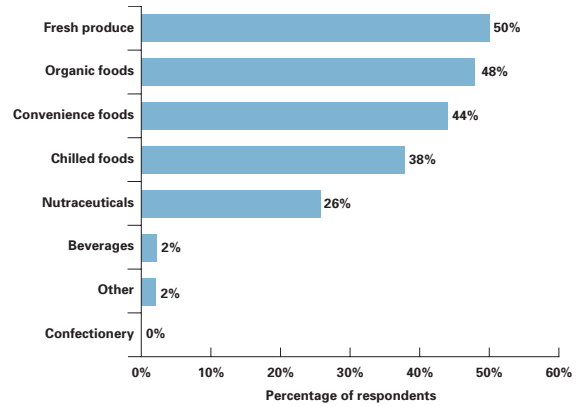
42% of respondents believe that price competition is the major threat to future growth and profitability in the Food Sector. Retailer consolidation (40%), growth of discounters (32%) and the problems of complying with laws and regulations (30%) also emerged as other factors that are considered major threats by a significant proportion of respondents. Conversely, trading down by customers, new entrants and declining product pipelines do not appear to be considered major threats to the sector’s future growth and profitability.

Interestingly, one respondent felt it necessary to demarcate between the threats to the Food Sector’s growth and its profitability, “I believe they should be seen separately. Declining consumer income is the main threat to growth while attempts by retailers to diversify their own margins is probably the main threat to profit levels”.

“The current Competition Commission inquiry into the grocery sector is likely to have an impact on the future consolidation of the sector through the introduction of greater scrutiny and regulation of concentrations within the sector. Other areas that are likely to be touched by the findings of the inquiry include regulation of retailers based on their treatment of suppliers, the holding of property and pricing policies. Business planning will need to take account of these issues if businesses in the sector are to meet growth and profitability targets.

Susan Hankey, Competition Partner – Consumer Products group, CMS Cameron McKenna

What specific subsectors do you believe will witness the best growth opportunities over the next 12 months?



Following the shift in consumer attitudes towards healthy eating in recent times, it is unsurprising that 50% of respondents believe fresh produce goods will enjoy the best growth opportunities over the next 12 months. Similarly, the expected increased emphasis on healthy foods is reinforced by the fact that organic foods (48%), chilled foods (38%) and nutraceuticals (26%) were also cited as probable high growth subsectors by a significant proportion of respondents. The fact that 44% of respondents identified convenience foods presents an apparent contradiction with the growth of healthy foods. It should be noted, however, that the two are not mutually exclusive - pre-washed vegetables are both healthy and convenient for example. Notwithstanding this, modern day lifestyles and changing demographics mean there is room for both healthy and less healthy foods to grow.

Sector Overview

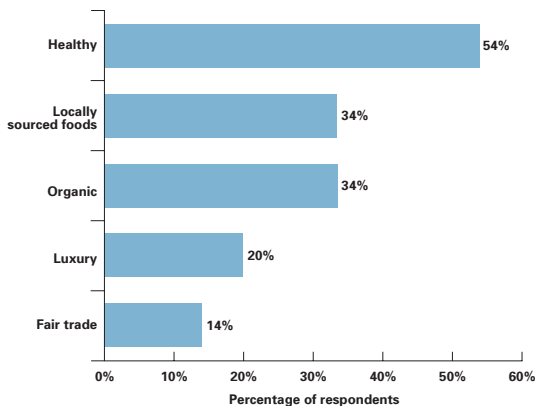
“Consumers’ appetite for fresh produce, organic food and high quality convenience foods will, whilst offering growth opportunities, also require a number of respondents to invest significantly in improving the efficiency and quality of their supply chains in order to remain competitive and deliver the quality of product demanded – manufacturers and retailers will also need to face the challenge of maintaining profit margins in such higher value and quality goods in a market where price competition is fierce”

Louise Wallace, Head of Consumer Products, CMS Cameron McKenna

“Changing consumer habits do take time but it is eminent that healthy foods, organic foods and the obesity issue will start to have a real impact on consumer demand in the near future. Food producers are preparing for this change and are looking for ways to enter the healthier segments.”

Maarten ter Haar, Rabobank International

Within the private label sector, which current trend sectors do you believe will become the front runner in the next two years?



Within the private label sector, the majority of respondents (54%) expect healthy foods to be the front runner in the next two years. Elsewhere and continuing the healthy eating theme, 34% of respondents expect both locally sourced foods and organic foods to prove popular in the private label sector in the next two years. The growth prospects of luxury foods (20%) and fair trade foods (14%) over the next two years are considered to be less lucrative in the eyes of respondents.

“The interaction between branded and own label offering is an increasingly sophisticated one, with both sides seeking to populate the space formerly occupied by the other and exploit changes in consumer perception. Private label products have seen huge growth by abandoning the traditional model of lower priced alternatives, and are offering budget, intermediate and premium lines, often under a tiered private label brand structure which has generated its own brand equity distinct from that leveraged from sector leaders. Equally, major brand owners are also offering a tiered structure and using sub-brands or new lines to compete at the lower value aspects of the market, leaving a smaller number of “super premium” brands to dominate the higher value price points.”

Tom Scourfield, Intellectual Property Specialist – Consumer Products group, CMS Cameron McKenna

“Local producers and manufacturers supplying the large retailers with goods for their private labels continue to face pressure on their profit margins and payment and delivery terms. However, growth in such private label sectors does offer significant rewards for well-run and innovative suppliers given the expected increase in market share of private label goods.”

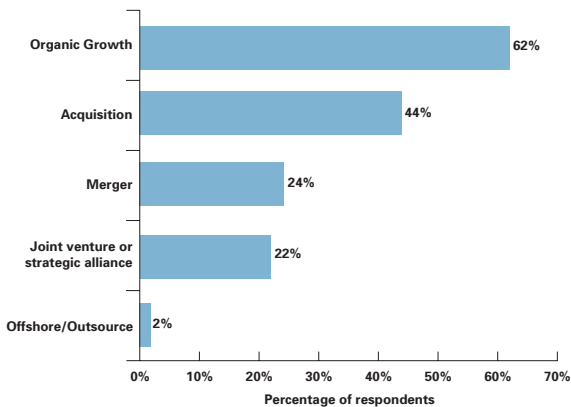
Sarah Hanson, Commercial Partner - Consumer Products, CMS Cameron McKenna

“Another issue which we believe will become more important for all participants in the market is the management of water resources in food and drink production. Many companies (for example, Nestlé) already have focussed water management programmes. Consumers are also increasingly basing purchasing decisions on how they feel manufacturers and retailers are addressing environmental issues as water management and carbon emissions.”

Louise Wallace, Head of Consumer Products, CMS Cameron McKenna

M&A and Company Growth

What do you expect to be the chief sources of growth for your company in the next few years?



Respondents typically picked more than one source of growth for their company in the coming years. A sizeable 62% of respondents expect their company to grow by organic growth. A combined 68% of respondents expect their company to expand its operations via a merger or acquisition while a joint venture/strategic alliance was selected by 22%. Given the recent expansion of the European Union that has created opportunities for companies to reduce labour costs through outsourcing, it is noteworthy that only 2% of respondents expect their company to enjoy significant growth as a result of either offshoring or outsourcing in the coming years.

“Organic growth is the gold standard for the large food companies, but genuine innovation is often the domain of the smaller companies. The key challenge for the large brands is that they enjoy fat margins in low growth segments – whereas innovation in new fast growth areas offers lower margins. There is also the added challenge that a lot of the growth is taking place in new channels (e.g. farm stores, vegetable boxes etc) where traditional branded players are simply not geared to compete.”

Oliver Wyncoll, Langholm Capital

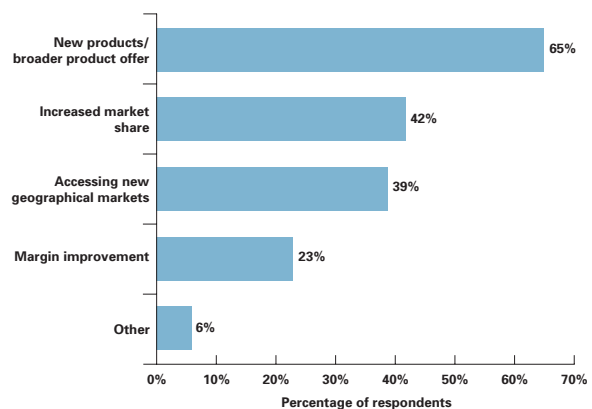
“The continuing availability and competitive terms offered by debt finance providers, coupled with record fundraising by private equity funds in the last twelve months, should provide opportunities for strategic acquisitions and disposals as well as access to finance for investment in organic growth. Deals such as the acquisitions of Unilever’s frozen food business, the acquisition of United Biscuits and the approach for Sainsbury’s demonstrate the continuing interest of private equity in the sector, not just for mid-market deals but also high profile or large listed companies.”

Richard Montijn, Corporate Finance Partner, CMS Derks Star Busmann

“Where growth is sourced through acquisition or merger the consolidation should factor in the involvement of competition authorities especially where high value transactions are involved. Authorities will be primarily concerned with ensuring consumers will continue to enjoy the benefits of choice, low prices and high quality products which are assumed to arise in a multi-player competitive market. Companies growing through merger and acquisition will need to convince authorities that their proposed efficiencies and increased consumer value will not result in a weakening of their suppliers’ positions, reducing supplier investment, innovation and diversity.”

Susan Hankey, Competition Partner – Consumer Products group, CMS Cameron McKenna

If organic growth: What are the main drivers for your organic growth?



M&A and Company Growth

Amongst the respondents who selected organic growth as their company’s principal driver of growth, 65% believe that new products and broadening the existing product base will be the principal drivers of their organic growth strategy. Amongst the 6% of respondents who selected another option other than those listed above, one respondent explained that their company will be focusing on accessing new market segments with particular emphasis on convenience foods. This compliments the above survey finding regarding the best growth opportunities over the next 12 months, where it was seen that 44% of respondents expect convenience foods to provide the best growth opportunities in the sector over the next 12 months.

“Food and drink businesses should not underestimate the costs, time and effort, not to mention the financial and reputational risk involved, in designing and bringing a new product to market and attempting to broaden geographical scope – an unsuccessful launch of a new product or venture can often have knock on effects in other parts of the existing business and reputation of the business as a whole.”

Susan Barty, Advertising & Disputes Partner – Consumer Products group, CMS Cameron McKenna

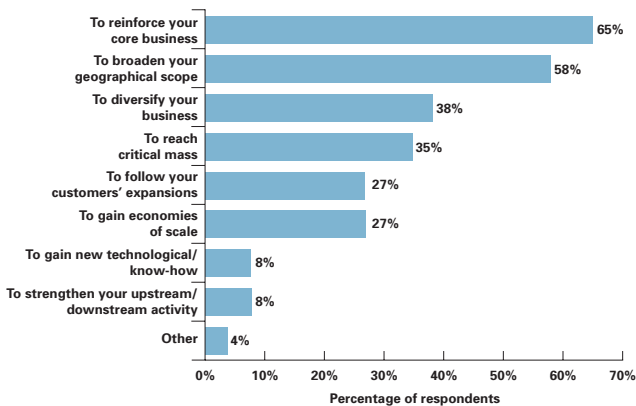
Amongst the respondents who asserted that their company will grow through a merger or acquisition, 65% believe that this will be driven by the need to reinforce core business activities. On the other hand, 58% believed any M&A activity undertaken by their company will be driven by the need to broaden geographical scope.

Business diversification (38%) was also selected by a substantial number of respondents. Technology gains and the strengthening of upstream/downstream activity (both 8%) did not emerge as important drivers of external growth in the eyes of respondents.

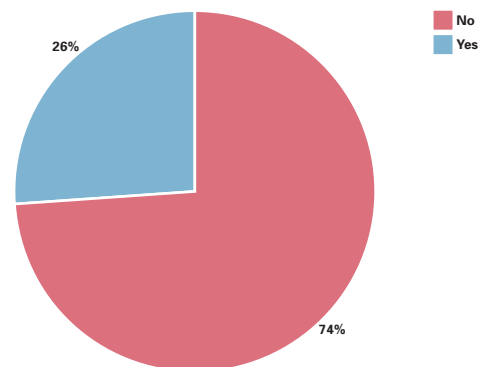
“In view of the growth and development of Central and Eastern European and Asian economies and the opportunities presented by such markets’ increased demand for consumer products, it is not surprising that a much higher percentage of respondents than in 2005 view broadening geographical scope as important. It does however seem that a large number of players do also see M&A as a somewhat defensive tactic to reinforce core businesses.”

Malgorzata Surdek, Commercial Partner, Warsaw, CMS Cameron McKenna

If mergers and acquisitions: Which of the following are the most important in your pursuit of external growth?



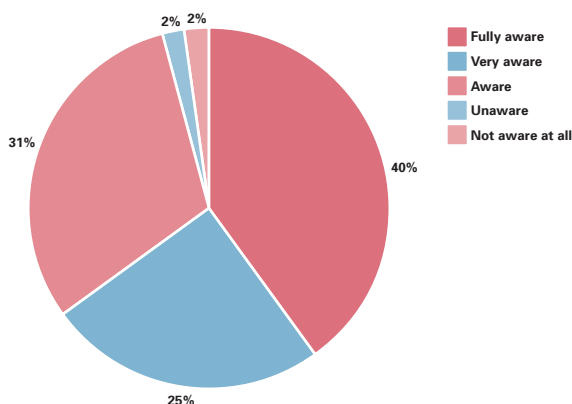
Have you disposed, or do you plan to dispose, of any non-core assets of your business in the last 12 or next 12 months respectively?



Nearly three quarters of respondents (74%) have not and do not plan to dispose of any non-core assets in the next 12 months.

Financing

How aware are you of the financing possibilities for acquisitions?

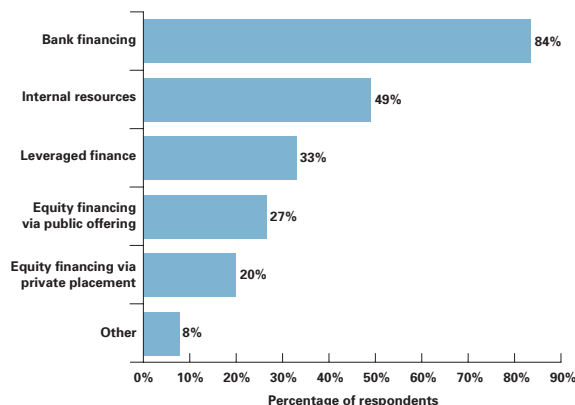


Only 4% of respondents profess to be less than aware of their company's financing possibilities for acquisitions. 40% claim to be fully aware while a further 56% believe they are very aware or aware of potential acquisition financing.

“The abundance of debt funding has driven M&A activity in the last few years, however as the cycle tightens there will be a flight to quality and scale. Private equity will continue to be attracted to the strong cashflows of the sector and the opportunities created by the restructuring of the multinationals. Certain PE funds also have a differentiated role to play in providing the circumstances, resources and experience to allow small businesses to innovate and grow rapidly in niche markets.”

Oliver Wyncoll, Langholm Capital

What financing options would your company consider using for making acquisitions?



A dominant 84% of respondents would consider using bank financing for making acquisitions. 49% would predominantly use internal resources while 33% of respondents would consider using leveraged finance. Equity financing via a public (27%) or private placement (20%) appear to be less popular financing methods but are nevertheless still chosen by a number of respondents. 8% of respondents selected another financing option with a public offering being mentioned. A number of respondents selected multiple potential financing options with one respondent reasoning “We tend to look at every possible financing possibility – our financing is already multi-sourced”.

“Respondents’ increased awareness of different funding possibilities and structures should provide enhanced opportunities for them to take advantage of the current availability of debt and equity finance to invest in organic growth as well as M&A. Recent interest rate rises may give rise to some concern but this is likely to be countered by growing innovation in financing solutions and structures, as well as the availability of finance from a wider range of debt providers and financial institutions.”

Richard Montijn, Corporate Finance Partner, CMS Derks Star Busmann

“Ample liquidity drives the current M&A market with increasing multiples and increasingly attractive debt structures. We’ve recently seen stapled financing offers of 9.0-10.0x EBITDA for large transactions in food. In addition, the equity part of financing structures is reduced by innovative financing tools and documentation and covenants are becoming less strict.”

Maarten ter Haar, Rabobank International

Financing

“Another big driver of change in the food sector is the commodity price rises caused by economic expansion in China and other countries. With the increase in biofuels production from crops like wheat, corn and sugar cane, costs of basic food-stuffs are continuing to increase with resulting pressures on margins which will lead to further consolidation.”

Maarten ter Haar, Rabobank International

What do you expect to happen to the level of M&A activity in the sector over the next 12 months?

Respondents appear to be very confident regarding M&A prospects in the next 12 months. Nearly two thirds of respondents (64%) anticipate an increase in M&A activity, while 32% expect M&A levels to remain the same in the coming 12 months. Furthermore, only 4% of respondents expect M&A in the Food Sector to experience a downturn.

“We believe that M&A activity will be fuelled by consolidation at the manufacturing and supply level as well as the appetite for products within sectors that respondents see as higher growth areas – health foods and drinks, locally sourced products and organic foods. In the UK, the outcome of the Competition Commission inquiry into the sector and the attitude of the Pensions Regulator and trustees may have an impact on M&A – particularly in respect of large public deals.”

Martin Mendelsohn, Corporate Partner - Consumer Products group, CMS Cameron McKenna

“As in general the absolute value (size) of food companies is low compared to other industry sectors, financial sponsors need to buy more food companies or only pick very large food companies, in order to sustain a healthy diversification of their portfolio over the various industry sectors. As such, financial sponsor interest in the food sector is less volatile compared to other industry sectors.”

Maarten ter Haar, Rabobank International

What do you expect to happen to the level of private equity activity in the sector in the next 12 months?

After the recent high profile buyouts of United Biscuits and Unilever's frozen food division by Blackstone and Permira respectively, it is perhaps predictable that 56% of respondents expect to see increased levels of private equity activity within the Food Sector. 40% expect the level of deal making from private equity funds in the sector to remain the same in the next 12 months while only 4% foresee a slowdown.

“2006 was a bumper year for deals involving private equity funds – with record funds raised by funds recently, we anticipate that private equity investors will continue to be attracted by the sector's cash flows, opportunities to leverage brands, improve efficiencies and increase profit margins. Competition for well-run businesses will increase, whilst exits through secondary or tertiary buy-outs and trade sales will also fuel further activity.”

Louise Wallace, Head of Consumer Products, CMS Cameron McKenna

“We believe that food remains a very attractive sector for private equity even at higher valuations than current industry averages. In their portfolios, financial sponsors need defensive assets in terms of cyclicalities. In general, food is a less cyclical industry compared to other sectors and generates relatively steady cash flows to pay-down debt in both bull and bear markets.”

Maarten ter Haar, Rabobank International

Are you planning to roll out greater numbers of new products in the next five years than in the previous five years?

65% of respondents plan to roll out a greater number of new products in the next five years. Indeed a number of respondents claim that such new products will represent a marked departure from previous products. Those sentiments were summed up to good effect by the following response, “We do plan to roll out a greater number of products but not in the conventional sense. We try to bring out new products that have very different ideas behind them”. The remaining 35% of respondents claim that their company does not plan to increase the level of new products rolled out in the next five years.

Do you plan to invest more in brand development in the next five years?

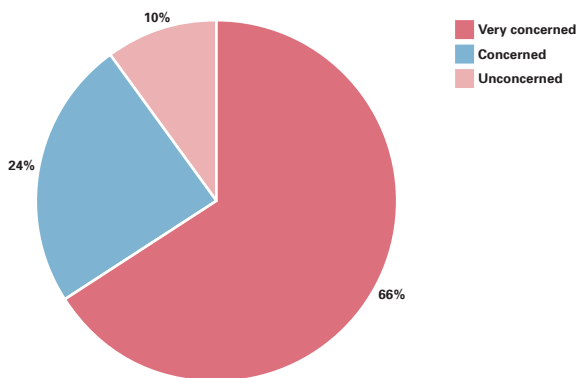
79% of respondents claim that their company plans to increase the level of investment behind brand development in the next five years.

“Brands remain the primary tool in the battle for customers’ hearts and minds and differentiation in the market, and hence a logical focus for continuing investment. As noted, the past year has seen increasing diversification within the brand structure itself as the market leaders respond to the growing challenge of private label competition. Due to the substantial cost of creating and clearing new brand developments, many commentators have also predicted the potential for an increase in “retro” or “revival” brands, where previously abandoned labels are resurrected, rebranded and relaunched to platform from latent brand equity. The changing face of advertising will also influence brand spending as markets and consumers fragment and become more dissipated as a result of increased choice in programming and distribution in the media. Whilst this can assist with targeted campaigns, the most appropriate forum for products with mass appeal is becoming more elusive.”

Tom Scourfield, Intellectual Property Specialist –
Consumer Products group, CMS Cameron McKenna

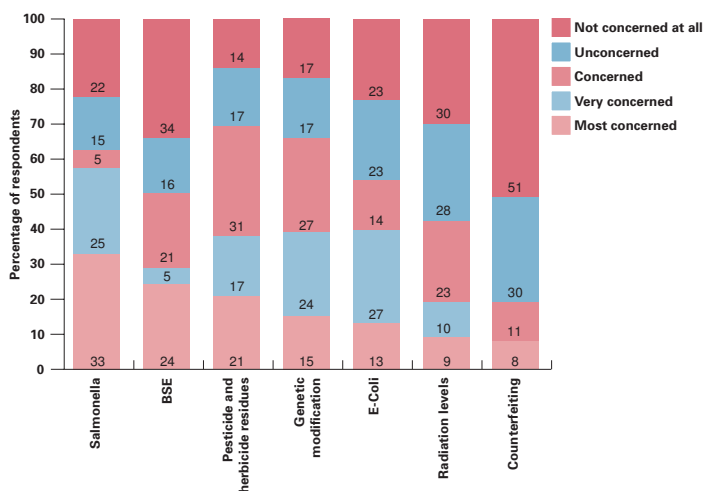
Regulatory and Safety Issues

How concerned do you think European consumers are about the safety of food produced in the EU?



Respondents appear to recognise the general food safety concerns amongst consumers in Europe. This is borne out by the fact that 66% of respondents believe European consumers to be very concerned over the safety of EU produced food while an additional 24% believe consumers to be concerned. Only 10% of respondents thought consumers were unconcerned.

Which of the following food safety issues are of concern to you?

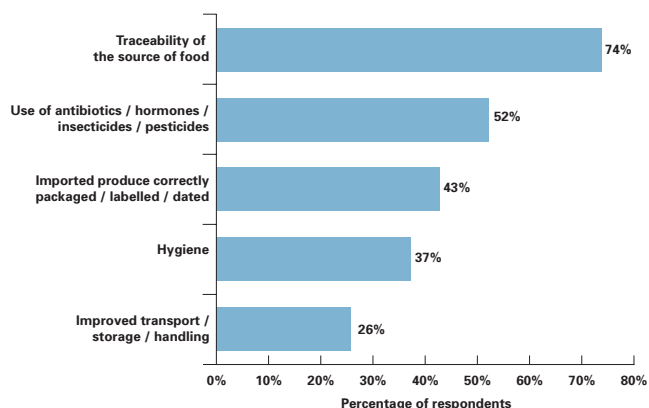


Respondents appear to be relatively concerned regarding a number of food safety issues. The primary area of concern appears to be the issue of salmonella, with 58% of respondents professing to be at least very concerned over the matter. Such concern amongst respondents was summarised by the following comment: “ For our company this is the main issue but it is unlikely to break out. But if it did, it would undoubtedly prove disastrous” . Pesticide and herbicide residues also seem to be a major cause for concern amongst respondents with 21% saying they are most concerned over this issue and an additional 48% claiming to be either very concerned or concerned. Moreover, half of the respondents are concerned about BSE. Radiation levels and counterfeiting do not appear to worry respondents with 58% and 81% respectively saying they are less concerned by these issues.

“Globalisation of processes means that it is much easier for contamination to spread to a much larger number of products. An increase in the specialism and availability of testing facilities and the importance given by consumers to, for instance, 'organic' claims, means that products and brands may be at increased risk of, at least publicly perceived, safety issues. Where the contamination has any possible human health impact the company must be seen to act responsibly. Further, where there is scientific uncertainty any action must be taken in accordance with the precautionary principle.”

Jessica Burt, Food Law Specialist –
Consumer Products group, CMS Cameron McKenna

What, if any, food safety issues need to be addressed by the industry itself or by organisations that oversee food safety regulation?



With regard to the above graph, it should be noted that a number of respondents commented that they do not believe that any prevalent food safety issues currently exist that need to be addressed. One respondent summed up such sentiments by remarking, “None of these issues are of particular concern to me – I think a lot has already been done in the past few years”.

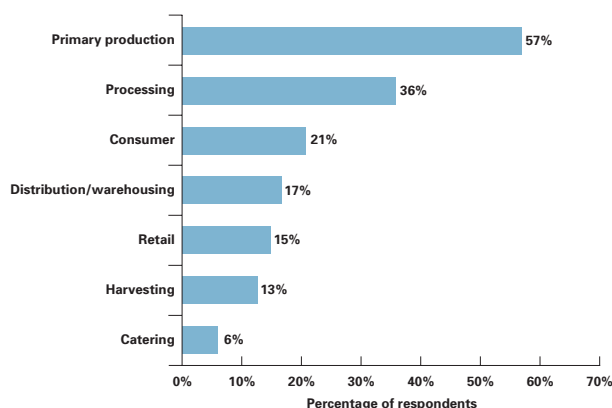
"Indeed with the EU General Food Regulation 178/2002, implementation of the more recent food hygiene regulations and other sector specific legislation, coupled with the priority provided to this by industry, food safety standards should be at an all time high. However, there should be no room for complacency, due diligence processes and risk management should be regularly audited and updated."

Jessica Burt, Food Law Specialist –
Consumer Products group, CMS Cameron McKenna

In response to recent high profile product recalls by companies such as Cadbury and Unilever, do you think retailers should have to do more to reassure consumers over issues?

Respondents’ views were mixed on the subject of whether retailers should have to do more to reassure consumers in response to the recent high profile product recalls. 47% of respondents believe retailers should do more, 36% disagreed with this point of view and 17% of respondents were unsure.

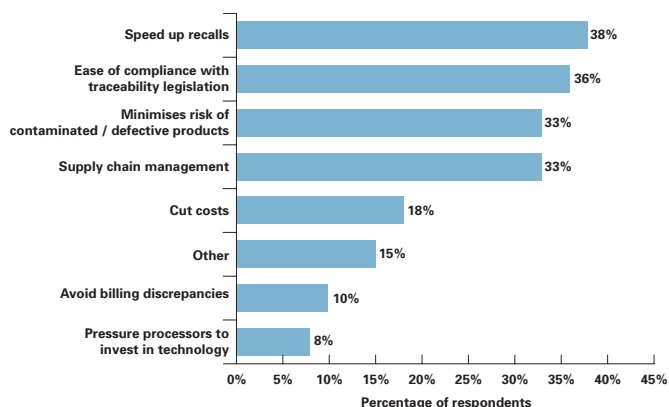
At what stage in the food chain, if any, would you be most worried about safety risks for your products/ brands?



Primary production is identified by 57% of respondents as being the stage of production that causes the most concern over food safety risks for their products and brands. The processing stage was cited by 36%. A small number of respondents conceded that there can be problems at any stage of the food chain with such views being typified by the following response: “All stages of the food chain are very important and should be monitored closely although as far as we are concerned the manufacturing process generally provides the greatest cause for concern”.

Regulatory and Safety Issues

Following EU food traceability legislation that came into force on October 27 2006, what do you believe to be the potential benefits of adopting RFID?



A significant amount of respondents believe that adopting Radio-Frequency Identification (RFID) will bring about a number of benefits for the food industry. 38% of respondents believe that RFID technology, which essentially incorporates the use of radio frequency to uniquely identify a product, will speed up recalls while 36% are in favour of adopting it to comply with EU food traceability legislation. Moreover, one third of respondents believe that RFID would be beneficial in that it will both minimise the risk of contaminated/defective products and help with the management of the supply chain. Respondents appear to be less convinced about the benefits of RFID with regard to pressuring processors to invest in technology (8%), avoiding billing discrepancies (10%) and cutting costs (18%).

"The EU Health and Nutritional Claims Regulation will come into force in 2007 and the increased voluntary regulation in the UK via OFCOM's restrictions on advertising of foods high in fat, salt and sugar that came into force from 1st April 2007 means this intuition is likely to be correct."

Jessica Burt, Food Law Specialist –
Consumer Products group, CMS Cameron McKenna

What do you believe will happen to advertising regulations within the sector in the wake of consumer group/ governmental pressures and growing levels of obesity?

Rather intuitively, 86% of respondents believe that advertising regulations will become more stringent in the wake of growing levels of obesity and pressure from consumer groups and the government. However, one such respondent did suggest that more stringent advertising regulations will not alone solve the current health problems that exist and noted, "Merely increasing controls over advertising will not help. There are various issues behind obesity such as a lack of exercise and parental control."

"It is clear that food advertising is going to change, particularly for foods considered high in fat, salt and sugar, and that the environment will continue to become tougher for food companies in terms of reaching their target market. Advertisers are already feeling the effect of the new advertising restrictions which have come into force and will have to take increasing care in terms of the content and scheduling of their advertisements."

Susan Barty, Advertising & Disputes Partner –
Consumer Products group, CMS Cameron McKenna

A Taste of Things to Come



The last year has seen a number of mid-market consolidations in the Food Sector and a flurry of acquisitions, with the private equity houses once again making their presence felt in the some of the biggest deals in the sector.

In November Permira announced that it had acquired the majority of the European frozen foods division of Unilever in the form of the brands 'iglo' and 'Birds Eye' for €1.725bn, and in December Blackstone added United Biscuits to its portfolio in a joint acquisition with PAI funds in a deal worth approximately €2.4bn. Whilst many food manufacturers have taken comfort in consolidation, the appetite for investments by private equity houses in high quality brands has continued (branded products accounted for 90% of United Biscuits sales in 2006).

Private equity is also set to make the headlines in the food and drink sector in 2007 with private equity as well as trade buyers showing a healthy interest in the advertised split of Cadbury Schweppes, the sale of Burtons to Duke Street Capital and the interest shown in J Sainsbury by private equity players.

Even with food and drink manufacturers facing a period of unprecedented change with issues such as climate change and sustainability now finding their way to the top of the social and political agenda, many are still predicting that the temperature will be turned up even further by the private equity houses and other wealthy investors. So, if this prediction is right, what are the legal topics most likely to find their way to the top of the agenda when carrying out due diligence on a potential target? Brands will almost certainly be there, in fact, one could possibly go as far as to say that brands are this year's black! It takes an enormous amount of time and investment to create a successful brand, yet it can be destroyed in a fraction of the time. Hence, another key area will be food safety; the consumers' health and safety is paramount. Then, with even more consolidation and acquisition activity predicted, anti trust issues are likely to be at the forefront of people's minds.

Leveraging strong Brands

An increasing trend in M&A activity has been the growing importance of brands in driving deals and providing key differentials in the market. Little wonder perhaps, that the overall importance a brand will play in the battle for consumers' hearts and minds will equally make its presence felt on the balance sheet and in the boardroom.

The majority of respondents to the study agreed that an increased focus in brands and marketing would be a key driver for growth, with most respondents also planning on significantly increasing investment in core brands over the next few years.

Strong brands are always a tempting target for an acquisition, whether as a bolt-on acquisition to an existing business or product line, or as a private equity purchase of the whole label. In addition, unlike some tangible assets, a strong brand backed up by a healthy intellectual property portfolio can easily be separated and purchased as an asset-only deal, or hived off and re-sold at a later date.

The importance of good due diligence on any brand-based acquisition cannot be overestimated. Whilst the brand itself will be the most important vehicle of commercial goodwill, the brand is only as good as its underlying IP portfolio and the constituent trade marks, designs and copyrights. When it comes to post-acquisition enforcement or leverage, an ill-prepared purchaser may find holes in the rights in specific product classes or entire geographic areas. In particular, it is not uncommon in the FMCG sector for the registered IP portfolio to lag behind the actual use in the market by up to two years. Therefore protecting nascent brand equity for new product lines can be a precarious business and open to competition from copycat and me-too products in the short term. By contrast, an IP portfolio may appear comprehensive, well organised, cross-licensed and entirely up to date but does not reflect the key attributes of the commercially important products.

A Taste of Things to Come

Good due diligence, as in all things, should involve a consistent dialogue between legal, commercial and sales and marketing, to ensure the acquisition lives up to its promise.

Fully understanding the impact that an acquisition of a brand can have on consumer perceptions of the existing product line and brand culture is also an important factor. Consumers also invest in brands, albeit in a very different way, and can be highly sensitive to any perceived shift in value, ethos or attributes. Goodwill is a sensitive asset, and can be diverted or damaged without care and attention. Consider for example the difficult reaction faced by Unilever on its acquisition of Ben & Jerry's, where consumer revolt over a perceived "sell-out" of their quirky brand hurt sales in the short term and required a major PR drive. For a more recent example of the challenge of fitting a niche brand with very specific attributes into a wider and more diverse range, one need only consider the acquisition of Green & Black's by Cadbury-Schweppes.

Food Safety

The safety of a product is critical to a business and nowhere is this more evident than in the food industry. A recall can have major implications for a food business both in respect of its reputation and brand, as well as commercial ramifications of meeting supply obligations and cashflow.

Although it is arguable that food in Europe has never been safer, there has generally been a rise in the number of withdrawals and recalls of products in recent years and particularly recalls over a number of products (Para Red and Sudan 1 recalls) or the entirety of a number of batches (Cadbury's recall.) The levels of recall now being seen is likely to be one of the indirect consequences of the drive for economies of scale and globalisation, whereby a contamination at the beginning of production can feed its way through to a much larger market than ever before. Crisis management plans should therefore evolve with the company to recognise this.

The Food Perception Study indicates that whilst the vast majority (90%) of food businesses believe European consumers to be 'concerned' or 'very concerned' about food safety, a number felt that in fact there were no prevalent food safety issues that needed to be addressed by the industry.

This may be as a result of recent legislation, from the EU food hygiene legislation that applied throughout the UK from 1 January 2006 introducing a 'farm to fork' approach to food safety by including primary production, to the bedrock of modern food safety legislation as set out in the EU General Food Regulation 178/2002, which set up the European Food Safety Authority (EFSA) and implemented requirements on traceability throughout the supply chain, as well as the 'Food Safety Requirements' requiring companies not to place unsafe food on the market.

So far so uncontroversial, however, the real change came in the formalising of the responsibilities of food business operators. Where there is any control over the food at any stage of its processing or supply and that business has a reason to believe the Food Safety Requirements have been breached then, if the product has left their immediate control, there is an obligation to withdraw it and notify the competent authorities. This has resulted in a much larger number of 'trigger' withdrawals of food than may otherwise have been the case.

The method of assessing whether there has been a breach of the Food Safety Requirements involves a risk assessment based on the available scientific evidence. Risk management should take into account various factors including the results of risk assessment, the opinion of the EFSA and the 'precautionary principle' (where there is scientific uncertainty only) in order to achieve the highest health protection to consumers.

Although there will never be zero risk in any product, in practice, the sensitivities concerning food are such that where there is any hazard foreseen to the consumer, no matter how unlikely, caused by something not envisaged in the product or warned against, it is likely a withdrawal will be ordered. Food businesses seeking to argue the unlikelihood of the hazard as justification against notification and withdrawal will need to have strong scientific evidence reinforcing their claim that human health is not at risk.

In summary, when carrying out due diligence, a purchaser should ensure that the target has sought to reduce risk, comply with its legal obligations and protected its brand. If the target has done this, it will offer the best protection to both its customer base and product(s).

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your industry your issues your lawyers

- Are you prepared for a health scare involving one of your products?
- How are changing attitudes to health and the environment affecting your business?
- What is your strategy for dealing with copycats and lookalikes?
- Do your distribution arrangements comply with EU competition rules?
- How is your business positioned to take advantage of the continued boom in M&A in the sector?
- Do your adverts meet the new rules for advertising to children?

At CMS we recognise that our clients operate within specific market sectors, each affected by different pressures. Through our dedicated Consumer Products group we provide you with professional advice from lawyers who understand your commercial needs.

For more information, email louise.wallace@cms-cmck.com

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A Taste of Things to Come

Anti-Trust

With more and more brands being bolted together with existing businesses or forming part of larger investment portfolios, two core competition law issues are likely to come into play – possible merger control filings or behavioural problems emerging from due diligence.

Merger control – Ketchup or sauce?

Many acquisitions will be subject to mandatory notification requirements to the merger control authorities whether in an EU-wide context or in national jurisdictions – many of which have surprisingly low qualification thresholds for this requirement. This is true even if the parties are not competitors.

If they are competitors, then market definition will be key to determining whether there is a serious issue which could hold up a deal or, in some cases, prevent it (rather than just a notification requirement as a bureaucratic necessity). Parties to acquisitions should pay attention to the individual markets in which they operate to avoid any increases in concentration of control in a particular narrow market context.

An example of an acquisition that caused the Competition Commission to examine differing markets was the Heinz purchase of HP Foods. In that case the Competition Commission in March 2006 distinguished separate markets for the supply in the UK of ketchup versus brown sauce. Narrow market definitions like this may appear exaggerated but they are standard practice and demonstrate the complexities of scoping a particular market for the purpose of merger control.

One of the most important aspects of any merger activity is the carrying out of due diligence checks. In this context there are a number of competition issues that should be considered in the due diligence process, such as those outlined below.

- Pricing issues
All retailers must be completely free to set their own prices as they wish. Whilst it is legitimate to recommend a retail price and even in some cases stipulate a maximum price, specifying a minimum retail price, a fixed retail price or enforcing a recommended retail price using any direct or indirect pressure, incentives or threats will constitute a serious infringement of the competition rules. This is an area that frequently gives rise to concern on the part of sales teams negotiating with retailers.
- Stocking and exclusivity arrangements
With the pressure on available shelf space ever increasing, manufacturers frequently seek a variety of ways to ensure their products are stocked in place of those of their competitors. These measures may be problematic under competition law, especially where the supplier enjoys a dominant position on the market. A “dominant position” means, in essence, being able to act independently of your competitors. The rule of thumb to define dominance is a market share above 40%.
- Category management
Manufacturers are frequently invited to participate in category management initiatives by retailers where they are asked for their recommendations on the product range for the category and other related matters. Participation itself does not give rise to any competition concerns but it should be carefully monitored. The relationship should be between the manufacturer and the retailer only. The disclosure of commercially sensitive information between competitors should be strictly limited. Category management should not be used as a forum for manufacturers to agree between themselves as to the appropriate listings or placements within a category.

The above are just some of the typical areas in which the Food Sector may face competition concerns in due diligence reviews of potential merger targets and of the markets in which they operate.

Conclusion

2007 is an exciting time for the food industry with additional consolidation looking highly likely (particularly involving private equity and foreign investors). Meanwhile companies are grappling with increased legislation, pricing pressure and numerous social issues from obesity to sustainability. By way of summary, Guy Weldon, a Partner at Bridgepoint Capital, whose portfolio of investments in the sector have included Golden Wonder, Noon Products and WT Foods businesses, comments that:

“2006 was a record year for private equity activity in the food manufacturing sector – its less cyclical characteristics, stable cash flows, opportunities to increase efficiencies and profit margins within businesses and to leverage well known brands should mean the sector remains attractive for private equity investors”.

By Louise Wallace – Head of Consumer Products
Richard Bull – Solicitor in the Consumer Products group
CMS Cameron McKenna LLP

Langholm Capital - “ More than just money”



Langholm Capital, as a differentiated private equity investor, focuses entirely on high growth businesses in the consumer sector across Europe that have the potential to exploit fundamental and long term changes in consumer behaviour or consumer demographics. This consumer and growth focus, as well as the resources of its major investors (Unilever and Rabobank) enables it to create value through accelerating and de-risking growth strategies.

Case Study:

Langholm Capital's acquisition of Dorset Cereals demonstrates a new type of private equity investment that is providing the vision, strategy and resources to implement genuine long term and sustainable growth.

Langholm Capital's next investment is as likely to come from its in-house sector research as from being contacted by a corporate finance advisory firm or investment bank. Such was the case when we found Dorset Cereals. The business was founded in the 1980's and had initially grown strongly on the back of the growing interest in healthy eating. It had a fantastic product, which was natural, healthy and used high quality ingredients. In the period following the fall of the Atkins diet and the rejection of overly processed foods this natural range of breakfast cereals was waiting to be re-launched in a new format. However it lacked the considerable investment and confidence to change the formula that had been so successful to date.

The founder of the business did not want to appoint advisers to inform the investment community or other potential buyers in the sector, who as a consequence would be likely to inform its key retail customers of his intention to sell the business. However, he was prepared to engage with professionals who knew the sector, and understood the opportunities and challenges that he faced.

To turn this opportunity into a deliverable investment it was also necessary to have the insight and capabilities to create a vision and strategy for where the business could go to and the confidence to fulfil the potential, all within a process that had the integrity and deliverability to enable a transaction to be completed at market value with utmost confidentiality.



At the time of Langholm's acquisition, Dorset Cereals was a fast growing and award winning manufacturer of healthy breakfast cereals, based in Poundbury in Dorset, employing 50 people. It produced a range of cereals under its own label and also as private label for major UK supermarkets. Its Dorset Cereals range was exported to over 50 countries and had created for itself a small, but loyal and enthusiastic group of followers who had themselves found or been recommended the product due to its exceptional taste, quality and natural credentials.

An ambitious brand led growth plan

Having agreed a transaction with the vendors who wanted to retire, the business needed a new management team that would share our vision, buy into the business plan and invest their own money. Whilst Dorset is a lovely county in the South West of England, with many desirable features, it is not the first place to start a search process for a seasoned management team. However, the quality and potential of the business, the ambitious plan that we had created and the commitment to investment and resources that the plan required, enabled us to find a management team who possessed the experience, skills and enthusiasm to match the ambition. Langholm was also willing to “over-invest” in a management team to the level of what the business could be and not where it was on acquisition. The MBI team, Peter Farquhar and Nigel Horsman, brought a wealth of experience in both the FMCG sector and in building vibrant brands. They have now become genuine “cereal entrepreneurs”.

The plan for Dorset Cereals at the time of the acquisition was to create a business where the brand had genuine points of difference and to implement a strategy that was innovative and responsive to consumer trends. In essence there was an opportunity to break the “category rules” and go where the traditional brands would find it hard to go. We also planned simultaneously to implement growth plans through creating new products and entering new markets.



With substantial investment from Langholm in senior management, marketing, brand communication, packaging manufacturing, supply chain and new product development, the business has been transformed to one that is brand-led, with a focus on the consumer. The brand is now the fastest growing in the UK cereals category, exporting to over 60 markets and employing over 100 people. It continues to win awards for its product and its packaging.

The market opportunity

The overall UK breakfast cereals market, is large but shows low growth. The sector is dominated by Kelloggs, with several other large players. However, within the overall market there are several pockets showing higher growth, such as healthier cereals and hot cereals. Additionally, several brands have been successful in moving into cereal bars.

A number of the larger brands struggle to translate their brand equity into the growth trends within food in a credible way. The interest in more natural food, with provenance in its sourcing and the trend to premium are challenges for the big brands, where the credentials and trust that consumers require are harder to substantiate.

Relaunching the brand

In 2006, after significant investment by Langholm in the factory; new packaging; brand communication and new product development, the new look Dorset Cereals was re-launched. The brand, with its recipes and taste credentials to the fore, and a brand essence which stands for “honest tasty and real” has captured many new hearts and minds, with a 400% uplift in sales value to date since re-launch in just 12 months, and 1 million households penetrated.

Since re-launching the brand, management have also launched 18 new products, including mini variety packs; a range of 3 porridges; organic muesli; tasty toasted spelt and chunky slices. The brand is positioned to move outside of its current sector and become a genuine cross-category brand.



Langholm Capital - “ More than just money”



The Value of Langholm Capital’s model in creating value

Finding investment opportunities has become increasingly challenging in a market where there is more money than ever chasing good investments. Having the credibility to convince the owner that he would get a market price and that in engaging with Langholm he could be confident that the transaction would be progressed professionally, confidentially and with integrity, were critical components of making a transaction happen.

For Dorset Cereals, finding the right management team with the requisite skills, experience and enthusiasm, and willingness to work in Dorset, was the next step in the transaction. Backing the management team with significant investment for a small company with serious ambitions was essential in making the investment attractive. Langholm also delivers on its commitment of providing “ more than just money” . As Peter Farquhar, CEO and shareholder puts it, “ when I need help or advice Langholm expertise is always available, but when I just need to get on with it, I get the autonomy to get the job done” .

Having the insight and networks of Langholm, Unilever and Rabobank at its disposal, has provided substantial other opportunities to accelerate and de-risk the growth plan, whether it be introductions to leading brand agencies, pack design agencies, technical new product development specialists, or assistance with use of Unilever’s financial models for customer and product profitability. Sometimes doors open faster and plans can be implemented with more speed and confidence given the wealth of experience at the disposal of the management team.

The future of Dorset Cereals

There are relatively few new brands that really capture the hearts and minds of consumers as well as their mouths: there are Innocent; Rachel’s Organic; Yeo Valley; Green & Blacks and Gū, who have achieved this status in recent years in the UK. To that short list has been added Dorset Cereals. All of them have broken the mould and the category rules in some way and each has been able to move out of its initial subsector.

The future is very bright for Dorset Cereals, with more tasty new products planned for launch that encapsulate the “ Simple Pleasures of Life” , more new markets to enter and new opportunities with major chains of international retailers interested in finding new brands that are on trend with consumers’ desires and values. There is also the opportunity to take the Dorset values of “ Honest tasty and real” and create a genuine cross-category brand. Who says private equity is always looking to strip, squeeze and re-organise, after all private equity can be more than just money?

More than just money

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Rabobank International



Cross-border transactions in food are really taking-off

Rabobank

As M&A specialist in the international food sector, Rabobank is more than pleased to provide a contribution to the Food Sector Report 2007. The survey of food sector industry respondents has produced findings which reflect many of our own experiences of the food sector. In particular we note the central role of M&A as the food sector consolidates and seeks to respond to the challenges it faces. Key conclusions from the study are:

- Over three quarters of respondents are optimistic about future growth and profitability
- Main threats are considered to be retailer consolidation and industry overcapacity
- The main driver behind growth is increased levels of innovation in added-value food areas
- About 70% of respondents expects to grow through mergers and/or acquisitions
- Nearly two thirds of respondents anticipates an increase in M&A activity in the coming 12 months
- Primary industry sectors for increased M&A activity are fresh produce, organic foods and convenience food
- Principal drivers behind M&A activity are reinforcement of the acquirer's core business and broadening of geographical scope.

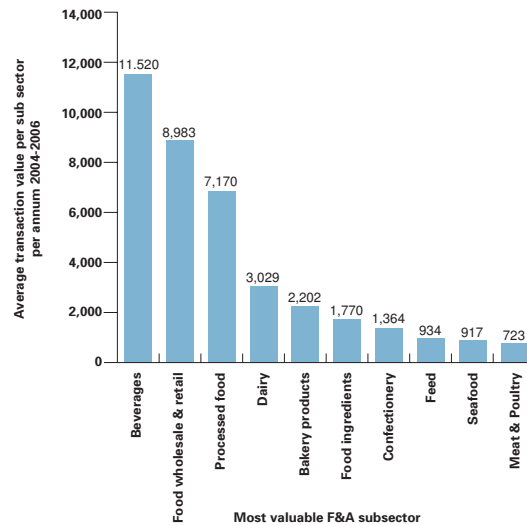
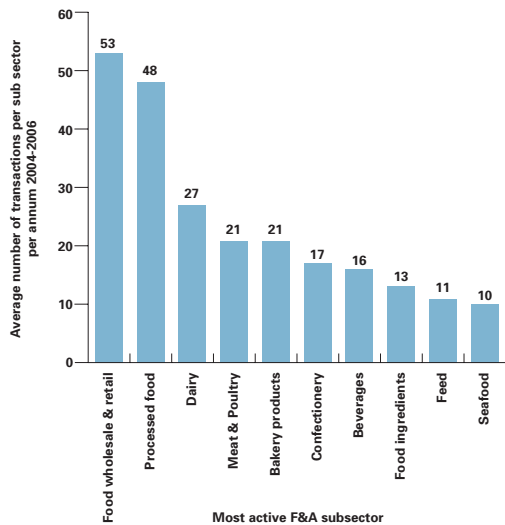
Major transactions in food are on the rise

In 2006, the European food sector witnessed high levels of M&A activity: total transaction value reached EUR 48bn, slightly below the 2005 record of EUR 51bn (2004: EUR 32bn). In the food sector the number of major transactions, which we take to be those valued at over EUR 1 billion, are relatively limited compared to other industry sectors. 2006 however, was a record-year in terms of major transactions which included amongst others the EUR 2.8bn acquisition of UK food conglomerate RHM by UK branded foods manufacturer Premier Foods, the sale of UK biscuits manufacturer United Biscuits by Finalrealm (a consortium comprising Cinven, PAI, DB Capital Partners, and Kraft Foods) in a EUR 2.4bn secondary buyout to Blackstone Group, the acquisition of Egidio Galbani by Groupe Lactalis for EUR 1.8bn, and the sale of Unilever's Frozen Foods division in a EUR 1.7bn sale to Permira.

Steady transaction volume shows fragmentation of the market

In terms of volume, 321 transactions in food were recorded, a 9% increase compared to 2005, indicating that the consolidation of the European food sectors is gaining further momentum. The food sector tends to be rather stable in terms of volume, with over 300 transactions per annum being recorded in Europe consistently, even in 2002/2003 when the M&A market overall saw a significant downturn in activity as equity stock markets fell. With this average of 300 transactions per annum, the food sector ranks at the top of the most active industry sectors in terms of M&A transaction volume compared to other industry sectors. In terms of value, however, the food sector ranks substantially lower, indicating the relatively high level of fragmentation within the European food markets. We expect this volume level of transactions to continue in 2007. Corporate M&A activity is strong with food multinationals continuously pruning their portfolios and smaller and medium-sized enterprises either exit or acquire companies to change their strategic positioning. In addition, volume growth is further fuelled by financial sponsor's interest in the sector. Also newly emerged subsectors, such as biofuels, will have a positive impact on the expected transaction volume. In terms of M&A activity on a subsector level the food wholesale & retail, processed food and dairy sectors have been consistently most active within the food sector. Beverages ranks top in value due to a small number of large transactions. The main difference between the volume and value analysis is the meat & poultry subsector which ranks #4 in terms of volume but only #10 in terms of value which indicates the relatively fragmentation of the market and added-value generating capacity of this subsector.

Figure 1: M&A activity per subsector in the period 2004-2006



Source: Rabobank, mergermarket

Eastern-Europe and Russia eyeing more interest in terms of M&A

Last year, in terms of geographical split, the UK, France and The Netherlands were relatively overweight in terms of both transaction value and volume. The German economy went through a difficult year and as such M&A activity in 2006 was rather limited. The food sectors in both Spain and Italy are still very fragmented, which explains the relatively low transaction value in these countries (both countries do have a significant deal volume). On the other hand are the Eastern European countries and Russia definitely on the rise. Western European food producers have invested heavily in transferring production to the east by building new factories and by acquiring local food manufacturers. In addition, Western European food retailers are already in the top-5 of supermarket operators in Eastern Europe and the first inroads into the Russian market have also already been made. Especially Russia had a good start in 2007 with 13 transactions announced in the first five months totalling EUR 1.8 billion in total transaction value. On a global scale, cross-border transactions within Europe lead the way as in these mature markets consolidation is the game to play for both companies and financial sponsors.

Tension between retailers and producers main driver of M&A activity in Food

Food retailers and food producers are on the opposing sides in the food arena. Both groups combat each other for a part of the consumer price for food products. With substantial levels of GDP-growth throughout Europe, food consumption and thus sales levels rise across the board. However, in terms of profitability it is still the food retailers who are taking margin from the food producers. Not only the Dutch economy but also in the UK, Germany and France pressure from food retailers on prices are continuing. This natural tension between food retailers and food producers is the principal driver behind the continuous M&A activity in the European Food sector. According to the survey, respondents consider price competition and retailer consolidation as the main threats to future growth and profitability in the food sector and to counter such threats, companies are actively pursuing economies of scale through horizontal growth and reduction of overcapacity. Both measures fuel the M&A market and in particular cross-border transactions. The number of cross-border transactions has increased rapidly over the last 3 years. Noteworthy is the fact that in the 2005 survey, only 18% of respondents considered broadening of geographical scope a driver behind growth, whereas in this year's survey 58% of respondents said so.

Rabobank International

Branded players preparing to counter private label success

Another important driver behind the increased M&A activity in the European food sector is the year-on-year growth of the private label segment. In the battle between food producers and food retailers, the retailers use private labels to position their product offering to consumers at the expense of branded products. European private label penetration has increased rapidly in recent years at the expense of market share and margins of branded goods producers. Although private label is still successful, there is an increased focus and investments from food producers on product innovation and branding. The majority of the respondents to the survey believe that increased levels of innovation will be the principal driver of growth in the Food sector with the second driver being focus on brands and marketing. The trend towards healthy, organic food is embraced by the food producers as both fresh produce and organic foods rank as the top subsector for best growth opportunities in this year's survey. As such, further M&A activity is expected from multinationals as real innovation is foremost the domain of smaller and medium sized companies. A recent example – although from the US - is Energy Brands Inc., known as Glacéau, a company specialized in enhanced water products. Glacéau is the fastest growing beverage company in the US, with a sales CAGR of 200% per annum since it was founded in 1997. Tata Tea, the Indian tea manufacturer and part of Indian industrial conglomerate Tata Group, acquired a 30% stake in Glacéau in August 2006 for USD 677 million. In May 2007, Coca-Cola Corporation announced the acquisition of 100% of Glacéau in a cash deal valued at \$4.1 billion. Glacéau was attractive to Coca-Cola because of its position in the enhanced water and energy drink categories, which Coca-Cola is betting will make up a large portion of the beverage industry's growth in North America through 2010.

Increased interest from financial sponsors for food assets

In terms of volume, in 2006, 128 financial sponsor related transactions in the European food sector were reported versus 140 in 2005. In 2006, financial sponsors were particularly active in the major transactions category, snapping up EUR 1 billion plus targets such as United Biscuits and Unilever's Frozen Foods division. And the two largest transactions in 2007 to date (US Foodservice and Provimi) also involved financial sponsors. Food companies make interesting buyout propositions due to their relatively stable level free of cash flows which allow for a rapid repayment of debt. In addition, the relatively high level of fragmentation of the European food industry offers ample opportunities for buy-and-build strategies and for exits to strategic buyers. Financial sponsors are playing a leading role in the consolidation of the European food sector. With financial sponsors breaking record-after-record in terms of fundraising, there seems to be no limit to the appetite of financial sponsors. Another important driver behind the increase in financial sponsor activity in the European food industry is the favourable debt markets. On average, debt multiples for the food industry in small and medium-sized transactions have increased from between 3.0 – 4.0 x EBITDA in 2003 to 4.5 - 5.5 x EBITDA in 2006. For the major transactions, recent debt packages have gone as far as 7.0 – 8.0x EBITDA and the stapled financing package for Cadbury Schweppes US Beverages division is rumoured to be around 10.0x EBITDA.

M&A outlook

In terms of growth prospects, respondents in the survey are optimistic for the near future. Only 8% of respondents believes growth prospects for the coming 12 months to be worse compared to 12 months ago and 30% is straight-out bullish and expects the coming 12 months to grow faster than in the last 12 months. In terms of profitability, respondents to the survey were more cautious. In our opinion rising commodity prices and a difficult environment to pass these on to the food retailer or end-consumer will have a negative effect on profitability levels in the food sector. Nevertheless, Rabobank is optimistic on the prospects of the M&A market in food for the near-future. Major deals already announced in the first five months of the year include the USD 7.1bn sale of US Foodservice by Royal Ahold to a consortium of Clayton, Dubilier&Rice and KKR, the sale of a 74% stake in Dutch feed company Provimi by CVC and PAI for EUR 996m to a combination of Permira and SVG Capital, the acquisition by Danish dairy food co-operative Arla of the remaining 49% interest in Arla Foods UK for EUR 325m and Tereos' EUR 300m acquisition Tate & Lyle Food & Industrial Ingredients Europe from Tate & Lyle plc. Furthermore, we expect a strong increase in transactions in Eastern Europe and Russia.

Subsector specialisation important in food-related M&A transactions

In our opinion, to operate successfully in the field of M&A in such a fragmented and diverse market as the European Food sector requires a high level of subsector specialisation, local as well as pan-European knowledge of companies and financial sponsors and in-depth research capabilities. Rabobank is specialised in the food & agribusiness only and operates on a global scale from 289 international offices in 38 different countries. We believe that this focus on one industry sector gives us an edge over our competitors. As such, Rabobank has demonstrated an impressive track record in M&A in the food sector, concluding more deals in the European Food sector than any other advisor consistently for the last 3 years. Also in 2007 we rank #1 with 15 transactions to date. We believe that our position is because we prove to our clients our ability to turn strategy into completed transactions. We look forward to continuing to serve our clients in this sector.



Rabobank

Rabobank, your trusted M&A advisor in the food sector.

In the course of nearly 110 years, Rabobank has grown from a collection of small, cooperative rural banks into the largest all-finance concern in the Netherlands, the world's leading food & agri bank and a globally respected Triple A bank. In terms of Tier 1 capital, Rabobank ranks among the world's fifteen largest financial institutions.

We are trusted by our clients with advising them on challenging M&A transactions. Both corporate clients and financial sponsors recognize our in-depth knowledge of the international food & agri business. With 60 M&A advisors specialized in the food & agri business worldwide, we are able to service our clients on both a local, pan-European and global basis.

www.rabobank.com



Bakkersland Groep B.V.
(Netherlands)

Sale of Bakkersland Banket to Gilde Participaties

Financial Advisor



Clayton Dublier & Rice Fund VII
(U.S.A)

Joint acquisition with Kohlberg Kravis Roberts & Co L.P. of U.S. Foodservice from Royal Ahold N.V. USD 7.1 billion

Financial Advisor



Milk Partnership Ltd.
(U.K.)

Sale of minority stake in Arla Foods UK Plc. to Arla Foods Amba

Financial Advisor



Nederlandse Bieten Federatie
(Netherlands)

Strategic advice with respect to the sale of CSM Suiker B.V. EUR 240 million

Financial Advisor



Premier Foods Plc.
(U.K.)

Sale of MBM Produce Ltd. to Abbanoy Produce Holding Ltd.

Financial Advisor



Baarsma Wine Group Holding B.V.
(Netherlands)

Sale of Baarsma Wine Group Holding B.V. to Veenwijk Holding B.V.

Financial Advisor



Incotec Holding B.V.
(Netherlands)

Sale of Incotec Holding B.V. to management

Financial Advisor



Saputo Inc.
(Canada)

Acquisition of Land O'Lakes West Coast industrial cheese business USD 216 million

Financial Advisor



Baarsma Wine Group Holding B.V.
(Netherlands)

Acquisition of Cellarmaster Wines Europe B.V. from Foster's Group Ltd.

Financial Advisor



American Sugar refining Inc.
(U.S.A)

Acquisition of Tate & lyle Canada Ltd. USD 254 million

Financial Advisor



Rodilla
(Spain)

Sale of 35% in Rodilla to Damm

Financial Advisor



Pfeifer & Langen K.G.
(Germany)

Acquisition of 49.9% of Italia Zuccheri Commerciale Srl.

Financial Advisor



Nutreco Holding N.V.
(Netherlands)

Acquisition of Maple Leaf Animal Nutrition business from Maple Leaf Foods Inc. CAD 500 million

Financial Advisor



Perdigão S.A.
(Brasil)

Acquisition of Plusfood Groep B.V. from Cebeco Groep B.V.

Financial Advisor



Koninklijke Smilde B.V.
(Netherlands)

Sale of Gebr. Smilde B.V. and Gebr. Smilde GmbH to Vion N.V.

Financial Advisor



Tereos/Syral
(France)

Acquisition of 50% in Tate & Tyle's Food & Industrial Ingredients division (TALFILE) by Syral SAS GBP 200 - 220 million

Financial Advisor

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