



HOULIHAN LOKEY

Consumer, Food, and Retail Specialty Ingredients

Implications of, and Considerations in, the Current Market Environment

MARKET UPDATE | COVID-19



Remarks From Tim Larsen, Managing Director in Houlihan Lokey's Consumer, Food & Retail Group

The COVID-19 pandemic has impacted our world, nation, economy, and industry in ways that were unimaginable only months ago. At the time of this writing, more than 1.5 million confirmed cases of COVID-19 have been identified around the world, the U.S. unemployment rate is estimated to be as high as 13%, and economists are bracing for a decline in national income as deep as 30% in the second quarter of 2020. And while our industry routinely confronts challenges, often serious ones, the challenges of the COVID-19 pandemic make many aspects of how our community typically functions impossible.

The key truth revealed through a pandemic is that every individual is directly part of a system of potential transmission of the virus, regardless of one's current state of health. And for this reason, social distancing becomes a critical method for slowing the transmission of the virus.

One bright spot in the face of these challenges and the overall economic crisis is found in the food and beverage ingredients (also known as specialty ingredients) sector, which is currently exhibiting the same recession resistance characteristics it delivered during the last downturn.

Here is what we are observing:

- The typical avenues of purchase for food and beverage products, retail, and increasingly e-commerce, remain open and available as the rest of the economy shutters.
- Each of the 42 states that have declared stay-at-home or shelter-in-place orders have deemed food and beverage suppliers to be "essential" industries that will remain operational.
- These trends in concert seem to be contributing to strong performance at points of sale and in financial markets for specialty ingredients, and our sector is earning its reputation as both a growth category and a safe haven.

In all market environments, Houlihan Lokey specializes in helping our clients navigate change and uncertainty. As COVID-19 and the resulting economic consequences continue to evolve, we are closely monitoring the capital markets and working with many companies seeking to strengthen their near-term and long-term liquidity positions and overall balance sheets. We bring to bear a broad range of product and service solutions across the capital structure for companies in the food and beverage industry, and our Capital Markets Group places bespoke debt and equity capital primarily with non-traditional capital providers who remain "open for business" even in the midst of the current crisis. We stand ready to share our expertise and insight on the unique challenges and opportunities you may be facing.

Sincerely yours,

Tim Larsen

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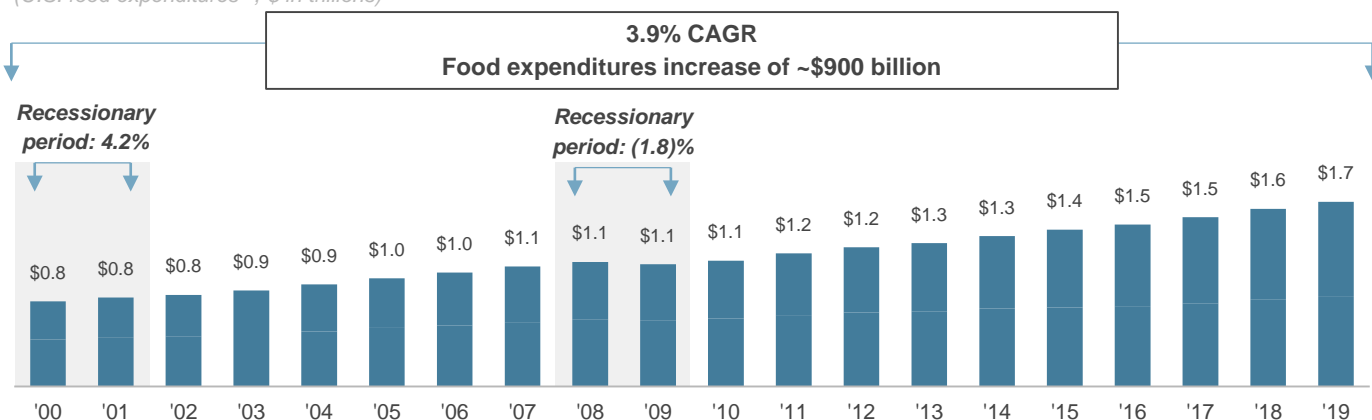
Implications of, and Considerations in, the Current Market Environment

The food and beverage sector—and more specifically, the specialty ingredients sector—tends to perform well during periods of historic market disruption.

Food, Beverage, and Specialty Ingredients as a Safe Haven

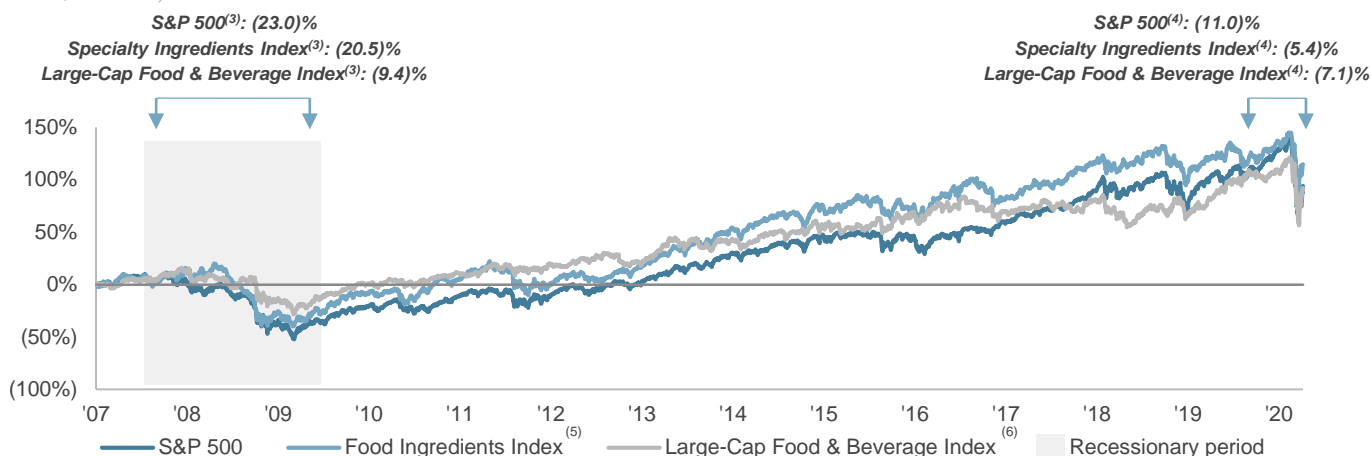
The ongoing disruption to global capital markets is a stark reminder of the food and beverage—and more specifically, the specialty ingredients—sector's unique position as a safe haven for investors. If you've been in a food retail store in recent weeks, you will have been reminded of the food and beverage category's essential role to the consumer.

(U.S. food expenditures⁽¹⁾, \$ in trillions)



Over the past few weeks, shares of both food and beverage and specialty ingredients companies have materially outperformed the broader market indices. Although all episodes of economic downturns and market volatility are different in many ways, specialty ingredients sector equities have consistently outperformed and we see no reason why this episode would end any differently.

(Index⁽²⁾, 1/3/2007)



(1) Source: USDA. (2) Source: S&P Capital IQ. (3) Relative performance for calendar years 2008–2009. (4) Relative performance for 3/2/20–4/8/20 period. (5) Food Ingredients Index comprised of Ajinomoto, Archer Daniels Midland, Ashland, Balchem, CHR Hansen, Corbion, Darling Ingredients, DSM, Givaudan, Glanbia, Ingredion, IFF, Kerry, Lonza, Olam, Sensient, Symrise, T. Hasegawa, Universal, weighted average index by company market capitalization. (6) Large-Cap Food & Beverage Index comprised of Campbell Soup, Coca-Cola, Conagra, General Mills, Hershey, Hormel, Kellogg, Keurig Dr. Pepper, Mondelez, PepsiCo, and Tyson, weighted average index by company market capitalization.

Implications of, and Considerations in, the Current Market Environment (cont.)

The food and beverage sector—and more specifically, the specialty ingredients sector—tends to perform well during periods of historical market disruption.

Food, Beverage, and Specialty Ingredients as a Safe Haven

Flight to safety in the specialty ingredients sector in turbulent economic episodes is driven by the following factors.



Stable, predictable consumption of food and beverage products across economic cycles.



Counter-cyclical nature of profitability in the sector as raw material prices decline in a downturn, but consumption continues to grow.



“Sticky” nature of specialty ingredient customer relationships: Food and beverage companies are perhaps less likely to reformulate products while navigating a period of uncertainty. Specialty ingredients manufacturers are particularly insulated from reformulation risk due to the pivotal nature of a given specialty ingredient in the finished product’s sensory or functional characteristics at a relatively low “cost-in-use.”



Strong business mix diversity: Specialty ingredients providers are typically not indexed to the performance of a single consumer packaged brand, end market of focus, or distribution channel of focus, and this diversity creates a portfolio of balanced business mix exposure which is attractive in times of market uncertainty.



Channel compatibility: Specialty ingredients providers will benefit from the expansion of their customers into newer distribution channels (e.g., Amazon/e-commerce and other technology disruption).

Relevant Observations for Specialty Ingredients Business Owners

Over the past several weeks, Houlihan Lokey has spoken with numerous owners of specialty ingredients businesses, and we have identified major themes as they navigate through the uncertainties of the current market and business environment amid the COVID-19 outbreak.

Importance of a Strong Balance Sheet

- In the face of an unprecedented period of market uncertainty, owners of specialty ingredients companies are focused on solidifying balance sheets and more specifically liquidity positions.
- Houlihan Lokey believes that focusing on balance sheet strength today will position specialty ingredients business owners for maximum operational, capital financing, and corporate finance flexibility throughout the duration and de-escalation of the COVID-19 crisis.

Emphasis on Reliability of Supply Chain

- Due to the uncertain and fluid nature of travel restrictions and epidemic-driven business interruptions, North American food and beverage brands and manufacturers will be increasingly focused on utilizing specialty ingredients suppliers with a U.S. manufacturing presence.
- Houlihan Lokey anticipates food and beverage manufacturers placing an emphasis on domestic manufacturing will continue following the resolution of the current COVID-19 outbreak, as the perceived risk profile associated with international-driven supply chains will likely be significantly altered.

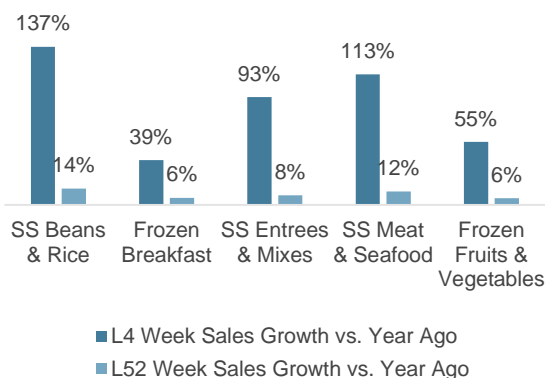
“To minimize disruption, food and beverage companies should create business continuity plans. Companies should **revisit their supply chain’s design** and consider **sourcing goods locally to match consumer demand.**”

– The National Law Review, 4/7/2020

Retail Market ‘Spike’

- As consumer shopping habits have drastically changed as a result of the COVID-19 outbreak, specialty ingredients companies that service center-of-the-store retail categories have likely seen an increase in sales over the past few weeks as consumers have drastically increased their purchases of center-of-the-store products (such as frozen meals and shelf-stable meals).

(MULO retail sales growth as of 3/22/2020—Last 4 weeks vs. Last 52 weeks⁽¹⁾)



(1) SPINS U.S. MULO Retail Sales Data as of 3/22/2020.

Relevant Observations for Specialty Ingredients Business Owners (cont.)

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Headwinds in the Foodservice Market

- As a result of recent government regulations/guidance and often mandatory shutdowns, the foodservice market is facing a period of unprecedented challenge.
- Specialty ingredients providers that service foodservice-focused food and beverage manufacturers have seen sales from these accounts rapidly decrease, and in some cases completely disappear, for a period of up to several weeks.

In Recent Weeks, Restaurant Sales Have Decreased Significantly⁽¹⁾⁽²⁾

(47%)

Decrease Year-over-Year in U.S. Restaurant Sales from March 1–22

40%+

of U.S. Restaurants Have Suspended Operations

(~11-27%)

Estimated Decrease Year-over-Year in U.S. Restaurant Sales in 2020

Strong Performance of the Pet Food Market

- Specialty ingredients providers indexed to the pet food market have likely seen an increase in sales as retail purchases of pet food and treats surged since the onset of the COVID-19 crisis, with weekly year-over-year sales up over 50%.⁽³⁾
- A portion of the increase is attributable to consumers stockpiling pet food as they have done with other supplies; however, a large portion of the increase is driven by a dramatic uptick in pet purchases and adoptions, as consumers seek to stave off the loneliness caused by social distancing.
- The significant uptick in pet ownership driven by quarantine is likely to cause a permanent increase in the need for ongoing pet food purchases, both in the U.S. and globally.

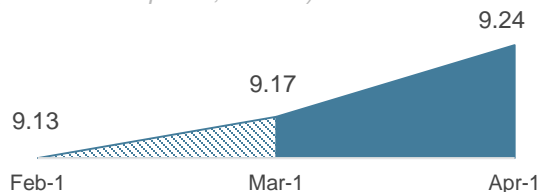
In Recent Weeks, Retail Pet Food Purchases Have Surged⁽³⁾

50%+

Increase Year-over-Year in Weekly Dog and Cat Food Sales

Sharp Acceleration in Pet Adoptions During Social-Distancing⁽⁴⁾

(PetSmart adoptions, millions)



Opportunity to Further Customer Intimacy

- During times of unprecedented market volatility, Houlihan Lokey anticipates that food and beverage manufacturing companies will increasingly rely on specialty ingredients suppliers as a source of key market intelligence and as collaborative partners in navigating this turbulent time period.
- Houlihan Lokey believes the COVID-19 outbreak offers specialty ingredients companies the opportunity to further develop customer relationships, the benefits of which will likely extend far past the current crisis.

(1) Restaurant Business; (2) Technomic; (3) Nielsen for the week ended 3/20/2020; (4) PetSmart.

How Houlihan Lokey Can Help

Our firm is extremely well equipped to help our clients navigate uncertain times. We respond quickly to challenging situations and are constantly helping clients to analyze, structure, negotiate, and execute the best possible solutions from both a strategic and a financial perspective.

What We Offer

1 Corporate Finance

Mergers and Acquisitions

Capital Markets

Private Funds Advisory

Board Advisory Services

2 Financial Restructuring

Company Advisory

Distressed M&A

Liability Management

Creditor Advisory

3 Financial and Valuation Advisory

Portfolio Valuation and Fund Advisory

Transaction Opinions

Corporate Valuation Advisory Services

Transaction Advisory Services

Real Estate Valuation and Advisory

Dispute Resolution Consulting

Corporate Finance

We have been the most active advisor to the North American specialty ingredients sector for several years and have long-standing relationships with capital providers, including private equity funds, family offices, commercial banks, and other senior credit providers, insurance funds, asset managers, and mezzanine fund investors.

Financial Restructuring

We have the largest restructuring practice of any global investment bank. Since 1988, we have advised on more than 1,000 such transactions (with aggregate debt claims in excess of \$2.5 trillion). We served as an advisor in 12 of the largest 15 bankruptcies from 2000–2019.

Financial and Valuation Advisory

For nearly four decades, we have established ourselves as one of the largest financial and valuation advisory firms. Our transaction expertise and leadership in the field of valuation helps inspire confidence in financial executives, boards of directors, special committees, investors, and business owners we serve.

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