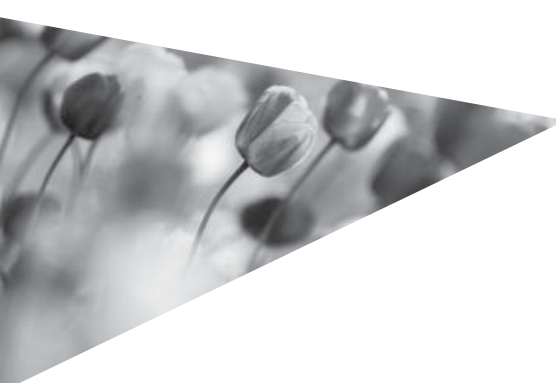


Issue 3  
April-June 2010

**Consumer Products  
Deals Quarterly**

# Deal-makers increasingly active

Analysis of transactions in the global  
consumer products sector





# Welcome

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Welcome to the third issue of *Consumer Products Deals Quarterly* (CPDQ) – a report from Ernst & Young that analyzes acquisitions and disposals in the global consumer products sector.

Readers may remember that in our last issue we highlighted a continuing return of confidence, set against the backdrop of a bumpy economic recovery. Our expectation was for further improvement in deal activity, with a greater focus on the mid-market, which has been borne out by the Q2 10 numbers.

Deal-makers, however, remain relatively cautious because of uncertainty over the sustainability of the recovery and worries over sovereign debt problems. While these concerns may continue to produce quarter-by-quarter fluctuations in the level of deal activity, we believe underlying sentiment remains positive and deals, such as the £2.5b acquisition of SSL International by Reckitt Benckiser, which was announced as we went to press, support this optimistic view. We continue to believe that the trend in market activity is up. Particularly noteworthy is a spate of moves made by companies from developing markets such as India and Brazil as they emerge as champions on the global stage.

Our analysis, as previously, is based on data collected by FactSet Mergerstat and on insight from our global professionals. In this report, we assess what's driving deals today, which geographies and subsectors are most active and who the key players are. Building out our analysis of key trends, we also look ahead to consider what may happen in the deal space in the next few months.

We hope that this data and the perspectives we offer will be of use to the leaders of consumer products companies and to the financial investors who continue to focus on this sector. We are happy to provide further insight on request. Finally, I would be happy to receive feedback and comments on CPDQ so don't hesitate to send me an email.

**David Murray**  
Global Consumer Products Transactions Leader  
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# Overview



## Deal-makers increasingly active

The second quarter saw continued activity in global consumer products deals although no recovery proceeds in a straight line. Volumes were up, but total and average deal values fell, reflecting continuing uncertainty in the macroeconomic outlook. Despite this caution, however, we believe that the underlying trend is for deal activity to continue to grow. We believe that the fourth quarter of 2009 marked the bottom of the market.

### Underlying sentiment is positive

Perspective is an important part of confidence. In Q3 09, market participants were searching for signs that the worst of the recession was over and that the first phase of a global recovery was underway. A year on, that improving trend in economic activity is a reality and the focus of risk assessment has shifted to potential factors that could derail the recovery.

While credit remains tight, lending appetite among banks has improved over the course of 2010. European sovereign debt problems, however, have raised concerns about their potential impact on bank balance sheets and the possibility of a knock-on effect on lending behavior. From a broader macroeconomic perspective, concerns also exist over the sustainability of the recovery in the face of government efforts to rein in swollen budget deficits. Looming regulatory change, too, has introduced an element of caution among some industry players.

There is, however, an important change in mindset from waiting for signs of recovery to considering the risks in an improving market. Understandable caution in the face of an unfolding recovery will be reflected in the type and scale of transactions completed, but in our opinion, the belief that the worst is over will continue to underpin the recovery in deal activity.

### Caution drives changing deal mix

The absence of mega deals and the reduction in deal values in Q2 10 may be indications of that caution. Even stripping out the first quarter's two "mega deals," total deal value in Q2 10 fell by US\$5.3b (32%). Average disclosed deal value, meanwhile, fell back to US\$140m (from US\$515m in Q1 10), consistent with an average of US\$136m for Q4 09 and Q3 09. It is important to note, however, that a smaller average disclosed deal value does not imply that deals are being concluded at lower average transaction multiples.

"We are currently seeing an increase in deal activity quarter on quarter. This is led by the food sector where transaction activity is recovering at a much faster rate than other subsectors. Although the volume of big-ticket transactions slowed during the second quarter, the sector has continued to see a steady increase in deal activity – particularly small, strategic deals."

David Murray  
Global Consumer Products Transactions Leader



It is difficult to predict whether in the next couple of quarters there will be further strategic “mega deals.” Renewed uncertainty over the economic outlook is unlikely to decrease risk aversion among potential corporate buyers, delaying decisions and lengthening the due diligence process.

But, despite a lack of very large deals in the second quarter, the Kraft/Cadbury and Heineken/FEMSA transactions have had a continuing impact, helping underpin confidence and encouraging further deal activity at the mid-market levels. Within that increased flow of mid-market deals it is possible to discern three broad transaction types:

- ▶ Emerging market growth opportunities
- ▶ Developed market consolidation
- ▶ Financial consolidation

### Emerging market growth opportunities

The need for companies facing relatively subdued growth rates in developed markets to gain access to faster-growing developing economies, which offer exposure to an emerging middle class with an increasing appetite for brands, is well established. Increasingly apparent in the data, however, is the trend for companies based in emerging markets to expand outside their domestic markets to exploit consumer and product synergies. In Q2 10, BRIC countries completed 18 foreign acquisitions (35% of deals) compared with only 6 in the first quarter. India was particularly active, with total deals increasing to 18 in Q2 10 from 10 in the previous quarter, of which 9 were foreign acquisitions.

“Few expect a return to vigorous growth in developed economies in the near future.”

Gregory Stemler  
US Consumer Products Transactions Leader

### Developed market consolidation

Few expect a return to vigorous growth in developed economies in the near future, so focus has shifted to the need to achieve scale by expanding geographic scope and product range through in-market consolidation.

With retailers exerting pressure on margins and consumers downtrading, private label continues to strengthen and consolidation among own-brand food producers is an emerging trend, particularly in the US. Ralcorp Holding’s acquisition of the American Italian Pasta Co in Q2 10 was predominantly an own label acquisition, as was the Q1 10 acquisition of PBM Holdings by Perrigo. Private equity (PE) firms have also recognized the growing potential of private label. Own label is an important element in Goldman Sachs’ acquisition of Michael Foods in Q2 10. We believe that food sector consolidation, particularly in North America, will continue.

### Financial consolidation

For companies unable or unwilling in current market conditions to secure the large strategic targets on their radar, tidying up their existing portfolio provides a sensible alternative. In Q2 10, for example, UniCharm acquired an additional stake in UniCharm Petcare.

### Food leads the charge

Food deals accounted for 71% of deal volume in Q2 10, an increase against the previous quarter of 7 percentage points, and the highest percentage since our records began in Q1 07. Unlike Q1 10, when deal volumes increased in all subsectors, food transactions were solely responsible for the increase in deal volume in Q2 10, with transaction numbers falling slightly in beverages, tobacco and HPC compared with the previous quarter.



## Subsector deal breakdown Q2 10

Deals announced	Q2 10	Q2 09	Year-on-year change (%)	Q2 10	Q1 10	Sequential change (%)
<b>Corporate deals by subsector</b>						
Beverages	35	51	-31%	35	37	-5%
Food	147	120	23%	147	117	26%
HPC	26	23	13%	26	27	-4%
Tobacco	1	10	-90%	1	3	-67%
<b>Total</b>	<b>209</b>	<b>204</b>	<b>2%</b>	<b>209</b>	<b>184</b>	<b>14%</b>
<b>PE deals by subsector (based on seller sector)</b>						
Beverages	8	10	-20%	8	10	-20%
Food	28	16	75%	28	26	8%
HPC	2	7	-71%	2	3	-33%
Tobacco	-	-	-	-	1	-
<b>Total</b>	<b>38</b>	<b>33</b>	<b>15%</b>	<b>38</b>	<b>40</b>	<b>-5%</b>
<b>Total CP deals by subsector, corporate and PE</b>						
Beverages	43	61	-30%	43	47	-9%
Food	175	136	29%	175	143	22%
HPC	28	30	-7%	28	30	-7%
Tobacco	1	10	-90%	1	4	-75%
<b>Total</b>	<b>247</b>	<b>237</b>	<b>4%</b>	<b>247</b>	<b>224</b>	<b>10%</b>

## Europe still out in front

Europe continued to dominate cross-border buy-side activity in Q2 10, while in contrast the share of US-based companies in the deal flow edged lower. The Kraft/Cadbury deal showed in Q1 10 that US companies have an appetite for large strategic acquisitions that really push the envelope, but as yet they remain less active than their European counterparts. Longer-term foreign exchange trends, however, may have a role to play in coming quarters. After a long period of dollar depreciation, this year's sovereign debt problems have weighed on the euro, reversing the declining trend in the US currency. A relatively stronger dollar may feed through into increased deal activity.

## PE holds steady

The number of deals completed by PE decreased slightly in the quarter, but financial sponsors have been able to make larger transactions happen. Total PE announced deal value increased to US\$2.9b in Q2 10 up US\$2.1b from Q1 10, and up US\$0.7b from Q2 09. PE firms were active sellers – 3 of the top 4 deals in the quarter were private equity sales. Goldman Sachs' purchase of a stake in Michael Foods for US\$1.7b was the largest deal in the quarter and illustrates the continuing activity in secondary transactions in which one PE firm sells to another. With IPO prospects remaining uncertain, secondary transactions or a sale to a corporate buyer currently provide the best exit routes for financial sponsors.



## Bumps ahead but direction broadly positive

It would be premature to suggest that there are no clouds on the economic horizon. Uncertainty over the sustainability of the recovery and the potential impact of sovereign debt problems on the credit markets suggest that deal-makers will continue to take a very prudent approach. We would not be surprised if this were reflected in softer Q3 10 numbers. Our broad view, however, is that the worst is behind us and the underlying trend in deal activity is up.

## Data highlights Q2 10

### Volumes are increasing

Deal volume in Q2 10 rose by 23 (10%) to 247 from 224 in Q1 10. Growth in Q2 10 was driven exclusively by food deals, which increased by 32 deals (22%) to 175 from 143 deals in Q1 10. Food transactions have now recovered back to 2008 levels.

### Deal values decreasing

Despite deal volumes increasing, with no mega deals in the quarter, deal values decreased in Q2 10 compared to Q1 10. Total deal value was US\$11.2b, a decrease of US\$32.0b (74%) against Q1 10. Excluding the US\$19.1b Cadbury/Kraft deal and Heineken's acquisition of FEMSA Cerveza SA for US\$7.6b from the Q1 10 data, total deal value in Q2 10 fell by US\$5.3b (32%).

### Europe still dominates volume

Europe (excluding the UK) continued to dominate cross-border transactions, although its share of buy-side deals decreased to 40% in Q2 10 from 47% in Q1 10. The US share of cross-border buy-side deals decreased by 2 percentage points to 12%.

### BRIC countries are making more foreign acquisitions

Although in total BRIC deals have decreased by 2 from Q1 10 to 52 in Q2 10, the BRIC countries made more foreign acquisitions on a proportional basis. In Q2 10, foreign acquisitions accounted for 35% of BRIC deals, compared with 11% in Q1 10.

### PE still active

There were 38 PE deals in Q2 10, a decrease of 2 deals (5%) compared to the previous quarter, however an increase of 5 deals (15%) against the same quarter in 2009. As a proportion of total deals, 15% were PE transactions in Q2 10, compared with 18% in Q1 10. The quarter's biggest deal was a PE transaction, compared with Q1 10, when the entire top 10 comprised corporate deals.



# Volume and value

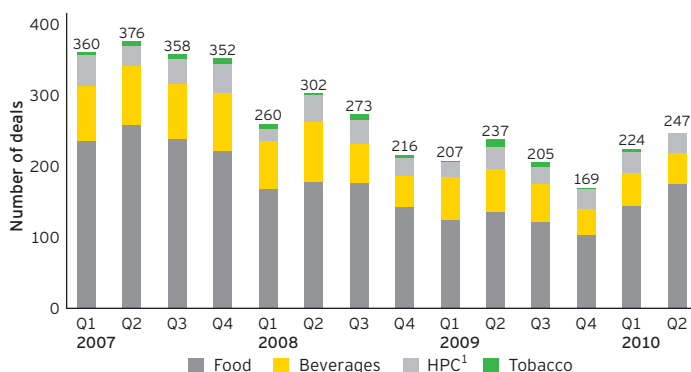
## Activity increasing with a growing number of smaller, strategic deals

Deal volumes continued to rise in Q2 10, although at a slower pace than in Q1 10. With no mega deals completed in the period, both total value and average disclosed transaction value declined.

### Volume expansion concentrated in food sector

Total deal volume in Q2 10 rose by 10% to 247 from 224 in Q1 10. Within that total, 175 deals were announced in the food sector, bringing the level of food transaction activity back to 2008 levels. Since we began keeping records in Q1 07, the peak quarter for deal volumes has been Q2 07. As of Q2 10, food deals were at 68% of their Q2 07 peak level, while total deals were 66% of their Q2 07 peak level, indicating that food deals are recovering faster than other subsectors.

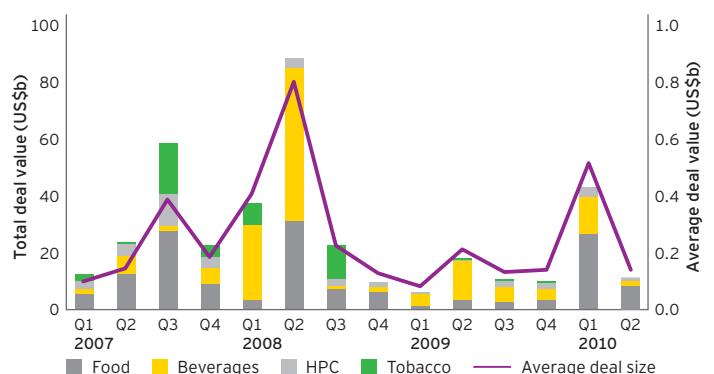
#### Deal volumes Q1 07 to Q2 10



### Absence of mega deals pushes value lower

Despite deal volumes increasing, deal values decreased in Q2 10 compared with Q1 10, largely because no mega deals were completed during the period. Total deal value was US\$11.2b, a decrease of 74% against Q1 10. Excluding the US\$19.1b Cadbury/Kraft deal and Heineken's acquisition of FEMSA Cerveza SA for US\$7.6b from the Q1 10 data, total deal value in Q2 10 fell by US\$5.3b (32%).

#### Deal values Q1 07 to Q2 10



The lack of mega deals also pulled down the average disclosed deal size. However, we note that the average deal size, excluding mega deals, has broadly remained in the US\$100m to US\$200m range since Q1 07.

<sup>1</sup> Household and personal care.



# Top 10 deals

## Food leading the way as focus shifts to mid-market

The top 10 deals in Q2 10 had a combined value of US\$7.8b, 70% of total deal value in the period. In contrast, the total combined value of the top 10 deals in Q1 10 was US\$39.6b and was dominated by the Kraft/Cadbury and Heineken/FEMSA transactions. But in Q2 10, the impact of the year's mega deals was still being felt, with their positive impact on market confidence helping to support an increase in mid-market deal volumes.

The food sector dominated not only overall deal activity in the period, but also accounted for the majority of the top 10 deals, of which 6 were food, 3 were beverages and 1 was an HPC deal. The quarter's biggest deal was a PE transaction, compared with Q1 10, when the entire top 10 comprised corporate deals.

A number of factors help explain the prevalence of food sector deals. Food is by definition the broadest sector within consumer products and is less consolidated than the other non-food subsectors. This quarter's transactions, however, also highlight the broader underlying themes driving deals.

### Top 10 deals, Q2 10

Buyer name	Seller name/unit name	Disclosed value (US\$m)	Announced	Deal type	Sector
Goldman Sachs Group, Inc.	Thomas H. Lee Advisors LLC/Michael Foods, Inc.	1,700	21 May 2010	PE	Food
Marfrig Foods SA	Keystone Foods Holdings LLC/Keystone Foods LLC	1,260	15 June 2010	Corporate	Food
Ralcorp Holdings, Inc.	American Italian Pasta Co.	1,153	21 June 2010	Corporate	Food
Aryzta AG	Lindsay Goldberg & Co. LLC/Fresh Start Bakeries, Inc.	900	8 June 2010	Corporate	Food
UniCharm Corp.	UniCharm Petcare Corp.	699	30 April 2010	Corporate	HPC
Chipita SA/Management	Vivartia SA/Chipita SA	547	15 April 2010	PE	Food
Atlantic Grupa dd	Istrabenz dd/Droga Kolinska dd	476	19 April 2010	Corporate	Food
William Grant & Sons Holdings Ltd.	C&C Group PLC/C&C Group PLC/Spirits & Liqueurs Division	399	30 April 2010	Corporate	Beverages
Carlsberg A/S	Chongqing Beer Group Co. Ltd./Chongqing Brewery Co. Ltd.	349	9 June 2010	Corporate	Beverages
Britvic PLC	Fruité Entreprises SAS	293	18 May 2010	Corporate	Beverages



“Food companies from developing markets are increasingly looking at opportunities to expand overseas as they seek to become the new global champions.”

Patricia Novosel  
Global Food Leader

## New global champions

Brazilian meat processor Marfrig Foods' acquisition of Keystone Foods Holdings illustrates the growing importance of overseas expansion by companies in the developing world, as they seek to become new global champions. Marfrig became the second-largest player in the Brazilian meat processing market last September through the acquisition of Seara from Cargill. Adding major US distributor Keystone positions Marfrig as a leading supplier to some of the world's largest restaurant chains including McDonald's, Subway and Chipotle. During the quarter, Marfrig also completed the small bolt-on acquisition of Northern Ireland's O'Kane Poultry for US\$37m. Rapid expansion, however, can be accompanied by execution risk and all eyes will be on Marfrig as it integrates several transactions.

Marfrig is not alone in its international expansion plans. Last year, Brazil's JBS, the world's biggest meat processor, bought a 64% stake in bankrupt US chicken producer Pilgrim's Pride for US\$800m.

## Emerging market growth opportunities

There is an alternative to the big strategic deal when building a significant presence in a market. In Q2 10 Carlsberg, through its indirect wholly owned subsidiary, Carlsberg Brewery Hong Kong Ltd, agreed to acquire an additional 12.3% minority stake in Chongqing Brewery Co Ltd from state-owned Chongqing Beer Group Co Ltd for approximately RMB2.4b (US\$349.2m), bringing its stake to approximately 39%. Carlsberg had to fight off competition for the stake from China Resources Enterprise and, reportedly, from Anheuser-Busch InBev. Carlsberg eventually paid RMB40.22 per share for the additional stake, a premium of more than 60% to market prices prevailing before Chongqing Beer Group announced at the end of the first quarter that it planned to reduce its stake.

Carlsberg's strategy in Asia-Pacific has been to pick up smaller stakes in leading brewers, partly as a way of getting round government reluctance to allow foreign ownership. In China, Carlsberg has built a leading position in the country's Western provinces, where less beer is currently consumed than in the more prosperous Eastern provinces, but which offer growth potential. Chongqing, for example, enjoys an almost monopoly position in some areas and Carlsberg claims to have a 59% volume share of Western China's beer market.



## Private label comes of age

Private label has been one of the gainers during the recession. Consumers have traded down – and are showing few signs of returning to premium brands – while retailers have rationalized the number of brands they are prepared to stock. The trend has been most marked in “commoditized” food categories such as bread and frozen foods. Private label penetration rates have reached 39% in the UK and 34% in Germany (2009 data), with the US (19%) coming off a low base, but growing aggressively.<sup>2</sup> We believe that private label will continue to gain market share.

During Q2 10, Ralcorp, the American breakfast cereal producer continued its expansion into the own brand market. Ralcorp, which is primarily a private label producer, but which recently purchased the Post cereal brand, was engaged in a flurry of deal activity.

Ralcorp's US\$1.15b purchase of American Italian Pasta was the largest of four deals it announced in the second quarter. Ralcorp also acquired frozen breakfast food producer Sepp's Gourmet Foods as well as two Canadian private label bakery businesses, North American Baking and J T Bakeries. This diversification through acquisition may mark an attempt to build scale in the fragmented private label market.

“Private label has been one of the gainers during the recession. The trend has been most marked in ‘commoditized’ food categories and we believe private label will continue to gain market share.”

**John Rothenberg**  
Chair of the Ernst & Young European Corporate Development Leaders' Network and former Head of M&A at Unilever

## Achieving scale in mature markets

Ralcorp's spate of deals also fits into a second trend prevalent in lower growth more mature markets. Pursuing increased sales volume by M&A activity is a classic deal driver as it broadens product range and geographic scope. A further 3 of the second quarter's top 10 deals follow this rationale:

- ▶ Swiss baking business Aryzta acquired Fresh Start Bakeries, a portfolio company of Lindsay Goldberg & Co, for US\$900m. Through this transaction, Aryzta lessened its dependence on the European markets by gaining access to large US retailers.
- ▶ William Grant filled a gap in its portfolio with the purchase of the Spirits and Liqueurs Division of C&C Group for €300m (US\$399m). Previously, William Grant had no Irish whiskey brand in its portfolio. The addition through this deal of the Tullamore Dew brand will allow the company to leverage its distribution strength to take advantage of the growing popularity of Irish whiskey in the US market.
- ▶ Britvic confounded expectations for a further Pepsi bottling acquisition by buying French group Fruité Entreprises. The deal gives Britvic a leading syrup brand, which is a good fit with its existing portfolio that includes Robinsons and Fruit Shoot. Britvic should achieve both cost and revenue synergies as well as extending its geographic reach. Britvic is still expected to consider possible further deals with Pepsi.
- ▶ A further top 10 deal fits into the theme of achieving scale by acquisition, albeit in the less mature Balkan markets. Croatian food and health care firm Atlantic Grupa agreed to buy Slovenian food maker Droga Kolinska, in a deal which will create one of the largest food and drink companies in the Balkans.

<sup>2</sup> Planet Retail, CAGE Conference, March 2010.



## Rationalizing the portfolio

The desire to tidy up an existing portfolio is a consistent driver of deals, particularly in a market environment where risk aversion may be reducing the appetite for larger strategic deals. In this category in Q2 10, UniCharm completed a tender offer to acquire an additional 58.6% stake in UniCharm Petcare that it did not already own, for approximately JPY62.8b (US\$699m).

## PE's appetite

In Q2 10 PE was active in the market, both as a buyer and a seller, showing a continuing appetite to complete high value transactions when the right opportunities arise.

On the buy-side of the market, the second quarter's largest deal was a PE transaction, the US\$1.7b purchase of Michael Foods by Goldman Sachs from rival PE group, Thomas H. Lee Advisors (see PE Section for further analysis).

The top 10 deals also contained a second PE purchase. Spyros Theodoropoulos, current CEO of Chipita, backed by Olayan Financing, agreed to acquire biscuit business Chipita from Vivartia, which is ultimately owned by Marfin Investment Group for US\$547m. The rationale for this deal was Marfin's decision to deleverage its balance sheet following this year's turmoil in Greece's financial markets.

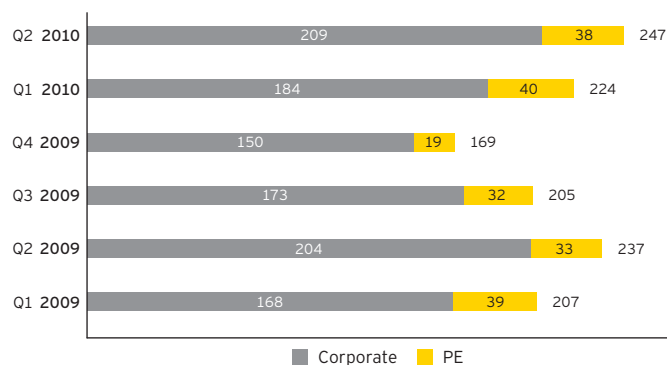
PE firms were even more active as sellers during the quarter. Three out of the top 4 largest deals in the quarter featured a private equity firm as the vendor. In addition to Thomas H. Lee's disposal of Michael Foods, Lindsay Goldberg & Co. sold Keystone Foods to Brazil's Marfrig Foods and Fresh Start Bakeries to Switzerland's Arysza.

# Private equity

## Flight to quality

The number of deals completed by PE decreased slightly in the quarter, but total announced deal value increased to US\$2.9b in Q2 10 up US\$2.1b from Q1 10, and up US\$0.7b from the same period a year ago. Consumer products, particularly the food sector, are on the radar for PE buyers, but the search for the best quality deals irrespective of sector is the underlying deal driver for many financial sponsors.

Corporate/PE deal breakdown Q2 10



Goldman Sachs' purchase of a stake in Michael Foods for US\$1.7b from rival PE group, Thomas H. Lee Advisors was the largest deal in Q2 10 and illustrates a number of market themes:

- ▶ **PE deal sizes are holding up.** In addition to the recent Michael Foods deal, in July 2010 Carlyle Group agreed to buy listed nutritional supplements maker NBTY for US\$3.8b

- ▶ **Competition can be fierce.** This is particularly true for companies perceived to be the best quality businesses. Carlyle paid a 57% premium to NBTY's average share price for the month prior to the announcement and, according to Reuters, fought off competition from Blackstone Group. A number of PE funds have plenty of dry powder available and need to deploy that capital before their fund expiry date, adding to the competition for good quality assets
- ▶ **Secondary buyouts are common.** Goldman Sachs bought Michael Foods in a secondary buyout. Reflecting uncertainty in public equity markets and caution among trade buyers, secondary buyouts, in which one PE firm sells to another, are currently often the only available exit for financial sponsors
- ▶ **The ability to finance larger deals is returning.** Leverage is creeping back up for the best quality deals. Goldman Sachs is estimated to be the world's largest private equity fund, while Michael Foods is the world's largest egg processor. Under Thomas H. Lee's seven-year ownership, debt was reduced and cost savings achieved. Prior to Goldman's acquisition it jumped up to 5.8 times, a high level for post-credit crunch markets



## Private equity deals by subsector in 2010

PE deals by subsector (based on seller sector)	Q2 10	Q1 10	Q2 09
Beverages	8	10	10
Food	28	26	16
HPC	2	3	7
Tobacco	–	1	–
<b>Total</b>	<b>38</b>	<b>40</b>	<b>33</b>

Private equity activity in the consumer products sector has been concentrated in the food subsector, which partly reflects the prevalence of food sector deals within total activity. Food is by definition the broadest sector within consumer products and is less consolidated than the other non-food subsectors. An added attraction for PE buyers is that consumer products companies are cash generative.

We believe that private equity will continue to be active in the food subsector. After the end of Q2 10, for example, Unilever announced the sale of Findus Italy to Birds Eye Iglo, which is owned by Permira, in a deal worth more than €800m. Savvy private equity buyers have also identified those segments of the portfolios of large food companies, which offer the best growth potential. Part of the rationale for the Michael Foods deal, for example, was to allow Goldman Sachs to tap into the private label growth story.

We expect private equity to remain active in the consumer products sector, although the lending appetite of the banks remains a limiting factor on the recovery of large deal sizes. PE buyers are likely to have to continue to contribute a large proportion of equity capital and also take advantage of non-bank financing such as the high yield bond market. But where reduced banking market capacity is most clearly seen is in the greater focus on backing only the highest quality businesses – both buyers and lenders are competing for the best quality deals, which will lend support to valuation multiples.

# Geographic focus



## BRICs broaden their horizons

Although the total number of BRIC deals decreased slightly in the second quarter, the BRIC countries are making more foreign acquisitions. In Q2 10, foreign acquisitions accounted for 35% of BRIC deals, compared to 11% in Q1 10.

Our analysis seeks to identify trends in M&A activity as they emerge. Readers, however, should note that our data relates only to publicly announced deals in BRIC countries and analysis by Ernst & Young professionals suggests that deal activity considerably outstrips published transactions.

### Brazil bulks up

Deal volumes in Brazil remain relatively low, with just five deals announced in Q2 10, a drop from the first quarter's eight deals. But both the domestic and cross-border transactions being announced fit well with the theme that companies from the BRIC countries will be among the next generation of global consumer products champions.

In May, Citrusuco Paulista, a subsidiary of Fischer SA Comercio Indústria e Agricultura, agreed to merge with Citrovida Agro Industrial, a subsidiary of Grupo Votorantim, for an undisclosed amount. The merger of these two Brazilian orange juice firms will create one of the world's largest orange juice companies, with sales in excess of US\$1b. This quarter's transaction is part of an ongoing trend for consolidation between Brazilian companies to create businesses with world-leading market positions. Last year, for example, Perdigão, Brazil's largest food company, merged with smaller rival Sadia, to create Brasil Foods, which is now the world's largest poultry company.

Cross-border activity provides further evidence of Brazil's growing strength in the meat-processing sector. In Q2 10 Marfrig bought major US distributor Keystone, which is a leading supplier to some of the world's largest restaurant chains including McDonald's, Subway and Chipotle. Marfrig, which last September, became the second-largest player in the Brazilian meat processing market through the acquisition of Seara from Cargill, also completed the small bolt-on acquisition of Northern Ireland's O'Kane Poultry for

US\$37m. Marfrig's activity also builds on an emerging trend for Brazilian expansion into the US market. Last year Brazil's JBS, the world's biggest meat processor, bought a 64% stake in bankrupt US chicken producer Pilgrim's Pride Corp for US\$800m.

### Russia is a long-term play

Our view is that Russia remains strategically important, although executives are acknowledging that it will take longer to realize the upside potential this market offers. Deal-makers are concerned about risk and Russia is perceived as particularly risky. Harder hit by the economic downturn than its BRIC peers and with a government prone to changing legislation at short notice, Russia is currently a challenging country for M&A, particularly for overseas owners.

But while double digit-growth is not expected, the Russian economy has started to recover. GDP growth will be 4.5% to 5% this year, unemployment is falling and disposable income is rising.

Russia is a European BRIC market with several things in its favor. GDP per capita is four to six times higher than in China and India and sales per capita are 5 to 20 times higher.<sup>3</sup> We also believe that while the premium sector will continue to hold up, there are significant opportunities to address the emerging post-crisis value-led consumer. Russia is a market where premium and affordable can happily coexist.

Recognition of the long-term opportunity, but concern over the near-term risks – as well as a continuing mismatch between vendor and buyer price expectations – is causing many potential overseas corporate buyers to maintain a “wait and see” attitude towards acquisitions in Russia. Significant consolidation in the fragmented retail food sector, for example, has long been expected, but has yet to happen and major international players such as Tesco and Wal-Mart remain on the sidelines.

<sup>3</sup> Adapting to the new reality in Russia, Ernst & Young.



A small number of the big global consumer products players, which already have an established presence have been prepared to increase their exposure to Russia. In June, leading global dairy producer Danone announced the merger of its Russian dairy-produce operations with Unimilk. Danone will take a controlling (57.5%) stake in the new venture, which will become the largest dairy company in Russia. In 2009 Danone held a 15% share of the Russian milk market, Unimilk 17% and Wimm Bill Dann, the Russian dairy and juice group, 29%.

The Coca-Cola Company, meanwhile, is awaiting government approval for its purchase of Nidan from a private equity group, Lion Capital. Nidan is the fourth largest fruit juice company in Russia with a market share of 13%, while The Coca-Cola Company and its bottlers, through their Russian joint venture Multon, already have a 19% share.<sup>4</sup>

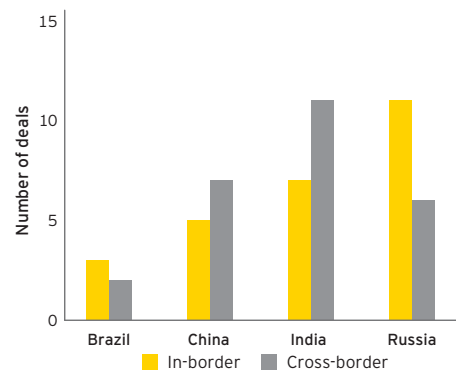
Domestic players, both corporate and PE, are more active in the Russian M&A market, making bolt-on acquisitions and consolidating holdings, particularly in the fragmented food and retail consumer products markets. A lot of this activity between privately owned companies, however, will not be captured in our data.

## India makes inroads overseas

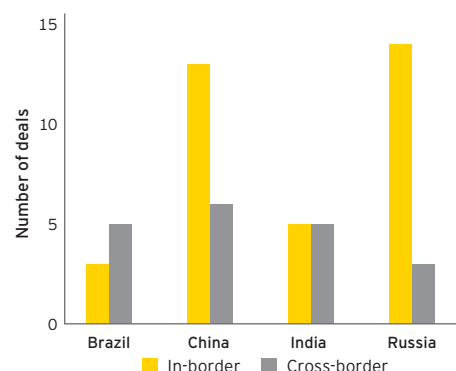
One of the most noticeable trends in the second quarter was the increased number of foreign acquisitions made by Indian companies. In Q2 10, Indian companies made 18 deals, of which 9 were foreign acquisitions, a sharp increase on the 3 overseas purchases made in the first quarter.

Second quarter activity was dominated by the multiple transactions carried out by two companies. Godrej Consumer Products, the manufacturer and distributor of household and personal care products, bought two hair care companies in Argentina and

BRIC in-border/cross-border deals Q2 10



BRIC in-border/cross-border deals Q1 10



<sup>4</sup> Data from Rosstat, Russia's Federal State Statistics Service.



acquired an Indonesian pesticide maker in Q2 10. Godrej also bought out the remaining 51% stake in its household insecticides joint venture with America's Sara Lee for US\$235m. Jay Shree Tea & Industries also announced four deals in the quarter, acquiring two tea plantations in Uganda and a further two in Rwanda.

Indian companies, many of which have not previously had a presence in international markets, are now testing the water by acquiring local brands overseas and are clearly targeting other emerging market countries. Rather than try to break into the developed markets of Europe and the US, many prefer to expand into markets with a similar market structure and patterns of consumer behavior to the Indian domestic market.

One exception to this pattern is Tata Beverages, which has growth ambitions on a much larger scale and is already well established in developed markets. In 2000 Tata purchased Tetley Group, which at the time was the largest acquisition in Indian corporate history. Tata Beverages is now the world's second-largest global branded tea operation, with a presence in more than 60 countries.

In Q2 10 the company's CFO outlined Tata Beverage's expansion plans to the Indian media. Tata is planning to strengthen its presence in the overseas markets of the US, the Middle East and Russia, and to build a portfolio beyond tea and coffee, expanding into new products in the ready-to-drink tea, health drinks and functional drinks subsectors. While the company said there was nothing immediate on the horizon, it admitted that it is considering acquisition opportunities across the globe.

## China still focused on domestic market

Consumer products deal activity in China is strongly linked to the growth potential of domestic consumption. The majority of deals announced, therefore, continue to be in-border transactions, which can be placed into three broad categories:

- ▶ **Private equity providing growth capital.** PE houses, such as Carlyle and Warburg Pincus are active in the Chinese market and in the vast majority of cases, rather than a full LBO, they provide growth capital through the purchase of minority stakes of between 20%-40% in privately owned companies. The eventual exit is usually expected to be via an IPO

- ▶ **Corporate deals.** Large overseas consumer products companies, continue to look to increase their presence in the Chinese market. In 2008, for example, Johnson & Johnson completed the acquisition of Beijing Dabao Cosmetics, while in Q2 10, Carlsberg Brewery Hong Kong, agreed to acquire an additional 12.3% minority stake in Chongqing Brewery

Regulatory hurdles for foreign buyers are not a major issue in the Chinese consumer products market. However, for transactions of significant size and where a long-established Chinese brand is involved, however, stricter regulatory approval may be required at the state rather than the local government state level, which lengthens and complicates the approval process.

A greater challenge for inbound strategic buyers is to find sufficient buyout opportunities. The Chinese consumer products market remains fragmented, with many companies that are relatively young and are still building scale. Often owners are unprepared to sell the business while it is in a rapid growth phase and when shifting ownership between generations has yet to become an issue.

The cross-border deals that have taken place tend to be dominated by transactions between Chinese and Hong Kong-based companies. China thus far is lagging behind Brazil and India in the push to buy overseas in the consumer products sector. This is partly explained by China's strength as a manufacturer, which means that the resources sector has been the focus of foreign acquisitions. There are early signs, however, that China will follow other BRIC country companies in pursuing international expansion.

In July 2010, for example, China's state-owned Bright Food Group bought a majority stake in New Zealand regional milk processor Synlait Milk for US\$67m. The deal will enable Bright Food to source high-quality infant and whole milk powders for Chinese consumers. The transaction followed Bright Food's failed bid, earlier in July 2010, for Sucrogen, CSR's Australian sugar operations, which were bought by Singapore's Wilmar.

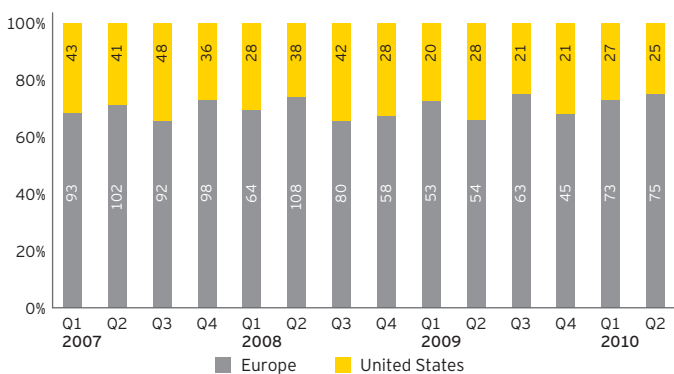


# Europe dominates on cross-border deals

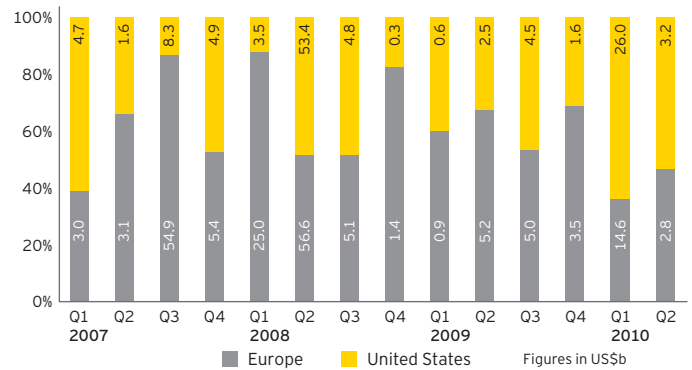
There were 97 cross-border deals in Q2 10, an increase of 5% against Q1 10. This increase is lower than the 10% increase in total consumer products deals in the same period suggesting that in-border deal activity increased at a greater rate than cross-border activity.

Europe (excluding the UK) continued to dominate cross-border deals, although its share of buyer region deals decreased from 47% in Q1 10 to 40% in Q2 10. The US share of buyer region cross-border deals decreased by 2 percentage points to 12%.

## Europe/US volume<sup>5</sup> comparisons, Q1 07 to Q2 10<sup>6</sup>



## Europe/US value<sup>7</sup> comparisons (US\$b), Q1 07 to Q2 10<sup>6</sup>



The data on deal value for Q2 10 also support the picture that the US is lagging behind Europe in snapping up overseas acquisition opportunities. The most active buyer region by value in the second quarter was Europe, which accounted for 41% of total value. Cross-border sales deals in Q2 10, however, were dominated by sales by the United States (57%).

Longer-term foreign exchange trends may have an impact on the relative activity levels of US compared with European buyers in coming quarters. After a long period of dollar depreciation, this year's sovereign debt problems have weighed on the euro, reversing the declining trend in the US currency. A relatively stronger dollar may feed through into increased deal activity.

<sup>5</sup> The volumes recorded in this chart relate to cross-border deals.

<sup>6</sup> The definition of Europe in these charts includes former East European countries and Russia.

<sup>7</sup> The values recorded in this chart relate to cross-border deals.

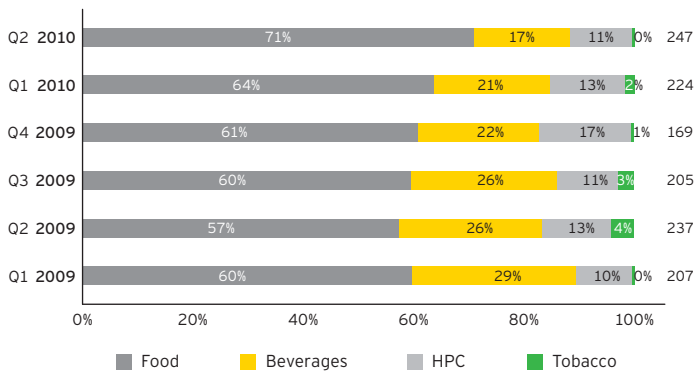


# Sector focus

## Securing the supply chain

Food and beverages accounted for 88% of total deals in this quarter, up from 85% in Q1 10, but this proportion remains in line with the historical trend for these two categories to account for 80%-90% of total deals.

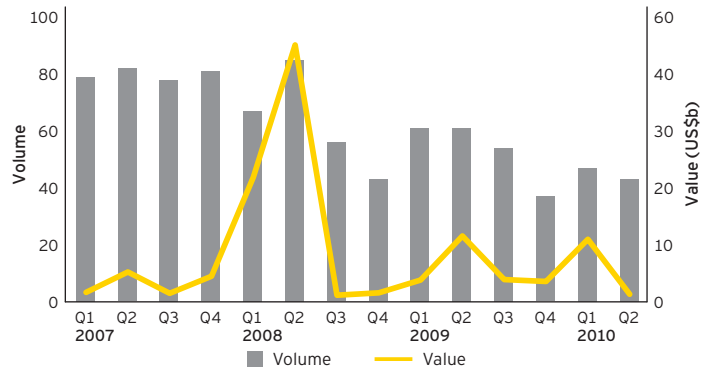
**Total deals announced by subsector (volume)  
Q1 09 to Q2 10**



### Beverage makers looking to supply chains

Without a mega-deal similar to the first quarter's Heineken/ FEMSA transaction, total beverage deal value in Q2 10 decreased by US\$11.6b to US\$1.6b, a drop of 88% against Q1 10. The largest beverage deal in the quarter was the William Grant and Sons acquisition of the spirits and liqueurs division of C&C Group for US\$0.4b (see Top 10 deals Section).

**Number and value of beverage deals Q1 07 to Q2 10**



“Food deal activity tends to drop off more quickly in a downturn and rebound more quickly than beverage and HPC deal activity. HPC, however, is showing some signs of a faster pace of revival with the announcement after the end of the quarter of the substantial £2.5b acquisition of SSL International by Reckitt Benckiser.”

**David Murray**  
Global Consumer Products Transactions Leader



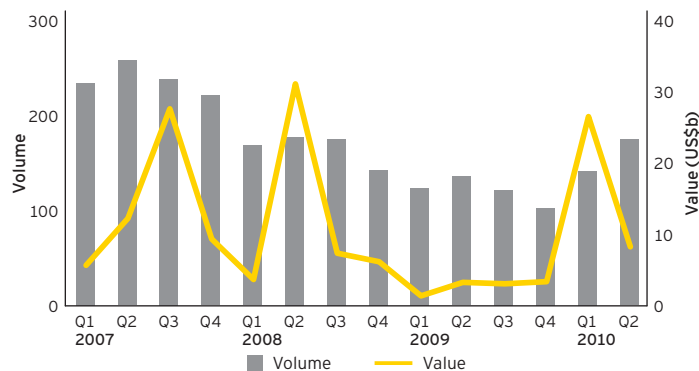
Route to market is a key element for beverage companies and in a riskier economic environment many are considering their relationship with their distributors. Supporting distributors through financial arrangements is one alternative, but there are also signs that bringing capacity back in-house is the preferred route for some. In Q4 09 PepsiCo decided to repurchase its largest anchor bottlers, while The Coca-Cola Company is in the process of bringing the majority of its North American bottling operations back in-house. We believe that a desire to consolidate supply chains will continue to be a driver of future deal activity in the beverage sector.

While some are looking to increase vertical integration, Fosters is reducing the extent of its horizontal integration. In May 2010 Fosters announced that it would de-merge its beer operations from its struggling wine business. The de-merger and separate stock market listings for the wine and beer units is planned to be completed in the first half of 2011. Stripped of the sapping effect on earnings of the wine division, Fosters' beer business is expected to attract potential bid interest from both corporate and private equity buyers.

## Food deals back to mid-2008 level

In the second quarter food deal activity was broadly in line with deal volumes seen in Q2 08 and Q3 08. Mirroring the global figures, food transactions also formed the large majority of deal volumes within the BRIC countries. The proportion of BRIC deals accounted for by food in Q2 10 was 65% compared with 71% for total global volumes.

### Number and value of food deals Q1 07 to Q2 10

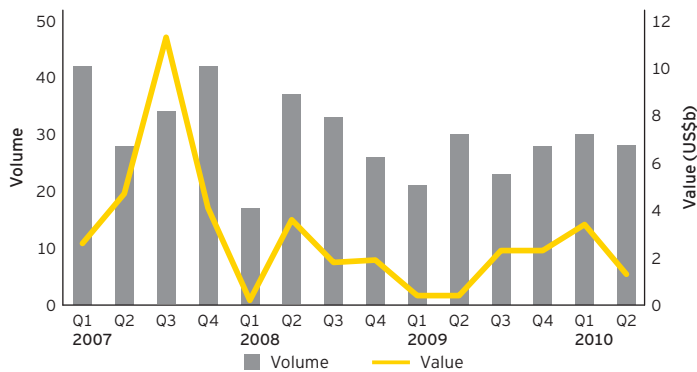




## Building a base in HPC activity

At 28 deals, Q2 10 HPC deal activity was broadly flat compared with Q1 10 when there were 30 deals. Total deal values declined in the second quarter, but Reckitt Benckiser's move on SSL International, announced in July, is evidence of an ongoing appetite for deals of a more significant size in the HPC sector.

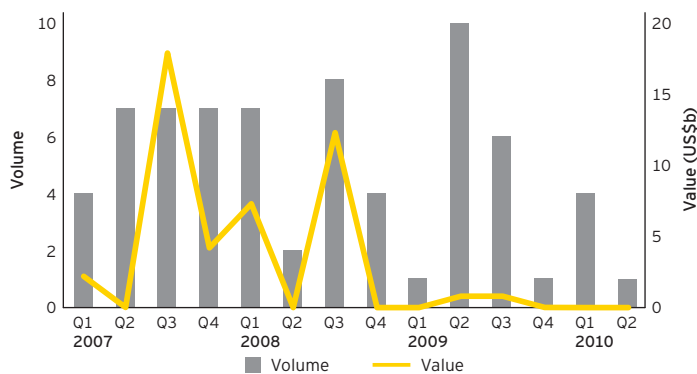
Number and value of HPC deals Q1 07 to Q2 10



## No significant activity in tobacco

There was only one announced deal in the tobacco sector in Q2 10, which was an acquisition in Greenland by Denmark's Chr Augustinus Fabrikker for an undisclosed deal value.

Number and value of tobacco deals Q1 07 to Q2 10



Given that the tobacco sector is now largely consolidated, we expect that, in future, the major global players will concentrate on smaller deals to build local scale or on deals that expand their product ranges beyond traditional tobacco-based products.



# Methodology

## Data source and industry scope

*Consumer Products Deals Quarterly* is based on Ernst & Young's analysis of FactSet Mergerstat data from Q1 07 to Q2 10. Data was pulled from the FactSet Mergerstat database using standard industrial classification codes.

For the purposes of this publication, our definition of consumer products is only those companies in the food, beverages, tobacco and HPC subsectors.

Deal activity and valuations may fluctuate slightly based on the date that the FactSet Mergerstat database is accessed.

## Qualifying deals

- ▶ Deals include transactions between companies in the four consumer products subsectors; consumer products companies acquiring businesses in other subsectors and non-consumer products companies acquiring consumer products companies
- ▶ PE deal activity includes both full- and partial-stake transactions and was analyzed based on acquisitions by firms classified as PE, alternative investment management groups, certain commercial banks, investment banks, venture capital and other similar entities
- ▶ For non-consumer products acquirers, deals were classified based on the consumer products sector of the seller
- ▶ Equity investments were included (corporate and PE)
- ▶ Joint ventures were not included
- ▶ The value and status of all deals highlighted in this report are as at 30 June 2010
- ▶ All dollar amounts are in US\$ unless otherwise indicated
- ▶ There is no minimum US\$ deal threshold
- ▶ Only disclosed deal values (as per FactSet Mergerstat) are used in all value analyses
- ▶ As used in this report, "total value" refers to the aggregate value of deals with disclosed values for the period under discussion

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Whether it's squeezed margins, brand erosion, business complexity or new regulatory requirements, today's consumer products companies must think differently in order to prosper. Ernst & Young's Global Consumer Products Center brings together a worldwide team of professionals to help you achieve your potential – a team with deep technical experience in providing assurance, tax, transaction and advisory services. The Center works to anticipate market trends, identify the implications and develop points of view on relevant industry issues. Ultimately it enables us to help you meet your goals and compete more effectively. It's how Ernst & Young makes a difference.

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