As COVID-19 Impacts Consumer Behavior, Investors Remain Hungry for Food & Beverage Acquisitions

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As COVID-19 spreads throughout the globe, food & beverage consumption at home has increased significantly. Rising demand has caught the attention of private equity investors with capital ready to deploy and corporate buyers eager to modernize their brand portfolios and align themselves towards growth. Brands and investors alike are already pondering how the changes in consumer grocery shopping precipitated by the pandemic will impact the industry and M&A in the year ahead.

To uncover just that, Lincoln International spoke with a myriad of food and beverage brands as well as corporate buyers and private equity investors. What follows are observations and insights straight from the mouths of some of the industry's leading brands and investors.

Emerging Food & Beverage Themes During COVID-19

Demand for both comfort and better-for-you foods rises year-over-year.

Throughout the pandemic, many people looking for emotional comfort have gravitated toward indulgent, comfort foods and nostalgic brands evocative of childhood.

For others, the constant COVID-19 news cycle has inspired them to eat healthier, boost their immune system, and get fit. With studies showing a link between type-2 diabetes and COVID outcomes, the consumer mindset for many is simple: give yourself the best chance of fighting off COVID-19 by taking care of your health. Even pre-pandemic, healthy eating was on the rise, and now food and beverage brands expect that trend to accelerate as many consumers tend to the factors within their control that can positively impact their health.

Where better-for-you brands once were marketing to vegans and those with strict dietary constraints, they are now appealing to a broader group of consumers. Today's shoppers are increasingly flexitarians seeking a more balanced, plant-forward diet, as well as mainstream consumers seeking products featuring functional benefits to help with immunity, gut health or inflammation.

One executive of a plant-based food brand experiencing strong sales growth during COVID-19 attributed the success not only to consumers eating at home more, but to their motivation to maintain a healthier diet and lifestyle.

Food and beverage brands with flexible production and multiple avenues for growth fare best.

In the early weeks of the pandemic, when consumers raided grocery store shelves in panic-buying mode, manufacturers and distributors struggled to keep up. It was quite a challenge to meet the increased demand – all while implementing new safety procedures to protect employees and shoring up supply chains to ensure access to ingredients. Several big food and beverage companies pared back the number of SKUs they offer, focusing on maximizing production of their most popular products. Distributors were under pressure to provide quality service to retailers, but their trucks only had so much space. Top performing products and "essential goods" were prioritized. For many emerging brands, this unfortunately meant fewer deliveries of their products to the stores and more stock outs.

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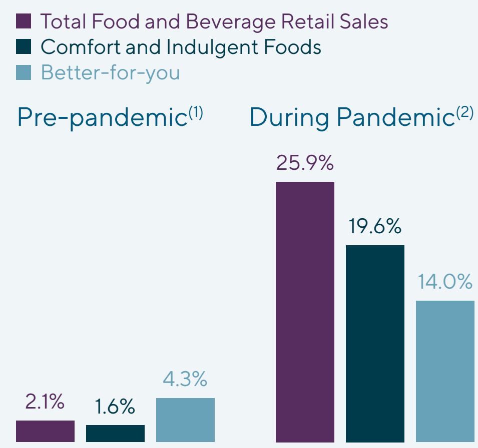
YoY Food & Beverage Retail Sales Growth %



Source: SPINS Multi-Outlet Channel (powered by IRI). Multi-Outlet channel data includes Food, Drug, Mass, and select Club, Military, Dollar stores; Lincoln International determined categories included in comfort and indulgent foods and better-for-you groupings

(1) SPINS MULO data from 12/30/19 through the period ending 02/23/20

(2) SPINS MULO data from 02/24/20 through the period ending 06/14/20

Consumers Resolve to Eat Well

73% of consumers plan to eat and drink healthier due to COVID-19

Source: FMCG Gurus, April 2020

Fruits, Veggies and Supplements on the Rise

43% are eating more fruits and **42%** are eating more vegetables than before

Source: Influence Central, June 2020

33% say taking dietary supplements and vitamins is more important than in 2019

Source: New Hope Network NEXT Data and Insights, April 2020

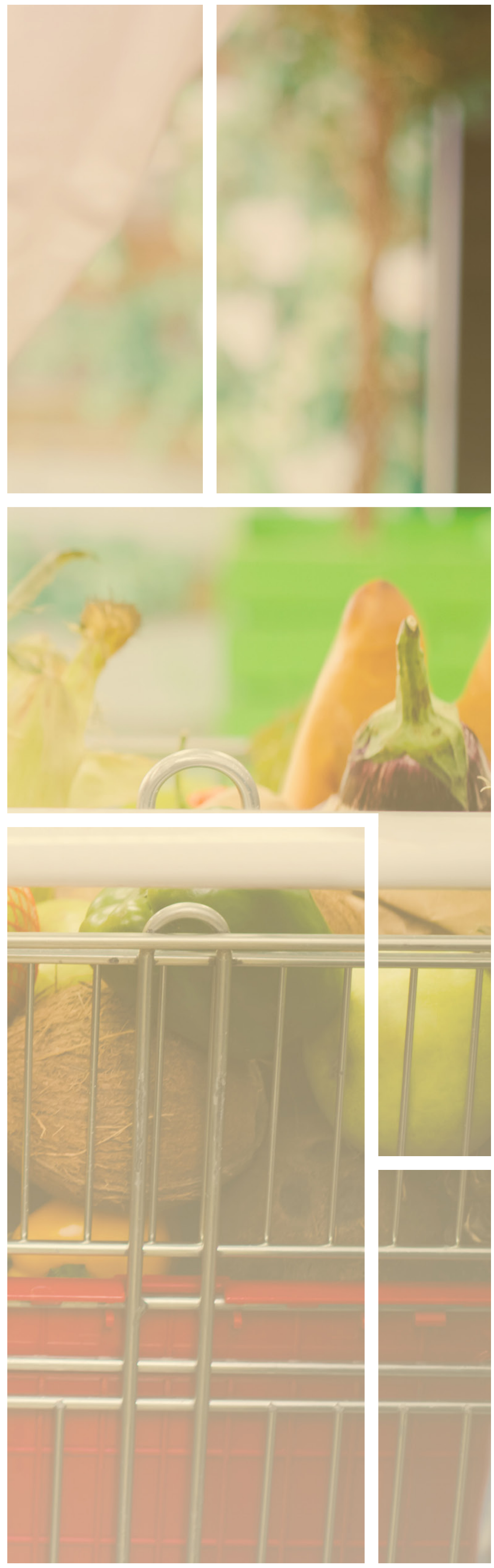
As Restocking Improves, Better-for-You Brands May See a Boost

Just **39%** in June vs. **56%** in April said they are buying what is available with less worry about product or brand preference

Consumers buying better-for-you products climbed from **27%** in April to **35%** in June

Source: New Hope Network NEXT Data and Insights, June 2020

Although these dynamics have normalized to some degree, the threat of another COVID-19 spike or a production facility shut down looms in the minds of food and beverage operators. In navigating these challenges, many food and beverage players agree: flexibility is key. For example, companies with inventory built up or flexibility in manufacturing have likely had an easier time responding to the pandemic. It's an evolving situation that is leading big food companies to adjust their supply chains. For instance, General Mills recently disclosed they are expanding their network of outsourced contract manufacturing partners to help meet demand - despite the higher costs.



Expanding retail distribution is another hurdle for brands in the COVID-19 environment. Although some brands report that they are having virtual meetings with some retailers, many others say these important meetings have been postponed. As many retail category buyers stopped taking meetings with brands, it has become more difficult to secure new retail accounts. For companies considering a growth capital raise or a sale transaction, having growth plans dependent on gaining new points of distribution presents a challenge. Many brands are continuing to achieve strong growth during the pandemic, but often that growth is generated by multiple avenues (e.g., higher sales velocities in existing retail accounts, accelerating online sales).

The rise in e-commerce grocery shopping is here to stay.

The growth of online grocery purchases was a shift that was long anticipated but accelerated by the pandemic. In fact, data from FMI demonstrates that prior to COVID-19, 14.5% of grocery shopping was online, but by March and April this figure climbed to 27.9%. It is a change that food and beverage executives agree will be long-lasting. Many consumers who had never tried online shopping for groceries before COVID-19 have now been brought into the fold.

While most brands affirm the longevity of e-commerce, there are still kinks to be ironed out to ensure a high-quality customer experience. Poor substitutions, missing items, and delays in order delivery may turn off customers from online shopping altogether.

Brand discovery has suffered during the pandemic – not only in stores where many consumers are focused on securing a strict shopping list of essential items and getting in-and-out quickly, but also within e-commerce platforms. With the transition from in-store browsing to the digital aisle, brands that are not well-known can lose out on sales from impulse shoppers who would otherwise stop to taste a sample or check-out new products. In parallel, many households financially impacted by COVID-19 may be less inclined to take a chance on a new product, especially if it is priced at a premium. Between focused budgets and less time in store, categories which benefit from impulse shopping have been impacted.

As e-commerce platforms from Instacart to Prime Now improve their UX and searchability by feature (e.g. gluten-free, plant-based), there may become greater opportunities for organic brand discovery within the digital grocery store.

The demand for online groceries driven by the pandemic has forced food and beverage brands to shore up their previously underdeveloped direct-to-consumer e-commerce capabilities as well. Loyal customers may turn to direct online orders to secure their go-to favorites.

Online Shopping Booms

Online Grocery Delivery and Pickup Sales have surged from **$1.2B** in Aug 2019 to **$7.2B** in June 2020

Customers purchasing groceries online have grown from **16.1M** to **45.6M** during the same timeframe

Source: Brick Meets Click/Mercatus Grocery Survey, June 2020

But UX Is Far from Perfect

Yet **49%** said their online grocer did not have everything in stock that they wanted to buy

45% reported not receiving all items ordered online

Source: 2020 U.S. Online & In-Store Grocery Shopping Study from Retail Feedback Group, May 2020

Brand Discovery Suffers

40% of consumers plan out ahead of time what they want to purchase so they can minimize time in physical grocery stores

37% say they make fewer impulse purchases

Source: HelloFresh OnePoll study, May 2020

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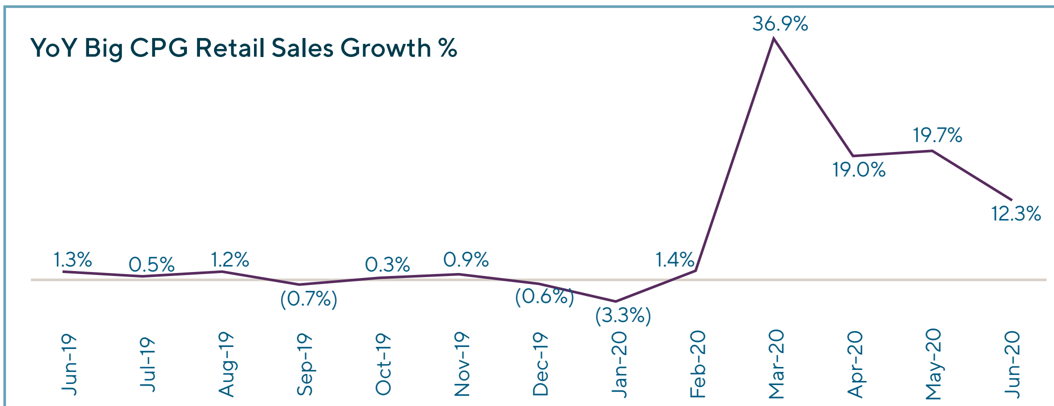
Key M&A Takeaways for Food & Beverage Sellers:

For food and beverage brands considering an M&A process amidst the pandemic, it's only natural to ask how these developments will impact buyer appetite, valuation, and the likelihood of a successful transaction. The following takeaways shed light on the state of the market and what to expect going forward.

COVID-19 has not dampened M&A appetite:
Despite the economic conditions, corporate and private equity investors in the food and beverage space are aggressively pursuing opportunities to deploy capital. Pre-COVID, some strategic buyers were distracted or on the M&A sidelines for various reasons (e.g., divesting assets, integrating acquisitions, and deleveraging, etc.), while others remained actively seeking opportunities in-line with their strategies. Now amidst COVID-19, the buyer landscape remains largely unchanged, but the recent uptick in growth experienced by big food companies (after years of stagnant or declining sales trends) complicates matters. One could argue a big food buyer might be less willing to pay up for a growth brand if their legacy brands are achieving strong growth in this moment. However, it remains to be seen if the current growth uptick of their legacy brands will endure or be short lived. With fundamentals unchanged, big food and beverage companies will likely continue to acquire fast-growing brands that align with today's consumer preferences and improve the acquirer's real or perceived growth profile.

YoY Big CPG Retail Sales Growth %



Source: SPINS, monthly year-over-year growth % based on four week quads in MULO through 06/14/20

Note: Includes sales of food and beverage brands from selected big CPG companies including: B&G Foods, Campbell Soup Company, Coca-Cola, ConAgra Brands, General Mills, Hain Celestial, Hershey, Hormel Foods, The J.M. Smucker Company, Kellogg, Kraft Heinz, Mondelez, Nestle, PepsiCo, and Unilever

Investors expect pre-pandemic valuations to hold:
Despite many companies with strong balance sheets electing to delay a sale process to wait out the peak of the pandemic, corporate buyers say valuation multiples for quality companies are expected to be unaffected by the current climate. Essentially, while the COVID-19 environment has induced challenges in pricing private companies, valuation multiples for quality food and beverage companies will largely stay the same as buyers factor in the unprecedented pandemic conditions.

Brands must be fluent with data and tell the right story:
Buyers will inquire about company performance and the impact of COVID-19 during due diligence. Whether the pandemic has resulted in increased or decreased sales for a particular brand, it is critical to collect the relevant data to be able to tell the right story to potential investors in the future. For example, it is incumbent upon brands who have grown during the pandemic to make the case through POS data and consumer insights that their increased sales level is the new baseline rather than a one-time bump. A best practice is to closely track sales velocities and repeat purchase metrics for your brand versus competitors in your category. Brands with industry leading velocity and a loyal consumer base will be of interest to buyers because these metrics are indicators that brands are poised for sustainable growth and increased market share over time.

Profitability is critically important:
While strategic buyers would typically pay a premium price to acquire a target that projects rapid growth in the future, corporate and private equity investors are now more diligent than ever before in evaluating bottom-line profitability of target companies. Top-line growth is not enough; investors are interested in demonstrated profits.

Buyers seek to capitalize on distressed companies:
In the harsh economic climate taking a toll on foodservice companies and other businesses facing challenging financial circumstances, certain investors are looking to acquire distressed assets or companies that are a good fit for their business. In the current climate, food & beverage companies that are suffering due to the pandemic are drawing heightened interest.

Buyers and sellers adapt and incorporate virtual meetings into sale processes:
The demand from corporate buyers and private equity investors looking to deploy capital during the pandemic has forced dealmakers to adapt, often conducting business via virtual video meetings. In some cases, buyers are requiring an in-person meeting as one of the final steps prior to closing a transaction. In other cases, transactions are being completed without the buyer ever meeting the target's management in-person.

Acquirer appetites remain strong, but investors are evaluating opportunities with increasing amounts of scrutiny and caution than in typical times. Food and beverage sellers need to think strategically about when to pursue a sale—and how to demonstrate strong performance during the pandemic—in order to maximize their likelihood of a successful transaction.

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