HOULIHAN LOKEY

EMERGING BRANDS

Building Your Brand the Right Way

The catalyst behind this profound transformation is the emergence of smaller, independently owned brands driven by risk-seeking entrepreneurs striving to achieve what Big Food has historically struggled to achieve on its own. In the wake of the recent Kraft Heinz $15 billion write down, the evidence is clear that consumers today are more demanding than ever. Big Food must partner with the brands of tomorrow to generate long-term value for shareholders and consumers alike.

The New Rules of the Game

Numerous factors can explain the upheaval rumbling throughout the $378 billion U.S. food industry.[1] Shifting economic cycles, growth of private-label brands, changing family structures and demographics, and evolving tastes and preferences have all rewritten the rules on where growth is coming from. Consumers today, led by millennials, are rejecting many of the mass-produced, anonymous heritage brands in favor of healthier, more innovative products with an authentic purpose for being, often backed by passionate founders with a vision to help consumers combine convenience with healthier, more wholesome lifestyles.

Emerging brands are responding to these changes by developing products made with simple ingredients, superior nutritional value, convenience, and exceptional perceived quality relative to old, tired, heritage brands.

Big Food needs to partner with emerging brands to continue generating long-term value for shareholders and consumers. Focusing purely on cost cutting is only a stop-gap measure.

How to Build a Great Brand

While the food and beverage industry is poised for disruption, intense competition still exists among emerging brands. In fact, the competition is even greater now given the advancement of technology, and readily available outsourced production capacity, which has significantly lowered a brand's barrier to entry into the food and beverage space. Achieving success demands a rare mix of attributes.

Product Quality

In keeping with the value they place on healthy, non-processed ingredients, millennial consumers are more discerning than ever, reading labels carefully and putting extra care into the food that

[1] Packaging Strategies

goes into their bodies. An emerging brand aspiring to reach large-scale success needs to go well beyond “me-too” status by delivering a product that tastes good, is nutritious, clear about sourcing, and made with simple ingredients. An emerging brand must leave consumers pleasantly surprised, even shocked, when they discover that such a pleasant tasting product is actually better for them. While these product characteristics were perceived to be unique in the past, they are table stakes in today’s marketplace given how demanding consumers have become.

“If your brand is only growing through deep discounting, what you have is just a hobby, not a scalable business.”

Brand Building

Turning a consumer’s infatuation into a fanatical communal following requires that a brand stay closely attuned to consumers’ feelings and perceptions towards the brand. Most companies are now leveraging sophisticated data analytics to gain insights into what consumers are saying about their brands, particularly on social media. Constantly listening to how consumers perceive the brand should be an emerging brand’s number-one KPI. But this is only the first step. Converting this feedback into continuous improvements in taste, nutritional value, packaging, and brand messaging, for instance, will gradually drive stronger brand affinity and advocacy.

Financial Discipline

Successful entrepreneurs are laser-focused on achieving profitable growth. Steady cash flow allows them to continue investing in the brand without forcing the entrepreneur to dilute his or her stake in the company. A disciplined pricing architecture that maintains parity across multiple retail channels is critical. Consistent pricing also means resisting aggressive discounting and trade spend, which will only erode margins, often forcing entrepreneurs to raise additional capital. If your brand is only growing through deep discounting, what you have is just a hobby, not a scalable business. After all, why create a business only to wind up being an employee for the very company that you have created? Maintaining a disciplined financial approach while being bootstrapped provides the entrepreneur with optionality to raise additional capital at the right time without the risk of being over diluted.

#1 All North American Consumer, Food, and Retail Transactions

Thomson Reuters ranks Houlihan Lokey as the top North American M&A advisor in the consumer, food, and retail space in 2018.

The Houlihan Lokey Consumer, Food & Retail (CFR) Group has earned a reputation for providing superior service and achieving outstanding results in M&A advisory, capital-raising, restructuring, and financial advisory services. The Consumer, Food & Retail Group is a trusted advisor to companies in the CFR industry and combines extensive market capabilities with in-depth industry knowledge to help maximize shareholder value for clients. In 2018, the group was ranked the No. 1 M&A advisor for all North American CFR transactions by Thomson Reuters.

2018 M&A Advisory Rankings
All North American Consumer, Food, and Retail Transactions

Advisor	Deals
Houlihan Lokey	**28**
Goldman Sachs & Co	24
Lazard	21
Piper Jaffray Cos	20
Generational Equity	19

Source: Thomson Reuters

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The M&A Option

Some companies, such as Amy's Kitchen, have taken a public stance about their choice to remain private. Other brands, however, set their sights on a potential sale. In every case, entrepreneurs should always aspire to become a major, billion-dollar brand, while very few ever actually get close. In fact, in the world of food and beverage there are 70 brands over $1 billion in retail sales, with only one brand, Chobani, being introduced in the last 15 years.[2] Before a business can make the most educated decision about when to pursue an exit and how much it is worth, an entrepreneur must have an intricate and nuanced understanding of what exactly the market data is telling him or her.

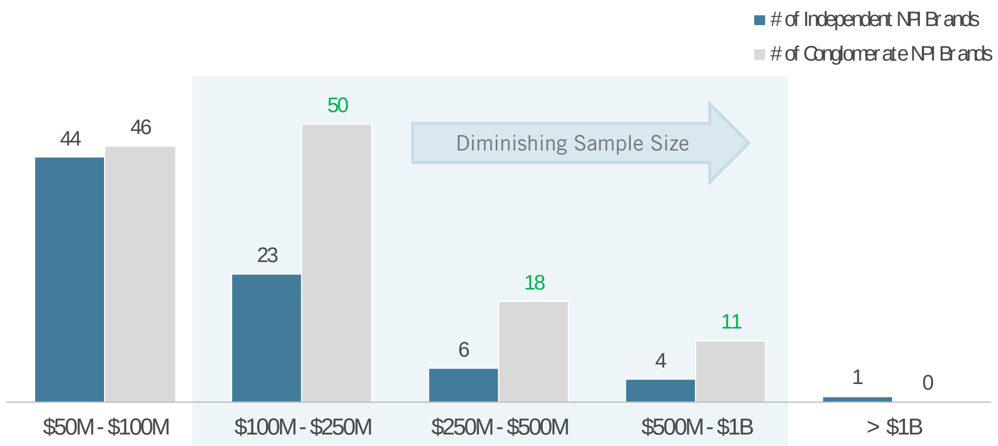
What Is the Data Telling You?

The Natural Product Index (NPI) compared sales levels at privately held, independent brands and Big Food NPI brands across all categories. Figure 1 charts the steep decline in the number of independent NPI brands beyond $100 million in sales. The number of independent brands with $250 million or more in sales is almost immaterial with Chobani being the only independent NPI brand over $1 billion in retail sales.

Emerging brands must build the right case studies with the right metrics at the right retailers.

Likewise, once independent brands reach $100 million in retail sales, their growth is quickly overtaken by the growth of conglomerate NPI brands (see Figure 2). Clearly, independent emerging brands endeavoring to scale have little chance of doing so independently unless they are part of a larger organization. Large organizations can often flex their muscle by helping emerging brands scale significantly through the realization of revenue synergies (i.e., expanding the brand's shelf

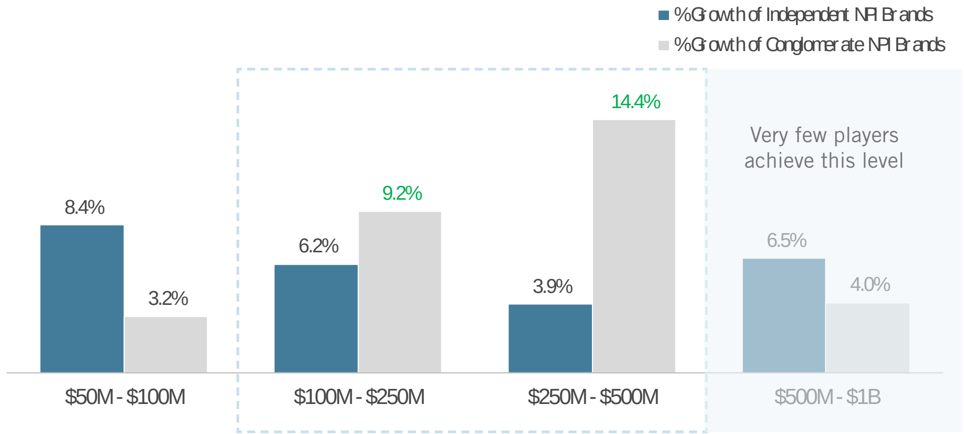
Figure 1: The decline in independent NPI brands after reaching $100 million in retail sales is notable.



Source | SPINS U.S. Natural Channel, Specialty Channel, Multi-Outlet Channel and Convenience Channel as of 10/07/2018.

[2] SPINS

Figure 2: Market data confirms that independent emerging brands can achieve true scale more easily by becoming part of a conglomerate.



Source | SPINS U.S. Natural Channel, Specialty Channel, Multi-Outlet Channel and Convenience Channel as of 10/07/2018.

set and facings, ACV and channel expansion, drive increase in brand awareness, etc.) post acquisition.

Taken together, these two findings support the position that emerging brands should start to contemplate an exit upon reaching $100 million to $150 million in retail sales before their growth curve decelerates. One exception is for platform brands that have proven extendibility outside their core categories (i.e., achieving approximately $50 million to $100 million of sales in each category outside their core category).

What Is the Market Telling You?

Attracting an aggressive buyer who is willing to pay a premium value for an emerging brand that is based on a significant future value is extremely difficult to activate organically. Whatever presumptions an emerging brand may have about its market appeal, the axiom “timing is everything” plays a central role in a potential exit. If a potential acquirer is willing to act preemptively, the entrepreneur should listen to what that potential acquirer has to say. Like the game musical chairs, it is critical that an emerging brand be in the right place at the right time. Nothing would prevent that same strategic buyer from acquiring a competing, less attractive emerging brand or from developing a formidable, competing brand internally, both of which could severely dampen the chances of an emerging brand’s eventual exit.

When Are You Ready

Potential strategic buyers assessing an emerging brand look for compelling metrics in two core areas—strong velocities and premium price points. Emerging brands that are not distributed widely but demonstrate strong turns (velocity) on shelf while commanding a price premium, are attractive propositions to strategic acquirers. What Big Food cannot do is generate strong velocities for their products or sell their products at premium prices when their brands have a lack of equity with today’s consumers.

Select Recent Transactions

TATE'S BAKE SHOP SOUTHAMPTON, NY
a portfolio company of
Riverside
has been acquired by
Mondelēz International
Sellside Advisor

ANGIE'S BOOM CHICKA POP
a portfolio company of
TPG GROWTH
has been acquired by
CONAGRA BRANDS
Sellside Advisor

THANASI FOODS
portfolio company of
encore consumer capital
has been acquired by
CONAGRA BRANDS
Sellside Advisor

Stacy's
Stacy's Pita Chip Company, Inc.
has been acquired by
PEPSICO FritoLay
Sellside Advisor

ZARBEE'S NATURALS
a portfolio company of
L CATTERTON
has been acquired by
Johnson & Johnson CONSUMER INC.
Sellside Advisor

The second area strategic buyers look for is proven relevant case studies with the "right" retailers. An emerging brand with great metrics in the wrong retailers raises the question about scalability. In other words, having successful metrics across the channel leading mainstream grocer retailers, mass merchandise, club, and online is critical. This is not to say that having successful case studies in the natural channel has no value because the consumer who shops in that channel is a highly sought after demographic. Those consumers tend to be both "influencers" and "heavy users." However, only having case studies in a small, albeit fast-growing, channel does not demonstrate a brand's scalability.

A prime example of how these factors can come together perfectly in a successful acquisition is Mondelez's purchase of Tate's Bake Shop. Tate's was able to outperform a major competitor's leading SKU, providing Mondelez the conviction that they are onto something with Tate's.

Brands with exceptionally strong organic price points...

Prices expressed on a price per oz basis.

Tate's Bake Shop	$0.70	67% Higher than the legacy "premium brands"
Pepperidge Farm	$0.42	(40%)
belVita	$0.35	(50%)
Keebler	$0.23	(67%)
Oreo	$0.21	(70%)
Chips Ahoy!	$0.21	

Source | SPINS U.S. Food latest 24 weeks as of 12/31/2017.

Prices expressed on a price per oz basis.

SkinnyPop Popcorn	$0.73	~20% Higher than the legacy "premium brands"
Angie's	$0.60	
Smartfood	$0.55	(25%)
Smartfood	$0.50	(32%)
Smartfood	$0.41	(35%)
Popcorn Indiana	$0.39	

Source | Nielsen total U.S. xAOC as of 12/21/2013.

...and velocities have a better chance of attracting a buyer

	Sales $/TDP	Sales ($M)	TDP
Tate's Bake Shop	$231K	$16.2	70
Pepperidge Farm (Milano)	$230K	$21.2	92

Source | SPINS U.S. Food latest 52 weeks as of 12/31/2017.

Tombstones included herein represent transactions closed from 2006 forward.

Choosing the Right Advisor

Understanding what the market is looking for calls for an advisor with a particular range of capabilities. Guiding you through the entire process requires deep knowledge of the food and beverage industry, insights into what's driving the M&A market, extensive relationships with potential strategic partners, and proven transaction expertise. An objective, credentialed advisor knows their way through each step of the process, from valuation and identifying the best strategic fit to terms and all of the variables that go into a successful exit.

The strength of an advisor comes down to a handful of critical priorities: the quality of their industry relationships and the skill, experience, and creativity of their execution team. A seasoned and highly skilled team of advisors steeped in the food and beverage marketplace can:

- Understand exactly what it takes to build an emerging brand in the space.
- Apply deep market knowledge to effectively position you on the emerging-brands market map.
- Bring extensive relationships to the engagement, which will generate a high level of dialogue with industry-leading strategic buyers.
- Demonstrate rich transaction expertise in a variety of scenarios, ensuring that you get the right deal done.
- Deploy the A-team from start to finish. You want the team you hire to be the team that will work with you throughout the process.

Drawing on our deep sector expertise and the strength of our relationships, Houlihan Lokey's Consumer, Food & Retail (CFR) Group has earned a reputation for providing superior service and achieving outstanding results in M&A advisory, capital-raising, restructuring, and financial advisory services. Working with emerging brands specifically, we provide our clients with powerful advantages that make all the difference in the course of an exit process.

As part of a larger, independent investment bank, Houlihan Lokey's CFR team can leverage all the supporting resources that come with a fully dedicated and integrated industry team approach. The rich sector-level insights and resources that CFR employs set us apart in the industry. Senior-level professionals are involved in the day-to-day diligence process, using a tailor-made approach that meets the unique needs of each client. Thanks to our track record, we can carefully examine what factors culminated in previous winning deals and then leverage these same variables to help produce equally positive results for current clients.

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ABOUT HOULIHAN LOKEY

Houlihan Lokey (NYSE:HLI) is a global investment bank with expertise in mergers and acquisitions, capital markets, financial restructuring, and valuation. The firm serves corporations, institutions, and governments worldwide with offices in the United States, Europe, the Middle East, and the Asia-Pacific region. Independent advice and intellectual rigor are hallmarks of the firm’s commitment to client success across its advisory services. Houlihan Lokey is ranked as the No. 1 M&A advisor for all U.S. transactions, the No. 1 global restructuring advisor, and the No. 1 global M&A fairness opinion advisor over the past 20 years, according to Thomson Reuters. For more information, please visit www.HL.com.