

Investment Paper Premier Foods

Name

Instructor

Course

Institution

Date

Executive Summary

Premier Foods company has continued strong performance, with increases in revenue and profits compared to an already high baseline from the previous year. The growth in revenue has been driven mainly by price rises, stemming largely from our UK business. Industry outlook remains positive; however, we expect some decline in volumes and revenue in the coming year as consumption patterns normalize following the exceptionally high demand in 2020. Management projects rising profits going forward as investments made start generating fuller returns. As managers, we are considering an acquisition of the company through a management buyout (MBO). This allows existing leadership to gain greater control and benefits by becoming owners. However, financing is challenging as these deals require substantial capital from both debt and equity sources. Initial feasibility analysis will be critical in determining if an MBO makes strategic sense and is workable financially. Defining the seller's timeline and identifying financing options will also be key next steps.

Valuation is among the most important components we will need to tackle. MBO pricing considers what is affordable given debt limitations and future cash flow forecasts tied to growth and market expectations. Due diligence across all areas of the business will help ensure reported finances accurately represent company fundamentals, which directly impact valuation. This process should be more straightforward given our inside position. Finally, the close will require additional due diligence, purchase and shareholder agreements, further negotiations and more. We will examine how the company achieved excellent performance - through timing, sales and margin growth, deleveraging, multiple expansion or other means. This helps assess if the results are sustainable and stem from proprietary strategy and execution rather than transient factors. The goal is building a portfolio of skilled managers implementing strategies in attractive markets

with durable competitive advantages. Ongoing evaluation and evolution of leadership and strategy will enable sustained success.

The Business and the Commercial Opportunity

Premier Foods is a market leader in the production and processing of sauces, cooking aids, ambient, fresh and frozen food products. It operates in both the UK market (where it accounts for around 20% of revenues) and worldwide (80 percent of revenue). The management team has been refocusing the product mix on higher-value, higher-margin items that also tend to be less volatile, as well as growing into new markets. Premier Foods was founded in 1975 following a merger between the Chivers and Hartley's food businesses. In the 1990s and 2000s, the company expanded through a strategy of mergers and acquisitions to become the UK's largest food producer. Major acquisitions included Herta, Sharwood's and Marlow Foods. The company is currently led by CEO Alex Whitehouse, who took over from former CEO Gavin Darby in 2019 after activist investors called for a change in leadership. Premier Foods operates in 5 key categories: ambient cooking products, sweet treats, ambient culinary, grocery, and international. We examine demand and supply in turn for each of them.

1. Ambient Cooking Products

Premier Foods holds a 28% market share in ambient cooking products and is the market leader in cooking sauces, gravies and cake mixes. Major brands include Bisto, OXO, Loyd Grossman, Homepride and Sharwood's. Cooking from scratch has been on the decline for decades, driven by trends like more women in the workforce, smaller households and growing interest in international cuisines. This has benefited sales of cooking aids like stocks, bouillons and sauces. More recently, the lockdowns during the COVID-19 pandemic led to a strong increase in at-home cooking and demand for ambient cooking products. Future growth is

expected to be driven by innovation and new product development. Premier Foods aims to lead trends towards more premium and authentic products. For example, a new range of regional curry cooking sauces was recently launched under the Sharwood's brand.

2. Sweet Treats

The sweet treats division includes cakes, desserts and icing sugar. With iconic cake brands such as Mr Kipling and Cadbury cakes, Premier Foods holds the #1 market position in cake and #2 in ambient desserts. The cakes market has faced considerable challenges in recent years. Sugar taxes, growing health consciousness and increasing competition from discounted own label ranges have put pressure on sales. Premier aims to return the division to sustainable growth through renovation and innovation behind key brands. Recent initiatives include new healthier options, more premium offerings and increased digital marketing campaigns.

3. Ambient Culinary

Under the Ambient Culinary division, Premier Foods produces products like packet soups, stocks, bouillons, gravies, custards and baking ingredients. With strong market positions across categories, Premier enjoys benefits of scale in procurement, production and distribution. Sales are boosted by ongoing consumer trends for convenience and hassle-free meal solutions. Recent innovations include new product formats and increased focus on organic, reduced fat and reduced salt offerings. International expansion in areas like the Middle East has further supported growth for brands like Batchelor's.

4. Grocery

The grocery portfolio includes Branston pickle, Loyd Grossman cooking sauces, Frank Cooper's preserves and McDougall's flour. Branston is the undisputed market leader, with strong brand equity developed over decades. Pickles and preserves remain popular for traditional British meals, despite the decline in cooking from scratch. Both Loyd Grossman and Branston have benefited from investments in premium product innovations and brand building campaigns. McDougall's holds niche positions in heritage categories like baking ingredients, custard powder and gelatine. Overall, the grocery division delivers steady profit streams thanks to leading brand positions and diversified categories. But growth requires balancing heritage with staying relevant to modern consumers.

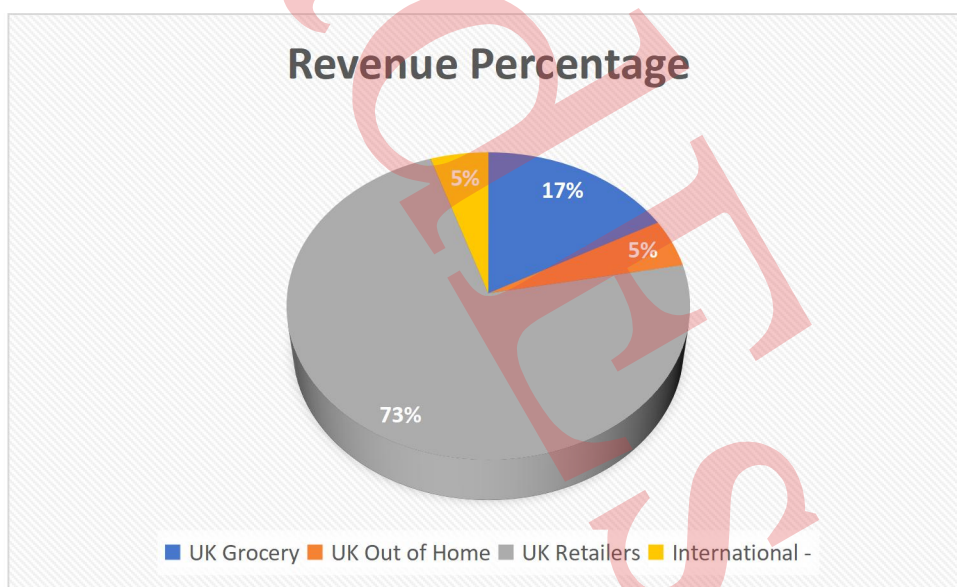
5. International

International sales outside the UK account for around 15% of Premier Foods' revenues. Exports span ambient cooking products like Sharwood's and Loyd Grossman sauces to iconic sweet brands like Mr Kipling cakes and Cadbury cakes. Premier also has an overseas production site for Batchelors and Smash in the Middle East. Future international expansion will focus both on growing emerging markets through local partnerships and production, while also introducing more products from the UK portfolio into established European and North American markets. Building scale internationally will improve efficiency and growth for Premier Foods over the long term.

Market Context

As previously stated, Premier Foods is a leader in the UK ambient food sector with market leading positions in cooking sauces, cake mixes, pickles and other categories. Overall it is the #1 or #2 player across 75% of its portfolio. Having size in its private-label categories, as

well as dependability when working with significant clients who all have high expectations in terms of service and quality levels, has benefitted the firm. The \"branded\" sector is a highly competitive industry in which even competing with other suppliers is extremely difficult. Factor like private label competition, discount retailers and changing consumer trends have created an environment of very aggressive pricing and low margins industry-wide. The figure below breaks down revenues by geography and by category. At FY20, 17% of revenue came from the UK grocery channel, 5% from UK out of home, 73% from UK retailers and 5% international. Its most important overseas market is Ireland, followed by continental Europe, Australia and the Middle East.



Premier Foods supplies a wide variety of retail outlets including Tesco, Sainsbury's, Asda, Morrisons, Aldi, Lidl, B&M Stores, Poundland, Iceland and others. Approximately 40% of sales come from branded products, while 60% is made up of retailer private label. Top customers are the major grocery multiples who account for the bulk of sales. Maintaining strong relationships with these retailers through excellent service levels and alignment on strategy is critical.

Premier Foods has maintained #1 or #2 market share in many key categories over decades through consolidation and steady renovation of brands like Bisto and Mr Kipling. Having a portfolio with scale and brands that resonate with consumers has benefitted the firm against rising private label and discount competition. Consumer trends changing to more premium, organic and healthier options do pose risks however. So constant innovation through new products and variants is required, while trying not to undermine the core equity of well-loved brands.

Management

Premier Foods current management team is:

Name	Position
Colin Day	Chairman
Alex Whitehouse	Chief Executive Officer
Duncan Leggett	Chief Financial Officer
Richard Hodgson	Senior Non-Executive Director
Roisin Donnelly	Non-Executive Director
Tim Elliott	Non-Executive Director
Tania Howarth	Non-Executive Director
Helen Jones	Non-Executive Director
Yuichiro Kogo	Non-Executive Director
Lorna Tilbian	Non-Executive Director
Simon Rose	General Counsel, Company Secretary

Business Plan

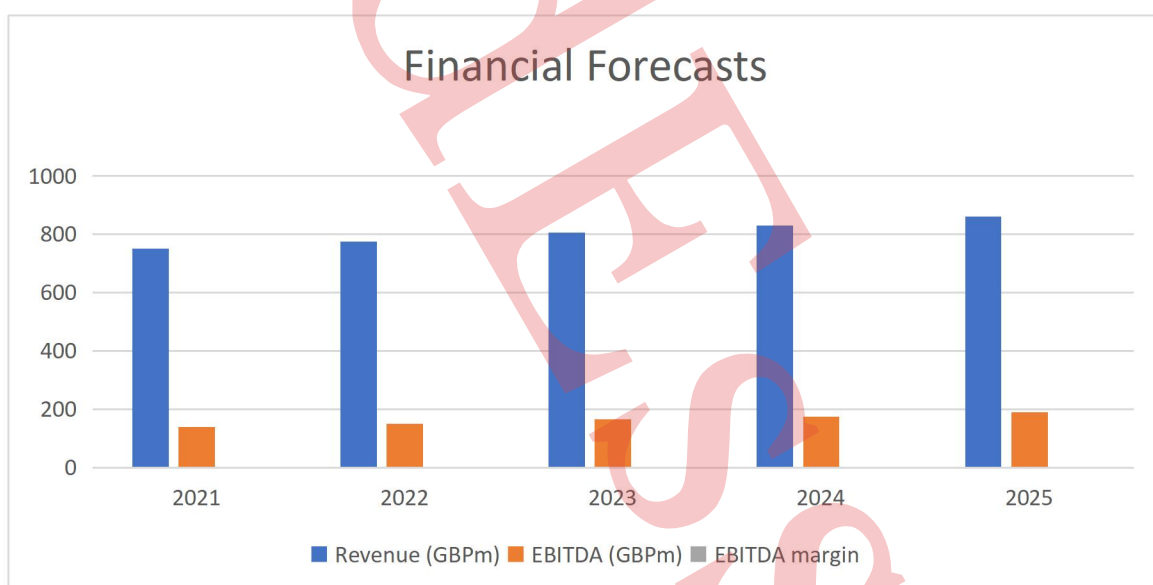
Strategy

Premier Foods aims to drive a value-recovery strategy focused on restoring consistent growth behind power brands. Management's plan includes:

- Aggressively growing strategic "Power Brands" through product innovation and renovation
- Improving efficiency of business operations and supply chain
- Tight control of overhead costs
- Developing sales capabilities and shopper insight
- Increasing investment in marketing to support core brands.
- Restoring trust with customers and regaining lost listings.
- Developing strategic partnerships with retailers aligned to growth plans.
- Building employee engagement and strengthening company culture.

By focusing efforts on power brands, Premier can leverage its scale to invest efficiently in consumer-led innovation and insights to capture evolving shopper needs. Growing priority brands like Batchelors, Mr Kipling and Loyd Grossman through premium and modern variants will let Premier defend market positions, unlock pricing power and gain listings.

Financial Forecasts



Risks

Branded packaged foods remains a highly competitive space facing pressures from changing consumer trends, discounters and retailers pushing own label. Failure to respond quickly enough to evolving shopper needs and preferences is a risk for Premier Foods' portfolio of trusted but often legacy brands. Key players like Unilever and Nestle also have far greater brand investment budgets to drive innovation and retain share. Execution risks exist around the ability to deliver complex turnarounds spanning portfolio optimization, cost reduction and cultural change. Premier Foods' high leverage also leaves the company exposed to potential demand shocks or input cost rises squeezing margins. Careful management of debt levels and cashflows is critical. Economic weakness and rising living costs could potentially impact Premier's mainly value positioned brands that appeal most to low- and middle-income consumers.



Valuation

To assess Premier Foods value, we employed a DCF model assuming 1.5% terminal growth and 7% terminal margin. Our fair value estimate is 285p per share, representing 20% upside. 2021 has started off strongly with continued revenue and profit growth even as pandemic demand normalizes. H1 revenue grew 2.6%, while Branded sales expanded 4.3% excluding disposals. Trading profit increased 18% to £93m. Higher prices, cost control and operating leverage are driving margin gains. Net debt also reduced by £40m. While mindful of comparatives and cost inflation, management maintained full year guidance given brand momentum. Our forecasts are thus broadly unchanged.

Currency in USD

Valuation Measures ⁴		Trading Information	
Market Cap (intraday)	1.40B	Stock Price History	
Enterprise Value	1.75B	Beta (5Y Monthly)	1.11
Trailing P/E	11.63	52-Week Change ³	22.26%
Forward P/E	10.33	S&P500 52-Week Change ³	14.98%
PEG Ratio (5 yr expected)	N/A	52 Week High ³	8.75
Price/Sales (ttm)	1.05	52 Week Low ³	6.59
Price/Book (mrq)	0.85	50-Day Moving Average ³	7.57
Enterprise Value/Revenue	1.61	200-Day Moving Average ³	7.69
Enterprise Value/EBITDA	8.88	Share Statistics	

Premier Foods trades at 7.2x 2021 EBITDA, a 35% discount to comparable peers on median. The lowly rating likely reflects execution risks and high financial leverage. But successful de-leveraging and evidence of brand revitalization improving top line should warrant multiple expansion. Profitability gains in 2021 support that Premier's value recovery plans are taking hold. If upcoming brand investment sustains growth trajectories, the gap to sector benchmarks seems overly pessimistic.

Due Diligence

Extensive due diligence would still be needed by the prospective lead financier and/or private equity firm throughout the process of MBO. It's likely that shareholders will only grant access once principal terms are agreed. But as existing managers, we already possess working knowledge of the company. Premier prepares financials to global reporting standards like IFRS. Debt management has been satisfactory over time, with firm appropriately balancing deleveraging against growth investment as the chart below shows. This indicates financial standing to meet obligations without strain.



Exit Options

The 2021 EV/EBITDA multiple of 7.2x suggests Premier Foods is potentially undervalued currently and hence primed to realize a higher exit valuation after our targeted performance improvements. Post buyout, we would look to sell our full equity stake to a sponsor or strategics after 5 years having grown profits by 50%+ through focused brand building. Premier Foods likely still holds appeal for industry consolidators given its portfolio of household names. Private equity could also monetize brands through disposals while improving the cash generation of remaining operations. A public listing to crystalize returns is also possible depending on market conditions nearer the exit horizon.

Recommendation

I believe the management buyout represents tremendous potential for Premier Foods to enter a new growth phase. It would allow executive management control to hone strategy and make bolder decisions on innovation, partnerships and more. I would propose exploring options for Alex Whitehouse to retain C.E.O and board role post deal. This would enable retaining his consumer goods expertise while empowering new leadership to put their own stamp on operations. For employees, independent ownership can offer superior opportunities compared to subsidiary status within a global food giant. To unlock Premier Foods' full potential, sustained brand renovation and financial improvement over the upcoming years will be key.

Part 2

Introduction

A management buyout (MBO) offers the opportunity for existing executives to acquire a controlling stake in the company they manage. This case evaluates a proposed MBO of Premier Foods led by CEO Alex Whitehouse. Premier Foods is the largest UK food producer with a portfolio spanning iconic brands like Batchelors, Loyd Grossman and Mr Kipling. However, despite strong market positions, the company has faced years of stagnant growth and lagging financial returns. An MBO could allow new autonomy to revitalize performance through more aggressive investments behind power brands. Yet theory suggests potential risks around governance, incentives and value creation that must be addressed to ensure the deal succeeds. This part will analyze two critical considerations - optimal capital structure and value capture mechanics – and how they interrelate for the proposed Premier Foods buyout.

Optimal Capital Structure (Debt vs. Equity Balance)

The initial MBO financing outlined suggests a “combination of both debt and equity” (Investment Paper, 2023, p. 1). High leverage is common in buyouts to maximize returns. However, capital structure theory indicates potential downsides to excessive debt. The tax benefits of interest deductions must be balanced against costs like financial distress and agency issues (Myers, 2001). Has the appropriate debt level for Premier Foods been determined? According to Modigliani & Miller (1963), in the absence of factors like taxes and bankruptcy costs, capital structure is irrelevant. But with these frictions, additional debt can lower a firm's weighted average cost of capital (WACC) to a point by providing tax shield benefits, thereby maximizing firm value. The trade-off theory proposes an optimal leverage level balancing these

tax shield benefits against bankruptcy expenses and volatility from higher borrowing (Kraus & Litzenberger, 1973).

For Premier Foods, historical leverage approached 5x EBITDA, indicating concerns over excessive debt levels in the past. Significant deleveraging occurred under former CEO Darby, suggesting moves to reduce debt burdens (Investment Paper, 2023). Thus, increasing leverage again under an MBO may worry creditors without clear improvements in cash flow generation projected. An LBO financial model would likely assume even higher initial leverage of 6-7x debt/EBITDA based on private equity standard practice (Axelson et al., 2013). Careful analysis on whether Premier Foods' business risk and operating profile can prudently support such a quantum of debt is critical.

Potential Financial Distress Costs

Excessive leverage also raises the risks of financial troubles from earnings volatility or demand shocks. The costs of distress like asset fire sales, staff turnover or loss of customers can be severe (Opler & Titman, 1994), with recent research quantifying the negative impacts on profitability (Glover, 2016). Premier Foods operates in consumer staples packaging where expenses for inputs, freight and distribution are seeing inflationary pressures. Its value brand portfolio also targets low- and middle-income shoppers most impacted by the current UK cost of living crisis (Investment Paper, 2023), further increasing demand uncertainty amid high leverage. These factors in combination may raise chances of financial distress. While tighter loan covenants could provide early warning signs, they also limit strategic flexibility for management.

Management Incentives and Governance Implications

Jensen (1989) contends that leveraged buyouts (LBOs) can reduce agency costs by increasing management ownership and employing debt as a disciplining mechanism. However,

for Premier Foods, substantially higher leverage ratios through increased debt also pose risks of skewing executive incentives in an unhealthy direction. Excessive debt levels may motivate managers to pursue extremely risky strategies to generate large returns in hopes of meeting expensive interest and principal payments. Such short-term focused decision-making could jeopardize the long-run future growth and brand equity of Premier's underlying business.

Additionally, the proposed management-led buyout structure presents inherent corporate governance challenges stemming from high information asymmetry. Cumming and Walz (2010) note that in MBOs where current executives aim to take a company private through assumption of significant leverage, outside minority shareholders can suffer disadvantages from far less visibility into company performance, strategy and financial health relative to insider management. This lack of transparency poses risks that major shareholders like private equity backers receive preferential treatment or transactions compared to lesser investors lacking influence and visibility into Premier's affairs post-buyout. For example, management could obscure poor results or misallocate capital to benefit majority owners first, raising ethical issues in governance. Thus, while agency cost reductions represent a theoretical benefit of increased managerial ownership and disciplined debt repayment requirements, the heightened leverage contemplated for Premier Foods also introduces adverse selection hazards from distorted manager incentives towards imprudent risk-taking.

Management Ownership and Risk Preferences

Signaling theory highlights that higher insider ownership stakes better align managers with outside investors by reducing conflicts of interest. But increased managerial leverage through debt can also shift risk preferences detrimentally by incentivizing short-term performance at the expense of long-term value. Studies show many LBO defaults occur when

executives with too much equity at stake make overly risky bets trying to boost returns, such as implementing deep cost cuts that erode brand equity and growth prospects over time (Berg & Gottschalg, 2005). For Premier Foods, have proper incentive structures and oversight been devised to instead encourage prudent long-term stewardship by the new executive-owners post buyout?

Board Independence and Governance Quality

Robust corporate governance and oversight mechanisms are vital for monitoring executive decision-making within privately-held leveraged buyout (LBO) firms, where information asymmetry poses heightened risks (Cornelli & Karakas, 2013). Yet past LBO transactions have empirically witnessed declining board independence, often with fewer respected independent directors not affiliated with management post-buyout (Acharya et al., 2009). Complete management control introduces hazards wherein executives could engage in inappropriate related-party dealings or self-interested actions without accountability. For Premier Foods, securing high-quality independent directors to serve on the future board should therefore comprise a shareholder protection within the acquisition terms to establish proper governance. Acharya et al. (2009) recommend independent directors represent over 60% of an LBO company's board to provide adequate authority and oversight capabilities. Structuring the board as such can safeguard minority investors who otherwise lack visibility into financial reporting or strategic investments in a privately-held entity following an MBO exit. Furthermore, independent committees could oversee controls around related-party contracting, executive remuneration and audits to uphold accountability. Instituting these governance mechanisms helps align management incentives through oversight of Premier Foods' post-buyout board – balancing

executives' operational flexibility in pursuing turnaround plans with responsibility to minority shareholders unable to closely monitor their actions privately.

Value Creation and Management Execution Risks

A fundamental premise underpinning management buyout (MBOs) is that liberating executives from public markets enables superior strategy execution, investment allocation, and value creation. Yet for Premier Foods, realizing such outsized performance improvements depends heavily on the capabilities of current leadership to deliver operationally. Complications arise around properly assessing the management team's aptitude to achieve strategic targets as well as appropriately sharing any resultant value gains between insiders and external shareholders. Specifically, the planned turnaround hinges on accelerating innovation pipelines and optimizing brand investment returns – responsibilities falling largely on the same executives who oversaw years of stagnation historically. Robust governance mechanisms would need institutionalizing to ensure minority investors reasonably participate in profits should management succeed in catalyzing growth post-buyout. However, risks persist over whether requisite skills and competencies actually exist within Premier's incumbent leadership ranks to meet growth objectives in the first place.

Strategy Execution Risks and Organic Growth Potential

Premier Foods aims to restore brand momentum via increased innovation pipelines and marketing support behind priority platforms like Batchelors, Loyd Grossman and Mr Kipling (Investment Paper, 2023). This organic growth-led strategy relies on successful execution by largely the same leadership team unable to reverse declining sales trajectories historically however. Past branded foods turnaround attempts saw limited tangible success for Premier. So critical evaluation would focus on whether the capabilities and skills actually exist within

Premier's current executive ranks to deliver on the articulated business plan and long-term vision. Do they have the strategic competencies, consumer marketing aptitude and operational expertise to compete effectively against aggressive industry rivals?

Appropriate Incentives Alignment with Value Distribution

While greater ownership stakes could increase management motivation, incentive structures must still promote sustainable, long-term value creation without unduly advantaging insiders. Prioritizing short-term cost savings or temporary volume spikes from price cuts could slowly erode brand equity over time. Optimally, bonus schemes should reward consistent margin expansion and cash flow improvement each year instead. And will management receive an appropriate share of profits relative to any private equity backers? Their inherent informational advantages regarding Premier's business poses risks of unfair related-party transactions or underperformance obfuscation that could disadvantage non-insider shareholders unable to accurately monitor internal financial reporting.

Conclusion

In conclusion, while the proposed MBO offers opportunities for increased management control to unlock growth potential, lingering concerns around governance oversight, incentive structures, value distribution and leverage risks need addressing to ensure successful investment outcomes. Appropriate capital structures balancing financial risk-taking with flexibility warrant determination. Structuring considerations that provide proper minority shareholder protections and alignment of interests between owners and managers should improve the prospects for realizing Premier Foods' organic growth strategy if executed effectively. Premier's portfolio of brands and categories offers a solid foundation. But optimizing deal terms, putting in place balanced governance, and instilling stewardship-focused incentives will be integral to restoring

consistent brand momentum through sharp strategic investment and skillful execution under enterprising leadership.

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Appendix

Appendix