REPORT

Beyond the mega-merger

What is next for M&A in the specialty food and beverage ingredient sector?

Roland Berger

Management summary

The specialty food and beverage ingredient sector has been shaped by mega-mergers over the last few years in order to meet key consumer, customer and regulatory challenges. We are entering a new period of M&A, where we expect to see some of the major strategic players slow down their M&A activity to take care of integration and debt leverage, while carving-out businesses. It is also expected that private equity will re-engage, leveraging their immense dry powder, and smaller specialty food and beverage ingredient players will find opportunities to build their positions.

The specialty food and beverage ingredient industry continues to have many challenges to solve—consumers want cleaner labels, natural ingredients, increased convenience and more economic options, while regulators are increasing scrutiny on the industry. With solutions to these challenges comes room to expand the pie—and in the world of M&A, multiply it.

Cover: Pitijopo/iStock

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Fast facts

USD **5**

The average NTM price/earnings trading premium for specialty food and beverage ingredient companies over the S&P 500 between 2014 and mid-2023.

45%

EBITDA growth for specialty food and beverage ingredient companies since 2014 (excluding companies that completed a major M&A).

>15x

EV/EBITDA multiples in most recent public specialty food and beverage ingredient transactions.

1

How the specialty food and beverage ingredient sector creates value

The specialty food and beverage ingredient sector[1] includes functional ingredients such as flavors, sweeteners, texturants, colors, nutraceuticals, botanicals, preservatives, amongst others. These ingredients are typically added at rates of less than 10% to packaged food and beverage product formulations for specific functionalities, e.g., sweetening, mouthfeel, flavor, nutrition, etc.

Together, the major public specialty food and beverage ingredient companies that did not complete a major acquisition in the past 10 years expanded EBITDA over 45% since 2014.[2] The food and beverage Consumer Packaged Goods (CPG) sector[3] saw EBITDA grow under 30% in the same period. The specialty food and beverage ingredient industry has also outgrown the underlying demand for food and beverages (~4% p.a. revenue growth for the major specialty food and beverage ingredient players vs. ~3% p.a. for packaged food and beverages over 2014-2023), driven by increasing consumer demands and regulatory requirements. ▶ A

Consumers have increasingly demanded clean labels, natural ingredients and healthier products, while regulators have been intensifying their regulations on ingredients. For example, in December 2023 the European Food Safety Authority (EFSA) lowered the acceptable daily intake (ADI) of erythritol, a commonly used sugar alcohol for zero-calorie foods and beverages, to 0.5 g/kg of bodyweight–an amount many consumers reach daily. Similarly, the WHO is conducting cancer research on a range of food ingredients and released a statement that aspartame is a possible carcinogen in July 2023. Driven in part by the media around these regulations and studies, many consumers have become skeptical of the ingredients used in their food and beverage products, driving towards food and beverage labels with fewer ingredients and specifically those with fewer chemical-sounding names. Consumers are looking for natural ingredients, for example, natural flavors or extracts, rather than those produced synthetically. At the same time, consumers continue to demand convenient and economic food options. Combined, these regulatory requirements and sometimes conflicting consumer demands create an industry-wide challenge.

Specialty food and beverage ingredient players have met these demands and challenges by innovating with advanced ingredients and formulations. These advanced ingredients and formulations have increased the value generated by the specialty food and beverage ingredient sector, often through replacing traditional synthetic, cheaper ingredients. Take, for example, the replacement of a standard liquid lactate/(di)acetate system with a natural vinegar alternative for meat preservation: the natural solution costs 1.5-2x the traditional solution, while still only representing 0.5-2% of the final product price. These ingredients have expanded the size and value generated by the specialty food and beverage ingredient sector.

The specialty food and beverage ingredient industry continues to have many consumer, customer and regulatory challenges to address. As these parties continue to demand more, the industry continues to rise–and expand–to meet the challenge.

1 The sector excludes bulk commodities, e.g., flour, sugar, etc.

2 Includes Givaudan, Symrise, Kerry, Tate & Lyle, Ingredion and Novozymes

3 Includes Coca-Cola, ConAgra, PepsiCo, Tyson Foods, Kraft Heinz, General Mills, Mondelez, Campbell Soup

A The industry is driven by 11 key trends

Clean-label
Consumer preference for minimally processed, natural formulations with fewer ingredients on their labels
Example ingredient: Cultured celery extracts to replace nitrate preservatives in meats

Functional foods (Health+)
Increased demand for products offering functional benefits that can reduce stress, risk of disease and weight loss
Example ingredient: Addition of oleoresins and essential oils to food products for stress relief

Healthier versions (Health-)
Trend towards healthier versions of the same product (reduced fat, sugar or salt formulations) to reduce disease risk
Example ingredient: Salt replacements based on mineral salts, e.g., potassium salts

Waste reduction
Increasing focus on reducing food waste from excess food or packaging and increasing sustainability
Example ingredient: Use of antioxidants in sauces and dressings

Flexitarianism
Growing trend among millennials and gen-z towards eating less meat for health, taste and animal welfare justification
Example ingredient: Plant-based proteins (e.g., soy, pea, fava) for protein fortification

Snackification
Urbanization has driven a snackification of foods and demand for ready-to-go formats
Example ingredient: Pectin texturants used in fruit-based snacks

Ethnic tastes
Consumer preference for ethnic flavors, including incorporations in non-traditional food and beverage products
Example ingredient: Incorporation of spices and seasonings into new categories

Food safety
Prevention of food-borne illnesses based on processing, spoilage, handling, preparation and storage practices
Example ingredient: Preservatives and packaging preservation technologies

Traceability
Increasing demand for traceable food products so consumers know where their food comes from
Example ingredient: Organic natural extracts with certificates of origin

Regulatory
Regulatory practices seek to ban unhealthy foods and practices (e.g., trans-fats, feed antibiotics, animal welfare)
Example ingredient: Starches used to replace titanium dioxide in baked foods

Processed food economization
Increasing efficiency of producing processed foods decreases costs for manufacturers and consumers and enables globalization of processed foods
Example ingredient: High-intensity sweeteners with low "dose" requirements drive improved processed food economics

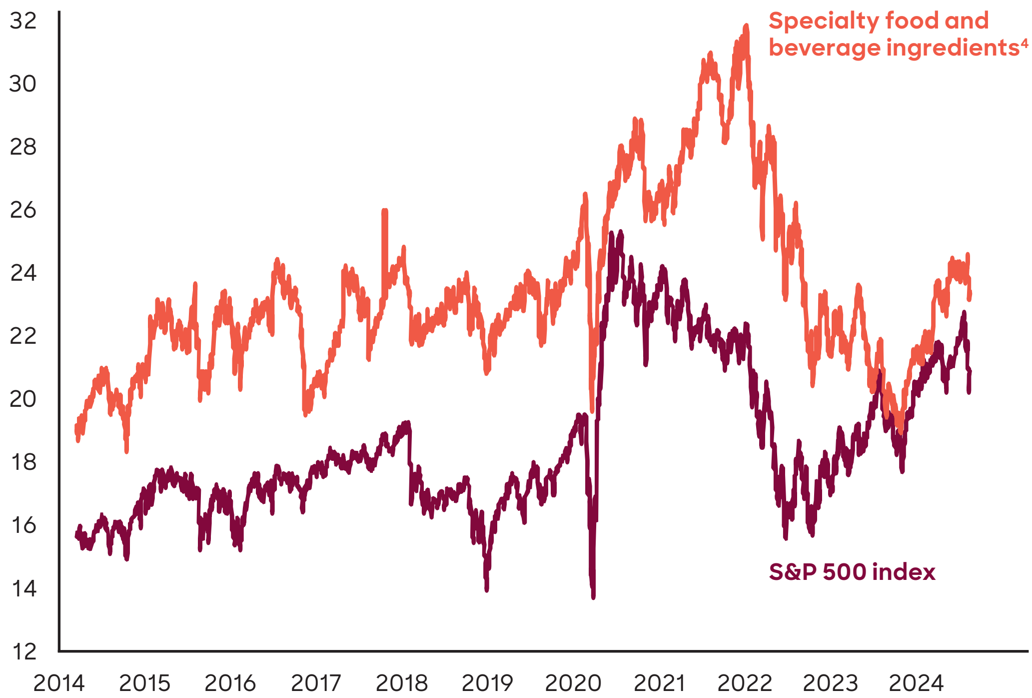
Source: Roland Berger

2

Industry valuations: trading multiples

Despite the value the specialty food and beverage ingredient sector creates, trading multiple growth in the sector has under-paced the S&P 500 since 2014. Price/forward EPS (next 12 months) grew 33% for the S&P 500 over the last 10 years, while the average of the selected public specialty food and beverage ingredient players grew just 21%. ▶ B

B Prior to mid-2023, the sector traded at an average premium of USD 5 on a price/forward EPS basis vs. the S&P 500
Share price/forward EPS [USD, next 12 months]



4 Includes Symrise, Givaudan, Kerry, Tate & Lyle, Ingredion and Novozymes

Source: S&P Capital IQ, Roland Berger

Prior to mid-2023, the specialty food and beverage ingredient sector traded at an average premium of USD 5 on a price/forward EPS basis compared to the S&P 500. Since mid-2023, the premium has quickly dissipated. Valuations in the specialty food and beverage ingredient sector were impacted by reduced growth expectations, with some mixed results from the merged specialty food and beverage ingredient businesses, increased debt-driven riskiness and broader macroeconomic drivers, such as inflation, that hit the food and beverage industry harder than other sectors. ▶ **Spotlight**

However, this generalization does not tell the whole story—there has been a dichotomy in multiples growth. Flavor houses' price/forward EPS grew by over 42%[5] in the past 10 years, while traditional corn-based ingredient players saw a 3%[6] increase in price/forward EPS. Investors have valued players who can build and sustain margins through specialty products, provide broad product solutions and innovate to meet consumer trends.

5 Includes IFF, Symrise, and Givaudan

6 Includes Tate & Lyle and Ingredion

TOPIC SPOTLIGHT
FOR AND AGAINST THE RETURN OF THE SPECIALTY INGREDIENT VALUATION PREMIUM

Reasons to believe the industry will go back to trading with a premium above the S&P 500 index

The specialty food and beverage ingredient industry was hit in recent years by impacts that are being resolved or are already resolved. For example, destocking is largely in the past, debt leverage challenges can be at least partly resolved with expected interest rate cuts and inflation is expected to continue cooling.

The specialty food ingredient industry still has major consumer, customer and regulatory needs to address, and is positioned to do so with technology and application capabilities. Furthermore, the companies that completed recent mega-mergers are still sorting out their integrations but should begin creating value via commercial solution synergies and cost synergies over the next couple of years.

Reasons to believe the industry will remain trading around the S&P 500 index

Innovation head room is diminishing. Major categories that experienced significant growth in previous years, such as plant-based proteins, were over-hyped and the room for food ingredient companies to innovate in these sectors is becoming limited given lack of CPG investment.

As inflation impacts consumer spending, the top focus for food and beverage innovations has flipped from clean label to economization. Consumers are focused on value-based products and private labels. A study conducted by Food Business News in March and April 2024 with 224 industry participants working in product development (45%), marketing and sales (19%), company management (16%) and other roles (20%) showed that cost reduction was the top product food and beverage development trend in 2024 with 59% of respondents, identifying it as a key trend for product development. Cost reduction was followed by clean label (53%) and convenience (50%). The focus on natural ingredients and clean label ingredients may be reduced and lower-cost synthetic ingredients may be prevalent, shrinking the market value.

Overall, we are optimistic about the return of the premium for the specialty food and beverage ingredient sector, but there are strong arguments on either side.

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The role of M&A to meet industry needs

As the investment community has rewarded players that can holistically solve consumer demands for cleaner labels, nutritional, tasty and affordable products, players have looked to M&A to address their portfolio and capability gaps. A single ingredient, or even class of ingredients, is not enough to solve the demands of consumers and support the food and beverage CPG industry. For example, sugar plays a multi-functional role in formulations: sweetness, preservation and mouthfeel. Simply having a single natural sweetener or even a range of natural sweeteners in the portfolio does not enable a complete sugar replacement solution for food and beverage products. M&A has become a requisite for players to quickly build-up more comprehensive portfolios and capabilities to serve the food and beverage CPG industry.

C **M&A activity has driven increased EV/EBITDA multiples, rising above 15x in most recent deals**
Selection of sector transactions [EV/EBITDA][7]

7 EV/EBITDA multiple calculations differ. Time periods differ between LTM, FY, NTM. EBITDA figures vary between adjusted and unadjusted. Only includes transactions with available information; 8 Considered a primary focus of acquiree business

Source: S&P Capital IQ, Annual reports, Press releases, Roland Berger

As we discussed in our report titled, “Opportunities in F&B application: How to capitalize on the new landscape and emerging trends," M&A for specialty food and beverage ingredient strategics is driving towards two end games: a broad strategy towards integrated solutions and a deep strategy (e.g., focused on biotechnology.) The capabilities needed to succeed in the two end-games differ in terms of the type of portfolio (ingredients), technologies, application-related capabilities and customer access. For winning in integrated solutions, portfolio breadth and application know-how matter the most; for deep technology leadership, fundamental research and technical capabilities are key.

The combination of consumer and regulatory trends driving value growth potential, and the industry push to move to one of these two end-games has driven M&A activity in specialty food and beverage ingredients. Acquisition multiples were about 8-15 in the early 2010s and rose to 14-28 in the early 2020s. Both trading multiples and transaction multiples underwent a similar growth over the period. ▶ C

Since 2021, many of the major specialty food and beverage ingredient companies have combined through industry-transforming mergers (including the merger of IFF and DuPont’s Nutrition & Biosciences division, the merger of DSM and Firmenich, the merger of Novozymes with Chr. Hansen and most recently, Tate & Lyle’s acquisition of CP Kelco). This string of announcements reflects that customers and the financial community have pushed specialty food and beverage ingredient players to broaden their portfolios and capabilities to develop solutions and/or deep focused capabilities to meet consumer and regulatory needs.

4 What is next for specialty food and beverage ingredient M&A?

Roland Berger expects we are entering a new phase of M&A activity. The rest of 2024 is likely to remain slow for M&A with lengthy due diligence processes, but begin picking up as interest rates start to come down. There is a backlog of deal activity driven by: weak M&A activity in 2023 into 2024, carve-outs to come from recently merged players and the end of private equity holding periods. As market conditions improve, this deal backlog could result in a frenzy of M&A activity. While the earlier part of the decade was marked with industry-defining mega-mergers, we expect the next period will have several interesting dynamics at play. ▶ **Spotlight**

Several of the major specialty food and beverage ingredient players will shift focus from acquisition mode to completing their integrations, driving synergies and optimizing their portfolios. It will be critical for these players to focus on portfolio management to build coherence across their portfolio and capabilities.

Several of these major specialty food and beverage ingredient players will carve-out assets with a lower strategic fit. These carve-outs will mainly be in less on-trend segments and will make strategic sense as these players focus on higher-value segments, where there is synergy in cross-segment solutions capabilities or where it plays into their deep focus approach.

Many of the targets are likely to be in less attractive, slower-growth segments, potentially coming from carve-outs. Transaction multiples are likely to be more modest for these assets. These targets may have been neglected under prior ownership structures.

New owners can unlock value through good management, operational adjustments and overhead management.

Natural ingredients will continue to be a focus for buyers. Regions that are natural clusters of small-to-medium enterprises in this sector, e.g., Spain, could be ripe for M&A where new ownership can enable internationalization and scale. Private equity-style roll-up strategies can build a model that takes these players from playing in a narrow set of natural ingredients and/or applications to a broad natural solutions or technology leader.

Combined, these factors will bring a different set of players into the M&A arena: Private equity is likely to increase buy-side activity given their large sums of dry powder and smaller specialty food and beverage ingredient companies with strong cash positions can become more active.

TOPIC SPOTLIGHT
THREE DRIVERS OF THE DEAL BACK-LOG

Weak M&A activity in 2023 into 2024

M&A was down across sectors in 2023 and into 2024 driven by a confluence of factors. Higher interest rates drove buyers to safety. Valuation expectations between buyers and sellers became mismatched with sellers reluctant to lower valuations in light of the changing market and buyers resistant to buy at the high multiples of 2021 and 2022. High stock market valuations decreased the attractiveness of making divestments. Combined with significant macroeconomic uncertainty, these factors slowed activity and created a backlog for future M&A.

Portfolio optimization and carve-outs needed by major player

After a period of growth and a series of mega-mergers, large specialty food and beverage ingredient companies need to turn their attention to their portfolios and optimize their positions. Not all the assets these players have acquired build towards their target end games and some of them can be carved-out to focus their portfolios, and in some cases, manage their debt leverage. Strong portfolio management supports both the broad solution and deep focus end games, providing coherence in the portfolio and capabilities. Carve-outs can bring a different class of targets to the market: narrow in scope, primarily off-trend, long-running businesses that have often been underinvested within their current ownership structure.

Long private equity holding periods driving exits

Private equity players have decided not to exit as many businesses in the past 18 months given the weak M&A market. However, their sponsors still expect them to return their funds and most PEs need to sell their assets within a 5-7 year period. For many assets, these periods are coming to an end. For some of these private equity players, the deals they made during the hot M&A period are now underwater, complicating their exits. Nevertheless, many private equity players will be making exits from their portfolio companies, ramping up in 2025.

Summary

The last decade of the specialty food and beverage ingredient industry was shaped by growth and culminated in major merger activity. As we pass the mid-point of 2024 with decreased investor optimism as seen by the virtual elimination of the sector's premium to the overall market, it is clear we are entering a new period of M&A activity in the specialty food and beverage ingredient industry. This period will bring new players and new opportunities, as the sector rises to meet the needs of the ever-more demanding consumer, customer and regulator.

AUTHORS

Alexander Belderok
Senior Partner +31 6 4382-4920 alexander.belderok@rolandberger.com

Michelle Briffett
Principal +1 248 482-5763 michelle.briffett@rolandberger.com

Eesha Nayak
Principal +31 6 4280-6075 eesha.nayak@rolandberger.com

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Publisher

Roland Berger LP
177 Huntington Avenue, 18th Floor
02115 Boston
USA
+1 617 310-6600

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