EUREKA

BAKING INDUSTRY M&A REVIEW: *A look back and what the future may hold*

INTRODUCTION

The baking industry has witnessed extensive consolidation. Since 2004, 106 bakery transactions have been consummated. It has been one of the more active M&A sectors in the food & beverage industry. The consolidation has taken place in virtually all channels, including fresh bread, in-store bakery, commercial aisle, foodservice and convenience. Within each of these channels, certain buyers have emerged as the primary drivers of deal activity, and the competitive landscape has changed.

We now believe that we are entering a new part of the consolidation cycle. 2011 appears to be the first year where deal activity will be down significantly. There are some logical reasons for this downward trend. More importantly, it is likely that the future deal dynamics will be different.

Eureka has closely tracked the baking sector and corresponding M&A activity. We have aggregated a significant amount of knowledge and data through our own research, deal activity, discussions with buyers and industry executive relationships. The purpose of this report is to share with our middle market food clients, prospects and referral sources some of our research and observations on baking deal activity and possible trends going forward.

Should you have any questions regarding this report, please feel free to contact Eureka's Food & Beverage Team.

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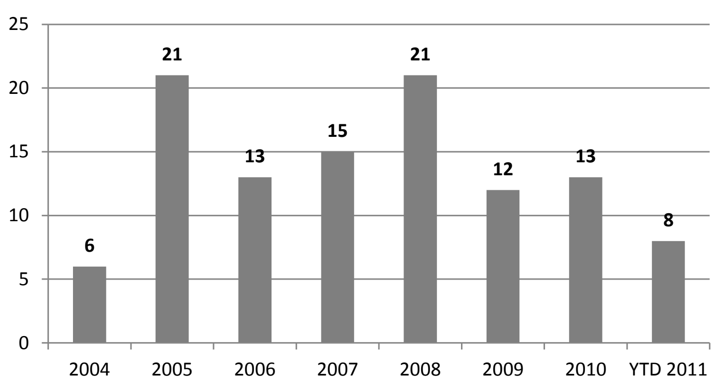
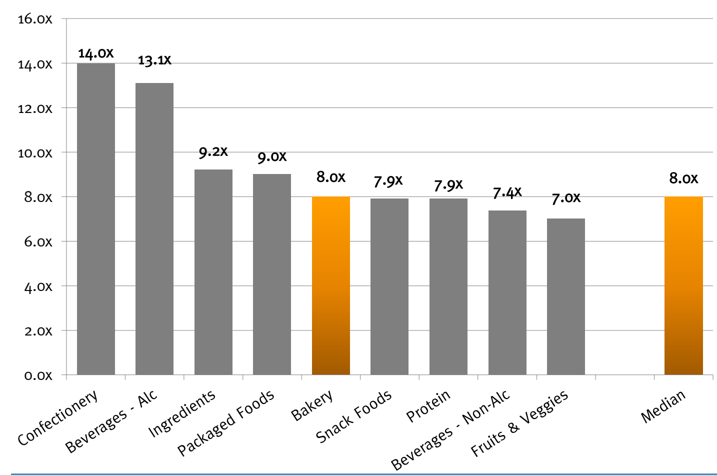
HISTORICAL TRANSACTION METRICS *

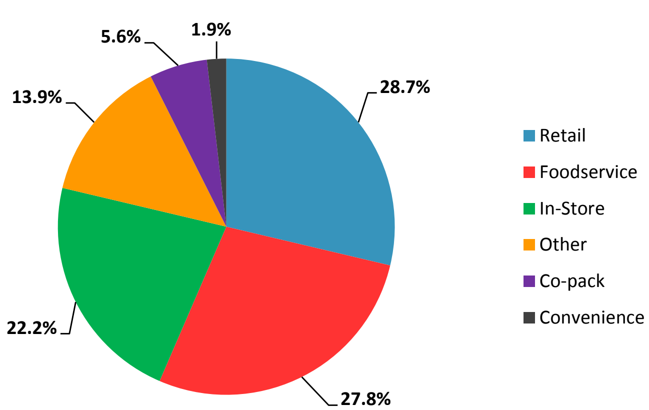
Baking Transaction Volume
U.S. Targets – 2004 - Present



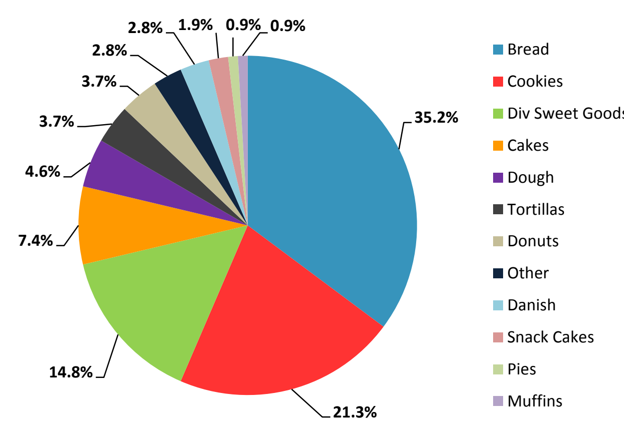
Median EBITDA Multiples Paid by Food Subsector
U.S. Targets – 2004 - Present



Baking Transaction Mix: Primary Channel
U.S. Targets – 2004 - Present



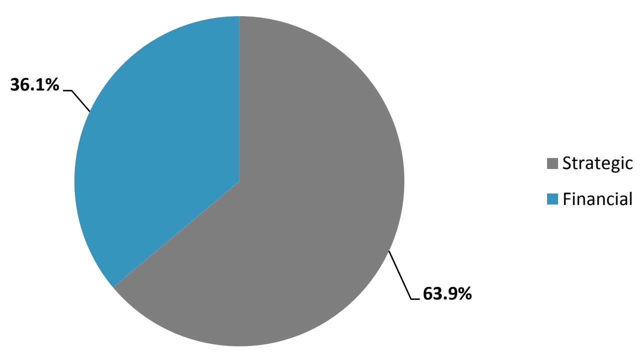
Baking Transaction Mix: Primary Product
U.S. Targets – 2004 - Present



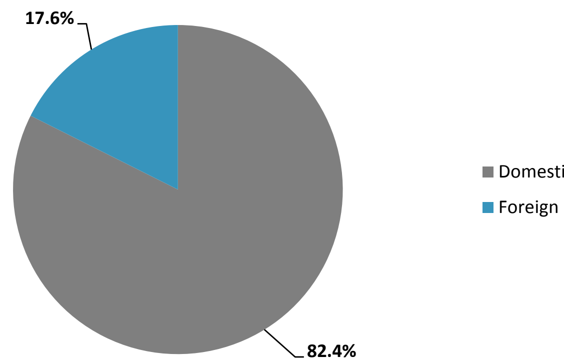
*Source: Capital IQ and Proprietary Eureka Database

HISTORICAL BUYER DETAILS *

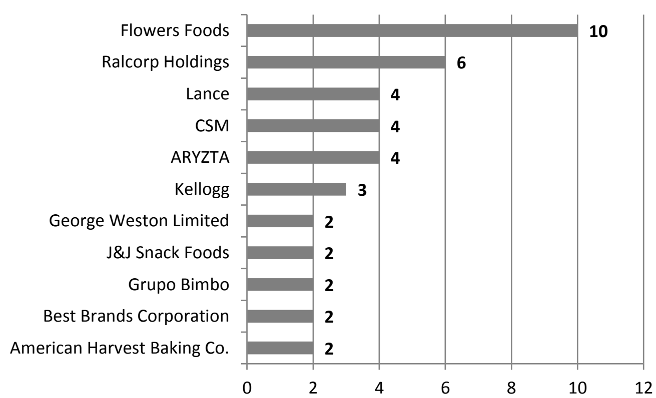
Buyer Mix: Strategic vs. Financial
U.S. Targets – 2004 - Present



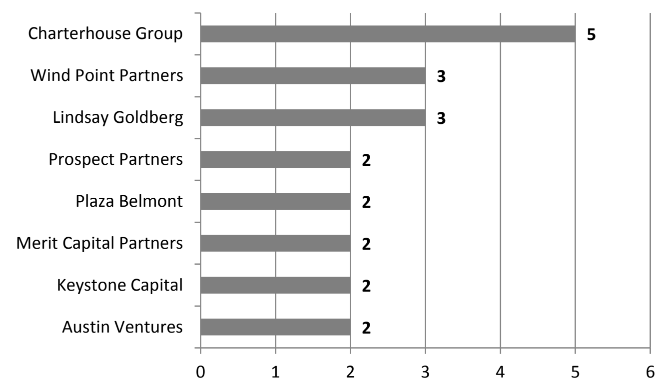
Buyer Mix: Domestic vs. Foreign
U.S. Targets – 2004 - Present



Most Active Strategic Buyers
U.S. Targets – 2004 - Present



Most Active Financial Buyers
U.S. Targets – 2004 - Present



*Source: Capital IQ and Proprietary Eureka Database

CONSOLIDATION DRIVERS

Customer base is consolidating and/or looking to drive efficiency and margin in the supply chain

- Grocery channel has undergone significant consolidation and has left fewer independent and regional chains
- National / larger chains are heavily focused on the perimeter of the store and the in-store bakery – driving efficiency, product consistency and margin in the ISB
- Grocery is losing share to large, alternative food retail formats – these accounts are looking for national relationships and suppliers who are willing to work on thinner margins
- Foodservice operating dynamics have improved, but operators are still looking for ways to reduce costs and drive margin out of the supply chain
- Larger players are using M&A to consolidate the supply chain in response to the changing customer landscape and dynamics

U.S. Food Retailer Market Shares

Market Channel	2003	2010	Net Change % 2003 - 2010	2015	Net Change % 2010 - 2015
Total Traditional Grocery	**56.3%**	**46.8%**	**-9.5%**	**43.9%**	**-2.9%**
Traditional Supermarkets [1]	50.0%	40.2%	-9.8%	34.1%	-6.1%
Fresh Format	NA	0.9%	NA	1.6%	0.7%
Limitd-Assortment	2.1%	2.6%	0.5%	4.6%	2.0%
Super Warehouse	1.9%	1.9%	0.0%	2.4%	0.5%
Other (Small) Grocery	2.2%	1.2%	-1.0%	1.2%	0.0%
Total C-Stores	**12.4%**	**15.4%**	**3.0%**	**15.8%**	**0.4%**
Convenience (w/Gas) [2]	10.6%	13.2%	2.7%	13.5%	0.3%
Convenience (w/o Gas)	1.9%	2.2%	0.4%	2.2%	0.0%
Total Nontrad. Grocery	**31.3%**	**37.8%**	**6.5%**	**40.4%**	**2.6%**
Wholesale Club	6.9%	8.3%	1.4%	9.1%	0.8%
Supercenter	11.3%	17.0%	5.7%	20.3%	3.3%
Dollar	1.4%	2.1%	0.7%	2.0%	-0.1%
Drug	4.4%	5.5%	1.1%	5.8%	0.3%
Mass	6.6%	4.4%	-2.2%	2.7%	-1.7%
Military	0.6%	0.5%	-0.1%	0.5%	0.0%

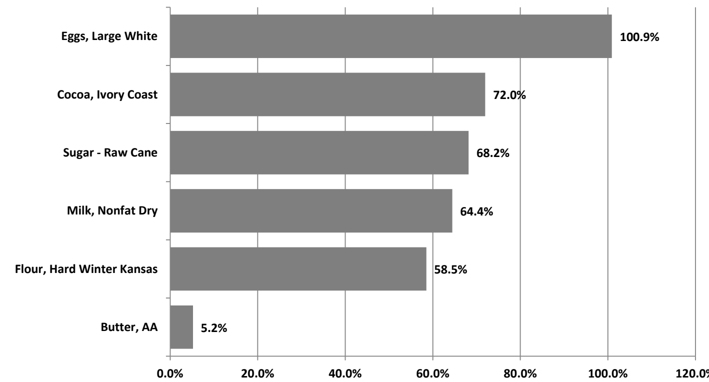
[1] 2003 figure combines "Conventional", "Superstore", and "Food/Drug Combo".
[2] Does not include gasoline sales.

Source: Competitive Edge, June 2004; The Future of Food Retailing, Willard Bishop, June 2007, June 2009 and June 2011

Price increases have not keep pace with the skyrocketing cost of raw materials

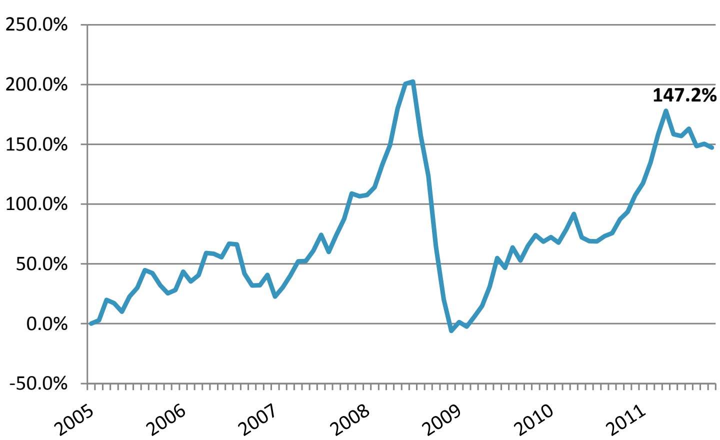
- Input costs have skyrocketed over the last six years
- A weak economy and fragile consumer demand have limited the ability to raise prices
- What was once thought to be a "temporary phenomenon" has now become the new reality
- Larger players are using M&A to build scale and realize purchasing synergies as a means to bridge the margin gap created by the pricing and raw material variance

Baking Input Cost Inflation
% Change – 2005 - Present



Source: Commodities Research Bureau & The Wall Street Journal

Brent Crude Oil
% Change – 2005 - Present



Source: International Monetary Fund

Rising fuel prices and freight costs are making it difficult for players with regional manufacturing to serve national accounts

- National accounts in food retail and foodservice drive volume and quickly absorb plant capacity
- Regional players with excess capacity are forced to utilize their existing production footprint to serve national accounts
- Freight costs for regional players can quickly erode margins on national accounts, thus making regional players less competitive and putting current capacity utilization at risk
- Larger players are using M&A to create a national production footprint and platform for profitably serving national accounts

Stagnant organic growth is driving the desire to broaden product capabilities and customer relationships

- Many companies are seeing growth stagnate in their core businesses, and with margins under pressure, using pricing to win new business is less of an option
- Larger players with access to capital are looking to drive growth through the acquisition of new products and customer relationships
- New customers and products facilitate cross-selling, provide diversity and create value to an acquirer through increased growth and reduced risk

Organic Growth vs. Acquisition Growth
Public Baking Companies

	Growth from 2009 - 2010				Growth from 2008 - 2009			
Company	Org.	Acq.	Curr.	Total	Org.	Acq.	Curr.	Total
ARYZTA	-8.6%	2.6%	-0.3%	-6.3%	-3.0%	8.5%	-3.0%	2.5%
Canada Bread	-6.9%	NA	NA	-6.9%	0.1%	NA	NA	0.1%
csm	1.0%	12.2%	3.9%	17.0%	-3.3%	0.1%	1.5%	-1.7%
FlowersFoods	0.4%	7.3%	NA	7.7%	-0.9%	7.7%	NA	6.8%
Ralcorp	-2.0%	6.0%	NA	4.0%	4.0%	34.0%	NA	38.0%
Mean	**-3.2%**	**7.0%**	**1.8%**	**3.1%**	**-0.6%**	**12.6%**	**-0.8%**	**9.1%**

* Org. is organic growth, Acq. Is growth from acquisitions, and Curr. is growth based on currency fluctuations.

Source: Company Filings and Investor Presentations.

CONSOLIDATION DRIVERS – cont.

Food safety standards are increasing, and the corresponding compliance costs for smaller players can be significant

- Ensuring food safety within the supply chain is paramount, and larger chains are taking extensive measures with their suppliers to safeguard the food they sell to customers
- The initial and ongoing investment in time and people to comply with Silliker audits and SQF certifications can be significant
- Food safety compliance can create a selling barrier for smaller players

THE CONSOLIDATION IMPACT & FUTURE OF BAKING M&A

Consolidation Impact

The consolidation has enabled larger players to add scale and realize cost advantages over smaller, regional baking players. Larger players will look to gain share from smaller players and leverage: a) broader product offerings; b) more competitive pricing; c) national production / distribution footprint; and d) greater supply chain efficiencies.

Over the longer-term, customers will likely encounter the negative impact of a more consolidated supplier base. The potential for a lack of new product innovation, customer service and overall flexibility can create opportunities for the regional and independent baking players to win large pieces of business. These opportunities will likely exist over time.

In the interim, it is logical for the lower end of the market to also consolidate. The same benefits that accrue to the larger players are also proportionately available to the regional and independent players, but the smaller players can remain flexible.

We believe there is a compelling business case for the regional and independent players to either merge or make acquisitions. In doing so, we think there are several factors that will lead to winning business and creating enterprise value: a) product focus and discipline; b) national or super-regional production footprint; c) purchasing economies; d) consistent product innovation; and e) superior customer service.

Future of Baking M&A

Our sense is that the buyers that have been historically active will continue to make acquisitions, but their criteria will be more focused. It is clear in our discussions with many of the active buyers that their size threshold is higher. They are also much more narrow in their product and geography needs. Said differently, the deals will be <u>larger</u>, <u>fewer</u> and <u>more strategic</u>.

A prime example is Ralcorp's $545 mm acquisition of Sara Lee's private label frozen dough business. Ralcorp was historically a very active buyer in the baking space, particularly with smaller companies. Over the last couple of years, their baking deal activity has decreased, and their deal size has increased. Our sense is the same will be true with CSM and Aryzta, both of which completed large deals last year at very healthy multiples.

This leads us to our next point – larger companies will be rewarded with higher multiples. Larger companies generally trade at EBITDA multiples that are 1.0x to 2.0x more than smaller companies. Our sense is this will hold true going forward, as there will likely be some "scarcity value" for companies with scale.

For the regional / independent bakery looking to exit in the future, there will still be buyer interest in the sector, but there will be fewer buyers and lower multiples. Our sense is that valuation multiples have peaked, and will likely come down, particularly for smaller companies. This is why there is logic to the regional / independent bakeries also consolidating. It will not only improve their competitiveness, but also increase buyer interest and valuation going forward. Larger companies that possess the criteria we outlined in the preceding section are likely to be rewarded.

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